RCM Alternatives

RCM Alternatives:
Whitepaper

Managed Futures 2016 Strategy Review

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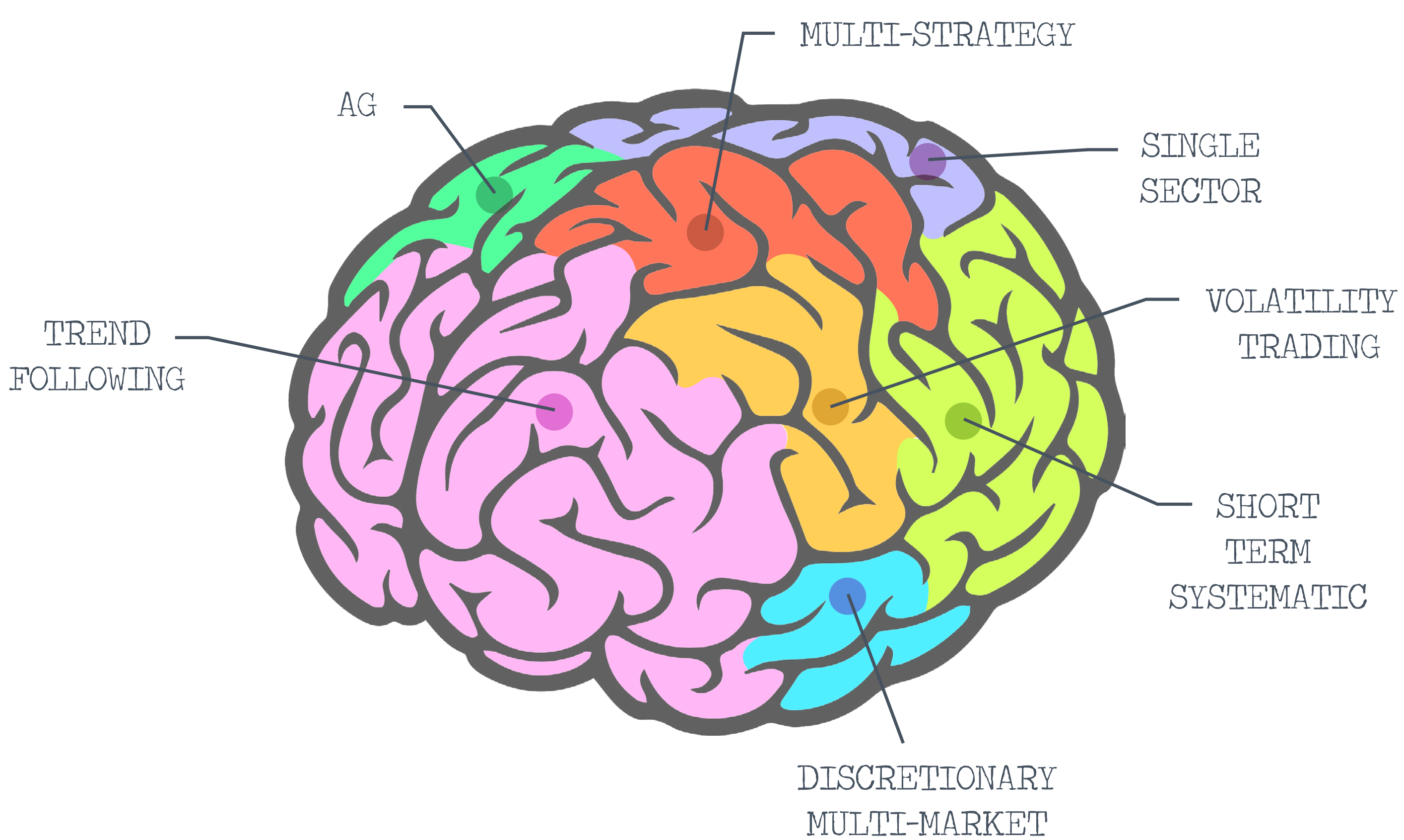
You would think that in a year where we started off with the first rate hike in nine years, China's economy in free-fall, and Crude Oil pushing $30 a barrel on the biggest decline in the market's history, managed futures investors would be remembering 2016 as one for the ages. It surely looked that way mid February, when the S&P 500 was down a rough 260 and managed futures were stepping up to the plate – delivering that non (negative in this case) correlated performance they're known for and finishing February as the highest performing asset class.

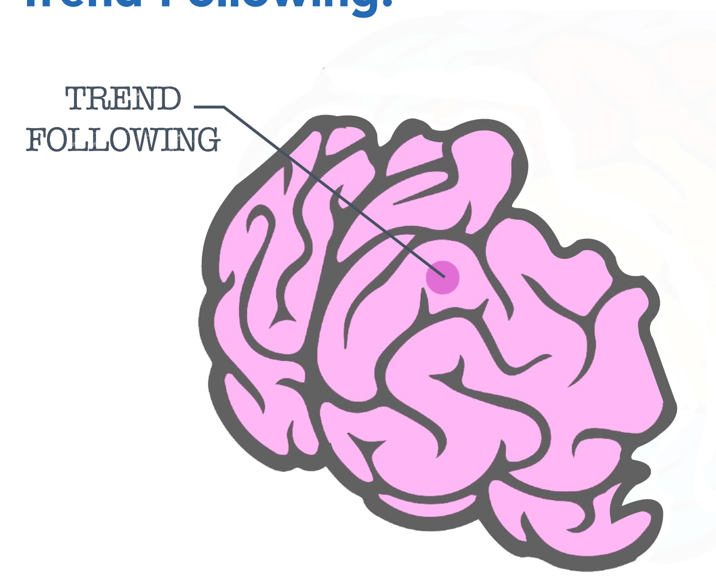
But there's more to the year than just those months ending in "y"; Managed Futures spent the latter part of the year giving up those returns as global financial markets began yet another slow, up crawling move where volatility was sucked out of every nook and cranny to push US stocks, for one, to new historical highs. Sure, there were bouts of excitement via Brexit (where managed futures on the whole did quite well), a bond market sell off, and the US presidential election shocker; but in retrospect it was merely false breakout producing noise. In the end, Managed Futures as an asset class ended off the year down -2.55% using the SocGen CTA Index. Nothing to induce panic and mass outflows, but nothing to write home about either.

Of course, that's the index performance, and the index is made up of different programs – some of which did better, some of which did worse. What's more, in the unique world of managed futures, those programs which make up the asset class can be doing quite different things, as different as short volatility and long volatility, short term and long term, Corn focused or Gold focused. The asset class is like all of our brains in that regard, with the different strategy types all part of the whole (the asset class brain, if you will),with the component strategies making up how the whole responds to market action (what the body is saying to the brain).

Here's our annual look at how the various types of managed futures strategies, as we classify them, did in the year gone by.



Trend Following:



Unlike other years where the lack of trends contributed to the downfall of performance from trend followers, there appeared to be plenty in the way of trends in 2016. Indeed, there was a rally in Crude from $35 to $55, the U.S. Dollar having its biggest up-trend in recent history, and Hogs dropping from $72 to $42 in five months. Not to mention great follow through to the downside in the British Pound following Brexit.

So where were the trend followers? They were there, and they were participating, but 2016 was a year full of high volatility of volatility, not just increased volatility. What's that mean? Well, the volatility expansions lasted moments instead of months, either causing the trend following strategies to be late in getting into the trend (it spiked into existence versus grinding into existence), and/or getting into the trend, only to give back the returns on a reversal. Take that US Dollar move, for example, which happened so quickly, in a matter of weeks, that many managers were unable to capture the trend; or Copper which shot up post-election night, but again, too fast to capture at attractive levels.

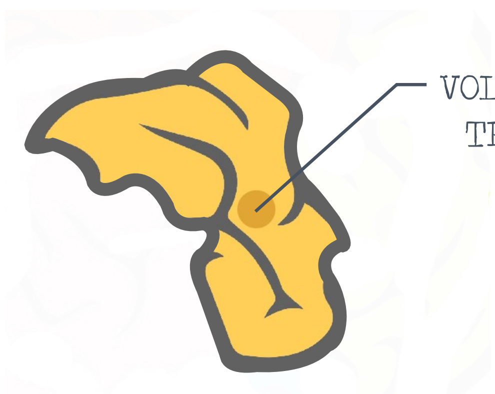
From a simplistic approach, it's easy to think that trend followers should have been able to capture these trends, but there are so many variables to consider here. One, they are built to capture new trends, not pick tops and bottoms. A few of the biggest moves of the year - bonds selling off and Crude Oil rallying – were from historic highs/lows. Mathematically, it takes a while for the down trend that brought prices that high or low, to signal its done. Think having to cross back above a 100 or even 200 day moving average, for example. Additionally, the largest players don't have significant exposure to the markets that did move in nice orderly trend fashion, like Hogs. They are too big to have any meaningful exposure there, and it showed. Finally, the result of not wanting/able to have meaningful exposure to markets like Hogs is more exposure to financial markets like stocks (where we saw a record number of days without a 1% move and currencies (where we saw a stunning correlation with managed futures performance as currency volatility crumbled).

Even with all of the diverse trend following strategies out there, few were able to find profits given these headwinds – and in the end it was a survive to fight another day kind of year. Witness the trend following/ industry bellwethers, AQR Capital Management Managed Futures Strategy Fund N Program and Winton Capital Management Futures Fund Program*, which were unable to find the black in 2016, with AQR down roughly -9% and Winton down approximately -4% as proof it was a poor year for trend followers. One exception we noticed was Transtrend, which was up roughly 7%.

Overall performance: **Poor**

Volatility Trading:

Besides some individual stand outs in the Multi-Strategy and Discretionary categories, the Volatility trading sector were the rock stars of 2016. This space is growing each year, and becoming more diverse in the process. Where we used to see a steady diet of vanilla option selling here, the space has added new strategies incorporating VIX futures, with what once was a purely short volatility space rapidly becoming



more and more of a volatility trading space, able to profit from either increases or decreases in volatility.

For more on how this sort of trading works (buying and selling the fear gauge futures) we outline it all here and here. The short version is that each Volatility manager tends to approach the VIX from a market structure standpoint – trying to capitalize on its unique tendencies of being a "qaudrivative" of sorts, (a derivative of an index of a derivative of an index) where arbitrage opportunities can exist when one of the four components of that "quadriviative' doesn't keep pace with the other legs. Here was a great quote from our live event on VIX Traders this summer explaining why the VIX sometimes spikes and sometimes crawls:

> *Tim Jacobson had a great talking point here, saying to think of the VIX as a radar screen – where all of the known information the market is reflected on the screen in various blips and dots. The sum of all that information comes out to be the current VIX level. Continuing, he stated that unless one of those known blips becomes larger, or a new unforeseen blip hits the screen, the VIX won't move. The larger the blip and more unexpected its arrival on your screen (and closeness to your ship) the larger the movement in the VIX will be.*

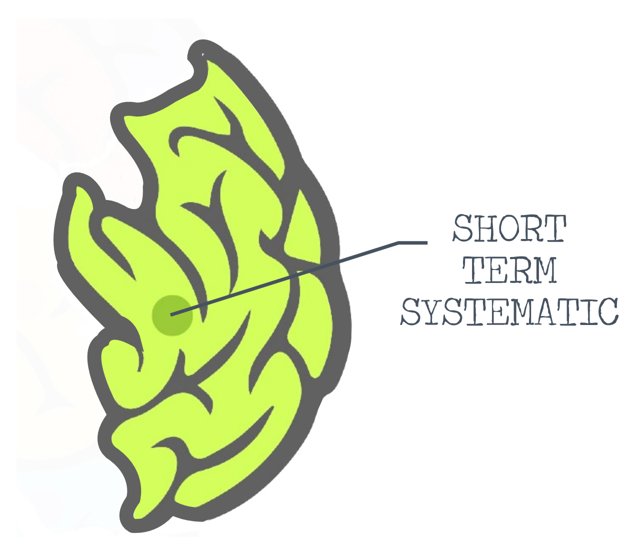
Back to 2016, this was the one and only sector where the majority of the managers we cover saw good returns. This is particularly true for S&P options traders that trade weekly options vs the end of the month variety. Managers like Global Sigma Group Global Sigma Plus Program*, Tianyou Asset Management Tianyou Fund Program*, and Goldenwise Capital Management Quantitative Multi-Strategy*. Meanwhile, products that hedge on the VIX and E-mini S&P such as Pearl Capital were able to profit from the unique and frequent movements of the VIX futures.

This is an increasingly attractive segment of the managed futures space from our viewpoint, being generally a low margin usage product with low correlations to the rest of an alternatives portfolio (especially CTAs); allowing investors to add it to current portfolios of managers with very little impact in terms of additional capital or additional portfolio level drawdowns and added volatility.

Overall Performance: **Good**

Short Term Systematic:

The Short Term side of the Managed Futures brain typically reacts the same way as trend followers, just on much shorter time span. We're talking momentum trades grabbing days to weeks long moves, versus weeks to months long moves. With trend following, it's like remembering important dates like your wedding anniversary or your friends 60th birthday party, whereas short term trading is a lot more like remembering your dentist appointment next week or your dinner plans this weekend with your friends.



It's difficult to categorize this section, with some managers in and out of positions within hours, and others holding multiple days; but generally speaking it was not a good environment for this type of strategy for many of the same reasons as the trend following space – mainly the decline in volatility across financials, which make up the bulk of short term trading strategy portfolios given the greater volume and liquidity there. Remember the days leading up to the election, for example, when uncertainty was in the air and stock markets frozen in their tracks – to the tune of the S&P not moving outside of a 1% range for more than 38 days.

That's bad news for traders who rely on large intra-day moves. Consider the e-mini S&P with a bid/ask spread of .25 points, index price of say 2,200, and average daily move of just 0.45%. That's an average daily move of about 10 points, or just 40 times the bid/ask spread. Contrast that with an average move of 1.13% (25 points), where there's movement 100 times the bid/ask spread, and you can see the value to short term traders of larger daily moves.

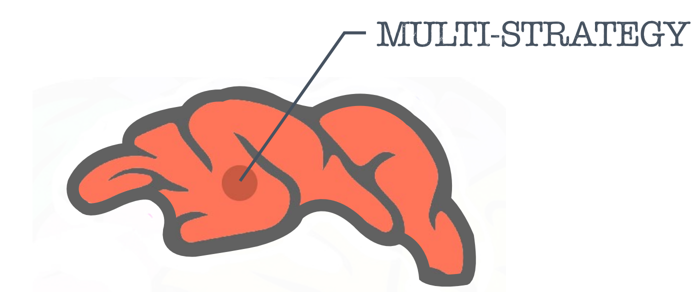
Which brings us to the biggest moves of the year in Brexit and the US election. Moves which we should expect programs able to capture short term moves would benefit from. In a word, that didn't happen in both cases, because both cases were reversals of the expected outcome. Now, short term systematic traders weren't positioning their portfolios for one outcome versus another. There was no 'betting' on the vote results, but positions in many cases were entered based on the market movements leading up to the results (where, again, the opposite of what happened was being priced into the market). The sharp spikes (in the opposite direction) once both election results were announced caused some pain in this space because of those reasons. In short, short term doesn't like this type of binary bollocks.

Overall, the short term strategy performed slightly better than trend followers (mainly due to the moves being shorter in duration), but not as well as we would have hoped, with programs like the Attain Eco Capital Futures Fund Program* seeing losses on the year, while bellwethers like Crabel Capital MGMT DIV. Futures 4X Program* and Quantitative Investment MGMT (GIM) Global Program doing better. Way better in the case of QIM, who was a stand out performer in all of the hedge fund world up a very impressive 16%!?!.

Overall Performance: **Below Average**

Multi-Strategy:

Multi-strategy as we define it within the managed futures space differs from the multi-strat hedge fund category that's garnering a lot of assets recently. Multi-strat hedge funds typically employ multiple hedge fund strategies, such as long/short equity, merger arbitrage, equity market neutral, risk parity, and more – within a single fund. While multi-strat managed futures programs similarly spread their investments

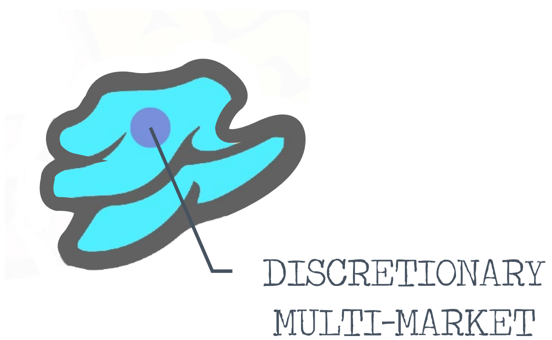


across many strategies, they limit those strategies to models working on exchange traded futures markets (so no credit lines or convertible bonds or the like).

Managed futures based Multi-strategy programs typically have a trend following base, with other non-correlated strategies such as short term, mean reversion, or currency carry added to their portfolio of models to perform during flat to losing periods in trend following. Generally speaking, these strategies will usually do well, but underperform Trend following when Trend Following does well, and are designed to outperform when trend following is not. So, with trend following coming in below average in 2016, did multi-strategy deliver the goods via their other models?

Did diversification into other yield producing strategies help soften the trend following/momentum/macro blow? It sure did! The carry trade, for one, was working well for most of the year, while volatility capture and long equity overlays were able to push other multi-strats into the black for the year.

Managers like Revolution Capital MGMT Alpha Program*, Welton Investment Partners Global Directional Program*, and Millburn Ridgefield CORP. Multi-Markets Trading L.P. Program* were somewhat of Managed Futures outliers in 2016 thanks to their built in diversification, with pretty good years.



Overall Performance: **Above Average**

Discretionary Multi-Market:

When we think of the brain, we think of people that use their left or right side; free spirited or calculated; go with the flow or planner. Well, if all the other strategies are left brained (analytical and objective) based on the way they trade using a systematic approach, Discretionary is right brained (intuitive, thoughtful, and subjective) using their experience to make decisions on where the markets will be in the future (along with analytics and objective risk controls). We're talking George Soros (discretionary) versus Ray Dalio (systematic) here.

So how did the Soros' of the world fare in 2016? Well, an August Forbes article titled 'Is Discretionary Macro Dead' might give you a clue. Or the news that fabled discretionary manager Paul Tudor Jones was laying off traders and hiring quants to improve on performance and stem outflows. It wasn't a great environment for most discretionary traders, for the reasons which have plagued fundamentals based investors for years – mainly central bank controlled markets, and the lack of interest in putting in exposure in stock markets at all time highs or bond rates at all time lows. Everything in their being says these markets are ripe for big reversals, but on we climb, and slowly upwards.

At least there was movement in rates this year, and that was one of the reasons success by some discretionary programs we track closely here. Chief among them was Three Rock Capital MGMT Global Macro Program, who was 10.41% in 2016, and up 24% over the past two years {Disclaimer: Past performance is not necessarily indicative of future results}. Another discretionary trader (coming out of a systematic shop!) that's worth a mention is Sunrise Capital Partners Evolution Program*, who's discretionary program was up 27% in its second year of trading.

Performance: **Mostly below average**

Ag:

There's no other way to slice it, discretionary fundamental agricultural CTA's struggled in 2016. The primary challenge was reconciling record

production with demand in many key commodities. Corn, soybeans, wheat and hogs all set production records in 2016, with global supplies set to expand further in 2017. These are not generally the underlying fundamentals that bull markets are made of.

Hog prices declined sharply from their summer peak,

falling to 7-year lows in October. While a number of traders accurately predicted price weakness in the fall, most were surprised by the sharp v-shaped reversal in the 4th quarter. Ideas that record kills would overwhelm packer capacity, taking hogs under $40 never materialized. Instead massive pork export demand, and record black packer margins set off a 40% rebound in prices.

The corn and soybean markets also perplexed traders in 2016, with crop production for both eclipsing even the most optimistic projections. While corn and soybean crops set records, prices have remained stubbornly strong. Soybeans are nearly 20% higher than last year, even as USDA reports continue to show final crop numbers increasing, and South American production growing as well. 2016 U.S. corn production is estimated at record 15.1 billion bushels, with carryover at a 29 year high. Corn prices are off their highs, but have plateaued at levels well above bearish projections.

On the demand side of the equation, China has been a resilient force underpinning agricultural commodity prices, especially in soybeans where they remain the world's largest importer. Post-election inflation ideas have also been supportive to commodity prices. But going into 2017, optimistic demand ideas will be countered by a sharply rising $U.S dollar, higher interest rates, and expanding global production. Add the uncertainty of the Trump administration's trade policies with China and Mexico, and 2017 is shaping up to be an interesting, and hopefully profitable year, for discretionary agricultural CTA's.

Despite all of that, Tanyard Creek Capital Livestock Program pulled off a 6% return in 2016 off of their play in the meat markets. Wharton Capital Management Agricultural Futures Program* wasn't as fortunate in the same markets, down roughly 4%. Finally, Four Seasons Commodities CORP. Hawkeye Spread Program was able to pull in a positive return on the year, up roughly 2%, with their work in the grain markets.

Performance: **Poor**

Overview:

You can see from the dispersion in 2016 returns that there's more to the managed futures space than just trend following. The most common reason we hear people investing in Managed Futures is for crisis period performance, and there's no better way to get that exposure than a tried and true trend follower. But for numerous others, managed futures can be an alpha producing, go anywhere type of strategy in the search for absolute returns. Unshackled from the pre-conceived notions of what a managed futures investment looks like – those in search of absolute returns can find unique talent in unexpected places (like VIX futures).

At the end of the day, if you're looking to access Managed Futures solely for crisis period, know that you are trading in likely losses during low volatility, complacent times, for peace of mind and likely gains when stocks are in free fall. If you're looking for both absolute returns and crisis period performance, look to diversify within the Managed Futures sectors to capture both sorts of returns, in a sort of core/satellite approach where systematic trend following type approaches are the core, and non-correlated strategies of different types fill out the portfolio adding different return drivers within the managed futures/macro allocation.

Here's to better performance for more of the strategy types in the new year. Look for our Managed Futures 2017 Outlook coming soon, with a deeper look at the statistics behind the overall market environment in the year ahead. Sign Up to receive the 2017 Outlook and all of our other research and education here.

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We recommend investors visit the Commodity Futures Trading Commission ("CFTC") website at the following address before trading: http://www.cftc.gov/cftc/cftcbeforetrade.htm

Managed futures accounts can subject to substantial charges for management and advisory fees. The numbers within this website include all such fees, but it may be necessary for those accounts that are subject to these charges to make substantial trading profits in the future to avoid depletion or exhaustion of their assets. Investors interested in investing with a managed futures program (excepting those programs which are offered exclusively to qualified eligible persons as that term is defined by CFTC regulation 4.7) will be required to receive and sign off on a disclosure document in compliance with certain CFTC rules The disclosure document contains a complete description of the principal risk factors and each fee to be charged to your account by the CTA, as well as the composite performance of accounts under the CTA's management over at least the most recent five years. Investors interested in investing in any of the programs on this website are urged to carefully read these disclosure documents, including, but not limited to the performance information, before investing in any such programs. Those investors who are qualified eligible persons, as that term is defined by CFTC regulation 4.7, and interested in investing in a program exempt from having to provide a disclosure document, are considered by the regulations to be sophisticated enough to understand the risks and be able to interpret the accuracy and completeness of any performance information on their own.

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WHAT WE DO

We build great Managed Futures portfolios with clients looking to access the managed futures space in a meaningful way. That's been our specialty for more than a decade, with our experienced team up to the challenge of finding unique managers to fit unique needs.

For Investors

Research & Educate

We believe education means more than just a glossy brochure showing how managed futures is non-correlated to the stock market. We believe it means ongoing analysis of what's happening now, not just what happened over the past decade; and we provide daily research and commentary via our popular 'Attain Alternatives' blog covering all things alternative investments, as well as periodic whitepapers digging deeper into topics, guest posts by fund managers, and more.

Scout Talent

You can think of us as talent scouts, helping investors scour the world of alternative investment opportunities in an effort to identify those with robust, consistent performance, sophisticated risk management processes, and well-developed operational infrastructure. This selection is done through our proprietary filtering algorithm before performing one-on-one meetings and "real-time due diligence" where we analyze daily trading.

Tailor Portfolios

Armed with a menu of talented managers, we then provide customized portfolio and strategy advice to better generate target returns and protect principal while meeting the diversification, return, and risk needs of investors ranging from high net worth individuals to pension funds. Clients invest in these portfolios by opening a brokerage account with us, where we earn a portion of the trade-by-trade costs and fees paid to the portfolio managers you enlist. There are never any add-on, portfolio-level fees for our services.

Make It Easier

We make the actual investment part, with the paperwork and funding and all the rest, as easy as possible. We do this by eschewing a 'one size fits all' approach in favor of a consultative approach where we work with clients to find solutions that work for them in terms of structuring the investment. These include vanilla individual futures accounts, to the creation of 'Funds of One' or direct access to managers. The choice of clearing firms considers the investor's requirements for credit rating, balance sheet, and more; while consideration is given to smart collateral options via T-Bills, Notes, Corp. Debt, & Stocks.

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