ARR Global L/S Equity Strategy

Investor Letter, Second Quarter 2021

Dear Friends and Investors,

ARR Investment Partners generated a net return on the first managed account of 1.5% in Q2 of 2021. The cumulative net return since January 2015 is 107.7%, or an annualized return of 11.9%.[1]

ARR PERFORMANCE

Source: Interactive Brokers Account, in USD, net of 1.5% management fee and 20% performance fees; unaudited; as of 30.06.2021

Market Review

During Q2 2021, we saw a strong market with ongoing sector rotation from cyclical companies to technology, consumer staples and real estate equities. The driving forces behind this rotation are the US yield curve and inflation expectations. In the first half of the Q2, both yields and inflation expectations continued their rising trend, as the US inflation rate hit 5% in May, the highest rate since 2008. In general, commodities and financials tend to perform well in a high-yield and inflationary environment. Expensive growth companies whose valuation is justified by strong future income streams tend to underperform as their future earnings are discounted with a higher interest rate. 2020's favourite technology growers extended their Q1 loss into a deeper dive in the first half of Q2. In order to hedge our exposure to the technology sector, we took a short position in the ARKK ETF, whose constituents are predominantly expensive high growth stocks. This short position turned out to be the largest contributor to our Q2 performance.

In the second half of Q2, we began to see a reversal of this trend as US long term yields stabilized. Commodities and Financials started to cool down and high-growth technology companies hit a bottom after a strong sell-off. In extreme cases like ARKK, the sell-off was as severe as over 40%. The turning point in inflation expectation and yields appeared after the Fed officials eventually changed their rhetoric. The Fed showed more emphasis on the strength of the economy than the risk for the first time since the pandemic and officially started talking of tapering. Although the short-term yield jumped up, longer-term yields decreased. Instead of being scared off by the tapering, investors are more relieved from sustained inflation. This enhanced the bullish mood in the market through the second half of Q2.

[1] **Source: InteractiveBrokers. Net of adviser fees. Time weighted return relates to the longest established separately managed client account, unaudited.*

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Investment Review

During Q2 2021, we generated 1.5% returns for our investors. In this section, we would like to analyse our returns in the context of our investment objective and approach. ARR Investment Partnvoers aims to provide an uncorrelated source of absolute returns regardless of market direction. We deliver this by investing in uncorrelated long and short themes that should each work out individually. We adjust our market exposures with overlay ETF or Future trades to avoid big losses due to unforeseeable market events. We generate new investment ideas using well-understood investment patterns in areas of expertise and with the help of our proprietary portfolio and risk management system (PARIS). Then we wait patiently for the best opportunity to implement these investment ideas when the fundamental catalysts and technical signals align to create a high risk-return investment opportunity. We dedicate our effort to constantly improving our process. In the short term, a fund might achieve good performance with a bad process due to luck, or bad performance with a good process if it is unfortunate. Over the long run though, only funds with great and constantly improving processes can achieve sustained good performance. That is why we put so much emphasis on PARIS.

In Q2 our biggest single stock profit contributor was Euronext. In general, we like stock exchanges as an investment theme as they have monopolistic characteristics and profit from the recent trading frenzy. As the EU's largest exchange group, Euronext sustained an annual compounding growth rate of 16% over the last three years thanks to its success in the cash equity business. During Q2, Euronext completed the acquisition of Borsa Italiana. This acquisition broadens Euronext's product offering by adding Fixed Income trading capacity and ownership of a clearinghouse. At the same time, it further deepens the liquidity pool of Euronext's strong Cash Equity and ETFs trading arm, enhancing Euronext's leadership position in Equity trading. This acquisition levelled up Euronext's leadership as an exchange both in scale and in scope, making it more attractive for companies wanting to go public, which we believe is the long-term competitive advantage of Euronext.

In the Pharmaceutical space, we have picked BioNTech as a long-term winner with earnings momentum, which became our third-largest profit contributor in Q2. In the Q3 letter of 2020, we already mentioned BioNTech SE as a promising pharmaceutical disruptor with impressive R&D ability. In April BioNTech started to outperform with a sequence of operational data reminding investors of the exceptional business developments. BioNTech put out a revenue forecast of almost €10 bn and the stock was trading at an expected P/E multiple of less than 5x. Moreover, scientists estimated the effective period of the vaccine to range from 6 months to 3 years, thus recommending an annual administration of a vaccine. The possibility of recurring revenue will provide a high base for BioNTech's revenue beyond pandemic and hence allow for a much higher valuation.

There were also themes where we put in effort but did not yield particularly good returns, including gold and silver miners, and Crypto-related companies. We invested in gold stocks as an inflation hedge in early May as the inflationary concern increased with inflation surpassing 5% and real interest rates became even more negative. Several of the invested gold miners have extraordinarily strong production growth in the coming years and hence should increase earnings significantly even in a lower gold price environment. Despite those strong fundamentals, we incurred losses as the gold price decreased in the beginning of June. The Fed's dot plot chart, which was published after the FED meeting, showed a faster than expected rate hiking plan, consequently cooled inflation concerns and caused the gold price to decrease.

Another theme that did not go according to our plan was a pair trade in the crypto space. As we mentioned in our monthly letter in May, we have conducted extensive research and identified Marathon Digital Holdings as a high conviction short idea. We believe Marathon runs an unsustainable business model in a highly competitive market and has a hyped valuation. It has uncertain revenue but constantly increasing costs. At the same time, management prioritises themselves over shareholders in making strategic decisions because of the uniquely structured remuneration plan. Meanwhile, we understand how the correlation between Marathon's share price and the Bitcoin price may influence our trade, so we decided to hedge out the crypto-currency risk by investing in a fundamentally benign business in the crypto-space. We identified Voyager Digital Holdings, a crypto broker, as having exceptional growth prospects and profiting from the crypto market volatility. Voyager has a unique competitive advantage as it offers high interest on major coins traded through its platform. Retail users favour this feature a lot and Voyager's user base is currently on an explosive growth trajectory. Quarter over quarter sales grew by 16x in Q1 and the operating margin was higher than 50%. At the same time, Voyager's market share is small enough to allow for the rapid growth to continue for many more quarters.

Late in May, China suddenly started a nationwide coordinated crackdown on the Bitcoin mining. China alone contributes around 50-60% of global hash rates, the difficulty rate at which Bitcoins are mined. Taking China's hash rate out means in theory a sudden doubling of all other miner's payoff. All the North American Bitcoin miners, including Marathon, celebrated this news and rebounded significantly from the bottom. On the other hand, Voyager took a hit from the Bitcoin price which crashed in May and has stayed weak since then. This movement cost our performance on both the short and the long side. Although the Bitcoin miners have benefited from China's crackdown in the short term, we believe their business models are still flawed in the long term. The hash rate will not stay low forever, as Chinese miners will either migrate overseas where the Bitcoin mining activity is not regulated or sell their machines to an overseas miner. Moreover, all the major miners are ramping up their mining capacities, hence it is just a question of time till the hash rate increases again.

There are two sectors where we profited in Q2, but we believe the true potential is a lot bigger. These two sectors are the technology and the PGM sector. We are still optimistic about these two sectors and will analyse their potential in more detail in the following 'Market Outlook' section.

SYSTEM DEVELOPMENT

During the second quarter, we extended our quantitative commodity price modelling to help us better judge the commodity and cyclical sectors, where we have strong expertise and made profits historically. After testing and fine-tuning technical based trading strategies, we included over 300 factors from economic indicators to market and financial ratios. We employed advanced machine learning algorithms in each step of factor classification, factor selection, model fitting and model comparison. Then we used economic theories and intuitions to explain the model fitted. From there we summarised concrete criteria to determine the commodity trend. Having this rule-based mechanism to determine where we are in the commodity cycle, allows us to better judge investment opportunities in this volatile sector.

During the quarter, we also created more useful investment tools for the purpose of quick analysis. For example, we created a tool to assist in picking equity options across different maturity and strike prices. This tool helps compare the expensiveness of each option and conducts a case study to find the

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option with the best risk-return in implementing our desired trade. These new tools can assist us in choosing the right instruments when we hedge risks.

Market and Investment Outlook

Going into the third quarter of 2021, we remain optimistic for the remainder of the year despite the recent volatility. Economy-wise we have seen a stream of business and employment data stronger than expected. The US GDP growth topped 6%, and PMI topped 60, while initial jobless claims decreased to the lowest level since the pandemic started. All these numbers confirm our base case of an economy transitioning from rapid recovery into expansion. Market wise, investors appear to be reassured by the Federal Reserve's timely action with inflation fears starting to wear off. The 30-year Treasury yield decreased over 40 bps and the 10-year Treasury yield decreased over 30 bps. With the long-term discount rate decrease, strong earnings momentum of all major sectors and continued fiscal stimulus, we expect to see a reasonably strong market for the rest of 2021 despite potential short term market corrections.

Despite our optimism about the general market, we aim to provide an uncorrelated source of return. To achieve this target, we will stick to the long-term winners with persistent competitive advantages on the long side, and on the short side short bubbles or structural losers with the highest convictions. When we are optimistic about the general market, we will invest in liquid market indices such as the NASDAQ future to gain market exposure if the risk reward is very attractive. Thanks to its high liquidity and long trading session, we can largely reduce liquidity risk and gapping risk by implementing those investments with futures.

In the coming Q3, our focus will once again be on the growth sectors such as technology, cannabis, and the renewable sector. As described in the **Market Review** section, we saw technology and renewable energy stocks regain momentum by the end of Q2. The technology sector was the sector with our highest weighting through Q2. There we invested in many winners with unique edges, including Adobe, Amazon, Microsoft, and Shopify. All these companies posted earnings that have beaten both historical records and analyst expectations. Despite having already generated decent returns, we expect those stocks to perform well in the long run and will adjust position size according to the risk reward opportunities.

Following the virtual summits in April, global leaders have stepped up their commitment to cut carbon emissions. Some countries like the US and China aim to achieve this by increasing infrastructure spending to reduce reliance on the traditional energy sources. Others such as European Union countries rely on reducing emission allowances to raise the carbon price and motivate firms to switch to cleaner energy sources. Under either approach, we believe the renewable energy firms will see increasing demand for their products and policy support for them to expand production. There we can find many long-term success stories and we thus focus our effort on finding the best companies.

At the same time, we think there are great opportunities in the commodities space but are careful due to the high volatility of the sector. From our historical studies, we understand that the demand growth often outpaces supply in an economic boom like we are currently in. For example, transitioning from a traditional economy to a renewable economy inevitably causes large commodity demand, such as for Platinum Group Metals (PGM). In the last quarterly letter, we proposed Sibanye-Stillwater as a good investment in the PGM space because it is generating a lucrative profit from the current palladium price boom. It is valued as cheap as 3x PE, has a 10% dividend yield, and recently started a share buyback which underlines the significant

undervaluation. The uneven distribution of the COVID vaccine has left many commodity-producing countries such as Indonesia, South Africa and Brazil in the worst ever shape while commodity consuming countries are getting out of the pandemic. We will keep following the situation in commodities and cyclical stocks and wait patiently for an entry point where we deem risk-return is attractive.

Thank you very much for your continued trust in my team and me!

Best,

Christian

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