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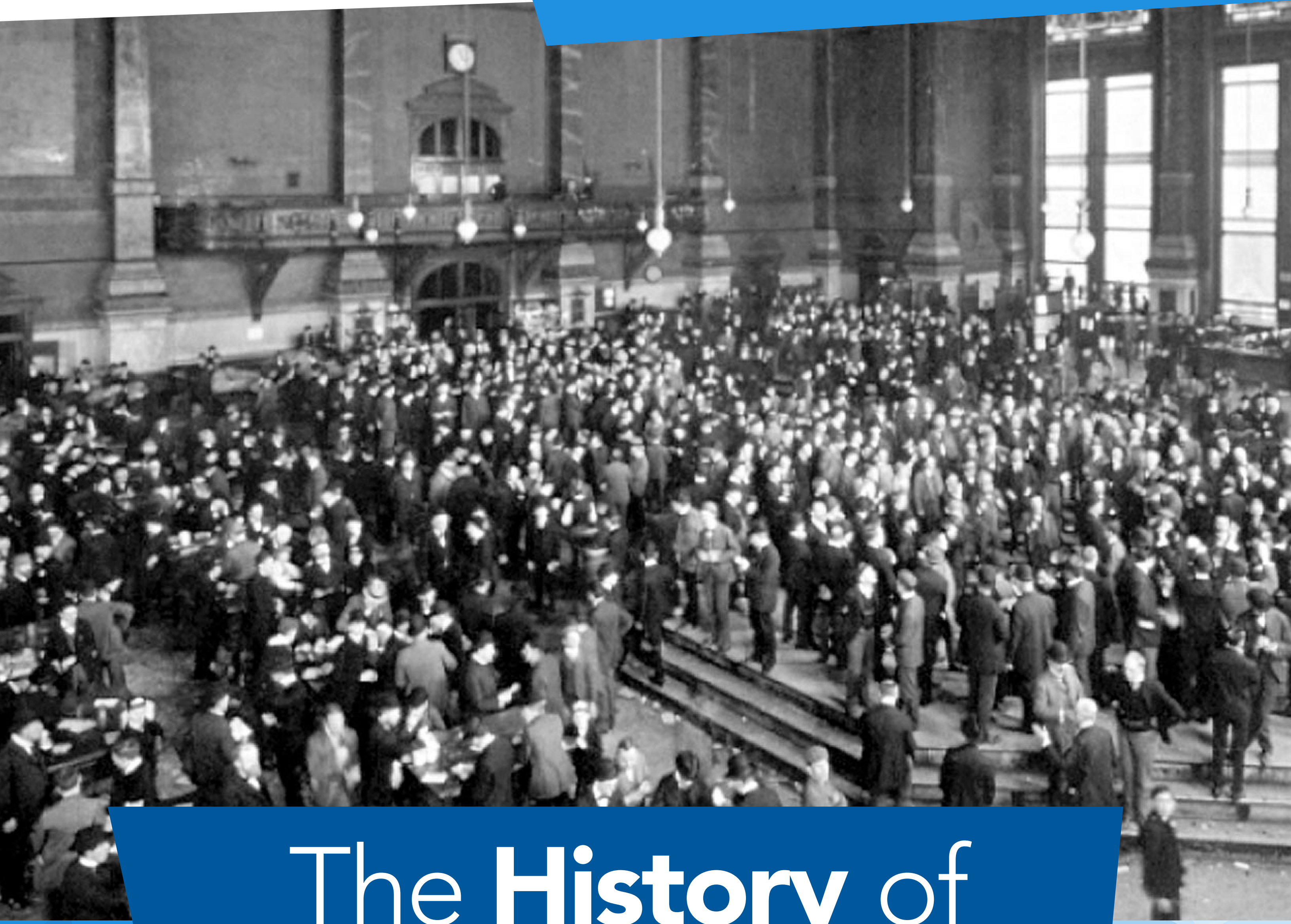

The **History** of **Managed Futures**

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Assets under management (AUM) in the managed futures world didn't take off until the mid-2000s, but CTAs have been around for decades. And the futures contracts they trade? Those have a rich history stretching back across centuries. Sometimes, the best way to understand something is to learn where it all began. So here, we take a look at the history of managed futures.

Futures markets started in earnest in the late 1800s in Chicago as a way for the grain and cattle farmers of the Midwest US to insulate (hedge) them from adverse price moves between the time they planted their crops and the time they brought their crops to market.

Many people incorrectly assume "futures" markets has to do with predicting where prices will be in the future, but it is more about locking in a future price today than predicting where the price will be tomorrow.

The farmers of yesteryear were better able to plan their planting, decide how many cattle to slaughter/breed, and so on if they could lock in the price they would earn on those goods today, giving launch to futures contracts which guaranteed the farmer the ability to sell his crop at the agreed to price when harvest time game.

On the other side of the futures contract is the speculator, who willingly sets a price with the hedger today in hopes of prices moving higher (if he bought from the hedger) or lower (if he sold to the hedger) for him or her to profit. From those simple beginnings in the 1800s, global futures markets have grown exponentially, topping 21 billion contracts traded in 2012 as they have branched out to futures markets on foreign currencies, stock indexes, domestic and foreign government bonds, and more. And those trading pits… they have mostly given way to ones and zeroes on a screen as the bulk of futures market volume these days is done electronically. So while the futures markets have been around for a long time, but managed futures is quite a bit younger. It wasn't until around the 1980's that the idea of using systematic models to trade commodities started to gather steam. Even so, managed futures didn't truly make its mark until after one of the most famous trading experiments of all time: the Turtle Traders.

The Turtle Traders

For futures traders, and especially trend-followers, one of the most important formative stories is undoubtedly that of Richard Dennis and his Turtle Traders. Their story has all of the trappings of a classic:

one man, a rag-tag group of students, and a bet - that he could teach a disparate group of people to be successful traders.

We have been thinking about the Turtles quite a bit lately due to the sudden passing of one of their most successful and charismatic members. We were certainly not the only ones saddened to learn of the passing of Liz Cheval - and the outpouring of condolences from across the industry demonstrated the impact that she had on the people who knew her. Ms. Cheval was the head of trading firm EMC Capital, and seeing the impact that she had made us wonder - where are the Turtles now? And what have they done with the knowledge and skills imparted to them in that famous experiment? The answer, for the most part, is they have continued to apply that knowledge – with the members of what we'll call an expanded Turtle List in the managed futures business controlling close to $1.2 Billion in assets.

Now, not all of the Turtles remained traders for life. As varied as their backgrounds were coming into Dennis' offer, so too were their pursuits after leaving it. Their paths have ranged from teacher to Las Vegas gambler to snowmobile enthusiast. But some of them did continue trading, starting their own CTAs and bringing their skills to another generation of traders – creating what we've heard referred to as "Grand Turtles".So just how many "Turtles" were there? No one seems to agree, since everyone has a slightly different idea of who counts as a turtle trader. After the inaugural class that was brought on in 1983, Dennis and Eckhardt followed up the next year, repeating the "experiment" with another class of 8 turtles. But there were others who worked with Dennis and learned his techniques who have been labeled turtles despite never officially taking part in the formal experiment. And do you include Eckhardt himself? All in all, in taking a fairly liberal definition, there were around 24 individuals (+ Eckhardt) who could be considered turtles.

But before we get ahead of ourselves, we need to revisit the story of the Turtles for those who may not have heard it before. Then take a look at what the members of Dennis' famed cohort are up to today to find out just how much of an impact that simple bet is having 30 years later.

No, this Isn't a Movie

For those seeking the most detailed look at Dennis and the turtle traders, Michael Covel's book The Complete Turtle Trader is an invaluable source of information about Dennis, the Turtles, and the turtle trading method. But for those who haven't heard it before, the short version looks like this: it all started with a disagreement and a wager. Dennis, who had reportedly made a fortune trading in the futures markets by his early 30s, believed there was nothing special about how he traded. He thought that anyone could learn his trading techniques and make money just as he had. His partner, William Eckhardt, had a different opinion. He believed that people like Dennis possessed some inborn skill or intelligence that made them more capable than the average person. In his view, successful trading necessitates that certain innate advantage, and no amount of instruction could instill it into someone who was lacking. And so, the bet was born. (And if that sounds like a certain trading movie you've seen before, there's a good reason).

The pair placed an innocuous ad in the Wall Street Journal in both 1983 and 1984, offering an opportunity that seemed too good to be true. Dennis would teach a select few his proprietary trading method and provide them with capital to trade. A famed trader spilling his secrets was astonishing enough, but in another unusual twist, the ad noted the pair's willingness to take applications from anyone, including those with no prior experience in trading. It was truly an open door, and for good reason. Dennis feared that filling the turtle's ranks with traders and MBAs would mean too many students with bad habits to break. And it might not even prove his point, since bringing in talented traders wouldn't prove that his techniques could be taught to anyone. Dennis wanted a wide cross-section, so the ad remained incredibly broad. And so the applications came pouring in.

Through odd tests and intense interviews, they winnowed the field down to an inaugural class of just 14 students. The deal was simple: Dennis would keep 85% of any profits that the turtles made trading his money, and they would keep the other 15%. In return, the turtles were not allowed to trade for anyone else, and they were bound by stringent confidentiality agreements. And even though Eckhardt was on the nay saying side of the bet, he took a central role in teaching the turtles their trading methods. Still, the lessons were hardly comprehensive - the turtles spent just two weeks getting a crash course in Dennis' trading method before being given $1 million apiece and set loose on the markets.

The Turtle Trading Method

So what were they taught? It was the basics of trend following, but their lessons were as much about the philosophy of trading as a mechanical blueprint for making trades. Dennis emphasized the importance of price movement above all else - he scoffed at traders who pored over news or crop reports looking for an edge. For Dennis and the turtles, price was the only information that mattered.

Lessons also focused extensively on risk management and avoiding emotional behavior. The turtles were taught that losses must be cut short - to become attached to a trade is to court disaster. Conversely, profits should be allowed to run until the trend came to an end.

It was the basic outline of the philosophy that virtually all trend followers adhere to today (the long volatility profile which exchanges small but frequent losses for rare but much larger gains), but in the early 1980s, it was somewhat revolutionary - proving quite successful for the turtles. According to Covel, the Turtles were able to produce excellent returns, and Eckhardt was forced to concede that Dennis had been right - you could teach ordinary people the skills necessary to be successful traders. He'd lost the bet, but the stakes had never been the point (nor, indeed, could anyone say whether the bet had defined any stakes to begin with). They had in many ways laid the foundation for the adoption of systematic trend following amongst traders and asset managers.

The Performance

While there aren't any audited track records or the like, the results of the experiment were a resounding confirmation of Dennis' hunch that trading was perfectly teachable. According to Covel's book, by the time the 5-year run had ended (and despite some ups and downs among the Turtles along the way), the group had collectively made over $175 million *{Disclaimer: Past performance is not necessarily indicative of future results}!* But far more interesting to us is the more verifiable performance of one of managers who stayed in the trading world, as that performance is subject to audit and included in registered CTAs disclosure documents. We compared the performance of Chesapeake Capital's – Diversified program (run by Jerry Parker) against the performance of an index that tracks the Managed Futures space as a whole, the Barclayhedge CTA Index.

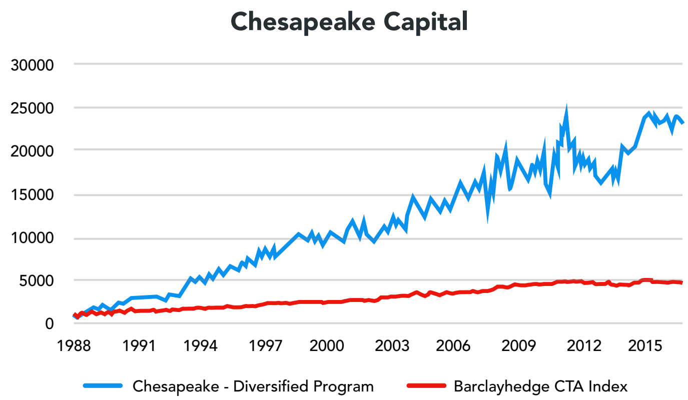
The results are fairly astounding:

Fig. 1: Performance

	Chesapeake Composite	BarclayHedge CTA Index
Total ROR	2,175.91%	367.08%
Comp ROR	**11.41%**	**5.47%**
Stdev	19.80%	9.86%
Sharpe	**0.58**	**0.56**
Max DD	-31.57%	-15.66%
MAR	**0.36**	**0.35**

The Chesapeake Composite had volatility about 2 times higher than the CTA index, and a Maximum drawdown just over 2 times the CTA Index, but an absolutely incredible Compound rate of return: nearly 6 times higher than the CTA Index. Plotting them on the same graph, the performance of the index is barely visible compared to the returns that this single program has achieved:

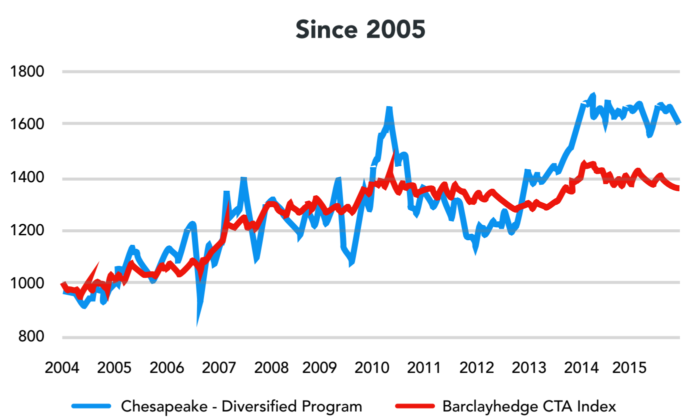
Fig. 2: Return Growth



Past performance is not necessarily indicative of future results. managed futures indices provide a glimpse of the asset class, and do not include the performance of all ctas in the managed futures universe. This composite performance record is hypothetical, as these programs may not have traded together in the manner shown in the composite. please view the important risk disclaimer regarding this portfolio below.

The program turned $1,000 into roughly $277,000 since the programs beginning in 1988. Again, past performance is not necessarily indicative of future results, and we wanted to get a better look at how Chesapeake performed over the past 10 years to get a more timely view of how one of the turtles compared with managed futures as a whole.

Fig. 3: Return over the past decade



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All in all, that "bet" between Dennis and Eckhardt has gone much further than either of them could have ever imagined. Eckhardt, for one, has become much more than a floor trader - managing more than $400 million, while the rest of the turtles and the companies they helped mold represent more than $1.2 billion in assets under management as of 2015. They've also generally done well for those who have invested in them, despite the struggles that all CTAs have experienced over the last few years. And they've given rise to a cottage industry of books about their story and the methods they used.

Managed Futures Thanks You, Turtles

What achievements in the managed futures industry can we attribute to Richard Dennis and his group of traders? Well, in many ways the turtles brought systematic futures trading into the managed asset space. They showed more than anything that a systematic approach to trading futures markets worked – that you didn't have to be a discretionary trader with a knack for knowing where the market was headed in order to make money as a trader. So while not all CTAs are turtles, they all owe a little something to Richard Dennis.

And they've made individual contributions, too. Jerry Parker of Chesapeake Capital was one of the first Turtles (and one of the first CTAs) to realize that the secret to building a large asset base was to strip out as much volatility out of the system as possible while still generating a healthy dose of return. His reasoning was that while the original turtle trading strategy produced great returns, it came at too high of a cost (drawdowns), and that investors far removed from the trading floors of Chicago would be more open to a trend following investment if risk was managed more effectively.

According to the data available on Barclay Hedge, Chesapeake was launched in February 1988 with $1.90 million AUM. This number quickly grew to $10mm by February, 1989 and over $1 billion AUM in

February, 1999. Chesapeake still manages in excess of $500mm today.

Mr. Parker's second significant contribution to the modern CTA landscape is that he built his company in Roanoke, Va. far from the trading pits of Chicago in Roanoke, Va. Before you knew it trend following programs began popping up throughout the US and around the world as the systems that did not require any knowledge other than the market high, open, low and close to be successful.

In addition to Chesapeake Capital, the turtle trading experiment gave birth to a generation of money managers including Liz Cheval, Paul Rabar, as well as several C&D Commodities alumnae like Tom Willis, Mark Walsh, and Bob Moss. Not to mention future generations of turtles like Salem Abraham, Howard Seidler, and countless others. And of course, there is Eckhardt.

From our vantage point, a disciplined, process driven investment approach is the most important take away from the turtle experiment that can be applied to managed futures investments today. Every CTA we work with, including discretionary traders, has a well-defined risk management strategy. Common risk management ideas that we take for granted today including only risking a small percentage of equity on each trade, exiting trades at predetermined stop loss points, and not adding to losing trades can in some way all be credited to Turtles.

But having the discipline to follow these rules is even more important. Mr. Dennis found this out for himself the hard way, with numerous stories out there about how Richard deviated from his rules and blew up this new program or that one, finally retiring from managing others money in 1988.

In our opinion, you could do a lot worse than entrusting your money to a former Turtle. But you are also likely getting a little bit of the Turtle experience and lessons in nearly any managed futures program you do invest in.

Remembering Liz Cheval: From Turtle to Titan

EMC Chairwoman Liz Cheval was certainly one of the most prominent Turtle Traders. Sadly, she passed away in March of 2013, depriving the industry of one of its brightest and most talented members. In 2011, we had a chance to sit down with her for an interview. She shared her insights on trading, markets, and especially on her experience as one of the legendary Turtles taught by Dennis and Eckhardt, which we've shared as it originally appeared below:

In many ways, it can all come down to one decision - one choice in one moment that crystallizes a path in front of you. That path is rarely straight and often difficult to navigate, but once that moment has come and gone, the rest is history. For Liz Cheval, chairwoman of the close to $150 million managed futures program EMC, that decision was the choice to respond to Richard Dennis' famed turtle trader ad. Ms. Cheval was working as a trade clerk at the Chicago Board of Trade, when the ad was placed. She found herself being pushed to apply, even by those competing against her for a slot (including her employer). When called into an interview, she began to think that maybe she was missing something.

"It was not until the end of the interview, as Mr. Dennis' top executive explained the nature and the details of the program that I began to believe it was the real deal," Cheval recounts. Being selected may have been the easy part. After the interview began a rigorous amount of training, and the competition was fierce, especially in a male dominated environment, something she was used to. When the training was done, it was time to hit the pavement running. The turtles were hungry to spread their wings and test their mettle.

"The ability to adapt to change is the key to long term success in trading"

Cheval remembers making phone calls upon completion of the program, trying to gauge the level of interest for outside investors. That former employer who had encouraged her to apply? He became EMC's first client, investing $1 million. While it certainly has not been a bed of roses, Cheval has done very well for herself. EMC , which she ran with former turtle Brian Proctor, had $148.75 million in assets under management in before her death, and is still well respected in the industry. She credited the nuanced strategies involved in managed futures with keeping her in the game. Even with this success, Cheval knew that you need to keep pushing to make it in this industry. "The ability to adapt to change is the key to long term success in trading. It's relatively easy to develop a profitable trading strategy over a short time frame. It's far more challenging to develop a reliable method to continually adapt the strategy to future market conditions," Cheval states. Adaptation is especially important in an environment like what is seen today. In her mind, the theory of the game makes the challenge all the more worthwhile."You need both a successful trading strategy and,

Liz Cheval Founder and former Chairman of EMC Capital

more importantly, a reliable method to adapt the strategy to future market conditions. A successful trading strategy requires robust systems and sound risk management principles. The trading strategy is only as good as your research process. You have to identify robust estimators and develop a process to continually adapt the systems based on these reliable estimators," Cheval says. "You have to be disciplined in executing both trading and research strategies, in good periods and bad. A CTA has to be committed to their strategy whether it is in or out of favor." "Money centers will shift, performance will change, but overall, global markets are large and expansive," she quipped. "Markets and managers will adapt."

We couldn't agree more.

The Birth of the Juggernauts: AHL, Man Group, & Winton

"We were always in the process of conducting big experiments that would involve computers running all weekend… There was certainly a degree of intellectual excitement interspersed with a lot of anxiety, too, because things were always breaking down."
– David Harding

Shortly after the turtle traders, three bright British men were able to up the stakes, with the then radical idea of coding trading rules into computers to systematically test, analyze, and execute trading strategies. It's hard to believe, but a few 20 year olds interested in computers eventually became industry stalwarts: Man AHL,Winton, and Aspect Capital.

According to a few great Institutional Investor articles, it all started at London sugar brokerage named Brockham Securities where owner Cyril Adam charged his son, Michael with updating the commodities charts – at ask he took to automating with computers, and that eventually turned into coding technical indicators. The work was plentiful, and Adam quickly brought on Oxford classmate (and computer programmer) Martin Leuck to assist. They then found Cambridge alum David Harding, who had one a stint on the trading floor of the LIFFE and gone on to work at a UK based CTA named Sabre Fund Mgmt.

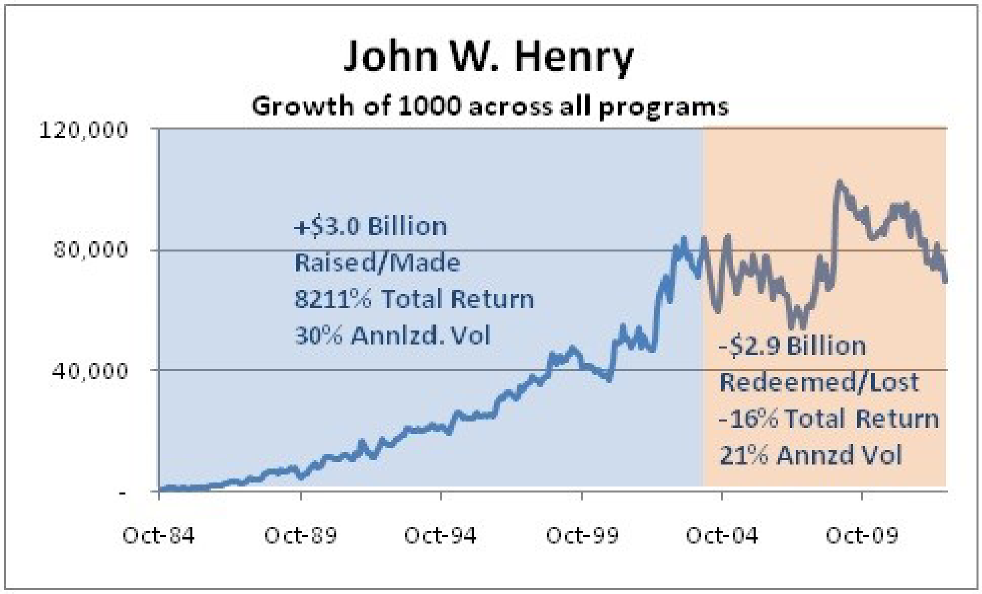
"I spent about three years getting divorced and then thrown out of my company that I had built up." - Harding

After Adam's father fired Leuck and Harding while they were on vacation (after being at odds over their vision for the future of the brokerage), the trio left to launch their own CTA, named AHL for the first letter in each of their last names. The story might have ended there, and we would be talking about AHL as the king of the managed futures mountain – but the performance of AHL caught the attention of another British company, Man Group; who had success owning 50% of a US trading company named Mint which also used systematic models, leading to a +20% net returns according to Institutional Investor. Man set out to buy AHL in three stages between 1989and 1994. As Lueck says, "They sort of hosed us down, dressed us up, and took on the distribution of the AHL strategy." That dressing up worked quite well, to the tune of over $25 Billion in assets on the AHL strategy at its peak (now down to $14 Billion)Things started looking less than rosy shortly after the ink was dry on the final stage of the buyout, however; with the founders desired focus on lowering costsand increasing research reportedly at odds with Man's transactional model and hesitation to spend money on R&D. The conflicts came to ahead in 1994 around the time of Man's public stock offering, and by 1996 the three names behind AHL were gone, with Harding moving on to setup Winton Capital and Leuck founding Aspect Capital, both in 1997. As for Adam, he went on to join a band and perform under the name Mike Marlin.

Fast forward to the present and David Harding is now even more of a legend than he was during AHL, having surpassed his former employer in terms of assets under management on the way to becoming the world's largest managed futures program with over $24 Billion in AUM (down a few billion from their peak, though).And Lueck and Aspect Capital aren't doing too shabby either, currently among the very top of the managed futures world with over $5 Billion under management.

Two of the richest men in the UK and a rock and roll singer – must be a fun reunion when they get together.

John W. Henry – A Look at One of the Greats



To hear that John W. Henry was shutting down his eponymous managed futures shop in 2012 was the kind of news that draws us like a moth to a flame.

Here was an industry stalwart in every sense of the word. A man who helped put managed futures on the map, and helped his pocket book to the tune of becoming a billionaire. He is a literal Hall of Famer, having received the Futures Hall of Fame award (whatever that is) from the Futures Industry Association. This isn't quite Paul Simon hanging up his guitar, or Steven Spielberg deciding to get out of the movie business – but it's close in terms of shock factor in the managed futures space. This raises one huge question - well, actually, it raises hundreds of questions - but the big one is this: what in the world happened? We don't just mean this week in the announcement that he was done, either. What happened in the past 8 years to transform a behemoth into a blip on the radar? Where did John Henry go wrong? Eight years ago he was managing $3 Billion and on top of the managed futures world, with a hot young upstart called Winton measuring in at only about 1/3 the size of Henry's managed futures empire.

Why was 2004 the top for Henry, yet just a launching point for Winton and other billion-dollar managers? But most importantly for investors - how can we learn to identify when a top-tier managers' best days are behind them?

Did he Take his Eye Off the Ball?

Excuse the all too easy baseball pun here – but the easy answer for many is to say things started to go downhill when Henry started to stray from his managed futures roots and dabble in sports, buying the Florida Marlins, then Boston Red Sox, a Nascar team and an English soccer squad. If he had only spent less time analyzing pitchers and trying to hire the next Billy Beane – and instead spent more time researching new models and risk parameters for his CTA – then things might have been different… or so the logic goes.

This would be exactly the kind of shift that an ongoing due diligence program is designed to catch, and something we wrote about not long ago in a newsletter. The general idea is that by staying in close contact with a manager, you can get a feel for when things might be going awry in a way that might impact performance. There is never a guarantee that you'll see the curve ball coming, but you've always got a better chance of it if your eyes are open.

The problem is that this logic starts to fall apart when we look at just when Henry started these other business ventures, which, according to the Disclosure Document for the JWH programs, began as early as 1987:

"Since the beginning of 1987, [Henry] has devoted, and will continue to devote, a substantial amount of time to business other than JWH and its affiliates."

Even if we use the later date of 1998, according to a great 2007 blog post (they had blogs back then?) from the late Greg Newton, the shift of focus to include a sports empire doesn't appear to have affected the performance (which held up until the end of 2004). His heavy-duty distractions did not begin until he became involved in major league baseball… Henry bought the Florida Marlins in 1998.

Maybe it's the Boston Red Sox curse, which Henry supposedly lifted by bringing a World Series title to Beantown? He became involved there in 2002, and things have been bad on the managed futures side for most of the time since. So while the brains of the operation shifting his focus to baseball seems like an easy due diligence red flag, the numbers don't really support it as the cause of the decline. Regardless, any investor after the year 2000 would have known of this concern. A more nuanced "taking his eye off of the ball" argument – and something to consider when conducting due diligence on a manager – is the number of programs in the stable. For JWH, the answer is: quite a few. There are 17 different "capsule performance" tables in the JWH D-Doc. This can be another worry in the due diligence process – can a manager run 17 world-class programs at once? And if not, which would you rather see: 17 mediocre programs, or 1 excellent one?

It's a plausible story, but in this case, perhaps a more likely culprit in terms of "who's minding the store" is the high manager turnover.

Manager Turnover

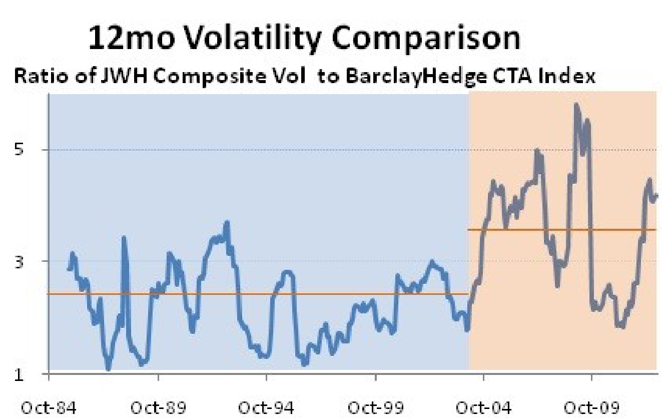
So if the boss isn't always running things, you had better have a very high level of confidence in whoever is picking up the slack. Leadership transitions are often due diligence red flags, but as it turns out – this one isn't all that straightforward, either. We'll borrow heavily from Greg Newton in parsing the Disclosure Document and news clippings on Henry company hires here:

Like those stomach-churning drawdowns, management turnover is nothing new at JWH. Before

John W. Henry

Rzepczynski's record tenure ended in January [Others shown the door at much the same time as Rzepczynski included long-time marketing executive Ted Parkhill; Bill Dinon, head of sales; and Andrew Willard, director of technology], past holders of the president title included Verne Sedlacek, now president and chief executive officer of Commonfund; Bruce Nemirow, now a principal of Capital Growth Partners, a third-party marketing company; and Ken Tropin, who, after a distinctly less than amicable split with Henry, went on to found Graham Capital Mgt Inc in 1994. That firm's assets passed JWH's several years ago.

Between Nemirow and Sedlacek, Peter Karpen, a former chairman of the Futures Industry Association; and David Bailin, now head of alternative investments at US Trust, held similar responsibilities, without the title of president.



It's easy to look back on it in hindsight and say that a bunch of people jumping ship in 2007 was a bad sign, but consider how it looked in the moment: the person leaving had been there 9 years, while the person replacing him had been there 12 years.

That certainly doesn't look so bad, especially when compared with a program (Winton) which is just getting started or a management team with 5 years or less of experience.

Adapt or Die (But Be Careful With Those Adaptations)

Did hubris play a part? Again, from Greg Newton:

JWH generally has not changed the fundamental elements of the portfolios due to short-term performance, although adjustments may be, and have been, made over time. In addition, JWH has not changed the basic methodologies that identify signals in the markets for each program.

JWH believes that its long-term track record has benefited substantially from its adherence to its models during and after periods of negative returns; however, adherence to its strategy may lead to prolonged periods of market losses and high risk, according to its current disclosure document.

Did a stubbornness to adhere to the models which had worked in the 80s, 90s, and start of this century cause those models to become outdated? That seems doubtful. As we say around here, "Systems don't break, they just become more risky." It would appear that this is exactly what happened to JWH. Of course, some on the risk management side of a successful CTA might say that a model becoming more risky is the same thing as that model breaking. After all, the risk is the most important part. And we wouldn't argue too much there.

In the end, it looks like it may have been the worst of both worlds for Hentry: sticking with the base models but tweaking the position sizing. Per page 34 of the JWH D-doc, we learn that the position sizing has been changed 16 times across 9 programs since 2003. And these weren't all position size reductions – many were increases.

On one hand, if you are taking losses at a high trading level, then trying to gain those losses back at a reduced level, it's going to take much longer to return to profitability. But if those losses we due to unresolved flaws in your trading method, raising your position sizes is just doubling down on a losing strategy.

Live By Volatility, Die by Volatility

Most of those in the industry will tell you John W. Henry was simply too volatile for modern tastes, and you can see when taking a look at his programs' track records some big numbers on both sides. Take the financials & metals 36% annualized volatility for example, or the multiple years with above 40% gains or more than -17% losses, and you can see that Henry's model was one of high risk for high return.

But it's more than just the fact that the JWH programs were volatile – what stands out is how much more volatile they were than "normal" and the fact that they were getting more volatile compared to the competition. The above look at the ratio between the JWH composite's rolling 12mo annualized volatility and that of the BarclayHedge CTA Index shows that the JWH programs were about 2.25 times more volatile, on average, than the index during their boom times (the first 20 years), and had jumped to 3.49 times more volatile, on average, in the past 8 years.

Again, this is something more easily seen with hindsight, but this is easy enough to analyze in real time. It's especially concerning how volatile a program is not just in absolute terms, but in relation to its benchmark as well. And if it's 5 times more volatile – as JWH was a few times in 2008 – you had better be sure you are getting 5 times more the return as well. Which brings us to…

You Have to Make Money

At the end of the day in this business (or any other), no amount of name recognition nor bulletproof due diligence can make up for the failure to make money for your clients over a five year period, and that, more than anything else, led to John W. Henry closing up shop.

Consider the Financials & Metals program again. Heading into 2005 the program had never experienced back-to-back losing years. In fact, only once had the program suffered more than 1 losing year in any 7 year period (losing two out of three between 92 and 94). The program then saw losses in three consecutive years between 2005 and 2007, and when including this year's down performance, the program has now lost money in 5 of the past 7 years.

Fig. 4: Percent of Periods Profitable

Percent of Periods Profitable			
	1yr	**2yr**	**3yr**
First 20yrs	86%	90%	100%
Past 8yrs	29%	33%	60%

The three years of losses ending in 2007 are likely what led to Merrill pulling the plug in that year (right before the program experienced a big bounce back, but that's a topic for later), but the table above shows that something is materially different in the past eight years when compared to the first 20 for the Financials & Metals program.

A CTA's job is twofold. First, to generate absolute return performance, so that a customer who gives the program at least three years to do its job will be rewarded with positive performance. And second, to stay ahead of the competition.

It's no easy task, to be sure, and John Henry's gold-lined trash cans are probably filled with the brochures of contenders who tried and failed. But since 2004, it has been Henry's programs which have failed on both counts. They haven't remained positive across the bulk of the rolling three year periods, with some of the rolling three year returns falling below -20%. And while those years haven't been kind to many other CTAs, JWH failed to stay ahead of the competition. They spent most of the past eight years with rolling 36 month returns below that of the BarclayHedge CTA Index.

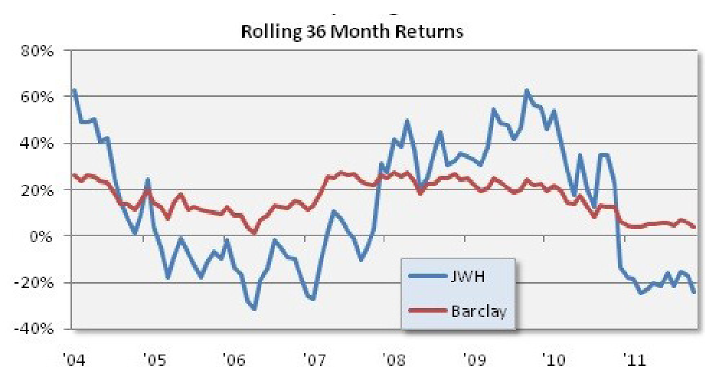
Henry was lagging the index and seeing large negative 36 month returns as early as 2005, meaning there were chinks in the armor that appeared well before Merrill pulled the plug in 2007. But pulling the plug on an underperforming advisor has to be one of the hardest things to do for the individual investor. Especially when you are considering pulling the plug on a Hall of Famer.

It's all Relative

It's a zero sum game, as managed futures detractors like to say. But the reality is that it is not that black and white. There isn't always one clear winner and one clear loser. It's more like a few thousand winners, a few thousand losers, and many more in between.

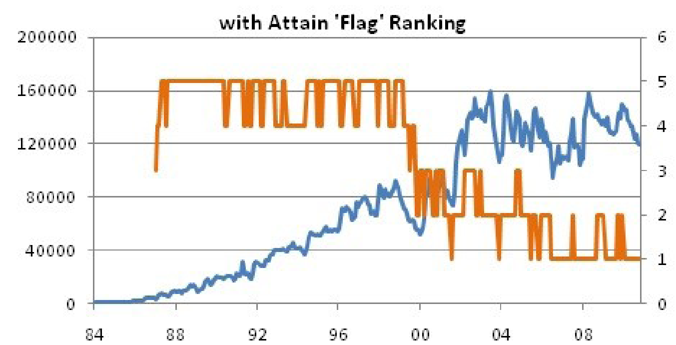
The job of the investor, then, isn't necessarily to find the winner and avoid the loser, but to find the one doing a better job of winning than the others. What does that mean? Providing return with less volatility, more consistency, experiencing smaller drawdowns, shorter

Fig. 5: JHW vs BarclayHedge CTA Index



drawdowns – the list goes on. Which brings us back to Henry. You see, while he is up (big time) in the zero sum game overall, the biggest takeaway for us following this pseudo-autopsy on the John W. Henry programs was in how the program started to become one of the worst winners according to our ranking algorithm.

Fig. 6: JHW Financials & Metals



The biggest warning flag to us was seeing how his ranking fell despite the program going on to make new equity highs.

You see, we don't just rank on performance – we rank on comparative performance, across many time frames, and incorporate risk metrics to normalize the performance across programs. So you not only have to do well – you have to play the game better than the next guy in terms of controlling risk, delivering consistency, and more. The fact that the John Henry programs started to fall in our rankings after their 1999 drawdowns is a sign of poor relative performance. In other words, they weren't just doing poorly because of a bad managed futures environment – they were doing poorly AND performing worse than their peers were in that same environment. You can get away with rough years, but you can't do worse than your peers for an extended period of time and hope to stay in the game.

Lessons Learned

Don't cry for Henry – he's doing just fine: still worth $1.5 billion, and the 389th richest person in the US according to Forbes. But do pay attention to the potential lessons within this story:

1. Past performance is not necessarily indicative of future results. It's not just a disclaimer, and the performance of the Henry Financials & Metals program shows the reality of that – with winning years in 17 out of its first 20 years followed by losing ones in 5 out of 7.

2. Know what sort of program you are getting involved with. John Henry's programs were notoriously high volatility, and willing to take larger losses in exchange for home-run type years - meaning losses of -20% and more shouldn't have surprised anyone.

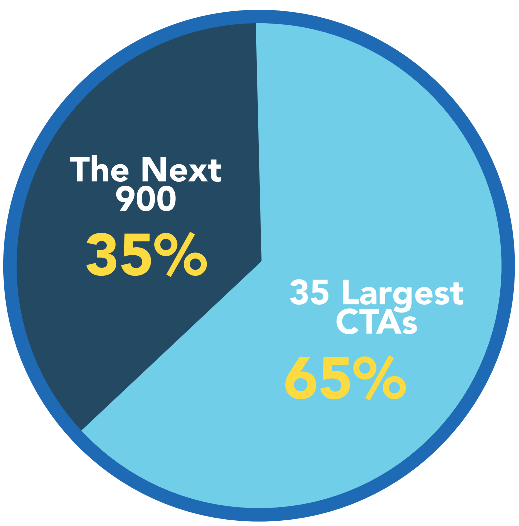
3. Beware the big brokerage house (Merrill Lynch types) selling a big brand name managed futures program. While Henry was a poster child for managed futures as late as 2004, there were warning signs for his programs well before that. The big brokerages believe they are being conservative when selecting the well-known program with a long history of success, but they could be better served identifying lesser-known programs with the risk and reward profile their clients want. They are often late to the party and late to get out.

4. Henry is still a Hall of Famer. Yeah, we know… we said there were warnings, his main program has our lowest ranking, and we wouldn't recommend a JWH program for our clients. But having said all that, he also made a lot of money for a lot of people in his early days (and knowing how these things cycle he'll likely go on to make himself another small fortune just by trading his own money). We've never met him, and don't know what sort of person he is – but we're willing to bet that many of the clients involved with him during the '80s and '90s still think he's worthy of that hall of fame distinction.

Managed Futures Today

Today's managed futures landscape has evolved to a place where some of the largest money managers in the world are managed futures programs, such as Winton Capital and their $25 Billion+ in assets under management. Indeed, the amount of money in managed futures is now dominated by those at the very top of the pyramid, with just 4% of commodity trading advisors managing over 65% of the assets allocated to managed futures.

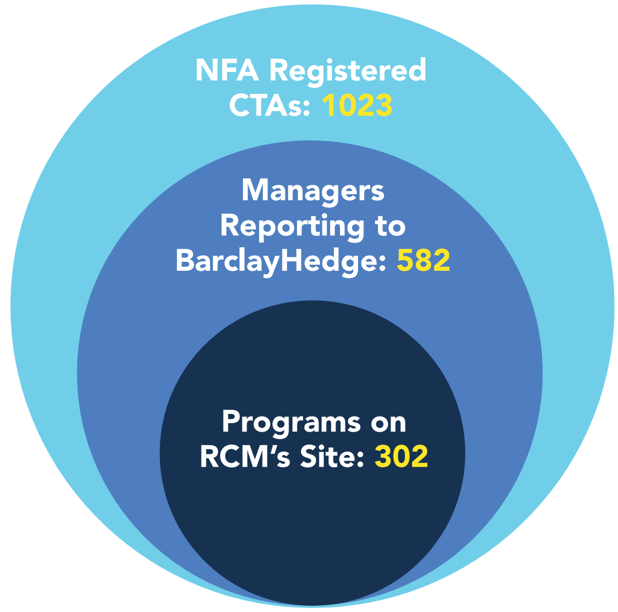
DAVID vs. GOLIATH - the AUM Split



Of course, we don't think that sort of size concentrated at the top is necessarily a good thing. For one, the larger a CTA becomes, the harder it is for them to access certain markets such as physical commodities.

But from managed futures billionaire David Harding of Winton, to the legend of John Henry leveraging managed futures success into ownership of the Boston Red Sox, to the tale of Bill Eckhardt and the Turtle Traders – there are plenty of alluring stories to entice skilled traders to try their hand at becoming professional Commodity Trading Advisors (CTAs), and they are coming in droves – about 1000 registered at last count, to be exact.

What does it mean for investors? That there is a constant evolutionary battle going on where the fittest survive (and a few lucky ones per Taleb), resulting in those remaining with longer track records being higher quality. Some call this survivorship bias - we call it survival of the fittest.



Be sure to read the next article in the series
[The Alternative Files: Stats, Players, & Definitions](#)

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We recommend investors visit the Commodity Futures Trading Commission ("CFTC") website at the following address before trading: http://www.cftc.gov/cftc/cftcbeforetrade.htm

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