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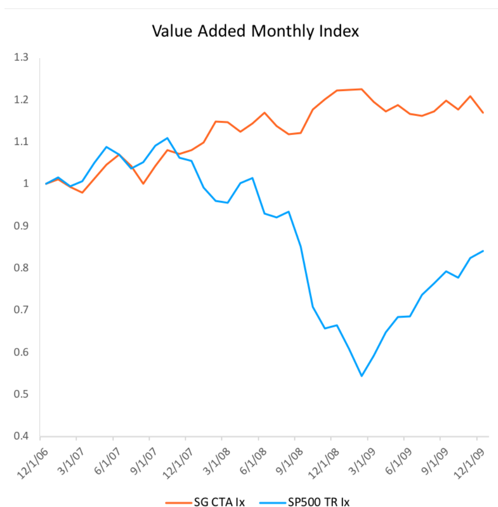
Uncorrelated Strategies in Times of Covid-19

April 2020

Here comes a new crisis bringing with it a spike in volatility reminiscent of 2008. Once again, investors are reminded of the diversification benefits associated with managed futures and check to see if this time the strategy will "save" them.

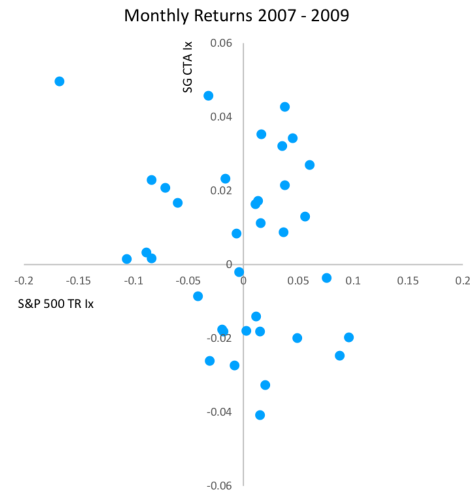
Following is an assessment of the opportunity that awaits both managers and investors.

A walk down memory lane



Back in the 2008, managed futures proved to be uncorrelated and performed well. It is an effective strategy with a long history as a diversification tool vis à vis other strategies and markets. 2008 was just an overt example of this and convinced many investors of the merits of having exposure to the strategy.

	SG CTA Index	SG Trend Index	SPX
H1 2007	7.08%	8.60%	6.96%
H2 2007	0.91%	-0.02%	-1.37%
H1 2008	8.30%	15.25%	-11.91%
H2 2008	4.40%	4.89%	-28.48%
H1 2009	-4.52%	-7.65%	3.16%
H2 2009	0.23%	3.09%	22.59%



And leading into this crisis, 2007 had not been a bad year for the strategy either.

Many remember managed futures managers performing well in the second half of the crisis. However that does not tell the whole story. As shown in the table above covering 2007-2009, managers performed better in the first half of 2008.

2008	SG CTA	SG Trend	SPX
Q1	6.15%	8.46%	-9.44%
Q2	2.03%	6.26%	-2.73%
Q3	-4.16%	-6.90%	-8.37%
Q4	8.93%	12.66%	-21.94%

And the quarterly table above offers a better representation of what actually happened in 2008. Q3 for managed futures was a challenging quarter (albeit better than the S&P). This was primarily due to a challenging July and August.

Managed futures correlation to the S&P during that period 2007-2009 was -0.22 using monthly data (-0.14 using daily). While slightly negative, they are favorable correlation characteristics between the equity markets and the managed futures strategy.

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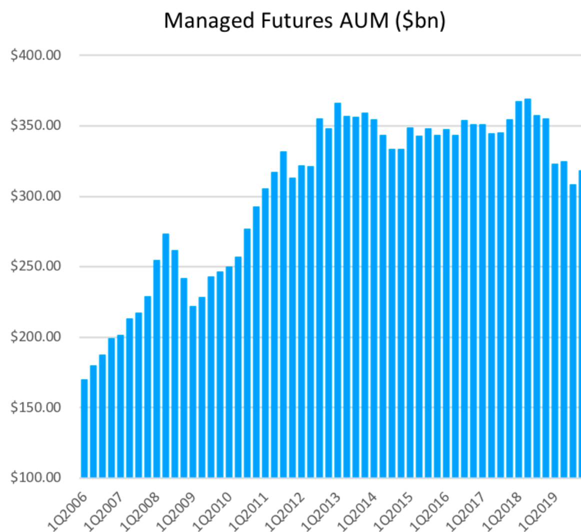

Source: BarclayHedge

Despite this out-performance in 2008, managed futures suffered an "ATM effect" where investors redeemed from this "winning" and "liquid" strategy to meet demands that could not be satisfied by other parts of their portfolio.

Investors withdrew 13% of AUM from managed futures, bottoming in 2009 at $222bn. Once the crisis passed, investors realized they were under-exposed and poured $137bn back into managed futures between 2009 and 2013 - a 62% increase.

However another debate emerged in the industry. Attribution analysis revealed managed futures had historically generated a decent part of their returns from the fixed income asset class. As interest rates fell to low levels and the economy started improving, investors started questioning if managers would be able to perform in a rising interest rate environment. Numerous managers in the space published research papers. Campbell & Company, whose 2013 paper concluded that the managed futures "strategy has not historically been rate regime dependent". In 2015 AQR concluded the same (here). Welton began researching assets classes that could prove fruitful in a rising rate environment....and RG Niederhoffer Capital Management concluded that the party for managed futures was over.

But is the efficacy of managed futures solely dependent on its relation to interest rates ?

After all, it is simply a fact that investors are attracted to strategies that have performed well in the recent past. The intellectual debate about how managed futures would perform in a rising rate environment was overshadowed by the lackluster returns in managed futures versus the better returns in the S&P and other hedge fund strategies.

Between the end of 2008 and the end of 2019, investors have made only 13% in managed futures vs 351% by holding the S&P. While investors redeemed only about 15% from the strategy, they certainly have not rebalanced into managed futures. As an asset class, it now represents only 10% of hedge fund assets compared to its 2013 peak of 20%.

The best-known and most prevalent managed futures strategy, trend-following, became regarded as a crowded, alternative beta strategy. Managers offered cut-price dumbed-down models in a bid to retain assets. Some even questioned whether trend-following was broken (Abbey).

Then came 2020....

Often, a spike in volatility catches everyone by surprise. Even systematic futures strategies are not immune (Efficient), particularly trend-followers. Contrary to common belief, these strategies are not long volatility in the short run, and there tends to be wide dispersion of returns among managers.

In Q1-2020 when the S&P fell 19.6% with a peak to trough of -30% the SG CTA index fell only -0.54% and the SG trend index rose 2.29%! All that while HFRI was down -9.39%.

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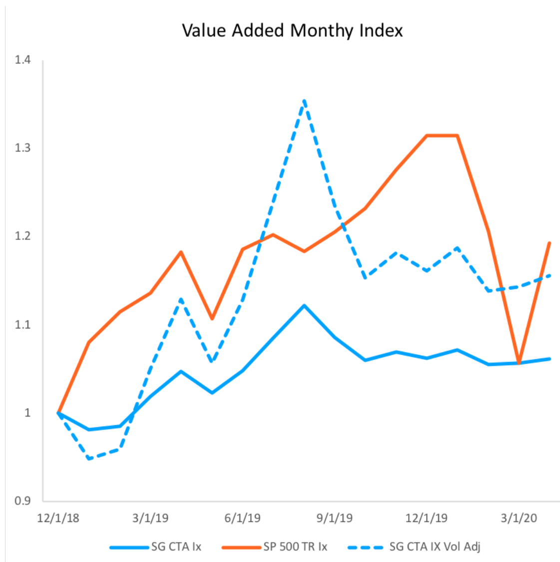
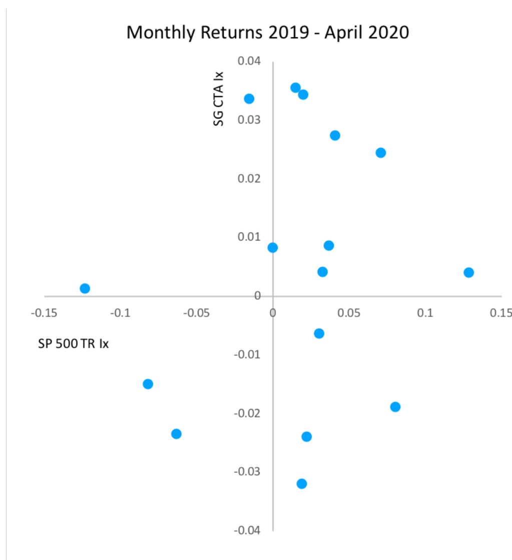
For a strategy that is not long volatility, particularly at inflection points, it has held up well.





As an asset class, managed futures shows again that it does not seem to follow the equity market. And when many other strategies become correlated, managed futures stands alone.

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So what is the opportunity?

From a performance standpoint we are not palm readers…. Nor do we have a view how managed futures will perform going forward. As we discussed above, astute managers have debated themselves if managed futures could perform again and came to different conclusions. Now, crises happen and markets do not trend up forever. Uncertainty around the near-term performance of equities and fixed income will continue to roil markets for the foreseeable future.

The share of assets allocated to managed futures is low on a historical basis. There has been some indication of redemptions in the space (here) in Q1 2020, but our intel tells us that it is concentrated with a few managers that had underperformed, and some of these redemptions were actually initiated before the crisis, either end of 2019 or early 2020.

The asset class has once again demonstrated its lack of correlation to equities and its ability to profit through volatility. We expect assets to flow to managed futures.

Given wide dispersion in manager performance, allocators will want to dig deeper into the managed futures bench - a single allocation to a big name manager simply won't cut it.

Asset allocators need ways to weather-proof their portfolios and managed futures should be part of the process. Therein lies the opportunity for managers to prove their mettle. They have to make the case that their program meets an allocator's specific needs.

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