



Can You Outsmart a Chimp? | August 2016

"A blindfolded monkey throwing darts at a newspaper's financial pages could select a portfolio that would do just as well as one selected by experts."

Burton Malkiel – A Random Walk Down Wall Street

Whether they like it or not, every investment professional knows of the great dart-throwing chimp. The one that beats the experts at everything from picking stocks to forecasting geopolitical events. He is our punch line reminder that the future is unpredictable.

The difficulty with this predicament is that we are constantly required to make judgements about the future. Is this the right time to buy a house? Will we survive a five-hour plane ride with the kids? If I take the QEW will I get to my meeting on time?

While accurately predicting Toronto traffic is a fantasy, it would be nice to outperform a monkey with a dartboard. So how can we make better forecasts?

This is the question that Dr. Philip Tetlock and the folks at the Good Judgement Project set out to answer. Through extensive tournaments, they were able to identify a group of 'Superforecasters' (also the name of Tetlock's latest book). These individuals consistently outperformed intelligence experts, betting markets, the wisdom of the crowd, and yes, the chimp.

The good news is that they don't have any special powers and we too can be Superforecasters. The bad news is the secret sauce is a rigorous approach and cognitive effort.

Their hard work begins by decomposing the problem into the 'known' and the 'unknown', fleshing out the blind spots, biases and assumptions. They then attack from the outside in, formulating an estimate with generic data and then making adjustments based on the particulars of the situation (not the other way around). This probability estimate is then updated with new developments, being careful not to either under or overreact to the information.

It is also worthy to note that their performance improved when they worked in teams where they were comfortable openly challenging each other's assumptions and conclusions.

Overall the common thread to their accuracy was resisting the urge to jump to conclusions and balancing different, and even clashing, perspectives. And as with so many things, the best way to improve this skill is with loads of diligent practice, where successes and failures are critically analyzed.

Last but not least, it doesn't hurt to have a bit of luck on your side. After all, each of us has been on the wrong side of chance at some point, and when dealing in probabilities with uncertainties, we can do with all the help we can get.



The Fund

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2016	0.19%	1.49%	5.32%	3.51%	0.60%	0.54%	1.73%	1.63%	-	-	-	-	15.91%
2015	-	2.29%	2.51%	1.27%	2.46%	0.25%	0.73%	(0.25%)	1.68%	1.71%	1.37%	0.87%	15.86%

The Algonquin Debt Strategies Fund LP was launched on February 2, 2015. Monthly returns are based on 'Series 1 X Founder's Class' NAV as calculated by SGGG Fund Services Inc. and are shown in Canadian dollars, net of all fees and expenses.

We entered August expecting it to be a boring month in corporate bond markets. Instead, issuers sold \$6.7 billion of new bonds in the domestic market and credit rallied strongly (round 1 to the chimp). But this was one of those times we were happy to be proven wrong. The increased activity created a larger set of opportunities. This combined with the good performance in credit spreads and the interest earned from our positions generated a strong return for a typically quiet month.

Credit

Nine times out of ten, we would lighten up on risk heading into Labour Day as September is traditionally a supply heavy month. This time, we have opted to maintain our current positions believing that some of the supply was pulled forward into August, and also because demand appears to be robust. Primary deals are so oversubscribed that very few people are happy with the allocations they have been receiving. As such, we feel there is a good deal of support underpinning credit spreads.

That is our base case, but there are several factors that could change that. September is typically a difficult month for equities. Also events such as the US election debates and meetings for the Federal Reserve, European Central Bank, Bank of England and Bank of Japan are potential sparks that could unsettle the markets.

Rates

Governor Yellen and company have served notice that further rate hikes are coming soon. The Federal Reserve doesn't like to act close to an election date, meaning that the potential meetings for hiking rates are September 21st and December 14th. Our view is that December is the likely date as with the US election decided, the Federal Reserve will also have some clarity on the potential for fiscal stimulus.

Several months ago we forecasted a stronger Canadian economy by the middle of the year in response to the weak currency. Unfortunately, the response has been much more tepid than expected (round 2 to the chimp). That said, with the Federal Reserve poised to hike later this year, the currency ought to weaken further allowing the Bank of Canada to remain on hold for the balance of 2016.

Given the magnitude of bond buying by the European Central Bank, Bank of Japan and Bank of England, we predict longer term rates will remain fairly well anchored at current levels even if the Federal Reserve manages to hike the overnight rate twice in the fall (take that you damned dirty ape!).



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