ALTERNATIVES WATCH

Quant trading legend Eckhardt welcomes new market trends

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Veteran fund manager and quantitative investing pioneer Bill Eckhardt launched the Chicago-headquartered Eckhardt Trading Company in 1991, with the systematic research-driven hedge fund firm utilizing a short-term trading style built around a series of functionary algorithms.

Eckhardt — whose trading expertise stretches back to the 1970s — combines highly-adaptive, highly-liquid evolutionary computing technology with a strong focus on certain risk metrics, particularly volatility, to develop trading signals across a range of markets and asset classes. He is perhaps best known for his role with Richard Dennis in training commodity traders in Chicago that became famously known as Turtle Traders.

The effectiveness of the firm's robust approach is borne out "time and time again" by the fund's performances, Eckhardt told *Alternatives Watch*, helping the firm generate a strong track record and volatility-adjusted return profile stretching back more than 30 years.

Between August 1991 and August 2022, ETC Evolution Strategies' total return outflanks the cumulative performances of a number of notable benchmarks including the S&P 500 Total Return Index, a 60/40 stocks and bonds mix, the JP Morgan Global Government Bond Index, and the Barclay CTA Index. The firm has frequently generated double-digit returns since the late 1990s, and in 2022, the fund delivered an annual return of almost 13%.

“My background is academic. It’s pure mathematics, not applied mathematics. I also had a strong background in philosophy, specifically the philosophy of science,” Eckhardt said, explaining how this academic grounding formed the basis of his approach to theory-building and theories around trading, and ultimately shaped his investment pedigree. “When I started there wasn’t even a concept of a quant — there was some scientific, mechanical trading, and I had a big advantage as I was one of only a few people doing that. I was considered an outcast.”

The firm’s links with the academic sphere remain: the William Eckhardt Research Center at the University of Chicago provides post-graduate interns across all scientific disciplines to work with the firm on challenging and developing new theories.

Risk management

“The paramount principle is that risk control is far and away the most important factor. A lot of trading systems have individual layers that are just trading on insight,” Eckhardt said. “They spend a lot of time trying to determine where markets are going to go, when in fact you can never know with any degree of certainty or success where the markets are going. But you can know your risk and understand your risk.”

He added: “Every system we have uses an evolutionary analysis extensively and everything we have, every test — on risk, on volatility — we have designed ourselves. The system never passes all the tests right out of the box, but certain systems can be improved in order for them to pass the tests.”

With macro uncertainty and banking pressure underpinning much of 2023’s broader investment landscape, the firm’s short-term, volatility-based approach seems particularly timely in the current trading environment.

Facing renewed volatility

Following a period during which Eckhardt Trading returned the bulk of its capital to investors and operated essentially as a family office managing Bill Eckhardt’s own money together with that of a select group of clients, the firm was overhauled and relaunched in 2020.

Part of this relaunch included a new UCITS-compliant strategy, the Tages Eckhardt Systematic Short-Term UCITS Fund, hosted on hedge fund seeder Investcorp-Tages’ platform. The fund, which uses market volatility as a key metric to identify and capture alpha by trading several diversifying models across multiple time horizons and volatility regimes, gained more than 14% in 2022.

The firm — which today manages around $200 million in assets — has also added several new strategies in order to broaden its scope beyond a purely volatility-based offering and better capture opportunities regardless of market conditions.

Bill Eckhardt acknowledges that volatility poses a critical challenge to the entire investment management industry at the moment, but stresses that, for his firm, the aim is to understand volatility and ultimately “make it work for us.”

“In terms of information, there is a bad signal-to-noise ratio. In other words, we have very weak signals coupled with a lot of noise. We have special techniques, additional analysis, to distinguish the two,” Eckhardt explained.

Comparing volatility to the two faces of Janus, he said: "Volatility is absolutely essential to understanding risk, though volatility is not the same as risk. On the one hand, volatility can be a real hindrance — it can make it hard to execute a strategy. But it can also be something that helps you."

Having designed its systems around understanding and capturing risk, and how best to take advantage of the assortment of opportunities arising from volatility through consistent application, Eckhardt Trading's models have proven "effectively reactive" to various market conditions, according to Rob Sorrentino, the firm's president and chief operating officer.

"In the long-run, this is what has differentiated us as a firm," Sorrentino told *Alternatives Watch*.

"The fourth quarter of 2018, when stocks and bonds went down at the same time, proved to be a crack in the wall. Yet our systems reacted very quickly and defensively," he noted. "In 2020 when Covid hit, it was a much faster and more violent break — but again our systems performed in the way they were supposed to perform. Then in the past year with the Russian invasion of Ukraine — again, the volatility reacted in a certain way and our systems reacted quickly to it."

Sorrentino said Eckhardt's processes of validating volatility standards, measurements and proprietary formulas have consistently acted in the way they are supposed to act, regardless of how the volatility is behaving, while at the same time certain competitors have stumbled.

"You'll find over the last three-to-five years that there have been a lot of firms that have been successful at various points, but they've fallen apart at different times during different volatility regimes," he added. "This is a critical point that we try to communicate to clients."

Eckhardt's team believes the events of the past year have dramatically altered the structure of a traditional 60/40 equities-to-bonds portfolio mix. As the firm reopens to new capital, Eckhardt suggested that investors are realizing how the firm's method of exploiting volatility is "very additive and extremely relevant" to a wider portfolio.

"We like to be able to use all the tools in front of us on the desk, rather than tie one hand behind our back," added Nick Bolton, Eckhardt's head of investor relations. Reflecting on the firm's UCITS performance, he said the inclusion of commodities has proven a key driver of returns.

"Bill has always viewed commodities as an important asset class with which to diversify a portfolio, and so we did everything we could to include commodities in our UCITS strategy. It has proved a differentiator for us, if you look at our performance over the past 18-month period compared with some of our peers who can't use commodities," Bolton explained. "Whilst cyclical, they will remain valid until the inflation trade has run out of steam."

Ultimately, the team believes that, from a strategy point of view, the firm is in a "good spot right now."

"We have new flows coming in again. Though we were closed to new investment for a while, Bill's relationships in the industry are long and deep, so we are now selectively starting with certain investors we know," Sorrentino added. "The Federal Reserve put is now gone, and volatility is back — so having systems that are based in volatility is very relevant for investors at the moment."