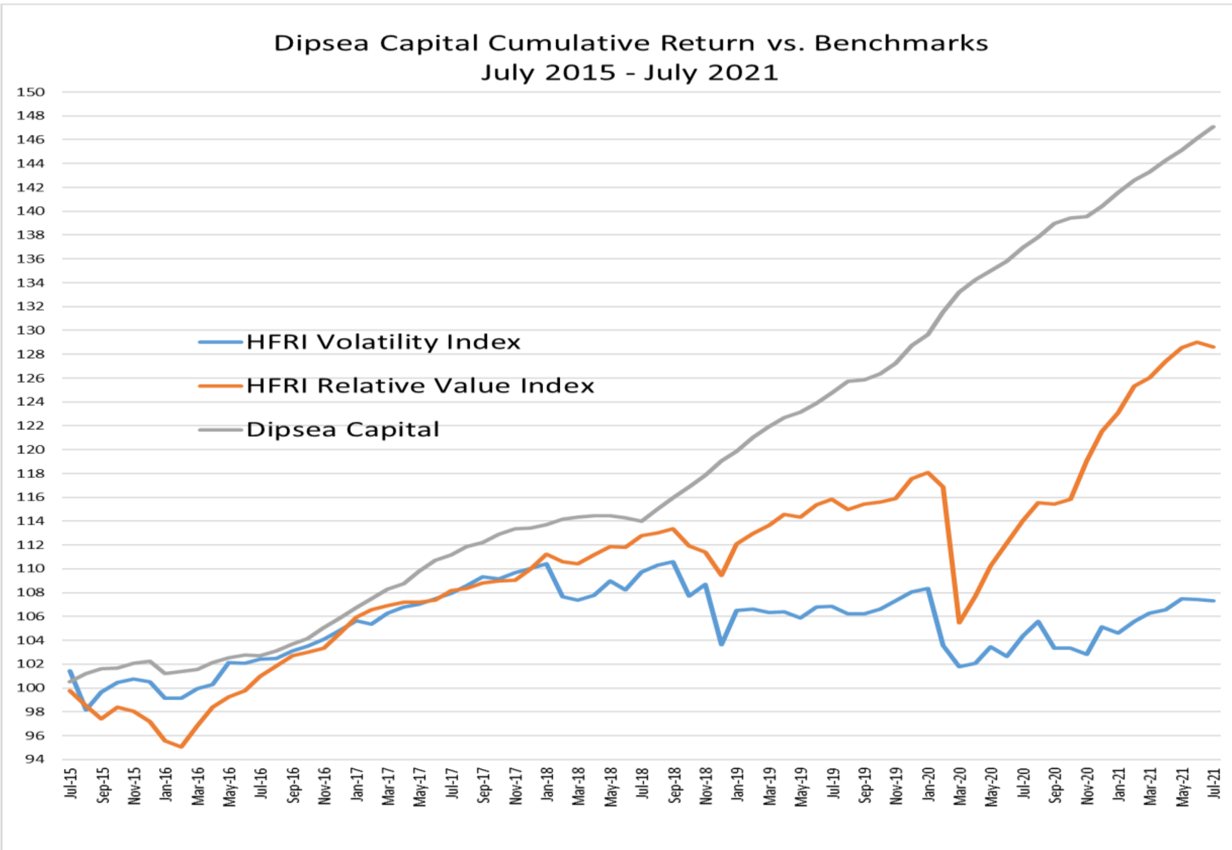
Will our Friend the Fed Continue to Back the Trend? – Dipsea Capital August 2021 Commentary



The Dipsea Capital Fund returned 0.33% in August, 5.13% year-to-date, and 7.10% to partners for the last twelve months. The Fund has compounded annually at 8.68% for the trailing three year period. In a similar pattern to the last three months, the S&P 500 continued its strong upward trend before experiencing a gap down mid-month from which it quickly recovered – ultimately reaching 4530 and finishing the month up 3.04%. The Nasdaq gained 4.00%.

The CBOE's VIX index initially drifted lower, to as low as 15, before spiking to 25 mid-month as the S&P 500 traded down 1% on the 18th. One of the relationships we monitor is the relationship between implied volatility (VIX) and the volatility of volatility (VVIX). The ratio of the VVIX to the VIX has been rising and reached a high of 7.3 in mid-August. When the VVIX reaches extreme levels in relation to the VIX, it can portend a market correction. A ratio of 8 or higher has preceded market corrections in recent years as can be seen in the graph below.

We managed the portfolio throughout August with modest exposure and experienced consistent performance. Index trading accounted for 66% of August's return, with the remainder coming from single-names. Dipsea's net market exposure averaged -0.4%.

Market and Strategy Thoughts

As the stock market continues its spectacular move higher, there is widespread awareness of the Fed's role in the market's continued rally. However, it is fascinating to observe how close this relationship has been ever since 2009's QE1, as this excellent graph from Yardeni Research illustrates.

With the exception of last year's Covid crisis, the only sizable market corrections all the way back to 2009 have occurred when central banks have either paused or withdrawn liquidity. The million dollar question is: will central banks continue to be supportive in the face of inflation concerns? And if they do, will their easy money policies still be effective if there is another external shock or market fundamentals deteriorate?

The S&P 500 reached its fastest doubling in history this month as it passed 4500, up from its low of 2240 on March 23rd, 2020 during the Covid breakout. However, market breadth continues to decline as we mentioned last month. The Nasdaq, for one example, is climbing on an increasingly narrow base as the number of stocks within the index trading above their 200 day moving average continues to steadily fall, as can be seen in the following graph showing this relationship since 2018.

For the above reasons, we feel very strongly about the continued non-correlation of Dipsea's returns. Our monthly returns may mask how uncorrelated our returns are, as the market has also been up consistently – we are happy to report that our daily returns (before any effect from fees, in other words our daily gross returns) continue to be completely uncorrelated to the market as well. Since January 1st the Dipsea Capital Fund's daily returns' correlation to the S&P 500 is -0.25, indicating there is no relationship between the two.

Thank you to all our investors for your support; we wish everyone a wonderful fall season ahead and look forward to continuing to manage your capital on your behalf.

Sincerely,

Christopher Antonio

Chief Investment Officer and Founder