

SafeMoneyMetrics and Multi-Advisor Analysis

Marlee-Jo Jacobson ©

This month we'll introduce the value SafeMoneyMetrics™ adds to building and monitoring multi-advisor portfolios. Although any number of advisors can be used, to uphold the integrity of simplicity we chose variable allocations between two advisors. Because the reliability of any strategy requires clear definition of its' inherent weakness, we defined what we can perceive. I am unsure what they detract from the value SafeMoneyMetrics™ adds only that they do exist. As more weaknesses are revealed to us, they will be included in future articles.

Bottom Line

Your ability to quantify the consciousness, perception, motive and analytical skill of a practitioner (trader, analyst or advisor) is THE ONLY VITAL ELEMENT for success in any endeavor –

For an in-depth foundation of the principles supporting SafeMoneyMetrics™ we recommend reading Standards for Advisor Evaluation and Universal Principals for Investment Selection at www.sanctity.com/ Monthly Articles.

SafeMoneyMetrics™ systems have multiple applications – and can be designed to incorporate any time frame including intra-day data. For in-depth information on the benefits of SafeMoneyMetrics™ targeted to specific markets including hedge funds we recommend going to www.safemoneymetrics.com

Definitions –

Realized Ratio – Measures realized profits relative to actual capital at risk. The percentage value (20%, 34% or - 15% etc) always represents a "relative" scenario. A consumer understands that either 20%, 34% or - 15% was earned or lost relative to a specific capital allocation.

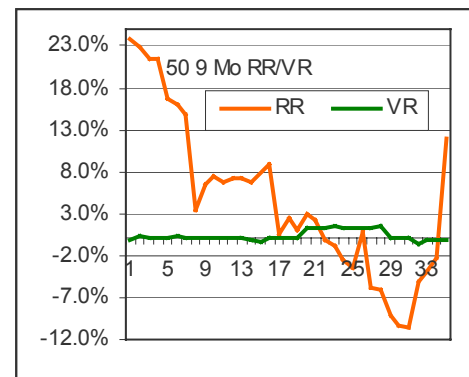
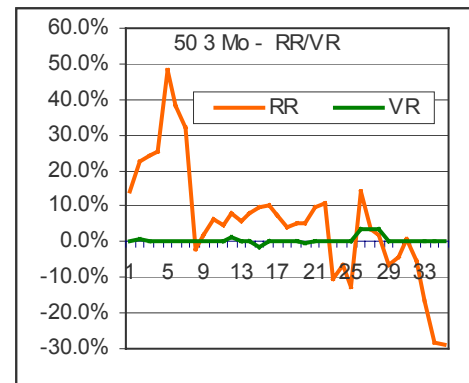
Volatility Ratio – Represents unrealized profits or losses (open trade equity) relative to a specific capital allocation.

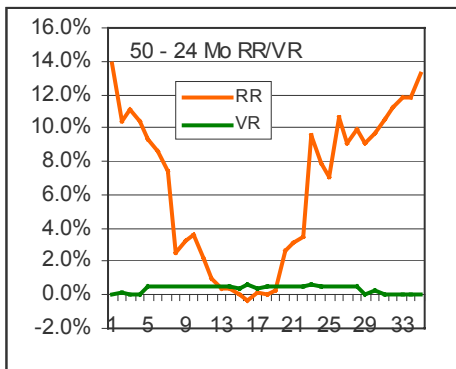
Net Ratio – Represents the difference between a realized and volatility ratio also relative to a specific capital allocation.

Funding level Ratio – Represents realized and unrealized returns relative to the advisors actual cash or accepted funding level for the same time frame.

A Brief Overview -

Simply stated – we perceive that true value of any managed futures/options investment is measured by capital at risk relative to return over variable time frames and market conditions. An advisor's ability to transfer unrealized profits or losses into realized profits minimizing capital at risk is quantified by a constant relationship between the SafeMoney Realized and Volatility ratio. Remember Einstein and relativity. Equally important is your awareness of time frames relative to perception and decisions. Specifically look at the 3 and 24 month charts below.





Three graphs above represent relationships between a realized and volatility ratio on a mix of two advisors over three time frames. Fifty percent (50%) of the assets were allocated equally to each advisor. Because of space limitations, only three time frames, 3, 9, and 24 months are graphically illustrated. I calculated 3, 6, 9, 12, and 24 months using four different splits – 50%-50, 55%-45, 60%-40, 65%-35. Tables will be presented later. Capital allocations and time frames are always user defined. We can contract time to increase risk management.

Realized Ratio – is represented by the orange data points. Although any capital at risk formula can be applied, we chose the maximum margin used for trading defined by the advisors disclosure document, relative to realized trading profits at the end of each month. One weakness is that the capital at risk was NOT all at risk at anyone time during the month. Profits and losses were also not all realized at anyone time during the same time frame. Another is that maximum margin is probably conservative. Many advisors do NOT use anywhere near the maximum margin requirement.

Advisors chosen for this demonstration have two different account size and maximum margin requirements. One can argue that we are evaluating apples and oranges therefore the work has little validity. As time passes we'll learn how to effectively equalize differences. For now, bringing your attention to the weakness is the best we can offer.

Any SafeMoney ratio is meticulous when applied to every trade using the margin requirement or percent of capital allocated, translated into a dollar denomination. Trades can then be sorted by market and totaled by month. Sorting presents the ability to analyze how each market

adds or detracts profits to or from the composite. Sorting also gives us information to correlate the trading results of each market within the portfolio to prove that diversification is prudently applied.

Nothing is hidden when SafeMoneyMetrics™ is applied to individual trade data.

When possible we analyze one account relative to the advisors composite 13 column track record. When client accounts commence trading with any particular advisor, we easily track every trade then sort by any time frame needed for a particular analysis. Client accounts are monitored relative to the advisors composite past performance used as the benchmark and the advisors monthly performance moving forward using a weighted average. The weighted average can be user defined.

With esteem and affection for my favorite industry colleagues Stark and Barclay and contrary to their viewpoints – I do NOT believe in using benchmarks - indexes external to the investment unless someone can PROVE that the benchmark has ANY relative comparative value to the investment being considered. Then I would need awareness of weaknesses and differences between the benchmark and investment. I am 150% convinced that applications of benchmarks and indexes are frequently abused in the investment evaluation and marketing process causing more harm than good.

Volatility Ratio – is represented by the green line. Again defined by capital at risk relative to open trade equity for the same time frame that the realized ratio is calculated. Open trade equity is useless until translated into realized trading profits. We've witnessed hundreds of thousands of dollars jiggle around before they were translated into realized nothing.

The volatility ratio applied to intra-day data quantifying each trade and then the composite portfolio can effectively manage risk in current reality as well as past performance.

A relationship between the realized and volatility ratio fluctuates between a few possible scenarios. A High, moderate or low to negative realized ratio relative to a high, moderate or low

to negative volatility ratio. Each user can create their own decision rules relative to different positions between the ratios. For example -

1. Low realized and Low volatility over a specific time frame and market condition can be used to add capital only if reasons for using the advisor remain stable – If there are solid reasons to change the advisor then capital can be removed from the account –
2. High Realized and Low Volatility can be used to take profits –
3. High Realized and High volatility can be used as early warning to de-leverage assets.

Again the analysis applied to time frames is a major factor for allowing its usefulness to evolve. Time frames are partially defined by the trading strategy and current market conditions.

Possibilities are only limited by the creativity of the analyst. The most important factor for maximizing the strength of SafeMoneyMetrics™ is to be aware of time and relationships between the ratios. Ratios do NOT serve any useful purpose when seen in isolation. As a matter of fact nothing in the universe can accurately be perceived in isolation.

Notionally Funded Accounts and Risk Management

An advisors ability to maintain account stability at their accepted funding levels is quantified by a relationship between the SafeMoney Net Ratio and the Funding Level Ratio.

Most trading advisors ask for large accounts (Over \$1M) – Rather than fund an account with \$1M – they may accept 25% or \$250K as actual funding. (Or other variations of the total account size.) If account assets are drawn-down to or below the \$250K clients are responsible for bringing the account back up its minimum funding value. These same advisors may only use 5% of the \$1M for margin at any one time. Simply stated:

- **5%** of a \$1M account = \$50,000
- \$50,000 represents **20%** of the \$250,000 acceptable funding level.

Net Ratio – Since our net ratio is the difference between the realized and volatility ratio, we can comfortably claim that it works as a perfect

“internal” benchmark to monitor an account’s funding level ratio and traditional rate of return. (see www.safemoneymetrics.com / Why SafeMoney - for principles supporting an “internal benchmark.”)

Funding Level Ratio –is represented by the advisors accepted funding levels relative to realized and unrealized returns. It has two basic purposes:

- To determine efficient use of capital relative to return and cost –
- To determine and monitor effective use of leverage over variable time frames and market conditions.

When an investments net ratio drops below the funding level ratio we have early warning of impending “unwanted” losses – and should carefully reassess the investment. WHY?

A net ratio always portrays the maximum percentage return (or loss when below the 0 baseline) because the capital base used to calculate the return is the lowest. The funding level ratio is always a lower percentage than the Net Ratio because the capital base it uses is greater than what is used for the net ratio. Finally traditional rate of return calculations are ALWAYS much lower than both the net and funding level ratios because they are calculated using the notional or fully funded account value.

50-50 3Mo	RR	VR	NR	FLR
Average	5.7%	0.3%	5.4%	4.8%
Minimum	-28.7%	-1.3%	-28.7%	-15.2%
Maximum	48.1%	3.8%	48.1%	28.5%

50-50 6Mo	RR	VR	NR	FLR
Average	4.7%	0.3%	4.4%	4.5%
Minimum	-28.1%	-1.5%	-28.1%	-6.5%
Maximum	2.1%	35.6%	20.7%	8.7%

50-50 9Mo	RR	VR	NR	FLR
Average	16.3%	0.1%	16.4%	8.9%
Minimum	3.5%	0.0%	3.5%	0.5%
Maximum	23.9%	0.4%	23.9%	14.2%

50-50 12Mo	RR	VR	NR	FLR
Average	12.3%	0.0%	12.3%	6.4%
Minimum	4.4%	-0.1%	4.4%	1.6%
Maximum	19.6%	0.3%	19.6%	11.3%

50-50 24Mo	RR	VR	NR	FLR
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Average	4.6%	0.4%	4.2%	4.0%
Minimum	-0.4%	0.0%	-1.0%	1.1%
Maximum	13.8%	0.6%	13.8%	8.2%

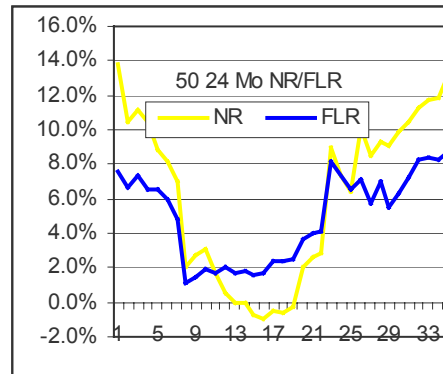
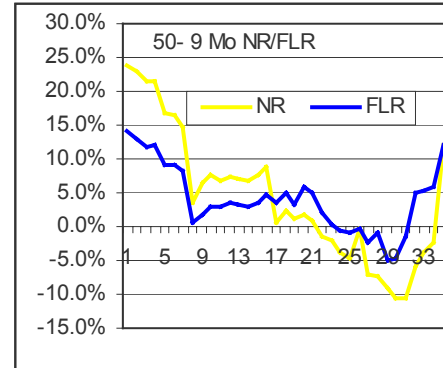
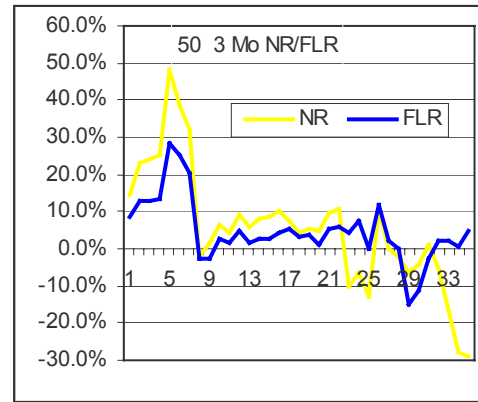
The five data tables represent the average minimum and maximum of all four ratios for a 3,6,9, 12 and 24month time frames when assets were equally split between two advisors. **Look at the NR and FLR** column in all five tables. Over any 24 month period the net ratio fell BELOW the funding level ratio which tells us that leverage being used in this investment is too risky for current market conditions.

When defining these two ratios we always want a wide gap between them. Before they narrow or cross we would suggest that the investment be de-leveraged.

If the realized ratio is really high under these conditions – profit taking would also be a very wise decision. In reference to profit taking – if clients remove 50% of their profits annually – or 25% every time the advisor takes an incentive fee they are “building an automated risk management system” into their managed futures account. Leave instructions when the account is opened and you’ll have more free time to enjoy life.

Three graphs to the right represent the 3, 9 and 24 month time frames for the Net and Funding level Ratios. Although an account can be funded at \$250K, clients pay management fees on the entire \$1M so the ratio serves two purposes.

1. We ONLY want advisors that maximize realized returns with minimum volatility on the least amount of capital over variable time frames and market conditions.
2. When we monitor the difference or gap between both ratios it becomes a remarkable early warning signal that excessive leverage is causing unwanted risk.



To be continued in subsequent articles:

“ There is never a conflict with person or condition, but rather a false concept mentally entertained about person, thing, circumstance or condition. Therefore, make the correction within yourself, rather than attempting to change anyone or anything in the without.”
 Joel Goldsmith “ The Infinite Way” Pg 149

**Services From
Sanctity/SafeMoneyMetrics**

Kim Hunter – editor of Risk and Reward magazine is also a Freelance Writer. – She is available to write

about SafeMoneyMetrics™ for print and electronic media. Based in London Kim's skills are exceptional for people interested in communicating the benefits of SafeMoneyMetrics™ Risk Management Services to the International and Institutional marketplace. My esoteric state of consciousness, incorrect grammar and excessive wordiness is automatically removed from the writing, allowing SafeMoneyMetrics™ to reach a larger international audience.

Kim's first article on SafeMoneyMetrics™ was published in Risk and Reward Magazine. You can access the magazine FREE at www.fow.com

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For Hedge Funds of Funds – In conjunction with the industry's most prominent traditional trading managers we build and manage dynamic managed futures and options strategies. Because SafeMoneyMetrics™ is integrated into every aspect of the service. Our composite efforts offer less risk than what ANY traditional resource alone can probably provide.

For Broker Dealers, Banks and Other Financial Institutions Sanctity/SafeMoneyMetrics™ will design and support profit centers for broker-dealers, futures commission merchants or any group interested in managed futures and options. The process begins with management and filters into a vigorous marketing strategy for advisors and educational process for clients of each participating advisor. Compensation is negotiable and includes revenue sharing or annual retainer paid monthly. Broker-dealers and other institutions may be exempt from registration if managed futures are under 10% of their gross revenues. ALL RISK MANAGEMENT MARKETING AND CLIENT EDUCATION STRATEGIES INCLUDE SAFEMONEY METRICS.

For Traditional Financial Advisors or Introducing Brokers – we act as Risk Managers and General Partners for private label limited risk partnerships beginning at \$500,000.

For Trading Advisors –SafeMoneyMetrics™ can be offered as a third party risk management and marketing strategy. Trading Advisors have no out of pocket costs. We can be compensated by the client or FCM sponsoring your services.

For Electronic and Print Media - SafeMoneyMetrics™ designs investment models teaching prudent integration of managed futures into other alternative investments and a traditional portfolio. Services can be supported with monthly articles, research and simple ratios on a data-base of advisors.

For National and International Commodity Exchanges and Associations - SafeMoneyMetrics™ can be integrated into managed futures and options marketing. Services can be offered through the

exchange as a benefit to clearing member firms and their clients.

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From All of Us