



**FINANCIAL  
INVESTMENTS  
INC.**



## Financial Investments, Inc. Newsletter

**April 2009**

### The Option Writer's Report

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#### FCI Continues 2009 with Positive Returns

Returns with each program for the month of March, 2009 and YTD returns are as follows:

	March 2009	YTD
FCI-Option Selling Strategy (OSS)	+5.36%	+18.03%
FCI-Credit Premium Program (CPP)	+4.52%	+19.07%
S&P 500 Index	+8.40%	-10.00%

(Past performance is no indication of future results.)  
(Returns are net of all fees.)

#### About FCI



Financial Commodity Investments, (FCI), is now a wholly owned subsidiary of the Financial Investments, Inc. family.

FCI is a commodity trading advisor (CTA), a member of National Futures Association (NFA), and registered with the Commodity Futures Trading Commission (CFTC).

FCI executes investment strategies on behalf of an investor directly in the investor's own account. FCI trades options in a diversified range of commodities including energies, grains, softs, metals, and financial commodities. FCI is open to non accredited investors with a minimum of \$50,000. Participants in FCI have unlimited risk.

**Cumulative Return FCI-OSS vs S&P 500 through March, 2009 (net of fees)**



You can learn more about FCI at [www.financialcii.com](http://www.financialcii.com) or call (703) 435-2777

FCI uses a pro-active management style of monitoring and managing investments in relation to risk, return, capital requirements, and market directions. Policies are in place to adjust positions as needed. FCI uses conservative money management exposure guidelines.

FCI provides personalized attention to our institutional investors with customized reporting. FCI is totally dedicated to the needs of both Institutional and Individual clients.

Harry Markowitz, published Modern Portfolio Theory, won the Nobel Memorial Prize in Economic Sciences in 1990, advocates that a portfolio should have exposure to commodities as a form of non-correlated asset diversification.

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## Understanding the Discipline of Being an Investment Manager

Investors who are not traders themselves need to have an idea how professional money managers operate. They follow a clearly defined system which spells out what makes a good investment within the context of their investing strategy. They use the same techniques every time to identify a trade and if it can meet the specific goals as defined by their system.

## Cumulative Return FCI-CPP vs S&P 500 through March, 2009 (net of fees)



## FCI Risk Management

FCI has established a policy of proactive risk management. The strategy is based upon the solid practice of total focus on the clients' goals. Its implementation consists of:

- Pro-active and continuous monitoring and management of investments in relation to risk, return, capital requirements, market direction.
- Clearly defined policies and procedures in place to adjust positions as needed.
- Conservative money management guide-lines in place.

For more information: [www.financialcii.com](http://www.financialcii.com) or call (703)-435-2777

## The FCI Strategy

Options are a very little understood investment tool. Most think that options are mainly a way to leverage capital and increase Return on Investment. That is only a minor aspect of the capabilities of options. In reality, options were developed primarily as a method to control risk. Used by a manager who fully understands the uses and capability of options has a much superior tool which can not only make money in all market situations-up, down and sideways-but also reduce risk at the same time. The intent of this article is not to go into an in-depth discussion of options, it is to talk about the strategies used by FCI.

Let's start with a definition of what an option is. An option is a contract that gives the right of the holder to a specified number of shares or amounts of an underlying asset provided that a specific price is hit within a specific time period as specified in the option contract. Option contracts vary in length from one month up to over three years. Most investors see options as a highly leveraged method to participate in price movement without having to pay the full price of the underlying asset. Most investors think that the way to make money with options is to be correct about the direction and amount of price movement within a certain time period. This is a very simplistic view of options and not the strategy used by FCI.

Each option contract has a seller and a buyer. Naturally, the seller and buyer are on opposite sides of the proposition. In other words, if an investor thinks the price of an asset will increase and surpass a strike price within certain period of time, less capital is used to purchase the options than to buy the underlying asset. The seller is willing to sell the buyer an option contract either short (put) or long (call). Here comes a part most investors don't understand; the seller does not have to own the underlying asset to sell an option against it. Writing (selling) an option generates cash that is paid by the option buyer. This premium paid transfers control of the underlying asset to the buyer, for the life of the option. When the buyer exercises the option to purchase the underlying asset at the contractual price, the option seller is obligated to deliver the underlying asset at the contractual price and the quantity as

Each trading system has predetermined what an acceptable win-loss ratio should be. A certain amount of losses are expected and taken in stride. The key to successful trading is discipline and trust in the system which has been tested over a long period of time. Losses are an inherent part of the game which is to have more winners than losers and that the winners have a significantly higher margin than the losers. Professional investing is hitting for average and not hitting home runs. With discipline and trust in the system based upon real experience, a manager has no emotional response to downturns.

Unfortunately, clients who aren't professional money managers can panic and pull their investments out without understanding how a professional money manager works. The gauge to use is to measure the stated goals of each fund. In the case of OSS, it is 1%-4%; and for the CPP fund it is 3%-7% per month.

## What is "Absolute Return"?

According to Investopedia, in general, a mutual fund seeks to produce returns that are better than its peers, its fund category, and/or the market as a whole. This type of fund management is referred to as a relative return approach to fund investing. As an investment vehicle, an absolute return fund seeks to make positive returns by employing investment management techniques that differ from traditional mutual funds. The Option Selling Strategy (OSS) and The Credit Premium Program (CPP) are separately managed accounts that are traded in accordance with the terms of the respective disclosure document.

Absolute return investment techniques include using short selling, futures, options, derivatives, arbitrage, leverage and unconventional assets. Keep in mind that even during normal times, over 75% of mutual fund managers performed below the benchmark S&P 500. Throughout the current financial crisis, the FCI

represented by the number of contracts exercised. Studies indicate that option exercise occurs approximately 20% of the time. In other words, option sellers are normally correct the other 80% of the time. Options expire as a result of the price of the underlying asset at the time of expiration to be less than the strike price of a call option, or more than the strike price of a put option, making exercise of such options uneconomical to the buyer of the contract. At this point the option seller retains the cash premium received and has no more obligation on the contract.

## FCI Option Selling Strategy Program (FCI-OSS)

In the FCI OSS program, the fund will sell option contracts on commodities futures. What makes this strategy so successful is that FCI sells contracts that are far out-of-the-money. That is why most of the OSS trades made in this fashion (over 90%) expire worthless and the fund can keep the premiums paid by the buyers of the options.

The further an option is out-of-the-money, the less probability that it will hit the strike price which will trigger the option. As a matter of fact, the probability of a certain out-of-the-money option reaching its strike price is measurable instantaneously at any price.

### OSS Program

- Sell far out of the money contracts
- Lower profit margin, higher win ratio (close to 90%)
- Fewer trades
- Risk is unhedged, use preset stop losses
- Since inception, the FCI-OSS program has generated a compounded average annualized return of 20%, net of fees, for our investors. (Past returns are no guarantee of future performance.)

Not that a 20% annualized return is bad but an investor might ask, "if the OSS fund is correct almost 90% of the time, why aren't the fund returns sky high?" The reason is that the further out-of-the-money an option is the lower the premium price. The FCI strategy is to make many small wins that produce relatively small profits that add up to an impressive annualized return.

There is risk with this rather conservative strategy. For instance, when the Black Swan\* (unexpected events) rears its head as we have seen recently, the risk is greatly increased. For example, if the fund had been selling puts and the price takes an unexpected plunge and hits the strike price, the fund is required to fulfill the contract it wrote. There are ways to protect against any large loss during a Black Swan event. This is why the new FCI Credit Premium Program (CPP) is presented.

\*Black Swan refers to an impactful event that happens only rarely. It was the title of a popular book written by Nassim Nicholas Taleb.

## FCI Credit Premium Program (FCI-CPP)

The FCI CPP program directly addresses the Black Swan event within the context of selling options to collect premiums. Additionally, this program provides the ability to capitalize not only on the premium strategy but also provides the ability to take advantage of unexpected counter moves. The following is a simplistic example of the way it works. The Fund will sell an option contract which is closer to at-the-money than the OSS program. This provides larger premiums for collection when the option expires useless (to the buyer). Because the option being sold is closer to the strike price, it usually has a slightly higher probability of moving into-the-money and forcing the assignment of the contract. To protect against the higher probability of hitting the strike price, the fund will simultaneously buy an out-of-the money contract to hedge the risk. How does this work?

OSS and CPP strategies have outperformed the bench-mark. Past performance is no guarantee of future performance.

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#### CPP Program

- Sell closer to the money contracts
- Higher profit margin, higher win ratio (close to 80%)
- More trades
- Can Morph to take advantage of large adverse moves
- Positive 6.94% return to investors for the Black Swan CY 2008 and has generated an average yearly return of 27% since inception.

(Past returns are no guarantee of future performance.)

As an Example:

FCI sells a contract with a premium of \$1 per unit. If there are 1000 units in the contract, that means a potential premium collection of \$1000 if the contract expires out-of-the money. This is where the OSS program usually stops. What happens if the contract goes into-the money and the contract is assigned? The seller of the contract must go into the market and purchase the units at the market price. If the market makes a big unexpected counter move, this can be risky. What the CPP program does is hedge against this risk by purchasing a contract that will take advantage of a counter move because as the price triggers the contract that was sold, the purchased contract increases in value as it gets closer to the money. This increase in the value of the purchased option can help to offset the losses in the sold contract. Not infrequently, this spread can be morphed by buying back the sold contract quickly and letting the countermove make profits on the purchased contract. This is called Morphing. Ironically, by using this strategy, some very large gains can be made as the market overreacts to unexpected news.

Disclosure: There are substantial risks involved in trading options on futures and equities. The high degree of leverage that is often obtainable in options trading can work against you as well as for you. The volatile nature of the futures and high degree of leverage used in options may result in clients losing more than their original investment. Please consider carefully whether options are appropriate to your financial situation. Only risk capital should be used when trading options on futures and equities. Past results are not necessarily indicative or a guarantee of future results.

Futures/options products are not suitable for all individuals.