

The Cambridge Strategy

Question	Answer
How do you think you can achieve an above average performance?	The Cambridge Strategy achieves above average performance through a systematic process that combines a proven alpha generation model with strict risk management practises.
What are the strengths of your investment approach?	<p>We believe our approach has three major strengths;</p> <ul style="list-style-type: none"> ▪ Systematic alpha generation: using a series of proprietary algorithms that identify trades in both trending and non-trending markets. This has enabled performance to be maintained in different market conditions. ▪ Money management and foreign exchange experience: trades are generated by the system but are transacted by a portfolio manager in each of the time zones. This initiation of trades by a portfolio manager greatly eliminates event risk and allows for pro active position management. ▪ Risk management: we employ an extremely disciplined system whereby each trade is allocated an identical amount of risk capital. Risk assigned is a function of “ruin strategy” a methodology that proactively adjusts the risk capital based on how the model is performing on a risk adjusted basis.
What are the risks of your investment approach?	The model generates alpha by the opportunistic capture of statistical irregularities. The risk is that the system ceases to capture these irregularities.
Describe the ideal market situation for you to perform.	A trending environment.
Describe the worst market situation for you not being able to perform.	The strategy has not historically performed well in a “False Breakout” environment. Low volatility also produces inferior returns.
Can you achieve a performance if markets are trend less or choppy?	Yes, two of the three algorithms the strategy employs look for statistical irregularities in loss of momentum environments which are typically choppy.

<p>What is your expected worst draw down?</p>	<p>The strategy implements a 2% VAR limit to a two standard deviation movement in the underlying on a 24 hour period. Our worst peak to trough drawdown has been 1.4% and our worst 24 hour drawdown has been 1.03%.</p> <p>The strategy implements a monthly stop loss of 5%, and works to a “ruin strategy” of a 5% chance of a 10% drawdown. We do not anticipate a maximum drawdown of more than 8%.</p>
<p>What is your expected volatility?</p>	<p>Our target volatility is 10% p.a. our actual volatility since inception has been 7.43%. Rolling 12 month volatility is 2.3%.</p>
<p>What is your expected downside volatility?</p>	<p>Our targeted downside volatility is 8%. Our actual downside volatility since inception has been approx. 3%.</p>
<p>Any reason why you did not perform well within the last 2 years?</p>	<p>In 2004 the strategy produced returns of 29.23% with one down month of 0.03 basis points. September through November, the strategy returned 18.9% illustrating that in strongly trending markets the strategy can perform well. In 2005 the strategy returned 9.28% in choppy conditions.</p>
<p>What kind of systems do you use to achieve the projected performance?</p>	<p>Our algorithms are programmed in CQG; our risk is monitored in Bloomberg.</p>
<p>What kind of instruments do you use to stay within the risk limits?</p>	<p>We stay within our risk limits using strict stop losses and portfolio VAR limits. We have not had a single breach of our risk limits in 700 trading days.</p>
<p>How do you differentiate your approach from other market participants?</p>	<p>We feel that we are differentiated by three things:</p> <ul style="list-style-type: none"> ▪ Our foreign exchange and money management experience: the principals are career professionals with combined tenure of over fifty years all at major institutions at the highest level. ▪ Our risk management technique: being both simple and disciplined, it greatly reduces the volatility inherent in the approaches taken by other market participants. ▪ Our systematic alpha generator: this provides signals in both trending and non-trending markets.

<p>Who is your closest competitor?</p>	<p>We feel that we are unique in combining alpha generation and risk management in this method.</p>
<p>Outline your philosophy on risk control.</p>	<p>Cambridge bases its leverage and risk management on an approximation of return distributions based on Monte Carlo historical simulations. Every other characteristic is deduced from this.</p> <p>The Cambridge Strategy calculates leverage employed on a weekly basis. Leverage employed is essentially a self correcting mechanism, that relies on the historical Sharpe Ratio, and historical volatility of returns to proactively and dynamically adjust leverage to optimize returns. While the Sharpe Ratio does have inherent flaws, it is more than a score, and the Fund uses it to generate “ruin” probabilities using Monte Carlo simulations. These ruin probabilities dictate the notional risk inherent in each trade, which in turn dictates the position size and leverage used.</p> <ul style="list-style-type: none"> ▪ The rolling Sharpe Ratio for the previous 52 weeks is calculated. ▪ The strategies historical volatility of returns are calculated. A “ruin” % loss is calculated. Currently this is based on a 10% loss of capital to investors. An acceptable probability of “ruin” is assigned to the strategy. Currently this is at 5%. i.e the strategy is willing to accept a 5% probability of losing 10% of investors capital based on past risk/return parameters. ▪ Based on the strategies Sharpe Ratio a Monte Carlo simulation is run against a range of loss limits. Based on an acceptable probability of “ruin” of 5%, the percentage of the annualized volatility that corresponds to a 5% probability of “ruin” is then calculated. Leverage is then calculated based on the level of leverage that corresponds to the level of annualized volatility that equals a loss of 10% of capital employed. ▪ Leverage is adjusted via a basis point limit per trade which impacts position size. ▪ This leverage (which is expressed as a position size) is then compared to historical position size to calculate a ratio which is then used to adjust the basis point risk per trade. (Cambridge uses basis point risk per trade to dictate the position size). Currently the basis point risk per trade is set at 13 basis points. Basis point risk per trade, and consequently position size is adjusted monthly. Expected returns are calculated from the normal Sharpe Ratio, position size and historical volatility. Currently expected returns are 16%. ▪ The implications of this methodology are significant. Leverage is dynamically adjusted to reflect market conditions. An improving Sharpe Ratio results in more leverage being employed, as does a lower volatility of returns. The reverse is true. This allows the strategy to increase leverage as risk adjusted performance improves, and results in leverage being reduced as risk adjusted returns deteriorate. In a trending market, this can result in a significant improvement of returns.

	<p>Portfolio VAR</p> <p>Once the individual risk capital trade parameters have been set, the entire portfolio is subjected to a VAR test. Cambridge calculates risk using VAR generated by movements in the underlying spot by different Standard Deviation scenario's.</p> <p>Cambridge posts three sets of VAR risk, a simple movement, a worst case scenario (Portfolio VAR), and an adjusted worst case scenario (Adjusted VAR) where the VAR risk is modified by the pre-determined stops set against each trade. Cambridge uses FENICS for all risk calculations. Risk is calculated for one, two and three Standard Deviation movements and is shown in VAR of capital under management. It is based on a one day time horizon. Cambridge has an absolute adjusted portfolio limit of 2% VAR for a 2 Standard Deviation movement in the underlying on a one day time horizon.</p>
<p>What kind of sensitivity do you expect if currency moves are >2% in one day and why?</p>	<p>Depending on the leverage employed at the time, a 2% movement in currencies would result in 2% or more sensitivity VAR if the portfolio was 100% correlated. In practice this would probably not be the case and the underlying sensitivity would be considerably less.</p>
<p>With which asset class is your product correlating the most and why?</p>	<p>None. It has a low correlation to equities and bonds.</p>
<p>How do prevent yourself from trading errors?</p>	<p>Trades are set up and risk profiled trade by trade they are then entered in a blotter which is filed each day, the trades that are entered on the blotter include the risk parameters of the trade. A secondary trade blotter is also created with all the trades of the day, and this blotter is reconciled with the prime broker on a daily basis.</p>
<p>Describe the exact investment process.</p>	<p>Propriety algorithms are used to identify trades through constant screening of real time data over eleven currency pairs and two time frames.</p> <p>The steps in the algorithms are binary, and we monitor the potential trades as they evolve through our system. A colour coding scheme is employed within the model to define the stage each potential trade has reached. A yellow signal denotes a trade has the potential to trigger. Green or blue signals denote that a trade is close to being triggered. Finally a red signal denotes that the trade has been triggered.</p> <p>Trades that have a high probability of being executed are risk modelled. This process involves the identification of primary and secondary levels of support and resistance. In the case of a long position the aim is to place our stop loss level below the secondary support and our take profit level ahead of secondary resistance.</p>

	<p>Once these have been established a ratio of potential profit to loss is calculated. Ideally we would like to see a ratio of better than 1.0, however trades will be implemented where the ratio is better than 0.8. A trade will not be implemented where the ratio is below 0.8.</p> <p>Upon execution each individual trade becomes incorporated into the strategies portfolio. The portfolio itself is constantly managed to ensure that it never exceeds a limit of 2% VAR for a 2 standard deviation movement in the underlying on a one day time horizon.</p> <p>Portfolio managers execute the trades once they have been risk modelled and sized. This is done as a control measure. Its purpose is to mitigate risk and is not an attempt to enhance alpha generation.</p> <p>Managers retain the discretion to raise take profit and stop loss levels in cases where they feel there are confirming signals. Stops though are immutable and can not be moved down under any scenario.</p>
What makes this investment process competitive?	<p>We believe the strategy is essentially a simple strategy, with a proven alpha generator, implemented by highly experienced foreign exchange professionals, using a disciplined risk management approach. It performs well in both trending and non trending markets which makes it competitive against its peers.</p>
Describe the exact decision process when making a trade.	<p>The strategy is systematic. Trade size and entry levels are determined using a combination of our risk management model and proprietary algorithms.</p>
Conflicts of interest	<p>None</p>
Performance Benchmark	<p>EuroHedge Index</p>
Prevention of style drift	<p>Style drift is prevented by the nature of the process within the system. Portfolios are monitored weekly to ensure an adherence to the strict trading guidelines.</p>
Describe what kind of product structure you would suggest to offer for the institutional client in order to produce maximum investment security.	<p>We believe that managed accounts are an appropriate structure because of the transparency and security of the investment. An offshore fund vehicle is also suitable.</p>