

Patrick Welton, Welton Investment Corporation: “Yield-starved investors in a flat recovery cycle simply can’t afford to confuse a beta manager for an alpha manager”



[Welton Investment Corpora...](#) [1] [United States funds](#) [2] [Managed Futures](#) [3] [Hedge](#) [4]

Dr Patrick Welton, chief executive of Welton Investment Corporation, says the firm’s flagship Global Directional Portfolio programme, which was launched in 2004 and now has some USD1bn in assets under management, aims to capitalise on the full range of investment opportunities available in the global futures markets, spanning multiple asset classes, strategy types, holding periods and directionality.

GFM: What is the history and background of your company, principals and funds?

PW: Welton Investment Corporation was founded by myself and Annette Welton in California’s Silicon Valley in 1988 while I was a postdoctoral physician at Stanford University. Using a suite of proprietary futures strategies, the firm originally traded personal investment capital, but in 1989 the firm began trading client capital, most notably for Commodities Corporation.

In June 2004, the firm’s flagship Global Directional Portfolio programme was launched, a managed futures/quantitative global macro strategy that currently trades about USD1bn. Welton Investment Corporation comprises 21 professionals, including an experienced senior management team comprised of myself and six principals. The Global Directional Portfolio is offered as a managed account and via a Bermuda-based master-feeder fund structure with onshore and offshore vehicles.

GFM: Who are your main service providers?

PW: We’ve been very deliberate when selecting our service providers. Our fund is audited by Deloitte & Touche and our fund administrator is JP Morgan Chase. For added transparency and risk management purposes, we retained Brown Brothers Harriman to execute our cash management policy and directly provide custody to all securities in the fund’s name.

Our fund uses a multi-prime broker arrangement to diversify our risk among a handful of major prime brokers. We also use a third-party risk reporting provider, Investor Analytics, to enhance the quality and credibility of the daily transparency offered via our private client web site.

GFM: What is your distribution strategy and targeted client base?

PW: For the past decade or so, the firm has been keenly focused on developing the necessary capabilities to serve the institutional market. As anyone knows, this choice is much more than a marketing decision – it's an ongoing, firm-level commitment.

For example, when our flagship Global Directional Portfolio programme was launched in 2004, we deliberately designed it with correlation and volatility specs to suit the institutional segment. Over the years we've formalised and refined many of our processes, buttressed our organisational structure with the appointment of an independent director, opened a New York office, developed educationally-focused white papers, and attempted to mitigate risk across the enterprise. It's a multi-year process, but it's the right thing to do because it naturally opens doors across other investor segments as well.

This year we were able to begin capitalising on these efforts. Our firm assets have approximately doubled in 2011, going from about USD600m to USD1.2bn by mid-year. Institutional investors have been a significant driver of that growth, including a large US public pension plan and a large US endowment.

Our growth has been diversified too, however, and that was also always one of our objectives. We're experiencing strong inflows via some of our investors' alternative mutual fund offerings, and we recently began offering two newer products that are also gaining traction.

GFM: What impact has the recent global financial crisis and economic downturn had on your business?

PW: The global financial crisis was a catalyst for growth for the alternatives industry generally, but it was particularly influential for managed futures.

This year hedge fund industry assets under management exceeded pre-crisis highs because investors realised they needed to diversify their equity beta exposure better, and others are seeking yield during this flat recovery period.

Managed futures has benefited from this demand-side shift, too, but it's more than just a tactical yield play. For many, the crisis demonstrated that managed futures is a worthy perennial portfolio holding because the facts illuminated by the crisis were simply too dramatic to ignore.

In 2008, the S&P lost some 38 per cent, while hedge funds lost about 21 per cent. Managed futures indices made 13 to 14 per cent in 2008, and that's what first got people's attention. When they looked closer, however, investors realised that the strategy has delivered equity-like returns with bond-like volatility for two to three decades. Experienced investors knew all this before 2008, but the financial crisis was like an unfolding case study with a global audience.

Consequently, managed futures today is one of the largest hedge fund strategies by assets, but the signs suggest the movement has a ways to go. A steady stream of managed futures-based US mutual funds and Ucits products are coming out every month, Morningstar recently added the strategy to its alternatives taxonomy, and recent investor surveys I've read all identify increasing institutional demand.

From a near-term performance standpoint, the stagnant economic landscape has challenged virtually every hedge fund strategy during 2011, and managed futures has experienced this too. Managed futures indices are about flat so far in 2011, and we are too. This is to be expected, and this temporary market dynamic is dwarfed by the magnitude of the forward investment opportunity that the crisis facilitated.

GFM: Please describe your investment process.

PW: The Global Directional Portfolio was conceived to try to capitalise on the full range of investment opportunities available in the global futures markets, a design consideration consistent

with the programme's absolute return objective.

It does this by employing a broadly diversified portfolio architecture that spans multiple asset classes, strategy types, holding periods and directionality (taking either long or short positions). For example, the programme trades approximately 100 global futures markets and over the counter foreign exchange forward markets, spanning all four major investment asset classes: commodities, currencies, equity indices and currencies.

The Global Directional Portfolio also employs not only momentum strategies, but also mean reversion and fundamental strategy groups – this strategy depth represents a significant differentiator between the programme and traditional CTA and macro offerings). It also trades across a wide variety of trading holding periods ranging from days to several months.

As a sophisticated collection of investment strategies rather than a single strategy, setting the parameters for how these multiple strategies will be combined and weighted is ultimately a qualitative assessment by our portfolio management team. Here, portfolio construction decisions are guided by the programme's clear objective – to deliver increasingly superior absolute return performance while continuing to maintain a near-zero correlation and beta to equities and other hedge fund styles. By maintaining this unwavering focus, Welton hopes to ensure that the programme will continue to deliver the dual traits of alpha plus portfolio-enhancing diversification that investors' value.

GFM: How do you generate ideas for your funds?

PW: Research is performed by a multi-disciplinary group of accomplished individuals with backgrounds in various fields of investment, trading, finance, science and mathematics. This diversity produces inspired ideas for novel areas of research. Ideas also come from the study and analysis of primary demonstrable premiums in the capital markets, translational research from other investment disciplines, and academic literature review.

Refinements to existing strategies are also constantly being considered based on the results of the team's ongoing internal benchmarking efforts. Exploration and re-examination in each area are routine and implicitly part of the investment process.

GFM: What is your approach to managing risk?

PW: We believe risk goes well beyond investment risk. In fact, we've formally identified about a dozen distinct enterprise-wide risks that a firm like ours needs to recognise and actively mitigate. including organisational risk, counterparty risk, financial risk, compliance risk, and business continuity and disaster recovery risk.

We disperse front-line responsibility for monitoring these risk areas throughout the organisation, set up a system of checks and balances, and then our enterprise risk management officer is ultimately charged with big-picture oversight.

We further mitigate investment risk by imbuing our trading strategies themselves with mitigating measures. Our primary method is by methodically diversifying our exposure across multiple non-correlated strategies, about 100 global commodity, currency, interest rate and equity index markets, and trade holding periods ranging from a day to many months. Out of 100 trades, we might make money on only 52, but to us steadily compounding a succession of small gains is inherently less risky than a strategy that relies upon the outcomes of a handful of concentrated bets.

GFM: How has your fund performed?

PW: Our average annualised net performance since June 2004 is about 12 to 13 per cent, with a near-zero correlation to the equity markets, which is in line with our research expectations.

GFM: Are you looking at any particularly attractive opportunities right now?

PW: Our systems are constantly monitoring an entire matrix of capital flow potentials across all of the major asset classes; sometimes the opportunities before us are stronger than others.

GFM: What do investors currently expect from managers, and how do you deal with those expectations?

PW: The demands have evolved over the last two to three years. From an investment perspective, investors want a straight-talk explanation outlining how your strategy generates returns. What is the manager doing to sustain their edge into the future? What are the underlying drivers, and does the manager understand if their methods are harnessing them, or are they just kidding themselves?

The scrutiny being applied to these all-important questions has increased for the better. I think this shift came about after the collapse because so many alternative strategies seemed to be equity beta dressed as alpha. Today, yield-starved investors in a flat economic recovery cycle simply can't afford to confuse a beta manager for an alpha manager.

GFM: How do you view the environment for fundraising over the coming 12 months?

PW: We are optimistic.

GFM: Do you have any firm plans for further product launches?

PW: We don't have any firm product launches planned, but we are examining requests to create products from different combinations of our existing strategies. Our Global Directional Portfolio programme is the product of more than two decades of investment research, and it's comprised of many highly diversified underlying strategies. Consequently, our intellectual property is fairly deep, so investors are increasingly asking us to look at recombining and reweighting some of our strategies to create new products that fit their style objectives.

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