Managed Futures

Is The Trend Your Friend?

May 2012*

KEY POINT

Managed futures have shown their ability to thrive in up and down markets.

In their 2010 Alternative Investment Survey of U.S. Institutions and Financial Advisors, Morningstar discovered that 66% of financial advisors believe that alternatives will become as or more important than traditional investments over the next five years. Even more interesting, advisors awarded top ranks to managed futures strategies as offering the greatest growth potential through 2015 amongst alternative strategies.

The appeal of managed futures is that they have shown an ability to thrive in up and down markets. Of course, we all know that past performance is no guarantee of future results. Managed futures managers also have the ability go long[1] and short[2] in all four asset classes (stocks, bonds, currencies and commodities) across 150 global markets — creating an immense opportunity for investment.

The overwhelming majority of managed futures managers (~75%) are known as trend followers. Trend followers seek to capture the majority of a market trend, up or down, for profits in all major asset classes. Many trend followers use proprietary and fully automated technical trading systems based on a highly objective, disciplined set of rules predefined by the fund management. So unlike traditional money managers, managed futures managers do not predict where the market is going, rather they wait for prices to trend and then react. The remaining managed futures managers are specialized traders. Their strategies include, but are not limited to, short-term, discretionary, sector-specific, and counter-trend trading.

[1] ***Long.*** *Buying an asset/security that gives partial ownership to the buyer of the position. Long positions profit from an increase in price.*

[2] ***Short.*** *Selling an asset/security that may have been borrowed from a third party with the intention of buying back at a later date. Short positions profit from a decline in price. If a short position increases in price, covering the short position at a higher price may result in a loss.*

** Originally published February 2010.*

Looking Forward by Looking Back

Managed futures professionals often talk about 2008 (the "Credit Crisis") when identifying the potential benefits of the asset class—a time when the trend was truly managed futures' friend. Whether it was equities, interest rates or the commodities markets, most managers were able to capitalize on seemingly smooth long-term trends over the year, in the midst of the global economic crisis. During a time of extreme volatility for equity markets, traditional asset classes suffered their steepest declines in decades, while managed futures delivered positive returns of more than 15%.

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During a time of extreme volatility for equity markets, traditional asset classes suffered their steepest declines in decades, while managed futures delivered positive returns of more than 15%.

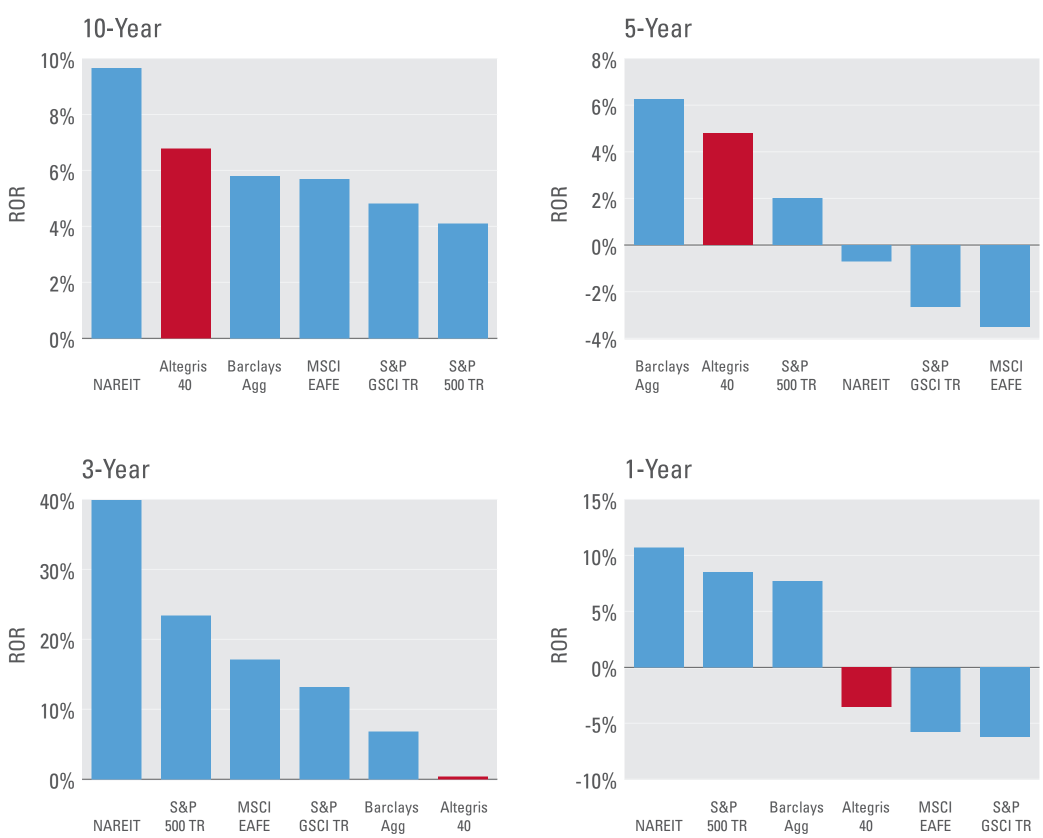
In contrast, sideways price action across several markets wreaked havoc on both short- and long-term trend followers in 2009. Managed futures rebounded in 2010 ending the year up over 11%, but volatile markets in 2011 left managers down 3% on average. Looking forward, it is important to remember that the last few years represent only three calendar years over a significant history for an asset class that has profited over the long-term, through various market cycles.

Perhaps more compelling, on an annualized basis managed futures was among the top two best-performing asset classes over the 10-year time frame ending in March 2012, as well as the past five-year period (FIGURE 1). Of course, past performance of any asset class or index is not necessarily indicative of its future performance.

FIGURE 1.

ANNUALIZED RATE OF RETURN OVER MULTIPLE TIME PERIODS

10-, 5-, 3-, and 1-Year trailing as of March 2012



Source: Altegris

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FIGURE 2.

RATE OF RETURN OVER 10 CALENDAR YEARS | January 2002–December 2011

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
S&P GSCI TR 32.08%	MSCI EAFE 38.57%	NAREIT 30.40%	S&P GSCI TR 25.56%	NAREIT 34.02%	S&P GSCI TR 32.68%	Altegris 40 15.47%	MSCI EAFE 31.78%	NAREIT 27.55%	Barclays Agg 7.86%
Altegris 40 15.22%	NAREIT 38.47%	MSCI EAFE 20.24%	MSCI EAFE 13.56%	MSCI EAFE 26.35%	MSCI EAFE 11.18%	Barclays Agg 5.24%	NAREIT 27.79%	S&P 500 TR 15.06%	NAREIT 7.31%
Barclays Agg 10.27%	S&P 500 TR 28.69%	S&P GSCI TR 17.27%	NAREIT 8.52%	S&P 500 TR 15.79%	Altegris 40 7.18%		S&P 500 TR 26.45%	Altegris 40 11.33%	S&P 500 TR 2.12%
NAREIT 5.22%	S&P GSCI TR 20.72%	S&P 500 TR 10.87%	S&P 500 TR 4.89%	Altegris 40 6.70%	Barclays Agg 6.96%		S&P GSCI TR 13.67%	S&P GSCI TR 9.02%	
	Altegris 40 15.99%	Barclays Agg 4.34%	Altegris 40 4.51%	Barclays Agg 4.33%	S&P 500 TR 5.50%		Barclays Agg 5.93%	MSCI EAFE 7.74%	
	Barclays Agg 4.11%	Altegris 40 2.57%	Barclays Agg 2.43%					Barclays Agg 6.56%	
Positive returns									
Negative returns									
MSCI EAFE -15.94%				S&P GSCI TR -15.10%	NAREIT -17.83%	S&P 500 TR -37.00%	Altegris 40 -7.98%		S&P GSCI TR -1.18%
S&P 500 TR -22.11%						NAREIT -37.84%			Altegris 40 -3.23%
						MSCI EAFE -43.39%			MSCI EAFE -12.13%
						S&P GSCI TR -46.49%			

Source: Altegris

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Furthermore, comparing annual asset class performance over this time frame, managed futures have delivered positive returns in eight of the past ten calendar years (FIGURE 2).

What Is 'Alt' This Talk About Risk-Adjusted Returns?

Looking at returns alone, however, does not paint a complete picture. For instance, on a long-term basis, the U.S. equity market returned 4.1% (annualized) over the past 10 years. From this data, you might think allocating to the equity market was a stable selection. Nevertheless, we all know that the equity market experienced quite a bit of volatility over this period. From the dot-com bust, through various wars in the Middle East, and the housing market collapse, the equity market rode several waves of volatility, and put investors through several periods of significant altegris

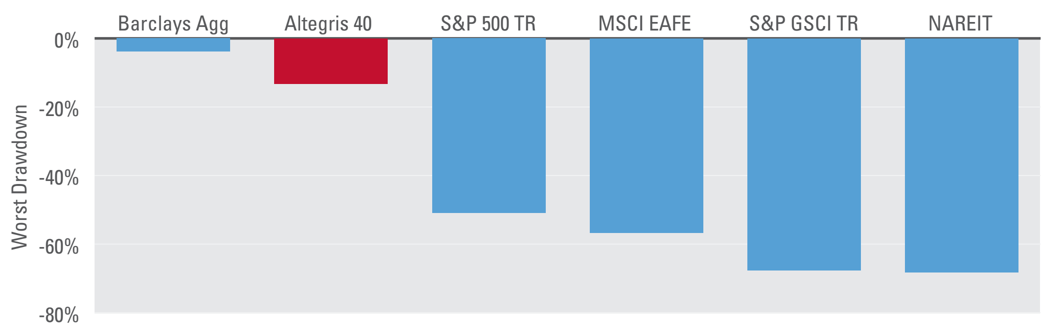
drawdowns (peak to valley rate of return). During this time period, the worst drawdown maxed out at nearly -51% for equities (FIGURE 3). If you invested in the equity market in October 2007, by February 2009 you had lost more than half of your total capital through the credit crisis.

In contrast, the worst drawdown for managed futures over the same time period was -13% during the six months from the end of February 2004 to August 2004. Bonds were the only asset class that had a relatively low drawdown of -4%. However, on a total return basis, managed futures outperformed bonds over the same time period, with annualized returns of 6.8% over the last 10 years.

Taking into account the returns and the corresponding level of risk, we believe managed futures can represent a better risk-adjusted return than long-only, emerging market equities, real estate securities, and commodities for those investors for which managed futures may be a suitable option (FIGURE 4).

FIGURE 3.

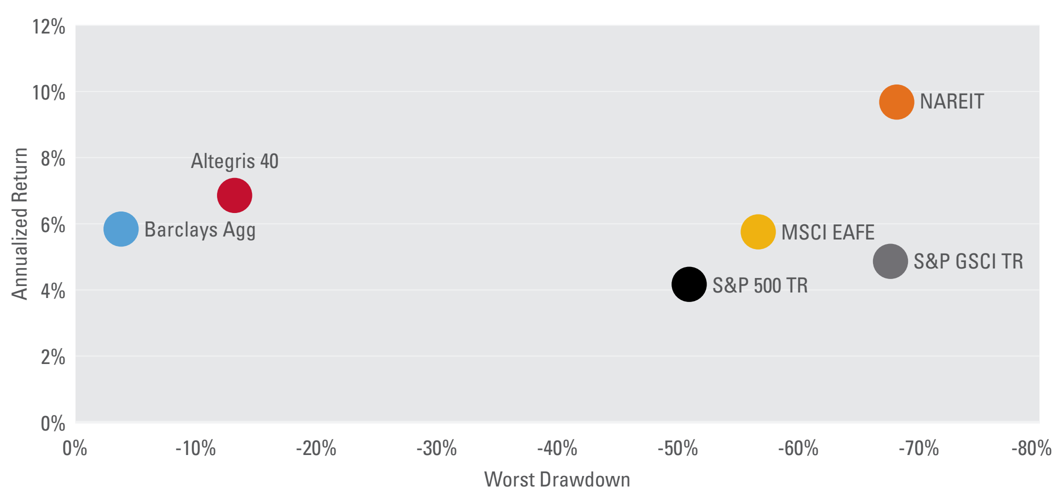
WORST DRAWDOWN | Six major asset classes April 2002–March 2012



Source: Altegris

FIGURE 4.

10-YEAR DRAWDOWN/RETURN COMPARISON | Six major asset classes April 2002–March 2012



Source: Altegris

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No Asset Class is an Island

It is important to understand the potential role of managed futures in an investment portfolio, particularly the historical correlation with other asset classes. Most investors have a broad asset allocation, with a heavy weighting of stocks and bonds whether directly or through mutual funds that invest in such. In addition to stocks and bonds, research, most notably that of Dr. John Lintner, has demonstrated that it is desirable to invest in multiple asset classes, particularly ones with little correlation to existing investments, in order to attain a well diversified portfolio.† Our data suggests in 2008 when U.S. equities declined nearly -37%, investors whose portfolios included allocations to managed futures, in addition to equities, in many instances weathered the storm far better than those who did not, given the fact that managed futures rose by more than 15%.*

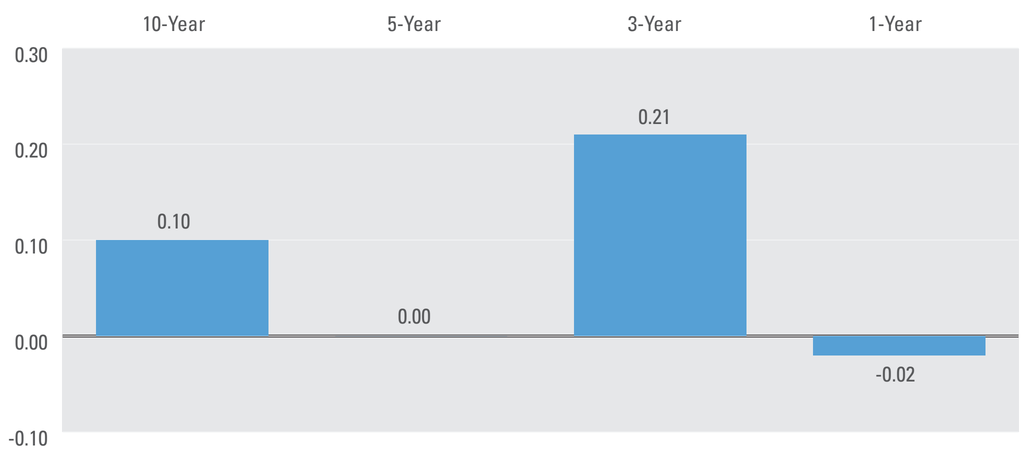
Similarly, the performance of managed futures has demonstrated a lack of historical correlation with investments in emerging markets, real estate, commodities and even bonds. Over the course of the past decade, managed futures have consistently demonstrated low or even negative historical correlations to each of the major asset classes. With all five of these major asset classes combined in an equally-weighted portfolio, managed futures averaged near zero historical correlations to the portfolio over the past 10-, 5-, 3- and 1-year time frames (FIGURE 5).**

Portfolio Impact

Historically, these near zero correlations have resulted in an improved risk-adjusted return profile for the average investor that remained invested in the managed futures asset class. For example, a traditional portfolio with 50% allocated to equities and 50% allocated to bonds provided annualized

FIGURE 5.

MANAGED FUTURES CORRELATION TO MAJOR ASSET CLASSES | Correlation to equally weighted portfolio of five major asset classes over multiple time frames as of March 2012



Source: Altegris.

†"The combined portfolios of stocks (or stocks and bonds) after including judicious investments in leveraged managed futures accounts show substantially less risk at every possible level of expected return than portfolios of stock (or stocks and bonds) alone." -Dr. John Lintner, "The Potential Role of Managed Futures Accounts in Portfolios of Stocks and Bonds", 1983.

**Source: Altegris*

***Correlations are subject to change and may vary over time.*

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historical returns of 5.6% with a worst drawdown of -25.2% (April 2002 through March 2012). For the portfolio that included an allocation to managed futures over the same ten-year period (33% equities, 33% bonds, and 33% managed futures), the statistics improved dramatically. Annualized returns increased by nearly 1% to 6.3% while the worst drawdown decreased by nearly half to -13.4% (FIGURE 6). Of course, when comparing performance of asset classes represented by indices, past performance of any asset class or index is not necessarily indicative of its future performance.

Short-Term Pain, Long-Term Gain?

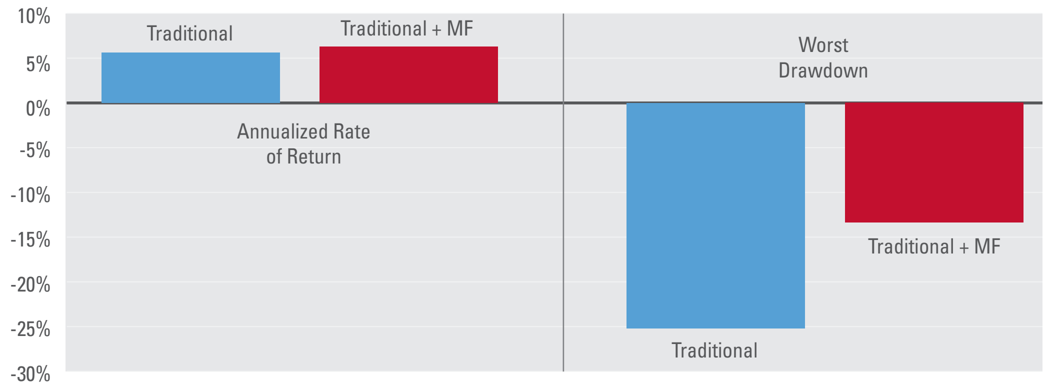
At Altegris, we believe perseverance is rewarded over time. Clearly, it is important to look at performance on a longer time frame rather than purely short-term swings. A smooth trending environment like 2008 may or may not return again.

Likewise, a choppy, unfavorable market is equally unpredictable. Most investors are seeking appreciation over a long time frame, through various market cycles.

Over the long-term, managed futures have proven their resilience and diversification benefits for many investors. As a result, we believe that managed futures can be a critical asset for the portfolios of sophisticated and suitable investors.

FIGURE 6.

ADDING MANAGED FUTURES | April 2002 – March 2012



Source: Altegris

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APPENDIX 1. INDEX PERFORMANCE STATISTICS

SIX MAJOR ASSET CLASSES COMPARING 10-, 5-, 3-, AND 1-YEAR TIME FRAMES

As of 31 March 2012

	10-Year			
	Ann ROR	Std Dev	Max DD	Total Return
Altegris 40	6.79%	10.51%	-13.24%	92.83%
Barclays Capital U.S. Aggregate	5.80%	3.64%	-3.82%	75.82%
MSCI EAFE — Net	5.70%	18.63%	-56.68%	74.04%
NAREIT Composite Total Return	9.66%	24.48%	-68.17%	151.51%
S&P 500 Total Return	4.11%	15.92%	-50.95%	49.65%
S&P GSCI Total Return	4.81%	24.78%	-67.65%	59.90%
	5-Year			
	Ann ROR	Std Dev	Max DD	Total Return
Altegris 40	4.79%	9.64%	-10.27%	26.33%
Barclays Capital U.S. Aggregate	6.26%	3.57%	-3.82%	35.45%
MSCI EAFE — Net	-3.51%	22.70%	-56.68%	-16.37%
NAREIT Composite Total Return	-0.70%	31.28%	-66.48%	-3.46%
S&P 500 Total Return	2.01%	18.92%	-50.95%	10.46%
S&P GSCI Total Return	-2.64%	27.35%	-67.65%	-12.51%
	3-Year			
	Ann ROR	Std Dev	Max DD	Total Return
Altegris 40	0.36%	8.96%	-7.18%	1.07%
Barclays Capital U.S. Aggregate	6.85%	2.66%	-1.64%	21.99%
MSCI EAFE — Net	17.13%	20.59%	-22.38%	60.69%
NAREIT Composite Total Return	40.14%	23.95%	-16.86%	175.22%
S&P 500 Total Return	23.41%	16.00%	-16.26%	87.97%
S&P GSCI Total Return	13.21%	21.12%	-22.14%	45.10%
	1-Year			
	Ann ROR	Std Dev	Max DD	Total Return
Altegris 40	-3.56%	8.34%	-7.18%	-3.56%
Barclays Capital U.S. Aggregate	7.73%	2.50%	-0.57%	7.73%
MSCI EAFE — Net	-5.76%	19.96%	-22.38%	-5.76%
NAREIT Composite Total Return	10.69%	20.51%	-16.86%	10.69%
S&P 500 Total Return	8.53%	16.08%	-16.26%	8.53%
S&P GSCI Total Return	-6.22%	19.99%	-22.14%	-6.22%

Source: Altegris

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APPENDIX 2. INDEX CORRELATION STATISTICS

SIX MAJOR ASSET CLASSES COMPARING 10-, 5-, 3-, AND 1-YEAR TIME FRAMES

As of 31 March 2012

10-Year Correlation April 2002–March 2012	Altegris 40	S&P 500 TR	Barclays Agg	MSCI EAFE	NAREIT	GSCI Total
S&P 500 Total Return	-0.10		-0.05	0.90	0.72	0.33
Barclays Capital U.S. Aggregate	0.17	-0.05		0.06	0.18	0.01
MSCI EAFE — Net	0.03	0.90	0.06		0.69	0.43
NAREIT Composite Total Return	-0.01	0.72	0.18	0.69		0.24
S&P GSCI Total Return	0.22	0.33	0.01	0.43	0.24	

5-Year Correlation April 2007–March 2012	Altegris 40	S&P 500 TR	Barclays Agg	MSCI EAFE	NAREIT	GSCI Total
S&P 500 Total Return	-0.08		0.10	0.92	0.83	0.61
Barclays Capital U.S. Aggregate	0.05	0.10		0.20	0.21	-0.05
MSCI EAFE — Net	0.06	0.92	0.20		0.76	0.66
NAREIT Composite Total Return	-0.16	0.83	0.21	0.76		0.39
S&P GSCI Total Return	0.13	0.61	-0.05	0.66	0.39	

3-Year Correlation April 2009–March 2012	Altegris 40	S&P 500 TR	Barclays Agg	MSCI EAFE	NAREIT	GSCI Total
S&P 500 Total Return	0.14		-0.27	0.91	0.81	0.66
Barclays Capital U.S. Aggregate	0.24	-0.27		-0.14	-0.08	-0.25
MSCI EAFE — Net	0.20	0.91	-0.14		0.76	0.69
NAREIT Composite Total Return	0.04	0.81	-0.08	0.76		0.31
S&P GSCI Total Return	0.25	0.66	-0.25	0.69	0.31	

1-Year Correlation April 2011–March 2012	Altegris 40	S&P 500 TR	Barclays Agg	MSCI EAFE	NAREIT	GSCI Total
S&P 500 Total Return	-0.22		-0.38	0.93	0.90	0.80
Barclays Capital U.S. Aggregate	0.50	-0.38		-0.22	-0.07	-0.10
MSCI EAFE — Net	-0.01	0.93	-0.22		0.84	0.80
NAREIT Composite Total Return	-0.17	0.90	-0.07	0.84		0.69
S&P GSCI Total Return	0.20	0.80	-0.10	0.80	0.69	

Source: Altegris

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GLOSSARY

Alpha. Alpha measures the non-systematic return, that which cannot be attributed to the market. It reflects the difference between a fund's actual return and its expected return, given its level of systematic (or market) risk (as measured by beta). A positive alpha indicates that the fund has performed better than its beta would predict. Alpha is widely viewed as a measure of the value added or lost by a fund manager.

Beta. A measure of the relationship of a fund's movement relative to a benchmark, such as a market index. Beta is the correlation (a measure of the statistical relationship between fund and benchmark) multiplied by the magnitude of relative volatility of the fund to the benchmark. A fund with a beta of 1.2 relative to a benchmark, for example, is expected to move 12% when the benchmark moves 10%. When the fund is comprised of the same instruments as the benchmark, beta can be thought of as a measure of relative volatility. A low beta does not necessarily indicate that the fund has low volatility; rather, it may indicate that the fund's returns are not related to the movement of the market benchmark.

Correlation. A statistical measure of how two securities move in relation to each other. Correlation is mathematically expressed by 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.

Drawdown. A drawdown is any losing period during an investment time frame. It is calculated by taking the peak to valley loss relative to the peak for a stated time period. The figure is expressed as a percentage.

Leverage. When investors borrow funds to increase the amount that they have invested in a particular position, they use leverage. Investors use leverage when they believe that the return from the position will exceed the cost of the borrowed funds. Sometimes, managers use leverage to take on new positions without having to liquidate other positions prematurely. Leverage can effectively increase the potential for higher capital gain returns on investment capital, but can also increase the risk of greater capital loss.

Long. A position that can profit from an increase in the security's price.

Short. A position that can profit from a decrease in the security's price.

Volatility. A measurement of the change in price over a given time period. Typically, higher volatility is associated with an elevated level of risk.

INDEX DEFINITIONS, DESCRIPTIONS AND RISKS

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, by ending monthly equity (assets) for the previous month, as reported to Altegris. The Altegris 40 Index represents the dollar-weighted average performance of those 40 programs. The Index started in July 2000; data is available back to 1990.

Barclays Capital U.S. Aggregate Index. The Barclays Capital U.S. Aggregate Index covers the U.S. Investment grade fixed rate bond market representing taxable U.S. dollar securities.

S&P GSCI Total Return Index . The S&P GSCI Total Return Index measures a fully collateralized commodity futures investment. Currently the S&P GSCI includes 24 commodity nearby futures contracts.

S&P 500 Total Return Index. This 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.

MSCI EAFE Index. The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Index consists of the following 22 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.*

FTSE NAREIT Composite Total Return Index. The FTSE NAREIT Composite Total Return Index includes both price and income returns of all publicly traded REITs (equity, mortgage, and hybrid).

	Representative Index	Characteristics	Key Risks
Managed Futures	Altegris 40 Index®	40 top AUM managed futures programs, monthly, as reported to Altegris	**Market risk.** Prices may decline. **Leverage risk.** Volatility and risk of loss may magnify with use of leverage. **Country / regional risk.** World events may adversely affect values.
US Bonds	Barclays Capital US Aggregate Index	Wide spectrum of taxable, investment-grade US fixed income	**Interest rate risk.** Bond prices will decline if rates rise. **Credit risk.** Bond issuer may not pay. **Income risk.** Income may decline.
Commodities	S&P GSCI Total Return Index	24 principal physical commodities that are the subject of active, liquid futures markets	**Market risk.** Prices may decline. **Derivative risk.** May be subject to higher volatility. **Leverage risk.** Volatility and risk of loss may magnify with use of leverage.
US Stocks	S&P 500 Total Return (TR) Index	500 US stocks; weighted towards large capitalizations	**Stock market risk.** Stock prices may decline.
International Stocks	MSCI EAFE Index	1,000+ stocks from 20+ developed markets in Europe and the Pacific Rim	**Stock market risk.** Stock prices may decline. **Country / regional risk.** World events may adversely affect values. **Currency risk.** Unfavorable exchange rates may occur.
REITs	FTSE NAREIT Composite Total Return Index	Publically traded US real estate investment trusts (REITs)	**Stock market risk.** Stock prices may decline. **Industry risk.** Adverse real estate may cause declines. **Interest rate risk.** Prices may decline if rates rise.

Important Considerations

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. 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.

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. 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.

Altegris Advisors LLC is an SEC-registered investment adviser that advises alternative strategy mutual funds that may pursue investment returns through a combination of managed futures, equities, fixed income and/or other investment strategies.

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About Altegris

Altegris has one core mission—to find the best alternative investments for our clients. Altegris offers what we believe are straightforward and efficient solutions for financial professionals and individual investors seeking to improve portfolio diversification with historically low correlated investments.

With one of the leading Research and Investment Groups focused solely on alternative investments, Altegris follows a disciplined process for identifying, evaluating, selecting, and monitoring investment talent across the spectrum of hedge funds, managed futures funds, and other alternative investments.

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 $3.27 billion in client assets, and provides clearing services to $327 million in institutional client assets.*

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Genworth has approximately 6,400 employees and operates through three divisions: Insurance and Wealth Management, which includes U.S. Life Insurance, Wealth Management, and International Protection segments; Mortgage Insurance, which includes U.S. and International Mortgage Insurance segments; and the Corporate and Runoff division. Its products and services are offered through financial intermediaries, advisors, independent distributors and sales specialists. Genworth Financial, Inc., which traces its roots back to 1871, became a public company in 2004 and is headquartered in Richmond, Virginia. For more information, visit genworth.com. From time to time, Genworth Financial, Inc. releases important information via postings on its corporate website. Accordingly, investors and other interested parties are encouraged to enroll to receive automatic email alerts and Really Simple Syndication (RSS) feeds regarding new postings. Enrollment information is found under the "Investors" section of genworth.com.

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