



Managed Futures are not a New Asset Class

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In the ongoing search for more diversification – especially low correlations to stabilize returns in a difficult stock environment – advisors have recently shifted towards alternative investments. From real estate and REITs to gold and other commodities, a recent [FPA survey](#) found that 91% of advisors are using some form of alternative investments.

Sadly, though, the focus on finding investments that have a low correlation to equities has grown to such an obsession that we're willing to name anything that has a low correlation as "a new asset class." Indeed, correlation was ranked as the number one criterion for choosing an alternative investment in the FPA's survey, although that survey did not indicate whether correlation was with respect to equities or other asset classes. While some alternatives truly have their own investment characteristics unique from stocks and bonds, other alternatives – like managed futures – simply represent an active manager buying and selling existing asset classes.

It's about time for us to start distinguishing between a real alternative asset classes (e.g., commodities or real estate) and the value of managed futures.

The inspiration for this article comes from a conversation I had recently with some planners about the use of managed futures in a portfolio as a new "alternative asset class." The planners were considering whether the returns of managed futures had a low enough correlation to be viewed as a different asset class, and they were struggling because some managed futures funds are more correlated to markets than others.

In considering the question, recall what a managed futures fund *is* in the first place. The managed futures industry consists of [commodities trading advisors \(CTAs\)](#) who invest in futures contracts, generally either using a proprietary trading system/methodology they have developed or simply by investing with discretion. Depending on the manager style and approach, they may go long or short futures contracts, and a manager may use future contracts in any number of market segments, from metals and grains to equity indexes to currencies to bonds.

The prices of futures contracts will fluctuate with the price of the underlying asset (gold, wheat, S&P 500, the Euro, the 10-year Treasury, etc.), although because only a percentage of the futures contract's value is required to trade it, futures trading implicitly involves leverage. Some managed futures funds may try to follow momentum trends; others have more market-neutral strategies.



Nonetheless, price changes for a managed futures fund are a result of price changes in existing asset classes (bonds, equities, commodities, currencies, etc.), which are purchased using a futures contract instead of the underlying investment itself. The overall returns of a managed futures fund are driven by the trading strategies of the fund manager.

A managed futures fund is nothing more than an active manager running a go-anywhere long/short strategy implemented using derivatives. If we are looking at a fund manager who directly went long the S&P 500, short the Euro, short the 5-year Treasury, long the 10-year Treasury, long gold, and short wheat and cocoa at the same time (without using derivatives), we'd view it as an incredibly eclectic mix of investments for that manager, and we'd hope that he or she was making some good investment decisions. The fact that the manager happens to do the exact same thing using futures contracts does not change the underlying nature of the strategy and investment!

As many point out, many managed futures funds have produced returns that have low correlations to traditional stocks and bonds. To which I say: *Of course* they have! Many of them are investing in half a dozen or more different underlying asset classes, net long on some and net short on others, or they're holding market-neutral positions and betting on prices or spreads to widen or narrow. *Of course* they're going to have a low correlation to a single long-only asset class benchmark!

But if I hold the portfolio mentioned earlier – long the S&P 500, short the Euro, short the 5-year Treasury, long the 10-year Treasury, long gold, and short wheat and cocoa – and generate returns that have a low correlation to stocks and bonds, it's *not* because my portfolio is invested in a new asset class. It's because I have some a broad mix of long and short positions of a whole bunch of *existing* asset classes!

Of course, all of this is not to imply that managed futures are a "bad" investment. There are some strong performers. The most popular index for tracking managed futures funds is the [Barclay CTA Index](#) (no relationship to the [Barclays global financial services firm](#)), which shows some remarkably stable returns – only five down years in the past 30 (including 2011 year-to-date), and a positive 14.09% return in the difficult 2008 calendar year.

Many of the managed futures investments available today in mutual-fund form have short track records (e.g., [Altegris Managed Futures Strategy Fund](#) (MFTAX) and [Natixis ASG Managed Futures Strategy Fund](#) (AMFAX)), but some are simply fund-of-funds using outside managers (CTAs) who may have more of a historical track record (e.g., the aforementioned Altegris fund or the [Equinox MutualHedge Frontier Legends Fund](#) (MHFAX)). On the other hand, many of the funds are expensive, and there are definitely some survivorship bias problems in the tracking indices, [as a Wall Street Journal article pointed out recently](#).



Notwithstanding the costs and performance concerns, there is still a great deal of allure to managed futures funds and the opportunity to earn positive returns in what has been and may still be a difficult ongoing investment environment for equities. But shed the notion that investing in these gives you an additional asset class in your portfolio. It simply means you're expecting the implementation of the active manager's strategy to produce favorable (and low-correlation) returns; whether that expectation is reasonable or not depends entirely upon the manager's skill, the effectiveness of his or her models, and his or her ability to execute. You'd better know a whole lot about those manager attributes before handing over your clients' money. And if you're a passive-index investor and believe markets are efficient, you should stay away altogether. If you don't believe predictable inefficiencies occur in the markets, there's no reason to give your money to a derivatives-based go-anywhere long/short active money manager whose sole job is to capitalize on those anomalies and opportunities!

The bottom line, I can't stress enough, is not that managed futures funds are bad. They may be a decent (or dare I say, good?) investment for some clients – at least if the underlying active manager is good. But generating low correlation returns does not make it a new asset class. It just makes them an "interesting" active manager!

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