**Managed futures under pressure on fees**

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**Could a new systematic macro fund that charges less than half of traditional hedge fund fees trigger a wholesale price war in the world of computer-driven hedge fund strategies?**



Causing a stir: Cantab Capital Partners is undercutting the competition with a 0.5% management fee and a 10% performance fee

Cantab Capital Partners’ new CCP Core Macro fund set the cat among the pigeons in January with a 0.5% management fee and a 10% performance fee, against the hedge fund standard 2% and 20%. Cantab founder Ewan Kirk said: “Once firms have invested in technology and research, they may be able to offer parts of their portfolio at significantly lower fees.” Kirk thinks that firms need the scale – typically at least $2bn – to cover these overheads before rolling out lower-cost products.

There have always been different fee structures among managed futures funds. While management fees of up to 6% were not uncommon during the 1980s, in general fees have followed interest rates downhill. Interest rates matter because up to 90% of a managed futures fund can be sitting in cash, earning interest. This interest income historically more than covered a fund’s fixed costs. Now, near-zero interest rates in developed markets mean funds must produce positive investment returns simply to tread water.

The Dow Jones Credit Suisse broadly based managed futures hedge fund index returned -2.93% for 2012, although performance for the strategy recovered in January to a monthly gain of 2.67%. Some investors believe fees need to fall if performance continues to disappoint. APG, Europe’s largest pension fund, said last month it was “allergic to two and 20”.

Winton Capital Management, the largest managed futures firm in Europe, does not apply performance fees to any interest earned on investors’ cash. A spokesman for Winton, which has $26bn under management, said: “Our fees have been fairly competitive since 1997 when Winton was founded. In the Winton Futures fund, our main flagship fund, we’ve always been one and 20 rather than two and 20 or three and 20 in the case of some of our large competitors.”

The fee factor

Factors such as target volatility, diversification objectives and the prevailing market conditions all influence what fees investors are willing to pay. Pete Drewienkiewicz, head of manager research at pension fund investment consultant Redington, said: “The most significant factor for us is the fund’s target volatility – we typically scale all fees and returns to a 10% target volatility in order to compare commodity trading advisers [funds that trade futures] on a level playing field”.

Kirk agreed: “The scaling by volatility is identical to scaling by assets and therefore $100m at 20% volatility should have twice the management fees of $100m at 10% volatility.” That said, Cantab’s new fund still appears to have halved risk-adjusted fixed fees: it targets volatility of 10%, compared with 20% for Cantab’s existing fund that charges 2% management fees.

For other investors, the correlation of a strategy to equity and bond markets is more important than volatility. Managed futures funds have historically provided strong returns in years when equity markets have tumbled, such as 2008 and 1998. Chris Schelling, director of absolute and real return assets for Kentucky Retirement Systems in the US, said: “The more uncorrelated a strategy is the more fees we would pay. A larger alpha element of returns, and a smaller beta component, can make a case for paying more.”

Thomas Schneeweis, professor of finance at the Isenberg School of Management, University of Massachusetts Amherst, said fees need to be considered in the context of broad market conditions.

He said: “[Investing in] a managed futures trader is like purchasing an option, since the returns are very conditional on unexpected future events. The higher the volatility of the event impacting the strategy, the higher the probability of the option having value, and fees should be paid accordingly.”

The capacity and scalability of a strategy are important factors. If a sub-strategy, such as higher frequency or shorter-term trading, is capacity-constrained, managers may be able to justify some form of scarcity premium. As commodity markets are smaller than financial markets, CTAs that specialise in these may argue that they need to charge more.

Fee income can fund a wider suite of broker and exchange relationships that may allow some funds to expand their investment universe, and by extension, the amount of assets they can put to work. CTAs have scoured the globe for new markets such as Malaysian palm oil or carbon emissions and some CTAs, such as Rotterdam-based Transtrend, trade as many as 300 markets now.

Ease of replication

Cantab’s main quantitative hedge fund runs $4.5bn and is closed to new money. As it is constrained by capacity, it charges the traditional fee structure of 2% and 20%. Kirk said: “The pricing of any fund… should only be influenced by how easy it is to replicate.”

Florian Dettmer, partner at $100m Liechtenstein-based managed futures firm AIMhedge, agreed: “If you just replicate an index or comparable you obviously should get less.”

Drewienkiewicz said he hoped hedge fund replication products and exchange-traded funds could exert downward pressure on fees in future, but others are more sceptical about whether this will happen. Rudolph Shally, co-manager of €27m Amsterdam-based managed futures fund Istar Capital Management, said the performance of such products has often been disappointing and some have been discontinued.

Schneeweis said: “With passive index funds, which generally charge fees of 50 basis points, one is losing the manager option to change strategy quickly. That has value and should be paid for.”

As well as the ongoing addition, deletion and evolution of models, some CTAs, for instance, retain the discretion over risk management, letting humans step in and override model signals to reduce risk.

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