Portfolio Performance 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*
>
> *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*

Alex here.

Every few months we sit down and pore over our trade logs, journal, and public writings from the previous quarter(s). We review what we thought markets would do, how we placed and managed bets on these opinions, and then compare them to how reality *actually* unfolded.

It's a ruthless study of our mistakes; in thinking and in execution.

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

Pain + Reflection = Progress.

You know, on a bit of an aside, I don't care for Dalio as he's devolved into a CCP apologist. And I find this strange, you know, cause he's such a "Principle's" guy and all. But I suppose when you open up a big local China-based arm of Bridgewater, the whole *whose bread I eat, his song I sing* bit sadly comes into play. I still love the quote though, which is why I include it.

Anywho, these reviews are without a doubt the most valuable exercise we do.

Sharing this review process is unusual for a trading site. We're one of the few services that are transparent with our performance. I know of many that tout their BS records by pulling gimmicks on a paper account, claiming nonsense 80% win rates, 850% annual returns. And most don't give trade structure at all, they just say buy X and sell Y as if that means anything. Total useless garbage if stops, sizing, portfolio management, etc… aren't included.

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 forthright… to bare our warts and all. At the end of the day, like you, we just want to become better at the game of markets. Being fully transparent helps us do that.

The Palindrome (George Soros), one of the best to have ever played the game, had a win rate in the mid-30s. That means, on average, every 2 out of 3 trades lost him money. Yet, the guy was a perpetual cash machine over 30+ years. He knew how to lose and still win. *Being good at being wrong* is one of, if not *the* most, important skills 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.***

Our job as speculators is to learn to make smaller and smaller mistakes by mercilessly studying our big ones. This is how we continuously refine our process in a way that increases the positive asymmetry of our trading approach over time.

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 **no** secret to anything they do.

They are just incredibly efficient at executing the basics:

- Cutting losses short and protecting capital
- Knowing when to sit on hands and letting winners run
- Going Totis Porcis when the Trifecta (fundamentals, sentiment, technicals) aligns
- Mental flexibility, strong opinions weakly held, and respecting price as the final arbiter of truth

Now let's look at our year to date numbers and see where we can make smaller circles.

Macro Ops Portfolio

Return Metrics *Through April 15th
YTD: **+31.3%**
Annual Vol: **11.32%**
Sharpe Ratio: **1.54**
Max DD from NAV high: **-11.43%**

For reference, the SPX is down -8.3%ytd. The Qs are down -15.7%ytd. And TLT is down -16.4%ytd.

I include these market returns only for comparison as we measure our performance on an absolute basis and not against any particular benchmark. We care more about how we executed our process in *relation* to the opportunities available over that time period.

Trading commodity futures (we remain long nearly the entire Ag and energy complex) and being invested in a basket of commodity-related stocks (AFM.TSX, PANR.LSE, VIST, PDN.ASX, YCA.LSE, CRK, ENB, CTVA) have made up the bulk of our returns year-to-date.

While our strategic book, which is comprised of longer-term company-specific bets (SQ, TWTR, XP, LDO, POWW, DSRT, VIV, CLPT) have mostly been a wash year-to-date. Some up, some down, some unch'd.

This is to be expected as market/factor opportunities are cyclical. Which is one of the big benefits of having a go-anywhere macro approach versus being pigeonholed to just high-growth tech or resource stocks or only FX, etc…

Having a +EV system for various markets, especially ones that often move counter-cyclical to each other, is helpful in a number of ways. First, it smooths out your equity curve since you naturally shift your attention (and capital) to where the opportunities are while lightening up your exposure — and attention — to those that are dead in the water.

Second, and even more importantly, is that it **preserves your mental capital**. There are few things more taxing than opening your portfolio and seeing red every day while devoting all your focus to a market that could be trading in a shit regime for 6-months, 1-year, 2yrs, etc…

All in all, I give our performance and execution over the last four months a solid B.

We've done a number of things well. Our macro calls and positioning have been mostly on point.

In early December, we identified the change in market regime due to a Trifecta of transitioning drivers (hawkish shift at the Fed, slowing growth, persistent inflation, etc..). In my Dec 2nd *Market Note: A Big Deal...* I wrote:

> ***This is a significant shift in Fed messaging****. And it comes at a time when markets are at* ***3-year highs in Trend Fragility****, valuations are at or near record highs, credit spreads are coming off record tights, and the SPX is trading like a wet rag in a very extended parabolic Buy Climax.*
>
> *I know I'm starting to sound like a ZeroHedge copywriter here but I do on occasion turn cautiously bearish, if not outright run for my bomb shelter. The thing is... we were already rolling over into a significant deficit in the global credit impulse. And* ***this bearish turn from the most important central bank is only going to accelerate that squeeze.***

We've stuck with our call for an extended sideways volatile regime since and continue to do so. We then were one of the few shops to correctly call the Russian invasion of Ukraine. On Feb 18th in our note titled *A Russia-Ukraine PSA* I wrote:

> *In addition, mobilizing a military of this size is costly. Not to mention it carries a kind of momentum of its own. These things are difficult to stop once they get going. And so,* ***odds are Russia invades Ukraine and does so soon****. How far he pushes, whether they stop at the Eastern regions or push for the capital are to be determined.*
>
> *As far as the West goes, it's fed up with Russia's behavior. The poisoning of UK residents, the annexation of Crimea, the meddling in democratic elections, constant cyberattacks, and its frequent military adventurism has helped to unite the West in a way that's been sorely needed.* ***This means that this time the West's response won't be like what we saw following Crimea. It means there's potential for things to escalate.***
>
> *The other day I did a zoom call with a handful of my former USIC buddies. All of them work on the private side now, doing consulting or contracting. But they're still very much plugged into the loop.* ***The general consensus put that odds at 80% that Russia invades within the next week.***

We've also done a pretty good job of managing our aggregate open risk in the portfolio, tactically moving up and trailing stops, taking partial profits, etc… These helped us convert our paper gains into realized ones and prevent the market from digging back into our pockets. It's important to always be lasered in on this, especially when we're in a sideways volatile regime like we are now.

So, great, kudos to us as these are some of the few things we did well. But this isn't super interesting stuff because we don't learn much from our wins. The real nuggets are in the missed opportunities, the mistakes, and the total fuck ups. So let's now turn our attention there.

Here's where we were sloppy and where there are lots of room for improvement.

Asking so what, and what, and what?

When I was going through training to become an interrogator, one of the things they beat into your head is to drill down a 1,000 feet into every single detail that comes up during the interrogation.

No point is *too* small, no off-the-cuff remark *too* insignificant…

They say something about a truck they once rode in, well what was the model of the truck? The year? The color? Did it have any identifying features? If so, where were these located? Tell me about the driver's side door, the passenger side, the hood, the interior, are the windows tinted? How tinted?

The point of this aggressive style of questioning is to create as full of a picture as possible since you never *know* what detail will be the thing that connects to that other small detail from what you thought were completely unrelated people/events… which then opens up your perception to a whole new level of understanding.

This style of follow-up questioning *needs* to be done in trading and investing as well.

It should be applied to your thesis and positioning.

You think X event is going to occur and you have 75% confidence in this scenario playing out.

You need to then ask yourself, *so what?* So what if this does play out, what happens? What do these markets do? How does the Fed respond? How are investors positioned, who's offsides, and how will they react? And on and on…

This is what we try to always do at MO but we dropped the ball big time this year, and unacceptably so. This resulted in a LOT of chips left on the table.

And here I'm talking about how we played the Russian invasion of Ukraine. We called it nearly to the day. We assigned 80% confidence to the call. And yet, how did we position?

Sure, we were long wheat, sitting in high cash, and short the DAX and Qs. But did we size up? Nope... Did we load up on USDRUB? Nope… even though I repeatedly pointed out the opportunity to do so in the days leading up to the event (link here).

This *really* rubs me wrong, because it's just total process failure and laziness. To me, errors of omission in trading are far more painful than errors of commission. I don't mind being wrong if I thought it was a reasonable bet. That's part and parcel of the game.

But I do LOATHE when a big bet comes, I see it, but I don't swing for the fences and fully exploit it. That's just weak sauce and unacceptable because outsized opportunities don't come along too often.

So this is something we've been talking about and are going to work to improve on in our process going forward.

Concluding thoughts…

> *Excellence is an art won by training and habituation. We do not act rightly because we have virtue or excellence, but we rather have those because we have acted rightly. Excellence, then, is not an act, but a habit.* ~ Aristotle

All in all, it's been a decent few months 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 half.

With that said, there's obviously a lot that we can improve upon in our trading. I don't view this as a negative but rather a positive. Our mistakes and shortcomings are opportunities to learn and grow.

Two big areas of focus for the team and me this year are (1) systematization and (2) enhanced filtering.

I'm of the belief that the inbound future will be characterized by *significantly* higher variance and accelerating entropy. This trend towards ever-increasing chaos is being driven by **three unstoppable forces**. We'll be discussing these forces and their implications in-depth in a report coming out later this week.

So what does this mean?

It means a significant increase in noise over signal. As market participants, we're always swimming in a sea of data. This sea is going to become a torrential deluge.

An increasingly important skill will be having high-value filters that separate wheat from chaff, giving us 80% of the info we need to make +EV decisions while cutting out ALL of the rest. Perfection is a pipe dream in this game. It's folly to think otherwise. We want to optimize for good enough, leveraging our system to exploit the environment's inbuilt power laws.

In a world awash in data and information, our focus and attention become incredibly scarce resources. Resources that require iron-clad systems and processes to protect them.

So we are working on building these filters. Tools and heuristics which we'll then share with the community.

Systematization is a part of this. I wrote in a note the other week about how a big project we're currently working on is **regime identification**. This is the idea that you can't know where you're going if you don't know where you stand.

We use this quite effectively with the SQN market regime tool for our swing trading. This is great. But we want to bring market regime identification to all our systems, including our strategic long-term investment portfolio.

We're part of the way there with our Trend Fragility, TL Score, N&N tools, Growth Composite, etc… But this is only scratching the surface of what's possible.

We're building out tools that will then be made available on the HUD. These tools will be used in aggregate to give backtested high-value signals that determine what market regime we're in (sideways vol, high-risk bear, bull quiet, etc…).

Each regime will then have the backtested data on how various markets/assets/sectors perform. We can then take this knowledge as an invaluable contextual input and compare it to the technical picture which all together tells us where to focus our analytical work, our positioning, as well as where to lighten up on risk and turn more defensive.

This is our Big Rock right now and will continue to be going into the end of the year.

I like the idea of forced constraints. They make you think out of the box and approach problem sets differently than you would otherwise. One guiding constraint I'm currently working with is: **what if I could only look at markets end of day, and what if I could only work on markets three days a week**?

What would I need to succeed under this scenario, what tools, what frameworks, etc…

One anecdote that has long stayed with me was when Jesse Livermore told the story about the incredibly successful investor who lived somewhere in the Sierra mountains.

The guy only got the newspaper once every two weeks or something and that was the extent of his information flow. Yet, he somehow managed to turn that information disadvantage into an advantage. And he had decades of outsized returns to show for it.

I have no interest in actually cutting myself off from markets or only working on markets 3-days a week. It's just a thought exercise to spark some hopefully creative solutions that we can bring to our entire approach. I'll be writing and exploring this more in the weeks and months to come.

MO is nearly 7-years old. Honestly, that's hard for me to believe. Years are starting to fly by like months. This time 7-years ago I was full-time at the FBI and working on MO nights and weekends. We had *no idea* what we were doing back then. We were clueless when it came to building a business, copywriting, and building a website.

I really didn't think much would come from it and looked at it more as a hobby and thought it'd be cool if a few retail die-hards signed up. You could say I was a little too conservative in my expectations…

The community we've built is awesome. We have Market Wizards, a few of my personal trading idols, seasoned HF managers, very skilled under-the-radar retail investors, motivated college grads, and everything in between. I think we have the best Collective of hard-charging, maniacally obsessed traders and investors anywhere in the world.

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.

It's a big honor and extremely humbling to have you read our work and we love all the feedback you guys give us. Here's to many more works of trading, learning, and growing alongside y'all!

> *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