Primary Concerns

3rd October 2018

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Material Witness - *insights from the Manager*

Heading for a Hundred?

- September saw a handy 2.1% gain for the portfolio with curves relatively stable, energy the obvious winner, and livestock more sheepish than bullish...

Thierry Ralet, CEO & Founder

Mark to Market - *observations from the front line*

No Prize for Second Place

- In what may well be a sign of just how mature this cycle is, gains have become increasingly concentrated in a few key sectors. Equities provide the main example of this, but commodities, too, have become distinctly polarised...

Sean Corrigan, Chief Investment Strategist

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Heading for a Hundred?

The paper portfolio which we are running at present on a month-to-month basis, solely for illustrative purposes, showed a return of 2.1% in September, due to gains in energy, agriculture & metals but somewhat diminished by a negative performance in 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.

Once again, during September, the spread between the U.S. and international oil benchmarks was back at the cusp of $10/barrel. Historically, this is a wide differential—only being substantially exceeded during the period 2011-14—a period *also* characterized by generally elevated prices which were aggravated outside America by all manner of actual and feared disruptions and conversely kept somewhat in check by the first inklings that a revolution in onshore production was underway.

Today, the main external worry is what the American repudiation of the nuclear accord with Iran will do to the global supply balance: at home, there are severe logistical problems—the perverse consequence of the frackers' extraordinary extractive productivity—especially in the dominant Permian region of north-west Texas.

A further sign of the difference between the two can be had from comparing the curve shapes. The gap between the December and January contracts for WTI is around 10¢ a barrel—close to the lowest in a year—while that for the like expiries in Brent is only just short of five times as wide in what we take to be a clear sign that the market does not expect 'geopolitical' tensions to dissipate any time soon.

With regard to our portfolio, after the sizable moves in the preceding two months, curves were much more stable in September, meaning only small adjustments would have been performed and correspondingly small enhancements achieved.

Looking ahead to October, 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, and we are mixed on livestock (one long/one short). From a broader perspective, the overall exposure is currently short on BCOM and long on GSCI due to the weighting differences between the indices in agriculture & energy. Overall, the total dollar position is neutral.

Thierry Ralet

CEO & Founder

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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%	2.1%				6.9%

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	88.3				232.6
BCOM - Livestock	-9.6	-4.2	-1.5	44.3	-9.1	-0.8	-29.4	2.0	-59.6				-67.8
BCOM - Grains	-50.7	-120.0	36.7	-42.8	39.6	164.5	-63.0	80.9	47.3				92.6
BCOM - Metals	18.7	-8.2	-16.2	-70.0	4.2	-42.1	-41.1	-23.9	29.7				-148.9
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	-10.4				49.2
GSCI - Energy	168.3	-65.6	131.8	270.1	95.0	40.0	-121.2	-159.5	121.0				479.9
GSCI - Metals	13.2	-6.0	-11.3	-53.5	1.4	-53.5	-41.0	-16.4	22.4				-144.7
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	75.6	37.6				144.8
GSCI - Livestock	-7.8	-5.3	70.2	2.8	-14.2	-2.1	-4.8	3.8	-71.1				-28.4
Total Alpha	105.1	-380.4	396.8	252.0	134.2	340.0	-303.3	-40.7	205.2				708.8

Performance since inception (AUG-15)

	2015	2016	2017	2018	ITD
Portfolio CAR	27.4%	-9.8%	17.1%	6.9%	12.5%
Benchmark	0.0%	0.0%	0.0%	0.0%	0.0%
Alpha (bp)	2736	-982	1707	694	1250
Volatility	19.6%	12.8%	9.8%	8.1%	13.4%
IR	1.39	-0.76	1.75	0.85	0.94

Mark to Market - *observations from the front line*

No Prize for Second Place

Though often treated as something too embarrassing to be brought up in polite conversation, the fact much of the recent strength of the US stock market is attributable to a bare handful of giant tech stocks is a widely known fact. Taken as a whole, the Nasdaq 100 price is currently around 20% ahead of where it ended 2017, while the Value Line arithmetic (a construction which tries to reflect the average stock's performance) is up only 5% and its geometric counterpart (better matching the median stock) is up less than 2%.

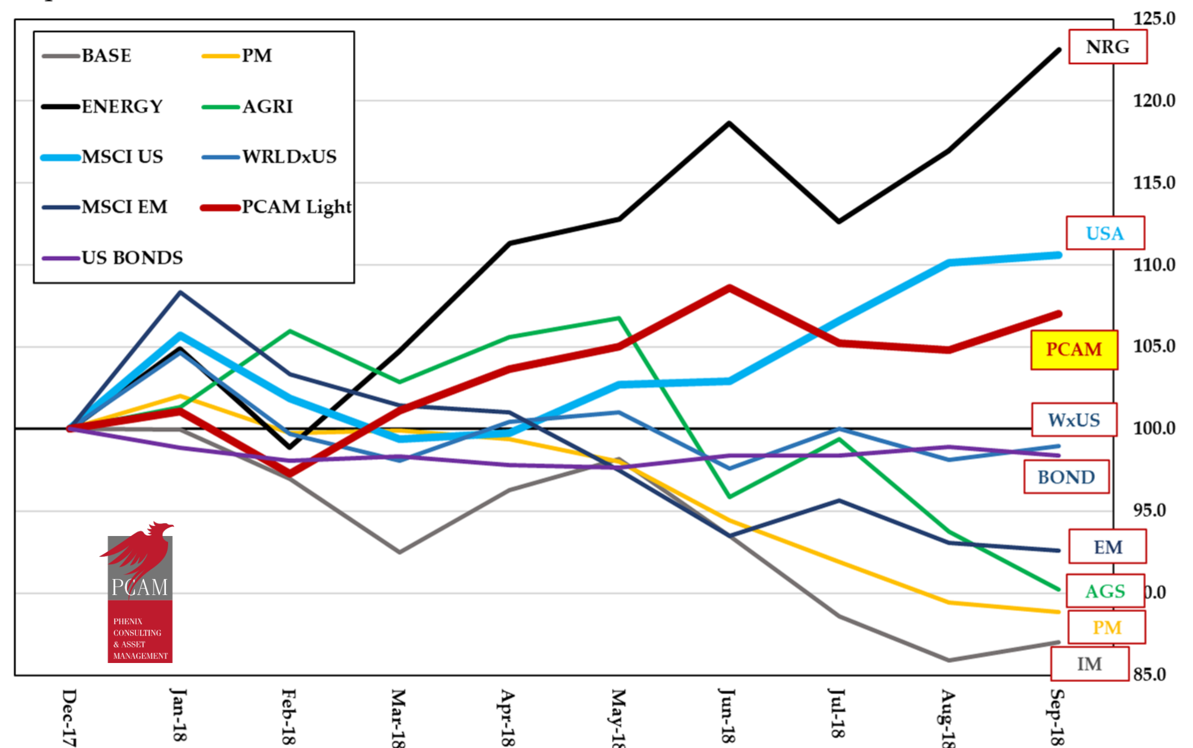
Similarly, while the FANG-boosted US market ended the quarter showing total YTD returns of 10.6%—helped in no small measure by $1.3 trillion in M&A activity, $345 billion in buy-outs and buy-ins, and a general level of equity retirement of around two-thirds of reported earnings—the rest of the world's Developed markets stuttered to a 1% loss, with their Emerging equivalents slumping no less than 7.4%. Bonds in general were also lacklustre, with the broad US universe ending September 1.6% in the red. In contrast, leveraged loans—boosted by a red-hot CLO uptake—are one of the few bright spots, having so far managed a 4% gain in 2018.

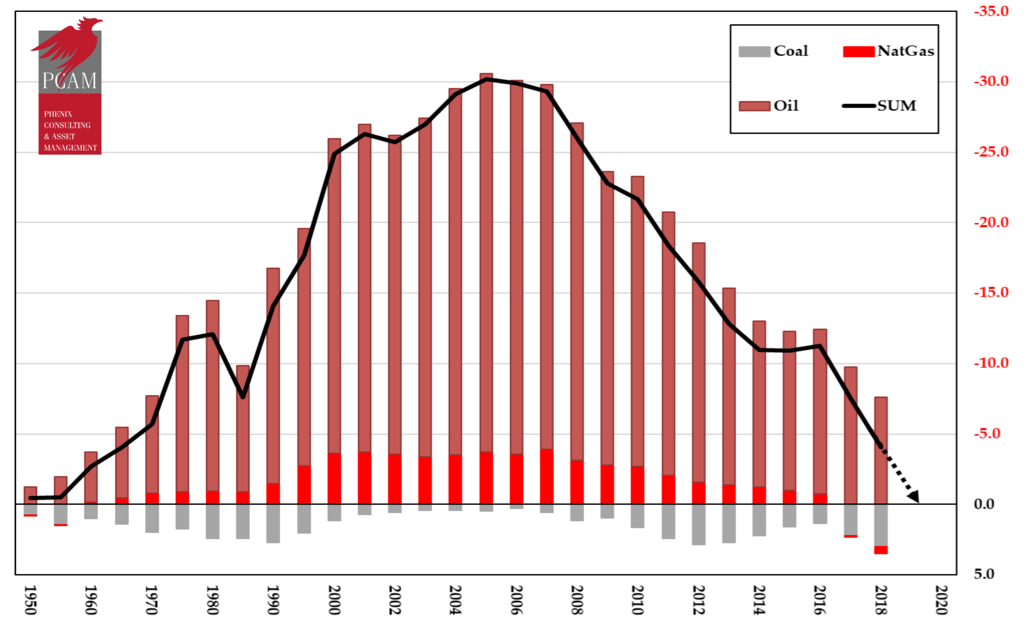
It is therefore only a small stretch to say that a dollar-based investor has had to be unhealthily dependent upon a narrow group of securities and/or the least well-protected and therefore the most cyclically-vulnerable reaches of the credit market if he was to spread any butter on his bread these past nine months.

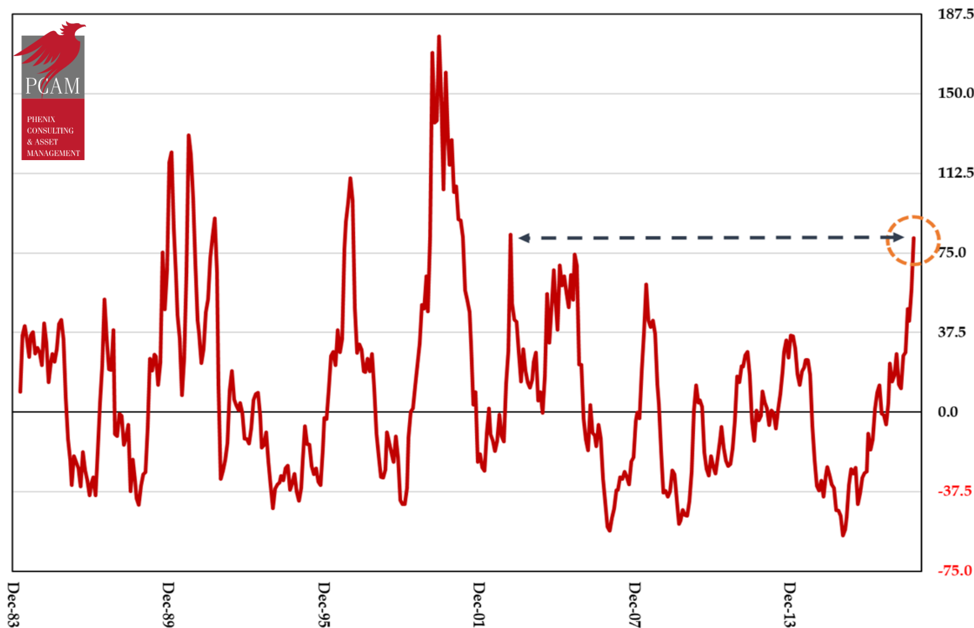
Commodities, too, have been characterised by a noted concentration of gains with energy's stellar 23% performance having to shoulder the burden of the circa 10% losses suffered in each of the other three main sectors.

Against that backdrop, we might modestly suggest that the PCAM 'Lite' scorecard (as we might designate the notional portfolio we have constructed without the intended benefit of more frequent rebalancings and discretionary interventions) has done fairly well to achieve the plus 7% excess return it has. Add in an further 160/70 basis points in collateral earnings and that all leaves a comfortable enough margin over the contemporary increase in the US CPI index. The typical overseas investor also had a forex pick-up of 3% against the majors, an edge which came in just shy of under 8% among America's 'other' trading partners.

In truth, the highly polarised sectoral performance of commodities has arisen, at least in part, from a particularly unfortunate constellation of events—most of them driven by what we have sometimes referred to as 'Contra-preneurs'; namely, our political overlords and the technocrats and pen-pushers who so assiduously serve them to cut our wealth.

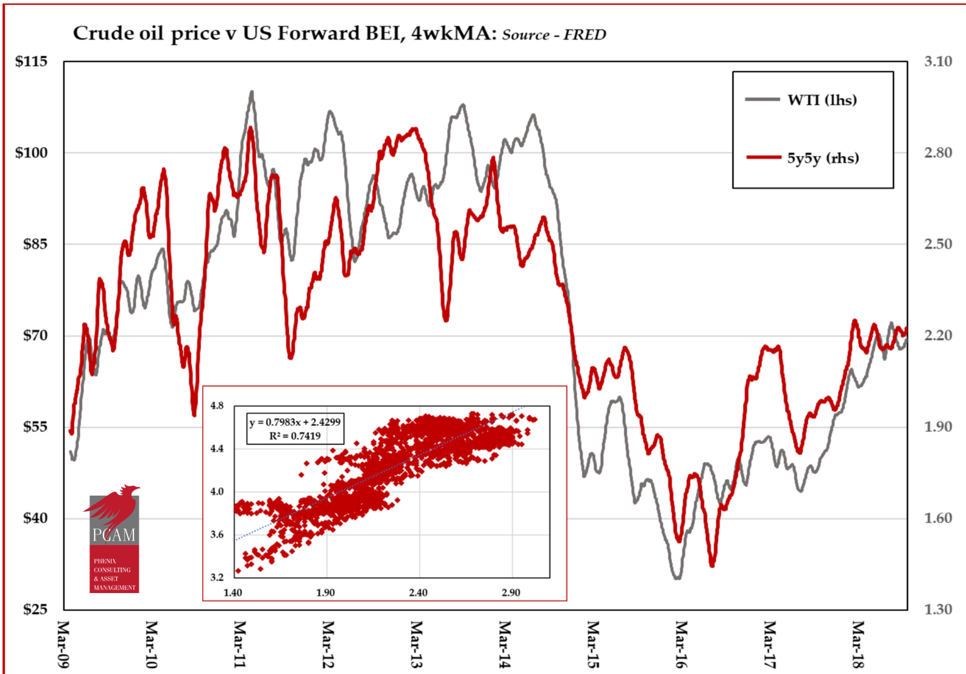






Agricultural prices have been pummelled not only by the technical proficiency of the America's farmers in delivering another set of bumper crops but by the impact of the trade disputes with China. Base metals, too, have suffered—though perhaps more in relation to the effect of that latter nation's turbulent credit markets on the scale of speculative positioning than to any obvious diminution of demand thus far in the real economy. The precious metals have endured their own trail of tears: platinum being depressed by 'Dieselgate' (though now so cheap relative to its petrol-engine competitor, palladium, that surely a shift might be envisaged); gold being disadvantaged by rising US interest rates; silver—well, just being silver.

This has led to one of the strongest gains for energy in terms of the other commodities in the past 15 years (right) and has seemingly put an end to that same period's relative bear market, as we can see top-left. Though again more a question of politically-threatened supply rather than of naturally occurring demand, the one notable feature is the very different impact to be expected on a United States where record exports of coal, natgas, and refined products has set the energy deficit to its lowest in half a century (above).



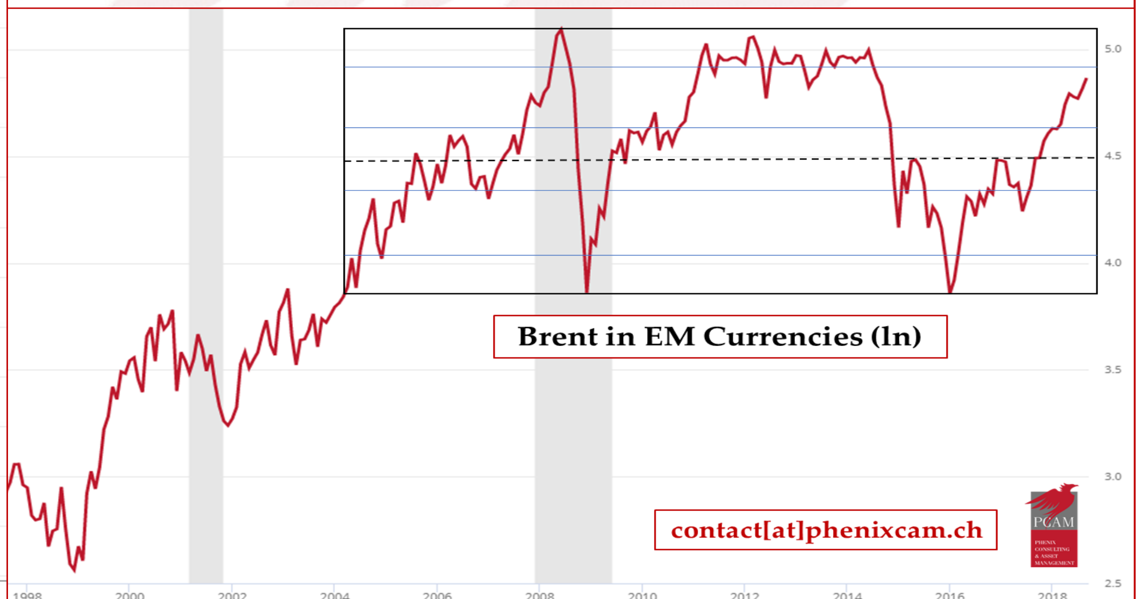
A continuation of the price rises will of course still see winners and losers, but their numbers—if not necessarily the magnitude of the consequences—will be much more balanced within the country's borders, this time around. This can only serve to lessen the pressure on the Administration to act to counter the effects. Such cannot be said to apply to net energy importers elsewhere, for many of whom the stronger dollar in which their oil is priced constitutes an additional source of woe (below). For the biggest of them all, the concurrent fall in the renminbi has pushed the local price of a barrel up by 60% these past twelve months, to hit a 4-year high, while a unit of LNG goes for twice the CNY price of last October. It would be better not to ask about India, given the state of the rupee, its crumbling mountain of bad loans, and the widening current account gap with which its bureaucrats are presently wrestling.

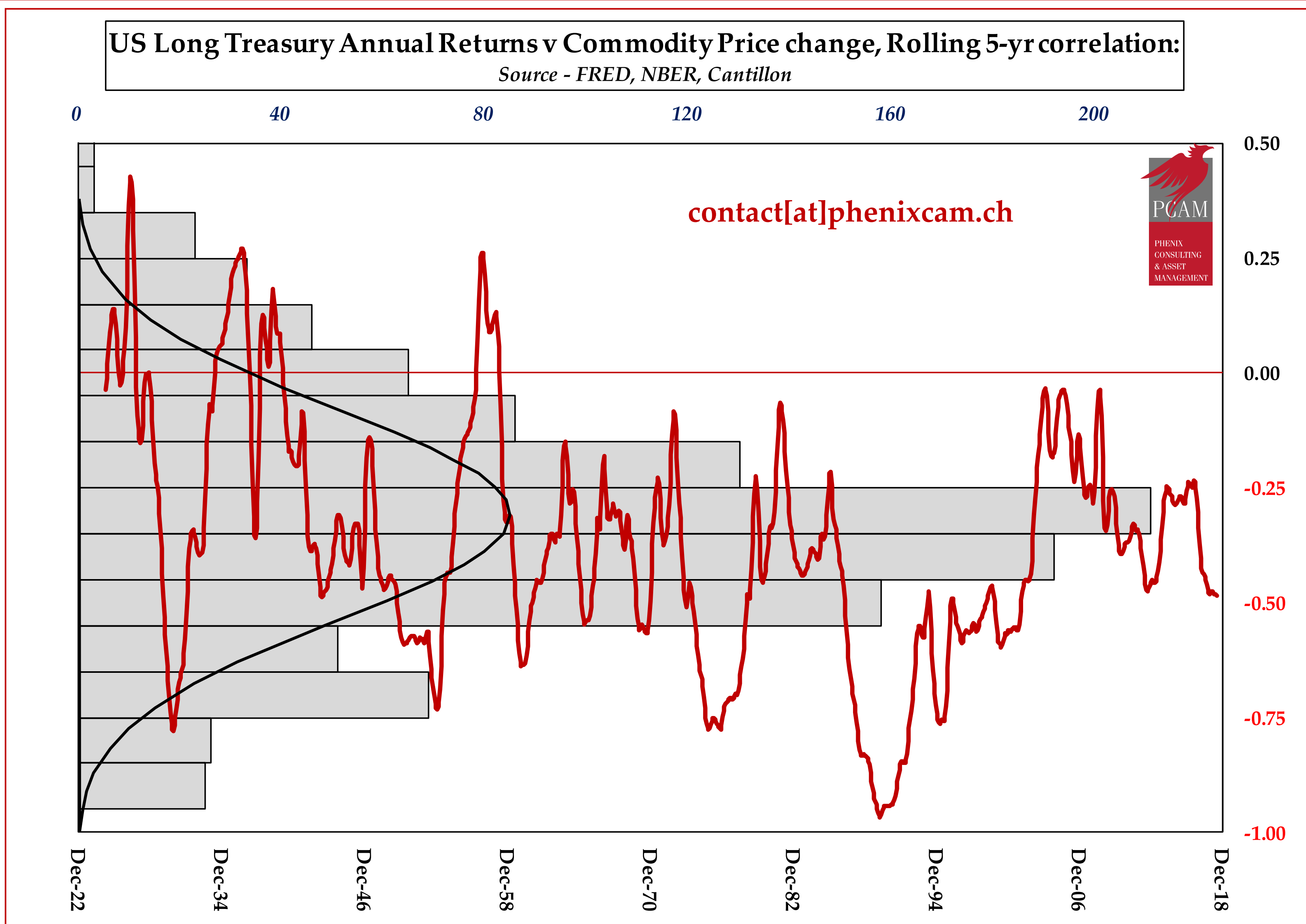
As seen left, the oil price also has direct implications for US monetary policy and, by extension, fixed income markets. At some point that will also begin to exert a drag on equities, too—an asset class already struggling to stay ahead of the black stuff , even where the stocks in question are theoretically its most direct beneficiaries (left lower).

Commodities may yet Trump all the competition in 2018.

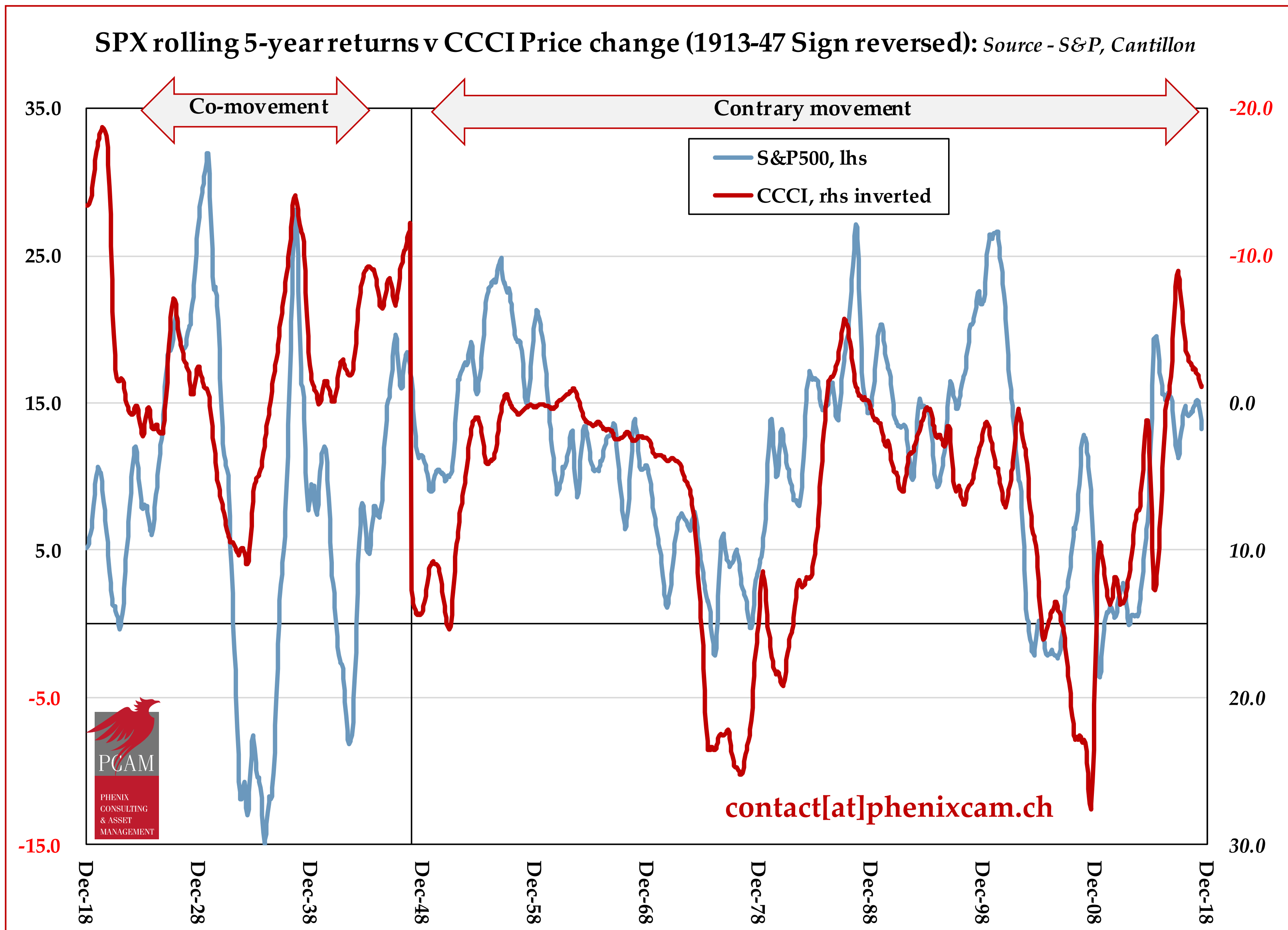
Sean Corrigan

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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