

MAAP January Review

February 1, 2010

For January, the MAAP portfolio was down, with all six asset classes incurring a loss. Grains were the biggest contributor, representing close to half of the portfolio loss, followed by energy representing approximately a quarter of the portfolio loss. The remaining four asset classes, metals, currency, bonds, and equity futures incurred small losses, collectively representing approximately a quarter of the fund's loss in January.

Systematic Risk Process Triggered in late January

The collective decline, across the 12 markets in the three commodity sectors, was sufficient to trigger an automatic leverage reduction in the commodity portion of the portfolio just before month end. This is the first time that the risk process has been triggered in real time since the system was employed on a real time basis beginning July 1, 2009. The June 2009 MAAP Review (http://www.aisgroup.com/Commentaries/June09_Maap.pdf) provides a fuller description of the risk process. Following are excerpts from that commentary: "The system is straightforward and not subject to interpretation. It will assign positive or negative points to each of the twelve commodity markets traded in MAAP. The point system is based on where the daily price is in relationship to average prices for that market over different time periods. A composite point level is then computed for the twelve commodity markets. If the composite reading for the twelve markets drops below the predetermined minimum level, leverage must be reduced to a maximum of 50 percent of our potential leverage on the long side. Leverage on commodity long positions can only be brought back to maximum when the portfolio point system rises to a predetermined positive level.

"The system is designed to be long-term, with infrequent signals. During the 17 years that MAAP has been traded, from 1992 through mid-2009, there were only seven negative signals. Three of those would have avoided significant commodity market declines, while two signals would have added minimal value, and two would have modestly reduced upside gains as commodity prices continued to rise. This highlights the fact that no system or approach is without its limitations. It is precisely for this reason that we will employ it to reduce, rather than to eliminate, discretionary positions. However, the long-term nature of the approach should avoid the problem of frequent whipsaws that many systematic traders are subjected to."

It is our belief that recent commodity market weakness is a temporary interruption (e.g. intermediate correction) in the second phase of the secular commodity bull market that commenced in late 2001. This temporary interruption is primarily the result of the Chinese government decision to rein in bank loans and to moderate the rate of business expansion in China, not to end growth. Intermediate corrections are difficult to predict due to their usually abrupt occurrences in response to news developments. It is difficult to know whether it has run its course or will continue for several more weeks. Because growth is also taking hold in the developed countries, this relatively new global expansion should continue for the next several years. In addition, the momentum of middle class growth in the developing world is dynamic and will likely cause a resumption of upward price pressures in the commodity sectors as 2010 unfolds. In addition we anticipate a Chinese move to allow the yuan to appreciate which will also increase upward pressure on commodity prices by late 2010.