Fortem Capital Alternative Growth Fund

Quarterly Commentary – 29th September 2023

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Total Return	2023	Q3
UK 100	5.5%	2.2%
US 500	12.7%	-3.4%
Europe 50	12.6%	-4.9%
Japan 225	24.0%	-3.4%
Hong Kong 50	-7.0%	-4.3%
US 2000	2.5%	-3.4%
Swiss 30	5.4%	-2.7%
BCOM	-7.1%	3.3%
US Treasury	-1.2%	-3.2%
Euro Property	-7.0%	3.6%
PGF	**7.5%**	**0.1%**
AGF	**-0.8%**	**1.2%**
DGF	**1.9%**	**0.2%**
US Equity Income	**12.0%**	**-3.6%**

After the liquidity driven rally that characterised the first half of the year, it is perhaps unsurprising that markets took something of a breather in the third quarter. Developed market indices were down across the board, barring the energy-heavy UK 100, as rising bond yields once more put pressure on risk assets and upside surprises in data as well as increased energy prices gave cause for question over whether the battle against inflation has been truly won, at least to the extent that policy is set to return to the 'new normal' of the past 15 years any time soon.

Of perhaps greater note with regards to fixed income was the emergence of issuance of US government debt as a consideration. Both the announcement of over $1trn of borrowing in Q3 ($300bn higher than May's estimate) and that the issuance is likely to occur further out on the curve, given how heavy bill issuance has been thus far in 2023, has given the market something of a reality check, even for those predicting either a soft landing or no landing at all. Supply must also be considered with regards to bonds, particularly now.

Against that backdrop of a market beginning to at least normalise, even if not aligning with its reality, the Fund produced a 1.2% return over the quarter.

Diversifier

The majority of the Fund's Diversifier exposure sits in the long-established premia of Commodity Curve, Rates Volatility, FX Value and Equity Volatility.

As one might expect, the Fund's rates volatility strategies benefitted from the market's surprise at the amount of issuance the US Government requires in order to fulfil its spending plans, at a time when the world at large are becoming less enthralled by the USD.

In commodities, cuts by OPEC+ returned the oil complex back to extreme levels of backwardation, an unusual phenomena heading into a global slowdown in demand. Saudi Arabia are now in a period of managed supply, but this is not sustainable over the long term given that cuts are replaced with US shale production.

The tilt towards defensive strategies carrying negative beta remains in place as we head into the back end of the year.

Protection

The Fund retains its overweight to the protection bucket, weighting to which remains at the very top of the range.

The opportunity was taken in September to rearrange the make-up of that protection somewhat. Moves down in equity volatility had been particularly severe during the year and so further protection was added in the equity volatility space through an additional S&P put spread.

The current hiking cycle more than any other has been characterised by rates consistently surprising to the upside, this is different to previous hiking cycles which were far better predicted and may mean that the mini-banking crisis is not the end of who has been wrongfooted in terms of short-term financing needs. The Fund maintains its positions in CDS protection which will provide convexity in the event of any systemic credit issues coming to light.

Income

The Fund's collateral continues to benefit from the high levels of yield afforded to the most short-dated and credit-worthy collateral in the current environment, allowing the defensive positioning in a rampant bull market to have been flat in terms of carry.

Outlook

The three scenarios remain the same:

1. The Fed has tightened the perfect amount; soft landing
2. The Fed has tightened too much; hard landing
3. The Fed has not tightened enough; higher for longer

Since Q4 2022 the market has become increasingly confident of scenario 1 and indeed heading into 2023 the soft-landing narrative shifted to no-landing at all.

This outcome is of course possible and would benefit the more traditional asset classes in multi-asset portfolios. But, on the balance of probabilities, it remains unlikely given that the landing strip is incredibly narrow and that never once has it been achieved in previous rate rise cycles.

The above has not changed since last quarter, but as we move towards the end of the year we may update our own probabilities as to where we are headed in terms of those three scenarios.

There is little doubt the global economy already finds itself in a manufacturing recession. This has been offset this year by strong services and a consumer willing to spend down its savings accumulated during the non-normal times of saving during the pandemic. We are now seeing leading indicators in services beginning to turn down and cracks beginning to emerge in consumer driven oil demand and driving miles in the US. In addition to this the levels of bankruptcies being seen are at levels similar to 2020 when the global economy was in lockdown.

Compared to other hiking cycles, the pain naturally takes longer to feed through as the corporate world as well as consumers took advantage of the ultra-loose policy of the preceding years and locked in highly attractive terms; only those needing to refinance would feel any pain. Therefore, rather than ‘how much higher?’ the pertinent question to ask becomes ‘for how much longer?’ One only need listen to the central bankers themselves to understand that there is a new normal of higher for longer that markets must come to terms with and if this is the case then a refinancing wall will need to be crossed.

Equity also must remain vulnerable as long as the equity risk premium remains so low, almost irrespective of where the economy is headed. The end of the year is often characterised by a ‘Santa rally’ as winners tend not to be sold before January in order to avoid the crystallisation of tax in the US. Those mechanical conditions are not apparent this year as there are offsetting losses available on any bond that has been bought in the past 18m as well as the rally in equity being incredibly narrow; only 200 out of the 500 stocks comprising the S&P are up this year, in a year in which the index is up 13% YTD.

The market is confident of two things. The first is that the federal Reserve and other central banks’ resolve will not be tested due to the avoidance altogether of conditions that would test it. The second is that at the first sign of trouble that once more policy returns to the post-GFC profligacy of zero rates and unlimited liquidity. If either of those assumptions turn out not to be true, or more importantly if the perception over those assumptions were to shift, then investors should brace for a reality check as assets reprice to that new reality.

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