The Benefits of Non-Correlated Alpha

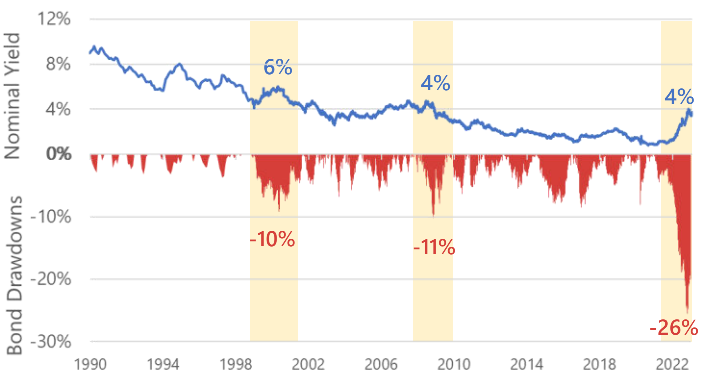
In 2022, 60/40 portfolios suffered as both stocks and bonds sold off and the power of bonds as a diversifier (and, accordingly, a means of reducing portfolio volatility) deteriorated. Meanwhile, inflation exacerbated the issue and eroded real returns. These challenges indicate an increased need for alternatives that offer both diversification to equities and bonds as well as compelling long-term returns.

IN 2022, MANY INVESTORS FACED SEVERAL KEY CHALLENGES

1) Diminishing Returns of a 60/40 Portfolio

Both equities and bonds suffered deep drawdowns in 2022. While the trajectory for equities is marked with uncertainty, bond return potential has diminished as historically low yields translate to lower coupon payments, negative real yields, and less scope for price appreciation.

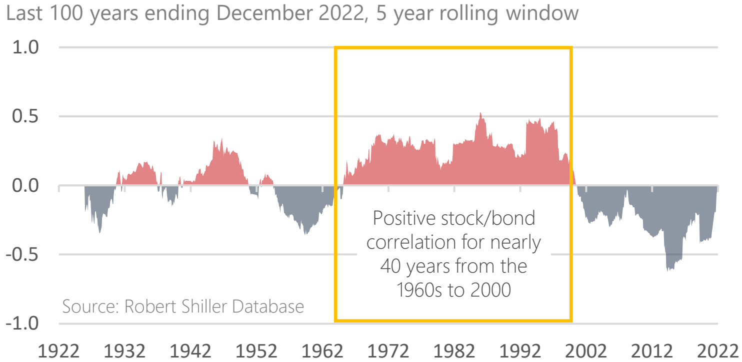
Global bonds recorded worst drawdown on record in 2022, with little yield cushion to soften the blow.
Bloomberg Global Aggregate Index, Jan-90 to Dec-22



2) Positive Stock/Bond Correlation

Equity/bond relationships are not static, and there have been extended periods of positive stock/bond correlation. Today, historically low yields mean that the protective character of bonds is in jeopardy and investors may see positive correlations between stocks and bonds.

Correlations between S&P and US 10yr
Last 100 years ending December 2022, 5 year rolling window



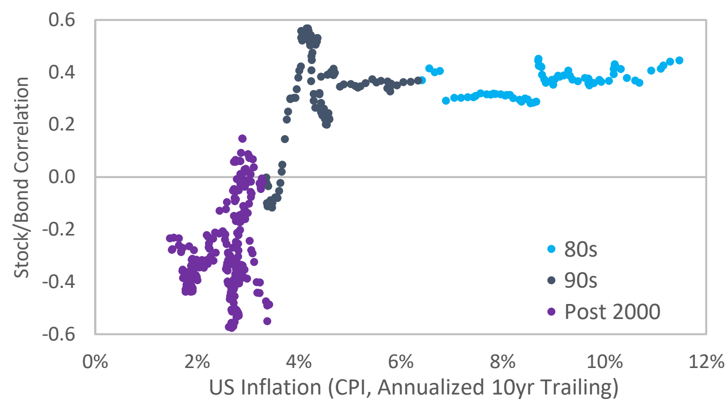
3) Volatility and Market Uncertainty

Given geopolitical developments and macro imbalances, markets exhibited increased volatility in 2022 alongside the potential for market shocks. Should the equity hedging benefits of bonds continue to diminish, as it had in 2022, the ability to manage portfolio volatility will become more challenging.

4) Inflation Sensitivity

CPI reached a 40-year high of 9.1% in June 2022. Elevated inflation presents a significant risk to stock/bond portfolios in terms of asset valuation, erosion of real returns, and positive correlation. When inflation rises, real yields decline alongside the market price of bonds. Inflation can also weigh on stocks when combined with hawkish monetary policy, as we saw in the 1970s, potentially leading to simultaneous losses in stocks and bonds and positive correlations.

Stock/Bond Correlation has Increased with Inflation
Last 40 years ending December 2022



THE ROLE OF ALTERNATIVES

1) **ENHANCE RETURNS**
Ideally, investors should seek alternative strategies with positive long-term return and low correlation characteristics, which offer the potential to enhance the risk-adjusted returns of a broader investment portfolio.

2) **PROVIDE DIVERSIFICATION**
Many alternatives have low correlation to stocks and bonds, with the ability to profit in both rising and falling markets with no inherent bias and the potential to provide equity crisis returns.

3) **REDUCE VOLATILITY**
Diversification properties result in the potential to reduce the overall volatility and drawdowns of a broader investment portfolio. Active risk management approaches can help navigate market volatility and changing market dynamics.

4) **INFLATION AGNOSTIC**
Many alternatives can perform well in inflationary or non-inflationary regimes and can capitalize on increasing commodity prices during inflationary periods.

WHERE CAN INVESTORS TURN TO FOR DIVERSIFICATION?
NOT ALL ALTERNATIVES ARE CREATED EQUAL

Many investors seek diversification through alternative strategies. However, not all alternatives provide the desired diversification benefits. Diversification benefits vary significantly across styles, and many strategies have positive correlation during equity down markets.

Correlation of Alternatives to Equities

Based on Monthly Data from January 1990 through December 2022*

	HFRI Index:	Trend Following	Macro	Relative Value	Emerging Markets	Event Driven	Credit	Equity Hedge	Hedge Fund Composite
Equities Up	Correlation - Equities > 5%	0.00	-0.01	0.28	0.37	0.31	0.42	0.49	0.35
Equities Up	Correlation - Equities > 3%	-0.11	-0.05	0.22	0.33	0.32	0.36	0.48	0.35
Equities Up	Correlation - Equities > 1%	0.00	0.12	0.36	0.43	0.42	0.36	0.58	0.51
Equities Up	Correlation - Up Markets	0.08	0.20	0.38	0.45	0.44	0.38	0.56	0.53
	Correlation - All Periods	0.09	0.32	0.58	0.69	0.72	0.74	0.77	0.77
Equities Down	Correlation - Down Markets	-0.11	0.09	0.55	0.64	0.66	0.55	0.63	0.67
Equities Down	Correlation - Equities < -1%	-0.17	0.02	0.58	0.63	0.66	0.57	0.61	0.65
Equities Down	Correlation - Equities < -3%	-0.24	0.02	0.69	0.73	0.71	0.64	0.63	0.72
Equities Down	Correlation - Equities < -5%	-0.22	0.13	0.71	0.67	0.70	0.63	0.59	0.69

Color scale: 1.00, 0.75, 0.50, 0.25, 0.00, -0.25, -0.50, -0.75, -1.00

2022 CASE STUDY

In 2022, markets experienced a trifecta of a selloff in equity and bond markets, increased market volatility, and elevated inflation, making it a difficult year for many investors. From an asset allocation perspective, investors should consider allocating to alternative strategies that, ideally, have positive long-term return potential and diversifying characteristics during difficult equity environments. Importantly, diversification should be a constant rather than a reaction to short-term market conditions.

2022 Markets

Investor Challenge	2022 Market Moves		
Depressed Returns	Equity Performance MSCI World	↓	-17.7%
Erosion of Stock/Bond Diversification	Bond Performance Bbg Global Aggregate	↓	-16.3%
Increased Volatility	Equity Volatility VIX Index	↑	+4.5
Increased Volatility	Bond Volatility MOVE Index	↑	+44.5
Inflation	Inflation US CPI, Dec-22	↑	+6.5%

2022 Performance of Alternative Strategies*

HFRI Index	2022 Return
Trend Following	10.67%
Macro	9.31%
Relative Value	-0.90%
Credit	-2.59%
Hedge Fund Composite	-4.25%
Event Driven	-5.04%
Equity Hedge	-10.37%
Emerging Markets	-12.59%

Data Sources: Bloomberg, eVestment, HFR, Inc.
All data is estimated through December 2022

*Alternative strategies above are represented by their respective HFRI indices. Data is presented from inception in January 1990 with the exception of the Credit and Trend Following indices, which are available from January 2008. For purposes of this presentation, we show broad hedge fund indices as categorized by HFRI, but our selection is not meant to be an exhaustive representation of all potential alternatives. Other investment strategies, including private equity, real estate, and venture capital, among others, are often considered to be diversifiers to traditional stock and bond portfolios but are not shown here due to limitations on the availability of a representative index or other constraints or considerations.

LONG-TERM BENEFITS

Market conditions continually change, and the best way to construct a portfolio resilient to changing market regimes is through proper diversification. Allocating to strategies that have low correlation to equities and bonds can be a valuable portfolio construction tool with the potential to lower the volatility and soften the drawdowns of an overall portfolio while adding to returns over the long run. These strategies are meant to complement – rather than compete with – traditional investments. And while it is unreasonable to expect any strategy to perform well at every discrete point in time, holding diversifying alternatives as a long-term, strategic allocation in a diversified investment portfolio offers the potential for significant benefits.

Below, we show the impact of allocating to macro and trend following strategies, which are widely regarded as effective diversifiers within an investment portfolio.

Potential Benefits of Allocating to Macro and Trend Since Inception of SG Trend Index, January 2000 to December 2022	Increases Overall Returns	Improves Risk-Adjusted Returns	Lowers Overall Volatility	Reduces Drawdowns	Reduces Beta to Equities
	Annualized Return	**Information Ratio**	**Annualized Volatility**	**Worst Drawdown**	**Beta to MSCI World Index**
"Traditional" 60/40 Portfolio	4.63%	0.44	10.47%	-36.09%	0.65
Traditional Portfolio with 10% Macro and 10% Trend	4.97%	0.58	8.64%	-27.99%	0.52

Macro and Trend are represented by the HFRI Macro Index and the SG Trend Index, respectively. Data Source: eVestment, HFR, Inc.

THE BOTTOM LINE

- In the current investment landscape, there is a need for alternatives that can offer both positive returns and diversification to both equities and bonds.
- Diversifying strategies such as macro and trend following offer significant long-term return and diversification benefits, with the flexibility to capture moves across a variety of market environments.
- Allocating to diversifying strategies as a strategic, long-term investment within a diversified portfolio can potentially enhance risk-adjusted returns and reduce overall volatility and drawdowns.

RELATED CONTENT

Building Portfolio Resilience at the Macro Level

Bloomberg Invest: Why Macro is Killing It

Curbing Systemic Risk with Diversification

Trend Following Primer

Macroeconomic Drivers of the Bond-Stock Correlation

Bond Returns; Looking Back to the Future

A Quantum of Solace;

Alternatives to Fixed Income

The Whole is Greater than the Sum of the Parts

In Search of Negative Beta

Protecting Against Equity Selloffs

IMPORTANT DISCLOSURE

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Source of data: Graham Capital Management ("Graham"), unless otherwise stated

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INDEX DISCLOSURE

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BLOOMBERG GLOBAL BOND INDEX: The Bloomberg Global Aggregate Bond Index is a broad-based market capitalization weighted measure of the global investment grade fixed-rate debt markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers. There are four regional aggregate benchmarks that largely comprise the Global Aggregate Index: The US Aggregate, the Pan-European Aggregate, the Asian-Pacific Aggregate and the Canadian Aggregate Indices. The Global Aggregate Index also includes Eurodollar, Euro-Yen, and 144A Index-eligible securities, and debt from five local currency markets not tracked by the regional aggregate benchmarks (CLP, MXN, ZAR, ILS and TRY).

HFRI MACRO INDEX: The HFRI Macro Index is a sub-index of the HFRI Fund Weighted Composite Index and is composite index of over 900 Investment Managers which trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard currency and commodity markets.

HFRI TREND FOLLOWING DIRECTIONAL INDEX: The HFRI Trend Following Directional Index is a global, equal-weighted index of single-manager funds that report to the HFR Database. The HFRI Trend Following Directional Index is comprised of funds that employ trend following strategies such as Macro: Currency – Systematic, Macro: Systematic Diversified, certain Macro: Multi-Strategy funds and other Macro funds that utilize, to some degree, trend following.

HFRI RELATIVE VALUE INDEX: Investment Managers who maintain positions in which the investment thesis is predicated on realization of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed income, derivative or other security types. Fixed income strategies are typically quantitatively driven to measure the existing relationship between instruments and, in some cases, identify attractive positions in which the risk adjusted spread between these instruments represents an attractive opportunity for the investment manager. RV position may be involved in corporate transactions also, but as opposed to ED exposures, the investment thesis is predicated on realization of a pricing discrepancy between related securities, as opposed to the outcome of the corporate transaction.

HFRI EMERGING MARKETS INDEX: Emerging Markets funds invest, primarily long, in securities of companies or the sovereign debt of developing or 'emerging' countries. Emerging Markets regions include Africa, Asia ex-Japan, Latin America, the Middle East and Russia/Eastern Europe. Emerging Markets - Global funds will shift their weightings among these regions according to market conditions and manager perspectives.

HFRI EVENT DRIVEN INDEX: Investment Managers who maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated, and frequently involve additional derivative securities. Event Driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company specific developments. Investment theses are typically predicated on fundamental characteristics (as opposed to quantitative), with the realization of the thesis predicated on a specific development exogenous to the existing capital structure.

HFRI CREDIT INDEX: HFRI Credit Index is a composite index of strategies trading primarily in credit markets. It is an aggregation of following 7 HFRI substrategy indices. HFRI ED: Credit Arbitrage Index, HFRI ED: Distressed/Restructuring Index, HFRI ED: Multi-Strategy Index, HFRI RV: Fixed Income-Asset Backed Index, HFRI RV: Fixed Income-Convertible Arbitrage Index, HFRI RV: Fixed Income-Corporate Index, and HFRI RV: Multi-Strategy Index.

HFRI EQUITY HEDGE INDEX: Investment Managers who maintain positions both long and short in primarily equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques; strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios. EH managers would typically maintain at least 50% exposure to, and may in some cases be entirely invested in, equities, both long and short.

HFRI COMPOSITE INDEX: The HFRI Fund Weighted Composite Index is a global, equal-weighted index of single-manager funds that report to HFR Database. Constituent funds report monthly net of all fees performance in US Dollar and have a minimum of $50 Million under management or $10 Million under management and a twelve (12) month track record of active performance. The HFRI Fund Weighted Composite Index does not include Funds of Hedge Funds.

MSCI WORLD INDEX: A market cap weighted stock market index of 1,652 global stocks and is used as a common benchmark for 'world' or 'global' stock funds. The index includes a collection of stocks of all the developed markets in the world, as defined by MSCI. The index includes securities from 23 countries but excludes stocks from emerging and frontier economies.

S&P 500 TOTAL RETURN INDEX: An unmanaged, market value-weighted index measuring the performance of 500 U.S. stocks chosen for market size, liquidity, and industry group representation. Includes the reinvestment of dividends. The S&P 500 index components and their weightings are determined by S&P Dow Jones Indices.

Stocks and bonds are represented by the MSCI World Index and the Bloomberg Global Aggregate Index, respectively, unless otherwise noted.