SANDBAR
ASSET MANAGEMENT

Alpha Insights: Unmasking the Hidden Enemies of Performance; Ka Nama Kaa Lajerama. April MTD performance of strategy (+0.11%, YTD +8.96%),

Unmasking the Hidden Enemies of Performance; Ka Nama Kaa Lajerama

There has been no lack of market driven topics to discuss at length over the last 6-8 weeks and no doubt your inboxes are overflowing with commentary as the volume of 'information exchange' gets dialled up. The clear purpose of our updates is not to create more informational overload, repetition or noise, but you provide real time updates of our own idiosyncratic portfolio, observations and actions.

In times of market stress the most asked question we get after "how is performance?", is "what are you most worried about / what is the biggest portfolio risk?". The title of this note answers the first, so let's get straight to the second question.

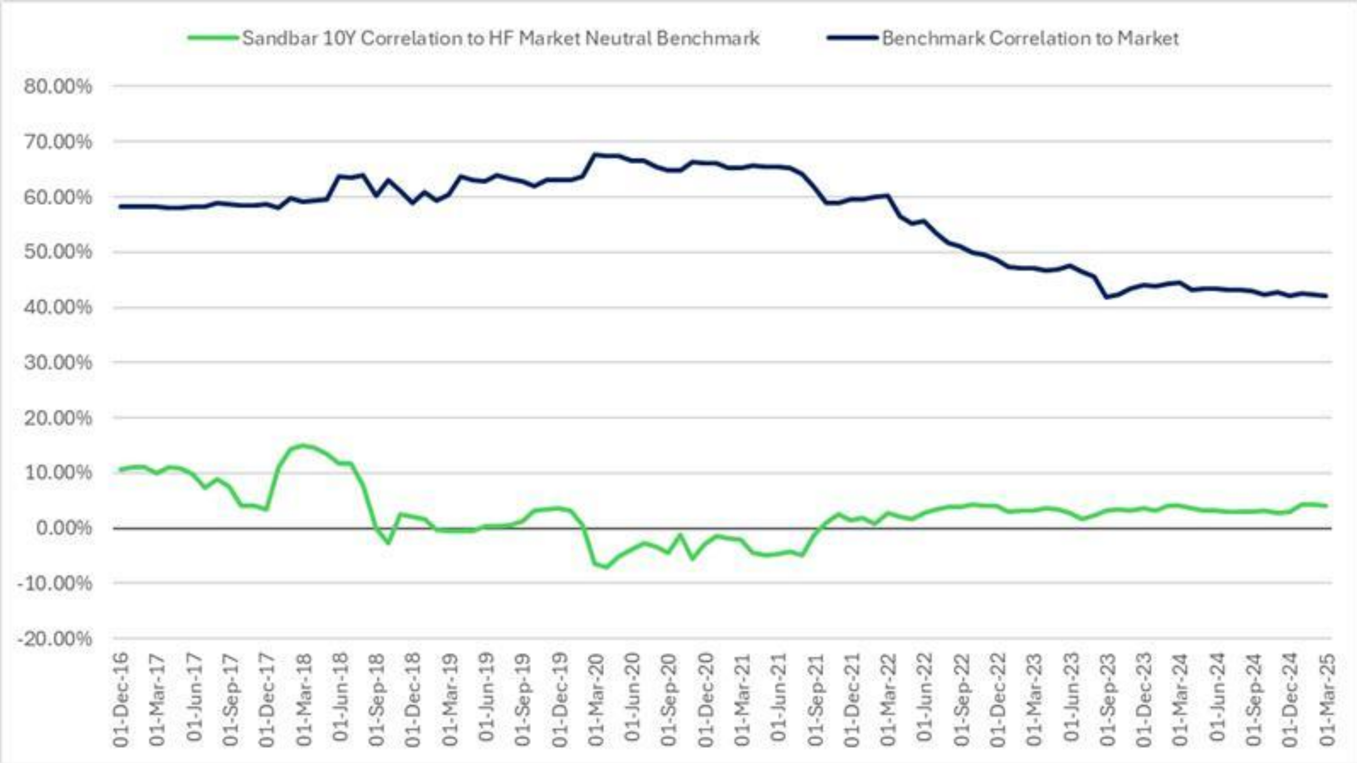
Running equity market neutral portfolios for nearly two decades, the answer to what keeps us up at night is the same now as ever, "the hidden risks that can manifest in a portfolio that are difficult to identify and thus hedge out by our risk model." As a strategy with our core focus on generating zero correlation portfolios, this question is at the centre of our risk management DNA, and hence as a team we debate this question ad infinitum, both in good and in bad performance periods. Either making or losing money on residual factor exposures (regardless of whether they are expected or unexpected) is a risk management red flag.

First of all, a few up front statements regarding our view of operating risk models to construct market/factor neutral portfolios:

- We don't assume that any risk model, including our own, is perfect at identifying all factors and the scale of risks associated. Models all operate under some set of pre assumed conditions and variables
- We also know that when using historical data to test a portfolio, and an event occurs that's not happened before, the model isn't perfect
- The magnitude of risk associated with any single factor is dynamic over time
- Often the more complex the models become, the more inaccurate the output becomes, as assumption errors tend to multiply exponentially
- If you extrapolate extreme periods of volatility as the new normal or plug a synthetically assumed extreme prevalent market condition into the model then your conclusion will always end up as (1) go to cash first, and then (2) stock up on guns, ammo and supplies because you are assuming the end of the World

For all these reasons, we spend an outsized proportion of our time as a team thinking about these hidden enemies to performance and delivering a totally uncorrelated idiosyncratic return stream. Often time it involves putting the risk model to one side and putting on our thinking caps to fully triangulate the potential implications of a new market dynamic or event. This might even include building a bespoke new model, as we did for example throughout the drawn-out Brexit process, constantly trying to plug in our most updated end market impacts and generating fundamental and risk betas to potential outcomes. The point is we cannot just sit on our laurels with blind faith that the model will capture something it was never designed to capture.

Over time our returns and correlations to the market benchmarks are the best testament to the fact that this work pays off. As you can see in the chart below which plots our rolling correlation to market benchmarks, we are clearly doing something very different.



Source: Sandbar Risk Team, Bloomberg

If you have any questions, feel free to reach out to the team.

The Sandbar Team

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ADDITIONAL RIDERS

Indices:

The MSCI World Index, which is part of The Modern Index Strategy, is a broad global equity index that represents large and mid-cap equity performance across 23 developed markets countries. It covers approximately 85% of the free float-adjusted market capitalization in each country and MSCI World Index does not offer exposure to emerging markets. For further information on the index, please see www.msci.com/world.

Equity Market Neutral strategies employ sophisticated quantitative techniques of analyzing price data to ascertain information about future price movement and relationships between securities, select securities for purchase and sale. These can include both Factor-based and Statistical Arbitrage/Trading strategies. Factor-based investment strategies include strategies in which the investment thesis is predicated on the systematic analysis of common relationships between securities. In many but not all cases, portfolios are constructed to be neutral to one or multiple variables, such as broader equity markets in dollar or beta terms, and leverage is frequently employed to enhance the return profile of the positions identified. Statistical Arbitrage/Trading strategies consist of strategies in which the investment thesis is predicated on exploiting pricing anomalies which may occur as a function of expected mean reversion inherent in security prices; high frequency techniques may be employed and trading strategies may also be employed on the basis on technical analysis or opportunistically to exploit new information the investment manager believes has not been fully, completely or accurately discounted into current security prices. Equity Market Neutral Strategies typically maintain characteristic net equity market exposure no greater than 10% long or short.

The Indices are presented as Sandbar feel that they serve as a useful point of comparison with aspects of the Fund's portfolio management and composition. The Fund's portfolio will not replicate any Index and no guarantee is given that performance will match the Indices; it is not possible to invest in any index.

There are significant differences between the Strategies investments and the Indices. For instance, the Fund may use short sales and leverage and may invest in securities that have a greater degree of risk and volatility, as well as less liquidity, than those securities contained in the Indices. Moreover, the Indices are not subject to any of the management fees or expenses that the Strategy must pay. It should not be assumed that the Strategy will invest in any specific securities that comprise the Index, nor should it be understood to mean that there is a correlation between the Fund's returns and the Indices' performance. Each Index is included for informational purposes only.