



## Sanctity Capital Management SafeMoneyMetrics™

"Your Direct Risk Management Solution for  
Managed Futures"

### 50. How to Optimize Positive Investment Returns Using Constructive Beliefs.

Do you ever consider the validity of analytical applications used for evaluating managed futures investments? Heightened awareness of beliefs driving investment decisions (personal and impersonal), can significantly improve your bottom line. At the very least, profitability is increased because the cause of many unnecessary losses are reduced or eliminated.

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### Original Intention and Current Application

For our purposes, original intention and current application needs to be defined. Consider the following analogies. If I took "Synthroid" (a drug originally created for under active thyroid glands) as a diet aid there would be excessive high risk of ill-health. Some people inaccurately *believe* that an under active thyroid causes excessive weight gain. The *erroneous belief causes* a new application for synthroid to develop. Over time, awareness of the drugs real or *original purpose* can be diminished. Another example, when laws are used to *knowingly facilitate* wrong-doing, high risk of loss is increased. People *believe* that laws can constructively be used *against the law*. Over time society becomes permeated with a dual use of law. A cause of unwanted loss is a *current application* of law diametrically opposed to the *original intention* of law, which is to protect people.

An optimally positive result can never be created from the imprecise application of any method. The statement has no opposition and is universally true from the beginning of time.

If hedge funds are used to offset traditional investment risk, risk of loss is increased if beliefs motivating the investment decision are inaccurate. Hedge funds were created in the 80's because investment advisors wanted incentive based compensation, like commodity trading advisors were already being paid. Before the advent of hedge funds, advisors could only be compensated as a percent of assets. The word hedge originated with commodities over 100 years ago. Before the term was tactlessly applied to hedge funds, the word hedging was a pure commodities term. The word indicates "risk management". The futures markets are used to offset risk of the underlying cash market. Hedging is the *primary or original purpose* of futures; managed futures are only a by-product.

### Your Doorway to Optimized Investment Potential

Last month offered insight into the potentially high risk of using indexes as benchmarks. Why? Currently, indexes are used as investment benchmarks, whereas the *original intention* of indexes was to determine stock market trends. Go to <http://www.safemoneymetrics.com/asmarticles.htm>  
# 49 Indexes: High Risk of Current Applications and Low Risk Solutions.

This month a few widespread investment applications are currently defined relative to their *original intention*. Using caution and common sense, you can potentially improve your bottom line by avoiding the prospective harm caused by incorrect analytical applications.

Two fundamental belief structures dictate our decisions, personal and impersonal. Impersonal is what we take in from the world around us and personal is what comes from within and projected onto the world. Personal, we bring to the party, impersonal we take home from the party. Both structures include erroneous beliefs that we need reflective time to question or think about.

A few impersonal beliefs and methods of evaluating managed futures investments are listed below. An alternative method of perceiving, therefore evaluating similar situations is also included.

**Standard Deviation** is used to partially evaluate investment risk. The term originated from statistics and measures deviation from a mean or average. If the standard deviation is low, an investment is considered to be more favorable.

**Alternative:** Futures prices are volatile because of leverage used. High leverage and price volatility is a gift or strength of this particular marketplace that allows potential profits to be extracted from price movements. Only when prudently used, the autonomous price movement of commodities prices makes it a superior vehicle for diversification. If returns are positive yet volatile, it does not necessarily infer that an investment has high risk. Risk can also be partially determined by evaluating capital at risk and cost. For example, assume two investments each having a minimum account size of \$1,000,000. Both produce annual returns over the most recent five years ranging from -5% to +37%. Advisor A is profitable 8 out of every 12 months, advisor B is profitable 6 out of every 12 months. Advisor A uses 5% of the \$1,000,000 and Advisor B 10%. Volatility or the standard deviation of monthly returns does not necessarily indicate a high risk investment.

**Managed Futures Accounts Use No Leverage.** While contacting advisors for their minimum funding levels, a few offered investments that priced the commodity out at its full contract value. Directed to institutions, these investments are marketed to people having a stock market mentality. Specifically, assume one crude oil futures contract is purchased at price of \$67.00 a barrel. A contract is 1000 barrels. Full contract value is \$67,000. Assume the initial margin requirement to a non exchange member customer is \$6075. The advisor deposits \$6075 to the clearing firm and the clearing firm deposits \$4500 with the exchange. The managed account owner deposits \$67,000.

**Alternative:** Find talented traders and let high leverage work for you. Use the marketplace as intended, and allow yourself to benefit from the uniqueness offered by futures.

**Benchmarks** are indexes used to compare investment performance, and evaluate industry trends. Simple indexes are created by averaging the monthly rate of return data of all advisors included, then dividing a total by the number of advisors. Indexes can be categorized by strategy and sector. For example, options, inter-bank, fundamental or technical could be a strategy

index. Stock indexes, financials, grains, meats could comprise sector indexes. If an investment performs better than the benchmark, it's OK, if not, maybe the investment is re-evaluated. If the index is positive, the industry sector is considered positive.

**Alternative:** Averages perpetuate mediocrity. Assume 37 advisors are used to create a stock indices index. By creating an average, the best and worst are lost, the strongest hold up the weakest. Advisors included in any index have variable account sizes, strategies, capital at risk and a myriad of other factors that make them *rightfully* quite distinctive from each other. Most important, when used for comparing an investment, it's wise to remember that very few advisors included in any index have similar account parameters as the investment being compared.

Choose an investment based on internal standards, yours. Review the history of the advisor, or group of advisors being considered and establish a benchmark internal to the investment. Establish capital additions, distributions and rebalancing decisions relative to the *internal benchmark* and your original standards. You'll happier and can probably improve your bottom line return with less effort.

**Managed Futures Indexes** are *currently* created from *monthly rate of return data*. Rate of return data is fundamentally produced by a person taking action under a past market condition that will never exactly repeat itself. Indexes *originated* from the stock market and are created from the *price behavior of individual stocks*.

Evaluating price behavior of a stock market, or sector is quite different from evaluating trading talent.

The stock market industry perpetuate a belief that indexes built on price data are useful benchmarks for evaluating investments. Be careful because the same parameters needed in managed futures are applicable to traditional investments. The equity industry also needs an accurate method of evaluating trading talent. The process of comparing trading talent to the movement of stock prices probably needs to be reevaluated.

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Always Room for Improvement\*\*\*

We appreciate your 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?

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