Investment Decision Sheet

Background

Trend Following, Managed Futures, or Systematic Trend funds are described in the following documents.

Morningstar (May 11, 2022)

Systematic trend funds mainly implement trend-following, price-momentum strategies by trading long and short liquid global futures, options, swaps, and foreign-exchange contracts. Strategies invest across geographies and assets, including equities, fixed income, commodities, currencies, and more.

Hedge Fund Journal (Issue 98 October 2014)

Modern-day trend-following strategies are about systematically finding trends in market prices, riding them, and getting out before they revert. For this type of momentum strategy, there is both an art and a science to execution. The science of modern systematic trend following is facilitated by computational power and trading automation. Subjective (or discretionary) rules of thumb and heuristics have been replaced by structured systems of trading rules creating autonomous trading systems, the synonymous "black boxes." A modern systematic trend-following system has become more like a finely tuned and engineered machine. These machines adjust their outputs (trading positions) as a function of price movements (inputs). Each system includes internal components (risk management systems) to regulate stressors and shocks.[2] The design of these systems is structurally simple, efficient, and transparent. Simplicity and robustness are essential, as these trading systems manage hundreds to thousands of positions simultaneously.

Concept/Idea/Thesis

After a review of the Trend Following Sector in January 2018, we recommended Montlake Dunn WMA in January of the same year; at the time the main reason for inclusion of a fund from this sector was the hope that it could provide insurance against unforeseen events and potentially generate positive returns in rising and falling markets (FPW Asset Class Review January 2018).

Overtime we have improved our knowledge and understanding of this sector and now see these types of funds not only as an insurance policy, but a hedge against rising volatility and an important portfolio diversifier. The low correlations to other asset classes are an extremely important factor in a market where it is hard to find true diversification.

Objective

The aim of this review is to establish whether allocation in client portfolios to this sector should increase and if Montlake Dunn warrants remaining our first choice.

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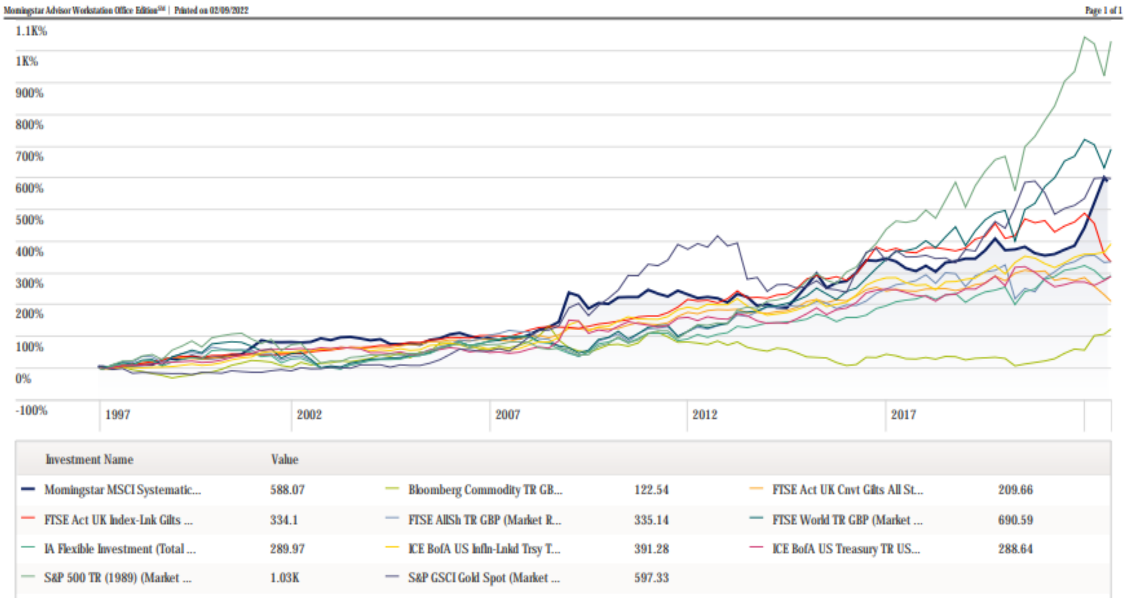
Evidence (Factual)

Over the last twenty-five years the Morningstar MSCI Systematic Trading Index has only been outperformed by the S&P500, FTSE All-World, and Gold.



Over most periods in the last fifteen years the sector has been in the top 25th percentile of performance; consistently above the median level of return.

Name	Total Ret 3 Mo	Total Ret YTD	Total Ret 1 Yr	Total Ret Annlzd 2 Yr	Total Ret Annlzd 3 Yr	Total Ret Annlzd 5 Yr	Total Ret Annlzd 10 Yr	Total Ret Annlzd 15 Yr
UK Base Rate PR	0.35	0.62	0.67	0.38	0.40	0.48	0.47	0.87
FTSE Act UK Cnvt Gilts All Stocks TR GBP	-6.94	-18.55	-19.66	-11.18	-6.86	-2.23	0.93	3.36
FTSE Act UK Index-Lnk Gilts AS TR GBP	-6.85	-23.94	-23.51	-9.72	-7.08	-1.49	3.56	5.27
ICE BofA US Treasury TR USD	6.45	4.64	5.41	0.12	-0.80	2.39	4.07	6.55
ICE BofA US Infln-Lnkd Trsy TR USD	6.68	7.40	10.95	6.80	4.25	5.46	5.01	7.79
IA Flexible Investment	-0.58	-7.09	-6.07	5.92	4.68	4.14	6.81	4.92
FTSE AllSh TR GBP	-3.55	-2.11	1.01	13.24	3.85	3.33	6.78	5.11
S&P 500 TR (1989)	4.11	-2.39	5.00	15.75	14.11	14.13	16.65	13.07
FTSE World TR GBP	1.96	-3.89	0.50	13.00	10.69	10.13	13.04	9.89
Credit Suisse Hedge Fund USD	0.95	11.66	16.74	12.05	5.82	6.35	7.24	7.37
S&P GSCI Gold Spot	1.15	9.88	12.30	0.20	5.71	7.65	3.39	10.36
Bloomberg Commodity TR GBP	0.77	43.84	51.02	38.72	18.94	10.98	1.97	2.30
Morningstar MSCI Systematic Trading	1.40	26.85	45.14	21.75	10.96	10.87	7.39	8.93
Median	0.95	0.62	5.00	6.80	4.68	5.46	5.01	6.55
Maximum	6.68	43.84	51.02	38.72	18.94	14.13	16.65	13.07
Minimum	-6.94	-23.94	-23.51	-11.18	-7.08	-2.23	0.47	0.87

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Detail from [Kepler Research] demonstrate the ranking of Trend Following Funds since 2003.

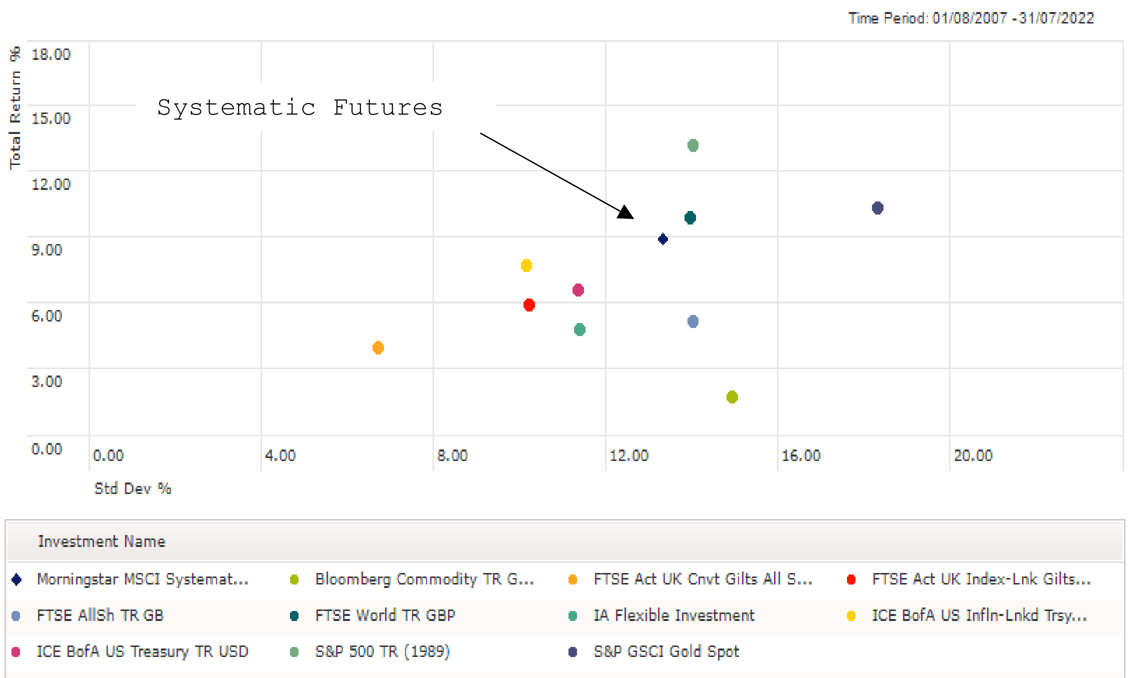
FIG 4: MANAGED FUTURES CALENDAR RETURNS (PERFORMANCE RANKINGS – TOP TO BOTTOM)

2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Commodities	Commodities	Chinese Equities	Global Equities	Credit	Chinese Equities	HY Bond	RV Volatility	SG Trend 19.7%	Global Equities
SG Trend 23.8%	Global Equities	Gold	Chinese Equities	IG Bond	EM Equities	Commodities	SG Trend 0.0%	Macro	Event Driven
Macro	Equity Hedge	EM Equities	EM Equities	Gold	Global Equities	EM Equities	Global Equities	Global Equities	Equity Hedge
RV Volatility	SG Trend 9.1%	Global Equities	Gold	HY Bond	Gold	Event Driven	Credit	Chinese Equities	Credit
Gold	Credit	IG Bond	RV Volatility	Macro	HY Bond	RV Volatility	Macro	Credit	HY Bond
Credit	Macro	Event Driven	HY Bond	SG Trend -8.1%	Equity Hedge	Credit	Equity Hedge	RV Volatility	RV Volatility
Equity Hedge	RV Volatility	HY Bond	Equity Hedge	Global Equities	IG Bond	Global Equities	HY Bond	Equity Hedge	SG Trend 2.7%
Event Driven	HY Bond	SG Trend 6.3%	Event Driven	Equity Hedge	Event Driven	Gold	IG Bond	IG Bond	Chinese Equities
HY Bond	Event Driven	Credit	SG Trend 9.2%	RV Volatility	Credit	IG Bond	Event Driven	HY Bond	Macro
IG Bond	EM Equities	RV Volatility	Commodities	Commodities	RV Volatility	Macro	Chinese Equities	Gold	EM Equities
Global Equities	Gold	Macro	IG Bond	Event Driven	SG Trend 2.2%	Equity Hedge	Gold	EM Equities	IG Bond
EM Equities	IG Bond	Equity Hedge	Macro	EM Equities	Macro	Chinese Equities	EM Equities	Event Driven	Commodities
Chinese Equities	Chinese Equities	Commodities	Credit	Chinese Equities	Commodities	SG Trend -6.1%	Commodities	Commodities	Gold

2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
HY Bond	Gold	Gold	EM Equities	SG Trend 20.9%	Chinese Equities	Chinese Equities	EM Equities	EM Equities	Chinese Equities
Chinese Equities	IG Bond	EM Equities	HY Bond	Gold	EM Equities	EM Equities	Commodities	Global Equities	EM Equities
EM Equities	HY Bond	Commodities	Chinese Equities	Macro	Gold	Gold	Gold	HY Bond	Global Equities
Global Equities	RV Volatility	HY Bond	Global Equities	IG Bond	Commodities	Global Equities	Chinese Equities	RV Volatility	HY Bond
Credit	Credit	SG Trend 13.1%	Credit	RV Volatility	Macro	HY Bond	Global Equities	IG Bond	Commodities
RV Volatility	Macro	Credit	Gold	Credit	Global Equities	RV Volatility	RV Volatility	Commodities	Macro
Gold	Event Driven	Global Equities	Commodities	Event Driven	IG Bond	Event Driven	Macro	Event Driven	Gold
Event Driven	Global Equities	Equity Hedge	Event Driven	Equity Hedge	SG Trend 8.6%	Equity Hedge	Equity Hedge	Gold	Event Driven
Equity Hedge	SG Trend -7.9%	Macro	Equity Hedge	HY Bond	Event Driven	SG Trend 8.2%	HY Bond	Macro	Equity Hedge
IG Bond	Commodities	IG Bond	IG Bond	Commodities	Equity Hedge	Macro	Event Driven	SG Trend 2.7%	IG Bond
Macro	EM Equities	Chinese Equities	Macro	Global Equities	HY Bond	IG Bond	SG Trend 0.7%	Equity Hedge	SG Trend 11.9%
Commodities	Equity Hedge	Event Driven	RV Volatility	Chinese Equities	RV Volatility	Commodities	IG Bond	Chinese Equities	
SG Trend -3.5%	Chinese Equities	RV Volatility	SG Trend -4.8%	EM Equities					

Source: Bloomberg, Kepler Partners LLP. As at 29/04/2021

The fifteen-year risk return profile is close to the FTSE World TR Index.



Rolling six-month returns for the Morningstar MSCI Systematic Trading Index

- Mean return 4.58%
- Median return 2.84%
- Minimum return -14.95%
- Maximum return 49.57%

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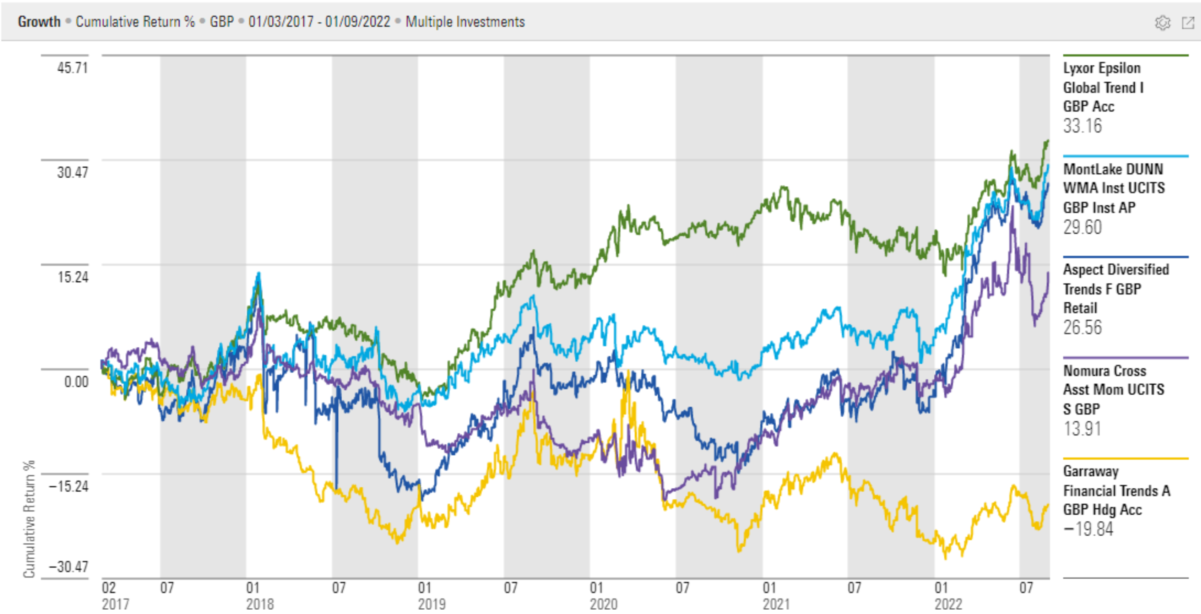
There are five funds that meet our criteria in Morningstar (UCITS structure, available in GBP, track record of at least five years, and in the systematic trend category).



Our initial selection in 2018 was for Montlake Dunn WMA Inst UCITS that is described as *"…a 100% systematic medium to long-term trend following program, encompassing a portfolio of financial, energy, metal, and agricultural futures markets. The investment objective is to extract profits from up & down-trends, resulting in a return stream that exhibits very low correlation with traditional asset classes. The DUNN WMA Institutional UCITS Fund targets half the volatility of DUNN's flagship WMA Program and is expected to average circa 11.5% annually over time."*

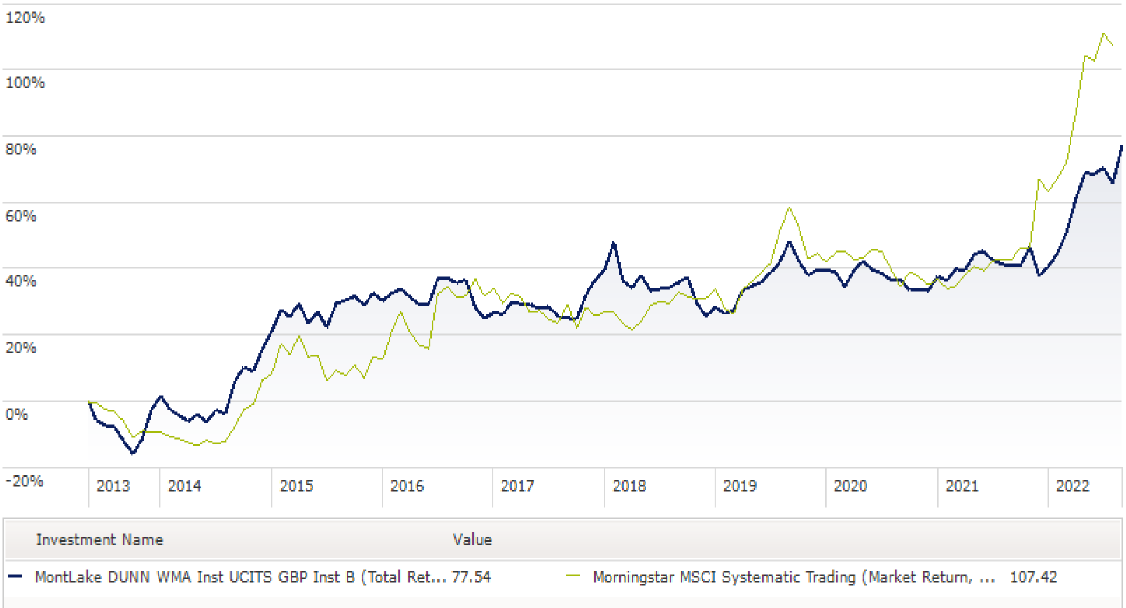
The fund is based on the Dunn WMA Program that dates back to 1974; up to 2014 performance was in excess of the benchmark and S&P500.

DUNN WMA Program Performance*

* The above performance pertains to the performance since inception of the Dunn World Monetary and Agriculture (WMA) Program, which is not a UCITS regulated Fund.

Investment Decision Sheet

Since 2014 returns have been comparable to the benchmark but have lagged well behind the S&P500 (not shown here).



Correlation to other asset classes over the last five years has been modest and withing a range of -0.25 to 0.15.

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1	MontLake DUNN WMA Inst UCITS GB...															
2	Bloomberg Commodity TR GBP	0.21														
3	FTSE Act UK Cnvt Gilts All Stocks TR...	-0.25	-0.37													
4	FTSE Act UK Index-Lnk Gilts AS TR ...	-0.23	-0.15	0.87												
5	FTSE AllSh TR GB	0.10	0.47	-0.08	0.08											
6	IA Flexible Investment	0.06	0.36	0.02	0.18	0.87										
7	S&P 500 TR (1989)	0.01	0.31	0.14	0.29	0.74	0.90									
8	S&P GSCI Gold Spot	0.15	0.00	0.44	0.41	-0.26	-0.16	-0.12								
9																
10																
11																
12																
13																
14																
15																

Time Period: 01/09/2017 to 31/08/2022

1.00 to 0.80 | 0.80 to 0.60 | 0.60 to 0.40 | 0.40 to 0.20 | 0.20 to 0.00
0.00 to -0.20 | -0.20 to -0.40 | -0.40 to -0.60 | -0.60 to -0.80 | -0.80 to -1.00

Evidence (Opinion)

In the Hedge Fund Journal ([Trend Following With Managed Futures October 2014]) highlight the benefits of trend following compared to a buy & hold long only strategy. Using data between 1223-2013 by adopting a trend following strategy investors would have achieved significantly higher risk adjusted returns.

Table 2

Performance statistics for buy-and-hold and trend-following portfolios from 1223 to 2013.

	Buy-and-Hold Portfolio	Trend-Following Portfolio
Average Return (ann)	4.8%	13.0%
Standard Deviation (ann)	10.3%	11.2%
Sharpe Ratio	0.47	1.16

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In their article "You Can't Always Trend When You Want" (January 2019), AQR look to address the perceived underperformance of trend following funds in more recent times.

- *The lower performance of the strategy in the current decade is not explained by an inability for trend following to translate trends into profits or a lack of diversification across global markets.*
- *Instead, the average size of market moves across global markets has been more muted than usual in the current decade and is the primary explanatory factor for recent trend performance.*
- *There is little evidence to suggest this is a permanent structural change for markets, providing hope that trend-following strategies should be able to deliver performance more in line with long-term expectations going forward.*

This factor is also identified by Abbey Capital "The Market Environment for Trend Following" (September 2019) and they draw the conclusion that…

The performance of managed futures and Trend following in recent years has been below longer-term levels. While disappointing, the returns have not been outside standard statistical expectations and we have seen difficult periods in the past. In our opinion, the most compelling explanation is that the market environment has been characterised by fewer major moves and fewer sustained multi-month trends than in previous decades and we see evidence of this in our proprietary market indicators and proxy Trend following systems. Why there have been fewer major trends in markets, is more difficult to address categorically. Historically, major trends have tended to occur episodically, with several major moves occurring in some year and relatively few in other years. The lower number in recent years may just reflect normal statistical fluctuation.

If proof was needed for this theory, it came in 2022, Morningstar drawing attention to the performance for Systematic Trend Following in their market update "Systematic Trend Funds Buck the Trend in April" (11th May 2022). In April of 2022 as most asset classes fell in value Systematic Trend was one of only 4 of the 109 Morningstar categories to produce a positive return.

Kepler Absolute Hedge highlighted the need for patience with Trend Following in their 9th May 2022 publication on Managed Futures

We believe that the best way for investors to harness the long-term benefits of Trend is to retain a degree of patience during periods of muted performance. Fig. 6 below highlights two examples of such periods, during which an allocation to Trend produced flattish returns (and elevated volatility) over a relatively protracted time frame before performance powerfully coming back to life in the subsequent 3-year period. The LHS shows the period before and after the implosion of the dot.com bubble, and on the RHS the performance rebound in the wake of the ongoing resurgence of inflation. In both cases, patient investors would have been rewarded handsomely.

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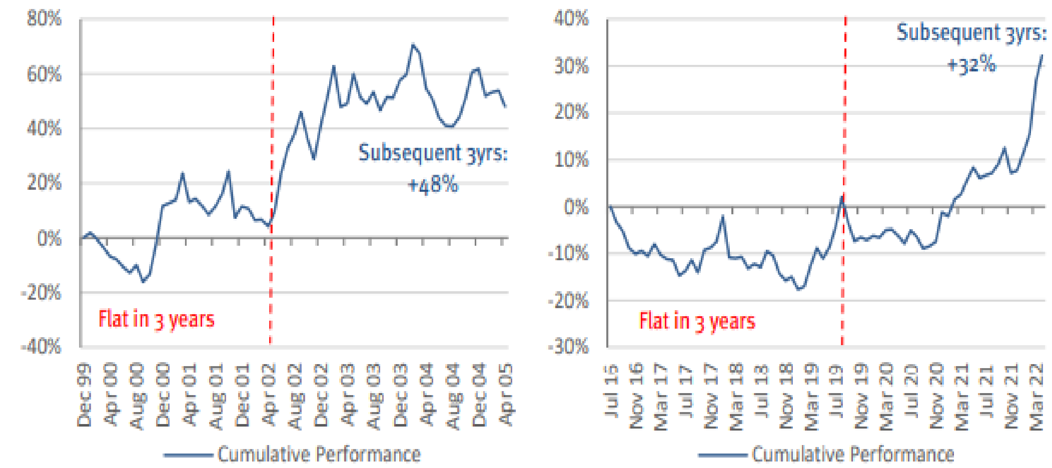
Fig 6: SG Trend Index Performance Rebound Examples (2000 and 2022)



Source: Bloomberg, Kepler Partners LLP

Kepler Absolute Hedge also provide some additional information on Montlake Dunn following their meeting with Management in April 2022.

DUNN WMA Institutional UCITS is a systematic medium to long-term trend following program encompassing a portfolio of equities, rates, currencies and commodities (key to portfolio construction). The strategy manages about $1 billion in assets across the flagship program and the UCITS fund (run with half of the leverage). The firm does not charge a management fee (for the UCITS the AMC is the platform fee).

The program is managed by a very experienced investment team, with more than 45-year track record (one of the longest in the space). Albeit the fund remains faithful to traditional medium-term trend following systems, the strategy has evolved over time to overcome some the key weaknesses of trend following (i.e. how to manage trendless markets and reversals). These improvements include advanced parameters re-calibration (2006), the addition of a (faster) time series momentum-based model to complement the core price-based volatility breakout model (2009), and the implementation of an adaptive risk program (2013).

The adaptive risk program aims to maximise the risk-adjusted profile of the strategy by optimising entries/exits at the instrument level, while also acting as a portfolio risk mitigation tool when the opportunity set for the strategy worsen (e.g. in trendless market). The UCITS program targets 12% annualised volatility.

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Positives/Negatives

Positives	Negatives
Top four asset performance long run	No guarantee of positive years
Strong performance in volatile markets and post flat years	Long periods of sideways trading can lead to questions regarding the merits of the funds inclusion
Risk adjusted returns better or comparable to global equities	There can be a wide dispersion in returns
Return dispersion is higher to the upside over the long term	High costs & performance fees
Back testing over almost 800 years shows trend following outperforms buy & hold long only	Difficult concepts to explain
Historical and recent evidence shows out performance when volatility returns - if we expect volatility this sector should perform well	Often secretive and difficult to keep pace with understanding strategies
Montlake Dunn has visible track record of almost 50 years	
Montlake Dunn one of strongest performers of those available	
Montlake Dunn has very low correlation to other asset classes making it one of few true diversifiers	
Kelper Absolute Hedge highlight Montlake Dunn's experience, track record, and willingness to evolve	

Other Factors Influencing Concept/Idea

None at present

What Could Change Outcomes

Unknown and unforeseen events that create volatility are likely to have a positive impact on returns; however, if we see loosening of monetary policy or fiscal support that would be beneficial for risk assets expect further periods of modest returns.

How to Implement It

Whilst we have considered alternatives, initially in 2018 and again at this review, Montlake Dunn with its long track record and recent strong performance in market volatility makes it the ideal choice.

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Conclusions

The original 2018 analysis was valid, although perhaps was only scratching the surface as to the benefits that this type of asset could provide for portfolios – particularly at a time where the prices of many assets is so high, and diversification is hard to achieve.

Recent returns and the further analysis in this report should also lead us to the conclusion that we should consider increasing allocations across portfolios – particularly if expect volatility.

Whilst this is not a panacea for investment portfolios it could certainly provide us with a strong alternative to cash, and possibly other assets that we are less confident about.

Decision/Action (Including review trigger)

In the current climate and prospect of more volatility across all asset classes, we should consider increasing the allocation to the fund somewhere between 5%-10%; there may even be a case for the reduction of some of our holdings in other asset classes.

Model portfolio test will not be completed to see the impact on risk/return profiles by increasing the allocation.