



MODULE 5 UNIT 3

Video Set Video 1 Transcript

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NIR VULKAN: Hello everyone, and we are now in Module 5 in this programme. And what we're going to do now is try and understand the due diligence process that algorithmic traders, people who came up with the models, go through in order to get the models trading. So, maybe you have a model and you're talking to a fund that's going to trade your model. Or maybe even, you have a fund and you're trying to talk to investors, but these are maybe sophisticated investors, investors that already have some experience with systematic funds, and so, they know what questions to ask. So, I'm going to make sure that you know what questions they would ask as well so you are kind of familiar with that process.

I'm going to begin with the obvious thing to remind you that we're talking about hedge funds, and we're talking about uncorrelated returns. So, sort of, at the risk of saying the obvious, because sometimes people forget the obvious – that they would look for uncorrelated returns. So, you know, what we build here is the kind of stuff that's supposed to do well when market go up and when market goes down, okay? You've seen this... in Module 4 in what I've done; those of you who have done the additional programming with Stefan have seen it also in Module 3 and 4 in that stuff when we talk about 2001, 2002. You know? And investors would be looking for that. If you came up with a model that's kind of only similar to a buy-and-hold kind of strategies, that's fine, maybe there's a space for that model, but it will be highly correlated with what they know how to do already, so it really, really need to be much, much better, okay? And that's kind of unlikely because they're quite good at what they're doing.

So, we really are looking for something that's uncorrelated. And how do we achieve this is, as you've seen throughout this programme, by having different asset classes and by trading things like commodity futures, effects futures, some stock indices futures, et cetera. So that will mean you will have some correlation with these asset classes, right? If you're trading commodities, you know, and there's a big movement in gold, you will have that correlation with everybody else who's trading gold. But because you have a lot of them and because they're so different from one another, you will build a box that its returns are hopefully uncorrelated with, kind of, major stocking indices, and so on. And so, that correlation level should be small.

In other words, what I'm trying to say to you is make sure you have something unique. Something unique is better than something good, if that makes sense. So, something unique and good is the best, but it's the uniqueness that will get you the allocation because they have big portfolios and they would look at correlations, and obviously, if you are uncorrelated and decent, you will get money; if you are very good but correlated, you probably wouldn't get money, if that makes sense. So, that's the obvious thing before you even start is to make sure you are in the right sector.

The other things that they would look for is, they would try and challenge you a little bit in terms of the performance of the model that you present to them. That's the obvious, is the correlations. Beyond correlations, they would look at you, at the team. And this is something we spend a lot of time on talking in Module 3, and especially Terri Duhon talk to you a lot about that. They would be suspicious of teams that are only technical people, okay. Not because they don't like technical people, but because these things tend to fail a lot. And so, they would look for a mixture of people between traders or people with

knowledge of the markets and people with good technical understanding. Of course, you are what you are. You can't change who you are, but you can ensure that you have the right people on board. And so, I would really strongly advise you to make sure you have a diversified team between you.

That also means you have some level of experience in the team as well. So, not just the diversification in terms of background, but also in terms of experience because, you know, there's something about managing real money and having bad years and losing money that, I think, sort of makes you appreciate the game more. And I mean, I'm always wary when I see some of these brightened new people coming in and promising the moon. And they mean it, yes? They're not wrong. They want to see that you have a team that wouldn't panic when there is a drawdown. They wouldn't start changing what they promised they would do just because things go bad.

And so, they would look for a level of experience, and they would look for diversity of the team in terms of backgrounds. And you have to ensure you have these things put together; otherwise, it would be very unlikely that they will go with you.

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