

INTRODUCTION

Short term Crude oil price direction remains unclear

Despite prices below cash extraction costs for many producers, it is difficult to predict the timing and magnitude of the supply response.

RISK LEVELS

Overall levels are now higher than in last six months

We have significant risks in both Oil and Agriculture.

F SHARE CLASS PERFORMANCE*

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD
2014		-0.10%	+0.45%	+0.43%	+1.05%	+0.32%	+0.06%	+4.86%	+2.82%	-3.50%	+1.02%	-0.34%	+7.08%
2015	+1.65%	-0.53%	+1.40%	+0.06%	-0.08%	-4.40%	+1.56%	-0.33%	-1.21%	-0.31%	+0.29%	+0.03%	-2.01%
2016	-0.49%												-0.49%

RETURN PROFILE*

PARAMETER	VALUE
Annualized Return	2.19%
Annualized Standard Deviation	4.92%
Sharpe	0.45
Skewness	-1.32
Max Drawdown	-5.65%
Drawdown Start to End	16 months

LOW CORRELATION*

RISK FACTOR	CORRELATION
S&P 500	11%
VIX S&P 500	-14%
GSCI	-3%
OVX (Oil VIX index)	-14%
HFRX Global Hedge Funds	18%
HFRX Macro / CTA	11%

* All calculations are based on manager estimates based on Returns of F Share Class Net of Fees from 3. February 2014 until last business day of reporting month. For the Table "High quality absolute returns" we use daily returns, except drawdown is calculated on monthly returns and for calculating correlations we use daily returns over five business days overlapping.

OPPORTUNITY

Long Front to Back Crude Oil Volatility

Global crude oil markets are oversupplied leading to growing global stock levels. Many anticipate the imbalance will correct in mid-2016 leading to higher prices. This situation, along with low prices, have led to some interesting volatility opportunities. If one models prices using normality (\$/bbl) rather than lognormality (%-change), one can observe that the market is pricing in roughly the same daily \$/bbl price moves for February and June futures contracts. Namely, the volatility of shorter term options is too low compared to longer term.

CAUSE

A combination of limited producer hedging and a lack of option shorts in the front of the curve along with speculative call long positions further out have led to a volatility curve that prices nearly the same amount of uncertainty per day for the next 2 months as 6 months. Crude oil time spreads normally strengthen with a rally of prices and weaken with lower prices. This results in shorter term contracts moving more than longer term yet the market prices equal movements.

EXPRESSION

We chose to purchase calls and puts symmetric around the futures price (25-delta strangles) in twice the quantity on February 2016 futures versus selling calls and puts of the same strike (straddles) on June 2016 futures in Brent. We chose to be net long gamma and pay time decay as we feel uncertainty is underpriced but remain overall flat volatility. If we experience large moves then we will become longer volatility and gamma as we approach the February strikes. If the market is quiet we do not anticipate a further weakening of February versus June volatility.

RESOLUTION

We will rebalance our delta as the market moves to capture the time decay. We will dynamically trade the front and back option positions based on their relative normal volatility levels to take profit if the front appreciates. Likewise we will add to risk as the levels permit. We believe the trade can work well both in a bearish scenario (containment issues causing the prompt to dislocate), and bullish scenario (producer hedging further out the curve limits backend move).

RECAP

Brent oil prices traded in a wide range in January. Initially we had sold off enough that the contribution to gamma from our prompt options was insignificant leaving us net short June options. We did not like the risk-reward of this structure and restructured as explained in the “Crude Skew” opportunity below. This opportunity generated a negative return and is now closed.

OPPORTUNITY

Crude Skew

Global crude oil markets have been oversupplied leading to growing global stock levels. Many anticipate the imbalance will correct in 2nd half of 2016 leading to higher prices. In January prices made new lows of 26-27 USD/bbl with the fundamental speculative community very short crude oil. This price is close to cash extraction costs for many marginal producers.

CAUSE

In general, speculators looking to express longer term bullishness have driven demand for call options in the 6 month and beyond tenors. Little producer hedging offsetting this flow has led to a large call skew in normal terms as well as high implied volatilities. However, prices have continued lower due to ongoing oversupply without sufficient (as of yet) supply side response (lack of investment, natural declines, etc).

EXPRESSION

We chose to purchase ratio calls spreads with strikes above the market. The positive call skew allows us to achieve a wide range of upside exposure to prices with relatively low upfront premium. Fundamentals suggest a price recovery should be limited and hence we are happy to become short above 50 USD/bbl in the next few months. We express our risk in both Brent and WTI using June 2016 expiry but are investigating other tenors as well. If prices head lower our exposure is limited to the relatively small upfront premium.

RESOLUTION

The scenarios where this opportunity will do well is if we do see a robust supply side response starting to filter through and/or the market experiences a short covering rally. The producer community has capacity to hedge on a rally, but the current size of the spec community short argues for at least an initial imbalance if shorts wants/needs to cover. If no supply response occurs, and/or storage containment issues are experienced, we see further downside as possible. Depending on the timing of such an event we may chose to add to our position for a later recovery.

RECAP

Crude oil prices hit a low in the latter half of the month and we initiated positions as the market was trying to form a base in the 30 USD/bbl region. Into month end prices then rallied sharply and call skew sold off (in normal terms). This opportunity generated a positive return.

OPPORTUNITY

Long Soybean Call Skew (with Short Delta)

Global soybean stocks are ample and projected South American crop sizes are projected to be large. Clarity on policy in Argentina regarding taxation of soybean exports is likely to bring on-farm stored soybeans to market. However, we are in a key growing phase for Argentina which is showing some signs of heat stress.

CAUSE

Overall positioning by managed money is very short on a historical basis. Given the fundamentals this is reasonable. However, the market is pricing higher uncertainty of low strike options (puts) than high strike options (calls). A bullish surprise is very likely to lead to higher price uncertainty.

EXPRESSION

The March component of this trade is re-structured from our unsuccessful volatility long in December. We are net short prices with an overlay of long call options versus short puts - now in both March and May expiry. Overall we are close to flat volatility.

RESOLUTION

We believe the most probable scenario is that Argentinian weather concerns will subside and prices will ultimately go lower in a controlled fashion as farmers sell their developing crops in coming weeks. We did find it compelling to have the long call/short put overlay due to the short positioning and lack of premium to high strike options. An explosive rally will find us taken out of our short price position and long volatility.

RECAP

Soybean prices were very range bound but headed overall higher in January. The result is a loss for this opportunity.

OPPORTUNITY

Short Wheat

By historical standards the wheat balance sheet shows very ample stocks for both the US and the world. US wheat is overpriced relative to FSU and French origins making it difficult to compete in the export market. As a result, wheat is unlikely to rally significantly outside its recent range.

CAUSE

At the end of October we saw Chicago wheat trade towards the higher end of its trading range on the back of continued FSU dryness aided by a large short position in the speculative community as reported by the CFTC. Implied volatility increased with price.

EXPRESSION

We chose to sell high strike call options on March Chicago wheat and buy 1x2 put spreads below the market also in March. We bought more put spreads than we sold calls. In addition to being short the market we benefit from implied volatility dropping with prices.

RESOLUTION

We plan to adjust our overall market exposure proactively as the market reacts to news and position changes, but in general we will wait for prices and implied volatilities to work their way lower over time. We plan to buy our call options back in price weakness and potentially add in price strength.

RECAP

Again, wheat prices were quite range bound with little significant news. We managed the changing delta with time and price by buying and selling futures. Late in the month we exited the position. This opportunity generated a positive return and is now closed.

ABOUT THIS NEWSLETTER

The Tulos Capital newsletter will be presented in a manner consistent with our approach to portfolio construction.

We group our portfolio into a number of independent opportunities. Following an initial comment on risk levels, the focus will be on presenting opportunities as evaluated in our framework. Namely:

- A. Introduction: what is the opportunity?
- B. Cause: why does the opportunity exist?
- C. Expression: how do we best structure our book from a risk reward perspective to capture the opportunity?
- D. Resolution: what time frame or price will resolve the situation?
- E. Recap: what has happened since we entered the trade?

It is not the purpose of this letter to provide detailed background analysis, history of events, or trade structure analysis. The investment team is available to discuss these points on an adhoc basis with investors.

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