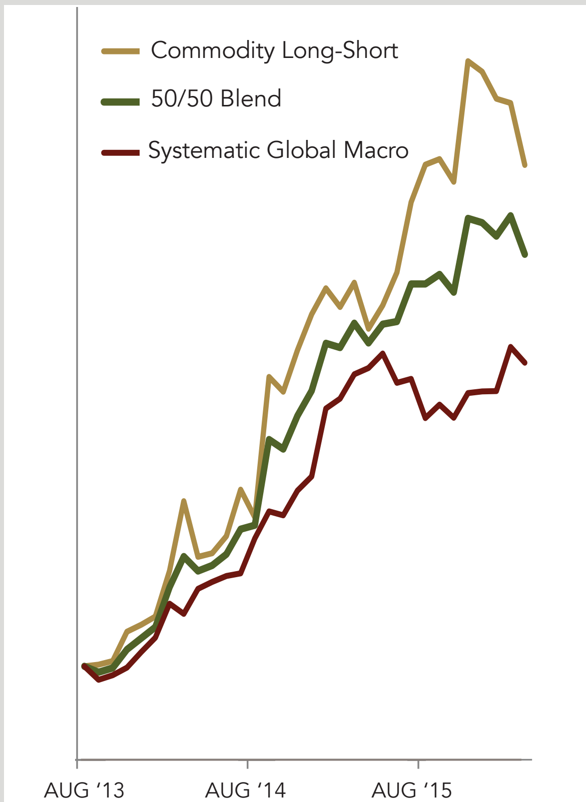
RED ROCK

April 2016

A (DIVERSIFICATION) DREAM COME TRUE

Recently we have received a lot of questions about how our two strategies may combine together. This is a topic about which we are very fond. Our newer Commodity Long-Short strategy was *designed to be systematically different* than our original Systematic Global Macro strategy. It is not a surprise to us that our happiest investors seem to be those that have exposure to both of our two programs. In this paper we will examine how the two strategies hypothetically combine together – and how they may benefit portfolios of stocks and bonds – and portfolios of stocks, bonds, and CTAs.

Performance of CLS, SGM, & Hypothetical 50/50 Blend



Our two strategies have had a very low correlation of only 0.14 to one another

- In the above, the gold line is our Commodity Long-Short program's actual, net of fees composite track record since its September 2013 inception. The dark red line is our Systematic Global Macro program's actual, net of fees composite track record for the same period. The green line is a hypothetical 50/50 combination of the two programs. (Past performance is not necessarily indicative of future performance.)
- More importantly than the performance of either strategy over this period, we'd argue the most noteworthy characteristic is the extremely low 0.14 correlation between the two strategies. This is why the combination of the two looks so appealing. (Past performance is not necessarily indicative of future performance.)

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Performance Metrics for CLS, SGM, & Hypothetical 50/50 Blend

	COMMODITY LONG-SHORT	SYSTEMATIC GLOBAL MACRO	50/50 BLEND	
Annualized Return	23.52%	13.60%	18.56%	
Annualized Volatility	18.18%	8.43%	10.54%	
Sharpe (0)	1.29	1.61	1.76	↑
Sortino (0)	3.19	3.53	5.15	↑
Max Drawdown	-11.00%	-7.00%	-4.25%	↓
Ann. Ret. / Max DD	2.14	1.94	4.37	↑

Past performance is not necessarily indicative of future performance. 50/50 Blend is Hypothetical.

- While our Commodity Long-Short program has produced higher returns, those returns have been accompanied by higher volatility. The latter reality is intentional; we run our CLS program at a higher volatility ("heat") setting than our SGM program.
- It is important to remember that, due to the inherent (i.e. free, as opposed to having to pay to borrow to lever up equities) leverage of futures markets, a CTA manager makes a subjective choice as to what level margin-to-equity / volatility / heat setting to operate his or her program – but the level chosen is *not*, in and of itself, a source of "goodness."
- Since the relationship between such characteristics as returns, volatility, and drawdowns for each of our two programs are functions of the subjective decision that we made regarding how much volatility to target with each program, *risk-adjusted metrics* (i.e. "reward to risk ratios") must be applied to get an accurate and normalized comparison between the two programs' performance.
- While the Sharpe Ratio is the most popular risk-to-reward ratio, as we convey in our white paper, *Sortino: A 'Sharper' Ratio*, the Sortino ratio is a more appropriate measure to use. This is because the Sharpe ratio, by assuming that the returns it is measuring are normally distributed, unfairly and incorrectly penalizes programs whose returns exhibit positive asymmetry (skewness). In reality, investors typically welcome upside volatility and perceive only down-side volatility as actual risk.
- Note the colored arrows in the above table. It is no wonder our happiest investors are those that have exposure to both of our two programs. By combining the two strategies, the Sharpe ratio increases, the Sortino ratio goes up, the MAR (annualized return / maximum drawdown) increases, and the maximum drawdown decreases. (Past performance is not necessarily indicative of future performance.)

Why do the two strategies complement each other so well? A few reasons are that they have different return drivers, they trade different portfolios, and they hold positions for different lengths of time.

Which program will likely perform best going forward? We cetainly do not know; spreading one's bets may be the most advantageous, lowest-risk approach.

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Stocks, Bonds, & CTAs

Winton Capital, the largest and undoubtedly one of the best CTAs of all-time, stated that *"The long-term historical correlation of CTAs with global stock markets is essentially zero."*

Back in 1983, Harvard professor Dr. John Lintner was onto this and acknowledged how valuable Managed Futures / CTAs could be when he said, *"...portfolios...including judicious investments...in managed futures accounts show substantially less risk at every possible level of expected return...than portfolios of stocks (or stocks & bonds) alone."*

The preponderance of the assets under management by CTAs is, and always has been, since the early days of our industry, invested utilizing "trend-following" methodologies generally similar to our Systematic Global Macro program.

While three decades of history and piles of academic analysis has shown that "trend followers" can help add diversification to traditional portfolios of stocks and bonds, we thought we could add significant value for our own capital, and for potential investors, by designing a strategy that would have and maintain a very low correlation to trend following strategies.

Said another way.... we postulated that:

... if Stocks + Bonds + CTA Trend Followers = Good

... then maybe Stocks + Bonds + CTA Trend Followers + CLS = Better?

Stocks, Bonds, CTAs, & Commodity Long-Short

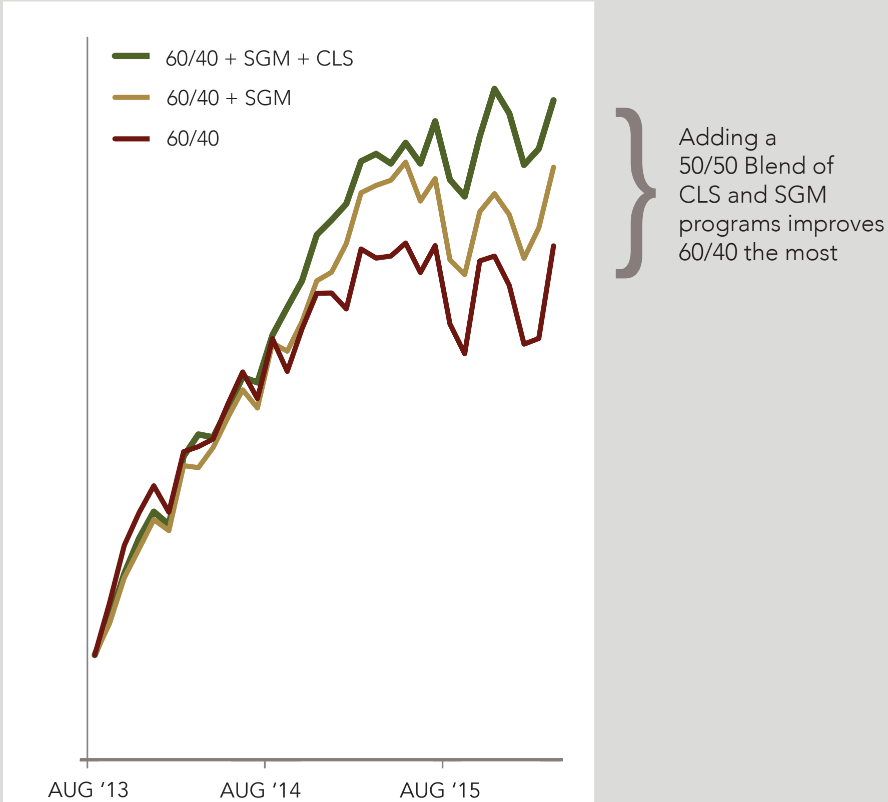
In the below table and via the chart on the following page, we present and analyze the performance of a traditional 60% stocks / 40% bonds portfolio, a hypothetical portfolio made up of 75% of the traditional 60/40 portfolio along with a 25% allocation to our SGM program, and finally a hypothetical portfolio comprised of 75% of the traditional 60/40 but with a 25% allocation to a 50/50 blend of both our SGM and CLS programs. For the period since its inception in September 2013 through March 2016, would our Commodity Long-Short program prove to be a 'diversifier for diversifiers'?

	100% TRADITIONAL 60/40	75% 60/40 + 25% SGM	75% 60/40 + 25% 50/50 Blend
Annualized Return	7.95%	9.36%	10.60%
Annualized Volatiity	7.03%	5.73%	5.24%
Sharpe (0)	1.13	1.63 ↑	2.02 ↑
Sortino (0)	2.18	2.97 ↑	4.05 ↑
Max Drawdown	-5.24%	-5.31%	-3.63% ↓
Ann. Ret. / Max DD	1.52	1.76 ↑	2.92 ↑

Past performance not necessarily indicative of future results. 60/40 is Vanguard's VBINX Balanced Index Fund. Source: Vanguard. Portfolio combinations and results are hypothetical.

(analysis continued on next page...)

Hypothetical Portfolio Growth of 60/40, 60/40 + SGM, & 60/40 + 50/50 Blend



Past performance not necessarily indicative of future performance. Portfolio combinations are hypothetical.

- As most investors know, over this period, the traditional 60/40 portfolio of stocks and bonds has produced impressive results (7.95% annualized returns, 1.13 Sharpe).
- 'Proving' Dr. Lintner correct and as we'd expect, adding a 25% allocation to our Systematic Global Macro program improved the results of the 60/40 baseline portfolio handily. Sharpe and Sortino ratios both went up – as did the annualized return / maximum drawdown metric.
- The most impressive results were obtained by adding a 50/50 blend of both CLS and SGM programs to the traditional 60/40 portfolio. Both Sharpe and Sortino ratios almost doubled, the maximum drawdown was reduced, and the annualized return / maximum drawdown metric nearly doubled.
- Both principals of Red Rock Capital continue to keep their personal capital invested at a 50/50 (vol-weighted) exposure to both CLS and SGM programs.

It is important to remember that both of our two investment management programs should be considered as portfolio diversifiers / complements – **not** as panaceas for improperly diversified and / or over-leveraged investors trying to make a quick buck in the short run.

APPENDIX

Overview of the CLS and SGM Programs

Commodity Long-Short	
Inception	September 2013
Portfolio Universe	Only invests in a diversified mix of 28 tangible / hard / physical commodity futures such as corn, wheat, sugar, precious & base metals, energies and some other foods & softs (no financial futures)
Position Holding Time	9 days, on average
Correlation to U.S. Stocks	-0.26
Driving Force Behind Strategy	Physical commodity futures markets behave very differently than financial markets, and CLS was specifically designed to exploit clearly identifiable short-term supply and demand imbalances found in these markets.

Systematic Global Macro	
Inception	September 2003
Portfolio Universe	70 globally diversified futures markets spanning all sub-sectors: financial futures such as interest rates, bonds, currencies, stoc indices plus commodity futures such as grains, precious & base metals, foods & softs, livestock & energies.
Position Holding Time	180 days, on average
Correlation to U.S. Stocks	-0.04
Driving Force Behind Strategy	Designed to utilize measurable, objective information to help identify and capture major capital flows that manifest themselves as sustained price trends regularly occurring arond the globe.

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Important Disclosures

This document is for informational purposes only and it is not a solicitation for investment. Past results are not necessarily indicative of future results. An investment with any Commodity Trading Advisor should only be made after careful study of the advisor's Disclosure Document including the description of the objectives, principal risks, charges, and fees associated with such an investment. Red Rock Capital, LLC is not responsible for subsequent modification to, or accuracy of, performance data.

Hypothetical Results

HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM.

ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.

About Red Rock Capital

Red Rock Capital is an award-winning commodity investment management firm. During 2016 Red Rock's Systematic Global Macro Program will proudly celebrate its 13th anniversary. The firm is lead by Thomas Rollinger, most notably a devoted pupil and former protégé of quantitative hedge fund legend, Edward O. Thorp. Given recent developments with the firm, plus increasingly favorable market conditions, Red Rock is especially well-positioned to grow and thrive in the managed futures industry.

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