March 2019 Newsletter

Dear Investor,

The Global Volatility Summit ("GVS") brings together volatility and tail hedge managers, institutional investors, thought-provoking speakers, and other industry experts to discuss the volatility markets and the roles volatility strategies can play in institutional investment portfolios. The GVS aims to keep investors updated on the volatility markets throughout the year, and educated on innovations within the space.

True Partner Capital has provided the latest piece in the GVS newsletter series.

Cheers,
Global Volatility Summit

Event

The tenth annual Global Volatility Summit ("GVS") is scheduled for Wednesday, March 13th, 2019 at Chelsea Piers in New York City. This year's event will feature fresh panel topics, manager discussions, keynote speakers, and a new US Politics panel. Space is limited, so we encourage you to register as soon as possible.

2019 Manager Participants

36 South Capital Advisors
Argentière Capital
Artemis Capital Management
BTG Pactual
Capstone Investment Advisors
Capula Investment Management
Dominicé & Co
GCI Asset Management
Graticule Asset Management
III Capital Management
Ionic Capital Management
Lake Hill
Man
Parallax Investment Advisors
Penso Advisors
Pine River Capital Management
TPRV Capital
True Partner Capital

2018 Event Recap

The 9th Annual Global Volatility Summit was held on March 14, 2018 at Chelsea Piers in New York City. 14 hedge fund managers were joined by senior professionals from hedge fund consultants, the institutional investor community, and leaders in the industry to discuss volatility, tail hedging, macro and quant strategies within the investment context. Three keynote speakers, Lance Armstrong, David Gallo, and Ryan Holiday temporarily drove the conversation away from the central content to speak to volatility across other contexts including athletic competition and underwater astonishments. The event hosted the first-ever GVS Think Tank Panel, which featured three industry experts across East Asia policy studies, macro quantitative and derivatives strategies, and US politics. Among these panelists included Ryan Hass, Marko Kolanovic, and Demetri Sevastopulo.

Confidential: For institutional investors only

03 -2019: Written by Mr. Tobias Hekster and Mr. Govert Heijboer, Chicago / Hong Kong

Party like it's 2017?

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Party like it's 2017?

Mr. Tobias Hekster and Mr. Govert Heijboer

With equity markets roaring up in the start of 2019, one can be forgiven to have forgotten that a mere ten weeks ago the bears were firmly in control with plenty of shell-shocked investors liquidating their market exposure. Maybe this explains the severity of the rebound, with money on the sidelines rushing back in once a further sell-off into a real bear market was averted. If the fourth quarter of 2018 were a brief mental exercise in what markets would look like when off the monetary life-support, the doctors at the Fed and other central banks have quickly decided the patient is not yet ready.

An old Dutch proverb goes "gentle healers make stinking wounds"', which loosely translates as,it is better to treat a problem thoroughly even if the treatment is painful, otherwise it may get worse. The markets immediately took the flexibility expressed by Powell on not only future rate hikes but also on the Fed balance sheet run-off, as an invitation for an extended bull party. The monetary punchbowl was back in the middle of it, just like in 2017. As if 2018 never happened. Permit us to suggest it would be wise to reflect on last year taking into account the Dutch proverb.

While we appreciate a good party as much as the next person, we wonder whether the perceived similarities with 2017 ring true. We dare say that despite the rosy mood and cratering volatilities globally, we are not entering a sustained period of depressed volatilities. Market complacency has gone too far, too fast.

Implied volatilities have come down radically over the past 10 weeks. **Table 1** below compares the 1-month at-the-money implied volatility on December 28th 2018 for several global indices with their current levels. Although part of the decline is driven by higher index levels (in general, options with higher strike prices command a lower implied volatility), significant supply of volatility has hammered down options prices.

Table 1: Changes in Implied Volatility

	1M ATM (12/28/18)	1M ATM (3/4/19)	Change
S&P 500	28.9	10.5	-64%
Nikkei 225	36.1	14.3	-60%
Kospi 200	20.5	13.1	-36%
Hang Seng	26.5	15.8	-40%
Eurostoxx 50	23.5	11.5	-51%

Source: True Partner Capital

However, implied volatility is only one side of the equation. Where implied volatility can be seen as the cost of potential movement (in the form of daily time decay), the revenue of options depends on the actual movement the markets exhibit. From the actual movement perspective, the following statistic is telling. During all of 2017, there were a total of seven trading days in the S&P 500 with a >1% move, while in January 2019 alone we have already experienced seven of these trading days.

The observation whether volatility is 'cheap' or not depends on the degree of actual daily movement. When comparing the current levels of implied volatility with our generic (proprietary) measure for actual movement, most indices trade around fair value, as depicted in **Table 2** below.

Table 2: Current Implied and Realized Volatility

	1M ATM (3/4/19)	20D realized proxy	Realized / Implied
S&P 500	10.5	9.5	90%
Nikkei 225	14.3	12.4	87%
Kospi 200	13.1	13.5	103%
Hang Seng	15.8	15.6	99%
Eurostoxx 50	11.4	10.5	92%

Source: True Partner Capital

In other words, volatilities in key indices such as Nikkei, S&P 500 and Eurostoxx 50, have compressed to such an extent that they are actually trading at their current realized levels. Anecdotal evidence says the volatility-short trade is alive and kicking. A valid question is how much room there is to run from here. When implied and realized volatility have converged at these low volatility levels, the benefit from a volatility short position (assuming the trader hedges his or her risk dynamically) would only lie in further volatility compression. Selling options is only a carry trade as long as the daily receipt of time decay exceeds the actual daily movement. As both movement and implied volatility have come down radically since the end of December, it is not a surprise that the CBOE Eurekahedge Short Volatility Index was able to recapture a sizeable chunk of December's losses in January. (and it is our expectation they ought have recovered more in February).

In order to judge how much momentum the volatility short trade has left in the short term, we should revert back to 2017. For most of the year, dismal levels of realized volatility invited yet more volatility sellers in a reinforcing feedback loop that seemed to go on perpetually until it didn't. While it only cracked up in February 2018, the first signs of frailty were already visible at the end of 2017. **Table 3** below shows that in October 2017 implieds were still comfortably above actual movement, fueling the feedback loop. But come December month end, that was mostly gone.

Table 3: 2017 Realized and Implied Volatility

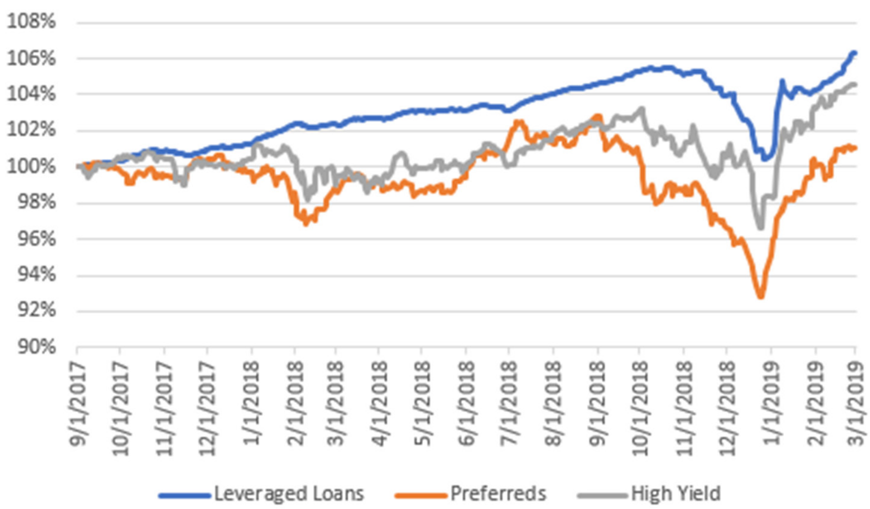
	1M ATM 26/10/2017	Realized / Implied 26/10/2017	1M ATM 28/12/2017	Realized / Implied 28/12/2017
S&P 500	8.3	65%	7.6	93%
Nikkei 225	12.1	86%	10.8	76%
Kospi 200	10.5	76%	12.4	98%
Hang Seng	13.2	84%	13.6	105%
Eurostoxx 50	11.1	73%	10.7	101%

Source: True Partner Capital

In our view the current volatility landscape is more in line with the very end of 2017. From a behavioral perspective this makes sense as well. By backtracking on rate hikes and balance sheet reduction, the Fed yet again reinforced the Powell Put; previously also known as Yellen Put, Bernanke Put and Greenspan Put…. Hence, there was a rush to cash in on this renewed market backstop by selling volatility and buying equity. As the process is perceived to be a repetition of the past, logically the speed of the process increases which explains the breakneck pace of volatility declines this time around.This increased speed can be seen as a "learning curve", although the "knowledge" learned can be disputed.

Interestingly, in addition to the compression of volatility, other typical higher risk carry trades have roared back to life from their December swoon. For example High Yield (as reflected by the HYG ETF), Preferred Shares (as reflected by the PFF ETF) and Leveraged Loans (as reflected by the S&P LSTA US Leveraged Loans Index) are all trading at or very near their highs. A veritable dash-for-trash seems to be on after Powell's flexibility comments, with risk assets getting priced near perfection.

Chart 1: Recent Performance of Selected Carry Trades



Source: True Partner Capital; Bloomberg Data

Amongst all the frothiness observed in the markets, for the near future, there is still a difference between concluding it is December 2017 again and predicting whether and when February 2018 will happen again. While all it takes is a catalyst with which a quick unravelling of the Goldilocks Markets could take place, markets have shown to be quite adept at ignoring all kinds of negative news and threats for a prolonged period. Until then, it pays for a volatility trader to remain patient and diligent, knowing that all parties come to an end.

About the authors

Mr. Govert Heijboer, Co-CIO of True Partner, has been active as a market maker trading in the European and Asian derivatives markets as well as positional trading since 2003. Govert started

as a trader/researcher at Saen Options in Amsterdam and rose to become the director of derivatives trading and a member of the executive team in 2007. In 2008 he moved to Hong Kong to set up and assume responsibility for all trading activities in the new Saen Options Hong Kong branch office. Govert holds a PhD in Management Science and an MSc in Applied Physics from the University of Twente, Netherlands. He is a founding partner and has worked on the launch of the True Partner Fund since March 2010.

Mr. Tobias Hekster, Co-CIO of True Partner, has been actively trading for the past 21 years in various different roles in several markets across the globe. Starting at IMC in 1998

as a pit trader in Amsterdam, Tobias has established the off-floor arbitrage desk, headed the Chicago office in the transition from floor trading to electronic trading and set up the Asian volatility arbitrage desk in Hong Kong. Tobias holds an MSc in Economics and he teaches as an Adjunct Associate Professor at the Chinese University of Hong Kong and as an Adjunct Professor of Financial Practice at National Taiwan University.

About True Partner Capital

True Partner Capital is a team of former market makers and IT specialists that have been working together for more than 15 years.

Their combined expertise on trading, execution and risk management as well as the proprietary trading technology, allows the team to identify and capitalize on trading opportunities.

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