Global Macro
The Ultimate “Go-anywhere” Mandate

June 2012*

“I don’t play the game by a particular set of rules; I look for changes in the rules of the game.” —GEORGE SOROS

Some of the world’s most legendary investors have made their fortunes pursuing a global macro strategy, a “go-anywhere” approach in which the manager positions its portfolio to profit from the impact of macroeconomic developments on global financial markets. Paul Tudor Jones described the week leading up to the October 1987 Crash as “one of the most exciting periods of my life” because he had shorted the U.S. equities market. George Soros, one of the founding fathers of global macro investing, earned the sobriquet “Slayer of Sterling” by shorting the British pound in 1992 and netting his investors more than $1 billion overnight. Hedge fund luminaries such as Louis Bacon, Julian Robertson and Michael Steinhardt all earned their fortunes trading global macro strategies, and while many of these managers have been immortalized from one “big trade,” their reputations were earned over decades of employing a disciplined, analytical investment process that allows for potential profit opportunities across both bull and bear markets.

Introduction

Of all the investment strategies, we believe global macro stands alone as possibly the most flexible and opportunistic. Global macro managers assume that somewhere in the world, there’s an opportunity to make money—and importantly, they possess the talent to discover it before others. While no two global macro managers are exactly alike in terms of style or strategy, they all employ a “top-down” investment approach. From their 30,000-feet high perspective, they examine the economic landscape below, trying to spot anomalies, mispriced assets and major shifts in economic patterns.

* Originally published June 2011.
Global macro investing is therefore the ultimate “go-anywhere” mandate, a search for profits without regard to borders, economies, or politics—and it relies upon the skill of managers to take positions across liquid regions and asset classes around the world. Because of their wide-ranging mandate, global macro managers can invest in French stocks or Peruvian debt, wheat futures or gold bullion; they can also go long the U.S. dollar or short the euro. Their ability to invest in any market, long or short, has earned global macro managers the reputation of being able to potentially preserve capital in down markets, while also making potential profits in normal ones. Of course, there is no guarantee that any strategy will always perform well in every market environment.

Global macro managers place an enormous emphasis on fundamental macroeconomic data and events to generate trading opportunities (FIGURE 1). The managers construct their portfolios by assessing economic variables such as interest rates, government policies, and inflation. They analyze pronouncements from a country’s central bank, attempting to predict fiscal and monetary decisions and the impact of these decisions on financial markets. While they may analyze price movements and derive technical patterns from them, they are not necessarily trend-followers; in fact, the key difference is that global macro managers anticipate price trends whereas trend-followers react to price trends. The global macro manager focuses his attention on fundamental macroeconomic data and makes trading decisions based on his analysis, whereas the trend-follower focuses primarily on price data and does not form an opinion on where equities, interest rates, or commodity prices are headed.

FIGURE 1.
GLOBAL MACRO MANAGER DATA INPUTS

<table>
<thead>
<tr>
<th>Economic Data</th>
<th>Financial Market Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>Interest rate levels (relative and absolute)</td>
</tr>
<tr>
<td>Inflation</td>
<td>Yield curve shape and slope</td>
</tr>
<tr>
<td>Monetary policy</td>
<td>Corporate earnings</td>
</tr>
<tr>
<td>Unemployment</td>
<td>Country P/E ratios</td>
</tr>
<tr>
<td>Sovereign budget deficits/debt levels</td>
<td>Relative exchange rates</td>
</tr>
<tr>
<td>Flow of trade statistics (i.e. imports/exports)</td>
<td>Supply/demand of commodities</td>
</tr>
<tr>
<td>Demographic factors (age of population, worker skills, per capita income)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Altegris
Global macro investing came of age in the 1980s, when managers like Soros, Robertson and Jones attracted vast new pools of assets. With hundreds of millions to invest, these managers sought to take large positions in highly liquid markets—bonds, currencies, commodities and equity indices (as opposed to individual stocks which are much less liquid)—asset classes that traded billions of dollars each day (FIGURE 2). In today’s marketplace, liquidity remains among the key requirements of successful global macro investing. As was the case three decades ago, the world’s most liquid markets (currencies, equity index futures, and interest rate futures) are fertile ground for the enterprising global macro manager and allow for active long and short trading throughout a market cycle.

Global macro managers seek absolute returns; they are not measured by their performance relative to an index such as the S&P 500 Total Return or the Russell 2000. They aim to make money in bull, bear or flat markets as opportunities arise. Unlike traditional managers who are constrained by a long-only mandate, global macro managers have the ability to dynamically position their portfolio long and short to try to profit across varying market regimes (FIGURE 3). Global macro managers’ “go-anywhere” approach and their focus on absolute returns are designed to produce results that have a low correlation to traditional financial markets that produce alpha. Altegris believes that the challenge of successful global macro investing lies in identifying those managers who provide sustainable alpha while successfully managing portfolio risk.

Global macro managers have the ability to dynamically position their portfolio long and short to try to profit across varying market regimes.

For illustrative purposes only. Source: Altegris
Discretionary vs. Systematic

There are two kinds of global macro managers: discretionary and systematic. Altegris believes that a diversified approach to global macro investing requires an allocation to both strategies, as they are in many respects complementary and provide unique and differentiated sources of alpha throughout a market cycle.

The Discretionary Manager

The discretionary manager scans the world and assesses geopolitical trends and opportunities. He procures information from a variety of sources—global business leaders, senior political officials, academic experts in economics and politics—anyone with useful information or insights. The manager typically employs an investment team with advanced degrees or specialized knowledge to help him “frame” the data in the proper perspective. Drawing upon these sources, the manager will develop a top-down “world view,” arriving at opinions about where the world economy is heading and which economies or markets will be the winners and losers if that world view is correct. This top-down world view is often broken down into “themes”—broad conclusions that carry significant investment implications. For example, the manager’s world view could conclude that China’s robust growth will continue for the foreseeable future, which in turn would inspire the theme of rising commodity prices. The manager would then focus on the markets which would be most impacted by long-term Chinese growth; in this case, the oil and copper markets (two of China’s largest imports). Several other markets could be impacted by this broad theme, including the currencies of commodity-driven economies (for example, the Australian dollar), or the equity indices of large oil exporting countries like Canada. Given his familiarity and experience in trading across multiple regions and asset classes, the global macro manager assesses the impact of the underlying theme upon each market and selects the particular market (or markets) which he believes are most mispriced relative to its underlying fundamentals.

The global macro manager’s investments are made in a number of markets around the world and across asset classes, often intentionally, so that the various investments are, theoretically, non-correlated. In order to profit from these “themes,” the discretionary manager will typically invest in a concentrated fashion so that his portfolio can be assembled and disassembled very quickly. Needless to say, the discretionary manager’s world view has to be constantly under review, and investments have to be made nimbly and flexibly. In the example above, the price of copper can be affected very quickly by global events (as recent history has proven). The manager’s positions could be held for days or conversely for years, depending upon market developments and the manager’s trading style. Again, the key is for the manager to adapt and respond to global economic developments and shift his portfolio in an effort to profit from these ideas.

One of the key benefits of a strong discretionary global macro manager is that he can produce significant “crisis alpha” (as defined in the glossary included at the end of this document) if he has correctly anticipated how events will unfold or can move more quickly than the market to take advantage of these developments. Clearly, judgment and experience are key when selecting global macro managers and the preferred choice will be someone who has successfully traded through a number of global crises.

KEY POINT

A strong discretionary global macro manager can produce significant “crisis alpha” if he has correctly anticipated how events will unfold or can move more quickly than the market to take advantage of these developments.

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1 Two investments are “non-correlated” if their prices (and the fundamental drivers of those prices) don’t move in tandem. For example, the U.S. equity market and the Chilean peso are typically non-correlated.
The Systematic Manager

The other main type of global macro investor is the systematic manager. This manager has usually developed a top-down model for how global economic conditions affect asset prices. The systematic manager selects a large set of quantitative data which he feels reflects or predicts meaningful underlying patterns across global economies. The data is drawn from around the world (hence “global”) and focuses on quantifying the impact of fundamental economic data on financial market prices (for example, the impact of GDP changes on equity market prices or the sensitivity of inflation on global interest rates). In this regard, the manager is different from “trend-followers” who use price data alone to discern patterns after they unfold rather than trying to anticipate them as the global macro manager does. The systematic global macro manager typically relies upon a staff of math- or economics-trained Ph.D.s to automate or “systematize” that data into a model from which he derives algorithms for trading. Systematic managers will also enhance their macro views with a computer-based trading system, seeking to gain an execution advantage by employing cutting-edge trading technologies.

The systematic global macro manager will usually trade in a more diversified way than the discretionary manager, and will invest for a longer haul. Therefore, the systematic manager will tend to perform better when economic fundamentals have a meaningful impact on financial market prices over longer-term periods. While the systematic manager’s models may take longer to adapt to a changing fundamental picture, the discretionary manager will be more responsive to the potential of a “new” environment (for example, an economic slowdown triggered by an exogenous event) before it is reflected in the data. Thus, while a discretionary manager may perform well in volatile (even bear) markets, the systematic manager prefers steady, fundamentally-driven market environments which allow his models to develop statistically significant pictures of the world’s economies (FIGURE 4).

FIGURE 4.
DISCRETIONARY VS. SYSTEMATIC STRATEGY COMPARISON

<table>
<thead>
<tr>
<th></th>
<th>Discressionary</th>
<th>Systematic</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Data inputs</strong></td>
<td>Primarily fundamental data (i.e. GDP, inflation, etc)</td>
<td>Primarily fundamental data (i.e. GDP, inflation, etc)</td>
</tr>
<tr>
<td><strong>Alpha drivers</strong></td>
<td>Managers’ brain/experience</td>
<td>Computer models</td>
</tr>
<tr>
<td><strong>Markets traded</strong></td>
<td>FX, interest rates, equity indices, commodities</td>
<td>FX, interest rates, equity indices, commodities</td>
</tr>
<tr>
<td><strong>Key investment professionals</strong></td>
<td>Economists/policy experts</td>
<td>Ph.D.s in Math and Science</td>
</tr>
<tr>
<td><strong>Trading &quot;style&quot;</strong></td>
<td>Thematic; trade around world ‘view’ as prices ebb and flow</td>
<td>Both thematic and arbitrage-focused</td>
</tr>
<tr>
<td><strong>Ideal market environment</strong></td>
<td>Volatile markets; large price moves</td>
<td>Strong influence of economic fundamentals on market prices</td>
</tr>
<tr>
<td><strong>Most difficult market environment</strong></td>
<td>Low volatility, muted price moves</td>
<td>Weak influence of economic fundamentals on market prices</td>
</tr>
<tr>
<td><strong>Portfolio composition</strong></td>
<td>Several larger trades focused on a few key themes</td>
<td>Diversified portfolio with many positions across markets and asset classes</td>
</tr>
<tr>
<td><strong>Portfolio turnover</strong></td>
<td>Weeks/months, very fast during crisis periods</td>
<td>Weeks/months on average</td>
</tr>
<tr>
<td><strong>Key performance drivers</strong></td>
<td>Manager skill and nimble trading</td>
<td>Model development and testing; portfolio risk management</td>
</tr>
</tbody>
</table>

Source: Altegris
Bear Market Case for Global Macro

Discretionary global macro managers can produce strong returns (that is, they outperform both relative to indices and in absolute terms) during periods of uncertainty or crisis. As they are best known for their contrarian, fast-moving nature, discretionary global macro managers can switch positions in a moment’s notice when the facts and circumstances change. Their ability to understand the impact of global events—whether positive or negative on financial market prices—enables them to be better positioned to make money when other market participants are frozen with uncertainty. As shown in the following example, many discretionary global macro managers understood in mid-2008 that with the global economy beginning to soften and commodity demand being eroded, the price of oil would peak and freefall from its all-time highs (FIGURE 5). As a result, many discretionary managers shorted WTI Crude Oil at the onset of the credit crisis; in this case, managers anticipated that a global economic slowdown (which had just begun to appear in the economic data) could not support the all-time high prices within the oil markets and successfully shorted oil to profit from this disconnect.

FIGURE 5.

![WTI Crude Oil Graph]

Source: Bloomberg. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. For illustrative purposes only.

Bull Market Case for Global Macro

In general, systematic global macro managers tend to produce the strongest level of alpha during bull markets. That’s because, historically, bull markets tend to be correlated with sustained positive fundamental data, which is what systematic managers excel at understanding. As highlighted in the following graphic, many systematic managers were able to capture the strong market opportunity in emerging market (EM) equities during the 2001-2007 period (FIGURE 6). During that time, systematic managers who were able to interpret the strong relative valuations of emerging markets equities (as indicated by their low price to earnings ratios and strong growth rates when compared to developed market equities) as a significant investment opportunity may have taken positions in the corresponding markets. Despite the significant rally in EM equities from 2001-2006,
their P/E ratios remained low and reflected strong earnings growth within the region. Led by the robust fundamental data, many systematic managers remained long EM equities until late 2006 when valuations became more in-line with their developed market counterparts.

**Strategy Performance/Correlation to Traditional Markets**

As a result of its go-anywhere approach, the global macro strategy (as represented by the Barclay Global Macro Index) has achieved a +8.99% annualized return from January 1997 through March 2012 as compared to the S&P 500 Total Return (TR) Index, which returned +6.18% annualized (FIGURE 7). Of course, past performance is not indicative of future results. Driven by its ability to preserve profits during bear market periods, the global macro strategy experienced significantly lower volatility (6.1% on an annualized basis) when compared to the 16.5% annualized volatility of the S&P 500 TR Index over the same period.
Global macro returns have also exhibited a low historical correlation to traditional financial markets over time, particularly due to their overall strong performance during bear markets. As the accompanying chart shows, global macro managers as a whole have demonstrated significant “crisis alpha,” or the ability to make profits when long-only strategies have experienced large losses (FIGURE 8). In fact, the global macro strategy has produced positive returns during four of the five worst quarterly performances of the S&P 500 TR Index (since January 1997) while also generating profits during the five best quarters of S&P 500 TR Index returns.

**FIGURE 8.**
PERFORMANCE OF BARCLAY GLOBAL MACRO INDEX DURING TOP FIVE WINNING/LOSING QUARTERS OF S&P 500 TOTAL RETURN INDEX
January 1997-March 2012

Top Five Losing Quarters of S&P 500 TR Index since January 1997

- Q408: -21.96%
- Q302: -17.28%
- Q301: -14.68%
- Q311: -13.96%
- Q202: -13.39%

Top Five Winning Quarters of S&P 500 TR Index since January 1997

- Q498: 15.93%
- Q297: 15.60%
- Q209: 15.40%
- Q309: 15.40%
- Q203: 15.40%

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. There is no guarantee that any investment product will achieve its objectives, generate profits or avoid losses. The referenced indices are shown for general market comparisons and are not meant to represent any particular Fund. An investor cannot invest directly in an index. Moreover, indices do not reflect commissions or fees that may be charged to an investment product based on the index, which may materially affect the performance data presented. Date ranged based on common period of data availability for shown indices. See index descriptions and risks on page 10. Source: Altegris.

**Conclusion**

A global macro approach is considered by many to be one of the most flexible and opportunistic of investment strategies. With its “go-anywhere” mandate, no liquid financial market is off limits to the manager. Using fundamental macroeconomic analysis to anticipate price movements within some of the most liquid global financial markets, the global macro manager takes long and short positions and seeks to profit across both bull and bear market environments. Due to their unique styles and differentiated return profiles, Altegris believes that a well diversified global macro portfolio should include both discretionary and systematic disciplines, which may provide both upside participation during bull markets and potential downside protection during bear markets. As global macro managers seek absolute returns across both bull and bear markets, the strategy offers investors a potentially powerful portfolio diversification tool when included within traditional equity-focused portfolios. Due to its fundamentals-based approach, global macro strategies may also provide for strong alpha production and potential diversification benefits when added to a portfolio of trend-following strategies. Finally, the key to successful global macro investing is identifying managers with the skill and experience to successfully navigate the world’s financial markets.
GLOSSARY

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

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

**Correlation** – A statistical measure of how two securities move in relation to each other. Correlation is mathematically expressed by the correlation coefficient, which ranges between -1 and +1. Perfect positive correlation (a correlation co-efficient of +1) implies that as one security moves, either up or down, the other security will move in lockstep, in the same direction. Alternatively, perfect negative correlation means that if one security moves in either direction, the security that is perfectly negatively correlated will move by an equal amount in the opposite direction. If the correlation is 0, the movements of the securities are said to have no correlation; they are completely random.

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

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

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

**Standard deviation** – Is a statistical measure of how consistent returns are over time; a lower standard deviation indicates historically less volatility.

**VAMI** – value added monthly index. A graph that shows the compounded growth of a $1,000 investment on a monthly basis.

**Volatility** – A measurement of the change in price over a given time period. Typically, higher volatility is associated with an elevated level of risk.
INDEX DEFINITIONS, DESCRIPTIONS AND RISKS

Barclay Global Macro Index – The Barclay Global Macro Index tracks the performance of ~175 global macro programs, by ending monthly values, net of fees, as reported to Barclay Hedge.

*Characteristics:* ~175 global macro programs by monthly values as reported to Barclay.

*Risks:* Market risk—prices may decline, leverage risk—volatility and risk of loss may magnify with use of leverage, country/regional risk—world events may adversely affect values.

MSCI Emerging Markets Index – The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of the following 26 emerging market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, Turkey and Venezuela.

*Characteristics:* free-float adjusted market capitalization index consisting of 26 emerging market country indices.

*Risks:* market risk—prices may decline; currency risk—unfavorable exchange rates may occur; country/regional risk—world events may adversely affect values.

S&P 500 Total Return Index – The S&P 500 Total Return Index is the total return version of S&P 500 index. The S&P 500 index is unmanaged and is generally representative of certain portions of the US equity markets. For the S&P 500 Total Return Index, dividends are reinvested on a daily basis and the base date for the index is January 4, 1988. All regular cash dividends are assumed reinvested in the S&P 500 index on the ex-date. Special cash dividends trigger a price adjustment in the price return index.

*Characteristics:* 500 US stocks; weighted towards large capitalizations.

*Risks:* Market risk—prices may decline.

INDEX HISTORICAL PERFORMANCE

As of 31 March 2012

<table>
<thead>
<tr>
<th>Index</th>
<th>Annualized Returns: 10-, 5-, 3- and 1-Year Comparison</th>
<th>Annualized Standard Deviation: 10-, 5-, 3- and 1-Year Comparison</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>10-Year Apr 02–Mar 12</td>
<td>5-Year Apr 07–Mar 12</td>
</tr>
<tr>
<td>Barclay Global Macro Index</td>
<td>6.69%</td>
<td>4.62%</td>
</tr>
<tr>
<td>S&amp;P 500 TR Index</td>
<td>4.11%</td>
<td>2.01%</td>
</tr>
</tbody>
</table>

*Past performance is not indicative of future results.* Standard deviation is a statistical measure of how consistent returns are over time; a lower standard deviation indicates historically less volatility. The referenced indices are shown for general market comparisons and are not meant to represent any particular Fund. An investor cannot invest directly in an index. Moreover, indices do not reflect commissions or fees that may be charged to an investment product based on the index, which may materially affect the performance data presented. There is no guarantee any investment will achieve its objective, generate profits or avoid losses. Source: Altegris.
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There are substantial risks and conflicts of interests associated with managed futures and commodities accounts, and you should only invest risk capital. The success of an investment is dependent upon the ability of a commodity trading advisor (CTA) to identify profitable investment opportunities and successfully trade. The identification of attractive trading opportunities is difficult, requires skill, and involves a significant degree of uncertainty. CTAs have total trading authority, and the use of a single CTA could mean a lack of diversification and higher risk. The high degree of leverage often obtainable in commodity trading can work against you as well as for you, and can lead to large losses as well as gains. Managed futures and commodities accounts may be subject to substantial charges for management and advisory fees. It may be necessary for accounts that are subject to these charges to make substantial trading profits in order to avoid depletion or exhaustion of their assets.

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

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

Veteran experts in the art and science of alternatives, Altegris guides investors through the complex and often opaque universe of alternative investing.

Alternatives are in our DNA. Our very name, Altegris, highlights our singular focus on alternatives, the highest standards of integrity, and a process that constantly seeks to minimize investor risk while maximizing potential returns.

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