GRAHAM CAPITAL MANAGEMENT, L.P.

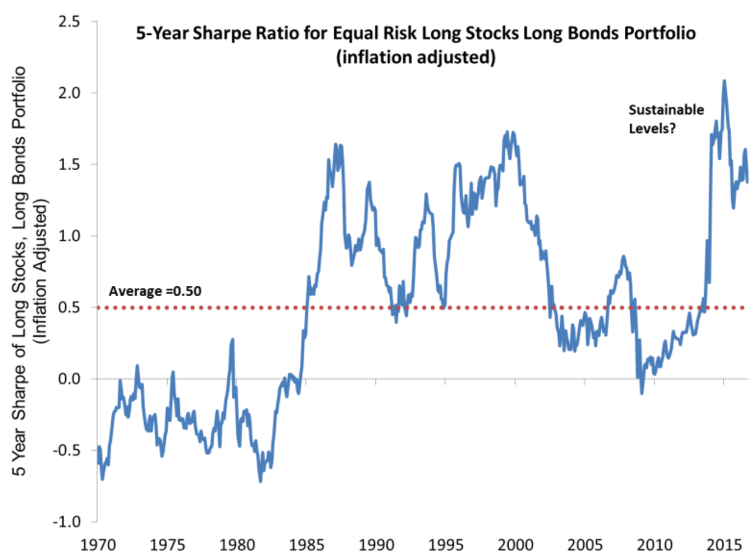
As of October 10, 2016

THE SEARCH FOR PORTFOLIO DIVERSIFICATION & ABSOLUTE RETURNS

As investors have been reminded constantly, the global economy and financial markets have been in "unprecedented" territory in recent years with aggressive forms of monetary policy thrown at major economies, which have shown slivers of growth but also an equal share of uncertainty. Depending on one's perspective, this "unprecedented" period has now lasted the better part of a decade. While uncertainty persists, what is clear is that risk assets have staged a remarkable recovery in the aftermath of 2008. In the early years post-2008, this recovery was fueled by attractive valuations and optimism over the potential for future growth. In more recent years, the recovery has been fueled by ever-more accommodative monetary policy that has generated a long list of acronyms (QE, LTRO, QQE, etc.) and monikers (Operation Twist, helicopter money, yield curve targeting). This era of easy monetary policy has lifted asset prices to lofty heights, but it has also lowered current and future portfolio return expectations as global rates have converged towards zero, or in certain cases, have turned negative.

While asset prices have prospered in recent years and traditional markets like stocks and bonds have soared in value - a period we at Graham Capital Management have referred to as the "Golden Age of Beta Investing" - in more recent quarters, investors have become increasingly concerned that market valuations are stretched and ripe for reversal. This concern does not seem unfounded when one examines the performance of long only assets as compared to past history. As Chart 1 at right makes clear, the Sharpe ratio of a long stocks/long bonds portfolio is at historically high levels. As seen in Chart 1, this metric tends to be mean-reverting over time, and therefore, future return expectations appear diminished.

Chart 1:



As the opportunity cost of holding cash has become increasingly expensive, and as future portfolio return expectations have diminished, investors are increasingly scrambling to achieve reasonable rates of return without simply stacking up layers of excessive risk. This problem is all the more acute in the public pensions space where a combination of pension funding shortfalls and high target rates of return (in the range of 7-8%) that are very difficult to achieve in a zero-bound world, pushes these investors to take additional risk, despite potential reservations. Even further still, in a world where safe haven bond yields are at historic lows, a "diversified" portfolio of stocks and bonds (relying on negative correlations between stocks and bonds) may not be all that diverse - or safe - on a going forward basis. Amidst this backdrop, where investors are forced to take more risk to seek out increasingly meager returns, we have heard greater and greater concerns among clients who are striving to balance return goals with portfolio diversification and asset preservation during periods of market crisis.

Although alternative investments could potentially offer solutions to many of these issues (holding out the prospect of non-correlated returns), some investors have become disenchanted as many alternative strategies have actually exhibited relatively high market beta, while underperforming these betas in recent years. Charts 2 and 3 below provides the beta and annualized alpha of a variety of hedge fund indices relative to the S&P 500, and paint a somewhat uninspiring picture of moderate to high betas and low alphas. In fairness, indices are by definition an average and there are always exemplary performers. Furthermore, we do not believe this pattern of relatively high betas and low alphas among hedge fund styles will persist indefinitely in the future; the Golden Age of beta investing cannot continue forever, as Chart 1 demonstrates all too well. Eventually, asset prices will mean revert and true long / short managers will demonstrate renewed value. Nonetheless, currently it is understandable that investors are seeking clear diversifying strategies with low betas and the potential for high alpha in both rising and falling market environments.

Chart 2:

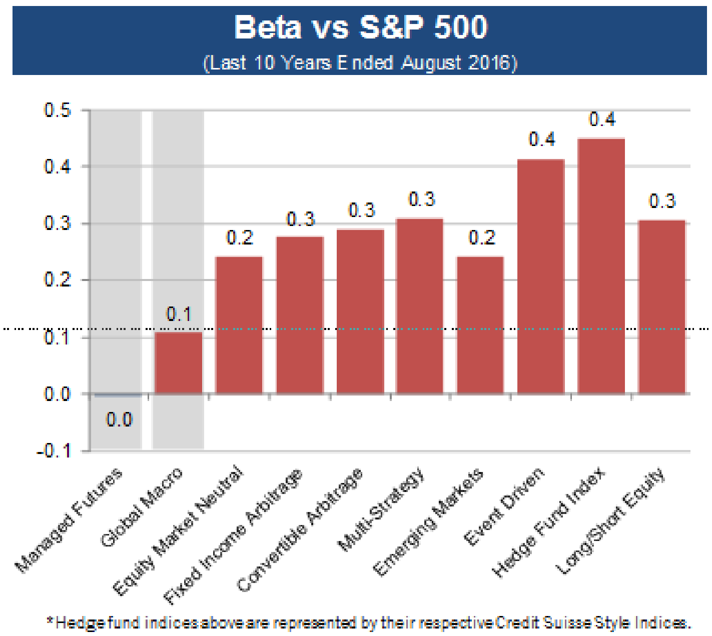
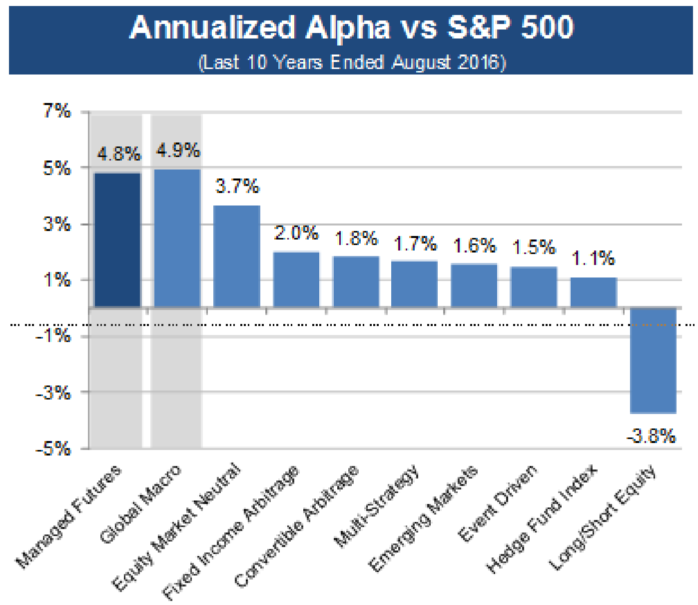


Chart 3:



Given our experience in quantitative and discretionary macro strategies, it is not lost on us that strategies such as ours in the managed futures and global macro space demonstrate low beta and high alpha relative to other hedge fund strategies. We believe there are many reasons for this phenomenon. For instance, managed futures and macro strategies are truly long and short in nature; there is no bias to be long as is the case with many other alternative strategies. Importantly, the market universe traded tends to be highly liquid, which provides the ability to exit losing positions or to get short markets when warranted. In addition, managed futures and macro strategies trade a broad range of global markets and therefore are not confined to any one market sector, but rather can seek trading opportunities across multiple market sectors. Furthermore, whereas a large portion of the investment community utilizes value-based or mean reversion trading techniques, managed futures and macro strategies tend to emphasize directional trading techniques that capitalize on prices diverging or breaking out from a given level, as opposed to prices converging to a given level of perceived value or equilibrium. The "value trap" or "catching a falling knife" pitfalls that can occur with value and mean reversion strategies tends to be less relevant to managed futures or macro strategies. All of these factors sum to an investment style that tends to be different than many other traditional and alternative investment strategies, and generally displays low correlations (and betas).

While these aforementioned characteristics are inherent to managed futures and macro strategies, at Graham we have taken this goal of offering diversifying alpha strategies a step further, and have made this goal a common building block of our strategies.

On the quantitative side of Graham's business, meanwhile, where we employ proprietary trading algorithms (i.e., "trading models") to identify market price trends or to examine fundamental data points, we have the ability to target portfolio diversification or beta exposures in an even more focused manner. Our models screen for a diverse range of profit opportunities across liquid global markets, and then utilize a portfolio construction process that assesses short-term market correlations in order to enhance portfolio diversification. In other words, we seek to avoid having overly concentrated positions in our portfolio, with the simple goal of avoiding outsized losses when markets reverse. In addition, while managed futures strategies may inherently display low market correlations, we have taken this a step further and developed some strategies that by design have zero or negative beta to traditional markets. These "capped beta" strategies seek to provide even further portfolio diversification benefits to our clients, while realizing alpha opportunities across a broad range of markets.

On the discretionary macro side of Graham's business, we allocate capital to internal portfolio managers who each tend to focus on unique or differentiating strategies across global currency, fixed income, equity and commodity markets. One of the hallmarks of our discretionary macro business is that our portfolio managers tend to have very low pairwise correlation (in other words, they tend to have diverse return streams). Recognizing that correlations are not stable, however, we then scrutinize our portfolios daily to ensure that internal position correlations as well as external markets correlations are within desired risk tolerances.

In many ways, the low or negative beta part of the equation is easier to realize than the high alpha (although many managers fail to realize the low beta!). The alpha comes from many intangibles such as talent and experience, but also from concrete measures such as robust portfolio construction and risk management. Clearly the market opportunity set also drives one's ability to generate alpha. For macro strategies, which traditionally have generated a large portion of profits from currencies and fixed income, the low volatility and range bound nature of these markets in recent years has been challenging. Nonetheless, at Graham Capital Management, we have found ways to be profitable on both sides of our business over recent years, and to generate returns at or near the top of the industry peer group. These "unprecedented" times appear likely to continue in the near-term at least, and we believe the benefits of diversifying alpha will be increasingly appreciated by investors now and into the future.

Graham Capital Management is a $13 billion alternative investment firm founded in 1994. Graham is differentiated from other firms by its depth of experience in quantitative and discretionary trading, disciplined risk management, significant investment of proprietary capital and substantial investment in operational infrastructure. In quantitative trading, the firm has a long history of investing significant resources in its quantitative research initiatives and is committed to a statistically sound quantitative research process. In discretionary trading, the firm has a multi-portfolio manager discretionary macro platform with a foundation based on diversification and disciplined risk management. The firm employs a rigorous daily risk oversight process to ensure optimal portfolio construction and to guard against overly concentrated risks.

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Index Definitions:

S&P 500: 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.

MSCI World Index: A free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. The MSCI World Index consists of 24 developed market country indices.

Credit Suisse Long/Short Equity: The Credit Suisse Long/Short Equity Hedge Fund Index is a subset of the Credit Suisse Hedge Fund Index that measures the aggregate performance of dedicated short bias funds. Long/short equity funds typically invest in both long and short sides of equity markets, generally focusing on diversifying or hedging across particular sectors, regions or market capitalizations.

Credit Suisse Event Driven: The Credit Suisse Event Driven Hedge Fund Index is a subset of the Credit Suisse Hedge Fund Index that measures the aggregate performance of dedicated short bias funds. Event driven funds typically invest in various asset classes and seek to profit from potential mispricing of securities related to a specific corporate or market event. Such events can include: mergers, bankruptcies, financial or operational stress, restructurings, asset sales, recapitalizations, spin-offs, litigation, regulatory and legislative changes as well as other types of corporate events.

Credit Suisse Emerging Market: The Credit Suisse Emerging Markets Hedge Fund Index is a subset of the Dow Jones Credit Suisse Hedge Fund Index that measures the aggregate performance of dedicated short bias funds. Emerging markets funds typically invest in currencies, debt instruments, equities and other instruments of countries with “emerging” or developing markets (typically measured by GDP per capita).

Credit Suisse Hedge Fund Index: A leading asset-weighted index that uses a rules-based construction methodology, identifies its constituent funds, and minimizes subjectivity in the Index member selection process. It aims at a maximum representation of the Index Universe. To minimize survivorship bias, funds are not removed from the Index until they are fully liquidated or fail to meet the financial reporting requirements.

Barclay CTA Index: A leading industry benchmark of representative performance of commodity trading advisors. There are currently 532 programs included in the calculation of the Barclay CTA Index for the year 2016, which is unweighted and rebalanced at the beginning of each year. To qualify for inclusion in the CTA Index, an advisor must have four years of prior performance history. Additional programs introduced by qualified advisors are not added to the Index until after their second year. Please note, the Barclay CTA Index is only comprised of CTAs that submit performance data to Barclay and is not necessarily indicative of the entire CTA community as a whole.

Credit Suisse Multi-Strategy: The Credit Suisse Multi-Strategy Hedge Fund Index is a subset of the Credit Suisse Hedge Fund Index that measures the aggregate performance of dedicated short bias funds. Multi-strategy funds typically are characterized by their ability to allocate capital based on perceived opportunities among several hedge fund strategies.

Credit Suisse Convertible Arbitrage: The Credit Suisse Convertible Arbitrage Index is a subset of the Dow Jones Credit Suisse Hedge Fund Index that measures the aggregate performance of convertible arbitrage funds. Convertible arbitrage funds typically aim to profit from the purchase of convertible securities and the subsequent shorting of the corresponding stock when there is a pricing error made in the conversion factor of the security.

Credit Suisse Fixed Income Arbitrage: The Credit Suisse Fixed Income Arbitrage Hedge Fund Index is a subset of the Credit Suisse Hedge Fund Index that measures the aggregate performance of dedicated short bias funds. Fixed income arbitrage funds typically attempt to generate profits by exploiting inefficiencies and price anomalies between related fixed income securities.

Credit Suisse Equity Market Neutral: The Credit Suisse Equity Market Neutral Hedge Fund Index is a subset of the Credit Suisse Hedge Fund Index that measures the aggregate performance of dedicated short bias funds. Equity market neutral funds typically take both long and short positions in stocks while seeking to reduce exposure to the systematic risk of the market (i.e., a beta of zero is desired). Equity market neutral funds typically seek to exploit investment opportunities unique to a specific group of stocks, while maintaining a neutral exposure to broad groups of stocks defined for example by sector, industry, market capitalization, country, or region. Credit Suisse Global Macro: The Credit Suisse Global Macro Hedge Fund Index is a subset of the Credit Suisse Hedge Fund Index that measures the aggregate performance of dedicated short bias funds. Global macro funds typically focus on identifying extreme price valuations and leverage is often applied on the anticipated price movements in equity, currency, interest rate and commodity markets.

Credit Suisse Managed Futures: The Credit Suisse Managed Futures Hedge Fund Index is a subset of the Credit Suisse Hedge Fund Index that measures the aggregate performance of dedicated short bias funds. Managed futures funds (often referred to as CTAs or Commodity Trading Advisors) typically focus on investing in listed bond, equity, commodity futures and currency markets, globally.

Barclays Global Aggregate Bond Index: Barclays Aggregate Bond Index is a market value-weighted index that tracks the daily price, coupon, pay-downs, and total return performance of fixed-rate, publicly placed, dollar-denominated, and nonconvertible investment grade debt issues with at least $250 million par amount outstanding and with at least one year to final maturity.

Bloomberg Commodity Index: The index is made up of 22 exchange-traded futures on physical commodities.

HFRI Hedge Fund Index: The HFRI Fund Weighted Composite Index is an equal-weighted index that includes over 2000 constituent funds which have at least $50M under management or have been actively traded for at least 12 months. There are no fund of funds included in this index. All funds are reported in USD and returns are reported net of all fees on a monthly basis. Individuals cannot invest directly into this index.

It should not be assumed that an investment in any of the funds described herein will be profitable. None of the statements made in this letter are intended to imply that an investment in a fund is safe, conservative, risk free or risk averse. An investment in a fund managed by Graham entails substantial risks, and a prospective investor should carefully consider the summary of risk factors included in the fund’s relevant prospectus in determining whether an investment in a fund is suitable. Graham's investment fund offerings do not consider the specific investment objective, financial situation or particular needs of any investor and an investment in a fund managed by Graham is not suitable for all investors. Prospective investors should not rely upon this document for tax, accounting or legal advice. Prospective investors should consult their own tax, legal, accounting or other advisors about the issues discussed herein. Investors are also reminded that past performance should not be seen as an indication of future performance and that they might not get back the amount that they originally invested. Tables, charts and commentary contained in this document have been prepared on a best efforts basis by Graham using sources it believes to be reliable although it does not guarantee the accuracy of the information on account of possible errors or omissions in the constituent data or calculations. The information contained in this document is strictly confidential and no part of this document may be divulged to any other person, distributed, resold and/or reproduced without the prior written permission of Graham.

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