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Abraham Trading

31 years and just getting started

By Dan Collins

Salem Abraham had his future pretty well sorted out in college when a chance meeting with original turtle trader Jerry Parker set him off in a new direction.

Parker married a cousin of Abraham's and the two struck up a conversation regarding trading and Parker's long-term trend following approach.

The systematic approach appealed to Abraham's penchant for math, and—coming from a business-oriented family from Canadian Texas—he was drawn to the entrepreneurial nature of trading for a living.

His grandfather was heavily involved in the gas and oil business—which Salem figured on working in—but the sector's struggles in the late 1980s had Salem looking at other opportunities.

"I was thinking 'how can I make a living in finance and math.' I also wanted to move back home to Canadian Texas," Abraham says. "My grandfather wanted me to work with him in the oil and gas business, but at the time the oil and gas business had just gone through a shock. The energy markets had dropped by two thirds and a lot of people were going bankrupt."

He began researching futures markets and the trend following approach following discussions with Parker and began trading while still studying at the University of Notre Dame.

His family seeded him with a $50,000 trading account, which he managed to grow to $66,000. "Growing up in an entrepreneurial family that is the way they encouraged us to do something on our own," Abraham says.

His early success did not last, however, as he put on a short Eurodollar interest rate position in October of 1987 just before the market crashed. "They cut interest rates 2.5% following the crash. Eurodollars were up 258 basis points and I was short," He says. "I lost half my money on that trade."

Abraham says the crash caused a 37-standard deviation move in Eurodollars. Decades later he was on the wrong side of another 30+ standard deviation move, after the Swiss central bank removed its peg to the euro currency. "With the Swiss franc move, I was on the wrong side but I only lost 1%. You can see how much better we got in managing risk," Abraham says.

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In between those two major market events, Abraham went from a college kid interested in trading and exploring this new world of systematic managed futures strategies to one of the most successful and longest running commodity trading advisors; thriving and surviving through multiple market environments and adjusting his approach to stay relevant in the ever-changing trading world. Oh, and a husband, father of eight and the head of a multi-pronged business family centered in little Canadian Texas.

“One thing that helped me to survive in this industry is the entrepreneurial spirit that was instilled in me by my grandfather.”

Abraham graduated from Notre Dame in December 1987—a semester early—and with one market crash already under his belt, went on to launch—against his grandfather’s advice, but with his blessing and support—Abraham Trading Company.

“We started with 21 markets and now we are trading 90—a lot of these 90 markets were not in existence when we started,” Abraham says.

His grandfather partnered with him, but famously told him—“of all the ways to lose money, why did you pick the fastest.” But he didn’t lose money, in fact the program earned 142% in 1988, its first year, and double digit returns in each of its first four years. This was the golden age of managed futures—particularly diversified long-term trend followers—when traders took on greater risk and a three-digit return was possible in a strong trending environment.

Abraham Trading grew rapidly, taking in more than $100 million in assets—when that constituted a lot of money. They were similar to a lot of the early trend followers, but maintained a strong allocation to commodities even as their assets grew. The program only produced two down years in its first 17 years of existence and, and 12 of those years produced double digit returns.

However, a flat period in the late 1990s had caused Abraham Trading to lose a great deal of its assets. “In the late 1990s we averaged about 4.5%, what you could earn with T-bills at the time,” Abraham says. “We went from $132 million under management in 1995 to $3.7 million in 1998.”

This was before the industry sought more conservative institutional investors, and many allocators required hefty performance covenants. A large chunk of his allocation came from Commodity Corp—which seeded numerous managed futures programs at the time. They required their managers to average a 30% return over two years—a level that seems preposterous in today’s Sharpe ratio focused investment landscape—and when Abraham Trading missed the mark, they pulled their investment, which caused others investors to leave because, following Commodity Corp’s exit, they became too high a percentage of Abraham’s overall portfolio.

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This was unfortunate because the strategy would produce double digit returns over the next five years.

While Abraham had confidence in his approach and maintained his long-term trend following strategy, he explored innovative techniques in his proprietary trading.

"One thing that helped me to survive in this industry is the entrepreneurial spirit that was instilled in me by my grandfather," Abraham says. "I have done other deals—oil and gas deals, water deals etc.—that has helped my CTA," Abraham says. And what was burgeoning in the futures arena at the time was electronic trading. Abraham was impressed with the Chicago Mercantile Exchange's vision to create electronic markets so he began purchasing memberships in the exchange. He also was one of the first short-term high frequency traders with the launch of E-mini S&P 500 futures. He brought in 20 T-1 lines into his offices in the two-stop light town of Canadian and employed his team to execute arbitrage trades between the E-mini S&P 500 and equity-based exchange traded funds with proprietary money from 1998 through 2005. Abraham, who claims to have made up 1% of that early electronic volume, proudly holds onto a letter that memorializes his unique place as one of the early electronic heavy hitters. Oh, and he did pretty well on his exchange memberships after CME went public. "We recognized that CME would be the dominant player. I made 10X my money on CME stock," he says.

But after a 10% drawdown in 2005 Abraham realized that the new world of institutional investing looked down upon the type of volatility that produced some of the eye-popping returns of Abraham Trading and other early trend followers.

Abraham began researching multiple approaches and dialed down the volatility of his program in 2006. He added short-term trend and momentum strategies to his long-term trend following approach. In 2007 he added a stock index and a mean reversion strategy. This also allowed him to dial down the leverage as well. "From 2006 to 2008, we implemented all these different models and we averaged just short of 20%, but our volatility was down at 11 and that is where we have been since 2006. Our volatility prior to 2006 was about 32% annually, double the volatility of stocks," Abraham says.

"Just because you haven't had a flat tire in the last 10 years doesn't mean you take your spare out of your trunk and put it in your garage

While Abraham Trading added a stock index component, they are very careful not to produce equity market beta. "We avoid long stock exposure. One of my worries is over exposure to beta," Abraham says. "We saw that in January and February of this year and in October when stocks [corrected] and some CTAs got sucked into that. Because of our limitations on long stock exposure we didn't get pulled in."

Abraham understands that what he is offering is an alternative to traditional investments. "The reason people want us in their portfolio is they want diversification from long equities so we are really careful not to have too much exposure in our portfolio," he says. "There are some CTAs who have introduced beta, it is actually helpful from a Sharpe ratio standpoint, but it is not helpful when you are put in a bigger portfolio when they already have stock exposure."

He points out that equity markets have been sending signals that stocks could have made a top, but emphasizes that you need portfolio diversification regardless. "Just because you haven't had a flat tire in the last 10 years doesn't mean you take your spare out of your

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trunk and put it in your garage," Abraham says. "You always want your portfolio built in a way that it can survive a hurricane, whenever the hurricane comes."

Abraham Trading has been unique—even among systematic trend followers—in its commitment to commodities. They maintain about a 55% exposure to commodities that has served it well, especially with other managers overexposed to financial markets. "We particularly like the extra commodity exposure in this environment of heavy-handed central bank [activity]," Abraham says.

He points out that their strong performance in 2014 was due to its exposure to meats and milk. While others CTAs benefited from a strong fourth quarter move in financial markets, they performed well throughout, earning 21.27% on the year.

"The vulture is a patient bird; just give it time, crap is going to go wrong."

He says there is an internal debate among managers over whether to strive for a stronger individual Sharpe ratio or the Sharpe ratio of your client. He suggests that it is a mistake to only look at you risk metrics and not what you are providing to a larger portfolio.

He compares it to his pancake recipe.

"It has flour, milk, sugar, eggs and baking powder. Baking powder tastes horrible. If you taste test everything before you put it in, you would say don't put in any baking powder and I'm not sure I want the eggs, but I love sugar and let's include milk," Abrahams says. "You don't taste test every product before you put it in, you want to see what it is going to do to the end product. My end product has to be good. This baking powder helps the pancakes be nice and fluffy and I like nice and fluffy. So you put things in your portfolio with a purpose and that is where the CTA space and global macro are so helpful. And where long/short equity is not so helpful because often long/short equity doesn't give you the diversification that you are looking for."

Despite a long successful track record Abraham Trading, along with the broader managed futures space, is going through its longest period of poor performance.

"The last 10 years have been incredibly crappy, the worst I've seen," Abraham says. "The question is, is something broken? Have markets changed? I don't think it is different; we have had a very quiet period the last 10 years. When I started in 1988, we had a drought. When I look at our biggest years it has been a drought, a war, another war and financial calamity. When I look at the next good years there were minor calamities, like an orange juice freeze, a big glut in cattle, a squeeze in the base metals or a grain disruption in China."

Abraham points out that it has been a relatively quiet period in terms of market disruptions since the "Great Recession" and is worried investors may have become complacent.

Abraham pointed out that one of the greatest attributes of managed futures is that is one of the very few investments that tend to do well when everything else is getting whacked.

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"The vulture is a patient bird; just give it time, crap is going to go wrong. That is what people need to remember," Abraham says. "And when the crap hits the fan it is not evenly distributed. You have to give yourself the opportunity to make money, which is going to help offset the money you're going to lose elsewhere."

Abraham has managed to combine two important elements of successful trading that often seem to be counterintuitive: The ability to maintain consistency and stick to a successful strategy while also continuing to innovate and improve your approach. With this combination, Abraham Trading may still be around for another 31 years.

ABRAHAM TRADING COMPANY

Company Name: Abraham Trading Company
Strategy Type: Trend following
Portfolio Manager: Salem Abraham
Location: Canadian, TX
Inception Date: January 1, 1988

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