CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

CTA - Commodity Trading Advisors*: A "trendy" investment?

60 seconds with the fund manager

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This marketing communication is intended for non-professional investors.

* A CTA is a strategy that invests in futures contracts and aims to exploit price fluctuations in the bond, stock, currency and commodity markets using systematic trading models. A futures contract is a commitment to buy or sell an underlying asset (such as a stock index, commodities, government bonds) on a specific date at an agreed price.

Steeve Brument

Global Head of Alternative Investments,
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60 SECONDS WITH THE FUND MANAGER

Steeve Brument explains how a strategy invested in futures can deliver performance by harnessing the various market trends.

Why invest in a futures strategy?

A CTA strategy mainly uses futures to invest in a wide range of financial assets, including equity indices, short-term and long-term interest rates, currencies, and commodities. CTA strategies take a quantitative approach to detect and exploit both upward and downward trends on these various markets.

A good CTA strategy must offer a portfolio the additional returns needed, particularly during market slumps, in order to enhance its robustness and limit its volatility. To accomplish this, each CTA manager has his own style. To maximise yields while limiting losses, it is important to be fully diversified in order to tap into various market configurations – diversified in asset classes traded, diversified in time horizons to detect trends, and diversified in the quantitative models used. As long as there is a trend, its direction hardly matters; the important thing is to detect this trend and to make best use of it, as this is exactly what is needed to offer returns to investors when they need them the most.

What are your strategy's performance drivers and their advantages for investors?

We have developed a quantitative method that analyses the most liquid futures markets on a constant basis, both to detect their main trends and to capture shorter-term shifts. Our main performance driver, trend-following, comes with two complementary short-term strategies. While trend-following strategies help capture wide-amplitude swings, our shape-recognition and contrarian strategies help capture short-term oscillations. We are investing in 36 of the most liquid futures contracts across four asset classes[1], including equities, interest rates, currencies, and bonds, and our risk-management algorithms equally weight the risk between asset classes thus offering efficient diversification at all times. Final returns are based on the accumulation of various positions taken by our

(1) Indicative data, likely to vary over time.

models, whether bullish or bearish. They are designed to be decorrelated from traditional asset classes, which offers an edge to any investor seeking diversification.

How does your management strategy stand out?

Our approach stands out in many ways, starting with the objective we set ourselves more than 10 years ago when we developed our strategies. We wanted to offer investors a product that could tap into the main trends while offering greater robustness than a trend-following strategy alone.

To do so, we have made diversification the key to our management process.

Trend-following strategies are applied to a wide range of horizons (from six weeks to 12 months) and account for 70% of the risk budget at any point in time, while contrarian and shape-recognition strategies, which are used to capture shorter-term trends, each account for 15% of our risk budget(2).

We have also focused on risk management and diversification between asset classes. In practical terms, weighting our risk budget equally among four different asset classes and 36 underlying futures contracts(3) gives us equal exposures to trends, regardless of the markets in which they develop.

In terms of risk management, our system allows us to be especially responsive when market risk increases.

Since 2006, these choices and our returns have helped us stand out, as they have allowed us to outperform the CTA indices(4), particularly when trend-following strategies have encountered less favourable environments.

Why invest today in your strategy?

As our strategy is only loosely correlated to the markets, we don't believe there is any particular time to invest in our strategy. Since the launch of the strategy, we have posted a performance disconnected from traditional asset classes and other alternative strategies, with a volatility profile around 10%(5). Our strategy has historically shown a positive performance in phases of market stress (e.g. 2008 global financial crisis, recessionary fears in 2018, Covid in 2020, inflation and war in Ukraine in 2022)(6), as these phases naturally provide very clear and easily identifiable trends. This allows us to make a positive contribution to our clients' portfolios when they most need it. Adding this type of strategy to a diversified equity and bond portfolio has historically(7) helped enhance quality and performance by reducing volatility and drawdown of the overall portfolio.

But aren't some market environments more favourable than others?

Our main strategy is to tap into major trends. A favourable environment consists of several trends that are loosely correlated among themselves and that last for several months. When the markets move sideways or suffer sudden "risk-on risk-off"(8) shifts, our contrarian and shape-recognition strategies are able to take advantage of it, whereas the trend-following strategy (our main performance driver) will lack opportunities. The robustness of our approach is based, among other things, on the complementarity and low correlation between our strategies.

Our studies(9) show that trend-following strategies work best beyond a certain level of volatility, which remains relatively high today, fuelled by geopolitical and macroeconomic uncertainties.

(2) Indicative data, likely to vary over time.
(3) Indicative data, likely to vary over time.
(4) Past performance does not guarantee future results and is not constant over time.
(5) Indicative data, likely to vary over time.
(6) Past performance does not guarantee future results and is not constant over time.
(7) Source: Candriam, https://www.candriam.com/en/professional/insight-overview/publications/research-papers/ctas-throughout-the-business-cycle--a-form-of-economic-rationality-/
(8) The concept of "risk-on risk-off" is an investment paradigm according to which asset prices are driven by changes in investors' risk tolerance.
(9) Sources: Candriam and Bloomberg.

The main risks of the strategy are:

• Risk of capital loss:

There is no guarantee for investors relating to the capital invested in the strategy in question, and investors may not receive back the full amount invested.

• Equity risk:

Some strategies may be exposed to equity market risk through direct investment (through transferable securities and/or derivative products). These investments, which generate long or short exposure, may entail a risk of substantial losses. A variation in the equity market in the reverse direction to the positions can lead to the risk of losses and may cause the performance to fall.

• Sustainability Risk:

The sustainability risk refers to any environmental, social or governance-related event or situation that might affect the performance and/or reputation of issuers invested in.

Sustainability risks may be subdivided into three categories:

• Environmental: environmental events may create physical risks for the companies invested in.

• Social: refers to the risk factors linked to human capital, the supply chain and the way companies manage their impact on society.

• Governance: these aspects are linked to governance structures.

The sustainability risk may be specific to the issuer, depending on its activities and practices, but may also be due to external factors. If an unforeseen event occurs in a specific issuer such as a strike or more generally an environmental disaster, the event could have a negative impact on the performance. In addition, issuers which adapt their activities and/or policies may be less exposed to the sustainability risk.

• Derivative risk:

Financial derivatives are instruments whose value depends on (or is derived from) one or more underlying financial assets (equities, interest rates, bonds, currencies, etc.). The use of derivatives therefore involves the risk associated with the underlying instruments. They may be used for purposes of exposure or hedging against the underlying assets. Depending on the strategies employed, the use of derivative financial instruments can also entail leverage risks (amplifying downward market movements). In a hedging strategy, the derivative financial instruments may, under certain market conditions, not be perfectly correlated to the assets to be hedged. With options, an unfavourable fluctuation in the price of the underlying assets could cause the strategy to lose all of the premiums paid. OTC financial derivatives also entail a counterparty risk (though this may be attenuated by the assets received as collateral) and may involve a valuation risk or a liquidity risk (difficulty selling or closing open positions).

• Emerging market risk:

Market movements can be stronger and faster on these markets than on the developed markets, which could cause the performance to fall in the event of adverse movements in relation to the positions taken. Volatility may be caused by a global market risk or may be triggered by the vicissitudes of a single security. Sectoral concentration risks may also be prevalent on some emerging markets. These risks may also heighten the volatility. Emerging countries may experience serious political, social, legal and fiscal uncertainties or other events that could have a negative impact on the strategies investing in them. In addition, local depositary and sub-custodial services remain underdeveloped in non-OECD countries and emerging countries, and transactions carried out in these markets are subject to transaction risk and custody risk. In some cases, it may be impossible to recover all or part of the assets invested or delays in delivery when recovering assets may arise.

• Interest rate risk:

A change in interest rates, resulting in particular from inflation, may cause a risk of losses and reduce the performance of the strategy (especially in the event of a rate increase if the strategy has a positive rate sensitivity and in the event of a rate reduction if the strategy has a negative rate sensitivity). Long term bonds (and related derivatives) are more sensitive to interest rate variations. A change in inflation, in other words a general rise or fall in the cost of living, is one of the factors potentially affecting interest rates and consequently the NAV.

• Foreign exchange risk:

Foreign exchange risk derives from the strategy's direct investments and its investments in forward financial instruments, resulting in exposure to a currency other than its valuation currency. Changes in the exchange rate of this currency in relation to that of the strategy may negatively affect the value of assets in the portfolio.

• Model risk:

The management process of some strategies relies on establishing a model which is used to identify signals based on past statistical results. There is a risk that the model is inefficient and that the strategies willperform poorly. There is no guarantee that past market situations will be reproduced in the future.

• Arbitrage risk:

Arbitrage is a technique which consists in benefiting from the differences in prices recorded (or anticipated) between markets and/or sectors and/or securities and/or currencies and/or instruments. If such arbitrage transactions perform unfavourably (a rise in sell transactions and/or fall in buy transactions), the performance may fall.

• Volatility risk:

A strategy may be exposed (taking directional positions or using arbitrage strategies for example) to market volatility risk and could therefore, based on its exposure, suffer losses in the event of changes in the volatility level of these markets.

• Leverage risk:

Compared with other types of investment, some strategies will operate with a high level of leverage. Use of leverage can entail high volatility and the performance may be negatively impacteddepending on the leverage level.

The risks listed are not exhaustive, and further details on risks are available in regulatory documents.