MontLake

AlphaQuest UCITS Fund

CTA/Managed Futures

February 2022

Performance Returns

The AlphaQuest UCITS Fund returned 1.19% in February (USD Institutional Share Class).

AlphaQuest UCITS Fund Monthly Performance

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Y-T-D
2022	-0.46%	1.19%											0.73%
2021	-2.50%	6.11%	3.25%	1.30%	-0.27%	-0.70%	0.75%	-1.33%	-0.27%	4.19%	-3.52%	-1.46%	5.25%
2020	1.69%	1.04%	5.93%	0.11%	-4.00%	0.75%	2.27%	-1.46%	-3.54%	-0.26%	-2.59%	0.66%	0.19%
2019	-4.96%	-1.34%	2.47%	-1.28%	2.38%	4.93%	0.88%	4.74%	-2.44%	-1.80%	0.64%	-1.10%	2.68%
2018	9.69%	-0.08%	-0.29%	1.43%	0.73%	-1.25%	-2.34%	-0.51%	0.68%	-1.74%	-5.29%	1.20%	1.58%
2017	-4.33%	-2.70%	-0.99%	-0.69%	-2.54%	0.15%	-1.78%	-1.51%	0.70%	3.15%	0.45%	-1.45%	-11.14%
2016												-0.22%	-0.22%

The performance figures quoted above represent the performance of the AlphaQuest UCITS Fund USD Institutional Founder Pooled Share Class since launch on 9th December 2016 through 31st December 2020 (Mgmt Fee 1 Perf Fee 15) and USD Institutional Share Class beginning 1st January 2021 (Mgmt Fee 1.5 Perf Fee 20). These performance figures refer to the past and past performance is not a reliable guide to future performance.

Investment Objective and Strategy

The AlphaQuest UCITS Fund's investment objective is to seek capital appreciation over the long term. The AlphaQuest UCITS Fund invests, on a long and/or short basis, in a globally diversified portfolio representing the major asset classes of equities, fixed income and currencies. It also gains exposure to commodities, on a long and/or short basis, through the use of structured financial instruments ("SFIs"). The AlphaQuest UCITS Fund targets, over the medium term, a realized volatility in the range of 10%-12%, in order to adhere to UCITS investment restrictions.

Quest employs a systematic trading program (the "Program"), diversified by asset class and with individual positions intended to provide a return over different time horizons, that seeks to deliver positive alpha (alpha is a statistical measurement used to determine the risk-reward profile of a potential investment). The Program is comprised of a number of trading systems, each of which generates individual trades. These trading systems generate trades on the basis of price movement indicators which seek to identify situations where there is potential for an increase in the price volatility of a given market. Risk controls are integrated into the Program to measure the potential risk associated with trades generated by the Program. Generally, the Program will determine that AlphaQuest UCITS Fund should take a long position in a market that has shown an upward trending price or a short position in a market that has shown a downward one.

Fund Facts

AlphaQuest UCITS Fund	
Structure	UCITS Fund
Domicile	Ireland
Liquidity	Daily
Fund AUM	$40.6 million
Firm AUM	$1.931 billion
Inception	9th December 2016
Passport	Ireland, UK, France, Lux and Switzerland (Qualified Investors Only)

Share Class	Institutional / Inst. Pooled	Retail Pooled
Currency	EUR/GBP/CHF/USD	EUR/GBP/CHF/USD
Mgt. Fee	1.5%	2%
Perf. Fee	20%	20%
Min Init. Sub.	1,000,000	100,000
ISIN Codes	EUR: IE00BD08G390 / IE00BD08G739	EUR: IE00BD08GM87
	USD: IE00BD08G622 / IE00BD08GB72	USD: IE00BD08GQ26
	CHF: IE00BD08G515 / IE00BD08G952	CHF: IE00BD08GP19
	GBP: IE00BD08G408 / IE00BD08G846	GBP: IE00BD08GN94

The Manager

Key Biographies

Nigol Koulajian

Founder and Chief Investment Officer

Nigol Koulajian is the Founder and Chief Investment Officer of Quest. Mr. Koulajian founded Quest in March 2001 to pursue his passion for quantitative investment research and strategy development, which he has focused on from the beginning of his career in the early 1990's. After lengthy research, Mr. Koulajian identified specific strategies using proprietary techniques that have been continuously enhanced over the past nineteen years and became the basis for the growth of Quest. The firm, which is based in New York, currently manages approximately $1.9 billion in assets. In 2002, Mr. Koulajian started the NOK Foundation, which is committed to promoting the study and practice of yoga and meditation globally. Mr. Koulajian has acted as a board member of the Omega Institute and David Lynch Foundation. Mr. Koulajian earned an MBA in finance from Columbia Business School and a BS in electrical engineering from Notre Dame.

Brian Brugman

Director of Research

Brian Brugman is the Director of Research at Quest, spearheading the firm's research and investment strategy development. Mr. Brugman joined Quest in June 2021 after spending fourteen years at AllianceBernstein where he played a leading role in the construction of the firm's systematic macro investment capabilities. At AllianceBernstein, Mr. Brugman was a Senior Vice President and Portfolio Manager on the Multi-Asset Solutions team, having managed the firm's Systematic Macro strategies since their inception. Mr. Brugman holds a Ph.D. in Physics from the University of California, Los Angeles and a B.S. in Physics and Applied Mathematics from the University of California, Riverside.

Performance Commentary

The AlphaQuest UCITS Fund ended February up 1.2%, outperforming the S&P 500 Total Return Index (-3.0%) but underperforming the SG CTA Index (+2.4%). Despite the Fund's underperformance relative to CTAs, we are extremely pleased with the Program's positioning during the month, which was more heavily geared towards convexity in lieu of generic trends—which are more commoditized and can become overtly overcrowded. The Program demonstrated this during the month when, at the height of the crisis in Ukraine, it generated strong returns on the month. While this performance was surrendered in the near term, the value of such positive skew is immense to investors' portfolios in the long run.

When seeing large gains such as those the Program experienced, it's natural for one to be tempted by profit taking—especially in the current regime of frequent market interventions. While such a feeling is understandable, it is important to highlight the dangers of cutting trades short too early. Our research has consistently shown that taking profits too early reduces positive skew and returns in the long term.

The Program is designed to deliver positive returns with positive Alpha and positive skew. We continue to research ways to maximize results across those three areas without diluting any one characteristic individually.

In February, among sectors, commodities contributed the most as energy, metals, and agriculturals were all positive. Sanctions on Russia led to uncertainty in each commodity subsector due to Russia's prominent role as a supplier of oil and natural gas, Ukraine supplying 16% of world corn and 12% of world wheat, Russia being the world's top wheat supplier at 17% of the market, and rising geopolitical tensions leading to a bid for precious metals. Fixed income was the second-best contributor as the Program benefitted from the continued rise in yields; U.S., German, and Japanese 10-year yields have now risen for six of the last seven months. The Program was short equities and long the U.S. dollar going into February as a result of January's risk-off event. Reversals in both positions at the beginning of the month led to negative contribution overall.

Among trading system families, trend crowding contributed the most, profitable in all sectors but foreign exchange. Intermediate-term and long-term trend following were both marginally positive, benefitting from the aforementioned trends in energy and fixed income. The shortest term volatility breakout models struggled as they were whipsawed in the first half of the month.

Market Commentary

"Always remember that the future comes one day at a time."
- Dean Acheson

The Russian invasion of Ukraine is one of the most significant geopolitical developments in recent decades and could have profound macroeconomic consequences for years to come. Let there be no mistake, as this letter is being written, physical and financial wars are underway. Russia's invasion effectively translates into a declaration of war on Ukraine. The West, led by U.S. and European allies, has effectively declared an economic war on Russia in response. While in this note we will focus on investment implications, we also recognize the human toll it has taken and likely will continue to take on many. Our thoughts and hopes go out to those affected by these violent events, as does our wish for a peaceful resolution.

Since the end of World War II in 1945, and particularly since the collapse of the Soviet Union in 1991, investors have benefited from a more stable world order. After the latter event, investors benefited from a unipolar world that supported globalization, open economies, and reduced geopolitical volatility. These secular trends had the effect of driving inflation lower and asset returns higher over many decades. While most investors take such stability for granted, a predictable and rules-based world order is an unusual arrangement, with few historical precedents.

Today, the world is at risk of becoming multipolar, with established powers (U.S., Europe, and allies) competing with prior foes (Russia), as well as ascending powers (China). Although this theme has been developing for some time due to rising populism and isolationist tendencies in many countries, current events have led to its rapid acceleration. We believe there will be meaningful financial and geopolitical implications as a result of this transition.

We anticipate five major themes will be dominant in the new multipolar world:

1. An increase in activities with less immediate economic benefits, such as defense spending and supply line reconfiguration
2. Even more upward pressure on inflation
3. Central banks will be trapped, with limited options to address inflation challenges quickly
4. Geopolitical confrontations: greater risk of more frequent wars
5. Reduced real return for most financial assets, higher volatility, and greater risk of large drawdowns

It is worthwhile to describe each of these and their implications for markets in more detail.

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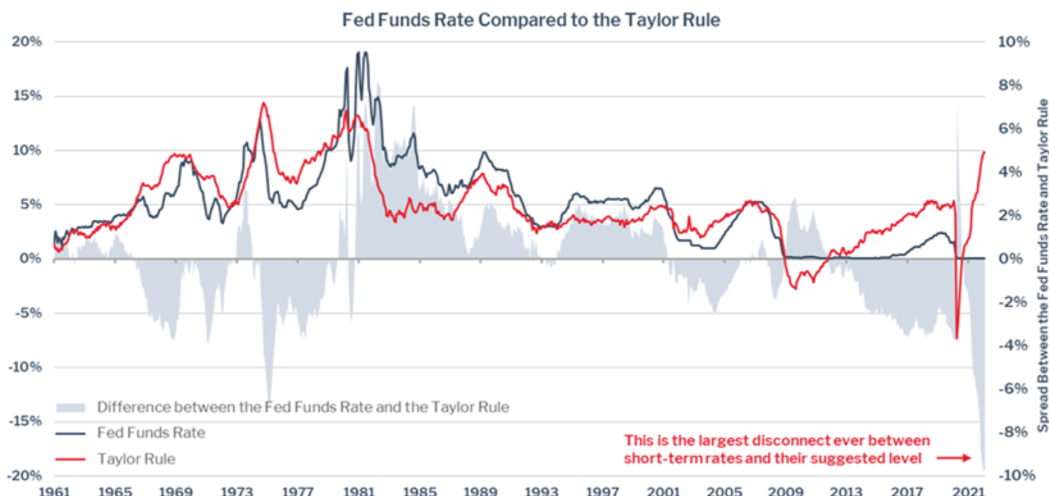
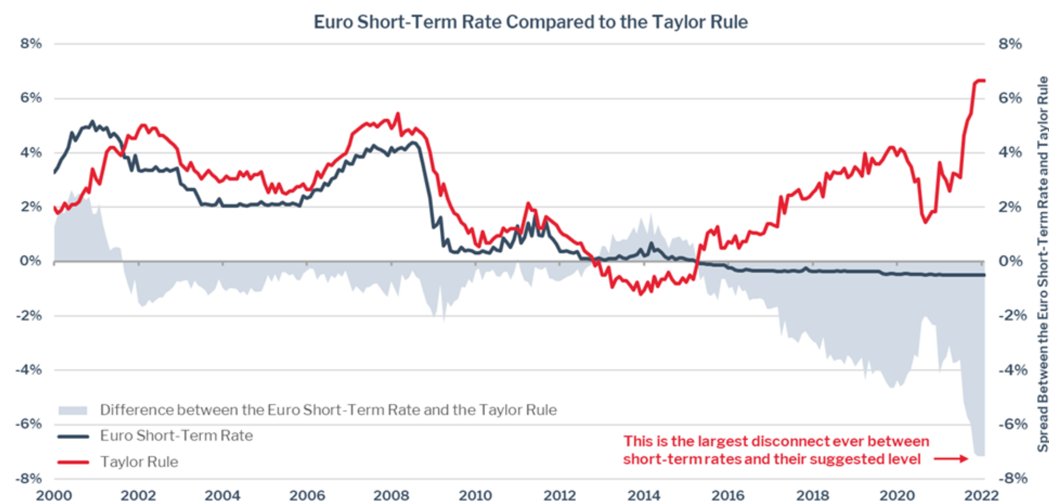
Investors have benefited from secular trends towards lower taxes, an ability to globalize supply lines, and access to cheap commodities for decades. Looking forward, all of these are likely to diminish, both as a result of COVID-19 and geopolitical reconfiguration. For example, many countries in Europe and Asia have signaled a commitment to spend more on national defense, which may limit other areas of investment temporarily but will inevitably increase tax burdens. Individuals and companies that had benefitted from cheap commodities like natural gas from Russia will now need to look to more expensive alternatives. Finally, supply lines and suppliers have been in the process of re-nationalization prior to 2022 and are likely to move even faster now. For instance, consider the experience of clients currently utilizing outsourced providers based in Ukraine. All of these reversing trends will increase expenses and are likely to have a negative impact on aggregate profitability in the coming decade.

As we've written about in past, policy makers were behind the curve even before this supply shock. Now, some western central banks are signaling a need to be "patient" and keep policy accommodative longer than they otherwise would. One way to measure how abnormally loose policy is today is to compare current rates with a rules-based policy, such as the Taylor Rule. This rule, developed in the 1990's by economist John Taylor, suggests a policy rate based on current growth and inflation levels. As the charts below show, since 2015 the policy has been meaningfully looser for both the Federal Reserve and European Central Bank than the rule would predict, and to an even greater extent today. In fact, at present, both are almost four standard deviations below their averages, and this doesn't even include the policy effects of central bank balance sheets. Even with these extreme divergences, policy makers have indicated a need to stay loose as geopolitical tensions rise—they are effectively trapped.

Central bank policies are the most simulative in decades even as inflationary pressures are surging



Source: Quest Partners LLC, Bloomberg; January 1961 through February 2022. DISCLOSURES: Past results are not necessarily indicative of future results. Derivatives trading involves substantial risk of loss and may not be suitable for everyone. This is not a solicitation.



Source: Quest Partners LLC, Bloomberg; January 2000 through February 2022. DISCLOSURES: Past results are not necessarily indicative of future results. Derivatives trading involves substantial risk of loss and may not be suitable for everyone. This is not a solicitation.

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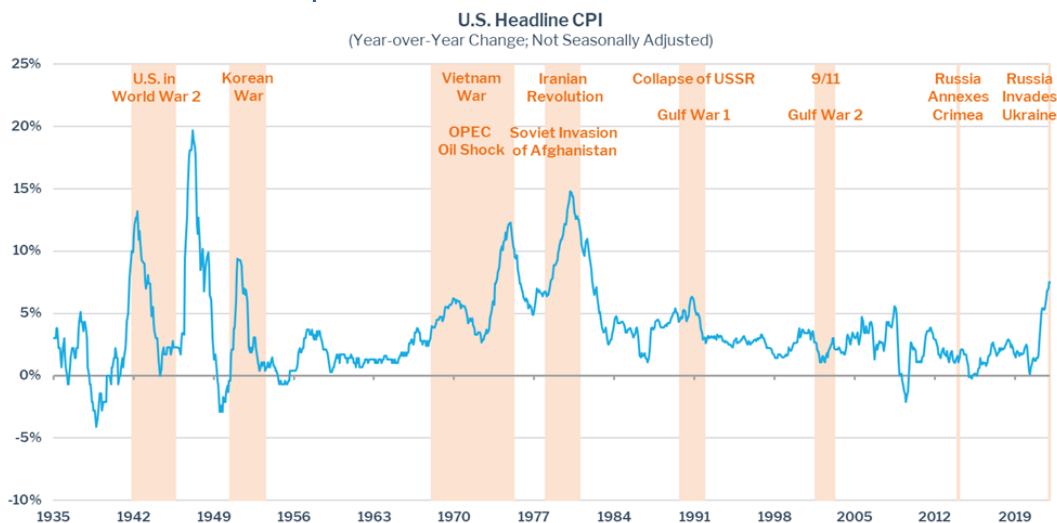
Looking back at past geopolitical risk episodes, inflation has often followed. As described above, rising inflation is often due to increased costs and disruptions felt as well as the need to maintain accommodative policy. The key challenge for central banks is that it is very difficult to reign in these inflationary pressures without causing significant disruption to economic growth and financial markets. The era of high inflation of the 1970's was ultimately vanquished by huge increases in interest rates which caused a recession in the early 1980's. Such options are unlikely to be adopted today given the high levels of debt and how dependent the real economy is on financial market values remaining elevated.

Geopolitical risks tend to exacerbate inflation



Source: Quest Partners LLC, Bloomberg; January 1935 through January 2022. DISCLOSURES: Past results are not necessarily indicative of future results. Derivatives trading involves substantial risk of loss and may not be suitable for everyone. This is not a solicitation.

In a multipolar and unpredictable world, geopolitical conflicts are likely to continue to present themselves unexpectedly. As of this writing, Russia's nuclear arsenal is being put on active alert, neighboring nations are militarizing their borders, and peace talks are stalling. While de-escalation is certainly possible in the coming days, the continued risk of a repeat in Europe will likely remain for a long time. Furthermore, there are many other disputed borders around the world, particularly surrounding China. The possibility of either side seeking to harden its position through the use of force will continue to be a concern. Prudent investors should be prepared for these conflicts to arise with increasing frequency relative to the past several decades.

The net result of all these dynamics will likely be lower real returns for most financial assets, higher volatility, and the risk of faster and larger drawdowns. In the face of surging inflation, central banks are less likely to step in and support markets at every turn, as they have in the past decade. As we discussed in last month's letter, we have seen the velocity of major market drawdowns increase over the past several years as leverage increased and hidden risks became more acute. Traditional sources of return (e.g., large-cap multinationals) and diversification (e.g., nominal sovereign bonds) are likely to disappoint. Some hedge fund strategies that generate high Sharpe ratios through a "convergent" investment approach are also likely to disappoint as the stable regime breaks down. Conversely, "divergent" investments that benefit from expanding volatility and breaks from past trends are well positioned for such environments. As such, we expect CTAs and the Program, in particular, to do well.

The Program's consistent focus and disciplined approach has delivered substantial Alpha, strong negative correlation to market benchmarks, while also delivering attractive absolute returns over time. Regardless of the outcome of the situation in Ukraine, volatility is likely to be higher moving forward and could result in greater uncertainty. We expect such developments to provide a favorable performance backdrop for divergent strategies such as the Program.

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