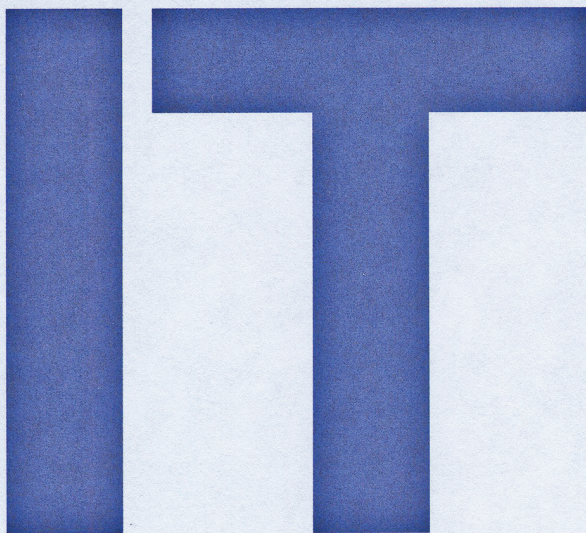


USING THE WHOLE FIELD

Global macro funds are the investing world's singles hitters, in search of consistent performance instead of home runs.

BY ERIC UHLFELDER



IT WAS AUGUST 1992 WHEN GEORGE SOROS SAW A RARE CURRENCY TRADE ALIGN.

A dozen years earlier, the European Economic Community (forerunner of the European Union) introduced the Exchange Rate Mechanism, which was designed to keep continental currencies within a trading range of one another. When spreads between targeted and actual exchange rates strained currency links, ERM coordinated multi-central bank intervention—purchasing weaker currencies and selling stronger currencies to sustain exchange rates.

Speculators, who thought such links couldn't be maintained, periodically tested such exchange-rate coordination. They knew interest rates were still the charge of individual central banks, whose agenda included economic growth—a goal often at odds with supporting a currency's value.

Soros believed the British pound had entered ERM overvalued versus core European currencies. To maintain this link, Britain had to push up interest rates to drive demand for the pound. Yet the rising cost of borrowing was a drag on the country's already stagnant economy.

Soros thought this imbalance could not stand and aggressively shorted the pound. The German Bundesbank, the standard-bearer of continental currency policy, grudgingly conceded the futility of supporting the currency and, by September 1992, Britain allowed its currency to float. The pound sank, and Soros was a billion dollars richer.

CLASSIC MACRO

Soros's sterling gambit was a classic global macro play, revealing a compelling side of the strategy: a go-anywhere investment approach, unrestricted in terms of geography, asset class or currency preference, that focuses on broad financial market behavior.

One may think this approach should make it easier to recognize a good investment than finding the next hot stock. But it doesn't. Managers are lucky to get their bets right half the time.

Decades ago, global macro investing was more akin to

big-game hunting, the domain of affluent individual investors who predominated in the hedge fund space. But just a few years after Soros's coup, macro managers got socked by unexpected interest rate increases, the sequential collapse of emerging markets around the globe and the fallout from the sudden demise of Long-Term Capital Management. Massive government market intervention after the financial crisis further muddled the strategy.

Investors poured out of the space, and today it represents only 6% of all hedge fund assets.

Global macro funds were forced to recast themselves in the 21st century "as more measured managers than their swashbuckling forebears...relying on less leverage and more care, using derivatives, risk controls and other innovations to construct asymmetric positions that limit losses," says Matthew Ridley, a hedge fund manager and industry consultant.

As the predominance of hedge fund investors has shifted from family offices and high-net-worth individuals to institutional investors, who now account for more than two-thirds of hedge fund assets, greater emphasis is now placed on more conservative management that seeks steadier, less volatile returns.

Today's macro managers bet on the movement in various stock indices, interest rates, commodities and foreign exchange rates, using cash and derivatives to gain straight and leveraged exposure. Some managers are trend followers, while others may seem to be contrarian investors trying to position early into a rally or fall.

They can coordinate trades, anticipating short-term U.S. bond prices may fall as interest rates rise, while betting higher rates will strengthen the dollar versus the euro.

Or they may hedge investments. In taking a long position in copper, expecting the metal to rally, managers might short stocks in Chile (a leading producer of copper, to which its economy is geared) in case the price of the metal falls.

Because global macro funds typically make hundreds of short-term trades a year, they usually don't swing for the fences, typically looking instead to collect lots of singles. At the same time, they will quickly exit trades when prices move against them. This tends to produce range-bound returns, especially relative to stocks.

Among the most compelling long-term performers is David Gerstenhaber's Argonaut Global Macro strategy, which has generated annualized returns of more than 11% since its launch in July 2000, with gains having been virtually uncorrelated to equities. He credits his success to intensive assessment of "macroeconomic data, central-bank policies and government and market data that's maintained in a real-time global proprietary economic database."

When his analysis doesn't generate a strong conviction about interest rates or stock market trends, he will look at more targeted exposure, such as energy or metals. When sufficient opportunities can't be found, he has no problem building up cash.

However, 2011 revealed that even seasoned managers such as Gerstenhaber can get slapped around. That year's volatility was highlighted by intensive government intervention in finan-

cial markets around the world, the threat of the euro's collapse and dizzying gyrations of "risk on, risk off" trades, all of which screwed up the timing of many of the manager's investments. The result: The strategy lost 13.3%, its only calendar-year loss.

While Gerstenhaber made up most of the loss in 2013, his profitability over the past several years has been more uncertain than it was during the strategy's first decade of operations, illustrating the challenges that have confronted most macro managers.

In response, Gerstenhaber's management has become more tactical. When trend signals start to get fuzzy, he is now inclined to take profits and reduce risk sooner than he had been. "With market trends likely to be more short-lived than they were pre-2008, when trends lasted 12 to 18 months, we now are more nimble in getting into and out of investment themes," he says.

Expecting greater disconnects among asset classes and

growing volatility for the rest of the year, Gerstenhaber sees improving opportunities in global macro. And industry data through the first quarter corroborated this sentiment, with global macro funds having generated returns of 3.79%.

CONTINUED APPEAL

Despite extended stock and bond trends that should've been a boon for macro managers, five-year annualized returns of the BarclayHedge Global Macro Index through March were just 3.4%, while the S&P 500's gains were nearly 14.5% a year. Nevertheless, strategy assets have grown 240% since 2008 and now exceed \$200 billion.

Why does the strategy continue to attract new assets? The appeal of the strategy may lie in its steady track record, as stock and bond performance becomes more uncertain, and its lack of correlation to the equity market.

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COMPARED

to alternative funds, macro hedge fund managers tend to be more seasoned, with more investment tools in their arsenals.

best year recorded by macro managers was 1999, when they averaged gains of 20.2%; the worst was in 2011, when they were down 3.7%. This reflects the strategy's fairly contained performance range.

Comparing five-year trailing correlation with the market to the past year, global macro performance is diverging from the S&P 500, having shifted from 0.62 to 0.12. This makes global macro the hedge fund strategy that is the second-least correlated to the S&P 500.

One of the most extreme macro funds that's least correlated to the market is the Singapore-based Quantedge Global Fund. It has generated the highest returns within the macro space, along with the greatest volatility.

While the fund's management declined to be interviewed for this story, it did provide a recent pitch book that outlines the billion-dollar-plus fund's approach to investing.

The managers embrace risk, targeting annual standard deviation of 30%. This makes the fund much more exposed than others to severe drawdowns—the amount a fund may lose before recovering to its previous high-water mark.

In a matter of just four months in 2008, Quantedge had lost nearly 45%. However, for the year, its performance was comparable to the industry average—down 22.6%.

Despite that loss, the fund has delivered annualized returns of over 30% since launching in October 2006. And over the past five years, returns have topped 40%, with slightly lower than average volatility.

Quantedge has achieved these numbers not through outsized bets, but through extreme diversification across scores of developed market stock and bond indices and a wide range of commodities and currencies. It relies on proprietary statistical models to project volatility, returns and the correlation between assets and aggressive capital rotation.

But this really doesn't explain how management works—an understanding that's requisite before moving into any investment. Still, Quantedge has demonstrated what is possible from extreme macro exposure.

Number two on our select list is Haidar Jupiter. Its annualized rate of return since starting up in January 2002 through March was 17.60%, with a worst drawdown of 17%. Where most macro funds have been struggling over the past five years, Haidar's returns, like Quantedge's, also accelerated—to nearly 30% a year. But it achieved growth with less volatility—under 17%.

Said Haidar, the fund's manager, says he generated higher profits during much of this time from a series of tactical trades that were more akin to relative value strategies than macro. They included leveraged exposure to the massive issuance of sovereign debt (which followed the financial crisis) before it came to auction.

FIGURE 1

Select Global Macro Hedge Funds

Minimum assets \$100M and five years of performance with data through March 2015. Ranked by five-year annualized returns.

NAME (TICKER)	INCEPTION DATE	FUND SIZE \$M	% 1-YEAR RETURN	% 3-YEAR ANNUALIZED RETURN	% 5-YEAR ANNUALIZED RETURN	ANNUALIZED SINCE INCEPTION	5-YEAR ANNUALIZED STANDARD DEVIATION	5-YEAR SHARP RATIO	WORST DRAWDOWN
Quantedge Global Fund	Oct. '06	1,274	26.91	22.89	40.31	30.95	27.89	2.44	44.65
Haidar Jupiter International Ltd.	Jan. '02	356	40.12	29.41	29.68	17.60	16.84	3.98	17.06
Graham Absolute Return	Jan. '05	677	22.66	10.50	11.29	13.67	7.83	1.43	13.31
Campbell Global Assets SPC—Multi-Strategy Segregated	July '02	387	36.13	9.92	11.25	7.69	11.88	0.94	22.92
Stratus Fund Ltd. Class C USD 1.5X	Dec. '03	156	29.95	9.52	10.59	14.62	9.46	1.11	16.68
Element Capital Fund Limited	April '05	5,712	8.99	9.97	10.45	21.79	6.69	1.55	7.83
CommonWealth Opportunity Master Fund	Dec. '08	563	5.19	6.93	9.09	13.48	5.68	1.59	10.38
Barclay Global Macro Index	Jan. '97		9.39	4.12	3.40	8.18	3.91	0.85	6.42
Barclay Hedge Fund Index	Jan. '97		4.07	6.35	5.21	9.20	5.51	0.93	24.09
MSCI EAFE Index (US Dollars)	Jan. '75		-3.46	5.98	3.14	7.82	16.63	0.18	58.24
S&P 500 Total Return Index	Jan. '80		12.73	16.12	14.47	11.72	12.85	1.12	50.95

Source: BarclayHedge

FIGURE 2

Select Global Macro Mutual Funds

Minimum assets of \$90 million and three years of performance with data through April 2015.
Ranked by five-year annualized returns.

NAME (TICKER)	INCEPTION DATE	FUND SIZE \$M	% 1-YEAR RETURN	% 3-YEAR ANNUALIZED RETURN	% 5-YEAR ANNUALIZED RETURN	1-YEAR STANDARD DEVIATION	3-YEAR ANNUALIZED STANDARD DEVIATION	3-YEAR SHARPE RATIO	EXPENSE RATIO
Dreyfus Dynamic Total Return A (AVGAX)	May '06	987	14.65	10.46	9.33	5.59	7.03	1.45	1.50
KCM Macro Trends R-1 (KCMTX)	Aug. '08	94	8.22	11.50	5.13	9.11	10.26	1.11	1.70
MFS Global Alternative Strategy A (DVRAX)	Dec. '07	576	5.60	6.14	4.87	3.17	3.66	1.64	1.40
UBS Dynamic Alpha P (BNAYX)	Jan. '05	319	4.97	6.60	4.73	2.54	4.40	1.43	1.10
William Blair Macro Allocation I (WMCIX)	Nov. '11	1,360	7.18	9.99	N/A	4.68	7.34	1.33	1.07
JHancock Global Absolute Ret Strats A (JHAAX)	Dec. '11	7,322	6.67	3.97	N/A	3.04	3.11	1.25	1.71

*Returns are gross of any sales loads. Source: Morningstar

"We established short exposure, for example, to three-year bonds before they hit the market, when they tend to initially sell off," Haidar says. "We then rotated long once the market absorbed these new securities and prices corrected."

At the same time, he will have long exposure to 10- or 30-year bonds to hedge his interest rate risk. These perpetual trades, which he said are known as "supply concession trades," accounted for about two-thirds of his profits.

Haidar also generated consistent returns through calendar trades—gaining long equity exposure for just several days at the end of each month—when institutional and retail assets typically flow into markets, juicing up prices of major equity indices in the U.S., Europe and Japan.

Confident about the protracted availability of cheap money and believing the broad risk of bankruptcy was limited, he periodically sold North American high-yield, credit-default swaps.

While many managers were hit hard when the Swiss Central Bank dropped its peg to the euro in January, Haidar made money on the sudden jump in the franc's value. Knowing the link was temporary and watching the euro tumble at the end of last year, he established a small long franc position. "Since it requires massive purchases of the euro, we felt the Swiss would find it too expensive to maintain the link with the euro," Haidar explains, especially as sluggish continental growth and quantitative easing was fueling the decline of the euro versus the dollar.

The fund is positioned to benefit from further strengthening of the U.S. dollar, weakening of commodity prices, rising bond prices as interest rates decline and falling stocks. "But these positions could quickly change," he says.

'40 ACT ALTERNATIVES

Compared to alternative funds, macro hedge fund managers tend to be more seasoned, with more investment tools in their arsenals, and more of them have delivered stronger performance over a longer period. But they come with higher fees, greater minimum investments and less liquidity, and they frequently are more levered than mutual funds.

The William Blair Macro Allocation I Fund, which started in late 2011, has delivered three-year annualized returns of nearly 10% with volatility of less than 7.4. With \$1.36 billion under management, the fund has one of the largest asset bases of an alternative '40 Act fund.

Co-portfolio manager Tom Clarke explains the fund primarily uses ETFs and a host of derivatives, including index futures, swaps and options, to establish the fund's long and short equity, foreign exchange and credit positions. The fund maintains no commodity exposure.

At the end of April, the fund was 38% net long stocks—bullish on foreign equities, bearish on U.S. shares. The fund is long on emerging market currencies versus the U.S., Australian and New Zealand dollars and the euro. And it is 10% net short on 10-Year U.S. Treasury, euro zone and Japanese bonds, believing they are substantially overvalued, meaning he thinks rates are likely to rise substantially over the next five years.

KCM Macro Trends is a \$94 million Houston-based fund that's been around since 2008—with five-year annualized returns of over 5%. But it has been more volatile than other funds, with a standard deviation around 13.5. Over the same time, investors have seen a couple of yearly gains above 25%, a flat year and one down year, when it dropped 13%.

Manager Martin Kerns runs his fund like a hedged equity product. Two-thirds of his book are equities, whose exposure is shaded by select foreign exchange, high-yield credit and commodity allocations to add alpha and protect against falling stock prices.

His exposure is guided by broad macro trends, with individual positions determined through bottom-up research. Because his bullish outlook has limited hedging, Kerns's portfolio has been buffeted by choppy markets.

Since the financial crisis, diversification away from stocks and bonds has proved costly. However, adding proven global macro managers can deliver absolute returns that can smooth performance. Now may be an opportune time to consider gaining such exposure.

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