COMMONWEALTH LIQUID ALPHA FUND

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1Q18 PERFORMANCE REVIEW

Commonwealth Liquid Alpha Fund ("Liquid Alpha") returned -0.06% in 1Q18 net of all fees and expenses. The fund continues to outperform the (non-investable) benchmark SG CTA Index, which returned -2.89% for the quarter. Performance also compared favorably to the largest comparable mutual fund strategy, which was down over 3%. The broad stock and bond indices also lost ground last quarter, as the S&P 500 fell -0.76% on a total return basis, and the Barclays Aggregate dropped -1.46%.

In the year-end letter in January, we wrote:

> *"While it may take time to percolate through the system, we believe that the reversal of the Fed's near-decade long policy of liquidity provision, the slowing of ECB bond-buying, and the reduction in Chinese fixed asset investment together represent a three-pronged attack that will likely lead to less complacent, more volatile, and more divergent markets."*

We can't take much credit for clairvoyance, as at least parts of this statement have been credibly advanced by many market commentators since the Fed started raising rates in 2015. However it took only a few weeks from that writing for equity markets to make what we believe was a Gestalt shift. Throughout 2017, markets behaved in a historically placid manner, steadily clipping off positive days and weeks like clockwork. The S&P 500 rose in all 12 calendar months (first time ever). S&P 500 volatility dropped to historic lows (monthly annualized volatility below 5%, or about one-third of long-term averages). And credit spreads fell to the tightest levels in over a decade (in Europe, they tightened to the narrowest levels ever). This quiet euphoria persisted into January, but quickly evaporated in early February when the S&P 500 fell over 6% in 2 days.

A Gestalt shift doesn't just mean an incremental informational change (e.g. "S&P 500 earnings expectations have been revised 5% higher, so the market has 5% more upside than we thought") or evolution of thought ("maybe the market deserves to trade at a 20x earnings multiple, given the level of interest rates, so it has 10% upside") but a wholesale reversal in psychology and perception. The term describes the phenomenon when one's interpretation of his experience changes from one thing to something qualitatively different. A classic example is the drawing to the right. Do you see a chalice? Or do you see two faces looking at one another? Both interpretations are equally true, but the human mind can only process one at a time: We see the drawing as an either/or proposition, and there is an "ah-ha moment" when we shift from one perception to the other.

Similarly, markets tend to focus on one set of perceptions at a time. Stocks climbed the proverbial wall of worry in 2017, ignoring a Fed tightening cycle, the forthcoming reversal of QE in Europe, a sea change in Chinese leadership, and Trump's Smoot-Hawley redux of trade war saber-rattling. A Goldilocks environment persisted (which is by no means unusual late in the cycle when the yield curve is flattening but still positively sloped). Global synchronized growth was ongoing (but showed little risk of overheating and prompting a Fed policy error), tax cuts were imminent and earnings would soar as a result, interest rates were still low, and America finally had a U.S. President who was staunchly pro-business, leading to historically strong consumer sentiment and small business optimism.

But volatility is mean-reverting. In late January and early February, market participants underwent the Gestalt shift, going from focusing on one set of realities to the other, from the chalice to the faces, as it were. Instead of Goldilocks, according to Odey Asset Management's Tim Bond, the fear became "an inverted Goldilocks scenario, growth… too hot for current policy settings and too cold for highly valued cyclical asset prices." All of the bullish data points listed above are (nearly) as true now as they were last year: the US Administration is still pro-business, broadly speaking (though trade war risks have risen of late). Interest rates are still low, relative to history. Earnings growth is still projected to be strong, and earnings continue to be revised higher. But empirically speaking, there seems to have been a regime change. In 2017, there were only eight days on which the S&P 500 closed up or down more than 1%.

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In 1Q18, there were 23 such days, putting the market on pace to move by 1% in nearly half of trading days in 2018. That is a Gestalt shift.

Like many market participants, Liquid Alpha was not ideally positioned for a wholesale market reversal. However, a hallmark of systematic investment processes is their adaptability. Our underlying managers were able to quickly reposition portfolios, reduce risk, and take advantage of market opportunities, resulting in an ostensibly flat quarter net of fees (positive on a gross basis). As a result, the fund outperformed both the most relevant benchmark and largest comparable fund, as well as the broad stock and bond markets. While Liquid Alpha is not designed to act as a perfect hedge for equity market beta, the strategy does purposefully have the potential to generate "crisis alpha" in persistently turbulent markets. It's worth noting that in the last 6 weeks of the quarter, when the S&P 500 fell -3.3%, Liquid Alpha gained 2.6%.

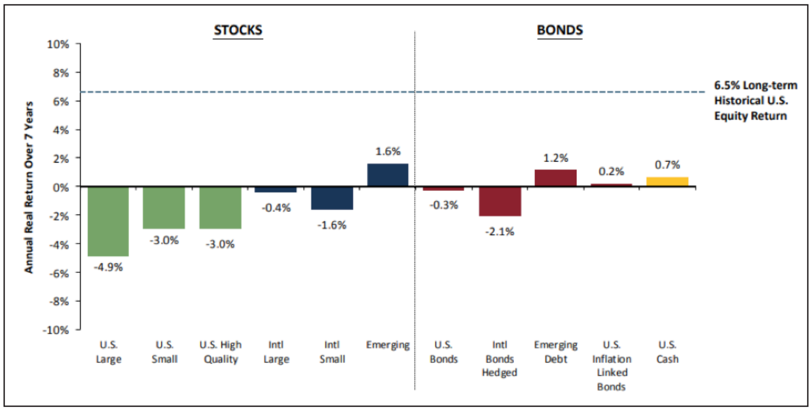
	1Q 2018	Since Inception (Jan 2016)	Sharpe Ratio (LTD)
Liquid Alpha	-0.06%	0.12%	0.01
SG CTA Index	-2.89%	-2.81%	-0.13
AQR Managed Futures (AQMIX)	-3.19%	-6.70%	-0.28
S&P 500	-0.76%	31.40%	1.59
Barclays Aggregate	-1.46%	4.71%	0.72
50 / 30 / 20 Stock / Bond / Alts	-0.58%	16.65%	1.56

Source: Morningstar, CBandT estimates

It's also important to point out that a shift in volatility and correlation regime need not necessitate a bear market in stocks. The yield curve has not yet inverted (typically a harbinger of recessions and bear markets). While the global economy has decelerated this year, it is still growing, and still unlikely to enter recession in 2018. As a result, our view continues to be that U.S. equities are unlikely to enter a prolonged bear market this year and, given recent weakness, we see decent (high single digit) upside to the market as a whole in the next 12 months, and significantly more upside to a number of out-of-favor individual stocks. But the market regime has unequivocally shifted. Volatility and uncertainty are higher. Future expected returns in stocks and bonds remain well below long-term historical averages. Therefore, capital allocators would be prudent to position themselves for this new reality. One way to do this is to lower overall portfolio risk by increasing exposure to market-neutral and risk-mitigating strategies such as Liquid Alpha.

On a related note, please recall that the Liquid Alpha strategy, which was previously only available to CB&T trust clients, is now available in a Limited Partnership (LP) structure with the same liquidity and investment terms. This allows both qualified CB&T clients who hold assets in agency or retirement accounts, as well as qualified investors who are not currently clients of the firm, to access the strategy. If you have questions about Liquid Alpha and how it works to mitigate risk and enhance return in your portfolio, please don't hesitate to contact us.

7-Year Asset Class Real Return Forecasts



Source: GMO (U.S. inflation is assumed to mean revert to 2.2% over 15 years)

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2Q18 OUTLOOK

Markets are certain to experience many gyrations this year based on the perceived pace of Fed tightening and ECB action. Will Jay Powell hike two or three more times? Or more?? Will the ECB end its QE program earlier or later than they have previously signaled? What about the Bank of Japan? And China? While these smoke signals are sure to provide both risk and opportunity for short-term traders (and Liquid Alpha is invested with a couple), for asset allocators with long time horizons such as ourselves, the bigger picture is clear: The remainder of 2018 will see the global economy and global markets navigate the first rising rate environment since 2004-07. LIBOR, the rate to which most private credit is tied, has been on a methodical grind higher since last Fall. Many market commentators directly link the volatility that emerged in late January and early February to this rising cost of capital. While liquidity remains ample and the demand for high yield paper relatively strong, the fact is that rates are higher and continue to rise. Investments that might have made sense even two months ago when credit spreads, and therefore borrowing costs, were at all time tight levels are certainly less economical now.

12-Month London Interbank Offered Rate (LIBOR), based on US Dollar

Source: FRED, ICE Benchmark Administration Limited (IBA)

As we have noted previously, this may or may not lead to a re-rating of equity market multiples (in theory it should), and Liquid Alpha currently has little directional bias in the US equity markets. Nevertheless, these conditions should mean higher volatility and dispersion among assets classes and markets. We have already seen this occur over the past 4-6 weeks: The average daily range in the S&P 500 in 2017 was 0.6%; in January it was 0.7%; since February 1 it is nearly 2%. This macro backdrop enhances the opportunity set for relative value and market-neutral strategies, and we are tilting our portfolio to take advantage of this.

With Liquid Alpha, we continue to offer what we believe is a unique value proposition for trust and wealth clients: a rules-based asset allocation approach, making investments across every liquid global aset class, accessing best-in-breed managers while harnessing structural alphas (in the form of reduced fees and transaction costs) that, when added to a traditional 60/40 portfolio, increases returns and significantly reduces volatility. Thank you for your support and best of luck in the remainder of 2018.

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