

# Trend Following Isn't the Only Managed Futures Strategy

Part of building a resilient portfolio is incorporating true diversifiers, such as managed futures, which offer little to no correlation to the broad markets.

Traditionally, managed futures strategies have been associated with commodity trading advisors (CTAs), which use trend-following models to trade a broad range of futures markets. However, trend following isn't the only managed futures strategy—there is also a niche of managed futures funds employing counter-trend trading models.

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Often, it is assumed, and wrongly so, that counter-trend is the opposite of trend following. To better understand how each strategy works, let's take a closer look.

Trend following is the most common trading system employed by managed futures. In general, a trend following system aims to invest in the direction of the long-term trend of a commodity, interest rate, exchange rate or equity index. A trend is considered the dominant direction of movement for a market over a specified timeframe.

Trend following comes with a distinct statistical signature. For the most part, trend following systems trade infrequently, have a low percentage of winning trades (25%-45%), and have a high winning trade to losing trade ratio (usually greater than 2). Additionally, trend-following strategies tend to give back substantial profits at market turning points and they are subject to whipsaw in directionless markets.

Counter-trend systems on the other hand are far less common but offer a systematic framework for trading that is equally as effective as trend following. Counter-trend systems generally have shorter duration trades, a higher percentage of winning trades, and a smaller win/loss ratio than their trend following counterparts.

A typical counter-trend strategy will trade more frequently than a trend-following strategy and produce 55% to 65% winning trades with a winning trade to losing trade ratio around 1.0. The majority of counter-trend models look to sell short-term overbought levels and buy short-term oversold levels. This behavior allows counter-trend models to thrive in directionless markets, like the ones we've seen lately. The drawback though is that they often struggle in steady, trending environments.

Since trend following and counter-trend strategies feature different trading methodologies, there are benefits to pairing the strategies together in a portfolio. When paired, they can provide greater diversification to a portfolio and historically have been additive to performance.

All trading strategies have market environments in which they will perform well and environments in which they will struggle. As with all strategies, advisors need to understand why and when the strategy will work. It is a keen understanding of a strategy's mechanics and its thesis that will help an advisor construct a well-rounded portfolio, including managed futures strategies, and remain steadfast during cycles of good and bad environments.

## KEY TAKEAWAYS

- It is assumed, and wrongly so, that counter-trend is the opposite of trend following.
- Since trend following and counter-trend strategies feature different trading methodologies, there are benefits to pairing the strategies together in a portfolio.
- Understanding a strategy's mechanics and its thesis will help an advisor construct a well-rounded portfolio, including managed futures.

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