Newsletter (4) – Citadel: The Most Successful Hedge Fund of All Time

(1) Introduction:

In today's newsletter, we explore Citadel, a benchmark of success in the hedge fund industry and the leader in net gains. Founded by Ken Griffin in 1990, Citadel has grown from a small investment firm into a multi-strategy industry leader, reshaping the financial industry. In the following, we will examine Citadel's growth, its distinctive strategies, and the approach that sets Griffin and his team apart from other hedge funds.

(2) Ken Griffin and The Founding of Citadel:

Ken Griffin's journey to becoming one of the most influential hedge fund managers began in a Harvard dorm room. While studying economics, Griffin started trading convertible bonds from his dorm, quickly capturing the attention of early investors. In 1990, with $265,000 in initial capital, he launched Citadel in Chicago.

Griffin aimed to build a hedge fund with a difference. At a time when most hedge funds operated as single-manager firms, he structured Citadel to connect the collective intelligence of multiple teams. His goal was clear: create a "nesting doll" structure of mini-hedge funds within Citadel. This model of distributed decision-making became Citadel's trademark. He introduced a culture of early responsibility and steep learning curves where "the most junior person who is qualified to make the decision should make it", creating a unique environment that positioned Citadel as a magnet for top financial talent.

Griffin's intense and proactive leadership style played a key role in Citadel's rise. Known for his persistent attention to detail, he often moved his desk to departments facing challenges, offering immediate feedback and tracking errors. For example, when Citadel needed a new database to monitor its positions and transactions, he bought a book on the subject and programmed it himself, demonstrating this exact proactive, results-driven approach rooted in Citadel's culture.

(3) Citadel's Evolution and Growth:

Following its founding, Citadel quickly diversified from convertible arbitrage into other asset classes and strategies. In 2001, it expanded into equity trading, adding statistical arbitrage by 1994 and commodities by 2002. Unlike traditional hedge funds that relied on a single strategy, Citadel's early adaption of a quantitative and multi-strategy approach allowed it to thrive in changing market conditions.

Then, in 2002, Citadel expanded by creating Citadel Securities, a separate entity as a market maker – another significant milestone in the company's growth. Since then, Citadel Securities has grown into one of the largest market makers in the U.S., executing nearly 40% of all U.S. retail stock trades and around 25% of the overall U.S. stock market volume. Through this separate entity, Citadel developed a unique edge through its market insights and liquidity, allowing it to respond quickly to volatility.

In the 2008 financial crisis, Citadel faced one of its biggest challenges, suffering a 55% loss in AUM despite its diversified model, marking one of the fund's most unsuccessful years. Through analyzing the failures of other firms, Griffin responded by investing more in Citadel's risk management practices, making diversification now a core part of its future strategy. This proactive approach enabled Citadel to fully recover by 2012, expanding its workforce and

resources globally. Today, Citadel employs over 2,500 people and holds nearly 9% of hedge fund industry assets, establishing itself as an industry leader.

(4) Strategies Behind Success:

Apart from Citadel's diversified, multi-strategy approach, two distinctive elements are key in their unmatched success: Griffin's commitment to learning from failures, and a unique talent acquisition strategy.

Ken Griffin emphasizes that Citadel's wins are only part of its story – real strength lies in learning from losses, both Citadel's own and others'. Griffin refers to these financial losses as "tuition", viewing them as investments in expertise that allow Citadel to emerge stronger from setbacks. After the financial crisis of 2008 for example, Griffin applied lessons learned from the failure of Long-Term Capital Management in 1998: He understood the mechanisms that enabled LTCM to survive losing nearly all its equity and applied similar principles to protect Citadel's stability during volatile times. Griffin's proactive efforts to learn from these crises have enabled Citadel to adopt a risk management approach that consistently adapts to new market realities.

Another unique aspect of Citadel's success is its strategic talent acquisition from other firms that faced failures. For example, after Enron's collapse in 2001, Griffin brought in Enron's entire quantitative research team to lay the foundation for Citadel's commodities division. Since its inception, this division has generated over $30 billion, capitalizing on both Griffin's foresight and the expertise of the acquired team. Griffin's ability to find valuable talent in instable environments and to integrate these hires into Citadel's structure has reinforced the firm's adaptability and success across market conditions. Griffin's philosophy of hiring "winners in life" rather than only "winners in finance" exemplifies this exact dedication to talent.

(5) Case Studies:

Leveraging these competitive advantages, Citadel has capitalized on difficult market environments in recent years, demonstrating the unique strength of its multi-strategy approach, combined with its adaptive learning culture and talent strategy.

In 2022, Citadel made hedge fund history with a record-breaking $16 billion profit, the largest single-year profit for any hedge fund to date. Within market volatility, inflationary pressures, and aggressive rate hikes, Citadel's multi-strategy model and diversification allowed it to thrive. Citadel's flagship fund achieved a 38.1% return, surpassing broader hedge fund industry averages, which saw small gains or even losses. Much of Citadel's 2022 success is attributed to its balanced strategies in equities, commodities, and fixed income. In particular, Citadel's commodities trading division capitalized on rising energy prices, while its interest rate positioning profited from the market adjustments following Fed rate hikes. This year's remarkable performance highlighted Citadel's ability to not only handle, but profit from complex market conditions.

Another successful period for Citadel was during the COVID-19 market crash in 2020, presenting an entirely different set of challenges. As global markets saw significant downturns, Citadel quickly shifted capital into resilient sectors, such as healthcare and technology, enabling it to deliver strong returns while protecting against broader market declines. Citadel's Wellington fund posted a 24.4% return, significantly outperforming the broader market and most other hedge funds during the initial pandemic shock. This response

demonstrated Citadel's adaptive, multi-strategy model to both mitigate risk and seize opportunities in unpredictable conditions.

(6) Conclusion:

In summary, Citadel's journey under Ken Griffin reflects a constant dedication to improvement through a combination of strategic risk management, adaptive learning, and a commitment to acquiring top talent. By continuously reworking its multi-strategy model, Citadel has set a new industry standard. As Citadel advances, Griffin's focus on building "the most formidable team in hedge fund history" underscores the firm's dedication to resilience and industry leadership in the years to come.