November 5, 2017

MBS Mantra October 2017 returns: 0.84% Net, 7.89% YTD, 1.9 Net Sharpe

Hello. Please find attached the October 2017 Fact Sheet for our MBS Strategy. This can be accessed from our website as well.

In this letter, we provide a peek into our unique proprietary process and strategy.

News: As of November 15th, we will have a new address: 243 Tresser Boulevard, 17th Floor, Stamford, CT 06901. Our phone numbers will remain the same.

MBS Absolute Return Strategy - October report

Our strategy continues to provide "uncorrelated" returns, in spite of investing in MBS bonds: 0.84% Net, 7.89% YTD, 1.9 Net Sharpe, 0.22 Beta to Barclays Agg, 0.06 Beta to the S&P.

This derives from our process of investing in bonds when their returns from cashflow, (and thus cashflows) are high, and selling them when returns from cashflow drop. We thus compound high cashflow returns, creating a portfolio cashflow and return stream that aims to be higher than that of individual bonds. We use a systematic long-short-like process to screen bonds, subjecting bonds to fundamental analysis once they have been identified as potential purchase candidates. Our current return hurdle is 2yr + 500 (~6%), above which we buy and below which we sell, with a highly diversified portfolio to stabilize idiosyncratic bond behavior.

This is a unique process that was created in the 1990s, (when I headed the MBS Strategies Group at Nomura), as a result of seeing a disconnect between OAS and actual MBS returns. This triggered a research process to understand MBS returns and risk. **The process has been developed, fine-tuned, and systematized over 20+ years**, and has been responsible for many of the almost-10,000 MBS trades totaling billions identified in the secondary markets, and executed for 200+ institutional money managers and hedge funds over that period. A side-effect of this process is that it also identifies arbitrage opportunities and mispricings.

Our portfolio generated approximately 2.7% cashflow for October - a direct effect of our investment cashflow screening process. **A high cashflow ratio keeps portfolio duration low - we estimate ~2 years - risk adjusted returns high, and gives us low correlations to other markets, resulting in a 2.3 gross Sharpe ratio.** Graphs in our pitch books show that 1.5% to 5% monthly cashflow has been the norm for our portfolios going back to the 1990s.

Price appreciation is one of the main causes of cashflow return declines, forcing us to sell bonds. We are possibly the only manager that dislikes price appreciation, as we prefer stable cashflows and consistent returns over short-term capital gains. We do not rely on price change for our returns. We directly target portfolio and bond total return, instead of relying on factor based models that might hopefully correlate with actual returns, but usually only capture market Beta and market average returns. This process and mindset gives us an edge over most of our competitors.

Beta and Correlations

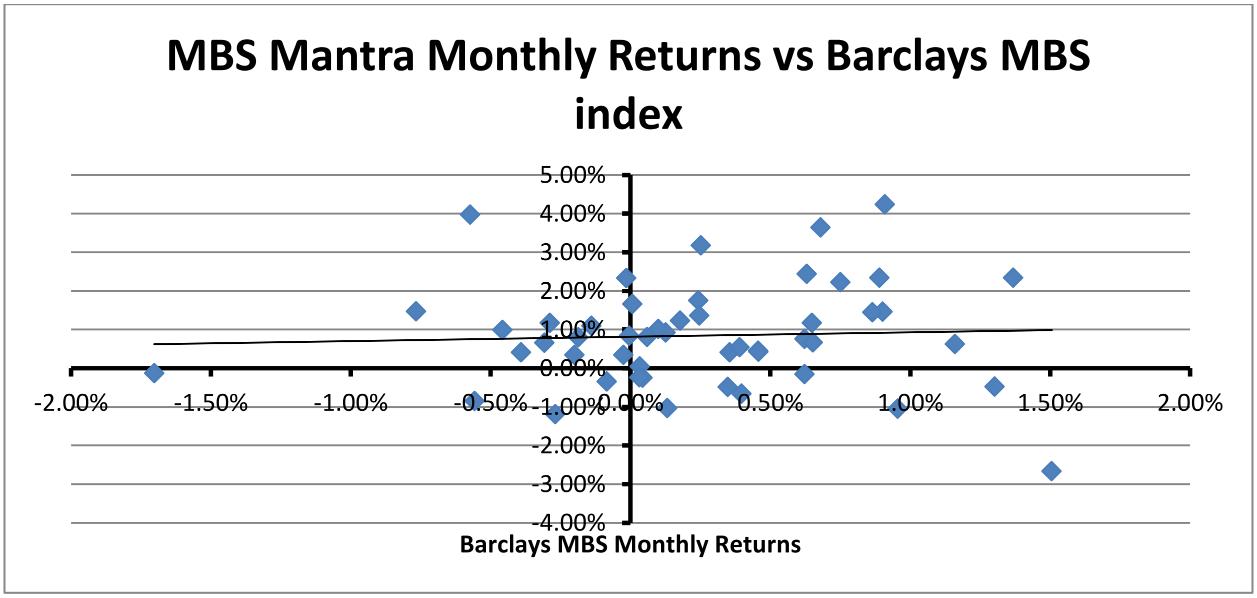
There is a tremendous need from the Asset Allocation community for "uncorrelated alpha generating strategies". We have 2 solutions, of which this is one.

In this world of excessive Beta risk, most investors have a hard time believing that an uncorrelated strategy can still exist. That is because almost all asset classes and strategies that they have been exposed to rely on price change for their returns.

Our returns are not driven by price change. Our emphasis on cashflow returns, makes our correlations and beta low, making this strategy very valuable for Asset Allocation and risk reduction. The following table from our Fact Sheet shows our 4 year statistics versus benchmarks.

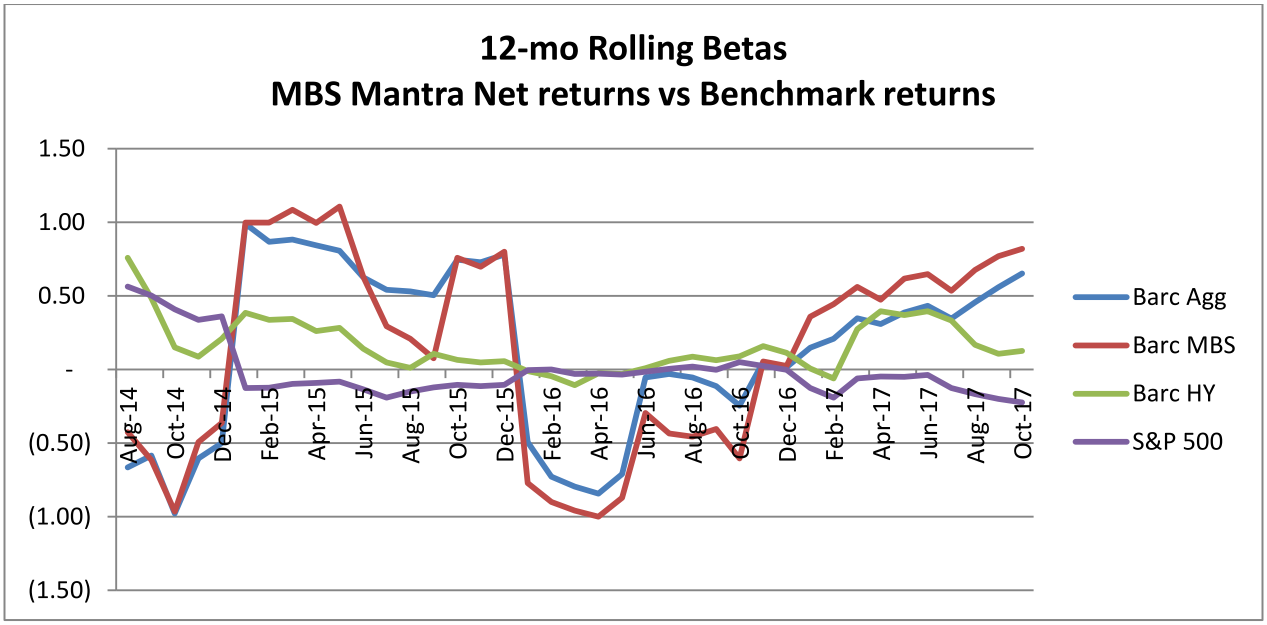
	Barc Agg	Barc MBS	Barc HY	S&P 500
Beta	0.22	0.11	0.13	0.06
R-Squared	0.02	0.00	0.02	0.01

This graph compares MBS Mantra monthly returns vs the Barclays MBS Index, and also shows the fitted line whose slope is Beta and intercept is Alpha. One can see that the relationship is not very strong, resulting in low correlations (R) and R-Squareds. We also have fewer drawdowns than benchmarks (26% vs Barc MBS 32%, Barc Agg 38%).



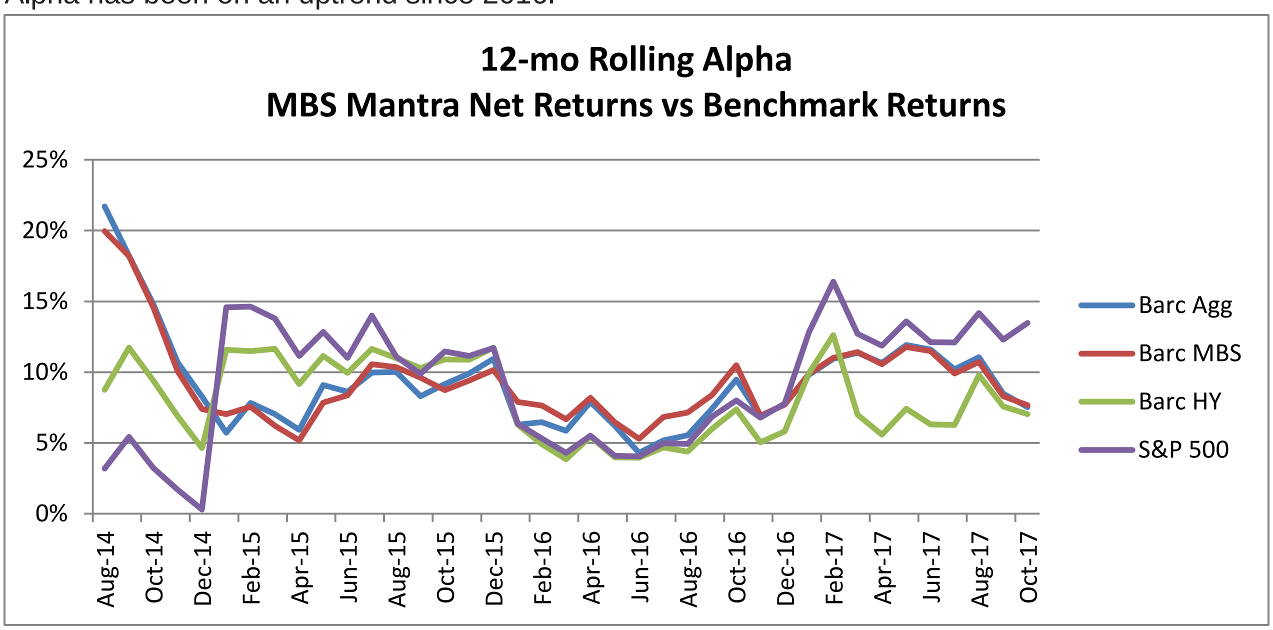
A similar graph exists versus other benchmarks.

We view Beta as a more relevant measure of risk than correlations or standard deviation, as it incorporates a magnitude-of-risk measure as well. The next graph shows our 'Rolling 12-month Betas' versus a number of benchmarks.



On average, we have a stable but slightly negative Beta to the S&P - of late it has gotten more negative! Our Beta relative to other bond market benchmarks is quite volatile, (and currently on an uptrend), making it impossible for us to find a consistent hedge using fixed income products.

What should make our strategy intriguing is our Alpha. The following graph shows our 12 month rolling Alphas (annualized) vs Benchmarks. In an environment of richening markets, our Alpha has been on an uptrend since 2016.



Please feel free to ask questions. If you have specific investments or funds that you would like to compare our returns to, we would be happy to run the numbers. When comparing us to other funds, please remember that we do not use any leverage.

Regards, Samir.

Samir Shah

President and CIO

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"Alpha Through Analysis"

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