10 years ANNIVERSARY

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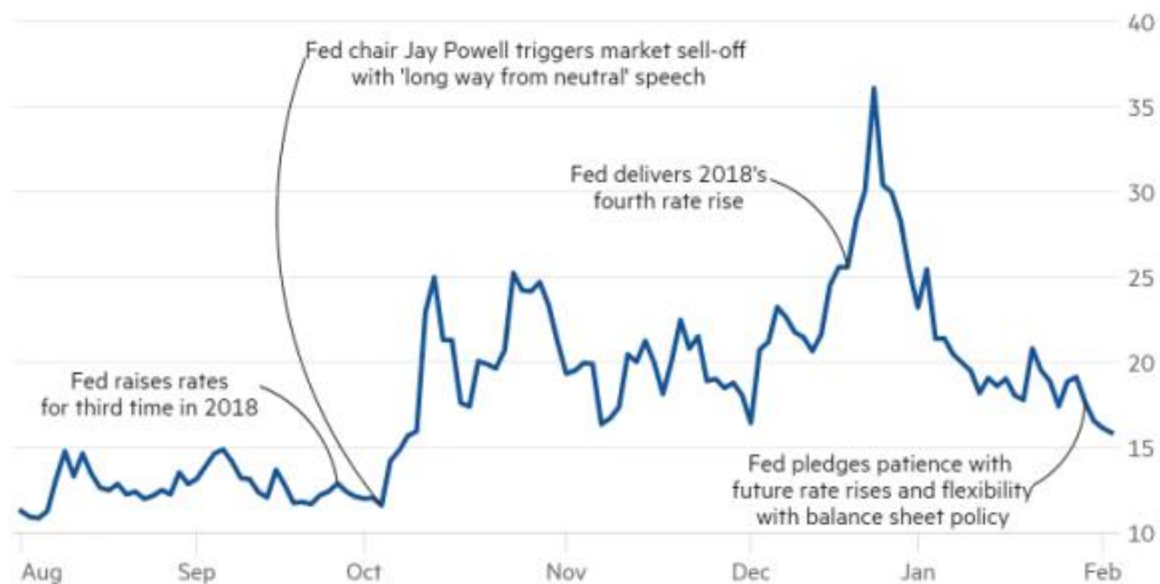
Ayaltis Funds – January 2019 Commentary

Market Commentary

January saw markets in general post their best month in more than eight years bouncing back from a violent V-shaped drop. Equity markets, represented through the S&P, lost -9.18% in December and -18.8% from peak-to-though in Q4-2018, but bounced back +7.9% in January. This left the US equity markets with a combined December-January loss of -2%. 88% of S&P 500 stocks were up in January, as the market indiscriminately bounced back from the depressed Xmas' Eve drop driven by the dramatic stance reversal of the US central bank which capitulated on further interest rate hikes when markets dropped. In parallel, European countries are promising either tax cuts or more public spending while China has drastically moved from credit tightening to easing. The policy hesitation appears to be global. The rally-supporting punch-bowl that started to be taken away is for now back, fostering a valuation-party extension, courtesy of central banks and governments.

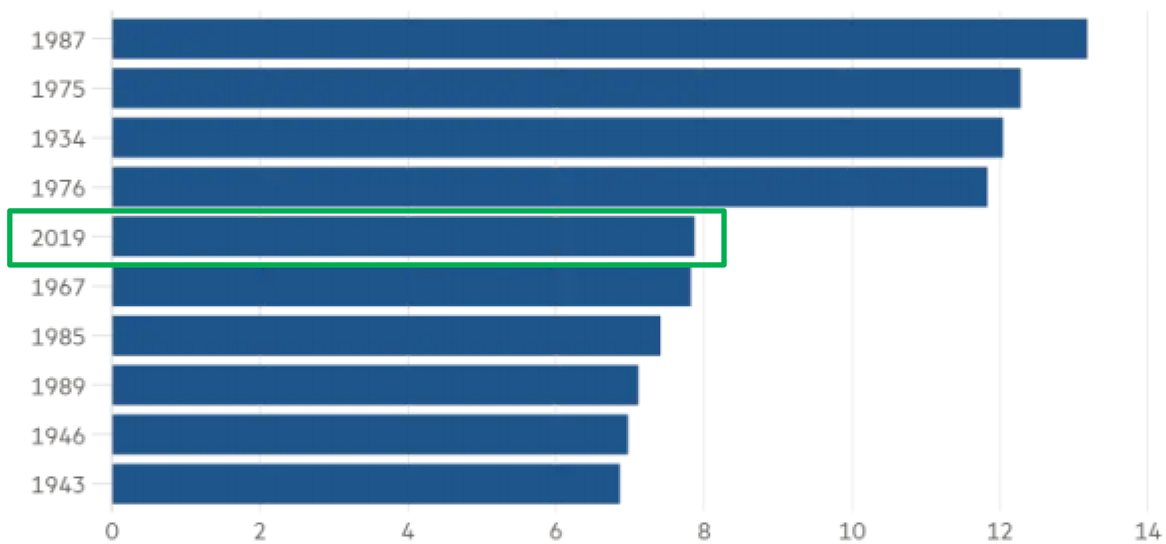
The recovery may become sustained if markets believe the new monetary/fiscal stance and/or enhanced corporate financials support current equity valuations. Nevertheless, growth downgrades, geopolitical risks and pressure on earnings remain very real concerns for the near future.

Graph 1: VIX Index: Dovish Fed Dampens Volatility



Source: Financial Times

Graph 2: S&P 500 Performance in January since 1924



Source: Financial Times

Portfolio Commentary – Areca Value Discovery

During these strongly rebounding January markets, our flagship fund delivered +0.20% essentially from idiosyncratic events as alien to the rebound rally as they were to the market correction in December 2018. Just market-direction independent event capture.

During this two-month stomach-churning episode, our portfolio successfully passed a real-life stress test fully avoiding the market's V-shaped pattern. This is extremely comforting as it confirms our successful rotation to eliminate generic residual market exposure to capture essentially powerful sources of idiosyncratic returns. Our portfolios are now exposed to increasingly diversified evolving relative value strategy implementations. These strategies were spawned by the violent market transformation fostered by the relentless supportive stance of central banks who have become the trusted de-facto market hedgers. We struggled to adapt to this new reality in 2016, but today our portfolio is well positioned.

Betting on a directional stance on the risk-insurer/risk-taker paradox is now fully dependent on the proverbial "don't bet against the FED" rule. Neither of these is our investment stance: we have successfully neutralized both profiles while concentrating on idiosyncratic events structured to be high-return producing and independent from either of these directional risks.

The dramatic December-January abyss visit by markets, which all our portfolios successfully avoided reinforces our commitment to our strong uncorrelated high risk-adjusted return performance. Our market resilient positioning while capturing independent sources of alpha is paying-off: All underlying strategies did rather well in January with the only exception of Structured Relative Value.

Relative Value Fixed Income managers were the biggest contributor to performance this month. The result further supports our forward-looking decision to focus in the space as action returns to yield curves. The result is even more encouraging since the performance was definitely not driven by one-directional yield moves but the contrary. Mid-range sovereign yields bounced back from the mini-flight to quality of December, only to fall back again towards the end of the month. The P&L of our managers was not unidirectional because they went into high gear trading mode and captured the full spectrum of opportunities.

Our **Systematic Relative Value** strategy was a positive, albeit a more muted contributor. Their results over the complete market yo-yo period has been nothing less than spectacular: nicely positive every month since July of last year. This is a vindication of the allocation to these next generation, machine assisted, nimble implementations of practical way to beat not only central banking generic directional manipulation but also its pernicious effects on the traditional behaviour of factors we have recurrently described. Also, these implementations are designed to specifically exploit the footprint of other systematic algorithmic implementations. The successful navigation of this allocations through these extremely unusually volatile markets is extremely promising for our returns forward. We intend to allocate to this sector. Fundamentally driven models suffered early on in the month from their light allocation but made up ground versus the end of the month. One of our hedge funds, set-up as a multi manager managers platform witnessed how 80% of fundamental managers were negative in Q4 2018, and rebounded in January, while quantitative strategies were much more resilient with the split between positive and negative managers being closer to 50%. Another manager, with thousands of quantitative models at play captured better opportunities in the mid-cap space and in the consumer non-cyclical sector.

Discretionary Relative Value managers were the second largest contributor this month with all managers performing positive to strongly positive. As expected, our semi-directional manager who focuses on exactly the recurrent equity market's yo-yo behaviour perfectly jumped on the bounce back opportunity, capturing attractive returns. Opportunistic nimble traders were the second best contributors within this segment as the market moves were relatively easier to capture once established during the complete roundtrip cycle.

Our **Event Driven** managers delivered the third largest contribution to performance. The space is the picture-perfect representation of our focus on idiosyncratic sources of return not correlated to long-biased markets. Irrespective of the drop in December or the bounce-back rally in January, events continue to supply a diversifying source of attractive market neutral returns. The best source of alpha this month was in mergers followed by customized equity based lending which continues to perform, immune the central banking direction

Our **Distressed** manager was marginally down for the first time since August 2018. The result is paradoxically very encouraging: Distressed is a traditionally long-biased strategy. However, given the status of credit markets we would be insane running a long bias. Our manager is long cheap distressed soon to be re-priced on market-direction independent events while being short highly priced bonds soon to be stressed on market-direction independent events. The latter led to minor losses in January 2019. Given current markets, the manager attempts to run as neutral as possible. Given their strong positive performance since August 2018 and the moderate

negative performance this January, we are happy to note their net defensive positioning versus eventual credit spread widening.

Our **Global Macro** managers were the second largest detractor to performance. Among the most affected managers was an equity exposure to a sector which saw an index discontinued and then not yet redefined. The market independent event drove the hedges of the manager out of sync, depriving the portfolio of performance. The position was very small. The rest of the macro space performed on a balanced neutral manner.

Our **Structured Relative Value** manager was the worst performing strategy this month after having been the best performer in December. The defensive short position on corporate debt embedded to protect the targeted optionality-driven bond events in that strategy detracted significantly this month. Exactly the opposite behaviour of the previous month when it provided massive protection delivering the two-month defensiveness of a traditional outright hedge. The violent net neutral result eclipsed the normal performance of underlying bond events.

Portfolio Commentary – Azure

Our portfolio with a focus on equity strategies delivered a strong performance with a return of +1.16%. It is extremely compelling to put its performance in context of 2018. While markets got stressed in previous year and most equity hedge funds delivered negative returns, our Azure portfolio displayed strong defensive returns, ending the year up 1.16%. A look to the L/S equity or market neutral space immediately catches the eye: Azure significantly overperformed its competitors when the bullish trend that followed Trump's election began to show signs of fatigue. The extreme defensiveness does not jeopardize the ability of the fund to capture rebounds. The violent short-squeeze of January 2019, which created one of the strongest rallies in history, was nicely navigated by most of our managers. Only 3 funds out of 18 closed the month marginally down.

Both Systematic and Discretionary Relative Value positively contributed to the performance. It is important to highlight that computer-driven funds contributed two thirds of the overall performance. Our manager selection process allows us to identify not only the most defensive (and as much as possible convex) and advanced algorithms, but we managed to further neutralize the negative impact of V-shape short-squeezes, enhancing the stability of the portfolio in any market conditions. We are in the process of adding a couple of compelling strategies within the next few months that rely on differentiated and non-correlated trading styles. As we look into 2019, we are excited about the robustness of our portfolio but even more, we are eager to exploit our promising fund's pipeline.

Portfolio Commentary – Narrapuno Spectrum

Our portfolio of best ideas delivered a positive return with the strongest contributor on the Relative Value Fixed Income side. Event Driven, too, added to the positive monthly results whereas Global Macro detracted performance. Within Global Macro performance was mixed. A commodity biased trade led to losses. Structured Relative Value accounted for the majority of

the losses within the portfolio. The short credit hedges were a drag on performance as the risk-on sentiment pushed the credit space higher.

Portfolio Commentary – Convexity

Our portfolio with a focus on convex strategies delivered its first negative monthly return since inception in August 2018. The portfolio is designed to exploit volatility spikes when markets get stressed as in December 2018 but is expected to suffer as the market bounces back as in January 2019 to recover from its dramatic drop. While Systematic Relative Value managers achieved a positive performance, losses on the Global Macro largely stem from tail hedge positioning.

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