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CTA manager warns investors against current attachment bias

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According to Nobel Prize winner Richard Thaler, who used psychology to explore the cognitive biases of investors, investors generally feel the pain from losses twice as much as pleasure from gains, judgment on investment is skewed by an initial piece of information or experience, and investors assign excessive value to what they already own in their portfolios.

"At J8, we coin these traits the 'attachment bias'," says Dr.Tillmann Sachs of J8 Capital in a recent paper. "Investors chasing performance and holding on to loss-making positions while selling profitable trades prematurely are the hallmarks of such attachment bias." A solution to that bias is systematic, rules-based investing, he continues.

His managers spend considerable time and effort when developing their strategy to avoid such behaviour. "We choose parameters and explanatory models such that we deliberately avoid behavioural attachment bias," he explains. "By combining distinct and independent signal engines, we built an overall unbiased model that is yet adaptable to change.

"Importantly, we want the model to work with a wide range of changes within each parameter and thereby avoid overfitting. For this purpose, we test a wide range for each parameter for each variable in each model and do so in different historic market environments. The final strategy model then results in generating buy or sell signals which we implemented in the markets with confidence."

Investment industry professionals must continue to innovate and create new and unique solutions for investors, he concludes. We too often become comfortable with existing themes and leave aside diversification and protection. Investors have been focusing on long-only equity strategies in the current bull market, but while that may have been a good solution, it may not be so going forward.

The investment process relies too often on historical data and recency bias. That is attachment bias. Investors should try to identify investment opportunities and expectations that hold when going forward. They need to bear in mind the old adage ‘buy low and sell high’. They will need to protect themselves against a Fed monetary policy tightening or other event leading to a correction or a bear market. “A process-driven, professional investment structure is a prudent diversification tool,” he says.

The J8 Global Absolute Return Strategy was up 5.16% YTD after a negative November, and up 33% since inception in January 2015. The fund is formulaic and fully systematic. It trades liquid exchange-traded futures on 20 commodity markets, futures on G10 currencies, and futures on North American and European government bond markets only. J8 Capital, which has about $52m in AuM, is based in London.

The Eurekahedge CTA/Managed Futures is up 5.6% YTD, and the HFRI Macro: Systematic Diversified Index is up 6.5% YTD - both after a negative November.