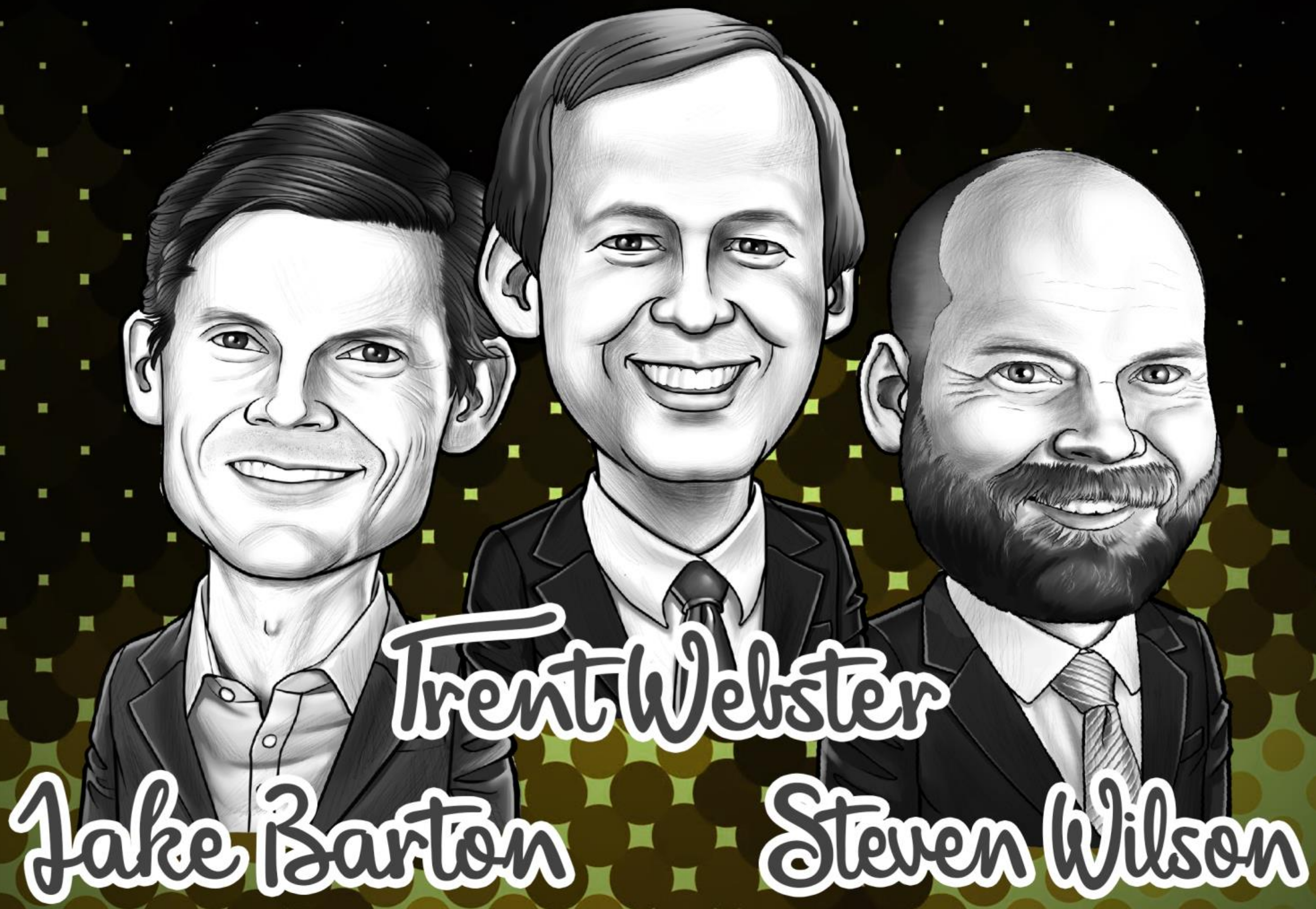
TOP TRADERS ROUND TABLE

EPISODE #21



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"It's almost unbelievable that it's 2019 and people are still paying performance fees on beta. How did that happen?" ~ ***Steven Wilson***

The following eBook serves as a detailed transcript of Episode #21 of the Top Traders Round Table Podcast. You can find show notes and more information on this episode right here: toptradersunplugged.com/rt21

I sincerely hope these interviews serve as a useful resource for you in your career and endeavors in the world of trading. If you have indeed enjoyed these shows, please consider giving the podcast a rating and review on iTunes. It would help spread this knowledge to traders everywhere.

As you read this transcript, remember to keep two things in mind: all the discussion that we'll have about investment performance is about the past, and PAST PERFORMANCE DOES NOT GUARANTEE OR EVEN INFER ANYTHING ABOUT FUTURE PERFORMANCE. Also understand that there's a significant risk of financial loss with all investment strategies and you need to request and understand the specific risks, from the investment manager, about their products before you make investment decisions.

Niels: Welcome back to Top Traders Round Table, a podcast series on manage futures brought to you by CME Group, and the Managed Funds Association where I continue my conversation with Steven Wilson who is a senior portfolio manager in the Public Markets Group at the Teacher Retirement System of Texas; Trent Webster who is the Senior Investment Officer of Strategic Investments for the State Board Of Administration of Florida; as well as Jake Barton who is a Senior Portfolio Manager at Promus Capital which is a multi-family investment firm. I hope you enjoy the conversation.

I want to bring you back in, Jake, but I want to shift the topic a little bit, but still relating to this, and that is the investment theory versus data. When do you know if you're wrong?

So I'm sure that within your teams you rely on a certain amount of investment theory in your investment decisions, but I'm not so sure that there aren't times where you want to say, "If the data doesn't support the theory, the data must be wrong." How do you go about deciding when to rely on the data, and when to stick to the theory?

Jake: That's a very good question. I may need to think about it for a little bit. One of the nice things is that there is more and more data available now. I think data was one of the things that could be your proprietary edge for a while.

Really when you think about... when I hear CTAs I think about alpha, even hedge fund, you hear hedge fund, you think, 'What is the alpha they're going after?" A lot of times that alpha was having proprietary access to inefficient markets or having data that revealed where the inefficiencies where, and so that data was the edge.

We've had a fair amount of regulation on the financial industry over the last ten years that has made the dissemination of information a lot more normalized, a lot more pre-populated and standardized. So I think now it's tougher to find... There's a lot more data, in some ways, but there's also a lot less interesting information that's differentiated when I'm thinking about let's say hedge funds and public stocks and so forth.

Everybody has access to the same information, whereas maybe there is a little more dispersion ten, fifteen years ago. So data has come into play for sure, and I think data will always challenge the theory.

No theory works if it's wrong financially, right? I mean you could have the greatest theory in the world, and if you just keep losing money for your clients, you have to throw in the towel, or the money will all disappear - whether it disappears organically or everyone just leaves and pulls their money out.

So, to me, there's a balance there. I think if you want to just generate market return; if you just want to generate the benchmark; if you want to generate the index, you don't need too much theory, you just invest. If you want to get ahead of that, I think there has to be a theory behind it. So for all looking just to be the status quo, then you don't need to have a theory. If you want to beat that, you do need a theory. But, if your theory is continually contradicted by the data, then you need to formulate a new theory. That's probably how I look at it.

Niels: Yeah.

Trent, how do you balance theory versus the data that comes back?

Trent: Well I'm an empiricist and not a theorist, so we use the theory to back up the empirical. So for us, obviously (we talked about this earlier), that there are all sorts of theories in academia in which I do not believe to be true. I'm a pragmatic empiricist, and if the data supports what we think is right, and we will go through with that. If the data says we're wrong, we'll change our minds. In the end... I've always thought that in the end, I'll make anyone a deal, I'll always admit you're right if I can have the money. Right? So, okay you're absolutely right sir, mister academic, markets aren't efficient, but I found a way to make money, so I'll take the money. For us, it's very much a pragmatic, empirical exercise.

Steven: Yeah, I think maybe I'll try and take a different crack at this question because I don't generally disagree with anything that's been said. Our philosophy tends to be, "Let's gather as much data as we can, and let's understand what data is important and which data is not. Most importantly, when do you interject to apply human judgment to a decision?" Right?

So a lot of decisions could get made automatically, but there are certain times where you need to decide, "I need to step in and add context to this. The data can't, or computer can't, or whatever."

So we have a number of risk signals and things like that that say look something's going on with this manager, its returns are outside of a certain profile, you need to spend some time understanding the context behind what's happening. A lot of times we'll say, "Nope, everything's fine." We understand why certain things are happening. The data supports this conclusion or that conclusion.

Other times we'll say, "OK the data is speaking to us in a way that we know that something is highly unusual here and we need to do something about it." I think knowing and having a strong foundation in math and statistics and all that is highly important, but then not losing sight of the ability of the human mind to add context to any data that you are bringing in.

Niels: I mean you kind of anticipated my next question because I did want to try and apply, in practice, to some of the manager selection side. If a manager is going through a tough time and obviously as we've talked about in the CTA space, there's been plenty of examples of that in the last few years. I mean how do you go about specifically deciding whether the manager is still delivering what should be to be expected?

Jake: Trent and Stephen kind of touched on it already, and I think you know that data and the theory really can be married together if you have a very robust selection in investment committee and process and you spell out what it is, why are you investing in this asset class, why have you chosen this manager, what are you expecting how they performed historically, what they're saying the future prospects look like in the current market environment, how they're trading etcetera. If you have a very robust process, then you can create a band of expectations that you're looking for from that manager that can be empirically measured. When they fall outside of that, you should have a process that says well what do we do then?

Often times I've seen investment committees that have a very good process going into the investment, and they maybe even... The very good ones also have a reason for exiting a manager, but it's sort of the post mortem analysis that sometimes falls short. What went wrong? Why did it go wrong? How can we avoid doing this again?

That part is hard to set aside because it's sort of the... it feels like some cost or something. You know that opportunity came and went and we need to move on and put our money to work somewhere else now. It's hard to step back and say okay let's sit there and think about all the mistakes we just made or why that didn't turn out well.

Every manager is going to be different, but I think you do figure out when is enough, enough. When is this manager...what does style drift look like? When is his process broken? When is this strategy not working anymore? And it's going to be different for every manager, but that's something that the more time you spend on the front end, the easier it is to take the appropriate action on the back end.

Niels: Do you have a specific approach on this or?

Trent: Yeah, I mean when managers underperform you want to know why. We've had situations where... or a situation where a manager had done extremely well, was supposed to be one type of strategy, turned out to be another and it imploded. That does happen.

I think, in some respects, managed futures may be a little different than some of the other hedge fund strategies. As long as you understand and you have confidence in the model, and the modeling process remains robust. If it's explainable why a manager has underperformed that can be very, very reasonable.

What makes hedge funds somewhat unique is that you also have to worry about the stability of the platform of the organization. My impression, which may be completely wrong, is that you don't have necessarily the same business volatility in some of these managed futures firms. There seems to be a lot of them that have been hanging around for a long time with four or five hundred million dollars maybe in equity long/short manager couldn't or a credit manager couldn't.

We want to understand why a manager has underperformed and if the process in their modeling remains robust. I think if it's something that is stagnant for a long period of time that would give us some real pause and concern. But, if a manager continues to do research, continues to more deeply understand the markets that we're in. You know you go through periods of underperformance. It happens.

Niels: Sure, absolutely.

I want to shift gears a little bit and talk about something that has been in the press recently, and it comes from Ray Dalio, whom I'm sure many investors are familiar with as found of the largest and most successful hedge fund that we have right now. One of his big arguments, right now, is that there is a big crisis coming, we're in the seventh or eighth inning, and one or two years from now we should expect a really big crisis in the world. That's how I understand his interviews at least.

So, I'm just curious to know whether things like this have an influence on how you think about your portfolio going forward, or are you not really paying too much attention to this kind of analysis from people like that?

Steven: Sure, if you just have your head in the sand all the time and don't listen to people that are obviously intelligent and smart then that's probably not a good idea. What I would say about the way that we approach this, and I hope this isn't a cop-out. Since we're such a large pot of money it's very hard to move on a dime, so, we have to have structural allocations to things that we know will outperform whenever there is a crisis.

And, we have to have the governing structure to tolerate potentially a low carry during large risk on, that kind of thing. So, I think we just lived through ten years of mostly up markets, through disappointing returns from your chief risk mitigator which would be hedge funds. If you have the governance structure to see it through and to keep that portfolio in place, then I think you should have a high chance of outperforming just straight old 60/40 next time there is a situation like Mr. Dalio is describing.

Can we suddenly allocate two billion more to risk mitigating hedge funds in the next three months? No, that's not within our ability, but we've got the protection there that we need when that does happen because we're not part-timers.

Trent: That's an excellent question. We have, for the last three or four years spent a lot of resources and time increasing... We've gone from zero to twenty percent of our book in four years in these types of strategies, and we'll probably inch a little bit higher. One of the ways you can mitigate what Mr. Dalio's outlook would be to hire Mr. Dalio, as we recently have.

I can't comment on whether or not what he's articulating will occur. Our view on this is we don't think that structurally the United States, the American markets are a problem, unlike in 1999 and 2006, which were very obviously a problem. Human nature is really interesting because if you go back and look at the Shiller data, from Robert Shiller's website, you can download it. I've done this, go back to the 1870 spreadsheet, you actually find out, I think it's thirteen different episodes during that time period where you've had a 30% or more real decline in the value of stocks, in the returns from stocks. And, in every single case except one, it has been spaced out by at least a decade. We've had two of those in 2002 and 2009/2010, in there.

Throughout history that hasn't happened and it's so deeply embedded into people's minds that this is a common way now of how the natural markets work. We don't think that that's a normal case. We don't see imbalances that we saw, which were obviously maybe we didn't know how it was going to play out in 1999 and 2006. The imbalances that we worry about are what's going on in China, and what's going on in Europe in terms of the currency, but not what's happening here in the U. S.

The worry here, in the U. S., is that there's an incredible amount of negative convexity in the market built up through the unwinding of quantitative easing and we saw that back in last quarter. That was as much a reaction against the unwinding and the tightening of interest rates. How that exactly plays out? I have no idea.

So, what we're looking to do is anticipating some sort of bear market and then what we do when we're in the bear market? So, at the beginning of this podcast, we said we're starting look at risk assets and starting to map out three, four, five moves ahead. What do we do when all of this happens?

Niels: Hmmm. Any input on your side Jake?

Jake: Yeah, I think there are two ways to look at it, and one is that the phrase you hear all the time is nobody knows when the next recession is, or nobody knows when the next stock market crash is. If we did, then we would always find a way to avoid it. So, that may tempt people to say, “Well I’m just not going to borrow. I’m just going to go long in the equity markets and never look back.”

The reality is you often have, after those events happen, somebody does a lot of research on it, and you say, “Oh look there was a lot of leverage in the system.” Or, suddenly there was a massive illiquidity and here’s who the market players were, and here’s where there’s a massive, crowded trade going on here. This regulatory change happened, and people had to get out, and they all got out at the same time.

Because we always have the hindsight benefit and all these crises seem very explainable after the fact, that means that there’s always going to be an endless supply of people trying to figure out when the next one is going to come. So, there are two competing philosophies: one is you can’t predict them, but other people are really trying to find it.

Ray Dalio really managed the credit crisis. He managed his firm through the credit crisis well and is a smart guy, and he’s spent a lot of time researching the debt crisis and credit crisis in general throughout history. So, I think it’s always worth listening to smart people who have proven themselves through their performance, through their leadership of their time to see what lessons can we learn from it.

There may always be something different up ahead. It always looks a little bit different. But, sometimes, it’s a cliché, history doesn’t always repeat itself, but it does rhyme. It’s worth having an academic view, it’s worth talking to smart people to try to understand what it is.

At the end of the day for most people, If you’re just teaching a class to the general lay people in the market, you probably say, "Just be diversified." Try to really understand what diversification is. Back to my concept of the spectrum, as markets start to unwind, you need to broaden your sense of what non-correlation looks like, or what diversification looks like and really be and really have that managed futures exposure to balance out equity. Not that it’s going to be a hedge, as we talked about earlier, but just over time, over several cycles that uncorrelated nature us going to create a better end portfolio than just being concentrated in one asset class.

Niels: Sure.

Steven: I want to tag on to what Trent said. The most important thing is to have an asset allocation that's responsive to various environments. But, as Trent said, you need to be ready whenever the market gives you a big opportunity, either by having the staff that can diligent certain trade ideas that are dislocated or having a selection of managers who can respond. Because, if you just let the crisis happen to you and hope that you compound out of it for whatever reason, you're going to be missing some huge opportunities.

Trent: Living through the worst financial crisis of our lifetimes really happened over nine months. It really started to roll over in August of 2008 and bottomed in March of 2009. Then you looked at the tech bubble, it started to roll over at the end of 2000 and went to October 2002.

So you have one that was nine months and one that was twenty months. That's not a long period of time. So, I think that you have to be prepared for these things and react to them. These bear markets can be, they can go down a lot but, historically they don't last all that long unless you have a protracted economic problem which I don't see in this country, at least not here.

I want to be respectful of your time, and I've got a couple of items left that I think would be interesting to hear your view on. If we look at the investment environment in the last ten years. Interest rates have been low. So, when you look at a strategy like private equity, it's given managers a chance to get cheap leverage for a long time, and returns have been good, in part, maybe perhaps they don't have to market their own positions all the time.

But, in the hedge fund world returns in the last ten years haven't been great, and in some strategies, the low interest rates have further reduced returns and, as we've seen, some late movers certainly into these alternatives have put a lot of thought and scrutiny on fees. So, I just want to hear your view of where we are in the fee discussion after now, a few years where, certainly, it's been in the media. Are we coming towards the end of the pressure on managers?

I heard even a little today that consultants are now under pressure on their fees. So, maybe, because I know you've got an intimate way to look at that, you started a few years ago if my memory serves me right. So, maybe, Steven, you could tell me about where you sit on this discussion.

Steven: Sure, so you're referring to our 1 and 30 fee structure which we really started developing in 2016 and then went a bit more public with it in 2017. Really, it was a response to what had been a low return environment for hedge funds for a number of years.

What we realized was that when your hedge fund portfolio is doing 5% net, and you break it down into what's the gross that the managers are making and what's the net that you are keeping, you suddenly discover that the managers aren't hurting nearly as much as you are, especially when markets are doing double digits every year, like they were, and you're sitting at half of that return or less.

We just discovered that in a low return environment the tradition 2 and 20ish type model breaks down. For someone to deliver three net to you and maybe they had a gross of six or seven, and they kept more than half of the value add, we didn't feel that was very fair.

So, what we said was, alright we could just go out and hammer down the level of fees on everybody, but that comes with a whole raft of adverse selection issues. There are literally certain types of alpha that are reliable and very expensive to manufacture. So, if you just go out and try and push fees down, they'll tell you to pound sand, and then you don't have access to that potentially very useful return stream.

So, what we said was, rather than change the overall level of fees we want to change the shape of fees. We want to set up a fee structure that, when a manager does very well, we're happy to pay you above market rates, and when a manager doesn't do very well, then we want to be protected on the downside, and we want our share of the alpha that is generated to be consistent.

So, what we decided was that we would have a structure where, in any given year, a manager would get the greater of the decided management fee or the performance fee as opposed to and. You didn't get both you got one or the other.

The easiest way to think of it is I know I'm going to pay you a performance fee in a given year, but I'm going to pay you an upfront one percent as a draw on that, and you have to make that up in performance fee dollars before you get any more performance fee. What that really did is it said that in low return environments this makes my hedge fund allocation a lot more defendable to my investment committee, my board, because I can point to it and say, "Yes, it didn't do as well as we thought, yes, we understand why, and yes, the managers are not getting really fat and happy and rich off of high fees."

So, that was really the impetus. We've been doing it for almost three years now. We have about seventy-five percent uptake in our portfolio, and we've already realized significant savings from having implemented it. The one other thing I would mention that we did was that instead of paying performance fees on absolute returns, we've switched to an alpha basis only. So, for managers .5 long S&P 500 they get paid on their value add relative to the beta delivery. So, it's been a big shift for us in thinking, but it's been successful so far.

Niels: Sure.

Trent, what is your thinking on fees and how has that evolved on your side?

Trent: Let me first state a couple of things; obviously, we always like lower fees. Who doesn't? Everybody wants to pay less for something. I think that's human nature. We're not necessarily averse to paying fees.

There's a lot of people who are upset that you pay high fees to these very rich guys and that's just not fair. Well, everybody uses Microsoft Office, right? You're paying one of the richest men in the world something with 98% profit margin on it. So, I can get you a spreadsheet for free or you can buy Excel for 98% profit margin. Are you better off net by paying that 98% margin or going for free?

So, I'm not necessarily averse to it. Having said that I do think that, in hedge funds, for a long period of time LPs have paid very expensive fees for beta and I think that those managers which can create alpha should get paid well for it, but those managers which it paid beta should not be in a...

I commend Steve and what they're doing at Texas Teachers because of the idea that if you have half exposure to the S&P 500 and you're half volatility, and whatever beta you think you are, you shouldn't be paid if you can't generate whatever risk-adjusted return the market is giving you. So, I don't necessarily, for example, expect equity long/short funds to outperform the S&P 500. I do expect them to outperform on a risk-adjusted basis. I think that's perfectly fair.

Our work suggests that equity long/short managers, and I'll pick on them for a minute, have created value. The problem is that in the fee structure they take all and more of it. So, over the last ten years, this group has underperformed the S&P 500, or Russell 3000, or whatever you want, on a risk-adjusted basis, on a Sharpe basis. That's just not acceptable.

So, I think that that has to change, but I also think that the opposite could happen: for those managers which have a truly unique alpha generating machine, fees actually may go up. I don't want that to happen, but that's what might happen because you've got three trillion dollars allocated to hedge funds and a lot of people questioning this allocation. Some of that may flow into the areas which are, generally, truly value creating and away from areas which are not.

Niels: Yeah.

Steven: It's almost unbelievable that it got to this point that it's 2019 and people are still paying performance fees on beta. How did that happen?

Jake: And I think that's changing. That's why we're talking about it here. There's a lot of pressure on the fee structure that managers are taking in. I'm a free market guy. I'm all for it. If a manager is not delivering alpha, he's either going... People who still like the strategy are going to ask him to give it to them for nothing, or for as little as possible. If he's producing alpha, then he can take or leave the money, and he'll be fine either way. There will be enough people that will be willing to pay that price for what he or she is delivering.

So, I think free market forces are going to resolve a lot of this. Sometimes it takes awhile. Sometimes people make an investment, and it's just hard to leave that relationship that has been cultivated over years, and these cycles can take five to ten years, maybe, before you reach that equilibrium where they should be, where managers are being paid what they should be.

The problem is that there's a lot of pressure that is media generated as well. It's not just purely pressure from investors saying, "I'm tired of paying this," or, "I don't think you've earned it." If you're big enough, like you guys are, you can structure creatively. You can do managed accounts, you can structure creative fee structures just for yourself.

For the masses, they're sort of at the whim of whatever people like you are paving the way for them, and they're just picking up whatever the market is giving them. But, the media is really hounding hedge funds and fund managers and suppressing the fee structure. The danger there is that you eventually just push all the money to the large, multi, multi, multi-billion dollar fund managers who can afford to charge very little, just a small management fee and no incentive fee for their product because they have twenty billion dollars and they're fine with that.

If that happens, which is to some extent what you see. You've seen the trend towards the people who are able to gather assets. If you have five billion, you can get to seven and ten billion pretty easily. If you have fifty million, you may never get to a hundred million.

Once you get to a certain critical mass, it's just so easy to go and grow larger and larger and that allows you to be able to charge a smaller fee. That's the trend that seems like has been happening, and the problem is that you then squeeze out all the emerging managers. It's very hard for someone to get started in this industry. I think we need their input, we need their creativity, we need new programs and new managers out there being innovative and entrepreneurial and trying their best at creating alpha.

Then, they're never going to get off the ground. It costs so much today to start a trading business, to start a CTA, to start a hedge fund. The regulatory compliance burden on them is so overwhelming. I fear that those people are going to get squeezed out.

So, I've been seeing a lot more, in the last two, three years even, it's been around for much longer than that, but I see more, and more investors who are seeding emerging managers, which I love to see. Because then you can create whatever fee structure works to get those guys off the ground and get them to one hundred, two hundred million, whatever that tipping point is where then they can go after more institutional assets and grow.

So, as long as there is a healthy environment for small start-ups to get planted and start growing. The fee structures, hopefully, will follow and work themselves out in the free market way.

Steven: I've seen a lot of the emerging manager programs, you see a lot of news about those. Do you see a lot of money going into things like CTAs which are comparatively much more expensive to run than like an equity long/short emerging manager? Or is the capital not flowing there?

Jake: Yeah, I think you're correct in what you're seeing. I don't think that CTAs are getting as much. You guys may be able to speak to this, I'd be curious to know if you guys have dedicated emerging manager programs.

It's funny, when I was at Efficient Capital Management, we thought an emerging manager was one hundred million, two hundred million, maybe under one hundred million. A lot of pension funds that I've talked to their emerging manager program is a billion. So it's very different.

Steven: Ours is two billion and under.

Jake: Two billion and under. I don't know, terminology gets lost. I don't know, I'd be curious to hear your thoughts.

Steven: From the ones I've seen there might be a macro manager in there, but one out of twenty managers might be managed futures. I've yet to see a small CTA in any of these portfolios. Just an observation.

Jake: Do you think it's performance driven?

Steven: I think it's a lot easier to wrap your mind around what an equity long/short manager is doing which is probably why the space is a bit more commoditized anyway. So, if you're a small, start-up CTA, you probably have to differentiate yourself somehow relative to the big players. Because, otherwise, somebody is just going to buy a medium to long term trend from one of the blue-chip names. So that just requires a lot of education that an emerging manager program might not have the time to do.

Trent: That's exactly it. Our only fund the funds program is actually in managed futures. One of our managers does see that they have that specialized knowledge.

Steven: You'd have to be.

Trent: And they've done very well at it. They've been quite successful. They've gotten good economics at it, but they're specialists. They've done it forever.

Niels: Good, I've got one, sort of more business type questions and then maybe a different question to end this conversation.

We talked a lot about the risks. We talked a lot about how you navigate the environment, but I also just, very quickly, want to hear where you see some opportunities that excite you at the moment when you look at the landscape. So, maybe, Trent, I'll come to you first and just very quickly, what excites you right now in this alternative space?

Trent: Well, I'm probably more excited now than I have been for a long time simply because we think we're entering into a bear market. I've already mentioned a few things like higher risk equity.

The one area that is really intriguing is the triple B section of the investment grade bond market. There are now three trillion dollars, or so, of triple B bonds and it's up like some 300% in the last ten years. A lot of that is with light indentures and with really high leverage. I think that I think I read, a trillion dollars has leveraged like 3.2 of times, which is the same as the double B junk. You know what I mean.

A lot of that has been raised for financial engineering and mergers and buybacks and things. So, you've actually got a lot of really good businesses with lousy balance sheets, and the microstructure of the market has really changed where you don't have the banks sitting in the inventory of all this stuff. Instead, it's mutual funds and ETFs and some of it is people like us.

But, that's a really interesting thing because you can see gaps really open up in the Bond Markets. You have really wide bid out spreads in January, February of 2016 in the loan market and you might see that again in the corporate bond market. It could be massive. It could be hundreds of billions of dollars. So, that could be one of the best risk-adjusted returns we see. Whenever we go into recession, maybe we banned recessions, it is never going to happen again, but when that happens, it could be just a really, really interesting opportunity.

Niels: Sure.

Jake, where does your excitement lie?

Jake: Sure, I mean it's nothing too novel. It's stuff everyone has heard it before. I think we're progressing technologically at such an exponential rate. It's just astounding when you see all the new things that are coming out.

So, crypto is something that everybody has heard, it was an explosive topic everywhere when everyone had another ICO, and it was just way overplayed. As those markets sort of crashed, people stopped talking about it. But I think the tokenization of assets is still a really interesting thing that has gotten swept a little bit to the side because of cryptocurrencies. Tokenization as a technology, or as a new way to get access to assets and slice things up and track things and so that's an interesting thing in the world of higher tech and pharma and whatnot.

I think there's stuff we're doing with the gene project and curing cancers. I think there are a lot of things that our children will have to deal with that our parents have had to deal with because of what we're doing and the innovation that's happening in that space.

Also, I know we've sort of reverted a little bit from the globalization push that happened over the last decade or two, but I think there's still a lot that is happening in terms of you think of certain areas. They didn't have to build the infrastructure that we did in America or in Europe, and it can leapfrog straight to mobile technology, satellite technology and so forth.

So, you're putting a lot of powerful computers in the hands of people who have not had any technology at all and just gaining access to the billions of people in the world. There's so much brilliance out there that is untapped that I think technology is going to unlock. What that does, who knows what. Certainly, in frontier markets and emerging markets, you're seeing a lot of...

One of the things that we invested in our multi-family offering is microfinance. That's an interesting space. We're seeing a lot of small rural areas really turning around because of the opportunities that technology is bringing them and capital is bringing them too. That's why open markets are good, and if you can bring capital to places where people have ideas, but they just don't have the capital to get off the ground, I think there are some interesting things happening there too.

Niels: Steven, what's getting your attention at the moment?

Steven: I'll maybe restrict my comments to maybe the hedge fund space since we've kind of covered the globe as far as opportunities. So, the things that I really like right now are retrocession reinsurance, which is sort of the peak of the peak risk.

You've had a meaningful contraction in that market that wasn't that big. Big enough to start with and there's a number of players with big balance sheets that are pretty advantaged in that space. You saw rates go from, call it, mid-single digits two years ago to mid double digits or in the teens now. I think that's a big opportunity.

I'm a little bit of homer, but all CTAs, especially down CAP I'm a big believer in. I think you still have a really good shot at having a good caring return, mid-single digits in normal times, and then we've seen those CTAs respond during really good times for other CTAs as well. So, our experience with that has been pretty positive.

Then, just from an alpha perspective, the opening of the onshore Chinese equity markets is a big deal. We've been putting a lot of money to work there. Typically it has to be in a long-only format or something that has got beta sensitivity. But, to the extent that you can fit it in your asset allocation, it's extremely liquid and extremely inefficient space to try to pick stocks. Do I want to pick stocks in the U.S, or do I want to pick stocks in onshore China? I think I know where I want to be.

Niels: OK, so as we start to wrap up this wide-ranging conversation, I want to come back to each of you, one last time, and just ask you a more personal question just so our listeners get a chance to experience this side of you as well. So here goes, what is your favorite hobby or activity outside of work and family and, also, what reading do you almost never miss?

So, let me stay with you, Steven, on that one.

Steven: Alright, well, outside of work and family, if I get a free amount of time, I like to drive out to the desert in west Texas where there's nobody living out there. If you ever saw it, you'd understand why. It's very beautiful but it's very harsh. I like to go out to the Big Bend National Park, spending time out in the desert camping and backpacking, or up in the mountains there. That's my favorite hobby. As far as the reading that I never miss, I think I'll have to be boring and say that I read the Bridgewater Daily Observation every day.

Niels: Probably a good choice. What about you, Trent?

Trent: I'm not sure if this is a good thing or not, but I have evolved into a Whiskey collector. So, those of us who are involved in this little subculture like to go Whisky hunting. So, I had developed, or created, or have a collection of one hundred and forty bottles of Whisky. I'm not sure if that's a good thing or not, but it's a lot of fun. I guess the thing that I never miss is basically anything by Michael Lewis. I'm just readying the Undoing Project, right now. I read Irish Poker five times when I was a kid, and ever since then he's always been my favorite author.

Niels: Trent?

Trent: Your question threw me off. I thought maybe you were talking about the quantum realm. So, I have seven children, so outside of work and family, I didn't think that was a frontier I haven't explored. I like soccer, I love outdoor sports, skiing, snowboarding, I just haven't done any of those things in twenty years, but I do enjoy them when I get to them. Reading, I'll go boring too, the Wall Street Journal I still think is a really well-written magazine. I like the opinion on page two. You get some really interesting and good writing in that section.

Niels: Fantastic, OK. I also just wanted to end up with asking you if there is any question that you want to ask each other, or if there is anything that you felt that I left out that you want to bring up as we come to a close.

Steven: Does State Board Of Florida do any internal? Are they thinking about that?

Trent: Internal hedge funds?

Steven: Common factor type stuff. There's a lot of big pots of money that they're looking to bring certain types of strategies, and I was curious how you all look at that.

Trent: Not in hedge funds, no. We will, I think that risk premia is a big deal I think. Thus, we've done a little bit of that. I think it's going to become a much bigger deal in the next five years. I think if you can do it in house, I think that's very beneficial. We do it already in our global equities where we have factor investing in global equities, but we're not set up to do that cross the other markets.

Steven: I think a lot of big pots of money want to do it, but they realize it requires a lot of staff. So you have to hire and do that.

Trent: It's a certain level of expertise because we have talked to people who have done that, and, you're right, we don't have the internal resources to do that yet.

Niels: Great question.

Steven, Trent, and Jake thank you very much for sharing your thoughts and opinion on today's topics. I really appreciate your openness during our conversation. It is so important to have practitioners like you to share these ideas because when ideas become conversations that lead to action that's when real change happens.

To all our listeners around the world let me finish by saying that I hope you were able to take something from today's conversation onto your own investment journey. If you did, please share these episodes with your friends and colleagues and send us a comment and let us know what topics you would like for us to bring up in the upcoming conversations with industry leaders in managed futures.

From me, Niels Kaastrup-Larsen and our sponsors, CME group and the Managed Fund Association, thanks for listening and I look forward to being back with you on the next episode of Top Traders Round Table.

In the meantime go check out all the amazing free resources you can find on CMEgroup.com as well as TopTradersRoundTable.com