

# CTAs and Macro in a Multi-Strategy Context

Stockholm (HedgeNordic) – Johan Tjeder is the portfolio manager of Atlant MultiStrategy External (AMSE), a fund that invests into other hedge funds exhibiting low correlation to equity markets. By design, the portfolio is tilted towards CTAs and Macro. A logical choice, if you are to create an uncorrelated portfolio that is to deliver a meaningful return above the risk free rate, says Tjeder (*pictured*).

"We are targeting an annual return of 5% above the risk free rate. These returns should be generated independently of equity market direction and to a limited downside risk. CTA and Macro strategies become a natural core allocation in this context. They have the potential to generate returns irrespective of the direction of the equity market and they provide sufficient volatility in order for us to reach the stated return target," Tjeder says. The current portfolio holds an allocation of around 40% to CTA and Macro.

Other strategies include Long/ Short Equity, Equity Market Neutral and Multi-Strategy hedge funds. The focus is on European managers. "While the original idea was to only include Nordic names, this became too great a limitation as the fund grew, but following our decision to make the fund available in a daily liquidity format, we still hold a few Nordic names", Tjeder explains. The CTA part of the portfolio is, for the most part, made up of trend following strategies. As these strategies tend to have a volatility profile higher than that of the regular hedge fund, the risk profile of the fund also tends to vary over time, according to Tjeder.

"We are looking to keep the volatility of the fund in the range of 2-8%, annualized. But we will allow the portfolio to exceed that range in the short term in order to reach our stated return target," Tjeder says, adding that: "given the trend-following nature of the CTA allocation, you need to allow for somewhat higher volatility levels from time to time. Periods of strong CTA performance typically coincide with the managers adding to risk." One also must take into account the diversification effect in the fund; currently it sits at roughly 50%, i.e. half of the individual funds' volatility are mitigated by the low internal correlation of the holdings. Tjeder is treating the CTA and Macro part of the portfolio as separate risk buckets, rather than lumping them together, which is a regular exercise among providers of hedge fund benchmarks. "CTAs and Macro could be seen as having overlapping characteristics.

For example, you should expect them to capture broad market trends as they unfold, both from the long and the short side. There are, however, distinct differences in the way they seek to capture trends", explains Tjeder, suggesting that. "While CTAs need price to confirm the direction of a trend, a Macro manager could anticipate the trend by looking at fundamental input factors.

According to the same logic, CTAs need a price trend reversal in order to reduce risk, while the Macro manager typically reduces risk or extricates himself from a trade when he sees a fundamental valuation level being reached. There are diversification benefits to be gained by including both CTA and Macro in a portfolio context." When selecting managers, Tjeder follows a rigorous process in order to find strategies that could contribute positively to the overall risk/return characteristics of the fund. Over time, the portfolio is expected to hold 15- 20 names and in any given year, the d turnover of managers will depend on the extent to which holdings live up to expectations, but Tjeder expects to exchange 2 to 3 managers a year, while of course hoping for none. The fact is that the sell process is also built on a quantitative model. "For each fund we do have an expected return and an expected volatility.

This means that when there is an unexpected negative move, we directly calculate the probability of such a move, and given the level of that probability in relation to the rest of the fund's performance, we decide if we are going to reduce, sell or hold", Tjeder says. The fact that Atlant Multi-Strategy External is a fund of hedge funds makes the focus on manager fees a crucial consideration when selecting funds to the portfolio, according to Tjeder. Going the hedge fund replication path, i.e. selecting programs that are replicating a style factor such as trend-following to a significantly lower cost, has, however, not been considered a viable approach so far.

In concluding, Tjeder underlines that "We have considered the option to have a low cost trend beta component as a core CTA allocation, and to have active strategies trading around that core. However, I believe that markets are evolving and that you need to have a research-driven approach in order to stay on top of the game. A static replication approach is likely to underperform over time, despite its obvious fee advantages, and as we trade institutional share classes and discuss fees individually with all managers, the cost advantage is not as big as it seems at a first glance."