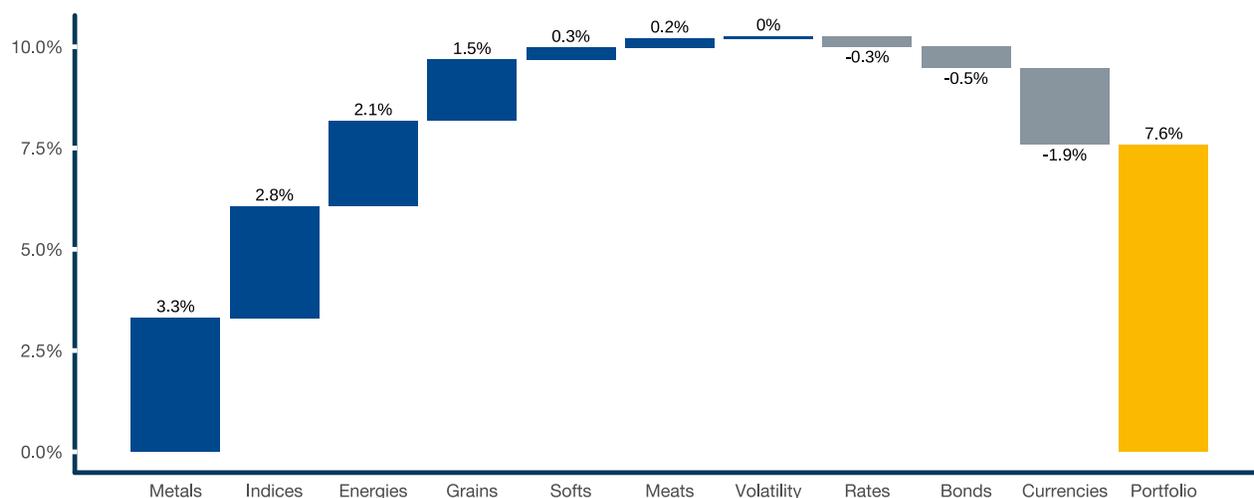


## PERFORMANCE REVIEW

In the opening quarter of the year, the Evolution program continued to show robust performance and returned 7.6 percent, almost exactly the same amount as in the previous three months.

**Figure 1. Q1 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.

**Metals** were the largest positive sector, led by platinum. Interestingly, as the trend in platinum became most intense, our non-linear models drastically reduced exposure, flipping short to capture some more gains as it sold off. Long copper positions also offered meaningful returns, mostly in February, while our small position in gold resulted in a modest loss.

**Equity Indices** also contributed with sizeable gains, with the lion's share derived from long positions in the S&P500, FTSE100, DAX and Russell 2000. It is noteworthy that our systems also took profitable short positions in the FTSE100 on two separate occasions throughout the quarter. The program also drew positive returns from short positions in IBEX and MIB, with marginal losses from the CAC40 and TSX60.

**Energies** were also a meaningful source of returns, largely from our long exposure to crude oil, gasoil and RBOB. Our short position in heating oil was a large detractor, while our short in natural gas had marginal negative contribution.

**Grains** benefitted from long positions in bean oil, canola, corn and soybeans as well as short positions in mill wheat and soy meal. Though the quarter began with a large long position in the sector, exposure was trimmed in late January and closed March with balanced allocations both long and short.

Marginal gains in **softs** and **meats** largely stemmed long positions in cotton, lean hogs and live cattle, with small gains from our shorts in coffee and cocoa.

**Currencies** were our largest detracting sector, with a long position in the Swiss Franc bearing the brunt of the losses, followed by our short in the British Pound. Long positions in the Aussie and Kiwi dollars also had a negative impact. In March, our systems transitioned from a minor long position in the Japanese Yen into a large and profitable short exposure.

Exposure to **bonds** led to small losses, mostly from our short positions in German Bunds and long positions in German Buxl, Japanese Government Bonds and UK Gilts. Importantly, the program offset most of the losses on trades in European bonds with meaningful gains from short positions in 5-year, 10-year and 30-year US Treasuries.

Long positions in rates resulted in marginal losses in the Aussie 3-year, Eurodollar and Euribor.

## RESEARCH HIGHLIGHTS

ReSolve's continuous push towards innovations and improvements is currently focused on two main areas of exploration: feature selection and intraday models.

We have made a great deal of progress in the last few months on what is perhaps the most fundamental problem in active portfolio management: distinguishing true edges from random noise. The most successful approach merges experience, knowledge of market structures and underlying dynamics, as well as a deep fundamental understanding of traders and portfolio managers to curate the most relevant features for each market, with robust statistical methods to identify and emphasize the strongest relationships. The ultimate objective is to develop the ability to add new best-in-class features in a continuous pipeline, and have the algorithms sort and weight the new features systematically to evolve and sustain high performance.

In addition, we are close to concluding the buildout of the core data and trading engines for our intraday trading stack. Over the next few months, we will begin mining and trading at intra-day frequencies, and on a much wider variety of instruments and synthetics. Stay tuned for announcements on this front in the coming quarters.

## GENERAL MARKET REVIEW

Global risk assets rallied during the first quarter of the year in the wake of positive developments on the two main fronts that have dominated headlines over the past 12 months – pandemic and stimulus. Despite concerns over mutations and more virulent variants, the first two months saw a decrease in infection rates while vaccination rollouts ramped up in the US and the UK. Comprehensive data from Israel, where well over half of the population has received at least one vaccine dose, has indicated an effectiveness ranging from 95 to 99 percent, raising hopes that a return to normal could be in sight.

President Biden signed a historic USD 1.9 trillion stimulus package – the size and scope of which goes beyond any other fiscal outlay since the beginning of the pandemic – and is already planning an infrastructure bill that could be twice as large. Meanwhile, Chairman Powell pledged not to raise rates until 2024 and described the expected 2.4 percent CPI for this year as a “temporary surge”. The Fed also upgraded 2021 GDP growth expectations to 6.5 percent, which would be the highest pace since 1984. Meanwhile, strong manufacturing PMIs and labor market numbers were tempered with much lower-than-expected retail sales. Inflation break-evens continued to climb, though the Fed's purchases of TIPS over the last twelve months may be meaningfully impacting any signal that might be gleaned from the nominal versus inflation-adjusted rate differential.

The combined prospects of huge additional fiscal largesse and economic reopening fueled inflation expectations and precipitated a selloff in global sovereign bonds. US Treasuries were the hardest hit by the so-called bond vigilantes. A disappointing auction of 7-year US Treasuries led to an unwinding of approximately USD 50 billion of longer maturities and a continued steepening of the yield curve. The yield on the 10-year rose by 82 basis points while the notes fell approximately -4.3 percent. Though the 30-year saw a rise of similar magnitude in its yield (+76.5 bps), longer duration led to an almost -10 percent drop in the bonds. The message seems clear: investors are expecting the Fed to follow through on its promise to keep short-term rates lower for longer and allow inflation to rise above 2%.

Amidst rising yields, the US dollar rose almost 4 percent, with the greenback rising steeply against the Euro, Swiss Franc, Yen, and several emerging market currencies, though it lost just over one percent against the Loonie. Global equities were broadly up, led by Europe, Japan and the US – though the latter experienced a significant rotation, with small caps enjoying strong gains while the technology sector and other growth stocks rose only modestly (and were even slightly down in February). But the main highlight of the year's opening three months was undoubtedly the commodity space, led by energy, grains and livestock, though softs were largely down. Metals were mixed, with strong gains in aluminum, copper and platinum buttressed by losses in gold and silver.

After two intense months, the reflation trade – firmly established as the consensus narrative across the investment zeitgeist – lost steam in the second half of March, leading to partial reversals in some of the recent trends. There was a feeling of the old “buy the rumor, sell the news” market adage, though much of the data and news flow suggests the economic recovery marches on and inflationary pressures continue to build.

**The most consequential question for portfolios**

Concerns over possible side-effects from one of the most widely available vaccines has led several European countries to limit or suspend its use, further delaying the continent's reopening and recovery, even as several regions are witnessing a rise in cases, triggering renewed restrictions. Recent economic data, widespread vaccination and the bounce in the greenback point to relative US strength, whereas China just issued a more conservative growth target of 6 percent for this year, meaningfully below the 8 percent expected by most economists, and scrapped its 5-year GDP target in favor of growth "within a reasonable range". Hopes for an olive branch evaporated as the strategic meeting between the two superpowers turned into a tense finger-pointing session. US officials expect China to continue flexing its muscles and soon test the Biden administration in the geopolitical arena, possibly over Taiwan. Yet another sign of declining global cooperation came from Europe's plans to restrict vaccine exports, while the incident in the Suez was a sore reminder of the frailty in global supply chains.

Are we witnessing a temporary blip of rising prices within a longer-term deflationary trend, or a structural shift into an inflationary regime? The answer will have critical implications for portfolios over the coming months, and possibly years. The debate continues, and developments over the last few months have provided fuel for both camps. As uncertainty reigns supreme over global markets increasingly dominated by narratives and themes, investors should continue to lean on diversification and risk balance to meet their long-term objectives.

Sincerely,

Your ReSolve Team

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