EXEMPLAR
PORTFOLIOS

EXEMPLAR DIVERSIFIED PORTFOLIO

MANAGER'S COMMENTARY

MARCH 31, 2012

March returns were driven by losses of 148 bp from long fixed income positions and 106 bp from currency positions. Offsetting these losses were gains of 69 and 62 bp respectively from short base metal and long equity market positions. Other markets had minimal contribution to the portfolio.

Other than positions in agricultural markets, there were no major changes to core positions, just adjustments based on risk management. The portfolio remains net long equity indices, fixed income markets and the crude complex, long the USD and short Euro currency against major currencies, and short base metals and Natural Gas. It should be noted that the net long equity exposure is driven primarily by positions in US equity markets. Exposure to other equity markets is (net) minimal, with small longs in the Dax and Hang Seng offset by shorts in Australia and, to a lesser degree, Canada. These equity market shorts are in line with weakness and shorts in base metals markets.

Within the agricultural sector, positions remain mixed but have tilted to net long within grains as both Soybean and Canola positions reversed from short to long. As a result, short Wheat and Soybean Oil positions are now about 1/3 of the long exposure to Canola, Corn and Soybeans. Similarly, exposure to soft commodity markets is mixed, with long Sugar, Short Cocoa and effectively flat Coffee exposure.

Continuing the trend of the past few months, positions remain much more varied within sectors than over the past few years, reflecting a reduction in market correlations and broad risk on/risk off themes. Broad macro risks remain though which, despite the correction last month, has thus far explained the persistence of our model conviction to trading in and out of the long side of fixed income markets.

Looking backwards, it is often easy to rationalize long term trends that have become a matter of historical precedent. China's urbanization and entry into the WTO in 2001, for example, explains the demand-pull behind the commodity bull market since 2002. Looking ahead is a bit trickier as we can't, obviously, predict future unkown events. Nevertheless, it is possible to identify potential secular trends and look at market dynamics to gain clues as to which ones are taking root.

To this end, the current divergence between equity and commodity markets (base metals in particular for now) over the past few months, in addition to the relative outperformance of US equity markets and the USD, seem to be evidencing the following themes, which could guide the corresponding long-term investments for some time:

• The breakdown of broad risk on/risk off themes seem to indicate that while markets continue to be prone to headline news about European problems, there appears to be less concern that an event risk that will freeze financial systems and markets. Barring an event risk, correlations should continue to break down and volatility should generally trend lower.

• Structural debt, deficit and demographic trends in Japan and Europe, in conjunction with favorable trends in US energy production and independence could continue to favor the USD against major currencies for some time, and continue to support superior relative performance of US equity markets. In particular, the head start in accessing tight oil and gas in North America will create a cost advantage for North American manufacturers and an eventual reduction in oil imports. Manufacturing advantages and less required energy imports should generate a downward trend in the US trade deficit, which would be supportive of the USD.

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• Weakness in commodities reflects two converging trends. First, the era of high commodity prices has, as in the past, led to investments that have resulted in new supply coming to market. Second, the trend of supply catching up to demand is occurring at a time when capital spending in China is slowing. Though China still has a lot more to grow, if future growth rates are lower and supply is catching up to commodity demand, the opportunity in commodities will generally be on the short side as prices are expensive and roll yields tend to be negative in commodities if supply is adequate.

As always,however, we don't know the unknowns. For example, although there are factors that favor a strong USD against majors, China's intentions to diversify its holdings of USD could truncate any gains. Furthermore, if China attempts to move more trade into the RMB (which they will likely do, as evidenced by the creation of the offshore RMB bond market in Hong Kong), this may have consequences for other foreign holdings of US dollars.

Long-term price trends always arise from policy decisions and from deeply rooted economic cycles and fundamentals that take years to play out. They are always known with the benefit of hindsight but, until they are known, they are best identified through long-term approaches to trend-following and prudent approaches to risk management and limiting losses. This is the strategy of Exemplar Diversified Portfolio and IMFC – to utilize quantitative and statistical tools to identify and capture long-term macroeconomic-based trends and manage the risk imbedded in markets.

Thank you for your continued support

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