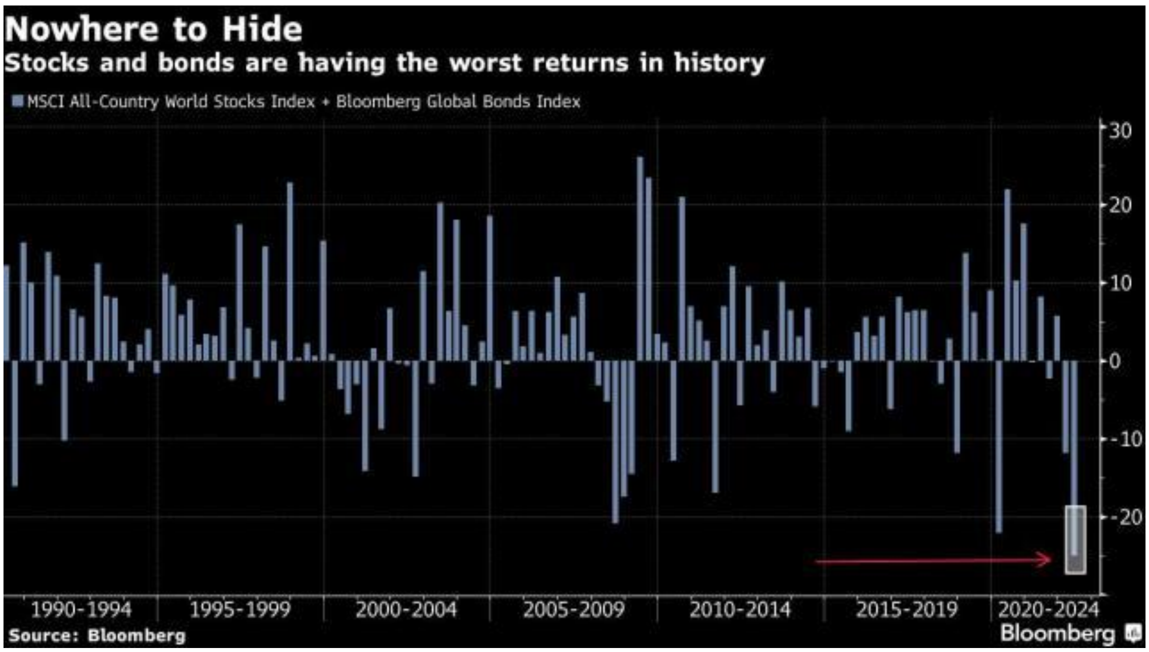
ABR Dynamic Funds – 1H 2022 Newsletter

<u>Market recap</u>

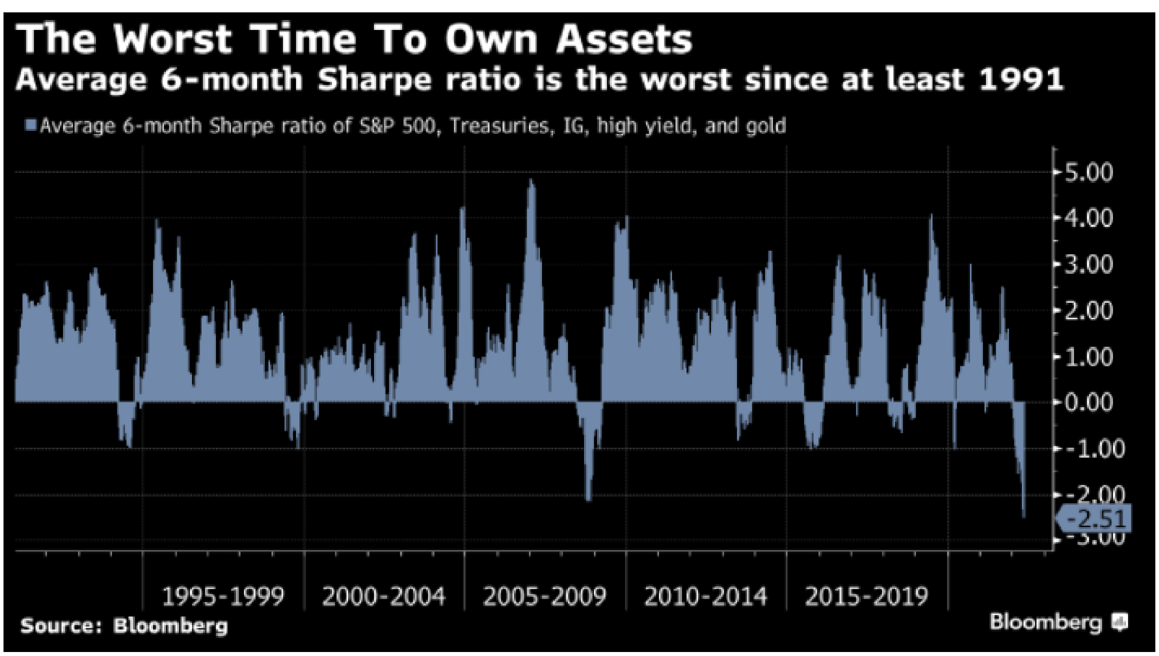
Every investor is already painfully aware of that fact that 2022 has been a terrible time, so this section will be just 3 quick charts before turning to volatility.

Stocks and bonds are down together and more than usual, especially in the case of bonds. The following chart from Bloomberg shows the quarterly returns of a portfolio of global stocks and global bonds. Second quarter has been the worst in 30+ years.



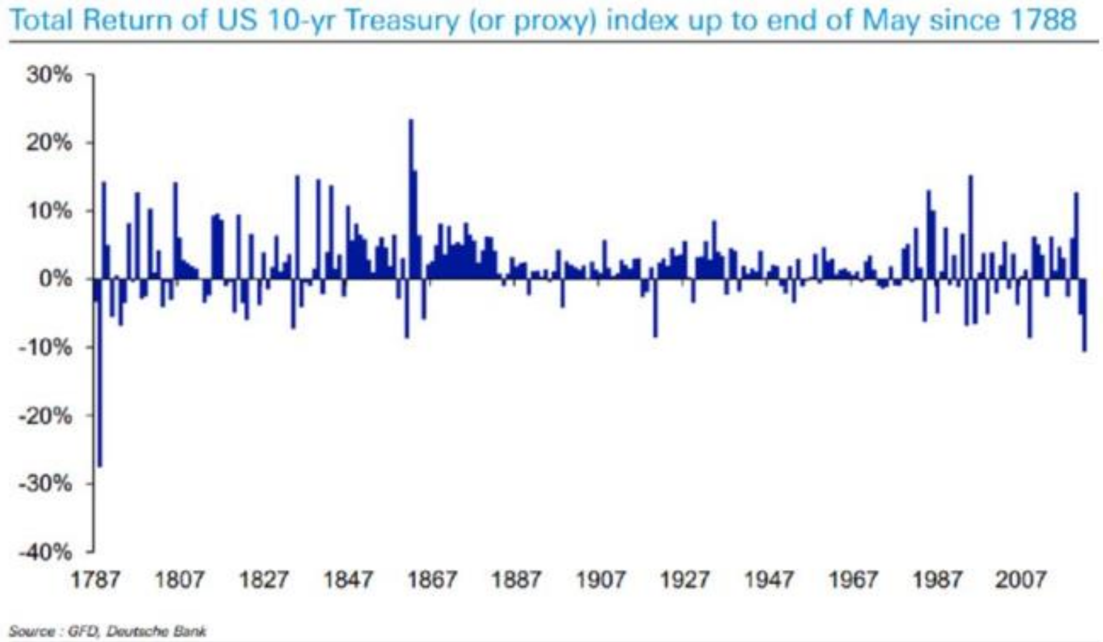
Q2 2022 intra-quarter data

Aside from some commodities, there has been little help to be found. The following chart from Bloomberg shows the average of the 6-month Sharpe ratios of the S&P 500, treasuries, investment grade bonds, high yield bonds, and gold. The most recent figure is the worst since at least 1991.



Q2 2022 intra-quarter data

In fact, some things have lost to an historically noteworthy extent. The following chart from Bloomberg (and GFD) shows the annual returns of the US 10-year treasury index, including proxies and estimates determined and compiled by GFD, since 1787. 1788 was the last year that was worse than 2022, according to GFD.

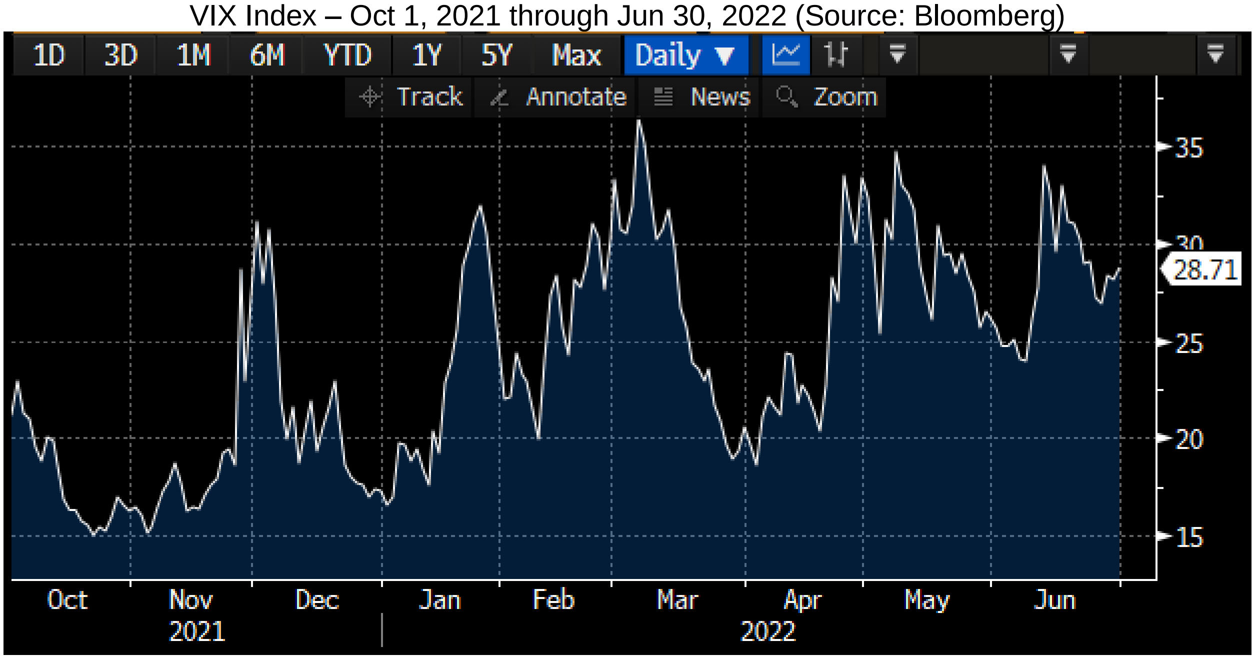


Source: Bloomberg

We think volatility, especially viewed together with equities, has been comparably unusual.

The S&P 500 has neither sold off with conviction and panic, such as in 2008 or 2020, nor has it sustained a rally, such as in 2013, 2021, etc. The effect on volatility has been unusual, to say the least. Volatility has been only moderately elevated and has undergone numerous rapid reversals.

VIX Index – Oct 1, 2021 through Jun 30, 2022 (Source: Bloomberg)



The VIX Index has risen above 30 a total of 9 times this year, the most in any 6-month period over the full history of the VIX since 1990. However, the VIX has not climbed meaningfully higher than that nor dropped to its usual lower levels.

In fact, over its full history since 1990, the VIX Index has spent nearly half the time below the lowest value recorded this year, and yet the VIX has not even climbed as high as 37 this year. **In other words, based on volatility, there have been no calm bull markets, and no major volatility crises (marked, in part, by large and sustained uptrends in volatility) this year, *even when viewed with the granularity of daily data*.** It's been only repeated turning points.

Percentage of time VIX Index closed between 20 and 35:

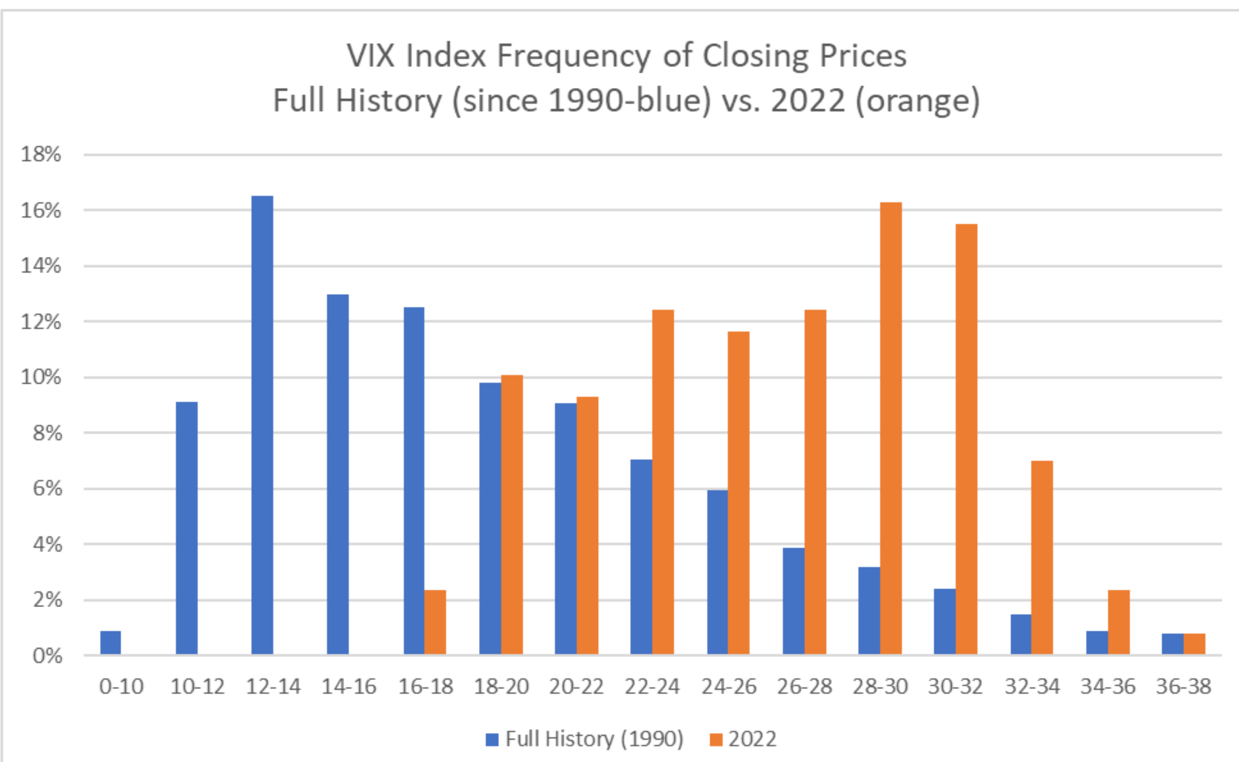
- Full History: 33.3%
- 2022: 86.0%
- This range may be suggestive of turning points and uncertainty.

Percentage of time VIX Index closed below 20:

- Full History: 61.5%
- 2022: 12.4%
- This range may be suggestive of more stable bull markets.

Percentage of time VIX Index closed above 40:

- Full History: 2.4%
- 2022: 0.0%
- This range may be suggestive of at least the beginning of a possible volatility crisis.



Data Source: Bloomberg

Does that mean the VIX is “broken”?

In a word, no. Claims that the VIX is broken have generally taken one of two forms: the VIX should be higher, or the VIX should be moving opposite the S&P 500 more often.

- Some people have claimed that the VIX is broken because it is too low. However, the average VIX Index level of 26.3 has been fairly accurate, given the level of realized volatility in the S&P 500, which has been 24.6%.

- Other people have claimed that the VIX is broken because it has moved in the same direction as the S&P 500 too often. However, it has done so this year at approximately the same frequency as it has done so over its full history (23% vs 21%, respectively).

Volatility (specifically, the VIX Index) makes sense this year. Rather, it is the previously mentioned choppiness in volatility as well as the combination of volatility and equities that have been particularly unusual in 2022. **<u>Putting together volatility and equities, the S&P 500 is down 20% in the past 6 months, and it is down with muted volatility of just under 25%. That equity return is in the worst 1 percentile with volatility below 25%, over a 6-month period</u>, and it has created an unusually unfavorable environment for equities paired with volatility hedges or volatility trend following strategies.**

<u>ABR 75/25 Volatility Strategy</u>

Is the ABR 75/25 Volatility Strategy doing what it normally does?

Yes, the strategy has continued to seek to follow volatility trends in 2022, producing a dynamic beta to the S&P 500 in response to changes in volatility.

- Beta following VIX Index < 30:
    - 0.73 (1H 2022)
- Beta following VIX Index > 30
    - 0.37 (1H 2022)

Since the selloff worsened in second quarter, the betas have been lower, and the beta reduction after the VIX closed above 30 has been greater.

- Beta following VIX Index < 30
    - 0.63 (2Q 2022)
- Beta following VIX Index > 30
    - 0.15 (2Q 2022)

These betas indicate that the strategy has been preparing for a crisis approximately when it has done so in the past. For example, in the Covid-19 crash, the strategy didn’t begin to produce a positive absolute return on down days in the S&P 500 until the VIX was above 40.

However, when the strategy has prepared for a crisis this year, in response to rising volatility, volatility has reversed sharply lower and equities sharply higher each time. These sharp reversals lower in volatility have been the source of the underperformance of the ABR 75/25 Volatility Strategy to the S&P 500, underperformance which mostly vanishes upon the removal of 2 such events:

- 4 days in March (March 15-18)
  - S&P 500: +7.0%
  - ABR 75/25 Volatility Strategy: +1.5%
  - ABR 75/25 underperformance: -5.5%
  - These 4 days occurred within a period in which the VIX Index was reversing sharply lower from 36 to 19.

- 5 days in May (May 23-27)
  - S&P 500: +6.6%
  - ABR 75/25 Volatility Strategy: +1.4%
  - ABR 75/25 underperformance: -5.2%
  - These 5 days occurred within a period in which the VIX Index was reversing sharply lower from 33 to 25.

Conclusion

What does ABR do in response to such unusual events?

Be patient. That answer may not be very satisfying to some readers, but we are thoroughly convinced it is the sound answer. Portfolios and strategies can be optimized for 1st percentile events. However, that effort is likely to come at the expense of the other 99% of environments. Therefore, in the case of a primarily volatility-trend following strategy that has historically performed well in calmer bull markets and in major volatility crises (marked in part by large and sustained uptrends in volatility), we believe that effort is likely to come at the expense of long-term results and at the expense of major volatility-crisis results.

How long will it continue?

We don't know. Based on history, there is reason for long-term investors to feel positive about the outlook for the future:

- Since WWII, after previous 1st percentile 6-month periods with the S&P 500 down at least 20% and volatility below 25%, the average upcoming 6-month return in the S&P 500 has been +10.2% (with a range of +30.4% to -17.5%), vs +4.3%% (with a range of +50.2% to -46.5%) for all 6-month periods.

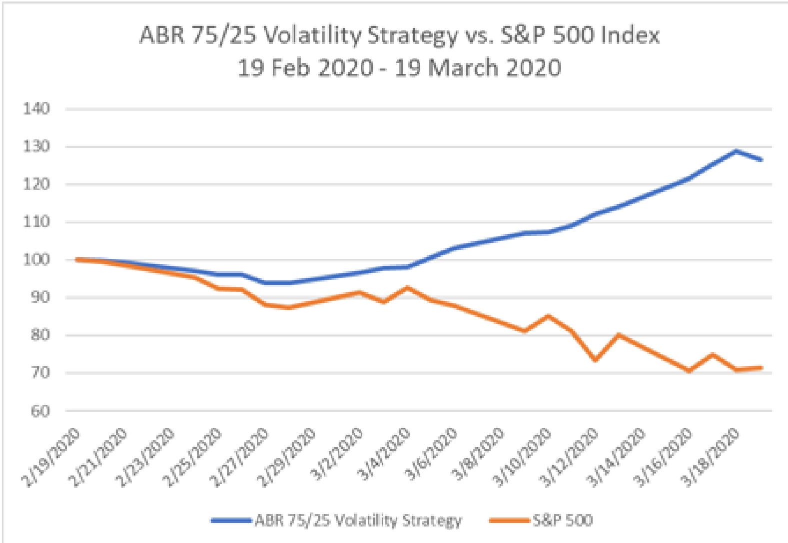
- Two such 6-month periods strung together back-to-back has been only a 0.04 percentile event.

- Once the S&P 500 has reached the definition of a bear market (down 20%), over the upcoming one-year period, it has been higher 75% of the time and by an average gain of 17% (source: Barron's).

These historical facts, of course, do not guarantee a similar outcome this time, and they are not meant to suggest a precise bottom in markets or positive upcoming performance for volatility-based strategies.

Will this end with a whimper or bang?

We don't know that either. We hope, for the sake of most investors, that it ends with an equity rally, a "whimper" if you will. However, if it ends in a "bang" (by which we mean, in part, a large and sustained uptrend in volatility), we believe the ABR 75/25 Volatility Strategy has the potential to produce favorable results, based on its design and its historical results. For example, here is a reminder of the Covid-19 crash.



Date	ABR 75/25 Volatility Strategy	S&P 500	Daily % Outperformance
2/19/2020	100	100	
2/20/2020	99.8	99.6	0.2%
2/21/2020	99.3	98.6	0.5%
2/24/2020	97.0	95.3	1.0%
2/25/2020	96.1	92.4	2.1%
2/26/2020	96.0	92.1	0.3%
2/27/2020	93.8	88.0	2.0%
2/28/2020	93.9	87.3	1.0%
3/2/2020	96.5	91.3	-1.9%
3/3/2020	97.8	88.8	4.2%
3/4/2020	98.1	92.5	-4.0%
3/5/2020	100.5	89.4	5.8%
3/6/2020	103.1	87.9	4.4%
3/9/2020	107.0	81.2	11.3%
3/10/2020	107.3	85.2	-4.7%
3/11/2020	109.0	81.1	6.5%
3/12/2020	112.2	73.4	12.4%
3/13/2020	114.1	80.2	-7.6%
3/16/2020	121.5	70.6	18.5%
3/17/2020	125.3	74.8	-2.9%
3/18/2020	128.7	70.9	8.0%
3/19/2020	126.7	71.3	-2.1%

The period shown above is intended to provide a closer look at the “crisis alpha” that the ABR 75/25 Volatility Strategy provided in the Covid-19 equity market crash. This period is more favorable than, and not representative of, all performance periods or of long-term historical performance. For example, the current environment with near-constant trend changes in volatility has resulted in negative relative and absolute performance for the strategy. Please see the disclosures section for more information, including standardized performance.

For more information, please contact us at info@abrfunds.com.

Disclosures

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Certain performance information show above is hypothetical. Hypothetical performance does not reflect actual trading experience and does not necessarily reflect the deduction of all expenses. HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM. ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO

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The “ABR 75/25” Volatility Strategy is represented by 75% of the returns of the ABR Dynamic Blend Equity & Volatility Index Powered by Wilshire (ABRVXX) and 25% of the returns of the ABR Enhanced Short Volatility Index Powered by Wilshire (ABRXIV), respectively (collectively, the ABR Indexes). The “long volatility” element (ABRVXX) is shown net of hypothetical expenses of 2.00% fixed and 20% incentive fees, and the “short volatility” element (ABRXIV) is shown net of hypothetical expenses of 2.00% fixed and 20% incentive fees. Actual expenses may vary. ABRVXX was launched 4/30/2015, and ABRXIV was launched 1/31/2017, such that performance information before those dates constitutes pre-inception (hypothetical) index performance. Investors cannot invest directly in an index. These results are based on hypothetical performance results that have certain inherent limitations. Hypothetical trading programs in general are designed with the benefit of hindsight. The inception date of the US pooled vehicle was 8/3/2020. For more information on the live-trading performance of various ABR-advised strategies, please contact us. Wilshire® is a service mark of Wilshire Associates Incorporated (Wilshire) and has been licensed for use by ABR Dynamic Funds, LLC. The ABR Indexes are not sponsored, endorsed, sold or promoted by Wilshire, and Wilshire makes no representations or warranties with respect to the ABR Indexes. ABR Dynamic Funds, LLC may receive compensation in connection with licensing the ABR indices to third parties.

The ABR 75/25 Volatility Strategy has historically demonstrated significant and rapid outperformance of the S&P 500 in extreme equity market crises (“crisis alpha”), including in the first month that the S&P 500 dropped in the Covid-19 crisis (shown above). Major equity market crises, marked in part by extended uptrends in volatility that reach very high levels of volatility, have historically provided the most favorable environment for the trend-following model used by the ABR 75/25 Volatility Strategy and thus for its performance, both in 2008 (pre-inception) and in 2020 (shown above in live data). Other environments, such as the current choppy market with repeated trend changes, have been less favorable and resulted in negative performance, both on an absolute and on a relative basis (-32.5% YTD for the ABR 75/25 Volatility Strategy). Therefore, the performance shown above is more favorable than, and not representative of, all performance periods or of long-term historical performance. For the periods ending June 30, 2022, the ABR 75/25 Volatility Strategy returned -26.5% over one year, +4.8% over 3 years, +4.7% over 5 years, and +13.0% over the full history since 2006. Periods longer than one year have been annualized.

Incorporating a dynamic volatility strategy into a portfolio is designed to help an investor potentially mitigate, and potentially benefit from, volatility in the U.S. stock market. However, all investing involves risk including the possible loss of principal. There can be no assurance such a strategy will achieve a gain or prevent a loss. Volatility assets and strategies may not be suitable for some investors due to their financial circumstances and risk tolerance. A volatility strategy should not be viewed as a complete investment program.

Volatility assets entail their own unique risks that investors should consider when evaluating a volatility strategy. Volatility-based futures can become volatile and difficult to value and can be imperfectly correlated to the underlying asset or index. Due to leverage, the loss on a long futures contract could greatly exceed the initial investment. The loss on a short contract theoretically is unlimited since the appreciation of the shorted asset also theoretically is unlimited. Thus, a small investment in derivatives could have a large potential impact on the performance of a portfolio. Further, a volatility strategy may at times call for high portfolio turnover rates, which increases brokerage costs. High turnover also may generate net short-term capital gains.