March 2020 Commentary

First of all, we want to say that we hope you are all healthy and safe. Our thoughts go out to the many who are suffering through this very challenging period.

The Dipsea Capital Fund returned 1.24% to partners for March, 3.48% year-to-date, and 9.22% for the last twelve months. February's extreme market action at the end of the month was a harbinger of worse to come as the Covid-19 threat became a worldwide pandemic and oil sank to a 17 year low of $23 a barrel (Brent) as Saudi Arabia and Russia kicked off a price war. March saw the S&P 500 plunge 24% before recovering some ground in the last week and finishing the month down -12.35% and -19.60% for the year-to-date. In my 35 years of trading the market, I have not witnessed a selloff of this magnitude in such a brief period.

Dipsea Capital posted its 20th consecutive positive month in March. The majority of our return was generated during the first half of the month with directional plays on days the market rebounded. Our net market exposure averaged -0.1% for the month.

The CBOE's volatility index (VIX) made another major leap in March, peaking at 83 on March 16th, a 69% rise. It remained elevated for the rest of the month as huge market swings continued to take place. We maintained gross exposure at modest levels throughout the month. Our daily models signaled a shift to a more benign environment on March 23rd, after which we raised gross exposure moderately for the last five days.

S&P 500 index trading was our core profit center throughout the month, however we wanted to highlight a couple of individual name positions, both sized at less than 1%, to illustrate the opportunities we have been finding. Our first example is a directional trade. Dipsea's signals indicated a bullish directional trade in Slack (WORK) the last week of the month, which we implemented by buying outright Calls with a 45 delta. As the stock rallied strongly in the next few days, the Calls experienced accelerated appreciation with their delta rising to 80 and we progressively shorted the stock against them to lock in gains, making an 11% net return in three days.

Another trade with a volatility, rather than directional, orientation was in Occidental Petroleum (OXY). OXY suffered selling pressure early in the month over possible bankruptcy concerns after it announced a cut to its dividend. Its options became severely dislocated and exhibited a pronounced skew, which we regarded as a huge overreaction considering an event before expiration in only four days as extremely remote. We established a bear Put ratio spread with the long leg at a strike price 25% away from the last sale at an implied volatility of 300% and the short leg 70% away at an implied volatility of 1200% (a massive price discrepancy). As at expiration OXY traded above the strikes of both our long and short positions, we simply collected the net proceeds, making a 127% net return in four days.

Market Landscape

We are facing a completely new equity market landscape with tremendous uncertainties - to name just a few: how much debt will ultimately be issued to stimulate the economy, what will interest rates be, will we experience extremes of deflation or hyperinflation, what will be the ultimate impact to employment, and what will be the extent of corporate defaults.

Tactical, short duration trading presents unique advantages in this environment and we believe will continue to be a highly effective investment strategy. In comparison, fundamentals-based investing faces the major challenge of relying on valuation methods that are distorted by the chaos created in interest rates from the unprecedented and apparently unlimited monetary easing coming from central banks. We expect continued elevated volatility in markets.

Tailwinds supporting higher stock prices include:

1. Massive monetary and fiscal stimulus has been enacted.
2. The broad U.S. market is at a 20% discount to where it was to begin the year which some may perceive as a buying opportunity.
3. A possible alignment among oil producing countries to stop the price war.
4. There are some signs of Covid-19's effects abating in different countries.

Headwinds to higher stock prices include:

1. The jump in unemployment to a projected rate of greater than 10% will further impact consumer spending.
2. Most economists believe a worldwide recession has begun.
3. Corporate ratings downgrades and defaults are projected to spike from the combined effect of elevated leverage and drop in revenues.
4. Despite the selloff, the U.S. stock market's cyclically adjusted P/E ratio (CAPE ratio) remains elevated at 23.5x, 41% above its historical mean of 17.
5. Covid-19 remains a serious threat to lives and economic activity.

Portfolio Thoughts

The changed landscape of higher uncertainty and volatility creates a significantly greater opportunity set for Dipsea Capital and we expect this will be reflected in our returns. As has been the case since our inception, we do not stretch for returns by resorting to taking on greater risk through directionality or leverage. Please reach out to us if you would like additional information on our market exposures and return expectations.

We have been providing information on Dipsea Capital's consistent positive performance during down market days. This was the case in March as well, despite the highly volatile market action. However, in contrast to February, we were more profitable on up market days:

	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
March, 2020	12	7 (58%)	-45.9%	+0.1%
February, 2020	10	7 (70%)	-13.5%	+1.8%
January, 2020	9	6 (67%)	-5.9%	+0.5%
2019	102	75 (74%)	-44.4%	+3.4%

As income tax season is upon us, we wanted to remind our U.S. investors that, as usual, a significant portion of Dipsea's returns benefit from long-term capital gains treatment under the IRS's Section 1256.

We have continued to operate without disruption in the current environment and remain focused on managing the portfolio and ensuring seamless operations. We want to thank our existing and new partners for your support and continued trust.

Sincerely,

Christopher Antonio

Chief Investment Officer and Founder