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Profiting from trends you can rely on

The CFM IS Trends Trust is a proven alternative beta strategy in action. Liquid, low cost and with a low level of correlation to traditional markets, it ticks all the boxes for investors.

Advisers and investors are becoming increasingly familiar with alternative beta strategies – which attempt to capture, in a systematic way, behavioural biases and alternative risk premia. It's the kind of strategies which make up the building blocks of most hedge fund strategies.

Alternative beta investment products have a great deal to offer in terms of addressing the portfolio challenges which plague investors in volatile markets – in particular, the need for real diversification and de-correlation from traditional equity and bond benchmarks. Alternative beta aims to provide a scalable set of strategies capable of delivering returns that are de-correlated from equities and fixed income, over a period of three to five years – particularly when those returns are needed most, namely in periods of market stress. They are also liquid and low cost.

Capital Fund Management (CFM) president Philippe Jordan says the CFM IS Trends Trust (CFM IS Trends) invests in the alternative beta strategy of long term trend-following, which recognises that a rising price tends to continue to rise, and a falling price to fall, and captures these trends systematically. CFM IS Trends invests across five global core asset classes – commodities, currencies, fixed income, short-term interest rates and equities – and in more than 100 different markets worldwide.

A proven concept

Jordan says alternative beta strategies are conceptually simple and have proven to be persistent for more than 200 years. Long-term trend following in particular aims to be both uncorrelated to traditional markets, but also "long volatility" which means that it tends to deliver positive performance during times of stress. This means it can play a crucial risk management role within a portfolio.

"Alternative beta strategies can reduce overall portfolio risk by smoothing out the return path of a portfolio. This is important because we know that human nature is such that investors often sell when assets fall, at the worst possible time. By smoothing the return path, we help investors stay invested, which is proven to lead to better overall returns over time," he explains.

CFM research shows trend following has exhibited a favourable relationship with market stress over time.

Looking at the worst historical periods of market crisis, trend following has been positive and anti-correlated to the S&P 500, providing downside protection, the quantitative manager says.

Where the IS Trends Trust differs from other long term trend following strategies is in the quality of the implementation – in particular portfolio construction, systematic risk management and operational risk control. Not to mention cost minimisation.

The implementation edge

Put simply, the trust identifies long-term trends in a time series of prices, in a systematic way. It then invests in these trends via a pool of liquid futures contracts – and can invest in up to 120 futures contracts at any given time across the five asset classes mentioned earlier.

The investment manager says price-based data is a robust means of identifying trends "because there's been such a lot of it." The research team looks at data sets that go back 50 to 150 years or up to 200 years using large scale data processing and "employs a number of slow moving averages of prices to detect and participate in both up and down trends".

Some of the recent uptrends in the past six months include crude oil, the US dollar, base metals, and overall global equities markets.

"The system we have in place will basically turn if any of these sectors have, for the previous several months, been heading in one direction, up or down," Jordan says.

But isn't trend following just investing in momentum?

That's exactly the point, according to Jordan. Because rising prices tend to continue to rise and falling prices to fall, CFM IS Trends invests long to capitalise on rising prices but will go short when falling prices continue to fall.

Jordan explains long-term trend following as a strategy is not new and it forms the basis of many managed future and CTA strategies available in Australia and globally.

Alternative beta strategies, like long-term trend following, can provide the kind of effective diversification and risk management previously only known (and used) by very few, usually via investment in a hedge fund. But that's precisely where CFM IS Trends represents an evolution in investing.

"We now understand that many factors which contributed to the non-correlated, strong returns of hedge funds can be captured in alternative beta strategies – and more importantly, we have been able to make these available in a low cost form to both institutional and retail investors," he says.

Jordan does offer a word of warning, citing the common misconception that trend following is protective of your equities portfolio at all times or in an instantaneous market move.

"That is not entirely true. The trend seeks to be protective of your equities portfolio over time," he says.

In this sense the CFM IS Trends Trust has shown to be an absolute return strategy, with constant levels of risk.

Jordan explains the investment portfolio begins with an equal allocation of risk across all sectors. It then uses particular methodologies to break down individual futures contracts into "modes". By taking into account each contract's sensitivity to the trend, we can add robustness via the portfolio construction process.

The quote

Because long-term trend following aims to be de-correlated from equity and bond markets it can protect a portfolio, particularly during times of market stress.

Choose your risk and reward

Where CFM adds value for investors and advisers, and where it has an edge in the markets, is in its distinctive approach to investment options and fees.

The trust is split across two sets of unit classes, with different volatility targets and fees. Class A targets 10% volatility and has a 0.6% per annum management fee, whereas Class B targets 15% volatility and charges 1.125% per annum. This means that investors can choose whether to pay higher fees for a potentially higher return, but on the flipside, accept a higher level of volatility.

"We believe that you should pay beta fees for a beta strategy, which isn't something we see everywhere in the market, so this as a very strong point of differentiation for CFM," Jordan says.

"There is no need for investors to pay high fees for what are essentially low cost strategies, or for actively managed strategies which do not perform as expected. And this is one of the ways in which we see ourselves as industry disruptors – we are offering investors access to high-quality, proven alternative beta strategies which are not only liquid, but low cost."

He adds that CFM's "uniqueness" as a firm is the by-product of 26 years' experience dealing with trends at various frequencies, ranging from intra-day trends all the way up to seven or eight months.

"We were, and still are, pioneers in alternative investment strategies, and are one of only a handful of global investors to apply rigorous academic techniques to analyse the massive amounts of data now available, using state-of-the art technology," Jordan says. **FS**

Watch the video on www.fsitv.com

The CFM IS Trends Trust is Lonsec and Zenith rated and available on several major platforms. It is distributed in Australia through Winston Capital Partners. As at 28 February 2018, after fee performance since inception (July 2017) was 8.4%.
For more information please see www.cfmaltbeta.com.au