CTA/Managed Futures: A Growth in Investor Interest

Sarah Corran, Joanna Hammond and Ross Ford explore CTA/managed futures funds, which many investors are turning to in order to add stability to their investment portfolios in current uncertain economic conditions. What can CTA funds offer? How have they performed in the past, and what is the outlook for the future?

CTA/managed futures have often been regarded as an "all-weather" investment choice, with historical performance characteristics that make the strategy highly relevant during periods of relatively low returns and generally rising asset class correlations. In this article we examine which investors are committing to CTA funds and how the performance of these vehicles has appealed to increasing numbers of investors over the past 10 years. We also take a closer look at the CTA industry today, including what types of funds are in market, and how the industry has grown since its inception.

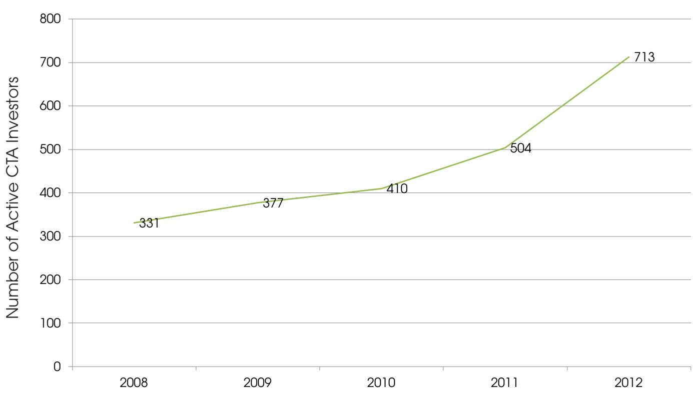
As shown in Fig. 1, the number of institutional investors active in managed futures has been increasing over the past four years, with the number of institutions allocating capital to CTAs rising year-on-year. Interest in this strategy is in part due to institutional investors increasingly targeting investments that provide both transparency and liquidity within their hedge fund portfolios during times of heightened market volatility and slow economic growth. Since the global financial crisis in 2008, many institutional investors have been looking to diversify their portfolios to better weather such periods of unusual market stress. Managed futures offer a wide array of liquid and transparent strategies that provide institutional investors a number of benefits, including reduced volatility and loss-mitigation during crisis periods, as well as the offer of genuine diversification in a portfolio.

Investments in CTAs are attractive to a wide range of investors across the hedge fund investor base. Leading CTAs and managed futures-focused funds by the number of institutional investors using them include the BlueTrend Fund, which is managed by UK-based BlueCrest Capital and Winton Diversified Programme, which currently has over $10bn in assets under management. Abbey Capital's ACL Alternative Fund and GAM Trading II are among the leading funds of CTAs utilized by institutional investors.

As shown in Fig. 2, CTA funds are particularly popular among funds of funds, with 42% of all funds of funds on the Preqin's Hedge Fund Investor Profiles database expressing an interest in the strategy. Many multi-managers look to invest in CTA hedge funds in order to diversify their hedge fund portfolios and generate uncorrelated returns in a volatile investment climate. An example of a fund of hedge funds with a particular interest in CTAs is London-based International Asset Management, which increased the weighting of its portfolio towards trend-following CTAs, as it feels such liquid strategies allow for more efficient opportunistic investing in the current economic environment.

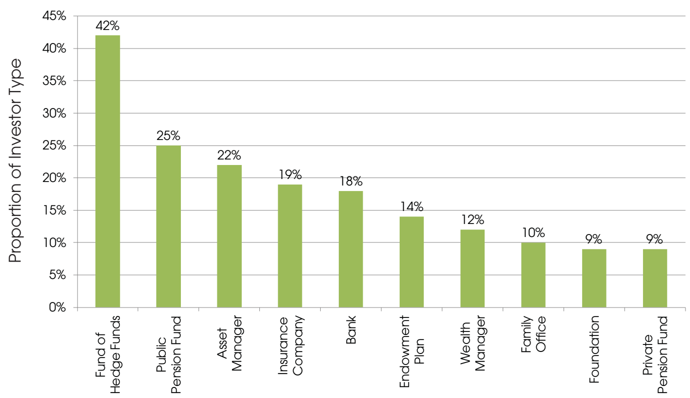
Fig. 2 also highlights a significant interest in CTA hedge funds among public pension funds, with 25% of all public pension funds having a preference for this strategy. Since the onset of the financial crisis, public pension funds have become more demanding when it comes to their liquidity and transparency requirements; they are also looking to construct diversified portfolios of funds that can produce uncorrelated returns. Therefore, many public pension funds seeking new and potentially more effective ways of diversifying their holdings target CTAs, given the strategy's track record of low correlations coupled with its upside return potential. One example of such an investor is the City of Stamford Police Pension Fund, which looks to invest in CTA funds as part of its diversified hedge fund portfolio. Asset managers and insurance companies also represent significant proportions of investors in CTAs, with 22% of asset managers and 19% of insurance companies interested in the strategy.

Fig. 1: Number of Institutional Investors in Hedge Funds Actively Investing in CTA Funds, 2008-2012



Source: Preqin Hedge Fund Investor Profiles

Fig. 2: Proportion of Each Institutional Investor Type with a Preference for CTA Funds



Source: Preqin Hedge Fund Investor Profiles

Managed futures is a widely used strategy among Europe-based investors, with a quarter of all investors based in the region expressing an interest in CTAs, as shown in Fig. 3. The region boasts a diverse investor base comprising a large number of sophisticated hedge fund investors, including both funds of hedge funds and institutions such as pension funds and insurance companies. Asia-Pacific and Rest of World-based institutional investors also display a preference for CTAs, with 23% and 19% of investors in these regions respectively expressing an interest in the strategy.

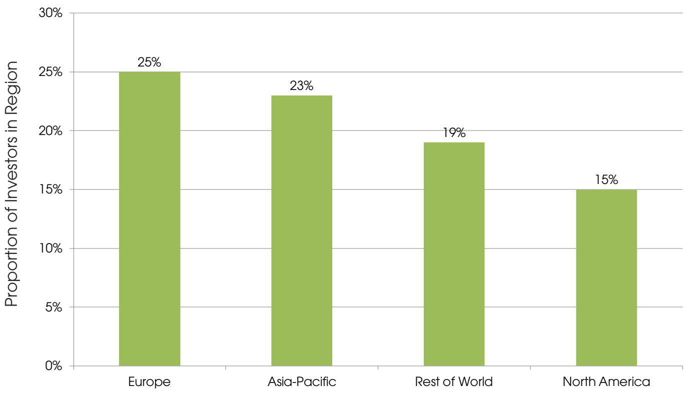
Fig. 3 also reveals a notable interest in CTAs among North America-based institutional investors, with 15% of investors in hedge funds in this region having a preference for CTAs. The United Negro College Fund is an example of a North America-based investor that considers investing in managed futures/CTAs as part of its hedge fund portfolio.

Why Are Investors Adding CTAs to their Portfolios?

CTAs clearly have a growing appeal to a wide range of institutional investors. The liquidity these funds can provide is certainly an attraction for this audience, but additionally, the returns characteristic of CTA funds contribute to their strong appeal to investors, particularly following the market crisis of 2008.

Fig. 4 shows the trailing returns of CTAs and hedge funds over several time periods. Fig. 5 shows the quarterly returns of hedge funds, CTA funds and the S&P 500 between 2008 and September 2012.

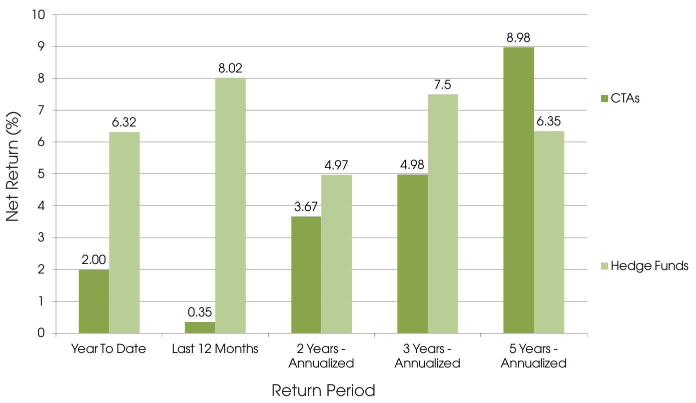
Fig. 3: Breakdown of Institutional Investors in Hedge Funds with a Preference for CTA Funds by Geographic Location



Source: Preqin Hedge Fund Investor Profiles

Over the most recent time frames, CTAs have underperformed compared to hedge funds, Fig. 4 shows. The relatively poor performance over the last 12 months of the CTA industry, which generated just 0.35% in returns over the last year compared to the 8.02% returned by hedge funds, has done little to improve the returns over an annualized two or three-year time frame. The choppy market conditions seen in 2012 have proved difficult for CTA vehicles that pursue trend-following strategies, as it is hard to see clear trends in the market, particularly with high levels of government intervention. This was also the case in 2009, when CTAs posted returns of 4.31%.

Fig. 4: Performance of CTAs and Hedge Funds (As at September 2012)



Source: Preqin Hedge Fund Analyst

However, CTAs performed well in 2008, making 19.11%, while hedge funds lost 17.01%. In the longer term (annualized over five years) CTAs have performed better than hedge funds, producing returns of 8.98% compared to the 6.35% returned by hedge funds. This better long-term performance from CTAs is a result of the superior returns achieved by the strategy in 2008.

Despite lower returns in recent years compared to other hedge fund strategies, investors have continued to have a strong interest in CTAs. Fig. 5 gives some insight into the real value of CTA funds as part of an institutional portfolio. Hedge fund and equity market returns show a significant degree of correlation – in times when the S&P 500 is not performing well, hedge funds also have a tendency to perform negatively, albeit with dampened negative performance. In 52 of the months since January 2002 the S&P 500 has been in negative territory the Preqin Hedge Fund Index was negative for 28 of these months, compared to 21 months when looking at the Preqin CTA Index.

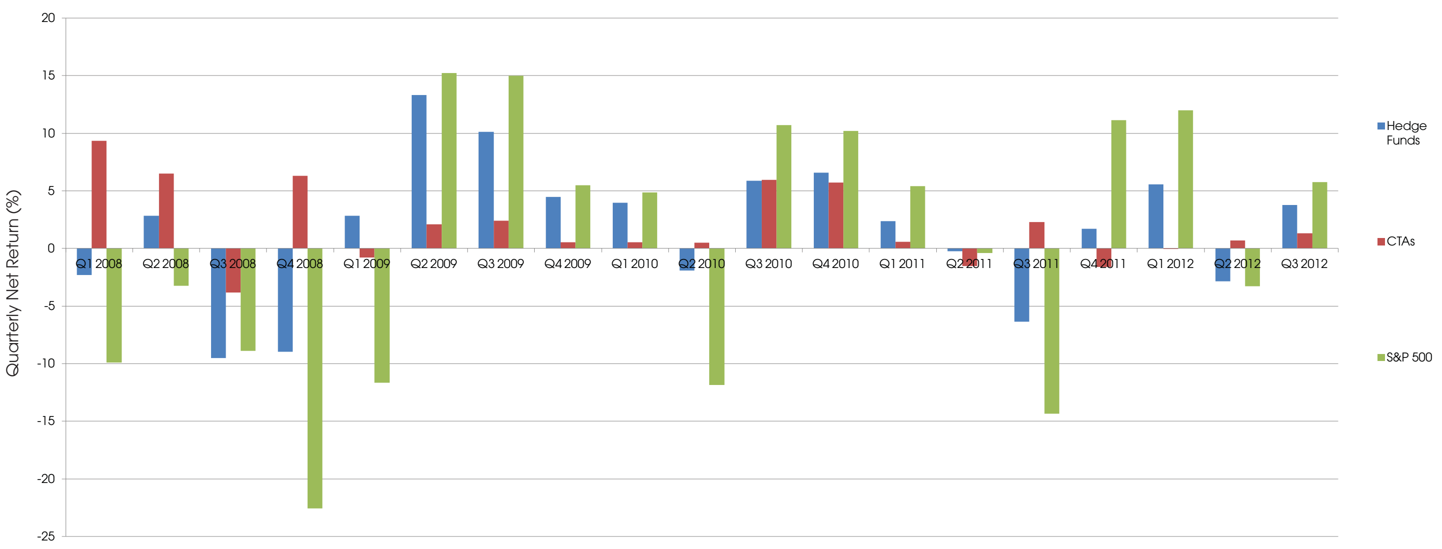
When looking at the correlation coefficient of the S&P 500 and hedge funds, in positive markets the correlation coefficient is 0.46 and in down markets it is 0.64. CTAs, on the other hand, show a negative correlation coefficient of -0.23 in down markets and a slight positive correlation of 0.06 in up markets. This indicates that investors can hedge against portfolio correlation and downside losses by adding CTAs to an investment program in times when their wider hedge fund returns might be performing below their expectations. CTAs are adaptable and systematic; they also have diversified holdings in primarily futures markets, and lack long bias to equity markets. Therefore, they have shown they can perform well in crisis environments, where equity prices are declining, credit and liquidity dries up, and investor behaviour leads to opportunities for CTAs to capitalize on persistent trends being forced through markets.

An analysis of performance statistics on Preqin Hedge Fund Analyst also shows a number of potential advantages of investing in CTA funds over the longer term. The three-year Sharpe ratio (calculated with a risk-free rate of 2%) of single-manager CTA vehicles is 0.45, almost half that of single-manager hedge funds (which generated 0.91 times more than the risk-free rate). However, over a five-year period, the Sharpe ratio of CTAs is 1.01, notably larger than the 0.50 ratio of hedge funds. Over the longer term, CTAs have proved to provide better risk-adjusted returns than hedge funds. The same trend can be seen in volatility statistics; over a three-year period single-manager hedge funds are less volatile, with 6.07% volatility, compared to the 6.67% volatility of CTA funds. Over five years, CTA investments have a volatility of 6.93%, lower than the 8.74% volatility of hedge funds.

The CTA Industry Today

With more institutional investors allocating to CTA funds than ever before, investor demands have begun to change the CTA industry. Preqin Hedge Fund Analyst currently tracks detailed information on 429 CTA managers, which manage a combined 1,298 CTA vehicles. Fig. 6 shows the number of CTA vehicles launched each year tracked by their year of inception. In 2004 the industry saw a significant jump in the number of CTA programs launched. This followed two years of strong performance by the CTA sector, when CTA funds posted average returns of 22.37% and 27.19% in 2002 and 2003 respectively.

Fig. 5: Average Quarterly Net Returns of Hedge Funds, CTAs and S&P 500, 2008 - Q3 2012



Source: Preqin Hedge Fund Analyst

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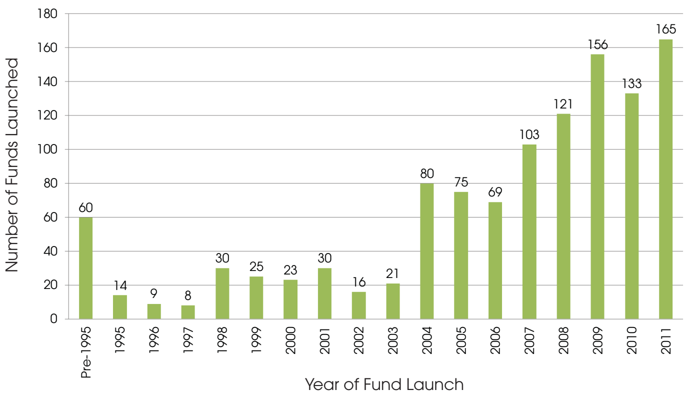
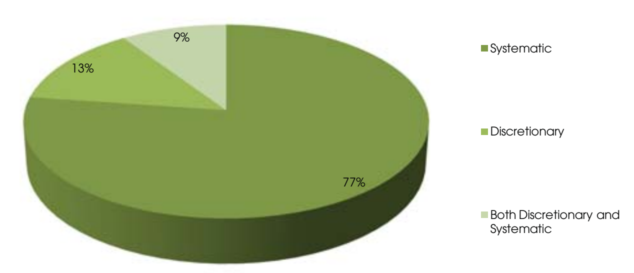
Download Data

Fig. 6: CTA Fund Launches by Year, Pre-1995 - 2011



Source: Preqin Hedge Fund Analyst

Fig. 7: CTA Funds by Trading Methodology



Source: Preqin Hedge Fund Analyst

There was another spike in CTA launches in 2009 following the very strong performance of managed futures programs in 2008 (posting benchmark returns of 19.11% versus negative 17.01% for the hedge fund index). The value of CTA programs in an institutional portfolio was emphasized to investors following the events of 2008, and the number of CTA funds in the industry, as well as the number of investors allocating to these CTA vehicles, has been increasing since that time.

Types of CTA

Almost a quarter of the CTAs listed on the Preqin Hedge Fund Analyst database are structured as managed accounts. This is a significantly higher proportion than in the hedge fund industry as a whole, where 3% of funds tracked by Preqin are structured as managed accounts. Managed accounts offer investors greater control of their investment, greater transparency, and lower counterparty risk. Managed accounts also usually require a higher minimum investment; the mean minimum investment for CTA managed accounts is $2.2mn, which is almost three times the mean minimum investment for all other CTA structures, which stands at $0.8mn. CTAs offer increased liquidity to their investors – Preqin data shows that investors in CTAs can access their capital on average every 22 days with 14 days notice. This is substantially higher liquidity than the hedge fund industry as a whole, where investors can only access capital on average every 1.6 months with 40 days notice.

Fig. 7 shows that 77% of the CTA funds on the Preqin Hedge Fund Analyst database use a systematic approach to investing. Systematic funds use computer algorithms, based on technical and fundamental analysis, to execute trades based on specified parameters. Thirteen percent of funds use a discretionary trading methodology and the remaining 9% of CTAs use a combination of a systematic and discretionary approach.

Preqin tracks a number of different strategies that are used by CTAs: trend following, macro, pattern recognition, counter trend, option writing and arbitrage. The most commonly employed CTA strategy is trend following, where the CTA uses technical analysis of market prices to identify long- or short-term trends in financial markets; this strategy is used by over 70% of managed futures funds. Macro-focused is the next most favoured by CTAs, with 21% of all vehicles using this strategy; other CTA strategies are used by around 10-15% of CTA vehicles.

Figs. 8-10 show some key CTA funds from Preqin's Hedge Fund Analyst database.

Outlook

The desire for diversification and pursuit of uncorrelated returns continues to attract many institutional investors to CTAs. Institutions

Fig. 8: Net Returns of Top Performing CTAs in 2012 YTD (January - September 2012)

Program Name	Manager	Net Returns in 2012 YTD (%)
Clarke Global Magnum Program	Clarke Capital Management	55.48
eFED Commodity Futures Fund	Ebullio Capital Management	46.00
The Forecast Portfolio	Forecast Trading Group	42.10
Global Ag - Global Ag Returns-I	Global Ag	38.19
Ram Aggressive Program	RAM Management Group	37.98
LJM Aggressive Strategy	LJM Partners	36.78
Systematic Alpha Multi-Strategy Futures Fund - Class B (Double Leverage)	Systematic Alpha Management	30.56
WPD Crabel Futures - Class J	Crabel Capital Management	28.27
LJM Moderately Aggressive Strategy	LJM Partners	27.30
Clarke Millennium Program	Clarke Capital Management	27.12

Source: Preqin Hedge Fund Analyst

across the hedge fund investor base are demonstrating an ever growing interest in CTAs as they seek strategies that can provide asset protection in falling markets and diversify their portfolios away from a reliance on equity and bond instruments.

The use of CTA funds is still relatively niche in the institutional community, with many investors having made their first allocations to such vehicles in the past few years. An earlier Preqin study showed that institutional investors have been disappointed with performance in the industry in 2012, with managed futures funds coming in as the second highest ranked strategy in terms of investor disappointment with returns. However, over the longer term CTA funds have performed well and have shown a negative correlation with public markets. Should CTA funds continue to perform in this way, those investors that have exposure to the strategy could reduce downside risk in their portfolios.

Understanding both the performance of the CTA industry as well as the sources of capital for these funds is vital for anyone seeking to make their headway in the managed futures space, be it through investment in a fund, launching a new program or providing third party services to the growing number of CTA funds in the marketplace today.

Fig. 9: Five Leading Managed Futures Programs Used by Institutional Investors

Fund	Fund Type	Fund Manager	Location
BlueTrend Fund Ltd	CTA	BlueCrest Capital	UK
ACL Alternative Fund	Fund of CTAs	Abbey Capital	Ireland
GAM Trading II	Fund of CTAs	GAM	UK
Lynx (Bermuda)	CTA	Brummer & Partners	Sweden
Winton Diversified Programme - Winton Futures Fund	Multi-Strategy	Winton Capital Management	UK

Source: Preqin Hedge Fund Analyst

Fig. 10: Five Leading Managed Futures Programs by Assets under Management (AUM)

Fund	Firm	Firm Location	Inception Date	Fund AUM ($mn)	Strategy
Winton Diversified Programme – Winton Futures Fund	Winton Capital Management	UK	01-Oct-97	10,572	Multi-Strategy
Diversified Trend Program - Enhanced Risk	Transtrend	Netherlands	01-Jan-95	9,700*	Systematic, Trend Following
BlueTrend Master Fund	BlueCrest Capital	UK	01-Apr-04	9,408*	US, Systematic, Trend Following
Renaissance Institutional Diversified Alpha Fund	Renaissance Technologies	US	01-Mar-12	5,561	US, Systematic
Discus Feeder Limited	Capital Fund Management	France	01-Dec-07	3,159	Global, Systematic, Trend Following

Source: Preqin Hedge Fund Analyst

*Estimate