MontLake

AlphaQuest UCITS Fund

CTA/Managed Futures

November 2021

Performance Returns

The AlphaQuest UCITS Fund returned -3.52% in November (USD Institutional Share Class).

AlphaQuest UCITS Fund Monthly Performance

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Y-T-D
2021	-2.50%	6.11%	3.25%	1.30%	-0.27%	-0.70%	0.75%	-1.33%	-0.27%	4.19%	-3.52%		6.81%
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.

The Manager

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.

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

Structure	UCITS Fund
Domicile	Ireland
Liquidity	Daily
Fund AUM	$41.9 million
Firm AUM	$1.908 billion
Inception	9th December 2016
Passport	Ireland, UK, France, Lux and Switzerland (Qualified Investors Only)

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

Share Class	Retail Pooled
Currency	EUR/GBP/CHF/USD
Mgt. Fee	2%
Perf. Fee	20%
Min Init. Sub.	100,000
ISIN Codes	EUR: IE00BD08GM87
	USD: IE00BD08GQ26
	CHF: IE00BD08GP19
	GBP: IE00BD08GN94

Performance Commentary

The AlphaQuest UCITS Fund had a challenging month in November, ending down -3.5% and modestly underperforming its beta-adjusted exposure to the SG CTA Index, which returned -3.2%. The bulk of the loss occurred toward the end of the month when news of the COVID-19 Omicron variant led to gap moves in markets during overnight hours—which were exacerbated by illiquidity around the Thanksgiving holiday. Despite the November return, the Fund remains up +6.8% for the year, ahead of the SG CTA Index year-to-date return of +6.4%.

November was essentially a tale of two parts: For most of the month, the markets were focused on robust economic growth and surging inflation. Rising COVID-19 vaccination levels and declining cases in many parts of the world led some commentators to declare the 'end of the pandemic'. Equities and commodities were trending higher, government bonds were under pressure, and the U.S. dollar broke out to multi-year highs against several major currencies. These trends abruptly reversed on November 26th when the World Health Organization announced that a new variant of COVID-19 was potentially more transmissible, virulent, and had the potential to evade current vaccines. The news caused massive moves in several markets which were accentuated by poor liquidity due to its timing around a major U.S. holiday. Within a few hours, S&P 500 futures declined -2.5%, crude oil fell -14.0% (for its largest decline since the April 2020 collapse), and the U.S. dollar declined -2.0% relative to the Japanese yen. These moves adversely impacted the Program's long positions in equities, crude oil, and the U.S. dollar, and short positions in fixed income. The Program's short-term, systematic nature, paired with embedded risk management, helped to protect from further losses, resulting in exits in the majority of such exposures and the Program beginning to position into the direction of the selloff.

As we have often highlighted, the Program acts swiftly but not instantaneously. When there are sudden news events and corresponding gap moves, there is a high likelihood that the Program will experience losses, particularly if on the first day of a market selloff as this usually coincides with a reversal of existing short- and medium-term breakouts and trends. It can take up to a few days to reposition the portfolio into the direction of the volatility expansion—the speed of adaptation depending on the nature and size of the market move. As such, the late November 'Omicron' episode was no different and the change in exposures was in line with similar instances in the past.

All sectors but equities were negative. Commodities was the biggest detractor, with the bulk of the losses coming from the crude oil complex. Minor losses in natural gas, copper, and gold also detracted from portfolio returns. Short positions in government bonds led to fixed income being the second-worst performer, as prices surged on the prospect of renewed lockdowns and weaker growth. Foreign exchange experienced declines, particularly in the U.S. dollar relative to the Japanese yen and euro. Contrary to recent 'risk-off' events, it was noteworthy that in this episode, the U.S. dollar declined meaningfully. Equities were a bright spot in the portfolio as strong gains in U.S. and European indices in the early part of the month provided a cushion to the selloff which occurred later.

All trading system families but short-term volatility breakout were negative. Long-term trend following trading systems, that can maintain positions for weeks to months, and Trend Crowding trading systems were the biggest detractors as several mature trends reversed abruptly. Although the Program had modest exposures, the size of the decline across all sectors contributed meaningfully to overall performance. Intermediate-term trend following trading systems, which trade time horizons of a few days to a few weeks, also underperformed. The short-term volatility breakout trading systems that can trade up to a few days were profitable in November, generating their best returns in equities and foreign exchange.

Market Commentary: 'Transitory' inflation has been retired

On November 30th, U.S. Federal Reserve Chair Jerome Powell finally acknowledged what markets had been signaling all year: that significant and persistent inflationary pressures have been building and that they are not as transitory the central bank had been propagating. With shortages of physical assets emerging and anecdotal evidence of widespread price increases from surveys such as the Federal Reserve's own Beige Book, the central bank could no longer risk further damage to its credibility by talking down inflation and pretending it would be temporary.

As we have written in prior letters, the extent of money printing by central banks at the time when inflation is surging is unprecedented in modern financial history. The chart on the following page shows 'real' interest rates, or the difference between 3-month Treasury bill rates and the U.S. Consumer Price Index.

'Real' rates are currently at their most negative level since the late 1970s, when inflation was rampant, and the Federal Reserve was scrambling to bring it under control.

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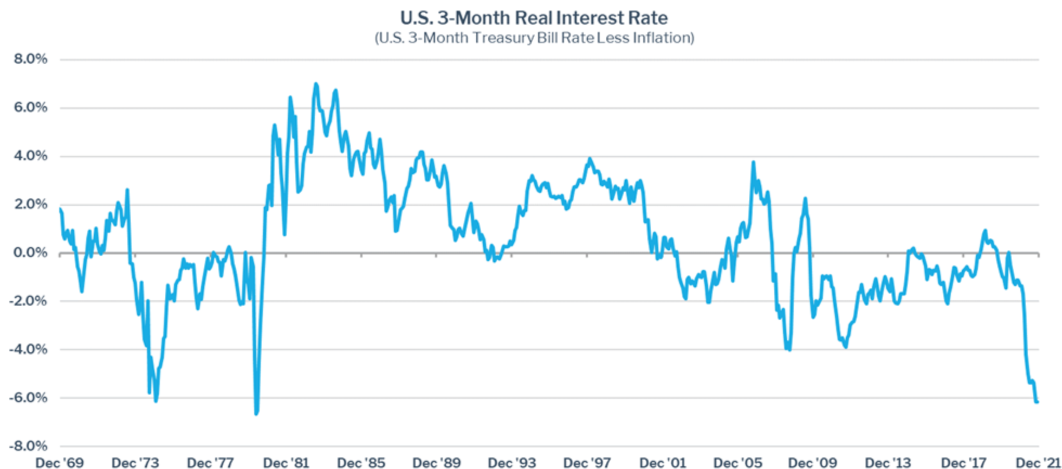
High inflation and near-zero interest rates have created the most negative real interest rates since the late 1970s



Source: Quest Partners LLC, Bloomberg; December 1969 to November 2021. 3-month rate is USGG3M Index and inflation is CPI YoY Index.
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.

Given such extreme levels, it is interesting to examine the performance of CTA strategies relative to the level of real interest rates. The table on the following page breaks down real yields over the past fifty years into 'quintiles' or each twentieth-percentile bucket from low to high real-yield levels.

CTAs[1] perform strongly when real yields are at extremes

Performance of CTAs[1] by Starting Level of Real Yields				
Real Yield Quintile	Average Real Yield (Start of Period)	Forward 12-Month CTA Return[1]	Share of Observations in Quintile	Probability Quintile Return Deviates from Population Mean[2]
1	-2.5%	5.6%	20%	89%
2	-0.8%	4.5%	20%	3%
3	0.4%	3.3%	20%	96%
4	2.1%	2.9%	20%	99%
5	4.1%	6.4%	20%	100%
All	**0.7%**	**4.5%**	**100%**	

Source: Quest Partners LLC; January 1970 through November 2021.
[1]The CTA strategy utilized is a 10-day by 100-day moving average crossover model, equal weighted across the four sectors and trading the following seven markets: S&P 500, U.S. 10-Year Treasury, German bunds, Gold, Crude Oil, USDJPY, and GBPUSD. Market performance utilized where available. The above figures are excess returns and do not include the return on cash which would be required to collateralize such an investment. THE ABOVE PERFORMANCE IS DERIVED FROM A HYPOTHETICAL TRADING STRATEGY. PLEASE REFER TO THE HYPOTHETCAL PERFORMANCE DISCLOSURE IN THE ADDITIONAL DISCLOSURES SECTION AT THE END OF THIS DOCUMENT.
[2]Based upon a two-sided T-Test of observations in the Quintile vs all observations

The analysis above shows that CTAs[1] tend to perform strongly when real yields are either very low or very high. For example, future 12-month returns are +5.6% in the lowest quintile and +6.4% in the highest quintile. These returns are significantly greater than those of the middle quintiles when real yields are more 'normal'. Additionally, as shown in the right-most column, the returns at the extremes are also statistically significant. The column shows the probability that the average return within the quintile is significantly different from the average observation. High levels of probability indicate that there is indeed greater dispersion from the mean.

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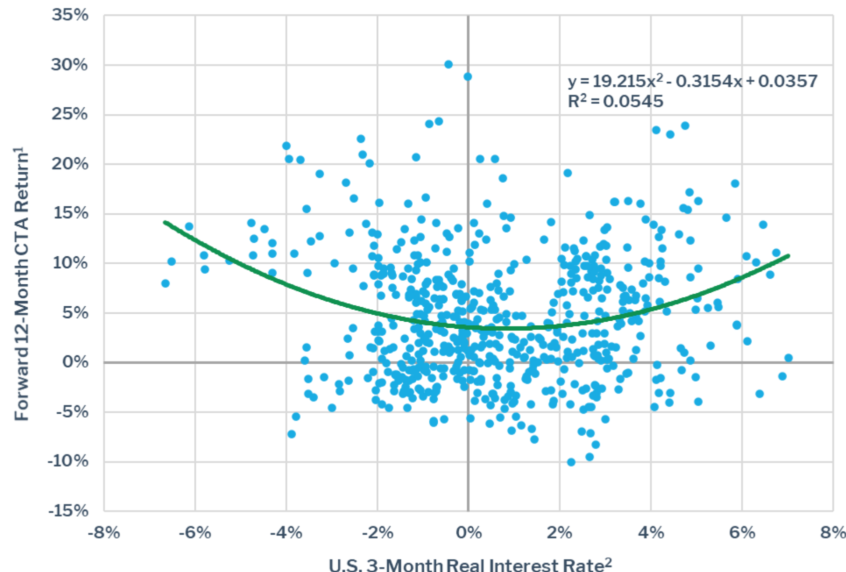
Another way of highlighting this relationship is through the scatter plot and the regression line of real yields and future CTA returns. It is interesting to note the curvature or 'smile' of the regression line which indicates that not only do CTAs tend to perform better when real rates are very low or very high, but they do so in a non-linear or accelerating pace. In other words, CTA returns can be markedly better at the extremes.

The CTA real-yield 'smile' is evident; the highest and lowest real rates are best for CTAs



[1]The CTA strategy utilized is a 10-day by 100-day moving average crossover model, equal weighted across the four sectors and trading the following seven markets: S&P 500, U.S. 10-Year Treasury, German bunds, Gold, Crude Oil, USDJPY, and GBPUSD. Market performance utilized where available. The above figures are excess returns and do not include the return on cash which would be required to collateralize such an investment. THE ABOVE PERFORMANCE IS DERIVED FROM A HYPOTHETICAL TRADING STRATEGY. PLEASE REFER TO THE HYPOTHETCAL PERFORMANCE DISCLOSURE IN THE ADDITIONAL DISCLOSURES SECTION AT THE END OF THIS DOCUMENT.

[2]3-Month Real Interest Rate is the U.S. 3-Month Treasury Bill Rate less CPI for All Urban Consumers, not seasonally adjusted

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Extreme levels of real yields indicate high levels of uncertainty related to inflation and/or that monetary policies are at disconnect from economic realities. Both conditions lead to higher volatility and hence it is not surprising to observe CTAs performing better during such periods.

For markets and investor portfolios, the implications are significant. Valuations for most assets are currently at or near-record highs when inflation uncertainty is surging and central bank policies are turning restrictive. Investor behavior, conditioned by decades of successful central bank interventions and low market volatility, is also at an extreme. Most portfolios are risk-on and hedging is light or non-existent given how difficult and expensive it has been to neutralize any form of risk.

While the environment of the past may yet perpetuate, the pressures are undeniably building. With so many things at extremes, there is little margin of error and investors may be surprised at how different the outcomes can be for markets and their portfolios.

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MontLake

Contact Details

Investor Contact
Bastions Partners Office SA
61A Route de Chêne
CH-1208 Genève - Switzerland
Michel Brulhart T: +41 (0)22 3220 326
m.brulhart@bastionspartners.ch

Management Company
Waystone Fund Management (IE) Ltd
3rd Floor, 76 Baggot Street Lower
Dublin, Ireland
T: +353 1 533 7020
investorrelations@waystone.com

Investment Manager
Quest Partners LLC
126 East 56th Street, 25th Floor
New York, NY 10022, USA
T: +1 212 838 7222
investorrelations@questpartnersllc.com

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