DIPSEA

CAPITAL, LLC

Interest Rate Volatility – Dipsea Capital February 2021 Commentary

The Dipsea Capital Fund returned 0.75% in February, 1.58% year-to-date, and 8.40% to partners for the last twelve months. The stock market rallied strongly for the first half of the month, but sharply reversed course after that. The S&P 500 finished up 2.76%.

Equity volatility in February initially declined as the market rallied, but the VIX index experienced a 10 point spike to 31 on the 25th. This was our most profitable day for the month (+15 bps) as the combination of higher implied volatilities and the S&P 500 dropping 2.2% benefitted our long put spread positions.

Index trading accounted for 70% of February's return, with the remainder coming from single-names. Dipsea's net market exposure averaged +0.5%.

The CBOE Skew Index remains elevated at 141 and VIX futures, though relatively flat, indicate continued elevated market volatility at approximately 30%. Both are positive indicators for our strategy.

Market and Strategy Thoughts

As interest rates spiked in February, we are reminded of the often latent volatility in fixed income that can be so easy to forget. The rising yields of U.S. Treasuries and the implications and impacts of this have come to the forefront recently as through the end of February, the 10-year's yield had risen 50 bps in 2021 to 1.42% and has risen further in March, to currently 1.60%. This has had a substantial impact to fixed-income portfolios. For example, through February Vanguard's Core Bond fund is -2.52%. The S&P's U.S. Treasury Bond Current 10-Year Index is -5.52% year-to-date through March 5th. Losses of this magnitude wipe out more than a year's gains.

We are not macro investors, however it is interesting to note that history suggests yields may have a lot more to rise. The average yield for the 10-year Treasury bond over the last twenty years is 3.17% (2001-20, MacroTrends).

Dipsea's returns have no relation to the direction of fixed income indices - since inception our correlation to the J.P. Morgan Global Bond Index is -0.02. Thus our fund may serve as a portfolio diversifier without any duration risk.

The U.S. equity options complex has continued to experience large retail inflows, particularly to long VIX exchange-traded products. This has had the effect of increasing the volatility risk premium (the difference between the implied volatility priced into options and the underlying security's realized volatility), which is beneficial to Dipsea's strategy, particularly when driven by indiscriminate buyers.

A Bank of America survey of 225 global fund managers early last month revealed that their long exposure to equities and commodities is the highest it has been in a decade and only 13% expressed asset price bubble concerns. As we have mentioned before, whether this bullish sentiment continues or shifts, with a consequent market reaction, we believe our short-dated, flexible approach to investing will serve our investors well.

Thank you for your continued trust and support.

Sincerely,

Christopher Antonio

Chief Investment Officer and Founder