May 2022 Update

June 9, 2022 - Commentary

Key Commentary Headlines:

- *Our hedged portfolio delivered its second consecutive month of outperformance to the equity indices we target*
- *Our hedges were a key part of the outperformance as we harvested gains in our hedges and reinvested those gains in our equity portfolio*
- *Our equity portfolio delivered positive returns versus the equity indices that were flat for the month*
- *The strong equity performance is more impressive when you consider that growth stocks were losers for the month in the indices – yet our equity portfolio delivered solid returns*
- *June is off to a solid start with continued outperformance*
- *Earnings season finished and our stocks continue to beat analyst expectations; more importantly, we are starting to see more positive stock price response to strong EPS and Revenue beats*

Greek poet Archilochus: "We don't rise to the level of our expectations, we fall to the level of our training."

James Clear adapted this saying in his best-selling book, ***Atomic Habits***. He changed it to: "You don't rise to the level of your goals. You fall to the level of your systems." We embrace this mantra at Alpha DNA. It means that you must have systems and processes (i.e., habits) that ensure the discipline and effort necessary to succeed. At Alpha DNA, we have made significant investments in our systems and we are disciplined enough to stay true to our rules. Our approach is solidly grounded in a tried and true investment approach: find and invest in companies that are growing at a pace that exceeds Wall Street expectations. Over time, these companies are rewarded disproportionately when compared to their peers.

That discipline and resilience has begun to pay off in recent months. Our portfolio returns have begun to show outperformance for 2+ months now and we credit our systems and our commitment to those systems.

May is the second consecutive month that our hedges and equity portfolio worked in unison to deliver index beating performance. You might recall that April was a big down month for the markets with the S&P 500 down -9% and the Russell 2000 down -10% for the month. These are the two indices we use for our hedges in the Large Cap and Mid-Small cap hedged equity strategies, respectively. Our equity portfolios show high correlation to these indices. In April, our hedges appreciated materially and that helped produce the majority of our outperformance in the month. In addition, our equity portfolios delivered index like returns in April despite high beta and growth exposure which were the relative losers in April.

Those trends continued in May in our favor. We took profits in our hedges around mid-month and reinvested those profits into the equities in the portfolio. This is equivalent to a rebalance of a portfolio in which you sell some of your winners and redeploy those profits to your losers. We realized our profits from our hedges and redeployed the profits into equities. This worked out well because the markets rallied in the back half of the month. This might look like a timing decision but it is not. We showed discipline and followed our rules for taking profits in hedges when markets reverse upwards. We are not forecasting a bottom in the market as the markets could still correct lower. Our criteria was met and we followed our rules. The portfolios remain hedged – but at lower levels of protection.

Remember that quote earlier about relying on your systems and processes? One of our key rules is always taking profits in hedges with material gains. We have a saying we originated at Alpha DNA: “If you own market hedges and you never take profits from your hedges, you are not a hedged strategy. You are a low volatility strategy.” There is a big difference. One positions you for eventual market recovery while the other does not.

While our hedges were helpful in May, our equity portfolios delivered strong returns in the month that exceed the return of the hedges. The equity only portion in our All Cap Hedged Equity strategy delivered +1.9% returns. The Large Cap equity portion delivered +4.6% and the Mid-Small Cap Equity portfolio delivered +0.7%. The broad equity indices were flat for the month with the S&P 500, Russell 2000, and Russell 3000 delivering +0.18%, +0.15%, and -0.13%, respectively. But the divergence in performance by style continues to be stark in the broad markets. Large Cap growth was down -1.36% in May while the Large Cap value index was up +1.64% for the month. In the small cap space (ie, the Russell 2000), the growth index was down -1.89% while the value index was up +1.92% for the month. Given the flat returns for the indices and the modest growth bias that our portfolio shows, we are happy with this month’s results.

So far in June

There have only been 6 trading days in June but the trends continue in our favor – though over a small sample size, of course. We are up +1.3% in the Large Cap Hedged Equity and +1.3% in the Mid-Small Cap Hedged Equity for the month. The All Cap strategy (which combines the two preceding strategies) is up +1.2% thru close on June 8^{th}. Let’s hope this trend continues. In general, our equity portfolio has behaved better since late March. We implemented some modest changes in late March that affect our universe of stocks for consideration in our portfolio. It has proven beneficial.

Earnings season closes strong

The earnings season for firms announcing Q1 results is mostly completed and our results continue to be strong. You should recall that our algorithms are designed to find stocks that have demand for their products that is likely to translate to improved EPS (earnings per share) and revenue results. In particular, we are looking for results that will surprise when compared to the Wall Street analyst consensus. We believe that a portfolio constructed from those stocks will routinely outperform the markets over the long run.

We have had 85 portfolio companies announce earnings since April 1st. We have had 89% of the companies beat the Wall Street consensus for EPS. Over 90% of the companies have either met or beat expectations for revenue which means that only 8 companies had a material miss on revenue expectations. We had 29 companies provide upward guidance on revenue and/or EPS while only 4 companies provided any downside guidance. That is a ratio of more than 7 to 1. We have always said that we would be content with a 2:1 or 3:1 ratio but we have been able to consistently exceed those goals.

For comparison, across the entire universe of the Russell 3000 that we track, the percentage of companies beating on EPS expectations has been close to just 70% and the percentage that beat revenue expectations was just around 72%. Being around 90% for both provides better potential outcomes for our portfolios. Our average EPS beat in size was close to +33% while the average across the Russell 3000 was just +7%.

In addition, we are beginning to see stocks move more around earnings when they announce positive results. Of course, the market dynamics in 2022 have been driven by macro events and policy more than earnings and revenues. We are starting to see more stocks move in earnings as a result of positive surprises like Gitlab (GTLB) which announced last week and was up +25% on its day of earnings. We are optimistic that the markets can deliver more price response for individual stocks because of specific stock related reasons and less price response for macro reasons.

Comparison to Hedged Equity Leaders

Several broad indices are now testing levels we have not seen since pre-Covid. As a result, we think it is important to bring the 2-year returns into our comparisons. We had a solid April because our hedges were productive but our one-year returns are now lagging. However, our 2-year performance is still above our average peer competitor's fund returns. In fact, our 3-year and 4-year returns enjoy an even wider spread when compared to our peers. Given the material exposure to small- & mid-caps and the negative returns of small-cap over the past year, we believe the portfolios have performed admirably. Reach out to us and we'll share with you the analysis. These hedged equity mutual funds are the largest Hedged Equity mutual funds by Assets under management according to Morningstar.

Total Return (%) *As of 5/31/2022*		**May 2022**	**One Year**	**Two Year**
Alpha DNA All Cap Hedged Equity SMA		**2.50**	**-12.65**	**8.58**
Alpha DNA Large Cap Hedged Equity SMA		**3.84**	**-6.06**	**9.89**
Alpha DNA Mid-Small Cap Hedged Equity SMA		**1.42**	**-18.52**	**9.15**
JHQAX	JP Morgan Hedged Equity Fund	-0.08	-4.46	6.91
GATEX	Gateway Fund	-0.56	-3.66	6.41
SDRAX	Swan Defined Risk Fund	-1.30	-1.43	8.47
GTSOX	Glenmede Secured Options Portfolio	-0.86	2.62	13.54
CAHEX	Calamos Hedged Equity Fund	-0.44	-2.86	6.93
	S&P 500 Index	0.18	-0.30	18.28
	Russell 2000 Index	0.15	-16.92	16.93

Source: Morningstar

Performance data quoted represents past performance and is no guarantee of future results. *Current performance may be lower or higher than the performance data quoted. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than original cost. Returns less than one year are not* *annualized. For the most recent standardized performance for the funds, click on the following respective ticker: JHQAX; GATEX; SDRAX; GTSOX; CAHEX.*

These funds were chosen for comparison because they are some of the largest publicly traded funds employing a hedged equity strategy and have at least a five-year track record. We figured, let's compare ourselves to the BIGGEST players in the industry.

PERFORMANCE as of 5/31/2022

Managed Accounts	MTD	Last 3 mo	YTD	1 Year	3 Year	ITD
Alpha DNA Mid-Small Cap Hedged Equity (Net)	1.4%	-8.1%	-18.5%	-18.5%	14.9%	17.7%
Benchmark: Russell 2000	0.2%	-8.7%	-16.6%	-16.9%	9.7%	5.8%

Managed Accounts	MTD	Last 3 mo	YTD	1 Year	3 Year	5 Year	ITD
Alpha DNA Large Cap Hedged Equity (Net)	3.8%	-2.0%	-12.7%	-5.1%	13.1%	13.5%	14.0%
Benchmark: S&P 500	0.2%	-5.2%	-12.8%	-0.3%	16.4%	13.4%	13.3%

Managed Accounts	MTD	Last 3 mo	YTD	1 Year	3 Year	5 Year	ITD
Alpha DNA All Cap Hedged Equity (Net)	2.5%	-6.1%	-15.5%	-12.6%	13.7%	8.1%	6.4%
Benchmark: HFRI Quant Directional	0.2%	-0.8%	-4.5%	4.1%	10.6%	6.8%	6.2%

For all returns covering more than 12 months, the returns are annualized. For the Alpha DNA Large Cap Hedged Equity, the inception date is 3/1/2017. For the Alpha DNA Mid-Small Cap Hedged Equity, the inception date is 1/1/2018.

You can find a summary of our returns below. Please reach out to talk to us about these exciting cutting-edge strategies at (443)-288-6444. Or email us at wayne.ferbert@alphadnaim.com

Disclosures:

Note: Returns are expressed in US Dollars net of fees.
Alpha DNA Investment Management is a registered investment adviser and investment manager that specializes in quant equity strategies. Alpha DNA is a separate accounts manager and all returns expressed herein are solely from the separate accounts business within Alpha DNA.

ALPHA DNA ALL CAP HEDGED EQUITY Composite includes all institutional and retail portfolios that invest in a diversified portfolio of over 50 total U.S. equity positions – either long and/or short. The strategy aims to reduce systematic market risk by identifying the stocks most likely to out-perform other stocks based on changing demand. Risk is further mitigated by implementation in market neutral posture when the research indicates potential for a downward market. The portfolio is designed to find picks that will out-perform the counter-parts. The Internet Advantage Strategies is a series of strategies based on an innovative new research approach; ALPHA tracks the digital Internet footprint of publicly traded companies to find hidden demand trends in the market place. This composite includes all portfolios that were at least 70% dedicated to this strategy. The benchmark is the HFRI Quantitative Directional Equity Hedge Fund Index. The HFRI Quantitative Directional Equity Hedge Fund Index is a subset of the HFRI Equity Hedge Fund Index that measures the aggregate performance of equity hedge funds that employ quantitative strategies that can use long and short equity positions and the portfolio can be positioned net long or net short. HFRI benchmark will always include an estimate from HFRI for the most recent month. The returns are typically finalized by HFRI within one month after the end of the reported month – but can sometimes be revised up to 90 days later by HFRI.

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All investments involve the risk of potential investment losses as well as the potential for investment gains. Prior performance is no guarantee of future results and there can be no assurance, and clients should not assume, that future performance of any of the model portfolios will be comparable to past performance.

These results should not be viewed as indicative of the advisor’s skill. The prior performance figures indicated herein represent portfolio performance for only a short time period, and may not be indicative of the returns or volatility each portfolio will generate over a long time period. The performance presented should also be viewed in the context of the broad market and general economic conditions prevailing during the periods covered by the performance information. The actual results for the comparable periods would also have varied from the presented results based upon the timing of contributions and withdrawals from individual client accounts. The performance figures contained herein should be viewed in the context of the various risk/return profiles and asset allocation methodologies utilized by the asset allocation strategists in developing their model portfolios, and should be accompanied or preceded by the model.

Standard deviation is a measure of the dispersion of a set of data from its mean. The more spread apart the data, the higher the deviation. In finance, standard deviation is applied to the annual rate of return of an investment to measure the investment's volatility.