A REVIEW OF CTA PERFORMANCE IN 2017

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INTRODUCTION

A very strong run of returns in the second half of 2017 led to positive returns for CTAs over the year and represented a significant turnaround from the mid-year drawdowns experienced by our CTA indices. Equity indices were fertile grounds for trend following, with only a limited number of other markets offering opportunities. Short-term strategies struggled, especially at the start of the year, and on average non-trend strategies outperformed.

This snapshot analyses the performance of managed futures strategies during 2017 using the SG CTA Indices, attribution data from the SG Trend Indicator, and simulations designed to show the market environment and opportunity set for momentum trading across varying time horizons and markets.

INDEX PERFORMANCE

CTAs closed 2017 in positive territory as shown by our flagship SG CTA Index, which finished up 2.48%. Our CTA Mutual Fund and Trend Indices also finished in the black, as detailed in Exhibit 1. The CTA Index outperformed trend followers slightly, but trend followers did provide a significant positive run of performance in the second half of the year, turning around a challenging first half of the year to push CTAs back into the black. 2017 proved to be a difficult year for short-term strategies; after the SG Short-Term Traders Index led performance in 2016, these strategies ended in the red -6.73%.

EXHIBIT 1

Index Summary Statistics for 2017

	2017 Return	2017 Volatility	2017 Max Drawdown
SG CTA Index	2.48%	7.36%	-6.51%
SG CTA Mutual Fund Index	3.32%	7.41%	-5.48%
SG Trend Index	2.20%	9.90%	-9.72%
SG Short Term Traders Index	-6.74%	5.30%	-8.36%

Source: SG CIB

In a break from the norm, this was the first year the CTA Mutual Fund Index outperformed the CTA Index in its four-year history and ended up being the best performing index during 2017. As in previous years, the volatilities of the CTA and CTA Mutual Fund Indices were comparable, but CTA Mutual Funds were able to edge ahead at the very end of the year. As we noted in our mid-year performance review, index volatility in 2017 was marginally lower than the long-term average for each of our indices as a result of marginally lower average constituent volatilities. In particular, despite losses for shorter-term strategies, at the index level they recorded the lowest volatility of any of the indices. This low volatility was due partly to lower constituent manager volatility as well as low pairwise correlations between short-term strategies. The Trend Index was the most volatile index during the year and recorded volatility of 9.90%, still substantially below its historical average of 13.68%.

Lower volatility in 2017 resulted in markedly smaller maximum drawdowns at the index level within the year, even for the Short-Term Traders Index, which produced negative returns. However, over the long run, the Short-Term Traders Index extended its existing drawdown

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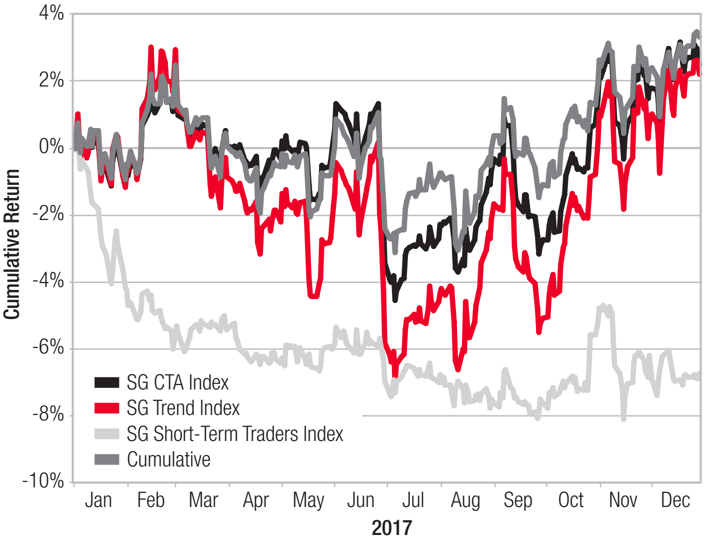
and reached its deepest ever point, approximately -16% underwater. The CTA Index also experienced losses in the middle of the year that also marked its deepest all-time drawdown.

The paths that the different CTA indices took during the year were very different. Exhibit 2 details cumulative CTA performance through the year and reveals that trend followers suffered large losses in the middle of the year after bond prices fell sharply following Draghi's bullish assessment of the eurozone's economic recovery. Trend followers lost -7.16% over the course of eight days from 27th June to 6th July, equal to approximately three-quarters of their maximum drawdown for the year. Prior to this, performance had begun positively before giving back gains to be flat for the year.

The Trend Index returned +9.90% in the second half of the year to recover losses and end positive. The experience for the CTA Index was relatively similar and both indices had only one negative month in the second half of the year; indeed October 2017 was the best return month for the Trend Index since November 2014. The CTA Index drawdown and recovery was less extreme through the year due to the presence of non-trend strategies in the broader index and resulted in the ultimate outperformance of the CTA Index. In comparison, Short-Term Traders rapidly lost -6.03% in the first two months of 2017. Index performance then drifted slowly downwards for the remainder of the year despite a brief unsustained run-up at the end of October of +2.74%, and overall short-term managers experienced nine months of negative returns.

EXHIBIT 2

SG CTA Indices Cumulative Returns 2017



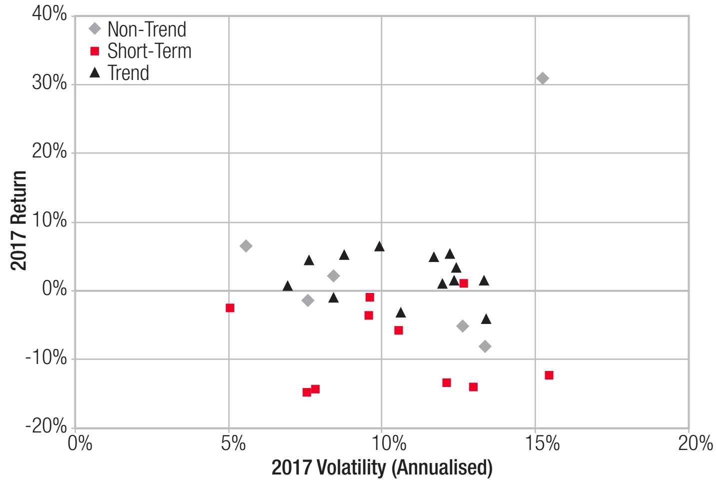
Source: SG CIB

As usual, the range of individual manager fortunes varied and is plotted in Exhibit 3, comparing their returns and volatilities for 2017. The most distinct cluster is the trend followers, which are grouped around a mean return of 2%, in line with the Trend Index overall return. Ten out of the 13 trend-following index constituents recorded positive performance and there was a 10.5% range of returns (-4% to 6.5%), which was slightly smaller than historical observations.

Short-term strategies underperformed in aggregate, and these constituent managers were loosely bunched into two groups, an upper cluster, which returned around -2%, and a lower cluster around -14%. One manager did eke out a positive return of 1.08%, but the overall experience was negative and the range of strategy returns was 1.5 times larger than that of trend followers. There was one exceptional positive outlier, a non-trend strategy which returned 31%. Non-trend managers could not be grouped into a specific cluster and were split into three positive and negative returns. It is worth noting that the positive outlier also displayed one of the highest return volatilities in 2017, approximately 15%, which was slightly higher than every other CTA constituent but one. Despite this the manager's risk-adjusted returns were still the highest of any constituent in the CTA indices during the year.

EXHIBIT 3

2017 Performance for SG CTA Indices Constituents

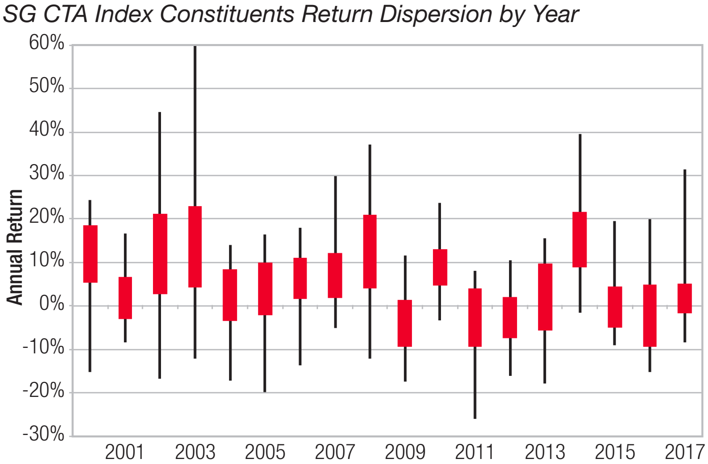


Source: SG CIB

CTA returns in 2017 were, however, remarkably undispersed, as evidenced in Exhibit 4, in which the best and worst performers are at the end of the whiskers, and the interquartile range is shown by the box. Despite the positive outlier being the fifth highest maximum return since 2000, the difference between the best and worst performers was only slightly higher than the historical average. This was helped by controlled downside returns; the minimum manager return in 2017 was again the fifth best historically since 2000: -8% compared to an average of -13%. The top quartile of returns was lower than average: only 5%, resulting in a relatively compact interquartile range equal to 7%, which was nearly half the average of previous years and the lowest of any year.

EXHIBIT 4

SG CTA Index Constituents Return Dispersion by Year



Source: SG CIB

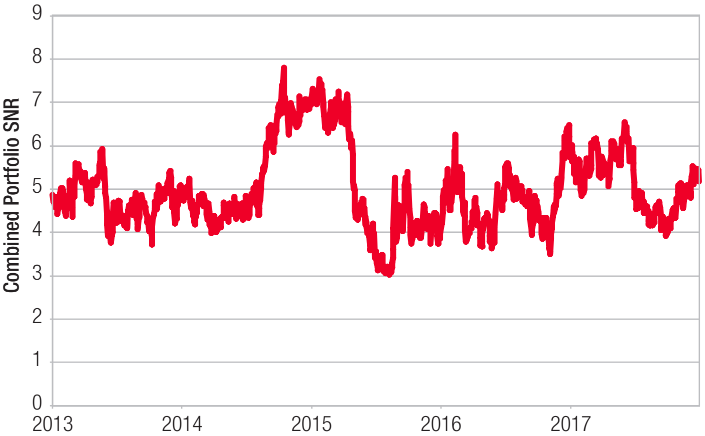
MARKET CONDITIONS FOR TREND FOLLOWING

As in previous CTA performance reviews we calculate a Signal-to-Noise Ratio (SNR) for each of the 55 markets in our Trend Indicator portfolio[1]. Ideal environments for trend following of strong directional moves with little volatility are represented by high SNR values. In contrast, volatile markets with limited directionality, or "choppy" conditions, would be more challenging and have a lower SNR.

To represent medium- to long-term trend following, we have combined the SNR calculations across markets and time frames to focus on look-backs of between 80–120 days. The combined SNR over the last five years is shown in Exhibit 5. The average SNR in 2017 was 5.2, which was 10% higher than last year's value of 4.7 and almost exactly equal to the average value over the last five years. The SNR began the year relatively elevated, sustaining values close to 2014 and 2015, and peaked at a maximum value of 6.5 at the beginning of June. There was a relatively sharp fall in the combined SNR value starting at the end of June to a low point of 3.9 in September, as conditions for trend-following strategies deteriorated in the middle part of 2017. Finally, the SNR value recovered in the final quarter, a steady increase of one-third that coincided with a run-up in index performance, as seen in Exhibit 2.

EXHIBIT 5

Combined Portfolio SNR for 55 Markets (80–120 days)



Source: SG CIB & Bloomberg

The market "trendiness" in 2017 was primarily driven by high SNR values in the Equity index sector, which were at times more than double the values of all the other sectors and presented good conditions for trend following, with an average value of 7.6 throughout the year. The average SNR value of the other sectors was 4.2 during 2017 and these markets proved more challenging.

1 For a full explanation of the calculation of the SNR please see Appendix 1

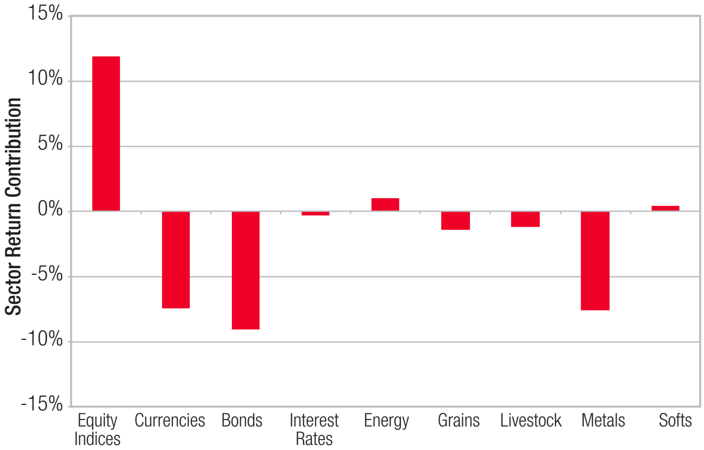
SG TREND INDICATOR RETURNS AND ATTRIBUTION

The SG Trend Indicator's returns closely matched the SNR values described above; overall returns were disappointing but the individual sector returns were very different. The Trend Indicator returned -14.96% in 2017, substantially underperforming the Trend Index, and would have been the worst individual risk-adjusted return of the trend-following constituents due to underperformance in the second part of the year. There is always return dispersion amongst trend followers, and the Trend Indicator's single-model portfolio realised a high correlation of 0.74 to the Trend Index in 2017, very close to the long-term correlation value of 0.76.

The Trend Indicator's sector returns are shown in Exhibit 6 and the clear driver of positive performance was Equity Indices, which contributed 11.91% at the portfolio level. This was the result of consistent gains from upwards trends in equity markets throughout the year. In contrast, the Currency, Bond, and Metals sectors all contributed large losses for trend followers last year.

EXHIBIT 6

2017 Trend Indicator Performance Attribution by Sector

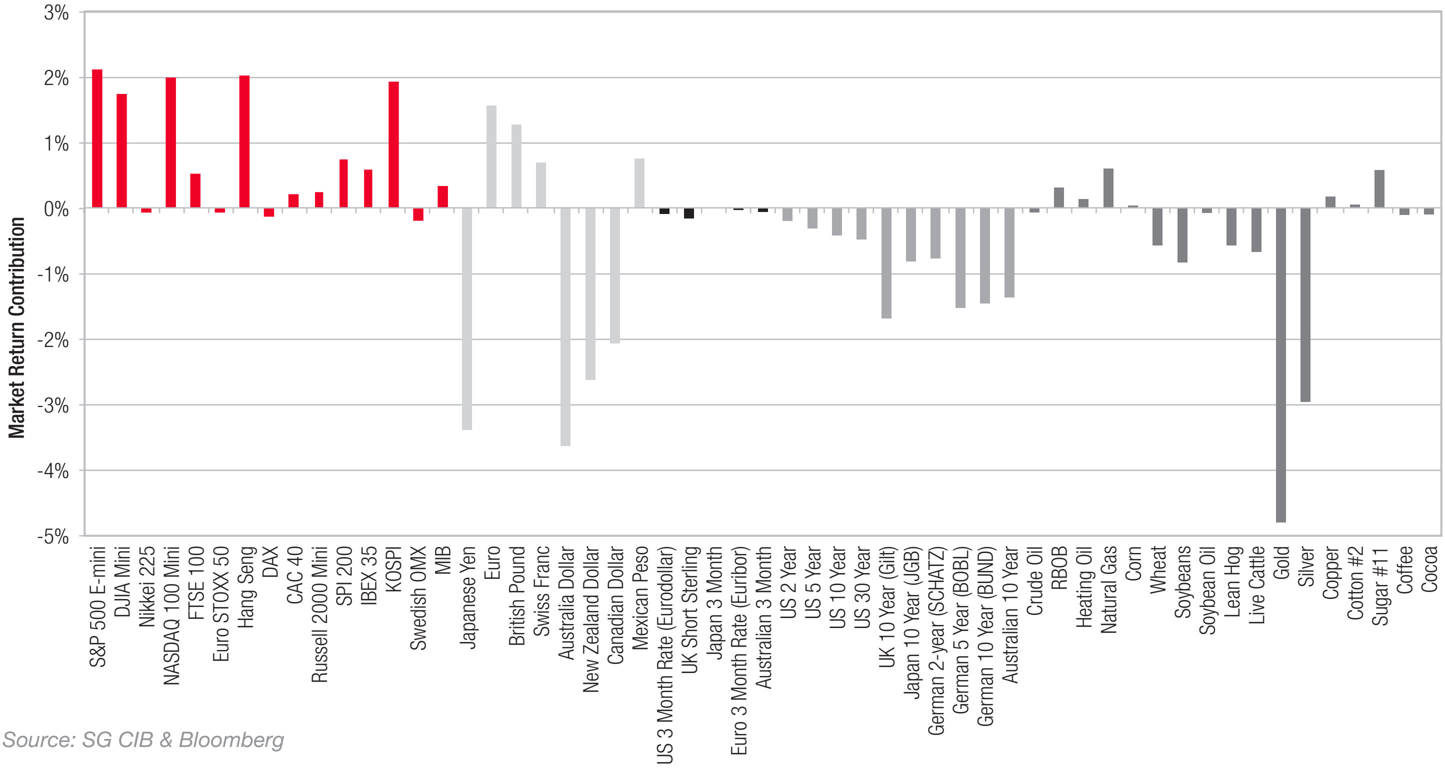


Source: SG CIB & Bloomberg

The results within each sector were interesting and are broken down in Exhibit 7, which shows the performance attribution by market. Trend-following gains in Equity markets were the result of relatively large gains in five markets that were long all year and captured upwards trends, in particular the S&P 500, which contributed the largest gain of any market, up 2.10% at the portfolio level. The remaining Equity Indices either contributed considerably smaller marginal returns or – in the case of four markets – small losses. As we have observed in the past, our model may be slightly faster than other managers, and a slower model would have potentially done better. Currency market performance was also split between winners and losers. There were four positive markets, the result of short USD trends developing in Q2,

EXHIBIT 7

2017 Trend Indicator Performance Attribution by Market



Source: SG CIB & Bloomberg

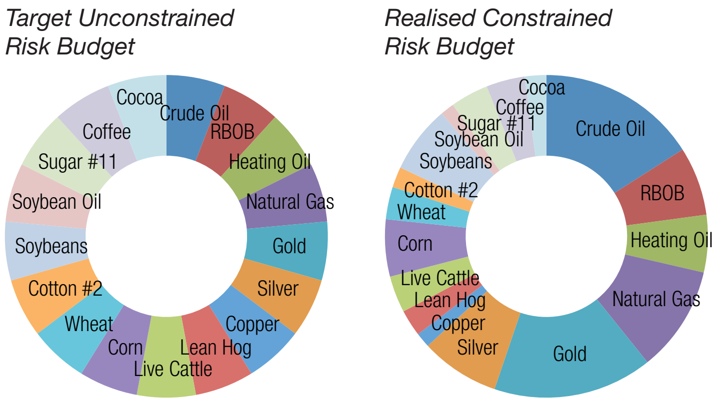
and four large losses that outweighed the gains. In these Currency markets, trends did not materialise and our model was whipsawed long and short a number of times in a series of losing trades.

Bonds and Interest-Rate sector market performance suffered steady losses thoughout 2017 and all these markets contributed negative returns to the portfolio, which were compounded by two large reversals; the first at the end of June and the second in September.

Losses were amplified in a number of markets as our portfolio-construction methodology targets equal risk allocations between sectors and markets. The low volatility in many of the Commodity and Interest-Rate markets would have resulted in target position sizes that would have been too large relative to the available liquidity. As in previous years, all Interest-Rate market performance was reduced by position-size caps and performance was muted. The majority of Commodity markets also had position-size caps in place during 2017, with risk budget reallocated to markets with larger liquidity such as Crude Oil and Gold. This is depicted in Exhibit 8, which shows the target-unconstrained risk budget versus the liquidity-constrained portfolio. This amplified the negative contribution of Gold, which was the worst performing market in 2017 – down -4.80% – alongside less severe losses in Silver, in a similar series of losing trades as markets moved sideways. The Trend Indicator's reallocation of risk highlights how important risk allocation to sectors and markets is and the differences that can exist between trend-following managers.

Finally, there were relatively positive returns from commodity markets in the Energy and Soft sectors; Natural Gas, RBOB Gasoline and Heating Oil all captured downwards moves with the model positioned short from Q1, as well as Sugar benefiting from a downward trend in the first half of the year.

EXHIBIT 8



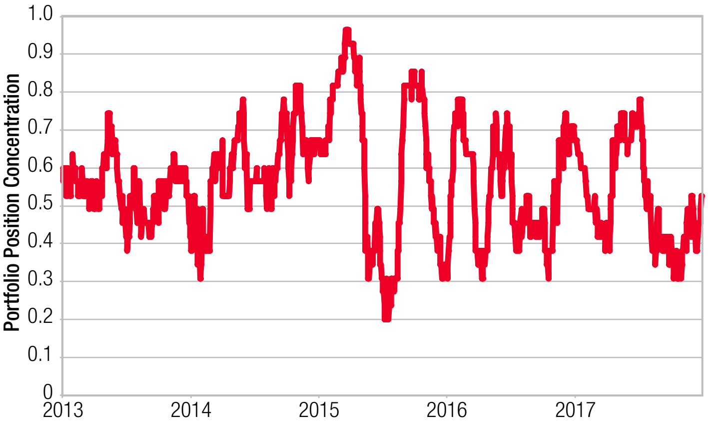
Source: SG CIB & Bloomberg

Other than Equity markets, the lack of clearly defined sector trends is displayed by the Portfolio Position Concentration (PPC) measure shown in Exhibit 9[2]. This confirms that no one thematic trade dominated the portfolio in 2017, despite the fact that a number of equity markets trended upwards. The average PPC value for 2017 was 0.52, which was only slightly lower than the recent average of 0.58, but in Q2 it did appear a theme was developing as the PPC approached a value of 0.8. This indicates a potentially large number of markets within each sector were starting to align themselves in a similar direction (be that long or short) in the middle of the year, but these trends did not persist, as the PPC value quickly decreased to nearly 0.3 and markets reverted and moved independently.

2 For a full explanation of the calculation of the PPC please see Appendix 2

EXHIBIT 9

SG Trend Indicator Portfolio Position Concentration

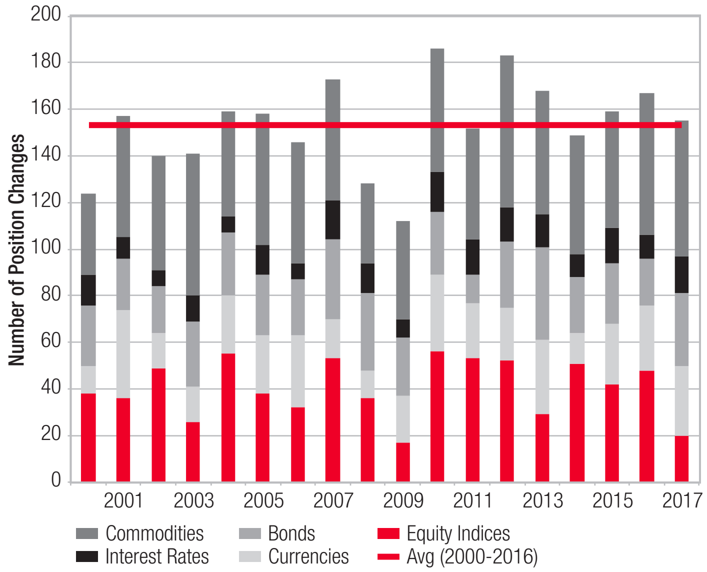


Source: SG CIB & Bloomberg

A similar development is visible in the number of days in position for our Trend Indicator model over all markets. The average trend length did peak at just over 100 days in July before a number of market reversals caused it to fall back down again, and the average over the entire year was 85 days. Overall, the number of position changes executed by the Trend Indicator was almost exactly equal to the long-term average, as shown in Exhibit 10. However, the total value of 155 position changes masks the distribution of those trades in each sector. There were only 20 trades in Equity Indices, approximately half the average, and the second lowest ever for that sector since 2000. The other sectors experienced relatively more position changes than their respective historical averages, a result of the sideways markets identified above. For example, currency markets changed direction 30 times. That is nearly four times per market and 30% more than average.

EXHIBIT 10

Number of Position Changes for Trend Indicator by Year



Source: SG CIB & Bloomberg

MOMENTUM MODEL SIMULATIONS

As with previous performance reviews, we will use a series of simple price-momentum models in order to look at the return opportunities across model time frames. Appendix 3 details the calculation methodology of these momentum models and the construction of the resulting heat map, which is shown in Exhibit 11.

The average *z*-score value in 2017 across all of the 4,400 model/market combinations was 0.11, which was significantly higher than the previous two years and correlates with better trend-follower performance than in those years. The obvious “warm” vertical stripes were in Equity Indices, which represented positive performance opportunities for momentum strategies and had the highest average sector score of 1.28 over all parameters. There were certain equity markets which displayed particularly good opportunities; in particular the Dow Jones Industrial Average recorded the highest average market value at 3.56, as well as the best individual market and model combination, equal to 3.74 for all look-back parameters of 65 days or greater – the result of one Long trade. Over look-backs less than approximately 65 days the *z*-score values did start to diminish slightly.

The other sectors did not present consistent positive performance opportunities across many model time frames. Their average *z*-score values were negative across all parameters and also between look-backs of between 80-120 days, which we typically associate with medium- to long-term trend following. The best individual look-back was 345 days and provided an average *z*-score of 0.46 across all sectors and markets. This highlights that longer-term models may have provided better opportunities for trend followers, and scanning across the heat map, there is slightly more “warmth” when looking at model parameters over 280 days. The other standout individual markets were Copper and US 3-Month Interest Rates on the positive side, recording average *z*-score values of 0.92 and 0.93, and maximum values of 1.37 and 1.35, respectively. Despite the potential for return opportunities in certain markets, as we noted previously there were position-size caps in place for many interest-rate and commodity markets. On the negative side the Australian 10-Year Bond was a particularly difficult market for trend followers to navigate, with the lowest average value of any market at -2.09 and lowest individual look-back value equal to -5.73 between medium-term time frames of 45 to 265 days.

CONCLUSION

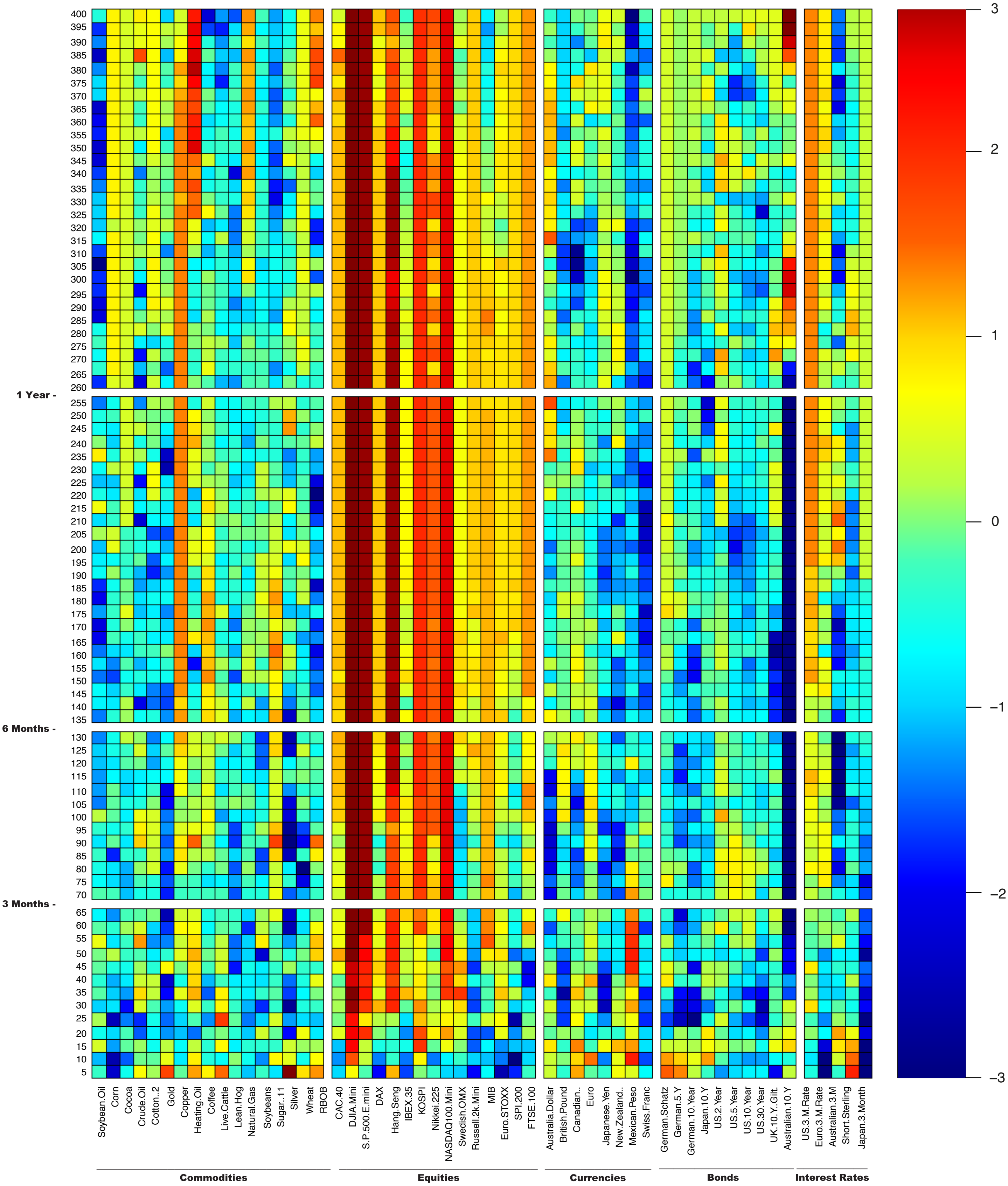
CTAs completed a positive year of returns in 2017, but there was a large drawdown in the middle of the year before a positive run of performance from trend followers put CTAs back in the black. Five of the final six months were positive in the second half of the year and the Trend Index had its best month’s return since November 2014. The Short-Term Traders Index experienced large losses at the beginning of the year and never recovered from its deepest-ever point underwater, as short-term strategies struggled throughout the year.

The dispersion of individual CTA manager returns was lower than usual in 2017 and typically grouped into clusters, apart from a number of non-trend strategies that were more dispersed and out-performed – especially one positive outlier returning 31%.

Equity Indices presented good opportunities for CTAs, but overall the opportunity set was muted by challenging conditions in other markets. The other sectors experienced sideways markets, which led to losses through a series of “whipsaw” trades and sharp reversals against prevailing trends. We noted that the risk allocation to sectors and markets of our Trend Indicator was an important part of its underperformance, and that longer-term momentum models may have ridden overall market price moves more favourably.

EXHIBIT 11

Heat Map of Model Time Frame / Market Z-scores for 2017



Source: SG CIB & Bloomberg

APPENDIX 1
SNR CALCULATION

The n-day SNR for a given market is calculated by taking the absolute price change over an *n*-day period and dividing it by the average *n*-day volatility. We chose to use an average true range as the volatility measure as it is best able to capture more of the intraday and overnight volatility in a way that a measurement of Close-to-Close price change does not.

The SNR for a given market is therefore calculated as follows:

$$\mathrm{SNR(n)} = \frac{\mathrm{ABS}(\mathrm{P_t} - \mathrm{P_{t-n}})}{\mathrm{ATR_n}}$$

The output of this calculation is relatively intuitive, for example, an SNR value of five indicates that the market has moved five times the volatility (average true range) over the given look-back period.

Average SNR values can be taken across multiple markets to calculate a Portfolio SNR. A Combined Portfolio SNR is calculated by averaging the Portfolio SNR across multiple values of *n*.

APPENDIX 2
PORTFOLIO POSITION CONCENTRATION CALCULATION

Using daily positions history from the Newedge trend indicator we assign a position to every market. Each long position is given a '+1', and each short a '-1'. For each sector (Commodities, Equity Indices, Currencies, Bonds and Interest Rates), we calculate the degree for position concentration as follows:

$$Sector\ Position\ Concetration\ (SPC) = \frac{ABS(\sum Market\ Positioning)}{Count\ of\ Sector\ Markets}$$

These values are then aggregated into the Portfolio Position Concentration (PPC) as a function of sector weighting as below, this gives a range bound indicator between 0 – 1:

$$Portfolio\ Position\ Concentration\ (PPC) = \sum SPC_i \times \omega_i$$

$$Where\ \omega_i = Sector\ Weight$$

Source Paper: "SG Prime Services AlternativeEdge snapshot: How many trades are there currently?"

APPENDIX 3
MOMENTUM MODEL SIMULATIONS CALCULATION METHODOLOGY AND HEAT MAP SETUP

MOMENTUM MODEL AND *Z*-SCORE CALCULATION:

In this paper we calculate a series of simple price-momentum models in order to look at performance across parameter sets.

These models are calculated using the following rules:

If Closing Price >= Closing Price *n* days ago, then go long at tomorrow's close

If Closing Price < Closing Price *n* days ago, then go short at tomorrow's close

We apply the above rules for values of *n* from 5 to 400 in intervals of five days, employing the continually adjusted futures series we use for the Newedge Trend Indicator. This gives us a total of 4,400 model / market combinations.

In order to show the return opportunity set available for these combinations we calculate a *z*-score (or Sharpe ratio) as follows:

z-score = [Model P&L using 1 futures contract] / [Standard Error of P&L]

HEAT MAP CONSTRUCTION:

The 55 markets are listed on the horizontal axis and are separated in asset class groups. The vertical axis represents the various look-back values (values of *n*) and is separated to show where a three-month, six-month, and one-year look back would sit.

Each of the 4,400 *z*-scores that we calculate is represented by one box in the heat map with the colours being determined the specific *z*-score. Squares that are coloured

- **Yellow or Red** Illustrates a good opportunity set for that model / market combination
- **Green** Illustrates flat performance
- **Blue** Highlight negative returns

In this heat map we have assumed frictionless markets and zero transaction costs in order to seek out pockets of heat where there may have been an opportunity set. For those models with short look-back periods the impact of these transaction costs would have been significant, and what may appear to be a good model / market combination may not prove to be profitable when actually traded (this is very dependent on the execution skill of a manager).

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