

# Trends are back

BY DANIEL P. COLLINS

**Every time trend following goes through a difficult period there are those who like to bury the strategy, but the recent bad stretch had even some believers worried. Then trend-following came roaring back in 2014 and looks ready for an extended run as market trends and volatility have gotten their mojo back.**

In recent years as we discussed the difficult environment for managed futures in general and trend following in particular, many traders and analysts blamed the poor performance on the risk-on/risk-off nature of markets since the credit collapse of 2008. The thinking went that with markets reacting to central bank policy instead of real fundamentals — or technicals for that matter — trends could not be sustained.

**“ Each of these individual markets are focusing on their own set of fundamentals, which is encouraging...”**

—Salem Abraham

While the performance across the board was poor — there are always managers, even trend-followers, who perform well in difficult periods — there seemed to be something different this time. The trend-following strategy periodically goes through difficult periods — so much so that headlines of “Is trend-following dead?” or “Does trend-following still work?” are a running joke in the industry. But few poor performance periods lasted as long as the most recent. The Barclay CTA Index had never had back-to-back negative years since its launch in 1980 until 2011-12 and 2013

made it three consecutive negative years (see “A tough stretch,” page 20).

#### **Turning off risk-on/risk-off**

“For the first time since 2008 we had trends in markets that were not driven as much by political announcements and governmental interference in the markets,” says Sol Waksman, president of BarclayHedge.

Martin Bergin, president and CFO of

Dunn Capital Management (up 35.67% in 2014), says, “The influence of the central banks created this risk-on/risk-off, which means you had sharp reversals. That is always bad for trend-following and then sharp recoveries because central banks were actually coming into the market and putting things back in sync.”

“During the [poor performance period] trends just didn’t last long enough to capture [moves],” says Donald Wiczorek, founder of Purple Valley Capital, who earned 87.49% in his trend-following program in 2014 (see “Wiczorek: Going

old school,” page 25). “As soon as the market started going one way there would be some sort of an intervention that would cause it to reverse. Trend-followers got chopped up for a while.”

The Fed had trumped the economic fundamentals.

“You had this huge amount of cash that was falling into the economy that had to be put to work. Now people have to actually choose, based on economic fundamentals, where they want their money to work,” Bergin says.

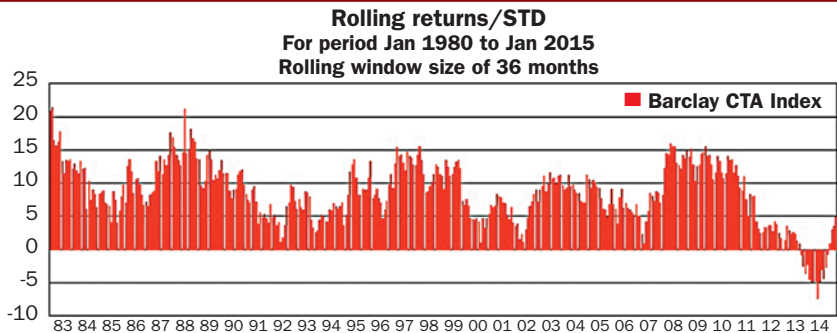
Marc Levitt, founder of Silicon Valley Quantitative Advisors (up 85.93% in 2014) agrees, “Some of the risk on/risk off was driven by Fed policy but most of it was a reaction to Fed policy.”

“Never before had a Fed or central bank been actively trading the market,” says Edward (Bill) Dreiss founder of Dreiss Research Corp., up 85.89% in 2014 (see “Dreiss: Still riding the trend,” page 21). “You could imagine every morning when they got up they were checking to see what the Dow had done. You had fairly high volatility but it would rear off in one direction and then either economic reality would raise its head or the Fed would do something and it would run off



## A TOUGH STRETCH

For the first time in the history of the Barclay CTA Index, a rolling 36-month return dropped into negative territory during the recent poor performance period.



Source: BarclayHedge

in the other direction. That is horrible for a trend-follower, particularly a long-term trend-follower.”

### Breakthrough

Often the most obvious answer is the correct one and 2014 simply was a great year for managed futures because there were multiple trends.

A long period of low volatility had come to an end that year, particularly in currency markets. “Historically, currencies have been one of the leading sectors for trend-followers so when we lost those markets that was one of the reasons we struggled,” says Wiczorek. “Finally we are getting some dichotomy in central bank policy. The Fed is about to hike, the euro is pressing [and] the Central Bank of Japan is trying to destroy its currency. It is really awesome; it causes these huge explosions because of all this pent up pressure.”

Currencies were the top performing sector for most managers along with energies, meats and interest rates. “We really kicked it into gear being long the dollar,” says Levitt. “At times we were completely long the dollar or short [other] currencies. [We caught] the yen and euro moves.”

The best sectors were currencies, energies and bonds,” says Bergin. “Energies early in the year, currencies late in the year and bonds throughout.”

It was similar for Abraham Trading Company. “Currency markets did well, interest rates did well, we made money in grains, it was pretty evenly distributed,” says Salem Abraham (see “Abraham:

Reinventing a legend,” page 23).

Wiczorek adds, “Markets are trending again, which will create a lot of opportunities for trend-followers. Rising prices attract buyers and falling prices attract sellers. Trends will exist.”

While Waksman acknowledges that trend-followers have good and bad years without Fed activity, he adds, “When somebody at the [European Central Bank] makes an announcement, and in two minutes it is everywhere, then all major market sectors are moving in lock step—some up, some down—that is a much more difficult situation.”

Clearly the risk-on/risk-off nature of markets reacting to central bank policy had a negative effect on trend-following. One only needs to look at how the prospect of tapering roiled the bond and equity markets in the summer of 2013. That massive move was in reaction to a methodical process that would not begin for another six months.

The key to Waksman’s point is, “in lock step.”

### Correlation break-up

“It wasn’t so much the volatility coming back into the markets as the de-correlation of the markets,” Bergin says. “For a number of years the markets were all trading in lock step. Equities traded the same, bonds, the energies. Even across markets it was long bonds, short everything else. That is where everyone was sitting for four years.”

But in 2014 that correlation broke down. “Each of these individual markets are focusing on their own set of fundamen-

tals [which is encouraging]; typically that is a supply-side equation not a demand-side of the situation,” Abraham says. “At some point the supply side matters too. We are starting to get markets moving and uncertainty and that always makes for interesting [trading].”

“We entered into a period where the markets became relatively uncorrelated,” Dreiss adds. “As you know they have been fairly highly correlated for many years. We got out of that and that helped in terms of volatility. That is what was remarkable. I had 11 straight months, 13 straight weeks, where I was up, which is highly unusual. Usually, I will have more variability in returns.”

### Who did well?

As noted above, many sectors performed well. While everyone remembers the sell-off in crude oil in the second half of the year, the energy sector provided strong trends in the first half, currencies and interest rates performed for most of the year and meats performed strongly for diversified managers.

Strong performance in the most liquid sectors helped large managers perform well.

“Where we see it most clearly is in the returns of the large trend followers,” Waksman says. “For the longest period [analysts] have said the real returns come from your smaller managers because your large managers have so much money under management that they have no flexibility, and [that] larger managers have toned down their volatility because the management fee is a significant source of revenue.”

This year the big guys outperformed. Waksman points out that the Barclay BTOP50 Index—largest 50 managers by money under management—was up 12.31%, whereas the broad Barclay CTA index was up 7.68%. “That is a significant difference, and if you dig deeper and look at the components of BTOP50 and you look at the systematic traders subset, it was up 19.59%.”

While trends in the largest sectors allowed the big boys to do well, good trends in agriculture helped support diversified traders with large physical commodity exposure. Meats were the

# Dreiss: Still riding the trend

**E**dward (Bill) Dreiss launched his first commodity trading advisor (CTA) before there was a Commodity Futures Trading Commission (CFTC) and such a regulatory distinction existed.

Dreiss is one of the original long-term trend followers who has survived the end of trend following so many times that he can only chuckle over the recent hand wringing regarding the strategy.

“The real underlying reason that any trend-following system works in the market is persistence — this is from Benoit Mandelbrot’s analysis and the idea that markets are chaotic and have fat-tailed distributions — that is fundamentally the edge,” Dreiss says. “So, you have some reasonable method of determining trend changes then trends will tend to run, statistically speaking, longer than you might imagine.”

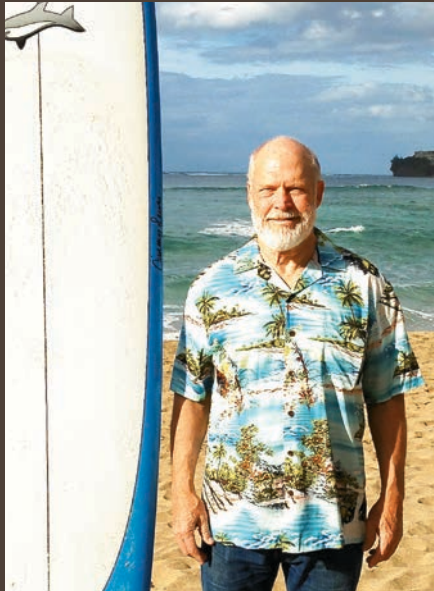
Dreiss’ strategy did well across the board in 2014. He earned strong returns in interest rates, stock indexes, meats and energies. “Almost everything was pretty good,” he says. “The thing that distinguished the year, which started in late 2013, is the markets started not only trending but with little volatility. So I was making money on a steady basis without the volatility that usually accompanies profitable runs.”

In that sense it was a better year than 2008 when Dreiss’ program returned 140.60%. “Profitability in 2008 was based on almost everything going in the same direction; this was almost the opposite of that,” Dreiss says. “We had a lot of markets following their own fundamentals and moving in a fairly orderly fashion. We weren’t having the craziness of 2008. For me it was an ideal market environment.”

Dreiss, who operates his CTA in Hawaii, based much of his research on the work of Mandelbrot. In the mid-1980s developed his fractal wave algorithm (FWA) based on fractal geometry. “It basically decomposes price into various fluctuations, something roughly similar to Elliott Wave, but it is truly systematic,” he says. “I use these turning points; I can draw trendlines through the turning points and use them to generate buy and sell signals.”

What he ends up with is a series of zigzags creating a pattern of higher highs or lower lows. “This is a basic Dow Theory pattern that was promulgated by Charles Dow way back when,” says Dreiss. “My computer program identifies those patterns and uses them to [find] turning points, and I use those turning points to draw trendlines through support and resistance and that is the basis of my trading system.”

It is difficult to discuss things such as fractal waves and in



BILL DREISS

PHOTO COURTESY OF BILL DREISS

the same breath talk about how simple Dreiss’ approach is, but he manages to.

“Conceptually it is a pretty simple system. The only thing that is different is it is truly mechanical. As I have gotten older I realized that there are a lot of systems out there, there is nothing particularly unique about my system. I operate in a certain time frame and that is as important as anything. If they are in tune with the fluctuations of the markets they are going to do better,” he says.

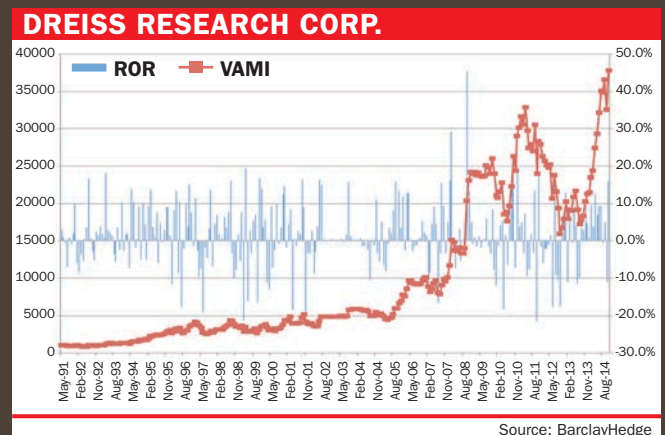
Dreiss, who was one of the first traders to use computers, likes to keep things simple because he has always preferred spending time surfing than writing code.

He has managed to produce a compound annual return of 16.80% since launching his CTA in 1991 based on his

simple belief that markets exhibit fat tails. And continues to surf at the age of 72.

“The problem with the fat tail mathematics is the standard deviation is indeterminate and standard deviation is the primary metric for evaluating risk in term of the various models, so you have a quandary,” Dreiss says. “The Sharpe ratio relies on standard deviation and standard deviation is bullshit. It literally does not have any mathematical meaning in markets that have fat tails. This is true with a lot of models that are widely accepted in the financial community and are based on faulty premises.”

Dreiss has done the heavy lifting of system building and is content to trade his own money and a few customer accounts that have stayed with him over the years. He had one of his best years in 2014 and likely will still be earning returns off of fat tails, and spending a good deal of time surfing, the next time trend following is declared dead.



Source: BarclayHedge



## TOP CTA PROGRAMS ABOVE/BELOW \$50 MILLION

Below are the top CTAs managing more than \$50 million as of the end of 2014. Programs have a minimum track record of 36 months through December 2014. Statistics were calculated since program inception dates, unless otherwise indicated, from a universe of 298 programs.

CTA	Current YTD Return	Compound Annual Return	Sharpe Ratio	Worst Drawdown	Up Dev/Down Dev	Best 12 Mo. (4 Qtr) Period	Worst 12 Mo. (4 Qtr) Period	Money Under Mgmt.	Start Date
Mulvaney Capital Mgmt. (Gl. Markets)	67.37%	16.01%	0.46	45.02%	1.54	115.15%	-35.30%	\$218M	May-99
ISAM Systematic - USD	61.95%	13.74%	0.67	34.79%	1.71	77.78%	-20.33%	\$755M	Jun. 01
RCMA Asset Mgmt (Merchant Commodity)	59.19%	17.92%	0.76	36.74%	1.51	69.57%	-32.71%	259.0M	Jun-04
Two Sigma (Enhanced Compass)	57.71%	31.39%	1.54	19.26%	2.07	78.43%	-14.90%	\$6,328M	Jan. 05
SMN Diversified Futures Fund	57.29%	8.73%	0.33	37.58%	1.44	67.97%	-23.88%	\$82.6M	Nov. 96
Tactical Invest. Mgmt. (Inst'l Comm)	50.06%	17.71%	0.59	45.51%	1.7	77.93%	-35.65%	\$65.5M	Apr. 93
P/E Investments (FX Aggressive)	49.08%	13.33%	0.64	33.33%	1.56	49.08%	-24.58%	\$3,900	Oct. 03
KeyQuant SAS (Key Trends)	46.19%	16.68%	0.83	19.15%	1.7	51.74%	14.88%	\$140M	Jan. 10
Lynx Asset Mgmt (Lynx 1.5 Bermuda)	42.15%	12.30%	0.53	22.55%	1.36	46.44%	-18.04%	\$404M	May. 08
Beach Horizon LLP	41.32%	11.35%	0.57	31.27%	1.64	65.80%	-20.35%	\$104M	May. 05
GIC (Global Diversified)	40.41%	9.00%	0.32	41.06%	1.5	80.59%	-27.17%	\$70.2M	Nov. 98
Progressive (Tulip Trend K)	39.79%	7.32%	0.29	26.45%	1.28	55.19%	-20.24%	\$386.8M	Aug. 09
Cantab Capital Ptnrs (Aristarchus)	39.32%	6.84%	0.39	34.87%	1.27	39.33%	-34.87%	\$3,800M	Mar. 08
Kelly Angle Inc (Genesis)	38.09%	15.49%	0.39	45.59%	1.45	158.51%	-37.83%	53.3M	Apr-00
ACL Alternative Fund Limited	31.57%	9.02%	0.56	22.71%	1.5	41.79%	-15.98%	2332.7M	Jan-02
Capital Fund Mgmt (Discus C USD 2X)	31.07%	2.72%	0.1	48.94%	1.2	47.09%	-35.03%	50.0M	Dec-07
ACL Global Fund	30.74%	8.05%	0.41	38.69%	1.24	49.89%	-33.56%	111.2M	Dec-00
Covenant Capital Mgmt (Aggressive)	29.49%	19.84%	0.91	20.41%	1.92	110.34%	-16.30%	159.5M	Feb-04
Quaesta Capital AG (v-Pro Dynamic)	27.16%	11.81%	0.92	17.98%	3	30.42%	-16.98%	389.5M	Jul-07
Covenant Capital Mgmt (Original)	27.06%	13.23%	0.67	28.60%	1.78	73.93%	-22.16%	160.0M	Sep-99

Below are the top CTAs managing less than \$50 million as of the end of 2014. Programs have a minimum track record of 36 months through December 2014. Statistics were calculated since program inception dates, unless otherwise indicated, from a universe of 476 programs.

CTA	2014 Return	Compound Annual Return	Sharpe Ratio	Worst Drawdown	Up Dev/Down Dev	Best 12-month period	Worst 12-month period	Money Under Mgmt.	Start Date
DeltaHedge (Boote)	91.72%	35.74%	0.86	45.13%	1.47	91.72%	-38.62%	4.9M	Dec-11
Hobereau Investments (Gl. Capital)	89.84%	13.33%	0.78	23.16%	1.82	89.84%	-19.72%	1.0M	Jul-11
Purple Valley (Diversified)	87.49%	22.67%	0.51	49.34%	1.87	138.33%	-33.81%	4.4M	Aug. 08
QQFund.com (Investment Program 1)	87.01%	35.15%	1	35.81%	1.63	109.61%	-26.30%	1.6M	Sept. 08
Silicon Valley Quant. (UQP Large)	85.92%	9.28%	0.32	37.21%	1.31	85.93%	-29.67%	2.9M	Jan. 09
Dreiss Research Corp.	85.89%	16.80%	0.46	51.44%	1.4	140.77%	-40.85%	9.0M	May-91
Progressive (Palm Trend K (one of many))	75.99%	5.45%	0.24	42.32%	1.31	75.99	-29.50%	11.1M	Jan. 10
Shad Trading (SHAD 1 Prop.)	59.43%	11.18%	0.77	18.97%	2.62	59.43%	-14.63%	1.0M	Jul-10
TMS Capital Mgmt (TriFex)	58.89%	3.05%	0.05	60.89%	1.58	87.94%	-45.91%	6.7M	Jan-04
Somers Brothers Capital (Divers)	49.49%	13.95%	0.49	33.56%	1.36	84.47%	-21.83%	2.4M	Jan-05
Schindler Capital (Dairy Advantage)	48.98	48.65%	0.72	41.49%	3.05	627.74%	34.73%	9.0M	Aug. 05
Abraham Trading Company (Salem 2X)	48.53%	8.60%	0.4	31.03%	1.37	53.41%	-25.25%	34.0M	Jan-08
M.S. Capital Mgmt (Gl. Divers. Prop.)	47.22%	10.40%	0.37	38.89%	1.51	109.49%	-23.26%	3.2M	Sep-97
Wharton Capital Mgmt (Ag Futures)	46.88%	18.02%	1.13	11.99	1.97	77.56	-10.69%	1.2M	Sep-11
CM Capital Mkts. Bolsa (NS Selection)	43.25%	12.82%	0.82	13.15%	1.85	48.85%	-9.22%	24.2M	May-08
Ancile Capital Mgmt. (Gl. Markets)	42.75%	12.14%	0.69	16.17%	1.55	43.91%	-9.39%	2.6M	Apr-05
Olton Capital (Macro FX)	42.46%	23.89%	2.07	5.97%	3.03	57.09%	-3.49%	6.5M	Jan-08
Majestic Asset Mgmt (Gl Diversified)	42.15%	5.20%	0.3	32.91%	1.31	42.15%	-26.34%	25.5M	Sep-08
Efficient Access Fund LLC 4X	39.92%	7.88%	0.38	32.06%	1.24	60.30%	-28.68%	34.4M	Feb-04
Melissinos Trading (Eupatrid)	38.12%	9.91%	0.61	22.71%	1.42	38.12%	12.66%	2.3M	Jan. 11

Source: BarclayHedge

strongest sector for Abraham and Purple Valley. Wiczorek says that he maintained a long position in cattle for the entire year.

It was not just cattle; Abraham, despite more than \$400 million under management, was able to trade milk futures. "It's a diversifying element. Milk is not correlated with anything, maybe a little with cattle. We like it because it helps us diversify. It is a little bit of a challenge but it is a

tradable market," Abraham says.

Schindler Capital Management earned 48.99% in 2014 and has a compound annual return of 48.03% since 2005, trading nothing but milk.

The Systematic Traders Index is a closer proxy to trend following and had its best year, 10.34%, since 2008. "The bulk of the returns were made in the last five months of the year; you had dollar

strength, you had a stock market that was moving up and you had commodities sinking like a stone, led by energies. And T-bonds were moving up. Everything was staying on trend," Waksman says.

### Treasuries forever

Perhaps nothing defines the power of trend following as well as the rally in fixed income. The long-term bond rally

# Abraham: Reinventing a legend

**S**alem Abraham launched his long-term trend following strategy in 1988 right out of college. He had a passion for trend following and systematic trading partially based on stories he read in *Futures* magazine.

His family owned a ranch in Canadian, Texas and was in the oil and gas business. His grandfather famously asked Salem regarding his dreams of trading, "Of all the ways to lose money, why did you pick the fastest?"

Abraham, however, did not lose. He earned more than 100% in his first full year and built one of the most successful long-term trend-following programs in the industry, with a compound annual return of 39.07% during its first seven years managing assets of more than \$100 million.

A flat performance period beginning in the late 1990s, however, caused redemptions and forced Abraham to build back his CTA from nearly scratch, which he did. His program earned extremely strong returns from 2000 through 2004, but the industry was changing and if he wanted to tap into institutional allocations, he knew he had to adjust his approach. Allocators were not as interested in huge returns as smoother return streams and high Sharpe ratios, so in 2006 Abraham employed a multiple-strategy approach and dialed down his leverage.

He added short-term and counter trend strategies. "We did trend following for 17 years," Abraham says, "The last nine years we traded more strategies; that broadened our diversification and reduced our volatility so our annual standard deviation was just under 10%."

"We added short-term trend, some momentum strategies and a stock index program traded differently and we added a mean reversion strategy. When you blend those together it pulled down the overall volatility but it still allowed you to make a nice return like we saw in 2014," he says.

Abraham's core strategy earned 21.20% in 2014 — its X2 program, which still uses less leverage than the original, earned 48.53% — but when normalizing the standard deviation it outperformed nearly all the programs in the Barclay database in 2014.

"So, not only are we making money but making money in a smooth fashion. It's nice to make money; it is better to make it smoothly," Abraham adds.

"That was certainly a big change and it has been helpful. Unfortunately, the last five years we had crummy performance but from 2006-08 we averaged about 20% with volatility at 10 or 11, and in 2014 it all came together."

The one thing that Abraham has remained consistent with for more than 25 years is his allocation to commodities. He has always maintained at least a 50% allocation to physical



SALEM ABRAHAM

PHOTO COURTESY OF SALEM ABRAHAM

commodities, which accounted for even more of his profits in 2014.

"There were a lot of places to make money in 2014," Abraham says. "Everyone talks about how the last quarter was great; it was, but the first three quarters were good too. Our returns were evenly distributed throughout the year. Two thirds of our money was made in commodity futures, that is one of the things that make us unique. The meat sector was the best, the big rally in cattle and hogs. Another great trade was long milk."

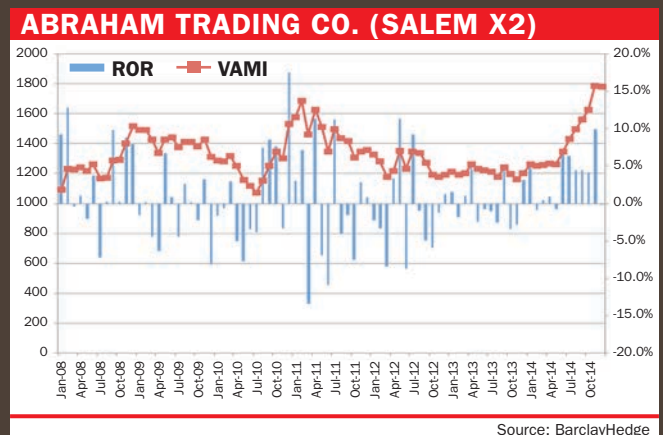
Yet despite approximately \$400 million under management, Abraham is still able to allocate trades to milk, which provides valuable non-correlation to the rest of the markets he trades.

"We milked the milk trade all year long," Abraham jokes. "We have been trading it for five years. We pride ourselves on understanding these thin markets and knowing how to trade them and getting something done without getting beat up too much."

It is something that Abraham has done well for years. His original and adjusted program never lost more than 11% in any year despite trading at a level capable of earning triple digits.

His new approach allows less drama. "We have done the research and the math; it is like a fund of funds. You blend strategies and get the average rate of return of all the strategies but you get much lower volatility," he says. "Sometimes you get a sophisticated client who understands trend following and is fine with the volatility, but most people, even if they want you to be that piece of the puzzle, still have to explain to an investment committee why you were down 12% in a month."

Abraham compares performance to weather in Texas. After a long drought things turned around in 2014 and he is looking for another profitable stretch.



Source: BarclayHedge

was supposed to be dead because the Fed was slowly reducing its purchases of long-term Treasuries. Few analysts saw bonds moving up; it was simply a matter of the pace of the decline. But trend followers don't have to make a fundamental case for a move, they just need to recognize a trend and exploit it. That was true for Treasuries as well as other sectors.

Kuen-Yih Hwang, principal of QQFund.com (+87.01% in 2014) trades

“Once the U.S. government announced tapering, the conventional wisdom was that interest rates in the United States are going up...”

—Sol Waksman

10-year notes and the Nasdaq 100 in a risk parity and trend-following strategy. “We made a bet that 10-year [notes] would go up in 2014. Trend following in equities was good,” Hwang says. He was long the Nasdaq 100 and 10-year note for most of the year and overweighted bonds in the October move. It worked, as they were up 19.86% in October.

“Once the U.S. government announced tapering, the conventional wisdom was that interest rates in the United States are going up; well, they are not,” Waksman says. “Once you had all the unrest in the Middle East the conventional wisdom was that energy prices are going up.”

Waksman points out the benefits of systematic trading exploiting market moves without the noise of expectations. “With QE you had conventional wisdom that it would lead to hyperinflation, gold is going through the roof, the stock market is going up. Yeah [stocks are] going up in the United States but not in other places. You can go on and on,” he says.

The point being trend followers exploit trends, which are not always rational and usually overshoot. During the fall nearly all the experts saw \$80 as the absolute bottom crude oil could go. Trend followers weren't necessarily smarter than all the experts; they simply just hopped upon the trend and let it take them where it was going.

“The classic is energy,” says Levitt. “Finally the imbalances between supply

and demand, [stalling Chinese] growth and fracking — that mismatch caused people to think about supply and demand. Saudis weren't going to be a swing producer and it created a hell of a trend.”

And once those forces are in play it is nearly impossible for producers to alter it. “To say because it costs \$50 or \$60 per barrel it is some kind of floor—that has never been the case. Especially when people have bonds to pay. They need the cash

flow, people have done irrational things for a while,” Levitt adds.

The point being producers are not going to shut down the minute price drops below their comfort level. They need revenue more than ever. They already spent the money to get those wells producing and now need the revenue regardless of the price they will receive.

“That is what is great about trend following,” Wiczorek says. “We look like rock stars because we caught that move. It is not predictive, we just took the signal. Most trend followers got short anywhere from \$90 to \$100 per barrel and it closed out the year at \$45 per barrel. Markets can move much further than anyone expects. Even the most bearish Wall Street analyst predicted crude to finish the year at \$85 to \$90. That is the thing about markets; they try to inflict the most pain across the most traders.”

#### What's next?

There is no guarantee that just because trend followers broke out in 2014 there will be clear sailing ahead, but it appears that the Fed will continue to step back and allow fundamentals to rule. And if they reverse course at this point, it would most likely be because of some extraordinary equity market disruption, the type that typically creates a strong environment for trend followers.

Bergin says that with quantitative

easing ramping up in Europe just as the U.S. Fed is preparing to tighten, that divergence in policy should be good for the market. “Europe and Asia seems to be taking on a different profile that bodes well for CTAs. But we don't know.”

A bigger threat to active management may be the complaints about fees and the number of index funds attempting to create managed futures beta.

“It is normal for people to be frustrated with poor performance in the alternative space, particularly managed futures. People focused on fees but at the end of the day, if you aren't making money it is hard to do well,” Abraham says.

He expects strong performance will temper complaints on fees. “Price is not the only thing. If it was I would be eating spam all the time instead of a rib eye steak. I'll pay more for the steak than spam. To replicate trend-following systems is not that hard, but what is really difficult is to do what we did, make a trend-following model that will give you a [high] Sharpe [ratio].”

“There is a lot to be said for active management,” Waksman says. “It is alive. You have someone at the controls who has the ability to readjust, re-evaluate, to keep testing. A lot has been said about index funds, that the single biggest problem with active management is the fee structure. Go tell that to someone whose funds just made 35% last year.”

It is a bottom-line business and a bottom-line world. While volatility is often seen as a bad thing, it is what drives returns. “Volatility is a good thing, volatility is very different from risk,” Wiczorek says. “Volatility is what we use to throw us up to the next level. By cutting losers and riding winners we harness and skew that volatility to the upside and skew returns to the upside.”

So far 2015 looks to be a pretty volatile year.

“It is like weather in Texas,” Abraham says. “In the last several years we have had droughts but we had droughts before and they passed, and the rains come and things get back to normal; hopefully this is the end of the drought in managed futures, [though] there is always another drought in the future.” ■



# Wieczorek: Going old school

**P**urple Valley Capital principal Donald Wieczorek just turned 29. That's more than 40 years younger than fellow top trader Bill Dreiss, but the two share a common trading philosophy. Wieczorek, an admirer of Salem Abraham, developed a trend-following approach while still in college just as Abraham did.

His age is relevant given his approach, which is old-time trend following.

Purple Valley was launched in August 2008, just in time to catch the second half of that extraordinary year, earning 66.31% in the last five months.

Wieczorek was interested in trading while attending Williams College in Williamstown, Mass., but as an economics major he was pushed toward investment banking so he interned with JPMorgan's equity capital markets group.

He noticed that many professionals had a hard time predicting market movements, which led to a Eureka moment of sorts. "I stared becoming a profitable trader when I realized you don't need to predict market movements to make money," Wieczorek says.

"A lot of my professors, who all had MBAs from Harvard or [the University of] Chicago, kept telling me that what I was trying to do is impossible," he says. "What drew me to it was more the way of trading: Cutting losers and riding winners. I wanted to be in a lot of markets. I didn't want to just be in stocks, I wanted to have access to corn, gold, crude oil or currencies. I just loved markets; if there was any big move anywhere in the world I wanted to be able to capture it. By virtue of developing my system, all of a sudden trend following popped out."

He devoured any material on trading he could in an attempt to develop his style. He read Jack Schwager's Market Wizards books and dozens more.

He discovered several common themes. "They all cut their losers quickly; they all tend to have winners larger than losers; they are diversified so that they catch a lot of the major trends; and they are very patient and disciplined in their approach," he says.

That all spelled out long-term trend-following. "I just put that all together and created a system that fits me. It makes it a lot easier to go through a drawdown because when you run a system as aggressive as mine, you are going to have drawdowns. Because it fits me, I can stick to it."

Wieczorek took a slow and steady approach, working on perfecting his system rather than raising assets. "A lot of new traders avoid trend following because it is overly saturated. I approach it as the way I could make money best for investors," he says. "There are still a lot of people out there that don't know trend following exists—that is where I have been focusing—not



DONALD WIECZOREK

PHOTO COURTESY OF DONALD WIECZOREK

so much the huge allocators but smaller investors."

And they are beginning to take notice despite launching into a difficult environment. While Purple Valley looks like a pretty meat and potatoes long-term trend follower that earned strong returns in the last half of 2008 and in 2014, its returns from 2009 through 2013 — the worst five-year stretch in the history of managed futures — produced a compound annual

return of about 3.5%. Not great, but you will take it when couched between 66.31% and 87.49%. That compares favorably to a similar worst five-year stretch for the S&P 500.

Winning positions last from between two and 12 months while losers are usually closed out within a week. "We only get out after a trend is over," Wieczorek says. "Giving up of unrealized gains is the largest cause for drawdowns. We don't limit the upside."

It is an old-school approach but one that has survived profitably through a difficult environment.

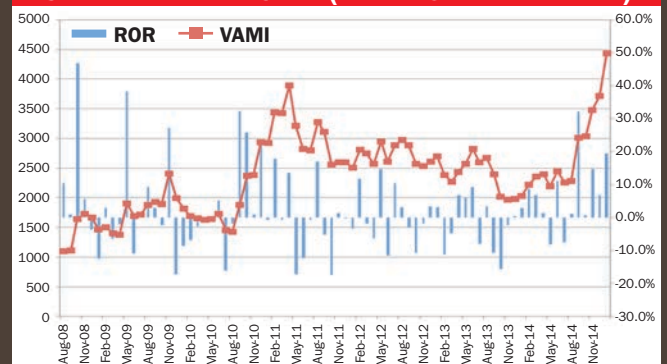
"It is like an elevator. The up and down of an elevator is fine, that is the volatility. If you want to end up making a lot of money or compounding at a high rate of return you are going to need to be able to stomach a little bit of the up and down of the elevator to get to a really high level," he says.

"Trend following does a really great job on the risk side. Unfortunately, the [investment] industry doesn't quite get the difference between risk and volatility. They just look at something that is volatile and assume it's risky. I would argue the opposite," Wieczorek says. "I know every day what my exit point is and where positions are going to be knocked out. It helps me sleep at night."

One could say Wieczorek is wise beyond his years.

"Some people think I am too young but I want to do this for several decades," Wieczorek adds. "I am an emerging manager with tons of time on my hands."

## PURPLE VALLEY CAP. (DIVERSIFIED TREND)



Source: BarclayHedge