FIDES + RATIO LLC

Uncorrelated Strategies As We Exit COVID-19

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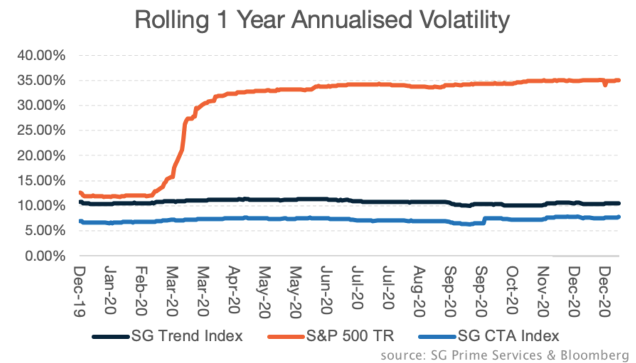
Around this time last year, we talked about managed future's low correlation to equities and its positive crisis alpha. In 2020, as in 2008, managed futures again proved to be an uncorrelated and strong-performing diversifier in a challenging period. In fact, daily correlation to the S&P in 2020 was almost nonexistent (0.04 for SG CTA and -0.07 for SG Trend).

	SG CTA Index	SG Trend Index	SPX
Q1 2020	-0.54%	2.29%	-19.60%
Q2 2020	-2.15%	-3.07%	20.54%
Q3 2020	-0.70%	-1.20%	8.93%
Q4 2020	6.76%	8.48%	12.15%
2020	3.16%	6.28%	18.40%

This low correlation was important at the heart of the COVID crisis, and the SG CTA and the SG Trend Indices were in positive territory (at +0.16% and +1.87% respectively) when the S&P was at its lowest in the whole year in March 2020 (-9.48%).

But the bulk of the performance came in Q4 2020, when the SG CTA Index ended the year with its best monthly return in more than five years at +5.46% in December. Trend-following strategies led the pack and the SG Trend Index had a +6.42% gain that month as well.

These performances come in the context of high volatility in the equities market. Even though the three indices' volatilities were stable before the COVID Crisis, the SPX's volatility picked up from 12% in end of February 2020 to more than 30% in April. It remained at that level for the rest of the year, while both the SG CTA and SG Trend indices' volatilities remained at their usual levels (around 7% and 12% respectively) during the whole year.



	SG Trend Volatility	SPX Volatility
Q1 2020	10.69%	16.79%
Q2 2020	11.23%	33.08%
Q3 2020	10.64%	34.04%
Q4 2020	10.32%	34.77%
Q1 2021	10.52%	27.03%

With this in mind, and for argument's sake, we can adjust the SG Trend's volatility to the SPX's. Based on the previous quarter's numbers, we apply the SPX's volatility to the SG Trend's performance and divide it by the SG Trend's volatility. We get the following returns for 2020:

	SG Trend Index (Volatility Adjusted)	SPX
Q1 2020	2.29%	-19.60%
Q2 2020	-4.82%	20.54%
Q3 2020	-3.52%	8.93%
Q4 2020	27.14%	12.15%
Q1 2021	13.39%	6.17%

Thus, taking into account an adjusted volatility, in Q4 2020 investors could have made 27.14% in managed futures vs 12.15% by holding the S&P. However, in 2021 the SPX's volatility is slowly returning to pre-crisis levels.

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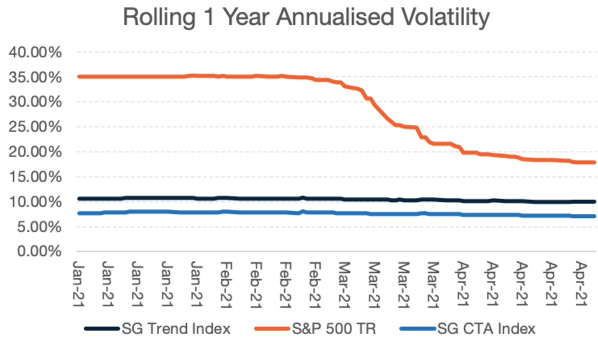

Nevertheless, so far 2021 appears to be another good environment for managed futures:

	SG CTA Index	SG Trend Index	SPX
YTD 2021	5.95%	3.97%	6.17%

Here again, in Q1 2021 the SG Trend performance is hitting 13.39% if we adjust it to the high level of volatility in the equities market.

Strong trends in commodities

In 2020, strong trends in commodities across agricultural and energy markets contributed to the performance of trend-following strategies. We can use the extreme case of lumber to illustrate this, even though it is a commodity not often traded by managed futures managers.

From March to December 2020, the price of lumber went from $296 to $840. There was an unexpected increase in demand for housing construction for which the supply was underprepared due to (amongst other reasons) the wet weather in the Southeast US. On May 7th 2021, it quotes at $1,671 (a +383% increase YoY).

Similarly, Brent rose +254% in less than a year, from $20 in end of April 2020 to $70 in May 2021. The COVID crisis caused extreme events in commodities: As global demand collapsed and storage capacity filled, the front month US oil contract printed -$38/bbl a barrel in April 2020!

A new interest rate environment …

As we mentioned in our last paper, many investors had started challenging managed futures dependence on interest rates in the US before the crisis. Now that returns are picking up and rates are rising, the debate on managed futures' ability to perform in a rising rate environment will resume for investors and managers.

The already decreasing US10Y reached an all-time low in 2020, and the US30Y did the same but both are starting to pick up.

Opinions diverge between the managers who believe that managed futures cannot perform in a rising-rate environment, and those making the case that they can profit from the other trends resulting from rising rates. We believe that interest rates are not a black and white indicator for managed futures.

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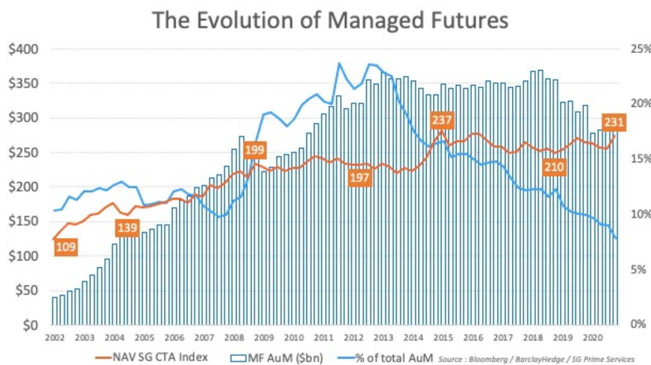
Since rising rates often signal strong economic conditions, this could be a good news for trend-following strategies. It could also mean that it is time to act bullish on commodities, often used as a way to diversify and serve as a hedge against the return of inflation.

AuM that should start picking up

If we look at the COVID crisis, AuM went from \$318bn in 2019 to \$302bn in 2020[1]. In comparison, during the 2008 financial crisis investors withdrew their assets from managed futures from a peak of \$274bn in Q2 to \$222bn in Q1 2009 (an 18% decrease). The recovery in AuM peaked at \$370bn in Q2 2018 and has constantly been decreasing ever since due to performance.



Q1 2020, investors made the biggest withdrawal since 2002 : -\$40bn, bottoming at \$323bn (a -13% drop from the previous quarter). The COVID crisis intensified the already-existing ambivalence towards managed futures.

In our previous paper, we had mentioned that managed futures peaked in terms of "market share" 2013, representing 20% of hedge fund assets. In 2020, it accounted for 10% of total assets under management and 7.9% in Q4 2020 (lowest point since 2002).

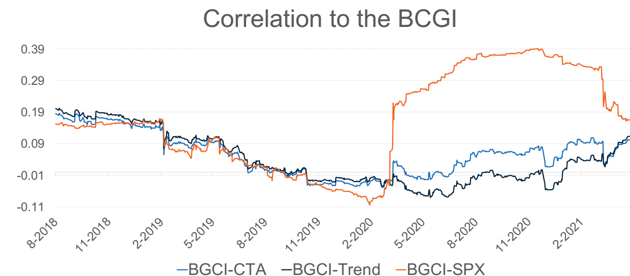
Moving on to new opportunities…

Recently and after ten years of underperformance, investor interest in managed futures (macro, systematic and commodities) is making a slow but steady comeback.

We are also witnessing a real reflection on ESG topics since 24% of overall flows into U.S. stock and bond funds were attributed to sustainable funds in 2020[2]. The role managed futures will play in matters of ESG is still unclear. It has now become certain that regulations like the SFDR in Europe will accompany this newfound interest, but we are still unsure as to how it will suit futures and commodity markets. These products are more complex than government bonds or securities, and the ESG rating of futures markets can be very subjective.

With the HFRI Macro Discretionary Thematic Index up +13.9% in 2020 and +3.8% YTD2021, we will also take a closer look at discretionary macro strategies that have recently been trending.

We wonder if in the recent past, family offices investors did not diversify their portfolio with cryptocurrencies as an alternative to managed futures. It offered uncorrelated returns coupled with volatility. However, correlation characteristics did not hold true during the COVID crisis. The correlation of the BGCI to the S&P picked up mid-March 2020, and the rolling 12 months correlation went as high as 0.39 at the end of November. The BGCI's correlation to the SG CTA and SG Trend Indices remains low.



[1] Barclayhedge : CTA AuM

[2] A Broken Record: Flows for U.S. Sustainable Funds Again Reach New Heights

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As an aside, we are not quite sure how the astonishing carbon footprint of cryptocurrencies squares with increasing interest in ESG.

As cryptocurrencies become more and more correlated to the equity market, it might not be a viable way to diversify in the long run. Managed Futures, however, still do not seem to follow the equity market and remain an efficient way to diversify.

Conclusion

2020 was a challenging year for everyone. Back in Q1-Q2 nobody knew where the world was going and not everyone was predicting an equity rebound.

Once again, managed futures proved to be a resilient asset class that every institution should have in their portfolio.

When it came to manager selection, dispersion of returns showed that not all managers are the same: fees and/or asset size as the only criteria are far from assuring a good investment.

We anticipate that the current market dynamics will provide a fertile ground for managers to perform. And the continued positive performance will attract more assets into the strategy

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