

FUTURES INTELLIGENCE

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The World Is Small

One of the pleasures in talking with people in hedge funds and managed futures is that you get a feeling for diverse places even if you can't go there. While working on this issue of OFI from New York, I enjoyed chats with people on different sides of the planet.

Bill Dunn in Stuart, Florida, discussed alligators and snakes in the Everglades National Park. It was a fascinating discussion, like his remarks on long-term trend following in [Founding Father Q&A](#). Tony Gannon in Dublin, Ireland, had gorgeous pictures from that city—they're so lovely we had to include one with his [Insider Talk](#).

This is truly a global industry. The markets are global, the investors are global and the managers are global. One investor was saying that Dubai remains vibrant despite the financial crisis. Another investor was talking about how the recession affects his neck of the woods in Connecticut. By the way, investors are interested in futures and macro strategies, as the surveys we summarize in [News Briefs](#) show.

Despite all the railing against globalization, it has to be a good thing in the long haul that money, skills and wisdom converge from all over the world. Wisdom is the word when reading a paper by Professor Harry Kat from City University in London—excerpts are in [Futures Lab](#). Ditto with [Practitioner Viewpoint](#) from Alan Rohrbach, who hails from Chicago, a great city whether windy or calm, icy or hot.

Chidem Kurdas
Editor
kurdas@opalesque.com

The Super-Cycle Correction



Our author is *Alan Rohrbach*, president and chief analyst of capital markets consultants Rohr International Inc. Long a proponent of an approach that recognizes broad cyclical trends, here he argues that trend analysis offers advantages for understanding markets in the super correction we're living through.

Mr. Rohrbach started his career on the Chicago Mercantile Exchange and has taught the exchange's technical analysis course. Through the Rohr Report he has assisted portfolio managers and dealers as well as corporate financial managers for over 25 years. Incorporating fundamental analysis and technical projections into a broad 'macro' focus, he analyses trends in major financial markets along with energy and gold.

Gloria Steinem famously said, "The first problem for all of us, men and women, is not to learn, but to unlearn." While she was referring to gender relationships, that is a very good precept for enlightened portfolio management. Too much of what passes for qualified analysis and portfolio theory is plagued by over-reliance on assumptions, often including faith in the general upward trend of equities and economies.

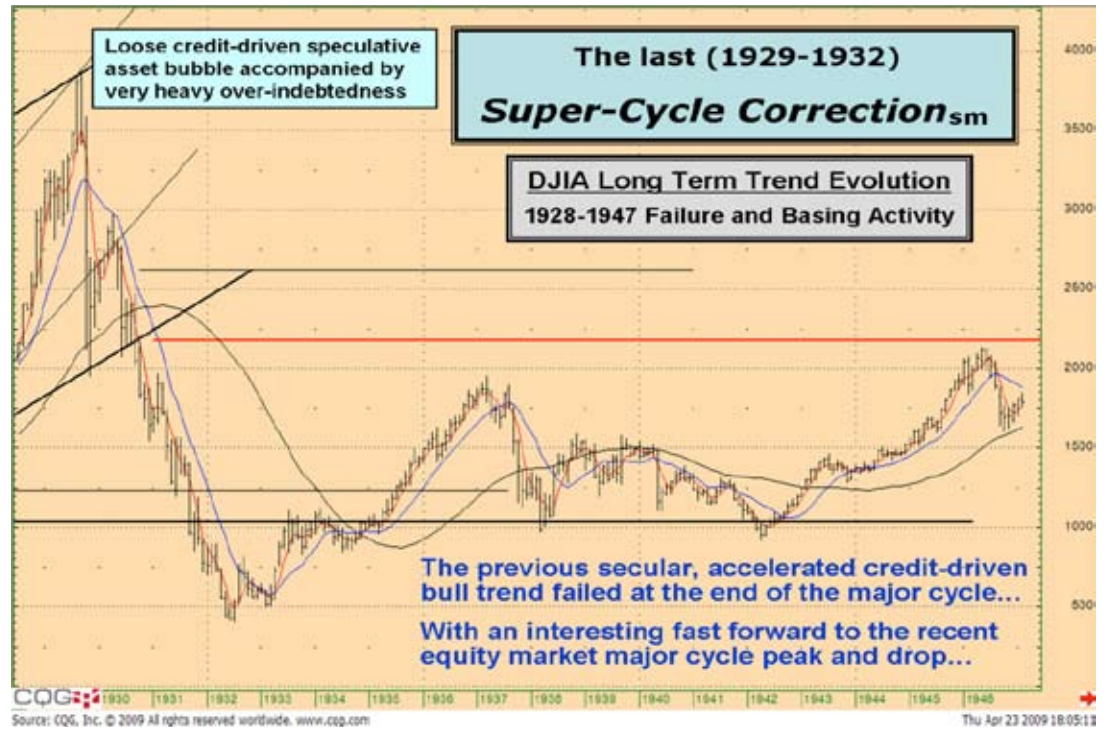
Once in a couple of generations, 'buy-and-hold' and even the best models are significantly derailed by what I call a super-cycle correction. Even the most sophisticated managers can suffer from too great a reliance on models that distract from understanding the underlying asset trends and corrections.

The long-term charts below illustrate the similarities between the October 2008 equity market failure and September 1930 technical failure of that era's bull trend. Despite the gains in equities since early March, it is likely that the current market outlook is for a distended bottoming phase similar to the one that prevailed through the 1930s and even into the 1940s.

A picture is worth a thousand words. The 1920s over-extended credit bubble ended in a period of major insolvency. That required decades of slow rebuilding of wealth before a sustained bull market could emerge once again. The manifestation of this in stock prices was a distinct inability to go above the technical failure level of 1930—the Dow Jones Industrial Average of 220.

PRACTITIONER VIEWPOINT

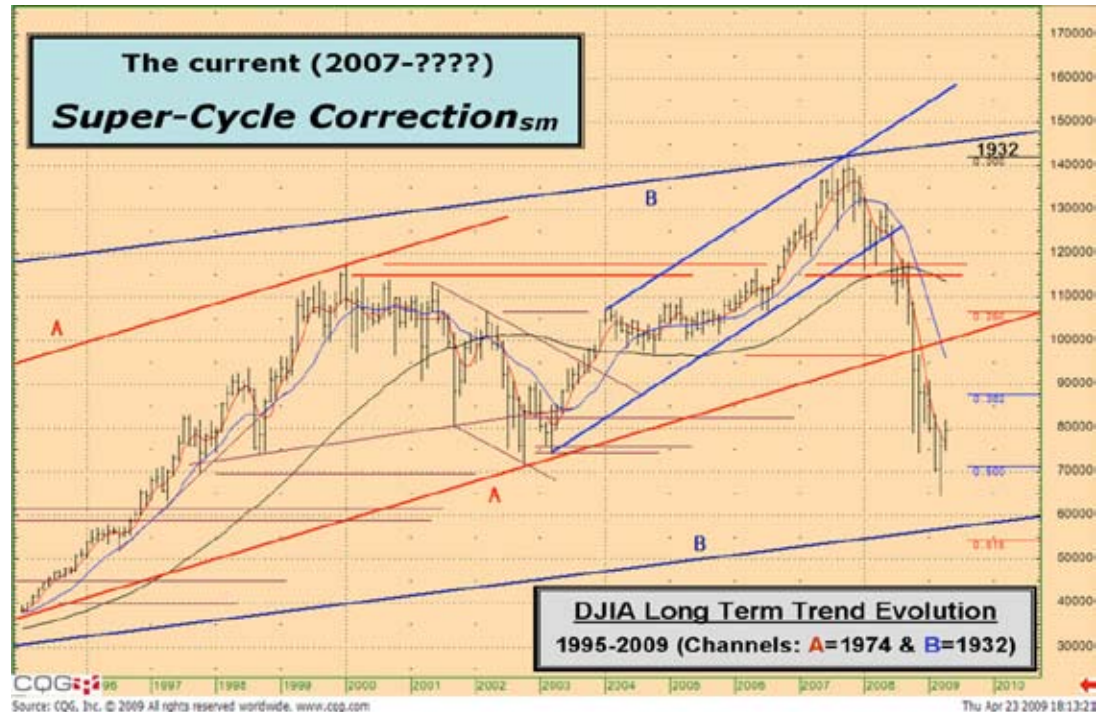
CHART 1



This historic pattern has implications for the price recovery potential after October 2008. And the economic fundamentals are completely consistent with this technical view.

Last October's equivalent DJIA failure below the major trend channel support from the 1974 low (indicated by the A lines in chart 2) was indicative of a similar end of an era. And it likely heralds a period of broad liquidation and price basing to come prior to any sustained recovery back above the Dow 10,000 area. It is also interesting that prospects for corporate earnings and multiples wholly support that view.

CHART 2



The difference is we do not yet know how low 'low' is. In spite of my Channel B projection from the 1932 low showing upper 5,000 area support for the DJIA, that is only a working assumption. On some historic statistical measures 5,000 is optimistic.

What we do know is that the unwinding of the bubble will cause significant multi-month bidirectional swings in equity markets and will also affect other asset classes. This is a failure of the 'fundamental' economic long-term growth cycle that was in place since the mid-1970s trough. The over-extension and collapse of the credit cycle is part of the story.

Of course, this is merely a basic view that requires supporting with quite a few other indicators and close monitoring. The main point is to recognize a simple fact of investment life, namely that there are major trends and cycles and they interact. In particular:

- It is possible to use broad 'trend' insights of a cyclical nature.
- There are specific benefits from a well-rounded trend analysis as it applies to the intermediate-term price movements.

Portfolio managers need to 'un-learn' the idea that serial variations of the buy-and-hold strategy are always viable. The received wisdom from some quarters is "if you have not sold you have not really taken a loss." Our corollary to that somewhat misguided axiom is: "If you have never sold, you have never actualized a profit."

This is the reason portfolio managers might benefit from the perspective of successful trend analysts and embrace two important concepts, even if they seem challenging to implement. The first is the need to identify when major trends reverse, whether for a broad asset class or individual instruments.

The second is how to use effective capital preservation exit strategies that apply no matter how good the returns have been up to a given point. This is especially important with equity markets likely locked into broad bottoming activity for at least the next several years and possibly a decade or more. Highly active intermediate-term trends are likely to be the case for the equities as well as other asset classes while the current unsettled economic situation is being resolved.

Meanwhile, cogent asset allocation does not just mean investing mostly in the subsets of one asset class like equities. One has to spread positions among diverse asset classes, ranging from debt to energy and precious metals. There may also be times when overall risk exposure needs to be reduced by holding a larger than normal cash reserve.

Investors' Preferences for CTAs and Macro

Two separate surveys suggest a rising or relatively stable demand for global macro and commodity trading advisor strategies, depending on the evolving conditions in credit and stock markets.

One study, by The Bank of New York Mellon and consultant Casey Quirk, found that investors worldwide are re-defining hedge funds by liquidity and risk exposure. From this perspective, global macro and CTAs belong to the "classic hedge liquid" category and are defined by not having consistent exposure to equity or credit market risk and not relying on any illiquidity premium for returns.

The preferences of investors vary across the different economic scenarios. In the bull case, investors are expected to gravitate toward strategies with higher market exposure, in particular long/short equity, and illiquid strategies such as distressed investing. By contrast, in the bear case, "classic" strategies like CTAs and global macro are the most favored.

In the baseline case there is a balance of strategy categories, but hedged market exposure strategies have an edge over "classic" because many of the latter are capacity constrained, according to the report.

Nevertheless, the Bof NY Mellon-Casey Quirk authors find that the classic category has more stable prospects. "A key implication is that while their share varies by scenario, the absolute opportunity for "classic" hedge fund strategies is the most stable going forward, as their relevance to investors is less dependent on external capital market returns," the report says.

A separate survey of Middle Eastern hedge fund investors by CapIntro Partners found that global macro and CTA are the top strategies – after distressed investing – favored for 2009. For changes in strategy allocation, 19% of the Middle Eastern investors interviewed said they favor distressed, 17% favor global macro and 15% CTAs.

Dubai Mercantile Exchange Appoints New Directors

Ali Tabbal and John Sandner were named to the board of directors of Dubai Mercantile Exchange Ltd. Mr. Sandner was chairman of the Chicago Mercantile

Exchange for 13 years and continues to serve on the CME Group board of directors and executive committee. Mr. Tabbal is presently chief financial officer of Dubai Holding and was previously director of finance at TECOM

DME chairman Ahmad Sharaf said the new appointments bring valuable industry and regional expertise to the board of directors. "We look forward to working closely with them and harnessing their insights and counsel as we work with the executive management team to drive a new phase of growth at the DME," he said.

The DME has created the Oman Crude Oil Futures Contract, recognized as the third global benchmark for crude oil and the first successful exchange-traded contract for crude oil for East of Suez markets.

Altegris Expands Research Team

La Jolla, California, based alternative investment firm Altegris hired Mark Dombrowski as a senior research associate focusing on operational due diligence and risk. Previously he was at Bank of America Merrill Lynch, where he developed financial models and did due diligence for potential IPO offerings and M&A opportunities. Prior to that, he worked for Context Capital Management with responsibilities for trade reconciliation, daily portfolio monitoring, portfolio valuation, and risk monitoring.

Altegris, led by Allen Cheng, finds and selects managed futures programs for its clients as well as hedge funds and other alternatives. Investors have allocated more than \$2 billion through Altegris. Mr. Dombrowski's role includes conducting due diligence on new funds and managers for Altegris investments.

Swine Flu Roils Hog Futures

Pork futures gained on the Chicago Board of Trade last Friday as fears lessened about the swine flu epidemic that appears to have started in Mexico. Earlier in the past week prices for US hogs fell as a number of countries, including big importers China and Russia, responded to the outbreak by banning pork imports from regions where the flu was found.

Health officials say people catch the virus from other people, not by eating pork. However, American pork exports have already dropped.

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PUBLISHER

Matthias Knab - knab@opalesque.com

EDITOR

Chidem Kurdas - kurdas@opalesque.com

ADVERTISING DIRECTOR

Denice Galicia - dgalicia@opalesque.com

EDITORIAL ADVISOR

Tim Merryman - tmerryman@opalesque.com

CONTRIBUTORS

Bucky Isaacson, Frank Pusateri, Pavel Topol, Ty Andros,
Walt Gallwas.

FOR REPRINTS OF ARTICLES, PLEASE CONTACT:

Denice Galicia dgalicia@opalesque.com

www.opalesque.com