

February 22, 2018

## Special Market Comment

### Dear Friends & Partners:

As a steward of your assets, considering recent market behavior, increasing communication and providing clarity are now more crucial than ever.

While the market had solid upside today, I would not say we have seen the end of the declines. Rather perhaps it is the beginning of the return of volatility. Remember, we have had one of the longest periods in market history with low volatility. Volatility as illustrated by the VIX, commonly referred to as “the fear gauge”, was far below its long-term average of 19 as we departed 2017. In fact, the VIX ended the year on December 29, 2017 at 11.04 only to have an intra-day high of 50.04 on February 6, 2018!

It is important to remember that volatility is neither predictable nor a reason to panic. The current bull market has featured several sell-offs since 2009. Candidly, volatility is the mother’s milk of high returns.

With higher volatility, it is crucial to maintain disciplined execution of our investment strategy. The LRT portfolio is structured as a mix of bonds and stocks. This approach improves risk management. Historically, there have been only three years in the last 90 where both stocks and bonds ended the year losing money:

1. **1931:** The Great Depression.
2. **1941:** People were still dealing with the hangover of the Great Depression and had a new worry of the US entering World War II (and the economic repercussions that might follow), which was declared in December ’41.
3. **1969:** The last stage of a bull market – high turnover, momentum driven, performance chasing – that ended badly. The Fed chairman at the time likened it to the exuberance of the Roaring Twenties. It was very similar to the dot-com boom except electronics were the internet stocks of its day.

In a “normally functioning” market, stocks and bond prices have a negative correlation, thereby allowing for the benefits of diversification. If investors are worried about the pace of the economic recovery and its impact on corporate profitability, they would be selling stocks and buying bonds pushing yields lower. Therefore, losses in one’s stock positions would be partially offset by gains in one’s bond positions. The inverse happens when investors are optimistic about the economic outlook.

The negative long-term correlation between stocks and bonds allows us to dramatically improve the risk-return ratio of the portfolio relative to a stock only portfolio. Note that I write “long-term correlation” – over a period of a few days anomalies can and do occur. In last week’s sell-off, stocks, bonds and commodities all declined – there were literally no safe haven asset classes. Our view remains that the “normal” market correlations will reassert themselves. The sharp decline in bond prices, which occurred over the past several weeks could be brief, as speculative “short” positioning in the bond market futures is already at record levels. Moreover, US Treasuries represent exceptional value (they have higher yields) compared to sovereign debt from other developed economies.

At LRT, we view the recent market volatility as an opportunity. As the decline occurred while corporate fundamental and economic growth are both accelerating buoyed by recent passage of US tax reform. Simply put, price declines in the face of improving fundamentals portends OPPORTUNITY.

In volatile times, focusing on those aspects under our control is the basis for disciplined investment process execution and robust performance.

From here on the frontline, expect continued increased communication and portfolio clarity as required. As always, I welcome your questions and happy to address any topics about the LRT portfolio or my perspectives about the markets at large.

This memorandum and the information included herein is confidential and is intended solely for the information and exclusive use of the person to whom it has been provided. It is not to be reproduced or transmitted, in whole or in part, to any other person. Each recipient of this memorandum agrees to treat the memorandum and the information included herein as confidential and further agrees not to transmit, reproduce, or make available to anyone, in whole or in part, any of the information included herein. Each person who receives a copy of this memorandum is deemed to have agreed to return this memorandum to the General Partner upon request.

Investment in the Fund involves significant risks, including but not limited to the risks that the indices within the Fund perform unfavorably, there are disruption of the orderly markets of the securities traded in the Fund, trading errors occur, and the computer software and hardware on which the General Partner relies experiences technical issues. All investing involves risk of loss, including the possible loss of all amounts invested. Past performance is not indicative or a guarantee of future performance. We do not provide tax, accounting, or legal advice to our clients, and all investors are advised to consult with their tax, accounting, or legal advisers regarding any potential investment. For a more detailed explanation of risks relating to an investment, please review the Fund's Private Placement Memorandum, Limited Partnership Agreement, and Subscription Documents (Offering Documents).

This memorandum is for general information purposes only, and should not be regarded as an offer to sell or a solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be in violation of any local laws. All persons interested in subscribing to the Fund should first review the Fund's Offering Documents, copies of which are available upon request. The information contained herein has been prepared by the General Partner and is current as of the date of transmission. Such information is subject to change. Any statements or facts contained herein derived from third-party sources are believed to be reliable but are not guaranteed as to their accuracy or completeness. Investment in the Fund is permitted only by "accredited investors" as defined in the Securities Act of 1933, as amended. These requirements are set forth in detail in the Offering Documents.

**LRT Capital Management, LLC**  
401 Congress Street, Suite 1540  
Austin, TX 78701  
Office: +1 512 852 4320  
[www.lrtcapi.com](http://www.lrtcapi.com)