MODULE 2 UNIT 1
Video 1 Transcript

IN COLLABORATION WITH getsmarter™

Module 2 Unit 1 Video 1 Transcript

NIR VULKAN: Hi everyone, and welcome to Module 2. I hope you enjoyed the first module. What we're going to do in this second module is we're going to look at the history of hedge funds and, in particular, of systematic or algorithmic trading firms. This is now a huge business, but it's actually not that old. You will see, kind of, the 1930s and the first short selling and kind of the growth in the late '80s of funds. So, we give you an overview of that.

Very, very briefly, hedge funds are kind of a loosely regulated entities, allowing large investors, not individual investors – that's why they're loosely regulated – to make investment in what we now call alternative assets. And the idea or the hint is in the name, "hedge", "hedge fund". The idea is to create returns that are uncorrelated with the major stock indices, so that you can have good years when the market is having a bad year, for example, or that in general, that you have uncorrelated returns with the market.

And of course that makes sense because most institutional investors, for example, the University of Oxford, where I am in now, will have a large chunk of their wealth invested in stocks and shares. But they would want to hedge their bets and to have some of their wealth also managed by something that doesn't necessarily go down when everything else goes down, hence hedge funds. And that's where it comes from.

So, hedge funds have been around for a while and you will see the history of that in this module. And systematic kind of fits nicely with that, partially because the hedge funds have always been at the front, the most sophisticated of all these traders. And so they were more susceptive for, you know, new technologies and anything like that, and the use of computers in the early days and the use of, kind of, more sophisticated statistical models.

So, they were set up for that, partially because as you will learn with us in this programme, algorithmic trading tends to be systematic, so it's not specific for an asset class. So, the way you make money is by making lots of bets in different assets. And, in order to do that, you need to have a large capital and so hedge funds would be the obvious thing to do. In other words, if you and I came up with a simple model, you know, a good algorithmic model that require, you know, 30 different markets, we couldn't just ask our rich uncle for a bit of money to trade in because the minimum ticket to implement this, given all these markets, would be something like 5 or 6 million.

So, what I just described to you is very normal in the world of systematic trading. And so it sort of make sense to go to the hedge funds. And also again, you will see in this programme, hedge funds typically are less regulated, so you can do short selling, you can use futures, and these are the kind of tools you would want to do with most of the systematic trading. Not always, but that's kind of one—they go together most of the time. So, I think you will find this helpful, seeing where it comes from and hearing about some of the most successful funds that emerged over the years. And you will get to see interviews with some of the executives of these funds who will tell you about their experience and their history.

We will also look at the kind of famous Turtle experiment and, actually there's a newer version of that, which we would look at again, and this is the old sort of thing. Can anybody be trained to be a good trader or is it something you're born with? And I love those things because of course there's never a correct answer. For us, it's important to say that obviously there’s an element of science about it. Otherwise, this programme wouldn’t exist, so clearly there’s a huge element of training, but there’s also a lot of kind of intuition. So, you will see this famous experiments over the years where people took people almost off the streets and trained them, and learned to see if they can do well or not.

Hopefully, this is something you will enjoy. And, for those of you who are not from finance, I think this is really, really crucial you pay attention to this because, you know, this is an industry with some history. And you should know this history if you want to do well in it, if you want to join this industry and have some impact on it. I hope you enjoy Module 2.