11th March 2025

Alpha Insights: We've seen this movie before. The benefit of market neutral portfolios; March MTD performance of strategy (+0.20%, YTD +6.96%)

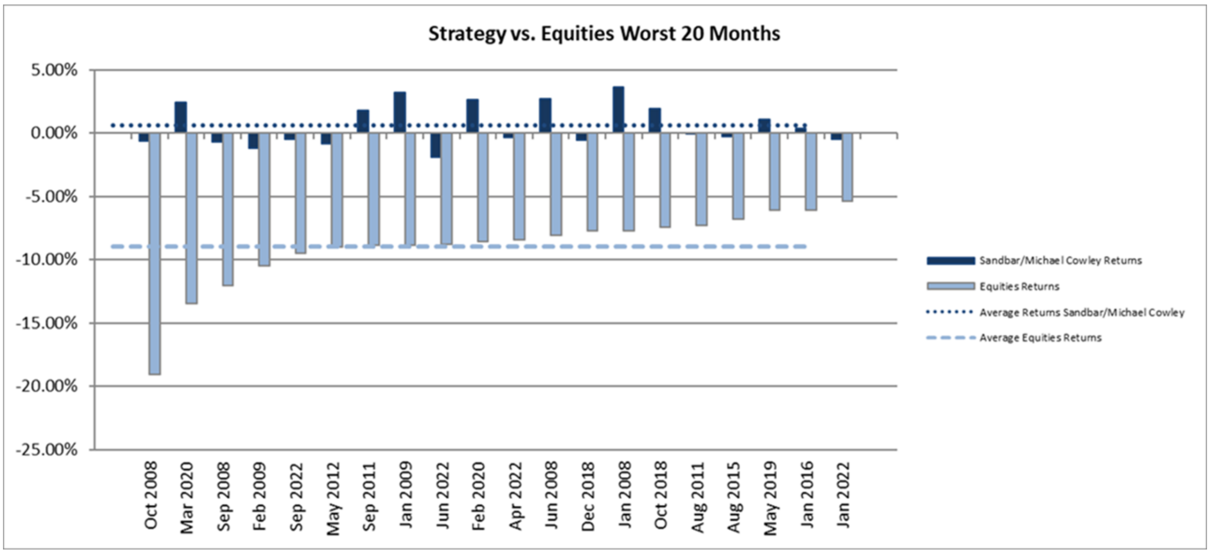
"Experience is the teacher of all things", so the quote goes by Julius Caesar. Looking at recent moves in markets and their positive correlation with broader HF performance is a good reminder of this lesson.

Running equity market neutral portfolios exclusively for close to two decades now “we've seen this movie before” on numerous occasions. Extended gains in equity markets, poor hedging of downside risk, extremely concentrated portfolio positioning with big overlaps between investor cohorts (at the stock, factor and thematic levels), and simply too much complacency by investors/market participants, all set off by an unexpected yet inevitable domino effect of triggers/catalysts resulting in an aggressive unwind.

The question we get from investors time and time again during each screening of this ‘movie’ is “What are you doing differently”. So here we go:

Focus on the construction of zero beta/zero correlation portfolios

We don’t care if the market is up, down or doing backflips, our sole focus is always on constructing portfolios with little or no correlation to markets, peers or any systematic risk factor. Those who have been regular readers of our newsletters and/or have met us during presentations will have seen the below chart – our performance in the worst 20 monthly market drawdowns. The correlation is near zero – we were up 9 out of 20 of the worst monthly drawdowns in the market prior to February. The swing factor and primary determinant of our returns should always be stock alpha, good or bad.



Sandbar Asset Management

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How do we maintain near zero correlation?

- **Rigorous and systematic daily hedging of market risk** to ensure the idiosyncratic/stock risk of the portfolio is the core driver of returns. Put differently, we do not ever want to be losing (or even making) money on factors outside of stock selection, so we need to systematically neutralise any residual systematic portfolio exposures where possible. Again, this is a process we carry out daily using both internal and external risk models.
- **Back testing portfolio correlation and betas to the performance of a broad selection of macro and risk factors and running scenario analysis against a selection of events, including market stress**. Most recently, outside of index level moves, the three main drivers of fundamental L/S HF pain appear to be sharp declines in momentum and beta factors, along with broader crowding. We systematically monitor and hedge our factor exposure, with a particular focus on momentum. Regarding crowding, it is an insidious factor that demands more creativity and homework. To measure our exposure, we collect PB and Quant research provider data sets on crowding (both on the Long and Short Side) running our portfolio nets. We also run portfolio correlations and betas to dominant macro drivers and thematics as well as bank baskets (the GS HF VIP Long and Short Baskets are one example). Ultimately, crowding often overlaps with price momentum, so our work hedging out that factor remains core to our ability to avoid being actors in the "movie". Ultimately, we know we are doing our portfolio construction well when we observe zero correlation to these factors.
- **Focus on alpha opportunities**. The target of our risk management framework is to keep us out of trouble by ensuring our performance is almost exclusively driven by our stock picking alpha. The advantage we have historically displayed in times of extreme market moves and volatility is the agility of our investment process borne out of our investments in our proprietary inhouse systems. We cannot overstate what a critical part of our risk management process it is to have real-time daily outputs spanning all manner of potential macro and thematic factors and alerting tools, but also proactively alert us to any creeping increases in them.
- **A constant evolution/enhancement of process given changing market dynamics**. We don't sit still as a business or as a team. While others are talking, we are running. We know we must adapt to market themes and trends and use the data we collect both about the market and our own performance (whether good or bad) to iterate with the aim of enhancing our processes and our performance. Our risk and investment processes have greatly evolved from the time of other extreme market moves, like the February 2020 Covid-19 crash to the June 2022 Factor unwind, to name just a few from recent memory. As we stated in our opening paragraph, "Experience is the teacher of all things", and we continue to learn from these recent market moves with the goal of staying true to our investment process and principles in our aim to deliver an entirely correlated alpha return stream for our investors.

We will be expanding on these themes in our March newsletter, but in the meantime please reach out with any questions to the team.

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The investment performance displayed represents the results of Sandbar Strategy Performance data for this time period. The performance data represents unaudited performance and presented gross of all fees. The Strategy may incur expenses that had not been previously applicable and such expenses may impact the Strategies performance. The performance results presented herein assume the reinvestment of all principal, dividends, interest and profits in the Strategy.

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

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.