

MANAGED FUTURES, YOUR QUESTIONS ANSWERED

Question

Managed Futures Funds & Commodity Trading Advisors (CTAs) have received a lot of press recently, what are Managed Futures? And what are their benefits?

Answer

2008 will likely be recognized as the breakout year for managed futures. Not just because the industry was able to generate positive returns, but because the Managed Futures was able to generate these positive and non-correlated returns during volatile and changing market conditions. While the main benefits of managed futures have been prevalent for years, it took a year like 2008 to finally highlight the unique characteristics of this asset class.

The unique benefits of managed futures include professional management, the ability to profit from up, down and sideways markets, and the simple fact that managed futures are not strongly correlated to other asset classes.

CTAs are the professional money managers or traders that make up the managed futures industry. CTAs trade their clients' money on a discretionary basis and transact almost exclusively in the futures markets. At first glance, one might assume that all commodity trading advisors are alike, but CTAs differ in terms of their trading strategies, the markets they trade, their experience levels and the style of trading they use.

Because of their differences, it is important to distinguish the different types of CTAs. Comparing a manager that trades gold and silver on a short-term basis against a manager that trades corn futures on a long-term basis is not the best form of evaluation. In a sense, it is like comparing a manager of a US technology mutual fund against a manager of emerging markets fund. Therefore, the first process in evaluating the managed futures industry is to differentiate between the various ways that managers yield returns.

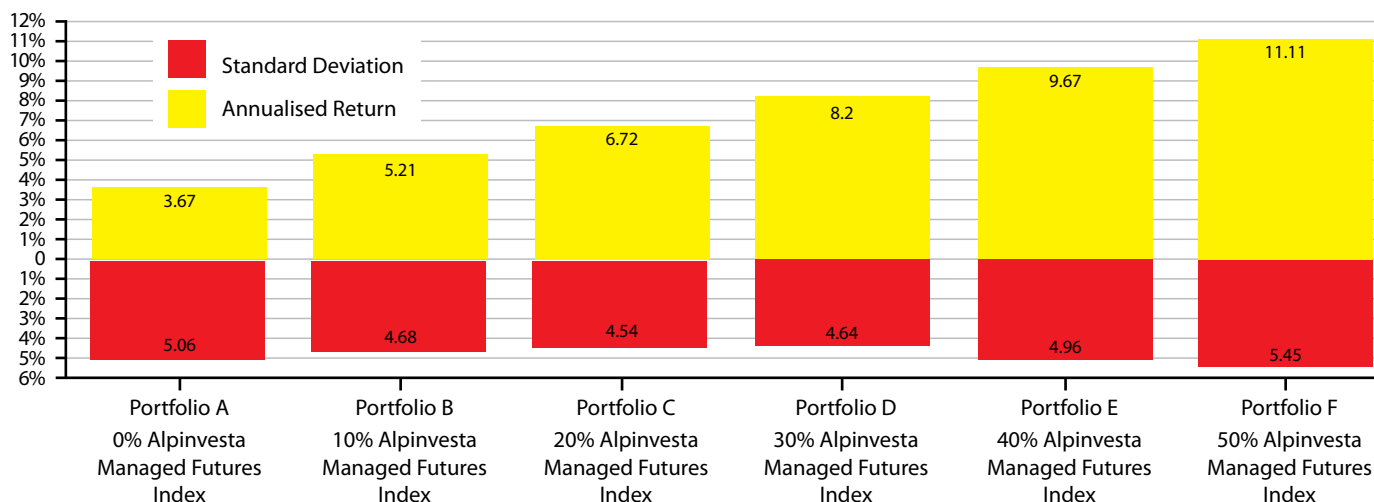
Question

Why should I use Managed Futures in a portfolio

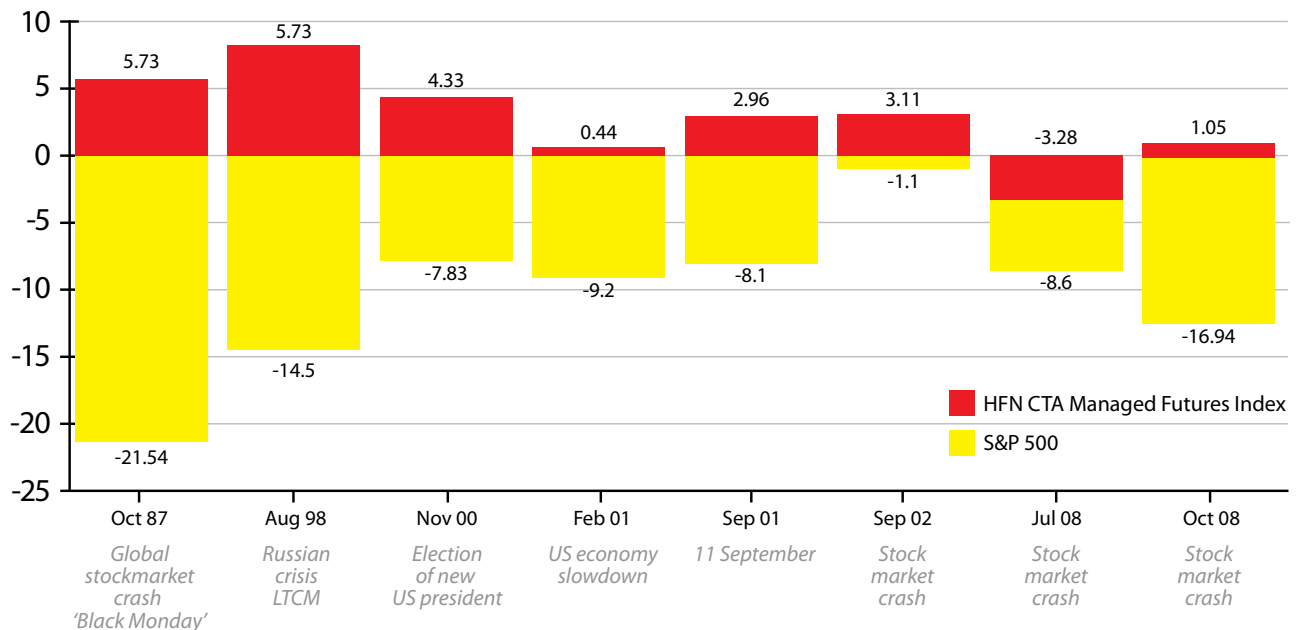
Answer

There are four main reasons investors should consider allocating to managed futures;

1. First, investors will look at using managed futures or CTA's to diversify their portfolios due to their lack of correlation to traditional investments. The chart below highlights the effect of adding Managed Futures* to a portfolio – 60% Equities (MSCI World) + 40% Bonds (JPM Global Bond Index) – it increases the return whilst reducing the risk.



2. Secondly, the Managed Futures Industry has demonstrated over the last 30 years, strong defensive characteristics in times of market volatility. During the major market crashes over the last 10 years, managed futures have consistently not only weathered, but significantly out-performed major markets. The HFN CTA Index was + 12.04% versus the S&P 500 Price Index of -38.49% in 2008.



Source: Alpinvesta, 31st December 2008

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3. Managed Futures offer clients a chance to make money in both falling as well as rising markets through their ability to 'short' the market.

4. Finally, managed futures markets represent some of the most highly traded markets in terms of volume like the currency markets and so many managed futures offer investors highly liquid funds that are easy to get in and out of without extensive lock-ups.

Investors sometimes falsely assume that an investment in just a single strategy CTA will add the same level of diversification to their portfolio. Clearly, this is not the case. There are additional risks with only investing in a single CTA. Ideally an investor should invest into an actively managed Index or Fund of managed futures funds that blends together managers with different styles in order to reduce the risk and alleviate drawdown.

Question

How do managed futures differ from hedge funds?

Answer

Managed futures are often stripped out and not seen strictly as hedge funds, but rather as part of a broader hedge fund universe. We look at our hedge fund exposures and our managed funds exposures as two separate things. For example, a lot of managed futures funds are long-term or medium-term trend followers, they tend to do well when there are very pronounced trends, whether those trends are up-trends or down-trends or patterns, whether they're in equity markets or commodities or currencies. Hedge funds generally try to identify mis-pricing anomalies and have to determine clear trading opportunities with a clear exit plan. This by comparison can carry more unknown risk versus managed futures.

Another key differential is the scalability of the Managed Futures industry. Having already experienced exponential growth in terms of money under management, this number (\$225.5 billion according to Barclay Hedge) this still pales in comparison to the amount of money under managed for hedge funds (\$1718.4 billion according to Barclay Hedge). Managed futures trade across some of the most liquid markets in the world and this offers far greater scope for sustained trading opportunities and possibility or outperformance versus the broader hedge fund styles.

Question

What is the outlook for managed futures in 2009?

Answer

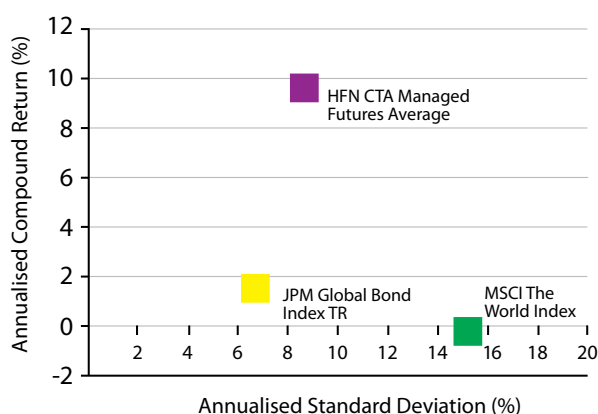
Given the current levels of volatility and the massive government interventions we have recently witnessed there seems to be a lot of money sitting on the sidelines, however managed futures continue to look a "hot" spot for investment. What we know is that managed futures offer one of the best areas for 2009, primarily due to the nature of their trading style and the liquidity they offer.

As stated, the current volatility is the highest witnessed across many markets, the ebb and flow of volatility is alive and will continue to create money making opportunities for managed futures traders. Given the enormous fiscal and monetary responses, which may continue, substantial moves in our markets are likely. Precious metals look to be a natural hedge against currency and interest rate movement as central banks continue to print new money. Again, 2009 will be difficult year for financials and real estate due to lack of financing and there will be a multitude of plays on the short side.

A lot of hedge funds are looking to increase allocations to managed futures as they are still faced by redemption outflow. Managed Futures provide a liquid asset with upside for these guys during turbulent times and a risk management tool on assets that are held which can't be sold without the fear of being marked down.

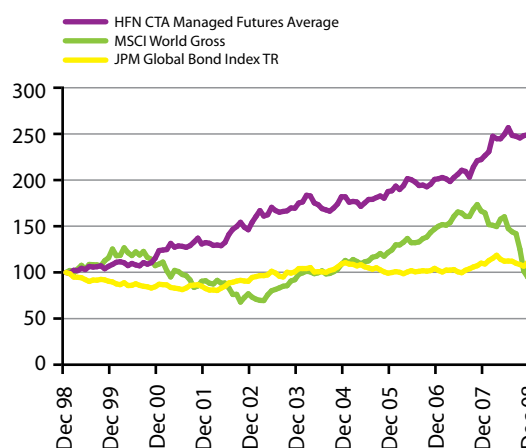
Generally, Managed Futures should continue where they left off in 2008 but the art will be picking the right managers. Investors should remember that the returns of Commodity Trading Advisors are not necessarily dependent on the whether or not we are in a commodity bull market. Rather, returns are a byproduct of the markets traded (ranging from commodities to financials to currencies), the strategy that the manager implements, and the actual skill of the manager trading the program.

Managed Futures show lower volatility than equities but with a higher return.



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Managed Futures show lower volatility than equities but with a higher return.



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Source: Alpinvesta/Pertrac & HFN Database 1st Jan 1999 – 31st Dec 2008.