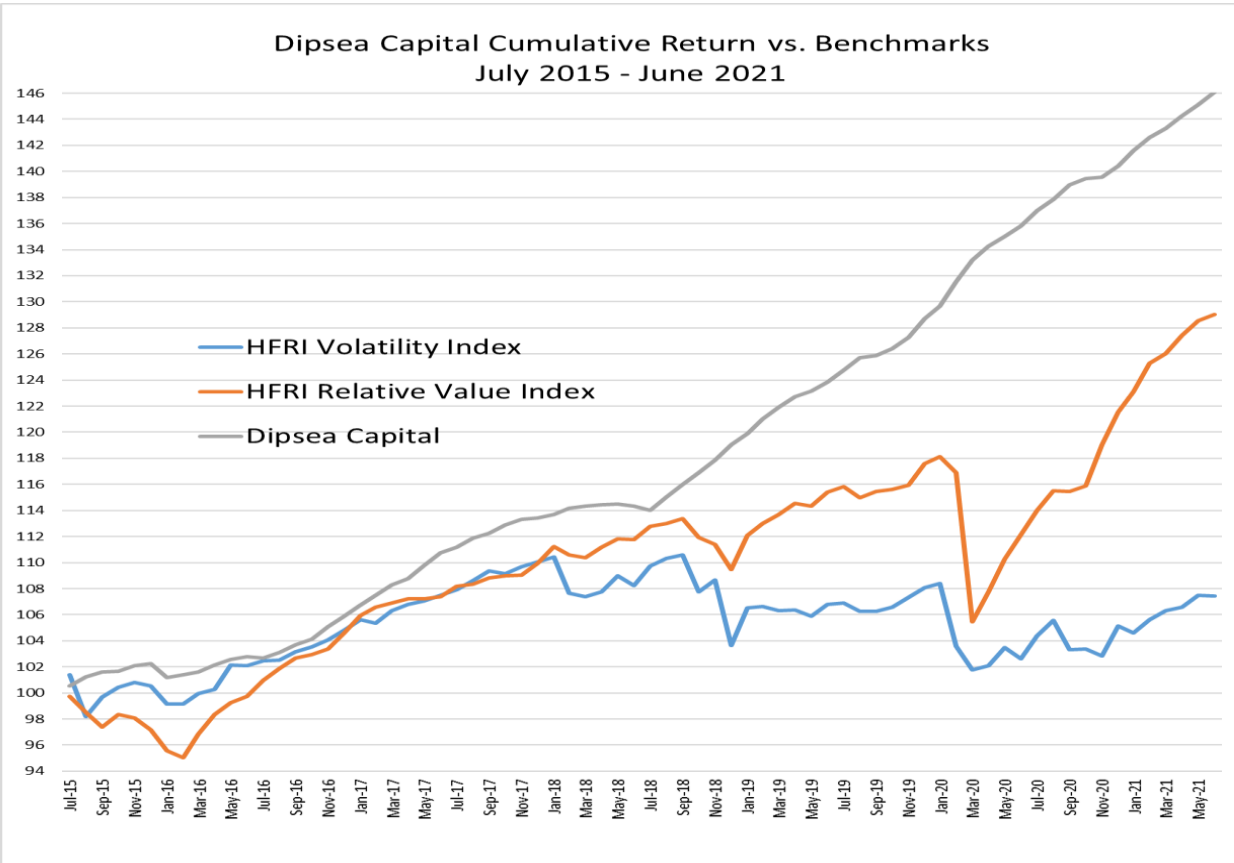
DIPSEA
CAPITAL, LLC

Real Economy Animal Spirits – Dipsea Capital July 2021 Commentary



The Dipsea Capital Fund returned 0.70% in July, 4.79% year-to-date, and 7.41% to partners for the last twelve months. The Fund has compounded annually at 8.87% for the trailing three year period. The S&P 500 continued its strong upward trend before experiencing a gap down mid-month from which it quickly recovered and finished the month up 2.38%. The Nasdaq gained 1.16%.

The CBOE's VIX index drifted higher in July, from 15 to 18, with a spike to 22 mid-month as the market gapped down on July 19th. Skew remained elevated in July, with the CBOE Skew Index averaging 154. This worked in our favor for both net collecting trades as well as directional spread trades that we financed by selling at strike prices experiencing a high degree of skew.

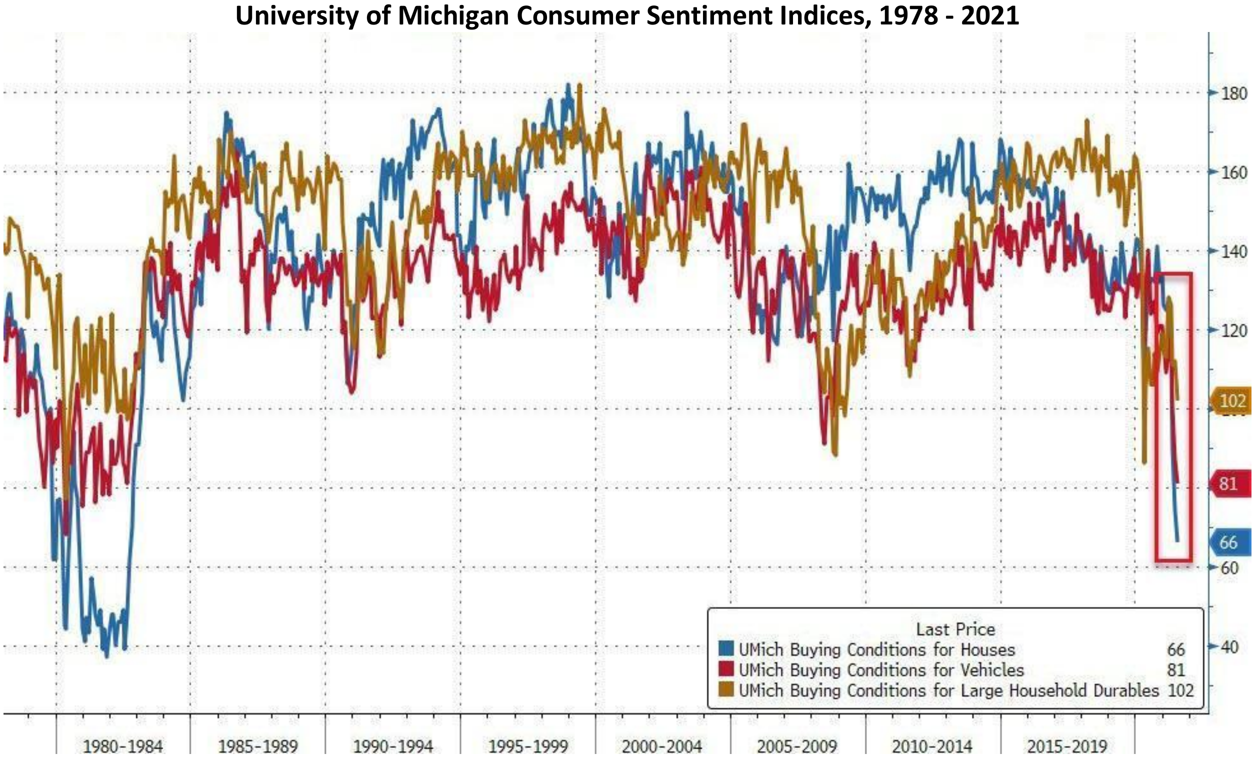
Index trading accounted for 52% of July's return, with the remainder coming from single-names. Dipsea's net market exposure averaged -3.3%.

Similar to June, we had steady performance throughout the month with our most profitable days as the S&P 500 hit an air pocket mid-month. The S&P 500 opened 1.34% lower at 4269 on July 19th. Our signals had directed us to a net short tilt to the portfolio at the prior day's close (-7%). Our initial setup in SPX index options actually allowed us to profit from both long and short volatility positions as the gap down made our longs with a weighted average strike price of 4220 appreciate and our shorts 240 points lower (at 3980, -8% from the prior day's close) expired worthless. The fund was +0.16% for the day.

Market and Strategy Thoughts

As we continue to monitor the general economic environment, we note the strong earnings for the S&P during Q2 – reported earnings so far indicate a year-on-year growth rate of 85%, the highest since Q4 2009. This is unsurprising as they both represent rebounds from periods of severe economic recession. What stands in stark contrast, in our view, is the profound shift in consumer sentiment in the latest surveys. A more granular look beyond headline consumer sentiment, which is now at a five-month low, shows that spending intentions on houses, autos, and large household durable goods have crashed to multi-decade lows. We believe this portends either another recession or more rounds of government stimulus programs, either of which could inject uncertainty and volatility into the so far highly blasé equity and fixed income markets.

University of Michigan Consumer Sentiment Indices, 1978 - 2021



Market sentiment, on the other hand, remains profoundly resilient and complacent. In July, U.S. equity indexes prevailed against no less than the headwinds of 1) escalating concerns about the Covid variant, 2) a China market correction triggered by regulatory pressures, and 3) an underwhelming revenue forecast by Amazon. Investors for now are equally complacent looking ahead; the one to three month spread on VIX index futures recently fell to one of its lowest levels in years.

We believe it is clear that these conditions are fueled by the Federal Reserve's unprecedented largesse. Another example: Money center banks' loan balances secured by customers' securities portfolios have actually surpassed credit card loan balances.

We expect the market's dynamics to provide ample opportunity for Dipsea's strategy, regardless of market direction. Market breadth is narrow, with only 35% of S&P 500 names trading above their respective 50-day moving average. We remain vigilant in our portfolio construction yet poised to profit on risk premia extremes with our tactical approach in the short-dated options space. We look forward to your comments and wish everyone a great rest of the summer.

Sincerely,

Christopher Antonio

Chief Investment Officer and Founder