Man AHL Alpha (AUD)

2023 Review and Outlook

Marketing Communication

January 2024

Executive summary

Measures of inflation broadly retreated in 2023, but the level and future path of interest rates was firmly on investors' minds. A shockwave rippled through the financial community in March with the collapse of Silicon Valley Bank ('SVB'), triggered by the sudden rate rises from central banks to combat inflation. Concerned that this might be the canary in another GFC coalmine, investors flocked from equities to the safety of bonds. This effect was short-lived however and, despite renewed tensions in the Middle East, a US credit downgrade and debt-ceiling concerns, risk assets powered ahead albeit from a narrow technology-led base. Only late in the year, when central banks made more dovish noises (although without actually cutting rates), did bonds start to rally.

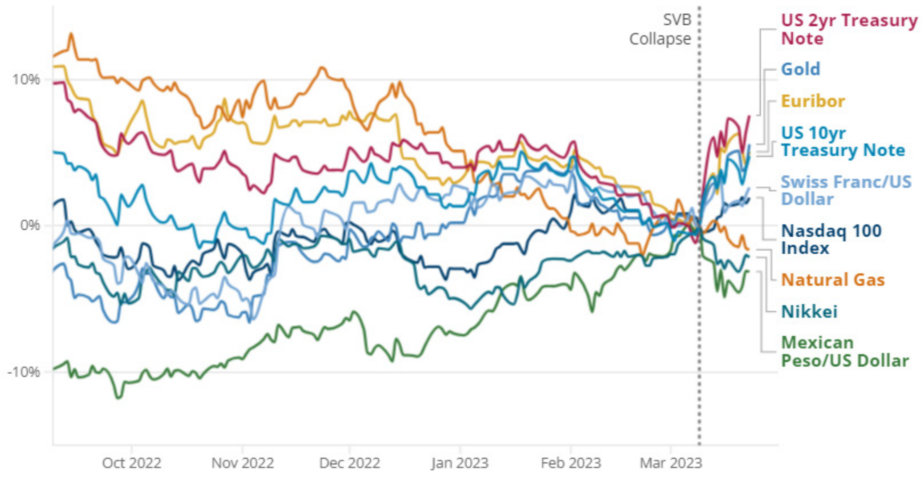
Man AHL Alpha (AUD) (the 'Fund') returned -0.8% net of fees in calendar year 2023. The dominating event was SVB, and its associated price action which was sharply counter to pre-existing trends. Over the course of the year, losses from equities, fixed-income, and commodities were offset by gains in FX and credit.

Despite lacklustre performance, we continue to believe that we are in a fertile environment for trend-following. Trend-following strategies have historically performed well in both inflationary and disinflationary regimes. History also shows that sharp reversals, such as those that caused the losses around SVB, are frequently followed by a period of strong performance. Trend-following continues to be a worthy partner to traditional investments, in our view, performing well when equities don't, such as in 2022, yet not providing significant drag in good years for risk assets, such as 2023.

Performance review

Risk assets entered 2023 in ebullient form; equities rose and the US-dollar fell. Bonds, on the other hand, continued to sell-off. This made the price moves around the mini-banking crisis in March that started with Silicon Valley Bank, but subsequently ensnared First Republic and Credit Suisse, particularly painful for trend following strategies. Two-year US Treasury Yields saw their biggest daily decline in 30 years on March 8th and, as Figure 1 illustrates, assets which had been rising, fell, and assets which had been falling, rose. In this flight-to-quality, commodities were the only exception, being relatively immune to what many market participants feared might become another financial crisis, a-la the Great Financial Crisis ('GFC') of 2008.

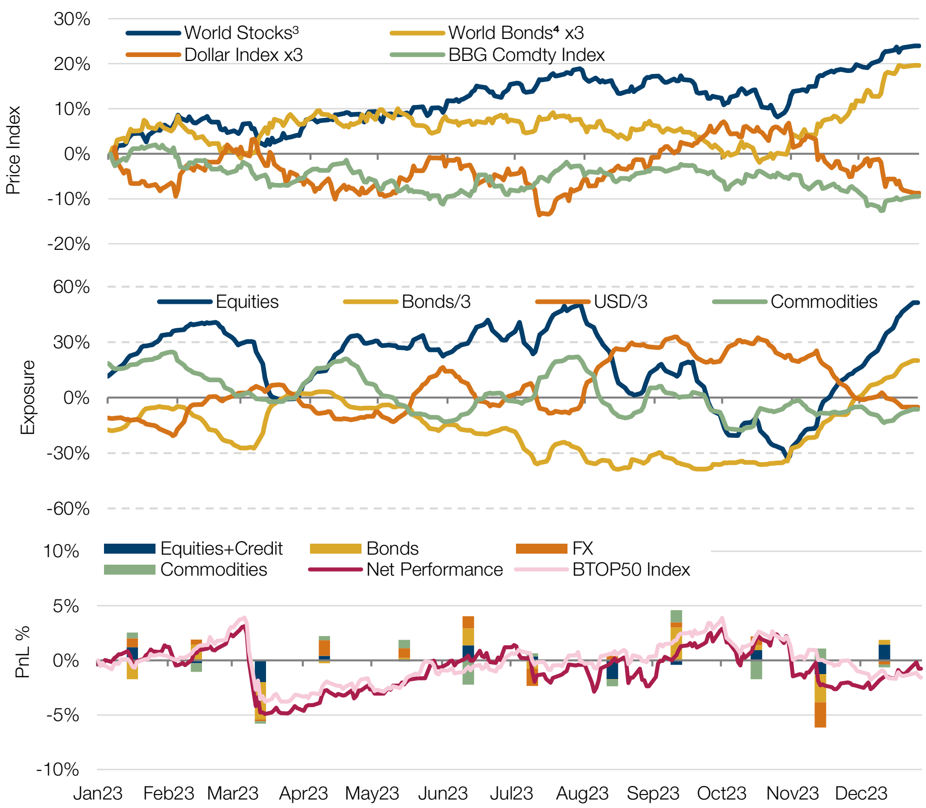
Figure 1. Market Prices Ahead of SVB Collapse, Normalised and Rebased as of 9 March 2023.



Source: [Trend-Following: Rolling With The Punches]

The Fund responded as a trend-following strategy typically does in this environment. We refer our reader to [Trend-Following: Rolling With The Punches] for more detail, but as can be seen in the middle panel of Figure 2, the Fund cut positions from both a reversal in the trend, and because of the spike in volatility. Such sharp reversals across asset classes are bad for trend-following strategies, and losses were incurred in March particularly in stocks and bonds (lower panel, Figure 2)

Figure 2. Decomposing Performance of Man AHL Alpha (AUD) in 2023. Market Prices (Top), Fund Exposure (Middle), PnL (Bottom).



Source: Man Group database, BarclayHedge, Bloomberg. Data as at 31 December 2023. Barclay BTOP50 is not a benchmark of the Fund.

Past performance is not indicative of future results. Returns may increase or decrease as a result of currency fluctuations.

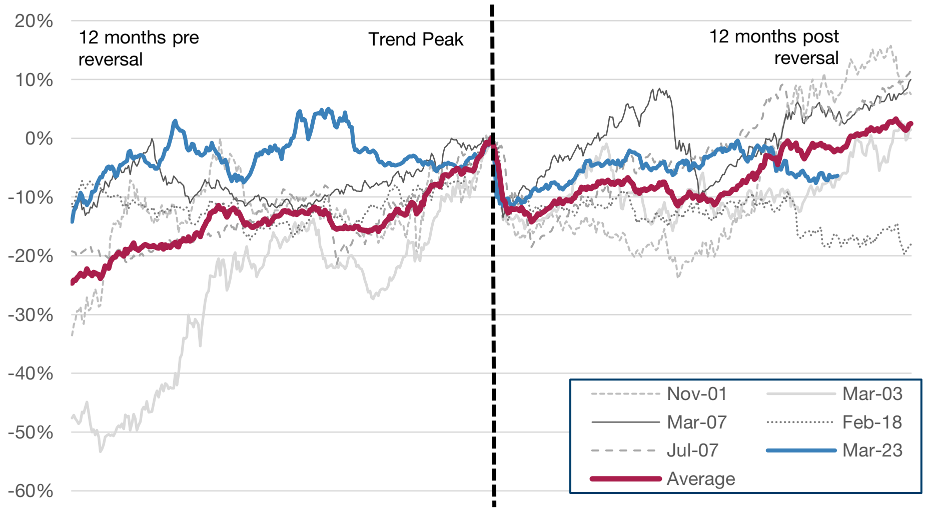
The next GFC did not materialize, of course, and equities resumed their upward trend into Q3 while bonds were weak (top panel, Figure 2). Thus the Fund built back into positions extant before March.

In August a "higher-for-longer" narrative emerged, propelled by hawkish central banks and diminishing concerns around a hard landing. This caused equities to falter, bonds to continue selling off, but a rally in the US dollar through to the end of October. The long equities position was cut, the short USD position quickly migrated to long, and the Fund built further into its short bonds position.

This narrative came to an abrupt halt in November on a lower-than-expected CPI print in the US, and dovish noises from central bankers on both sides of the Atlantic. Equities rose, bonds rose, and the US-dollar fell (top panel, Figure 2), causing a shift from short to long equities, short to long bonds, and long to short USD (middle panel, Figure 2). Losses were incurred across asset classes (lower panel, Figure 2).

Over the course of 2023, exposures in the Fund changed sign in equities twice, bonds three times, and commodities and FX multiple times. For a trend-following strategy, such position changes take their toll on performance. Nevertheless, we can take solace from our observation, published first shortly after the SVB crisis (Trend-Following: Rolling With The Punches) and updated in Figure 3, that significant reversals occur during fertile trending environments, and indeed the return over Q2 and Q3 was +7.0%, which is in keeping with historic post-reversal periods.

Figure 3. Trend-Following Returns 12 Months Pre- and Post-Reversal. Updated from Trend-Following: Rolling With the Punches and Trend-Following: Movin' On Up.



Source: Societe Generale and Man Group database. Data as at 31 December 2023.

A Closer Look at Performance By Asset Class

2023 performance was not dominated by one asset class, either positive or negative (Figure 4).

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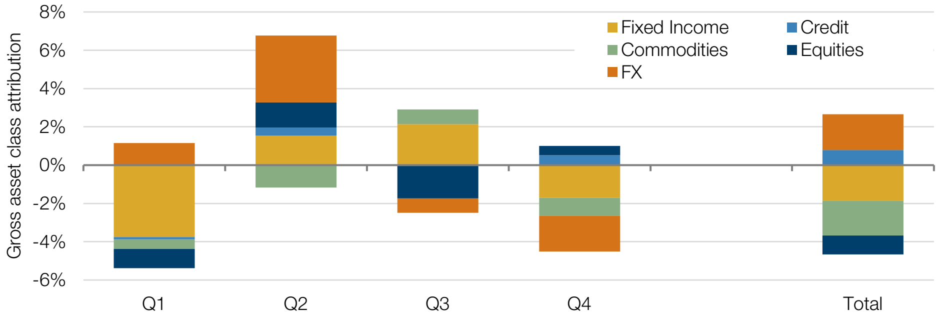
Figure 4. Man AHL Alpha (AUD) Attribution by Asset Class in 2023.



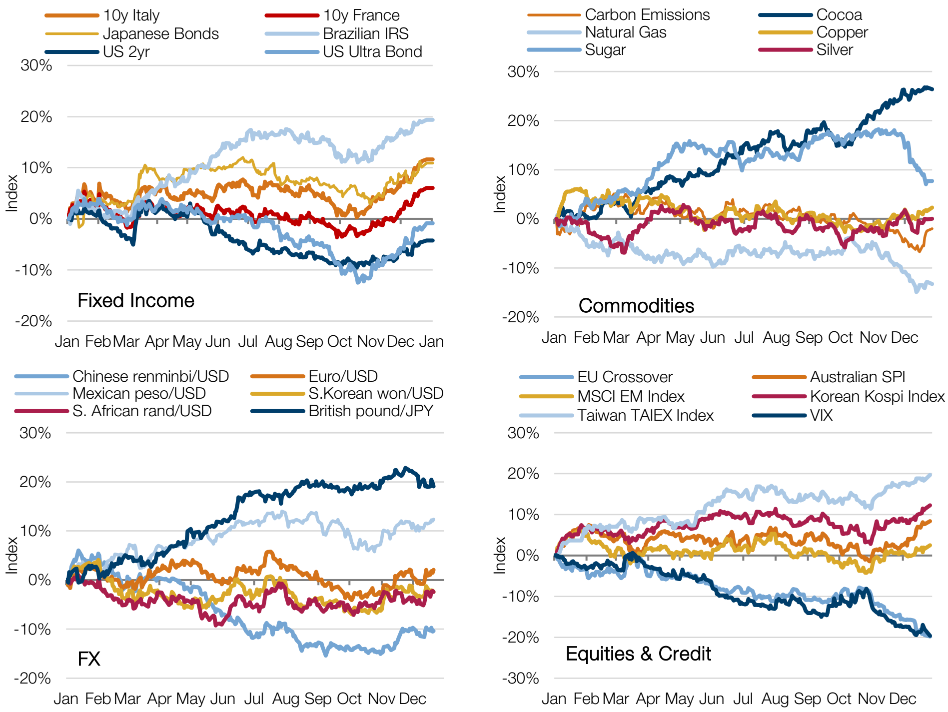
Source: Man Group database. Data as at 31 December 2023.

Trading around 550 markets, however, there are quite different drivers within asset classes, which we explore in Figure 5.

Fixed Income

Fixed income trading generated losses in Q1 and Q4, caused by reversals associated with the SVB flight-to-quality event and end of the "higher-for-longer" narrative respectively. These features can be seen in all price timeseries in the top left-hand-side plot of Figure 5, to a greater or lesser extent. In aggregate, trading in US fixed income was profitable because of the extended downward trend mid-year, during the "higher-for-longer" phase, while European bonds were more range bound and generated losses. Interest-rate-swaps (IRS) in emerging markets, such as Brazil, were diversifying, generating positive attributions from net long positions.

Figure 5. Price Series for Best (Blue) and Worst (Red) Performers by Asset Class in 2023. Normalised to 10% Return Volatility



Source: Man Group database. The organisations and/or financial instruments mentioned are for reference purposes only. The content of this material should not be construed as a recommendation for their purchase or sale. Data as at 31 December 2023.

Commodities

Commodities generated the greatest losses for the Fund in 2023, with metals being the greatest detractor, irrespective of base or precious. Bad weather in Africa propelled cocoa prices to multi-decade highs, generating one of the cleanest trends of the year. The Fund's short US natural gas position reaped the reward of falling prices in Q4 driven, in particular, by the twin forces of high inventories and falling demand resulting from warmer-than-anticipated weather.

FX

Trading in FX was profitable in aggregate in 2023, stemming from some nicely diversifying price trends, as illustrated in the bottom left-hand chart in Figure 5. Japan's accommodative monetary policy relative to other countries was bearish for the yen, leading to declines versus the British pound, for example, and profits for the Fund. Similarly, concerns around the country's real-estate sector and an increasingly cloudy macro-outlook sent the Chinese renminbi lower against the US dollar. The Mexican peso gained against the greenback from attractive interest-rate differentials and strong economic fundamentals. The strength of the US currency in July to October, related to the higher-for-longer narrative, on the other hand, only reversed trends both before and after this period in the case of the Euro, leading to losses.

Equities

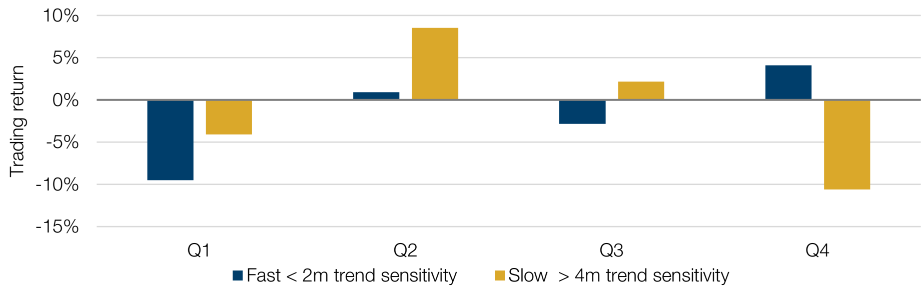
Equities trading generated a small loss overall in 2023, driven primarily by losses in Q1 and Q3, as illustrated by worst performers, Australian SPI, Korean Kospi, and MSCI EM indices in Figure 5, bottom-right. Taiwan provided a notable exception, however, with the Fund profiting from longs in both TAIEX futures and FTSE Taiwan Index as the country's chipmakers thrived in the Artificial Intelligence boom. Elsewhere, there were profits for the Fund's short VIX futures position and long credit positions, as 2023 turned out to be far less volatile than 2022.

Performance by Model Speed

In Trend-Following: What's Not To Like? we make the point that trend-following is an intuitive strategy. When markets reverse direction frequently and when the strategy's positions flip from long to short too often, as they did in 2023, it is perhaps unsurprising that performance is lacklustre. In 2023, performance by trading speed or, to put it another way, trend-length, was also intuitive.

As Figure 6 illustrates, "fast" trading, or models with trend sensitivities less than two months, underperformed "slow", with trend sensitivities in excess of four months, in all but the fourth quarter. None more so than in Q2, when the feared repeat of the GFC did not materialize and price patterns extant before the SVB crisis resumed after it. Figure 2 showed that the Fund closed its positions quickly in March, driven by faster trend models and responsive volatility scaling. In hindsight, of course, this was the wrong thing to do; trading slow, riding out the storm, and profiting from a rebound would likely have been a better strategy. But had GFC#2 happened, the Fund would likely have been able to respond quickly, get short, and provide the 'crisis alpha' for which responsive trend-following strategies are famous (see The Need for Speed in Trend-Following Strategies and Trend-Following: A Different Point of Skew).

Figure 6. Return by Trend Horizon. Simulations of models run at ~15% volatility.



Source: Man Group database. Data as at 31 December 2023.

New Research

2023 was a productive year for research, on both model and market fronts.

On the model side, the team incorporated a new predictor which utilises intraday information, and research is ongoing into dynamic allocations to trading speed, which we anticipate will simultaneously enhance crisis alpha properties and minimise churn in quieter periods.

Markets research also continued apace. Around a dozen alternative markets were added, including inflation swaps and US gas basis markets.

A Few Parting Thoughts on 2023

As we wrote in our 2022 annual review, we entered the new year with high hopes. History showed that both inflationary and disinflationary environments were fertile for trends. Further, the inflationary burst of 2022 had tied the hands of central bankers who, unable to cut rates, could no longer artificially prop up risk assets. The era of the 'Fed put' was at an end.

We cannot deny that 2023 has failed to live up to these high expectations, and we believe that there may be two reasons. First, March's SVB crisis was an idiosyncratic event that reversed prevalent trends. Second, the market narrative has centred around when central banks would end their hiking cycle and whether cuts would be imminent. This narrative abruptly changed in November, leading to losses.

Do these two points make us doubt our central thesis, that we are in a fertile environment for trend-following? Indeed, it has been a frustrating year, but our view has not changed. On the first point, we showed earlier that painful reversals such as SVB in March should be taken in a wider context, and they do not typically mark a watershed in the profitability of trend-following strategies. The second point, around the change in the direction of central bank policy, is perhaps something of which we should have been more cognisant last year. It is clear that the interest-rate cycle has lagged inflation itself. Central bankers have to ensure that the inflation beast has been slain before they commence cutting rates. Inflation peaked in 2022 in many nations, but it is only towards the end of 2023 that it appears that rates have peaked, and this has been the key market debate, in our view. Trend-following strategies thrive when markets have a clear direction, but may struggle at the cusp, when the direction changes. It may well be that 2023 has represented the cusp.

What is clear is that trend-following strategies in 2023 did not give up much of 2022's gains; this was a concern of some investors we spoke to at the start of this year. Further, the complementarity of trend-following strategies to traditional investments remains abundantly clear. If we take the ubiquitous '60/40' portfolio of 60% World Stocks[3] and 40% World Bonds[4] as representing a 'traditional' investor portfolio, then we see that in 2022, the 60/40 portfolio[5] of World Stocks[3] and World Bonds[4] returned -14% while the Fund returned +10%, while in 2023 60/40 returned +17% and the Fund -1%.

We have written about this complementarity a number of times, and we refer our reader to Trend-Following: What's Not To Like? for more information. In essence, trend-following performs as well as equities in the long term, is lowly correlated, has better risk-management properties, and generally works well when equities and multi-asset strategies don't. Further, even when trend-following returns are lacklustre, their inherent crisis-alpha properties can be monetized and used to generate greater returns in portfolios for similar risk (see Trend-Following: If It Moves, Monetize It!. To coin a phrase, what's not to like about that?

We wish our reader a prosperous 2024.

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Investment Policy of the Fund

Short description

The Fund aims to generate medium to long term returns while restricting the associated risks, by trading a diversified portfolio of Investments. The Fund aims to perform independently of traditional stock and bond investments thereby providing valuable diversification benefits and enhancing the risk/reward profile of a traditional investment portfolio.

Type of assets

In order to achieve its investment objective, the Fund invests in a varied portfolio of instruments which may include, but is not limited to, securities, futures, options, forward contracts, swaps, CFDs and other financial derivatives. The Fund may also enter into total return swaps and invest in undertakings of collective investments as well as retain amounts in cash and cash equivalents.

Benchmark degree of freedom

The Fund is actively managed; no benchmark is used as a universe for selection or for performance comparison purposes.

Past performance is not indicative of future results. Returns may increase or decrease as a result of currency fluctuations.

Notes

Man AHL Alpha (AUD)[1] and market indices calendar returns

1 January 2019 to 31 December 2023

	Man AHL Alpha (AUD)[1]	Barclay BTOP50 Index[2]	World Stocks[3]	World Bonds[4]	Dollar Index	Bloomberg Commodity Index	60/40 Portfolio[5]
2023	-0.8%	-1.4%	24.3%	7.1%	-2.1%	-12.6%	17.3%
2022	9.9%	13.4%	-15.4%	-11.2%	8.2%	13.8%	-13.5%
2021	3.0%	10.0%	24.4%	-1.4%	6.4%	27.1%	13.5%
2020	6.8%	5.0%	14.3%	5.6%	-6.7%	-3.5%	11.4%
2019	7.7%	6.7%	28.4%	8.2%	0.2%	5.4%	20.2%

Past performance is not indicative of future results. Returns may increase or decrease as a result of currency fluctuations.

1. The table shows the actual performance of Man AHL Alpha (AUD) Class A Units. Performance data is shown net of fees with income reinvested, and does not take into account sales and redemption charges where such costs are applicable. Returns are calculated net of a 1.5% management fee and a 20% performance fee. Past performance is not a reliable indicator of future performance.
2. Barclay BTOP50 is not a benchmark and os not representative of the investment strategy. It is shown for illustrative purposes only.
3. World stocks represented by MSCI World Net Total Return Index hedged to USD.
4. World bonds represented by Barclays Capital Global Aggregate Bond Index Hedged USD.
5. 60/40 portfolio is based on 60% MSCI World Net Total Return Index (hedged to USD) and 40% Barclays Capital Global Aggregate Bond Index (hedged to USD).

None of these indices are benchmarks for the Fund. They are intended to provide a comparative indication of particular asset classes, investment sectors, or financial markets more widely ("market backdrop"). Unless indicated otherwise, the investment process of the Fund is independent of these indices
Source: Man Group Database and Bloomberg.

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Important Considerations

One should carefully consider the risks associated with investing, whether the Fund suits your investment requirements and whether you have sufficient resources to bear any losses which may result from an investment:

Investment Objective Risk: There is no guarantee that the Fund will achieve its investment objective.

Market Risk: The Fund is subject to normal market fluctuations and the risks associated with investing in international securities markets. Therefore, the value of your investment and the income from it may rise as well as fall and you may not get back the amount originally invested.

Counterparty Risk: The Fund will be exposed to credit risk on counterparties with which it trades in relation to on-exchange traded instruments such as futures and options and where applicable, 'over-the-counter' (‘OTC’, ’non-exchange’) transactions. OTC instruments may also be less liquid and are not afforded the same protections that may apply to participants trading instruments on an organised exchange.

Currency Risk: The value of investments designated in another currency may rise and fall due to exchange rate fluctuations. Adverse movements in currency exchange rates may result in a decrease in return and a loss of capital. It may not be possible or practicable to successfully hedge against the currency risk exposure in all circumstances.

Liquidity Risk: The Fund may make investments or hold trading positions in markets that are volatile and which may become illiquid. Timely and cost efficient sale of trading positions can be impaired by decreased trading volume and/or increased price volatility.

Financial Derivatives Instruments: The Fund will invest financial derivative instruments (‘FDI’) (instruments whose prices are dependent on one or more underlying asset) to achieve its investment objective. The use of FDI involves additional risks such as high sensitivity to price movements of the asset on which it is based. The extensive use of FDI may significantly multiply the gains or losses.

Leverage Risk: The Fund's use of FDI may result in increased leverage which may lead to significant losses.

Emerging Markets: The Fund may invest a significant proportion of its assets in securities with exposure to emerging markets which involve additional risks relating to matters such as the illiquidity of securities and the potentially volatile nature of markets not typically associated with investing in other more established economies or markets.

Model and Data Risk: The Investment Manager relies on quantitative trading models and data supplied by third parties. If models or data prove to be incorrect or incomplete, the Fund may be exposed to potential losses. Models can be affected by unforeseen market disruptions and/or government or regulatory intervention, leading to potential losses.

Commodity Risk: The Fund may have exposure to commodities, the value of which can be volatile may carry additional risk. Commodity prices can also be influenced by the prevailing political climate and government stability in commodity producing nations.

Important Information