RED ROCK

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# AN HONEST UPDATE ON THE TREND FOLLOWING LANDSCAPE

Anyone who follows managed futures knows it has been a tough period for trend followers. However, when reading several of the major industry publications we see a significant amount of fanfare regarding some managers' "recent performance" and we think it is important to keep the longer term in mind. Whether or not a manager is up +5% year to date is near meaningless if not kept in the correct perspective.

Theoretically, a manager could be up +5% one year, then +10% the next, then down -3%, and back up +8%...yet still be under their high water mark. Do you think a savvy, loyal investor who has not seen a net new equity peak in 40+ months really cares if a manager is "up" this year to date? We argue that they should not.

Understandably, a loyal, long-term investor with any of these managers should be concerned with: 1) when was the last net new equity high made, 2) what is the current drawdown from that last peak, and 3) how good have the manager's risk-adjusted returns been over the long-run?

We decided to perform an objective analysis on the performance of many of the best-known trend following managers. We created our own metric with which to rank similar managers against each other. Our metric gives 25% weight to the Time Since Last Equity Peak (Months), 25% weight to Current Drawdown (%), and 50% weight to the manager's Sortino Ratio (Target = 0) over the past 10 years. This is a simple, quick method to rank managers against each other. Admittedly, however, and by design, the rankings do not have proportional information embedded in them, i.e. how *much* better is

| | | | | Rank | | | |
|---|---|---|---|---|---|---|---|
| *As of Aug 31, 2013* | Time Since Last Peak (Months) | Current Drawdown (%) | Sortino (Target = 0) | Time Since Last Peak (Months) | Current Drawdown (%) | Sortino (Target = 0) | FINAL RANK |
| **WINTON** | 4 | -8.36 | 1.74 | 1 | 1 | 1 | **1** |
| **RED ROCK** | 28 | -12.04 | 1.43 | 4 | 3 | 2 | **2** |
| **TRANSTREND** | 28 | -12.58 | 1.16 | 4 | 4 | 4 | **3** |
| **BLUETREND** | 28 | -19.86 | 1.40 | 4 | 9 | 3 | **4** |
| **ABRAHAM** | 30 | -15.15 | 0.99 | 12 | 6 | 6 | **5** |
| **ECKHARDT** | 28 | -23.36 | 0.80 | 4 | 11 | 9 | **6** |
| **ASPECT** | 18 | -18.42 | 0.56 | 3 | 8 | 12 | **7** |
| **DUNN** | 4 | -13.03 | 0.38 | 1 | 5 | 16 | **8** |
| **ISAM** | 30 | -33.68 | 1.00 | 12 | 18 | 5 | **9** |
| **MAN AHL** | 56 | -16.73 | 0.86 | 19 | 7 | 8 | **10** |
| **MILLBURN** | 28 | -22.64 | 0.38 | 4 | 10 | 16 | **11** |
| **DRURY** | 30 | -26.18 | 0.61 | 12 | 14 | 11 | **12** |
| **WELTON** | 30 | -31.41 | 0.76 | 12 | 16 | 10 | **12** |
| **CHESAPEAKE** | 28 | -33.91 | 0.41 | 4 | 19 | 14 | **14** |
| **ALTIS** | 32 | -35.34 | 0.92 | 17 | 20 | 7 | **14** |
| **GRAHAM** | 28 | -26.05 | 0.37 | 4 | 13 | 18 | **16** |
| **SUNRISE** | 45 | -23.83 | 0.42 | 18 | 12 | 13 | **17** |
| **HYMAN BECK** | 30 | -29.33 | 0.39 | 12 | 15 | 15 | **18** |

*Source: BarclayHedge, AlphaMetrix, Altegris, IASG. Sortino = last 10 years except: BlueTrend from April '04; Welton from June '04. Past performance not necessarily indicative of future performance. For informational purposes only. Red Rock Capital, LLC not responsible for modifications to or accuracy of performance data.*


Red Rock Capital, LLC
5000 Birch Street, Suite 3000
Newport Beach, CA 92660

www.RedRockCapital.com

As is often overlooked and misunderstood in the managed futures industry, a manager's returns, volatility, and drawdown are functions of a subjective decision that has been made by the manager - i.e. how "hot" are they running their program. For this reason, only studying the managers' time since last peak and current drawdown level are not sufficient; a risk-adjusted metric must be applied that normalizes managers' returns against one another.

As we point out in our new white paper, *Sortino: A 'Sharper' Ratio*, the Sortino ratio is a more appropriate measure to use than the Sharpe ratio because the Sharpe ratio assumes that the returns it is measuring are normally distributed, and, hence, unfairly and incorrectly penalizes managers whose returns exhibit positive asymmetry (skewness). In reality, investors typically welcome upside volatility and perceive only downside volatility as actual risk.

Considering the length of some of the managers' drawdowns, we believe concern is warranted, from a current or prospective investor standpoint, as to whether or not such managers will *ever* make another new equity high again.

Unfortunately, as we've seen too many times before in our industry, managers who share the above mentioned concern that they will never make another new equity high, *close down* that particular program and conveniently launch another. Buyer beware of people selling good "recent" performance; do yourself a favor and keep the bigger picture in mind.

– Thomas N. Rollinger, Managing Partner
– Scott T. Hoffman, Partner

## ABOUT RED ROCK CAPITAL, LLC

Red Rock Capital is a systematic global macro hedge fund (CTA). Managing Partner & Chief Investment Officer Thomas Rollinger is a 16-year industry veteran and previously worked with renowned hedge fund manager and "godfather of the quants", Edward O. Thorp. Partner and Chief Technology Officer Scott T. Hoffman, also with 16-years experience, founded the firm in 2003 and has an electrical engineering background.

## CONTACT US

Thomas N. Rollinger | Managing Partner, Chief Investment Officer
trollinger@redrockcapital.com | www.redrockcapital.com | 949.648.9506
5000 Birch Street, Suite 3000 | Newport Beach, CA 92660