What your financial adviser doesn’t know—or isn’t telling you—can hurt your portfolio. With government debts at an all-time high and the U.S. dollar’s dominant status in question, there’s never been a better time to seek a sophisticated modern portfolio that has the potential to profit in both bull and bear markets. Managed futures can do that. High-Performance Managed Futures shows you how.

MARK H. MELIN has written/edited three books, including The Chicago Board of Trade Handbook of Futures and Options, as well as coauthored the official Managed Futures CD-ROM for the Chicago Board of Trade. Melin has worked extensively in the futures and options industry as a consultant for organizations such as the Chicago Board of Trade, OneChicago: The Single Stock Futures Exchange, as well as several Futures Commission Merchants (FCMs) and Broker Dealers (BDs). He is currently a division director with a leading FCM in Chicago.

In High-Performance Managed Futures, The New Way to Diversify Your Portfolio, Mark Melin, a veteran Managed Futures industry expert, updates a New York Times Bestseller and presents the comprehensive, no-nonsense guide to investing in managed futures programs, where experienced money managers invest client assets in markets as diverse as metals, grains, soft commodities, energy, indices, interest rates, foreign currencies, and U.S. government bonds.

High-Performance Managed Futures provides invaluable insight into an asset class that has performed independently of the stock market for over thirty years. You’ll find that Melin’s book is a must-read for investors and financial advisors. This book contains compelling evidence and justification for the inclusion of managed futures in almost all portfolios.

“Managed futures can no longer be ignored, particularly considering today’s highly volatile stock market. High-Performance Managed Futures provides valuable insight into an asset class that has performed independently of the stock market for over thirty years. I find that Melin’s book is a must-read for investors and financial advisors. This book contains powerful evidence and justification for the inclusion of managed futures in almost all portfolios.”

— ROBERT ROUGHACK, Chairman, Viking Financial Markets LLC

“High-Performance Managed Futures gives all investors critical insights into an innovative style of investing that can no longer be misunderstood.”

— MICHAEL W. COVEL, bestselling author, Trend Following and The Complete TurtleTrader

“Once again, during times of crisis, managed futures has delivered as an investment. High-Performance Managed Futures is a must-read for sophisticated modern investors. And, probably the most valuable insights for those of us who do our own investing.”

— JOHN SUNDT, CEO, Alignex Investments

“Managed futures are one of the world’s most-underrated asset classes and should be considered in any modern portfolio. High-Performance Managed Futures demonstrates how much success has been missed in this area and does so in a logical and interesting format.”

— SCOTT SLOTONSKY, Author, Master of the Futures and The Complete Guide to Electronic Trading Futures; Former Director, Global Services Division, MTS Institute; Chicago Board of Trade

“Mark Melin has written an authoritative and insightful book on managed futures. All investors who seek to diversify their portfolio should have this on their bookshelf.”

— DR. HOSSAIN KAZEMI, PhD, CFA, Program Director, Chartered Alternative Investment Analyst (CAIA) Association, Editorial Board, The Journal of Alternative Investments, Professor of Finance, University of Massachusetts Amherst

A modern look at meaningful asset diversification using managed futures.

In High-Performance Managed Futures, The New Way to Diversify Your Portfolio, Mark Melin, a veteran Managed Futures industry expert, updates a New York Times Bestseller and presents the comprehensive, no-nonsense guide to investing in managed futures programs, where experienced money managers invest client assets in markets as diverse as metals, grains, soft commodities, energy, indices, interest rates, foreign currencies, and U.S. government bonds.

Many of today’s investors are betrayed by either short-term thinking or another of Wall Street’s mantras—buy and hold. High-Performance Managed Futures exposes market myths, while also detailing how managed futures can help investors achieve meaningful asset diversification.

High-performance Managed Futures provides invaluable insight into an asset class that has performed independent of the stock market for over thirty years. You’ll find that Melin’s book is a must-read for investors and financial advisors. This book contains compelling evidence and justification for the inclusion of managed futures in almost all portfolios.

Melin has worked extensively in the futures and options industry as a consultant for organizations such as the Chicago Board of Trade, OneChicago: The Single Stock Futures Exchange, as well as several Futures Commission Merchants (FCMs) and Broker Dealers (BDs). He is currently a division director with a leading FCM in Chicago.

MARK H. MELIN has written/edited three books, including The Chicago Board of Trade Handbook of Futures and Options, as well as coauthored the official Managed Futures CD-ROM for the Chicago Board of Trade. Melin has worked extensively in the futures and options industry as a consultant for organizations such as the Chicago Board of Trade, OneChicago: The Single Stock Futures Exchange, as well as several Futures Commission Merchants (FCMs) and Broker Dealers (BDs). He is currently a division director with a leading FCM in Chicago.

In High-Performance Managed Futures, The New Way to Diversify Your Portfolio, Mark Melin, a veteran Managed Futures industry expert, updates a New York Times Bestseller and presents the comprehensive, no-nonsense guide to investing in managed futures programs, where experienced money managers invest client assets in markets as diverse as metals, grains, soft commodities, energy, indices, interest rates, foreign currencies, and U.S. government bonds.

Many of today’s investors are betrayed by either short-term thinking or another of Wall Street’s mantras—buy and hold. High-Performance Managed Futures exposes market myths, while also detailing how managed futures can help investors achieve meaningful asset diversification.

Melin has worked extensively in the futures and options industry as a consultant for organizations such as the Chicago Board of Trade, OneChicago: The Single Stock Futures Exchange, as well as several Futures Commission Merchants (FCMs) and Broker Dealers (BDs). He is currently a division director with a leading FCM in Chicago.

MARK H. MELIN has written/edited three books, including The Chicago Board of Trade Handbook of Futures and Options, as well as coauthored the official Managed Futures CD-ROM for the Chicago Board of Trade. Melin has worked extensively in the futures and options industry as a consultant for organizations such as the Chicago Board of Trade, OneChicago: The Single Stock Futures Exchange, as well as several Futures Commission Merchants (FCMs) and Broker Dealers (BDs). He is currently a division director with a leading FCM in Chicago.

In High-Performance Managed Futures, The New Way to Diversify Your Portfolio, Mark Melin, a veteran Managed Futures industry expert, updates a New York Times Bestseller and presents the comprehensive, no-nonsense guide to investing in managed futures programs, where experienced money managers invest client assets in markets as diverse as metals, grains, soft commodities, energy, indices, interest rates, foreign currencies, and U.S. government bonds.

Many of today’s investors are betrayed by either short-term thinking or another of Wall Street’s mantras—buy and hold. High-Performance Managed Futures exposes market myths, while also detailing how managed futures can help investors achieve meaningful asset diversification.

Melin has worked extensively in the futures and options industry as a consultant for organizations such as the Chicago Board of Trade, OneChicago: The Single Stock Futures Exchange, as well as several Futures Commission Merchants (FCMs) and Broker Dealers (BDs). He is currently a division director with a leading FCM in Chicago.

MARK H. MELIN has written/edited three books, including The Chicago Board of Trade Handbook of Futures and Options, as well as coauthored the official Managed Futures CD-ROM for the Chicago Board of Trade. Melin has worked extensively in the futures and options industry as a consultant for organizations such as the Chicago Board of Trade, OneChicago: The Single Stock Futures Exchange, as well as several Futures Commission Merchants (FCMs) and Broker Dealers (BDs). He is currently a division director with a leading FCM in Chicago.

In High-Performance Managed Futures, The New Way to Diversify Your Portfolio, Mark Melin, a veteran Managed Futures industry expert, updates a New York Times Bestseller and presents the comprehensive, no-nonsense guide to investing in managed futures programs, where experienced money managers invest client assets in markets as diverse as metals, grains, soft commodities, energy, indices, interest rates, foreign currencies, and U.S. government bonds.

Many of today’s investors are betrayed by either short-term thinking or another of Wall Street’s mantras—buy and hold. High-Performance Managed Futures exposes market myths, while also detailing how managed futures can help investors achieve meaningful asset diversification.

Melin has worked extensively in the futures and options industry as a consultant for organizations such as the Chicago Board of Trade, OneChicago: The Single Stock Futures Exchange, as well as several Futures Commission Merchants (FCMs) and Broker Dealers (BDs). He is currently a division director with a leading FCM in Chicago.
Founded in 1807, John Wiley & Sons is the oldest independent publishing company in the United States. With offices in North America, Europe, Australia and Asia, Wiley is globally committed to developing and marketing print and electronic products and services for our customers’ professional and personal knowledge and understanding.

The Wiley Finance series contains books written specifically for finance and investment professionals as well as sophisticated individual investors and their financial advisors. Book topics range from portfolio management to e-commerce, risk management, financial engineering, valuation and financial instrument analysis, as well as much more.

For a list of available titles, visit our web site at www.WileyFinance.com.
High-Performance Managed Futures

The New Way to Diversify Your Portfolio

MARK H. MELIN
# Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preface</td>
<td>ix</td>
</tr>
<tr>
<td>Acknowledgments</td>
<td>xiii</td>
</tr>
<tr>
<td>Disclaimer</td>
<td>xv</td>
</tr>
<tr>
<td><strong>CHAPTER 1</strong></td>
<td></td>
</tr>
<tr>
<td>Understand It: The Truth about Risk and Misunderstood Investments</td>
<td>1</td>
</tr>
<tr>
<td>What Is This “Managed Futures” I’ve Never Heard About?</td>
<td>2</td>
</tr>
<tr>
<td>Stock Market “Safety” and Other Myths</td>
<td>3</td>
</tr>
<tr>
<td>Invest with Stock Market Neutral Programs</td>
<td>5</td>
</tr>
<tr>
<td>The Stock Market Is Not “Safe” or “Conservative” and Does Not Offer True Diversification</td>
<td>6</td>
</tr>
<tr>
<td>It Works in Practice but Does It Work in Theory?</td>
<td>14</td>
</tr>
<tr>
<td>Wall Street’s Motivation for Keeping Managed Futures a Secret</td>
<td>16</td>
</tr>
<tr>
<td><strong>CHAPTER 2</strong></td>
<td></td>
</tr>
<tr>
<td>Define It: Establish Performance and Risk Targets</td>
<td>25</td>
</tr>
<tr>
<td>The Simple Managed Futures Definition</td>
<td>27</td>
</tr>
<tr>
<td>Target Risk/Reward Profiles</td>
<td>28</td>
</tr>
<tr>
<td><strong>CHAPTER 3</strong></td>
<td></td>
</tr>
<tr>
<td>Work With It: Build Basic Portfolios Using Targets</td>
<td>41</td>
</tr>
<tr>
<td>Portfolio Diversification versus Individual Manager Selection</td>
<td>43</td>
</tr>
<tr>
<td>Individual CTA Analysis and Portfolio Considerations</td>
<td>52</td>
</tr>
<tr>
<td><strong>CHAPTER 4</strong></td>
<td></td>
</tr>
<tr>
<td>Realize It: The Old Way versus High Performance</td>
<td>69</td>
</tr>
<tr>
<td>The Fastest-Growing Asset Class?</td>
<td>69</td>
</tr>
<tr>
<td>This Unique and Very Special Asset Class</td>
<td>70</td>
</tr>
<tr>
<td>Managed Futures Defined</td>
<td>72</td>
</tr>
<tr>
<td>Decoding the D Doc</td>
<td>85</td>
</tr>
</tbody>
</table>
## CONTENTS

### CHAPTER 5

**Don't Be a Victim: Leverage Managed Futures Regulation and Account Structure to Avoid Hedge Fund Fraud**

- Managed Futures Regulation, Account Structure, and Protection
- Transparency: The Ability to See and Understand an Investment
- Auditing Performance and Money Flow
- Tight Regulatory Control: Meet the NFA and CFTC

### CHAPTER 6

**Recognize It: Volatility + Volatility and Lintner's Message**

- Volatility Used to Reduce Volatility
- All Volatility Is Risky ... To Different Degrees
- Standard Deviation as Measure of Volatility

### CHAPTER 7

**Use It: Reward-Adjusted Deviation (RAD) Considers Past Probability and Rewards Success**

- Study 1: Exploring RAD with Math
- The Test of Success
- Study 2: Average Drawdown: RAD versus STD When Actual Risk Improves
- Study 3: Where CTAs Fall Based on RAD
- Risk “Indicators” Don’t Indicate Risk

### CHAPTER 8

**Protect it: Principal-Protected, Conservative, and Risky Investments**

- Don’t Be Fooled
- Four Steps to Creating Principal-Protected Products
- Strategies to Maximize Return

### CHAPTER 9

**Use All of It: Overlooked Points of Correlation**

- Is Managed Futures the World’s Most Noncorrelated Asset?
- Balance Risk and Return: Managed Futures Cushion during Stock Turbulence
- Correlation Study: Major Indexes
- Managed Futures Noncorrelation Is Not an Accident
Appendix E: Regulated versus Unregulated Entities 268

Appendix F: Markowitz and Lintner: A “Modern” Investment Method Half a Century Old 271

Notes 281

About the Author 297

Index 299
Preface

This book reveals a unique method of investing independent of stocks and the economy—a method that studies have shown has outperformed the stock market for the past 27 years, judging success by the major indexes, their drawdown statistics, recovery time, and total returns.

The investment method is derived from a Nobel Prize–winning theory that was later revised by a legendary Harvard University professor. But what is most amazing is that many investors and even financial professionals are not aware of the asset class, or they misunderstand the investing method.

Welcome to High-Performance Managed Futures

This book is divided into two sections: The fundamental section from Chapters 1–5 contains information that might surprise even the most experienced investor. Here performance is discussed—and performance can be both positive and negative. The book then reveals managed futures portfolio-building fundamentals, showing how risk targets are established and basic portfolios built. After these headlines have been discussed, the book dives into the structure of the asset class and industry regulation, including performance auditing. Upon completing Chapter 5 readers should possess a basic understanding of the managed futures asset class, at which point sophisticated investors are encouraged to move to the second section of the book, Chapters 6–12, where unique portfolios are built, traditional academic thought is challenged, and most importantly, risk and risk management are discussed in frank detail, a topic for all investors.

It’s Not for Everyone

Some investors might consider the book’s ideas exciting and cutting edge with significant potential; call this group the optimists. Others, the traditionalists, might be less receptive to changing their fundamental belief system.
and will complain and nitpick. Still others, call them the intelligent risk managers, might say “there is no free lunch,” as my father always told me. Everything is a matter of understanding true risk and reward. While realistic optimists are welcome, this book is written for sophisticated, intelligent risk managers.

This book is appropriate for intelligent, qualified investors who desire higher performance and consider acceptable risk an intelligent concession to appropriate reward, and recognize some risks simply deserve a polite “no thank you.” It is written for investors who use only risk capital to diversify investments with the goal of not becoming entirely dependent on the stock market or the economy at large; for those who understand performance measures are tools that measure past performance and do not indicate future results. For that matter, they recognize no one has a magical crystal ball or can predict the future; future projections are based on logical thought process and making intelligent connections, but any projection into the future is nothing more than opinion—pure conjecture. If this describes you, then read on and discover a truly interesting investing method.

This book provides insight into what for many is a very different concept: a new world; indeed, the world of High-Performance Managed Futures. It will be new for those who live their lives in the confines of a stock-centric world. The reason for this starts in the educational system that all but ignores futures and options, with a few exceptions, and mirrors societal values and dictates the source of investing power is centered on the stock market and a little island in New York. This book indeed leads a stock-centric world on a journey of discovery.

A HIGHLY REGULATED INDUSTRY

Managed futures is a highly regulated investment. The tight industry regulation can be a major benefit to investors, particularly when it comes to audited returns performance and specific intelligent regulations regarding transparency and how client investment capital cannot be directly manipulated by the investment manager under the limited protection of account segregation. These investor protections should be used as an international template when considering prevention of hedge fund fraud.

Communication with potential investors is highly regulated. While this book is considered free speech, anyone regulated in this industry is required to provide a reasonably balanced view of risk and reward. Facts must be supported by reality and anything deceptive is considered fraud, plain and simple. While it may be annoying, in this regulated environment participants are also required to consistently point out that past performance is not
indicative of future results. Readers must also understand opinions can be right or wrong; no guarantees available. This book is significantly based on the author’s opinions and in many cases those opinions may be evident to some but not stated.

**DISCOVERY FOR THE RIGHT REASONS**

The trend in managed futures has started, as evidenced by what has been one of the fastest growing major asset classes over the past decade. In part, the goal of this book is to educate investors and nudge a powerfully emerging investing trend over its tipping point. While this is exciting, it is not a reason to invest in anything. Investing involves intelligent risk–reward decisions that all investors must individually make; all will not travel this path, as it should be. The hope is those that venture down what can be an exciting and rewarding path first focus on intelligently understanding and managing risk and avoid being dazzled by powerful returns alone. It is when risk is properly managed that sweet reward comes into most appealing focus.

In addition, to the valuable information and concepts provided in this book, I have also developed a web site—www.wiley.com/go/managedfutures—that expands upon the information provided in each chapter. It also links you to valuable white papers, videos, interactive calculators, and recommendation tools; grants you access to CTA performance data and portfolio building tools; and provides you with discounts on books, white papers, and software products. Although most of this material will be available to the general public, some information will only be available to registered book users. (Since you bought this book, you will receive a free six month standard membership. Your membership code and password instructions will be provided on the web site.) So, at the end of each chapter, be sure to look for the “On the Book’s Web site” icon and continue learning of new ways to diversity your portfolio. I hope you enjoy reading this book as much as I enjoyed writing it.

MARK H. MELIN
Acknowledgments

This book has been written in a number of different environments, with thanks to friends and family at each location. It started with the fresh ocean breeze of L.A.’s South Bay, constantly annoying a friend by the reciting of book passages and analogies while he was trying to watch his Saturday morning EPL soccer; to the edgy, invigorating force contained in Chicago’s Wicker Park, where the laptop often shared a park bench with those who called the street home; to the gritty power of the West Loop where friends would congregate to watch Sunday football and I tackled my laptop; to the more trendy River North and then out to the leafy suburbs where much time was spent on a long, wide back porch overlooking the ever-changing beauty of a tranquil lake, with a supportive father and family when it mattered.

The futures and options industry is really a community. A cultural foundation in a Midwestern city of strong shoulders, it is dominated by an innovative futures exchange that fosters growth in what could be one of the fastest growing investment opportunities in history.

This community has several anchors, including the brokerage community, which was once dominated by strong families. I had the good fortune of entering this world first as a managed futures program manager, a consultant to many of the exchanges, and then by working for a trading family that found its origins in the hog pits of Chicago. The family patriarch was one of the legendary figures during the heyday of pit trading, a bygone era to be sure. His sons and daughter, forging their own identity, first started an introducing brokerage (IB) business out of a college dorm room that stepped up and later became one of the top 50 futures commission merchant (FCM) brokerages in the world. They later sold this company to another legendary Chicago family who traces its roots to Iowa and Hollywood. This company was founded by a former movie producer who had a vision of a commodity future while shooting a film in Japan, just as the Nixon administration issued a soybean embargo on the island nation. The family business was essentially passed from father to son, who shares the father’s vision but runs the firm with his own professionalism, flair, and mission to create sustainable futures investing—the perfect home for a managed futures focus.

These are stories from a powerful industry that has a small-town feel, where people know the players, centered in one of the country’s largest