ETALON CAPITAL

From Reality, Not From Models

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The past year had taught us an important lesson. The lesson being that we should base our decisions and actions on reality instead of religiously adhere to certain models or modes of thought.

Disastrous performance by quantitative hedge funds during 2020, the inability of models and their operators to adjust to unfolding reality, undelivered promises of hedged returns - all this makes one conclude only one thing: something is wrong here.

After accumulating some amount of experience analyzing companies, I came to conclusion that in the equity markets it is much more important to know what not to do, instead of knowing what to do.

During 2020, besides the fact that market was overwhelmed by covid narrative, there was a positive side to all the chaos. A lot of noise, and non-sense, and conflicts of interest, and lies were washed away. And the exercise of plain common sense, without the need for too much of sophistication, would be enough to achieve good results.

While restaurants and hotels are closed, supermarkets are doing fine. While airlines and travel companies suffer, consumer goods packaging is in demand. While banks are questionable, home improvement retailers such as Home Depot, Lows and Tractor Supply Company are doing well because people stay at home.

Plain common sense, nothing more.

While quantitative and algo hedge funds are working hard on adjusting their models, activist investors are getting ready for a real fight in 2021. They had already doubled number of campaigns in the last quarter of 2020 compared to the third quarter. It is safe to assume that this trend will continue into 2021.

While quantitative and algo hedge funds hire more and more quant analysts to try to extract alpha using the same approaches and the same data available to every other market player, a robust IPO market seems to extend into 2021 with M&A activity also expected to pick up steam in 2021.

So instead of focusing on this actual reality and events, it looks like quants are stubbornly flogging a dead horse.

And if they think that they are already on top of the covid narrative, they should also think twice. Cleaning up the debris of covid is not over yet. And it is only reasonable to assume the next year or two hold enough surprises.

So, we want to wish quants success in their efforts, with only one small warning: that if they will persist with their stubbornness for too long, the dead horse might explode in their face a second time.

Everybody else will be much better off by addressing unfolding reality, remembering that models are only means and tools to accomplish objectives and create meaning, exercising plain common-sense judgement, and taking advantage of the unique opportunity to confront honestly with reality without the need for too much of sophistication.