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Nordic Insights

HEDGENORDIC

Managed Futures / CTA

Editors **Note**

Managed Futures are dead! Again.

Managed Futures for many investors only had some cameo appearances on the big screens until they had their first lead role in 2008, arriving to the rescue of financial-crisis struck portfolios like super-heros. In the period following, money poured into CTA strategies, growing the industry from 206 billion Dollars in 2008 to 331 billion USD by the end of last year, according to BarclayHedge.

Ever since 2008 though Managed Futures have struggled to find an environment to match historical returns. Widely followed BarclayHedge CTA Index recorded its firs time ever three back to back negative years (2011: -3.1%; 2012: -1,7%; 2013: -1.4%) The average Nordic CTA avoided that fate with Nordic Hedge Index CTA sub index saving itself to positive territory virtually in the last trading days of the year.(NHX CTA 2013: +0,87).

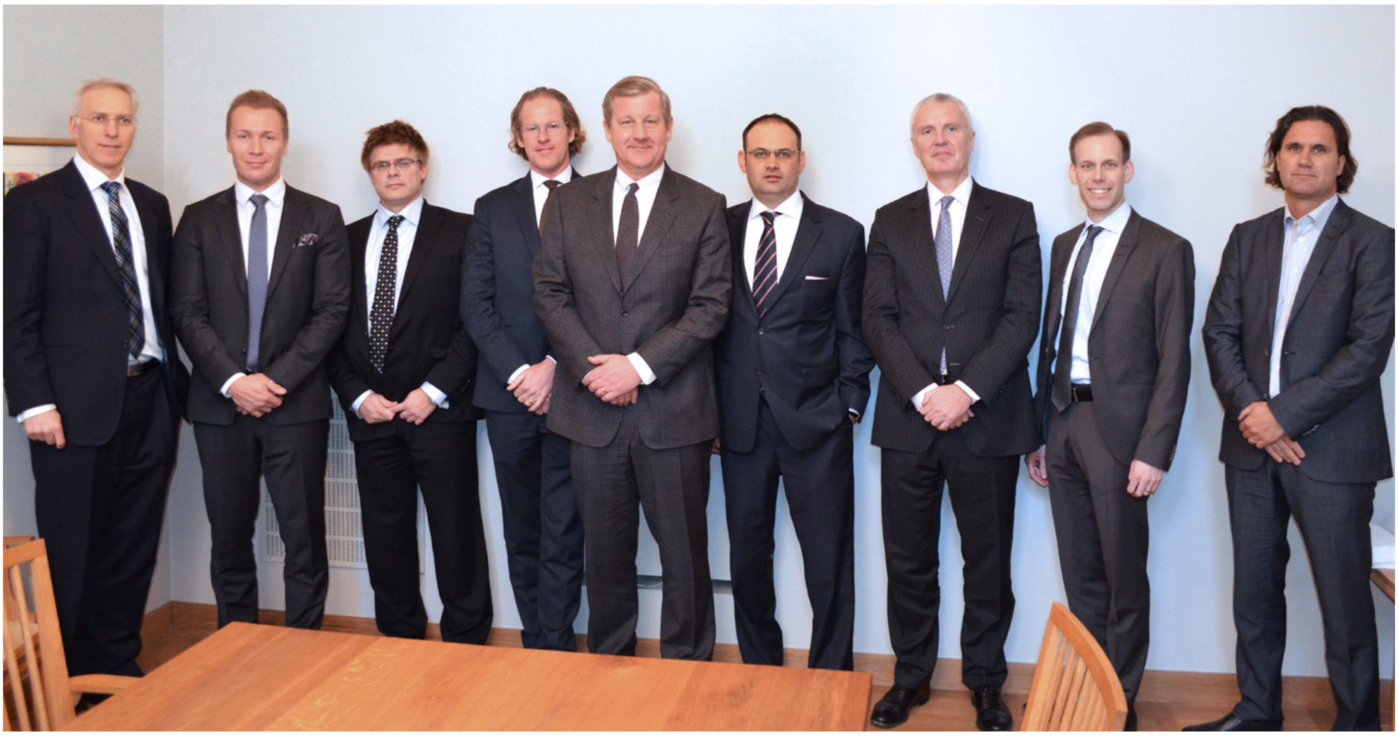
It seems like the industry has met its Kryptonite in markets influenced and „manipulated" by government and central bank interventions and politically influenced monetary and fiscal policies.

We are delighted to have gathered the representatives from leading Nordic and international CTAs for a round table discussion on recent performances and the role managed futures play as an industry and for institutional portfolios. The managers following HedgeNordics invitation represented roughly 25 billion USD. We were fortunate to have a diverse group, among them with three BTOP 50 funds some of the largest managers in the world, as well as smaller, emerging managers, dedicated trend followers, a long-biased commodity manager, a systematic global macro manager and hosting the discussion at their offices, RPM with a multi manager „fund of fund approach."

We are pleased to present you an excerpt of the session in this paper. The format chosen to compose this summary intends to let the reader participate as close as possible and "listen in" to the discussion among industry professionals in their own words.

Enjoy getting some "Nordic Insights" to Managed Futures.

Kamran Ghalitschi
Publisher HedgeNordic.com



Round **Table** – Participants

Hans-Olov **Bornemann** – Head of SEB's Global Quant Team, Senior Portfolio Manager

Hans-Olov Bornemann is the Head of SEB's Global Quant Team which he founded in October 2003. Bornemann is also the Portfolio Manager of the successful SEB Asset Selection fund, the oldest UCITS-compliant Managed Futures / CTA funds (launched in Oct 2006).

The fund and the investment team have repeatedly received awards and short listings in international hedge fund magazines. With more than USD 1 billion in AUM, SEB Asset Selection belongs to the largest CTAs in the world and is a constituent of major CTA-indices, e.g. NewEdge's CTA Index, Barclay Top50 Index etc. Prior to joining SEB in 2003, Bornemann was Managing Director and head of Deutsche Bank's Nordic Equities Business. Leading to up to that, he had a career as a top-ranked equity analyst at Deutsche Bank and S.G. Warburg (part of UBS today) and also head of Nordic equity research. Hans-Olov carries an MBA from Stockholm School of Economics and Business Administration, including an exchange year at Darden Graduate School of Business Administration, University of Virginia, USA.

Anders **Blomqvist** – Portfolio Manager, Ålandsbanken

Anders Blomqvist is fund manager and quantitative analyst at Ålandsbanken since 2005 (former Kaupthing Sweden). Anders has developed the strategies in Ålandsbanken Commodity Fund and is portfolio manager since its launch in 2010. Anders work with derivative strategies, asset allocation and portfolio construction in the group for tactical asset allocation, TAAQR, at Ålandsbanken.

He handles the derivatives portfolios in the global macro fund Defined Risk 12 and in the low-risk fund Brig 6. Anders has also worked with an ALM study for Nuclear Decommissioning Trusts, NDTs, at NISA Investment Advisors, LLC, St. Louis, USA. Anders holds a Master of Science degree in Engineering Physics and received his PhD in Optimization and Systems Theory at the Department of Mathematics at the Royal Institute of Technology (KTH) in Stockholm in 2005.

Svante **Bergström** – Founding Partner, Portfolio Manager, CEO – Lynx Asset Management

Svante Bergström is a BSc. Econ and Business Admin graduate from the Stockholm School of Economics. Between 1984 and 1991, Svante Bergström worked for Hagströmer & Qviberg Fondkommission, both as a stock broker and later as head of the firm's bond trading department. In 1993, he joined Nordbanken as a quantitative analyst and a bond trader within the Strategic Trading unit. In 1996, Mr. Bergström set up Nordbanken's Proprietary Trading unit, where the investment methodology for Lynx was originally formulated. Bergström is a founding partner and has been portfolio manager of Lynx since the fund's inception.

Jesper **Nyberg** – Partner, Portfolio Manager Estlander & Partners

Jesper joined Estlander & Partners in 2000 as a Portfolio Manager and Researcher. Jesper Nyberg's commitments have included risk management, quantitative analysis, producing new trade ideas and developing the systematic programs. Jesper is currently working as Head of Nordic Sales, focusing on institutional clients and also works on portfolio management, currently focusing on fundamental models. Jesper Nyberg is also a member of the Executive Board. Previously Jesper Nyberg worked as a stock analyzer at ABB Aros Securities Ltd. where he was responsible for risk management. He was also actively involved in decisions concerning portfolio management. In 1999 Jesper Nyberg graduated as M.Sc. from the Hanken School of Economics in Helsinki.

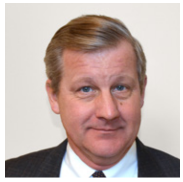
Björn **Österberg** – Managing Director, Chief Investment Officer, IPM Informed Portfolio Management

Björn Österberg is responsible for the management and development of IPM's investment process, and a member of the Investment and Risk committees. He joined IPM in 2008, having previously served seven years at AP4 as a Senior Equity Portfolio Manager.

Before that he was Head of Quantitative Research at Unibank/Nordea, and Head of Quantitative Research and a member of the proprietary trading team at JP Bank. Björn holds an M.Sc. in Engineering Physics from the Royal Institute of Technology in Stockholm, and has several years of additional studies in both Financial Economics and Macro Economics from Stockholm University.

Mikael **Stenbom** – Founder and CEO of RPM Risk & Portfolio Management AB

Mikael Stenbom is the founder and CEO of RPM Risk & Portfolio Management AB. RPM is a CTA specialist offering multi-strategy CTA solutions through funds or other type of investment vehicles that can be customized or standardized. Prior to forming RPM, Mikael was on the founding team of the OM derivatives exchange which was later to become NASDAQ OMX. Mikael also had a few years as a CEO of a management consultancy company before setting up RPM in 1993.



John **Wareham** – Chief Commercial Officer, Aspect Capital

Mr. Wareham, who joined Aspect in September 2005, leads the company's Sales, Client Services and Marketing teams. Mr. Wareham has more than twenty years of senior-level experience in the financial markets. From November 2001 to September 2005, Mr. Wareham was globally responsible for the Foreign Exchange and Emerging Markets businesses at AIG Trading Group and AIG Financial Products (AIG is a provider of insurance and financial services).

From April 2001 to November 2001, Mr. Wareham was the Chief Operating Officer for Atriax Ltd., a foreign exchange trading platform. From February 1995 until April 2001, Mr. Wareham was with Merrill Lynch (an international investment bank) where he held a number of positions, including Global Head of FX Options Trading, Head of Private Client Strategies Group and Global Head of Foreign Exchange Sales and Trading. Mr. Wareham worked for Goldman Sachs (an international investment bank) from February 1991 to February 1995 as a Senior FX Options Trader. Mr. Wareham was with Morgan Stanley (an international investment bank) as a FX Options Trader from January 1987 until February 1991. From June 1986 to January 1987, Mr. Wareham was in Credit Analysis at Lehman Brothers (an international investment bank), and he was a Trainee Credit Analyst in the Republic Bank of Dallas NA from June 1985 to June 1986. Mr. Wareham holds a BSc (Economics) from the London School of Economics and an MPhil from St. Antony's College, Oxford University.

Kamran **Ghalitschi** – Publisher HedgeNordic.com

Kamran started his career in 1994 as broker/dealer trading US equities and derivatives in the asset management division of Bank Austria. Kamran was head of marketing and sales for the online brokerage division of Raiffeisen and spent a year as PR consultant servicing financial media as well as foreign investment funds on the Austrian market.

In 2004 he joined an Austrian CTA working in several marketing, sales and management positions in Vienna, Frankfurt, Amsterdam and Stockholm. Kamran then joined an Amsterdam based multi-family office with a focus on fund of hedge funds. He founded Nordic Business Media in January 2011 which publishes HedgeNordic.com, the Nordic Hedge Index and is organizer of the Nordic Hedge Award.

Nordic **Insights:** Managed Futures/CTA

Kamran Ghalitschi: *2013 was a bit of an odd year for Managed Futures. Some programs ended up in the red, some in the green, with quite a big divergence between funds traditionally doing very similar things. How do you look back at 2013, and the period lying behind us in general since 2008*

John Wareham: Our returns were slightly negative last year – the Aspect Diversified Fund was down about 4.5%. Aspect and I guess most of the industry, saw a reasonably profitable first quarter and a solid fourth quarter - while most of the challenge was centred around the May/June period which saw sizeable reversals in fixed income and equity markets. In general, there were some very strong trends in 2013 with equity and particularly precious metals markets profitable for our trend following models last year. We found the frequent reversals in energy and fixed income markets to be far more challenging.

We share your observation Kamran, that ***there was a substantial divergence in the performance of leading trend following managers last year*** - probably the biggest for five-six years. As ever, a lot of this dispersion was probably a function of some high level differences in the frequency response and the risk allocations that are maintained by different managers. Broadly speaking, if your risk allocation was more biased towards equities, if your equity portfolio was more biased to the larger markets and if you were slightly more biased to slower than faster models, then you probably performed towards the top end of the competitive range last year.

Conversely, managers with a larger allocation to energy and fixed income markets will have found life far more challenging. I also suspect that for many managers, the real source of poor performance in 2013 was not trend following at all. Many managers who performed particularly badly in 2013 suffered most from the performance of their non-trend following models such as an excessive allocation to carry.

Anders Blomqvist: We were up almost 13% despite that it was a difficult year, being long-biased on commodities. The commodity index was down again, so the starting point was, so to say, negative. ***Trend following was not the best strategy last year in commodities.*** The good thing was that correlations came down significantly, both between commodities and other asset classes and within commodities. Corn futures and crude oil hardly had any correlation last year and that is good for CTA manager I believe. Among some of the bigger commodities like oil and oil derivatives were pretty hard to trade.

Svante Bergstrom: I would say that compared to the industry, we were quite successful last year. We were up between 11% and 12% depending on the currency class. The return itself is definitely good for the year. But if you look at the composition of the return, I am maybe less proud because it was pure equity positions that made the profits. But that is the nature of our approach.

If you look at how the Lynx program is designed, we build the portfolio on a bottom-up basis, allowing our models to take positions where they see the best trends for the time being.

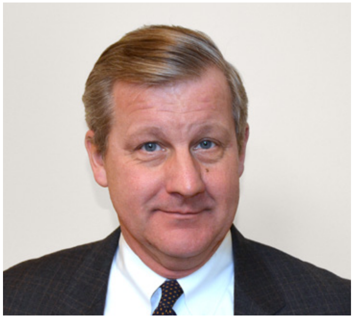
That means during last year we had quite a heavy tilt towards equities. Other years, the portfolio composition has looked very different. Being up based on profits from stocks in a year when markets have rallied is fine, but it is perhaps not the year you are most proud of.

Jesper Nyberg: Our year was quite two-fold. Looking at the performance in 2013 vs. peers we differed quite a lot as we made strong gains during the first half of the year, both in absolute and relative terms. Usually in these kinds of inflection points when new trends emerge, i.e. the environment we saw during the first half of the year, how we allocate risk in our strategies results in us usually being more reactive in the early part of the trend. This reactivity can then naturally hurt us more in whipsawing markets, which we saw during the second half of the year. Out of our two main strategies Alpha Trend ended up slightly in positive territory for the whole year and Freedom slightly in negative territory.

The best performing markets during the first half of the year were short positions in gold and short positions in Japanese Yen. What we saw during the year and especially during the first half was that global financial markets partly normalizing. This could be seen for instance in falling global cross-correlations and hence the diversification effect of trading different asset classes improved. The returns from different asset classes came at different times and it was not only a risk on/risk off trade. What was also good for us in the beginning of the year was a slight pickup in volatility and as trend followers have a long volatility characteristic, stable or rising volatility is naturally better than falling global market volatility.

Falling volatility has been the dominating environment during the last years and markets have to a high degree been central bank and liquidity driven. During the second half of the year the market again returned to falling volatility, whipsawing markets and hence the give-back of profits from the first part of the year. Overall equity positions ended up in positive territory, but as they are, on average, quite a small part of our portfolio it was not enough to make it a good year when the other asset classes ended up in negative territory.

Mikael Stenbom: It was definitely an equities year. There were some CTAs with some special features built into their systems that were able to extract profits from energy or from Japanese Yen. The dominating observation from our perspective, however, was a general market environment that was slowly, slowly, moving back to something that may be described as normal.



But this whole process was disturbed by various political events. First came the tapering announcement in May, which reversed most trends. Then, the non-tapering announcement in late summer, which created new volatility. Then the US government shut-down and after that the threat of the US default.

Anders Blomqvist: I think the tapering announcement in May was a part of the normalization. After that, we had the real interest rates going up. The 10-year real interest rate in the US went from the negative to the positive. But I fully agree: now we are much more in a normal kind of market and correlations between bonds and equities are not as negative anymore.

Bengt Lindblad: ALFA Commodity fund is a pure trend following CTA. The fund was up around 4% last year, with no big drawdowns. We are satisfied with that result if we compare us to our benchmarks, especially since we trade the equity markets very restrictively. People keep saying the current market environment is tough.

But we know of no other environment than this one, since we launched in the middle of it. Since inception, June 2010, we are up 33%, with a standard deviation of 13%. This is not a bad return at all, not even when compared to other asset classes.

The most important reason why we beat our benchmark over time is that we focus on money management.

Hans-Olov Bornemann: Last year, when the twenty largest CTA-funds in the world delivered a break-even result, we were happy to report a positive return of almost 5% in SEB Asset Selection and approximately 8% in SEB Asset Selection Opportunistic. In 2013, CTA funds had a very good run until May. The problem at that point was that the guidance from the Federal Reserve was deviating from the previous guidance and thus caused a major price decline in both equities and bonds. Needless to say, investors do not appreciate surprises from central banks. ***CTAs in particular are sensitive to unexpected reversal situations and experienced substantial pain*** at the time. In the autumn, the Federal Reserve tried to correct the previous guidance and thereby delivered another surprise to the market.

However, at the end of 2013, they got their communication right and have since then avoided to cause further market turbulence. Looking into the next 1-2 years, we are quite optimistic about the potential for trends to develop. It seems that central bankers and politicians will not be required to intervene as much as they have been over the last five years. Such a market scenario is very positive for CTAs.

Björn Österberg: Our performance profile was somewhat different last year. In contrast to most trend following strategies we had two slow first quarters, in principle flat. After a decent third quarter things were looking decent until we gave back some profits in December. All in all we were up some 4% in trading P&L. However, I would like to pick up on what Svante said about the composition of returns as we had the opposite experience.

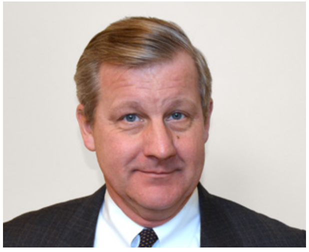
Despite the weak ending of the year I am actually satisfied with the composition of returns where we in principle had one weakness being our equity strategy, which was down quite significantly during the early part of the year, whereas most other asset classes worked fairly well. When I took part in this discussion round a year ago we were talking about markets returning to fundamentals and we were talking about correlations. We were hoping for correlations to come down and for fundamentals to return, and I think they did in the sense that ***markets in 2013 were fundamentally driven; the macroeconomic themes we are looking at were very profitable.***

Our valuation themes worked well in currencies and fixed income, but less so in equities. This is quite interesting as we can see from the long only equity side of our business that value within markets had a perfect year, whereas the cross equity market value theme did not perform. What fundamentally based managers struggled with last year was to a large extent the poorly performing risk premia themes. We obviously gave back some there as well, but to a rather small degree as evidenced by our strong currency performance.

***Kamran Ghalitschi:** 2011, 2012, 2013 have been three back to back down years for most CTA indices. While the drawdown is not massive what is noticeable and painful for investors is the-time-off-peak. So I would like to talk a little bit about how investors may see CTAs differently than they did when they went into them with flying colours in post-2008. How have portfolio compositions for institutional investors changed? How do you as portfolio managers adapt to this? Maybe we should talk a little bit about investor sentiment and how you as industry reacted to your investors demands.*

Svante Bergstrom: There are two types of investors. You have those that invest in CTAs because they want high returns. Those investors should be disappointed because they have not had any significant returns over the last three years, and other strategies have been doing better. But that is probably not the best way to look at CTAs. Then you have those who look at CTAs from a diversification perspective. They put us into a portfolio with traditional assets. They look for crisis alpha, negative correlation, and something to protect them when things are going sour in their big portfolios. And those investors, even if they are disappointed after these three years, should look at their overall portfolio to see what kind of returns they have had.

It has been a great period for traditional assets with no major drawdowns. Investors have made tons of money from both bonds and equities. So they should give us some more time and see what happens when stock markets turn down during a longer period. Not just a month, or a couple of months, but if you have a down year for stocks. Then you can ask: are CTAs delivering again or are we not? But before that happens, I think they should sit back and keep their allocation to CTAs as a diversifier in their portfolio.



Mikael Stenbom: ***A problem for the whole industry is that investors typically invest in CTAs because of the diversification argument, but they tend to evaluate CTAs on a stand-alone basis.*** After a year or two of good equity markets and more modest CTA performance, the diversification argument is forgotten and it is all about absolute returns in the relatively short term. So, they may de-invest, typically before the next equity distress period.

During that distress period they are not invested and CTAs deliver a strong return; Crisis Alpha. Investors are then reminded of the diversification benefits, and invest just before a period of mediocre performance.

Bengt Lindblad: I totally agree, the money is floating in where the results are.

Anders Blomqvist: To follow up there, what I hear from the private banking side, is that this is actually what works. There is a good demand for hedge funds and hedge fund portfolios despite a few good equity years. Within those portfolios, there is quite an acceptance that CTA have a role. Then there is of course lots of equity long-short, but typically with a long bias as well.

Hans-Olov Bornemann: We can clearly see two different client segments. The first one understands that CTA funds should be used and evaluated in the context of the client portfolio rather than on a stand-alone basis. That is basically half the client base that we have. The other half seems to be more, say, opportunistic. They try to time their investments in our fund. The ones that have taken a contrarian approach and bought our fund on temporary dips, have done quite well, but the ones that have bought the fund after it has been going up and sold it after it has been going down, have not done so well.

In any case, one needs to remember that ***timing a CTA product is very different from timing the market.*** Since CTAs are already trying to time the market, you as a CTA-investor would be trying to time somebody else's timing of the market – a pretty difficult thing to do. We therefore recommend our clients to invest in SEB Asset Selection with a longer term perspective, that is on a buy and hold basis.

Anders Blomqvist: So, this second type of investors, are they out now?

Hans-Olov Bornemann: Let us put it this way, they have definitely been selling out for some time, but right now it is actually the opposite – they are starting to get into CTAs again. What they are doing is they are using the CTA product as a hedge against poor equity markets. And some of them now sense that the equity market has become overvalued. Therefore, it makes sense to complement your portfolio with an investment in a CTA fund. Maybe the smart money could potentially do it that way, but most investors will not be successful in making such market timing decisions.

***Kamran Ghalitschi**: Is there a difference in talking to independent investors who can make their own decisions quickly like a family office or a high net worth individual. You may have long political processes in a bank to overcome that hinder efficient timing?*

Hans-Olov Bornemann: Some big banks are really slow, but I know from my own bank that a well working machinery can also be incredibly fast. The whole advisory part and fund-of-funds, which are basically implementing that sort of strategy, they can be incredibly quick. However, if it is about a decision to include or not to include an external fund into the product range for distribution to the bank's clients, the bank carries out a rigorous due diligence of the external manager. That, of course, takes a bit of time.

John Wareham: My perspective is that ***there are signs of an improving degree of investor sophistication with respect to their use of trend following programmes*** - and this is helping many investors to remain appropriately patient with their CTA allocations. To Mikael's point, we all know that you should buy CTAs after a period of underperformance and I suspect that we all recognize that over the last 10 years, we have seen very few investors who are able to systematically 'buy low' and 'sell high' in terms of the CTA allocation. This is something of a paradox since most of the people we talk to are smart enough to recognize the logic of buying into drawdowns - but not many are good at 'timing' their allocations accordingly, presumably for reasons of institutional inertia and excessive caution.

Nevertheless, I do agree with Svante's earlier point that most investors are attracted to CTAs because they like the diversification benefits. Those investors who allocated on the basis of a sophisticated understanding of the strategy and its long-term portfolio benefits are still invested - in spite of performance having been disappointing for the past couple of years. Of course, some investors talk about portfolio diversification, when what they really want is absolute return - and my view is that many of the redemptions that we have seen from the trend following space over the past 12 or 18 months have been from those investors that were really after absolute return anyway. It is difficult to know whether this process has finished, but I feel pretty confident of the stability of the assets from people who really do have a sophisticated understanding of the long-term utility that they were pursuing, in the first instance.

Our challenge as an industry is to articulate a message of some hopefulness and optimism - which is that the strategy continues to have traction, and that it does continue to successfully capture trends as they reappear. That is to say, trend following is not structurally broken. The world's financial markets have been distorted by a pattern of 'risk-on, risk-off' reversals for some time - and this has made markets choppy and difficult for trend followers., We see however that these environmental head winds are starting to abate: trends are clearly starting to return to the markets and prospects for future returns are starting to look more promising.

Nevertheless, recent performance has obviously placed pressure on the industry's AUM. However, if we can weather this period of poor returns and the brief hiatus in CTA asset raising, we will find that the industry is growing again and that our collective client base is more informed about what it needs and why it has allocated to CTAs. On a two or three year view, I am very optimistic for assets under management within the industry. We may not have reached the bottom of the cycle yet, but we are certainly seeing signs of increasing interest, particularly from people that have not invested in CTAs before. I take that to be pretty encouraging because these are investors who are prepared to buy the strategy on the basis of its 'long-term diversification' and 'persistence of returns' benefits. They are definitely not chasing short-term performance. These are investors who are coming to the asset class in search of its long-term advantage and who are prepared to look beyond short-term performance. That strikes me as a pretty encouraging sign.

Svante Bergstrom: I fully agree. What we have seen in the past few years is larger institutions, like big pension funds, both in the US and in Europe, coming into CTAs. They were not there if you go back five years or so.

They are new to this, but they have done their homework and my impression is that that kind of money will be much more long-term in nature. They will be there and they will evaluate their investment every five years or so, but they will not chase the latest monthly returns.

John Wareham: Some part is driven by an important sea change in the attitude of the major asset consultants, some of which have historically been rather suspicious of quantitative strategies and of CTAs in particular. Actually over the last two to three years, we have seen a number of these organizations beginning to recommend CTAs as an important portfolio holding. .The consultant-advised institutional investor sector is one area where I expect to see solid asset growth in the next two to three years.

Svante Bergstrom: And another good thing with that is that those big institutions are starting off with something like a one percent allocation in their portfolio, which is far below where they should be in the longer term. So they will just dip their toes now and if things work out, they will increase that allocation over the coming five or ten years.

Jesper Nyberg: ***During the last years the importance of client communication has risen a lot.*** Previously when trend followers were generating solid returns, many investors were buying because of the performance and not maybe analyzing the return characteristics more in depth. Nowadays as a company we have been focusing a lot on helping the investors understand more in depth how we operate, when trend followers make money and also how we differ from other trend followers.

We want to be as transparent as possible towards the client and serve the client continuously with research pieces and make sure we operate according to our core values. From an investor point of view, one of the challenges is that there is a somewhat diverging trend within CTAs with some managers moving away from pure momentum strategies into a more diversified approach. In our strategies we want to maintain the core as a momentum driven approach so that we keep the crisis alpha component that non-directional strategies are maybe not able to produce. This evolution within the industry into non-directional parts naturally makes it more difficult for investors to analyze the possible returns streams and here we want to stay true to our core business of having a clear directional focus within the strategies and especially within Alpha Trend.

Bengt Lindblad: Regarding investments in trend following CTAs in drawdowns. Thomas Stridsman, the manager of ALFA Commodity Fund recently published an article describing the mean reversion and negative auto correlation tendencies of trend-following returns, which justifies the type of investment strategy Hans-Olov mentions; that is, buy our dips and sell our tops.

Jesper Nyberg: Over the past several months at Estlander & Partners we have been evaluating the post crisis results of managed futures relative to a longer time perspective. These analyses are a part of our core quantitative research but we also wanted to get a better picture of what can be expected for the strategy in the future. In the methodology we used a theoretical long straddle portfolio as a proxy for trend following in order to be able to analyze market movements rather than model specific behavior. We were able to extend the analysis back to the 1950´s and hence covering multiple economic cycles. The correlation between the Newedge CTA index and the long straddle portfolio is a high as 0.8 and we find that the single best explanatory variable of CTA returns is the change in volatility.

This correlation is 0.6. Both bond returns and US dollar returns have considerably smaller explanatory power. This research then provides some constructive insights, amongst others that volatility since 2008 has collapsed and reached levels not seen since the 1960´s, hence penalizing long volatility exposure and hence resulting in losses for trend followers. At the current historical low volatility investors should also re-evaluate the opportunities for trend followers.

Rising volatility tends to be the best environment for trend followers but also stable volatility has mostly been beneficiary for trend followers. The recent equity rally has also deepened the need for true diversification and our portfolios continue to provide this diversification by having a sufficient broad commodity exposure, an exposure to liquid financial markets and a disciplined and objective risk taking.

Kamran Ghalitschi: *Mikael, you are of course also an investor in CTAs, not just a product supplier. How is your confidence and patience level with your underlying managers?*

Mikael Stenbom: We have no doubt. We have not found any evidence of a fundamental shift or change. If you strip out the risk-free interest rate and compensate for the weak trends in the markets over the last few years, we see no change in CTA performance. ***The weak trendiness in markets is most likely an effect of political and central bank intervention and the general uncertainty and risk aversion that have prevailed.*** The big question is therefore how long it will take before politicians and central banks go back to „normal".

If they do not, it would certainly be a permanent shift but we find that unlikely since it would imply a political shift away from free markets as the main mechanism for resource allocation into something more totalitarian.

Kamran Ghalitschi: *I read from the research you put out at RPM, Mikael, you see more potential with the smaller evolving managers than with some of the giants in the industry. 2013 was actually the first time in a while that BTOP 50 outperformed the broader CTA indices. Do you find investors are saying "we are so exposed to the big names, such as AHL, TransTrend, Lynx, and Aspect we need to diversify within our CTA holdings?"*

John Wareham: The drift seems to be towards a sort of core-satellite construct. The majority of institutional investors with whom we work would prefer to invest with leading and larger managers.

Most institutional investors are comfortable with a core holding of two or three of the most obvious names - which is then supported by either a self-managed portfolio of smaller managers or a managed portfolio of smaller managers.

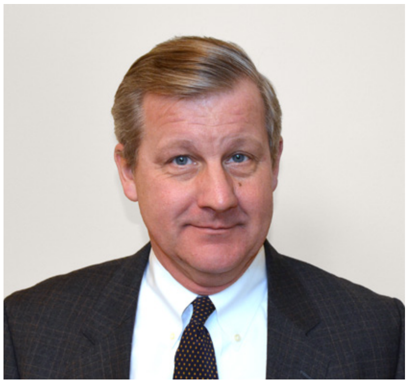
Svante Bergstrom: With respect to what the clients are doing, if we look at the flows over last couple of years with the bigger pension funds coming into the industry - if you are going to put one or two percent of your portfolio into CTAs, you might ask yourself: is it really worthwhile to do the full research on smaller managers to get the protection and the correlation benefits that you are there for? Or do you write a ticket to a couple of the big names that you know will have the infrastructure that you want as an institutional investor? So it does not necessarily mean they believe the bigger names will deliver better performance. It could also be a safer bet trying to avoid a blow-up or regulatory problem or something like that.

Bengt Lindblad: Of course we have seen this problem. To attract new investors the last years we have packaged ALFA Commodity Fund with other hedge funds in a multi strategy fund, ALFA Quant Fund.

Björn Österberg: From my perspective, and note that this is not my primary area of responsibility, ***I struggle to see how the smaller managers are able to cope with the increasing organizational hurdles that regulators are enforcing.***

In a small organization, having a dedicated legal and compliance resource must be very expensive and I am not sure that large institutional investors will be satisfied with these functions being outsourced, as many managers used to do in the past.

Bengt Lindblad: You need to be much better compared to your benchmark. If you really are better you can probably attract money. But you need to be much better.



Mikael Stenbom: ***There is no doubt that typical, successful CTAs go through a life cycle.*** Generally speaking, the big names today were not the big names 10 years ago. The big names 10 years ago were not the big names an additional 10 years ago. If we look at the collective of the current very large managers they had on average their best performance in their early days. I am not primarily talking about absolute performance. I am talking about performance relative to the industry as a whole. Their best performance typically occurred during the very first years – when they were emerging CTAs, but the risks associated with investing in emerging CTAs are significant.

Again speaking generally, when you look at both the very successful CTAs as well as the entire CTA universe, there seem to be a period between two and seven, eight years of age where average CTA is outperforming the industry at the same time as the risks normally associated with emerging managers, like operational risks, legal risks, drop out risks, are reduced significantly. This period in a CTAs life-cycle is what we call the evolving phase. If you want stellar returns and are prepared to accept these risks, you invest with emerging managers.

If you want to have competitive risk-adjusted returns you ignore the emerging managers and focus on the ones that are between two and seven years of age, and depending on strategy - are trading, less than two billion Dollars, give and take. But the individual skill of each CTA is certainly a factor here and we know that there are managers in this room that have managed to deliver competitive performance with larger assets. But, as our research indicates, for each manager, there seem to be a point where the combination of AuM and age brings the relative performance down to average or below average levels.

Hans-Olov Bornemann: It is quite interesting what you are saying, Mikael, because we have been looking into these things as well. The evidence is very clear, there is no correlation between the size of the research team and the risk-adjusted returns, or the length of the experience and the risk-adjusted returns. In fact, in terms of risk-adjusted returns versus experience, there is actually slightly negative correlation. This is basically supporting what you are saying here, that younger managers with 5-10 years of CTA experience may have some sort of advantage.

It is quite amazing to see how the oldest and largest CTA firms in the world haven't been able to keep up with smaller research teams. But this is just a general observation and I think what most investors have come to realize is that you need to look at the individual cases. A lot of investors are looking more and more at the performance numbers. They are also paying a lot of attention to how well the managers have been able to keep the risk under control and to avoid major drawdowns. There is clear preference to choose best performing managers rather than the ones that have been around the longest.

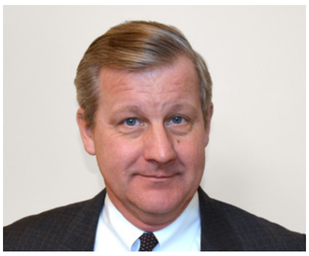
Björn Österberg: You were saying that there is no correlation between the sizes of the research team and output. We have not done any research on this, but, everything else being equal, I am convinced that there must be a strong correlation between the two at the startup of a research team.

If you have an infinitely small team, going from zero to one researcher makes a huge difference, and from one to two probably makes an even bigger difference. What is interesting though is where marginal benefit of additional researchers starts to flatten out? Having 40 or 50 PhD's probably makes less of a difference, but there is definitely a correlation between the number of research you put in and the amount of expected return you can create. Is that not what investors are paying for in our part of the hedge fund space?

Hans-Olov Bornemann: We looked at 23 of the largest CTAs in the world, and clearly they do have a few more researchers than just a couple. If you are a true start-up with only one or two people, of course an additional researcher will be a nice addition. But if you are looking at the teams that have 5-10 years of experience and are among the most successful in the world already, an additional researcher is unlikely to have a big an impact on the overall performance of the fund. This observation is also confirmed in the study we did. ***There is basically no correlation whatsoever between team size or length of experience and risk adjusted returns.***

***Kamran Ghalitschi:** I assume bigger teams would have their researcher working on different things, too not only on the core program.*

Hans-Olov Bornemann: Nowadays, yes, certain managers have started to diversify their product range. I was recently attending the CTA-Leaders conference in London and one of the largest players in the world was saying that they had problems in keeping 100 researchers busy and motivated by studying the trend following phenomenon. So they started research other fields and launched new products instead. That made these researchers clearly happier than they were before.



Mikael Stenbom: I was lucky enough to be on the founding team of OM, or OMX once it later became NASDAQ OMX. There were seven individuals who created a derivatives exchange. We developed the stock options and interest rate options and currency options. And we developed the OMX index option and future in six weeks.

Most of the original team left after, say, five or six years. After an additional five, six years we were looking at that organization and said, "What are they doing? Nothing is happening." I think, in addition to the declining or the diminishing economies of scale in research, the very large CTAs are forced into do a different kind of research that is more focused on the implementation, execution, how to avoid slippage, how to avoid market impact, how to avoid endogeneity in the market, which is of course valuable and necessary but perhaps more defensive.

***Kamran Ghalitschi:** Improving slippage and similar things can be performance drivers, too where you can squeeze a lot of performance out, not just defensive mechanisms.*

Mikael Stenbom: Yes you can squeeze out, but typically as you grow larger and larger and larger you become more and more endogenous in the market. It becomes more difficult to uphold your edge or to squeeze out and be profitable. You do not necessarily develop new ideas how to trade a market or find new patterns to trade, but you try to squeeze out, minimize the cost of trade, and a lot of research is put in into that.

Svante Bergstrom: We have a team of four or five people working purely with research on execution algorithms. We look closely at the numbers for execution costs, and it is actually cheaper for us to trade now than it was five years ago when our asset base was smaller. I think ***there is a trade-off and to some extent getting more assets and being able to invest in research and execution helps a lot.***

When I look at our numbers and our team, I can see that the big research team has added a lot of value over the years. We can also see that given the models we had in the portfolio five years ago, if we had not made any changes since then, not added any new models to the portfolio, we would not be have been able to deliver the kind of returns that we have done. Having a bigger team has really added value. But, of course, it is different from firm to firm.

Anders Blomqvist: We started by saying that there was a dispersion among the managers in 2013; there was both poor performance and quite okay performance. Now we ask for trend following because that is the crisis alpha that is well-defined and that is what we want. But on the other hand we spread out as well. Is that because of model modifications?

Do we do a little bit here and a little bit there and then we forget about the trend following part? That would be scary, because if a few years of poor performance make you look for other sources of return, then when you really need that crisis alpha, is it really there still?

Hans-Olov Bornemann: You are fully right in saying that ***there is a larger diversity in the CTA space today***. The largest player in the industry is no longer a traditional, clean, trendfollowing fund, but rather a multi-strategy product with the CTA tilt. Two large CTA-players who have been playing risk premiums by being long bonds, did very poorly in 2013. But, you also have the core CTA segment, where you find the funds that have been sticking to the knitting, making sure that they do not lose the attractive characteristic of being a tail-risk hedge and protecting client portfolios in the case of the equity market entering into a major decline phase. Most clients will appreciate this consistency in strategy.

John Wareham: I strongly agree with that. It is a massive strategic 'call' to decide to become something that is not a trend follower, either as a consequence of short-term desperation with recent performance or as a consequence of long-term ambition. I think it is very difficult for a manager to sit across the table from an investor and ask him or her to be patient with their trend following allocation, if at the same time the investor is not able to look back across the table and be comfortable that the manager himself is willing to be as patient with trend following as he has just asked the investor to be.

It is about a commitment to style purity. ***The critical thing in an investor's mind is that they need to know that when they most 'need' you, you are going to be there*** - when trends are strong, you will be making money, particularly if we see another equity bear market, when CTAs can deliver maximum utility to a portfolio. It will really disappoint an investor if the S&P is down 30% next year, and their CTA managers are 'long' of the S&P on the basis of a mean reversing strategy which turns out to dominate their trend following positions. For this reason, I think investors will be increasingly keen to understand where individual managers sit on the continuum of style divergence. This is because they are seeing less patience with trend following from their managers than they would like to see.

Jesper Nyberg: That is also interesting from a research point of view, the fact that we have a situation where the recent environment has been so different than before. One of the questions on the research and development is naturally how big a weight this recent period should have in the portfolio construction. Having solid research processes and avoiding over fitting models to recent history is maybe more important now than ever.

At the same time the global market space is in a continuous evolution process and hence also managers must be able to evolve, but all the time keeping in mind what kind of return characteristics investors are expecting from their investment. One can say that the best research is made in difficult periods, but the worst implementations are also made in drawdowns.

Bengt Lindblad: ***I firmly believe that the best trading teams and funds are dependent on the knowledge and skill of one person.*** These top traders or researchers have made it to the top over time as they have delivered consistent strong risk-adjusted returns. As the fund grows, problems develop over time as the smart strategies you once started with can not handle the increased trading volume. To deal with the increasing volume new strategies are developed, new traders and researchers are hired and so on. Most managers fail in keeping their edges and competitive returns over this phase.

The likelihood to find a new star trader or researcher through regular job recruiting is very, very low. If you compare these star traders or researchers with scientists and the institutions they work for, who has won the Nobel Prize, it is not very likely any Nobel Prize winners come from the same institution two years in a row. Likewise, it is not very likely any or trading organization would retain two subsequent top performing managers.

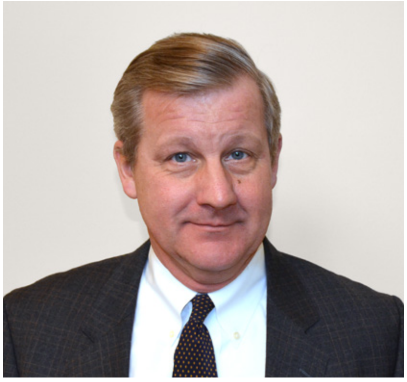
Björn Österberg: True, some individuals are more important than others here, but I don not think that automatically implies that fewer researchers are better. Take this as an example - if there is one star researcher per 50, then if you have 10 people on your research team you have some likelihood of having a star performer, and if you have 50 people on the team your likelihood of having that star performer is much larger.

But if you have 50 firms, each with only one researcher, one of the firms is going to be extremely successful and well known because the firm happens to be hosting that star performer, while the others might disappear. Some people will then interpret this selection bias as evidence that it works just as well to have only one researcher.

***Kamran Ghalitschi:** How will changes in regulation, like AIFMD affect the CTA space?*

Svante Bergstrom: I do not think there will be a big impact. It will impact the industry in the way we just talked about, big firm versus small. But performance wise, it does not really matter.

Anders Blomqvist: Compared to other hedge funds, futures are centrally cleared and simple stuff.



Mikael Stenbom: The one negative effect is that the change in itself, the scope of the change and the complexity of the new regulation that created a lot of uncertainty, which has been like a wet blanket thrown over many investors and other market participants as well as many, I believe, would-be CTAs. It has been a slow period in terms of new investors, new assets and newcomers to the industry. The industry will, however, organize itself in new ways with lots of outsourcing that could lead to reduced costs for the individual manager.

Hopefully, there will be stability in the regulatory framework, which will be helpful. There will be some harmonization at least within the European Union, that is also positive. Although we are going through a very difficult period now from a regulatory perspective, provided that we are approaching the end of it and that we are going to live in a stable framework for the next 10 years . In a couple of years from now we will say this was pretty good.

Hans-Olov Bornemann: Investors appreciate top performing CTA teams that are part of a stable and solid organization. A lot of the regulation has been coming in recent years and a lot of investors were actually asking for stricter regulation. If you are not able to provide assurance that the organization you are working for has the full capability to follow all the regulations, investors will look for another fund to invest in. I think it is fair to say that the hurdle has been raised a little bit in the industry.

Jesper Nyberg: Especially in Finland, where we from the start had very few alternative managers, the number has decreased even further since 2008. Also the willingness of investors to invest in start ups in this sector has decreased, making it clearly more difficult to enter the market.

I do not know if this is a good thing, because ***there would definitely be more room for alternative managers and diversifying return streams in investor portfolios.***

Mikael Stenbom: I do agree that there is a much higher hurdle than now at this point in time. But I think that that will be lowered dramatically in the coming years. The industry will find ways to be more efficient in dealing with the new regulations.

John Wareham: ***John Wareham: I am not sure that all of this new regulation is going to massively improve investor protection or transparency.*** That said, we devote considerable time and resource to understanding and being compliant with all new regulations - and it is a costly exercise. We see it as another barrier to entry for newer and smaller managers.

Mikael Stenbom: There is a new area of academic study called “the audit society”. Resources are taken away from actual producing a service or a product and put into documenting that service or product or describing it or controlling it or auditing it. This trend seems to be global and affect every kind of industry from healthcare to finance. A friend of mine, an engineer who works for a large telecommunication manufacturer, said, “We can not work anymore. We have no time to work. We are just documenting and checking boxes.”

A Danish professor in sociology in a recently published book pointed out the problem: the instruments used for checking and auditing and documenting sooner or later start to define the actual activity. So what you are not able to check does not exist, right? And that is quite dangerous for society as well as for finance. Check-the-box-mentality does not marry well with creativity and innovation.

Jesper Nyberg: Regulation and markets naturally evolve but what is a good thing for a CTA is the fact that humans are not evolving, or the patterns of how we humans behave. Fear, greed and herding are dominant characteristics of people reacting to information and this causes trends in longer perspective. And a systematic trend follower approach will capitalize on these inefficiencies also going forward.

***Kamran Ghalitschi**: How do you respond to client requests on carve outs, or customizations to your programs?*

Svante Bergstrom: We get that kind of request from time to time, but not very frequently. You might have a client say, "I think I want your FX exposure and your contrarian models." We would not do that. The reason is that if you look at the kind of product we offer, we target a Sharpe Ratio of one. If we can deliver that, then that is great. But as soon as you start to pick out pieces of the program, then suddenly your expected Sharpe Ratio drops to something lower. And I think that the lower number in the end will make the client less happy. He or she will not be staying as long as a client that has the full program. So therefore we do not do customization.

John Wareham: We do see a continuing stream of requests for customization and of course it is tempting, but practically impossible, to meet every request. So it is a matter of commercial balance. I would however distinguish between requests for programme customization ('can you reconfigure the alpha generating models to better suit my particular requirements?') from requests for product customization ('could you build a fund of one to accommodate my allocation?'). In terms of programme customization, our appetite is generally more limited. Of course, it is relatively straightforward to provide simple customizations - but even punch-outs of specific sectors or contracts or specific gearing requests can involve their own complexity in terms of a re-build of the portfolio construction and the risk controls in order to configure a robust stand-alone portfolio.

So we tend to decline requests for the construction of portfolios that we do not think are likely to be successful over the long term (for reasons of excessive risk concentration, for example) or where we are being drawn into an explicit alpha overlay conversation - which is not our business. In terms of product customization, we are often asked to accommodate requests for bespoke vehicles and different forms of account carriers and our ability to accommodate many of these requests is a function of business scale and an important source of competitive advantage.

By way of further example, we launched an ERISA-compliant fund in the USA at the beginning of this year because we have a strong view on the corporate pension plan market in the USA and because we have a sufficiently robust operating infrastructure to allow us to handle ERISA-related processes. The demand for these kinds of bespoke account carrier or alpha-carrying vehicles is not going to go away - because large institutional investors have a very well-developed sense of what kind of product they want and because well-developed CTAs will continue to make the necessary products available.

Björn Österberg: We started our business by setting up customized accounts for our investors. Even today, the majority of our investors are invested in dedicated accounts, so we are both familiar and capable of dealing with their specific requirements. Their requests can be such as "we do not want to trade this or that country", or it can be of a larger scope like our central bank type clients, who typically do not want to trade equities as an asset class, because it is not part of their mandate.

Given that the client is sophisticated enough to understand and appreciate the impact any tailoring might have in terms of expected risk and return characteristics we try to cater to these adjustments. Having said that, we have not to date, and probably would not, take away any of the model components originally applied to the agreed investment universe. Put another way, we are happy to exclude a currency or two, but we would not want leave out the macroeconomic or risk premium themes applied to the agreed set of currencies.

Hans-Olov Bornemann: We are more on the lines of not taking out any specific parts, but rather trying to satisfy the needs in terms of risk profile. Clearly, there are different segments in the market, which ask for different risk levels. Such requests we do accommodate. But, we do not recommend clients to just cut out a slice of the pie, because the portfolio has been optimized from an overall perspective. If you were just to go for one part, you would need to carry out a new optimization in order to get more favorable characteristics. We try to accommodate client requests, but we will only do it if we can assure top quality in the product.

***Kamran Ghalitschi**: May I invite you to a quick round of closing comments and closing thoughts. what are your feelings, ambitions going into 2014 and going onward?*

Bengt Lindblad: We believe in money management regarding the ALFA Commodity Fund. To handle volatility during negative or low-return periods that is the most important thing. Using systematic strategies for adding and deducting volatility depending on market environments is the most important factor for a trend-following CTA, we believe.

Svante Bergstrom: What we look for is, of course, the run up for CTAs, and hopefully we will see that in the coming year. If not, we look to our staying power. We make sure that we are in this game for the long-term. We will be here for years to come, even if we continue to have a flat period for CTAs, because we firmly believe in the trend following concept, and at some point we will get back on track for the industry and for trend following, and you do not want to miss out on that. So building our resources in the firm is a very important part of what we are doing right now.

Anders Blomqvist: We are a little different in trading only the commodity markets. But some parts of what you say here also apply to long commodities. There have been a few poor years for long commodity exposure. And there is a growing impatience among the investors. We bought this asset because it was a diversifier and it should be a reasonable return, and it has not been. So, similar to trend-following CTAs, and for me as a manager, the important thing is to stick to your strategy. ***The worse the environment, the harder you work to compensate for that.*** On the markets, as we said in the beginning, I think the environment is much more fruitful today than it was just two or three years ago. So I am optimistic.

John Wareham: We are unified by our long-term ambitions for the industry. While we acknowledge that the future is uncertain, we do not think that trend following is fundamentally broken, because we do not think that the investor behaviour has fundamentally changed. ***Our asset class has always produced returns that have been episodic and unpredictable*** - and experience demonstrates that when performance returns, it does so very powerfully. Are we closer to the point when strong trends return to the global financial markets than we were 12 months ago? You would have to think so, but it is not clear when that is going to happen. In the meantime, we take a view believe that this is a time to remain faithful to the systematic delivery of the returns offered by a trend following strategy. We are determined to continue researching our way to a continuously improving programme because we have extreme faith in what we do. This period of disappointing performance is tremendously frustrating and the challenge is to remain focused and to be sure that we are ready to profitably capture trends whenever and wherever they re-emerge.

Björn Österberg: For us, it is very much business as usual. We continue to focus on increasing the stability and improving the risk return characteristics of the programs we run. This means increasing diversification among asset classes and themes, implementing new ideas to the asset classes we trade as well as adding new asset classes, new markets, and new dimension, etc. I believe this continuous development that we are doing is what our clients expect from us. In terms of the challenges going forward, one area for us will be to convince investors that it will pay off to invest in fundamental themes despite the outlook for continued central bank interventions. There has been a tendency among investors to link the central bank interventions to the lagging performance of fundamental strategies, when in most cases the central bank actions confirm that fundamental imbalances exist and are available to exploit in the longer term. As with most of you, I suppose, we continue to discuss the diversification benefits of our program and the entire systematic industry in fact. I am optimistic about the future though and truly believe that there are some excellent opportunities out there for our investment strategies.

Jesper Nyberg: Investors are naturally asking when will this turn around and the situation will improve for CTAs and unfortunately we do not have a crystal ball that could help with the answer. What we can tell them is that we will remain true to our core business and naturally focus on R&D, but still we are going to keep our trend following characteristic. This also means maintaining the long volatility profile, so that investors when investing with us know exactly what they are getting. Overall the market environment has started to normalize when looking at correlations and the effect of central banks on markets.

This should result in a better environment for trend followers to clients. Past years have been chasing carry-like returns, equity, narrowing spreads etc. Carry is not necessarily good for momentum. We believe we need a catalyst for momentum. There are several possible catalysts out there and these can change the situation quite promptly. Additionally, the Fed tapering should result in a normal market environment. As the economic growth in different parts of the world is different we should also see regional imbalances build up and all of these are factors that can result in bigger trends so we are expecting a better year for trend followers in general, even though there will naturally be bumps in the road also in 2014.

Mikael Stenbom: We are generally quite optimistic on CTA returns for 2014 and for next year. The main reason for that is that ***trend following is highly correlated to changes in the general business cycle.*** What trend following does not like of course is standstill or abrupt change in the business cycle. We had a global growth pretty synchronized at say 1.5% per annum over the last couple of years. If you look at the US GDP changes, there is a flat line over three years. That seems to change, right now. It seems like the US is gaining some momentum.

What is also interesting is that there seems to be a growing divergence between major regions in the world which also could lead to some interesting trends developing this year and the next . Our focus is to maintain the crisis alpha characteristic in our mandates, and continue to add new innovative strategies that will deliver supporting returns in the periods between the episodic return events that trend follower typically enjoy.

Hans-Olov Bornemann: I am actually quite optimistic about the outlook for CTAs for 2014 and 2015. The reason is quite simple. What we have seen since 2009, is a strongly recovering equity market. And we have seen optimism growing year after year. There may still be some potential to see further advances in the equity market, but what we are observing right now is above all that new bubbles are being built up. CTAs are very good at taking advantage of bubbles, both on the way up and on the way down. At the inflection points, some losses may occur, but after a while when the trends get established, CTA funds are very well suited to take advantage of the market development. What should you do if you think that the equity market is or will be coming to a peak at some point over the next 1-2 years? Of course, you could try to sell your equities and buy bonds when the shift happens.

But, when will it happen? If you shift too early, you may miss out on a nice equity rally and potentially suffer losses on your bond positions, should interest rates go up. If you shift too late, you may be making a corresponding mistake. The fund managers of CTA funds do not think it is possible to exactly forecast when such regime shifts will occur. That is why CTA funds are taking positions on the basis of mathematical models that have been constructed in such a way that their positions dynamically adjust to the most recent market development, to follow the prevailing market trends. In this kind of scenario, many clients will be looking to invest in funds that can help them create a better balance in their overall portfolio. The largest pension funds in the world have come to the conclusion that CTA funds are the best at meeting this objective. I think that a lot of people will be positively surprised about the performance of CTA funds over the next couple of years. Asset bubbles are building up again – just like they were during 2007. Markets that fly too high will eventually come down. We made good money in 2007 and 2008. I would not be surprised, if 2014 and 2015 turned into some pretty good years for us!

***Kamran Ghalitschi**: And what a fantastic note to end on. Gentlemen, thank you very much.*

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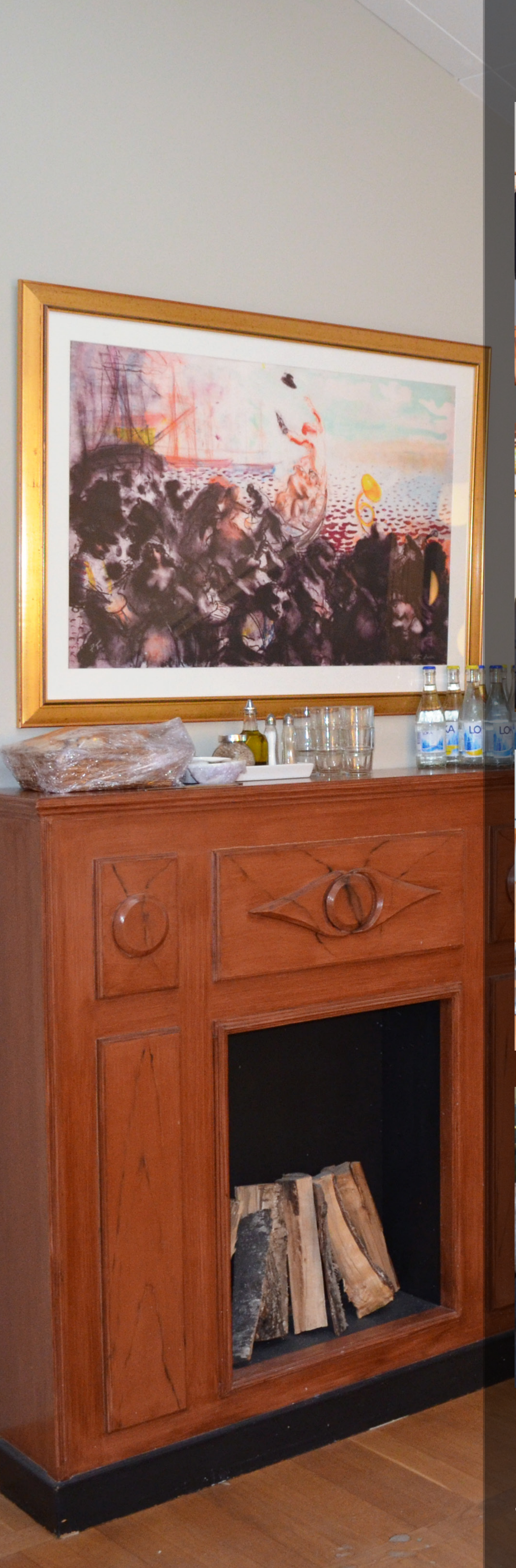

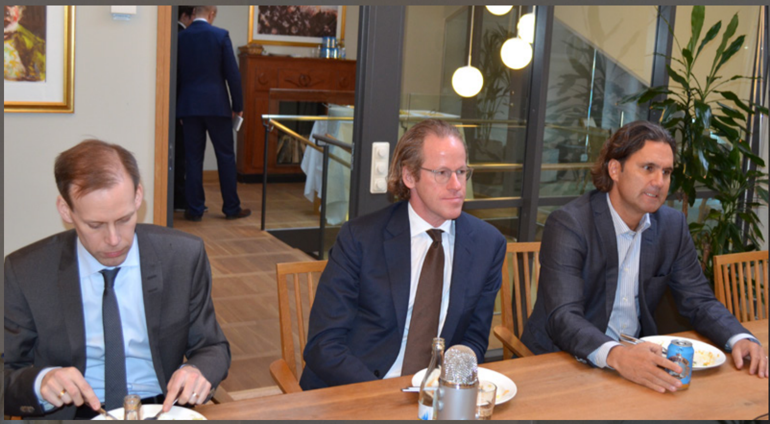

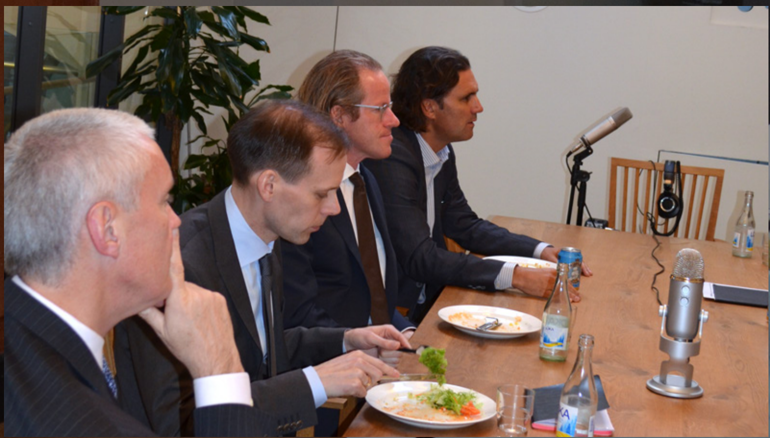

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