Illustrative Example

Note that the narrative of this article is for illustrative purposes only, telling a simplified tale of how what began as a simple business agreement has grown into an industry that now manages more than $300 billion.
Managed futures is an asset class managed by professional investment managers who trade futures contracts.

In some ways, similar to buying or selling stocks and bonds, these professional investors typically react to price movement across all markets by trading (buying or selling) futures contracts in expectation that prices will continue to follow the same up or down trend.

There is a common misconception that “managed futures” is synonymous with “commodities.” However, managed futures is a versatile investment strategy that can actually invest in futures contracts across four asset classes—stocks, bonds, commodities and currencies.
What exactly is a futures contract?

A futures contract is an agreement between two parties to exchange a set amount of goods, at a set price, at a certain time in the future.

To better understand futures contracts today, and the broader managed futures asset class, it is helpful to understand their past.

**AN ILLUSTRATIVE EXAMPLE:**

Farmers and ranchers had a lot of uncertainty about the future.

The farmer had concerns that the price of his corn might fall before he could sell it; the rancher, who needed corn to feed his cattle, feared that prices might rise before he could buy his corn.

Since both the farmer and the rancher had uncertainty about the future price of corn, they decided to agree to a price that day for the corn that they would exchange in the future. Their agreement was beneficial to
both of them, making it so they no longer needed to be concerned about tomorrow's prices because their contract met each of their future needs.

Over time, agreements like the one between the farmer and rancher became more common, and with their popularity came a more formalized and standardized process:

+ **The creation of centralized exchanges.**
  Rather than farmers and ranchers needing to find each other, they were able to go to centralized exchanges, similar to how stocks are traded, to buy and sell the same contracts they previously had to negotiate and write themselves.

+ **Bringing buyers and sellers together.**
  The introduction of exchanges brought buyers and sellers together on a global basis to hedge their price risks more efficiently.

+ **Increased accessibility and variety.**
  As trading became more accessible, more contracts of various types were traded.
Types of contracts

In addition to commodities, such as corn and wheat, contracts were developed for all types of items. Whether a person, or company, was concerned about interest rates or currency exchange rates, the exchange had or created contracts to meet their needs.

A CURRENCY HEDGING EXAMPLE

An electronics manufacturer in Japan (an exporter) was concerned that the exchange rate between the Japanese yen and US dollar would fall between now and the scheduled delivery date for a shipment of televisions to an electronics store in the US.

If the exchange rate (price of yen) fell, the Japanese manufacturer would receive less money.

An electronics store in the US (an importer) was concerned that the currency exchange rate between the Japanese yen and US dollar would rise before its scheduled delivery of televisions from Japan.

An increase in the exchange rate (price of yen) would make the televisions more expensive for the store to buy.

Both were able to hedge their concerns (price risk) by buying (by the US electronics store) and selling (by the Japanese television manufacturer) yen contracts. The manufacturer in Japan was then able to know for certain how much it would receive for the future shipment of the televisions it was manufacturing. Likewise, the store in the US knew with certainty how much it would be paying for the televisions.
Investors observed the buying and selling of futures contracts and realized that, beyond just hedging, trading these contracts had profit potential. Just like any other investment, if contracts were bought at a price lower than the actual future price, or sold at a price higher, investors could make money.

### One Illustrative Example of How Investing Using Contracts Works

Investor Mary believes that the euro is going to increase in value against the US dollar over the next six months. She is trying to decide the best way to invest according to her opinion about the future value of the euro.

<table>
<thead>
<tr>
<th>Mary’s Options</th>
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<tbody>
<tr>
<td>✗ She could go to the bank and exchange her US dollars for euros, and then keep the money in a suitcase under her bed for the next six months</td>
</tr>
<tr>
<td>✗ She could fly to Germany* and open a bank account</td>
</tr>
<tr>
<td>✗ She could move to Germany*</td>
</tr>
<tr>
<td>✓ She could buy euro futures contracts</td>
</tr>
</tbody>
</table>

Futures contracts offer an easier way for Mary to invest according to her views.

*In this example, Germany is used to represent any eurozone country.*
Who trades futures contracts?

There are essentially two types of people who trade futures contracts: hedgers and investors. Both hedgers and investors can trade contracts in all four asset classes: stocks, bonds (interest rates), currencies, and commodities.

+ **Hedgers**, such as farmers and manufacturers, seek to avoid the impacts of unexpected future price movements.

+ **Investors** on the other hand, such as professional money managers and fund companies, seek to profit from future price moves. They are the predominant traders of futures contracts. Investors are sometimes referred to as speculators.

Can anyone trade futures contracts?

Yes, though investors should be aware that the accounts needed to trade them (in addition to the tools needed to monitor the associated markets) are more complex than other types of trading accounts used for investments like stocks, bonds, or even mutual funds.
Then what, exactly, are managed futures?

Managed futures are portfolios of futures contracts and options that are managed by professional investment managers who use their own trading systems.

These managers primarily use trend following models that react to price movements to capture trends (up or down) in stocks, bonds, currencies, and commodities.

These professional investors trade futures contracts not to hedge their crop prices or currencies, but instead look to potentially profit from movements in prices.

In summary, managed futures is a flexible and opportunistic asset class whose managers invest in futures contracts across all four major asset classes. Futures contracts are liquid, exchange-traded vehicles that, although historically developed to hedge price risks, are now used to trade in investment portfolios.
IMPORTANT RISK DISCLOSURE

There are substantial risks and conflicts of interests associated with Managed Futures and commodities accounts, and you should only invest risk capital. The success of an investment is dependent upon the ability of a commodity trading advisor (CTA) to identify profitable investment opportunities and successfully trade. The identification of attractive trading opportunities is difficult, requires skill, and involves a significant degree of uncertainty. CTAs have total trading authority, and the use of a single CTA could mean a lack of diversification and higher risk. The high degree of leverage often obtainable in commodity trading can work against you as well as for you, and can lead to large losses as well as gains. Returns generated from a CTA's trading, if any, may not adequately compensate you for the business and financial risks you assume. CTAs may trade highly illiquid markets, or on foreign markets, and may not be able to close or offset positions immediately upon request. You may have market exposure even after the CTA has a request for closure or liquidation. You can lose all or a substantial amount of your investment.

Managed futures and commodities accounts may be subject to substantial charges for management and advisory fees. It may be necessary for accounts that are subject to these charges to make substantial trading profits in order to avoid depletion or exhaustion of their assets. The disclosure document contains a complete description of each fee to be charged to your account by a CTA. If you use notional funding, you may lose more than your initial cash investment. If you purchase a commodity option you may sustain a total loss of the premium and of all transaction costs. If you purchase or sell a commodity future or sell a commodity option you may sustain a total loss of the initial margin funds and any additional funds that you deposit with your broker to establish or maintain your position. If the market moves against your position, you may be called upon by your broker to deposit a substantial amount of additional margin funds, on short notice, in order to maintain your position. If you do not provide the requested funds within the prescribed time, your position may be liquidated at a loss, and you will be liable for any resulting deficit in your account. This brief statement cannot disclose all the risks and other significant aspects of the commodity markets, and you should carefully study the disclosure document before you trade, including the description of the principal risk factors of an investment. PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

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With one of the leading Research and Investment groups focused solely on alternatives, Altegris follows a disciplined process for identifying, evaluating, selecting and monitoring investment talent across a spectrum of alternative strategies including managed futures, global macro, long/short equity, event-driven and others.

Veteran experts in the art and science of alternatives, Altegris guides investors through the complex and often opaque universe of alternative investing.

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