December 14, 2009 PIonline.com $14 an issue / $259 a year crain

Pensions&Investments

THE INTERNATIONAL NEWSPAPER OF MONEY MANAGEMENT

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ABRAHAM TRADING'S **SALEM ABRAHAM:**
"You want your seatbelt to work in a wreck, not when you're **not** in a wreck."

Alternatives

Growth spurt forecast for managed futures

Institutional investors to account for 60% of assets within five years, up from one-third

By Christine Williamson

Some 60% of all managed futures assets will come from institutional investors within five years, up from about one-third now, experts predict.

Managed futures assets totaled $213 billion as of Sept. 30, according to Barclay Hedge Ltd. At that rate, assets in managed futures are likely to grow to $500 billion over the next five years, according to executives of single-manager firms and funds of funds.

Some institutions have been using managed futures for years, including the $5 billion pension fund of Eastman Kodak Co. and the $48 billion Virginia Retirement System. More recent converts include the $83 billion Teacher Retirement System of Texas, the US$115 billion Caisse de Depot et Placement du Quebec and the $198.9 billion California Public Employees' Retirement System.

Managed futures managers, also known as commodities trading advisers, trade in futures in three financial sectors — currency, stock indexes and interest rates — and three non-financial sectors — energy, metals and agriculture. Institutions are accessing the asset class via specialist CTA funds-of-funds managers, through direct investment in single-manager CTAs and via investment platforms that offer a choice of hundreds of vetted traders.

The newfound popularity of managed futures managers or CTAs

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MANAGED

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during 2008's market crisis — when almost every other asset class was deeply negative and managed futures scored positive gains — did not go unnoticed by institutional investors.

As equity returns plummeted in the last four months of 2008, managed futures returns soared. The Barclays CTA index was up 14.09% in 2008, while the Standard & Poor's 500 index sank 36.99% and the Morgan Stanley Capital International World index dropped 41.93%.

In the first quarter of 2009, the Barclays CTA index returned -1.88%; the S&P 500, -10.98% and the MSCI World, -10.65%.

As performance of global equity markets started rebounding in March, returns of managed futures managers sagged.

In the second quarter, the S&P returned 15.91%; the MSCI World, 22.38%; and the Barclays CTA index, 0.77%. In the third quarter, the S&P was up 15.59%; the MSCI, 17.97% and the Barclays CTA, 1.93%.

The non-correlation to equity markets and the downside protection offered by CTAs are catching the attention of executives at pension funds, foundations and endowments.

"You want your seatbelt to work in a wreck, not when you're *not* in a wreck," said Salem Abraham, president and co-founder of CTA manager Abraham Trading Co., Canadian, Texas. "After the rough ride of 2008, investors are looking much more carefully at managed futures."

Abraham Trading experienced $110 million of net outflows in the fourth quarter of 2008, most of which was the result of client liquidity needs because of severe market downturns in other asset classes, Mr. Abraham said.

Assets at his firm have risen significantly to $465 million as of Nov. 1, from $310 million as of Dec. 31, with flows fairly evenly divided equally among institutional investors, hedge and managed futures funds of funds, and high-net-worth individuals.

Performance was so much better than that of hedge funds and long-only managers in last year's market decline that "institutional investors have had to focus their attention on the portfolio benefits offered by such a thoroughly uncorrelated asset class. Managed futures has become a strategic allocation in its own right now, rather than a very small part of an overall alternatives allocation," said Ernest L. Jaffarian, president and CEO of Efficient Capital Management LLC in Naperville, Ill.

Efficient Capital manages $1.9 billion in managed futures funds of funds, of which about 33% is for institutional investors.

Added allocation

The Austin-based Teacher Retirement System of Texas is an example of a pension fund that added a managed futures allocation because of the lack of correlations, especially to so-called traditional hedge funds approaches.

This past summer, as part of an overhaul, fund officials carved out a 5% allocation to managed futures strategies within the fund's $3.4 billion hedge fund portfolio. Officials expect to have completely invested the allocation by early next year.

Texas Teachers' investment staff analyzed the hedge fund portfolio and found it had excessive market exposure. The makeover was designed to enable the portfolio to provide a "neutral alpha stream," said Lee Partridge, former deputy CIO.

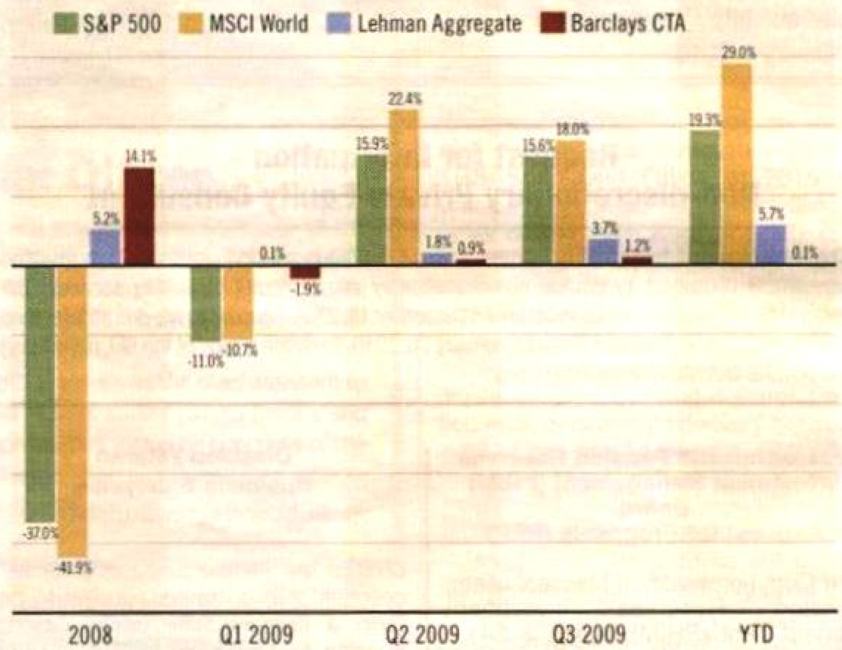
By reducing fairly heavy weightings to long/short equity, distressed, merger arbitrage and credit managers and adding uncorrelated strategies such as managed futures, equity market neutral, relative value and global macro, Mr. Partridge said market beta in the hedge fund portfolio was reduced.

Meanwhile, institutional investors of all sizes have issued requests for proposals and for information on managed futures, and many are close to making their final selections, sources said. None would give names.

"The market opportunity is explosive for managed futures on the institutional side. The managed futures story — the performance of these strategies in 2008 — is incredibly compelling for institutions," said Adam T. Rochlin, senior vice president and head of the alternative investment strategies division of MF Global Ltd., New York. MF Global manages $1.8 billion in its flagship commingled managed futures fund of funds; between 25% and 30% of the assets are from institutional investors.

Another big attraction was the easy liquidity provided by managed

Contrarian Managed futures performed well during 2008's market turmoil, but lagged in 2009.



Source: Bloomberg LP and MSCI Barra

futures strategies throughout the market crisis last year and through March 2009, even as many hedge funds slammed redemption gates shut, said Tony Gannon, CEO of Abbey Capital Ltd., Dublin.

Institutional investors were as dismayed by hedge fund managers' lack of liquidity in 2008 as they were by their poor performance, he said.

"Hedge fund gating and restrictions on redemptions put a big premium on liquidity, and a certain segment of institutional investors (is) beginning to move toward strategies that readily provide and guarantee it," Mr. Gannon said.

Abbey Capital manages about $1.4 billion in managed futures funds of funds, about 50% for institutional investors with daily redemption terms.

The fairly recent institutionalization of the managed futures industry also has made it much less scary for institutional investors.

CTA managers traditionally have been independent futures traders, generally small and lacking the infrastructure and safeguards that institutional investors require.

"The maturation of managed futures and their infrastructure has evolved remarkably in just the past five years," said MF Global's Mr. Rochlin. CTAs have added institutional-quality investment and operational risk management systems and have learned "to attribute exactly where their performance is coming from," he said.

One firm that has developed a robust managed futures investment platform is AlphaMetrix Alternative Investment Advisors LLC, Chicago. The platform offers investors access to vetted CTAs that can be combined into liquid, transparent, customized funds-of-funds portfolios offered as separate accounts. AlphaMetrix performs due diligence on the CTAs and provides institutional-quality infrastructure, said Alex Kins, president and CEO.

Assets managed on AlphaMetrix's CTA platform increased $1 billion to $2.2 billion as of Nov. 1, mostly from institutional investors. ■