

## What We Do When EGT Underperforms

There will be periods when EGT underperforms. That's a given, but understanding what causes its underperformance, as well as how we respond during these periods, is vital knowledge for every investor.

Without it, our investors will likely second-guess our approach and our ability to execute it over time. This lack of confidence will then likely lead to performance-chasing (abandoning it during normal drawdowns, buying it back during hot streaks) and ultimately hurt their returns. We don't want that.

In this write-up, we address:

1. we can and will experience periods of underperformance, either losing money outright or lagging behind other investments
2. how we respond when we do

Losing periods present entry points to go back to first principles. Why allocate to EGT in the first place? What role does it serve in your portfolio? Do you believe in its foundational pillars such as trading with the trend, maximizing opportunities, riding winners, cutting losses and managing downside risk?

These are the right questions, not "why is it down this month, quarter or year."

We expect periods of underperformance before we even set foot on the field. Our thorough research tells us this. In all of our simulations and stress-tests, periods of losses are always present. Experiencing them in real life is a different matter however, so this is where open communication can help us all stay on track and remain calm.

With all of this being said, let's get to what we actually do when EGT underperforms.

## **We don't change anything**

This is the most important sentence in this write-up. When EGT underperforms, we do not adjust the system, override signals, add discretion or chase what's been working lately. The system was built and tested across decades and decades of price data over thousands of trades. How it performs in any given month or year is irrelevant, not statistically significant.

There are two common ways managers blow up.

The first is concentration and conviction. That is, making a large bet, falling in love with the thesis and refusing to change the position even when the market moves against them. The narrative becomes more important than the present reality, which is the price. They hold. They average down. They tell investors it'll come back. Sometimes it does. Often it doesn't. When it doesn't, the damage can be catastrophic.

The second way is by tinkering; adding a little discretion here, skipping a signal there, tweaking parameters after a bad stretch. Then one day they're trading a system that didn't generate their track record. No single change looks reckless, but the cumulative drift destroys the edge quietly over time and you usually don't know it's gone until the damage has become severe.

We don't do either. We don't make concentrated bets or fall in love with positions. When price tells us to exit, we exit no questions asked. And we don't tinker with our system because we feel frustration, embarrassment or some other feeling. We know our edge largely rests in us following our system.

## **We make smaller bets**

As our equity declines, we adjust our position sizes proportionally so that we don't compound our losses recklessly. Think how you'd behave if you had lost

your job. Would you spend less or more? Spending more, or even the same, would put you in the fast lane to debt and in a deeper hole to climb out of.

So, when we lose, we reduce our bets. We adapt to our situation and prioritize survival. We aren't interested in digging the hole faster or deeper for ourselves to ultimately climb out of.

When markets improve and we start making money again, however, we ramp up the position sizing. Adaptability is what EGT is all about. It's built into the rules that guide the trading. EGT handles risk-scaling as equity increases and decreases.

## **We keep expenses low**

We run lean. Even during profitable times, we run lean. This area isn't talked about very often, but I believe the lifestyle creep, both on an individual and business level, must be watched diligently. Similar to position sizing, it must be kept to a healthy proportion of income and wealth in order to avoid the pressure to keep up — either with your previous standard of living or with the people around you.

There's countless examples of businesses that catch a wind of profitability, scale up their operations too fast (because they anticipate even more profits) and then have to scale down even faster (under immense pressure I might add) when they inevitably hit the next rough patch.

For a systematic trend-follower like us, keeping expenses low is not actually that hard to do. We don't need fancy offices, bloated staffs or cutting edge technology to listen to the computer. We'd need these things to attract very large sums of capital, but that's not our focus. Our focus is returns. And that focus relieves an expensive burden off our shoulders.

## **Our tracking portfolio remains the same**

During losing periods, traders can be tempted to cut ties with the markets that have cost them money. "I can't look at this stock anymore." "This market just takes my money over and over trade after trade. I'm done with it."

Cocoa had been stagnant for *years* before it woke up by producing an enormous trend in 2023–24. Markets are unknowable. Some wake up when others go to sleep and vice versa.

We track and trade 100+ markets all the time. Not because every market is productive every year, but because we don't get to know in advance which ones will be. In order to be positioned to capitalize on the large profitable trends, we must be there for the times the market doesn't produce much.

When we do add or remove a market from our universe, it has nothing to do with recent performance, ours or the market's. If we weren't tracking it before, we don't add it now to chase what would have worked. If we were tracking it and it's been quiet, we don't drop it because it's been frustrating. The universe we trade is a long-term structural decision, not a reaction to recent performance.

## **We place every trade**

Continuing with the theme of not changing anything, we simply execute the trades the system says to do. Our long-term edge requires it. Not when we feel good about it, but every time regardless of how we feel.

This is harder than it sounds. The old-timers, the managers who built 30 and 40-year track records, experienced serious drawdowns that tested their commitment and character. Ed Seykota, one of the best trend-followers ever, has said on record that he still experiences doubt during drawdowns. Even after decades of success, he still feels it. That's the human condition.

One mistake every once in a while is enough to seriously damage returns. The best opportunities tend to come when we aren't feeling great, when we don't

have our best stuff. We are weakest link in the entire operation, so we have to stay strong during those stressful times and simply do the trades.

The feelings don't go away. You don't graduate past them. What changes is your relationship to them. You feel the doubt, the frustration, the impatience and you place the trade anyway. You honor the feeling without letting it make the decision. That's as close to a Holy Grail as you're going to get in the markets.

## **We talk to our investors**

This might sound unrelated to The Strategy, but it isn't. When EGT is underperforming, frustration, impatience and even anger can spring up. We don't suppress that, but say it out loud. Expressing it allows us to examine it and stay on track. Why are you frustrated? What are you expecting that isn't happening? Do you still believe in the rules?

These conversations almost always result in reconnecting with why EGT works over the long run and recommitting to it. No strategy tweaks needed; just a conversation, some venting and a handshake or a hug.

Markets move for reasons we often don't know, so pretending otherwise is a short-term medication that erodes long-term trust. Investors know deep down, but we remind them anyway, that even the best systems and managers go through painful periods.

Morningstar examined roughly 9,000 mutual funds and ETFs and found that the best long-term performers (10+ year returns) routinely had average and below-average performing 1-3 year periods. So, the managers that were in the top quartile over the long run were not consistently there year in and year out. To get the best performance, you would have had to sit through a lot of average.

This is the reality many people simply cannot accept, but if you can then you have a massive advantage. Brilliant years come and go, but a reliable process, repeated without deviation, is what lasts and pays the bills over the long run.

Morningstar study: [morningstar.com/funds/why-consistent-fund-performance-is-overrated](https://www.morningstar.com/funds/why-consistent-fund-performance-is-overrated)

### What we expect from investors during losing periods

As we stick to the system, we expect our investors stick with us. We expect them to trust us to do our part and we encourage them to express themselves freely to us. When this is done honestly, we typically get back on track after one conversation.

However, we understand that investing is hard. Trend-following can be particularly hard because it's counter-cultural, it doesn't have the benefit of "we're all in this together" like a buy-and-hold approach does. The return profile can also be streaky, so waiting around for those strong profitable periods can be taxing. Our investors have jobs, families and bills to pay. This investment is one piece of their life that has plenty of other pressures in it.

So when things are quiet or going sideways, we reach out. We check in to see how they're feeling about things. We remind investors why they hold an investment with us in the first place, that these periods are to be expected, etc. We want to be a calming and helpful presence.

### **One more thing...**

We invest heavily in EGT right alongside our clients. When EGT underperforms, we feel it too. We believe in leading by example and eating our own cooking. This is the most direct way to communicate our trust and commitment to EGT for the long run.

*Past performance does not guarantee future results.*