Episode 179: Forecasts, Futures and Funds: Inside the Hedge Fund Playbook

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SPEAKERS
Alex Murguia, Wade Pfau, Briana Corbin

Briana Corbin 00:00
The purpose of retire with style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to risaprofile.com/style, and sign up to take the industry's first financial personality tool for retirement planning. You global, macro, event driven managed futures. These are big words, big strategies, but Wade and Alex break it down so you'll know exactly how hedge funds can fit into a smart retirement plan. It's not just for the ultra wealthy. It's for the ultra prepared.

Wade Pfau 00:58
Hey everyone, welcome to retire with style. I'm Wade. I'm here with my trusty co host, Alex, and we're here to talk some more about the topic of hedge funds, and in particular, getting into the last few strategies that have been on the plate for Alex to tell everyone about the global macro strategies, the event driven strategies and the Managed futures. But before we get to that, Alex, how are you doing? I'm

Alex Murguia 01:22
doing well. Wade, thanks for asking. Thank you for asking. How was your weekend?

Wade Pfau 01:27
All right, very good, very good. Yeah, we're recording a bit later than usual in terms of release dates. This is almost coming out live, but we're a day before release here. Yeah, yeah. Quite current markets have been doing pretty good recently.

Alex Murguia 01:42
Can't complain. Yeah, it goes to show you the earlier the other episodes we did on just market volatility and what to make of them and the like. And look when that was going on it and it could still be volatile. Don't get me wrong, it by no means is everything one and done and on to the next chapter. But the reality is it's a very different tenor right now, though, and it was a month ago. Things, things have a funny way of doing that, and we kind of tend to forget. And then the next events, next series of unfortunate events happen. And you know, the way we get a little

catastrophic sometimes, but again, with the caveat that things can still go down as much as they can go up. Look how we're feeling now, and many times cooler heads prevail, right?

Wade Pfau 02:32
Historically, that's amend the case. But absolutely risk is definitely the words there for a reason, so you can never be too overly optimistic. But yeah, getting into the episode this week, we talked about the question of the week, and Alex said it might actually be useful to ask the question at the start of this episode, because it relates well to some of the topics this week. Our trustee pal Keith on the YouTube channel makes quite a few comments. Thank you for those comments, Keith. He actually had a couple of questions in there, so we're actually picking which question to do this week from Keith. And the question that came up that we Alex thought fit in well with this episode is, please don't make fun of him, but what does derivatives mean? And given that our high school students across the nation took the AP calculus exam last week, they may be asking the same question, but that would be a different kind of derivatives. So in the context of investing, what are derivatives? Alex,

Alex Murguia 03:31
derivative is, I'll give you an example. Wade is the underlying asset, and I'm a derivative of

Wade Pfau 03:41
no riding on the coattails,

Alex Murguia 03:43
yeah, exactly, exactly, exactly. I don't mind carrying you away. Just don't drag your feet. All right. No, in investing a derivative is a financial contract, right, whose value is ultimately derived, hence the word from the price or the performance of an underlying asset. And that's the key. So, from a pure definitional standpoint, derivative derives from the price or performance of some sort of underlying underlying asset. All right, key points here is, what is an underlying asset? It could be a stock, it could be a bond, it could be a commodity, currency, interest rate, market index. So you have a lot of them now. Why are they used for? They're used for a couple of reasons, just simple hedging, hedging risk. Let's say I'm an airline company, and I want to budget in for fuel costs, and I want some expected price. I'm not interested in it going down. I'm not interested in it going up. Obviously, if it goes down, it's better, but there's risk to that waiting, and I'm doing the budgeting. And frankly, I want to know what fuel is going to cost. To me six months from now. So they end up using derivatives to lock in on a price. You know, they're not again, it's not a matter of making positive or negative trade. They just want to lock it. Well, if

Wade Pfau 05:12
prices go up and they wait to buy the fuel, they're worse off. If prices go down, they're better off. But they don't necessarily want to take the bet or take the risk or or take a gamble on which direction prices are going to go exactly.

Alex Murguia 05:24
So there's that, there's it's used for that. It's also used for speculating terms I think prices are going to go up. So I'm going to do such and such to movement right now. There are certain types of derivatives out there. There's futures, there's options, there's swaps and there's forward contracts. Right futures is ultimately an agreement to buy and sell an asset at a future date at a fixed price. Options is you have the right, but not the obligation, to buy and sell at a certain price

before a certain date. Okay, swaps, which is another type of derivatives, this contracts to exchange cash flows. Usually see this with interest rates. Interest rate swaps, forwards are similar to futures, but they're more private and customizable. They're not traded on exchanges, if you will. All right, so those are the differences. Now, the two main ones that you see a lot, at least in the comment obviously, in the rate market, swaps and forwards and all of that is all the rage, but that's kind of beyond what usual investors are looking at or hear about. Usually they're in the world of futures and options. And so there are some differences between those that are that I think are, are interesting and good for you to know, especially you. And you wake up in the news, and the news organizations are telling you S and P futures, you can't, kind of avoid that, right? And so what are some differences right between futures and options? The obligation. I said it earlier, within a futures contract, both the buyer and the seller are obligated to fulfill it at expiration. Options, you have the right, but not the obligation, to exercise the option, like if you're out of the money, if you're not going to make money on that, you can just let it go and expire worthless, and you're out the premium that you pay for it, right? Assuming you're not doing things. You're not selling naked calls and stuff like that, yeah,

Wade Pfau 07:26
maybe just for an example, like a call option is the option, but not the obligation to buy a particular asset at a strike price, a fixed price agreed with the option. So if you have an option on the s, p5, 100 to buy it at a particular price. If the price goes up, you've you want to take advantage of that option. You want to buy it at the lower price and sell it for the higher price and make a profit. If the price of the s, p5, 100 goes down, you don't want to buy it for the higher price at that point. So Hugh, the option expire,

Alex Murguia 07:59
yet the option expire, and you're out the money that you paid for the premium on the right for that option, okay? And that's fine. I mean, you can, you can lose a lot of money if you start selling options, you know, without the underlying, without any underlying, and then you're, you're in trouble. But that's, that's for another conversation. The cost for futures typically know upfront costs, but you're required to have margin on that just to make sure you can actually start making these payments. If you're on the wrong side of that trade. For options, the buyer pays the premium. You know the right for that option. Upfront risk, you have unlimited risk on futures, on both parties, for buyers, it's limited to the premium that you pay, right? It means for that the payout, with regards to the futures, because you have the right to buy, because you have to buy and everything, it's more of a linear payout with options. Options can expire worthless, so it ends up being non linear. In that sense, futures are less flexible because you must fulfill a contract, unless it's closed early, you don't you have much more flexibility with options, especially American style. You can kind of sell them beforehand and the like. So there, there's that. Those are the key features there. The other piece that's interesting is, some items are more related to future, some are more related to options. And part of that is, you know, the delivery of things, right? Commodities, you see them a lot with futures contracts. You know, oil, corn, wheat, gold. Now you see that because in the futures contract you're making the delivery of it. Remember the airline example, you're actually delivering that, that stuff, currencies you use. You know, futures are used a lot by forex traders. They're just hedging exchange rate risk, so they're using futures to do that. See the same thing with interest rates, and you see that a lot with stock indices, where you're trading futures, not necessarily options. You can have an ETF then and trade options on that ETF that represents a. Don't know the Q, the Q, the the triple Q's and things like that. But for the most part, you see, you see stock indices traded with futures

options. Those are popular with individual stocks, ETFs and indices. And when you want to trade volatility, there's no delivery on volatility. When you know you see that a lot options on VIX, options on a particular stock, options on a particular set of ETFs, which are underlying indices. You see that like that, but that's ultimately the derivatives. Is what you're getting at is the you're you're trading on something that's derived from an underlying asset. That's ultimately where the the etymology, I don't know that's right. I guess I had to write down derivative and break that, but that's, that's effectively where it begins to come from. And with that,

Wade Pfau 10:52
yeah, that question works perfectly with some of the hedge fund strategies we're discussing this week, the first of which I mentioned, we'll be talking about three, the global macro strategies, the event driven strategies and the Managed futures. Think there may be some connections with at least two of the three, but let's, let's dive into that. Alex with triple macro strategies

Alex Murguia 11:13
and global macro strategies, to me, that's kind of what you think about when you think of the George Soros of the world, or the TV shows like billions, you know, where they're kind of trading, and those are effectively the folks that are trying to play four dimensional chess with the world economy. They're they're begin to start investing based on macroeconomic trends. They're focusing on interest rate, currencies, commodities, everything, everything that could be traded there. It's in their wheelhouse, if you will. And they have high flexibility on asset allocation. They're going to go all over the place. They tend to take more though a broad, top down approach, and then they begin to try to look at economic trends around that, political events, natural disasters, what are the implications and knock on effects that that's going to have? Things like that? They look at monetary policy, and they're trying to effectively take that and assess where things are moving on a global macro scale. As you know, it's embedded in the name global macro. These funds begin to take positions in currencies, obviously through futures, interest rates, commodities often using what way?

Wade Pfau 12:28
Derivatives, derivatives,

Alex Murguia 12:29
ding, ding, yeah. And if they're doing it with commodities and currencies, they're using options or futures, wait probably

Wade Pfau 12:38
more in the future. Futures, yeah, exactly.

Alex Murguia 12:41
And so, due to their flexibility, though, these strategies tend to be highly opportunistic, and, you know, they require strong forecasting skills to be very successful. You know, like Soros, he made his name by betting against the English pound, and he made tons of money off of that. It became a little bit of a pariah in England at the time, but that's how he did it, right? He saw some sort of opening that he thought he had, that no one else did, and he took it. And that's, that's. Those are, like I said, these are where the stuff of TV shows simply because it's, it's kind of interesting in that sense. Now, what? What's going on here? What role do they play within an investment portfolio? Well, it's very hard to say, okay, my macro global is going to represent x

amount of asset class, because they don't think like that. To me, this would be something that you would have in the portfolio that just roams around assuming, again, the caveat that we didn't say at the beginning, Wade you may want to help me out. These are not endorsements of any of these strategies. These are hedge funds. Many of these hedge funds, you need to be an accredited investor, which you need to have certain limits on your net worth, income, you know one or the other. You need to somehow be knowledgeable with regards to things we're getting into these, because there's a lot out there about hedge funds, and we get prospects all the time that are asking us about this, and many times they hear it from somebody and it's like, should I be in this? And so the idea here is not to endorse any of these, but just to help you become an informed consumer, if you will, and how something like this could potentially play a role within a portfolio. That's it. The other piece is, many of these are becoming you're getting a lot of liquid alternatives to this. By liquid is that these were largely sold as private funds. You know, you're you're a limited partner within a fund, and you're able to participate. But to be a limited partner requires those hurdles that we mentioned earlier, but they're liquid, and so a lot of folks are beginning to systematize a lot of these trading strategies and make them available to the broad consumer base. Because they're systematized. They're, you know, they're able to provide an extra level of liquidity because they're less beholden on these like long. Are in beds. They're just, they're just playing, you know, they're just going through their trades systematically. And so because of this availability, increase in more and more availability of these, I think we thought it was worth just putting the, you know, providing a lay of the land. That's the caveat that we wanted to put out there. Wait, anything that I missed?

Briana Corbin 15:19
Ever wanted to ask Wade and Alex a question live and actually get an answer? Well, now's your chance join us on June 2 at 2pm eastern for a special YouTube Live Q and A Wade and Alex will be answering your questions and chatting with you in real time. Yes, actually live. Already have something to ask. Head over to retirewithstyle.com to send in your questions, and don't forget to subscribe to our YouTube channel, so you'll get a heads up when we go live. All the links are in the show notes, so we'll see you on June 2. Don't leave us hanging.

Wade Pfau 15:53
No, makes sense. Now, just a question I have, does this rely on forecasting ability or is there?

Alex Murguia 15:59
Yes? No, absolutely, this is the global macro. Folks are the ones that you know are they're going to think they're the smartest people in the room. Whether they are or not is up for debate, but they're going to be, they're going to feel they're the smartest people in them. Because they're effectively saying, I can look at the world and and spot where there are openings, and I'm going to take advantage of it in a manner that you can that you can now talking about asset classes and the role within the portfolio, because they go all over the place. It's very hard to allocate this in terms of a traditional asset class. This is my large cap value asset class. This is my large cap growth asset class, domestic. No, because they're going to go international, they're going to go international, they're going to go domestic, they're going to go into commodities, they're going to go into interest rates, currencies, bonds, wherever there's an opening, they're in it. And so it's one of those that it's it can be a little difficult to assess how much within the portfolio you want, because you want to see how it plays with the other things nicely. At least when I'm looking at a portfolio, I'm looking to complement different asset classes and capture those returns of those asset classes. This one's a little different, because it's asset

class agnostic, and it just jumps around, and it's more interested in opportunities. I don't care where they are, as long as they're opportunities, that's where I'm going to be at it's that kind of attitude now that being the case, because it's not in any one place at any given time, it's going to invariably offer strong correlational benefits to equities, in the sense that it's going to be somewhat uncorrelated to equities, they're going to always try to zig when others are zagging. So you can expect them to be where very few people are at any given time right now, because positions of these, of these holdings, shift quickly. This is all tactical. So this is a double edged sword in the sense of, not only are they picking individual securities or individual strategies that aren't necessarily index, that aren't that aren't beta driven, they're pure Alpha. They're switching quickly. They're also tactical as opposed to strategic. And what I mean by that is Warren Buffett, you can make the case. Was a strategic investor. He was active in the sense of he was picking stocks, but he wasn't getting in coke and then into Pepsi, and then next month, getting back into Coke and then getting back into Pepsi. You'd buy Coke, you'd buy the business and call it a day. Obviously, more than that, but that kind of thing. He wasn't thinking, Oh, my goodness, currents, the currency exchange between the US and Europe is different. It's going to affect cokes earnings. So I'm getting out of coke, and I'm going into a more I don't know, whatever the soda in Europe is, RC cola for all I know, you know, I'm gonna buy that. Now they don't do you know, these folks are really just musical chairs constantly. Now, if they do their job right, they're gonna perform well in volatile or crisis periods, because these are moments where opportunities begin to technically open up more, whether they can call it more so than anyone else, is up for you to decide, but theoretically, that's when they should do really well during crisis moments. And you could also hedge for geopolitical they also tend to hedge for geopolitical and inflationary shocks with regards that. Now again, this is diverse. It's a strong, diversified component to a portfolio. Many things can diversify a portfolio, such as baseball cards, doesn't necessarily make it a good investment, so it has to be beyond just diversifiable. So here you're ultimately, you're more ultimately betting of all the strategies here you're ultimately building on Uber manager skill, because you're effectively giving them a carte blanche to do whatever they want all over the world, to find opportunities.

Wade Pfau 19:46
All right, in terms of historical performance, have you looked at those kinds of numbers? Because we usually tend to say that individuals have a hard time outperforming or it's the whole idea the efficient way. Market. Yeah,

Alex Murguia 20:01
I'll get to that towards the end, when I'll cover them all together on that one, but in terms of, because we talk about it, and then I'll just, like, go through them, but effectively here. I mean, how can individuals even access them now if they wanted to look at it? I mean, the reality is, of unlike some of the other things that we mentioned, where you're you're beginning to see sort of semi liquid funds and interval funds that are providing access. You know, there are very few funds you would see this via hedge fund, but, you know, just basic private placements within hedge funds, there are some ETFs that are starting to offer sort of this macro style exposure, but they're, you know, they're few and far between, and they're going to be limited simply because of the constructs of, once you're an ETF or a mutual fund, you have certain constraints imposed on you in a good way for investor protections from the governmental agencies, right? But you you are beginning to see some ETFs that are able to dip their feet in that pool a little bit more. You see this a lot more. You know, across more common denominator opportunities. You know, within SMAs, separately managed accounts, right? They are more available in Europe

through UCI Ts, as those are effectively like the UK, the mutual fund equivalents of in Europe, right and there are some platforms that advisors have access to right now, such as I capital and CAIS. You're seeing these marketplaces develop that they're providing access, feeder access, to a lot of global, top global macro managers, so that advisors can then present them to clients. Other than that, I don't see many direct client like consumer client opportunities beyond just the actual hedge funds themselves.

Wade Pfau 21:51
Okay, well, let's move on to the second type for the day, which would be event driven strategies. Event

Alex Murguia 21:59
driven strategies, I kind of like these a lot because they're boring in in one sense of the word, but they're actually quite interesting in another sense. They're not necessarily trying to take advantage of these crazy global macro pieces. They're just trying to profit from corporate actions where, if the outcome occurs, there's going to be, there's going to be opportunities there, right? And so with regards to mergers and acquisitions and restructurings, you see them trying to take advantage of those. For example, here there's a merger arbitrage strategy, right? And in a merger arbitrage strategy, that's an event. A merger is an event, right? What you see here is like, company A is going is selling for $30 a share, and they're gonna buy Company B for $20 a share, right? And now what happens is they announce it. You know, they announce, hey, I'm gonna buy Company B for $20 a share. And Company B, right now, is trading at $15 a share, right when the news of the merger happens, the company, company B doesn't go from $15 to $20 a share. It goes, probably make up a number, but it's directionally. It's like this. It goes from $15 so let's say $18 a share. So there's still $2 left to be had. $2 on 18 is a good percent, you know, I don't know, 13% whatever. It's a nice percentage gain to be had if the deal goes through, right? So if you're able to affect it, so there's that. Now, why it doesn't it go to $20 a share? Because they offer was for $20 a share. There's always a chance the merger doesn't go through. There's government intervention blocking the deal. The last 10% of the of the deal isn't quite worked out. The CEO didn't get the parachute he wanted, so he mixes the deal. There's another company that wants to come in as a white knight and buy it for $25 a share instead of 20. There's a lot of things that could happen that won't that may affect the the actual deal going through. And so effectively, people wait until the last day. Now a merger Arbitrage Fund would would do something along the lines of, what I'm going to do is I'm going to buy it at 18, and I'm gonna short the company that's acquiring because what they're what they're effectively doing is locking in on that 2% by doing that, by on the $2 by doing that. Because regardless if the companies go, regardless of the market movement, at this point, they've locked in on that spread between between the price and the acquisition price, and they've protected themselves from market movement by shorting the company that's acquiring and going long on the company that's getting bought out. And so there's that implied 2% return that they get and they're done, not 2% return. Or $2 to be had there, and they're done. And they try to do this over and over again. So what they're ultimately betting on is that this event will take place, whether it happens or not. That's the that's the piece to be had there. There's also corporate restructurings and arbitrage. I mean corporate restructurings and bankruptcies. These are when companies are effectively and these are more activist investors. Now this, I mentioned him earlier, but I mentioned before, but this is where the Carl icons of the world are introduced. And these folks are, they're going to get in, you know, a company's distress, right? And so they begin to buy the bonds of the companies. Why? Because the bonds are selling for, let's say, as opposed to $100

on par, they start selling for pennies on the dollar, right? You can have corporate bonds for $20 not $100 right? Why would you do that? Why would they even have that? Because there's an issue with the company. That's the only reason they're selling for that low. So they buy them up. The company goes bankrupt, the equity holders, the stockholders, are effectively rendered useless. They their last in line for creditors, right? And so there's different levels of credit, the different levels of bonds that have get to the table first. And these folks are, these are, these are folks that bring lawyers, guns and money, and they bring them all three. They bring all three of them, you know, to the negotiation table, because they're trying to get their pound of flesh, right, and because what they want to do is the bonds that they have, they bought them cheap. They in the restructuring. They're going to convert into equities, right? And so what they had with pennies on the dollar, when everything gets restructured. All of a sudden, they're sitting on 40% of the company, 50% of the company, 60% of the entire company, right? They're involved in the restructuring. They get in on that. They wait a few years, they sell it, they're out, right. And so I'm saying that very casually, but that's what's involved in these corporate restructurings and bankruptcies, they get involved at that level. They're not necessarily buying Kmart because they think it's a great company. They're buying Kmart because they want to get involved. What they want, you know, they're expecting you to go bankrupt, and they want to get involved when the restructuring time comes around. So they'll have a seat at the table, and many seats at the table, because they're figuring all the equity holders will lose everything. And so that leaves all new PI to be split. And if I have enough of a controlling interest with my bonds that I bought a pennies on the dollar, I'm going to have a say on how that pie is split up later. And so you get, you begin to see that with these, these sort of strategies. These are strategies that are long and drawn out, but once they hit there, it could be very impactful to somebody's bottom line. And so this is, this is, this is one that actually interests me quite a bit in my alter ego. This is kind of what I wish I would have been i It's, I find it fascinating. There's this kind of dynamic, if you will. But make no mistake about it, you need to come strong with fundamental analysis. And I wasn't kidding when I said lawyers, guns and money. You really need to you need to have legal expertise around this, because you're really unwinding a lot of things to put it back together again.

Wade Pfau 28:22
Now, is going to be less correlated with the market too, because these sorts of events really are just at a company level. That's not necessarily there could be correlations between bankruptcies and markets, but it's relatively weak. Yeah,

Alex Murguia 28:36
absolutely. Because what these these folks are in. They don't the merger arbitrage is hedging the market, so they're just betting on the the deal going through. So that's a complete, yeah, very similar. We talked about market neutral strategies and things like that earlier. It's a complete, sort of divorcing from that, and it becomes more like a market neutral strategy if they set their trades right, but they're doing it based on Mark, you know, merger arbitrage stuff. Now, what happens when, when there aren't any deals to be, to be had? It's not like there's a merger happening every day, at least at scale, that you can begin to really create a, you know, a significant fund out of that. That's where, you know, they'll be in treasuries for a long time, things along those lines. So you'll see a lot of the returns are somewhat muted relative to the market, because it's, you know, they're getting returns from treasuries when there's not money being put to work, and then they're waiting for certain deals to close, right? Sure, like I said, the return on a stock going from 18 to $20 it's $2 but on a percentage basis is nice. It doesn't happen every

day. It doesn't happen every month, and so you kind of have to wait for these things to pop up. There are some ETFs, though, that do the merger arbitrage themes. Then they offer access to investors. There are some event driven credit stuff available, but that's. Available through private funds. And there's some interval funds that are able to provide this. And interval funds are funds that are traded on exchanges, but they're they're traded only, like once a quarter, if you will. Now some of these names that you've heard, Elliot management, Pershing Square, so the fuck those. Those are the lead activist investors. When they say active investor, they take board seats and things like that. They're effectively driving towards an event, because that's the other way to think about it. There's nothing going on yet. There's no bankruptcy. But you know what? I want to take a significant stake in this company. I am going to get bored. I'm gonna get it. I'm gonna invest in it. I'm gonna demand a board seat, because I have such a such a big amount I'm going to put in certain directors that I want on my board. Think about how litigious and and you have to be effectively, a fighter. You know you have to be to to be able to pull this off. And then you're gunning for some sort of merger. You're gunning for some sort of sale and the like. So you're actively it's an antecedent, sometimes to an event strategy, because you're kind of leaning to an event now, going, that's the Elliot's of the world and the Pershing squares of the world. Heck, I think Elliot management even took over an Argentine warship for a little bit to be able to get their money back from buying cheap Argentinian bonds. But you know, some, some folks that do this in a systematic way, from a merger arbitrage standpoint, is AQR, I think it stands for Applied quantitative research. That's a fun company. They offer merger arbitrage strategy a long standing fund is the merger fund. That's an one that's available to retail investors. And again, this is not an endorsement. This is more just FYI kind of thing I know, man group and BlackRock. They offer hybrid multi event approaches as well. So they are, there is the ability of these are strategies that interest you to look into this further from a due diligence standpoint. No. But again, they offer plat. They offer access across across the board.

Briana Corbin 32:06
Are you getting close to or are you in retirement? Well, investing during retirement is a little bit different than during your working years. Your investments are there to help you pay for retirement, and now is when they need to earn their keep to make sure you're on the right track. Download retirement researchers, eight tips to becoming a retirement income investor by heading over to retirement. Researcher.com/eight tips again. Get your copy of retirement researchers, eight tips to becoming a retirement income investor by going to retirement researcher.com/eight tips. That's the number eight tips.

Alex Murguia 32:46
So then we have managed futures. Yeah, manage futures. And luckily, we just did the question on futures. And so obviously, they're managing futures, right? They're using futures contracts to trade commodities, currencies and financial instruments. Now, these are largely trend following approaches. They're not necessarily I think gold is going to go up, so I'm buying gold, and I'm going to stick with it. They're not interested in that. They're looking at the trends around this, the trend following. Why? Because managed futures, the things underlying it, commodities, currencies, huge volatiles, volatility swings, and so when you can, when you have assets that have significant amount of volatility, it's easier to trade, because it's just, you know, there's dispersions that, you know, they run up, they run down, they don't necessarily just Stay at zero, right? It's harder to have a trend following strategy when there's never any opportunities for any trends. And so within commodities, you see this a lot. You see this with managed futures a lot. But you'll you'll see like commodities trading advisors and stuff like that. And trend following

versus mean reversion following, that's just a fancy way of using like moving averages. A lot of these are done simply with moving averages, though they'll give some finer math behind it, but at the end of the day, the 80% solution is they're using 100 and let's just say 120 day moving average. And if it's above the moving average, they buy. If it's below the moving average, they sell. And they just repeat that process over and over again. And they do that with futures contracts to give himself more of a more of a pop in the returns. And you do that. You can do that with all the commodities. You can do that with commodities, hard commodities being like gold, silver, those kind of things. You can do it with Soft Commodities being more like, cool, you know, corn, or, you know, things that kind of, you know, you use up, if you will, yeah, things that you you can do that with currencies. You do those sort of financial instruments. But it's really, you can have them all in one or you can just focus on hard metals. You can focus on the soft things you know, that. Those kind of items. And with that, like I said, they're largely trend following strategies. And because they're trend following strategies with assets that are like hard hard assets, they have a low correlation with stocks and bonds. But again, so what if there's no expected return around that? Now someone will say, well, there is, there is, there is momentum out there. And if you can capture the momentum through a trend following strategy, then you should be able, you should take advantage of it, right? And so that, you know, for us, we, we, you know, we don't necessarily expose our portfolios to that, but others do. And that's the gist of what you would get within managed futures. Now to go into your question Wade about expected returns around this, results vary. It's hard to say, yes, no, that kind of thing. Results vary. What I would say for global macro, it's going to be dependent on the timing of the market cycle that you're entering, but these strategies are are opportunistic, so they're going to vary by the macro cycle that you're in. You do have that low beta and low correlation, so that's always a benefit. But you're looking at here because they're really gunning for high returns. You know, you're looking at six to 12% obviously, the great managers do a lot better that kind of thing. But of all the hedge fund strategies that we've mentioned, this would be the one that you quote, unquote, go all in on. You know, from a from a risk return standpoint, thinking that I'm going to make a huge return off of right event driven, those are going to be significantly more muted. Those are you're just betting on the event, at least from the merger arbitrage perspective, from the folks that go in and go into the corporate restructuring, you know, getting people out of bankruptcy and the like, those are going to be high, high return strategies as well. Very similar, if not more so, than the global macro. Because, you know, you know, you go from owning bonds for pennies on the dollar to all of a sudden owning 40% of a company or 60% of a company, and even if that company is Kmart, which had no future, you could sell the assets. Could sell the real estate. You can sell certain things that you know, you're kind of resetting when you, when you when you effectively declare bankruptcy and restructure, you're resetting everything. And so to some extent, everything becomes a profit at that point. So it can be very, very advantageous from that stance, the event driven, the Managed futures, you know, you're looking at like market like returns. I don't think you're going to get more than that. It's really the market like returns with they're going to sell it on the lower correlation to the markets, because you're dealing with futures, which are largely commodities, currencies and the like, you know. And again, those are This concludes, like the hedge fund sort of arc, where we talked about long, short strategies, global macro, event driven, market neutral, manage futures and the like. Again, there's just because we said these and these are all viable in themselves, but it's not you should get them, or you should put a little bit of your of everything in your portfolio. There's many ways to earn returns, right? You don't need to get everything. You know, I would view it in the sense of, how does this complement what I currently have? Is it worth it? Do I qualify? Do I need that? Do I need the aggravation? Is it worth it for me? You know, to some extent, a lot of people will say yes, you're missing out. If you're not exposing your portfolio to this, and you should be. I'm of the opinion that you first ask yourself, why is it that you're investing? And it's usually because you have some sort of retirement income plan that you want the portfolio to sustain your retirement? Can you do that with a combination of stocks and bonds? If the answer is yes, then you have to have a real strong reason to include more things in it. And in addition to that, annuities, if you really think about it, what are they? They're structured contracts, right? They're structured contracts where, you know, well, you may want to get into this wait real quick. A RYLA can be seen as something that's structured and hedging against markets and providing and providing income. You know, it's not as sexy as saying hedge fund global macro, but the reality is, it can be more effective in your portfolio than a hedge fund strategy.

Wade Pfau 39:32
Yeah, it's using financial derivatives to provide a structured return so that you're not getting the bell shaped curve of traditional market returns with tails to the far left, tails to the far right, most of the returns in the middle. You can structure the return to reduce or eliminate tails and and then that can help retirees, especially if you're cutting off downside tails so that. If you're targeting a high probability of success, you don't necessarily need as much assets to succeed with a high probability of success, because the tails where the low probability of big losses if you're cutting some of that out of the picture, makes it easier to make the plan work. Yeah.

Alex Murguia 40:18
And so it's a funny sort of thing, right? Where we're kind of talking about stocks, bonds, anything else that you add, there has to be a reason for it, and I think that reason has to do with your retirement income plan. This is retired with style, right? So we're focusing on folks transitioning to distribution, not necessarily just purely accumulation. And if you're talking about that, you know, you have to think, what value does this add for my distribution? And if you're looking at these, then I don't see how you don't look at other structured products that are contractual based from an income standpoint, such as, like a RYLA or something like that, because they're using kind of hedge fund like you, they're using derivatives. To your point. They're using futures and things like that to structure it. Because it's called an annuity, it seems like, oh, this this sucks. This is boring. This is silly. But the reality is, the sophistication is, is, is comparable to what you get in some hedge fund trading strategies. And so like

Wade Pfau 41:18
a fixed index annuity at a very basic level, it provides principal protection, because you buy bonds that when you get the interest from the bonds, your initial principal is protected. But because the interest rate is positive, you don't have to put all the money into the bonds. You have some leftover. And you buy call options on the index, so if the market goes up, you participate in the upside of the index with principal protection. That's the basic idea of a fixed index annuity. So you're

Alex Murguia 41:46
saying is we should call, we should. If these were called quote, unquote hedge funds, as opposed to annuities, it'd be all they'd be all the rage, right? I'm being cute by a half there. But the reality is, you have to ask yourself, what role does this play within my portfolio? Again, the reason we brought this up is just to discuss, look, these are what these things are about alternative investments. These are the hedge funds, and these are their strategies. We're still going to go into other types of alternatives, such as venture capital, private equity and the like.

We just wanted to discuss the last this episode in the past one hedge funds. What are these strategies? About? Each of these particular strategies, too could be their own session. We just don't want to have 30 episodes on hedge fund strategies. But each of these are their own little island in and of themselves. But again, now that you hear these and you hear the titles, I think you're a more informed consumer than you were before you heard this podcast, at least. I hope right way.

Wade Pfau 42:51
That's the goal.

Alex Murguia 42:53
And I think that's it. That's a wrap. All right,

Wade Pfau 42:56
we covered the question, if with enough, since we do have the YouTube Live coming up, that'll be on June 2, Monday, June 2, at 2pm Eastern time. We'll do a YouTube Live, and we welcome your questions for that. And we have the new retire with style.com website, where it's an easy place to provide your post, your questions to us, and we look forward as well, interacting live with the audience there on YouTube to answer questions on June 2,

Alex Murguia 43:26
there we have it. Yeah, guys, put in the questions. We love answering them. We're gonna devote a lot of episodes after we're done with this on just Q and A's and so give it to us. Thank you so much, everyone. We'll

Wade Pfau 43:38
catch you next time on retire with style.

Briana Corbin 43:41
Wade and Alex are both principals of McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, Virginia. The opinions expressed in this program are for general informational and educational purposes only, and are not intended to provide specific advice or recommendations for any individual or on any specific securities to determine which investments may be appropriate for you, consult your financial advisor. All investing comes with the risk, including Risk of Loss past performance does not guarantee future results. The