Primary Concerns

4th July 2018

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Material Witness - *insights from the Manager*

Volatility is back

- Big swings in prices mean we will be reducing exposures and staying closer to balance next month, but things went well in June, despite the turbulence…

Thierry Ralet, CEO & Founder

Mark to Market - *observations from the front line*

Don't all leave at once!

- Emerging Markets have been creating anxieties across the board amid rising fears of a disorderly retreat. Commodities will not be immune, but may not suffer as much…

Sean Corrigan, Chief Investment Strategist

PCAM

PHENIX CONSULTING & ASSET MANAGEMENT

Material Witness - *insights from the Manager*

Volatility is back

The paper portfolio we are running at present on a month-to-month basis, solely for illustrative purposes, showed a positive return of +3.4% in June, mainly due to gains in softs and grains, assisted by the energy complex and the precious metals, but reduced somewhat by the losses attributable to their industrial counterparts.

We would again point out that the model's returns do not reflect the full benefit of our unique methodology because they do not incorporate the effects of the intramonth rebalancing we will regularly be carrying out.

Moreover, the better to illustrate the advantages of our approach, we also report results on an excess return basis—i.e., without the additional earnings to be made on the underlying collateral. Indeed, if investors were to follow our suggestion of designating some part of their existing bond holdings to this purpose—for which commodities are a natural, negatively-correlated hedge—the impact on the portfolio could be even more favourable.

Volatility made a forceful return for most commodities last month, notably with large daily moves in WTI & Brent (and with the spread between the two moving from an unusually wide US$10/bbl to just US$5 by month end). We also observed several changes in the curves in livestock during the month.

If the fund were operative, we would have rebalanced the portfolio several times in this period for the loss of a few basis points in execution costs but with a small surplus from the improvements thus made in some of the – mostly smaller - positions which would have been involved.

Moving into July, one of our models is slightly long while the other is neutral with regard to WTI so we maintain our long there, though with a reduced exposure to reflect the relative lack of corroboration between the analyses.

Agriculture stays largely on the short side (cotton excepted). As for precious metals, we have one model telling us to short gold and the other doing likewise for silver. Base metals, by contrast, tend to the long side.

From a broader perspective, the general increase in volatility which has taken place in recent weeks has led us to tone down our exposures on both the long and the short sides and also to maintain what is almost a complete balance between the two in dollar terms.

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The story so far...

Historical Performance

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2015								-2.7%	8.0%	1.0%	8.3%	10.8%	27.4%
2016	4.2%	6.1%	-4.9%	-3.2%	-1.8%	-1.8%	4.2%	-2.4%	-3.8%	0.8%	-2.6%	-4.3%	-9.8%
2017	-1.2%	1.9%	6.3%	-0.4%	3.3%	1.9%	-3.9%	4.6%	-1.6%	2.3%	0.6%	2.3%	17.1%
2018	1.1%	-3.8%	4.0%	2.5%	1.3%	3.4%							8.5%

Performance Attribution 2018

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Tot
BCOM - Energy	55.7	-117.2	76.6	127.5	-14.0	60.8							189.5
BCOM - Livestock	-9.6	-4.2	-1.5	44.3	-9.1	-0.8							19.2
BCOM - Grains	-50.7	-120.0	36.7	-42.8	39.6	164.5							27.4
BCOM - Metals	18.7	-8.2	-16.2	-70.0	4.2	-42.1							-113.7
BCOM - Precious Met.	-	22.2	-	-	11.3	31.9							65.4
BCOM - Softs	-22.0	-7.4	22.3	12.4	-4.2	16.1							17.2
GSCI - Energy	168.3	-65.6	131.8	270.1	95.0	40.0							639.7
GSCI - Metals	13.2	-6.0	-11.3	-53.5	1.4	-53.5							-109.7
GSCI - Precious Met.	-	-	-	-	4.8	12.4							17.2
GSCI - Agriculture	-60.9	-68.7	88.2	-38.9	19.2	112.8							51.7
GSCI - Livestock	-7.8	-5.3	70.2	2.8	-14.2	-2.1							43.7
Total Alpha	105.1	-380.4	396.8	252.0	134.2	340.0							847.6

Performance since inception (AUG-15)

	2015	2016	2017	2018	ITD
Portfolio CAR	27.4%	-9.8%	17.1%	8.5%	13.8%
Benchmark	0.0%	0.0%	0.0%	0.0%	0.0%
Alpha (bp)	2736	-982	1707	855	1384
Volatility	19.6%	12.8%	9.8%	7.0%	13.5%
IR	1.39	-0.76	1.75	1.22	1.03

Mark to Market - *observations from the front line*

Don't all leave at once!

Ever since this time last year, we have been pointing out the seemingly intractable mutual contradictions involved in China's attempts to solve what has since become more of a quadrilemma than a mere two- or three-pronged conundrum.

Trying to cut back on shadow financing while the banks on whom the authorities would rather rely are struggling to generate sufficient deposits to keep money growth from falling; attempting to encourage 'deleveraging' while still pouring concrete on an Olympian scale, both at home and abroad; hoping to reform both regulation and simple price discovery in the nation's dysfunctional capital markets – all these were bad enough. Now, however, comes the added hurdle of trying to frame a face-saving (as well as an economy-preserving) response to the Trump Administration's overt hostility over trade.

The immediate results have not been hard to discern. The broad CSI300 has fallen by a quarter from its January high in local currency terms alone, taking it back to levels first reached back in the pre-GFC spring of 2007. On top of that, of course, the currency has recently spiralled lower, losing almost 50 big figures (just shy of 8%) in an accelerating panic which induced no less than six central bank spokesmen to chorus statements aimed at calming the market this week.

For commodity investors with exposure to passive, long-only indices, this is of key importance. Nor – given the usual close correlations between the two asset classes - can they be much comforted by the turmoil being experienced in a number of other emerging markets, such as South Africa, Hungary, Poland, Indonesia, the Philippines, Brazil, Turkey, and Argentina – all of which have seen their equity markets slump anything between 25% and 50% these past few months, when measured in an appreciating US dollar.

MSCI Emerging Markets price v GSCI spot, r2=0.77: *Source -MSCI, SPX*

One can advance any number of explanations for why commodity indices and EM equities do enjoy such a tight relationship, ranging from the latters' acute sensitivity to overall growth – whether as the major producers or as the predominant, heavily-populated and rapidly-industrializing, marginal users of raw materials – to the simple fact that easy money policies, such as have been pursued this past good while, not only tend to inflate goods (i.e., commodity) prices, but simultaneously drive a search for yield among investors who, along the way, become increasingly desensitized to risk and who thus overload on lesser credits and more volatile sectors, both.

All this raises two principal issues with which we must deal: can commodities at least partially 'decouple' from weakness in EM bond and stock markets and, if not, how best to minimise drawdowns?

The answer to the former question is a slightly wary, 'perhaps' – at least until the problems are seen to spread to the wider 'real' economy from today's few isolated hotspots and the cause therefore becomes something more than one induced by over-exposed Western portfolio managers suddenly shedding their former easy complacency and instead succumbing to a collective fit of the vapours. Here, the one thing we *can* attest is that EMs have been on a tear, relative to commodities, of a kind not seen in a quarter of a century so a certain margin of safety may have intruded to lessen the immediate magnitude of the shock to be transmitted between the two.

Accordingly, if relative prices were to regress to the fairly well-defined trend linking them, commodities could continue to outperform, effectively adding half again to the ~25% gain already made since EM equities' peak last year.

As for the second consideration, while not wishing to make a whole season of endless cerulean blue from the brief flight of a single, fork-tailed, insectivorous bird, as Thierry points out in his report above, the fund showed a notional excess return of nearly three times that offered by the plain vanilla GSCI last month, despite all the intervening upheavals.

Long may it continue.

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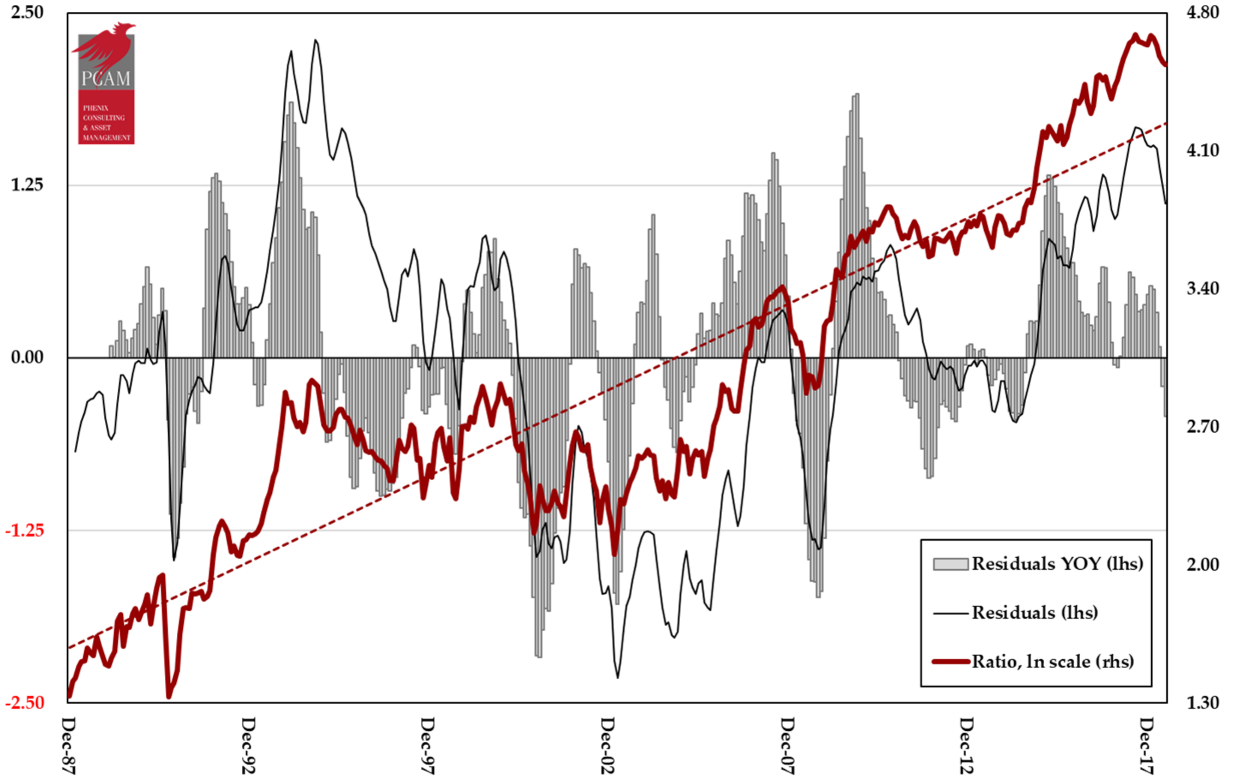
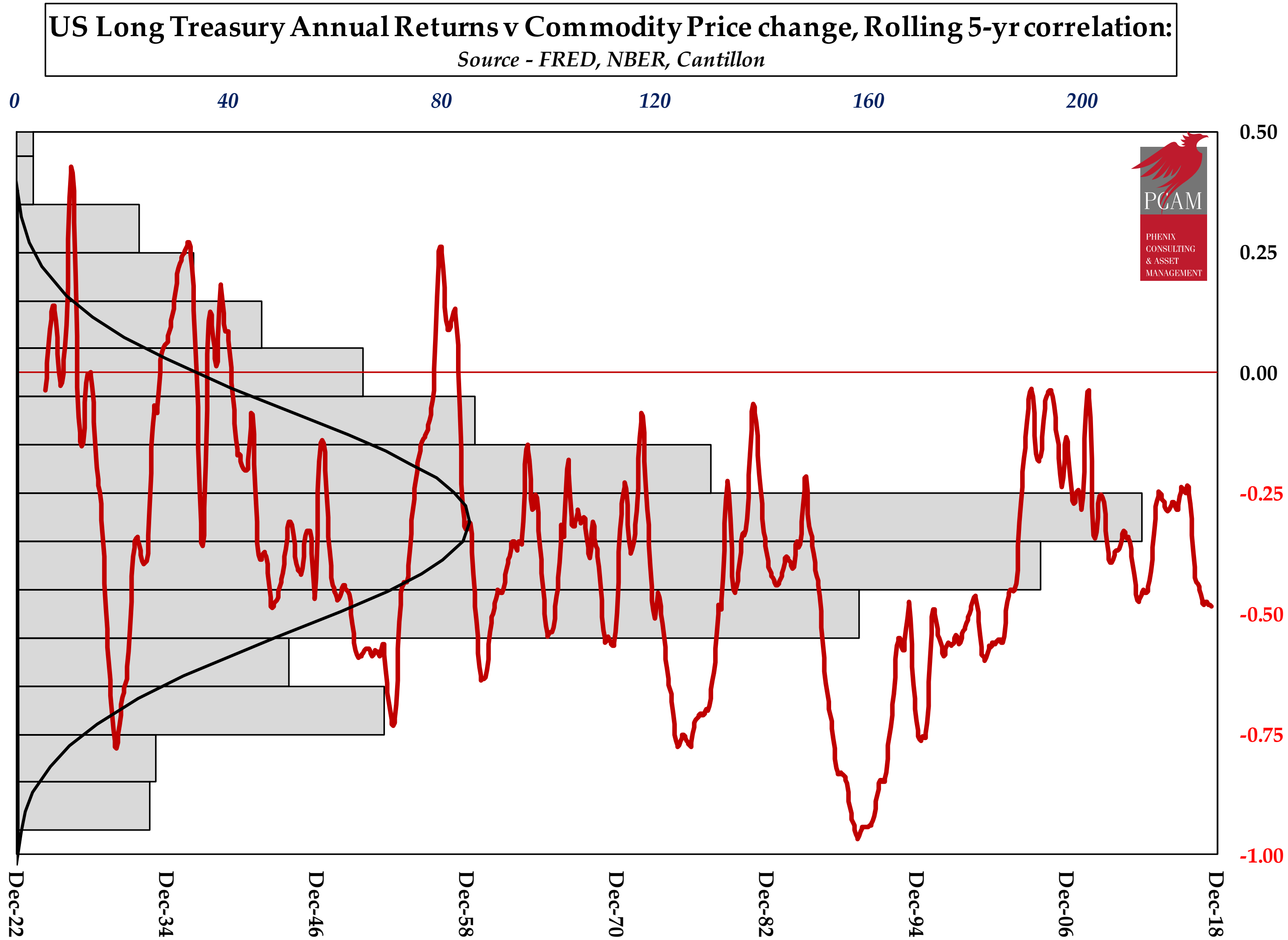
Sean Corrigan

Chief Investment Strategist

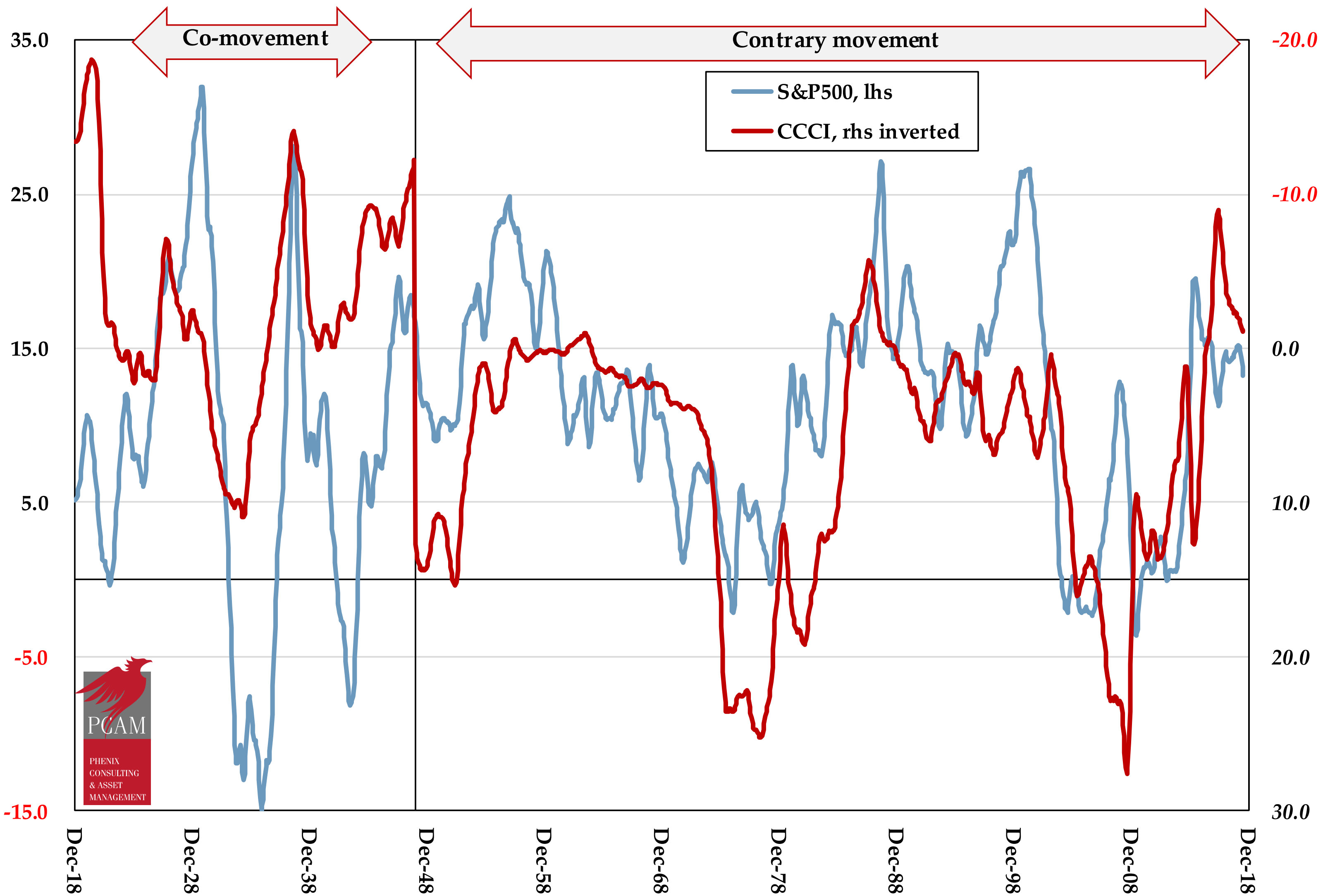
MSCI EM Equity TR v S&P GSCI ER, r2=0.84: *Source - MSCI, S&P*





There has been only one sustained spell of positive correlation between commodity prices and 5-year rolling bond returns since the start of WWII—and that, six decades ago. We reiterate the point that it is primarily the fixed income portfolio which would benefit from the application of a commodity overlay

SPX rolling 5-year returns v CCCI Price change (1913-47 Sign reversed): *Source - S&P, Cantillon*



As for commodities and equities, though correlations per se have swung from positive to negative without leaving much of a clear pattern, since the War, there has been a more evident tendency for periods of rising commodity prices to coincide with episodes of lowered stock returns

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- This Fund achieves its market exposure through the use of commodity-linked financial derivative instruments.
- Commodity prices and therefore the value of commodity-linked financial derivative instruments can be more volatile than investments in traditional securities.
- At times the Fund may be concentrated in one or more individual commodities which may further increase volatility.
- Although the majority of the Fund's assets will be invested in cash, cash equivalents and short-dated instruments, investors should be aware that the Fund may not benefit from the returns arising from those investments and that those investments will serve primarily as collateral for financial derivative instruments (principally swaps).
- Investors may see the value of their investment fall as well as rise on a daily basis, and they may get back less than they originally invested.
- Investors should be aware that, in response to certain market circumstances, for temporary defensive purposes the Fund may have very limited, if any, exposure to commodity-linked financial derivative instruments.
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- The Fund will be managed with reference to the volatility of its benchmark but not with respect to the benchmark's constituents.
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- The Fund's investment approach is speculative and entails risks. There can be no assurance that the investment objective of the Fund will be realized.
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