# CTA Spotlight: Buckingham Global Advisors, LLC

## Getting to Know Charles Dai

***Q: Charles, let our readers know a little about yourself and how you became a CTA?***

A: Starting out as a software programmer working in various non-related industries, I subsequently obtained an MBA degree from University of Chicago during the financial crisis of 2008. It was a difficult time for an MBA graduate to look for a job. But fortunately, I witnessed the historical and record-breaking market movements during 2008-2009.

Like many traditional post-MBA students from Chicago, I went to work on the sell side & buy side for many years. My ultimate goal was to start my own trading firm. My studies on the efficient market hypothesis (EMH) from the University of Chicago ultimately inspired my index option trading strategy. I believe that to in order to beat the market consistently one needs to find a market with inefficiencies such as the S&P 500's derivative market. Due to the natural imbalance of supply and demand in puts vs. calls on S&P 500 index options, most major buy side firms are inclined to purchase only put options on S&P 500 in in an effort to hedge tail risk. As a result, put option prices are often driven up. This biased behavior causes the put option to be overpriced approximately 80% of the time (i.e. demand is greater than supply). To capitalize on this phenomenon, I designed a program which only sells put options because in my model, call options are rarely overpriced.

At the University of Chicago, I worked on an option-based quant replication model in an MBA class taught by Prof. Pastor Lubes. Over many years of enhancements and further development, I started to use the model to manage client assets in March 2015, and registered to become a CTA in July 2015.

## Why Buckingham Global?

***Q: How does your trading method work and what is the theory behind it?***

A: We adopt a pure quantitative model which we back-tested over 20 years of S&P 500 data. Based on a number of factors including volatility, price, volume, momentum, etc., the model generates strikes and weights. We typically buy and sell options in a certain ratio; the options we sell have higher implied volatilities while the options we buy have relatively lower implied volatilities. Certain combinations of long and short options yield a more attractive return profile than pure option selling strategies. Both of our options programs, Weekly Emini and the All Season Programs, have adopted this methodology. The Weekly Emini Program is more suitable for bull and/or neutral markets, whereas the All Season Program is for neutral and/or bear markets. Past performance is not necessarily indicative of future results. There is considerable risk of loss trading options and futures.

***Q: In your opinion, how are you different from other CTAs with similar strategies?***

A: Unlike many other option programs, Buckingham Global do not engage in the call side, because our research/model suggests that call side premium does not justify the occasional S&P melt-up, which is typical in bull market. The most recent example is January 2018, when the S&P 500 rocketed up 6% within a few weeks. There are multiple melt-up instances in the past 5 years. Our goal is to make money in those periods, even though we expect that these results will be less than the S&P 500. Of course there is no guarantee that this strategy will not incur drawdowns, and we can never guarantee positive results.

Additionally, Buckingham Global focuses on short, near term options, with 2-8 days to expiration, with the goal being to have those options expire worthless and collect the premium. We usually do not adjust our positions, unlike many of our competitors. The adjustment, in our opinion, cuts both ways. However, we feel the risks outweigh the reward when options are rolled further out in time.

Lastly, we implement a pre-defined trading plan once the position is initiated. We posit that our system predicts when to hedge, and at which level, and when it has to take a loss on particular positions. All of this is executed without human emotion and is completely objective. Our risk management strategy is entirely mechanical and systematic. In our research, we've modeled all possible scenarios during the 1 week option cycle. We stick to a solution in a consistent manner. However, as you know, markets environments can change or adapt, and past performance is not necessarily indicative of future results.

***Q: How much of the decision making in your trading is systematic and how much is discretionary?***

A: We are 80% systematic. Our models give us general guidelines on what strikes to trade in what quantity. 20% discretionary is the timing we put on our position. We usually start on previous week's Thursday, and trade our entire week's positions before the weekend. In high volatility environment, we would delay to initiate the position for a day or sometimes we wait until an important market event to pass, such as job number announcement, Fed decision etc. Exiting trades is done in a systematic way – once our limit gets hit, we exit the position without hesitation. However, that does not guarantee that we will not take losses as we exit. We hope to control the drawdowns and keep them within the parameters of our trading system and risk management.

***Q: How do you manage risk?***

A: We short index futures and long index puts to hedge risk. Short futures are intended to reduce drawdown and provide us time to cut losses, since options are not as liquid as futures in a fast market. Futures can reduce our exposure immediately. Long puts are used to hedge portion of short puts and also sometime makes more money when certain market conditions are met.

In general, we treat drawdown as an "investment", because drawdowns typically create much better environments and opportunities in the future. We see such occasional drawdown as part of our CTA program and never intend to eliminate it. We try to contain the drawdown in a more tolerable level, typically within 10%. Of course, there is no guarantee that this objective will be met.

***Q: Can you describe how you handled the extreme volatility spikes in the first few days of February 2018, when in one day the DOW dropped as many as 1600 points and the S&P dropped over 150 points?***

A: We meticulously followed our trading plan and systematic risk management rules. We lost 6% during the first few days of February, but our risk management worked according to plan in this scenario. By Monday morning, we exited our remaining positions as it hit our risk limit. In our 25 years of back testing, such events, with different magnitudes, occurred on average 1.5 times per year.. We are always looking to prepare for the next large move. We believe that the worst thing to do in such critical times, is to exercise discretion. We do not want to "think" on the spot when the market hits us like it did on February 5th. We cut losses mechanically.

After all, it is a game of statistics - we have 52 times to play each year, we know the odds - we make money the majority of the time, and taking losses is just part of the game. However, past performance is not necessarily indicative of future results. There is considerable risk of loss trading options and futures.

***Q: What type of market environments are good, bad and neutral for you and why?***

A: Uptrend and oscillating markets are best for the Weekly Emini Program. A slightly bearish market is still okay. Markets with sudden VIX spikes are tough to trade but afford opportunities to take advantage of higher premium for future weeks.

***Q: How do you attempt to minimize potentially large losses in your program?***

A: Our goal is to systematically cut losses. Our trading model has analyzed over 1,000 data points of weekly data, and we believe taking frequent losses at certain S&P points lowers the probability of experiencing much bigger losses. We see drawdowns as an "investment" - drawdown creates much better trading environments and opportunities in the future given the mean-reversion nature of S&P's volatility.

## 2018 Outlook

***Q: What is your outlook on the overall market and economy in 2018?***

A: As we turn our attention to 2018, we believe the drivers for the strong market return are still valid. In our opinion, the secular bull market will stay intact but volatility will return for the following reasons:

1. High valuation;
2. A new Federal Reserve Chairman and other personnel changes;
3. Potential tax impacts;
4. Increased inflation and rapid increase in interest rates; &
5. Geopolitical risks such as North Korea tensions.

The equity market has just corrected 10% in the few days of February. As we forecasted at the beginning of 2018, the market's volatility will increase back to historical normal ranges of 15-20 VIX (volatility index). Investors are cautioned not to extrapolate 2017's performance into 2018, with the expectations bar now set quite high heading into 2018.

***Q: What is your outlook for your program in 2018?***

A: We still target 15-20% return after fees. It may not be as an easy sail as 2017's market, so a few turbulent weeks are very much expected in 2018. And of course, there is no guarantee that this objective can be met or that losses will not occur.

Thank you Charles for the interview…..

**Past performance is not indicative of future results.**

**There is an unlimited risk of loss in selling options. You should carefully consider whether commodity futures and options is suitable for you in light of your financial condition.**

**An investor must read and understand the CTA's current disclosure document before investing.**