

## Quarterly Commentary – 30th September 2024

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As has become the norm, the third quarter of 2024 saw risk assets reprice higher, but not without the odd bout of volatility to contend with. In fact, risk assets performed so well that to the end of Q3 the S&P 500 has enjoyed its best start to a calendar year since the turn of the century.

Early August did see some volatility as the already thin liquidity at that time of year was strained further when US data soured just as the Bank of Japan hiked rates, leading to an unwind of the ever-popular Yen carry trade. However, this was something of a storm in a teacup; the VIX did see a significant rise, but go even a little out on the term structure and volatility remained relatively subdued. The VIX's use as a barometer for volatility continues to wane. Those who were short gamma did get burned. As ever, when clipping some volatility to pay for protection; buyer beware.

The episode did likely prompt the Federal Reserve to take Jackson Hole as its opportunity to announce a turn in the cycle and pivot away from their inflation mandate, the war having been won (sic), and to employment, which has been weakening in the US for a year or so, as is normal for this stage in the cycle. This turn in the narrative prompted risk assets to resume their rise and at the time of writing, with the first 50 basis point cut in the books, the benchmark index is at a new all-time high.

As a result, the bond market is where the more notable moves have been seen, and where pricing for a while remained far ahead of the Fed's own Summary of Economic Projections. The cuts being priced were suggestive of a full-blown crisis rather than the softest of landings that equities were foretelling. Again, both of the major asset classes cannot be right. It remains to be seen which is.

Commodity markets have until recently been out of vogue for some time within the minds of multi-asset investors. During the quarter, an escalation in tensions in the Middle East not seen for at least twenty years brought them front and centre. Israel's incredible retaliation against another of Iran's proxies in Hizbullah caused Iran to enter the conflict directly, firing missiles directly into Israel. The reaction in energy markets was volatile, but it is important for investors to understand that the world has moved on from the 70s with regards to its resources. Shale has entered, proving unbreakable in the 20-teens, and Saudi have dropped the ball once more over the past 18m ceding market share to OPEC+ members unwilling to stick to their quotas. Before now, taking back that market share would likely have led to oil prices of sub-\$50. As long as the Strait of Hormuz remains open, Saudi are likely to plug any gap in supply that an Israeli strike may cause.

Against that backdrop the Fund returned 1.9% over the quarter. The Fund was launched in April 2024.

### Income

The Fund is fully collateralised by short-dated, high-grade debt. As such, it's liquidity profile extends to the liquidity profile of the Income portfolio. As long as the environment does not return to one in which interest rates are floored at zero, the Income portfolio should continue to provide a base level of return such that the Fund can produce positive returns even when defensively positioned and at its maximum spend on the Protection portfolio.

### Beta

The Fund makes no allocation to the beta portfolio.

### Diversifier

The Fund monetises the premia of commodity carry curve.

Commodity curve strategies are a staple, classic, structural risk premia. Commodities themselves tend to be accessed through futures, most market participants are not taking physical delivery of barrels of oil, tonnes of sugar etc.

Total Return	2024	Q3
UK 100	9.8%	1.8%
US 500	21.7%	5.8%
Europe 50	13.1%	2.4%
Japan 225	14.8%	-3.6%
Hong Kong 50	29.0%	21.5%
US 2000	11.2%	9.3%
Swiss 30	12.8%	1.6%
Global Equity	18.9%	6.4%
Global Bond	7.0%	3.6%
Commodities	1.7%	-0.6%
<b>PGF</b>	<b>5.2%</b>	<b>1.2%</b>
<b>AGF</b>	<b>1.8%</b>	<b>1.0%</b>
<b>DGF</b>	<b>5.1%</b>	<b>1.6%</b>
<b>USI</b>	<b>20.9%</b>	<b>5.8%</b>
<b>ARF</b>	<b>5.3%</b>	<b>1.3%</b>
<b>CARF</b>	<b>-</b>	<b>1.9%</b>

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The shape of the futures curves tend to be upward sloping, or what is known as in contango. The shape also tends to be concave. This shape is driven by:

- A positive cost of storage
- Producers hedging selling futures further out on the curve

Since the term structure is not straight, there are contracts with more negative roll as they move towards expiry than others, allowing a strategy to be constructed that goes short the front of the curve, where the most negative roll tends to reside, and long further out. Crucially, this leaves the strategy insulated from parallel shifts up and down in the term structure. The persistent return is structural, based on the physical make-up of the market and uncorrelated. Incidentally, the premia this Fund earns is that which commodity trackers give away continuously having to roll up the curve to maintain exposure. A good barometer of the premia in action in oil for instance is looking at the long-term return of an 'oil tracker' versus the long-term return of oil spot prices.

The commodity curve strategies were positive during the quarter in spite of the dramatic escalation in geopolitical tensions seen during the period. While short-term mark-to-market is driven by changes in the shape of the futures curves, the premia itself and its returns through time are not driven by the spot price and/or the volatility of the spot price.

Traditionally, it is natural gas that dominates at this time of year as we head into winter in the northern hemisphere and, even in the week during which Iran entered the war itself rather than its traditional participation via proxy, natural gas had a bigger impact on the strategy than oil.

One cannot talk about a commodity strategy without talking about geopolitics, particularly now. However, curve strategies, although susceptible to mark-to-market as any curve strategies are based on shifts in the shape of the term structure, have tended to produce positive returns in all environments. 2022 is a good example; the worlds second biggest crude producer, biggest NG exporter and fourth biggest grain exporter got blacklisted by most of the world, even if the strait of Hormuz was closed there would unlikely be that much disruption to supply. In 2022 commodity curve posted positive returns against that backdrop.

### Protection

The Fund makes no allocation to the Protection portfolio.

### Outlook

Traditionally, winter is the happiest hunting ground for commodity carry curve strategies as the premia available in natural gas is highest. We enter the current winter with levels of storage high relative to longer term averages and the longer term weather forecasts suggesting mild weather on the whole. These are typically good conditions for harvesting premia in gas. Risks remain with regards to oil and any severe supply disruptions. However, the oil market is a very different one compared to the 1970s; shale has entered the fray and proved impossible to kill, and Saudi are desperate to reclaim market share they have lost to OPEC+ members not sticking to their production quotas. Any supply disruption would be temporary with numerous market participants eager to fill the gap without killing price. For Saudi, taking that from Iran would be the perfect crime. It is also worth remembering that commodity carry curve strategies are countercyclical, by nature of nearly half of BCOM being made up by energy and industrial metals, it tends to perform best during a deterioration of economic conditions, it is why it makes for such an effective diversifier.

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