2016: A Year In Review

> *To others, being wrong is a source of shame; to me, recognizing my mistakes is a source of pride. Once we realize that imperfect understanding is the human condition, there is no shame in being wrong, only in failing to correct our mistakes. ~ George Soros*
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> *Recognize that you will certainly make mistakes; so will those around you and those who work for you. And what matters is how you deal with them. If you treat mistakes as learning opportunities that can yield rapid improvement if handled well, you will be excited by them. ~ Ray Dalio*

One of my favorite things to do at the end of every quarter is go through all my trades and the thinking behind them. I review what I thought markets would do (easy since I'm constantly writing about markets and have detailed records) and compare it to how things *actually* played out. This helps me see what I got wrong, what I got right, and where I may have totally missed the boat.

Sharing this review process is highly unusual for a trading site. We're one of the few services that are completely transparent with our performance. I know of many that tout their BS records by pulling gimmicks on a paper account, falsely claiming a 80% win rate, 350% annual return, etc.

But we're traders first and foremost. And as traders, all we have is our risk-adjusted P/L.

One of our principles when starting MO was to be completely transparent and upfront with you guys… to show you our warts and all. At the end of the day, like you, we just want to become better traders. Being fully transparent helps us do that.

Studying your mistakes is the quickest way to evolve. The great thing about the game of speculation is that no matter how good you get, you'll always get things wrong. The objective study of your failure provides the opportunity to rapidly learn. Here's one of my favorite quotes from Dalio:

> *I learned that everyone makes mistakes and has weaknesses and that one of the most important things that differentiates people is their approach to handling them. I learned that there is an incredible beauty to mistakes, because embedded in each mistake is a puzzle, and a gem that I could get if I solved it, i.e. a principle that I could use to reduce my mistakes in the future.*

This is why it's imperative for a trader to keep a detailed trading journal. You can't solve your puzzles if you don't have records of your thinking on why you took certain trades.

Before we dive into our annual performance, let me give you guys a brief overview of what this year looked like for us outside of markets. 2016 was a big and busy year for Macro Ops.

The beginning…

This time last year Macro Ops did not exist… it was just a twinkle in your author's eye, heh.

MO wasn't really born until late February of this year. And we've come a loooong way since then.

Here's our quick origin story.

In Dec of 15', I had just accepted a job offer at Bridgewater and had moved all of my things (two duffel bags, I live like a spartan) out to Connecticut to find a place to live before starting BW's boot camp.

But Tyler, Anish and I had also been toying around with building a trading service ever since we left our previous employer a few months prior.

The original site was called Foundation Investing (a horrible name which I take full credit for). The site was lame.

None of us had any experience doing web design, producing copy, marketing, or writing and publishing trading articles for that matter. We were green behind the years and naive as hell. (I'm glad, because without that naivete and unfounded optimism we would have never made it this far.)

Anyways, going back to December 15', the original plan was that I would work at BW to pay my bills while we slowly built Foundation Investing over time.

But that's obviously not how things played out. To keep this story short; we were all having fun building the service and the closer I got to my start date at BW, the more I realized I didn't want to be another cog in a giant machine. BW is amazing and Dalio is an idol of mine if you haven't already noticed. But they're also huge (over 1500 employees) and everything is extremely siloed.

I'm also not the corporate office type. I hate meetings and prefer doing my own thing. I told BW thank you but no thank you, packed up my bags, and moved to DC with my girlfriend.

Tyler, Anish and I all agreed to devote a year to the site to see how things panned out and then reassess at year's end (now).

I took up a short-term contract working full-time in one of my old capacities for a government agency. I worked nights and weekends on the website.

Tyler and Anish were able to work full-time on the site. They've built the vast majority of what you see now. And we all studied our asses off to learn the publishing game. Around February of last year, we changed our name to Macro Ops since we're macro traders. It was a much better fit for who we are and what we're doing.

I left my government contract in August to focus on MO full time.

Nine months ago we would go weeks without a single visitor coming to our site. We'd celebrate every time just *one* person signed up to our email list.

Now our monthly pageviews are in the tens of thousands and rapidly accelerating. We've been featured in everything from Business Insider to Valuewalk to Forbes and Marketwatch.

Building this site and growing the MO community has been awesome and extremely humbling. It's also been difficult and quite a roller coaster. I can't remember who said it, but they hit the nail on the head in saying, "Starting a company is like eating glass and staring into the abyss."

I don't think I've ever repeatedly fallen on my face more times than I have in the past year starting MO with Tyler and Anish. But I've also never learned more and experienced as much personal growth in the same time period. And I know Tyler and Anish would say the same.

Our goal from the very beginning was to build the trading service/site that we always wanted but that didn't exist. A site that was completely in a league of its own when it comes to education, trade theory, analysis tools, trading returns, and the quality of its community.

We don't aim to grow into a giant Motley Fool-type business because that would mean serving the common denominator. We want to foster a community of the best — of traders, who, like us, are singlemindedly focused on becoming the absolute best; who think differently than the average market participant and strive for a deeper understanding of how this game works.

The MO community is still small, but I think we've been successful in our hunt for quality because you guys are awesome.

And for that, I have to say thank you for being a member and believing in what we're trying to do here. None of this would be possible without you guys and I promise that we'll be working around the clock to bring you a lot… lot... lot more value in 2017 (we have some big plans and huge upgrades coming in 17').

We've come a long ways and we've still got a long ways to go.

The first year is always the toughest in any venture so I'm glad it's out of the way. I know next year will bring its own challenges and I'm excited to meet those and chew on some more glass.

Strategic Portfolio Performance 2016

The Strategic portfolio (Strat) is our bread and butter. It's our main strategy and was the first port we put up when we started the service.

Strat is also intended to mimic our tracking fund that consists of a pool of money I manage for some high net worth investors. We'll be using it to market our hedge fund in the coming year. This starter fund is also in the process of getting linked up to FundSeeder. We'll share the fund ID # with you guys soon, so you can track our real-time audited results.

Like the site, Strat has gone through some major changes since its inception.

We initially started off with a committee model, where the three of us managed the portfolio together. After trying this for the first eight months, we concluded that it didn't work.

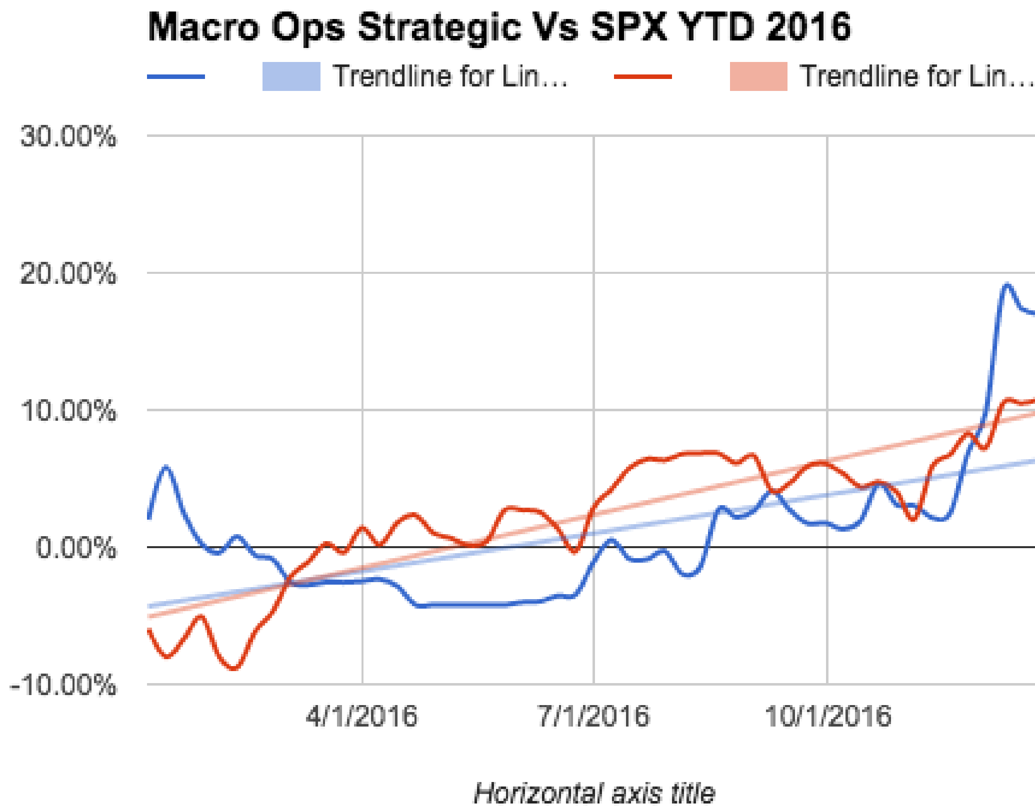
The issue with this form of portfolio management is that it's too bulky and slow. You can only execute on something when you get the approval of all three in the committee. And more importantly, it diffuses responsibility, which is never good in trading.

I think of managing a portfolio like a general leading his men into battle. My troops are my capital and the enemy is the market participants on the other side of my trade. This is why I take very, very small losses. A general can't afford to lose his men… I hate losing my men. It's also why I'm willing to sit in cash for long periods of time. I don't want to risk my capital unless a worthwhile opportunity arises.

So just like you couldn't have three generals managing the same unit in a battle, you can't have three traders managing the same portfolio.

This last September I took over management of the Strategic portfolio and Tyler and Anish began managing the Tactical and Income portfolios. This approach is working a lot better and will continue to be our model going forward.

Below is a chart showing the return of the Strategic portfolio (blue line) against the S&P 500 index (red line) ytd. Strat returned 17.9% this year, beating the SPX index (which returned 10.3%) by over 700 bps with a shallower drawdown.



The above chart is calculated on a weekly closing basis. On a daily basis, the contrast between Strat and the S&P index is even more apparent. The index had multiple large intraday and intraweek drawdowns; dropping over 12% at the start of the year. The Strat portfolio's lowest reading of the year was (4.2%). It also reached a daily equity high of up 25.4% a few weeks ago.

Compared to [Barclays Global Macro Hedge Fund index] which tracks 150 macro funds and is down -0.5% on the year, Strat (which is a macro fund) looks even better.

We manage all of these portfolios on an absolute basis, meaning we don't measure ourselves against any benchmark like the S&P. We grade ourselves on a long-term cumulative basis and not according to any arbitrary time frame, as most hedge funds do. I'm just showing this as way of comparison.

2016 was a tough year for active traders… it was a "killing field" as Dan Loeb said for hedge funds, especially Macro oriented ones. Personally, it was the hardest trading environment I've ever been in. And I've been doing this for a while.

The reason is mostly due to the central banks' suppression of volatility and the lack of any real market trends for the majority of the year. Active managers need movement to make money.

The low-vol regime is now clearly over and the next few years should be great for active managers (us included).

Looking at 2016 from a trading and returns perspective; I spent most of the year feeling like I was repeatedly getting my teeth kicked in. I struggled getting a read on the macro at times and kept getting whipsawed by false moves. This was a good year for macro traders to just “not lose” much money. So I’m happy with our performance considering the tough environment.

All in all I would give myself a C+ to B- for the year.

The positives are that we protected our capital and were extremely patient. Strats returns are primarily due to our willingness to sit in large amounts of cash through the middle of the year (not an easy thing for a trader to do).

We were also working on a million other things this year apart from markets. Not only was I working a full-time job but Tyler and Anish and I were busting our asses 24/7 building up the site and trying to generate an audience.

So much of good trading is just patience and keeping your powder dry for ripe opportunities. And we did a decent job of that this year which allowed us to capitalize on the trends that began forming in the last few months.

Now onto the fun stuff… the negatives.

My Mistakes

The plus side of a challenging year like this is the growth and learning that comes from it. This year has been one of the best years as far as my personal trading education goes. I’ve learned a lot.

With that said, I made some huge blunders that I’m really kicking myself over.

Let’s start at the beginning of the year.

My failure to recognize the clear shift in the Fed

I went into the year extremely bearish. I was in the same camp as Raoul Pal, Jesse Fielder and all those guys. I thought the bull market had peaked and was turning over.

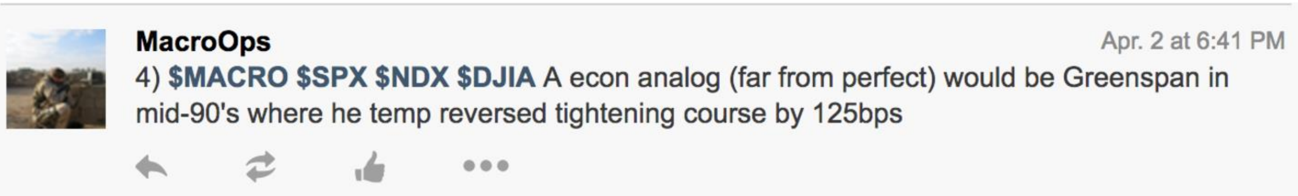
I believed this to be true because the Fed was raising rates and the shadow rate had already gone up a sizable amount. This was flattening the yield curve and causing liquidity to tighten significantly. The credit markets were signalling that a recession was likely on the way.

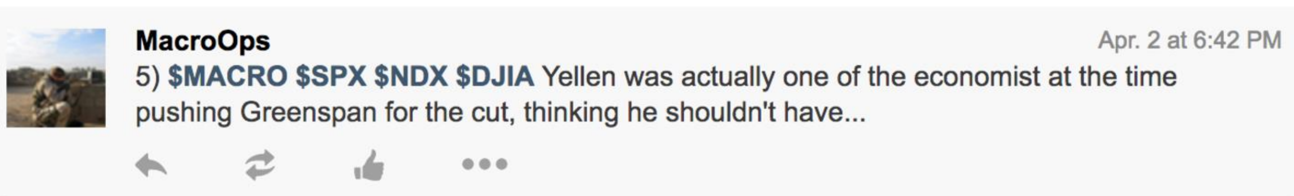
The stock market also looked like it was turning over, thus “confirming” my belief. At the beginning of the year I think this was the right opinion to have. But it was also *too* one dimensional. It was 2nd order thinking when I needed to be thinking at the 3rd level and higher.

If the Fed stayed on its proposed rate hiking path, we would be reeling from a recession and bear market right now. What I failed to think of was the Fed’s (Yellen’s) reaction to the turmoil and volatility in markets, especially when public sentiment was still so bearish with memories of 2009 fresh in our minds.

Looking back, it was obvious what the right call was. Of course the Fed would do exactly as they did — reverse course and become uber-dovish. If I could only start up Hindsight Capital, I'd be rich!

I even *thought* about this alternative thesis in early April:



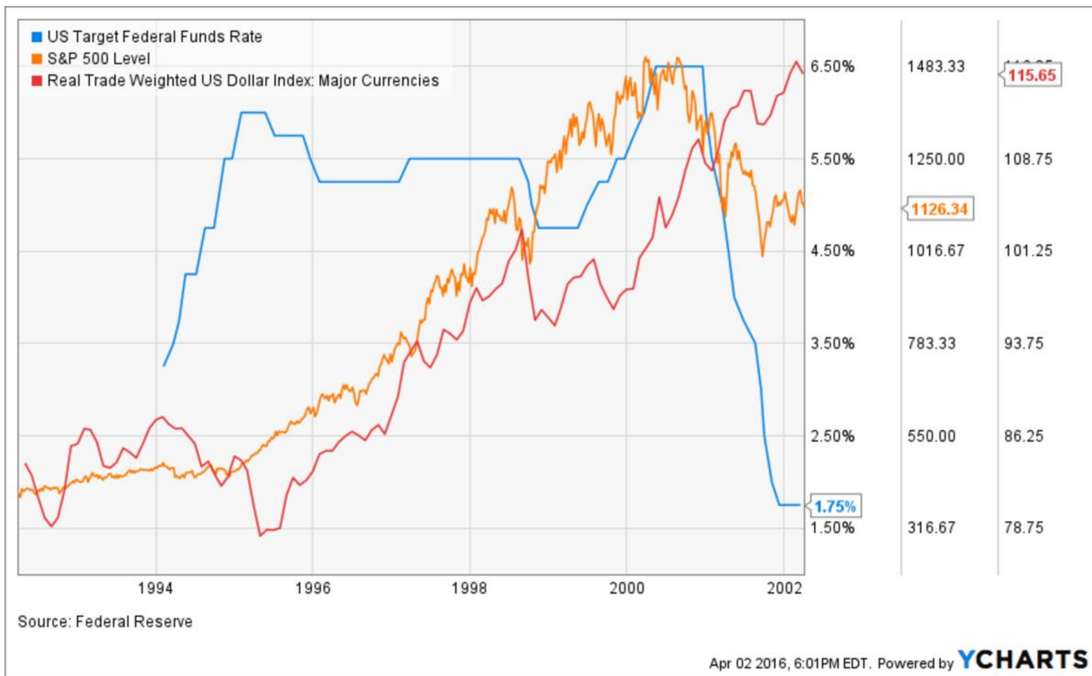


MacroOps
Alex

Apr. 2 at 6:43 PM

6) **$MACRO $SPX $NDX $DJIA** raised in the first place. This led to equities going on a tear forming a blow off top

SYMBOLS (4)	CURRENT PRICE	SINCE MESSAGED
MACRO Global Macro	0.00 (0.00%)	



MacroOps Apr. 2 at 6:45 PM

9) $MACRO $SPX $NDX $DJIA Possibly. I would alter my bearish stance if the SPX closes above 2100 on the weekly.

MacroOps Apr. 2 at 6:45 PM

10) $MACRO $SPX $NDX $DJIA What it comes down to right now, I have little conviction on next six month path of markets. And that's fine.

MacroOps Apr. 2 at 6:46 PM

11) $MACRO $SPX $NDX $DJIA Good time to "sit on hands" as Livermore would say. Work on research and process and wait for price to signal

But I was stubborn and didn't change my view until the end of Summer. This ended up being okay regarding the broader stock market which continued to be a losing trade during that time. But this bearish thinking blinded me to my second and most costly blunder of the year:

Calling the bottom in commodities but not participating in it

This one pains me… in hindsight it was so easy to see… such an obvious call and an amazing R/R proposition.

We called the bottom in oil and a few other commodities within two weeks of their actual lows. And we even publicly stated, multiple times, that oil and commodities would likely rally a good deal from that level. But we didn't trade it…

This was because I was still too wrapped up in my stock market bear/dollar bull thesis. It blinded me to the amazing asymmetric opportunity at hand. If I only hadn't been so stupid our returns could have been massive this year.

These large selloff, bottoming plays are my bread and butter too. I usually slay the shit out of these. I will continue to kick myself over this well into the foreseeable future.

Gold and metal miners

This is my last big mistake of the year (though I made countless smaller ones). Missing out on the huge rally in gold miners in the beginning of the year hurt. My only solace was that I was right in my call at the time that the rally was a false trend. But I failed to appreciate the strong psychological and sentimental drivers behind the move.

Even Soros style “false trends” can last a while and be very profitable. The move in gold was a prime example of this.

Again, I missed this move because I was too mentally focused on the dollar bullish thesis which kept me from examining what was happening with a fresh mind and different perspective.

My biggest takeaway from this year

Like I said, 2016 was a great year in that markets taught me a lot. My biggest take away this year has to be the importance of keeping “strong opinions, weakly held”.

All three of the above blunders were made because I was too rigid in my thinking. I became too locked into a thesis which kept me from objectively assessing new information as it came in. It retarded my ability to adapt and change my mind.

Mental flexibility is one of the five defining traits of the greatest traders. It's absolutely paramount and is something I failed at this year. But it's a mistake I'm really excited to learn from… an awesome puzzle that I can work on solving. I'll make sure to honor it as one of my trading principles going into the new year.

This is where one of the greatest benefits of the Hub and Comm Center come into play. I used to like having my trading opinions and keeping them to myself. Sharing them with you guys and having you share your differing point of views while attacking my theses (talking about you Jamie) made me more agile in my thinking. That type of Red Teaming is invaluable and something I hope we can cultivate even more going forward.

And from here I'll hand things over to Tyler…

<u>Income Portfolio Review</u>

2016 was a fantastic year for short volatility strategies. All the scary macro events: Fed tightening worries, the Brexit vote, and U.S. elections pumped vol to high levels which set up lucrative opportunities to play the mean reversion lower.

For most of the year we harvested the vol premium by selling strangles on SPX. It worked out pretty well. But we took some damage on the call side during the strong market rally in March and also the post-Trump rally. This is the issue you run into when harvesting overpriced implied volatility through strangles.

Strangles aren't a pure play on vol due to the strike dependency of the short options. It leaves you exposed to strong trends. You can still be right on the volatility forecast but lose out because the market trended past one of your strikes.

This concept is often misunderstood. <u>Volatility does not imply trending and trending does not imply volatility</u>. It's possible to have price trending while volatility decreases. The volatility lecture in the price action masterclass talks about this concept more in-depth.

Anyway, let's go over the two challenging times of the year.

When it came time to place the April cycle, we held off on shorting the call side because the market was so oversold in mid-Feb. We finally sold the calls after a few weeks of watching the market go straight up. But

despite waiting to sell into strength, the market continued to rally relentlessly into the beginning of May. The loss on the calls cancelled out the gain on the puts and we ended up scratching that cycle. Looking back, there’s not much more we could have done there. We avoided shorting aggressively in the hole, but still got burned. You can’t win em’ all.

The Trump rally at the end of the year had the potential to cancel out our profits again due to short deltas on the calls getting out of control. But staying attentive to price action allowed us to remove the call side before the meat of the move occurred. This adjustment saved the trade and locked in another winning cycle for us.

On top of removing the calls we juiced the end of the year vol crush by buying VIX puts. We wrote about this trade extensively in the November MIR post-election section. It turned out to be a huge winner. The puts we bought for $1.20 went up to $2.40 and we locked in a 100% gain on the position. This short vol trade is one of our favorites because you can put a lot of leverage in it without worrying about VIX reversing and blowing out your account. By going long options you cap your risk to the amount of premium you purchase.

All in all this portfolio performed exactly how we intended it to. It’s a great diversifier from our divergent trend/macro strategies running in the other portfolios.

Tactical Portfolio Review

We opened the Tactical portfolio in early March as a way to diversify our team members’ convictions. As we explained earlier, the co-management approach proved to be much tougher than we expected. When you add in slightly different mental models and intuitions all based on completely different past experiences, you’re left with a paralysis where true expression isn’t allowed to flourish.

Performance lagged for most of the year as we worked out the kinks. The slow market grind in the summer created a lot of choppy market action which is a huge pain when you’re trying to play breakouts.

Looking back, the main issue with this account were risk points that were too tight. Throughout the year we would cut losers only to watch them turn around and complete the trend we were playing for in the first place. This is an age-old trading problem. Do you give losers more time to turn into winners and risk a larger loss? Or do you aggressively manage risk and rack up many small cuts?

The most frustrating one of the year was Goldman which we originally bought during the final week of August. Instead of holding on for the nearly 43% rally, we took a loss and never re-entered.

Learning from Goldman, we decreased leverage and widened stops for all positions placed in Q4. Performance turned around and we think this tactical management tweak will continue to improve results going forward.

The model for this portfolio is still getting honed and sharpened around the edges. It wasn't in production during the first quarter and suffered for it. The first few months of the year had some great trending action. We hope increased patience with our trades will deliver a much better 2017.

Multi-Strat

Traditional asset management involves diversifying between asset classes that are uncorrelated i.e. 60% in stocks and 40% in bonds. The idea is when one asset class does poorly, the other asset class does well. The net result is better risk-adjusted performance or a "smoothing" of the account equity curve.

The same theory can be applied to trading models as well. If you have multiple strategies that are uncorrelated, you can combine them to create smoother overall performance. In the professional fund management world this is called "multi-strat", "multi-manager", or the "platform model". It's how all the big hedge funds structure their businesses these days. Stevie Cohen, Paul Tudor Jones, Ken Griffin, Israel Englander, all billionaires on the Forbes 400 list, have been running multi-manager platforms for a while. And there are many more not-as-famous trading shops using the multi-strat platform with much success as well. It's hard to match the robustness and consistency you achieve by running multiple trading models side by side.

Take a look at our multi-strategy (combo of Strat, Income, and Tac) performance for 2016 below:

The diversification achieved using the combo of trading models created a performance curve with extremely low drawdowns. At its worst point in 2016, our multi-strat model was down (0.95%). Compare that to the worst drawdown in the SPX this year (on a weekly basis) of (8.77%).

So if consistency, robustness, and low drawdowns is your goal (a combo very well suited for professional fund management) then the multi-strat style works wonders.

If your goal is extreme account growth, then the multi-strat style is not the optimal choice. When you combine strategies into a multi-strat format it dampens both drawdowns AND returns.

For example, let's say you wanted to run two models side by side, Portfolio A and Portfolio B. Portfolio A ended up returning 30% for the year and Portfolio B returned -10%. The net performance is NOT 20%. Portfolio A returned 30% on half your money contributing 15% to the whole nut. Portfolio B returned -10% on half of your money contributing -5% to the whole nut. The net return is 10%.

	Portfolio A	Portfolio B
Return	30%	-10%
Weights	0.5	0.5
Weighted Return	15.00%	-5.00%
Net Return	**10.00%**	

That's why defining your goals is one of the most important components of any trading and investing journey. What do you care about more? What do you want out of the game? Do you want to raise institutional money? Is preserving capital with very little drawdown your focus? Is maximizing account growth with triple digit returns your focus?

These decisions are highly personal and vary depending on whether you're an individual investor or a professional looking to manage outside capital. If stability is the goal, more diversification across models is the correct approach. If your sole focus is account growth, then you want to allocate aggressively towards your favorite or best performing model.

Thanks again to all of you for an amazing 2016. We're excited for an even better 2017!

- The Macro Ops Team