

# 2019 First Quarter Review

(data as of March 29, 2019)

## Summary

The Fund was up +1.5% for the quarter. Please find below a table of recent and long-term performance.

## Performance<sup>1,2,3</sup>

**Table I – Trailing Annualized Returns – 3/29/2019**

	YTD	1 Year	3 Year	5 Year	Since Inception
Trend Macro	1.5%	-12.2%	0.5%	0.9%	4.0%
CSHFI Global Macro Index	1.5%	1.9%	3.5%	2.4%	2.9%
HFRI Composite	5.9%	0.9%	5.1%	3.1%	3.3%
HFRI Macro Index	2.9%	0.3%	0.1%	1.3%	0.5%
MSCI ACWI Index	11.6%	0.5%	8.5%	4.4%	0.5%
Barclays US Agg. TR Index	2.9%	4.5%	2.0%	2.7%	2.7%
EMBIG Index	6.6%	3.5%	5.2%	4.8%	5.1%

## Q1 2019 Performance Summary

While the performance for the quarter was modestly positive, we believe we have laid the foundation for a solid year of performance, especially since the macro back-drop is turning out more or less as anticipated.

In our last letter, while we anticipated that global growth would slow, we argued that the risk of a recession in 2019 or even 2020 was extremely low. The challenge we anticipated for markets was that global growth was slowing at the same time as central banks were winding down quantitative easing. For us the global growth story went through China. As long as the US and China resolved their trade dispute, the global economy would be okay. What has definitely surprised us is the speed with which the Fed was willing to do a dramatic U-turn on policy and the extent of the market rally.

The Fed going on hold informed us that the environment for carry was likely to be very good, especially in EM. Hence, we positioned ourselves long carry in EM via both currency and credit while hedging via buying protection in developed markets credit indices, where valuations are stretched and creditor protection has weakened.

Our positioning on the long side of our portfolio worked. While the short side of the portfolio performed its function, the sharp rally in high yield credit ending up costing us more than we would have liked. Volatility in Argentina in March also caused us to give back some of the returns from that position.

- 1. PERFORMANCE REPORTING REFERS TO TREND MACRO ONSHORE LP. PAST RESULTS ARE NOT INDICATIVE OF FUTURE RESULTS.**
- Performance figures for the Fund are net of fees and expenses, without provision for federal or state income taxes. Performance assumes a day one, new issue eligible investor who made no subsequent additions to, or withdrawals from, its capital account.
- Indices are referenced in the performance table. Please see notes on the last page of this document for additional information relating to indices. Annualized performance is calculated by compounding and annualizing monthly performance.

**Table II - Performance of Key Markets (YTD, 3/29/2019) <sup>3</sup>**

	YTD
S&P 500	+13.1%
MSCI ACWI	+5.3%
MSCI EM	+9.9%
JP Morgan EMBI	+6.6%
Citi US HY Index	+7.4%
10 Year Treasury Yield	-28 bps
10 year Bunds Yield	-31 bps
Crude Oil	+32.4%
DXY Index	+1.2%

## Q1 Detailed Performance Analysis

**Table III - YTD Attribution of Gross Trading P&L**

Asset Class	YTD	Geography	YTD
Credit	+0.6%	Asia	+0.1%
Equities	-0.3%	Developed	-1.1%
Rates	+2.0%	EEMEA	+2.3%
Currencies	-0.4%	Latin America	+0.4%
		Corp Credit	+0.5%
		Multiple	-0.2%
<b>Total</b>	<b>+2.0%</b>		<b>+2.0%</b>

**Table IV - Long-Short Attribution of Gross Trading P&L**

Asset Class	Long	Short	Relative Value	YTD
Credit	+1.7%	-1.0%		+0.6%
Equities	-0.1%	-0.2%		-0.3%
Rates	+2.1%	+0.0%	-0.2%	+2.0%
Currencies	-0.4%	+0.0%	+0.0%	-0.4%
<b>Total</b>	<b>+3.4%</b>	<b>-1.2%</b>	<b>-0.2%</b>	<b>+2.0%</b>

See below a breakdown of contribution from the key portfolio themes in Q1 2019. As you can see, this has very little to do with the performance of broad markets over the quarter.

**Table V - Contribution of Key Themes in Q1 2019**

Theme	Contribution
Argentina Credit/ FX	+0.4%
EM Credit	+1.0%
Egypt Rates/FX	+1.5%
Nigeria Rates	+0.8%
US & Europe HY Shorts	-1.0%

### Credit

A key building block of the portfolio in Q1 was to be selectively long EM credit. We identified short-dated EM debt as the most appropriate expression of this view, given our concerns that the Fed might still hike if growth accelerated or inflation surprised. Corporate credit performed robustly (where we are limited to a maximum of 10% of AUM), contributing 0.5% over the quarter, fueled by gains in China real estate debt. Sovereign debt in Ukraine (0.3%) and Ecuador (0.2%) also contributed to gains. While DM credit indices rallied in Q1, our greatest concern about markets lies in this area. Spreads are tight, covenant protection is weak and leverage (especially amongst US BBBs) is high.

## Equities

Equity hedges cost the portfolio 0.3% during the quarter. Equity volatility is extremely low today, and remains a preferred way to hedge macro risks in the portfolio.

## Local Interest Rates & Currencies

This was the most profitable part of the portfolio over the quarter. Long positions in Egypt (+1.5%) and Nigeria (+0.8%) were the largest contributors to performance. Following a visit to Ghana, we made a decision to exit the position, a decision that turned out to be well-timed.

## Market Outlook

The IMF's revised global growth forecast for 2019 is 3.3%. A manufacturing slowdown is the primary reason. The slowdown in manufacturing is partly due to the US-China trade dispute, and partly due to Chinese policymakers' attempts to reduce leverage, which slowed growth in 2018. The pain has been felt everywhere, but most acutely in Europe, which suffers from low growth and depends heavily on exports to China as a source of growth. We expect Q1 to be the trough in global growth with improvement in subsequent quarters. However, given the size and nature of China's stimulus and the late-cycle nature of the US recovery, we emphasize that global growth will still slow in 2019 vs 2018. What policy makers have done is to take the risk of recession off the table for now.

So, what are the risks to the economic outlook?

- The US and China don't reach a trade deal. Given recent statements from both sides, we would consider this a low probability event.
- A hard Brexit. This will cost Europe almost 60bp in growth at a time when Europe is forecast to grow 1.2% in 2019 and the impact on the UK economy would be several times larger in magnitude. Fortunately, the UK Parliament seems to have ruled out a hard Brexit. Yet, getting a deal seems to have some intractable parliamentary math at present. The decision has been punted to October.
- The US imposes tariffs on European auto exports. Again, we think this is a low probability event. Tariffs on European autos, in terms of economic impact, would make the steel and aluminum tariffs seem like a walk in the park. We think the Trump Administration will use auto tariffs as a carrot to perhaps gain some concessions from the EU.

A key point we would like to make here is that all three event risks have low probabilities because voters would punish those responsible at the polls.

## US – China

It now appears that the Trump-Xi summit might only take place at the G-20 Summit in June. One can make an argument that because of the intractable nature of some of the issues, détente is the likely outcome. This posits a piecemeal solution with China buying more US goods, opening more of its markets and making some guarantees on intellectual property in exchange for the US agreeing to roll back tariffs. It seems the issue of China's compliance with the deal will be addressed by a bilateral panel. There will likely be little progress on China's subsidies to SOEs or on issues of technology where it pertains to national security. The US and China will remain wary adversaries for a very long time.

## Market Outlook (cont.)

### The Fed

The Fed has paused. This is in the market. The bigger story as elaborated by Fed Vice Chair Richard Clarida and Fed Governor John Williams is that the Fed is moving to a new concept of inflation targeting. Putting technicalities aside, the clear message to investors is that the Fed intends to consciously let the economy run hot and generate an inflation overshoot.

So that's what we need to monitor. Does the recent pick-up in wage inflation show signs of legs, in which case bond markets would react negatively and ultimately force the Fed back into play?

Our internal models predict core CPI at 2.3% by end-2019 and core PCE at 1.9%. These aren't aggressive forecasts, as core CPI is already at 2.1% yoy. The key unknown is non-linearities in price and wage formation, which is why we will be watching wages closely.

However, markets are somewhat schizophrenic. On one hand, stocks have had the best Q1 in decades. On the other hand, the yield curve inverted, bond yields rallied aggressively and the market priced in cuts in 2019 and 2020. This divergence between risk-free assets and risk assets will need to be resolved. This time, we think the bond market has it wrong.

### Oil

OPEC wants to extend quotas to H2-2019. New quotas will be decided in June after the Trump Administration decides on Iran waivers. OPEC does not want to be surprised again. We believe that production cuts by OPEC and Russia has put a floor on oil prices. The slowdown in global growth is not meaningful enough to offset these cuts. In fact, supply issues emanating from Venezuela, Mexico, Libya and potential Iran sanctions all represent upside risks to oil prices.

### Equities

What is problematic for US stocks is that earnings growth is forecast at 5% in 2019 and 6% in 2020. Following the 25% rally since late-December 2018, the S&P 500 trades close to 16.8x 2019 earnings after trading at 14.5x in December. It is difficult to argue that multiples should continue to expand in an environment of low and stable EPS growth. However, having witnessed equity market behavior for over two decades, we would not rule out one more speculative rally, which would ultimately be the set up for the end of the current cycle.

How scared do we need to be about recession risk? Not very in 2019, according to our research work. But the equally important question is where are the excesses in the economy? We would argue that the biggest excesses are to be found in certain sectors of the equity market but, more importantly, in credit where tight spreads and weak covenants into a slowing economy make spreads vulnerable. However, the potential losses are diffused, as they will be borne by investors and funds and not impact the banking system as in 2008. That's the main reason we see the next recession as much shallower than in 2008.

### Italy

On April 9th, Italy cut its GDP forecast for 2019 to 0.1% and raised the deficit forecast to 2.5%. The framework for a flat tax was announced and the PM stated there was no intention of hiking the VAT in 2020 as agreed to with the EC. Italian bond yields continue to decline, driven by the relentless grab for yield by European investors who have few other choices. This is nicely setting up for some interesting developments as Italy commences budget negotiations for 2020 in the fall.

## Market Outlook (cont.)

### Argentina

The thesis on Argentina is based on the creation of a virtuous cycle which will lead President Macri to be re-elected in the fall. It has several key building blocks.

- The first is Peso stability. The current account deficit has shrunk from \$32 billion in 2017 to \$9 billion in 2019. The country has an overall Balance of Payment surplus of \$15 billion. In addition, Treasury will be selling \$9.6 billion and there is \$22 billion in agricultural exports till year-end. Finally, BCRA can intervene in the forward market up to \$2 billion. In the face of this dollar supply, it is very difficult to envisage a Peso crisis as in 2018. Furthermore, private sector M3/GDP is 17.7%, which is lower than in 2004. At this level of private sector M3/GDP, most of the monetary base should be seen as transactional money in the economy and hence very sticky. Hence, the ability of Argentines to convert Pesos into dollars at a time when the monetary base will be shrinking 30% in real terms due to a tight monetary policy is very limited.
- The second building block is that inflation should start to decline in May. President Macri announced a broad agreement with companies to contain prices, as well as other measures to provide a temporary boost to the economy ahead of the election. If inflation is 2% a month or lower by election time, we think his electoral chances increase substantially. Our inflation forecasts have been revised lower in our models due to this agreement.
- The third building block is that real incomes start to rise: pensions will be hiked by 10% in real terms in April to recover the real losses in 2018. The govt.'s strategy is to front-load wage increases in March and May ahead of elections. There is a strong correlation between real wages and the President's popularity.
- The fourth building block is that growth improves (the data on IP, construction, agriculture, etc. show this). The government will use its fiscal flexibility to pump-prime the economy via SME lending programs and farm credits. In addition, the govt. is launching almost 800 infrastructure projects targeted strategically at districts where it needs the votes.

So, what are the polls saying? The polls still show the President's party ahead of Cristina Kirchner. Polls also show them tied in the 2nd round. We expect that, as the above virtuous cycle unfolds, polls will change in Macri's favor. It is very important to note that despite a self-inflicted peso crisis in 2018, Cristina Kirchner's approval ratings never rose. All that really happened was Macri's ratings declined. If there are better economic times ahead, this should reverse.

After a rally in Jan and Feb, Argentine assets sold off in March. The surprise was on inflation. Our models fully anticipated that inflation prints would be high in Q1 due to hikes in regulated tariffs, but meat prices caught everyone off guard. More recently, meat price inflation is showing signs of slowing sharply, which should reinforce the disinflation process.

We continue to be positioned in select sovereign and quasi-sovereign credit with low duration and double-digit yields. Most of our credit exposure is hedged via sovereign CDS and we expect this to continue until we see the polls change more decisively. Dollar yields are now 14-16%. Because of our view on the upcoming virtuous cycle, we don't think we will have to wait too long.

## Portfolio Positioning

The quarter ended with a VaR of 20 bps. Overall risk levels did not change much during the quarter. While at the surface this looks unusually low, it is more a reflection of the idiosyncratic risks within the portfolio that we have chosen to take, and the market beta that we have consciously chosen to eschew.

There is a trifecta of issues that we need to integrate into our analysis. These are slowing growth (priced in) with the potential to surprise to the upside (but equity market valuations having captured most of that), stable oil prices (with the potential for supply to tighten) and negative real yields in developed markets (with virtually no risk of a recession). And lastly, there are potential economic surprises, we have highlighted earlier in the letter.

When we integrate this into our positioning, we believe that EM hard currency bonds will be the prime beneficiaries. We prefer shorter duration bonds because that reduces the risk of losses from an economic slowdown or from a sell-off driven by rising yields. While EM corporate credit has rallied in the first quarter, we have been extremely disciplined and rotated out of exposures when our price thresholds have been hit. We are also seeing a robust issuance calendar. We intend to fully use our allocation to corporate credit as yields are still attractive in a number of companies supported by solid fundamental underpinnings. We have sovereign credit allocations mainly in Argentina, Ukraine and Ecuador.

Emerging market FX is trickier, for reasons we discussed earlier in the letter. We would look for opportunities in EM FX where there is a natural cushion (oil) in addition to coupon and favorable inflation trends. Egypt and Nigeria continue to check the box favorably on all these points. In Nigeria T-Bill rates have declined by nearly 300 bps from its high, following an election which President Buhari won quite comfortably. Our exposure in Nigerian T-Bills are partially hedged through the futures facility with the Nigerian Central Bank. Given current oil prices, Nigeria should have a substantial current account surplus and should have no problem in maintaining its reserves in the near term.

We have added some duration to the Egyptian exposure which was previously in T-Bills. We could see another 100 bps in rate cuts in 2019.

Developed market bonds are vulnerable and shorting them could become even more attractive as the year progresses. US equity valuations fully reflect a benign Fed and a US-China trade deal. Therefore shorting US equities (given how low vol. is) is a preferred vehicle to hedge against macro risks. While US and European HY credit are vulnerable given weakening economic fundamentals, we could see valuations continue to overshoot if investors continue to seek yield.

So to summarize, we have put together a portfolio of idiosyncratic carry, which in itself has the potential to generate solid returns. An economic turnaround in Argentina could generate additional capital gains. The low duration protects the portfolio from unanticipated spreads widening. Lastly, we believe that the developed rates complex should present some compelling opportunities over the rest of the year.

**Table VI – Portfolio Positioning (Key Trades)**

**Risk-off**

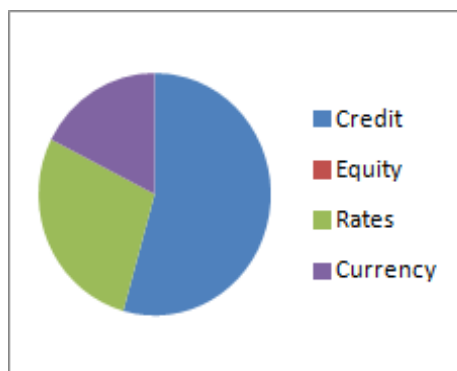
Theme	Positions
China Trade Tariffs	Long China Rates
EM Specific Risks	EM Credit shorts

**Risk-on**

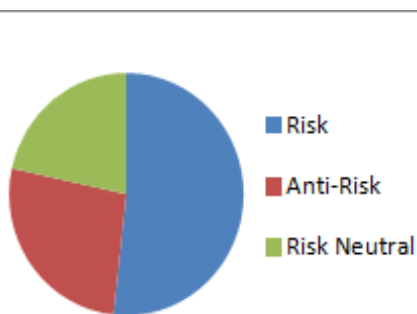
Theme	Positions
Sub-Saharan Africa	Egypt and Nigeria local rates
EM Credit Select Opportunities	Ukraine, Ecuador, Corporate bonds
Argentina Resurgence	Sovereign and Provincial Credit with tactical hedging

**Chart V - Current Exposures in Portfolio (Isolated VaR) as of 3/29/2019**

**Asset Type:**



**Risk-on vs. Risk-off**



**DM vs. EM**



**Business Update**

As of April 1, Firm AUM are at \$ 1.5 Bn. Employee headcount is unchanged.



## Disclaimers

All Daily VaR numbers are derived to 95% confidence using a variance-covariance model with a 2 year time series and 0.94 decay factor.

The investment performance data set forth herein is confidential and should not be disclosed and/or forwarded to any other person. This document is not intended to be, nor should it be construed or used as an offer to sell, or a solicitation of any offer to buy interests in any of Trend Capital Management's funds. No offer or solicitation may be made prior to the delivery of a definitive private placement offering memorandum.

Information included herein is unaudited, based on estimates and subject to change. Trend Capital Management is under no obligation to update the estimated information included herein. The estimated net performance results presented herein assume no interim period contributions or withdrawals and are presented net of Trend Macro Onshore LP's operating expenses, management fee of 2% per annum and incentive allocation of 20% of the portfolio's net capital appreciation. The actual results achieved by an investor may vary materially from these figures due to a number of factors including, but not limited to, the timing of capital activity or variations in net performance between the onshore and offshore vehicles.

A number of indices are referenced herein. Each index is presented because Trend Capital feels that it serves as a useful point of comparison with aspects of the Fund's portfolio management and composition. The Fund's portfolio will not replicate any of these indices and no guarantee is given that performance will match any of the indices; it is not possible to invest in any index.

There are significant differences between the Fund's investments and the indexes referenced below (the "Indices"). For instance, the Fund may use short sales and leverage and may invest in securities that have a greater degree of risk and volatility, as well as less liquidity, than those securities contained in the Indices. Moreover, the Indices may not reflect the reinvestment of income or dividends and are not subject to any of the management fees or expenses that the Fund investors must pay. It should not be assumed that the Fund will invest in any specific securities that comprise the Indices, nor should it be understood to mean that there is a correlation between the Fund's returns and the Indices' performance. Some of the Indices (e.g., the HFRI Indices) also may be affected by "survivorship bias" because they cannot include performance data for issuers that are removed from the index because they no longer meet index criteria and cannot include performance from failed hedge funds that no longer exist, which may cause the results of the Indices to skew higher due to the fact that they are calculated using data for successful hedge funds only. The Indices are included for informational purposes only.

**CSHFI Global Macro Index:** Asset weighted hedge fund index derived from the Credit Suisse database of more than 5,000 funds. The Global macro managers carry long and short positions in any of the world's major capital or derivative markets and these positions reflect their views on overall market direction as influenced by major economic trends and events. The portfolios of these funds can include stocks, bonds, currencies and commodities in the form of cash or derivatives. The funds invest globally in both developed and emerging markets.

**HFRI Composite:** The HFRI Fund Weighted Composite Index [Ticker: HFRIFWI] is a global, equal-weighted index of over 2,000 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 a twelve month track record of active performance. The HFRI Fund Weighted Composite Index does not include Funds of Hedge Funds.

**HFRI Macro Index:** The HFRI Macro (Total) Index [Ticker: HFRIMI] is based on the performance of funds that 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. Managers included in this index employ a variety of techniques, both discretionary and systematic analysis, combinations of top down and bottom up theses, quantitative and fundamental approaches and long and short term holding periods. Macro strategies are distinct from relative value strategies in that the primary investment thesis is predicated on predicted or future movements in the underlying instruments, rather than realization of a valuation discrepancy between securities.

**MSCI ACWI Index:** The MSCI ACWI Index [Ticker: MXWD] is a free-float weighted index. It was developed with a base value of 100 as of December 31, 1987. MXWD includes both emerging and developed world markets.

**Barclays US Agg. TR Index**(f/k/a/ Lehman Brothers Aggregate Bond Index) [Ticker: LBSTRUU] is an unmanaged index that covers the U.S. Dollar-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The index includes corporate bonds, U.S. Treasury bonds and bonds in the following sectors: government-related, mortgage backed securities, asset-backed securities and commercial mortgage backed securities and U.S. agency hybrid adjustable rate mortgage securities. Qualifying bonds must have at least one year until maturity, regardless of optionality, and must be rated investment grade (Baa3/BBB-/BBB- or above).

**EMBIG Index:** The JPMorgan EMBI Global Total Return Index [Ticker: JPEIGLBL] is a broad, diverse U.S. dollar denominated emerging markets debt benchmark that tracks the total return of actively traded debt instruments in emerging market countries. The EMBI Global includes U.S.dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least \$500 million.

Statistical Properties - Referenced Indices (cont.)

**MSCI EM:** is an index consisting of 24 countries representing 10% of world market capitalization. The Index is available for a number of regions, market segments/sizes and covers approximately 85% of the free float-adjusted market capitalization in each of the 24 countries.

**JPMorgan Emerging Market Bond Index:** an index that tracks the total return for the U.S. dollar-denominated emerging markets debt, including Brady bonds, Eurobonds and loans. It does not include fees or expenses.

**DX** – US Dollar Index

**iTraxx Crossover** - Up to seventy five (75) European entities with non-investment grade credit ratings as published by Markit.

**iTraxx Senior Financials** - Twenty Five (25) financial entities from the Markit iTraxx® Europe index referencing senior debt.

**Citi US HY Index** - The US High-Yield Market Index is a US Dollar-denominated index which measures the performance of high-yield debt issued by corporations domiciled in the US or Canada. Recognized as a broad measure of the North American high-yield market, the index includes cash-pay, deferred-interest securities, and debt issued under Rule 144A in unregistered form. Sub-indices are available in any combination of industry sector, maturity, and rating

**PAST PERFORMANCE IS NOT INDICATIVE NOR A GUARANTEE OF FUTURE RESULTS. NO ASSURANCE CAN BE MADE THAT PROFITS WILL BE ACHIEVED OR THAT SUBSTANTIAL LOSSES WILL NOT BE INCURRED.**