



# Alternative Investment Analyst Review

## **EDITOR'S LETTER**

**Diversified Hedge Fund Portfolios**

*Hossein Kazemi*

## **WHAT A CAIA MEMBER SHOULD KNOW**

**Adaptive Investment Approach**

*Henry Ma*

## **FEATURED INTERVIEW**

**Kathryn Kaminski On Trend Following with Managed Futures**

*Kathryn Kaminski, CAIA*

## **RESEARCH REVIEW**

**Comparing Three Generations of Commodity Indices: New Evidence for Portfolio Diversification**

*Philipp J. Kremer*

## **CAIA MEMBER CONTRIBUTION**

**Beyond Venture Capital: An Innovative Approach for Investment in New Ventures and Projects**

*Manuel Stagars, CAIA*

## **INVESTMENT STRATEGIES**

**Procyclical Behavior of Hedge Funds: A Portfolio Manager and Investor's Perspective**

*François-Éric Racicot and Raymond Théoret*

## **PERSPECTIVES**

**The Hedge Fund Conundrum: Are Funds Meeting Investor Expectations or Not?**

*Kevin Mirabile*

## **IR&M MOMENTUM MONITOR**

**IR&M Momentum Monitor**

*Alexander Ineichen, CAIA*

## **VC-PE INDEX**

**VC-PE Index**

*Mike Nugent and Mike Roth*

## **THE IPD GLOBAL INTEL REPORT**

**The IPD Global Intel Report**

*Max Arkey*



**Kathryn Kaminski, CAIA  
On Her New Book, *Trend  
Following with Managed Futures:  
The Search for Crisis Alpha***

## A View to the Futures: Following Trends with Kathryn Kaminski

In the late fall, Barbara J. Mack, AIAR Content Director, spoke with author Kathryn Kaminski, Ph.D., CAIA about her new book, *Trend-Following with Managed Futures: The Search for Crisis Alpha*.

**BJM:** You completed a Ph.D. at MIT Sloan and have done a wide variety of interesting things since then. You also have the CAIA designation. How did you discover CAIA and why did you decide to complete the program?

**KK:** I found out about the CAIA designation through 100 Women in Hedge Funds – I had been working for RPM, a CTA fund of funds in Stockholm. At that time, I joined 100 Women in Hedge Funds and saw an advertisement for a CAIA scholarship for women. Since I teach courses on derivatives and hedge funds, it was an obvious choice for me. I found the materials to be very interesting, and I am a great advocate of CAIA. I like the fact that it is pretty broad; if I take the perspective of most academics, we tend to stick to our regime and don't always learn about things like REITs and infrastructure investing. As it turned out, I enjoyed some of those topics the most – they were outside of my field and learning about them helped me to become more versatile, with a view on the whole industry. That is an important thing to do in finance; especially if you teach, you need to know about many things, and it never hurts to learn more.

**BJM:** So you have been hard at work and your new book, *Trend-Following with Managed Futures*, came out late last summer. What can you tell us about the motivation behind the book and how did you find your co-author, Alex Greyserman?

**KK:** My Ph.D. thesis at MIT was on stopping rules and investment heuristics. I later became interested in CTAs and was working as an allocator. A couple of years ago, I started writing white papers on trend-following and wrote a paper for the CME Group called “In Search of Crisis Alpha,” which became quite popular. This particular piece is often used by managers and allocators to help educate investors and launched a friendly relationship with the CME. We shared a mutual goal of providing education on managed futures and promoting the managed futures industry. Randy Warsager, who is in

charge of hedge fund relationships, sent me articles that he knew would interest me and informed me about key topics of discussion. Alex Greyserman, chief scientist at ISAM (a systematic CTA), had similar interests and also had a relationship with the CME. Randy introduced me to Alex's work with ISAM, and we decided to meet. I went in with the intention of writing a research paper together and the meeting ended with the challenge of writing a book.

As it turned out, Alex and I have very similar backgrounds – we both come from a signal processing background and turned to quant finance. I'm more on the behavioral finance and investment side and Alex has been building systems for trend-following funds for 25 years, which means that he knows all the ins and outs of how to design and construct the systems. Writing the book was an educational mission --Alex teaches courses at Columbia on how to build trading systems and develop trading strategies, and I teach courses on derivatives and hedge funds. We wanted to present the subject as objectively as possible; so, for example, there are no names of funds in the book - we have lists of funds, but they are called “CTA 1”, “CTA 2”, and so forth. We did not want to highlight one fund or another - the book was produced independent of any marketing objective. Our goal is that any investor can read the book and gain a detailed understanding of what trend-following is about and why it should work.

In part, our mission stemmed from the fact that a number of questions about trend-following have never been answered in an adequate way. There are some great trend-following books out there, but most of them have different goals – some are very fantastical and intriguing, but they can be quite anecdotal. Other books are very sales-oriented. We treated the creation of this book as if we were teaching a course. In fact, while I was writing the book, I had CAIA in mind because this is an area where there needs to be more education for financial professionals. The academic community basically disregarded trend-following and momentum in futures trading until the paper by Moskowitz, Pedersen, and Ooi was published in 2012. However, I had been a big fan of trend-following long before that time. In the asset management industry, a lot of people know that it works and the academics are finally coming around.

**BJM:** The book was released in the summer of 2014. Can you describe how you covered the topics and what

the points of emphasis are?

**KK:** There are five parts to the book. The first part begins with a historical perspective including an 800-year analysis of trend-following. In chapter two, we talk about futures markets in general - futures trading, the managed futures industry, and the futurization of the OTC derivatives markets. The third chapter covers the basics of building a systematic trend-following system. Here we introduce one equation that is used for the entire book. This is important, because there are so many ways that you can design a systematic trend-following system. Our goal was to have a general equation that gives a single frame of reference for the book and includes an analysis of how to build a trend-following system: from entry to exit, and through position sizing, adjusting for dollar risk per position, and so forth.

The second part of the book covers the theoretical foundations of managed futures markets. In chapter four, we discuss the adaptive market hypothesis, speculative risk premiums, and crisis alpha. This chapter talks about Andrew Lo's work and how to think about markets as ecologies and provides connections with behavioral finance, so it's fun. Chapter five explains the act of divergent risk taking, risk and uncertainty, and the philosophy behind trend-following strategies. At the end of this chapter, we address the question - "Is the strategy actual tradable?" and look at the importance of exit and entry. Chapter six is on the role of interest rates in futures trading, including earned interest and roll yield. The third part of the book is focused on trend-following as an alternative asset class. Chapter seven focuses on statistical properties - crisis alpha, conditional correlation, skewness, the higher order moments - these are the basics. Chapter eight is on drawdowns, volatility, and correlation and we talk about the relationship between strategy volatility and market volatility and how that works, because it is a bit complicated. Chapter nine is on the hidden and unhidden risk in alternative investments, particularly related to trend-following and we cover credit risk, liquidity risk, price risk, and leverage risk. We explain these risks and examine how trend-following systems fall into those different categories. At the end of the chapter, we touch on margin, leveraging, and how dynamic leveraging works. Chapter ten provides a more general discussion of the macro environment and the impact of government intervention and regulatory change.

The fourth section of the book is on indexing and benchmarking. Chapter eleven discusses return dispersion in the CTA space and how different choices of parameters for trading systems can create return dispersion from one systematic fund to another. This discussion leads to chapters twelve and thirteen, which are on style analysis and benchmarking. Here, similar to the Fama and French three-factor model, we design a model for benchmarking CTA returns as a function of their construction style. We show how you can create a market size factor, an equity bias factor, and a trading speed factor to supplement an underlying trend-following strategy. Using this model, different CTA indices and individual CTAs can be examined to perform style analysis and performance attribution. This is one of the most exciting parts of the book and has been very well-received by CTA investors.

Finally, the last section of the book covers a series of more advanced portfolio level topics from the investor perspective. Chapter fourteen discusses equity bias, dynamic leveraging, and the importance of mark-to-market. Chapter fifteen discusses size, capacity, and liquidity. Here, we take a closer look at how important commodity or small markets are with regard to the different strategies. Chapter sixteen addresses the move from pure trend-following to a multi-strategy approach and is intended to prompt a discussion from both individual and global portfolio perspectives on the pros and cons of the multi-strategy approach. Chapter seventeen evaluates dynamic allocation to trend-following strategies. This chapter focuses on when to invest or divest, answering the questions - "Should I buy when the strategy is in a drawdown, or should I buy when the strategy has done well? Is return chasing a good way to invest in CTAs, yes or no?"

**BJM:** With the book published and out in the world, how does that feel and what are your plans now?

**KK:** It takes quite a long time to finish a book and I had no idea how satisfying it would be. My immediate focus is on continuing to publicize and promote the book. I spoke at Quant Invest in London in September, Battle of the Quants in London in November, and several other events are planned. We are always considering which conferences will be best for reaching out and hopefully talking about this book will keep the momentum going. Our main audience is the institutional investor but also fund managers, students, and the CTAs themselves.

The CTA space seems to be on the upswing now and, if that is the case, this is a good time to be talking about these issues. This is why I am delighted to be able to announce that in 2015 I will be joining a well-respected and forward looking systematic manager, Campbell & Company. Their focus on innovation and education will provide a great opportunity for me to continue to expand on my past work.

To learn more about Trend-Following and Managed Futures: The Search for Crisis Alpha, visit: <http://www.wiley.com/WileyCDA/WileyTitle/productCd-1118890973.html>

### Author Bio

**Kathryn Kaminski** is a Director at Investment Strategies at Campbell & Company. Prior to her recent move to Campbell & Company, she was Deputy Managing Director at the Institute for Financial Research (SIFR) and affiliated faculty at the Stockholm School of Economics. She is a featured contributor to the CME Group. Kathryn has experience working for a CTA fund of funds as well as quant experience in both emerging fixed income and credit markets. She lectures on derivatives, hedge funds, and financial management at the Stockholm School of Economics and has lectured previously at the Swedish Royal Institute of Technology (KTH) and the MIT Sloan School of Management. Kathryn completed her Ph.D. at MIT Sloan, conducting research on financial heuristics with Professor Andrew Lo. Kathryn's new book, *Trend-Following with Managed Futures: The Search for Crisis Alpha*, is co-authored with Alex Greyserman, Chief Scientist of ISAM, and was published by John Wiley & Sons in August 2014. Kathryn is a 100 Women in Hedge Funds PAAMCO CAIA Scholar and a CAIA Charter Holder.