SHINNECOCK PARTNERS

March 29, 2016

Should Investors Assume the Fetal Position by Going to Cash?
By Alan Snyder

Should investors assume the fetal position by going to cash?

There are many things to worry about, yet what is the right balance between the positives and the negatives? Do we overweight current events? For example, three months ago most Wall Streeters worried about rising interest rates from a strengthening economy, then in January and early February, people determined a recession was imminent only to reverse again in the past three weeks to think we will muddle along. Compounding the challenge, cash generates next to nothing but capital losses are painful to long-term returns. Some thoughts on the environment:

U.S. Political Uncertainty

Polls show dissatisfaction, low trust and downright dismay with leading candidates. Our world will never be the same! However, history buffs would remind us that the current rancor is mild versus the early days of our republic.

Worldwide Economic Unease

European slow growth with concerns of the E.U. fracturing; Brexit is too close to call; Euro depreciation versus the dollar; ongoing tension between Northern European countries and their less fortunate southern periphery; Draghi is the little Dutch boy with his finger in the dike with negative interest rate experimentation of unknown consequences.

Far East turmoil with China's growth markedly slowing and aggressive challenging in the South China sea by neighboring countries and the U.S.

India, a newly discovered contender to China, has had structural reforms slowed despite a dynamic Modi as prime minister.

Japan stumbles with little structural reform, negative interest rates, and almost total reliance on monetary measures.

Middle East hammered from excess oil production, religious warfare, and unsteady U.S. policies.

U.S. slow growth in manufacturing and fears of recession from the long-of-tooth economic upswing, but currently strong unemployment statistics. Of course, there is a raging debate about whether unemployment and unemployment claims are leading, lagging or coincident indicators.

<u>The Media Pushes Positives Aside</u>

Ratings increase from focusing on "disasters" like many of "The Donald's" bombshells. Strong employment, consumer spending increases, slowly rebounding commercial and residential construction, increasing single family home purchases, higher state spending from increasing tax receipts, bio-medical advances from miracle drugs, technological innovations, etc., are all swept away from the under reporting.

<u>Another Perspective</u>

Against this backdrop, or maybe because of it, market volatility is high in bonds, equities, currencies, and commodities. Investors' alternatives are many yet the correct or safe path is unclear at best.

Is it time to hide, go to cash if even possible, hunker down and ignore the turmoil, freeze in place like the quivering white rabbit looking into the snake's eyes, or assert "I am a long term investor"? Experts don't offer much solace or sagacious counsel. Recent economic journals, *Barron's* and *The Economist* write opinion pieces saying "on the one hand" and then turning around 180 degrees describing "on the other hand."

Pulitzer Prize winner Jared Diamond, author of *Guns, Germs, and Steel* and *Collapse* offers insights. Having had the pleasure of interacting with him on a personal level, Jared suggests that in investing, experience counts to an unusual degree versus other fields of endeavor, and that you should know yourself in regard to risk tolerance, and consider one's time horizon.

Building on his insights is the following historical example. Sewell Avery, who ran Montgomery Ward after WWII, became convinced that the economy was in dire straits and unlikely to recover any time soon. He cut spending, manned the bulwark, and ultimately drove the company into bankruptcy. In this vacuum, Sears rose like the phoenix commanding the retail space for years as a result. There is a lesson here, we believe.

Betting that the investing world will end is not a long-term strategy. Equally so, measuring risk-adjusted returns must be a consideration. Technical execution coupled with deep understanding of your own investor preferences is critical for capital preservation and achieving the benefits of compounding growth (the true miracle of successful investing). There is a tradeoff. Directional investing, concentrated allocations, and low diversification can be extremely successful if one is correct on the direction. However, if one is incorrect, the results can be catastrophic.

Shinnecock and its offerings are not characterized by directional, concentrated or correlated wagers. Good or bad, our Shinnecock Income Fund embodies this philosophy as a current investment alternative for uncertain times:

1) Interest rates – no one has consistently predicted rate direction. Therefore, the portfolio is of relatively short duration in case rates do rise. If a recession, there is a significant buffer against rising defaults.

2) Multi-strategy – there are currently four categories of loans: consumer, small business, short-term real estate bridge loans and life settlements. Peeling the onion for a deeper dive, consumer lending and small business lending are split further between platform lending (a.k.a peer-to-peer) and collateralized niche lending. There is a bias, with a heavier emphasis on collateralized lending. This diversification lowers correlation between each segment and other asset classes, like traditional equities and bonds.

   The segments balance between old (e.g., niche collateralized lending) and new (e.g., platform lending) approaches. As we recently detailed, life settlements started out years ago and did poorly. Today, it enjoys institutional controls and has done well.

3) Multi-manager – we made a conscious decision to use domain experts in each of the selected strategy segments. Others might choose to select loans themselves and save the costs of the domain expert. We decided that expertise outweighed any possible cost savings.

4) Aggregated strategies and managers – after 27 years in business, Shinnecock has the infrastructure in place, the hard-knock experience in picking talent with the underlying due diligence, and the blue chip service providers to safeguard investors. As eaters of our own cooking, we decided that our costs should be modest.

5) Scale – as an institutional capital pool, we have negotiated lower fees and/or better liquidity terms from most of the underlying managers, versus what is available to an individual investor. We expect this opportunity to grow as the fund becomes larger, benefitting all of our investors.

Our income fund is but one example. Core, our multi-strategy fund, Shinnecock Futures Fund, our multi-strategy managed futures strategy, Shinnecock Aviation Conduit Funds, hard-asset investments in Boeing and Airbus jets, and Shinnecock Niche Opportunity Fund, investing in off-the-beaten-path niche investments, all have the same principle – protect capital while seeking a diversified return.

We don't want to be glib or too wordy but do seek to stimulate reflection. Most importantly, we welcome your input and thoughts.