

# ARR Global L/S Equity Strategy Investor Letter, Third Quarter 2022

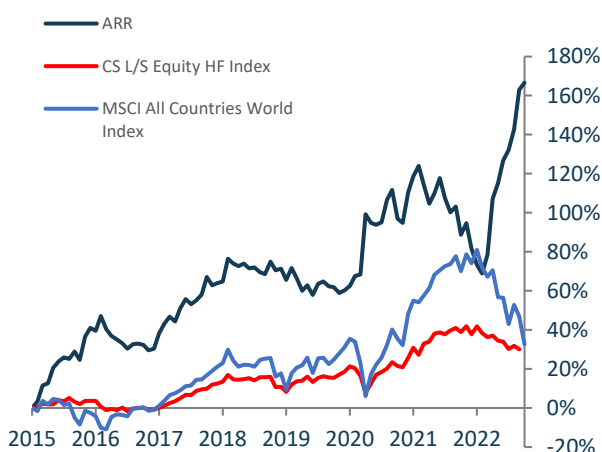


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Dear Friends and Investment Partners,

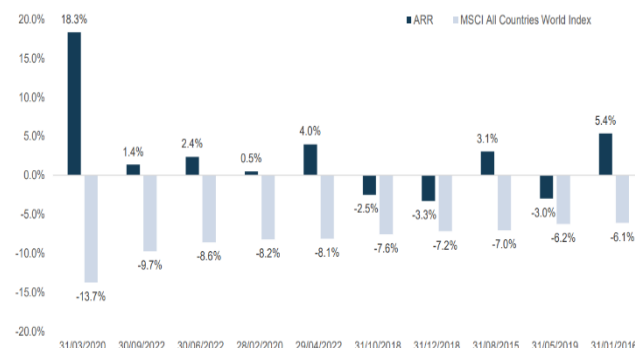
I hope you are well!

Having generated net returns of 4.5% in July, 8.4% in August, and 1.4% in September, we are happy to announce that we have ended Q3 with net returns of 14.8%, compared to -7.3% returns of the MSCI All Country World Index. This puts us at a Year-to-Date net performance of +53.9%, compared to MSCI ACWI's performance of -26.7%, and the Credit Suisse L/S Equity HF Index performance of -8.3%. The chart below shows our performance in comparison to MSCI ACWI and CS L/S Equity HF Index since our inception in January 2015. The outperformance is more than 100% and we outperformed every major index (including Nasdaq) in USD since 2015.



This quarter, we were recognised for our outperformance relative to other global hedge funds, having been shortlisted at the With Intelligence HFM European Performance Awards 2022 for the category "Global Equity Under \$500m", while also ranking number 4 for the Equity Long/Short Rankings by BarclayHedge in their monthly performance rankings for the month of August 2022. In September 2022, we generated 1.4% in net returns, while the MSCI All Country World Index had one of its worst monthly drawdowns since our inception, with a negative return of -9.7%. The September performance underlined our core strength which is

generating positive returns and preserving capital during market selloffs. As seen in the next chart, in 7 out of the 10 worst performing months of the MSCI ACWI since 2015, we have generated positive returns.



Our outperformance also yielded publicity, as I was interviewed by the popular alternative investment platform AlphaMaven and featured as a guest speaker on Jon Kingston's podcast Capital Employed FM - where I discussed my background, my experience in the 2011-2014 Russian Bear Market, and our investment philosophy at ARR Investment Partners. You can listen to the podcast [here](#).

### Investments Made Over Last Quarter:

Our investments in the renewable energy space materialised inconsistently – with both our best and worst performing positions being from this sector – across different geographies. Despite improving fundamentals and supportive macro-drivers like the Inflation Reduction Act and increased calls for energy security in Europe, those equities went through market correction, triggering our stop losses. Another one of our underperformers was in the European residential real estate space - although the company is extremely undervalued by classical real estate valuation metrics, and we expected a rebound, the yield increases forced a stock correction which triggered our stop loss. Regardless of how strict our investment process and criteria are, or how high a conviction we might maintain, we have a disciplined stop loss policy which we use to limit our losses.

Our investment tenet of going “Long Dynamic Profit Growth” boded quite well with the Lithium sector. Increasing Lithium prices and substantial scale-ups in production were strong drivers in Lithium producers’ stock prices. We purchased a relatively large position in a major Lithium producer, after the announcement of the Inflation Reduction Act, and exited at the right time, near the peak. Our investments in other Lithium companies also proved to be fruitful, owing to our general investment thesis of going long on key stakeholders for energy transition.

We also generated upside by shorting shipping companies, given the cyclicity of the sector, increased demand risks, and record fuel prices. These companies, which are in an earnings bubble in our opinion, may seem undervalued but have significant headwinds for the foreseeable future. The stock prices held steady across July and August despite worsening fundamentals. With global freight rates falling approximately 30% in the month of September, shorting these companies presented a good risk-adjusted reward.

To manage our portfolio risk well, and to stay ahead of macroeconomic developments, one of our largest positions included shorting a company in the commercial real estate space. Companies in this space usually have higher amounts of debt, and increased interest rates were bound to have a negative impact on their financial health. With decreasing consumer confidence, and the long-term market trend of online e-commerce, having a short position here fits in well with our investment theme of shorting structural losers.

### **Our Market Outlook:**

Our base case is that the current market environment is quite similar to the 2000-2003 Dotcom Crash, with some key differences. During the Dotcom Bubble, supporting forces from the central banks prevailed, such as decreasing interest rates, whereas what we see now is the opposite. The valuations during the bubble were even more stretched, and we do

not expect the Nasdaq to crash the way it did then, as its current major constituent companies have far better fundamentals and profitability than those during 2000-2003. A more comparable investment portfolio to the Dotcom Crash would be the ARK Innovation ETF (ARKK). This fund is currently at -60.3% Year-to-Date, and consists to a large extent of similarly technologically evangelistic and unprofitable companies, which have business models that are not sustainable in the current market environment.

However, quite similar to the black swan events arising from the Dot-Com Bubble, such as Enron or 9/11 - which wiped out billions in value given the negative investor sentiment and value destruction- we have seen similar losses in the crypto currency space, and the UK bond market with the crashing gilt. Given the macroeconomic developments, decreased consumer demand is bound to materialise in the form of earnings decreases - as seen, for example, in the latest FedEx earnings report where EPS was USD 3.44 compared to the consensus estimate of USD 5.10. The stock crashed more than 20% in one day. Our view is that this bear market, similar to the Dot-Com Crash, will have a repetitive series of selloffs, bear market rallies/rebounds, and subsequently greater selloffs.

In fact, a significant number of companies which went public during the Dot-Com bubble, filed for bankruptcy within just 5 years of their IPO. Finding those highly leveraged companies which are unable to sustain cash flows in this economic environment – the US has over 100 companies with market capitalisations in excess of USD 1 billion but have negative EBITDA – is one of the themes that we have decided to focus our shorting efforts on, as generating a 100% upside on those short positions is indeed a real possibility. We have seen a massive misallocation of resources over the past few years, where companies which never should have been funded in the first place have raised billions.

However, given the uncertainty of the times, we are aware that our view of the market is not infallible – therefore, we focus on the 4 extreme situations and patterns which are a core part of our investment strategy and offer an asymmetric risk reward: Long Dynamic Profit Growth, Long Stock Rebounds, Short Hypes/Bubbles and Short Structural Losers. Those investment patterns are quite uncorrelated between each other but as well with the general market indices.

We presently see a plethora of investment opportunities in the market and will do our best to capitalise on them.

I look forward to the rest of the year and hope to continue the good progress made thus far. Thank you for your trust in my team and me!

Best,

Christian

## Net Monthly Returns Since Inception

(%)	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual	ARR Cumulative	CS L/S Equity Cumulative
2015	3.3	7.9	1.0	7.0	2.7	1.8	-0.7	3.1	-3.4	9.7	3.2	-1.0	39.5	39.5	3.6
2016	5.4	-4.6	-2.4	-1.3	-1.5	-2.1	1.7	0.3	-0.5	-2.2	0.7	6.0	-0.9	38.3	0.0
2017	3.7	2.4	-1.7	4.6	3.2	-1.7	1.2	2.0	5.7	-2.6	0.8	0.5	19.2	64.8	13.4
2018	7.1	-1.4	-0.8	0.8	-1.5	0.3	-1.5	-0.5	3.8	-2.5	0.4	-3.3	0.5	65.7	8.2
2019	3.6	-3.0	-3.8	1.7	-3.0	3.6	0.7	-1.5	-0.3	-1.9	0.9	1.4	-2.0	62.4	21.3
2020	3.2	0.5	18.3	-2.2	-0.5	0.7	5.8	2.5	-7.0	1.1	8.0	3.9	34.6	118.6	30.9
2021	2.4	-4.3	-4.5	2.5	3.8	-4.6	-3.6	1.5	-7.2	3.1	-6.7	-4.6	-20.7	73.3	41.8
2022	-2.5	5.7	16.0	4.0	5.3	2.4	4.5	8.4	1.4				53.9	166.6	30.1

Source: InteractiveBrokers, Credit Suisse, time-weighted performance of first managed account in USD, net of fees; unaudited; as of 30.09.2022. CS L/S Equity Index is reported with a one-month delay.

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