# Editors' Letter

As we near the completion of our second year of the *Alternative Investment Analyst Review* we are pleased to welcome Keith Black as an Editor of AIAR. Keith brings a diverse skillset to AIAR with extensive experience both as a practitioner and an academic.

As we develop this issue, we find ourselves facing a slowly recovering economy, facing potential risks for rising interest rates, increasing inflation, regulatory changes, and rising energy prices. This issue of AIAR includes a variety of articles that address many of these risks.

Burkhardt, Duncan, and Liu consider the use of drawdowns as a risk measure for hedge funds and commodity trading advisors. The authors provide insight into deriving drawdown distributions in order to provide investors with tools to analyze historic drawdowns and predict future drawdowns.

Many investors are turning to real assets as inflation risk grows. Unfortunately, many real asset investments are not suitable for a wide range of investors due to their low liquidity. This issue's "CAIA Member Submission" section features a timely article by Anton Loukine on investing in real assets through liquid vehicles.

This issue's literature review focuses on crude oil price and volatility forecasting. Behmiri and Manso provide a comprehensive review of the literature, prefaced by a tutorial on time series modeling by Edward Szado.

Fulli-Lemaire's article focuses directly on inflation risk management. The author provides alternatives to the standard approach to inflation hedging - inflation-linked bonds.

This issue features a perspective on regulatory changes in futures markets by CAIA member Kathryn Kaminski.

We hope that the articles featured in this issue of the *Alternative Investment Analyst Review* will provide insight into some of the risks and opportunities faced by investors in the current market environment. As always, we encourage and appreciate your feedback and look forward to your submissions to AIAR.

Keith Black
Hossein Kazemi
Edward Szado
Editors AIAR

# Call for Articles

Article submissions for future issues of *Alternative Investment Analyst Review* are always welcome. Articles should be approximately 15 pages, single-spaced, and cover a topic of interest to CAIA members. Additional information on submissions can be found at the end of this issue. Please email your submission or any questions to **AIAR@CAIA.org**.

Chosen pieces will be featured in future issues of AIAR, archived on **CAIA.org**, and promoted throughout the CAIA community.

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*What a CAIA Member Should Know*



**ABSTRACT**: Drawdowns, which measure losses relative to most recent high water marks, are a natural consequence of investing in risky assets. Because it plays an important role in an industry in which performance fees are asymmetrical – paid only when a manager is making new highs – it is important to understand the forces that determine drawdowns. The work reported here shows that drawdown distributions – both the distribution of all drawdowns and the distribution of deepest or worst drawdowns – can be explained using the mean and volatility of returns together with a manager's length of track record. And with this framework, one can make educated guesses about what kind of drawdown experience one can expect over various horizons going forward.

*CAIA Member Submission*



**ABSTRACT**: With interest rates in most of the developed countries near zero in nominal terms and negative in real terms, investors are increasingly looking for ways to protect their capital against the erosion of purchasing power as well as unexpected changes in interest rate term structure and inflation. One approach that may help to accomplish this objective is increasing the allocation to real assets. Real assets are often associated with long-term, illiquid investments in physical assets. However, it is possible to construct a portfolio of liquid instruments that help to overcome the typical issues inherent in illiquid forms of investments while achieving similar characteristics and outcomes. This paper examines various components of real assets from the Canadian and U.S. perspective, their liquid implementation, as well as the benefits of adding liquid real assets to a portfolio of traditional investments.

*Research Review*



**ABSTRACT**: The importance of crude oil to the world's economy is a proven statement; the reason why economists have devoted great efforts towards developing methods to forecast price and volatility levels and generated a vast number of studies. The goal of this article is to review the existing literature on crude oil price forecasting methods. We categorized the existing forecasting techniques into two main groups, including quantitative and qualitative approaches; and then we performed an almost comprehensive survey on the available literature with respect to these two main techniques.



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**ABSTRACT**: The U.S. subprime financial crisis, the ensuing "Great Recession," and the sovereign debt scares that spread throughout much of the industrialized world brought about a new order characterized by higher inflation volatility, severe commodity price shocks and uncertainty over sovereign bond creditworthiness to name just a few. All of these factors tend to put in jeopardy both conventional inflation protected strategies and nominal unhedged ones, from reduced issues of linkers to negative long-term real rates, they call into question the viability of current strategies. This paper investigates these game-changing events and their asset liability management consequences for retail and institutional investors. Three alternative methods for achieving real value protection are proposed.



**ABSTRACT**: The world of derivatives as we know it is in a state of flux. Prior to the credit crisis, the derivatives game was played on two very different fields: over-the-counter (OTC) derivatives were traded via dealer networks and exchange-traded derivatives (ETD) were traded via centralized clearing houses. Although in theory the nature of derivatives contracts should be roughly the same, in application, the rules as well as the mechanism by which these contracts change hands, varied substantially. The financial crisis that unfolded in 2008 led to a sharp review of the way derivatives contracts are traded and collateralized. In an attempt to level the playing field and create a more cohesive approach to regulating derivatives markets, legislation such as the Dodd-Frank Act in the U.S. and EMIR in Europe spearhead the restructuring and reorganization of the way that the derivatives game will be played.

These regulatory forces coupled with industry demographics are migrating contracts from dealer networks onto exchanges, spawning the next wave of futurization. By definition, futurization is the migration of traditional dealer based bilateral contracts into similar standardized futures-style contracts which are centrally cleared and exchange-traded. For example, swap futures (or futurized swaps) are new, exchange-traded variants of swap contracts which are meant to mimic swaps. To use an analogy, futures are to forwards as swap futures are to swaps. To appease users of swaps, these new futures contracts are an attempt to keep some of the customizable features of swaps while maintaining some of the advantages of a centralized exchange. Across the derivatives industry the push for transparency and transferability has already begun and, despite many opposing views, it does remain evident that the future of derivatives markets is futurization.