GRAHAM CAPITAL MANAGEMENT, L.P.

March 28, 2016

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Sent by Email to: rule-comments @sec.gov

Re: Proposed Rule on the Use of Derivatives by Registered Investment Companies and Business Development Companies (File Number S7-24-15)

Dear Mr. Fields:

Graham Capital Management, L.P. is a registered investment adviser and commodity trading advisor who is an active manager in the alternative mutual fund strategy market. We currently trade a managed futures strategy on behalf of ten registered investment companies; our trading for these funds represents about a quarter of their aggregate AUM of approximately $9.0 billion. We generally agree with the joint comment letter of the Managed Funds Association and the Alternative Investment Management Association ("Joint Letter") and submit these comments in strong support of two of its primary provisions: i) that the proposed rule's derivative exposure limits be adjusted to reflect the risk of a fund's actual investments; and ii) that the proposed rule's VaR requirement for the 300% derivatives exposure limit be amended to impose an absolute VaR limit for a fund.

The Joint Letter recommends that the calculation of derivatives notional exposure in the proposed rule be adjusted according to the risk of the derivative investment being made, as it is arbitrary to treat all notional exposures as equal. The SEC's current proposal treats a $1 million investment in the S&P 500 the same as a $1 million investment in the Euro or British Pound contract or a $1 million investment in the two year US Treasury Note. Yet the S&P 500 is several times more volatile than those currencies, not to mention the two-year Note, as illustrated by the attached chart (Chart 1) showing the maximum one day moves of a $1 million investment in these (as well as other) financial instruments.[1] A rule that treats the notional amounts of these investments as each portending the same degree of risk therefore violates simple financial sense. Indeed, one unanticipated consequence of the proposed rule's undifferentiated treatment of notional exposure is that it limits the full diversification of a 40 Act derivatives strategy, because

[1]On this matter, we also endorse the relative evaluation of risk of different investment sectors in the final rule "Margin and Capital Requirements for Covered Swap Entities" of various prudential regulators (80 Fed.Reg.74839 (Nov. 30, 2015) at 74909) as the basis for adjusting derivatives notional exposure for purposes of the proposed rule's limit.

40 HIGHLAND AVENUE
ROWAYTON, CT 06853

TEL 203-899-3400
FAX 203-899-3500

it limits the strategy's capacity to include far less volatile financial instruments in a portfolio. The proposed rule thus acts as a Procrustean bed, permitting only the most volatile financial instruments in a compliant portfolio and precluding other (relatively non-correlated) instruments (notably FX and short-term bond investments) into a portfolio's base exposure that, being less volatile, require greater weight in the portfolio to make a diversifying impact. Without the extra capacity afforded by a haircutting of notional exposures, any managed futures strategy that could be traded within the proposed rule's exposure limits would not be nearly as well diversified. We therefore support the Joint Letter's recommendation that the proposed rule adopt the relative risk approach of the prudential regulators above for its calculation of derivatives exposure.

The Joint Letter also recommends that a registered investment company be permitted up to 300% derivatives exposure if its portfolio stays below an absolute VaR limit. Though the SEC has expressed reservations about the adequacy of VaR as an independent measure of risk, it does propose using a VaR limit in conjunction with the notional exposure limit of 300%.[2] The Joint Letter suggests a 20 day 99% VaR limit of 20%, which has the advantage of being consistent with the VaR limit applicable to UCITS funds. But a lower absolute VaR limit may also be broadly acceptable, since most alternative strategies have VaRs that are materially lower than that of a 40 Act fund tracking the S&P 500 (or portions thereof), the traditional investment universe for mutual funds. Chart 2, for example, displays the comparative VaRs (calculated according to the RiskMetrics approach) of the S&P 500 index and the managed futures strategy that Graham currently trades, without any constraint operating on its derivatives exposure, on behalf of registered investment companies. We believe it shows the reasonableness of allowing a fund to have up to a derivatives exposure limit of 300% so long as its VaR remains no greater than the VaR that is presumably generated by countless existing plain vanilla 40 Act funds.

We urge the SEC to adopt both of these amendments suggested by the Joint Letter. We ask that the SEC not deny investors access to investment opportunities that have less overall volatility than equities. Alternative investment strategies using derivatives, in general, have a low correlation to the equity market and can therefore diversify many retail investors' portfolios and insulate them from equity market collapses such as occurred in 2000 and 2008, and that will likely occur again.

Sincerely,

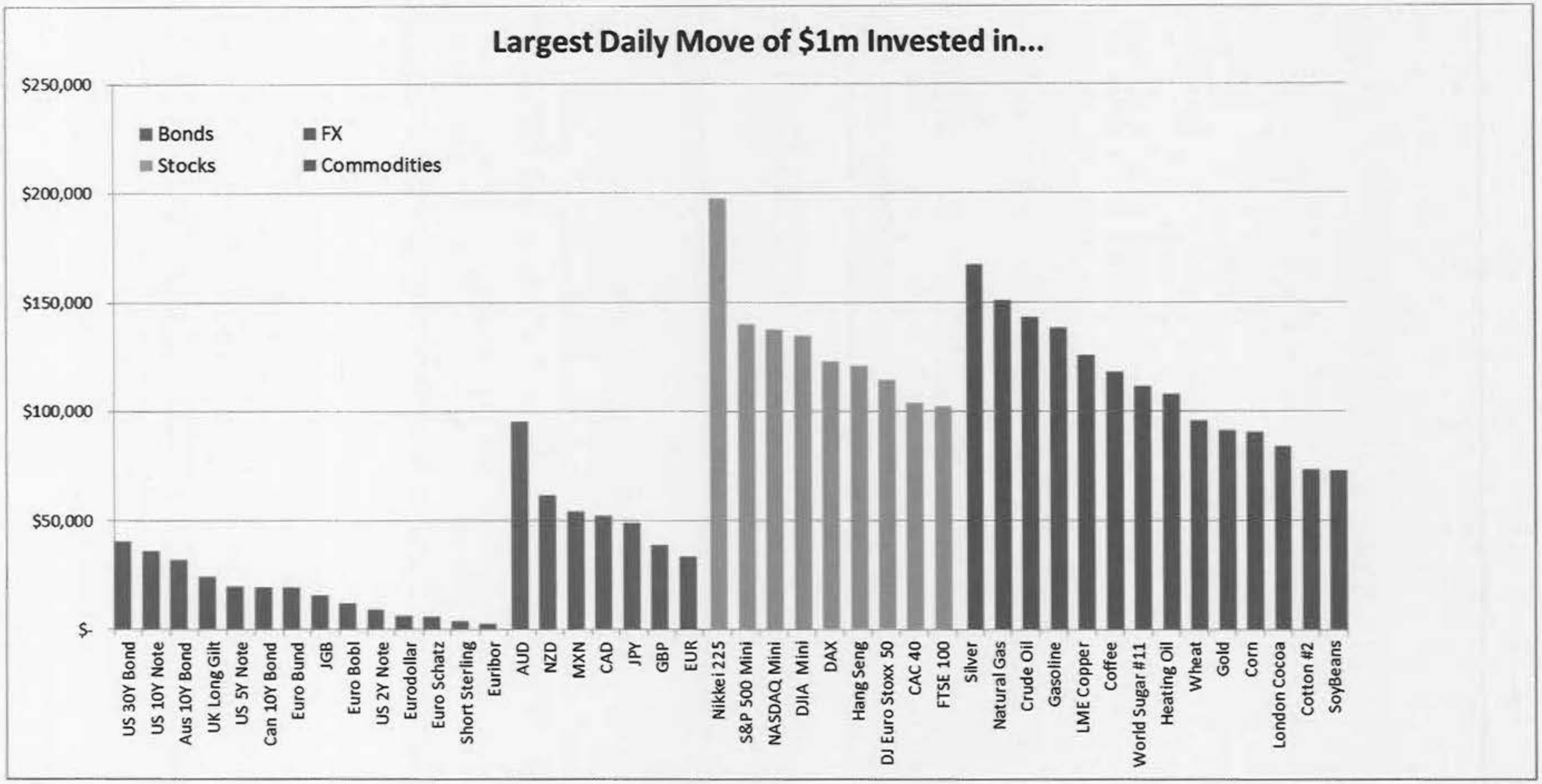
Robert E. Murray
Chief Executive Officer

Attachments

---

[2]The proposed rule permits notional exposure to increase from 150% to 300%, if after every derivatives transaction the VaR of the fund is lower after the transaction than before. Many diversifying transactions will accomplish this, but by no means all, assuming the new transactions are somewhat correlated with the existing portfolio. Indeed, this requirement, as written, will likely be met by very few funds, as every trade would need to be a near perfect hedge. Having an absolute VaR limit here rather than a relative one, can meet the purpose of limiting the risk of the portfolio, while still permitting a portfolio that is highly diversified.

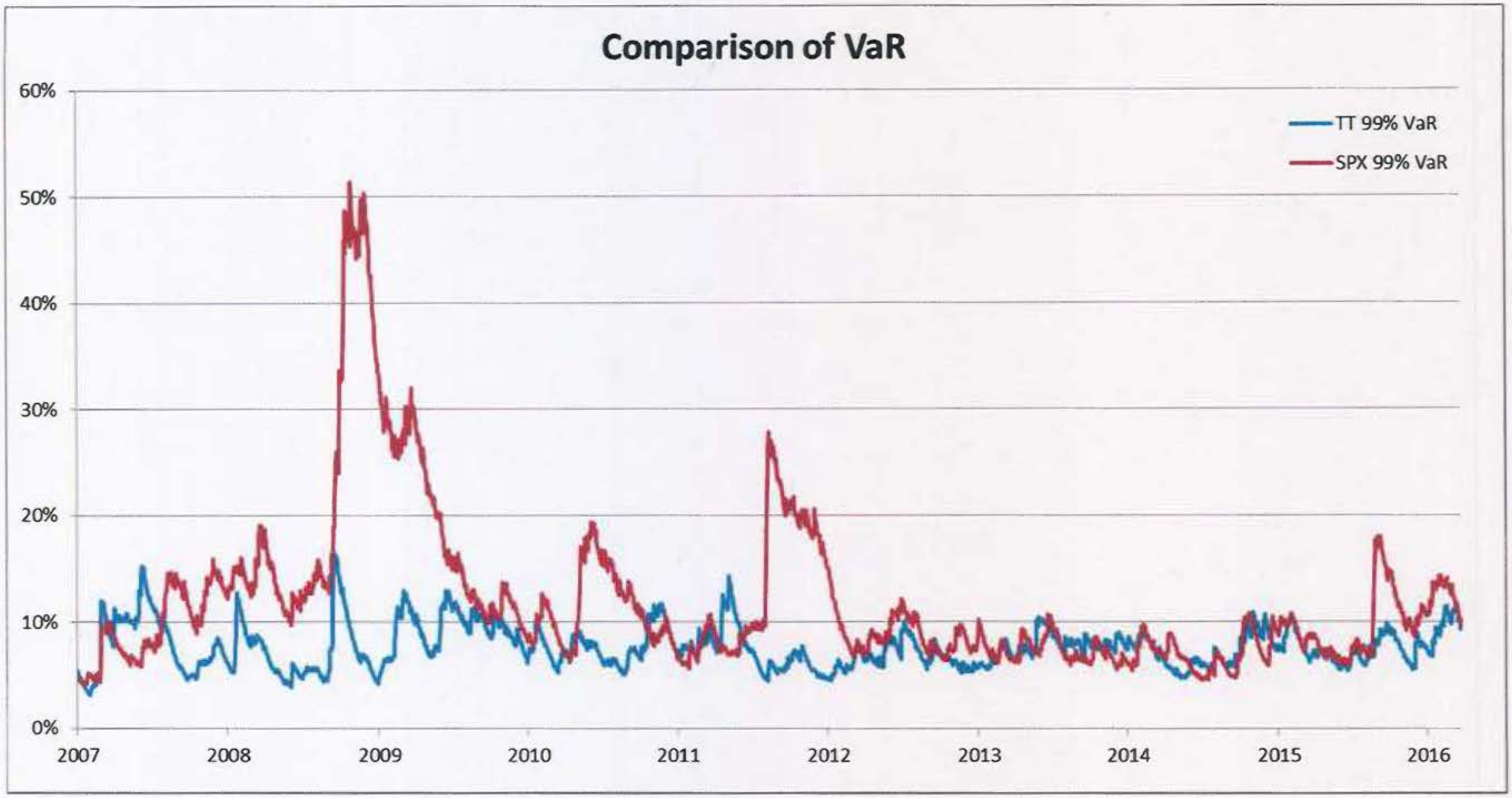
Chart 1



Largest absolute daily move of $1m invested each day in various assets over the 10-year time period 2006 – 2016. All returns calculated from daily futures prices on various exchanges.

This chart demonstrates how 'notional exposure' can often be a misleading measure of risk. Historically, $1m of notional exposure to bonds and FX has moved significantly less than an equivalent investment in stocks or commodities.

Chart 2



Comparison of 20-day Value at Risk (VaR) between GCM Tactical Trend (TT, 12% annualized volatility) and the S&P 500 (SPX). VaR is calculated using the common RiskMetrics-type approach: $\text{VaR} = 2.33 \times \sigma \times \sqrt{20}$, and σ is the realized volatility calculated from squared returns with a decay parameter of 0.94.