DIPSEA

CAPITAL, LLC

January 2020 Commentary

The Dipsea Capital Fund returned 0.74% to partners for the month of January and 8.16% for the last twelve months. U.S. equity markets started the year on an unrelenting upward grind, but this trend broke down the last week of the month – the S&P 500 ended flat (-0.04%) for January. Dipsea Capital posted its 18th consecutive positive month. We are pleased to have achieved positive results both during the market's rise as well as during the correction in the last week while maintaining a low net market exposure throughout (averaging -0.3%).

The early market action in the month was strongly bullish, primarily due to earnings announcements' surprises. We want to take this opportunity to remind our investors that our strategy excludes having exposure to companies around the time of their earnings announcements as this can be a particularly volatile period. Having said this, for the month we had meaningful gains in Apple and Amazon. Our market regime signals positioned us correctly for the spike in volatility and strong selloffs that took place Monday the 27th and Friday the 31st, such that we were profitable both days on Put spread and tail protection positions.

Market Landscape

We continue to witness multiple competing influences in the markets. In our view, this struggle suggests continued choppy market action throughout the remainder of the first quarter.

Tailwinds supporting higher stock prices include:

1. Unprecedented monetary easing: For the first time ever, all three of the world's largest central banks, the Fed, ECB, and the BoJ, are expanding their balance sheets simultaneously. In the U.S. there is a commitment that inflation is not an issue and policymakers express no concern about it potentially exceeding their objective of 2%.
2. Persistent worldwide economic growth: The unemployment rates in the U.S., Germany, UK, and Japan are at all-time lows.
3. A lower discount rate: The low 10 year Treasury rate has increasingly been cited as a fundamental reason for stocks to continue to appreciate.
4. Consistent upward market price momentum supporting basically all asset classes.

Headwinds to higher stock prices include:

1. The U.S. stock market's cyclically adjusted P/E ratio (CAPE ratio) remains elevated at 30.9x, 82% above its historical mean of 17.
2. Credit card charge-off rates remain a concern regarding the US consumer's continued strength. Discover Financial Services reported a jump in its charge-offs rate to 3.41%, its highest Q4 rate since the financial crisis.
3. Despite a number of surprises to the upside, as of January 31st Factset reported negative Q4 earnings growth of -0.3%.
4. Numerous sentiment readings are indicating historical exuberance based on investor behavior with some at extremes not seen since 2000.
5. The coronavirus outbreak may have more than just a transient negative impact on corporate profits, particularly in high growth regions of the world.

Portfolio Thoughts

In our December letter we highlighted several statistics about Dipsea Capital's performance in 2019, such as its low daily correlation to the S&P 500 (0.15) and average net market exposure (-1%). Given January's increasingly volatile market action, we decided to take a closer look at our performance during down market days. We found the following results:

	S&P 500 down days	Dipsea Capital # of up days on down S&P 500 days	Cumulative return of S&P 500 down days	Cumulative return of Dipsea performance on down S&P 500 days
January, 2020	9	6 (67%)	-5.9%	+0.5%
2019	102	75 (74%)	-44.4%	+3.4%

In other words, for 2019 the cumulative effect of the S&P 500's negative days would be to convert a dollar into 56 cents, while Dipsea's cumulative performance on those days was +3.4% (gross). Another way of describing this performance is calculating the Downside Capture Ratio, or the ratio of the manager's performance to market performance during negative periods. Dipsea's Downside Capture Ratio for 2019 was -7.7 (the number is negative given that the fund achieved positive performance during the negative market returns).

We remain ever vigilant to the market's gyrations with the goal of continuing to produce steady, uncorrelated returns for our investors. Thank you for the opportunity to be a trusted steward of your capital.

Sincerely,

Christopher Antonio

Chief Investment Officer and Founder