

Landmark Asset Management Investor Notes

Topic: Zero Correlation Study

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Zero Correlation: The Art of Portfolio Diversification

Building a well-balanced portfolio begins with a simple premise -- Don't put all of your eggs into a single basket. Every investor has at one time or another heard this pearl of wisdom, but few take it to heart until their portfolio takes a major hit. There is no time like the present to take a serious look at your portfolio and ask "Am I diversified?"

This issue of *Investor Notes* will focus on a correlation study of three asset classes, stocks, bonds and managed futures, to illustrate the power of portfolio diversification.

The key to diversification is proper asset allocation. In today's investment world, there are a host of investment vehicles an individual can use to construct a diversified portfolio. The goal, however, is to combine investments that behave differently over time to lower the volatility of the general portfolio while attempting to maximize returns. The best way to determine if asset classes offer similar or different return characteristics is to calculate their historical correlation based on monthly returns.

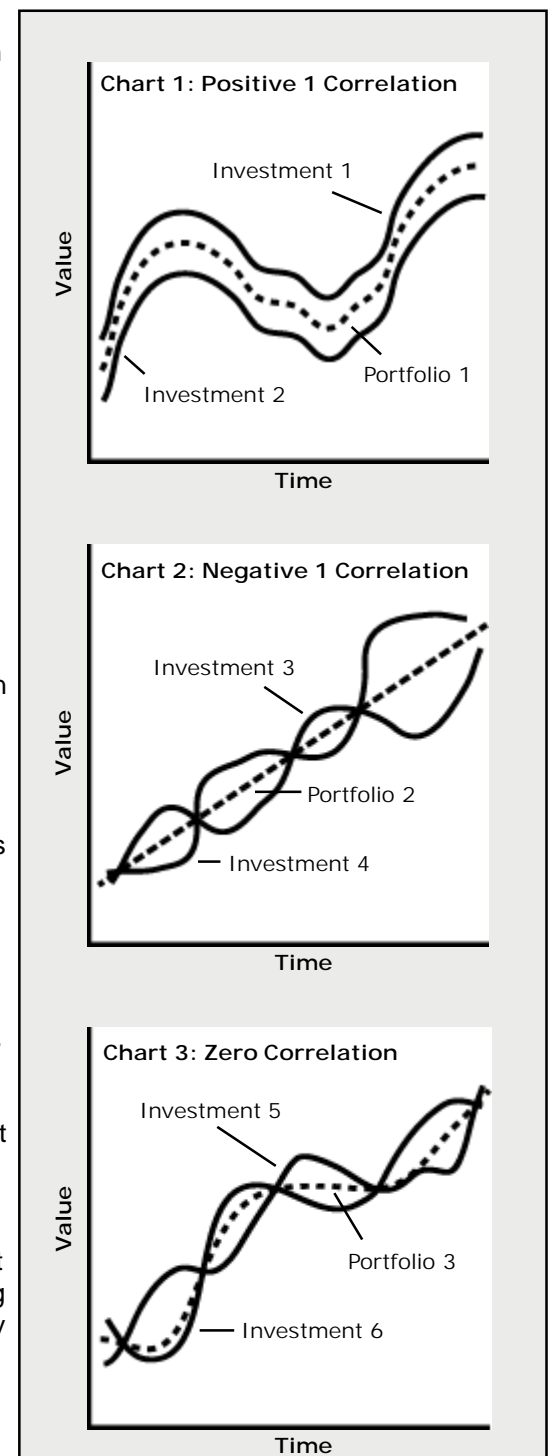
Correlation Basics

Investments that behave in a similar fashion have high levels of correlation. If two investments move in lock step with one another, displaying similar volatility/return characteristics, they would have a correlation of +1. Chart 1 reflects two investments with a positive correlation. If however the two investments exhibit a counter cyclical volatility/return patterns, they would generate a negative correlation of -1. Chart 2 illustrates two investments with a negative correlation. Perfectly negative correlated investments generally do not exist in the real world.

There is, however, a middle ground where investments are neither perfectly positively or negatively correlated. An asset class that has a pattern of return that is *unrelated* to another has a near zero correlation. And therein lies the key to portfolio diversification. An asset class that has a near zero correlation to other investments within the portfolio offers a potential smoothing effect to the portfolio's volatility. Chart 3 shows two investments with a near zero correlation. At times these investments may trend together weakening the diversification effect, while at other times, they may trend in opposite directions strengthening the diversification effect, but historically they offer a reduction to portfolio's volatility over time.

As an asset class, managed futures add a level of diversification not found in the typical stock and bond investment portfolio.

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Correlation Analysis

How diversified is your portfolio? The correlation studies below compare three separate asset classes: stocks (S&P 500, Dow Jones and NASDAQ), bonds (Lehman Brothers Bond Index) and managed futures (MAR Index), over a 16+ year time span. The MAR Index acts as an historic proxy for managed futures accounts, like those offered by Landmark Asset Management. Chart 4 uses the MAR Index as a benchmark for comparison against the other indices. Notice the strong near zero correlation that exists between the MAR Index and the other asset classes. This near zero correlation suggests that adding managed futures into a traditional stock and bond portfolio would actually add a level of diversification. The MAR Index acts independently to the other indices. Therefore, managed futures can provide investors with a totally separate basket in which to protect a portion of their investment eggs.

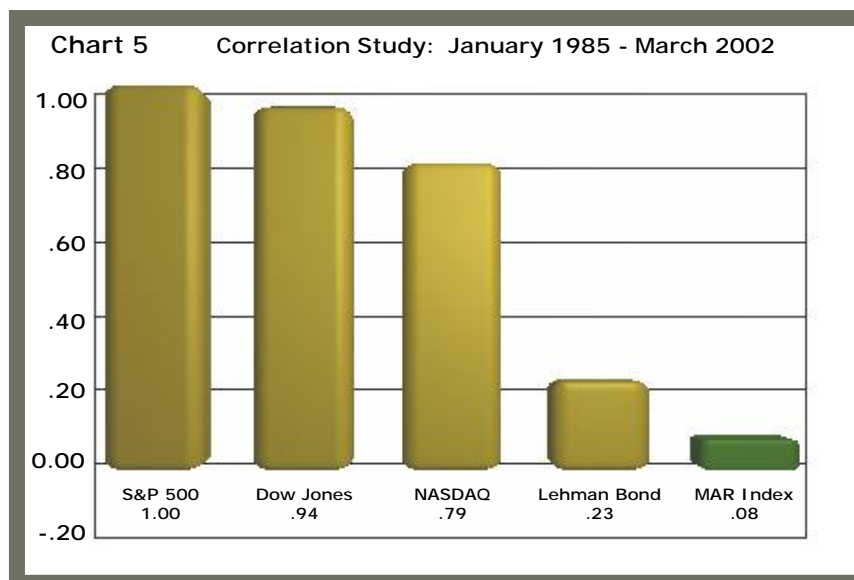
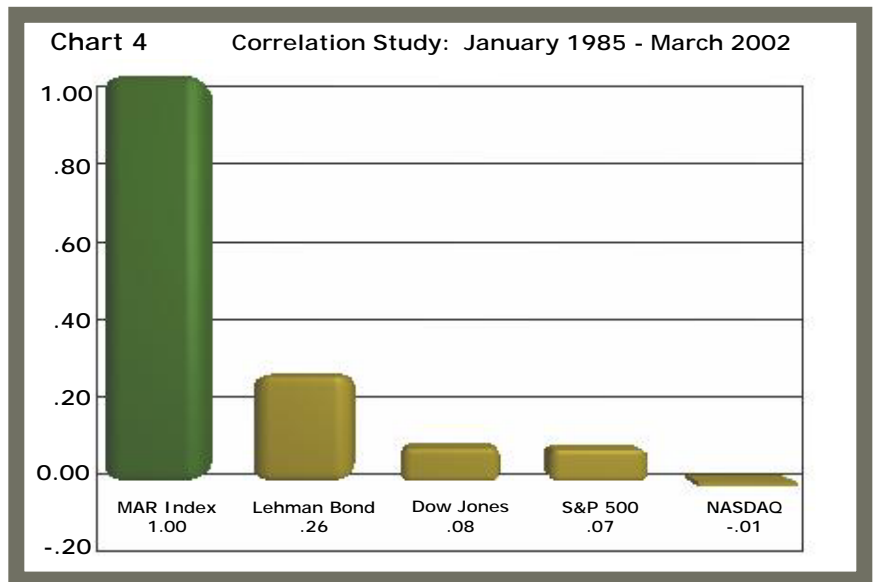
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The correlation study shown in Chart 5 uses the S&P 500 Index as its benchmark comparison based on the same test

data. Notice the very strong correlation between the major stock indices. The S&P 500 Index and Dow Jones Industrial Average have a correlation of .94 while the S&P 500 Index and the NASDAQ have a correlation of .79. Remember investments that move in step with one another, displaying similar volatility/return characteristics, have a correlation of +1. The strong correlations between these stock indices should come as no surprise given that each index is based on either large, mid or

small cap stocks. The operative word here is "stocks." Their strong correlation suggests that they will move together offering the typical portfolio little diversification especially during periods of excessive volatility. The modern investment portfolio is evolving from a pure stock and bond portfolio to one that also includes a strong component of managed futures. Why? True portfolio diversification.

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PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

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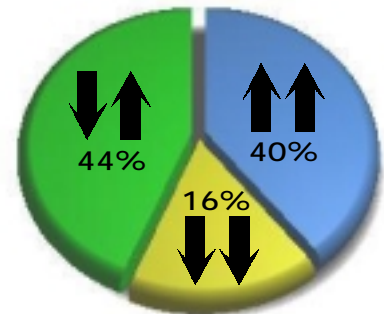
Investment Comparison

Let's continue our analysis by comparing the MAR Index to both the S&P 500 Index and Lehman Brothers Bond Index in greater detail. The investment comparison below illustrates the independent nature the MAR Index has to traditional stock and bond indices. During the 16+ year test period, the MAR Index experienced positive returns simultaneously with both indices over 40 percent of the time. This occurred during the greatest bull market the stock market has ever seen. More importantly, the MAR Index generated opposite returns to both indices over 41 percent of the time, which is a testament to its independent nature. The bottom line is managed futures have an historic near zero correlation to stocks and bonds. Therefore they can offer a level of diversification that both protects and enhances the performance of traditional portfolios.

Investment Comparison Between the MAR Index and S&P 500 Index

January 1985 - March 2002

↑↑	Both produced positive returns	40% based on 82 of 207 months
↓↑	Returns were opposite to one another	44% based on 91 of 207 months
↓↓	Both produced negative returns	16% based on 34 of 207 months

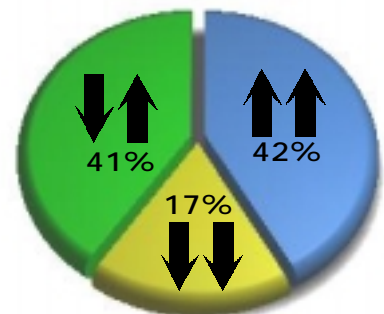


For a practical presentation on the advantages of adding managed futures into a portfolio, visit our Web site and look for the Flash title **Managed Futures: Efficient Frontier Portfolio Analysis**, located in our Media Center.

Investment Comparison Between the MAR Index and Lehman Brothers Bond Index

January 1985 - March 2002

↑↑	Both produced positive returns	42% based on 87 of 207 months
↓↑	Returns were opposite to one another	41% based on 84 of 207 months
↓↓	Both produced negative returns	17% based on 36 of 207 months



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