

# INVESTING FOR UNCERTAINTY

Diversify across market regimes with managed futures



In their latest white paper, “[The Managed Futures Ecosystem: The Rise of the Managed Futures ETF](#),” AlphaSimplex’s Kathryn M. Kaminski, Ph.D., CAIA, Chief Research Strategist and Portfolio Manager, and Scott M. Sample, CFA, Client Portfolio Manager, trace the evolution of managed futures and spotlight the asset class’ historically diversified returns across market regimes.

Throughout time, the authors discovered, “*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.*”

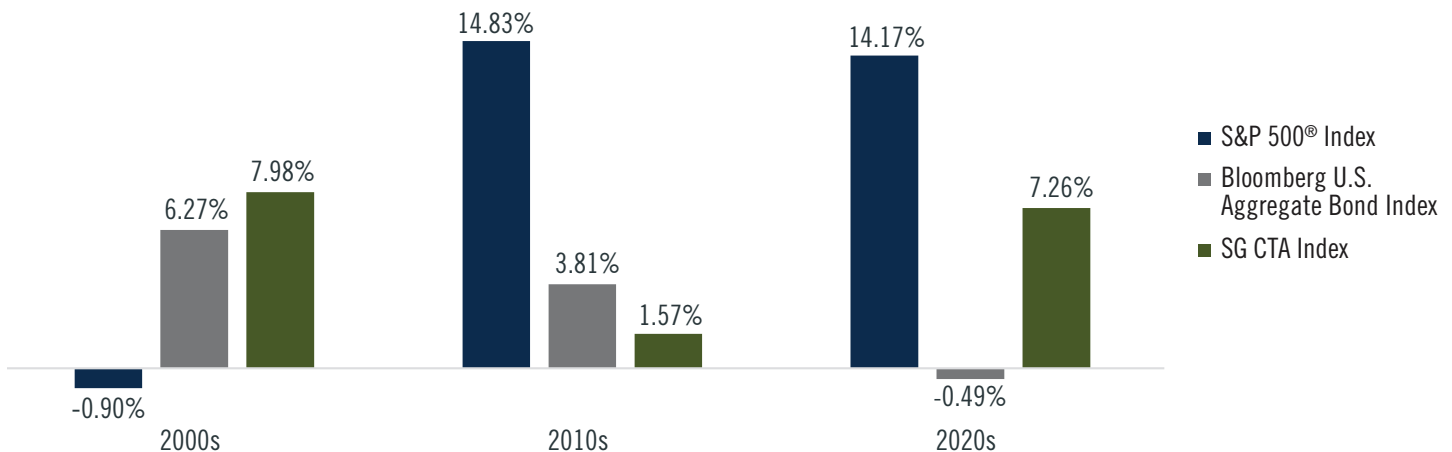
AlphaSimplex coined the term **crisis alpha** to reflect these potential gains from periods of market stress or dislocation.

## Low Correlation to Traditional Asset Classes

Since the turn of the 21<sup>st</sup> century, managed futures have provided historical diversification benefits to investors, including low correlation to traditional asset classes.

As illustrated in the chart below, Kaminski and Sample show relative returns by decade for managed futures versus stocks and bonds.

**RELATIVE RETURNS TO TRADITIONAL ASSET CLASSES HAVE INFLUENCED MANAGED FUTURES ADOPTION: AVERAGE ROLLING 12-MONTH RETURN BY DECADE**



**Past performance is not necessarily indicative of future results.** See last page for index definitions. Sources: Bloomberg, AlphaSimplex.

Average rolling 12-month returns for equities (S&P 500® Index), fixed income (Bloomberg U.S. Aggregate Bond Index), and Managed Futures (SG CTA Index) from 1/1/00 to 3/31/24 plotted by decade.

During the 2000s, when equities were largely negative, managed futures achieved positive returns. The following decade was strong for equities, but a bit more challenging for managed futures. In the 2020s, as of 12/31/23, both managed futures and equity markets experienced positive returns while bonds struggled.

**The historical case for including managed futures in a larger portfolio is clear. Adding managed futures may diversify an investor’s holdings to help manage risk over time.**

To further support this point, Kaminski and Sample demonstrate that the correlation between managed futures and U.S. equities, international equities, fixed income, and commodities since 2000 is extremely low.

**POTENTIAL FOR DIVERSIFICATION AND A MORE EFFICIENT PORTFOLIO**

Index returns, risk, and correlation data (1/1/2000 – 12/31/2023)

Correlation Matrix						Risk-Reward					
	1	2	3	4	5		Return	Std Dev	Max Drawdown	Sharpe Ratio	Beta
1 SG CTA Index	1.00					SG CTA Index	4.45	8.73	-14.26	0.34	-0.07
2 S&P 500® Index	-0.12	1.00				S&P 500® Index	7.03	15.47	-50.95	0.40	1.00
3 MSCI ACWI ex-USA Growth Index	-0.06	0.87	1.00			MSCI ACWI ex-USA Growth Index	4.27	17.08	-57.37	0.23	0.95
4 Bloomberg US Aggregate Bond Index	-0.01	0.11	0.18	1.00		Bloomberg US Aggregate Bond Index	4.05	4.14	-17.18	0.56	0.03
5 S&P GSCI Index	0.10	0.33	0.46	-0.08	1.00	S&P GSCI Index	0.79	23.10	-87.22	0.08	0.50

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

**Past performance is not indicative of future results.** Source: Morningstar Direct and Virtus Performance & Analytics. All data calculated since SG CTA Index inception (1/1/00), Sharpe Ratio (risk-free rate is 90-Day Treasury Bill) and Beta calculated against the S&P 500® Index. See last page for glossary and index definitions.

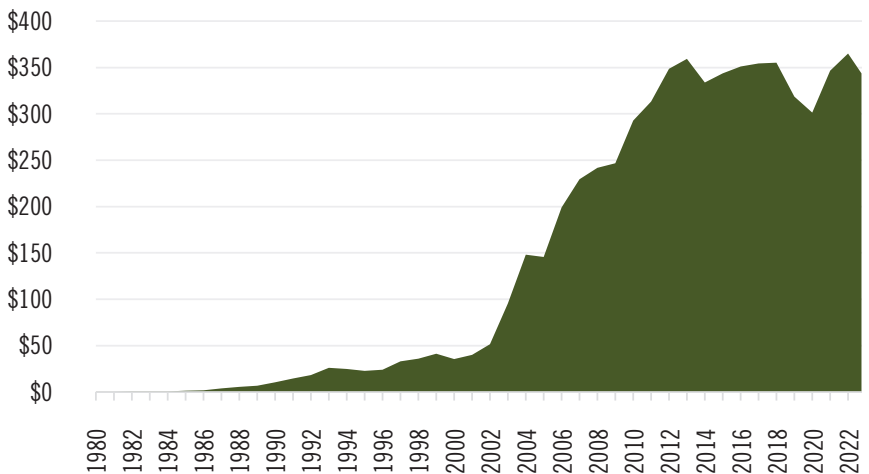
**A Brief History of Managed Futures**

The contemporary multi-asset approach to managed futures, according to Kaminski and Sample, “bears institutional roots back to the 1970s.” Institutional use cases stayed relatively low until the mid-2000s, when managed futures exploded on the back of a challenging macro environment for traditional assets throughout the global financial crisis.

Individual investors did not have similar access to this asset class until recently. Early attempts to bring managed futures to individual investors in the late 1990s and early 2000s resulted in several false starts that earned managed private funds a reputation for high fees and lack of transparency. As a result, the market for publicly traded and regulated managed futures funds is still relatively young and rapidly evolving. While managed futures comprise one of the largest alternative investment sectors for institutions, public funds retain a small portion of the space (approximately 5% of the \$336.4 billion in assets as of 12/31/23).

**ASSETS IN THE MANAGED FUTURES SPACE SINCE 1980**

Managed Futures Industry AUM (USD Billions)



Sources: BarclayHedge, Morningstar Direct, AlphaSimplex.

## How to Access and Incorporate Managed Futures

The rise of alternative ETFs has been instrumental in helping individuals access transparency, daily liquidity, and ease of trading in the managed futures space. Within the ETF wrapper, however, there can be a wide dispersion between styles and return profiles. Index tracking or replication strategies are an emergent trend that offer investors the broad characteristics of managed futures while seeking to limit single manager risk.

Thanks to the simplified set of markets typically utilized in an indexing approach, replication strategies may also be particularly well-suited to the ETF structure. Mutual funds or prominent LP offerings often feature dozens or even hundreds of managed futures markets. And, while such a highly differentiated opportunity set may be a potential source of alpha and return dispersion for private fund managers, ETF replication strategies that include fewer options across core asset classes may help managers keep spreads tight and reduce transaction costs for investors.

## AlphaSimplex's Hybrid Approach to Managed Futures Replication

AlphaSimplex has been at the forefront of researching and developing systematic, quantitative alternative investment strategies since the firm's founding in 1999. The Virtus AlphaSimplex Managed Futures ETF (ASMF) takes a hybrid approach to managed futures, combining aspects of top-down replication with proprietary bottom-up insights.

- **Managed Futures Industry Replication** – Top-down approach utilizes advanced statistical techniques to identify and emulate core exposures or beta of the 20 largest managed futures funds in the world to deliver the aggregate view of the industry while reducing single-manager risk.
- **AlphaSimplex-Informed Trend** – Bottom-up approach incorporates proprietary model data to influence portfolio positioning with the objective of enhancing risk-adjusted returns and reducing tracking error.

AlphaSimplex combines robust statistical techniques with informed industry expertise, includes a wide asset set, and incorporates risk-management controls. The result is a portfolio with the potential to closely track a diversified portfolio of leading managed futures strategies.

### Key Features

- 1 **Diversification** Replication models utilize 20 liquid futures contracts across global equity, fixed income, currency, and commodity markets.
- 2 **Risk Management** Disciplined, systematic approach to risk management process that considers volatility and correlation, among other aspects of risk.
- 3 **ETF Accessibility** ETF and index-replication approach reduces fees and single manager risk while offering daily liquidity and transparency.



For more information, contact us at 1-800-243-4361 or visit [www.virtus.com](http://www.virtus.com).

The commentary is the opinion of AlphaSimplex. This material has been prepared using sources of information generally believed to be reliable; however, its accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice or an offer of securities.

#### IMPORTANT RISK CONSIDERATIONS

**Exchange-Traded Funds (ETF):** The value of an ETF may be more volatile than the underlying portfolio of securities it is designed to track. The costs to the portfolio of owning shares of an ETF may exceed the cost of investing directly in the underlying securities. **Derivatives:** Derivatives may include, among other things, futures, options, forwards and swap agreements and may be used in order to hedge portfolio risks, create leverage, or attempt to increase returns. Investments in derivatives may result in increased volatility and the portfolio may incur a loss greater than its principal investment. **Equity Securities:** The market price of equity securities may be adversely affected by financial market, industry, or issuer-specific events. Focus on a particular style or on small, medium, or large-sized companies may enhance that risk. **Interest Rate:** The values of debt instruments may rise or fall in response to changes in interest rates, and this risk may be enhanced for securities with longer maturities. **Credit Risk:** If the issuer of a debt instrument fails to pay interest or principal in a timely manner, or negative perceptions exist in the market of the issuer's ability to make such payments, the price of the security may decline. **Currency Rate:** Fluctuations in the exchange rates between the U.S. dollar and foreign currencies may negatively affect the value of the portfolio's shares. **Commodity and Commodity-Linked Instruments:** Commodity and commodity-linked instruments may experience a return different than the commodity they attempt to track and may also be exposed to counterparty risk. **Foreign & Emerging Markets:** Investing in foreign securities, especially in emerging markets, subjects the portfolio to additional risks such as increased volatility, currency fluctuations, less liquidity, and political, regulatory, economic, and market risk. **Leverage:** When a portfolio is leveraged, the value of its securities may be more volatile and all other risks may be compounded. **Financial Concentration:** Because the portfolio is presently heavily weighted in the financial sector, it will be impacted by that sector's performance more than a portfolio with broader sector diversification. **Portfolio Turnover:** The portfolio's principal investment strategies may result in a consistently high portfolio turnover rate. A higher portfolio turnover rate may indicate higher transaction costs and may result in higher taxes when the portfolio is held in a taxable account. **Quantitative Model:** Investments selected using quantitative models may perform differently from the market as a whole or from their expected performance. There can be no assurance that use of a quantitative model will enable the portfolio to achieve positive returns or outperform the market. **Market Price/NAV:** At the time of purchase and/or sale, an investor's shares may have a market price that is above or below the fund's NAV, which may increase the investor's risk of loss. **Market Volatility:** The value of the securities in the portfolio may go up or down in response to the prospects of individual companies and/or general economic conditions. Local, regional, or global events such as war, terrorism, pandemic, or recession could impact the portfolio, including hampering the ability of the portfolio's manager(s) to invest its assets as intended. **Prospectus:** For additional information on risks, please see the fund's prospectus.

#### GLOSSARY

**Alpha** is a risk-adjusted measure of an investment's excess return relative to a benchmark. **Beta** is a quantitative measure of the volatility of a given portfolio relative to the overall market. Higher beta suggests higher volatility. Beta can also refer to relative volatility to a portfolio's stated benchmark. **Correlation:** A measure that determines the degree to which two variables' movements are associated. The correlation will vary from -1 to +1. A -1 indicates perfect negative correlation and +1 indicates perfect positive correlation. **Maximum Drawdown** measures the peak-to-trough decline during a specific record period of an investment, fund, or commodity. A drawdown is usually quoted as the percentage between the peak and the trough. **Sharpe Ratio** measures the efficiency, or excess return per unit of risk, of a manager's returns. It is calculated by taking the portfolio's annualized return, minus the annualized risk-free rate (typically the 30-Day T-Bill return), divided by the portfolio's annualized standard deviation. The greater the Sharpe Ratio, the better the portfolio's risk adjusted return. **Standard Deviation** measures variability of returns around the average return for an investment portfolio. Higher standard deviation suggests greater risk. **Tracking Error** measures the difference between the performance of an asset or portfolio and that of its corresponding benchmark index.

#### INDEX DEFINITIONS

The **Bloomberg US Aggregate Bond Index** measures the U.S. investment grade fixed rate bond market. The index is calculated on a total return basis. The **MSCI ACWI ex USA Growth Index** captures large and mid cap securities exhibiting overall growth style characteristics across 22 Developed Markets (DM) countries and 24 Emerging Markets (EM) countries. The growth investment style characteristics for index construction are defined using five variables: long-term forward EPS growth rate, short-term forward EPS growth rate, current internal growth rate and long-term historical EPS growth trend and long-term historical sales per share growth trend. The **S&P 500® Index** is a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The **S&P GSCI® Index** is designed to reflect the performance of a production-weighted basket of physical commodities. The index is calculated on a total return basis with all proceeds reinvested. The **SG CTA Index** is designed to represent the performance of the 20 largest Trend Following commodity trading advisors (CTA) programs in the managed futures space. To qualify for inclusion in the index, a program must be open to new investment, report returns on a daily basis, be an industry recognized trend follower as determined at the discretion of the SG Index Committee, and must exhibit significant correlation to trend following peers and the SG Trend Indicator. The index is equally weighted, and rebalanced and reconstituted annually. AlphaSimplex Group, LLC is a part of the SG Trend Index. All indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment.

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