Pegasus Volatility Managed Account

Back by Unpopular Demand **2023 Performance Report: +57.5% Gross +46.0% Net**

.... this time with hedging.

Dear Sirs,

"Every man takes the limits of his own field of vision for the limits of the world."
Arthur Schopenhauer, Studies in Pessimism: The Essays

It's been several years since the last missive, as all the Fund managed to perform through end-2022 post-fee was double the S&P500 – at double the volatility. The above mouse and a leveraged ETF could manage the same with less verbiage or squeaking. I've therefore brought the Fund private for now, reset the performance clock, brushed off some coding books and run cross-correlations[*] to rebuild the hedging book. Schopenhauer discarded his philosophy more than once although hopefully the reconstituted Fund will have a rather less contradictory result.

2023, imperfectly executed[†] but still pleasing, boasted a +46% return on 2023 net of hypothetical fees, beating the S&P by about double on a net basis with less than double the volatility. As there was no crash this year, hedges have proven repetitively costly. If a market face-plant eventually arrives, returns-versus-vol will be properly tested. Primary hedges include volatility derivatives, AUD/JPY and a despicable single-name discussed further on.

Doubtless endless letters cluttering the reader's inbox will articulately and uselessly cover 2023 in review, so instead let's pose the question: why did the fastest monetary tightening in history for a would-be Volcker, combined with a vicious inflationary impulse that lasted for far longer than most (including me) had thought possible, *not* cause a proper recession? Or for that matter a crash in crypto and junk (latter could well happen this year)? The Fund did not bet on an economic crisis as:

a) nearly everyone else thought there'd be one and how bad is a recession going to be really if Mister Market and Corporate-land are preparing for it; and

b) not to sound callous but how economically significant is it if the lower 80% of income brackets are most exposed to inflation yet benefited the most from of Covid shutdowns (universal basic income) and an extraordinary rise in wages, for the first tentative trend from capital to labour[‡] in generations? Does it matter?

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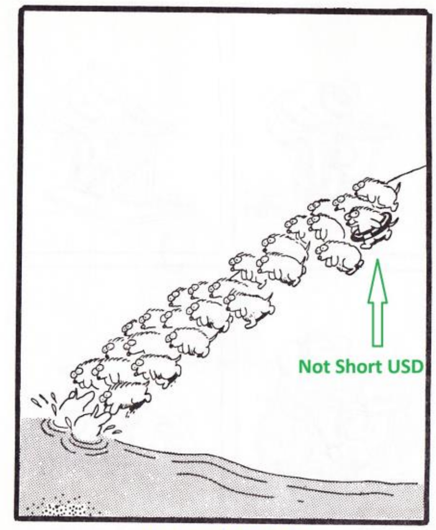
[*] 14 million correlations across econometric, forex, bond, stock, and pretty much anything else tradeable, only to validate what was already guessed at. Simpler is often better but less impressive

[†] Speaking of simpler, moved from 3rd order to 2nd order derivatives in November – more liquidity as well

[‡‡] A healthy thing. What is needed more, a 19-year old truck driver or a 25-year-old surplus to requirement sociology major? Rather interestingly, US studies have shown that a plumber earning US$100,000 would and does take a significant pay cut as well as job retraining as they perceive some useless white-collar profession their neighbour has to be more desirable than the plumber they were beforehand. Does this hold true in apprenticeship countries such as Germany?

c) what if anything does it mean if there's still pervasive gloom from the consumer, at poll levels not seen since 1981 when a severe recession was underway coupled with rising inflation? That's there's room for a further bull run?



Gary Larson's *The Far Side*

Though a recession is a guarantee somewhere along the line, a US unemployment rate that Europe can only salivate over as well as a bouncy LEI index correspond to being structurally short Vol for awhile further. Collateral is held in USD for margins and AUD/JPY crosses, and given the sheep-herd that goes for global central banks (ex-Japan[§]), declining US short-end interest rates shouldn't necessarily bode weakness for the Dollar, which also seems to be consensus for the moment – and not mine:

1) US real growth rates exceed and should continue to do so for myriad reasons that of of Euroland and much of Asia, in general spurring demand for USD;
2) Even with say 100 bips decline in US yield, it stands to reason the other central banks will follow suit and it'll still have a real yield advantage;
3) I've been on Wall Street 20 years now and it's been the 20th time that this is the Year of Europe. No it isn't, no it won't, nor will it ever ever be; it's a largely lovely museum slowly gathering dust and fading into irrelevance[**]. So why own the € with a lower interest rate?


Apropos Nothing


ruffles notes What He Said

Outside of its structural hedging, the Fund's main short position throughout the year has been NatWest Plc, the largest pure-UK bank. You cannot send interest rates to the stratosphere, arguably with a potent admixture of arrogance (believing central banks are the solution to inflation and not a contributory cause, namely their own zero-rate policies in the first place and a **war** going on), and foolhardiness(not pausing to gauge long-term effects) without some sort of consequence. Commercial paper is outside the Fund's purview and the seemingly inevitable slow-motion collision awaiting Junk spreads aside, mortgage rates in Britain have tripled for residential. *Tripled*. One mortgage broker of mine has a client whose £8,300 monthly payment has soared to £22,000 and he's forced to sell. To a cash buyer. Cue a huge number of others and inevitable jingle-mail.

Bizarrely, nearly all of British residential mortgages are less than 5-year fixed, meaning a duration of 2.5 years until they revert to floating. Granted many homeowners have paid back their houses over the course of aeons, but for those who financed at 65% LTV? All things equal, cash-only and mortgage deals should mean a repricing of UK residential real estate by 40% downwards or more. US property prices have been held up by supply constriction as its mortgages are often 30-year so why sell up if your next house's financing cost is so much more. Britain doesn't have this gigantic passenger seat airbag.

Yes, Welcome to Me

Who owns the other side? Welcome to the wonderful world of NatWest and its £717 billion asset book – less Nigel Farage's accounts of course. £341 billion is in retail and commercial[††]. Of that amount, £3.5 billion, or 1%, has been set aside for bad loans. Yep, 1%. NWG's market cap is £19 billion, or about 5% of the

[§] This bears watching; will they actually tighten one day soon? That'd be a large move out of risk-on
[**] Far better to live in though
[††] https://investors.natwestgroup.com/results-centre.aspx

resi/commercial book if everything else stayed just tickety-boo.

The Fund managed to top-tick for once and bought ATM December ’23 puts early in the year, covered and went long after Farage-gate was all over the press, and is short again July ’24 puts at 210 pence. Call it a hedge if you like; if there’s a hand grenade somewhere in the financial system, Ockam suggests it’ll be in the UK if it’d be anywhere outside of the junk market.

If he weren’t still dead today, Schopenhauer would have despised NatWest as much as he did Hegel[‡‡]. I hate NatWest and so can you[§§].

Alongside the NatWest put, the Fund is short £. Reasoning being that either in the worst-case NatWest gets bailed out – politically toxic and hammering the pound, or there’s a sharp emergency interest rate cut to buoy asset prices, also hammering the pound[***]. Or both.

On an entirely different note and rather removed from the Fund’s short-term profile, I cannot shake a thick coating of deflationary pixie dust off me. As cloudy as the crystal ball may be, there does not yet either seem in practice or theory a limit to the future capacity of AI for displacing numerous white-collar professions such as legal, accounting and design work among a long list, whilst at the same time no one is having children anymore. It’s anyone’s guess what decreased supply of workers (quite a bit of wage pressure) versus reduced demand will be in terms of capital/labour balance, but what is clear is that the appalling demographics everywhere except India <u>must</u> be deflationary in the long run if the global economy was built for further growth and has excess structural supply– at the same time as technological progress drives down the inputs required to supply each first-world lifestyle lived.

Why hasn’t anyone written a book on this with Japan and Italy as a guide? What *did* work in the former in the last 20 years? Healthcare infrastructure?

What if we all turn Japanese as per the song, except without the social harmony? How do you invest? Lock in any long-duration free cash flow asset, finance on the short end as interest rates logically go to zero or negative? I’ve been doing so in private business so here’s hoping until a better risk/reward shows up.

Conclusions are when you get tired of thinking. Junk spreads worry me. A lack of a large-scale naval landing-barge buildup in Fujian means China does not.

Philip Hahn

I’M OFTEN WRONG.

PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS. THAT’S A RELIEF.

THE INFORMATION CONTAINED IN THIS PRESENTATION HAS BEEN PREPARED SOLELY FOR INFORMATIONAL PURPOSES AND IS NOT AN OFFER TO SELL OR PURCHASE OR A SOLICITATION OF AN OFFER TO SELL OR PURCHASE ANY INTERESTS OR SHARES IN FUNDS.

THERE ISNT’T ONE BUT IF THERE WERE, PLEASE CONSULT THE ADMINISTRATOR NAV RELEASE FOR YOUR SPECIFIC SHARE RETURN.

NO PART OF ANY COMMUNICATIONS MAY BE CONSIDERED AS INVESTMENT ADVICE. OR EVEN A GOOD IDEA. DON’T SUE ME.

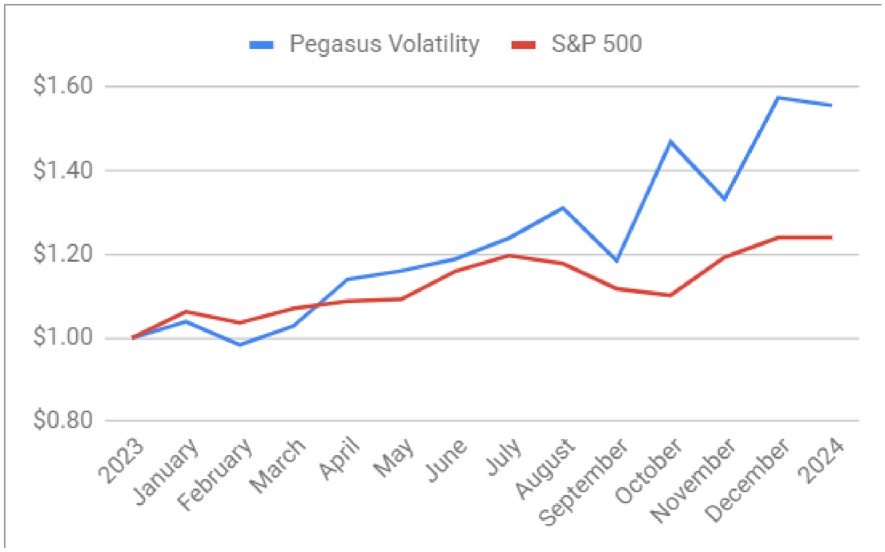
[‡‡] Though Schopenhauer’s hilariously depressing and knowingly self-contradictory philosophy was redolent of an Escher painting, his hated of Hegel was unwavering. So he was right on that one at least. I rather ignored his turn towards orientalism but the early work was wonderful

[§§] I’m often wrong

[***] Really, I’m often wrong. Even says so again in the disclaimer

Performance Statistics (Net)			
	Summer	Winter	Total
2023	+15.2%	+31.0%	+46.0%

Return Since January 2023 Incept:	**+46.0%**	Significant Exposure:	Short Volatility
Average Monthly (Geometric):	+3.2%		Short NatWest
Monthly R-Squared to Benchmark (S&P 500):	0.03		Long Volatility Derivates
			Short Risk-On Currencies



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

Fund Domicile:	Denmark - Managed Account	**Investment Objective**
Manager:	Philip Hahn	
Prime Broker:	Saxo Bank	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.
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%)	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/Gates:	No	