ARR Global L/S Equity Strategy

Investor Letter, Second Quarter 2023

Dear Valued Friends and Investment Partners,

We hope this message finds you in good health and spirits.

We are pleased to report a fair Q2 2023 performance, posting a net return of 1.1%. As we progress through the year, our year-to-date net return stands at 7.5%, instilling confidence in our ability to achieve our target annual return of 10%. Since our inception, our total net return has been an impressive 173.6%, with an annualized net return of 12.6%. It is noteworthy that the average return of long-short equity hedge funds, as represented by the Credit Suisse L/S Equity HF index, has been less than 40% since 2015.

During the quarter, the market backdrop featured low volatility and modest market growth, mainly due to the performance of several mega-cap stocks like Nvidia, Microsoft, Apple, etc. The broader investment universe experienced only modest price increases. Since July we have seen a broader based bull market.

Highlights of our best-performing positions:

1. Profitable Futures Trading: During the quarter, we made significant profits from trading futures on the S&P, NASDAQ, and Russell 2000 indices. One lesson learned from our negative performance in 2021 was to use futures instead of stocks for broad market calls, as well as for exposure and risk management purposes. Trading futures, on average, has been highly profitable since last year. Notably, our trading in NASDAQ futures was the second-largest positive contributor to our performance last year.

2. Undervalued Kazakh Banks: Our long position in select undervalued Kazakh banks, notably Halyk Bank, delivered excellent returns. Even at present, Halyk Bank continues to trade at an attractive 2.9x P/E, offering a promising 30% EPS growth YoY this year and an impressive 17% dividend yield.

3. Shorting of US regional banks: Our successful shorting of certain US regional banks, including Western Alliance and Pacific West, proved rewarding. These banks faced challenges like deposit outflows to larger institutions, declining net interest margin due to rising funding costs, and substantial exposure to commercial real estate, which we deemed increasingly risky. Although these challenges persist, we wisely closed our shorts with significant profits while closely monitoring the sector.

4. Benefiting from Big Tech: Our exposure to prominent Big Tech names like Microsoft, Alphabet, and Nvidia bolstered our portfolio. These investments exemplify our dedication to dynamic profit growth strategies, recognizing that significant market shifts, such as the AI boom initiated by ChatGPT, take time to be fully priced in. We believe that the AI sector is just beginning a new multi-year growth trend, and these companies stand to benefit from the adoption of artificial intelligence for years to come.

5. Seizing Opportunities in Lithium: Our short positions in lithium producers SQM and Albemarle proved timely, capitalizing on the downturn in lithium prices in China. These positions were further advantaged by exaggerated headlines about the potential nationalization of their lithium assets in Chile. We utilized this market panic to cover our short positions at a very good time.

As part of our commitment to transparency and continuous improvement, we would also like to share some valuable insights gained from unsuccessful investments:

1. Chinese Polysilicon Producer: Regrettably, our long exposure to a Chinese producer of polysilicon, a vital material used in solar panel production, did not yield the expected results. Despite the company's market capitalization being lower than the net cash on its balance sheet and its initiation of a significant buyback program, the stock price continued to decline. As a result, we made the difficult decision to execute a stop loss, protecting our portfolio from further losses. Low valuation alone is not a good enough reason to buy even if the net cash is higher than the market capitalization.

2. Thermal Coal Producers: Our short positions on thermal coal producers, based on sliding coal prices, did not unfold as anticipated. Unfortunately, the share prices did not follow the expected trajectory, and we were stopped out of the positions. While implementing stop losses can be challenging, we view it as an integral part of our robust risk management process, which ultimately ensures the consistency of our results. European gas prices have crashed 90% from their peak in August 2022 and thermal coal prices decreased by approximately 70%. After such a strong decrease we see the risk of a reversal in gas prices and correlated coal prices and hence will stay cautious.

3. VIX Volatility Index: In the effort to hedge against potential market volatility, we held a long position in the VIX volatility index through an ETF. However, as volatility declined throughout the quarter, we were compelled to close our long position through a stop loss. Our approach to managing risk means acknowledging when hedges are no longer aligned with prevailing market conditions.

Market Outlook: Identifying Opportunities Amid Uncertainty

As we navigate the complex market landscape, we would like to provide an overview of our current outlook. Several famous investment gurus paint a very bearish picture, with high valuations and rising interest rates being notable concerns. However, we have learned the hard way not to rely solely on forecasters' predictions, as such forecasts often reflect the forecaster's biases rather than a clear glimpse into the future. Instead, we focus on the market breadth and the behaviour of specific cyclical sectors. In this regard, the picture is convincingly bullish for the US markets, where we see promising opportunities.

While the US markets exhibit positive signs, the outlook for Europe and China remains less clear. We are carefully monitoring developments in these regions to identify potential investment prospects.

Our primary objective is to unearth investment ideas with substantial upside potential. Our dedicated team strives to implement these ideas in a manner that ensures a favourable risk-reward ratio, safeguarding your investments in the event of unforeseen challenges.

Currently, our research indicates the best opportunities lie in the following areas:

1. Semiconductor and US Tech Companies: We are bullish on certain semiconductor and US tech companies, where we believe significant growth potential exists in the coming years.

2. Listed Asset Managers: We see attractive prospects in selected listed asset managers, taking into account their growth trajectory, market positioning and low valuations. As we come closer to the end of the hiking cycle, those companies will significantly profit from lower interest rates.

3. Emerging Markets Tech Stocks: Certain emerging markets tech stocks have caught our attention, presenting compelling upside due to their combination of growth and extremely low valuation.

4. Silver Producers: Recently, we have also added two silver producers to our investment portfolio, as we see significant potential in the silver market due to an evolving supply demand imbalance.

Positive Business Developments and Growth Initiatives

In terms of business development, we are excited to share several positive developments with you. First and foremost, we extend our gratitude to everyone who introduced new investors to our growing investor community. Our goal is to establish a first-class infrastructure, and to achieve this, we recognize the need to significantly grow our assets under management.

While we have been ranked as a top-performing long/short equity strategy several times in the past, we believe there is ample room for performance improvement through better infrastructure. Addressing these low-hanging fruits from a business operations perspective is a key priority. Our aim is to fortify the foundation for even greater performance in the future.

We are proud to have had a highly successful year 2022, which resulted in a significant performance fee. To ensure the long-term stability of the business and to provide a safety buffer, we have chosen to keep this fee in the company. This approach ensures that our business runs smoothly, team members are well compensated, and we can always afford all third-party services, even during challenging times such as a performance dip. Till now, every investor who has been invested for at least 3 years with ARR has profited from significant returns, and I want to make sure that the business is set up in a very robust, resilient, and antifragile way so that we can compound money in the long run, which is most crucial for investment success.

In pursuit of operational excellence, we have engaged one of the UK's best business coaches. His guidance has been invaluable in streamlining our investment and business processes. Though not immediately visible to investors, we expect this progress to yield tangible results in the years to come.

In the near future, we plan the launch of an Actively Managed Certificate (AMC) which will replicate our global l/s equity strategy and will allow us to grow our investor base. Moreover AMCs present significant tax advantages for certain investors, making it a logical step to offer this investment structure to our investors. In the coming weeks I will contact the existing investors for whom I think this investment structure might make more sense than the separately managed account structure.

We appreciate your continued trust and confidence in our investment expertise. My team and I remain dedicated to pursuing excellence, analyzing market trends, and identifying promising opportunities to help achieve your financial goals.

Should you have any questions or require further insight, please do not hesitate to reach out to me. I look forward to a prosperous future of shared success.

Best regards,

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	-3.1	-1.4	-0.2	46.9	154.5	33.4
2023	4.7	-4.2	6.0	-1.0	2.2	0.0							7.5	173.6	39.6

Source: InteractiveBrokers, Credit Suisse, time-weighted performance of first managed account in USD, net of fees; unaudited; as of 30.06.2023. CS L/S Equity Index is reported with a one-month delay.

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