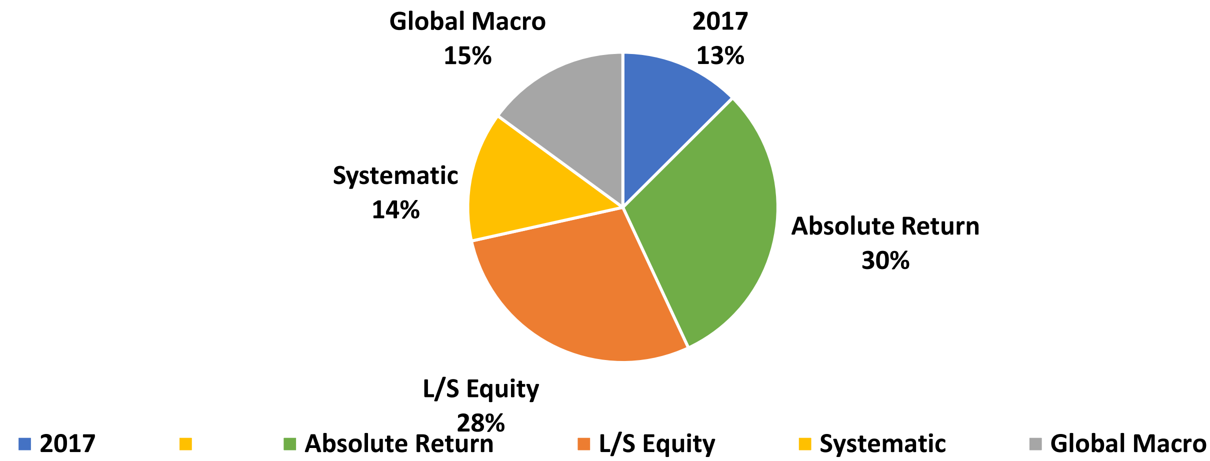
Strategy Series - Long/Short Equity (Part 1)

Alpha Diversified Fund - Positioning 7/31/2022



Long/Short Equity Discussion

To say this has been a challenging year for investors would be an understatement. What is particularly rare about this year is the fact that traditional diversification options haven't worked. Diversifiers such as 60/40 equity/bond portfolios, new assets like cryptocurrencies, and defensive assets such as consumer staples, utilities, real estate, and even gold failed to protect investors from losses. The situation is like those in 2008, with global financial crises, and in early 2020, with Covid-19 lockdowns that led to a liquidity shock and financial market meltdown. In a challenging market environment like the one we are in, long-short equity can be a successful source of diversification. Long-short equity strategy can lower the volatility, preserve investor capital, and generate positive returns in both bull and bear markets.

So, what exactly is Long-Short equity? It is an investing strategy in which a manager takes long positions in stocks that are expected to appreciate and short positions in stocks that are expected to decline. The aim is to minimize market exposure and profit from stock gains in long positions and price declines in short positions. Typically, long-short equity investing is based on bottom-up, fundamental analyses of an individual company in which investment is made. These fundamental analyses often accompany a top-down analysis of opportunities and risks associated with broader sectors and industries. The long-short covers a wide range of strategies, and a manager can focus on a particular sector, a category such as large-cap & small-cap, growth, or value. Most investors fear volatility associated with equity investing. A fund manager using long-short equity avoids volatility by hedging positions across industries, individual regions, and market capitalization bands. The approach is also used to hedge against un-diversifiable market risk.

The stock market tends to go up over long periods; therefore, it makes sense for investors to incorporate long-short equity into their overall investment strategy. Furthermore, the goal for an astute investor is to find managers who earn their fees by generating alpha over owning the S&P 500. Most managers fail; therefore, finding the diamond in the rough is crucial. So, what differentiates a successful long-shot equity manager from a mediocre one? A successful manager in my opinion can fall into one or all of the following categories:

Is smarter than the rest and sees the world differently positioning accordingly
Establishes and leverages better processes to identify opportunities
Possess special knowledge in his area of expertise

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Gary Lehrman from Wolf Hill Capital is one such manager who has delivered alpha during these times of turmoil. Not only has his fund been able to preserve investor capital, but it has also made significant gains. S&P 500, in comparison, is down 12.6% (YTD)

Wolf Hill Capital's portfolio comprises 25-30 high conviction long and short ideas and is managed with relatively low net exposure. The fund focuses on mostly overlooked small to mid-sized companies and has developed an information edge over the years. The fund avoids over-diversification by limiting to 15-20 long and 10-15 short positions, in line with research findings that over-diversification leads to subpar performance. Wolf Hill Capital relies on an extensive fundamental research process and has compounded at approximately 29%/year, net of fees, since its inception in 2017. The fund maintains a portfolio with low correlations with global equity indices and hedge fund benchmarks.

	Jan	Feb	Mar	April	May	June	July	Wolf Hill (YTD)	S&P 500 (YTD)
2022	0.1%	1.6%	-1.3%	0.6%	2.2	-5.8	9.8	6.78%	-12.6%

To conclude, prudent investors should consider long-short equity in their portfolio not only for diversification but also for the potential to generate positive returns during all market cycles, including the rare one we are in.

If you would like to learn more about the Alpha Diversified Fund and discuss exposure to the long-short equity investment category, please reach out to Mark Kress at 415-290-7164 or mkress@alphawealthfunds.com

I would like to acknowledge Ravinder Singh of Victoria University's contribution to this article.