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# The Managed Futures Ecosystem:
## *The Rise of the Managed Futures ETF*

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May 2024

## The Rise of Managed Futures

Incorporating diversified sources of return within investment portfolios is a widely accepted core tenet of asset allocation. A search for strategies that can provide attractive total returns and diversification to both equity and fixed-income allocations, however, can yield surprisingly limited results.

Managed futures strategies have historically generated positive long-term absolute returns independent of overall market direction, providing a differentiated source and pattern of returns when compared to traditional stock and bond portfolios. Through their ability to take long or short positions across a diverse set of global markets, these strategies have tended to display low long-term correlation to traditional stocks and bonds, which may provide much-needed diversification benefits, especially during periods of market crisis or dislocation.

In this paper we seek to summarize the brief history of publicly traded managed futures funds to date, highlighting the evolution of category characteristics likely to be of significance to investors considering an allocation to the space, including the return profile, performance dispersion, fees, and transparency. In doing so we contrast common traits between public and private funds and conclude with some thoughts on investor preferences and use cases offering the potential to drive continued uptake in the small but growing managed futures ETF landscape.

## Return Characteristics of Managed Futures

Managed futures is a category of alternative investments that trades highly liquid futures and forward contracts. The strategies are dynamic and provide exposure to a wide range of asset classes both long and short over time. The strategies are highly liquid and capital-efficient in their use of derivatives contracts. The most common strategy in the space is trend following but there is a range of other strategies such as carry, global macro, and other cross-asset approaches. Due to the dynamic lowly correlated nature of these strategies they have provided diversifying returns across different market regimes. Figure 1 plots the relative return profile for managed futures versus stocks and bonds over the past three decades. From this graph, we can see that during the 2000s, a period often touted as a lost decade for equities, managed futures experienced positive returns. The following decade was strong for equities but a bit more challenging for managed futures. And so far for the current decade, we can see that both managed futures and equity markets are experiencing positive returns while bonds have struggled. This highlights the diversification benefits of alternative strategies over different market regimes.

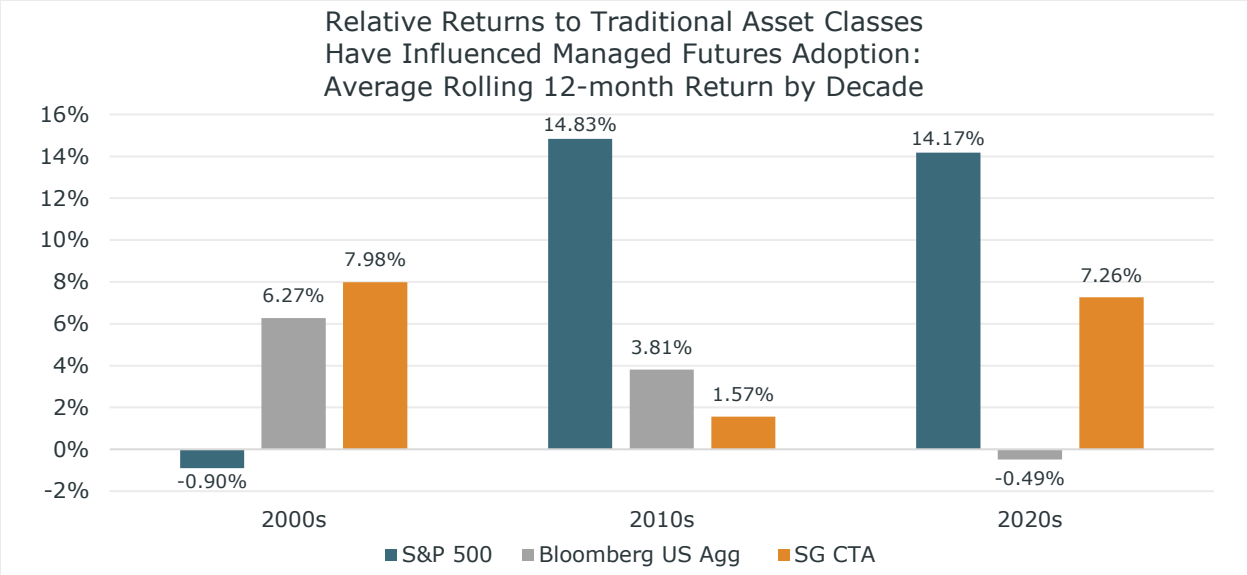


*Figure 1: Average rolling 12-month returns for equities (S&P 500), fixed income (Bloomberg U.S. Aggregate Bond Index), and Managed Futures (SG CTA Index) from January 1, 2000 to March 31, 2024 plotted by decade. Past performance is not necessarily indicative of future results. It is not possible to invest directly in any index. Source: Bloomberg, AlphaSimplex.*

Another key characteristic of managed futures is a low correlation to traditional asset classes over time. Figure 2 plots the correlation between managed futures and key traditional asset classes including U.S. equities, international equities, fixed income, and commodities. Given the diversifying return characteristics and low correlation to traditional assets over long time horizons, it is not surprising they have been adopted as a tool for portfolio diversification.

**Correlation Matrix**

| | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| 1 SG CTA Index | 1.00 | | | | |
| 2 S&P 500® Index | -0.12 | 1.00 | | | |
| 3 MSCI ACWI Ex USA Growth Index | -0.06 | 0.87 | 1.00 | | |
| 4 Bloomberg US Aggregate Bond Index | -0.01 | 0.11 | 0.18 | 1.00 | |
| 5 S&P GSCI Index | 0.10 | 0.33 | 0.46 | -0.08 | 1.00 |

Time Period: Since Common Inception (1/1/2000) to 12/31/2023

1.00 to 0.67 | 0.66 to 0.33 | 0.32 to 0.00 | -0.01 to -0.33

**Risk-Reward**

| | Return | Std Dev | Max Drawdown | Sharpe Ratio | Beta |
|---|---|---|---|---|---|
| SG CTA Index | 4.45 | 8.73 | -14.26 | 0.34 | -0.07 |
| S&P 500® Index | 7.03 | 15.47 | -50.95 | 0.40 | 1.00 |
| MSCI ACWI Ex USA Growth Index | 4.27 | 17.08 | -57.37 | 0.23 | 0.95 |
| Bloomberg US Aggregate Bond Index | 4.05 | 4.14 | -17.18 | 0.56 | 0.03 |
| S&P GSCI Index | 0.79 | 23.10 | -87.22 | 0.08 | 0.50 |

Time Period: Since Common Inception (1/1/2000) to 12/31/2023

Calculation Benchmark: S&P 500® Index

*Figure 2: Correlation characteristics of managed futures (SG CTA Index) versus other key asset classes including equities (S&P 500), global equities (MSCI ACWI Ex-USA Growth Index), fixed income (Bloomberg US Aggregate Bond Index), and commodities (S&P GSCI Index). Index returns and correlation data are from January 1, 2000 to December 31, 2023. Past correlations are not necessarily indicative of future correlations. Source: Morningstar Direct.*

## Managed Futures for The Masses: A History of Growth

Managed futures is among the most time-tested of alternative investing styles. Despite origins in commodities futures trading, a heritage made evident by the commodity trading advisor

(CTA) moniker that remains in vogue today, the contemporary multi-asset approach to managed futures bears industry roots and institutional adoption spanning back to the 1970s. Attempts to bring managed futures products to the masses have witnessed a fair share of false starts over the years. During the late 1990s and early 2000s for example, a spate of private fund launches marketed to individual investors earned more of a reputation for high fees and lack of transparency than for diversification potential, sometimes charging investors as much as 9% per annum with few disclosures.[1] Investors rightfully balked and today the vast majority of the managed futures industry's $336.4 billion in assets under management continues to be accessed by institutional investors through privately managed hedge funds or separate accounts. Figure 3 plots the evolution of assets in the Managed Futures space from 1980 to the present and (on the right) publicly traded funds in the U.S. relative to the broader industry. From this figure, we can see how managed futures is one of the largest alternative investment categories in the institutional space while public funds remain only a small and more recent portion of the space.

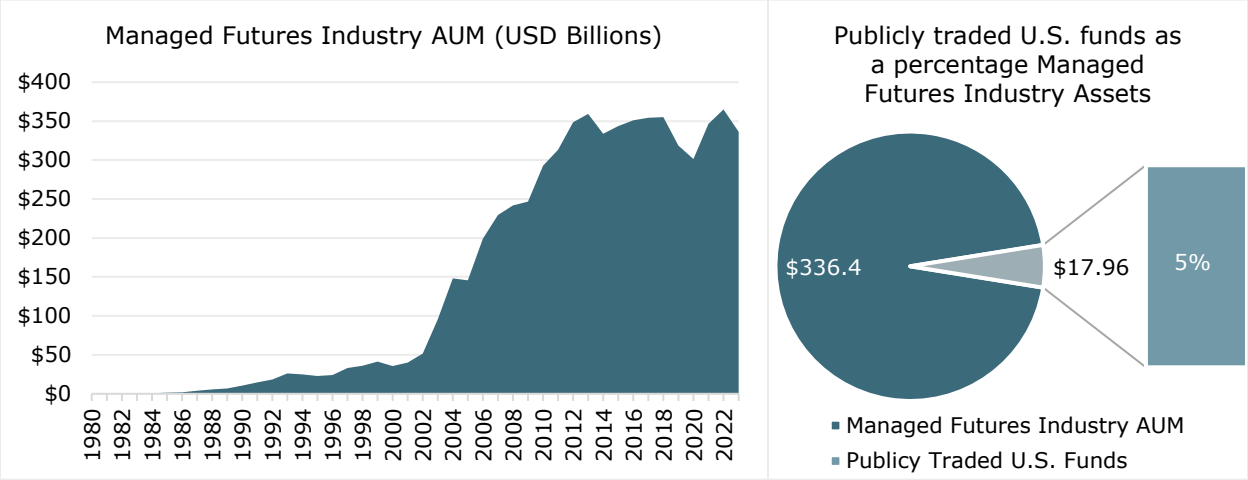


*Figure 3: Left: Assets in the Managed Futures space since 1980. Right: publicly traded U.S. funds as a percentage of Managed Futures industry assets as of December 31, 2023. Source: BarclayHedge, Morningstar Direct, AlphaSimplex.*

Publicly traded and regulated managed futures funds, however, represent a relatively young and rapidly evolving market. Since the first U.S. '40 Act managed futures mutual fund launched in 2007, investor adoption has shown to be swift but cyclical along its path to today's $18.5 billion in category assets, which represents a meaningful but still niche segment of the alternatives fund market.[2] Figure 4 plots the evolution of assets and the number of category constituents in the U.S. '40 Act systematic trend category since 2007.

[1] Evans 2013.
[2] To clarify the differences between access vehicles for managed futures, we provide a table of various characteristics for these vehicles in the appendix.

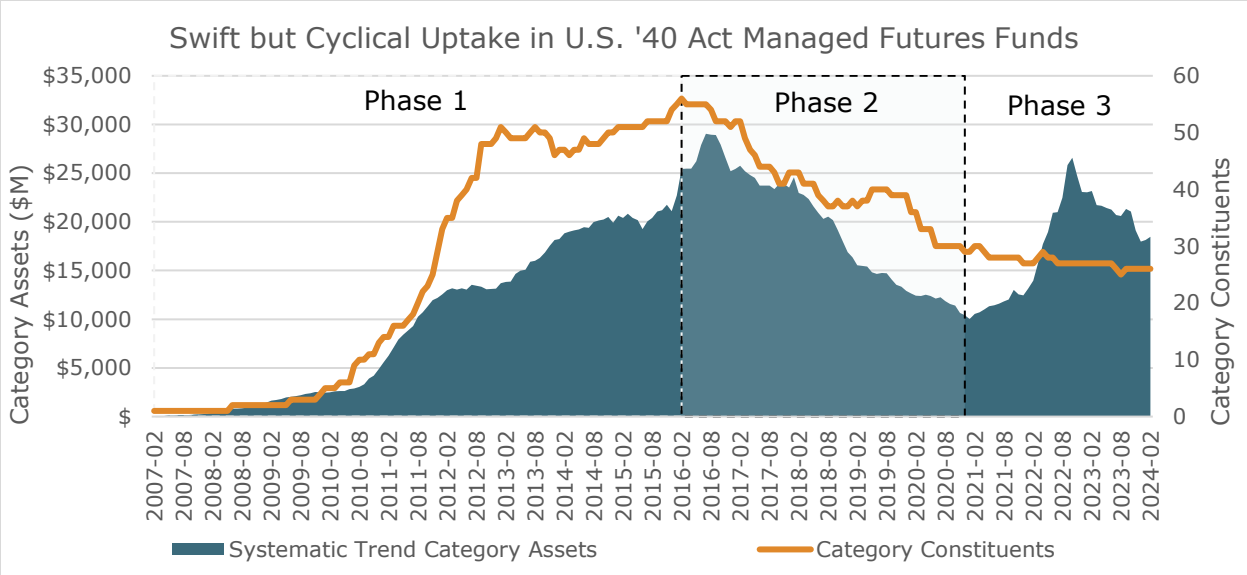


*Figure 4: Evolution of managed futures assets in the U.S. '40 Act mutual fund systematic trend category. Data from 2007 to February 2024. Source: Morningstar Direct.*

## Evolution of Managed Futures Products

A look beneath the surface reveals an evolution of the market landscape that to date could be characterized across three phases: beginning with product proliferation, followed by consolidation or maturation, and most recently renewed interest and innovation.

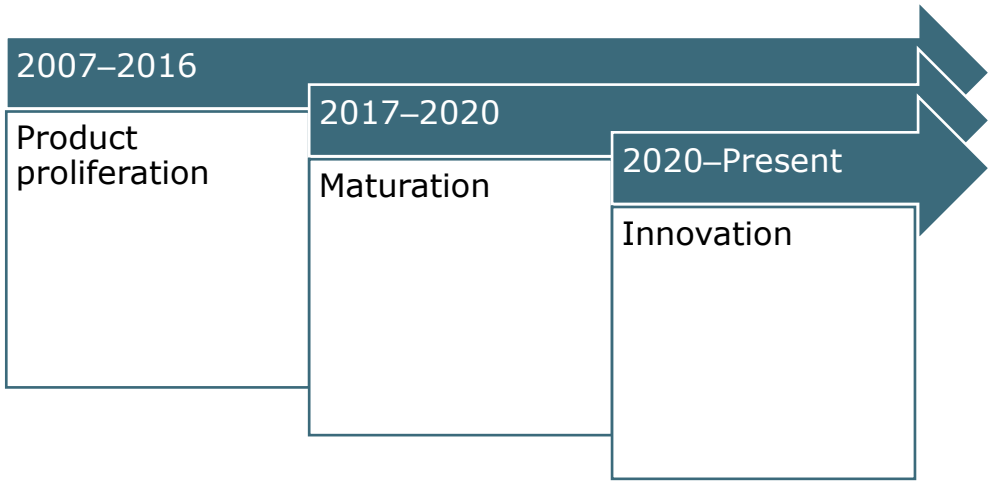


*Figure 5: The phases of evolution in the managed futures U.S. '40 Act mutual fund space.*

### Product Proliferation (2007–2016)

Early adoption of managed futures funds was aided by the tailwind of a challenging macro environment for traditional asset allocations. For example, as seen in Figure 1, the average

12-month rolling return of the S&P 500 from 2000–2010 was -0.90% versus +7.98% for the SG CTA Index, a common hedge fund benchmark that tracks the 20 largest institutional managed futures funds. With a timely launch in 2007, the first U.S. '40 Act managed futures fund returned +8.53% in 2008 versus -37.29% for the S&P 500, helping to springboard the nascent Systematic Trend category[3] to a rapidly growing group that hit a peak of nearly $30 billion in assets across 55 funds by 2016.

### Maturation (2017–2020)

Tailwinds turned to headwinds for managed futures funds by 2017 as investor enthusiasm waned against the backdrop of improving return profiles for traditional assets and growing investor concern regarding the complexity and quality of liquid alternatives in general. This period of consolidation saw the number of managed futures funds nearly halved to 29 category constituents by the end of 2020, helping to reduce fees and weed out less successful products. Figure 6 plots the Systematic Trend category's average fees from 2007 to 2024. From this graph, it is clear that consolidation and competition reduced fees from over 2% to a current average fee of 1.62%. Another interesting part of this consolidation process is that by 2017 the correlation of the average fund's returns to the hedge fund benchmark had risen significantly, from just 0.5 in 2007 to consistently landing north of 0.95, suggesting an increasingly institutional-grade cohort amongst the underlying managers. The right-hand chart of Figure 6 plots the rolling 12-month correlation between the Systematic Trend category and the SG CTA Index. From this graph, it is clear that the overall correlation of the U.S. public fund category is now more in line with the institutional hedge fund index.

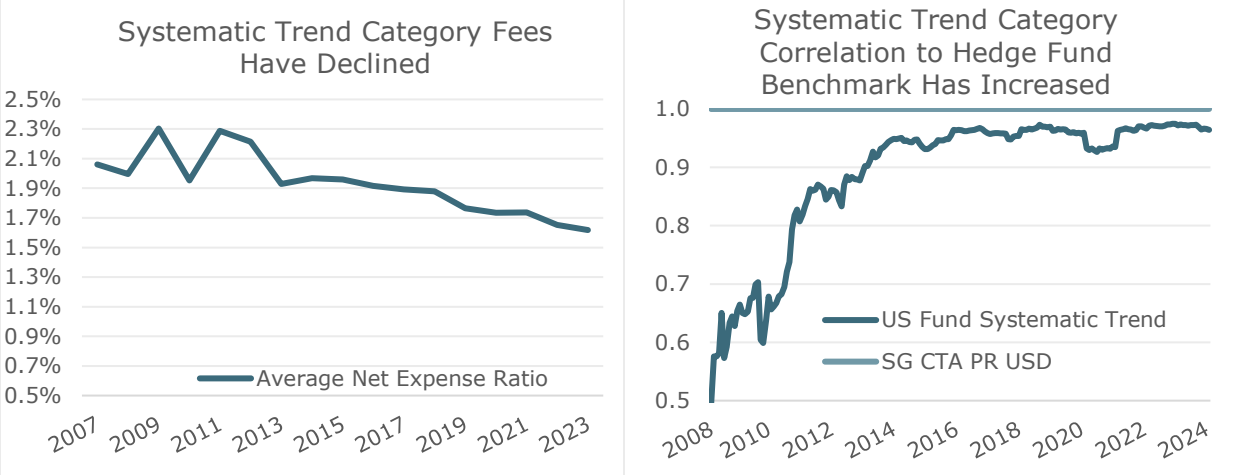


*Figure 6: Left: Average category fees for the managed futures U.S. '40 Act category from 2007 to February 2024. Right: Correlation between the managed futures U.S. '40 Act category and a commonly-used institutional index (SG CTA Index) from 2007 to February 2024. There is no assurance that past patterns in fees or correlation will continue in the future. Source: Morningstar and AlphaSimplex.*

[3] Systematic Trend is the most common sub-style of managed futures strategies; it is also the category Morningstar uses for most managed futures funds.

## Innovation (2020–Present)

Renewed interest in managed futures has been stoked by a series of disruptive events beginning with the COVID-19 pandemic, subsequent rising inflation, and geopolitical tensions, to name a few. Additional proof points for systematic trend funds' diversification potential were particularly clear in 2022. During this period, increasingly seasoned track records were punctuated by a +17% average return as stock and bond indices declined by double digits. Product development and innovation have continued to accelerate alongside demand aided by regulatory tailwinds set in motion just a few years prior. Assets within systematic trend ETFs rose more than six-fold to just under $1.5 billion in the three years ending 12/31/23.

Critical to the recent innovation and accelerated adoption of alternative ETFs are two SEC rules, often referred to as the "ETF rule" and the "Derivatives rule", which lowered the barriers of entry for bringing new ETFs to market.[4] These rules created a more consistent and transparent regulatory framework, particularly as it relates to the utilization of derivatives within ETFs.

The "ETF rule" and "Derivatives rule" were passed to help facilitate greater competition and innovation within the industry and the corresponding impact on the alternative ETF market since has been profound. In the five years ending December 31, 2023, the number of ETFs within Morningstar's Alternative and Non-Traditional Equity category groups grew from seventy-seven ETFs representing $5.7 billion in assets to three hundred eighty representing just under $140 billion in assets.

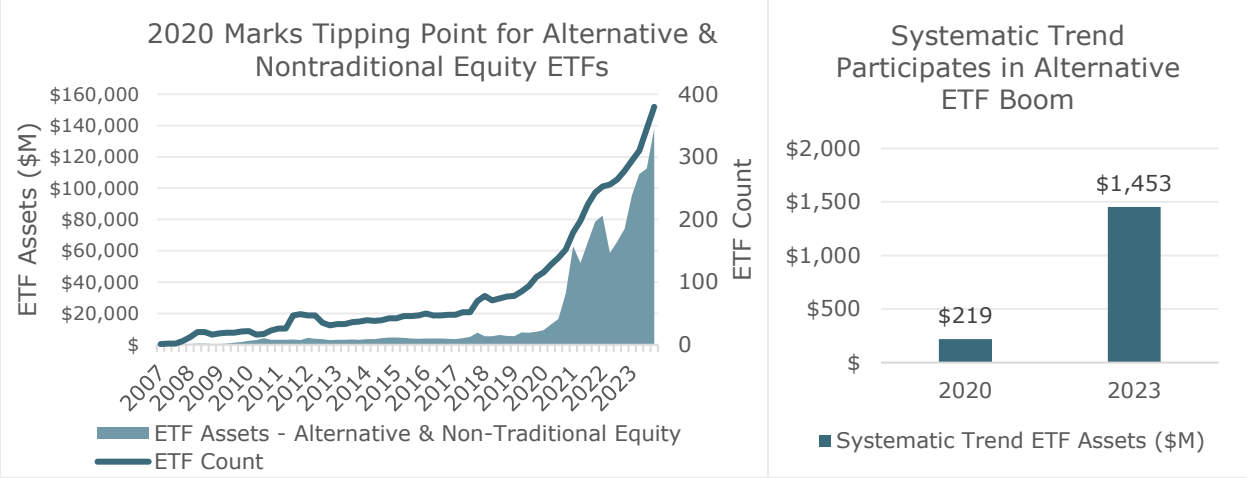


*Figure 7: Left: ETF assets within Morningstar's Alternative and Non-Traditional Equity category groups from January 1, 2007 to December 31, 2023. Right: ETF assets within Morningstar's Systematic Trend category as of December 31, 2020 and December 31, 2023. Source: Morningstar Direct, AlphaSimplex.*

[4] "ETF rule" and "Derivatives rule" refer to rules 6c-11 and 18f-4, respectively, under the Investment Company Act of 1940.

# Managed Futures ETFs: The Next Phase

One of the key advantages of public funds is their transparency, regulation, and access to a wider range of investors. ETFs provide a convenient access point for accessing fund investments in a daily liquid vehicle similar to a mutual fund. As a result they have several common use cases for both retail and institutional investors. Common use cases for Managed Futures ETFs are described below.

## Direct Investment in Managed Futures

Similar to Managed Futures mutual funds, ETFs provide comparable returns with an often simplified approach. Daily liquidity and ease of trading in ETFs provide a simple method to access Managed Futures returns and index tracking or replication strategies are one emergent trend amongst recent ETF launches within the liquid alternatives space.

As previously discussed, the performance of publicly traded funds has evolved to increasingly resemble that of private institutional funds. However, it is important to recognize that dispersion amongst manager styles and return profiles for managed futures is wide for both public and private funds relative to traditional asset classes. For example, looking at return dispersion within the Systematic Trend category, total return between top and bottom quartile funds varies by 3.88% annualized over the most recent five-year period versus a gap of just 0.63% for the Intermediate Term Core Bond category.

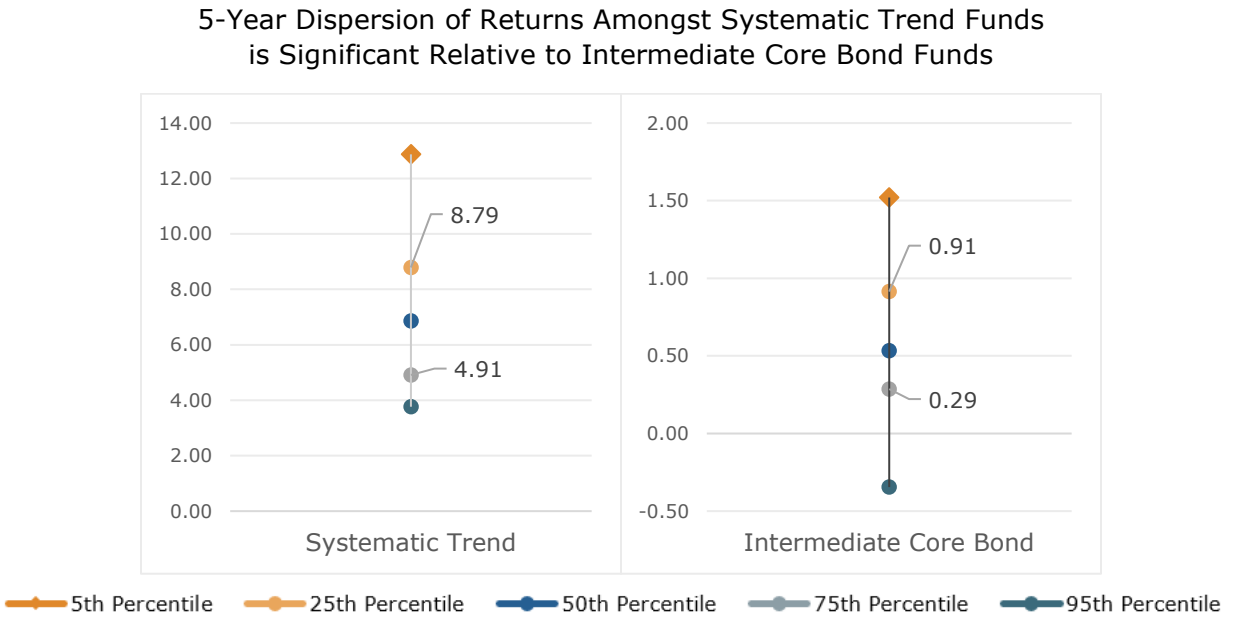


*Figure 8: Dispersion of 5-year annualized returns among funds within Morningstar's Systematic Trend and Intermediate Core Bond categories. Past dispersion is not necessarily indicative of future dispersion. Source: Morningstar Direct and AlphaSimplex as of February 29, 2024.*

On the one hand, the dispersion of returns suggests potential benefits to taking a targeted approach to single-manager selection. Simply tracking the index or peer group may prove more appealing for those looking to target the broad characteristics of the space while seeking to limit the risk of a single manager failing to deliver upon expectations.

Interestingly, managed futures index replication may be particularly well suited to the ETF vehicle structure because of the simplified set of markets typically utilized in the approach.[5] Flagship mutual funds or LP offerings of prominent managers in the space often feature dozens or even hundreds of markets. Replication strategies, on the other hand, more commonly feature only one or two dozen markets across the core asset classes. A highly differentiated opportunity set is a potential source of alpha and return dispersion amongst the private fund managers, but the more modest basket of instruments associated with index tracking can help ETF market makers keep spreads tight and reduce transaction costs for investors, particularly in the formative stages of an ETF as it seeks to increase in size and trading volume.

## Model Portfolios: Diversification with Lower Fees

Model portfolios represent an important source of asset growth for alternative ETFs. Looking at the U.S. model portfolio universe under Morningstar's coverage, AUM recently increased to $424 billion as of June 2023, up from $286 billion in June 2021. In addition to streamlining the investment process and providing a more consistent client experience, reduced costs are a sometimes-overlooked benefit for advisors that choose to adopt model portfolios. According to Morningstar, the average allocation model was 17bps less per annum than the cheapest share class of allocation category mutual funds.[6]

ETFs tend to have lower fees than mutual funds and provide index-like returns which can easily be incorporated into model portfolios that have an allocation to alternative investment categories. For example, while the average net expense ratio for the Systematic Trend category (which includes mutual funds and ETFs) has declined to 1.62%, the average ETF expense ratio is 0.85%. Alongside the industry trend of increasing model portfolio adoption so too has the opportunity set increased for alternatives within models for advisors looking to outsource this more complex corner of the portfolio construction process.

## Liquidity and Portfolio Completion

Although many think that ETFs are a retail-specific product, there are a surprising number of institutions who are adopting the use of ETFs in their portfolios. Why is this the case? For many institutional investors, mutual fund investment is not a common access point due to

[5] A closer examination of approaches to index tracking or replication strategies is a subject of a forthcoming paper.
[6] Millson and Kephart 2024; data as of December 31, 2023.

their fee structures and approval processes. In addition, many institutions are already accessing the space via funds of one, co-mingled funds, or separately managed accounts. These access points are fee efficient, but they require more complex subscription and redemption processes for changing allocations with individual managers. As a result, a liquid ETF product can provide a method for building a liquidity buffer that can easily be adjusted daily. This can be a method for portfolio completion and allow a full allocation of capital with flexibility. This specific use case demonstrates why ETFs are also of interest to institutions as a portfolio completion and liquidity tool in addition to their uptake by retail investors.

## The Evolving Managed Futures Ecosystem

In this paper, we highlighted the growth of the managed futures space as new products and vehicles begin to expand outside the private fund space. The U.S. ’40 Act space also provides a roadmap of possibilities for evolution in the newly growing managed futures ETF space. As more investors have access to diversifying returns, they will also have more tools and access points for building portfolios that include an allocation to alternative investments such as managed futures.

# Appendix

## Characteristics of different investment vehicles[7]

| | SMAs | LPs | Mutual Funds | ETFs |
|---|---|---|---|---|
| **What investors own** | Collateral and futures /forward contracts | Interest in LP | Shares of the mutual fund | Shares of the ETF |
| **Typical Minimum Investment** | ~$50M | ~$5M | ~$1K | The price of one share (Can be less than $100) |
| **Customization Ability** | Yes; typically volatility is customizable | No | No | No |
| **Taxation** | Typically utilized by institutional investors only. | Typically K-1 Reporting. | Typically 1099 Reporting. Some tax efficiencies gained by use of 1256 contracts. | Typically 1099 Reporting. Similar tax efficiency as Mutual Funds due to limited potential to utilize in-kind share redemptions. |
| **Fees[8]** | Typically negotiable | Average Management Fee: 0.93% plus incentive fee (if applicable) | Average Net Expense Ratio: 1.64% | Average Net Expense Ratio: 0.85% |
| **Transparency** | Daily access to security-level information | Monthly holdings | Monthly holdings | Daily holdings |
| **Liquidity** | Daily | Typically monthly | Daily | Intra-day |

[7] Source: Morningstar Direct as of March 31, 2024 and AlphaSimplex internal estimates.
[8] Source for fee data for Mutual Funds and ETFs is from Morningstar Direct as of March 31, 2024. Fee data for LPs is from eVestment as of June 30, 2021.

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