

Managed Futures Market Review

MANAGED FUTURES PERFORMANCE

Managed futures CTAs started 2010 on the right foot. Returns were modestly positive, although performance from one manager to the next varied widely depending on each program's strategy, investment time frame, position concentration, and margin to equity. For the quarter, CTAs returned approximately 3.02 % as measured by the Altegris 40 Index (see **Figure 1**).

Figure 1

Managed Futures Performance vs Indices

	2008 & 2009 Returns			20 Year Returns April 1990 - March 2010			
	Q1 2010 Return	2009 Return	2008 Return	Total Return	Ann ROR	Std Dev	Max DD
Altegris 40	3.02%	-7.98%	15.47%	437.64%	8.77%	12.09%	-15.00%
HFRI Fund Weighted Composite	2.57%	20.00%	-19.03%	894.63%	12.17%	7.04%	-21.42%
S&P 500 TR	5.38%	26.45%	-36.99%	426.40%	8.66%	14.98%	-50.95%
Barclays Aggregate Bond	1.78%	5.93%	5.24%	297.84%	7.15%	3.84%	-5.15%
MSCI EAFE - Net	0.85%	31.78%	-43.39%	182.19%	5.32%	17.24%	-56.68%
NAREIT Composite Total Return	9.47%	27.79%	-37.84%	561.18%	9.90%	18.82%	-68.17%
GSCI Total Return	-0.90%	13.67%	-46.49%	138.06%	4.43%	21.82%	-67.65%

SOURCE: International Traders Research (ITR) INDICIES: Altegris 40: Altegris 40 Managed Futures Index; HFRI Fund: HFRI Fund Composite Index; S&P 500: S&P 500 Total Return Index; US Aggregate Bond: Barclays US Aggregate Composite Bond Index; MSCI EAFE: MSCI EAFE Composite Index; NAREIT Composite: NAREIT Composite Total Index; GSCI Total Return: GSCI Total Return Index. There is no guarantee that any investment product will achieve its objectives, generate profits or avoid losses. PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

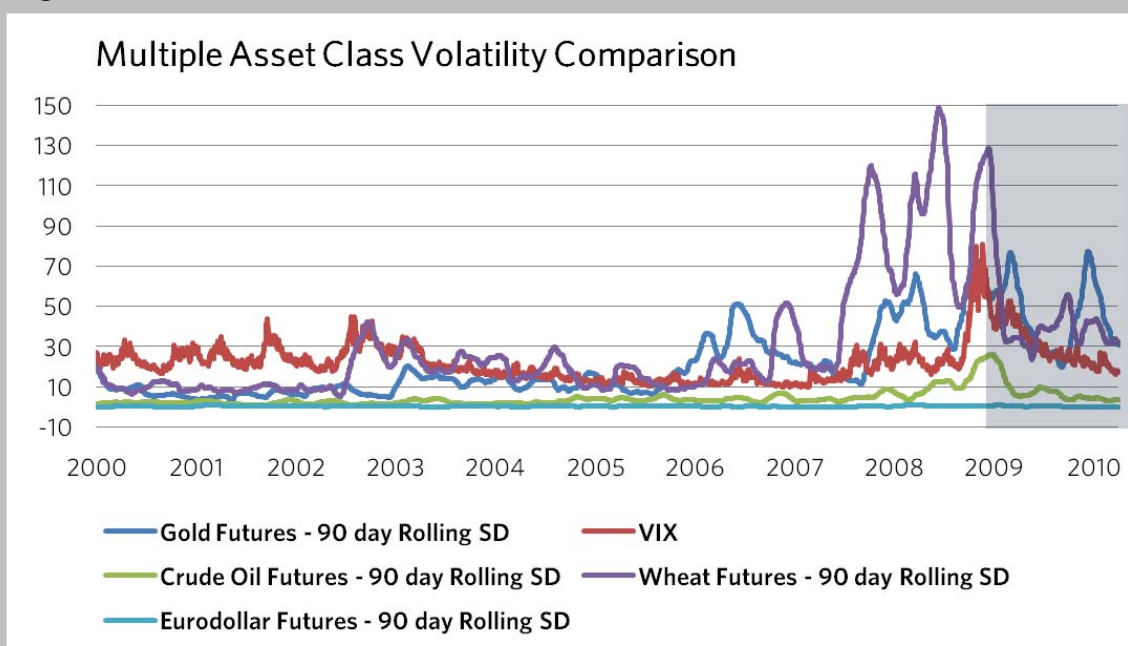
In past letters, we've opined on the macro economy, and how the difficult environment for managed futures in 2009 was borne from macro related uncertainty. Whether it is the threat of hasty US policy shifts, Greece's credit woes, the rise and fall of the US Dollar ("USD", representing the US Dollar Index and/or the US Dollar compared to a basket of other currencies) or Chinese monetary tightening, the macro economy is still rearing its ugly head despite improved returns for the managed futures asset class. In this letter, we will discuss each of the three primary managed futures strategies and delve into their macro and fundamental performance drivers for the first quarter of 2010.

1. Short Term Systematic

Due to their idiosyncratic nature, short-term systematic managers are the least similar to each other of all the managed futures strategies. Still, these programs all need some degree of price persistence to make a profit. For some managers this may be only two days of persistence, while for others it could be two weeks. However, many markets traded in tight ranges throughout the 1st quarter, making it difficult for many programs to capture profits.

The single greatest impact on performance for short-term managers has been the massive contraction in volatility across multiple markets. As represented in **Figure 2**, since Q4 2008 through the end of Q1 2010, volatility across markets contracted precipitously, albeit to more normal levels relative to history. Q1 2010 was notably difficult for two common short-term managed futures sub strategies: volatility breakout and mean reversion managers.

Figure 2



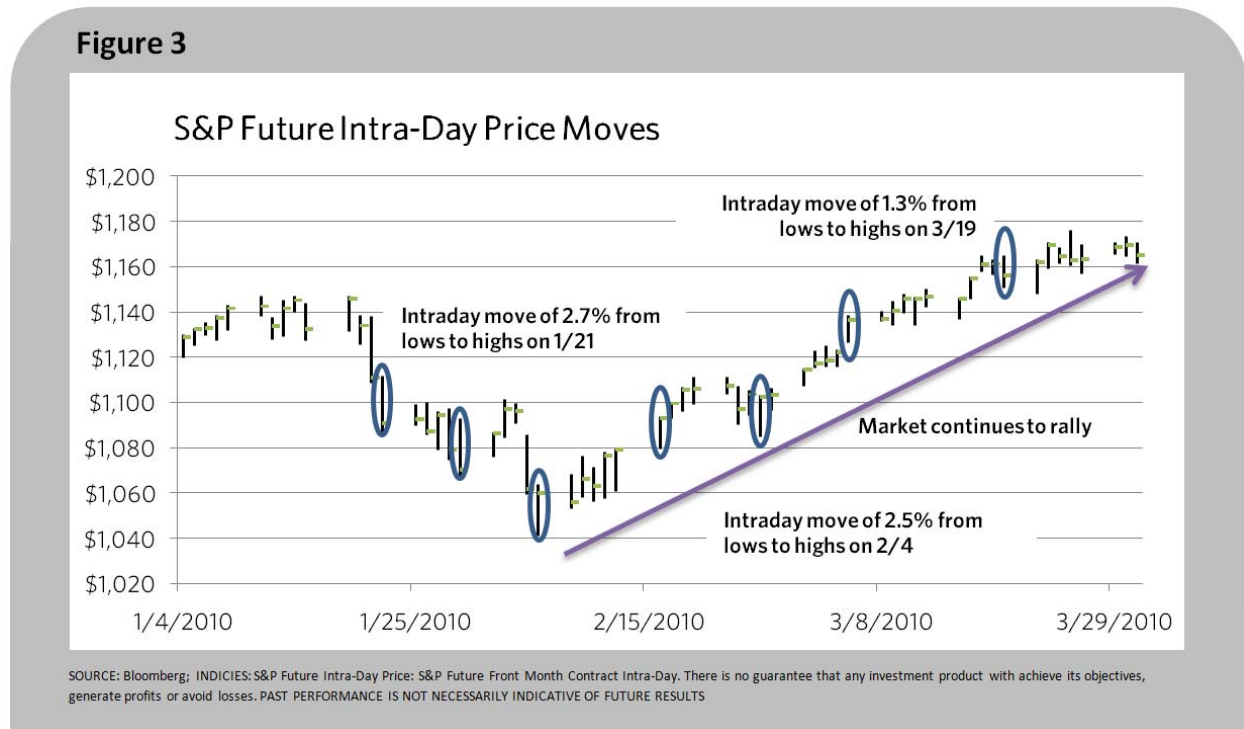
SOURCE: Bloomberg; INDICIES: Gold Futures: Gold Front-Month Futures Contract; Crude Oil Futures: Crude Oil Futures Front-Month Futures Contract; Eurodollar Futures: Eurodollar Futures Front-Month Futures Contract; Wheat Futures: Wheat Futures Front-Month Futures Contract. There is no guarantee that any investment product will achieve its objectives, generate profits or avoid losses. PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

• **Volatility Breakout Short Term Managers**

When volatility is declining, returns deviate from average returns only slightly, leading to tight trading ranges across markets. Recurrent reversions to the mean led to many systems frequently hitting stops, leading to losses. Volatility contraction can be difficult for long-term trend followers as well, but in Q1 longer-term trend following managers did not hit their stops as frequently as their short-term brethren. Short-term managers with volatility breakout systems were hit particularly hard. Periods of volatility breakouts allowed their systems to increase positions. Nevertheless, these breakouts rarely followed through: positions were bought on the contraction, price persistence followed minimally, and then reversals led to stop outs.

• **Mean Reversion Short Term Managers**

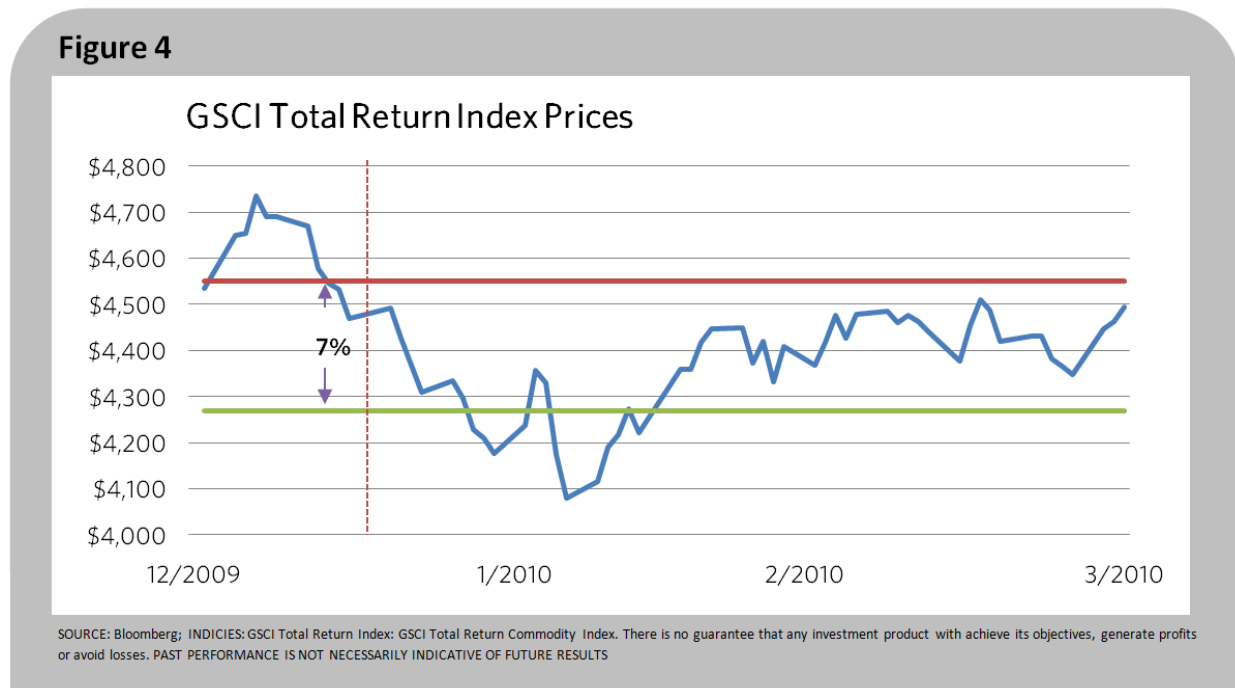
Q1 was also a difficult period for mean reversion managers, particularly those invested in stock indices. March was especially challenging as prices ebbed and flowed intraday, but interday the market marched higher and higher. Programs that look for reversions to the mean after a several day period were stopped out too early to see their positions realize any value. In **Figure 3**, you can see that out of the 23 trading days in March, S&P futures were up 18 of those days, resulting in an approximately 6% return for the month. However, on an intraday basis, there were several reversals.



2. Discretionary CTA

In 2009, many markets were negatively correlated to the direction of the USD, and in a big way. While USD correlation seems to have subsided this year, and tried and true fundamentals appear to be resurfacing, it was still a difficult quarter for discretionary commodity managers. Just when managers were becoming more comfortable with the less macro-influenced environment, their sense of security was thwarted by Chinese macroeconomic policy. The Chinese Central Bank announced on January 12th its first of a series of tightening measures to quell their booming economy.

Fearing Chinese demand may falter and slow growth globally, the S&P 500 GSCI Index inched its way down until early February, when prices rebounded due to a more sanguine US unemployment report. Since then the market has trended up slightly, but in an uneven manner. As delineated in **Figure 4**, commodity prices, as defined by the GSCI, have traded in a choppy 7% band throughout the quarter, with prices ending the quarter near where they started.



Clearly, commodity market prices are still greatly influenced by the macro landscape. Nonetheless, each quarter our managers are seeing a modest return to fundamentals, albeit slower than expected.

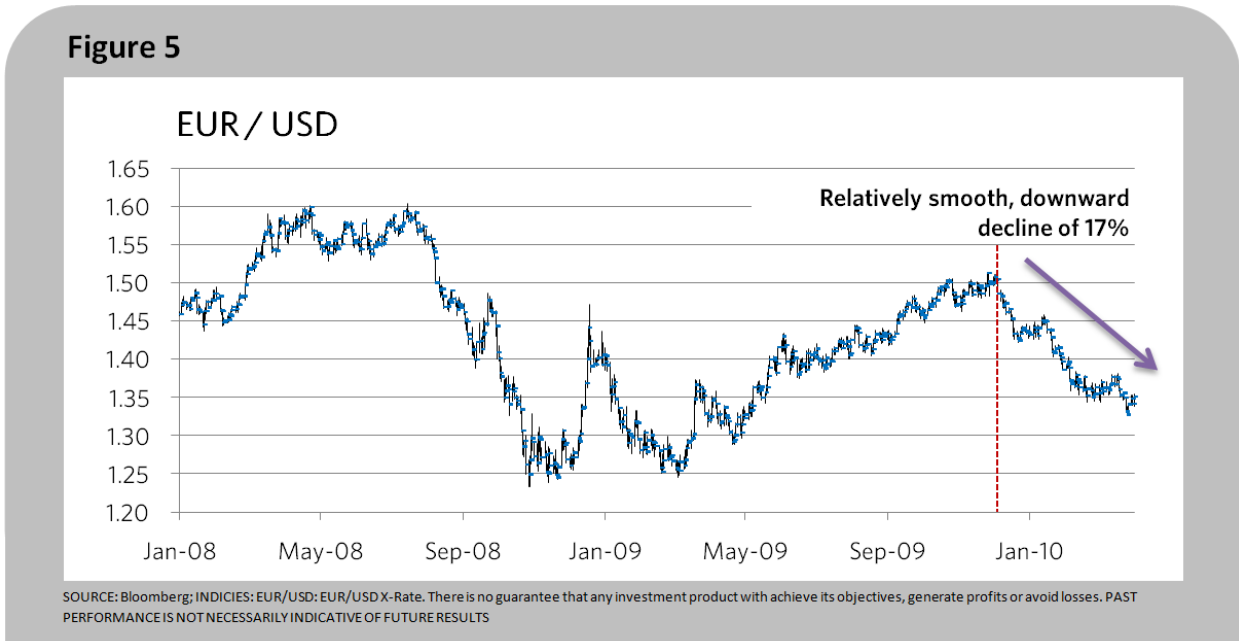
As economies eventually emerge from the recession, as emerging market demand picks up, and as USD correlation continues to weaken, we are optimistic about commodities as an asset class from both a macro and fundamental supply and demand perspective over the long term. In our opinion, the best way to gain exposure to commodities is through managed futures CTAs, which can be both long and short various commodity futures contracts. Unfortunately, we have no crystal ball telling us exactly when the current tight trading ranges across commodity markets will subside. This is where we rely on our managers to trade the current markets wisely, but with an eye towards the future.

3. Trend Following

Trend following is the largest component of the managed futures asset class, representing approximately 80% in the Altegris 40 Index as of March 31st. You may have seen a piece we recently published entitled, [Is the Trend Your Friend?](#) Clearly, 2008 was the best of times for trend following, whereas 2009 was a difficult year that lacked significant trends. 2010 thus far has started to show some promise. While not all markets were trending over Q1, certain markets showed the propensity for longer-term trend development - a positive for managers in the space.

• **The Euro's Decline**

The most profitable trade for most managers in Q1 was short EUR/USD. The Euro has been declining rather steadily since the end of last year versus the USD, the Aussie Dollar, Swiss Franc, and the Yen as news regarding the PIIGS (Portugal, Ireland, Italy, Greece, and Spain) sovereign debt concerns reverberated throughout the markets. Greece's staggering deficit in particular seemed to cause investors to lose faith in the Euro. Additionally, the USD has been a safe haven for investors avoiding the Euro's weakness due to its reserve currency status. As you can see from **Figure 5**, this trend has persisted long enough to enable trend following programs to participate, and their participation over Q1 has been quite profitable.

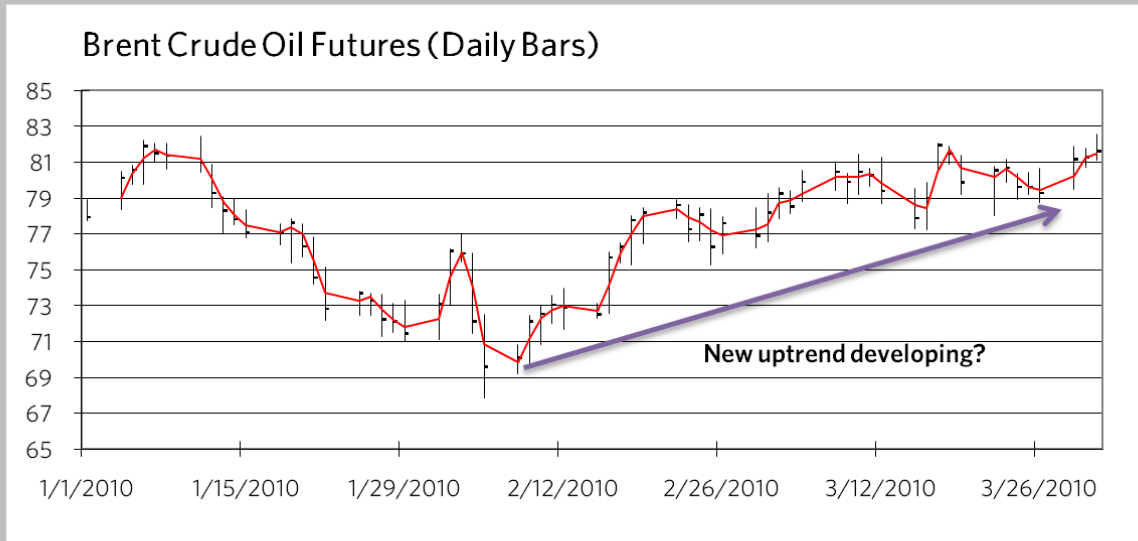


On March 26th, the European Union and the International Monetary Fund publically agreed to bail out Greece, providing some short-lived support to the ailing currency. However, just exactly how the EU and IMF plan to aid Greece and its other indebted neighbors so far remains in question, causing ongoing volatility within a prevailing downward trend. However, a sustainable and believable bailout package may prompt a trend reversal.

• **Choppy Energy Markets**

For the quarter, one area that seemed to frustrate many trend following programs was energy; crude oil in particular. In January, upward trends in energy persisted just long enough for trend following systems to buy into the market, only to find themselves stopped out shortly thereafter as the trend reversed the other way. The January 14th announcement by the CFTC to reduce speculation in the energy markets as well as continued concerns over the US economic recovery led to uncertainty, and continued choppiness through mid February. However, much of that chop abated around February 10th. Front month crude oil futures recovered to nearly \$80 a barrel from its February lows of \$70 a barrel. While March was also choppy, the general trend in energy seems to be largely positive, see **Figure 6**. We suspect this trend will continue if positive macro news out of Europe and the US persist, and as investors consider seeking riskier assets.

Figure 6

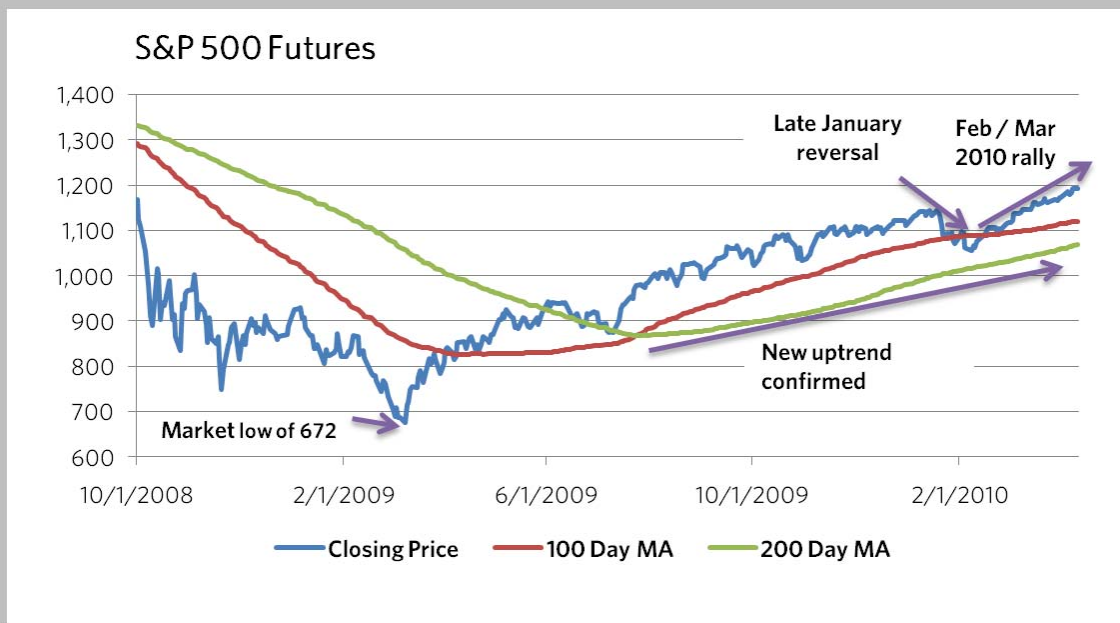


SOURCE: Bloomberg; INDICIES: Brent Crude Oil Futures Index: Brent Crude Oil Futures Front-Month Futures Contract. There is no guarantee that any investment product with achieve its objectives, generate profits or avoid losses. PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

• **Equities Trend**

Longer-term trend followers generally need a noteworthy period of price persistence before they enter into positions. We witnessed this last year as many managers took their time unwinding their short stock index positions from the credit crisis and transitioning to long stock index positions, despite the fact that the market had been rallying since its March 2009 lows (see **Figure 7**). Stock index exposure eventually increased for many managers at year-end 2009, and as a result, many trend followers were long stock indices going into January 2010. Half way through January, it looked as if a continued uptrend along the equity curve was beginning to take shape. However, towards the end of the month, concerns over sovereign risk in Greece sent global equity markets in the other direction, creating losses in stock indices across the majority of trend following programs. Unlike energies, many trend followers were fortunate to avoid getting stopped out of their stock index long positions. Instead, many stayed long stock indices despite the market’s reversal, and made back much of their losses in February and March. Since February 5th, the S&P 500 has shown a strong technical uptrend, although it remains to be seen whether this uptrend will show continued persistence.

Figure 7



SOURCE: Bloomberg; INDICIES: S&P 500 Futures Index; S&P 500 Futures Front-Month Futures Contract. There is no guarantee that any investment product will achieve its objectives, generate profits or avoid losses. PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

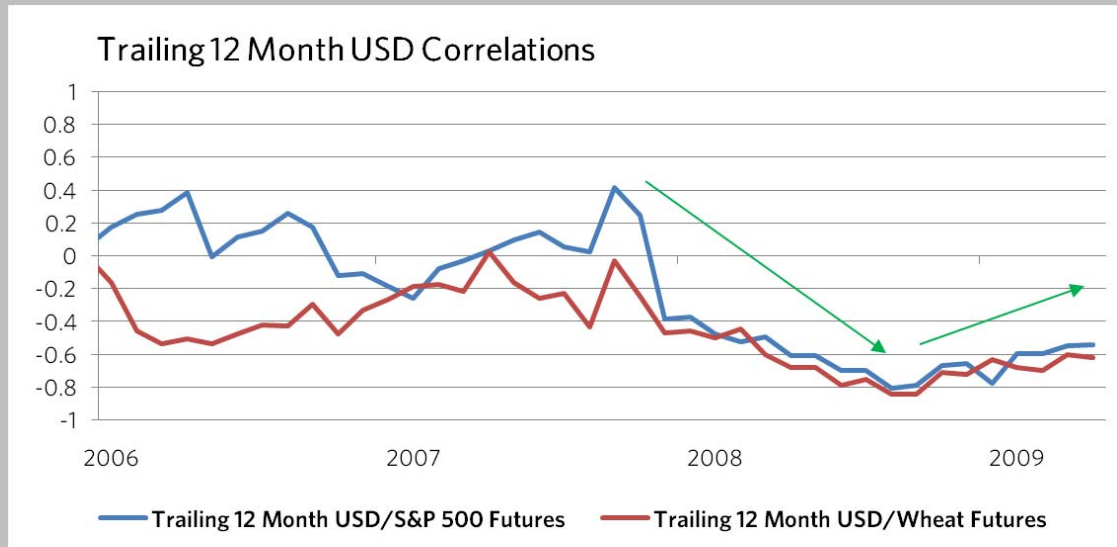
CORRELATIONS & TREND FOLLOWING

Markets that are highly correlated to one another frequently present adverse conditions for trend following managers. This is because if one market were to rise or fall, the others tended to rise or fall in tandem; a unitary bet with little diversification benefits. Logically, trend following managers tend to perform well when correlations between markets aren't high. When correlations are decreasing, trends that do exist are often mutually exclusive.

For quite some time now, a strong negative correlation has been particularly true with commodities and the USD. The USD has a natural inverse relationship with commodities such as wheat, which is represented in **Figure 8**. This is because as the USD depreciates 1) dollar-denominated assets such as commodities rise as fears of inflation drives capital into the commodity markets 2) many commodities are USD denominated, therefore when the dollar falls, the commodities are cheaper, thus incentivizing buyers and increasing demand. In 2009, cross-market correlations were especially high, and many systems were initiating similar long commodity / short USD trades as a result. Consequently, many trend following programs reigned in risk last year due to the strong negative correlation between the USD and other asset classes.

Likewise, a strong negative relationship also existed between the USD and stock indices, particularly in 2009. When looking at stock indices in 2009, it was often the case that as the USD weakened versus a basket of other currencies, the equity market rose. Towards the end of 2009 through the beginning of 2010, this market condition has shown significant signs of decoupling, with trailing 12-month correlations between S&P 500 futures and the USD Index moving from -0.72 at the end of 2009 to -0.50 by the end of Q1, a change of nearly 30%. Looking at the graph below, you can see the strong inverse trend developing between the USD Index and the S&P 500 futures over 2009. Towards the end of 2009 and the beginning of 2010, the strong negative correlation began to weaken.

Figure 8



SOURCE: Bloomberg; INDICIES: S&P 500 Futures Index: S&P 500 Futures Front-Month Futures Contract; Wheat Futures Index: Wheat Futures Front-Month Futures Contract. There is no guarantee that any investment product will achieve its objectives, generate profits or avoid losses. PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

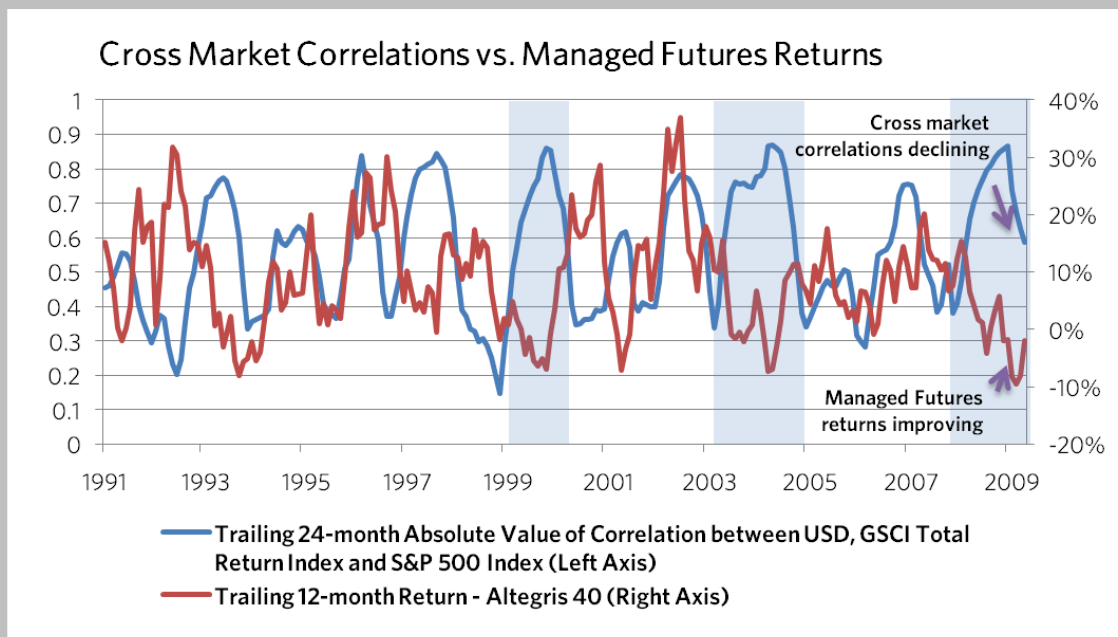
The recent decoupling of USD correlation has been a short-term phenomenon, and we are not yet sure if it is sustainable. However, it has been enough of a shift to markedly impact market exposure signals for trend following models. As the strong negative correlation between the USD, commodities, stock indices, among other asset classes receded in Q1 2010, margin to equity has gradually increased for many programs. This is because, all else being equal, trend following programs are generally designed to take more risk in markets that are idiosyncratic, and less correlated. If the trend indeed becomes our friend again, increased risk taking can be beneficial since persistent trends may result in amplified positive returns.

OUTLOOK

We discussed thus far that when cross-market correlations are high, managed futures tend to underperform. Conversely, when these correlations decouple, performance of managed futures as an asset class tends to perform quite well.

We took this analysis one step further, and looked back at correlations between the USD, the S&P GSCI Commodity Index and the S&P 500 to see just how correlated the USD, commodities and the stock market were to each other on a trailing 24 month absolute basis. We then compared these correlations with trailing 12-month returns for managed futures, as represented by the Altegris 40 Index (see **Figure 9**).


Figure 9



SOURCE: Bloomberg; INDICIES: S&P 500 Index; S&P 500 Index; Altegris 40: Altegris 40 Managed Futures Index; GSCI Total Return Index; GSCI Total Return Commodity Index. There is no guarantee that any investment product will achieve its objectives, generate profits or avoid losses. PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

You can see that it was often the case that during periods when cross-market correlations are extremely high (see blue line), such as in 2000, 2004, as well as 2009 (see shaded areas above), managed futures performed at their historic lows. Likewise, when cross-market correlations are declining, managed futures have often performed well. This relationship has held up well over certain periods; however, there is no guarantee this relationship will continue to hold in the future.

Fortunately, so far in 2010 cross-market correlations have come down considerably. From a peak of 0.87 on a trailing 24-month basis towards the end of 2009 to approximately 0.60 as of March 31st, cross market correlations have declined nearly 32%. At the same time, managed futures performance has begun to improve, as delineated by the red line above.

We certainly cannot guarantee that cross-market correlations will continue to decouple, nor can we promise managed futures returns will continue to improve. Markets are still heavily influenced by the macroeconomic landscape, and the investment environment in general is still uncertain, although optimistically so. Recent short-term returns can be encouraging; however, we cannot reiterate enough that an investment in managed futures is a long-term venture that has thankfully proven its worth over time. 

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The risk of loss in trading commodities can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. In considering whether to trade or to authorize someone else to trade for you, you should be aware of the following:

If you purchase a commodity option you may sustain a total loss of the premium and of all transaction costs.

If you purchase or sell a commodity future or sell a commodity option you may sustain a total loss of the initial margin funds and any additional funds that you deposit with your broker to establish or maintain your position. If the market moves against your position, you may be called upon by your broker to deposit a substantial amount of additional margin funds, on short notice, in order to maintain your position. If you do not provide the requested funds within the prescribed time, your position may be liquidated at a loss, and you will be liable for any resulting deficit in your account.

Under certain market conditions, you may find it difficult or impossible to liquidate a position. This can occur, for example, when the market makes a "limit move."

The placement of contingent orders by you or your trading advisor, such as a "stop-loss" or "stop-limit" order, will not necessarily limit your losses to the intended amounts, since market conditions may make it impossible to execute such orders.

A "spread" position may not be less risky than a simple "long" or "short" position.

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As a result, there exists a conflict between Altegris' interest in maximizing the commissions and fees paid by you (in which it will participate) and your interest in minimizing those commission and fees.