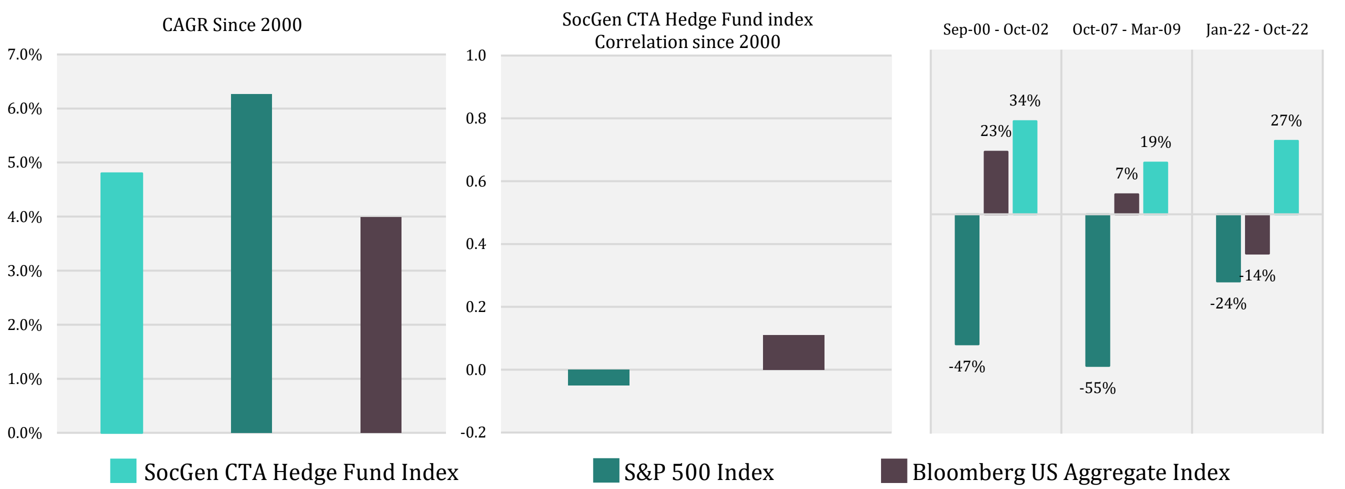
MANAGED FUTURES: DBI'S GUIDE FOR ADVISORS

This is a short form guide to investing in managed futures for you: financial advisors in the wealth management space. In sum, we think managed futures is the single most valuable diversifier you can add to a portfolio of stocks and bonds – more "bang-for-the-buck" than private equity, private credit, REITS, commodities and many other widely-used alternatives. Since 2000, the strategy – as measured by the SocGen CTA Hedge Fund index[1], in our view the best source of long-term data on the space – has delivered:

75% the return of stocks, 120% that of bonds

Near zero correlation to both stocks and bonds

"Trifecta" of gains during the dotcom, GFC and 2022



With stocks and bonds moving in tandem for the first time in decades, the diversification benefit is even more acute: a 10% allocation in 2022 would have cut losses in a 60/40 portfolio by a fifth[i]. We believe every advisor should include managed futures as a 5-20% allocation over the next decade.

The trick is getting the allocation right. Those who discovered the space in the 1990s might remember egregious fees and extreme volatility. Many of you who were early adopters of managed futures mutual funds in the 2010s had bad experiences. The good news is that times have changed: managed futures mutual funds and ETFs today are far better than a decade ago. The bad news is that there still are a few major "landmines" that can trip you up. This guide can be

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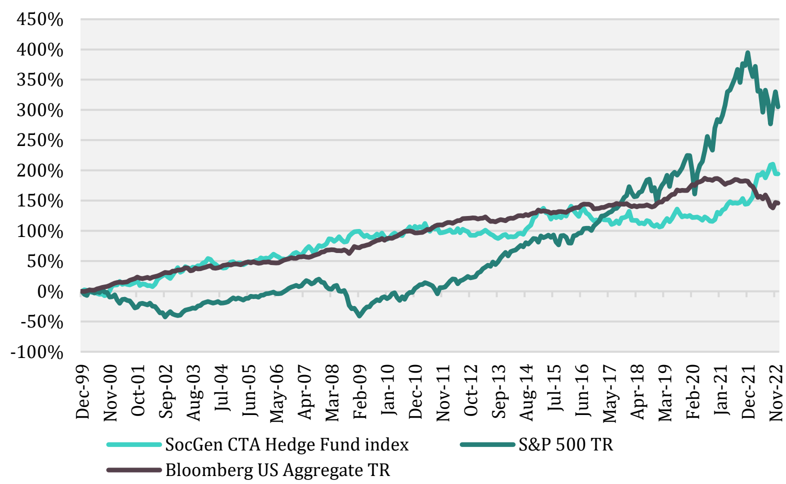
a starting point to help you build a durable strategy to invest in the space, hopefully sidestep the key landmines and help to manage client expectations.

1. It's Not as Complicated as it Sounds

Here's what you need to know about "managed futures": it's an investment *strategy* that hunts for trends in dozens or hundreds of assets for which there are futures contracts – think crude oil, Treasuries, S&P 500, Japanese yen. In other words, if crude oil is rising (falling), they might go long (short) the futures contract and bet it continues. Firms use *quant models* to study past prices to decide what to buy and sell, and *diversify* across commodities, rates, equities and currencies. As markets (and prices) shift, they *tactically* move around – hence, *managed* unlike, say, buying and holding gold. Why *futures*? Because it's an extremely liquid, efficient way to bet on these price moves.

We think of it this way: managed futures funds ride market waves. The best time is when market earthquakes cause a few tsunamis, like 2022; sometimes it's choppy and they bounce around but don't make much forward progress. The good news is that there are always waves, and managed futures funds potentially are a way to make money off them.

2. The Long-term Returns Are Better than You Realized



The return statistics above – "75% of the return of equities, 120% of the return of bonds" – shock a lot of people. Many learned of the strategy during the recent "long winter" of 2015-20, when a combination of the Fed put and near zero interest rates meant low returns, especially relative to soaring stocks and bonds. The chart on the right provides more historical context. Since 2000, the SocGen CTA[2] has offset equity risk during all the three prolonged bear markets and managed to keep up with fixed income during most of the great bond bull market – only to flip to an inflation play and make money from the recent rise in yields. From a more technical perspective, low correlation to the rest of your portfolio means more "alpha": 300-400 bps per annum to *each* of stocks and bonds –unusual for a diversifier.

3. There's a Simple and Clear Reason Why It Should Work

Like the illiquidity premium, value factor, etc., *trend-following* has the ability to generate *alpha* because most investors are not set up to make money this way. In general, we're trained to think markets revert and buy the dip. Like Buffett's trope about cutting flowers and watering weeds, we often sell winners too soon and hold losing positions too long. Model portfolios based on ten- or twenty-year assumptions will not turn on a dime. Wall Street strategists that touted "low rates forever" won't retract that advice based on a few datapoints. "Biases" and these kinds of "constraints" mean many investors leave money on the table. Managed futures funds try to sweep it up: in 2022 most managed futures funds detected the signs of inflation early, repositioned portfolios quickly and rode it. That kind of alpha generation, we believe, is not going away any time soon. You can think of managed futures as *outsourcing a portion of your portfolio*

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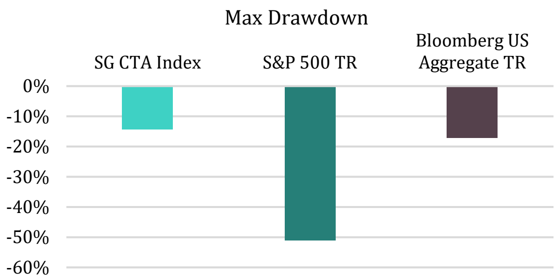
to a tactical strategy that might find trades – in 2022, shorting Treasuries and the yen – that most of us likely won't or cannot do on our own.

4. It Has Been Less Risky than You Fear



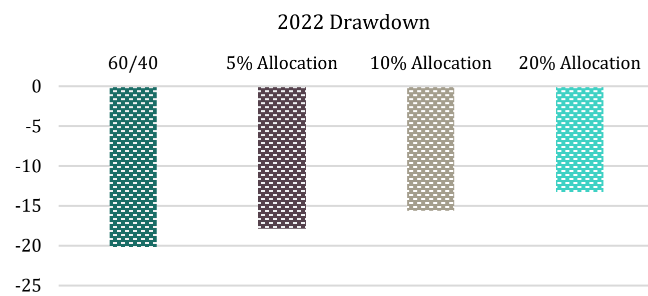
A "quantitative, long and short, leveraged derivatives-based strategy" conjures images of blow ups. And yet, the SocGen CTA Hedge Fund index[3] has had a volatility of around 9% since 2000, about halfway between stocks and bonds. More tellingly, over the same time period, the maximum drawdown is -14% – less than a *third* of equities and now, *even less* than bonds. Why? Managers diversify across markets and size positions prudently – after all, they don't want to blow up either. Their models also ruthlessly cut losing positions – no white-knuckle grip here like with some fundamental investors. Lastly, futures contracts are incredibly liquid so funds can get out of positions when they need to. Short answer: many of fears about managed futures are overblown.

5. Unfortunately, You Probably Cannot Time It

Or, if you can, you know something we don't. We jumped into the space in 2015 to hedge a portfolio for a crisis that hit in … 2022. Some of the smartest allocators to hedge funds bailed just before the rebound. Our strong advice is to pick the right allocation size and stick with it.

6. So How Much Should I Allocate?

Here's the math: add 5% to a 60/40 portfolio, and historical drawdowns improve by over 10%; add 20%, the benefit triples. Here is a chart from our partners, iMGP, on the impact during 2022[i]. The answer will depend a lot on all the idiosyncratic features of your business and portfolios: holdings today, your competitive positioning, client makeup, etc.



7. Investing is a Lot Trickier than It Seems

Now the big issues. If the SocGen CTA Hedge Fund index came in a mutual fund or ETF, investing in the space would be easy. That index, though, just represents the average performance of twenty leading managed futures hedge funds and you can't invest in it. An institution might invest directly in half a dozen constituents of the index to approximate it. Your job is more difficult. Given accreditation and other issues with hedge funds, most of you will invest only in mutual funds or ETFs, where there are more good options than a decade ago, but still slim pickings relative to the hedge fund world. As a practical matter, you can pick from four strategies:

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	Single Manager	2-4 Single Managers	Multi-Manager	Replication
Mutual funds/ETFs	Both	Both, but few ETFs	Mutual Fund only	ETF only
Pros	• Single line item • Brand names • Always a few hot dots to choose from • Fees (usually) lower	• Same as Single Manager, but • More diversified/ predictable	• Single line item • Brand names • More diversified/ predictable • Tendency to match index	• Single line item • Potentially more diversified/ predictable • Designed as "index-plus" • Can be less expensive
Cons	• Extreme dispersion • Recent outperformance often luck, not skill • Difficult as long-term hold	• Cluttered bucket • Difficult to track/explain multiple funds	• Expensive • Unlikely to outperform	• Can seem too simple, a knock off

To build a durable long-term strategy to invest in the space, we believe that *the primary goal of fund selection should be to reliably match or outperform the index or benchmark*. During the 2010s, many early adopters chose the "single manager" path and selected funds they believed would accomplish this. For reasons described in the next section, we think this approach is too risky and explains, in part, why many advisors grew frustrated with and abandoned the space.

8. Single Manager Risk Can Be a Huge Landmine

Single manager risk means you may pick a fund that underperforms everybody else (the benchmark) … by a lot. Why care? Because it's hard to explain to clients why "the best guy in the space" is suddenly the worst. How much of a risk is this? Last year, the *strategy* (SocGen CTA Hedge Fund index[4]) was up 20% but around a fifth of mutual funds and ETFs actually *lost* money.[ii] During the 2010s, the most popular single manager fund (by far) underperformed the index by 20% over five years. Some of you have told us that dealing with a single manager "problem child" can mean a 5% allocation consumes 30% of your time – explaining it to clients, deciding if/when to redeem, etc.

This landmine is particularly tricky because most mutual funds today look great relative to the index. Unfortunately, that's largely a function of the fact that the industry regularly shoots the wounded: 40% of mutual funds and ETFs from five or six years ago are gone today. (The dead funds, obviously, mostly underperformed.) The cold statistical reality is that recent stars are no more likely to outperform, and just as likely to end up near the bottom of the pack. Plus, given how this industry works, you'll get barraged with calls about a top performer, not the fund that lost money last year, and the pitch will be "we built a better mousetrap" rather than "we got lucky." Caveat emptor.

Many of you battle-hardened veterans figured this out and today pick 2-4 single managers. It takes more time to monitor, but we hear it's worth it to reduce "problem child" risk. For those who want a single line item to fill the strategy bucket – in essence, outsource single manager diversification – we encourage you to consider one of the few available multi-manager mutual funds or replication. The multi-manager pitch is that they can provide valuable diversification and select managers who, on average, will outperform the index enough to offset higher fees. The replication approach is to mimic the core positions of all the funds in the index and potentially outperform through fee and expense savings.

From an asset allocation perspective, we want to underscore this: the *strategy* (SocGen CTA Hedge Fund index) has potent long-term diversification benefits, single manager funds generally will not due to *idiosyncratic* risk. That distinction is critical when formulating a strategy to invest in the space.

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9. Fees and Expenses Can Increase the Risk of Dead Money

Few care about fees in banner years. And fees often seem secondary when evaluating a fund on a hot streak. But as a long-term allocator, they can matter a great deal. In particular, it's the tough years when people start asking questions. Look at it this way: in choppy seas, the *strategy* (SocGen CTA Hedge Fund index) might deliver 3-5% per annum over cash – but no better than cash *after* fees and expenses. That was a huge problem during the "long winter" in the late 2010s, when cash was earning roughly zero and, hence, clients made zero. Mutual funds generally have higher management fees than the hedge funds in the index, but no performance fees; ETFs tend to be less expensive.

There's no perfect answer here. Some of the better performing mutual funds last year had high fees, as did some of the worst. Lower fees in some products were cold comfort after years of persistent underperformance. We think the fee question plays out in a few ways. First, lower fees can matter a great deal when you – the allocator – are judged in part on the all-in cost of investing, whether on client statements or to land new business. Second, clients may be more patient during those inevitable lower return periods – it's just grates on people when it looks like everyone is making money but them. Lastly, all things being equal, client capital grows more over time: by analogy, at the institutional level, the largest allocators rarely pay "headline" fees and hence typically outperform the index – which gave rise to our expression, "in hedge funds, fee reduction is the purest form of alpha."

10. Clients Management Requires Its Own Strategy

By now, many of you will be convinced about the benefits of the *strategy* but wondering how to manage clients. First, rather than try to describe how the sausage is made, we think you should pick metaphors that resonate: "flood insurance where, with this policy, you get paid while you wait" or "these are smart investors who use computer models to try to ride the market waves." Perhaps it's better to frame the allocation as a "hedge against another decade like the 2000s" or "years of higher inflation." Second, we think the allocation should be framed as a "strategic, long-term diversifier" – not a trade. Just like stocks and bonds, clients should expect to see the allocation in their statements in ten years. Along this line, we caution against overselling hot dots, which can lead to unrealistic performance expectations as well as a short-term mindset. Third, we encourage setting expectations about both good periods, like 2022, as well as lower return periods. We think the most effective way to do this is to anchor ongoing results to the *strategy*, and implicitly reference the long history of results through different market regimes. Finally, we think fees should be part of the discussion, since more "equitable" fees structures can foster patience over a market cycle.

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We hope you found this short form white paper useful. We believe that education – both theory and practice – will be critical to bring more of you into the managed futures tent. For some, education is about learning the basics of the strategy and its potential benefits; for others, it's about correcting common misunderstandings. In either case, we hope this paper is a step in the right direction. As always, we welcome any and all feedback!

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GLOSSARY OF TERMS

Maximum Drawdown measures the peak to trough decline of investment performance over a given period of time.
Compounded Annual Return measures the annual rate of return of an asset over multiple time periods.
Annualized Standard Deviation measures the annualized volatility of an asset over multiple time periods.

SOURCES

Some of the information presented in this brochure includes information that has been obtained from third-party sources.

INDEX DEFINITIONS

Bloomberg USAgg Index is a broad-based benchmark that measures the investment grade, US Dollar demonated, fixed -rate taxable bond market.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks and is designed to reflect the performance of large domestic companies across all major industries. Index performance utilized is total return and reflects interest, capital gains, dividends and distributions.

SG CTA Index is designed to reflect the performance of a pool of CTA funds. The index is reconstituted annually.

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[i] iM Global Partner, “Questions About Managed Futures Allocations.” November 2022.
[ii] 2022 performance of constituents of the Morningstar US Systematic Trend index. Bloomberg data.