CANOSA

Annual newsletter 2014

This is the 2014 annual newsletter for the Canosa Global Macro Fund, covering:

i) CIO 2014 Review and Market Outlook 2015
ii) COO Review 2014
iii) CRO Review 2014

Feel free to contact the Canosa team should you wish to discuss or require any additional information on the topics below.

CIO 2014 REVIEW AND MARKET OUTLOOK FOR 2015

2014 was characterised by a precipitous decline in the global inflation outlook and the US economy decoupling from subtrend growth almost everywhere else in the world. Disappointing global demand meant inflation struggled to gain any traction during the first half of the year, while a sharp selloff across the commodities spectrum, not least oil, sealed its fate after the summer. Accordingly and, contrary to our expectations, developed fixed income markets more than reversed the losses from 2013 and were amongst the best performing assets. As the fortunes of the US economy diverged from those of its trading partners the Dollar posted its best year since 2005. Despite associated weakness in energy stocks, the S&P 500 still finished the year not far off its historical highs and enjoyed its longest streak of annual gains (6 years) since the 1990s.

As we head into 2015 we see the global disinflationary dynamic as being well entrenched. Amongst other factors, this will offer firm support for expensive fixed income markets. The effort from G4 central banks to reflate their economies is ongoing. Indeed, at the margin, we see this liquidity provision accelerating despite the cessation of asset purchases by the Federal Reserve. Given current guidance and expectations of quantitative easing the ECB and the Bank of Japan (BoJ) together will likely purchase $1.3tr of bonds this year relative to the $1.0tr that last year was bought by the Fed and the BoJ. Combined with institutional demand for duration, which regulation has de-sensitised to prices, and a wary retail investor, it will take a powerful force to de-rail the fixed income rally.

As we saw in 2013, the Fed certainly has the ability to generate a sell-off in fixed income markets. However, the current trajectory of inflation in the US suggests that the Fed is likely to remain benign, contrary to recent rhetoric. Considering the moves in energy prices, the strength of the Dollar and the current stubbornness of Fed's and consensus' forecasts for core inflation, the bar for downside surprises in consumer prices looks a low one. Furthermore, while the Fed seems willing to downplay the drag on growth that US currency strength will likely exert, there are surely limits to how much more Dollar strength it can withstand. Simply put, the more the dollar appreciates, the more it undermines the drivers supporting it – the US growth engine and a central bank on course to raise interest rates. For now, the decline in oil and long end interest rates provides a helpful offset, but a crucial question for 2015 will be the durability of this important theme.

The impetus for US growth in 2015 will pass to the consumer in 2015. Total Income for the private sector is growing at post crisis highs thanks to the addition of nearly 3 million jobs in 2014. With weak headline inflation over the next few quarters, aggregate real incomes are likely to increase around 5%. Since consumers (70% of GDP) spend approximately 95% of income, personal consumption expenditure should contribute somewhere between 3.25–3.5% to GDP growth for most of this year. This dynamic should allow the economy to remain robust to the Dollar strength described above for some time. It will also be a core underpinning to the global economy where other economies are struggling to gain such a firm footing.

We expect the Euro area economy to continue its glacial recovery this year. Rigidities associated with a one-size-fits-all monetary policy coupled with weak labour markets acts as a strong break on growth. The single currency area has entered 2015 in deflation and will not likely emerge from this state until the fourth quarter. However, we do not expect this to be a death knell for the economy as some forecast. A potentially more significant risk in Europe centres on its politics. The forthcoming Greek election on 25 January will undoubtedly be a source of noisy market headlines though the probability of the country exiting the Euro area should remain low. Investors should also watch closely political developments in Spain and even France after the recent tragic events. We expect the ECB to announce sovereign bond purchases in January, yet without signs of a more meaningful pick-up in growth, European risk assets will continue to underperform their global peers.

Conversely, Japan has become the new beacon for the reflation trade and is at the centre of our positive view on risk. Free from the shackles of a consumption tax hike this year and at the behest of a government and central bank that is unreservedly committed to herding investors along the risk spectrum, Japanese equities are set to outperform. The current high level of equity volatility in Japan is likely keeping investors at bay though we expect that a combination of BoJ and GPIF (public pension fund) buying will sedate volatility as we move through the first half of the year. We also expect earnings upgrades as well as the push for improved corporate governance to lend support to the market. For the stars to be fully aligned for Japanese stocks we need to see a pick-up in global growth this year. Current activity data suggests this is not imminent. However, the positive impact of the recent oil decline should be felt through this year and provide a meaningful boost to world GDP.

We expect the deceleration of Chinese growth and the reorientation of its economy towards its consumer to continue. There remains a significant amount of spare capacity in China though we believe that the authorities currently have the determination and wherewithal to manage the economy lower in an orderly fashion for the time being. Not that this will be much comfort to many other emerging market (EM) economies that have been struggling in the context of this growth deceleration as well as weak demand in Europe. Indeed, EMs now face another foe: US dollar strength. History, whether it be the late 1980s or the late 90s, has not been kind to many EM economies as we transitioned to a stronger USD. Some offset will come from robust US consumer demand though there are likely to be some adverse events along the way for those countries with more precarious balance sheets. We look to implement trades that will exploit these dynamics.

Australia remains vulnerable in this environment. Just as China's economy faces a long transition period, so does Australia as it rebalances its own economy. As such, its economic malaise is largely structural in nature as opposed to cyclical. While the RBA is likely to maintain a more reactive rather than proactive posture given this backdrop, we expect enough pressure to build to force them to cut rates later this year.

PORTFOLIO UPDATE

The last quarter of 2014 saw a material pick up in volatility in both rates and equity markets. Indeed, the frequency of outsized price moves already experienced in the first week of this year has been alarming notwithstanding the surprise abandonment of its currency floor by the Swiss National Bank. While it is difficult to know exactly what is driving this shift, a lack of liquidity, especially in some asset classes, appears to be prevalent.

As such, we are more inclined to run a lower structural exposure for the time being as markets acclimatise to higher volatility and express our views on the back of market sell-offs. During the recent weakness in Japan we have been adding to our long equity exposure there and have reduced some of the inherent equity risk premium by pairing it with an index of global equities. We have also been adding on weakness to our basket of US consumer orientated stocks and homebuilders. The cocktail of a rapidly improving labour market, rising real incomes and a windfall from lower oil prices should ultimately place US households in a very strong position.

In fixed income we have a bias to be long the very front end of the US curve though are managing this exposure tactically. In a low inflationary environment, this has an attractive 'risk-off' property while also expressing the view that the recent oil and US Dollar moves skew the likelihood of Fed rates hikes to later in the year. We are received in Brazilian front end rates also, where we expect a mix of lower than expected inflation and very weak growth will keep the central bank from hiking as much as the market currently expects. Depending on the policy action of the ECB later in the month, particularly with regards to the clauses on implicit risk sharing amongst countries, we are looking to get short Euro area peripheral spreads.

In FX we hold a short Euro and long US Dollar bias. We hold the Dollar against a basket of developed market currencies and, as discussed above, still believe that this theme has more room to run. The Euro also has more room to fall versus its peers as the ECB finally gears up to drive its balance sheet higher alongside negative deposit rates. At the time of writing, the Swiss National Bank has just removed its currency floor to the Euro. While this was not something we expected them to do, we had removed all our short Swiss Franc exposure in the first half of December.

We thank our investors for their support over the course of 2014 and look forward to further dialogue over 2015.

2014 – WINNERS AND LOSERS

Top 5, 2014

The top 5 trading views that drove positive performance in 2014 are summarised below:

Trade	*PL (% of NAV)*
Long Australia rates, outright and vs US Rates	5.4%
Long USDJPY	2.5%
Long Europe rates, outright and vs US rates	1.8%
Long USDCNH forward points	1.2%
Long Italy, outright and vs EM Sov and Bunds	0.8%

Bottom 5, 2014

The trading views which contributed the greatest negative PL in 2014 are as follows:

Trade	*PL (% of NAV)*
Short US rates	–4.8%
Long European dividends	–2.7%
Long Europe banks vs short EM	–1.2%
Short Australia FX	–1.1%
Long Europe equities	–1.1%

London, January 2015
Tim Attias and Santiago Alarco, joint CIOs

COO REVIEW 2014

Canosa Capital LLP launched the Canosa Global Macro Fund on 1 May 2013 with an AUM of $272mm, in partnership with Brummer & Partners. The fund as at the end of December 2014 had an AUM of $847mm with a total of 15 investors. The fund currently has clearing and prime brokerage relationships with Goldman Sachs, Credit Suisse and Citi Group, together with standalone custody arrangements with Citibank and Bank of New York Mellon. The fund trades with 10 ISDA arrangements (with an additional 2 being negotiated and one key ISDA agreement being renegotiated).

The team of six has increased to eight with the addition of Stephen Elgie (Portfolio Manager), who has previously worked with the joint CIOs and joined Canosa from Caxton, and James Wrisdale (Strategist) who joined Canosa from Goldman Sachs Asset Management. The core Canosa team is supported by B & P Fund Services, both in London (a team of eight) and Stockholm, covering Risk, Shadow Accounting, Middle Office, Back Office, IT, Compliance, Legal and Marketing services.

Through a combination of Citco and B & P Fund Services, a stable operational infrastructure has been in place throughout the year, with multiple levels of control, capacity and redundancy. This has ensured true segregation of duty, independent oversight and monitoring of the fund. Parallel controls have operated on a daily basis including a full set of reconciliations, which ensure the risk of operational failure or NAV misstatement is minimised. Throughout 2014, there have been no negative operational events or periods where the infrastructure was not available.

Canosa Capital LLP was authorised under AIFMD on 21 July 2014, and has been in full compliance with the regulatory framework. There have been no breaches of the FCA rules to report. Canosa Capital LLP is an Exempt Reporting Adviser with the SEC in the US since May 2014. We have expanded our compliance monitoring programme to include detailed independent Email testing, focussed best execution and market abuse testing on a quarterly basis. To date compliance testing has not provided any negative results. Canosa continues to comply with the Hedge Fund Standards Board.

The Board of Directors have met four times in 2014, and have ensured that the fund has operated within its investment guidelines. Each board meeting has included a full and detailed report covering performance by the joint CIOs, attendance by the fund's service providers including the fund administrators, legal counsel, auditors and clearers/primebrokers. There are no negative issues to report from the board meetings to date. In addition to the formal quarterly board meetings, there have taken place monthly calls to discuss performance since January 2014. These calls have taken place every month without exception and have ensured that the Fund Directors have a timely understanding of the fund's NAV and the factors behind performance, as well as any other issues affecting the fund.

Both the fund and Fund Manager are currently undergoing their second statutory audits, with the fund also having a detailed money laundering audit. The first money laundering audit performed in January 2014 by KPMG led to an enhancement of money laundering controls operated by Citco over the fund and its investors.

Canosa Capital LLP and its infrastructure will continue to manage Canosa Global Macro Fund in a stable environment through 2015.

London, January 2015
Raza Khan, COO

CRO RISK SUMMARY 2014

MONTHLY RETURNS

The monthly net NAV returns of the USD A Class Share Series in 2014 were as follows:

Monthly performance, Canosa Class A, 2014, %

January	–0.23
February	1.88
March	–1.39
April	–2.68
May	0.38
June	0.74
July	0.70
August	–1.36
September	2.95
October	–8.70
November	2.00
December	–0.95

- Net return YTD –6.95%
- 2014 monthly return volatility 10.8%
- Net return since inception +1.75%

Daily P&L

Taking the larger data sample of daily returns for the year (gross of fees), the gross return on the fund was –5%, annualised daily volatility 11.2%.

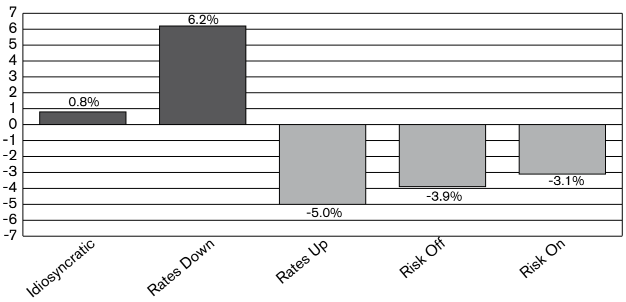
ANALYSIS OF RETURNS

Daily returns, 2014

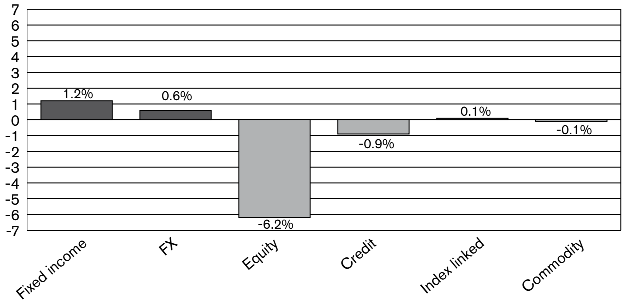
P&L	*Number*	*% of days*	*Average PL*	*% days PL exceeds +/-0.5%*
Total days	252	100	–	37
Positive days	128	53	0.49	18
Negative days	124	47	–0.55	19

Returns attribution by category

The Fund groups its trades into 5 categories. The returns attribution by category, in per cent (%), is illustrated below.



Returns attribution by asset class, %



Returns attribution by strategy

The fund held a total of 99 core strategies during 2014.

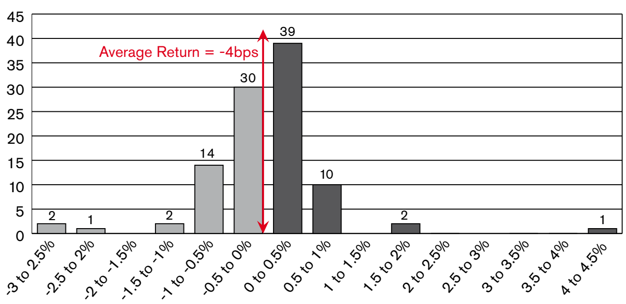
- 52 (i.e. 53%) of these contributed positively to performance adding a total of 22% of gross P&L,
- 47 (i.e. 47%) added net losses totalling –26%.

The average strategy P&L was +43bps for the positive performing strategies and –56bps for the negative. The greatest profit from a single strategy was +4.4% from the Long AUD Rates strategy. The greatest negative contributor was –2.7% from Eurodollar Dec 4 into Dec 6 strategy. In total 3 strategies contributed more than 1% of P&L each and 5 strategies contributed more than –1% negative P&L. All other strategies contributed P&L of between –1% and +1%, as illustrated by the chart below.

Strategy performance

	No of strategies	*% of stategies*	*Aggregate P&L*	*Average strategy P&L*	*Max profit or loss*
Total	99	100	–	–	
Positive Contributors	52	53	22%	43bps	4.4%
Negative Contributors	47	47	–26%	–56bps	–2.7%

Distribution of core strategy returns



VAR

Summary of Fund VaR

For the majority of the year to mid October, Fund VaR was in a 30bp range between 80bps and 110bps. (The exception was a period of 5 trading days in April when VaR exceeded 110bps, peaking at 130bps.)

Stop losses triggered a substantial reduction in risk in October. As a result, VaR was cut from 105bps at the start of October to a low of 24bps, in line with the Fund's Risk Policy, and this lower level of risk was maintained until the end of October. In addition, reduced risk was maintained through November with an average of 53bps in the month and a peak of 68bps. Increased asset volatility in the first half of December pushed VaR up to a peak of 94bps but this was reduced for the remainder of the month back down to around the 70bps level.

Experienced P&L vs VaR

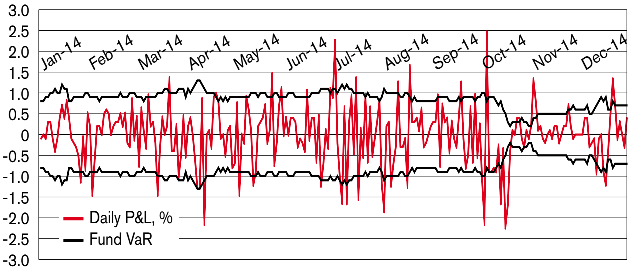
Out of 252 trading days, the Fund experienced 27 days (i.e. 11%) where negative P&L exceeded the Fund's theoretical VaR. The greatest break of VaR was on 15 October when the PL was –2.2% vs a VaR of 54bps – that is, a break of –165bps. The average break was –43bps. The exceptional volatility of October resulted in 9 negative VaR breaks in that month – that is, one third of the total 27 breaks for the year. Excluding October, the Fund PL broke negative VaR on 18 days (i.e 8%) which is more in line with the expected 95% confidence level range.

Daily profit exceeded VaR on 21 days (i.e. 8%) with the greatest break being 160bps on 3 October when PL for the day was 2.42% and VaR was 83bps.

	Number	*% of days*	*Average break*	*Greatest break*
Daily profit exceeds VaR	21	8%	36bps	160bps
Daily loss breaks below VaR	27	11%	–43bps	–165bps

Fund VaR vs daily P&L

1 January 2014–31 December 2014, %

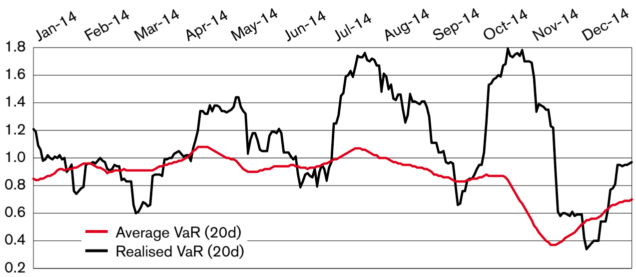


REALISED VAR

The chart below illustrates the realised VaR vs the average theoretical VaR. Realised VaR was close to theoretical VaR for the first 3 months of the year. Thereafter, the experienced PL was greater than theoretical VaR would imply for most of the rest of the year.

- **April** – a large negative PL day on 10 April is largely responsible for April's break.
- **May** – a volatile month for PL (20d volatility = 11.6% on gross daily PL) – but moves were both positive and negative resulting in a slightly positive return on the month.
- **July** – gross return of 2.2% on the month vs a volatility of 16% – that is, a Sharpe ratio of 1.9.
- **August** – the start of August saw a continuation of July's volatility but this abated during the second half of the month, hence the drop in realised VaR below.
- **October** – extremely elevated volatility levels in assets reflected by raised realised VaR on large daily PL swings, until risk was substantially cut mid-month.

Realised VaR



[The realised VaR is calculated from the 20 day P&L volatility. The average calculated VaR is the average of the theoretical VaR on a 20 day rolling basis.]

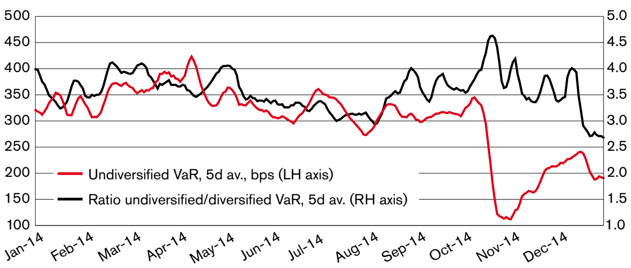
UNDIVERSIFIED VAR

The ratio of undiversified VaR / diversified VaR varied from 2.7 to 4.6. The average over the year was 3.6.

Undiversified VaR ranged from 112bps to 423bps, averaging 303bps.

Risk reduction in the first half of October was concentrated in correlated themes – that is, short rates and long equities. The impact of this was to leave a more diversified, albeit much reduced, fund – hence the initial rise in undiversified / diversified ratio. Further risk reduction was more general which is why the ratio subsequently dropped.

Undiversified vs diversified VaR



London, January 2015
Jenny Ponsonby, CRO

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EXECUTIVE SUMMARY

Strategy	Global macro
Goal	Long term uncorrelated positive returns
Methodology	Generate returns through macroeconomic trends and mispricing in global markets
Targets	Expected volatility: 8–12% Net return: 10–15% p.a. Sharpe ratio: >1 Correlation: No systematic correlation with the equity markets
The team	2 CIOs. 4 Research, Strategy and Execution. 1 CRO. 1 COO.
Investor and co-owner	Brummer & Partners, a leading Nordic hedge fund group

ASSET MANAGEMENT CONCEPT

Canosa's investment objective is to generate long term uncorrelated positive returns, whilst limiting the downside risk, by investing a diversified portfolio of liquid financial securities in global markets across multiple asset classes. The managers will seek to profit from trends and mispricing in the global markets based on the analysis of the macro environment.

INVESTMENT PHILOSOPHY

The fund's managers will seek to achieve the investment objective by employing a global macro investment strategy on a top-down, opportunistic basis. The managers may, in its discretion, take outright directional risk positions on a particular investment opportunity, based upon the nature of such opportunity, as well as the risk/return profile of the relevant market. In addition, the fund managers may also create relative value exposure via combinations of trades, for example in related long and short positions in any asset class.

Canosa's investment instruments will fall into four principal asset classes:

- Fixed income, including, but not limited to bonds, swaps, credit default swaps, over the counter "OTC" forwards and options, exchange traded futures and options;
- Foreign currencies, including but not limited to, spot and forwards, OTC options and swaps, exchange futures and options contracts and ETFs on G20 currencies as well as emerging market currencies;
- Equities, including but not limited to, exchange traded futures and option contracts, OTC forwards, swaps, options, dividends, single stocks and ETFs on G20 and emerging market equity indices; and
- Commodities spot, forwards, futures and options relating to single commodities and indices.

INVESTMENT PROCESS

The investment process will be premised upon a top-down approach. Components of the investment process will include:

- fundamental analysis, built on research and analysis of current economic data;
- studies of positioning and market sentiment and environment recognition;
- investment thesis;
- optimal trade expression;
- diversified portfolio construction; and
- risk management.

RISK MANAGEMENT

The fund management company seeks to ensure that the fund's average risk level, as measured by the annual standard deviation over a rolling twelve-month period, is kept within the 10 to 15 per cent interval.

The Board of the fund management company sets limits for the risks that the portfolio managers are allowed to take in their asset management activities. Analysis and control of market risks, using for example different Value-at-Risk models (VaR), are important parts of the portfolio managers' work. Risk measurement and risk control are made by separate units within B & P Fund Services AB, a wholly owned subsidiary of Brummer & Partners.

PORTFOLIO MANAGERS

Tim Attias, founder – Tim was portfolio manager at Rubicon Fund Management, a discretionary global macro manager, from April 2008 to December 2010, becoming co-CIO (with Santiago Alarco) from August 2009. He started his career in 1988 as a futures broker at GNI Intercommodities. Tim then joined Salomon Brothers in London in 1992, initially on the institutional fixed income sales desk, moving to fixed income arbitrage trading in 1995 and was promoted to Managing Director in 1998. In 2000 he joined ABN Amro Proprietary Desk with Santiago Alarco, leaving ABN in 2008 to join Rubicon. Throughout his trading career he has been involved in several trading strategies from relative value, emerging markets to global macro. Tim holds a BSc degree in Political Science and Sociology from Exeter University.

Santiago Alarco, founder – Santiago was portfolio manager at Rubicon Fund Management, a discretionary global macro manager, from September 2008, becoming co-CIO (with Tim Attias) from August 2009 and then sole CIO until his departure in March 2011. He started his career in 1987 at Banco Santander de Negocios in Madrid as an equity research analyst. Santiago then joined Salomon Brothers in London in 1989 in the institutional fixed income sales desk, moving to Morgan Stanley as an Executive Director in 1992. He rejoined Salomon Brothers Arbitrage and Proprietary Trading Desk in 1996 and was promoted Managing Director in 1999. In 2000 he joined ABN Amro Proprietary Desk with Tim Attias, leaving ABN in 2003 to take sabbatical. In 2006 Santiago joined Alpha Value Management as a partner, leaving to join Rubicon in September 2008. Throughout his trading career he has been involved in several trading strategies from relative value, emerging markets to global macro. Santiago holds a degree in Economics and B.A. CUNEF, Madrid.

PRODUCT STRUCTURE

Management fee	1% p.a.
Performance fee	20% over hurdle rate (high watermark)
Liquidity	Monthly subscriptions and redemptions (5 banking days notice)
Minimum investment	EUR 1m, USD 1m, SEK 7.5m
Lock-up/gate	None
Custodian	Citibank NA
Auditors	KPMG
Inception date:	1 May 2013

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