SafeMoneyMetrics®

A Mini Managed Futures Course For Investors

This course can be passed to anyone that you believe can benefit; especially financial service professionals. Your simple act of passing this course along can help more people make wiser decisions.

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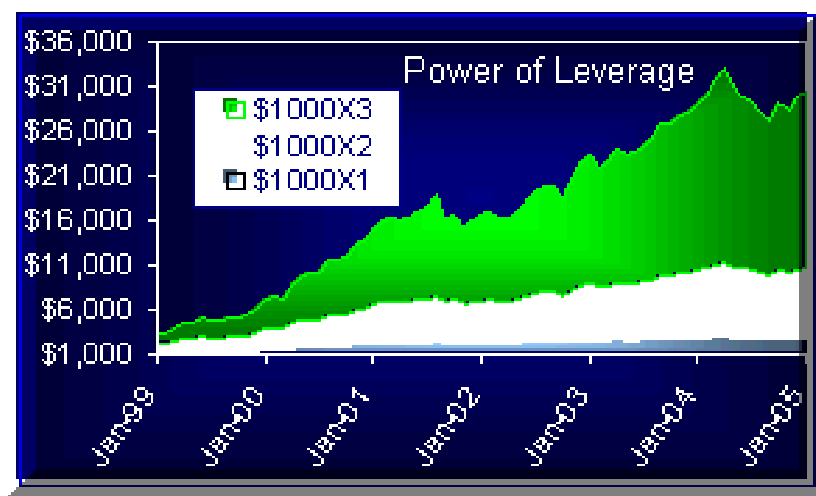

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This is not a solicitation for investment.

Why Managed Futures ?

Managed Futures – A High Point

The greatest attribute of managed futures is that performance movements have no relationship to market movements. You heard that correctly. Markets can go up, down, sideways or do nothing and there is NO relationship between market movements and potential returns.

Careful observation will reveal that many investments are marketed using erroneous applications of Modern Portfolio Theory. Specifically, many people perpetuate the degree of correlation between market movements, rather than performance results from those markets.

Who cares how markets correlate? We ONLY need to care about how traders will function under "potentially difficult future market conditions." Nothing else matters! Returns in managed futures, have zero correlation to returns of any other investment, and that includes any hedge fund that does NOT already include managed futures. That's because of how capital and time are used with futures relative to other investments.

It can ALWAYS be PROVEN that inclusion of managed futures into any traditional or hedge fund investment will ALWAYS reduce composite portfolio volatility. Managed Futures have the CAPACITY to increase composite returns and reduce total risk exposure.

Remember: The words "always can be PROVEN" does NOT guarantee future profitability of any investment. Managed futures can improve the return potential of an intelligently diversified portfolio under unknown future market conditions.

We can avoid the industry because of fear or "hearsay", and deprive ourselves of the unique attributes offered ONLY by managed futures; or we can approach the industry with discrimination and wisdom to allow the good it offers to flow in our direction!

Using Weakness to Create Strength

There is no perfect investment. Each component of the typical portfolio carries clearly defined limitations. For example: Growth Stocks only perform well in a bull market. Bonds present an opportunity for principal loss if the asset is sold (interest rate risk). Cash is not easily accessible in illiquid real estate investments. Energy Partnerships and Stocks are subject to the price risk of underlying oil prices. Hedge funds may be comprised of only illiquid investments.

> Each investment has its own set of economic and human circumstances that require it to perform. If those circumstances are not present, it affects our portfolio as a whole.

Substantial financial rewards may be realized by accepting that managed futures are also imperfect but bring their own positive advantages that easily compliment your existing investments. The synergy of a well-balanced portfolio reduces risk to the entire structure. Unique benefits of managed futures easily offset the risk of

traditional investments.

Total liquidity and skilled use of leverage are considered the greatest benefit of any managed futures strategy. History teaches us that performance and price movement of futures greatly differ from traditional investments during various market cycles and does not track well. The question investors must ask when they survey available capital management vehicles is; **How can I utilize these discrepancies to my advantage?**

Using only 20% or less of your total portfolio automatically considers and reduces the above average risk of using leveraged investments. To fully understand market movements within managed futures, it is necessary to step outside conventional thought and reach towards something more direct, adaptable, liquid and potentially lucrative. Compared to traditional investments that are usually held for one year or longer; high leverage makes futures a "tool" offering a time **value use of capital** totally unique to investments. Positions within a portfolio may be held anywhere from minutes and hours to days and weeks. A condensed time frame allows us to capitalize on the markets volatility and shorter-term trends to seek long-term capital appreciation.

An ability to integrate an investment with a time value use of capital so distinctive gives you opportunity to incorporate a "Yield Curve Effect" into your entire portfolio. This is November 24,2010 – Facts below were gathered from 1995. The collapse of our financial system in 2008 took everything but the futures markets! Since 2008 commodity exchanges are clearing more futures markets because the risk management model used in our industry far surpass systems built for other financial sectors.

- Goldman Sachs conducted a twenty-five 25 year study concluding that by allocating only 10% of a traditional investment portfolio to managed futures, investors can vastly improve performance.

- **The Chicago** Mercantile Exchange Group concluded "portfolios with as much as 20% of assets in managed futures yielded up to 50% more than a portfolio of stocks and bonds alone. The study further stated the increase in performance utilizing futures could be done with comparable risk to using stocks and bonds. **http://www.cmegroup.com**

- University of Massachusetts, Dr. Thomas **Schneeweis concluded that:** On a stand alone basis, the risk (standard deviation) of an average individual CTA has no more risk than an average stock in the S&P500. A portfolio of CTA's has similar risk to that of the S&P 500. Over the past 10 years, an investment in a portfolio of CTA's provides risk and return benefits when combined with stocks and bonds.

- Syracuse University, Dr. Fernando Diz, **Professor of finance concluded that:** Over 15 years (1980 -1994), the managed futures industry outperformed the S&P500 and Russell 3000 indices by a sizable 488 and 750 basis points per year, respectively. This is **net of** all **costs deducted for professional management but not deducted for the index's returns.**

- **Over the** past 35 **years comparing five major advances and declines in the S&P 500 and corresponding futures performance concluded:** During greatest stock advances futures were positive in each advance. During the greatest stock market declines futures were also positive, In all but one decline

of the S&P 500, the advance in futures completely offset the loss in the S&P 500.

- Harvard, **Stanford and Notre Dame Universities** all use managed futures in diversifying their investment portfolio with tremendous success. From before 1996 Notre Dame's investment in professional management resulted in returns of more than 30%, with Stanford reporting similar results. **With the Stock market having one of its best years** in **history in 1996, the single best performing asset class in** Harvard's portfolio was managed futures, returning 46% as of a December 2, 1996 article in Barron's.

- In 2001 the regulators approved futures contracts on individual stocks. This was a strong indicator that increased stock market volatility will sustain itself over the coming decades. Futures once only used for hedging grains, meats, and soft commodities NOW exist for all major financial markets.

<u>Only when</u> superior use of time related to money is used, managed futures have ability to offer the comfort of lower volatility within a highly leveraged volatile arena. Direct access to the short side of markets allows risk associated with owning equities to be translated into potentially substantial profits.

Stock and Mutual fund managers switch positions only from long to cash during anticipated trend changes. In futures and options, traders have choices of hedging with options, using spreads or going from long to short when appropriate.

The perception that managed futures alone, carry more inherent risk than Growth Stocks was first destroyed by the stock market crash of 1987, and again with all stock market volatility over the past 23 years. Look at the standard deviation of traditional money managers relative to managed futures from 2000 until NOW, November 2010. You'll learn something.

Success = Prudent Application and Moderation

Managed futures can be designed to offer less volatility than most stock portfolios. It is true that misuse or abuse of greater leverage available in managed futures can produce dramatic short-term changes and excessive losses in portfolio value. When this facility is used with skill and in moderation, by reliable resources over an extended time period, it can produce outstanding results from a limited commitment of capital.

A sound plan is essential to protect and increase your assets. Managed futures can provide a vital element in this plan. Equities and managed futures are totally autonomous when it comes to performance. This automatically reduces risk. Value of the managed futures industry has grown beyond all expectations with the introduction of new products and opening of exchanges globally. Trading has become an economic necessity conducted on a 24-hour basis around the world. Modern communication provides instant accessibility to all markets.

The futures markets are living growing and doing the job they were created for. Futures reduce economic risk and establish stability for their underlying commodity or asset. When properly structured managed futures offer the potential of:

- Outstanding performance with limited capital.
- Performance in bull, bear or sideways markets.
- A direct totally liquid investment.

- The ability to use shorter-term market trends to create long term capital appreciation.
- Potential for immediate gain.

A Very Simple Allocation Example

We created a $1000 Value Added Monthly Index, (VAMI) using equal value of the S&P 500, Russell Growth 2000, NASDAQ and a Long Term Bond Index. The index is used for generic presentations and teaching models. The monthly Rate of Return for each index is added then divided by four. The result is added or subtracted from a cumulative $1000 Unit value. Our only purpose is to show trends in traditional portfolio performance.

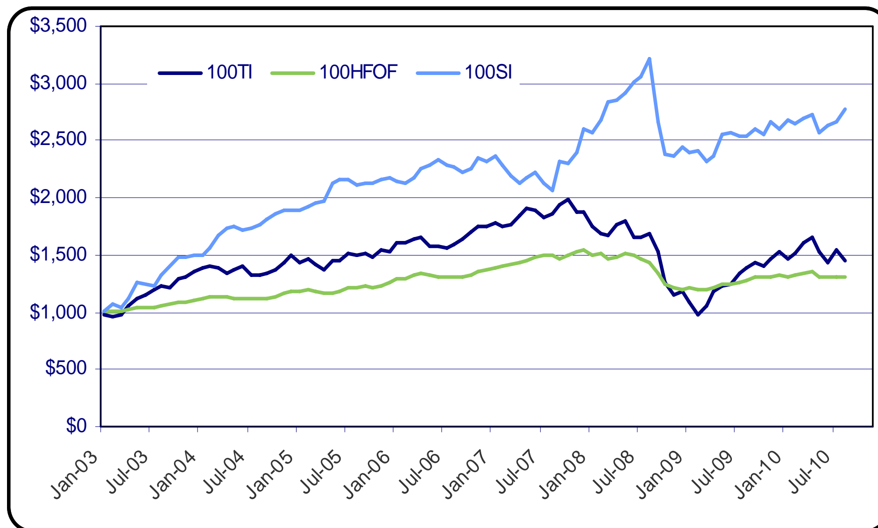
A Hedge Fund Index was created using the Barclay Hedge Fund of Fund data, also to represent trends.

Finally, a managed futures index using three advisors was created using ONLY traditional rate of return values. That means NO leverage. The index is ultra conservative. Two of the three advisors I would never allocate money to. Our index has one purpose, **to show performance trends** NOT performance. We call it the SafeMoneyMetrics® Index (SI).

The data tables and graphics below represent 100% allocated to a Traditional Index (TI), then 20% allocated to the managed futures (80-20TISI). 100% allocated to the Hedge Fund Index, then 20% allocated into the SafeMoneyMetrics® Index. Finally 100% to managed futures, or the SafeMoneyMetrics® Index. The total return column is through the end of September 2010.

	100TI	80-20TISI	100HFOF	80-20HFSI	100SI
2003	31.4%	18.2%	15.7%	10.2%	2.7%
2004	9.8%	6.7%	3.9%	3.5%	2.5%
2005	6.7%	8.7%	6.8%	9.1%	14.9%
2006	9.7%	9.2%	6.4%	6.8%	7.8%
2007	5.2%	6.3%	10.4%	10.2%	9.7%
2008	-32.5%	-24.9%	-19.8%	-15.2%	-4.5%
2009	41.2%	29.6%	9.4%	9.2%	8.7%
2010	-0.6%	0.8%	-0.4%	1.1%	3.9%
Total Return	**30.3%**	**24.2%**	**23.4%**	**24.6%**	**33.2%**

The chart on the next pagerepresents $1000 VAMI for three indexes. Nothing was reallocated. Looking at the patterns in movement from January 2003 through September 2010, one can easily see how independent each index is from the other. Managed futures travel to the sound of their own drum. Even if futures do nothing, or show losses for a specific time frame, they correlate with a total portfolio that reduces risk of the composite strategy under unknown market conditions.



A Few Questions to Ask Before Opening a Managed Futures Account

1) Relative to what I know about stocks and bonds how do you make money?

It is volatility and change that investors usually fear that allow profits to be taken from the futures markets. Without promises or guarantees futures traders are usually more profitable when markets are dynamically changing. Futures trading benefits from falling prices by short selling, rising prices by going long (buying) and maybe even price differentials between commodities by using spreads. A spread is buying one market and selling another expecting the difference in prices to narrow or widen, whatever direction moves in our favor. If prices appear too volatile positions may be hedged with options. If you own stocks or bonds under unfavorable or emotionally unsettling market conditions, you can partially offset some of the investment risk with managed futures.

Since I truly believe that the stock market is speculative, I need to quantify the last statement. You can diversify risk capital into managed futures. When well done, the composite risk of all risk capital will be less than without managed futures. If NOT well done, your risk will increase!

Let's pretend that the job of diversification is well done!

By using 15% or less of a total portfolio the leverage offered in managed futures can offset potential losses from stocks or bonds.

For example: Hypothetically speaking let's assume, that you have a total portfolio of $1,000,000 including a retirement fund earning 10% annually. (According to Morningstar, the ten-year historical average for stock funds is 10% annually). Use 10% or $100,000 for managed futures. Assume all money is lost and the portfolio is left with $900,000 still earning 10% annually. Without incurring any more risk, the portfolio earns back all capital lost in less than 18 months.

Assuming your worst fears have been dealt with, let's move to the upward potential of managed futures.

Assume $100,000 allocated to futures averages 20% annually for the next decade. Cumulated all profits reinvested is $619,173, divided by 10 years it becomes $61,917 or a 62% average annual return. The $900,000 investment base, cumulated for 10 years at 10% becomes $2,334,368. Total value is now $2,953,541. After 10 years, a 10% allocation to futures now represents 20.9% of the total portfolio value. Futures contributed over 600% on the original investment over the decade. That's the gift in leverage! **All examples are used for educational purposes. We do not claim or guarantee that returns cited have or can be attained.**

2) How does professional management allow risk to be managed?

Hypothetically speaking lets pretend that $100,000 was allocated between two advisors: $45,000 to one and $55,000 to another. Although account sizes differ as to markets traded, most advisors consistently commit a fixed portion of assets for trading. For example, maybe $4500 to $11,250 (10% to 25%) of capital is used as original margin for ALL trading; the balance is excess and idle in your account.

Advisors may risk 50% of the original margin requirements, or maybe 1 to 3% of capital on each trade. They may only choose trades that offer a 3 to 1 profit to loss ratio. Every trader is different. Most advisors build strategies where testing proves that at least 53% of trades need to be successful. There is never any guarantee of success, only that prudent risk management is built into a good strategy.

We believe that shorter-term strategies should have a much higher percentage of profitable trades. The risk/reward ratio per trade is usually lower too! Awareness to changing market conditions before excessive losses occur differentiates good money management from mediocrity. Diversifying through time values, strategies, market sectors and markets traded all have to be considered. Having proper floor facilities for order execution and trade allocation saves money on slippage and errors. We have touched the tip of an iceberg concerning possible methods of risk control. Reading disclosure documents and risk management profiles created by SafeMoneyMetrics™ brings more detail to your attention.

Profiles will be defined in section five.

Remember: Investment strategies are only as good as the consciousness and talent of a mind designing them and discipline of the personality implementing them. Truthfully, nothing else matters!

Traditional risk disclosure leaves us with an impression that markets are dangerous with no method of managing risk. Fire is also dangerous when risk is not managed. Intelligent industry professionals successfully manage risk. Our job is to define "intelligent or successful" and teach you how to locate it!

3) Why do draw-downs appear larger in some accounts?

Draw down and account volatility is related to percentage of account value. For example if a $15,000 account has a draw down of $5000 that's 33.3%, considered high risk when draw down is used to measure risk. Yet $5000 of $30,000 is only 15% well within industry norm for a conservative investment.

Contrary to traditional applications of draw-down analysis, we believe that advisors having the same account sizes, using similar margin requirements, trading similar markets can be compared with each other. Many professionals do not consider the

parameters above when using draw down, as a measure of risk. Within that context, information you receive will be inaccurate.
Many well-established advisors require larger account sizes relative to capital actually used for trading. This tactic increases their management fees and reduces the "illusion" of risk.

4) What is notional funding?

With your knowledge and consent, your account is traded as $100,000 while funded with $50,000. You are responsible for the entire $100,000 commitment. Funding a $100,000 with $25,000 gives you four times the leverage. Notional funding is great, when properly evaluated. Look at http://research.safemoneymetrics.com/research.html Leverage and Cost to learn how notional funding can comfortably be evaluated.

If you want a long-term relationship with managed futures, take time to understand the leverage, cost and volatility of notional funding. Like all new relationships, we believe it takes about a year into managed futures, before you are truly comfortable.

5) What is your perception of good judgment in deciding how long to keep my account open when it is not profitable?

Personally, when using shorter term trading, if a trader loses money over any consecutive five month time frame, I am miserable and usually close the account. Option traders, personally, three months is long enough. They should be profitable 9 months annually. Defining performance relative to time is a necessary function of risk control. Understanding past performance relative to current market conditions, the investment strategy and your self is helpful.

Long-term trend following strategies may take one to three years to see daylight. We have seen good traders break even or lose money within a year, then dramatically increase account value simply because a trend has started in markets they happen to trade. (As long as a trader has the humility to recognize it as a trend and not skill, you should do well). Short-term breakout or channel strategies require less time. Again look at the frequency of trading and percent of profitable trades. If someone claims they can successfully day trade, you should see account profitability rather quickly within a week or two. I know floor traders that make money every day! Some day trading strategies only trade once a week, they may need two or three months. Always ask for a profile of how the investment works or guidelines before you commit. Profiles can help quantify future account activity.

6) Our opinion of why is risk is healthy!

Life without some degree of risk becomes stale and we become fearful beyond what is considered healthy fear that protects us. Boundaries for living become a function of fear causing a contraction of life, rather than taking calculated risk that expands the boundaries of life with strength, courage and love.

We're not suggesting reckless abandon with your capital or your self, what we are suggesting is the simple ability to transform your perception of risk, from one of fear and loss to a perception of opportunity for gaining strength, courage, growth and potential money. Remember fear contracts and lowers energy, where strength

and love expand energy. Living in a conscious state of expansion is healing to the body and spirit because life is lived through us and simply flows.

Take time to walk in nature, do you ever see a tree fearing the risk of natures elements, or a flower fearing to become more of itself. Nothing is trying to live it just lives. Life expands by itself when we get out of the way. Calculated risk is parallel to a caterpillar becoming a butterfly. If it does not become the butterfly it dies, people are no different. When we listen to the silence within, nature knows when its time to move on.

7) How can I determine if costs to my account are fair?

Rather than comparing securities to futures or managed accounts to limited partnerships, we believe each industry and industry sector has its own merits. Each should be assessed independently of one another. A few alternative ideas to contemplate are: Accurate cost evaluation must be done using a relative thinking process. For example it is impossible to assess whether $35.00 is too high or low without considering other factors.

One must also consider number of trades, profit to loss ratio and percentage of profitable trades. For example, in crude oil each point is worth $10.00. If cost is $35.00 and the strategy encompasses 25 point trades or $250.00; your cost represents 14% of each trade. If 50 points are used, cost comes down to 7%. Now consider the percentage of profitable trades relative to a profit to loss ratio. If profitable trades are only 45% with a profit to loss ratio on each trade of 3.1 you may still have a good strategy.

We prefer viewing costs relative to risk and return, rather than account equity. For example: Assume a $100,000 account risks only 10% to realized a 30% return. $10,000 was at risk and $30,000 was realized. The return represents 300% on capital at risk and 30% on account equity. Traditionally people say costs are 5% or 10% of account equity. They say a trader has to overcome $5000 or $10,000 annually before a client can profit. Truthfully, a trader only has to overcome a management fee, partially covered by interest earned for the account. Other costs are a function of trading or account activity! If an account is active and I earned 300% on capital at risk! Who Cares!

8) How can I determine how much capital to commit to an account?

Good question, start with the least amount possible for what you expect to accomplish and say "prove it." For example, a retirement portfolio has $750,000 and a regular stock and bond portfolio is $350,000 for a total of $1,100,000. 10% of that is $110,000. Start with as little as 50% of the 10% if possible. If after one year the investment performed according to predetermined standards, maybe consider adding capital if your ability to profit is increased.

Another alternative is notional funding. Use the entire $110,000, funding two accounts. Take partial profits when advisors take their incentive fees. Stick with this pattern until your original capital is returned. Thereafter consider leaving 75% for reinvestment and remove 25% from the account annually, or maybe leave 50% and remove 50%. We believe long-term success includes rewarding yourself annually.

9) How can I compare one professionally managed account to another?

First and foremost be comfortable with the people first then look at numbers. Also use SafeMoneyMetrics™ Advisor Analysis. Rather than comparison, consider correlating two investments. Find out what risk was taken to achieve the rewards, rather than looking at just rewards.

Read article # 39 Managed Futures-How to Select Advisors with SafeMoneyMetrics

You need comfort and trust to live through negative performance inherent with managed futures. Honestly live with the risk. Talk about it, feel it, live it. Use your imagination to visualize at least five or seven losing months annually.

Looking at returns without understanding the process of how they were created is useless. Market conditions never repeat themselves, traders change, and a myriad of factors that are never repeated need to be considered. If two different investments have similar risk/return numbers, even if one has slightly higher costs, choose people you are more comfortable with. Live well with the downside and let potential profits be a pleasant surprise!

10) Why do you use investment profiles?

Profiles are designed in section five.

Profiles offer additional preparation for the realities of managed futures. At times, profile use individual trade data, other times the use capital management procedures built into a trading strategy. When based on strategies built into trading, profiles are labeled as hypothetical with a disclaimer. Focusing only on past performance and a composite track record presented in disclosure documents leave imbalances regarding future performance.

- Profiles are supplemental information filling an important void.
- They quantify a process your account goes through so potential rewards can be achieved.
- They provide an opportunity to get comfortable with how your account works, no matter when it opens.
- They help align your expectations with realities of the investment.

Past performance has its place however it doesn't offer tomorrow's reality. Proper risk analysis also includes:

- individual trade analysis,
- current market conditions, and
- time "windows."

Time windows show monthly returns during various time frames ranging from 1 to 36 months, rather than annual returns. Annual returns may show a 50% return, however if your account is opened in June, it can reveal losses by December.

Deception by omission is probable when only evaluating annual returns. Time windows and investment profiles reduce the problem of omission.

Bringing weakness to the surface is more important than talking about past returns. Staying with the investment under adverse circumstances dramatically increases your success potential and we love success!

11) I'm over 65 are your services good for me?

If you're in reasonably good health, look at the worst possible outcome of your decision. If the potential loss does not affect your life style or anyone that you are financially responsible for, we cheerfully invite you into our world of managed futures. The philosophy, learning process and experience can be invigorating. It has been our experience that when new perceptions of reality and risk are applied to other areas of life, little surprises are endless.

Check out the articles and investment guides, see what appeals to you.

Our work provides financial insight and a philosophy that transforms fear into strength. Strength brings quiet peace and endures throughout your lifetime.

12) Why is comfort so important before I invest?

How many times have you caught yourself emotionally acting on something you perceived to be true, yet time revealed that the perceived truth was only illusion? When we act on false or incomplete information, we hurt not only ourselves, but cause unnecessary grief or loss to the recipients of our decision. This process if left unattended can cause ill-fated losses to any managed futures account.

Sometimes we act or react to beliefs based on fear or hearsay that have no connection to truth or the current reality of a situation. Sometimes we react or make decisions based on someone else's experience of a situation. Other people's experience was caused by their beliefs and actions. Nothing else is possible.

Simply stated professional traders and hedgers love the futures markets. They believe that the markets reduce price risk and are great to trade. These people are rewarded relative to their thoughts and beliefs. Other people fear futures; those people have negative beliefs that probably attract negative experiences!

Markets do nothing – they exist. Our approach causes our experience. Look at the growth of futures over the last two decades.

> To repeat, beliefs cause perception.
> Perception causes our actions and reactions to people and events around us.
> Consciously or unconsciously we ALWAYS create own experience.

Maybe look at the investment guide, Profit and Peace of Mind.

Asking yourself questions when strong feelings rise to your attention, uncovers beliefs that cause the uncomfortable feeling. The external experience is only a trigger – for something going on within. With work, there is no perception or belief that cannot be altered. With insight and reflection, you have the power to dramatically and permanently alter your reality. Nine out of ten times you'll find that it's not the investment that bothers you, but your perception and fears of what "could happen" as causing negative reactions. As negative or fear based issues resolve them selves, your awareness level will rise along with your energy.

Freedom from fear and conflict automatically increases energy and the quality of our decisions. If you feel good about where you are headed rather than tense, you've successfully completed the task of internal conflict resolution.

God is within all of us, at the center of our being…"I come that they may have life, and have it more abundantly." It's God within that should and will lead us to wherever we need to be! Nothing else matters!

How to Evaluate Your Current and Future Needs

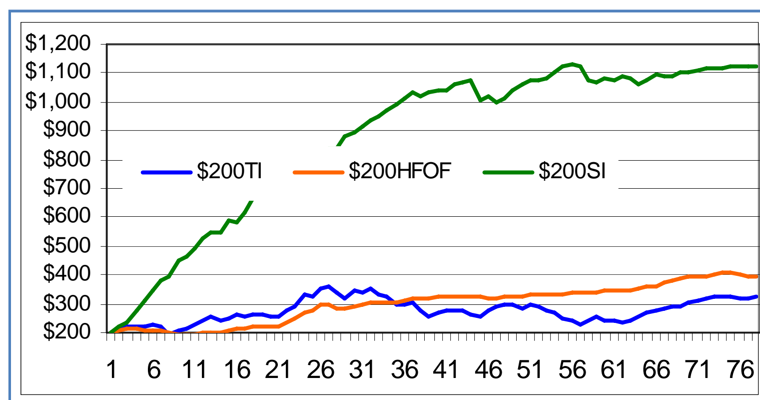
Risk Considerations Seven Questions to Ask Yourself

Consider the real risk of managed futures relative to the real risk of possible alternatives to managed futures. We added a few ideas under each statement below. Use our ideas to formulate your own strategy.

1. Where should the capital come from?

Capital allocated to managed futures should only and always be at risk money. We consider capital allocated to the stock market, at risk money. T-Bills and bonds can be used as original margin in futures; additional margin must be met with cash. If the account is funded with cash, interest can be credited to the account daily. The advisors management fees USED TO BE are partially offset by interest.

We developed opportunity lost scenarios. Consider capital allocated to managed futures, as lost potential someplace else. For example: $100,000 allocated to managed futures, can also be allocated to hedge funds, the stock market, or a myriad of other investments.



Create your own graph using any investment. Choose any investment and use a monthly rate of return to allocate $100, $200, or whatever amount you are considering.

Because that money will NOT be someplace else, create the exact capital unit for investments you will not be using. Above, $200 is allocated to a traditional, hedge fund and managed futures index. Deduct the traditional and hedge fund values from the managed futures return. The net difference is an ultra conservative "guesstimate" of the excess return potential.

Equally important to excess return, watch the correlation between managed futures and other investments used in your model. Movement of managed futures are opposite to and independent of the traditional and hedge fund index. It's called negative correlation. This movement is what reduces the risk of your composite portfolio.

Traditionally, the risk free rate of return and past performance is used with probability theory. Usually three economic scenarios are used each having a one third (or other) probability of occurring. Returns are calculated above the t-bill or any other risk free rate of return under these specific economic scenarios.

The opportunity lost scenarios, as described above are not generally considered. Like stocks, trending markets also "favor" positive returns for managed futures. However a preference would be to build talent driven composite portfolios.

2. How much should be allocated?

Maybe use 50% of what you are actually considering until self-knowledge and comfort deepens. The investment needs to prove itself. Sometimes if we move too quickly with "the entire capital commitment", the first steep negative return period may evoke an excessive negative reaction, thus causing ourselves unwanted losses, that otherwise could have been avoided.

This is stage one of a long-term marriage with managed futures. Let the investment earn your trust. With futures, less is better until you become comfortable with the investment, and people you are working with.

Use capital that you can comfortably live without.

3. What considerations should determine the amount of capital committed?

Emotional: Use only money you can comfortably live without. Most people live with others and your decisions impact those people. When appropriate, discuss the investment with those closest to you. If anyone is miserable with your decision, it might be wise to avoid managed futures. WHY? The first negative return period will be compounded with "I told you so". Life is about Love – not excess strife over an investment decision. Work through all emotional considerations until you are comfortable with the bottom line under any possible life circumstance.

Health: My most self-defeating decisions have been made under poor health conditions. Never get involved with managed futures if you are in ill health.

Time: How much time are you considering for managed futures? For people like me, managed futures are treated as others treat stock investments or mutual funds. We build strategies and just leave the investment alone.

Money: 50% of your risk capital or 10% of your net worth excluding your home is a good starting point.

4. How should I evaluate probabilities of the composite portfolio?

Evaluate managed futures as a contribution to the entire return. There are times when the futures will be negative, stocks positive, and visa versa. When managed

futures are perceived as an allocation strategy used to reduce risk of a traditional portfolio, we are optimizing the markets purpose and potential.

> Many people choose to perceive futures as a speculative venture, rather than as a risk management strategy. Returns are seen in isolation, rather than within a complete and larger investment dynamic. If you take this approach, you may unknowingly cause your own losses because your expectations may not be accurate relative to what the investment can realistically deliver.

Coming from a family business background, futures were an every day part of growing up. Everybody in the family had commodity accounts, as did friends and relatives. Futures were one of four businesses, all related. Even then, futures were seamlessly integrated into a composite business. We built profit centers in futures for people involved with the cash commodity. Jacobson Commodities Inc, a cleaning member of NYMEX designed hedge strategies and managed capital. My perspective of the markets is probably more conservative than most people. The markets are NOT toys. They should be taken seriously and used with wisdom and moderation.

My Father had a saying: "Always walk with two feet on the ground and never lose your balance." Moderation allows us to carefully approach the markets always maximizing their optimum upside potential.

5. How should assets be allocated within the managed futures investment?

This depends upon available capital. Many people will only have capital for one account, or one trader. Under these circumstances, contrary to popular belief, I would choose a trader with focused skills in one or two markets rather than a broad based diversified strategy.

Many people choose investments based on what they want to be involved with rather than choosing talent of a trader. For example: Someone might want to trade stock indexes. A grain trader might be a better risk/reward investment for a particular capital amount. So leave yourself open to evaluating a strategy and talent rather than having opinion on a sector or particular market.

If capital allows diversification into more than one investment, the multi-advisor strategy could be optimized monitored and readjusted using SafeMoneyMetrics®.

6. Define the risk and time to rebuild the portfolio back to its current value net of the allocation into managed futures.

This statement is KEY for deciding how much capital to allocate. The statement was used for defining the maximum downside risk. If all money was lost, without incurring any more risk, how long would it take to rebuild capital. The mental process removes all fear of loss from your decisions.

7. What are the possible alternatives to managed futures?

Believe it or NOT, managed futures have NO competition. They offer a unique use of time and money that remains unsurpassed by any other investment opportunity. There is 100% liquidity. Trading talent creates the return. The only need and use of

capital is for margin requirements and covering trading losses. Your money is not being spent or used for inventory, research, or a myriad of other things that money is needed for in business. Think about it. Managed Futures have no competition and are a valuable addition to any portfolio.

Build a Winning Investment Strategy

The outline below leads to a clear strategy. We believe it imperative to have everything below defined for yourself, before you approach any investment firm.

Everything you need to get from your investment firm or advisor is defined below. The objective is your investment profitability, not winning a popularity contest with your broker! Keep your standards high and never compromise!

Current and Future Reality

The following outline will help you mentally restructure. You learn that managed futures can be structured with less risk and volatility than what the past five years probably offered. Clearly answer the following:

Financial Objectives – Current Reality

1. How are your investments currently allocated?
2. How comfortable are you with the current allocation?
3. What were your returns over the past five years relative to your capital at risk and volatility?
4. What type of volatility did you experience?
5. Were you comfortable with the degree of volatility experienced?

6. Using the same parameters what do you expect over the next 5?

7. What part of the portfolio do you perceive needs to be readjusted?
8. If you reallocate capital FROM someplace – what is the risk – loss – and opportunity loss? (Use the model defined on page 6 & 7).
9. WHO is involved with your investment decisions?
10. Who's life is affected by a potential loss and to what degree?
11. Are your basic needs met?
12. Does the allocation to managed futures represent capital from stocks or another risky portion of your portfolio?
13. What would you reasonably like to earn annually on a total portfolio?

14. What do you expect from managed futures/option allocation? Is your expectation realistic?

Future – Where you want to be!

1. Think 10 years out – what do you see as the end result?
2. Are your current actions aligned with your long-term objectives?
3. What adjustments need to be made in your actions now?
4. Are your long-term financial objectives realistic relative to your strategy for building capital?

5. What are the weaknesses in your strategic planning and how can you compensate for them?

Portfolio Focus

1. Is this a personal or professional investment?
2. Is this a corporate, partnership or retirement investment?
3. What are your current challenges to making this investment?
4. What is the probability of overcoming those challenges?
5. What is your realistic potential for making this investment?
6. What time frame are you looking at for the initial investment?
7. How long is your timeframe for this investment?

Capital Allocation

1. How much will be allocated to the investment?
2. What percent of the total portfolio does this allocation represent?
3. What type of allocation does the investment represent?
(Retirement, partnership, corporate, personal, etc.)

4. Alternatives
   - What alternatives exist other than managed futures?
   - What are the risks and potential of those alternatives?
   - How do the alternatives integrate into the your portfolio?

5. Investment Choices
   - What kind of managed futures/options investment is good for you?
   - What are the expected market conditions related to your preferences for market sectors.

6. Timing Expectations
   - For how long will the capital be allocated?
   - Are your expectations in alignment with the investments potential to deliver relative to a specific time frame

7. Reallocation and Distribution Process Defined.
   - What portion of profits do you want distributed and what is reinvested?
   - When should the investment be reallocated to another advisor?
8. Integrated Draw-down Analysis
   - What downside can you tolerate only on this allocation?
   - What downside in your traditional investments will effect the original allocation to managed futures?

Choosing and Working With Your Investment Management Partners.

Choosing Your Investment Partners

You want investment partners that accept and work with a process that you bring to them. Their expertise is integrated into **your strategy**. Avoid opinions and a focus on past performance as a selling point for any advisor.

If for some strange reason, you get involved with managed futures without us! Start as follows:

The CME Group lists firms that specialize, or at least offer managed futures.

A few of these firms are involved with the hedge business and you may find superior traders affiliated with the firm. Contact a few firms to see how comfortable you are. If you choose that route, SafeMoneyMetrics® can be integrated into that process.

While searching for one or two people with values you can live with. It's important that they are accepting of your self-imposed strategy for designing a managed futures investment. You'll understand how important, when the due diligence and investment profiles are requested!

When all work from part 3 and 4 is complete, 50% of your job is done. Your investment partners can integrate work you did with their expertise to build your working strategy.

It's important to understand that we know most advisors in the industry. The process defined herein will work for anyone. Insider knowledge and industry contacts are not necessary for success!

The following process is generic and can be used under all circumstances.

Initial Selection Process

1. Start by getting a list of reliable investments that are "doable" with your available capital.

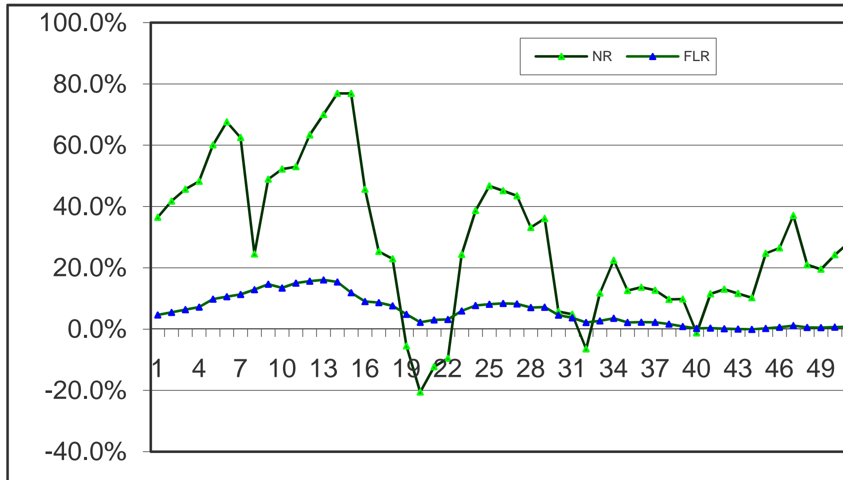
Used for Article # 30

A	B	C	D	E	F	G	H	I	J
Adv	Average Notional	Average Actual Cash	Max Margin	Margin Used	Mgn to Cash	Net Realized / Unrealized	TR-ROR	FLR	Net Ratio
1	$1,000,000	$300,000	5%	$50,000	17%	$300,000	30%	100%	600%
2	$1,000,000	$500,000	10%	$100,000	20%	$300,000	30%	60%	300%
3	$1,000,000	$250,000	20%	$200,000	80%	$300,000	30%	120%	150%
4	$1,000,000	$700,000	15%	$150,000	21%	$300,000	30%	43%	200%
5	$1,000,000	$400,000	25%	$250,000	63%	$300,000	30%	75%	120%
6	$1,000,000	$600,000	8%	$80,000	13%	$300,000	30%	50%	375%
7	$1,000,000	$350,000	30%	$300,000	86%	$300,000	30%	86%	100%
8	$1,000,000	$800,000	15%	$150,000	19%	$300,000	30%	38%	200%

From the initial list a few advisors are selected. The table above represents nine advisors. Column B is the minimum account size. They all use $1,000,000 and produced a 30% Traditional return (Column H). Advisors #1 and #2 used the least amount of capital (Column D) to produce the 30% return, and they had the widest gap between the Net and Funding Level ratio. They become our first choice!

Advisors selected from the list can also be analyzed using SafeMoneyMetrics® Advisor Analysis.

2. After the initial analysis is completed, the "best" advisors for your needs are individually selected. That includes being aware of:
    - The monthly net and funding level ratios for the entire track record. This provides understanding of the maximum risk at the accounts minimum funding level under variable market conditions. **WHY?** Because we are NOT funding your account at the required account size, we want to optimize the use of leverage.



To successfully increase leverage, a Net Ratio should always remain well above the Funding Level Ratio. If the Net sharply declines or drops below the FLR- LEVERAGE MAY BE TOO HIGH for the market conditions. This relationship is applied to monthly advisor data before an account is opened and to all trade data for each client account after it starts trading. The short-term relationships are compared to longer-term time frames. Profit distribution, leveraging and de-leveraging investments are timed using this relationship.

We evaluate a relationship between the rate of return on actual capital at risk and the funding level, NOT the traditional rate of return. Advisors using less capital to produce the greatest returns go into our YES pile! Volatility of returns are considered, however they matter much less when using SafeMoneyMetrics®.

Take time with the definitions and value added by Advisor Analysis.

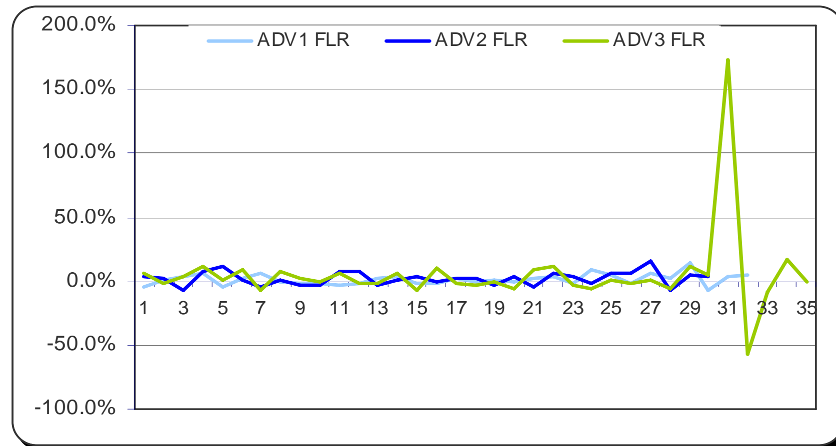
There is a massive difference between SafeMoneyMetrics® and the traditional advisor selection processes. When a traditional selection process is used with an accurate belief system and meticulous thought process, a working synergy between SafeMoneyMetrics® and tradition leaves less room for error!

3. There is now enough information on each advisor to begin qualitative analysis. We are more interested in market conditions that allowed returns, than the returns. This is a beginning phase for constructing multi-advisor portfolios. WHY? From the list of acceptable advisors, a portfolio that will endure most market conditions can be constructed.

The first question to ask is what happens if all advisors in the mix are down at the same time?

Building the Strategy – A Brief Overview

Before performance data is integrated, the net and funding level ratios for EACH advisor individually need to correlate properly. Remember we want one up when the other is down, etc. From that foundation we begin to allocate capital until the risk return potential is optimized. The graph below is the funding level ratio for three advisors.



Investment Profiles and Due Diligence Your Key to Comfort!

Rather than continuing my monologue of how portfolios are built, focus on investment profiles and due diligence reports. If you decide to work without us, you need a format of the content to properly care for yourself.

WHY? The following information prepares you to live through a process of trading. Future account activity is defined so your expectations are aligned with what the investment will probably do. The information prevents you from making decisions based on your reactions to events, that you were NOT told about. This is one of the largest causes of ill-fated losses in managed futures!

I've seen people close their account with large losses only to witness the advisor make new highs after the account was closed! Clients cheat themselves from their own investment opportunity because they were not prepared for negative return periods.

The Investment Profile

Ask your investment firm for the following information. So they stay calm, tell them that their answers are probably not exact. The information does NOT need to be based on past performance data, they can "guesstimate" future trading. This is required information to prepare your self to live with commodity trading.

1. Largest Possible Loss
2. Average Loss
3. Largest Probable Profit
4. Average Profit
5. Largest string of losing trades in both number of trades and total dollar losses.
6. Longest string of losing months. (Maximum drawdown) and time to new highs.

7. Largest INTRA-DAY drawdown. Account equity can have a peak to valley daily drawdown that is NOT visible with monthly data. Get the information for each advisor and ask for a "worse case possibility for a mix."

8. Largest Equity Swing on a trade. You will probably live through unrealized profits of over $6000 turned into $1500 profits or probably less. You'll think the trader is an idiot. I promise when it happens several times, you'll absolutely know the trader has gone mad! Although we try to avoid traders that do this, we may not be able to. So GET THE INFORMATION AND PREPARE YOURSELF!

9. Average number of monthly trades.
10. Maximum number of monthly trades.

You have now prepared yourself to live through the process of trading commodities. Are we having any fun yet?

Due Diligence

Most investment firms conduct a thorough due diligence on every trader they work with for several reasons. Foremost is liability. They are responsible to their marketplace. Most firms have financial arrangements with advisors that you never hear about. They may even hire advisors because of political or friendship reasons. The quality of their decisions are probably influenced by a myriad of circumstances you will never know about, and they may not even be aware of. POINT: Take care of yourself, and do it well!

Ask the firm or the advisor for their standard due diligence. Compare it to the questions listed below. Anything missing that you perceive pertinent, get answered.

Questions

1. Are you a discretionary or systematic trader?
2. What type of Strategy do you trade?
3. What Markets do you focus in?
4. Is the exact strategy applied to all markets?
5. Do you use multiple systems in each market?
(If so, how is capital allocated to each system and market within the strategy -
6. What mathematical parameters did you use to calculate your required account size?
7. How did you determine different acceptable funding levels?
8. What if any discretion is used?
9. What if any fundamental analysis is applied?
10.What if any independent research is integrated?
11. What "time frames" do you apply? Average time of profitable and losing trades:
12. How often is the strategy upgraded and what prompts the alterations?
13. If you trade multiple markets (MPT Style) - How do you monitor your drawdowns? By individual market, the composite, individual trade analysis, other please describe.
14. How do you monitor the efficiency of your strategy relative to current market conditions?
15. Is the person making the trading decisions been the same throughout the length of the track record?

16. How many programs do you offer, what are their account sizes and market selections?
17. How many trades for each program can I expect monthly and how are trades entered and allocated?
18. What are your risk return requirements? (Expressed either per trade, margin committed or as a percent or equity.) For example: Do you have ratios for trade selection that express actual capital at risk relative to profit potential of the trade? Please describe:
19. How much capital do you want to manage and how much equity can your current strategy manage without affecting performance?
20 How will clients be notified if strategies are changed**?**
21. What is the maximum draw down a client should be prepared to live with for each account size you trade? (Does not have to be related to past performance)

21. **a)** What is the maximum intra-month draw-down your worst account has experienced?
21. **b)** What is the fully funded account size expressed in # 21a ?
21. **c)** What percent is the actual funding level of the account size expressed in **#21b?**

22. How long should I commit my capital without making money before giving up on you?
23. Under what market conditions do you not make money?
24. How does your strategy adjust to changing market conditions, particularly a major increase in volatility?
25. Does your strategy stand aside or it is always in the market? Please describe
26. What would prompt you to completely halt trading and stand aside?
27. How are new accounts entered into already existing positions? New Positions?
28. How does the program exit markets? (stops, mit, market orders etc).
29. How does it exit from profitable positions?
30. How does your strategy protect unrealized profits?
31. Do you track equity peaks in unrealized profits to market exits? If so do you monitor the ratio or loss from a high until the strategy exits the market?
32. Does your strategy adjust to current market conditions or do you need current market conditions to adjust to what your strategy is?
33. How are you prepared for catastrophic moves?
34. What is a financial standard for trade selection? For example: Do you require a risk/reward potential for trades before they are taken? Please describe any REAL capital at risk relative to profit potential standards that are built into your strategy. Ideas to stimulate your self-expression are included below.

- Transaction costs relative to anticipated profit per trade
- Margin - Percent of Account Equity - Risk to Potential Reward per trade ratios
- Maximum allowable loss per month
- Maximum allowable loss per trade relative to percent of profitable trades - relative to profit to loss ratio of total number of trades.
- Ratios that monitor profit to losses and possible changes for each market.
- Maximum percent of equity to risk if equity drops 5%, 10%, 15% above 15%
- Maximum peak to valley draw down -
- Maximum allowable standard deviation of monthly returns for each market and the composite portfolio.
- Tracking error that measures peak performance of the strategy relative to current reality.

35. What percent of total capital is risked on each market sector at any one time? Are the allocations within each sector allocated to each market relative to any particular thought process? Please describe:
36. How does account size affect capital management strategies? For example: If someone gives you $500,000 and someone else $1 Million does the $1 million get double what the $500,000 trades or are there other differences?
37. What modifications do you make in your trading strategy/systems when in a draw down?
38. Explain your concept pro/con regarding diversification?
39. How are options used with your strategy?
40. What was the average fee structure that your track record was calculated at?
41. What was the average commission to equity ratio the track was calculated at?
42. What percent of monthly return belongs to interest earnings? (not needed lately!)
43. Has your track record been recalculated because of NFA intervention? If so what was required of you?
44. Is your 13 column calculated by an accounting firm or in house?
45. What mathematical distortions do you perceive exist between the method of track record calculation required by the CFTC and the truth of what an investor can expect? What would you tell an investor that would increase his comfort and can rectify the natural distortion?
46. What percent of actual capital on a fully funded account is REALLY at risk at any one time using your strategy? An average range will suffice!
47. What questions would you add to this list if you were sponsoring this service to clients?
48. Why would someone entrust you with their money, rather than with another advisor?
49. Understanding that what can go wrong may be perceived as negative, in derivatives, we consider high intelligence an ability to consider and prepare for it. Have you considered the absolute downside, how it can happen, and prepared for the potential event? Briefly Describe.
50. Do you have a bias for the long or short side of a market?
51. Have you ever analyzed your trades to see if a bias exists, if so what did you learn?

Discipline and Business Risk Management

1. What is your weakest point when trading?
2. How do you manage stress daily?
3. What other means of support do you have other than managing client funds?
4. Do you trade your own account and how is it traded differently than client funds?
5. What do you most frequently screw up relative to your business, and how do you adapt to the crummy habit?
6. Who manages all administration and client service within your company?
7. How much do you believe administration takes away from your time needed with markets?
8. Do you have any programs that were closed? If yes please add length of program before it closed. How much capital was managed? Why did you close?
9. Do you compensate any third party, unrelated to Sanctity when we market your services? If YES Who and how much?
10. Do you share in incentive fees? If so under what circumstances and how much?

Miscellaneous Questions

1. What "early warning" indicators of system failure are built into your strategy?
2. If you were to build an exponential average of your monthly rate of returns – or other self selected method of quantifying trading results what weight would you place on the latest piece of data relative to previous –
3. Would that percentage or weight remain constant? If not what would prompt you to change it?

4. How did you decide what weight to use?

5. You have parameters or a benchmark where you know if what you are doing works -
How do you quantify from that benchmark -
   a. When you need a minor review -
   b. A major overhaul -
   c. A new high standard has been set –
   d. When to stay out of the markets -
   e. When and if - to increase or decrease leverage used?

6. Where do you believe your perceptions are inaccurate and how do you compensate?
7. What do you believe motivates you to be a money manager?
8. How would you like to be known to the marketplace?
9. What values are important for you to give and expect to have honored from the marketplace?
10. What is your greatest fear relative to managing money? What have you done to diffuse the energy or deal with the fear in practical terms?

This concludes the Mini Course for Investors. We hope you found it useful. We also have a Mini Course for Advisors and one for Business Development.

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