

INVESTOR LETTER Q3/2020

OCTOBER 2020

The pessimist complains about the wind;
the optimist expects it to change;
the realist adjusts the sails.

- William Arthur Ward

Dear investors,

For the quarter ending September 30, 2020, Tramondo Dynamic Equity USD I returned +10.6% net of all fees, compared with the MSCI AC World's +8.1% and HFRX Equity Hedge's +3.6% for the same period.

For the year-to-date period ending September 30, 2020, the Tramondo Dynamic Equity USD I returned +17.5% net of all fees, compared with the MSCI AC World's +1.9% and HFRX Equity Hedge's -3.0% for the same period. Assets under management stand at USD 154m.

Please find below a summary of each month of the third quarter of 2020 and our outlook.

REVIEW

July marked a strong month with a second protagonist – the USD Index and its biggest decline in a decade, which was responsible for one third of the return of the MSCI AC World. Major central banks took something of a back seat over the past weeks, having already flooded the market with liquidity and taken rates close to their lower bounds. In addition, economic activity improved, but besides the flow of news from COVID-19, they had little impact on global markets. Hence, we saw a trending month led by our US and emerging market holdings

underpinned by strong quarterly earnings and solid market breadth. Therefore, we kept the net allocation to “fully invested” over the whole month. We used the opportunity of less volatile markets to identify and reduce/exit laggards and strengthen market leaders.

August marked another strong month for the fund. It also meant the end of the second quarter's earnings season, which surprised on the upside relative to weak expectations. Unsurprisingly, the healthcare and information technology sectors were particularly strong – our two largest overweights. In terms of monetary policy, the Fed announced a shift to average inflation targeting at the Jackson Hole virtual conference, confirming that monetary policy will remain supportive for the foreseeable future. Hence, we saw a trending month led by the whole portfolio. At the end of August, we tactically reduced our net exposure to 75% for various reasons outlined in the next paragraph.

We identified several reasons for a cautious stance regarding September/October: 1) The leading US market was very extended from its 50-day and 200-day moving averages, which very often led to pullbacks, while the rest of the world struggled to keep up pace, 2) Breadth has waned on the push up in August as compared to its initial surge into

June highs, 3) Intermarket divergence between Nasdaq/S&P 500 vs the broad market (Value Line Arithmetic Index) and severe bifurcation as stock concentration increased with Apple being 6% of the S&P 500, 4) Sentiment has finally shown signs of individual sentiment joining institutional sentiment in getting (very) optimistic (low put/call ratio, contrarian indicator), 5) Seasonality and cycles did point to very unattractive risk/reward for September, 6) Trend exhaustion was showing up. Thus, we hedged the portfolio via one third each SPX, NDX and SX5E futures.

The month of **September** started with the final climax run up in the US, followed by a very sharp sell-off led by technology stocks and other leading companies mainly in the US growth area. While the stock portfolio took a - well-deserved - breather after two prior strong months, our hedge could make up for the initial underperformance and compensate effectively. Whenever the market corrects, we look for traces like scouts and study the price behavior of our holdings and sectors, especially for relative strength. Because of their price behavior, leading stocks are an indicator of market trends where they tend to correct first but also rebuild relative strength first, while, in addition, new market leaders might emerge. Hence, one of our main observations was that materials and industrials (reflation, see outlook section) started to improve considerably – two sectors we started to over-weight and close the underweight, respectively. Thereafter, having observed a bottoming in technology and moderate pullbacks with a healthy sector rotation in a corrective fashion we increased the net allocation back to “fully invested” taking net profits of roughly 1% on our hedges while the stock portfolio caught up with the market in the final days of the month.

For the quarter, our top contributors were Vestas Wind Systems, Amazon, Alibaba, Salesforce and Taiwan Semiconductor while our worst contributors were Fortinet, Rio Tinto, Vertex Pharmaceuticals, Netflix and American Tower.

OUTLOOK

The fourth and final quarter of 2020 with the US presidential election will bring a very eventful and challenging year to an end. Furthermore, we will have a very close eye on the US-Dollar Index and US yields, respectively, as their movements have significant implications.

Regarding the presidential election we keep an open mind and let the tape (price) dictate the direction as “Mr. Market” is always right. The quality of our stock portfolio should not be significantly affected as we are little exposed to major electoral programs (bank regulations, fossil fuels, drug pricing, tech scrutiny which we see as a positive as spin-offs would increase stand-alone valuations in the long run) that could be negatively affected especially by a Biden win. If history is any guide, a market rally into an election usually leads to the incumbent party to win the presidential election. Additionally, as the economy is still threatened by the uncertainty of COVID-19 it has less an impact if the republican or the democratic side wins as either one including its government will first focus on stabilizing the economy. We tend to see a greater opportunity by adjustments of the net asset allocation and, therefore, keep a close eye on our four pillars for hedging: macroeconomic backdrop, market sentiment, market internals and market technicals while we do not fight the tape!

Considering the most recent moves in the US-Dollar Index and US yields, we slowly but surely gather hints on possible newly emerging stock market leaders. Value stocks (materials, industrials, energy and financials) have often outperformed growth stocks when the US dollar weakened and global growth strengthened (such as from 2001 – 2007). However, the relationship between value and growth stocks, the dollar, and global growth broke down this summer. There are two reasons why this happened. First, investors were too slow to price in the tailwind that growth stocks in the tech and health care sectors (which remain our two biggest overweights) would end up receiving from the pandemic. Second, rather than rising in response to better economic growth data, real rates fell during the summer months.

A falling discount rate benefits growth stocks more than value stocks because the former generate more of their earnings farther into the future.

A bearish USD is bullish reflation which would push cyclical sectors such as materials and industrials but also emerging markets where we started to find attractive companies with improving fundamentals. In terms of yields we see little upside as the Fed will not hike rates at least until 2023, and it will take even longer than that for interest rates to rise elsewhere in the world. Hence, we believe that companies with the highest beta to rising yields such as developed banks are stuck in a structural downtrend (except as strong bounce candidates that would not worry us much). However, we see attractive characteristics in emerging market banks such as in HDFC Bank in India (digital banking/urban penetration, stable margins, healthy asset quality, consistent performance and superior management).

Fundamentally, the focus will be on the forthcoming Q3 earnings season during which we should get insights into the status quo, trends and sentiment as well as the market's risk appetite. Specifically, we will be looking for confirmation of the existing tailwinds for companies supported by secular growth trends and, most importantly, the reaction of the market to earnings releases.

With the uncertain outlook so dictated by the virus, but also given the potential for a vaccine, we continue to believe it makes sense to aim for a strong portfolio with high-quality holdings that can benefit from attractive growth prospects. By identifying these companies that solve and/or offer products for specific types of demand, we will be able to profit from increased revenue visibility. Furthermore, by screening for the quality of balance sheets and operating stability, we are able to hold a set of companies whose earnings we believe approach a strong set of consistency. Given the reliability of earnings, price changes mainly reflect changes in expected return as opposed to changes in future earnings, creating attractive alpha opportunities.

The bottom line is that we will focus on price and what the market is telling us instead of trying to

predict the winds. At Tramondo, we stick to our investing credo **"In investing you cannot direct the wind, but you can adjust the sails"**.

We thank all our investors for your continued confidence in Tramondo Investment Partners AG. We wish you all the best personally and professionally - be well, be good and take care during these unprecedented times and last but not least may the Christmas Rally take place!

Best wishes,
Tramondo Investment Partners AG

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