REVOLUTION DOES A 360

Revolution Capital Management

AUM: Alpha Program

Traders: Michael Mundt, Rob Olson

Strategies: Trend reversion/ short-term pattern recognition

Location: Denver

"...if the trend steepens, [we oppose] it. That is why we call it trend reversal."

When we first spoke to the principals of Revolution Capital Management, they were playing up their new short-term Mosaic Program back in 2008.

It seemed a little strange because the firm had a more traditional trend program that was producing solid returns. It was doing so well that the principals at the time — Michael Mundt, Mark Chapin and Rob Olson — brought it to futures legend Bill Dunn to kick the tires. Dunn saw the team had tremendous talent but was looking to partner with a short-term strategy to enhance Dunn's more traditional long-term trend-following approach.

Revolution built Mosaic with the help of Dunn for that purpose but continued to trade its Alpha Program adding some different time windows. "Alpha is looking to trade deviations around the trend, more typically in the direction of the long-term trend, but not always," Mundt says. "It basically gauges the trend over a medium-term lookback and looks for deviations. If there are interruptions in the trend or if the trend flattens or pulls back, it tends to buy in the direction of the longer-term trend, and if there is acceleration in that trend, it tends to short on a presumption of a [correction]."

Sounds plausible, but it appeared to be a typical medium- to long-term trend strategy; and allocators, as well as Dunn, were looking for something else.

Meanwhile, most of the short-term programs failed to provide diversification in the previous few years, which were difficult for trend followers. Mundt says that short-term strategies either relied on momentum, which was somewhat correlated with trend following, or mean reversion, which was less correlated but acted similarly to option writing. "What Mosaic has done is mixed momentum and countertrend in a different way to balance out the return streams and risk," he says.

"Alpha, because of its 0.4 to 0.5 correlation, was in a lot of people's minds too close to trend-following, even if we said it is not actually trend-following," Mundt says. "Trend-following had a challenging couple of years and there was an appetite for systems that had zero correlation to it.

"So Revolution built Mosaic, which tested well vs. other short-term programs, to run on the powerful Dunn infrastructure. It did well initially, doing exactly what it was built to do, produce solid returns during periods when trend-following struggled. Mosaic was getting the lion's share of the marketing effort because that seemed to be what the investors were demanding."

But the growth of electronic trading and high-frequency algorithms changed the markets. "In the last few years the very short-term program has had as hard a time as has trend-following," Mundt says. "The short-term space is so difficult because trading costs are so paramount to success, yet as the markets transitioned from pit to electronic no one knew how those costs would change. The hope was that they would go down, but with HFT it is not clear that was the case."

As trend-following struggled in the post financial crisis world of quantitative easing and risk on/risk-off markets, short-term strategies proved to be just as vulnerable. While Mosaic chopped around in the new environment, Alpha continued to provide steady returns, and by 2011 allocators decided to take a second look.

"Slowly but surely market demand finally realized that with a 0.4 correlation to trend-following, Alpha's performance would add value to portfolios," Mundt says. "People used to dismiss it. It was like talking to a wall, [but] when short-term and trend-following had problems, people got more interested in our pitch."

What they were interested in was Alpha's returns in two very difficult years for trend followers: 16.46% in 2012 and 11.55% in 2013. This, with a conservative less than 12% annualized volatility, has produced a Sharpe ratio of .95. After years of being an afterthought to allocators, Revolution's Alpha program is top dog, managing $312 million; Mosaic manages $218 million. "It is capturing pieces of the trend or in some cases, if the trend steepens, opposing it. That is why we call it trend reversion," Mundt says.

"In the past Alpha was lumped in with trend followers and ignored by allocators looking to diversify away from trend-following. We always felt that was an unfair oversight and for whatever reason people have come around to now seeing it as a diversifier," Mundt says. "A strategy has to meet the right mind set of the investor at the right time. [Sometimes] people will make a good effort to market something that nobody wants and then five years later everybody wants it; and the only thing that changed was their viewpoint."

Both systems are off to a good start in 2016. Alpha is up 4.78% through April and Mosaic is up 9.16%.

Daniel P. Collins