CTAs and hedgies: the quest for performance

Capital Trading Group's **Nell Sloane** on why managed futures may be the better bet

As investors in global markets we long for performance. We search for it in every corner, we analyse it in all of its historical perspective. Sometimes we chase it, sometimes we attempt to anticipate it.

Simply put, an investor's reality is driven by the constant desire and pursuit of performance. However, in a world of below par growth, monetary policy distortions and eccentric political processes, performance is more desire than hard currency.

In the last 18 months, beta has faltered, fixed income flat-lined and alpha generally disappointed. Hedge funds as a category have failed to produce the outperformance that was expected of them at a time when long only traditional funds started to lag.

For years, hedgies complained of a lack of volatility – a legitimate complaint when running a long-short book. Yet when volatility finally arrived, they were the first ones to buckle.

Perhaps, hedgies are the victims of their own success. Too much money flowing into the largest outfits pushes managers into crowded trades and the most liquid assets, therefore increasing the correlation to traditional asset classes.

Or perhaps, some cynics say, the burden of fees that are too high and the plethora of untalented managers, attracted to the space by those very fees that suppress performance, have done the trick.

Whatever the reason, the Barclay Hedge Fund Index shows an aggregate positive performance of 0.8% from the beginning of the year to the end of May. This compares to a 3.4% upside in the S&P 500 benchmark.

In aggregate, hedgies have underperformed the equity benchmark significantly since 2012.

And what about those other representatives of skill-based performance, aka CTAs? Their performance this year is just about in line with the hedgies and up to April, it was ahead.

The Barclay CTA Index showed a positive 0.4% YTD through May, which while rather unexciting, does come with low correlation to the S&P 500.

On a more granular basis, the best performers were currency traders with an estimated 4.0% performance YTD.

The worst action came from the agricultural traders that recorded a negative 1.1% YTD. Systematic traders returned 1.1%.

The Barclay CTA Index is not an investable index and does not represent the entire universe of all CTAs or hedge funds. Nor is the performance of this index indicative of the performance of any individual CTA. Rates of return may differ and maybe more volatile than those of the index.

But it provides a general indication of asset class performance. While past performance is not necessarily indicative of future performance, what should we be expecting going forward?

Perhaps a little bit of the same – which is not exactly a bad thing. In other words, in a world of low expected returns, mildly positive and low correlation performance may just be what an allocator needs in her mix of assets.

As equities and bonds correlations are expected to increase significantly, CTAs may help tremendously in portfolio construction.

While the annualised rate of return of managed futures has constantly decreased since the glory days of the 80s and 90s, the aggregate performance is still positive and uncorrelated to equities. This element to an allocator is as good as gold, especially today.

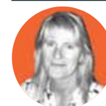
Renowned bond king Bill Gross has repeatedly opined on the current environment as one where all forms of carry are compressed therefore distorting future returns and risks for most asset.

At this juncture, one's focus should be not on the size of the potential returns but rather on the nature of them and their timing.

Naturally, as we have often elaborated on these pages and elsewhere, the real advantage comes from one's ability to create a portfolio of CTAs that is actually superior to the broad and generally un-investable index.

Research and disciplined methodologies can significantly increase long term results, in spite of short term noise. Indeed, a realistic horizon for a portfolio of managed futures should be five years.

In conclusion, desired performance will be a function of variables that we cannot control, such as global macro contingencies or political buffoonery, and variables that we can and should control – such as rigorous global asset allocation, disciplined research processes and long term views. ◻



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