A Big Investor Feels Little Fear Of Derivatives

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NEW YORK – For many institutional investors, derivatives are too hot to handle these days. But don't tell that to Richard Rose, the chief investment officer of the San Diego Employees' Retirement System.

Mr. Rose is a true believer, at least when it comes to one of the most traditional derivative-investment strategies: putting money into managed futures. Run by managers known as "commodity-trading advisers," these funds use publicly-traded futures and options to bet on price trends in currencies, commodities, stocks and bonds.

Richard Rose

Just last week, Mr. Rose, persuaded his fund's board members to more than double the fund's current allocation to managed futures, to 5% of its assets, boosting its total investment in these products to about $110 million from $45 million. In addition, he won approval to use futures in an "overlay" strategy: putting up only the margin, or collateral, required to take positions in futures and options markets. That means that instead of having to keep $110 million in a separate account, the fund will be able to deploy those funds elsewhere. The $16

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A Big Investor Boosts Derivatives Stake

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llion or so required for margin payments · the managed-futures positions will me from its operating budget.

"This is really kind of revolutionary for e industry; we seem to be the first stitution to take this next, very logical ep," Mr. Rose says, referring to the erlay strategy. But, he adds, "There e, historically, good rates-of-return asso- ated with accepting a higher degree of latility."

In the wake of the disastrous high-risk vestments made by Orange County, only few hundred miles to the north of San iego, Mr. Rose concedes his fund's activi- es have come under more scrutiny. "Our oard has to balance the negative image at surrounds derivatives with the reality at this program really belongs in a versified portfolio of investments," he ys. And indeed, it took only an hour and half to win board approval for both oosting the investment and using the verlay strategy.

But pacesetters like Mr. Rose remain carce in the world of managed futures, hich is primarily the domain of those ealthy individual investors willing to ke high risks in quest of hefty returns.

In fact, less than a year ago, Virginia etirement Systems, the state pension und, pulled the plug on its $460 million nvestment in managed futures, claiming t was costly, volatile and didn't generate he kind of returns that justified the risk. Meanwhile, the misadventures of public-fund managers in Orange County and Wisconsin, and the collapse of Barings PLC after it incurred massive losses in exchange-traded stock futures, have driven home the message that investing in anything more than plain old stocks and bonds can be dangerous.

"This isn't an environment in which institutions are dying to jump into anything at all that sounds like a derivative," says David Love, who markets managed futures to institutional clients. "These aren't products like those that sunk Orange County, but it's still a big perceptual problem."

Indeed, in the institutional community, dabbling in such unconventional investments can be risky to one's career.

"It's hard to be a pioneer in something like this," says Philip Maisano, president and chief executive officer of Evaluation Associates, a pension consultant in Norwalk, Conn. "If you're a pioneer, you're going to either wind up a hero, or shot dead. So anyone who's pioneering in something unusual or risky is going to be pretty happy to have no one hear about it."

It's difficult to track down other trailblazers. While managed-futures traders and advisers confirm that companies such as Conrail and other state and city funds, such as Illinois Teachers Retirement System, have put small amounts of money into managed futures, most officials in charge of that money didn't return repeated calls seeking comment.

Even when a pension fund's chief investment officer is willing to dabble in the unconventional, the hurdles can be considerable. Above all, there's the challenge of getting a pension fund's board of directors to agree, particularly with debacles like Orange County and Barings still so fresh in everyone's mind.

But there's help at hand from pension consultants and a growing number of managed-futures advisers. These industry boosters make a case that such investments can, if properly managed, produce a double bonus: Not only can they enhance returns, but because they tend to move independently of stocks and bonds, a dash of managed futures can go a long way to reduce the volatility of a traditional portfolio.

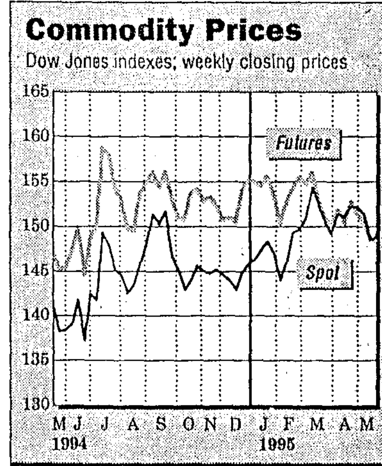
Ned Joachimi, chairman and chief executive of Wellesley Group Inc., a Waltham, Mass., pension-fund advisory firm, recently used that argument to persuade the Chicago Transit Authority's pension fund to steer $30 million, or about 5% of its assets, into managed futures. In fact, he argues that a 10% allocation to "alternative" investments, including managed futures, is the perfect investment strategy. "That's the level we think is ideal, although we haven't gotten the CTA to sign off on that much yet," he says. "You might as well not be playing the game at all if you've only got 1% or 2% invested."

For Mr. Joachimi, managed futures offer an equity-like return, while reducing risk. Mr. Rose agrees: Although his 25 managers as a group have underperformed the Standard & Poor's index since the managed-futures program began a year ago, they are still yielding "high single-digit returns" and they reduce volatility of the portfolio as a whole.

But investing in managed futures isn't cheap. Management fees can run as high as 3% annually, with commissions adding to that cost. Managers also receive "incentive fees" of as much as 15% or 20% of any profit. That compares with fees of well under 1% at many basic equity funds, and of as little as 0.10% at stock-index funds.

"Fee schedules are becoming more institutionalized" as traders seek to attract more pension-fund money into managed futures, says Patrick Hart, chairman of Hart Bornhoft Group Inc., a Denver-based firm that advises institutions on managed-futures investments. "They like the idea of dealing with more sophisticated investors with more dollars to invest, who are going to be around for longer than the typical retail guy."

Indeed, Mr. Hart says he's seen other changes among managed-futures managers over the last five years. Reporting and risk-management standards are up, he says, and he now has a list of more than 900 companies he believes are qualified to manage institutional funds. That's up from only 600 a year ago.



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	Close	Net Chg.	Yr. Ago
Dow Jones Futures	148.34	− 0.15	146.88
Dow Jones Spot	148.94	− 0.23	140.87
Reuter United Kingdom	2320.4	− 2.70	1975.2
K R-C R B Futures*	233.47	+ 0.45	233.69

*Division of Knight-Ridder.

Spot Lumbe

Compiled by
Lengths. Pric
wholesalers
prices.