

The logo for TrimTabs, featuring the word "Trim" in white serif font on a dark blue square, followed by "Tabs" in white serif font on a light blue square.

TrimTabs

The Leading Independent Research Firm for Equity Market Liquidity

# THE HEDGE FUND FLOW REPORT

SHOWING ONLY THE TOPICAL STUDY INCLUDED IN THE JULY 2008 ISSUE



**BarclayHedge**

The Global Leader in Alternative Asset Research

**Returns of Commodities Explain Only 11.9% of Returns of CTAs since January 2000, but This Percentage Jumped to 60% in Last 12 Months.**

**TOPICAL STUDY - Betting on Commodities through CTAs**

In this topical study, we examine the relationship between the returns of commodities and the flows and returns of commodity trading advisors (CTAs). We address the following questions:

- How sensitive are the returns of CTAs to the returns of commodities?
- Are CTAs becoming more sensitive to the returns of commodities?
- Do commodity returns explain flows into CTAs?
- Can flows into CTAs help predict the returns of commodities?

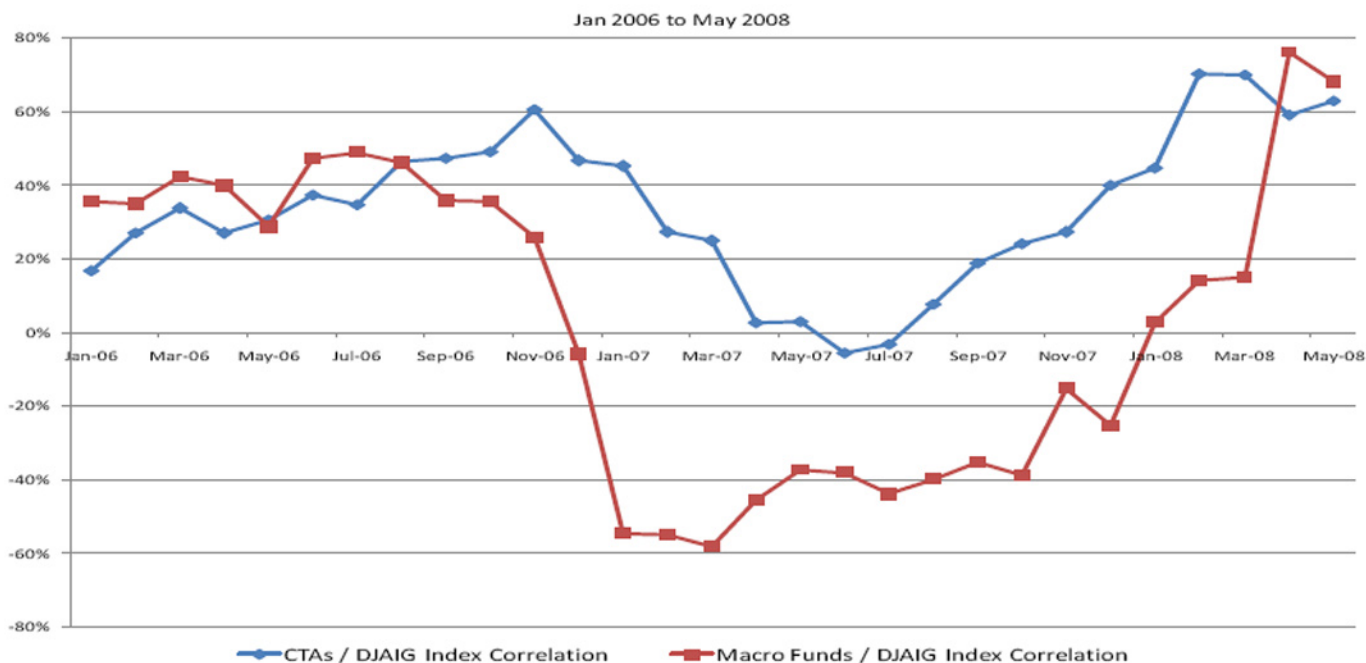
We measured the correlation of the returns of CTAs and the returns of the Dow Jones-AIG Commodity Index for each sub-strategy between January 2000 and May 2008. As expected, the correlation coefficient is statistically significant for all strategies except Currency. The correlation is highest for Diversified CTAs at 34.5%. For all CTAs, the R-squared indicates that the returns of the Dow Jones-AIG Commodity Index explain 11.9% of the returns of CTAs. We believe this number is relatively low for three reasons:

1. Our sample of CTAs includes some CTAs that trade only currency and interest rate futures. The returns of such CTAs should not be correlated with the Dow Jones-AIG Commodity Index.
2. The Dow Jones-AIG Commodity Index is an aggregate of several commodities, while CTAs can decide to overweight certain commodities.
3. CTAs can go long or short on the commodities they trade. For example, CTAs lost 2.4% in April even as the Dow Jones-AIG Commodity Index gained 3.4%, suggesting most CTAs had a net short exposure to commodities.

	Correlation Coefficient	R Squared	P Value
Agricultural	22.2%	4.9%	2.7%
Currency	5.6%	0.3%	58.1%
Discretionary	35.9%	12.8%	0.0%
Diversified	38.8%	14.99%	0.0%
Fin./Met.	25.4%	6.4%	1.1%
Systematic	34.5%	11.8%	0.0%
Systematic	34.5%	11.8%	0.0%
<b>All</b>	<b>34.6%</b>	<b>11.9%</b>	<b>0.0%</b>

The correlation between the returns of CTAs and the returns of commodities increased in the past six months. The 12-month correlation between the returns of CTAs and the returns of the Dow Jones-AIG Commodity Index rose from 0% in May 2007 to 60% in May 2008. Macro hedge funds, which often use strategies similar to those of CTAs, also increased their exposure to commodities. The 12-month correlation between the returns of Macro funds and the Dow Jones-AIG Commodity Index reached 68% in May 2008. Being long commodities has been profitable for investors in Macro funds and CTAs, as they returned 4.2% and 7.0%, respectively, in the first five months of 2008.

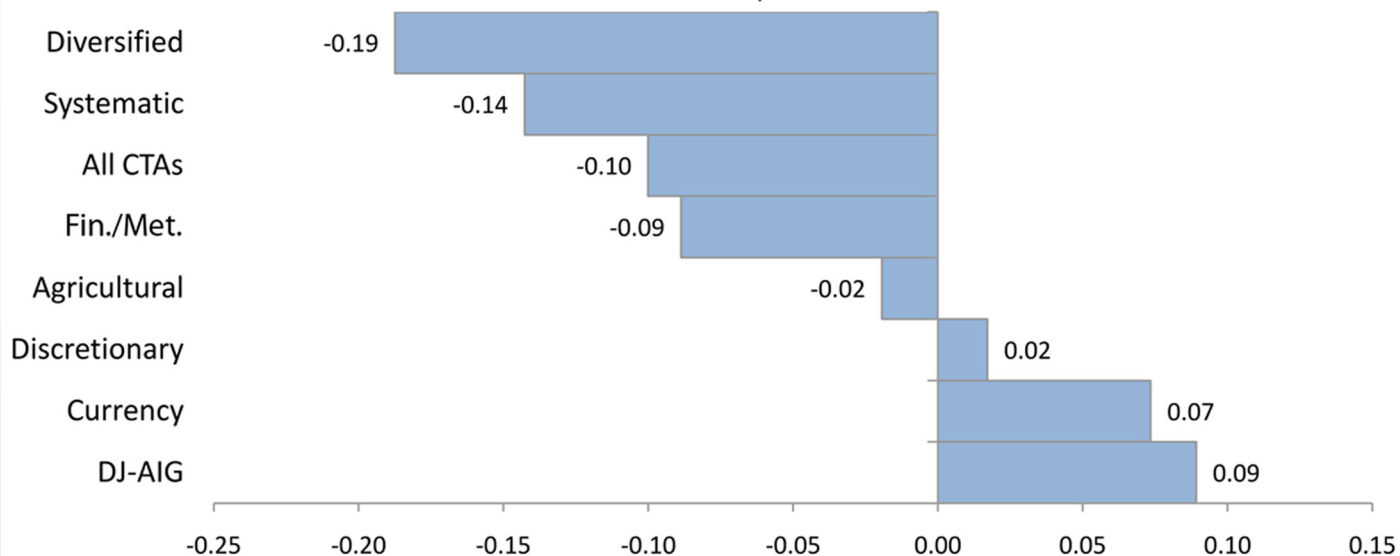
**12-MONTH RETURN CORRELATION WITH DOW JONES AIG COMMODITIES INDEX**



We also measured the sensitivity of the returns of CTAs to the returns of the S&P 500. Four of the six CTA strategies have negative betas. On average, CTAs rise 0.1% when the S&P 500 drops 1%. Interestingly, the negative beta does not arise from CTAs' exposure to commodities. Since January 2000, the returns of the Dow Jones-AIG Commodity Index have been positively correlated to the returns of the market. Therefore, most CTAs must actively hedge market risk, which explains their recent popularity among investors.

**BETA OF CTAs**

Jan 2000 to May 2008



## No Significant Relationship between Flows of CTAs and Returns of Commodities.

To determine the relationship between the flows of CTAs and the returns of commodities, we examined both whether the returns of commodities explain the flows into CTAs as well as whether the flows of CTAs help predict the returns of commodities.

In the first case, we regressed the three-month moving average of the returns of the Dow Jones-AIG Commodity Index against the flows into each sub-strategy of CTAs from January 2000 to May 2008. The low t-stat values show that in all cases, the returns of commodities are not a significant factor in predicting the flows of CTAs. The explanatory power, as indicated by the R-squared value, is highest for Discretionary CTAs, but it is a mere 3.8%.

### 3 MONTHS MOVING AVERAGE DJAIG RETURNS AND FLOWS

	Correlation Coefficient	R Squared	T-Stat	P Value
Agricultural	3.2%	0.1%	0.3	75.4%
Currency	7.3%	0.5%	0.7	47.8%
Discretionary	19.4%	3.8%	1.9	5.6%
Diversified	10.8%	1.2%	1.1	29.0%
Fin./Met.	14.0%	1.9%	1.4	17.0%
Systematic	15.2%	2.3%	1.5	13.5%
<b>All</b>	<b>15.9%</b>	<b>2.5%</b>	<b>1.6</b>	<b>11.8%</b>

We also regressed the three-month moving average of the flows into each sub-strategy of CTAs against the returns of the Dow Jones-AIG Commodity Index from January 2000 to May 2008. The results show that the flows of CTAs have no meaningful predictive power on commodities returns. The explanatory power, indicated by the R-squared value, is highest for Agricultural CTAs, but it is only 1.1%.

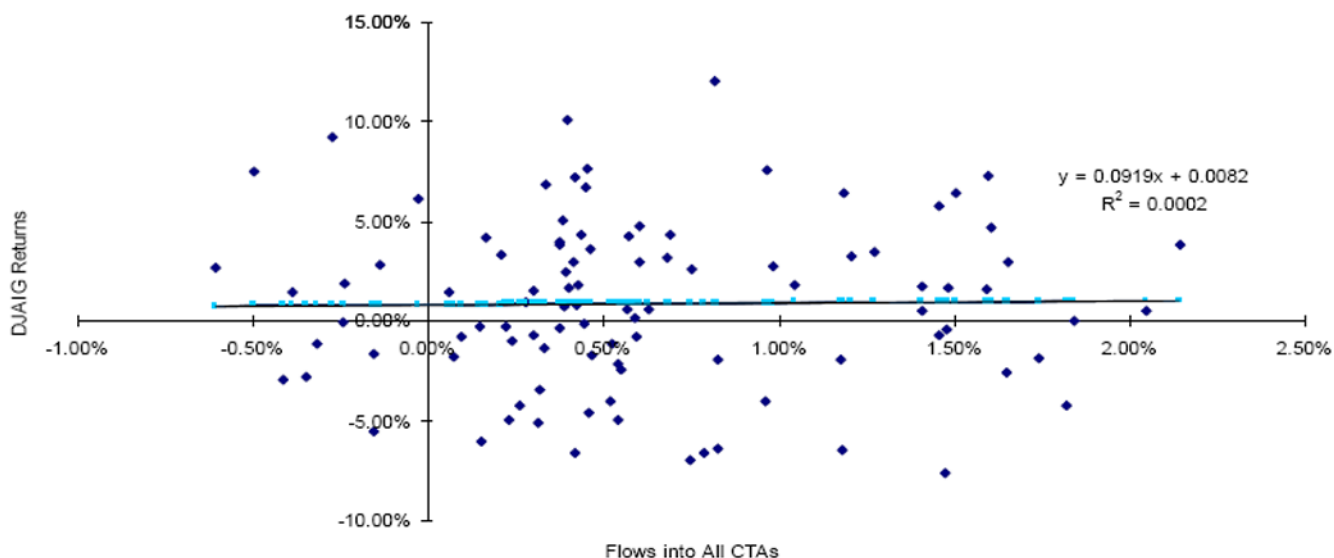
### 3 MONTHS MOVING AVERAGE FLOWS AND DJAIG RETURNS

	Correlation Coefficient	R Squared	T-Stat	P Value
Agricultural	-10.6%	1.1%	-1.0	30.0%
Currency	9.5%	0.9%	0.9	35.4%
Discretionary	2.9%	0.1%	0.3	77.9%
Diversified	-4.2%	0.2%	-0.4	67.8%
Fin./Met.	3.1%	0.1%	0.3	76.2%
Systematic	-1.6%	0.0%	-0.2	87.4%
<b>All</b>	<b>1.3%</b>	<b>0.0%</b>	<b>0.18</b>	<b>9.5%</b>

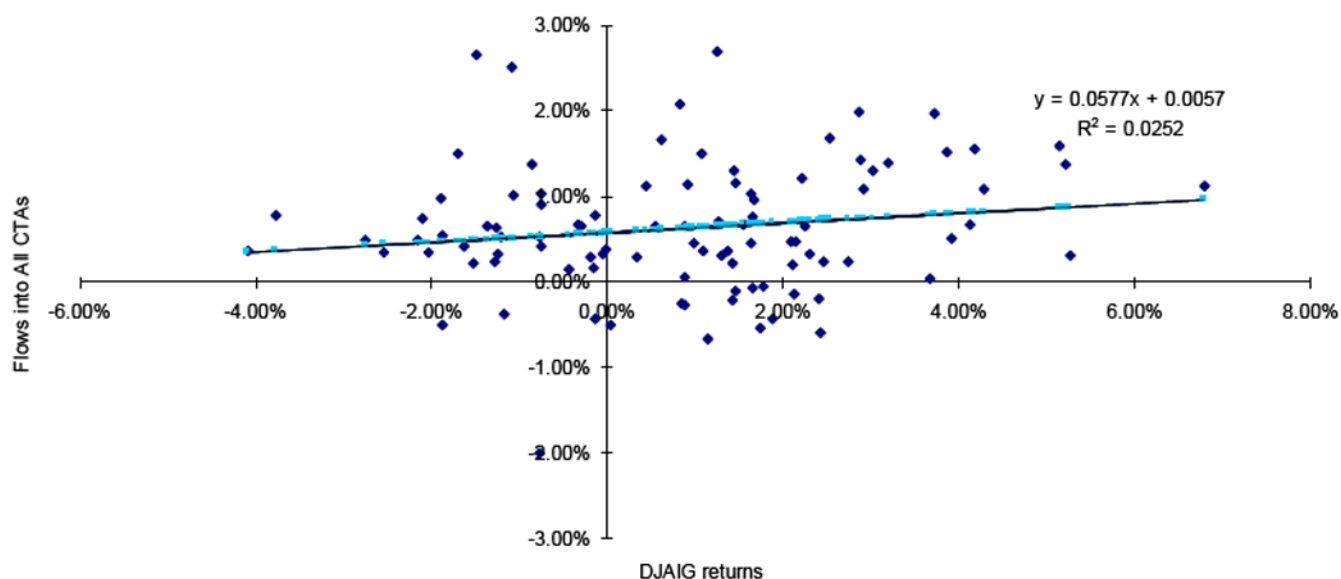
The scatter plots below confirm our findings. The first plot shows the returns of the Dow Jones-AIG Commodity Index on the x-axis and the flows of all CTAs on the y-axis. The second plot shows the flows of all CTAs on the x-axis and the returns of the Dow Jones-AIG Commodity Index on the y-axis. In both cases, the predicted lines are poor indicators of the actual values.

The flows of CTAs cannot help us determine the future returns of commodities, which confirms our earlier finding that the flows of hedge funds do not explain much of the returns of hedge funds.<sup>2</sup> The lack of a relationship between the flows of CTAs and the returns of commodities is surprising because performance chasing is common in most of the investment vehicles we track. One explanation could be that the primary investors in CTAs are funds of hedge funds and that their investment process is more sophisticated than piling into the latest hot investment.

## CTAs FLOWS vs DJAIG RETURNS (January 2000 to May 2008)



## DJAIG RETURNS vs CTAs FLOWS (January 2000 to May 2008)



<sup>2</sup> "Are There Capacity Constraints in Hedge Fund Industry?" TrimTabs-BarclayHedge Hedge Fund Flow Report, June 2008.

This article was included in the July, 2008 issue of the TrimTabs Hedge Fund Flow Report.

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