Liquid Alternative Investments Company
Data * Analytics * Information* Education

Global Macro Strategy Commentary

July, 2014

I. Global Macro Strategy Commentary

A. Strategy Outlook

We are moderately bullish on the global macro strategy for the following reasons:

- U.S. and global economic growth appear to be on a sustainable path
- Interest rate differentials between developed countries will widen as they pursue different monetary policies, presenting opportunities for both carry trades and currency trend positions
- The possible turnaround in interest rates would present an opportunity to short bonds and help the hedge funds that are correctly positioned. Higher U.S. rates would also help the U.S. dollar and thus macro currency plays.

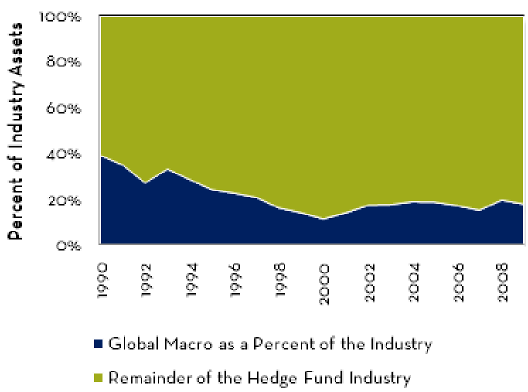
Possible Tail Risk Events

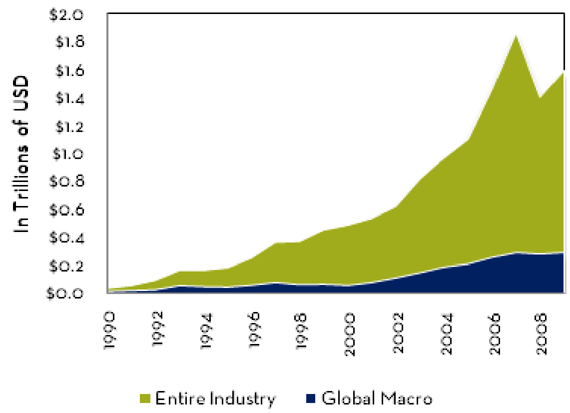
- The continuing unrest in the mid-east, which has spread to Israel and Palestine, could result in a spike in oil prices, threatening global economic growth
- Sudden tightening of monetary policy in the U.S. would also undermine U.S. growth and therefore global growth

B. Overview

1. Private Global Macro Funds

Global macro was the strategy that first brought hedge funds to the attention of the investment community during the 1990s when managers such as George Soros, Paul Tudor Jones, Michael Steinhart and Julian Robertson posted large gains from taking directional positions on currencies, interest rates and commodities. Global macro now accounts for around 8% of the total amount invested in hedge funds and 11% of the amount invested in alternative hedge funds and ETFs. [1]





From the HFR 2009 Global Hedge Fund Industry Report.

2. Liquid Alternative Global Macro Funds

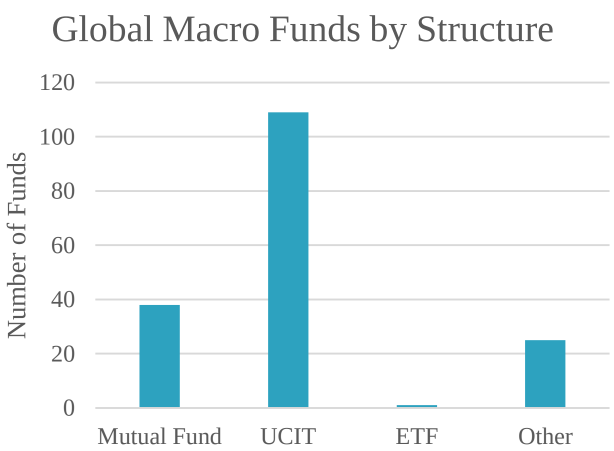
The past few years have seen a dramatic increase in the number of liquid alternative funds implementing global macro discretionary strategies. This growth reflects the downside protection and risk-diversification benefits that liquid global macro funds provided during the 2008 financial crisis as the well as the rapid growth in the liquid alternatives industry as a whole. Common liquid alternative fund structures include primarily U.S. domiciled mutual funds and

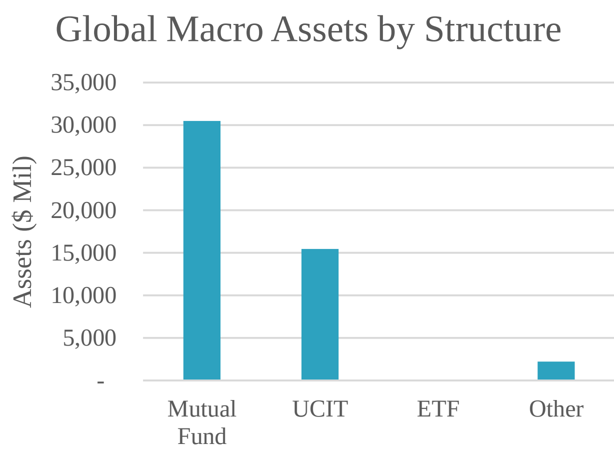
[1] Hedge fund data from: "Hedge Funds An Institutional Look", Commonfund, February 2013. Alternative hedge funds and ETF data from an analysis of the Liquid Alternative Investments, LLC database.

European domiciled UCITS.[2] Global macro is readily adaptable to the increased regulatory and liquidity requirements of these structures. Global macro funds generally invest liquid derivatives and global asset classes and are less reliant on leverage than other hedge fund trading strategies such as relative value arbitrage or merger arbitrage.

The following exhibits provide an overview of the characteristics of liquid global macro funds.[3] Mutual Fund and UCIT structures predominate in this sector, with mutual funds garnering a larger asset base that UCITS. ETFs have thus far failed to gain significant traction.

Global Macro Liquid Funds Landscape

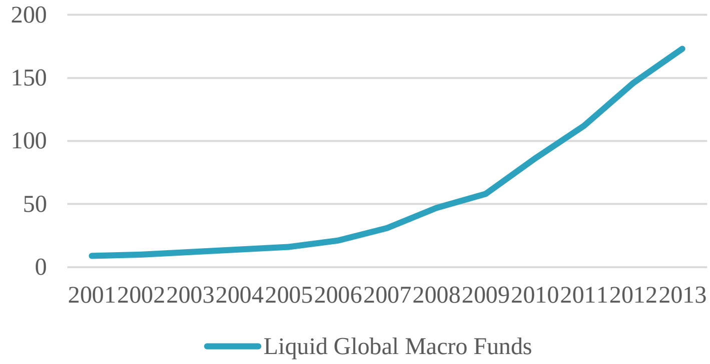




Growth in Liquid Global Macro Funds

[2] UCITs are broadly equivalent and comparable to '40 act funds in the United States. European regulatory authorities impose similar requirements related to maximum leverage, liquidity, asset diversification and eligible securities and assets.

[3] These exhibits draw upon data from the Liquid Alternative Investments, LLC database. Funds were designated as global macro discretionary based upon a quantitative analysis of their historical risk-return characteristics, factor exposures and correlations to traditional assets and a qualitative analysis of fund holdings and disclosures.



Growth in liquid global macro funds has been especially strong in the post-2008 period reflecting their outperformance during the financial crisis as well as the broader uptake of liquid alternative funds.

10 Largest Mutual Funds Implementing Global Macro Discretionary Strategies

Reflecting this rapid growth, 9 of the 12 largest mutual funds implementing global macro strategies were launched subsequent to 2010. Assets under management are also highly concentrated: MainStay MarketField Fund, which has outperformed over the past few years, controls nearly half of the total assets invested in liquid alternative funds. The following exhibit illustrates the high asset concentration in both mutual fund and UCIT structures.[4]

Fund Name	Structure	Fund Assets ($ Mil.)	Company Name

[4] The funds were ranked by assets under management.

Natixis ASG Global Alternatives A	Open-End Mutual Fund	2,854	Natixis Funds Trust II
Scout Unconstrained Bond Instl	Open-End Mutual Fund	2,361	Scout Funds
Loomis Sayles Strategic Alpha Y	Open-End Mutual Fund	1,257	Natixis Funds Trust II
Legg Mason BW Absolute Return Opp I	Open-End Mutual Fund	1,106	Legg Mason Global Asset Management Trust
Eaton Vance Glbl Macro Abs Ret Advtg A	Open-End Mutual Fund	1,056	Eaton Vance Mutual Funds Trust
William Blair Macro Allocation I	Open-End Mutual Fund	670	William Blair Funds
Eaton Vance Rich Bern All Asst Strat A	Open-End Mutual Fund	377	Eaton Vance Growth Trust
MFS Global Alternative Strategy A	Open-End Mutual Fund	329	Mfs Series Trust Xv
Dreyfus Global Real Return A	Open-End Mutual Fund	282	Advantage Funds, Inc.

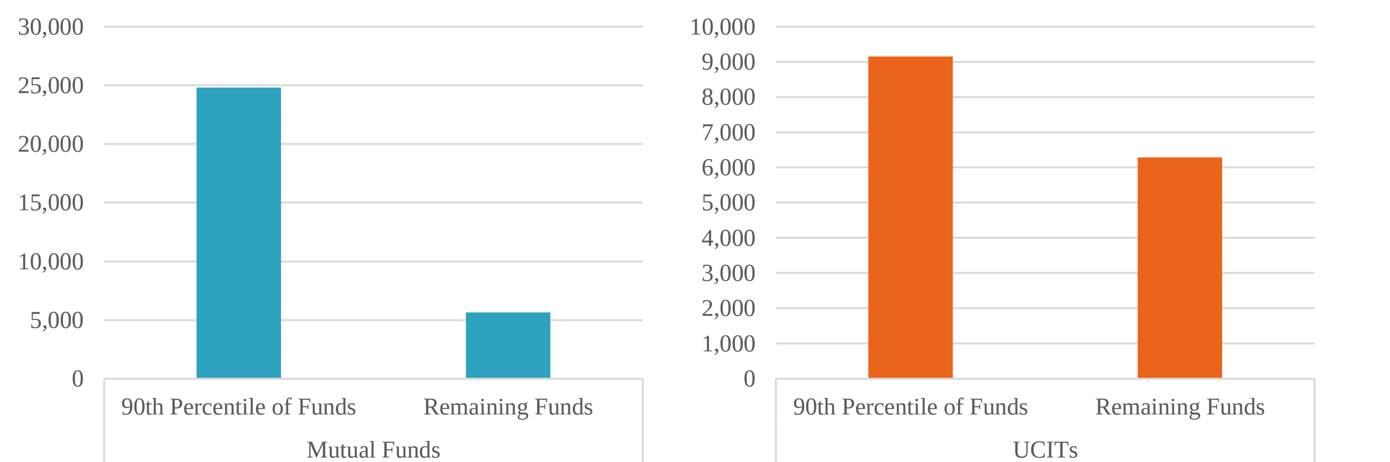
Fund Name	1 Year Annualized Return	1 Year Standard Deviation	1 Year Sharpe Ratio	1 Year Sortino Ratio

Natixis ASG Global Alternatives A	9.4%	5.6%	1.62	2.37
Scout Unconstrained Bond Instl	0.2%	1.8%	-0.08	-0.10
Loomis Sayles Strategic Alpha Y	4.2%	1.7%	2.22	-
Legg Mason BW Absolute Return Opp I	0.6%	4.2%	0.07	0.14
Eaton Vance Glbl Macro Abs Ret Advtg A	1.0%	3.4%	0.20	0.21
William Blair Macro Allocation I	12.1%	6.2%	1.89	8.19
Eaton Vance Rich Bern All Asst Strat A	12.6%	5.5%	2.21	3.37
MFS Global Alternative Strategy A	6.2%	3.2%	1.86	5.32
Dreyfus Global Real Return A	9.5%	4.0%	2.31	7.99
Altegris Macro Strategy A	-7.9%	4.2%	-1.99	-2.84

Fund Name	**3 Year Return**	**3 Year Standard Deviation**	**3 Year Sharpe Ratio**	**3 Year Sortino Ratio**	**5 Year Return**
Natixis ASG Global Alternatives A	4.5%	8.4%	0.48	0.65	5.5%
Scout Unconstrained Bond Instl	-	-	-	-	-
Loomis Sayles Strategic Alpha Y	3.9%	4.9%	0.69	0.71	-
Legg Mason BW Absolute Return Opp I	3.3%	4.2%	0.65	1.13	-

Eaton Vance Glbl Macro Abs Ret Advtg A	1.7%	5.1%	0.23	0.30	-
William Blair Macro Allocation I	-	-	-	-	-
Eaton Vance Rich Bern All Asst Strat A	-	-	-	-	-
MFS Global Alternative Strategy A	8.0%	3.9%	1.91	2.22	7.7%
Dreyfus Global Real Return A	4.1%	5.6%	0.64	0.92	-
Altegris Macro Strategy A	-	-	-	-	-

High Asset Concentration in Liquid Global Macro Funds



C. The Global Macro Strategy

In broad terms, global macro funds take positions in a wide variety of markets based on investment themes developed by analyzing economic, political and financial trends. While most other hedge fund strategies analyze individual securities or a narrow range of securities (i.e., mortgage backed securities), global macro funds may take positions in all the world's major markets: equities, fixed income, currencies and commodities.

Global macro funds are marked for their flexibility and broad-gauged investment guidelines which means that they are able to respond quickly to emerging information and trends and are allowed to use a wide variety of instruments – including derivatives (exchange traded or over-the-counter futures, forwards, options and swaps), indices, individual securities and leverage -- to reflect their views. While global macro may not use much borrowing to leverage their position, they gain leverage through the use of derivatives, which often call for a fraction of the nominal amount in collateral.

Overview of Global Macro Strategy

Markets	**Instruments**	**Economic Factors**	**Financial Markets**	**Strategy Types**
Currencies Commodities Equities Debt	Futures Forwards Options Swaps	Business Cycle GDP Growth Interest rate levels Inflation Unemployment Budget Deficits/Debt Flow of trade Demographic factors	Yield curve shape/Slope Monetary policy Country P/E ratios Corporate Earnings Exchange rates Liquidity Movements in global cash flows	Directional or Momentum Mean Reversion Carry Trades Relative Value Convergence Trades Divergence Trades

Global macro managers vary in terms of the types of strategies they favor (directional, relative value, carry trades), their instruments or choice, markets they follow, amount of leverage they utilize, extent of position turnover and duration, concentration of positions, and the extent to which they take positions based on the use of systematic or quantitative methods versus subjective or discretionary approach. This wide diversity makes it difficult to compare global macro to each other on a one-for-one basis, except to the extent to which a number of them take large positions in similar markets.

D. Types of Global Macro Strategies

Directional or momentum trade: a manager will bet on discrete price movements, such as long US dollar, short gold or long Indian government bonds.

Relative value trades: These consist of pairing a long and short position in similar assets to take advantage of a relative mispricing, with the expectation that the price of the assets will either converge or diverge to their "correct" or anticipated pricing. The strategy attempts to take advantage of temporary deviations of security prices from long-term value or expectations. These deviations may stem from macro-economic news, government actions, trading activity, information asymmetry, or changes in expectations and risk-aversion.

Carry Trades: Another common global macro strategy is to take attempt to take advantage of interest rate differences between two markets or time periods. For example, the yen carry trade (i.e., borrowing Japanese yen through the currency forward market and investing the proceeds in higher yielding currencies, such as the Australian dollar) was widely utilized and resulted in large profits for global macro hedge funds.

E. Risk, Return and Correlation Characteristics of Global Macro Strategies

Global Macro Annual Performance

	Barclay Global Macro Index	LAIGI Aggregate Global Macro Discretionary Index
1997	19.7%	-
1998	12.7%	-
1999	20.2%	-
2000	11.9%	-
2001	6.3%	-
2002	7.1%	-
2003	18.0%	-
2004	3.0%	-
2005	9.4%	-
2006	7.8%	-
2007	11.4%	-
2008	-0.7%	-
2009	7.5%	-
2010	6.7%	6.3%
2011	-3.7%	-1.5%
2012	2.6%	6.7%
2013	4.8%	3.1%
2014 YTD	-0.5%	-0.5%

Global Macro Annual Standard Deviation and Sharpe Ratio

Standard Deviation:	Barclays Global Macro Index	LAIGI Aggregate Global Macro Discretionary Index
1997	10.3%	-
1998	6.7%	-
1999	7.3%	-
2000	8.4%	-
2001	3.6%	-
2002	3.3%	-
2003	5.2%	-
2004	4.3%	-
2005	5.4%	-
2006	6.7%	-
2007	5.7%	-
2008	6.5%	-
2009	5.5%	-
2010	4.7%	8.3%
2011	4.0%	4.9%
2012	3.7%	4.2%
2013	4.1%	3.9%

Sharpe Ratio:	Barclays Global Macro Index	LAIGI Aggregate Global Macro Discretionary Index
1997	1.33	-
1998	1.07	-
1999	2.07	-
2000	0.63	-
2001	-0.15	-
2002	1.02	-
2003	3.07	-
2004	0.37	-
2005	1.32	-
2006	0.56	-
2007	1.06	-
2008	-0.88	-
2009	0.82	-
2010	1.10	0.57
2011	-1.13	-0.61
2012	0.47	1.24
2013	0.93	0.97

LAIGI Aggregate Global Macro Discretionary Index Monthly Performance

	2010	2011	2012	2013	2014
Jan.	-	0.0%	2.3%	1.8%	-1.2%
Feb.	-	1.3%	1.8%	-0.3%	0.6%
Mar.	-	0.2%	-0.1%	0.9%	-0.3%
Apr.	-	1.2%	-0.1%	0.9%	0.1%
May	-	-0.9%	-1.9%	0.0%	0.8%
Jun.	-1.7%	-1.1%	0.3%	-2.3%	-0.5%
Jul.	1.6%	0.0%	1.9%	1.0%	
Aug.	-0.7%	-1.1%	0.8%	-1.2%	
Sep.	3.6%	-2.3%	1.7%	1.0%	
Oct.	1.2%	2.4%	-0.5%	0.9%	
Nov.	0.0%	-2.1%	0.3%	0.1%	
Dec.	2.1%	0.9%	0.2%	0.2%	
Annual	**6.3%**	**-1.5%**	**6.7%**	**3.1%**	**-0.5%**

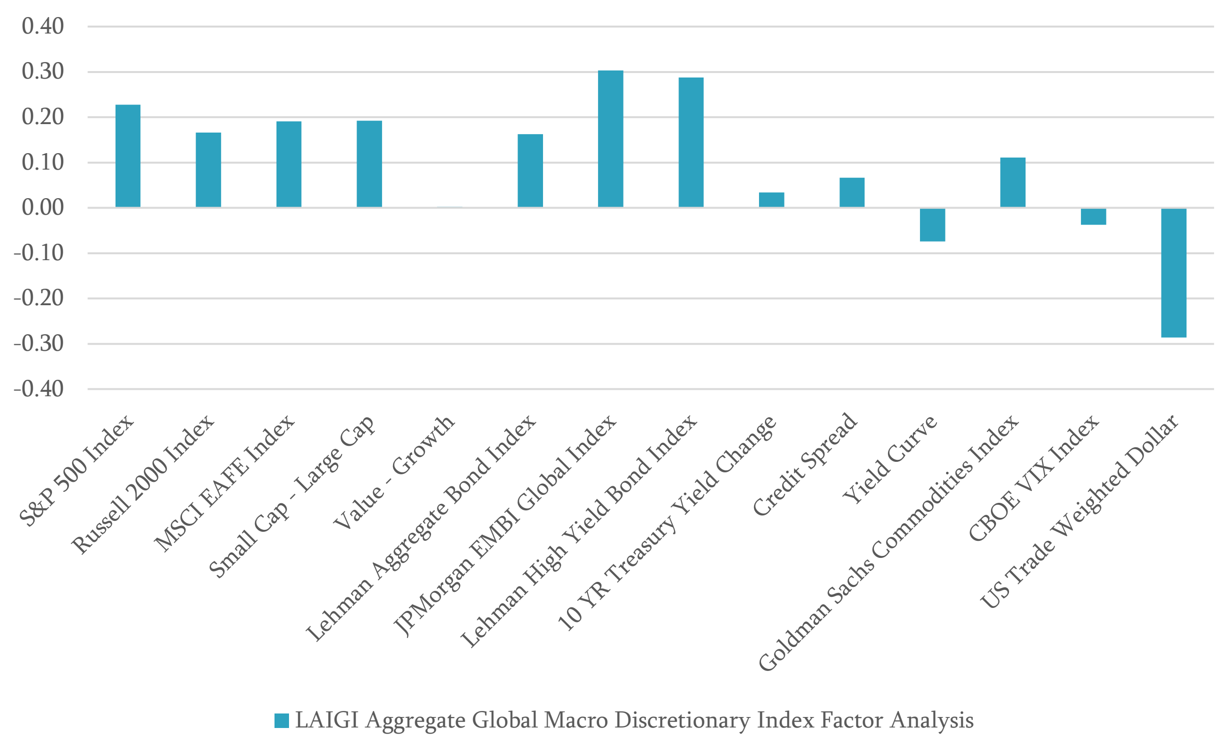
II. Outlook for Global Macro in 2014

A. Drivers of Global Macro Performance

Any trading strategy must needs to react to economic and financial variables. We use a procedure known as "factor analysis" to find correlations between the performance of a strategy and the major economic and financial factors that drive this performance. We find that Global Macro is correlated to the following factors: U.S. and International stock markets, commodities, small cap stocks and high yield bonds. High yield bonds are also a good proxy for emerging market bonds and credit spreads, additional factors that determine global macro performance.

In formulating our outlook for global macro strategies for 2014, we will examine the trends and outlook for these, as well as some macro-economic factors.

Liquid Global Macro Factor Exposures



Factor loadings were computed on returns data from December 2006 to April 2014.

B. 2014 Market Risk Factors

Global macro managers are focused on a number of themes that may affect multiple markets in which they take positions. These include:

- The possibility of a rise in U.S. interest rates [for example to 3-4% on the 10-year Treasury] which would result in large losses for managers that are net long bonds;
- A severe crisis in one or more emerging nations (Brazil, India, Indonesia, South Africa, and Turkey);
- Conflict in the Middle East resulting in disruption of oil supplies;
- a shift in Japan's recent efforts to reflate their economy through low interest rates and fiscal spending (a strategy known as Abenomics);
- the possibility of severe crisis or even a default of a Eurozone country [possibly Greece];
- A marked slowdown in China' economic growth compared to market expectation

1. Is there a global macro asset bubble?

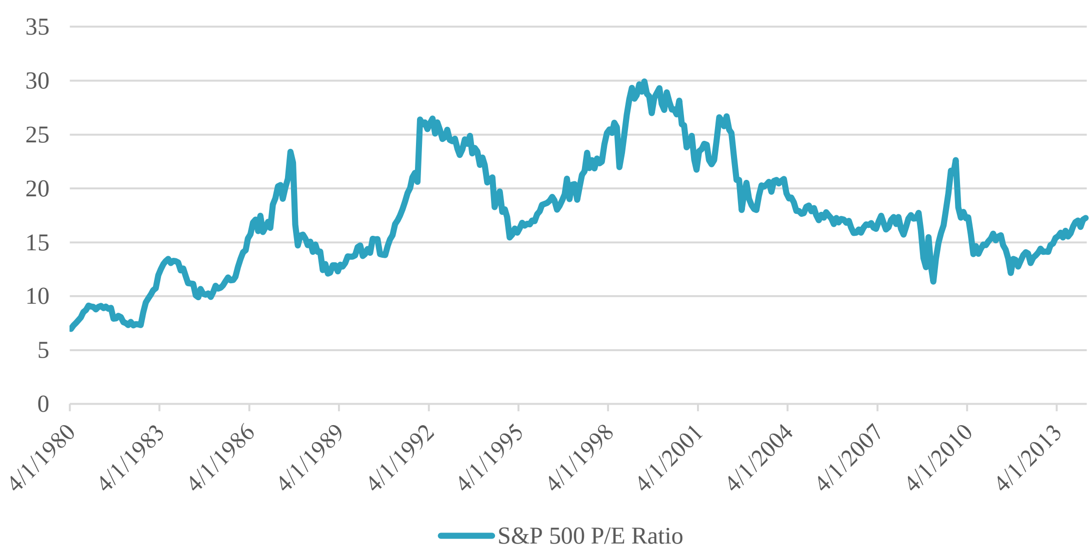
A somewhat more diffuse, but related factor is the possibility that we are in an "asset bubble" in which the rise in asset prices (notably those of stocks and bonds) are a temporary result of lenient monetary policy -- notably in the U.S., the UK and Japan -- rather than economic fundamentals, setting up the possibility of sharp market reversals should monetary authorities reverse these policies. For example, Seth Klarman, head of the Baupost Group, warns of the possibility of central banks reversing their loose-money policies. According to him, "On almost any metric, the US equity market is historically quite expensive. A sceptic would have to be blind not to see bubbles inflating in junk bond issuance, credit quality, and yields, not to mention the nosebleed stock market valuations of fashionable companies like Netflix and Tesla Motor."[5]

Sharp reversal in trends would present both dangers and opportunities for Global Macro managers. If asset prices do decline, some managers will inevitably be caught on the wrong side of the move. However, those that are properly positioned or nimble enough to jump on the reversal could end up doing very well.

C. Equities

The 2013 rally in developed equity markets has greatly undermined the case for the purchase of equities on the grounds of low valuation. However, continued easy monetary policy and moderate economic growth should result in moderate gains from equities in the coming year.

U.S. Equity Historical Price to Earnings Ratio

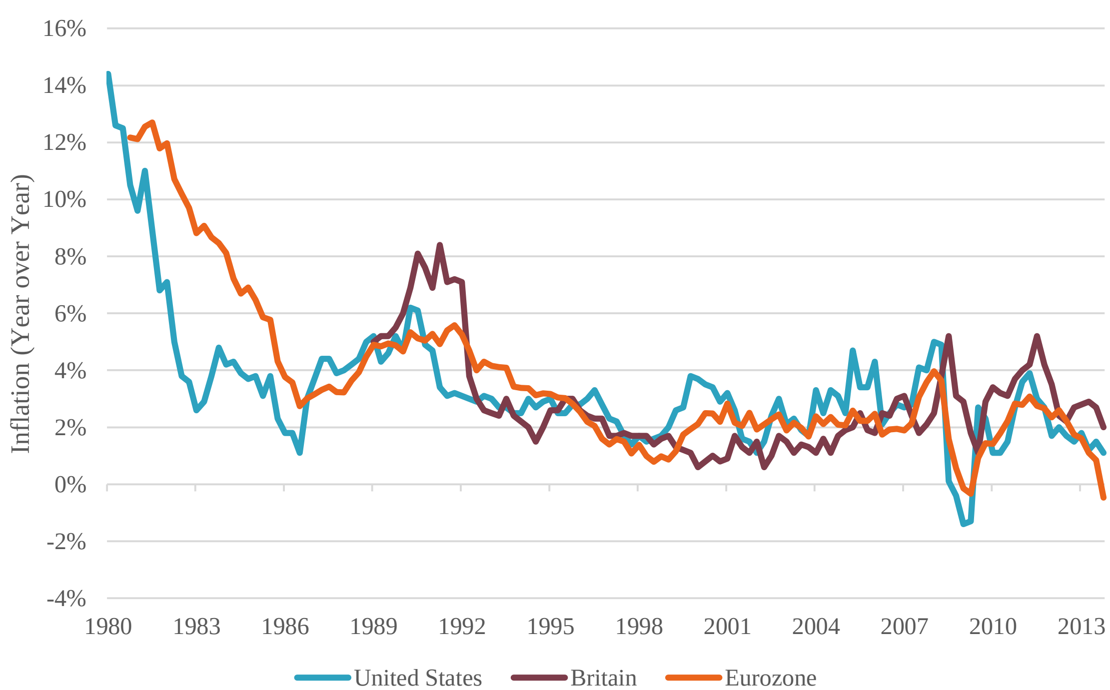


[5] "Seth Klarman warns of impending asset price bubble", The Financial Times, Mar 9, 2014

D. Inflation

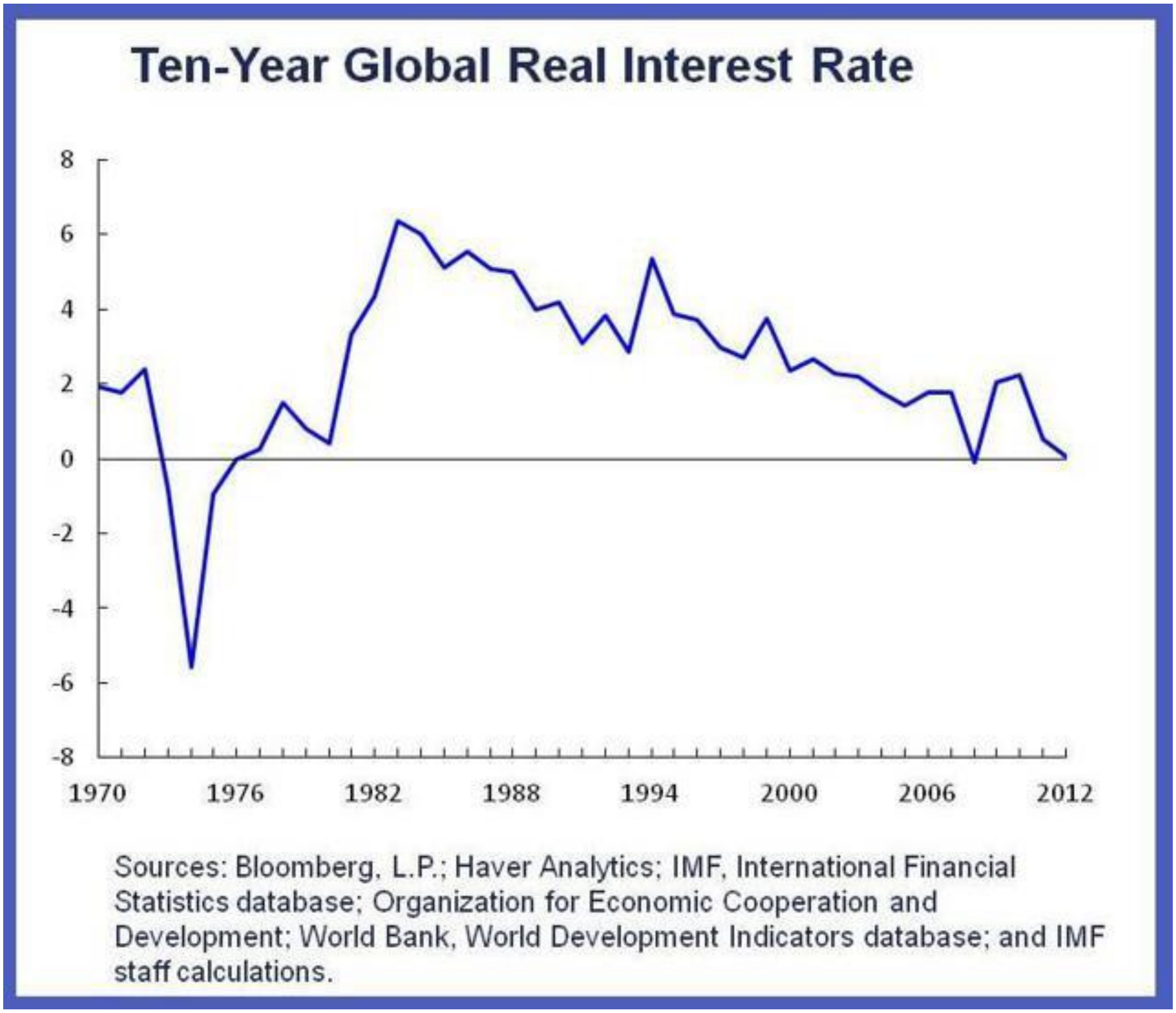
In a recent report, the IMF recently warned G-20 nations of "a new risk stems from very low inflation in the euro area, where long-term inflation expectations might drift down, and raising deflation risks in the event of a serious adverse shock to activity." With the worldwide deleveraging anticipated to continue in the medium-term future, it is unlikely that inflation will re-emerge as a threat. Certainly, central banks (with the exception of Japan – see below) have not acted to increase inflation or inflationary expectations. In fact, the opposite. While most developed country central banks have set inflation targets of around 2% per year. However, since declaring its 2% target the Fed has undershot almost 90% of the time; American inflation is now just 1.2%. Euro-area inflation is 0.7% and falling. In Britain, where above-target inflation was the norm for much of the recovery, consumer prices rose at just 1.7% in the year to February.

Declining Inflation across the Developed World



E. Interest Rates

The recent combination of loose monetary policy and weak economic conditions in advanced economies has result in *real* interest rates globally of around zero in 2012, down from 6 percent in 1983 and around 3% in 2000. As noted above, a modest improvement in global economic growth and some monetary tightening in the U.S. may nudge real interest rates higher, but not to any significant extent.



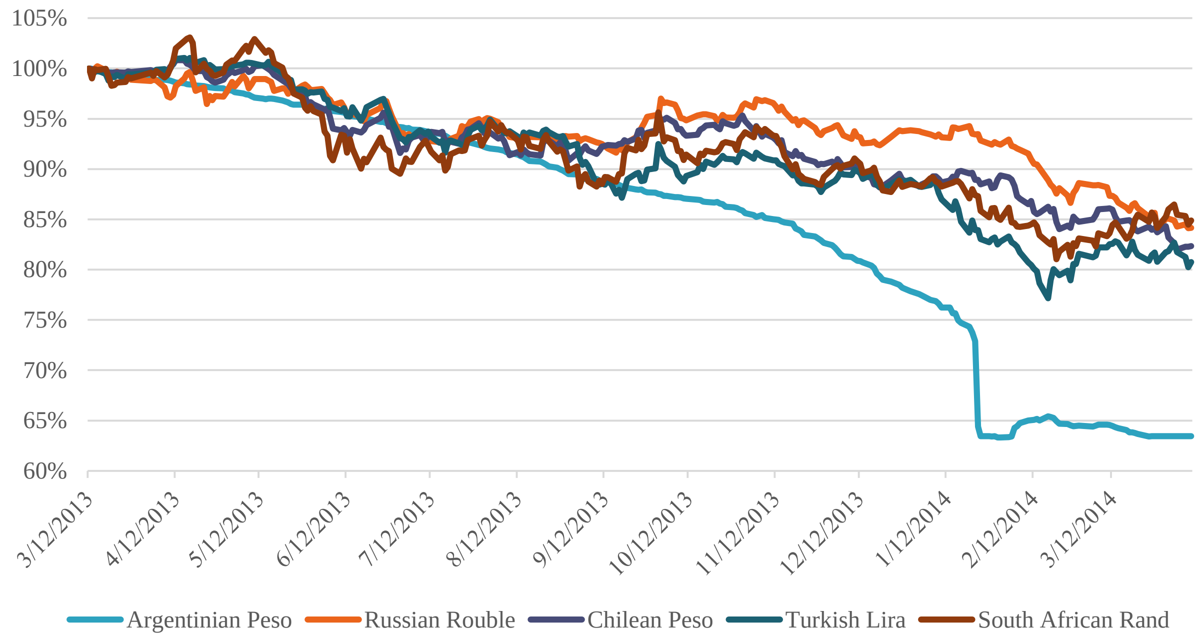
Interest rate policy is essentially caught between the desire to avoid asset bubbles by excessively loose monetary policy and to avoid stifling economic growth by excessively tight policy. A sharp spike in interest rates is unlikely given the slow pace of economic growth and the large debt burden carried by the advanced economy. The recycling of the trade surpluses by China and OPEC, leading to massive purchases of U.S. government bonds, will also continue to keep interest rates in line in the near term.

F. Emerging markets

Emerging markets face a double potential threat in 2014: a slowdown in their economic growth and continued depreciation of their currencies against the U.S. dollar; both will largely depend on global economic growth and interest rate trends.

A sharp distinction needs to be drawn between emerging nations that require external funding, and are thus vulnerable to increased interest rates and economic slowdown, as well as the adverse effect on their debt caused by the devaluation of their currencies. However, export gains following currency devaluation may result in gains in their equity markets if economic growth picks up.

Exchange Rate against US Dollar

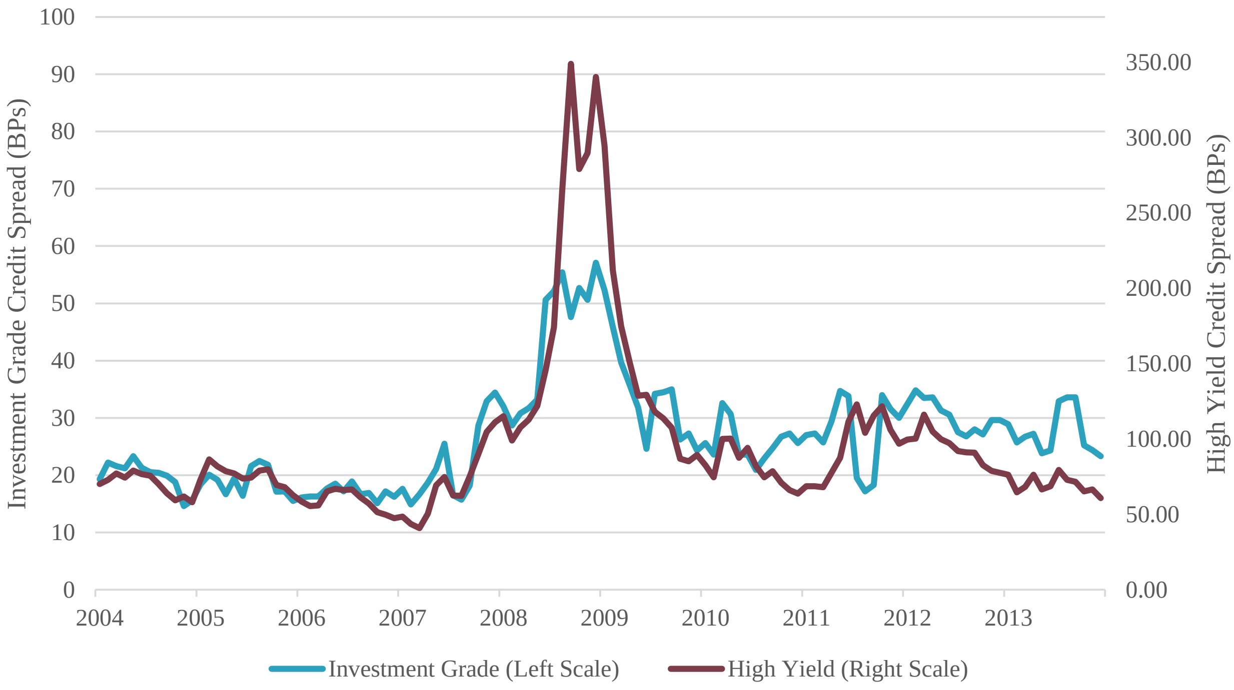


On the other hand, creditor countries have been showing moderate growth and stable monetary and fiscal policies, which may result in currency depreciation. Combined with higher interest rates than in advanced economies, these currencies may present an opportunity for profitable carry trades.

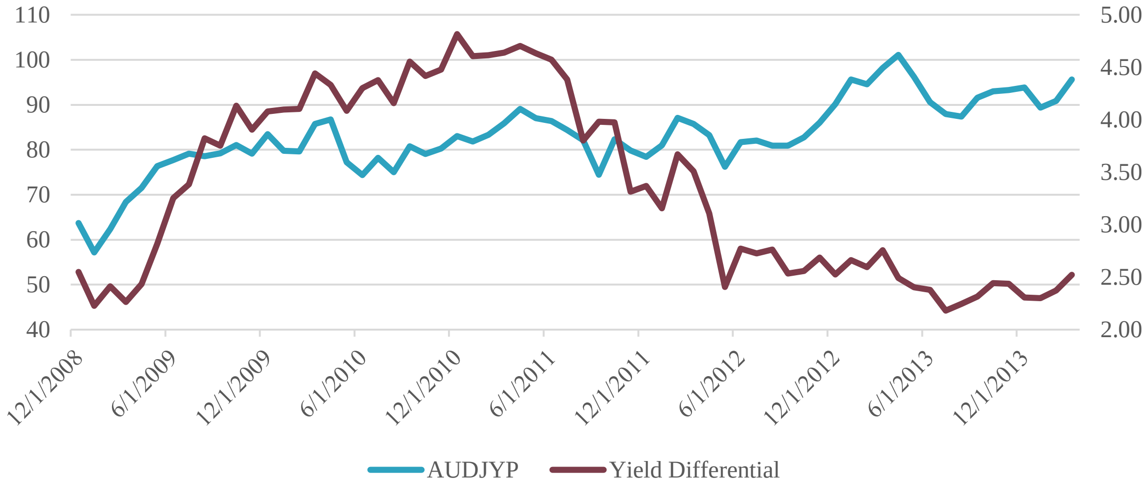
G. Credit Spreads and Carry Trades

Credit spreads and carry trades work best when a wide interest rate differential exists between the investment and hedge positions and the instruments are relatively stable (or at least not trending against the position). The profitability of these trades often comes down to whether the interest rate differential is sufficient to cover the risk of possible currency losses. As shown below, the global tightening of spreads has greatly reduced the available interest rate "buffer" available for carry trades. Nonetheless, the reach for yield has tempted hedge funds to pursue carry trades, albeit at higher leverage to compensate for the smaller spreads.

Credit Spreads



Expensive Carry Trade

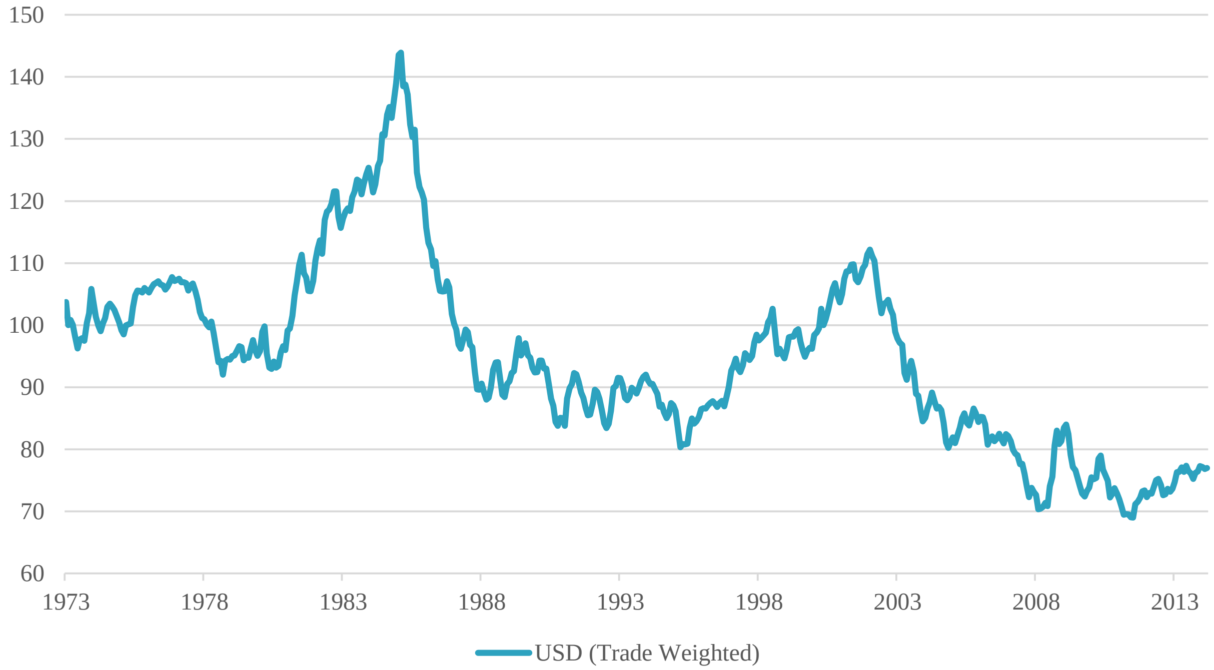


One of the most favored carry trades of shorting the Japanese yen against higher interest rate countries, such as Australia, has virtually disappeared as the yield differentials have narrowed sharply and the stronger yen took its toll on those with short positions.

H. Foreign Exchange Markets

The lack of trends in interest rates, inflation and economic growth has negatively impacted the profitability of currency trading as has the investigations by various governments into the possibility of manipulation of FX rates. The coming months may present more opportunities as the U.S., Europe and Japan follow different monetary policies, resulting in interest rate and currency trends.

Decline in the U.S. Dollar


150
140
130
120
110
100
90
80
70
60
1973
1978
1983
1988
1993
1998
2003
2008
2013
USD (Trade Weighted)