CULROSS GLOBAL

Macro Outlook Summary

August 2025

A traditional long only portfolio of equities carries full exposure to the risk of a fall in equity markets. Stress testing the portfolio involves defining various scenarios in which the relevant equity markets fall by a chosen amount and then calculating how much the portfolio would lose. But equity market crashes tend to produce similar correlated returns regardless of which equity market one is considering. The popular expression is “all correlations go to one” – meaning different markets all move in lockstep together when they crash. So it doesn’t make any difference which markets are owned – the crash is not avoided in any material way. Putting it another way, the apparent diversification from owning different equity markets fails just at the point when it is most needed and so the portfolio does badly in the stress test. This is the fundamental risk of owning a long only portfolio of equities.

Our Funds do something rather different and have little or no structural net long exposure to equities. As a consequence, looking back over 25 years, they have never lost from equity crashes of which there have been many. If the Funds do have net long equity exposure, it is opportunistic and traded. That is not to say the Funds have no risk but one way to describe what we do is that we have exchanged market risk for manager risk.

Each manager we invest in pursues a specialist strategy with a portfolio of longs and shorts which are usually approximately balanced. There is no net market risk because of the balance but there is relationship risk, meaning that each long against short may not perform as expected if the relationship breaks down. This is typically termed spread risk. We rely heavily on the manager’s understanding and management of this spread risk so we choose our managers for their proven skill in their chosen field.

If the long and short asset are very similar or the same but in different geographies then the spread would be an arbitrage. To illustrate, the price of gas in different stations is always different. So there is a theoretical arbitrage in that one could buy from the cheap and take the gas to the higher priced station and sell. If one were able to do this with all costs being covered and a profit remains then this would be an attractive arbitrage trade because there is little to no market risk.

In a crash markets become disorderly and spread relationships often break down i.e. price differences widen rather than converge. Arbitrage risk is different to market risk, the loss is usually smaller but there’s a loss nonetheless. Adding exposure to long volatility strategies is a reliable counterbalance to this risk of loss in that volatility will rise when equity markets collapse and spread relationships break down. This is the rationale behind our Volatility Opportunities theme which is dynamically weighted according to our view of market conditions and prospective risks.

Our returns are derived principally from individual managers making money from a price relationship that's substantially out of line and will revert. The relationships are extremely varied across all instrument types and asset classes and global. Each manager is doing something completely different. As a result, in a stressed market our diversification by manager is very likely to remain effective and indeed when long only investments have produced huge losses our Funds have repeatedly delivered profits.

For investors with a conservative investment goal pursuing 'wealth preservation' we believe an allocation to this sort of Fund will prove wise and timely as equity markets reach ever greater heights with ever greater risks.