# Trend-Following: If it Moves, Monetise It!

September 2023

Time to read: 7 minutes

How can trend-following's "crisis alpha" credentials be monetised when there's no crisis?



Author

**Graham Robertson, DPhil**
Head of Client Portfolio Management, Man AHL

## Introduction

In our recent note, "**Trend-Following: What's Not to Like?**", our key point was that trend-following and equities returned about the same in the long term, yet got there by very different routes: trend-following tended to do well when equities didn't (tech bubble burst 2000-3, GFC 2008-9), and equities performed well during the 'CTA winter' in the aftermath of the GFC. Our suggestion was that trend-following was highly complementary to traditional investments such as equities and the ubiquitous 60/40.

It is always fascinating to read feedback. Perhaps it should not have been surprising that the negatives were in focus. Yes, the CTA winter did last 10 years, and performance was flat. We stated this. But we also pointed out that equities lost half their value twice since 2000.

Let us take this criticism on the chin and use the opportunity to flesh out a point we alluded to in our note, namely how we can monetise trend-following's negative correlation to equities when risk assets turn south. Spoiler alert: we can allocate to a trend-following strategy alongside a traditional portfolio, improve overall return and risk characteristics and not materially underperform in the 'CTA winter' of 2009-19. Sound too good to be true? Read on.

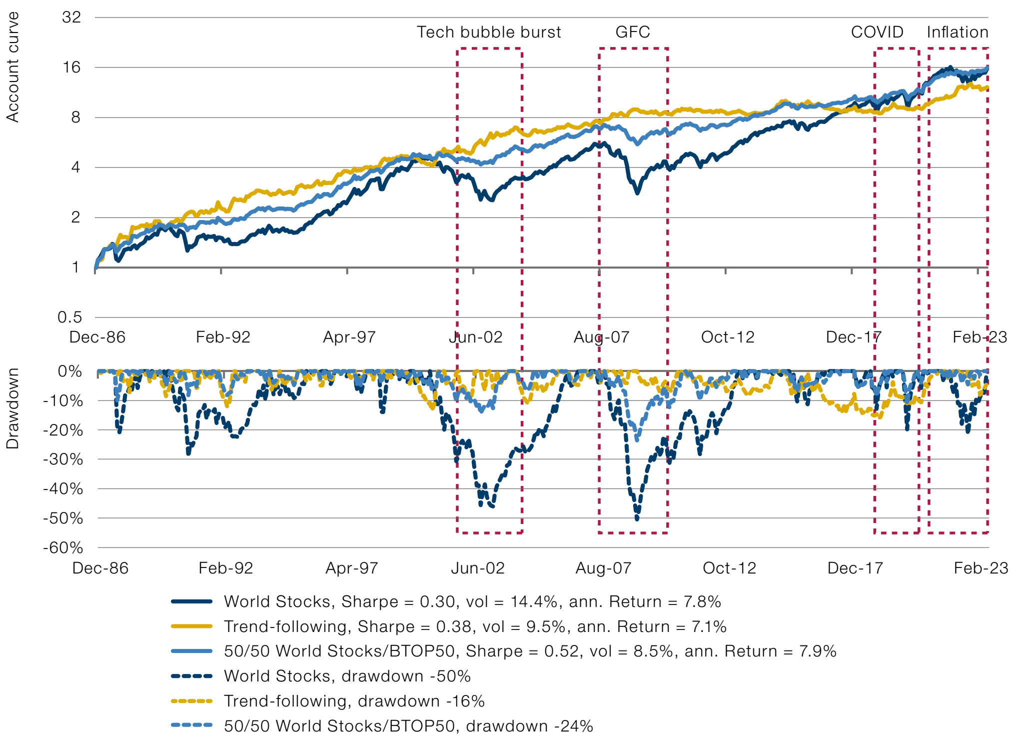
> "The key concept here is monetisation; using trend-following's observed 'crisis alpha' characteristic, meaning its ability to perform well during crisis periods for traditional portfolios, to facilitate greater exposure in the good times."

## If It Moves, Monetise It

The key concept here is monetisation; using trend-following's observed 'crisis alpha' characteristic, meaning its ability to perform well during crisis periods for traditional portfolios, to facilitate greater exposure in the good times. If we're less concerned about a fall, we tend to run, ski, snowboard, climb – you name it – faster.

In Figure 1, note how a portfolio of 50/50 stocks/trend-following performs just as well as a pure equities portfolio (around 8%), yet has significantly lower volatility (10% versus 14%), and around one third the drawdown (16% versus 50%). To coin a phrase, what's not to like about that? Well, we could be picky and say that yes, risk-adjusted returns are higher in the blended portfolio – the Sharpe ratio is 0.52 versus 0.30 for World Stocks – but you can't eat Sharpe ratio. Returns are what really matters to end investors, such as those from pension funds. Wouldn't it be nice if this improvement in risk could be monetised?

**Figure 1. World Stocks, Trend-Following (Barclay BTOP50), and 50/50 Blend Since Inception of BTOP50 Index in 1986. Account Curve (Top), Drawdown (Bottom)**




World stocks represented by MSCI World Net Total Return Index hedged to USD. Trend-following represented by Barclay BTOP50 Index. Source: Man Group database, Bloomberg, BarclayHedge. Date Range 31 December 1986 to 30 June 2023. Please see the important information linked at the end of this document for additional information on hypothetical results.

“Although our blended portfolio looks better than World Stocks in pure statistical terms, we have two problems. First, returns are the same, and second, it underperforms a World Stocks portfolio for 10 years starting in 2009.”

We also have the CTA winter problem. Between 2009 and 2019, trend-following strategies were broadly flat, returning -0.4% per annum compared with World Stocks at +10.3% (Table 1). It is unsurprising that any blend of trend-following with World Stocks underperforms.

**Table 1. Statistics for World Stocks, Trend-Following (Barclay BTOP50), 50/50 Blend, and 2x Levered 50/50 Blend**

| | World Stocks | Trend-Following | 50/50 World Stocks/ Trend-Following | 2x 50/50 World Stocks/Trend-Following |
|---|---|---|---|---|
| **Ann. Return** | 7.8% | 7.1% | 7.9% | 11.7% |
| **Volatility** | 14.4% | 9.5% | 8.5% | 16.9% |
| **Sharpe** | 0.30 | 0.38 | 0.52 | 0.48 |
| **Max Drawdown** | -50.4% | -16.1% | -23.6% | -44.7% |
| **Ann. Return, 2009-19** | 10.3% | -0.4% | 5.1% | 9.1% |

Source: Man Group database, Bloomberg, BarclayHedge. Date range: 31 December 1986-30 June 2023. Please see the important information linked at the end of this document for additional information on hypothetical results.

In summary, although our blended portfolio looks better than World Stocks in pure statistical terms, we have two problems. First, returns are the same, and second, it underperforms a World Stocks portfolio for 10 years starting in 2009.

## Switching Up a Gear

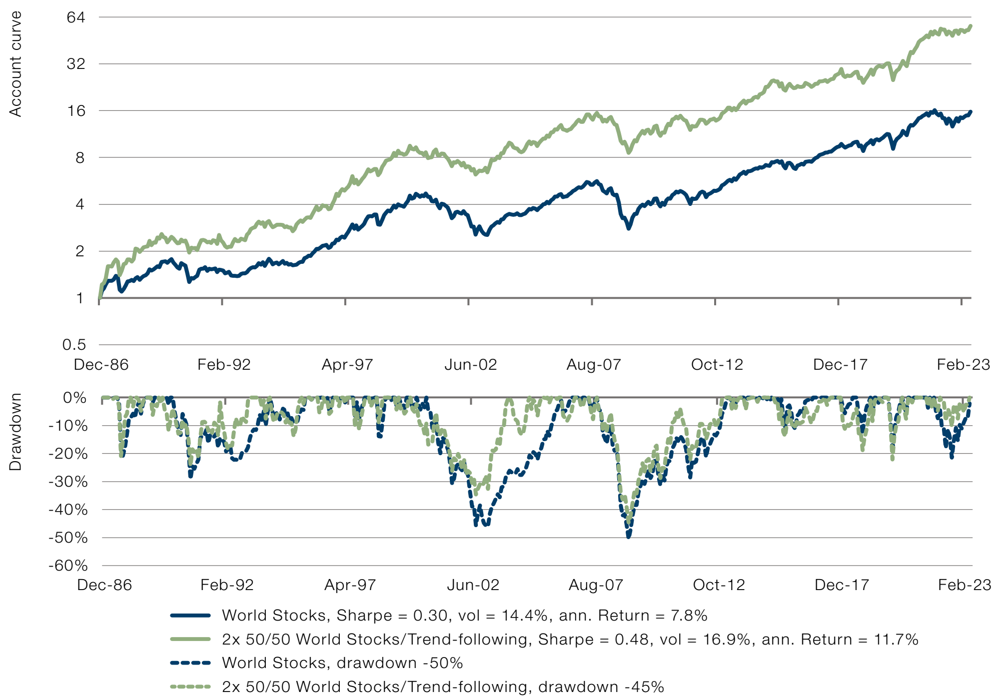
“What we have done, through this additional gearing, is monetise trend-following’s defensive properties, thereby solving our two problems.”

In the final column of Table 1 we illustrate what happens when we gear up our blended portfolio by a factor of two, funding the additional exposure – 100% in this case – at the prevailing cash rate. Compared to our original World Stocks portfolio, in the first column, we notice that for our geared blended portfolio in the final column:

1. Overall returns are significantly better; 12% versus 8% per annum
2. Returns during the CTA winter 2009-19 are about the same, around 10% per annum (our critics are happy!)
3. Volatility and drawdowns are about the same

Eureka! What we have done, through this additional gearing, is monetise trend-following’s defensive properties, thereby solving our two problems. We can take more exposure in the good times because we know that the downside is taken care of through trend-following’s crisis alpha properties. We illustrate the starting World Stocks portfolio and final twice-geared blended portfolio in Figure 2.

**Figure 2. World Stocks and 2x Levered 50/50 Blend of World Stocks and Trend-Following (BTOP50). Account Curve (Top), Drawdown (Bottom)**




World Stocks represented by MSCI World Net Total Return Index hedged to USD. Trend-following represented by Barclay BTOP50 Index. Source: Man Group database, Bloomberg, BarclayHedge. Date range: 31 December 1986-30 June 2023. Please see the important information linked at the end of this document for additional information on hypothetical results.

> "Leverage is often associated with additional risk and followed by a gnashing of teeth and a sharp intake of breath. In this case, the leverage is afforded by the diversification offered by the trend-following strategy."

## Some Parting Thoughts

Our reader may have picked up on our frustration at some of the comments on our original "**Trend-Following: What's Not to Like?**" piece, and indeed this was the motivation for writing this article. By concentrating on the CTA winter, in a sense our critics were saying, "In one of the best periods for our strategy (stocks), your strategy (trend-following) does badly". It is hard to argue with this kind of logic. Defining the CTA winter as being the 10 years from 1 January 2009, as we do in this article, performance of World Stocks is in the 83$^{rd}$ percentile of rolling 10-year returns, while trend-following is in its 1$^{st}$ percentile. That this 1$^{st}$ percentile corresponds only to an annualised loss of 0.4% is remarkable in itself, in our view. What we have suggested in previous articles in this series is that this diversification should be celebrated. In this article we have shown how this diversification can be monetised.

Gearing, or leverage, is the key to this monetisation, and indeed this is a well-trodden journey along the Capital Markets Line, maximising return for a given level of risk[1]. Leverage is often associated with additional risk and followed by a gnashing of teeth and a sharp intake of breath. In this case, the leverage is afforded by the diversification offered by the trend-following strategy. Because of trend-following's low correlation to stocks on average, and negative correlation in crisis periods, the twice-geared portfolio has very similar risk characteristics to the original World Stocks portfolio, namely volatility and maximum drawdown. We refer our reader to our article "**Leverage Does Not Equal Risk**" for a more in-depth discussion.

But we can do better still. First, trend-following can be tuned to perform better in crisis periods, as we discussed in "**The Need For Speed In Trend-Following Strategies**". Second, there are various ways of representing both the traditional portfolio and trend-following strategies in a cash-efficient manner, through implementation in the form of futures. In fact it is possible to gear portfolios without additional cash. In short, you can potentially implement this strategy without needing to raise another dollar.

We will explore the benefits of cash efficiency in our next note.

**1.** https://www.investopedia.com/terms/c/cml.asp#toc-what-is-the-capital-market-line-cml

## Bibliography


Robertson, G. (2023), “Trend-Following: What’s Not to Like?”, *Man Institute*, Available at: **https://www.man.com/maninstitute/trend-following-what-not-to-like**

Abou Zeid, T (2022). “Leverage Does Not Equal Risk”, *Man Institute*, Available at: **https://www.man.com/maninstitute/leverage-equal-risk**

Mackic, A. (2023), “The Need for Speed in Trend-Following Strategies”, *Man Institute*, Available at: **https://www.man.com/maninstitute/need-for-speed-trend-following**

## Author

**Graham Robertson, DPhil**
Head of Client Portfolio Management, Man AHL

Graham Robertson is a partner and Head of Client Portfolio Management at Man AHL and is a member of the investment and management committees. He has overall responsibility for client communication across Man AHL's range of quantitative strategies. Prior to joining Man AHL in 2011, Graham developed capital structure arbitrage strategies at KBC Alternative Investment Management and equity derivative relative value models for Vicis Capital. He started his career at Credit Suisse in fixed income before moving to Commerzbank, where he established the relative value team and subsequently became Head of Credit Strategy. Graham holds a DPhil from the University of Oxford in Seismology and a BSc in Geophysics from the University of Edinburgh.

**Simulated Hypothetical Performance Results**

Hypothetical Results are calculated in hindsight, invariably show positive rates of return, and are subject to various modeling assumptions, statistical variances and interpretational differences. No representation is made as to the reasonableness or accuracy of the calculations or assumptions made or that all assumptions used in achieving the results have been utilized equally or appropriately, or that other assumptions should not have been used or would have been more accurate or representative. Changes in the assumptions would have a material impact on the Hypothetical Results and other statistical information based on the Hypothetical Results.

The Hypothetical Results have other inherent limitations, some of which are described below. They do not involve financial risk or reflect actual trading by an Investment Product, and therefore do not reflect the impact that economic and market factors, including concentration, lack of liquidity or market disruptions, regulatory (including tax) and other conditions then in existence may have on investment decisions for an Investment Product. In addition, the ability to withstand losses or to adhere to a particular trading program in spite of trading losses are material points which can also adversely affect actual trading results. Since trades have not actually been executed, Hypothetical Results may have under or over compensated for the impact, if any, of certain market factors. There are frequently sharp differences between the Hypothetical Results and the actual results of an Investment Product. No assurance can be given that market, economic or other factors may not cause the Investment Manager to make modifications to the strategies over time. There also may be a material difference between the amount of an Investment Product's assets at any time and the amount of the assets assumed in the Hypothetical Results, which difference may have an impact on the management of an Investment Product. Hypothetical Results should not be relied on, and the results presented in no way reflect skill of the investment manager. A decision to invest in an Investment Product should not be based on the Hypothetical Results.

No representation is made that an Investment Product's performance would have been the same as the Hypothetical Results had an Investment Product been in existence during such time or that such investment strategy will be maintained substantially the same in the future; the Investment Manager may choose to implement changes to the strategies, make different investments or have an Investment Product invest in other investments not reflected in the Hypothetical Results or vice versa. To the extent there are any material differences between the Investment Manager's management of an Investment Product and the investment strategy as reflected in the Hypothetical Results, the Hypothetical Results will no longer be as representative and their illustration value will decrease substantially. No representation is made that an Investment Product will or is likely to achieve its objectives or results comparable to those shown, including the Hypothetical Results, or will make any profit or will be able to avoid incurring substantial losses. Past performance is not indicative of future results and simulated results in no way reflect upon the manger's skill or ability.

**Important Information**

This information is communicated and/or distributed by the relevant Man entity identified below (collectively the 'Company') subject to the following conditions and restriction in their respective jurisdictions.

Opinions expressed are those of the author and may not be shared by all personnel of Man Group plc ('Man'). These opinions are subject to change without notice, are for information purposes only and do not constitute an offer or invitation to make an investment in any financial instrument or in any product to which the Company and/or its affiliates provides investment advisory or any other financial services. Any organisations, financial instrument or products described in this material are mentioned for reference purposes only which should not be considered a recommendation for their purchase or sale. Neither the Company nor the authors shall be liable to any person for any action taken on the basis of the information provided. Some statements contained in this material concerning goals, strategies, outlook or other non-historical matters may be forward-looking statements and are based on current indicators and expectations. These forward-looking statements speak only as of the date on which they are made, and the Company undertakes no obligation to update or revise any forward-looking statements. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those contained in the statements. The Company and/or its affiliates may or may not have a position in any financial instrument mentioned and may or may not be actively trading in any such securities. Past performance is not indicative of future results.

Unless stated otherwise this information is communicated by the relevant entity listed below.

**Australia:** To the extent this material is distributed in Australia it is communicated by Man Investments Australia Limited ABN 47 002 747 480 AFSL 240581, which is regulated by the Australian Securities & Investments Commission (ASIC). This information has been prepared without taking into account anyone's objectives, financial situation or needs.

**Austria/Germany/Liechtenstein:** To the extent this material is distributed in Austria, Germany and/or Liechtenstein it is communicated by Man (Europe) AG, which is authorised and regulated by the Liechtenstein Financial Market Authority (FMA). Man (Europe) AG is registered in the Principality of Liechtenstein no. FL-0002.420.371-2. Man (Europe) AG is an associated participant in the investor compensation scheme, which is operated by the Deposit Guarantee and Investor Compensation Foundation PCC (FL-0002.039.614-1) and corresponds with EU law. Further information is available on the Foundation's website under www.eas-liechtenstein.li. This material is of a promotional nature.

**European Economic Area:** Unless indicated otherwise this material is communicated in the European Economic Area by Man Asset Management (Ireland) Limited ('MAMIL') which is registered in Ireland under company number 250493 and has its registered office at 70 Sir John Rogerson's Quay, Grand Canal Dock, Dublin 2, Ireland. MAMIL is authorised and regulated by the Central Bank of Ireland under number C22513.

**Hong Kong SAR:** To the extent this material is distributed in Hong Kong SAR, this material is communicated by Man Investments (Hong Kong) Limited and has not been reviewed by the Securities and Futures Commission in Hong Kong. This material can only be communicated to intermediaries, and professional clients who are within one of the professional investors exemptions contained in the Securities and Futures Ordinance and must not be relied upon by any other person(s).

**Japan:** To the extent this material is distributed in Japan it is communicated by Man Group Japan Limited, Financial Instruments Business Operator, Director of Kanto Local Finance Bureau (Financial instruments firms) No. 624 for the purpose of providing information on investment strategies, investment services, etc. provided by Man Group, and is not a disclosure document based on laws and regulations. This material can only be communicated only to professional investors (i.e. specific investors or institutional investors as defined under Financial Instruments Exchange Law) who may have sufficient knowledge and experience of related risks.

**Switzerland:** To the extent the material is made available in Switzerland the communicating entity is:

- For Clients (as such term is defined in the Swiss Financial Services Act): Man Investments (CH) AG, Huobstrasse 3, 8808 Pfäffikon SZ, Switzerland. Man Investment (CH) AG is regulated by the Swiss Financial Market Supervisory Authority ('FINMA'); and
- For Financial Service Providers (as defined in Art. 3 d. of FINSA, which are not Clients): Man Investments AG, Huobstrasse 3, 8808 Pfäffikon SZ, Switzerland, which is regulated by FINMA.

**United Kingdom:** Unless indicated otherwise this material is communicated in the United Kingdom by Man Solutions Limited ('MSL') which is a private limited company registered in England and Wales under number 3385362. MSL is authorised and regulated by the UK Financial Conduct Authority (the 'FCA') under number 185637 and has its registered office at Riverbank House, 2 Swan Lane, London, EC4R 3AD, United Kingdom.

**United States:** To the extent this material is distributed in the United States, it is communicated and distributed by Man Investments, Inc. ('Man Investments'). Man Investments is registered as a broker-dealer with the SEC and is a member of the Financial Industry Regulatory Authority ('FINRA'). Man Investments is also a member of the Securities Investor Protection Corporation ('SIPC'). Man Investments is a wholly owned subsidiary of Man Group plc. The registration and memberships described above in no way imply a certain level of skill or expertise or that the SEC, FINRA or the SIPC have endorsed Man Investments. Man Investments, 1345 Avenue of the Americas, 21st floor, New York, NY 10105.



MKT009094/ST/GL/W