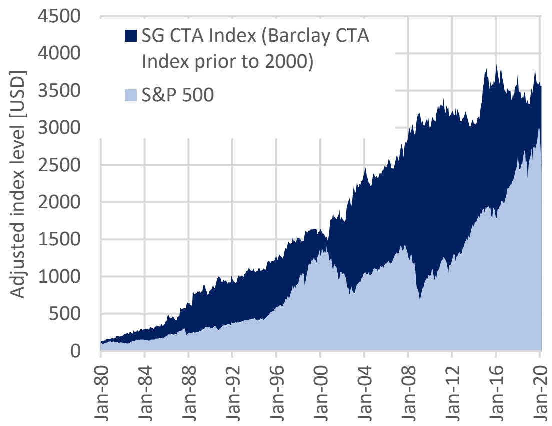
CTAs – A continuing success story

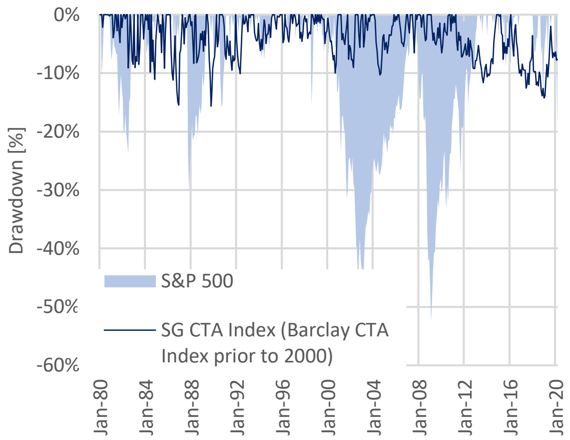
The CTA value proposition

The long-term value proposition of Commodity Trading Advisors (CTAs) includes capital preservation, portfolio diversification, and capital appreciation. CTAs may benefit from raising and falling markets by trading long and short positions. The typically uncorrelated returns with other asset classes offer portfolio diversification to existing investment portfolios. Most CTAs use a systematic investment process, which helps to reduce behavioural bias and operational risk. The investment process is repeatable and strategy development uses long data histories for testing. This creates greater investment confidence.

CTAs have shown profitability over an entire business cycle

This graph shows the continuing success story of CTAs. It shows how CTAs in aggregate are generating long term positive returns and offer capital preservation during significant market down turns. Barclay Hedge started tracking manager's performance since the early 1980s and created the first CTA benchmark index. Today, the SG CTA Index is the most popular benchmark index to track the performance of the CTA and managed futures industry[1].





Long-term performance and drawdown analysis of the SG CTA Index (Barclay CTA Index prior to 2000) and the S&P 500, starting with $100 on 31 December 1979. NOTE: Past performance is not necessarily indicative of futures results. The risk of loss in commodity interest trading can be substantial. Source: Barclay Hedge, Societe Generale, ICE Data, J8 Capital Management LLP.

How do CTAs work?

Our research[2, 3] suggests that the typical risk-weighted CTA portfolio consists of 35% exposure to government bond markets, 30% to commodity markets, 20% to currency markets, and 15% to equity

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[1] Both, the Barclay CTA Index and the SG CTA Index are not representative of the entire population of CTAs or any particular CTA, they may not have been adjusted for fees/commissions, they cannot be traded by individual investors, and actual rates of return experienced by investors may be significantly different and more volatile than those of the index.

[2] Sachs, T., Tiong R., "A liquid and investible Benchmark Index for the Commodity Trading Advisor and Managed Futures industry", Journal of Index Investing, Institutional Investor Journals, Spring 2016, Vol. 6, No. 4, 99. 30-70.

[3] Chen, H., Sachs, T., Tiong R. "Common Denominators in the Commodity Trading Advisor and Managed Futures Industry". Journal of Index Investing, Institutional Investor Journals, Winter 2014, Volume 5, Number 3, pp. 46-58.

markets. Most CTAs hold long and short position based on momentum or trend following signals. The overall risk exposure is often managed to a target volatility.

Managed risk

Unlike many hedge funds or discretionarily managed investment strategies, most CTAs use a systematic and rule-based investment process. CTAs typically do not target a specific return but target a long-term consistent risk profile instead. Most CTAs use target volatility mechanisms that reduce market exposure during volatile markets and increase exposure during less volatile markets. Also, most CTAs allocate less to risky and more to less risky markets within a risk weighted asset allocation.

The drawdown analysis above shows that the systematic investment and risk management process of CTAs can provide greater certainty during uncertain times.

Portable alpha

Most CTAs trade unfunded futures and options which only require margin funding. This makes CTAs a prime candidate for unfunded portfolio overlays to manage the overall risk of investment portfolios. They provide portable alpha and offer an efficient tool in portfolio management. Notional funding arrangements allow for capital efficient implementation of CTA strategies without locking-up capital that otherwise is not needed for trading the strategy and can be deployed elsewhere.

Covid-19

Data from Prequin[4] shows that during the first quarter of 2020, CTAs were the only hedge fund strategy with positive returns (+2.15%), while all other hedge fund strategies were negative with the S&P 500 PR Index down -20%.

This short yet violent episode shows that the CTA value proposition holds. CTAs continue to help preserve capital during these unprecedented times. With increased market uncertainty, systemic price adjustments, and novel trends in the markets, the CTA success story continues into a new era.

About the author

Dr. Tillmann Sachs is the Chief Investment Officer and Head of Research of J8 Capital Management LLP. Prior to establishing J8 in 2012, Tillmann originated structured derivatives solutions and focused on customized rule-based trading strategies with Barclays Capital, UBS, and AIG.

Tillmann earned a Ph.D. in applying artificial intelligence to risk quantification from Nanyang Technological University in Singapore, a Dipl.-Ing. in Civil Engineering from RWTH Aachen in Germany, and a M.S. in Construction Management from Hanyang University in South Korea.

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[4] Prequin Insights: "How Hedge Funds Are Performing in the COVID-19 Environment", by Christopher Beales, 21 April 2020. Click here for the link to the report.