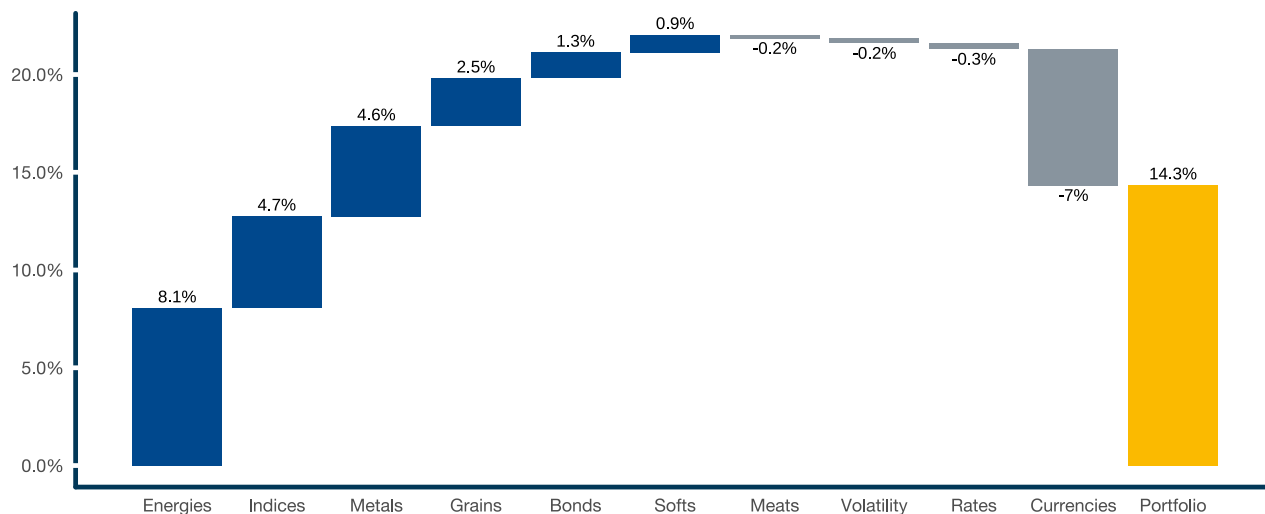


PERFORMANCE REVIEW

The Evolution Program delivered a 14.3% return for 2021, drawing a meaningful portion of profits earlier in the year from energies, metals and equities. After a flat third quarter, energies and equities along with agricultural commodities drove a volatile and profitable final three months.

Figure 1. 2021 Return Attribution



Source: ReSolve Asset Management. Results may differ due to rounding. Performance is expressed in USD. Strategy attribution is a best efforts approximation, net of all applicable borrowing costs, fees and fund accruals for the period. Indicated returns of one year or more are annualized. Past performance is not indicative of future performance.

Energies drove the largest share of P&L, mostly from longs in crude oil, heating oil and gasoil. Carbon emissions and natural gas also contributed on the long side. Our systems were agile in reducing exposure and avoiding the brunt of the November selloff.

Metals benefitted primarily from long exposure to copper. Platinum was another important source of return, with active trading and profitable long and short positions that flipped several times throughout the year.

Equities were a close third best sector, where longs in the Swiss SMI, British FTSE and S&P500 were the best performers, followed by the Canadian TSX60, Nasdaq and Dutch AEX. The strategy also profited from a short position in the Hang Seng in the third quarter.

Bonds were the only sector where gains were drawn predominantly from short positions. Largest contributions came from shorts in German Bunds and 10-year Treasuries, followed by 5- and 30-year Treasuries (which also marginally benefitted from long exposures in the third quarter). The Canadian and Korean 10-year bonds, along with UK Gilts, were other noteworthy profitable shorts.

Grains also drove P&L, with most gains stemming from longs in mill wheat, corn and palm oil, followed by soy and canola. Active trading protected gains when volatility spiked in the second half.

Softs offered modest gains, primarily from cotton and coffee, while cocoa drove small profits on both long and short positions.

Currencies were the main detractors, primarily coming from the Swiss Franc and Japanese Yen. Positions in the Australian, Canadian and New Zealand dollars also led to losses.

GENERAL MARKET REVIEW

Investor sentiment and risk appetite continued to be dominated by the news flow surrounding the pandemic and its repercussions. The first half of the year saw renewed optimism with the successful rollout of vaccination campaigns – initially in the US and UK, followed by Europe – leading to a significant decrease in infection rates across western countries. The signing of a historic USD 1.9 trillion stimulus package in the US, the size and scope of which go beyond any other fiscal outlay since the beginning of the pandemic, was the other major driver of the economic recovery.

The case for more persistent inflation gathered steam throughout the year. Data from the United Nations pointed to a whopping 31 percent rise in global food prices for the 12-month period ending last July. Food prices in the US jumped by 8 percent over a similar period, driven largely by imports, while gas lines in Britain and other shortages in developed economies captured headlines across much of the world. Supply-chain disruptions became the most overused catchphrase in recent memory.

Though the Fed had been trying to ignite inflation since 2009, it began to indicate discomfort as inflation readings remained higher than expected throughout the second semester. Aside from supply-demand mismatches, the major inflationary thrust was exacerbated by expansionary fiscal policy directed at the population at large, associated with their higher propensity to spend it. Stubbornly low Labor Participation was another important variable, which appears to be swinging the bargaining pendulum away from capital in the form of higher wages. By mid-December, the FOMC voted to accelerate the pace of asset purchase tapering and signaled as many as three rate hikes may be warranted in 2022.

Commodities were the best performing asset-class, led by the incredible rally in the energy sector, where the price of UK natural gas rose four-fold, carbon emissions doubled, and crude oil and distillates increased between 50 and 80 percent, approximately. While copper and other base metals enjoyed double-digit gains, precious metals – including gold, silver, platinum and palladium, were down for the year. Agricultural commodities also saw huge gains, led by oils (palm, canola and bean), along with coffee, corn, cotton, sugar and wheat. Global equities experienced another strong year, led by US, European and Canadian stocks. Japanese shares had modest gains, while Chinese indices suffered from government intervention and were broadly down. Government bonds were also largely in negative territory in the wake of rising inflation, while the US Dollar strengthened against most major and emerging market currencies.

For the past decade, investors have shifted focus from the macroeconomic data itself, to an emphasis on how the data might affect Fed policy. Apart from the Fed's recent promise to "remove the party's punch bowl" sooner than expected, most other central banks have indicated loose monetary conditions for the foreseeable future. And even though, as of the writing of this commentary, markets are once again throwing a tantrum given the more hawkish tone in recently released FOMC minutes, there are reasons to doubt whether the Fed may be willing, or perhaps even able, to follow through. For one, higher inflation for a prolonged period would eventually erode, in real terms, part of the enormous debt pile that has dragged on growth for years. This suggests that, despite tough rhetoric, inflation might in fact be a feature, and not a bug, of the current policy agenda.

Further, the apparent demise of Biden's Build Back Better fiscal package removes an important tailwind for the economy just as the effects of COVID-relief legislation begin to fade. Recent evidence points to a slowdown in activity, not only in the US but also in much of the world. The Chinese economy is particularly concerning given recent draconian lockdown measures in some regions, not to mention the yet unknown knock-on effects of the likely collapse of its largest real-estate developer. Investors should expect no respite from the heightened uncertainty they've had to endure in the last few years. At the very least, they should be positioning for greater interest rate and inflation volatility, with direct effects on market multiples and growth expectations.

Sincerely,

Your ReSolve Team

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