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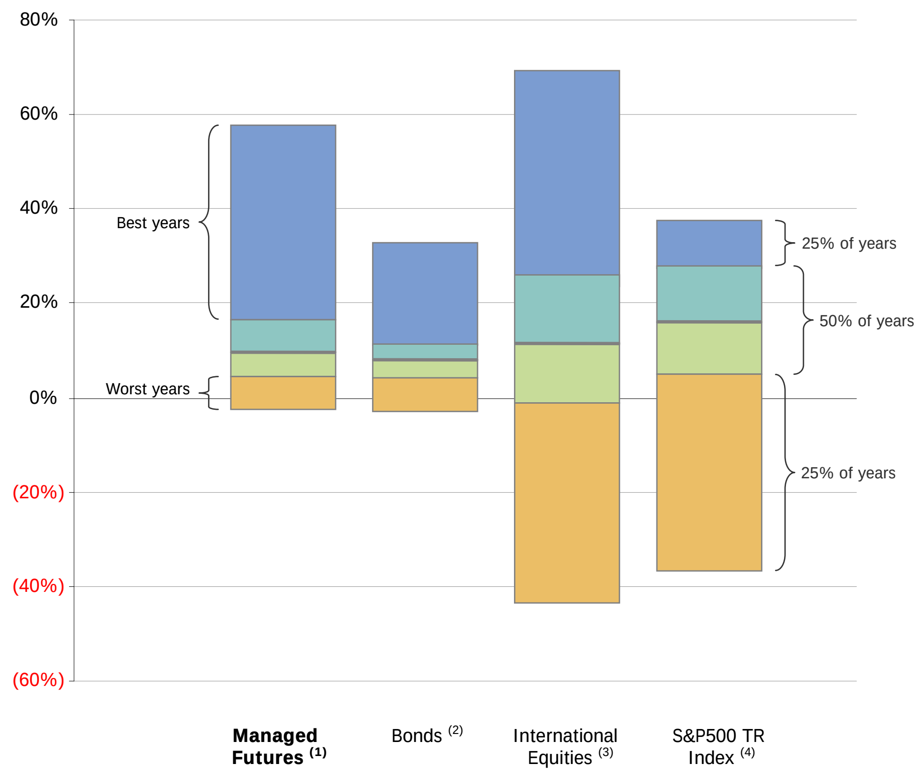
Managed Futures: A New View

Managed futures is one of the oldest and most established alternative investments, yet many investors are unfamiliar with the strategy's performance traits. A fresh look at the strategy's past performance in the chart below reveals its tendency toward controlled downside risk, with an asymmetric tendency toward upside performance. This paper will examine these past performance tendencies, describe why the strategy is able to perform in this fashion, and explain how the strategy is best incorporated into investors' portfolios.

The following chart plots the quartile ranges of all calendar year returns for each investment between 1980 to 2009, representing a total of 30 data points per strategy.

As the chart reveals, managed futures' historical performance reflects an absolute return profile, exhibiting bond-like downside control with equity-like upside potential.

Dispersion of All Calendar Year Returns
Over the Last 30 Years (1980 to 2009)



Past performance is not necessarily indicative of future results.

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A 30-Year History of Absolute Return Performance Traits

Managed futures has historically returned 4-16% per annum during half of all calendar years studied, sustaining small losses in only 2 out of the last 30 years. In addition, managed futures also generated returns that rivaled the magnitude of equities during some of the strongest bull market periods. Even more importantly for investors than the magnitude of these gains, however, is when they occurred. Some of managed futures' highest gains occurred when broad market prices were moving sharply downward, as was the case in 2008 when the S&P 500 Total Return Index lost -37% and managed futures gained +22%. While past performance is not necessarily indicative of future results, managed futures' historical tendencies would suggest that it warrants consideration as a true absolute return investment strategy.

How Is This Possible? Fewer Constraints Leads to More Investment Opportunities

Managed futures' performance is attributable to the fact that its practitioners are among the least constrained investors in the world, enabling them to tap into a broader array of return drivers under a wider variety of economic conditions. For example, the breadth of the global futures and foreign exchange markets allows managers to trade all four investable asset classes: global equity indices, commodities, interest rates and all of the world's major currencies. They can invest for durations ranging from minutes to many months, using a variety of strategies such as price momentum and fundamental arbitrage. Moreover, these managers' ability to invest either long or short allows them to take an agnostic approach to the markets, methodically repositioning their portfolios to try to profit during rising or falling economic conditions alike.

A Tactical Investment? No, a Core Buy-And-Hold Investment

Investors are sometimes perplexed when assessing managed futures' place within a diversified portfolio. For example, investors sometimes presume managed futures is a tactical strategy that must be properly timed. However, over reasonable investment horizons there is neither a "good" nor a "bad" time for managed futures, and so a buy-and-hold approach is both the simplest and the most appropriate.

The buy-and-hold approach works best because managed futures' strongest performance is often the result of unanticipated shock events, events preceded by few clues, if any. Downside timing is equally difficult to predict, but more importantly, the risk of sizeable losses is generally low and so downside risk is less concerning. For example, over the last three decades a weak year for managed futures was flat to slightlynegative. By comparison, the S&P 500 Total Return Index lost -10% or more one out of every ten years on average since 1980, which suggests that the stock market, not managed futures, demands significant tactical investment acumen due to its well-established tendency for large episodic downside shocks.

Index data obtained from Bloomberg and Morningstar.

[1] "Managed Futures" is represented by Morningstar's CASAM CISDM CTA Asset Weighted Index.

[2] "Bonds" is represented by the Barclays Aggregate Bond Index.

[3] "International Equities" is represented by the MSCI EAFE Index.

[4] "S&P500 TR Index" stands for the S&P 500 Total Return Index.

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