

QUARTERLY

[Varengold Managed Futures Report No. 1]



[Varengold Managed Futures Report No. 1]

The World of Indices

Lukas Diehl

Senior Vice President - Varengold Asset Management

Page 5 - 11

Unemotional global investing using Intrinsic Value

Charles Ekins

Deputy CIO - Valu-Trac Investment Management Limited

Page 12 - 17

FORT's Risk Management

Yves Balcer

Principal - FORT Investment Management LP

Page 18 - 21

Dear reader,

the Asset Management of the Varengold Wertpapierhandelsbank AG is proud to present you the first edition of the Varengold *Quarterly*. As the name of this publication presumes, it will be released every 3 months to provide you with detailed information about managed futures. This asset class becomes more and more popular. In the first 3 months of the year 2011 the assets under management reached an amount of over 290 billion USD which means an increase of 34% compared to the previous year. Based on its over 16 years of experience in managed futures the Varengold Bank intends to give you a closer look on this kind of alternative investments by pursuing a scientific approach with this newsletter. For this purpose we fall back on direct expert information and backgrounds from leading asset managers. In this edition we managed Charles Ekins, CIO of Valu-Trac Investment Management Limited and Yves Balcer, CEO of FORT LP Investment Management to provide us each with an article.

With the *Quarterly* we hope to be able to offer you an interesting and informative lecture and wish you lots of fun when reading it.



Yasin Sebastian Qureshi – founder and managing director





The World of Indices

Lukas Diehl - Varengold Asset Management

The table below contains an overview of selected managed future indices. These indices can be helpful to compare the increasing amount of investment vehicles with each other.

Managed Futures Indices	Q1	YTD	2010	2009	2008	annualized volatility	annualized return	maximum drawdown
Altegris 40 Index	-2.42%	-3.62%	11.33%	-7.98%	15.47%	11.04%	7.00%	-13.24%
Barclay CTA Index	-0.93%	-1.50%	7.05%	-0.10%	14.09%	7.15%	5.59%	-7.74%
BTOP50 Index	-1.48%	-3.48%	6.38%	-4.77%	13.58%	9.03%	5.71%	-11.63%
CASAM CISDM CTA Equally Weighted Index*	1.15%	1.07%	14.29%	0.61%	21.76%	8.83%	8.63%	-8.75%
HFN CTA/Managed Futures Index	-2.84%	-2.81%	9.16%	1.85%	10.97%	8.37%	8.29%	-9.35%
IASG CTA Index	-1.30%	-1.40%	13.05%	2.98%	26.00%	9.57%	15.28%	-7.89%
Newedge CTA Index	-2.66%	-3.96%	9.24%	-4.30%	13.12%	9.13%	6.32%	-10.31%
Stark 300 Trader Index*	-0.73%	-1.72%	7.97%	-4.18%	11.41%	8.47%	5.69%	-9.70%
Stock indices	Q1	YTD	2010	2009	2008	annualized volatility	annualized return	maximum drawdown
DAX (Frankfurt)	4.76%	6.68%	16.06%	23.85%	-40.37%	22.73%	0.51%	-68.29%
MSCI The World Index - Gross	0.68%	5.62%	12.34%	30.79%	-40.33%	16.65%	1.70%	-53.65%
Commodity indices	Q1	YTD	2010	2009	2008	annualized volatility	annualized return	maximum drawdown
Reuters - CRB Commodity Index	-6.03%	0.43%	29.95%	33.42%	-23.74%	14.70%	10.28%	-40.86%

Source: Varengold Asset Management
As of: 30.06.2011
* As of: 31.05.2011

Managed futures are becoming increasingly popular as a safe asset class in a crisis. As an addition to the traditional portfolio, they offer an effective way to reduce the risk of unexpected market developments and thus increase returns. However, if investors are to find the right product, they must comb a steadily growing market. Indices can help overcome this challenge.

A look at existing indices can be a useful basic guide to the managed futures market. A closer analysis of their underlying features and structures then allows potentially attractive investment opportunities to be identified.

For those wishing to invest in alternative investments, indices as benchmarks are a good starting point for comparing individual sub-strategies. A managed futures product already in the portfolio can be compared with the relevant indices for evaluation, making it simple to check how the asset class as a whole has performed over a given period. Care must

nevertheless be taken when selecting a managed futures benchmark index, to ensure equivalent products are used and the comparison is therefore useful from the investor's perspective. Alongside a quantitative index evaluation based on returns and maximum drawdowns, investors should also examine qualitative characteristics. What are the underlying strategies employed by the CTAs included in the index? How many managers are covered by the index? And what hurdles must managers first overcome to be listed at all?

Who operates where: sub-strategies and markets

To give an example, one of the oldest indices, the HFN CTA/Managed Futures Index, includes eleven different trading models. The prominent Barclay CTA Index collects data on seven sub-strategies, while the Altegris 40 Index, established in 1990, examines only three. A look at the sub-indices casts light on the results and enables a comparison of the indices. A breakdown is particularly simple for the CTA-Index, the Barclay BTOP50, and the indices of NewEdge, IASG and Stark. Returns for the

individual sub-strategies are extremely easy to follow and understand. Those trading strategies which have contributed most to the month's performance of the index as a whole can be identified at a glance. However, the reduced number of trading models in the smaller indices need not necessarily result in poorer performance. Careful CTA selection is also a key.

„ Indices help to get started with comparing the sub strategies. “

Taking the hurdle: criteria for listing

A manager must meet specific criteria to be listed, and these are defined individually by each index. Databases in which the CTAs are registered are used in the selection process. The best-known examples are BarclayHedge Ltd, Stark & Company, EuroHedge Database, HedgeFund.net Database and Morningstar Inc. Criteria may include the scale of assets under management (AuM), the duration of performance or indeed a CTA's ranking in a particular database. For example, the Stark 300 CTA Index, based on individual performance, only includes the top 300 managers in its calculations. This equals a form of preselection, in other words preliminary due diligence. The IASG CTA Index, on the other hand, demands a live track record of at least three years and thus offers a clearer overview and more detailed record. Once a CTA is included, he is checked on a regular basis to ensure he still meets the quality criteria. Such checks may be monthly, quarterly or annually to minimise any distortion. An important factor here is the "survivorship bias", in other words the fact that unsuccessful CTAs eventually liquidate their funds and report returns either irregularly or not at all. This means the reported collective, overall performance of an index is in fact better than the actual situation warrants, as inactive managers are regularly excluded from calculations. One example is NewEdge CTA, which has been

in operation for around 10 years. Each month, NewEdge CTA replaces the CTAs removed with new CTAs who fulfil the criteria for listing; however it continues to record the data in the index history. Inactive managers in the Barclay CTA Index, which undergoes annual rebalancing, are automatically replaced and therefore do not affect index performance.

Weighing in the balance

The remaining managers continue to contribute to the final results, and there are two possible forms of weighting. Barclay, NewEdge, IASG, HFN and the CASAM CISDM CTA Equal Weighted Index all weight all listed CTAs equally. Each manager therefore accounts for the same proportion of overall performance irrespective of his size. Stark 300 and Altegris 40 apply a different method: results generated by individual managers are weighted in index performance calculations according to the volume of assets under management in each case. Managers of larger funds are thus more heavily weighted than smaller CTAs. It is hard to assess whether or how far the various weighting models do justice to the managers listed. Size does not necessarily allow conclusions on the results generated – a fact asset weighting considers. If only a few managers in the index perform well but represent the majority of the assets managed,

Managed futures are becoming increasingly popular as a safe asset class in a crisis.



equal weighting risks producing disproportionately disappointing results due to the poor performance of the majority of managers.

Investor goals: investing and participating

Some indices, Barclay BTOP50 and the NewEdge CTA Index among them, specify in their conditions for inclusion that managers be open to new investments. Altegris 40 makes no such requirement. It includes managers who have no free capacity and in whom no further funds can be invested. An examination of those indices containing investable managers is consequently of particular interest to potential investors. Indices provide contact details and further information on investment options on request. However, it should be remembered that there are no financial products on the current market which represent a given index or exactly reflect index performance.

Calculus

Results must be calculated regularly in line with weighting and rebalancing specifications, and each index has its own committee for this purpose. The committees consider both the individual data for the managers in the programme and the said managers' weightings. Fees arising for any investments are disregarded: huge differences are possible as manager-specific fees and participations vary enormously. As the indices represent potential rather than real portfolios, the inclusion of such fees is in any case irrelevant.

However, great attention is also paid to precision and thoroughness to produce useful indicators. That is why the task is only rarely outsourced to external service providers such as International Traders Research, Inc., which provides the calculations for the Altegris 40 Index. On the other hand, internal index committees frequently offer their services to external clients. They usually set up a separate department specialising in such work, for depending on the number of CTAs included in the index, the scope of such calculations can be considerable.



David and Goliath

The number of managers represented in an index may be strictly defined or variable. The Altegris 40 Index, for example, the “smallest” index, always lists 40 CTAs. The HFN, on the other hand, invariably includes over 500 managers. Yet the number of CTAs is no basis on which to assess index performance. A rising number of managers may indicate increasing diversification, but this can be offset by the quality of the manager selection.

The figures talk

A close look at results of the individual managed futures benchmark indices reveals that those with broad diversification, for example the Barclay CTA Index with over 500 managers, have lower risk and return figures. Whilst the smaller Altegris 40 saw losses of around 10% over the course of the year, the HFN Index was never below this mark. This affects annual returns: the large indices usually generate lower returns than the small, but report steadier performance over the years. The flipside is that the risks of poor investments also rise; not only potential profits but also potential losses are infinitely greater. Lower Sharpe ratio numbers are indicative of this risk.

Investors should pay particular attention to the period covered. For example, the results of the first eight years (1980-87) following the creation of the Barclay CTA Index distort the annualised returns and volatility. Disregard these years and annualised returns fall by around 45 %. A useful comparison with indices set up later is thus clearly impossible. Comparisons should be

based on comparable periods.

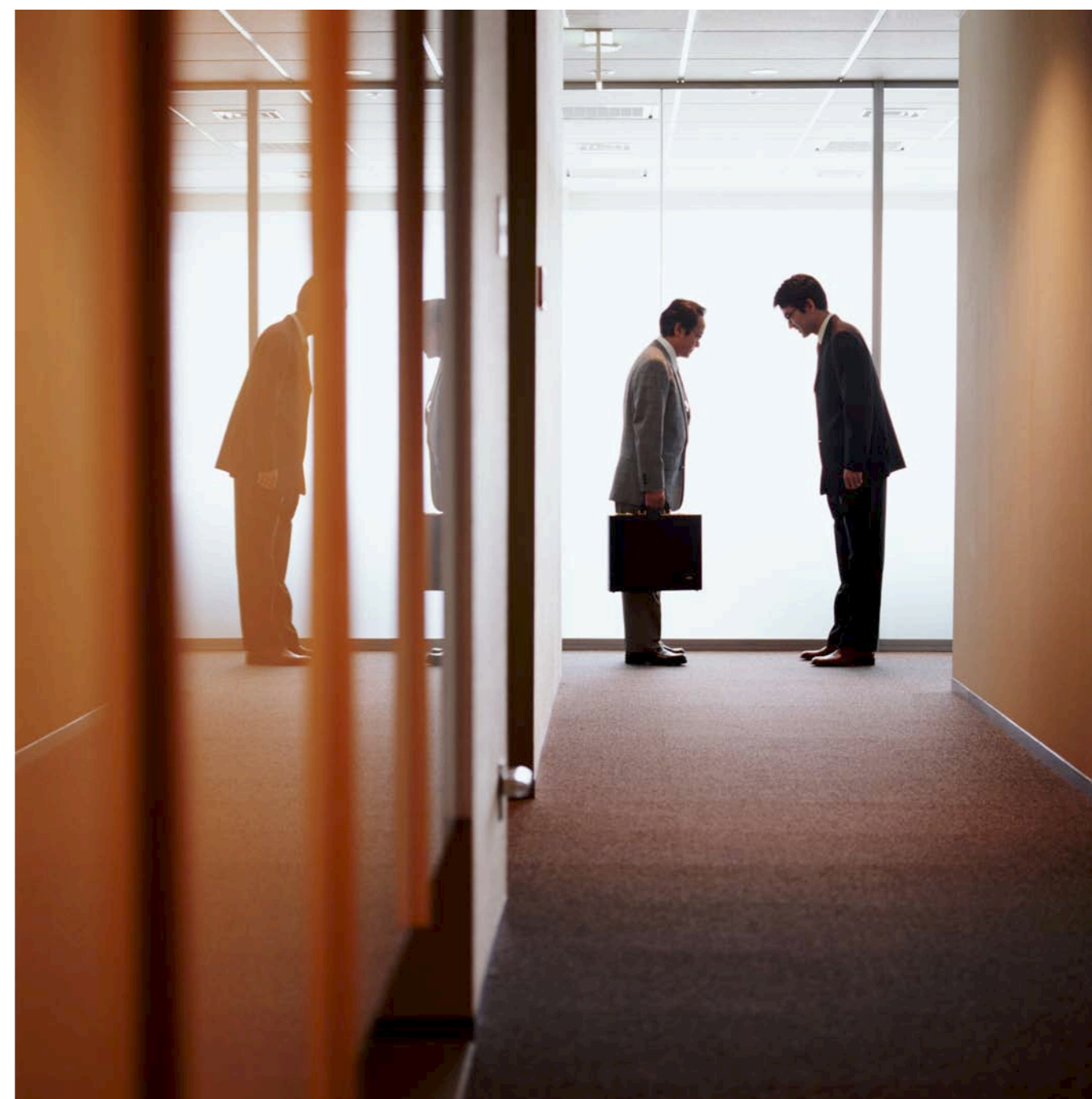
All in all, there is a high correlation (0.82 – 0.98) between all the indices considered. All generated good returns in the successful CTA years 1993, 2002 and 2008; returns in the weaker years of 2004 and 2005 were only moderate. 2009, when above all long-term trading strategies faced a difficult trading environment, was a year of losses for all indices. The best-performing was the HFN CTA/Managed Futures Index with a slight increase of 1.85 %, while the Altegris 40 Index fell a disappointing 7.98 %. Strong figures were reported by the IASG; HFN, BTOP50 and the Barclay CTA Index have steadily performed well. Altegris 40 and Stark 300 have increased their returns over the years. However, with top annualised Sharpe ratio numbers and an outstanding cumulative ROR, IASG results far exceed those of all other indices.

Of considerable interest is a closer examination of the CASAM CTA Index universe. Until October of 2010, it issued both an equally weighted and asset-weighted index. The two had the same features and structures and differed only in how the managers listed were weighted. While the asset-weighted index fell by 2.59% in 2009, the results for the equally weighted index were 0.61 % for the same year. Returns for the equally weighted index were also around 5% higher than those of the asset weighted index in 2010. One possible interpretation of these results would be that the smaller managers performed better than those with a greater volume of AUM. That this was the case became increasingly clear over time.

“Look before you leap”

For an investor with a managed futures product in his portfolio, managed futures indices serve as a useful benchmark for comparing the investment with the asset class as a whole and

evaluating the product’s performance. It is in principle advisable to compare a single manager strategy with an index which has a limited number of target managers, for example NewEdge the Altegris 40 Index. Fund of fund products, on the other hand, should be evaluated against





The World of Indices
Lukas Diehl - Varengold Asset Management

Name	Barclay CTA Index	Barclay BTOP 50	NewEdge CTA Index	Stark 300 CTA Index	HFN CTA/ Managed Future Index	CASAM CISDM CTA Equal Weighted Index	Altegris 40 Index	IASG CTA Index
year of inception	1980	1987	2000	1982	1976	1979	1990	1977
included programs	565	28	20	300	584	108	40	335
weight	equal	asset	equal	asset	equal	equal	asset	equal
rebalancing	annual	annual	annual	monthly	monthly	monthly	monthly	monthly
reporting	monthly	daily	daily	monthly	daily	monthly	monthly	daily
annual. Returns 2010	7.07%	6.38%	9.24%	7.92%	9.22%	14.29%	11.33%	12.20%
annual. volatility (1%)	7.17%	9.12%	9.10%	8.52%	8.36%	8.78%	11.08%	9.74%
annual. Sharpe ratio	0.71	0.61	0.68	0.62	0.95	0.91	0.64	1.5
maximum drawdown	-7.74%	-11.63%	-10.31%	-9.70%	-9.35%	-8.75%	-13.24%	-7.89%
further information	www.barclay-hedge.com		www.new-edge.com	www.starkre-search.com	www.hedge-fund.net	www.alternative-investments-morningstar.com	www.managedfutures.com	www.iasg.com

Source: Varengold Asset Management
 As of: 30.06.2011

the Barclay CTA or Stark 300 Index. An index's transparency and frequency of reporting is also important for an investor. If he wishes daily comparability, he will of necessity use the NewEdge CTA or BTOP 50 Index: the latest status for these indices is published on the websites daily. However, most CTA indices calculate prices monthly, which should be often enough for a general overview of the asset class.



Lukas Diehl
 Senior Vice President
 Asset Management
 Varengold Wertpapierhandelsbank AG
www.varengold.de
www.varengold-am.com
 July 2011



Unemotional global investing using Intrinsic Value

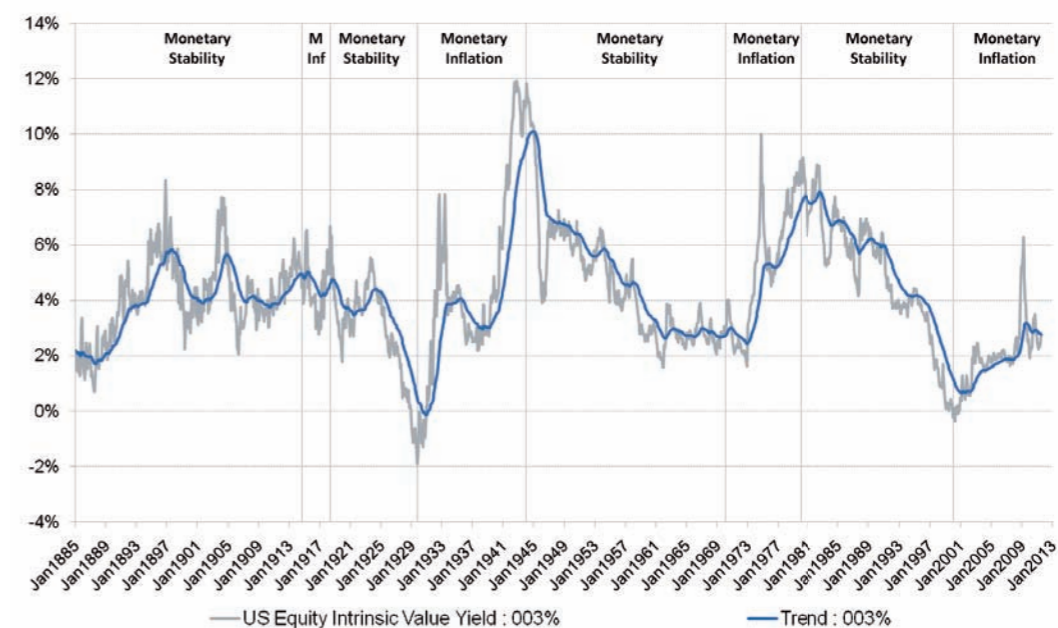
Charles Ekins - Valu-Trac

It is inherently difficult to predict future market prices. However, all assets have an underlying Intrinsic Value that can be calculated on an objective and globally consistent basis. Allocating according to the level of Intrinsic Value is a sensible starting point for global investors. However, cheap assets can sometimes stay cheap or become even cheaper (the so-called "value trap"). It therefore makes sense to include use of technical measurements (such as overbought/oversold and typical trend following measurements such as momentum and moving averages) to help determine when to take advantage of attractive Intrinsic Value. At Valu-Trac, the level of underlying Intrinsic Value is the primary measurement because Intrinsic Value underwrites the investment. To ignore the underlying Intrinsic Value can be dangerous, especially in turbulent times. As Warren Buffet said: "It's only when the tide goes out that you learn who's been swimming naked".

Intrinsic Value for income producing assets (i.e. Bond and Equity markets) lies in the potential income return. The primary reason for investing in an income producing asset is to receive a future income stream. Intrinsic Value for Equities can be determined by calculating the net present value of potential future income streams. At Valu-Trac, we measure potentially distributable income streams on a globally consistent basis by taking the actual dividend paid and combining it with part of the adjusted retained cash earnings, which we then project forwards using objective growth rates based on history. We compare the net present value with the actual price to create an annualised measure of the potential income return ("Intrinsic Value Yield"). The objective is to invest in assets which have

high (i.e. attractive) Intrinsic Value Yield, preferably when the Intrinsic Value Yield is also falling. Intrinsic Value Yield for Bonds is the real gross redemption yield.

Graph 1 below shows the level of Intrinsic Value Yield for the US Equity market since 1885. It shows how Intrinsic Value can be used as a navigational tool to identify the opportunities and dangers. For example, it highlights the extremely high (attractive) value after Pearl Harbour in 1941; the attractive levels in the early 1980s before the beginning of the 20 year bull market in the 1980s and 1990s. It also shows the context of the opportunity in 2009 after the 2008 credit crunch. What stands out clearly is the fact that, at the height of the dotcom boom at the end of 1999, the US Equity market had become extremely poor value that has only been surpassed once in the last hundred and thirty five years (in 1929).

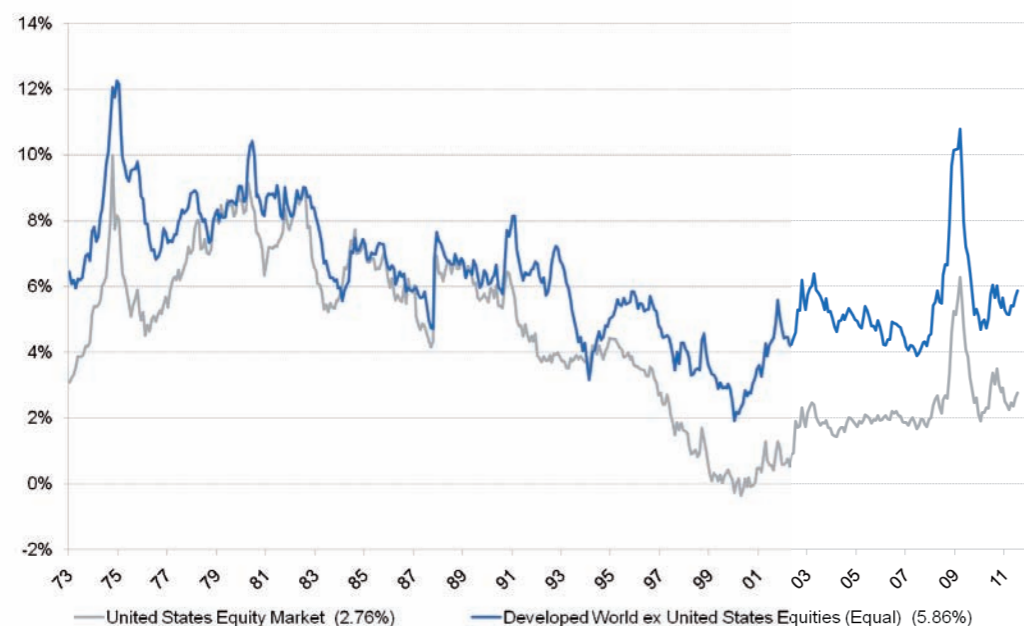


Graph 1 also highlights periods of Monetary stability and Monetary inflation over the same period. Equity and Bond markets are priced in "fiat" (i.e. paper) money, which can be debased by Governments and Central Banks pursuing political objectives. It is important to have knowledge of the monetary background - whether the world is in a period of monetary stability or instability, as it has profound consequences for assets such as Equities and Bonds which are priced in paper money. Graph 1 shows how Intrinsic Value Yield fell in the bull market in the 1920s during a period of monetary stability after World War I; rose in the 1930s bear market which was a period of monetary instability; fell during the bull markets which were driven by the monetary stability introduced at Bretton Woods in 1944; rose in a bear market

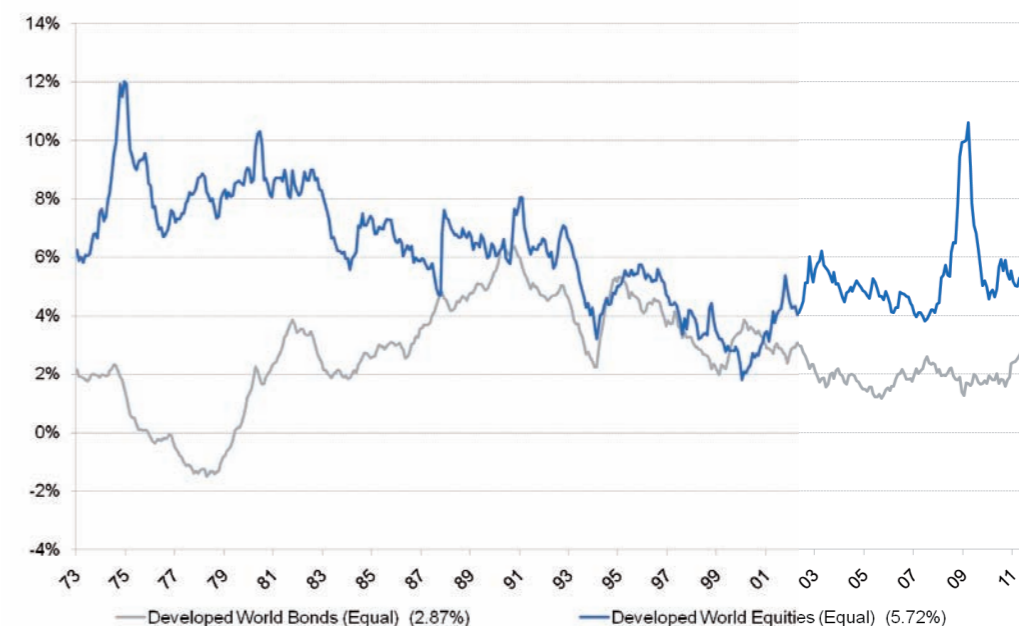
during the monetary inflation of the 1970s after the US abandoned monetary prudence and the Gold standard; and fell during the 1980s and 1990s bull markets following the return to stability under President Reagan and US Federal Reserve Governor Paul Volcker. The World returned to a period of monetary instability in 2000, which ultimately is a consequence of the World Debt problem which has caused Governments and Central Banks to print money to avoid Debt deflation. This monetary instability is in turn the real cause of the 2008 credit crunch and the two severe bear markets in Equities since then (2000-2003 and 2007-2009).



Unemotional global investing using Intrinsic Value
Charles Ekins - Valu-Trac



Source: Valu-Trac



Source: Valu-Trac

Graph 2 shows that the level of Intrinsic Value for World Equity markets ex the US (equally weighted) at 5.5% (blue line) is more attractive than for the US Equity market at 2.6% (red line). The conundrum for global equity investors has been that the US Equity market has been a market with poor value but which has been outperforming, perhaps because investors are fearful of the consequences of the structural debt problem and have fled to larger, more liquid markets which (probably incorrectly) are perceived as being safer.

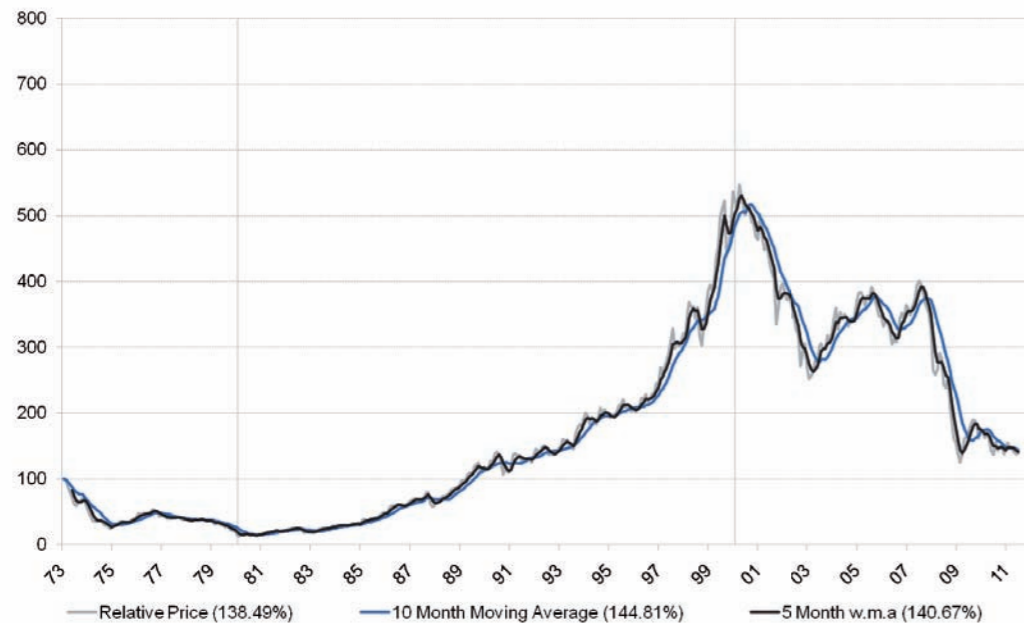
Graph 3 shows a comparison of the Intrinsic Value Yield for World Equity markets (blue line) and World Bond markets (red line). One would normally expect Equities to be better value than Bonds (i.e. the blue line to be higher than the red line) because Equity investors demand a "risk premium". Whenever Bond value starts to compete with Equity value such as in 1987, 1990, 1994 and particularly in 2000, it normally spells trouble for Equities.

Currently Intrinsic Value for World Equities is higher than for World Bonds, which are strategically unattractive due to low real yields. Technical measurements are also supportive for Equities. For example, relative Price momentum is positive, and moving averages of relative Price are also rising in favour of Equities continuing to outperform Bonds.

The apparent attraction of Equities is rather cynical and even potentially dangerous. The current monetary inflation is finding its way as liquidity into Equity markets, and it is possible that Equity markets will continue to deliver positive returns for the time being. However, history shows that ultimately monetary inflation undermines man-made currencies relative to real assets such as Gold, and in turn destroys Equity and Bond markets. At its current price, Gold's content in the World Monetary Base has fallen to only 11% (which compares to 90% when Gold was last officially revalued at the Smithsonian Agreement in 1935 to deal with the Debt problem then). This shows Gold to be cheap within the context of its content of the World Monetary Base.



Unemotional global investing using Intrinsic Value
Charles Ekins - Valu-Trac



Source: Valu-Trac

Graph 4 above shows that Gold typically outperforms Equity markets during periods of monetary instability and underperforms during periods of monetary stability. With the current Debt problem, it is difficult to see a return to monetary stability until Governments return to a policy of monetary discipline. Investors in Equity markets should therefore be keeping a vigil to ensure they are ready to alter their investment strategy in the likelihood that Equity markets will eventually be undermined by the World Monetary instability, and that Gold is the safe asset to be as currencies are debased in the face of the Debt mountain.



Charles Ekins
Deputy CIO
Valu-Trac
Investment Management Limited
www.valu-trac.com
July 2011

WARNING: This Report is based on information obtained from sources believed to be reliable but is not guaranteed as being accurate, nor is it a complete statement or summary of the securities, markets or developments referred to in the report. The Report should not be regarded by recipients as a substitute for the exercise of their own judgement. Any opinions expressed in this Report are subject to change without notice and Valu-Trac Investment Management Limited is not under any obligation to update or keep current the information contained herein. Sources for all tables and graphs herein are Valu-Trac Investment Management Limited unless otherwise indicated. Value of investments can fall as well as rise and you may not get back the amount you have invested. Income from an investment may fluctuate in money terms. If the investment involves exposure to a currency other than that in which acquisitions of the investments are invited, changes in the rates of exchange may cause the value of the investment to go up or down. Past performance is not necessarily a guide to future performance. The Report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient and is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. If you have any doubt about any of the information presented, please consult your stockbroker, accountant, bank manager or other independent financial advisor. Valu-Trac Investment Management Limited and its affiliated companies, employees of Valu-Trac Investment Management Limited and its affiliated companies, or individuals connected to them, may have or have had interests of long or short positions in, and may at any time make purchases and/or sales as principal or agent in the relevant securities or related financial instruments discussed in this Report. © 2011 Valu-Trac Investment Management Limited. Authorised and regulated by the Financial Services Authority. SEC Registered Investment Advisor. Registered with the CFTC as a CTA/CPO and NFA Member. All rights reserved. No part of this Report may be reproduced or distributed in any manner without the written permission of Valu-Trac Investment Management Limited. Valu-Trac™ is a registered trademark.



Many investors are good at identifying profitable investment opportunities, but only a few have a good long-term performance record. Why? There are two critical elements a manager must have besides investment acumen. The first is to have the discipline to stay with the chosen investment style through the many ups and downs in the market; and second is to limit losses when the investor is on the wrong side of the markets. Even the best investors are wrong quite often, and without risk control most of the gains made when the investor is on the right track are frittered away. In this note we will focus on this second element and discuss how FORT controls and monitors its market risk.

The principal line of defense against unfavorable events is to limit exposure to the markets. This implies that however comfortable we are with any investment idea there is a limit to how much risk we will take to ensure that it is not too large in case it turns out that we are wrong. In order to control or monitor the exposure of our portfolio, we must decide how to measure it. We investigate three common measures of exposures and see how they apply to the portfolio strategy of FORT: Margin-to-Equity (MtE), Value-at-Risk (VaR) and Leverage.

We argue that:

- (1) MtE is a measure of the worst one day loss an investor can experience if all positions go wrong due to a once in a lifetime event in the market. In FORT's experience no daily loss has exceeded the MtE.
- (2) Monthly VaR at the 99% confidence level measures the worst monthly loss an investor

would very likely experience at least once over an eight year cycle. FORT's Contrarian program has existed for 8 ½ years and has had one month where losses have exceeded the monthly VaR.

(3) Leverage is not a meaningful measure of risk for a futures portfolio.

A brief description of how a futures contract works

A futures contract is a standardized contract between two parties to exchange a specified asset of standardized quantity and quality for a price agreed today, the futures price, but with delivery occurring at a specified future date, the delivery date. Note that the contract itself costs nothing to enter; the buy/sell terminology is a linguistic convenience reflecting the position each party is taking (long or short). To insure the ability of both the seller and the buyer to fulfill their obligations for the contract, any gains or losses due to the change in the futures price is credited or debited respectively daily from the investors' account. This process is called daily mark-to-market. Furthermore, to insure that these daily payments take place, exchange have instituted the concept of margin. Margin is the amount of funds the exchange requires from the buyer (or the seller) to insure that they can meet their daily mark to market obligations, also called margin calls. If an investor does not have enough funds to post the necessary margin, then its position can be liquidated by the exchange.

Margin to Equity

Margin is set by the exchanges by balancing two offsetting factors. It is set high enough to ensure that the buyer and the seller can meet their daily margin calls even when markets have large change in futures price. The exchanges have a business incentive to compute precisely the risk inherent in a futures position. Otherwise their clients will renege on their debts. If the margin is set too high, then investors are likely to bypass futures contracts and gravitate towards over the counter swaps on the underlying assets. The exchanges will lose their business. In practice, the futures contracts have several operational advantages over OTC swaps. As a result, the margin is set a little higher than it

should be just based on price change.

MtE is the margin an investor posts on all the futures contracts it holds in its portfolio divided by the equity an investor has in its portfolio. The margin is set to ensure that the investors are able to pay for almost all daily market fluctuations. The portfolio margin is additive across futures contracts in the portfolio, the implicit assumption being that on a very bad day all positions may go wrong at the same time. Therefore, MtE is a good proxy for an upper bound to the worst daily percent loss an investor may ever experience.

MtE is computed by the futures clearing broker on a daily basis and is easy to verify for any





FORT's Risk Management Yves Balcer - FORT LP

third-party monitor. FORT sets its maximum MtE at 14%. If FORT is fully long or short in all markets where it operates, the portfolio MtE will be 14%. In general, there are many positions that are below their maximum allowable size. Historically, FORT's MtE has averaged 9% with a low of 4% and a high of 14%.

Has the experience of FORT with MtE as an upper bound on risk been satisfactory? In over 17 years of trading at FORT and 8 1/2 years for the Contrarian program, the daily loss was always less than our MtE. The three largest actual losses encountered by Contrarian were -5.3% (with MtE of 6.7%) on August 16, 2007, -4.2% (with MtE of 11.8%) on April 2, 2004 and -4.0% (with MtE of 8.5%) on July 26, 2007.

Value-at-Risk

Value at risk is the loss a portfolio will experience once in a while but with some regularity. It is generally expressed over a fixed horizon, we prefer 1 month, and with a certain level of confidence, we use 99% level. This means that 99% of the time the monthly loss will be less than the VaR value. There are many ways to compute VaR: one can simulate possible paths for prices through Monte Carlo methods (however, it is not easy to create multi-period realistic paths across markets); one can find the sensitivity of the portfolio to underlying factors such as inflation, growth (however, this is subject to the same problems but at the factor level); alternatively, one can look at the historical path of all assets in the portfolio and see how the portfolio would have fared. This is the method we choose.

Does VaR analysis add value to risk control? We argued that MtE provides an upper bound to the inherent risk of a portfolio, but it is an upper bound and has validity for only one day. Portfolios of futures, such as FORT's, are extremely liquid. They could be liquidated in minutes and definitely within a day, but they are rarely adjusted that quickly to dramatic changes in the market conditions. Positions in these portfolios are somewhat sticky as it takes many days for the underlying models to generate the signals leading to a change in positions more consistent with the new environment. For this reason, FORT believes that a meaningful horizon for VaR analysis should match the average holding period of the portfolio, which in the case of Contrarian is one month.

FORT computed monthly VaR using 10 years of data at the 99% confidence level. Next, we examined the prediction of the monthly VaR at the 99% level for the entire 8 1/2 year history of the Contrarian program (103 months). In how many instances is the performance of the portfolio worse than the VaR level at the start of the month? For instance, for the Contrarian portfolio of Jan 1, 2003 the monthly VaR at the 99% level was 9.8%. Would it have been plausible to state that with 99% probability the portfolio losses for January 2003 would be less than 9.8%?

If we look to FORT Contrarian's history of 103 months for guidance, there was one monthly loss (October 2008) which was greater than what was predicted by VaR, exactly what the 99% confidence level implies (1 is 1% of 103). FORT's experience shows that monthly VaR at 99% confidence level is a good proxy for the

worst monthly loss an investor will very likely experience at least once during an eight year period (about 100 months).

Leverage

Leverage is computed by adding the face value of all the futures contracts in a portfolio divided by the size of the portfolio. If leverage is 2, then it means that for every \$1 of capital, the portfolio owns \$2 in assets. There are two basic difficulties with leverage as a risk measure for futures portfolios. First, leverage is an important concept when one must borrow to finance the leveraged position, and especially when there is a mismatch between the length of borrowing and the holding period of the financed positions. Futures have no financing risk. The risk of futures is limited to the price variation of the positions, which have to be settled daily. Second, futures portfolios have a wide variety of underlying assets, Libor, Bonds, Equity Indices, Metals, Energy and Industrial and Agricultural Commodities. The price volatility across these assets is very different for the equivalent monetary value of the underlying assets. For instance if from our previous discussion we use margin as a proxy of price volatility, a \$1million position in Natural Gas requires a margin of \$112,000,

while a \$1million position in 3-month Euroyen Interbank rate in Japan requires only \$100 in margin. This is a ratio of over 1000 to 1. Because there is no cost to financing our positions and price volatility risk is well measured by both MtE and VaR, FORT does not use leverage as a measure of risk.

Conclusion

Risk or volatility of returns cannot be eliminated from futures portfolios. They are the price one pays to get the return profile generated by a strategy such as FORT's Contrarian. But an investor, before investing in a strategy, should feel comfortable that the manager has the ability to control and monitor its risk. For FORT, the historical volatility of its returns has behaved in a manner consistent with expectations. There have been no black swans in the history of our performance. While the future remains uncertain, we take great comfort in the stability and the predictability of our risk profile.

Yves Balcer
Principal
FORT
Investment Management LP
www.fortlp.com
July 2011






Varengold

WERTPAPIERHANDELSBANK AG

VARENGOLD
WERTPAPIERHANDELSBANK AG

GROSSE ELBSTRASSE 27
22767 HAMBURG
Germany
T +49 40.66 86 49 0
F +49 40.66 86 49 49

www.varengold.de
info@varengold.de

