

# LIQUID ALTERNATIVES Flowing into the Mainstream

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In response to the 2008 financial crisis, investors began to recognize the importance of real diversification. After a strong bull run in equity markets, and a more than 30-year decline in fixed income yields, investors are once again looking at alternatives for their potential to withstand periods of market crisis. More specifically, they are looking for investments with the potential for significant risk-adjusted returns, lower correlation to traditional asset classes, and reduced portfolio volatility. With the advent of liquid alternatives, the opportunity to invest in alternative investments is more accessible than ever before. Not all funds, however, are created equal.

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## **LIQUID ALTERNATIVES: A SYNOPSIS**

Alternative investments and mutual funds have historically existed in separate realms—where high-net-worth and institutional investors have been the beneficiaries of access to the former, and a broader range of investors have taken advantage of the

strengths of the latter. However, recent years have seen a blurring of the lines between the two worlds—a shift that has gathered momentum since the 2008 financial crisis. With equity markets at all-time highs and traditional fixed income markets poised for a reversal, the shift has gained even more interest today.

With access to premier alternative investment managers, in a liquid, mutual fund format, investors can infuse their portfolios with more flexibility, potentially reduce correlations to stocks and bonds and potentially improve their risk/return profiles. At Altegris, we believe that liquid alternatives offer investors the best of both worlds—mutual funds and alternative investments—as they pursue their long-term investment goals.

### **What is a '40 Act Fund?**

Liquid alternative investments are open-end mutual funds registered under the Investment Company Act of 1940, and often referred to as '40 Act funds. Liquid alternatives combine many of the historic strengths of hedge funds with the benefits of mutual funds, and may be suitable for a wider range of investors.

### **Why Liquid Alternatives?**

- ▶ Liquid alternatives provide exposure to alternative investment managers in a liquid format giving investors exposure to the best of both worlds—the flexibility and convenience of mutual funds and the potential advantages of alternative investments.
- ▶ Altegris' liquid alternative funds give investors access to alternative investment managers that have demonstrated their investment skill throughout various markets, and in investment vehicles previously only available to the wealthiest of investors.

### **What Hedge Fund Strategies can I Access?**

While not all hedge fund strategies are suitable for a mutual fund structure, a large majority are. In this piece, we have identified five main strategies for discussion: 1) long/short equity, 2) long/short fixed income, 3) long/short real estate<sup>1</sup>, 4) managed futures and 5) global macro.

*Alpha measures the non-systematic return which cannot be attributed to the market. Long is buying an asset/security that gives partial ownership to the buyer of the position. Long positions profit from an increase in price. Short means selling an asset/security that may have been borrowed from a third party with the intention of buying it back at a later date. Short positions profit from a decline in price. If a short position increases in price, the potential loss on an uncovered short is unlimited.*

<sup>1</sup> It should be noted that any discussion of real estate as an asset class within the liquid alternatives space refers to managers who trade real estate investment trusts (REITs), as opposed to the actual physical underlying assets, which are non-divisible and highly illiquid.

### **Am I Getting Real Hedge Fund Talent?**

- ▶ Many premier hedge fund managers were not previously amenable to liquid alternatives. Now, they recognize the benefits—primarily the opportunity for a far more diversified asset base, a key feature given the “run on the bank” environment experienced during the 2008 financial crisis. This in turn gives investors access to talent previously unavailable in a mutual fund structure.
- ▶ The universe of liquid alternative investment managers is expanding rapidly, but not all are created equal. We believe there are clear advantages from having an experienced partner during your search for investment talent. Altegris has built significant relationships with top-flight, experienced alternative investment managers who have historically demonstrated an ability to deliver alpha, by investing both long and short.

### **How do I Evaluate Fees?**

Access to some of the world's most skilled investment managers in a liquid alternative mutual fund format may result in investors paying higher fees than traditional mutual funds. This is particularly true if the liquid alternative funds are accessing real hedge fund talent; a trade-off we believe is worthwhile if there is the potential to produce higher net of fee returns, low correlation to traditional asset classes, and reduced portfolio volatility.

### **How do I Add Liquid Alternatives to my Portfolio?**

History demonstrates the importance of gaining exposure to strategies that can potentially outperform traditional investments under a variety of market conditions. We suggest building a diversified portfolio of liquid alternatives that includes, but is not limited to, long/short equity, long/short fixed income, long/short real estate, managed futures and global macro strategies.

# The Emergence of Liquid Alternative Investments

One of the principal legacies of the 2008 financial crisis has been an increased focus on liquid, uncorrelated assets as investors seek to better manage risk in their portfolios—without giving up performance. It is no surprise, then, that increasing numbers of financial advisors and their clients are turning to liquid alternative investments to help meet this challenge.

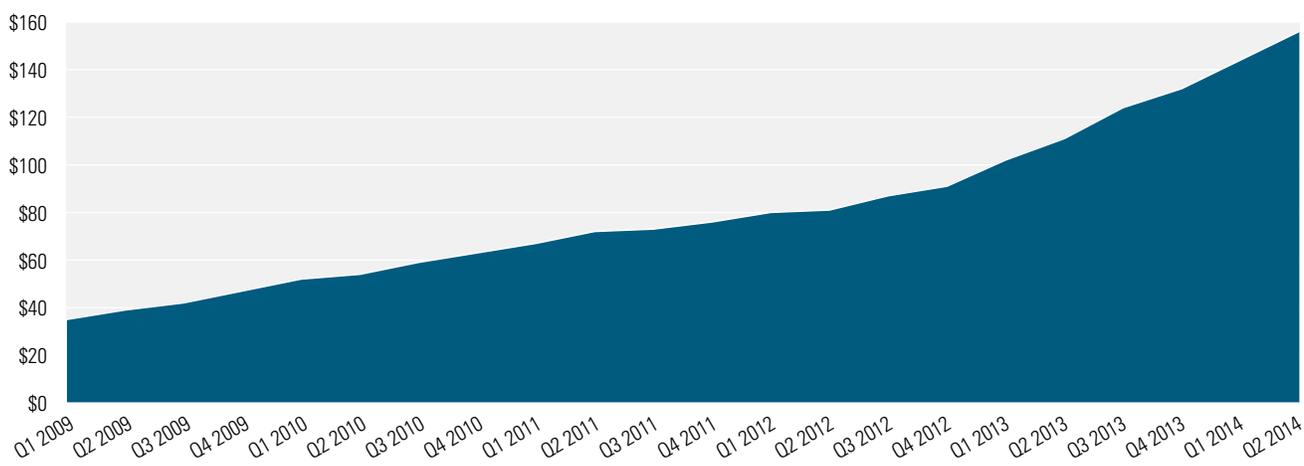
Hedge funds and other alternative investments have historically been exclusively available to institutional and ultra-high-net-worth investors. Today, liquid alternatives give a broader range of investors access to alternatives. At the same time, investors access the commonly recognized advantages of mutual funds, including daily pricing, daily liquidity, low investment minimums, fewer investor pre-qualifications, efficient 1099 tax reporting, board oversight and regulations developed over decades of mutual funds' existence.

Consequently, the investor base for alternatives has been expanding in recent years. As shown in Figure 1, assets in alternative mutual funds increased over 340% (over \$120 billion) from Q1 2009 through Q2 2014. While this increase is significant, it represents only approximately 1% of total US mutual fund assets (Source: Morningstar, Investment Company Institute). Liquid alternatives have grown, but further growth seems imminent.

Industry analysts expect the growth trend to continue. Goldman Sachs predicts that liquid alternatives are “in the early stages of a 5- to 10-year growth trend,” similar to the early stages of ETF growth. If estimates are correct, liquid alternatives assets could increase 15%-20% annually, creating a \$2 trillion AUM market, according to its recent report, “Retail Liquid Investments: The New Frontier.”

FIGURE 1.

ALTERNATIVE MUTUAL FUND ASSETS (\$ BILLION) | Q1 2009–Q2 2014



Source: Morningstar

Similarly, *kasina*<sup>2</sup> estimates that roughly 12% of financial advisors' assets under management are now associated with alternative investments, with an increasing slice of the pie moving into liquid vehicles. Thirty four percent of advisors have increased their allocation to liquid alternatives over the past several years, while only 6% of advisors have increased exposure to traditional hedge funds (i.e., Limited Partnerships).

Based on recent studies<sup>3</sup>, institutional investors tend to allocate between ~11% and ~59% in alternative investments, depending on the level of assets under management. Should retail investors aim for just the average of this range (35%), we should see a significant increase in the level of assets and number of liquid alternative funds available.

This trend of increased assets to liquid alternatives could benefit both alternative fund managers and

investors. Liquid alternatives offer hedge fund managers another avenue for asset growth at a time when competition has never been fiercer. Hedge fund managers can gain access to retail investors with fewer restrictions, and may welcome a larger number of smaller allocations from advisors and individual investors to diversify their asset base. Because more and more hedge fund managers are available in a liquid alternative format, investors have a much larger pool of talent from which to select. In addition, this presence of top-flight talent in liquid alternative funds could also increase the percentage of institutional assets in the space as institutional managers recognize manager names they have invested with in the past, and may compare the performance with their previously illiquid investments.

<sup>2</sup> Source: *kasina's Advisor Insights service, in partnership with Horsesmouth.*

<sup>3</sup> Source: *2013 NACUBO Commonfund Study of Endowments.*

# The Best Strategies for Liquid Alternatives

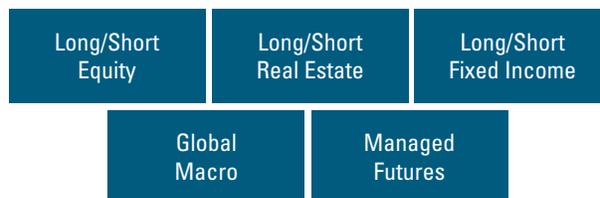
When evaluating what alternative investment strategies are most appropriate for a mutual fund format, there are two key features one must consider: liquidity and leverage.

- ▶ **Liquidity Considerations.** A key feature of liquid alternatives specifically is, as the name suggests, liquidity. The ease with which a fund portfolio can meet redemptions depends on the strategy's underlying securities. "Asset/liability mismatch" or setting an investor redemption schedule that does not coincide with the liquidity profile of the securities traded can be problematic. Fastidious evaluation of underlying security liquidity both prior to investment and on an ongoing basis is paramount.
- ▶ **Leverage Limitations.** Another consideration in selecting a strategy for a liquid alternative fund is the extent to which it relies on leverage to generate higher returns. Regulation of '40 Act products restricts the amount of leverage managers can use. Thus, strategies such as relative value and statistical arbitrage, while capable of producing attractive risk-adjusted returns, are generally unworkable in a mutual fund structure due to required levels of leverage beyond what is allowable.

The strategies we highlight in this paper, among others, all have the liquidity and the potential to generate attractive returns using acceptable levels of leverage, making them, in our opinion, some of the best strategies for inclusion in a liquid alternative format. In fact, we believe the majority of hedge fund strategies are viable options for a mutual fund that meet the liquidity and leverage requirements of the Investment Company Act of 1940.

These strategies include long/short equity, long/short fixed income, long/short real estate, managed futures, global macro, and some forms of event driven strategies that utilize credit and equity long short components.<sup>4</sup> There are a select few strategies, such as direct lending and distressed credit, which are better suited in a private fund structure where the illiquidity premium can be effectively exploited. Others are more highly leveraged, such as relative value, which are also not suitable due to mutual fund regulatory constraints on leverage.

- ▶ Long/short equity, long/short fixed income and long/short real estate managers typically go long on securities they expect to increase in value and short securities whose prices they expect to decline. Long/short real estate managers may also invest in assets, such as REITs, that could generate an advantageous risk-adjusted income stream.
- ▶ Managed futures involve highly technical strategies in which managers generally rely on proprietary, model-based trading systems to identify market trends and react to corresponding price movements across various markets.
- ▶ Global macro managers analyze macroeconomic data in an attempt to predict price movements using a variety of instruments.



<sup>4</sup> Event driven is a type of strategy that primarily invests in equity and debt securities of companies involved in a wide variety of corporate actions. These actions may include, but are not limited to, mergers, spin-offs, restructurings, litigations, debt exchanges, shareholder buybacks, proxy contests, security issuance, or other capital adjustments.

Despite obvious differences, and a specific set of risks, these strategies share key similarities. All generally focus on liquid, actively traded markets, primarily via centrally cleared instruments—publicly traded equities, fixed income securities, REITs, currencies and commodities from around the world. All of these strategies have the flexibility to go long and short, thus providing managers with the ability to generate returns in a variety of market environments. In addition, all can effectively pursue their investment approaches within the mutual fund regulatory constraints on leverage.

### LIQUID ALTERNATIVES VERSUS 3(c)(7) HEDGE FUNDS

While liquid alternative investments can deliver more transparency and liquidity than what is typically offered by hedge funds accessed via private placement or 3(c)(7) hedge funds<sup>5</sup> (Figure 2), the two types of vehicles are not mutually exclusive within a well-diversified portfolio. For investors with the appropriate levels

of investable capital, a hedged portfolio resulting from the inclusion of liquid alternatives can lead to simultaneously pursuing different less-liquid strategies offering higher risk—and potentially higher returns—by virtue of their longer investment horizons. We call this an “illiquidity premium.” The illiquidity premium may be especially advantageous for distressed credit, direct lending, and other less liquid strategies, which are not suitable in a mutual fund format, as these types of strategies have historically offered higher yields and any premium is further impacted by a longer time horizon. Of course, these less liquid strategies can come with significant risk of loss and capital that is not available to an investor for an extended period of time. As a result, liquid alternatives and private placement alternative investments can work in tandem to position a portfolio to further potentially generate strong risk-adjusted returns in both up and down markets. The element of liquidity in a portion of an alternative portfolio can change the nature of the illiquid alternatives an investor can consider.

FIGURE 2.

### MUTUAL FUNDS / PRIVATE FUNDS

Mutual funds and private funds offer different, but potentially complementary, characteristics for investors.

	Mutual Funds	Private Funds
<b>Liquidity</b>	Daily Liquidity Daily final NAV pricing	Typically monthly/quarterly liquidity Typically monthly final NAV pricing
<b>Taxes</b>	Form 1099 reporting	Form K-1 reporting
<b>Availability</b>	Available to most investors, subject to investment suitability	Available to accredited investors, qualified purchasers, etc., subject to investment suitability
<b>Access</b>	Automated subscription and processes (NSCC)	Manual subscription and redemption processes with advanced notice required

*For illustrative purposes only. There is no guarantee that any investment will achieve its objectives, generate profits or avoid losses. Source: Altegris.*

<sup>5</sup> A 3(c)(7) hedge fund is exempt from registration under the Investment Company Act and must comply with two basic requirements: (1) the fund can have only qualified purchasers as investors and (2) the fund can have no more than 499 investors.

Generally interests in 3(c)(7) funds will only be offered to a prospective investor who is: (1) a “qualified purchaser” as defined in the Investment Company Act of 1940, as amended (the “Investment Company Act”), and regulations promulgated thereunder, and, therefore, a “qualified eligible person” for purposes of Rule 4.13(a)(4) promulgated under the Commodity Exchange Act, as amended (the “CEA”); and (2) an “accredited investor” as defined in, and for purposes of, Regulation D under the Securities Act. An investment is suitable only for persons who have adequate means of providing for their current needs and personal contingencies and have no need for liquidity in their investments.

# Liquid Alternatives in your Portfolio

## HISTORY OF SIGNIFICANT RISK ADJUSTED RETURNS

Investors allocating to liquid alternatives can enjoy some of the primary potential advantages of mutual funds—a high degree of transparency, the ability to quickly invest and redeem (thus aiding in actively rebalancing port-

folios), and regulatory and board oversight. At the same time, investors reap the possible long-term rewards of alternative investment exposure, including the potential for significant risk-adjusted returns, as measured by the Sharpe ratio and lower volatility (Figure 3).

FIGURE 3.

Alternative strategies have been favorable to traditional asset classes on a risk/return basis and are largely uncorrelated.

PERFORMANCE TABLE | July 2000–June 2014

	Ann. Rate of Return	Ann. Standard Deviation	Worst Drawdown	Sharpe Ratio
<b>Long/Short Equity</b>	4.96%	8.32%	-30.57%	0.30
<b>Long/Short FI</b>	7.82%	3.52%	-14.56%	1.51
<b>Managed Futures</b>	5.59%	10.52%	-15.74%	0.29
<b>Global Macro</b>	6.16%	5.06%	-6.42%	0.72
<b>US Stocks</b>	4.14%	15.35%	-50.95%	0.11
<b>US Bonds</b>	5.68%	3.53%	-3.82%	0.90
<b>Real Estate</b>	11.35%	21.66%	-68.17%	0.41

CORRELATION TABLE | July 2000–June 2014

	LSE	LSFI	MF	GM	US Stocks	US Bonds	RE
	1.00	0.75	0.04	0.65	0.84	-0.08	0.55
		1.00	0.03	0.47	0.60	0.20	0.51
			1.00	0.63	-0.15	0.27	-0.01
				1.00	0.39	0.15	0.28
					1.00	-0.12	0.64
						1.00	0.16
							1.00

Past performance is not indicative of future results. There is no guarantee that any investment will achieve its objectives, generate profits or avoid losses. Returns are represented by benchmark indices 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. Indices: Managed Futures (MF): Altegris 40 Index (started July 2000; data is available back to 1990); Global Macro (GM): Barclay Global Macro Index; Long/Short Equity (LSE): HFRI Equity Hedge (Total) Index; Long/Short Fixed Income (Long/Short FI, LSFI): HFN Fixed Income (non-arbitrage) Index; Real Estate (RE): FTSE NAREIT Composite Total Return Index; US Stocks: S&P 500 TR Index; US Bonds: Barclays US Aggregate Bond Index. Real estate index reflects long-only exposure to the asset class, as there is no current index or benchmark with a long enough history to represent long/short real estate. Date range based on common period of data availability. Source: Altegris, Barclays, Bloomberg, HFR.

Standard deviation is a statistical measure of how consistent returns are over time; a lower standard deviation indicates historically less volatility. Drawdown measures the peak to valley loss relative to the peak for a stated time period. Correlation is a statistical measure of how two securities move in relation to each other. Sharpe Ratio measures return in excess of the risk-free rate, per unit of risk, as measured by standard deviation; assumed risk-free rate is 2.5%.

## ALTERNATIVES IN A PORTFOLIO

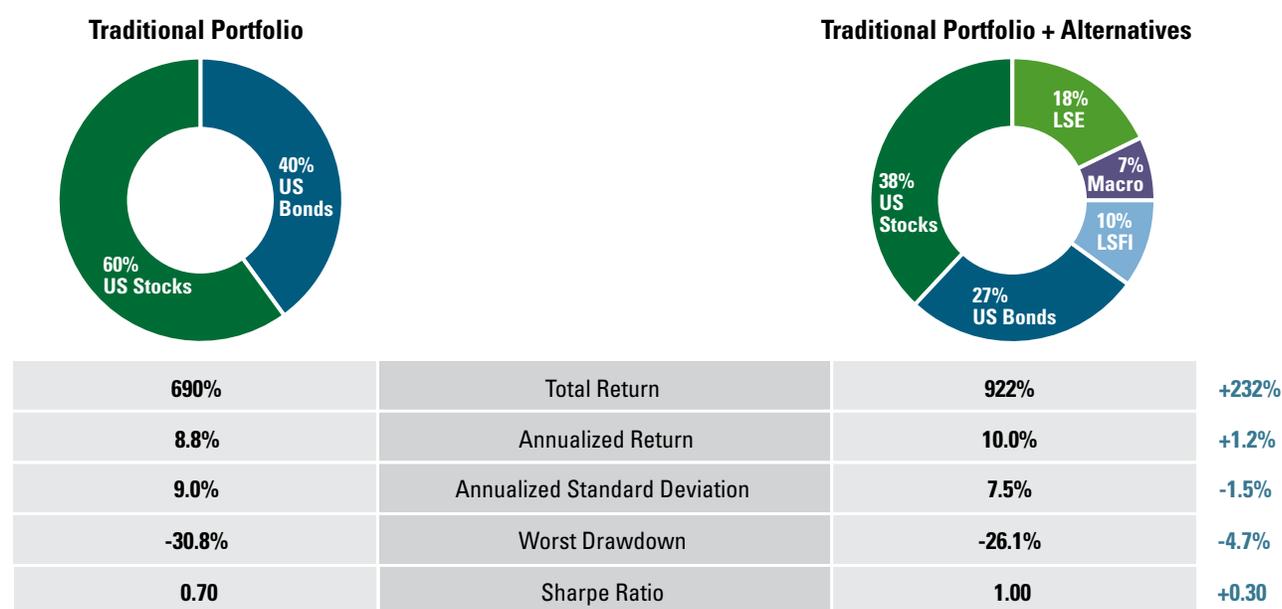
These statistics in isolation are compelling, but what's more important is the impact of alternatives in a portfolio. Figure 4 demonstrates that adding an allocation of alternatives to a traditional portfolio has the potential to increase returns, while reducing volatility and leaving a portfolio less susceptible to severe drawdowns.

However, even in the context of liquid alternative investments, it is important to keep in mind that the potential benefits of these strategies are typically realized over a long-term time horizon through multiple complete cycles in the markets. Investors should therefore expect alternative strategies to have periods of underperformance relative to other asset classes as well as outperformance.

FIGURE 4.

ALTERNATIVES IN A PORTFOLIO | January 1990–June 2014

Adding alternative investments can potentially enhance a portfolio's risk/return profile.



*This is a hypothetical illustration. Past performance is not indicative of future results. There is no guarantee that any investment will achieve its objectives, generate profits or avoid losses. The above is not intended, and should not be construed, as asset allocation advice. Returns are represented by benchmark indices 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. Indices: US Stocks: S&P 500 TR Index; US Bonds: Barclays US Aggregate Bond Index; Long/Short Equity (LSE): HFRI Equity Hedge (Total) Index; Long/Short Fixed Income (LSFI): HFN Fixed Income (non-arbitrage) Index; Macro: HFRI Macro (Total) Index. Date range based on common period of data availability. Source: Altegris, Barclays, Bloomberg, HFR.*

Standard deviation is a statistical measure of how consistent returns are over time; a lower standard deviation indicates historically less volatility. Drawdown measures the peak to valley loss relative to the peak for a stated time period. Sharpe Ratio measures return in excess of the risk-free rate, per unit of risk, as measured by standard deviation; assumed risk-free rate is 2.5%.

# Finding Talent: Due Diligence Required

Identifying and accessing the most talented investment professionals becomes more challenging as the universe of liquid alternative fund managers expands. This is because not all managers accessed in a '40 Act structure are “the real deal.”

At Altegris, we believe investors realize the full benefits of liquid alternatives only when they have access to premier, experienced alternative investment managers with a robust infrastructure behind them. These are managers who have

demonstrated the ability to deliver alpha over time across a variety of market environments, particularly during periods of crisis. The range of talent in the liquid alternative world appears to be wider than traditional investment management.

Figure 5 is a performance dispersion comparative analysis. This graphic compares average rates of return range of the top and bottom (highest and lowest performing) 25% of traditional, long-only mutual funds invested in large cap value stocks with

**FIGURE 5.**  
**PERFORMANCE DISPERSION OF LARGE CAPITALIZATION VALUE MUTUAL FUNDS, MANAGED FUTURES FUNDS, LONG/SHORT EQUITY HEDGE FUNDS AND GLOBAL MACRO HEDGE FUNDS | As of June 2014**

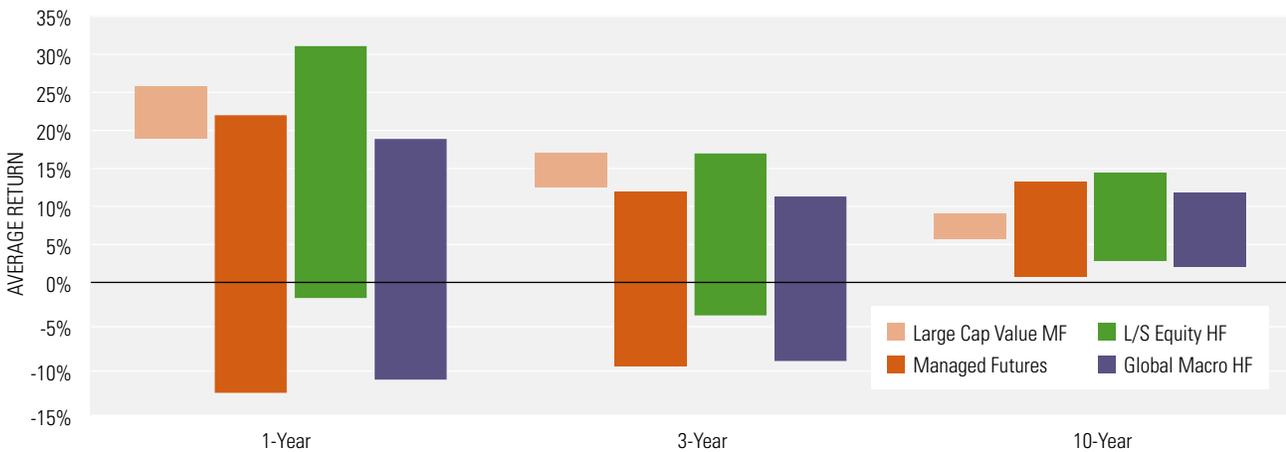


Figure 5 compares the range of the top and bottom 25% average rates of return of traditional, large cap value mutual funds with three categories of alternative investments: managed futures funds, long/short equity hedge funds and global macro hedge funds.

Past performance is not indicative of future results. There is no guarantee that any investment will achieve its objectives, generate profits or avoid losses. Large Cap Value universe includes 778 funds for the 10-year period, 956 funds for the 3-year period, and 1,088 funds for the 1-year period derived from Morningstar Category Large Cap Value. Long/Short Equity universe includes 507 funds for the 10-year period, 1,507 funds for the 3-year period, and 1,793 funds for the 1-year period derived from HFR Equity Hedge (Total). Global Macro universe includes 218 funds for the 10-year period, 783 funds for the 3-year period, and 973 funds for the 1-year period derived from HFR Macro. Managed Futures universe includes 226 funds for the 10-year period, 686 funds for the 3-year period, and 899 funds for the 1-year period derived from Barclay CTA. Source: Altegris, BarclayHedge, HFR, Morningstar.

three types of alternatives investments—managed futures funds, long/short equity hedge funds and global macro hedge funds. It's important to note that all of the indices used to represent these various types of investments are imperfect representations of true dispersion given their survivorship bias. That said, survivorship bias actually makes the data set represented look better than it likely would historically by removing poor performers from the indices. One can see that large cap value-oriented mutual fund returns are tightly clustered, meaning that most traditional large cap value managers have similar return profiles. The relatively small range of performance dispersion among the large cap value mutual funds makes sense because they are investing in a group of similar stocks, most of which are tied to an index. In contrast, the performance dispersion of alternative investments is much greater—there is talent at the top and there are managers who have returned poorly. Unlike traditional investments whose performance is typically measured relative to benchmarks, the absolute return nature of alternative investments is seemingly driven more by manager skill. Thus, doing your homework or due diligence and having the capability to discern who the “real deal” is and who isn't is particularly important.

### **A TRUSTED DUE DILIGENCE PARTNER**

Understandably, selecting alternative fund managers is a more time consuming and complex process than selecting passive index funds. It is a process that requires many levels of expertise on the part of the decision makers. The process is one which we highly recommend teaming with an experienced partner like Altegris. Our firm is able to blend top-down viewpoints with bottom-up analysis to identify the most compelling market opportunities. We have the experience and seasoned personnel in place to identify fund managers with the specific skill to try to capture these opportunities, and

combine that with a detailed multi-layered on-going due diligence process. Strong relationships with best of breed managers is also crucial, as many managers are capacity-constrained, making them reluctant to accept new assets without a pre-existing relationship.\* Altegris has a significant private fund alternatives business as well, which includes analyzing, approving and then recommending many well-known managers to clients who can tolerate the illiquidity in a partnership structure. Several of these managers are also part of our liquid alternatives portfolios. Altegris will use its resources to perform an ongoing evaluation of each manager in the portfolio—including constant ongoing investment review and risk monitoring. For multi-manager products, Altegris will then conduct advanced return analysis and risk profiles to actively construct, manage, and rebalance portfolios. Altegris is committed to sourcing, analyzing and providing access to what we believe are premier managers across an array of alternative strategies.

### **UNDERSTANDING LIQUID ALTERNATIVE FEES**

This complex selection and due diligence process is typically accompanied by higher fees than traditional long-only or passive index mutual funds, although generally less than a traditional hedge fund limited partnership structure that is typically offered with a 2% management fee and 20% performance fee. From a mutual fund investor's standpoint, potentially higher fees versus traditional mutual funds, but not necessarily lower net returns, may be appropriate in exchange for access to some of the best investment talent in the world. Liquid alternative funds that access an elite group of managers within the alternative investment universe, who have a history of consistently generating strong risk-adjusted returns in both up and down markets, and are supported by institutional-quality infrastructure, in our opinion, are worth this apparent trade off. Net risk-adjusted performance is the true measure of value received.

\* Altegris defines “best of breed” as managers which, in our opinion, have demonstrated success in terms of sustained investment edge, effective risk management processes and established operational infrastructure.

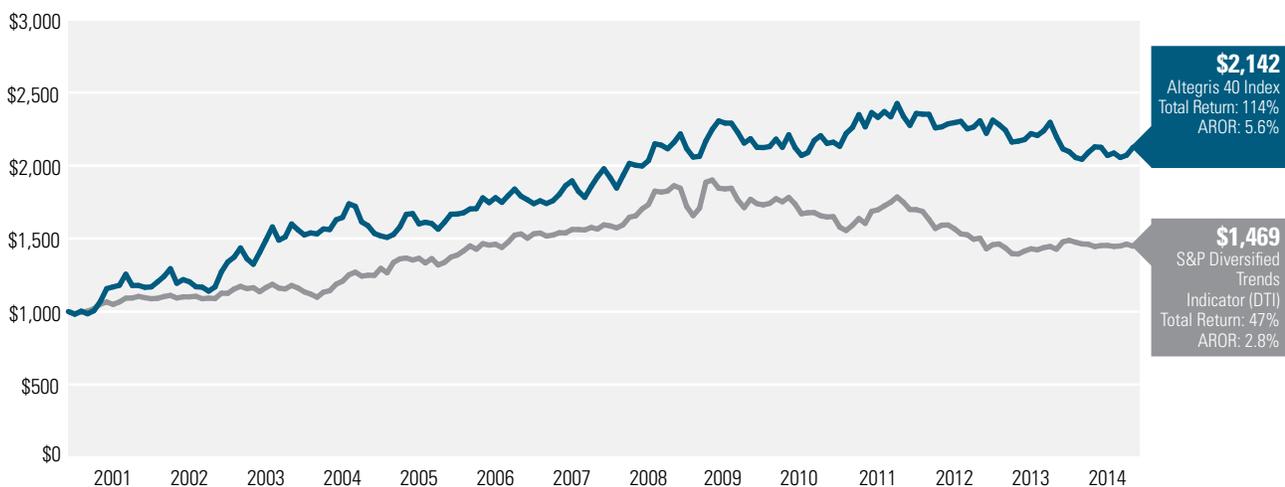
Figure 6 compares the performance of lower-fee, passive strategies within the managed futures category (represented by the S&P Diversified Trends Indicator [DTI]<sup>6</sup>) with higher-fee, active managers in the category (represented by the Altegris 40 Index<sup>7</sup>). Our example compares the compound growth of an initial \$1,000 in the DTI with an identical allocation to the Altegris 40. The substantial 67% outperformance in the cumulative return of the Altegris 40 versus the DTI since July 2000 underscores the contribution to performance that higher-fee active managers could make. Managers in the Altegris 40 Index charge both management and performance fees, yet have

outperformed a passive index over time with a low cost fee structure. This is why a focus on long-term, *net of fee performance* is key for alternative investment analysis.

Whether in private placement or mutual fund format, the best managers can be more expensive for investors to engage directly—if they are open to new investors at all. Regardless of the vehicle, the best managers are in a position to be able to command higher fees—if they can deliver consistently strong risk-adjusted returns; those fees represent a wise investment, in our view.

FIGURE 6.  
GROWTH OF \$1000 | July 2000–June 2014

### Higher fees in context: actively managed, managed futures have significantly outperformed passive managed futures on a historical basis.



*Past performance is not indicative of future results. There is no guarantee that any investment will achieve its objectives, generate profits or avoid losses. Returns are represented by benchmark indices 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 range based on common period of data availability. Source: Altegris.*

<sup>6</sup> The S&P Diversified Trends Indicator (DTI) is a composite of 24 highly liquid futures grouped into 14 sectors, evenly weighted between financial and physical commodities.

<sup>7</sup> The Altegris 40 Index is an asset-weighted index that comprises the 40 largest programs in the managed futures space, net of both performance fees (typically around 20%) and management fees (typically around 2%), as reported to Altegris.

# Preparing for the Markets' Next Phase

Alternative investments seek to navigate the risk of future volatility in financial markets. We believe investors should formulate long-term plans using strategies that have the potential to outperform in a variety of market conditions, including the ability to go long and short in various asset classes. Below we review the strategies most conducive to a liquid alternative format and the potential benefits thereof:

## **LONG/SHORT FIXED INCOME**

Long/short fixed income falls into the category of “non-traditional fixed income strategies.” These strategies have gained considerable attention lately since their goal is to help mitigate losses during periods of rising rates, while at the same time providing current income as well as capital appreciation. Non-traditional fixed income strategies are not tied to an index or a benchmark, which is part of the appeal.

In general, there are two types of non-traditional or “unconstrained” fixed income strategies: opportunistic and absolute return. Opportunistic strategies are viewed by investors as a less constrained version of traditional core fixed income. They are viewed as complements to existing core fixed income allocations as they provide a more opportunistic yet potentially more volatile return profile. Conversely, absolute return strategies are generally seen as a replacement for a portion of traditional core fixed income. Long/short fixed

income strategies, specifically, have historically been categorized as lower volatility, absolute return oriented investments. Long/short fixed income managers seek positive total returns regardless of credit or interest rate environment by combining deep, fundamental analysis with effective duration management. These managers can move freely in search of returns without benchmark constraints, while using a long/short discipline to manage duration and exposure.

One of the greatest sensitivities investors face now in fixed income is exposure to a rising rate scenario. Duration is a commonly used metric to measure the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates. For example, for every year or unit of duration, the price of a bond will move 1% in the opposite direction. If an investor's traditional bond portfolio has a weighted average duration of 5 years and rates rose 1%, this bond portfolio's performance would theoretically decline by 5%.

Figure 7 demonstrates how the ratio of a unit of payment (yield) versus a unit of duration (risk) has eroded for holders of traditional fixed income securities over the last 30-plus years. The more duration one takes on today, the less yield available relative to history, and the more susceptible one is towards a rise in interest rates.

Because of this unfavorable trade off, as shown by the benchmark returns in Figure 8, long-only fixed income has dramatically underperformed long/short fixed income in rising rate environments.

Duration management is important, and allocating to a long/short fixed income strategy aims to reduce duration and a portfolio's sensitivity to interest rates. However, investors should not allocate to a long/short fixed income manager solely on this basis. A true long/short fixed income manager sees the current volatile and rising rate environment as an opportunity to generate absolute returns. Managers with the skill to adeptly manage duration risk and

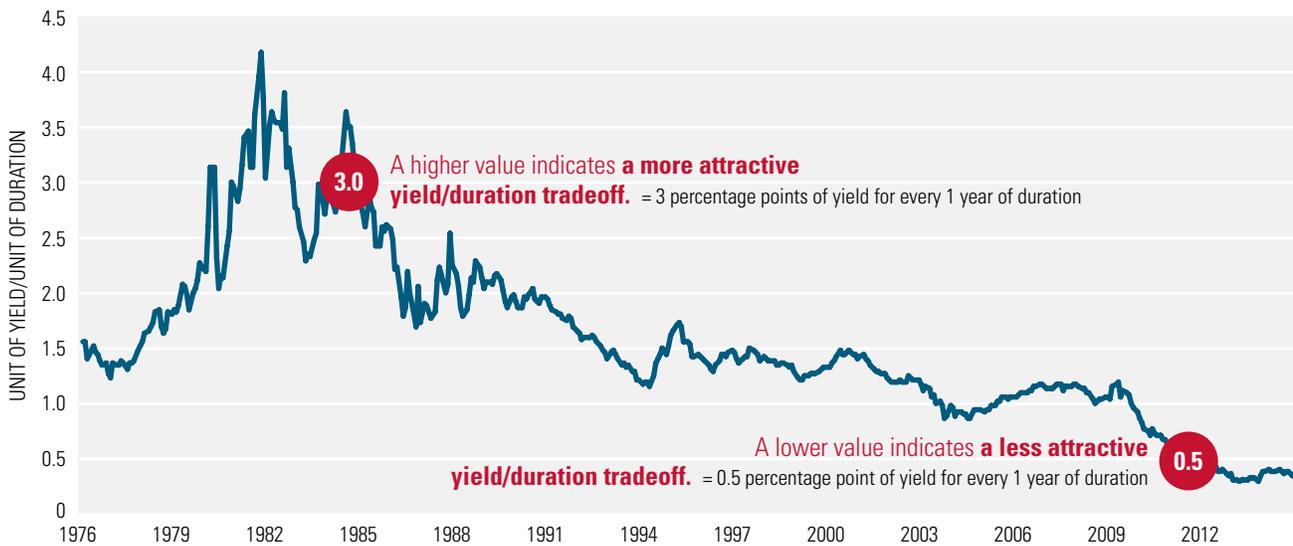
identify non-conventional fixed income opportunities have the potential to outperform those who are constrained to an index because they cannot short fixed income or fixed income derivatives when credit markets are deteriorating.

With rates sitting near historic lows, the long-only outlook for fixed income is more volatile, and therefore in our view, unlikely to produce upside returns or provide the type of insulation from a declining stock market as it has over the last 30 years. Rates could fall even further, but that scenario is unlikely in a growing economy. Regardless of what the future may hold, long/short fixed income managers have the ability to take advantage of various interest rate and credit environments by investing across an array of fixed income sectors in investments of varying credit quality and maturity. Of course, a manager's judgment about security selection may prove to be inaccurate and may not produce the desired results. In addition, long/short strategies are considered speculative and involve significant financial risk.

FIGURE 7.

**TRADITIONAL FIXED INCOME: LESS ATTRACTIVE YIELD/DURATION TRADEOFF**

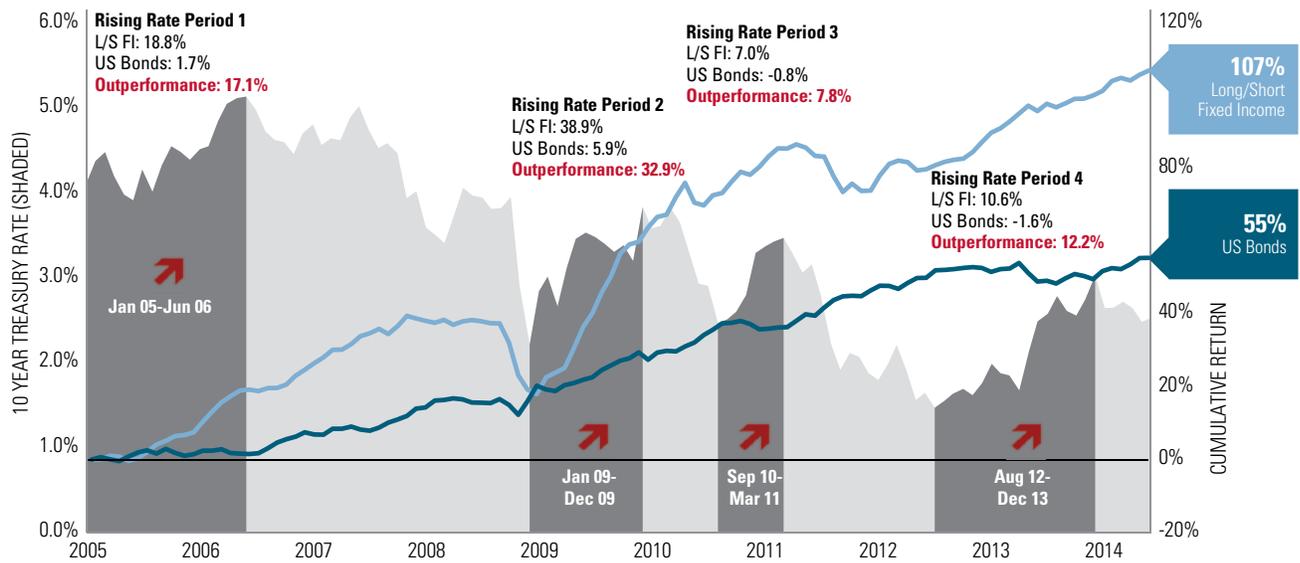
Barclay's US Aggregate Bond Index: Unit of Yield per Unit of Duration | January 1976–June 2014



Unit of yield per unit of duration is derived from Barclay's US Aggregate Bond Index's yield divided by its duration. Yield and duration measures based on data availability from source. Unit of yield per unit of duration examples: a bond with a 12% yield and 4-year duration would have a unit of yield per unit of duration value of 3.0; a bond with a 2% yield and 4-year duration would have a unit of yield per unit of duration value of 0.5. Past performance is not indicative of future results. Source: Altegris, Barclays.

FIGURE 8.

PERFORMANCE DURING RISING RATES | January 2005 – June 2014



Past performance is not indicative of future results. Rising rate periods are those in which the 10-Year US Treasury rate increased by at least one percent. Performance represents cumulative returns over specified time period. Outperformance refers to the performance of the HFRX Fixed Income-Credit Index relative to the Barclays US Aggregate Bond Index. Returns are represented by benchmark indices 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. Difference benchmarks and time periods may result in materially different outcomes. Indices: Long/Short Fixed Income: HFRX Fixed Income – Credit Index; US Bonds: Barclays US Aggregate Bond Index. Date range based on common period of data availability. Source: Bloomberg, HFR.

Long/short fixed income managers who 1) understand the credit cycle, 2) have managed through periods of crisis, 3) possess the ability to generate yield at lower risk with less sensitivity to interest rates, 4) can take advantage of relative credit disparities and/or changes in the yield curve, potentially have an even greater opportunity to outperform. Given the relatively liquid nature of many fixed income instruments coupled with the current opportunity set makes long/short fixed income another important strategy to consider under the liquid alternatives umbrella.

**LONG/SHORT EQUITY**

With the exception of a flat 2011, the broad stock market has rallied—and hard—post 2008. In particular, 2013 was a watershed year, with the S&P 500 Index gaining 29.6%—the stock market’s best year since 1997. Most securities in the index moved up in lock step, creating only a few idiosyncratic opportunities,

particularly on the short side. We cannot predict when traditional equity markets will slow down or even reverse, but we are confident that the current bull market will not exist in perpetuity.

Many investors share our opinion, and are searching for new opportunities for the equity exposure in their portfolios that might allow for greater downside mitigation, while still enjoying the return potential of the upside. Long/short equity is one such alternative to long-only equity exposure; it is an alternative investment strategy that seeks to generate returns that are driven more by stock selection than by market direction. Typically executed by hedge fund managers in a private fund format, long/short equity managers **actively select** stocks by taking long positions (buying stock) in companies they expect to increase in value and short positions (selling borrowed stock) in companies they expect to decrease in value. Long/short equity managers may also adjust how much **exposure** they have to

the broad market, by varying the mix of long and short positions in their portfolios based upon market conditions (e.g., more long exposure when bullish, more short exposure when bearish).

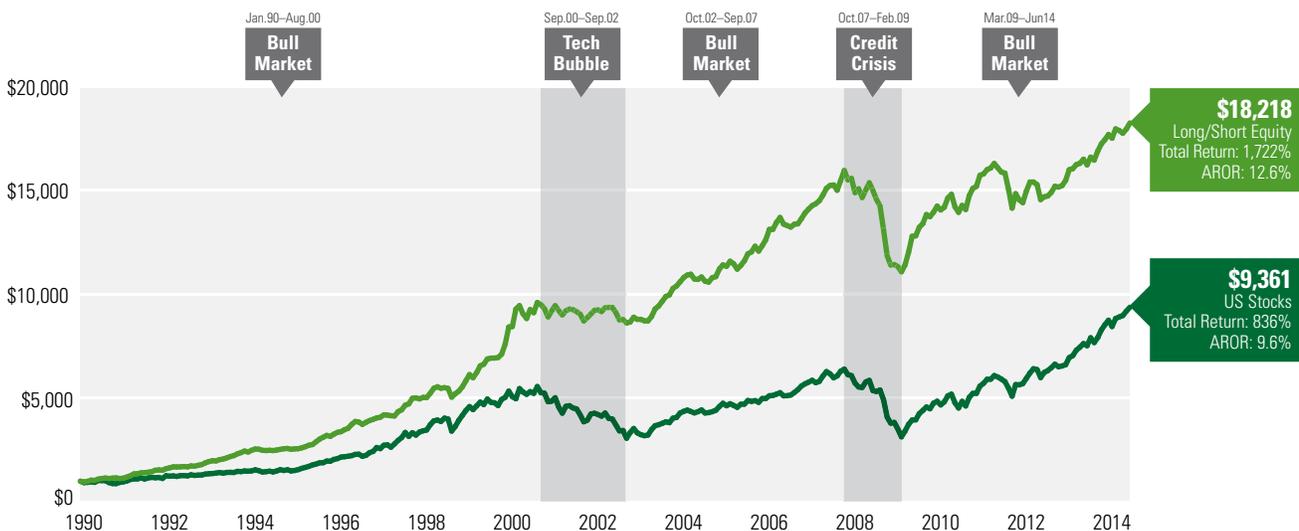
We believe investors need to have this hedged exposure to equities, through experienced managers that select securities both long and short, and who can reduce or increase exposure to the market through fundamental security selection or hedging. Amid equity market uncertainty, more flexible investment approaches like long/short equity can prove essential to investors. However, investing in long/short equity is not an insurance policy. A manager’s judgment about security

selection may prove to be inaccurate and may not produce the desired results. In addition, long/short strategies are considered speculative and involve significant financial risk. While past performance is no guarantee of future results, long/short equity has a significant track record of outperforming the market<sup>8</sup> on a total return basis (Figure 9). This outperformance may be attributed to long/short equity managers aiming to deliver returns across a broad array of market conditions and reduce volatility through active stock selection as well as by market exposure management. The benefit is a strategy with the potential to capture upside in rallying markets while being less affected during down markets.

FIGURE 9.

**GROWTH OF \$1,000 DURING BULL MARKETS & CRISIS PERIODS | January 1990–June 2014**

Long/short equity has historically exhibited a stronger total return than US stocks over their indices’ common time period.



*Past performance is not indicative of future results. The total return of an investment is only one measure of performance. Performance should not be the sole consideration when making an investment decision. There is no guarantee that any investment will achieve its objectives, generate profits or avoid losses. Returns are represented by benchmark indices 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. Indices: Long/Short Equity: HFRI Equity Hedge (Total) Index; US Stocks: S&P 500 TR Index. Date range based on common period of data availability. Source: Bloomberg, HFR.*

<sup>8</sup> The “market” referred to throughout this paper is represented by the S&P 500 Total Return Index.

## LONG/SHORT REAL ESTATE

The real estate industry moves much more like a “super tanker” than a “speed boat,” an analogy that can be used to describe how most of the core fundamental drivers within real estate change slowly (e.g., leasing cycles, length of tenant leases, construction cycle times, government approval times, and the overall economy). As shown in Figure 10, different markets and real estate segments can gradually move throughout the cycle, but each phase provides its own unique opportunity set. For example, when real estate markets/segments are in a growth phase and fundamentals are strong, long/short real estate managers can position their portfolios with a longer bias, capitalizing on price appreciation. However, it is the ability to short that allows long/short real estate managers to take advantage when markets/segments become overheated. As is the case with any sector, there is concentration risk and the possibility that the strategy may not produce the desired results. In addition, shorting securities is considered speculative and involves significant financial risk.

A truly skilled manager can gain alpha through individual short opportunities, which may be

regional or property type in nature, in which local developers may overbuild a particular area or particular type of real estate. In turn, this may lead to reduced rents and occupancies, and reduced cash flows to the operating companies. Shorting also provides the ability to potentially hedge additional risks, such as the effects of movements in interest rates or equity markets on the returns of REITs.

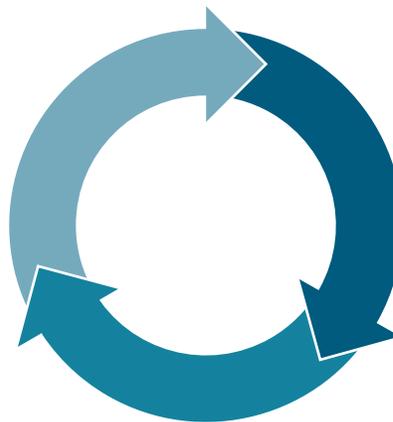
Short opportunities may also be found when there are wholesale negative changes in the lending environment to real estate. For instance, during the recession of 2007–2010, when the residential market (for sale housing) declined in both volume and price, banks that lent to mortgage origination and investment businesses that were active in residential mortgage securities all found themselves in an acute liquidity crisis. Banks also stopped lending to commercial real estate companies, which put them in their own liquidity crisis, as they could not roll over maturing debt. Opportunities in companies whose balance sheets might not withstand such unanticipated changes in the level of bank lending can only be accessed by real estate managers with the ability to go short in their toolkit.

FIGURE 10.

### STAGES OF THE REAL ESTATE CYCLE CREATES OPPORTUNITIES TO ADJUST EXPOSURES

#### MARKETS OVERHEAT

- ▶ High rents and high occupancy rates spur building boom
- ▶ Excess new inventory under construction
- ▶ Owners have leverage



#### MARKETS STABILIZE

- ▶ New construction stops and market slowly absorbs excess inventory
- ▶ Empty buildings get tenants
- ▶ Low rents and occupancy
- ▶ Tenants have leverage

#### MARKETS GROW

- ▶ Increasing market demand outpaces existing supply, driving rents and occupancy rates upward
- ▶ Higher occupancy means higher rents
- ▶ Owners gain leverage

## MANAGED FUTURES

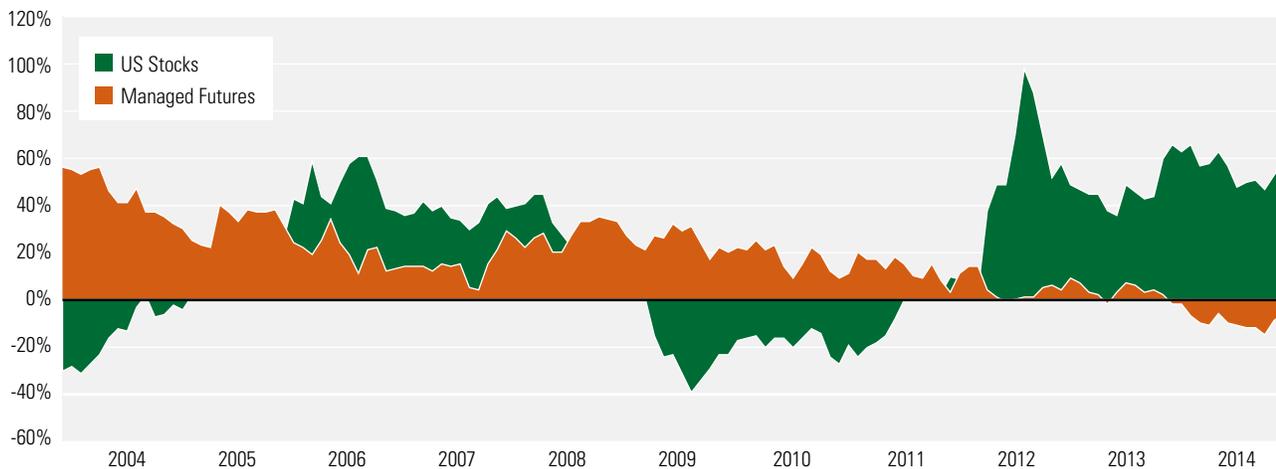
Managed futures managers pursue a highly technical approach, generally utilizing proprietary, model-based trading systems to identify a wide variety of market trends and react to corresponding price movements in global markets. This systematic methodology is very different from traditional, discretionary asset managers, and there are periods in which diversification benefits of managed futures has both enhanced and detracted from portfolio returns. Due to its divergent style, managed futures managers have been largely uncorrelated to the traditional equities. For example, Figure 11 shows a 36-month rolling return chart of managed futures, as represented by the Altegris 40 Index, versus US stocks, as represented by the S&P 500 Total Return Index. The differentiated approach of managed futures is evident in the lack of correlation between the strategy and US stocks.

The need for uncorrelated strategies, such as managed futures, has been less apparent thanks in part

to quantitative easing. Equity markets have ascended with the help of Fed stimulus and with very few hiccups along the way. Over the same time period, managed futures managers struggled.<sup>9</sup> The result was underperformance versus traditional equities post the 2008 financial crisis—an expected outcome—for an uncorrelated strategy. It further highlights the need for a diversified portfolio because there are periods in which other asset classes will drive enhanced portfolio returns. While some upside may be given up during non-crisis periods like the recent past, an allocation to managed futures can potentially help minimize losses and smooth the ride during periods of crisis. We believe that strategies such as managed futures have proven their worth over extended periods of time and therefore investors with longer-term horizons and a permanent allocation to managed futures may be positioned best to take advantage of the benefits of this strategy. After all, **investors cannot predict exactly when diversification of a non-correlated asset may benefit a portfolio.**

FIGURE 11.

### MANAGED FUTURES VS US STOCKS 36-MONTH ROLLING RETURNS | July 2000–June 2014



*Past performance is not indicative of future results. There is no guarantee that any investment will achieve its objectives, generate profits or avoid losses. Returns are represented by benchmark indices 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. Indices: US Stocks: S&P 500 Total Return Index; Managed Futures: Altegris 40 Index (started July 2000; data available back to 1990). Date range based on common period of data availability. Source: Altegris, Bloomberg.*

*Diversification does not ensure profit or protect against loss in a positive or declining market.*

<sup>9</sup> For further discussion on the historical performance of managed futures as well as current market influences, please see Altegris' "Three Reasons for Managed Futures and Macro... Now"

## GLOBAL MACRO

Of all the investment strategies under review, we believe global macro stands alone as possibly the most flexible and opportunistic. It can also be quite liquid, making it an ideal strategy for a '40 Act mutual fund structure.

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. Unlike traditional managers who are constrained by a long-only mandate, global macro managers have the ability to invest in any market, long or short, and have earned the reputation of being able to potentially preserve capital in down markets, while also potentially making profits in bull, flat, and even bear markets; global macro managers are not measured by their performance relative to an index such as the S&P 500 or Russell 2000. Global macro's flexibility is further underscored by the fact that the strategy has historically exhibited strong performance in bear markets—particularly relative to equities. Figure 12 illustrates how global macro managers as a group have demonstrated significant “crisis alpha”—that is, the ability to make profits in periods when long-only strategies have experienced substantial losses. Due to its fundamentals-based approach, global macro strategies may provide strong alpha production and potential diversification benefits when added to a portfolio. At Altegris, we believe that

the challenge of successful global macro investing lies in identifying those managers who provide sustainable alpha while successfully managing portfolio risk.

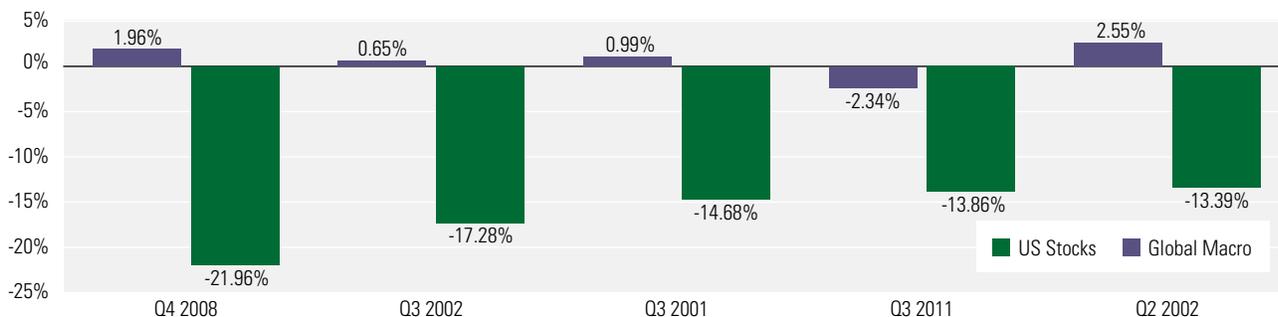
Similar to managed futures, global macro managers have struggled in the wake of quantitative easing, despite the clear uncertainties present in global markets. Post financial crisis, markets moved more in tandem to ebbs and flows in investor sentiment in response to the latest news event. Paul Tudor Jones, who manages one of the largest and most esteemed macro hedge funds globally, summed the performance of global macro best by saying that trading has “gotten to be very difficult, when you depend on price movement to make a living, and there is none.” Indeed, the exceedingly low levels of volatility across global markets have continued to create headwinds for global macro managers, and there have been relatively few opportunities on which to capitalize since the 2008 financial crisis. This has resulted in significant underperformance of global macro relative to the US stock market during recent years.

It is our strong opinion, however, that complacency in the midst of a historic bull market can be perilous, and history has shown time and again that volatilities can rise quickly and unexpectedly. For this reason, global macro strategies should remain a key divergent allocation in investors' alternative investment portfolios.

FIGURE 12.

GLOBAL MACRO AND US STOCKS RETURNS | January 1997–June 2014

Global macro has produced positive returns during four of the five worst quarters for US stocks since January 1997.



Past performance is not indicative of future results. There is no guarantee that any investment will achieve its objectives, generate profits or avoid losses. Returns are represented by benchmark indices 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. Indices: Global Macro: Barclay Global Macro Index; US Stocks: S&P 500 TR Index. Date range based on common period of data availability. Source: Altegris, Bloomberg.

# Conclusion

As liquid alternatives flow into the mainstream, investors now have access to premier alternative investment managers, in a liquid, mutual fund format. Where alternatives were previously unavailable to retail investors, the democratization of the hedge fund universe allows investors to potentially infuse their portfolios with more flexibility, reduce

correlations to traditional portfolios and potentially improve their risk/return profiles.

Finding the best liquid alternative options requires a trusted partner. Invest wisely, ask tough questions, and pay attention.



For more information and perspectives on alternatives, please visit **[www.altegrisacademy.com](http://www.altegrisacademy.com)** or contact your alternatives consultant at Altegris Investments **(800) 828-5225**.

## **RISKS AND IMPORTANT CONSIDERATIONS**

*It is important to note that all investments are subject to risks that affect their performance in different market cycles. Equity securities are subject to the risk of decline due to adverse company or industry news or general economic decline. Commodities are affected by adverse weather, geologic and environmental factors and heightened regulatory oversight. Bonds are subject to risk of default, credit risk, and interest rate risk; when interest rates rise, bond prices fall. REITs are affected by the market conditions in the real estate sector, changes in property value, and interest rate risk.*

*Alternative investments involve a high degree of risk and can be illiquid due to restrictions on transfer and lack of a secondary trading market. They can be highly leveraged, speculative and volatile, and investor could lose all or a substantial amount of an investment. Alternative investments may lack transparency as to share price, valuation and portfolio holdings, and are subject to substantial charges for management and advisory fees. Complex tax structures often result in delayed tax reporting. Alternative investment managers typically exercise broad investment discretion and may apply similar strategies across multiple investment vehicles, resulting in less diversification. Trading may occur outside the United States which may pose greater risks than trading on US exchanges in US markets.*

*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, which is difficult, requires skill, and involves a significant degree of uncertainty. CTAs may trade highly illiquid markets, or on foreign markets, and the high degree of leverage often obtainable in commodity trading can lead to large losses as well as gains. Returns generated from a CTA's trading, if any, may not adequately compensate for the business and financial risks assumed. Managed futures and commodities accounts may be subject to substantial charges for management and advisory fees. Past results are not indicative of future results. Mutual funds involve risk including possible loss of principal. An investment in an alternatives strategy mutual fund should only be made after careful study of the prospectus, including the description of the objectives, principal risks, charges, and expenses of the fund.*

*The analyses herein are based on numerous assumptions and past market conditions. Different benchmarks, market conditions and other assumptions could result in materially different outcomes. The reference to the statements or opinions of persons or firms not affiliated with Altegris is intended for informational purposes only and does not constitute investment research, and should not be viewed as investment advice. The inclusion of such does not constitute endorsement, sponsorship by, or affiliation with Altegris with respect to any persons or firms named.*

### **ALTEGRIS ADVISORS**

*Altegris Advisors LLC is a CFTC-registered commodity pool operator, commodity trading advisor, NFA member, and SEC-registered investment adviser that advises alternative strategy mutual funds that may pursue investment returns through a combination of managed futures, global macro, long/short equity, long/short fixed income and/or other investment strategies.*

## ABOUT ALTEGRIS

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

Altegris searches the world to find what we believe are the best alternative investments. Our suite of alternative investment solutions are designed for financial professionals and individuals seeking to improve portfolio diversification.

With one of the leading research and investment groups focused solely on alternatives, Altegris follows a disciplined process for identifying, evaluating, selecting and monitoring investment talent across a spectrum of alternative strategies including managed futures, global macro, long/short equity, long/short fixed income, event-driven and others.

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.

*The Altegris group of affiliated companies is wholly-owned and controlled by (i) private equity funds managed by Aquiline Capital Partners LLC and its affiliates ("Aquiline"), and by Genstar Capital Management, LLC and its affiliates ("Genstar"), and (ii) certain senior management of Altegris and other affiliates. Established in 2005, Aquiline focuses its investments exclusively in the financial services industry. Established in 1988, Genstar focuses its investment efforts across a variety of industries and sectors, including financial services. The Altegris companies include Altegris Investments, Altegris Advisors, Altegris Funds, and Altegris Clearing Solutions.*

## INDEX DEFINITIONS, DESCRIPTIONS AND RISKS

*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.*

**Altegris 40 Index.** The Altegris 40 Index® tracks the performance of the 40 leading managed futures programs, by ending monthly equity (assets) for the previous month, as reported to Altegris Investments, Inc. The Altegris 40 index represents the dollar-weighted average performance of those 40 programs. The Index started in July 2000; data is available back to 1990.

*Key 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*

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

*Key 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*

**Barclays US Aggregate Bond Index.** The Barclays US Aggregate Bond Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the US investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis. These specific indices include the Government/Credit Index, Government Index, Treasury Index, Agency Index, and Credit Index.

*Key Risks: interest rate risk—bond prices will decline if rates rise; credit risk—bond issuer may not pay; income risk—income may decline*

**FTSE NAREIT Composite Total Return Index.** The FTSE NAREIT Composite Total Return Index includes both price and income returns of all publicly traded REITs (Equity, Mortgage, and Hybrid). The index began on December 31, 1971 with a base value of 100.

*Key Risks: stock market risk—stock prices may decline; industry risk—adverse real estate may cause declines; interest rate risk—prices may decline if rates rise*

**HFN Fixed Income (non-arbitrage) Index.** The HFN Fixed Income (Non-Arbitrage) Index includes funds that are invested in fixed income instruments and tend to be long-biased holders of securities. Funds may employ long/short strategies attempting to benefit from under-or overvalued fixed income securities. These funds may be highly leveraged. The Index uses equal weighted averages of monthly returns funds reported by US and international investment managers and are grouped together based on primary strategy classifications contained in the HedgeFund.net Database.

*Key Risks: interest rate risk—bond prices will decline if rates rise; credit risk—bond issuer may not pay; income risk—income may decline; leverage risk—volatility and risk of loss may magnify with use of leverage*

**HFRI Equity Hedge (Total) Index.** The HFRI Equity Hedge (Total) Index tracks funds that maintain positions both long and short in primarily equity derivative securities. Equity hedge managers would typically maintain at least 50% exposure, and may in some cases be entirely invested in, equities – both long and short. HFRI Equity Hedge (Total) is a fund weighted index and reflects monthly returns, net of all fees, of funds that have at least \$50 million under management or been actively trading for at least twelve months.

*Key Risks: stock market risk—prices may decline; industry risk—adverse sector performance may cause declines; leverage risk—volatility and risk of loss may magnify with use of leverage; currency risk—unfavorable exchange rates may occur*

**HFRI Macro (Total) Index.** The HFRI Macro (Total) Index tracks managers which trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard currency and commodity markets. Managers employ a variety of techniques, both discretionary and systematic analysis, combinations of top down and bottom up theses, quantitative and fundamental approaches and long and short term holding periods. The HFRI Macro (Total) Index is a fund weighted index and reflects the monthly returns, net of all fees, of funds that have at least \$50 million under management or been actively trading for at least twelve months.

*Key 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*

**HFRX Fixed Income –Credit Index.** Includes strategies with exposure to credit across a broad continuum of credit sub-strategies, including corporate, sovereign, distressed, convertible, asset backed, capital structure arbitrage, multi-strategy and other relative value and event-driven sub-strategies. The index includes funds that have at least \$50 million under management and a 24-month track record (typical).

*Key Risks: interest rate risk—bond prices will decline if rates rise; credit risk—bond issuer may not pay; income risk—income may decline; leverage risk—volatility and risk of loss may magnify with use of leverage*

**S&P 500 Total Return (TR) 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.

*Key Risks: stock market risk—stock prices may decline; country / regional risk—world events may adversely affect values*

## **INDICATOR DEFINITION, DESCRIPTION AND RISKS**

**S&P Diversified Trends Indicator (DTI).** The S&P Diversified Trends Indicator is a composite of 24 highly liquid futures grouped into 14 sectors, evenly weighted between financial and physical commodities.

*Key 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*

***If used in the promotion of an investment company product, this report must be preceded or accompanied by the current prospectus for the Fund.***



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