Centurion Onsite – 9/23/14 – Milwaukee, WI – Stefan Behling (CIO, PM), Umran Zia (CEO, IR), TP, TR

Centurion would agree to $50mm in capacity for HAMF.

HISTORY

* Stefan and Umran have known each other since 2000. Umran was formerly the head of FX brokerage at BofAML and Stefan was the head of trading at Crabel Capital Management.
* Stefan met Toby Crabel in 1997, both were former professional tennis players. Toby hired Stefan as one of his first four employees at Crabel when AUM was less than $50mm. Initially Toby ran the firm out of his basement and eventually grew to over $3B.
* Stefan decided to leave Crabel in 2009 for a few reasons.
  + Stefan and his family wanted to stay in the Milwaukee area, but Crabel was beginning the process to the majority of its personnel to L.A.
  + Stefan disagreed with Crabel shifting its research from traders to academic quants.
  + Toby was increasingly interested in developing longer term trend following systems to compete with firms like Winton.
  + Stefan focus and interests remained with short term trading and he wanted Crabel to focus more on such short systems after 2007 and 2008. Stefan noted that in late 2007 and 2008 he was responsible for implementing discretionary exits for 1/3 of the portfolio, using the same entry signals but moving up the exits from 1-3 days to 0-3 hours based on his discretionary view of liquidity and volatility. He believes his efforts saved Crabel $16mm (from late 2007 – 2008)
  + Due to the liquidity of the strategy, Crabel was used as an ATM during the financial crisis and Toby downsized the firm by half
  + Eventually Stefan and Toby got on different wavelengths on the future of Crabel
* Toby is not a reference for Stefan. Stefan said that Toby is an extremely emotional person and his opinion of Stefan could change day by day, he would expect a better opinion to come on days when Toby’s strategy is making money. As an example of Toby’s emotional nature, Stefan added that Toby would talk about selling his cars when they were in a drawdown. They have heard that other investors have reached out to Toby, but do not know what was said.
* Umran brought up Stefan’s lawsuit against Crabel which related to Stefan’s 2008 bonus, which he was not paid. According to Umran the jury ruled in Stefan’s favor in a half hour. Stefan said that afterwards Toby asked him to pay tennis, which he declined.
* Stefan was mixed on how he talked about Toby, it seems that he has respect for how it built the strategy and firm early on, but his issues deal with things that occurred later on.
* After Stefan left Crabel Umran offered to help him find a job which led to the idea of starting Centrurion. Umran left his job in 2010 and they started building the firm that summer. They used a former Crabel programmer to set up the initial program, that programmer did not stay with the firm (from linkedin this appears to be Jason Leupold; per Umran, this is the only employee turnover to date). Umran noted that 3 or 4 seed deals feel through with Stefan’s lack of experience in front of investors being an early hurdle.
* Centurion’s seed investor started with 10mm and through the deal would receive a top-line revenue share. Within the first year the seed investor redeemed and lost their economics in the firm (the arrangement required them to invest for over one year). This is the only investor to redeem to date and they have asked Centurion that they not disclose their name. They would tell us that it was a large family office who was an early investor with other systematic strategies including Crabel and Monroe Trout. The family office was in a large drawdown. Umran called this a stroke of luck and they now joke that Stefan was worried about losing them as an investor.

FIRM

* As of 8/31/2014 Centurion has $160mm in AUM with 14 clients
* Another $75mm is expected to come in by year end, $50mm from Old Mutual through the QIF structure, $20mm in a managed account for a Chicago based FoF (not 40 act), and another $5mm managed account.
* They are planning to stop taking on smaller managed accounts (< $20mm) by year end and turn their focus to the QIF structure and the onshore/offshore fund vehicles. Regarding the QIF structure, they plan to offer discounted fees on the next $50mm and then move to full fee only. Once the QIF is at full fees they will be indifferent to money coming in through the QIF or the fund vehicle. The onshore fund will be funded this year.
* Centurion currently has 10 employees, 6 in MKE and 4 in NYC. They plan to keep the number of employees under 20 at full capacity (approx. $750mm)
* The Milwaukee office space is rented through Regus. Stefan likes the simplicity of this arrangement as Regus handles utilities bills (phone, cable, electric), provides amenities (conference rooms and kitchen area), and is secure for their 24 hour operation. Through Regus they could also expand their office space if needed quickly and efficiently. They feel this allows them to keep their focus on the strategy and the markets rather than on operational issues. Last, the current space is a 10 minute commute for Stefan. Centurion was not listed on the buildings directory and there was no signage in their space, though they believe they could add it. They are comfortable with the low profile and being under the radar, it has not been an issue while raising assets. Most of the meeting was held in a conference room that was not connected to their space. Their office space was down the hall and was approx. twice the size of a Hatteras office, with workstations for two traders, two research analysts and Stefan. White board with ideas and priority projects surrounded the area where the research analysts worked.
* The NYC office space is sub-leased and is in the same building that the former Hatteras NYC office was located in. Umran noted that their space was previously used by Galleon.
* Per Umran, the firm is breakeven at $75mm
* Stefan and Umran were funding the business prior to breakeven

STRATEGY

* Centurion seeks to take advantage of human emotion and behavior in the financial markets. Their models are based off of observed price action, seeing patterns and confirming through statistical analysis. They are not looking to discover why the patterns occur, but want to know that the odds are in their favor when they do.
* The firm’s traders are all either from Crabel or trained in house. Stefan believes that well trained traders can see things in the market and generate trading ideas to exploit what they are seeing better than academic quants.
* The strategy has a total of 78 models focusing on two main types of models, momentum and mean reversion. Approx. 70% are momentum and 30% are mean reversion. This ratio has been little changed as they have grown. Crabel was equally split between momentum and mean reverting models, but Stefan believes that the markets offer more opportunities for momentum models, also mean reversion models tend to be more correlated and have larger drawdowns.
* There is constant review and feedback on the models from the traders. Changes to existing models are typically very small tweaks, once a trader identifies a potential edit it is sent to the research analysts for further vetting.
* Crabel had over 500 models when Stefan left. Stefan believes that the ideal number of models may be around 150 to achieve the most diversification and maximize correlation benefits, but after that level additional models could fight themselves.
* Stefan calls it the opposite of trend following, looking for a large number of small winners rather than a small number of homeruns.
* Every trade has predetermined profit targets, stop loss, and time limits
* The strategy will systematically de-allocate to out of favor models based on a 2 year rolling sharpe, models with a sharpe below -1 are fully removed. Crabel never implemented a way to systematically de-allocate to strategies which Stefan always viewed as a problem – discussions on changes were typically occurring at the bottom of drawdowns. The Centurion strategy will also increase allocations up to an additional 25% using the same sharpe ratio analysis.
* Slippage is a key consideration for Centurion. It is built into their research and monitored live by the traders. Centurion seeks to keep slippage under 3% of the 10 day average range (spread?) or approx. $30 per trade (one side or round trip?). Slippage will be a key factor in determining when to close the strategy and the overall capacity of the strategy.
* Centurion has a short term focus but is not a high frequency trader, their systems look at 5 minute increments, not milliseconds. Stefan recognizes that speed can reduce slippage, but sees no evidence that being faster would improve the models which drive overall returns.
* Centurion’s research platform and order management systems are proprietary and work with one another. The systems can handle future growth of the firm. The only third party they use is their data source.
* Spread relationships are listed as a strategy in the DDQ, but are still in the R&D phase. For example, they are looking into how short term movements in the Yen affect future movements in the Nikkei, or gold and the 10yr UST. It is a work in progress and has moved down on their list of priorities. They believe their expertise is in price action, not spread relationships.
* The strategy at 1x has a vol target of 6%. Stefan said this level is consistent with Crabel low vol targets and fits his own risk appetite. He believes that at this level the strategy can still generate double digit returns. He said that double digit drawdowns are not in his DNA. To meet investor’s needs they also offer the strategy at 2x.
* Stefan walked us through the packet of trade examples, the same ones discussed in a previous research call, but with greater detail and clarity.
  + Successful mean reversion trade – Euro moved higher three days in a row, opened higher on the fourth day and a short was initiated, the trade timed out after the next day’s open. The Euro did move lower for the next two days, but these moves were not within Centurion’s time frame and were not considered missed opportunities.
  + Successful momentum trade – S&P 500 was trading in a tight range and consolidating, a large move representing 80% of the 10 day average range triggered a position in that direction (long), trade hit profit target and was exited.
  + Successful momentum trade – Soybean gapped higher triggering a long, the long was maintained until the end of the day as there was no retracement (never moved back below the open price)
  + Unsuccessful momentum trade – Crude oil, model was looking for a vol spike after trading in a tight range the previous 6 sessions and quiet trading during the first two hours of the day, after the vol spike a long was initiated, but the price reverse in a v shaped pattern and the trade was stopped out.
  + Unsuccessful momentum trade – S&P 500 pivot trade, model went long after breaking out above the previous pivot point, momentum failed and trade was stopped out.

TEAM

* In addition to Stefan and Umran, we also met with two of the traders and two research analysts
  + Bill Tiedt – Trades during European hours, Umran referred to him as their head of trading, was with Crabel for 10 years, he said that Centurion has a similar feel to his early days at Crabel but with even more resources. We came into their space just after European markets closed and Bill’s workstation was shut down. Bill noted that he spends 80% of his time trading and 20% of his time sending research ideas to the analysts.
  + Jon Kneeland – Trades during U.S. hours, was with Crabel for three and a half years – but that is not listed on his linkedin profile – re-confirm with Umran.
  + Darian Bailey – research analyst, hired out of University of Chicago, showed us the research systems including the list of all models and trailing sharpe ratios
  + Dan Goral – research analyst, previously worked in a high frequency trading firm in Chicago, wanted to move back to Milwaukee and joined Centurion
* Umran noted that they were able to build the team in part due to getting early investors to pay management fees early on with a hand shake agreement to go to 0/15 later
* Follow up with Umran regarding employee turnover – Jason Frederick was a trader at Centurion from January 2013 – June 2014, and James Dodd was a “Financial Consultant” at Centurion from September 2010 – October 2012
  + Dan Raddemann – trader, joined 2014, had spent 6 years as a trader at Crabel