



# Managed Futures Outlook 2020 **The Waiting Game**

318 W Adams St. 10th FL | Chicago, IL 60606 | 855-726-0060  
[www.rcmalternatives.com](http://www.rcmalternatives.com) | [invest@rcmam.com](mailto:invest@rcmam.com)

# Managed Futures Outlook 2020 The Waiting Game



What's in store for managed futures and global macro in 2020 is really a question of how much longer we're all willing and able to play the 'waiting game' with global markets seemingly hell bent on obliterating past records for the longest economic expansion EVER.

In an asset class built on delivering crisis period performance, it's now been 10 years of waiting for that next crisis to hit. It's been 10 years of waiting for a meaningful increase in cross asset class volatility. It's been 10 years of waiting for follow through on directional moves in assets not named the S&P 500.

That waiting period has led to the asset class providing performance in other ways, such as catching the sell off in energies in 2014 or rally in bonds in 2019. And that has led to frustration among investors who view that diversification of return streams and inability to capture short-lived downturns in equity markets as "undependable" returns. Those with something to lose are all playing the waiting game because there are some nasty forces at work out there, as evidenced by Ray Dalio's recent quote:

“This set of circumstances is unsustainable and certainly can no longer be pushed... [which] is why I believe that the world is approaching a big paradigm shift.”  
– Ray Dalio, Bridgewater

The key word in there is “approaching”. This quote was said in late 2019, but could have easily been said by any number of billionaire hedge fund managers (or even lowly centi-millionaires) at any time over the past decade. The train has always been approaching, and by definition is closer to arriving today than it was yesterday. But that doesn't mean we're done waiting. It could come in 2020, or given all of this uncertainty about the waiting game, investors increasingly seem to be channeling their inner [Homer Simpson](#), essentially saying the waiting game sucks, I'm fine being in the hungry hippo game of stocks and will ditch my managed futures/global macro protection.

“Now we play the waiting game.....Ahh, the waiting game sucks. Let's play Hungry Hungry Hippos!”  
– Homer Simpson

Will 2020 be more waiting? More undependable returns coming from who knows where? Or do all of the many headwinds facing the world (Trade Wars, elections, climate change, the longest equity rally ever without a recession, trillions in debt, and more) finally result in the next market crisis and reward those who continue to wait?

While we can never think our way into those answers, thinking about what might transpire across different markets in the year ahead can only help us better understand the asset class' return profile so we (as investors and managers) can better understand how we fit into the overall asset allocation puzzle.

## First, a quick look back on 2019

Way to go 2019. That was a little more like it, with managed futures sitting around +5% YTD as of December 18th when we went to print. This felt a lot like 2017, with basically every asset class, including alternatives like hedge funds, commodities, and managed futures/macro coming along for the ride. That's three years in a row for anybody counting of basically all ON or all OFF across our asset class scoreboard. So much for asset class diversification...

**Fig. 1: ON / OFF Assets**

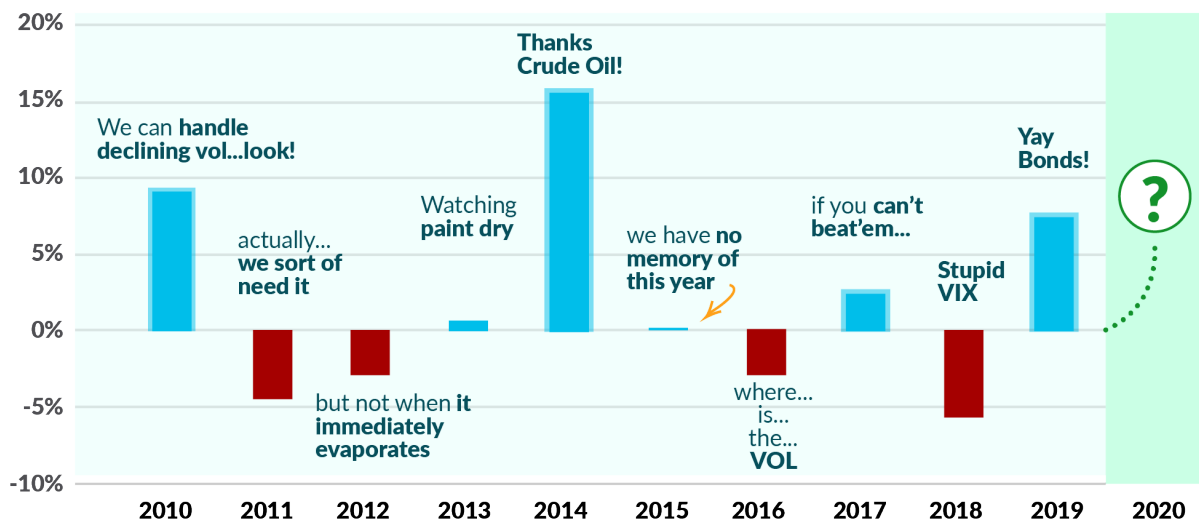
ASSET CLASS	2017	ASSET CLASS	2018	ASSET CLASS	2019
World Stocks	27.03%	*Cash	1.98%	U.S. Stocks	28.92%
U.S. Stocks	21.63%	Bonds	-0.21%	U.S. Real Estate	22.80%
U.S. Real Estate	9.37%	Hedge Funds	-3.33%	World Stocks	20.43%
Hedge Funds	6.23%	U.S. Real Estate	-4.28%	Commodities	13.69%
Commodities	4.49%	U.S. Stocks	-4.56%	Hedge Funds	10.02%
Bonds	3.57%	Managed Futures	-6.02%	Bonds	8.81%
Managed Futures	2.48%	World Stocks	-13.84%	Managed Futures	6.25%
*Cash	0.93%	Commodities	-13.86%	*Cash	2.09%

2019 Asset classes as of 12/12/19

Sources: SocGen CTA Index and Yahoo Finance

Managed Futures and Global Macro managers have essentially just one thank you note to write for 2019 – to global bonds (and maybe more correctly to the central banks... and maybe more correctly to just the Fed... but you get the point). While the trend in stocks was definitely up..... it wasn't a very tradable up, with the first three months of the year just a retracement and trend reversal of late 2018's sell off, and nasty little trend reversals lower in May, August, and September. Elsewhere, grains were held hostage by the Trade War with China, while energies basically did nothing.

**Fig. 2: Managed Futures - The Last 10 years**



Data: SocGen CTA Index

Bonds, though, against all the prognostications of higher interest rates - shot lower for the year in just the sort of continued directional move trend following type models crave. The move came on the back of a switch by the US Fed to rate cuts and a global push towards the negative interest rates that Japan and now Europe have been trying for a while, but all that was besides the point. It was all about the move itself for managed futures.

**Fig. 3:** 10 Year Treasury Rate



While the 10 Year Treasury Rate fell from a high of 2.79% to a low of 1.47%, managed futures as measured by the Socgen CTA Index made hay... earning nearly 12% between the day after the first print below 2.50% (3/25/19 - a rough proxy for when CTAs may have been getting short rates/long the bond prices) and the low of 1.47% on 9/3/19.



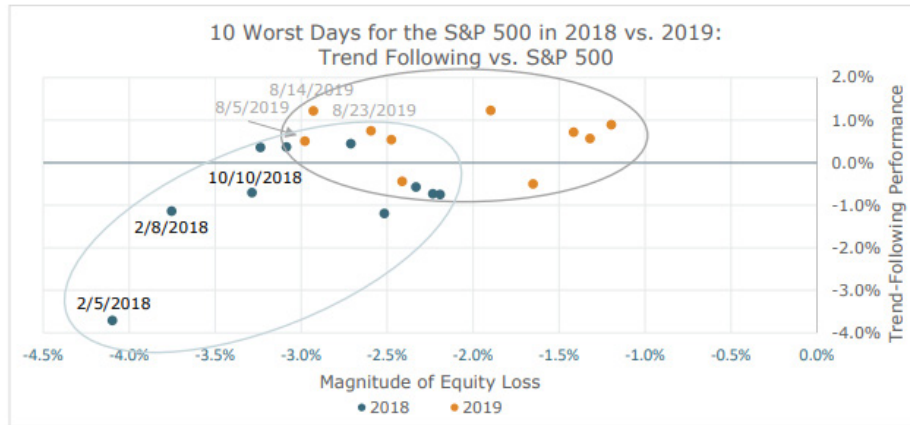
**Fig. 4:** A Tale of Two Rate Environments

2019	CTA INDEX	10 YR RATE	SPY
<b>During Bond Rally</b> <i>(3/25-9/3)</i>	<b>+11.77%</b>	<b>-39.51%</b>	<b>+4.70%</b>
<b>Rest of Year</b>	<b>-5.39%</b>	<b>+14.82%</b>	<b>+20.60%</b>

This unexpected lift of bonds pushing managed futures along in 2019 had a nice ancillary effect, as well...the return of investor's expectations for managed futures to rally when stocks sell off. Now, we've talked at length about how that is the wrong expectation - that the asset class is non-correlated, not negatively correlated; but you can only howl at the moon and expect an answer or different result for so long.

But for 2019, at least, those confused with non vs negative correlation didn't have to address it – with managed futures slotting nicely into place as a diversifier, showing a daily correlation of 0.02 with equities in 2019 versus the 0.26 reading in 2018, but more importantly for those who expect it to work this way – returning 1.22% across a May/June periods where equities sold off and recovered over 34 days putting in a low mark of -6.6%; and returning 1.43% when equities fell 6% over two weeks in August. This return to non-correlation can also be seen in some work by Kathryn Kaminski and AlphaSimplex, where they showed the contrast in a generic trend following program's results across the 10 worst days in the S&P 500 in 2018 and 2019.

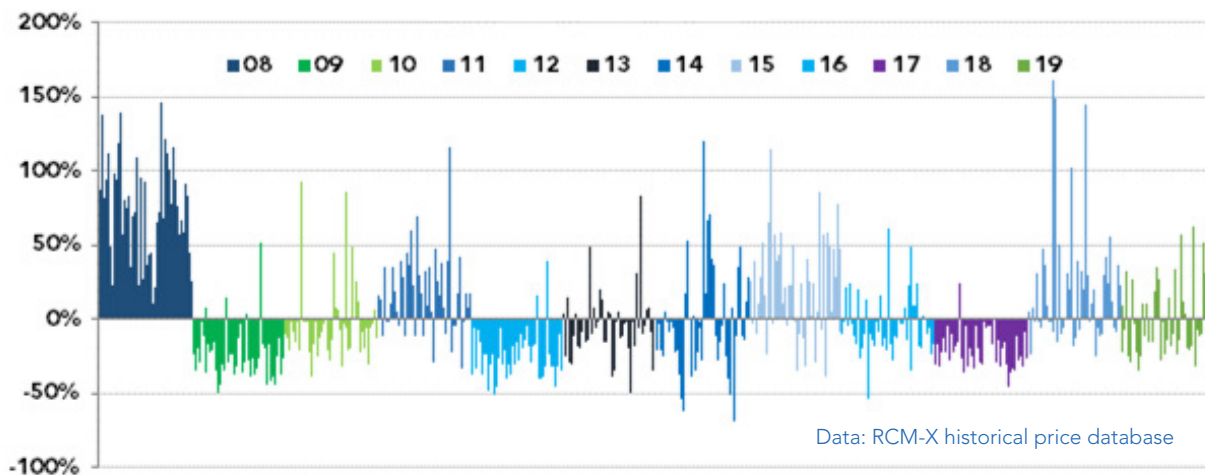
**Fig. 5:** Trend Following During the 10 Worst Days for the S&P



*Generic trend-following strategy performance during the ten days of worst performance for the S&P 500 in 2018 and 2019 YD. Data from 1/1/2018-8/31/2019. Source: Bloomberg, AlphaSimplex.*

That's all thanks to the diversification of managed futures portfolios and ability to look for volatility expansion and directional volatility in other markets. And here's our annual look inside that "engine room" of managed futures/global macro programs; analyzing the volatility in the global markets these programs track – and specifically, whether that volatility was expanding or contracting. Contradictorily given the gains on the year, only 40% of the markets we track for this study saw expansions in volatility as measured by their average true range. But, the 60% of markets decreasing in vol fell 17% on average, while the average increase was 25% - so maybe what we lacked in number we made up for in voracity.

**Fig. 6:** Volatility Increase/Decrease Across 47 Futures Markets



But enough of 2019, what's 2020 likely to look like?

## What we'll be following in 2020:

As always, we'll caveat this with the fact that we're not economists, predictors, or heads of research at a large bank - and even if we were, there's no proof (and, actually, quite a bit of proof on the other side) that those groups can actually predict anything with any sort of meaningful accuracy.

But, there's definitely value in thinking about the types of market actions and overall economic environment that could be beneficial to long volatility seeking managed futures and global macro programs. In short, investor's in those camps essentially want to know whether they need to keep wearing the life jacket around their necks in the bright sunshine while walking down the street - or not. They want to know when this waiting game may pay off.

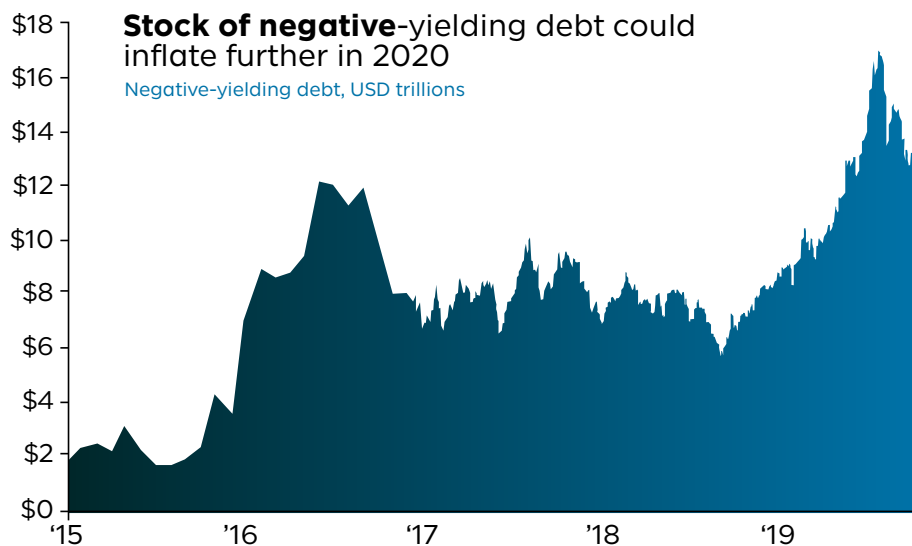
Here's a few of our focuses in 2020:



## Negative Interest Rates:

If you haven't heard yet - there's nearly \$16 Trillion in negative yielding debt sloshing around the world. That right, investors have given trillions and trillions worth of assets to governments and corporations with the understanding they will be getting back less than they invested if they hold to maturity. That sounds crazy, and irrational, and clearly unsustainable. Especially in the US, where we seem to feel a savings rate is part of the Bill of Rights. Why would we pay someone to hold our money? And indeed, more than a fair share of managed futures/global macro managers complain about the artificiality of negative interest rates and how it has messed with the trendiness of bond markets - feeling that it is an unnatural event caused by central banks over reach (as evidenced by the Bank of Japan owning about half and ECB about 30% of their respective governments bonds).

**Fig. 7: Negative Interest Rates:**



Source: Bloomberg, J.P. Morgan Asset Management. Data are as of November 26, 2019

But Pimco had an [interesting take this year](#), saying negative interest rates are a natural result of a savings glut and increasing negative time preference of the world's savers.

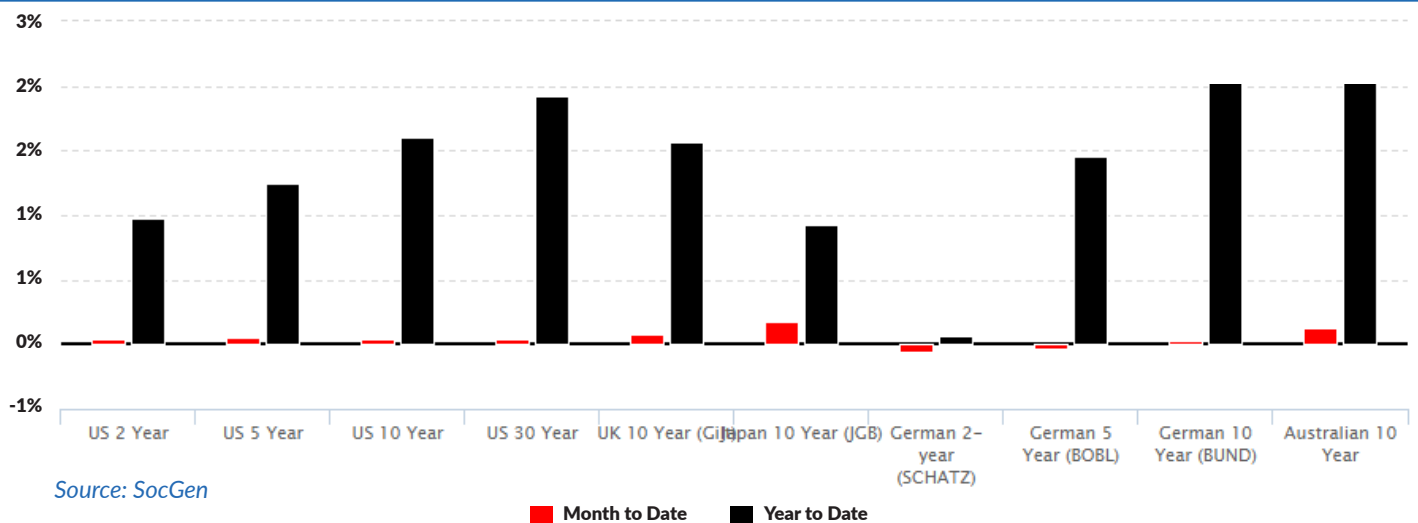
*It can be argued that in affluent societies where people can expect to live ever longer and thus spend a significant amount of their lifetimes in retirement, more and more people demonstrate negative time preference, meaning they value future consumption during their retirement more than today's consumption. To transfer purchasing power to the future via saving today, they are thus willing to accept a negative interest rate and bring it about through their saving behavior.*

There seems to be a consensus that rates won't go negative in the US, but surely this negative time preference concept is alive and well here in the US as much as in Europe, so we're not so sure. And it's never a good idea to think in absolutes. But here's the best part.....we don't care.

No, while a bond investor would by definition, get less and less return from their investment in bonds that yield less and less. And while a bond investor at close to zero or negative interest rates has all sorts of risk/reward issues – with bond prices having more room to fall (rates more room to rise) than they have ability to rally (rates down) in a flight to quality regime. The futures investor can capture the same return on, say, a 20% move in interest rates, that they did with rates going from 3.50% to 2.80% as they can from rates going from 1.50% to 1.20%. They'll just trade more contracts... while keeping their risk normalized between the two scenarios with tighter exits the lower the rates get.

Futures traders can also earn the roll yield when and if interest rate products go into backwardation, whereby even if rates remain unchanged, if they are expected to rise and don't – the futures price will converge to the cash price at the end of the contract and provide the difference (the roll yield). As proof of all of this, look at the returns of the SocGen Trend Indicator in 2019 across the interest rate products:

**Fig. 8:** Trend Indicator Performance in Interest Rates



You can clearly see the trend indicator having positive performance in the German Bobl, Bund, and Japan's Government Bonds (JGB), despite all of those yielding negative rates for much, if not all of the year, and despite all of them moving within a pretty tight range in terms of the absolute level of movement (the JGB, for example, moved from about 0% to -0.29% at its lows).



## Binaries: Trade War Tweets, US Elections, Brexit

### Dow plunges 450 points after Trump tweets on China trigger massive global selloff

Chinese officials reportedly pulled out of trade talks after Trump suddenly announced he would be more than doubling tariffs on most imported goods from China.



Headlines talking about a tweet moving markets hundreds of points have become much too commonplace for systematic trading programs of late. The run up to a trade war, or new president and resulting new economic policies, or Brexit vote are more than welcome. The run up is about investors positioning their portfolios for what may come. It's people lightening up on exposure, adding safety, and so forth. When enough people do that sort of thing at the same time – you get a mini rush for the exits that can push prices in a certain direction for a certain amount of time. What we in the business call a trend, or momentum. We love these – they're measurable, cyclical, capturable.

But what happens on the day the vote is tallied is something different altogether. The vote itself is a

binary event. It either passes or it doesn't. If it passes, x, y and z happen in markets. If it doesn't, a, b, and c happen in markets. You may be familiar with another popular binary event, the coin flip. Heads – you win, Tails – you lose. Suffice to say that the guys and girls with PhDs and sophisticated algorithms for tracking market prices and identifying patterns don't quite like their life's work boiling down to a coin flip. They despise these binary events, as they temporarily invalidate all of the math and research which go into the modern day systematic global macro or managed futures program. PS – We can't help but think of this particular [binary star system](#) when hearing Binary.

Now, of course – most programs are diversified across markets and market sectors, designing their risk budgets to not lose too much (or gain too much) on any one day's move in a single market. But there's still outsized risk (and possible reward) from markets quickly reacting to a binary outcome one way or another. What might this outsized risk look like? Well, you might see a trade's risk eclipsed by three to five times. For a program that risks less than 1% of their total portfolio, that's not such a big deal. For a program that risks 10% to 30% of the capital on each trade – that could be a very big deal. You can think of a binary event as concentrating weeks to months' worth of market movement into a single day's trading session, meaning you could see weeks to months of gains/losses in that day.

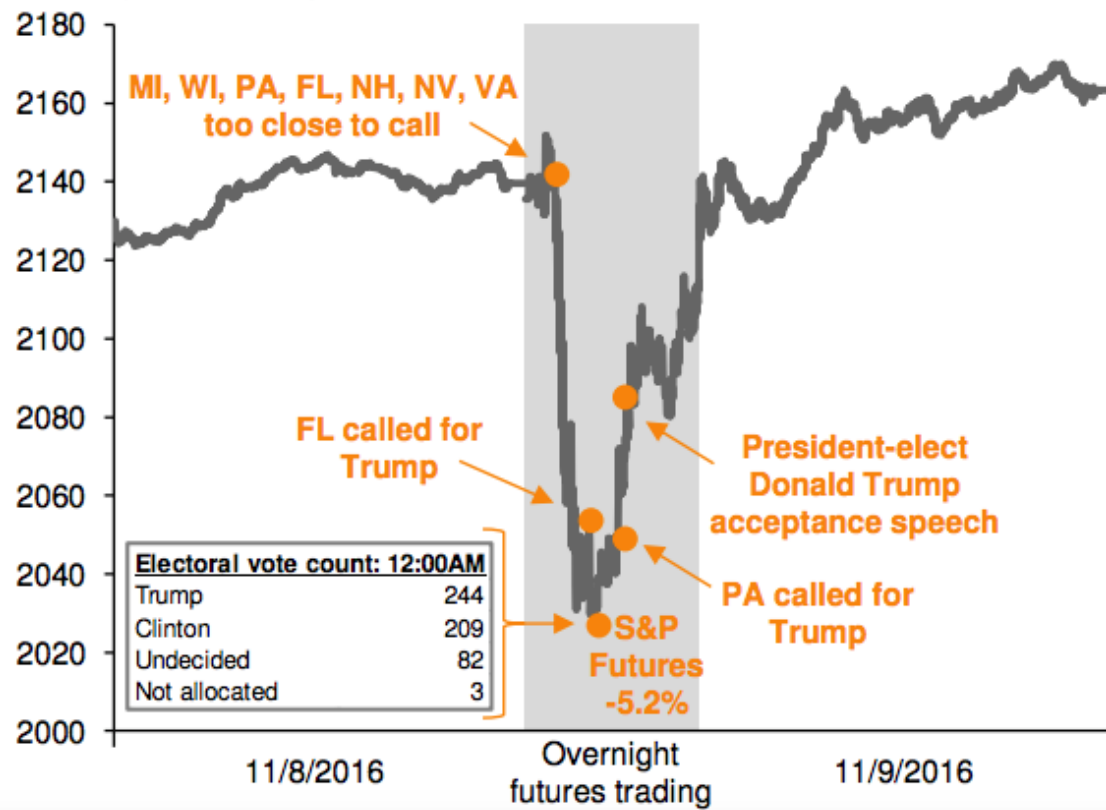
A good example of this was the last presidential election, when markets sold off heavily as it became clearer and clearer Trump would be the next US president. The S&P moved more than 125 points, falling about -6%, in a matter of hours. The range of the S&P in the 60 days before that had only been 110 points. We all know what happened next, the market quickly rebounded and is about 60% higher since then. But in that moment, all but the very quickest of systematic models were rendered useless upon the binary result becoming known. The binary event packed 60+ days of market movement into a few hours (on the overnight, sessions to boot). Code that into your AI.



**Fig. 9:** Election Corrections

**Election pullback corrected itself in overnight futures trading**

Intraday S&P 500 price index and S&P 500 futures market

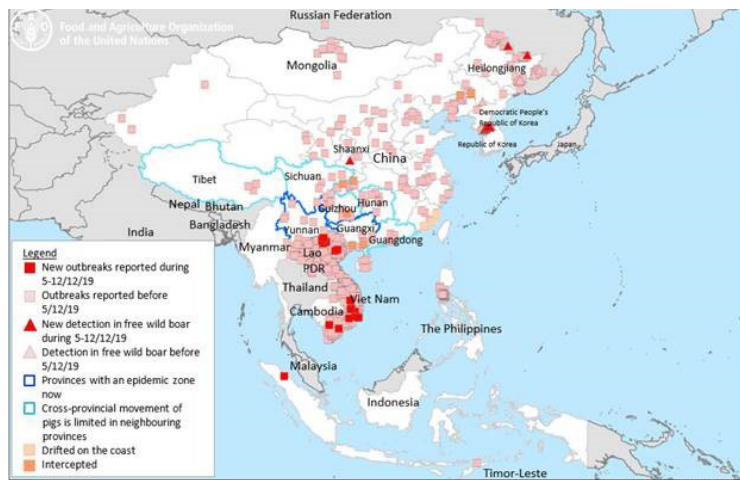


Market moving news has always been there, and likely always will be. But it sure seems different (framing and recency bias warning) in today's super transparent world where you can track where the tomatoes on your Impossible Burger came from. The telegraphed moves of the Fed, the measured words of every CEO and central banker, the ability of huge hedge funds and prop firms to trade off it in micro-seconds. All of it sure seems like it has dampened normal market moving news... and made these remaining binaries a little more market moving. The current technological, automated market appears to have squeezed in the distribution curve – making for taller heads (more observations of non-market moving news) and fatter tails (some rarer, very large moves). Beware the binary events in 2020!



## China's Asian Swine Flu Problem

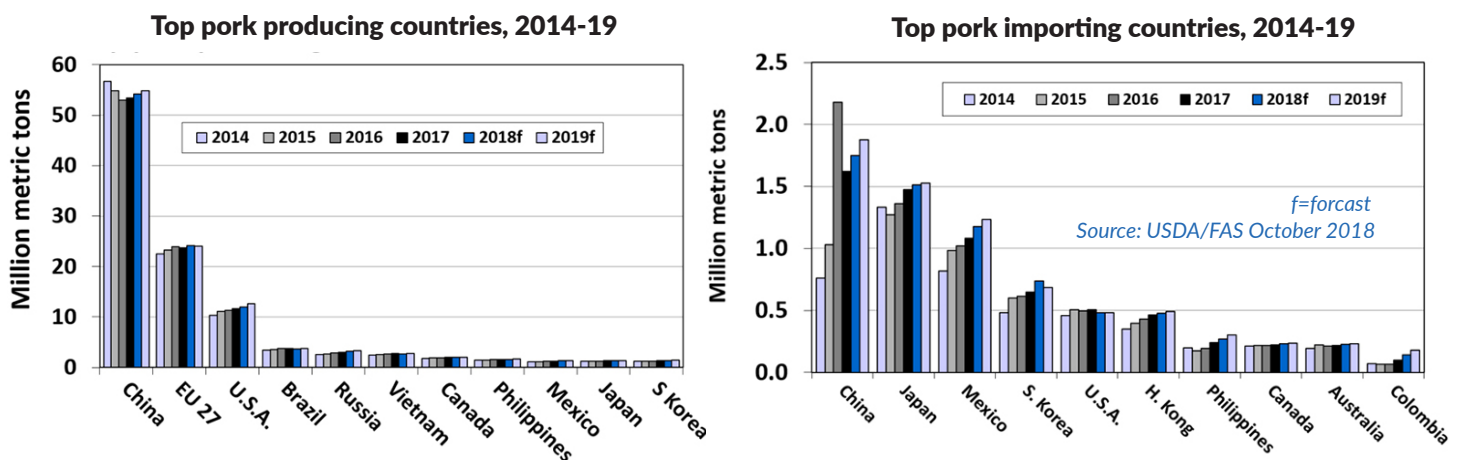
Is the whole world underpricing the risk of African Swine Fever (ASF) severely curtailing China's domestic Hog supply? ASF is highly contagious – as in if 1 or 2 of your pigs shows symptoms, you'll have to get rid of your whole lot kind of contagious – and there's no vaccine on the horizon. It took almost 35 years to eradicate the disease Spain after an outbreak in the 60s. So, you think it would be a big deal that ASF is showing up in the largest pork-consuming country in the world, China.



Source: Agricultural and Consumer Protection Program

China accounts for just below half of the world's pork production and is also the top pork importing country. We're talking A LOT of pork here - 450-500 million pigs "produced" in China each year versus the U.S. producing ~75 million pigs.

Fig. 10: Top Pork



Some are predicting ASF in China could erase anywhere between 20-40% of pigs in China, which means there will be a HUGE deficit between supply and demand in the country. In America, hog production is highly industrialized, and it's easy to get an estimation of how something like ASF would affect our hog production and much easier to control the disease, but in China, a lot of hog producers are still mom and pop farmers that live in close proximity to one another, both making it easy for it to spread while at the same time hard to control the sickness and estimate the possible effect.

The million-hog question is how this will affect the American market? It's a classic market fight between big supply and a big (but not yet known how big) demand problems out of China; which could bring a wild few years in the Hog markets and some spill over in other markets like cattle and grains. Looking past 2020, the long-term impact of this disease could last for years as the Chinese breeding herd (60 million sows) is being liquidated, creating a long-lasting pork shortfall. It may not be sexy to trade pigs in today's world of AI and risk parity and the like. But it's just the type of off radar market that can give traders the volatility their programs are craving through an event like this. Whether it be agriculture focused discretionary traders or multi-market programs with lean hogs in the portfolio (many billion dollar play managers don't in a meaningful way because of position limits), where the bacon's coming from in China next year will be worth watching.





## The strange evolution of the market/VIX relationship:

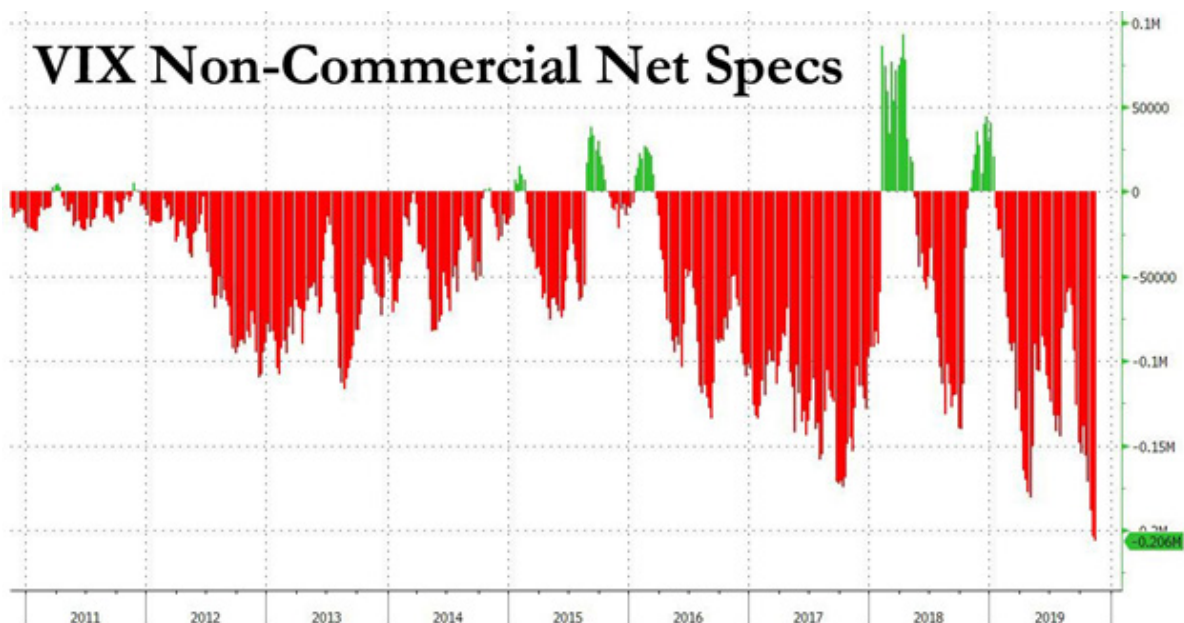
It's February 1st, 2018. Stocks have just given investors a 6% return in the month gone by, after posting 21% in 2017, after averaging about 15% per year in the 8 years before that. It seems like all systems go - business as usual - with a benign VIX reading of 13.50 showing markets expecting annualized volatility over the next 30 days of just 13.5%.

Just 4 days later, the VIX spikes more than 100%, going above 30 for the first time since 2011! Left in the VIX's wake: more than \$4 Billion or so in assets invested in exchanged traded products that tracked the VIX, with the majority of that on the short (read: wrong) side of the move; a near Billion dollar mutual fund selling volatility via options forced to close, allegations of market manipulation in VIX futures, and a stunned market which is now wondering after seeing the Dow drop 1,000+ points whether the fear index reflects moves in the stock market, or whether the stock market is now reflecting moves in the VIX.

The above excerpt is from [RCM's VIX and volatility whitepaper](#), and for sure is more of a look back than a look forward. The VIXmageddon event was close to two years ago now, after all, and there's Tesla Cyber Trucks and AirPods in everyone's ears to prove the point that times have changed.

But... did anything really change in terms of the VIX market? Did the VIXmageddon cause people to stop selling volatility as an investment strategy? Have there been more volatility spikes? Have the vol spikes that have happened been more long lived? Have speculators stopped selling VIX futures en masse?

**Fig. 11:** VIX Net Specs



Source: <https://www.zerohedge.com>



## Goodhart's Law -

When a measure becomes a target,  
it ceases to be a good measure

- Charles Goodhart

The answers, of course, are no, no, no, no, and absolutely not. As can be seen by the CFTC position reporting numbers, the VIX trade is alive and well, thank you very much. And it's not just alive. It's bigger than ever. The net short position of the 'non commercials' (read, speculators) sits at about 200,000 contracts, which is about 25% more than the previous record at the end of 2017 right before the VIXmageddon event. And as can be seen by the 8 year down trend line – this isn't a new story. Investors have been increasingly adding short vol exposure via VIX futures to their investment mix for the better part of 8 years. And that's just in the VIX futures. That's not even including the yield enhancement strategies selling options (short volatility) to get a little extra yield or other types of volatility harvesting strategies across all types of option markets, be it individual stock names, stock indices here and abroad, or even bond and commodity markets. Here's a note from [UBS's "Year Ahead 2020"](#) driving the point home that vol selling isn't some esoteric outlier of an investment strategy. It's an outright recommendation and portfolio sleeve at some of the largest investment shops in the world.

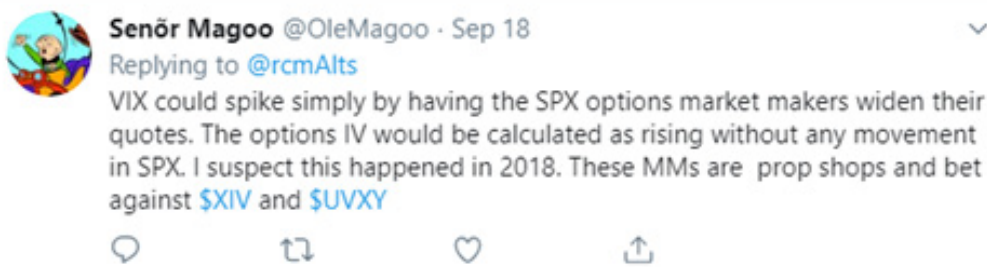
- Put writing. A put writing strategy might be relevant for investors who expect rangebound markets and higher volatility, for those looking to buy into market dips in a disciplined way, or for those looking to diversify their sources of portfolio income in a low-yield world.

That's all fine and good, and large pensions and endowments adding some short volatility as an equity replacement or yield strategy isn't all that crazy. They know the risks and know what they're getting into. But the question of where the tipping point is... of when does the tail start to wag the dog, is as poignant as ever.

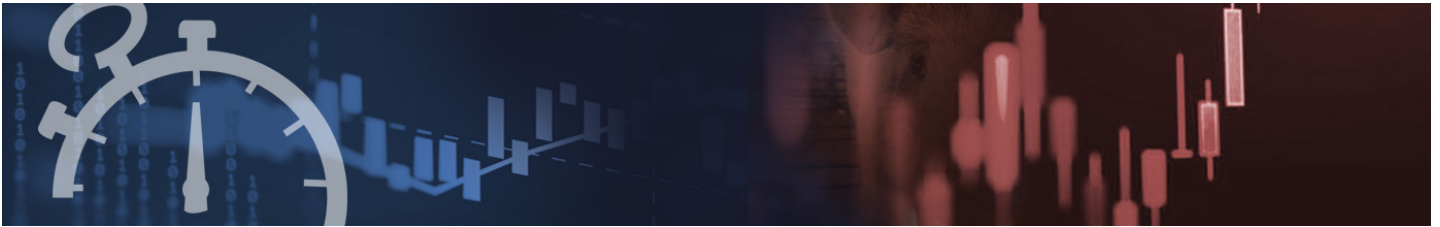
And that's because volatility and the VIX are now a player in the game, not just the score, to paraphrase a line from Chris Cole at [Artemis](#). Volatility is not just a measure anymore, but rather is invested IN – massively. And as February 5th, 2018 showed, we might not have a full handle on what that looks like when volatility expands on its own accord – because some hedge fund or short vol fund is liquidating, for example. Where do the lines blur in the interconnected workings of the volatility products (the players) with volatility itself (the score) on the markets their tracking (the standings?).

The consensus seems to be that the movement into this volatility as a product space has resulted in fewer vol spikes and shorter lived ones when they do happen. The taller heads we talked about before. But is that a feature, or a bug? Does that pinching in of the normal shape because of that investor appetite necessarily create fatter tails? Does it mean more Feb 18s in our future? Worse? And what sort of portfolio should investors be looking at knowing this segment of the market is growing? Long vol... comes to mind.

If they are selling vol, how do they make it more anti-fragile and able to withstand the next VIXmageddon. We put some of these thoughts to the VIX affociandos among @rcmalts twitterverse, and the resulting conversation was more than a little bit of fun.



Keep an eye on short vol exposure in 2020 and a new batch of long vol managers trying to profit from the eventual spike without losing too much until it comes.



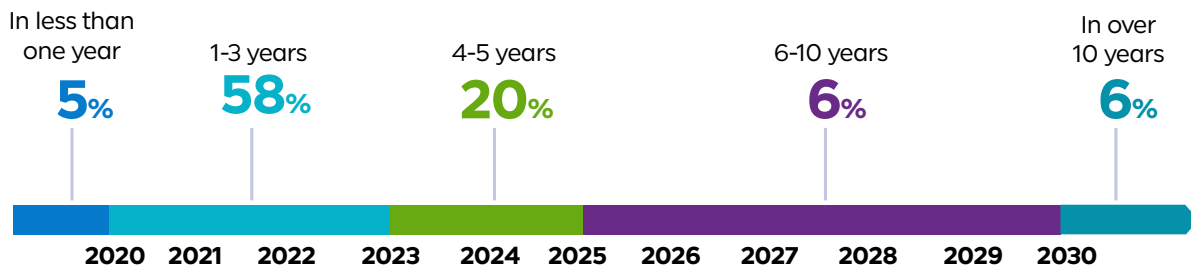
## The coming (but who knows when) market correction

Despite the eerie feeling that the more people who think a correction is coming probably argues more in favor of it not happening than actually proving prognosticators right; the titles of some of the 2020 market outlooks we’ve read from major banks read like we’re going to war or trying to figure out stopping [Lamar Jackson](#) in the SuperBowl.

- “U.S. Equities: Late-cycle defense” JP Morgan
- “Testing Limits” Blackrock
- “The Waiting Game” Natixis
- “Diversify & Defend” Nuveen
- “A Call for Resilience” Wells Fargo

That’s a whole lot of defensive talk, and you can almost give these groups props for going out on a limb and calling for a correction. But, what’s really happening is a sort of investor feedback loop in the guise of research reports that is reaffirming investors increasingly worrisome feelings that the ten year rally in stocks is getting a bit long in the tooth. More than 63% of institutional investors believe we’re due not just for a correction, but a “crisis” within the next 0-3 years, [according to Natixis](#).

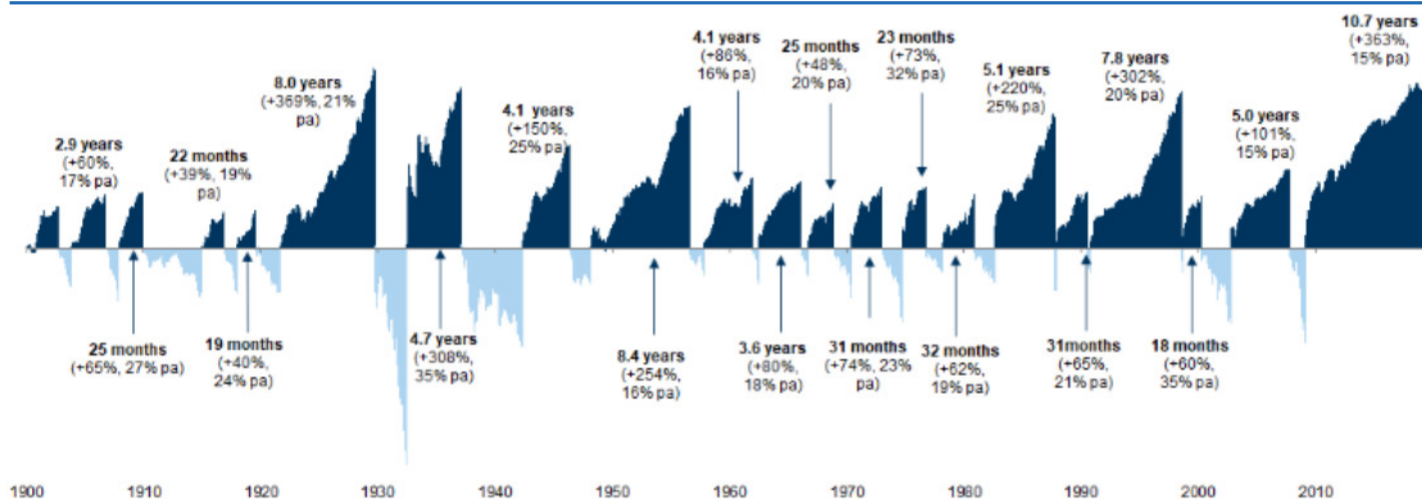
## When do institutional investors think the next crisis will hit?



6% of institutional investors do not think there will be another global financial crisis

And while you can put chart after chart up showing a correction is likely because of this problem or that in the economy, the main consensus appears to be that we're just sort of due for a correction. US Stocks hit new all time highs again here in December as we're writing this, extending what was already the longest bull market run, like ever, in US stocks without a 20% correction. We're at nearly 11 years, and some 400% higher since the last one. No wonder we've got [condos selling for \\$238 million](#).

**Fig. 12:** We are in the longest equity bull market without a 20% drawdown S&P 500



Source: GFD, Datastream, Goldman Sachs Global Investment Research

But saying this longest ever bull market has to end because it's the longest ever seems like either wishful thinking or circular logic, or both. Maybe it's the longest ever because it has a unique mix of factors that preclude it from having a correction? Maybe the financial industrial complex of Wall Street, asset managers, and central banks has gotten so good at dampening volatility and aiming for higher asset prices, torpedoes be damned, that this is the....wait for it.... new normal?

The (oddly publicity seeking) world's biggest hedge fund manager isn't buying the new normal argument one bit, instead arguing that the ["World has Gone Mad and the System is Broken"](#) essentially saying:

- There's too much investment demand, pushing interest rates down/negative and company valuations (especially startups) insanely high
- There's the need for more government debt supply, because Washington and rest of world can't rein in spending, and central banks are willing/able buyers of that debt in a perverse circle
- There's a huge need for money by pension and health care obligations for an aging population – with the choices cutting benefits, raising taxes, or printing money
- At same time all those pensions need money and can't really get it without tough choices, money is essentially free for the well to do and creditworthy

And his big ending is to say this is all unsustainable and we're approaching a big paradigm shift. But we're left with a sort of 'so what' question. What does he want us to do? Buy Bridgewater funds for protection? We've outlined [better risk parity plays](#). Does he want us to vote for some politician to fix all this? Or is he just putting a marker our there to say 'I told you so' if we have a big crash sometime in the next...?? Months?? Years?? The time frame is conspicuously vague in stating the world "is approaching..." When exactly?





## Tech regulation or not, big tech has some issues

While macro economists and worriers on a global scale like Dalio may be looking at tensions in the middle east, policy coming out of the White House, saber rattling with China, negative yielding debt, and all the rest as reasons markets may do this or that. The new truth may be that none of that matters as much as NFLX subscriber growth, Tesla's Model 3 production, or iPhone sales.

Amazon doesn't much care if the government shuts down, people still want their order the next day and Amazon's servers and warehouses full of robots will get it to them. Tesla probably benefits if there's geopolitical unrest in the Middle East. Likewise, the crazier things are in Washington – the more searches and posts of interest on Facebook and Google.

And with the near constant shift to passive index funds, the power of these companies in our real economy is becoming power in the markets, dictating how traders react to other influences. Put simply, it's going to take a lot for investors in these companies to sell, much less sell in panic to drive volatility across multiple asset classes. Josh Brown has referred to these tech heavyweights as the new American Gods, where people have more faith in their ability to learn and improve than we have in the President.

But is the tide turning... Scott Galloway, An NYU professor with an insightful blog and podcast (Pivot) has been hammering the big tech breakup drum for a while now, mostly because (in his words) they avoid taxes, invade privacy, and destroy jobs. But even he upped the rhetoric of late,

*Facebook is now ....a net negative for society... the social network is depressing our teens... Teen suicide has skyrocketed – up 77% for older teen girls and up 151% for younger teens...*

*There are many factors, but ground zero is the nuclear weapons we've put in girls' hands to objectify them, perpetually undercut their self-esteem, and enable them to bully each other relationally, 24/7. Hospital admissions due to self-harm are up 50% for 15-19-year-old girls and up 200% for 10-14-year-old girls. At Facebook, a sociopath is wallpapered over by a 700-person corporate communications department and a \$2 billion beard (Sheryl Sandberg).*

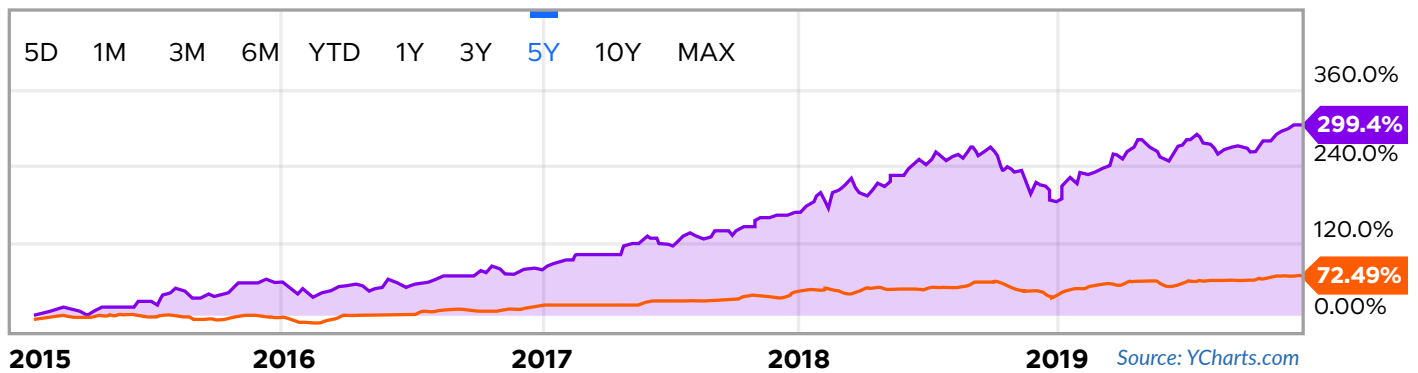
*.... The S&P is up 23% YTD, and the number of girls that decide to take their own life is up 151%... We are studying the wrong tests. Facebook, Inc. is a species failure – Scott Galloway*

It doesn't take too many of that type of article to get people to start to realize they maybe shouldn't be using this platform. And not too many more to perhaps insist this tech company or that be excluded from portfolios for ESG reasons. Add on election tampering, the fallout from the WeWork debacle, and someone like Elizabeth Warren getting elected US President - and it's not too hard to imagine a world where investors vote these popular kids out of class with their checkbooks.

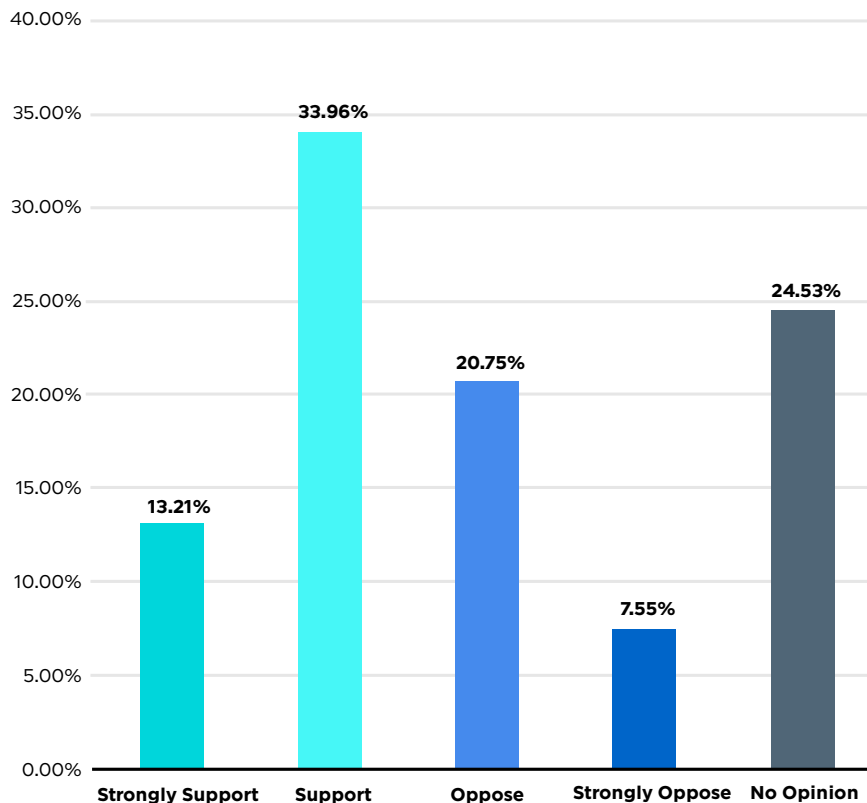
And that could be a big problem for a stock market that has been mostly built on the back of the rise of the Big 6 of Facebook, Amazon, Apple, Netflix, Google, and Microsoft (basically Fang plus Apple and Microsoft – who must have been really mad at being left out of that particular acronym). If we’re looking for a volatility catalyst in 2020, worries and hints of breakups and/or heavy regulation of these tech firms (a [battle on encryption](#) is currently brewing) sure seems like a good place to start. If we’ve learned anything over the past ten years, it is the lesson that as they go, the market will surely follow.

**Fig. 13: FAANMG VS S&P**

● FAANMG LEVEL % CHANGE ● S&P 500 TOTAL RETURN LEVEL % CHANGE



**Fig. 14: Do you support or oppose investigations into big tech companies?**



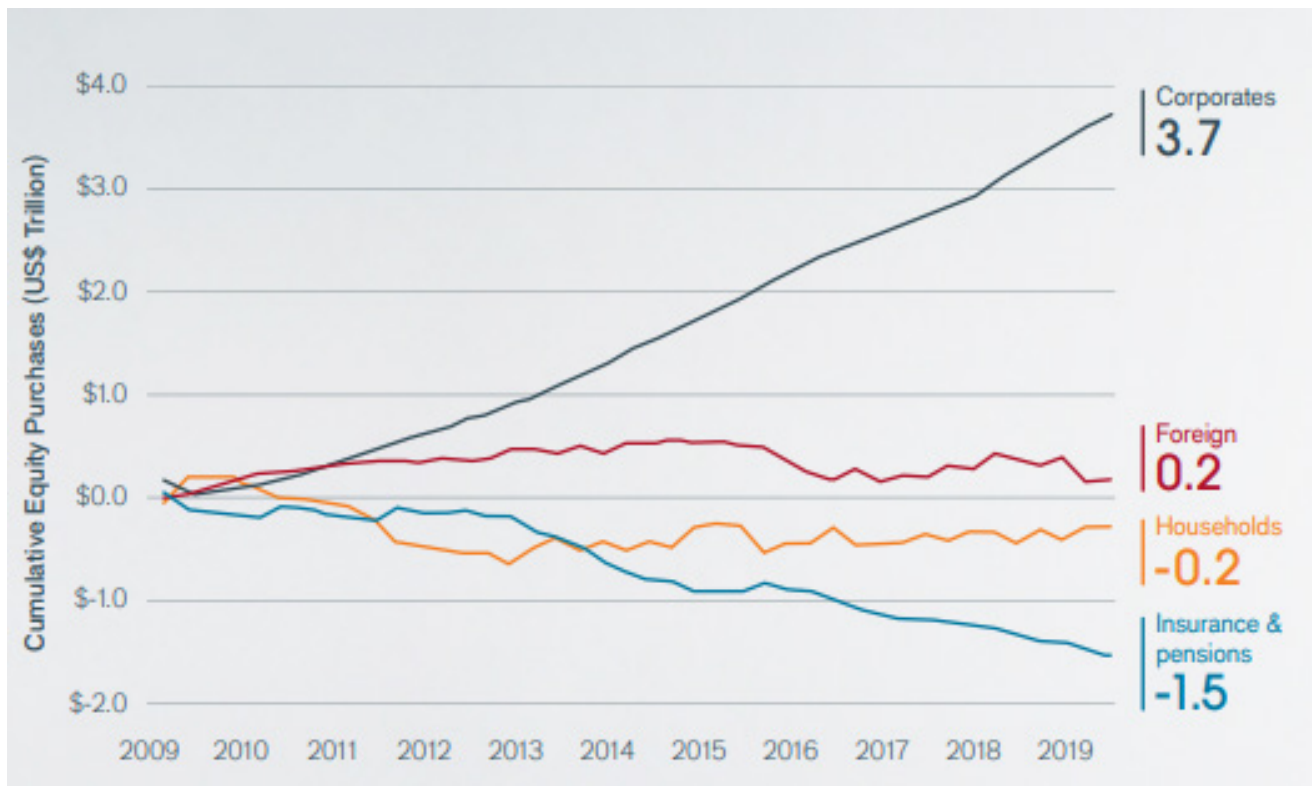
Source: <https://www.cnbc.com/2019/09/26/facebook-most-likely-to-suffer-in-antitrust-war-on-silicon-valley.html>



## Share Buybacks

One more drum starting to beat louder and louder is the feeling that the huge increase in stock buybacks over the past 5 years are dangerous for the stock market in general, and bad for workers and society as a whole. How loud? Loud enough for a new law to be proposed in the US Congress that would limit the amount of buybacks companies are able to perform and tie an employee dividend to buybacks. The bill is sitting in committee and doesn't look like it has a chance to go anywhere, but the sheer size of US corporate buybacks (nearly \$1 Trillion in 2019) is bringing a lot of interesting views to light.

**Fig. 15:** Buybacks in the Trillions



Source: Michael Hartnett, The Flow Show, Bank of America Merrill Lynch Research, 5 September 2019

You've got the Bernie Sanders type views that the money should be shared more evenly with the workers instead of enriching the shareholders. You've got voices like Chris Cole of Artemis saying they make the market as a whole more fragile – in a sort of single big support mechanism instead of many smaller, able to break support beams. And you've got Ben Hunt of the Epsilon Theory blog saying its less about fairness, and more about corporate “managers” enriching themselves.

*Do stock buybacks lift the stock market “artificially”? I guess. Kinda sorta...[but] IT'S THE WRONG QUESTION....The right question is whether or not stock buybacks are the best use of capital if you take a steward's perspective rather than a manager's perspective.*

*Under the narrative cover of “returning capital to shareholders” and the common knowledge of “aligned interests” and the cash windfall of “job-creating tax cuts” and the equity valuations driven by “extraordinary monetary policy” ... management teams....have sucked the FUTURE of their company dry for the NOW of their personal enrichment.*

*Dimon, Iger, Cook, Nadella, Pichai, Fink ... they're not founders like Gates or Bezos. They're not investors like Buffett or Dalio. They're management. And now they're billionaires. And all their captains and lesser brethren are centimillionaires. And all their lieutenants and subalterns are decamillionaires. And their main tool for this is the stock buyback.*

Of course, on the other side of this you have Cliff Assness, he of the managed fututres mutual fund that has gone from \$14 Billion to \$4 billion because of the Homer Simpson attitude on the waiting game and preference instead for a nice game of hungry hippos. He's a billionaire who didn't get that way from stock buybacks, and has had some fun Twitter battles with Mr. Hunt on this topic. Here's his summary:

*....despite a legion of attempts, there is no real case against buybacks, let alone enough to blame them for all sorts of economic ills. Much of the criticism is innumerate nonsense. Nonetheless, the various charges are repeatedly made in otherwise reputable places, with increasing stridency.... That suggests the attack on buybacks is a politically motivated crusade—let's blame public corporations for all kinds of evil. Americans have lots to debate...They should drop nefarious buybacks from their retinue of accusations and focus on real problems.*

What Cliff doesn't get into (maybe after reading this report?) is whether the real effect of stock buybacks is dampening market volatility. We often hear about the Fed put.... but rarely about the Apple and Microsoft puts, and whether that keeps a lid of their individual volatility, in turn affecting overall market volatility. In the end, the question for markets, and in turn alternatives, is what happens when and IF that nearly \$4 Trillion in stock buybacks over the past decade is no longer there. What if it is immediately pulled because of legislation? Is that crisis inducing? Maybe, maybe not.

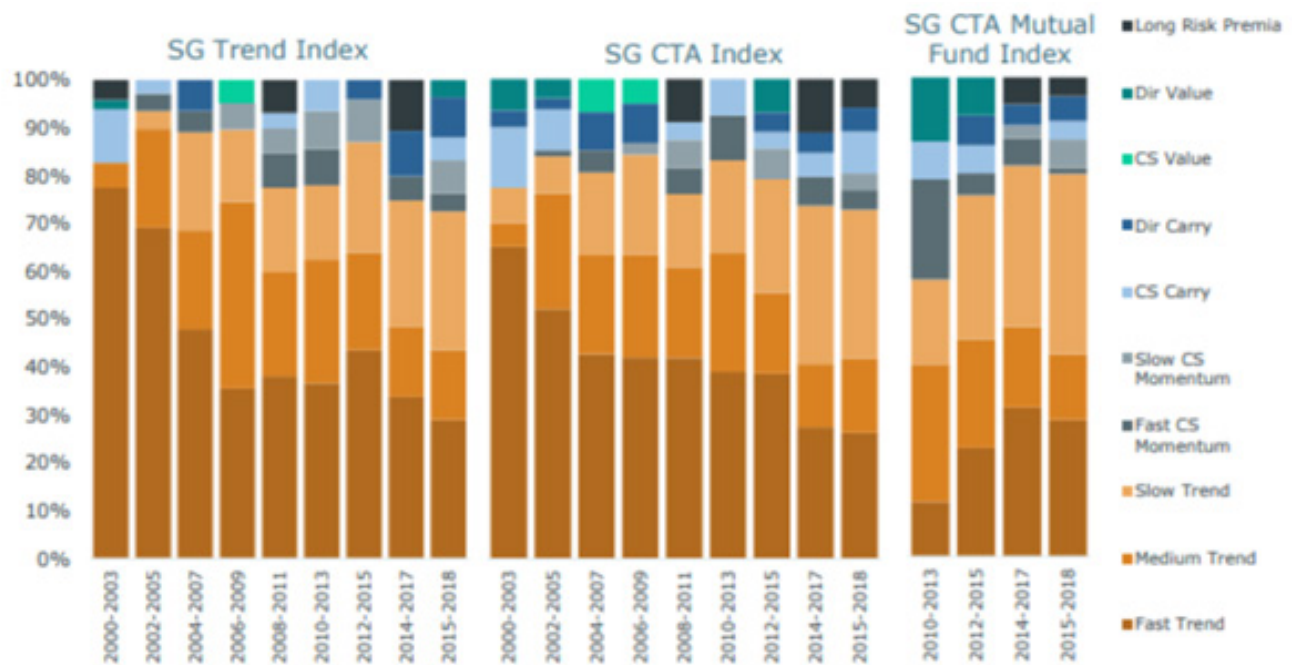


## One more thought on a coming correction

Does a correction come in 2020? Who knows? Certainly not managed futures and global macro before the fact. They'll do what they've always done (albeit perhaps with a little more machine learning and AI with the assist). They'll analyze prices in all sorts of markets and get into tons of moves, some false, and some true breakouts. Some on a very short day to day basis. Some on a much longer month-to-month basis. They'll look for some sort of catalyst to awaken volatility, and be there in a market crisis if it happens because of that willingness to participate in all the false breakouts lower.

BUT, we've been worrying about managed futures sort of pivoting from their classic return profile for a while now (link to profit loss mag article), mainly because when left with the choice, most firms would change their spots rather than go out of business waiting for vol and trends to return. And now we have some stats to go along with that idea, courtesy of Kathryn Kaminski and team at AlphaSimplex.

**Fig. 16:** Style Factor Risk Loadings Across Time



Risk factor loadings grouped by style of trading for three CTA indices (SG Trend Index, SG CTA Index, and the SG CTA Mutual Fund Index). Factor loadings are estimated using daily return data over 4-year horizons for the period of 2000-2018. The SG CTA and SG Trend indices began in 2000 while the SG CTA Mutual Fund Index began in 2010. Risk varies over time; the proportion of the total risk of each index explained by strategic factors as a fraction of the total risk explained by all factors is plotted for clarity. Source: Bloomberg, Societe Generale, AlphaSimplex

Their team analyzed several different factor models against managed futures returns across three different access points – the Trend Index, the CTA index of actual managers, and the mutual fund index of actual managers. Some interesting data is highlighted, including the appearance of long risk premia as more of a factor on the right (more recent) side of the chart. And the steady decline of fast trend in favor of slow trend as a factor.

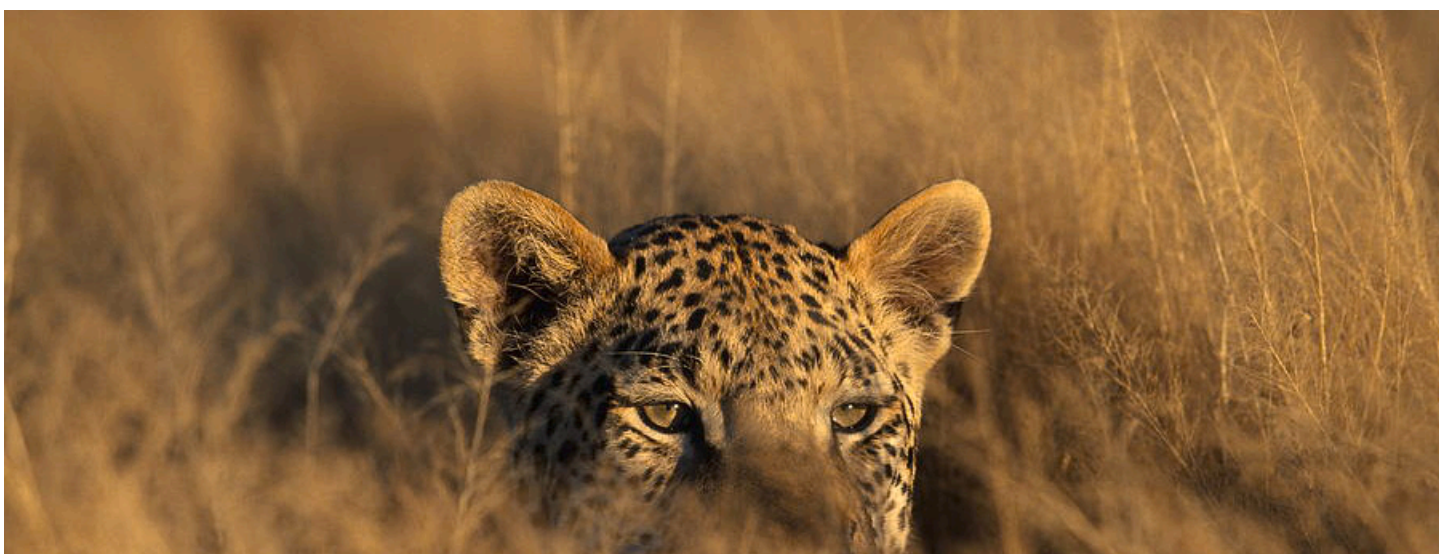
What are the two things that would have made your managed futures program perform better over the past 10 years....

- 1 A longer lookback period and reaction time so that the rare downmoves that did happen, and were quickly reversed, wouldn't have stopped you out of the long trend and/or gotten you into a false short trend breakout.

*And...*

- 2 Some more long exposure to equities, either through a long bias or outright positions (aka long risk premia, although, it should be noted AlphaSimplex isn't saying that long risk premia equals equity risk premia).

What does this mean looking forward. Well, assuming these managers aren't uber dynamic and able to switch model tilts on the fly. It means that an extended sell off will cause a bit more short term pain than in years past for the asset class, with them A. taking longer to exit the longs and enter the shorts because of more slow trend exposure, and B. having outright long risk premia exposure (read, long equity positions). This is all, on the average, and not directly tied to any one program, of course. But the leopard's spots should be watched closely in the next crisis.





## Conclusion

Here's the thing – there are no peeks at possible black swans in here. All of this is known. This isn't a deep look into the big unknown and positioning a portfolio for another 2008 financial crisis. The trick is finding out how all of these forces counterbalance one another in market prices. Will we continue to see asset price inflation (stocks at all time highs, bonds negative yields meaning they too are at all time highs in price). Will there be massive class warfare, revolutions, and the like as we're seeing in Hong Kong causing people to take risk off and put it in..... (negative yielding bonds? Gold? Bitcoin?).

Nobody knows what will happen. Not even his royal hedgeness Dalio. Which is maybe the point – maybe he's admitting he has no idea where we go from here – so don't blame him for what happens in All Weather?

For our two cents, we'll continue to look for dynamic investment strategies that react to paradigm shifts and get on board with them. Things that do well in volatility spikes, but also when the spikes don't happen. Investments that are setup for the Black Swan, but ever aware of the [White Moose](#). Antifragile alternative investments that spread risk across multiple long volatility return paths – not just the classic trend following approach which is rather path dependent on an extended directional move and cross asset correlations.

**Jeff Malec, CAIA**

Managing Director & Partner

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318 W Adams St. 10th FL  
Chicago, IL 60606  
855-726-0060

[www.rcmalternatives.com](http://www.rcmalternatives.com)  
[invest@rcmam.com](mailto:invest@rcmam.com)