

Finding Top Hedge Funds

Fundana, a Swiss fund of funds, uses LRSK to help identify new managers who are best able to respond to changing market conditions.

BY JON ASMUNDSSON

FINDING THE NEXT JULIAN ROBERTSON IS no easy task. For one thing, there are very few of them out there, says Dariush Aryeh, a founding partner at Fundana SA.

So the Geneva-based firm, which advises clients on hedge funds and oversees about \$900 million in

three funds of funds, instead focuses on identifying up-and-coming hedge-fund managers who share a skill with Robertson, the legendary investor who ran Tiger Management LLC: the ability to curb losses in market downturns. That talent, Aryeh says, is the key to outperforming over time. If you look at successful hedge-fund managers, he says, they typically don't make much more than others in rising markets. "It's on the crash, on every correction, that they limit the loss," he says. "We try to identify these people."

MANY NEW HEDGE FUNDS RACK UP IMPRESSIVE returns for a couple of years, Aryeh says. Often that's because their strategy jibes with the prevailing market environment. "You can succeed because you are a bull during a bull period," he says. "You can succeed because you are short during a crash period," he adds, referring to the practice of selling borrowed shares in the expectation that prices will drop. It often takes a change in market conditions to differentiate the skilled from the merely lucky, he says.

When markets turn, there are many ways to react, Aryeh says. Most managers simply add risk, buying more. That approach can be profitable until it ends badly. "When the market definitively crashes, you're out of business," he says. Instead, the best managers will reshape their portfolios at each crash, lowering risk, Aryeh says.

Fundana tracks the careers of more than 1,200 analysts and portfolio managers in a database. It records biographical information such as where a



Fundana's **Dariush Aryeh**, left, and **Michael Gerber** use simulated portfolios to track how new hedge-fund managers react to changing market conditions.

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person went to school and which investment bank or big hedge fund he or she worked at. “What it does is gives you all the people who might have worked with him at some point in his career,” says Michael Gerber, Fundana’s head of research. “It’s a way to optimize the questions that we ask.”

Each year, the firm looks at new hedge funds. Fundana typically focuses on about 40 to 50 funds that show potential, usually based on a manager’s record of overseeing money at a big hedge fund, Aryeh says. After performing due diligence, Fundana then makes a small investment of about \$1 million in each of about 20 new funds. “The first step is to understand what they are doing,” he says.



When viewing a 13F for a selected hedge fund, type **LRSK <Go>** to gauge the liquidity risk of the reported holdings. Type **PORT <Go>** to track performance.



To do that, Fundana builds simulated portfolios for each. The firm starts with a fund’s gross long and short exposures, Aryeh says. For example, a hedge fund may stock with a value equal to 80 percent of its assets and have short positions equivalent to 50 percent.

The firm uses a fund’s 13F filing—the quarterly holdings report that asset managers file with the U.S. Securities and Exchange Commission—to model its long holdings. To approximate the short

positions, Fundana creates custom indexes. It then compares the weekly returns reported by the fund with the performance of the simulated portfolio. When there’s a difference, Fundana looks for the reason, Gerber says. “The beauty of this system is that there are just three inputs,” he says. The fund has shifted its proportional long-short exposures, changed its stock portfolio or modified its short positions.

TO FIND INFORMATION ABOUT THE REPORTED holdings of hedge funds, you can use the 13F Filing Summaries (FLNG) function. Type **FLNG <Go>**, click on the arrow under Institution Type, select Hedge Fund Manager and press <Go>. Let’s take a look at the holdings of Viking Global Investors LP, the hedge fund run by Andreas Halvorsen that made \$12.3 billion for clients from its inception in 1999 through 2012, according to data compiled by LCH Investments NV and reported by Bloomberg News. Tab in to the COMPANY NAME field, enter **VIKING**, press <Go> and click on Viking Global Investors LP. To track the performance of Viking’s reported holdings, type **PORT <Go>** for the Portfolio & Risk Analytics function.

Fundana uses the Liquidity Risk (LRSK) function to gauge how quickly a manager can react to a change in the market, Gerber says. In its analysis, Fundana looks at average volume over three months to smooth out shorter-term variation, he says. Type **LRSK <Go>**, click on the arrow to the right of Avg Volume and select 3 Month. Next, click on the arrow to the right of % of Vol Tradable and select 20. Last, tab in to the field to the right of Port MV Remaining After, enter 20 and press <Go> to calculate the percentage of the portfolio that would remain after 20 days of selling at 20 percent of the three-month average volume. As of March 11, the figure for Viking was 2.61 percent of its reported holdings.

The hedge funds that have gone through crashes and survived tend to have the same skills: risk management, bottom-up analysis, understanding money flows and being open to all eventualities, Aryeh says. “They have the ability to very quickly react when there is wind against them,” he says.

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