Rollinger: Commodities beat all

BY YESENIA DURAN

While most commodity trading advisors were waiting for clear global trends to develop across financial markets such as interest rates, currencies and stock indexes, Red Rock Capital's Commodity Long-Short Program was successfully exploiting inefficiencies that clearly manifested themselves in physical commodity markets.

The program, managed by Red Rock Capital's Managing Partner and Chief Investment Officer Tom Rollinger, is designed to capture short-term, directional movements of volatility follow-through in a diverse portfolio of 20 liquid exchange-traded U.S. commodity futures. The portfolio is diversified across the agricultural, metals, livestock, softs and energy sectors.


TOM ROLLINGER

Positions are initiated in counter-trend and trending environments, and are held eight days on average. The strategy has produced annualized returns of 29.63% during a very difficult period for systematic trend followers.

The Commodity Long-Short Program uses a unique, quantitative pattern recognition strategy that is designed to capture long or short directional "volatility bursts" in physical commodity futures. The patterns are not visible to the "naked eye," according to Rollinger.

Rollinger was fortunate enough to receive a world-class education in trading system design and management from quantitative hedge fund pioneer Edward O. Thorp — who "Market Wizards" author Jack Schwager recently called "the best risk-adjusted trader ever."

Red Rock's flagship systematic program boasts an impressive 10+ year track record with a compound annual return of more than 9%. The program has a 13% annualized volatility and no correlation to the stock market. While it has been a steady performer, Rollinger believes the Commodity Long-Short program is timely and has had people talking recently. Red Rock also has produced a white paper that highlights the value of long/short commodity investing (see "Commodities: It's what's for diversification," page 44).

Rollinger says his program focuses on physical commodities with no financial futures because physical commodity futures are more susceptible to supply/demand shocks than are financials.

He explains: Hedgers, who utilize the commodity futures markets as a means to transfer price risk to speculators and investors, could be producers or consumers of various commodities, and depending on which one they are, could benefit from the price of that commodity either rising or falling. Producers of commodities are able to hedge their price risk by taking short positions in futures contracts on the commodity that they produce.

He says conversely, consumers can hedge their risks by taking long positions in the futures contracts on the commodities that they consume. "Due to these mechanics there is a premium that can be captured on both sides of the market if one is willing and able to [do so]," he says.

"Interestingly, and oft-misunderstood, is that this means that while the net supply of commodity futures contracts may be a zero-sum game, there is more to the story, because one group of participants (hedgers) is regularly willing to pay a premium, such as initiate and hold losing positions, to limit their risk," Rollinger says.

Since inception of the program in September 2013, it is up 19.94% through April 2014, and up 12.36% year-to-date.

"This performance is especially impressive considering it was produced during a period that saw a number of high-profile commodity funds close up shop and J.P. Morgan, Deutsche Bank and most recently Barclays all announce their exits from the global commodities trading business," Rollinger says.

Besides its impressive absolute returns, Rollinger says that the fact the strategy is so different—having produced 0.18, 0.19 and 0.13 daily correlations to diversified CTAs, trend-following CTAs and short-term CTAs respectively —is causing it to gain the attention of allocators and family offices.

Rollinger says he initially entered the systematic trading field for the unbounded upside financial potential, but his competitiveness and discipline took over from there.

"I've always been analytical and comfortable with numbers. I remember on road trips as a child, with my father's instruction, calculating the speed of our car in [miles-per-hour] by measuring how long it took us to reach the next mile-marker on the highway," Rollinger says.

"Our strategy is designed with mathematical expectation at its base. Thus, we expect both winning and losing trades to occur over meaningful periods. The strategy uses very strict risk-management techniques that have us quickly exit losing trades" he says. "So as long as trade outcomes are within statistical bounds of expectation for our strategy, we follow the strategy to a 'T'—thereby positioning ourselves to fully experience the strategy's true mathematical expectation/edge."

He says the strategy is designed to be very agile and it factors in and adjusts to recent spikes or jolts in price and/or volatility caused by a big news story, weather or catastrophes.

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