



## **Opalesque Exclusive: Short-term market timing can help hedge fund investors capture alpha through market beta**

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From Kirsten Bischoff, Opalesque New York: It has been proven many times that individual investors attempting to enter and exit hedge funds with market timing strategies, inevitably lose money. Research (most recently published by Morningstar) shows that investors lag market trends. Nerves often cause them to sell low and buy high, and on average, they underperform underlying funds by approximately 1.5%.

However, New York-based investment firm Spring Mountain Capital (SMC) has recently published a research paper that studies short-term market timing success, the active beta strategy that the firm uses when it invests into hedge fund products.

SMC manages a hedge fund as well as onshore and offshore funds of funds, and has recently been vocal about its support of smaller hedge funds. The firm, which holds approximately \$1.8 billion in AUM and advisory assets as of June 21, 2011 said that the perception of large hedge funds holding less risk was flawed, and that large hedge funds have risks smaller ones do not, including the risk of "triggering a large redemption cycle with a strong negative feedback loop." (Source).

While that research focused on the decreased risk of small and mid-sized managers, their current research highlights the importance of being nimble in the markets as the benefits of short-term market timing tend to be generators of hedge fund alpha. The firm also makes the case that this practice can be extended to individual investors and institutional investors through the creation of investment vehicles that maintain a market-timing objective.

This is an intricate part of the SMC philosophy, especially in the post-financial crisis environment. "Asset allocation is more important today than it has been at any other time in the past ten of fifteen years," Launny Steffens, Founder and Co-Managing Director of Spring Mountain Capital explained in an interview with Opalesque. "There are obviously a variety of circumstances occurring around the world: Greece default possibilities, issues in China, volcanoes, etc., and all of those events create circumstances where asset allocation is very important," he says.

"Evidence in Support of Shorter-Term Market Timing" was co-written by Haim Mozes, PhD, Spring Mountain Capital's senior quantitative consultant and Professor of Accounting at Fordham University's Graduate School of Business, and by Serge Cooks, CFA, a quantitative analyst at the firm.

Specifically, the co-authors have found that a collapsed timeline of months rather than years show market timing can be successful, and that in fact, market timing drives much



of the success of hedge fund managers. Therefore, they conclude that sophisticated investors who maintain the ability to adjust net exposures and utilize market timing (ie, hedge funds, or fund of hedge funds that utilize liquid vehicles such as managed accounts) can reap the benefits of a short-term market-timing strategy as well.

Just as hedge fund managers increase beta exposure in strong markets and decrease that beta exposure in bear markets, SMC says "individual investors should consider investment vehicles that allow the portfolio manager the flexibility to reduce net exposures."

"Obviously the Holy Grail of investing is alpha generation. Certainly there are managers that can deliver consistent alpha over time, but alpha volatility even for people with strong track records has been very significant. Therefore, having a process to capture active beta is just as important to generating alpha as finding interesting anomalies in the market," says Steffens.