Pegasus Volatility Managed Account

2020 Winter Performance Report: +54.2%

Dear Sirs,

„Any man whose errors take ten years to correct is quite a man.“

J. Robert Oppenheimer, often attributed about himself but actually addressing Albert Einstein

Well, ten more years then.

The decision was made to end the continually tiny Pegasus Macro experiment, after 1H 2020 proved disastrous. Your manager's philosophy was to enter the market, systematically and with leverage, at the point of maximum despair among market participants. In so doing the old adage, to buy when blood is running down the streets*, was made into a quantifiable number that *historically speaking*, usually meant the end of the selling cycle or within 4-5% thereof. My own approach was proprietary, but CNN's Fear and Greed Index is surprisingly good:

Buy when Fear & Greed is under 15 or so, sell in 3-6 months. Rinse, cycle, repeat. Presto. All the market's returns and then some, with far less downside.

Now add leverage for that has never gone wrong ever.

2020 had other ideas.

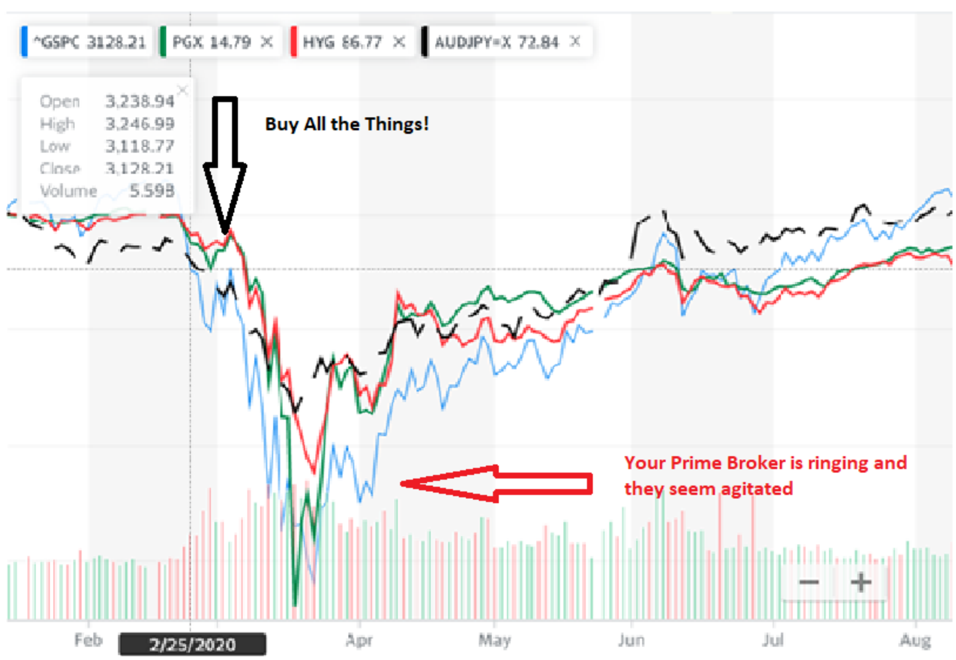
Blue: S&P 500

Green: Preferred Shares

Red: High Yield Bonds

Black: Australian Dollar vs. Yen

The crisis correlations and the relative betas of each instrument are important.



Put simply, the always-reliable approach failed completely, with another 25% to the downside after the quantitatively-measured peak emotional despair had arrived. If that is the new downside maximum to plan for

* One of Rothschild's better inventions, along with the world's first pigeon-powered arbitrage

(and in retrospect, always multiply that by 1.5-2x for safety), then the strategy really has no worth-while edge & so the Fund ended.

Selling a three-month at-money index Put at the signal point would have netted 7% while the market went sideways, but suffered the entirety of the down move plus the put's value would have expanded as the Vix index shot to the stratosphere. Little help there. Did your Manger utterly misjudge both human nature and the political response to the virus? Yes and in no particular order:

- The near-instantaneous return of instinctive tribalism and the shutting down of national borders & the barn door long after the horse, pig, snail, pet rock, and all other tortured analogies, bolted;
- The particularly modern and arguably infantile condition of accepting zero mortal risk[†], in the face of the entire history of the human species (and all others) whilst tolerating and even in some cases condoning every-day and politically palatable violence;
- Groupthink brought to an extreme[‡], aided by the visual media;
- A bizarre and deadly wilful disregard of the second-order effects of a State-mandated shutdown of the economy and the a) now-and-future death toll of the populace not receiving treatment for such optional situations as heart attacks and scheduled chemotherapy and b) the attendant despair, alcoholism, drug abuse, suicide and impacted lives of destruction of entrepreneurs, jobs and self-worth, far **far** outpacing the highly indirect among the elderly death toll of the horrid bug itself;
- Speaking of the State, a disregard by itself of its ability to shut in vulnerable groups, protecting them and the larger populace from them (economically). If only the State could issue tags to cars and monitor them on roadways, and cross-link that with a motor vehicle department's database; if only, and this really would make any tin-pot potentate salivate, the State could issue an ankle-tag like device voluntarily worn by its citizens, tracking their every move, that they should glance at every five minutes and often upload pictures of themselves with, tagging their location & activity to large social networks that hand over data to the State on demand. Megalomaniacs can but dream…
- Finally and damningly for the ever-tenuous justification of representative over direct democracy, the decision-making of those deem themselves the people's masters proved no better than the people themselves, in fact enabling them in their emotional impulses.

Did libertarianism finally emerge triumphant? Of course it did not. Netflix, Deliveroo and therefore Saving Lives by staying home and doing nothing, won. Well not nothing; once weekly a 'clap for carers' indulgence in virtue signaling whilst entirely ignoring the gaping structural failures of the NHS[§] and continually supporting by a 79% polling margin current government policy? Clearly![**]

In this and in other endeavours in life, the choice is either to quit, or learn from & rebuild. Opting for the latter, the question to be posed is: if sentiment indicators and prognostication were unable to predict such chaos and a further market crash, is there anything out there that did?

The answer is yes, and yes for other disasters throughout market history. If the reader will refer to the prior page, there is a representative number of other assets that participate in major risk-off events. Excepting the AUD/JPY carry trade (risk/carry & macro) cross, which features similar cheapness of related OTC options due to decreased

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[†] Tony Blair's fault as are all things. He invented the yellow reflective safety jacket; a well-known fact - Wikipedia that

[‡] With an equally daft converse reaction in the US by the opposing side, now that the bug has mutated into something actually quite concerning but over with soonish

[§] So much so that even the Army, brought into to help sort the mess, leaked that the NHS couldn't ration PPE gear to *itself*. The same armed forces that wanted to sell their last amphibious boat to Brazil, built two aircraft carriers with no planes on them, and whose tanks no longer work and haven't any replacement. Well, at least they aren't the ~~Wehrmacht~~ Bundesmacht's U-boat force. Or Nightingale hospitals without staff, 9 months later

[**] Bitter? Yes actually, and from shorting TSLA as well. There's no ticket off this blue ball yet, and Musk's flaming garbage bin thing needs some George Lucas aesthetics

forex gap risk[††] as the others though it meanders in price far more, these non-equity groups remain generally stable with flat (par) notional value whilst market conditions are stable. Once risk flows up from the equity holder into the Preferred and Junk bond credit, they collapse and do so with near-equal violence along with the S&P. Their behaviour then is essentially binomial, and related options quotes reflect this; they're priced cheaply as usually everything is smooth sailing, and only protect against major downside moves. But then isn't this all that an investor should really care about? Are these the ideal canaries in the coal-mine despite the assumed cross-asset correlation risk? If the price of Preferreds 'break the buck', is it time to take one's toys and go home?

Further these equity alternatives are refreshingly straightforward to model. Consider a painfully simple strategy with Preferred shares (essentially junior subordinated perpetual-ish bonds): sell them all when the 35-day moving average of price moves below its 73-day moving average. At a stroke the trader has eliminated 90% of portfolio downside, and dramatically increased its return per annum as the trade is re-assumed in the recovery phase and not yet back at par. Junk credit is faster at 11/102 MA. Notably for hedging, the S&P has no such simple rule no matter how much the data is tortured for bias extraction. Direct risk markets, such as the Vix and its related futures and options appear to share characteristics of both the former and latter.

Cognisant of the above, could risk and volatility directly be traded, overseen by exit timing, downside limitation and optimization of hedging via a basket of cross-asset options and positions and signals derived from their pricing information? This was put into practice for the second half of 2020 with a return of +54.2%, and the managed account stayed out of the market around several risk-off hiccups along the way. Such a performance figure is somewhat meaningless short-term in the context of a continuous move downward in the pricing of risk and thusly ideal sort-volatility trading conditions. 2021 should however provide some proper challenges.

Much optimization needs still be done, both in the choice and ratios of risk-on versus hedges, and especially in terms of order execution – some of the instruments in question are esoteric, and algorithms to trade them either oddly primitive or nonexistent depending on the broker and in some cases only one broker even makes markets in them. Your manager's fruitless foray into AI could have the unexpected benefit of being able to write proprietary trading algos to enter and leave these markets as needed in a more efficient guise as liquidity maker rather than taker.

Oddly primitive, given the size of these markets

Meantime the monetary backdrop is supportive and the fiscal pump-priming approaches Ludicrous Speed. Georgia's senatorial election pours Stimulus-branded racing fuel on the simmering vaccine coals, though the likely short 2-year shift of control of the Senate ought not to be overestimated[‡‡] as now moderates hold swing-vote power. All the 2020 calamities the reader is painfully aware of aside, your Manager is worryingly consensus-bullish. I will leave it to others to voluminously spill ink justifying why in their own manner.


And a disapproving lemur

Hopefully however the market will be over its skids at least once in 2021, for crisis breeds opportunity. And a lengthier summer letter rather than a promising start and dollops of supposition.

Kind regards,
Philip Hahn

[††] Forex options generally have a far smaller expected payout for market makers, as they can dynamically hedge nearly the entirety of the day unlike the stock and bond market. *Assuming correlations stay constant*, they are therefore a buyer's market

[‡‡] This overreaction tends to be true in general for markets in pricing political events, except in the case of extremely centralised states (UK) where a change in party may have drastic consequences. An occasional mint could be made simply selling volatility into every major US election

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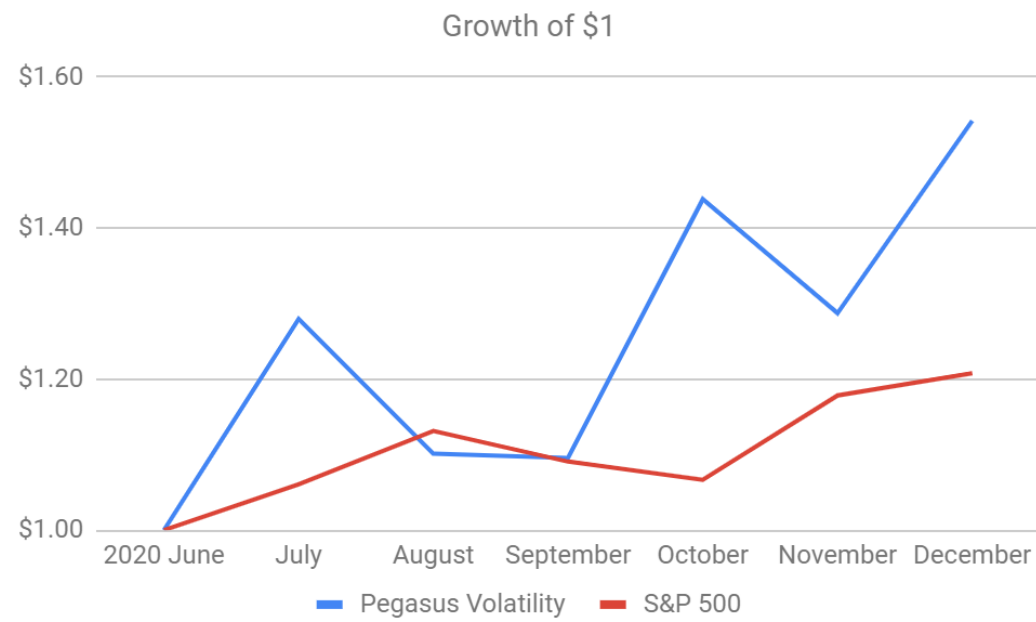
Performance Statistics			
	Summer	Winter	Total
2020		+54.2%	+54.2%

Return Since July 2020 Incept:	**+54.2%**	Significant Exposure:	Short Volatility
Annualised Return:	n/a		Long/Short Volatility Options
Sharpe:	0.45		Long Credit Hedge Options
R-Squared to Benchmark (S&P 500):	-0.43		Short Risk-On Forex Crosses



Managed Account Information	
E-mail: contact@pegasusfund.com	

Fund Domicile:	Managed Account	**Investment Objective**
Manager:	Philip Hahn	
Prime Brokers:	Saxo Bank, Interactive Brokers	Pegasus Volatility Managed Account is an embryo fund that seeks to generate returns through systematic long and short positions in US and global volatility and risk markets, as well as cross-asset hedging in equity, credit and volatility derivatives. Alpha generation is the sole goal.
Custodians:	Saxo Bank, Interactive Brokers	
Legal Advisor:	n/a	
Administrator:	n/a	
AUM:	Managed Account	
Minimum Subscription (non-US only sadly):	Closed	
Redemptions:	Monthly	
Management Fee:	Expenses (< 1%)	Choice and scale of the vehicles used to express the Managed Account's views are at the discretion of the manager. The Managed Account is currently Closed until it proves itself to the manager's satisfaction.
Performance Fee:	20%	
High Water Mark:	Yes	
Benchmark:	S&P 500	
Lockup:	No	