Lethame Capital Management

Technology : Research : Investing

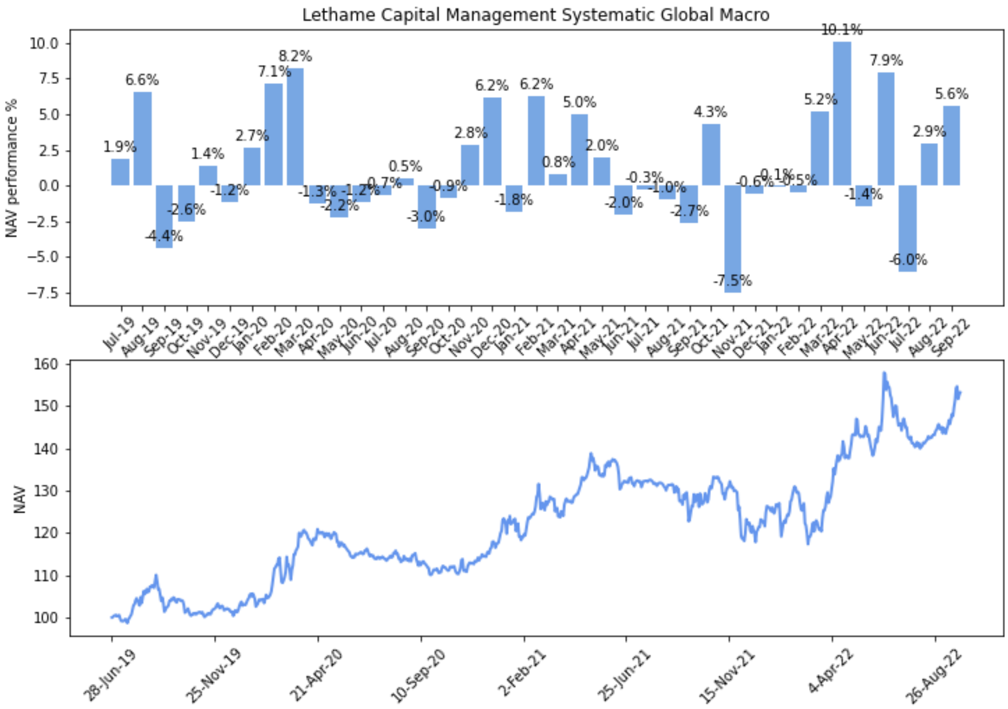
Program Update – Q3 2022

	Annualised Return*	Standard Deviation	Sharpe Ratio	Maximum Drawdown	Average Correlation
Lethame Capital Management	13.2%	21.4%	0.60	19.0%	-
S&P 500 Index	8.8%	23.6%	0.36	43.0%	3.8%
60/40 portfolio	2.0%	14.1%	0.11	24.0%	3.9%

***Returns since inception**

This commentary refers to the performance of the strategy of the personal investment vehicle of Piers D. Watson, please see disclaimer.

"The profitability of trend following appears to be a genuine market anomaly" – Lempérière et al 2014



Performance Review 3Q

Lethame Capital Management's (LCM) Systematic Global Macro Program returned 2.1% in the Third Quarter. The fall in equity prices experienced in the quarter appeared like a safe haven when compared to the return from bond markets. In this context the programs performance in the quarter was satisfactory.

Only four (Natural Gas, Corn, Live Cattle and Eurostoxx volatility.) of the twenty assets in the program produced a positive volatility adjusted return in the quarter.

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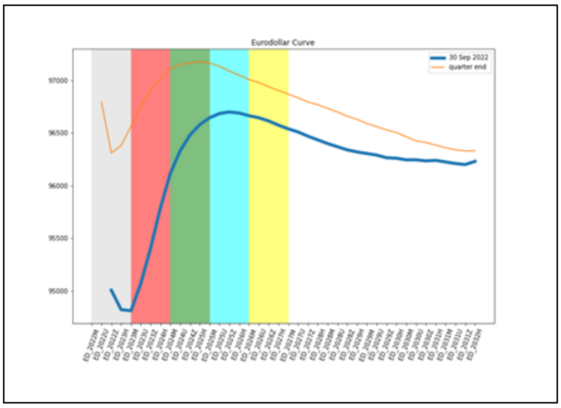
By far the worst performers in volatility adjusted terms were bond markets, closely followed by currencies. Both 2-year (-1.48x) and 5-year treasury bond (-1.13x) futures produced a reward to risk ratio worse than -1x.

The third quarter was somewhat lackluster compared to the strong returns of the first and particularly second quarters of 2022. This can partially be explained by the turn around in equity markets mid quarter, which began with a relief rally but ended on their lows. The price reversal pattern caused a significant shift in positioning of a number of assets from short to long and back.

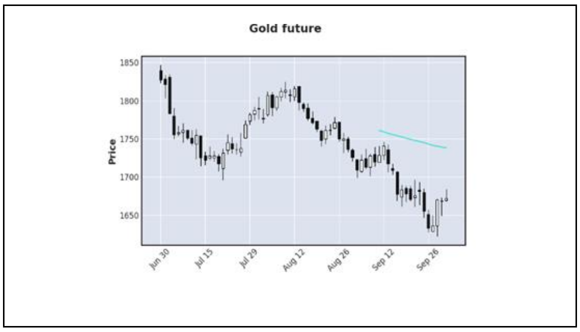
Inflation concerns have dominated investor sentiment this year and the third quarter was no different. In particular a third aggressive interest rate increase by the Fed in September added to fears that the U.S. economy was headed for recession causing risk assets to move decidedly lower.

The significant change in interest rate policy can be seen in the Eurodollar futures curve, a curve which is even more significantly inverted following Fed policy actions. The chart *"Eurodollar Curve"* shows the curves respectively at the end of the second quarter (yellow) and the end of the third quarter (blue).



The curve appears to sense something in the current economic environment which is reminiscent of the almost prescient Eurodollar curve of 2007.

Interestingly given the inflation concerns, gold failed to provide a hedge, a combination of higher interest rates and a stronger dollar being the dominant drivers of performance.

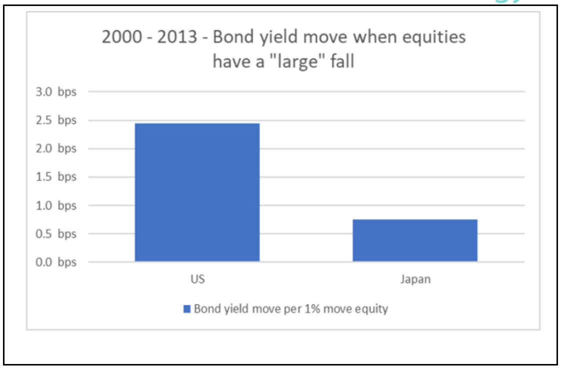


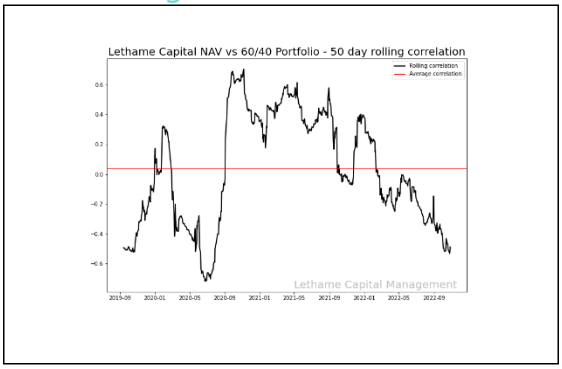
Gold futures continued trending down in the quarter, as demonstrated in the chart *'Gold Future'* and the strategy remained short.

<u>Trend following – the proof is in the pudding</u>

The approximate 20% decline in the 60/40 portfolio so far in 2022 highlights an argument LCM has long made. Bond markets generally, and US treasuries in particular, have been the *'miracle asset*' of the last forty plus years.

LCM has made this argument because when comparing a volatility equal portfolio of equities with a similar volatility weighted portfolio of bonds, since the peak in US interest rates in the early 80's, has seen the result that equities underperform by almost 75%. It is an anomaly that two asset portfolios of similar risk profiles should exhibit such divergent performance over that timeframe. Thus, LCM describes treasuries as a *'miracle asset'* which has done an outstanding job keeping investors safe.





Indeed, as highlighted by the chart *'2000-2013: Bond yield move when equities have a "large" fall'* LCM made the observation back in 2014 that US treasuries performed a significantly more defensive role than for example Japanese JGB's between 2000 and 2013. In fact, treasuries provided almost 5 times the return on average when equity markets had a bad day. It is notable that this was a period where Japan had already experienced many years of the *'unconventional'* monetary policy that the U.S. was at that time just embarking on.

An industry has been born out of this relationship, from the *'60/40 portfolio'* to *'Risk Parity'* but the reality is the negative correlation seen between bonds and equities in the period was actually abnormal and over the very long term they were more likely to be positively correlated.

LCM believes that the performance of 60/40 portfolios this year demonstrate the vulnerability of bonds to low starting yields and decades of structural overperformance. Therefore, investors are highly unlikely to enjoy the diversification benefits from bonds in the future as they have in the past. This means they either need to take less risk (fewer equities) or find an effective diversifier to replace the role of bonds.

Trend following strategies are one of the few investment strategies which seem to offer this diversification. In fact, it may be the case that they offer a 'good diversification' positively correlated to risk assets when times are good and negatively correlated when they are bad. The chart *'Lethame Capital NAV vs 60/40 Portfolio – 50 day rolling correlation'* highlights LCM's experience.

While there is no silver bullet in investment, we know that the one free lunch in finance is diversification. LCM can highlight significant academic studies showing how and why trend following offers this diversification and possibly even more than given Lempérière[1] describes the strategy as offering a "***genuine market anomaly***".

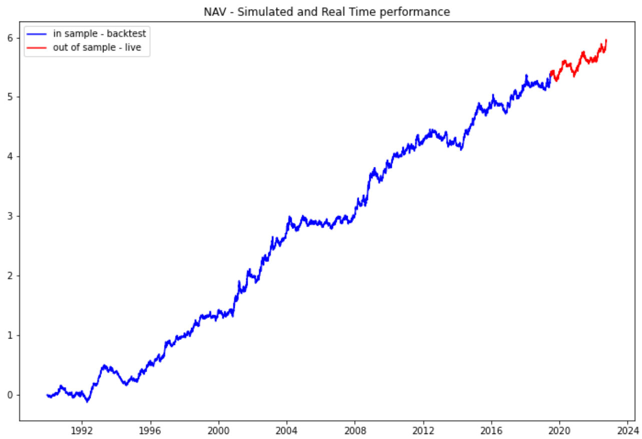
If you would like to discuss why trend following could be a strategy to consider please don't hesitate to get in touch.

[1]Lempérière, Y., et al "Risk Premia: Asymmetric Tail Risks and Excess Returns" SSRN: https://ssrn.com/abstract=2502743

Lethame Capital Management

Lethame Capital Management (LCM) is a private company established to manage capital using proprietary software and algorithms developed by Principal, Piers Watson, CFA FRM CQF. LCM's investment program utilises his thirty years of experience as a portfolio and risk manager covering multiple asset classes and follows years of research, analysis and technology development. The program is designed to provide a comprehensive and systematic exposure to a diversified range of return streams.

Program design has been borne out by the performance of the system since inception and is backed by comprehensive back-testing over the past 25 years (see the performance graph and table on the following page).



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
1994									4.38%	-0.09%	5.94%	-6.26%	**9.87%**
1995	1.47%	0.18%	-4.46%	7.59%	8.84%	1.37%	0.26%	-2.99%	4.38%	5.77%	5.85%	3.01%	**33.73%**
1996	-2.38%	-3.02%	2.66%	4.69%	1.38%	7.76%	-10.11%	3.32%	5.09%	4.65%	19.51%	-4.81%	**30.22%**
1997	6.92%	-5.03%	-1.84%	-0.37%	4.25%	1.79%	11.07%	-6.62%	2.93%	2.25%	-1.56%	1.28%	**32.68%**
1998	0.48%	2.10%	3.31%	-4.54%	7.34%	-0.03%	10.28%	8.94%	-6.51%	-1.29%	6.98%	8.54%	**35.68%**
1999	1.04%	-5.52%	1.01%	1.67%	-0.68%	2.02%	-3.13%	1.09%	-0.16%	-4.88%	2.83%	13.81%	**6.34%**
2000	-2.70%	-2.35%	-2.78%	-0.51%	2.71%	-3.55%	0.41%	6.80%	-3.01%	-4.91%	15.12%	12.07%	**49.69%**
2001	-1.50%	13.16%	14.36%	-12.11%	3.77%	-1.29%	-0.05%	14.05%	17.24%	1.24%	-6.35%	-3.13%	**38.00%**
2002	-1.13%	2.05%	-7.02%	5.24%	2.98%	10.14%	10.84%	2.09%	10.78%	-5.74%	-3.67%	13.08%	**39.79%**
2003	7.62%	11.88%	-8.22%	0.38%	9.08%	-2.19%	-4.35%	1.10%	6.28%	-0.20%	3.61%	8.13%	**23.45%**
2004	4.99%	16.29%	4.23%	-13.36%	0.65%	-2.01%	-5.83%	4.21%	0.61%	6.61%	5.48%	4.99%	**29.49%**
2005	-4.69%	-6.47%	-3.42%	2.42%	4.79%	-1.13%	-2.72%	1.86%	-0.90%	-4.27%	5.10%	-4.50%	**4.83%**
2006	-1.16%	-2.69%	6.65%	3.45%	-3.20%	-2.59%	-7.07%	1.09%	5.59%	3.55%	2.13%	4.36%	**6.22%**
2007	-0.95%	-4.37%	-4.50%	5.95%	5.96%	-3.66%	-2.00%	-3.45%	1.43%	3.46%	4.14%	-0.37%	**20.84%**
2008	12.77%	8.20%	4.03%	-7.42%	0.50%	14.44%	-7.40%	-2.01%	9.80%	17.15%	12.62%	4.98%	**63.44%**
2009	3.66%	5.34%	-4.96%	-3.68%	-5.86%	-1.91%	1.73%	6.58%	5.56%	-1.04%	17.19%	-9.87%	**-15.30%**
2010	3.62%	3.93%	11.47%	4.77%	-3.30%	3.53%	-6.20%	4.78%	-1.66%	6.58%	-5.25%	7.34%	**15.37%**
2011	3.42%	4.16%	-5.87%	9.11%	-2.78%	-8.20%	6.82%	11.66%	-3.50%	-6.10%	1.26%	3.96%	**-10.67%**
2012	5.62%	2.15%	1.57%	2.69%	5.85%	-10.97%	11.00%	-1.44%	-2.13%	-4.41%	-0.99%	-2.87%	**-6.17%**
2013	-2.67%	-0.37%	1.86%	8.49%	-10.51%	-9.74%	4.74%	-4.81%	3.41%	5.83%	2.26%	-9.51%	**1.08%**
2014	-1.00%	2.54%	-7.23%	2.90%	15.93%	10.88%	-5.72%	4.19%	6.29%	6.10%	10.18%	-1.57%	**31.39%**
2015	10.50%	4.36%	6.69%	-3.54%	3.94%	-11.17%	4.21%	-8.74%	10.62%	0.20%	10.02%	-8.31%	**19.47%**
2016	8.73%	8.12%	-5.94%	-2.86%	-3.21%	-0.37%	2.84%	-3.73%	-4.89%	-5.98%	2.31%	9.53%	**-11.08%**
2017	-2.67%	16.23%	0.44%	5.46%	3.30%	-11.18%	2.94%	2.17%	0.86%	15.73%	-0.72%	-0.79%	**3.36%**
2018	17.86%	-11.64%	-3.92%	-0.29%	-0.91%	1.58%	2.96%	2.65%	-2.57%	-2.47%	-2.83%	4.08%	**12.21%**
2019	-4.38%	9.14%	1.48%	5.40%	-2.16%	0.74%	1.88%	6.59%	-3.77%	-2.55%	1.36%	-1.20%	**12.17%**
2020	2.67%	7.11%	8.20%	-1.26%	-2.22%	-1.18%	-0.70%	0.47%	-3.00%	-0.86%	2.85%	6.20%	**18.97%**
2021	-1.83%	6.22%	0.80%	5.01%	1.97%	-2.00%	-0.29%	-0.98%	-2.84%	4.18%	-7.50%	-0.62%	**1.31%**
2022	-0.08%	-0.52%	5.17%	10.07%	-1.88%	8.42%	-6.02%	2.94%	5.62%				**25.07%**
	Simulated												
	Real Time												