ADVANCED ALPHA ADVISERS

Investor Letter: ART Strategy May 2026

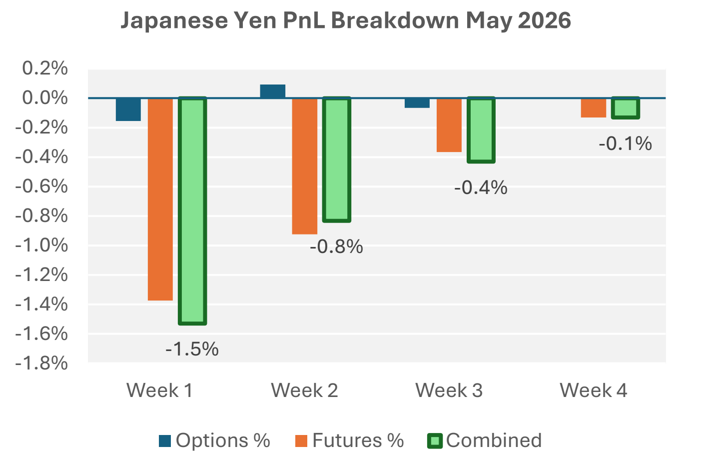

Figure 1: Japanese Yen Futures Price May

Total Japanese Yen Gross Pnl May: -2.9%

The Japanese Treasury intervened in currency markets several more times in the first half of May. While we were initially able to profit from this move the frequent, sharp, counter-trend jolts created impossible conditions for both the trend following strategy and the delta-hedged, short options. In the second half of the month volatility collapsed as the Yen was once again trapped between macro forces and intervention risk, making it difficult to find any meaningful trends.

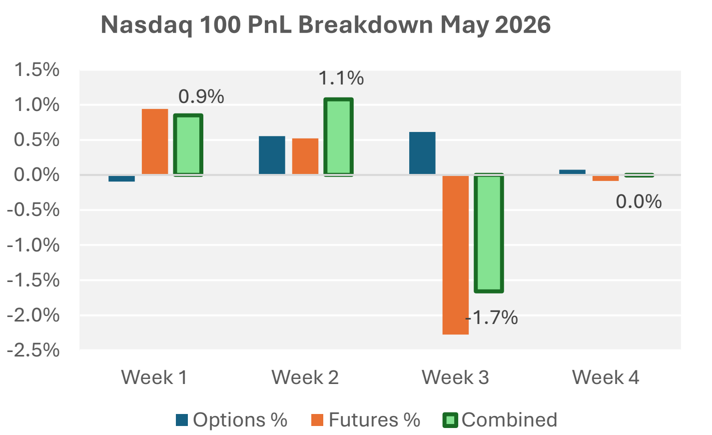

Figure 2: Nasdaq 100 Futures Price May

Total Nasdaq 100 Gross Pnl May: +0.3%

US equities continued their relentless move higher in May. In the first two weeks our futures algorithms were able to pick up on this trend and successfully follow it, however choppy conditions in the third week eroded this profit. The short options strategy was profitable in May, however this was limited due to our cautious approach in the face of geopolitical tail risk.

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This Month

Japanese Yen – these are strange times indeed. In the past, when the Japanese Government has intervened in currency markets it tends to happen in one or two big trades. Sometimes this triggers a sustained appreciation in the Yen and sometimes the impact wears off slowly. What we have never seen before are frequent interventions of various sizes over a period of two weeks with the price reversing immediately each time. This is unprecedented and it is difficult to trade. In response, we lowered volatility and kept option selling to a minimum. However, even at this reduced volatility the extremely choppy price action has been costly for the ART Strategy.

Having spent a reported $73bn (the largest amount for any intervention period), the Yen is now back to its pre-intervention price level and seems trapped. In the final two weeks of May volatility collapsed as the Yen was caught between strong macro forces on one side and intervention risk on the other. The price of the options are now at multi-year lows, apparently completely discounting the risk of further intervention and presenting an interesting buying opportunity.

We don't have any record of something like this happening in the past. It is a unique moment triggered by a combination of high oil prices, rising inflation, the growing size of the carry trade and an administration committed to defend the currency. It is impossible to know how long this will last, but it is possible that when it ends, it could end with a bang.

Nasdaq –markets continued to move higher, however, due to headlines around the Iran war, the moves were not 'clean', with prices zig-zagging considerably. To measure the quality of trends we use a metric called the Efficiency Ratio. This is the total move over the sum of the absolute intermediate moves measured over 36 hours. Essentially, if markets are moving, but the individual price paths are zig-zagged or sawtoothing, this will result in a lower Efficiency Ratio. In this environment, it is more difficult for our short-term, trend following strategies to find and capitalize on trading opportunities.

This year the Efficiency Ratio has been as low as we have ever seen it over the past 10 years.

In our opinion this is caused by a high level of uncertainty and considerable headline risk, most recently around the Iran war. This is sullying what would otherwise be a clean, persistent trend motivated by the AI theme.

These conditions have been challenging for the ART Strategy. The choppy price action has been difficult for the futures algorithms to navigate, while the broader, longer term trends have presented a threat to our options positions. To navigate this we have had to cut back on our options trading and proceed with increased caution.

Generally when the price action is this choppy it is because markets are range bound or volatility is very low. We can't find another example of markets ripping higher on one story, while the short-term price action is dominated by news about a different story.

This is another strange situation. However, despite this, the Nasdaq strategy was able to eke out a small profit in May on less than ideal conditions.

Looking Forward

The current conditions in the Japanese Yen are costly for the ART Strategy but they are also likely temporary. Macro pressures are pushing the Yen lower, while the Government is using its depleting reserves to push in the other direction. Something's gotta give.

We see three possibilities:

1) the pressure remains and the Treasury allows the Yen to slide further;
2) a massive, coordinated intervention which sends the Yen shooting higher;
3) a reversal in macro pressures as oil prices fall, the Fed becomes more dovish, or US stocks correct.

For ART, all three of these scenarios are better than the status quo. However, 2) and 3) could present major opportunities for the trend following strategy.

The Japanese Yen and US equities are linked. The carry trade, which is where people borrow in the low interest rate Yen and then invest in higher yielding US assets, has driven the Yen lower in recent years while helping to push US stocks higher. This is in addition to the flight of investment capital out of Japan into foreign assets, which has only intensified following an increase in domestic inflation.

This has worked out well for investors so far, however carry trades have a habit of unwinding if the economics no longer stack up. Higher Japanese interest rates or lower US asset prices could trigger an avalanche of repatriation as Japanese investors sell their foreign holdings and rebuy the Yen. This is what happened in August 2024, following a US stock market correction and an increase in Japanese rates.

Given where we are at the moment, there is a chance that the same thing could happen again. With US stocks at record highs, a hawkish Bank of Japan, a new Fed Chair with an unofficial mandate to lower rates and the continued threat of currency intervention, another carry trade unwind is not inconceivable.

When this happened in the summer of 2024, it was one of the most profitable periods ever for the ART Strategy. It created strong, organic trends in both markets, and persisted for weeks, followed by a months long reversal.

To be clear, this is not a prediction, we don't know what will happen in the future or how it will impact the ART Strategy. The Yen could continue to weaken and the carry trade could continue to pay out. However, it is fair to say that the current situation is not going to last forever.

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