OPALESQUE

Opalesque

# Managed Futures Roundtable

CHICAGO

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# Editors' Note

Dear Reader,

Our best product ideas are coming from our clients.

Our clients – you! – did suggest in early 2008 to start the Opalesque Roundtable Series with the aim of portraying the world's leading financial or alternative asset management centers. Opalesque Roundtables are actually the only ones that are produced by "real-world" get-togethers of the participants at the respective jurisdiction or region. This personal, on-the-ground meeting and interaction is vital for an authentic discussion and the think-tank like outcomes of our Roundtables.

In 2009 we launched the Opalesque Futures Intelligence with the help of Chidem Kurdas, Ph.D. Also this publication was suggested from our readers, as - after the demise of MARHedge - the managed futures and CTA-community was not covered by a professional trade publication. Both our Roundtables and the Opalesque Futures Intelligence have well over 40,000 readers each.

Today – and you guessed it: following readers' suggestions – we present you our first Opalesque MANAGED FUTURES Roundtable.

**As we discovered in this Roundtable, the level of interest in managed futures after 2008 spiked significantly. It is encouraging to see investors that have historically shied away from managed futures taking a thoughtful approach to this strategy. They are not simply chasing the "hot dot" or trying to merely boost returns, but rather follow a much more measured approach.**

**Historically, managed futures were often put into the hedge fund category. But after 2008, this can no longer be intellectually and quantitatively justified. More and more investors have carved out a new investment slice in the pie - managed futures. This is a systemic change going forward, and the participants of this Roundtable believe we won't go back to the old thinking in that regard.**

This Opalesque Managed Futures Roundtable was sponsored by the CME Group and took place October 20th 2009 at the CME Group office in Chicago with:

- **Ernest Jaffarian, President and CEO,** Efficient Capital Management
- **Steve Wolf, Co-Chairman,** Tradelink and DigiLog Capital
- **John FitzGibbon, Managing Director,** Lighthouse Partners
- **Aleks Kins, President and CEO,** AlphaMetrix Group, LCC
- **Joseph A. Canepari, President,** Rotella Capital Management
- **Dr. Francisco J. Vaca, Chairman and CEO,** Vaca Capital Management
- **Brian Proctor, Managing Director,** EMC Capital
- **Rick Redding, Managing Director,** CME Group

Enjoy "listening in" to the new Opalesque Managed Futures - Chicago Roundtable!

Matthias Knab
Director Opalesque Ltd.

knab@opalesque.com

Cover Photo: "The Bean" in Chicago's Millennium Park

# Participant Profiles

(LEFT TO RIGHT)
Rick Redding, Aleks Kins, Joe Canepari, Steve Wolf, John FitzGibbon, Dr. Francisco Vaca, Ernest Jaffarian, Matthias Knab, Brian Proctor

# Introduction

**Ernest Jaffarian**
Efficient Capital Management

I am the  CEO, President and Founder of Efficient Capital Management. Efficient Capital Management is a firm that specializes in the CTA space, running multi-manager portfolios on behalf of institutions and high net worth individuals. We currently allocate notional trading assets of a little over $2 billion to CTAs.

**Joseph Canepari**
Rotella Capital

I am the President of Rotella Capital Management.  Rotella is a CTA and proprietary trading firm with offices in Chicago and Seattle.  The firm researches and develops quantitative trading strategies, which are supported by advanced technologies.  It was founded in 1996 by Robert Rotella after he served as a Senior Portfolio Manager with Commodities Corporation.  We manage approximately $500m of client assets via two systematic strategies: Polaris, our flagship diversified trend following strategy that has been trading since 1991, and Orion which is designed to identify short-term profit opportunities in global markets.  Our proprietary trading activities currently include twenty systematic programs that run the gamut from high frequency trading to relative value strategies.  We employ fifty people and the majority of those professionals serve in research and technology roles.

**Dr. Francisco Vaca**
Vaca Capital

I am the CEO and CIO of Vaca Capital Management. Vaca is a quantitative asset management firm founded in 2000. We have two trading strategies, the first is an intraday, high-frequency trading model we use to trade equities listed on the NYSE and NASDAQ exchanges. The second is a global diversified managed futures program  CTA .

**John FitzGibbon**
Lighthouse Partners

I am a Managing Director with Lighthouse Partners and a member of the firm's investment committee. Lighthouse Partners is an alternative investment manager headquartered in Florida with offices in Chicago, New York, London, and Hong Kong. Lighthouse was founded in 1999 and currently manages approximately $5 billion across nine different fund of fund products. Lighthouse has built a proprietary managed account program with over 80 funded investments, which serves as the hallmark of its investment process.

**Aleks Kins**
AlphaMetrix Group, LLC

I am the President, CEO, and Founder of AlphaMetrix, an independent managed account platform specializing in liquid alpha strategies. Our core offering is building and operating managed account solutions for institutional investors, such as funds-of-funds, banks, advisor networks and high net worth investors. Unlike many of our peers, we do not create products, preferring to invite other asset managers to build their own fund-of-funds, indices or baskets on our platform. We currently offer more than 60 managers, mainly CTAs, F2  and Global Macro, and are beginning an aggressive expansion into other liquid alpha hedge fund strategies. In addition, we have an electronic platform offering near real-time performance tracking and analytics and groups providing due diligence, financial investigations and risk management. We started the firm in May of 2005 and the platform now has nearly $2.2 billion in assets.

**Brian Proctor**
EMC Capital Management

I am a Managing Director at EMC Capital Management. EMC is an alternative asset investment management firm that enjoys one of the longest running positive performance records in managed futures, with a track record dating back to 1985. Our "trading" investment strategy employs quantitative, systematic trading "strategies" over multiple time frames in a broadly diversified portfolio that includes global financial instruments, currencies, precious metals, base metals, energies, agricultural commodities and stock indices. Our clients include institutional and private investors in the U.S., Europe and Asia.

**Steve Wolf**
Tradelink, DigiLog Family of Funds

I am the Co-chairman of Tradelink and DigiLog Capital. We started the firm in 1979, and are based in Chicago; we also have a London office and employ around 200 people in total. Our company started as a proprietary trading firm - TradeLink. In 1996, we formed DigiLog Capital, which is the asset management side of the business, as a means to invest outside capital along with our own. The first strategy we offered was a CTA program, the DigiLog Full Portfolio, and have since also launched some additional hedge funds. We trade across a wide array of markets and time frames both in the prop space and in the managed money space.

**Rick Redding**
CME Group

I am Managing Director for Products and Services at CME Group, which is the world's largest derivatives exchange and it has products in every asset class. It is the consolidation of the CME, CBOT, and NYME2 and if we have to talk about how much we traded, we traded over a quadrillion dollars last year.

**Matthias Knab**

**And that is a real word, quadrillion?**

**Rick Redding**

Yes, it is a real word.

**Matthias Knab**

**What opportunities do you see at the moment in the managed futures space? Which opportunities are you pursuing in your firm, and what are of the new products that you are developing?**

**Joseph Canepari**

Our firm is an excellent case study of how a veteran CTA can evolve over its history. Rotella was founded with an intermediate-term, trend-following strategy called Polaris. Given that the strategy is systematic and its implementation is heavily dependent on technology, the strategy has evolved a great deal since its inception due to the many technological innovations that have taken place during its 18 year existence. Advancements in computing power, data storage and the migration of futures markets to electronic trading have had a profound impact on quantitative investment managers. In our case, we have been trading in a touchless or STP fashion since 2005 - our trading engines are co-located at several of the exchanges where we are members. The infrastructure and trading efficiency that STP provided has allowed us to expand our research into shorter duration strategies. The launch of our directional short-term Orion program is a direct result of such advancements.

Over time, the scalability of our research and trading infrastructure led to a significant expansion of the programs we trade and the nature of the firm itself. Whereas Rotella was largely an asset manager in its early history, it evolved into a multifaceted enterprise with distinct business functions that include asset management and proprietary trading activities.

Our prop trading activities complement and enhance our asset management activities. In addition to our public strategies, we have approximately twenty distinct strategies that we trade exclusively with prop capital. These activities provide three benefits. First, the prop capital provides a proving ground for our research, some of which will be used for our existing public strategies. Second, prop trading strategies can evolve into distinct trading programs to be held out to external investors. For example, we are now offering a futures based RV strategy named TEXO to the public. TEXO has been trading since 2007 and currently has $30m in firm capital in the strategy. The last benefit of our prop trading activities is that the return characteristics of these activities are complimentary to the return characteristics of the strategies in our asset management arm. The result is a more stable source of profits/revenues to operate and build the business with.

**Dr. Francisco Vaca**

We focus a lot of our research efforts on optimizing our trading models. For example, the liquidity in the markets we trade can decrease, which could translate into increased slippage. We are doing research to improve our slippage through algorithmic trading; which we believe can add substantial value to our models.

**John FitzGibbon**

In January 2007, we completed the transition of the Lighthouse Global Long/Short Fund strategy from being a fund of commingled hedge funds to a product built on managed accounts. In July of that year, we launched the Lighthouse Enhanced Global Fund, a managed futures fund with a key focus on short-term trading; that is, 90% of its managers are engaged in short-term futures trading. We believe that the opportunity set for short-term, high-frequency futures trading is not only relevant over longer periods of time, but particularly in this higher volatility environment, which fits well into larger asset allocation frameworks.

In January 2009, we launched the Lighthouse Navigator Fund, a multi-strategy fund of hedge funds solely dedicated to managed accounts. It is a very attractive proposition now as investors are seeking more transparency and better asset protection, not only in managed futures, but across all hedge fund strategies. There is a high level of investor demand to be able to drill down into the underlying exposures and to mitigate to the extent possible non-market risks, which may otherwise exist in the alternative asset industry.

**Joe Canepari** How many names do you have in your Navigator Fund?

**John FitzGibbon** We have roughly 50 managers in the portfolio presently.

**Aleks Kins** At AlphaMetrix, we continue the path we started roughly four-and-a-half-years ago with the idea of building an infrastructure, a system of checks and balances, designed to take the risk of fraud out of investing in alternatives.

For investors, we are a turnkey solution to outsource managed accounts at low cost. For managers and trading advisors, we support their operations and serve as a conduit for distribution.

We focus on liquid alpha strategies that can be priced in near real-time and provide the infrastructure, tools and services that allow the investor to spend more time analyzing trading strategies and less time aggregating data, working with service providers, and so on. Investors and fund-of-funds basically outsource these tasks to AlphaMetrix in order to spend more of their time creating and managing portfolios.

So while we are moving into other liquid alpha strategies, our story has been managed futures, managed accounts and technology. When we started, managed accounts and managed futures were popular within a certain circle, and that circle has greatly expanded due to the events of last year. If you think about it, managed futures have for a long-time been touted as a diversifier to all types of portfolios, and last year many large institutional investors across the globe really saw that it was more than just hype.

From an allocator's perspective, not only did last year's market declines make managed futures very popular, but with Bernie Madoff and the like, the advantages of using managed accounts for transparency, liquidity and custody of assets became more and more relevant.

But what many investors are realizing is that a managed account by itself is not necessarily a cure-all, because if the accounts are not monitored, then there could be greater liability and greater risk than within a limited liability structure.

We see ourselves as a solution provider offering the following three cornerstones: technology and infrastructure, legal structures and managed accounts.

On top of that we perform substantial research and due diligence. Last year, we started a company called AlphaMetrix Financial Investigations, where we brought on board the former Assistant Special Agent in Charge of the Chicago Field Office. He and his team have been instrumental in helping us learn that a true background check is more than a database search, how in a real financial investigation you follow a trail. We designed this group to better know the parties we work with, but due to outside demand, we have been opening up this service to outside clients.

We all try very hard to rid ourselves from any sort of conflicts. We are not an allocator, we do not run fund-of-funds, we are not a broker and we don't have proprietary trading. We are not anything but a managed account solutions provider. That has allowed us to team up with a very large number of different types of partners ranging from sovereign wealth funds to pension funds to wealth management groups looking for managed accounts. At the moment, we have about 110 institutions out of a total of 800 investors, with four bank networks bundling accredited investors into our structures through a private labeling format.

Having grown so strong in managed futures, we are also now extending into other liquid alpha strategies beyond managed futures, such as long/short equity funds.

**Dr. Francisco Vaca**

One of the things that concern me in this rush towards managed accounts is that we, as a manager, may give up too much control of the account to the investor.

As an example, suppose we manage $5 billion and one of our largest clients has a billion dollar managed account. Should they decide to take control of the assets and liquidate themselves at the worst of times, what happens to the other $4 billion of our clients?

We provide daily liquidity and have implemented algorithms to allow orderly liquidations of the account which may allow us to liquidate positions with low impact on the markets.

We know that while the instruments we trade may be liquid generally speaking, they may not be liquid every second. With this rush towards managed accounts, a new risk may emerge where a panic liquidation of one of our clients can trigger all kind of stops which can eventually create a very scary scenario.

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**Dr. Francisco Vaca**

While you may think such an event will probably never happen, in August 2007 we had a quasi-similar situation in the quant space. Different shops were running similar strategies with similar positions, and when one of them began to liquidate, stops were triggered for others and others were forced to liquidate as well to meet margin calls. I am a bit scared to see such scenarios repeated, which could be triggered through disorderly liquidations from a managed account holder.

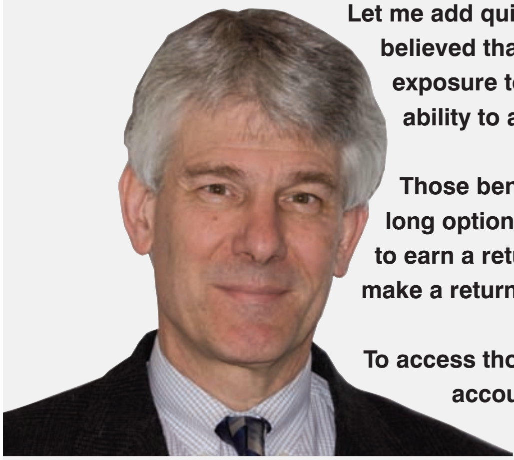
**Matthias Knab**

**Ernest, may I ask you to address this issue first, because one you are a veteran investor and secondly a bit unbiased, as you are not a managed account provider....**

**Ernest Jaffarian**

To give the appropriate framework, let me add quickly that Efficient Capital was founded over ten years ago because we believed that the academics had it right. Every well-balanced portfolio should have exposure to managed futures. We do think it is important to continuously improve your ability to access the benefits that are unique to the managed futures space.

Those benefits are well-known. The liquidity, the transparency, and in many cases, the long option-like, or a long gamma, the synthetic gamma-like profile which does not seek to earn a return based on taking credit risk or liquidity risk or default risk, but aims to make a return based on trader skill.



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**Ernest Jaffarian**

To access those unique benefits in the managed futures space requires the  managed account format. Once you have invested through the fund structure, many of the benefits that are unique and embedded in the managed futures space go away. That does not mean that the investment is a bad investment, it can still be a very good investment. It does mean, however, that you are leaving significant benefit opportunity on the table.

**Matthias Knab** **Like what, for example?**

**Ernest Jaffarian**

Like the ability to actively monitor risk, and to balance the positions. The perspective we just heard from Francisco is a perspective as a single manager. If a single manager has 5% of the investor's total portfolio exposure, and there is a need to balance and adjust, this will not be a  question of liquidating a massive account with one particular manager. It is a matter of making incremental adjustments.

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**This is where a firm like Efficient Capital really comes in. As a matter of fact, we view ourselves principally as a trading firm, not as a fund-of-funds. We think of ourselves as running the equivalent of a virtual proprietary trading desk.  As a responsible investor, I don't think you would say: "Well, the market conditions have changed, so I am going to fire all my proprietary traders, and will just go out and hire a whole new batch of proprietary traders."**

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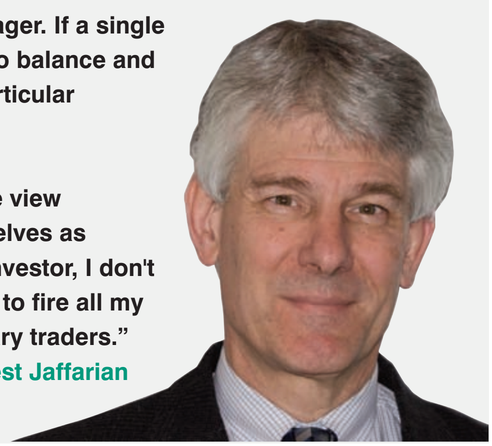

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Our portfolio engages more than 40 managers in order to achieve optimal returns for investors, and we continuously balance, adjust, and monitor for risk. Francisco would probably agree that a good trader will adjust his exposure depending on the market volatility, or adjust his positions relative to the correlation of one trading model versus another. We are continuously doing this.

As a trading firm, we utilize the ability to implement fundamental, sound trading principles in running a multi-manager portfolio. That is only possible with a managed account.

**Joseph Canepari**

In our experience, our clients ask us as the manager to execute trading level adjustments or liquidations. Ernest, how do you operate your relationships with your mangers – would you execute trading level changes or would you charge the manager with making those changes? For example, if you wanted to reduce an allocation by half, who would rebalance the underlying portfolio?

**In our experience, our clients ask us as the manager to execute trading level adjustments or liquidations.**

**Joseph Canepari**

**Ernest Jaffarian**

It would be a stunning event to reduce a manager by half. We rely on the managers to execute position changes within their systems. They are best prepared to do that. For example, if we are taking a manager from $30 million to $35 million or $25 million because of changes in volatility, or to rebalance the portfolio, or for whatever reason, the managers would execute in the way they believe is most beneficial to the investor.

**Joseph Canepari**

The method you employ is in line with the experience we have had with our clients. Assuming this approach remains industry convention, that should alleviate some of Francisco’s concerns because the managers are able to implement those changes themselves by using their execution algorithms which should mitigate market impact.

**Ernest Jaffarian**

Managers are very attuned to providing their returns and trading skill in the maximal way to the benefit of their clients, which is precisely the reason they are receptive to managed accounts in general. If they are providing no pass-through benefit that improves the client’s position, then managed futures does not make sense to them; but if they see how it is being used responsibly for the benefit of the client, there is a great receptivity to operating in that way.

**Dr. Francisco Vaca**

Of course, this is just a hypothetical question, however, over the last 12 months we have seen things we thought we would never see. We have seen a rogue trader within a French bank who liquidated positions in the middle of the night, and so on. Within finance and investing, new risks or risk potentials come up all the time - and I am just pointing out that with the increased use of managed accounts, new risk potentials may be created at the same time. I do hope that all our clients allow us the privilege of liquidating their manage account in an orderly fashion.

**John FitzGibbon**

I’d like to address Francisco’s concern about a managed account asset owner potentially liquidating an investment to the detriment of the manager’s main fund vehicle. I think if you look back at the experience of the vast majority of managed account asset owners, their impact on the strategies in which they are invested was de minimis, and as Ernest rightly points out, the vast majority of changes in allocations are executed through the manager that the asset owner has engaged.

It is important to recognize that the interests between the asset owner/client and the manager are aligned. The client does not want to lose its capital and wants to keep the NAV at the highest level possible, while executing changes exposures in the most efficient manner possible.

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**The issues we faced with the quant liquidation in 2007 and in 2008 with the more general financial liquidation and de-leveraging was more a consequence of changes in the stability of the overall capital base.**

**As long as a manager's capital base was sound, there was no need to liquidate, but there were knock-on effects of the more levered players who had their financing pulled and were forced to liquidate. You can't really say that managed accounts were responsible for that. The overwhelming majority of liquidations were either fund-based investments or some other financially engineered structure..**

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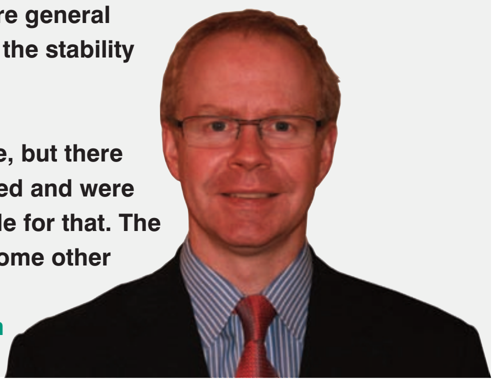

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**If you actually examine the last two quarters of 2008 and the first quarter of 2009, there was an interesting dynamic. At AlphaMetrix, we were anticipating what is called the ATM effect, meaning that investors like funds-of-funds would turn to us if they needed cash, as their money was in liquid managed accounts. While some of that actually happened, as a firm we actually experienced our biggest growth during that period. In fact, investors redeemed from other fund structures in order to avoid lockups. Even if that strategy or fund was fine, they put out their notice just to have control and timely access of the assets. Some of them then came to us with this money, and since in most cases investors on our platform are never more than 15 days away from their money, they said, "We know we can park it here, because we know we can get it back." But then they stayed.**

**Our experience is that when investors have the security of knowing they can get their money back when they need or want it, they use this right less.**

**Aleks Kins**

**Aleks Kins** Conceptually, Francisco has a valid point about investors heading to a free exit, but if you actually examine the last two quarters of 2008 and the first quarter of 2009, there was an interesting dynamic. At AlphaMetrix, we were anticipating what is called the ATM effect, meaning that investors like funds-of-funds would turn to us if they needed cash, as their money was in liquid managed accounts. While some of that actually happened, as a firm we actually experienced our biggest growth during that period. In fact, investors redeemed from other fund structures in order to avoid lockups. Even if that strategy or fund was fine, they put out their notice just to have control and timely access of the assets. Some of them then came to us with this money, and since in most cases investors on our platform are never more than 15 days away from their money, they said, "We know we can park it here, because we know we can get it back." But then they stayed.

Our experience is that when investors have the security of knowing they can get their money back when they need or want it, they use this right less. And if they are stuck with lockups, gates and hurdles, they will often proactively pull out from those less liquid directions.

You could argue that in a perfect world all investors would have their own managed accounts, but we know that this can't be true, because it would turn trading advisors into operations firms and it's just too complex to build and operate too many of these structures.

Therefore, one of the main ideas behind AlphaMetrix are what we call "pooled" managed accounts, which allow trading advisors to offer much lower minimums without any increase in operational complexity.

**Matthias Knab** **It is quite an irony that in some cases, the managed account money has turned out to be the sticky money, while in many cases investors who potentially faced gates, lock ups and change of terms preemptively got out, even if they liked the fund and it performed....**

**Brian Proctor** Let me go back to the question about developments and current events at our firm. We are a research and trading firm, so the primary developments that happen at EMC happen on those two fronts. EMC uses a quantitative approach to research that incorporates our expertise in trading and years of experience in research. The research process that we have been refining for years has now been systematized using current technology and advanced testing methods. This has been and will continue to be an ongoing process. Markets and market participants are continuously evolving, and our models must adapt to the changes in the markets we trade in order to remain viable.

We optimize trading systems and incorporate risk management techniques in a number of ways. First, we use out-of-sample data testing over discrete time frames to generate trading system parameters on an annual basis. This method helps to avoid the potential pitfalls of curve fitting. The parameters of the trading systems are determined using genetic algorithms running through a distributed processing cluster of computers. This process allows EMC to run the optimization process with far greater speed and efficiency, which in turn produces more reliable and reproducible results.

EMC employs a blend of independent, non-correlated systems in its portfolio. We set robust performance targets for each system and add systems that diversify the portfolio and that make a unique contribution to the blend. Each system is optimized to a unique supervalue that can be any weighted combination of performance metrics over different time periods. The diversity of systems in our portfolio allows us to capture profit opportunities in different ways and in different market environments.

Moving from developments in research to developments on the trading side, EMC has focused on advanced execution techniques on the electronic platforms we are trading on. Since 40% of EMC's portfolio is in commodity futures markets as opposed to financial futures markets, there is more expertise required in executing in those markets as the liquidity is usually not as deep. We have built several algorithms that allow for the best possible execution in those markets so that actual trading results are as close as possible to the hypothetical results generated in research.

**Matthias Knab** **How many programs do you have?**

**Brian Proctor** We have two programs right now - the Classic Program, which is a broadly diversified program trading 84 markets across the globe, and a Currency Program, which manages a portfolio of major and emerging currency markets. We are also working on a request to create a Commodities-only futures program.

**Steve Wolf**

Since we started as a proprietary trading firm, we have long maintained an approach which assumes that good choices for our effort and capital, will match the needs of a large group of investors.

At the moment, we see opportunities in the short-term, high frequency trading arena, which really is something that did not exist 10 years ago and continues to evolve daily. One of the advantages of our firm is that we have been actively pursuing quantitative based opportunities in the markets for the last 30 years. We started to build our current systems infrastructure about the time the Chicago exchanges allowed computers on the trading floor.

We continue to add to this infrastructure with the goal of making the most valuable data easy to access for the research and trading staff. We have also developed software which allows new strategies to be quickly plugged into the common execution platform. The execution logic is now becoming as important as the trading strategy itself.

**Joseph Canepari**

It is interesting to me that the managers are saying similar things. I don't know if I should be comforted by that or concerned. But seriously, when I reflect for a moment, I would certainly say that the story of our firm and the industry is the transformative effect of technological advances. In many respects, the industry has become a technology business.

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**Ernest Jaffarian**

I would like to challenge your statement here. There is no denying the fact that technology has dramatically changed the CTA world, created a breadth of opportunity that did not exist even a few years ago, created a number of unique and different trading strategy opportunities that by now have proven that they have the ability to extract Alpha. Nevertheless, there is a growing group of highly successful and talented fundamental traders trading on the full range of time frames.

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**It is quite interesting for me to see fundamental traders who rarely hold a position more than 10 minutes, who trade a broad range of markets in ways that historically have not been thought of as centered around a global macro set of fundamentals. You could almost say they trade more through a sort of floor-trading methodology.**

**Ernest Jaffarian**

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So I just want to add the corrective word that while there has been an increased level of depth on the technological side, there is an interesting development on the non-technological side in this space as well.

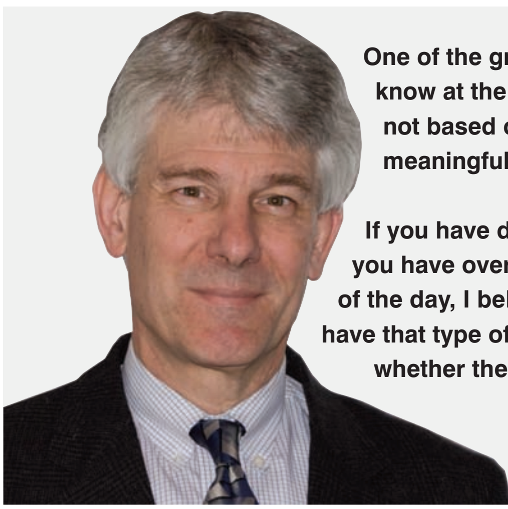
**Joseph Canepari** That's a good point, but clearly systematic strategies are responsible for the bulk of the trading volume on many of the futures exchanges.

**Aleks Kins** I agree very much with Ernest. From AlphaMetrix's perspective we see a growing number of fundamental traders who are not by definition systematic, but because they are not systematic does not mean they are not benefiting from technology. As Ernest pointed out, a lot of these managers can trade in a ten-minute frame.

Back when PCs were not as powerful, information was harder to come by and databases were limited, fundamental traders could really only cover a few markets. They specialized in a certain market or instrument. But now, with the advent of powerful technology and low-cost execution options, some fundamental traders trade a larger number of diversified markets than do the systematic trend followers.

**Matthias Knab** **A lot of CTAs and managed futures firms will of course claim that their technology is superior and that it is part of their edge. How do you know this is true? When you look at the shop, how do you actually evaluate their technology? What are you looking at?**

**Ernest Jaffarian** One of the great things about the CTA space is that it is liquid and transparent, and you do know at the end of each day precisely what the liquidating value of the portfolio was. It is not based on the three best bids. So you can get data that is real, verifiable, and meaningful, in reasonably high frequency.



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**If you have data on a manager that has been actively managing real money for five years, you have over 1,200 data points. That is enough to start doing some real math. At the end of the day, I believe that experience is a huge factor in the success of a trader. When you have that type of data over extended periods of time, you really can mathematically decide whether the trader has a basis for being considered.**

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Having said that, our experience tells us that if a trader does not have a world-class execution methodology, if they do not have an active and ongoing research effort, if they do not have an infrastructure that can support the operation under all market conditions. . . well, they must have these! Another set of criteria are the "soft factors," such as a strong character, experience, and what we call a brilliance factor.

**John FitzGibbon** I agree that character is very important and both the investment and operational due diligence teams at Lighthouse seek to insure that we are in business with managers who exhibit the highest levels of integrity. In terms of technology, you tend to build up a strong library of internal knowledge as well as some level of expertise of the various technologies that your managers are employing.

I think Ernest is exactly right that identifying a statistically measurable edge is one of the benefits of investing via managed accounts. The explosion in the number of data points goes far beyond just the daily P L stream. Being able to combine multiple return streams and create different data sets allows you to improve your asset allocation process.

As I said, the allocator is forced to have a level of expertise in applicable technologies. This includes an understanding of all of the different moving parts, specifically as it relates to futures, but also across the strategies and their integration with the prime brokers and the executing brokers.

It is true that most allocators are not really in the business of implementing security level technologies. However, we have spent years building our managed account program and the technology around integrating daily position level data.

**Matthias Knab** **Can you give me more background or details, how would you know if a firm really deploys world-class technology?**

**Aleks Kins** This is very pertinent question to what we do as a firm. We see it as a two-fold question. First, what role does technology play in giving the trading advisor an edge, and second, are they using the right technology to protect their company, its investors and partners?

Because we develop our own proprietary technology, we know what programming languages are the latest and greatest, what the limitations are, and what the security issues are out there. Thus, when we conduct operational due diligence on a trading advisor, we have the tools and the experience to evaluate how they have developed their programming, their IT network and so forth.

I mentioned before that former US Secret Service agents lead AlphaMetrix Financial Investigations. Everybody thinks of that these agents, with the wires in their ear, as only protecting the President. In fact, up until the Department of Homeland Security was formed, they were part of the United States Treasury, and one of the their mandates was preventing financial crimes, a largely technology-driven effort.

With the new group, we can now focus more on how hedge funds and CTAs deal with cyber risks. How vulnerable are they to hackers or internal threats? How vulnerable is the systematic trader or the quant shop to a disgruntled employee who is a senior developer or programmer? What if a foreign-based criminal organization decides to make the firm a target? We are taking steps to figure out how strong, how fortified is the individual firm and then take further steps where we help trading firms augment their capabilities.

**Ernest Jaffarian** Your question about technology is an example of a question that seems initially quite simple but in actuality is not so straight-forward. Consider, for example, a very good trader who on average makes a single trade once every three months. His demand on the technology side would be minimal compared to a trader who makes a trade every three seconds.

In short, the technological capability of a manager has to be evaluated in conjunction with his trading methodology. As we said, over the last few years there has been a huge advance in high frequency trading. It used to be that short-term traders were people who traded under three days. Now you could say it's under three minutes.

If you are a trader that trades with that type of velocity, you better have your server sitting at the exchange. If you say that you can make money and trade every few seconds and you do not have a server sitting in at the exchange, you are fooling yourself. So technology has to be evaluated relative to the nature of the trading methodology of the manager.

**John FitzGibbon**

Correct, it is important that the technology resides in an appropriate location to minimize latency and improve execution. As managed account owners, we push ourselves to make sure that we have risk management systems that operate virtually in real-time. As trades happen more frequently, we want to be informed and have the ability to react more quickly if necessary.

I also would like to commend CME on remaining on the cutting edge of allowing traders access to Fix protocol. They have a world class staff that is focused on not only driving their volume, but doing it in a way that maintains the integrity of the exchange. The CME continues to be a very good resource for high frequency trading.

**Rick Redding**

What we try to do, from an exchange perspective, is to provide technology to the people that need the high frequency trading the most. And if you provide this technology standard, what happens for people downstream? Firms like yours will provide more liquidity, and people that do not trade as frequently benefit from that liquidity.

When you think about the difference between securities markets and futures markets, most of the quantitative trading in the securities markets is really about order management. Because there are so many different pools of liquidity, the question is how to access best this liquidity? The futures side is really about pure quantitative trading and strategies. At CME Group we work hard to bring the latencies in the match engine down as much as possible. Why? The faster you can process trades allows people to create an infinite number of new strategies. But, if trading was just about speed, then we may end up with a market structure where there are only survivors at the end of the day.
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**And by the way, there is another fundamental difference to securities world – in the futures arena, you have actual global benchmark products. This further diversifies the strategies, as someone sitting on the other side of the globe may be probably looking at a much different trade than someone sitting in Chicago or New York. This is a great advantage for everyone in this room, because now you can come up with an infinite number of strategies.**

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**Steve Wolf**

It is so interesting to watch the evolution of the market place as the CME and other exchanges have made the transition from a very slow and limiting floor system to a system where the acknowledge times are measured in milliseconds. This has changed strategies – for example approaches which may have only been viable in long-term horizons may now be effective with a frequency of multiple trades a day. This is possible because the slippage, execution costs and even the fees are so much smaller than they were in the past.

Technology and changed rules have also altered the whole market structure, where basically the entire market making industry has migrated from the floor to what we have been discussing as high-frequency trading.

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**Steve Wolf**

This evolution has continued for a long time. We were among the first options market makers on the Board of Trade Floor and at some point the markets became efficient enough so that we found the edge provided to the market makers was so small that it was better for us to change our business and concentrate on taking liquidity as well

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**Ernest Jaffarian**

There are two really significant things that electronic execution has done for the entire space, and I am looking at it for a moment just through the FCM's eyes. Electronic execution is far more efficient, it takes far less manpower, you do not have the risk of the out trades having to be negotiated, etc. This has allowed the FCMs to significantly reduce transactional costs.

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**Even trades that trade longer-term trading strategies often execute electronically, because of the cost efficiencies involved in those processes. But, at the end of the day somebody is subject to the risk of those trades and if a trader "blew up", the FCM would be in a difficult spot. With electronic execution, for the first time an FCM is in a position to put a governor on the trading, limiting the maximum exposure that any trader can take, limiting the maximum trade size of an individual trades. This is something the traders themselves appreciate because they do not want to make a mistake.**

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So from a risk management standpoint and from a cost efficiency standpoint, electronic execution in the marketplace is hugely advantageous for all parties, from the people that are absorbing the ultimate risk to the investors themselves.

**Rick Redding**

Electronic trading in fact made the global markets a lot more efficient. You can take liquidity from the cash markets, the options markets to the futures markets and vice versa. In the past, only a handful of people had access to those markets, and it would have been a very manual process. So, it has actually brought the futures and securities markets together in that sense and made a lot of the markets more open. I am contrasting this to the dealer markets, where people may have an informational or an inventory edge.

**Matthias Knab**

**We have, at several times, underlined the role of managed futures and CTAs for the actual end investor. Numerous academical studies pointed out the benefits of adding managed futures and CTAs to a large portfolio. At the same time, if we really examine professional investors or institutional portfolios, not always are managed futures represented there. My two questions are: why is that, and why is this changing now?**

**Ernest Jaffarian**

I love this question. Ibbotson did a study in 2006 and I am quoting: "The optimal allocation to managed futures is greater than 50% for the moderate and aggressive portfolios." Again, they were examining the question how much out of a portfolio of stocks, bonds and hedge funds should you give to managed futures?

Why would their analysis suggest such a seemingly outrageous conclusion? Remember, the study was done in 2006, and I believe 2008 proved prophetic for their analysis. The reason is at the end of the day, people have learned they have to look at and understand the source of return.

EDHEC, the European research firm, suggested that in addition to having traditional beta, like exposure to stocks, bonds, or long commodities, it makes sense to add a diversifier which they called alternative beta. They define alternative Betas in three categories, all using the concept of risk.

You should be paid a premium for taking credit risk, for taking liquidity risk, and you should be paid a premium for taking volatility or what is sometimes called default risk. It is appropriate to have exposure to those types of risks as "alternative" sources of beta return. Then they went on to say, if you analyze the hedge fund world, you can explain well in excess of 90% of the returns through either traditional beta - being long an instrument, or alternative beta. That is why hedge funds can be replicated, because betas at the end of the day are replicable at low cost.

If you do not seek to make a return with traditional or alternative betas as your source of return, what is left? Well, EDHEC said, "Trader skill," and if you think of it as a line drawn in the sand and you put all of the beta returns on one side of the line and all of the non-beta returns on the other side of the line, and you think it may be a good idea to balance those exposures, you magically come up with a number like 50%.

It is virtually impossible to marry a managed futures return stream to any other asset over a reasonable period of time and not achieve a significant diversification benefit. As one consultant put it to me: "There is not a mean variance optimizer in the world that would not give a significant allocation to your portfolio." So why the hesitancy?

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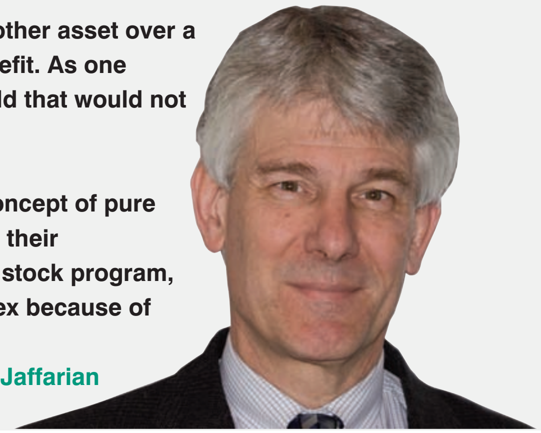
**At the end of the day, people still struggle with the idea of investing in a concept of pure trader skill. What is the asset in this case? Trader skill is not an asset from their perspective. But the same people will not hesitate to invest in a long-only stock program, because they think the long stock manager is going to outperform the Index because of what? Trader skill!**



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**Dr. Francisco Vaca**

To add to Ernest's comment, in our firm, we believe that if we are going to take somebody else's risk in a futures contract, we should get paid a premium for taking that risk. Very much in the same way, an insurance company that gives insurance on homes, theft, and cars, we are taking somebody else's risk; therefore, we should get paid for it.

In our business, it's a bit more complex - We say, “If we are going to get paid for taking risk, let's figure out how much we can get paid per unit of risk.”

We know that of all the things that one can measure in our industry, volatility is one that is highly predictable. Everybody can tell us with some level of confidence what the range of the S&P or of any other market will be tomorrow. However, nobody can tell us which way it is going to go.

Given that volatility is highly predictable, what we do then is venture to try to forecast the volatility, translate that loosely into risk and by means of statistical simulation, we find that, on average, we are going to make about one-and-a-half times our risk and then we tell the investors, “If we are risking 15% annualized volatility, expect to make 20% per year.”
We work our way backwards into the calculation, because we view this as managing risk exposure

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for our investors, rather than going and extracting alpha. Alpha is there by virtue of us taking the risk and, of course, it’s the management of the risk that allows us to keep the alpha, otherwise we would give it right back.

**John FitzGibbon**

Managed futures strategies have certainly proven their value of adding true diversification to a portfolio during periods of market stress. I think if you had to drill down to understand why there has been a level of hesitation among professional asset allocators to allocate to the strategy, it is really a function of their background.

I think traditional allocators that grew up on Wall Street will very likely be focused on the fundamentals of the equity or the credit market, and they are comfortable taking those risks. These people will not necessarily have the level of comfort with the more quantitative strategies,

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**These people will not necessarily have the level of comfort with the more quantitative strategies, particularly strategies that revolve around futures contracts. They may perceive futures as just being too volatile or just used for hedging purposes.**

**Looking at the typical fund of funds returns, I think it is important to note that fund of funds do have a significant correlation to replicators. Correlation is relatively easy to replicate. What is much more difficult to replicate is the mean that most hedge fund of funds have produced over time. From a return standpoint, you are far better off investing in a fund of funds over time, than in a replicator.**

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Although the correlation has been high, the bulge bracket fund of funds have far outperformed the replicators. Replicators have an advantage in terms of liquidity, but will ultimately have to stand the test of time with performance. We are focused on investing in strategies that provide more liquidity, and attempt to take it a step further and strip out exposures considered to be traditional or alternative beta. By having managed account across all strategies, we are able to reduce some of these more naïve betas.

**Aleks Kins**

Over the years, I have had the fortune of speaking to a lot of allocators both inside and outside the managed futures arena. It becomes pretty clear that the case for managed futures is out there, but it is not always easy to understand for groups that are not really focused in this field.

For example, if the vast majority of the world is convinced that a long-only equity strategy is considered mainstream, the next evolution is long-short equity, as it is a much easier conversation than going direct to higher frequency systematic futures trading, trend-following and so forth.

The CME and AlphaMetrix co-authored a paper updating the famous Lintner managed futures paper, in which we found that all the conclusions he made 30 years ago are even more true today, particularly about the diversification benefits.

As we saw last year, many hedge fund strategies work well during normal periods, but during periods of duress you can end up with a convergence of the markets and high degrees of beta and beta risk.
During those same periods or times of duress there are big global cash flows, and CTAs have been exceptionally good at finding and capitalizing on these tremors in the marketplace. In addition, they benefit from the fact that they are not limited to only equity markets, but highly liquid commodities, currency and interest rates. It's just that much more opportunity.

In fact, if you look at a breakdown of performance of CTAs over the years, very little of the alpha or the returns come from the equities market, even though equity indices are generally traded.

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**So in reality, the opportunity for managed futures is very different than from equity-based hedge funds. But let me drill a bit deeper into the question why are managed futures diversifiers? Managed futures in general are very good at capitalizing on shocks to the market, but on an average years there are smaller opportunities where skilled managers can take advantage.**

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We are seeing now from our vantage point a big wake up call across the board. Even with the original Lintner paper 30 years ago showing the importance of diversification, nothing is better than a real-world example, especially an example as large as what the world went through last year. Seeing all sorts of investors – especially those who have not been in managed futures before – adding allocations in this area further encourages us.

**Brian Proctor**

EMC has seen lot more interest in managed futures from institutional investors in 2009. There are several reasons for the heightened interest.

First, we were one of a very few strategies last year that delivered positive returns.

Second, our strategy proved to be truly uncorrelated to most other holdings in investors' portfolios, including most absolute return strategies.

Third, CTA's avoided the large losses that the passive, long-only commodity indexes incurred. We profited from long positions as commodities prices soared in the first half of 2008 and then profited from short positions when those same commodities went into a deflationary spiral downward in the second half of the year.

Fourth, CTA's offer programs that are liquid, transparent and are marked to the market every day, with no gates and no lock-up periods.

Finally, last year reinforced the fact that CTA's have had a history of delivering positive returns, especially during turbulent times. It was a great year to have had our investment strategy in your portfolio. Many investors that previously did not include CTA's in their portfolios have made a commitment to allocate to our asset class and are doing their due diligence at this time.
To give a little historical perspective - CTA's as an investable asset class have been around since

**To give a little historical perspective - CTA's as an investable asset class have been around since the late 70s or early 80s. That is when institutional investors first began to allocate to our strategy. During that time period the majority of CTA's had much higher average annual returns, higher standard deviation and bigger drawdowns. This type of return stream was accepted. Interest rates were in double digits and our investors were looking to us to make returns in excess of the "risk free" rate. We were incentivized to have a more aggressive strategy back in those days.**

**Over time, our firm and the CTA industry in general has evolved. Most institutional investors began to require a return stream with smaller returns, smaller drawdowns and a lower annual standard deviation. Those CTA's that adapted stayed in business. Most improvements made came in the area of risk management.**

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Over time, our firm and the CTA industry in general has evolved. Most institutional investors began to require a return stream with smaller returns, smaller drawdowns and a lower annual standard deviation. Those CTA's that adapted stayed in business. Most improvements made came in the area of risk management. EMC currently manages risk at the portfolio level as well as at the individual trade, market and sector levels.

Today many institutional investors are digging deeper into CTA strategies and want to know in detail how we build our trading models and risk management parameters. CTA's who have built successful trading strategies based on proprietary mathematical algorithms often find themselves trying to describe their quantitative approach without giving away the precise algorithms and ideas that have made the strategy successful. We've always been a bit reluctant to talk about the specific things that give us our edge against our competitors.

**Steve Wolf** I think we can all agree as Ernest pointed out that from a modeling point of view a large portion of the diversified portfolio should be in an asset class like managed futures. It would seem that the only good excuse for failing to use these strategies is that the capacity is limited.

**Matthias Knab** **So is there a capacity issue in the managed futures and CTA space?**

**Ernest Jaffarian** I assume that we will hear from the CME that the liquidity and depth of the futures' markets are grossly misunderstood and grossly underestimated. In the US alone, $1.5 trillion in market value is transacted every two weeks on the US stock exchanges. $1.5 trillion of market value is transacted roughly every day on the US futures exchanges. It is true that the transactional investment volume on the security side still vastly exceeds the transactional volume of professional futures trading. But if you add the interbank currency markets and offshore CFTC-approved futures volumes, the depth and liquidity in the futures markets are tremendous.

There may be capacity issues depending on the trading style and on an individual manager's level, but there is no capacity limit if you look at the size of the entire industry. Some styles can easily grow to a multibillion asset size, while others would have trouble growing to half-a-billion in transactional size. But for the industry at large, there is excess capacity available in the futures markets.

**Rick Redding** Ernest brought up that point before that any mean-variance optimizer would have a substantial allocation to managed futures. But in reality, things are rather constrained. People mostly allocate a single digit percentage to alternatives. One of the reasons is that they think there may not be enough liquidity. The irony of what we just went through in the last year-and-a-half was that the futures market was possibly the only market with sufficient liquidity. There was a price every day. People constrain it because of illiquidity considerations, but in reality managed futures actually should be used and not avoided, as one of their value propositions is exactly displaying the much searched liquidity. Therefore, it should be argued that the liquidity argument as a reason to constrain alternative investments does not apply for managed futures.

**Joe Canepari** We have all been in this business for a long time and we are very familiar with the benefits of investing in futures based strategies. Investors who are unfamiliar with the space can have a negative knee jerk response to the prospect of investing in the sector. In addition to John's points,

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the response can be explained in part by the fact that the return characteristics of most CTA strategies are different than the broader HF arena.  But, that is precisely why CTAs can benefit an institutional portfolio.

The other challenge we face is the view that CTAs are a homogenous space and one can gain exposure to the space via an allocation to one manager or program. I believe that is a mistaken view because there is great diversity within the CTA space.

**Investors who are unfamiliar with the space can have a negative knee jerk response to the prospect of investing in the sector. In addition to John's points, the response can be explained in part by the fact that the return characteristics of most CTA strategies are different than the broader HF arena.  But, that is precisely why CTAs can benefit an institutional portfolio.**

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**Joe Canepari**

At the end of the day, longstanding members of the futures arena like us have to spend more time educating the investment community about the merits of investing in futures based strategies.

**John FitzGibbon**

As to capacity, I think you have to break the futures universe down into a collection of strategies. For example, there can be capacity constraints within some very specific elements of short-term trading. The challenge as an allocator is to recognize that there may be a return compression in a particular segment or sub-strategy to which you allocate. If that is the case, it is not advisable to lever up the asset base in order to hit a specific return target.

On the other side, I believe strategies like trend-following or momentum are at this point very far away from any real capacity issue. Overall, managed futures as an asset class has a long way to go before hitting any material constraints.

**Joe Canepari**

To answer the question about CTA capacity you have to look at the underlying markets that they trade.  Futures and Forex are arguably the most liquid markets in the world.  The liquidity in futures markets coupled with the many different CTA strategies being employed makes the sector far less capacity constrained than many other hedge fund strategies.

**Aleks Kins**

In terms of capacity it is very important for investors to understand that systematically futures are different from equities markets, as futures instruments are zero-sum, and what is reported in the monitor is the open interest. It won't happen that all participants' assets flowing into the market all have the same direction, as within futures there has to be a buyer for every seller and vice-versa. By definition, money coming into the futures markets grows open interest and thus creates greater capacity. Open interest is a key measure to look at when examining the viability and capacity of a market.

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**Aleks Kins**

**Matthias Knab** **Is there any other important aspect we have not mentioned yet in our Roundtable?**

**Ernest Jaffarian** I would like to comment on the fundamental, systemic change within the asset management industry towards managed futures as a result of last year's events. 2008 was a game-changing year. When you have invested in an equity portfolio for ten years and have seen no return, you begin to wonder if the 60-40 model is going to work in the future. Let me comment quickly on what that means for managed futures, and what generally is ahead of us.

First, if you look at all the proposed regulatory changes that are circulated in the press regarding controlling hedge funds and so on, you will find that in the managed futures industry this has all been done already. This means that for us, there will really be no or very little regulatory impact. When people take a close look, they will realize that this has been a highly controlled, highly disclosed and regulated industry from the beginning.

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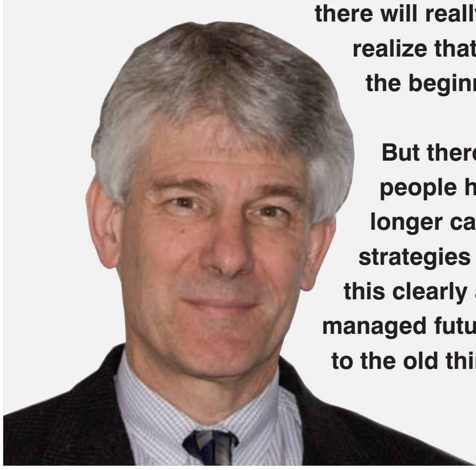
**But there is a second development which I think is even more significant. Historically, people have always lumped managed futures in to the hedge fund category. But now, no longer can people intellectually justify throwing the CTA asset into the same bucket as strategies that are primarily Beta driven, be it traditional or alternative Beta. We have seen this clearly among our client base. They have carved out a new investment slice in the pie - managed futures. This is a systemic change going forward, and I do not think we will go back to the old thinking in that regard.**



**Ernest Jaffarian**

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Sometimes people view CTAs as a homogenous space and say "sure, I want some CTA exposure", but what they do not realize that there is a lot of diversity within the CTA community. We talked about high frequency, momentum and trend-following strategies, but there are a lot of variations within that.

**John FitzGibbon** The level of interest in managed futures after 2008 spiked significantly. It is encouraging to see investors that have historically shied away from managed futures taking a thoughtful approach to this strategy.

They are not simply chasing the "hot dot" or trying to merely boost returns. I think they are taking a much more measured approach. They understand the volatility and timing risk of allocating to managed futures, and they are tending to dollar-cost average in. They are looking at the long-term and short-term correlation benefits to investing in managed futures and thinking much more clearly about how it fits long-term into their portfolio. This is encouraging and should lead to a more stable capital base in managed futures over time.

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