ARR Global L/S Equity Strategy

Investor Letter, Fourth Quarter 2022

Dear Friends and Investment Partners,

I hope you are well!

Our performance in Q4 2022 was muted following the outstanding results of the previous quarters, with a negative performance of 4.5% compared to a strong run of the MSCI All-Country World Index. Nevertheless, 2022 was our best year ever in terms of performance, with a net return of 46.8% vs negative 18.4% for MSCI ACWI. This demonstrates our ability to generate returns on falling markets. Since inception in 2015, we have earned a total net return of 154.5%, which corresponds to a 12.4% geometric average net return, meaning that we comfortably meet our return target.

Our least successful trades in Q4 were driven by excessively bearish expectations regarding the global economy, which did not materialize. We have learned the lesson that we should pay more attention to sentiment indicators, as their extreme values often mean that the market direction can easily change should any news supporting this change appear. If expectations are excessively bearish, it is quite common for politicians or central bankers to announce measures to support the economy. If such measures sound professional and convincing enough, their announcement leads to a drastic improvement in market sentiment, which was the case in Q4.

Lessons learned:

Germany's EUR 200 billion stimulus package, aimed at moderating the impact of soaring energy prices, was agreed upon in September and improved the economic outlook, particularly in Europe. Additionally, European gas prices, which peaked in August, declined to pre-war levels, easing inflationary pressures, and further improving the economic outlook. In December, China effectively ended its zero-Covid policy, adding to the positive sentiment over the world economy's outlook, which was reflected in rising commodity prices, particularly metals.

Our bearish view of the world economy at the beginning of the quarter was reflected by our short positions in certain steel stocks. We were expecting steel prices to decrease due to their cyclicality, but they moved in the opposite direction when China, the biggest steel producer and consumer, ended the zero-Covid policy, causing us to get stopped out. Another unsuccessful investment theme was buying shares in German residential real estate companies TAG and Vonovia. We expected rate hikes to slow due to an increasing likelihood of a recession and, from a business perspective, we expected a continued strong demand for the residential renting market, especially due to refugees fleeing the war. The share prices of those real estate companies decreased by 60-80% from their peak in 2021, and we thought their attractive valuation offered a good buying opportunity. Given that, for example, Vonovia has an average weighted maturity of debt of 7.4 years, higher interest rates will only gradually increase their average interest rate of 1.5%. Hence, we judged their refinancing risk as relatively low and market fears as overdone. However, we got stopped out of those positions and, in hindsight, should have been more patient and waited for better entry prices.

Best positions:

On the positive side, our most profitable trade was taking a long position on Meyer Burger Technology, a Swiss photovoltaic producer that perfectly fits into our dynamic profit growth investment pattern. Its revenue is expected to increase almost nine-fold in 2022-25e, and it is one of the beneficiaries of EU support for renewables. We have also benefited from several broader investment themes on both the long and short sides.

One such theme was shorting crypto mining companies, which we consider to be structural losers due to their unsustainable business economics. We estimate their total costs to mine a Bitcoin (approximately USD 91k per coin in Q3 2022 in the case of Marathon Digital) to be well above the Bitcoin market price for some time. With the Bitcoin price plummeting by 15% in Q4, this inconsistency became even more evident, raising concerns about the insolvency of such companies.

We have also successfully shorted some names among electric vehicle producers, in line with our hype/bubble investment pattern. We saw them as obvious losers from the rising Fed rate that leads to an increased cost of capital. As the majority of these new brands will be loss-making for the coming years, they might run into serious financial stress if competition worsens, and they do not execute well.

Among the themes of our successful investments were European and Kazakh banks, where we successfully identified the rebound investment pattern. The shares of these banks were down on the back of the Russia/Ukraine war more than could be justified from a business point of view. Moreover, we considered the macro backdrop, particularly rising rates, to become increasingly favourable for these companies.

Compared to 2021, last year presented a better environment for our strategy to perform well, as we generally excel during bear markets. The combination of a more favourable external environment and the valuable lessons we learned from our mistakes in 2021 allowed us to achieve our best annual performance to date. We aim to build on this momentum and continue delivering outstanding results. We are highly optimistic about this year, as we see numerous investment opportunities, particularly in structural growth stories in the renewables and defense sectors. As always, we will remain nimble, correct our mistakes swiftly, and capitalize on outstanding opportunities.

Although Q4 did not yield great returns, historically such temporary drawdowns provided excellent opportunities to increase allocation to our strategy and benefit from subsequent rebounds in returns. Alternatively, investors may opt to regularly (typically on a monthly basis) add money to the strategy as a more psychologically comfortable alternative to investing during periods of negative returns. This approach allows investors to benefit from cost averaging and avoid trying to find the tipping point in the strategy's performance.

I would like to conclude by stating that we have proven that even as a relatively small hedge fund, it is possible to achieve a place among the best hedge funds globally. With this accomplishment as a foundation, we are even more motivated to deliver outstanding results in the future and build on our success.

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	-3.1	-1.4	-0.2	46.9	154.5	33.4

Source: InteractiveBrokers, Credit Suisse, time-weighted performance of first managed account in USD, net of fees; unaudited; as of 31.12.2022. CS L/S Equity Index is reported with a one-month delay.

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