

21 Questions  
Answered  
ABOUT  
Managed Futures



KINGSVIEW®  
MANAGEMENT

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## **Risk Disclaimer**

**Past performance is not necessarily indicative of future results. The risks associated with trading futures and options are substantial. Futures and options trading is not suitable for all investors. One should carefully consider whether such trading is suitable in light of individual financial situations and risk tolerance levels. Only risk capital should be used for such investments. One can potentially lose all or more of the original investment. The risk of loss in futures and options trading is substantial, no matter who is managing your money.**

# WHAT ARE MANAGED FUTURES?

Managed Futures are an alternative investment vehicle in which the funds of multiple investors are traded by a professional portfolio manager called a Commodity Trading Advisor (CTA). They can include commodity pools, commodity funds, or individually managed accounts. In the latter, the funds are held in separate accounts and are traded in commodities markets such as grains, metals, energies, indices, or interest rates. The financial instruments traded are futures contracts, options, or a combination of both.

Managed Futures programs are usually used to try to seek profit on upward, downward, or even sideways movement in the commodities markets, without relying solely on the “buy and hold” concept widely utilized in securities trading.

**There is a substantial risk of a loss in futures and options trading, and individuals should determine the suitability of such investments based on their financial situation and risk tolerance levels.**



# WHAT IS A COMMODITY TRADING ADVISOR?

The Commodity Trading Advisor or CTA is the professional trader who makes the trading decisions for a Managed Futures program. Investors in a Managed Futures program will grant Power of Attorney over their account to the CTA to make trades on their behalf. The Power of Attorney may be revoked at any time by the client.

A CTA may be required to register with the Commodity Futures Trading Commission (CFTC) and a member of the National Futures Association (NFA). There are some exemptions for CTAs who meet certain criteria. A CTA is held to standards of compliance. The detailed performance of a CTA's trades for a Managed Futures program will be available for review by potential investors along with information about the trading strategy applied to the program. Much of this information can be found in the CTA's disclosure document, which must be read and reviewed by each client prior to investing. Clients are able to review their Managed Futures account at all times and may monitor each trade made by the CTA.

## HOW SAFE IS MY MONEY?

Money invested in Managed Futures accounts is held by a Futures Commission Merchant (FCM). FCMs operate under the Commodity Futures Trading Commission (CFTC), a US Federal regulatory agency, and the National Futures Association (NFA), a Congressionally-authorized self-regulatory organization. FCMs must maintain client accounts separately from their own operating funds and may not co-mingle any funds. They must meet minimum funding requirements and submit accounting records on a monthly basis to document their compliance. Further, FCMs are required to maintain a Business Continuity and Disaster Recovery Plan to enable ongoing operation and protection of client records and funds. This does not guarantee your funds against trading losses as the risks associated with trading are substantial.



# HOW ARE CTAS REGULATED OR LICENSED?

Like FCMs, Commodity Trading Advisors must answer to the CFTC and the NFA. CTAs may be required to be registered with the Commodity Futures Trading Commission (CFTC) and a member of National Futures Association (NFA). There are some exemptions for CTAs who meet certain criteria. They are subject to abide by compliance regulations governing how they operate in general as well as how they may solicit for business and represent themselves, their trading programs, and performance. Most Managed Futures programs (there are some exceptions) must present a Disclosure Document for review to potential investors. CFTC regulations strictly define and outline what this “D-Doc” includes and how it must be maintained and updated.

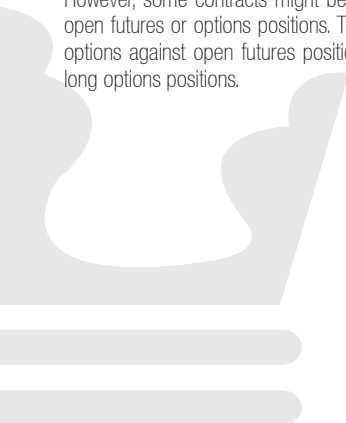
The D-Doc will include information about the CTAs themselves, their background and experience, as well as any details on conflicts of interest. The trading strategies used in the program will be described in sufficient detail to the degree that proprietary methods do not have to be revealed. The D-Doc must document the assets under management. Performance is listed by month and year and must include an explanation of how it is calculated. Performance will be listed net of fees which of course must also be completely explained as well. A very important section of the D-Doc must detail all possible risks of the Managed Futures program, particularly those that may be specific to the program and its strategies.

# HOW ARE THE COMMODITIES MARKETS USED FOR RISK MANAGEMENT?

The commodities markets today are still used to hedge price risk exposure as they were when they were created over 100 years ago. The rules of supply and demand remain primary influences on the price fluctuations of many commodities, but today the complexities of global politics and the economies of nations around the world have made the function of the commodities market even more critical to maintaining the global economic infrastructure.

Any business concern that must make budgetary projections for commodity products to buy or sell over periods of time will use futures to try to reduce the uncertainty of price risk exposure and to meet budget goals. A clothing manufacturer that buys cotton several times during the year might use futures contracts to try to establish prices to buy for many months out. So too would an airline that buys fuel or a food processor that buys corn, wheat, or oats. A farmer planting in the spring uses futures to attempt to lock in a selling price for his grain at harvest in the fall. Similarly, financial institutions use futures contracts on interest rates and the indices to manage the fluctuating value of funds and assets by locking in a favorable interest rate or currency exchange rate, for example. Hedgers still have a risk of loss in commodities markets, including basis risk i.e. a risk of the asset being hedged and the asset underlying the derivative not matching or the futures and spot prices not converging at expiration.





From the speculators point of view, futures markets represent a substantial risk of a loss as the speculators assume price risk and don't have an actual cash market position. However, some contracts might be used as part of risk management strategies for open futures or options positions. These might include, but are not limited to, selling options against open futures positions or selling different options contracts against long options positions.

# **WHY PARTICIPATE IN MARKETS THAT ARE FOR CORPORATIONS & FARMERS?**

Your life is touched by the commodities markets every day in many ways. Established over a century ago to try to manage the impact of supply and demand on the price of agricultural products, these markets are at the foundation of the global economic infrastructure. Starting with their role in managing the value of the world's currencies, the commodities markets are critical to the price stabilization of virtually everything that is bought and sold.

Futures markets are a mix of speculators and hedgers. Speculators assume many of the price risks associated with trading in futures and options, since they do not have a hedging position in cash markets. They bring liquidity to many of these markets, which could be considered a cornerstone of price discovery. Speculators are trying to capitalize on the fluctuations of futures contract prices. There is a substantial risk of a loss involved in trading futures and options.

Managed Futures are one possible gateway to these dynamic markets.

Please keep in mind that investing in Managed Futures is risky and not suitable for all individuals. Please consider investments carefully in light of your financial situation and risk tolerance.

# HOW DO MANAGED FUTURES COMPARE TO MUTUAL FUNDS?

A mutual fund provides investors a way to buy shares of a fund whose manager(s) trades on behalf of the investors. A managed futures program employs a Commodity Trading Advisor (CTA) to trade individual accounts using an approach that is applied across all the accounts invested in the same program. These programs may not be suitable for all investors, and carry a substantial risk of a loss.

A managed futures account offers full daily transparency while daily transactions in mutual fund holdings can occur without disclosure to the client. Liquidity in a mutual fund is based on the supply and demand of the fund's shares. Liquidity in a managed futures account may depend on the specific futures market being traded within the account – some markets have more participants and therefore more liquidity than others.

Traditionally, mutual funds trade short- or long-term positions on the 'buy-side' of the stock market while managed futures programs can use the flexibility available in the futures markets to position accounts to potentially profit in both up and down markets. Examples of such strategies include premium collection, trend following, and spread trading. This allows the potential for trading opportunities in bullish, bearish, or non-trending markets.

Being able to utilize multiple trading strategies is no guarantee of profit or limited loss in any Managed Futures program.

**Strategies using combinations of positions such as spreads and straddles are no less risky than taking straight long or short futures or options positions. Some short option or premium collection strategies have an unlimited risk of loss.**



# HOW DO MANAGED FUTURES PERFORM COMPARED WITH OTHER INVESTMENTS?

<b>ASSET CLASS</b>	<b>2010*</b>
S&P 500 (1)	12.78%
Commodities (S&P GSCI)(2)	9.03%
Real Estate(3)	26.37%
Bonds (4)	9.26%
Barclay Hedge Fund Index (5)	10.90%
Barclay CTA Index (6)	7.03%

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS. THERE IS A SUBSTANTIAL RISK OF A LOSS IN ALL TRADING.

**The information included in BarclayHedge statistics is based on information and data received by BarclayHedge from funds and managers and other sources and is not verified for adequacy, accuracy, or completeness.**

**To this end, the information may not be complete, and certainly is not representative of all CTAs. The Barclay indices do not encompass the entire universe of CTAs. In addition, the Barclay CTA Index is not weighted and is not representative of an actual portfolio which could be invested in.**

**\*2010 data is presented on an annual basis, not a lifetime one.**

1. <http://www.standardandpoors.com> ; Market Attributes: US Equities December 2010
2. <http://www.standardandpoors.com> ; Market Attributes: Commodities December 2010
3. [tools.ishares.com](http://tools.ishares.com) ; iShares Dow Jones U.S. Real Estate Index Fund 1 Year Annualized Return
4. [tools.ishares.com](http://tools.ishares.com) ; iShares Barclays 20+ Year Treasury Bond Fund 1 Year Annualized Return
5. [http://www.barclayhedge.com/research/indices/ghs/Hedge\\_Fund\\_Index.html](http://www.barclayhedge.com/research/indices/ghs/Hedge_Fund_Index.html)
6. <http://www.barclayhedge.com/research/indices/cta/sub/cta.html>



# HOW WOULD MANAGED FUTURES FIT IN WITH MY EXISTING PORTFOLIO?

Modern Portfolio Theory (MPT) is an investment theory that proposes an optimal mix in a portfolio that looks for the best possible returns on the expected level of risk. In an “efficient frontier” the potential rewards are relative to the overall risks. MPT suggests that a diverse collection of investments may have a lower collective risk than a single asset. However, they are not risk-free. Managed Futures provide a means for investors to try to diversify with potentially non-correlated assets.

Non-correlation is the degree to which multiple assets are not impacted by market movements in the same way. Assets that move in opposite directions under the same market conditions are fully non-correlated.

# HOW DOES NON-CORRELATION WORK?

Managed Futures has the potential to bring non-correlation to a portfolio in two ways.

Offering a range of trading styles, managed futures may be traded for downside or range-bound market movement during periods of bear markets when traditional "buy and hold" investments may be losing value.

It should be noted that Managed Futures programs will potentially trade for upside movement through bull market periods as well, offering the potential to profit under any market condition. Please note that there is also a substantial risk of a loss.

It is possible to lose your initial investment and more. Further, commodities offer a vast diversity of markets including grains, livestock, energies, metals, and other food and fiber products that are driven by a broad range of influences. They may be non-correlated to each other as well as to investments in securities.



# WHO INVESTS IN MANAGED FUTURES?

Any investor willing to assume the risks may invest in Managed Futures. The risks of investing in futures and options include a substantial risk of a loss and are not suitable for all investors. You can lose all of your initial investment and more.

As an asset class with a range of unique benefits, Managed Futures could be used by institutional money managers including foundations, trusts and endowments; public and corporate pension funds; insurance companies; banks; and family offices that invest the assets of wealthy families. Managed Futures may offer desirable benefits to investment portfolios with an opportunity to diversify with non-correlated investments.

# HOW MUCH INVESTMENT IS THERE IN MANAGED FUTURES?

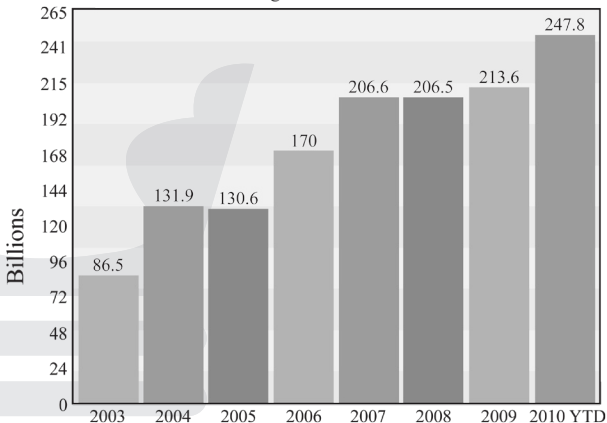
Managed Futures has seen phenomenal growth in recent years with more money being placed under management. Managed Futures have been available for about thirty years. In the early 1980s, there was less than \$1 billion in managed futures accounts. Over the next 20 years, investment in managed futures grew to over \$37 billion. (1) In the eight years that followed, however, assets under management have grown to over \$220 billion. That is a growth of over 600%! Please note that this growth is due to an influx of assets under management and not necessarily due to performance.



## CTA Industry - Assets under Management

### CTA Industry

#### Assets Under Management - Historical Growth of Assets



**PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.**

**Data courtesy of Barclay Hedge (1)**

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1. [http://www.barclayhedge.com/research/indices/cta/mum/CTA\\_Fund\\_Industry.html](http://www.barclayhedge.com/research/indices/cta/mum/CTA_Fund_Industry.html)



# ARE THERE TAX BENEFITS TO MANAGED FUTURES?

Futures are taxed differently than stocks. Taxpayers in the upper tax bracket may qualify for potential tax savings of as much as 30% on short term gains in futures vs. stocks.

Under the Tax Act of 1981, short-term profits in futures are taxed 60% at the long-term tax rate of 15% and 40% at the short-term rate of 35% tax while 100% of short-term profits in stocks are taxed at the 35% rate.

This information is no substitute for tax advice. Consult a tax professional to determine your eligibility.

# WHAT ARE THE FEES AND COMPENSATION OF A TYPICAL MANAGED FUTURES PROGRAM?

A Program may deduct a nominal annual management fee of 1.0%-2% of the account balance to cover operation costs. Transaction fees are charged to execute trades, however and CTAs are not paid any portion of the transaction fee unless specifically disclosed in the D-Doc (disclosure document). Some firms charge a one-time setup fee, or 'front-end fee' that typically ranges from 0.5% - 6% of the value on deposit in the account. Program performance will be listed net of all fees, excluding any one time setup fees. In such circumstances a Disclosure Document is required to include a dilution or break-even table.

Some Commodity Trading Advisors are compensated by a percentage of program profits, which is not a guarantee against losses. CTA incentive fees are generally 20%-25%, deducted off of the 'new highs' made in the account, meaning that under this scenario profits are only considered profits if they exceed the prior high performance in the account. Sometimes charging an incentive fee creates the potential conflict that the CTA may engage in riskier trades in order to generate such fee.



# HOW MUCH MONEY SHOULD I INVEST IN A MANAGED FUTURES PROGRAM?

Managed Futures programs generally specify a minimum investment to participate, usually ranging from \$10,000 to \$1,000,000 or more. To achieve benefits of portfolio diversification and enhancement of overall returns, Modern Portfolio Theory suggests that 20% of a portfolio could be invested in Managed Futures.

Ultimately, the amount of money you may put under management with a CTA should be appropriate for your personal investment goals and suited to your risk tolerance levels. Money invested in capital markets should be risk capital. There is a substantial risk of a loss in all futures and options trading, no matter who is managing your money.

# IF MANAGED FUTURES DON'T “BUY AND HOLD,” HOW ARE THEY TRADED?

Market participants who use futures for price risk management may hold positions for any length of time that suits their business needs. CTAs making speculative trades for the purpose of pursuing profit will conduct their trading according to a specific plan. The terms of this plan must be described in their Disclosure Documents and the Managed Futures program must be traded accordingly.

Futures and options contracts may be traded utilizing a broad range of strategies. Keep in mind that there is a substantial risk of a loss in all futures and options trading. The choices could include any of the following:

- Straight buy and sell
- Day trading to long-term durations
- Trading for potential profit across a range of prices
- Directional trading strategies
- Non-directional positions that may profit either way the market moves
- Fixed risk, fixed reward
- Strategies that collect the max reward upfront and then book the profit or loss at the time the position is closed



**It is important to note that options and futures markets are separate and distinct and do not necessarily respond in the same way to similar market conditions. Option prices do not move in lockstep with changes in the underlying futures market price.**



## HOW DOES LEVERAGE WORK?

Leverage in futures trading is powerful and should be understood as a primary inherent risk factor. The amount of margin required to open a position relative to the size of the futures contract being traded will indicate the leverage. As such, the amount of margin required will determine the percentage return or loss on a position. In this way, leverage works strongly in your favor when a position is on the winning side but leverage can result in significant losses when a position is down.

Higher margins are generally required for higher volatility markets as the potential for loss is higher and the margin serves as the performance bond against losses. Consider the difference in initial margin required to open positions in oats and wheat. Each contract is for 5000 bushels of the respective grain. The initial margin for oats is \$1148. But the margin to open a position on the far more volatile wheat contract is \$3375.

An oats trader actually has greater leverage on a futures contract but much less movement is expected by historical standards in that market than in the more active wheat market.

Low margin requirements are no guarantee that the potential for loss in trading any market is reduced. It is possible to lose your initial investment and much more.



# WHAT ARE THE DIFFERENT TRADING STRATEGIES THAT MANAGED FUTURES PROGRAMS USE?

Futures contracts and options contracts can be bought or sold. Both may be traded as spreads, positions that allow for combinations of contracts. Spreads in futures combine a long and a short position that trades on the difference between the two. **Strategies using combinations of positions such as spreads and straddles are no less risky than taking straight long or short futures or options positions.**

Options may be combined into spreads of two contracts or more for targeting specific risk profiles, market conditions, and trading objectives. You may have heard of these trading strategies and their intriguing, colorful names like “Iron Butterfly” or “Naked Strangle.” A unique options strategy is premium collection, a means by which the maximum potential defined reward of a trade is collected upfront, at the time the position is opened.

Whether the collected profit is retained or lost, is determined by market conditions at the time the position is closed.

CTAs often specialize in applying particular strategies that will form the basis of the trading methodology for a Managed Futures program.

Some strategies have an unlimited risk of a loss. It is important to note that options and futures markets are separate and distinct and do not necessarily respond in the same way to similar market conditions. Option prices do not move in lockstep with changes in the underlying futures market price.



# HOW DO I EVALUATE A CTA'S PERFORMANCE?

The CTAs disclosure document or marketing materials will likely contain performance information such as:

**Compound Rate of Return:** In addition to Monthly Returns and Year to Date returns, the Compound Rate of Return will indicate the overall percentage profit or loss a Managed Futures program has achieved during a time period. This is usually for the duration the program has been trading. This value may be listed as "Since Inception."

**Drawdown:** The maximum drawdown is a percentage indicating the biggest loss the program experienced from a historical high point to a low point. It is the biggest decline the program has experienced over a specified period of time.

The monthly drawdown will also be listed, indicating the largest drawdown during a month of trading.

**Sharpe Ratio:** This figure calculates the return achieved in a program's performance compared to the level of risk applied while trading the program.

Talk to your broker to determine if a Managed Futures program is appropriate for your risk tolerances.

# HOW DO I CHOOSE A CTA AND A MANAGED FUTURES PROGRAM?

It is possible to decide on a CTA and Managed Futures program by looking at returns and the risks involved. The Disclosure Document provided by every Managed Futures program will list the information necessary to make an educated decision about investing.

You may also review the CTA's education and work experience qualifications.

The basics of the trading program itself will be described to the degree that proprietary methods do not have to be completely revealed. Do you understand the trading strategies or are you more concerned with the overall risks the program takes?

Next, consider how the trading program fits with your investment goals. For example, a Managed Futures program in the S&P 500 would offer the potential to provide non-correlation to a portfolio of stock holdings on the S&P.

For a managed futures program and for any speculative financial investment, review the risks carefully. Some Managed Futures programs will present risk factors that are unique to the markets traded or to the program's trading strategy. All trading involves a substantial risk of a loss.



Generally, CTAs are compensated by taking a percentage of the program profits. Be sure you understand the fee structure and remember performance statistics are listed net of fees.

Finally, review the CTA's performance carefully and be sure to ask your broker any questions you have!

# **ONCE I'VE CHOSEN A MANAGED FUTURES PROGRAM, HOW DO I OPEN AN ACCOUNT?**

Your broker will arrange for you to fill out the forms to open a futures and options trading account with an FCM. You can often complete the forms online. This paperwork will ask you to list some financial information, such as your estimated worth and liquid assets. You will not be required to submit documentation for this information; it is intended to determine if futures and options trading is an appropriate investment for you. You will be required to submit a photocopy of your legal identification and to sign documentation confirming that you understand and accept the risks of trading. A basic tax form will also be included.

To begin trading in the Managed Futures program of your choice, you will sign paperwork granting Power of Attorney over your trading account to the CTA. The POA may be revoked at your discretion if you choose to close the account.



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