COMMONWEALTH LIQUID ALPHA FUND

Commonwealth Bank & Trust Company

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1Q17 PERFORMANCE REVIEW

Commonwealth Liquid Alpha Fund (Liquid Alpha) returned +0.8% in March and is up +1.4% year-to-date through 1Q17, net of all fees. Major drivers included long/short exposures in smaller commodity markets (especially agricultural commodities such as cotton, coffee, and grains), currency trading, long positions in foreign equity indices, and well-timed exposure in the interest rate sector. There were modest changes to the portfolio in 1Q17: Aside from routine allocation rebalancing, we added one short-term tactical manager that provides counter-trend exposure, diversifying Liquid Alpha's strategy mix. Four of the five underlying managers were profitable during the quarter, including our low-cost trendfollowing strategy. This strategy eked out a modest gain on the quarter, underscoring the importance of focusing on "structural alpha," especially when allocating to commoditized strategies. (By "structural alpha" we mean: low fees, low transaction costs, outstanding operational infrastructure and cost effective investment structure.) Generally speaking, non-trend strategies (especially relative value and tactical trading) were most successful in 1Q, while momentum-driven approaches were flat to negative. We anticipate adding one more short-term tactical strategy later this year, in either futures or equities, but this may not occur during 2Q17

PERFORMANCE TABLE

	Jan 2017	Feb 2017	Mar 2017	1Q 2017
Liquid Alpha	-2.08%	2.71%	0.80%	1.43%
SG CTA Index	-1.13%	2.24%	-1.01%	0.10%
S&P 500	1.90%	3.97%	0.12%	5.99%
Barclays Aggregate	0.20%	0.11%	-0.05%	0.26%
50 / 30 / 20 Stock / Bond / Alts	0.56%	2.48%	0.20%	3.24%

On an absolute basis, performance for 1Q17 was somewhat frustrating: while risk-adjusted returns were solid, and at the high end of our long-term target, absolute annualized returns were in the mid-single digits, somewhat below target. This is attributable to low market volatility in 1Q, which impacted Liquid Alpha in two ways. First, we expect our underlying managers to have higher Sharpe Ratios (i.e. risk-adjusted returns) when market volatility is elevated. Volatility has been near historic lows for most of the past year, created a headwind for Liquid Alpha. Second, there is the simple math to deal with: when markets don't move much, then strategies that invest in those markets will also have low volatility. This was the case in 1Q, and as a result Liquid Alpha realized about half its long-run volatility target. One response to this would be to add leverage until realized returns match target returns, and turn a blind eye to risk. Many allocators take this approach. However, as fiduciaries, this is not how we manage client assets. Periodic episodes of extreme low volatility are the price of prudent risk management.

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On a relative basis, Liquid Alpha outperformed its most relevant benchmark, the SG CTA Index, in March and continues to do so both life-to-date and YTD. The benchmark fell -0.8% in March, has gained +0.4% YTD, and is down -2.4% since year-end 2015 when Liquid Alpha launched. Performance also compares favorably, especially on a risk-adjusted basis, to the HFR Global Hedge Fund Index. This theoretically widely-diversified basket of alternative asset managers is up only +1.2% YTD, despite the tailwind of strong positive correlation to global stock markets (which are generally up a lot more). Liquid Alpha is up slightly more than the HFR Index YTD, despite the headwind of negative correlation to stocks. We say "theoretically" because the reality is that while all hedge funds are sold as alpha, many have a heavy beta component. This is the high-fee, low-value-added underperformance we hear bemoaned in myriad publications bashing "hedge funds," including Warren Buffett's most recent annual letter.

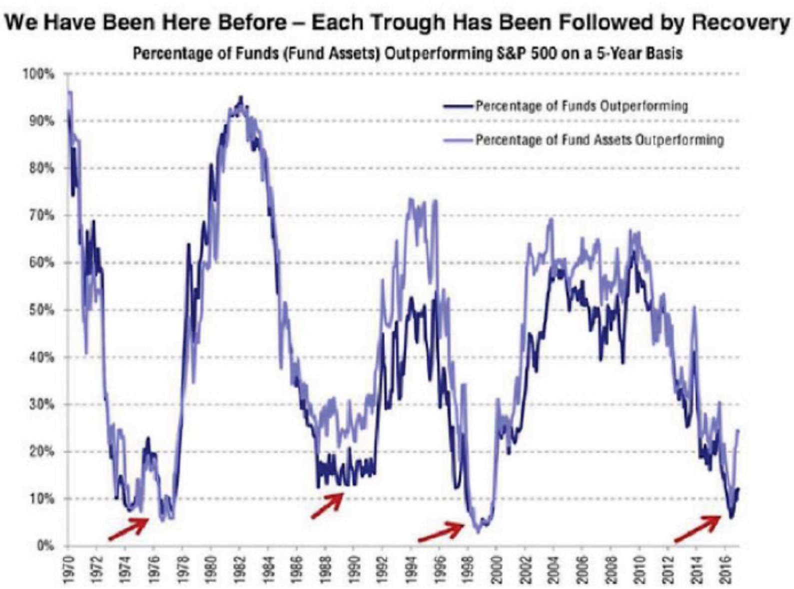
THE GREAT ACTIVE/PASSIVE DEBATE

"When reward is at its pinnacle, risk is near at hand." – John Bogle

More generally, the ire of the financial media and market pundits has been directed not just at hedge funds, but at active investment management in general. The mantra has been, "Why pay fees at all when a simple market index can be purchased essentially for free, and performs better?" To quote the somewhat dizzying logic of index fund pioneer John Bogle of Vanguard: "Investors as a group not only get what we pay for, we get precisely what we don't pay for. So if we pay for nothing, we get everything." True or not, investors seem to have embraced this thinking. Whereas hedge funds as a broad asset class (and hedge funds are very much NOT a broad asset class, but that's a discussion for a future commentary) continue to see net inflows, despite recent underperformance and negative press, the same is not true of actively managed mutual funds. Recent data shows that about $1 billion a day has moved from active to passive management since the Presidential election. As investment fiduciaries, we see firsthand a frantic price war occurring, with the largest global asset managers competing to offer passive market beta exposure at ever-cheaper prices. Warren Buffett tells investors that 90% of their investment portfolio should be in an S&P 500 Index fund and that "the only way an investor can get killed is by high fees or by trying to outsmart the market."

It seems a lot of investors have forgotten something pointed out at a recent luncheon we attended: "when you buy an index fund, no price discovery occurs." An investor is, quite literally, indiscriminately buying all the stocks that comprise that index. And as we have seen in every past, when the buying is indiscriminate on the way up, the selling will be indiscriminate on the way down. Markets are by their nature cyclical, and those cycles are ever-changing. Our fear is that this "low risk, low cost" approach will severely exacerbate the next market downturn, and ultimately prove to have plenty of risk, and plenty of cost. Many investors seem to be blindly increasing their stock market beta at precisely the point in the market cycle when they might be better served by pursuing additional diversification and additional active management.

Outperformance of Active vs. Passive Equity Management is Cyclical



Source: PAAMCO, CRSP, Bloomberg, Robert Shiller data, Instinet Research

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While we find many of the criticisms of active management seem misinformed, we cannot argue with the crux of the complaint: investors aren't well-served by paying high fees for a non-transparent investment that takes the same risks as the stock market, only to then underperform the stock market. Active management is only valuable to the extent that it provides intelligent portfolio diversification. This is why Liquid Alpha focuses on cost effective, absolute return strategies that are uncorrelated to traditional portfolios. It's also why we access these managers via separately managed accounts, providing us with liquidity, transparency, and control.

REVIEWING OUR APPROACH

Even though March was a negative month for the SG CTA Index, which is an equal-weighted index of the largest 20 CTAs (Commodity Trading Advisors) it was a positive month for Liquid Alpha. It's a major mistake for long-term investors to attach significance to small observation windows like a month or a calendar quarter or even a single year, but this month does provide a good opportunity to reiterate the reasons we think our approach to alternatives works, and why we think it will generate superior returns and portfolio diversification over time:

- **LOWER FEES.** Our investors can access high quality, institutional alternatives strategies at a lower all-in fee load than the industry average. The fees we pay managers are also biased towards performance fees (which we only pay if the manager makes money) and away from management fees (which investors have to pay regardless of performance). We are usually happy to pay large dollar amounts of performance fees, because it usually means our managers are performing well. As the Yale Endowment recently pointed out: "What [Warren] Buffett, [Malcolm] Gladwell and other fee bashers miss is that the important metric is net returns, not gross fees."
- **NICHE FOCUS.** Research consistently shows that smaller managers tend to outperform larger ones. Liquid Alpha has a strict focus on differentiated niche managers whose primary goal is generating outstanding risk-adjusted returns. We do not allocate to large, late life cycle managers who are focused on asset gathering at the expense of investor performance.
- **DIVERSIFICATION**. The basic investment management problem is to simultaneously maximize performance and manage risk. We believe diversification across multiple strategy types, themselves structurally uncorrelated to both stocks and bonds, is the best way to maximize risk-adjusted returns for client portfolios. We dive into this differentiator, and why it makes Liquid Alpha valuable, below.

Liquid Alpha allocates primarily to managed futures strategies, because this is the sub-category of alternative asset manager that has historically been most complementary to traditional stock/bond portfolios. This is evident from analysis going back decades, and was especially evident during the 2008 Financial Crisis. The majority of managed futures strategies are trendfollowing in nature (i.e. their portfolio positioning is designed to follow market trends) and medium- to long-term in holding period (typically understood in this sense to mean 1 to 4 month holding periods, on average). As one might suspect, this concentration to a specific frequency and a specific trading style means that they perform very well when there are very strong trends over periods of 30 days or more (see: the first 6 weeks of 2016) but struggle when market are more choppy (see: 2Q16 or March 2017).

Liquid Alpha seeks additional diversification in four important ways:

- **STRATEGY MIX.** Along with momentum, Liquid Alpha has exposure to other market effects, like value and carry, which are typically referred to in academia as "risk factors" or "exotic betas," as well as more capacity-constrained market anomalies that we believe qualify as true uncorrelated investment alpha. Our broad mix of approaches will likely mean underperformance when the average trendfollower goes on a large performance run. But over a market cycle it should also mean steadier results and higher compound returns.
- **TIME FRAME MIX.** Along with the intermediate- to long-term holding period that is the focus for most managed futures strategies, Liquid Alpha has exposure to strategies that are much more short-term in nature (under 10 day average holding period) and longer-term than most of the industry (over 1 year average hold).
- **MARKET MIX.** Many large trendfollowing managers optimize their strategies to handle enormous investment capacity, in the $20B+ range. As a result, they are only able to trade the largest 50-70 futures markets in the world, and are forced

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to concentrate on the very biggest, usually bond futures like the US 10-year Treasury. Because Liquid Alpha focuses on niche managers, whose focus is performance as opposed to capacity, our investors are able to access several hundred futures markets. Many of these additional markets are smaller commodity markets (e.g. agricultural commodities) or equity indices in non-G-7 countries (e.g. India or Brazil) that are inherently diversifying, but inaccessible to very large managers.

- **PORTFOLIO CONSTRUCTION.** Knowing that a clear-cut trend exists in a given market is easy to do. Knowing how to combine many trading signals of differing strength into a coherent and risk-managed portfolio is hard. Modern portfolio theory, as described by Harry Markowitz in the 1950s, gave investors optimization tools to help build such portfolios. But these tools have limitations and pitfalls. Used carelessly, they can actually exacerbate real-world market risk. They have also evolved and adapted quite radically over the past 60+ years. Managers utilize all different methods of construction portfolios, from the sublime to the ridiculous (or as Spinal Tap might say, from the stupid to the clever), and the distinction between the two is not always obvious. The devil is in the details. Liquid Alpha focuses on managers that exhaustive diligence has shown to use portfolio construction techniques that are differentiated and smart.

Using March as an example, while the fund entered the month quite long global equity indices and slightly long oil, similar to the typical CTA, these exposures were complemented with many other opportunistic and non-directional positions across currency and commodity markets. Additionally, Liquid Alpha did not hold the monolithic fixed income short that it seemed many CTAs held during the quarter, in the face of a Fed rate hike. Moreover, all of these positions were driven by a more diverse set of market drivers: value, carry, short term technical signals, seasonal factors, etc. In short, Liquid Alpha's exposures were more nuanced and flexible, and also looked less like the stock market. We think the factors above explain why Liquid Alpha tends to hold portfolios that are more diversified and therefore lower risk than the average alternative asset manager, and in turn why the fund has consistently outperformed. This, along with unique manager sourcing and a cost effective structure, constitutes our edge. We believe that future market environments, which may look like something other than "clear cut" bull markets for stocks, will serve to further highlight this advantage.