CTA Intelligence

Is chasing trends a dangerous game?

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Is chasing trends a dangerous game? According to a recent article in one leading financial newspaper "…even a moderately successful attempt using fundamental value wins out in the medium and long term" compared to momentum investing.

Quite a broadside on the discipline we've been practicing since May 1997.

Could it be true that even a run of the mill attempt at analyzing and investing in stocks would be able to beat the product of our diligent efforts? At the time of this writing, stocks have been marching higher globally for more than four years.

So, this should be an ideal time to show the preeminence of long-term value investing in stocks. Yet, after delving into the numbers, the results are not so clear.

Finding ourselves at a loss to define a "moderately successful attempt" at value investing, we decided instead to raise the standard and compare our trend-following approach to a "world renowned" value investment fund.

Due to the high esteem in which investors, including ourselves, hold Berkshire Hathaway, we decided to use the publicly available performance data of their A Shares for our comparison.

And, in order to maximize the amount of data, our analysis started with the inception of our Drury Diversified Trend-Following Program in May 1997 and continued through the end of November 2013.

During this 17-year period, the performance of Berkshire Hathaway and our program proved to be reasonably similar, when based on the three most conventional measurements of investment performance – rate of return, volatility and drawdown.

Our program produced a higher rate of return while exhibiting less volatility (when measured by the standard deviation of returns) and a lower drawdown, but broadly speaking both funds were in the same ball park.

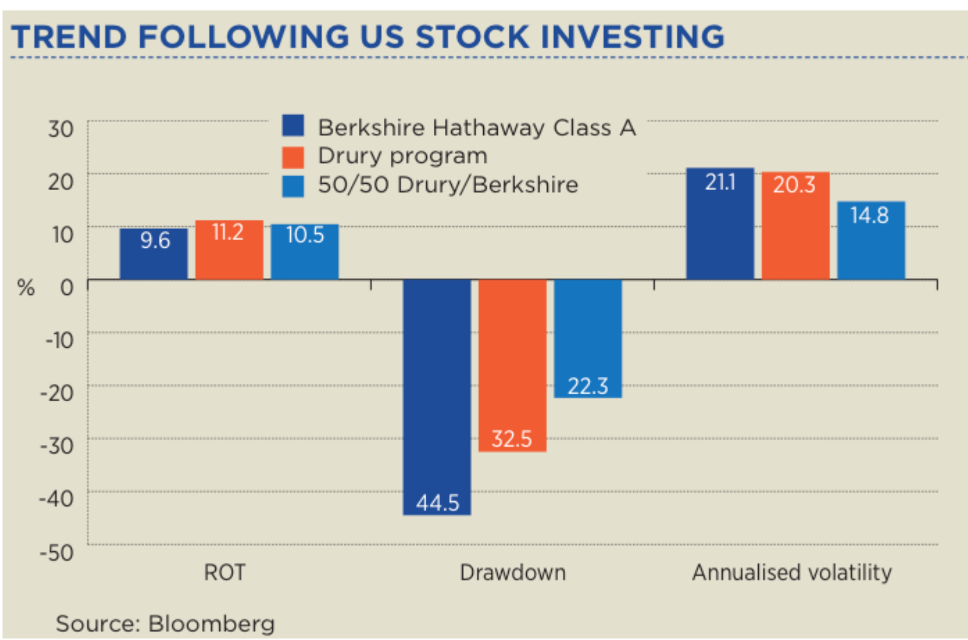
This analysis is not meant to imply that either the Berkshire strategy or our program is superior to the other, but rather that there’s not a single correct strategy to utilize.

In fact, we share Mr Buffett’s commitment to patient, disciplined investment. Momentum trading, when done systematically, is 100% disciplined and measured in its risk-taking, risk management and portfolio allocations.

Throughout the data period of our analysis, the strategies took turns over- and under-performing one another.

Consequently, there was almost no correlation (0.000462 to be exact) between the two funds.

In combination the two funds produce, in simulation at least, results with a greater risk-adjusted rate of return, less volatility and a lower drawdown, than either investment vehicle could produce individually.



So, is chasing trends a dangerous game? It would appear just the opposite.

Despite the claims of the article, momentum trading might actually be an effective complement to a fundamental equity investment in a diversified portfolio.