MELISSINOS TRADING

Trend-Following: Built for Market Instability, Chaos & the Unpredictable

Topics discussed in this paper:

Founded in 2011, Melissinos Trading LLC (MEL) is an alternative asset manager utilizing a systematic trend-following approach. Trading global commodity and financial futures markets, MEL has generated non-correlated returns to traditional equity, fixed income and real-estate investments. As of November 1, 2024, the firm manages approximately $10 million for individuals, entrepreneurs, local business owners and family offices.

November 2024

Getting Started: What the World Was Like

Back in 2007/08 when I first conceived of starting MEL the world was quite different. The Financial Crisis was in full swing. Unemployment was at 25-year highs. 100-year old financial firms were going bust. Real-estate was imploding. Hell, the New York Giants were still a respectable football team.

The ten years leading up to the Crisis was a very opportunistic period, one filled with large trends across many asset classes. Stocks went from their best ten-year stretch ever in the 90's to losing half their value just a few years later. Interest rates went from 6% in 2000 to 1% in 2004 then back to +5% in 2007. The U.S. Dollar Index lost 40% of its value. Commodities were making all-time highs. *[Charts on next page]*

This world had a profound effect on 23 year old Mike. It was chaotic and abundant with opportunity, which, to me, was the norm.

I learned that you must embrace change, not fear it. Change meant opportunity. I saw too many people making decisions based on what they stubbornly wanted the markets to be doing and, as a result, had trouble adapting and capitalizing. It cost them dearly. In 2008, people thought gold would soar to $10,000, a great depression would occur, governments would default on their debt, fiat currencies would implode and we'd get hyperinflation. None of that happened.

When you have hardened views, especially about the markets, you cannot be objective or manage risk. You wind up sticking with losers for too long in hopes of a rebound. A big mistake. You cut winners short because you think the price can't rally any further. Another big mistake.

I was lucky to learn these lessons when I had no opinions or beliefs about the markets or my abilities. I was lucky to see the wisdom and validity of simply going with the trends, not trying to figure out the markets.

<u>The World</u>

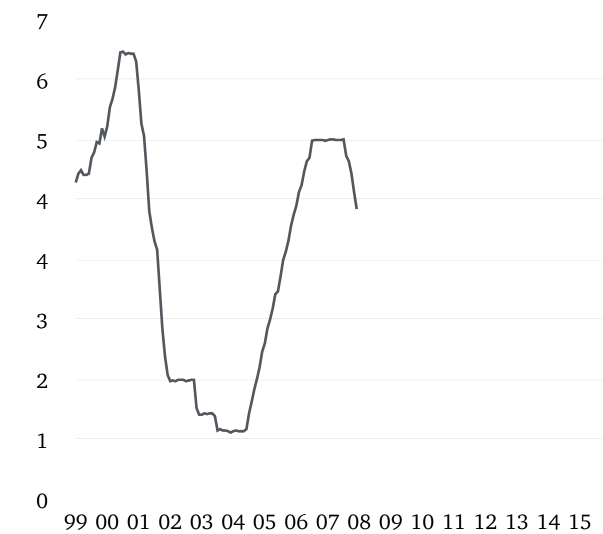
The staunch arrogance of today's equity investors wasn't present then. Stocks had recently gotten back to highs, but the recent decade had delivered only modest returns. Coupling this with rising commodity costs, tight credit markets and there was overwhelming feeling of building anxiety and tension. Despite this, many people didn't know what else to do so they stuck with what they knew, which was holding onto their stocks, bonds and real-estate.

Goldman Sachs Commodity TR Index

Jan 1999 — Dec 2007

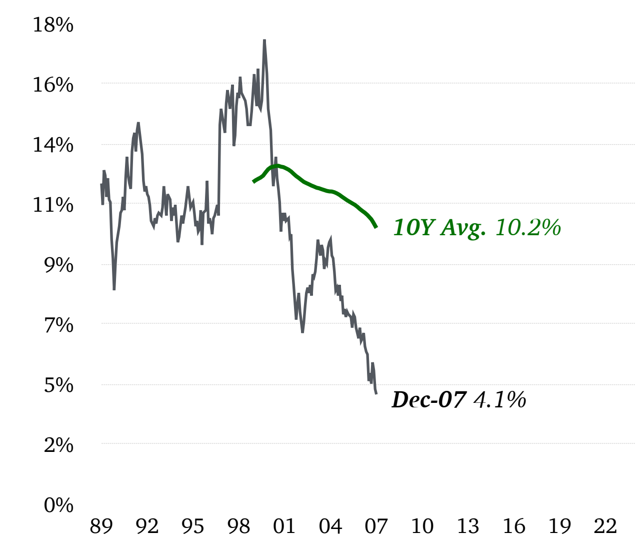
Fed Funds Rate

Jan 1999 — Dec 2007



S&P 500 TR: 10-Year Annualized Return

Jan 1980 — Dec 2007



U.S. Dollar Index

Jan 1999 — Dec 2007

Lucky to be Young and Dumb

I was lucky to believe that I wasn't that smart when it came to the markets. When I walked through the doors at Bear Stearns, I was of the belief you had to be a Warren Buffett type, a market wizard or some Ivy-league hot shot to succeed in the markets.

Well, this belief basically changed overnight. When you see very smart people lose a lot of money, not to mention go out of business, you start wondering if maybe there are other things more important than IQ. Learning this young was pure luck, a gift.

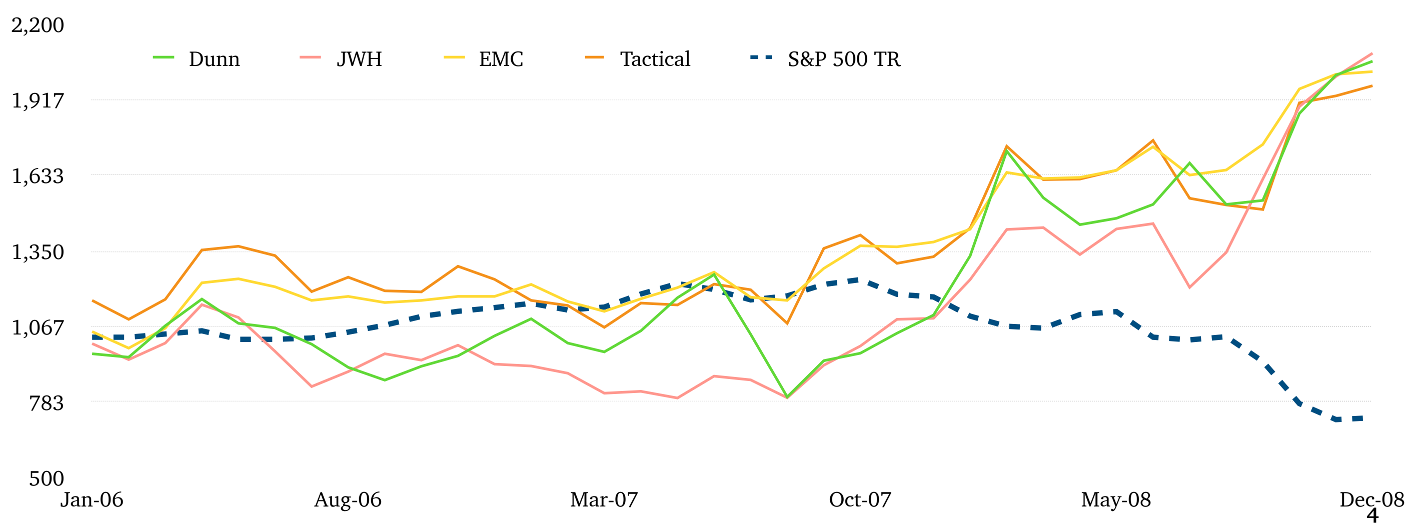
Being a baseball pitcher my entire life, my idol was Greg Maddux. He was not a physically impressive person. He didn't throw very hard nor did he have overpowering stuff. He looked like an accountant, not a multiple Cy Young and Gold Glove winner. What he did do was throw strikes, change speeds, eye-level and limit unforced errors. A simple and effective approach that worked for his 23-year Hall of Fame career.

Despite the massive losses traditional investors were taking in 2008, most continued to believe that they could figure out and predict the markets. They thought the crisis was a one-off event that they wouldn't have to worry about again; that this was a bump in the road on the never-ending uptrend in stock prices. They believed they simply got unlucky. They didn't learn a thing.

As I was learning about trend-following and tracking the performance, it was becoming apparent to me that this buy-and-hold-no-matter-what-happens approach wasn't what it was cracked up to be — but instead the riskiest strategy of all.

Trend-Following vs. Stocks

Jan 2006 — Dec 2008



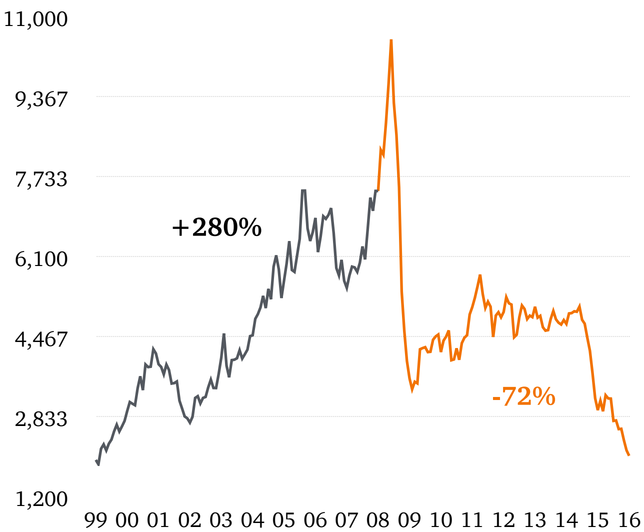
Past Performance is Not Necessarily Indicative of Future Results. This illustration is for informational purposes only.

The foundation of my investing philosophy started taking shape in 2008. I finally started to understand the validity of trend-following's core principles. Witnessing its success, especially during a time of extreme pain for investors and everyday people, further solidified in my mind that this was the path I was going to take with my life.

Who could've predicted the charts would've turned out the way they did? No one. And yet, trend-followers did well. That's the point. No need to predict. Just adapt and manage risk. It all started to make sense.

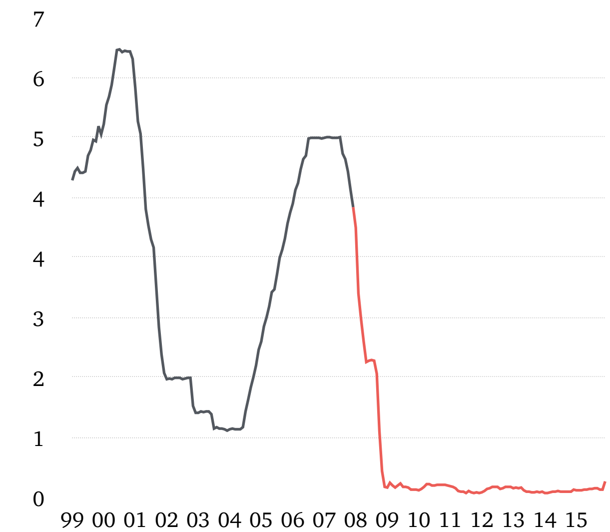
Goldman Sachs Commodity TR Index

Jan 1999 — Oct 2024



Fed Funds Rate

Jan 1999 — Dec 2015

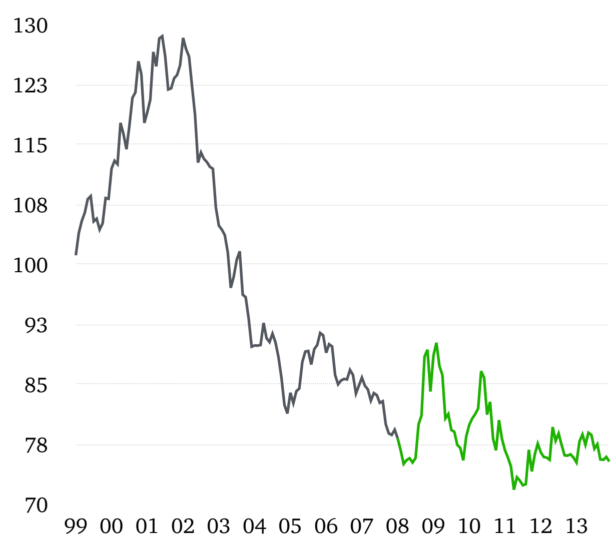


S&P 500 TR: 10-Year Annualized Return

Jan 1980 — Oct 2024

U.S. Dollar Index

Jan 1999 — Dec 2013



Principles that Guide Our Trading

I think it's important to have a philosophy. I'm not talking about tactics, but something deeper. Something that you are, not something you do. I'm a systematic trader, a trend-follower. When you know who you are, calm happens, executing becomes easy and the focus naturally shifts away from results to process. One advantage. It also attracts you to like-minded people who want a supportive relationship, not one where they pressure you to produce results (or else!). Another advantage.

When I meet with investors, I make it clear why I approach the markets the way I do and how I like to do business. This fosters trust and attracts others with similar taste. It has a calming effect too; allowing me to focus on what I do best (executing and improving the strategy) and investors to hold me accountable. This is a win-win relationship that will produce the best long-term results for everyone.

★ ★ ★ ★ ★ ★

Predicting isn't only unnecessary, it's dangerous. No one can predict the markets with any consistency, especially emotional investors. Markets simply do what they do. Patterns seldom repeat. Records are continuously broken. Historical correlations break down. Crazy is a constant.

Predicting is mostly about appeasing our feelings about the future. What's the Fed going to do? "They have no choice but to lower." Will inflation flare up again? "Definitely. And here are the stocks that will benefit most…" This is kind of the dialogue that occurs at most investment firms. Time-filling nonsense that tricks us into thinking we know what the future holds.

When we become so engulfed in our opinions, we neglect other, often better, opportunities. Investing time and toil into figuring it all out and vocalizing it to others makes it difficult to change your mind. You spoke with such confidence about stocks going up because and the Fed surprising us because, so you can't just accept defeat when you're wrong. You need to double down and stick with your conviction.

Riding sides is more lucrative than reading tea leaves. That's what we do. We do not predict what markets will do — how high or low they'll go — but ride the trends. This ensures that we do not miss major moves or leave profits on the table.

Accept and embrace volatility. It provides profits. Markets are crazy sometimes. They're not obliged to make sense. Most people cannot imagine crazy — such as $150 oil, interest rates at 10% (or back at zero), trillion dollar company valuations, a 70% decline in stocks, etc. The unthinkable happens often.

We can only capitalize on large trends by being willing to give back profits. This may seem counterintuitive, but in order to realize each trend's full potential, we must ride it to its end. This means sitting through significant reversals from time to time. This is by design — a feature, not a bug, of our approach.

Old fashioned risk management. We don't shy away from risk. It's what provides our profits, but we carefully monitor and control it. Every minute of every day we know what our risks are. From the business level to the portfolio, down to each individual position.

We trade only liquid futures and securities on regulated exchanges. This allows us to calculate our portfolio's value and risk each day. We prefer trading instruments with enough liquidity that allow us the ability to exit immediately during unexpected events. For this reason, we stay away from opaque illiquid hard-to-value investments.

We risk only a small fraction of capital on each trade. This reduces the changes of any one position dominating our PnL. We spread our small bets across many different markets — equities, fixed income, currencies, commodities and crypto. Diversification, small bets and aligning with the trends handles the heavy lifting of our risk management approach.

Many people equate volatility with risk. We do not. Risk, to us, is the probability of loss of capital. That is, when we risk a small fraction of our capital on a trade, we stand to lose that capital if the price hits our stop-loss. That is risk. Giving back profits is not risk, it's volatility. Volatility is fluctuating profits.

Be a generalist. We approach every market the same way. Each market has its own unique set of fundamentals, technicals and sentiment but people, and their mass psychology) are the constant. Trends develop as people react to changing fundamentals, risks and a myriad of other things. All of this gets distilled out in the price, so that's what we focus on. We let the market do the hard work and we simply follow its lead.

We trade over 100 markets — from Italian Bonds to Chicago Wheat to the Japanese Yen to Gold, etc. Opportunities can arise from anywhere, so we want to be there to profit. We don't try to force profits from a particular asset-class that's not moving well. Instead, we move capital to where there's minimal friction.

And we're always on the prowl looking for new markets to capitalize on. Recent ones include AI, crypto, blockchain and electric vehicles.

Perfect Doesn't Exist. Optimization has become a pervasive trend over the past decade. Stable markets have led investors into a false sense of security. The recent past reinforces new beliefs about the markets that can become very dangerous when you tailor your investing strategy to these beliefs. Examples include: they won't let stocks fall too much; inflation is transitory; high valuations cannot last; because of the debt, interest rates cannot go much higher than 5%.

Riding sides is easier, and safer, than picking tops and bottoms. There's no way to capture the entire uptrend in cocoa or downtrend in bonds. Trying to be perfect bears too much risk. It dances on the razor's edge of destruction. We're aware of our limitations. We know we cannot profit every month, quarter or make money on 100% of our trades. 40-50% is enough. Sustainability is what we're after, not perfection.

Investor Behavior Provides Opportunity

Over the past five years, market volatility has ramped up. Fundamentals have been changing fast, so investors have had to adjust to a new environment of higher interest rates, extreme valuations, inflation and geopolitical tension. While this may not necessarily give traditional investors the warm and fuzzies, this is an environment our approach thrives on.

Below, I'll walk through a few recent examples of how our approach capitalized on the transition towards more instability.

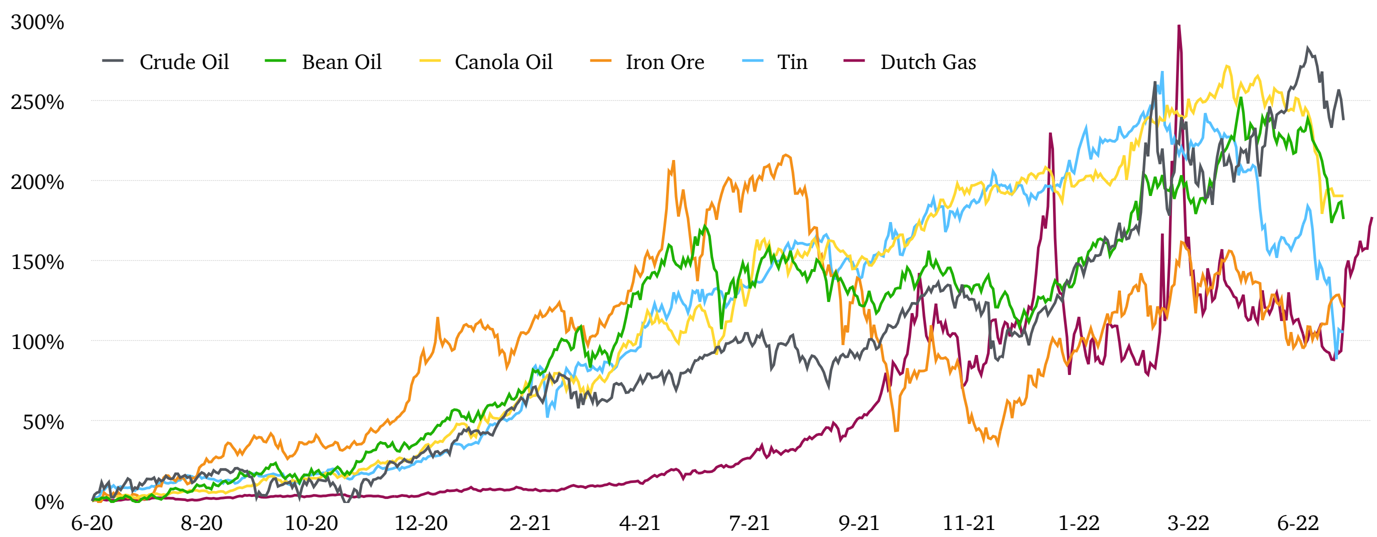
Example 1: *Inflation Catches Fire*

Covid-19, lockdowns, disruptions to the supply chain, massive global fiscal and monetary stimulus were the main fundamental factors that contributed to higher commodity prices. A speculative frenzy ensued, sending prices much higher than anyone expected. We stayed with the trends and reaped enormous profits.

Our trading philosophy thrives in these situations. When we initiated long positions, we didn't know the extent of the rallies that would occur, but that's the point — we didn't need to know. All we needed to do was be open-minded that such huge moves could occur, take responsible risks and go with the flow.

Inflation Surge

Jun 2020 — Jun 2022



Past Performance is Not Necessarily Indicative of Future Results. This illustration is for informational purposes only.

Example 2: *ZIRP Ends*

The markets underestimated how high inflation rates would rise, central banks included. Markets anticipated inflation to cool much sooner. It did not. So, central banks kept raising rates. Once again, we benefited from a trend that many people did not expect.

We initiated short positions in several government bonds in early 2021 when the U.S. 10Y Note was yielding ~1%. Little did we know we'd still be holding this position (plus other govt. bonds) three years later, finally exiting when yields were ~4%.

The story of how we make money isn't particularly exciting, but we don't care. Our investors don't seem to mind either. A trend develops, we take a responsible risk and if the trend continues we hold onto it. That's it. We don't have a crystal ball nor do we pretend to. We position ourselves to profit from the unthinkable and fortunately the unthinkable happens often enough for us to generate consistently strong profits.

Bond Prices Collapse

Jan 2021 — Dec 2023

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Example 3: *Cocoa Bubble*

Historically, cocoa hasn't produced many great long-term trends, but lots of whipsaws. When prices started rising in early 2023, we initiated a long position with little hope. Well, wouldn't ya know it, over the next two years (and counting) cocoa produced one of it's largest trends ever. This is a great example of the dangers of predicting. If you thought the new trend in cocoa wouldn't amount to much, because of its history, you probably wouldn't have taken a long position — and missed out on one of the best trades.

U.S. Cocoa Surges 400%

Jan 2023 — Oct 2024

Beware of "Alternative" Investments

Many people view their investments in hedge funds and private equity as alternatives, mainly for the purpose of diversifying their core holdings of stocks and bonds. However, one doesn't need to dive that deep to see that many of these "alternatives" do not provide much differentiation at all.

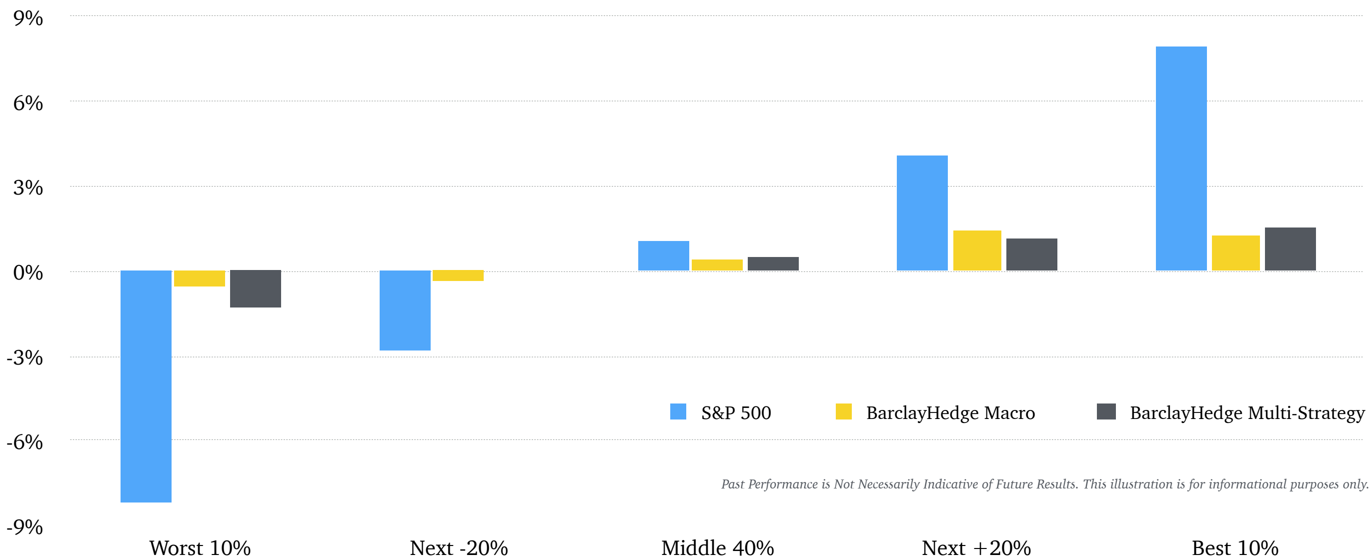
The performance of many of these alternatives largely relies on rising equity prices. The way firms present themselves might make you think differently, but the data says otherwise. Most of the people running these alt firms learned the same economic and investing philosophy that the local financial advisor did. They believe in "stocks for the long run" and other core tenets of fundamentals-based investing.

On the next couple of pages, we'll compare the performance of popular alternatives (global macro, multi-strategy and private equity) to the S&P 500 during both positive and negative periods.

In the chart below, we've broken down the monthly performance for the S&P 500 into quintiles — the worst 10% months, the next -20%, the middle 40%, the next +20% and the best 10%. Then we compared the performance to macro and multi-strat (private equity is shown in a separate chart on the next page).

Average Monthly Return Distribution: S&P 500 vs. "Alternatives"

2000 — 2024

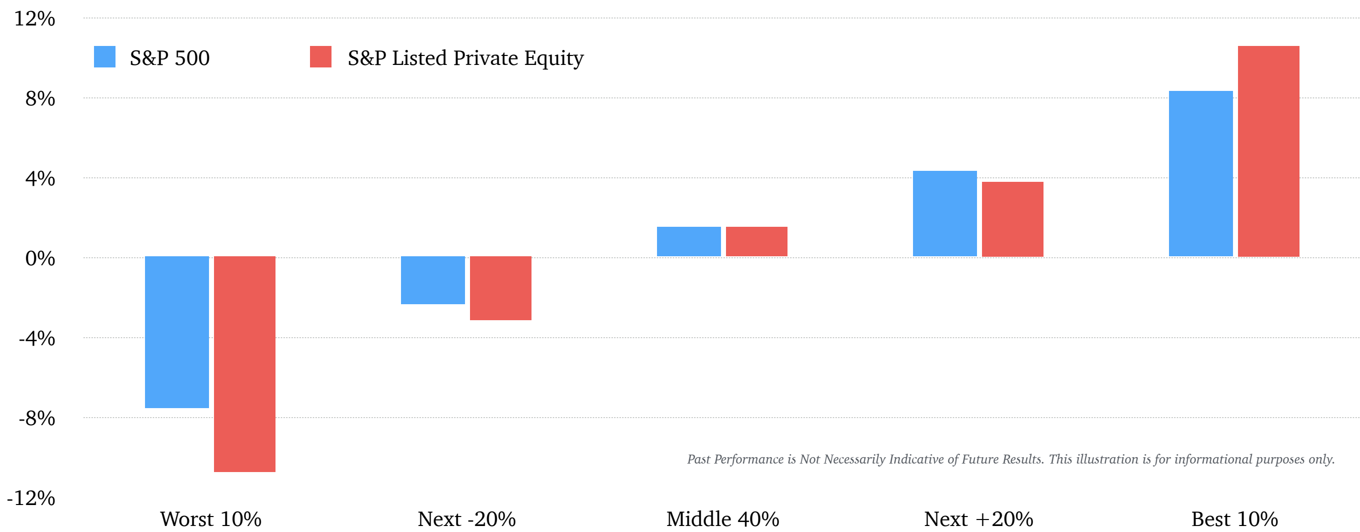


Both alternatives seem to protect capital pretty well during negative periods for the S&P 500. That's good. However, they severely underperform during bull markets. Not so good. In general, both display a similar performance pattern to equities albeit a less volatile one.

***Correlation to S&P 500**: Macro 47%, Multi-Strat 60%.*

Private equity is all the rage at the moment. Returns have been great over the past decade. Funds are launching left and right. AUM is exploding. Everyone "knows" it deserves a place in every portfolio. Well, if you're under the impression that it's an alternative, you're wrong. It isn't at all. What it is is a leveraged stock market position that will likely take a big hit during the next bear market. ***Correl. to S&P 500****: 89%*

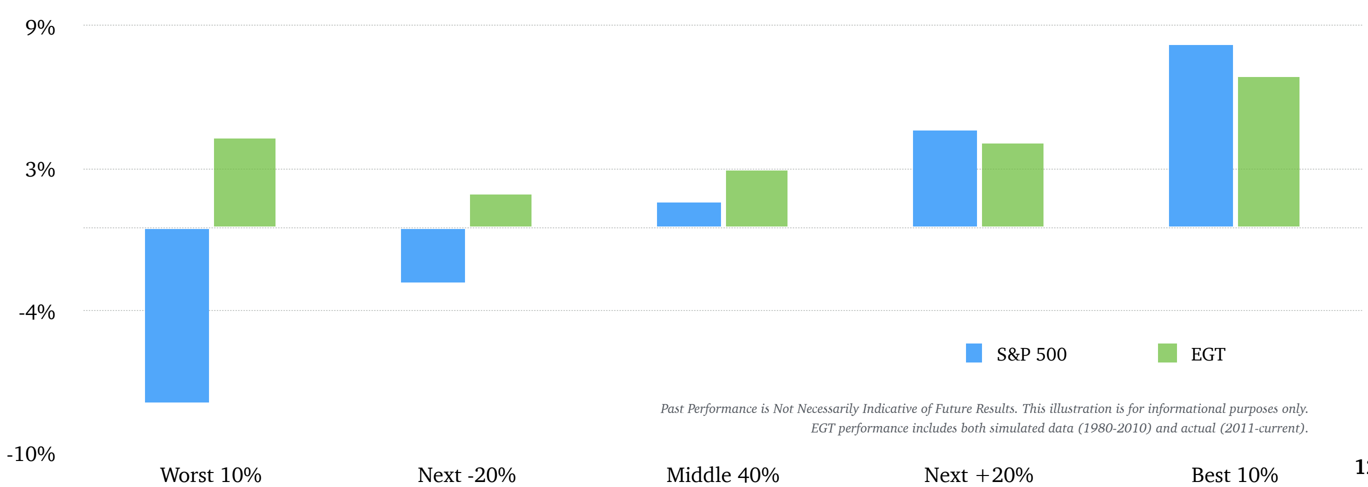
Average Monthly Return Distribution: S&P 500 vs. Private Equity *[2014 — 2024]*



If You Want a Real Alternative, Melissinos Trading is Just That

The point of the chart below isn't to show that we're profitable all the time because we aren't, but to illuminate what actual alternative performance looks like. You don't need an advanced degree to see that we don't look like stocks (or the other alts). We are what a real alternative looks like.

Average Monthly Return Distribution: S&P 500 vs. EGT *[1980 — 2024]*



***EGT's Correl. to S&P 500** [1980-2024]: -3%*. That's about as different as you can get over +520 months.

We're Clutch When You Need it Most

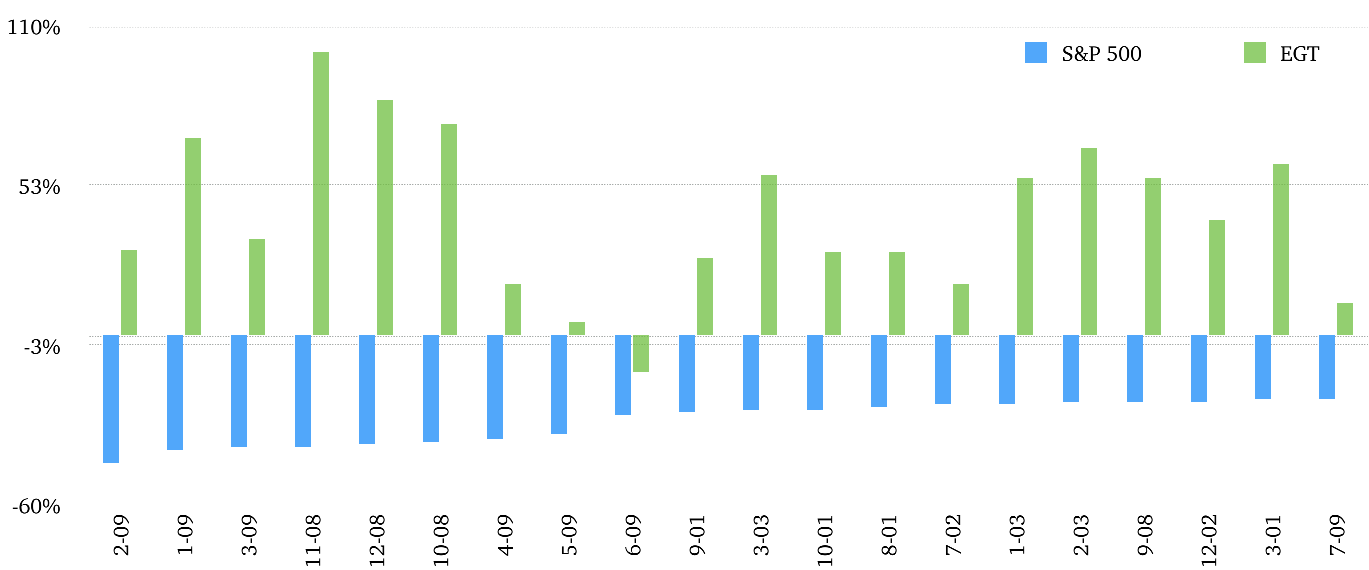
We haven't seen many negative 12-month periods for equities over the past 15-16 years; only 36 out of the last 188 to be exact *[19%; 1/09—8/24]*. But be careful not to fall into the recency bias trap. Deep and lengthy bear markets are real and will happen again.

Young investors think stocks cannot go down and that double-digit annualized returns are a given, but markets have a way of making you believe something can't possibly happen right before, well, that thing happens. Goldman Sachs' latest research suggesting poor equity returns over the next 10 years has ruffled a lot of feathers. People are dismissing it. People cannot imagine a world of near-zero or negative equity returns. As a reminder, scroll up to page 5. It has happened before and it will again.

No one knows when the next poor period for equities will come around. But if you value your money over believing in bedtime stories, you may consider taking a look at adding an investment like us to your portfolio.

What also makes us such a valuable alternative is that we're low maintenance. An investor can make an investment with us and leave it alone. Our returns have been consistent and reliable over time, so you don't need to worry about monitoring short-term performance or getting in at the perfect time. You don't need to enter and exit when specific environments start and stop. The best thing is to leave it alone.

Worst 20 12-Month Periods for the S&P 500 *[1980 — 2024]*



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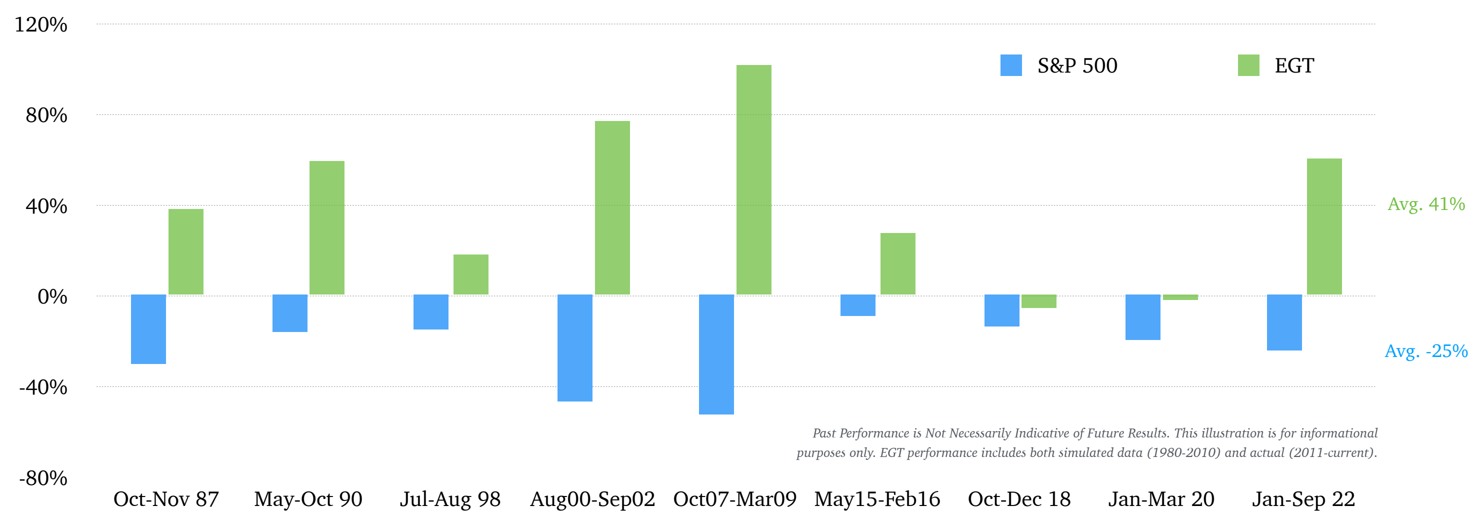
EGT performance includes both simulated data (1980-2010) and actual (2011-current).

And if we focus on the worst equity drawdowns, EGT delivers a similar performance profile.

Worst Drawdowns for the S&P 500 TR *[1980 — 2024]*



The Calm Could be Passing

Overall, market stability has negatively impacted our profitability over the past 13 years. We've seen short and sweet periods of strong trends sandwiched by long stretches of choppiness. This stable environment has been enormously profitable for equity investors, which is normal and what you might expect.

In recent years, however, stability has waned and trends have developed — no more ZIRP, the Covid crash, very strong inflation, the Russia-Ukraine war, a concurrent bear market in both equities and bonds, a new war between Israel and multiple terrorist groups, and last but not least political changes all across the world.

Are we on the cusp of a new wave of chaos and uncertainty? Maybe. The elements are certainly there for dramatic repricing to occur — inflation, interest rates, overvalued stock markets, rising global tensions, political reconfiguration, de-globalization, AI, etc.

I designed EGT to profit from instability and chaos, not calm markets. The fact that we've made money despite the environment being overwhelmingly stable in our lifetime is a positive, I think. It shows we can survive and eek out a gain even when things aren't going our way.

Every strategy experiences periods of underperformance. Back to when I first got into this business, equities hadn't gone anywhere in 10 years and experienced two 50% declines. The 10-year return was abysmal. If the calm is passing and we enter a period of high volatility, I believe we're extremely well positioned to deliver strong returns for our investors.

Disclosures

FUTURES TRADING INVOLVES A SUBSTANTIAL RISK OF LOSS
PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

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