altegris

ALTEGRIS ACADEMY
FUNDAMENTALS

THE FUNDAMENTALS OF **FUTURES**

TRUSTED ALTERNATIVES.
INTELLIGENT INVESTING.

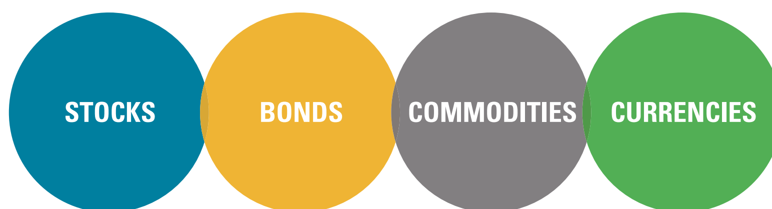
Illustrative Example

Note that the narrative of this article is for illustrative purposes only, telling a simplified tale of how what began as a simple business agreement has grown into an industry that now manages close to $300 billion.

Managed futures is an asset class managed by professional investment managers who trade futures contracts.

In some ways, similar to buying or selling stocks and bonds, these professional investors typically react to price movement across all markets by trading (buying or selling) futures contracts in expectation that prices will continue to follow the same up or down trend.

There is a common misconception that "managed futures" is synonymous with "commodities." However, managed futures is a versatile investment strategy that can actually invest in futures contracts across four asset classes—stocks, bonds, commodities and currencies.



› What exactly is a futures contract?

A futures contract is an agreement between two parties to exchange a set amount of goods, at a set price, at a certain time in the future.

To better understand futures contracts today, and the broader managed futures asset class, it is helpful to understand their past.

AN ILLUSTRATIVE EXAMPLE:

Farmers and ranchers had a lot of uncertainty about the future.

The farmer had concerns that the price of his corn might fall before he could sell it; the rancher, who needed corn to feed his cattle, feared that prices might rise before he could buy his corn.

Since both the farmer and the rancher had uncertainty about the future price of corn, they decided to agree to a price that day for the corn that they would exchange in the future. Their agreement was beneficial to

both of them, making it so they no longer needed to be concerned about tomorrow's prices because their contract met each of their future needs.

Over time, agreements like the one between the farmer and rancher became more common, and with their popularity came a more formalized and standardized process:

- **The creation of centralized exchanges.**
  Rather than farmers and ranchers needing to find each other, they were able to go to centralized exchanges, similar to how stocks are traded, to buy and sell the same contracts they previously had to negotiate and write themselves.

- **Bringing buyers and sellers together.**
  The introduction of exchanges brought buyers and sellers together on a global basis to hedge their price risks more efficiently.

- **Increased accessibility and variety.**
  As trading became more accessible, more contracts of various types were traded.

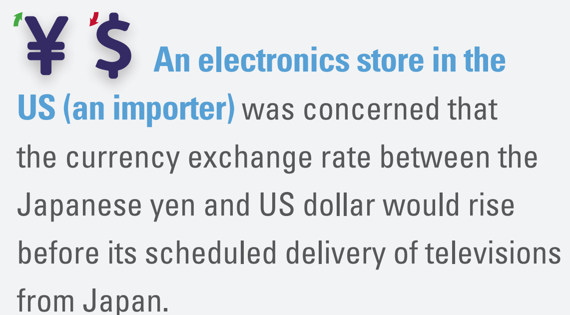
› Types of contracts

In addition to commodities, such as corn and wheat, contracts were developed for all types of items. Whether a person, or company, was concerned about interest rates or currency exchange rates, the exchange had or created contracts to meet their needs.

A CURRENCY HEDGING EXAMPLE

An electronics manufacturer in Japan (an exporter) was concerned that the exchange rate between the Japanese yen and US dollar would fall between now and the scheduled delivery date for a shipment of televisions to an electronics store in the US.

If the exchange rate (price of yen) fell, the Japanese manufacturer would receive less money.



An electronics store in the US (an importer) was concerned that the currency exchange rate between the Japanese yen and US dollar would rise before its scheduled delivery of televisions from Japan.

An increase in the exchange rate (price of yen) would make the televisions more expensive for the store to buy.

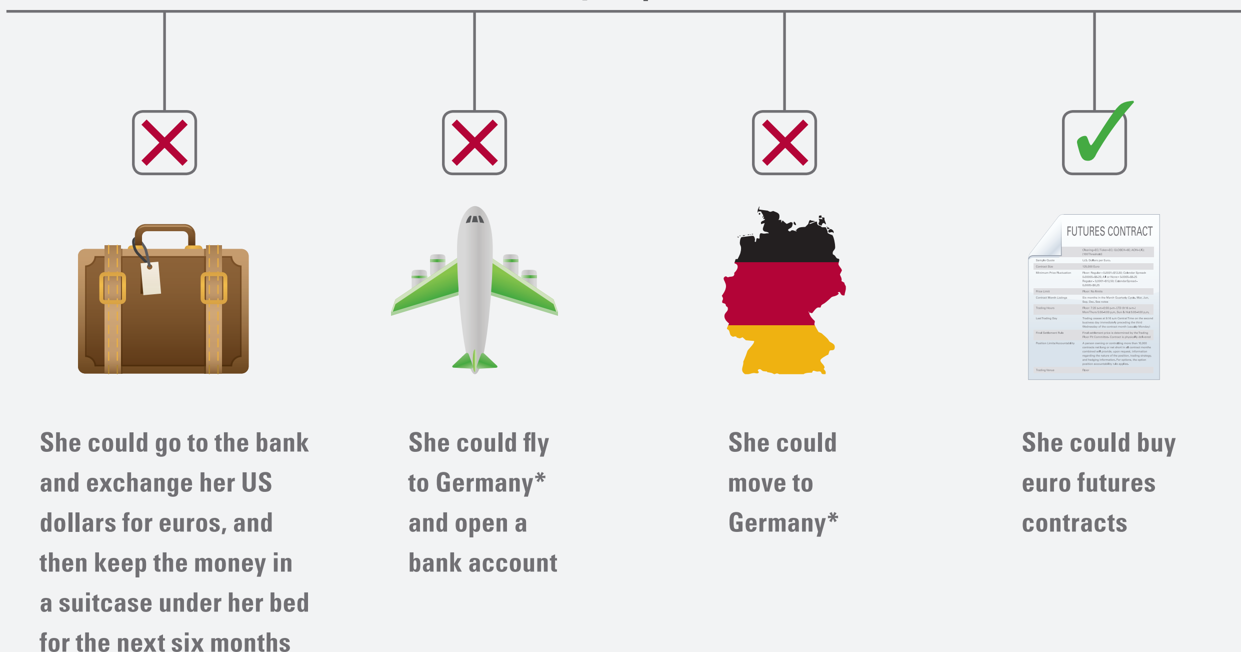
Both were able to hedge their concerns (price risk) by buying (by the US electronics store) and selling (by the Japanese television manufacturer) yen contracts. The manufacturer in Japan was then able to know for certain how much it would receive for the future shipment of the televisions it was manufacturing. Likewise, the store in the US knew with certainty how much it would be paying for the televisions.

Investors observed the buying and selling of futures contracts and realized that, beyond just hedging, trading these contracts had profit potential. Just like any other investment, if contracts were bought at a price lower than the actual future price, or sold at a price higher, investors could make money.

ONE ILLUSTRATIVE EXAMPLE OF HOW INVESTING USING CONTRACTS WORKS

Investor Mary believes that the euro is going to increase in value against the US dollar over the next six months. She is trying to decide the best way to invest according to her opinion about the future value of the euro.

Mary's Options



Futures contracts offer an easier way for Mary to invest according to her views.

** In this example, Germany is used to represent any eurozone country.*

› Who trades futures contracts?

There are essentially two types of people who trade futures contracts: hedgers and investors. Both hedgers and investors can trade contracts in all four asset classes: stocks, bonds (interest rates), currencies, and commodities.

- **Hedgers**, such as farmers and manufacturers, seek to avoid the impacts of unexpected future price movements.
- **Investors** on the other hand, such as professional money managers and fund companies, seek to profit from future price moves. They are the predominant traders of futures contracts.

Can anyone trade futures contracts?

Yes, though investors should be aware that the accounts needed to trade them (in addition to the tools needed to monitor the associated markets) are more complex than other types of trading accounts used for investments like stocks, bonds, or even mutual funds.

› Then what, exactly, are managed futures?

Managed futures are portfolios of futures contracts and options that are managed by professional investment managers who use their own trading systems.

- These managers primarily use trend following models that react to price movements to capture trends (up or down) in stocks, bonds, currencies, and commodities.
- These professional investors trade futures contracts not to hedge their crop prices or currencies, but instead look to potentially profit from movements in prices.
- Managed futures returns have followed a historically different path. See page 10 for more information.

In summary, managed futures is a flexible and opportunistic asset class whose managers invest in futures contracts across all four major asset classes. Futures contracts are liquid, exchange-traded vehicles that, although historically developed to hedge price risks, are now used to trade in investment portfolios.

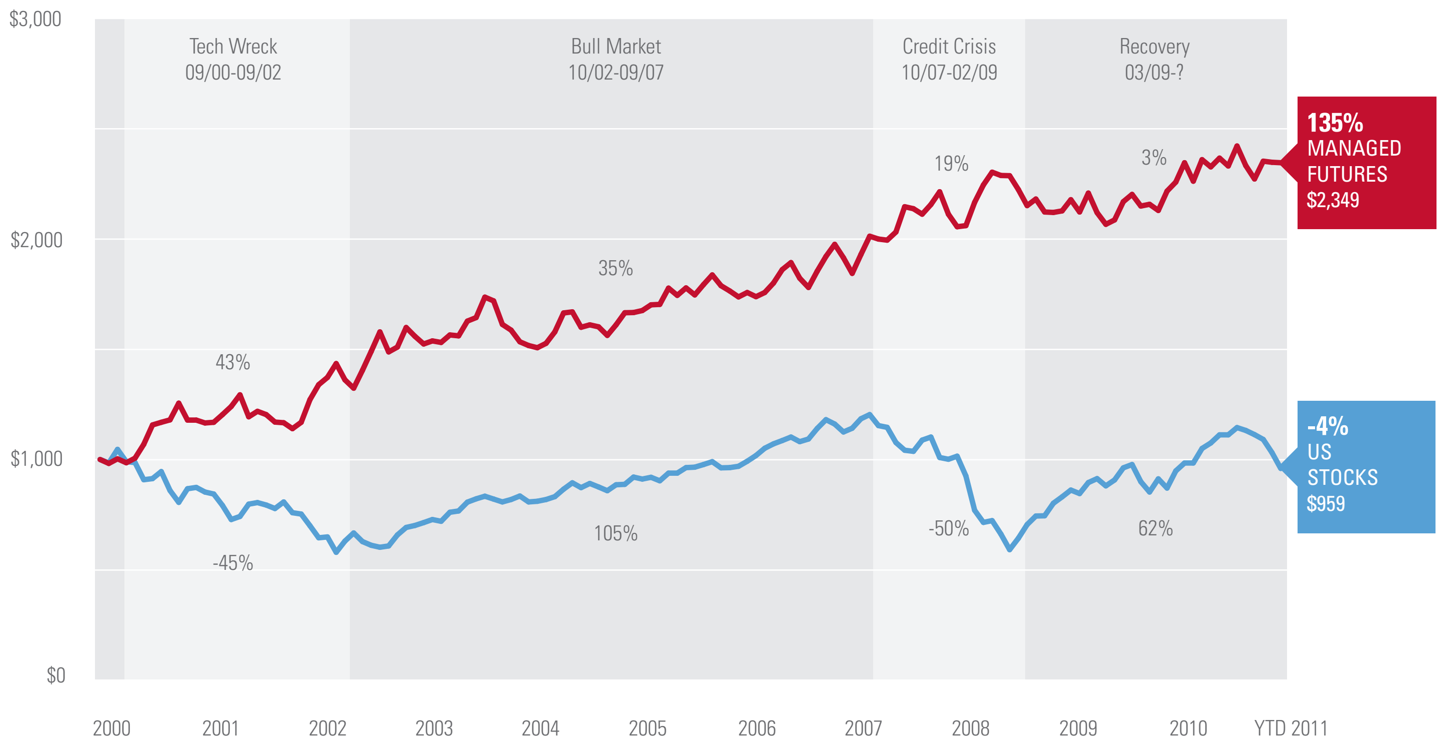
How have Managed Futures Performed in the Past?

Altegris developed the Altegris 40 Index® to represent the managed futures asset class more than a decade ago. The Index tracks the performance of the 40 leading managed futures programs, by ending monthly equity (assets) for the previous month, as reported to Altegris.

APPENDIX 1. MANAGED FUTURES PERFORMANCE

HISTORICAL PERFORMANCE OF MANAGED FUTURES VS. US STOCKS | VALUE OF AN INITIAL $1,000 INVESTMENT

July 2000–September 2011



PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. An investor cannot invest directly in an index. Moreover, indices do not reflect commissions or fees that may be charged to an investment product based on the index, which may materially affect the performance data presented. There is no guarantee that any investment product will achieve its objectives, generate profits or avoid losses. The total return of an investment is only one measure of performance, see page 11. INDICES: US stocks: S&P 500 Total Return Index; Managed futures: Altegris 40 Index (started in July 2000; data is available back to 1990). See index definitions on page 12. The referenced indices are shown for general market comparisons and are not meant to represent any particular Fund. SOURCE: Altegris.

The following charts display performance of managed futures and US stocks over various time frames. Of course, there is no guarantee that any investment product will achieve its objectives, generate profits or avoid losses. Performance should never be the sole consideration when making an investment decision.

APPENDIX 2. PERFORMANCE STATISTICS

PERFORMANCE OF MANAGED FUTURES VS. US STOCKS OVER 1-, 3-, 5-, AND 10-YEAR TIME FRAMES

As of 30 September 2011

RETURNS

	1-Year	3-Year	5-Year	10-Year
Managed Futures	3.91%	4.43%	6.19%	6.59%
US Stocks	1.15%	1.22%	-1.18%	2.81%

STANDARD DEVIATION

	1-Year	3-Year	5-Year	10-Year
Managed Futures	9.99%	9.45%	9.77%	10.85%
US Stocks	13.12%	20.95%	18.17%	15.68%

CORRELATION

	1-Year	3-Year	5-Year	10-Year
Managed Futures-US Stocks	0.46	-0.04	0.00	-0.09

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. Correlation is a statistical measure of how two securities move in relation to each other. Standard deviation is a statistical measure of how consistent returns are over time; a lower standard deviation indicates historically less volatility. An investor cannot invest directly in an index. Moreover, indices do not reflect commissions or fees that may be charged to an investment product based on the index, which may materially affect the performance data presented. There is no guarantee that any investment product will achieve its objectives, generate profits or avoid losses. INDICES: US stocks: S&P 500 Total Return Index; Managed futures: Altegris 40 Index (started in July 2000; data is available back to 1990). See index definitions and complete term definitions on page 12. The referenced indices are shown for general market comparisons and are not meant to represent any particular Fund. SOURCE: Altegris.

INDEX DEFINITIONS

An investor cannot invest directly in an index. Moreover, indices do not reflect commissions or fees that may be charged to an investment product based on the index, which may materially affect the performance data presented.

Altegris 40 Index.® The Altegris 40 Index tracks the performance of the 40 leading managed futures programs as reported to managedfutures.com each month. Each month, managedfutures.com ranks its' database to find the top 40 Composite CTA Programs based on ending monthly equity for the previous month. managedfutures.com then calculates the dollar-weighted average performance of those 40 programs for the monthly Altegris 40 Index performance. Although the Altegris 40 tracks only 10% of the CTAs who report their performance, their combined equity represents approximately 50% of the equity of the entire managed futures industry. The Index was started in July 2000; data is available back to 1990.

S&P 500 Total Return Index. The S&P 500 Total Return Index is the total return version of S&P 500 Index. The S&P 500 Index is unmanaged and is generally representative of certain portions of the U.S. equity markets. For the S&P 500 Total Return Index, dividends are reinvested on a daily basis and the base date for the index is January 4, 1988. All regular cash dividends are assumed reinvested in the S&P 500 Index on the ex-date. Special cash dividends trigger a price adjustment in the price return index.

GLOSSARY OF TERMS

Correlation. A statistical measure of how two securities move in relation to each other. Correlation is computed into what is known as the correlation coefficient, which ranges between -1 and +1. Perfect positive correlation (a correlation co-efficient of +1) implies that as one security moves, either up or down, the other security will move in lockstep, in the same direction. Alternatively, perfect negative correlation means that if one security moves in either direction the security that is perfectly negatively correlated will move by an equal amount in the opposite direction. If the correlation is 0, the movements of the securities are said to have no correlation; they are completely random

Standard Deviation. A statistical measure of how consistent returns are over time; a lower standard deviation indicates historically less volatility.

IMPORTANT RISK DISCLOSURE

Hedge funds, commodity pools and other alternative investments involve a high degree of risk and can be illiquid due to restrictions on transfer and lack of a secondary trading market. They can be highly leveraged, speculative and volatile, and an investor could lose all or a substantial amount of an investment. Alternative investments may lack transparency as to share price, valuation and portfolio holdings. Complex tax structures often result in delayed tax reporting. Compared to mutual funds, hedge funds and commodity pools are subject to less regulation and often charge higher fees. Alternative investment managers typically exercise broad investment discretion and may apply similar strategies across multiple investment vehicles, resulting in less diversification. Trading may occur outside the United States which may pose greater risks than trading on U.S. exchanges and in U.S. markets. PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

There are substantial risks and conflicts of interests associated with managed futures and commodities accounts, and you should only invest risk capital. The success of an investment is dependent upon the ability of a commodity trading advisor (CTA) to identify profitable investment opportunities and successfully trade. The identification of attractive trading opportunities is difficult, requires skill, and involves a significant degree of uncertainty. CTAs have total trading authority, and the use of a single CTA could mean a lack of diversification and higher risk. The high degree of leverage often obtainable in commodity trading can work against you as well as for you, and can lead to large losses as well as gains. Returns generated from a CTA's trading, if any, may not adequately compensate you for the business and financial risks you assume. CTAs may trade highly illiquid markets, or on foreign markets, and may not be able to close or offset positions immediately upon request. You may have market exposure even after the CTA has a request for closure or liquidation. You can lose all or a substantial amount of your investment.

Managed futures and commodities accounts may be subject to substantial charges for management and advisory fees. It may be necessary for accounts that are subject to these charges to make substantial trading profits in order to avoid depletion or exhaustion of their assets. The disclosure document contains a complete description of each fee to be charged to your account by a CTA. If you use notional funding, you may lose more than your initial cash investment. If you purchase a commodity option you may sustain a total loss of the premium and of all transaction costs. If you purchase or sell a commodity future or sell a commodity option you may sustain a total loss of the initial margin funds and any additional funds that you deposit with your broker to establish or maintain your position. If the market moves against your position, you may be called upon by your broker to deposit a substantial amount of additional margin funds, on short notice, in order to maintain your position. If you do not provide the requested funds within the prescribed time, your position may be liquidated at a loss, and you will be liable for any resulting deficit in your account. This brief statement cannot disclose all the risks and other significant aspects of the commodity markets, and you should carefully study the disclosure document before you trade, including the description of the principal risk factors of an investment. PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

About Altegris

Altegris searches the world to find what we believe are the best alternative investments. Our suite of private funds, actively managed mutual funds and managed accounts provides an efficient solution for financial professionals and individuals seeking to improve portfolio diversification.

With one of the leading Research and Investment groups focused solely on alternatives, Altegris follows a disciplined process for identifying, evaluating, selecting and monitoring investment talent across a spectrum of alternative strategies including managed futures, global macro, long/short equity, event-driven and others.

Veteran experts in the art and science of alternatives, Altegris guides investors through the complex and often opaque universe of alternative investing.

Alternatives are in our DNA. Our very name, Altegris, highlights our singular focus on alternatives, the highest standards of integrity, and a process that constantly seeks to minimize investor risk while maximizing potential returns.

The Altegris Companies,* wholly owned subsidiaries of Genworth Financial, Inc., include Altegris Investments, Altegris Advisors, Altegris Funds, and Altegris Clearing Solutions. Altegris currently has approximately $2.88 billion in client assets, and provides clearing services to $780 million in institutional client assets.

* *Altegris and its affiliates are subsidiaries of Genworth Financial, Inc. and are affiliated with Genworth Financial Wealth Management, Inc. and include: (1) Altegris Advisors, LLC, an SEC registered investment adviser; (2) Altegris Investments, Inc., an SEC-registered broker-dealer and FINRA member; (3) Altegris Portfolio Management, Inc. (dba Altegris Funds), a CFTC-registered commodity pool operator, NFA member and California registered investment adviser; and (4) Altegris Clearing Solutions, LLC, a CFTC-registered futures introducing broker and commodity trading advisor and NFA member. The Altegris Companies and their affiliates have a financial interest in the products they sponsor, advise and/or recommend, as applicable. Depending on the investment, the Altegris Companies and their affiliates and employees may receive sales commissions, a portion of management or incentive fees, investment advisory fees, 12b-1 fees or similar payment for distribution, a portion of commodity futures trading commissions, margin interest and other futures-related charges, fee revenue, and/or advisory consulting fees.*

Genworth Financial, Inc. (NYSE:GNW) is a leading Fortune 500 insurance holding company with more than $100 billion in assets and employs approximately 6,500 people. Genworth has leadership positions in offerings that assist consumers in protecting themselves, investing for the future and planning for retirement, and also offers mortgage insurance to help consumers achieve homeownership while assisting lenders manage risk and capital.

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Printed October 2011
300959_102111