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Do CTAs Suffer from Crowdedness?

A closer look at Commodities

CTA-Space Oddities

What makes Market Neutral strategies attractive for institutional Investors

Systematic, Discretionary - or both?

How Macro managers find their Edge

Macro & CTA - Same same, but different

Similarities and differences among distant cousins

CTA & Global Macro Strategies

Same same, but different?

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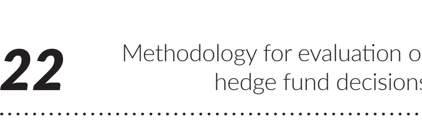

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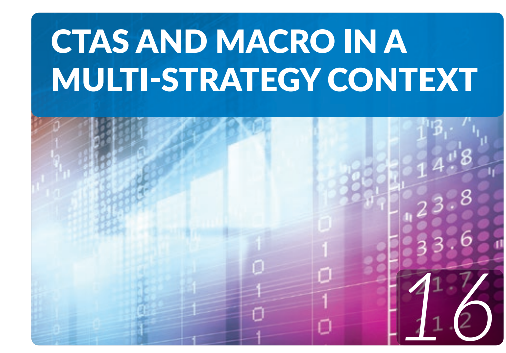

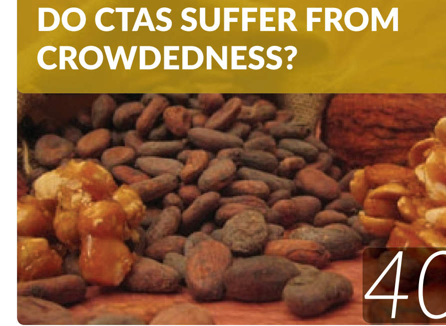

INTRODUCTION

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 from the sell and buy side from all tiers.

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 and seminars.

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The Editor

My opening Requiem…or an abuse of felis catus domesticus metaphores

Over the years, CTAs have been declared dead numerous times. Funny enough, the grave diggers tend to be most vocal around the same points in time as CTAs suddenly rebound. If one was to develop a timing indicator for CTA returns, by academics probably considered an unnecessary exercise, the number of Google hits on "ctas are dead" would be my suggestion for a leading indicator.

2014 was another one of those years when CTAs suddenly re-emerged from an extended period of non-performance, silencing a critical voice or two. The strength carried into early 2015, just when we published the last CTA report the sky seemed to be the limit. But then the strategy was beaten to the ground in a volatile second half of the year, finishing the year unchanged - at best.

In early 2016, CTAs are again the best performing hedge fund strategy, with the SG Prime Services CTA Index up 4.2% and

the SG Prime Services Short Term Traders Index up 6%, at the time of writing in early March. The CTA sub-index of the Nordic Hedge Index (NHX) even being up a whopping 9,6%. This compares to a mere 0.6% for NHX composite across all strategies, proving to things: (1) Benchmarking is pretty fun when in your favor, and (2) the dead cat is about to bounce again - but this one seems to have well over nine lives.

Macro strategies, also known for their potential to deliver lumpy returns, have disappointed return-hungry investors in recent years. With central bank interventions creating an environment with few opportunities and suppressed volatility levels, many macro strategies have failed to deliver on their promises. But is Macro today another dead cat bounce in the making? Asking allocators and managers alike, there seems to be a common belief that the tide is about to turn to these managers´ favor.

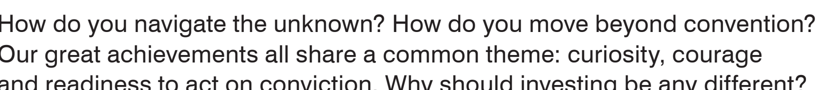
Diverging monetary policies, a normalisation of interest rates in the US and central banks having less impact on financial markets are all reasons mentioned to have a positive effect on the strategy going forward.

Often thrown in the same investment category bucket, Macro and CTA funds are typically viewed as having similar characteristics. *("Who cares?", one may say, "as long as the bouncing dead cat does not finally kick that bucket.")* Although there are similar traits, the strategies also differ in important aspects. An overview of the last 15 years performance shows that there is an apparent correlation of returns, however individual periods show significant performance dispersion. In this report we did combine the two strategies, each in itself of course anything but a homogenous group of traders.

As always in our Industry Reports we attempted to have a balanced mix of articles written by our own editorial team and others submitted by industry experts. In the heavy academic, research driven CTA and Macro space thirsting for ever more data and insight a particularly grateful industry for such an approach. But then, we all know what finally killed the cat…

Kamran G. Ghalitschi
CEO / Publisher HedgeNordic

READY
TOMORROW
TODAY



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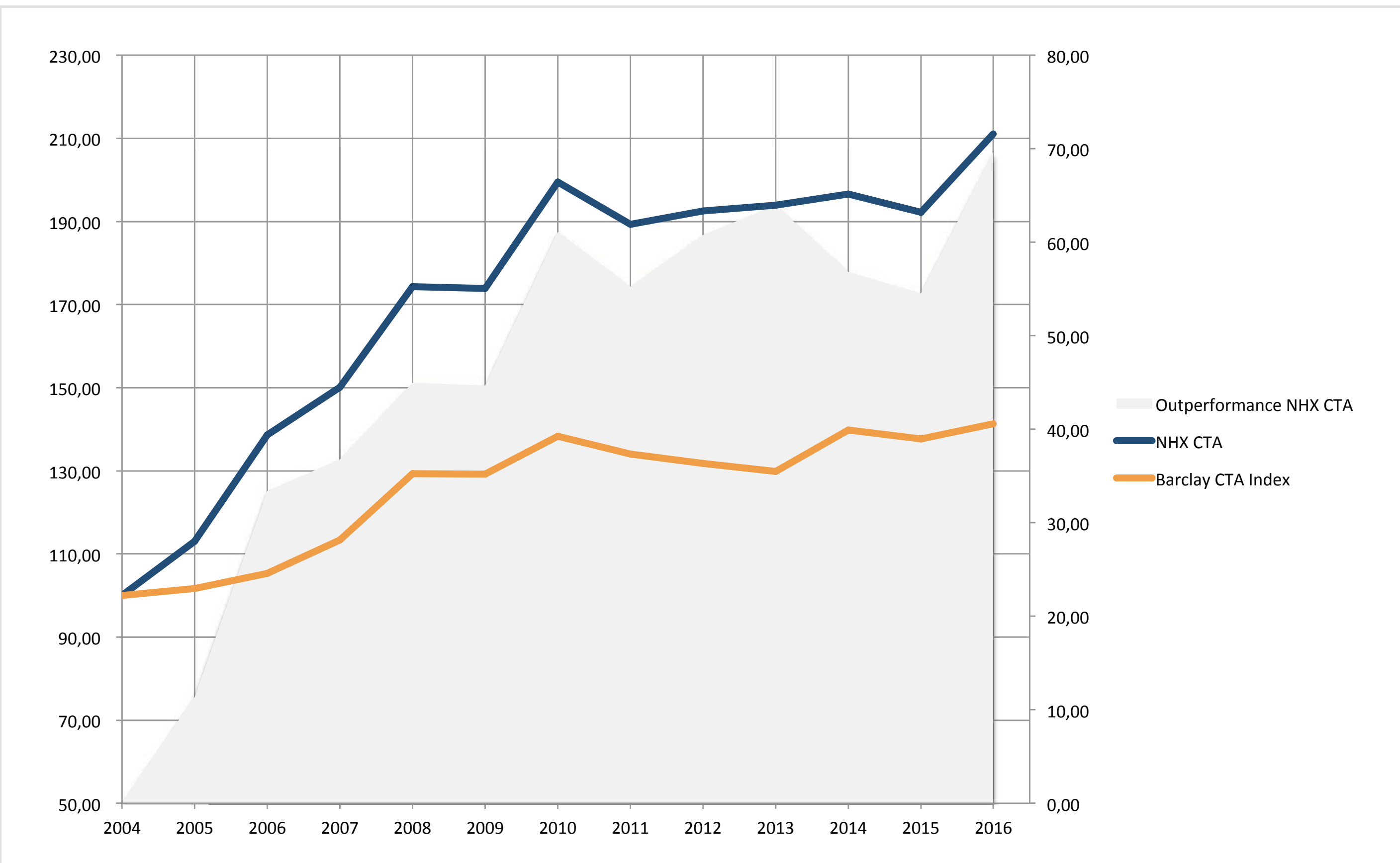
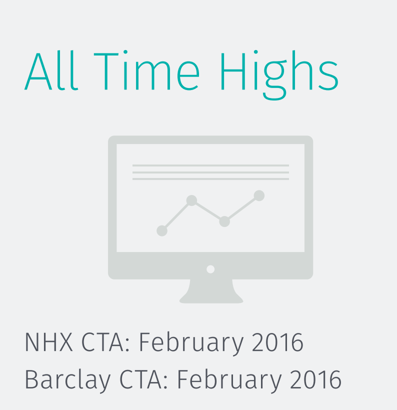
Nordic CTAs vs international Peers

This page spread compares the performance of the Nordic CTA space (NHX CTA) to Barclay CTA Index, since inception of NHX CTA in December 2004 with some random facts. ALL numbers are in absolute terms and not adjusted for volatility.



Source: nhx.hedgenordic.com, BarclayHedge per Feb. 29 2016

All Time Highs

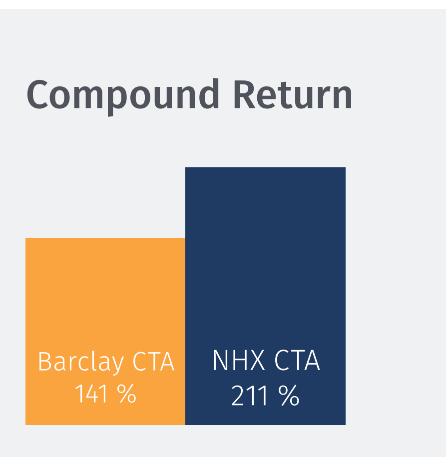


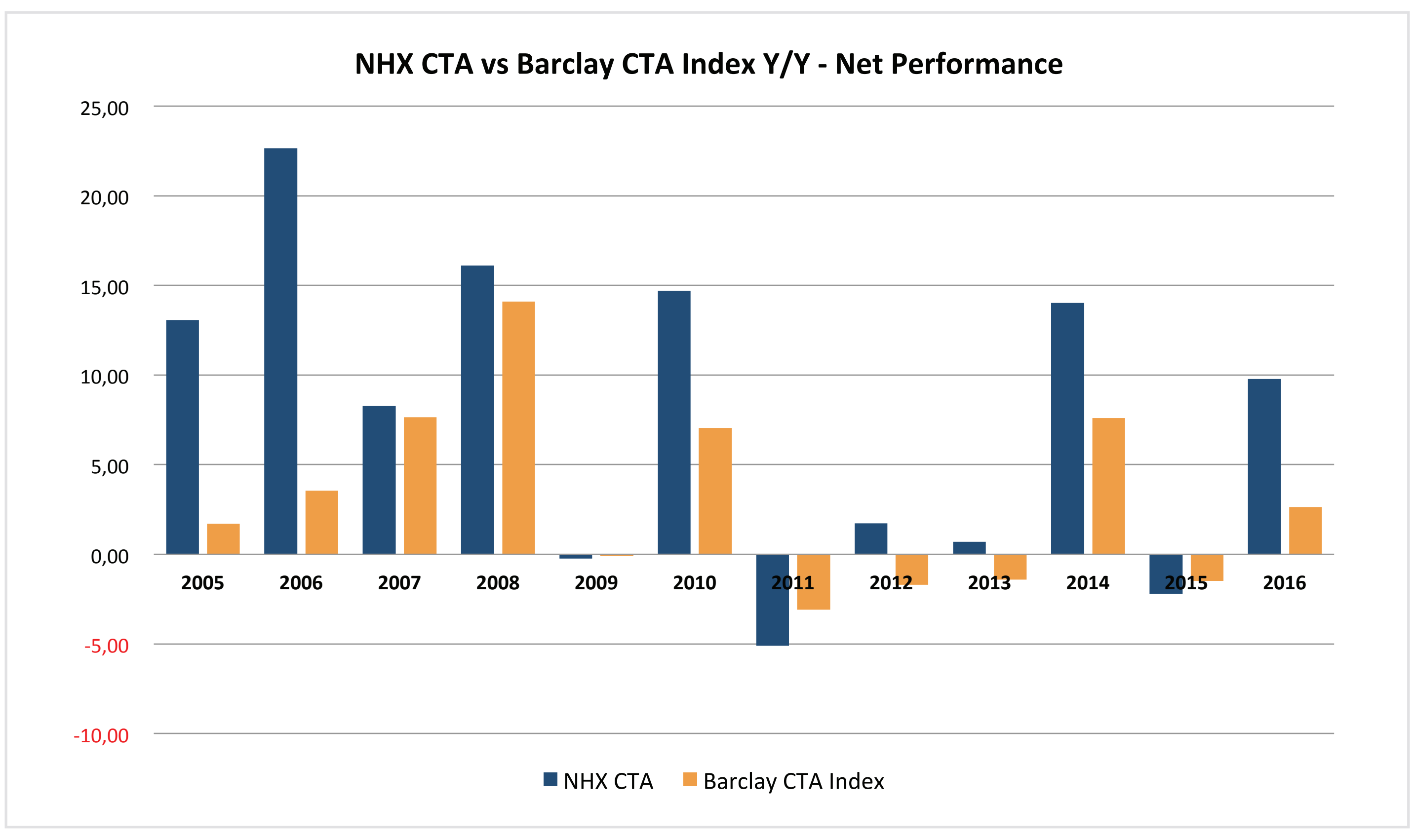
NHX CTA: February 2016
Barclay CTA: February 2016

Correlation

NHX CTA / Barclay CTA

Compound Return

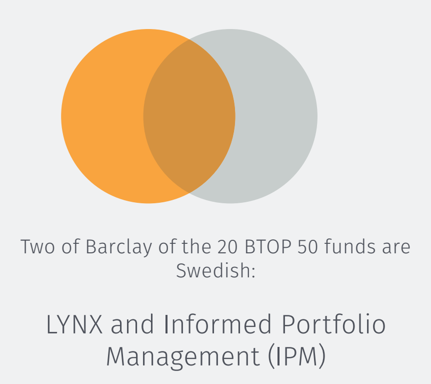




Source: nhx.hedgenordic.com, BarclayHedge, per Feb. 29 2016

Getting Close

The three years the two indices showed the closest returns were 2007, 2008 and 2009.



Two of Barclay of the 20 BTOP 50 funds are Swedish:

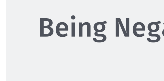
LYNX and Informed Portfolio Management (IPM)

Double Digits

NHX CTA had five years in which it returned double digit figures, Barclay CTA Index two

Every time both NHX CTA and Barclay CTA Indices had negative years, the Nordic managers underperformed.

In every “up year” of Barclay CTA Index, NHX CTA was up more



Being Negative

In the twelve years since the NHX is calculated, NHX CTA had three negative years, compared to five negative years for Barclay CTA Index

2015 – A YEAR TO FORGET FOR CTAS

By Jonathan Furelid

2015 offered somewhat tricky trading conditions where financial markets went from a risk-on stance in the first five months of the year to a risk-off mode starting during the summer as concerns over the Chinese economy and a collapsing oil price mounted. Nevertheless, the CTA-year of 2015 must be regarded as disappointing given exploitable trends seen in energies, metals and currency markets in particular.

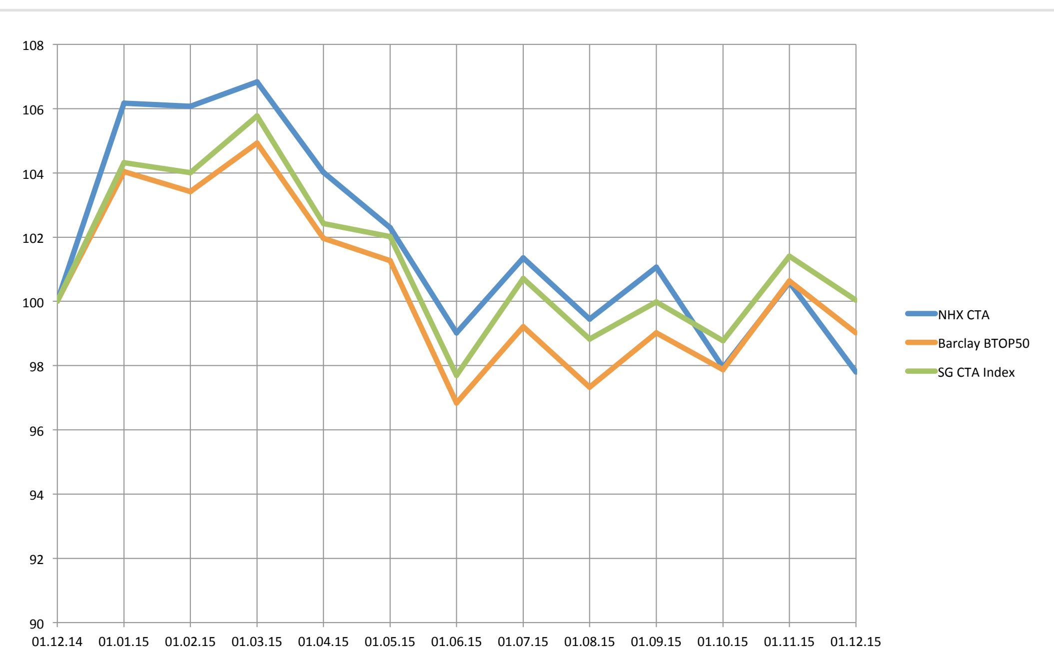
Nordic CTAs, as defined as the NHX CTA index, posted a loss of 2.2 percent in 2015, trailing leading industry benchmarks. The Barclay BTOP50 Index ended the year down 1.0 percent while the Newedge CTA indices (nowadays called the SG Prime Services Indices) finished the year more or less unchanged.

The year started off on a positive note for Nordic CTA managers as the risk seeking environment in the first quarter of 2015 benefited trend followers in particular. However, as the year progressed, Nordic CTAs failed to keep up with industry peers and fell behind during the market turbulence experienced in December (see chart 1).

Among Nordic CTA sub-strategy groups, trend following managers were generally down with industry giant LYNX posting a -7.9 percent loss for the year. SEB Asset Selection also struggled finishing down -1.5 percent. Nordea's Heracles Long/Short MI Fund was the big loser among trend followers posting a loss of -13 percent year-to-date.

Among sector specific CTAs, commodity focused MG Commodity had a stellar year, putting in a positive 12.5 percent to a very low volatility profile. The Swedish quant FX program, IPM Systematic Currency, also managed to eak out a 2.6 percent gain, following a strong run in December.

CHART 1. NHX CTA VS. BARCLAY BTOP50 AND SG CTA INDEX



Nordic CTA mangers as defined by NHX CTA compared to barclay BTOP50 and SG CTA index. Source HedgeNordic, BarclayHedge and SG Prime Services

On the Macro side, IPM's systematic Macro fund also did well gaining 4.4 percent on the year. Estlander's Global Markets program was closed during the year and taken out of the comparison.

Another program that decided to close to outside investors during the year was Romanesco's Persistence Program. The only short-term CTA program left in the comparison is thus the Estlander Presto account which suffered losses of -6.4 percent in 2015.

On the multi-manager front, the funds offered by Swedish CTA-specialist RPM showed mixed returns during the year. The RPM Evolving Fund, investing into smaller up and coming CTA managers lost -4.1 percent while the GALAXY fund, that invests into a set of more established CTA-names, gained 3.1 percent.

GALAXY is a newly added fund to the comparison given RPM's decision to make the fund available to investors in the Nordics through Swedish fund platforms, the full track record dates back to 2008.

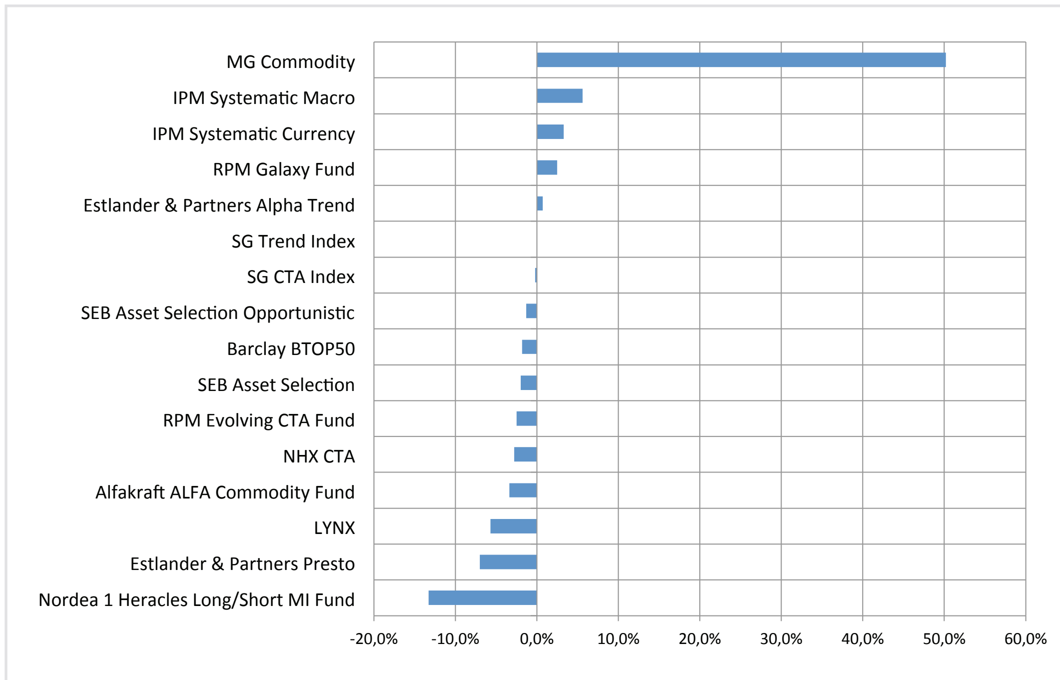
Table 1 summarises returns for the risk-adjusted returns for Nordic CTAs in the fourth quarter of 2015 as well as for the full year. All programs have been adjusted to the average volatility of Nordic CTAs (11.5 percent). Chart 2 ranks the 2015 performance for individual CTAs adjusting the programs to equal volatility.

RISK ADJUSTED TABLE FOR NORDIC CTAS IN Q4 AND 2015

Manager/Program	Volatility**	Oct	Nov	Dec	Q4 2015	2015
Trend Following						
Alfakraft ALFA Commodity Fund	11,5%	-1,5%	3,8%	-4,6%	-2,5%	-3,4%
LYNX	11,5%	-1,2%	2,2%	-2,8%	-1,9%	-5,7%
Estlander & Partners Alpha Trend	11,5%	-6,6%	3,1%	-2,4%	-6,0%	0,7%
Nordea 1 Heracles Long/Short MI Fund	11,5%	-4,4%	0,7%	-3,6%	-7,2%	-13,3%
SEB Asset Selection	11,5%	-4,8%	1,0%	-3,0%	-6,8%	-2,0%
SEB Asset Selection Opportunistic	11,5%	-4,9%	1,0%	-2,9%	-6,7%	-1,3%
Average	**11,5%**	**-3,9%**	**2,0%**	**-3,2%**	-5,2%	-4,2%
Macro/Fundamental						
IPM Systematic Macro	11,5%	-3,9%	-3,1%	2,5%	-4,6%	5,6%
Average	**11,5%**	**-3,9%**	**-3,1%**	**2,5%**	-4,6%	5,6%
Commodities						
MG Commodity	11,5%	2,7%	-2,6%	6,7%	6,8%	50,2%
Average	**11,5%**	**2,7%**	**-2,6%**	**6,7%**	6,8%	50,2%
Currencies						
IPM Systematic Currency	11,5%	-4,6%	-4,4%	7,8%	-1,7%	3,3%
Average	**11,5%**	**-4,6%**	**-4,4%**	**7,8%**	-1,7%	3,3%
Short-Term						
Estlander & Partners Presto	11,5%	4,3%	1,8%	-4,8%	1,1%	-7,0%
Average	**11,5%**	**4,3%**	**1,8%**	**-4,8%**	1,1%	-7,0%
Multi-Manager						
RPM Evolving CTA Fund	11,5%	-1,5%	3,8%	-3,4%	-1,2%	-2,5%
RPM Galaxy Fund	11,5%	-2,2%	6,0%	-3,8%	-0,4%	2,5%
Average	**11,5%**	**-1,5%**	**3,8%**	**-3,4%**	-1,2%	-2,5%
Nordic CTA Average	**11,5%**	**-2,8%**	**1,0%**	**-0,7%**	**-2,5%**	**3,5%**
Benchmarks						
Barclay BTOP50	11,5%	-1,8%	4,4%	-2,5%	-0,0%	-1,8%
SG CTA Index	11,5%	-1,7%	3,7%	-1,9%	0,1%	-0,2%
SG Trend Index	11,5%	-2,7%	3,5%	-2,2%	-1,5%	0,0%
NHX CTA	11,5%	-3,8%	3,3%	-3,4%	-4,0%	-2,8%
Benchmark Average	**11,5%**	**-2,5%**	**3,7%**	**-2,5%**	**-1,4%**	**-1,2%**

** Volatility adjusted to 11.5% annualized for all programs which is the average volatility for all managers in the NHX CTA category.

CHART 2. RISK ADJUSTED RETURNS FOR NORDIC CTAS 2015



Ranking of Nordic CTA returns 2015. All programs adjusted to equal volatility. Source HedgeNordic

The indisputable winner for the year is MG Commodity while the Nordic CTA space overall struggled.

So what is in the cards for CTAs in 2016? A heightened risk awareness in global financial markets might be a trigger for CTAs to start delivering outsized and uncorrelated returns again. Mounting fears for a slowdown in China, collapsing oil prices, the Feds hiking cycle leading to increased global interest rates divergence are only a few factors that may play into this. As always, CTAs tend to work well in times of equity market distress, let us see if the start to 2016 holds any clues about CTA-performance for the full year...

MACRO AND CTA: SAME, SAME *BUT* DIFFERENT

By Jonathan Furelid

Often lumped together as one hedge fund category, Macro and CTA funds are typically viewed as having similar characteristics. Although there are similar traits, the strategies also differ in important aspects. An overview of the last 15 years performance shows that there is an apparent correlation of returns, however individual periods show significant performance dispersion. Overall, the Macro/CTA category has had a period of non-performance over the last five years.

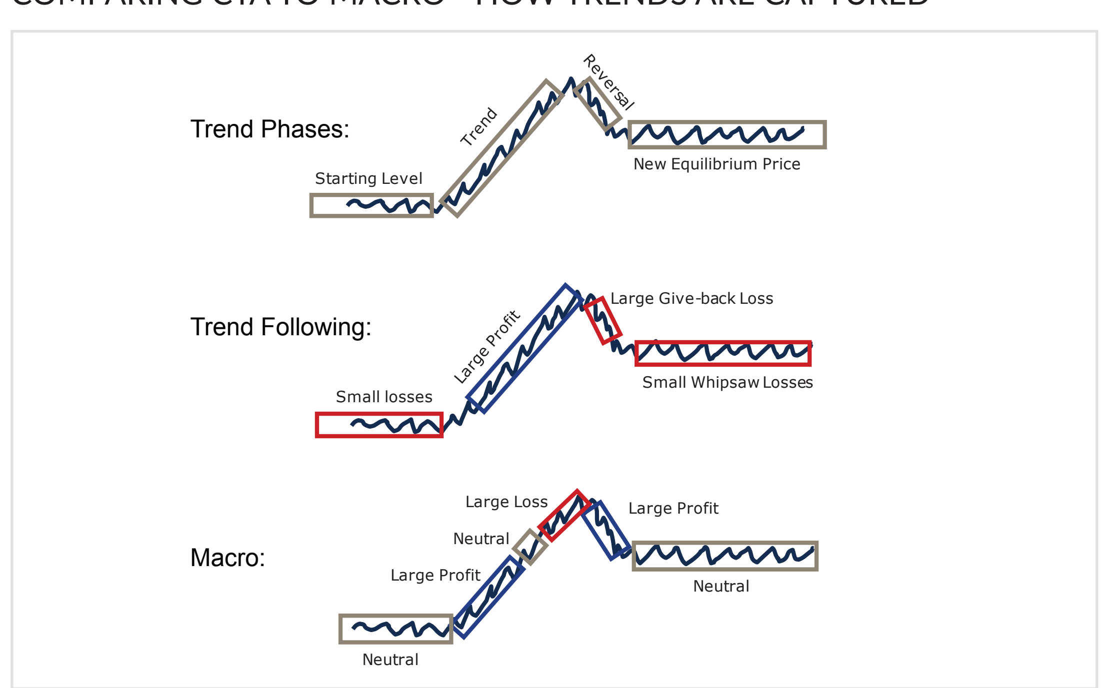
Providers of hedge fund indices typically view Macro and CTA funds as being part of the same strategy group. The fact that both strategies aim at capturing broad market trends in a wide range of asset classes makes the comparison viable, however there are also periods when the individual strategies show great performance dispersion.

Looking at the returns for Macro and CTA strategies over the last 15 years reveals that overall, the strategies follow a similar pattern and hold a steady high correlation but from time to time, correlation breaks (see chart 1 and 3 on page 12 and 13).

Plotting the monthly returns for the HFRI Macro Index and the HFRI Systematic Diversified Index (meaning CTAs), show that returns, apart from 2002, 2009 have followed quite closely, albeit with a clear outperformance for CTAs. On the back of relatively strong years in 2005 and 2006 coupled with exceptional returns during the financial crisis in 2008, CTAs have been the strategy of choice within the Macro category (see chart 1 and 2 on page 12).

But what are the most common traits of these strategies and where do they differ?

COMPARING CTA TO MACRO - HOW TRENDS ARE CAPTURED



The picture to the left shows how trend following and macro typically capture a trend. CTAs incur small losses in whipping markets make large profits during the trend and give back some of these profits when the trend reverses. Macro takes on positions in anticipation of a trend and makes large profits in its early parts, when trends get overextended fundamental PAGE trading typically incur losses (price moves away from fundamentals)

Source: RPM Risk & Portfolio Management

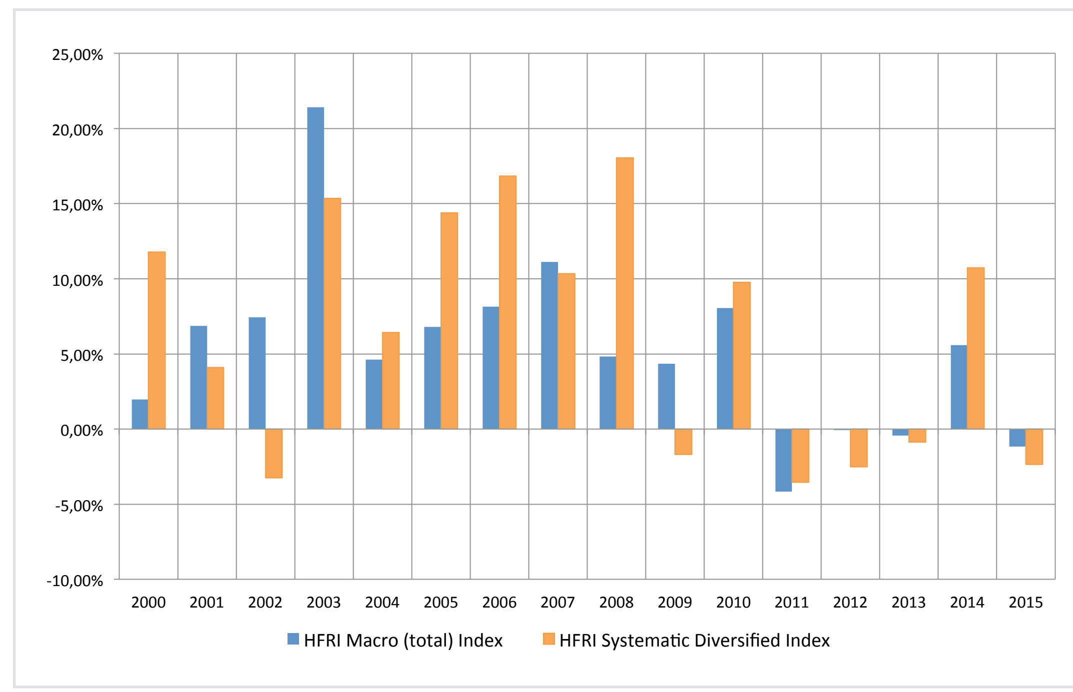
Overall Macro and CTA strategies share a common characteristic of seeking to produce returns when markets move broadly, independent of direction. However, the way they exploit these trends could vary immensely. The CTA category is more homogenous in nature as it looks to detect and exploit price trends by using computer algorithms. At its core, the strategy is trend following meaning that it looks for momentum in a wide range of assets and buys and sells in the direction of the trend. In order for a CTA to start building positions, it needs a price trigger from the underlying market, it does not try to anticipate a market move. Trades are carried through via liquid futures contracts primarily.

The typical Macro strategy, on the other hand, tries to assess the potential impact the fundamental economic data picture on asset prices. It does not need a price trigger in order to move into a position, rather it forms a view on over- and undervalued markets or contracts and buys low and sell high. This means that the typical Macro strategy takes positions ahead of a big market move and moves out of a position when the fundamentally justified value (according to the manager) has been reached. In this way, CTA and Macro complement each other, they capture the same market trends, but in a different fashion.

Generally speaking, Macro strategies are more heterogenous compared to CTAs, they encompass everything from pure systematic strategies to discretionary ones. They often seek to profit from relative value positions rather than outright directional plays and they use a wider range of contracts to express their views.

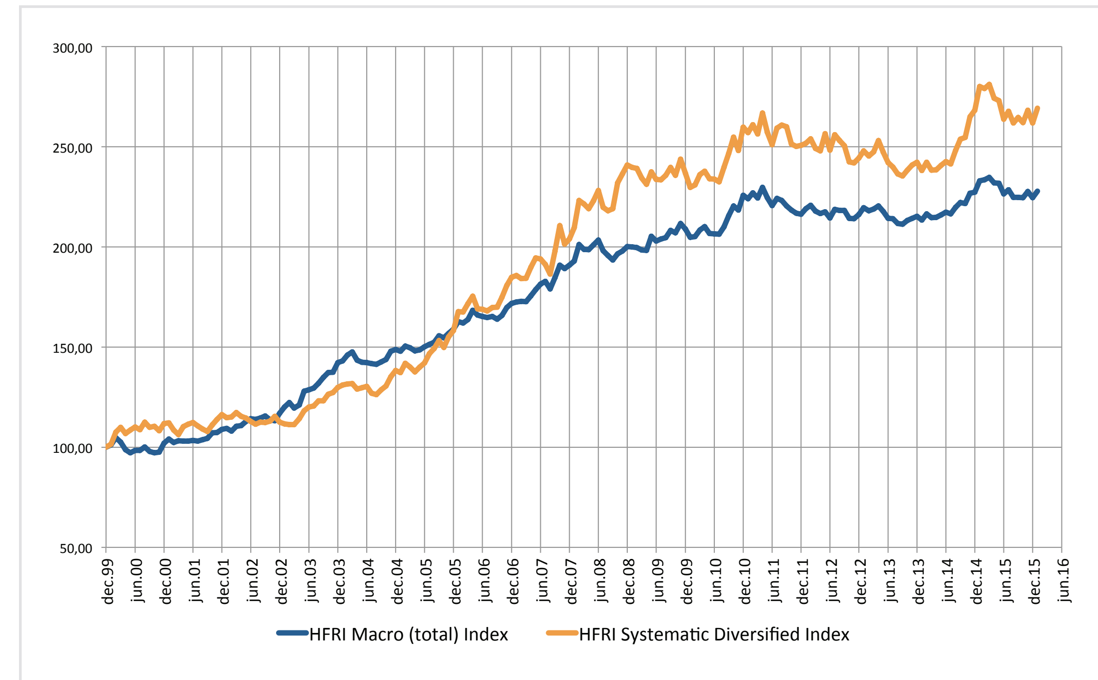
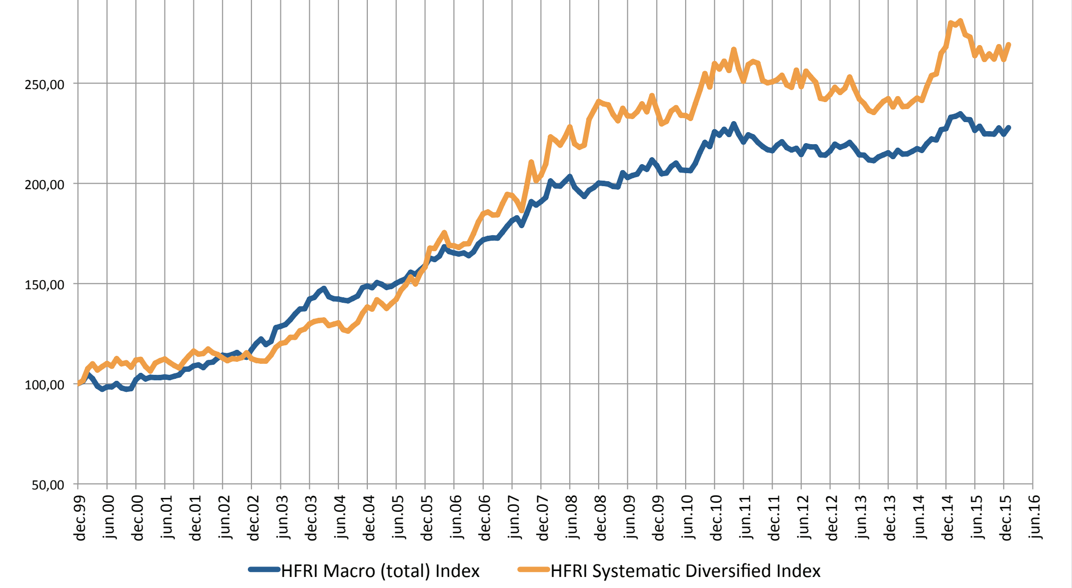
CTAs tend to outperform when market trends get overextended, such as during the financial crisis in 2008 and underperform when trends revert

CHART 1: HFRI MACRO VS HFRI SYSTEMTATIC DIVERSIFIED INDEX YOY



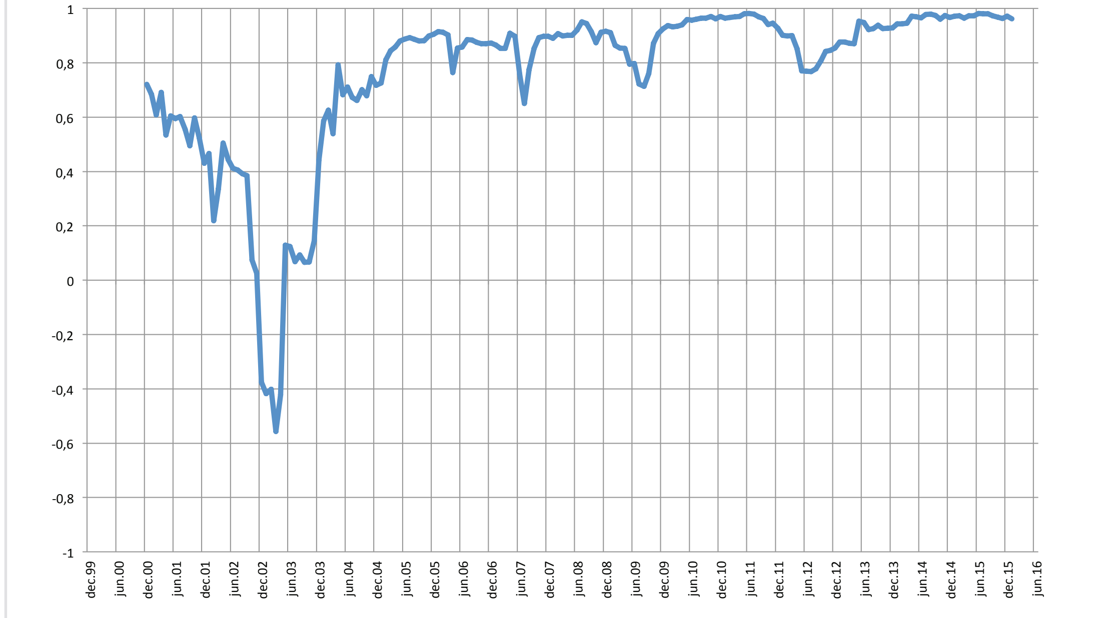
Source: HFR

CHART 2: HFRI MACRO VS HFRI SYSTEMTATIC DIVERSIFIED INDEX CUMULATIVE

Source: HFR

CHART 3: CORRELA'ON HFRI MACRO AND HFRI SYSTEMA'C DIVERSIFIED INDEX



Source: HFR

forcefully which was the case in 2009 when markets came back from the bearish sentiment experienced during the crisis year.

During the last five years, neither Macro nor CTAs have managed to live up to its strong historical performance characteristics, a number of different causes have been discussed among practitioners and academics alike.

Coordinated central bank activity, which has contributed to a lack of realized volatility and sustained trends across many markets has been a widely mentioned reason for the lack of performance in recent years. CTA and Macro managers are reliant on broad market moves and elevated volatility levels in order to perform.

The extremely low interest rate levels have resulted in funds trading futures contracts earning less from their cash collateral. A study conducted by Newedge (now part of Societe Generale) found that between 1990 and 2012, the return on cash collateral accounted for almost 50% of the return to Managed Futures (CTA) strategies.

Remains to be seen if the Feds rate hiking cycle will lead to increased central bank divergence and higher interest rates earned on cash, eventually turning into an improved opportunity-set for Macro and CTA strategies.

Managed Futures and asset flows – was 2015 a turning point?

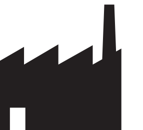
Managed futures recorded net inflows of 13 billion USD in 2015, the universe´s first annual aggregate net inflow since 2011, according to data from eVestment. This was a significant turnaround compared to the year before when the industry recorded a net outflow of 35 billion USD, despite strong performance of the sector. Total assets under management for the industry was estimated at 126 billion USD at year-end (according to eVestment). That number though is not undisputed and subject to calculation and inclusion methodology. BarclayHedge for instance estimates industry asset much higher, at 330 billion USD, which is more likely.

Whether or not a turning point, the asset flows are likely to be a reflection of investors search for uncorrelated alpha sources in a time where markets have become increasingly volatile. CTAs, widely known for their ability to produce outsized returns in difficult market environments, tend to receive investors attention every four year or so. It remains to be seen if the recent uptick in assets is a blip on the screen or the start to a more positive trend.

Judging from a recently published Prequin study CTAs retain positive sentiment among investors, despite negative performance in 2015, Barclay CTA Index and HFRX Macro/CTA Index both estimating 2015 at-1,5%. According to the study, some 27% of hedge fund investors plan to increase CTA exposure over 2016. If these numbers prove correct and if CTAs are in for a period with relatively strong performance, we are likely to see asset levels pick up significantly from these levels.

However, most likely only benefiting a selected few.

One trend that has been going on for quite some time in the Managed Futures industry is the ”big get´s bigger” theme. That trend was confirmed by eVestment in their latest hedge fund asset flow study that showed large managers accounted for as good as all of the new CTA allocations received at an aggregate level.



1080

Number of CTAs tracked by BarclayHedge

50%

Half of CTA industry assets is managed by 20 funds represented by Barclay BTOP50 Index

13 BUSD

Amount of new assets carried to CTA managers by investors during 2015

Table: Big get's bigger, 20 names that represent 50% of industry assets

	AUM (BUSD)
AQR Capital Mgmt. (Managed Futures Offshore)*	10,10
AlphaSimplex Group (Managed Futures)*	3,06
Aspect Capital (Diversified)	5,01
Boronia Capital (Diversified)	0,80
Campbell & Company (Campbell Managed Futures)	4,73
Cantab Capital Partners (CCP Quant Fund Aristarchus)	2,70
Crabel Capital Management (Multi-Product A)	1,84
FDO Partners (Global Quant Currency)*	2,95
FORT LP (Global Contrarian)*	1,59
First Quadrant LP (Tactical Currency Allocation L/S)*	2,20
Graham Capital Mgmt. (K4D-15V)	6,19
Informed Portfolio Management (IPM Systematic Macro)	1,62
ISAM LLP (Systematic Trend)*	1,12
Lynx Asset Management (Lynx Bermuda D)	6,08
Man Investments (Man AHL Diversified Plc)	17,90
Millburn Ridgefield Corp (Diversified Program)	0,94
QMS Capital Mgmt. (Diversified Global Macro)*	2,69
SEB Asset Mgmt. (SEB Asset Selection)	1,60
Systematica Investments (BlueTrend)*	7,70
Transtrend BV (DTP Enhanced Risk)	5,89

Source: SG CTA Index – all numbers from the BarclayHedge database per Jan 31st 2016.

The small number of managers included in the BarclayHedge BTOP50 Index, a CTA benchmark looking to capture 50% of the assets managed by CTAs globally, highlights the concentration of assets. Among the 1080 CTA names tracked by BarclayHedge, only 20 names show up in the BTOP50. This indicates that less than 2% of the world's CTAs are entrusted with more than 50% of total industry assets. Two names among the constituents, LYNX and Informed Portfolio Management (IPM), have a Nordic connection.

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CTAs and Macro in a Multi-Strategy Context

BY JONATHAN FURELID / HEDGENORDIC

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

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

The current portfolio holds an allocation of around 40% to CTA and Macro. Other strategies include Long/Short Equity, Equity Market Neutral and Multi-Strategy hedge funds. The focus is on European managers. "While the original idea was to only include Nordic names, this became too great a limitation as the fund grew, but following our decision to make the fund available in a daily liquidity format, we still hold a few Nordic names", Tjeder explains.

The CTA part of the portfolio is, for the most part, made up of trend following strategies. As these strategies tend to have a volatility profile higher than that of the regular hedge fund, the risk profile of the fund also tends to vary over time, according to Tjeder.

"We are looking to keep the volatility of the fund in the range of 2-8%, annualized. But we will allow the portfolio to exceed that range in the short term in order

Johan Tjeder, Portfolio Manager of Atlant Multi-Strategy External (AMSE)

to reach our stated return target," Tjeder says, adding that: " given the trend-following nature of the CTA allocation, you need to allow for somewhat higher volatility levels from time to time. Periods of strong CTA performance typically coincide with the managers adding to risk." One also must take into account the diversification effect in the fund; currently it sits at roughly 50%, i.e. half of the individual funds' volatility are mitigated by the low internal correlation of the holdings.

Tjeder is treating the CTA and Macro part of the portfolio as separate risk buckets, rather than lumping them together, which is a regular exercise among providers of hedge fund benchmarks.

"CTAs and Macro could be seen as having overlapping characteristics. For example, you should expect them to capture broad market trends as they unfold, both from the long and the short side. There are, however, distinct differences in the way they seek to capture trends", explains Tjeder, suggesting that.

"While CTAs need price to confirm the direction of a trend, a Macro manager could anticipate the trend by looking at fundamental input factors. According to the same logic, CTAs need a price trend reversal in order to reduce risk, while the Macro manager typically reduces risk or extricates himself from a trade when he sees a fundamental valuation level being reached. There are diversification benefits to be gained by including both CTA and Macro in a portfolio context."

When selecting managers, Tjeder follows a rigorous process in order to find strategies that could contribute positively to the overall risk/return characteristics of the fund. Over time, the portfolio is expected to hold 15-20 names and in any given year, the d turnover of managers will depend on the extent to which holdings live up to expectations, but Tjeder expects to exchange 2 to 3 managers a year, while of course hoping for none. The fact is that the sell process is also built on a quantitative model.

"For each fund we do have an expected return and an expected volatility. This means that when there is an unexpected negative move, we directly calculate the probability of such a move, and given the level of that probability in relation to the rest of the fund's performance, we decide if we are going to reduce, sell or hold", Tjeder says.

The fact that Atlant Multi-Strategy External is a fund of hedge funds makes the focus on manager fees a crucial consideration when selecting funds to the portfolio, according to Tjeder. Going the hedge fund replication path, i.e. selecting programs that are replicating a style factor such as trend-following to a significantly lower cost, has, however, not been considered a viable approach so far.

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

Man AHL on Style Drift Development Versus Deviation

BY KAMRAN GHALITSCHI / HEDGENORDIC

Quantitative managers constantly strive to improve their models and systems. When are changes advances or evolutions – and when should changes be deemed deviations or, that dreaded 'red flag' of fund allocators, 'style drift'? We had the opportunity to discuss the topic with AHLs CEO, Sandy Rattray, and here is what he had to say:

HedgeNordic: One frequently hears from the big CTAs that they have "never amended their systems" and models are essentially the same as decades ago. Still you employ herds of PhDs, sponsor universities and scholarships, organize youth competitions and put big budgets aside for research and development. What is the rationale behind this?

Sandy Rattray: Although still trend-following at their core, AHL's momentum programmes have certainly evolved in our near three decade long history. Broadly, there have been two strands to the research effort. First, model research has progressed from the original binary systems to continuous and discrete models operating over a range of trading speeds, spanning a few days to the best part of a year. Currently a research focus is on trend-following using machine learning, harnessing the expertise of the University of Oxford whose experience in this space extends to the aviation and motor industries.

The second research thread concerns market access. Trends do not typically exist in individual markets all of the time, so trend-followers try to diversify as much as possible by trading a wide variety of uncorrelated markets. The number of markets accessed by AHL's momentum flagship strategies now totals around 450, doubling since 2008.

HedgeNordic: At a quant house such as AHL there likely are constantly new models being developed and tested. In the process to implement them to the "live" trading system, are there discussions / considerations if they, and to what extent, could at least partially lead to a style drift?

Sandy Rattray: The research effort at AHL is indeed continuous and there exists a rigorous process for translating a research idea into a tradable strategy in client portfolios.

As a fully-fledged quantitative manager, we are able to offer our clients a range of systematic programmes, which means that there is no need for style drift in any one of them. As an example, a new momentum model or existing model applied to a new market would naturally find its way into one of AHL's momentum programmes. A new mean reversion or fundamental strategy would naturally find its home in AHL's multi-strategy programme, AHL Dimension.

HedgeNordic: In the long history of AHL, what would you say were the most crucial innovations / adaptions you undertook to stay competitive?

Sandy Rattray: In a history as long as AHL's, it will not surprise you to hear that picking just one is a hard task. However, if pushed, we would have to point to our access of non-traditional CTA markets, which began with the inception of the AHL Evolution Programme in 2005. This applies AHL's predominantly directional trading models to a unique set of markets, which are generally not traded by other CTAs. Besides the significant research effort required to move into these new asset classes, their operational complexity means that access is limited to managers with scale, strong industry links and meticulous counterparty risk management. Crucially, many of these markets are less influenced directly by the 'risk on/risk off' fluctuations that have been triggered by the on-going sovereign debt crisis. As a result, the AHL Evolution Programme generated strong returns, even over the 2009-13 period– one in which most trend-following CTAs have struggled.

HedgeNordic: How much is AHL today still the same beast it was 25 years ago? What areas largely stayed the same and which changed quite a bit?

Sandy Rattray: When Henry Ford first unveiled his Model T to the world it had four wheels and could transport four people from A to B. Today's self -driving prototypes also have four wheels and can transport their passengers wherever they need to go. But are they the same beast? Clearly not. Our models evolve, just like cars do. In fact, pushing this analogy further, some of our latest algorithms are machine learning ones, just like the ones in Google's driverless cars.

HedgeNordic: In an interview you said "fund management is especially difficult when a strategy is not working or worse when a fund is doing badly. There's pressure from many places to "fix it". And fixing it generally means changing it." In AHLs long history, was there ever the occurrence that "fixing it" and being impatient actually was / would have been the better approach – even in the long run?

Sandy Rattray: People tend to want to 'fix it' when they believe something is broken. The time that springs to mind was when momentum was perceived to be not working in the years immediately following the credit crisis. First of all, to get this period into perspective, trend-following strategies had broadly flat returns between 2009 and 2013, which is a long way from the 50% losses that equities experienced during the credit crisis.

At AHL, what we knew was that trends had been witnessed in markets for centuries, and that the period in question was characterized by unprecedented central bank activity which upset trends in two ways; first by causing strong reversals (remember what Hank Paulson's bazooka did to equity markets in 2009?), and by raising correlation ('risk-on, risk-off' markets) which removes the diversification we seek by trading hundreds of markets. Hence we felt there were good reasons for trend-following algorithms to struggle during this period, but we did not believe that momentum was broken.

By the same token, investors didn't give up on value investing just because value signals in equities did not perform as well as expected for five years in the late 1990's.

Further, we could see that momentum in the AHL Evolution Programme was still working. Its Sharpe ratio over the same period is in excess of one. As we describe above, Evolution accesses a range of non-traditional markets whose price drivers are less geopolitical or macro-economic than the futures and FX forward markets which are the traditional fayre of many trend-followers. Thus we knew momentum was still working, but we just had to look in a different place to find it.

HedgeNordic: To what extent would you say adapting a strategy to certain fund regimes, such as UCITS, can be described as style drift. After all, one must compromise on instruments, or underlying markets one can trade (e.g.: commodities) which may well have an effect on overall portfolio composition, internal correlations, risk allocations etc. Is that not a clear divergence from the defined investment style?

Sandy Rattray: UCITS structures give investors' confidence through their strong regulation and high level of investor protection, and Man AHL offers a range of UCITS compatible programmes. However, as a consequence, UCITS does impose constraints on a strategy, by limiting the range of instruments that can be traded, or limiting leverage, for example. Nevertheless we would not view this as causing style drift. Trend-followers trade a broad array of markets across multiple asset classes in order to maximize diversification and capture trends wherever they might be found. Stopping the direct trading of commodity markets, as UCITS requires, restricts the investment universe but it doesn't change the style, in our opinion.

> A DEFINITION OF STYLE DRIFT
> BY FARLEX FINANCIAL DICTIONARY
>
> A situation in which a mutual fund's investment strategies or goals change from what they were originally. Style drift can be explicit or implicit. For example, style drift may occur implicitly when a fund manager seeks ever-larger returns for shareholders and tries out any number of investment strategies to achieve them. This is usually thought to be naive or even dangerous. Style drift can arise explicitly when a fund's situation has changed a significant amount; for example, a stock in the fund may grow to the point where it is advantageous for the fund to change its capitalization requirements.

HedgeNordic: How does that look (referring to above questions) with bespoke solutions for investors, or customized managed accounts to meet clients' needs or requirements?

Sandy Rattray: As an established quantitative manager, AHL is well placed to offer bespoke solutions to clients that are tailored to their individual needs. It already offers a range of 'off the shelf' products giving investors access to its strategies, which exist internally in modular form. Bespoke solutions involve tailoring the selection of these modules to individual client needs. Man Group's in-house structuring and legal teams facilitate this process.

HedgeNordic: Is an emerging manager, with much shorter track record and small AuM more likely in your opinion to style drift, or compromise on trading approach in order to attract allocations while a larger, more confident manager may walk away from the "ticket" and not compromise on trading approach?

Sandy Rattray: As a fully-fledged quantitative manager, AHL is not solely dependent on momentum in futures markets working in order to be profitable. AHL trades a range of quantitative styles. In addition, being part of Man Group, one of the world's largest alternative managers, decreases this reliance on momentum further. It is possible that smaller managers would be under pressure to style drift if their dominant strategy is facing challenges.

HedgeNordic: The high concentration of AuM to a few names in the CTA space is commonly mentioned as a potential problem (capacity issues resulting in deteriorating performance). To what extent do you tweak the system to be able to handle a larger asset base? Could that make the program style drift in the end?

Sandy Rattray: We used to hear this question from clients, particularly in 2009-13 when returns from trend followers were muted. After a 30+% year in 2014 this issue does not arise so much! We should also point out in addition that we do not see trend-followers as being any bigger in terms of futures volumes or open interest than they have historically been.

Nevertheless, at AHL we are cognizant of the risk, and this is one of the reasons that we try and trade as many markets as we possibly can. We want to maximize diversification and also limit concentration. In our flagship programmes we now trade around 450 markets, which is around double the count of 2008 and higher than our peers.

HedgeNordic: Can in your opinion a change that does not affect the trading strategy, signal generation etc. but have an affect on other components, such as a change to order execution fulfill criteria of style drifting? (Example: CTA always has marketed and declared itself to be fully systematic, but then decides for whatever reason, some orders/markets/contracts are better executed "manually" to improve slippage)

Sandy Rattray: AHL is fully committed to best execution for its clients, which means minimizing slippage, defined as the difference between the sampled price in the market and the executed price. Rigorous analysis of trade data by AHL's execution research team shows that the biggest trades achieve the lowest slippage when executed by human traders, whereas algorithms handle smaller trades more efficiently. The reasons for this are fairly intuitive; humans can source liquidity in different places, where dealers may be axed to trade in a certain direction, for example. Note, however, that whether a trade is executed by a human or algorithm, the trade is systematically generated and there is no discretion as to whether execution occurs. Hence we would view this as cost minimization and not style drift.

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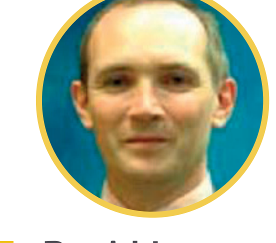
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by Marat Molyboga & Christophe L'Ahelec

Methodology for evaluation of hedge fund decisions

Marat Molyboga, CFA is the Head of Research and Chief Risk Officer at Efficient Capital Management, and an Adjunct Professor of Finance at Stuart School of Business.

Christophe L'Ahelec, CFA is an Assistant Portfolio Manager at Ontario Teachers' Pension Plan.

As the hedge fund industry has grown to about US $3 trillion in assets under management (AUM) in the first quarter of 2015 and represents a significant portion of institutional portfolios, academic and industry publications have provided valuable insights into certain aspects of portfolio management, particularly in the area of fund evaluation and portfolio construction.

Yet there is an apparent lack of a robust and flexible methodology that is capable of evaluating whether those insights can benefit a specific institutional investor once implemented with real world constraints.

There are several important challenges that need to be carefully dealt with. One – investors have their own objectives that vary substantially depending on the type of institution.

For example, a family office or an asset management firm might seek to maximize Sharpe ratio, a university endowment attempts to target returns that exceed the university's spending rate over a market cycle, and a pension fund pursues maximization of risk-adjusted return within an asset-liability framework. Two – sophisticated investors often impose rigorous filtering criteria or show stoppers such as the length of a track record and level of AUM. Most academic studies either completely ignore these show stoppers or selectively incorporate some of them with the purpose of accounting for certain biases such as small fund bias or incubation bias.

While accounting for biases is important, an institutional investor ultimately wants to know whether he will be able to benefit from a portfolio management technique given his own set of preferences and constraints. Three – most academic papers often compare portfolios that include hundreds of funds which might be irrelevant to an investor who plans to hire three to five hedge funds. By contrast, such investor would be interested in knowing the impact of his manager selection and portfolio construction decisions on the outcome distribution.

Generating out-of-sample results for multiple subsets of five manager portfolios within in a simulation framework gives that information. Four – the investor cares about the marginal impact of the hedge fund investment on his existing portfolio but that is often ignored. Finally, hedge fund databases provide returns with a delay of about one month that is ignored in academic papers, as reported in Molyboga, Baek and Bilson (2015), creating a significant barrier to implementing results of most studies.

In our research paper, "A simulation-based methodology for evaluating hedge fund investments", we introduce a methodology that is designed to evaluate hedge funds' investments subject to the realistic constraints of institutional investors. The methodology is customizable to the real-life preferences and constraints of investors, including investment objectives, performance benchmarks, desired number of funds in a portfolio, and rebalancing frequency. We illustrate the methodology by imposing the framework on a dataset of Commodity Trading Advisors with 604 active and 1,323 defunct funds over the period 1993-2014. We then measure the out-of-sample performance of three hypothetical risk-parity portfolios and two hypothetical minimum risk portfolios and their marginal contributions to a typical 60-40 portfolio of stocks and bonds.

We find that an investment in CTAs improves performance regardless of the choice of the portfolio construction approach. For the out-of-sample period between January 1999 and December 2014, a 10% allocation to managed futures improves the Sharpe ratio of the original 60-40 portfolio of stocks and bonds from 0.376 to 0.399-0.416 on average, depending on the portfolio construction methodology. Blended portfolios have higher Sharpe ratios in at least 89% of simulations and higher Calmar ratios in at least 89.5% of simulations. Minimum risk portfolios perform the worst for all performance metrics. For example, their average Sharpe ratios are between 0.299 and 0.304, significantly lower than the 0.319 average Sharpe ratio of the random portfolios from both an economic and statistical perspective. By contrast, equal risk methodologies deliver superior average Sharpe ratios of 0.342 to 0.362.
We repeat marginal contribution analysis for the range of CTA allocations between 5% and 60%.

While the empirical findings can immediately benefit institutional investors who evaluate the diversification benefits of managed futures, this analysis is merely an illustration of a methodology that can be applied broadly. We introduce a quantitative large-scale simulation framework for the robust and reliable evaluation of hedge fund investments by institutional investors. The framework is customizable to the preferences and constraints of individual investors, investment objectives, rebalancing periods and the desired number of funds in a portfolio and can include a large number of portfolio construction approaches.

Thus, the methodology can benefit portfolio managers, investment officers, board members and consultants who make hedge fund investment decisions. A full version of the paper is available for download on SSRN.

Figure 1: Distribution of Sharpe, out-of-sample 1/1999 – 12/2014, 10,000 simulations, 5 CTAs

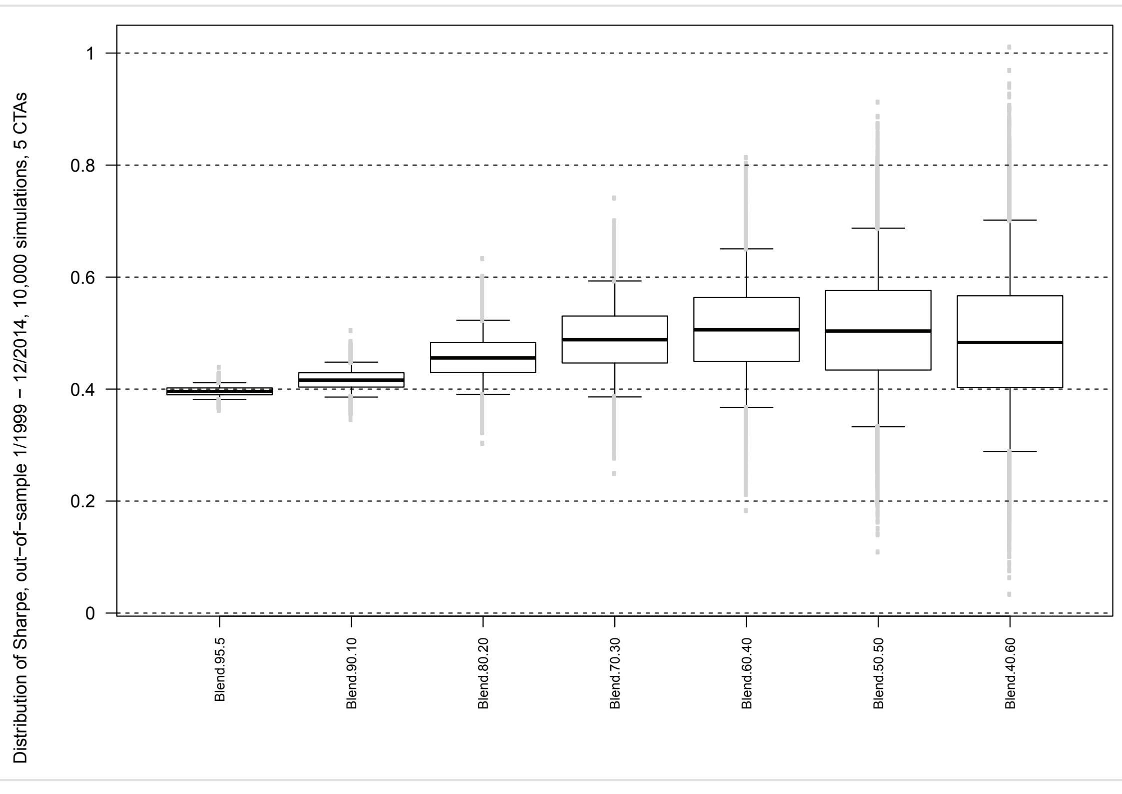

Figure 1 shows that the average Sharpe ratio of blended portfolio reaches its highest value of 0.507 at 40% allocation to equally weighted portfolios of five CTAs, which is substantially higher than 0.376, the Sharpe ratio of the original 60-40 portfolio of stocks and bonds.

Figure 2: Distribution of Calmar, out-of-sample 1/1999 – 12/2014, 10,000 simulations, 5 CTAs

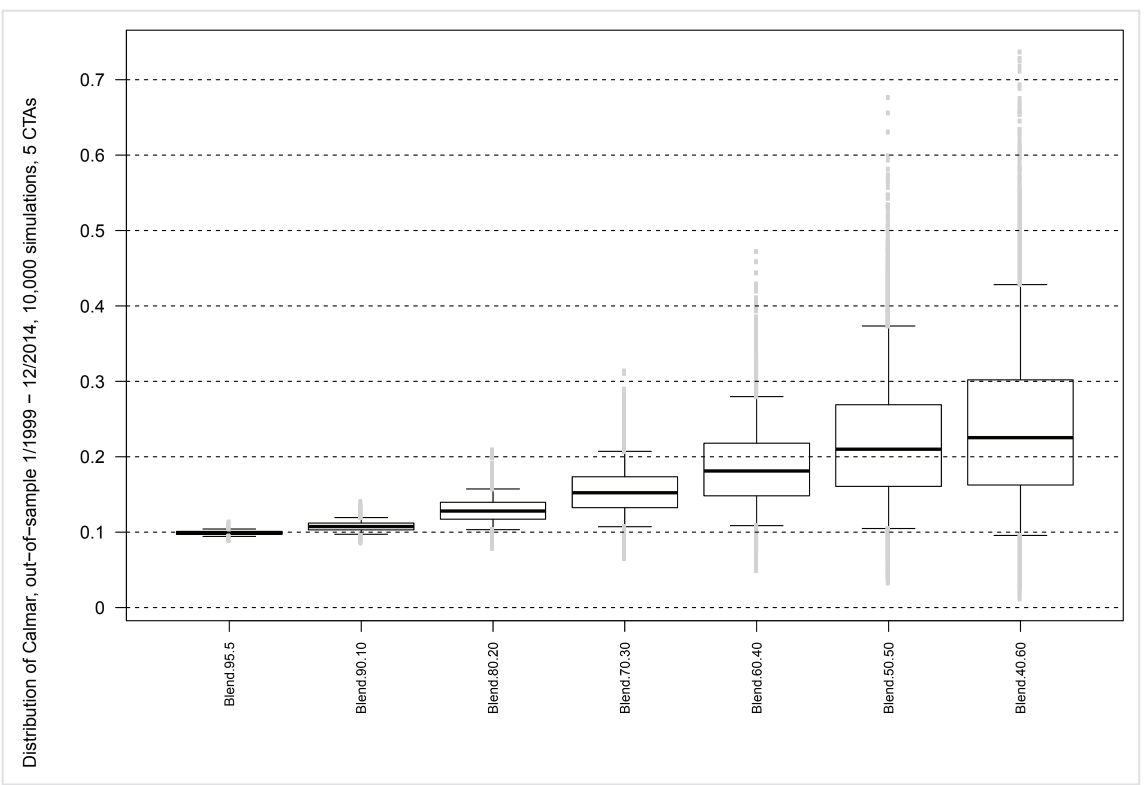

Figure 2 shows that the average Calmar ratio of blended portfolio reaches its highest value of 0.24 at 60% allocation to equally weighted portfolios of five CTAs, which is substantially higher than 0.092, the Calmar ratio of the original 60-40 portfolio of stocks and bonds.

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Michael Stephani

Gernot Heitzinger

A different approach to trend following

by Jonathan Furelid / HedgeNordic

Vienna-based CTA, SMN, has been running their SMN Diversified Futures Fund for close to 20 years. Continued research along the way has resulted in a trend following approach that uses a core momentum strategy with a risk overlay that ensures robustness and drawdown control. The approach has generated above industry returns and had the manager nominated for best CTA below 500 MUSD at this year's EuroHedge Awards as already the year before.

With its roots in the Austrian asset management industry and with clients being primarily local institutions, insurance companies, pension funds, wealth managers and banks, SMN has been a somewhat unknown player in the global Managed Futures space. Despite being one of the pioneers within the Managed Futures industry, only a fraction of the assets is from investors outside the home market.

After the launch of a new share class,"i14", which carries a

lower fee compared to the original program, SMN are now looking to tap into the international pool of CTA investors.

"We have, for historical reasons, been very attached to the local market. We are now launching a new share class that better meets the demand from international investors and better reflects the strong performance characteristics embedded in the program", Gernot Heitzinger, Managing Director at SMN explains, continuing:

"The performance of the program during the last few years has been highly competitive and also reflects the developments we have carried through on the research side. This has resulted in a number of characteristics that we deem stand out compared to the competition", Heitzinger says.

Among the features Heitzinger sees as key differentiators to classical long term trend following programs, three are highlighted as being particularly important.

"First of all, we hold a higher allocation to smaller markets, most of them in the commodity space, as well as to synthetic markets. Secondly, the system uses short-term correlation data in order reduce risk concentrations in the portfolio. Thirdly, a dynamic risk budgeting tool based on the overall market risk regime allow us to be more selective in our position taking", Heitzinger says.

The relatively high allocation to commodities and the two risk overlay tools were, according to the manager, the main reasons why SMN generated outsized returns in 2014. A year in which the program, adjusted for the fees that apply to the new share class, gained a whopping 58 percent.

"FX, Oil and interest rates were the big trades of 2014 and to some extent in 2015. We have also benefited from our relatively high allocation to smaller markets during the last couple of years. Markets, that are hardly accessible for our large competitors, Michael Stephani, Head of Portfolio Management and Quant Research at SMN, explains.

According to Stephani, trading so called synthetic markets, defined as the spread between two futures market, has also added significantly to the diversification of the portfolio and allowed the program to exploit trends in markets for which there are no listed futures contracts.

"When it comes to yield curves for example, there is no such thing as a yield curve futures contract, however, we can exploit trends in the yield curve by simultaneously trading a short-term and a long term interest rate contract, Stephani says. The current allocation to synthetics is around 25 percent of total portfolio risk.

Among the other features that SMN believes to be unique for their approach, the correlation overlay and the risk budgeting tool are systems that have contributed significantly to the strong performance recently, according to Stephani.

"The correlation overlay is measuring shorter-term profit and loss correlations in the portfolio. By doing that we try to identify risk concentrations that we are exposed to and that could lead to significant losses when markets that normally show low correlation suddenly start to correlate", he says.

"Interestingly, these tend to work very well when trends in markets get overextended. Right at the peak of these trends, price action typically gets more volatile and shows increased correlation to other parts of the portfolio, consequently we reduce our positions."

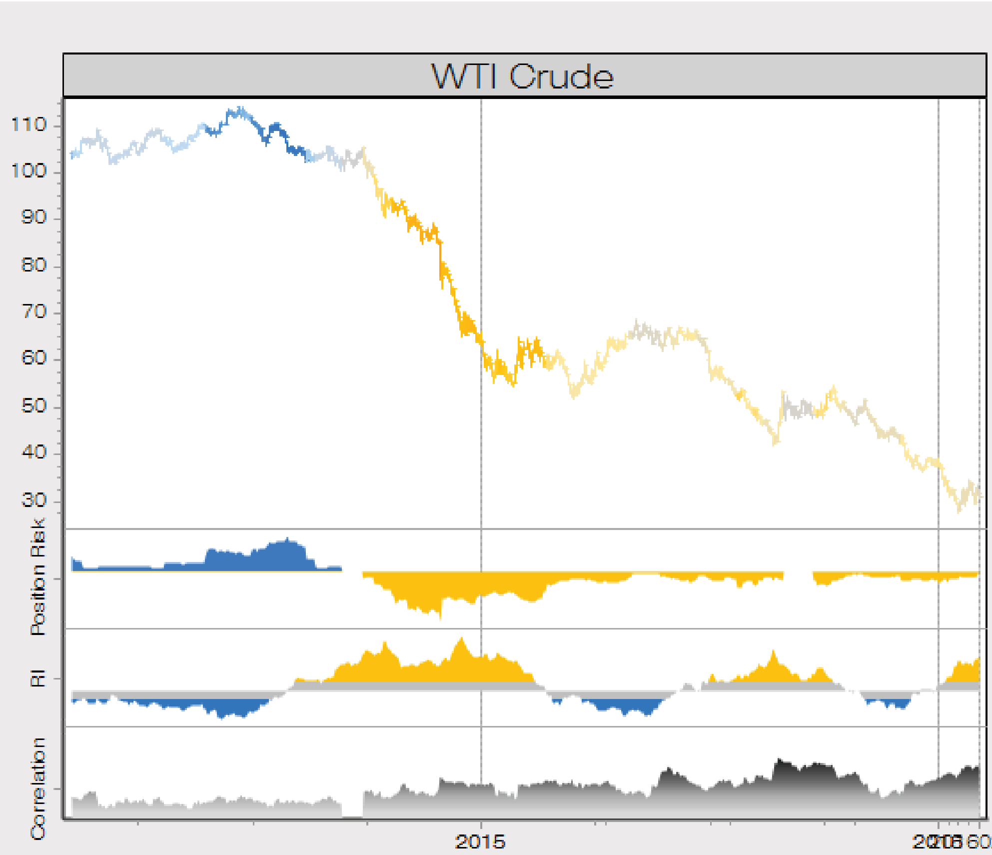
A recent example of how the correlation overlay works is SMN's position reductions in the crude oil contract following a long period of falling prices that had them enter into a significant short position.

The risk budgeting tool is built on a proprietary developed risk index that identify periods of strong risk-on or risk-off market regimes, periods where positions tend to get more aligned with the overall regime and reduce diversification benefits.

"The risk index indicates when we are in a strongly risk seeking or risk adverse market regime and has a direct effect on our position sizing. According to the risk characteristics of the respective position, its risk budgets get either increased or decreased", Stephani says.

"The risk budgeting tool also assists the trend following system in selecting trades. If the system detects a short position in an equity market during an environment where the regime is highly risk seeking, that trade will be allocated a smaller risk budget", Stephani explains.

The developments on the research side, most of which was implemented in 2010 and 2011 has had SMN stand out among industry peers. 2014 was naturally a big confidence boost but also in 2015, a year that was much more tricky for the CTA-industry overall, SMN had a relatively solid year with gains 2.4 percent. The start of 2016 also looks promising.



This Crude Oil (WTI) chart illustrates the main parts of SMN´s trading approach and the variability in position size resulting from the different input factors. Blue colour indicates a long position, yellow a short position. The deeper the colour, the bigger the position size (line 2). Line 3 and 4 show the readings of Risk Index (blue = risk affine, yellow = risk averse) and the current correlation data for this position. Together with trend strength and market volatility these input factors define the actual risk budget in a certain market.

”We have managed to outperform for quite some time now. I truly believe that our efforts on the research side are starting to pay off. We managed to put in positive numbers in 2015 and 2016 has not started badly”, Heitzinger says.

Looking forward, SMN are thinking of expanding their product offering. ”Next to implementing new markets to the existing portfolio, which will further enhance diversification, we are in discussion with our investors to offering a new product which is just trading niche markets, including less liquid ones. This shows low correlation to traditional trend following programs and is a great diversifier for almost every portfolio”, Heitzinger explains.

SMN, as a fully licensed AIFM, are looking to passport their Luxembourg fund onto new markets as they see increased interest from client groups outside of their home market. The fact that they were recently nominated for the second time in a row for the EuroHedge Awards for best CTA under 500 MUSD has clearly added to interest according to Heizinger.

”As we see growing demand for our SMN Diversified Futures Fund we are discussing how to make the fund accessible for new client groups and new markets. This is work in progress but I would expect us to be active in several new markets going forward. We are not likely to enter into the retail arena unless we find the right partner for it, but we clearly want to have a competitive offering lined up for institutions internationally. The new share class is the first step in this process, Heitzinger concludes.

How to Stay Young as You get Older & How DUNN Reduces Drawdowns Without Reducing the Upside

By Niels Kaastrup-Larsen, Managing Director, DUNN Capital (Europe)

“Oftentimes, more robust systems generate more volatile return streams!”

As a systematic manager, we do not have market views, thus we have chosen to focus on a few other topics we feel are important when evaluating opportunities within the alternative investment space.

The first topic I want to discuss is the internal debate that many investors face when choosing a manager: “do you go with an “old” manager or do you pick one of the new, up-and-coming managers?” In recent years, a number of “emerging” manager funds have been launched, based on the argument that new managers out-perform mature managers. And indeed, when you look at the performance data of newer managers, sometimes their results seem to be better than the industry benchmarks. But it is not always that simple.

Timing can be important when launching a fund and those new managers who launch during a market environment that particularly suites their

trading style can earn outsized profits during this time. However, most of the new managers that experienced good timing will eventually encounter an unfavorable market for their strategy which will bring their track record more in line with industry norms.

Another complicating factor to be considered when analyzing newer managers is capacity. In many cases, managers perform very well during their early years only to experience difficulty later when their portfolios become larger and less nimble.

Part of the reason why large mature managers do not out-perform the benchmarks, is because they become the benchmark themselves, due to their size. One would agree: it is difficult to outperform yourself. But if your choice is not purely based on performance, what other things do you need to consider?

Before we get to the answer, perhaps we need to consider the human bias in all of us that gravitates towards the latest and greatest gadget. For example, Apple has certainly found a way to make us want to swap our "old" device for the newest model, convincing us that new is better than old. Perhaps when it comes to technology, this may be true. But what about when it comes to investing, and specifically the quality of a manager?

Being in business for more than 40 years gives DUNN a number of advantages, but perhaps the most important one is that we have been in many drawdowns and learned from our mistakes, which builds stamina.

Developing trading systems is a process of "Trial & Terror" – you have to find all the things that don't work in order to discover the things that really are robust in the long run.

The key to success in any industry is innovation and persistence in order to create better methods and techniques. A culture of constant improvement and consistent processes combined with decades of real experience can allow you to **"Stay Young as You get Older".**

Robust Trading Systems Require Enduring Volatility

Ever since the CTA industry got started, investors have found it difficult to deal with the drawdowns and volatility that a strategy can generate as an unavoidable consequence of being a trend follower. If only we had a magic formula or algorithm that could take inherently volatile markets as their input and produce a steady return stream with no volatility and drawdowns. Unfortunately this does not exist.

This is the no-free-lunch part.

A robust system is one which works and is stable over many types of market conditions and over many timeframes. It works in Bond futures and it works in Oil. It works when tested in periods like 1970-1980 or 1995-2005. Robust systems tend to be designed around successful trading thesis or methods, classical money management techniques, and universal principles of market (and human) behavior. These systems are not designed around specific types of markets or market environments.

And here is the surprising thing about robust systems: Oftentimes, more robust systems generate more volatile return streams! This is because robust systems are not optimized to a particular market environment. The converse is also true. You can design systems with excellent returns and low volatility on historical testing, but which work only for given periods in certain market conditions. These systems tend to be curve-fit or data-minded and are not robust during live trading.

For a system to have the highest odds of profitability over time and across many markets, the inescapable tradeoff is volatility. Diversification is used of course, but it will only dampen the volatility so much.

How DUNN Reduces Drawdowns Without Reducing the Upside: addressing trend following's two main weaknesses

When sitting down with investors we usually end-up discussing the weaknesses of trend following and how to deal with them. I think it is universally known and accepted that trend following tends to have its worst performance during periods with sharp reversals in the prevailing trends or during non-trending environments. At DUNN we have studied trends for more than 40 years. It wasn't until 5 years ago though that we found a way to better deal with these two challenges.

Today we feel that our trading strategy is better equipped when trends reverse, due to the implementation of an Exit strategy, the sole purpose of which is to reduce our exposure before the market price changes its trend.

When it comes to dealing with non-trending periods we found the problem to be that most managers (including us at the time) are targeting the same level of risk (whether it be volatility or VaR). That equates to driving your car at 100mph regardless of whether you are on a highway or on a narrow mountain road. Frankly, that does not make sense. The problem is how do you calculate and set the correct "Speed" i.e. risk level.

We overcame this challenge in early 2013 with a risk management solution that allows us to recalibrate the risk budget each day and thus over time adapt our overall risk to the market conditions.

And this is how we have been able to **Reduce Drawdowns Without Reducing the Upside**. Let me just finish by mentioning our core beliefs: At DUNN we believe, that all markets will exhibit trends from time to time and that all markets have an equal opportunity to exhibit these trends. Thus we see a continuing opportunity to profitably exploit these trends by applying a measured investment strategy that removes emotional judgement and replaces it with data-driven analysis and decision-making.

William A. Dunn, Ph.D., is the Chairman Emeritus of DUNN, Martin H. Bergin is the President & Owner of DUNN

About DUNN

On October 18th, 1974, with 19 partners contributing a combined $137,000, Dr. William A. Dunn officially launched his finance career, trading client money in his 100% systematic managed futures strategy.

Trading only eleven markets, Dr. Dunn applied his trading algorithm and portfolio management rules, developed through several years of testing and simulation. As one of the first quant traders in managed futures, Dr. Dunn was in uncharted territory at the time and breaking new ground in an undeveloped alternative asset class.

In 2015, after a 5-year succession plan, Dr. Dunn transitioned full ownership of the firm to his longtime friend and protégé, Martin Bergin. Mr. Bergin, who has a deep background in finance and business management, has been with the firm since 1997 in various roles of increasing responsibility. He has been the firm President since 2007 and oversees all mission-critical operations of the firm. Mr. Bergin directs the firm's research and development efforts as well as the construction and management of the firm's managed futures portfolios. He also manages all operational and financial activities of DUNN. Dr. Dunn remains the firm's largest investor.

> "Can we conclude from a series of good years that the environment is good for trend- following, so that high returns are likely to continue? Or is the opposite true?"

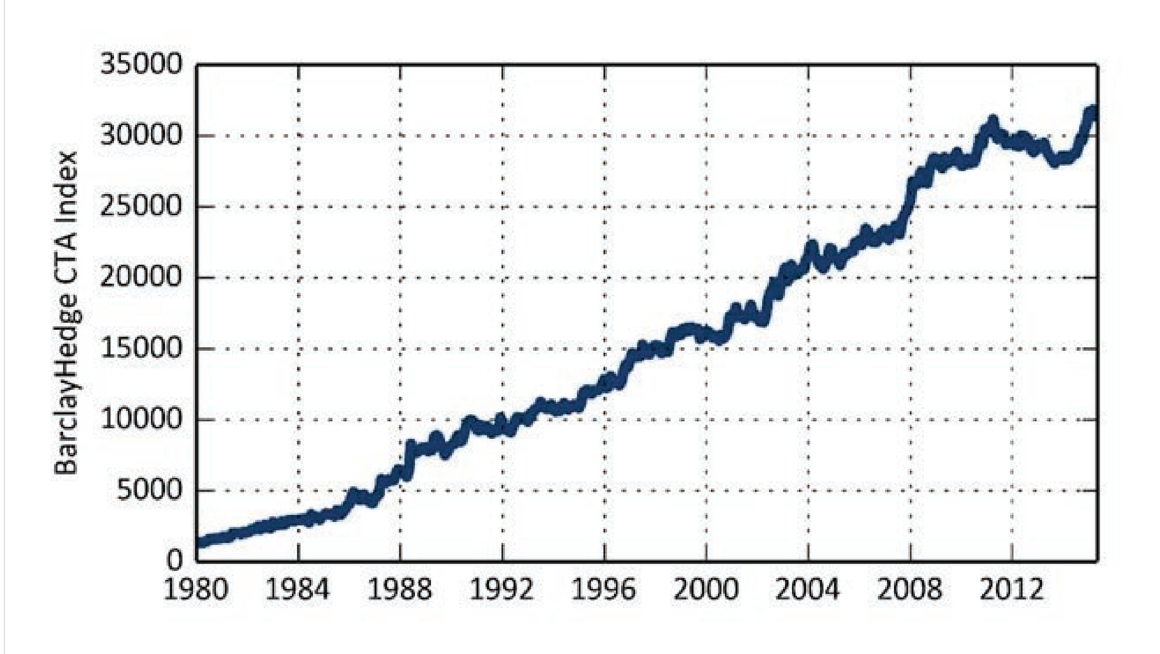
AUTOCORRELATION OF TREND-FOLLOWING RETURNS: *illusion and reality*

by Winton Capital

In the five years prior to 2014 managed futures trend-following strategies experienced a long run of weak performance, leading to speculation that the strategy might be 'dead'. The last six months of 2014 saw a reversal of these bad fortunes, with trend-following funds producing surprisingly strong returns. Prompted by these variations in performance, we ask: can we conclude from a series of good years that the environment is good for trend- following, so that high returns are likely to continue? Or is the opposite true? We give reasons to be sceptical, examine the evidence, and conclude that the case for either positive or negative effects is weak.

Good and bad periods for managed futures

The chart below shows how difficult recent years have been for trend- following strategies. It shows the BarclayHedge CTA index back to 1980. This is an independently-produced index which averages the performance of real funds. It includes systematic and discretionary traders, but is dominated by the performance of funds with a large trend-following component. Since 2011 this index had been in its longest ever drawdown, until the performance spurt that we saw at the end of 2014.



If last year was good, should we expect this year to be good too?

The question we address here is related to a previous client research paper[1], where we showed evidence that faster trend-following strategies have seen declining performance. These were changes in average performance over long periods of decades or more, whereas in this brief we are looking for short-term structure. Is a good year likely to be followed by another good year, and a poor year by another poor one?

To answer this question, we will look at the correlation between the previous and forthcoming years' returns for each calendar year (1980 to 2014). This is called the "lag-1 autocorrelation" of annual returns. We can also calculate a correlation coefficient for quarterly or monthly returns. In all cases we are looking for evidence of a relationship between past and future performance.

The use of control groups: deciding on the significance of results

The raw numbers for annual, quarterly and monthly autocorrelations do not tell the full story. As we have noted before[2], there is a strong analogy between testing for "real effects" in financial data and the testing of medical treatments. In both cases, it is important to compare the results of any test with a control group (or placebo) where we know the effect that we are looking for is not present.

Control group 1: the influence of performance fees

We use two different types of control in order to be more confident in our conclusions. The first is a randomly generated track record with similar performance to the BarclayHedge index, but no correlation at all between successive returns. These simulated returns are generated by a random walk with drift and variance chosen so that after fees are subtracted, the mean and variance of returns is the same as the BarclayHedge index. We apply a two per cent management fee each year, and a 20% performance fee.

This simulation has an important advantage over real history: we can run it for as long as we like, generating enough data to calculate long-term averages accurately. By simulating ten thousand years[3] of trading for our fictional CTA, we show that the autocorrelations on the three timescales are all negative, with values given in the table below.

Autocorrelation coefficient	Annual	Quarterly	Monthly
Simulated fund with no autocorrelation (10 000 years)	-0.05	-0.04	-0.02

This means that a "good" year is more likely to be followed by a "bad" one, and vice-versa. The same is true, to a lesser extent, for quarters and months. We refer to negative autocorrelation as 'mean reversion', because it implies that excursions away from a long-term mean tend to be followed by movements back towards the mean.

Performance fees cause mean reversion

We created a random fund with no correlation between successive gross returns, and then discovered mean reversion in its net performance. Why? The reason, of course, is in the difference between gross and net; the fees. Performance fees are charged only on the part of the profit that exceeds the previous "high-water mark", and this has induced the mean reversion.

Profits which are made after a similar or larger loss do not incur a performance fee. The net returns from these profits are therefore higher than those from other profits. It is this structure in the data that induces the apparent mean reversion.

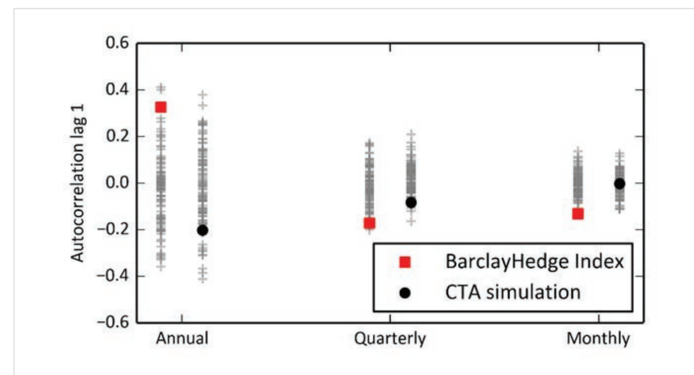
The conclusion from our first "control" experiment, then, is that a fund charging performance fees will show mean reversion, even if there is no such effect present in its underlying investment results.

Since performance fees cause negative autocorrelation we would expect to see some negative autocorrelation in the BarclayHedge index. To understand if there is structure beyond this we compare the BarclayHedge autocorrelation with that found in our "control" case. If the BarclayHedge data shows autocorrelation much larger than the ten-thousand-year simulation, then we can conclude that the extra autocorrelation is due to the underlying investment results.

A CTA with no fees

As another way of assessing whether CTA returns have autocorrelation, we will calculate the autocorrelation coefficients for a simulated medium-speed trend- following strategy on five of the most highly-traded futures markets. We use the gross returns (with no fees charged) for this CTA.

The chart below shows autocorrelation coefficients calculated at three different frequencies for the BarclayHedge index (the red squares) and the no- fees CTA simulation (the black dots). Both the index and the simulation data go back to 1980. The grey crosses indicate the results for another type of control group.



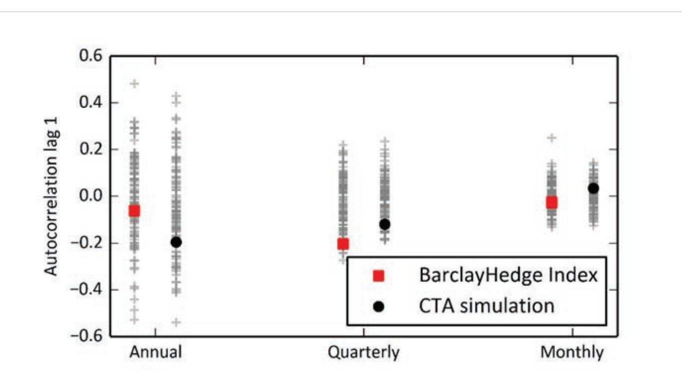
A second control group: assessing statistical significance

This control group is derived directly from the BarclayHedge data (or from the CTA simulation for the black dots) and is a version of the same data series, modified to have no relationship between subsequent returns. We do this by shuffling the order of the returns in the series. This is analogous to the use of a "placebo" in a clinical trial, and the purpose is to see what range of correlations we might expect by chance alone in a time series of this length. For each result there are 100 random placebos, marked with grey crosses.

The aim is to assess the statistical significance of the autocorrelation. If the results for the real data are outside the range of values generated by the placebos, then we can conclude that the measured autocorrelation is unlikely to have been generated by chance.

Autocorrelations are not significant for years or months

The BarclayHedge Index results at all three frequencies are at the outer extremities of the random results, suggesting that the observed relationships may not be due to chance alone. However there are some outsized returns in the BarclayHedge CTA Index during the 1980s. For example it records June 1988 as an up 27% month. This early data seems unrepresentative of the industry as it currently stands, so we repeat the analysis on data from 1990. The results are shown in the next chart.



The correlation between subsequent annual returns now looks to be almost zero for the BarclayHedge data and smaller in magnitude than for our ten- thousand year control case. At the annual frequency the actual results for both the index and the trend-following simulation sit within the range of the placebo results, which suggests that there is no significant link between performance in adjacent years.

The same is true of the result at a monthly frequency. There is no evidence of a link between performance in adjacent months. However, there does seem to be a significant negative effect in the quarterly data. This negative effect is present whether we take data going back to 1980 or 1990, and for both the BarclayHedge index and our back-tested simulation of a CTA.

How big is the quarterly effect?

The results for the quarterly frequency produced a negative correlation for both the real and simulated data, at the extremity of what we saw in the placebo results. The measured autocorrelations are larger in magnitude than the (-0.05) quarterly autocorrelation that we would expect

to be induced by charging performance fees, both for the BarclayHedge data, and for the simulation (which has no fees in any case). This is suggestive evidence that a good quarter for trend-following is more likely to be followed by a bad one.

However, the effect is small. To understand its magnitude, we can estimate how much a good quarter might change our expectations about the next quarter's return. For the BarclayHedge index, the historical mean quarterly return is 2.7%. A rough estimate[4] indicates that following the very best quarterly return since 1990 (9.6%, in the last quarter of 2000), the autocorrelation effect would reduce our expectation of the return in the following quarter from 2.7% to 1.3%.

A realistic view, informed by careful analysis, is that there is no reason to think that a good year for trend-following is likely to be followed by good or bad performance in following years. There is some weak evidence of a quarterly effect indicating that good quarters have been followed by quarters that are not quite so good. However the effect is so small that it would not have led us to expect losses in any quarter in the last 25 years.

[1]Winton Working Paper: 'Historical performance of trend following', December 2013
[2]Winton Working Paper: 'Blinded by optimism', December 2013
[3] Such a long period is necessary because the errors in estimation of the autocorrelation coefficient decrease only with the square root of the sample size: so one hundred times as much data is necessary to decrease the error by a factor of ten.

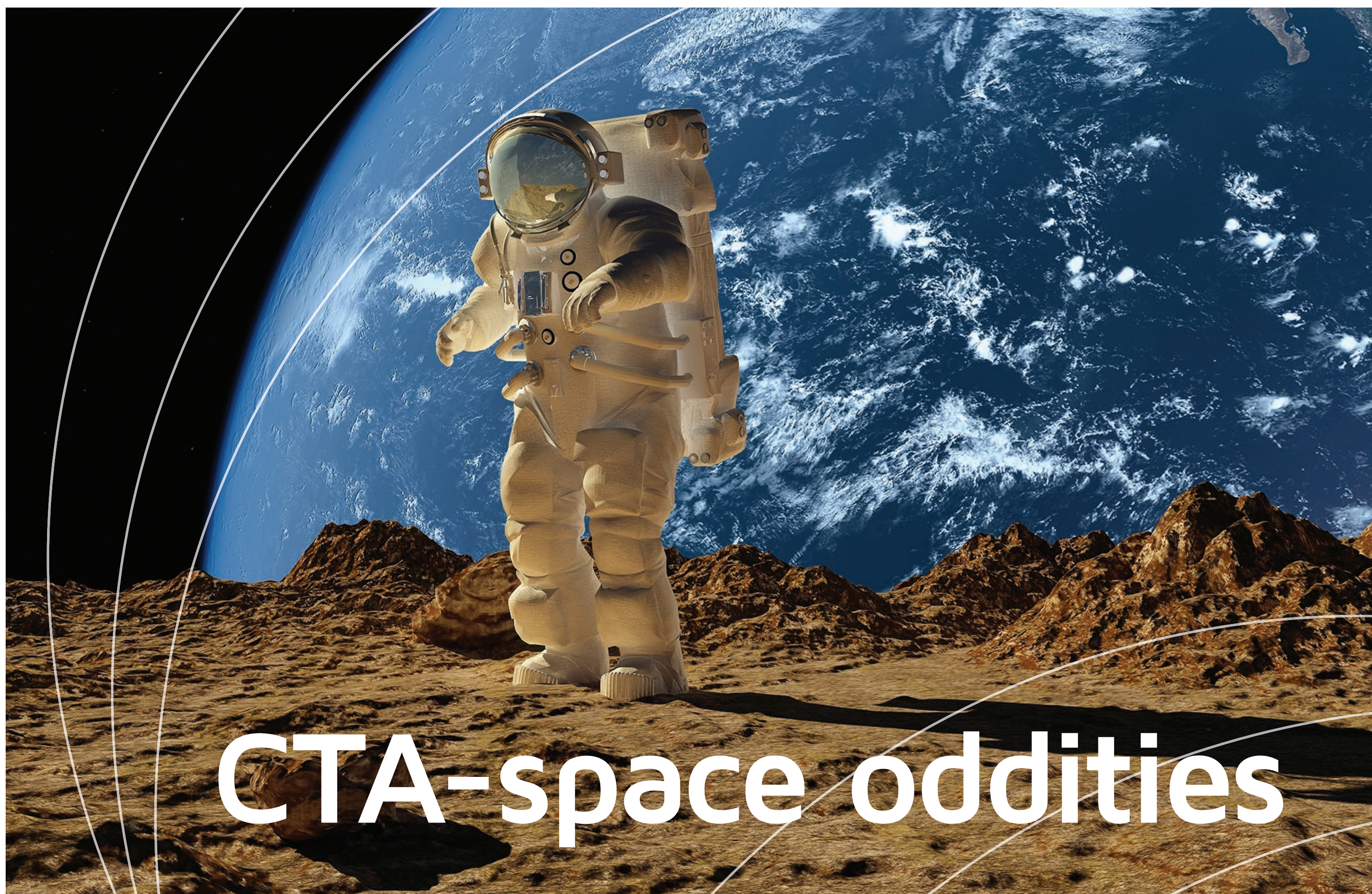
About Winton Capital:

Founded in 1997, Winton is a systematic investment manager that uses the scientific method to develop advanced investment systems.

Winton believes their approach to investment management, which does not subscribe to economic orthodoxy, can provide genuine diversification benefits. Winton currently has over $30 billion in assets under advice and employs over 400 people in nine locations around the world.

Through statistical analysis and mathematical modelling of historical data, Winton strives to identify profitable investment opportunities. Products range from highly diversified multi-asset solutions to regional long-only equities, available in a variety of wrappers and customisable managed accounts.

[4] As a first approximation, we suppose that with the mean removed, the quarterly gross returns r are a first-order autoregressive process $r_t = ar_{t-1} + \epsilon_t$,where ϵ is uncorrelated noise with mean zero (no assumption of normality is necessary). The autocorrelation coefficient is a. This means that a quarterly return which is better than average by r_{t-1} is followed, on average, by a quarterly return which is better than average by ar_{t-1}. In our case, we estimate $a = -0.2$, and the mean quarterly return for the index is 2.7%. So a quarterly return which exceeds 2.7% by a margin r was followed, on average, by a return which was $0.2r$ *less* than 2.7%. A 9.6% quarter would be followed, on average, by a 1.3% quarter in this model.



CTA-space oddities

by Mikael Stenbom CEO, Partner RPM Risk & Portfolio Management

Generally speaking, there are two oddities in investor behavior with regards to CTAs and hedge funds, especially among larger investors.

The first oddity has to do with size, expressed as Assets under Management (AuM). In general, large AuM is perceived as good, while small AuM is perceived as bad. The consequence of this perception is that managers with large AuM become larger. Managers with small AuM do not. Other qualities, like expected performance, play a secondary role.

Is this rational? From a strict risk/return perspective, it is not. A growing number of academic studies, as well as research from various providers within the alternative investment management industry, arrive at the same conclusion: large AuM is positively correlated with past performance (relative to peer groups), and negatively correlated to future performance. Simply put, , their best days are behind them.

Are there exceptions to this? Of course! But the focus on a few very large managers that have recently performed well obscures the fact that smaller and younger managers have – on average – a better risk-adjusted performance than their larger peers.

So why do some investors continue to favor already very large managers? The arguments put forth are not convincing, and can be summarized as follows:

1. They have superior operational quality (Fact: most managers of reasonable size today have adequate or more than adequate operations due to increased automation and outsourcing of administrative functions to professional organizations).

2. They have superior client servicing (Fact: Same as above, in addition to large managers being able to feed allocators with arguments, usually in the manager's favor).
3. They have long track records (Fact: For the most part, this is a negative when it comes to performance).
4. "We do not want to be a dominant investor from the manager's perspective." (exactly why it varies from allocator to allocator. Answers related to performance are rare).

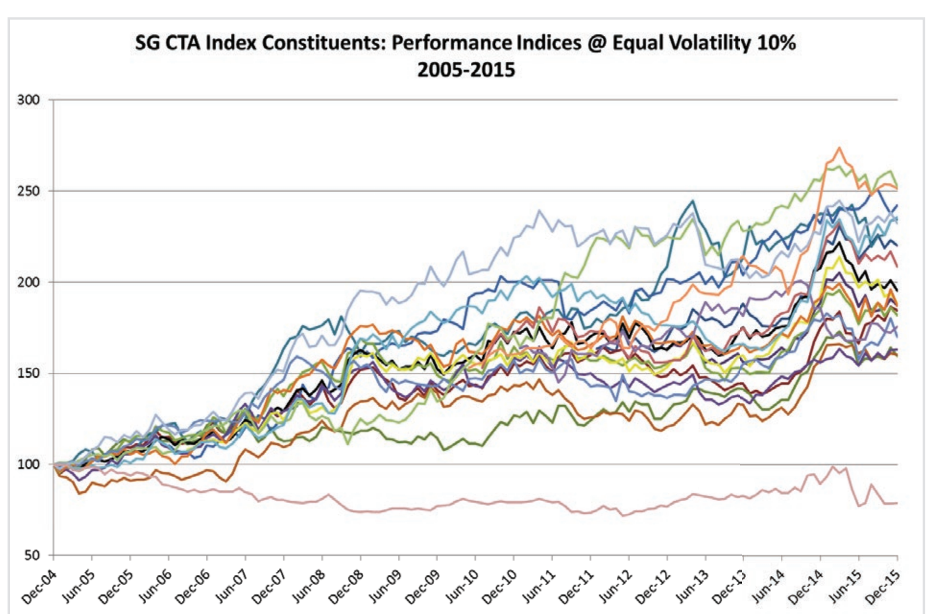
Have compliance departments assumed the responsibility for allocation decisions? Or is the continuing trend of investing in already large managers simply political, media and career risk management on the part of allocators – ergo, rational herding from the allocator's perspective?

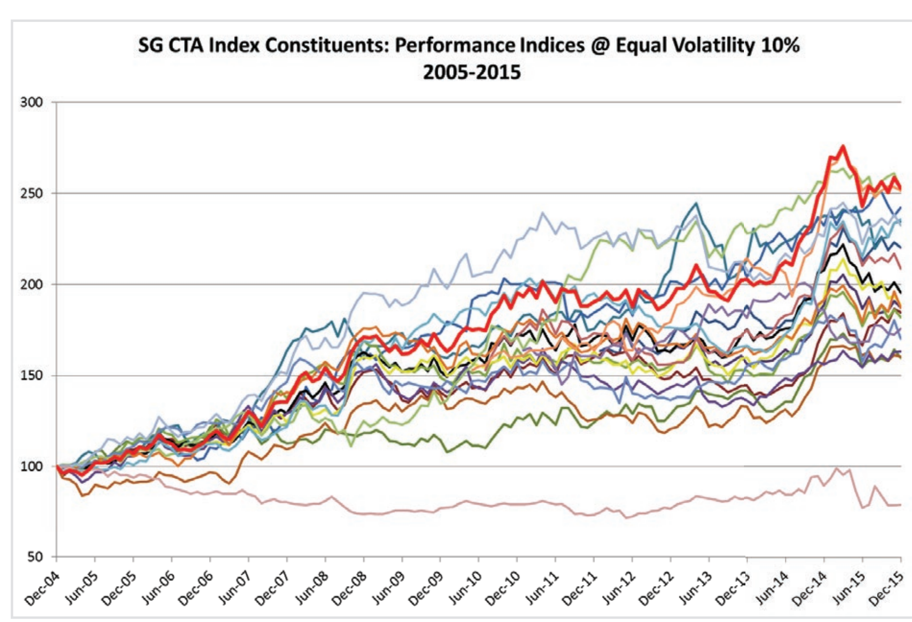
What can be done about this? Not much, so let us leave the issue for now. The ultimate owner of the invested capital pays for the inefficiencies.

The second oddity – which is quite frequent among CTA investors – is the attitude that "all CTAs are alike, so selecting one is enough."

This is like saying "all equities are alike, so I only invest in one."

It is true that there are periods when the majority of CTAs enjoy a positive performance. The same goes for equities. It is also true that there are periods when the majority of CTAs suffer negative performance. The same goes for equities.





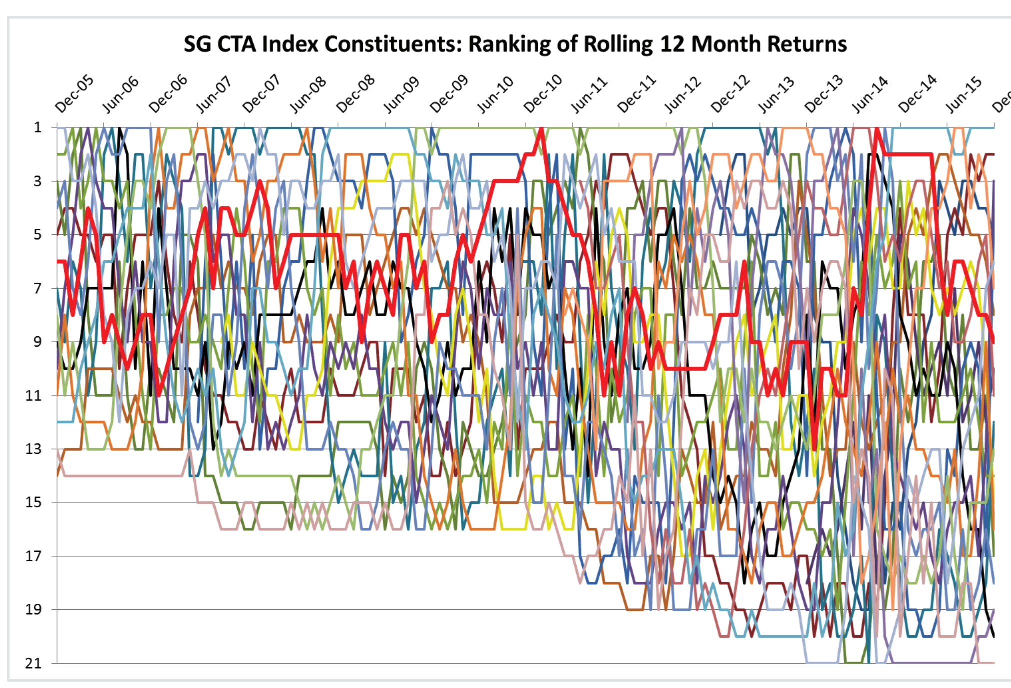
It is also true for both asset classes that diversification is the only free lunch available.

The chart to the left plots the 10 year performance of the 20 CTAs that today constitute the SG (formerly Newedge) CTA Index. Each color represents one CTA. Their individual track records have been levered/de-levered to reach a volatility of 10%. CTAs with track records shorter than 10 years are, for visual purposes, given the average index level of all older CTAs at inception.

The second chart includes the performance of a portfolio (thick red line) of all the CTAs, levered to reach a volatility of 10%. The allocations are assumed to be split equally among all active CTAs at the start of every month (monthly rebalancing). This implies an equal risk allocation, since all track-records are adjusted to the same volatility.

This investment looks pretty attractive. There are, of course, individual CTAs that at any given point in time have performed better than the portfolio, but there have also been a few occasions when the portfolio has performed better than all individual CTAs.

This is the free lunch Harry Markowitz was referring to. At the end of every month, capital is taken from the high performers and allocated to the poor performers. Sell high, and buy low. At the end of the plotted time period, December 2015, the portfolio has outperformed every individual CTA.



Is this magic? Absolutely not. This exercise requires no other skills than the ability to calculate standard deviation. It is the childishly simple application of a technique that has been used for many decades in equities fund management, but that for some reason has escaped many CTA investors. Is it doable? In principle, yes, but in practice, this particular example would require quite a large investment and some administrative work. But the general idea is applicable to smaller groups of CTAs, and is what managers of multi-CTA portfolios and funds do for a living.

There is also a political dimension to this. No allocator wants to go to the investment committee with the announcement that the single CTA they selected happened to be the worst performer over the last 12 months.

The next chart plots the ranking of each CTA over rolling 12 month periods. As can be seen from the shifting colors in the lower end of the chart, quite a few of them have been in the bottom drawer at some time. A smaller number have been in the top. The portfolio has been doing quite OK, sometimes on the very top, and quite seldom below the average.

CTAs have done well recently (including most of the larger ones). The reason is the price-trends that developed in sync with the stock market rout – as has been the case on numerous occasions throughout history. The strong performance will probably introduce new investors to the industry. Many of them will be disappointed because they will choose one large CTA that has performed well - perhaps among the best - in the recent past, but just in time for an absolute or relative drawdown.

Invest, but invest in a portfolio of CTAs. Diversify – take the available free lunch.

Mikael Stenbom , RPM Risk & Portfolio Management

About RPM:

RPM Risk & Portfolio Management AB was founded in 1993. The first investments in CTAs were made the same year. Over the years we have primarily served as the CTA engine of white labeling solutions to large international investment banks. Today RPM offers investment funds, risk management services, customized investment mandates, research, and CTA access to institutional clients worldwide. Recently we have also expanded our offering to include retail clients. RPM is authorized and regulated by the Swedish FSA (Finansinspektionen) as an AIFM and registered as a CTA with the U.S. National Futures Association. RPM is privately owned, based in Stockholm, Sweden and have a staff of 15 people. In total we provide service on approx. USD 2.0 billion.

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Do CTAs Suffer from Crowdedness?

A Closer Look at Commodities

by Anders Blomqvist
Lynx Asset Management

"Positioning data does not support the idea of crowdedness among CTAs."

Trend following CTAs have an enviable track record. In addition to superior absolute returns, their ability to show positive returns during large drawdowns in the financial markets, their crisis alpha, make them an ideal component in a traditional portfolio and in a portfolio of hedge funds. No wonder that the category has seen AuM rise significantly. An obvious concern is that the sheer size would exhaust the alpha associated with trend following. These concerns were voiced loudly during 2009-2012 when the industry in aggregate showed flat returns, but less so after great returns during 2014 and the start of 2015.

The futures markets are extremely deep and liquid. Equities, fixed income and currencies all have underlying cash markets which provide additional depth and liquidity, should it be necessary. For commodities the futures markets are the prime markets for both benchmark pricing and risk transfer.

While they are closely tied to the commodity cash markets through possible physical delivery, there is less depth and liquidity to be tapped from their cash markets than for the other asset classes. Hence, any issue with size for CTAs would most likely first appear in the commodity markets. In the following we will study the composition of the commodity futures markets and look for any indication of crowdedness.

The Composition of the Commodity Futures Markets

The US regulator CFTC, the Commodity Futures Trading Commission, and its predecessors have been collecting positioning data since 1924. In its current form, the commitments of traders (COT) report with weekly frequency and decomposition into commercials, non-commercials and nonreportable has been published since 1993. With the influx of commodity index investing in the decade up to 2008, CFTC proposed a refinement of the commercial category since the index investors positions ended up in the commercial category when banks hedged their swaps using futures.

Since 2009, and with historical data since June 2006, CFTC publishes a disaggregated report. The commercials are separated into producer/merchant/processor/user and swap dealer while non-commercials are separated into money managers and other reportables. Money managers are composed of CTAs and similar entities such as non-US hedge funds.

Several changes have affected the commodity futures markets over the past decades. They have finally moved from open outcry to electronic trading. That move has eliminated the floor trades while other traders have assumed the mantle of market making.

Since 2000, the interest from institutional investors for commodities, in particular long-only exposure, has grown. While being large by most metrics, the commodity futures markets are fairly small compared to the assets of the large institutional investors.

The first generation of commodity indices widely used were quite naïve in their rolling of the futures. As the assets of index investors grew, it became evident that they moved time spreads during their roll windows, most markedly the "Goldman roll". Despite the bear market in commodities over the past years, index investors still play a role in the commodity futures markets.

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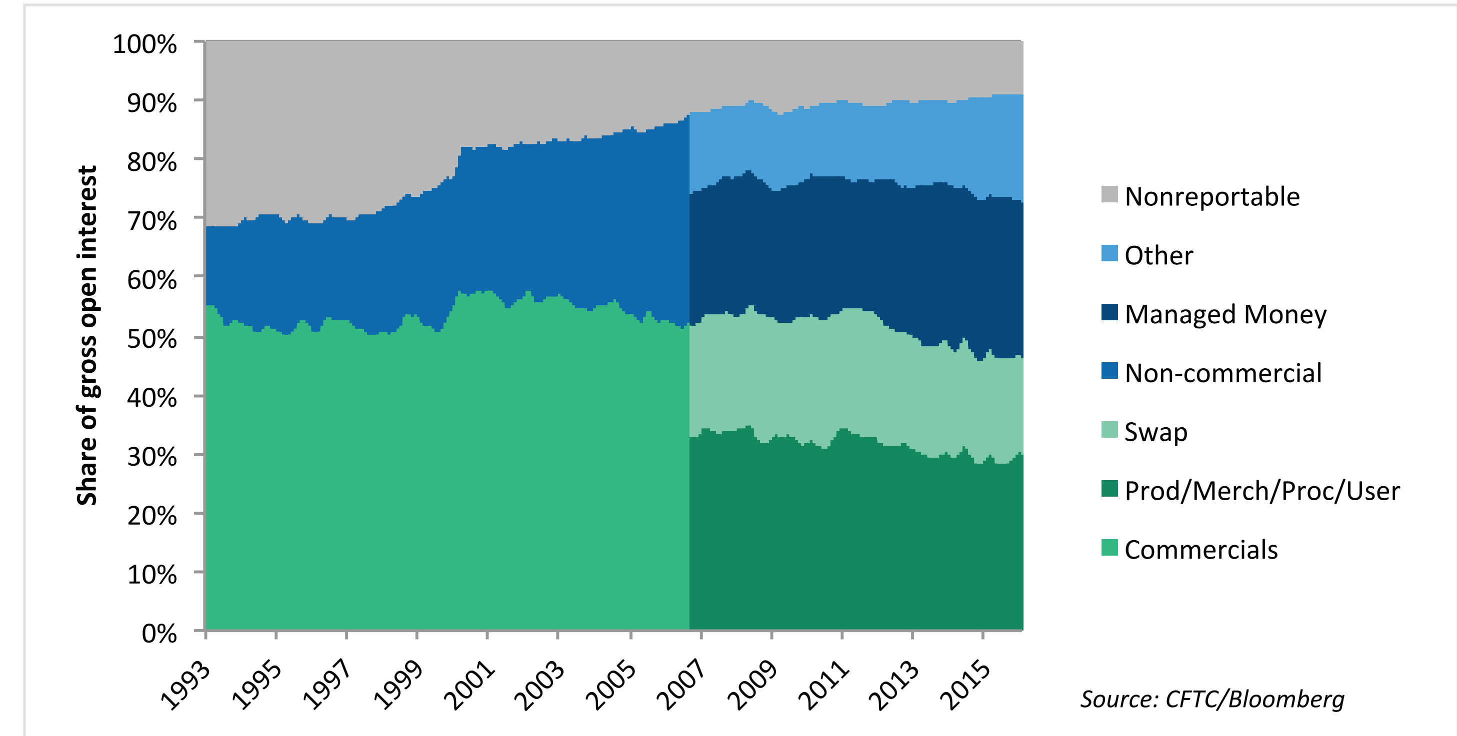
Commodity markets have been securitized to become more easily accessible – in particular for retail investors – thanks to ETNs, ETFs and structured notes. Several of these exchange traded securities have seen assets grow quickly. The positions of these investments show up as swap dealers in CFTCs COT reports when the issuers of these instruments hedge their swaps or when an ETF directly holds futures. Whereas the early index investors usually were long-only, the exchange traded products come in long and short versions. Also, there is a widespread use of embedded leverage. In many cases the leverage is reestablished on a daily basis, which requires a significant hedging activity toward the close on trading days with large price changes.

Recently, asset managers have introduced robo-advisers to retail and HNWI clients. Depending on how common the robo-advisers will become and how robust they are built they obviously can affect the markets – also the commodity futures markets in case these robo-advisers use the exchange traded commodity securities. A warning example in the history is the portfolio insurance schemes leading up to Black Monday in 1987.

In the diagram below the total gross position as a share of gross open interest is shown for commercials and the more granular measure for producers/merchants/processors/users for a set of the most liquid commodity futures. Both show a decline over the past decade with the broader category down about 6 percentage points versus 2.5 for the more precise category. On the margin we should expect trends due to hedging activity to be somewhat smaller than before.

We also note a significant shift from non-reportables to speculators. CFTC seem to be more ambitious in classifying the traders, and the move to electronic trading might have concentrated the holdings to larger entities which are classified.

Looking at the breakdown in disaggregated reports since 2007 we note that the swap dealers have held a fairly constant portion of the open interest. Hence, the index investors seem to stay in the market, but the increase in their position presumably happened before the advent of the disaggregated report. The net position of swap dealers (not shown in the diagram) is long, but as the institutional investors mature and the continued rise of both long and short securities, the long-bias might become less pronounced. These fairly unexperienced market participants have established themselves as a significant group and their behavioral biases can induce more trends in the commodity returns.



As for the CTAs, belonging to managed money, their share of the open interest has been fairly stable around a quarter of gross open interest over the past ten years despite an increase in the funds' AuM. This is possible since total market size has also increased, while some of the funds might have reduced their exposure to commodities. Hence, positioning data does not support the idea of crowdedness among CTAs. Their capability to trade against other market participants prone to generating price trends should be intact.

Commodities in CTA portfolios

Based on the positioning data there seems to be little cause for concern of crowdedness among CTAs in commodities. Yet, returns from commodities seem not, in general, to have matched the returns in other asset classes for trend following strategies over the past couple of years. That might, however, be just by chance as trends come and go. Trends in developed market equities (2013), USD (2014) and long bonds (2014) were generally smoother than the downward trend in energies (2014-). The next major profitable trend may show up somewhere else. A few years without a major profitable trend within an asset class is simply not reason enough to stop trading the asset class.

Commodity markets have been at the core of CTAs since their birth as the commodity markets have a longer history than the CTAs, while several financial futures have a much shorter history. Quantitative strategies such as CTAs typically only have a small statistical advantage over other market participants. As such, managers of these strategies want to be able to place as many independent bets as possible in order to generate returns over time. In this regard commodities, which are diverse and normally exhibit low correlations with one another as well as with financial assets, make up an excellent building block in a CTA portfolio.

About the Author:

Anders Blomqvist holds a MSc in Engineering Physics and a PhD in Optimization and Systems Theory, both from KTH, Stockholm. Blomqvist began his career in finance at Kaupthing/Ålandsbanken where he prior to joining Lynx in 2015 was the fund manager for a long-biased long/short commodity fund.

Blomqvist joined Lynx's 20-person research team as a senior quantitative analyst. The team has expanded gradually over the years and in 2015 six new researchers were hired.

- We are always interested in bright people from interesting academic fields, comments Henrik Johansson, Partner and Head of Research, who led the recruitment process.

- In this round of hires we also specifically searched for candidates with market experience, such as commodities, as well as people with a quant Macro background to complement our strong team of physicists, statisticians and mathematicians. We received a lot of interest and were able to cherry-pick among over 500 applicants, Johansson further comments.

Lynx Asset Management was founded in 1999 and today employs over 60 people, all dedicated to the diversified USD 6bn Lynx Programme.

"A few years without a major profitable trend within an asset class is simply not reason enough to stop trading the asset class."

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HONEY, I HEDGED THE PREMIA....!

by Björn Österberg and Mattias Jansson / IPM

Alternative risk premia have been a widely covered topic in the last decade. The idea of allocating across risk factors instead of traditional asset classes is gaining traction and the market is flooded with various product offerings in the alternative beta space. Hedging against risk premium exposures, as we do at IPM Informed Portfolio Management, is therefore sometimes perceived as odd, not least since we also support risk premium investing and believe that, properly handled, it is capable of increasing allocation efficiency. Below we try to shed some light on why we think it is a good idea to hedge against the golden goose.

In the context of modern portfolio theory, a risk premium represents the expected excess return for bearing risk that cannot be eliminated via diversification. Although this premium may vary over time, it can neither disappear nor be arbitraged away. It is a compensation for accepting and maintaining exposure to a specific and persistent source of risk.

Originally viewed as a reward for bearing volatility risk in traditional asset classes, such as holding equities over bonds or bonds instead of cash, the concept of risk premia has evolved over time.

With the introduction of the Fama & French value, size factors and a growing acceptance towards carry and momentum trading, risk could no longer simply be synonymous with plain volatility. How was it that their returns could be generated without being accompanied by a corresponding increase in risk as we knew it? Early attempts at explaining this involved concepts such as "hidden risk factors" and gradually this line of thinking lead to a more generalized framework. These days, risk not only encompasses "tail events" but also sometimes transcends the realm of what we can quantitatively measure.

It did not take long before more risk factors started to emerge. In the last decade the search for, and interest in, alternative risk premia has virtually exploded. Nowadays they are well-known, empirically tested sources of returns that, with reasonable effort, can be harvested via systematic long/short strategies.

This in turn has, quite naturally, paved the way for a new approach to portfolio construction where the objective no longer is to allocate between traditional asset classes, but rather to allocate to various premia. We believe that this makes a great deal of sense. Applied carefully it could significantly increase investors' potential to achieve true diversification in their portfolios, but it has some catches.

First of all, assets correlate, but so do risk factors. Some studies suggest that there are over 300 published alternative strategies capable of explaining cross-sectional returns in the equity space. Not only is this a very big number, but it also only covers a subset of all available asset classes. It is likely that some of these strategies will be arbitraged away and simply stop working.

It is also likely that some of them in fact never have worked but rather are just a product of randomness and statistical biases. However, it is also likely that several of them, in fact, are

Figure 1:

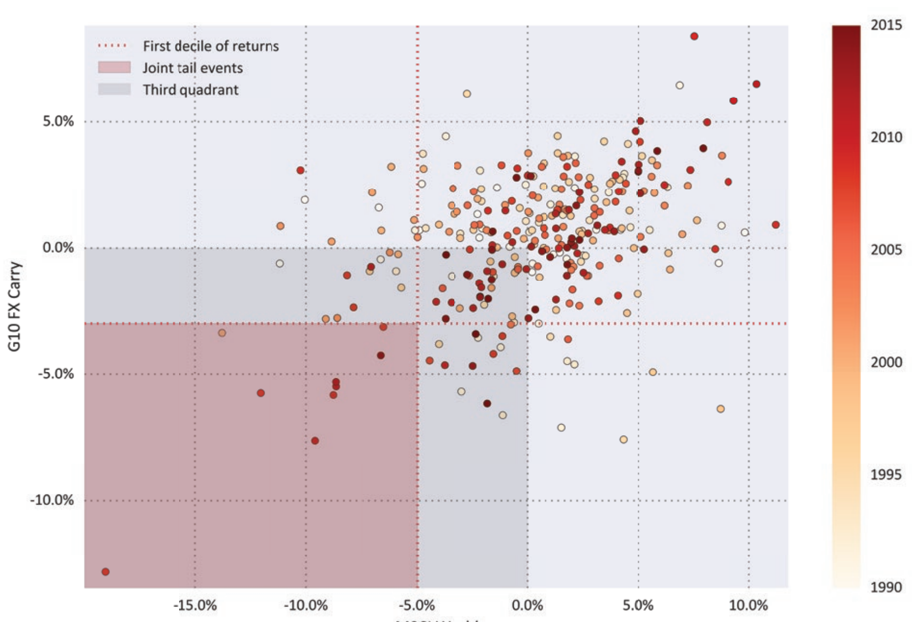

Figure 1: Scatterplot of monthly returns of generic G10 FX carry strategy vs. MSCI World. Each point is colored according to the year in which it was observed. Joint tail events, i.e. months where both investments post worst (first) decile returns, reside within red domain. Grey area represents third quadrant, i.e. months where both returns are negative. Source: Bloomberg/IPM.

Figure 2:

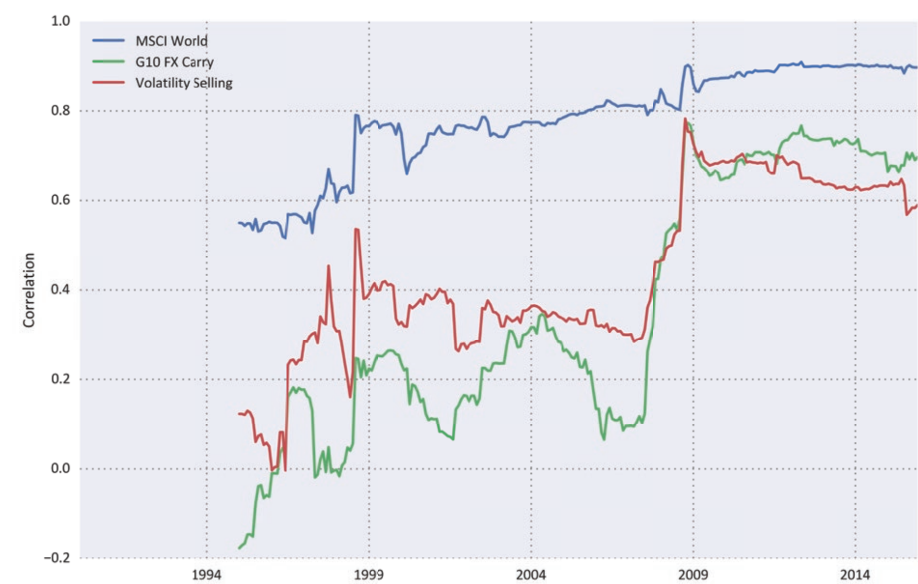

Figure 2: Five year rolling correlations between HFRI Fund Weighted Composite and three widespread risk factors (MSCI World, G10 FX Carry and Volatility Selling). Correlations are estimated via exponential weighting. Source: Bloomberg/IPM.

"the real deal" and will work simply because they capture premia offered in exchange for accepting some risk that investors in aggregate wish to offload.

Are all such premia unique? This is doubtful to say the least. What is more probable is that they exhibit overlap, i.e. load up on the same premia to varying degrees. A handy way of exemplifying this is to look at FX carry trading. This is probably one of the most well-known alternative strategies out there and it is widely recognized for loading up on growth risk (equity beta, see figure 1) as well as tail risk (volatility selling). The latter two, we would argue, are examples of broader, more generalized risk factors that resurface in many other contexts.

The point here is that allocating to risk premia has the potential to improve portfolio diversification, but not all premia offer the same "bang for the buck". Rather they have to be carefully examined and selected, ideally using both quantitative and qualitative criteria. Our own studies, for example suggest that a significant portion of a given return stream typically can be attributed to no more than six, largely orthogonal, generic premia.

Secondly, while we certainly should expect risk factor dependencies to exhibit time variation, we should also be on the lookout for any signs that might suggest that past relationships indeed are "a thing of the past". One such observation for instance, is the tendency for a number of well-known factors to converge (notice the increasing alignment in figure 1 for example). A some-what disquieting explanation of this is that it suggests compression due to widespread discovery and application.

With risk premium investing becoming increasingly popular, it is not out of the question that some risk factors start to co-depend due to "crowding". Using a composite hedge fund index as a rough proxy for general premium consumption, we can for instance quite clearly detect increasing dependencies towards a number of alterative risk factors (see figure 2).

It should be stressed that drawing conclusions based on short-term samples is a perilous exercise prone to identifying false positives. Certainly there may also be other explanations for this phenomenon, not least given the current economic environment. However, large scale allocations pose a potential tail risk and tail events by their very definition are shy creatures that we rarely get to observe as much as we would like. We therefore feel that potentially calling this put too early is forgivable.

What does this mean for investors looking to allocate to commoditized alternatives? Our take is that one should first of all acknowledge that back-tests of premium allocations may be "upwards biased" (beyond any typical discounting). If the tendencies highlighted here indeed are more than just statistical anomalies, diversification in "everyday surroundings" as well as during tail events may prove less than hoped for going forward.

Taking things one step further, passive risk premium investments as well as alternative investments in general may well warrant active risk management in order to maintain diversification at reasonable levels. Our own Systematic Macro strategy for instance invests in some 50 customized trading concepts, and even though neither of these are de facto generic risk premia, we still find that several of them implicitly load up on these "generics". In anticipation of future tail events as well as in keeping the product's potential to offer diversification to its investors, we started to actively manage these exposures a few years ago. This entails not only keeping a close eye on static tils, but also addressing temporary concentrations. Hedging the strategy in this regard makes for an improved and more nuanced risk taking.

While some of the points raised here are hardly unknown to the investment community, we do believe that deeper analysis of their implications is less common. Our experience suggests that this is ignored at one's peril. There may be dark clouds gathering on the horizon.

Björn Österberg CIO, Head of Research
IPM

Mattias Jansson Deputy CIO
IPM

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Andrew Gibson

Henric Malmqvist

IMPROVING SENTIMENT FOR GLOBAL MACRO

BY JONATHAN FURELID, HEDGENORDIC

International Asset Management (IAM), an independent specialist in tailor made portfolios of hedge funds, believes that the current market environment offers an improved sentiment for Global Macro strategies. However, the diverse characteristics of the strategy group require a disciplined approach to manager selection, the hedge fund specialist argues.

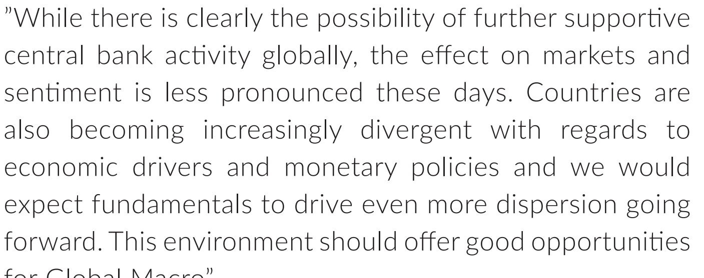
”We have considered Global Macro as one of the more interesting strategies since the start of 2015. The fact that financial markets are beginning to put more emphasis on fundamentals offers a compelling opportunity set for the strategy”, Henric Malmqvist, head of IAM's Nordic branch office, says.

Andrew Gibson, senior partner at IAM and member of the Investment Committee, adds that Macro strategies have had more pronounced role in client portfolios since second half of the last year.

“Looking at our allocations mid 2015 we had more risk in equity and event driven strategies. However, as we were recognizing that there was going to be a higher risk premium associated with these strategies in anticipation of Fed starting to hike rates, we tilted the portfolio to more defensive strategies. Global Macro tends to fall more into the defensive camp, Gibson argues.

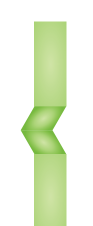
IAM sees the pickup in volatility, an increased divergence between economies and the waning impact of central bank activity as key drivers of the strategy going forward.

”Market volatility was arguably depressed by the levels of liquidity injected into the system post the global financial crisis. As these measures have eased, and in the case of the US indeed reversed, we have seen an increased level of volatility across asset classes, Malmqvist explains continuing:



”While there is clearly the possibility of further supportive central bank activity globally, the effect on markets and sentiment is less pronounced these days. Countries are also becoming increasingly divergent with regards to economic drivers and monetary policies and we would expect fundamentals to drive even more dispersion going forward. This environment should offer good opportunities for Global Macro”.

Although having a positive view on the overall characteristics of the Macro strategy given a favourable fundamental backdrop and increased levels of volatility, Malmqvist stresses that the strategy is not homogenous in nature.



“The Global Macro strategy encompasses a broad array of styles and we believe this to be crucial to understand”

”The Global Macro strategy encompasses a broad array of styles and we believe this to be crucial to understand in order to appropriately allocate to the strategy in a portfolio context”.

IAM considers a number of aspects when selecting Macro managers to client portfolios.

”There are many qualitative and quantitative factors to

WHY DO IAM FIND GLOBAL MACRO FUNDS ATTRACTIVE AT THIS POINT?

- Market volatility was arguably depressed by the levels of liquidity injected into the system post GFC (global financial crisis). As these measures have eased or indeed reversed (e.g. in the US), we have seen evidence of increased volatility across asset classes
- While there is clearly the possibility of further supportive central bank activity globally, the effect on markets and sentiment has arguably waned
- Countries' economic drivers and responses are increasingly divergent. We would expect fundamentals to drive more dispersion going forwards. Fundamental economic analysis forms the backbone for many Global Macro strategies
- Style choice is important but we believe the interaction of increased volatility and more emphasis on fundamentals offers a compelling opportunity set, not to mention the potential diversification benefits for portfolios given the broader economic backdrop

consider including portfolio manager background, asset class and geographical preferences, strategy time horizon, fundamental/trading bias, performance drivers and risk management. Through a disciplined approach we aim to characterise the different styles and how they add value when combined in a portfolio", Malmqvist says.

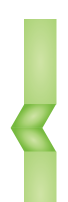
IAM works actively to balance its portfolio of Macro strategies across different styles and prefers to combine managers with complementary characteristics in order to gain diversification benefits.

"We are combining managers operating over different trading horizons and like to have some flexibility across both developed and emerging markets. Up until 2015, developed market fixed income oriented managers were de-emphasised given the largely correlated activity of key central banks", Malmqvist recalls.

"Since then we have increased exposure to include this profile of manager albeit focusing on those that are flexible across asset classes should that opportunity set decrease. We have also seen the pickup in volatility as offering a better opportunity set for those styles that encompass elements of tactical shorter term trading in their approach."

Andrew Gibson adds that IAM holds allocations to managers that have a strong local presence, meaning that they could view the world from a different lens and offer differentiating exposures.

"We have allocations to managers that are based in Asia that have a very different viewpoint of the world. Their proximity to Asian currencies makes them take on exposures against the USD and the Euro-block that differ from the positioning of Macro managers in Europe and the US. Also the fact that they are trading local rate markets makes them a good diversifier", Gibson says.



"we favour defensive strategies that have proven themselves in less risk seeking environments"

Looking ahead, Malmqvist sees defensive strategies that have the ability to profit from a bearish market sentiment as particularly interesting given the market backdrop.

"We believe that we are at an inflection point in terms of market sentiment, as a result we favour defensive strategies that have proven themselves in less risk seeking environments. Managers that have the ability to shift risk between structural and trading oriented opportunities are also favoured." Malmqvist says.

A manager that is considered fitting the preferences currently put forward by IAM is London-based Omni Macro, a hedge fund that was launched in 2007 by Stephen Rosen. The fund was awarded best Macro hedge fund at last year's HedgeWeek Global Awards.

"Omni Macro is a fund that would sit at the defensive end of the strategy spectrum and has demonstrated a bearish risk asset bias over time, most clearly illustrated versus global equities. IAM especially appreciate this fund from a portfolio perspective due to its de-correlation towards all major asset classes, Gibson explains continuing:

"We believe FX is an important asset class for Macro managers"

"The hallmark of the manager's successful track record is a strong discipline to focus on a few favourable asymmetric themes in liquid instruments. The flexible and tactical trading mixed with rigorous risk management has ensured low monthly losses and asymmetric gains across differing market cycles. The manager has a bias to FX and has positive contribution in each year over the 9 years since inception. We believe FX is an important asset class for Macro managers given market liquidity and the more constrained opportunities in fixed income", Gibson concludes.

About International Asset Management (IAM)

IAM is an independent, privately owned hedge fund specialist founded in 1989 with offices in London, New York and Stockholm. IAM creates tailor-made segregated portfolios and proprietary commingled funds and is also active as a hedge fund advisor in different parts of the research process. IAM has recently created a single manager platform of UCITS regulated hedge funds focused on a narrow field of liquid strategies.

WE THINK THE MARKET IS WRONG - AGAIN

by Jonathan Furelid, HedgeNordic

Ashwin Vasan is Founder and Chief Investment Officer of Trend Capital Management, a US based investment manager running 1.2 billion USD in its global strategy. Through rigorous fundamental economic research and thoughtful portfolio construction, the manager has been successful in generating attractive risk-adjusted returns in an environment that has been very challenging for macro trading in recent years. In an interview with HedgeNordic, Vasan shares his views on the challenges for macro trading, how he looks upon current market valuations and the opportunities ahead.

HedgeNordic: The last several years have been challenging for macro strategies, what do you see as the underlying reasons for that?

Ashwin Vasan: In my opinion, there are two reasons that can explain the lackluster performance of macro strategies in recent years. On the one hand, changes in regulation such as the Volcker rule and Dodd-Frank have made liquidity dry up which in turn has made it difficult for larger macro funds to trade the markets efficiently. On the other hand, there have been periods of systemic risk concerns, such as the Greek crisis and concerns around China that have made it a lot more difficult for managers that trade markets by primarily looking at charts and performing technical analysis.."

The traditional (or old-school) macro approach of taking large focused bets

is also much more challenging given the lack of liquidity. Today's markets require a more balanced approach to risk taking.

HedgeNordic: You mention liquidity and large funds, do you see the macro space as being over-capitalized?

Ashwin Vasan: What I am arguing is that if macro managers are going to make money more consistently over time they are going to have to be smaller to be more nimble. We have benefited from being relatively small. From the very start, we have said that the Trend Macro strategy is not intended to exceed $ 2.5 Billion, for the very reasons I enumerated earlier.

HedgeNordic: How have you managed to navigate through these difficult years?

Ashwin Vasan: What I believe we are doing differently in contrast to many other macro hedge funds is that we are not dependent on street research or technical analysis when forming our investment themes. Instead we are primarily relying on our own models and that helps us formulate views that can differ from consensus.

To give an example, in 2012, if you were dependent on street research on European macro-economics, you would not have been tremendously successful.

Conventional wisdom was predicting headwinds for the peripheral European economies. Our own research led us to diametrically opposite conclusions. When we actually spoke to the street to understand why the models we were building internally were so different from theirs, we found that some assumptions were being made in their models, assumptions that were later proven wrong.

HedgeNordic: How is your research aligned with street research and consensus market views today?

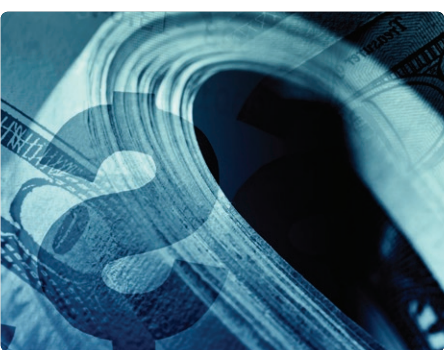
Ashwin Vasan: Even today we are in a position where we see our own analysis differing from the general market view. For example, the futures on the US fixed income market are predicting that over the next three years, the Fed will hike interest rates at the most two times. Our research has arrived at different conclusions that once again, differ from consensus.

The US fixed income markets are pricing in either a recession or at least a near-recession outcome. What our research shows is that within developed economies you have manufacturing doing quite poorly. On the other hand, the service sector is doing rather well. The significantly different composition of these two parts of the economy is the reason we think that expectations of a recession is incorrect. To be clear, we do not believe the economy is booming. Our opinion is just that we are not entering a recession, so the bond market is pricing a recession risk incorrectly. For the economy to boom, both the manufacturing and services sector need to do well.

HedgeNordic: So how do you position given this somewhat ambiguous fundamental backdrop?'

Ashwin Vasan: Because of the recessionary fears there has been a flight to safety and we have witnessed a very strong rally in sovereign bonds from the start of this year so we have started to take the other side of that trade. We expect that during the course of this year, long term as well as short term interest rates will start to move higher. In our opinion, US 10 year rates could be being closer to 3 percent by year end rather than closer to the 1.5 percent we have at the time of this interview.

HedgeNordic: We have mentioned developed markets but what about emerging markets, do you see opportunities given the current depressed valuations?



Ashwin Vasan: Emerging markets are suffering from headwinds. These markets tend to do well when liquidity is ample but liquidity is now tightening because the Fed is starting to hike rates. Emerging markets also typically do well in times of increasing commodity prices, since many are commodity exporters. The last issue is reforms and there are very few emerging markets economies that are serious about reforms today - reforms that are needed in order for them to prosper.

To us, the emerging market story is a very selective one. We favour countries that are actually pursuing reforms such as Mexico, India and Argentina.

HedgeNordic: There has been a very turbulent start to this year, has this made you change some of your longer term assumptions of where the markets are heading?

Ashwin Vasan: Our assumptions have not changed. However it is important to be cognizant to what the market is concerned about. In early January we moved very quickly as we realised that something was terribly wrong when the Chinese stock market plummeted by 7 percent in a single day. So we quickly reduced risk by cutting equity exposures and reducing duration in our credit book. As the sell-off became more severe in February, being confident in our research view that we are not entering a recession, we started to build exposure back again.

Our positioning is linked to where we find the best risk/reward ratio. Given the dramatic moves in the market, we have expressed our views by shorting US rates where we have taken advantage of the sharp rally seen in US interest rates. We have also established positions in currencies, where we long the US dollar versus Asian currencies. Our view is that China will have a weaker currency over time. It is a necessary adjustment given the ongoing restructuring and deleveraging that is taking place in their economy.

We also feel that some parts of credit markets are getting very cheap. As the market is pricing in a recession not only in the US but also for the global economy, we have added a number of positions in the credit space with relatively short duration where we felt risk/reward was good and that could allow us to ride the recovery of the markets, as concerns over the economy dissipate. In our view, credit was the better choice relative to equities which we felt was very difficult to manage, give the high levels of volatility.

HedgeNordic: When you say credits, do you also refer to US high yield which is currently under significant pressure?

Ashwin Vasan: On the credit side we do not trade single name credits, meaning individual companies, unless they are quasi-sovereign entities in emerging markets. In this environment, where we are not necessarily excited by all of US High Yield, in order to be successful here you have to trade single names. If you trade High Yield indices, over 20 percent is exposed to the energy sector and we are expecting, over the next 12 to 16 months, to see a significant increase in defaults in that sector.

In certain emerging markets, we look to benefit from the fact that spreads have gotten very wide, relative to their fundamentals. At the same time we want to limit the default risk by allocating to sovereign or quasi-sovereign debt rather than corporate credits where there exists a lender of last resort behind the underlying credit.

Ashwin Vasan
Chief Investment Officer of Trend Capital Management

FACT BOX

In cooperation with UBP Alternative Solutions, the Trend Macro UCITS fund was launched in July 2014. The UCITS fund is registered in Sweden for distribution and has SEK hedged share class, the strategy dates back to August 2011.

The strategy takes directional exposure and capitalizes on trends in currencies, fixed income, credit, and equity indices in both developed and emerging markets. It does not include any commodities or relative-value arbitrage.

The strategy trades a diversified portfolio of 10-30 investment themes, with an average holding period of 1-3 months.

The founder and CIO of Trend Capital Management, Ashwin Vasan, has over 20 years of investment experience. Previously, Ashwin was Partner and PM at Tudor Investment Corp for 10 years, before accepting the position of Global Macro PM at Shumway in 2009.

Adrian Owens
Investment Director
GAM Global Rates Team

Is 2016 Ripe for Discretionary Macro?

GAM's Adrian Owens discusses when discretionary, and systematic, approaches outperform

Since 2004, Adrian Owens has applied his experience and judgment to trading liquid currencies, interest rates and government bonds for the GAM Global Rates, and GAM Discretionary FX, strategies. Owens follows an eclectic approach where his fundamental views can be tempered by factors including technical, sentiment, positioning and price action. However, economic fundamentals do provide the rationale for his highest conviction trades.

Owens "recognises that discretionary and systematic are very broad descriptions, with each encompassing a myriad of styles and processes." Yet he finds discretionary approaches often do better when fundamentals and valuation are driving markets, whereas some systematic approaches that emphasise price action often outperform when big trends render fundamentals less relevant.

In early 2016 Owens is of the opinion that "Discretionary managers find it difficult to justify government bond yields, which look rich and expensive on many metrics so it is hard to take aggressive longs from a valuation and fundamental point of view."

Turning Points and Regime Changes

Owens' strategies are already positioned to profit from higher yields and he thinks "discretionary managers could be better at catching turning points at least in the immediate term". Systematic approaches that currently own bonds could take longer to latch onto any reversal in yields – but "if the move extends they may hang in there for longer after discretionary managers start to worry about valuations" he expects.

Turning points can usher in regime changes that play into the hands of skilful discretionary traders. Recalls Owens "When the Fed entered QE in early 2009 it was a regime change as correlations changed, in particular the inverse correlation between equities and bonds reversed and went positive." Similarly, Owens has recently noticed changing patterns of correlation, with the Euro replacing the US Dollar as the currency to buy during risk off phases.

Owens finds this type of "identifiable and understandable, one standard deviation correlation change" is tradable by discretionary managers, whereas "fear-driven three to four standard deviation moves that lead price action to take over tend to favour systematic traders" as applied in 2008. The crisis left "many beaten up assets such as bonds, credit, and high yield currencies looking incredibly cheap and discretionary managers benefited disproportionately". If 2009 was a vintage year for some macro funds, trend-followers gave back part of their 2008 profits.

Owens thinks a regime change could lie ahead in terms of government bond yields, because "Core inflation in the developed world is picking up while the US and even Europe are showing signs of recovery. Fundamentals and valuation point to higher yields- and indeed at the latest ECB meeting on March 4th, Mario Draghi said it would be hard to cut rates further".

Owens funds it surprising that Sweden's Riksbank this year cut rates further into negative territory, of minus 0.50%, and it has joined the "currency war" in threatening spontaneous intervention to weaken the Swedish Krona. Owens' career began as a UK Government economist in HM Treasury, working closely with the Bank of England. He enumerates why Sweden is manifestly one of the world's strongest economies.

"Sweden had growth close to 4% last year, is expected to grow 3-3.5% this year, has a current account surplus of 6%, house prices rising by double digits and core inflation moving higher". Owens, who follows policymakers at the Riksbank, thinks "it is making a myopic policy error in looking only at headline inflation when every other indicator suggests inflation is heading back to target levels". Though trend models have followed Sweden's interest rates and currency lower, Owens expects both to move higher.

> "Riksbank is making a myopic policy error in looking only at headline inflation"

Owens is also short of UK government bonds. "The market has been panicked into pricing in rate cuts but the UK does not need to cut rates as the real economy is in good shape" opines Owens. So pessimistic is the forward curve that the GAM strategy could profit simply if the Bank of England stays on hold.

Emerging Markets

Though Owens is predominantly short of developed market government bonds, he trades liquid emerging markets, and has another contrarian position - long of Brazilian government debt. "The consensus was that the resignation of finance minister Levy would be a disaster, on top of Petrobras and fiscal concerns, but the market recovered and has rallied since." Owens surmises "The politics was already in the price". Though trend-followers have been rewarded for shorting Brazilian government bonds, Owens thinks that "with inflation rolling over and the economy collapsing, the central bank could cut rates by 400 basis points."

Strategies rigidly wedded to currency carry have, by definition, been long of emerging market currencies, throughout their extended bear market. Owens thinks it is blinkered to view EMFX only in terms of carry and is "frustrated by the obsession over carry as it is only one dimension of a currency trade." He cites "many other real fundamental factors including China, weaker commodity prices, and a stronger US Dollar" as weighing down EMFX.

But some emerging market currencies are already perking up and nimble traders are on the case. The Mexican Peso selloff in February 2016 initially caused losses for Owens' strategy, but when the central bank mobilised intervention, the Peso position swiftly recovered losses and then moved into profit. Owens doubts whether some systematic strategies "have fast enough reaction speeds to have caught the reversal".

by Hamlin Lovell

LOMBARD ODIER

Jan Szilagyi

Giuseppe Sette

Judy Godinho

Vilas Gadkari

"The traditional Macro approach is being reshaped. The intuition of an individual "genius" can now be supported, and enhanced, by a consistent and check-list oriented search for investment opportunities."

Re-inventing Global Macro

– A holistic approach to cross-asset investing

by Jonathan Furelid

The Global Macro investment style has disappointed its investors in recent years. Despite a favorable market environment, encompassing major market dislocations and swift policy responses to correct these imbalances, the investment strategy has failed to deliver any meaningful returns since the crisis years in 2008 and 2009. But the strategy is far from dead, it is only in need of a makeover according to Lombard Odier Investment Managers.

"We think the challenge for Global Macro in recent years is closely linked to the trade-by-trade risk management typical of the strategy. Forming a holistic assessment of the entire portfolio has traditionally been the risk manager´s job. We believe there is a lot to be gained by applying portfolio construction methodologies, to exploit synergies between trades that can help the whole portfolio navigate volatile markets. And on idea generation, we think that a structured process can help us uncover alpha in the vast data available to managers", Judy Godinho, product specialist at Lombard Odier argues.

According to Godinho, idea generation in Global Macro investing has historically been the province of a high conviction, narrative driven style often leading Macro managers to rely on a small set of crowded trends and themes. We believe this style can be enhanced by a disciplined and consistent approach to detect an emerging imbalances – which can lead in turn to uncover new trends, away from the most popular trades.

"The traditional Macro approach I believe is being reshaped. The intuition of an individual "genius" can now be supported, and enhanced, by a consistent and check-list oriented search for investment opportunities. The fact that today we have increasingly available micro and Macro data across countries permit consistent and timely monitoring of business cycles in these economies", Godinho says.

The way Lombard Odier approach Macro investing is along the lines of a discretionary yet structured and repeatable process, always with a cross-country perspective in mind. The aim is to have Macro ideas translated into balanced portfolios with convex risk profiles.

"We deploy the classic global Macro approach in a methodical framework. In order to formalize our ideas into a clear and repeatable process, the team has developed a proprietary research

platform. The platform collects a vast array of investment methodologies and covers over 600 securities across all liquid asset classes. We rely on this framework to analyze the behavior of candidate portfolios in real-time as positions are added to or removed" Godinho says continuing.

"Our risk based approach means that we are looking to build portfolios that are prepared for short-term shocks but at the same time allow us to monetize on our longer term views. The focus on robust portfolio construction and the convexity of our positioning enables a longer term trading horizon and a de-emphasis on trading."

In constructing the investment portfolio, the research platform links the idea generation, portfolio construction and risk management parts of the process together and reassures that the convexity profile holds.

> *"Our risk based approach means that we are looking to build portfolios that are prepared for short-term shocks but at the same time allow us to monetize on our longer term views."*

"We do the groundwork in the idea generation part of the investment process. Here Macro and bottom-up data are carefully analyzed and we form an idea of what the underlying Macro drivers are. During portfolio construction we then test different combinations of ideas to end up with those that generate the best risk-return trade-offs. The sizing of positions is built partly on conviction but also on our assessment of the convexity contribution, we also ensure convexity versus risk factors, Godhino explains.

In October 2015, Lombard Odier launched a discretionary Macro fund managed by veteran portfolio managers, Vilas Gadkari, Giuseppe Sette and Jan Szilagyi, that builds on their research platform and process-driven portfolio construction process. By year-end, the portfolio was down 1.6%, in a period that was marked by significant market turbulence.

"It was a volatile time to launch and it demonstrated that our risk framework is sound. We see 2016 as offering ample opportunities."

Going into 2016, the portfolio is positioned for several idiosyncratic trades.

The team expects commodities footing here to last, even if they argue that a recovery of oil above might be dampened by returning supply, thus stopping the upside for most commodities.

In this scenario select Emerging Market equities can overperform. East Asian currencies should keep grinding lower, albeit with wide swings, dragged by the Chinese Yuan.

In developed markets, equities will probably offer larger moves on the downside than upside. However, given the extremely low level of interest offered by government bonds, equities will find a bid at oversold levels. This especially applies to high dividend stocks.

"US labor market data is clearly supporting the start of the Fed rate hiking cycle and we think the front end of the US fixed income is offering attractive opportunities given that signs of inflation in consumer prices and wages are starting to emerge in the US. In Europe we believe that equities will be supported by high dividend yield spreads to Bund yields, as well as further monetary easing and possible fiscal spending. As for US stocks, we foresee further tightening of US financial conditions will impact small and medium sized companies disproportionately", Godinho says and concludes:

"As always, you need to have a portfolio architecture that allows for the markets to move against your core themes in the short term. This is where I think the team's approach is different from the traditional Macro space."

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- A strategy which has the potential to generate returns in both rising and falling markets (+7.73% year-to-date on 29 February 2016)
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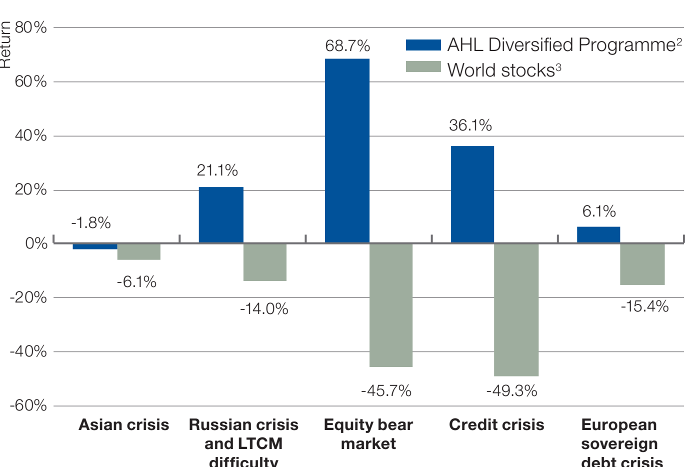
- Available in a number of different formats, including UCITS with daily liquidity[1]
- Offered by Man AHL, a pioneer in trend following strategies with a 25+ year track record
- Trading around 450 markets and constantly evolving

Performance during difficult equity market conditions

26 March 1996 to 29 February 2016



Asian crisis: 1.10.97 - 31.10.97; Russian crisis and LTCM difficulty: 1.8.98 - 30.9.98; Equity bear market: 1.4.00 - 31.3.03; Credit crisis: 1.7.07 - 28.2.09; European sovereign debt crisis: 1.4.11 - 30.9.11

The periods selected are exceptional and these results do not reflect typical performance. As a consequence, they give no indication of likely performance. Additionally, selective periods are subjective and may be different to periods selected as exceptional by other sources. **Past performance is not indicative of future results. Returns may increase or decrease as a result of currency fluctuations.**

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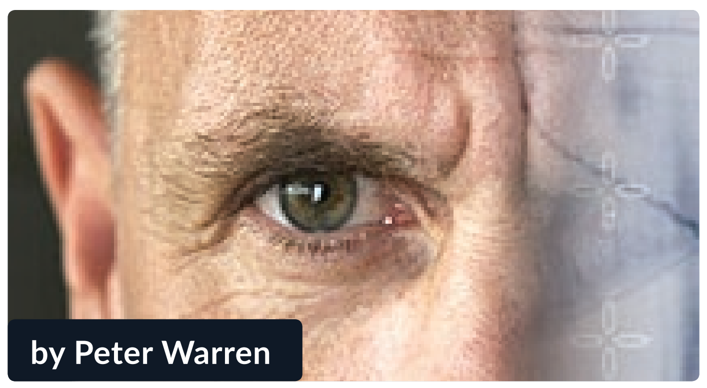
GLOBAL MACRO AND CTA FUNDS STRIKE BACK



by Peter Warren

The quantitative easing measures that started for real at the end of 2011 and that have continued up until the second half of last year, has made the investment climate for global Macro funds very challenging.

Global Macro managers seek to benefit from changes or dislocations in the economic or geopolitical Macro environment that the market has yet to price in. The opportunities that these strategies look to exploit could either be absolute or relative in nature.

One example of an absolute opportunity was the mispricing of CDS-contracts that occurred going into the financial crisis. The pricing of these contracts was extremely cheap as a result of banks and insurance companies competing to sell these contracts in order to increase the return of their bond portfolios.

What followed was a huge discrepancy between the performance of corporate bonds and the equity market. Contrary to logical thinking, the perceived safe part of companies' capital structures (bonds) declined in value, while equities continued to rise. Ironically, the same thing happened in 2015.

You could either see this as a relative value position (short equities/long bonds) or you could adhere to the view that the equity market was on steroids and go outright short.

When Macro managers find an opportunity that is judged to be substantial, the choice of financial instrument to express the view is next on the list. The toolkit at hand is only limited to the knowledge set of the manager and their funds' requirements for liquidity and valuation of positions.

The most common way for a Macro manager to express a view is through currencies or fixed income. Within equities the typical positioning is to take positions through index futures or in different sectors, either absolute or relative (long one sector and short another).

Macro funds only rarely invest in individual stocks as this is considered a too detailed approach (micro). Instead, they specialize in- and try to capture broader (Macro) trends as they unfold.

As already mentioned, these funds have struggled in a period where central banks have made financial markets detached from economic fundamentals. Performance numbers have by no means been catastrophic but as financial markets have temporarily lost their link to economic realities, these managers have had a hard time making money. Most Macro funds have delivered close to zero percent returns in recent years.

Experienced Macro investors have held on or added to positions in these funds. They seek to benefit from the diversification benefits and are recognizing the fact that no financial market can be fooled all the time.

FUNDAMENTALS WILL PLAY OUT; IT IS ONLY A MATTER OF TIME

No central bank can withstand fundamental pressures forever. Sooner or later something has to give resulting in a massive market correction. The SNB giving up the EUR/CHF peg on January 15, 2015 being the perfect example. Investors had continued to borrow Swiss francs despite the fact that the interest rate differential to other currencies was at historical lows. The central bank had to use an enormous amount of resources to keep the currency weak.

On January 15, the SNB (the Swiss National Bank) made the currency float, resulting in the largest correction ever experienced in a major currency on a single day. The resulting surge in the value of the Swiss franc caused both financial and human tragedies worldwide.

Given the common belief that the SNB would continue to keep selling its currency, the pricing of option contracts that would protect against a sudden spike in the Swiss franc was at its lowest level right before the event. Against the Norwegian Krone, the Swiss franc surged 39 percent in just a few minutes (see chart).

It is also ironic to see that global Macro and trend following funds (CTAs) had the largest net redemptions last year, which coincided with equity mutual funds having the largest net subscriptions. This highlights the fact that investors continue to look in the rear view mirror (focusing on past performance) rather than looking ahead when making investment decisions.

There's An Elephant In The Room – Let Us Talk About Performance

BY KAMRAN GHALITSCHI / PUBLISHER AT HEDGENORDIC

Famine and Feast for Macro and CTA

In early 2016, CTAs are the best performing hedge fund strategy, with the SG Prime Services CTA Index up 4.16% and the SG Prime Services Short Term Traders Index up 5.97%, at the time of writing in early March.

Though CTAs, and short term traders, have different return patterns (with shorter term traders an very diverse group in themselves!), these indices of both groups made very little, if any, money for a prolonged period of five years between 2009 and 2013, (as shown below). And 2014 was the first year of double digit returns since the crisis of 2008. In both years, CTAs successfully profited from trends including the collapse of oil prices.

	SG CTA Index	SG STT Index
2008	13.1%	11.74%
2009-2013	-2.3%	-9.0%
2014	15.7%	10.0%

In the Macro world, returns have been somewhat more stable, with the SG Prime Services Macro Trading Index delivering positive returns for six of the past seven years; however the level of return has been in single digits on average.

	SG Macro Trading
2008	5.8%
2009-2013	7.4%
2014	3.7%

But this is a tale of two halves. Digging into the two Macro Trading sub-indices reveals that quantitative Macro traders have, on average, done better.

	SG Macro Trading	SG STT Index
	Discretionary	Quantitative
2008	2.44%	11.71%
2009-2013	8.2%	6.9%
2014	-0.2%	11.45%

Cheap Insurance?

If investors are confident that CTAs and Macro funds will provide "crisis alpha" and come to the rescue during panics, then a return close to flat during benign financial market conditions is arguably 'cheap insurance'. Long volatility, short equity or short credit, strategies that also perked up in early 2016 could have incurred very large losses between 2009 and 2014.

QE and ZIRP

Over this period, some Macro and CTA managers blamed QE and central bank intervention for making markets more correlated and harder to trade. But zero interest rates have a more obvious impact. Interest on spare cash was, pre-crisis, an important source of returns. CTAs and Macro funds typically run margin to equity of 10-20%, meaning that as much as 80-90% of the fund can be sitting in cash. Before 2008, this might have earned as much as 5% or more in some currencies, so in some years interest on cash outweighed trading losses. After 2008, managers have been lucky to get any interest at all on cash, and interest income does not cover funds' fixed fees and expenses. Investors accessing Macro or CTA strategies through unfunded overlays/managed accounts naturally view returns as a spread over cash, and those investing through fund structures should, too.

Exceptional Performers

Still, the broad indices are only averages - and some differentiated strategies have performed particularly well. In the CTA world, the Man AHL Evolution strategy, which trades non-traditional markets including non-futures and non-exchange traded markets, delivered a Sharpe ratio above one between 2009 and 2013. Some shorter term traders have also distinguished themselves. In Macro, Sweden's Informed Portfolio Management AB (IPM), which applies systematic models to fundamental economic data, continues to generate strong returns post the financial crisis. On the discretionary Macro side, Moore Capital spinout Stone Millner has outperformed peers. Conversely, outliers at the bottom end of the performance leagues have, of course, dropped off the tables altogether, as some discretionary commodity traders and currency funds have shut down.

Outlook for Flows

But institutional investors are not just looking in the rear view mirror at recent performance. Rather they are seeking uncorrelated returns, according to Deutsche Bank's 14th Alternative Investor Survey, which gathers data from over 500 allocators controlling two trillion US Dollars, representing roughly two thirds of hedge fund industry now estimated at just below three trillion Dollars. The survey highlights that "The largest investment consultants and pension funds plan to add to one or more systematic strategies, including quantitative equity market neutral, CTA, quantitative Macro, quantitative equity and quantitative multi-strategy."

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Nominations: BestNordic CTA 2015

Nominations to the Nordic Hedge Award are a result of normalized, weighted data drawn from the HedgeNordic database and are based on absolute and relative performance, Sharpe Ratio, consistency of returns and long and short term annualized performance, expressed in a point scoring model. The model for determining short listed funds was co-developed by Nordic Business Media AB as organizer of the Nordic Hedge Award and Stockholm School of Economics. The model was fine tuned and coded by students of the Royal Institute of Technology, Stockholm (KTH).

Following the quantitative shortlisting of the five nominated funds, a jury of industry professionals will assign points to the individual funds. The quantative and qualitative scores will be added up to determine the winners and runners up. Winning managers will be distinguished at the final event oft he Nordic Hedge Award on April 27th in Stockholm.

Nominated in the category „Best Nordic CTA 2015“ are the following funds. (listed in random order)

RPM Galaxy
Risk & Portfolio Management (SWE)

IPM Systematic Macro Fund
Informed Portfolio Management (SWE)

Estlander & Partners Alpha Trend Program
Estlander & Partners (FIN)

IPM Systematic Currency Fund
Informed Portfolio Management (SWE)

SEB Asset Selection
SEB (SWE)

HedgeNordic congratulates the nominated funds and managers!