Logica

OCTOBER 2023

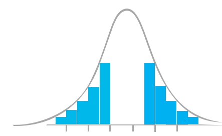
SUMMARY

Markets retreated mildly in October, albeit with a strong whipsaw toward month end. With that came a tiny gain in VIX/Implied Volatility ("IV"), though almost insignificant in terms of IV moves, and also surprisingly modest with respect to the realized volatility around the whipsaw decline in the S&P 500. Most sectors posted losses with the exception of Technology (+0.05%) and Utilities (+1.29%), which typically share little relationship. Concurrently, we continue to observe a radical disconnection in performance between the small value and large growth, as demonstrated by the divergence between the Russell 2000 and Nasdaq 100 Indices.

LOGICA ABSOLUTE RETURN ("LAR")

Upside/Downside Convexity - No Correlation

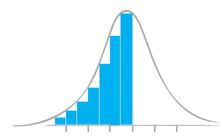
Tactical/dynamic ***balanced*** Put/Call allocation –Straddle



LOGICA TAIL RISK ("LTR")

Max Downside Convexity – Strong Negative Correlation

Tactical/dynamic ***downside tilted*** Put/Call allocation – Ratio Straddle



as of 10/31/23	MTD (%)	QTD (%)	YTD (%)
Logica Absolute Return[1]	**-2.0**	**-2.0**	**-12.4**
Naïve Straddle (1 put, 1 call)[2]	-4.6	-4.6	-17.9
Logica Tail Risk[1]	**0.2**	**0.2**	**-4.1**
Naïve Ratio Straddle (2 puts, 1 call)[3]	-1.2	-1.2	-21.3

Indices (as of 10/31/23)	MTD (%)	QTD (%)	YTD (%)
CBOE Volatility Index (VIX) pts	0.6	0.6	-3.5
CBOE Volatility Index (VIX) % chg	*3.5*	*3.5*	*-16.3*
S&P 500[4]	-2.2	-2.2	9.2
NASDAQ 100[5]	-2.1	-2.1	31.7
Dow Jones Industrial Average[6]	-1.4	-1.4	-0.3
Russell 2000[7]	-6.9	-6.9	-5.6

1. Returns are net of fees and represent the returns of Logica Absolute Return Fund, LP and Logica Tail Risk Fund, LP, respectively. Past performance is not indicative of future results.
2. Naïve Straddle Return: a 1.5 month out, S&P 500 at-the-money put and call bought on the final trading day of prior month and sold on the final trading day of current month. This return on premium is divided by a factor of 6 to be comparable to Logica's typical AUM-to-premium ratio. For illustration purposes only.
3. Naïve Ratio Straddle Return: a 1.5 month out, S&P 500 at-the-money put and at-the-money call (divided by 2) bought on the final trading day of prior month and sold on the final trading day of current month. This return on premium is divided by a factor of 6 to be comparable to Logica's typical AUM-to-premium ratio. For illustration purposes only.
4. S&P 500. The index measures the performance of the large-cap segment of the U.S. market. Considered to be a proxy of the U.S. equity market, the index is composed of 500+ constituent companies.
5. The Nasdaq-100 is a stock market index made up of 101 equity securities issued by 100 of the largest non-financial companies listed on the Nasdaq stock exchange.
6. The Dow Jones Industrial Average is a stock market index of 30 prominent companies listed on stock exchanges in the United States.
7. The Russell 2000 Index is a small-cap U.S. stock market index that makes up the smallest 2,000 stocks in the Russell 3000 Index.

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The Portfolio: Looking Inside

COMMENTARY & PORTFOLIO RETURN ATTRIBUTION[8]

LOGICA ABSOLUTE RETURN ATTRIBUTION			
As of 10/31/23	MTD (%)	QTD (%)	YTD (%)
S&P Puts	**3.63**	**3.63**	**-6.07**
Fast Scalping	*2.41*	*2.41*	*-0.79*
Slow Scalping	*1.22*	*1.22*	*-5.28*
S&P Calls	**-4.10**	**-4.10**	**-6.51**
Fast Scalping	*-0.65*	*-0.65*	*-1.33*
Slow Scalping	*-3.46*	*-3.46*	*-5.19*
Sector & Single Stock Calls	**-2.03**	**-2.03**	**-1.50**
Macro Overlay	**0.01**	**0.01**	**0.18**
Gold	*0.02*	*0.02*	*0.23*
Long-Term Treasuries	*-0.03*	*-0.03*	*-0.90*
US Dollar	*-0.01*	*-0.01*	*0.82*

LOGICA TAIL RISK ATTRIBUTION			
As of 10/31/23	MTD (%)	QTD (%)	YTD (%)
S&P Puts	**1.90**	**1.90**	**-2.58**
Fast Scalping	*1.33*	*1.33*	*0.07*
Slow Scalping	*0.56*	*0.56*	*-2.65*
S&P Calls	**-1.23**	**-1.23**	**-1.99**
Fast Scalping	*-0.22*	*-0.22*	*-0.13*
Slow Scalping	*-1.01*	*-1.01*	*-1.86*
Sector & Single Stock Calls	**-0.60**	**-0.60**	**-0.94**
Macro Overlay	**-0.02**	**-0.02**	**0.05**
Gold	*0.01*	*0.01*	*0.12*
Long-Term Treasuries	*-0.02*	*-0.02*	*-0.57*
US Dollar	*0.00*	*0.00*	*0.52*

"Have you ever noticed that anybody driving slower than you is an idiot, and anyone going faster than you is a maniac?"

- George Carlin

Our strategies in October saw a few opposing factors at play. Across our Delta and Vega scalping models, we extracted solid returns from our Fast Scalping modules, but less so from our Slow Scalping ones, highlighting how starkly results can contrast running the same signal, but at different frequencies. This makes sense, of course, given the whipsaw movement within the month, wherein "acting fast" provided more opportunity than waiting. We saw the exact opposite of this in prior months when trend penalized Fast Scalping and favored the Slow. And to state the obvious, we chose to bifurcate frequency (into Slow and Fast) given the unknowability around timing frequency regimes – we do not believe one can time the market's timing! While it is a major task to find edge in the forecast of Vega and Delta moves, they are still somewhat achievable, whereas most models would begin to overfit in attempting to optimize frequency.

Separately, while our **Sector & Single Stock Calls** outperformed the S&P 500 as we aim for, some of this exposure (specifically, the anti-momentum selections) generated a lower excess return than we would expect given the S&P 500's decline. In selloffs, we typically expect momentum to get hit a bit harder and anti-momentum to hold up a bit better (the conceptual pull-back from being "overbought" as opposed to the settling in from being "oversold"). But in October, the opposite occurred, wherein momentum (Technology) beat the S&P, and anti-momentum (circling around Value) took a considerably harder hit.

8. For illustration purposes only. Attribution returns are composed of daily returns, gross of fees.

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RETURNS.

Nasdaq 100 / Russell 2000

Part of this unexpected behavior may be attributable to factor dispersion we've brought up a few times in recent letters. However one wants to view it, for example, as demonstrated above with a proxy of large cap vs. small cap via the spread of Nasdaq 100 over the Russell 2000, we continue to see an aggressive extension of factor dispersion.

- Similarly, the S&P Small-Cap 600 Index has returned -5.01% YTD as compared with the (Large Cap) S&P 500's return of +9.23% YTD.
- And even more dramatically, the S&P 500 Pure Value Index is -9.1% YTD, as compared to the S&P 500 Growth Index at +15.3% YTD.

We've mentioned in prior letters that our strategies have been hurt by lack of market breadth, given that our **Sector & Single Stock Calls** concentrates more in momentum and anti-momentum exposures. Unlike 2022, during which we saw anti-momentum/value outperform, that bucket is underperforming in 2023, **and**, so is momentum. Put another way, if one isn't exposed to tech and/or the largest of the large cap names, there isn't *much*, if any, excess return to be had YTD.

"The Edge… there is no honest way to explain it because the only people who really know where it is are the ones who have gone over."

- Hunter S. Thompson

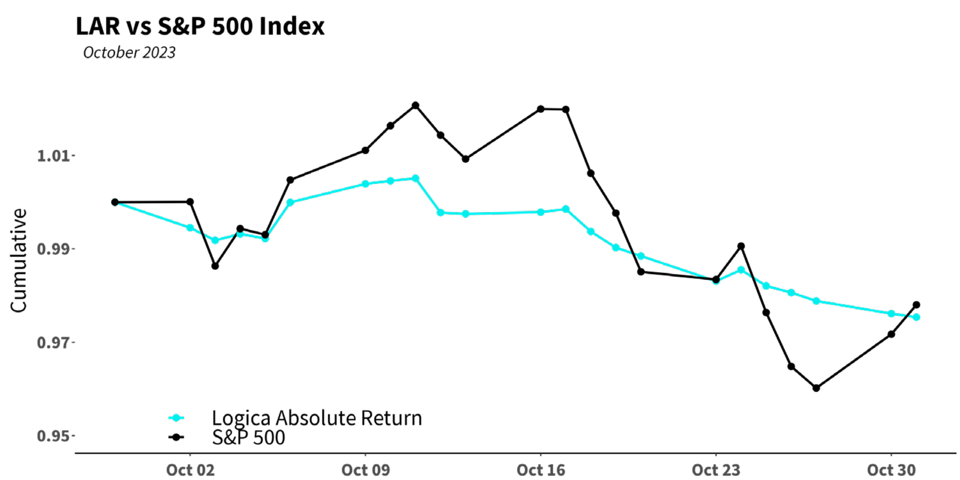
Elsewhere, and as we already mentioned in the summary, IV did not provide much of a tailwind month over month, wherein almost nothing happened in the "eyes of volatility". That said, there were certainly opportunities to take risk during the month, as VIX peaked at 21-22 before giving back most of its MTD gains in the final few days of the month. While we did begin some monetization of this intra-month spike, and while monetization of IV pops is a key part of our strategy, another even more crucial part of our model recognizes that there is a time to pause/slow this mechanism. We call this process "phase shift," i.e., our models are telling us that there's a reasonable likelihood that an IV move actually continues, and so it would be more prudent to prepare for an expansion rather than expect a reversion. This typically causes our strategies to simultaneously add some Vega and reduce Delta tilt, within reason, preparing for a potential further surge in IV.

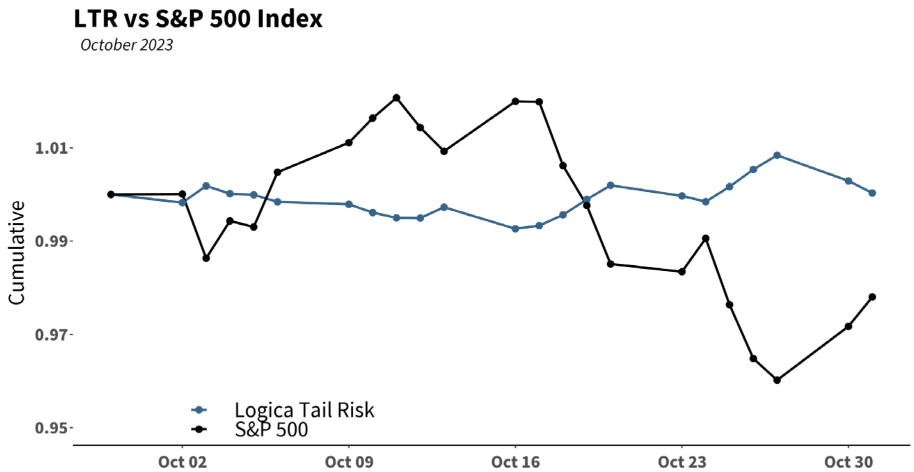
Our Phase Shift was on the edge of triggering on both 10/25 and 10/26. In this “edge” case (aka sitting on the statistical fence), our discretionary overlay chose to not increase Vega exposure, but to meaningfully reduce Delta tilt. In other words, being on the fence, we took somewhat of a middle ground between Phase Shift and “normal’ times. Over the next few days into month end, IV retreated dramatically and the S&P surged upward. Accordingly, we mitigated some pain by not having added the requisite Vega of a full Phase Shift, but concurrently, suffered a bit of drag by the Delta reduction we made (partial Phase Shift), which effectively lowered our up-capture into the quick and powerful market rally that ensued.

While it’s not much consolation to say something like “if the correction had continued aggressively downward, we’d have been in a great position,” we do greatly value this defensive component of our strategies. Broadly, the nature of our Phase Shift mechanism mirrors that of the behavior of IV itself: a bet with lower hit-rate, but higher payoff. And given the even lower hit rate than IV itself (that is, the hit rate of IV breaking out to the upside when it is on the precipice versus IV moving up on average, or from any point), we are hyper-vigilant around the conditions that trigger Phase Shift.

What wound up occurring in light of our positioning into the depth of the decline, and given the market’s energetic turnaround, is that we wound up near our max loss for the inflection point of the rebound, that is, in the trough of the straddle “valley”. And thus, coming out of the straddle trough meant a larger wall to climb (in option’s land -- a larger curve to ascend) in order to more fully participate in the market’s strong reversal.

Finally, looking more closely at our daily movement, we can see LAR was weighed down by its positive Delta exposure as the S&P began its decline into the latter part of the month. The inflection point mentioned above is clear toward the far right of LAR, as the S&P reversed and LAR (having become more “short” the market) continued its mild descent rather than capture upside as it did earlier in the month with the mild S&P climb. Separately, LTR avoided that headwind and nicely opposed the S&P 500 (as expected, and by design):



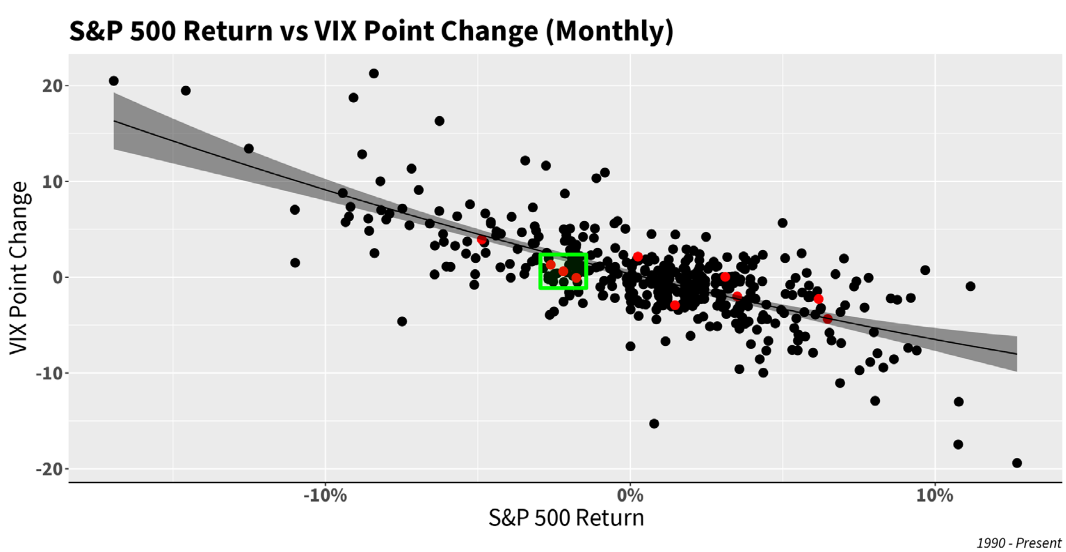


The Volatility Market: Looking Outside

"Just because something doesn't do what you planned it to do doesn't mean it's useless."

- Thomas Edison

As we can see in the chart below, the VIX/IV response in October was reasonably within expectation, though still, and unfortunately, a bit lower than one might hope or assume given the negative change in the S&P 500, alongside intra-month realized volatility.



With many long vol/tail risk strategies and ETFs struggling this year, we've had countless conversations with folks that ask some variant of the question "can we continue to rely on volatility?" Especially given IV's lackluster "performance" in 2022 with the S&P 500 down nearly -20% (of course, an exposure to IV is not typically ideal for an extended slow grind market – where other defensive exposures such as trend following might come into play. Nonetheless, the IV question still stands.)

While we can only speculate as to the direct causes of all the influencing market forces out there, volatility suppression that results from speculators chasing smaller and smaller bites of the Vol Risk Premium ("VRP") is most certainly the candidate that rises to the top of explaining IV's lackluster performance. More so, as IV fails to spike meaningfully higher on S&P drops, the suppression feedback loop increases; and the more times it reverts, the quicker the sellers will leap to sell into its jumps. But then a tale as old as time is the certainty that volatility suppression inevitably unwinds, and it usually does so in a dramatic fashion, as the timing of all those who need to rapidly exit is likely aligned with a stress event that instigates that joint eagerness. The question then is not if, but when.

A familiar story involves a recurring, often emotionally charged reassessment of an investment strategy or exposure. This most often occurs when an investor implements a strategy after its good times, only to experience an extended period of reversion back to its mean thereafter. This is an incredibly human thing to feel frustration over, and individually, here at Logica, we are certainly not immune. But then we step out to view the bigger picture. Ironically, the best time to invest in many strategies or exposures, is not when they look great – but perhaps when they look their worst.

As humans though, this is neither intuitive nor natural. What ends up happening is that something like volatility gets suppressed for months, even years, and the exact opposite exposure, e.g. short vol, becomes an increasingly attractive source of "return" (we put "return" in quotes because short vol provides it in the here and now, but more aptly, is transferring risk to a later date). Then the inescapable stress event occurs, and the rush for the exit is pronounced, to put it lightly, as literally all participants seek to rapidly exit the same small door. This inevitable Vol squeeze and related broader portfolio pain likely forces folks to reconsider their more "naked" portfolio exposures, and the idea of Long Vol as a hedge. However, soon after begins the decline/decay in IV that inevitably follows the dramatic pop; and so the cycle goes – a veritable dog chasing its tail!

"There's no such thing as a free lunch."

- Milton Friedman

The summary of these tales as old as time is that there is no free lunch in the capital markets. Today's source of return is tomorrow's source of risk, and the time in between, as speculators seek to capitalize on either side of the spinning coin, or perhaps time the regime switch, is the source of much frustration. At Logica, we understand deeply that many sources of alpha are concurrently the transfer of risk to a future date. Empirically, the great majority of strategies exhibit high negative skew, demonstrating this inevitable outcome within their own histories. And Long Volatility, of course, is the most reliable provider of positive skew at the most sporadic of times. Accordingly, while we infuse some component of IV timing in our own strategies (for example, increasing exposure when IV is "cheaper" and monetizing it when it is "expensive" in relative terms), it is our strong opinion that strategy timing is a fool's errand. Instead, we advocate finding the right portfolio balance, and ensuring that positive skew is consistently positioned alongside all that is the opposite.

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