

MANAGED FUTURES TODAY

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Safeguarding customers through segregated funds

The futures industry's rules for segregated funds help protect customer capital in the event of a brokerage bankruptcy.

By MFT Staff

In recent years, many investors found out the hard way they have very little recourse to recover funds in the event of a financial firm's bankruptcy. Although the Bernie Madoff "hedge fund" was by far the highest profile case, there were numerous less publicized bankruptcies and defaults at other firms and investments (including legitimate ones), in which investors found recouping remaining funds difficult or impossible.

Sometimes it's a case of being the last in line of a long list of creditors, a problem that's compounded when customer funds aren't separated from a firm's funds. Such "commingled" funds might have been used to fund the firm's operating expenses or in its own trading. If a firm enters bankruptcy, it can be very difficult or impossible to recover customer funds that were commingled in such a fashion.

However, all futures trading accounts, including managed futures, have the advantage of specific industry rules that require the segregation of cus-



tomers funds from the firm's own funds. The practice of segregating customer funds protects investors in the event of default at the Futures Clearing Merchant (FCM, the industry term for futures brokerage firms licensed to trade on futures exchanges in the U.S.) holding their account.

While FCM bankruptcies are rare, they do occur.

In 2005, Refco Inc. and 23 of its unregulated subsidiaries filed for Chapter 11 bankruptcy protection. However, Refco's regulated subsidiaries (where customers' futures trading and managed futures accounts resided) were unaffected and customers were able to continue trading and managing their accounts.

INVESTMENT RISK AND FIRM RISK

Although first-time managed futures investors might assume they're depositing money directly with the commodity trading advisor (CTA) running the fund,

in fact, customers open an account in their own name at an FCM. The CTA is then given the authority to trade per the fund's investment strategy.

Segregated funds possess a separate identity from FCM funds in the firm's bank account. Once funds are deposited, the bank signs a written acknowledgement stating it will not use the funds for anyone other than the customer. Also, the FCM is required to use these funds only in certain pre-defined instruments. The end result is that, in the event of a crash or FCM bankruptcy, customer funds can be more easily recovered.

FCM REPORTING REQUIREMENTS

Segregated funds are subject to stringent daily, monthly, and annual monitoring by industry regulatory agencies. Every day, FCMs must submit a report to the National Futures Association (NFA) detailing the breakdown of their customer funds. This "Segregated Investment Detail Report" (SIDR) lists the actual and expected segregated funds in the FCM's accounts. In addition, every FCM must file monthly financial reports with the Commodity Futures Trading Commission's (CFTC) Division of Clearing and Intermediary Oversight (DCIO) within 17 business days after the end of the month. Finally, the FCM is subject to a yearly audit by the Joint Audit Committee, a consortium of U.S. futures exchanges and regulatory organizations.

CFTC OVERSIGHT

The provision for segregated funds is stipulated in the Commodities Exchange Act. As a result, the CFTC, which is the futures industry equivalent of the Securities and Exchange Commission (SEC), regulates all practices for segregated funds. Any case of

malpractice results in an administrative proceeding before a CFTC law judge. If an FCM is found guilty of the charges, the CFTC can suspend or revoke trading privileges, assess penalties, or issue cease and desist orders.

There have actually been very few malpractice cases; most are the

result of technical or processing difficulties within an FCM, or a delay in reporting. For example, the CFTC imposed a civil penalty of \$300,000 in 2009 on a large FCM for violating rules related to segregation. Besides reporting process violations, the CFTC charged the company with not holding enough funds in its customer funds account. (The shortfall occurred because the FCM had purchased Treasury notes between 2007 and 2009 using a mix of its own and customer funds.) In response to the charge, the firm established a "segregation forecasting mechanism" to ensure that proper segregation was maintained between customer and company accounts.

Before making any investment in futures or managed futures, investors should research the company where they plan to open an account. The NFA makes this research easy at the BASIC (Background Affiliation Status Information Center) section of its website at www.nfa.futures.org/basicnet. ♦

Segregated funds are subject to stringent daily, monthly, and annual monitoring by industry regulatory agencies.

Tracking managed futures performance: CTA indices

CTA indices allow managed futures investors to track the performance of the industry as a whole, as well as specific sub-categories.

By MFT Staff

Investors and money managers interested in diversifying into managed futures are often attracted to the daily transparency and better liquidity over the typical hedge-fund structure. However, with hundreds of Commodity Trading Advisor (CTA) programs to choose from, it can be daunting to know where to start analyzing this arena. One place to begin is with CTA indices, which compile and track performance of different CTA programs.

However, you quickly discover there are also differences between the various CTA indices in terms of construction methodology, the number of CTA programs tracked, financial audit requirements, and minimum-asset requirements.

DIVERSIFICATION OPPORTUNITY

Sol Waksman, president of BarclayHedge, an Iowa-based managed money research firm, has been

tracking CTA performance since 1987. The Barclay CTA Index is the industry's oldest CTA benchmark. While Waksman admits there are differences in index construction and methodologies among the various CTA indices, one key point remains: "I would guess that all of the CTA indices show a very low level of correlation to equities," he says.

"The addition of managed futures provides significant diversification benefits."

According to Bob Dubuque, vice president at CTA-tracking firm IASG, CTA indices can help investors who are looking at com-

modities as an asset class. "It can give you an idea of the correlation to other asset classes," he says. "Commodities as an asset class have really evolved into a much more mainstream investment vehicle."

In addition to its CTA Index, BarclayHedge also calculates several sub-indices, including the Agricultural Traders Index, the Currency Traders

Managed futures simply may not lend themselves to benchmark analysis as well as other asset classes.

Index, and the Systematic Traders Index (see page 18). Other popular CTA indices include the Dow Jones Credit Suisse Managed Futures Index, the Newedge CTA Index, the Altegris 40 Index, the Stark 300 CTA Index, the CISDM CTA Equal Weighted Index and the IASG CTA Index. "CTA index snapshot" provides an overview of these indices.

BENCHMARKING

When investors begin their foray into the managed futures arena, there is one issue that is important to understand about benchmarking, or evaluating the performance of a particular CTA program vs. a benchmark index. Managed futures simply may not lend themselves to benchmark analysis as well as other asset classes, primarily because of the number of distinct, non-correlated markets being traded, as well as the broad range of strategies utilized to trade those markets.

"Managed futures are extremely diverse and there are all sorts of strategies and techniques," says Ranjan Bhaduri, chief research officer at AlphaMetrix LLC.

Barclay's Waksman adds: "A major concern is whether the index is a relevant benchmark to your portfolio. If your portfolio is comprised of currency traders only, would it make sense to benchmark it against the CTA Index? Is that a really relevant index given that CTAs could be long crude oil and short cotton? No."

Similarly, is there any value in comparing a CTA index to a widely watched commodity index, such as the Goldman Sachs (GSCI) commodity index?

"To use the GSCI as a benchmark is inappropriate," Bhaduri explains. "It's a pure commodity index, heavily weighted toward energy."

In addition to differences in market composition, commodity indices are passive (long-only), while CTAs can trade from both the long and short side.

CTA index snapshot

Let's take a brief look at each CTA index, outlining their methodology and requirements. A few of the differences among the following indices include the number of CTA programs participating, the minimum number of year's of performance data, and how results are weighted.

BARCLAYHEDGE CTA INDEX

The BarclayHedge CTA Index (www.barclayhedge.com) does not have a minimum asset requirement; however, it requires CTAs to have four years of prior performance history. There are currently 533 CTA programs in the index.

DOW JONES CREDIT SUISSE MANAGED FUTURES INDEX

The Dow Jones Credit Suisse index (www.hedgeindex.com > Benchmark Indexes) tracks CTAs with a minimum of \$50 million assets under management, a minimum one-year track record, and current audited financials. A total of 33 CTA programs are included.

NEWEDGE CTA INDEX

The Newedge CTA Index (located at www.newedgegroup.com > Brokerage Services > Research > AlternativeEdge Indices) aims to track the largest CTAs in the managed futures space. It currently requires minimum assets under management of \$801 million. The index is equally weighted and reconstituted annually. Currently, there are 20 CTA programs tracked by the index.

ALTEGRIS 40 INDEX

This index (www.managedfutures.com > Performance > Altegris 40 Index) is updated on a monthly basis, using a proprietary database of more than 500 CTA programs to identify the top-40 composite CTA programs based on ending monthly equity the previous month. Altegris only follows CTAs that are tracked by International Traders Research (ITR). The index has been active since January 1990.

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ANOTHER WAY

The next step is to understand how a money manager can use a CTA index to aid an investing approach.

"An index is a tool," Waksman notes. "Which tool to use depends on what you are looking to do."

As mentioned, some CTA indices and tracking firms offer sub-indices or the ability to strip out all the discretionary CTA programs and analyze, for

example, the performance of only trend-following traders. "We find indices that break down trend-following, systematic managers or discretionary managers more interesting," says IASG's Dubuque. In addition to the IASG CTA Index, the firm offers a trend-following strategy index, a systematic trader index, a discretionary trader index, an agricultural trader index, a diversified trader index, a stock index trader index, and an option strategy index.

"AlphaMetrix is introducing [in February] several indices that cover different types of strategies," says Bhaduri. "We've broken it down and it makes it much more appealing."

The firm's indices will also be available with real-time data later in the first quarter, he notes.

*CTA index snapshot continued from p. 7***STARK 300 CTA INDEX**

Stark & Company (www.starkresearch.com) has a broad Stark 300 CTA Index, as well as sub-indices focusing on systematic and discretionary styles, currencies, interest rates, stock index, and other market-focused categories. Stark indices are calculated monthly using an equity-weighted formula to determine performance. The Stark 300 index tracks the performance of the top-300 futures and forex traders.

CISDM CTA EQUAL WEIGHTED INDEX

CISDM publishes the CISDM CTA Equal Weighted Index. The number of constituents in the index (www.isenberg.umass.edu/CISDM/) changes from month to month, but usually totals over 100. The participants are published in *Barron's* each month at http://online.barrons.com/public/page/9_0210-commoditytradersadvisorsperformance_nov-commoditytradersadvisorsperformance.html. No minimum asset requirements are seen for the CISDM CTA index, nor are audited financials required. It is an equal-weighting methodology.

IASG CTA INDEX

IASG (www.iasg.com) has been publishing CTA data since 1992 and currently tracks approximately 335 programs in its IASG CTA Index (the number changes slightly month to month). IASG requires a minimum three-year track record and is an equally weighted index. ♦

SURVIVORSHIP BIAS

Another issue to understand is the so-called survivorship bias, which is an inherent part of any index. "In very general terms, survivor bias results in data from the firms that do not survive being removed from an index," Waksman explains. "As you go forward in time your sample size is decreasing. Taking an average of a smaller number does introduce some bias, because it is only an average of the winners."

Here's how BarclayHedge handles CTAs that close up shop: "If a manager goes out of business in June, in July we input a zero rate of return for them for the rest of the year. Once they go out of business, some people may elect to delete their performance from January to June. We do not," Waksman says.

AlphaMetrix's Bhaduri believes some critics have been very unfair to CTA indices in regard to survivorship bias. "The same problem exists in the S&P," he notes. "Enron is no longer part of any equity index. This can especially occur when you are dealing with investable indices."

Bottom line when it comes to using CTA indices? "From an education and research perspective, [investors need to look at] how clean the data is and how possible it is for the indices to be investable," Bhaduri says. ♦

INVESTMENT MYTH NO. 2:

You're already diversified.

Check again.

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Looking inside markets: The COT report

Analyzing the balance between different market players in the Commitments of Traders report reveals supply and demand dynamics not evident in price action.

By MFT Staff

Published each week by the Commodity Futures Trading Commission (CFTC), the Commitments of Traders (COT) report details the positions (“open interest”) of different types of traders in the U.S. futures (and options on futures) markets. The release reflects 70 to 90 percent of all positions in each market; the CFTC only includes positions that meet or exceed specific thresholds for each market (e.g., 400 or more Japanese yen futures contracts). Futures brokerages and clearing houses are required to report the futures and options positions of their customers that are at or above the CFTC’s reporting limits. The COT report, updated each Friday, reflects positions from Tuesday of that week.

In the broadest sense, the COT report breaks down the long and short positions of two major types of futures market participants: hedgers (“com-

mercials”) and speculators (“non-commercials”). However, there are different types of hedgers and speculators, and participants in one group may occasionally participate in a different group. In 2009 the CFTC began publishing a more detailed (“disaggregated”) version of the COT report with even more specific trader sub-categories (see “Understanding the COT players.”).

The commercials, or hedgers, often have existing positions in the cash market and are seeking to hedge directional risk by trading futures. They tend to know most about a market’s supply and demand. For example, beef producers who want to lock in their selling price for their

product in the year might sell August live cattle futures (LCQ11). The beef producers simply want to offset price risk; they don’t intend to profit from price moves.

Historically high or low levels in certain categories can help traders determine whether a market might be reaching a bullish or bearish extreme, or whether a trend is likely to persist.

Continued on p. 12

Understanding the COT players

The CFTC publishes Commitments of Traders data in various formats, with some reports longer and more detailed than others.

In the simpler “legacy” COT report, traders are simply divided into commercial (hedger), non-commercial (speculators), and nonreportable (small) positions. Figure 1 shows this report for the S&P 500 futures (SP) from Jan. 25. In the newer “disaggregated” COT report, this position data is divided into four more-detailed trader categories: 1) Producer/Merchant/Processor/User; 2) Swap Dealers; 3) Managed Money; 4) Other Reportables. Figure 2 shows the disaggregated COT report for crude oil (CL) futures for Jan. 18.

The Producer/Merchant/Processor/User group contains those traders traditionally referred to as “commercials,” or hedgers — large businesses that actually deal directly in the underlying cash market, such as grain merchants and oil companies, who either produce or consume the commodity in question. For example, an agribusiness that produces and sells grains to various food producers might sell wheat, soybean, or corn futures to lock in prices for these commodities to hedge against an unexpected price decline. On the other side of the equation, the food producer might buy contracts on these commodities to hedge against a future price increase. (In financial futures, a commercial trader might be a mutual fund manager who is hedging his stock holdings with stock-index futures.) This category of traders typically has access to supply and demand information other market players do not.

FIGURE 1: COMMERCIALS AND NON-COMMERCIALS: S&P 500

S&P 500 STOCK INDEX - CHICAGO MERCANTILE EXCHANGE FUTURES ONLY POSITIONS AS OF 01/25/11								Code-138741	
NON-COMMERCIAL			COMMERCIAL			TOTAL		NONREPORTABLE POSITIONS	
LONG	SHORT	SPREADS	LONG	SHORT	LONG	SHORT	LONG	SHORT	
(S&P 500 INDEX X \$250.00)								OPEN INTEREST:	
COMMITMENTS								308,010	
19,988	24,018	1,365	200,006	243,672	221,359	269,055	86,651	38,955	
CHANGES FROM 01/18/11 (CHANGE IN OPEN INTEREST: 12,422)									
3,729	221	296	3,337	10,882	7,362	11,399	5,060	1,023	
PERCENT OF OPEN INTEREST FOR EACH CATEGORY OF TRADERS									
6.5	7.8	0.4	64.9	79.1	71.9	87.4	28.1	12.6	
NUMBER OF TRADERS IN EACH CATEGORY (TOTAL TRADERS: 123)									
17	15	7	56	53	74	74			

Generally speaking, commercial traders are businesses involved in the production or consumption of the underlying commodity or financial instrument, and participate in the market to hedge. “Non-commercials” are mostly money managers who are speculating on behalf of clients.

Source: www.cftc.gov

FIGURE 2: THE “DISAGGREGATED” COT REPORT: CRUDE OIL

Disaggregated Commitments of Traders-All Futures Combined Positions as of January 18, 2011												
Reportable Positions												
Producer/Merchant			Swap Dealers			Managed Money			Other Reportables			
Long	Short	Spreads	Long	Short	Spreads	Long	Short	Spreads	Long	Short	Spreads	
CRUDE OIL, LIGHT SWEET - NEW YORK MERCANTILE EXCHANGE (CONTRACTS OF 1,000 BARRELS)												
CFTC Code #067651												
Positions												
269,029	423,553	217,695	271,663	229,100	249,173	56,970	158,932	78,657	103,309	195,136		
Changes from: January 11, 2011												
6,221	1,742	9,463	873	3,342	-5,117	-665	-12,749	-5,292	-7,210	1,737		
Percent of Open Interest Represented by Each Category of Trader												
78.0	78.4	77.6	78.3	78.1	76.6	9.8	10.6	9.9	6.9	19.1		
Number of Traders in Each Category												
51	55	20	26	40	85	33	69	44	48	49	86	

This newer version of the COT report breaks down in greater detail the positions of different types of traders in U.S. futures markets. The CFTC publishes the data weekly on its website (www.cftc.gov).

Source: www.cftc.gov

The Money Manager group contains those traders traditionally known as large speculators (“large specs”), which are the most important subgroup in the “non-commercial” category. These are commodity trading advisors (CTAs), commodity pool operators (CPOs), and hedge funds — institutional and quasi-institutional money managers who do not deal directly in the underlying cash markets, but speculate in futures contracts on a large-scale (and often long-term) basis for their clients.

A Swap Dealer (a subset of the broader “commercial” category) is defined by the CFTC as “an entity that deals primarily in swaps for a com-

Continued on p. 13

By contrast, non-commercials, or speculators, are seeking to profit from market trends, often taking the other side of the trade. Commodity trading advisors, commodity pool operators, and other futures money managers fall into this group. A third general group, “nonreportable,” represents small retail traders (as well as some small hedgers and professional traders

with positions below reporting levels) left after commercials and non-commercials have been counted.

Over the years, traders have analyzed the COT report to gain insight into market dynamics: Are commercial hedgers net long or short in a particular market? *How long or short are they?* What are the large speculators (money managers) doing? What about the general public? This data — especially when the long or short positions in certain trader categories reach historically high or low levels — can help traders determine whether a market might be reaching a bullish or bearish extreme, or whether a trend is likely to persist.

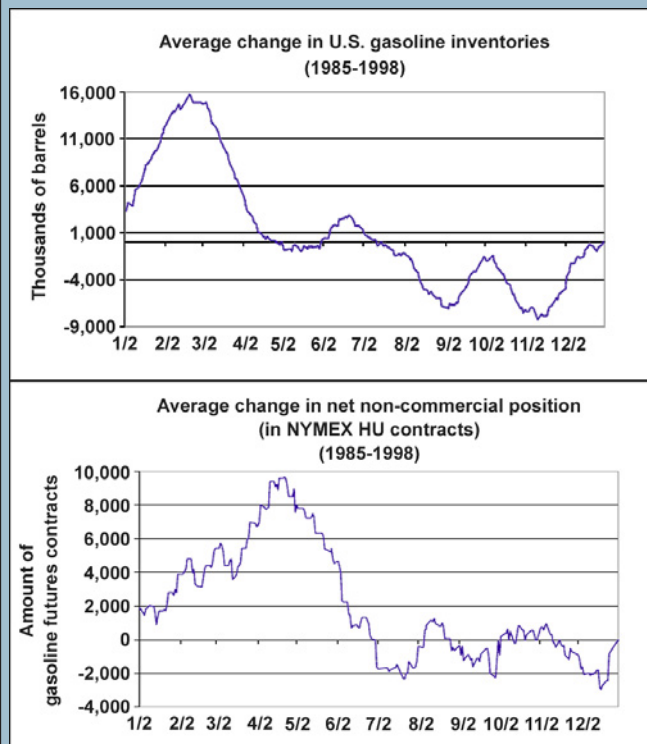
MAKING SENSE OF THE NUMBERS:

GAUGING SUPPLY AND DEMAND

Although anyone can access COT data each week, it doesn't mean the report is easy to interpret. Despite studying COT data for decades, professional traders and academics haven't found a simple, foolproof way to profit from the report; different traders employ different strategies depending on time frame and input from other market factors. However, the commercial and non-commercial groups often behave in predictable ways that offer clues about a market's future direction.

For example, in January 2009, several experts discussed the COT report and how to interpret it at a meeting of the Professional Risk Managers' International Association in Chicago. As originally reported in the February 2009 issue of *Futures & Options Trader* magazine, Hilary Till, co-founder of proprietary trading firm Premia Capital Management and research associate at the EDHEC Risk and Asset Management Research Centre, described how the COT report reveals

FIGURE 3: INVENTORIES AND NON-COMMERCIAL POSITIONS



Between 1985 to 1998, gasoline (ticker symbol: RB) inventories tended to peak in March and bottom in May. Seasonal trends in non-commercial positions followed inventories, suggesting buying gasoline futures in March and selling them in May could have been profitable during this period.

relationships between supply and demand. Till considered COT data helpful because, “when you’re back-testing you have some evidence that...can be tied back to fundamental factors,” she said. For more than a century, she added, traders, have noticed “seasonal trends in inventories mirror seasonal trends in futures markets.” As inventories rise, commercials producing or holding the physical commodity tend to hedge by going short futures; when inventories fall, commercials tend to unwind those hedges, pushing price higher. Non-commercials are often taking the opposite side of the market.

In Figure 3, the top chart shows the average change in gasoline inventories from 1985 to 1998, while the bottom half shows a similar trend in average net non-commercial gasoline positions. Comparing these charts shows inventories peak in March, while speculator positions don’t peak until May.

How can this type of information translate into trading? For example, Till and her colleague Joe Eagleeye found buying gasoline futures in March and selling in May, a strategy first proposed by Paul Cootner in 1967, was profitable from 1985 to 2002 and also made money from 2004 to 2007 (the strategy was quite

volatile, however).

In the grain markets, this idea, called the “net-hedging-pressure strategy,” translates into prices climbing after inventories peak and dropping before

Continued on p. 14

Understanding the COT players, continued from p. 11

commodity and uses the futures markets to manage or hedge the risk associated with those swaps transactions.” Swap dealers are typically on the other side of transactions with money managers (speculative traders) or traditional commercials hedging their exposure in the physical commodity. Swap dealers were broken out of the commercial category because these traders’ positions do not reflect the pure hedging actions taken by true “commercials.” The CFTC also created a separate group for commodity index traders (not shown) in 12 agricultural and “soft commodity” (coffee, sugar, cotton, cocoa) markets, to account for the trading activity of commodity index fund managers (including exchange-traded funds, or ETFs) that had been distorting the commercial category.

The final category, Other Reportables, represents all other reportable trader positions not placed into one of the other three categories. (The positions of small traders, including the general public, are reflected in the “non-reportables” category in other COT reports.)

In Figure 1, for each category of trader the report shows the raw position totals (number of open contracts), the change in these numbers from the previous week, the percentage of total open interest represented by each category, and the number of traders in each category.

Positions are shown as long, short, and (for all categories except Producer/Merchant) “spreading,” which represents the number of offsetting long and short positions held in a particular trader category. The long and short columns display any remaining positions beyond these offsetting positions.

The CFTC points out that traders in one category may sometimes be active players in another; the Commission categorizes traders based on their predominant trading activity. ♦

TABLE 1: FADING THE COMMERCIALS

Net commercial positions		
	Short	Long
Soybeans	4.35%	-1.21%
Wheat	5.71%	-10.53%
Corn	16.25%	-19.96%
Average annual returns (% per day * 250)		
<i>Soybeans, wheat, and corn futures increased when overall commercial positions were short and fell when commercials were long from 1967 to 1989.</i>		

harvest begins. In 1992, Henry Bessembinder, now a finance professor at the University of Utah, found this approach had value from 1967 to 1989. Table 1 shows soybeans, wheat, and corn futures rallied when commercial positions were net short and fell when commercials were net long. For example, corn rallied 16.25 percent annually when commercials were short and dropped 19.96 percent per year when they were long.

Figure 4 shows corn futures with commercial, non-commercial, and small trader positions (longs minus shorts) from August 2004 to January 2009. The commercial and non-commercial positions clearly move in opposite directions. For example, the commercials peaked in January 2005 as non-

commercials dropped to an eight-month low. And when commercials reached a three-year low in February 2007, non-commercials hit a relative high.

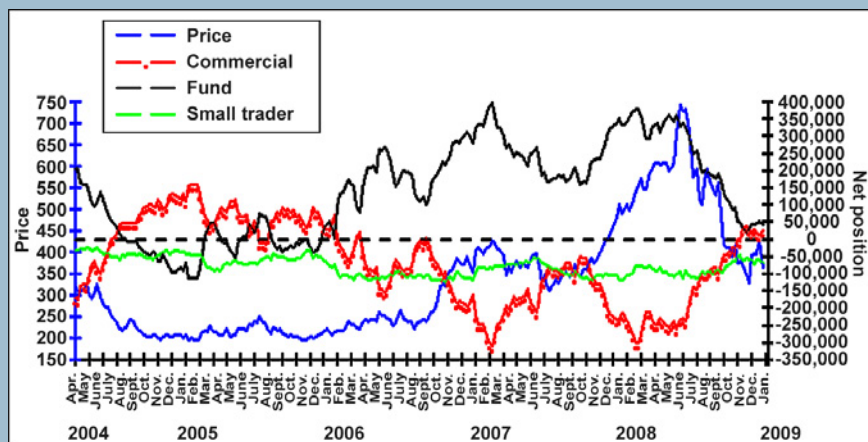
In addition, price tended to drop when commercials were long and climb when commercials were short. For example, price slumped when commercials were long in the second half of 2004. And price surged from August 2006 to February 2007 when the commercial positions were overwhelmingly short.

ONE PART OF THE PUZZLE

Generally analysts and traders distill the COT data to be able to measure current levels in one group relative to the levels in another group, or the current level to long-term historical levels. For example, the current COT report might show commercial traders are exceptionally long in a particular market, and have increased their long positions significantly over the past few weeks. At first glance this might seem to have a bullish implication, but if the current reading is, say, not even in the upper 50 percent of long commercial readings over the past five years, the bullish outlook is discounted.

Furthermore, COT readings are not timing signals by any means. Professional futures traders or money managers will tell you that creating a strategy based on COT data without considering price patterns and other market information is, essentially, foolhardy. COT analysis more typically function as a filter for taking trades in one direction or another, or as a supporting factor in a longer-term trend system. Nonetheless, the data is widely watched and provides information not found in other sources. ♦

FIGURE 4: CORN PRICES VS. POSITIONS



If you compare commercial and non-commercial positions, it's clear they move in opposite directions. Also, corn prices tended to drop when commercials were long and vice versa.

INVESTMENT MYTH NO. 3:

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Futures trading is not suitable for all investors, and involves the risk of loss. Futures are a leveraged investment, and because only a percentage of a contract's value is required to trade, it is possible to lose more than the amount of money deposited for a futures position. Therefore, traders should only use funds that they can afford to lose without affecting their lifestyles. And only a portion of those funds should be devoted to any one trade because they cannot expect to profit on every trade. All references to options refer to options on futures. Copyright © 2011 CME Group Inc. All rights reserved. CME Group is a trademark of CME Group Inc. The Globe Logo is a trademark of Chicago Mercantile Exchange Inc.

Mutual funds open managed futures to new investors

By MFT Staff

Managed futures have experienced explosive growth in the last two decades, increasing to \$247 billion under management from only \$11 billion in 1990. The primary driver of growth has been investor recognition of managed futures portfolio diversification value and its non-correlation to traditional asset categories such as stocks and bonds (for more details see “30 years of managed futures” from the May 2010 issue of *Managed Futures Today* at www.managedfuturesmag.com).

“If you look at the last decade, managed futures have outperformed equities by a long shot — managed futures up 126% while equities were flat to slightly up,” says Jon Sundt, president and CEO of Altegris Investors. “During that time period, managed futures have had a lower drawdown, lower standard deviation, and very low correlation to traditional investments. The correlation of managed futures to equities has been close to zero over three-, five-, and 10-year periods.”

However, most of the growth has come from institutional investors and very high net worth individuals. But a new structure for managed futures — mutual funds — opens the investment category to individuals with only a \$2,500 minimum investment.

“Institutions gain a lot of benefit from spreading their investments across all the major investment classes and making alternative investments,” says Lasse Pedersen, principal at AQR Capital Management. “Having an alternative investment strategy available in a mutual fund has allowed indi-

viduals to have a more institutional-like portfolio.”

Since Rydex/SGI launched the first managed futures mutual fund in March 2007, five additional companies have started funds. Mutual funds now account for more than \$3 billion of the industry’s \$247 billion under management.

DAILY LIQUIDITY

The mutual fund structure offers investors many benefits in addition to the low minimum investment requirements.

“One of the key advantages of the mutual fund structure is that investors have daily liquidity with the ability to get out of the trade at any time they like,” says Bob Enck, CEO of Equinox Fund Management. “The other key ingredient: There is an independent board of trustees that oversees the fund. That independence helps insure a high degree of oversight.”

DIVERSIFICATION

“The ability to invest in a strategy that can be long or short across a multiple commodity segments is another benefit of managed futures mutual funds,” says Andy O’Rourke, chief marketing officer of Direxion Funds. “You get broad diversification from the multiple commodity segments and the ability to profit from upside or downside trends. If you’re not capitalizing on both the upside and the downside, you’re probably not going to get sustainable returns.”

“The idea of being short might have been very

TABLE 1: MANAGED FUTURES MUTUAL FUNDS

Fund name/URL	Symbol	Min. investment	Inception date	Net expense ratio	AUM \$mil	Comment
Altegris Managed Futures Strategy Fund <i>alTEGRISMUTUALFUNDS.COM</i>	MFTAX	\$2,500	8/27/10	2.00	350	Five outside managers
AQR Managed Futures Strategy Fund <i>AQRFUNDS.COM</i>	AQMNX	\$5,000	1/5/10	1.50	1000	One internal manager
Direxion Commodity Trends Strategy Fund <i>DIREXIONFUNDS.COM</i>	DXCTX	\$2,500	6/10/08	1.87	133	Trades the Commodity Trends Indicator
Equinox MutualHedge Frontier Legends Fund <i>THEFRONTIERFUND.COM</i>	MHFAX	\$2,500	12/31/09	2.20	250	Five outside managers
Natixis ASG Managed Futures Strategy Fund <i>NATIXIS.COM</i>	AMFAX	\$2,500	7/30/10	1.72	200	One internal manager
Rydex/S&P Managed Futures Strategy <i>RYDEX-SGI.COM</i>	RYMFX	\$2,500	3/2/07	1.99	1,402	Trades the S&P Diversified Trends Indicator

scary to some individuals, but in a mutual fund structure you have professional managers doing it in a carefully monitored and diversified way so you get the benefits of shorting in a very risk-controlled fashion,” says Jerry Chafkin, president and CEO of AlphaSimplex Group, an affiliate of Natixis Global Asset Management.

Although mutual funds offer daily liquidity, managed futures are still a long-term investment. “Several well-known studies support the argument that managed futures can improve the efficient frontier when included in a portfolio’s long-term asset allocation,” Chafkin says. “When there is an extended market dislocation, managed futures tend to perform particularly well because they can identify the downward trend and start making money even as traditional investments continue to decline in value.”

Sundt emphasizes that “You don’t get into managed futures to chase returns; you invest in managed futures to give you steady long-term performance that is diversified from traditional investments.”

INSTITUTIONS

While the lower investment minimums of mutual funds are an advantage to individual investors, many

institutions are also investing in managed futures mutual funds.

“There seems to be a growing appetite by institutions for investing through highly regulated funds,” Enck says. “I think managed futures have been attractive to institutions because of the ability to utilize managed accounts, and mutual funds provide an additional layer of oversight and regulation for institutional investors. Many institutions are large enough to invest directly with a CTA but they don’t necessarily have the expertise to actively manage a portfolio of CTA programs.”

Each of the mutual fund companies we spoke with said registered investment advisors have been key to the success of their managed futures mutual funds.

“We’re getting allocations from the broker/dealer network and registered investment advisors because they’ve been looking for access to managed futures, but they’ve been avoiding it because of the cumbersome nature of private placements and public commodity pools,” Sundt says.

All the fund companies we spoke with also have additional managed futures mutual fund products on the drawing board, so we will provide updates about this segment of the industry in future issues. ♦

Managed futures book solid gains in 2010

Industry rebounds from flat 2009; agricultural funds top returns for the year.

Managed futures funds tracked by BarclayHedge posted strong returns in 2010, with the broad Barclay CTA index closing out the year with a 7.03% gain. The index represents more than 500 U.S. commodity trading advisors (CTAs).

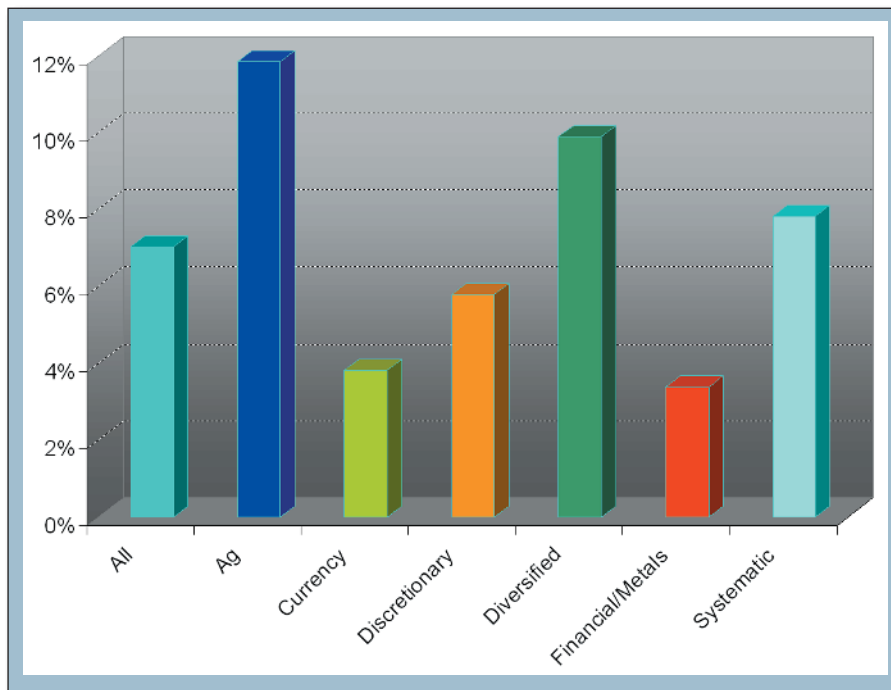
Perhaps the biggest surprise was the strength of agricultural futures fund managers. The Barclay Agricultural Index returned nearly 12% for the year — a big turnaround from its 1.40 decline in 2009. In fact, the manager sub-indices that posted the biggest 2010 returns were the ones that suffered the worst performance in 2009. The Diversified Traders index, which lost 3.61% in 2009, made an even more dramatic reversal by gaining 9.91% last year. Similarly, the Systematic Traders index, which dropped -3.38% in 2009, gained 7.82% in 2010. None of the six CTA sub-indices closed the year in the red; the Financials/Metals index posted the smallest gain (+3.39%).

Although only partial results were available for January 2011, the industry appeared to be starting off the year quietly, with most managers posting small losses and the Barclay CTA index down

approximately 0.35% with around half of all managers reporting.

The big bull move in commodities that dominated the second half of 2010 (big moves occurred in almost all market sectors; see “Commodity Snapshot,” next page) undoubtedly contributed to the year’s returns, as well as the increase in funds under management (see next section).

Updated industry returns are available at www.barclyhedge.com. ♦



Managed futures AUM hits new high

Q3 2010 total surpasses previous peak from 2008.

Managed futures assets under management (AUM) made a big jump in the third quarter of 2010 to hit a new all-time high of \$247.8 billion dollars, according to data from BarclayHedge.com. The new AUM total, which eclipsed the previous high of \$234.1 billion set in the second quarter of 2008, also marked a nearly 10% increase from Q2 2010,

and was the sixth consecutive quarter of net inflows into the managed futures industry.

The two management sectors that saw the biggest gains in funds under management from the previous quarter were financial/metal traders (+9.57%) and agricultural managers (+8.57%). The second group’s increase was especially noteworthy as its AUM had

Commodities extend run into 2011

Commodity indices poised to make a run at recouping half their losses from 2008-2009.

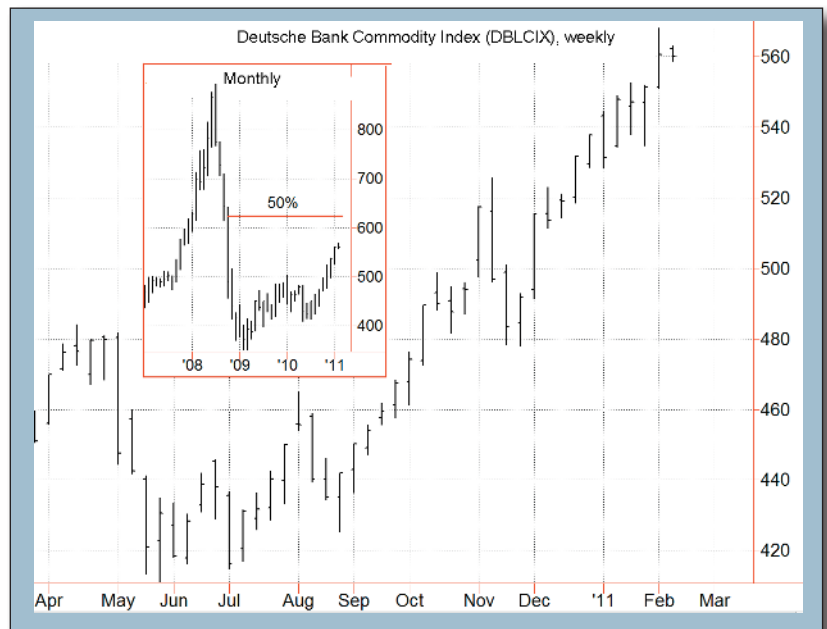
The broad commodity rally that began last summer extended into 2011, as commodity indices pushed to their highest levels in two and a half years. In early January, a longer-term chart of the Deutsche Bank Liquid Commodity Index (DBLCIX) showed commodity futures had shaken off the dust of the trading range that had dominated markets in the aftermath of the 2008-2009 financial crisis, and were on their way toward recapturing nearly 50% of their decline from that period.

Although the rallies in the marquee precious metals, gold and silver, stalled somewhat late in 2010, the slack was more than taken up by the extended rallies in grains (corn, wheat, and soybeans), soft commodities, and energy futures. Crude oil futures began attracting media attention early in 2011 as prices edged toward \$100/barrel for the first time in almost three years. Virtually every commodity sector contributed to the overall uptrend, including livestock (cattle and hogs), and a record-setting rally in cotton.

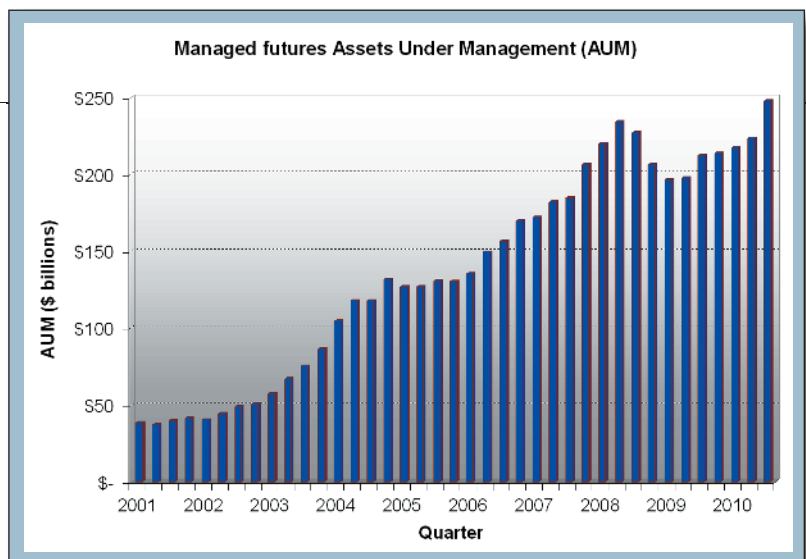
Financial futures: Stock index futures continued to benefit from the equity market's new year rally,

declined 20% from Q1 to Q2 2010.

Systematic traders made the smallest quarter-over-quarter gain (+2.52%), but maintained the largest portion of the industry's total AUM (\$179.6 billion). The only group to see a net outflow in the third quarter was discretionary traders (-19.29%). ♦



which was still gathering momentum into February in response to a positive earnings season. In early February, the S&P 500 index had rallied to its highest level since June 2008, and was much closer to its all-time high than its 2009 bottom. Benchmark U.S. treasury futures (T-bonds and T-notes) were still in a downtrend in early February after peaking in November. ♦



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