CTAs - Introduction

CTAs underwent a revival in 2014, making gains of 9.96% and exceeding the Preqin All-Strategies Hedge Fund benchmark for the first time since 2011. Although 2015 started well, with the All-Strategies CTA benchmark adding gains of 4.28% in Q1 2015, commodity market conditions made the returns environment a difficult one for many CTAs over much of the rest of the year, and by the end of 2015 the benchmark was underwater.

Despite the difficulties faced in 2015, investors look set to remain committed to CTAs in 2016; more than half of all investors in the strategy plan to increase their exposure as they seek an asset non-correlated to equity markets. In this section, we examine the performance of various CTA strategies over 2015, the make-up of current funds in market and the institutional investors that actively invest in these funds.

Key Facts

1,240
Number of active CTA programs.

1,067
Number of institutional investors that invest in CTAs.

52%
Proportion of CTA investors that plan to increase their exposure to the strategy in 2016.

67
Number of new CTAs launched in 2015.

CLOSED
84
Number of CTAs that liquidated in 2015.

69%
Proportion of CTA investors that stated return expectations had been met in 2015.

Source: Preqin Hedge Fund Investor Profiles and Hedge Fund Analyst

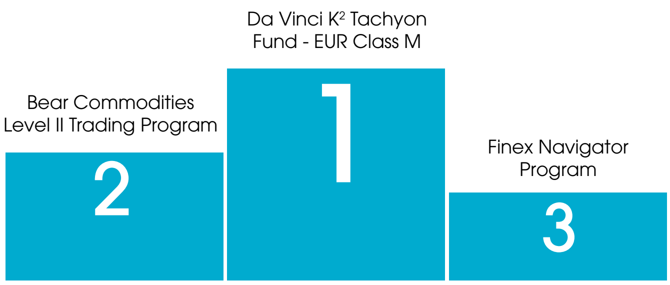
Performance in 2015

+0.95%
Discretionary CTA benchmark return in 2015.

-1.44%
Systematic CTA benchmark return in 2015.

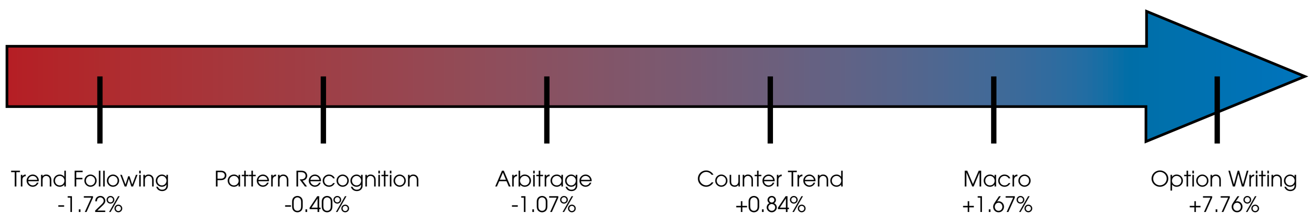
July 2008
June's loss of 2.35% was the worst monthly return for the All-Strategies CTA benchmark since July 2008 (-2.85%)

Top Three Performing CTAs in 2015



Source: Preqin Hedge Fund Analyst

Best and Worst Performing CTA Strategies in 2015 (Cumulative Performance as of 31 December 2015)

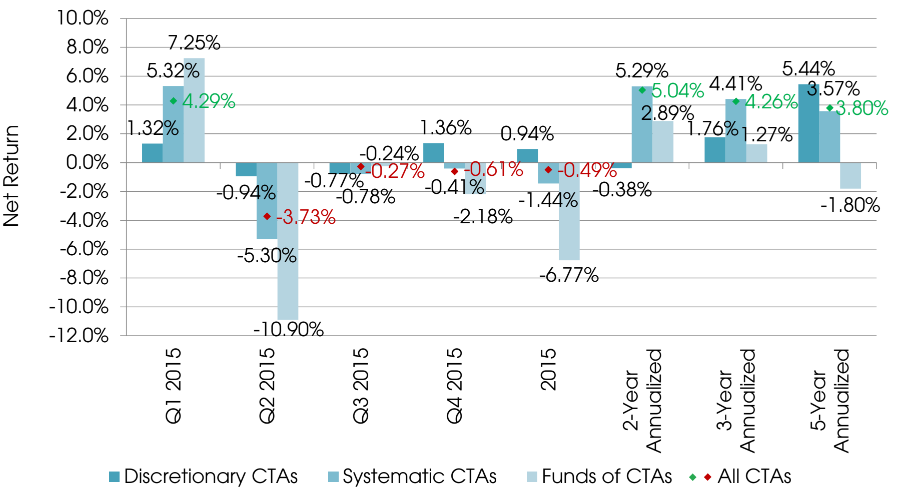


Source: Preqin Hedge Fund Analyst

Overview of CTAs

Intra-month price swings and volatility were a key theme throughout the 2015 commodity markets as the prices of commonly traded assets fluctuated from one month to the next. Unexpected rises in US oil reserves one month were followed by OPEC decreasing their oil production the next. Similarly, a drop in the revenue levels of Chinese industrial companies caused copper prices to hit six-year lows in September amid demand fears, only for major copper mining firms to announce cuts to their output, driving prices up in November, and again reversing large-scale price movements in a matter of weeks. The volatility and reversals in market trends were ever present during the past 12 months, which saw the 2015 Preqin All-Strategies CTA benchmark make a loss of 0.49% (Fig. 1).

Fig. 1: Performance of CTAs (As at December 2015)*



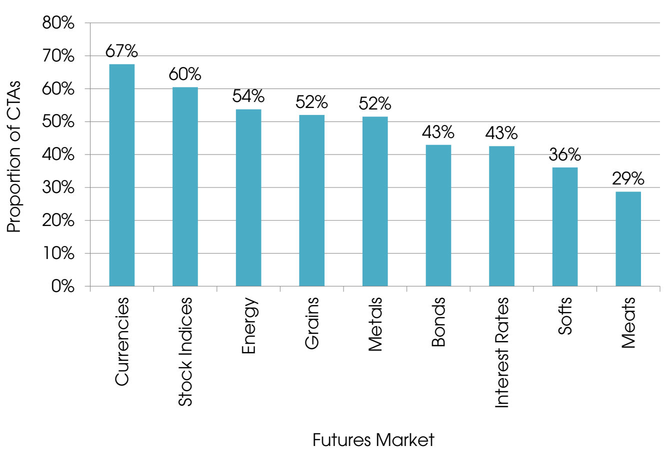
Source: Preqin Hedge Fund Analyst

Performance, Volatility and Correlation

2015 began with CTAs continuing to generate strong returns off the back of 2014; the Preqin All-Strategies CTA monthly return for January hit 3.71%, the highest single monthly return since December 2010. As Fig. 2 shows, the currency market is the most commonly traded futures market; as the Swiss national bank removed the pegging of the Swiss franc to the euro in January and the value of the Swiss franc rose, many CTAs were able to benefit. Performance stabilized as CTAs ended March having returned 4.29% for the first three months of 2015, their strongest first quarter since 2008 (Fig. 1). The second quarter of 2015, in contrast, delivered the worst quarterly CTA performance in over seven years, with all three months generating negative monthly returns for CTAs, ranging from -0.08% in May to -2.35% in June. Q3 2015 yielded a small loss for CTAs as market conditions in August counteracted any gains in July and September, and with the Preqin All-CTA Strategies 2015 YTD benchmark at +0.13% as of 30 September, the fortunes of CTAs in the fourth quarter would define the yearly performance benchmark. Losses in October (-1.11%) and December (-1.33%), with the latter following the Federal Reserve's interest rate hike, drove the 2015 CTA benchmark below 0% to end on -0.49%.

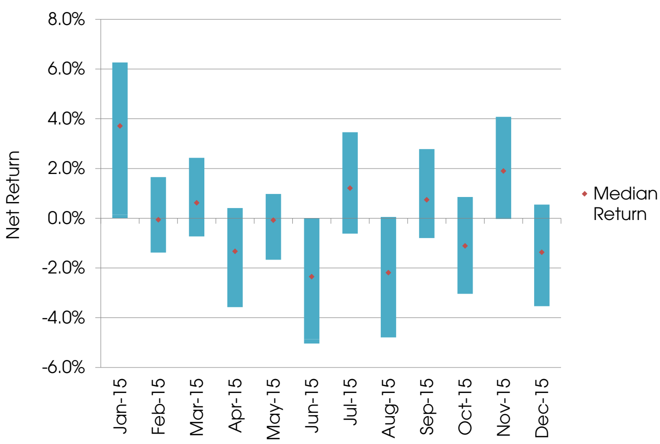
While CTAs exhibit similar volatility to hedge funds over a three-year period, for five months in 2015 the three-year rolling volatility of funds of CTAs reached a level higher than that of the S&P 500

Fig. 2: Top Futures Markets Traded by CTA Funds



Source: Preqin Hedge Fund Analyst

Fig. 3: Interquartile Range of Returns by CTAs, January 2015 - December 2015*



Source: Preqin Hedge Fund Analyst

**Please note, all performance information includes preliminary data for December 2015 based on net returns reported to Preqin in early January 2016. Although stated trends and comparisons are not expected to alter significantly, final benchmark values are subject to change.*

Total Return Index (Fig. 4). This short change in a historical trend emphasizes the turbulence in commodity markets in 2015. Funds of CTAs have not only been more volatile than their single-manager equivalents in recent years, but their performance during 2015 as well as over the longer two-, three- and five-year periods is below that of CTAs (Fig. 1).

CTAs have historically shown a low correlation to equities with negative correlation to the S&P 500 during times of equity market losses (Fig. 5). While three-year correlations of CTAs to equities and hedge funds increased during the first half of 2015, as fund managers aimed to capture the equity market upside, the poor performance of commodities saw CTA returns continuing to be more negatively correlated to the S&P GSCI Index as managers used hedging to offset the wide losses in the commodities markets.

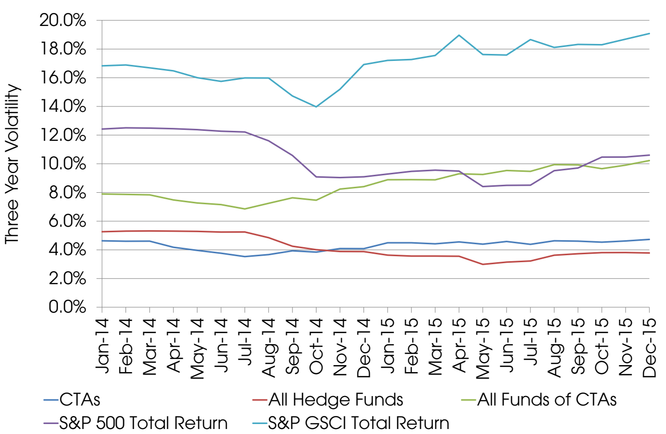
Strategies

The reversals of market trends in H1 2015 were most damaging to the most commonly utilized CTA strategy, trend following (Fig. 6). Sharp reversals in prices cut trends short and drove the Preqin Trend Following-CTA benchmark down to -5.68% in the second quarter (Fig. 7). In contrast, option writing strategies performed well throughout 2015, and finished the year with a return of +7.76%, over six percentage points higher than any other CTA sub-strategy. During the second quarter, when four of the six top-level CTA strategies generated quarterly returns below -3.44%, option writing CTAs returned 1.47%, highlighting the strategy's ability to generate returns in conditions where other strategies may struggle.

Discretionary vs. Systematic

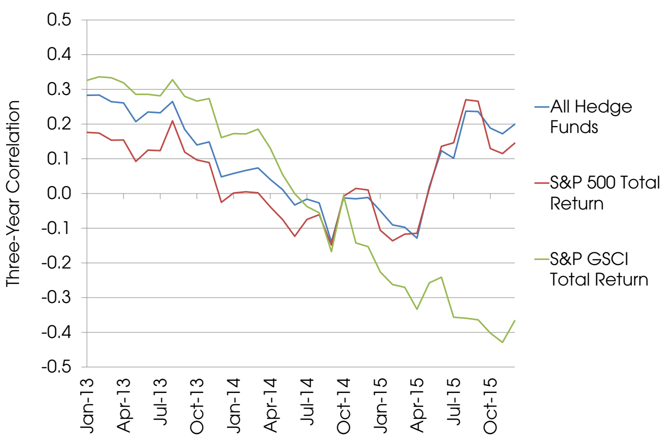
Systematic-only strategies dominate the CTA industry; however, the proportion employing a systematic methodology has fallen over the last year (Fig. 9). From 2008 to 2012, systematic strategies accounted for an increasing proportion of fund trading methodologies, from 52% to 78% respectively. A sustained bull market and a reduction in volatility in global markets since 2009 have sometimes challenged the effectiveness of the systematic trading method. Although systematic CTAs started 2015 on a high, returning 4.44% in January, losses in June (-3.26%) and in August (-2.36%) meant that by the end of 2015 discretionary traded CTAs had generated a higher 2015 return than their systematic counterparts (Fig. 10). 2015 has witnessed a reduction in the number of CTAs utilizing pure systematic strategies (Fig. 9). In 2015, 13% of new

Fig. 4: Rolling Volatility of CTAs, January 2014 - December 2015*



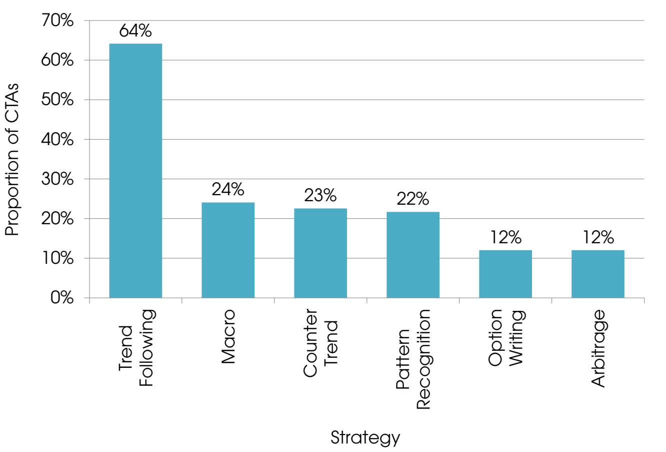
Source: Preqin Hedge Fund Analyst

Fig. 5: Rolling Correlation of Benchmarks to CTAs, January 2013 - December 2015*



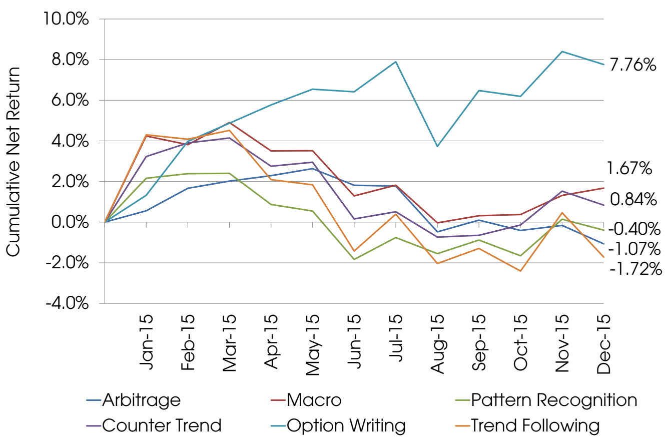
Source: Preqin Hedge Fund Analyst

Fig. 6: Breakdown of CTAs by Strategy Employed



Source: Preqin Hedge Fund Analyst

Fig. 7: Cumulative Performance of Top-Level CTA Strategies, January 2015 - December 2015*



Source: Preqin Hedge Fund Analyst

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CTA launches employed a combination of both discretionary and systematic trading strategies, the largest proportion of funds using both strategies since 2009, as portfolio managers in the sector sought enhanced flexibility.

Investors

Although the wider hedge fund industry saw poor performance in 2014, CTAs posted positive returns, generating +10.88% for the year, the strategy's best annual return since 2010. Despite negative returns in 2015, CTAs continue to hold a space within many investor portfolios. As of December 2015 over 1,067 institutional investors actively invest in CTAs, an increase from 1,017 in 2014 (Fig. 11). In fact, the number of institutional investors active in CTAs has been rising year-on-year since 2008. The strategy's ability to protect assets during periods of rising asset class correlations or volatile investment climates, as proved in 2008, is attractive to investors.

Approximately 44% of funds of hedge funds express an interest in CTAs (Fig. 12). Large institutional investors such as sovereign wealth funds (31%) and public pension funds (29%) also show a relatively larger appetite for CTA strategies as compared to other investor groups. These investors will have larger portfolios of funds, in dollar terms, than many other investors and favour a diversified approach to investment in hedge funds. At the other end of the scale, family offices and endowment plans, among the most long-term and experienced investors in hedge funds, display a relatively smaller preference for CTAs.

New CTA Launches

Sixty-seven CTAs launched in 2015 (Fig. 13). Although this number is likely to grow as a result of more data becoming available, 2015 looks set for the fewest CTA launches since 2006. Similarly, CTAs' proportion of all hedge fund products incepted each year has decreased to its lowest level since 2003 at 8%.

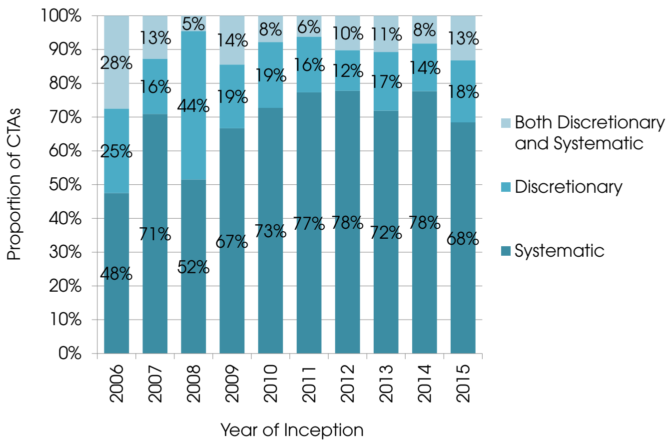
At the start of 2015, Preqin noted that demand for CTAs from investors would be relatively small in the year ahead. Our H1 2015 Investor Outlook, based on interviews with over 300 investors, showed that just 14% of CTA investors planned to increase their allocations over 2015, with 10% planning to decrease their exposure. However CTAs witnessed $25.4bn of inflows during 2015, with 52% of existing CTAs showing net inflows over the year, a greater proportion than hedge funds (41%). Investors' outlook for 2016 is more positive: 54% of CTA investors are seeking to increase their exposure to these funds over the year. Therefore we may see an increase in the number of CTAs coming into market in 2016 in order to meet this improved investor appetite.

Fig. 8: Net Returns of Leading CTA Strategies

Q1 2015	Q2 2015	Q3 2015	Q4 2015	Cumulative 2015	3-Year Annualized	3-Year Volatility
Macro 4.90%	Option Writing 1.47%	Pattern Recognition 0.97%	Counter Trend 1.49%	Option Writing 7.76%	Arbitrage 5.27%	Arbitrage 3.42%
Option Writing 4.87%	Arbitrage -0.20%	Trend Following 0.13%	Macro 1.35%	Macro 1.67%	Trend Following 4.83%	Pattern Recognition 3.97%
Trend Following 4.52%	Macro -3.44%	Option Writing 0.06%	Option Writing 1.20%	Counter Trend 0.84%	Macro 4.32%	Counter Trend 4.32%
Counter Trend 4.14%	Counter Trend -3.82%	Counter Trend -0.81%	Pattern Recognition 0.49%	Pattern Recognition -0.40%	Pattern Recognition 3.29%	Macro 4.33%
Pattern Recognition 2.41%	Pattern Recognition -4.14%	Macro -0.96%	Trend Following -0.43%	Arbitrage -1.07%	Counter Trend 3.24%	Trend Following 6.56%
Arbitrage 2.02%	Trend Following -5.68%	Arbitrage -1.68%	Arbitrage -1.17%	Trend Following -1.72%	Option Writing 1.93%	Option Writing 7.48%

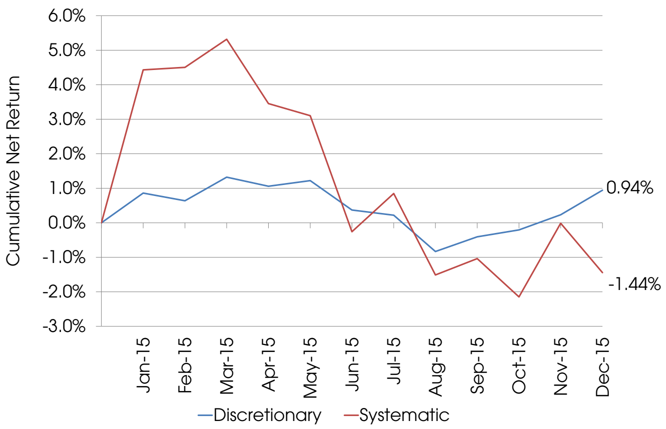
Source: Preqin Hedge Fund Analyst

Fig. 9: Trading Methodology Employed by CTAs by Year of Inception, 2006 - 2015



Source: Preqin Hedge Fund Analyst

Fig. 10: Cumulative Performance of Discretionary vs. Systematic CTAs, January 2015 - December 2015*



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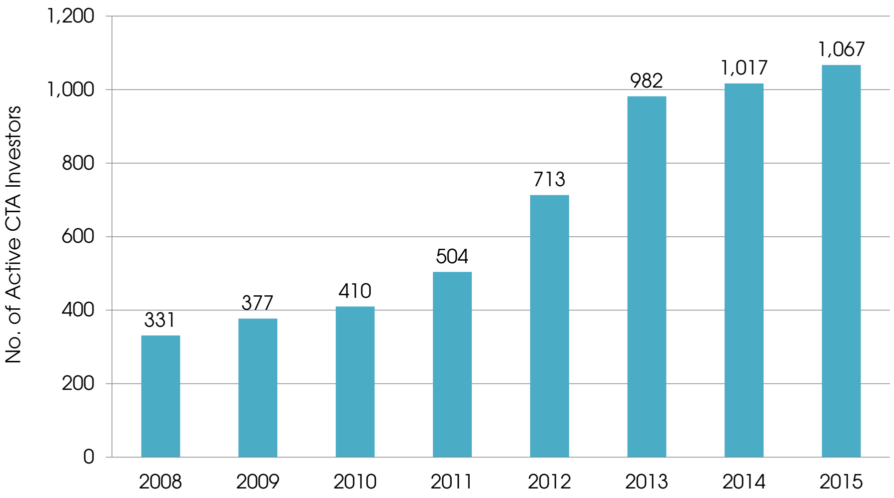
Outlook

Despite a strong start to 2015 for CTAs in Q1, commodity market conditions made return generation over much of the rest of the year difficult for fund managers. Oil production levels from US shale and OPEC operations drove the price of oil down to record lows. As the world's leading metal consumer, decreases in China's demand for 'early stage' metals has led to a drop in the prices of steel, iron ore and copper. US natural gas prices plunged to their lowest levels since April 2012 on the back of large reserves and a mild start to the 2015 winter reducing demand. Commodity market conditions have thus rippled through the corporate world, with oil giant BP's total third-quarter revenue dropping to $55.9bn in 2015 compared with $94.8bn the previous year. Furthermore, Glencore suffered one of the worst trading days in FTSE 100 history, as the firm's share price dropped 29% amid concerns regarding commodity prices and the uncertain path of future Chinese growth. These events have all impacted the performance of CTAs.

However, CTAs exist as a true alternative to traditional products, offering an effective hedge against difficult economic environments and market downturns.

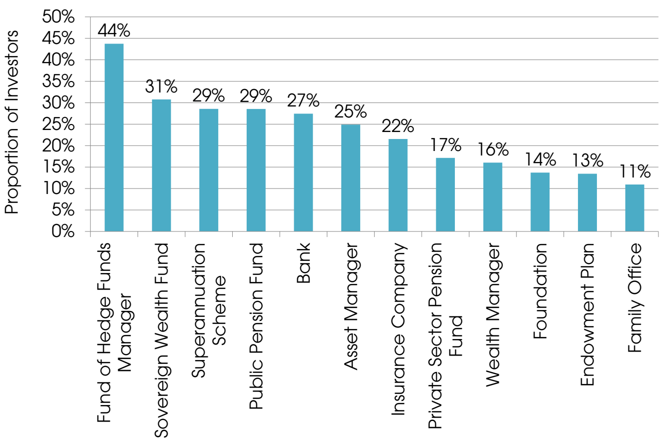
In 2015, we have seen relatively few new launches in the managed futures sector, as CTAs focus on existing products or fund managers on other strategies. The current market environment however may re-establish the value of CTAs as a non-correlated asset within diversified portfolios that can add downside protection for investors.

Fig. 11: Breakdown of Institutional Investors Actively Investing in CTA Funds, 2008 - 2015



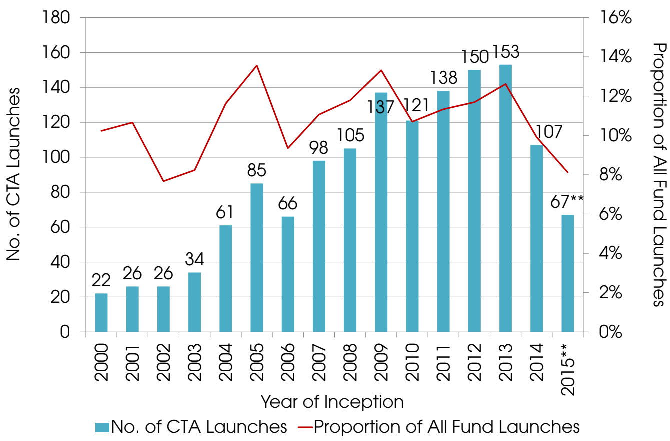
Source: Preqin Hedge Fund Investor Profiles

Fig. 12: Breakdown of Investors with a Preference for CTA Funds by Investor Type



Source: Preqin Hedge Fund Investor Profiles

Fig. 13: Breakdown of CTA Launches by Year of Inception and Proportion of All Fund Launches



Source: Preqin Hedge Fund Analyst

Fig. 14: Mean Liquidity, Fees and Investment Terms and Conditions for CTAs by Structure

Terms and Conditions	All CTAs	Commingled	Managed Accounts
Redemption Frequency (Days)	15	24	10
Redemption Notice (Days)	12	15	7
Minimum Investment ($mn)	1.3	0.7	2.1
Management Fee	1.60%	1.64%	1.57%
Performance Fee	20.80%	20.43%	21.10%

Source: Preqin Hedge Fund Analyst

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***The number of CTA fund launches is likely to increase as more data becomes available.*