DIPSEA

CAPITAL, LLC

**Under the Hood of Volatility Strategies – Dipsea Capital May 2021 Commentary**

"I can't find any period in history where monetary and fiscal policy were this out of step with the economic circumstances, not one" Stanley Druckenmiller on CNBC, May 11th

The Dipsea Capital Fund returned 0.60% in May, 3.36% year-to-date, and 7.50% to partners for the last twelve months. Stocks were mixed in May, with the Nasdaq down -1.53% after only partially recovering from a deep dive and the S&P 500 also experiencing volatility but recovering for a gain (+0.70%).

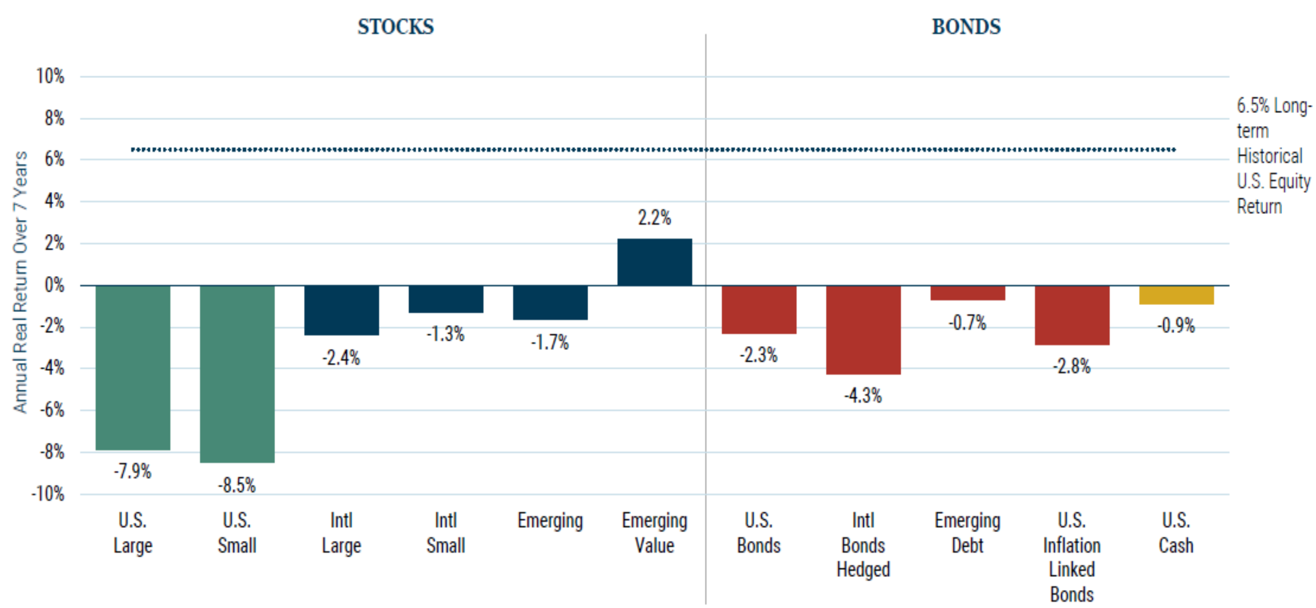
Inflation concerns came to the forefront in May after month-on-month core CPI consumer prices for March jumped 0.9%, its largest monthly increase since 1981, and 3% year-on-year. Adding fuel to the broad rally in commodities, the May 7th cyber-attack on the largest refined products pipeline in the U.S., Colonial Pipeline, resulted in its forced shutdown and a state of emergency declaration covering 17 east coast states. The market exhibited panic signals in the wake of these events: 1) The VIX index surged 65% in three days the second week of May to 28 and 2) the NYSE Tick Index recorded its worst reading since 1999 on May 11th as companies trading on downticks at one point exceeded those on upticks by 2,069. The markets calmed down after this, with the VIX falling all the way back to 16.

Despite this volatility, we had very steady performance through the month thanks to our adherence to our models' trading signals. We positioned the portfolio with greater directional tilts on specific days during the run-up the first week of the month (long) and selloff the second week (short), which led to our most profitable days. Index trading accounted for 78% of May's return, with the remainder coming from single-names. We profited on upside directional trades across various single-names that reached abnormally high levels of short interest. Dipsea's net market exposure averaged +1.5%.

**Strategy and Market Thoughts**

The upshot from Stanley's comment above is that the Federal Reserve's and Federal government's largesse is fueling gigantic asset bubbles in all markets. He is not alone in this sentiment. The following graph by widely followed GMO (Jeremy Grantham) is a forecast of annualized returns for major asset classes and shows the extent to which markets have "pulled forward" future returns. It is striking and sobering that there is only one with a positive expected real return over the next seven years, emerging markets value stocks.

**GMO 7-Year Asset Class Forecast, April 2021**




Source: GMO, assumes the U.S. inflation rate mean reverts to 2.2% over 15 years

As macro uncertainty heightens, we offer that investors can find a valuable ally in equity volatility strategies. Equity volatility has been a distinct asset class since the advent of the CBOE's VIX index in 1993 and equity option strategies provide investors with several benefits, for example:

1) equity volatility is typically inversely correlated to the direction of stock prices,

2) it's publicly traded and liquid,

3) it's prone to extremes in pricing but also mean reverting in nature,

4) one can position for outsized payouts in the event of market gaps,

5) the skew that is present in a name's or index's options chain creates the regular opportunity to set up "cheap optionality",

6) options' typical premium to the actual, realized volatility of stocks is another source of return,

7) a reversal of the implied volatility / realized volatility relationship during stress periods is followed by heightened option pricing due to the loss aversion bias, and

8) the expiring nature of options combined with the market move probabilities implied by their price provides a robust, data-driven, real-time value metric unlike that of any other security.

In short, equity volatility strategies utilize unique return drivers that are based on quantifiable probabilities around herd behavior and market biases. Dipsea Capital's adaptive strategy is designed to achieve consistent returns by identifying the market environment and applying the optimal strategies and positioning to maximize risk-adjusted return for the portfolio.

## Organizational Update

We are pleased to announce that we welcomed a new team member in May. Gene Koziarz joins as Head of Risk Management with 20 years' experience in equity derivatives. He began his career as a market maker at the Chicago Board Options Exchange (CBOE) and most recently was the Director of Trading and Portfolio Risk Management at Stratifi, a $400 million hedging solutions provider in San Francisco. Gene's responsibilities at Dipsea will closely mirror those of Kurt Romstad, who after many years at Dipsea decided to pursue other interests. We thank him for his contributions to Dipsea Capital and wish him well in his future endeavors.

We remain appreciative of both our long time investors and new partners' embracing of the merits of consistent, uncorrelated returns and as always, invite you to reach out with any questions or feedback.

Sincerely,

*Christopher Antonio*

Chief Investment Officer and Founder