CAESAR CAPITAL MANAGEMENT

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Executive Summary

- Caesar Capital Management is a single-manager fund.
- The Fund will be structured as a master-feeder fund. The master fund will be located in the British Virgin Islands (BVI). The feeder fund is located in the Netherlands. I am in contact with a BVI law firm to set up the fund.
- The Fund will outsource the administrative and clearing activities to third parties.
- I will always have a significant proportion of my net worth invested in the fund. This is also something that I demand from my future employees.
- Caesar Capital Management is an open-ended fund.
- I want to launch the fund with the backing from either a seed fund, fund of funds, or family office. The goal is the raise between $20 and $75 million.
- By default, Caesar Capital Management charges clients a 2% management fee and a 20% performance fee. In the beginning stage of the fund, I will split the performance fee between the L.P. (which in this case is the seed investor, whether it is a seed fund, family office, or fund of funds) and the fund. This may extend further into the future. Also, for the first 2 years, I will not charge a 2% management fee. Instead, I will only pass through the costs to run the fund. Once the fund is ready to hire people and attract more capital, I will charge a 2% management fee.
- Initial costs will be funded as much as I can by myself and the passed-through costs to investors. No profits will be made from the management fee (read: passed-through costs) which will only be used to start up the fund.
- The fund does not have an absolute performance target. Rather, the performance targets are to outperform the 60/40 equity/fixed income portfolio while achieving positive absolute returns which are higher than the inflation with very low to no correlation to overall markets.

Why I am starting a hedge fund

Ever since I was a young kid I was intrigued by finances and financial markets. I opened an account in my mother's name which I traded with my own money. I loved being involved in the markets and following the financial news. It really became my passion and decided that I wanted to do that for the rest of my life. At one moment I suffered a huge loss. I lost almost everything, and that was one of the most terrible and painful experiences in my life. It was also the best learning experience ever, because it gave me humility in the market and the fear of being wrong and losing money. After having that experience, I never wanted to lose money ever again. I took a break for a while but I returned because I was determined not to fail and eventually become the best in doing this. I am a highly competitive person, so what I love is that I got a scorecard every day. I won't win against the market every day, but the goal, of course, is to always win at the end. Another thing that I love is the sheer amount of responsibility that it brings. You really have to bring the best out of yourself and others to succeed and I am the one that has to make sure that happens. I will not only be responsible for the eventual success of the fund, but also for applying and governing financial regulation and ethics within the fund. Over the last couple of decades, we have seen a number of financial organizations not applying and governing financial rules and ethics properly which resulted in embarrassing and hurtful moments for the industry. I will do everything in my power to apply and govern financial regulation and ethics within the fund.

If the fund becomes successful, one thing I really want to do is to do good for the world. Not just giving money to a good cause, but actively helping people in need. One thing that I particularly want to do is help poor people. I lived it my whole life, so what I want is to give people who deserve it a chance of living a good life.

I believe that I have an edge over other portfolio managers and people because I know the consumer. In my research, I cover a lot of sell-side and buy-side research, which I will explain later. Time on time again I see Wall Street strategists, people whom I hugely respect for their knowledge, being wrong on the state and behavior of the middle- and lower-class. In contrast to basically everyone who works on Wall Street, I actually am the middle and lower class. There is a huge gap between Wall Street and the middle- and lower-class (which accounts for 50% of the US economy), and I believe I can be a bridge between them and make profits from the subsequent market mispricings.

The Future

Following game theory, I want to be an infinite player with Caesar Capital Management. The goal is to achieve a great compounded return, with very few and small losses. Taking on more risk can achieve higher returns over the short run, but a compounded return over the long run will almost always result in steep losses or flat returns where you wipe out years of gains. The goal of the fund is to generate positive returns every year, regardless of the market's direction. I won't reach the stars every year, but especially during times of market- and macro volatility the strategy should perform very well. However, also during normal market- and economic conditions the strategy should provide satisfying returns.
After a number of years, when the fund becomes a sustainable business and is ready to grow further, I want to introduce new strategies. I already have some ideas in mind, but those are now just balloons and I will only work on that if or when the fund is ready for that. After that, I would like to see the fund becoming a multi-strategy fund to be more flexible to our investors and within our investment strategy.
Right now, the fund is located in Amsterdam. At this stage of the business, it is a perfect location, because I am one hour away from London, Paris, Frankfurt, and Zurich. The time zone in which the fund is located (CET) is also perfect. In the early morning, I am awake to follow Asian trading, after that, European trading is opened, and U.S. trading goes from the afternoon to the evening. The costs of launching the fund here are also a lot lower than in i.e. New York City, because lawyers, accountants, employees, office space, etc. are a lot cheaper. Eventually, I want to open offices in New York and Singapore. This will improve communication between the fund and investors and also open doors to new possibilities in trading.
Once seeded, I want to focus on achieving outstanding returns, assembling an excellent team, and building a business that can stand independently. After between 1.5 and 2 years, I will start to raise money for the fund, presumably from Fund of Funds. So, how can I achieve those three goals in order to create a sustainable business?

Investment Strategy

Below I will explain the how (investment strategy), why (investment philosophy), what (investment process), and when (timing of investment opportunity).

Investment strategy

The investment strategy of the fund is a Global Macro strategy. The strategy is designed to profit off of economic trends which cause changes in asset prices, such as GDP growth, inflation, monetary policy, and international trade. A paper published by AQR Capital Management[1] shows that economic trend has an average annual return of 13.3%, 12.2% volatility, a Sharpe ratio of 1.1, and a -0.2 correlation to the S&P 500 measured from 1970 to 2022. My strategy differs in some aspects from the one used by AQR Capital Management, but the general idea is the same. The outperformance comes from the tendency of asset prices to systematically underreact to new information. To be clear: this is not a trend-following strategy. The strategy is used to find and capitalize on mistakes in the market, that result in large moves in markets over a period of time.

Volatility: The strategy that the Fund uses is a long volatility Global Macro strategy. The reason for an emphasis on long volatility is to profit off of market downturns. The VIX Volatility S&P 500 Index has a negative correlation to the S&P 500 of 81%. Besides that, the VIX has a negative Beta, particularly the magnitude of that negative Beta appears to increase during sharp market downturns. The long volatility trades are, relative to the other side of the portfolio, usually of a shorter duration. These long volatility trades protect the portfolio and are profitable during (equity)market downturns. The other part of the portfolio, which exists of the asset classes listed below, is positioned for macroeconomic events and -environments. A part of these positions are hedged, but that will be explained below. Of course, the goal is to generate alpha through long VIX positions following calls from the Macro analysis, but the importance of generating alpha using the VIX as a hedge against equity market downside (one that I, for example, did not predict) can not be underestimated.
Markets are not efficient. There is always uncertainty in markets as predicting the future is impossible. Uncertainty finds its expression in volatility. The range of uncertainties is uncertain and at times it can be practically infinite. Mispricings in IV can be spotted when uncertainty (or volatility) is not priced. This surprisingly happens rather often. When times are good, it is in human nature to forget about possible downsides. When times are bad, people usually don’t see how things can get better. Market participants behave the same.

[1] https://www.aqr.com/Insights/Research/White-Papers/Economic-Trend

Bonds: Bonds are a major player in the Global-Macro strategy of the Fund. Bonds are usually a perfect fit to express Macro views in markets. The Fund can take long- and short positions in government bonds, corporate investment-grade bonds, and corporate high-yield bonds. Whether or when to buy or sell a bond is determined by the macroeconomic analysis conducted by the Fund, just like every other asset class discussed below. Bonds can serve as one or more of the things below in the Fund's portfolio:

- Capital preservation: Only during periods of loose financial conditions and rising and/or high inflation, bonds in the Fund's portfolio can serve as capital preservation. U.S. Government bonds are best suitable here because they are highly liquid in case markets are pricing in a change in the economic environment, and because these bonds are in essence riskless. During these periods, cash is usually 'trash', and will only depreciate in value due to inflation. To protect capital against inflation depreciation, owning bonds is favorable over holding cash. Usually, bonds trade at a premium and yield relatively low during these economic environments. This means it is important to buy those bonds early in the cycle instead of late when markets start to speculate about central banks raising interest rates and therefore selling off. Despite the relatively low yield on bonds in a rising and/or high inflation environment, it is attractive to hold these bonds, because they provide a better yield than just holding cash which basically gets 'burned' in this economic environment.
- Fixed income: Especially high-yield corporate bonds have the potential to provide an attractive income. Those yields are usually higher than stock dividend payments, and those companies make dividend payments at their discretion, while bond issuers are obligated to make coupon payments. High-yield bonds offer a relatively high yield because the issuers are considered to have a greater risk of defaulting on interest and/or principal payments. In times of economic stress, the amount of defaults in the high-yield sector usually spikes. Under normal economic conditions, the default rate of high-yield bonds is under 5%. During the aftermath of the Dot-com bubble burst, the Great Financial Crisis, and the COVID-19 recession, default rates were respectively 9%, 13%, and 13%. The Fund wants to avoid holding high-yield bonds going in an environment of economic stress. However, high-yield bonds are the most attractive when this economic stress starts to abate. Usually, these bonds trade at a discount and offer a higher yield than they usually offer. In case the Fund holds high-yield bonds in times of economic stress, those bonds will be hedged through Credit Default Swaps on the bond.

  On average, U.S. high-yield bonds offer 300 to 500 basis points of additional yield relative to U.S. Treasury securities of comparable maturity. During the financial crisis of 2007-2008, high-yield bonds offered 1500-2000 basis points of additional yield relative to U.S. Treasury securities of comparable maturity.

High-yield bonds will only be bought at a discount, and never when markets are pricing in a period of economic slowdown or worse.
Sovereign bonds and corporate investment-grade bonds can also be used as a source of fixed income. They provide a lower yield than their high-yield counterparts but are safer. Corporate investment-grade bond yields also usually offer higher yields than stock dividends, so corporate investment-grade bonds are preferred over stocks on an income basis.

- Capital appreciation: Sovereign bonds are preferred over corporate bonds in terms of capital appreciation. Corporate bonds carry idiosyncratic risk. Many micro factors such as earnings reports, m&a, management changes, etc. have an influence on corporate bond prices. Following the Fund's Global Macro analysis, sovereign bonds are the better fit. However, the Fund also wants exposure to corporate bonds for capital appreciation. Corporate bonds historically offered similar returns to equity markets, but with lower volatility. During periods of interest rate cuts and an improving economic outlook, long bonds offer great returns. During periods of interest rate hikes, shorting bonds may provide great returns.
- Diversification: The correlation between U.S. equities and U.S. Treasury bonds varies a lot over time. The correlation between commodities and U.S. Treasury bonds is close to zero. Therefore, U.S. Treasury bonds add diversification to a portfolio with equities and commodities. Corporate investment-grade bonds offer the opportunity to invest in a variety of economic sectors. Corporate investment-grade bonds can therefore add diversification to equities as well as diversify a sovereign bond-heavy portfolio. High-yield bonds generally have a low correlation to other sectors in the fixed-income space, such as sovereign and corporate investment-grade bonds, so adding high-yield to an investment-grade heavy bond side of the portfolio enhances portfolio diversification.
- Potential hedge against an economic slowdown or deflation: During times when economies are slowing, inflation is usually slowing, which makes the fixed-income part of a bond more attractive, and therefore the price of the bond will usually increase due to more demand for bonds. Especially during times of deflation, returns on bonds are very attractive. When economies are slowing, equities and commodities usually don't do well, in contrast to bonds. However, during times of severe economic slowdown, recession, depression, etc., central banks may step in in order to boost the economy by lowering interest rates and in some cases quantitative easing. This will have a positive impact on bond prices. It must be noted that bonds are not always attractive going into every economic slowdown. Economic slowdowns may occur when central banks are in an interest rate hiking cycle. Bonds usually price in rate increases, so it is not the norm to buy bonds when the economy slows down. This applies to every asset and asset class that the Fund trades; it totally depends on the exact structure and nature of any (future) economic- and market environment how the Fund trades different assets and asset classes.

Equities: When economic environments are favorable or unfavorable for businesses, the Fund will usually allocate the most to corporate bonds and equity indices. Buying and/or selling individual stocks will be less. Individual stocks carry idiosyncratic risks and are more volatile than corporate bonds. Besides that, the yields on corporate bonds are usually higher than the dividends that stocks pay. The choice for equity indices instead of individual stocks has to do with volatility and the macroeconomic analysis that the Fund conducts. Individual stocks require a microanalysis. The case can be made for corporate bonds to require microanalysis, but they tend more correlated to treasury bonds. However, analyzing the companies of whom the debt potentially will or will not be bought will be done in detail. Generally, the goal of buying or selling corporate bonds (investment-grade or high-yield) is to get exposure to the corporate side of an economy. The same goes for the buying and selling of equity indices. Equity markets, as well as other financial markets, are a reflection of how well (or not well) the economy will be doing in the foreseeable future. Equity indices such as the S&P 500, FTSE 100, or the DAX 40 index represent basically the whole stock market of an entire country (respectively the United States, the United Kingdom, and Germany). Through these instruments, the Fund can profit from rising or falling economies predicted by the Fund's macroanalysis. Sector and other equity indices will also be used.

Currencies: In the Fund's strategy, currencies can serve as speculation and as a hedge. When the Fund takes a position in a foreign asset, currency risk occurs. This risk will usually be hedged to eliminate this risk, but this is further explained in the section 'Risk Management.
FX can also serve as a major source of alpha. The way a trade is implemented is very important to achieve the best risk to return. Usually, FX is more volatile than bonds, but therefore it has the opportunity to yield more. The convexity of the call will decide whether I take a direct position, or that I do it via options or something else. Currencies are usually fundamentally driven by macroeconomics, as well as bonds.

Commodities: Commodity returns are primarily uncorrelated to financial assets. As measured between 1970 and 2022, the Bloomberg Commodity Index (this index tracks 22 different commodity futures prices within seven categories) had a very low correlation to the S&P 500 and a correlation close to zero with global bonds (measured against the Barclays Global Aggregate Index). In contrast, the Bloomberg Commodity Index was positively correlated with the U.S. Consumer Price Index. This shows that commodities can diversify a bond- and equities portfolio. This also shows that commodities usually profit in a rising inflation environment. The Fund can take long and short positions in commodities.
Commodities tend to be the first asset class to react to changes in the macroeconomic environment. Commodities are a real-time scorecard of aggregate supply and demand, while other asset classes rather react to lagging economic data or react to changes in commodity prices (the reverse is also true, where commodities

might react to changes in Treasury yields, for example). This way, commodities play a major role in the strategy as an indicator, but also as investable securities.

Correlations: Listed below are the correlations between the asset classes the fund may invest in. The VIX Index has been left out, as it has an inverse correlation of close to -1 with the S&P 500.

	US Equities	Gov. Bonds	Corp. HY	FX	Commodities
US Equities	1.00	0.18	0.84	-0.40	0.43
Gov. Bonds		1.00	0.37	-0.25	-0.23
Corp. HY			1.00	-0.43	0.50
FX				1.00	-0.44
Commodities					1.00

Investment philosophy

My beliefs and my ideas about how to handle markets arose from studying people who in my eyes are among the greatest investors of all time. I studied investors like George Soros, Ed Thorp, Ray Dalio, Paul Tudor Jones, Jim Simons, Stanley Druckenmiller, and Howard Marks.
A general belief in academics and with a lesser degree in markets is that the Efficient Market Hypothesis is correct. In contrast, I believe the Efficient Market Hypothesis is wrong. In my opinion, the theory of reflexivity is right within markets. The theory of reflexivity opposes the general equilibrium theory, which states that markets move towards equilibrium and that moves away from equilibrium will soon be corrected where deviations occur in a random fashion. Here, the long-run equilibrium prices reflect the underlying economic fundamentals, which are not affected by prices. The theory of reflexivity states that markets tend to move towards disequilibrium. Financial markets are in the theory of reflexivity characterized by feedback loops. This also explains the existence of boom-bust cycles. There are two kinds of feedback. Positive feedback is self-reinforcing and negative feedback is self-correcting. Negative feedback tends to move towards equilibrium while positive feedback produces dynamic disequilibrium. A boom-bust cycle is set in motion when a trend and a misconception positively reinforce each other. The bubble will eventually pop when reality can’t keep up with expectations and when the problems that were swept under the carpet resurface. Bubbles have an asymmetric shape; the boom is long and drawn out, and the bust is short and steep. Obviously, boom-bust cycles are not always happening everywhere in markets. They are actually pretty rare. What usually happens is that asset prices find themselves in a negative feedback loop. However, the best returns can be generated by riding the boom-bust cycle.
In markets and portfolio theory, a 60/40 equity/fixed income portfolio is widely seen as the best risk-adjusted way to provide a return. I believe that that is wrong, or rather outdated. Looking at the returns of the 60/40 portfolio, some interesting things jump out. Since 1980, around the start of the great moderation, the portfolio had six down years of which two were double digits. It had a double-digit drawdown eleven times, two of which were more than 20%. Those drawdowns happened in years when bubbles popped. The correlation between equities and fixed income was positive in 31 of the 42 years measured since 1980. It is supposed to be a risk parity portfolio, but when the assets in the portfolio are positively correlated, it does not pare the risk like it is supposed to. In modern portfolio theory, a 25/75 leveraged equity/fixed income portfolio is preferred over a 60/40 portfolio because it has the same volatility but higher expected returns. Although that is a better alternative to the classic 60/40 portfolio, the correlation problem still exists.
In combination with the assumption that the theory of reflexivity is right and the Efficient Market Hypothesis is wrong, is there a better way to construct a portfolio? The goal is to generate alpha (outperforming both the S&P 500 and a 60/40 portfolio)

while minimizing risk. Taking the theory of reflexivity as a ground rule, I believe there are four (main) states in which a market can be.

1. Boom
2. Bust
3. Negative feedback loop toward equilibrium
4. Markets following a random path

To quote George Soros; “Markets are constantly in a state of uncertainty and flux, and money is made by discounting the obvious and betting on the unexpected.” There is always uncertainty in markets. There is no market participant (including computers) who has access to all the data of the world or that knows everything. Just like in economics, participants make irrational decisions. Because financial markets and economies have thinking participants, they are categorized as social sciences. Physics, on the other hand, is a natural science. It has universal laws, and outcomes can be predicted with precision. Economics and financial markets do not have universal laws. Yet, often economics and financial markets are treated like natural sciences. To me, one of the most important things to always remember is that no one knows everything, and neither do I. So, will there always be uncertainties and mispricings in markets. Uncertainty finds expression in volatility. The range of uncertainties is also uncertain and at times it can be practically infinite. When markets price in a low risk of volatility, buying volatility protection is the best move to make in my opinion. This way your portfolio is protected against market downside and corrections, or when bubbles burst. Because of the magnitude of the negative beta of volatility protection relative to the equity markets, market downside is supposed to reward the portfolio with positive returns.
In the long run, markets go up. The S&P 500 has an average annual return of 10.7%. Economies do grow in general, and so do equity markets. Markets are fundamentally driven by macroeconomics, which itself is heavily influenced by central banks. Therefore, it makes sense to hold risk assets in a portfolio. It doesn’t make sense to always hold risk assets in a portfolio, such as when we find ourselves in a boom/bust cycle. On the way up it is very profitable, but on the way down it is usually very catastrophic. Therefore, when I spot that assets in the portfolio find themselves in a bubble, I will shift to a very conservative stance and even might sell the risk assets altogether in order to avoid the inevitable pain that is to come. When bubbles have popped, assets are usually very cheap. This is the best time to buy assets. Nathan Mayer Rothschild once said: “Buy assets when there is blood on the streets, even when the blood is your own.”

Furthermore, my investment philosophy consists of various principles and lessons of successful hedge fund portfolio managers, and other investors, and some other beliefs of my own. Below I listed the principles of successful portfolio managers, which helped them become successful.

1. George Soros, Quantum Fund: There are times to be patient, and there are times to press.

2. George Soros, Quantum Fund: Markets are constantly in a state of uncertainty and flux, and money is made by discounting the obvious and betting on the unexpected.
3. Dawn Fitzpatrick, Soros Fund Management: Have the confidence to bet against the herd.
4. Colm O'Shea, COMAC: There is no holy grail in trading.
5. Colm O'Shea, COMAC: Flexibility is essential, you need to adapt.
6. Colm O'Shea, COMAC: Seek an asymmetric return/risk profile.
7. Steve Clark, Omni Partners: If you are out of sync with the markets, trying harder won't help.
8. Ray Dalio, Bridgewater Associates: Learn from every mistake you make.
9. Larry Benedict, Banyan Equity Management: Only trade if the market offers opportunities, not out of a desire to make money.
10. Kevin Daly, Five Corners Partners: Doing nothing and being patient is important if the market does not offer opportunities.
11. Ed Thorp, Princeton Newport Partners: Bet size can be more important than the entry price.
12. Tom Claugus, GMT Capital: Vary market exposure based on opportunities.
13. Jimmy Balodimas, First New York Securities: Don't trade out of emotion or euphoria.
14. Joe Vidich, Manalapan Oracle Capital Management: Never marry a position.
15. Stanley Druckenmiller, Quantum Fund: Don't look at earnings, look at the Fed. It is liquidity that moves markets.
16. Stanley Druckenmiller, Quantum Fund: If you make a mistake, correct it and move on.
17. Seth Klarman, Baupost Group: The avoidance of loss is the surest way to ensure a profitable outcome.
18. Howard Marks, Oaktree Capital Management: Trying to time the market is useless.
19. Paul Tudor Jones, Tudor Investment Corp.: Don't be a hero, don't have an ego. Always question yourself and your ability.
20. Paul Tudor Jones, Tudor Investment Corp.: No training or classroom can prepare you for trading, just trade the markets yourself.
21. Paul Tudor Jones, Tudor Investment Corp.: Be in control of your actions, and first and foremost, protect your butt.
22. David Tepper, Appaloosa Management: Replaying losses in your head is the only way you learn from your mistakes.

I will explain some of these principles as how I view them and how they are valuable to my investing. I think being contrarian to the markets is key to being successful in investing. I like George Soros' quote cited in number two the most about that. I do not have an information advantage, so anticipating a market shift is way more valuable to me than going with the market.

I agree entirely with Colm O'Shea that there is no holy grail in trading. In portfolio theory, the 60/40 portfolio is seen as some sort of holy grail, or in modern portfolio theory the 25/75 portfolio with leverage. This year (2022) equities and bonds (I take the 10-year Treasury bonds here) had a close to 100% correlation and were both down huge. I am more in favor of managing a portfolio proactively by adjusting to macroeconomics. Colm O'Shea also said that flexibility is essential in trading. The facts change every day, and market cycles can reverse on a single data point. Therefore I believe it is important to be adaptive and be ready to change a portfolio. Larry Benedict and Kevin Daly have similar principles. I think it is very important to chase opportunities, not money. Being patient is key, otherwise, you may lose a lot of money.
The last principle I want to mention here is from Paul Tudor Jones. He stresses that you should not want to be a hero and not have an ego in the market. I believe that it is important to always question your own positions and thoughts. If you don't do that, you will always get confirmation bias. I also think it is important to include Stanley Druckenmiller's principle "If you make a mistake, correct it and move on" here. If you find out that you are wrong, the best to do is to sell that position, even when it is losing, to prevent a huge loss down the road.

Additionally, I have got some of my own principles, which work very well for me. For starters, I never set price targets when I take a position. The facts change every day and thereby supposed price targets should change with it. But to me it is more about direction, and when you get out of a position. A fundamental change can occur, which signals you may have to get out of a position, even when it is losing money. When you set a price target, you get easily married to a position, and you will seek confirmation to prove your hypothesis right, instead of seeing the confirmation that you were wrong.
Something that I will never do as well, is trade cryptocurrencies. I believe most cryptocurrencies are a scam, and all of them are worthless. Cryptocurrencies are a limited supply of nothing, so to the extent, there is more demand than the limited supply the price goes up and vice versa. There is no intrinsic value except that there is a limited amount.
One of the principles that I consider one of the most important is that it is okay to hold 100% cash for a while during uncertain times. To me, the argument that you should always be exposed to the market makes no sense. I believe that if you don't know what markets will be doing and/or there is a lot of volatility, sitting in cash for a while is the best option, instead of risking money in an uncertain market.

Investment process

In this paragraph, I will explain how I spot opportunities in markets. The products that I trade are laid out in the Investment Strategy.
Throughout the day I usually read a lot of sell-side and buy-side reports, watch interviews with strategists and economists on Bloomberg and to a lesser degree CNBC, and collect (economic) data. What I like about those reports is that they all have different opinions. By reading those reports and listening to those who put them together at major banks and asset managers, I get a lot of insights and information on markets. Strategists write reports where they argue why certain asset classes would go up or down, and economists argue macroeconomics in their reports. I always write down the reasons why they think what they think, and then I can compare their reasoning and choose for myself the most logical outcome. This is a good way to find the consensus thinking in markets, and thereby a possibility to lean against that.
Together with this, I write my own analysis based on macro data and current consumer behavior. I use SQL to find anomolies in the data that can point me in the right direction of the correct economic- and market road ahead.
I also use artificial intelligence to analyze data more efficiently, and I use it in my decision-making process to make more optimal portfolio- and risk-management decisions.

Timing of investment opportunities

According to legendary hedge fund manager Ed Thorp, the bet size is as important as the timing of the trade. I agree with that statement. Another legendary investor, Howard Marks, states that timing the market is impossible and therefore trying to time the market is useless. I want to combine the bet size and the timing to create an optimal outcome.
First of all, I am not going to try to time the market in any circumstance. So, how do I create a bet size to make up for possible short-term losses due to mistiming markets? There are three types of bet sizes that I use; the Kelly Criterion with lower volatility assets, the Kelly Criterion with higher volatility assets, and lower volatility assets where I have a high conviction of being right.

The Kelly Criterion is the fraction of capital to wager to maximize compounded growth of capital. Even when there is an edge, beyond some threshold, larger bets will result in lower compounded returns because of the adverse impact of volatility. The Kelly Criterion defines this threshold. The Kelly Criterion indicates that the fraction of capital that should be put into an individual trade to maximize compounded return over the long run equals:

$F=P_W-(P_L/W)$

P_W= Probability of winning
P_L= Probability of losing
W= Dollars won per dollar wagered (i.e. win size divided by loss size)

For example, if a trader loses $1000 on losing trades and wins $2000 on winning trades, and 60% of all trades are winning trades, the Kelly Criterion indicates an optimal trade size is equal to 40% of the capital (0.60-(0.40/2).
Proportional overbetting is more harmful than underbetting. For example, betting half the Kelly Criterion will reduce compounded return by 25%, while betting double the Kelly Criterion will eliminate 100% of the gain. Betting more than double the Kelly Criterion will result in an expected negative compounded return, regardless of the edge on any individual trade. The Kelly Criterion implicitly assumes that there is no minimum trade size. This assumption prevents the possibility of total loss.

When I trade lower volatility assets such as bonds or index funds, I will use the Kelly criterion to determine my bet size. When I trade higher volatility assets such as the VIX or FX, I will use a lower bet size than the Kelly Criterion. When I time the market wrong and my analysis still suggests that I am right, I have the room to scale up and get a better median entry price. By doing this, I reduce the short-term loss of timing the market wrong. And if I turn out to be wrong, that also reduces the total loss of the trade.

The third bet size I use is when I have an unusually high conviction of being right. Trades like this can occur when markets are completely mispricing an event from happening. When markets price out a certain event from happening, but I believe there is a good chance of that event happening, I can take a high-conviction trade against the market. On these trades, there is a limited downside, and the potential payout can be big.
Parallels of such trades are George Soros' shorting of the British Pound in 1992 and John Paulson's bet on credit default swaps in 2007. The chance of those events happening is very small, but this is just to illustrate the mismatch in market pricing and reality from which I could potentially profit.

When I get started, I need to allocate the initial capital. When I do this, I will not let perfection be the enemy of good. I do not want to wait for the perfect investment opportunity to deploy the capital to it, because that may cause underinvestment and thereby underperformance. Although, I may stay in cash for a while if markets are extremely volatile to eliminate the risk of big losses. However, I need to say that I will not take unnecessary risks. One of the principles mentioned before tells that you should only trade if the market offers opportunities. Therefore, if the market does not offer opportunities, I can just sit in low-risk government bonds or high-quality investment-grade bonds. This way I am getting yield and am I invested.

Building a great team and a great business

To me, building a great team and building a great business are inseparable. You can't do one without the other. I believe that investing in people is the best investment a hedge fund can make. Starting off, I want to run the fund alone. Only after a number of months, I will start hiring people. By hiring the right people, I want to make the fund ready to attract more capital and grow further. I want ambitious, professional, humble, and competitive people. That is also the culture I want to create within the firm. I think credibility is very important for a hedge fund, and that is also what I expect from my team.

As the fund grows, the team will grow with it. The goal is to create a team and culture where the best ideas win. The prime example of that is what Ray Dalio has made from Bridgewater Associates. I want to create a meritocracy where the best ideas win. People that will get hired will come from all different backgrounds. They all have different views on things, and on how to approach problems. One thing that is really important is that employees need to be turned on by the markets. I really want them to be passionate about markets and everything around it and really dedicate their lives to it, whether they have a back- or front-office position. That is also what I am looking for in their professionalism. For many people, their job stops when they leave the office, but I do not want them to think like that.

Although I want to hire a team with very diverse backgrounds and opinions, there are certain types of people that I do want and people that I do not want. I do not want people in my team who were born with a silver spoon in their mouths. I want people who know what it is like out there in the real world, people who could not afford to lose their money when they grew up, and as well had to be responsible from a very young age. These people are disciplined, responsible, and know how important it is not to lose money. It is part of their personality. People who were born rich tend to have a much higher risk tolerance and never had to live with the responsibility to be careful with money. Furthermore, I want to keep the edge of actually knowing the ramifications of certain economic policies or -events on the largest part of the economy; the middle- and lower-class.

By building an excellent team and culture, the most part of building an excellent business is already done. The people make the business. There are also a lot of fundamentals that describe how the fund will behave. It will be an investor-friendly fund. I will frequently communicate with clients to sustain flexibility within the fund and the strategy. It will be as transparent as possible in sharing methods with clients. Also, investments in the fund will be very liquid.

In order to create a great business, capital needs to be raised to be able to stay in business when seed money gets withdrawn. The aim is to get strong results in trading and with that to attract new investors. It is important to strike while the iron is hot, so I will capitalize on performance momentum to raise assets. I will also put a lot of work into networking, so I can easier reach prospective investors. The client base will need to be diversified as well. Though raising assets is important, I will not go too

fast. That can cause trading performance to lag or the assets under management may outgrow the fund’s capacity.

Risk Management

When I find opportunities in markets, one of the most important things to do is to find the best risk/reward trade within that opportunity. Think about an options trade in FX instead of a direct FX trade or buying the VIX instead of shorting the equity market. Given that no one is immune to losing trades, it is necessary to have a plan when positions go against you. Previously, I wrote down the principles that describe the fund's trading style. Stanley Druckenmiller and his mentor George Soros are both known for relentlessly cutting losses if they make a mistake. I previously explained Stanley Druckenmiller's and Paul Tudor Jones' principles, but I will do it again here in light of risk management. Once I make a mistake, I will correct it and move on. This is critical to avoid steep losses.

Usually, people tend to have a confirmation bias. People have a certain opinion about something, and when the facts tell that it is wrong, people tend to ignore that and go search for reasons why their own opinion is right. Now the question is, how do I avoid this confirmation bias? In order to prevent human errors in risk management, I built a code in Python that will automate my risk management entirely. In order to prevent big drawdowns, I use portfolio Greeks in my risk management. When the Beta of a certain position is above 2.5, portfolio risk increases to such a degree that Gamma will matter more. When the Beta is above 2.5, the data will not match a normal distribution anymore, so a tail-risk event is becoming more and more likely. In such a tail-risk event, a huge drawdown is a very possible likelihood. The drawdown limit is 20%, so I will have to take measures once the portfolio reaches a 15% drawdown. This makes it crucial to manage the Beta of positions and the Gamma of the portfolio. Managing the Beta and Gamma will decrease the likelihood of a portfolio drawdown of 15-20%. When the drawdown is 15%, I will in any case cut losses, sell positions entirely, or hedge the positions entirely.

Obviously, the intent is to avoid a situation where there is a 15% or more drawdown. As said before, the fund takes positions that represent the macro view of the fund to generate alpha.

Because I run a Global Macro strategy, I might take positions in securities issued in all parts of the world, which might be denoted in different currencies. This brings currency risk with it. The two major currencies that the fund will be involved with are the U.S. Dollar and the Euro, and to a lesser degree the British Pound and Japanese Yen. This might change in the future, though. EM will not really play a role right now, but that might change once the fund hires people for front-office roles. I always make an analysis of the currencies previously mentioned, and that will lead to how I will manage my currency risk. I will always hedge my currency risk, but whether I entirely hedge it or partially, has to do with the combination of my own analysis and others, such as strategists and economists. I prefer hedging currency risk through options. Not only currency risk will be hedged, but also some riskier bets will be hedged,

preferred by options. And of course, this is also part of taking a humble and egoless approach to the entire investment process.
It is also important to not put all my eggs into one macro basket. I can't predict the future with 100% accuracy. Building tactical trades around my macro base case scenario makes sense at times, but it is also important to get some exposure to the opposite of my macro base case, in case I am wrong. The best way to do this is to look for positions that will either benefit across macro scenarios or that will deliver asymmetrically positive returns if a low-probability scenario unfolds hence requiring only a small risk exposure in the portfolio.
Within this strategy, I will never use a stop-loss on a trade. Stop-losses are only useful if you can time the market, but for me, that is not a possibility. If you place a trade and the markets go the other way, while the fundamentals still say you are right, a stop-loss might trigger a sell on the position. In this situation, you are losing money, while your analysis still suggests that the market will go in your favor. Price targets are therefore not a good way to manage risk. Analyzing the same position every time again when the facts change in a humble way is therefore a way better way to manage risk instead of using outdated information that you used when setting your stop-loss price target.
The ultimate goal, of course, is to get profitable trades. Once a trade gets profitable, the question that remains is when to get out. Here I basically use the same approach as when I decide to get out of a losing position. Because I adjust my analysis all the time in a humble and egoless way, I can adjust to the current market pricing and sufficiently judge whether I should sell my position or let profits run further.