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Behind the Money

Quant Shop JDFX Achieves Sub-BP Spread on $20 Billion Forex Trades

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ZURICH, Switzerland (HedgeWorld.com)—Forex fund JDFX is to re-launch with $50 million before the end of the year. The management and technical staff at the young quant shop are very excited about their alpha program which consists of three automated trading strategies (trend, counter-trend, and inventory) which have a correlation of less than five percent. In addition to their strategies, they are particularly proud of their in-house developed trading platform which they say has recently achieved sub-millisecond trade execution.

James Pieron, CEO of JDFX, told HedgeWorld that the algorithms developed in-house use advanced mathematical methodologies for real-time market adaptation. These include adaptive filters and neural networks, and give the firm the flexibility to react to changing market conditions, said Mr. Pieron. The trading platform can process over 1000 trades per second and ¼ million rates per minute, he said.

“In addition to performance our system is bank friendly”, added Mr. Pieron. He explained that the system has three counter measures to prevent hitting liquidity providers off-market. The first is a triple matching system which doesn’t allow a rate to be executed unless it is matched by at least two other rates from two different banks. The second assigns each in-coming rate a time-to-live (TTL) parameter, and will not attempt to trade old rates in a slow moving market. The third is a “last look” at the application program interface (API) level before execution. That is, if a new rate has arrived at execution time, the old rate is automatically swapped for the new. While this “last look” mechanism may increase costs to the firm around 85% of the time, it will protect the liquidity providers in a fast-moving market.

Liquidity providers and banks working with JDFX must also be quite excited. Jeff Ohl, COO at the firm, said that the fund moves approximately $10 billion per month for every $10 million under management. With $50 million under management, it could be moving unleveraged volumes of around $50 billion per month from launch.

Mr. Pieron said that in August/September live-testing, the firm had traded $20 billion with a round trip spread of 0.634 including slippage. Testing was performed with $50 million of private client funds with 2x leverage. Live testing vs. back testing was +/- 20 basis points. Currency pairs traded were the major USD crosses (cable, euro/$, $/Yen, $/Swiss francs).

The firm believes it has a significant technological advantage and plans to maintain this by devoting 50% of its budget to researching and developing new profitable alpha trading strategies. Half of the entire team will be working on research and development. All have technology or science background, with four of them arriving from ETH, Europe’s answer to MIT. The CIO, Luigi Amato, holds a CFA and was previously a quantitative analyst at Horizon 21. Mr. Ohl, has a background in economics with 15 years at well known financial institutions including JP Morgan, Credit Suisse and UBS, and Mr. Pieron has a mathematical and IT background followed by many years’ designing and implementing automated systems for organizations that include the US Department of Defense, Sun Microsystems and the Bureau of Criminal Investigation.

The fund suffered something of a setback earlier in the year when one of its relationship managers, a well-known trader in Zurich FX circles named Alfred Johnstone who had been with JDFX for nine months, began bypassing the computer system and making direct trades with liquidity providers via a messaging system. He walked out minutes before discovery.

The firm reacted by pulling the credit lines at the prime broker to cancel all orders and secure its NAV position. Mr. Pieron also decided that the firm needed to improve security measures and internal operating procedures. Established procedures now prevent non-authorized trading include agreements with the liquidity providers which restrict trading to the API, while directors and officer’s liability insurance has been taken with AON Switzerland.

“While I’m not happy about how we got here, I’m glad we’re here,” mused Mr. Pieron. “Having to stop trading and then re-launch is definitely a blessing in disguise. We have diversified our alpha program in the fund, tightened up our internal operations, and added AuM. We have also added an additional revenue stream with JDFX RMS, which will provide risk management services to foreign exchange brokers and is to be launched in January. The JDFX group is stronger than ever…”

The fund is targeting returns of 10% to 15% and volatility of 4% to 5%. While it puts risk per month at 5%, monthly returns over a year of testing have ranged between a loss of 0.04% and a gain of 2.6%, with annualized standard deviation of 2.7% and a Sharpe ratio of 3.25. The fund remains open to new investments, with a minimum investment of $5 million. Estimated capacity is between $300 million and $500 million. Currently, all client funds will be run via managed accounts.

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