



Combining Commodities Alpha and Beta

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Some statistical index information contained herein is courtesy of The Barclay Group (www.barclaygrp.com).

Active Management vs. Passive

- ■ What is a commodity index investment missing?
 - ■ “Short” Opportunities
 - ■ Cyclical Trades
 - ■ Weather and Other Fundamental Themes
 - ■ Term Structure Trades
 - ■ Other Arbitrage and Relative Value Trades
 - ■ Long Volatility Optionality
 - ■ Avoidance of Downturns (not all market participants are speculators)

Active Management vs. Passive

- ■ What is a commodity futures investment missing?
 - ■ Water
 - ■ Coal and Other Alternative Energy Sources
 - ■ Timber / Pulp Products
 - ■ Electricity/Utilities
 - ■ Emissions
 - ■ Shipping / Transport
 - ■ Other Materials (e.g. Steel)
 - ■ Resources Infrastructure

So What is Your Alpha?

OPPORTUNITY	Trend Overlay	Active Mgmt – CTAs	Active Mgmt – HFs & CTAs
Short Opptys	X	X	X
Cyclical Trades	X	X	X
Weather		X	X
Term Structure	poss	X	X
Arb / Rel Value		X	X
Long Vol / Options	X	X	X
Avoidance of downturns tolerated by hedgers	X	X	X
MARKET			
Water			X
Coal			X
Timber / Pulp			X
Electricity			X
Emissions			X
Shipping			X
Bldg Materials			X

Active Management vs. Passive

Comparing active natural resources managers* to indexes

*January 2002 to
December 2005*

Index	Compound Annual Return	Annualized Standard Deviation	Sharpe Ratio	Worst Draw Down	Correlation to S&P 500
Active Commodities*	20.99%	6.70%	2.86	-3.50%	0.38
DBLCI	25.70%	18.25%	1.31	-16.78%	-0.17
DJ-AIG	19.90%	13.43%	1.35	-8.12%	0.02
GSCI	23.78%	22.27%	0.99	-19.66%	-0.17
RJ-CRB	15.21%	9.78%	1.37	-5.93%	0.06
RICI	26.45%	13.90%	1.77	-10.63%	-0.07
SPCI-A	24.84%	17.83%	1.29	-12.21%	-0.08

**Equally weighted portfolio of up to 178 distinct non-financial Commodity Trading Advisors and natural resource sector hedge funds.*

Combining Passive and Active Exposure

Correlations of Active Commodities to Passive Commodities

*Correlation of
commodity indexes
to Active
Commodities
January 1991 to
December 2005*

Index	Overall Correlation	Correlation When Index Up	Correlation When Index Down
DBLCI	0.43	0.55	0.23
DJ-AIG	0.54	0.44	0.29
GSCI	0.45	0.45	0.25
RJ-CRB	0.41	0.24	0.25
RICI	0.47	0.5	0.24
SPCI-A	0.5	0.47	0.32

Correlation characteristics suggest active commodities strategies have some correlation to passive commodity indexes.

Can adding alpha to your beta source improve risk-adjusted returns while maintaining the asset class exposure you desire?

Commodities Alpha + Beta: Stock Market Hedge

Combined Passive/Active Portfolios – Bullish Stock Markets

*Passive / Active
Commodities
Portfolios Using
GSCI
January 2002 to
December 2005*

Portfolio	Compound Annual Return	Annualized Standard Deviation	Sharpe Ratio	Worst Draw Down	Correlation to S&P 500
100% GSCI	23.78%	22.27%	0.99	-19.66%	-0.17
75% GSCI / 25% Active	23.14%	17.92%	1.19	-15.53%	-0.13
50% GSCI / 50% Active	22.46%	13.56%	1.52	-11.05%	-0.06
25% GSCI / 75% Active	21.75%	9.47%	2.1	-6.17%	0.09
100% Active	20.99%	6.70%	2.86	-3.50%	0.38

*Passive / Active
Commodities
Portfolios Using
DJ-AIG
January 2002 to
December 2005*

Portfolio	Compound Annual Return	Annualized Standard Deviation	Sharpe Ratio	Worst Draw Down	Correlation to S&P 500
100% DJ-AIG	19.90%	13.43%	1.35	-8.12%	0.02
75% DJ-AIG / 25% Active	20.24%	11.30%	1.63	-6.40%	0.07
50% DJ-AIG / 50% Active	20.53%	9.35%	2	-5.10%	0.14
25% DJ-AIG / 75% Active	20.78%	7.72%	2.45	-3.80%	0.25
100% Active	20.99%	6.70%	2.86	-3.50%	0.38

Commodities Alpha + Beta: Market Shock Hedge

Performance of Passive/Active Commodity Portfolios During Top 5% Worst Months of S&P 500*, Jan. 1991 – Dec. 2005

Passive/Active Commodities Portfolios Using GSCI

	Aug-98	Sep-02	Feb-01 - Mar-01	Aug-01 - Sep-01	Nov-00	Jun-02 - Jul-02	Total
S&P 500	-14.46%	-10.87%	-15.46%	-14.14%	-7.88%	-14.92%	-77.73%
100% GSCI	-5.90%	4.57%	-5.32%	-10.00%	9.21%	4.01%	-3.43%
75% GSCI / 25% Active	-5.37%	3.53%	-3.63%	-7.78%	7.62%	2.34%	-3.29%
50% GSCI / 50% Active	-4.88%	2.43%	-2.01%	-5.80%	5.96%	0.65%	-3.65%
25% GSCI / 75% Active	-4.42%	1.26%	-0.14%	-4.01%	4.25%	-1.05%	-4.11%
100% Active	-3.99%	0.01%	1.03%	-2.40%	2.47%	-2.76%	-5.64%

Passive/Active Commodities Portfolios Using DJ-AIG

	Aug-98	Sep-02	Feb-01 - Mar-01	Aug-01 - Sep-01	Nov-00	Jun-02 - Jul-02	Total
S&P 500	-14.46%	-10.87%	-15.46%	-14.14%	-7.88%	-14.92%	-77.73%
100% DJ-AIG	-6.34%	3.77%	-4.68%	-6.79%	8.04%	1.39%	-4.61%
75% DJ-AIG / 25% Active	-5.73%	2.88%	-2.21%	-5.56%	6.54%	0.36%	-3.72%
50% DJ-AIG / 50% Active	-5.14%	1.96%	-1.76%	-4.42%	5.12%	-0.68%	-4.92%
25% DJ-AIG / 75% Active	-4.16%	1.01%	-0.34%	-3.38%	3.76%	-1.71%	-4.82%
100% Active	-3.99%	0.01%	1.03%	-2.40%	2.47%	-2.76%	-5.64%

*9 worst months of S&P 500 over 180 periods; when worst months were consecutive we consolidated into single aggregate period.

Levered Alpha + Beta: Inflation Hedge

Combined Passive/Active Portfolios – Correlation to Inflation

Passive / Active Commodities Portfolios Using GSCI

Portfolio	Correlation to Inflation (CPI)	1991 - 2005		2002 - 2005		
		Correlation When CPI Positive	Correlation When CPI Negative	Correlation to Inflation (CPI)	Correlation When CPI Positive	Correlation When CPI Negative
100% GSCI	0.12	0.12	0.21	0.19	0.17	0.44
75% GSCI / 25% Active	0.11	0.12	0.21	0.17	0.17	0.44
50% GSCI / 50% Active	0.09	0.13	0.22	0.13	0.18	0.43
25% GSCI / 75% Active	0.06	0.12	0.2	0.06	0.19	0.4
100% Active	0	0.1	0.14	-0.09	0.17	0.25

Passive / Active Commodities Portfolios Using DJ-AIG

Portfolio	Correlation to Inflation (CPI)	1991 - 2005		2002 - 2005		
		Correlation When CPI Positive	Correlation When CPI Negative	Correlation to Inflation (CPI)	Correlation When CPI Positive	Correlation When CPI Negative
100% DJ-AIG	0.11	0.18	0.18	0.18	0.28	0.36
75% DJ-AIG / 25% Active	0.09	0.18	0.18	0.15	0.28	0.35
50% DJ-AIG / 50% Active	0.07	0.17	0.18	0.1	0.26	0.33
25% DJ-AIG / 75% Active	0.04	0.14	0.16	0.02	0.23	0.3
100% Active	0	0.1	0.14	-0.09	0.17	0.25

Commodities *Levered* Alpha + Beta: Inflation Hedge

Combined Passive/Active Portfolios – Correlation to Inflation

Portfolio	Compound Annual Return	Annualized Standard Deviation	Sharpe Ratio	Worst Draw Down	Correlation to CPI
100% GSCI	23.8%	22.3%	0.99	-19.66%	0.19
50% GSCI / 50% Active	22.5%	13.6%	1.52	-11.05%	0.13
50% GSCI / 60% Active	25.3%	13.8%	1.69	-10.56%	0.14
50% GSCI / 70% Active	27.6%	14.3%	1.79	-10.65%	0.13

The ability to add an active manager alpha to the index beta depends on the source of beta. What is the most appropriate form of beta for this combination?

So What is Your Beta?

ETFs	Cost	Small.
	Tracking Error	Low.
	Liquidity	Very good.
	Reporting	Very frequent.
	Leveragability	Little to none
INDEX FUND	Cost	Fair to large.
	Tracking Error	Low.
	Liquidity	Poor.
	Reporting	Can vary.
	Leveragability	Little to none
SWAPS	Cost	Fair to large.
	Tracking Error	None to low.
	Liquidity	Fair.
	Reporting	Periodic
	Leveragability	Great
LEVERED INDEX CELL	Cost	Small to fair.
	Tracking Error	Low.
	Liquidity	Good.
	Reporting	Very frequent.
	Leveragability	Very good

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