



January 31, 2021

Thanks to investors for being so kind and supportive through this.

A few people encouraged me to continue making bets whenever I see an edge. I will. Poker trained me to keep making rational decisions even after many hands in a row go badly. That said, I'm not shorting individual companies until the [market wide mania](#) begins subsiding. I just don't see the edge in an environment where companies jump so much overnight, on no news. Asymmetry is too strong against us for it to make sense. Folks have told me this environment is many times crazier than the dotcom bubble, even. However, once this settles down there should be extra alpha on the short side for years. I will be aggressive when the time is right.

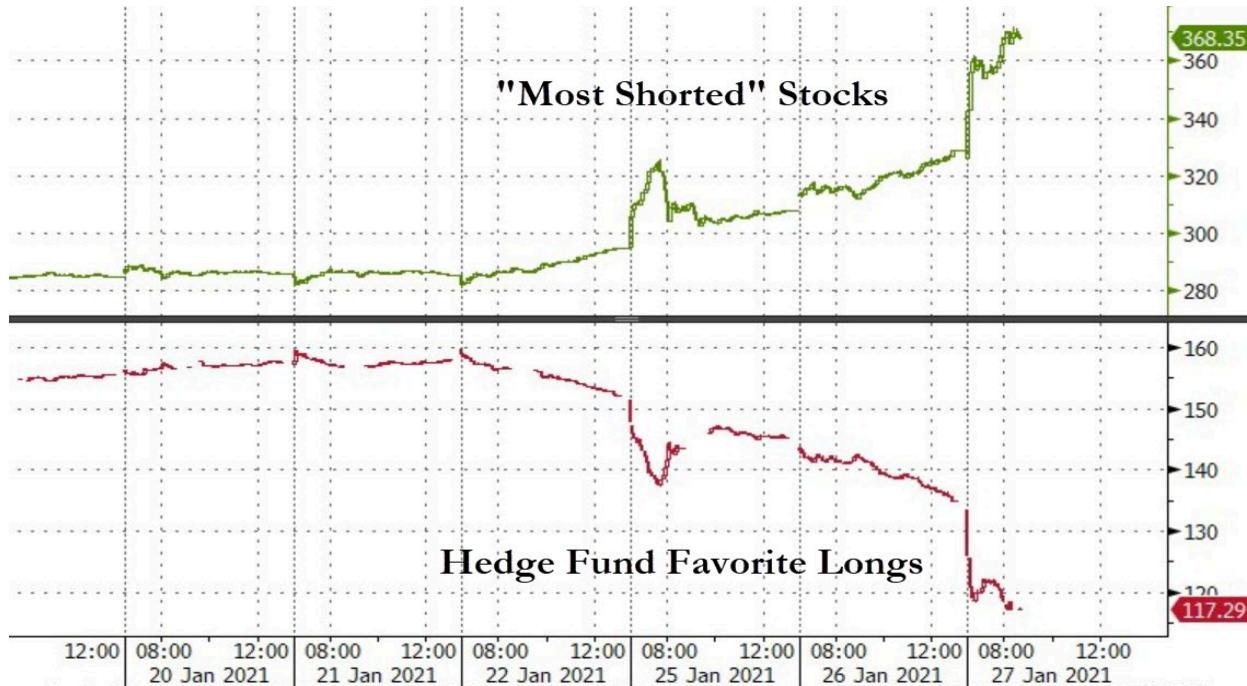
What Went Wrong

We're down 29% on the month, mostly from last week. This paper summarizes how that happened. While I reduced risk a lot, the cards came out incredibly bad for the few risks I did take.

1. Good companies traded down, bad companies traded up

This month, companies with good fundamentals traded down and companies with bad fundamentals traded up.¹ This hurts a portfolio that's long 200% good companies and short 100% bad ones. Because the index was 50% of our shorts, the damage was far less than for other highly leveraged funds. But this factor still cost us 10%:

¹ Other visualizations: [1](#) [2](#) [3](#) [4](#).



[Source: Zerohedge](#)

2. Too much gross exposure

I couldn't cut gross exposure enough. Our basket of longs is up 50-200%, and they're 2-4 months away from being long term capital gains. Now the IRR of tax savings is >30%, so quitting isn't an option. This experience taught me to slightly reduce the number of tax savings positions early on, since too many cripples flexibility during a crisis.

A friend is helping by contributing \$150k to de-lever the account until we can sell this basket of longs in a few months, so thanks to him. Another friend made the same offer in case it's needed. There's a good chance these positions just win from here too, since most longs are relatively cheap to the market and many are still cheap in absolute terms.

Side note: I'm waiting to combine the fund and legacy accounts because otherwise it'd be unfair to new investors who don't benefit from tax savings.

3. Will Meade's Express pump and dump

Will Meade did a pump/dump on our Express short right before the market closed on Friday the 22nd. Express had been largely shielded from the market mania given it had very low short interest. But his tweet caused the stock to go up more than 1,000% in three days - though I cut the position at an average price of about \$3.3 before far more damage was done. Will Meade's tweet cost us 5.5%:



Will Meade @realwillmeade · 15h

The stock that is identical to **\$GME** GameStop
(before its big run) is **\$EXPR** Express \$1.30 price target \$10

The stock that fits all the same criteria of Gamestop is
\$EXPR Express \$1.18 like \$GME had a share price under \$5
Just received \$140 million in financing from hedge fund Sycamore Partners and
Wells Fargo so both \$GME and \$EXPR had backing from a hedge fund.
A retail brand name that could turnaround.
\$EXPR has cash per share of \$1.63 above its share price
price to sales of 0.06 similar to \$GME before big run
short interest 13%
\$EXPR was \$10 in 2018



211

723



After this I quit microcap shorts for the time being since they're susceptible to random extreme jumps.

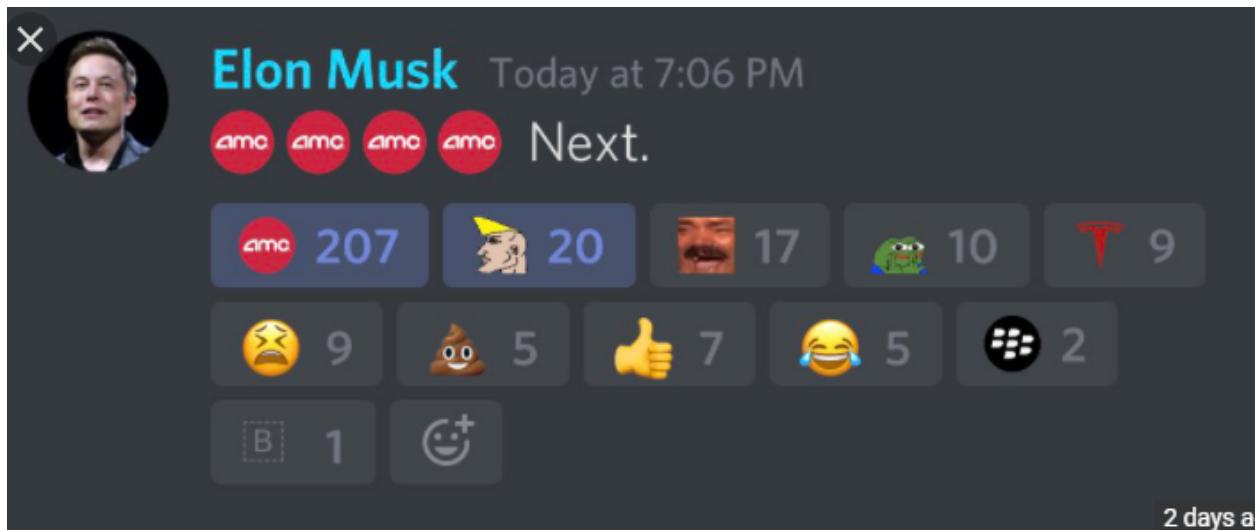
4. Elon Musk told followers to buy AMC

Last monday, I realized that heavily shorted companies had become extremely correlated and volatile, so I couldn't short too many at once². Thus, I switched to the index for most of my hedge, but kept my top 8 short picks, most of which had low short interest. I concentrated into just two highly shorted companies, AMC movie theaters and AAL American Airlines.

I *really* liked the setup on AMC. Unlike most companies, they made it clear they will endlessly sell shares, which punishes market gamblers and suppresses price. It's also a boring, predictable company that has no reason to be hyped. Unless something happened, it was unlikely gamblers could absorb the volume the company would sell - they shouldn't be able to push the price up too much but there was plenty of downside.

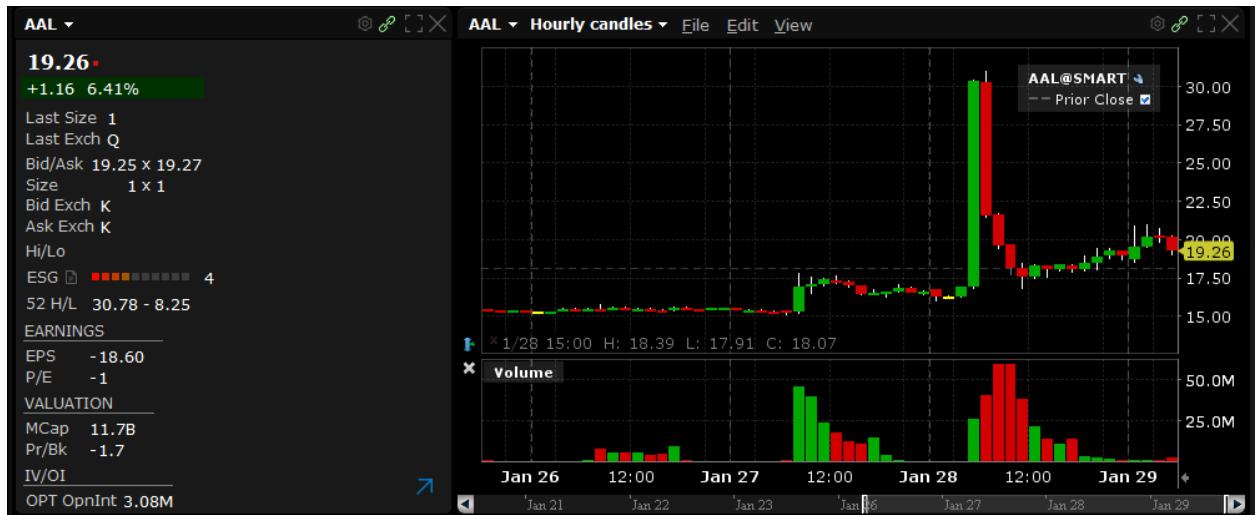
But something did happen: Elon Musk randomly pumped AMC stock in the after hours of January 26th, causing an [overnight 300%+ jump](#). Daily volume in dollar terms went up 700% overnight. He hates short sellers because they expose his lies, and this is his way of punching back. Now AMC will sell at least \$1.7 billion of shares to these gamblers, a transfer of wealth from the poor to the rich: AMC's bond holders. Elon knows how capital structures work and was willing to hurt ordinary people to spite his enemies. Elon Musk's pump cost us 8%:

² Normally a basket is protected because only a few go wrong at once.



5. American Airlines had a premarket pump and dump

I liked the American Airlines short because companies with such a high market cap were not squeezing up to that point, and they're in a bad spot. However, the day after AMC happened, American Airlines was the target of an aggressive pump and dump in the premarket:



I was short via long dated calls, and bought shares to cover in the premarket. I covered a lot at \$20, and then the rest near the top - who knows how high it could have gone. This was punishing because I lost on both the hedge since it came back down so fast, and the implied volatility of my call options went up, so I lost on that side, too. This pump and dump cost us 8%. After this event I decided to quit all individual shorts for now. No part of the market seems safe to short right now.

With American Airlines I made a mistake. While cutting position sizes on Wednesday due to our account's NAV hit, I accidentally *increased* the size in American by 20% rather than decrease. So we lost 3% more than we would have.

American Airlines is selling \$1 billion of new shares after this spike, similar to AMC.

6. Broker Report

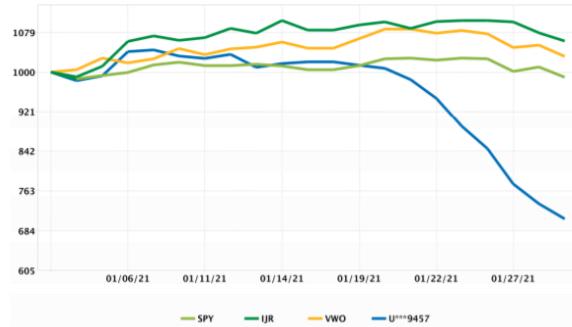
Risk Measures Benchmark Comparison

Analysis Period: January 4, 2021 - January 29, 2021

Risk Analysis

	SPY	IJR	VWO	U***9457
Ending VAMI	989.81	1,061.70	1,031.33	707.35
Max Drawdown	3.73%	3.71%	4.98%	32.26%
Peak-To-Valley	01/25/21 - 01/29/21	01/14/21 - 01/29/21	01/21/21 - 01/29/21	01/07/21 - 01/29/21
Recovery	Ongoing	Ongoing	Ongoing	Ongoing
Sharpe Ratio	-0.75	3.13	2.00	-9.21
Sortino Ratio	-0.93	6.27	2.98	-8.49
Standard Deviation	1.00%	1.61%	1.31%	2.93%
Downside Deviation	0.81%	0.80%	0.88%	3.18%
Correlation	0.44	0.61	0.38	-
β :	1.28	1.11	0.84	-
α :	-4.19	-5.25	-4.71	-
Mean Return	-0.05%	0.31%	0.16%	-1.67%
Positive Periods	12 (60.00%)	12 (60.00%)	13 (65.00%)	6 (30.00%)
Negative Periods	8 (40.00%)	8 (40.00%)	7 (35.00%)	14 (70.00%)

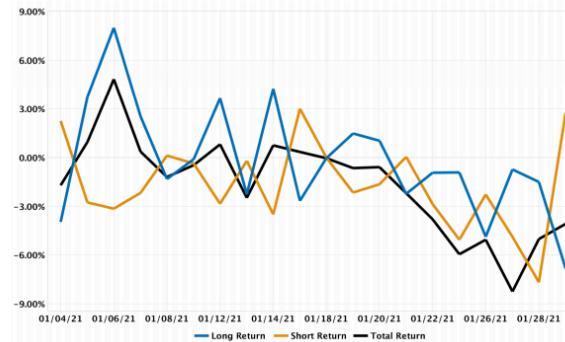
Value Added Monthly Index (VAMI)



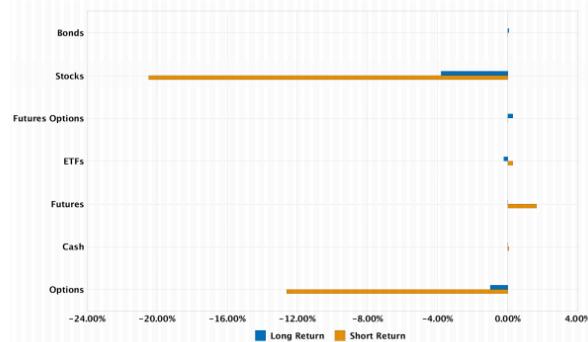
Performance by Long & Short

Analysis Period: January 4, 2021 - January 29, 2021

L & S Performance Comparison



L & S Performance By Financial Instrument Comparison



7. Concluding Thoughts

I don't expect the government to step in, at least not in time. An idea I learned from Jordan Peterson is that the left doesn't actually care about the poor. They're just envious of and hate the rich. In this case, they're happy to see a group of specialty hedge funds get hurt and are ignorant about what's happening outside of that. Meanwhile the right doesn't even pretend: they believe in markets and poor people should just know better. So while this has already been a transfer of \$10+ billion from the poor to the rich, I expect bipartisan support for this mania - shutting it down would falsely be construed as bailing out evil hedge funds.

My guess on what's going to end the mania is the vaccine taking effect and people returning to normal life. They'll spend their money on eating out, traveling, etc rather than gambling in the stock market. I also figure bad companies will aggressively sell new shares, which simply costs market gamblers too much.

My plan from here is buying quality companies at a discount that other long/short funds are being forced to sell right now. After that I'll be planning a big list of the best shorts to jump on as the market mania wanes. Once their correlation dies down, I can do a big basket and kill it over the next couple years.

Finally, going forward I will no longer reveal any short positions in these letters, on Twitter or on Seeking Alpha. Watching the market attack troubled short sellers at first opportunity was a wakeup call. Plus the constant death threats all over social media - I guess those ones don't break their safety policies.

David Orr