

OPALESQUE FUTURES INTELLIGENCE

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Opalesque launches new comprehensive Managed Futures resources website

We invite you to register at our **new comprehensive Managed Futures resources website** www.uncorrelated-investments.com where you will have access to free tools like:

- Managed Futures Academy: Comprehensive educational resource
- Video Tutorials: Understanding CTAs and their performance drivers
- Video Portraits: Meet some of the most successful managed futures managers
- Mark Melin's Industry Insider's Blog
- Needs Analysis: This interactive test helps you to determine your managed futures knowledge level

Will Volatility Lead to Price Persistence or Just Result in Directionless Range Expansion?

No one knows for certain if this **economic recovery is real** enough to withstand central bank withdrawing its artificial stimulus efforts, but if you listen to comments from Ben Bernanke there is a **promise that free markets might just receive a chance** to operate without Fed interference. Or will it?

It is interesting to note the market reaction to announcement by the Federal Reserve that the slow and easy withdrawal from stimulus – known as **tapering** – was **greeted with such utter shock**. The addiction is so bad that even the mention of stimulus withdrawal sent all “safe” assets lower. On the morning investors and casual debt crisis watchers could cheer the largely ignored fact that [S&P](#) raised the US debt rating, noting improving tax receipts and sequester induced spending cuts improved the short term outlook, the US Federal Reserve noted it may begin to taper from its controversial program of artificially supporting the US bond market to the tune of \$85 billion per month. The market reaction to this announcement was interesting, not that the Fed was watching the markets, which has been their public claim in the past. On May 23rd, stocks plunged but safe haven US bonds and the dollar took a temporary dive as well. **Trends in**

certain financial markets reversed, causing long term trend models to take expected losses during such trend reversals. Even short volatility CTAs were recently hit with volatility that appeared directionless. Was there no safe haven? This event proceeded Kyle Bass musing that Japan, which currently devotes close to 50% of tax revenue servicing on the debt, may find itself to be the first developed country to experience a debt crisis crash.

Although the Federal Reserve publically states it is not concerned with “market reaction,” is that really the case? While they may not be as concerned with the credibility of yield curve as a mechanism of price discovery – which has been significantly damaged – let’s see what happens when the equity markets react in a debt crisis crash where truly persistent price behavior may lead all markets significantly lower. It is the **stock market reaction that might get the attention of political leaders**, and it is for this reason that the recent comments by former Federal Reserve Chairman Alan Greenspan and US President Barack Obama distancing themselves from current Federal Reserve Chairman Ben Bernanke are so interesting. Never in recent memory has a Federal Reserve Chairman been so **harshly questioned by a president and former Federal Reserve Chairman**. Will the ultimate loosening of central Federal Reserve control over interest rate markets **lead to price persistence or just directionless volatility**? That is yet to be determined.

As discussed in the article “May Ends Lower for Managed Futures with a Bang,” trend followers, particularly those primarily trading the largest financial markets, **found difficulty navigating changing market trends in May**. Essentially when a **change** occurs in **beta market environment**, these programs should be **expected to find difficulty**. But that wasn’t the case with all trend followers, as **some found gain in short term volatility and price direction**, while others may have **exited certain positions in yield curve trades based** on discretionary market knowledge, as the article points out is the case. The **key is evaluating managers so as to strip out the beta from alpha** and have a reasonable expectation regarding performance through various market environments. This leads us to the second article on Wilshire, which provides interesting commentary regarding its **process for evaluating alternative investing talent**. Always a hot topic, Wilshire reveals its framework for alternative investment evaluation. **Setting proper performance expectations** is, in part, the topic of an article written by author and fund manager Andrew Abraham in this issue. Mr. Abraham discusses how **discipline and mean reversion** sometimes play a role in managed futures investment timing. The article points out that managed futures investing can **involve sharp reversals, extended periods of mediocre performance and sometimes sudden spurts of performance** when it matters most. As David Harding is fond of saying: “**You never know when a price trend is going to begin or end**. We just know they happen.” Well, they happen in free markets, that is.

Unfortunately fraud has been a hot topic of discussion the past few years. While the direct managed futures account appears to have taken a significant hit recently, efforts to **shore up investor protections may be on the verge of making the account structure more secure**. The articles on enhancements being made to the **FCM auditing process** and the **CFTC perusing US Bank** in the PFG fraud case are taking center stage. This is particularly interesting in light of the fact that MF Global appeared to be heading to a conclusion (just at publication time). The irony of all ironies could be that the **significant damage done by PFG and MF Global may just have put the investment protections at an all time high**. This PFG article is preceded by market commentary from managed futures participants and current managed futures events.

I hope you find this issue useful. If you have any comments or questions, feel free to reach out.

Mark Melin,
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Scoreboard Spotlight: Newedge CTA Index

Major "Large Cap" Index Recap (Year To Date*)

Index Monthly Return

Newedge CTA Index	-1.72%
iStoxx / Efficient Capital	-1.30%
BarclayHedge CTA Index	-1.28%

Year to Date Performance (as of June 25) -0.14%

Historical Worst Drawdown 10.30%

Monthly Standard Deviation 2.53%

Average Size of Win 2.19%

Average Size of Loss -1.86%

Sortino Ratio 2.09%

Newedge CTA Index monthly performance

Year	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Year End
2013	1.46%	0.10%	1.29%	1.45%	-1.71%	2.58%							
2012	0.70%	0.94%	-2.02%	0.08%	3.03%	-3.29%	2.95%	-1.18%	-0.81%	-3.01%	-0.13%	0.06%	-2.87%
2011	-1.45%	1.19%	-1.06%	3.59%	-4.48%	-1.66%	3.27%	-1.41%	0.75%	-3.75%	0.15%	0.67%	-4.45%
2010	-2.02%	1.30%	2.67%	1.39%	-1.41%	-0.24%	-0.47%	3.47%	1.29%	2.67%	-2.82%	3.32%	9.26%
2009	0.18%	0.16%	-2.46%	-1.97%	1.31%	-1.78%	-0.35%	0.88%	2.17%	-1.80%	2.71%	-3.25%	-4.30%
2008	1.68%	4.60%	-0.20%	-1.97%	1.74%	2.30%	-2.72%	-1.80%	0.33%	4.98%	2.09%	1.65%	13.07%
2007	1.14%	-1.75%	-1.40%	3.44%	3.23%	2.35%	-2.59%	-4.07%	4.29%	3.54%	-0.85%	0.86%	8.05%
2006	0.90%	-0.61%	2.24%	2.42%	-1.53%	-1.38%	-2.01%	-0.08%	-0.54%	1.35%	2.38%	2.62%	5.75%
2005	-2.63%	1.03%	0.32%	-2.01%	1.46%	1.92%	-0.14%	0.03%	1.62%	0.16%	2.69%	-1.16%	3.20%
2004	0.98%	4.05%	-0.92%	-3.90%	-1.50%	-2.47%	-0.67%	-1.28%	0.36%	2.89%	3.82%	0.42%	1.47%
2003	4.92%	4.69%	-5.54%	1.62%	5.40%	-1.42%	-1.29%	2.13%	-0.54%	2.24%	-0.20%	3.29%	15.75%

*Past performance is not indicative of future results. The performance of an index may differ from individual CTA performance. These CTA index contain the largest CTAs whose performance believed to have been audited by the National Futures Association (NFA). Performance sources are as of the last reporting date before publication: <http://www.newedge.com/content/newedgecom/en/brokerage-services/prime-brokerage/newedge-indices.html>; http://www.stoxx.com/indices/index_information.html?symbol=STXECMF; www.BarclayHedge.com; www.ManagedFuturesDatabase.com;

Pinnacle Award Winners Announced

This past week at press time the Pinnacle Award winners were announced on the eve of the Managed Funds Conference in Chicago.

2012 Best Diversified CTA – \$500 million+ (Assets under management)

Crabel Capital Management

Quick Facts (Futures 4X) Short Term Systematic
Track Record Dates Back To: 1992
Compounded Annual Return: 21.54%
Worst Drawdown: \$1.4 billion

2012 Best Diversified CTA – Less than \$500 million AUM

Stenger Capital Management, LLC

Quick Facts: Discretionary short term
Track Record Dates Back To: 2010
Compounded Annual Return: 12.26%
Worst Drawdown: 0.55%
AUM: \$204 million

5-Year Best Diversified CTA – \$500 million AUM

Two Sigma Investments, LLC

Quick Facts: (Compass) Fundamental Short Term
Track Record Dates Back To: 2005
Compounded Annual Return: 15.06%
Worst Drawdown: 9.85%
AUM: \$3.3 billion

5-Year Best Diversified CTA – Less than \$500 million AUM

Newton Capital Partners

Quick Facts: Discretionary, financial and metals
Track Record Dates Back To: 1998
Compounded Annual Return: 9.41%
Worst Drawdown: 8.13%
AUM: \$160 million

2012 Best Multi-Advisor Futures Fund and 5-Year Best Multi-Advisor Futures Fund

AC Investment Management, LLC

Quick Facts: (Master LP) Multi Advisor
Track Record Dates Back To: 2006
Compounded Annual Return: 7.60%
Worst Drawdown: 6.22%
AUM: \$479 million

2012 Best Emerging CTA

Global Sigma Group, LLC +

Quick Facts: Options / Volatility
Track Record Dates Back To: 2009
Compounded Annual Return: 18.88%
Worst Drawdown: 1.55%
AUM: \$66 million

2012 Best Single Sector CTA – \$500 million+ AUM and 5-Year Best Single Sector CTA – \$500 million AUM

Dominice & Co. Asset Management

Quick Facts: Short Term / Volatility
Track Record Dates Back To: 2004
Compounded Annual Return: 13.58%
Worst Drawdown: 14.35%
AUM: \$730 million

2012 Best Single Sector CTA – Less than \$500 million AUM

Rosetta Capital Management, LLC

Quick Facts: Discretionary, Agricultural
Track Record Dates Back To: 2000
Compounded Annual Return: 39.55%
Worst Drawdown: 39.67%
AUM: \$125 million

5-Year Best Single Sector CTA – Less than \$500 million AUM

AAA Capital Management Advisors, Ltd

Quick Facts: Discretionary, Energy
Track Record Dates Back To: 1998
Compounded Annual Return: 17.93%
Worst Drawdown: 27.57%
AUM: \$426 million

2012 Best Options Strategy and 5-Year Best Options Strategy

LJM Partners, Ltd.

Quick Facts: (LP Fund) Options
Track Record Dates Back To: 2003
Compounded Annual Return: 18.92%
Worst Drawdown: 42.26%
AUM: \$113 million

A lifetime achievement award was given to Keith Campbell, founder of CTA Campbell and Company, who was profiled in the last issue of Opalesque Futures Intelligence.

May Ends Lower for Managed Futures with a Bang

By Mark Melin

May ended down broadly for managed futures, with the benchmark large cap Newedge CTA index ending down -1.72% with the broader and less discerning Barclay CTA Index -1.27%. What garnered media attention were the returns of some of the larger trend following CTAs, such as Graham Capital down -3.9%; Transtrend -3.1% and the financial heavy AHL down 10%.

For the institutional allocator it is important to understand not just what happened, but why it happened.

"Classic trend models are not build for a near zero yield environment," noted Andreas Clenow, author of *Following the Trend* and a principal at Zurich-based ACIES Asset Management. "The classic models will tell you to take larger and larger trades on the upside on every new peak. Those models are completely unaware of the asymmetric risk in that trade. A very limited upside and a massive downside."



Andreas Clenow, author of *Following The Trend*, is also manager of the CTA *Globalanced Systematic*

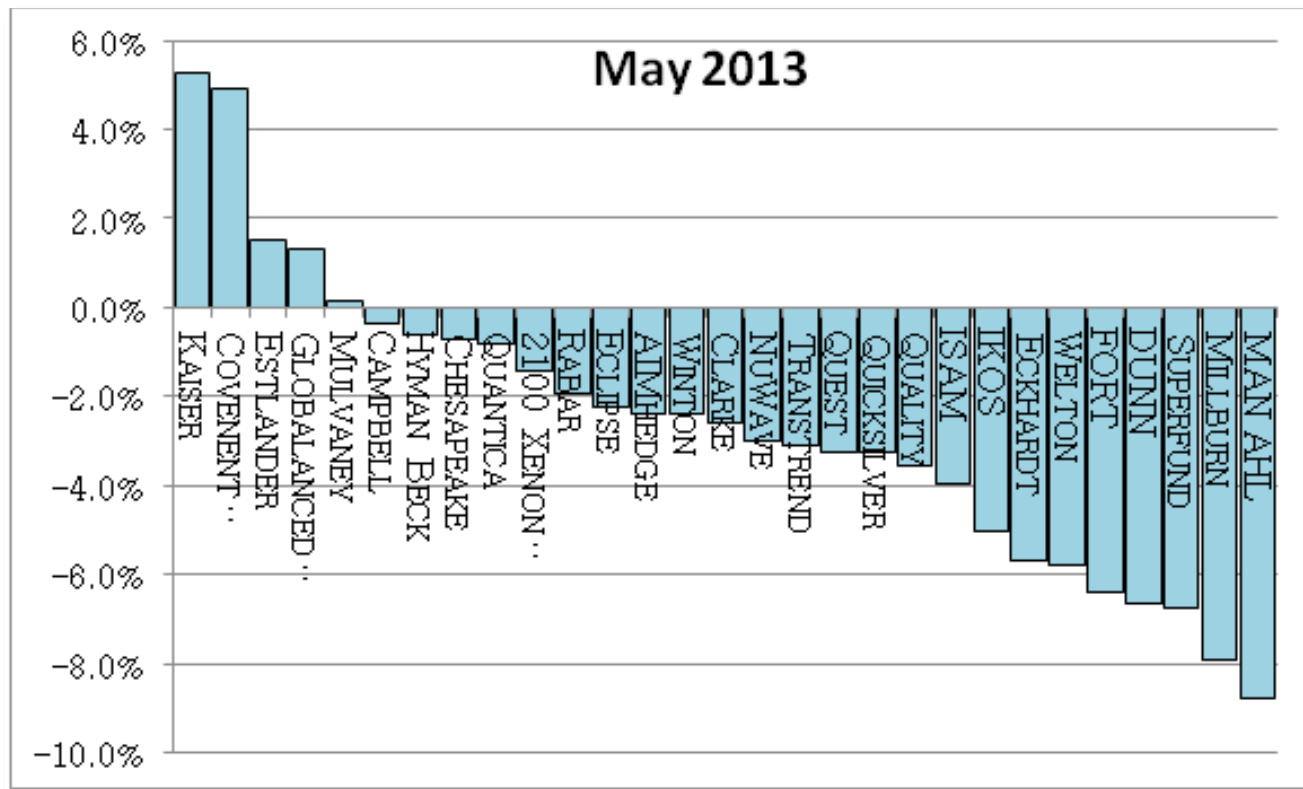
Mr. Clenow, who will be speaking at the Battle of the Quants event in London June 26, notes the performance differential is based on the size of assets each fund is required to manage. "Smaller CTA hedge funds, like me, can try to adapt their models to this situation. The really large ones have a problem. If you're managing tens of billions, you'll essentially limited to rates and forex. I know, they all claim to do hundreds of market, but we can all do basic math here. There is no way that they could move enough to matter in most of those markets. So they're driven by two sectors, and one of them has had big blinking red warnings on it for some time. They're just too big to act on it."

Sources indicate that one of the larger trend following CTAs had recently changed risk management regimes where they no longer utilized intraday stop orders to scale out of positions, opting to exit all trades near the end of the trading day, which proved problematic when liquidating large positions in a volatile market. This CTA was adversely impacted by events in Japan and the sudden change in bond market trend dynamics.

In their [blog](#), managed futures brokerage Attain Capital noted that the sheer size of their positions makes exiting positions quickly difficult – particularly when the algorithms the largest CTAs all send a sell signal at the same time. Covenant Capital, with over \$300 million under management, reported returns of +4.89% in May and is up 10.19% year to date in its original program. The CTA's programs, which have been audited by the National Futures Association, have a track record dating back to 1999 and a compounded annual return of 13.64% with annualized volatility of 17.04%. The aggressive program, with a track record dating back to 2004, has a compounded annual return of +21.72% and annualized volatility of 20.60%.

Other well known trend following CTAs ended positive in May, including Estlander, which was up near +1.75%, while the majority ended lower.

Major Trend Followers



Performance Estimate Source: CTA independent reporting, Globalanced Systematic estimates and www.managedfuturesdatabase.com. Past Performance is not indicative of future results.

Here is a key with Covenant and other “boutique” CTAs with near \$500 million in AUM: Not only are they more nimble at entering and exiting markets, but they have a much wider choice in markets traded, benefiting from trends in commodity and niche financial markets that large CTAs can’t practically enter.

But perhaps the most important consideration is that when a trend changes direction investors should expect losses regardless of the trend following program. Trend followers all capture the beta market environment of price persistence and when that price persistence ends in a given market, temporary losses are almost certain to follow. The alpha is in how the programs risk manage trend changes: some may utilize volatility based position scaling methods while other programs may simply absorb the losses in a temporary trend change anticipating the longer term trends remain intact, among many factors.

Institutional managers should recognize the risk management regime, trade hold period and markets traded of their investments to develop reasonably accurate performance and risk management metrics.

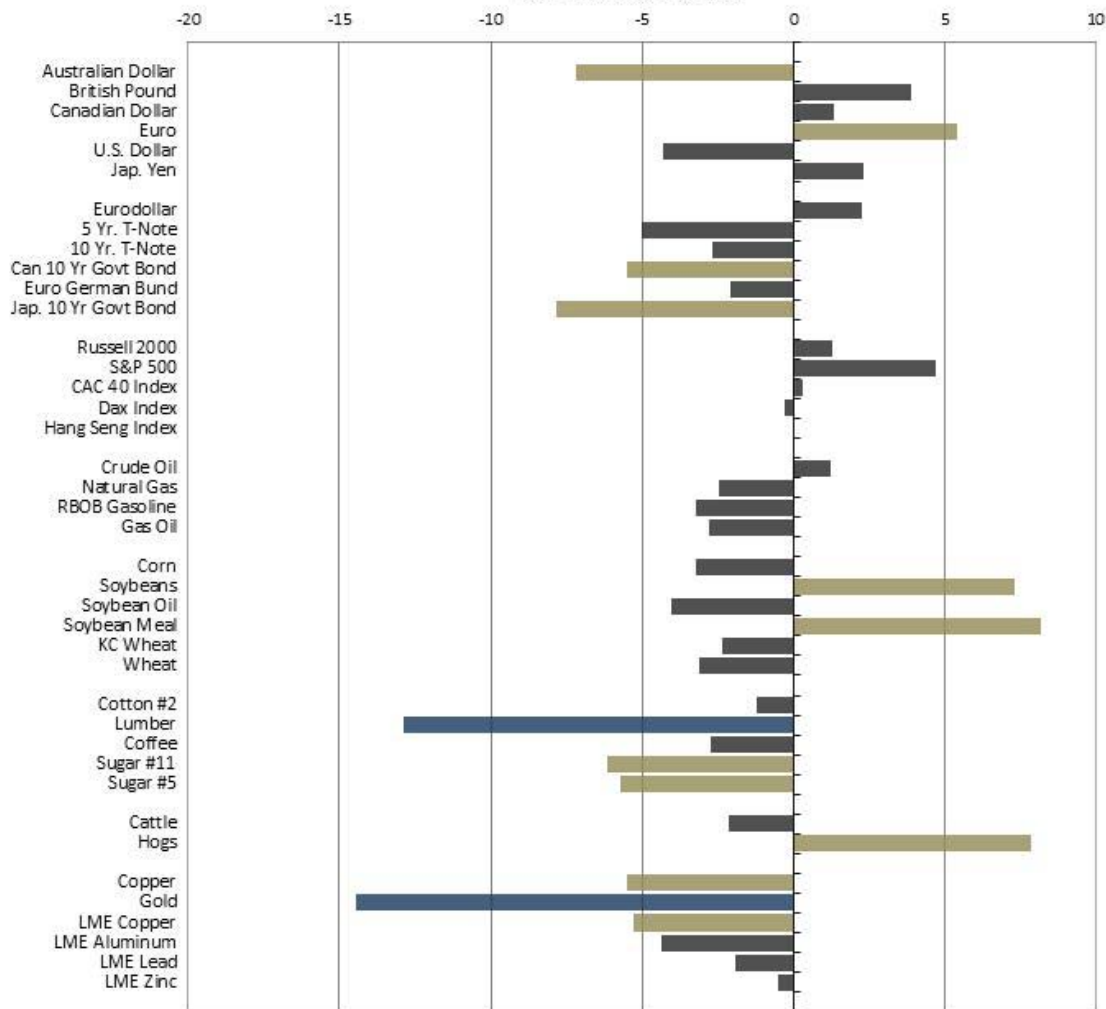
Spread Arbitrage / Relative Value Market Notes:

While trend traders had difficulty in May, certain relative value strategies showed signs of life. Emil van Essen, with \$372 million in assets under management, was up 1.6% in May.

In general agricultural spread traders noted opportunity in soybean complex spreads as cattle and hog markets, while certain corn / soybean spreads started to look interesting.

Trend Levels for 40 Markets

Run Date: 6/14/2013



Aggregate Trend Level for all trending markets: 104.25

Market Breakdown: Bearish 23.0769230769231%, Neutral 66.6666666666667% and Bullish 10.2564102564103%

- 66.6% of the markets are in neutral non-trending phase
- 28.2% of the markets are in a modest trending phase ... 4 are bullish and 7 are bearish
- 5.1% of the markets are in a strong trending phase ... none are bullish and 2 are bearish
- 0% of the markets are in an extremely strong trending phase ... none are bullish and none are bearish

Source: David Stendahl

As mentioned in the article above, markets have been trending below optimal levels.

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EXECUTION. CLEARING. PRIME BROKERAGE.

The Critical Difference

Alternative Investment Evaluation the Wilshire Way

By Mark Melin

What is the most effective approach for an investment consultant to evaluate the seemingly ever growing universe of liquid alternative investment managers?



Jason Schwarz, Managing Director with Wilshire Funds Management, recognizes the challenges in evaluating various complex alternative strategies. Wilshire advises on \$750 Billion in institutional assets.

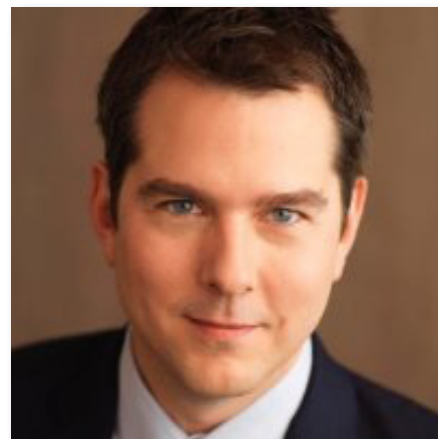
"This really is a question about the effective sourcing of new ideas," noted Jason Schwarz, a Managing Director with Wilshire Funds Management, the asset management arm of Wilshire Associates, "and then following a due diligence process that is scalable and repeatable." Historically, when conducting hedge fund manager due diligence, there hasn't been one "central clearing house" for information.

Given that the hedge fund manager databases only cover about 60% of the universe, investors had to rely on "soft sourcing," according to Jonathan Miles, Vice President and Head of Alternative Strategies with Wilshire. "We have had to attend conferences, ask fellow investors for referrals, and meet regularly with prime brokers. However, today this process is being streamlined by the emergence and rapid growth of liquid alternative funds."

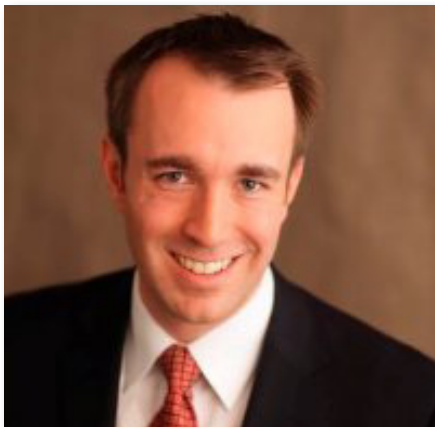
"Now the first step becomes the application of quantitative screens since there is a known universe of funds for which data is available," commented Schwarz at a recent liquid alternatives advisor conference. This allows the research process to focus on the heavy lifting of manager due diligence and identifying unique investment opportunities. "Ultimately, we believe that an investor is not buying a fund so much as an investment team and process, and as such, assessing the team is really a qualitative exercise. After the initial filtering stage, we must understand what is fundamentally driving the performance. What is the manager's edge? What is unique about their strategy?"

Noting that alpha generation is a zero-sum game, Wilshire Funds Management offers seven critical questions investors should consider when evaluating liquid alternative managers:

- 1) What market inefficiency or alternative systematic risk premia is the manager trying to exploit?
- 2) Why do these opportunities exist and is it reasonable to assume they will persist going forward?
- 3) What are the backgrounds (education and experience) of the key investment professionals? In particular, look for teams with significant experience investing in alternative strategies outside of the mutual fund universe. "Just because a manager has been successful investing in a long only strategy, does not necessarily mean they will add value by introducing a hedging or short component to create an alternative strategy" says James St. Aubin, Portfolio Manager and Vice President at Wilshire Associates. Those with an established hedge fund pedigree may be considered earlier in their fund's life than those without such a background. For instance, an experienced and well known hedge fund manager who launches a mutual fund version of a strategy



Jonathan Miles, Vice President and Head of Alternative Strategies with Wilshire. The firm was founded in 1972 and launched the Wilshire 5000 stock index in 1974.



James St. Aubin, Portfolio Manager and Vice President at Wilshire Associates, typically might evaluate an emerging manager after three years solid track record and \$250 million AUM. Managers with a known reputation and institutional background might receive a look with as low as \$50 million under management.

may receive consideration with just \$50 million in assets under management and a one year track record, assuming all other qualitative considerations are met. Meanwhile, an emerging manager with less experience might receive consideration only after three years of solid risk-adjusted performance and \$250 million in AUM.

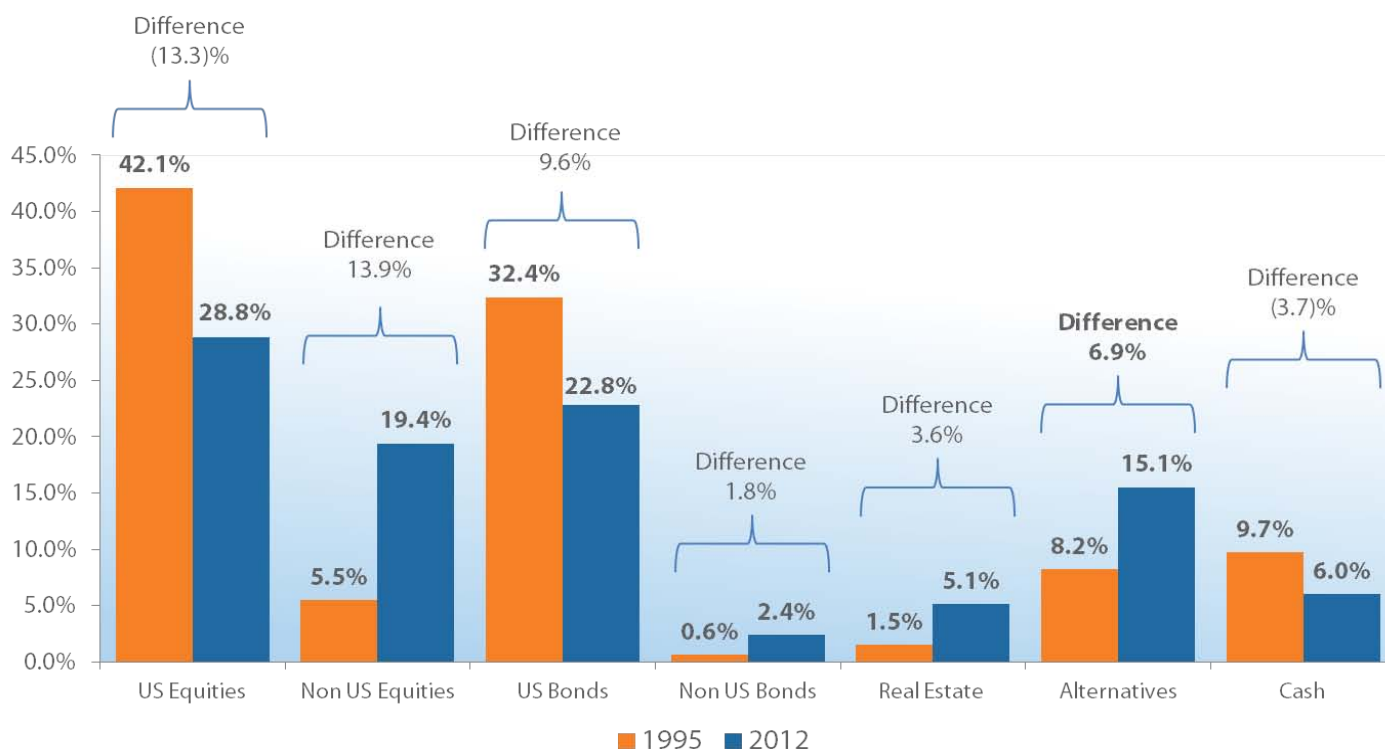
- 4) Does the firm's ownership structure promote investment team stability and properly align investment professional compensation with risk-adjusted returns?
- 5) What resources are supporting the strategy? Do they have significant capital to manage both the business and trading operations?
- 6) Is the investment process disciplined and repeatable? Is the manager able to take advantage of a rich opportunity set by implementing a sound process?
- 7) Identify the risk management process and seek demonstrated execution. How do they measure and manage risk in their portfolio(s)? How do they size their positions? What is their sell discipline?

Wilshire has been conducting alternative investment manager due diligence for over two decades and has been in business since 1972. The firm's Consulting business advises on over \$750 billion in institutional assets* while the Wilshire Funds Management division advises on over \$85 billion in assets for financial intermediaries.* The firm has built a strong business in providing retail financial advisors access to the sophisticated asset allocation and manager research capabilities often used by large institutional investors. And growing demand for liquid alternative portfolios among financial advisors has quickly become a key business for Wilshire, as the firm now oversees over \$500 million in liquid alternative strategies for retail clients.

Understanding alternatives is important to consider in an economy that currently appears to be driven by stimulus and quantitative easing, a point of caution expressed by yield curve trader Bob Southard at the recent JPMorgan Unconstrained Investment conference, which Wilshire attended. Wilshire is quick to note that it has observed a material shift in institutional assets into alternatives, noting that the allocation differential between 1995 and 2012 has been most positive for alternatives and negative for US equities and US bonds.

Institutional Trends: Allocations Shifting Towards Alternatives

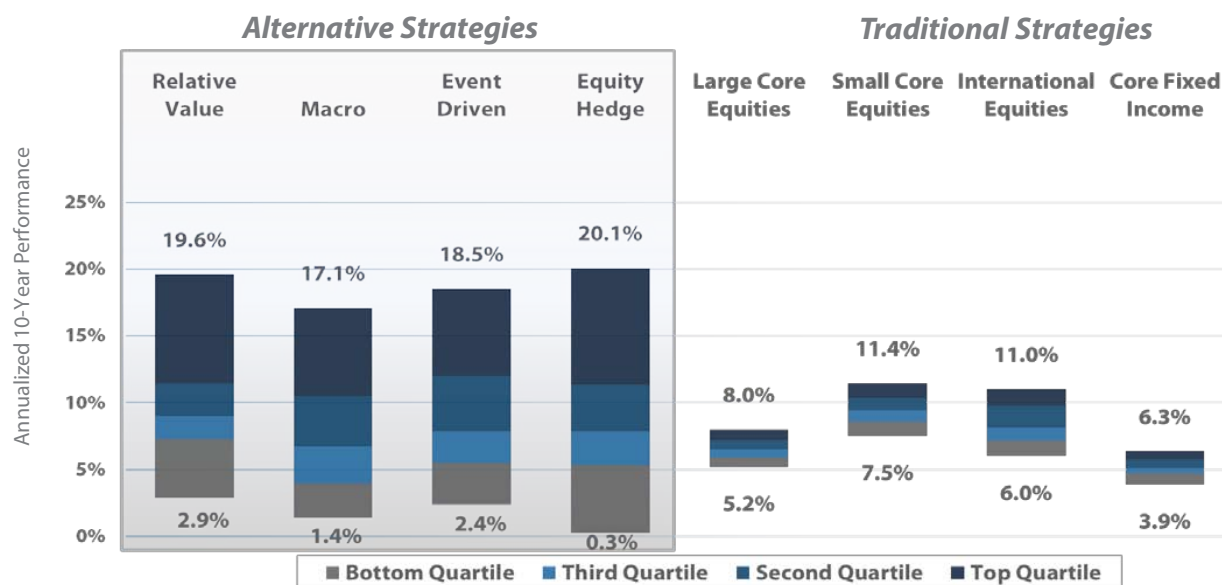
Source: wilshire TUCS



Unlike traditional asset class categories, manager dispersion is much more pronounced among liquid alternative strategies. The key for investors, particularly those utilizing alternative mutual fund products with limited track records, is to use sound due diligence practices to avoid the potential serious negative impact of sub-par managers. “Picking the wrong manager in the alternatives space can be far more costly than doing so on the long-only side,” said Mr. St. Aubin. To illustrate the point, Wilshire compared the dispersion in performance between the top 5% to bottom 5% performers in both traditional and alternative manager universes. “The risk of damaging overall portfolio performance with poor manager selection is simply much greater with alternative strategies,” continued St. Aubin.

“Picking the wrong manager in the alternatives space can be far more costly than doing so on the long-only side”

Annualized 10-Year Performance: 1/1/2003 – 12/31/2012



Source: Wilshire CompassSM, PerTrac. Large Core Equities represented by the Lipper Classification “Large-Cap Core Funds”, Small Core Equities by “Small-Cap Core Funds”, International Equities by the Lipper Objective “International”, Core Fixed Income by “Intermediate Investment Grade”. Alternative strategy custom peer groups are defined by their respective HFRI benchmark constituents.

Dispersion of Manager Returns: Large Spread Between Top and Bottom

With respect to manager selection, Mr. Schwarz advises clients to maintain realistic performance expectations through different market environments and through a full market cycle. “Even great managers are not immune from periods of challenging performance. A manager should be able to articulate in which environments they will do well and in which they will struggle,” St. Aubin said.

While there is certainly a “buyer beware” element to selecting alternative investment strategies, Wilshire believes firmly that this growing trend is overwhelmingly positive for retail investors. “For years, it was only institutional and certain very high net worth investors that had access to hedge funds and other investment strategies that have the potential to provide enhanced portfolio diversification and risk-adjusted returns,” Schwarz says. “The growing availability of mutual fund options is now leveling the playing field. However, careful due diligence and understanding what you are getting is key.”

*As of 12/31/2012.

Auditing of FCMs Enhanced by NFA, CMEGroup, AlphaMetrix Technology Pact

By Mark Melin

The National Futures Association (NFA) and the Chicago Mercantile Exchange (CMEGroup) both recently announced alliances with AlphaMetrix to enhance confirmation of investor assets on deposit at Futures Commission Merchants, the brokerage firms responsible for handling assets in the regulated derivatives industry. With this technical integration, the industry's self regulatory organizations will be able to identify and monitor in real time account balances in depositories holding customer segregated funds, a hot issue in MF Global and the PFG fraud.

AlphaMetrix offers a leading technical platform that provides professional asset managers the ability to gain detailed degrees of transparency into a fund's operations.

The managed futures direct account structure has been unique in alternative investing. Regulated by the NFA, CFTC and CMEGroup, investors can view significant trade transaction details – even peering into daily trade positions, all fees and margin to equity visibility. For a risk manager such transparency to the daily operations of the investment enables them to watch for style drift and overall exposure to position risk limits, a key component to active portfolio management regimes. It is this technical feature that regulators will now use to take their auditing one step further – confirming actual bank balances at FCMs.

“This confirmation of bank balances enhances the existing auditing process, where each registered managed futures CTA offering investments to the public undergo an NFA audit that targets the CTA’s reported performance, fee calculations and business operations.”

Performance that appears in marketing materials and that which is reported to the various managed futures databases is spot checked for accuracy. Audits of CTAs typically occur within the first three years of existence and then occur again depending on perceived need.

Stung by both MF Global and PFG instances, a situation where customer assets went missing from segregated account structure, regulators have moved aggressively to restore confidence. In the PFG situation false bank records were being provided to regulators, according to press reports and court documents (see related article below).



Managed Futures Kit

Get started with Managed Futures

Discover what you need to know about adding commodities and professionally managed futures trading to your portfolio.

Managed Futures are an investment option that can deliver a return source to your portfolio during times of financial market crisis and reduce your overall portfolio risk in the process.

In these educational materials you'll find out why:

- Managed futures is one of the fastest growing investment strategies in the world
- Managed futures may immediately reduce the overall risk of your portfolio
- Futures trading accounts offer an extra layer of checks and balances for your funds
- Managed futures are better able to handle the initial impact of financial market shocks

Managed futures and commodity trading advisors are one of the few investments one can make to reduce the risk associated with traditional investment portfolios while producing returns at the same time. This is the benefit of adding commodities via Managed Futures as a diversifier to your overall portfolio: it can produce returns even when stocks are declining.

About RCM

RCM Asset Management is the independent boutique in commodities, managed futures and forex that savvy investors and money managers can rely on to go beyond the status quo. With RCM Asset Management, you can develop strategies and products that are grounded in experience, but designed for the future.

RCM Futures is a next-generation commodity broker. We've been involved with the markets long enough to know that they are constantly changing, and that staying on top of those changes is essential to success.

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FUTURES TRADING INVOLVES THE RISK OF LOSS AND MAY NOT BE SUITABLE FOR EVERYONE.

The risk of loss in trading commodity futures and options can be substantial. Before trading, you should carefully consider your financial position to determine if futures trading is appropriate. When trading futures and/or options, it is possible to lose more than the full value of your account. All funds committed should be risk capital. Past performance is not necessarily indicative of future results.

Trend Trader / Portfolio Manager Andrew Abraham Reflects on Challenging Years For Managed Futures

At the recent New York CTA Expo, author and trend following CTA Andrew Abraham delivered a presentation on managed futures portfolio development in light of difficult market environments

By Andrew Abraham

In every strategy you can have positive market environments as well as negative periods. There is no Holy Grail nor is investing ever really easy.

The last 13 years in the stock market was less than lackluster with two 50% draw downs and flat returns. While most strategies faltered in the depth of 2007 and 2008 managed futures shined. Unfortunately many investors flocked to the space and thought they found the Promised Land.

There were both trends on the long side and the short side during this volatile period. Prices hit nose bleed highs on crude and then crashed back to earth. Crude hit highs in the \$140 dollar range only to crash to the \$30 dollar range. In both of these cases some trend following CTAs profited. Other markets such as wheat also had tremendous trends. Gold, silver and sugar also experienced moves. It does not matter if they are uptrends or downtrends commodity trading advisors have the potential to benefit via trends. However investors who chased returns were shortly disappointed in 2009 & thereafter. Too many investors seem to make the mistake of buying highs and selling lows of commodity trading advisors with managed futures.



Trend following fund manager Andrew Abraham is author of two books.

Continuing to 2013: It Has Been a Very Challenging Last 2 Years for Managed Futures.

I have met with family offices who thought they made the correct decisions investing in large CTAs in 2009 only to be disappointed and actually lose money. Many investors lose money even with successful managers! It is very easy psychologically to invest when a manager is having a good run. Too many investors, however, "Buy the Highs and Sell the Lows." Further, it is very easy to allocate to a large manager with billions under management (but they are not perfect and can lose money also).

"Many investors lose money even with successful managers! It is very easy psychologically to invest when a manager is having a good run."

The reality of managed futures over the last two years has been:

- Two Back to Back years of negative and sub performance

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- Repeatedly Heard – Trend Following is DEAD!
- Even received an Email from a perspective client – Find a New Line of Work!
- It is Never Easy!
- There are Always Losses & Long Durations of drawdowns.

However as much as Past Performance is not necessarily indicative of future performance, I am encouraged. A tremendous amount of money has left the space. Some of the most well-known legends are hanging up their coats. It is not out of the norm to have periods in excess of two years with flat to negative returns. As much as this sub performance can easily continue, one can think on a contrarian basis potentially. Business Week ran an article in the late 1970s called "The Death of Equities". We all know that the greatest bull market of all time started shortly thereafter. One must truly believe that "Anything can happen." Look at the Nasdaq meltdown, Japan's stock market implosion in 1989 from 39,000 to today's numbers or even crude oil volatile run from the \$140 dollar range to \$30.

When investing in managed futures possibly the goal is not just making money. On a personal level, even though I am a CTA myself I invest with other CTAs & managed futures in order to try to compound money over time & diversity, I am concerned about inflation. It is possible with all the money that has been printed throughout the world there is the threat of Inflation. Paul Singer, the principle of Elliott Associates L.P. \$16 Billion Hedge fund has stated in one of his recent presentations that *"The thing that scares me most is significant inflation, which could destroy our society."*

I have been trading managed futures and investing with CTAs since 1994. In order to be consistent I developed a set of rules in which I adhere to both in my trading as well as my allocation to other CTAs. As stated prior, my goal is to attempt to compound money over long periods of time.

Rules for Investing in World Class Money Managers

1. 10 year record- Seen various cycles
2. Liquid & Transparent- Managed Account
3. 15% CAGR (Compounded Annual Growth Rate)
4. Doing the Uncomfortable: Buying the Drawdown
5. Performing Strong Due Diligence
6. Allocating no more than 5% of assets in anyone manager
7. Accepting there is nothing perfect, no magic manager and even following these rules there still will be losses!

Some unique CTAs have been around for decades and have achieved these high hurdles. Conversely countless CTAs have failed. In every field there are always a few unique people with extreme talent.

- Salem Abraham 17.75% CAGR since 1988
- Chesapeake 11.63% Since CAGR 1988
- Clarke Worldwide 14.72% CAGR 1996
- Eckhardt Aggressive 19.87% 1991
- EMC 21.04% 1985
- Mark Walsh 19.99% 1985
- Saxon 19.43% 1993

However there is **NO HOLY GRAIL**. It is never easy! There are always long periods of drawdowns & losing periods even with unique CTAs who have been around for decades.

- Salem Abraham worst draw down -31.96%
- Chesapeake worst draw down -36.73%
- Clarke Worldwide worst draw down -27.15%
- Eckhardt Aggressive worst draw down -40.39%
- EMC worst draw down -45.35%
- Mark Walsh worst draw down -43.04%
- Saxon worst draw down -65.86%

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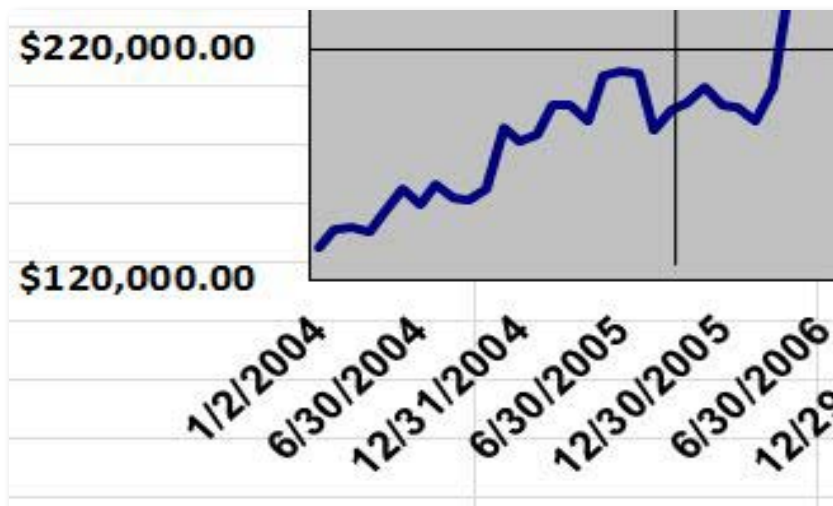
Drawdowns are inevitable. Even the successful unique CTAs that know how to deal with risk management, money management and proper trading psychology also went through some very ugly periods of trading. The irony is that probably the vast majority of investors who allocated to them did not achieve the success they did. As most traders and investors do they jump ship at the first draw down or period of illusive profits. An idea is to allocate during these inevitable drawdowns.

In order to succeed when investing in managed futures, one needs the proper perspective. As in this example we will detail what can easily happen and has happened. (In the graphics below Mr. Abraham highlights periods of long, flat managed futures performance and steep drawdowns, painting a realistic picture of both negative and positive performance.)



Graphics Source: Andrew Abraham. Past Performance is not Indicative of Future Results

How Easy It Really wasn't - 1 year + of No profits. From December 2005 until December 2006

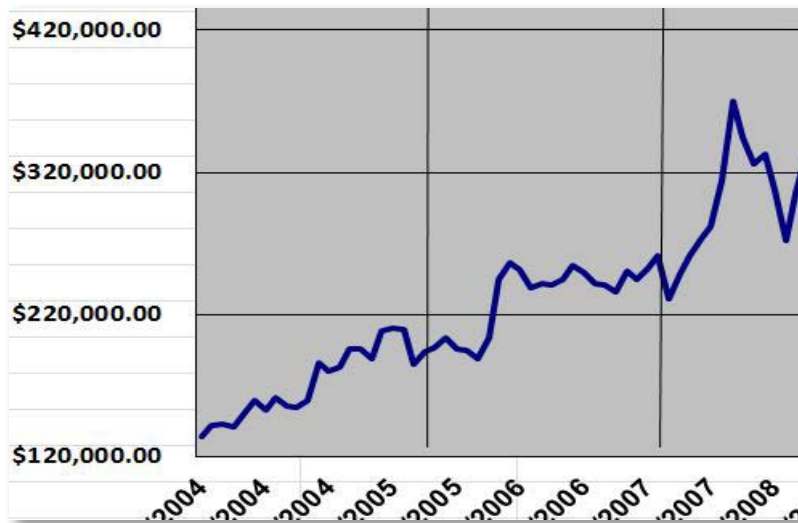


Graphics Source: Andrew Abraham. Past Performance is not Indicative of Future Results

MANAGED FUTURES

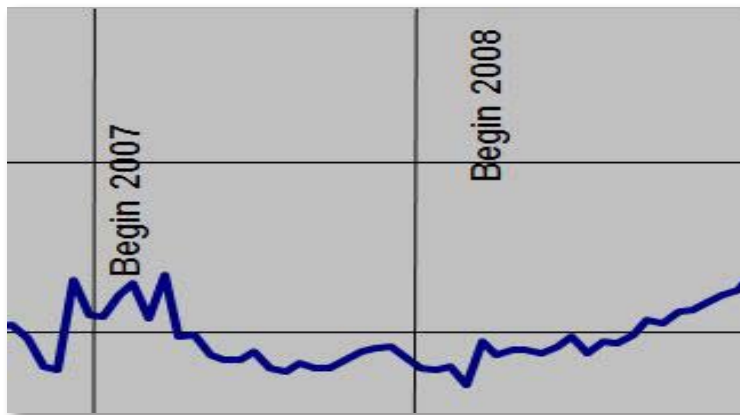
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Steep & Sharp Draw Downs



Graphics Source: Andrew Abraham. Past Performance is not Indicative of Future Results

Long Flat Period of Elusive Profits



Graphics Source: Andrew Abraham. Past Performance is not Indicative of Future Results

Andrew Abraham, Principle of Abraham Investment Management has 19 years of futures trading experience investing in CTAs as well as developing and running mechanical systematic trading systems for his own trading & CTA. Andrew is the author of the books – *The Bible of Compounding Money- How to Invest with World Class Money Managers* as well as *The Bible of Trend Following- How Professional traders compound money and manage the risks*. www.AbrahamCta.com – Andrew@AbrahamCta.com

Uncorrelated Investing Market Commentary

While much was made of the negative impact of the recent move higher in interest rates, below are several CTAs who benefited from the moves and their related market commentary.

Rate Move Plays Into 2100 Xenon's Bond Trading Models

The sudden plunge in bond prices played right into the strengths of 2100 Xenon's fundamental bond trading models in May, earning the Global Long/Short Fixed Income portfolio an estimated +2.4 per cent. The more diversified and higher volatility Managed Futures (2x) portfolio benefited from bond trading but it was not enough to prevent a loss for May of an estimated -1.42 per cent. The Australian markets were especially difficult last month for Managed Futures (2x); trading the Australian stock market and the Aussie Dollar cost the portfolio more than two per cent. Still the story remained the success of 2100 Xenon's Yield Curve and Momentum Dispersion models, which both benefited from yield curve steepening. Also, short-term bond trading revived for its first winning month of 2013.

“Trend-following models, however, struggled because they remained stubbornly long bonds and short the dollar.”

Trend-following models, however, struggled because they remained stubbornly long bonds and short the dollar. So far in June, 2100 Xenon remains short the global bond market, though recent volatility has forced the portfolio to systematically scale down its risk. Other exposures include a long bias in equities and a short bias in gold. Currency and commodity exposures remain mixed. The 2100 Xenon Managed Futures (2x) Program was down an estimated -1.42 per cent in May. The 2100 Xenon Long/Short Global Fixed Income Program was up an estimated +2.40 per cent in May.

2100 Xenon is a Chicago-based commodity trading adviser that provides diversified alternative investment strategies to the institutional and retail marketplace. 2100 Xenon manages a full range of managed futures products invested across global equity, fixed income, currency, metals, energy and commodity markets. The investment team has significant experience in managed futures portfolios. 2100 Xenon is an affiliated asset manager within Old Mutual (US) Holdings, the U.S.-based asset management business of Old Mutual plc. Listed on the London Stock Exchange, Old Mutual plc is an international financial services company providing asset management, insurance and banking services worldwide.

Reynoso Interest Rate Program Captures Rate Move

The month of May started with yields on the 10-year note hitting a low of 1.63% - a low in yield going back to December. This level represented a sharp drop from the 1.85% yield a month earlier. From that point, we saw a spectacular rise in yield, hitting a high of 2.23% on the 29th. We were positioned to capture most of the move, resulting in a gain of 14.60% for the month, bringing the YTD return to 6.44%. Despite the initial 22 bp 10-year note move against the program's position in April, the favorable move in May resulted in a net gain of 6.37% over the volatile April/May period.

The program takes a stance which profits from rising yields”

UNCORRELATED INVESTING MARKET COMMENTARY

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The program takes a stance which profits from rising yields, with discretionary options overlays for alpha enhancement and “tail risk” option protection against significant adverse price moves. Through the month of May, those options positions contributed a negligible cost to the returns, which we consider quite a feat in a market which accelerated as quickly as witnessed. Looking ahead, we’d be surprised to see a similar move this month. That being the case, we’ve “tightened” our hedge and overlay, potentially forsaking similar outsized gains in the program in return for locking in a good portion of last months profits. As always, these options will be adjusted throughout the month as events unfold.

CIO Joe Reynoso has 28 years trading experience with options expertise, including having co-founded a multi-national options market making firm (Helios). The flagship Volatility Program launched January 2002. The program trades options on S&P500 futures seeking to capture options mispricings by being either long or short. The Long Commodity Program launched January 2012. The program primarily trades grains and softs. Return differentiation is achieved in part by excluding energies and precious metals from the portfolio. The programs are traded on a discretionary basis utilizing a proprietary model for the volatility program and technical's for the commodity program. The trading program has a history of trading customized portfolio mandates for institutions.

Dix Hill Partners Notes Importance of Yield Curve Volatility

In May Dix Hill’s directional exposure in the yield curve varied across countries. The fund reversed its small long (bullish) US position in early May to a moderate bearish position and cut back its short JGB position. German and UK were reversed also to small bullish (long) positions. The main driver of our profits in May was the bearish US position in the yield curve. US macro economic data, led by a stronger than expected April payroll report, retail sales, housing and consumer sentiment, appeared to be a catalyst a sharp increase in Treasury Yields (10YR Treasury Yields rose approximately 50BP in May). The renewed signs of strength in economic data, coupled with statements from the Federal Reserve of a possible “ease in asset purchases,” led to expectations from investors that the FOMC will scale down the pace of its asset purchases gradually, potentially as early as 1Q’14. May was an example of not only how the multi-factor framework was correct on the direction of US interest rates but also the importance of bond market volatility in alpha generation. In the US, the MOVE Index, which reports implied volatility across options on the 2YR, 5YR, 10Yr and 30YR Treasuries, is currently stands around 80 versus a low of 49 in early May. For basis of comparison, the MOVE Index averaged 68 in 2012, versus its longer-term average of 102. This recent increase in volatility may reflect increased uncertainty regarding the future path of Federal Reserve policy, which, in turn will be closely linked to evolving macro-economic dynamics. In contrast, the limited spikes in bond market volatility in the last 1-2 years reflected “flights-to-quality” that were less fundamentally driven and less predictable.

“May was an example of not only how the multi-factor framework was correct on the direction of US interest rates but also the importance of bond market volatility in alpha generation.”

In Japan, Dix Hill’s small bearish position benefitted as once again the JGB market was highly volatile, mainly due to the BoJ bond buying and pledge to boost inflation to 2% in the next two years. Japanese GDP and Manufacturing data were also better than expected resulting in a spike in yields to 1% (on an intra-month basis), the highest level in more than a year. Germany and the UK small bullish positions led to small losses as economic data from both regions was mixed across the board.

As of early June, Dix Hill’s U.S. interest rate outlook has switched from very bearish to moderately bullish. Despite a better-than-expected U.S. employment report on June 7, forward-looking labor market data has softened, as has the performance of U.S. equity markets in recent weeks. In addition to these soft macro readings, the recent back-up in U.S. interest rates has pushed market valuation to neutral. This neutral reading is the first non-negative valuation measure (based on proprietary estimates), in some 17 months. Bearish technicals are acting as a partial offset to these factors, leading to a less-than-maximum position size on our U.S. long. Slightly long German Bund positioning has been increased to fully long. From a macro perspective, German export indicators appear weak, and the recent back-up in Bund yields offers better valuation in the short-term. We are positioned similarly long Japanese JGB’s for similar reasons—weaker leading macro indicators (such as a recently falling Nikkei), as well as a possible mean-reversion value play relative to the recent JGB yield backup. We remain only moderately long UK Gilts. In this case, the local UK

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macro data we track has improved a bit, acting as a bearish offset to positive valuation. Finally, Dix Hill has established very small steepening trades in Treasury 10's v 2's as well as Eurodollar futures.

Dix Hills Partners, LLC is an SEC registered investment manager and CTA, managing investments in global interest rate futures strategy since July 2003. Current AUM is approximately \$410mm and their research calls are utilized on over \$1.5B in assets through our partner Federated Investors. Dix Hills' investment decisions are based on a systematic interpretation of macroeconomic, valuation and technical factors and their relationships to global interest rates. As the strategy is highly fundamental and value oriented, the strategy performs best when market participants are responsive to economic information. Currently, we are focused on sovereign bond yields and the drivers thereof, with exposure in US Treasuries, German Bunds, UK Gilts, Japanese JGB's and Eurodollars. While our investment approach is best described as fundamental, Dix Hills Partners' process is data-oriented and highly systematic in terms of implementation. Furthermore, our average margin to equity ratio is in the 3%-5% range compared to a typical CTA range of 16% to 22%.

The opinions expressed in this section are solely those of the CTAs which were solely relied upon as source material for these articles. Past performance is not indicative of future results.

CFTC Goes After US Bank in PFG Case. The Smoking Gun Likely Found in Depository Agreement

By Mark Melin

The Commodity Futures Trading Commission (CFTC) recently filed a lawsuit against US Bank in what could turn out to be an interesting case. As a depository bank for futures brokerage firm Peregrine Financial Group (PFG), the bank was holding assets in the fraud case during a period of time when \$215 million of PFG's client assets disappeared. [Stringent rules](#) have been in place for decades that specify depository processes for handling customer segregated funds with strong penalty already on the books for misuse of fiduciary responsibility.



Outside his new corporate headquarters in Iowa during better times, Russ Wasendorf Sr was later convicted of fraud after a suicide attempt.

PFG, Fraud and "Senior"

PFG's CEO Russell Wasendorf Sr., now in his 70s, received a harsh 50 year sentence and was ordered to pay \$215 million in restitution. Mr. Wasendorf admitted providing the bank false documents and attempted to take his life in a failed suicide bid when the fraud was discovered by regulators. The brokerage executive was fond of a jet-setting lifestyle and at one point flew around the world in a private jet to rock concerts with his second wife and owned a variety of companies including restaurants, a construction company, book publishing and advertising in addition to the futures brokerage firm PFG. A former documentary film director, Mr. Wasendorf was known to spend lavishly on industry parties to promote himself as one of the top industry players, a goal that remained elusive. He built a spectacular \$20 million corporate facility in a small Iowa town just prior to the firm's demise in July 2012. Questions still persist as to the

whereabouts of missing money. Now without access to capital and much of his family disowning him, he is now said to be in prison contemplating a memoir. Mr. Wasendorf, known as "senior," is author of several financial books and, in better times, had talked about writing a fiction novel.

PFG had both a retail direct managed futures business headquartered in Chicago and an institutional managed futures division headquartered in Los Angeles that worked with Registered Investment Advisors (RIAs).

CFTC Pursues Violators of Bank Fiduciary Responsibility

The PFG incident marked the first time in history a depositor lost money out of a customer segregated futures account that resulted in the brokerage firm CEO being convicted of fraud. In a statement discussing the matter, David Meister, the CFTC's Director of Enforcement, said: "The Commodity Exchange Act and Commission rules protecting customer funds impose obligations on banks that hold those funds. As should be apparent from today's action, we will seek to hold a bank to account if it falls short on complying with customer fund protection obligations. Wasendorf stole vast sums of customer money, but his crimes do not excuse U.S. Bank from its own independent responsibilities."

This could be an apparent reference to the generally known fact that banks have extraordinary fiduciary responsibilities when

EDITOR'S NOTES

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handling customer segregated funds.

The Complaint alleges that U.S. Bank was a depository institution serving Peregrine, a registered FCM, and Wasendorf since 1992. From approximately September 2008 to July 2012, U.S. Bank unlawfully accepted Peregrine's customers' funds as security on loans it made to Wasendorf, his wife, and his construction company, Wasendorf Construction, L.L.C., to build an office complex for Peregrine in Cedar Falls, Iowa. The Complaint further alleges that from approximately June 2008 to July 2012, U.S. Bank improperly held Peregrine's customers' funds in an account U.S. Bank treated as Peregrine's commercial checking account and knowingly facilitated Wasendorf's transfers of millions of dollars of customers' funds out of this account to pay for Wasendorf's private jet, his restaurant, and his divorce settlement, among other things. U.S. Bank knew that these transfers were not for the benefit of Peregrine's customers, according to the Complaint.

US Bank Defends Itself

US Bank has vowed to defend itself but did not comment directly as to a signed depository agreement between US Bank and PFG. If they had such an agreement in place, one might expect US Bank to be in a different legal position than without the agreement. Instead, the firm released a blanket release to the press:

- * Like the CFTC, we are sympathetic to the victims of Mr. Wasendorf's self-admitted fraud.
- * U.S. Bank was also a victim of the same fraud – one that the CFTC failed to detect.
- * This lawsuit is without merit and represents an inappropriate attempt to reassign blame to U.S. Bank.
- * The regulatory program in place at the time allowed Wasendorf to intercept regulator communications that were intended for the bank and to falsify bank responses to those communications, all without the bank's knowledge – as Mr. Wasendorf has already admitted.
- * Wasendorf's scheme to keep the bank in the dark included creating a P.O. Box to intercept communications from the regulator to the bank.
- * As he has admitted, Wasendorf actively deceived the bank. At no time did we have any knowledge that Wasendorf was running a fraudulent scheme.
- * The bank did nothing wrong and we will defend ourselves vigorously.
- * Banks are not responsible for losses generated by customers who are fraudsters.
- * The lawsuit itself accuses the bank of violating technical regulations that have never been interpreted by any Court to apply when a bank is not notified that it was holding Customer Segregated funds.
- * The CFTC's theory against the bank is unprecedented, seeking to impose responsibilities that the bank never had and alleging violations that it never committed.



This prison photo was splashed on the cover of the New York Times business section after his failed suicide attempt and later admission of guilt.

DOCUMENT DISCLOSURE

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User agreement and confirmation of Qualified Eligible Person status

The user acknowledges and agrees to all of below:

User confirms that they are a Qualified Eligible Person as defined under the (CFTC) Regulation 4.7., because they are: Registered investment company; Bank; Insurance company; Employee benefit plan with >\$5,000,000; Private business development company Organization described in Sec. 501(c)(3) of the Internal Revenue Code with >\$5,000,000 in assets; Corporation, trust, partnership with >\$5,000,000 not formed to invest in exempt pool; Person with net worth >\$1,000,000; Person with net income >\$200,000 each of last 2 yrs. or >\$300,000 when combined with spouse; Pool, trust separate account, collective trust with >\$5,000,000 in assets; User also confirms they meet the following Portfolio Requirement: Own securities with a market value >\$2,000,000; Have had on deposit at FCM, in last 6 months, >\$200,000 in margin and option premiums; Have combination of securities and FCM deposits. The percentages of required amounts must = 100%.

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