

I want to kick off an ongoing discussion on portfolio construction.

This is a topic I spend a lot of time thinking about and it's one I think many global macro investors, like ourselves, neglect.

The classic macro portfolio is comprised of ever-changing bets and temporary asset allocations which move and shift at the whim of the PM.

There's nothing inherently wrong with this approach but I've long thought that there's a better way.

You see, as traders and investors we're always operating in a kind of "fog of war". We can't see the future. We don't know exactly what's around the corner. And we face two constant risks in general (1) that we'll have too much exposure in a falling market and (2) we won't have enough exposure in a rising market.

Big bets and fat pitches only come around so often. They are by their very nature, rare events. We're always operating under a veil of ignorance. And most of the time that veil is pretty damn thick. This isn't a good or bad thing. It's just the way it is.

Our portfolio construction should reflect this truth. It should be robust to our ignorance and the cyclical nature of big bets and fat pitches.

Jim Leitner, who's one of my all-time favorite macro traders and one of the best money managers most people have never heard of, built his strategy and constructed his portfolio in alignment with these truths. Here's a section from a piece we wrote on Jim a while back ([link here](#)).

We start off by acknowledging that we are ignorant, so we need to be systematic, clip some coupons, and earn some risk premia. It doesn't matter if it is in currencies, bonds, commodities, real estate, or equities. Of course, we have to be smart about it by reading a lot, talking to smart people, and being on top of it all while acknowledging that we're not that much smarter than the rest of the world. Then, every once in a while, we're going to stumble upon an exciting idea that's going to give us some extra alpha and the ability to outperform.

After these five main asset categories, we have a last category which we call absolute return. This is where we stick those great, out-of-the-box ideas we come across about twice a year. Sometimes we're lucky and find major mispricings once or twice a year, and sometimes we're unlucky and it takes 18 months before the next one comes along. When we find these fantastic ideas, we're willing to bet up to 10 percent of our fund on one idea. One that we think will double or triple, earning an extra 10 or 20 percent return for the entire portfolio.

The absolute return category is there in order to leave us open to making unsystematic money.

Having a beta strategy, an asset mix that delivers stable risk-adjusted real returns, as one's foundation for their portfolio does a number of things. It helps hedge us against our ignorance and protect us from the two general risks we constantly face of having either too little or too much risk exposure in various market regimes. And it frees up our mind-space and enables us to focus more on uncovering asymmetric big bets.

With a stable market exposure in a beta asset mix, we'll always be earning the steady risk premia that the broader global market has to offer. So we won't feel compelled to chase as much into sub-par trade ideas and fill our portfolios with 2nd and 3rd rate investments.

It allows us to be patient and wait for the setups to come to us, the veil of ignorance to be lifted somewhat. And then we can act in force. That's our Alpha overlay.

I'm going to be putting out more notes on this and sharing the ideas and work that I've done on this topic so far. I'd love to get thoughts and feedback from you guys and gals and hear what you think. **In the coming weeks, we'll be moving the MO port over to this mix of a beta foundation and alpha overlay.**

Look for more notes on the subject to come out soon.

Lastly, check out this presentation given by Leitner ([link here](#)). It's a great watch but this is a private video so please don't share with anyone.

That's all I've got for now.

See you in the CC.

Your Macro Operator,

Alex