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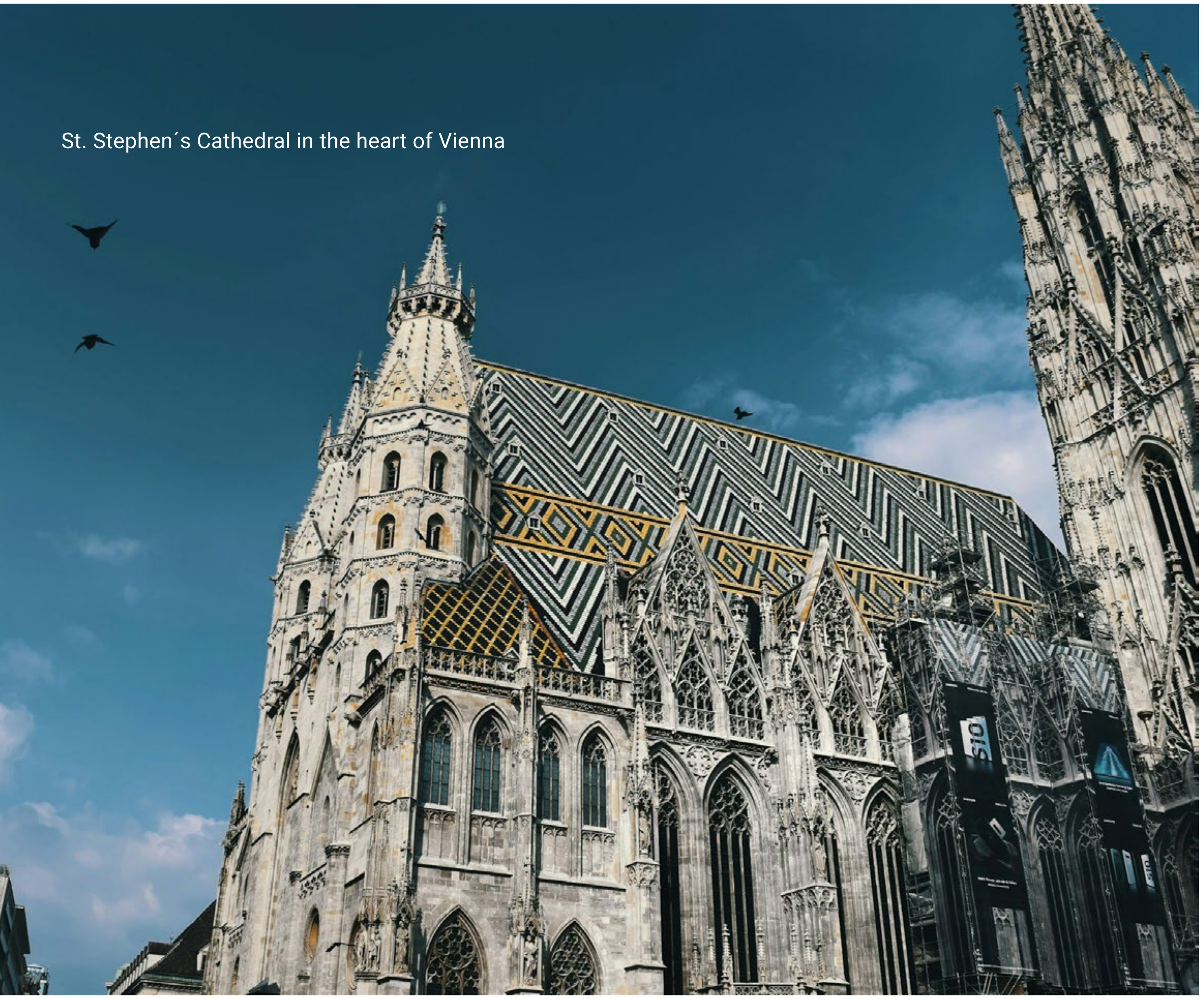

St. Stephen´s Cathedral in the heart of Vienna

SMN's Blend of Continuity and Change

By Hamlin Lovell – HedgeNordic

„Our front office signal generation, order management and execution management are all proprietary systems."

Austrian CTA manager SMN, located just a few meters from St. Stephen's Cathedral in Vienna, is committed to its style of trend following. The manager utilizes distinctive risk management overlays that have operated for over a decade, and their IT systems have always been built in house. The main area of recent innovation has been trading more markets.

MEDIUM TO LONG TERM

In its first decade SMN tried some shorter term trading models but since 2006 it has been firmly in the medium to long term trend follower category. "Lookback periods used to determine trend signals range from 80 to 750 trading days, which means from four months to three years. Meanwhile, holding periods average 100 days but naturally tend to be longer at 160-180 days for winning trades, than the 50-60 day average for losing trades, which hit their stop loss level," says Managing Director, Joseph Waldstein, who has been with SMN for 17 years and leads the Research & Development team of seven people.

Some positive trades have even been held for over a year. "We have been long cocoa since March 2023 and have been cutting the position due to risk management inputs from our system. These inputs were based on our sizing methodology and overlays," he pointed out in early May 2024.

RISK AND CORRELATION OVERLAYS

SMN's risk management algorithm is mainly driven by its two risk management overlays. In 2008 the risk on/risk off overlay was introduced, and in 2010 the correlation overlay was added. "They have increased our Sharpe ratio by ca. 20%," says Waldstein.

Joseph Waldstein, Head of Research & Development – SMN

As markets move between risk on and risk off the system automatically reacts. The top down measure of risk on or risk off regimes can lead to a reduction of position sizes for each instrument.

The correlation overlay flags up concentrations of risk when markets become more correlated. This

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can lead to risk reduction, and was recently helpful in March 2023 when interest rates reversed in response to the mini banking crisis.

"The mechanics behind the risk-management overlays add robustness in every layer," sums up Waldstein.

IN HOUSE IT

Austria boasts the highest percentage of organic food production in Europe, and SMN's models and operations are very much organically grown in a different sense, within the company. Though some hedge fund managers use various third party software packages for front, mid and back office functions, SMN's IT systems have always been in house. "Our front office signal generation, order management and execution management are all proprietary systems, coded in C Sharp language. We maintain our competence and are not reliant on any outside vendors, besides Bloomberg for execution instructions. But Bloomberg is just the interface, we manage the information ourselves," explains Waldstein.

ADDING MARKETS

The key area of recent innovation has been trading more markets. The reason for this is simple. Trend following is a relatively weak signal with a hit rate below 50%, but the win loss ratio is better than 50/50. Therefore a wider universe increases the chances of capturing some trends - even in periods when most markets are not trending.

"Recently the Japanese Yen, cocoa and sugar have been some of the biggest winners as they were unexpected outliers," points out Waldstein. The Japanese currency keeps making new lows against the US dollar. Sugar roughly tripled from Covid to early 2024 and has recently reversed by one third. Cocoa quadrupled in less than a year, and has also seen a 40% pullback this year.

SMN can also trade less well known agricultural markets listed on exchanges in several countries, which are not being accessed by many other CTAs, or indeed by alternative risk premia trend strategies that

Christophorus Lehmann, Alternative Investment Specialist – SMN

tend to trade a much smaller investment universe of major markets.

Since inception the SMN universe has grown from 70 to 200 markets and 300 different instruments, in several stages. "The first synthetic markets were added in 2008, and there are now 50 synthetic markets traded. Structural alpha markets were added in 2016, taking the total to 200 markets including some alternative commodities. The 300 instruments figure also includes multiple maturities in the same market, both for trading trends beyond the front month, and for constructing calendar spreads," says Waldstein.

There has not however been any innovation in instruments traded: apart from OTC currency forwards, all markets traded are listed futures. SMN has chosen its markets carefully and rejected far more than were added. "We place great emphasis on our due diligence of adding new areas of investment. More than 90% of our research leads to no changes," reveals Waldstein.

The investment universe expansion has proved its worth. "Backtesting shows that the risk adjusted returns would have been considerably lower without the extra markets, especially over the past 10 years and after 2009," says Waldstein.

SMN has profited in and around all major crisis years we can recall over the past 27 years: the 1998 Russia crisis, the 2000-2003 TMT bubble bursting, the GFC of 2007-2008, the European sovereign debt crisis of 2010, Covid in 2020, and inflation and quantitative tightening in 2021 and 2022.

"We can profit from a wide variety of macroeconomic and market regimes, including high or low inflation, growth or recession, and bull or bear markets in all of the asset classes traded," says investment specialist, Christophorus Lehmann.

The sorts of market regimes that are challenging for the strategy could occur within any broader macro or market environment. "The biggest risks for the strategy are a sudden reversal of trends that occurs too fast for the models to change direction, or a lack of trends in commodity markets that have always made up over half of the investment universe," says Waldstein. In some cases, the risk and correlation overlays may reduce or even avoid losses under these scenarios. In other cases, there will be a performance drawdown but this will often also sow the seeds for the next phase of positive performance, as the models will reverse positions in some markets, and find new trends in other markets. Over 28 years, SMN has adapted to all sorts of market surprises that nobody could have easily predicted, but in many instances the price action provided the clues that the models latched onto.