BARCLAY MANAGED FUNDS REPORT

Published by BarclayHedge, Ltd. ■ 800-338-2827 or 641-472-3456

VOLUME 21, NUMBER 2 2nd QUARTER 2009

BARCLAY ROUNDTABLE

In Midst of Market Meltdown, CTAs Gain 14% in Best Year Since 1990

Investors Have Redeemed $40 Billion from Oct-08 to Mar-09 in Spite of Robust Returns

2008 was a year not soon enough forgotten as a continued global banking crisis and deepening recession propelled the financial markets toward near lockdown. With market volatility at historical highs and liquidity close to nonexistent, there were few places for investors to hide as the equity markets lost nearly one-third of their value, investment-grade and high-yield credits both ended the year in negative territory, non-US markets followed suit, and even the once skyrocketing commodities markets plummeted. Obviously, directional investing was a painful experience, unless you were among the brave few to maintain a net-short portfolio.

Arbitrageurs fared just as poorly, as every imaginable spread relationship was confounded by global deleveraging and a flight to safety. Yet through all of the chaos and value erosion, one segment of the alternative investment universe forged ahead, redefining the concept of uncorrelated returns.

Enter Commodity Trading Advisors (CTAs), which as a group, earned a +14% return in 2008. While results varied, no matter how you sliced it and diced it – discretionary, systematic, focused, diversified, etcetera – most managers defied the investment universe and posted positive returns for the year. So with a phenomenal year behind them and some evidence of the beginning of normalcy in the world's capital markets, is there still a case for allocating to CTAs over the next 12 to 18 months? To answer this question and review the CTA landscape in more detail, we've assembled a panel of distinguished and seasoned practitioners. Our panel includes:

Matthew Beddall, Winton Capital Management. Mr. Beddall is the Chief Investment Officer and a director of Winton. His responsibilities are principally focused on managing the investment process behind the Winton Futures Fund and overseeing a large section of the research department. He has a first class honours degree in mathematics and computer science from Southampton University and an MSc in applied statistics from Birkbeck College, University of London.

Kevin M. Heerdt, Campbell & Company, Inc. Mr. Heerdt is the Chief Investment Officer at Campbell. He has served as CIO and Director of Research since July 2007, was Executive Vice President-Research from March 2003 to June 2007, and Chief Operating Officer from June 2005 to June 2007. His duties include risk management, research, and the development of quantitatively based hedge fund and options strategies. Mr. Heerdt has more than 20 years of experience in the industry. He holds a B.A. in economics and in international relations from the University of Southern California.

Jaffray Woodriff, Quantitative Investment Management, LLC. Mr. Woodriff has 22 years experience trading financial markets using proprietary quantitative models that he has developed. In 2003, Jaffray cofounded QIM. He guides all aspects of QIM's business and is chiefly responsible for the constant innovation and improvement of the models and techniques

INSIDE:

Past results are not necessarily indicative of future results. An investment in commodity futures and options involves the risk of loss. Please read the important disclosure on page 19.

Cranwood Capital Management - Fixed Income Arbitrage

(left to right) Mathew Powers (Senior Trader), Ferenc Sanderson (COO), Joseph Radostitz (Chief Risk Officer), Peter Powers(CEO & CIO), William Powers (Senior Trader, Research & Development), Jack Kraszewski (Senior Trader), Thomas Barno (Trader)

At a Glance:

Cranwood Fixed Income Arbitrage

Fund Assets:	$107 million
Firm Assets:	$117 million
No. of Employees:	16
Account Information	
Minimum Investment:	$250,000
Management Fee:	2.0%
Incentive Fee:	20%
Performance Analysis	
Start Date:	July 2005
Total Return:	177.70%
Compound Annual Return:	31.31%
Worst Drawdown:	3.68%
Sharpe Ratio:	3.36
% of Winning Months:	91.11%
Average gain:	2.65%
% of Losing Months:	8.89%
Average loss:	-1.00%
Correlations	
Barclay CTA Index:	+0.09
S&P 500:	+0.24
U.S. T-Bonds:	-0.12
World Bonds:	-0.22
EAFE:	+0.23
Annual Returns Past 5 Years	
2005 (partial year)	32.05%
2006	24.92%
2007	42.68%
2008	17.29%
2009 (1st Qtr)	0.62%

Past results are not necessarily indicative of future performance.

The original idea of a hedge fund back in 1949 was to create a private investment vehicle that was focused on absolute returns, offered protection against losses, invested in liquid exchange-traded instruments, was hedged at all times, and produced returns that were non-correlated with traditional benchmarks. Cranwood Capital Management has developed its strategy based on these original ideals, and this approach has resonated with institutional investors.

Beginnings

Pete Powers, Cranwood's founder and CEO, always harbored a passion to trade. He started out in Cleveland as a retail broker with Smith Barney before moving to Dean Witter Reynolds in the institutional fixed income department, and got his break when he was introduced to a seasoned trading veteran at the Chicago Board of Trade (CBOT). He moved from Cleveland to Chicago and joined SSS Commodities, which at that time was one of the largest traders in the 10-year Treasury pit.

When Powers arrived in Chicago, electronic trading at the CBOT was in its infancy. He worked his way up from runner to clerk, before leasing a seat on the exchange specializing in trading outright 10-year Treasury note futures. The desire to increase trading profit and reduce risk led him to trade Treasury futures spreads.

Having established himself as a trader, Powers next focused on building a business. He invested in infrastructure for his trading operation and put together a team to trade U.S. Treasury futures spreads around the clock. He hired several family members and close friends, teaching each one of them his disciplined approach to trading.

In 2002, Powers set up a proprietary trading operation called Elite Trading Company, LLC. Elite focused exclusively on a reversion to the mean strategy involving the disciplined trading of butterfly spreads on U.S. Treasury futures. His team became active day traders, focusing on the 2-5-10-year, the 5-10-30-year, and the 2-10-30-year butterfly spreads, ultimately trading up to 4,000 butterfly spread contracts per day. At this point, the business started to generate impressive returns.

Starting in 2005, Powers began to transition Elite into a hedge fund structure so that he could bring in outside investors. When the merger of the

CBOT with the Chicago Mercantile Exchange (CME) was formalized in early 2008, he changed the name of the company to Cranwood, the name of his father's trucking company. He also invested over $9 million so that Cranwood could acquire the necessary seats for a membership on the new exchange.

In April 2008, Cranwood Capital Management launched a master-feeder fund structure, incorporating Cranwood Fixed Income Arbitrage Fund LP, a Delaware domestic feeder, and Cranwood International Fund, Ltd, the BVI-listed offshore feeder.

Key Principals

Pete Powers serves as the CEO and CIO of Cranwood Capital Management, LLC. He has a long career of trading U.S. Treasury futures contracts and was one of the first to trade electronically. He has experienced every market cycle and shock since the late 90s. He's a registered floor broker at the CBOT, and has been a member of the National Futures Association since 1998. Powers graduated with a BSc. degree in finance from the University of South Carolina, Coastal in 1990.

Powers has built his business with people who could be trusted to execute the team trading approach and could man the trading desks around the clock. He feels that this is a key component to building a sustainable, institutional-quality business.

Today, the firm has 12 traders working in teams, executing the same trading process 22.5 hours a day, each and every day. Nine of the traders worked with Powers at Elite and have a combined 95 years experience trading U.S. interest rate futures contracts. Reflecting Pete's roots, there is a strong Cleveland bias to the firm.

Joseph Radostitz is the Chief Risk Officer, supervising the trading activity of Cranwood's trading desk. Joe has 14 years experience trading futures contracts, and was a member of both the CBOT and the Chicago Board Options Exchange. He was a Senior U.S. Treasury bond futures yield curve trader for Elite Trading Company. Radostitz has also acted as a mentor and trainer for many junior futures traders.

William Powers is a senior trader at Cranwood with the added responsibility for research and development of new products. Bill was previously a senior trader at Elite and has six years of trading experience in U.S. Treasury and Eurodollar futures.

Robin Mesch is the Chief Technical Strategist for Cranwood. She is a noted expert in the field of technical analysis and market theory, and for 20 years has built models with a select group of managers. Robin's work helped to develop an important component of Cranwood's proprietary trading approach. She has been regularly cited in the national media, and has been profiled in books such as Bensignor's *New Thinking in Technical Analysis* and Koppel's *Bulls, Bears and Millionaires*.

Trading Philosophy

Cranwood exploits short-lived discrepancies in the yield curve as a result of normal market operations over the 22.5-hour trading day. This is the essence of a mean-reversion strategy, and it explains why the firm is staffed around the clock, as opportunities can arise at any time.

While the yield curve is extremely efficient over time frames greater than one day, it is subject to brief intraday distortions. And although supply and demand for Treasury instruments are strongly correlated, they are not identical. The fact that these instruments do not move in a simultaneous manner creates the opportunity for deployment of an execution-dependent team approach to entering and exiting multi-legged positions.

Since the factors giving rise to the trading opportunity are not intrinsically structural, but rather a function of supply and demand, it doesn't appear that this opportunity will decrease over time. In fact, Cranwood traders have noted no diminution of opportunity over the past ten years.

Trading Edge & Risk Management

The alpha opportunity is based on supply and demand imbalances that are identified using Cranwood's proprietary trading model, on an experienced labor-intensive execution capability applying butterfly spreads using proprietary ratios, and on a strict and disciplined risk management system.

These features have been in place since 2005 and have been validated by the extraordinary volatility shock that impacted all asset classes since September 2008. They have helped protect the downside, which was one of the key features of the original hedge fund.

Cranwood's edge lies in its disciplined risk management. It starts with strict dollar rules risking a maximum of 1% of capital each day. Four percent of capital is held by its clearing broker with the remainder invested in a high quality, liquid money market account.

Traders build positions in small size, with a senior trader typically working the bid/offer on the so-called body of the butterfly while other traders simultaneously fill the offers/bids on the accompanying wings of the fly. Ultimately, all trades have a discretionary bias, making them very hard to replicate.

Cranwood does not hold positions going into known market-moving data releases or in front of major statements or Fed speeches. The approach is to let the market react to such "noise" and then initiate trades to take advantage of the tendency for the market to revert back to normalized trading day patterns.

At the end of the day, the exchange comes out with settlement prices and the portfolio is flat. In this way, regardless of the day's trading, everyone knows where they stand and can come in the following day with a fresh trading approach.

This systematized process has helped the firm generate up to 75% winning days every month over the last 5 years. This means that good months are pretty much a function of having very few bad days. So as long as the bad days are minimized, the process ensures that the good days will take of themselves. The biggest single risk factor for the strategy is maturity specific news. The largest drawdown was -3.68% which took place in June 2007. At the time, maturity-specific news drove futures prices for the U.S. Treasury 10-year contract down 2 full points while the other maturities didn't move. Risk management has been refined to avoid a repeat of this.

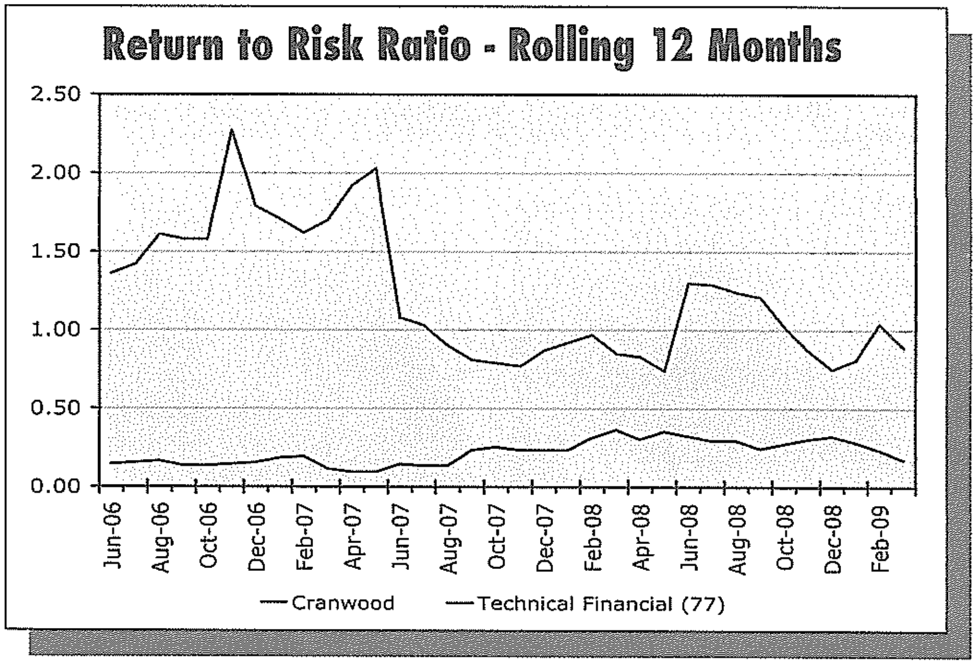

Figure 1.

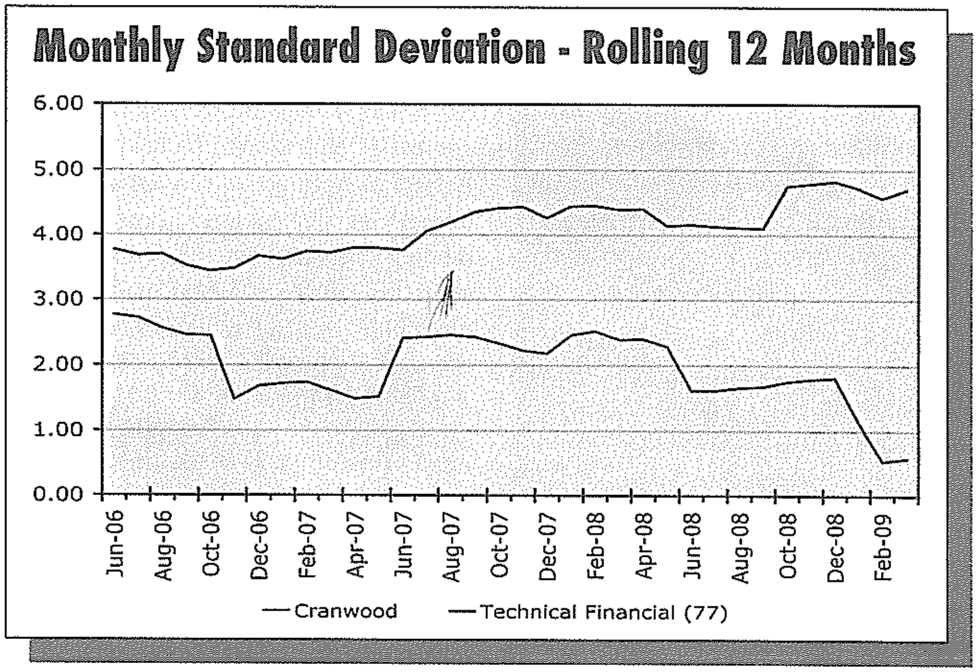

Figure 2.

Trade Ideas

At Cranwood, market data generates proprietary reversion to the mean analyses. The CIO and other senior members of the trading team have discretion with respect to the timing and size of the building of positions. These are determined according to upcoming news, announced speeches, or economic releases, as well as the recent behavior of the spreads that are traded.

Technical market processes drive trade outcomes, as transitory supply and demand imbalances create a quantitatively measurable discrepancy of sufficient magnitude that the anticipated realignment can be capitalized upon by the trading team. This is the pattern of every trade, profitable or not. The positions are manually executed in a labor-intensive process.

Peer Group Comparison

In order to better evaluate the effectiveness of Cranwood's approach to risk control, we've run a comparison of its standard deviation and risk-adjusted returns relative to the averages generated by its peer group. *Figure 1* compares the rolling 12-month risk-adjusted returns for Cranwood's fixed income arbitrage program with the average values for a universe of 77 CTA programs that utilize a technical approach to trade financial markets. The time period under consideration was the period from July 2005 through March 2009. Risk-adjusted returns are calculated by dividing the 12-month rolling average of the monthly returns by the 12-month rolling average of the standard deviation. As we can see, Cranwood has consistently outperformed the risk-adjusted return averages for its relevant subgroup. (From July 2005 through March 2008, returns are based on proforma adjustments to Cranwood's proprietary account to reflect fees. Customer accounts are traded in like fashion. From April 2008 onwards, returns are taken from the Cranwood Fixed Income Arbitrage Fund.)

Examination of the rolling standard deviation data in *Figure 2* is equally revealing. In every rolling 12-month period, Cranwood's standard deviation has been markedly lower than the average for its subgroup. Over the period under examination, rolling standard deviation for Cranwood has averaged 1.97 versus an average of 4.13 for the subgroup.

Future Plans

Over the past six months, understanding and appreciating trading capacity has been a key issue across all asset classes. Cranwood is no different. The reality is that Cranwood represents a miniscule portion of the daily volume of interest rate futures contracts traded on the CBOT. Cranwood's goal is to grow its assets under management to the $300-$500 million area.

There are several reasons that support positive asset growth and alpha generation outlook. First of all, the U.S. government continues to issue fresh supply in the cash markets as the size of weekly auctions and the refunding timetable continue to grow. Algorithm traders from established bank proprietary trading desks continue to reenter the interest rate futures markets. In addition, new maturities have opened up, such as the recent 3-year Treasury futures contract. There is talk of an eventual 7-year and 20-year Treasury futures contract on the horizon. Meanwhile, markets are expected to return to more normal volatility levels as volume levels continue to edge higher.

Ultimately, Powers plans for Cranwood to be a diversified investment management firm offering an array of alpha-generating products. ◊

Continued from pg. 5

tain a meaningful research effort. The same would appear to be true of retail equity trading. Certainly, some individuals do well with the retail products that are available, but I believe that sustained success is rare and has more to do with exceptional intuition and discipline than it does to the accessibility and ubiquity of trading tools. I also do not believe that retail investors have a meaningful impact on our opportunity.

Woodriff: We have no estimation what percentage of traded capital belongs to retail investors. But we have always preferred to trade in markets that have the most participants, so we would love to see an increase in liquidity due to more investors using off the shelf trading tools. Since we are generally uncorrelated to other CTAs, more traders would probably increase our expected returns in the sense that they would provide more liquidity for us, thereby reducing our frictional costs. ◊

The organization of this roundtable was assisted by Jeffrey F. Kuchta, CFA, a consultant with Strategic Capital Investment Advisors.

BARCLAY MANAGED FUNDS REPORT
is published by BarclayHedge, Ltd., 2094 185th Street, Suite 1B, Fairfield, Iowa 52556
www.BarclayHedge.com

In Iowa call
641-472-3456

Outside Iowa call
1-800-338-2827

Annual subscription rate: $150.00 (4 issues)
 ISSN 1060-3158