Pain + Reflection = Progress

> *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*
>
> *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. ~ Ray Dalio*

Every two quarters the Macro Ops team spends a week poring over our last six months of trading. We comb through our winners, losers, and the trades we almost pulled the trigger on, but didn't take.

We keep detailed records of our reasoning for taking trades and our thoughts on the market at the time *(running a newsletter helps)*. When reviewing, we compare these notes to how things *actually* played out. Our goal is to see what we got right, what we got wrong, and where we completely screwed the pooch.

This is the most valuable exercise we do. Nothing pays us higher returns than taking a step back and ruthlessly dissecting our process and execution. I've learned more from studying my trading journal than I have from reading any trading book…

Like Dalio says, *"embedded in each mistake is a puzzle, and a gem".*

Pain + Reflection = Progress.

One of the great things about trading is that mistakes are inevitable and constant. This game is dynamic and complex and we're all limited in our ability to understand the system of which we're all an integral part — like fish who know little of the water in which they swim. We all get things wrong…. a lot. This gives us plenty of puzzles to solve, gems to uncover, and truths to realize.

The Palindrome (George Soros), one of the best speculators to have played the game, had a win rate in the mid-30s. On average, 2 out of every 3 trades he made were losers. Yet, the guy was a perpetual money machine over three decades. He knew how to lose and still win. *Being good at being wrong* is <u>the most important</u> skill set a trader can develop.

One of my favorite market technicians, Ned Davis, put it like this,

> *We are in the business of making mistakes. The only difference between the winners and the losers is that the winners make small mistakes, while the losers make big mistakes.*

Much of our job then, as speculators, is to learn how to make <u>smaller</u> and <u>smaller</u> mistakes by ruthlessly studying our <u>big</u> ones. This is how we uncover first principles that comprise the foundation from which the entirety of our process is built upon.

This is akin to Josh Waitzkin's concept of "making smaller and smaller circles".

He notes,

> *It's rarely a mysterious technique that drives us to the top, but rather a profound mastery of what may well be a basic skill set.*

I've spent years dissecting the habits and practices of the greatest traders. And I can tell you that there's <u>**no**</u> secret to anything they do.

They are just incredibly efficient at executing the basics:

- Cutting losses short / protecting capital
- Sitting on hands / letting winners run
- Mental flexibility / strong opinions weakly held

This is what we'll be going over today. We will revisit the first principles of trading and see where we can make smaller circles and refine our thinking and process with the hopes of improving our performance going forward.

In this review, we will:

- Review our year-to-date *(through June 15th)* and trailing-twelve-month (TTM) performance
- Dissect our biggest winners and losers (focusing primarily on the losers)
- Cover lessons learned, the gems we can gleam from the mistakes we've made, and how we can improve our process
- And finally, we'll talk about where we are as a trading Collective and where we're headed over the coming year

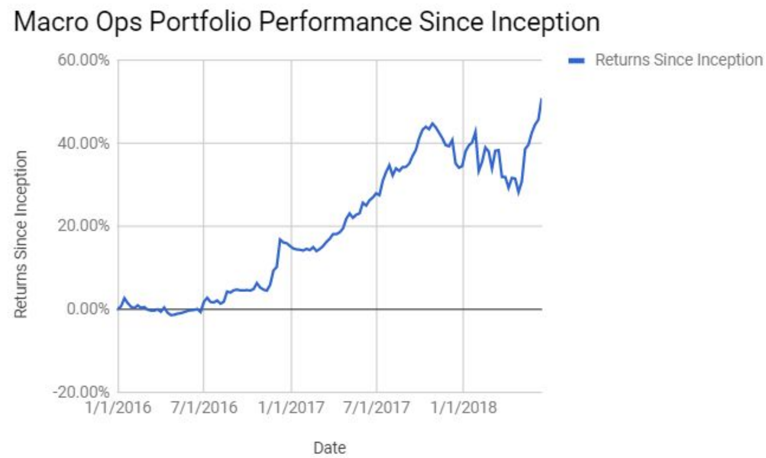
Enough with the fluff, let's to get to the goods.

Performance

Below are the performance metrics for the Macro Ops (MO) Portfolio:

Macro Ops Portfolio

Return Metrics *Through June 15th 2018
YTD: **12.20%**
12-Month Return: **19.52%**
Inception (Jan 1st, 2016): **50.99%**
Annual Vol: **11.32%**
Sharpe Ratio: **1.54**
Max DD: **-11.43%**



The YTD return for the Macro Ops Portfolio is **12.20%**. The trailing twelve month return is **19.52%.**

We evaluate ourselves on an absolute basis and don't compete against any particular index. But for comparison, the S&P over the same timeframe returned **3.97%** ytd and **14.24%** on a TTM basis.

By any objective measure, these are solid returns.

These returns are the result of a handful of lucky breaks throughout the year, which we were able to capitalize on by diligently applying our framework day in and day out.

Our long term returns will always directly reflect our ability to execute on our process.

It has nothing to do with our brilliance or occasional moments of genius. *(We lack the former and are only occasionally deluded by the latter.)*

We should emphasize a few keywords here, these being: *long-term returns*.

I often see many traders fall into the trap of doing what we poker players call *resulting*. Which is assigning meaning to statistical noise (aka randomness). It's dangerous to make broad assumptions about skill and strategy based off of a few hands instead of many cycles at the table. And so it is for traders and investors, where perfectly effective strategies can hit bad streaks that last weeks, months, and even years.

Determining what time frame is appropriate for teasing out signal, depends on one's strategy, trade frequency, and a host of other variables. And even then, we never truly know what's due to skill or to luck.

That's why we have to rely on logic and a certain amount of faith until we can compile enough data — experience enough cycles — to be able to pull valuable lessons from our results.

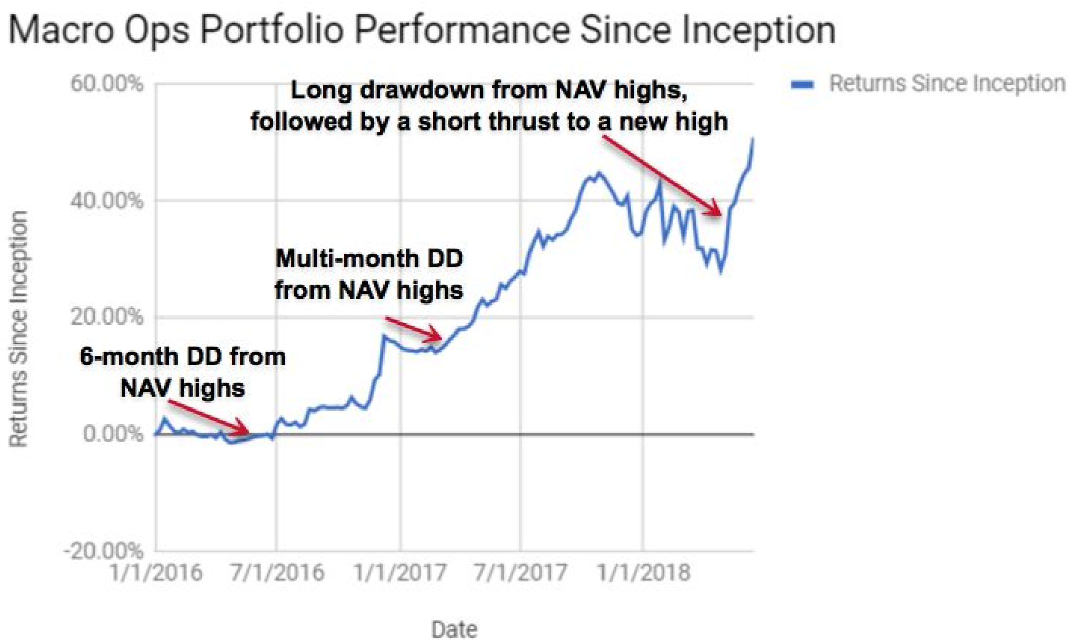
This brings us to an important point. And that's that as a speculator, you will spend the vast majority of your time in a drawdown from NAV highs. This is a reality of all trading strategies that look to exploit convex opportunities.

The returns for these strategies are inherently bunchy. They follow natural power laws, like Pareto's 80/20 distribution or really it's something closer to 90/10 in markets.

This means we should expect 90% of our profits to come from 10% or fewer of our trades, with the rest canceling each other out. We never know where or when these bottom-line trades are going to come and so we must accept the fact that we'll spend most of our time just grinding away; taking scratches and small losses and drawing down from equity highs until we catch a fat pitch.

Our performance this year serves as a perfect example of these truths: that returns are bunchy and follow power laws, that traders live in near constant drawdown, and that the merits of a strategy must be evaluated over the long-term.

Just take a look at the chart below showing our portfolio's net asset value since its inception in 2016. Over the last 3-years it has experienced three long grinding drawdowns from NAV highs followed by short thrusts to newer highs.



This seesawing equity path is a feature and not a bug.

Our process is built around trying to fully exploit the 90/10 nature of market returns. The equity paths of the greatest traders follow a similar pattern for the same reasons. There's just have some combination of smaller/shorter drawdowns and longer/larger thrusts up.

Our work then in trying to constantly improve as traders is reducing the amount we drawdown from new NAV highs and extending our thrusts up to new ones.

There's no secret to how to do this. It all goes back to the three basics we talked about at the beginning…

- Cutting losses short / protecting capital
- Sitting on hands / letting winners run
- Mental flexibility / strong opinions weakly held

Let's review our trading for the year and see what we could have done better, starting with our losers.

"To be successful you have to love to lose." Everett Klipp, *The Dao of Capital*

Over the last 6-months we've executed 54 trades. This number includes pyramiding trades, basket trades on a theme (which we view as a single position), and exiting trades from the prior year. In reality, the number of standalone trades we executed since the start of the year is closer to 25 which is around our sweet spot of averaging 3-4 trades per month.

Out of the 54 trades, 26 were winners and 28 were losers. This gives us a win rate of 48% year-to-date. This is above our long-term win rate which typically hovers around 41%. On average, our losing trades lost 55 basis points on our total capital and our average profits on our winners was over 2x the size of our losers.

Our biggest losing macro trades were:

1. Long Purple Innovations (PRPL) where we lost 1.2% of our capital
2. Long Yatra Online (YTRA) where we lost 1.1% of our capital
3. Long Nikkei futures (NKD) where we lost 1% of our capital

Our losses adhere to the same power laws as our profits; 10-20% of our losers will account for 80-90% of our total losses. This year has been no exception. The losses on the above three trades are multiples larger than the capital lost on the remaining 23 losing trades. Finding ways to reduce the size of our biggest losers can dramatically improve our overall results.

And just looking at these trades above, I recognize that most of these losses were not due to market randomness but rather to sloppiness in execution on our part.

Take Purple (PRPL) for example.

I entered this trade back in March, the stock quickly ran up 25+% only to gap down reverse on missed earnings. Because it’s an illiquid stock we weren’t able to exit the full position at our risk point and took a loss that was 20% larger than what we had intended.

This was stupid.

Because it's a relatively new SPAC and is illiquid I should only have taken a position if I was willing to make it an investment; meaning size it smaller and widen the risk point by a lot.

I still think the stock is an interesting value, especially at current levels. But, the mattress space is crowded and my experience in investing in that type of consumer business is limited. My position size should have reflected this limited experience. So instead of taking what should have been a 35bps loss, I took one 4x larger.

Yatra Online (YTRA) is a similar case study. It's also a relatively new and illiquid stock. We entered our initial position with too much size and too close of a stop. We have long-term conviction on the stock and our positioning and risk points should have better reflected this.

We have since reentered the stock with a smaller size and much wider stop. But we should have done this on the first attempt. My position sizing needs to better reflect the volatility and liquidity conditions of the underlying.

Our Nikkei loser is a combo of a number of mistakes.

The overall trade setup was decent, though not great. I don't regret putting it on. But where I screwed up was getting too aggressive with the pyramid and failing to move my risk point up after the move; especially considering the flashing warning signs that sentiment indicators were giving at the time of the trade.

I was too aggressive at a time when I should have been reducing my holdings and I was too loose with my risk point at a time when I should have been pulling them close.

Going forward I need to be more diligent in continuously assessing the Marcus trifecta of macro, technical, and sentiment and adjusting fire accordingly. I was sloppy here and that cost me.

Overall, we've done a decent job of protecting our capital these last six months. Especially, when considering the volatility at the start of the year. Even our drawdown of 11.3% from NAV highs — which is our largest drawdown from peak to trough, was exaggerated by the number of long-term DOTM calls we held on our books. Many of these temporarily fell to near zero during February's sell-off, which didn't at all reflect their true value.

But we did make a number of mistakes. Mistakes from which we can tease valuable lessons and improve our performance going forward. These are:

1. Position sizing and risk points need to better reflect the volatility and liquidity conditions of the underlying (ie, size smaller and stop wider in smaller cap stocks).
2. Always reassess broader market conditions (macro, sentiment, technicals) before executing a trade. It's easy to get tunnel vision when you get excited about something but it pays to step back and objectively reassess the environment.

Now let's take a quick look at our largest winners.

Our biggest macro winners so far this year have been (this percentage gain is on our portfolio's TOTAL capital. The actual underlying trades advanced much more):

1. Long TripAdvisor (TRIP) where we've made 6+% on our capital
2. Long W&T Offshore (WTI) where we made 3.2% on our capital
3. Long USD (DXY futures) where we've made 2.5% on our capital (position is open)
4. Long United Health (UIHC) where we've made 1.7% on our capital (position is open)
5. Long Interactive Brokers (IBKR) where we made 1.5% on our capital

Tripadvisor (TRIP)

I started digging into TRIP last fall. What I found was a very compelling value stock with a number of positive catalysts on the horizon. The more I dug into the company, the more I liked the stock due to its moat, the consensus negative sentiment on the company, and the broader macro tailwinds for the OTA market in general. TRIP checked the right boxes and that gave us high conviction in the asymmetry and positive EV of the trade.

We took our first swing at TRIP in early October but were stopped out a few weeks later for a small loss. This gives us a good opportunity to study the pros and cons of two different styles/approaches to speculating.

If we bought TRIP as an investment and not a trade, then we would have had to sit through large volatility over the ensuing months; including a 30+% drawdown at one point. The fundamentals never changed but the market was doing what markets do and was washing out the weak hands.

This would have worked out because the stock ultimately ran higher than our original entry. But, sitting on the position would have been mentally taxing and more importantly, we could have been wrong in our analysis. And in that case, the stock would have continued to sell off and we would have eventually cried uncle and taken a large loss.

Instead of doing that, we can just take multiple swings on a high conviction trade like we did here with TRIP.

This way we only risk small amounts of capital and never expose ourselves to a large drawdown. I think of this approach as insurance against my own ignorance. There's always the chance that I'll be wrong when taking a highly contrarian position.

The downside to this approach is that there's the possibility that the stock gets away from us and we end up buying at a higher price than our original entry. This is a worthwhile trade off in my opinion as I'd much rather have a poorer entry than hold through a large drawdown.

W&T Offshore (WTI)

WTI was a homerun for us. *Almost* everything went right on this trade. We nailed the macro call on being bullish oil last year. We bought WTI on textbook technical breakout. And held onto the stock through its up and downs throughout its monstrous trend over 8-months.

All in all, we got a **30x return** on our initial risk. Not too shabby…

But we still could have executed better.

Bullish oil was a high conviction theme for us. We played the trade by buying a basket of energy names. We eventually cut the other stocks because they failed to follow through, unlike WTI. As WTI's trend progressed we should've added on technical inflection points and built our position size to match our confidence level.

This is of course easier to say in hindsight. And it's just a fact of trading that we'll always have too little in our winners and too much in our losers. But I do feel I could have done a better job managing this trade over the life of its trend.

US Dollar (DXY)

We made the majority of our discretionary returns last year shorting the dollar. This year we've made them on the long side.

If I could only trade one market it'd be currencies. I've made the majority of my returns throughout my trading career trading forex. It's the ultimate macro market and there are numerous false beliefs and bad pervasive mental models used by players in the FX space that create a lot of edge for those who objectively and independently study it.

I'm overall pleased with the way we've executed our FX trades this year. We've been lucky in catching the trends at exactly the right times. I'm still very bullish the dollar and believe there's plenty more upside left for this move.

United Insurance Holdings (UIHC)

UIHC was a simple setup. A great looking chart and large amounts of insider buying are what originally drew my attention to the stock. It’s also an under the radar company with solid management and strong fundamentals.

The chart gave us a great inflection point at which to buy and allowed us to purchase in size.

I’m still holding the stock think there’s a good chance it will take out its all-time highs of $28 before the end of the year.

Interactive Brokers (IBKR)

IBKR is a great example of a great trade poorly executed.

We pitched the bullish case for IBKR in our August MIR from last year. This was a high conviction call and I believed the trade had a lot of positive asymmetry.

I screwed up because I missed the original inflection point in the technical breakout at the time we released ourcall. I then waited for a pullback because I was disappointed in myself for missing the initial entry. This is BAD trading. When you have high conviction on the asymmetry of a trade you don’t try and pinch pennies and wait for it to come back. You will almost always end up buying at much higher prices.

I then compounded this initial mistake by putting too little size into the trade. My position size was nowhere near my conviction level. This is largely due to the fact that I was pissed I missed the original entry.

The stock then ran straight up, nearly doubling over the following 6-months and I never added to the position. Another big mistake.

Even though this was a bottom line trade for us, our returns should have been more than twice what they were. But my poor execution and poor trade management kept me from fully exploiting the trend. Unsat…

Our biggest miss: GAIA

If any single trade epitomizes my failure in trade execution over the last year, it's GAIA. I did everything wrong on this trade and turned what should have been a monster winner into a small return. Let's go through the mistakes I made.

We first pitched GAIA in our March 2017 MIR. This was a high conviction, high asymmetry trade with a loooong runway.

But, similar to IBKR, we waited over a month to buy into the stock after missing its technical breakout and seeing it run up over 20%. I was upset that I missed our initial entry point and then waited for a pullback. The pullback never came so I finally put the trade on in much smaller size — just like in IBKR.

I then allowed myself to get shaken out of the stock after it rising over 30% from my entry point.

This exit made no sense. I was fundamentally VERY bullish on the company. Management was executing flawlessly and I continued to put out bullish updates on the stock all the way up. I did then, and still do, believe that GAIA is a $65+ stock within a few years. It's **now up over 150%** since our initial call. But I lost my position in the stock because I failed to be patient enough and give it the room it needed to run. My trade management didn't match my fundamental conviction. I failed to let my winners run…

This tendency to compound my mistakes is something I need to work on. I need to look at trades with fresh eyes and not let mistakes and poor execution of the past affect what I should do in the present. The market doesn't care if I missed my original entry, so I shouldn't either. I need to judge the trade on its merits in that very moment and then manage accordingly.

To sum up the lessons we can take away from our winners is:

- High conviction fat pitches only come around a few times a year
- Our performance hinges on our ability to fully exploit these trades
- This means we need to size and manage our trades so that they're in alignment with our conviction and our perceived asymmetry of the trade
- Portfolio concentration is also needed if we want to vastly outperform the market Druckenmiller and Tepper typically have 60+% of their long portfolio in just five trades
- We can accomplish this by being patient and trading less but being aggressive when a great trade comes along

It all goes back to the basics of:

➢ Cutting losses short / protecting capital
➢ Sitting on hands / letting winners run
➢ Mental flexibility / strong opinions weakly held

Conclusion

All in all it's been a good year for us in the markets. I'm personally loving the macro game right now. These volatile markets are my bread and butter and I think the second half of this year will be even better for the MO portfolio than the first. I'm seeing the beginnings of some powerful trends developing.

With that said, there's obviously a lot that I can improve upon in my trading. This is a good thing.

I'm on a path of continuous evolution and the only way to walk this path is by continuously and ruthlessly studying my failures. Doing so has become my favorite and most fruitful exercise. I look forward to dissecting my future mistakes again six months from now. I just hope they're not the same ones I've recently made — hopefully I'm making smaller circles then.

Macro Ops is now 30-months old. It's still a relatively young operation. We've come a long way since we started, but we still have a long ways to go.

The community we've built is awesome. I think we have the best Collective of hard-charging, maniacally obsessed traders anywhere in the world. And I love how global we are. We now have members on every major continent. That's a lot of eyes scouring markets and feeding intel and trade ideas into the group.

I want to give a big thanks to those of you who've joined us. Thank you for supporting us and bringing value to the community. I hope we give you plenty of value in return and I promise it'll only increase going forward.

Our mission statement today is the same as when we started.

- **Build the best community of like minded traders from around the world**
- **Continuously study markets and trade theory and pass this knowledge to the group**
- **Create a flywheel of growth where we teach members, they teach us, and on and on**
- **Use the expanse of the Collective to scour the globe for trades and make lots of money**
- **Develop and share our macro framework and tools with members empowering them to make their own informed macro trades**

Our primary directive going forward is to further refine and breakdown our global macro approach in a way that can then easily be shared with the group.

We want to make a much bigger push in creating short video courses on all things trade theory and markets related.

We just started work on building a platform where we can directly share our data and various market models with you guys. Essentially, Macro Ops has always been about the three of us (Tyler, AK, and I) building the trading site that we always wanted but didn't exist.

The plan is to build a platform that shares the unique data we have access to, along with our models for analyzing markets, so the Collective can use these tools and share their ideas and insights with one another. And hopefully we all make a ton of money together as a result.

It's a long road from here to there, and we've got our work cut out for us, but I'm more determined than ever to get us there.

Thanks for reading!

It's a big honor and extremely humbling to have you read our work and we love all the feedback you guys give us.

I’ll leave you with some wise words from the smiling fat man.

> *There are two mistakes one can make along the road to truth... not going all the way, and not starting. ~ Siddhartha Gautama (Buddha)*

Your Macro Operator,

Alex