HEDGENORDIC

PROMOTION. FOR INVESTMENT PROFESSIONALS ONLY. NOT FOR PUBLIC DISTRIBUTION

RT

December 2023

# Round Table Discussion: Managed Futures/CTA


# Editor´s Note...

## A wish to a Genie in Bottle...

2022 went down as a banner year for the Managed Futures space as a whole, logging in some of the best results in a decade. The current year though is turning out to be a lot more challenging for most trend following managers. Much of the dampened performance can be traced back by the collapse of SVB and following turbulences in the banking sector. And indeed, March 10th and March 13th 2023 were the two worst days of returns in the history of managed futures. This freak occurrence even had sober and pragmatic quants turn to ancient and mythical Middle Eastern creatures housing in bottles for solace

Once Again we were humbled and exuberant to attract some of the brightest stars in the CTA space to join us around a table to discuss various topics around Managed Futures which we can now share with you. A very sincere thank you to all participants for sharing your insights with us and for contributing in such a splendid way. A special thank you to those who made the long travel to Stockholm from California, Boston and Chicago.

Joining us for this year's event were Otto van Hemert (Man AHL), Per Ivarsson (RPM), Harold de Boer (Transtrend), Nick Granger (PIMCO), Martin Källström (Lynx), Kathryn Kaminski (AlphaSimplex) Elena Westerdahl (AP3), Chad Martinson (Efficient Capital), moderated by Kamran Ghalitschi (HedgeNordic).

We enjoyed a vivid and lively discussion, spanning many angles. After a recap of the trading year, looking at markets, performance and performance drivers as well as sources of dispersion for managers and strategies, some of the topics we discussed included "The Long Bond Bias Debate", "If a CTA doesn't hedge, what does it do?", "Diversification" , "Manual Intervention and Choices", "Client Communication", "Machine Learning, Artificial Intelligence, LLM", "Product Innovation" and an Outlook to the future of Managed Futures.

We hope you enjoy reading through this summary of the round table discussion.

**KAMRAN GHALITSCHI**
PUBLISHER, HEDGENORDIC

"If you wanna be with me, there's a price to pay. I'm a genie in a bottle You gotta rub me the right way. If you wanna be with me, I can make your wish come true. You gotta make a big impression, gotta like what you do"

Christina Aguilera

www.hedgenordic.com - December 2023
HEDGENORDIC

# PARTICIPANTS:

## THE ROUND TABLE DISCUSSION TOOK PLACE IN STOCKHOLM, SWEDEN, ON OCTOBER 17TH 2023

Nick Granger

Portfolio Manager, Quantitative Analytics

PIMCO

Nick Granger is a managing director in the Newport Beach office and leads PIMCO's quantitative portfolio management team.

He is the lead portfolio manager of PIMCO's flagship quantitative hedge fund strategy, along with oversight and portfolio management responsibilities across PIMCO's range of systematic funds.

Prior to joining PIMCO in 2020, Granger was based in London as chief investment officer and head of research at AHL, the systematic division of Man Group. In this role he was also portfolio manager of the firm's quantitative multi-strategy fund, and a specialist in systematic volatility strategies. Prior to Man Group, he was an equity derivatives strategist at J.P. Morgan.

Granger holds a bachelor's degree in mathematics from Oxford University, a master's degree in philosophy from Kings College London, and a Ph.D. in mathematical logic from the University of Manchester.

Harold de Boer

Head of R&D

transtrend

Harold is the architect of Transtrend's Diversified Trend Program, responsible for R&D, portfolio management and trading.

Harold was born and raised on a dairy farm in Drenthe. From a young age, he has been intrigued by linking mathematics to the real world around us. In the final phase of his studies, while working on the project that would later become Transtrend, he became fascinated by the concept of leptokurtosis — or 'fat tails' — in probability distributions, a topic which has inspired him throughout his career.

Harold's approach to markets is best described as a combination of a farmer's common sense and mathematics, never losing sight of the underlying fundamentals.

Kathryn Kaminski

Chief Research Strategist and Portfolio Manager

ALPHASIMPLEX

As Chief Research Strategist at AlphaSimplex, Kaminski conducts applied research, leads strategic research initiatives, focuses on portfolio construction and risk management, and product development.

Kaminski is a member of the Investment Committee and serves as a co-portfolio manager for the AlphaSimplex Managed Futures Strategy.

She joined AlphaSimplex in 2018 after being a visiting scientist at the MIT Laboratory for Financial Engineering. Prior, she held portfolio management positions as director, investment strategies at Campbell and Company and as a senior investment analyst at RPM.

Kaminski co-authored the book Trend Following with Managed Futures: The Search for Crisis Alpha (2014). Kaminski has taught at the MIT Sloan School of Management, the Stockholm School of Economics and the Swedish Royal Institute of Technology. Kaminski earned a S.B. in Electrical Engineering and Ph.D. in Operations Research from MIT.

Martin Källström

Deputy CEO and Partner

LYNX

Martin Källström is a Partner, Senior Managing Director and member of the Executive Management Team at Lynx Asset Management.

He is a co-opted member of the Investment Committee and is a registered Principal for Lynx with the CFTC/ NFA.

Before joining Lynx in September 2018, Martin worked for The First Swedish National Pension Fund (AP1) for 11 years as Head of Alternative Investments. At AP1 he successfully built a team and managed a USD 10 bn portfolio of hedge funds, private equity, real estate, infrastructure and farmland investments.

Prior to joining AP1, Martin created and headed the investment and actuarial consulting business for Aon in the Nordics and was a member of the global investment practice committee. He started his career as an actuary with Watson Wyatt and holds a MSc in Finance from Stockholm University.

Chad Martinson

CO-CIO; MANAGING DIRECTOR, INVESTMENTS

Efficient

Chad Martinson is the Co-Chief Investment Officer and the Managing Director of Investments at Efficient.

In this role, he manages the firm's investment process, serves as the Portfolio Manager, and helps shape strategic priorities as a member of the Leadership Team.

Martinson joined Efficient in 2002 after nearly a decade in the technology industry, serving as the firm's Chief Technology Officer. After leading the development process to build out Efficient's proprietary managed futures platform, he joined the investment team in 2005 and has served as the Portfolio Manager since the end of 2007.

Martinson graduated from Taylor University in 1994 with a BA in Chemistry/Pre-med. He holds a Series 3 license and is a Chartered Alternative Investment Analyst (CAIA) Charter Holder.

Elena Westerdahl

Senior Quantitative Analysts

AP3

Elena Westerdahl is one of the quants in the CIO-office team with focus on strategic asset allocation, asset-liability management (ALM) and runs a portfolio of systematic strategies.

Prior, she held a position as Chief analyst at Nordea. She has a broad experience of multi-asset derivative solutions as well as development of enhanced beta investment indices and structured products towards the nstitutional clients.

Westerdahl started her careeat KPMG Corporate Finance with focus on fundamental valuations of companies for M&As and later as a risk management consultant at Oliver Wyman, of Marsh McLennan, where she worked towards the world largest financial institutions. She holds an MSc in Applied Mathematics and MSc in Finance/Business administration.

# PARTICIPANTS:

## THE ROUND TABLE DISCUSSION TOOK PLACE IN STOCKHOLM, SWEDEN, ON OCTOBER 17TH 2023

Per Ivarsson

Head of Investment Management

RPM investments DIFFERENT MOVES.

Per Ivarsson, serves as Executive Vice President and CIO of RPM Risk & Portfolio Management AB. Mr. Ivarsson joined RPM in 2003.

Prior to joining RPM, Ivarsson provided consultancy work in investment banking, heading up a team of consultants in the interest rate and credit derivative areas.

Ivarsson holds a Master of Science in Engineering Physics from Chalmers University of Technology and studies in Financial Economics at the University of Gothenburg.

Otto van Hemert

Director of Core Strategies

Man | AHL

Otto van Hemert is Director of Core Strategies and a member of Man AHL's management and investment committees.

He was previously Head of Macro Research at Man AHL. Prior to joining Man AHL in 2015, Otto ran a systematic global macro fund at IMC for more than three years.

Before that, he headed Fixed Income Arbitrage, Credit, and Volatility strategies at AQR, and was on the Finance Faculty at the New York University Stern School of Business, where he published papers in leading academic finance journals.

Van Hemert holds a PhD in Economics and Masters Degrees in Mathematics and Economic

Kamran Ghalitschi

Publisher

HEDGENORDIC

Kamran Ghalitschi is the founder and publisher of HedgeNordic, a media dedicated to bring news research and analysis to an audience of Nordic financial industry professionals.

Kamran started his finance career in 1994 and worked in several positions as equity and options broker, in wealth management as well as in various marketing and sales roles for brokerage services and hedge funds.

www.hedgenordic.com - December 2023
HEDGENORDIC

Participants, left to right, Otto van Hemert (Man AHL), Per Ivarsson (RPM), Harold de Boer (Transtrend), Nick Granger (PIMCO), Martin Källström (Lynx), Kathryn Kaminski (AlphaSimplex) Elene Westerdahl (AP3), Chad Martinson (Efficient Capital) and Kamran Ghalitschi (HedgeNordic)

# ROUND TABLE DISCUSSION

## MANAGED FUTURES

THE ROUND TABLE DISCUSSION TOOK PLACE IN STOCKHOLM ON OCTOBER 17TH 2023. ALL REFERENCES TO DATES, TIMELINES, PERFORMANCES, NEWS AND EVENTS ARE TO BE SEEN FROM THAT POINT IN TIME.

In 2022, trend-following CTAs achieved one of their best annual performances on record. Many managers reaped the benefits of capturing surging commodity prices, declining stock markets, and more interestingly, proved successful in shorting bonds amid a rising interest rate environment. However, the investment landscape has taken a more challenging turn as we transitioned into 2023. Violent swings in asset prices, rapid shifts in interest rate expectations, and a general lack of clear and persistent trends have created a more difficult environment for trend-followers.

Some trend-followers remained positioned for further bond price declines going into 2023. However, the March turmoil within the banking sector, triggered by the collapses of Silicon Valley Bank and Credit Suisse, marked a significant turning point in performance for trend-followers and led to dispersion in performance. The turbulence in the banking system led to a surge in bond prices, as investors bet that the US Federal Reserve

www.hedgenordic.com - December 2023
HEDGENORDIC

would slow the pace of interest rate hikes to bolster financial stability.

As a CTA investor having a helicopter view of the entire space, Chad Martinson, Co-CIO at Efficient Capital Management, concurs that "the March event, the SVB collapse, and the regional banking crisis were certainly challenging for the space." He points out that March 10th and March 13th were the two worst days in the history of managed futures. "That particular event caused a lot of dispersion," says Martinson, who together with his team allocates $2.5 billion of investor assets to CTAs. He goes on to emphasize that performance is widely varied across similar styles this year, but overall, the space has been recovering from the drawdown after the SVB collapse.

Per Ivarsson, Head of Investment Management at Swedish multi-CTA manager RPM Risk & Portfolio Management, also views March as a challenging period and a source of dispersion in the space. "If I could have a genie and make a wish, it would be taking out the 10th and 13th of March and the year's performance would look completely different," jokes Ivarsson. "Bar from those two days, 2023 has been a nice CTA year."

"If I could have a genie and make a wish, it would be taking out the 10th and 13th of March and the year's performance would look completely different."

Per Ivarssom

Elena Westerdahl, AP3

Chad Martinson, Efficient Capital

According to Ivarsson, "The challenging month of March was a divider. From that point on, we have seen most of the dispersion. Year-to-date dispersion in the space boils down to how managers reacted to that particular event."

Elena Westerdahl from AP3, whose CTA exposure consists of both internal and external strategies, has also observed significant dispersion in performance in the CTA space. "Looking across the board, a lot of different CTAs with different providers exhibited very different performance," confirms Westerdahl, a senior quantitative analyst at AP3. Westerdahl, who is involved in running an internal systematic quantitative strategy at AP3, was also caught off guard by the events in March, saying: "It was a money-market trend and curve that moved a lot in March and hurt our portfolio as well." She notes that while some CTA managers managed this trend reversal well, for AP3, it was approximately flat for the year.

Otto van Hemert, Director of Core Strategies at Man AHL, argues that the speed of trading explains much of the dispersion across managers in 2023. "Faster

"The best thing to do in trends was to have used a simpler approach that was slow and concentrated in the most liquid, most familiar markets."

Nick Granger

www.hedgenordic.com - December 2023
HEDGENORDIC




trend followers may have cut losses quicker during the events in March, but also missed out on a portion of the rebound," explains van Hemert. "It's along those lines you can explain much of the dispersion in performance across different managers and models."

Martin Källström from Lynx Asset Management agrees with van Hemert's conclusion, saying that "we have seen a similar pattern, as our faster trend-following models faced some difficulties this year, especially during March as markets sharply reversed following intervention from the US Treasury and Federal Reserve in response to the regional banking crisis." Nick Granger, who leads PIMCO's quantitative portfolio management team, shares the same observation, noting that "the last few years have been unusual in that the best thing to do in trends was to have used a simpler approach that was slow and concentrated in the most liquid, most familiar markets."

Kathryn Kaminski, Chief Research Strategist of AlphaSimplex who coined the term "Crisis Alpha," offers a different perspective on the challenging period in the trend-following space in March. She emphasizes a longer-term perspective when analyzing performance, stating, "We often think about years as opposed to whole trades. For me, the last two years have been primarily about the fixed income trade as a whole." Kaminski highlights the rapid rise and fall of a profitable trend in the short end of the fixed income curve. She

> "Some of the more complex models employed by CTAs that use adaptive windows may have a lot of biases. A way to avoid these biases is by choosing the simplest model."
>
> Elena Westerdahl

notes that although the trend dissipated quickly and caused some pain, about two-thirds of that trend was captured by trend followers in the previous year. "We try to remind investors that it was a round turn trade, a very good trade still."

## The Long Bond Bias Debate

For many years, the prevailing belief among investors was that trend following could only make money by being long bonds. This perspective was rooted in the alignment of coupon carry with the price trend, making it difficult to go against this trend for extended periods. According to Kaminski, 2022 and 2023 offered valuable insights into the debate surrounding the long bond bias. She points out that the recent environment has sparked stimulating discussions on this topic, where clients with a clear long-bond bias have prompted thoughtful conversations. "It was a very interesting period in history for us, providing an opportunity to reflect on the concept of long bond bias, regardless of its origins or how one might acquire it and whether it can be avoided altogether," says Kaminski.

Nick Granger warns trend-followers to exercise caution about incorporating long bias in their portfolios. "Certain assets such as fixed income can accumulate carry into a long-term trend, inadvertently introducing a long bias into trend-following strategies," he explains. While some managers may find satisfaction with the carry stemming from fixed income in their portfolios over the 30 years up to 2021, Granger argues that "using faster models allows managers to sidestep much of this bias in the first place." According to Granger, "It's always very important, especially when adding new assets, to consider whether an asset comes with a bias and decide how best to address it."

Martin Källström acknowledges that "when you are slow, you will naturally incur some biases coming from risk premia in most types of assets." His team at Lynx Asset Management thinks a lot about identifying and managing these biases in all of their models, including in their machine learning approaches. "Our machine learning models performed very well during the bond market sell-off as they were developed to capitalize on opportunities which are differentiated from traditional investments," says Källström. "If you are not careful, you could very well end up with biases in your trend-following models."

Elena Westerdahl observes that "some of the more complex models employed by CTAs that use adaptive windows may have a lot of biases." Westerdahl suggests that a way to "avoid these biases is by choosing the simplest model." The reliance on adaptive windows "tends to make the models a bit over-engineered," making biases more apparent, as highlighted by Westerdahl. Källström, instead, contends that the simplest long-term

> "It is not about whether we are right on trends in this specific asset class, but whether our diversification is as large as we think it is."
>
> Harold de Boer

strategies have a high risk of incurring biases, particularly in terms of exposure to risk premia. "Advanced machine learning approaches also have potential biases, but there are many ways to avoid them when designing the features and output function."

Harold de Boer from Transtrend argues that the primary challenge in bond market positioning is not about speed and direction. "We've had two decades with low and falling rates. The correlations observed in that period likely aren't very meaningful for the current and future environment. But these correlations can explicitly or implicitly dictate position sizes in a diversified approach," says De Boer. For his team at Transtrend this means "it is not about whether we are right on trends in this specific asset class, but whether our diversification is as large as we think it is," according to De Boer. "Do we correctly assess the impact of the rate regime shift on correlations? And that isn't only a challenge for us, but probably also for many of our investors with respect to their portfolio."

## Investor Skepticism

The presence of the long bond bias had previously instilled skepticism among investors regarding the ability of trend-following strategies to generate profits money during declining bond markets. Transtrend's Harold de Boer recalls discussions with potential clients in 2020 who were skeptical of CTA programs and sought specialized products that would perform well in declining bond markets. "They didn't believe in the CTA program, instead they wanted something tailor-made. Consequently, they chose something that was not a CTA," he recalls. However, these very same investors are now looking to invest in standard CTA programs, recognizing their effectiveness.

Chad Martinson also finds the long bonds debate intriguing, highlighting that "for many years, investors believed CTAs were not going to be able to make money without the bond markets rallying as they have for the last 30 years. However, it didn't take long for them to realize that's not the case." He underscores the significance of the "short bond trade" and how it has become particularly encouraging for allocators and investors in this space "to see that trend-following can act as a hedge against inflation, and can make money being short bonds."

Otto Van Hemert from Man AHL also recalls the prevailing belief that trend followers could only prosper during bond bull markets. "There is now substantial evidence to the contrary," he emphasizes. "Bond bear markets often coincide with macroeconomic shifts, in particular around inflation events, and those are good trending environments, including in bonds themselves," he goes on to explain. "Looking at long-history empirical studies, it was always clear that trend-following systems tend to get bond bear markets right due to their ability to move at the appropriate frequency, slow enough for effective capture. The writing was on the wall."
Nick Granger recalls some internal discussions at PIMCO in 2021 about the firm's positioning in response to potential inflation. "As quants, we advocated for the idea that trend following could, in certain scenarios, serve as an effective hedge against inflation," recalls Granger. "Sure enough, it soon became apparent that trend following was, indeed, fulfilling a role as a pseudo inflation hedge by being short bonds and long commodities," elaborates Granger. "Trend following not only showed its capacity to generate profits in a bond sell-off but also served as an inflation hedge in this particular scenario."

While CTAs have indeed proven to be an effective hedge against rising inflation and its market repercussions, Van Hemert contests the use of the term "inflation hedging" as an objective of trend-following CTAs. "The word 'hedge' is too strong to describe what trend following does," argues Van Hemert, who often cites the 1987 Black Monday as an example of an event where CTAs do not function effectively as a hedge. "Trend is better described as a defensive diversifier."

Kathryn Kaminski and her research team concur with Van Hemert's observations. "When clients inquire about the most significant risk in our portfolios, my response consistently revolves around cross-asset sell-offs, which entail significant market shocks affecting multiple asset classes at the same time," she explains. Kaminski further emphasizes that such events are typically short-lived and seldom extend beyond a single day. "Unfortunately March was two days. It's these huge cross-asset risk shocks that that usually affect us negatively the most," she continues. "Investors need to understand that this is our Achilles heel and you can't predict them."




## If a CTA doesn't hedge, what does it do?

This question represents the foremost challenge for Kathryn Kaminski and other participants in the trend-following CTA space. "We invest significant effort in ensuring our clients have an intuitive understanding of


Per Ivarsson, RPM

our strategy. When our portfolio moves and changes, they should understand why we are making money when we are making money," says Kaminski. "It is always going to be the challenge to tell investors that we don't know the future and we can't tell them when trends occur, but that we will be there when they do occur."

According to Harold de Boer, "There's only one catalyst for a trend to develop, and that is money on the move. But what prompts money to move?" Money is set in motion by financial markets moving towards a new equilibrium due to shifting market variables. "The energy transition is an example of that. Another example could potentially be investors shifting away from their 60/40 baseline," says De Boer. "Trend represents a long transition risk," agrees Otto Van Hemert, who explains that "trends often coincide with big macroeconomic shifts, which can include both inflation and deflation," he elaborates. "If you have a big shock to the system, prices take time to adapt. This dynamic has a particularly noteworthy impact on the interplay between asset classes, whereby the response of one asset class to a shock triggers ripple effects across others."

"Just everything calm and easy is not great," sums up Van Hemert. A calm and stable environment is not conducive to trends; it's the turbulent, ever-changing backdrop that suits them best. Trend-following strategies do not need to understand why a market is trending, says Kaminski. Instead, they are designed to profit from trends as and when they emerge.

"CTAs like macro uncertainty and change," says Kaminski. "We CTAs have an approach that follows the market moves as they develop by using the data that's out there and listening to what people are doing and moving with it as things change," she elaborates. "We move in sync with the market rather than attempting to decipher the cause behind these movements. This approach offers liquid exposure to the evolving dynamics in the market, particularly in times of heightened macro uncertainty, crises, or other extreme macroeconomic conditions."
Chad Martinson goes on to emphasize that "this long transition risk, long macro uncertainty is multiplied when there is decoupling across geographies." According to Martinson, "central bankers in Japan, for instance, may have a very different approach than central bankers elsewhere. This divergence fosters unique transition opportunities at varying times and amplifies the potential for managed futures."

## Diversification

The decoupling across different geographies and asset classes may expand the pool of trends that trend-followers can exploit. Diversification plays a vital role in managing the increased pool of trends available to trend-followers as a result of geographic and asset class decoupling. "The key lies in the number of risk factors that the set of models or managers captures at any given time," argues Per Ivarsson from RPM. "At any given point in time, one, two, three, or possibly four of these factors come into play, but you need to have the ability to capture them," he elaborates. "Being active in your diversification, not just adding, but trying to make sure that you capture as many of those factors as possible, is the trick."

To have the ability to capture different sources of trend, Martin Källström and his team at Lynx advocate diversification across "strategies, time frames and liquid markets." For Källström, "methodology represents a particularly valuable route to diversification. Having a number of different approaches that all contribute to your overarching objectives is a very powerful tool for us to gain diversification."


Martin Källström, Lynx

> "...it was always clear that trend-following systems tend to get bond bear markets right due to their ability to move at the appropriate frequency, slow enough for effective capture. The writing was on the wall."
>
> Otto van Hemert

Källström emphasizes that diversification must align with the end objective. "As long as diversification is helping the program achieve our goals, we want more of it." Lynx Asset Management's flagship trend-following program has a dual objective of generating attractive risk-adjusted returns while providing protection to clients in stressed market environments. "With our objectives, we tend to focus more on faster strategies than many of our peers," says Källström. Achieving effective diversification also involves investing in a larger palette of highly liquid instruments, as Källström clarifies, "In terms of diversification, we have broadened our asset allocation, but it is super important for us to be able to act quickly as the environment shifts, so we are not trading less liquid markets."

Van Hemert reinforces Källström's earlier perspective about the potential for diversification within actual trend models. "Even within trend strategies, one can deploy different types of models," emphasizes Van Hemert. "These range from the moving average crossover models that we all know and love, to more breakoutstyle models that do behave quite differently at times. And there are various other types of models you can use." he elaborates. "This is a really interesting part of diversification beyond the other topics."

Chad Martinson, who is Co-CIO at a multi-manager CTA portfolio investment firm Efficient Capital Management, believes "very strongly in diversification and will take as much of it as possible." As an allocator to CTAs, he underlines the importance of diversification to manage idiosyncratic risk associated with trend-following managers. "Diversifying this idiosyncratic risk is key for us because we cannot predict which trend-following manager will perform best in a given environment," emphasizes Martinson. "Our aim is to provide the aggregate performance of the group, so eliminating that idiosyncratic risk through blending is key to diversification from our perspective."

For PIMCO's Nick Granger, "diversification may be most valuable when trend isn't working." The concept is grounded in the belief that trends can emerge unpredictably at any time and in any place. "During

> "Our aim is to provide the aggregate performance of the group, so eliminating that idiosyncratic risk through blending is key to diversification from our perspective."
>
> **Chad Martinson**


Kathryn Kaminsky, AlphaSimplex


Harold de Boer, Transtrend

periods when major markets lack clear trends, there's potentially huge value in having positions in more exotic alternative markets, often emerging markets, where trends could materialize while nothing is going on anywhere else." However, "once trends get going very, very strongly, the diversification almost naturally disappears, albeit it disappears in your favor."

An interesting argument against excessive diversification in CTAs relates to the return distribution. As Martinson describes, "The value of the return stream from a CTA lies in its positive skewness, which means that the upside during periods of economic distress is generally bigger than the downside, and people like that property of CTAs." However, he warns, "The central limit theorem suggests that once you average lots of different return distributions together, the result will converge to a normal distribution with no skewness." His team at Efficient Capital Management is "diligent about preserving this positive skewness when constructing portfolios of CTA managers."

Kathryn Kaminski corroborates these observations based on research conducted by her team at AlphaSimplex in 2016, titled "The Taming of the Skew." According to Kaminski, "As soon as N gets larger than two or three managers, we begin to lose some of the skewness properties associated with trend-following investing." In relation to the central limit theorem, Otto Van Hemert goes on to emphasize that "trend followers are not independent and identically distributed (IID), and diversifying across more managers does not eliminate all risk but rather preserves common tail risk." According to Van Hemert, "While these managers may exhibit low correlations most of the time, their correlations may align precisely during the worst possible times."

Harold de Boer, however, values diversification and dispersion among CTA managers, emphasizing, "It's very important that the CTA industry has become more dispersed again." He credits this dispersion as one of the primary reasons for the industry's improved performance in recent years. "If we all make different choices and open up to these different choices, certain CTAs will do well in specific environments, while others will outperform in other scenarios," he elaborates. "A good CTA manager can explain in what environment their trend-following model will do better and in which

www.hedgenordic.com - December 2023
HEDGENORDIC



environment it will do worse." De Boer believes that having a wide range of CTA strategies can allow investors to choose strategies tailored to different environments. De Boer concludes, "As an industry, we can offer more by acting as a marketplace with a variety of options, allowing investors to make soup out of many options."

## Manual Intervention and Choices

One factor that can contribute to variance among managers is the level of manual intervention. In systematic trend-following CTAs, trading decisions are generally guided by predefined algorithms that identify and capitalize on signals in various markets. However, there are instances where traders or portfolio managers may choose to intervene manually in the trading process. Harold de Boer describes running a systematic investment strategy as akin to guiding his granddaughter on a bicycle or skates to school. "In our job 'grabbing the child in danger' stands for the use of human discretion."

"It's not about how often I grab her or prevent something. I maintain constant vigilance while she's cycling or skating," says De Boer. He highlights the importance of discretion, a concept some are reluctant to embrace, as it signifies maintaining control. De Boer claims that Transtrend is both 100 percent systematic but also 100 percent discretionary. He emphasizes that the 100 percent discretionary aspect arises because every line of code in their program has been authored by a human. "Not a single market is entered into our program that we didn't enter ourselves," he adds.

> "It is always going to be the challenge to tell investors that we don't know the future and we can't tell them when trends occur, but that we will be there when they do occur."
>
> Kathryn Kaminski

Transtrend made discretionary decisions to cease trading Russia-related instruments after the outbreak of the conflict in Ukraine and suspended trading on the London Metal Exchange "after the exchange didn't respect the fundamentals of counterparty risk in March 2022," according to De Boer. He likens this discretion to the role of an airplane pilot. "I hope that the pilot takes over when something is happening. But I'm also aware that most of the time the plane is on autopilot and that is fine with me," says De Boer. "But if the pilots are telling me they are not going to use any discretion, I will take another flight."

While Otto Van Hemert agrees that every code written for a systematic strategy reflects a discretionary decision, he argues that "discretionary responses are often triggered by specific situations, with risk management being a key factor." While he underscores the significance of having multiple layers of risk management embedded in the systematic program, "there are situations that warrant manual intervention such as taking out Russian securities, or dealing with negative oil prices in 2020."

Nick Granger concurs, emphasizing the importance of vigilance, especially as managers venture into alternative markets like emerging markets. "As you go into some of the emerging and frontier markets, you have to be very aware of changing market conditions. There are assets suddenly becoming less liquid, either because of central bank interventions or other reasons," explains Granger. Granger and PIMCO's quantitative portfolio management team rely on their emerging market experts to provide insights on market conditions. He emphasizes their readiness to act upon advice when market risks not accounted for in their models become apparent. "Whilst we would never flip a position from long to short or short to long, we would effectively take the advice and insights from our emerging market traders where they see very specific risks in a country or asset not accounted for by quantitative models. In extremes, we would be able to act on that by deallocating from that market completely."

Lynx Asset Management also employs manual interventions occasionally, primarily as a risk management tool in highly unusual situations, according to Martin Källström. "Very infrequently, and always to manage downside risk in very extraordinary circumstances," he emphasizes. "These same circumstances often present interesting opportunities for us, though. That's why we are very careful when we do intervene."

However, Otto Van Hemert underscores the need for clients to have a clear understanding of the systematic program's processes and the extent to which discretion

www.hedgenordic.com - December 2023
HEDGENORDIC

is applied. "They need to know to what extent a manager is sticking within a certain process in applying the discretion," says Van Hemert. "They don't want the trend follower to say, 'Okay, today I'm a carry trader because I think the yields are better now, so let's forget about trend."

## Client Communication

Consistent with Otto Van Hemert's perspective regarding client communication and client understanding of CTA strategies, Harold de Boer emphasizes the importance of transparency. He believes in being "open and public about what we are doing." According to De Boer, "every manager faces choices and our choices are largely transparent to the public. We aim to be clear about the decisions we make and hope to see clients to be receptive to this approach."

Martin Källström also advocates a transparent and open approach at Lynx Asset Management. However, he points out that being specific about objectives matters more than divulging intricate process details, saying that "our experience is that it's more important to be specific about what you are trying to achieve rather than describing every detail of each individual model." According to Källström, "If clients are too focused on the small points, they risk missing the most important things." Instead, investors should keep an eye on the significant elements of a strategy or manager. "Generally speaking, the more informed investors are, the better the decisions they make."

> "Generally speaking, the more informed investors are, the better the decisions they make."
>
> Martin Källström

Nick Granger notes that investor education has improved significantly over the past decade. He cites the growing awareness of CTAs as diversification tools rather than pure absolute return instruments. "Investor education, certainly within our sector, has got a lot better over the last ten or 15 years, especially as CTAs are sold much more now as a diversifier than as an absolute return instrument," says Granger. He believes that "investors are increasingly allocating to CTAs for their protection properties."

Chad Martinson also emphasizes the critical role of transparency in the space. "I don't know how investors in the space manage risk without having access to the truth. And the truth is reflected by the exposures in a managed account, what the positions are, how the positions change," he elaborates. Transparency, he contends, is key to understanding the real exposure in a managed account or a trend-following program and how they evolve.

## Machine Learning, Artificial Intelligence, LLM

In the ever-shifting landscape of financial markets, the trend-following Commodity Trading Advisor (CTA) industry has demonstrated adaptability by responding to several notable developments in recent years. Lynx Asset Management, for instance, has been a strong advocate for the use of machine learning in trading. "We began our machine learning research in 2009 and started trading with machine learning models in 2011," says Martin Källström. "Today, it constitutes around 30 percent of the risk-taking and has become a highly successful part of the Lynx Program."

Seemingly, many interesting developments related to artificial intelligence revolve around large language models (LLMs). "The current buzz is a lot about LLMs. There are varying opinions on this, but we find it to be a fascinating and groundbreaking development that enhances our productivity, but have yet to see value from it when developing prediction models," says Källström. "LLM is a very valuable tool, but mostly for operational tasks."

Nick Granger from PIMCO views LLMs as a valuable tool for improving productivity. "We have been using LLMs for a couple of years and plan to expand the use of AI," says Granger. "The most obvious uses are efficiencies across the business. For example, we use the technology to summarize research, translate documents, create content, scrape transcripts of earnings calls, etc. This boosts productivity, so investment professionals have more time to focus on investing and servicing clients," elaborates Granger.

On the topic of generative AI, LLMs in particular, Otto Van Hemert identifies major applications in systematic macro rather than trend-following. "LLMs can simply read the entire internet and have been quite good at coming up with hypotheses," he elaborates. "It's a super assistant, but slightly more relevant for complementing other models outside the trend space, as far as we see it."

www.hedgenordic.com - December 2023
HEDGENORDIC

Elena Westerdahl from AP3 mentions that while the pension fund utilizes machine learning to some extent, they have encountered difficulties in identifying managers who can effectively deploy this tool. "We could not spot managers who can deploy machine learning and get traction with respect to performance, but some have figured out some predictive signals based


Otto van Hemert, Man AHL

on LLM." According to Westerdahl, "machine learning hasn't shown traction, primarily because of the over- or under-fitting problem due to scarcity of the financial data." Westerdahl points out that some managers use machine learning, although the final decision is often based on a simpler model. At AP3, Westerdahl and her team can use "LLM to extract data on positions, understanding market sentiment, mostly data scraping and categorization tasks."

Looking beyond machine learning and LLMs, Per Ivarsson from RPM observes that technological advances in recent years have revolutionized the industry and lowered barriers to entry for younger managers. "The technology in terms of cloud computing and other developments has revolutionized the industry. I remember way back when you went to meet managers in the US. They took you out back to proudly show the diesel generators they had as unbreakable backup power sources," recalls Ivarsson. "We don't even talk about these things today." Ivarsson also notes the ease of conducting due diligence processes remotely and the transformative effect on the industry. "It's low tech, but for us, it has changed the game quite a lot in terms of having to travel and the way especially younger firms can start up," says Ivarsson. "There's more headwind in other areas, such as compliance, but with technological advancements, barriers of entry have been lowered in the industry."

## Product Development: ETFs

Another noteworthy development in the CTA space is the emergence of trend-following strategies in an exchange-traded fund (ETF) format. Man AHL and AlphaSimplex have already launched or are in the process of launching trend-following strategies in an ETF wrapper. "The ETF is bringing the trend return stream to clients in a slightly different way," explains Otto Van Hemert from Man AHL. "It involves various considerations, including operational setup, the transparency provided to market makers, and the construction-deconstruction process," elaborates Van Hemert. "ETFs appear to be the preferred method for delivering trend-following returns to many clients. This represents a notable advancement in operational technology for delivering returns."

Kathryn Kaminski notes that institutional investors are employing CTA ETFs not to time CTAs, "but as a liquidity buffer to meet their targets." She observes that investors are using ETFs for transition liquidity, diversification, target adjustments, avoidance of rebalancing, and other strategic purposes. Kaminski emphasizes that investors are aware that ETFs may not offer all the features of a traditional CTA investment while they appreciate the additional option on their menus. "Investors don't get all of the bells and whistles with an ETF, but investors seem to understand that, they just want a tool. It shows that our industry is moving into a completely different phase where we have multiple avenues to reach investors."

## Outlook

The emergence of new players, the continuous development of more established managers, as well as the emergence of CTAs in an ETF wrapper are essential for a huge pool of investors worldwide, especially in the face of the current uncertain environment. "Investors out there do not know what's coming. They do not know what's next," says Kathryn Kaminski. "And that's what's nice about being a trend follower is we don't have to answer that question. It's a really exciting time because we're going to unfortunately go through a lot of very challenging macro environments."

Elena Westerdahl, representing an allocator with a more top-down approach to investing and a greater emphasis on how the macroeconomic landscape evolves, shares common concerns with other investors and allocators. "I

> "We could not spot managers who can deploy machine learning and get traction with respect to performance, but some have figured out some predictive signals based on LLM."
>
> **Elena Westerdahl**


Nick Granger, PIMCO

don't know where markets will go, but I am worried about the lack of fiscal discipline in the United States, about the escalating debt problem and the increasing cost of debt, which is hampering the real economic growth of the world's largest economy." While Westerdahl acknowledges "the fact that CTAs are still short in the bond space is the right lever to sit on," she remains cautious about expecting stellar performance from trend-following CTAs for the coming year. "But never say never."

Looking further ahead, Per Ivarsson from RPM believes "the future looks a lot brighter for the CTA space than the period of central bank moderation." There is an expanding array of developments that can trigger trends across financial markets, including the energy transition, climate change, regionalization, and "all those things that create those transition dynamics," according to Ivarsson. "There are signs that we are back into the world that was pre-GFC when markets were allowed to move. We have these transition dynamics that trend-following systems can benefit from."

Chad Martinson concurs with Kaminski, stating: "My crystal ball is notably foggy, so I don't know where markets are going to go. Being in a space where you don't need to predict and where you just want sustainable trends, is a reassuring position." While the recent discussions in the CTA space have focused on trends in the fixed-income space, Martinson points out, "Taking a step back and looking in the context of the past decade, CTAs are working on their fifth straight positive year. It seems the tide has shifted back towards CTAs."

www.hedgenordic.com - December 2023
HEDGENORDIC

# Nordic Insights

## HEDGENORDIC ROUND TABLE DISCUSSIONS

The HedgeNordic series of round table discussions titled "Nordic Insights" aim to bring together industry professionals and experts in their field in a vivid discussion. The setup allows to look at and discuss a specific topic within the financial industry from various different angles, and hear of different opinions and approaches. The group would typically consist of a colourful mix of representatives from the financial industry. The combination of having a relatively small, intimate group of individuals for the discussion behind closed doors in combination with a wide circulation to a relevant audience in the Nordic region through a summary of the discussion in a convenient read-up paper combines the best of the two worlds of professional and personal relationship building and broad communication and branding.

The size of the group and format chosen, combining a casual lunch followed by the actual work session and discussion give an excellent opportunity to network and get to know the participants and organisations behind them in both a more personal and professional manner.

The Round Table Discussion is hosted without audience, behind closed doors. The moderated discussion will evolve around topics pre-defined in collaboration with the participants prior to the event. To insure a dynamic and lively discussion the specific questions that will be discussed are not disclosed prior to the get together.











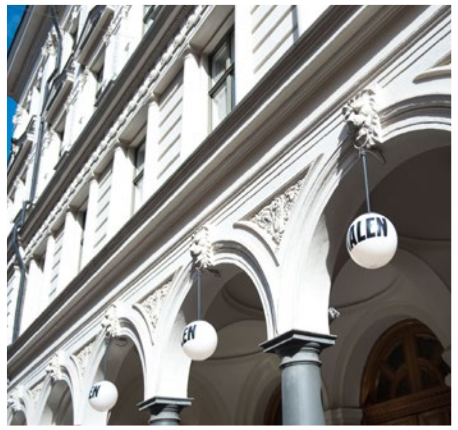


“Your single access point to the Nordic Hedge Fund Industry!”

## Publisher

Nordic Business Media AB
BOX 7285
SE-103 89 Stockholm, Sweden
Corporate Number: 556838-6170
VAT Number: SE-556838617001

Direct: +46 (0) 8 5333 8688
Mobile: +46 (0) 706566688

email: kamran@hedgenordic.com

**Photographer:** The awesome Binniam Halid

**Picture Index & Credits:**
Grisha Bruev---shutterstock.com
Everything---shutterstock.com

## About HedgeNordic

HedgeNordic is the leading media covering the Nordic alternative investment and hedge fund universe. The website brings daily news, research, analysis and background that is relevant to Nordic hedge fund professionals and those who take an interest in the region.

HedgeNordic publishes monthly, quarterly and annual reports on recent developments in her core market as well as special, indepth reports on “hot topics”.

HedgeNordic also calculates and publishes the Nordic Hedge Index (NHX) and is host to the Nordic Hedge Award and organizes round tables, seminars and other events for investment professionals.

www.hedgenordic.com

## GENERAL TERMS AND CONDITIONS

These are the terms and conditions which govern the use of „HedgeNordic Industry Report", an online magazine edited and distributed by electronical means and owned, operated and provided by Nordic Business Media AB (the "Editor"), Corporate Number: 556838-6170, BOX 7285, SE-103 89 Stockholm, Sweden.

### DISCLAIMERS AND LIMITATIONS OF LIABILITY

1. The Content may include inaccuracies or typographical errors. Despite taking care with regard to procurement and provision, the Editor shall not accept any liability for the correctness, completeness, or accuracy of the fund-related and economic information, share prices, indices, prices, messages, general market data, and other content of „HedgeNordic Industry Report" ("Content"). The Content is provided "as is" and the Editor does not accept any warranty for the Content.

2. The Content provided in „HedgeNordic Industry Report" may in some cases contain elements of advertising. The editor may have received some compensation for the articles. The Editor is not in any way liable for any inaccuracies or errors. The Content can in no way be seen as any investment advice or any other kind of recommendation.

3. Any and all information provided in „HedgeNordic Industry Report" is aimed for professional, sophisticated industry participants only and does not represent advice on investment or any other form of recommendation.

4. The Content that is provided and displayed is intended exclusively to inform any reader and does not represent advice on investment or any other form of recommendation.

5. The Editor is not liable for any damage, losses, or consequential damage that may arise from the use of the Content. This includes any loss in earnings (regardless of whether direct or indirect), reductions in goodwill or damage to corporate.

6. Whenever this Content contains advertisements including trademarks and logos, solely the mandator of such advertisements and not the Editor will be liable for this advertisements. The Editor refuses any kind of legal responsibility for such kind of Content.

### YOUR USE OF CONTENT AND TRADE MARKS

1. All rights in and to the Content belong to the Editor and are protected by copyright, trademarks, and/or other intellectual property rights. The Editor may license third parties to use the Content at our sole discretion.

2. The reader may use the Content solely for his own personal use and benefit and not for resale or other transfer or disposition to any other person or entity. Any sale of Contents is expressly forbidden, unless with the prior, explicit consent of the Editor in writing.

3. Any duplication, transmission, distribution, data transfer, reproduction and publication is only permitted by
   i. expressly mentioning Nordic Business Media AB as the sole copyright-holder of the Content and by
   ii. referring to the Website www.hedgenordic.com as the source of the information.

   provided that such duplication, transmission, distribution, data transfer, reproduction or publication does not modify or alter the relevant Content.

4. Subject to the limitations in Clause 2 and 3 above, the reader may retrieve and display Content on a computer screen, print individual pages on paper and store such pages in electronic form on disc.

5. If it is brought to the Editor's attention that the reader has sold, published, distributed, re-transmitted or otherwise provided access to Content to anyone against this general terms and conditions without the Editor's express prior written permission, the Editor will invoice the reader for copyright abuse damages per article/data unless the reader can show that he has not infringed any copyright, which will be payable immediately on receipt of the invoice. Such payment shall be without prejudice to any other rights and remedies which the Editor may have under these Terms or applicable laws.

### MISCELLANEOUS

1. These conditions do not impair the statutory rights granted to the readers of the Content at all times as a consumer in the respective country of the reader and that cannot be altered or modified on a contractual basis.

2. All legal relations of the parties shall be subject to Swedish law, under the exclusion of the UN Convention of Contracts for the international sale of goods and the rules of conflicts of laws of international private law. Stockholm is hereby agreed as the place of performance and the exclusive court of jurisdiction, insofar as there is no compulsory court of jurisdiction.

3. Insofar as any individual provisions of these General Terms and Conditions contradict mandatory, statutory regulations or are invalid, the remaining provisions shall remain valid. Such provisions shall be replaced by valid and enforceable provisions that achieve the intended purpose as closely as possible. This shall also apply in the event of any loopholes.