

Quantitative Investing: What's Changed, Why it Changed and How to Generate Alpha in the New Normal of 2009

This paper provides an overview of how the markets have changed for quant funds since the quantitative meltdown of August 2007. We will review what happened, detail what's different since that time and demonstrate how traditional market predictors have proven themselves inadequate to deal with the new market conditions. This paper will then recommend specific adjustments that quantitative investors may undertake to better position themselves to generate strong returns in today's new economic reality.

Who Turned Off the Lights?

Why has quantitative investing been so challenging since August 2007?

If you are a quant portfolio manager, you probably still wince when recalling what happened in August, 2007. Massive losses, correlation at the tails, curtains pulled back, chairs pulled out from underneath. Quants were the market kings from the dot.com bust until August 2007, but the events of those late summer days may have thwarted their absolute rule.¹

As with any seismic event, there was an enormous ripple that affected the market in ways that we are still feeling. Quantitative investors who have not corrected their strategies in reaction to these changes may continue to pay the price in the form of massive redemptions and lack-lustre returns.

This paper is a result of our dialogues with hundreds of quant fund managers worldwide during the past two years. Some are our customers, some are not, but all have generously given us their time and told us similar stories. From these conversations, consistent themes emerge. For quants, the main take-away is that the last two years represent the first few innings of a whole new ball game. Has your firm figured this out yet? If not, it may be at a disadvantage.

However, the good news is that with new realities come new opportunities for generating returns and getting back into the game. That's what we'll be focusing on in this paper.