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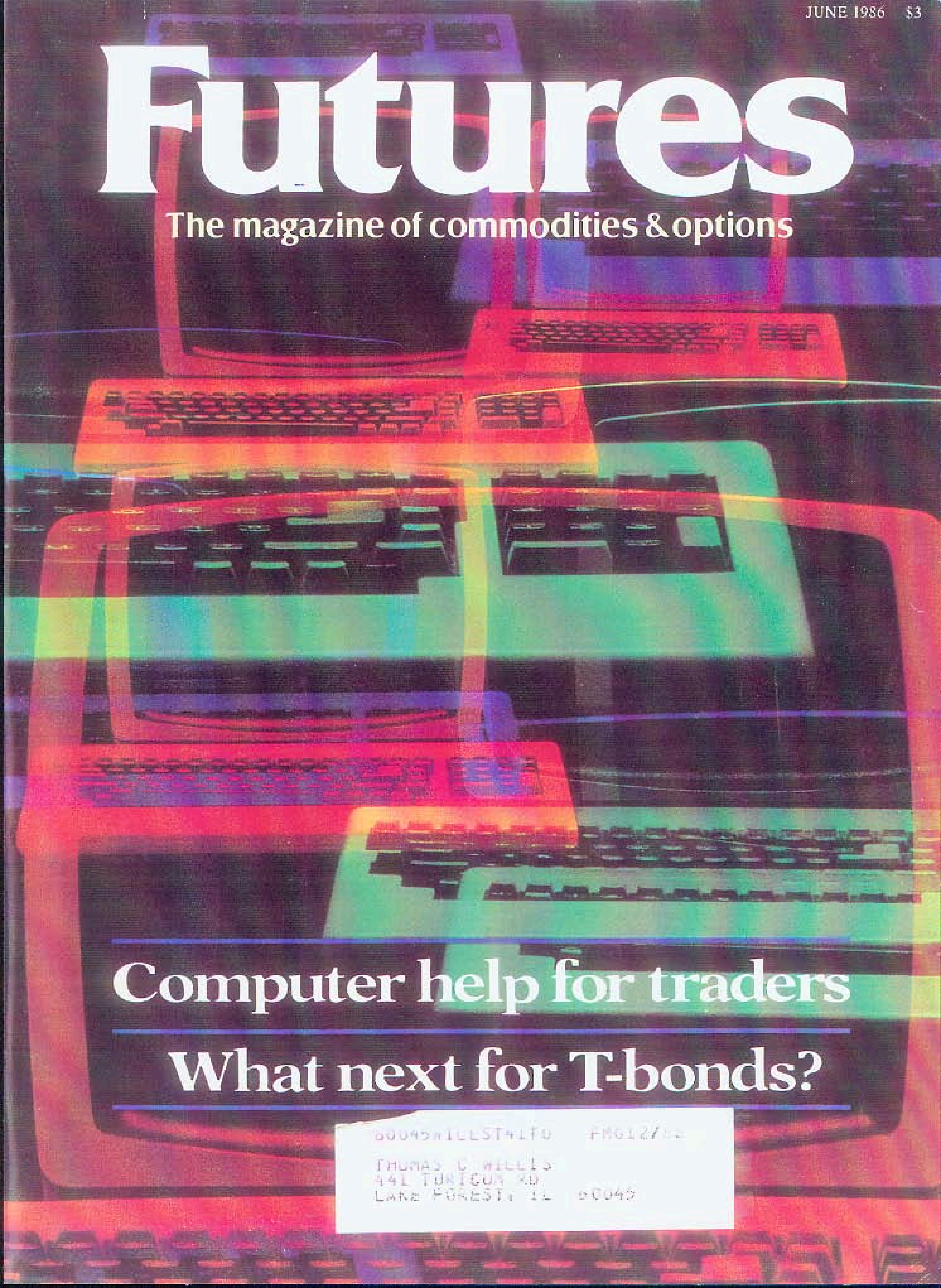

Computer help for traders

What next for T-bonds?

Do trading advisors run into a dollar trading barrier?

By Ginger Szala, associate editor

On their way to managing millions of dollars, commodity trading advisors (CTAs) sometimes seem to run into barriers, psychological or real, that can dampen their rate of return.

"There are no specifics, but it just seems to happen," one commodity pool operator (CPO) says about advisors whose performance is impressive initially but then falls off when they get into the big money.

Even CTAs agree there can be problems dealing with a growing amount of equity. But, as one put it, "A good trader will find a way to compensate," almost like a marathon runner would overcome the 20-mile barrier.

Good track records, trading experience, limited drawdowns and ability to adapt to new money flows are among areas CPOs look for first in CTAs. But many look for how much money CTAs manage, too. Some feel size is a major factor to consider when selecting a manager.

'Greatest potential'

Kenneth Shewer of Kenmar in Rego Park, N.Y., says his firm has found that CTAs seem to have their greatest potential when they manage between \$500,000 and \$3 million. The next greatest profit potential is when they have \$3-\$10 million. There, he says, they either drop back to \$3 million or move up to \$20 million. Other CPOs feel problems start at \$30-\$40 million under management.

So, does this mean investors should look for CTAs who manage smaller amounts of money? Not necessarily. For instance, Millburn Partners (see sidebar on page 44) manages \$400 million in commodity funds that have some of the best lifetime records.

However, big money might deter managers in several ways, says CPO Patrick Hart of Hart-Bornhoft Inc. in Denver. Dealing with position limits, liquidity, psychology, greed and administrative ability all can be problems when the money piles up.

Speculative position limits (see table) become a real problem in the agricultural area, where traders can have a net position of 600 contracts per commodity at most. A fairly active manager who assigns one contract per \$25,000 under management would hit limits on any of the grain contracts when he has \$15 million.

The CTA who specializes in agricultural commodities is affected most as his accounts grow. But widely diversified managers, like William Dunn of Dunn Commodities in Stuart, Fla., also can be affected when they hit those limits and are forced to trade other contracts with higher limits.

Dunn, who manages about \$60 million, quit accepting money for his standard 21-commodity fund in November 1984 because he had reached the position limits for several agricultural commodities. As a result, all new money was put into a fund that traded only currencies, precious metals, interest rates and stock indexes.

Other managers, like Tom Willis and Robert Jenkins of Willis-Jenkins Inc. in Chicago, manage about \$60 million and meet the same limits problem. But to expand their trading abilities, Willis says they trade more soybean complex products and agricultural options. In fact, Willis estimates about 50% of their trade strategies in the last two quarters have included option buying.

Paul Tudor Jones of Tudor Investment Corp. in New York manages about \$50 million and finds he has had to dilute client accounts in agricultural contracts to accommodate new money. For example, instead of putting two corn contracts in every client account, there might be one.

No dramatic difference

Dunn notes there isn't a dramatic difference in performance between his two funds. The average return for the standard fund was 31.4%. In a simulation of the newer fund, returns were 24.5%. But it could pose a problem for other managers moving into less familiar areas.

In addition to speculative limit problems in some commodities, liquidity may be a problem in others. A CTA may have to reduce trading in certain commodities if his orders become too large a force in a market not liquid enough to handle sizable orders without substantial slippage (the difference between order price and fill price).

Most CTAs see the danger of becoming too big a force in a market.

A big manager could find himself "a significant fraction, from 2% to 5% to 10%, of daily volume" some days, Dunn says. "That's not good, especially when you're a trend follower and you buy strength and sell weakness. (Your entrance into the market) could influence the market."

Jones says slippage alone could cut profits at least 15% if orders aren't fed into the ring carefully.

A former floor trader, Jones is savvy about how the pit feeds off large orders. To counter this, he formed his own network of brokers in each pit to place his orders or have someone they know place them. By having someone trade only for him, he believes he prevents significant slippage.

For instance, he trades about 9,000 T-bond contracts per month. If he can save one tick on each trade through his own broker, he saves more than \$3 million a year.

Time phasing is a common way big managers feed orders to the pit to reduce slippage. Small numbers of or-

continued

ders will be fed into the pit every 10 minutes or so until the total position is established. It could take two hours or two days, Dunn says.

"Sometimes (the price changes that take place) will be in your favor, and sometimes they won't be," he adds.

Orders for five to 10 contracts may mean 50¢ slippage, but 200 orders at once could mean $10, he says.

Mental barriers also can be a problem for managers who are intimidated by significant sums of dollars.

"If we look in terms of raw dollars, we'd all go blank," Willis says.

Instead, he trades and thinks in terms of $100,000 units, buying single contracts, not hundreds. This is easier to handle, especially with $60 million under management. In addition, he thinks percentages. Losing $1 million in a day could take its toll on anyone, he says. But a 5% loss is much easier to accept.

Changing styles

CPOs also complain about a sort of "bait and switch" with CTAs who change trading styles to accommodate big money after the CPOs have raised money by selling the CTA's past performance. This new style may not generate as large a return.

Even worse are CTAs who become risk adverse once they manage big money, several sources agree.

"There's always a temptation to live off the management fee," says a CTA who requested anonymity.

For example, if a CTA is managing $100 million and has a 5% management fee, he's assured of getting $5 million a year.

"They get shy," Shewer says. "They become more interested in preservation of capital than making profits."

But Ron Filler, attorney with Vedder, Price, Kaufman & Kammholz in Chicago, defends big money managers who might take less risk as they grow in equity. When managers get bigger and acquire larger clients, the game changes, he says. Then it's not how much is won but how little is lost. Several of his clients would rather take a 20%-30% return each year with small drawdowns than a 100% gain with a roller-coaster manager, he says.

Jones and Willis shrug off the aversion to risk theory.

"People pay me to take risks," Jones says, and Willis agrees, questioning why people enter a commodities fund if they don't want any risk.

Other CTAs, such as Dinesh Desai of Desai & Co., Mountain View, Calif. (see sidebar), stopped accepting additional equity three years ago.

"How much money does a man need?" asks Desai, who now manages about $40 million.

Of course, all managers have ups and downs, reqardless of increased equity problems. Some, who normally have had good records, might feel like Willis.

After averaging 40% gains annually over four years, Willis-Jenkins hit a rough period in late 1985 and early 1986. In March, however, the firm's funds bounced back with 30% profits.

"The industry had us dead and buried a few months ago," Willis says. "I mean, I could feel the dirt on my chest." □

Taking it to the limit

An active manager may trade one futures contract per $25,000 under management. If the manager is diversified into currencies or stock indexes, he can trade a substantial amount of equity before being affected:

$25,000 × 6,000 (position limit) = $140 million

However, if the manager concentrates on agricultural commodities, he might run into position limit problems sooner:

$25,000 × 600 (position limit) = $15 million

Selected position limits*

Contract	Position limit	(Number of contracts net long or short, all months combined)
Currencies (CME)	6,000	
S&P 500 Stock Index (CME)	5,000	
NYSE Stock Index (NYFE)	5,000	
Gold (COMEX)	6,000	(3,000 gross in spot month)
Silver (COMEX)	6,000	(1,500 in any one month)
T-bonds (CBT)	10,000	
T-bills (CME)	5,000	(2,500 in spot month during last three weeks of trading; 750 during last week of trading)
Coffee (CSCE)	1,000	(750 in any one month; 200 in spot month during delivery period)
Sugar (CSCE)	6,000	(4,000 in any one month)
Wheat, corn, soybeans (CBT)	600 each	(3 million bu. for each commodity)
Crude oil (NYMEX)	5,000	(1,000 in spot month)
Live cattle (CME)	450 in any month	(300 in spot month)

*Speculative limits only; hedgers have no limit.

Source: Commodity Futures Trading Commission

Going beyond futures

Millburn Partners in Ridgefield, Conn., passed the $50 million milestone in 1979. Today, with $400 million under management, it is the largest commodity trading advisor in the futures fund arena.

The firm, with partners Malcom Wiener, George Crapple and Harvey Beker, manages four private and seven public funds, including several of Heinold Inc.'s commodity funds. Operating for a decade and a half, Millburn's track record has been generally consistent. Except for a 9% loss in 1983, the firm's funds have earned returns from 20% to 63% since 1979. The higher returns came in the earlier years when Millburn managed less equity, while returns the last few years have averaged 20%.

Crapple says that, even with $400 million under management, position limits don't seem to be a problem. However, the firm has reached limits in agricultural products.

Millburn trades futures primarily. Only in currencies is a significant part of business done in the interbank market. Options and exchange for physicals are used only occasionally, he says.

Crapple says Millburn is able to operate unhampered because it uses a diversified mix of contracts, trading 35 commodities all over the world. Also, the firm does not leverage its accounts as highly as many managers do, committing only 15% of each account's net worth to margin. As "slow traders," the firm is able to spread trades over long time periods, dampening the effects of volatility and slippage. Crapple says an average system may signal a trade only about six times a year. □