# Primary Concerns

3rd August 2018

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## Material Witness - *insights from the Manager*

### Throwing a Curve Ball

*- Prices moved in advance of curves last month and both were notably volatile. Though our methodology shielded us from some of the fall-out, the portfolio still made a loss. We have effected improvements to the model as a result...*

*Thierry Ralet, CEO & Founder*

## Mark to Market - *observations from the front line*

### The Dollar-ous Stroke

*- Policy confusion in China has been given expression in a falling Yuan, worsening the impact on commodities of a generally stronger dollar and the diminution of global liquidity that generally entails. Keep alert and keep active...*

*Sean Corrigan, Chief Investment Strategist*

## Material Witness - *insights from the Manager*

### Throwing a Curve Ball

The paper portfolio we are running at present on a month-to-month basis, solely for illustrative purposes, showed a return of -3.1% in July, due to losses in all sectors except Precious Metals & Soft Commodities.

As usual, we would 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 re-balancing we will regularly be carrying out, once we are fully operational.

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.

Overall volatility continued to increase last month, but the principal manifestation of the more turbulent conditions took the form of several sharp and substantial changes in the shape of the various futures' curves. This meant that we had to execute rapid switches from long to flat or short in Brent, Heating Oil, NatGas, Aluminium, Copper, and Silver—changes which spared us some, but sadly not all, of the pain which commodity investors suffered over the period in question—such pain amounting to around -5.2% of the GSCI ER itself.

In part, this was because the price action was, for once, somewhat dissociated from said changes in the curves. Even after rebalancing twice a week, we could only make up 42bp of global performance—not to be sniffed at, perhaps, but still of cold comfort to the prospective seeker of absolute returns.

As a result of the experience, we have moved to improve the daily attribution model in order to react more quickly and more efficiently once the fund is launched.

Looking ahead to August, one of our models is slightly short, while the other is neutral, with regard to Brent. Conversely, the signals suggest the opposite positioning in WTI (viz., long and neutral) in WTI. This event is rare but it will help decrease overall volatility while allowing us to have larger positions in other, potentially more promising sectors, such as Agriculture which, after its heavy losses of recent weeks, seems finally to be offering a better mix of risk and reward. Elsewhere in the portfolio, after several months running short, we have cut our position in the precious metals.

From a broader perspective, the global net position is currently short.

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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% | -3.1% | | | | | | 5.2% |

### 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 | -31.7 | | | | | | 157.7 |
| BCOM - Livestock | -9.6 | -4.2 | -1.5 | 44.3 | -9.1 | -0.8 | -29.4 | | | | | | -10.2 |
| BCOM - Grains | -50.7 | -120.0 | 36.7 | -42.8 | 39.6 | 164.5 | -63.0 | | | | | | -35.6 |
| BCOM - Metals | 18.7 | -8.2 | -16.2 | -70.0 | 4.2 | -42.1 | -41.1 | | | | | | -154.8 |
| BCOM - Precious Met. | - | 22.2 | - | - | 11.3 | 31.9 | 8.3 | | | | | | 73.8 |
| BCOM - Softs | -22.0 | -7.4 | 22.3 | 12.4 | -4.2 | 16.1 | 32.3 | | | | | | 49.5 |
| GSCI - Energy | 168.3 | -65.6 | 131.8 | 270.1 | 95.0 | 40.0 | -121.2 | | | | | | 518.4 |
| GSCI - Metals | 13.2 | -6.0 | -11.3 | -53.5 | 1.4 | -53.5 | -41.0 | | | | | | -150.7 |
| GSCI - Precious Met. | - | - | - | - | 4.8 | 12.4 | 8.4 | | | | | | 25.7 |
| GSCI - Agriculture | -60.9 | -68.7 | 88.2 | -38.9 | 19.2 | 112.8 | -20.2 | | | | | | 31.6 |
| GSCI - Livestock | -7.8 | -5.3 | 70.2 | 2.8 | -14.2 | -2.1 | -4.8 | | | | | | 38.9 |
| Total Alpha | 105.1 | -380.4 | 396.8 | 252.0 | 134.2 | 340.0 | -303.3 | | | | | | 544.3 |

### Performance since inception (AUG-15)

| | 2015 | 2016 | 2017 | 2018 | ITD |
|---|---|---|---|---|---|
| Portfolio CAR | 27.4% | -9.8% | 17.1% | 5.2% | 12.3% |
| Benchmark | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Alpha (bp) | 2736 | -982 | 1707 | 522 | 1226 |
| Volatility | 19.6% | 12.8% | 9.8% | 7.9% | 13.5% |
| IR | 1.39 | -0.76 | 1.75 | 0.66 | 0.91 |

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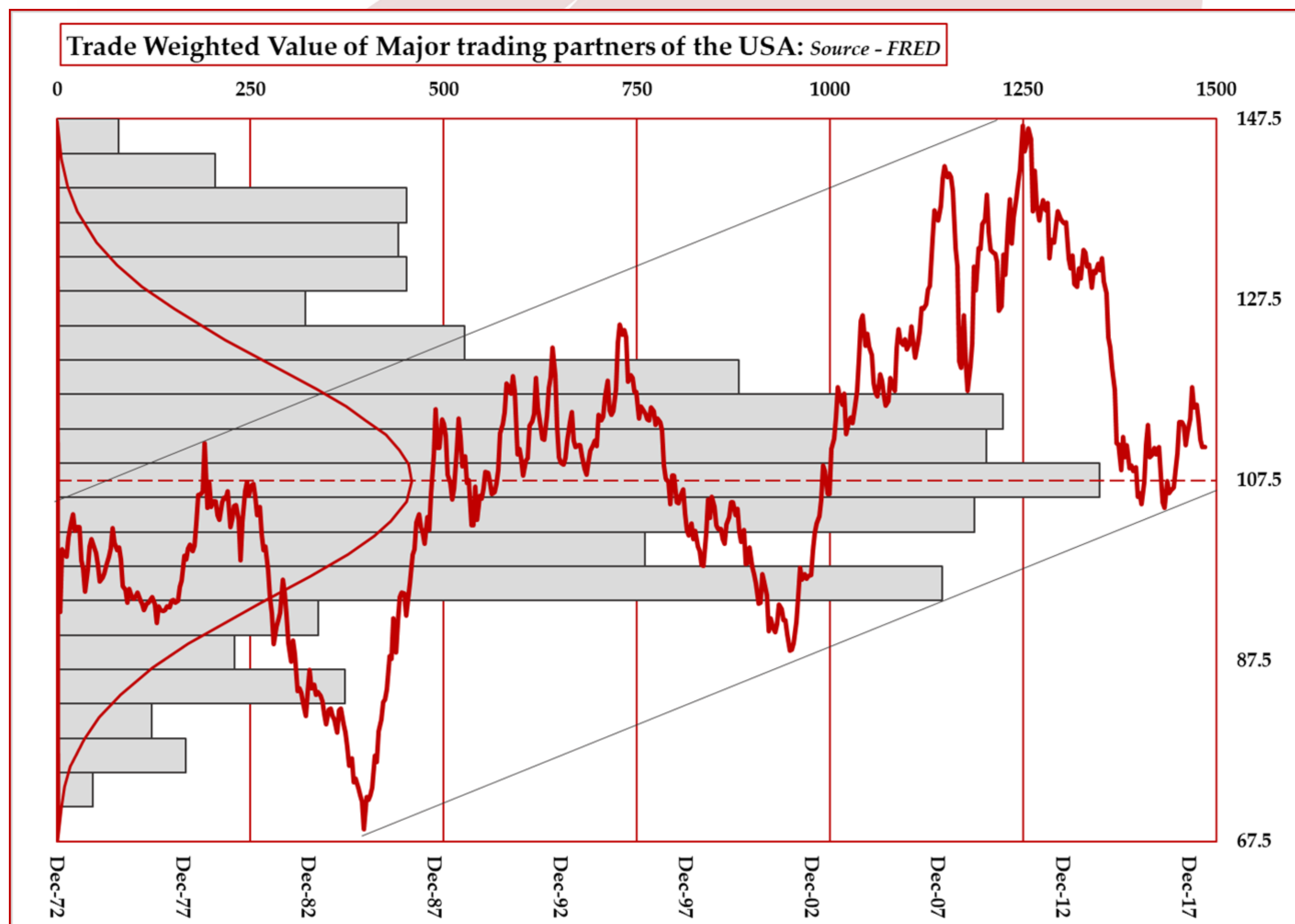
## Mark to Market - *observations from the front line*

### The Dollar-ous Stroke

This has not been the easiest of months for commodity investors. The usual political worries regarding oil supply have been compounded with the fact that the US shale patch is becoming a victim of its own success by way of overtaxing the infrastructure necessary to get the oil to market. The attempt by the Chinese to penalize the American Administration by foregoing imports of farm products—above all soybeans—has come at a time when crop conditions are at their best for some years and stocks are still elevated. Gold and silver are unloved; the former having broken a major trend line and moved below the high volume area in the somewhat top-heavy, $400 distribution it has mapped out these past five years and the latter flirting with the major, medium-term trendline which comes in around $15/oz. As for base metals, the barely suppressed panic roiling Chinese policy-making circles and the collapse—coincidental, or otherwise—of the yuan has, it is whispered, seen heavy liquidation of finance-trade stocks of metals.

As we have noted for some months now, Chinese financial conditions have been slowly tightening the noose. In what is at root an economic model largely based on the loosing and subsequent restraint of serial bubbles in equities, commodities, real estate, bitcoin, gold, garlic, apples, Muotai, and so on, the effects are predictably unpredictable. Sometimes one bubble pops up to take the place of the one the authorities have chosen to prick: sometimes the shock wave from the latter's implosion triggers a mass collapse of the foam which comprises so much of the activities being undertaken. What is certain is that the 'Trade Wars' have provided a politically–convenient cover for what are largely difficulties of a more local provenance. The ongoing programme of 'deleveraging' has catastrophically compressed the 'shadow market' without prodding the banks who are that programme's intended beneficiaries from fully taking up the slack, with what extra lending there has been being directed almost exclusively to the usual list of state-owned giants.

With the currency depreciating more than 10% in a matter of weeks—and at an ever more rapid pace as the move has developed—all those who have so blithely been borrowing abroad must be in desperate straights. Hence, presumably, the commodity liquidation. Finally, as we go to press, the central bank has been forced into action, slapping a steep 20% reserve margin on



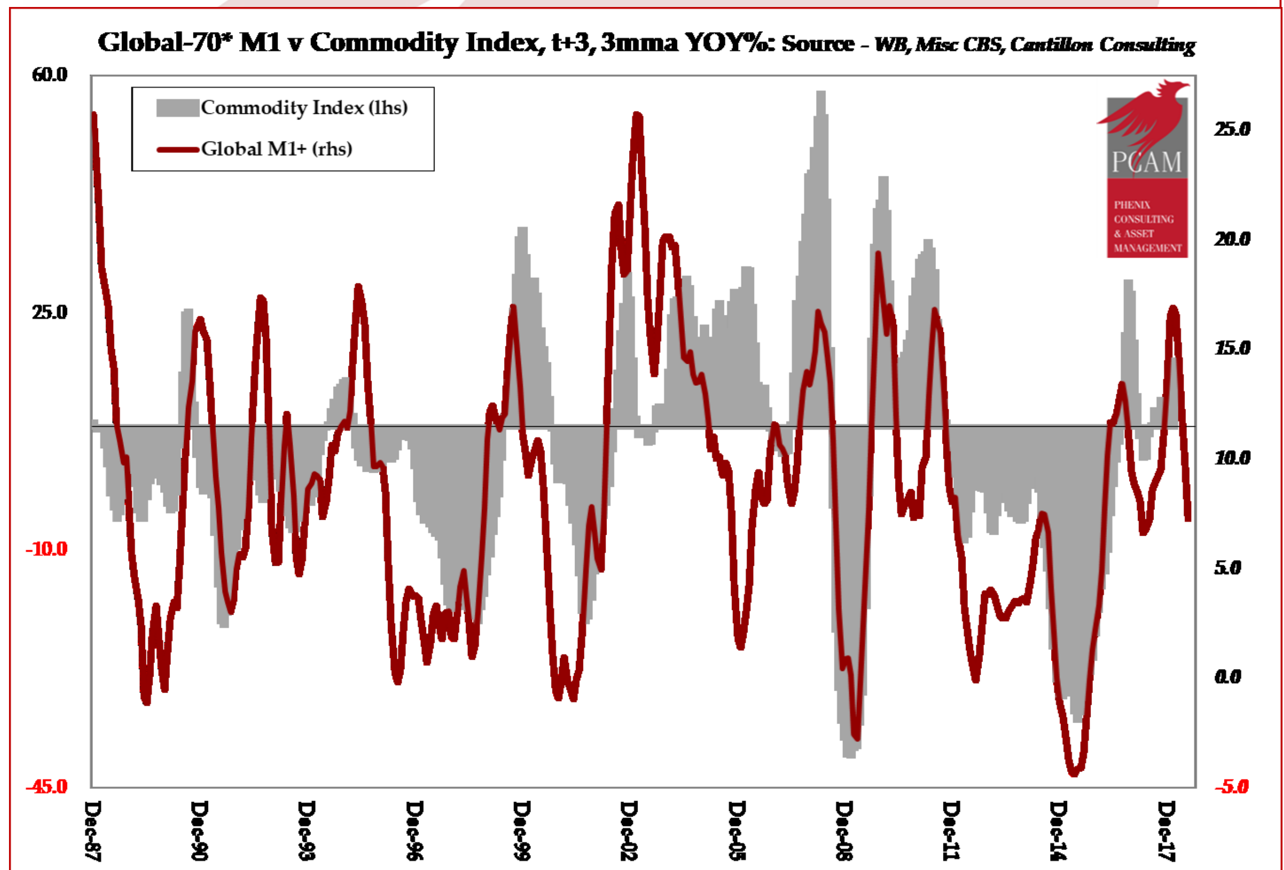
all forward FX positions (including derivative ones), in an attempt to halt the slide. Quite how compatible that will be with the Bank's simultaneous efforts to loosen monetary policy, remains to be seen. The horns of the Mundell-Fleming trilemma are certainly sharpening in the Middle Kingdom.

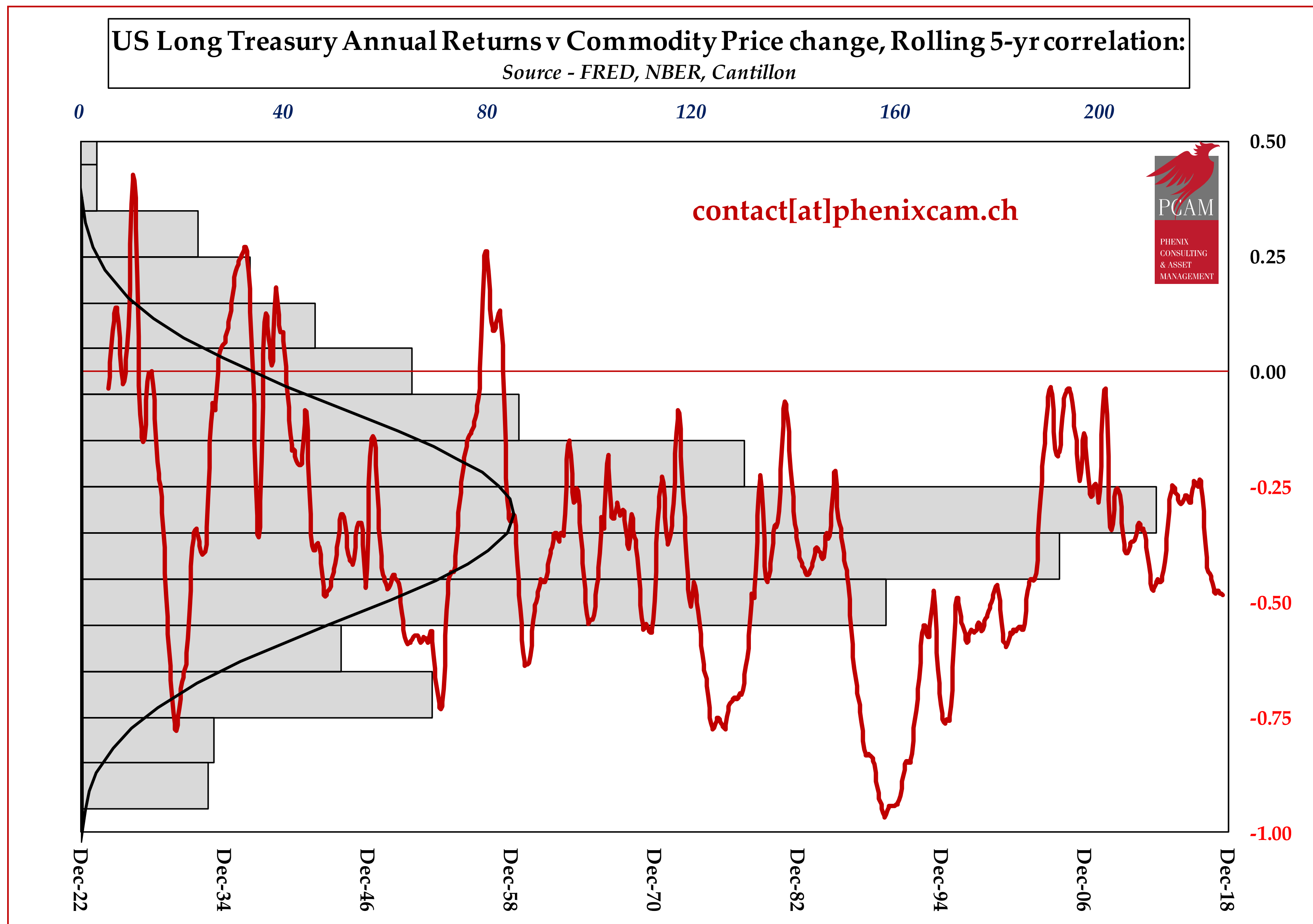
Though the strain on some Emerging Markets—who must be the world's most incorrigible, never-learn-from-experience, sovereign borrowers since Phillip II of Spain— is undeniable, all the angst over the rising dollar comes with it trading—not way up in the stratosphere—but slap-bang in the middle of the range of the floating-rate era. A technician might even note that the ~17 year separation from the last great turning point [see graph on previous page] matches the gap between that and its predecessor and he will also be aware that the channel in which the Greenback has been trading all this time is also fairly well-defined, suggesting some respite might be had, in the medium-term, at least.

With the ECB's efforts at further stimulating the growth of money and lending seemingly having run into a severe case of diminishing returns even before it is due to end (none of its heavy securities purchases since the autumn have served to increase the monetary base, but have instead mounted up as liabilities due to foreigners, as well as to the very domestic governments whose paper it is buying); with Japan's Yield Curve Control programme in disarray and with organic money growth slowing in several other jurisdictions, the addition of US dollar strength means that increments to global liquidity (to the extent that such an overarching concept has any meaning) have become much more miserly than this time last year. Hence, the less than propitious environment for outright commodity bulls and therefore the greater the need for intelligent, active management of one's exposures in this area

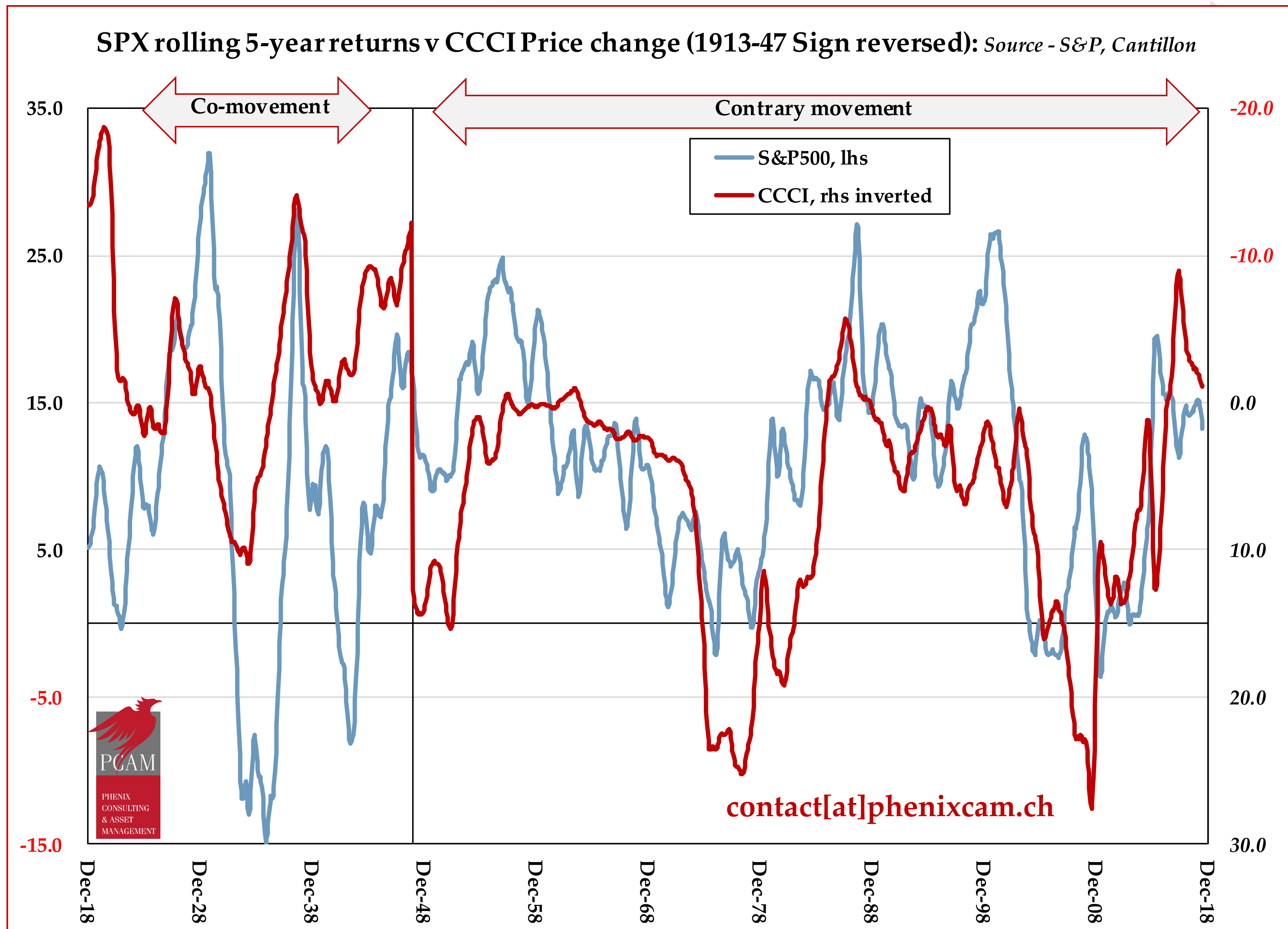
**Sean Corrigan**

**Chief Investment Strategist**

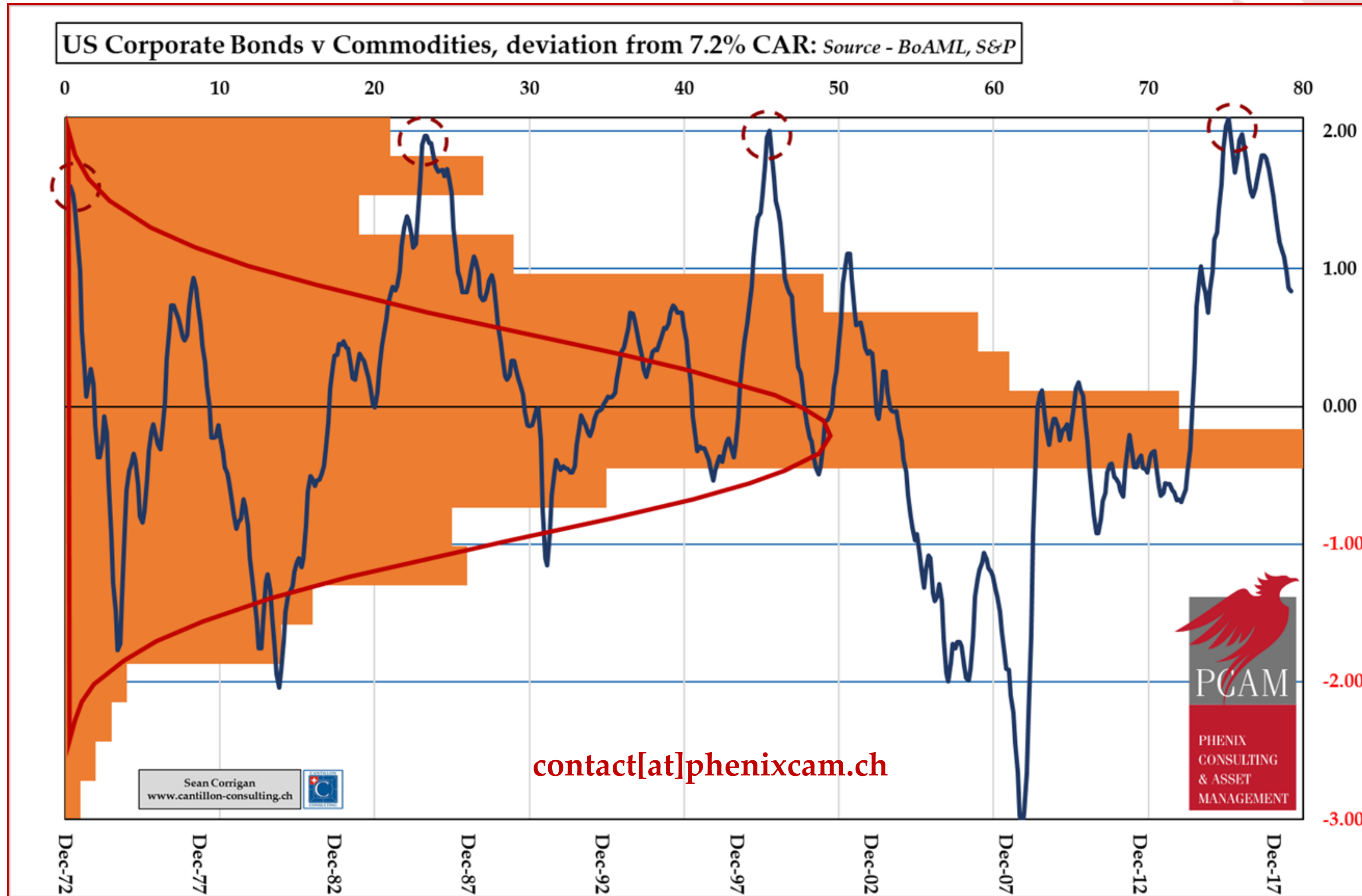





There has been only one sustained spell of positive correlation between commodity prices and 5-year rolling bond returns since the start of WWII—and that, six decades ago. We reiterate the point that it is primarily the fixed income portfolio which would benefit from the application of a commodity overlay




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




Even during the current retracement, commodities are still performing better *relative to trend* with regard to fixed income. Note that the same reduced amplitude of liquidity which is causing the formers' weakness is also the bane of an asset class still characterized by negative real and nominal yields, extended durations, and copious supply. Mean reversion remains the likelihood.

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