SUPPLEMENTAL RISK DISCLOSURE INFORMATION

Alternative Investments
Integrity. Knowledge. Experience.

When considering alternative investments, such as hedge funds and managed futures, you should consider various risks including the fact that some hedge fund and managed futures products use leverage and other speculative investment practices that may increase the risk of investment loss, can be illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing important tax information, are not subject to the same regulatory requirements as mutual funds, often charge high fees, and in many cases the underlying investments are not transparent and are known only to the investment manager.

With respect to alternative investments, such as hedge funds and managed futures, in general, you should be aware that:

- Returns from some alternative investments, including hedge funds and managed futures, can be volatile
- You may lose all or portion of your investment
- With respect to single manager products the manager has total trading authority. The use of a single manager could mean a lack of diversification and higher risk
- Many alternative investments that include hedge funds and managed futures are subject to substantial expenses that must be offset by trading profits and other income. A portion of those fees is paid to Altegris
- Trading may take place on foreign exchanges that may not offer the same regulatory protection as US exchanges

With respect to an investment in a hedge fund or managed futures fund, you should be aware that:

- There is often a lack of transparency as to the fund's underlying investments
- With respect to hedge fund of funds, the fund's manager has complete discretion to invest in various sub-funds without disclosure thereof to you or to us. Because of this lack of transparency, there is no way for you to monitor the specific investments made by the hedge fund or to know whether the sub-fund investments are consistent with the hedge fund's historic investment philosophy or risk levels
- A hedge fund of funds invests in other funds and fees are charged at both the fund and sub-fund level. Thus the overall fees you will pay will be higher than you would pay by investing directly in the sub-funds. In addition, each sub-fund charges an incentive fee on new profits regardless of whether the overall operations of the fund are profitable
- There is no secondary market for fund interests. Transfers of interests are subject to limitations. The fund's manager may deny a request to transfer if it determines that the transfer may result in adverse legal or tax consequences for the fund

A hedge fund's Offering Memorandum or a money manager's Disclosure Document describes the various risks and conflicts of interest relating to an investment and to its operations. You should read those documents carefully to determine whether an investment is suitable for you in light of, among other things, your financial situation, need for liquidity, tax situation, and other investments.

Keep in mind that the past performance of any investment is not necessarily indicative of future results. You should only commit risk capital to any Investment Product. Alternative investment products, including hedge funds and managed futures, are not for everyone and entail risks that are different from more traditional investments. You should obtain investment and tax advice from your advisers before deciding to invest.

Can Alternative Investments Help Diversify Traditional Portfolios?

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Modern Portfolio Theory tells us that holding a well-diversified 'basket' of investments can be one of the best ways for investors to reduce risk for a given level of performance. But how does this apply to alternative investments?

This report takes a brief look at the risks and benefits of the incorporation of alternative investments, including hedge funds and managed futures, into an investor's traditional portfolio as an aid to portfolio diversification.

Diversification of an investment portfolio makes good sense to most investors on a purely intuitive level. However, it wasn't until Harry Markowitz published his model of portfolio selection in 1952 that this concept became a formalized part of sound investment practice.

Modern Portfolio Theory

Put simply, Markowitz's model demonstrated in precise terms what many investors already knew– portfolios that are comprised of only a single asset are not the best we can do from a risk vs. reward perspective.[1] When we combine risky assets into a portfolio, we can develop an efficient portfolio set, known as the "Efficient Frontier". This concept defines the range of best combinations of risk and return available by distributing different percentages of a total allocation across multiple portfolios, and forms the basis of Modern Portfolio Theory.

Traditional Portfolios and Diversification

Investors can diversify in many ways, including by seeking portfolios of assets that mix different, investment types, sectors, and geographic concentrations.

For many investors, this has traditionally resulted in portfolios containing a diverse mix of stocks, bonds, and possibly real estate holdings.

Correlations Hold the Key

But beyond this basic concept of diversification, the key to Modern Portfolio Theory is really the revelation that the risk of any investment can be reduced and/or performance increased by forming a portfolio of diverse and non-correlated assets. That is, it is important not just to seek a diversity of asset types, but also to seek assets that have low or near-zero correlations to one another.

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Again, this point would seem to make good common sense. If we hold a number of different assets in a portfolio, but they all are highly correlated and thus tend to move either up or down together, the benefits of diversification may be lost. While the performance of portfolios of assets with such high correlations to one another may be fine when markets are up, when markets are down (often when diversification is most needed), it may be cause for concern.

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Why Diversify using Alternatives?

Alternative investments, including hedge funds and managed futures, have many unique characteristics, but can be defined at a basic level by their ability to utilize a wide array of trading techniques often (but not always) including selling securities "short" and employing leverage. For these reasons and others, these investments have historically proven to have low correlation with overall market activity. In the case of hedge funds, the S.E.C. recently stated that hedge funds have been used to diversify investments based on their historic low correlation with more traditional equity and fixed-income investments.[2] And in the case of managed futures, these products exhibit similar historic correlation properties. In fact, many managed futures programs have historically often been negatively correlated with equity indices in months when equity returns have been negative, and positively correlated when equity returns are positive.[3] Dr. John Lintner of Harvard University concluded that "The combined portfolios of stocks after including judicious investments in managed futures accounts show substantially less risk, at every possible level of expected return, than portfolios of stocks (or stocks and bonds) alone"[4]

"Alternative investments have historically proven to have low correlation with overall market activity."

"Historically low correlation with the stock and bond markets that make alternative investments a consideration to help diversify a portfolio."

We need to be careful when making generalities when it comes to these types of alternative investments, and past performance is not necessarily indicative of future results. Additionally, correlations are by their very nature subject to change. Having said this, it is precisely these historic correlation properties of alternative investments that make alternative investments at least a logical consideration for suitable investors from a portfolio diversification point-of-view.

Unique Investments with Unique Risks

Of course, there can be no guarantee that any particular alternative investment will achieve its objectives, generate profits or avoid losses. In addition, alternative investments often differ in significant ways from traditional investments and carry their own set of unique risks that should be clearly understood. Some of these risks are indicated at the end of this report, but often included are the fact that these investments often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing important tax information, are not subject to the same regulatory requirements as mutual funds, often charge high fees, and in many cases the underlying investments are not transparent and are known only to the investment manager.

"Alternative Investments can differ in significant ways from traditional investments, and carry their own unique set of risks."

Even after considering the risks and benefits of these investments, it is important to recognize that they will not be suitable for every investor. These investments are often unregulated and require strict requirements of potential investors including minimum levels of net worth. It is important that you and your advisers examine your own situation and existing portfolio carefully to determine if alternative investments may be a consideration.

The Challenge of Selection

And should you be a suitable candidate, the next step is determining which alternative investments make sense for your unique situation. As I stated earlier, generalities are extremely difficult to make in this space.

Every alternative investment is different: different manager, different resume, different prospectus, different trading style, different capacity, different leverage, different opportunities and different risks. As a result, it is to be expected that specific investments will have differing effects on portfolio diversification. To compound this complexity, the sheer num-

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ber of investment choices can be staggering. For hedge funds alone, the S.E.C. has recently estimated there are between 6,000 and 7,000 in the U.S. alone.[5]

These two facts mean selecting the right alternative investments to compliment a traditional portfolio is not an easy task. Proper product review through rigorous qualitative and quantitative investigation is critical. Constructing a portfolio requires in-depth knowledge of each specific investment, thoughtful integration with the existing portfolio, and diligent monitoring. But for the right investor and portfolio, these investments offer a very legitimate option to aid diversification.

End Notes

1. Harry Markowitz, "Portfolio Selection," Journal of Finance, March 1952.
2. "Implications of the Growth of Hedge Funds," S.E.C., 2003.
3. Burak Cerrahoglu and Dulari Pancholi, "The Benefits of Managed Futures," Center for International Securities and Derivatives Markets, March 2003.
4. Dr. John Lintner, "The Potential Role of Managed Futures Accounts in Portfolios of Stocks and Bonds," 1983
5. "Implications of the Growth of Hedge Funds," S.E.C., 2003.

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Risk Disclosure:

Alternative investment products, including hedge funds and managed futures:

- Involve a high degree of risk
- Often engage in leveraging and other speculative investment practices that may increase the risk of investment loss
- Can be highly illiquid
- Are not required to provide periodic pricing or valuation information to investors
- May involve complex tax structures and delays in distributing important information
- Are not subject to the same regulatory requirements as mutual funds
- Often charge high fees, which may offset any trading profits

In many cases the underlying investments are not transparent and are known only to the investment manager. Alternative investment performance can be volatile. An investor could lose all or a substantial amount of his or her investment. Often, alternative investment funds and account managers have total trading authority over their funds or accounts; the use of a single advisor applying generally similar trading programs could mean lack of diversification and, consequently, higher risk. There is often no secondary market for an investor's interest in alternative investments, and none is expected to develop. There may be restrictions on transferring interests in any alternative investment. Alternative investment products often execute a substantial portion of their trades on non-US exchanges. Investing in foreign markets may entail risks that differ from those associated with investments in US markets. Alternative investments often entail commodity trading, which involves substantial risk of loss.

Past results are not necessarily indicative of future results.

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