# Fortem Capital Progressive Growth Fund

FORTEM CAPITAL

## Quarterly Commentary – 31st December 2024

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2024 saw equity markets post another stellar year of returns led by the US 500, which posted its second consecutive year of returns greater than 20%. Global bonds in general continued their poor performance as government bond yields remain elevated, but investors found a happy hunting ground in high yield credit where spreads continue to tighten, buoyed by the general optimism over risk assets.

| Total Return | 2024 | Q4 |
|---|---|---|
| UK 100 | 9.6% | -0.2% |
| US 500 | 24.4% | 2.3% |
| Europe 50 | 11.0% | -1.8% |
| Japan 225 | 20.8% | 5.3% |
| Hong Kong 50 | 22.6% | -4.9% |
| US 2000 | 11.5% | 0.3% |
| Swiss 30 | 7.5% | -4.7% |
| Global Equity | 18.7% | -0.2% |
| Global Bond | 1.3% | -3.1% |
| Commodities | 5.4% | -0.5% |
| **PGF** | **5.3%** | **0.0%** |
| **AGF** | **1.2%** | **-0.5%** |
| **DGF** | **5.4%** | **0.3%** |
| **USI** | **23.2%** | **1.9%** |
| **ARF** | **7.1%** | **1.7%** |
| **CARF** | **-** | **-1.0%** |

The US economy continued to decouple from the rest of the global economy with the job market remaining buoyant, growth solid and inflation stubborn. The past few years have not been without growth scares with SVB, the tightening of conditions in summer 2023 brought on by US Treasury issuance, and the deterioration in data in summer 2024 all encouraging action from policymakers to loosen conditions significantly each time. These policy reactions had the effect of prolonging economic strength and strong labour conditions.

The latest of those reactions was the start of the cutting cycle following some relatively poor data in July. However, unlike most cutting cycles, conditions, led by increased term premium, have tightened significantly since the first cut in September; the market, in the absence of willingness from policymakers, is taking it upon itself to finally kill off inflation. This can and will only be achieved by a slowing of growth and dampening of demand. There is also, after a Republican clean sweep in November, a new administration which will decide its response to this slowing; they have been openly critical of the previous administration's Treasury issuance policy and have less tools at their disposal to loosen conditions.

The market has not priced this slowdown and is unprepared for this as an outcome.

The Progressive Growth Fund returned 5.3% over the year and was flat over Q4.

### Income

The Fund is fully collateralised by high-grade sovereign debt. As such, its liquidity profile extends to the liquidity profile of the Income portfolio. 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

The Beta Portfolio is the key driver of risk and return within the strategy. This portfolio has a number of investments linked to major developed equity market indices. The investments have strict rules around minimum protection levels such that they contractually earn defined positive returns even in significant drawdowns for the equities to which they are linked.

Q4 was another mixed quarter for the strategy's underlying equity indices. Given the relative valuations, the strategy remains heavily underweight to the US 500 market cap weighted with exposure instead taken to the less expensive equal weight index as well as US mid cap. In a year in which mega caps once again dominated the investment landscape this once more dampened mark-to-market but ensures that the Fund remains positioned to achieve returns significantly higher than target on a forward-looking basis, as it has since the 2022 lows having annualised at more than 11% since.

Within the current beta portfolio there are 53 investments with an average coupon of 8.9% and given moves in the underlying indices this translates to a GRY of more than 10%. There also remains plentiful protection within the portfolio; distances to both capital growth and preservation barriers are in the mid 30s meaning that markets can suffer significant falls with the Fund maintaining its positive return profile.

**Risk Overlay – Diversifier + Protection**

The Fund's risk overlay was a detractor during 2024 as one would expect in another year in which US equities re-rated aggressively higher. 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. The risk overlay should act as a ceiling on delta during those periods of acute stress, as it did in 2020, which is unlikely to be matched with regards to simultaneous stress on the pricing inputs to the Beta Portfolio.

**Outlook**

The strategy currently has significant levels of protection as well as significant levels of intrinsic value embedded within it such that its contractual GRYs across market scenarios from -20% to +20% are above target and double digit in flat markets. Equity markets are priced for perfection. Irrespective of one's prognosis for the global economy in 2025, US equities are pricing greater than 15% growth in earnings, these are levels rarely seen outside of recoveries after significant earnings contractions and recession. The equity risk premium (ERP) is highly elevated and tends to itself be cyclical. It stands to reason that equities may struggle to continue to produce super-normal returns in the coming years even if the landing is relatively soft. It is for precisely this outcome that a strategy such as this makes sense for investors; it will outperform lacklustre equity markets contractually and if policymakers tools to support asset prices indefinitely are finally running out, it will become an essential tool for investors who have borne the fruit of that policy for so long.

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