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47 How to Improve Managed Futures Risk Management with SafeMoneyMetrics™ CTA Indexes.

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“Your Direct Risk Management Solution for Managed Futures”
Risk and/or Investment Management - Trading Manager -
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47 How to Improve Managed Futures Risk Management with SafeMoneyMetrics™ CTA Indexes.

Content below was basically taken from the SafeMoneyMetrics™ CTA Index Definitions at <http://www.safemoneymetrics.com/indexes/indexes.htm>

How You Benefit

Conscious application of SafeMoneyMetrics™ CTA indexes can improve the advisor selection process. Investment profitability relative to time can also be semi-analyzed. How to not use SafeMoneyMetrics™ is mandatory so inherent weaknesses are included.

SafeMoneyMetrics™ CTA Indexes were built for all traditional indexes published by DB Stark. SafeMoneyMetrics™ can be licensed for application to any data base. People can use the indexes as site or media content. They are updated and online with the advisor rankings before the 5th of each month. Contact Daniel, Christian or Me (MJ) for details.

The SafeMoneyMetrics CTA rankings are sorted by the Net and Funding Level Ratio from best to worst over 6, 12, 24 and 36 month time frames.

<http://www.safemoneymetrics.com/rank/rankings.htm>

Time frames using the Net and Funding Level Ratio were also developed for the indexes. WHY? So people learn to constructively use the Indexes relative to an advisor, investment and the Advisor Analysis which is almost done! Almost means ask Christian Ramsey! <http://www.safemoneymetrics.com/Analysis/Analysis.htm>

A Few Benefits of SafeMoneyMetric™ CTA Indexes:

- The indexes are useful as timing indicators for entering or exiting specific types of managed futures investments.
- They are useful for determining the risk and cost of an investment relative to 'an index or industry average.'
- Investors can watch the indexes over time frames, if an investment is not performing better than the 'middle ground created by averages', research other investments.
- The indexes can establish acceptable downside boundaries. The data provided by an index can be used to semi-determine the worst you should expect for an investment related to that index over specific time frames and market conditions.

We use the word 'semi' because nothing on earth should ever be blindly accepted as 'The Divine Intervention of Superiority"! Specifically I would use a trader with volatile returns. They would need capital at risk to reward of at least 5 to 1, fair costs and the ability to use high leverage! That description does not fit into an industry average created by indexes!

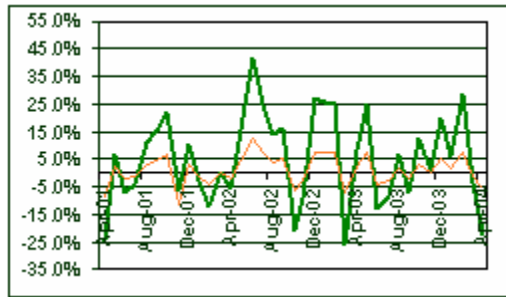
How to Understand the Index Data

The master table lists each index with its current Net and Funding Level Ratio. The number of traders in each index, assets managed and percent of assets represented by each index relative to total assets reported to the data base being used.

The -10.3% NR for April simply means that advisors in that index averaged a loss of 10.3% on capital at risk. Not the account size, or notional assets, but capital at risk. The -2.1% FLR is the loss on minimum funding levels for the index. The capital at risk and funding level formulas are described below.

Indexes for the Month of April					
Index	NR	FLR	No. of Traders	Assets Managed	Percent of Total Assets Reported
Stark 300 Index	-10.3%	-2.1%	300	40Billion +	*****
Approach					
Discretionary CTA Index	-14.6%	0.4%	*****	*****	*****

When people link to an index from the master table they see one graph and two data tables. Graphically, the green line represents a net ratio and the orange line is the funding level ratio. The latest 36 months is always presented.



Net to Funding Level Ratio Applications:

Investment stability is indicated when the NR is consistently above the FLR, especially when the difference is wide. The two ratios evaluate the net return earned on capital at risk relative to net return earned on minimum capital required to fund the account. If and when the net ratio moves into and below the funding level, leverage is too high at the minimum funding level under current market conditions.

The analysis reveals potential risk of an investment when funded at the minimum funding level over variable market conditions. When applied to indexes, the analysis reveals potential average risk of the sector represented by the index being evaluated.

SafeMoneyMetrics™ always monitors ratios in relationship to each other because nothing in the Universe lives in isolation.

The Data Tables

One data table summarizes the annual net and funding level ratios for a decade. We have two decades of data but a decade is sufficient!

WHY? The Universe does not make decisions to stay in tact based on past performance. Can you envision God saying; "I'll increase the sun rise by 10% because there was 10% less pollution generated by man". The Universe consistently regenerates Itself because that is what IT can do. The Universe is love and law. Nothing else exists! We need to trust Universal love and law more, past performance less. We are love and law, we are not past performance!

POINT – Consciousness of a trader causes the return. When people evaluate data, they are evaluating a result, or an effect. We need to understand the consciousness causing the result. SafeMoneyMetrics™ uses effects (data) to perceive consciousness. It gives us the ability to select higher quality traders. Higher quality is defined as "those that take the high road."

There is probably another article coming in this series called First Cause Risk Management for Optimal Profitability in Managed Futures. It's about evaluating and understanding consciousness as the simplest most effective risk management strategy on earth! The data articles were deliberately written first.

Back to the Tables

The annual table of Net and Funding Level Ratios gives the average, maximum and minimum for the year. They are useful for establishing boundaries. For now, consider them minimum requirements you should tolerate (more later).

Year	Ratios	Avg.	Max.	Min.
1994	NR	-1.1%	26.8%	-23.6%
	FLR	-0.4%	8.9%	-8.0%
1995	NR	8.5%	57.3%	-17.2%
	FLR	2.7%	18.1%	-5.6%

The time frame tables are probably more important for several reasons.

- People rarely enter an investment in January and leave in December.
- Times frames on indexes are useful to establish minimum expectations for comparison with individual investments for a specific time frame. Your investment needs to be equal to or better than the index for the same time frame. Shoot yourself if you settle for less!

Latest Monthly Time Frames				
	Ratios	Avg.	Max.	Min.
6M	NR	4.9%	28.8%	-22.5%
	FLR	1.3%	7.4%	-5.7%
12M	NR	3.8%	28.8%	-22.5%
	FLR	1.0%	7.4%	-5.7%

Formulas, Definitions and Applications

1. Capital at Risk (CAR):

A formula that represents actual capital used to produce a return; NOT the account size an advisor asks for, or minimum funding level. CAR is the foundation for all ratios. The CAR formula is adapted for different situations. Two examples are actual margin requirements for each trade, or when evaluating monthly data, we use the maximum margin.

Because monthly data is used to create all indexes, the maximum margin requirement for advisors in the index becomes the foundation for determining Capital at Risk. The exception would be foreign exchange traders, and the foreign exchange index. (We're working on it!)

Since accurate evaluation of capital at risk relative to return can only be determined by tracking all trades in the sequence that they are taken, please remember the inherent limitations of using a maximum margin formula.

Capital at Risk Applications:

CAR is also used to evaluate capital waste built into the investment. For example; assume we're evaluating two advisors each having a \$1M required account size. The advisor using the least amount of capital at risk to produce the highest realized return relative to the lowest volatility would probably be a better choice. (Highest RVR and Lowest CV- see below).

Net Ratio (NR):

Is the composite value of realized and open trade equity on capital at risk. (Realized Ratio + or - Volatility Ratio/ Capital at Risk Formula).

Funding Level Ratios (FLR):

Is the composite value of realized and unrealized open trade equity based on the minimum funding level account size.

A Few Limitations of SafeMoneyMetrics Indexes:

Based on benchmark definitions taken from

- William Sharpe/ Gordon Alexander - Investments Fourth Edition Pages 733-734.
- Sharpe and Alexander - Investments 4th Edition Page 737 23.2

With one exception, we do not believe that any managed futures index is a useful investment benchmark. Mr. Sharpe is quoted below.

"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".

A few of our own reasons are as follows:

- The nature of numbers is that averages create a middle ground. The best, worst and those next to the extremes are leveled off. Comparing an investment to an index or average establishes erroneous performance expectations. Any erroneous expectation is cause for ill-fated loss.
- Indexes are compiled with advisor data having different account sizes, investment strategies, margin to equity and minimum funding levels. Past performance calculations also vary. Although parameters for identifying and monitoring risk are easily identified on individual accounts, they would not realistically be comparable to an index, unless the index was specifically built to mirror an investment.

- There is no direct 'benchmark' relationship between an investment and an index. The text below was taken from an earlier article on indexes and relevance.

"Stock and bond market 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 proportions used in 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!

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 and investment evaluation purposes are 'erroneous.' The 'belief' underlying the application unknowingly increases risk for many investors."

In conclusion SafeMoneyMetrics™ Indexes, when used as 'industry wide indicators' are only as useful as the data base they are applied to. Data-base services can track assets reported. Although not factual, I have reason 'to believe' that data-base services have no indication of total industry assets managed relative to assets reported to their specific data base.

Useful SafeMoneyMetric™ Ratios:

The definitions below are included because, no matter what, people insist on using indexes external to their investment to judge the performance of their investment. The ratios below can be calculated and applied to any investment under consideration.

Cost Ratio (CR): Defined by a relationship between account costs relative to the Net or Funding Level Ratio. Traditionally costs are evaluated as a percent of the fully funded account value annualized. Cost analysis is improved when evaluated relative to return and capital at risk. For example - one of the industry's greatest traders had a 20% cost factor. People "perpetuate the illusion" that he needed to exceed a 20% return before clients benefited.

This industry wide thinking is 100% inaccurate. The trader earned over 100% annually on the fully funded account using 25% margin (Capital at risk). Now we "see" that he earned 400% on capital at risk and his costs were 20% relative to the 400% or Net Ratio.

Traditional Rate of Return (TR): SafeMoneyMetrics™ uses the TR relative to the Net and Funding Level Ratios for evaluating account stability at variable degrees of leverage. The TR is also used to evaluate costs relative to account size, capital at risk and return.

*****A Primary Benchmark:** Reward to Variability Ratio (RVR): When used with SafeMoney risk and investment management services the RVR estimates the capability to produce realized profits with respect to managing the risk of open trades. Traditionally the RVR is calculated by dividing the Risk Premium (RP is a return above the risk free ROR) by the Standard Deviation (SD) of returns. Since SD measures volatility and RP risk premium the result is a risk/reward ratio. For this advisor selection analysis we divide the average Net and Funding Level Ratios by their Standard Deviation (NR/StD and FLR/StD). A high RVR indicates a higher return relative to the amount of risk taken. For example Assume the NR= 23%, a SD of the NR for the same time frame is 30%, then 40% and 55%. $23/30=0.76\%$, $23/40=0.575\%$ and $23/55=0.418\%$ - As the SD increases or NR decreases the RVR decreases. This ratio is expressed as one number and is applied to every aspect of analysis, including comparison of investments.

*****Secondary Benchmarks:** Coefficient of Variation (CV): From statistics the CV measures absolute and relative dispersion. If the absolute dispersion is a standard deviation (S) and the average (A) is the mean, then the relative dispersion is called the coefficient. When a mean or average is close to zero, the CV is not useful $CV=S/A$ - When applied to composite SafeMoney analysis the CV is a Benchmark, used to monitor the average of each ratio over time frames relative to the last for that time frame. The CV is also used to compare advisors. Assume two trading advisors, one returns 55% with a StD of 35% and the other returns 35% with a StD of 15%. $35/55=63.63\%$ and $15/35=42.85\%$. The second advisor is more efficient.

Minimum Acct Size (MAS): Also called a fully funded or notional account size accepted by the advisor (Management fees are calculated on this account size).

Minimum Funding Level (FL): Cash used to fund an account expressed as a percentage of the Minimum Account Size.

Margin Minimum%: Margin used expressed as a percent of the minimum account size.

Margin Funding%: Margin used expressed as a percent of the minimum funding level.

Cost/MA: Annual cost relative to the Minimum Account Size (MA) accepted by the advisor.

Cost/FL: Annual cost relative to the Minimum Funding Level (FL). See # 4 Cost Ratio.

MA and FL Total Return: Based on the hypothetical account size for time frame being analyzed.

Max: The best value of a ratio within the time frame specified.

Min: The worst value of a ratio.

Time Frames: Ratios and benchmarks calculated over a specific time frames, rather than calculating annual return data. We perceive constructive evaluation of time frames to be superior to evaluating annual return data.

The End (2434 words)

Always Room for Improvement***

We appreciate your precious time sending constructive suggestions for change.

- 1. What do 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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