LCIV RF Absolute Return Fund
Q1 Manager Review

CIV Investment Team

LCIV RF Absolute Return Fund

Inception date	21 June 2016
Fund Size	£813m (as at 31/03/2018)
Number of holdings	N/A
Benchmark	N/A

Investment objective

To achieve low volatility and positive returns in all market conditions. Capital invested in the Sub-fund is at risk and there is no guarantee that a positive return will be delivered over any one or a number of twelve-month periods

Investment policy

The ACS Manager aims to achieve the objective by investing solely in the CF Ruffer Absolute Return Fund and cash and near cash.

Agenda

1. Review the quarterly performance of the fund.
2. Explain any portfolio changes relating to the fourth quarter.
3. Briefly discuss the outlook of the Ruffer team.

	LCIV Ruffer Absolute Return Fund
Q1 2018	-2.55%
Since LCIV Inception (annualised)	5.63%

Source: Bloomberg, as at 31/3/2018. Total returns, net of fees with dividends re-invested. Inception = 21/06/2016

Executive summary

The fund declined 2.55% over the first quarter with equity holdings detracting significantly from returns in what proved to be a highly volatile period for the asset class. Ruffer believes we have entered a more challenging period and warrant caution. The recent performance of the fund provided vital information for how the fund may perform in different environments ahead.

In terms of activity Ruffer implemented positions in short dated UK corporate bonds as spreads have widened, and, initiated equity put protection, which it felt favourable relative to additional protection via the VIX options. UK equities are deemed particularly attractive from a valuation standpoint and more cash may be put to work in the region going forward.

Business changes

Ruffer have informed us of the departure of Trevor Bradley, Investment director. Alex Lennard will continue to lead the team serving Institutional clients, as he has done since 2014. The investment approach for portfolios will remain unchanged. The investment strategy will continue to be led by Henry Maxey (Chief Investment Officer) and Jonathan Ruffer (Chairman). There is no change to the management of the Ruffer Absolute Return Fund.

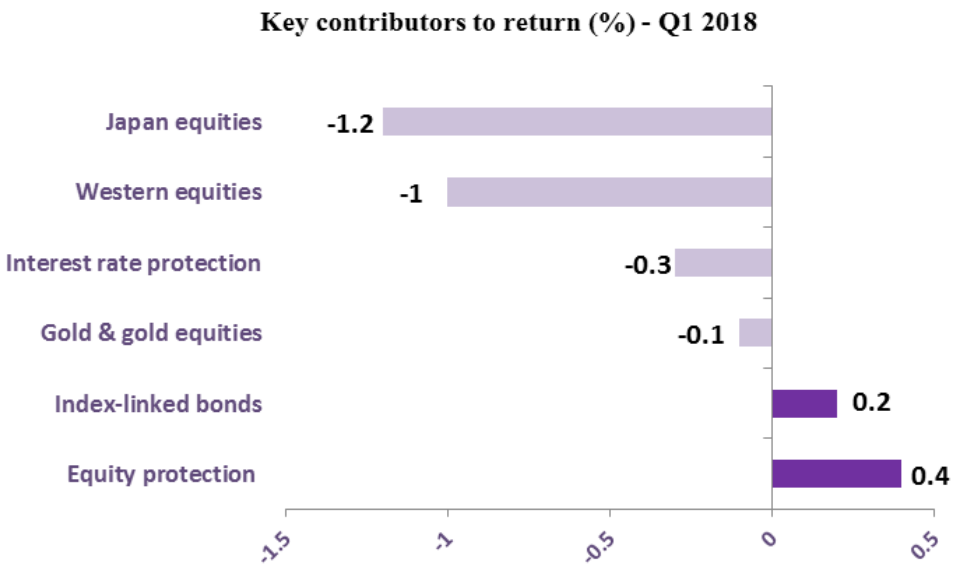
Q1 performance review

In stark contrast to the exceptional performance of markets since the middle of 2016, the first quarter of 2018 proved to be a bumpy ride for equities as volatility returned, starting with a an idiosyncratic risk event relating to products replicating the VIX index at the beginning of February, protracted by trade war rhetoric between the U.S. and China, as well growing regulatory pressures on Facebook - which could have alarming consequences for tech stocks as a whole. Markets were also caught slightly off guard by stronger than expected monthly U.S. wage growth data causing bond yields to rise sharply in expectation of higher inflation, which added additional pressure on equities. The sell-off took place across the board with the FTSE-All Share, S&P500 and the MSCI World down 6.9%, 4.3% and 4.7% respectively for the quarter in GBP terms.

With fears over investor complacency mounting following a dramatic market melt-up towards the back end of last year the environment was ripe for some sort of reality check. This quarter was a particularly important data point for both Ruffer and the London CIV as it provided the first strike for how the portfolio would perform in a more challenging risk-off environment. The Ruffer Absolute return fund lost 2.55% over the period as fear outweighed greed, but the protective assets proved to be geared towards a more marked sell-off than the relatively shortened pullback. With respect to the volatility sell-off in early February and the explosion of short VIX products – some of which cost investors over 90% of their capital – Ruffer, had correctly identified securities, namely VIX call options, that would be effective in diversifying the portfolio against a material rise in volatility as the portfolio was actually in positive territory whilst stock markets sold off. Ruffer's CIO went as far to say that that the recent flash crash is reminiscent of the Bear Sterns collapse in 2007. Ignore at your peril.
In the seven or so weeks that followed equity markets recovered and volatility settled until the steady drift lower in March as trade spats and a rotation towards short duration cyclicals hurt the equity exposure of the fund and took the return into negative territory.

At the asset level the fund's equity protection (0.4%) and index linked bonds (0.2%) provided small but positive contributions to return for the quarter:

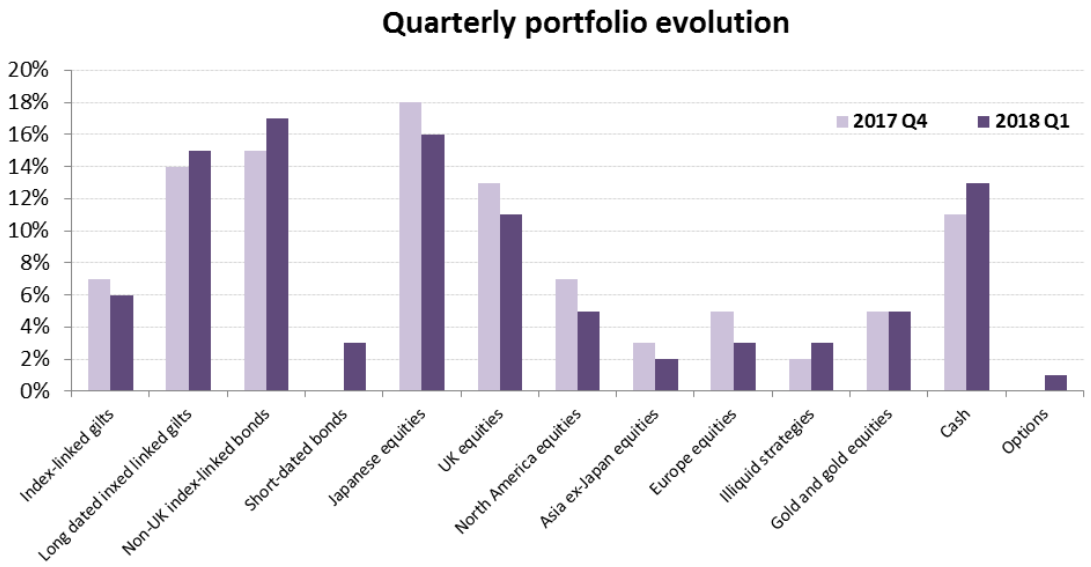
- Equity protection surged during February's 'flash crash'. Some profits were taken at that point, but protections retained lost some value as volatility fell back to some degree later in the quarter.
- While inflation-linked bonds mirrored equity weakness for most of the quarter, fears that trade spats could damage growth prospects drove yields lower towards the end of the period, producing a small gain overall.



Japanese equities (-1.2%) and Western equities (-1%) were the largest detractors from performance by a large margin.

- The general 'risk off' mood through February and March meant that Japanese financial equities fell by double-digits over the quarter, largely unwinding their gains posted in Q4 2017.
- Generalised equity market weakness produced a negative contribution from the portfolio's western equity positions.

Portfolio activity



Ruffer made a couple of changes worthy of note in the first quarter. Firstly, the team implemented a 3% position in short-dated (sub 2year) UK corporate bonds. With spreads widening across the U.S. and the UK the team are finding some interesting opportunities in the asset class and will continue to scour the space for names. Secondly, in the aftermath of the VIX decline in February Ruffer started to implement equity put options to bolster the equity protection within the portfolio after selling off around a third of the VIX option protection as the VIX spiked. These put options, which had not previously been particularly attractive due to 'strike risk', are now deemed more suitable as Ruffer do no expect equity markets to continue to posting new record highs in the relentless fashion that markets have become intoxicated by.

Looking ahead, the team are seeing valuation opportunities in UK equities and will look to put some of the fund's cash to work as analysts uncover suitable assets. Ruffer noted that the UK is deemed the most hated market by investors, who have shunned the region in recent years as uncertainty rose with political and economic risks a-plenty. The market has started to price in the collapse of many large well-known brands, but with careful selectivity one can tremendous value.

Conclusion

The quarter marked a valuable data point for both Ruffer and the London CIV. The performance of the portfolio was particularly pleasing in the aftermath of the VIX 'flash crash' in early February. Ruffer had posed that there were few safe places left to preserve capital in a severe

risk-off event and felt that VIX call options would offer the best, genuinely uncorrelated equity protection. This was heartening as it was these option positions which had hurt the fund in 2017. Their performance during the recent market action shows why the manager is so keen on these fear assets.

Nevertheless the portfolio did suffer a rather heavy loss in the quarter given its capital preservation focus – a loss larger than we had anticipated. Equity markets across the board struggled and Ruffer's exposure to Japanese financials particularly hurt as the global reflation theme was called into question by markets. We must not ignore the possibility of a continuation of gradually declining markets in periods ahead, particularly if increases in volatility are met with swift responses by central banks, who, have proved time and time again to step in as liquidity providers when required. This (coordinated exit) scenario has proven to be costly this quarter, and one must pose whether the construction of the portfolio could be more efficiently designed to mitigate against this risk. That said, we welcome the shift of attention towards more value centric areas of the market and hope that this can provide a decent margin of safety that could offer enhanced relative downside protection in any future quarters that resemble the most recent.

Meeting Attendees

Team CIV:
Ryan Smart: Investment Analyst

Ruffer
Alex Lennard; Investment Director
David Ballance; Investment Director

Important information
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