Pegasus Volatility Managed Account

Back by Unpopular Demand **2021 Performance Report: +99.6%**

…. this time with hedging.

Dear Sirs,

In lieu of a philosophical quote, this rather sums it up

Procrastination tends to rank rather low in the recommendations of *807 Habits of Highly Successful People I've Not Met* series of books, but its merits in the investment world seem rather unsung. In the case of a year-end letter, events have moved with such rapidity in the inflation/rates world that ponderables gathered throughout the year can be safely discarded for the issue at hand. Incidentally the managed account clocked in a 96.6% return for the year, or 77.3% net of hypothetical & uncharged fees. Largely this was achieved by not doing much at all and following the models and the manager's general view: risk-on via derivatives and aggressive hedging. We're in the process of converting into a BVI fee-charging incubator fund in the next few months and hopefully in time for Q2.

Your manager is a believer in trekking to see realities on the ground, and whilst last year meant a sojourn in Sweden to see how an island of sanity was operating, as things were in the before-time[*], this time it was in South Africa partwise to see the Omicron bogeyman for what it isn't – which the statistics and South African doctors at the epicentre confirmed. Maddening as the inevitable paroxysm of global reaction was, this ought to have been a risk-on trade if there ever was. So far the Vix has not confirmed, remaining stubbornly at 19 or above which might have been prescient.

The year would comfortably have been treble-digits were it not for the primary hedge, the AUD/JPY cross, which has rallied off of – Nevermind let's talk fashion instead, skipping the 90's grunge clothings the tweenies are bizarrely trundling around with and going straight to retro internment camps, which the Australians have built with gusto and tossed aboriginals and some anglos into with the help of the Army. I imagine all they had to do was dust off the manuals. Incidentally I have employees in suburban coastal Australia, who all have Covid & there's no herd immunity. The staggering irony would be if Evil Mary Poppins who runs the islands next door caught it. Along with Viennese police who without any trace of irony pull shoppers off the streets with *Ihre Papiere, Bitte*[†].

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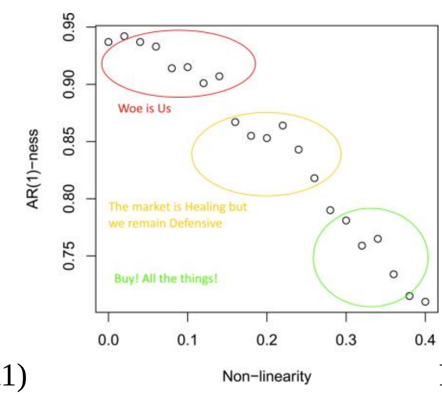
[*] Mel Gibson! Transavia PL-12 Airtruk!

[†] Austria overtook Sweden in death statistics. All one can do is shake an impotent fist of rage & vote with one's feet

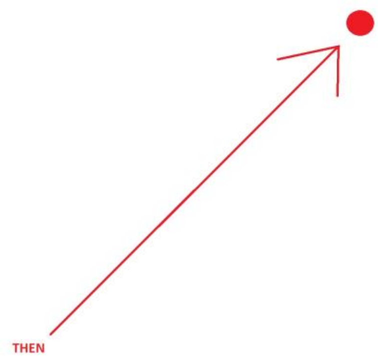
Against this the AUD has strengthened, consciously uncoupling to a degree from its risk-on/risk-off nature, as Wall Street once again rotates into inflation names, oil and raw materials. Some of the sting was stanched by the Fund's small derivative shorts against the GMEs and AMCs of this world, where the thesis of odd-lotters no longer receiving unemployment cheques has been muddled by meme stocks & bitcoin's propitious dive in concert with a week so bad for the 30-Year Treasury (no position) that it would rank by itself in the 5 worst years of the long bond's history. Was it tighter money? Institutional red-shiny-ball-chasing rotation out? Netflix&Chillers' boredom? Better lucky than good I say.

The Fund chooses this particular hedge (though CAD/JPY would be perfectly acceptable) for a number of reasons, including my own general perspective that the inflation jump is not a permanent feature of the system - cue velocity of money & supply chain undisruption - and that currencies offer liquidity, hedge cost & margin advantages when hedging primary short-volatility positions as long as the cross-asset risk can be accepted. This cost it hugely in 2021 as the AUD uncoupled somewhat in the wrong direction from the Vix in later months. The cross still continues to rally to much gnashing of teeth. Overall leverage and the hedge ratio have been rightsized. Some tactical trading – volatility options capturing extra premia as options on futures of options – aided the pleasing end result when the futures curve didn't offer enough oomph to make more straightforward trades worthwhile. Wading into some of the technicalities, I've learned not to overcomplicate things. It's all well-and-good having skewed non-Gaussian generalized autoregressive conditionally heteroskedastic models aplenty[‡], but it's simpler to visualize it using cutting-edge K-means clustering techniques:



Part1)

Part 2)



If you are in a mode whereby the next time period's volatility is strongly correlated with the prior, or at the point of a break either up or down, your trades shift accordingly. If at the end of a period, which is where human judgment comes into play with a consideration of macroeconomic, trade calendar, and political variables[§]: a transition towards a lower trend of risk pricing argues for straightforward risk-on futures that benefit from a mode change, whilst trend continuation tends toward 3rd order derivatives and less straightforward positioning that harvests extra premium.

The fun begins when 1) ►2). All the diversification in the world *except government bonds historically* collapses at exactly these moments; given the apparent end of the 40-year bond super-cycle, there may be nowhere to hide except filthy lucre itself. That's the thesis of this Fund: how to *sense* such moves beforehand with some degree of success, and how to hedge regardless against a completely one-day event such as a terrorist attack. There are ways as long as the next inevitable crisis builds up over time; one simple method is to easily keep track of a simple long-term moving price average versus short-term moving average on positions that have a generally

‡ If Hell is other people, leading with this is the antidote. If only Sartre was a statistician, he'd have been happier

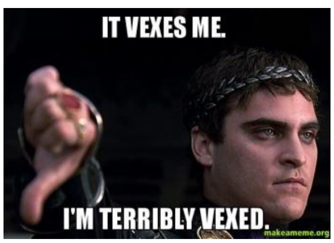
§ Also, ~~guessing~~ experience

binomial outcome, such as preferred shares or junk bonds. If these start to seriously weaken (the latter isn't heavily impacted by nominal rates per se as duration is pretty low), get out. Though this predicts 9 out of the past 5 recessions, it doesn't predict 0 out of the last 7 like your staff economist did. Autoregressively fire your forecaster and blame his heteroskedastic performance; he'll surely appreciate the studious reference.

The Fund uses this among other metrics to attempt to stare into its purblind crystal ball with a beady eye. Risky debt is smarter than equity in general and is not ominous – yet.

I'd venture to say in an investing world where >90% of anything is essentially short volatility, the above is the deciding factor. Take the darts from the monkey occasionally and he'll look like a genius.

The great unknown in 2022 therefore, likely outranking the previous letter's focus on China, is the trillion dollar question of what will happen if the Fed tightens very (too) quickly and an inevitable credit crisis happens somewhere and gov bonds fail to fulfill their lonely risk-off role. My belief is that options implied volatility will skyrocket as hidey-holes disappear and mandates kerb going to cash, and that bonds will still come to the rescue. Further, jawboning will immediately commence and the taper will be tapered. Counterpoint: in a paroxysm of actual good judgment, Powell was renewed as Fed chair and can be reasonably aggressive. Counter-counterpoint, in the first two weeks of this year in the meme/treasury plunge, the process has (so far) been quite orderly and the Vix has behaved itself despite torrents of wealth destruction. Hmm.



Another consideration is whether there is a difference between tightening and the end of easing, as in both cases there is a delta of moneys available to slosh through the system. From the historical record, the amount of nominal yield rises is perhaps most important, with stocks continuing to rise often if yields rise in an orderly manner. If my own transient inflation view is right, real yields should spring up quite nicely. What this means is ambiguous at best.

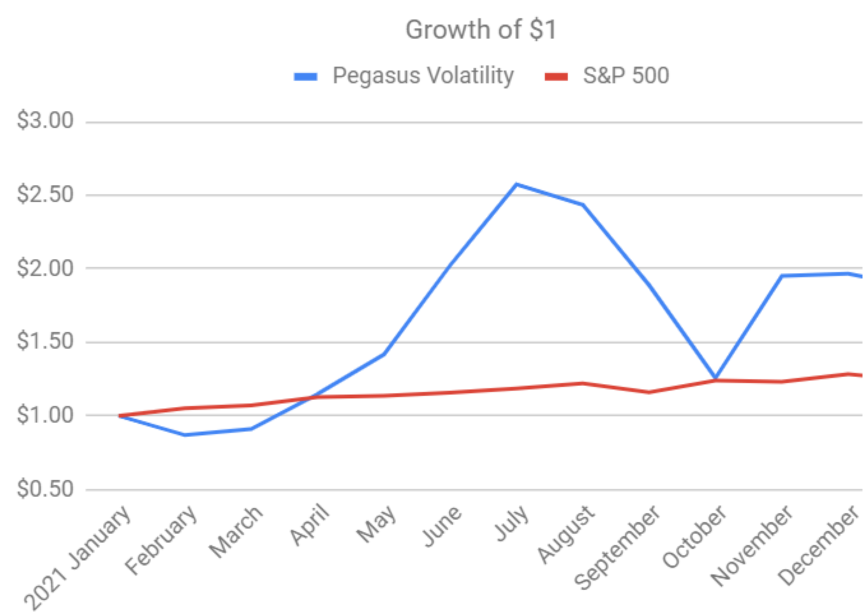
Conclusions are when you get tired of thinking. For this year, price will be the guide. I'm getting my dancing shoes on.

Philip Hahn

P.S. The account is being converted into a BVI incubator hedge fund. There are 11 slots left for hardy souls

Performance Statistics			
	Summer	Winter	Total
2020		+54.2%	+54.2%
2021	+62.8%	+20.7%	+96.6%

Return Since July 2020 Incept:	**+203.1%**	Significant Exposure:	Short Volatility
Average Monthly (Geometric):	+7.5%		Short Risk-On Currencies
Monthly R-Squared to Benchmark (S&P 500):	-0.10		



Managed Account Information

E-mail: contact@pegasusfund.com

Fund Domicile:	Denmark - Managed Account
Manager:	Philip Hahn
Prime Broker:	Saxo Bank
Custodian:	Saxo Bank
Legal Advisor:	n/a
Administrator:	n/a
AUM:	Managed Account
Minimum Subscription (non-US only):	Closed
Redemptions:	Monthly, no Gates or Lockup
Management Fee:	Expenses (< 1%)
Performance Fee:	20%
High Water Mark:	Yes
Benchmark:	S&P 500
Lockup/Gates:	No

Investment Objective

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.

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.