

Dedicated follower of market trends

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When mad cow disease was discovered in Washington state last December, cattle futures collapsed. However, the US dollar also continued its downward slide. As a result, the Mulvaney Capital Management Global Diversified programme, which invests in a mixture of commodities and financials, ended the month 5.35% up.

Managed futures is a risky business. One way of reducing the risk is to remove the human element in trading. This is why some Commodity Trade Advisors (CTAs) have taken the mechanical or systematic route. Unlike discretionary traders, who have the discretion to move in and out of markets, systematic traders are bound by the rules of their particular mathematical model.

Paul Mulvaney's model is the Mulvaney Capital Management Global

Diversified programme, which he launched in 1999 and which now has client assets of \$26.3m (€21m). Institutional or retail investors can invest in the program either through the Mulvaney Global Markets fund, a Bermuda-domiciled vehicle with a minimum subscription of \$100,000, or through individual managed accounts with a minimum account size of \$5m.

Mulvaney says his approach is totally systematic: "The essence of trading comes down to psychological factors. What's really difficult is keeping emotions out of the equation. A completely systematic approach does that automatically."

Despite a large amount of randomness, Mulvaney says, markets trend. A completely mechanical trading system can be designed to exploit these trends and produce acceptable risk-weighted returns. A fully computerised mechan-

ical system can trade in many more markets than a discretionary trader could handle.

Mulvaney's programme attempts to capture long-term trends in all the major sectors of the global financial and commodity markets, and is currently invested 51% in financials and 49% in commodities. The programme was constructed using data going back to 1982, so it is robust enough to handle major catastrophes such as stock market collapses and wars.

On average, the programme takes a position in each market once or twice a year and holds each trade for six months. It can hold them longer, he says. "When really big trends happen they can go on for years. We actually have core positions in our portfolio in the stock market and in interest rate products that we have had since late 2000.

"The way to beat the market is to have a longer time frame because psychologically participants seem to be too focused on the short term, and the shorter term the action the more chance that it is an aberration – just noise as opposed to true 'trendiness'."

The rules of Mulvaney's trading strategy are simple: buy on strength and sell on weakness; run profits and cut losses short. "If you take our initial position and it starts to generate positive returns then we'll increase it. If it starts to hurt the portfolio then we'll reduce it and ultimately exit."

Once the programme is in a trade it is not easily shaken out. If it is, Mulvaney will go back to the drawing board to query the original hypothesis. In other words, is this a genuine trend?

Mulvaney's initial commitment to any market is small – 0.5% or less of account equity. "The trading strategy I adopt involves very much getting in and out of positions on a piecemeal basis. Basic trend-following systems tend to make an all or nothing decision to be long or short, but there often isn't enough evidence to justify and outright long or short positions."

He is able to make these piecemeal adjustments with the aid of option pricing theory. Having a mathematical model for market pricing behaviour gives him an edge on the traditional 'test and trade' method, he says.

One problem is that the programme does not shine when measured by conventional measures of risk-adjusted returns, notably the Sharpe ratio. Mulvaney says this is inevitable, since the wrong paradigm is being applied. "Implicitly using the standard deviation assumes that the returns are normally distributed. But in fact our returns stream is very positively skewed, and highly asymmetrical. Our standard deviation is extremely high but this is because of the positive outliers. The standard deviation involves squaring the deviations from the mean and the outliers are what really push it up. So a very strong case can be made that CTAs' performance is severely penalised by the Sharpe ratio."

The Mulvaney Capital Management Global Diversified programme's annualised rate of return since inception is now 19.54% net of fees. This compares with 12.4% for the Standard & Poor's Managed Futures Index.