KeyQuant CTA program records 15% January return with strong performance in bonds and rates

Off the back of an impressive 46% return last year, Paris-based managed futures boutique KeyQuant has started 2015 with its best-ever monthly result – and is now planning to launch a new offshore fund structure for its CTA strategy in the coming months

Most managed futures funds made good money in 2014, in what turned out to be something of a banner year for systematic trading strategies.

But there are not many that have consistently outperformed over the past five years – through what has been, for at least three of those five years, a pretty grim period for CTAs.

CTA strategies have been under increased scrutiny in recent years, attracting criticism for a sustained period of losses – with some commentators at the time even questioning whether the wheels might have permanently fallen off this particular investment style.

Having attracted a fair amount of new capital from investors in the wake of their spectacular performance in 2008, the strategy style was beset by lacklustre returns – and, for many, sizeable drawdowns – over the three-year period between 2011 and 2013.

Anyone checking the back pages of *EuroHedge* for updates on the performance of the CTA grouping during that period was in for a routinely gruelling read.

Despite all this, there were some individual managed futures vehicles that succeeded in avoiding correlation and have been positioned to outperform – and one such strategy is the Key Trends Program run by Paris-based managed futures boutique KeyQuant SAS.

Not only did Key Trends make money while many other CTAs were losing it, the strategy continued to outperform when its peers were making a comeback last year: the EuroHedge Managed Futures Index posted a creditable median return of 19.74% in 2014, but the KeyQuant strategy more than doubled that figure – returning an impressive 46.05%.

Key Trends' 2014 return makes four years out of five in which the strategy has bested its CTA peers. The fund returned a similarly high 43.74% in 2010, its first year of trading, against a gain of 8.73% for the EuroHedge Managed Futures Index. And when CTAs in general began to struggle in 2011, the KeyQuant strategy made a gain of 9.0% against a loss of 3.79% for the index.

The fund lost 6.63% in 2012, but this represented only a slight underperformance compared to the broader CTA index, which was down by 5.48% for the year. Returns picked up to some extent in 2013 and were modestly positive for both the fund and the index, but Key Trends came out ahead with a gain of 1.60% compared with 1.02% for the aggregate peer group.

In the five years since launching in January 2010, the Key Trends Program has made a compound return of 150% for its investors, annualising at 19.71% with a Sharpe ratio of 0.98.

And the strategy has started off on a compelling note again in 2015, too, with a return in January of 15.74% – its biggest monthly gain to date.

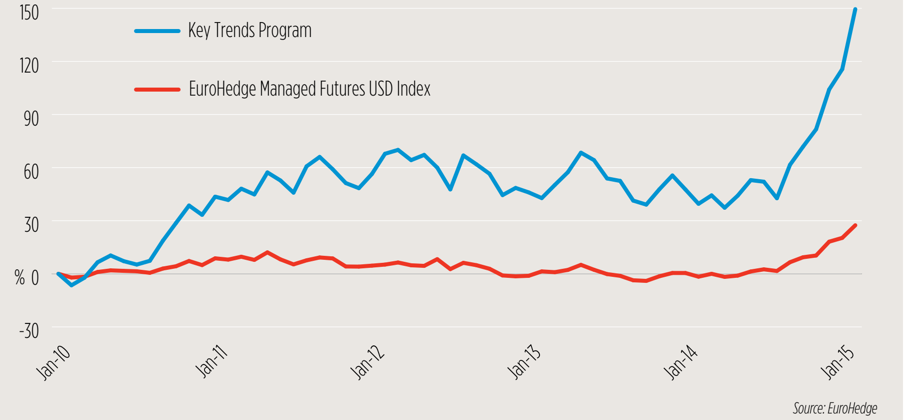
KeyQuant was founded in 2009 by a pair of Man-Fidex veterans, Robert Baguenault de Viéville and Raphaël Gelrubin. The Key Trends Program – a medium to long-term systematic trading system that invests in liquid global futures markets across equities, bonds, interest rates, currencies and commodities – has been managed as a Cayman strategy via segregated accounts since January 2010.

In April 2013 the firm launched Key Trends UCITS: a Luxembourg-domiciled, regulated version of the flagship Cayman offering. This onshore version is aimed at investors with less appetite for risk, and targets volatility of 10% compared with 20% for the offshore strategy.

In accordance with UCITS requirements, the onshore fund is prohibited from investing in commodities markets, but otherwise the portfolio largely mirrors that of the offshore original.

The Key Trends Program and its UCITS sister fund are built on what the founders describe as "an innovative probabilistic model", which they believe enables them to identify establishing trends more quickly than other systematic strategies and also to detect trend reversals sooner – thereby elevating their

Performance: Key Trends Program



Source: EuroHedge

Raphaël Gelrubin and Robert Baguenault de Viéville

strategy's profit potential above that of their CTA peers.

"Every day, our program is trying to estimate the probability of the next move in the markets, and to position itself to be on the right side of that probability," says Gelrubin. "Looking at our monthly returns, 50% will be up and 50% will be down — but the returns in positive months are twice as big as the negative months," he adds.

The strategy also employs a proprietary 'Global Economic Factor', or GEF, which assesses the strength of global economic trends in order to optimise portfolio exposure. "The role of the GEF is to increase or decrease global leverage," explains Gelrubin.

"It's based purely on the quality of trends we identify, and on the probabilities we can model," he continues. "We think all markets are linked together — though not necessarily correlated, as that has a mathematical meaning. So the GEF will leverage up or down our global exposure based on the quality of trends and unrealised P&L."

The strategy takes a purely systematic, price-based approach, and trades exclusively in futures. Key Trends currently trades once a day, and the average holding period for a position is more than three months.

The KeyQuant founders believe that investors should regard managed futures strategies as inherently long-term investments. "When you invest in a CTA, you shouldn't be looking at the next two or three months," says Baguenault de Viéville. "You have to say to yourself, 'I've chosen my two or three CTAs, and now I'm going to keep these investments for three to five years'."

He continues: "It's important for investors to recognise that CTAs are able to catch trends and make money when other strategies are not doing so. For example, when central banks increase their rates, CTAs will be able to make money when other strategies are likely to lose money."

Key Trends' bumper January return was driven primarily by long positions in bonds and interest rates, which collectively delivered a gross performance of 17% during the month. A long US dollar position added 3% for the strategy's currency exposure, and a net short exposure to energy futures gained 2%. Agriculture and metal exposures were flat for the month, and the program lost 1.9% in long equity index positions.

"In bonds, we've been seeing a very good trend since the beginning of 2014," says Baguenault de Viéville. "Generally, in 2014, a lot of people thought that CTAs would never be able to make money in the bond market again."

Gelrubin points out that the January return breakdown by asset class is in keeping with that of 2014 — a year in which the strategy made more than 24% on its bond positions and 10% on rates.

The strategy also earned a healthy 14% from a long US dollar position, 14% from a short energy position, and 5% from its short position on agricultural commodities — but lost 9.5% in equities.

"We've been able to catch this trend in bonds, as our systems were in place ahead of time," says Baguenault de Viéville. "I think this [algorithmic approach and systematic preparedness] is the main difference between macro managers and CTAs, and 2014 was a good example of that difference being played out," he adds — alluding to a year in which macro returns generally trailed behind those of managed futures programs by a distance, with the EuroHedge Macro Index ending 2014 up by just 73 basis points.

"January was a continuation of trends identified and set up in 2014," says Frans Harts, KeyQuant's head of sales and marketing. "The January gain in bonds is directly related to [the announcement of quantitative easing by ECB president] Draghi, and to the Bank of Canada reducing its rates." The probability of these measures coming into force had already been captured and modelled by the Key Trends system, and the portfolio was positioned accordingly, he explains.

Over the course of last month, the program switched from long to short on corn and cocoa, and went from short to long on its gold, EuroStoxx 50, S&P Toronto 60, FTSE 100, and CAC 40 exposures. The fund has been running a short Swiss franc position but reduced its exposure during January; it also made cuts to its long Euribor and five-year US Treasury positions, and to a number of long equity index holdings.

KeyQuant manages some $140 million at present, with $95 million invested in its offshore Key Trends Program — all via segregated client accounts — and the remaining $45 million managed via the Luxembourg UCITS vehicle.

The onshore pot includes a €30 million seed investment by French institutional investor platform Emergence (which is overseen by experienced Paris-backed hedge fund seeder and acceleration capital specialist NewAlpha Asset Management), which invested in the UCITS fund in 2013 and committed its capital for at least three years.

With regulator-imposed restrictions on its investment remit, and a target volatility half that of the offshore strategy, it is no surprise that the UCITS fund has posted more modest returns. But despite those limitations, Key Trends UCITS still made a very respectable 14% in 2014, and was up 7.02% last month.

Harts says that a Cayman Islands fund structure is in the offing, adding that he expects it will launch later in 2015. "The challenge for launching the Cayman fund is to have sufficient assets lined up for day one," notes Gelrubin, who specifies a target minimum of $25 million.

The Cayman fund structure will not replace the existing offshore accounts, but will be used when targeting new investors. "Each investor will have his or her own ideas about which way to invest," observes Gelrubin.

"Today, what's happening is that big institutions prefer to have a segregated account because it can provide more liquidity, while smaller institutional investors don't have the necessary set-up for that and are looking for fund structures," says Harts.

KeyQuant has established a primarily institutional investor base so far, with clients including pension funds and insurance companies alongside some family office money.

"We're already regulated, so the institutional quality of what we're offering will be exactly the same across all versions," says Harts, who also believes that KeyQuant's openness with investors is a distinct selling point.

He describes attending three-hour client meetings in which his PM colleagues have broken down the entire strategy. "We're not a black box," he says. "We're very transparent with our clients about how everything works, which is not something you'll get with a lot of the big CTAs."