STENHAM ASSET MANAGEMENT

Q2 2024 Investment Letter

with Kevin Arenson & Tim Beck

Market Commentary

Equities	Q2	YTD
MSCI World (USD)	2.2%	10.8%
MSCI EM (USD)	4.1%	6.1%
S&P 500	3.9%	14.5%
STOXX Europe 600 (USD)	-1.0%	3.4%

Fixed Income	Q2	YTD
FTSE Global Bonds	-1.6%	-4.0%
Investment Grade	-0.5%	-1.2%
High Yield	1.0%	2.3%
Bloomberg Global Agg Bond	-1.1%	-3.2%

Currencies	Q2	YTD
USD (DXY)	1.3%	4.5%
EUR (vs USD)	-0.7%	-3.1%
JPY (vs USD)	-5.9%	-12.4%
GBP (vs USD)	0.2%	-0.9%

Commodities	Q2	YTD
Gold	4.5%	12.7%
Oil (WTI)	-2.0%	13.8%
Natural Gas	47.5%	3.5%
Bloomberg Commodity	1.5%	2.4%

Source: Bloomberg as of 30 Jun 2024

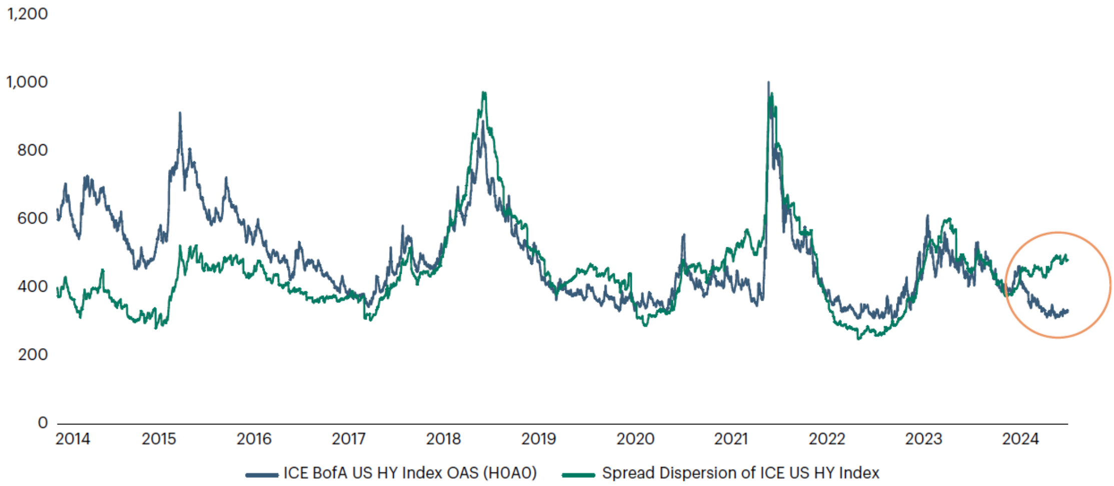
Markets continued to be positive in Q2, though to a lesser extent than Q1 or H2 2023. Risk assets initially came under pressure with a strong March US jobs report, higher-than-expected inflation, as well as concern over escalation of the conflict in the Middle East following a missile and drone attack by Iran on Israel. As these concerns lessened, markets recovered. Equities rose in low single digits globally while high yield spreads widened very marginally and remain tight at 351 bps at end-June. Commodities were mixed, though precious metals continued with strong performance for the year.

One key characteristic of markets has been the divergence in performance drivers within equities and credit. Equities have seen very narrow performance, with much of the YTD gain being led by a handful of mega-cap tech stocks, the so-called Magnificent Seven[1].

Monopolistic/oligopolistic dominance[2]

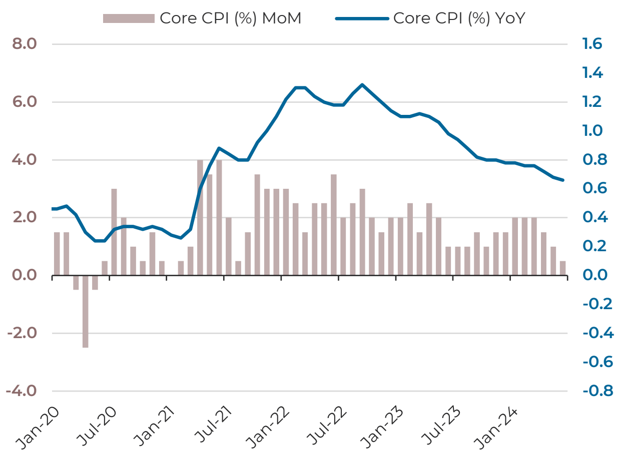
[1] Apple, Amazon, Microsoft, Meta, Nvidia, Google and Tesla.
[2] Source: BofA Global Investment Strategy, Bloomberg.

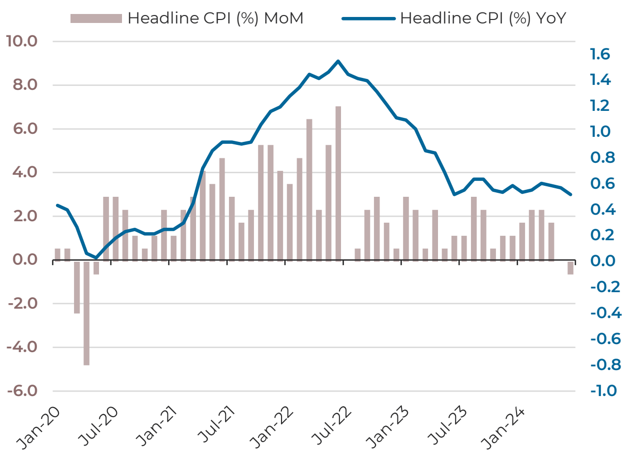
Credit, by contrast, has seen the majority of the market rally dramatically to very tight spread levels, but there is massive dispersion[1] between these higher-quality credits and names where there is a risk or expectation of restructuring, those rated CCC. You have (close to) record tight spreads with an elevated level of distressed debt.



Within credit, there has also been the prevalence of liability management exercises, which are often also seen as creditor on creditor, or perhaps more accurately equity on creditor, violence as equity owners look to take advantage of loose or lack of covenants in debt agreements to move assets to other entities, away from existing creditors, to preserve equity value. In fact, the level of distressed exchanges reached the highest level in Q2 since 2008. Actual defaults remain more constrained, but the change in balance in activity is something likely to remain and an important driver for investment approach.

Q2 saw a steady decline in inflation towards the longer-term target of 2% in developed markets. Central banks have kept interest rates higher than certainly expected at the start of 2024 and this does seem to be having the desired effect of bringing down inflation. Core CPI (which excludes food and energy costs) rose by just 0.1% in June - the lowest level in three years - and the headline CPI rate declined month over month for the first time since 2020.[2]



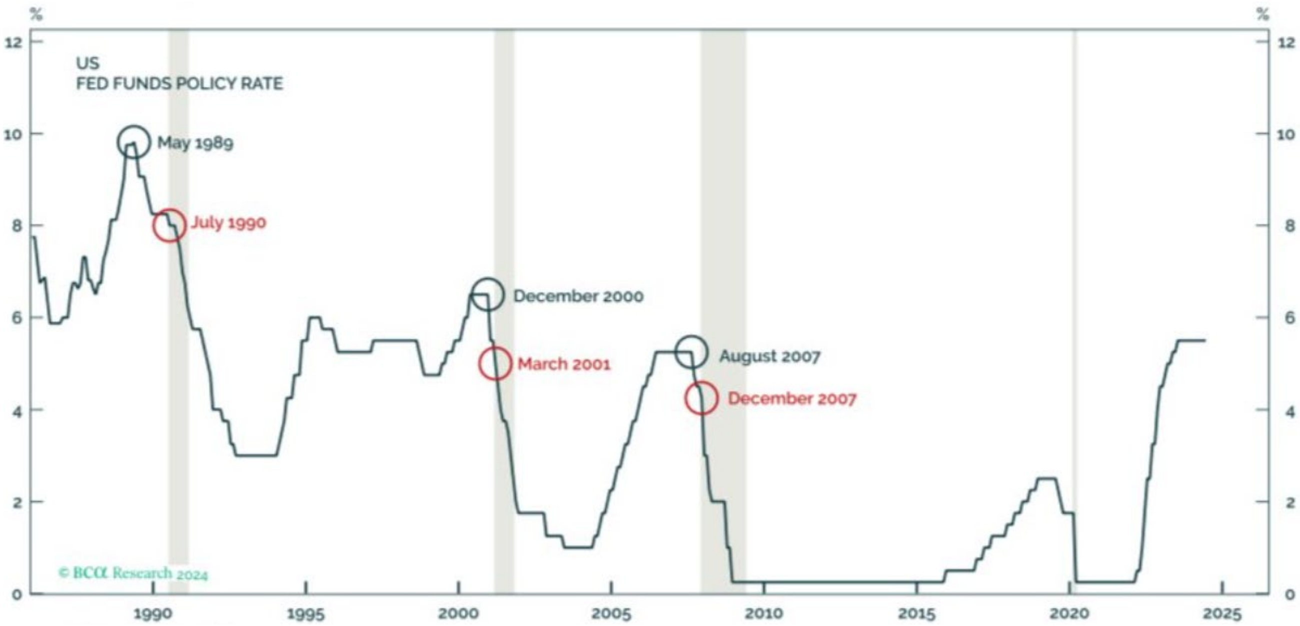


[1] *Dispersion measures the daily, market value-weighted, cross-sectional standard deviation between the option-adjusted spread of the ICE BofA US High Yield Index and the option-adjusted spread of each constituent in the Index. Source: Apollo Global Management.*

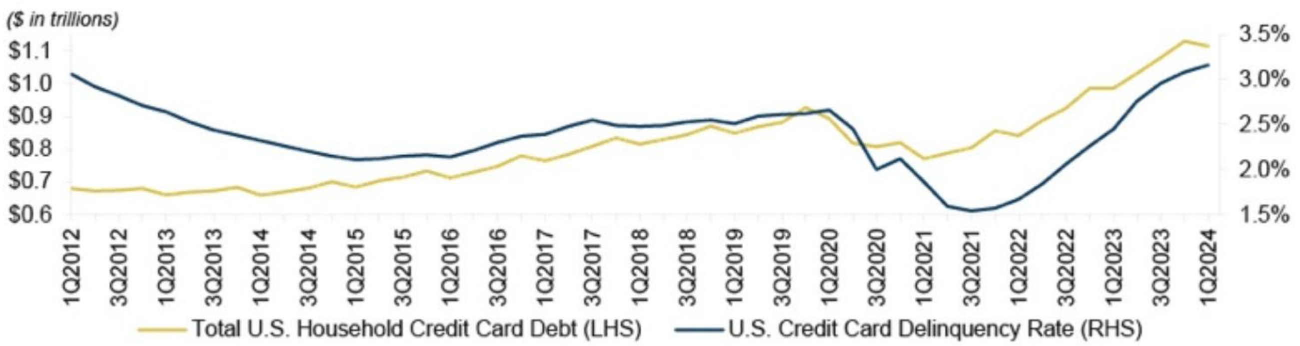
[2] *Source: Bloomberg.*

Much of the decline in inflation has been driven by weaker consumer spending. There has been some weaker data for the US economy, but nothing yet to really indicate a pending recession; Q2 growth in the US came in better than expected at 2.8% annualised. Recessions typically occur when corporates and/or consumers reduce spending and investment. Nominal consumer spending has reduced from 5% to 4%, slightly below the pre-Covid average and the principal driver for the lower GDP growth in 2024 compared with 2023. Combined with higher defaults on unsecured consumer debt, the question is whether the trend of a weaker consumer continues; consensus is that it will not result in recession with Bloomberg data showing that economists are predicting a 30% and 20% chance of a recession in the US and Europe respectively within the next twelve months, down significantly since February. There are some warning signs, as well as history, of a recession occurring soon after the first rate cut by central banks.

Recessions often start not long after the Fed begins cutting rates[1]



US credit card debt and delinquencies have not been this high in over a decade[2]



Events in the weeks after Q2 were in many ways more significant and eventful than the quarter itself, and really quite extraordinary. Most obviously, the assassination attempt on Donald Trump at a Republican Party

[1] *Shaded areas denote NBER-designated recessions. Source: Federal Reserve, BCα Research.*
[2] *Source: Federal Reserve Bank of New York as of 31 Mar 2024.*

rally, followed soon after by the withdrawal of Joe Biden as the Democratic Party candidate following intense pressure from senior Democratic Party members after what would (favourably) be called an unimpressive performance in the presidential debate. The UK also saw a general election and a change in government, with the Labour Party winning a strong majority (albeit on a popular vote of 34%) while in France, the parliamentary elections saw a lower-than-expected vote share for far-right parties, with a left-wing coalition winning the largest share of votes, though short of a majority. No government has yet been formed and it is unclear what form it would take and how stable it would be.

The US election will feature highly for the rest of the year. As seen by the events in only the last two weeks, we would hesitate to have any strong level of conviction in the outcome. If writing this just one month ago following Trump being the first former US president to be found guilty in a criminal trial, the expectations would have been different. In the wake of a failed assassination, opinion polls showed a high likelihood of Trump's victory against any potential Democratic candidates, though they have now narrowed significantly with Kamala Harris experiencing a polling bump since emerging as the Democratic frontrunner.

Our outlook remains consistent with prior quarters. We believe we are potentially seeing too much exuberance in markets given the risks and uncertainty that exists. That said, there are strong investment opportunities which our underlying managers are identifying and in which we are investing which are largely independent of market direction.

Strategy Allocations

We maintain limited directionality across our core portfolios. We feel this is the best way to navigate an uncertain environment. Our portfolios are designed and aiming to deliver high single-digit annualised returns in this environment with limited equity, credit or fixed income beta, which we feel is a compelling offering. We have been successful in, and continue to work hard to, securing access with the highest-quality managers, especially where capacity is constrained; this can be in new launches or with established managers.

Discretionary and Systematic Global Macro

Discretionary macro strategies were profitable during the quarter, but there was dispersion in manager performance. Our top contributors include two thematic directional managers, one of whom was positioned for weakness in the Japanese yen and the Chinese renminbi against the US dollar. The other manager has generated strong gains all year with a view that US rates will remain higher than global rates and curves will steepen. This manager has also held a long US dollar and long US equities bias. Two of our Asia-focused managers also had a good quarter with diverse gains, including paid positions in Japanese rates, shorts in China currency and rate flatteners in Australia. Our main detractor was a multi-strategy macro manager who saw losses across their macro trading and event related strategies.

Relative value managers had a quiet quarter, but were positive overall. For much of this year there has been a muted opportunity in fixed income relative value strategies. Plentiful balance sheets have made spreads tight. There were signs of more volatility in repo financing as the quarter drew to a close. Volatility in European fixed income also picked up around the surprise calling of French elections. Increased volatility suggests a better opportunity set for these strategies in the second half of the year.

Quantitative strategies were mixed with dispersion across statistical arbitrage managers. One manager focused on liquidity provision struggled particularly during the month of May. In general, May was a difficult month for these strategies, but we saw a good recovery into June.

Commodities were modestly profitable with gains from metals and European gas trading.

Our long volatility hedge was profitable as we saw volatility pick up in April, in particular across interest rates and currencies. Volatilities finished the quarter at an extremely low level, particularly in equities and currencies, thus offering good asymmetry.

Equity Long/Short

Our allocation to equity long/short managers collectively made a positive contribution to performance through Q2.

Equity markets were generally positive, though market performance was relatively narrow, led by the Magnificent Seven mega-cap tech stocks. The S&P 500, which is market-cap weighted and therefore skewed by the performance of the largest companies, rose by 3.9%. In contrast, the equal-weighted S&P 500, which is more reflective of the average stock in the index, declined by 3.1%.

Directional managers performed well, particularly those with exposure to major market themes such as AI growth, data centre buildout, grid electrification and the rise of obesity drugs. Pleasingly, our allocation to more hedged strategies also delivered strong results, with the top contributor being a large investment in a multi-manager platform strategy.

We have a diverse range of managers who are well positioned to capitalise on some of the megatrends driving markets. One of these themes is a rise in global power demand driven by the demand for AI and associated data centre buildout. Two of our specialist managers focused on utilities and infrastructure have a deep understanding of power markets across Europe and the US, and are well placed to identify the likely winners and losers from this theme. Additionally, our healthcare managers possess the knowledge to identify companies which are likely to benefit both positively and negatively from the enormous investments being made into weight loss drugs.

Most of our capital remains allocated to equity long/short strategies that we believe can generate positive P&L regardless of market direction. However, we are also comfortable taking more directional exposure in parts of the market where managers with niche expertise can generate outsized alpha, such as biotechnology.

There have not been any major changes to our positioning, but we continue to opportunistically assess new areas which we believe offer attractive returns and alpha. We are currently conducting research on a group of US financials-focused hedge funds.

Event Driven

Our event driven allocation was positive in Q2, with reasonable performance overall, consistent with achieving mid- to high-single digits. As would be expected, our lower-risk manager generated stable returns and now has achieved over 18 months of positive monthly performance. This manager has steadily increased the level of exposure during the quarter, which should benefit future performance. Importantly, more opportunities have been found in fixed income securities than in prior quarters as companies with debt (which would need refinancing) became incrementally more acceptable to being purchased. Our higher-risk manager saw more volatile, though still positive, performance as spreads moved on news surrounding large deals such as Nippon Steel's offer for US Steel and Exxon's offer for Pioneer Natural Resources. This manager retains a high level of investment.

Credit

Our credit allocation performed well in Q2. Importantly, even during brief bouts of volatility and spread widening, the allocation generated returns. There were a number of opportunities set up from events in Q1 which helped drive returns; often these were the result of liability management exercises and the provision of credit to the new entity. Our convertible bond manager performed well and continues to find strong opportunities through new issuance and refinancings, where we see increasing activity given the lower spread on convertible bonds compared with straight debt.

Our managers have decreased both net and gross exposure as spreads have continued to tighten. However, they remain invested and are identifying a number of catalyst-driven opportunities; with the increase in default rates and the impending maturities over 2-4 years, we think there will continue to be a very strong opportunity in long/short credit.

Summary

Our outlook remains consistent with prior quarters. We believe we are potentially seeing too much exuberance in markets given the risks and uncertainty that exists. We maintain limited directionality across our core portfolios with our underlying managers identifying strong investment opportunities which are largely independent of market direction. Our portfolios are designed and aiming to deliver high single-digit annualised returns in this environment with limited equity, credit or fixed income beta, which we feel is a compelling offering.

We are pleased to announce the launch of two new funds:

Stenham Tail Risk Solution will launch on 1 September. This is a commingled vehicle investing in hedge funds comprising long volatility and short credit strategies. The managers offer different styles of trading and complementary asset class expertise. The objective is to generate strong performance at times of market stress.

Stenham Credit Income Fund will launch on 1 October. This is a commingled vehicle investing primarily in funds which provide directly originated loans to corporates. These loans will largely be 1st lien, top of the capital structure, highly diversified and we feel the prospective returns (9-11% p.a.) relative to the risk taken is very attractive.

To learn more about these offerings, please contact your usual Stenham representative.

Thank you for your ongoing confidence. Please get in touch if you would like to hear more about our other strategies or funds as well.

Kevin Arenson
Chief Investment Officer

Tim Beck
Senior Investment Executive

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