# Primary Concerns

4th September 2018

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## Material Witness - *insights from the Manager*

### The pitfalls of prudence

*- Conflicting signals—and opposing moves—in Brent and WTI were enough to push our score narrowly into the red last month in the absence of what will be the corrective of intra-month rebalancing, once we are fully operational....*

*Thierry Ralet, CEO & Founder*

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

### The Second Least Dirty Shirt

*- Despite the sharp sell-off endured in the three months from mid-May, commodities are still leading the pack in 2018, if we look beyond the FAANG-supercharged performance of US indices. There is even hope for a brighter autumn ahead...*

*Sean Corrigan, Chief Investment Strategist*

## Material Witness - *insights from the Manager*

### The pitfalls of prudence

The paper portfolio which we are running at present on a month-to-month basis, solely for illustrative purposes, showed a return of -0.4% in August, due to losses in Energy & Metals which were not quite fully compensated by gains in Grains, Softs, and Livestock.

*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 intra-month rebalancing 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.*

Having started the month with converse positions in WTI and Brent Crude in the GSCI & BCOM, respectively, the former portfolio performed well during the first part of the month before suffering a subsequent marked decline, while the latter moved in the opposite sense, but did not do well enough to negate the overall slippage. Such are sometimes the drawbacks of what we otherwise maintain is our sensible aim to reduce volatility by avoiding the taking of large positions when the signals are not clear and even stand somewhat in contradiction to our perception of the fundamentals .

**For the record, we calculate that our weekly rebalancing methodology, had it been implemented, would have allowed us to cut the short Brent position around the 22nd and thus to have recorded a slightly positive performance at month end.**

Looking ahead to September, models and fundamentals are more aligned on both the oil contracts, with a slight bias to the long side. For now, we remain short of agriculture & softs (except cotton), and also short of livestock

From a broader perspective, the global exposure is currently short mainly due to this positioning in agriculture.

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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% | -0.4% | | | | | 4.8% |

### Performance Attribution

| | 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 | -13.4 | | | | | 144.3 |
| BCOM - Livestock | -9.6 | -4.2 | -1.5 | 44.3 | -9.1 | -0.8 | -29.4 | 2.0 | | | | | -8.2 |
| BCOM - Grains | -50.7 | -120.0 | 36.7 | -42.8 | 39.6 | 164.5 | -63.0 | 80.9 | | | | | 45.3 |
| BCOM - Metals | 18.7 | -8.2 | -16.2 | -70.0 | 4.2 | -42.1 | -41.1 | -23.9 | | | | | -178.6 |
| 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 | 10.0 | | | | | 59.6 |
| GSCI - Energy | 168.3 | -65.6 | 131.8 | 270.1 | 95.0 | 40.0 | -121.2 | -159.5 | | | | | 358.9 |
| GSCI - Metals | 13.2 | -6.0 | -11.3 | -53.5 | 1.4 | -53.5 | -41.0 | -16.4 | | | | | -167.1 |
| 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 | 75.6 | | | | | 107.2 |
| GSCI - Livestock | -7.8 | -5.3 | 70.2 | 2.8 | -14.2 | -2.1 | -4.8 | 3.8 | | | | | 42.8 |
| Total Alpha | 105.1 | -380.4 | 396.8 | 252.0 | 134.2 | 340.0 | -303.3 | -40.7 | | | | | 503.6 |

### Performance since inception (AUG-15)

| | 2015 | 2016 | 2017 | 2018 | ITD |
|---|---|---|---|---|---|
| Portfolio CAR | 27.4% | -9.8% | 17.1% | 4.8% | 12.1% |
| Benchmark | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Alpha (bp) | 2736 | -982 | 1707 | 479 | 1211 |
| Volatility | 19.6% | 12.8% | 9.8% | 8.0% | 13.5% |
| IR | 1.39 | -0.76 | 1.75 | 0.60 | 0.90 |

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

### The Second Least Dirty Shirt

After an 11-month run which saw broad-based, ~40% gains in commodities, the mid-May reversal seemed to put an end to the sector's hopes. An intensification of President Trump's 'Trade Wars', the spreading rot in emerging markets, and signs that China's creaky superstructure of credit had been rocked by the authorities' overly zealous attempts to rain in the wilder excesses of 'shadow' finance led to a particularly toxic mix of conditions.

The Trumpian tariffs combined both to excite fears about global growth and to increase the appeal of US assets over those of the nation's peers. The consequent rise in the dollar was enough to catalyse a sharp deterioration of the already poor fundamentals of a number of emerging markets—viz., Turkey, Argentina and South Africa—and was contributed to greatly by a drop of almost 10% in the value of the renminbi. Whether this came about by accident or design, we may never know, but what we *can* say is that it aggravated the credit squeeze underway and so led to a heavy liquidation of the sorts of industrial commodities often employed for the purposes of semi-licit finance, as much as for the fabrication of new structures and machinery. Simultaneously, the ongoing prospect of bumper harvests of beans, corn and even wheat, across the US did not sit well with the barriers being erected in the mutually-damaging game of tit-for-tat being engaged in with their principal importer, westward across the Pacific.

Courtesy: TradingView

Taken together, this was enough to knock almost 10% off the GSCI's tally of excess returns, costing holders just over a third of their preceding gains in what was one of those classic, 'up *by the stairs, down by the elevator'* market moves. Fortunately, by the middle of last month, with the COT reports showing greatly reduced totals of speculative longs in several of the formerly high-flying commodities (and, for some members of the community, even multi-month net shorts), much of the violence of the move seemed to have spent itself, allowing a steady recovery of more than half the losses in the three weeks since.

For many, this all was a sign that, once again, commodities had woefully disappointed their sponsors and that investors had best stick to the tried and trusted, horse-and-cart mix of equities and bonds.

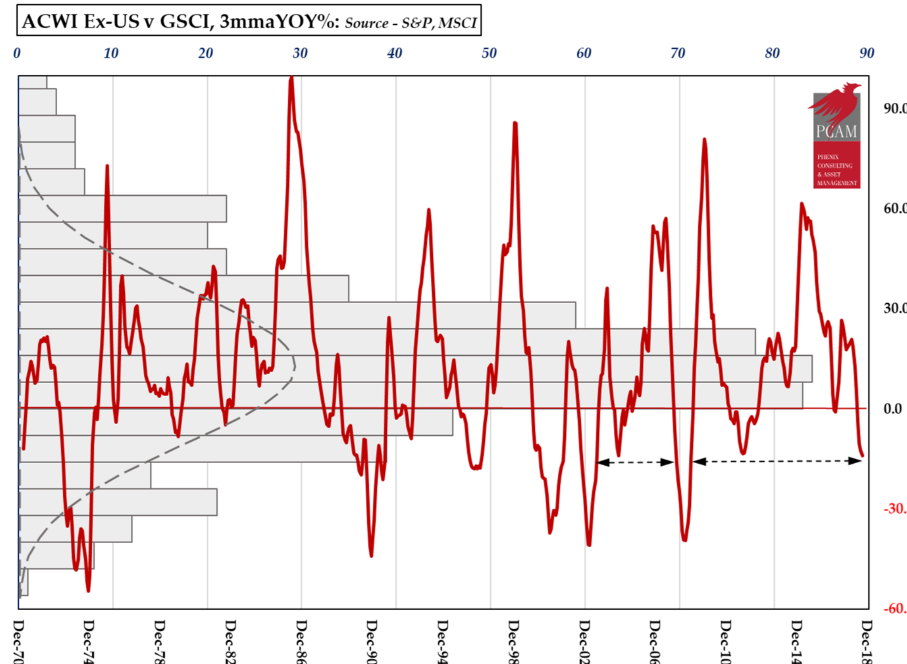
But, not so fast! If we look at the performance for the year so far, we find that commodities are still ahead of those two broad categories, with the exception only of the US stock market—an exclusion which

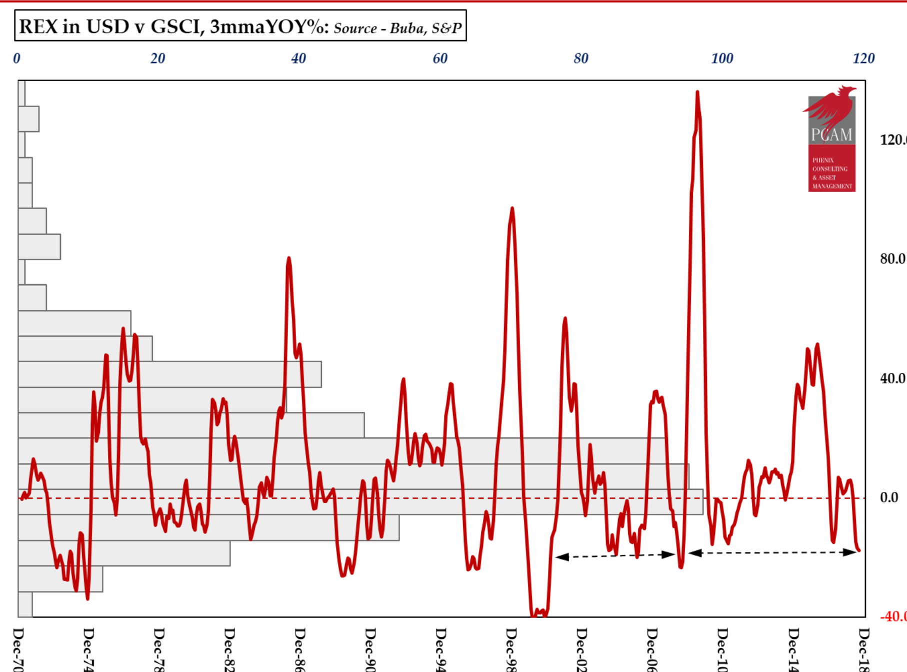
effectively boils down to, 'except the FAANG stocks which have made such a dominant contribution to returns there'.

To the end of August, total YTD returns for the GSCI were 7.6% while US equities were up 10%. But similarly, Japanese stocks were off 1.2% in dollar terms; European ones were down 2.3%; and Emerging Markets had fallen 6.9%; meaning the All-Country Index ex-USA has lagged commodities by roughly 10% in the past eight months.

Things were hardly better in the bond market (an asset class which regular readers will know we strongly insist is the perfect partner to a commodity holding). US Treasuries and investment grade corporates each lost around 2%;  US high-yield has continued to astound with a positive 2% score but such strength has not translated to the wider world where the Euro equivalent, for instance, was off 2%. Emerging markets—as measured by the $EMB ETF—have, needless to say, been a disaster, shedding 8.4% so far in 2018 giving us almost a 15% divergence in what are often held to be broadly substitutable assets.

As shown to the right, commodities have, in fact, enjoyed some of their best relative gains over so-called 'traditional' assets for some good while, outperforming non-US equities by as much as they have at any time this past 15 years, with the sole exclusion of the very height of 2008's pre-Crisis oil squeeze, and similarly outdoing non-US bonds (here proxied by the German REX index of Bunds) by one of the widest margins experienced these past two decades

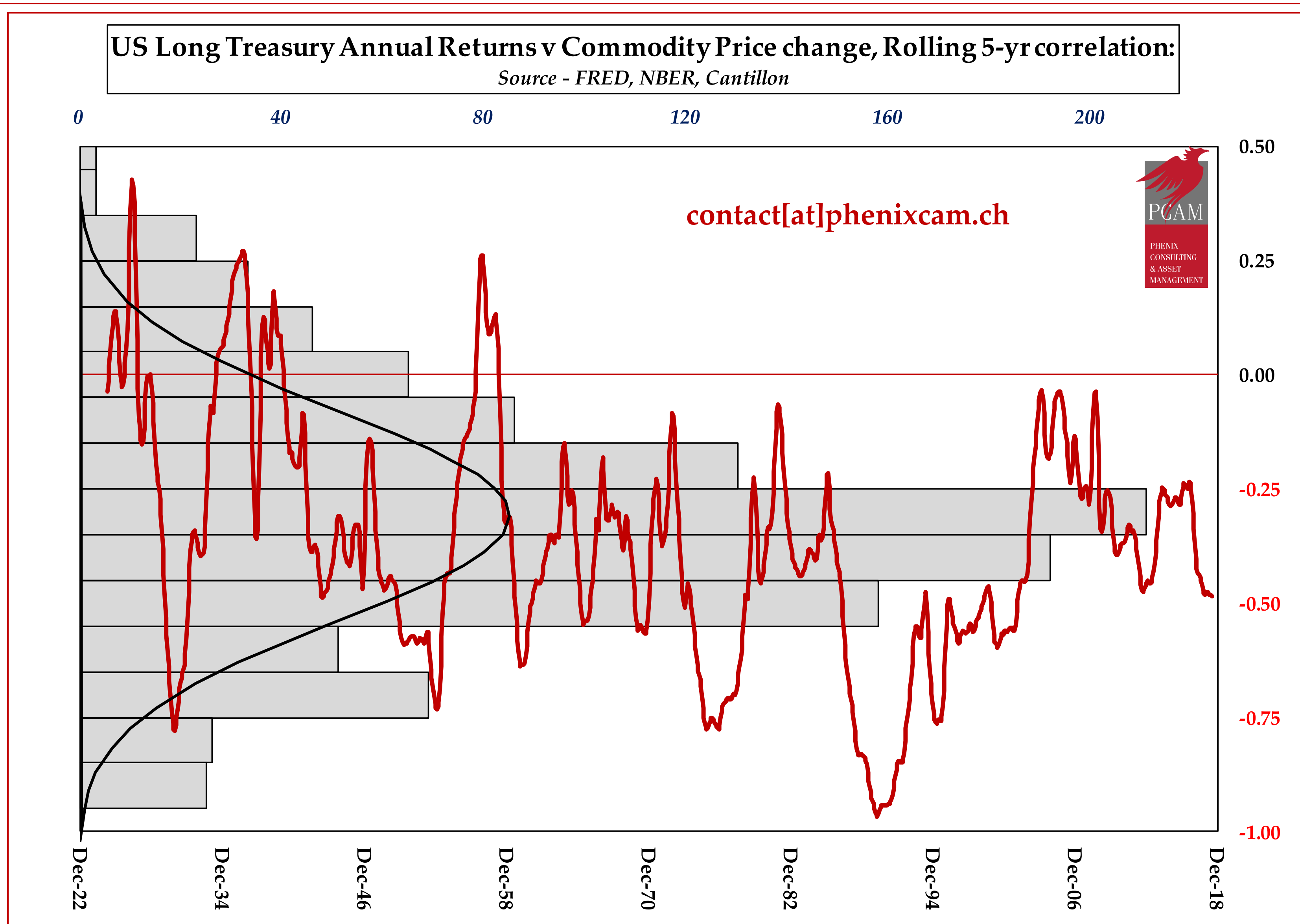


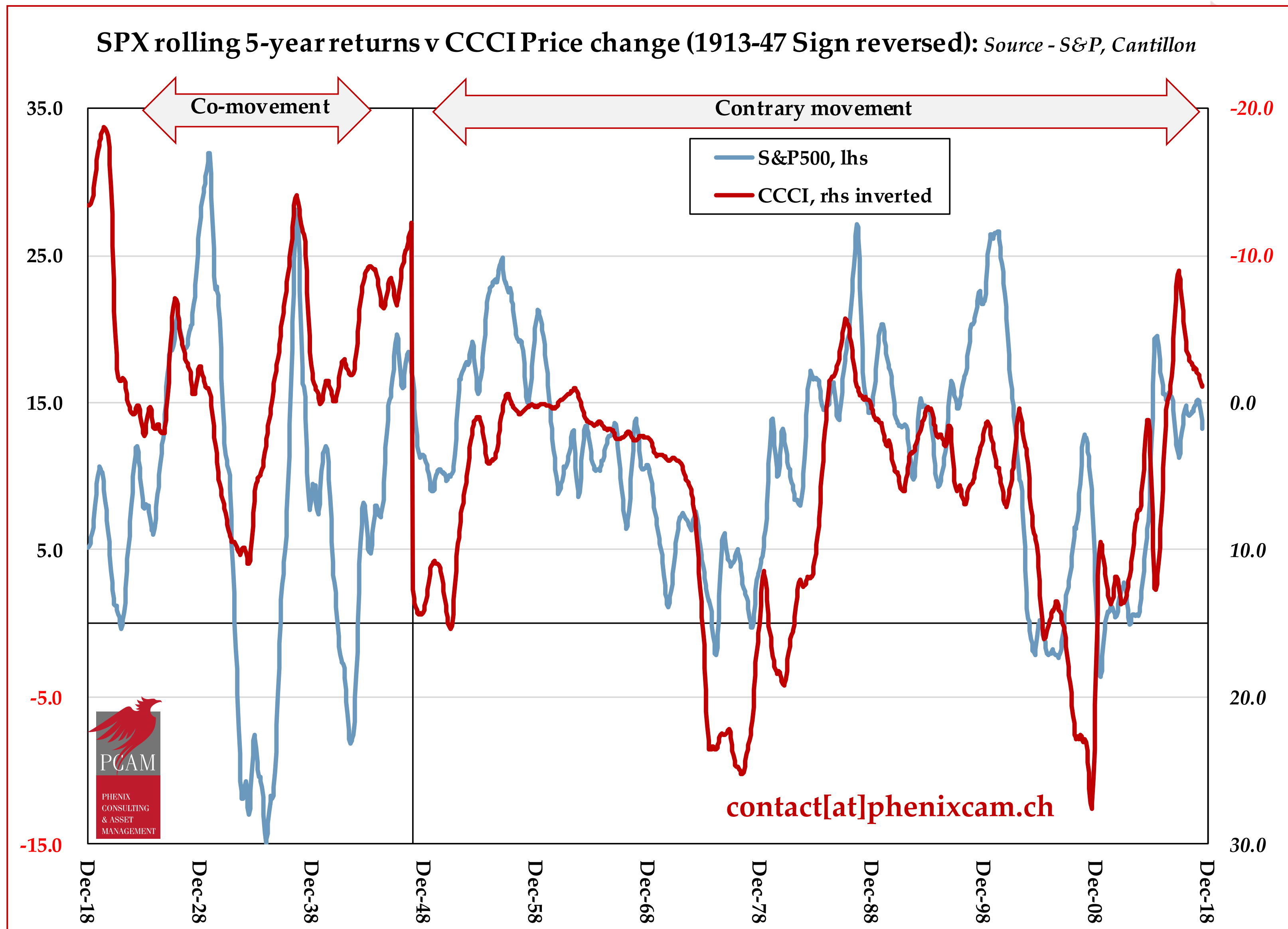

Of course, it is absolute returns that should matter most to investors who can only draw the coldest of comfort from a position which merely loses them less than the alternatives. Here, we can offer a small ray of cautious optimism. With the top of the last three month's bear channel currently being tested, a 50% retracement of the sell-off already having been completed, and with the momentum traders either out of the game or positioned the wrong way for a rise, it is entirely possible that the autumn sees new highs for the cycle, of the order which we tentatively project in our first graph (see above). Fingers crossed.

**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

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