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MAN'S AHL DIVERSITY WOES: NOW COULD BE THE TIME TO GET TRENDY AGAIN

After double-digit returns for over two decades, last year Man Group's AHL quantitative strategy suffered its biggest drawdown since inception. But is this a temporary blip or an indication of a terminal decline?

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Touted as a world-leading strategy, Man AHL Diversity is undoubtedly the jewel in the Man Group crown.

When *Citywire Wealth Manager* broke the news that Man would be launching a Ucits III version of its AHL strategy for the retail market, investors overwhelmingly welcomed the move. But after a difficult 2009 in which the polished track record lost its shine on the back of a 16.9% loss, some investors are growing sceptical about the strategy's ability to regain its impetus.

The problems have continued in the first few weeks of 2010 with the strategy losing low single-digits over successive weeks, something that always has repercussions for Man Group's share price.

Christopher Wyllie, head of portfolio management at Iveagh's multi-family office, participated in the Ucits offering when it came to the market. However, he is alarmed that the AHL drawdown, which currently stands at 17.9% and dwarfs the previous worst drawdown of 10.8% in 2002.

He said: 'This drawdown has been longer and deeper than previous occasions and it looks like they are beginning to live on borrowed time. This is straying from the historical norms.'

AHL and other managed future traders, also known as commodity trading advisers (CTAs), aim to identify and benefit from trends across global markets and asset classes. This strategy worked well in 2008, with AHL returning 26.5% while MSCI World TR Index (USD) declined 37.0%. However, the opposite was the case this year.

Ken Kinsey-Quick, a fund of hedge funds manager at Thames River Capital, said 2009 proved to be a nightmare year for managed futures strategies in the absence of long-term trends. He said: 'Long-term trends are fundamental to how they make money and 2008 was the last time they had big movements. Oil went from \$30 to \$140 and back to \$30 – that's fantastic for CTAs.'

'They can ride the price movement up, lose a bit of money, and then ride it all the way down. But when you get sideways and choppy markets, they don't do so well.'

Kinsey-Quick pointed out commodity, equity and currency markets all changed direction on several occasions during 2009, effectively confusing the quantitative models.

He said: 'These strategies like to make money in liquid markets like currencies, but they haven't got anywhere over the last 12 months as they have been quite volatile.'

Wyllie however, points out some trend-following strategies have done better than others and it would be a generalisation to suggest all CTAs lost money in 2009. Other such funds in Wyllie's portfolio, BlueTrend and German-based TrendConcept Multi-Asset Allocator, remained in positive territory.

He said: 'You have to ask yourself how responsive is your trend-following strategy? Those which had narrow trigger movements have done better and bought into equities much faster in April and May last year. There are important differences between approaches.'



David Miller: Not unnerved by AHL's underperformance or particularly surprised by it

Kinsey-Quick, meanwhile, suggests investors keep a close eye on how much the company behind the strategy is investing into the software. 'That's the only way they can keep ahead of everybody else,' he said.

'They are all smart people but if you think about it simplistically, it's the money that they spent on software that will give them the edge.'

As far as AHL is concerned, Kinsey-Quick argues that now may be a good time to take a contrarian stance and invest in the strategy because of the mean reversion

effect. He explained: 'CTAs are generally owned as part of a diversified portfolio. The smart money would go into it. They've gone into a period of poor performance and a lot of mean reversion goes into financial management.'

'From a pure investment decision now might be a good time. It's probably a good time if you want to be a contrarian.'

Wyllie agrees with Kinsey-Quick, highlighting that the previous large drawdowns of 10.8% and 10% have been followed by a rise of 25.3% and 29.9%, respectively.

He said: 'AHL people spent a lot of time illustrating the point that drawdowns have historically tended to follow up with quite good performance, with the idea being that you are buying it at a good time now.'

'The statistics certainly support that but it's disconcerting that this drawdown is continuing the way it is.'

However, Cheviot head of alternative investments David Miller said the underperformance of AHL has not concerned him or prompted him to withdraw money from the fund.

He said: 'Those types of strategies like nice big powerful trends – such as a strong dollar – to allow them to add value. Empirically, the environment last year – in which the market changed direction and the way the dollar started to weaken – was not captured by CTAs across the board.'

'We are not unnerved by the underperformance or particularly surprised by it. It will now depend on whether that is the right place to allocate capital.'

In his book in early 2009, legendary fund manager Anthony Bolton disclosed he sold shares in Man Group over lingering doubts about the 'sustainability of the AHL results, a concern that has proved incorrect to date'.

But as Bolton's prescient fears become reality and the Man Group's shareholders suffer with every month of AHL underperformance, the pressure to improve results is unlikely to go away.

PERFORMANCE OF AHL STRATEGY JULY 2008 TO JANUARY 2010



SOURCE: Reuters