MNI Wire

Portfolios:Institutl History Informs MSR Invstmnts'Quant Views

01:45 EDT / Jul 22

-- Manager's Counter-Trend Bets Beat Market Uncertainties

By Suzanne Cosgrove

Chicago (MNI) - After a long career managing big institutional derivatives desks, including Lehman Brothers' in the 1980s, Michael Rulle is running his own shop, weathering the drag of a U.S. debt impasse with counter-trend stock, fixed-income and energy moves.

President and CEO of MSR Investments LLC, Rulle said his managed futures fund's strategy is in a counter-trend mode about 75% of the time, and a trend-following, or directional, mode about 25% of the time.

Rulle said his fund's top risk allocations this week were equities indexes first (S&P 500, Nasdaq, Dow Euro Stoxx 50 and Nikkei 225 futures), followed by fixed income (2-, 5- and 10-year Treasuries), crude oil and the Japanese yen.

Historically, MSR maintains a 61% exposure to equities, 21% to fixed income, 14% to energy and 5% to currencies.

Interviewed on Tuesday, the day that President Obama and the congressional "Gang of Six" gained traction on a deficit agreement that boosted stocks late in the day, Rulle said his fund was long equities going in (a counter-trend move).

"Clearly the market believes there is no chance of a U.S. default given market prices," Rulle said. "How the current debt limit stalemate is resolved will provide only a first signal to markets as to the likelihood of a longer-term, permanent solution in the next year or two."

Although huge, the current U.S. debt tally "is not that crazy," he said. What is more worrisome, he continued, is "what it will be in 10 years if the growth of entitlement spending is not cut."

Rulle added, "Of course, if we simply try to monetize our way out of the entitlement problem, all bets are off."

As for Treasuries, "rates can't stay this low unless you get deflation," Rulle said. Yields will begin rising "when there is a perception that economic growth in the private sector will rise toward normal post-recession levels.

"What is highly unusual about the current economy is record-setting earnings combined with anemic GDP (gross domestic product) growth," he noted.

Expectations for the advance estimate of U.S. second-quarter GDP, set for release next Friday, call for growth similar to the 1.9% pace of the first quarter.

Despite his concerns about the long-term fiscal problems of the U.S., Rulle said he believes the situation in Europe is even worse.

"I have thought the euro has been overvalued for years, but clearly market participants disagreed with that view," he said. "From a purchasing power parity perspective, the euro is overvalued and has been for some time," although one can argue that is a backward looking measure.

"Personally, I have a hard time being bullish on economic growth in Europe -- which can (be) different than equity market performance in a global world -- at least in the medium term," Rulle said. He cited an older European population, earlier entitlement wave, larger debt outstanding and the difficulty of maintaining a centralized fiscal authority as reasons for his view.

MSR uses a proprietary strategy that evaluates the return distributions of a number of futures markets - equities, fixed income, currencies and energy -- over different time frames, picking 10 at a time to trade in the system.

The quantitative program re-weights the portfolio daily, keeping track of as many as 500 strategies at time in order to rotate different trades into the system.

The average length of a trade is about three or four days, Rulle said. His partner, Matthew Brown, operates the portfolio management and trade execution software. The firm's principals met when both worked at hedge fund Hamilton Partners, where Rulle was chief investment officer in the late 1990s.

When Rulle joined hedge fund manager Graham Capital as its president in February 2002, it had about $1 billion in assets under management. Those assets were nearly $8 billion by the time he left in November 2007.

He founded MSR Investments in 2008 and opened the fund to outside investors in 2010. As of June 30, the shop had about $14 million under management.

On a rolling 12-month basis, the fund had an annualized return of 20.65% as of June and annualized volatility rate of 6.62%, according to MSR. The returns assume a 2% management fee and a 20% incentive fee.

While the fund's trades are driven by a quantitative strategy, Rulle's influence is clearly felt.

Rulle's history includes managing swaps, options and other over-the-counter instruments, but he said directional traders have "very little reason to ever trade in the over-the-counter derivatives market.

"Almost any product that is traded over the counter can be replicated with algorithms using the futures markets," he said. "The OTC markets have already moved toward a futures-style framework for some of their more straight-forward products, such as interest rate swaps."

"This does not mean MSR would never trade in the OTC or cash markets," Rulle said. "It is just that at this stage in our development, even as we look out several years, we do not have any compelling reason to do so."

** Market News International Chicago Bureau: 312-431-0089 **