Frequently Asked Questions About Managed Futures

Individual and institutional investors are increasingly including Managed Futures as part of a diversified investment portfolio as they search for alternative or non-traditional investment opportunities, which can include commodities, private equity, venture capital, as well as hedge funds. The following are some frequently asked questions about Managed Futures:

1. What are Managed Futures strategies?

Managed Futures are a diverse subset of active hedge fund strategies that trade liquid, transparent, centrally-cleared exchange-traded products, and deep interbank foreign exchange markets. Managers in this sector are called Commodity Trading Advisors (CTAs). This name goes back to the origin of the strategy when, unlike today, most CTA activity was in commodities. Currently, their strategies are largely focused on financial futures markets — equity indices, fixed income, and foreign exchange — with additional allocations to energy, metals, and agricultural markets. There are also Commodity Specialist Managers that focus mainly or exclusively on commodity markets. They may further specialize in one or more asset classes within the commodity space, such as energy or agricultural.

2. Have Managed Futures strategies changed since they became popular in the 1970s?

The predominant strategy remains trend following, but this approach has evolved significantly in sophistication in recent years, and the overall space has become increasingly diverse.

» In general, trend followers aim to identify and exploit sustained capital flows across asset classes as markets move back out of and into equilibrium, often after prolonged imbalances. Other CTA styles thrive on volatility and choppy price action that accompanies these flows, as well as a variety of other market phenomena.

» The number and variety of short-term programs has risen sharply with the advances in trading technology, data analysis, and increased interest from quantitative traders in establishing their own trading firms.

3. How do the economic worldviews of investors influence their hedge fund strategy choices?

The worldviews of investors can directly influence their choices of hedge fund strategies because many widely-adopted strategies implicitly assume that markets will be stable and mean-reverting. These types of strategies are often designed to capitalize on steady or declining volatility and are, therefore, inherently optimistic about broad market conditions.

Systematic Trend Followers, to take one CTA style as an example, are by contrast not constrained by any economic forecast or view. They can employ directionally unbiased, divergent strategies that are designed to benefit when prices diverge from equilibrium levels and when capital flows create price trends, either upward or downward. They also aim to exploit situations in which markets re-establish equilibrium in the wake of new information or in the transition from one economic cycle to another. This diversification attribute has helped investors reduce the risk that portfolios face from extremely adverse overall market conditions, sometimes referred to as tail risk, that punish nearly all asset classes and strategies.

Managed Futures strategies, however, should not be treated as a portfolio hedge. Rather, they may be viewed as additional sources of uncorrelated returns. Although Managed Futures returns tend to be uncorrelated to other investments over the long run, correlations may be non-stationary over shorter time horizons and may temporarily converge during crisis conditions. Not all market dislocations are the same, making CTAs vulnerable to rapid reversals or the sudden onset of volatility.

4. Why should investors include Managed Futures in their portfolios?

Managed Futures strategies can be a source of uncorrelated alpha because they are directionally unbiased, often cover a variety of time frames in their position holding periods, and have historically sought returns independently of the prevailing economic or volatility regime.

Overall, these strategies have performed well during many periods that were difficult for equity markets and other hedge fund strategies. This is a result of the internal diversification, unbiased directionality, and the risk management styles of CTAs. The market conditions that have traditionally been difficult for CTAs employing trend following strategies have been those in which there is no follow through on trends, such that prices are mean-reverting. As a result, many CTAs incorporated additional strategies in an effort to capture these types of market characteristics as a complement to their trend following.

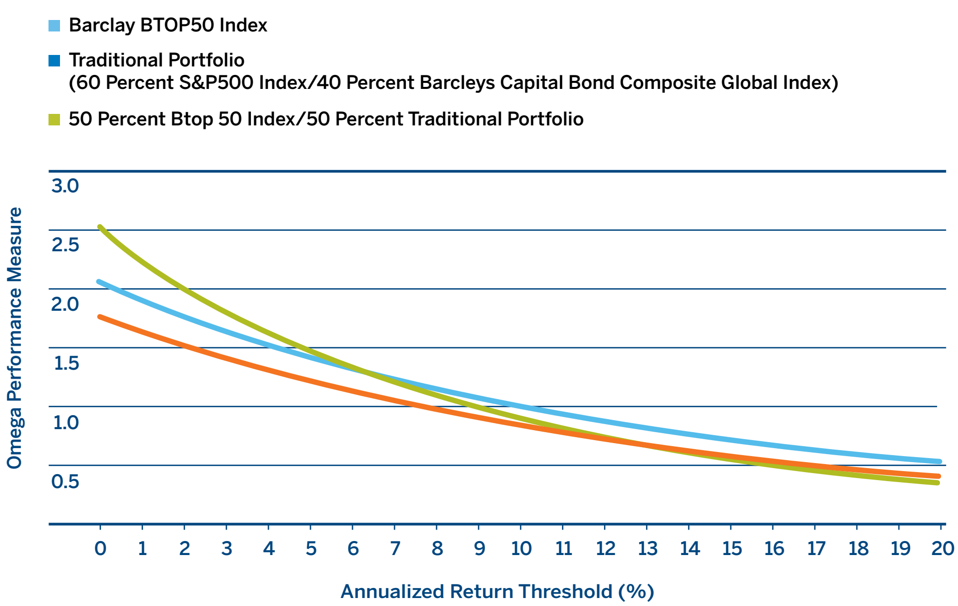
» Managed Futures strategies tend to reduce portfolio variance. The addition of uncorrelated variance may also have a beneficial effect on other performance and risk metrics.

» The exchange-listed underlying instruments used by CTAs facilitate risk management and mitigate many of the risks associated with model risk. The margining process also allows for flexible and effective cash efficiency.

On the risk side, Managed Futures present risks for investors just like any other hedge fund style. Investors can potentially experience volatility and substantial drawdowns, especially if the trading manager has set a higher return objective and takes more risk to try to obtain it. Investors should always conduct thorough due diligence to properly understand the potential risks and weaknesses of trading programs before investing. This is especially important because the trading methodologies employed by CTAs, the level of risk and return that is targeted, and the quality of the operational infrastructure of trading managers may vary widely across the space.

Regarding model risk, it is important to note with any hedge fund strategy that there is no guarantee that any model will capture or properly account for every aspect of reality. Certain types of modeling techniques may be susceptible to curve-fitting or over-optimization.

BTOP50 Index and Traditional Portfolio of Equities and Fixed Income (01/1987 – 06/2010)



5. What is the general approach CTAs take to risk management?

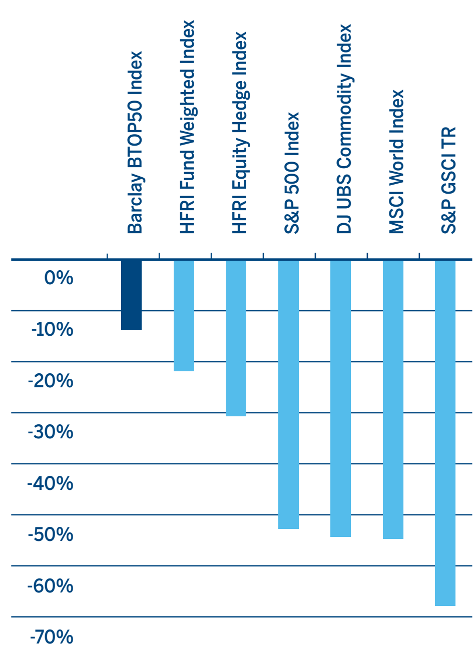
The risk management style of trend followers tends to create a positive convexity return profile, similar to what can be achieved using options. Although there is no guarantee that risks can be strictly controlled, trend-following managers generally seek to preserve upside potential and limit downside risk to predetermined levels through the use of stop-loss orders and other means.

6. How do maximum drawdowns (peak-to-trough declines) of Managed Futures compare to those of other hedge fund strategies?

Historically, drawdowns in many Managed Futures strategies have been significantly smaller than in most other hedge fund strategies.

As illustrated below, maximum drawdowns have been less than half those of the HFR Equity Hedge Index when comparing the Barclay BTOP 50* CTA Index for the period of January 1987 through June 2010.

Worst Drawdowns In Comparison (01/1987 – 06/2010)



7. What is the long-term track record of Managed Futures?

The following is presented to illustrate long-term performance comparisons among Managed Futures, equities, and several leading equity hedge fund and fund of funds indices. Further information and additional comparisons can be found in CME Group's paper, *"Lintner Revisited: A Quantitative Analysis of Managed Futures in an Institutional Portfolio"* and at **barclayhedge.com.**

Returns – For the period of January 1980 – November 2010 the Barclay CTA Index had an average annual return of 11.55 percent vs. 7.9 percent for the S&P 500.

Correlations – During that same period, the correlation between the Barclay CTA Index and the S&P 500 was insignificant at +0.01.

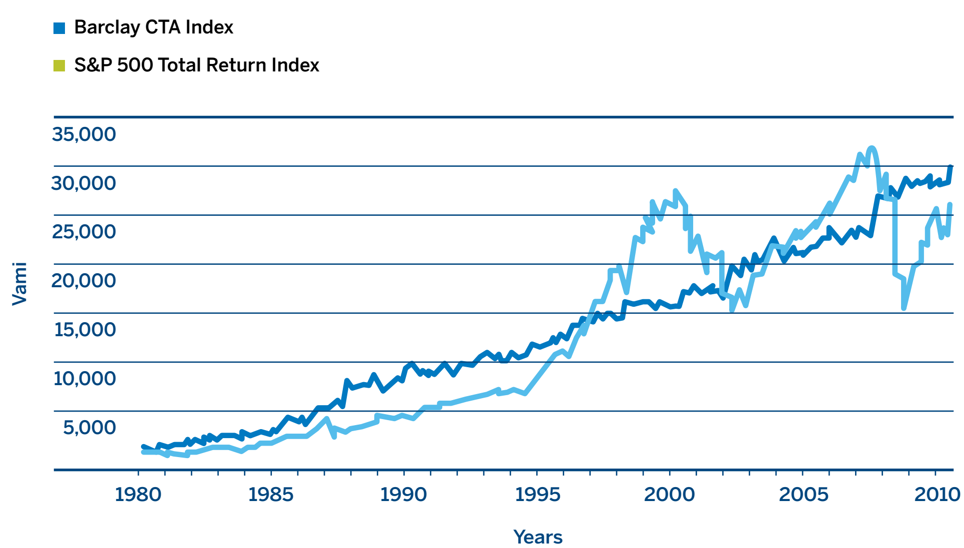
The correlation between the Barclay CTA Index and the S&P 500 was –0.12 for the period January 1997** – November 2010, which included several well-known episodes of major market turmoil. Looking more broadly, we see low correlations when comparing CTA performance with equity long/short funds and a general fund of funds index, as would be expected from the diverse styles employed and the wide range of products traded by CTAs. The correlation between the Barclay CTA Index and the Barclay Equity Long/Short Index was +0.03 for the January 1997 – November 2010 period and +0.13 with the Barclay Fund of Funds Index over the same period (see the accompanying table).

Jan 1997 – Nov 2010	Barclay CTA Index	S&P 500 TR	Barclay Equity Long/Short Index	Barclay Fund of Funds Index
Barclay CTA Index	1	-0.12	0.03	0.13
S&P 500 TR	-0.12	1	0.67	0.59
Barclay Equity Long/Short Index	0.03	0.67	1	0.88
Barclay Fund of Funds Index	0.13	0.59	0.88	1

By contrast, a high correlation is evident during the same period between the S&P 500 and two other hedge fund indices: the Barclay Equity Long/Short, +0.67, and Barclay Fund of Funds Index, +0.59.

Historical Volatility – For the January 1997 – November 2010 period again, the annualized standard deviation of returns of the Barclay CTA Index was 7.28 percent vs. 16.60 percent for the S&P 500; vs. 7.95 percent for the Barclay Equity Long/Short Index; and vs. 5.87 percent for the Barclay Fund of Funds Index. Many investors are unaware that CTA volatility in general has historically been lower than equity market volatility as well as lower than equity long/short hedge fund volatility as measured by broad indices.

Barclay CTA Index vs. S&P 500 TR (Jan 1, 1980 - Dec 31, 2010)



Past performance is not necessarily indicative of future results.

* The BTOP 50 Index seeks to replicate the overall composition of the managed futures industry with regard to trading style and overall market exposure.

** The Barclay Equity Long/Short Index and Fund of Funds Index were launched in January 1997.

8. Do CTAs employ leverage in their trading?

CTAs do not employ leverage in the traditional sense of borrowing money to increase exposure. Funds that are not being used as margin can be invested in treasury securities or various liquid instruments that meet the requirements of the customer's FCMs.

Futures contracts have implicit leverage, which is generally controlled, to a large extent, by the conservative margin-to-equity ratios employed by CTAs. These ratios imposed by clearing firms refers to the percentage of margin in a customer account that is permitted to be deployed as margin. Clearing firms act as third parties that aim to protect their interests by maintaining conservative margin-to-equity ratios. It is important, however, to note that risk policies at various clearing firms and CTAs vary and that customers should inquire with their own clearing firm(s) as to what the ratio would be for the customers' account(s).

9. Do CTAs generally offer position and strategy transparency?

Full transparency is generally available at the level of the exchange-traded instruments. This facilitates risk management because the notional exposure, margin usage, and prices of the instruments are known.

» Transparency at the manager level depends on the policy of the manager and the structure employed, whether a managed account or a fund. With individual managed accounts, full transparency and control of funds is available.

10. Are the products that CTAs trade liquid?

CTAs generally utilize the most liquid exchange-traded products with the highest level of open interest, which enables them to offer investors excellent liquidity terms.

11. Do CTAs impose gates and lockups on investors?

CTAs generally have liberal redemption policies, usually monthly or quarterly with no restrictions, if not better. Some CTAs offer daily liquidity. Unlike what took place in some other hedge fund strategies, CTAs generally did not impose either gates or lockups during the financial crisis of 2008 – 2009. With separately managed accounts, investors can terminate a trading manager's power of attorney and liquidate positions themselves. CTAs cannot restrict customers from making withdrawals from their managed accounts.

12. Is there research that supports the inclusion of Managed Futures in portfolios?

There is a substantial body of research, including John Lintner's seminal research in 1983 and numerous recent articles, that demonstrate the portfolio benefits managed futures can offer. The Lintner research was updated and expanded recently and is available in a long and short version from CME Group.

For more information about Managed Futures, or to view and order Managed Futures materials, visit the **CME Group Managed Futures Resource Center** at **cmegroup.com/managedfutures.**

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