Crypto

How Two Crypto Hedge Funds Dodged the Market Collapse

- Pythagoras runs market-neutral and trend-following funds
- In crypto, every year is a decade in traditional finance: Dong

Photographer: Angel Garcia/Bloomberg

By Vildana Hajric
December 4, 2022 at 10:00 AM EST

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The cryptocurrency space is undergoing one of its roughest stretches in memory, with trouble brewing at exchanges and lenders, and token prices collapsing. But one company has been able to ride out the volatility.

Pythagoras Investment Management LLC has two funds that have been rare bright spots in a market that's been eviscerated by a number of scandals. Both its Market Neutral Fund -- a strategy that doesn't have exposure to the price of any crypto at any time -- and its trend-following Pythagoras Token Fund have each gained about 8% this year, according to the company. Meanwhile, the world's largest digital token Bitcoin is down around 60% this year.

"We particularly outperform in bear markets," Mitchell Dong, chief executive officer of Pythagoras, said. "Our absolute-return funds are positive whether the market's up or down -- whether it's a bull market, a bear market, we're going to have positive returns."

Pythagoras's market-neutral fund utilizes arbitrage, meaning it is simultaneously buying the same crypto at different places and different prices, therefore buying low and selling high. Meanwhile, its trend-following fund uses technical indicators to detect short-term trends in the crypto market, Dong said.

Bitcoin Crash

The coin has collapsed in value since its all-time high

Source: Bloomberg

Bloomberg

The crypto market has been engulfed in scandals in recent weeks as Sam Bankman-Fried's once-high-flying crypto exchange FTX filed for bankruptcy, reminding investors of the implosions of other digital-asset firms earlier this year. FTX's collapse also dragged down other companies.

Pythagoras's arbitrage fund had a 10% exposure to FTX before the exchange's collapse. The company says it requested a full withdrawal of funds and received about 7%, which spurred it to hedge by shorting the FTX's native token FTT.

The FTX collapse spurred a plunge in cryptocurrency prices, with Bitcoin at one point dropping below $16,000 -- way off its highs of near $69,000 just a year ago. The coin is now hovering around $17,000.

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Pythagoras's fund strategies play off the fact that crypto, which is global and traded on numerous exchanges, is driven by retail investors, said Dong.

"The idea is to use quantitative, technical indicators to try to detect trends, either up or down," he said. "When you detect an upward trend, you go long when you think the psychology of people is that they think it's going up. And when the trend is going down and everybody's selling, you go short."

Dong, whose prior roles included running hedge funds for more than 25 years and trading uranium and electric-power contracts, among other things, founded Pythagoras in 2014 after Bitcoin caught his eye. "Buying and holding Bitcoin comes with 90% drawdowns. That's not my risk-return profile," he said. "I want steady returns of 1-2% per month, with no losing months. That's the target."

Pythagoras is not alone, other market-neutral shops have also recorded positive returns this year. The strategy doesn't look as attractive during bull markets, when coins tend to see big upward surges, but in a bear market, they can stand out, traders say.

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"The reason we can continuously produce returns is that crypto is a young and a very rapidly changing market," Dong said. "In crypto, every day is drama, and every week is an adventure. Every quarter there's a paradigm shift and every year is a decade in traditional finance."