Manager Survey: State of the Industry

Our biannual state of the industry survey finds firms optimistic that performance in 2014 will improve but bearish on industry asset growth

BY MATT SMITH

Following two years of slowdown and a halt last year in the growth of the managed futures industry according to most asset flow surveys, CTA managers are becoming less bullish as they enter 2014.

While a majority of managers in our inaugural state of the industry survey six months ago forecast a modest rise in assets for 2013, less than a third hold the same view for this year. And 30% of the nearly 50 CTAs that took part in our latest survey think industry assets will shrink in 2014.

Meanwhile, most managers think growth, if it comes, will on balance be more attributable to performance than inflows.

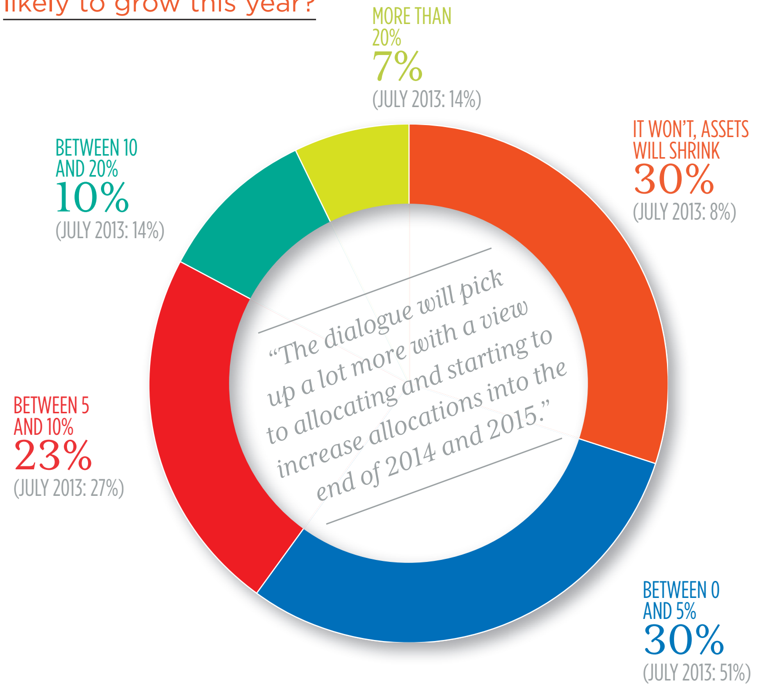
A recent Preqin survey found that just 4% of investors active in hedge funds thought CTAs will present the best opportunities in 2014, compared to 16% a year earlier.

In our survey, managers also sensed a negative shift in investor sentiment towards managed futures as a strategy. Almost 75% of respondents felt investors were more negative towards managed futures compared to 12 months ago. This compares to 24% of respondents when asked the same question six months ago.

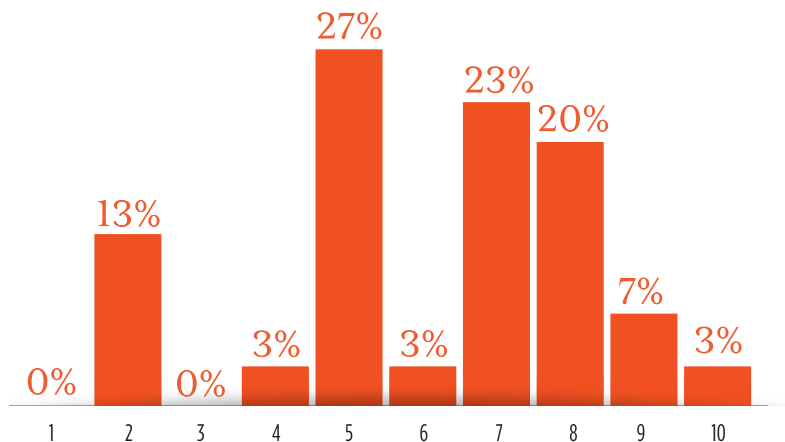
Just 13% felt investors were becoming more positive, while a similar number thought sentiment was about the same.

Unsurprisingly, a majority of mangers continued to rate the current climate as very difficult,

Assuming the managed futures industry had assets of around $330bn at the end of 2013, by how much do you forecast it is likely to grow this year?

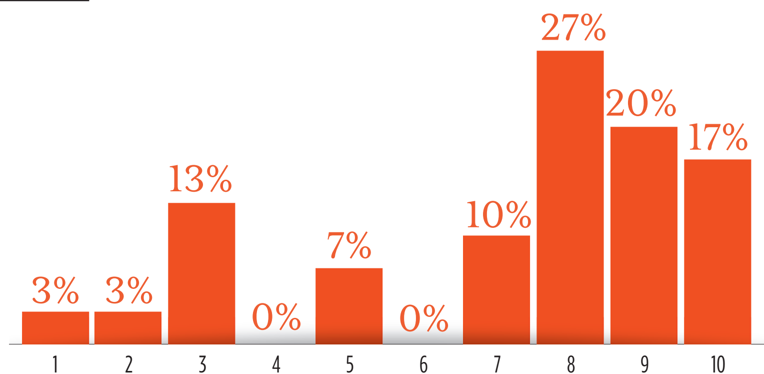


Using a scale of 1-10, how do you think the balance of growth will be split between asset flows and performance (1 being wholly from asset flows and 10 purely from performance)?

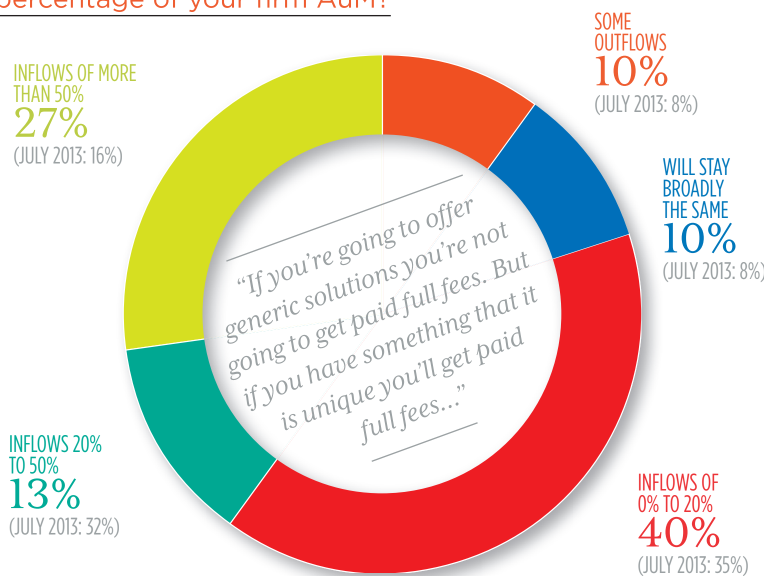


How would you gauge current investor sentiment towards managed futures strategies compared to 12 months ago?

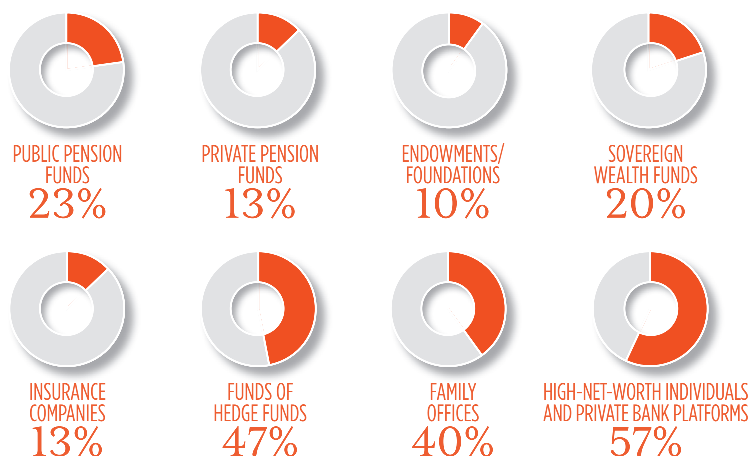
Using a scale of 1-10 (1 being very easy, 10 being extremely difficult) how would you rate the current climate for raising assets?



What size of net asset flows do you expect this year as a percentage of your firm AuM?



Sources respondents expected to deliver the greatest inflows this year



but were again more upbeat about their own firm's prospects for asset growth. Four out of ten respondents expected to receive net inflows this year of up to 20%, with 27% expecting a growth of 50% or more. Just 10% expected outflows.

A number of respondents continued to bemoan the greatest flow of assets going to the largest CTAs and predicted a further consolidation of this trend. But others predicted a move towards smaller and mid-sized managers, and those showing "differentiating features".

"Many experienced allocators spent the end of the year looking for more boutique exposure, and we expect that trend to accelerate," says Covenant Capital co-founder Scot Billington.

"Most large investors have their beta style exposure through large managers, so they are looking to widen their portfolios' variety of markets and trading tactics by making substantial allocations to boutique managers. Those boutiques have the institutional grade infrastructure and length of track record that institutions require, but the trading is not restrained by size."

Billington adds another new trend among fee-savvy allocators is the search for higher volatility programs, where they can invest less and minimise management fees while better controlling risk, both trading and third party.

The well-established trend for an increasing amount of asset flows into the industry coming from institutional sources was borne out in our latest survey. Nearly one quarter of respondents (23%), considered public pension funds would be one of the greatest sources of inflows in 2014, compared to 11% six months ago.

Yet more than half of respondents still rated high high-net-worth individuals or private bank platforms as a key source of assets, and the figure for FoHFs was similar to six months ago.

The US was again named as likely to be the most fruitful source of new money, cited by 77% of respondents compared to 65% six months ago. Just 20% of respondents expected Europe to be the greatest source of new assets.

According to the BarclayHedge CTA index, the managed futures industry ended 2013 down 1.4%, although the larger mangers by Newedge's benchmarks were slightly up.

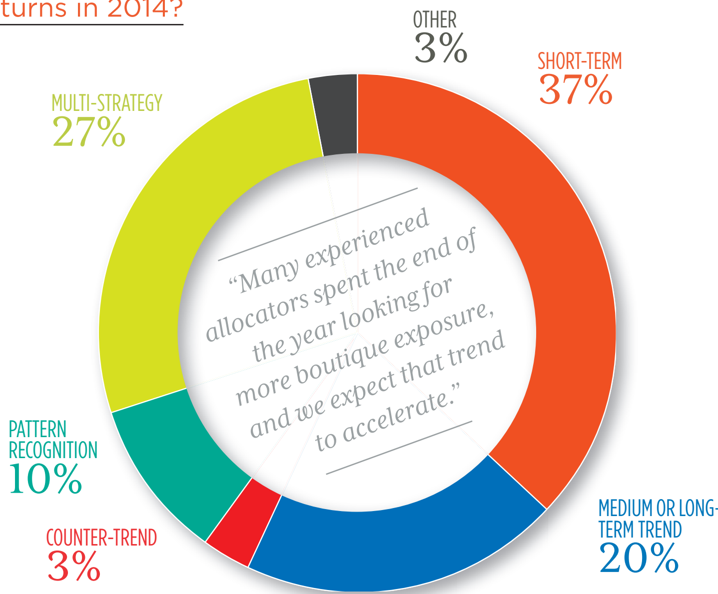
Based on the market and regulatory environment, a majority of managers had a positive outlook that managed futures performance in 2014 will be better than last year.

Most respondents (37%) thought shorter-term strategies would yield the highest returns in 2014. This compares to just 20% of respondents who thought medium- to long-term trend followers would come out on top this year, the most-tipped strategy in our previous survey – although this was undertaken before the damaging trend reversals in the summer months of 2013.

Alexei Chekhlov, portfolio manager at short-term CTA Systematic Alpha, says the anticipation and "exaggerated" expectations of high returns from long-term trend followers has not been justified over the past five years, and large investors

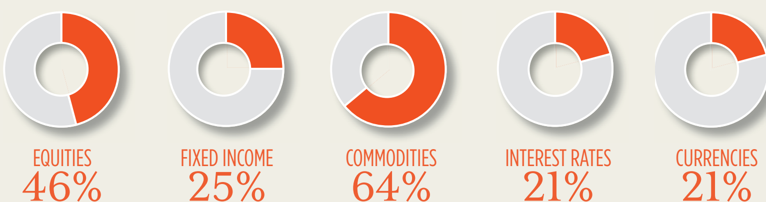
Based on the market and regulatory environment, is your outlook for managed futures performance to be better in 2014 than last year?

Which strategy do you expect to achieve the highest returns in 2014?



LAUNCH ACTIVITY

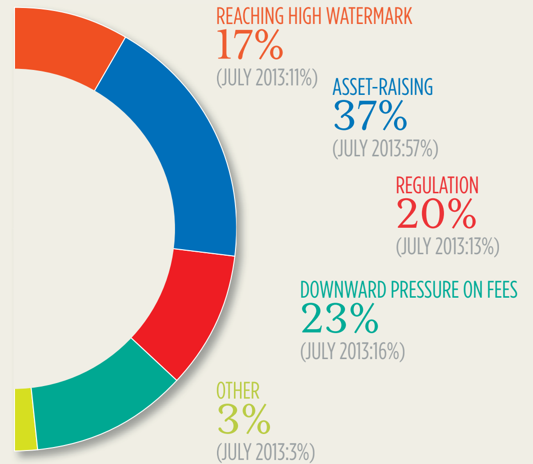
Which sector(s) do you expect to be the most profitable for you in 2014?



How do you think the number of CTA launches in 2014 will compare to last year?

BIGGEST CHALLENGES FOR 2014

What do you think will be the most significant challenge you face this year?



were now "coming to terms with reality".

He says a reduction in exposure to long-term trend-followers, and maybe increasing allocations to short-term CTAs, which have shown stronger alpha recent years, will probably take place.

Commodities were tipped by the highest number of respondents as the sector expected to be most profitable in 2014, followed by equities.

Asset-raising continued to top the list of the most significant challenges facing managers, but the figure has dropped from 57% to 37% since our last survey. Matt Breakwell, COO and co-founder of London-based Wraith Capital, says he expects a shift in investor interest in managed futures as 2014 unfolds.

"As there is more talk about the changing environment to more of a trading environment, as a result, CTAs will start to become more at the forefront of people's minds in terms of allocating into 2015," he says.

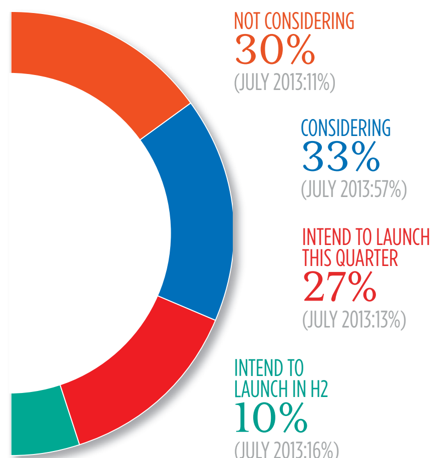
"The dialogue will pick up a lot more with a view to allocating and starting to increase allocations into the end of 2014 and 2015."

However, a greater number of managers than last year rated downward pressure on fees as the biggest challenge they faced, followed by regulation and reaching high water marks to generate performance fees.

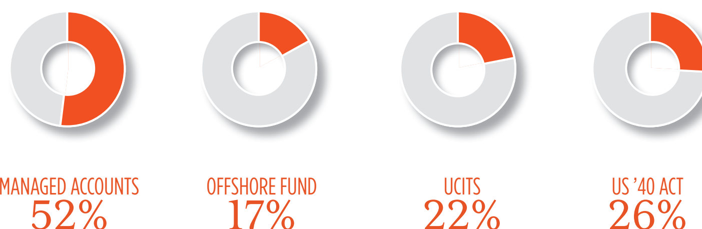
A call for less of a regulatory burden and a more common sense approach from regulators was cited in a number of managers' wish lists, with one respondent advocating a merger of the CFTC and SEC.

Given the current climate for managed futures, and the hurdles for new entrants into the sector, respondents were pessimistic when asked about prospective launch activity in 2014. Alarmingly, two thirds of managers surveyed believed the final tally for CTA launches in 2014

Are you planning any new program/ strategy launches this year?

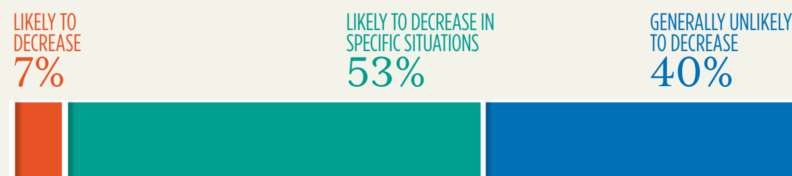


If you intend to launch a new vehicle, what structure(s) will this take?



FEE COMPRESSION

Are you considering a reduction in the level of your fees this year?



Are you willing to negotiate a reduction of fees to secure investment?

would be lower than the 106 that debuted last year, which ranks as the fewest since 2006, when just 65 were launched, according to Preqin data.

Of the established managers who took part in our survey, one third said they were considering a new program or strategy launch this year, while a similar proportion gave a firmer intention. Managed accounts were the most favoured new vehicle for those intending to launch.

But whereas in our last survey one third of those intending to launch were planning a Ucits vehicle, six months later 22% expressed such a preference. New European rules restricting the way many CTAs have previously gained exposure to commodities through a swap on an index, which are due to come into force on 18 February, may have dampened appetite for the structure. A preference for launching a US '40 Act mutual fund however rose from 14% to 26% since our last survey.

On fees, fewer respondents than last year were opposed to considering a decrease, when 60% said they were generally unlikely to reduce them. Now, just 40% hold the same view, with more than half of respondents saying they were prepared to lower fees in specific circumstances.

Some respondents predicted a reduction, or removal, of management fees as a trend to watch in 2014, with downward pressure on fees continuing to come from institutional investors. Others forecast lower fee beta type products or "carve outs" of flagship programs, particularly to fit within '40 Act structures, which offer potential new sources of assets.

"Investors will pay alpha rates for alpha – and that could be a sleeve of a program or a full flagship program if it's worth it," says Nigel Ekern, new managing director of Eclipse Capital.

"But for trend-following or hedging type programs, you're not going to see investors willing to pay full fees."

He adds: "If you're going to offer generic solutions you're not going to get paid full fees. But if you have something that is unique you'll get paid full fees for that."

Mike Harris, president of Baltimore-based Campbell & Co, says that while some of the money invested in the firm's new mutual fund, which raised $600m since its spring launch, was recycled from other managed futures funds, much came from new investors.

"We have always thought of mutual funds in the US as a retail product but the biggest traction we saw was from institutional investors who had a '40 Act mandate but couldn't access CTAs before. Now they are starting to see those doors open up."

Given the challenges of the recent years, during which time many managers have been in drawdown and not earning incentive fees, it was not surprising that recruitment activity has changed little in the past six months.

According to our survey, half of respondents said their firm employed about the same number of people as last year. CTA