Abbey Capital

# Three reasons to consider Managed Futures in 2021

June 2021

## Quick-read analysis

5 minutes

# What's included?

This quick-read analysis explores three reasons to consider managed futures in 2021.

**It covers:**

## 1. Stronger trends in commodities

## 2. The rising risk of higher inflation

## 3. Performance potential in equity bear markets

# 1. Stronger trends in commodities

So far in 2021, there have been strong uptrends in commodity markets, with many commentators discussing the possibility of a new 'commodity super cycle' .

These strong commodity trends are potentially creating opportunities for managed futures - and trendfollowing strategies in particular.

The majority of managed futures strategies have generated positive performance this year, in part by holding long positions across a wide range of commodity contracts in the energy, metals and agricultural sectors.

Here are the key points.

## Uptrends in commodity markets

Rising inflation expectations and an improving demand outlook have boosted industrial commodities like crude oil and copper. Meanwhile, agricultural contracts like soybeans and corn reached multi-year highs in May 2021 as strong Chinese demand and adverse weather in both the US and Brazil helped prices to rise.

## Percentage of markets trending hits 10-year high

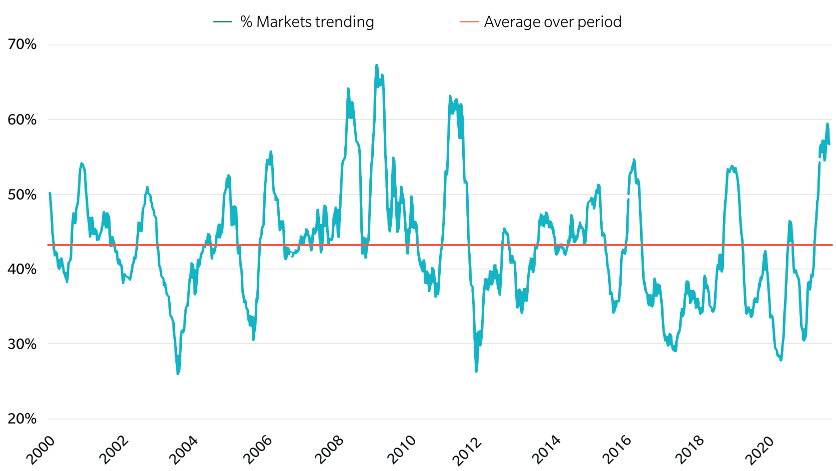
The percentage of markets trending is a proprietary measure used by Abbey Capital to track the number of markets experiencing price trends. This measure has historically correlated with performance in managed futures. In 2021, the percentage of commodity markets trending reached its highest level in almost 10 years (see Chart 1).

## Dynamic risk allocation

Managed futures is a dynamic, quantitative investment strategy that allocates risk based on the strength of price trends and other quantitative trading signals. When strong price trends emerge in a sector - as we've seen in commodities in early 2021 - managed futures strategies will typically rebalance their portfolios and allocate more risk to that sector.

**Chart 1**

*100-day average of the percentage of commodity markets trending (based on 20 & 120 day moving averages): Jan-2000 to May-2021*




**Source:** Abbey Capital, Bloomberg.

This chart examines the diversified set of 55 contracts used in the SG Trend Indicator, covering equities, fixed income, currencies and commodities. Data above is shown from Jan-2000 onwards. Please see page 9 for information on the Percentage of Markets Trending indicator.

# 2. The rising risk of higher inflation

Higher inflation has been a key theme for markets in 2021 and may continue to be so in the coming years – potentially increasing the case for portfolio diversification*.

This is because higher inflation has historically affected the bond-equity correlation, meaning now might be the time to consider alternatives to bonds - as explored in our recent whitepaper.

Alternative strategies that have performed well in higher inflation environments over time - like managed futures - may be worth consideration.

Here's a quick overview of the current market context.

## Higher inflation as the global economy reopens

Reflation has been an important driver of market moves in 2021, with significant US fiscal stimulus and forecasts of a sharp rebound in the global economy. US inflation and inflation expectations have both increased as a result. US year-over-year CPI hit a 13-year high in May 2021, while inflation expectations reached multi-year highs earlier this year.

## Bond-equity correlation uncertainty

Over the last 20 years, inflation has trended lower and bonds and equities have been negatively correlated - with bonds offsetting equities during equity drawdowns. If we see higher levels of inflation, this correlation could turn positive - as was the case in the 1980s and 1990s (see Chart 2). This means bonds and equities would be more likely to sustain losses at the same time.

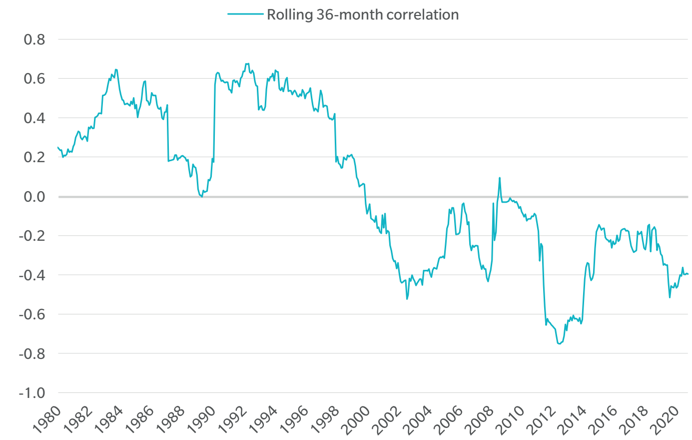
## Early evidence of correlation change

We have seen some evidence of an inflation-led shift in the bond-equity correlation already in 2021, with higher US yields negatively impacting US stocks at times. This coincided with the rolling 60-day correlation between the S&P 500 and the US Treasury long bond future turning positive, reaching its highest level since 2006.

*Diversification does not assure profit, nor does it protect against a loss.

**Chart 2**

*Rolling 36-month correlation between the S&P 500 Index and the US Treasury Long Bond Future: Aug-1980 to May-2021*




**Source:** Abbey Capital, Bloomberg.

For an explanation of the index referenced please go to page 9.

Indices referred to in this document are not directly investible, are not based on the entire population of equities, hedge funds or CTAs and are not indicative of the performance of any particular manager or fund. Furthermore, these indices may not be directly comparable. As a result there are inherent limitations with using these indices for representative purposes and the above is shown for illustrative purposes only.

# 3. Performance potential in equity bear markets

With stock valuations at high levels relative to history, some commentators have argued there is a risk of a possible bubble in equities.

In this environment of high equity valuations, it may be important for investors to prepare for an equity sell-off - and identify assets that could outperform during negative periods for equities.

With US bond yields at relatively low levels compared to previous decades, now might be the right time to consider alternative strategies for portfolio diversification*.

Managed futures is one diversification strategy that may be worth consideration*. Here's why.

## Low correlation

Managed futures have historically exhibited a correlation of close to zero to equities. The ability to hold long and short positions across various markets means that managed futures strategies can see positive returns during periods of equity market weakness.

## Historical performance in equity sell-offs

Over the last three decades, managed futures strategies - like bonds - have typically been positive when US stocks have experienced sharp declines. This is not true for all hedge fund strategies; many have historically had a positive correlation to equities, which may explain the underperformance of these strategies relative to managed futures during some equity drawdowns (see Table 1).

## The outlook for bonds

Historically, the starting level of yields has been a good predictor of future returns - so lower bond yields could point to lower returns in the years ahead. This may limit the ability of bonds to continue to provide strong returns in equity sell-offs, so investors may want to consider other strategies - such as managed futures - to diversify portfolios*.

*Diversification does not assure profit, nor does it protect against a loss.

### Table 1

*Performance of various US Treasury, managed futures and hedge fund indices during the worst ten monthly declines in the S&P 500: Jan-1990 to May-2021*

| | | S&P 500 Index | JP Morgan US Treasury Index | Barclay CTA Index | HFRI Fund Weighted Composite Index | HFRI Equity Hedge Index | HFRI Event Driven Index | HFRI Relative Value Index |
|---|---|---|---|---|---|---|---|---|
| 1 | Oct-08 | -16.9% | -0.2% | 3.4% | -6.8% | -9.5% | -8.2% | -8.0% |
| 2 | Aug-98 | -14.6% | 2.8% | 5.9% | -8.7% | -7.7% | -8.9% | -5.8% |
| 3 | Mar-20 | -12.5% | 3.3% | 1.7% | -9.1% | -10.9% | -12.4% | -9.8% |
| 4 | Sep-02 | -11.0% | 2.8% | 2.4% | -1.5% | -2.0% | -1.5% | 0.3% |
| 5 | Feb-09 | -11.0% | -0.6% | -0.2% | -1.2% | -2.2% | -1.4% | 0.5% |
| 6 | Aug-90 | -9.4% | -1.1% | 6.7% | -3.5% | -1.9% | -4.5% | -0.5% |
| 7 | Feb-01 | -9.2% | 1.3% | -0.6% | -2.2% | -2.6% | -0.4% | 1.1% |
| 8 | Dec-18 | -9.2% | 2.3% | 0.2% | -2.5% | -3.8% | -2.3% | -1.7% |
| 9 | Sep-08 | -9.1% | 0.6% | -0.3% | -6.1% | -8.1% | -6.0% | -5.9% |
| 10 | Jun-08 | -8.6% | 0.8% | 2.0% | -1.3% | -2.4% | -1.6% | -0.6% |
| | **Average** | **-11.2%** | **1.2%** | **2.1%** | **-4.3%** | **-5.1%** | **-4.7%** | **-3.0%** |

**Source:** Abbey Capital, Bloomberg.

Data is shown for this period as it is the earliest data available for the HFRI Fund Weighted Composite Index. The indices in Table 1 may not be directly comparable and are shown for illustrative purposes only. See page 9 for a description of indices

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# For more analysis from the Abbey Capital Markets Team, download our recent content on the 60-40 portfolio:

**QUICK READ**

Why now might be the right time to reassess the 60-40 portfolio

**WHITEPAPER**

Low bond yields and the 60-40 portfolio

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# Description of Indices

**Barclay CTA Index (Start Date: Jan-1987)**

The Barclay CTA Index is a leading industry benchmark of representative performance of commodity trading advisors. There are currently 416 programs included in the calculation of the Barclay CTA Index. The index is equally weighted and rebalanced at the beginning of each year. Note that the Barclay CTA Index is derived from data which is self-reported by investment managers based on the performance of privately managed funds.

**JP Morgan US Government Bond Index (Start Date: Jan-1985)**

The JP Morgan US Government Index is a leading measure of US government bond market performance. The Index measures the total return of US Treasury securities across the whole yield curve.

**S&P 500 Index (Start Date: March-1957)**

The S&P 500 Index is an index of 500 US stocks chosen for market size, liquidity and industry grouping, among other factors. It is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in its aggregate market value.

**Hedge Fund Research, Inc. ("HFRI") Equity Hedge Index (Start Date: Jan-1990)**

The index includes investment managers who maintain positions both long and short in primarily equity and equity derivative securities. Strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios.

**HFRI Event Driven Index (Start Date: Jan-1990)**

The index includes investment managers who maintain positions in companies involved in corporate transactions of a wide variety such as mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Event Driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company specific developments.

**HFRI Relative Value Index (Start Date: Jan-1990)**

The index includes investment managers who maintain positions in which the investment thesis is predicated on realisation of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed income, derivative or other security types.

**HFRI Fund Weighted Composite Index (Start Date: Jan-1990)**

The HFRI Fund Weighted Composite Index is a global, equal-weighted index of over 1,400 single-manager funds that report to HFR Database. Constituent funds report monthly net of all fees performance in US Dollar and have a minimum of $50 Million under management or a twelve (12) month track record of active performance. ■

# Percentage of Markets Trending – Information and assumptions

Page 3 examines the diversified set of 55 contracts used in the SG Trend Indicator. The SG Trend Indicator is a market-based performance indicator designed to have a high correlation to the returns of trend following strategies.

The sample period is September 2010 to January 2021 as this is the range for which Abbey Capital have continuous price data for all of the 55 contracts used in the SG Trend Indicator.

The analysis categorises each market as either (i) Trending, (ii) Consolidating/Reversing or (iii) No Trend using 20-day and 120-day moving average crossover analysis.

The results are aggregated to calculate the percentage of markets in each phase. Chart 1 shown on page 3 of this document shows the 100-day average percentage of markets in a trending phase.

Definition of different market phases:

**Trending**

If the fast moving average is between the price and the slow moving average, the market is Trending.

**Consolidating/Reversing**

If the price is between the moving averages, the market is Consolidating.

If the slow moving average is between the price and the fast moving average, the market is Reversing.

**No Trend**

If the moving averages cross when the system is in a Consolidating/Reversing phase, the system will return to No Trend once the price action crosses either of the moving averages. ■