What advisers should know about managed-futures funds

Often overlooked by advisers, these noncorrelated strategies can fit well in a thoughtfully constructed portfolio

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By **Matthew Shannon**

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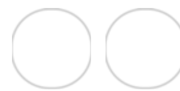

No one likes to pay for insurance but everyone likes to have a policy in place when something unexpected happens.

The same can be said for adding a noncorrelated, or negatively correlated, asset class to an investor's portfolio. When the market is moving higher day after day, these assets are almost certain to underperform. But when the market turns mdash; and as we have seen again recently, it can turn quickly and emphatically — non-correlated asset classes demonstrate their value. The challenge for financial advisers is to help clients understand this, and to position these noncorrelated strategies properly within a portfolio.

One asset class that is often overlooked by advisers is managed futures. These funds are sometimes thought of as using opaque strategies that are difficult to explain to clients and expensive to execute. Historically, there has been some truth to this. The strategies can be complex and, with some

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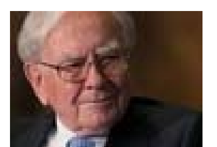

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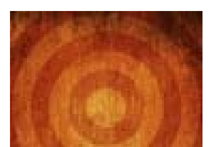

funds, there are layers of fees that are not always obvious to the investor.

For example, many managed-futures funds can have published expense ratios in the 2% to 4% range and those often don't include additional fees paid to offshore subadvisers.

Further, the value of holding non-correlated assets has not been exactly self-evident following six years of a stock market that has mostly gone up.

(Related insight: Why managed-futures funds are drawing big interest)

However, given the events of the last few weeks, we're all reminded again that markets move in both directions, thus making an even stronger case for noncorrelated strategies in a thoughtfully constructed portfolio. These days, there are all manner of "alternative" funds that hold themselves out as providing downside protection. Managed-futures funds provide a different kind of hedge as they often invest in many different asset classes (currencies, commodities and bonds, for instance). Because of this asset class diversification, they are often described as a source of "crisis alpha" — and this latest downturn supports that position. And coming into this month, if one looks back over the five worst periods for the S&P 500 since 1994, the BTOP 50 (an index generally representative of the managed-futures space) outperformed the S&P each time. In fact, the BTOP 50 had a positive return in four of the five periods and was only slightly negative in the fifth.

One example of this type of fund is the Aspen Managed Futures Strategy Fund (MFBTX). Like other managed-futures funds, the Aspen fund has lagged the S&P during the long bull market though through a full market cycle the returns should be comparable.

As an adviser, I have had to frequently remind clients what the expectations are for a fund like this and why we are recommending a position in this asset class.

(More: Managed futures shine anew, but mystery remains)

As advisers, we like to emphasize the power of compounding. Unfortunately, you can't compound what you don't have and a permanent loss of capital can be disastrous for anyone, but especially for investors nearing retirement.

Advisers using alternative investments still struggle with allocations

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There are several caveats for advisers who are considering adding managed futures to their client portfolios. Some managed-futures funds use excessive leverage, and that can result in unsettlingly large swings in NAV. In some cases, there is very little transparency as to how the strategy is actually being executed and not all funds pursue strategies designed to maximize the benefits of low or negative correlation to the equity markets. In our experience, a diversified, rules-based, trend-following approach has provided the best long-term outcomes for our clients. The good news is that there are now index-based funds available, such as Aspen's fund, which address all these shortcomings, providing transparent, liquid, relatively low cost access to the historical DNA of managed futures.

For all these reasons, an adviser taking a thoughtful, holistic approach to risk and return in portfolio construction should consider including managed futures. It's not just for high-end clients, either; whether the client has $5,000 or $5 million, we believe these funds have an important role to play. While you may have some convincing to do in the midst of an extended bull market, when stocks turn down, as they inevitably do, your clients will thank you for the thoughtful portfolio construction.

Matthew Shannon is managing director, investments and senior institutional consultant with Legacy Strategic Asset Management.

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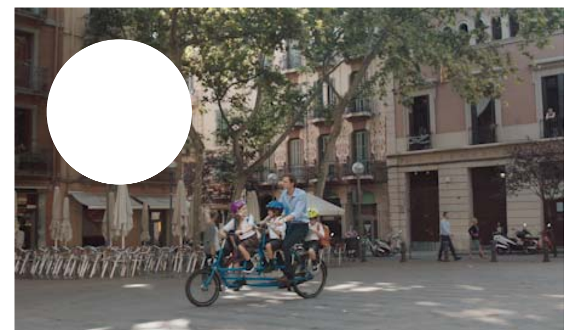

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