

A New Year message from Tim Wong, CEO of AHL



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Dear Investor

2012 has been somewhat of a repeat of 2011 where the sentiment of global markets can easily change following the words of a politician, central banker, or some geo-political headline. The brinksmanship displayed by US leaders in July gave rise to choppy US equities, and sets a difficult precedent for the upcoming debate over the "fiscal cliff". Closer to home, the debt woes of the European periphery have permeated to the core, and politicians have often disappointed markets by their inability to react swiftly.

Characterised by the now ubiquitous term "risk-on, risk off", these conditions are not conducive to the formation of trends and give rise to increasing correlations between markets, both of which make life difficult for trend-following strategies such as ours. Indeed, year-to-date, the performance of our Alpha and Diversified trading programmes is about flat¹.

As momentum traders we aim to make money for our clients when there are clear trends in markets and during extreme risk-off periods. Unfortunately, neither of these conditions has been met in recent times, but we've seen numerous instances in our 25-year history where we have profited handsomely as opportunities have presented themselves, and I anticipate that this time round will be no different.

Whilst I am disappointed not to be reporting stronger returns, there is much to be upbeat about: Our operational strength and trading expertise affords us the ability to enter into markets that other CTAs find difficult to access. Hence, while most CTA portfolios have struggled to cope with the recent choppy environment, these non-traditional markets have presented us with much better opportunities to make money. For example, while rates in the G7 are pinned at 0%, we trade a number of emerging market rates, which have a much higher propensity to trend from their current levels. We also seek idiosyncratic markets such as power, where prices are primarily driven by local factors such as weather effects, rather than broader macro themes. AHL has been growing its exposure to these instruments steadily since 2005, building up the pre-requisite market relationships and trading know-how in the process, to the extent that they now constitute a quarter of the risk of the Alpha and Diversified Programmes.

On the execution front, we continue to refine our state-of-the-art trading platform and eleven banks now contribute streaming prices for 45 FX pairs and 5 billion contracts directly to us. Offering a slippage reduction of around 15% over the request-for-quote system we operated last year, this execution milestone has acted as a springboard for the development of new strategies which are currently in test trading. In late 2011, our first co-located execution server was installed in the Chicago Mercantile Exchange, helping us mitigate the predatory behaviour of high frequency traders. Now, at the end of 2012, 20% of our electronic orders are executed through our bespoke algorithms on our co-located infrastructure. All-in, these improvements in execution have been instrumental in making AHL's current cost of trading the lowest in our 25-year history.

We are continuously refining our momentum systems in order to adapt to the environment in which we operate and capture the trends wherever and whenever they occur. Adapting our trading speed, for example, has enabled us to ride out short-term changes in market sentiment; identifying and trading the carry component of price moves separately has provided the means for us to capture pure momentum more effectively.

Throughout 2012, we have developed and implemented a suite of seasonal and mean-reverting models. Like momentum models, they are robust across asset classes and trade at a range of frequencies from a few days to a few months. They clearly benefit AHL's flagship funds at times like these when trends are not prevalent in markets. They play an even larger part in Dimension, our multi-strategy managed futures programme, which seeks to capitalise from a broad range of market inefficiencies. Year-to-date this programme has weathered the choppy environment well, returning around a positive 4%².

The appointment of Matthew Sargaison to the role of Chief Investment Officer, in a move from Chief Risk Officer, has given impetus to the research effort and a dozen new research ideas have progressed into client trading this year. Our new research framework has created an efficient and streamlined process for translating ideas into live trading strategies, and I am pleased to report we have seven new strategies currently in test trading. Douglas Greenig, who took over as Chief Risk Officer in April, has brought with him a wealth of real-world trading experience. His drive to understand our sensitivities to various scenarios is proving invaluable in today's financial markets where headline risk and increasing correlation of instruments pose interesting questions for portfolios.

¹There may be variations across other funds. ²Applicable to the programme, net of fees, as of 11 December 2012.

At the start of the year, we set ourselves some ambitious goals: We wanted to instigate a series of research projects on new alpha signals in all sectors and thoroughly examine all of our models in light of the current market environment. We wanted to release a new research platform with better data, more functionality, state of the art user interface and, most importantly, an integrated idea-to-trading environment that allows efficient testing and implementation of new research. Also we set out to upscale our operational infrastructure that would allow us to extend our reach into new and diversifying markets. It isn't often that you can look back over a year and see that you have achieved pretty much all you have set out to do. Yes, the market environment for CTAs could have been better but I am extremely pleased about the achievements of the team. We enter 2013 with the lowest execution cost base, the broadest range of markets and the greatest diversity of models in our history, all of which makes me very excited about our ability to generate strong returns for our clients in the months and years ahead.

I thank you for your on-going support and commitment to AHL.

Yours sincerely



Tim Wong, CEO, AHL

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