



Trend-Following: Movin' on Up

October 2023

Time to read: 5 minutes

How have trend-following approaches tended to perform following a market shock? And why market reversals are not occurring as frequently as it might seem.

For institutional investor, qualified investor and investment professional use only. Not for retail public distribution.

Author

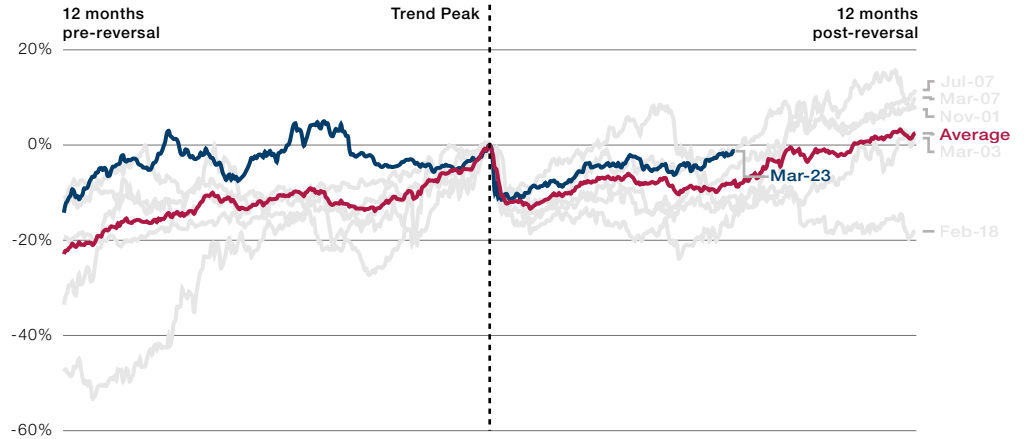


Rupert Goodall
Client Portfolio Manager,
Man AHL

Deja-vu all over again

In April this year, following the collapse of Silicon Valley Bank (SVB) and the market reversals that caused losses for trend-followers, we looked to history to see if there might be clues to trend-followers' subsequent performance. To do this, we plotted the five worst five-day distinct drawdowns of the Société Générale (SG) Trend Index since January 2000 (Figure 1), aligned at the pre-reversal point, and extending backwards and forwards 12 months.

Figure 1. Trend after a reversal - Performance in the 12 months prior to and post a reversal



Date range: 1 January 2000 to 30 September 2023. Source: Man Group database and Société Générale.



Trends invariably re-emerge following a reversal with trend-following strategies typically recouping losses within six to 12 months.”

The pattern that emerged was revealing. Firstly, reversals, by definition, occur at the end of a trend; with an average return, denoted by the burgundy line, of over 20 percent in the 12 months prior to the trend peak. Secondly, losses around the reversal are broadly well contained; this is trend-following behaving as it should, with models quickly reacting to close out positions. Finally, and perhaps most importantly, trends invariably re-emerge following a reversal with trend-following strategies typically recouping losses within six to 12 months.

This pattern should hopefully instill confidence in trend-following; however, does it hold true for March's SVB induced reversal? This is plotted as the blue line in Figure 1, centred on the peak of 9 March, 2023, and includes returns through to 30 September, 2023. The results, at first glance, are encouraging as it appears that history may well be repeating itself, with subsequent performance currently tracking above the historical average. However, with March still prominent in the rearview mirror and with markets violently oscillating, what is the likelihood we will see a deviation from history's script?

‘Once you notice a phenomenon, you believe it happens a whole lot’¹

If the Baader-Meinhof phenomenon, or frequency illusion, is any guide then the immediacy of March's reversal may result in the perception that reversals occur more frequently now than they have done in the past. Indeed, in the space of two years we have seen a global pandemic, war returning to Continental Europe and the worst bond sell-off since the Napoleonic era, so investors may be forgiven for letting out a Primal Scream, heading to The Winchester, having a nice cold pint and waiting for the next reversal to inevitably materialise (although granted, we are not facing a scenario quite as apocalyptic as in *Shaun of the Dead*).

To dispel this perception, before it becomes embedded in our collective psyche, we can again look to history and posit the question; are we amid a reversal of fortune for trend-following strategies where reversals occur with greater frequency?

1. 'Why are we so illuded?', Arnold M. Zwicky, Stanford University, September 2006.

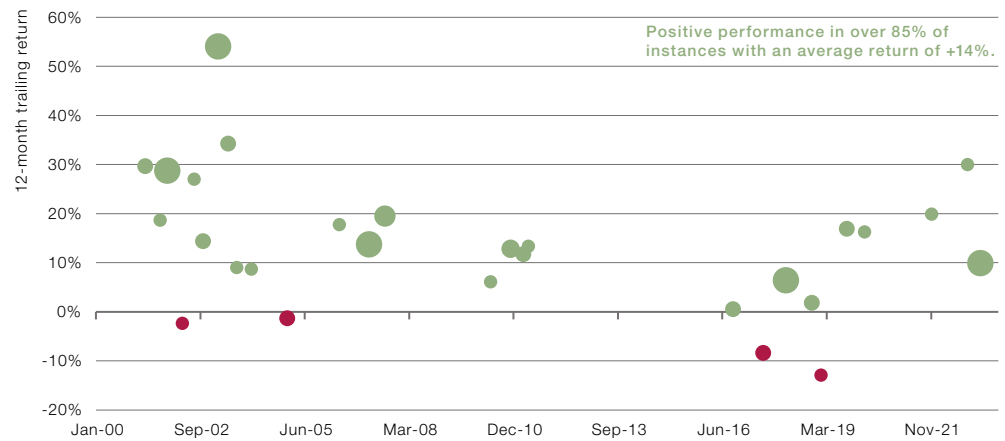


The broad scatter of plots shows that reversals are relatively evenly distributed over history, with no indication that these have become more frequent in recent times.

To answer this, in Figure 2 we plot the instances where the SG Trend Index loses more than five percent over the trailing five days against the corresponding 12-month trailing return of the index as at the peak before each reversal date. The plots are then sized in accordance with the magnitude of the five-day drawdowns, with the largest plot corresponding to a loss of greater than ten percent.

The conclusions that we can draw are twofold: firstly, the broad scatter of plots shows that reversals are relatively evenly distributed over history, with no indication that these have become more frequent in recent times (so much for Baader-Meinhof). Secondly, reversals tend to cluster around periods where trend-following performance has been positive, occurring here in over eighty-five percent of instances.

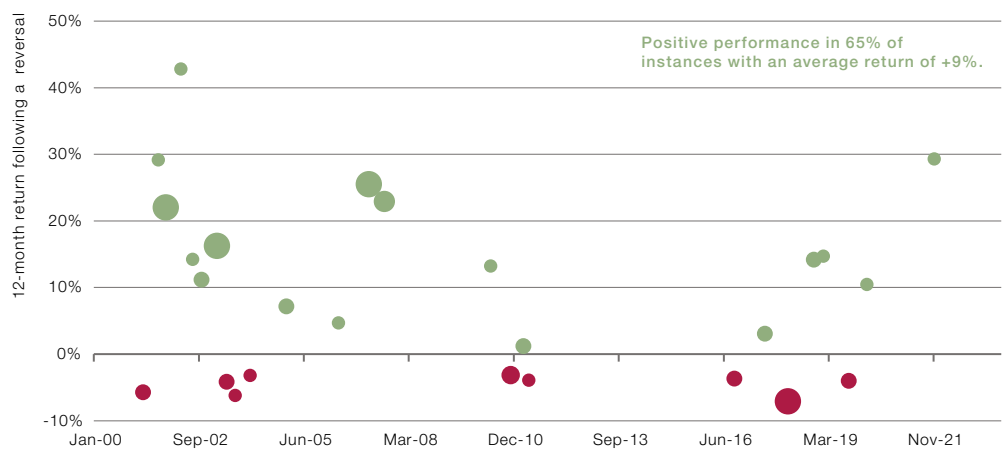
Figure 2. Trend-following performance in 12 months preceding a reversal of more than 5% in five days. Size of point represents the magnitude of the reversal.



Date range: 1 January 2000 to 31 August 2023. Source: Man Group database and Société Générale.

In Figure 3, we analyse trend-following's performance in the 12 months after a reversal. For this purpose, November 2022 and March 2023 have been excluded given that these reversals occurred less than 12 months ago. In keeping with our original results, we find that the average return across all instances is a gain of nearly ten percent, with positive performance in 65 percent of cases.

Figure 3. Trend-following performance in 12 months after a reversal of more than 5% in five days. Size of point represents magnitude of the reversal.



Date range: 1 January 2000 to 31 August 2023. Source: Man Group database and Société Générale.

Conclusion

The patterns we have outlined should hopefully instill confidence in trend-following. While it may seem that market reversals are occurring with greater frequency, we have shown that there is no indication that this is the case. Further, when reversals do occur, we find that trend-following strategies tend to recoup losses within six to 12 months. Whether we will see a deviation from history's script in relation to March's SVB induced reversal remains to be seen, but at the time of writing, performance is tracking above the historical average.

In other words, when faced with a reversal, we believe that investors should take comfort from history and **Keep Calm and Carry on Trend-Following**.

Author

Rupert Goodall

Client Portfolio Manager, Man AHL



Rupert Goodall is a Client Portfolio Manager at Man AHL. He is responsible for communicating Man AHL's investment strategies to clients. Prior to joining Man AHL in 2022, Rupert worked at Man FRM for four years, focusing on the operational and oversight functions of the managed account platform. Rupert holds a

BSc (hons) in Economics from the University of Bristol.

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.

This material is proprietary information and may not be reproduced or otherwise disseminated in whole or in part without prior written consent.

Any data services and information available from public sources used in the creation of this material are believed to be reliable. However accuracy is not warranted or guaranteed. ©Man 2023.

MKT009126/ST/GL/W