Abbey Capital

Three Reasons to Consider Managed Futures in 2020

Key Takeaways

1. **High valuations and the record bull run in US equities may increase the case for diversification**
2. **Managed futures can be an effective diversifier for traditional portfolios**
3. **Historically, managed futures has shown that it can outperform traditional hedge fund strategies during periods of market stress**

February 2020

Private & Confidential

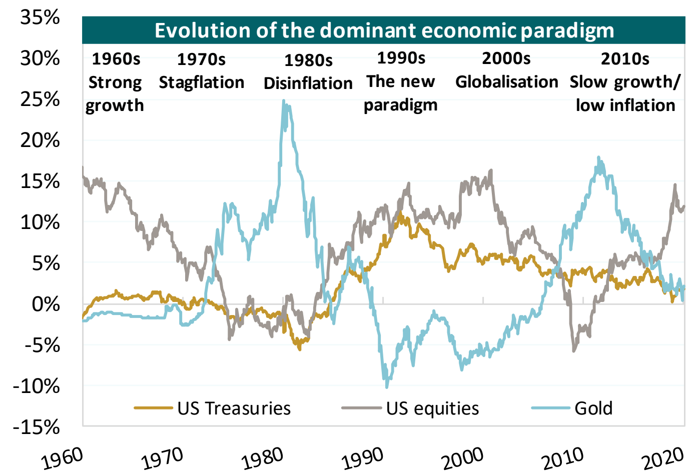
Three Reasons to Consider Managed Futures in 2020

1. High valuations and the record bull run in US equities may increase the case for diversification

The record bull run enjoyed by the S&P 500 since 2009, coupled with concerns over global growth, raises questions about when the US stock market will enter its next bear market. Although US equities have delivered strong returns in the last decade, history has shown that assets can go through long periods of out- and underperformance before reversing (Chart 1) and that past returns are not necessarily indicative of future returns.

With lingering US-China trade tensions, coronavirus fears, the US election and UK Brexit negotiations still on the agenda this year, in our view portfolio diversification should be a consideration for asset allocators in 2020. The case for diversifying with alternatives appears to be a solid one, considering that multiple S&P 500 sectors have elevated valuations relative to history and longer-dated US yields are near record lows.

Chart 1. Rolling 10-year after ex-inflation returns: Jan 1960 to Jan 2020



Source: Abbey Capital, Bloomberg. US equities are represented by the S&P 500 TR Index. See the back page for a description of indices.

2. Managed futures can be an effective diversifier for traditional portfolios

One such alternative is the a $318bn[1] managed futures industry that has appealed to institutions given its long-term zero correlation to equities and positive returns in previous US equity bear markets.

Managed futures funds employ a range of bidirectional systematic and discretionary strategies across equities, bonds, commodities and currencies. Typically, managed futures tends to perform best when there are trends across a diversified set of futures markets, which could occur in both rising and falling equity markets.

The differentiated drivers of managed futures have historically contributed to its **zero** long-term correlation to a traditional bond-equity portfolio[2]. In fact, managed futures has historically performed positively during both bull and bear equity markets (Table 1), while its drawdowns have tended to occur during different periods to equities, as returns are linked to the environment for trendfollowing rather than the strength or weakness of equity markets.

Table 1. Barclay CTA Index in bull and bear periods for the S&P 500: Jan 1987 to Jan 2020

Period	Equity Phase	S&P 500	Barclay CTA Index	Correlation
Jan-87 - Aug-87	Bullish	36%	37%	-0.06
Sep-87 - Nov-87	**Bearish**	**-30%**	**10%**	**0.25**
Dec-87 - Aug-00	Bullish	559%	156%	0.03
Sep-00 - Sep-02	**Bearish**	**-46%**	**23%**	**-0.45**
Oct-02 - Oct-07	Bullish	90%	24%	0.12
Nov-07 - Feb-09	**Bearish**	**-53%**	**16%**	**-0.30**
Mar-09 - Jan-20	Bullish	339%	9%	0.16

Source: Abbey Capital, Bloomberg. Data is shown for this period as it represents the earliest dataset available. See the back page for a description of indices.

[1] Source: BarclayHedge.
[2] Based on data from 01 January 2000 to 31 January 2020, measured by the daily correlation between the SG CTA Index and a hypothetical portfolio of a 60% allocation to the S&P 500 TR Index combined with a 40% allocation to the JP Morgan US Government Bond Index.

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Past results are not indicative of future results.
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3. Historically, managed futures has shown that it can outperform traditional hedge fund strategies during periods of market stress

The difference between managed futures and traditional hedge fund strategies is illustrated in Table 2, which shows the performance of the Barclay CTA Index versus the HFRI Fund Weighted Composite through S&P 500 drawdowns in excess of 10% since 1990.

The table shows the Barclay CTA Index has outperformed the HFRI Fund Weighted Composite Index in each of the historical S&P 500 drawdowns in excess of 10%, illustrating that the positive performance delivered by managed futures in past equity bear markets is not something that is shared with all hedge fund strategies.

One possible reason for the relative outperformance is that some hedge fund strategies may have an inherent positive equity beta (i.e. tend to perform best in environments which are positive for equities). These strategies could be prone to the possibility of correlations 'going to one' in times of stress, whereby they fall alongside equities during bear markets. Historically, this differs to managed futures which, has often seen its equity correlation fall or become negative in market stress periods (Chart 2).

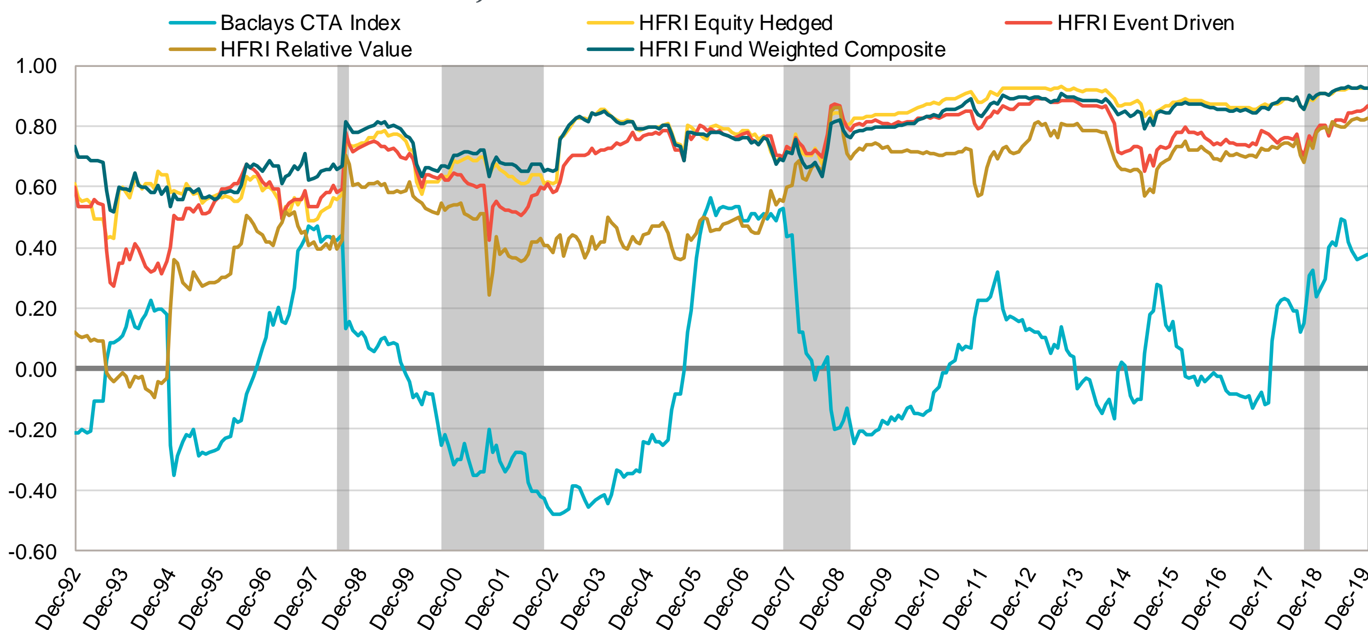
While it is important to acknowledge that managed futures may not always outperform other diversifying strategies during periods of market stress, historical returns highlight that investors could benefit from an allocation to managed futures over other non-traditional assets.

Table 2. Barclay CTA Index vs HFRI Fund Weighted Composite Index in S&P 500 drawdowns over 10%: Jan 1990 to Jan 2020

	S&P 500	Barclay CTA Index	HFRI Fund Weighted Composite
Nov-07 to Feb-09	-53%	16%	-21%
Sep-00 to Sep-02	**-46%**	**23%**	**-4%**
Jul-98 to Aug-98	-16%	6%	-9%
Jun-90 to Oct-90	**-16%**	**19%**	**-2%**
Oct-18 to Dec-18	-14%	-2%	-6%

Source: Abbey Capital, Bloomberg. Data is shown for this period as it is the earliest data available for the HFRI Fund Weighted Composite Index. See the back page for a description of indices.

Chart 2. Barclay CTA Index and HFRI Indices rolling 36-month correlation with S&P 500 (periods of S&P 500 drawdowns in excess of 10% shaded)



Source: Abbey Capital, Bloomberg. Data is shown for each index at the date which there is complete 36-month correlation data. i.e. indices are shown from 36-months after inception. Periods of S&P 500 drawdowns exceeding 10% are shaded. See the back page for a description of indices.

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Description of Indices

Barclay CTA Index (Start Date: Jan-1987)

The Barclay CTA Index is a leading industry benchmark of representative performance of commodity trading advisors. There are currently 510 programs included in the calculation of the Barclay CTA Index. The index is equally weighted and rebalanced at the beginning of each year.

SG CTA Index (Start Date: Jan-2000)

The SG CTA Index is a daily performance benchmark of major CTAs; it calculates the daily rate of return for a pool of CTAs selected from the larger managers that are open to new investment. Selection of the pool of qualified CTAs used in the index is conducted annually.

JP Morgan US Government Bond Index (Start Date: Jan-1985)

The JP Morgan US Government Index is a leading measure of US government bond market performance. The Index measures the total return of US Treasury securities across the whole yield curve.

S&P 500 Total Return Index ("S&P 500 TR Index") (Start Date: Feb-1988)

The S&P 500 Index is an index of 500 US stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 TR Index is the total return version of the S&P 500 Index. Dividends are reinvested on a daily basis and all regular cash dividends are assumed reinvested in the index on the ex-date.

Hedge Fund Research, Inc. ("HFRI") Equity Hedge Index (Start Date: Jan-1990)

The index includes investment managers who maintain positions both long and short in primarily equity and equity derivative securities. Strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios.

HFRI Event Driven Index (Start Date: Jan-1990)

The index includes investment managers who maintain positions in companies involved in corporate transactions of a wide variety such as mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Event Driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company specific developments.

HFRI Relative Value Index (Start Date: Jan-1990)

The index includes investment managers who maintain positions in which the investment thesis is predicated on realisation of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed income, derivative or other security types.

HFRI Fund Weighted Composite Index (Start Date: Jan-1990)

The HFRI Fund Weighted Composite Index is a global, equal-weighted index of over 1,400 single-manager funds that report to HFR Database. Constituent funds report monthly net of all fees performance in US Dollar and have a minimum of $50 Million under management or a twelve (12) month track record of active performance.

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