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Managed Futures: An Undiscovered Asset Class

Superfund Financial (Middle East) Ltd., a member of the Superfund group of investment companies, recently became one of the first managed futures fund providers to be licensed to operate in the Dubai International Financial Centre. The Superfund group recently celebrated its 10th anniversary. Superfund companies have established offices in over 16 countries, collectively employing more than 370 employees worldwide. Assets in excess of $1.5 billion for more than 50,000 private and institutional investors worldwide are managed in Superfund funds.

As of October 2006, the Superfund flagship fund, Superfund Q-AG, returned 505% since inception in March 1996, an annualized return of 18,4% each year.

Automation, Experience and Discipline are the Keys to Choosing a Partner

The key attraction of a managed futures fund for any investor must rest with a sound investment partner with demonstrated experience in monitoring markets and risk management. All Superfund managed futures funds use the same proprietary trading system that has been developed and refined over the past 10 years. The system, which relies on sophisticated studies of technical analysis and monitoring of trading patterns in over 100 liquid futures markets, has resulted in a strong annual average performance for Superfund funds. As of October 2006, the Superfund flagship fund, Superfund Q-AG, returned 505% since inception in March 1996, an annualized return of 18,4% each year.

Although human research and analysis are an essential part of the system, human emotion has been removed from the final decision-making process. Traders buy and sell orders online, enabling them to continuously monitor risk levels and reset "sell" orders for every open position. The Superfund philosophy has always been to identify long-term trends, follow them for as long as the profits run and exit early to cut losses, when a trend no longer seems to be sustained.

Today's investors are confronted, like never before, with the challenge of risk and return as they seek new opportunities for their capital. Stock and bond markets have shown a bit of resilience but many key indices, such as America's NASDAQ and Japan's Nikkei, continue to trade below their historical highs. Many equity hedge funds are struggling as well. Commodity and currency markets look exciting, however not many investors know how to participate individually in this area.

Many would agree that, in an ideal world, an asset class would exist that takes advantage of the best opportunities available across the financial markets. Such an opportunity would also be simple to understand and provide a substantial return at a risk level comparable to or lower than traditional investments.

Christian Baha is the founder and owner of the Superfund Investment Group, which has more than 1.5 billion USD under management. In January 1992, Christian launched his first company that developed and marketed financial software applications. From this platform, he launched Teletrader Software AG, which is currently a publicly-held company offering financial software products. In 1994, he established Austria's first discount brokerage firm, followed by the launch of Superfund's first managed futures fund for private investors in 1996, called the Superfund Q-AG.

Since we don't live in an ideal world, managed futures, a thirty year-old asset class (sometimes linked to hedge funds but with a unique risk/return profile), comes very close to providing that elusive investment opportunity. Although no single investment can satisfy 100% of an investor's needs, it is highly likely that a managed futures component will improve an investor's overall portfolio.

Unlike other hedge fund strategies, managed futures only trade in instruments that are sold on regulated exchanges and the funds themselves have registration and reporting requirements with relevant regulatory authorities.

There are four key reasons why investors are drawn to managed futures:

- The low correlation of managed futures performance to other asset classes, including stocks and bonds
- Portfolio diversification, through exposure to different commodities, currencies, diversified stock indexes and interest rates.
- The potential to simultaneously reduce overall portfolio volatility and enhance portfolio returns
- The potential for high performance over a long-term investment period

Futures: One of the World's Oldest Financial Instruments

Managed futures funds trade a diverse portfolio of financial and commodities futures contracts. A futures contract is a financial agreement between buyers and sellers that establishes a pre-agreed price and quantity for items to be delivered in the future.

The first known futures contract was signed in ancient Mesopotamia for a farmer's annual yield of wheat. In the late 19th century, organized futures markets developed for agricultural products. Futures exchanges in Chicago and London made it possible to trade futures without necessarily requiring participants to receive or deliver large amounts of physical commodities. This opened the door for futures to be used not only to enhance returns but also to hedge risk.

The concept of futures grew exponentially when, starting in the 1970s, the Chicago Mercantile Exchange created the first financial futures contracts, based on bonds, interest rates, currencies and equities. The increasing liquidity of the markets created an opportunity for the first managed futures funds to emerge.

A New Definition of Performance: Absolute Return

What the early pioneers of managed futures realized was that investors could benefit from holding a range of futures contracts, managed by experts who could maintain a disciplined trading focus that continually monitored markets and risk levels. Soon, a small community of Commodity Trading Advisors, known as CTAs, emerged. CTAs incorporated a new expectation for absolute returns: Targeting positive performance whether the overall markets are up or down. Unlike traditional mutual funds, managed futures trading advisors have the ability to go both long (taking positions that anticipate an increase in prices) and short (taking positions that anticipate a drop in market prices) and thus have the potential to profit from rising or falling markets. Managed futures funds therefore hold the potential over a long-term period of outperforming traditional equity benchmarks.

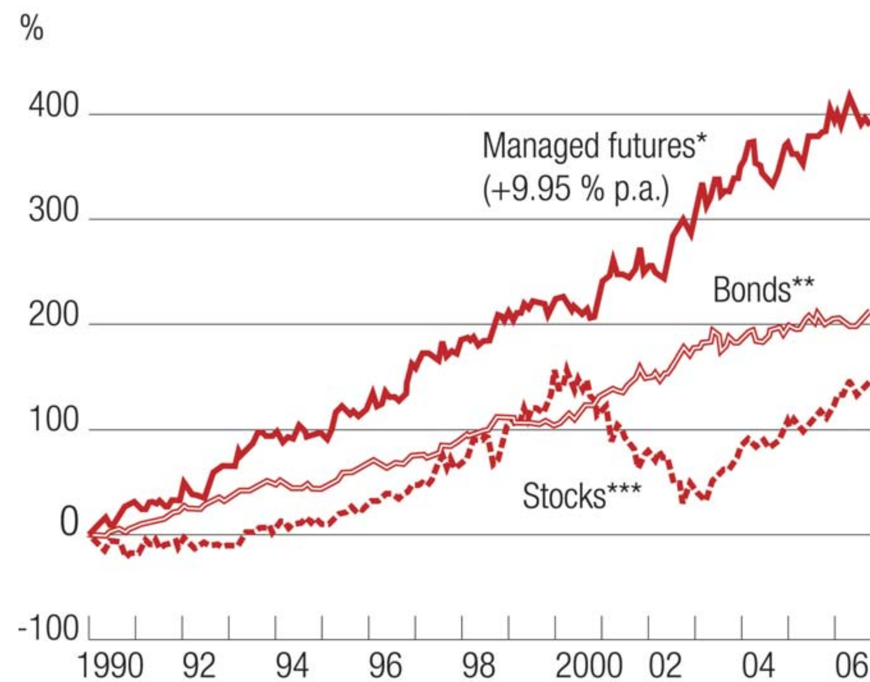
The Barclay Group's CTA Index, perhaps the best known and widest measure of performance for managed futures programs, shows a 13.5% compound annual return between January 1987 and July 2006.

A Non-correlated Investment Choice

At the same time as the early pioneers began delivering outsize returns for clients, a series of academics began to notice another reason to add managed futures into traditional portfolios: The non-correlation of managed futures to other investments.

In particular, two Harvard professors demonstrated convincingly that there was a sound basis for including managed futures in an overall investment portfolio. First, Professor Harry Markowitz advanced the concept of modern portfolio theory. A cornerstone of Dr. Markowitz' Nobel prize-winning research was the concept of an "efficient frontier" of investments, whereby he proved that adding a mix of diverse asset classes into an investment portfolio, held the potential to lower the overall volatility of the entire portfolio while enhancing investment return.

Managed futures vs. stocks and bonds



* CISDM CTA Asset Weighted Index
** JPMorgan Govt. Bond US
*** MSCI World

Source: Superfund

Another Harvard professor, Dr. John Lintner, enhanced the modern portfolio theory with a seminal study in 1983 that concluded that "portfolios…including judicious investments…in leveraged managed futures accounts show substantially less risk at every possible level of expected return than portfolios of stocks (or stocks and bonds) alone."

Expanded Interest for Many Reasons

Although initially only available to large institutional investors and high net worth individuals, managed futures funds and CTAs have recently made the investment available to a wider range of individuals, with initial fees now starting as low as $5,000. Today, it is estimated that $150 billion is invested in managed futures worldwide, up nearly four-fold since 2001.

A large part of the interest in managed futures continues to be linked to the broad exposure to diverse markets from commodities to currencies and interest rates, making this ultimately a very diverse and therefore arguably safer investment. Many take comfort in having investments in commodities, which relate to trading goods that are needed and used in daily life.

Others see the wide basket of futures contracts that underlie a managed futures fund as an investment equivalent to an airbag that can protect their portfolio even in the worst of times. In fact, a study of managed futures performance during the 10 worst months of performance for the Dow Jones Industrials demonstrated that managed futures performed positively during nine of the Dow's deepest slides.

History has also shown that managed futures, unlike bonds and stocks, also perform well in rising interest rate markets. Several studies also have shown managed futures to have a low or even negative correlation with hedge funds. As a result, managed futures funds further reduce the risk in portfolios and generally have enhanced returns as well. ■