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Megalio Vision Fund

Alternative Asset Management (A²M) CEO Nicholas Edwards doesn't want to tell you the compounded returns over the past 20 months on his Megalio Vision Fund.

“If I'm brutally honest with you,” Edwards told *FINalternatives* from A²M's London offices, “I don't show that for two reasons.” The first is that the Megalio Fund doesn't compound returns. The second is that “if something looks too good to be true, by and large, people will think it is too good to be true—it scares the pants off them. I mean, even our net numbers now scare people.”

We'll get back to the scary numbers, but first, some background.

Technically, the Megalio Vision Fund doesn't exist yet. Technically, it's still the Alternative Vision Fund established by Edwards in January, 2008. A²M is in the process of changing the name, which Edwards says will allow the firm to use the original structure, sparing new investors the—considerable—charges of establishing a new fund. The name change is not simply cosmetic: the Megalio Fund (the name comes from the Greek word for “magnificent”) takes a very different approach to investing than did the Alternative Vision Fund, which traded low-volatility, high turnover products “purely through computers.”

By May of 2008, says Edwards, the Alternative Vision Fund was doing well, “up 17, 18%.” Then came the market upheavals and “Unfortunately, that did for us...Like many other automated trading systems, our system did not hold up well at all.” Edwards says investors were compensated for their losses (the fund held only a few million at the time) and he and his traders went back to the drawing board.

“We felt there was need for radical shakeup of approach. We realized that the markets were unlikely to recover from this difficult phase for some period of time.” So they hired consultants who crunched the fund’s 2006 numbers and discovered that while the returns at 375.54% were “terrific,” the standard deviation of returns, at 114%, represented “too volatile a ride for most investors to tolerate.”

Although A²M uses no leverage, it suffers “a high level of intrinsic risk because we’re margin trading using futures.” To de-risk the investment without losing returns, they decided to retain their bottom-up approach but introduce four key top-down risk control strategies that “taken individually,” says Edwards, “are not startling...but when you take them together, are very powerful.”

Whereas Edwards’ traders had historically taken a multi-market approach (trading in the DAX, the CAC, the FTSE, S&P, “a bit of gold, a bit of NYMEX crude”) the first risk-control strategy was to focus on a single market—the DAX.

The second strategy, says Edwards, was to blend bull and bear markets: “Traders are not locked into long or short, each can go either way, but there are two senior individuals within this team of three and they have a strong bias. One has a very strong bias toward alpha generation on the short side of the market, so he’s the bear, and the other has a strong bias toward alpha generation on the long side of the market, he’s the bull.” Edwards allocates 50/50 between the bull and bear traders who “tend to keep each other out of trouble.”

Risk-reduction strategy number three is a maximum capital of allocation of 80 lots (bear in mind, it’s futures only) per GBP 1 million of capital.

And strategy four is that profits are never compounded. All profits above the line, says Edwards, are held offshore and accrue, to the benefit of investors, in the fund NAV. Should an investor wish to increase the amount of his capital at risk, he may do so, but that decision is his alone.

Having chosen a strategy, the next step was to prove it worked.

“We’re all very clear here about what’s needed,” says Edwards, “and you need track record, you need consistency and you need evidence of physical returns. So we said, we will give it 12 months, we’re confident in the return profile, and we will then go to the investor with physical returns and say, ‘Here we are. Aren’t we clever? Now invest money with us.’”

Which brings us back to those numbers mentioned earlier.

For the last 20 months (since they began proprietary trading of physical assets in February 2009) the fund (with assets of GBP 200,000) has achieved returns of 276.06%, net of all fees and charges. Edwards says they have the documents to back this up and are happy to show “actual, physical daily statements” to prospective investors. Had that been compounded (hold onto your pants) the return would have been 515%. (In his presentation to investors, Edwards assumes AUM of GBP 2 million. The reason, he says, is that costs associated with running a fund would be overwhelming at GBP 200,000.)

October marked the first month they began accepting assets and Edwards says they’re being “very prudent and careful.” (On the day we spoke, the fund’s position size, which could be as high as 80 DAX, was 35 DAX.)

He puts their comfort zone at 5,000 lots (divided 50/50 between the bull and bear markets) and says he’d like to cap the fund at GBP 30 million—an amount he’s optimistic about raising within the next six months. That will put him below the radar of institutional investors, but he’s not concerned, saying institutionals would be unlikely to accept the risk levels involved. His ideal investors are high net worth individuals or small family offices. Investors no doubt able to tolerate the risk behind the kind of numbers he’s quoting:

“Our annual return is 165.4%. We are targeting returns of 100% net, so at the moment we’re smashing those returns to bits. I can’t guarantee what we’re going to do in the future but I can tell you our stated aim is to achieve returns of 100% net to the investor.”