

This is an interview I recently did with Eric Leake of Anchor Capital for my friends at CMG so they could send it to you. The purpose of this Special Report is to give our clients a better understanding of what Anchor Capital does. Eric runs some very interesting managed account programs that I think merit your attention. Eric has been selling his investment research and system signals to hedge funds and other institutional money managers for some time. He plans to start a hedge fund himself, but recently decided to go the route of offering direct-managed accounts, for which I am very happy, as it allows access to all investors rather than just accredited high-net-worth investors.



Eric has a very impressive background. He is on the board of Rydex Financial Services and has helped them develop a number of their funds. He is well-known in the trading world, as he speaks at numerous conferences, teaching various aspects of technical and quantitative trading. Eric commands a lot of respect from the true professionals in the money management business. While you can see the performance data elsewhere, I thought it would be useful to understand the methodology that drives Anchor Capital's rather outstanding performance.

I've decided to let Eric tell you in his own words what it is they do that is so unique. Let's start our conversation (my questions are in bold).

Eric, how did Anchor Capital come into existence?

My partner, Dr. Dennis Barker, and I established Anchor Capital in 1996. Dr. Barker had a distinguished career as a dentist, with a specialty in TMJ, but was also quite successful as a stock market investor. I entered the investment business in 1993 as a broker. We first started sharing investment strategy ideas in 1994 and then officially merged our practices in 1996 with the launch of Anchor.

Tell us a little about the evolution of your business model and how you got where you are today.

We started with a simple focus, and really, it's the same focus we have today: *what's the single best way to grow assets while at the same time managing risk?*

We started with a very technical approach to what we now know as long/short directional trading, although we didn't call it that back then. Basically, the idea is to identify intermediate- to long-term market trends and align our capital accordingly. Trend following was really the foundation of our strategy, and that methodology – as a single strategy, single vision – worked

really well for about five or six years. The markets were trending so well, little else was needed to produce returns with small drawdowns. However, market cycles can change from trending environments to trendless environments and from periods of low volatility to periods of high volatility. Accordingly, we felt that this should be factored into our decision process and made enhancements along the way.

Trend following is still a key part of what we do, but it plays a smaller part today in our overall portfolio allocation than it has in the past.

When did the current model that you're using really come into existence and why do you think it gives you an advantage over some of the other investment strategies out there?

I think it was around mid-2003 that I first became concerned with our dependence on a single methodology, a single decision model, if you will. I started looking for additional ways to extract returns from financial markets, besides waving a flag at the market top and waving a flag at the market bottom.

We became students of quantitative trading – no matter what kind of trading it was. We ended up developing some very effective trading methodologies. A number of these were strategies that couldn't be deployed by an RIA firm like ours because they required derivative products – or securities we didn't really have a connection to for trading.

For example, our long/short high yield bond model. It wasn't until two years ago that Direxion and ProFunds came out with a short high-yield bond fund. Until that time, if you wanted to short high-yield bonds, you had to go to credit default swaps – derivatives of high-yield bonds.

Today our portfolios are allocated across a basket of noncorrelated quantitative trading models. The key is the noncorrelation. Not even inversely correlated, but noncorrelated. The result is what we have termed “Multi-Strategy Portfolio Management”. The key benefit being more consistent results with higher returns and lower draw-downs.

Okay. You mentioned two of the strategies just now – the high-yield hedging strategies as well as the long/short index strategies. Can you talk about how those are different from each other as well as about the two other components, mean reversion and statistical arbitrage?

Sure. We all know trend following pretty well: whether your time frame is five days or five months or five years, the idea is to get lined up with the market. If your model decides that the market is going higher, you're going to profit as it goes up. Your return is directly correlated to the market's ability to trend in the same direction for a prolonged period of time – or at least long enough for you to generate a profit. This is fine for trending markets. When the market is jumping up and down, however, it tends to be very hard on directional trading strategies because they hit the ground quite a lot.

Mean reversion is just the opposite of trend following. The basic concept is that when prices move to extremes, there's a strong tendency for them to revert to their average, or to their mean. It's a very popular strategy among hedge funds to go hunting for securities that have had multi-standard-deviation moves, very quickly, away from their average prices. We have identified, for

our purposes, that you have a much higher probability of being accurate buying the dips, rather than shorting the peaks.

Our mean reversion strategy basically says, we don't care what the overall market trend is or if the outlook is bullish or bearish. This particular sector has been beaten down over a relatively short period and no one wants it. The selling has been extreme and our model has identified a high probability of a “dead-cat bounce”. We’ll step in after a security is down 5% to 15% over just a few days, buying cheap. We will only be there for the high-probability rally. These short-term movements higher can be very dramatic. However, once it bounces, we're gone.

So when you combine these two strategies, you basically have something in the portfolio for *each market environment* – one to profit from trends, one to profit from short-term extremes.

If the market is trending well, long/short directional models are likely going to do well. If the market is noisy without much trend – filled with price extremes over short periods of time – that's a beautiful environment for mean reversion. The combined result is much smoother returns.

You mentioned that you're trading the sectors with the mean reversion strategies. What are you ultimately using as the instruments underlying the strategies? You mentioned that hedge funds use some different things, some derivatives. What are you actually trading within the models?

We are trading indexed mutual funds. Specifically, products from Rydex, ProFunds, and Direxion which give us daily liquidity, no transaction fees, no spreads, no execution issues – we can get in, we can get out, and we can also get leverage very cheap.

We can, of course, do these trades with stock baskets, futures, lots of things; but there's a real advantage to using these daily liquidity mutual funds because we get the market-on-close price, we only have to trade once a day and we can get 1 ½ :1 to 2:1 leverage without having to be on margin with margin interest and execution costs.

The two portfolios that have really been getting a lot of attention are Radius and Stratus. First, tell us about the differences between the allocations and secondly, why investors might choose one or the other.

Both Radius and Stratus are multi-strategy portfolios. Radius is our most concentrated portfolio and potentially produces the highest returns. Stratus is more diversified, so the returns tend to be smoother.

How do you determine when to be in a particular strategy?

It's very static. Everything we do is based on risk testing and modeling. The decision to include a particular strategy has to be proven to be robust over multiple market cycles. If we do make allocation changes to a portfolio, it's something that may happen on a once-a-year basis. Swapping strategies in and out is not anything we do on a daily or quarterly basis.

But each different allocation within the model has its own signal of when to be long, short, or in cash.

Correct.

Is there a time when all the signals, for instance, are saying that you should be in cash?

Absolutely. It could happen. More than likely one model will be long while another is short, creating a similar market-neutral position.

Okay. Now talk a little bit about your research – you said you sell information and your signals to hedge funds. What kind of money is being traded on your research?

Firm-wide assets, there's almost \$400 million allocated to our trading strategies from a number of firms, banks, and funds. In fact, right now the majority of those are investment advisory firms.

How big is the money you manage within your firm?

Currently we manage about \$70 million total where we're actually pulling the trigger on trading.

Obviously the research process is a very large component of why these models are successful. Tell us more about how risk management is built into these models and specifically how you start with the research process and actually build the models up.

If you haven't figured it out yet, we are wannabe "gearheads". We love studying the markets and trading strategies in general. We run some proprietary trading capital, so we talk to lots of traders, we subscribe to a number of services, we love to keep our heads in – what's working, what's not working – and we love to tap ideas for strategies. We've probably tested several thousand trading strategies over the last five years. Of course, 99 percent of them end up on the cutting room floor, so to speak. Very few ideas can survive our testing process; but going through that many tests and that many different ideas, we've developed a very systematic process to determine what counts as a strategy worth going forward on. So the few ideas that actually have legs are usually pretty interesting.

We're constantly looking for one thing: *a statistically viable model that is not so sensitive to the past that it will actually work in the future.*

Curve fitting is a big problem with quantitative strategies, probably the biggest problem. We have a number of ways to test for that. I won't bore you with all eight or nine steps, but it includes things like testing over a multiple-security universe. For example, if you have a strategy that works on a particular security or index, the results should be similar when applied to correlating securities. If your trading model works on the QQQQ but fails miserably on the QLD, you have a problem. They can degrade, but they shouldn't be polar opposites – that is a sign of curve fitting or data mining.

We use sensitivity testing, curve-fit analysis testing, and basically throw everything but the kitchen sink at our models to see if we can break them. Our premise when testing a new idea is, "It's complete garbage and I'm going to prove why". I hate to be a cynic, but our basic world

view is that most trading strategies are pretty well fit to the past, and upon rigorous testing will not hold up as something worth taking risk on.

The eight strategies that we trade with our own capital and client money are those that have gone through a number of years of rigorous testing, thousands upon thousands of sensitivity tests, and have actually stood the test of time. That's five to eight strategies from probably more than several hundred over the years.

One of the things that we focus on, that a lot of investors ask us about, is certainly risk management. Do you specifically have absolute stop-losses or is risk managed within the models?

We do utilize stops and they're particular to each strategy. If a stop improves the risk/return, then it's in there. If we put stops in and they didn't improve the results, they're not in there. Every decision that we have for every model is not based on I *think* this should work or I *feel good* about this working, it has to prove itself out through quantitative testing.

Is there a discretionary component to the management of the two portfolios?

Absolutely. Our own years of experience trading the market comes in two ways: first, what we really have here is our best ideas quantified. A lot of these strategies are things that we know to be true through experience and we've refined them down to "ones" and "zeros", forcing rules around them to see if they hold up. Some of our alpha, how we view the market and what we think about trends, is baked into the models because that's part of the modeling process.

Secondly, we call ourselves 95% mechanical quant because there are occasions where we will, through our edge in trading markets over the years, override a trade. However, we have a very specific rule about the way we do it: *we can only override a trade in the direction of risk management.*

We do not allow ourselves to use manager discretion if in doing so we take on more risk, no matter how right we think we are.

How often do you override your trades, your models, in any one given year?

We've overridden trades maybe three times this year, out of about 70 trades. We have not overridden any long/short index trading this year, but generally, once or twice a year we will.

You mentioned that the holding periods for the mean reversion and the equity trading are very different. Can you talk about how long they are? Have you guys thought to any extent about the tax consequences of those, or is that not a part of what the strategies are designed to do?

We're really not designed to be a tax-efficient strategy. We expect that 100% of our gains are going to be short-term capital gains. Our objective is absolute returns.

Different parts of the portfolio will trade at different frequencies. The long/short index strategies can range from three- to nine-month holding periods. Our shortest trades are typically four to five days.

What's the typical exposure for each of the strategies? Once you put a trade on, do you go 100% long or short, or are there different allocations? How is that determined?

To the extent that each strategy is allocated to a portfolio, there are 100% allocations. The position size that we take is based on our own position-sizing algorithm, because that's another way we manage risk. Not just should we be long or short, but how much should we be long or short.

Will you ever have a half allocation in the small caps?

Sure.

Finally, give me a bit about your background, Eric.

I'm 37 years old. I have three kids. My youngest daughter is going to be 1 next week. My daughter, Jillian, is 8 and my son, Ryan, is 5.

I was a communications major in college. It's kind of funny, I didn't even know what a stock was. Then I became interested in financial planning. Once I became Series 7 licensed and began to really study the markets, I saw my passion was not sitting across the coffee table from Mr. and Mrs. Smith talking about insurance and mutual funds – my passion was the markets. I was drawn to the technical side. I'm a Level II Chartered Market Technician, I'm on the board of Rydex Financial Services and I'm on the board of NAAIM (National Association of Active Investment Managers) and a member of the American Association of Professional Technical Analysts (AAPTA).

Being on the board of Rydex is pretty impressive, actually.

Thanks. I spent a number of years really digging in deep and talking to guys much smarter than me – I wanted to get next to prominent market technicians and pick their brains, so I got a fast education on risk management and all the various ways to manage money. I buried myself learning to write code and to be much more of a quant than the visual technician I had been early in my career.

I think being on the board of NAAIM and being involved in AAPTA and the MTA (Market Technicians Association) and different types of analytical societies has helped tremendously.

We really owe a lot of where we are today, our thinking on risk management and portfolio strategies, to the incredibly generous people who have pioneered the way before us. I learned a lot from many great people and I'm very grateful.

Thanks for taking the time to talk with us.

To see the performance data for the programs Eric and I have been discussing, you can ask your professional representative at CMG.

IMPORTANT INFORMATION ABOUT THIS INTERVIEW

This interview was used with permission from John Mauldin. John Mauldin is the President of Millennium Wave Advisors, LLC (MWA), which is an investment advisory firm registered with multiple states. John Mauldin is a registered representative of Millennium Wave Securities, LLC, (MWS), a FINRA registered broker-dealer. MWS is also a Commodity Pool Operator (CPO) and a Commodity Trading Advisor (CTA) registered with the CFTC, as well as an Introducing Broker (IB). Millennium Wave Investments is a dba of MWA LLC and MWS LLC.

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In addition, CMG has included a links to important disclosure documents below.

CMG Capital Management Group, Inc. ADV

<http://www.absolutereturnstrategies.net/cmgdocs/advcmgcapgmt.pdf>

Millennium Solicitor Disclosure Statement

http://www.absolutereturnstrategies.net/cmgdocs/millennium_solicitor.pdf

Millennium Wave Advisors, LLC ADV

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Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that future performance will be profitable, or equal to either the Anchor

Capital Stratus/Radius Multi-Strategy Programs (the “Program”) performance results reflected or any corresponding historical index. The historical index performance results are provided exclusively for comparison purposes only, so as to provide general comparative information to assist an individual client or prospective client in determining whether the performance of the Program meets, or continues to meet, his/her/its investment objective(s). It should not be assumed that Program account holdings will correspond directly to any comparative index. Please review the above Program discussion as to the Program description, objectives and the underlying securities in which it invests. The Program performance results do not reflect the impact of taxes.

For reasons including variances in portfolio account holdings, variances in the investment management advisory incurred, market fluctuation, the date on which a client became a Program investor, and account contributions or withdrawals, the performance of a specific CMG client's account may vary substantially from the indicated Program performance results.

In the event that there has been a change in a client's investment objectives or financial situation, he/she/it is encouraged to advise CMG immediately. Different types of investments and/or investment strategies involve varying levels of risk, and there can be no assurance that any specific investment or investment strategy (including the investments purchased and/or investment strategies devised or undertaken by CMG or Anchor) will be either suitable or profitable for a client's or prospective client's portfolio.

ADDITIONAL NOTES AND RISK FACTORS

1. The management fee is 2.25% paid in arrears on a quarterly basis. Clients will open an investment advisory account with CMG, and Anchor will act as a sub-advisor for the purpose of enacting trades according to their system. CMG will provide ongoing account monitoring and investment advisory services, as well as ongoing due diligence on Anchor. CMG pays Anchor a portion of the fee as a sub-advisor. Millennium Wave Advisors, LLC (MWA) and Altegris Portfolio Management, LLC (APM) may act jointly or separately as solicitors for CMG. If registered with a net worth of \$1.5 million and above, APM and MWA are acting as joint-solicitors for CMG. In the event APM refers you to CMG and you open an account through them, CMG will pay APM 85 basis points on the first \$25 million of assets introduced to CMG by APM. On assets introduced to CMG by APM greater than \$25 million, CMG shall pay APM 50 basis points on such amounts. CMG will also pay MWA 1/3 of the net fees CMG receives.

If you registered with a net worth of \$1.5 million and below, MWA acts as sole solicitor and CMG shares an ongoing referral fee equal to 1/3 of the advisory fee received by CMG with my investment advisory firm, Millennium Wave Advisors, LLC.

It should be noted that CMG is responsible for individual client suitability and will help you decide whether the Anchor program is appropriate for you and what allocations you should make to the Anchor program, as well as to other recommended managers and programs.

The details of these fee arrangements are more fully described in the solicitor's disclosure documents that were provide to you at the time of solicitation and available in the link provided below.

2. The program uses ProFunds, Rydex and Direxion sector and index funds, as well as a money market account. There is no obligation for Anchor Capital to look for other funds to use. Please see risks from the underlying fund families prospectuses at the links provided below:

ProFunds: <http://www.profunds.com/ProFundsInfo/Content/DownloadProspectus.fs>

Rydex Funds: http://www.rydexfunds.com/service/prospectuses_reports.shtml

Direxion Funds: http://www.direxionfunds.com/document/regulatory_documents.html.

RISKS OF FUNDS:

Please note that the Anchor Capital program uses a wide variety of index and sector mutual funds from the three fund families mentioned above. Below are some of the common risks that are inherent in such funds.

Market Risk – Due to market conditions, the value of the Fund’s investments in equity securities and equity derivatives, such as futures and options contracts, may fluctuate significantly from day to day. This volatility may cause the value of your investment in the Fund to decrease.

Active Trading Risk – A significant portion of the Fund’s assets come from investors who take part in certain strategic and tactical asset allocation programs. The Fund anticipates that investors who take part in these programs may frequently redeem or exchange shares of the Fund, which may cause the Fund to experience high portfolio turnover. Higher portfolio turnover may result in the Fund paying higher levels of transaction costs and generating greater tax liabilities for shareholders. In addition, large movements of assets into and out of the Fund may negatively impact the Fund’s ability to achieve its investment objective.

Derivatives Risk – The Fund’s use of equity derivatives such as futures, options, and swap agreements to pursue its investment objective may expose the Fund to additional risks that it would not be subject to if it invested directly in the securities underlying those derivatives. These risks may cause the Fund to experience higher losses than a fund that does not use derivatives.

Leveraging Risk – The more the Fund invests in leveraged instruments, the more this leverage will magnify any losses on those investments. Since the Fund’s investment strategy involves consistently applied leverage, the value of the Fund’s shares will tend to increase or decrease more than the value of any increase or decrease in its benchmark. Leverage will also have the effect of magnifying tracking error risk.

Market Segment Risk – The Fund is subject to the risk that the over-the-counter market may under-perform other segments of the equity market or equity markets as a whole.

Medium Issuer Risk – In comparison to securities of companies with large capitalizations, securities of medium capitalization companies may have more price volatility, greater spreads between their bid and ask prices, significantly lower trading volumes, and cyclical or static growth prospects. Medium capitalization companies often have limited product lines, markets or financial resources, and may therefore be more vulnerable to adverse developments than large capitalization companies.

Swap Counterparty Credit Risk – The Fund is subject to credit risk on the amount it expects to receive from swap agreement counterparties. If a swap counterparty defaults on its payment obligations to the Fund, this default will cause the value of your investment in the Fund to decrease.

Tracking Error Risk – The Fund’s investment adviser may not be able to cause the Fund’s performance to match that of the Fund’s benchmark, either on a daily or aggregate basis. In addition, because the Fund is tracking the performance of its benchmark on a daily basis, mathematical compounding may prevent the Fund from correlating with the monthly, quarterly, annual or other period performance of its benchmark. Tracking error may cause the Fund’s performance to be less than you expect.

Trading Halt Risk – If a trading halt occurs, the Fund may temporarily be unable to purchase or sell options or futures contracts. Such a trading halt near the time the Fund prices its shares may limit the Fund’s ability to use leverage and may prevent the Fund from achieving its investment objective.

Early Closing Risk – The Fund is subject to the risk that unanticipated early closings of securities exchanges will result in the Fund being unable to sell or buy securities on that day. If an exchange closes early on a day when the Fund needs to execute a high volume of securities trades late in a trading day, the Fund might incur substantial trading losses.

Short Sales Risk – Short sales are transactions in which a fund sells a security it does not own. If the security the Fund sold short goes down in price between the time the Fund sells the security and closes its short position, the Fund will realize a gain on the transaction. Conversely, if the security goes up in price during the period, the Fund will realize a loss on the transaction. The risk of such price increases is the principal risk of engaging in short sales. The Fund may also be subject to expenses related to short sales such as borrowing and margin accounting maintenance costs, which may negatively impact the performance of the Fund.

3. Comparison to the NASDAQ-100 and S&P 500 Index (“Index”) is for comparative purposes only and does not imply any similarity between the composition of the model portfolio and that of the Index. Anchor’s strategy is to pursue its objective without investing directly in the securities included in the Index, or by investing in the same proportion that those securities are represented in the Index.

4. Performance Disclosure – CMG Capital Management Group, Inc. (“CMG”) is an SEC registered investment adviser located in the Commonwealth of Pennsylvania. Anchor Capital Management, Inc. (“Anchor”) is an SEC registered investment adviser located in the State of California. CMG has entered into a sub-advisory agreement with Anchor. Anchor serves as the sub-advisor to the strategy. CMG serves as the advisor. If you request further data it is important to review all performance disclosures thoroughly that will accompany that information.

Information pertaining to Anchor’s advisory operations, services, and fees is set forth in Anchor’s current disclosure statement, a copy of which is available from Anchor upon request.

For information pertaining to the registration status of Anchor please refer to the Investment Adviser Public Disclosure web site, <http://www.adviserinfo.sec.gov>. For additional information

about Anchor, please refer to Schedule F and Form ADV, Part 2. Please read the brochure carefully before you invest or send money.