



ALTEGRIS FUTURES EVOLUTION STRATEGY FUND MANAGER

David Harding

Founder and President of Winton Capital Management

Mr. Harding founded Winton Capital Management in 1997, and continues to lead the firm's research efforts. He was previously one of the founders and principals of Adam, Harding & Lueck (AHL), a systematic commodity trading advisor formed in 1987 that was later acquired by The Man Group. Before that, Mr. Harding assisted in the development and marketing of futures fund management services at Brockham Securities, served as an Associate Member at Sabre Fund Management, and was involved in gilt trading and sales at Johnson Matthey & Wallace. He began his career trading futures at Wood MacKenzie in 1982.

ABOUT THE SUB-STRATEGY

- + The strategy leverages its founder's pioneering role in systematic trend following trading.
- + The firm takes a scientific, inter-disciplinary approach to research and investing.
- + Winton is a commodity trading advisor with assets under management of more than \$25.6 billion as of Dec. 31, 2012.

Trend following innovator Winton applies financial mathematics to managed futures markets

Winton Capital Management is one of the managers accessed by the Altegris Futures Evolution Strategy Fund. Following is a Q&A about Winton's philosophy and expertise managing a strategy substantially similar to that which is accessed by the mutual fund.

ALTEGRIS: What is your background and the history of the firm?

WINTON CAPITAL: Originally, I studied physics at Cambridge University. I left in 1982 and went to work on the floor of the London Financial Futures Exchange, which was the first financial futures exchange outside the United States. I started working on the day that the exchange opened, and I've been trading futures ever since—well over 30 years. From the very beginning, I was very interested in the research process—in using math, scientific methods and computing to study data and numbers, and look for ways of forecasting the probability of different future returns occurring.

We can't forecast prices—nobody can forecast the future perfectly. But it is possible to make statements to a limited extent about the probability of different things happening in the future, and to “bet” on the probabilities. And I, in conjunction with my partners with whom I founded my first company, decided there was something in this technical analysis business. So we founded a company called AHL, which went on over the next 30 years to become the largest CTA in the world—until it was eclipsed last year by Winton Capital, which I founded 15 years after starting AHL.

The reason that both of those operations have risen to become large companies is the systems we have used have worked. And they've worked in the face of the overwhelming intellectual orthodoxy that says it is not possible to forecast prices by using price histories. That is exactly what AHL and

Winton have done. The method that we've used is called diversified trend following—a basket of trend following systems trading in stocks, bonds, commodities and currencies all over the world that seeks to capitalize on up trends and down trends by taking both long and short positions, and diversifying across markets.

ALTEGRIS: What is your investment philosophy?

WINTON CAPITAL: I have controversially said to existing and potential investors that I have never believed in trend following. What I *have* believed in—and continue to believe in—is the scientific method. I believe in the rigorous analysis of data, and making valid inferences from that data using the scientific method. It was by using the scientific method that we were able to make the strong inference 25 years ago that there were trends in markets—that when a market is going up, for example, it's slightly more likely to carry on going up, rather than reverse and go down. And if you correctly invest in those trends over a long enough period of time, across enough markets, you can make money.

It's not really such a surprising inference. After all, practically everybody uses the terms bull and bear markets as though trends exist. It's just that the financial orthodoxy had a theory that said there were no trends. But they hadn't looked at the data. What the data showed is that there were *trends*—and that is what we focused upon, and that's what has worked for the last 25 years.

I think the reason it has worked is because markets are human institutions, and, as such, they exhibit some human characteristics. They exhibit fear and greed. They also exhibit herd behavior. But my great faith going forward is not in the fact that trend following will work for the next 25 years, but the fact that the scientific method will remain valid. And by having, as we have here, a large team of scientists who use rigorous mathematical/statistical/scientific training to analyze data and draw

honest conclusions about that data. And using that as the basis for our strategy, we should be more successful than wishful thinking or making up stories—which is what so many people's investment strategies are.

ALTEGRIS: What are some examples of trends that you've observed and traded?

WINTON CAPITAL: One example was when Gordon Brown, then the UK's Chancellor of the Exchequer, decided to sell Britain's gold reserves. The Bank of England's gold reserves were sold at \$282 an ounce in 1999, and today, the price is \$1700 an ounce. If you look back over the period, there has been an almost straight-line rise from when the gold reserves were sold—and that is what we would call a trend. We haven't been positioned long all the time, but we have been long for most of the time. We haven't made money every year, but we've certainly made money overall from that sustained up trend. Similarly, we made money from the sustained down trend in the stock market that began in 2008, which lasted for the better part of a year. That was another detectable and pronounced trend—and we can potentially make money from those big trends.

Now, on the other hand, we tend to lose a lot of money when markets go sideways—when they go up and down and up and down, and our computer says, buy, sell, buy, sell. So I'm not suggesting that we have discovered some way of telling which way the market is going to go that is incontrovertible. We just have the potential in my view to make money more often than we lose it overall, over long periods of time. That's all.

ALTEGRIS: What is your primary competitive edge?

WINTON CAPITAL: Collaboration is absolutely essential to the idea behind Winton Capital. I attribute our success at managing money over a long period of time not just to the presence of trends in markets, but to

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having the scientific method necessary to understand and believe and design a system to exploit those trends. You actually have to have done it. It's not enough to look backwards and say what you should have done 30 years ago—everyone knows what you should have done 30 years ago. What we have achieved in the last 25 years is... we've actually done it! And we've done it because of science. What I'm counting on going forward is not more trends—though trends will no doubt be part of the way we trade. I'm counting on the fact that scientific research and large-scale scientific collaboration will pay dividends in a world with a large number of possible and interrelated investments to choose from.

We also have a very big research team—more than 100 people—that we have handpicked from different advanced branches of science. And these people work together in a collaborative way advancing a broad front of scientific discovery, in fields relevant to financial mathematics and its application to liquid trading markets. That's an important point to make: We only apply our analysis to liquid markets such as stocks, futures and currencies. There are many, much less liquid markets where there are lots of accountability risks with banks and so on, and we don't do any of those things. They're not amenable to our skill set.

We believe that we have a competitive advantage in the application of financial mathematics to liquid markets through long experience and the resources we're able to devote to it.

ALTEGRIS: What are the primary risks for the strategy?

WINTON CAPITAL: The risks are that you lose money. And there are two ways that you can lose money: One is quickly and the other is slowly.

The way that you run the risk of losing money quickly is if you're caught on the wrong side of a major market event. No amount of statistical analysis can predict 9/11 or something like that. So you obviously should not invest money unless you can afford to lose some. Losing money quickly will happen as a result of a complete out-of-the-blue surprise.

Losing slowly can happen as well—we call it death by a thousand cuts. Maybe there are too many people trying to do the same trades, so losses add up and our approach simply becomes expensive. Trend following is an active strategy—it buys and sells, it incurs commissions, it incurs slippage in the markets, it incurs management fees. So there are a variety of costs associated with it that can add up and result in losing money slowly.

I am in a position to push the company in the direction of taking calculated risks. We don't seek the lowest common denominator in terms of decision making here. Money management is a tough business, and the consensus decision about money management is usually not right. In fact, there's a saying that if you want to know the truth, find something that everyone agrees about and it's the opposite in investment management.

ALTEGRIS: What role can your strategy play in a diversified portfolio for an investor?

WINTON CAPITAL: Well, we haven't made much money, if any, in the last couple of years—but we haven't given up a significant amount of the gains that we made in the preceding years, either. And there are some circumstances in which we have the potential to be one of the better investments in somebody's portfolio over the next five or 10 years. There is obviously no assurance of that, but there are some circumstances—such as substantial declines in currencies or rises in inflation, which would be negative for stocks or bonds or investments from particular countries—where the conditions would be propitious for the sort of strategy that we run.

I would say that there is always room in a portfolio for a top-class investment manager who has some form of competitive advantage. And I think that Winton can fairly claim to have a reasonable competitive advantage in the application of financial mathematics to markets.

RISKS AND IMPORTANT CONSIDERATIONS

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