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## #46. Managed Futures and Superior Risk Management. Close the Gap Between Belief, Truth and Relevance.

Created by Advisorpage, DB Stark&Co., Sanctity Capital Management and SafeMoneyMetrics.

"Your Conservative Approach to Managed Futures"  
Risk and/or Investment Management - Trading Manager -  
Business Development – Investment Guides – Research – DataBase

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## #46. Managed Futures and Superior Risk Management Close the Gap Between Belief, Truth and Relevance.

There are aspects of investment analysis that work well for traditional investments. When applied to managed futures, these long standing traditional procedures unknowingly increase risk. We evaluate a few 'mass beliefs' currently influencing the selection of managed futures investments.

When erroneous beliefs are identified and released, truth dramatically improves profit potential because the 'unseen' cause of risk is removed from the environment.

\*\*\*\*\*

When well done managed futures will reduce the composite standard deviation of any traditional investment portfolio. We can consistently prove it! MJJ 212-777-3862 [mj@sanctity.com](mailto:mj@sanctity.com)

\*\*\*\*\*

### William Sharpe states that:

"Frequently portfolio performance is evaluated over a time interval of at least four years, with returns measured for a number of periods within the interval - typically monthly or quarterly. This provides a fairly adequate sample size for statistical evaluation."<sup>1</sup>

We believe that managed futures need a more direct thought process for fundamental valuation to have substance. **WHY?**

1. Rate of return calculations for managed futures incorporate data having no relevance to actual risk taken to receive a specific return.

2. Time weighted, dollar weighted, actual funding and notional funding are four methods of calculating rate of returns. Because multiple methods of calculating returns exist, the possibility of accurately comparing investments using only traditional rate of return calculations is slim.

3. Quantifying an advisors trading skill using only performance data can be a major cause of unseen risk. **WHY?**

- How performance was achieved is usually overlooked.
- Market conditions relative to skills and strategy may not be considered.
- Actual capital at risk relative to realized returns is not considered.
- Prudent cost evaluation relative to return is forgotten. (Cost evaluation relative to account equity is traditionally evaluated. We prefer evaluating cost relative to the return on capital at risk).
- Leverage and cost used in the available data, relative to what we need for the investment needs to be evaluated.
- Equity growth relative to return needs to be evaluated.
- The perceptions and beliefs of the analyst building your investment is a primary colossal consideration.

### **Benchmark Portfolios and Relevant Investment Comparison**

To quote Mr. Sharpe again: "The essential idea behind performance evaluation is to compare the returns obtained by the investment manager through active management with returns that could have been obtained for the client if one or more appropriate alternative portfolios had been chosen for investment. The reason for this comparison is straightforward - performance should be evaluated on a relative basis, not on an absolute basis.

In order to infer whether the manager's performance is superior or inferior, returns of similar portfolios that are either actively or passively managed are needed for comparison. Such comparison portfolios are often referred to as benchmark portfolios.

Selecting benchmark portfolios should prove relevant and feasible, meaning they should represent alternative portfolios that could have been chosen for investment rather than the portfolio being evaluated".

2

Benchmark portfolios or indexes according to "what should be" as defined by William Sharpe for managed futures investments do not exist. They can be created, but do not naturally exist. Imitating traditional stock indexes, the managed futures industry creates indexes comprised of advisor performance. Each index contains advisors having similar market sectors or strategies. Indexes such as: Energy, Stock Index, Grains, Financial, Inter-Bank, Systematic and Diversified Traders exist. Indexes can be created for any purpose.

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## Superior Risk Management Closes the Gap Between Belief, Truth and Relevance

Industry participants and the media directly and indirectly use indexes published by industry professionals as benchmarks for comparison to specific investments, or for referring to the pulse of an industry or sector. I receive the Alpha report from Investment Advisor Magazine. It carries the Carr/Barclay CTA Index and a hedge fund index. The index is published along with the S&P, NASDAQ, Russell 2000, and a myriad of other stock and bond market indexes.

\*\*\*\*\*Stock and bond indexes are comprised of closing stock or bond prices at the end of each day. Indexes directly mirror prices of the stocks or bonds in it. If someone developed a grain index and daily prices for all the grain markets were included, then that futures index mirrors the equity indexes and has useful relevance.

If people bought the grain markets reflecting the exact values of the index, then the index serves a useful purpose. If people invested in grain traders based on values of the grain index, they are increasing their risk because there is no relevance between the grain index and the performance of any grain trader! \*\*\*\*\*

In the scenario above, the gap between 'belief', 'truth' and 'relevance' is wide, therefore risk of loss is increased.

\*\*\*\*\*

CTA and hedge fund indexes reflect the returns of trading talent applied to markets, whereas debt and equity indexes reflect the market prices of stocks or bonds in each index. I perceive that the industry wide applications of using CTA and Hedge Fund indexes for benchmark or investment evaluation purposes are 'erroneous.' The 'belief' driving or underlying the application unknowingly increases the risk of many investors.

\*\*\*\*\*

Unless created to mirror the exact investment, when indexes are used as benchmarks to compare specific investments, understand that the strategy misrepresents truth, increasing risk and the causes associated with ill-fated losses. **WHY?**

Because advisors included in each and every index all vary in:

- Account size, beginning equity and notional funding values relevant factors in benchmark analysis.
- Accounting method used to calculate returns.
- Degrees of risk used to produce returns.
- Strategies used to produce returns.
- Costs vary for each advisor.

To duplicate the performance of any index capital would need to be allocated to each advisor in the index comparative to how the index is weighted and calculated.

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## **A Foundation Burdened With Error Will Only Multiply Error – Nothing Else is Possible**

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### **Belief Management and the Standard Deviation**

Traditional texts from the New York University Professional Bookstore for MBA students on investment analysis and risk management devote several chapters on building multiple investment portfolios using standard deviation and correlation analysis as a risk management strategy. That strategy is NOT extended into managed futures investments. Specifically

- Modern Portfolio Theory and Investment Analysis – Elton/Gruber
- Essentials of Investments – Bodie/Kane/Marcus.

Most interesting is Gruber's book and the admission of needing more knowledge for evaluating futures investments. They use traditional rate of return data of public commodity funds to lightly reference managed futures and why the investment should be avoided. Everyone in the industry knows that public commodity funds have the worst performance of any managed futures investment.

Why did these people choose public fund data for their study?  
Why not an index of advisors with superior performance?

POINT: What is being taught in universities are 'erroneous beliefs' understood to be fact. Sit back and reflect on the impact that 'erroneous beliefs' and inaccurate information have on our society!

Truth is that account size and leverage can be and are used to manipulate return data. A smaller account size using more capital for actual trading will always have a higher standard deviation. It's the nature of numbers. A standard deviation only measures volatility of return, not the profitability of an investment. Volatile returns do not necessarily mean that an advisor has more risk.

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### **SafeMoneyMetrics™ and Superior Risk Management**

For Investment Managers and Analysts, SafeMoneyMetrics™ can:

- Detect early warning signs of strategy imbalances under current market condition.
- Evaluate performance at a capital at risk relative to realized return level.
- Evaluate a trader's ability to translate unrealized into realized returns.
- Consistently evaluate trading talent under current market conditions.
- Meticulous evaluation and comparison of advisors using a capital at risk relative to return efficiency model.

- Scrupulous examination of analytical applications used in a strategy. What we believe and think can never be separated from what we do.
- Builds an accurate comparison and evaluation of multiple advisors.

Using the net, funding level and the return to variability ratio SMM can build a fastidious model for comparing traders across a broad spectrum of markets and strategies traded.

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Download A Guide to SafeMoneyMetrics

<http://www.safemoneymetrics.com/research/SMMguide5-6-04.pdf>

and A Guide to Managed Accounts

<http://www.sanctity.com/articles/scmguide4-13-04.pdf>

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Briefly SafeMoneyMetrics™ evolved from hedging and is a direct approach to analysis. It has four stages and can be applied at any level of investment analysis.

1. Advisor Rankings (Facilitates the initial advisor selection)
2. Preliminary Advisor Analysis (Analyzes each advisor)
3. Multi-AdvisorAnalysis (Integrates into a SafeMoneyMetrics Optimal mix.)
4. Risk Management (Daily monitoring and rebalancing when necessary)

The four stages and other benefits of SafeMoneyMetrics™ as a complete project management strategy will be described in another article. The benefits are superior risk and investment management, compliance, improved client relations, and unique marketplace positioning.

#43 How to Select SafeMoney Advisors is a good summary article

<http://www.alwaysafemoneymetrics.com/articles/archives.htm>

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### **SafeMoneyMetrics™ Builds Bridges**

1. For the first time in managed futures history, investments can be compared across a broad spectrum of strategies on an equal basis.
2. Strategies can be built with a consistent meticulous method of quantifying capital at risk relative to return.
3. Substandard investments are easily identified and avoided.
4. Costly analytical errors based on erroneous and superfluous information are reduced or eliminated from the evaluation process.
5. Volatile sideways markets offer exceptional opportunity for specific spread and option strategies to flourish. Accurately creating multi-advisor strategies can evolve into one investment that can benefit from most market conditions.
6. Managed futures can reduce or eliminate the long duration of non profitable stock market returns. (Managed futures should prove a positive intention in less than 18 months).

## The End 1583

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### **Always Room for Improvement\*\*\***

We appreciate your precious time sending constructive suggestions for change.

1. What you want more of.
2. What you want less of (except God and philosophy).
3. What needs more clarification.

Use the email link

<mailto:mj@alwayssafemoneymetrics.com?subject=ASMSuggestions>

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### **Do you want superior managed futures investments?\*\*\***

Always Use SafeMoneyMetrics!

Complimentary Mini Courses for Investors, Advisors and Business Development

<http://www.alwayssafemoneymetrics.com/freemini.htm>

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### **Service Profiles and Contact Information \*\*\***

#### **Advisor Rankings\*\*\***

At the end of every month, the previous month's data is updated. They are currently published at three sites,

<http://www.sanctity.com>.

<http://www.safemoneymetrics.com> and

<http://www.alwayssafemoneymetrics.com>, Advisor Rankings.

As time passes research projects, indexes, benchmarks, Top rankings and anything we perceive as useful will be created! We'll joint venture SafeMoney ranking projects with other providers of managed futures data and industry professionals. There is a greater positive impact for the marketplace and 'almost' unlimited financial potential.

#### **Affiliate Program\*\*\***

Information and risk management services are distributed through an Affiliate Program fundamentally valuable to the entire managed futures industry, financial service professionals, trade associations, electronic and print media. Service and revenue profiles for are available. There are no registration requirements and the target market is defined at <http://www.alwaysafemoneymetrics.com/affiliate/affiliate.htm> -

The program is managed by Managed Affiliate Programs.  
<http://managedaffiliateprograms.com/start.php?affid=1018>

### **Risk Management\*\*\***

<http://www.safemoneymetrics.com>

### **Investment Management\*\*\***

<http://www.sanctity.com>

Limited risk investment management and trading manager services. The service is useful to all institutional and high-end-retail investors.

### **Business Development\*\*\***

<http://www.sanctity.com>

We build profit centers in managed futures.

Profit centers are useful to national and international financial service professionals, trade associations, banks and broker-dealers. Traditional Fee based revenue is increased as a by-product.

### **Complimentary Services\*\*\***

<http://www.alwaysafemoneymetrics.com/free.htm>

Mini Managed Futures Courses for Investors, Financial Advisors and Business Development. A complimentary guide called Standards for Advisor Evaluation details the fundamentals of SafeMoneyMetrics and why they work.

### **Investment Guides \*\*\***

<http://www.alwaysafemoneymetrics.com/guides/guides.htm>

Promise to optimize the positive potential of managed futures by reducing the probability of ill-fated losses. You can review the content, and table of contents for three investment guides.

If not 150% satisfied, your money is cheerfully refunded.

### **Pass Along \*\*\***

Please pass this to everyone that you think can benefit. Included are independent financial advisors, broker-dealers and futures industry people, you can financially benefit from passing this information to others by joining the Always SafeMoney Affiliate Program.

<http://www.alwaysafemoneymetrics.com/affiliate/register.htm>

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<sup>1</sup> William Sharpe/ Gordon Alexander - Investments Fourth Edition Pages 733-734.

<sup>2</sup> Sharpe and Alexander - Investments 4<sup>th</sup> Edition Page 737 23.2