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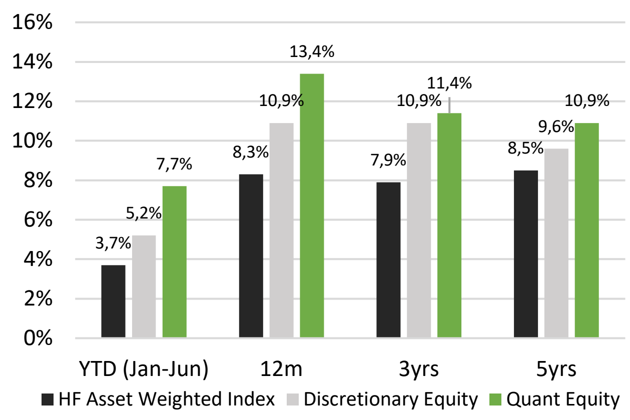
HUMANS VS. MACHINES: HOW QUANT HEDGE FUNDS ARE OUTRUNNING THE PACK

For decades, the image of a hedge fund has been inextricably linked to the singular brilliance of a discretionary portfolio manager – often an individual with an unparalleled intuitive grasp of specific companies, sectors or markets, an uncanny ability to sift through complex information, and the foresight to make high-conviction bets. This traditional paradigm, heavily reliant on human insight and subjective judgment, is now facing a profound transformation. The investment landscape is rapidly evolving with the ascendance of systematic investing, a data-driven approach that leverages advanced computational power, algorithms, and vast datasets to identify and execute trading opportunities. Increasingly, these "quant" strategies are not only challenging but, in many market conditions, outperforming their discretionary counterparts, signaling a significant shift in the very definition of alpha generation in modern finance. So, what's driving this seismic shift?

Chart 1 – Quant Equity Has Been the Best Performing Hedge Fund Strategy Over the Past 5 Years



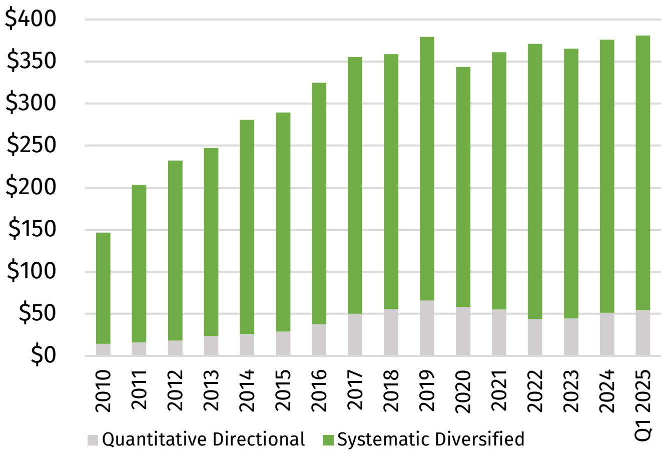
Source: Barclays Capital Solutions, as of June 30th, 2025

First, factor and statistical arbitrage equity strategies have thrived. After an extended period of low dispersion, the sudden increase in rate volatility led to a widening of spreads between winners and losers. This environment provided ample opportunities for strategies that exploit mispricings and relative value discrepancies among securities. Whether through exploiting divergences in fundamental factors, behavioral biases or statistical relationships, these models found a renewed landscape rich with profitable opportunities that had been largely absent during the preceding era of ultra-low interest rates and compressed market dynamics. In fact, most systematic strategies went through a “quant winter” during the 2015-2019 period with low rates and suppressed volatility.

Second, technological advancements are profoundly reshaping the landscape of investment research and trading. The rapid evolution of areas like artificial intelligence, machine learning, and big data analytics is transforming how financial professionals gather, analyze, and act upon information. These innovations are leading to more sophisticated predictive models, automated trading strategies, and more efficient market operations. By 2023, nine out of ten large hedge funds were deploying these new toolkits to generate signals, execute trades or manage risk. According to a 2023 report published by Barclays, the share of hedge fund assets run by quantitative programs has climbed to 35%, up from just 10% in 2010. Satellite imagery, credit-card exhaust, option-implied curves and social-media NLP (natural language processing) now feed massive amount of data into research pipelines, letting models refresh multiple times intra-day where discretionary peers still think in quarters. Some AI systems can execute trades in microseconds, spotting tiny inefficiencies before humans can even notice anything. But models don’t (yet) build themselves, and managers must hire scores of highly paid data scientists, engineers, and mathematicians to design the models that process massive datasets. This technological upgrade, therefore, represents a massive investment from managers, encompassing both significant infrastructure development and substantial recruitment efforts.

A higher volatility world has been challenging for the 60/40 mix with falling expected returns (especially in 2022) while hedge fund performance improved significantly over the past five years. Quants, with low equity beta (most of the time being market neutral) and positive convexity in selloffs, became the go-to diversifier for pensions and insurers looking for liquid diversifiers. Thanks to their ability to neutralize multiple risk factors, quantitative models are typically run with significantly higher leverage—often up to 20x—allowing for enhanced capital efficiency. As a result, quant equity funds have delivered strong performance, generating double-digit annualized returns over the past five years (see chart 1) with much lower volatility. Furthermore, quant hedge funds have performed remarkably well during downturns which adds to their appeal. As a result, quant hedge funds have experienced positive net inflows in recent years, a notable achievement when contrasted with the industry-wide redemptions seen elsewhere. This surge in demand, however, quickly led to a challenge: Tier 1 quant managers rapidly reached their capacity due to inflows and outstanding returns. Consequently, investors are now actively seeking out alternative options within the quantitative investment space.

Chart 2 – Quant Hedge Funds: More Than a Decade of Consistent AUM Growth ($B)



Source: Hedge Fund Research, as of March 31st, 2025

Multi-PM platforms have been leading efforts in this expansion, exemplified by industry titans like Millennium, DE Shaw, Schonfeld or Point72 (Cubist). The immense scale of these firms confers a significant competitive advantage. Their vast capital base allows them to invest heavily in cutting-edge low-latency infrastructure, providing them with unparalleled speed in trade execution and data processing—a critical edge in today's fast-paced markets. Furthermore, this scale (and their cost pass-through structure) enables them to pay top dollar for the brightest quantitative talent, attracting and retaining the intellectual capital essential for generating consistent alpha. Today, most multi-PM funds have increased their quantitative allocation significantly to fall within the 20%-30% range. This upward trend is likely to continue, reflecting the growing reliance on data-driven strategies within these sophisticated investment powerhouses.

Quant funds, while powerful, face some key risks that can undermine their performance going forward. First, overfitting occurs when models are too finely tuned to historical data, capturing noise instead of genuine patterns—leading to poor results when faced with new or unexpected market conditions. Second, data crowding has become a growing problem, as many funds now rely on similar datasets (such as satellite imagery or web traffic), reducing the uniqueness of insights and eroding potential alpha as trades become more crowded and predictable. Third, the use of black-box models—especially deep learning systems—raises serious transparency concerns; even if these models make profitable decisions, portfolio managers may not fully understand how or why, complicating risk oversight and compliance. Finally, regulatory scrutiny is intensifying as these funds grow in influence and complexity; authorities are increasingly focused on whether algorithmic trading introduces systemic risks or unfair advantages, and new rules could constrain the flexibility and innovation that quant strategies currently enjoy.

Together, these risks highlight the importance of balancing a portfolio between “old school” discretionary hedge fund strategies and innovative systematic programs. This approach underscores our belief in the fundamental principle of diversification in portfolio management. Discretionary funds might excel in identifying unique opportunities or navigating complex geopolitical events, while systematic funds offer disciplined, data-driven execution and can capitalize on market inefficiencies in a consistent manner while also eliminating any emotional bias.

If you have any questions, or would like to discuss about our strategies, please do not hesitate to reach out.