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INSIGHTS

# Managed Futures During Equity "Crises"– An Update

*The Managed Futures asset class has acquired a reputation among investors for providing what is known as "crisis alpha" – the ability to generate returns at a time of market crisis.*[2]

**HIGHLIGHTS**

- **CHART:** Historical Performance of Equities and Managed Futures during Crises

Most individual and institutional portfolios generally have substantial (often 50% or larger) positions in equities and equity-related asset classes. Because the "risk" of these asset classes is generally quite high, the major portion of the total risk of these portfolios is driven by equities. Hence, most financial crises, almost by definition, involve large declines in equities, often accompanied by trends in other markets, as most investors resort to panic selling of risky assets all at the same time. Generally, market volatility also spikes during these times. Many equity market crises are also characterized by a "flight to safety," with increased investments into assets such as the US Dollar, precious metals, and US Treasury securities. These strong price trends and the accompanying volatility expansion has often proved to be an environment in which managed futures have thrived.

A good recent example of this was the period December 2015 – February 2016, when the S&P 500® Total Return Index lost -6.6%, while the VIX® Index, a forward-looking measure of equity market volatility, spiked by more than 27% (increasing from about 16% at the end of November 2015 to more than 20% at the end of February 2016). The "crisis," in this instance, has been attributed to Mario Draghi's underwhelming stimulus measures announced in early December, perhaps exacerbated by the US Fed's first rate hike, albeit widely anticipated and long overdue, since 2006. Over this period, the Barclay BTOP 50® Index, which is often used as a proxy for the managed futures asset class, gained approximately +3.5%.[1]

Several commentators have addressed and analyzed this characteristic of managed futures during past crises. Here, we update those results, using a slightly different definition of a "crisis." We look for periods since 1987 during which the VIX® Index increased by 25% or greater, or hit an absolute level of at least 30%. We then try to identify the qualitative reason for this volatility spike, e.g., the events of 9/11/2001, the

[1]*The penultimate "crisis," which lasted from January to March of 2018, is the only one to date during which managed futures underperformed equities.*

[2]*See, for example: In Search of Crisis Alpha: A Short Guide to Investing in Managed Futures, Kathryn M. Kaminski (CME Group).*

***Definitions of Terms and Indices can be found on the back page.***

PAST PERFORMANCE DATA QUOTED HERE REPRESENTS PAST PERFORMANCE. CURRENT PERFORMANCE MAY BE LOWER OR HIGHER THAN THE PERFORMANCE QUOTED ABOVE. PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RESULTS.

DIVERSIFICATION DOES NOT ENSURE PROFIT OR PREVENT LOSSES. AN INVESTMENT IN MANAGED FUTURES IS SPECULATIVE AND INVOLVES A HIGH DEGREE OF RISK. YOU CAN LOSE MONEY IN A MANAGED FUTURES PROGRAM. THERE IS NO GUARANTEE THAT AN INVESTMENT IN MANAGED FUTURES WILL ACHIEVE ITS OBJECTIVES, GOALS, GENERATE POSITIVE RETURNS, OR AVOID LOSSES.

Greek crisis, etc. Next, we examine the returns on the S&P 500® Total Return Index, equities, and the BTOP 50® Index—a proxy for managed futures—during those periods. Our results are summarized in the table below.

*In every single one of these seventeen crises, as we define them, equity markets traded lower, ranging from -0.8% to from -46.4%. Managed futures, by way of contrast, showed only five periods with negative returns, ranging from -2.8% to -0.2%; each of these returns, however, in four of these five instances, managed futures outperformed equities. In the remaining twelve "crises," managed futures earned positive returns ranging from +1.0% to +18.7%.*

**Historical Performance of Equities and Managed Futures during Crises (%)**

1987 - PRESENT

| PERIOD | STARTING VIX® | ENDING VIX® | CHANGE IN VIX® | EQUITY RETURNS | MANAGED FUTURES RETURNS | DESCRIPTION OF CRISIS |
|---|---|---|---|---|---|---|
| SEP-NOV 1987 | -- | -- | -- | -29.7 | 8.5 | Black Monday |
| JUL-OCT 1990 | 15.50 | 30.04 | 93.8 | -14.1 | 13.5 | Iraq invades Kuwait |
| FEB-MAR 1994 | 10.63 | 20.45 | 92.4 | -7.0 | 1.0 | First Fed hike since 1989 |
| JUL-AUG 1998 | 19.71 | 44.28 | 124.7 | -15.4 | 5.4 | Russian default and LTCM crisis |
| SEP-NOV 2000 | 16.84 | 29.65 | 76.1 | -13.1 | 6.0 | USS Cole; Mad Cow outbreak; Bush v Gore |
| FEB-MAR 2001 | 22.02 | 28.64 | 30.1 | -14.9 | 5.3 | Bush inaugurated; US and Britain attack Iraq |
| JUL-SEP 2001 | 19.06 | 31.93 | 67.5 | -14.7 | 4.1 | Events leading up to 9/11 attacks |
| APR-SEP 2002 | 17.40 | 39.69 | 128.1 | -28.4 | 18.7 | Enron and WorldCom; End of tech bubble |
| DEC-FEB '02-03 | 27.50 | 29.63 | 7.7 | -9.7 | 17.5 | War in Iraq; SARS outbreak |
| JUN-FEB '08-09 | 17.83 | 46.35 | 160.0 | -46.4 | 7.2 | Global financial crisis (The Great Recession) |
| MAY-JUN 2010 | 22.05 | 34.54 | 56.6 | -12.8 | -2.8 | Greek crisis |
| MAY-SEP 2011 | 14.75 | 42.96 | 191.3 | -16.3 | -2.1 | Eurozone debt crisis; US credit downgrade |
| APR-MAY 2012 | 15.50 | 24.06 | 55.2 | -6.6 | 2.2 | Continuing European crises |
| AUG-SEP 2015 | 12.12 | 24.50 | 102.1 | -8.4 | -0.2 | Chinese currency crisis |
| DEC-FEB '15-16 | 16.13 | 20.55 | 27.4 | -6.6 | 3.5 | Draghi stimulus fiasco; first Fed hike since 2006 |
| JAN-MAR 2018 | 11.04 | 19.97 | 80.9 | -0.8 | -2.6 | Tarriff/Trade war fears |
| OCT-DEC 2018 | 12.12 | 25.42 | 109.7 | -13.5 | -1.9 | Italy, Brexit, US policies, and other geopolitics |

*VIX® data begins in January 1990.*

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It is worth exploring possible explanations for these historical results. These are summarized succinctly in the paper by Kaminski, cited earlier, as follows:

- Managed futures strategies tend to be highly liquid and trade almost exclusively in futures markets with minimal credit exposure; hence, they may be less susceptible to the illiquidity and credit traps that are generally prevalent during equity market crises.
- They are dominated by systematic trading strategies, with no long equity bias; hence, they tend to be less susceptible to behavioral biases and the emotion-based or panic-driven selling that is often triggered when large losses are experienced.
- They trade across a wide range of sectors and markets, and can hold either long or short exposures, depending on perceived price trends; hence, they have the potential to profit from both up-trends and down-trends across multiple global futures markets.

Our evidence is based purely on historical data, and there is no assurance that these patterns will necessarily repeat during future crises. Managed futures as an asset class tend to have low correlations to most other asset classes, which means they have the potential to provide diversification benefits by lowering the overall risk of a portfolio. However, they should not be viewed as "hedges," because a hedge is identified by its high negative (rather than low) correlation to the asset under consideration.

For more information on managed futures, please contact your investment professional or visit **equinoxfunds.com**.

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# APPENDIX

## DEFINITIONS

**Correlation** is measured on a scale from 1.00 to -1.00. [1.00] Investments with high correlation tend to rise and fall together. [0.00] Non-correlated investments tend to move up and down with no relation to one another. [-1.00] Investments with negative correlation tend to move in opposite directions.

**Crisis alpha** refers to profits or gains that can be made by exploiting certain market trends during times of market turmoil.

**Hedge** is to make an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

**Long Position** refers to the buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value.

**Short Position** is a position whereby an investor sells borrowed securities in anticipation of a price decline and is required to return an equal number of shares at some point in the future.

**Volatility** is a measure of fluctuation in the value of an asset or investment. Lower volatility improves the stability and lowers the risk of an investment portfolio.

## INDEX DESCRIPTIONS

**Investors cannot directly invest in an index and unmanaged index returns do not reflect any fees, expenses or sales charges.**

The **Barclay BTOP50 Index® (BTOP50)** seeks to replicate the overall composition of the managed futures industry with regard to trading style and overall market exposure.

The **S&P 500® Total Return Index** is widely regarded as the best single gauge of the US equities market. This world-renowned Index includes 500 leading companies in leading industries of the US economy.

The **VIX® Index** is a forward-looking measure of equity market volatility. Since its introduction, VIX has been considered by many to be the world's premier barometer of investor sentiment and market volatility.

## A WORD ABOUT RISK

THE PURCHASE OF A MANAGED FUTURES INVESTMENT INVOLVES A HIGH DEGREE OF RISK. SPECIFICALLY, YOU SHOULD BE AWARE THAT, IN ADDITION TO NORMAL INVESTMENT RISKS, MANAGED FUTURES INVESTMENTS ENTAIL CERTAIN RISKS, INCLUDING, IN ALL OR SOME CASES:

- MANAGED FUTURES OFTEN ENGAGE IN LEVERAGING AND OTHER SPECULATIVE INVESTMENT PRACTICES THAT MAY INCREASE THE RISK OF INVESTMENT LOSS.
- MANAGED FUTURES CAN BE HIGHLY ILLIQUID.
- MANAGED FUTURES ARE NOT REQUIRED TO PROVIDE PERIODIC PRICING OR VALUATION INFORMATION TO INVESTORS.
- MANAGED FUTURES MAY INVOLVE COMPLEX TAX STRUCTURES AND DELAYS IN DISTRIBUTING IMPORTANT TAX INFORMATION.
- MANAGED FUTURES ARE NOT SUBJECT TO THE SAME REGULATORY REQUIREMENTS AS MUTUAL FUNDS.
- MANAGED FUTURES OFTEN CHARGE HIGH FEES

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3025-NLD-1/8/2019