Managed Futures: The Next Five Years

Campbell & Company

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For the past 5 years, the annualized performance of the S&P 500 Index has been +18.4% (through May 2014). If you believe that this level of performance from equities is likely to persist, there is little need for portfolio diversification. Looking back over a longer timeframe, however, suggests that the recent results may not be sustainable: over the last 20 years, the annualized return of the S&P was nearly half the 5-year value. A look at consecutive 5-year periods reveals an even greater disparity in results (see below).

The last 5 years were phenomenal for investors in equity indices.

Will the next 5 years offer the same opportunities?

Trailing 5-year periods:		S&P Return (annualized)
Jun-09	May-14	18.4%
Jun-04	May-09	-1.9%
Jun-99	May-04	-1.5%
Jun-94	May-99	25.9%

During raging bull markets, like the one we've been in since 2009, it can be difficult to maintain allocations to protective strategies. While put options, for example, were quite useful during periods like 2000-2002 and during the financial crisis of 2007-2009, the last 5 years would have been extremely punitive due to the steady erosion of value incurred by put options during sustained rallies. Investors who relied on Managed Futures to provide portfolio diversification fared much better: the Barclay CTA Index was approximately flat for the last 5 years, while the S&P surged 130%. Though Managed Futures is *not* a 'put' on the stock market, and will *not* profit during every single stock decline (see sidebar), the strategy has historically done well during bear markets due to its ability to go short equity indices and dynamically adjust positions to capture trends that may develop in other sectors.

Strategy Outlook

Comparing the performance of the CTA Index to that of a put option provides an interesting but limited perspective on recent strategy returns. The perspective is limited because, in addition to providing portfolio diversification, Managed Futures also seeks to provide attractive stand-alone risk-adjusted returns. From *that* perspective, the strategy has recently come up short.

Managed Futures Q&A: Reviewing the basics

What type of assets do managed futures funds invest in?

Funds typically invest in currencies, commodities, interest rates and equity indices, using futures and forwards to express long and short positions.

How does the strategy profit?

Underlying investment styles seek to capture a variety of market inefficiencies, most notably the tendency of markets to exhibit momentum. Other inefficiencies may be captured through investment styles such as mean reversion, carry, and relative value.

What type of environment is good/bad for managed futures?

The strategy tends to do well when markets are exhibiting strong directionality, whereas choppy markets with frequent trend reversals are more difficult.

Are the returns correlated to stocks and bonds?

Because of its diversified nature, the strategy tends to have little long-term correlation to traditional assets; it may be long a market while it is trending up, and short a market while it is trending down.

Why does that matter?

This leads to one of the unique features of Managed Futures - the potential to profit during sustained equity declines. Historically, the strategy has tended to thrive in bear markets, such as the 2000-2002 period and in 2008. However, at the beginning of corrections, momentum-based strategies may incur losses due to the swift change in market direction.

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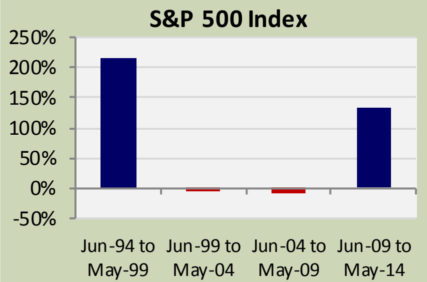
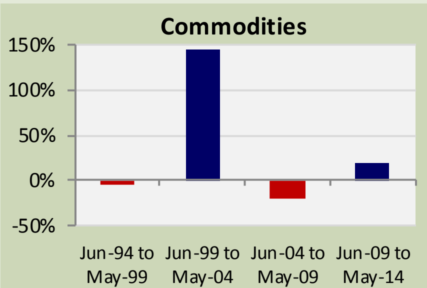
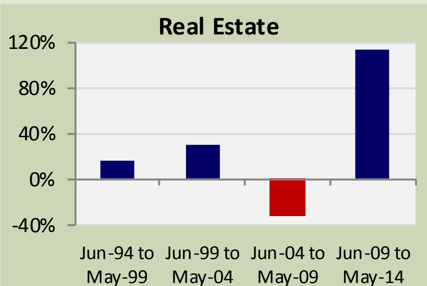
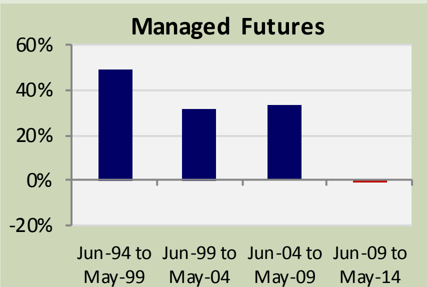
Total Return in Trailing 5-Year Periods









Equities, as well as diversifying investments like Commodities, Real Estate and Managed Futures, have all tended to exhibit cyclicality.

Commodities: S&P GSCI Total Return Index
Real Estate: Dow Jones US Real Estate Index
Managed Futures: Barclay CTA Index

There are several possible reasons why the environment has been difficult for the industry. The challenge in identifying these reasons stems from the fact that, unlike 'Long-Short Equity', which tends to have a consistent positive correlation to stocks, Managed Futures returns are not consistently correlated to any market or sector.

The dominant factor driving global market activity since the financial crisis has been the unwavering commitment by the Fed and other central banks to flood the system with liquidity. While it is difficult to determine causality, market conditions developing concurrently with the unprecedented level of interventionist policy include an increase in correlations across markets, an extreme decline in realized and implied volatility, and a marked uptick in headline-driven trend reversals. All of these effects may have contributed to the inhospitable environment for Managed Futures strategies. That being said, there have certainly been pockets of opportunities. In 2013, for example, the QE-driven surge in stocks provided an attractive target for trend-based strategies. Strong performance in the equity sector helped the Campbell Managed Futures Program more than 12% during 2013.

As tapering continues and monetary policy shifts back towards center, the environment for Managed Futures may improve, with more opportunities and fewer headwinds.

While many Managed Futures programs were profitable in the equity sector in 2013, overall industry returns were still negative: the Barclay CTA Index returned -1.4%. However, as tapering continues and monetary policy shifts back towards center, the environment for Managed Futures may improve, with more opportunities and fewer headwinds.

By some measures, the industry has already started to see a recovery, with gains for the CTA Index in 3 of the last 4 months (through May 2014). It will be interesting to see if this is the beginning of a broader shift in performance. As shown in the charts, it is not just the S&P 500 which has historically exhibited cyclicality. Diversifying investments like Commodities, Real Estate and Managed Futures have also shown the same cyclical tendencies, at least over the last few 5-year periods.

Cyclicality of Returns

	US Equity	Commod-ities	Real Estate	Mgd Futures
Jun-94 to May-99	+	-	+	+
Jun-99 to May-04	-	+	+	+
Jun-04 to May-09	-	-	-	+
Jun-09 to May-14	+	+	+	-
Jun-14 to May-19	?	?	?	?

In summary, the global diversification provided by Managed Futures may prove to be extremely valuable as we enter the next phase of the economic recovery. The next five years may look like the last five, in which US Equities, Real Estate and Commodities all performed extremely well, or perhaps they will look like the prior five years, when all three strategies incurred significant losses, and Managed Futures strategies performed well. Regardless, at Campbell we believe in the ability of our portfolio to provide our investors with both attractive risk-adjusted returns and portfolio diversification. We are looking forward to the next few years.

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Balance

Discipline

Innovation

Evolution

Systematic

Simplicity

Intuition

Multi-Disciplinary

Cutting-Edge

Team

CAMPBELL

The Campbell Schematic:

Our approach to strategy and portfolio architecture is the result of more than 40 years of research, innovation and experience. The following principles serve as the foundation for our investment process:

***Employ a balanced approach*:** A balanced portfolio tends to lead to a more balanced return profile and limit the impact of tail events. At Campbell, the portfolio construction process is designed to provide a balanced exposure across a number of dimensions, including investment style, strategy type, sector, geography and time horizon.

Evolve and innovate: One of the most valuable insights gained from our extensive experience in investment management is that evolution is a critical component of success. We have experienced firsthand extreme environments like the ’87 market crash, the dot-com bubble and the financial crisis, and in each case have incorporated lessons learned. We continually seek out innovative ways to refine our approach.

Adhere to a disciplined systematic approach: Using quantitative methods, we have developed a robust, diversified portfolio of rules-based strategies, expressed through a multi-tiered portfolio construction process. Our systematic approach helps eliminate the emotional component from investing, which can often lead to suboptimal outcomes.

Embrace simplicity and intuition: Each of our trading systems is rooted in an intuitive investment hypothesis. Rather than blindly mining the data, we seek to identify strategies which make economic sense, which can then be tested using a range of statistical methodologies. Throughout the strategy development process, we seek to minimize the risk of data-fitting by avoiding complexity; all else equal, simple is better.

Leverage a multi-disciplinary team: Our diverse group of researchers, which includes PhDs in Physics, Economics, Applied Mathematics and many other fields, brings unique and complimentary insights to strategy development. We aim to provide a stimulating, collaborative environment, encourage intellectual freedom and maintain a cutting-edge technological infrastructure to support the research process. All of these factors have contributed to very low turnover among key investment professionals, whose average tenure with Campbell is more than 9 years.

Our approach to strategy and portfolio architecture is the result of more than 40 years of research, innovation and experience.

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Campbell Managed Futures Program: Performance shown for this Program is actual performance of one representative institutional managed futures account, net of all fees and expenses, including a 1.5% (2% prior to May 2013) management fee, a 20% quarterly performance fee, trading costs of approximately 0.80% annually, offering expenses not to exceed 0.50% per annum, combined cash manager and custodian costs of approximately 0.06% per annum, and operating expenses not to exceed 0.50% per annum. The representative account began trading in February 1998. There can be no assurance that Campbell & Company or the Campbell Managed Futures Program will make any profits at all, or will be able to avoid incurring substantial losses.

This does not constitute an offer or solicitation. Investments in managed futures may be offered by disclosure document delivery only, which includes additional information on risks, charges and liquidity. Managed futures employ leverage; they are speculative investments that are subject to a significant amount of market risk and they are not appropriate for all investors. Although adding managed futures to a portfolio may provide diversification, managed futures are not a perfect hedging mechanism; there is not guarantee that managed futures will appreciate during any market condition.

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