We are pleased to report that the Discretionary Global Macro Program generated +41.8%, net of fees, in 2020. December proved to be a challenging month with a -2.5% return. All in all, we believe the year's performance validates our strategy of disciplined trading within a fundamental framework.

Focus on the big picture

Fundamentals are critical and represent trends that play out over years and even decades. We place many trades throughout the year, some of which follow themes that provide a baseline that we use to anchor our portfolio positioning. Here are the fundamental themes driving our longer-term positioning as we enter 2021:

- Equities hitting a "1999 style" final melt up to end the secular bull market that began in 2009. Could last another 3 months or 3 years but ends with bear markets in stocks and a sideways churn for a decade to work off the excess.

- Bull market in precious metals this decade, as the monetary system is re-set, due to Fed money printing and a slow return of inflation. The last re-set was in 1971 under Nixon – this decade is the fulcrum for the next re-set. Gold and silver will be in structural bull markets throughout the decade.

- Bear market in the US dollar, as the Fed becomes easier (at the margin) with monetary policy than other central banks.

- Bull market in copper and many other commodities in the years ahead, as electric vehicle adoption curves and inadequate supply from a decade of underinvestment in commodity production catches up.

- Broad sideways churn for a few years in long-term interest rates before the next multi-decade structural bear market takes hold. For those of you who are firmly in the secular stagnation camp due to debt and demographics, just picture a Fed balance sheet of $40-50 trillion at the end of the decade. Fiat debt can be wiped away. It's just a matter of political will. Insane? We think not.

Of course, we often trade against these themes when they get overextended. Sometimes we are correct, as when we shorted the euro in late summer 2020 after the short US dollar theme became too overextended. Sometimes we are wrong, as we have been lately in attempting to short grain markets based on what also seemed to be overextended trends without adequate fundamentals behind them. We expected weaker Chinese demand to drive grains lower, but the supply side of the market is much tighter than we believed. You never really understand all the fundamentals that drive a market until after the fact; hindsight is 20/20 and not something we waste our precious energy on.

Trading futures involves substantial risk of loss and is not suitable for all investors.
Past performance is not necessarily indicative of future results.

Psychology: our actual business

Potential allocators to our strategy tend to spend 80% of the time in a meeting discussing our research and fundamental analysis as outlined above. It's human nature to want to understand the markets and understand the process by which a manager allocates capital. The reality of investing in publicly listed markets – whether macro, equity long/short, or otherwise – is the following:

- 10% of the business is fundamental analysis and research
- 10% of the business involves understanding the technical makeup of the market, including flows and sentiment
- 80% of the business is managing our own (i.e. the portfolio manager's) psychology

This is a difficult concept to internalize. The numbers in the three bullet points above may vary from person to person, but the broad point will be the same. Success over time is almost exclusively the purview of how you manage your own psychology, and much less about how well you do research or time your trade entries into a particular stock or commodity. To understand why, we'll take a quick detour into the philosophy behind our approach.

Philosophy

Let's dig a little deeper into the philosophy behind managing money in a liquid strategy. Although we firmly believe that the higher-level points here apply to all strategies, including equity and credit strategies, these comments are personal to our approach.

Over time, we know that we lose on ~60% of our individual trades, win on ~40%, and have a positive profitability expectancy over time since our winners are much larger than our losers. These numbers have held up consistently over both our full six-year track record and in each individual year. Here are some immutable facts that spring from this:

Losing money on half or more of your trades is a necessity in order to compound capital in the long-term. Why can't we smooth things out more and try to deliver an 80% or 90% win rate on our trades with more shallow retracements during our drawdowns? We cannot do that because it violates the power law nature of markets. When trading liquid markets, you are exploiting the herd behavior of other participants. Markets make extreme moves, and our job is to risk a dollar to make 5 or 10 dollars on our best ideas. 10% of our trades will account for 90% of our profits. This is the same for almost every successful money manager in history. Given that most of our losing trades are profitable at some point, even if for only a brief hour or day or two, before they are closed at a loss at our stop loss point, we could, in theory, raise our "hit rate" by closing these trades out when they are in a profit. What would this lead to? It would lead to a guaranteed higher level of short-term peace of mind, both for us and for our clients. It would also lead to us compounding capital at 2-4% per year, or possibly negative 2-4% per year, instead of at 20%+.

We've written about this phenomenon in the past but it's so important that it is worth re-stating in this year-end letter. To compound capital at a high rate, we will inevitably have more losing than winning individual trades, to allow those winners that create multiples of their initial risk to flower. This means that in any given year, we should be expected to have 3 or 4 large up months, 2-3 smaller but still noticeable down months, and 5-6 months of treading water, where little happens. In a normal year this may mean we have 6 months of negative returns. By applying basic

Trading futures involves substantial risk of loss and is not suitable for all investors.
Past performance is not necessarily indicative of future results.

math and knowing that streaks occur in any game (flipping a coin and counting heads or tails) or business (hedge fund returns) that is driven by probability and statistics (chance, in layman's terms), we will have streaks of down months. These streaks are drawdowns. They are unavoidable. They are the cost of compounding capital.

Back to psychology

We spend about 3-4 hours of each day reading research reports so that we can formulate our own opinions on the markets. We spend 30-60 minutes each night reviewing our charts and deciding whether to make changes to our portfolio. This is the same process that we've followed since starting our business in 2014. We explain this in every conversation that we have with prospective allocators. It leads to questions and inevitably takes up a large portion of each call.

And yet we feel that the more important topic to discuss and the factor that really drives our performance over time, is our personal psychology and our ability to navigate the tough times physically and mentally. Closing out an amazing winning trade after 2 months is wonderful. Anyone can do it. The traders who today are posting 300% returns from their accounts on Twitter from holding tech stocks are no different than the traders who did so in 1999 or those who did so in the "bucket shops" at the turn of the century over a hundred years ago (except that they didn't use Twitter to post in the latter two cases!). The real reason so few hedge funds put together a 10-year track record, let alone a 20 or 30-year record is that this approach is a losing game from an emotional and psychological perspective. You are losing money on most trades, on most days, and net of all else, as the years grind on, managing money is a negative business from a human psychology standpoint. In fact, it may be the only business that requires that you harm your psychological well-being to be successful.

We love our jobs and love this business. As we think about the next decade and about growing our business, we must make sure we spend the majority of our time managing our psychology and honing our resiliency.

We would also ask that everyone following us try to disregard the daily and monthly returns. We do not manage our portfolio to these timeframes. With a focus on annualized performance, we feel that you will be a very satisfied investor with AG Capital over a long period of time.

Wishing everyone a healthy start to 2021,
AG Capital

Trading futures involves substantial risk of loss and is not suitable for all investors.
Past performance is not necessarily indicative of future results.