Alpha Insights: Dungeons & Dragons & Drawdowns; March MTD performance of strategy (+1.78%, YTD +8.54%)

The Hits Keep Coming, No Matter the Inning

Given continued market volatility MTD we thought it valuable to give a brief update on our performance and views. Earlier in the month we dedicated our commentary to outlining why we focus so single-mindedly on constructing factor neutral portfolios and the benefits of their near-zero correlation return streams. Even if still very pertinent to current market conditions (not just those we have seen over the last 6-8 weeks, but time and time again over the years) we won't go over this again here. Please follow this link https://sandbaram.com/ if you missed our recent commentary.

Over the last couple of weeks, we have been hit with a barrage of statistics and data points from Banks and Prime Brokers attempting to place current market conditions for Hedge Funds in historical context. GS PB reported that the multi-strategy fund cohort suffered one of the sharpest drawdowns on record since early February. More recently, they highlighted a 4 sigma recovery day for this group as crowding thematics squeeze higher. In our own universe, the de-grossing levels across US Industrials by certain PBs are also historic in velocity and magnitude.

PBs are quick to point out they are fielding unprecedented levels of incoming from HFs on the data, presumably a mix of schadenfreude and a desire to assess the extent to which everyone is in the same boat. Ironically, the most common incoming question around the de-gross and de-risk dynamics remains the age old: 'What inning are we in?' Put simply, the question can be translated as both 'how much more pain is in store?' and 'how long before we can load up on crowded names again with all our peers?'.

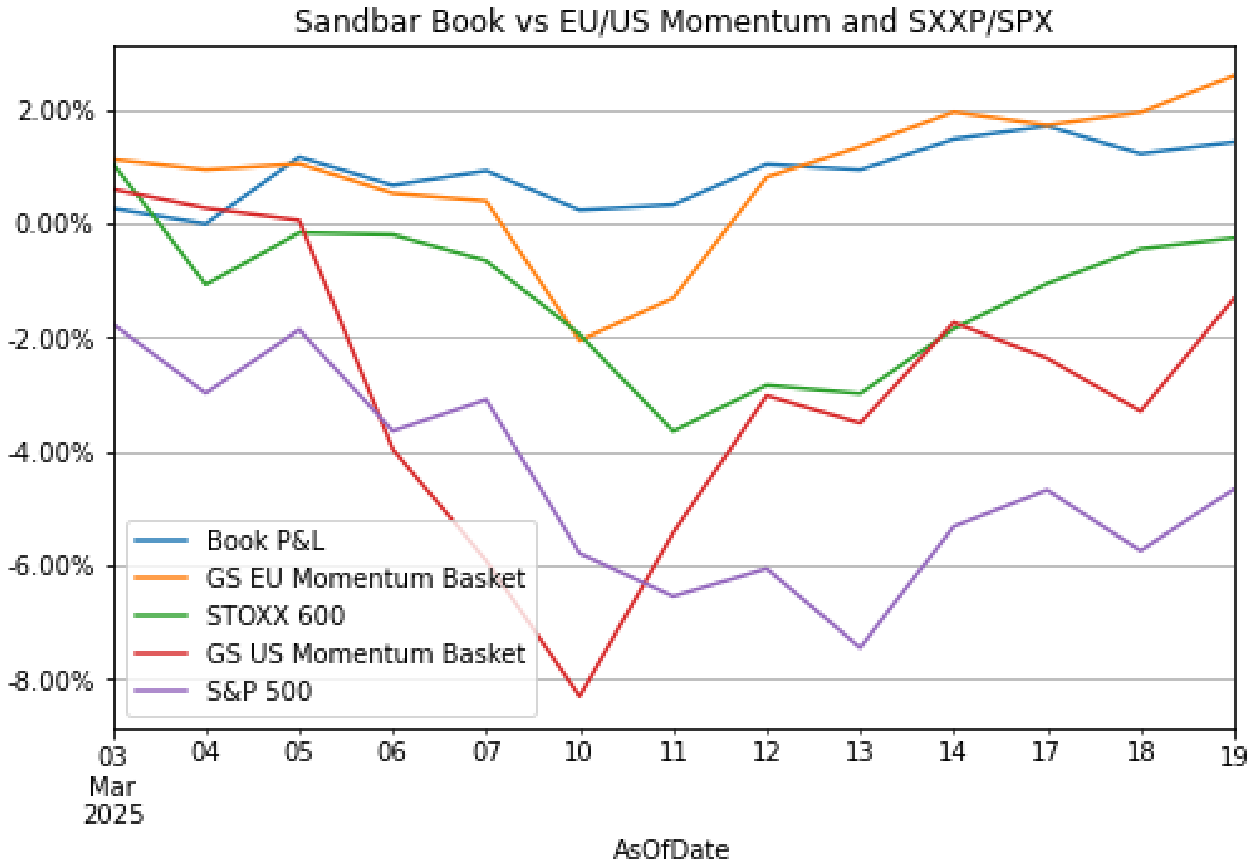
We would make two observations as objective observers with no skin in the game on when crowded portfolios will start to work again. The first is that we seem to be rewriting the Guinness Book of Hedge Fund Records rather regularly. As more money chases the same themes with greater levels of leverage (and similar risk models and constraints), it seems that every year we are subjected to a new raft of 'biggest ever' and 'worst ever' dynamics. Another way to think of this is that the left tails seem to be getting much fatter by the year.

The second observation is that through our process we observe and monitor these crowding dynamics religiously – but only because we want to avoid any performance or risk exposure to them at all costs. When we read about these Guinness Book type outlier data points it is a stark reminder of why we do what we do; both why we have invested so heavily in the risk infrastructure that allows us to take a forensic lens to our portfolio exposure to any crowded cohort of stocks or theme we can identify and why we will continue to do so.

We are humble enough to recognize it is almost impossible to time when these events will happen and none the wiser on when the bubbles will pop and for how long. Asking what inning we are in almost represents an admission that investors have lost control of their own portfolio risk. Once again, it should be clear why we spend so much time focusing on minimising our exposure to them, and more broadly ensuring our returns are de-correlated from any and all manner of macro factors. Moreover, if it wasn't obvious to us before, this most recent period of record-breaking drawdowns reminds and factor madness reminds us why it was so important for the team to make the enhancements we did regarding our factor hedging coming into 2025.

We certainly don't want to have to ask what inning were in with our risk.

To both of these points, please see the chart below showing our daily returns MTD vs the market and momentum factor. We would think that most HFs would want to hide their daily data given their direct or indirect exposures and how investors will be able to more clearly see ”what they are paying for”. We certainly have nothing to hide.



Source: Sandbar Risk Group

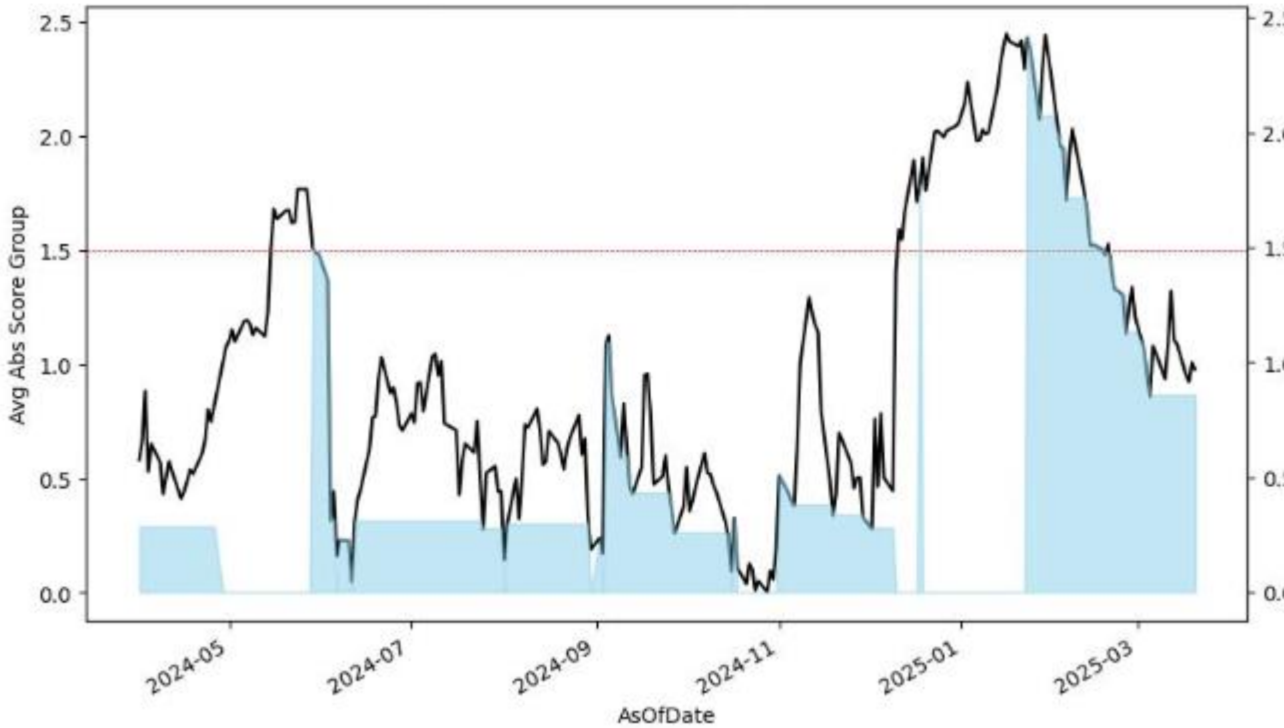
Strategy Enhancements; Dungeons & Dragons, The Relative Valuation Quest

Those investors who have met me over the years will hopefully always be reminded of the consistency of our process and message. They might also have taken notice of both (1) my rather critical view on valuation frameworks under ’traditional’ discretionary fundamental Equity Long/Short Hedge Fund structures (notably regarding their in-built biases), and (2) my habit of linking what we do to my favourite RPG game, Dungeons & Dragons (D&D).

So not to break the habit of a lifetime, here we go again. For those not fortunate enough to have played, in D&D players undertake a ’quest’ which normally involves solving many tricky puzzles and defeating monsters in order to find some treasure or earn some reward at the end. The challenge we observe consistently in discretionary focused fundamental investing is similar. The ’quest’ is to find the ’true’ value of a stock in order to capture elusive idiosyncratic alpha. The "puzzles" and "monsters" are often not external like in D&D, but instead the human biases and uncertainties that cloud analysts judgment. Just as a D&D party faces traps and illusions designed to mislead them, fundamental analysts face market noise, human biases, emotional reactions, and inherent market unpredictability.

To better equip our analysts against these obstacles and protect our process from its obvious potential pitfalls and risks, we set about analysing our significant historical performance and attribution data, including how we define valuation metrics and realised results of how these metrics drive investment decisions. The conclusions were stark and clear, and as a result we have incorporated a systematic, data-driven relative valuation framework into our investment selection and portfolio construction process. This framework acts as a guide rail and as an important safeguard, with specific decision-making protocols designed to mitigate common human biases and enhance our ability to navigate market uncertainties in a timely fashion. Ultimately, this helpful cheat code, will much more often than not lead to a more consistent and successful "quest" for alpha.

Intra-sector Relative Valuation Output



Source: Sandbar Risk Group

We will be expanding on these themes in our March newsletter (ex the D&D bit unfortunately at the request of the rest of the team), but in the meantime please reach out with any questions.

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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.

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