ALTEGRIS FUTURES EVOLUTION STRATEGY FUND MANAGER

Stanley Fink

Chairman and CEO at ISAM

Mr. Fink is Chairman and CEO of ISAM, which he joined in 2008. Previously, he enjoyed a tenure of more than two decades with Man Group, highlighted by leading the firm's IPO in 1994 as Group Finance Director and culminating with being named Group Chief Executive Officer in 2000. Mr. Fink also served as Deputy Chairman of Man until 2008. He was named to England's House of Lords in 2011.

ABOUT THE SUB-STRATEGY

+ A systematic, trend following managed futures trading strategy.
+ Approach has a 30-year track record of producing returns with low correlations to both broad market indices and other alternative investment strategies.
+ ISAM is a commodity trading advisor with almost $1 billion in assets under management as of December 31, 2012.

Longtime industry experience guides ISAM's leadership as it continues to enhance trend following strategy

ISAM is one of the managers accessed by the Altegris Futures Evolution Strategy Fund. Following is a Q&A about ISAM'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?

ISAM: I joined Man Group in 1987, when the company was a collection of businesses, including commodities and two financial businesses—one in futures and one a hedge fund business based on the systematic CTA (commodity trading advisor) style of trading of Mint Investments, co-founded and run by Larry Hite. I became finance director in '89, and Man did an IPO on the London stock market in '94 that I led, and then I took over as head of the fund business in '96. I had worked with Larry since I joined Man, but I worked with him particularly from '96 onwards.

I stepped down as Man's CEO in 2007 and stayed as a non-executive deputy chairman for a transition period until 2008. Then I left and helped found ISAM in its current form. And fairly soon afterwards, we signed a joint venture with Larry and started to implement the system that he had been running since the late 1970s. So our basic system and philosophy—a futures-based trend following system using sophisticated models—has been run in a reasonably continuous form since the late 70's, and it has actually been back-tested as far back as the Second World War. ISAM as a business has grown from 10 people to around 40 currently, with assets under management of almost $1 billion.

ALTEGRIS: What is the investment philosophy and trading style for the strategy?

ISAM: While markets appear to move in a random walk, when you analyze them deeply, you see that they have a slight tendency to trend. Which means that if the market goes up over a few seconds, a few minutes, a few hours or a few days, there is a slightly greater tendency for it to move in the same direction in the next short time period. Now that's not a permanent feature of every market; it's periodic and episodic. But it persists throughout time when you look across a lot of markets, and by using a series of different time scales (we use models that have at least 10 time-scale differences) and applying the system consistently across many markets (we use 70 or more), we have delivered something that has produced positive returns and a very decent Sharpe ratio[1] over the 30-plus years that it's been actively traded. Of course, past performance is no guarantee of future results.

We focus on futures that are liquid and traded on markets where we trust the counterparties. So it's typically markets within the Office of Economic Cooperation and Development countries, where there are reliable clearing mechanisms. We try to have a reasonably balanced portfolio between physical commodities and financial markets. We have a relatively high weighting to physical commodities, because we find that at certain stress points, they tend to correlate less closely with each other than do financial markets.

ALTEGRIS: How would you describe the process of developing new trading ideas for your program?

ISAM: If a new market becomes liquid enough to trade, we would research it and use data to check that the system worked within a reasonable scope in that market. Then we would back-test that trading using data over several years. We believe having a system that works across all markets is better than trying to finesse individual markets, because then you can't be driven by one-off factors that are not repeatable or predictable. Then we would perhaps run the system with no money in it, to see what the computer would do, and whether it performed in line with what we would expect through a period of time. And then if all of that worked, we would start to allocate client money to that market.

ALTEGRIS: What are the primary competitive edges for your firm and strategy?

ISAM: I think it's a very scalable strategy. While every individual futures market has limited capacity, the fact that there are 70 or more markets, and many of them are financial markets as well as commodities, means you can get real diversification between them. At the same time, because we're relatively small and nimble, we can take exposure to some of the smaller markets that our larger peers can't. We also have significant liquidity—because of our size, we can exit most of our positions in a few minutes. In addition, we're pure—we stick to trend following. We don't do other strategies.

More broadly, our strategy has a low historical correlation to other hedge fund styles, and it actually has a slightly negative correlation to stock market returns. So that means it's generally good for our strategy when there's a crisis and the stock market melts down. Diversification is key—it's as close as you get to a free lunch in financial markets.

One of the things about being in the industry for a long time is you've lived through periods where the strategy underperforms one or two other investment categories. And, to be honest, very recently has been

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such a period, where the strategy is down because the markets have been choppy. But sometimes newer managers are tempted, if the system doesn't work for a year, to either change the system or look at operating slightly different systems in different markets. Having been around the business for 25 to 30 years, like Larry and I have, gives you the courage to live with the pain of some short-term poor performance without trying to radically adjust everything. What you have to do instead is a series of minor improvements, each one carefully tested before it's implemented.

ALTEGRIS: What are the primary risks involved in pursuing your strategy?

ISAM: I think the primary risk is a significant period in which markets don't trend and move sideways, as we have seen recently. There can also be freak events like a 9/11 or a Japanese earthquake, where a lot of markets move much more severely than back tests would show you. If something like that happens out of the blue, it can have a very positive or negative effect—it can be purely random based on the positions held at the time. But, to be fair, these types of events would affect almost all strategies.

In contrast, there are also scenarios like the buildup to the Gulf Wars where there was a warning that they were coming. When scenarios build over time, once an event finally occurs, our systems can make a profit. That's an attribute that helps this strategy diversify traditional portfolios.

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

ISAM: I think that for an investor who's long-only, by adding an element of managed futures, you can potentially have an enhanced return for the same level of risk, or you can have the same return at a lower level of risk, depending on how you blend the portfolio. But, overall, you can potentially improve your risk-return ratio. Also, if you go back to some of the worst periods in the markets, it would be quite good for our system. Of course, there's no guarantee that any investment will achieve its objectives, generate profits or avoid losses.

Our systems tend to adjust quite well for pure volatility, in that they try to take a constant value at risk. So if volatility increases, the systems just scale the positions, and vice versa. But if a market is sideways and choppy, that makes it very hard for us to make money. However, on a historical basis, the darkest hour is often before the dawn—it is after these choppy periods that some amazing trends started to emerge.

I believe that we're potentially at one of those points currently. The world will come out of the recession, and the trends will be very interesting when that happens, in my view. But our systems won't take that viewpoint, of course. They will just follow the weight of money and the direction of markets.

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1. Sharpe ratio is a measure of profit per unit of risk. The higher the ratio, the better a portfolio's risk-adjusted performance.

RISKS AND IMPORTANT CONSIDERATIONS

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