DIPSEA CAPITAL, LLC

Extreme Market Events' Impact on Returns – Dipsea Capital November 2020 Commentary

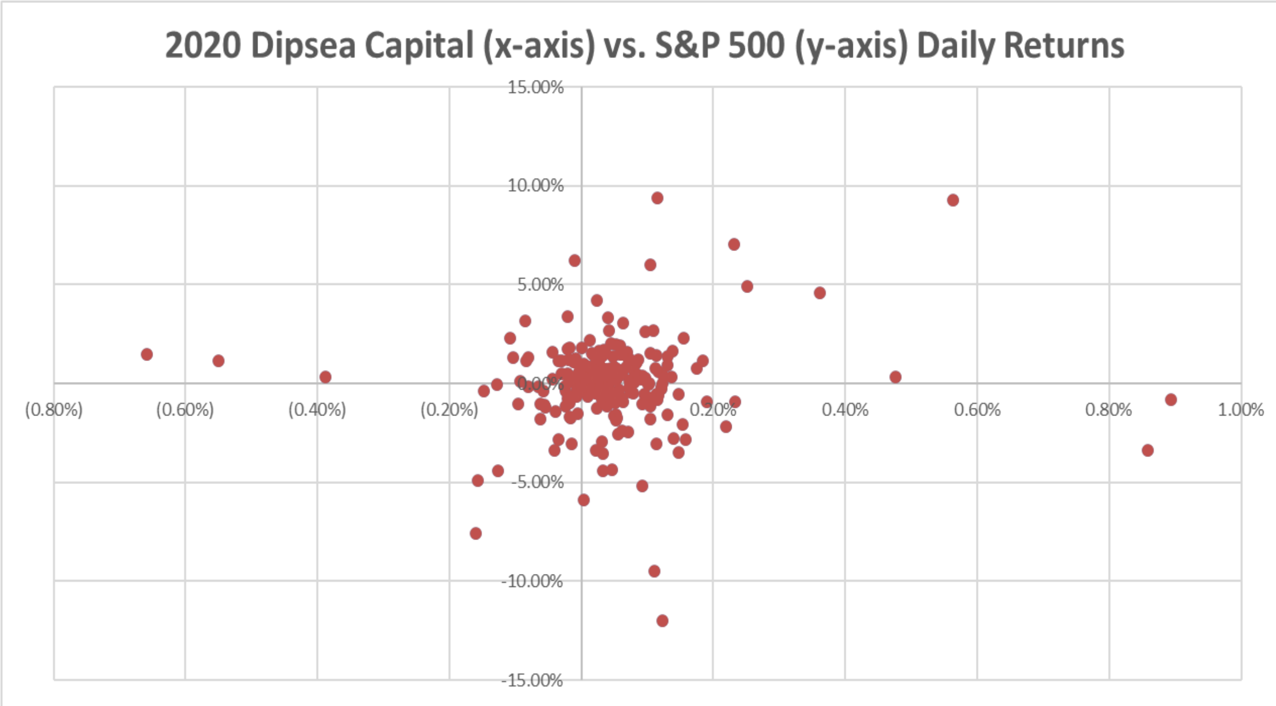
The Dipsea Capital Fund returned 0.06% to partners for the month, 8.40% year-to-date, and 9.65% for the last twelve months. Equity markets melted up across the board in November - the S&P 500 gained 10.75%.

The animal spirits driving the market were highlighted on Monday November 9th as the market gapped higher on the open by 3.3% on Pfizer's pre-open news of their Covid-19 vaccine. We were net short going into this as our signals indicated the strong market momentum of the prior week had ended on Friday. Given this positioning, we immediately took action to neutralize the portfolio as our risk management protocols dictate, though this meant realizing a larger loss than what would have transpired by the end of the day.

To put the magnitude of this event in perspective, the +3.3% move on November 9th was 2.5x greater than the largest upside opening gap for the S&P 500 in a similar setting since 1982 (the setting defined as occurring after the day the S&P 500 hit a 52-week high). In other words, a once in 38 years event. The extreme market volatility is also illustrated by the fact that this was the third week in a row that the S&P 500 broke out of the trading range expected by the options market. The current market rally may have the effect of clouding investors' memories, but 2020 has been a year of extreme market action that has certainly tested trading managers' mettle.

Such extreme market events can and do impact our returns at Dipsea. To what extent? What do outlier days look like at Dipsea? We just had a lackluster month due to an extreme market event, so we thought it would be a good opportunity to dig a bit into our daily numbers for this year of extreme volatility after this period that does not particularly flatter us.

In the following graph we plot Dipsea's daily gross returns against the S&P 500's daily returns and summarize the data in the table below it.



Source: NAV Consulting

Dipsea Capital Fund January – November 2020 Gross Daily Returns Distribution				
# Dipsea positive days when market negative	# Dipsea positive days when market positive	# Dipsea negative days when market negative	# Dipsea negative days when market positive	# Dipsea flat days
63	100	28	25	15
27%	43%	12%	11%	6%

From the above, we note that in terms of frequency, Dipsea's ratio of winning to losing days continues to be highly robust, at 3.1x (163 to 53). Dipsea's returns also exhibit a high degree of positive skewness (1.44), which is a measure of not only frequency but also magnitude.

As to magnitude of extreme returns, the graph shows that Dipsea has experienced several days this year with returns that are multiple standard deviations away from our average. For example, we experienced a 5.3 sigma negative day this year. We lost 0.66%. We also had an extreme outlier to the upside, a 6.4 sigma day. We gained 0.89%. We hope these figures are helpful in illustrating and gauging how moderate Dipsea's risk profile is.

Dipsea's net market exposure for the month averaged +0.2%. Index trading accounted for -11% of November's return, with the remaining 111% coming from single-names.

Market and Strategy Thoughts

Given the magnitude of recent market moves, we regard the following excerpt from a recent article by Bloomberg reporter Justina Lee as highly insightful: "In a Capital Market Risk Advisors survey on lessons from 2020, risk managers concluded that they need to conduct more stress tests that aren't simply based on historical scenarios -- and should sometimes use their "gut feelings" when it comes to a shock as unquantifiable as Covid-19."

The above conclusion is in fact what we at Dipsea have incorporated into our investment process since inception on the belief that strategies that employ 100% systematic trading expose investors to greater risk. For this reason, Dipsea employs a process that combines a systematic component with rules-based trader discretion.

The CBOE's VIX index collapsed from 38 to 21 during November. This is unsurprising given the massive rally that took place. However, we expect that an environment of high uncertainty regarding corporate earnings and balance sheets, fiscal and monetary policy outcomes, and Covid-19's devastating effects to again drive market volatility higher. I feel confident that following our models' signals and adhering to our portfolio management rules will continue to yield strong risk-adjusted results for our investors.

We welcome any comments or questions from our readers. As always, thanks to our investors for your support and we wish everyone a very special holiday season.

Sincerely,

Christopher Antonio

Chief Investment Officer and Founder