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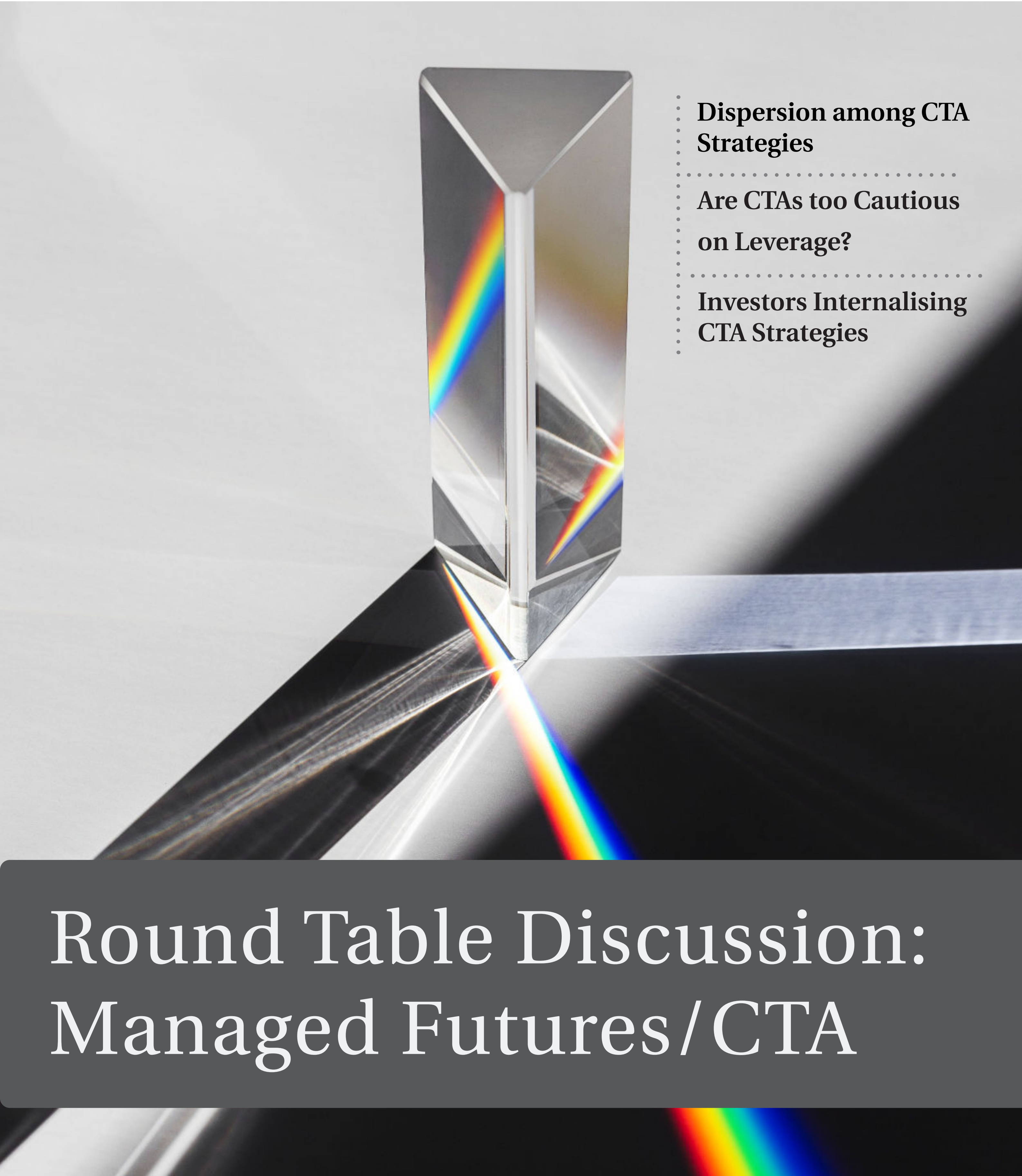

Round Table Discussion: Managed Futures/CTA

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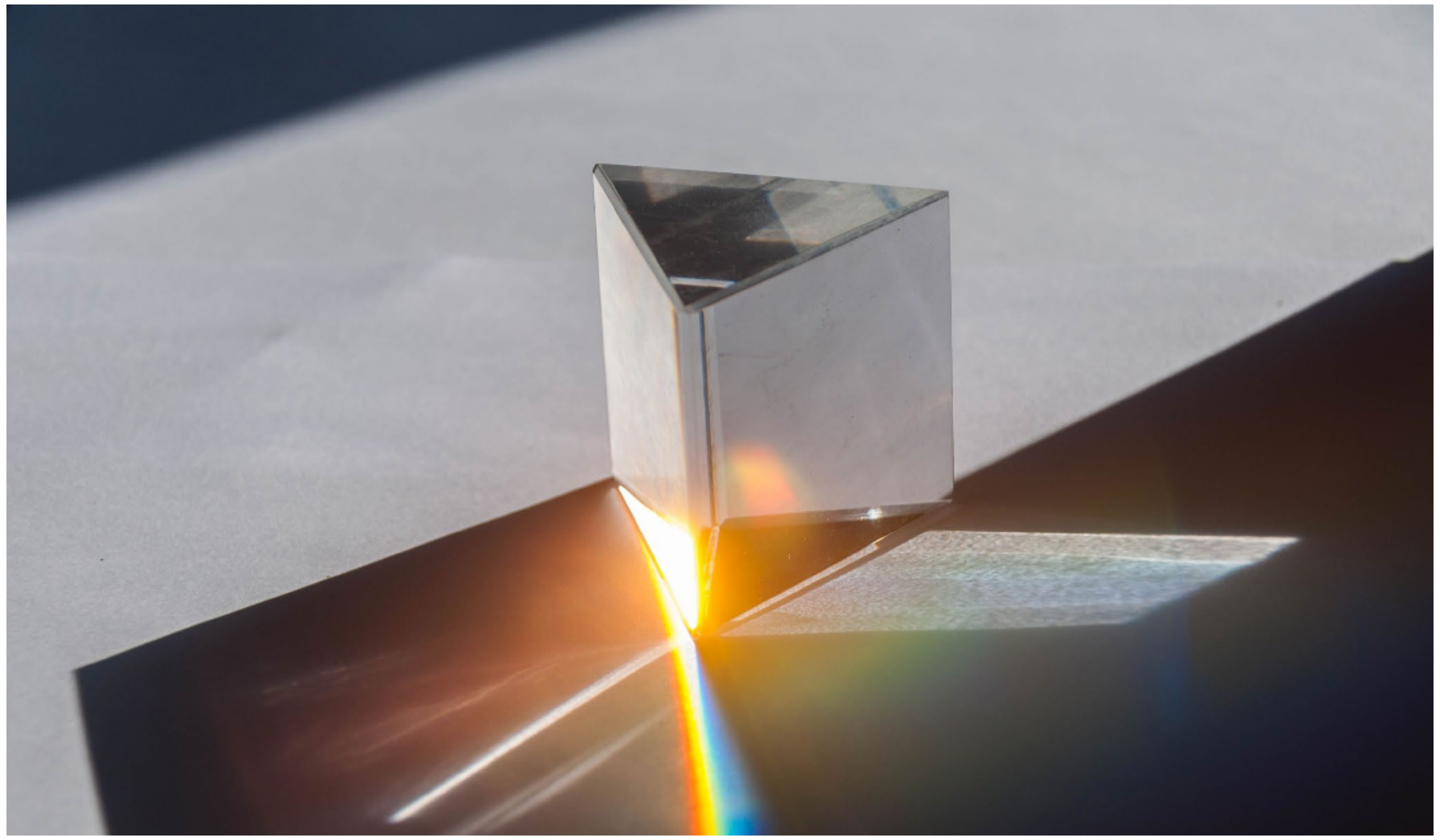

Editor´s Note...

CTA Dispersion - All but a Homogenous Group

On November 5th 2019, HedgeNordic invited to its traditional, annual CTA roundtable in Stockholm. This was already the seventh year running we had the privilege of hosting this event, which has become a fixed point and much treasured highlight in our agenda.

We were, again, extremely pleased with the lineup of managers we were able to gather around the lunch table to discuss the status of the CTA space. We welcomed Gernot Heitzinger (SMN), David Denison (Florin Court), Kathryn Kaminski (AlphaSimplex), Martin Källström (Lynx), Razvan Remsing (Aspect Capital), Artur Sepp (Quantica Capital), Alex Lowe (ISAM), Harold de Boer (Transtrend) Chad Martinson (Efficient Capital) and Christian Lundström (Swedish Pensions Agency) to the discussion, which was moderated by Jonathan Furelid.

Without the benefit of a crystal ball available at the time we met in early November, there was no way to know that CTAs on an index level were on track to secure their best year of performance in half a decade. The SG CTA Index closed 2019 up by 6.2%, the strongest returns since 2014. Though all sub-sections managed to clock in black numbers, there was much dispersion among the various strategies, and, indeed, managers within a specific strategy, too. The SG Trend Index faired best, advancing by 9.2%.

Notably, with AlphaSimplex, Aspect, ISAM, Lynx and Transtrend, we had gathered half the constituents of the SG Trend Index around the table in Stockholm.

HedgeNordic´s own CTA-Subindex to the Nordic Hedge Index, which currently includes 16 funds, fell behind its international peers and closed the books up just shy of 1%, having suffered losses in September, October and November and only inching back slightly in the year´s last month. For us in the Nordic region, too, dispersion was the big topic with individual manager´s performances ranging from -8.9% for Estlander & Partners Alpha Trend II - Class P to +15.4% for Lynx (Sweden).

Leaves me to thank all the participants of the round table discussion for their time and efforts for joining us and then putting together this write up and wishing you a good read (and some steadiness) when diving into some Nordic Insights to Managed Futures / CTA.

There was a rich plate of topics and themes to feast on and the lively discussion brought some interesting insights and opinions to light.

Topics that were discussed included recent performance of the individual managers at the table and the industry as a whole and the role CTAs play - be it as a tail hedge, crisis alpha or an actual performance engine. Relating to performance, we discussed the large dispersion of performance among different CTA strategies that seemed to be a characteristic of the year 2019, and what the causes and consequences may be.

Christian Lundström challenged the managers suggesting they were too cautious in using leverage available and thus surrendering performance, which triggered an interesting discussion around volatility, among others. Managers shared their views and experience on losing mandates from large institutional investors who had been internalizing simple trend models. At least this trend has seemed to have started reversing. Wrapping up we looked at developments in the CTA space and how new technologies such as machine learning and artificial intelligence as well as alternative data sets were incorporated into trading strategies, or indeed, resulting in new trading approaches.

Enjoy the read, have a great year 2020 ahaed and happy trading!

KAMRAN GHALITSCHI
CEO & PUBLISHER HEDGENORDIC

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PARTICIPANTS:

THE ROUND TABLE DISCUSSION TOOK PLACE IN STOCKHOLM, SWEDEN, ON NOVEMBER 5TH 2019

Alex Lowe

Managing Director

ISAM

Alex Lowe is, along with Roy Sher, responsible for the day to day running of ISAM. He is a member of the ISAM Systematic Trend Investment Committee, the ISAM Compliance and Risk Committee and the ISAM Capital Markets Management Committee. Alex was previously at Man Group, where he was CEO of Man Global Strategies (MGS) and a Director of Man Investments Ltd. MGS was a division of Man Group, running over 100 products investing $19bn of client money into a wide range of hedge fund strategies, across the globe. In addition, MGS was responsible for a pool of $500m of Man Group's proprietary capital for investments into early stage managers.

Prior to Man, Alex worked as a Senior Trader at BNP Paribas in Paris from 2001 -2003 where he was responsible for Equity Relative Value Trading, setting up a series of quantitative model, and at ING Barings from 1998 2001 as a senior salesman. Alex graduated from the University of Newcastle with a degree in Politics and was a Captain in the British Army.

Christian Lundström, PhLic

Head of Fund Selection and Compliance Unit

PENSIONS MYNDIGHETEN

Christian Lundström is the Head of Fund Selection and Compliance Unit at the Swedish Pensions Agency, heading the fund selection and due diligence for the premium pension fund platform (approx. SEK 1.300 billion).

Christian's background is in manager selection from his previous employment as a fund manager at Carnegie Investment Bank, Folksam, and other firms. Christian has also a background in academia, receiving his B.S., M.S., and Ph.Lic., degrees in economics from Umeå University, authoring numerous peer-reviewed papers related to commodity trading strategies and CTA funds."

David Denison

Partner, Deputy CIO

FLORIN COURT CAPITAL

David Denison has 16 years of hedge fund experience, following his earlier academic career. Prior to joining FCC, David was the Head of FX at Man/AHL, which he had joined in 2008 as a senior quantitative researcher. As Head of FX, he was responsible for the modelling and investment management of AHL's multi-billion dollar FX portfolio. Prior to AHL, David worked at IV Capital (2006-2008) and Gloucester Research (2002-2006) focusing on quantitative research in equities.

Prior to joining Gloucester Research, David lectured in Statistics for five years at Imperial College, London, focusing on modern computational statistical methods. David holds a Ph.D. from Imperial College, London, and his 1997 dissertation won the Savage Award. He gained a first-class mathematics degree from Oxford University in 1994. He is the author of "Bayesian Methods for Nonlinear Classification and Regression", Wiley, 2002.

Chad Martinson

Co-CIO, Managing Director Investments

Efficient capital management

Mr. Martinson is the Co-Chief Investment Officer and the Managing Director of Investments at Efficient. In this role, he manages the firm's investment process, serves as the Portfolio Manager, and helps shape strategic priorities as a member of the Leadership Team. Mr. Martinson joined Efficient in 2002 after nearly a decade in the technology industry, serving as the firm's Chief Technology Officer.

After leading the development process to build out Efficient's proprietary managed futures platform, he joined the investment team in 2005 and has served as the Portfolio Manager since the end of 2007. Mr. Martinson graduated from Taylor University in 1994 with a BA in Chemistry/Pre-med. He holds a Series 3 license and is a Chartered Alternative Investment Analyst (CAIA) Charter Holder.

Kathryn Kaminski, Ph.D., CAIA

Chief Research Strategist and Portfolio Manager

ALPHASIMPLEX

As Chief Research Strategist at AlphaSimplex, Kaminski conducts applied research, leads strategic research initiatives, focuses on portfolio construction and risk management, and product development. Kaminski is a member of the Investment Committee and serves as a co-portfolio manager for the AlphaSimplex Managed Futures Strategy.

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

Kaminski co-authored the book Trend Following with Managed Futures: The Search for Crisis Alpha (2014). Kaminski has taught at the MIT Sloan School of Management, the Stockholm School of Economics and the Swedish Royal Institute of Technology.

Kaminski earned a S.B. in Electrical Engineering and Ph.D. in Operations Research from MIT.

Gernot Heitzinger

CEO

smn

Gernot Heitzinger, CEO, is responsible for the Portfolio Management activities and Client Relations of SMN. He started his career in banking at the equity trading desk of an Austrian bank, changed into asset management as an equity fund manager.

In 1998, Heitzinger became CIO of an Austrian Pension Fund until he took over a management role at INVESCO, US based asset management company. In 2004 he joined the management board of SMN.

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PARTICIPANTS:

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Harold de Boer

Managing Director

transtrend

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

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

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

Artur Sepp

Director Research

QUANTICA CAPITAL

Dr Artur Sepp is responsible for the Research at Quantica Capital AG. Prior, Artur worked at Julius Baer in Zurich as Senior Quant Strategist, developing algorithmic solutions and strategies for trading and portfolio advisory. Before that, Artur worked in leading roles as a Front Office Quant Strategist for equity and credit derivatives trading at Bank of America Merrill Lynch in London and Merrill Lynch in New York since 2006.

Artur holds a PhD in Mathematical Statistics from University of Tartu, an MSc in Industrial Engineering and Management Sciences from Northwestern University, and a BA in Mathematical Economics from Tallinn University of Technology.

Artur's research and expertise are with econometric data analysis, statistical machine learning and computational methods along with corresponding technology and applications for quantitative trading, wealth management and asset allocation. He is the author and co-author of several research articles on quantitative finance published in key journals.

Martin Källström

Senior Managing Director and Partner

LYNX

Martin Källström is a Partner, Senior Managing Director and member of the Executive Management Team at Lynx Asset Management. He is a co-opted member of the Investment Committee and is a registered Principal for Lynx with the CFTC/NFA.

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

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

Razvan Remsing

Director of Investment Solutions

aspect capital

Razvan Remsing joined Aspect Capital in July 2010 and is Director of Investment Solutions. Razvan and his team are an integral part of the product development and research functions at Aspect and also provides quantitative expertise to Aspect's clients on investment process and the development of new product ideas.

Razvan's primary responsibility is client communication on matters relating to strategies, products, performance and research. Prior to Aspect, Razvan worked at Skybound Capital, Clear Horizon Capital, and PeregrineQuant (now Vunani Fund Managers) in various quantitative research roles.

He graduated with distinctions in Mathematics, Applied Mathematics and Physics from Rhodes University. He holds a BSc (Hons) in Theoretical Physics from Wits University and was awarded an MSc in Financial Mathematics from the University of Cape Town and is a CFA Charter holder.

Jonathan Furelid

Journalist

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Jonathan Furelid is working as a freelance communications consultant and journalist with a special focus on the Nordic asset management industry.

Jonathan's previous experience include roles as risk manager and investment analyst at RPM Risk & Portfolio Management and head of investor relations communications at Laika Consulting.

Jonathan has been working with Hedge Nordic on a freelance basis since 2012.

Jonathan Furelid holds a M. Sc. in Business Administration from Linköping University.

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Participants, left to right: Christian Lundström (Swedisch Pensions Agency), Kamran Ghalitschi (HedgeNordic), Alex Lowe (ISAM), Chad Martinson (Efficient Capital), Gernot Heitzinger (SMN), Kathryn Kaminski (AlphaSimplex), David Denison (Florin Court), Artur Sepp (Quantica Capital), Martin Källström (Lynx), Harold de Boer (Transtrend), Razvan Remsing (Aspect Capital), Jonathan Furelid (HedgeNordic)

ROUND TABLE DISCUSSION

MANAGED FUTURES

THE ROUND TABLE DISCUSSION TOOK PLACE ON NOVEMBER 5TH 2019 IN STOCKHOLM. ALL REFERENCES TO DATES, TIMELINES, PERFORMANCES, NEWS AND EVENTS ARE TO BE SEEN FROM THAT POINT IN TIME.

On November 5th, 2019, HedgeNordic hosted its annual CTA roundtable in Stockholm, including some of the world's most distinguished managers within the field of systematic futures trading. The purpose of the gathering was, among other things, to discuss recent performance, the role of CTAs in multi-asset portfolios, whether managers are too cautious on leverage and how institutional investors are currently dealing with the strategy.

On This Year's Performance

Commenting on recent performance, managers gave an overall positive picture of the year so far, with the "problem child" being commodities and programs with a relatively high allocation to this particular sector.

Katy Kaminski: This year has been both exciting and exhilarating but also challenging at certain points. We published an insights piece written by me entitled "Markets

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in Motion - the return of trend". This piece highlights what we saw in 2019; a massive momentum move in bonds. This move has been the biggest this year. This move started in Q4 of 2018 as the U.S. Fed stepped in to "do as appropriate." Big moves can be positive for trend-following strategies and we have seen a positive year for our Funds, particularly in our UCITS fund, which does not include many commodities. Commodity markets have been highly idiosyncratic this year, with shocks coming in both directions. Our models have had relatively lower conviction in commodity trends, something that has also been positive for us year-to–date.

Gernot Heitzinger: Well, we're the dispersion here definitely. We had very tough year so far. We have always been quite commodity-heavy, not only in our "alternative markets" product, which is a commodity-only product, but also in our traditional product, where actually we had way too little exposure to bonds for this scenario. The interesting thing is we had one investor, where we had a dedicated account which was exclusively in bonds, but the investor decided to shut it down in February, just before the real rally started. 20 years of experience show that itis always a call to raise your allocation, when most investors give up. Nevertheless, our risk index took us out of bonds too early and commodities was a very difficult area to be in. We were up only three by the end of August. Then we had a big draw down in September, which was the second worst month since our inception 23 years ago. We are now down 15% for the year. We always had a very high allocation to commodities. But it reminds me of the situation in 2013 where we also were lagging the industry a lot. It helped in 2014, but let's see what comes up next this time.

Chad Martinson: We're running several multi-manager portfolios these days. But our flagship fund, which runs at 12% volatility, is up close to 15%. The last two months have been negative, but because the diversifying strategies in the portfolio have performed reasonably well, we have meaningfully outperformed the industry. The strong relative performance from the diversification on the books has helped mitigate some of the pullback. In our trend product, which maximizes cash efficiency and runs at more than 30% volatility, is up more than 50%. It was up nearly 90% earlier in the year. We actively manage for volatility at Efficient. So, you allocate a lower nominal amount to a manager with higher volatility and you realize the same impact on return as another manager with lower volatility.


Jonathan Furelid, HedgeNordic


Martin Källström, Lynx

Harold de Boer: I recognize the commodities element. Transtrend has a commodity background. And since we became a CTA there has always been a decent amount of commodities in the program. It is a way for us not to be too concentrated in just one big trend. We recognize the big trend in bonds, and all the safe havens, which was absolutely the best trend this year. We profited well from that, but never want to be overly concentrated in just one trend. We are happy that by the end of August we were at new equity highs again, after a drawdown that started in February 2018. The SG Trend Index as a whole is still in a drawdown that started in 2015 which is too long of a drawdown. So by being diversified we can do well, but yes, it means that you can lose in commodities sometimes, just as you can lose in bond markets in other periods.

Martin Källström: When it comes to performance this year, it's important to remember how last year played out, particularly in the fourth quarter. Those final few months of 2018 were very interesting as stocks fell sharply and we, along with many others, turned our portfolio defensively in response to the risk-off event. As a result, we came into 2019 with a very low net position in equities and an increasingly long fixed income exposure. That repositioning in fixed income markets has served us very well this year, although we did miss out on some of the strong returns in equities, particularly in the first quarter. While we have made money in stock indices, relatively large price swings have not been overly conducive to our trading strategy. Currency and commodity markets have generally been difficult for us this year, although we have generated strong double digit returns for both our flagship program and for our long only balanced fund - Lynx Active Balanced Fund. The new Lynx Constellation program which is employing machine learning models to optimize a high idiosyncratic Sharpe Ratio, just launched on the 1st of October, but has also gotten off to a good start. With that said, it is still early to assess performance, of course.

Artur Sepp: Our flagship fund is up 35% gross ytd. It is a great performance given our volatility target of 12%. Since the end of August, we are flat. This year, I think what for us was exceptionally good was how the model was able to predict the early upturns in equities and bonds. The model increased allocations to equities in January and February; fixed income exposure increased

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before March, then peaked, and then gradually reduced during the summer. I think, and also coming from last year's performance, the main message for us, apart from the performance, is to have confidence in the model and also to know the areas where we need to improve. I'd say on the commodities side we didn't have much risk allocation. We lost some money, but it was not detrimental to performance.

Christian Lundström: From the fund selection side, or at least representing a fund platform, in terms of CTAs, it's safe to say that the last 10 years have not been that good performance-wise compared to stocks. So, it's hard to convince investors to buy CTAs, but I think the coming 10 years will be better. The macro environment is helping CTAs build up and I think with Trump and some trade wars, it would be a good position to have, especially as a hedge towards that. I think that the next 10 years will be better than the last.

Razvan Remsing: We've had an interesting year so far. We have a number of strategies at the moment that are actually quite different to one another. We have a whole range of trend programs that span all the way from the most liquid markets to the alternative market spectrum. In the trend space we've done, I'd say, pleasingly well. The flagship fund is having a strong year. The alternative market space, which can be commodity heavy, has actually also been doing well this year with predominantly trend. We do utilize a top-down model that helps us navigate concentration in times when the opportunity-set narrows.

The opening statement from Kathryn was that it was all about fixed income this year. If one gets the fixed income trade right this year, that's the major source of profits. But then there have also been some other sharp rotations. One could also have a good year by navigating those rotations well. Some of the research enhancements we've done over the years has helped us navigate the bond rotation in September.

We had our peak positions beginning of the year and actually through the summer months we've been aggressively selling out of fixed income. Not because we've got a crystal ball that tells us when things are going to turn around, but simply because when the portfolio had little else on the table, really the risk of a reversal then would have been far more detrimental.


Razvan Remsing , Aspect

"If one gets the fixed income trade right this year, that's the major source of profits. But then there have also been some other sharp rotations. One could also have a good year by navigating those rotations well."

Razvan Remsing

But yes, we were down in September, and a bit down in October as well. One of our other strategies that is sizable and gathering investor appetite is a relative value, systematic macro strategy, which had a good time last year and this year is near flat but had usefully strong months in May and August. The big returns were at times when equity markets fell. I think for us it's been a question of describing that performance profile and a lot of our institutional clients are coming to us requesting variants of trend. Those are starting points and eventually they pick and choose a mix of strategies in the right balance that make most sense to their portfolio. It's been a much more successful year than the challenges of last year.

David Denison: We are up net about 10% to the end of last month. And that, as everyone knows, has a lot to do with fixed income. But also, something no one's mentioned is that credit has been very good for us this year as well. And we've been hit in all those usual ways with the commodity story; and being an alternative markets fund you do have quite a few commodities to choose from. And I wish that we had had far less really.

Alex Lowe: I'd pretty much echo what everybody said. Difficult January, difficult September, difficult October, only made money really in fixed income and credit. And that's been a real help. But diversification hasn't helped you at all. Sometimes it's better just to buy Apple shares, that's just how it is. The 30-year bond trend continues. And we're in it. And we're up two or 3% year to date. But diversification away from that, whether it's equities, commodities, alternative markets, just hasn't helped.

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“I think almost every investor benefits from including CTAs in their portfolios from a diversification standpoint.”

Christian Lundström

Are CTAs to be Seen as a Hedge?

Commenting on the role of CTAs and whether the strategy should be seen as tail protection/“hedge” as strategic long-term diversifying component to a traditional portfolio of stocks and bonds, or in fact a performance engine, managers and allocators had somewhat different opinions. Most managers agreed that it is important to be explicit about the strategy´s investment goal in order to have clients having reasonable expectations.

Christian Lundström: I think almost every investor benefits from including CTAs in their portfolios from a diversification standpoint. Say that you have fixed income and equities, CTAs definitely have a place there. If you get the time series momentum right you get a risk premium from that. In fact, I think you can get to two things from CTAs. Firstly, some kind of equity tail hedge, at least from the short-term trading CTAs. Actually, I see CTAs as two asset classes, on the one hand you have some CTAs that tend to be short term volatility breakouts, the type of strategies with one week holding periods and shorter. On the other hand you have the classic trend-following CTAs capturing the time series momentum risk premium.

From my research, I find that short-term CTAs have a positive factor loading against the VIX and I think you could combine those with traditional long volatility strategies you can create a relatively good hedge product against the equity tail risk that isn’t really available today. That is, I think investors should treat short-term and long-term CTAs as two different assets with different characteristics.

Further, when analyzing long-term CTA performance, I find in my research that trend following is generating positive returns net of cost and that’s why you should have long-term CTAs. But it’s not really a good hedge against equity tail risk in the short perspective which one may be lead to believe from the crisis alpha literature. Of course, in the long run, it’s a good hedge, in extreme periods, like the one we had in 2008. Thus, you should have both short-term and long term CTAs but for different reasons.

Today, I think managers mix short and long trade signals to try to make CTAs more diversified than simply trend-following. But from my perspective, you should break it off to make a long volatility product and a pure trend-following product. But that’s maybe my opinion. If you deliver CTA system exposure to clients, I think that if you’re able to capture long vol really well, that this very good thing to have.

Harold de Boer: I will say you should actually not invest in “CTAs” at all. You could invest with a Aspect for example or with any other manager you like, but not in “CTAs”. I think that was one of the big mistakes made; this whole idea of that this is just a style. CTAs were doing very well in the 90’s when we were not considered a uniform industry, but different CTAs doing different things. All of them happened to benefit from trends. The average of all these different approaches defined what because knows as trend following. And this style did well in environments that were difficult for stock markets. This is explained by our choices to do things differently, and that choice is even more Important today to be able to do well again in such environments.

There are different ways that CTA programs can do well during stock market declines. Having a large exposure to long bonds is just one of them and this has again proved to provide such protection during some trade war related downturns in stock markets earlier this year. However, in other stock market declines such protection came mostly from sizable positions in commodities. And in yet other periods protection has come from currencies. So that’s why we try to have a multitude of themes in our program.

I think currently the largest systemic risk in investments is hidden in the widespread implicit assumption that liquidity is available for free. The extent to which an investment program is sensitive for this is more determined by the extent to which free liquidity is assumed, even in large sell-offs, than by the specific style or strategy itself. It also applies for long-only stock market investors. You will have some investment managers that assume this liquidity is available for free and others that are not assuming that. The ones that are assuming it, will likely do very poorly in a big sell off, especially in a liquidity sell off.

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This is the same for CTAs. In fact, in any style, there are managers that are really liquidity assuming, which is absolutely the big bubble at this moment and others that are away from it. To protect from that, it's better to select the right managers, irrespective of whether they are CTAs or hedge funds or traditional managers, than to select the investment style.


Christian Lundström and Razvan Remsing

Martin Källström: I would like to bring us back to the very important original question, whether CTAs are a hedge or just a diversifier. I think this ultimately comes down to how each manager designs their specific strategy. At Lynx, we believe that it serves us – and our clients – well to be explicit with our investment goals. The goal of our flagship program is to generate attractive risk adjusted returns while also protecting portfolios of traditional assets when crises occur, specifically when they develop over a longer period of time; a sudden fall in equity markets is not something we are designing our models to profit from. We believe that a trend following approach is very suitable for this objective. However, we have found that our older, univariate trend following models are not performing nearly as well as our more advanced interpretations of trend. By adapting our approach, we have been able to retain the strong return distribution properties of trend while expecting a better risk adjusted return.

As a CTA, managed futures manager, or whatever you want to call us, we can apply a wide range of investment strategies and hence construct portfolios for different investment purposes. Since we try to be very explicit with the goal and the strategy style, clients can come to us with different investment objectives. We can even, to the point raised before regarding solutions, customize our strategies to a specific investor's preference. We believe this is important given that our investors have become increasingly sophisticated regarding how portfolios are built.

Alex Lowe: I was just going to amplify that. Easily the most important thing in this discussion about whether a tail hedge or crisis alpha, is clarity and transparency. You're so right Martin. We are all dealing with that. When I grew up at Man we had a largely retail investor base and it was fine and okay to say that this is a complicated black box. You don't understand it. It goes up. And that's wonderful if that's your business model and you have lots of retail investors and it does go up. But the truth is that this thing that we have does have a role and it depends how you position it as to what its role is. You can get into trouble when you simply talk about crisis alpha or tail risk as the whole thing. I think that's a danger of over-simplification and I think that what we do in the whole is quite simple, but it does need to be really clearly articulated, accurately explained.

I think actually we're all quite a lot better at that than we were five, six or 10 years ago. And it will behoove our industry much better if we continue to do that. And then the surprise of going down 10% in a month, that we all have lived through, isn't such an issue. So you allow, the transparency into the black box. You allow, the layer of investing, to get comfortable i.e. this difficulty to get not only the portfolio manager comfortable, but then the CIO, and then there's the investment committee and then there's a board and these guys are less invested in the strategy they may be less "in tune" with what it is you're trying to do.

All of this really just demonstrates the dangers pigeon holing yourself as just its crisis alpha against equity markets. It is rubbish because it's been manipulated and, I would say simplified. Then we get into an interesting conversation which probably is a better fit for later on, which is how easy it is to remain true to what you do and the difficulty when the business brings the investment management side under pressure. And then how do you manage that internally and all those very complicated.

Chad Martinson: You're absolutely right. Articulating the value proposition accurately is key. An Investor that thought managed futures would diversify their portfolio for the short-lived equity pullback in February of last year was quite disappointed. We find that investors want the tail risk protection and the positive convexity of managed futures. However, in order for investors to hold the investment and realize these positive return characteristics, it must deliver a positive return over the long-term. As an industry, we must recognize that investors need that portfolio protection during times of true crisis and we just deliver. Unfortunately, we have not had any real crisis for some time and investors grow weary.


Chad Martinson, Efficient Capital

> "As an industry, we must recognize that investors need that portfolio protection during times of true crisis and we just deliver."
>
> **Chad Martinson**

I think the managed futures industry was sitting around the table on Christmas Eve of last year saying, "Okay, maybe now's the time." Making money in December when equities were in a free fall. The first two days in January were some of the best trading days in quite a long time. And then, equities roar back to post new highs later in 2019. From our perspective, it's been very encouraging that even though equities had a moderate risk off event, followed by a stunning recovery, the industry has, for the most part, managed to generate positive returns. I think that's giving investors a little bit of encouragement.

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We do categorize managers as short and long-term CTAs. Unfortunately, there are not many managers that are short enough in their trading to really do well during a pullback like we experienced in February after an exponential move higher in January. We don't have any high frequency strategies in the portfolio, but I think perhaps there was some opportunity there. But certainly, the shorter-term components in the portfolio have more crisis alpha and will be quicker to respond, but in some cases that comes at the cost of return.

Razvan Remsing: Let's bring it back to the liquidity point. Some of these fast strategies are very good on paper. But in practice, if you're trying to put billions of dollars to work to meaningfully provide crisis protection to a big institutional portfolio or class of investors, it's not going to be there. I think they are nice and niche in small size but not in big size. It is a challenge we have often come across when we talk to the largest allocators. They are asking: "what can you give us that has a credible return profile in big AUM size that doesn't soak up all the liquidity and then suffer from the inevitable bleed."

Katy Kaminsiki: We value working with our clients on transparency and helping them to have clarity in regards to expectations. We often write articles and provide context for our investors to help them navigate both the good and the bad times for systematic strategies. For example, during the difficult reversal events of 2018, we published an insights piece entitled "Crisis or Correction: Managing expectations for Managed Futures."

We feel it is important we give our investors clear messages that can help them understand our performance and what to expect in different environments for our strategies. 2019 has been an easier year for Managed Futures so we have had fewer difficult questions to answer but we still need to keep educating our clients and working with them to understand what to expect going forward.

Artur Sepp: I find that nowadays investors understand that CTAs deliver convex returns profiles relative to equity markets, in some sense by delivering a straddle profile. We can deliver when the equity market is in a sustained crisis period. We can also deliver when equity markets are in a sustained bull period. Unfortunately, there is a middle period, which may last for years, and a conventional CTA approach does not deliver well in those normal periods.

"It is quite nice to have that breadth of things to look at, because trend following is not terribly difficult in some sense; you just need to be looking in many different places."

David Denison

David Denison, Florin Court

As Martin said, how do we manage the expectation over the whole cycle? Then we need to add an element in our strategy so that we deliver something within the normal period without sacrificing performance in tails. This is the biggest challenge, which I believe we are managing very well. And I think our goal is to deliver in those periods without losing the style consistency. We work on some requests for our sophisticated clients to illustrate the diversification befits of our program in all type of conditions.

Chad Martinson: One comment related to performance; I don't know if you all are getting this question, but one of the questions that I get - isn't it true that managers just caught the bond move? I love that question because the answer is: "yes, absolutely!" It's true that we just captured the bond move. In other years, it's absolutely true that we just caught the equity move. And others, it is true that we just caught the currency move. I wish we had more strong market moves, so we could answer that type of question more often. This year, bonds moved in a way that provided significant opportunity and traders were able to capitalize on the move. Unfortunately, it's been a while since this type of move has happened.

David Denison: One thing we're always looking at in our portfolio is where the next big move is coming from. If I look at last year, our best assets were basically things to do with Turkey. How did I know about that? There's no easy way. Last week it was Chile. It is quite nice to have that breadth of things to look at, because trend following is not terribly difficult in some sense; you just need to be looking in many different places. I think that's the key, because in the crisis, and all of the simulations I often see, equities don´t do that much for you. It's always about FX. It's about bonds or it's about commodities – not equities. You always think, "Oh okay, yeah, we'll get that right though." Equities go down too fast and then come back so quickly. It's actually the hardest asset class - I think - to make money in those turnarounds.

Harold de Boer: I agree. Trends like in Turkey, last year, cannot really be predicted. However, one can predict which factors could at some point trigger a trend. For example, Brexit had a big impact in 2016 and of course we all could predict that this would not be the last Brexit related trend which could manifest itself in various markets. The actual event of course, we cannot predict.

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To be able to profit from such developments I think it is important that the markets that could be sensitive to such potentially large underlying trends are a significant part of your program. Of course we cannot promise to always make a profit out of it. But we want to be there where it happens. Whether it's political moves like Brexit or in other major themes, such as the energy transition.

Are CTAs too Cautious on Leverage?

The discussion went on to CTAs and leverage. Christian Lundström suggested that CTAs were too cautious on leverage and that in order to maximize returns, the strategy should take on more. Managers highlighted that there were other aspects to take into account that goes beyond academia including clients not wanting to take on headline risk and the business risks related to running a CTA firm.

Christian Lundström: I did some research on optimum leverage. If you scale up your returns two times, you don't necessarily end up with twice the return on your investment over time, and that there is an optimal leverage level. What that says is that if you have an alpha stream, or you have some form of trading performance, stocks or CTAs or whatever, you always have an optimal leverage point. If you apply leverage beyond that point, you actually decrease your expected return. And that's hard intuitively to accept, but it's due to the draw downs. That is, if you apply too much leverage, you actually get a negative expected return on the leveraged strategy even if your base strategy has a positive expected return.

> "When we analyzed more closely we realized that the low volatility was at the root of the problem. Any investor that aims to harvest a risk premium will have to realize that something is fundamentally wrong when you have a long running drawdown with low volatility. "
>
> Harold de Boer

According to my research and forthcoming book chapter in Oxford Handbook of Hedge Funds authored by myself and Jarkko Peltimäki from Stockholm University, we derive the optimal leverage for a CTA index of 300%. That is, you should lever the daily returns three times, but no more, if you want to maximize your long-run CTA strategy profit. When contrasted to the optimal leverage for equity indices of around 110 %, CTA funds are generally too cautious with leverage. From this insight I would argue that CTA can benefit in terms of increased profit by applying more leverage than they are currently.

Harold de Boer: We did some research on this. We experienced a long deep drawdown in the period of 2009, 2010, '11, '12. Different from earlier deep drawdowns, this one occurred with a very low volatility of daily returns, significantly below historical levels. When we were in the period we were saying, "Well, okay, performance is not good, but at least the risk is well under control. Look how low volatility is."

But when we analyzed more closely we realized that the low volatility was at the root of the problem. Any investor that aims to harvest a risk premium will have to realize that something is fundamentally wrong when you have a long running drawdown with low volatility. Subsequently we have made a series of specific choices for the way we run our program, which has resulted in daily volatility growing back up to healthy levels again. While the drawdowns have not grown deeper. Drawdown is not directly explained by volatility, this is also a reason why the Sharpe ratio is not a relevant measure. And, this problem of a too low volatility still seems to be manifest in the SG Trend Index.

You really see that the volatility of the SG Trend Index has been coming down after 2009 while its drawdowns have become longer. There is no direct relationship between volatility and drawdown. If you compare various CTAs in the index and you plot their volatility against their drawdowns, you will see not see a straight line. For example, Lynx has a pretty high volatility, the same goes for a number of other CTAs at the table here. It's typically the more passive approaches, which have become very popular, that tend to have a low volatility with deep drawdowns. Leverage in its typical definition barely impacts the volatility-drawdown relationship. And therefore also not the length of drawdowns. Mitigating

Gernot Heitzinger, SMN

long lasting drawdowns can be done in many different ways. But the basic idea is that you can should actually be taking enough risk, and not shy away from it, also not "discretionary" in anticipation of events that could result in market volatility, such as elections, crop reports or interest rate decisions. The only measure that controls downside risk while not hurting profitability is diversification over different trends. This will typically lead to a higher daily volatility, without longer lasting deep drawdowns. You will see with CTAs there's a big difference there. I think the CTAs with a higher volatility and low drawdowns relative to that have the bigger chance of doing well, especially crisis periods.

Gernot Heitzinger: I'm actually not in the herd because on our proprietary accounts we are invested in a 40 percent volatility strategy, which is not the best investment at the moment as you might imagine. I think the big problem is that most clients don't understand this concept. They are really afraid of having headline risk, having a position in their portfolio, which is down 20-25 % or whatever, even if it's only with half the money invested or maybe a quarter of the money. On the other side, they will not pay you for that. Actually, for the higher vol strategy, you should charge a higher fee. And people say, "No, I rather prefer a low volatility strategy because I don't want to have so much volatility because that's dangerous." And that's really why I think the industry is always going down and down and down with the volatility they offer to their clients. But I think you're completely right, Christian. Leverage is too low on average.

Alex Lowe: It depends a great deal on at what clients you are talking to. And it's not always as easy as saying deep institutional clients really understand leverage. We had a client a long time ago, who remains nameless, who invested in a managed account and insisted on showing the performance internally on cash. So, whatever that is, three and half times leveraged. You have minus 10% month which becomes minus 30%. There are very few institutions in the world who can go through this. And that comes back to the whole volatility issue is actually the reason that you accuse us, not unreasonably, of being

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>
> **Gernot Heitzinger**

scared of it is I think sensible business pragmatism. At the end of the day, we are a business and we have to survive.

In fact, I think it's basically the only rule of running a CTA: survive. So, you put yourself in a position where your investors properly understand it and you are consistent to the mandate and all that sort of stuff that we've talked about. And then you deliver on it. If you are too volatile your investors just simply can't live with it. And if you do that, you do a disservice to us all. And you do a disservice to the wider managed futures offering. I think I´m a bit of a missionary by this stuff, because I do think the pension funds really need us. Particularly in the UK where there is a massive pension fund crisis. But it requires a level of business confidence both within our industry and from the allocator
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Harold de Boer: If a client is seeing a big drawdown and understandably is worried about that then it isn't that obvious to have your investor relation person telling them: "You know what, we have the solution, we will increase the volatility." To explain this message really requires the investor relations person to be very capable. They have to be willing and able to say things that clients are not immediately expecting. If we don't succeed in doing this, we don't deserve to be a successful investment manager. In essence, this is the big issue with the commercial success of hedge funds in general. In the '90's CTAs became successful because we were all doing things that were unorthodox. We all were able to find and offer non-confirmistic answers and solutions. We avoided the beaten tracks. We can do so by investing in ways that people don't expect and by often not doing the things that people expect one should do. Offering and explaining enough volatility is part of that. So is questioning everything that many people find important. If we don't do that, we don't deserve to be in this industry.

Razvan Remsing: There's one more thing to add to this. I like the non-conformist argument. I tend to agree with that, but one can be non-conformist yet still consistent. One can be consistently non-conformist so that at least once you take your clients over the line and you do all that educational work with them, what they then receive from the manager should no longer be a surprise. It may at times be disappointing, but not surprising. But back to the leverage point. It is only the most sophisticated investors that have very few decision makers on their

"The other investor types just chase performance and drop the investment as soon as it's turned around. And so yes, there is an optimal point academically, but practically most people can't hold and don't stomach high volatility through the cycle."

Razvan Remsing

investment boards and you get them all in the room then if they reach consensus they all buy into this. Those are generally the only ones that can live with high volatility. The other investor types just chase performance and drop the investment as soon as it's turned around. And so yes, there is an optimal point academically, but practically most people can't hold and don't stomach high volatility through the cycle.

Chad Martinson: You may remember that 36 vol trend program that we're running. We invest in this high vol program to maximize cash efficiency. However, we report the numbers back to ourselves as 12 vol because we need to look at everything normalized across the book. Even though we're investing in a high vol program, we all have our reports normalize the results to a volatility of 12.

Martin Källström: Many of our clients are using us to trade a managed account. We don't always know where leverage is on their side, or how the account is perceived internally. When it comes to leverage in our funds and commingled vehicles, I think we should be mindful of who the investors are and what type of tolerance they have. We have a 1.5X version of The Lynx Program which indeed is punchy. I must say that we have not seen a very high demand for that type of volatility.

Alex Lowe: The honest truth is, and I agree with you and here's the thing, we make the high vol slightly more expensive because it should be because it's the inverse of a vol discount? But there are some clients that don't hold it.

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Martin Källström: One needs to understand that there are differences in investors' risk appetite and tolerance.

Artur Sepp, Quantica Capital

For some, having a volatility too low doesn't make sense because it doesn't make an impact in the rest of the portfolio. For others, particularly those caring about the performance of a single line item, high volatility can be very difficult to deal with, especially if it is associated with low Sharpe Ratio.

Harold de Boer: It also depends on how this volatility is brought down. Take 2016, just before the referendum in June. No one said it publicly, but some CTAs seemed to have brought down their Brexit sensitive positions. Then you end up with low volatility. But then you did not profit from the volatility when you should have after the results came out. What about interest rate decisions by central banks? Are you going to size down your positions? We all know the events that will lead to large moves in the markets. Intervening in your program in anticipation of such events might seem like a safe idea, but these types of interventions tend to bring down the return more than the volatility. So this is not just a matter of leverage; you cannot be out of the market every time the market could be moving. You can only be rewarded if you actually bear risk.

Christian Lundström: I get what you are saying about that, but my point is that you have very good funds in terms of risk reward from a leverage point of view and you should not be afraid of use more leverage because your product can take a lot more before imploding. I rather think that your conservative usage of leverage stems from a lack of confidence from your investors who still view your funds as black boxes. And that's sad.

Gernot Heitzinger: We are quite a small team which has been together for long periods and we have done that for more than 20 years. For ourselves we have invested in our strategy at a 40 vol. Especially in times like this you realize how even the most experienced guys react when you have down minus 35, 40% years. Everybody knows in theory how it works and it's still much easier than if you're an outside investor who says, okay, I have no clue of what these guys are doing at this vol. Therefore, most clients prefer less volatile strategies although the maths are clearly advising towards a higher vol if psychology allows it.

Harold de Boer: I think it's psychologically easier for clients to allow higher volatility when they know that at least the actual people managing the money know what volatility is about and what it feels like, compared to relying on a manager whose team does not know this and has not experienced it in real life.

Internalizing Trend Strategies

The next subject discussed the recent trend among Nordic institutions to internalize trend following systematic strategies and if this is a development seen elsewhere. According to the CTAs around the table, it looks differently depending on region and there is a tendency among those who once internalized to come back to outsourcing again. This has also to do with the fact that fees have come down quite significantly.

Harold de Boer: Internalizing has been a topic in the biggest pension funds in The Netherlands, which has a massive pension fund industry. The biggest ones have always been reluctant to outsource. And if they believed in some strategy, they would do it internally. In the US it's different. In Canada it's different.

Katy Kaminsiki: I have spoken with many different institutions and even highly sophisticated, widely staffed, and well-resourced firms, those who brought Managed Futures strategies in-house, have had some challenges. The argument I would make with most of the large institutions today is if you can get this strategy for a reasonable fee, why would you want to live through this day to day? Fees have come substantially down. So internalizing a dynamic multi-contract futures program with the type of things that we have to do on a day–to-day basis I think is hard for a pension fund. Most of the funds that I've known to internalize these programs eventually stopped doing so. We will see what happens with the Swedish pension funds. The core challenge the investor faces with trend following is the simple concept that it is very easy to replicate the correlation to the industry. It is not necessarily easy to replicate the return of the industry; those who build trend programs may well suffer return dispersion.

Martin Källström: I think that the question is very much related to if you are a believer or not in trend following beta, i.e. that a generic trend following system can compensate an investor for a commonly accepted risk. If you believe in that, and some still do, you could build and employ a simple internal trend following system. Our research suggests though that if you want to achieve positive risk adjusted returns from trend following, you not only need to be quite advanced and smart in signal generation, but also have a strong operational infrastructure and can execute orders in markets in a way to make a significant difference to returns. I see signs that the pendulum is swinging, and many investors are now realizing that it's not so certain that above average – or even average – returns can be generated from this naive way of following trends. You need to be much smarter than that. Many investors are now beginning to appreciate the value in hiring an external experienced manager, even though it is more expensive. Some institutions are further ahead than others, but that movement has begun.


Katy Kaminski, Alpha Simplex

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>
> Katy Kaminski

Harold de Boer: As an industry we have contributed to that development ourselves. We have embraced pseudo academic research that 'proved' our strategies. But that has led to a false impression that active strategies can be easily be reproduced and has attracted investors that want to have this confirmation. I was recently in a panel with someone from a very successful CTA that had published a simulation and I asked "This is a very strange thing to publish because you have a great actual performance. Why would you want to publish simulated returns?" And then he said, "Yeah, but there is such a large group of professional investors that wants empirical evidence." Well this is a total nonsense of course, because empirical in healthcare research means that you test the real person. So the real track record is empirical. Any publication in a high standards journal making assumptions, that are not even right, has nothing to do with being empirical. In our industry showing real life performance used to be the only allowed empirical evidence. We do not really serve our clients by jumping on the trend of, "Oh, it has to be scientific. So let's publish academic papers based on simulated results".

David Denison: I'm actually quite happy about in-house CTAs as they have been around for about three or four years now, maybe a bit longer than some of the low-cost funds, and they probably have had enough evidence to show their internal funds don't actually work that well. Let's be honest: when you go and speak to investors who are doing a CTA in house, you often find that out.

The in-house CTA managers are now saying they are looking for full CTAs that are going to give them some diversification and something a little bit different, because they're finding doing these 60, 70 standard markets is really not going to get you that much. And there has to be something else: whether it's in signals or whether it's in markets or whether it's in just how you




"So the real track record is empirical. Any publication in a high standards journal making assumptions, that are not even right, has nothing to do with being empirical."

Harold de Boer

manage risk. There are plenty of different ways to do things, but the fact is they've tried. I think they are now going to pull away a bit and get to talking to each other about it.

Razvan Remsing: I definitely agree with this latest statement about investors pulling away from doing it themselves. Part of my role is to engage with allocators in many different regions and the adoption of in-house practices varies by region and investor type. It's mainly a function of what AUM institutions have which gives them scale, how sophisticated their investment teams are and how underfunded they were when they started.

The institutions that really are chasing big returns have actually tried to outsource because they just can't catch up. The longer it takes them to build these things, the further behind they fall and their liabilities need matching. But five to six years later, we have seen some clients allocating internally coming back to us and saying, actually it's been quite a tough process.

And a lot of differences center around cost. There's a price point in every region. Some regions are more sensitive to price than others. There are still a few regions and client types out there that care about net returns primarily, that is nice to see, but they're reducing in number. What is an interesting development is that people generally see trend as a widely accepted and as a needed factor within traditional portfolios but also a factor that has been largely commoditized. That's fine. Investors tend to now say: "Well I want to do a bit more with my trend and I want to add a bit of non-trend factors to help with the straddle profile. But what do we do in the quiet periods?" And that's when it's sensible to put other strategies in the mix.

When some allocators start to build their own internal fund of funds, it can be challenging because they end up paying fees everywhere and again it's sub-optimal. We've changed our business model to be able to compete alongside fund-of-funds that try to provide that service. But our solutions have far more coherent view of the risks and trade efficiencies so we could blend different products and styles and then provide a robustly risk managed portfolio to that institutional client, which may well still be trend-heavy but has a lot of other things within it in the right proportion. And that I think is a trend that is growing in Australia, in North America and in the UK.

It's about being able to demonstrate we can add value on top of what they get from the street or what they get from a number of different managers. But it's better to have potentially one manager and do a bit more with them than to have several managers. On the flip side you don't win all these mandates. But the ones you win, you end up being a more meaningful part of that, that institution's make up and you can build products for them, with them and now that seems right.

Katy Kaminsiki: In addition to being in Managed Futures, we have been expanding in the alternative risk premia space (ARP). Return dispersion is definitely an issue for Managed Futures but for ARP the number of degrees of freedom is far greater and there are many different choices, creating a wide degree of heterogeneity in the space. This space was also challenging in 2018, but given the wide range of choices there are still opportunities going forward.

Christian Lundström: In the premium pension fund platform we have around 20 absolute return funds and at least one CTA, SEB Asset Selection, one of the oldest UCITS CTA funds in the world. The platform I represent accepts only UCITS funds with daily liquidity. This restricts the absolute return fund space drastically, but we do what we can with those limitations. I think CTAs are perhaps the best hedge fund strategy to hope for if you want to add diversification to a portfolio of equity funds and we would like to see more CTAs.

We are currently adding an absolute return category for funds on the platform. We do this to make it easier for our clients to separate traditional equity relative return funds from absolute return funds as they play different parts in portfolio construction.


Harold de Boer, Transtrend

On CTA dispersion

Although widely a solid year for the CTA industry in 2019, manager dispersion remained high. There was quite a wide agreement among the participants that this is less of a problem and that the dispersion trend is likely to remain if not increasing further in intensity. Managers should be increasingly focused on what they can bring to the table by staying true to their respective skill-sets and investment targets, was the collective opinion.

Katy Kaminsiki: There are a number of decisions CTAs make that can drive return dispersion. The first and simplest is sizing and timing in individual asset classes. The second relates to risk management and portfolio construction. For the first, individual exposures to certain asset classes had a substantial impact this year. Ability to follow the sizeable bond trend this year drove the lion share of returns. In addition to this, the overall commodity exposure was also a key differentiator. Those with weaker signals in the commodity markets were less scathed by a very range bound and event-risk prone environment for commodities.

The second driver of return dispersion is style choices such as speed, market size, and correlation. In 2019, we found that smaller markets again underperformed larger market trends, similar to 2018. Slower trend speeds also seemed to be more favorable in 2019. Diversification continued to help in 2019, as less correlated market trends provided better relative trend opportunities. These style factors and the timing and risk allocation to different markets are all choices made by individual CTAs in a given year. Different decisions may provide somewhat different results. At the end of the day, getting the bond trend correct was the biggest driver of returns in the space in 2019.

Chad Martinson: Performance dispersion is guaranteed, but that's where we live and breathe in terms of what we offer investors. If you select a basket of managers, you have a better chance of getting a stable return with a tighter distribution rather than an outlier result. If you pick the best CTA over a given year, it's unlikely you're going to be able to beat that. That has been something about which we've been trying to educate the investment community. We recommend going with a basket of managers rather than a single manager because you

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>
> **Katy Kaminski**

will inevitably pick the best recent performing manager and that manager is unlikely to serve you well moving forward.

Alex Lowe: Dispersion this year has actually been quite large and obviously also due to the fixed income moves. But one of the things that we have not talked about the great deal, particularly when you compare yourself with the indices and other managers, you can't measure it. But it's very hard to know for competitors, but more importantly for investors, exactly how clear you are to the mandate.

I don't know everybody's mandate around here, but ours is pretty clear and pretty transparent. I mean I even heard it described the other day in a due diligence meeting where we were competing for a mandate as we all do as a manager described this little cream on top. The stuff that's non-trend is cream on top.

If you look at the SG index, you have no idea. Honestly, no idea at all. How pure are CTAs? And this comes back to Martin's point as well. What are we? What does it say? What does this manager do and all those sort of things? I do think as an industry we struggled slightly because we don't have FTSE 100 index that we just are.

Harold de Boer: No we shouldn't have this at all! I think dispersion is great, and there should be even more. And it should be consistent with the what each of us explains about our programs. A client should understand why different CTAs behave differently; this one is more short-term, this one is more active in this area, etcetera. That way clients can really choose for which purpose they invest with which manager.

Alex Lowe: But Harold, I'm going to take you on slightly on that because whilst I agree with you entirely, in my experience that is not generally realistic. I agree with it, but it's very hard for a large pension funds to move like that. And we are saying it's coming, but again, it's not one size fits all. For these large institutions that only seven, eight years ago really got comfortable with systematic investing and were under-allocated in 2008 it's hard, genuinely hard to devote the time to develop that level of understanding.

Harold de Boer: Ultimately, investors want performance. Also pension funds. To deliver performance we have to concentrate on the thing that we are doing. And that's

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what it is. It's like traveling. You can take a boat from here to France or you can take the train. If you opt for the train, clients should see your railway. And if you opt for the boat clients want to see you sail through the sea. If the see is frozen, sailing will not go well. But everyone will understand that. What you surely should not do is promising a vehicle that can move everywhere. Those kind of vehicles do exist, but they are slow everywhere.

Gernot Heitzinger: One positive thing that I've seen as the clear negative outlier here on this table, we got a significant investment by an existing investor last week, although performance is really poor currently. They took a close look into why that was the case. And they understood that we have done nothing wrong. We have done what we told them we would do and we received a good inflow. It is absolutely vital that you make sure your investors understand what you are doing.

Harold de Boer: We had one such investor in the past, I believe around 2001. In fact, it was a Swedish investor. They had just started investing and had questions because we did better than they had expected; better than other CTAs. We could explain precisely why. A few months later they called us before the month was over. "This month, we expect that you will have underperformed, for precisely the same reason". And indeed we did. They understood what choices we had made and accepted that this could lead to outperformance in some environments and underperformance in other environments. That's the kind of investor you want because then investors understand and this helps them in making the right choices and obtain diversification.

Katy Kaminsiki: I was just going to make the point that this is a bigger challenge for many of you who are not sitting in the U.S., where it's been such an incredible market for the last 10 years. In fact, U.S. investors have seen phenomenal returns even in bonds. It's really hard right now because this is when they probably need us most. That's really the scary part for me. The sentiment I sometimes hear from investors is, "Oh, we'll get that when that starts working again."

Alternatives have had a really hard time in the U.S., especially liquid alternatives. I am hopeful that people will stick around. If you look historically, this is a very rare period. Putting some simple stats on this, 94% of rolling annual returns for the S&P 500 are positive from 2010 to present, whereas in 2000-2010 only 50% were

"For these large institutions that only seven, eight years ago really got comfortable with systematic investing and were under-allocated in 2008 it's hard, genuinely hard to devote the time to develop that level of understanding."

Alex Lowe


Alex Lowe, ISAM

positive. I just find it difficult to imagine that this trend is going to stay like this, especially with all the political tensions and issues going forward.

Chad Martinson: You've got a risk-free asset returning 20% a year. In the S&P 500.

Razvan Remsing: Something else that I've observed and which is increasingly evident is that a lot of the allocators have got big teams. One can talk to the CIO who often makes the final decision. But there generally is a group of analysts that do the bulk of the work. You have to get through to them and for them to actually feel strongly about recommending your strategy. Increasingly I'm coming across individuals that started their careers post-2008 so they've been around for about eight years, which is a decent stretch, good experience. They've never lived through another way of doing things. To Kathryn's point, we've never had such a strong period for traditional portfolios as the last decade. You didn't have to do anything else. But there's another macro factor, which has been so ignored and that's inflation. Nobody believes inflation can ever come back. Traditional portfolios, regional asset owners are so badly positioned should inflation come back. I've even had younger colleagues, when I speak about inflation, they think I'm crazy because it's been worked away. It's another indicator that things are likely to change and just doing what worked for the last 10, 15 years in a traditional sense, it's highly unlikely for that to remain the status quo.

Martin Källström: I think that most investors are of the view that the past 10 years have been exceptional, and we are now likely entering a different phase which will be more difficult. Finding ways to achieve diversification in a portfolio is something that is on everyone's mind. But we haven't seen a lot of action yet.

People have been complacent with good results. The big risk is obviously that investors are not proactive enough, and that they are only starting to allocate to strategies like CTA's as a reaction to a downturn in markets. Being clear on your objective and to avoid being guided by the rear-view window is crucial. It is very important that investors are having an appropriate mandate and a clear objective.

Then we as managers need to be very explicit with what we are trying to achieve. If we are starting to style drift or are vaguely defining our objective, we make it difficult for investors. With that said, some may prefer a multi-strategy one stop show, but I believe that most investors today are increasingly looking for building blocks with distinct performance characteristics.

Christian Lundström: I think you should be true to your strategy and dispersion does not have to be a problem – its expected if you bring something else to the table. Moreover, I think CTA providers should consider launching all weather funds where your CTA strategy is added to traditional assets such as stocks, bond and commodities. The real value of CTAs, as I see it, is as a diversifier to equity holdings, it is not because you want returns. If you want returns you buy stocks, and CTA cannot compare to stocks in the long-run. If you buy the idea that CTAs value addition is diversification, you can tailor this effect in an all-weather fund by adding all asset classes in optimal proportions and rebalance over time. I think Lynx recently started an all-weather fund of this sort and I think that's a good thing.

Chad Martinson: The other question - is it the cream on top or is it the crumbling foundation underneath? A lot of times those complimentary strategies perform very well in a normal environment but don't perform very well in a crisis.

Artur Sepp: When inflation comes, what is going to work next? In any back test when you see equity market draw downs, is it actually the bonds that contributed more or FX? We ran a few long-dated simulations and we are confident that the key to handle the inflationary effect is to produce a broad diversification across equities, bonds, FX, and commodities markets. FX and commodities are in particular robust diversifiers of the bond tail risks.

Martin Källström, Lynx

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Christian Lundström, Swedisch Pensions Agency

Katy Kaminsiki: Many of us, including me, have done a lot of research on how CTAs might navigate a new interest rate environment. We need to remember that most of the data we use today starts in the 90s, this data has been analyzed to death, and it contains a miraculous bull market for bonds. If you go back farther into the '70's you see very interesting moves in bond markets where you see bond volatility and equity volatility spike at the same time and you see positive bond and stock correlation. That market environment we all know is actually a good environment for trend following because we can go short fixed income and we can do it in size. A rising rate environment can create new trends for Managed Futures but it would be highly challenging for long-only fixed income investors.

Harold de Boer: That's an important element. If you run a program and are basically concentrating on optimizing on the past 10 years or something, you can be sure you are not going to find the relationships that have existed in other periods and that could return. And that's exactly why you should not optimize on anything. It's really not enough. That's why it's so important that you understand the markets that you're trading and know what kinds of things can happen.

By backtesting over the past 10 years we would learn nothing about the sensitivity of our program to a Brexit. However, we of course do understand which markets could be sensitive to Brexit. This understanding - instead of data-mining - inspired us to investigate whether we could trade somewhat larger in some of these markets. We don't know what's going to happen. We can't predict it. You can add markets and trade them. In recent months like many others we lost on shorts on British pound. But we profited by being short British gas vs pound which is of course very much related. We were so sizably invested in the British gas because that was on the list of markets of which we had said beforehand that this is kind of market in which Brexit could potentially manifest itself in the form of a strong trend. So, if we want to be able to be sizably invested in different trends, we have to add that kind of market to our program. Inflation is another theme. We may have not seen it for a while so

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"We find a lot of value in alternative data because there we can still use our understanding of real-world effects. We try to capture and then decide what sort of data we need to do it better or faster or get ahead of the main effect."

Razvan Remsing

backtests on the recent past will not reveal anything useful in this respect. Again, we can think about what kind of markets could potentially move, which markets in particular could be sensitive for it. That could also be synthetic markets. If we add enough of such markets to our universe, the program will be able to participate in inflationary trends whenever they do occur. So, there's a lot of things we can do but the most important thing is to understand markets instead of doing some simple kind of optimization.

CTAs, new technology and strategy innovation

Concluding the session, managers discussed new technology and its impact on strategy innovation. Machine learning and the use of alternative data were mentioned as important progressions in recent years, although some claimed it was more about buzzwords than actual progress. Lynx is so far the only manager having launched a strategy entirely focused on machine learning.

Martin Källström: We have just launched Lynx Constellation which is based on the machine learning models we use in the flagship program. Almost all our models today are based on advanced multi-variate concepts, but only 12 of the 40 can be defined as machine learning algorithms. This is an area where we have been quite successful for a long time. Our first machine learning model started trading in June 2011. There is a natural limitation to how large of an allocation the flagship program can have to the machine learning models given its objective. Since there is excess capacity in these models, we have built a new strategy based on the market forecasts from these models.

The investment style of Lynx Constellation is machine learning and we have a very clear goal to generate a high Sharpe Ratio with no correlation to markets. Actually, we explicitly control for correlation properties in the portfolio optimization process. The launch of Lynx Constellation has been an obvious development for us. We are also considering launching a standalone strategy employing our macro-based concepts. Using macro data to build idiosyncratic models that forecast markets is something we have been doing for a long time within the flagship program. Similarly, to our machine learning models, they would have a natural limitation in the Lynx program given the program's objective.

Razvan Remsing: Another way that you can increase your breadth is through the use of alternative data. By incorporating other data sources, ultimately, you're looking for predictability somewhere. There are challenges there of course because alternative data is often not as robust. It's not as reliable, doesn't have too much history. So the complexity comes when you try to understand how you can use that new data to predict things that you have got better stability on. Another buzzword is machine learning. We don't deploy unsupervised machine learning models as sort of standalone strategies. We do, however, utilize machine learning techniques across the investment process. For us our biggest challenge is interpretability. Being able to back up the decisions that the model made opposite clients.

Trend often comes out as a very nice pattern because it's a very stable, reliable pattern once you de-noise the system. And, of course, machine learning is also very good with non-complex interactions, but one can be easily seduced. I think it's still quite difficult to distinguish when machine learning models are broken. Performance is a good indicator when they could be working. But when they're going sideways, at best it becomes interesting to decide when they are no longer working. So, we generally prefer to have more hypotheses than fewer.

And we find a lot of value in alternative data because there we can still use our understanding of real-world

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effects. We try to capture and then decide what sort of data we need to do it better or faster or get ahead of the main effect. So those are the advances we are making at the firm. But ultimately it comes back down to keeping it fairly intuitive. The approach should be fairly clear to what we tell our clients.

Martin Källström: Let me just quickly comment on Razvan's point about the interpretability of machine learning results. I agree that the biggest challenge we have with complex strategies is how to interpret the outcome. I think investors need to approach complex systematic strategies differently because of the limitations we have as humans in processing large amounts of data and understanding complex non-linear relationships. This is specifically what machine learning is used for. Understanding and avoiding the risks with these techniques are really the focal point for us. If we demand that all positions are easily explainable by a cause and effect relationship, we will have huge issues, even with conventional multi-variate models.

Chad Martinson: It goes back to the earlier part of our conversation where we were describing what we do and helping investors understand when it should perform well and what constitute a challenging period. From our perspective as an allocator, "the machine made me do it" is not a reasonable answer to questions resulting from a period of challenging performance. It is critical to be able to interpret, understand, and communicate exactly why a strategy is suffering losses during periods of challenging performance. I think this will be important for everybody doing machine learning.

Katy Kaminsiki: We have about 40% of our portfolios in adaptive models that utilize methodologies from what is often termed "machine learning." Our trend program is a pure play on trend following and we work within those constraints. Across the firm though, our research has also focused more broadly on ARP, which opens us up to a wide range of interesting new strategies, new data, and potentially new assets.

David Denison: I used to work at an equity stat-arb fund. They were doing adaptive learning for years already in 2000. It's actually amazing how long it took for some of the CTA world to do it. But the big difference is: you have lots of equities; you've got a lot more data; and you still don't really have that many factors to deal with. In the CTA space, I mean, how many different oil markets are there? So, it's a lot harder to deal when you've got limited futures to look at, than when you're looking at equities. We trade things relatively slowly - we can't really trade that quickly - so we don't actually do any machine learning. But it still surprises me how CTAs talk about this now, when the equity guys - who have been making tons of money doing this, and have done for years - they don't need to talk about it that much, because those guys don't actually need any more money.

Chad Martinson and Harold de Boer

> "It is critical to be able to interpret, understand, and communicate exactly why a strategy is suffering losses during periods of challenging performance. I think this will be important for everybody doing machine learning."
>
> **Chad Martinson**

Harold de Boer: This industry is prone to running after terminology. There are all kinds of hypes, terms that are popular. Often there's a big difference between the term being used and what the investment manager is really doing. Machine learning for me is one of these terms. You can do very stupid things with machine learning and you can do the right thing. Alternative data is another term that's very popular right now, but you can do very stupid things with alternative data. But you can also do wise things with it. Alternative markets or non-standard markets, this also a hype right now. Again, you can do very stupid things in those markets, but you can also do wise things. Running after terminology is embedded in human nature. It goes back for millions of years, when the homo sapiens became successful and wiped out other human species around the world, such as the Neanderthals. We, homo sapiens, were the first species that was able to unite around imaginary concepts, which enabled us to gather groups of more than a hundred people. We can embrace brands like Rolex, soccer teams like Feyenoord, national flags or human rights, all examples of ideas that enable us to be part of a bigger group. When you're a small group of people, not united by terminology, you are forced to explain to each other what you're really doing. Then you don't talk about alternative data, but you talk about how you're using for instance rainfall data and see whether there's an impact on grain. That does make sense. Alternative data is just a hype that more than 100 people can run after. To be commercially successful as a manager you want

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to have clients, so you preach terminology, you preach machine learning, you preach alternative data and you preach alternative markets. But to be successful as an investor, you have to realize that it's all about whether you understand the market that you're talking about. Do you understand the data and do you understand your machine? Are we willing to accept that this may not attract investors that prefer to march after terminology?

The question is: do we want to start with terminology, or do we want to start with the content? I prefer the content. That's precisely why I am not in sales.

Razvan Remsing: But you could probably extend this to the concept of alpha and beta. That's just a way for people to apply a framework to decompose and explain things. Just because they can explain it now, they say it is beta, therefore it is cheap. So, I think there's a spectrum there of just having the right language to label things. That's not always the most useful way to explain its complexity or utility.

Harold de Boer: We wrote a series of articles on alpha and beta, all published on our website. The conclusion is, there is only negative alpha – so you have to avoid alpha. There is one article in particular on crisis alpha, which explains there is crisis beta and there is negative crisis Alpha. The crisis beta is something you should pursue. And while doing so one should be careful not to get too much negative crisis alpha. Which brings us back to running after terminology.

The commercially easy message is to say we deliver crisis alpha. Are we willing to say "We are not after crisis alpha; we want to avoid alpha."? Bringing this message forces us to explain what we are really doing. And yes, we could be missing out on potential investors that really run after terminology. However, the remaining investors will have really understood what they have chosen, since they chose content over terminology.

Artur Sepp: I think the primary focus of trend following is to apply price data. If we want to deliver style consistent returns, we need to focus of delivering the straddle payoff relative to equity markets. Of course, there could be some cost of not delivering during calm periods, when trend signals are not strong. Of course, we can apply alternative data to generate signals that are not entirely conditional on the price to deliver "alpha" during normal periods. Definitely we can apply machine learning for

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Artur Sepp

fundamental data to deliver uncorrelated performances of our CTA signals conditional only on the price space. However, we risk losing the style consistency and this is not what investors want us to do. Therefore, we apply advanced statistical methods only to price data to deliver style consistent CTA returns.

Martin Källström: The biggest challenges with using fundamental data are the low signal-to-noise ratio and data quality. Unlike price data which can be collected at a high frequency and is continuously available during trading hours, processing fundamental data requires a more sophisticated approach. The risk of overfitting to noise is something we are extremely careful to avoid, and we believe that this risk increases when using lower quality data. With that said, combining machine learning with non-price data is a research priority for us.

Katy Kaminsiki: When I talk to investors about machine learning, what I say is that what we're trying to do is just understand the response function of a market price in a somewhat nonlinear way. I mean that's really what machine learning's really trying to do. Right? In the context of classic trend-following, it's about fixing your time horizons; your models are measuring over these specific fixed time horizons and putting them together. But if you use machine learning, you can actually learn a more nonlinear approach to trading markets based on price movements.

And you might be able to then trade, let's say bonds, differently than you might trade FX. And so to me, I usually just distil it down to that simple idea. Typical trend techniques are linear relationships and machine learning just or other techniques allow you to learn something non-linear in hopes of trading market trends more effectively.

-------- THE END ------

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Nordic Insights

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

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