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The past year has uncovered some of the most unsettling weaknesses in the US and world financial systems since the beginning of the Roosevelt Administration in 1933. Students of history will opine a major contributing factor to the economic woes of the time was not terribly dissimilar to events underlying current “Sub-Prime” mortgage dislocations and massive foreclosure rates. To even have hoped such a tsunami wouldn’t have bathed the stock & bond market s in uncertainty and volatility seems unreasonable to the point of bedlam.

We see reports daily about families on the brink of financial ruin, about well-employed middle and upper-level managers feeling the strain of high fuel costs affecting their commute, and it wasn’t but a month later we began to see the effects of higher transport costs on everything from manufactured goods to food stuffs to “Florist’s Trans World Delivery” (FTD).. .

Yet, amongst the cacophony of “wails” arising from the floors of the various stock exchanges, a few erstwhile financial pundits have commented on an eerie serenity which has come over some of the exchanges in both NYC and Chicago. At least, nobody on those exchanges is lamenting the collapse in housing – they’re too busy trading both more frequently and more profitably lately.

For - the first tool falling readily to the “Fed-Head’s” hand is, has been and perhaps forever will be…..interest rates. Money supply comes in a rather distant second and at the rear slogs along (in relative obscurity) the little old guy known but to a few (OTHER little old guys) by the initials “R.R.” (reserve requirements).

It’s not my intent to discuss economics , simply to point out the inevitable reaction to the FED’s initial rate cuts was a further-decline in an already-weak greenback. Over-simple? You bet – but more than a few of those responsible for largest state-funded pension plans have been re-allocating portions of their retirement portfolios into “asset plays” for just short of a decade now, waiting for the inevitable to occur – which it just has.

ERGO – some of the largest (after Social Security) pension plans in the **world** were essentially “insured” against the decimation pervading our economy, we know not **how** deeply as yet. Many will likely doubt me when I suggest (1st) that it’s never too late to take out insurance and (2nd) that the Futures Markets are actually NOT the “Casinos” many believe them to be. Rather, they act as insurers on the order of Lloyd’s of London, AIG, Swiss RE, et al – and do so by providing a central venue wherein risk can be passed by those seeking price stability in lieu of potential speculative excess, preferring the constancy upon which a multi-generational business enterprise may be built. At the same time - similarly to Lloyd’s in the Rothschild days when Nelson fell at Trafalgar and Napoleon at Waterloo (BOTH insured by Lloyds rumor has it), our commodities exchanges provide a central location wherein those actively seeking great rewards while willing to accept risk in a negotiated exchange with those seeking to offset such risk – may meet, conduct and conclude their transaction to the satisfaction of all parties directly engaged, and many parties blissfully unaware such things have arisen from men’s minds – yet blithely benefitting from the steady, reliable and reasonably-priced supply of goods and services coming from such as the man who sought to offset his risk in our little tale – so that he wouldn’t have to tack on his own insurance premium and call it “excise tax” or “surcharge” or “VAT”. It suggests the use of the exchange mechanism for that which it was originally conceived – except, we’re not discussing hedging pork bellies (still an active enterprise in itself, however)…It’s the offsetting of risk from within and without your retirement portfolio. It’s been going on in the agriculture community for two centuries in its current form and predates that by millennia sans the exchange medium of cash. In financials, it’s been going on for two generations now, and in that regard, I hereby proffer my sincerest apology for not having the prescience to present it for your consideration before this.

As you’ll see in the first chart below, commodity values consistently tend to move counter to stocks and bonds, while the higher leverage available in commodities minimizes the capital commitment to required to place it into practice.
This means the Lion’s share of risk can be offset for a “premium” on the order of 10%.

The chart immediately following, illustrates the unheard-of level of asset flows INTO the genre over the last decade – while counter-intuitively ramping UP as the first cracks in the home mortgage façade began to emerge (the asset inflows chart is Java-scripted to the Barclays database, hence the numbers are current to the night prior to my sending this note), . .

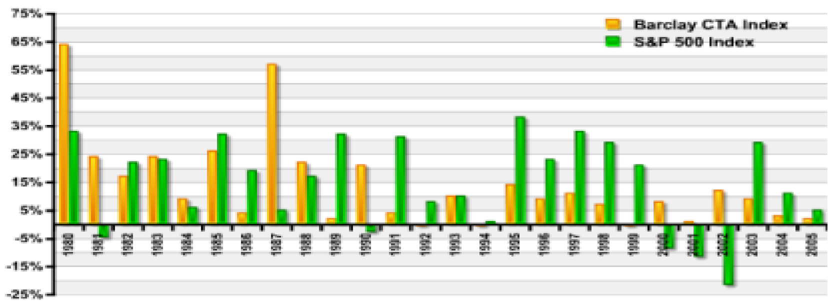
Lastly, this year has seen rather spectacular price spikes in many commodities. Those spikes are subsiding somewhat at the moment.

As yet, no clear picture emerges as to whether current price weakness is a normal consolidation of recent gains preparatory to another up leg, or whether at peak levels, demand elasticity had finally been achieved thus blunting runaway prices along with the shortages they portend and the hyper-inflation they can foment. Thus, some might say there exists a “moment” of “opportunity”. Hogwash!
One does not emerge from a three car pileup relatively intact, only to go out the next day and bargain hunt prices.

Why Managed Futures?

Until recently, Economic Theorists generally concurred there were eight reasons to consider Managed Futures within a well-rounded overall portfolio. With the revelation of the sub-prime crisis, not to mention the ripple effect still working through the Economy - it seems there are now "nine". Or, at least one might well argue, a major but underlying implication of the original reasoning has been painfully propelled to the forefront of current economic dialog. Indelicately but directly stated: countless investors might have been spared at least some of the financial destruction they've endured – had they only seen fit to re-allocate a small portion of their investment capital to this sector as a HEDGE against just the type of economic Tsunami encountered. Indeed, the term "HEDGE" applies to the application of a portion of portfolio assets to this asset class - much more accurately than the common misconception of anything futures-related falling (de-facto) into the category of "speculation".

(1) Managed futures often outperform alternatives. Correlation between stocks and commodities is nearly zero, so commodity futures have often experienced positive performance during times when the US stock market was lackluster. Increased awareness of the benefits of managed futures has resulted in a more than a tripling of assets under management from $37.9 billion in 2000 to $135 billion in Q1 2006 (Source: Barclay Group, LTD). Many analysts agree diversifying 10-20% of a securities (equities and fixed-income) portfolio into futures enhances overall portfolio stress tolerance while concurrently enhancing yield. For the vast majority of working professional, this means Managed Futures should be considered in the vein of another Mutual Fund from the viewpoint it's actively managed by professionals on your behalf. .



Non-correlation of diversified Managed Futures portfolio to the cash S&P500 Index

The Barclay CTA Index is a leading industry benchmark of comparative CTA/CPO performance.
When the Index was devised, the decision was made only to use Advisors with a minimum track record of four years. Once an Advisor (more accurately, an advisor's product) has bested that longevity benchmark, any new trading programs (or products) said Advisor brings to market, will qualify for inclusion In the index after two years of trading.

(2) Little or negative correlation leads to better risk-versus-reward ratios. Losing a bet from flipping three quarters is statistically less likely than losing a bet from flipping one quarter. Diversification offers long-run advantages when one allocates a portion of their assets to less or negatively correlated markets with similar potentials for return. Managed futures represent potential hedges against such factors as inflation risk and business cycle movements which may adversely affect a pure stock/bond portfolio.

(3) Percentage-based costs mean CTAs primarily target consistent returns. Commodity Trading Advisors (CTAs) typically have percentage-based profits as their largest source of income. Because incentive fees mean CTAs make more money when you do, they have incentives to make as much profit as possible for their investors.

(4) Commodity portfolios make diversification easy. CTAs often target many markets using multiple strategies, which reduces your volatility risk. Not every investor has the ability to stare at a computer screen all day for this specific purpose. Managed futures provides every investor the opportunity to diversify through professional managers.

(5) Flexibility means not being a bull or a bear. Managed futures programs are not the same as mutual funds: CTAs are not limited to only buying. They can buy and sell futures, write or purchase options, and speculate in bull or bear markets.

(6) The potential for global market exposure is simple. By their very nature, commodities are markets dependent upon global factors. Furthermore, foreign exchange and index futures allow for global diversification without the need for a microscope on several thousand foreign stocks and bonds.

(7) You have the ability to choose. There are many CTAs out there and they all want your business. That not only means that you can be choosy about risks and rewards, but also about capital requirements and fees/costs. You have options so find what works for you.

(8) CTAs have history. The managed futures business has existed for several decades and the most consistent CTAs are the ones who have a long-term track record.

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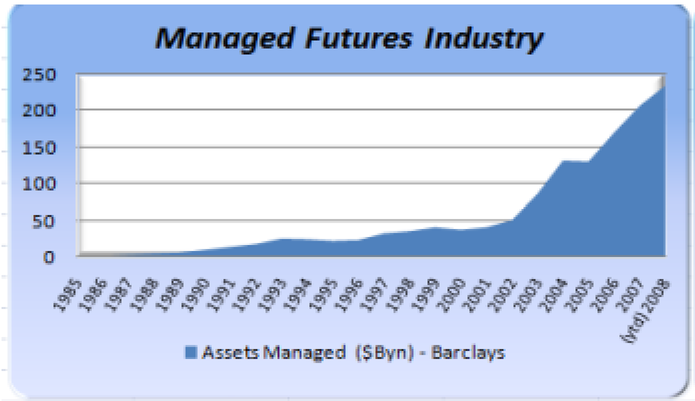
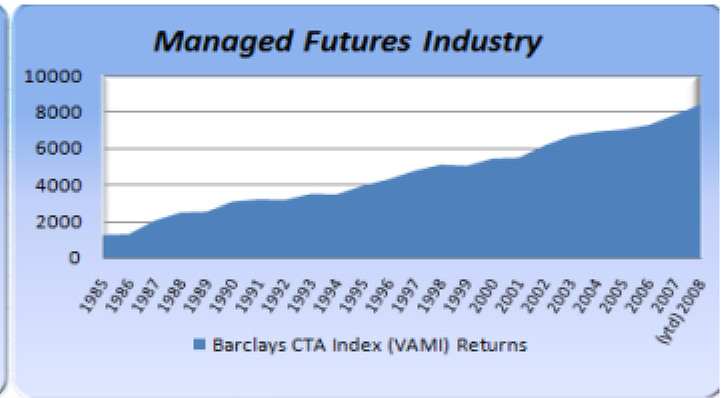
Absolute Returns

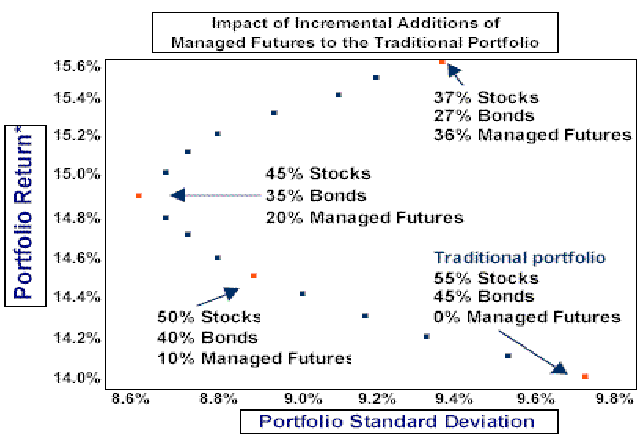
The allure of alternative investments lies in their ability to provide absolute returns regardless of conditions such as a strong economy, low inflation, or a bullish stock market, indeed, one of the key benefits of an investment in futures is this ability to profit in virtually any economic environment.
Not surprisingly, the amount of assets allocated to alternative investments has increased dramatically over the past several years as investors search for alternatives to the stock and bond markets. In evidence, may we submit the below graphics illustrating (left) accelerating asset-allocation velocity (right) continued positive returns generated within in a panoply widely disparate market environments over the last two decades (click charts for source data)..

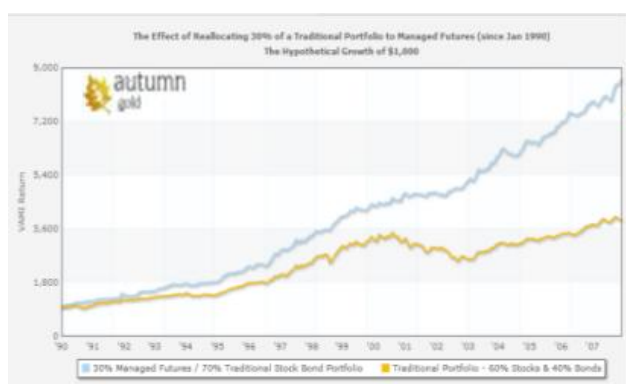




Independent Research:

A study published by the Chicago Mercantile Exchange concluded that portfolios with as much as 20% of assets in managed futures yielded up to 50% more with comparable risk than portfolios of stocks and bonds alone. The enclosed graph, "Impact of Incremental Additions of Managed Futures to the Traditional Portfolio," provided by 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. However, a portfolio comprising 45% stocks, 35% bonds, and 20% managed futures offers an investor the greatest returns and least amount of risk.





Viewed another way, the chart from “Autumn Gold” (above right) shows how a hypothetical portfolio of stocks and bonds would have fared with a 30% overall portfolio reallocation to managed futures beginning in 1990 and carried forward to 2007 (blue line includes futures, gold does not).

Recent research by Gary Gorton, of the Wharton School and K. Geert Rouwenhorst of Yale University , examined commodity futures as an asset class. Gorton and Rouwenhorst constructed an equally weighted index of commodity futures monthly returns over a 25 year period. They found that the returns and Sharpe ratios were similar to equities. Commodity futures, however, are negatively correlated with both equity and bond returns. This negative correlation is due to different behavior over the business cycle. Commodity futures are positively correlated with inflation and changes in expected inflation.

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According to Dr. Harry M. Markowitz, the Nobel prize-winning economist and father of modern portfolio theory, portfolios with decreased volatility and increased performance can be created by diversifying among asset categories with low to negative correlation, such as stocks and commodities. Subscribers to this theory believe an investment portfolio containing alternative investments with low to negative correlation stands to perform better, with lower overall risk.

View Full Reports online:

Facts and Fantasies about Commodity Futures

The Markowitz Approach

Online Alternative Assets Investment Library

How do I get started?

(1) Do your research. Rates of return should not be the only factor you face when deciding which is the best CTA for you. First consider key numbers like maximum expected drawdown, maximum margin, stop-loss risk, and other. Then, consider ratios commonly used within the professional CTA ranking industry such as the Sharpe Ratio (the risk-adjusted rate of return given opportunity costs), the Calmar ratio (compound annualized rate of return), and others. Sometimes, this analysis could be very time consuming and it may be helpful to consult a CTA.

(2) Ask questions. CTAs often prefer to focus on their reports and charts while letting their performance speak for themselves. This is why it is oftentimes useful to consult third-party analysts and online CTA guides when you cannot get a multi-million dollar fund manager on the phone. These analysts work on your side because they usually work off of incentive fees also, so make use of this specialized resource.

(3) Diversify, diversify, diversify. Investments 101 taught you to diversify across different commodities, but you should also consider diversifying across different strategies too. The best way to do this is to use managed futures to your advantage: work with different CTAs and analysts so that you are not exposed to only one method and commodity sector.

(4) Make the call. It is difficult trusting others with your money. We would point out it's also difficult performing surgery on one's self. Seek out professionals with whom you can communicate and feel you share some common ground. It may be comforting to know TAA's primary income source derives from participation in the profits their collective effort produces on your behalf (see Disclosure Document for details). Once you've come to appreciate our "common ground" includes standing shoulder-to-shoulder on same side of the table, rather than the generation of transactional commission income…. Make the call and take action.

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