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Virtus AlphaSimplex Mgd Futs Strat I ASFYX

A close-knit team running a differentiated strategy.

Morningstar's Take ASFYX

Overall Morningstar Rating™	★★★★★		
72 US Fund Systematic Trend (29 Feb 2024)			
	3 Yr 72 funds	5 Yr 68 funds	10 Yr 45 funds
Morningstar Rating™	3★	5★	5★

Morningstar Medalist Rating™	Bronze
Analyst-Driven %	100.00
Data Coverage %	100.00

Morningstar Pillars	
Process (24 Jan 2024)	Above Average
People (24 Jan 2024)	Above Average
Parent (8 Mar 2024)	Average
Performance (24 Jan 2024)	
Price (24 Jan 2024)	

24 Jan 2024 | by Hyunmin Kim

A compact team of researchers behind AlphaSimplex Managed Futures combines conventional trend-following models with original ones to offer a differentiated managed-futures strategy.

A modestly sized but skilled and well-organized investment team of 10 oversees this strategy. Among those 10 are five named managers, most of whom boast long tenures with AlphaSimplex. CIO Alex Healy and chief research strategist Kathryn Kaminski set the research agenda and take a collaborative approach to portfolio management alongside senior research scientists and comanagers John Perry and Philippe Lüdi. All managers serve as generalists, working on component models, portfolio construction, and people management, except for comanager Robert Rickard, who specializes in cash management. The remaining members of the investment team also bring strong quantitative skills and relevant backgrounds to contribute to research. The supporting cast of six traders and three risk-related personnel is not as robust as larger peers but sufficient to maintain this strategy.

The team follows a well-defined and iterative research process to execute and improve this systematic trading strategy. It combines conventional trend-following models with proprietary models that learn from market behavior and dynamically adjust the trend horizons. Then it deploys the combination of models to roughly 100 futures and forwards markets that it deems liquid enough to trade in (usually more than $1 billion in daily trading volume). The firm's investment committee meets weekly to assess potential enhancements, and any new ideas must go through a thorough testing period, including extensive peer review and months of paper trading, before they are introduced to the live portfolio.

The strategy's relatively high volatility budget (annualized target of 12%, with a 17% limit) and single-asset-class risk budget (up to 50%) mean that the fund can experience both strong outperformance and underperformance against other trend-following peers. However, the team keeps a tight grasp on the portfolio's risk metrics to mitigate excessive drawdowns, and this strategy's institutional shares generated a compelling 5.1% annualized return over the trailing 10 years ended December 2023. That showing places the fund in the best-performing decile of the systematic trend Morningstar Category.

Process Above Average | Hyunmin Kim | 24 Jan 2024
A differentiated suite of models augments a sensible and repeatable process, leading to a renewed Above Average Process rating.

The strategy combines conventional trend-following models with proprietary models designed to profit from trends in different markets. For each market it trades in, it allocates 30% of its risk budget to well-known trend signals that tend to be most effective in a six- to 12-month horizon. Another 30% goes to shorter-horizon signals designed to detect quickly moving markets with signal windows that range from five days to three months. The final 40% goes to adaptive horizon models, a unique feature of AlphaSimplex, that dynamically adjust the trend horizons based on previous market patterns. When multiple time horizons agree on an asset's trend direction, more confidence is placed in that trend.

The strategy targets a relatively high 12% long-term annualized standard deviation of returns (with an upper limit of 17%). However, it operates within appropriate risk controls, including limits on daily volatility, correlations, value-at-risk, concentration, and liquidity through automated diagnostic systems as well as separate risk team reviews.

The research process supports the program's ongoing improvement. The firm's investment committee meets weekly to assess potential new signals or data sets to add to the trading program. It employs an iterative process to thoroughly test new ideas, including extensive peer review and paper trading, before a new signal is added to the live portfolio.

The fund invests in roughly 100 markets across four broad asset classes (equities, fixed income, commodities, and currency). Rather than chasing esoteric markets like some peers, the team sticks to the largest, most liquid parts of the market (more than $1 billion a day in daily average trading volume) and adds new markets incrementally. For instance, it recently started trading aluminum contracts in Comex, as the liquidity and breadth have improved in that exchange while conducting ongoing research to make sure not to take an undue portion of the market. Other recent and upcoming additions include iron ore and EU carbon emissions, as well as short-term interest-rate contracts that serve as Libor alternatives.

Position sizing depends on the composite score of the underlying signals. When the three distinctive suites of models agree on an asset's trend direction, greater risk is assigned to that asset. Single-asset-class risk allocation can vary from 0 to 50%; that upper limit is higher than a typical systematic trend-follower and can be a significant performance differentiator for AlphaSimplex. As of December 2023, the strategy allocated 35% of its risk budget to equities, 20% to fixed income, 22% to currencies, and 24% to commodities. Top long positions included U.S. equity indexes such as the S&P 500 and the Nasdaq-100, as well as French 10-year bonds and the Polish zloty. Top short positions included the Japanese yen and U.S. two-year notes.

People Above Average | Hyunmin Kim | 24 Jan 2024
A compact but competent, collaborative group of researchers drives this strategy, justifying a renewed Above Average People rating.

AlphaSimplex's 10-person investment team is modest in size but has shown stability since the departure of comanager Robert Sinnott in 2019. Four out of five named managers have worked with the firm for more than a decade, and comanager Kathryn Kaminski brought welcome additional industry experience when she joined the team in May 2018. The group also maintains a good track record of retaining and growing junior talent to more senior positions, with the current CIO and comanager Alex Healy as a case in point. Members of the investment team come in with strong quantitative skills and relevant backgrounds, contributing to the research-intensive process. The firm's positive reputation in the industry and solid recruiting channels at Boston- and Cambridge-based universities also means that talent infusion is less of a concern here. All managers except Robert Rickard (who manages the cash positions) are generalists and contribute to multiple aspects of the strategy, including component models, portfolio construction, and people management.

The investment team has sufficient supporting resources, although they are on the lighter side compared to industry peers. It is supported by six traders who work around the clock and a three-person risk team. The use of a third-party execution algorithm and marketing support from Virtus removes peripheral distractions and allows researchers to focus on their core competency.

Parent Average | Hyunmin Kim | 8 Mar 2024
As Virtus Investment Partners evolves its investment affiliate roster and fund lineup, it retains an Average Parent rating.

The publicly traded firm uses a multimanager approach. It fully owns all but one of its 14 affiliated asset managers and also uses subadvisors. Since 2020, it purchased six affiliates, expanding its alternative offerings through its 2021 Westchester Capital Management acquisition and its 2023 purchase of AlphaSimplex. In 2022, Virtus combined its three fixed-income affiliates—Newfleet, Stone Harbor, and Seix—into one legal entity, Virtus Fixed Income Affiliates, though each affiliate maintains its brand and continues to manage money independently.

Virtus has also made some changes to its investment lineup. Voya became a meaningful subadvisor for Virtus, after Voya bought the US business from Allianz Global Investors, which was banned by the SEC from running registered funds in the US for 10 years. Virtus maintained some of the portfolio management teams that moved to Voya but hired affiliates for most of the 17 mandates that AGI ran. More recently, Virtus announced in November 2023 it was moving on from longtime subadvisor Vontobel in favor of affiliate Sustainable Growth Advisors.

Virtus offers distribution and back-office strength, while allowing affiliates investment autonomy. Some managers are strong, such as equity specialist Kayne Anderson Rudnick.

Performance | Hyunmin Kim | 24 Jan 2024
The team has delivered compelling long-term results, but its relatively high volatility budget means that investors can see some high highs and low lows.

Partly owing to its slightly higher volatility target and flexible asset-class exposure constraints, AlphaSimplex can trail other trend-following peers at market inflection points. For instance, the institutional shares' 10.3% loss in 2023 put the fund in the worst-performing quintile of the systematic trend Morningstar Category. Sharp market reversals in that year posed a significant challenge to trend-followers, including AlphaSimplex. However, the strategy makes this up when trends run, such as 2022 and 2020, when it gained 35.7% and 13.6%, respectively, and placed in the best-performing quintile of the same category. Over longer stretches, the performance tends to smooth out to a compelling number. Its 5.1% annualized returns over the trailing 10 years ended December 2023 topped its category average, category index (Credit Suisse Managed Futures Index), as well as the SG Trend Index, an industry composite of ten sizable trend-following strategies for which AlphaSimplex is part of.

The strategy has also delivered on its goal of generating positive returns during market crises and serving as a portfolio diversifier. Over the past decade ended December 2023, when the U.S. (S&P 500) and global equity markets (MSCI ACWI) were down, this fund showed negative down capture ratios of 17.1% and 19.9%, respectively. It has maintained this profile with a negative beta to both domestic and global equities.

Price | Hyunmin Kim | 24 Jan 2024
It's critical to evaluate expenses, as they come directly out of returns. Based on our assessment of the fund's People, Process, and Parent Pillars in the context of these expenses, we think this share class will be able to deliver positive alpha relative to the category benchmark index, explaining its Morningstar Medalist Rating of Bronze.

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The Analyst-Driven % data point displays the weighted percentage of a vehicle's pillar ratings assigned directly or indirectly by analysts. For example, if the People and Parent ratings are assigned directly or indirectly by analysts but the Process rating is assigned algorithmically, the Analyst-Driven % for an actively managed vehicle would disclose that 55% of the pillar weight was assigned by analysts and the Analyst-Driven % for a passively managed vehicle would disclose that 20% of the pillar weight was assigned by analysts.

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Bonds are subject to interest rate risk. As the prevailing level of bond interest rates rise, the value of bonds already held in a portfolio declines. Portfolios that hold bonds are subject to declines and increases in value due to general changes in interest rates. Portfolios that invest in lower-rated debt securities (i.e., "junk bonds") involve additional risks because of the lower credit quality of the securities in the portfolio. The investor should be aware of the possible higher level of volatility, and increased risk of default. Tax- free municipal bond funds may be subject to state and local taxation and the Alternative Minimum Tax.

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Equities are typically subject to greater fluctuations in market value than other asset classes due to factors such as a company's business performance, investor perceptions, stock market trends and general economic conditions. Stocks of small or mid-sized companies involve additional risks; such companies may have a higher risk of failure, are not as well established as larger blue-chip companies, and have historically experienced a greater degree of market volatility than the overall market average.

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Investing in international securities involves special additional risks. These risks include, but are not limited to, currency risk, political risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

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Trading may be halted due to market conditions, impacting an investor's ability to sell a security.

Market Price Risk
The market price of securities traded on the secondary market is subject to the forces of supply and demand and thus independent of the NAV. This can result in the market price trading at a premium or discount to the NAV, which will affect an investor's value.

Market Risk
The market prices of securities can fluctuate as a result of several factors, such as security-specific factors or general investor sentiment. Therefore, investors should be aware of the prospect of market fluctuations and the impact it may have on the market price.

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Portfolios that invest exclusively in one sector or industry involve additional risks. The lack of industry diversification subjects the investor to increased industry-specific risks.

Virtus AlphaSimplex Managed Futures Strategy Fund (ASFYX)

As of 12/31/23	1-Year	5-Year	10-Year	Since Inception	Inception Date
ASFYX	-10.32	9.16	5.14	4.86	7/30/10

Performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Please visit virtus.com for performance data current to the most recent month end.

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