



August 2020 Commentary

Dipsea Capital posted its 25th consecutive positive month in August. The Dipsea Capital Fund returned 0.62% to partners for the month, 7.08% year-to-date, and 9.62% for the last twelve months. U.S. equity markets rallied strongly in August, with both the S&P 500 and Nasdaq reaching new highs; the S&P 500 gained 7.19% and the Nasdaq 9.59%. The Fed announced a major change in policy the last week of August which will grant it more leeway in seeking to produce higher inflation. What is striking to us is what over a decade of the Fed's efforts have so far produced, conveniently illustrated in the following graph:

Asset Prices vs. Real Economy Prices, 2009-20



Source: Datastream, Haver Analytics, FRED, Goldman Sachs Global Investment Research

The graph indicates how easy money policies since the Great Recession have vastly inflated financial assets yet have had little effect in comparison on the real economy. In our view this raises some real questions about current market levels and the recovery from this recession.

We managed the portfolio very tactically in August, given the frothiness we observed in the market as the FAANG stocks, Tesla, and SPACs rallied strongly for no significant reason. In addition to this, a rare disconnect developed during the second half of the month as while the market rallied strongly, implied volatility rose simultaneously, particularly in Nasdaq names. Normally they are negatively correlated. This market effect reminded me of January 2018, which was followed by a 10% S&P 500 selloff over the next month and a half.

The CBOE's volatility index (VIX) dropped to a low of 21 mid-month but bounced back to 26 by month end, driven by the FAANG names and Tesla. Dipsea's volatility regime signals continued to signal an overall benign environment, which was confirmed as S&P 500 1-month realized volatility continued its steady decline, dropping into the single digits by month end (9%). Therefore we continued a balanced strategy of seeking gains in both directional and volatility oriented trades. Net exposure for the month averaged 0.5%. Index trading accounted for 57% of the August return, with the remaining 43% coming from single-names.

Portfolio and Market Thoughts

Tesla has garnered a lot of attention recently as it qualified to join the S&P 500 index after reporting for Q2 its fourth straight profitable quarter and later announced a five-for-one stock split the evening of Aug 11th. As we mentioned above, one highly unusual effect of Tesla's massive rally in August (+72%) was that its implied volatility also rose spectacularly.

As can be seen in the table below, significant upside skew (Put – Call difference) developed as the volume of Call buyers outpaced Put buyers immediately after the stock split announcement. Tesla was our top single-name contributor this month as our bullish signals on it led us to capitalize on short duration short Put ratio spreads and opportunistic long Call spreads when the upside skew presented itself.

TSLA 25-Delta Put - Call Spread Last 20 Days				
Date	ATM IV	25-Delta Put IV	25-Delta Call IV	Difference Put – Call
31-Aug-2020	109.1	109.0	116.9	-7.9
28-Aug-2020	99.7	99.3	104.9	-5.6
27-Aug-2020	93.8	93.9	97.7	-3.8
26-Aug-2020	82.9	83.4	84.8	-1.4
25-Aug-2020	81.2	81.9	83.5	-1.6
24-Aug-2020	81.7	82.6	84.6	-2.0
21-Aug-2020	78.6	80.4	80.9	-0.5
20-Aug-2020	72.1	72.5	75.7	-3.2

TSLA 25-Delta Put - Call Spread Last 20 Days				
Date	ATM IV	25-Delta Put IV	25-Delta Call IV	Difference Put – Call
19-Aug-2020	68.9	69.5	72.2	-2.7
18-Aug-2020	71.2	71.1	76.1	-5.0
17-Aug-2020	72.5	72.2	77.5	-5.3
14-Aug-2020	70.6	71.2	71.0	+0.2
13-Aug-2020	71.5	71.5	72.3	-0.8
12-Aug-2020	71.9	71.9	76.4	-4.5
11-Aug-2020	64.5	66.4	64.5	+1.9
10-Aug-2020	63.6	64.1	64.3	-0.2
7-Aug-2020	62.7	63.2	64.6	-1.4
6-Aug-2020	61.8	61.8	63.8	-2.0
5-Aug-2020	63.3	63.9	64.9	-1.0
4-Aug-2020	64.6	64.9	65.1	-0.2
3-Aug-2020	66.4	67.6	67.0	+0.6

The opportunity set for Dipsea’s strategy continues to be attractive. The CBOE’s skew index closed the month at 145 and remains elevated. This can create attractive trading opportunities in which the elevated skew is used to set up long gamma profiles at minimal to no cost.

The VIX futures curve is currently steep with a peak in October at 33 and indicating elevated market volatility continuing through year end. This is an important indicator that makes us cautious about market direction, however, our mindset at Dipsea is to focus on what is happening in the moment, rather than what may unfold in future months. For this reason, despite our inclination, we are not adopting a bearish tilt to the portfolio until the market begins to confirm this view. Having said this, we have added some long exposure to volatility products with October expirations.

We want to thank our existing and new partners for your support and continued trust. As we approach the end of summer we wish you an enjoyable Labor Day weekend and productive fall season ahead.

Sincerely,

Christopher Antonio

Chief Investment Officer and Founder