



Hedge Fund Report: LN North America Equity Long Short

August, 2024

Summary

LN North America Equity Long-Short (LNLS), launched in 2018 by WWC, is a top-ranked fund with US\$250 mm assets under management (AUM). Complimenting fundamental core positions with tactical trading, it has produced an annualized net return of 18.2% and Sharpe Ratio of 1.35 with a max drawdowns of 8.9% since its inception, compared to that of 12.1%, 0.31, and 24.8% respectively of the S&P500 total return index (SPX) during the same period.

The LNLS investment team won multiple industry awards for its performance. Its client services and operations are handled by the larger WWC, which has sound regulatory compliance and quality custodian, brokerage, accounting, legal, and other service providers.

LNLS will likely continue to generate attractive absolute and risk-adjusted returns and investors should consider an allocation, certain caveats and the need for due diligence notwithstanding. This report examines the history, team, strategy, risk control, service providers, operations, governance, performance, and terms before providing an assessment of LNLS.

History and Overview

The founder and CIO established WWC in 2011, after years working as a research analyst and portfolio manager (PM) at large asset managers. Headquartered in City1, WWC has several funds and a combined AUM of US\$1.3 bn. Launched in 2018 to focus on the US and Canadian equities, LNLS investment team includes a PM, the founder of WWC, co-CIO of WWC, and an analyst. PM studied Psychology at University1, interned with WWC founder when he was a college student, and now has more than 15 years of experience in investing. PM has managed the LNLS portfolio since its inception and received multiple performance awards from a leading industry publication. Co-CIO joined WWC in July 2023. A veteran in equity derivatives, co-CIO was a Managing Director at a major bank, has a Bachelor of Commerce degree from University2, and has more than 20 years of experience in investing.

LNLS investment strategy combines fundamental research and tactic trading. A 12-person team of WWC handles its client services and back-office operations. LNLS currently only has an on-shore investment trust serving Canadian investors, subject to the oversight by CSA (the Canadian Securities Administrators) and SEC (the US Securities and Exchange Commission). LNLS is open to establishing a Cayman master-feeder for off-shore investors.



Team

LNLS has a capable PM and a small investment team with complimentary skills in fundamental bottom up analysis, tactical trading, and derivatives. It is supported by established WWC client and operation teams, which include 4 persons in client relations, 6 individuals in operations/accounting/compliance, 1 accountant, and 1 IT specialist. WWC conduct annual reviews of its staff, and new hires are subject to background checks. To avoid conflict of interest, all trading for personal accounts by employee must be approved by the Chief Compliance Officer.

PM and his family is a large investor in LNLS, and all WWC staff are investors of LNLS funds, aligning interests with investors.

Investment Strategy and Process

LNLS generates returns by holding core long positions and conducting tactical long and short trades. The investment team maintains a watch list of roughly 200 stocks, supplemented with research reports from its brokers and third-party providers. PM makes the final call on all major portfolio decisions, with WWC founder and co-CIO act as a sounding board.

For its core long positions representing 50-60% of the portfolio, LNLS uses bottom-up fundamental research to select 20-50 high-quality businesses, usually in large-cap names. The largest single position size is around 7-8% AUM, with the top 10 positions making up about 30% of the portfolio. LNLS typically holds these core longs for two to three years. To hedge core holdings, LNLS regularly purchases equity index ETF and single stock puts with 1-3% AUM, adjusting the hedge size according to the market environment and the desired net exposure.

For tactical trading representing 15-20% of the portfolio, LNLS searches for long and short opportunities from stock-specific catalysts. While it may purchase stocks or calls for longs, it usually uses puts and put spreads with defined risk and reward for shorts. The typical splits among longs and shorts are 70/30. LNLS normally holds 4 or 5 of trading longs and shorts, each usually lasting 1 to 3 months with an average size of 3-5% AUM. Although its mandate allows 1.75x gross, LNLS derives leverage from options and usually has a gross exposure below 1x. With low leverage, hedging, and tactical long-short trading, LNLS is designed to be a low-volatility fund.

Fundamental equity core holdings plus tactical trading has long been one of our favorites. The complementary skills of the LNLS investment team in research, derivative, and tactical trading appear to have what it takes to produce impressive performance.

Risk Control

LNLS manages risk through knowing its core positions well, using modest leverage, diversifying, hedging, and counter-cyclic short-term trading.



LNLS normally has less than 100% in gross exposure, far below its limit of 175%. Net exposure varies from a negative 60% to a positive 40%. The max single core position is limited at 15% but is usually at 7-8% AUM, and max single trade size is 10% but usually at 3-5% AUM. LNLS does not allow naked selling of puts and calls. It does not have a liquidity limit on position size, given its modest AUM.

Service Providers

LNLS uses Morgan Stanley and TD Securities as its custodians and prime brokers. Its auditor is KPMG, and its legal advisors are Baker & McKenzie and AUM Law. Pinnacle Fund Services is its fund administrator. They are all independent and reputable firms in the industry.

Operations

LNLS conducts research and investing while WWC manages client relations and service providers, provides support systems and data, and ensures compliance; outsourcing most of its back-office operations to service providers.

The investor relation managers market LNLS and ensure that investor inquiries are handled promptly. They work with the fund administrator to ensure client subscription and redemption are handled properly and monthly NAV (Net Asset Value) reports are delivered on time.

The compliance officer maintains internal control and coordinates legal advisors to prepare AWL (anti-money laundering) reports and filings to ensure compliance with regulators. The fund operating staff tracks client and ABCLS accounts independently of the fund administrator. The operation team is also responsible for coordinating outside auditors and lawyers to prepare annual audits and tax returns. Its IT person works with an outside IT firm to maintain and secure LNLS systems that house accounts, records, research and trading tools, databases, et al.

Governance

WWC is a limited partnership controlled by its founder and LNLS is a WWC in-house fund (trust) serving Canadian investors, different from a Cayman master-feeder many investors are accustomed to. Otherwise, LNLS functions like a normal fund, with sound regulatory compliance and internal control, and well-respected service providers.

LNLS' governing document, the OM (Offering Memorandum) sets out its structure, investment strategy, risk parameters, fee levels, rights of the manager and investors, and other details. The document contains a wealth of critical information. Investors should review this document carefully before investing in LNLS.



Performance

LNLS has produced a net annualized return of 18.2% and a Sharpe Ratio of 1.35 (using a risk-free rate of 5%) since its inception in Aug 2018 to Aug 2024. During the same period, the annualized return and Sharpe Ratio of the SPX were 12.1% and 0.31 respectively. The max drawdown during the period was 8.9% for LNLS and 24.8% for the SPX. Table 1 shows the monthly returns of LNLS, and Chart 1 compares its equity curve with the SPX. The correlation between monthly returns of LNLS and SPX was 0.22. Chart 2 shows the scatter plots of the two monthly returns series, confirming the low correlation between LNLS and SPX.

Table 1: LNLS monthly returns since inception

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2024	(0.12)	1.26	(0.50)	0.34	(1.53)	(1.56)	2.80	1.37					1.99
2023	3.31	0.52	1.25	(0.09)	(1.62)	0.19	0.48	1.01	2.16	2.21	(0.61)	1.60	10.81
2022	9.57	4.96	1.82	2.14	2.51	0.30	1.50	(0.16)	1.44	5.61	2.03	2.60	39.75
2021	2.81	5.48	7.78	0.64	7.09	(0.64)	1.05	(1.29)	6.33	(0.09)	0.97	9.06	46.03
2020	0.15	(1.95)	(7.09)	5.13	2.50	1.62	1.72	1.61	1.88	(1.39)	5.42	1.35	10.84
2019	3.19	0.55	2.09	0.65	(0.23)	1.92	0.76	3.25	0.62	1.21	0.32	1.22	16.63
2018								(0.51)	(0.19)	(4.45)	3.48	(5.57)	(7.28)

Chart 1: LNLS Portfolio vs SPX

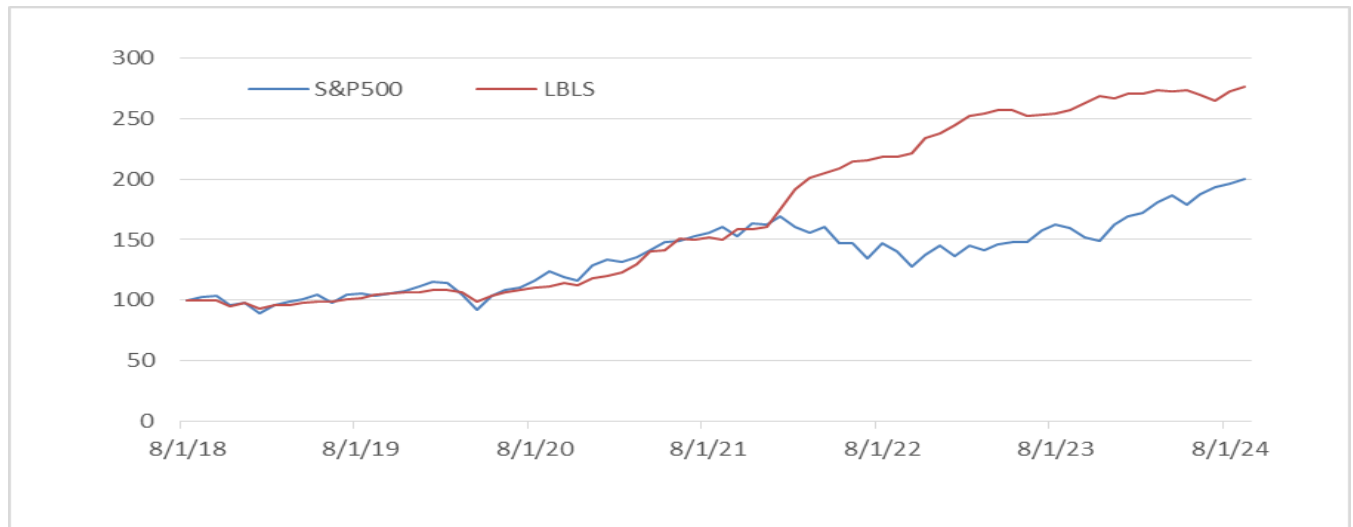
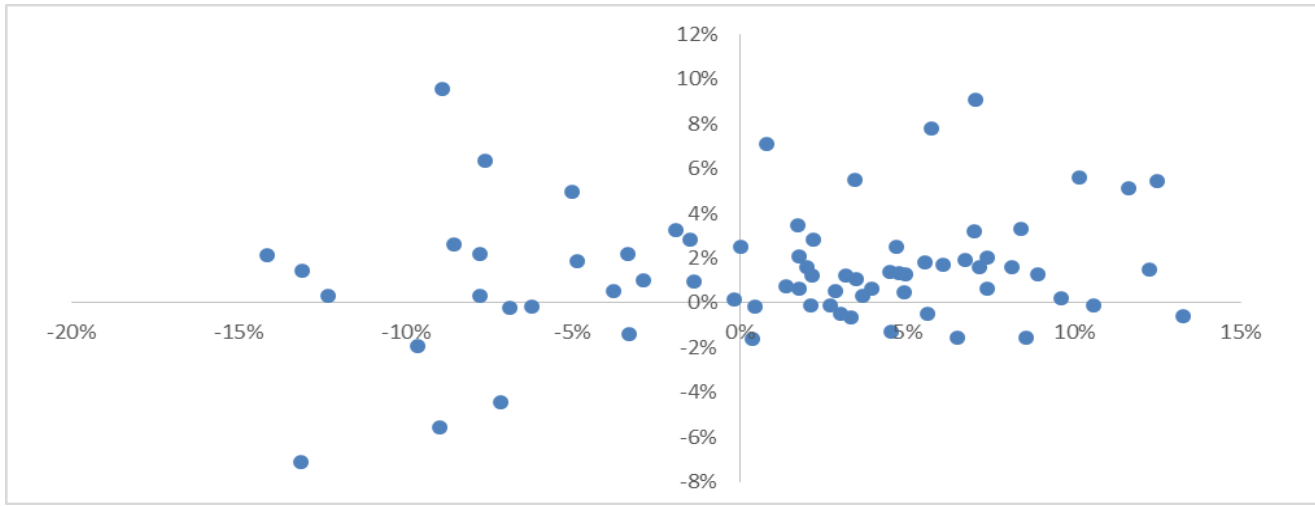


Chart 2: Scatter Plot: Monthly Returns of LNLS (vertical axis) vs SPX (horizontal axis)



Terms & Facts

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|-----------------------|-------------------------------|
| 1. Currency | US\$ |
| 2. Domicile | Canada |
| 3. Structure | On-Shore Investment Trust |
| 4. Fund Administrator | Pinnacle Fund Services |
| 5. Custodian | Morgan Stanley, TD Securities |
| 6. Prime Brokers | Morgan Stanley, TD Securities |
| 7. Auditor | KPMG |
| 8. Legal Advisors | Baker & McKenzie, AUM Law |
| 9. Min Subscription | US\$250,000 |
| 10. Management fee | 1.5% per annum |
| 11. Performance fee | 20% |
| 12. High watermark | Yes |
| 13. Hurdle rate | No |
| 14. Subscription | Monthly |
| 15. Redemption | Monthly, with 30-day notice |

Assessment

LNLS has a capable investment team with complimentary skills, enabling it to effectively execute a strategy that combine fundamental core positions with tactical trades. Such strategy has enabled a few investment managers to weather the ups and downs with flying colors through several market cycles over decades. LNLS appears to be a credible new comer, and it uses a very conservative exposure and a straightforward but effective risk control, producing attractive absolute and risk-adjusted returns since inception. Its support and compliance functions appear to work well, and it has respected independent service providers.



The initial screen suggests that LNLS should be a candidate for consideration, based on public information and materials provided by the fund, with the following caveats:

- **Strategy details:** LNLS did not take full advantage of the modest 1.75x leverage available to them. We understand that LNLS derives extra leverage through options, but in funds with similar strategies, it is not uncommon that core positions take up 1.0 to 1.5x gross exposure. However, LNLS only has 50-70% gross exposure in core positions, which may explain why it nearly consistently underperform or barely track the market during its upswings. It is perfectly fine if LNLS simply wants to be conservative. We will probe during our due diligence if there are any issues that constraint capital utilization, as well as learn other details of its strategy and process. It may worth your while for investors to do the same.
- **Limited track record:** While its performance is solid, LNLS has only experienced one period of 25% market decline since its inception. Major market dislocations could witness equity indices drop 40-50% or more. Although we believe LNLS would likely perform well during these periods given its strategy and low gross and net exposure, investors should keep that in mind and diversify their portfolio.
- **Process and governance:** LNLS is a relatively small fund, nimble and unconstrained by formality. On the other hand, it relies heavily on the individual PM and is light on process. We believe the involvement of the founder and co-CIO of WWC, being the mentor figures, provides the desired balance. We plan to visit LNLS during due diligence to get a tangible feel. We encourage investors to do the same.
- **Due diligence:** This report is based on public info from reputable sources and materials provided by LNLS, which we assume to be reliable given the intense regulatory scrutiny in the Dodd-Frank era. We validate facts and data mainly in our due diligence stage of the fund selection. Also in our effort to distill hundreds of pages down, omissions and subjective selections are inevitable, and possible errors are likely. Investors investing on their own must conduct thorough due diligence before their investment decisions.