1/20/12

QMS On-Site Meeting with Michael Brandt, Peter Nolan, and Adil Nathani, all managing Principals

Ty Powers and Mike Hennen of Hatteras Funds

AUM: $30M current AUM, expect to be $55 by end of February

Registration: The team has built the structure to be SEC ready and is willing to become registered

Key Takeaways/Assessment/Next Steps: We were impressed with both the infrastructure and caliber of personnel at QMS. All members have extensive experience in quantitative models and Mr. Brandt has done extensive research on the impact of economic data on trading models. The mix of traditional CTA trend/momentum investing with systematic global macro models is unique and could fit nicely with the short/intermediate term and fixed income strategies we currently have in the Managed Futures UFT. We recommend moving along in the due diligence process, scheduling a subsequent onsite and beginning the ODD process.

Michael Brandt – Mr. Brandt reviewed his full background and how he eventually started QMS in 2008. Mr. Brandt began his career in CMO research in ’96 and moved into FI futures trading and modeling in Chicago before earning his PhD from Chicago and then joining the faculty at Wharton and then Duke. While teaching, he’s served as a consultant to Citadel, DB, and others. In 2008 while at Duke, Mr. Brandt was approached to build a macro-driven investment platform for the firm with a seed commitment of $200M in exchange for 15% equity interest in the fund (QMS). DB committed to building out the infrastructure of the fund but in 2010 had to shut the program down as it was part of the bank’s prop desk. Since DB pulled its capital within 2 years, they lost the claim to 15% of QMS equity.

Adil Nathani – After graduating from Duke in ’85 he joined Doug Breeden at Smith Breeden until ’92, then joined AMBAC and then Normandy Asset Mgmt. Mr. Nathani then joined CDC, a French state-owned investment management group that managed more then 200B which Mr. Nathani eventually oversaw half of by the time he departed. He then was recruited by Vikram Pandit to join Citi as a partner at Old Lane and most recently as Chief Risk Officer of LATAM. He left his post at Citi in search of an opportunity to be a senior member of an investment manager. While Mr. Nathani is touted as an experienced operations and risk manager and no doubt has the credentials to substantiate this claim as a member of the QMS team, we believe a significant amount of the risk controls have already been built into the models by Mr. Brandt and the original QMS team and are monitored by them. Mr. Nathani appears to have committed a significant amount of capital to the firm although it is unclear the extent of his involvement with day-to-day operations.

Investment Process

QMS’s objective is to integrate their research and implementation processes to combine economic research with mathematic application. Half of the QMS portfolio are CTA-type trend and momentum models and the other half are systematic global macro models. Both trade a universe of 100 futures and forward contracts globally. The strategy implements a “hierarchical” construction starting at the portfolio level, to strategy, themes (between 10-12), and models (>100 with more than half and closer to 75% dedicated to the trend/momentum). The portfolio is optimized using an extension of the black-litterman model developed by the QMS team. A full blueprint is summarized in the QMS pitchbook. The model implementation process is started with idea generation by the team followed by multiple levels of backtesting and peer reviews. Average holding period for the fund is 20 days although this will differ between the momentum and macro portions where the CTA models will be days to weeks and macro measured in quarters.

Mr. Brandt recommended a minimum $5M trading level with the sweet spot at more than $10M. the fund will typically be ~20% M/E, and this ranges from the low teens to high 20’s). They target a vol of 15% and the goal is to generate a 1.00+ sharpe ratio over the long term.

Infrastructure

QMS utilizes cluster computing across 60 server nodes and maintains redundancy in the cloud. 75% of the server’s capacity is utilized for testing of models while the other 25% is used for data, trading, front and back office. The team is moving offices in the next month and plan to have redundancy but there could be a risk of interruption during the transition. This will most likely not impact a potential account with HAMF as we’d have to wait on SEC registration to become active prior to allocating which should be well after the move. All three pieces of the computing process (backtesting, trading, back office) were developed in-house by principals of the firm. In general, Daryl Caldwell is primary point for risk management/portfolio construction functionality; Richard O’Brien for trading; and Robert for backtesting. While these people were identified as primary architects/operators of each component, according to Mr. Brandt all procedures are well documented and back-up operation should be seamless (all members of the team are well versed in all aspects/operations and could run independently).

Performance/Comps

