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The case for managed futures in an investment portfolio

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At DBi, we are convinced that managed futures is the single most valuable diversifier investors can add to a portfolio of stocks and bonds. We believe it provides more bang-for-your-buck than many other widely used alternatives, such as private equity, private credit, REITS and commodities.

Since 2000, managed futures – as measured by the SG CTA Index[1], which in our view is the best source of long-term data on the space – have demonstrated 1) strong relative returns, 2) a low-to-negative correlation to equities and bonds, and 3) an ability to deliver positive returns during periods of market stress.

This diversification benefit became evident during the challenging market conditions of 2022, when stocks and bonds were moving in tandem: a 10% allocation to managed futures in 2022 would have cut losses in a global 60/40 portfolio[2] by more than a fifth over the calendar year.

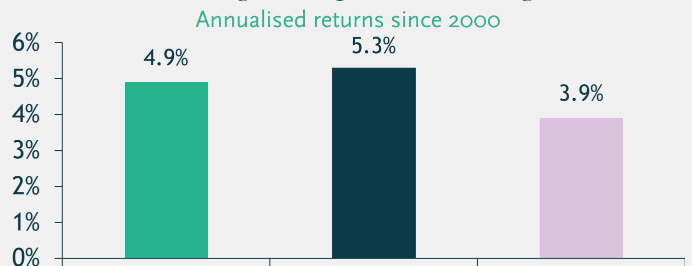
It is important to pay attention to the allocation in a portfolio, of course. Some investors have expressed nervousness about these strategies or have had issues with hedge funds in general in the past, but we believe that times have changed. The managed futures mutual funds and ETFs of today are far better than they were a decade ago.

Nevertheless, there still are a few major pitfalls that can trip investors up. This paper is a starting point to support our clients in building a durable strategy to invest in managed futures while avoiding as many of the drawbacks as possible.

Diversification benefits of managed futures

92% the return of global equities, 125% of global bonds

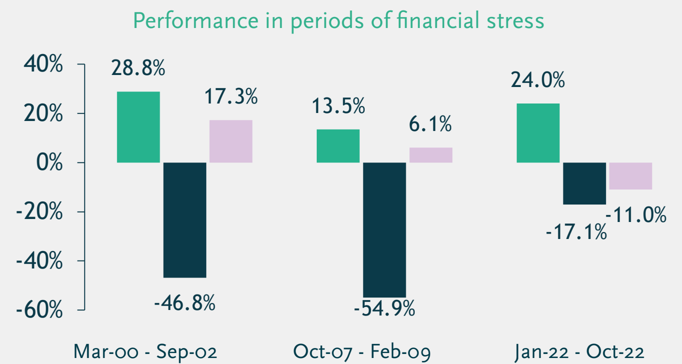
Annualised returns since 2000



Source: iM Global Partner, eVestment. Annualised index returns in USD terms of SG CTA Index, MSCI ACWI Index, and the Bloomberg Global Aggregate Index from 31/12/1999 to 30/04/2024.

Gains during the dotcom, global financial crisis and 2022 market downturn

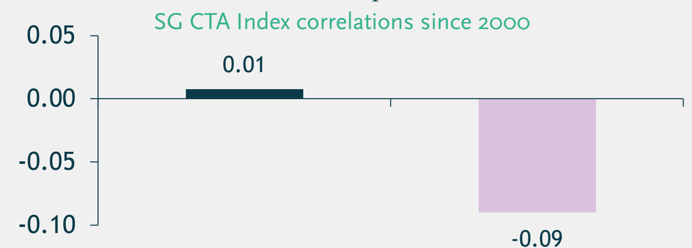
Performance in periods of financial stress



Source: iM Global Partner, eVestment. Chart shows returns of SG CTA Index, MSCI ACWI Index, Bloomberg Global Aggregate Index in USD terms during select periods of market stress.

Low correlation to equities and bonds

SG CTA Index correlations since 2000



Source: iM Global Partner, eVestment. Correlation of SG CTA Index vs global equities as measured by an index managed by MSCI, and Bloomberg Global Aggregate Index between 31/12/1999 and 30/04/2024.

1.The SG CTA Index is designed to track the largest 20 (by AUM) CTAs and be representative of the managed futures space. The index is not representative of the entire population of CTAs or hedge funds. The index's performance may not be indicative of any individual CTAs or hedge funds and the index may not have been adjusted for fees/commissions. The index cannot be traded by individual investors. The actual rates of return experienced by investors may be significantly different and more volatile than those of the index.
2.The calculation assumes a portfolio with 60% invested in the MSCI ACWI Index and 40% invested in the Bloomberg Global Aggregate Bond Index.

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1.

Straightforward access to the hedge fund space

Managed futures is an investment strategy that looks for trends in dozens, or hundreds, of assets that can be accessed through futures contracts such as crude oil, bonds, equities and currencies. A futures contract is a financial derivative that makes it possible for investors to hold long or short positions in specific asset classes, as opposed to buying and holding something like a stock or bond, or even gold.

In other words, if crude oil is rising (or falling), a hedge fund manager might go long (or short) with a futures contract and bet that this trend will continue. Hedge fund managers use quant models to study past prices to decide what to buy and sell, and then diversify across commodities, rates, equities and currencies. As markets and prices shift, these managers tactically move around and change their exposures to the asset classes. This is where the 'managed' in managed futures comes from – and it is an extremely liquid and efficient way to bet on these price moves.

In essence, managed futures funds are simply taking advantage of market waves. The best time to do this is when significant market movements cause extreme volatility, like we saw in 2022; other times markets are choppy and they bounce around but don't make much forward progress.

The good news is that there are always waves and managed futures funds are designed to take advantage of these opportunities.

Trend-following strategies like managed futures have the ability to generate alpha because most investors are trained to think markets revert and then buy the dip. Like Warren Buffett's trope about cutting flowers and watering weeds, we often sell winners too soon and hold losing positions too long. In 2022, most managed futures funds detected the signs of inflation early, repositioned portfolios quickly and rode the wave.

That kind of alpha generation, we believe, is not going away any time soon. You can think of managed futures as outsourcing a portion of your portfolio to a tactical strategy that might find trades that many investors may not be able to do on their own.

2. Diversification that reduces single-manager risk

One of the advantages of managed futures strategies is the diversification benefits they can provide to investors. While on the surface the idea of investing in a "quantitative, long and short, leveraged derivatives-based strategy" may seem complex and prone to blow-ups, the reality is the opposite.

Since 2000, the SG CTA Index has had volatility of just under 9%, compared to around 16% for global equities and just over 3% for global bonds.[3] Over the same time period, the maximum drawdown is -14.3%, less than a third of equities and roughly similar to bonds, as the chart on the right shows.

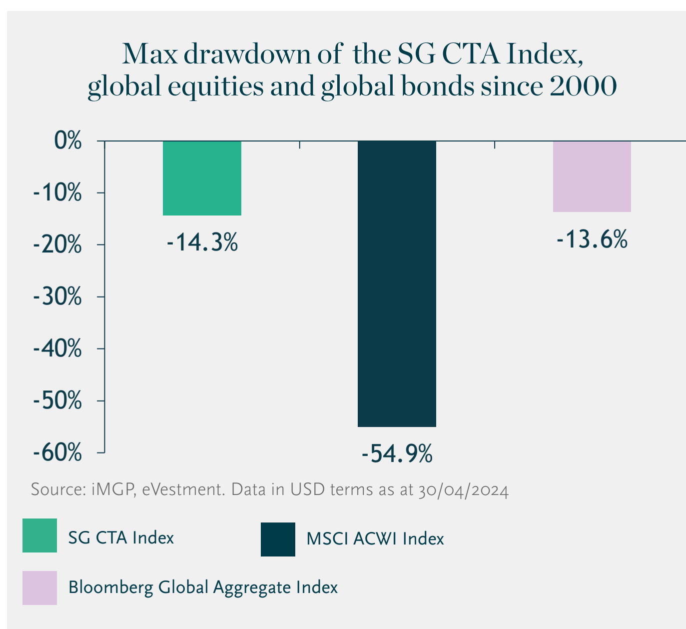
This is the product of managers diversifying across markets and size positions prudently. Their models also ruthlessly cut losing positions to avoid a white-knuckle ride, which some fundamental investors can go through. In addition, futures contracts are highly liquid, so funds can exit positions when they need to.

By replicating a selection of leading CTAs in a single fund, the DBi Managed Futures strategy is not only reducing risk by way of diversification, but also it also helps to mitigate one of the biggest risks of investing in hedge funds: manager selection and single-manager risk. One of the major pitfalls of selecting hedge funds is the possibility of choosing the one that underperforms the market by a wide margin. By replicating a group of them, these risks are minimised.

For example, in 2022 the managed futures asset class as a whole went up by 20%, but around a fifth of mutual funds and ETFs in this sector actually lost money, according to Bloomberg data.[4] In the 2010s, the most popular single-manager fund underperformed the index by 20% over five years.

The reality of this industry is that recent star managers are no more likely to outperform the market than other managers, and are just as likely to end up near the bottom of the pack at some point. Many battle-hardened investment veterans have figured this out and today pick two to four single managers for their allocations. This requires more effort to monitor, but it helps to mitigate single-manager risk.

For those who want a single-line item to fill the strategy bucket – in essence, outsource single manager diversification – this can be achieved by investing in a multi-manager fund or through replication.



3. Source: iM Global Partner, eVestment as of 30/04/2024. Data in USD terms.
4. Source: Bloomberg, 31 December 2022. Performance of constituents of the Morningstar US Systematic Trend index.

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3.
Low correlations and a long-term performance track record

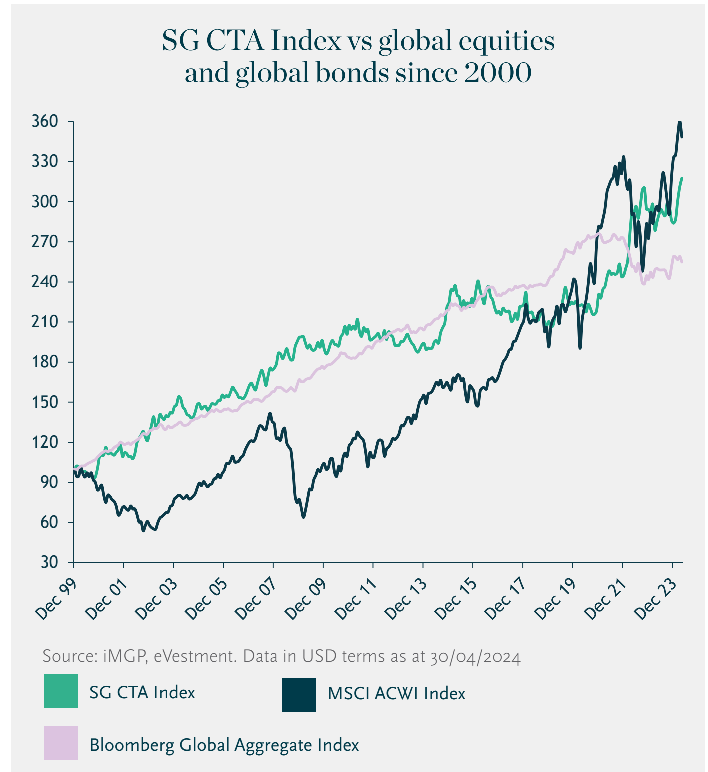
Many people first learned of managed futures during the so-called long winter of 2015-20, when a combination of the Fed put and near-zero interest rates resulted in low returns. But when you zoom out and look at performance from the past 20 years or so, the long winter doesn't look so long.

Since 2000, the managed futures asset class, as represented by the SG CTA Index, has offset equity risk during all three prolonged bear markets and managed to keep up with fixed income during most of the great bond bull market – only to flip to an inflation play and make money from the recent rise in yields.

It is our core belief that one of the best ways to deliver higher returns to investors is to keep fees and costs as low as possible. It may be true that few investors care about fees in good years and fees often seem secondary when evaluating a fund on a hot streak, but as a long-term allocator, they can matter a great deal. In particular, it's the tough years when people start asking questions. In choppy seas, managed futures might deliver 3-5% per annum over cash, but no better than cash after fees and expenses.

That was a huge problem during the late 2010s, when cash was earning roughly zero and, hence, clients made zero. Mutual funds generally have higher management fees than the hedge funds represented in the SG CTA Index, but no performance fees; ETFs tend to be less expensive. There's no perfect answer here. Some of the better performing mutual funds in 2022 had high fees, as did some of the worst. Lower fees in some products were cold comfort after years of persistent underperformance.

We think the fee question plays out in a few ways. First, lower fees can matter a great deal when investors are judged in part on the all-in cost of investing. Second, investors may be more patient during those inevitable lower return periods, it just grates on people when it looks like everyone is making money but them. Finally, all things being equal, capital grows more over time.



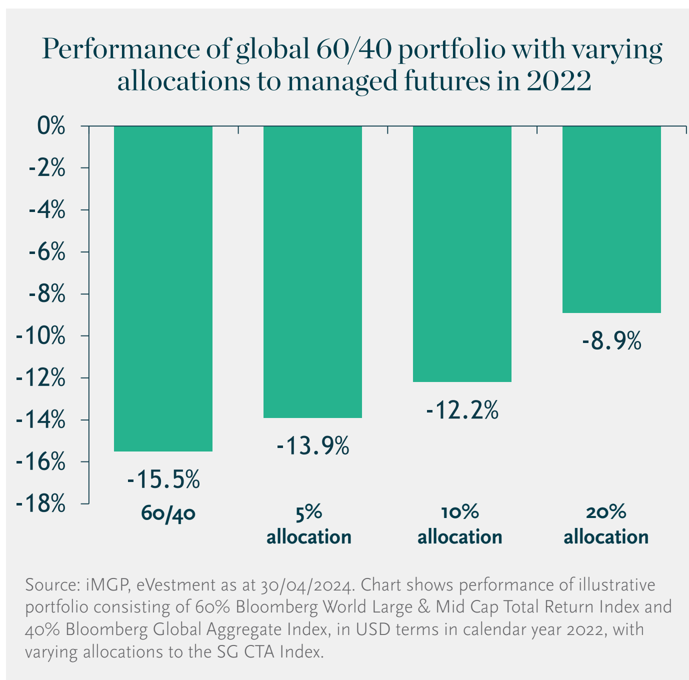
Source: iMGP, eVestment. Data in USD terms as at 30/04/2024

4.

Managed futures can help to mitigate losses

The chart below shows the impact on drawdowns in a global 60/40 portfolio consisting of the MSCI World Index and Bloomberg Global Aggregate Index in 2022, a year when both equities and bonds both had a torrid time.

iM Global Partner's research found that adding a 5% allocation to managed futures would have reduced drawdowns by more than 20%, while a 20% allocation would have reduced drawdowns by more than 40%. The ideal allocation for any given portfolio will of course depend on a number of factors and variables, including current holdings, investment time horizon and attitude to risk.



Source: iMGP, eVestment as at 30/04/2024. Chart shows performance of illustrative portfolio consisting of 60% Bloomberg World Large & Mid Cap Total Return Index and 40% Bloomberg Global Aggregate Index, in USD terms in calendar year 2022, with varying allocations to the SG CTA Index.

5.

And finally...

In 2022 the volatility that we witnessed left few areas of the market unscathed and made many investors feel exposed. Managed futures proved to be one of the few bright spots, offering positive returns that bucked the broad market trend. Between January and October 2022, global equites were down 17.1% and global bonds fell by 11%, while managed futures registered a 24% gain.

This behaviour was not a one-off occurrence. During the downturn that came after the dotcom bubble burst in 2000, managed futures went up by 28.8% between March 2000 and September 2002, while global equities fell by 46.8%. A few years later, immediately before and during the height of the global financial crisis, global equities dropped 54.9% between October 2007 and March 2009, and managed futures increased by 24%.

Indeed, over the long term, managed futures as an asset class have delivered steady returns, capturing most of the upward movement of markets during good years, and mitigating the downside in bad years. As these strategies become more accessible to a wider group of investors, managed futures can be increasingly viewed as a potential diversifier in a portfolio, offering low correlation to equities and bonds. ■

How to access managed futures as an investor

While the options for investing in managed futures are increasing, there are still some limitations. If the SG CTA Index were available as a mutual fund or ETF, investing in these strategies would be significantly easier.

The fact is that the index just represents the average performance of 20 leading managed futures hedge funds – and you can't invest in it. Of course, an institution could invest directly in half a dozen constituents of the index to approximate it, but it's not easy to do.

Given accreditation and other issues with hedge funds, most investors today are likely to gain exposure via mutual funds or ETFs, which offer much more attractive options than a decade ago. That said, the pickings are still relatively slim compared to the hedge fund world.

Most investors, in practice, can choose from four strategies:

- Single Manager
- 2-4 Single Managers
- Multi-Manager
- Replication.

To build a durable long-term strategy to invest in the space, we believe that the primary goal of fund selection should be to reliably match or outperform the index. During the 2010s, many early adopters chose the single-manager path and selected funds they believed would accomplish this. However, this approach can be too risky, which is why DBi developed a strategy that aims to provide exposure to this asset class through a vehicle that offers transparency, simplicity, daily liquidity and low fees.

	Single Manager	2-4 Single Managers	Multi-Manager	Replication
Mutual funds/ETFs	Both	Both, but few ETFs	Mutual Fund only	ETF/UCITS only
Pros	• Single line item • Brand names • Always a few good options to choose from • Fees (usually) lower	• Same as Single Manager, but • More diversifed/ • predictable	• Single line item • Brand names • More diversified/ predictable • Tendency to • match index	• Single line item • Potentially more diversified/ predictable • Designed as • "index-plus" • Can be less expensive
Cons	• Extreme dispersion • Recent outperformance often luck, not skill • Difficult as • long-term hold	• Cluttered bucket • Difficult to track/ explain multiple funds	• Expensive • Unlikely to outperform	• Can seem too simple

Source: DBi, iM Global Partner

About the author

Andrew Beer has more than 25 years of experience in the hedge fund industry. Over the past decade he has focused on identifying strategies to outperform leading hedge fund portfolios with low fees, daily liquidity and fewer downside risks.

Andrew is Managing Member of DBi, a pioneering firm specialised in hedge fund replication, and co-manager of the firm's strategies.

Contact us

DBi manages a range of liquid alternative strategies. iM Global Partner's managed futures strategy is available as an ETF.

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