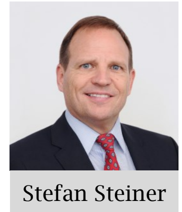
Crossbow Partners
Experience & Discipline

Market Update April 2024

Passive - Active - Absolute

Passive investment strategies have experienced a huge boom in recent years. The success was based on good stock markets and low fees. We wrote in our last newsletter that, in our view, the stock markets have achieved excess returns in recent years compared to the fundamental development of the global economy and that this will decrease over the next few years, which could result in a correction or a longer sideways market . In this scenario, index products are not interesting because there is no return over a long period of time, as we saw after similar valuations in the late 1990s or before the global financial crisis in 2008. In 2022, the volume of index products fell for the first time in years due to weak performance. This will again happen if investors are dissatisfied with the returns and make redemptions. This leads to the sales of the underlying securities and thus to continuous pressure on the returns of passive products, such as ETFs.

We would not recommend switching from passive long-only to active long-only products because this hardly changes anything. Many active products have such narrow investment guidelines that they are still very close to the index, but charge higher fees, which ultimately does not help the return. We would go one step further and select products that have an absolute return target and do not want to track an index.


Stefan Steiner

These managers are completely free to choose their investments and only buy what will achieve a higher valuation within a reasonable period of time. Managers can also use futures to hedge their portfolios against market corrections or sell short individual securities where they expect lower valuations. This approach focuses on generating alpha and is therefore largely independent of stock market developments.

Absolute oriented investment products – and this includes hedge funds – work particularly well in markets that move sideways for a long time because in such an environment, without market stress, managers have the opportunity to generate an attractive alpha on the long and short sides of the portfolio.

The following “In the spotlight” section shows the benefits of the absolute investment strategy achieved with the CB Greater China Portfolio (USD). Page 2 of the newsletter shows that the risk in technology ETFs is greater than expected and what a possible addition could be.

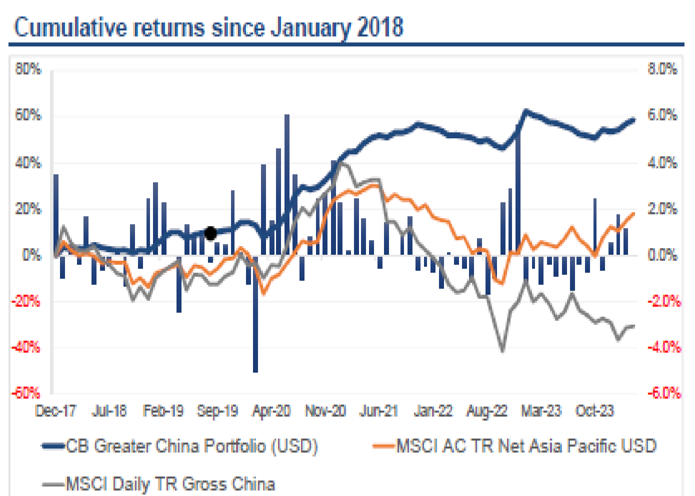
For more information please contact ss@cb-partners.com.

In the spotlight

The Chinese stock market has lost -60% over the past three years since its peak in February 2021. This is more than the Western markets lost in the great financial crisis of 2008-2009. It started with the real estate crisis in China, which ended in the bankruptcy of most construction companies, but also the Covid lockdown, which never wanted to end, and finally the solidarity with Russia in the war against Ukraine, which deterred investors, had a very negative impact.

The market has stabilized since the beginning of 2024 and we expect a slow but steady recovery accompanied by economic policy measures because growth and employment are vital for the Chinese Communist Party. The CB Greater China Portfolio (USD) has retained capital during this difficult phase and will now take advantage of the opportunities presented by the market distortions of recent years. After the portfolio was very market-neutral, two new managers were recently integrated who make somewhat more aggressive bets. The goal is a double-digit positive return in 2024. If the market suffers another setback, the hedging is aimed at preserving capital, as it worked well from 2021-2023.

The chart below shows the result of the certificate in blue versus the Chinese equity market in gray.

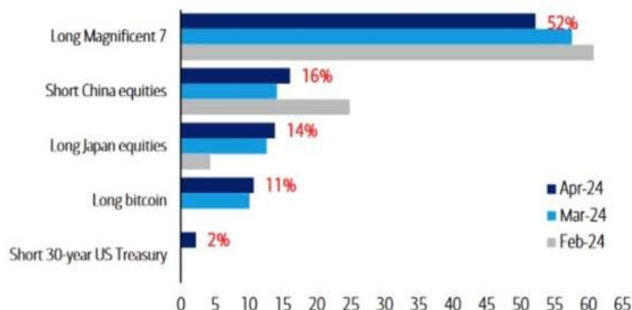


TMTC Fund Opportunity

Since the US Fed's pivot late last year, risk assets and specifically equities have rallied strongly across the globe, reaching all-time highs in various countries. By pivoting at the FOMC meeting in November – by not hiking to 5.75% and instead indicating cuts would come next in 2024 – the Fed engineered a loosening and essentially pulled interest rates across the curve down into the low-mid 4% levels. This sparked a significant equity market rally. Since late October, the S&P 500 Return Index gained almost 30%, whereas the Nasdaq 100 Index rallied 30%, with both indexes reaching all-time highs.

Dominance of the Magnificent 7

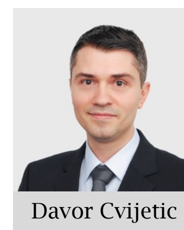
A large part of the index gains can be attributed to the strong comeback of the "Magnificent 7". This group consists of major players like Apple, Microsoft, Amazon, Google, NVIDIA, Meta, and Tesla, which have shown substantial growth and profitability compared to the broader market, based on their leadership in AI and other technological advancements. However, the significant weighting of the Magnificent 7 in the S&P 500 poses considerable risks. Such heavy concentration can increase market volatility and risk, as the index becomes overly reliant on the performance of these few stocks. This concern is underscored by the most recent BofA Global Fund Manager Survey, where "Long Magnificent 7" has remained by far the most crowded trade.



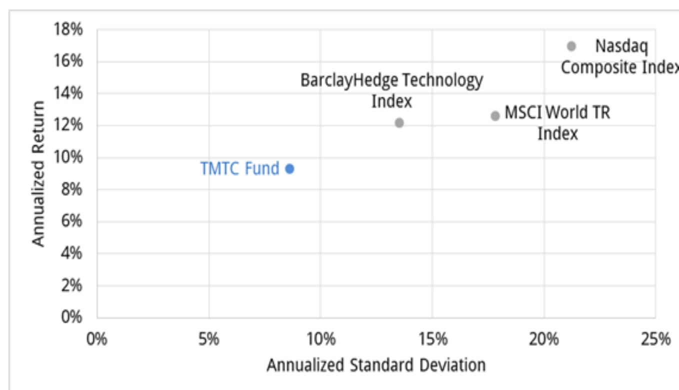
Source: BofA Global Research

TMTC Sector Specialist

Given the current high valuations and heavy weighting of the Magnificent 7 in the index, paired with the crowdedness in those names, shifting some gains from these equities into a diversified technology and consumer fund ("TMTC Fund") with lower net exposures is recommended. The TMTC Fund is run by a very experienced PM, has live returns since beginning of 2019 and delivered strong risk-adjusted returns since then. Compared to the traditional indexes, the fund had much lower drawdowns.



Davor Cvijetic



Source: Crossbow Partners, Bloomberg

This fund is managed by a team of specialists in the technology, media, telecommunications and consumer sectors. The portfolio consists of long alpha and short alpha positions with a net exposure below 20% on average. The manager usually expresses 15-18 themes in the portfolio made up of sub-books each containing 2-3 long and 5-6 short positions. The strategy focuses on targeting undervalued companies or businesses experiencing secular changes, undergoing strategic pivots, or at inflection points in their earnings. Specific themes where the fund is involved include consumer/ leisure, internet, payments, media, and software. The consumer sector, for example, is poised for growth, driven by real wage growth outpacing inflation which enhances spending power. Additionally, a labor shortage in the US is expected to maintain upward pressure on wages, supporting consumer spending. To address labor shortages, companies are likely to increase investments in automation and other technologies. These trends will benefit select consumer-facing and tech companies.

Amidst the recent run-up and crowdedness of the tech sector, we recommend investors to consider reallocating some of the gains to an experienced sector specialist with an actively managed strategy that is focused on identifying winners and losers in the TMTC space.

For more information please contact Davor Cvijetic at dc@cb-partners.com.

Unexceptional Endowment Performance

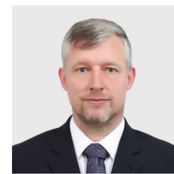
Richard M. Ennis looked into the realized performance of Endowments ("Unexceptional Endowment Performance"). Conventional wisdom has it that the investment offices of leading universities are exceptional in the realm of institutional investing. Siegel (2021), for example, provides a fulsome account of what he sees as their competitive advantages. He concludes, "Endowment funds have...structural advantages...that should allow them to earn above-market risk-adjusted returns in the long run." Is endowment exceptionalism real? Is it myth? A little of both?

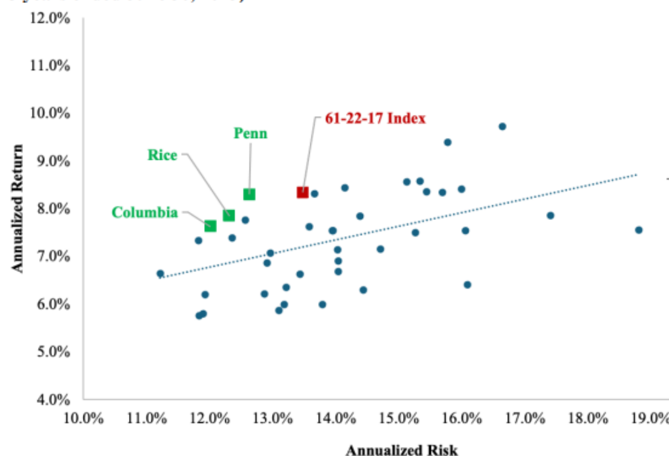
Ennis examine the performance of a sample of 41 large US endowments over the 15 fiscal years, 2009 -2023. First, he analyzes a composite (equal-weighted average) of their returns, and then he analyzes individual fund returns. In both cases, he creates customized benchmarks using quadratic programming, a technique that statistically fits broad market indexes to the subject return series to form a hybrid index. The market indexes are Russell 3000 stocks, MSCI ACWI ex-US stocks (hedged) and Bloomberg Barclays US Aggregate bonds. The resulting benchmark weights for the composite are 61%, 22% and 17%, respectively. No combination of broad market indexes has a better statistical fit with the subject return series.

Excess Return of Endowment Composite

Fiscal Year	Composite Return	Benchmark Return	Excess Return
2009	-20.7%	-20.1	-0.6
2010	11.8	13.8	-2.0
2011	20.2	23.4	-3.2
2012	1.5	1.7	-0.2
2013	12.0	16.8	-4.8
2014	17.3	19.8	-2.5
2015	6.2	6.6	-0.5
2016	-1.6	0.3	-1.9
2017	13.2	16.0	-2.8
2018	10.9	10.8	0.1
2019	6.5	7.7	-1.2
2020	4.0	5.2	-1.2
2021	42.4	33.4	9.0
2022	-4.3	-12.5	8.2
2023	3.7	14.7	-10.9
Annualized	**7.4%**	**8.3%**	**-0.9%**

The table compares composite returns and those of the benchmark. The difference between the two is excess return. Annualized excess return is -0.9% for the 15 years. For the first 12 years, excess return averages about -1.7% per year within a narrow range. The 2021 return reflects a sharp gain for venture capital, which didn't last long. The composite returns of 2022 and 2023 exhibit return smoothing caused by lags in reporting net asset values of private assets. Notwithstanding the return smoothing, which muddies the waters in the latter years, the composite registered a cumulative loss relative to benchmark of 13% for the study period and underperformance in 12 of 15 years.


Armin Vogel



Investor Demand Trends for Alternative Investment Strategies

Agecroft Partners compared the answers from investors from their 2022 cap intro event with data recently compiled from the Global Virtual Cap intro 2024 event. The three strategies that saw the largest increase in demand:

1. Equity market neutral increased by 16% due to investor concerns about equity valuations and favorable conditions for stock selection.
2. Fixed Income/long short credit increased by 11% due to significantly higher interest rates.
3. Other diversifying strategies increased by 26% which demonstrates that investors are broadly open to any strategy that will help diversify their portfolio away from the capital markets.

Strategies that saw the biggest decline in demand include Cleantech/ESG/Impact Investing and Cryptocurrencies. Both saw a complete reversal compared to their historical trends, but should be interpreted differently based on real-world investment flows.

If you would like to receive the above mentioned papers, please contact Armin Vogel at av@cb-partners.com.