Flash Notes – Fund update

March 2020

Man AHL TargetRisk

Most multi-asset funds have been caught in the recent market sell-off with a magnitude unseen since the global financial crisis in 2008-2009. In an environment where cash is king and government bonds provide limited diversification benefits (with even negative returns for the last 2 weeks), the Man AHL TargetRisk outperformed most of its peers returning -6.6% YTD (clean fee share class in USD as at 19.03.2020) versus -17.2% for 50/50 benchmark.

Please find below an update on the **Man AHL TargetRisk**, its positioning, portfolio activity and outlook related with the recent market crisis.

Dynamic risk management

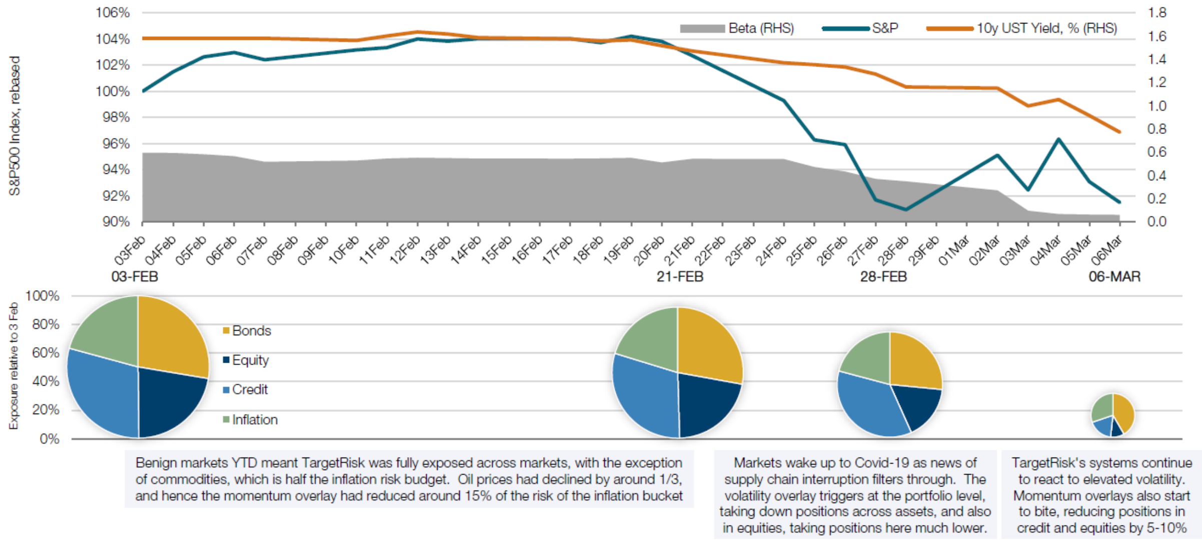
First, by way of background, the systematic program trades equities, bonds, credit, and inflation assets, weighted broadly equally in risk terms. Commodities are not actively traded but implemented with an ETF to guarantee the UCITs format of the fund. Three risk overlays that sit on top of this core allocation:

1) Volatility targeting: aims to counter persistent fluctuations in volatility by dynamically scaling up the portfolio at times of low volatility, and scaling down at times of high volatility
2) Momentum overlays: aim to reduce the exposure to assets that are in a downward trend, i.e., “don’t fight the bear market”
3) Bond equity correlation triggers: seeks to degear the portfolio when the risk of a bond-driven sell-off increases, as indicated by bond price declines plus increasing (intraday) bond-equity correlations

These are highly dynamic, necessitating, in fact, the use of only the highest liquid instruments by asset class: 50 in total, covering futures, CDS indices, inflation linked bonds, and a commodity index. It is the impact of the overlays which drives the asset allocation within the strategy, as explained and illustrated in action hereafter.

Investment process in action: February until March 6th

The chart below illustrates how the asset allocation of the TargetRisk fund changed as February progressed into the first week of March. The upper panel plots price change of S&P500 and yield of US 10-year Treasuries as market backdrop, although strategy trades these and other instruments. TargetRisk’s beta to the S&P 500 is plotted alongside, as calculated by RiskMetrics based on 3-year lookback.



Source: Man AHL

Note how beta changed from a stable 0.5 to around zero over the last week of February and first week of March.

The explanation for this is evident when we consider the notional allocation by asset class on the Friday of each week, plotted in the lower panel of the chart above.

The chart annotates how the overlays are affecting the exposure at both asset class and program level. **In summary, the highly volatile period over the two week period at the end of February has caused TargetRisk to cut overall exposure by 70%, cut exposure to risk assets (credit and equities by 80%) and shift asset allocation to a much more bearish stance, resulting in a beta of around zero to the S&P500**. As we might anticipate, the correlation overlay remained inactive because we saw conventional behaviour of stocks and bonds.

All this has happened systematically according to trading rules built from research which considers decades of information. There is no crystal ball.

It highlights **two key differences between Man AHL TargetRisk and conventional asset allocation techniques**. **First, TargetRisk uses its risk overlays to allocate between assets, not explicit predictions of market returns. Second, TargetRisk cuts its total exposure to markets without investors having to sell their investment.**

Investment process in action: March 6th and afterwards

In order to summarize, the fund entered March with **overall gross exposures reduced by around 70% relative to the start of February**. This resulted primarily from volatility scaling; the principal means by which the fund is risk-managed. Another non-performance related point is worth mentioning: with a reduction of over 70% in Trend's gross positions, **market liquidity is less of a concern** to us than it might otherwise be.

Form March 6th and after, **faster negative momentum signals also started to cut long positions in risky assets**, specially equities and credits, as prices fall.

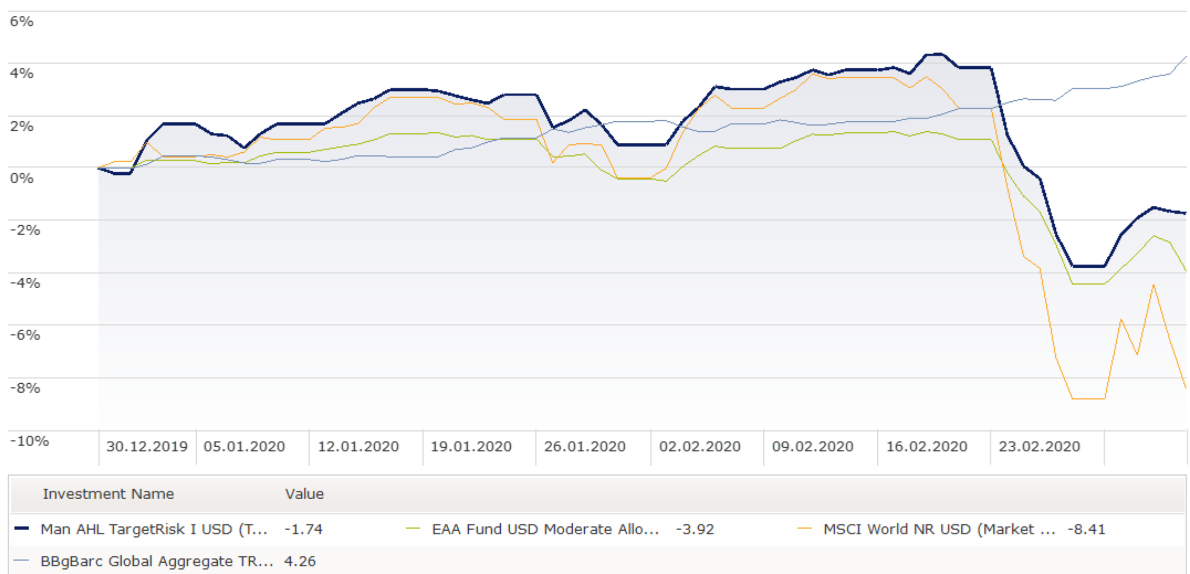
Then, **the asset class mix has shifted to a much more defensive stance** and led to the shift from positive to negative beta over the timeframe. As at March 13th, the portfolio exposure has been reduced even further, by more than 80% meaning that **from an exposure of ~350% in early February, the strategy was at a total portfolio exposure of ~50%.** Equity, credit and commodities exposure are single digit, and bond/inflation linked bonds exposure were substantially reduced. The correlation overlay (HEAVY) did not yet triggered. The momentum overlay de-gear signal additionally decreased across commodities, equities and credit. In commodities the exposure was reduced by around 40%, equities by around 25% and credit by around 35%.

In March 17th/18th, the correlation risk overlay was activated but triggering limited de-risking on portfolio asset allocation as exposure has been reduced already massively.

As of today (March 19th), volatility overlay (on portfolio and all asset classes) and momentum overlay (all asset classes) remain active. Correlation overlay is not yet fully activated. Current gross exposure is around 40%, mainly in linkers and govies.

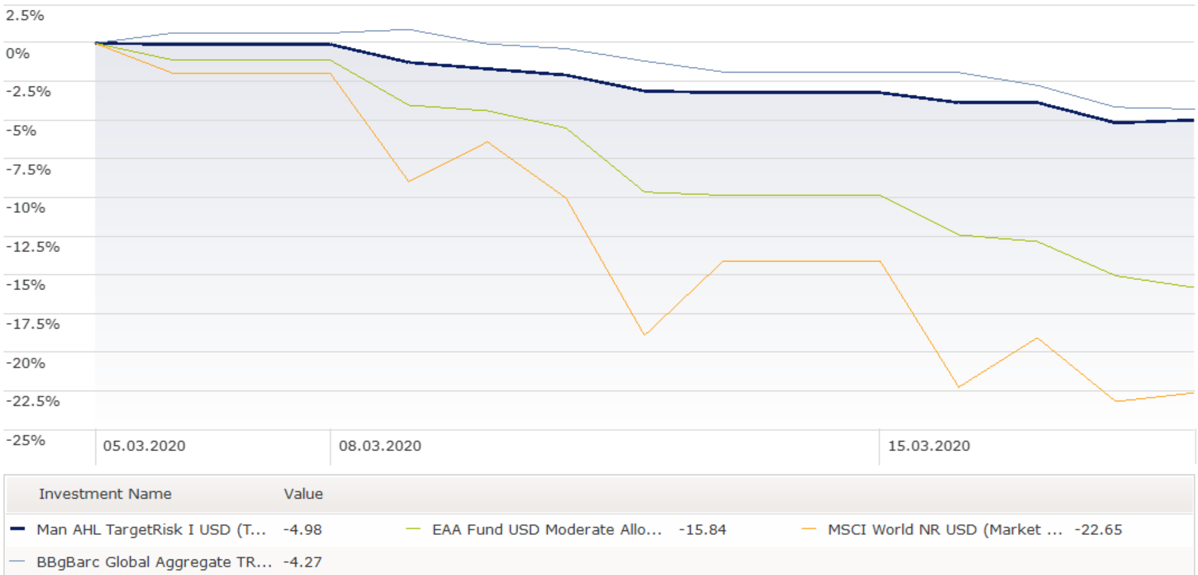
Performance pattern

Until March 6th, dispersion of performance within the USD Moderate Allocation Morningstar peer group was not strong, particularly from the peak (February 24th). Most of mixed-asset funds experienced a slump of roughly -5% in the last week of February. During this period, the fund exhibited solid relative performance, despite being negative, against its Morningstar peer group average, as shown in the graph below:



Source: Morningstar, WS Partners, from 31.12.2019 to 06.03.2020

But the fund really made the difference showing strong downside protection in the following 2 weeks until March 19th. The aggressive derisking of the portfolio, deleveraging of gross exposure and very cautious positioning resulted in a 10.9% outperformance compared to average peers outlined by the green line (-5% vs -15.8% during the period).



Source: Morningstar, WS Partners, from 03.03.2020 to 19.03.2020

Outlook

As systematic traders, we do not have a view on what happens from here. We let market activity inform our systems, and have these systems react in a way we have taught them to do, honed by over thirty years of research. What we do know is that we are currently positioned to seek benefits should this market bear continue to roar, and that trend-following's 'crisis alpha' credentials were to remain intact, at least if the AHL Trend Programme is any guide. Furthermore, we have yet to hear of Covid-19 affecting computers, and fully anticipate the systems to maintain business as usual through these difficult times for us humans.