Thales Annual Letter

Thales Research

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thalesresearch.substack.com

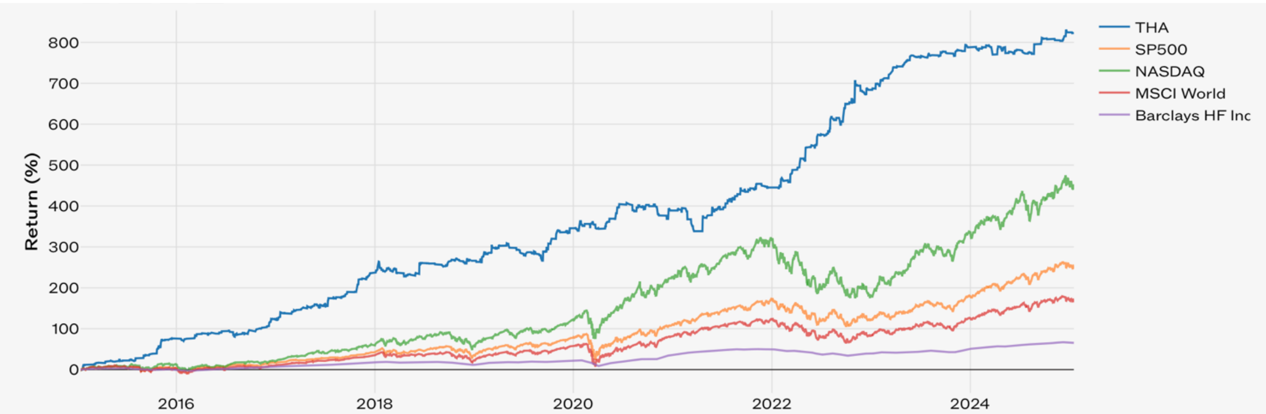
Introduction

With the release of the very first ThalesResearch Annual Letter for 2024, a brief intro about us is in place; we are an event-driven specialist global macro strategy and a research company. For more information about our process we recommend taking a look at our FAQ here, our past investor letters, and our event-related research here.

If you had to write a song about our performance in 2024, it would be a lullaby. We traded with a historically tight range of max drawdown 3% and return of 4%. That doesn't mean there weren't some great opportunities this year, some of which we caught and some we missed.

Most importantly, after a lackluster H1, we have traded with a 5.6% return and a 1.3% drawdown since August. Overall, we are confident that moving into a new market regime will create more opportunities going forward.

Table 1: Thales gross returns for 10 years



Return table	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2015	11.3%	0.5%	3.8%	3.5%	0.1%	0.3%	0.8%	5.4%	7.2%	12.5%	12.2%	1.3%	75.7%
2016	-1.2%	0.7%	6.2%	1.2%	-0.2%	3.2%	-6.1%	2.9%	4.8%	1.7%	3.0%	7.9%	26.1%
2017	7.0%	-0.5%	3.5%	3.4%	2.4%	0.6%	5.1%	0.4%	4.9%	6.5%	4.3%	5.1%	51.7%
2018	1.1%	0.3%	-1.5%	-1.8%	1.7%	7.2%	-0.3%	-0.5%	1.8%	1.7%	-3.0%	1.9%	8.7%
2019	2.9%	2.5%	2.8%	1.5%	-1.4%	-3.3%	0.4%	-1.6%	3.8%	10.8%	-0.3%	2.4%	21.7%
2020	2.0%	0.4%	-2.6%	2.8%	2.7%	7.4%	-0.1%	-0.2%	0.2%	-0.9%	-4.3%	2.5%	9.7%
2021	0.4%	-4.8%	-6.2%	7.4%	4.5%	0.0%	5.2%	2.3%	1.1%	1.2%	1.6%	-0.8%	11.5%
2022	0.9%	2.3%	4.6%	4.2%	5.6%	4.3%	0.9%	5.0%	4.8%	0.5%	3.4%	0.6%	43.8%
2023	1.6%	2.0%	3.2%	0.6%	2.9%	-0.6%	1.1%	-0.4%	1.0%	-0.6%	0.9%	0.9%	13.3%
2024	-0.8%	1.4%	-2.6%	1.4%	-0.6%	0.5%	-1.0%	2.7%	1.4%	0.0%	-0.6%	2.3%	4.1%

Total: 819.4%

Brief overview of the macro narratives in 2024

There was very little to write home about in H1 on both the macro data and central bank fronts, apart from a brief inflation scare in April. This led to tight ranges in FX and a generally smooth curve-up in equity markets.

Volatility picked up in August. Investors had accumulated a huge, long position in the USDJPY, and when US inflation started pointing down, alongside a more hawkish BOJ and one bad employment report from the US, the long position unraveled as investors scrambled to exit their USDJPY longs.

Across a five-day period from July 26th to August 3rd, investors dumped Japanese stocks (-30% drawdown in Nikkei), the SP500 experienced an 8% correction, and the USDJPY collapsed nearly 1500 pips.

Chart 1: Four-hour charts of SP500, USDJPY and Nikkei 24 July to 6 August

However, just as quickly as the crisis had unfolded, markets realized this was more positioning related than actual growth scare, and stocks recovered. USDJPY recovery took a bit longer, as the low inflation and hawkish BOJ narrative persisted for a few more months.

Chart 2: 4h price action on Nikkei, a quick recovery

The second main market mover in H2 was of course the *US presidential election*. We have written extensively the subject and the ensuing result on our Substack, so if you are interested on our takeaways, you can access the research here.

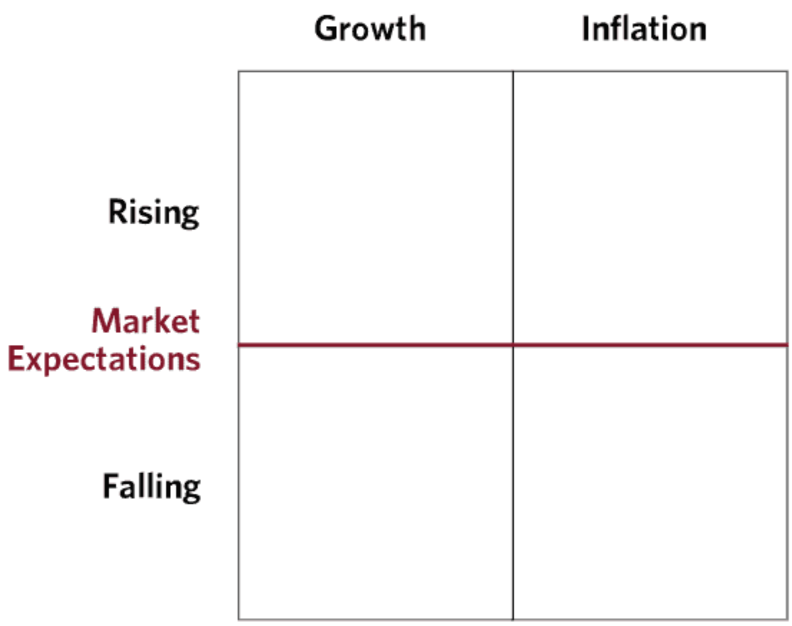
Macro regimes – where the hell are we, where are we going and how do regimes impact our performance

Purely anecdotally, macro regime changes are the primary reason most trading strategies have a shelf life of 2-3 years! Therefore, one should do one's best to understand these regimes in order to adapt to different market conditions.

As event-driven traders, we are not trying to forecast the future regime; we are just trying to know where we are so we can adapt our trading accordingly. However, no matter how we try to adapt, there's no question some regimes are better for specific strategies than others. The main question is managing risks so you don't lose too much under unfavorable regimes and perform strongly on any regime.

To understand regimes at a high level, there's no better way to start than Ray Dalio's four-quadrant framework. In terms of main macro drivers, regimes are primarily driven by inflation and growth.

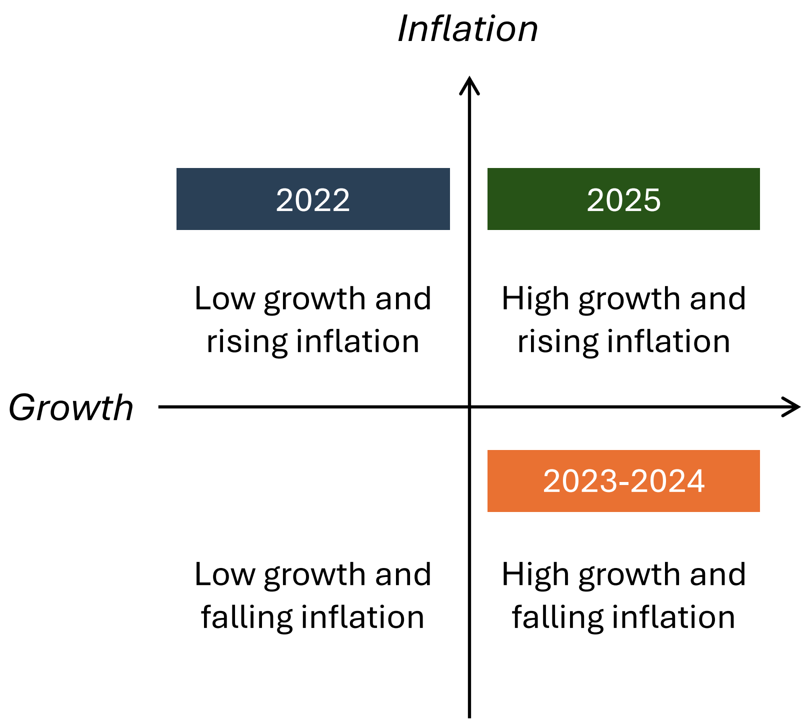
Picture 1: Four quadrant market regime framework developed by Ray Dalio & Bridgewater



We have spent last two years in an environment of falling inflation and high growth. There have been two false alarms during this period, mainly the August 2024 US employment report scare, and the carry trade unravel (falling inflation and falling growth). Also, the SVB mini-banking crisis in March 2023 could be considered a false alarm (again many thought we were moving to a regime of falling inflation & falling growth).

The only true time we had falling inflation, and a falling growth regime was during H1 2020 due to Corona and before that, the Financial Crisis in 2008-2009. In both situations, we moved to a rising growth regime, most notably due to the policy steps taken.

Picture 2: Thales Research applied four quadrant market regime framework with example years



It seems relatively clear that the regime is shifting to an environment of rising inflation and high growth. A protracted period of higher-than-expected growth is the main driver of this shift, pushing inflation expectations up alongside more expansionary US policies.

In terms of event trading in FX, this sort of regime unequivocally means more opportunities as there's more uncertainty and volatility.

Disclaimer – there are different regimes

Now, we are assessing the US regime, but of course, there are many different regimes. The UK, for example, is currently in a stagflationary regime. Regardless, the US is the driving force for global moves; therefore, we think getting it right is the most important part.

For an extreme example, one can look at Finland. We have spent the better part of the last 2-years on a low growth and falling inflation regime, and the Finnish stock market is one of the worst-performing stock markets globally. Finland has been in a difficult position with the war in Ukraine, demographic shifts, strong labor unions, and high interest rates, relatively speaking. No wonder most people here think lottery is the only way to get rich![1]

[1] Unfortunately this one is only in Finnish -> https://danskebank.fi/sinulle/artikkelit/2024/09/suomalaisten-usko-lottovoittoon-vaurastumisessa-ei-horju

Are you going to be taking more risks in this new regime?

This is a good question which we received a lot lately. We don't think 2024 was our worst year, because on some other years, while we finished year positively, we had significantly higher drawdowns. We think a strategy that can deal with very tight drawdowns and feasible risk-reward serves a purpose.

While our goal is to beat SP500 over the long-term, in the short-term we are first and foremost risk managers. The answer is we will take more risks when opportunities emerge.

Patience is key and we are certain great opportunities will emerge over next 2 years based on our studies of history – they always do. We would expect more opportunities overall this year than past two years given changes in regime.

Conclusion

Thales as a strategy has reached a mature age of 10-years, which is quite unique in in FX space. To illustrate what markets have done during that period, EURUSD from 1.15 to 1.03 and SP500 started 2015 at 2044, and is now roughly at 6000, moving up over 200%. Point being – FX is a near-zero sum game over long periods and a tough market to trade!

Research shows even top managers can underperform over prolonged periods.[2] And underperformance is subjective, we have returned gross over 60% with a 5% drawdown over the past 3-years.

We are optimistic the period of relative underperformance is over as we move to a new regime. Nevertheless, we have been through various cycles during the lifeline of the track and are prepared for all regimes.

We remain confident as always, trusting our process' and think there will be a plethora of fresh opportunities for those that have researched the space deeply and have remained patient enough to remain able to take advantage of those opportunities. We are looking forward to the next decade of the track and are confident we will overperform the relevant benchmarks during that period.

Best regards,

Thales Research team

[2] https://content.rwbaird.com/RWB/Content/PDF/Insights/Whitepapers/Truth-About-Top-Performing-Money-Managers.pdf

ABOUT THALES

Thales is an event-driven hedge fund strategy deployed on data releases and monetary policy decisions in G10 currencies post-event. The strategy manages circa 25 mn at Darwinex and has have won the Hedge Fund Journal award for Best Performance in FX for the past 5 years (incl. 2023 and 2022).

ABOUT AARNIKOTKA

Aarnikotka Tutkimus (EN: Gryffon Research) is a trading signal provider and a research company based in Jyväskylä Finland. We provide trading signals directly to Thales (THA) strategy managed by Darwinex, an FCA and CNMV regulated investment platform in Spain and UK.

IMPORTANT NOTICE

This investor letter is not an offer or solicitation to raise funds from any type of investor, nor its purpose is to provide investment advice in any form. Contents of this report are for informational purposes only.

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