

## CTA MANAGED FUTURES PINNACLE AWARDS

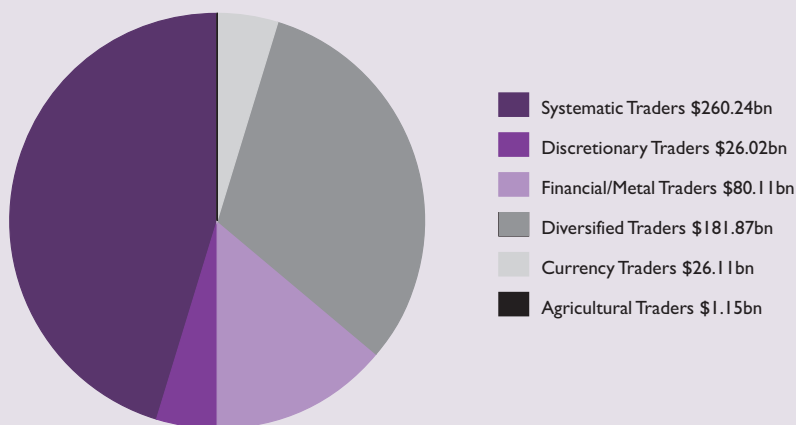
# Pinnacle Awards showcase the best of the CTA sector

Earlier this month, CME Group and BarclayHedge hosted the Managed Futures Pinnacle Awards, a celebration of the best performing Commodity Trading Advisors in the US across a variety of categories. CTAs have long been seen as good in a crisis but the industry is more diversified and more bullish than ever, found **William Mitting**.



Leigh Loftus 2012, ThinkLeigh Photography

### Assets under management by strategy



Source: BarclayHedge

Not many people who aren't in the CTA community have heard of Professor John Lintner. However, for CTAs Lintner, the man who in 1983 released a paper arguing for the worth of investing in managed futures as a diversifying strategy, is a legend.

"Portfolios...including judicious investments... in leveraged managed futures accounts show substantially less risk at every possible level of expected return than portfolios of stocks (or stocks and bonds) alone," said Professor Lintner in his groundbreaking study.

Almost 30 years since Lintner announced the findings of his research and the CTA industry is doggedly proving his findings true. Investors are taking note. Assets under management by CTAs have increased from around \$600m in 1983 to over \$320bn today. Investors have flooded to the sector since the financial crisis with AUM increasing by over 50% since 2010.

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### Influx of funds

On the face of it, the flood of funds into CTAs is not surprising. 2008 was one of the best years on record for CTAs returning over 14% compared with a 37% drop in the value of the S&P 500. CTAs have long sold themselves on being uncorrelated to traditional asset classes. They certainly proved their worth in the crisis of 2008.

The past few years have been tougher for the industry. The absence of sustained trends in the markets and an increase in volatility caused by government interventions, or rumours of interventions, have defied models and upset some of the traditional trend following strategies.

But to write off CTAs on the basis of a couple of negative periods over the past three years, is to misunderstand the industry. A common mistake made by investors in managed futures is to be too short-term. Managed futures, whatever the mix of time frames in the CTA portfolio, are longer term investments. Over any five year window of the last 25 years, they have always profited and this period looks set to be no different.

Trend following managed futures funds tend to have strategies focusing on longer term, more path dependent volatility. When you have strong trends, CTAs tend to do very well. The trend following part of the industry, which accounts for around 60-70%, has suffered in the wake of the recent market conditions.

In addition, CTA strategies in general, tend to record a sudden burst of positive performance. During 2008, when CTAs returned 14% amid the chaos of the financial meltdown, two months (February and October) accounted for almost all that return.

For this reason, impatient or over-active investors in CTAs tend to perform worse. Like the managers in the industry, the investors in CTAs that tend to perform well are the ones who stick to their course and wait for the irrationality of the markets to end. Keynes' old adage that the markets can remain irrational longer than you can remain solvent does not apply to CTAs, who tend to preserve capital and wait for the regression to normal.

The CTA industry is also constantly innovating and developing new strategies to adapt to the "new normal" and continuing the move to diversify away from traditional trend following strategies.

### Combating volatility

In 2008 there was a whole range of sustained moves that CTAs were able to capture with their models. Now movements are less predictable, not as linked to market fundamentals and shorter term.

When you have markets that are unduly influenced by political events, there are a lot of false starts. Trend followers have found it tough over the

### The Managed Futures Pinnacle Awards 2012: winners

The Managed Futures Pinnacle Awards were decided based on quantitative data provided by BarclayHedge for the various award categories. Awards were presented at a dinner at the Museum of Broadcast Communications in Chicago on June 11.

The Managed Futures Lifetime Achievement Pinnacle Award was presented to Ken Tropin, Graham Capital Management, for his contributions to the development and maturation of the managed futures industry. For an interview with Ken Tropin, see page 27.

The winners were as follows:

#### BEST BEAR MARKET MANAGER

**Best Bear Market Manager (HF Index) \$100-299M AUM**

Mulvaney Capital Management

**Best Bear Market Manager (HF Index) \$300M+ AUM**

International Standard Asset Management

**Best Bear Market Manager (S&P 500) \$100-299M AUM**

Mulvaney Capital Management

**Best Bear Market Manager (S&P 500) \$300M+ AUM**

DUNN Capital Management

#### BEST DEFENSIVE

**Best Defensive (Diversified) \$100-299M AUM**

Emil van Essen

**Best Defensive (Diversified) \$300M+ AUM**

GMO LLC

**Best Defensive (Single Sector) \$100-299M AUM**

Newton Capital Partners

**Best Defensive (Single Sector) \$300M+ AUM**

Dominicé & Co

#### BEST DIVERSIFIER

**Best Diversifier (CTA) \$100-299M AUM**

Newton Capital Partners

**Best Diversifier (CTA) \$300M+ AUM**

Two Sigma Investments

**Best Diversifier (Multi Advisor) \$100-299M AUM**

6800 Capital

**Best Diversifier (Multi Advisor) \$300M+ AUM**

AC Investment Management

#### BEST RISK ADJUSTED

**Best Risk Adjusted (Diversified) \$100-299M AUM**

Vegasoul Capital Management

**Best Risk Adjusted (Diversified) \$300M+ AUM**

Two Sigma Investments

**Best Risk Adjusted (Single Sector) \$100-299M AUM**

Newton Capital Partners

**Best Risk Adjusted (Single Sector) \$300M+ AUM**

Axiom Investment Advisors

#### GREATEST RETURNS (HIGH VOL)

**Best Return (High Volatility - Diversified) \$100-299M AUM**

Emil van Essen

**Best Return (High Volatility - Diversified) \$300M+ AUM**

International Standard Asset Management

**Best Return (High Volatility - Single Sector) \$100-299M AUM**

Paskewitz Asset Management

**Best Return (High Volatility - Single Sector) \$300M+ AUM**

Dominicé & Co

#### GREATEST RETURNS (LOW VOL)

**Best Return (Low Volatility - Diversified) \$100-299M AUM**

Vegasoul Capital Management

**Best Return (Low Volatility - Diversified) \$300M+ AUM**

Two Sigma Investments

**Best Return (Low Volatility - Single Sector) \$100-299M AUM**

Metro Forex

**Best Return (Low Volatility - Single Sector) \$300M+ AUM**

P/E Investments

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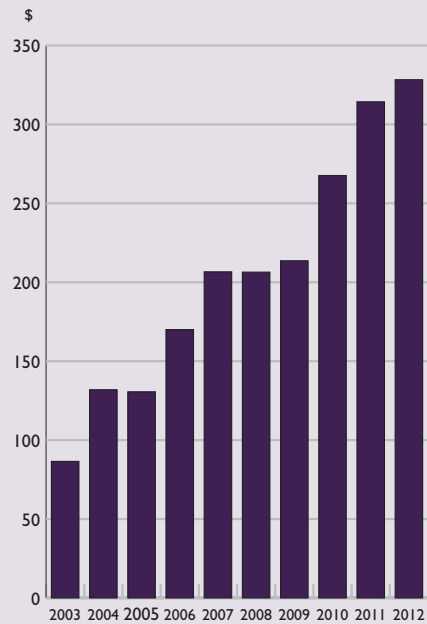
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### CTA assets under management



Source: BarclayHedge

last few years as markets move not on fundamentals but on a rumour of what the ECB might be about to say.

One key message from the Managed Futures Pinnacle Awards was that the industry has come a long way over the past few years. As assets under management have grown, so too has the sophistication of the sector. Traditional strategies have been adapted to the shorter term trends and trend following is no longer the default strategy for investors.

Sol Waksman, the founder and president of BarclayHedge, told the attendees at the awards show that the industry had fared well despite the challenging market conditions: "The past few years have not been the best for the industry.

"Wild swings from risk on to risk off and then back to risk on again against a backdrop of massive government intervention in the interest rate markets have impacted prices in all major market sectors and have taken their toll on investment portfolios."

Waksman pointed out that AUM had increased by 54% since January 2010 despite the lower performance of CTAs compared with 2008.

"Returns alone do not tell the whole story," he said. "In the earlier period of more robust returns, inflows accounted for only 15% of the AUM increase, while 85% came from appreciation. In the more recent period, those numbers are reversed with 85% coming from inflows and 15% coming from appreciation.

"Typically money flows into investments when returns are good and flows out when returns disappoint. The fact that asset inflows have increased during a difficult period is somewhat surprising and counter-trend," said Waksman.

Waksman hailed the performance of CTAs during the crisis. "Perhaps after 25 years, John Lintner's findings that managed futures are not correlated with stock and bond portfolios has finally become mainstream," he said. "Maybe investors are

looking at the political economic landscape and seeing all the uncertainty on the horizon and making a strategic decision to allocate to managed futures in anticipation of better returns ahead.

"Or maybe after living through the liquidity crunch of 2008, during which investors took full advantage of the more than ample liquidity available as they redeemed more than 15% of total industry assets at year end without impacting the efficient flow of futures markets or without managers having to limit or restrict redemptions in any way, they have come to realise that return of capital can be as, or even more important, than return on capital."

### The end of the trend?

Since the 80s the industry has changed completely. It used to be that almost 100% of CTAs were trend followers. Today there is a plethora of strategies, both systematic and discretionary, which generate non-correlated returns for investors.

The end of the trend has long been discussed among CTAs but the reality is that they have continually adapted to the ever changing market condition, to the perennial emergence of a "new normal".

Commodities have usually been a good bet for CTAs (although their name comes from their CFTC regulatory coverage rather than their investment focus). However, those looking to invest in commodities to diversify have struggled recently.

In August 2011, in an article for FOW, Stonehenge Asset Management reported the findings of a study it had compiled into the correlation between CTAs and commodities. The firm compiled a proprietary commodity index consisting of a weighted portfolio of all the commodity asset classes, including: agriculture, livestock, metals, energies and softs. It then calculated the correlation to the Barclays BTOP 50 index, the CTA performance index compiled by BarclayHedge.

It discovered that from 2002 to 2009 the correlation between the two indexes was 18% or almost non-correlated. From 2009 to present, the correlation is 45%.

Steve Michael, principal at the firm, said: "We believe that long term success in utilising alternative managers as a means to diversify a traditional portfolio, reduce volatility, and increased absolute returns is in danger and becoming unsustainable.

"As the managed futures industry has become more mature we must not fall into the complacency trap which may be the result of exceptional market conditions. Our space has always been a driving force of innovation and it benefits us all to keep our eye on the ball and continue to provide the means to sustainable long term success through cutting edge thinking and the development of new ideas."

### Innovation and adaptation

CTAs are innovating to heed Michael's warning. AC Investment Management, which took home the Best Multi-Adviser Diversifier (AUM \$300m+) award, runs a discretionary commodity futures investment strategy.

AC Founder Ernest Scalmandre said that the environment for commodity trading has been good for the firm this year, which has avoided shorter term correlations through adapting its investment strategy.

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*Chris Topple*  
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"Government intervention doesn't have as much of an influence as the variety of ETFs and commodity index funds that have cropped up over the past decade.

"In the short term today when people are buying stocks, or the market is risk on as it is termed, commodities go up too. And when people are afraid and stocks are being sold off, commodities fall with the stock market. This really doesn't make any sense to us but the fact is that the index participants, the ETFs and the long only commodity investors have an influence on the short term price."

All this prevents an obvious challenge for a CTA trying to diversify against the prevailing market sentiment. "Risk on, risk off has made it more difficult for fundamental commodity traders," said Scalamandre. "The crisis in Greece has nothing to do with the price of corn in Illinois."

AC Investment Management has extended the duration of the trades to mitigate the shorter term volatility in the markets and escape the time frame for the correlations between commodities and equities that have nothing to do with the supply and demand.

Emil van Essen is another award winner that has been forced to adapt. The firm has fared well during the past 12 months and that was acknowledged with three award nominations and taking home the awards for Best Returns in the High Volatility (\$100-299m AUM) category and for Best Defensive (diversified) category – in and of itself a comment on the current market conditions.

Emil van Essen, who runs his eponymous firm, said: "Most of our profits come from finding many small edges in the markets where others don't look. These model types have always worked well and continue to do so.

"What seems to be changing is the tendency of all commodities to react to the risk on/off environment with violent up or down moves. This has caused recent losses in our hedging program.

"These recent market changes are likely here to stay and will provide many opportunities for those who can adapt first. We have recently begun working on a new model that will take advantage of this recent developments."

Emil van Essen is a spread trader. The strategy is about looking for when markets become extended and positioning so that the fund wins when they return to par. He looks within the markets for opportunities to capture relative value, a great example of the enrichment of CTAs.

2011 saw the introduction of two new styles of trading that Essen said have worked well during the year. "We have been successful at adapting to the changing ways long only funds are rolling from one contract to the next. We also added new inter commodity spreads with some unique alpha generating opportunities.

"Finally we are introducing a new strategy involving the relative value of different baskets of commodities. The goal as always is to diversify into new approaches that are not correlated with our traditional trading methods and allows us to maintain high returns while reducing risk."

Other award winners have overcome the market volatility by trading on the fundamentals. Newton Capital Partners, which was the big winner on the night taking home three awards, has thrived through trading on the back of market

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### A lifetime of achievement: an interview with the winner of the Lifetime Achievement Award

Kenneth G. Tropin is chairman, founder and a principal of Graham Capital Management. Tropin founded Graham in 1994 as a quantitative macro hedge fund and over the last eighteen years has grown the firm into an industry leading alternative investment manager focusing on global macro discretionary and quantitative hedge fund strategies.

At the Managed Futures Pinnacle Awards, Tropin picked up the Lifetime Achievement award for his contribution to the industry. We caught up with him to get his views on the current crisis and the past 30 years.



**You have had 30 years in the CTA industry. What have been the key changes over that time?**

Over the past 30 years there have been significant changes in many areas of the business. It has become a more institutional industry, the markets that managers are involved in are much more global today and the professionalism of the industry has increased with the influx of institutional funds. Both Investors and managers are more sophisticated now than they were three decades ago.

**We have seen AUM increase significantly over the past 30 years from less than \$1bn to over \$300bn today. Is this increase in professionalism the reason for that?**

The increase in investor interest is primarily to do with the lack of correlation that managed futures has had with other asset classes. It is unique in the hedge fund space along with discretionary macro in that there is really no correlation to risk factors that investors are typically exposed with.

That has been the driving force as to why institutions have increasingly allocated more capital to CTAs. The managers are more conservative, professional and institutional these days. That is an important factor but the driving force is that clients want to invest in an asset class or strategy that is non-correlated to their other investments.

**Recently, there have been increased correlations with CTAs and markets falling. Is that a problem for the industry?**

There are going to be times when correlations are not stationary and increase but over the long-haul CTAs have not been correlated to the equity markets.

**How have the strategies employed by Graham Capital Management evolved over the past 30 years?**

In the earlier days of the business we had relatively straight forward trend following strategies and as the space has become more crowded those strategies have become more sophisticated and advanced.

Graham Capital Management has built out a discretionary macro business, which has now become the biggest part of the group representing 55% of AUM. It is a platform of over 30 discretionary trading teams managing proprietary and client capital.

The discretionary teams within the business are not correlated to each other so we have this source of Alpha that is reasonably consistently successful and is relatively uncorrelated not only with other hedge funds but with the various managers within the Graham platform.

**There has been a lot of bad press recently around high frequency trading. Are you seeing a negative impact on the market, a distortion of the markets traditional behaviours, as a result of the increase in HFT?**

I don't think that high frequency trading is distorting the market environment. Once in a while you get a big move in the market that is attributed to programme trading. On the average day though it is not much of a factor.

The biggest factor that everyone is contending with is the fact that there are periods of illiquidity nowadays because of the lower levels of proprietary trading by investment banks and there are times when people are trying to do the same trade at the same time and you need more liquidity. We see that in every capital market. It is

something that managers need to be aware of and be successful in trading through.

**You have lived through a few crises over the past 30 years. What sticks in your mind?**

There have been a lot. I can remember the 1987 market crash. At the time I was managing Dean Witter's business of allocating money to our in-house trading programmes as well as the outside managers that we had in those days.

On the day of the crash, almost all of the managers were short equities so we had a great day but the next day they were short bonds and bonds went up by a 5-10 standard deviation move following overnight action from the Fed.

I can remember the highs and lows of that two day swing. 1987 is remembered as a watershed year for CTAs as they had a great fourth quarter but the reality was it was due to foreign currency not equities as there were big moves in the currency markets in the fourth quarter.


**Market moves in the current crises seems to be more dictated by government intervention than real underlying fundamentals. How much of a challenge is that for CTAs to navigate?**

It is harder at the moment because it is always difficult for your systems or for discretionary traders to manage around what politicians are doing on a one off basis. It is challenging to have an edge on a one-off rescue package. Ultimately though the market is bigger than its participants and in the long term, the central banks are not going to have as big an impact as they have had this year

**And where is your money now?**

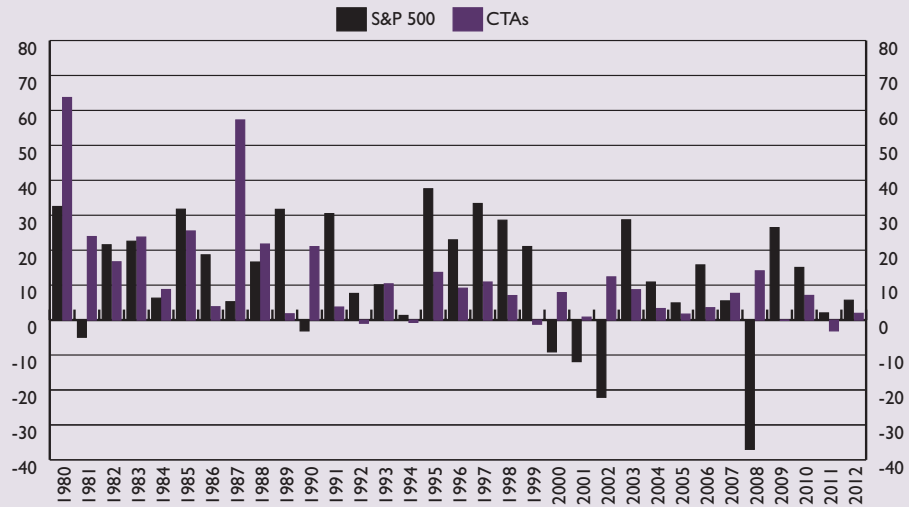
We don't talk about our positions publically but it would not surprise us to see the European crisis get a bit worse throughout the year.

**What advice would you give to people coming into the industry now?**

There are no secrets. The people who are going to be successful are those who work harder and smarter than the people around them. You have to set your goals high and attempt to surpass those goals and surround yourself with the brightest and most talented people you can find. If you do that and are committed, resolute and determined, you can accomplish great things. 

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CTAs vs S&P 500 performance since 1980



Source: BarclayHedge and S&P 500

news, rather than market rumour focusing its activity around hard numbers coming from events such as the non-farm payroll announcements as opposed to attempting to second guess EU politicians or reacting at lightning speed to market movements caused by rumours of bailouts. The firm has not had a negative year since its inception in 2000.

### Radio frequencies

As the breadth of the Managed Futures Pinnacle Awards demonstrates, today there is no one size fits all definition of a CTA strategy. Lintner Revisited, a re-evaluation of Lintner's research compiled by Alphamatrix and CME Group, compared the variety of different trading strategies to a radio receiver, each of which tunes in to a different market frequency.

The diversification of the industry means that not

only are CTAs no longer correlated to the market, they are often not correlated to each other. For this reason, larger CTAs, such as Graham Capital Management (see box) can pursue various different discretionary strategies within the same office.

Trend following, despite challenging periods, has always rebounded historically over the past several decades because particular markets eventually return to a trending environment in due course, as capital flows resume in one direction or another. Nowadays the managed futures is richer and more robust than ever, which reinforces the low correlations with traditional investments and other hedge fund strategies.

With innovations such as the Managed Futures Pinnacle Awards promoting the industry to a wider market combined with the strong performance of CTAs, AUM looks set to continue to grow exponentially.

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