COMMONWEALTH LIQUID ALPHA FUND

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3Q18 PERFORMANCE REVIEW

Commonwealth Liquid Alpha Fund ("Liquid Alpha") returned -2.67% in 3Q18 net of all fees and expenses, and returned 1.12% YTD through September 30. The fund underperformed the benchmark SG CTA Index during the quarter, but continues to outperform both year-to-date and inception-to-date. The index returned 1.30% for the quarter and is down -3.46% YTD. Liquid Alpha also lagged the largest comparable mutual fund strategy, which gained 2.8% on the quarter, but continues to outperform that fund both YTD and ITD, as that mutual fund has lost about 6.5% YTD through September 30.

This was an unexciting quarter for global macro and managed futures strategies in general, as they continued to underperform a 60/40 stock/bond or risk parity portfolio. Liquid Alpha's underperformance during 3Q was entirely driven by the fund's exposure to emerging markets. Excluding EM, the fund would have been profitable and outperformed its benchmark on the quarter. The large managers that comprise the benchmark index typically have negligible exposure to these smaller, less liquid markets because they are generally not nimble enough to trade them on a large scale without incurring significant slippage. Liquid Alpha's focus on niche managers means that, for better or worse, we can access these niche markets. Exposure to EM has added to performance both YTD and ITD. However this was not the case in 3Q, as Liquid Alpha came into the month net long emerging market currencies, and was caught wrong-footed when the financial crisis in Turkey led to widespread weakness across EM assets. We continue to believe that active, long/short exposure to a diverse set of tradable instruments, including EM, will be additive to the fund over the long run, as it has been since the fund's launch in 2016. As an aside, EM currency exposure has now moderated and we have ostensibly zero net exposure to the sector. The largest exposure to EM is currently to the Mexican peso, and it represents less than 5% of the fund's overall risk.

	3Q 2018	Since Inception (Jan 2016)	Sharpe Ratio (LTD)
Liquid Alpha	-2.67%	1.30%	0.07
SG CTA Index	1.30%	-3.38%	-0.14
AQR Managed Futures (AQMIX)	2.80%	-6.48%	-0.23
S&P 500	7.55%	41.78%	1.87
Barclays Aggregate	0.02%	4.57%	0.60
50 / 30 / 20 Stock / Bond / Alts	3.10%	21.82%	1.82

Source: Morningstar, CBandT estimates

The best performing markets for the quarter were energy and agricultural commodities, while currencies (especially EM) were the driver of the majority of losses. Trend and value strategies were the biggest losing investment styles. It is not often that these typically complementary strategies align to the downside, but it does happen from time to time. Relative value and tactical trading strategies were profitable. Three of six managers were profitable on the quarter, with the losers meaningfully larger than the winners.

3Q18 continued the second longest performance drought for the global macro and managed futures space since your portfolio manager began allocating to these strategies in 2005. (Currently, it has been 32 months since the SG CTA Index last made a new high water mark.) Many managers in the space have not made new equity highs since late 2014, although 4 of 6 current manager holdings in Liquid Alpha have hit new high-water marks in the past year. It is worth noting that the longest drawdown ended in 2014. After making a new equity high in March 2009 (almost exactly mirroring the stock market), the Index spent 25 months in drawdown, reaching new highs during the European debt crisis in 2011. Then began the longest-ever performance drought, bottoming in the Spring of 2014 with a peak-to-trough drawdown of a little over 12% that took 42 months to go from peak-to-peak. From that nadir, over the ensuing calendar year, the Index went on a 25% performance run, largely driven by significant moves in global interest rates. As in other areas of nature, every drought ends in a rainstorm.

The fact that the past few years have also been marked by the best performance in history for long-only domestic equity investing (at least from a risk-adjusted perspective) has underscored the performance gap relative to diversifying strategies. While recent US equity returns have been exceptionally strong, many investors, in our view, have become anchored to the experience of the past 3-5 years and forgotten the experience of the prior twenty. This kind of recency bias has occurred before and will in all likelihood occur again. In both 2007 and 2013, many allocators made these same comments: managed futures as a strategy was broken, and it was time to abandon it in favor of more "asset-oriented" investment styles. Better to put money to work in commodities (2007), unconstrained fixed income (2013), or private equity (both times). In both cases, reversion to the mean was swift and severe, with 2008 and 2014-15 being two of the best periods on record for managed futures.

Since 1999, the managed futures benchmark has returned about 4% annualized net of fees, and the S&P 500 has returned about

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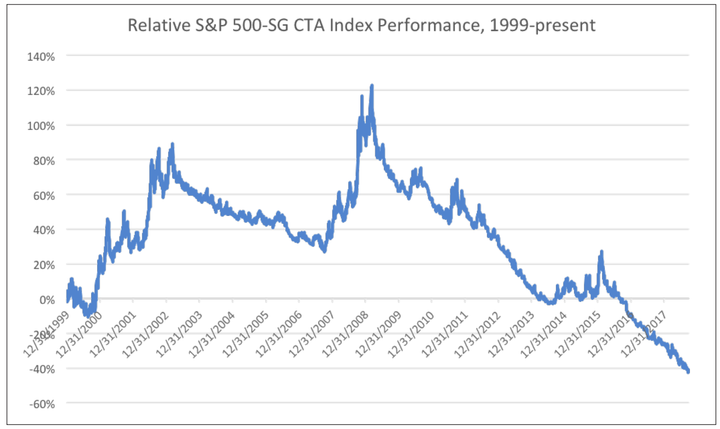
6% annualized. So, if we assume this is the "normal" state of affairs then stocks should gain about 2% a year more than managed futures in an average year. However, since 2014, the S&P has outperformed by about 13% annualized, basically gaining ground in a straight line since the February 2016 stock market lows. It may seem perplexing, given the current state of stock markets, to know that managed futures outperformed the S&P 500 by about 13% annualized from 1999 to 2009, testament to the long-term cyclicality of markets.



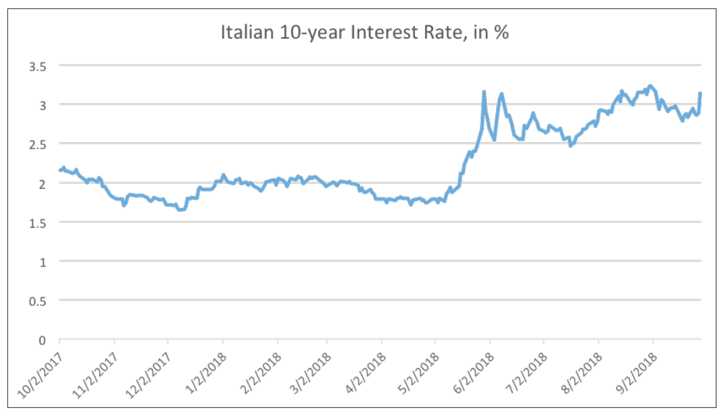
Source: CSI, Societe Generale

While it's possible that this massive relative outperformance will persist, that has not been the case in the past and we doubt it will be the case in the future. The performance-chasing investor who piled into managed futures at the depths of the financial crisis was rewarded with a decade of underperformance versus stocks. Could it be that the performance-chasing investor who follows the current trend and doubles down on the stock market at this point faces the same future? We don't pretend to know. But, as we wrote in last quarter's letter, quoting Peter Bernstein, "diversification is the only rational deployment of our ignorance." We continue to think that investors are best-served by staying disciplined, and maintaining (or increasing) allocations to diversifying strategies, given the macro and valuation backdrop globally.

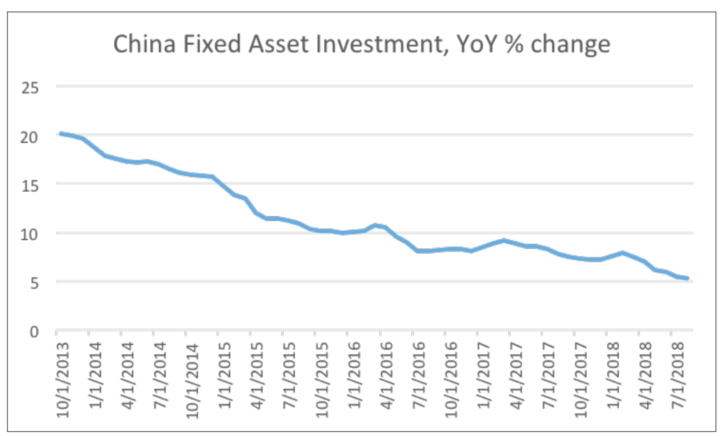
4Q18 OUTLOOK

We wrote last quarter:

> *"Markets have moved from a global asset bull market, characterized by low volatility and little dispersion (think every stock in your portfolio moving quietly, in lockstep), to something less placid. Are we entering a global asset bear market? Certain asset classes, like emerging markets, Italian bonds, and the Euro currency (among other non-USD currencies), certainly do not look healthy."*



These comments hold true as we move toward year-end. The Fed tightening cycle and robust relative economic performance of the US economy have led to a strong US dollar and a breakout in 10-year Treasury yields to the highest levels in 7 years. The US budget deficit has ballooned to its largest level in more than 5 years, so there may be further shoes to drop in terms of bond vigilantism. Emerging markets and "peripheral" economies like Italy continue to be under pressure for this same reason, as the rising dollar and inflation put pressure on their balance sheets. Italian 10-year yields broke to new highs at quarter-end.



In addition to the reversal of the global central bank liquidity tide that has served as a market tailwind since the Financial Crisis, we've previously pointed to China as a macro headwind. Specifically, Xi's focus on structural economic reform and desire to reverse some of the malinvestment that has taken place in

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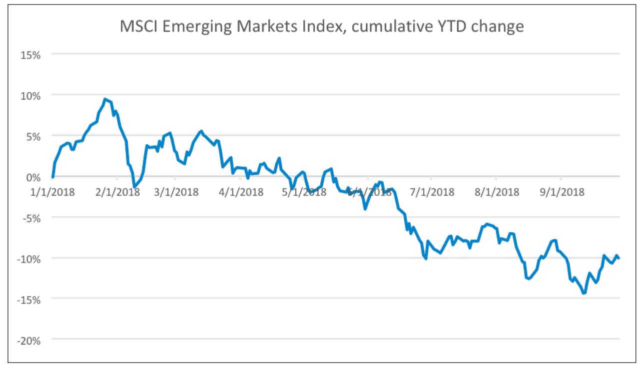
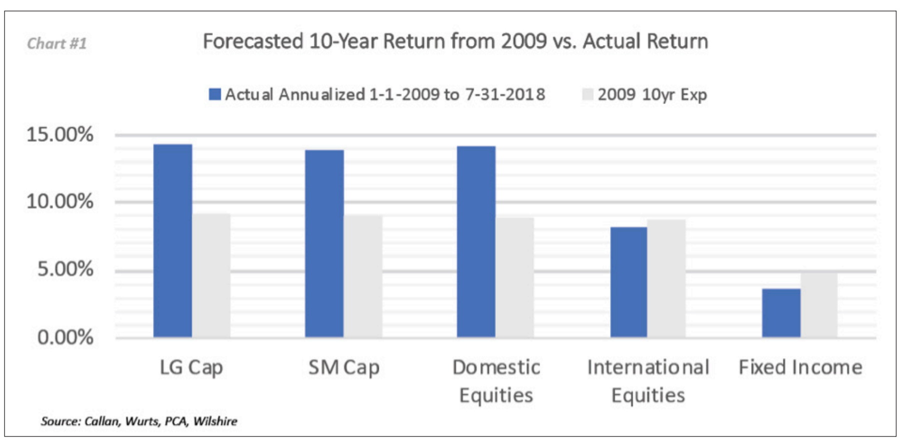
China has led to a slowing of fixed asset investment, which was the driver of economic growth and raw materials demand really ever since China joined the WTO in 2001. This headwind has been steady for the past 5 years, and shows no signs of reversing.



Does this ultimately matter for US markets in Trump's new mercantilist America? We would argue an emphatic "yes." As Tim Bond from Odey Asset Management wrote in a recent research note: "Roughly speaking, China is the destination for about half of all industrial capital equipment and the growth rate for Chinese equipment demand has halved in 18 months." Throw tariffs into the picture, and it's no coincidence that emerging markets (dominated on a relative GDP basis by China) are now in a bear market.

US megacap stocks, an oasis within a turbulent world through 3Q18, finally started to show some cracks, selling off in the first weeks of October. While we do not see massive near-term downside in US equities, we do expect market volatility to move higher as economic uncertainty, be it related to the Fed and inflation or China and trade wars, increases. And while we continue to think that US equities will return 5-10% for FY2018 (as we've been saying since late 2017), the longer-term picture is more troubling. Current valuation levels have historically been associated with negative 10-year subsequent returns for the stock market.

Recent market returns have certainly been better than most experts had predicted. The chart below from Infinity Capital shows the benchmark returns forecasted by four major institutional investment consultants in 2008, and the actual 10-year returns that were realized by those benchmarks.



Clearly, the experts were overly pessimistic when surveyed back in 2008. The question then becomes: is this just an example of cognitive bias due to the doom and gloom market backdrop of 2008? Or is this a case of outperformance "borrowed" from the future, and therefore will have to ultimately be "paid back" with interest?

It's certainly true that most investors tend to be most optimistic at the top and most pessimistic at the bottom. But if that's the case, market positioning and sentiment also imply poor returns for equities over the next decade. Currently, the average investor allocation to equities is over 70%, according to AAII. Historically, this has been associated with future 10-year returns in the low single digits, barely enough to keep up with the current inflation rate.

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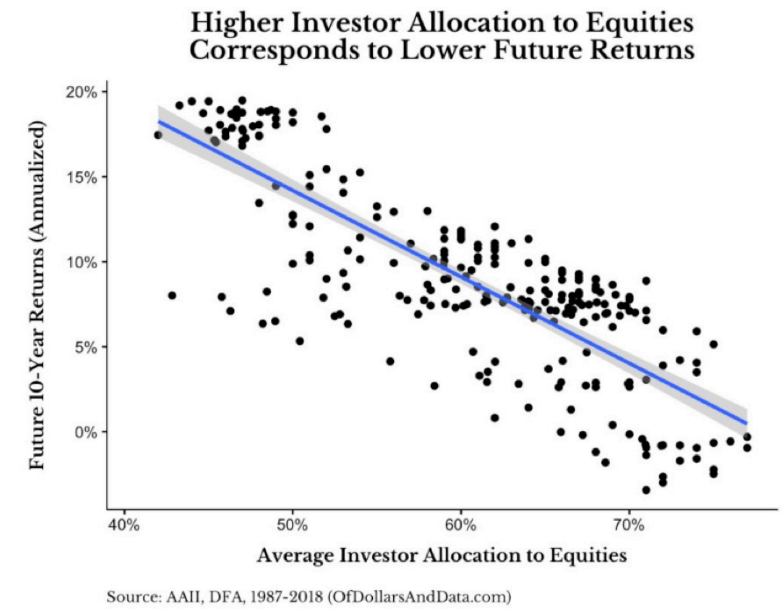

All of the data presented here is admittedly anecdotal, and tells us about what long-term relationships between prices, sentiment, and valuation have looked like in the past. But none of them are very useful for short-term market timing decisions. None of them mean the music can't keep playing for another quarter or another year or even two. And most US economic indicators imply that we are at least 6 months if not a year, at minimum, away from recession. But stocks tend to discount a recession well before backward-looking GDP data tells us we have entered one. Corporate debt to GDP is at an all-time high, as is net debt to EBITDA, even with corporate cash at all-time highs. At this point in the cycle, remaining aggressively overweight equities and ignoring the potential benefit of diversifying strategies is making a bet that "this time is different." Given the turbulence we have seen this year in foreign stock markets, in fixed income markets, and now in US equity markets, we don't think this is a safe bet. We don't know when the next bear market will come, but that's exactly why it makes sense to maintain healthy allocations to both equities and diversifying alternatives. Thank you for your support and best of luck in the remainder of 2018.

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