Fortem Capital Alternative Growth Fund

FORTEM CAPITAL

Quarterly Commentary – 28th March 2024

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At the end of the previous quarter, we suggested that the declaration of victory over inflation had come too early to be priced in with any certainty.

That declaration turbo-charged an easing in financial conditions that began last Halloween and has led to data across the globe picking up. As a result, policymakers have been forced to row back on that dovishness and we have seen the Fed 'dots' shift to a higher inflation rate, higher long term interest rates and even hints at a higher neutral rate.

Jerome Powell did an expert job in tempering any reaction to the longer-term dots moving higher with a dovish statement, but since then messaging has become muddled as Fed Governors have been talking about no cuts in 2024 and the neutral rate of interest or r* (the rate which is neither expansionary or contractionary to economic conditions) having moved higher.

February also saw heavy coupon issuance (vs Bills in October that kick-started risk assets' run), and term premium has been rising in bonds steadily since but has yet to find its way into other asset classes possibly due to robust growth expectations or the market still not believing the Fed in their commitment to returning inflation to target.

Against this backdrop, other asset classes including equity saw another quarter of significant gains with the broad basket of global equity up 8.9%.

Total Return	2024	Q1
UK 100	4.0%	4.0%
US 500	10.4%	10.4%
Europe 50	12.8%	12.8%
Japan 225	21.4%	21.4%
Hong Kong 50	-2.5%	-2.5%
US 2000	5.2%	5.2%
Swiss 30	6.8%	6.8%
Global Equity	8.9%	8.9%
Global Bond	-2.1%	-2.1%
Commodities	0.9%	0.9%
PGF	**2.2%**	**2.2%**
AGF	**0.8%**	**0.8%**
DGF	**3.0%**	**3.0%**
USI	**10.2%**	**10.2%**
ARF	**4.6%**	**4.6%**

The Fund returned 0.8% over Q1 2024.

Income

The Fund is fully backed by short-dated high-grade debt. As rates have risen, so has the return available from the Fund's collateral, with the collateral yielding 4.9% as at quarter end.

Beta

The Fund makes no allocation to the Beta portfolio. This is one reason that it has provided investors positive convexity at all points of market turbulence, irrespective of the cause.

Diversifier

The Fund's rates volatility positions have been the main beneficiary of the move back to 'higher for longer' with some help from the equity premia.

The commodity strategies, the Fund's biggest risk weight and highest conviction, remain muted as commodity markets continue to be stubborn in their moves back to contango, their long-term home.

The FX value premia has been the most disappointing over the past 18 months, largely down to the weakness in an already weak Yen, in which the Fund has a net long position. However, as Japan wakes from its monetary slumber and the rest of the world eventually starts to move the other way, the outlook here is highly constructive.

Rates curve has been the worst performer, again as yield curves have re-flattened, but one suspects that they must structurally steepen once more either through the back end if indeed the landing is soft, growth expectations rise and term premiums alongside them. Or, possibly more likely, through the front end if a hard landing lies ahead and rate cuts come faster than the market expects when they eventually do.

The Diversifier portfolio continues to be positioned defensively.

Protection

Unsurprisingly, as credit and equity markets have brushed off the move back to 'higher for longer' in spite of their meteoric rise in light of the pivot to 'lower for sure' at the end of 2023, the Fund's protection has once more been a drag on portfolio performance. The Fund remains at the top end of its protection spend with a combination of puts and CDS.

During the quarter there was one addition to the protection bucket. With volatility being so low, and protection so cheap, the equity volatility profile was tweaked to be long both wings and provide upside volatility participation. This has allowed the Fund to retain its defensive positioning in a strongly rising market whilst still achieving the lower end of its target return.

The Fund remains heavily biased towards long volatility strategies across equity, rates and commodities. During recent periods where volatility has peaked its head above the parapet, the Fund has provided some convexity. Those periods have all been short-lived as policymakers have continued to be willing to do whatever it takes to loosen financial conditions, suppress volatility and ensure that any strategies such as this that are (truly) long volatility remain muted.

If the prognosis from here is a soft or even no landing, then where the portfolio is positioned will likely mean the return profile is at its most muted, but still positive. Even in that scenario, there is no longer a guarantee that the 60/40 continues to flourish given upcoming Treasury issuance and the rise in term premium that might follow.

If we were to see a hard landing, where economic data and employment deteriorate quickly, growth and inflation expectations fall, volatility spikes and policymakers cut rates aggressively then duration would likely be a multi-asset portfolio's friend once more. But, given that there are still upside risks to bond yields and cash is paying so handsomely, most are not running the type of duration positions that might have been the case heading into previous recessions.

It is if we were to see higher rates volatility on the back of the market moving away from pricing a soft / no landing scenario to higher for much longer, whether because of a continued reacceleration in inflation, further supply catalysts in treasuries or a combination of the two then there is a real gap in traditional asset allocations. In this scenario bonds and equities sell off together again.

In spite of the return to 'higher for longer' and increased treasury issuance, most risk assets remain buoyant. It could be the case that the landing is indeed set to be soft, but the market remains 'all-in' on that prospect. The fact that the market overestimates the probability of a soft landing means that volatility is mispriced and that most assets that are currently buoyant are short volatility proxies. As such, it makes sense to retain some long volatility exposure in portfolios in case the landing is bumpier than expected, which should add some much-needed convexity to multi-asset portfolios in a crisis.

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