RCM Alternatives

Managed Futures /Global Macro
2018 Strategy Review

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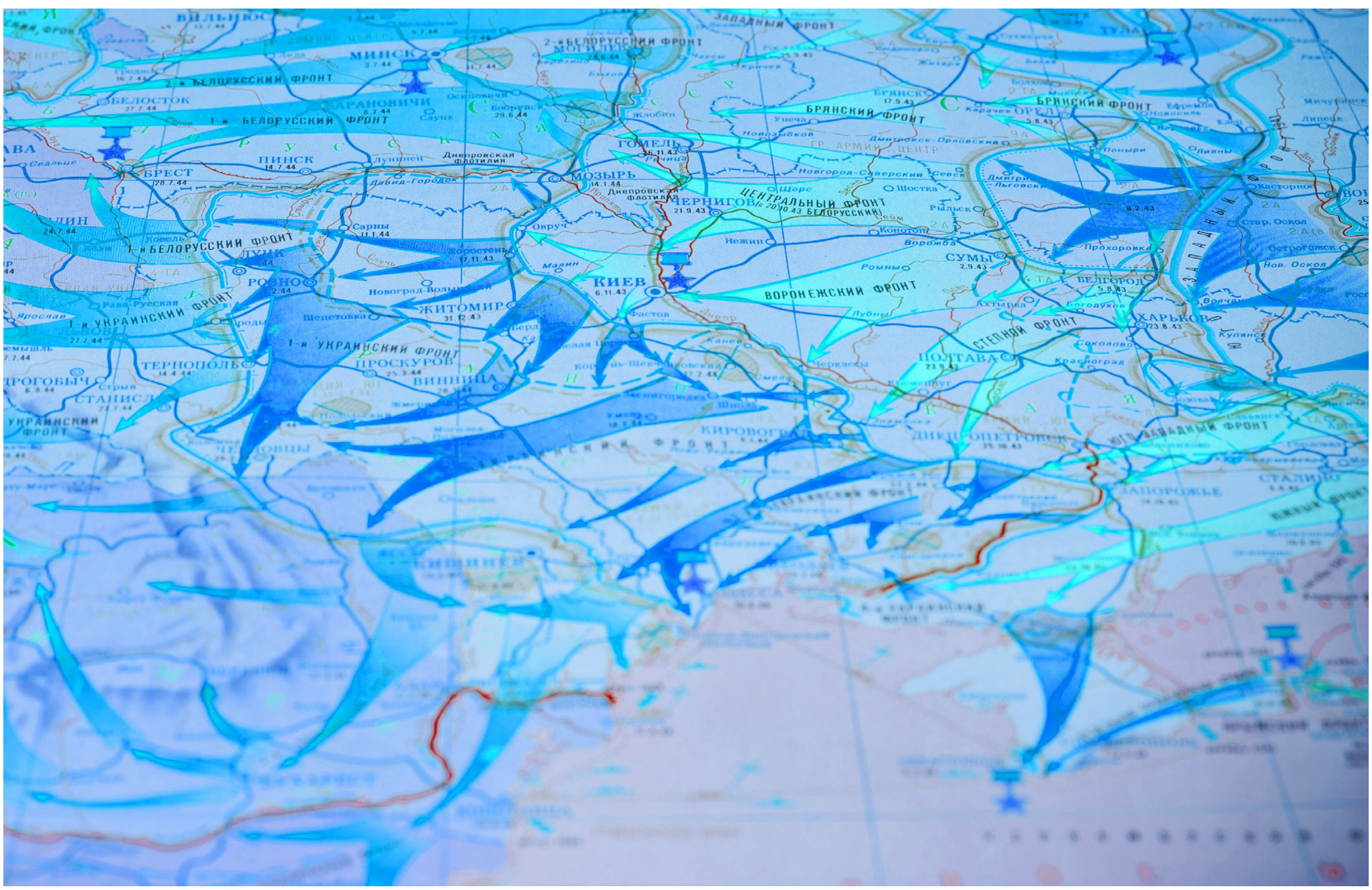
2018: Trees Don't Grow to the Sky

Regression to the mean. Or, as we've been known to say before, trees don't grow to the sky. That sentiment seemed to be the theme of 2018 market movement. Stocks finally came off their record setting highs. The VIX came out of hibernation, in a big way, putting many volatility sellers out to pasture. Interest rates were on the rise after decades of declines. And the cryptocurrency thing...we're still not sure what to make of that world, but that towering redwood of bitcoin at $20,000 was reduced to a small $3,500 sapling in 2018. Mean reversion is real, folks. Trees, even blockchain ones, don't grow to the sky.

Looking at the alternative investment landscape as a whole, 2018 was a disappointing year for managed futures and global macro across most strategy groups. With equities getting hit hard, this was a prime opportunity for CTAs, managed futures, and macro to come off the mat and show investors the power of diversification. Instead, the lesson was that sometimes non-correlation does not equal negative correlation, especially in the short term.

Trend followers were whipsawed in February and again in October, thanks to unfortunately being in line with the dominant trend (equities up), resulting in a down year. Short term momentum traders were whipsawed by those same V-shaped reversals and added the V-shaped recoveries to the grievance list. Agriculture traders by and large sat on their hands watching another bumper crop come and go. And volatility trading was the ultimate zero-sum game, with some notable winners alongside some remarkable flameouts.

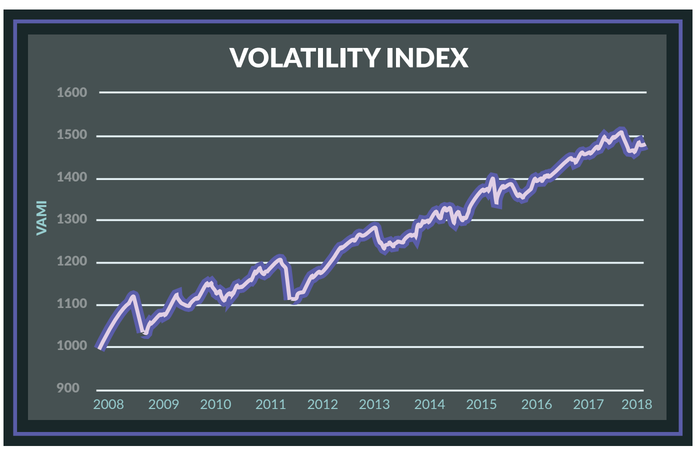
Here's our review of each strategy type in 2018, starting off with volatility trading - which once again proved to be the most interesting game in town.



Volatility Traders:

2018 Performance: Very bad to very good
Short volatility: Bad to very bad
Market neutral volatility: Average to good

The most memorable market story of 2018 was the volatility event of February 5th, fondly called on our blog and elsewhere: Vixmaggedon. A black swan event of sorts, but not really given everyone knew the short volatility trade was going to end disastrously at some point. The writing was on the wall once the media reported on a target manager growing his net worth from $500,000 to $12,000,000 by shorting VIX in August '17. If a retail trader from Florida figured out how to become a millionaire overnight, you can bet there were plenty of so called geniuses on LaSalle St. doing the same thing at much larger multiples, not to mention a retail VIX ETN that was primed for a blowup as well. The events of February were the ultimate zero-sum game. Programs like Pearl Capital, who were long the VIX heading into the spike, were the winners (with Pearl bringing in 30% returns in a single trading session), while on the other side of the coin were the short sellers like Goldenwise and LJM, who suffered large losses and effectively put out of business by the mammoth move.



In comparison to the events of February, the rest of 2018 was relatively calm from a volatility perspective. There was a pop in the VIX in October and volatility generally remained elevated throughout the 4th quarter, but Q4 proved to be tough sledding for most of those trading vol as the vol of vol kept declining.

Pearl Capital finished out 2018 at +14% for its best year on record, while another top ranked volatility trader - Blue Diamond Asset Management - rebounded from a tough 2017 to make 17% last year and hit new equity highs. Elsewhere, vol seller Warrington Asset Management deftly avoided the VIX spike landmines by posting a nice year of +5%, as did emerging manager Double Helix at -1.10%. Finally, Delta neutral strategy Certeza Macro Vega navigated the environment cautiously and finished slightly down.

Trend Following:

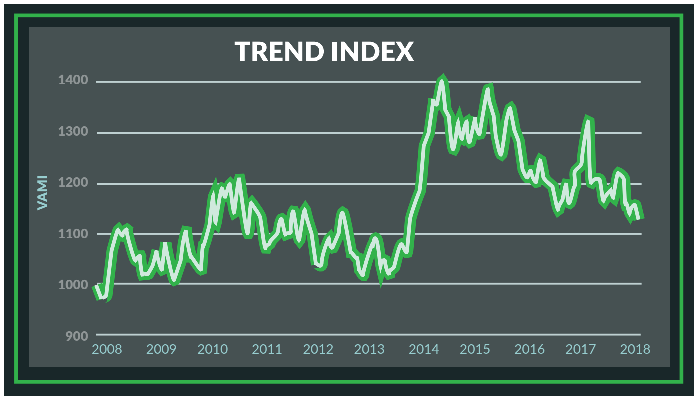
2018 Performance: Poor

Trend followers started 2018 strong with a big month in January due to the strong upward stock index trend, but those gains were quickly erased in February as nearly every trend reversed course - setting the table for headlines such as Bloomberg's: "Trend-Chasing Quants Post Worst Returns in 17 Years" and eventually leading to another disappointing year for managed futures flagship sector. The SG Trend Index, which is designed to track the 10 largest trend following CTAs open for investment, fell -8.11% in 2018, its worst year on record, while others de facto benchmark, AQR, saw losses of -8.88%.

The business landscape for trend following remains murky at best with sustainable trends tough to come by and revenues dwindling due to trend coming to be seen as a beta component that can be added for mere basis points. Smaller CTAs like Clarke Capital have been forced out of the markets, while the asset gathers like AQR continue to see AUM fall.

An offshoot of trend is a newer group of programs that are retaining some trend following DNA, while doing more with dynamic asset allocation to overweight exposure in sectors that are exhibiting strong trends and underweighting or having no exposure in sectors that are underperforming. Example programs include Rational/Resolve Adaptive Asset and Emil Van Essen GTAP.

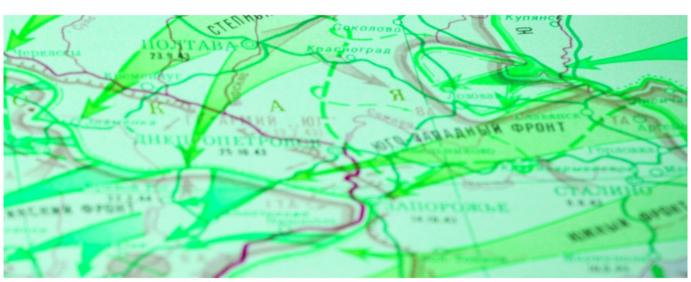
Glancing at the markets, the trend of the year was short crude oil with crude oil prices falling 25% from October into the end of the year. Outside of the energy sector we also saw big down moves in sugar, copper, and coffee; while cocoa, wheat, and palladium were the top performing long trades. The lack of financial markets in that list of trending markets is one of the big reasons for the underperformance in this strategy group.



Agriculture:

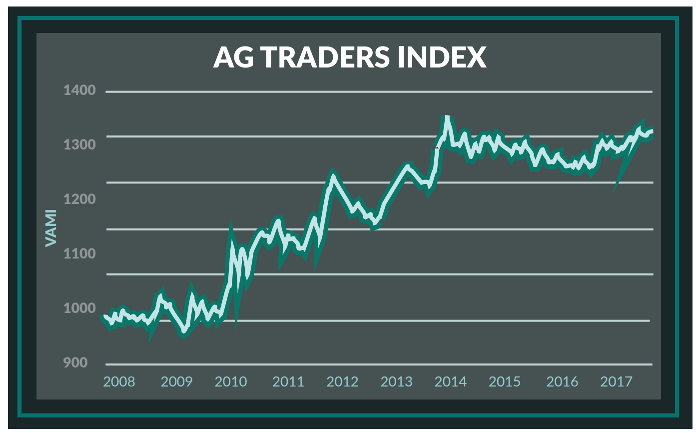
2018 Performance: Below average

2018 made for a difficult environment for the ag trading strategies as they were forced to answer the question – Are Tariffs a Black Swan? Agriculture markets, and specifically soybeans, were caught in the crossfire of the US/Chinese trade war; and proved that tariffs and/or threats of tariffs aren't helpful to discretionary traders who are trying to read the tea leaves. Discretionary ag trading is an exercise in economics 101, where alpha is derived in analyzing supply & demand to predict future crop and meat prices. Throw a trade war into the mix where a tweet could send prices limit up or down, and those forecasts get thrown out the window rather quickly. The other struggle for ag traders is that the US is pretty good at growing crops. With technology continuing to infiltrate the farm, the impact is resulting in greater and greater yields. 2018 was another bumper year for corn as well as soy.



According to Melinda Goldsmith at Four Seasons Commodities Corp (which beat out the overall indices at -2% for 2018), the ag trade of the year was supposed to be short beans, but the threat of tariffs being on/off or a Presidential tweet constantly on the horizon made it difficult for traders to stick their necks out.

There were some opportunities to be had in the meats with programs like Sector Arc and Tanyard Creek (who specialize in hog trading) standing out amongst their peers. GammaQ was positive on the year at 3.5%, while Wharton Capital was down slightly. All in all, this strategy outperformed stock indices and the CTA index, all while avoiding the sharp tariff moves - so maybe we shouldn't be complaining too much.

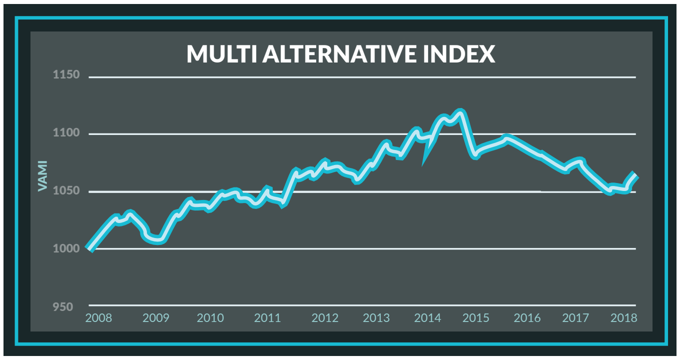


Multi-Strategy:

2018 Performance: Good, but not great

In what seems like the smartest strategy in the room (at least on paper), these managers look to blend the best ideas of the systematic trading world – trend, short term, momentum, mean reversion, etc. into a single trading strategy that performs in a variety markets and market conditions. There are some big names managing big dollars in this sector like Revolution, Quest Partners, and QMS .

And while 2018 was better than previous years, their trend components still seemed to have a large impact on their performance, capping potential gains from their other strategy types. In addition, most of these programs continue to be well below their highwater marks. Standing out was Campbell & Co., which continues to impress with their Absolute Return Portfolio that is a mix of trend-following, macro, equity index futures, as well as cash equities; while newer entries like Katonah Capital that utilize artificial intelligence outperformed most of the CTA industry, and groups like Welton performed in line.



(Note: Multi-strategy as we define it within the managed futures space differs from the multi-strat hedge fund category that's raised a lot of assets. Multistrat 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, but limit those strategies to models working on exchange traded futures markets (so no credit lines or convertible bond). 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).

Short Term Systematic:

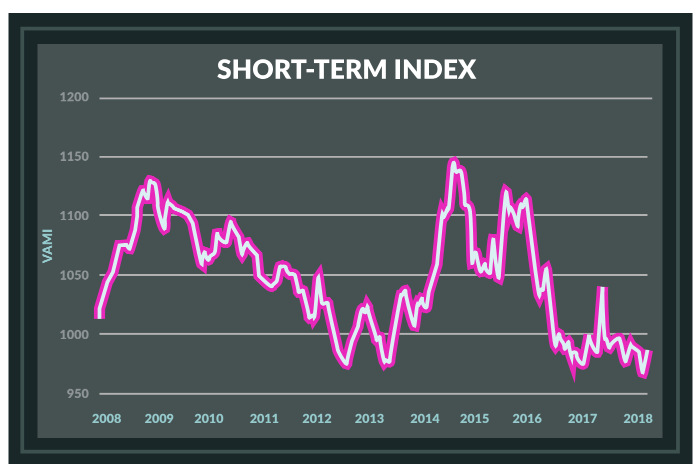
2018 Performance: Below average

The short term side of the managed futures strategy quiver 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 akin to 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.

Toby Crabel (Crabel Capital) and Jaffrey Woodriff (QIM) have been the kings of this group for as long as we can remember. Crabel benefited from a strong January and was able to navigate the remainder of the year without a big hiccup, while QIM started the year slow and was never able to fully recover. Newcomer to RCM, Tiber Capital, started 2018 off hot, but fell back to the pack after a difficult stretch from August to November.

We also include systematic day trading in this group. Day trading is considered the holy grail for investors who want CTA exposure, but don't want to tie up a significant portion of their investment in margin. Ideally, day traders give similar exposure to a short term trader without the overnight risk... although we



find that ideal scenario is usually much easier said than done.

Among day trading programs, the short-biased 3D Defender program (call us for details) delivered the defensive performance it's geared towards, returning +8.14% in 2018. Emerging manager Soaring Pelican bounced back from 2017 losses with a strong Q1 and held onto it the remainder of the year, while newcomer Numeri Capital gave back most of their gains in the final three months of trading to end just on the right side of positive. Meanwhile, Degraves Capital Management, who provided decent returns from 2013 through 2015, threw in the towel in May after 2 ½ years of disappointing returns.

Discretionary Global Macro:

2018 Performance: Mixed to poor

The famous go anywhere at any time trading strategy is a shadow of its former self. Legendary masters of the universe like Kovner, Tudor, and Soros are long gone spending their time and money on other intellectual pursuits. Other heavyweights like Brevan Howard have seen assets under management decline for years. But others are more optimistic as a new group of emerging global macro traders – coming out of places like Caxton and Graham Capital – are now getting back in the game as CTAs. With market volatility heating up, time will tell if global macro can return to its glory days. Among managers we follow, Greenwave Capital was the top performer at just over 3% for the year. Three Rock Capital – Global Macro grinded out +2.98% in 2018 while Sunrise Capital – Evolution (QEP) fell 7%.

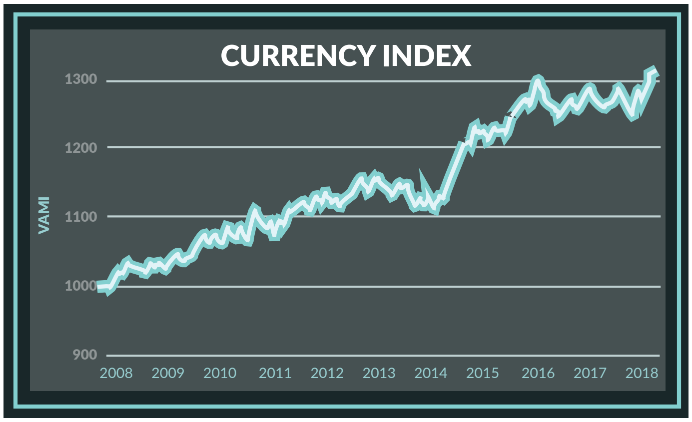
Commodity & Sector Specialists:

2018 Performance: Poor

Single sector strategies are probably the most *non-managed futures* managed futures sector. They focus on one sector, or one market with a niche into how they look to find returns – like just S&P, copper, or energy traders. It's for this reason, some single sector programs don't even consider themselves managed futures.

A quick look at our manager rankings shows that four out of the top 10 programs in our CTA ranking universe are commodity specialists or sector specialists. Programs like Polar Star from South Africa specialize in commodity spreads and had losses/gains of 5.89%. A little closer to home is Chicago-based Evergreen Commodity Advisors which was up 14%. Jaguar Investments saw positive gains in their Ultro (copper) Strategy at +6.6%, as well as Aegir (energy) at 2.5%. Boston-based P/E Investments specializes in currency trading and has their best year since 2014 with gains of just over 14%, while energy specialist (with an AI/machine learning twist) East Alpha (call us for details) shone in their first full year on the scene with gains of +27%.

One sector that fell drastically short of expectations is bitcoin futures. Bitcoin futures were launched on the CME as well as CBOE coming into last year to much fanfare, but the volumes never really caught up to the hype. A few CTAs like Systematic Alpha, which returned -10% versus bitcoin's -73% loss, are incorporating bitcoin futures into their trading and could be in position to succeed should volatility return to this sector in 2019.

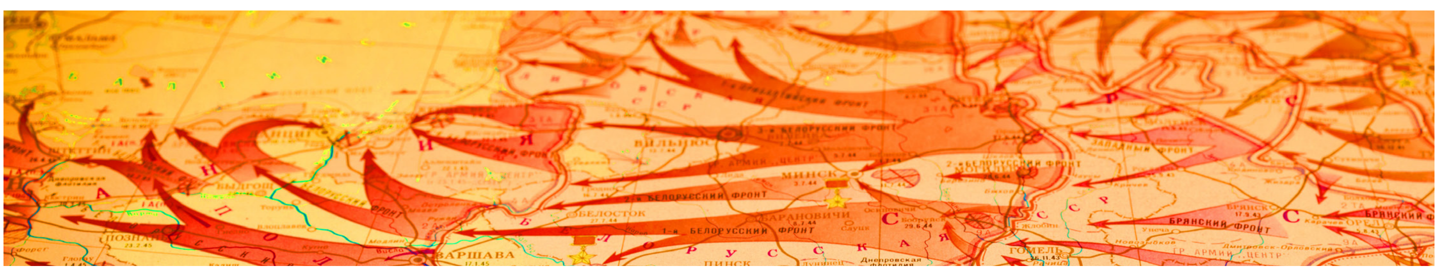


Conclusion:

There you have it. The good, the bad, and the ugly. The ugly was mainly focused on the short volatility sellers, where many would have predicted such an outcome. But with volatility increasing, a large down trend in energy prices, and sell off in equity markets – it was a little unexpected to see strategies like trend following, short term, and multi-strat end up in the bad bucket. While the good seemed to be concentrated on the very niche strategies focused on single sectors like meats or energies.

All in all, we're sure most investors expected more out of their diversifiers, especially with nearly every other asset class being down on the year. But non-correlation can result in down less than stocks just as easily as it can mean up when stocks are down. Investors don't have to like that, and indeed we're seeing more and more investors desire tactical negative correlation (a program that delivers *when* there is a sell off) in place of non-correlation (programs which *might* deliver in a sell off) – so they're not left with that unfulfilled feeling.

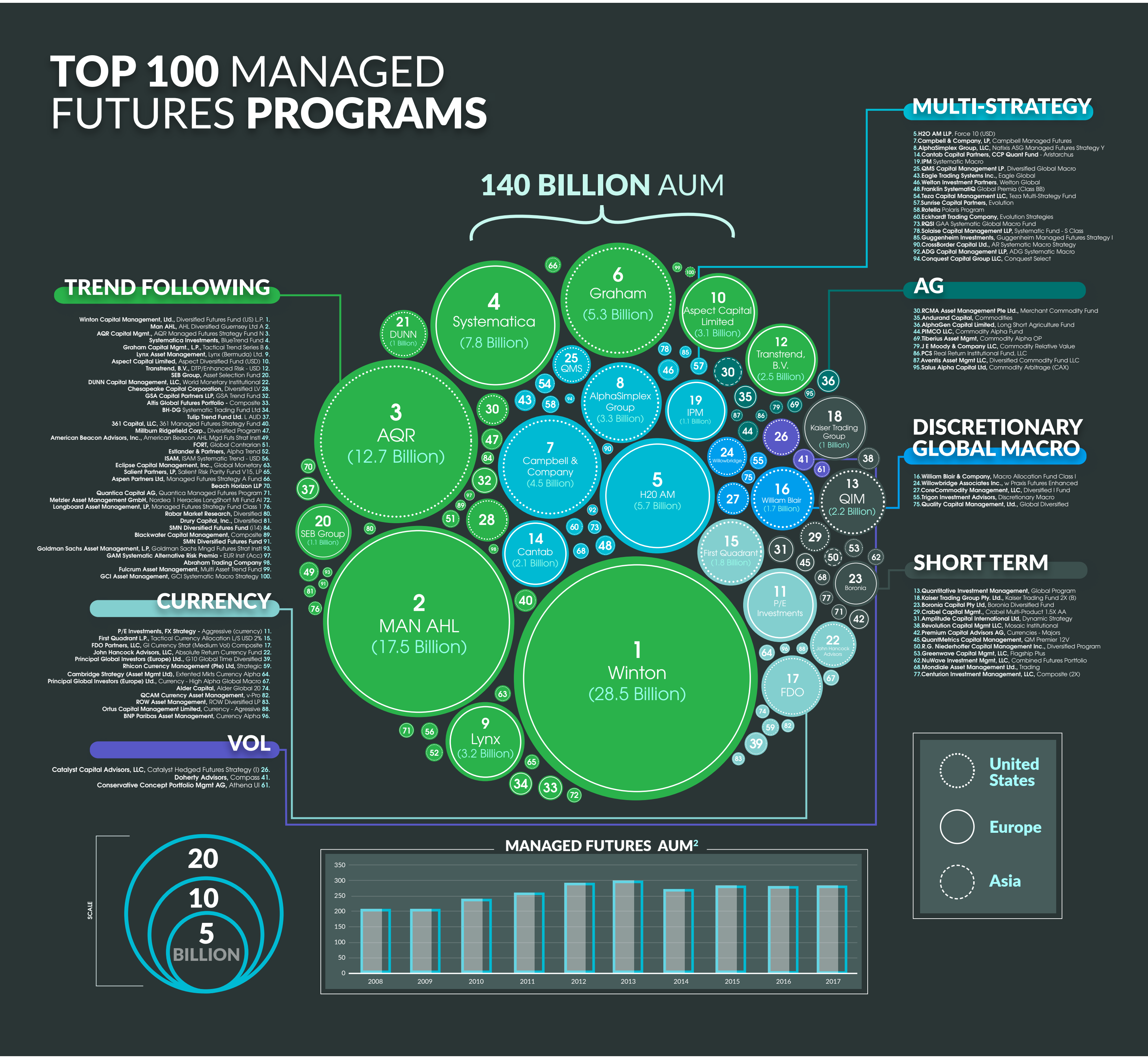
We're all for that, and all for a general souring on the managed futures/macro space. Because just when people are ready to throw in the towel on classical trend following or a sophisticated multi-strat approach is likely the exact point when that strategy will deliver. Keep a look out for our Managed Futures 2019 Outlook whitepaper coming soon for more detail on what could drive market moves resulting in improved performance. We'll take a deeper look at the statistics behind the overall market environment in the year ahead. Sign up to receive the 2019 Outlook here.



DISCLAIMER: Categorizations are RCMs own, based on what most closely represents each programs strategy, and may not necessarily match the programs stated investment strategy. The index charts for each strategy group have the following sources: Trend = SocGen Trend Index, Short Term = SocGen Short Term Traders Index, Ag = Barclayhedge AG Traders Index, Currency = Barclayhedge Currency Index, Multi-Strategy = SocGen Multi -Alternative Risk Premia Index,Volatility = HFRI Volatility Index, Global Macro = Barclayhedge Global Macro Index.

The graphic on the following page displays the Top 100 Managed Futures Programs by assets under management (AUM) across 100 unique managers, meaning managers with two large programs such as MAN AHL only have their largest program listed. The data is from RCM's internal database, as sourced from BarclayHedge, and represents the average monthly AUM of each program from inception through June of 2018. The graphic includes only those programs which report to BarclayHedge, and is therefore not inclusive of the entire universe of managed futures programs. The assets under management consists of the aum reported by the Barclayhedge CTA database minus the Bridgewater – Pure Alpha II Fund.

PS- How much money is allocated amongst these various strategy types? Glad you asked. We put together the following infographic on the **Top 100 Managed Futures Programs** to visually see just that. **Enjoy!**



Futures Trading is complex and involves the risk of substantial losses.
Past Performance is Not Necessarily Indicative of Future Results.

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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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