ASPEN MANAGED FUTURES BETA INDEX QUARTERLY COMMENTARY

We are switching from a monthly to a quarterly commentary cycle for the Aspen Managed Futures Beta Index ("AMFBI" or the "Index"), to allow for more in-depth commentary. Observing a quarterly timeline also enables a more context-rich view of the financial and economic backdrop. We will also leave the format and length more open-ended, allowing for deeper dives in periods of particular interest, or for extra items like economic analysis or detailed discussions of strategy mechanics, as appropriate.

Performance Overview

The Aspen Managed Futures Beta Index returned -4.3% in the first quarter of 2017, with monthly returns of -1.03%, -0.08%, and -3.19%, respectively. While such performance is not an outlier for the strategy, it is on the low end historically—even given the extended backdrop of low-vol, choppy markets in the post-Great Financial Crisis era. It is the third-worst quarterly performance since the Index went live in 2011.

Losses were driven entirely by AMFBI's Trend sub-model. Within the Trend model, the performance attribution varied meaningfully by asset class, and the narrative around what drove performance also differs by asset class, so it is worth investigating each asset class individually.

Trend Model: Equities

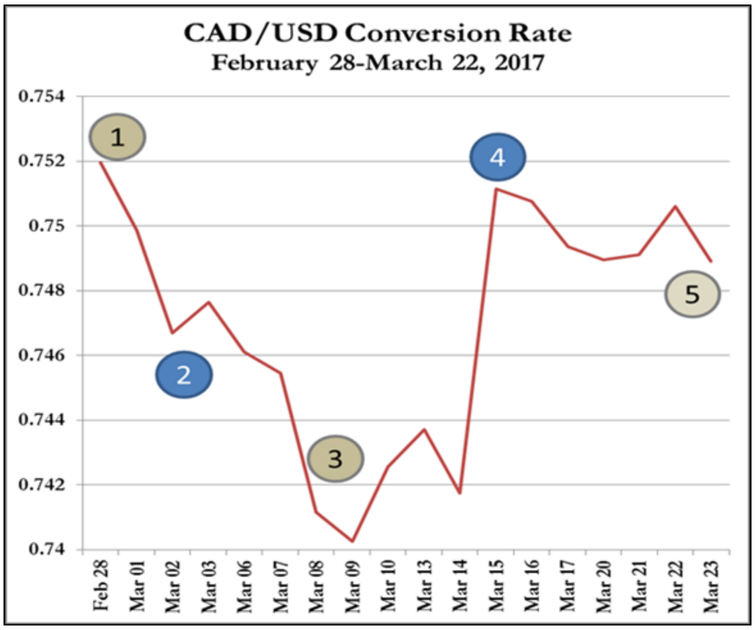
2016 was a good year and Q1 2017 was a good quarter for global equity performance. Given that backdrop, one would expect that the Trend model would profitably trade on the long side in equities, and that expectation is correct. All equity trends remained long the entire quarter, and trend trading in equities was profitable, contributing about +0.8% to performance for the quarter. It was the only profitable asset class in the Trend model.

This is only the fifth time in AMFBI history that all equity markets in the model have remained on the same side (long or short) over the course of an entire calendar quarter, and it is only the fourteenth time that this has occurred in any of the four asset classes since the 2003 inception of the model. In 12 of those 14 occurrences (86%), performance attribution from the relevant asset class has been positive. Success in such backdrops is exactly what would be expected: Long-lived trends are typically profitable trends, since losses imply whipsaws and whipsaws cause trends to change. In fact, like virtually all intermediate-to-long-term trend following systems, the Trend model actually has more losing than winning directional trades by count over time, but the greater duration and magnitude of the winning trades leads to long-run profitability in trend following overall.

Trend Model: Currencies

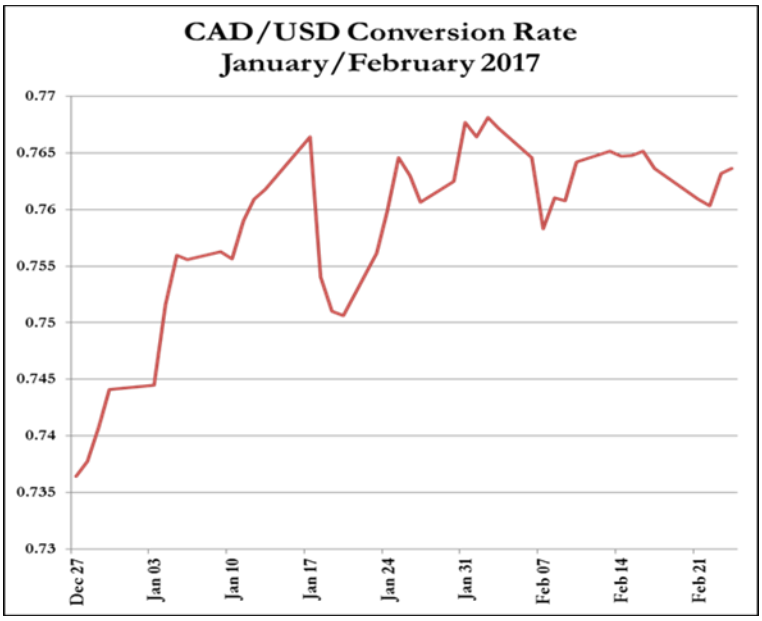
Currencies were the most problematic asset class in the Trend strategy in the first quarter, with a -2.5% return contribution. The difficulty was most keenly concentrated before and after the Fed rate hike, when the currency markets experienced a classic "V-bottom" bounce—a pattern where trend systems post losses in the initial leg down, turn short, and then post losses on the subsequent bounce back up.

Below is an annotated graphical illustration of what occurred. To avoid an overly noisy graph, we'll look at just one representative currency (Canadian Dollar), but other currencies followed a similar pattern.

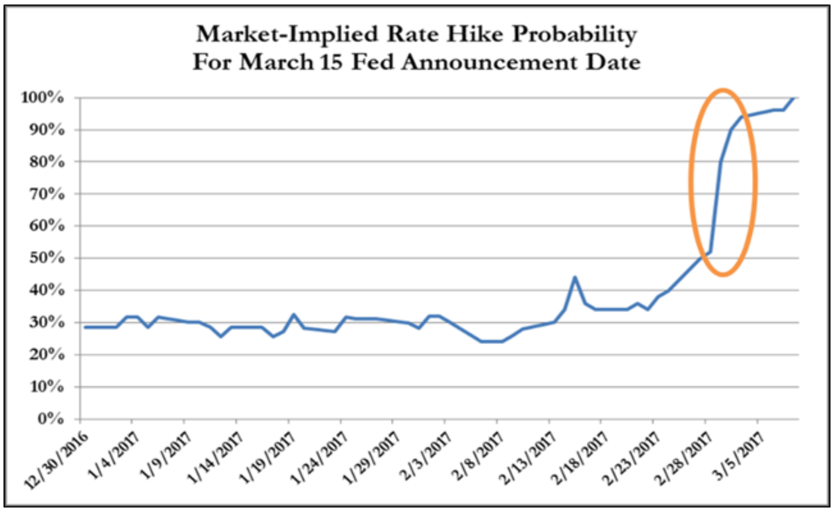


Currency “V-bottom” timeline:

1. The Trend model entered March on the long side in most currencies, due to the preceding path of FX rates. For example, here is a chart of trailing CAD prices:



2. In the first week of March, market expectations of a rate hike in the mid-March Federal Reserve meeting jumped from about 50% to nearly 100%:

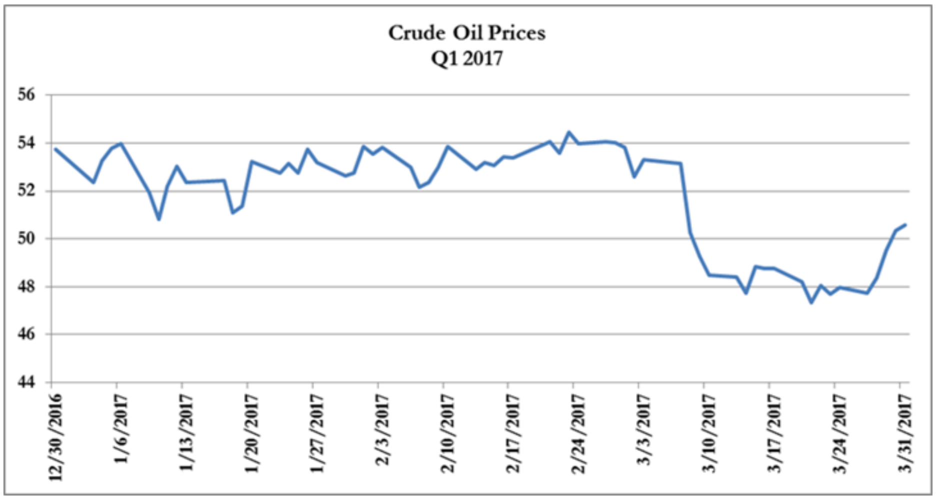


The sudden spike in rate hike expectations had ramifications for many financial markets. In currencies, the prospect of a rate increase led the US dollar to rise against most currencies, causing FX rates to move against the Index's long currency trend positions. This was the first, downward leg of the "V".

3. In response to the rapid decline in many FX rates, trend following positions turned short across the entire currency complex on March 8th.
4. As expected, the Federal Reserve announced a 25 basis point increase in the Federal Funds rate on March 15th. However, whether investors in aggregate were expecting stronger hawkishness (forward rate projections were unchanged) or simply "sold the news", the market response was surprisingly dovish. Long-term interest rates came down, stock prices rose, and the dollar fell against global currencies—to the detriment of Trend positions that were now short FX against the dollar. This was the second, upward leg of the V-bottom move in currencies.
5. As is often the case with trend following systems following a V-bottom (or V-top) drawdown in a given asset class, AMFBI subsequently retreated to mixed trend positioning in currencies. Canadian dollar in particular remained a short position (albeit less strongly so), but other currencies flipped back long.

Trend Model: Commodities

Commodities contributed -1.6% to Index performance. It was an example of the type of trendless chop that can befall trend following at times. In such times, there often isn't much of a story to tell about the evolution of commodity prices—in fact, the lack of a clear storyline is precisely the issue for trend following in such backdrops. Copper was the lone bright spot in the commodity complex, though gains in copper were accrued entirely in January. Energy sector trades were the most problematic in the quarter—largely due to trendless chop, but also partly due to a similar Fed-related V-bottom price track in March:



Trend Model: Fixed Income

Aside from a single rebalance in early March, fixed income positioning remained net short the entire quarter, even as interest rates declined modestly. AMFBI first went net short fixed income in late October of last year, and fixed income was the strongest contributor to the Index's +3.1% performance in November. The net short positioning that prevailed throughout Q1 was largely due to the November interest rate spike remaining in most trend lookbacks over the course of the quarter. Attribution from fixed income trends was -1.1% for the quarter.

Counter-Trend

Counter-Trend attribution (+0.3%) was mildly positive in the first quarter. Low Broad Risk Indicator readings for most of the quarter held Counter-Trend allocations at the high end of their allowable range, and the displacement of Trend by the allocation to Counter-Trend was also helpful in a difficult backdrop for trend following.

Despite the small end-to-end Counter-Trend return, and despite the low prevailing market volatilities overall, Counter-Trend attribution actually took a rather circuitous path in the first quarter. The model added 0.7% to Index performance in January, in keeping with generally risk-on conditions that month. After a lull in February, the apparent end of the "Trump rally" in early March and the Fed-related FX agitation thereafter drove year-to-date Counter-Trend attribution into negative territory briefly, before an end-of-month recovery brought quarterly attribution to its final level.

Performance Relative to Peers

The Aspen Managed Futures Beta Index has experienced some curious cycles of out- and underperformance relative to the managed futures industry peer group since the beginning of last year. The most recent quarter's relative performance was to the downside: After AMFBI outperformed the BTOP50 category average by 3.8% in the 4th quarter of 2016, the roles were reversed in the 1st quarter of 2017, with AMFBI underperforming BTOP50 by 2.6%. It is of course a trivial truism that model differences are the reason for two consecutive periods of unusually wide performance dispersion, but whereas AMFBI's ability to get short in fixed income faster than most CTAs was a major driver of the outperformance in Q4, underperformance in Q1 was likely largely attributable to many CTAs' overweights to long equity positioning. Note that AMFBI was also long equities the entire quarter, and profitably so, but the model won't over-weight equity trends, which limited the magnitude of the profits from equities (which proved to be the only profitable Trend model asset class in the quarter).

Longer-Term Performance Comparison

AMFBI's trailing 12-month performance (-4.71%), though negative, runs either mildly or meaningfully ahead of the CTA industry, depending on which benchmark is used. The BTOP50 in particular had a -8.5% trailing one-year return figure as of quarter-end. The differential is most notably attributable to AMFBI's substantial outperformance of CTAs with long fixed income biases during the post-US election interest rate spike.

Over longer timeframes, the vagaries of various sub-periods smooth out a bit more. On a three-year lookback, AMFBI's annualized performance (+1.4%/year) trails that of BTOP50 (+1.7%/year) by an amount that is less than what our own research indicates the long-term difference is expected to be between volatility-targeted trend models (the majority of CTAs nowadays) and non-vol-targeted models like AMFBI—in exchange, of course, for vol-targeted models providing less portfolio convexity and potentially much less crisis alpha. On a trailing five-year basis, AMFBI (+1.2%/year) actually leads BTOP50 (+0.66%/year) slightly, partly because the Taper Tantrum—when AMFBI was up and most CTAs were down due to long tilts in equities and fixed income—is still in that lookback.

Looking Ahead

As we begin the second quarter, US equity markets seem to be continuing the performance pause that began in early March. Within the Trend model, global equity trends are still positioned net long, but less so than they have been most of the year, with not much more sideways-to-down activity required to push equity positioning into a non-directional mode.

Trends in the other three asset classes are already directionally mixed, and there are relatively few strong trends (i.e., for most markets, the different monthly trend lookback lengths do not all agree). This is to be expected given the choppy backdrop of the prior quarter, and it means that at least in the short term the magnitude of the return contribution—positive and negative—will likely be relatively small for currency, fixed income, and commodity trends, while the model waits for trends to re-emerge. As of this writing, the Broad Risk Indicator remains at 0%, leaving Counter-Trend allocations at their maximum levels, though of course that can change rapidly.

We and other managed futures commentators have noted for years that the long-running post-Great Financial Crisis low-volatility backdrop, which is a primary cause of lackluster trend following performance, may be masking underlying risks in the financial system. As we discuss in a new video, while the artificially imposed low-vol environment reduces the immediate profit potential for trend followers, it likely simultaneously increases the importance of the latent crisis mitigation potential for trend strategies. Recently, even observers outside the managed futures industry have started to take notice of the seeming disconnect between real-world risks and remarkably low financial volatility—particularly in the equity markets, where actual and implied volatility (e.g., the VIX index) have been near historic lows.

With rising rates in the U.S., a change from short-term rate reduction to long-term rate stabilization in Japan, and less dovish ECB commentary in Europe, there are signs that the slow, uneven unwind of the extraordinary post-GFC central bank and government accommodationism may be underway. Hopefully a successful unshackling of the markets' customary risk monitoring capabilities will occur without major incident, which in turn would increase the likelihood that trend following systems would be able to generate a reasonable profit even in the absence of a crisis. In the meantime, trend following remains an operative mitigation tool in the event that hidden risks prove too large for the financial system to handle.

Important Disclosures

Past performance is no guarantee of future results.

All AMFBI monthly returns shown do not include transaction cost, but are net of 1.50% for estimated fees and other expenses. An investor cannot invest directly in an index.

This document does not constitute an offer to sell or solicitation of an offer to buy any security. The information contained herein is provided for educational purposes only and is not intended to solicit interest in any investment opportunity.

Data has been obtained from reliable sources. Aspen Partners believes the information herein to be reliable; yet no warranty or guarantee is made as to its accuracy or completeness.

Benchmarks & Indices

AMFBI is constructed using a quantitative, rules-based model designed to replicate the trend-following and counter-trend exposure of futures markets by allocating assets to liquid futures contracts of certain financial and commodities futures markets. The index therefore seeks to reflect the performance of strategies and exposures common to a broad universe of futures markets, i.e., managed futures beta.

"Barclays AGG" represents The Barclays Capital Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type.

"BTOP50 Index" represents the Barclay BTOP50 Index, an index of the largest investable CTA programs, as measured by assets under management.

"Euro Stoxx 50" represents a stock index of Eurozone stocks designed by STOXX, an index provider owned by Deutsche Börse Group and SIX Group. It is made up of fifty of the largest and most liquid stocks.

"Goldman Sachs Commodity Index," also known as the S&P GSCI, is a long-only index of commodity returns.

"S&P 500" represents the S&P 500 Total Return Index, a widely recognized, unmanaged index of common stock prices.

"SG CTA Index (formerly, the Newedge CTA Index)" provides the market with daily performance benchmarks of major commodity trading advisors (CTAs).

The Barclays AGG, BTOP50 Index, Euro Stoxx 50, S&P GSCI, SG CTA Index, and S&P 500 are unmanaged and do not represent the attempt of any manager to generate returns on an investment. These benchmark indices do not include transaction costs and other expenses.

Definitions

Broad Risk Indicator (BRI): A proprietary, broad market risk analysis system.

Compound Annual Growth Rate: The year-over-year growth rate of an investment over a specified period of time.

Forex: A commonly used abbreviation for "foreign exchange," it is typically used to describe trading in the foreign exchange market by investors and speculators.

Maximum Drawdown: The greatest peak-to-trough decline during a specific period of an investment.

Sharpe Ratio: A measurement of risk-adjusted performance which subtracts the "risk-free" rate of return from an investment's performance.

Standard Deviation: A measurement of the annual rate of return's dispersion from its mean, indicating an investment's volatility.