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HOW MUCH SHOULD YOU ALLOCATE TO MANAGED FUTURES?

November 3, 2008

With the record of various asset classes so far this year abysmal for everything but managed futures (check the YTD numbers in our last newsletter here), many people have been calling Attain saying they get it.

These investors get that managed futures can be a great diversifier. They are saying they want exposure to managed futures, they want the diversification, they want to be able to go long AND SHORT commodities (something criminally lacking from the bevy of commodity funds and ETFs which popped up over the past two years), and so on…….. But, a few have said – Attain hasn't covered one big question……

And that question is; "How much should I allocate to managed futures?" If you're ready to diversify, what percent of a total portfolio should and or could be allocated to managed futures?

This is a great question, and one that is frankly asked too rarely. We all hear about diversification, and many put a managed futures program, hedge fund, or commodity ETF to work in their portfolio. But the devil, as always, is in the details. Are you allocating enough to your portfolio's "diversifier"? Are you allocating too much?

As you can see, the seemingly simple question of how much to allocate becomes rather complex rather quickly. Allocate too much, and you could be increasing the overall risk for the portfolio. Allocate too little, and the diversification may not have enough punch to actually offset a crisis period like we're in right now.

A study done by the Chicago Mercantile Exchange many moons ago, attempted to tackle this problem for the average investor by publishing a study on the effect differing allocations to the Managed Futures asset class have on a so called traditional portfolio (stocks & bonds).

The graph below from the Chicago Board of Trade shows that a traditional portfolio (55% stocks, 45% bonds, and 0% managed futures) presents an investor with the greatest risk and lowest returns. This is what anyone reading this newsletter would expect (especially recently), and is the whole reason for seeking out alternative investments which can both increase the return and reduce the risk.

As you can see in the table below, as incremental amounts of managed futures are added to the portfolio, the return increases as the risk decreases (just what we're looking for) up to the point where a portfolio comprised of 45% stocks, 35% bonds, and 20% managed futures offers an investor the greatest returns and least amount of risk.

After that level, things start to go the other way, with increases in return coming at the expense of increases in risk as well. The ideal portfolio is an efficient one, where you can get the maximum amount of return for the lowest amount of risk; and indeed this type of graph is called an "efficient frontier" chart.

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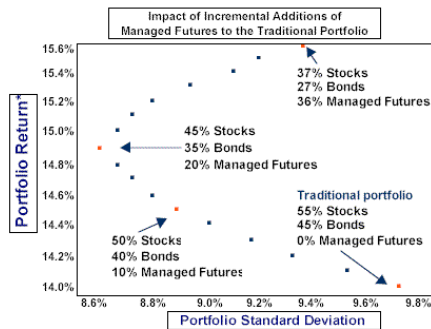

So that's it? The answer is 20% towards managed futures? Not so fast. It unfortunately is not as easy as simply looking at the past return data and generating an efficient frontier.

For starters, the data is dynamic. The CME's study above was from back before the internet bubble burst, and represents much higher average stock market performance. Running the same study today, after managed futures have been steadily outperforming stocks, sees the efficient frontier having moved significantly. When using data up through the end of October, the data now shows the ideal portfolio as 40% stocks, 20% bonds, and 40% managed futures. (a doubling of the allocation).

So is this the answer – 40% of a portfolio in managed futures. That could be part of the puzzle, but take a closer look at the numbers in the updated efficient frontier chart above. We're talking about compound annual returns of just 5% at the ideal portfolio mix level, at the efficient frontier. So while this may be the mathematically correct level (based on past data, and assuming your other investments are just stocks and bonds), it may not be the so called efficient frontier for your portfolio. Many investors are willing to take on more risk than that for some extra return, and if we actually look at the Barclay's managed futures index performance versus the S&P 500 performance from 1994 to the present, we can see that the returns are about equal, but that the managed futures index has much less volatility in returns. (nearly half the volatility at 8% vs 15%). Past performance is not necessarily indicative of future results.

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Compound ROR	'94-Oct 07	'94 - Oct 08	Difference
Bonds	3.84%	3.86%	0.02%
Cash	4.07%	3.94%	-0.13%
Commodities	4.77%	1.86%	-2.91%
Managed Futures	5.83%	6.06%	0.23%
Hedge Funds	11.11%	9.51%	-1.60%
Real Estate	13.98%	8.93%	-5.05%
US Stocks	10.98%	6.89%	-4.09%
World Stocks	8.90%	3.63%	-5.27%

Risk (Volatility)	'94-Oct 07	'94 - Oct 08	Difference
Bonds	5.24%	5.43%	0.19%
Cash	0.46%	0.47%	0.01%
Commodities	9.30%	13.19%	3.89%
Managed Futures	7.96%	7.90%	-0.06%
Hedge Funds	7.53%	7.71%	0.19%
Real Estate	14.06%	16.97%	2.91%
US Stocks	13.98%	14.96%	0.98%
World Stocks	13.50%	15.32%	1.82%

Risk/Reward Shift

There is something else interesting going on in this table showing the risk and reward characteristics of various asset classes. The table above shows the risk and reward profile of various asset classes for the 13 years ending from January 1994 to October 2007 (right before the credit crunch took root) as compared to the 14 years ending October 2008.

You would not expect a single year to have much affect on numbers compiled over 150+ months of data, but we can see that some dramatic shifts in risk and reward have occurred in the past year. The average returns for everything except managed futures and bonds have come down dramatically (world stocks being cut in half, from 8.9% to 3.6%), while the risk (as measured by volatility) has increased dramatically for these same asset classes. This can be seen better graphically in the chart in our chart of the week section below. The Risk/Reward Shift chart shows the current level of return per unit of risk (as measured by volatility), with the same assets risk/reward levels as of October 2007 also listed.

The chart clearly shows a significant shift lower (less return) and to the right (more risk) for hedge funds, real estate, commodities, US and World Stocks. For anyone putting together a diversified portfolio including these pieces, this is clearly disturbing, as the goal on the efficient frontier chart is just the opposite - to go up and to the left (more return, less risk).

Things will definitely oscillate back the other way, perhaps resulting in some higher returns for asset classes such as US stocks (and hedge funds, in my opinion), but it will be very difficult for each of these asset classes to "work off" the increased risk which is now part of their profile. That increase in risk is the troubling part for portfolio builders who are looking at reducing portfolio volatility, as it isn't likely to change back after a bounce back to the upside (it may even increase depending on the size of the bounce). That leaves them with only one option, mathematically speaking, to lower portfolio volatility, and that is adding higher amounts of those assets which have lower volatility.

For this reason, many investors are allocating higher amounts than usual to managed futures. With their historical risk roughly equal to hedge funds, and only behind cash and bonds in terms of low volatility; the risky world of futures trading is becoming a safe haven of sorts for investors seeking safety from the record high volatility (risk).

So what is the proper answer? What percentage of a total portfolio should be allocated to managed futures? Unfortunately there is no singular answer which will work for everyone. We have some clients who have upwards of 75% of their portfolios in managed futures in this environment. And while that has historically been a very high number which would result in higher portfolio risk for sure, with only the hope of higher portfolio returns, it is actually right in line with what the efficient portfolio calculates as the ideal weighting from Nov 2007 through October 2008. Over that short period, the efficient portfolio was 85% towards managed futures and 15% cash.

But unless you will be readjusting your portfolio very frequently, we don't recommend using a time period as short as 1 year for calculating your efficient frontier. In fact, if we had looked at the 13 year period ending October 2007, the efficient frontier would have told us that 80% of assets should be in hedge funds, and 20% in real estate. That obviously wouldn't have worked out well over the past year, as real estate has crumbled and hedge funds have had their worst period perhaps ever.

The best advice we can probably give is to balance out your portfolio as evenly as possible between the major asset classes – Bonds, Cash, Commodities (long only), Managed Futures, Hedge Funds, Real Estate, US Stocks, and World Stocks – to form a base portfolio. From there, try and retain enough flexibility to increase allocations in areas which are outperforming (such as managed futures right now) and decrease areas which are struggling (such as World Stocks).

So an aggressive investor may be looking at an allocation of 50% or more to managed futures during this prime environment, while a more conservative investor may only be looking at taking the 5% or 10% which she has moved away from stocks and reallocating that to managed futures to bring its total exposure up to around 20%.

In the end, it's a personal choice based on what else you have in your portfolio, and where you think we're headed in terms of market conditions.

- Jeff Eizenberg
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IMPORTANT RISK DISCLOSURE
Futures based investments are often complex and can carry the risk of substantial losses. They are intended for sophisticated investors and are not suitable for everyone. The ability to withstand losses and to adhere to a particular trading program in spite of trading losses are material points which can adversely affect investor returns.

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Chart of the Week : Efficient Frontier Graph - showing the effect of incremental additions of managed futures to the traditional portfolio

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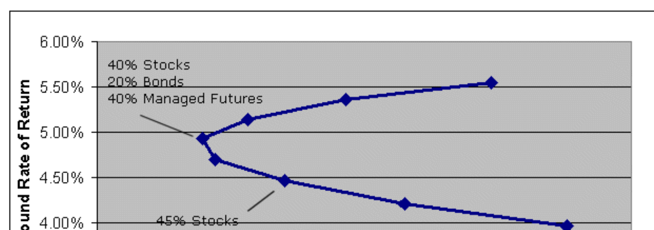

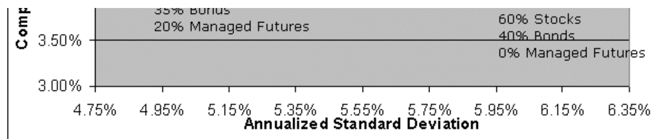

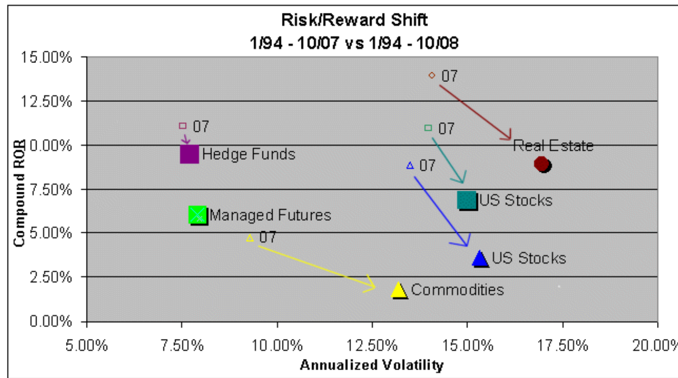

IMPORTANT RISK DISCLOSURE
The graphs and tables above are intended to be examples and exhibits of the educaitonal topic discussed above. They are for educational and illustrative purposes only, and do not represent trading in actual accounts.

The Week in Review: Red October sees losses across the board

Overview

Perhaps the fear of October every year following the 1987 October crash was warranted after all. This October was a crash of a different kind, where nearly all assets and markets sectors were under heavy selling pressure on concerns of a possible global recession becoming a reality. The selling started in global equity markets and worked its way through nearly all futures markets, particularly physical commodities. The only silver lining was a small bounce in stocks and commodities in the last week of the month, but only time will tell if the downward trends will continue or if we have truly hit a bottom.

While many people may think the stock market was the worst performer in October, there were actually worse performers, such as Unleaded Gasoline losing -38% and Crude Oil seeing its largest ever monthly point and percentage loss (-30%). These are monthly numbers, remember, even though they seem like large annual-type numbers.

Not far behind energies was the metals complex, which saw heavy selling in industrial metals on the basis of weakening demand due to a global slowdown. High Grade Copper was down a smooth -36% and Silver -21%. One odd move for the month was Gold down -18%. With all assets seeing sell offs, this seemed like the perfect time for Gold to take off on safe haven buying (if ever there was a case for Gold, this seemed like the time), but the precious metal actually lost -18% for the month.

Grains a Softs were not far behind, with Wheat down -21%, Corn down -18%, Cotton -23%, Coffee -13% and Sugar -12%. These sharp price declines seem to be pricing in the possibility that people are going to stop eating and wearing clothes in the pending recession.

Moving on to the financials – the equity markets were the catalyst once again, and finished sharply lower with notables including Hong Kong's Hang Seng down –23 %, SP Midcap 400 – 22 % and Russell 2K – 21 %.

Finally, it was a bad month to be a so called commodity currency, as those countries with heavy commodity production saw their currency values hammered lower against the US Dollar, with the Aussie Dollar -16 %, Mexican Peso – 15 % and Canadian Dollar -12%

CTAs

Many multi-market trend following managers found success in October as nice trends developed across many different market sectors. This actually all looked like the same trade, as most markets trended downwards along with the stock market, in what is essentially a trade shorting the Global Economy. Investors were pulling money from a variety of investment vehicles including hedge funds and CTA's as the panic selling seen in the stock market spilled over into alternative investments and commodities. However, unlike traditional long only stock investments like mutual funds, multi market managers had a chance to make money even when the markets as a whole were moving lower. Short trades in stocks, energies, foreign currencies and grains proved successful in October, while long treasury positions also added to the bottom line. The APA Modified program was the top performer amongst Attain's recommended CTAs in October, with gains of +14.99% for the month. Not too far behind was the APA Strategic Diversification Program, which had estimated returns of +6.26%. Both APA programs benefited for short stock index, short currency, short grains, short metals and long treasury trades in October.

Dighton USA Swiss Futures was another manager enjoying the volatility with approximate returns of +9.59% after several successful shorter term trades in the energy and stock index sectors.

Hoffman Asset Management also had a very nice October with approximate returns of +4.74%, as did Robinson Langley who had estimated returns of +4.64%. Next in line was DMH Futures Management with estimate returns of +1.86%, followed by Long Term Trading Navigator with estimated returns of +1.38%. Clarke Capital Management saw its Global Magnum program finish up +0.43% (est) while the Global Basic Program was unchanged. Northside Trading also finished near breakeven for the month.

For Option Selling CTA's October 2008 will be the new benchmark for measuring risk - A true "Black Swan" event. In a month where index markets tumbled more than 20% in some cases, commodity prices fell sharply, and the VIX (CBOE Volatility Index) spiked to all time highs - any manger focused on selling volatility certainly felt the pain of the markets. The estimates for the months were as follows: Ace Investment Strategists -25.98%, Ascendant Strategic 1 -27.59%, Cervino Diversified Options -4.83%, Cervino Diversified 2x -9.63%, Crescent Bay PSI -9.24%, Crescent Bay BVP -12%, FCI -20.36%, LJM Partners -63.9%, Raithel Investments -7.89%, Zenith Index -10.28%, and finally Zenith Diversified -13.65%.

As a reminder to investors utilizing any of the above short volatility strategies - please take a minute to review your portfolio to ensure that you have some long volatility exposure in your portfolio as well. If you'd like to discuss this point in more detail e-mail us at invest@attaincapital.com.

Agriculture and Grain mangers finished October with a mixed range of returns (+3.02% to -13%). Toping the month was NDX Shadrach with a gain of +3.02%. Shardrach is now ahead an estimated +39.87% for 2008, matching its historical compound annual rate of return, with an all time max drawdown of -14% in July of this year. You can learn more about NDX via our July 21st newsletter (http://www.attaincapital.com/managed_futures_newsletter/289) or check out the back page of this month's Futures Magazine to read an interview NDX Capital's manager, Phil Herbert. (hopefully they don't succumb to the Futures Magazine jinx) Elsewhere, Chicago Capital ended the month down -6.21% and Rosetta Capital lost aprox. 13%.

Trading Systems

With the otherworldly moves in global equities and corresponding spike in volatility, trading systems were a perfect match for the trading environment of October. The key to their ability to perform well in this environment is fairly straightforward- they take the emotion out of trading by simply sticking to the rules regardless of the "fear factor" that can influence discretionary traders.

Beginning with the day trading systems, ATB Follower v3 ESX made +$6985 for the month after trading multiple contracts nearly every trading day of the month. This made for some large swings both positive and negative, but the good outweighed the bad thanks to some moves of over 10 % intraday on more than one occasion. Not too far behind was another Eurex system, BetaCon 4/1 ESX which was + $4,229 for the month. Compass SP was relatively quiet because of an internal filter that keep the system from trading on days it deems to be overly volatile-but still was able to finish the month + $3,418. Elsewhere, Waugh eRL was extremely active and closed out the month +$3,620. Finally, BounceMOC eMD was +$1,040 while BounceMOC eRL was -$688.17.

Moving further out in trade duration to the swing systems, the Bounce swing systems had nearly identical results to their day trading counterparts with the eMD + $1,026.60 while the eRL was - $680. Ultramini ES dropped $120 for the month after getting stopped out more often than reaching its profit objectives and rarely staying in a trade overnight, let along stay in trades for more than an hour which is unusual for swing systems, but these are anything but typical conditions.

Long term multi-market systems followed the trends previously discussed in the overview section and most just held onto current positions. Gold was a trend that came alive in October, after previously being held up due to the usual flight to precious metals in times of financial distress. Another trend that fully developed was the long U.S. Dollar Index trade- after rallying nearly $10 throughout the month.

IMPORTANT RISK DISCLOSURE

Futures based investments are often complex and can carry the risk of substantial losses. They are intended for sophisticated investors and are not suitable for everyone. The ability to withstand losses and to adhere to a particular trading program in spite of trading losses are material points which can adversely affect investor returns.

Top 5 CTAs (Past 12 Months)

Past Performance is Not Necessarily Indicative of Future Results.

Rank	Program Name	12 month Return	12 month Drawdown	Min Investment (k)
1	Pere Trading Group, LLC Pere Trading Program	521.82%	29.78%	$100
2	Clarke Capital Management, Inc. Global Basic	139.95%	7.53%	$50
3	Clarke Capital Management, Inc. Global Magnum	66.76%	2.90%	$100
4	Dighton Capital USA Swiss Futures Trading	54.27%	4.44%	$100
5	Attain Portfolio Advisors Modified Program	46.07%	15.53%	$250

Figures listed are as of 11/03/2008.

IMPORTANT RISK DISCLOSURE

The rankings above are the top ranked CTAs offered at Attain over the past 12 months using a risk adjusted ratio which equals the period return divided by the period DD.

Investments in CTAs can be subject to substantial charges for management and advisory fees. The % returns in the CTA table above include all such fees, but it may be necessary for those accounts that are subject to these charges to make substantial trading profits in the future to avoid depletion or exhaustion of their assets.

The regulations of the Commodity Futures Trading Commission (CFTC) require that prospective clients of a CTA receive a disclosure document when they are solicited to enter into an agreement whereby the CTA will direct or guide the client's commodity interest trading and that certain risk factors be highlighted. The disclosure document contains a complete description of the principal risk factors and each fee to be charged to your account by the Commodity Trading Advisor (CTA). This document is readily accessible at this site using the Disclosure Document link at the Attain website.

Top 5 Systems (Past 90 Days)

Hypothetical Model Accounts using Computer Generated and Actual Client Fills.

Rank	System Name	90 Day Return	Return in Dollars	90 Day Drawdown	DD in Dollars	Min Investment (k)
1	Strategic Bonds	36.23%	$5,434.38	0.67%	$100.00	$15
2	Duna 256 DAX	137.31%	$34,328.42	16.81%	$4,201.91	$25
3	ATB TrendyLow ESX v4	133.76%	$6,019.03	17.46%	$785.73	$5
4	Duna 254 DAX	130.59%	$32,648.29	17.12%	$4,279.98	$25
5	BetaCon 4/1 ESX	117.62%	$5,881.22	18.26%	$913.04	$5

Figures listed are as of 11/03/2008.

IMPORTANT RISK DISCLOSURE

The rankings above are the top ranked Trading Systems offered at Attain over the past 90 days using a risk adjusted ratio which equals the period return divided by the period DD.

The % returns in the trading system table above are hypothetical in that they represent returns in a model account. The model account rises or falls by the exact single contract profit and loss achieved by clients trading actual money pursuant to the listed system's trading signals on the appropriate dates, or if no actual client profit or loss available - by the hypothetical single contract profit and loss of trades generated by the system's trading signals over the test period. The hypothetical model account begins with the initial capital level listed, and is reset to that amount each month. The % returns reflect inclusion of commissions, fees, and the cost of the system. Commission and fee cost = # of monthly trades * $50.00 ($30 for eminis). The monthly cost of the system is subtracted from the net profit/loss prior to calculating the % return. For systems with one time

purchase costs, the monthly cost is calculated by dividing the purchase cost by the number of months in the reporting period.

HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN; IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM. ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK OF ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL WHICH CAN ADVERSELY AFFECT TRADING RESULTS.

THESE PERFORMANCE TABLES AND RESULTS ARE HYPOTHETICAL IN NATURE AND DO NOT REPRESENT TRADING IN ACTUAL ACCOUNTS.

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