Kyklos Capital

Outlook: Active Management In Action. Sri Lanka As a Cautionary Tale.

"Nature provides a free lunch, but only if we control our appetites." William Ruckelshaus

Actively-managed portfolios should have different holdings than those of a passive index ETF. A successful active manager should not only generate returns above a benchmark-- "alpha", in trader-speak-- but also reduces risk by diversifying into low-correlated assets. Kyklos is an actively managed small-Emerging/ Frontier equities fund which is not benchmarked to any index. Our holdings offer an extraordinarily low overlap with the assets in most portfolios, and an extremely low correlation with major asset classes. Our returns zig when others zag, offsetting portfolio risks.

Investor portfolios which are concentrated in Developed and (perhaps) core Emerging assets— i.e., practically everybody— do not own the same stocks as we do. And even passive investors in our small-Emerging/Frontier markets have very low risk of overlapping with our holdings. We compared Kyklos's holdings since its launch in 2016 with those of the largest ETF for our markets, the iShares MSCI Frontier and Select Emerging Markets ETF (FM). Overall, Kyklos has **owned less than 2%** of the over 300 stocks owned by the ETF during that time, which represented **less than 1%** of the assets of the ETF. Kyklos's exposure to those few shared positions averaged under 12% of our portfolio. Investors in Developed, Emerging and even Frontier funds who invest in Kyklos are getting almost zero overlapping of their existing holdings.

As one should expect, the correlation of Kyklos with the S&P 500 Index is only about **one-half that of the ETFs for core Emerging or small-EM/Frontier markets (below).** Passive ETF investors can gain by allocating some of their assets to an active manager such as Kyklos, to chase higher returns while lowering their portfolio's overall risks thanks to diversification, otherwise known as a "free lunch".[1] Take it when you can get it.

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[1] https://www.riaintel.com/article/b1n6y96sggls1b/a-new-defense-of-portfolio-diversification

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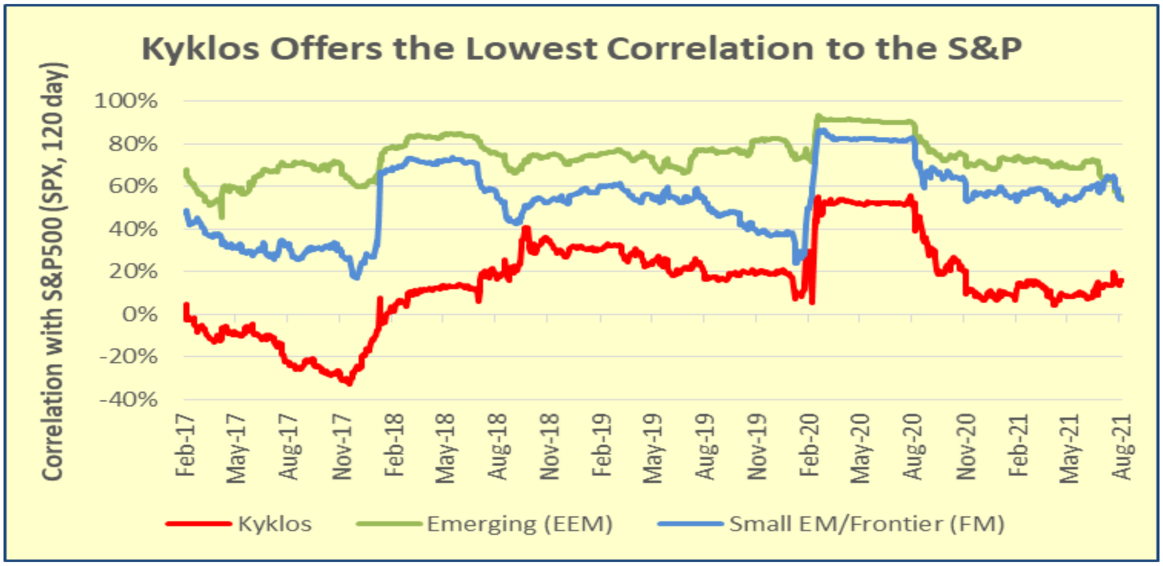

A Followup on Sri Lanka. Sri Lanka, once a significant part of our portfolio, made news in late August by moving toward currency controls and worsening financial stress. As research shop Tellimer writes today, "Sri Lanka's president, Gotabaya Rajapaksa, has declared emergency powers to secure supply of food items at "fair" prices, from 31 August." We also hear from other funds of severe delays in receiving portfolio sale proceeds. Fortunately, Kyklos exited its last Sri Lanka position in January after our macro model ranked Sri Lanka among the worst countries for FX risks, an early red flag. As we wrote then, "The local investors in Sri Lanka have driven its stock market up over +50% since July (MSCI Sri Lanka Index). Meanwhile, investors in Sri Lankan government bonds went the other way, and demand yields above 25% for bonds that traded at less than 6% one year ago. Our model implies that both investor views will not win, and we have acted accordingly." The MSCI Sri Lanka Index is -17% since then, likely reflecting a much weaker currency than the official exchange rate. One bullet which we happily dodged.

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