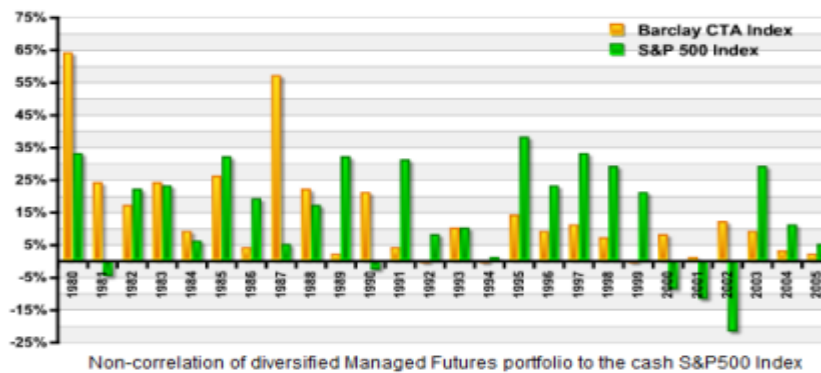


## Why Managed Futures?

*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. .



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.

The intent was to insulate the Index from the exaggerated volatility expected to be created by those inevitable start-ups destined to fail as is the case with and industry's new ventures.

The net effect of these Index restrictions has proven to be two-fold, in that the negative skewing of Index performance was smoothed (as expected), however when determining this to have been the case, it was also found that the typically higher returns generated by incubator CTAs were also smoothed out, therefore essentially negating the entire exercise

**(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.

**Absolute Returns**

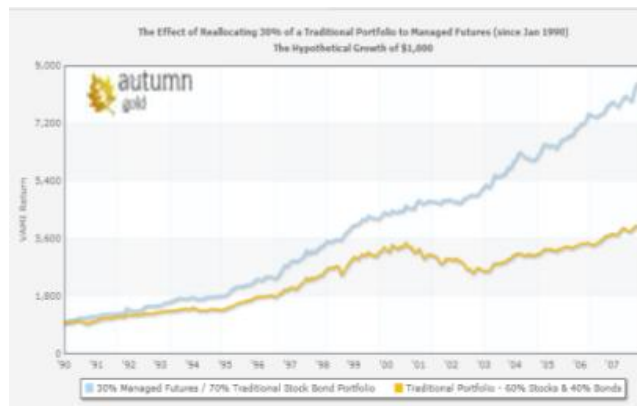
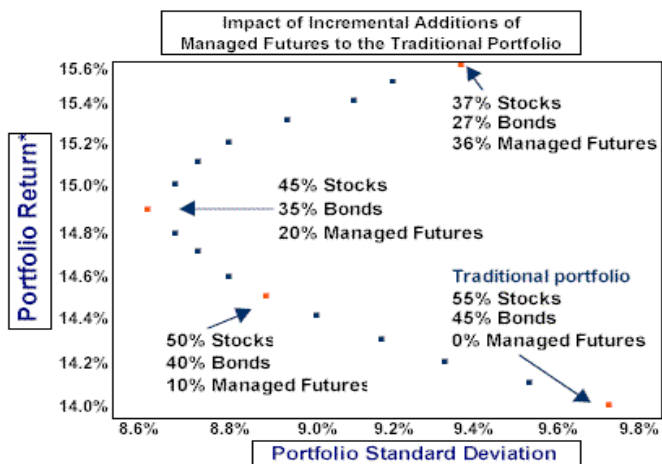
The allure of alternative investments lies in their ability to provide absolute returns regardless of conditions such as a strong economy, low inflation, or a bullish stock market, indeed, one of the key benefits of an investment in futures is this ability to profit in virtually any economic environment. 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.



Source: Barclay Hedge

**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 line 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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[View Full Report online: Facts and Fantasies about Commodity Futures](#)

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.

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[View Full Report online: The Markowitz Approach](#)

### **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.