Fortem Capital Progressive Growth Fund

FORTEM CAPITAL

Quarterly Commentary – 30th September 2024

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Total Return	2024	Q3
UK 100	9.8%	1.8%
US 500	21.7%	5.8%
Europe 50	13.1%	2.4%
Japan 225	14.8%	-3.6%
Hong Kong 50	29.0%	21.5%
US 2000	11.2%	9.3%
Swiss 30	12.8%	1.6%
Global Equity	18.9%	6.4%
Global Bond	7.0%	3.6%
Commodities	1.7%	-0.6%
PGF	**5.2%**	**1.2%**
AGF	**1.8%**	**1.0%**
DGF	**5.1%**	**1.6%**
USI	**20.9%**	**5.8%**
ARF	**5.3%**	**1.3%**
CARF	**-**	**1.9%**

As has become the norm, the third quarter of 2024 saw risk assets reprice higher, but not without the odd bout of volatility to contend with. In fact, risk assets performed so well that to the end of Q3 the S&P 500 has enjoyed its best start to a calendar year since the turn of the century.

Early August did see some volatility as the already thin liquidity at that time of year was strained further when US data soured just as the Bank of Japan hiked rates, leading to an unwind of the ever-popular Yen carry trade. However, this was something of a storm in a teacup; the VIX did see a significant rise, but go even a little out on the term structure and volatility remained relatively subdued. The VIX's use as a barometer for volatility continues to wane. Those who were short gamma did get burned. As ever, when clipping some volatility to pay for protection; buyer beware.

The episode did likely prompt the Federal Reserve to take Jackson Hole as its opportunity to announce a turn in the cycle and pivot away from their inflation mandate, the war having been won (sic), and to employment, which has been weakening in the US for a year or so, as is normal for this stage in the cycle. This turn in the narrative prompted risk assets to resume their rise and at the time of writing, with the first 50 basis point cut in the books, the benchmark index is at a new all-time high.

As a result, the bond market is where the more notable moves have been seen, and where pricing for a while remained far ahead of the Fed's own Summary of Economic Projections. The cuts being priced were suggestive of a full-blown crisis rather than the softest of landings that equities were foretelling. Again, both of the major asset classes cannot be right. It remains to be seen which is.

Commodity markets have until recently been out of vogue for some time within the minds of multi-asset investors. During the quarter, an escalation in tensions in the Middle East not seen for at least twenty years brought them front and centre. Israel's incredible retaliation against another of Iran's proxies in Hezbollah caused Iran to enter the conflict directly, firing missiles directly into Israel. The reaction in energy markets was volatile, but it is important for investors to understand that the world has moved on from the 70s with regards to its resources. Shale has entered, proving unbreakable in the 20-teens, and Saudi have dropped the ball once more over the past 18m ceding market share to OPEC+ members unwilling to stick to their quotas. Before now, taking back that market share would likely have led to oil prices of sub-$50. As long as the Strait of Hormuz remains open, Saudi are likely to plug any gap in supply that an Israeli strike may cause.

Against that backdrop the Fund returned 1.2% over the quarter and 5.2% in the calendar year-to-date.

Income

The Fund is fully collateralised by high-grade sovereign debt. As such, it's liquidity profile extends to the liquidity profile of the Income portfolio. This part of the Fund returned 0.9% over the quarter. A key pricing input for the Beta portfolio is rates, when rates are high, the level of return available from the Beta portfolio for a given level of risk is similarly higher than when they are low all else being equal. The current rate environment is allowing the Fund to incept positions with defined returns above the Fund's return target, without taking on more risk than is and has always been stipulated at outset.

Beta

There were mixed results for the Fund's underlying equity indices to which it has exposure. US markets were particularly strong, in particular the US 2000, to which the Fund has the majority of its US exposure. European markets were more subdued, in particular the Swiss Market Index, which the Fund also takes exposure to. Japan was the laggard as the unwind of the Yen carry trade, which was the main cause of the turbulence seen in August, cause the Yen to spike and the Japanese stock market to fall heavily. Although the Japanese market finished the quarter only 3.6% below where it started it, its journey to get there was a volatile one; it suffered a drawdown of 27% from its July 11th peak to its August 5th low, including a 12.4% fall on the 5th itself, its biggest single day fall since the 1987 Black Monday crash. In spite of this, and the Fund's reasonable exposure to Japan as an underlying geography, the Fund weathered that storm in one of its major underlyings well as a consequence of its conservative setting of barriers at outset as well as its risk overlay.

Risk Overlay – Diversifier + Protection

The Fund's risk overlay was a detractor over the period given risk assets' ascent higher in Q3. However, it did provide some buffer during the period of turbulence in early August, as can be seen in the difference between the Fund's drawdown versus the basket of underlying equity indices (the 'proxy basket') on the factsheet, even allowing for delta. As a reminder the risk overlay is not designed to have a pronounced effect on the overall return profile of the Fund, but rather its risk profile during acute market stress. Since launch, the overlay has had a positive impact overall; the Diversifier investments have more than paid for the Protection, as they have in the Alternative Growth Fund which is effectively the overlay in single strategy form. Indeed, the genesis of the Alternative Growth Fund was a demand from the market for a type of risk overlay to perform in portfolios the role that this risk overlay performs within the Progressive Growth Fund. Both have provided positive returns, even in a generally rising market, but have added convexity when most needed.

Outlook

The Fund to date has achieved annual returns of 4.8% per annum since launch, below its stated target of 6-7%.

When looking at a Fund such as this, there are only really four ways in which it can be behind its return target:

1. The Income portfolio suffers capital loss
2. The contractually defined returns are not commensurate with the return target after fees
3. The investments are maturing at a capital loss / no capital gain by being below barriers after 6y
4. The mark to market is such that there is intrinsic value in the Fund in order to return it to target

Given the Fund's Income portfolio takes exposure to the governments of the UK, US and Japan, this would require a default from one of those governments.

The average contractual annual return of investments in the Beta portfolio since launch is 8.1%. Minus OCF this leaves the Fund above its stated target return. There was a period during which coupons achievable with barriers for capital growth and protection in the 60s, consistent with the strategy we set out at launch, achieved significantly lower coupons than this. 2021 saw the Fed put re-emerge, flooring volatility as well as ZIRP. This led to a poor pricing environment. It leaves a portfolio manager with a choice; change the risk profile of the Fund by upping the barriers to keep returns commensurate with target at all times, or accept that there will be periods when pricing is relatively attractive (see past 18m), standard (see when Fund launched) or poor (see 2020 / 2021). We did not and will not change our protection levels at outset, and accepted lower returns for a period in the knowledge that over the long term the average levels achieved should deliver on the Fund's stated objective, as they have begun to and as they should continue to as shown by the forward looking returns embedded here.

The Fund has not had an investment reach maturity. There were two investments, out of the 150 the Fund has incepted in the Beta portfolio, that were linked to the Hang Seng index. These investments were incepted near the start of the Fund's life and both were restructured at a net positive impact albeit without achieving their full returns. Of the remaining 148, all investments have either paid out their full amount at maturity or are still live within the portfolio. The current average distance to protection and growth barriers of those investments within the portfolio stands at near 40%.

The Fund's underlying equities have not been the best performing equity indices relative to the major protagonists of S&P etc. That mark-to-market has been a drag on performance, and did also mean that some of those low return investments stayed in the portfolio for three years. However, this does mean that on a forward looking basis there must be some intrinsic value to catch up for the Fund to return to its target given the two points raised above. Those low return investments have rolled off, terms have improved significantly without changing the risk profile of the Fund such that the current GRY sits at 9.8%, which is excellent given the levels of protection present as mentioned previously. Current investors have had to wait patiently for an improvement in the return profile as terms have improved, but that patience has started to pay off; over the past 2 years the Fund is annualising above 12%, as it needs to return to target. The forward looking, contractually stipulated returns remain well above that long term target, and that is how it will get there.

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