

SafeMoneyMetrics™

" Your Direct Risk Management Solution for Managed Futures"
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Client Risk Management Definitions and Explanations

Focus and Summary

Benchmark indicators defined directly below are identical for your account, advisors and/or any multi-advisor investment. The only difference is the time frame applications. Short, medium and long-term time definitions vary with each analyst. My "belief" is that people should evaluate annual account profitability with a maximum downside of 18 months. Many people live with negative returns longer than 18 months. Your decisions need to reflect your beliefs, not mine.

Experience has taught me to co-develop a maximum loss value in time and capital with each investment. **For example:**

#1. Maximum Loss - Close the Account:

Year1: Pre define a capital loss % and time relative to start date and initial funding level

Subsequent Years: Apply the Year 1 definition using only capital in the account as a starting value. Annual time begins 12 months from the previous start value.

Example: Year 1 starts on July 1, 2006 with \$100,000. A maximum loss decision could be a capital loss of 25%, and/or no profitability for 12 months. Assume the first year ends with a profit of \$20% and 10% was distributed. The second annual start value is \$110,000 on July 1, 2007. Again, the maximum loss decision is a capital loss of 25% or 12 months with no profitability. Etc Etc as the years pass!

#2 Maximum Loss - Close the Account:

The account's minimum net ratio drops below the minimum funding level across all time frames and stays there for 30 days. The advisor's minimum net ratio drops below the minimum funding level ratio across all time frames and also stays there for 30 days: **Do Nothing** if your account's most recent net ratio starts to move above the funding level ratio, while the realized to volatility ratio is also more positive. Finally the RVR on your account (short-term time) begins to rise - - the Advisor may be into a renewed profitability mode.

#1 Distribute Profits:

Distribute 50% to 100% of all profits whenever the advisor is paid an incentive fee; until your initial capital is returned. Then distribute 25% to 50% of all profits for the duration.

#2 Distribute Profits:

Your account's realized to volatility ratio is optimally wide (realized high - volatility low), while the RVR is topped out (stable or slow decline = increasing risk). Your account's net ratio is also higher than the funding level and equal to or better than the advisor's maximum net and funding level ratio position. The advisor's RVR has also peaked.

Profitability Trends Relative to Account Conditions

Increased Profitability with Lower Risk

1. The latest net ratio is above the funding level.
2. Recent time frames; net is above the funding level ratio.
3. Recent time frames; net and funding level ratio are above their respective minimums.
4. Recent time frames; net and funding level are above the advisor's (or composite allocation's) respective minimums.
5. The realized ratio moves higher and away from the volatility ratio.
6. The 51% rule trend changes.
7. The reward to variability ratio (RVR) moves higher while profits increase or remain the same.
8. Account profitability is stable or moves higher, while the maximum loss for the time frame decreases.
9. The reward to variability ratio (RVR) moves higher and the coefficient of variation moves lower.

Increased Risk with Lower Profitability

1. The latest net ratio is below the latest funding level ratio.
2. Recent time frames; net is below the funding level ratio.
3. Recent time frames; net and funding level ratios are below their respective minimums.
4. Recent time frames; net and funding level ratios are below the advisor's (or composite allocation's) respective minimums.
5. The realized ratio moves lower and into the volatility ratio.
6. 51% rule trend changes.
7. The reward to variability ratio (RVR) moves lower while profits move higher, lower or remain the same.
8. Account profitability is stable or moves lower, while maximum loss for the time frame increases.
9. The reward to variability ratio (RVR) moves lower and the coefficient of variation moves higher.

Explanations

The SafeMoneyMetrics™ Risk Analysis Process

Cost, risk and trading talent relative to profitability under current market conditions is the focus of SafeMoneyMetrics™ risk analysis. SMM™ defines performance trends and potential decisions by quantifying relationships between ratios. For Example: A high realized relative to a low volatility ratio might signal profit distribution. A high volatility ratio and low realized can also indicate profit taking, however since the latter position between both ratios indicates increased risk - there are other considerations.

Differences between a Realized and Volatility ratio is defined by the RVR Internal Benchmark described below. (See: www.sanctity.com/articles.html # 39). SafeMoneyMetrics™ Client Risk Management Services monitors client accounts relative to the advisors. On-line services offer reports on a composite allocation and up to five advisors used within that allocation. Analysis including each market traded by each advisor is customized and available upon request. See www.safemoneymetrics.com/services.html.

Imbalances are fundamentally defined as trends in profitability relative to volatility, leverage and correlation under current market conditions, compared to the Internal Benchmark or why capital was originally allocated to a particular investment. Imbalances are efficiently

located at the level of cause so catastrophic losses can probably be reduced and sometimes avoided.

SafeMoneyMetrics™ always monitors ratios in relationship to each other. Nothing lives isolation. For example: Evaluating realized returns relative to account volatility and capital at risk used to produce the returns, has more value than evaluating an isolated return. Analyzing trends in the Net relative to Funding Level Ratio provides insight into the risk of leverage being used under current market conditions. If an investment uses many markets prudent diversification only exists if the "positive returns" produced by each market constructively correlate with each other.

The most important aspect of SafeMoneyMetrics™ is that the "Benchmark" is always INTERNAL or part of the investment rather than external to it. To understand why, you can go to <http://www.safemoneymetrics.com> and download a guide called "Standards for Advisor Evaluation." It provides the foundation of thought driving SafeMoneyMetrics™.

Fundamental Weaknesses

If the Capital at Risk value is erroneous SafeMoneyMetrics™ produces invalid results. When analyzing monthly data or any composite time frame, capital used to produce a specific result was NOT at risk all at the same time. When SMM™ is applied to every trade or composite daily data, this weakness does not exist.

Remember that investment analysis can only analyze what already happened. When decisions for the future are based on the past, the value of those decisions is limited. Although SafeMoneyMetrics™ reveals deeper levels of truth that can facilitate higher quality decisions, it also uses past data. Considering the latter statements, it is wise to remember that any analysis is merely a tool, not a Universal law.

Annual statistics, therefore annual cost calculations for client accounts are probably inaccurate because the number of data points/30 days are used to calculate months. Clients using multiple advisors probably have more than one data input for any specific day. Annual Cost Calculation = Total Cost/Years

Definitions

Sometimes a definition is included in our documents that may not be used in a particular report.

1. Capital at Risk (CAR): A formula that represents only capital used to produce a return. NOT the account size an advisor asks for, or the minimum funding level. CAR is the foundation for all ratios. The formula is adapted for different situations. Possibilities are numerous and limited only to the analyst's creativity. Two examples are actual margin requirements for each trade, or when evaluating monthly data the advisors maximum margin. CAR is also used to evaluate capital waste built into the investment. For example - assume we evaluate two advisors each having a \$1M required account size. The advisor using the least amount of capital at risk to produce the highest realized return relative to the lowest volatility would probably be a better choice. (Highest RVR)

2. Realized Ratio (RR): Realized profitability relative to real capital used to produce the return. (Net Realized Profits / Capital at Risk Formula.)

3. Volatility Ratio (VR): Evaluates fluctuations of open trade positions relative to capital required to maintain the position. Wide fluctuations in the VR indicate increased account volatility. Increased volatility may or may NOT indicate increased risk. (Open Trade Equity / Capital at Risk Formula.)

4. Net Ratio (NR): Is the composite value of realized and unrealized (open trade) equity on capital at risk. (Realized Ratio + or - Volatility Ratio/ Capital at Risk Formula).

5. Funding Level Ratios (FLR): The Funding Level Ratio indicates profitability relative to the minimum funding level (or funding level chosen by the client) for the time frame being analyzed. Account stability is indicated when the FLR is consistently below the NR, especially when the difference is wide. Leverage is too high when the NR begins to fall into and below the FLR. Excessive account sizes hide volatility – management fees are paid on the entire account while only 5 or 10% of total assets are used for trading. (Realized Ratio + or - Volatility Ratio/ Capital used to fund the account or leverage chosen by the client).

6. Cost Ratio (CR): Defined by a relationship between account costs relative to the Net or Funding Level Ratio. Traditionally costs are evaluated as a percent of the fully funded account value annualized. There is increased value when costs are evaluated relative to return and capital at risk. For example - one of the industry's greatest traders had a 20% cost factor. People “perpetuate the assumption” that he needed to exceed a 20% profit before clients benefit. This thinking is 100% inaccurate. The trader earned over 100% annually on the fully funded account using 25% margin (Capital at risk). Now we “see” that he earned 400% on capital at risk and his costs were 20% relative to the 400% or Net Ratio.

7. Notional Assets: Account size that the client elects for trading. Cash is committed but not necessarily in the account. Advisors are required to calculate Traditional Rate of Return based on notional assets. Remember that account size has no relevance to trading talent. Because clients pay management fees on the advisors minimum account size; SafeMoneyMetrics™ provides a method of analyzing fees relative to investment quality.

8. Traditional Rate of Return (TR): SafeMoneyMetrics™ uses the TR relative to the Net Ratio and Funding Level Ratio for evaluating account stability at variable degrees of leverage. The TR is also used for traditional presentations. The monthly TR for each advisor or investment is taken directly from the advisors disclosure document or their thirteen-column track record. The Daily or Custom TR used in client risk management uses the realized and unrealized profit or loss net of transaction costs (before advisor fees) divided by account assets.

9. *The Primary Benchmark - Reward to Variability Ratio (RVR):** In this report, estimates the ability to produce realized profits with respect to managing the risk of open trades. Traditionally the RVR is calculated by dividing the Risk Premium (RP is a return above the risk free ROR) by the Standard Deviation (SD) of returns. Since SD measures volatility and RP measures risk premium, the result is a risk/reward ratio. We divide the Realized Ratio by a St.Dev of the Volatility Ratio. (RR/SDVR).

A high RVR indicates a higher return relative to the amount of risk taken. For example Assume the Realized Ratio (RR) = 23%, a Standard Deviation (SD) of the Volatility Ratio (VR) for the same time frame is 30%, then 40% and 55%. $23/30=0.76\%$, $23/40=0.575\%$ and $23/55=0.418\%$. As the SD increases or RR decreases the RVR decreases. The ratio is expressed as one number and is applied to every aspect of analysis, including the comparison of investments. Time frames are variable.

10. RVR to Funding Level Return: Account profitability relative to account volatility. A declining RVR indicates increased risk. If the RVR declines along with returns, it indicates a need for further investigation into cause and possible re-evaluation of the investment.

11. *Secondary Benchmarks - Coefficient of Variation: (CV):** From statistics the CV measures absolute and relative dispersion. If the absolute dispersion is a standard deviation (S) and the average (A) is the mean, then the relative dispersion is called the coefficient. When the average is close to zero, the CV is not useful $CV=Standard\ Deviation/Average -$

The CV is used to monitor trends in ratios, profitability and to compare advisors. Increased efficiency is indicated by lower CV's. When used with the Reward to Variability Ratio, look for widening differences or a high RVR and Low CV.

Cost/BA: Annual cost to the account relative to the Billing Account Size (BAS) accepted by the advisor.

Cost/FLR: Annual costs as a percentage of the annual return earned on cash used to fund the account.

Cost/NR: Annual costs as a percentage of annual returns earned on actual capital at risk.

Billing Acct Size (BA): Also called minimum account size. Account size accepted by the advisor (Sometimes advisors calculate management fees on this account size).

Funding Level %: Cash used to fund an account expressed as a percentage of the Billing Account Size.

Margin Billing Account (MBA) %: Margin used for trading expressed as a percent of the billing or minimum account size.

Margin Funding (MFA)%: Margin used for trading expressed as a percent of actual cash funding an account.

Max: The best value of a ratio within the time frame specified.

Min: The worst value of a ratio.

Capital Account Values: Daily account values are used. Capital Account Values graph the starting relative to current value and the percent of change. When the current value rises or falls below a client elected value, decision rules are triggered. For Example: Take profits, add capital, leverage or de-leverage, change the advisor or strategy.

\$1000 FLR Vami: \$1000 = 100% Single advisor strategies graph the composite value relative to the value of each market within the composite.

Realized to Volatility Ratio: Available on client account data. the relationship reveals the investments ability to translate open trade equity into realized profits. A high realized ratio relative to a low volatility is optimal.

Net to Funding Level Ratio: Account profitability relative to account risk at specific degrees of leverage under variable market conditions.

Asset Growth to ROR: If the Rate of Return decreases as assets increase it could indicate lower future returns.

FLR/Traditional and Hedge Fund Index: When included, you can evaluate the correlation trend between all three indexes. You can also replace these indexes with your own traditional and hedge fund data. See <http://analysis.safemoneymetrics.com>.

Decision Applications: Monitor profitability relative to risk and volatility trends in a client account relative to the multi-advisor investment chosen. Client preferences dictate customized decision rules.

Time Frames: Net, Funding Level Ratios and total profitability are analyzed over specified time-frames.

Correlations: When available, CRM evaluates returns between each advisor in a multi-advisor investment. Custom analysis can evaluate each market traded by each advisor. The analysis reveals increased or decreased risk under current market conditions.

51% Rule: This analysis uses seven data points. Within that time frame the average profit relative the percent of profitable periods is revealed. A comfortable North East slope is desirable! For complete understanding read article #38: "Traditional Risk Management and SafeMoneyMetrics", at <http://www.sanctity.com/articles.html>

Allocation and Leverage: This is available with multi advisor analysis. What percent of the composite account was allocated to each advisor and how much leverage is used. The analysis uses the starting and current VAMI.

Graphics: Time frames vary with the purpose of each presentation.

Explanations End Here

Related Sites and Services

Sanctity Capital Management

<http://www.sanctity.com>

Limited risk investment management and business development in managed futures. For sophisticated investors, hedge funds, institutions and advisors. All strategies use SafeMoneyMetrics. Sanctity has library links to traditional educational resources in managed futures. Health, spirit and philosophy libraries are also included.

SafeMoneyMetrics™

<http://www.safemoneymetrics.com>

Managed Futures: A risk and investment management service that optimizes potential returns by preventing ill-fated losses. Mini courses, articles, investment guides.

SafeMoneyMetrics™ Affiliate Program

<http://www.safemoneymetrics.com/affiliate.html>

Optimize potential returns with SafeMoneyMetrics™. Editorial content, investment guides, affiliate program. Free mini courses, monthly articles, advisor rankings.

Analysis SafeMoneyMetrics™

<http://analysis.safemoneymetrics.com>

SafeMoneyMetrics advisor analysis on-line. You can analyze any advisor for \$30.00 any multi-advisor strategy for \$45.00. Annual subscriptions offer unlimited usage for \$595.00. Annual leases are \$3000. You have a private label platform and can sell unlimited subscriptions and direct usage keeping 80% of the gross revenue.

CTA-Reports SafeMoneyMetrics™

<http://cta-reports.safemoneymetrics.com>

Get a SafeMoneyMetrics report on any advisor in the data base. Use the SafeMoneyMetrics™ CTA Rankings to isolate advisors with good relationships between their Net and Funding Level Ratios, then get complete analysis on each. The service is our gift to investors.

The Ultimate Advisor Resource

<http://resources.advisorpage.com>

Advisorpage is a resource directory listing well over 2000 products, services and news. The site attracts over 10,000 investment advisors searching over 30,000 pages a month. FCM's, IB's and CPO's can list their services. CTA's can present performance, press releases and basic due diligence information to a growing network of financial advisors, independent broker dealers and industry-specific vendors and service providers.

Mr.Excel™

<http://www.MrExcel.com>

Provides over 30,000 Excel questions each year at their message board. Provides custom Excel application programming services.