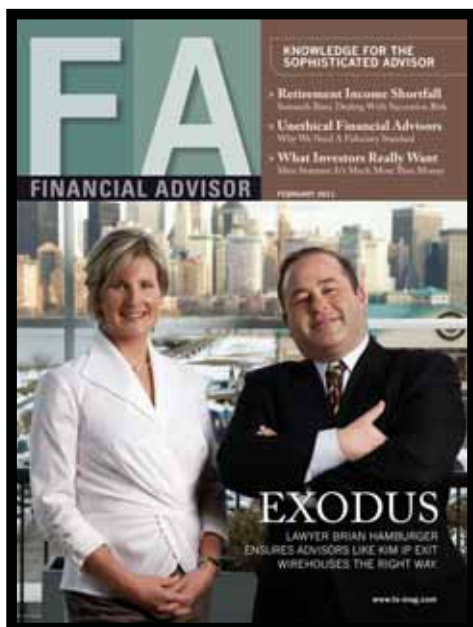




# Introduction & Industry Commentary



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# Managing Interest Rate Exposure in Volatile Markets

Kirk Barneby, Portfolio Manager, American Independence Financial Services





## What Do Fixed Income Investors Do Now?

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“June saw flows into bond funds more than doubling from the volumes in May, to \$22 billion, as risk-averse and equity-shy investors continued to search for yields higher than the near-zero levels they are earning in money market funds. We expect continued sizeable inflows into the bond fund area as demand for cash substitution is bolstered by interest in flexible bond funds with mandates permitting for defensive approaches in dealing with the prospect of rising interest rates in the coming years.”

Strategic Insight, June 2010

The asset shift to fixed-income is potentially at risk given the odds of interest rate and inflation increases. Investors are now vulnerable.

Today, many credit focused, long only fixed income managers only adjust duration to react to changing interest rates. As a result, these portfolios generate less income and greater credit risk.



# Is Traditional Diversification Working?

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## What it does

- Seeks to maximize total return by taking advantage of price movements in the U.S. Treasury bond market.
- Expands sources of returns in fixed income beyond credit plays to take advantage of rate changes through changes in duration

## Process Overview

- The fund uses a model driven process to develop interest rate outlooks that are used to set the duration of a treasury portfolio
- Monthly optimization and rebalance captures general cyclical trend in interest rates while allowing the potential to benefit from short-term deviations in the trend

## Why is this fund different?

- Offers potential for appreciation in rising or falling interest rate environments
- Total return is the focus

## How to use it

- May diversify<sup>1</sup> a core fixed-income allocation
- May be used to replace bond exposure for those who use fixed income as a diversifier and volatility dampener
- May be funded from equities as a potentially non-correlated source of

<sup>1</sup>Diversification neither assures a profit nor eliminates the risk of experiencing investment losses.



## Investor Concerns: Changing Interest Rates

Investor Belief	Standard Solution	Option : L/S Interest Rate Strategy
<ul style="list-style-type: none"><li>▪ Expects interest rates will rise</li></ul>	Long-only portfolio shortens duration (go to cash or near-cash)	<ul style="list-style-type: none"><li>▪ Long/short portfolio can go negative duration to profit if rates rise</li></ul>
<ul style="list-style-type: none"><li>▪ Uncertain about interest rates</li></ul>	Go to neutral duration and “wait & see”	<ul style="list-style-type: none"><li>▪ Dynamically adjust duration based on interest rates forecasts, economic theory and experienced modeling</li><li>▪ Monthly rebalancing, which seeks to capitalize on short-term outlooks, but maintain awareness of long-term trend</li></ul>
<ul style="list-style-type: none"><li>▪ Expects interest rates to fall</li></ul>	Long-only portfolio lengthens duration	<ul style="list-style-type: none"><li>▪ The duration of the Long Short Interest Rate Strategy Fund can have double the average duration of the Barclays U.S. Aggregate Bond Index</li><li>▪ Dynamically adjust duration monthly, which attempts to capitalize on short-term outlooks, but maintain awareness of long-term trend</li></ul>

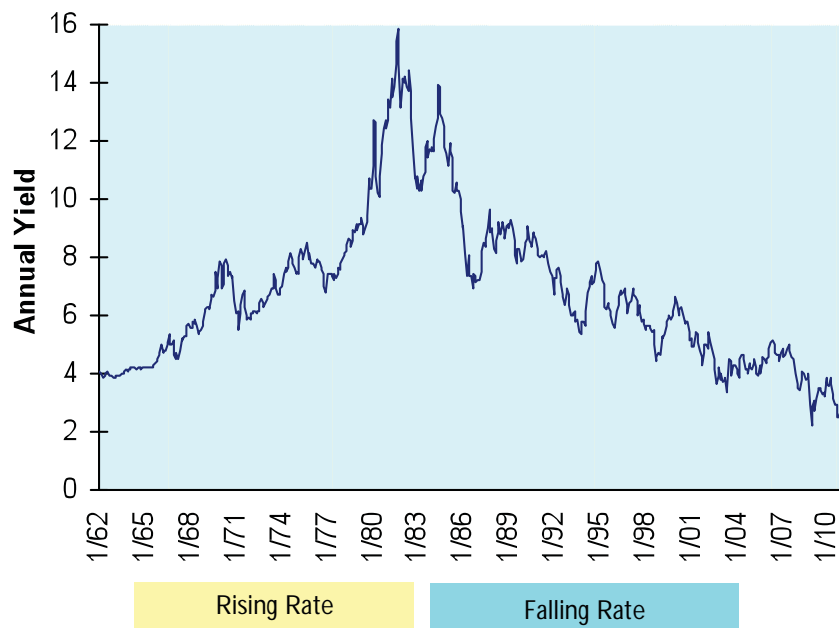


## Long-Term Trends and Short-Term Movements

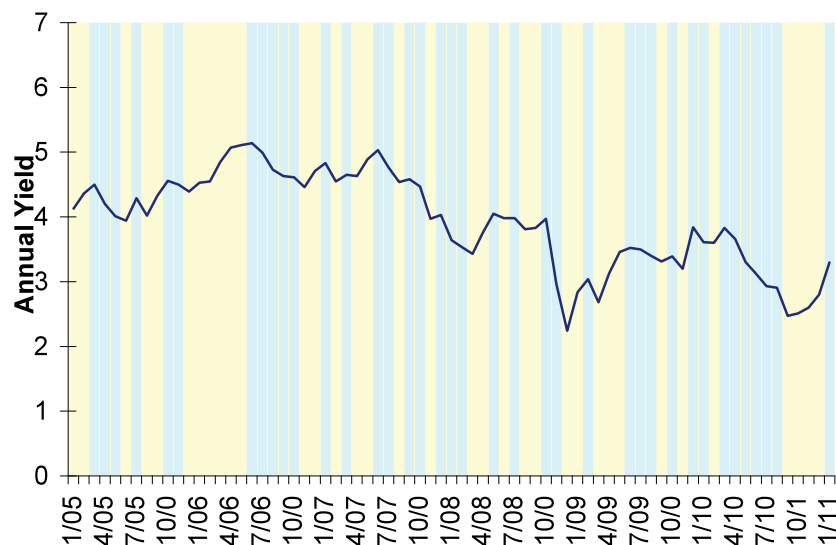
### Case for Active Long Short Management

- Long-term trends typically persist for a year or more, but monthly rate movements show more variability.
- 10-Year rates are near historical lows.

**US Ten Year Treasury Bond Yields**  
January 1, 1962 to January, 2011



**US Ten Year Treasury Bond Yields**  
January 1, 2005 to January 1, 2011



Source: Bloomberg Performance displayed represents past performance, which is no guarantee of future results.



## Investor Concern: Credit Risk

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### Investor Belief

#### CREDIT RISK

Worried about credit due to changing conditions that affect individual companies or governments as well as general political and economic developments

### Standard Solution

Shift between credit plays, often away from Corporates and into Treasuries or Asset-Backed Securities or vice-versa

### Option : Long Short Interest Rate Strategy

- Diversify<sup>2</sup> position with a strategy that seeks to profit from isolating interest-rate movements, not credit bets
- Attempts to reduce credit exposure by investing in Treasury-linked vehicles

<sup>2</sup> Diversification neither assures a profit nor eliminates the risk of experiencing investment losses.



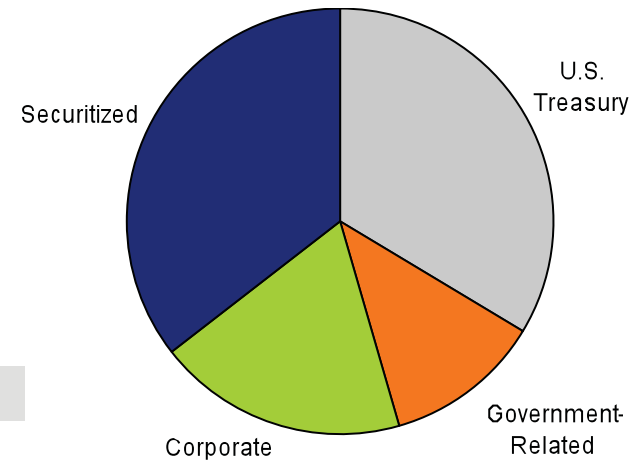
## Core Fixed Income Has Substantial Credit Exposure

Barclay's Capital Aggregate Weightings as of 12/31/10

<b>Barclays Capital U.S. Aggregate Index</b>	<b>100.00</b>
U.S. Treasury	33.73
Government-Related	11.96
Corporate	18.83
Securitized	35.48



- Over 50% of risk taken is exposed to credit risk



Source: [www.barcap.com](http://www.barcap.com)

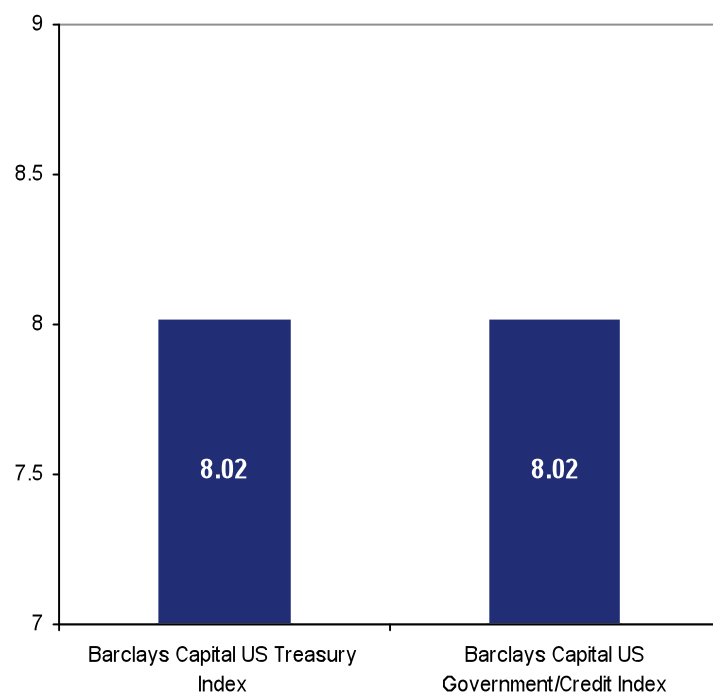
Notes: Core fixed income is represented by the Barclays Capital U.S. Aggregate Index. Corporate is represented by Investment Grade Only – High Yield is not included in the Aggregate Index. The index is unmanaged, is not available for direct investment, and is not intended to represent any particular fund.



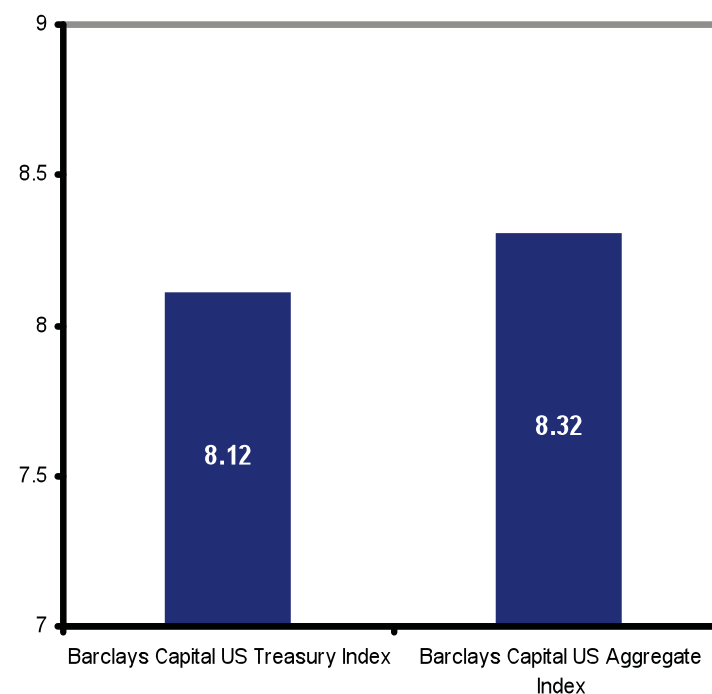
## Treasuries—A Competitive Fixed Income Performance Benchmark

- We believe that historically investors not justly rewarded for taking the credit risk associated with corporate bonds.

Treasuries vs. Government Credit  
Feb. 1, 1973<sup>3</sup> to Dec. 31, 2010



Treasuries vs. Aggregate  
Jan. 1, 1976<sup>4</sup> to Dec. 31, 2010



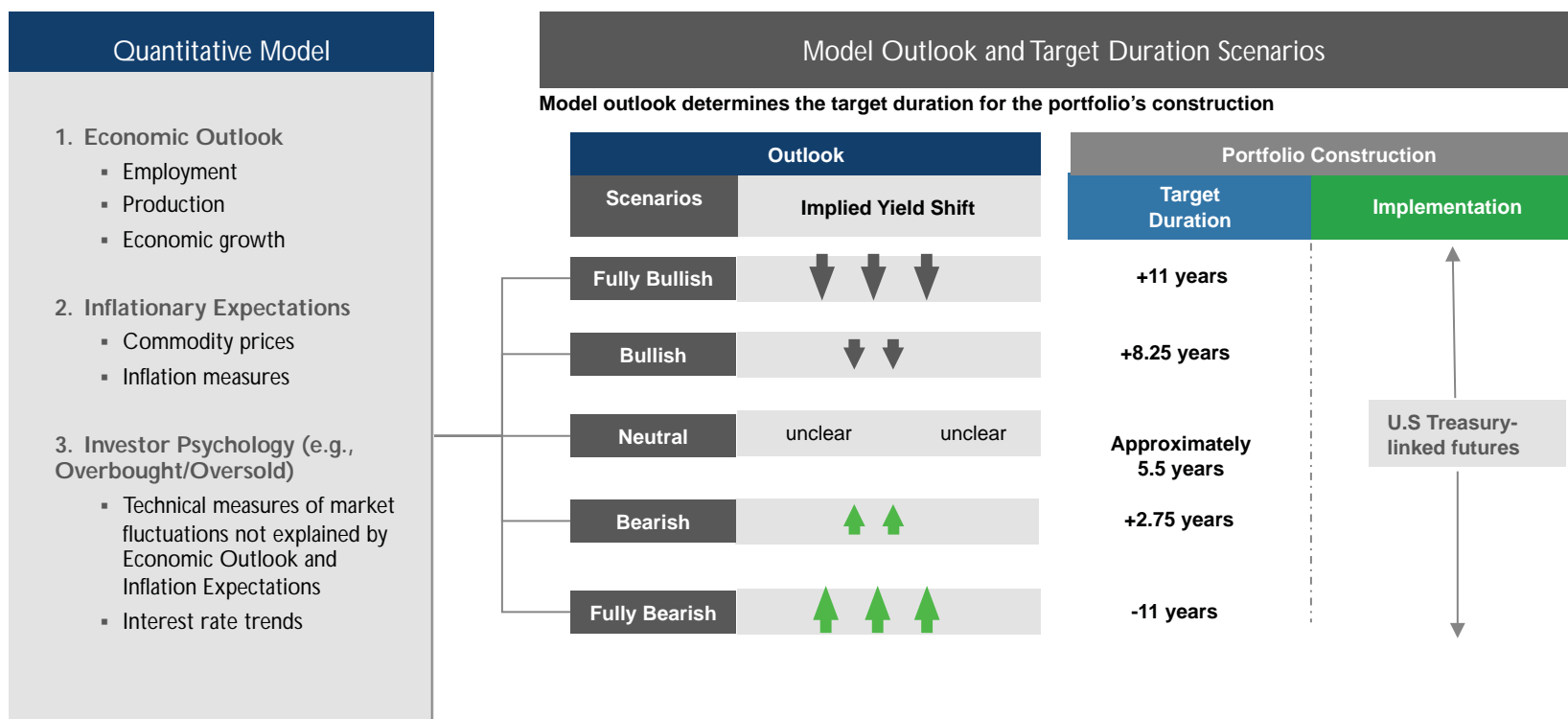
Source: Barclays Capital. **Performance displayed represents past performance, which is no guarantee of future results.** The indices are unmanaged, are not available for direct investment, and are not intended to represent any particular fund.

<sup>3</sup>Inception date of the Barclays Capital Government/Credit Index <sup>4</sup>Inception date of the Barclays Capital Aggregate Bond Index



# Long Short Interest Rate Strategy Fund Investment Process

- Quantitative factors and technical measures combine to produce an interest rate outlook that ranges from fully bearish to fully bullish
- Monthly forecast and rebalancing captures general cyclical trend in interest rates while allowing the potential to benefit from short-term deviations in the trend





## Potential Risks to Consider

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- **The Long Short Interest Rate Strategy Fund is not suitable for all investors.** • The Fund's use of derivatives such as futures, options and swap agreements will expose the Fund to additional risks that it would not be subject to if it invested directly in the securities underlying those derivatives. • Certain of the derivative instruments, such as swaps and structured notes, are also subject to the risks of counterparty default. • The Fund's market value will change in response to interest rate changes and market conditions among other factors. • You may have a gain or loss when you sell your shares. • In general, bond prices rise when interest rates fall, and vice versa. • The Fund is not guaranteed by the U.S. government. • The Fund is also subject to early closing risk, investment technique risk, portfolio turnover risk, trading halt risk, and the risks affecting any underlying investment companies. See the prospectus for more information on these and additional risks.
- Shares of mutual funds are not deposits or obligations of any bank, are not guaranteed by any bank, are not insured by the FDIC or any other agency, and involve investment risks, including the possible loss of the principal amount invested.
- *For more complete information regarding the fund, call 800.258.4332 or visit [www.rydex-sgi.com](http://www.rydex-sgi.com) for a prospectus and a summary prospectus (if available). Investors should carefully consider the investment objectives, risks, charges and expenses of a fund before investing. The fund's prospectus and its summary prospectus (if available) contains this and other information about the fund. Please read the prospectus and summary prospectus (if available) carefully before you invest or send money.*
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