Core Alternative Capital

Given the recent hysteria in the markets and online surrounding various small cap stock performance, we felt it prudent to briefly discuss what may have gone wrong (in the context of the hedge funds involved), and how our approach differs.

A little background: since the beginning of 2021, a certain group of stocks (including GameStop, AMC Theaters, and Nokia, among others) have been the targets of a disparate group of retail investors buying their shares in an effort to force a "short squeeze." The names were chosen ostensibly because they were found to be amongst the highest "short interest" companies in the market, and much of the short positions were held by large hedge funds. With the retail traders buying as much as possible, and gaining critical mass along with millions of followers on internet message boards, they were able to push the stocks significantly higher, in excess of 10x in just a few weeks, which of course then did force the short squeeze on the hedge funds who needed to buy as well to cover their shorts.

This all reached widespread zeitgeist on Wednesday, January 27th, as these stocks once again doubled in value in a single day, but this time it coincided with the broad markets declining about -2.5% on the day.

The reason we feel it important to discuss this is because of the hedge funds involvement. One type of hedge fund strategy is "long/short equity", whereby a fund will buy stocks they believe will go up, and short stocks they believe will go down. Problems with this strategy can arise if there is an issue with a specific short position; namely, due to the idiosyncratic/company specific risk of being short an individual company, if that stock goes up by a large amount then it can be devastating to the strategy, and the investors within. This of course is reflective of the general nature of shorting versus buying long, e.g. that a long has limited downside, because a stock can only lose 100%, but a short has theoretically unlimited downside, because a short stock could rise infinitely. The hedge funds involved have allegedly incurred significant losses in the last few weeks, with some well-known multi-billion-dollar funds declining 15% or more.

In comparison to a long/short equity strategy, our flagship *Core Alt strategy does not short individual companies*. We utilize broad market indices and related options to hedge the downside of our long portfolios. In this way, we are insulated from the "short squeeze" for two reasons. First, our hedges have limited downside because we typically use put options, and our maximum loss is the cost of the premium paid up front. Second, the broad market is not susceptible to the same kind of risks that can occur with individual stocks, due to the nature of the difference between systemic (market) and idiosyncratic (stock specific) risks.

While the merits of shorting individual companies can be debated by others in the future, we will continue to manage all of our strategies with the goal of balancing risk and return, and continue to focus on managing broad market risk.

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