Rodrigo Gordillo: 00:06 Welcome to Gestalt University, hosted by the team of ReSolve Asset Management, where evidence inspires confidence. This podcast will dig deep to uncover investment truths and life hacks you won't find in the mainstream media, covering topics that appeal to left brain robots, right brain poets, and everyone in between. All with the goal of helping you reach excellence. Welcome to the journey.

Speaker 2: 00:28 Mike Philbrick, Adam Butler, Rodrigo Gordillo, and Jason Russell are principals of ReSolve Asset Management. Due to industry regulations, they will not discuss any of ReSolve's funds on this podcast. All opinions expressed by the principals are solely their own opinion and do not express the opinion of ReSolve Asset Management. This podcast is for information purposes only and should not be relied upon as a basis for investment decisions. For more information, visit investresolve.com.

Adam Butler: 00:54 Hello, and welcome to the latest edition of Gestalt University, the podcast of ReSolve Asset Management. I am Adam Butler. I'm the chief investment officer at ReSolve. And today I had a chance to sit down with Jason Buck from Mutiny Fund. Mutiny Fund specializes in deploying funds and strategies to make tail hedging available to smaller investors.

Adam Butler: 01:16 So we cover all the facets of tail hedging and how they employ an ensemble of managers that approach tail hedging from a variety of different angles to ensure broad coverage of different types of tails. We also touch on the Dragon portfolio and how investors should think about adding tail hedge strategies to their more traditional portfolios.

Adam Butler: 01:42 I think this is a really great program that a wide variety of different types of investors and advisors will get a lot out of. So without further ado, I bring you Jason Buck. Please enjoy. So I'm here with Jason Buck from Mutiny Funds. If you don't know me, it's Adam Butler from ReSolve Asset Management. Jason, thanks for joining me today.

Jason Buck: 02:02 Thanks for having me. I appreciate it.

Adam Butler: 02:03 This is going to be fun. Now, Jason, I think you've known Rodrigo for longer than we've had a chance to correspond. How did you guys connect?

Backgrounder

Jason Buck: 02:13 I think I originally met Rodrigo in person finally in Miami at Context a few years ago. But I've actually been following the ReSolve crew and you guys' writing for a number of years. I want to say going back four or five years, because I came from kind of that global tactical asset allocation space. I've always loved what you guys put out there and so I was just kind of a fan of reading all of you guys' work. And then it just turns out that Rodrigo and I sat down to have lunch together a few years ago in Miami.

Adam Butler: 02:38 Well, that must've been like a Vulcan mind meld, because Rodrigo has always been front and center about tail hedging. He was one of the first guys in Canada to bring the Universa fund series to Canadian retail investors, and is continuously nudging us in that direction of making sure that we've got our tails covered, so to speak. So that must have been a really fruitful conversation. You probably don't remember the facts.

Jason Buck: 03:05 Yeah, it was a lot of tail risk talk, but I think even more, it was a lot of e-Foil talk at that time and paleo diets, keto diets, et cetera. So it was wide ranging. So yeah, it was a mind melt on more than one front.

Adam Butler: 03:15 That's quite a Venn diagram. So that's a good segue. So Mutiny Fund, you guys focus on tail hedging. Obviously, you're going to tell a little bit about your story and what Mutiny Fund does. But how did you come to have this vision to create this type of structure? What is your background and how did you grow into this?

Jason Buck: 03:34 I'll give you a quick synopsis of my background. So just a lifelong entrepreneur, but also that stereotypical story. I bought my first stock at like 13, 14 years old. So I've always been fascinated with markets. So while I was building businesses over time, I was always trading and trading multiple asset classes and teaching myself how to trade over time and trying to soak up as much information as I could.

Jason Buck: 03:53 When it came to the great financial crisis, I was a commercial real estate developer. And that pain that you felt when liquidity dried up, I never wanted to feel that pain again. And from that point on, I started teaching myself options, I started teaching myself how to trade VIX's.

Jason Buck: 04:06 I spent the better part of the last decade working on that. But at the same time, I was tracking a lot of the managers in the space. It's a very small niche corner of our world, but there are some really great managers in the space. And working with the guys at RCM Alternatives, kind of tracking those managers over the last 5 to 10 years.

Jason Buck: 04:22 What I finally came to terms with is I'm probably a better entrepreneur than I am a trader. And so looking at all the different path dependencies that happen in a risk off environment, I thought it was better to find very niche specific traders that can handle those different path dependencies. And then as you guys are big fans of, I created an ensemble basket of those managers so we could cover as many path dependencies as possible. But it also springs out of post GFC.

Jason Buck: 04:45

You had a lot of people, family and friends that were reading Nassim Taleb books or a Chris Cole white paper or even a Spitznagel's book. And they go, "Great. I read it. I want to protect my portfolio. How do I become more robust or antifragile?" And I go, "Great. Do you have $20 million?" And they say no. Well, there are no options for you. So just my partner, Taylor Pearson, and I got tired of having those conversations and there being nothing in the marketplace.

Jason Buck: 05:08

So we spent the better part of the last couple of years figuring out, how could we be the first ones to bring a tail risk or a long volatility product to retail clients that are accredited but may not have that level of $20 million plus to be able to invest in these tail risk managers, where we could create a better basket, we felt of, and ensemble these managers and offer a retail access for as low as $100,000.

Tail Hedging Ensembles

Adam Butler: 05:31

So who is the target for this? You say it's sort of retail investors, or I guess distribution through advisors who get it. What role do you see this playing in portfolios? I see you've sort of got a neat narrative arc on your own podcast. And you start with this concept of diversification, which is obviously near and dear to our heart at ReSolve. So how does tail risk or the Mutiny vision of how to manage tail risk fit into portfolios?

Jason Buck: 06:00

We view it as a couple of different ways. And we built this by entrepreneurs for entrepreneurs initially. Taylor's audience is primarily 25 to 40-year-old entrepreneurs, a lot of which have had their first liquidity event. And so we look at tail risk with an entrepreneurial eye. As you guys know all too well, we care more about drawdowns than we do necessarily volatility, because we need to be able to eat those returns at the end of the day.

Jason Buck: 06:21

So with that aspect, we catered it primarily towards younger entrepreneurs. But as you know, everybody will need sequencing risk protection, especially retirees. So that's just another fit for it. But going back to, I love, like I said, global tactical asset allocation portfolios, like you guys built, and I've been a fan of that and have been building those for over a decade.

Jason Buck: 06:40

But what always was concerning in the back of my mind, I always have this nagging voice in the back of my mind, "What if? What if? What if?" And if markets are in an uptrend, you get a sharp selloff, and typically people go well. In '87, they were in the downtrend. In 2006, 2007, they were in a downtrend. I go, yeah, those aren't statistically significant when this happens.

Jason Buck: 06:57

And unfortunately, we just saw what happened in March. So we just view that layer of long volatility or tail risk as part of the overarching portfolio. So if you go back to like Chris Cole's white paper on the Dragon portfolio, the 100-year portfolio, he has 20% each roughly in stocks, bonds, gold, commodity trend, and long volatility tail risk.

Jason Buck:	07:18	That's kind of the way we look at a nice well-functioning portfolio, is you need that long volatility tail risk as part of that overarching portfolio, like that you guys build, because you need that phase shift. Typically, when we move from risk on to risk off, it's a very violent phase shift.
Jason Buck:	07:33	And we'd like to capitalize on that, monetize it, and then roll those profits into maybe commodity trend, if we have a prolonged recession, or if markets V back up like we saw. None of us know the future. So we want to be prepared for as many path dependencies or eventualities as possible.
Adam Butler:	07:48	You construct the Mutiny portfolio, as you say, an ensemble. Has that been an ensemble of different option-based strategies or are there a number of other types like short-term trend following and VIX trading? How do you think about the ensemble?
Jason Buck:	08:03	D, all the above. It's two layers of ensembles. So we look at it as buckets. We have a VIX bucket, which is VIX arbitrage, colloquially called VIX's more relative value or VIX trading. We have another bucket that we call our dynamic options, which is those tail risk options. And we have a third bucket that we call dynamic futures or short-term futures.
Jason Buck:	08:19	To your point, like short-term trend following in futures, even intraday. So within those buckets, we view those, gives as the three primary buckets of path dependencies for risk-off scenarios. They also cover each other nicely and they trade different market micro structures, whether it's VIX, options or those Delta One futures.
Jason Buck:	08:34	But then within those buckets, we also like diversify across managers within that buckets that have different idiosyncratic risks or idiosyncratic ways they look at capturing or monetizing those returns with different path dependencies. And to your point, where you've pointed out so well, is they have different deductibles.
Jason Buck:	08:51	So you have the premium you paid, but then you need that path dependency to reach your deductible hurdle. So we try to layer in those deductibles, even within that options bucket. Because as you know, this stuff is very dynamic and none of us know these path dependencies. So we want to layer in as many path dependencies as possible. Hopefully more than one manager will monetize it. But we always have a position on across the variable spectrum.
Adam Butler:	09:12	Do you have a good grasp of your expected impulse to a market downdrift? Obviously you can quantify the expected Delta and Vega and Theta and Volga and all that stuff on an options portfolio or on an aggregation, an ensemble of options portfolios. It's obviously harder to quantify some of those important dimensions of the tail hedge within the ensemble. How do you guys think about that?

Jason Buck: 09:43

Yeah, I think you're absolutely correct. I think that a lot of times we fool ourselves in creating... If we line up the Vega, the Delta and the Volga, if we give a shock test, this is what our returns will look like. It's not that simple. And so the way we view it is, I think Nancy Davis said it best, its debit card investing when you're buying options.

Jason Buck: 10:00

You know what the cost is when you buy that option. You don't know what the path dependency or the monetization of that return is going to be. And that's why we try to cover as many of those paths as possible. But by overlaying those and over different deductible horizons, whether it's from negative 5 to negative 15 down, from negative 15 to negative 30, from negative 30 and beyond, we like to overlay those.

Jason Buck: 10:22

Like I said, I have this nagging voice in the back of my head that says you cannot give me a precise number for what that risk off is going to look like and what that return is going to be. So that goes back to the ensemble approach. It's like, I want to cover it with as many overlaying managers as possible, because you never know what that path dependency is going to look like.

Adam Butler: 10:40

It's almost like a Heisenberg uncertainty principle, in so far as you know generally that you've got a state of the market covered. You can't quite quantify the state. You can't quantify the probability of the state. You can't quantify the exact impulse that you're going to get when the state occurs. You've got the ground covered, but you don't quite...

Adam Butler: 11:02

You only know what it really is going to look like when you observe it in the moment. You can't anticipate it, which I always find this is one of the harder questions when you think about how to allocate to tail hedge strategies. How do you size it? Typically, in a portfolio, you size something based on some kind of either it's expected marginal Sharpe ratio. That's sort of the more traditional way to think about it.

Adam Butler: 11:26

Maybe it's expected value at risk or something like that, if you want to get really fancy. But it implies some sort of ability to estimate, A, the probability of gains and losses, and B, the magnitude of gains and losses. Different metrics apply, symmetry or not, whatever. Either way, in this case, as you say, we don't really have a good sense of the probability of whatever that type of market environment is that will crystallize gains from this type of strategy.

Adam Butler: 11:56

And then not only do we not know the probability of it, we don't know the expected payoff. It's kind of like you want something in your hip pocket that you've got a high confidence is going to do something when you need it, but you don't know quite what need it means. You don't know quite what something is. Even still, I actually really sympathize with this vision, because it explicitly acknowledges what I think I find most discomfort with tail hedge strategies, which is the hubris in believing that you can anticipate the shape of the tail that you are hedging.

Adam Butler:	12:35	What security is going to exhibit the tail? What is the rate at which the tail is going to manifest and what is the depth? How quick is the recovery? No one knows all that stuff. Options-specific guys, they create ladders. They create conditionalities to minimize the carry and they trade around it and all that kind of stuff. But you still don't know what the trade-off is going to be.
Adam Butler:	12:58	Is it going to hit the point at which you actually get paid on the premium or is it you're just going to pay the deductible and you're not going to get paid? I actually really sympathize this? Is that how you guys thought about it when you were creating this product?
Jason Buck:	13:10	Exactly from the scratch your own itch. So Taylor and I were looking for products for ourselves. So we started looking at all the managers in the space and said, okay, if I invest with this manager and I put a quarter million with them, implicitly saying their path dependency is going to be right. And so that is untenable for me, because I have this voice in my head that says, "What if? What if? What if?"
Jason Buck:	13:27	And so to your point, I know we've gone back and forth, sometimes in the DM's and stuff. And thinking about the way you talk about it is like, since 1980, if we only have like three, four or five of these events, we don't have enough sample size to really... Like you're saying, we can't mathematically put a figure on, how do I offset my portfolio?
Jason Buck:	13:41	So the way we try to think about it a lot is like by creating an ensemble approach, and this is what you guys are so great about with ensembles and looking at a basket of ensembles, is by creating stuff that are fairly robust and fairly uncorrelated. We can hopefully harvest that rebalancing premium over time. And that way during a risk on cycle, if we're flat at zero, fantastic. We've done an amazing job while still being open to all that convexity during a risk off event. And that's the way...
Adam Butler:	14:06	Think of balancing actually. So are you rebalancing across managers on a regular basis as well?
Jason Buck:	14:11	Sure. So the heuristic we use is that we rebalance quarterly. And then unless a single manager is up double digits in a month, then we'll take from that winner and redistribute across the losers. And hopefully over time that creates a ratchet like effect or portfolio, where we cruise along as like flat, maybe slightly positive, slightly negative.
Jason Buck:	14:27	Then you'll see some sort of pop in volatility or option space. And we try to monetize that which is, as you said, key. And then we cruise along at that next plateau, waiting for the next event. It's as hard as you said it is as far as even putting these trades on, but people don't even... It's exponentially actually harder to monetize the trades.

Jason Buck: 14:44 As you referenced, it's like, not only do they monetize, how do they monetize and how much do you monetize knowing if there's a second or third leg down from here? Are you protected on that...

Adam Butler: 14:54 Well, who makes that decision? Is it the underlying manager that makes the decision about whether they're going to crystallize gains? Intra-month or intra-redemption period, they distribute it. And then if you get a distribution intra-month, then you'll... I mean, obviously you can't subscribe for new units intra-month, so you'll have... Or can you?

Jason Buck: 15:12 Depending on the manager and it's function at AUM. But with most of our managers, we have separately managed accounts. We have the intraday liquidity. And so yes, if we wanted to, we could, but we also like to let them do their own thing. But that's why we talk very specifically about what their monetization processes are and we try to have different managers with different monetization styles. And so that's part of it, that overlapping process. But we get to see those trades intraday and, like I said, rebalance monthly or quarterly, depending on what's going on in the marketplace.

Adam Butler: 15:40 We still, I think, need to drill into how a potential client, an investor or an advisor, should think about sizing this investment. What's the expected carry? How do you size it based on, well, it's tough to know what the expected payoff is? By the way, I would say this to almost any... I'd say this to an equity manager or a bond manager.

Adam Butler: 16:01 I talk to consultants all the time and they're always asking about capital market expectations and what's the expected return on risk parity. And I always say, well, the expected return is higher than what you're going to get on your traditional portfolio, but I have no idea what that is. I have no capital market expectations. Everything is sort of relative.

Adam Butler: 16:17 So I think the risk parity portfolio, if done properly, is relatively more attractive on a risk adjusted basis. But I have no sense of exactly what the slope of the capital market line is. And I don't mean to put you on the spot here, but I do think it's an interesting question about how to think about the expected carry versus the expected payoff versus the amount of capital that you need to commit to this as a long-term strategic investment. How do you guys think people should think about this?

Jason Buck: 16:42 And that's why I was excited for us to have a conversation, because we're both epistemic humility guys. We admit that we can't predict the future and we just do our best in the interim. And so there's multiple ways to think about it. As always with any sort of portfolio construction, you have to have a minimum of 10% allocation to any sleeve or else it's not really going to ballast or buoy your portfolio at all.

Jason Buck: 17:00

The other way on the far extreme is to look at this as my partner, Taylor Pearson, has coined the term, like an entrepreneurial put option; is as an entrepreneur, I may want to have all my assets in a long volatility tail risk position. Because my house, my car, my business, my job, my girlfriend's business, all of these things are implicitly short volatility. They go up with the market.

Jason Buck: 17:19

I want to ballast that overarching portfolio. But that's a deeply, much more philosophical thing that is hard sometimes to wrap your head around. So scaling back a little bit, the way I like to think about it is you want to ballast or offset those implicit short volatility products in your investment portfolio. So implicit short volatility, we're talking stocks, bonds, real estate, PE, VC, all those things are implicit short volatility. And what I mean by that is they're harmed by volatility.

Jason Buck: 17:45

During a risk on times, they're great. But then they flip during a risk off. So if you think about, if you ballast those out 50/50, your stock/bond portfolio with this sort of long volatility, that's going to help you compound wealth over time. What's actually very interesting I think to you, is that the way I think about it, for some reason, people have glommed on to this idea of the 60/40 portfolio: 60% stocks, 40% bonds.

Jason Buck: 18:08

And as you guys have written so well about, that's really 90% stocks, when you think about the risk adjusted basis. So when I mention this and I just point out mathematically actually, if you think about it, your short volatility, let's just use stocks for this example. Let's just use some rough numbers. Let's say stocks have a 10% return with a 50% drawdown.

Jason Buck: 18:24

If I'm balancing them with a tail risk long volatility strategy that has small drawdowns but large returns every once in a while, so you have negative 10% drawdowns and you ever then a 50% return in the selloff. So it's the opposite of the stocks. You actually should be 40% stocks, 60% long volatility tail risk in that sort of scenario. And that balance, because of the huge tail risk to the stock position, is that portfolio combination rebalanced over time will compound wealth better than any other system I've seen.

Adam Butler: 18:53

This dovetails well into the discussion of the... What's Chris Cole's portfolio you mentioned earlier?

Dragon

Jason Buck: 18:59

Dragon.

Adam Butler: 18:59

The Dragon portfolio. But before we get there, I want to just sort of glom on to this idea of entrepreneurial risk, because I think it's important for advisors to also recognize that they're entrepreneurs. So as Meb and Corey and Wes and all these guys have constantly harped on the reality that an advisor is typically double or triple levered to equity beta because of their fees.

Adam Butler:	19:25	Their ability to maintain clients plus their fees. All of these are highly sensitive to the return on equities. If their equity is cut in half, in all likelihood, their book of business gets cut by a third, at least. So their income goes down by a third. So from an advisor as an entrepreneurial standpoint, this is something that you should probably be thinking about as a way to hedge not only the true risks in your client portfolio, but also the hedge on your own book of business.
Adam Butler:	19:52	So you get a double whammy on the benefit from trying to think through better ways to manage your tail risk on your book of business. So with that said, just in terms of the Dragon portfolio, what's so great about that is its sort of like your ensemble can be considered as one sleeve of the broader ensemble, where you've broadly got assets that are not just sort of responsive to the typical macroeconomic risks we always harp on, which are typically inflation surprises or growth surprises, but also convexity.
Adam Butler:	20:27	So if you sort of think about traditional risk parity, managing the risk of inflation and growth shocks, the Dragon portfolio adds this extra dimension, which is this convexity dynamic, where you've got certain assets that are strongly procyclical. I know that option managers don't really define convexity in this way, but I think it's a useful construct to think about it as having assets that do very well in procyclical environments or risk-on type environments and other types of markets that do well or strategies that do well in risk-off environments.
Adam Butler:	21:01	And strategies like risk parity do very well typically in risk-on environments while stuff like intermediate to longer term managed future strategies, for example, do well in a certain type of risk-off environment, but they're not sort of short term risk-off environments. They are longer term. If you measure your skewness or your convexity on a quarterly basis, like many institutions do, then intermediate to long term trend following is complementary from a convexity standpoint to a typical endowment or pension portfolio.
Adam Butler:	21:34	If you measure it at higher frequency at the sort of monthly, weekly or daily level, then you need to look to other alternatives. Do you guys see your type of strategy and tail strategies in general as kind of fitting into that sleeve?
Jason Buck:	21:49	Yeah. I like to go back historically, and I hope you agree with me on this. This concept around risk parity or a Dragon portfolio, it dates back to Harry Brown in the 1970s, when he came up with permanent portfolio: 25% stocks, bonds, cash, and gold. And then Daleo came along. I wish we had paid a little more respect to Harry Brown. But he vol-targeted the bonds with the stocks, which made sense at the time.
Jason Buck:	22:09	And then quite frankly, Chris Cole's Dragon portfolio is just a modernized version of permanent portfolio to me. And so that's why I've always been building from a permanent portfolio basis. To me, that's the foundation that you build intellectual

lattice work on top of. So if I think about that permanent portfolio of stocks, bonds, gold and cash.

Jason Buck: 22:26 What I think is interesting is if we modernize that a little bit, you can take that gold position, because that's supposed to be there for inflation or maybe deflation or default. But you take that gold position and you substitute commodity trend or managed futures. And that gives you maybe a more dynamic gold bucket, maybe a partial gold part commodity trend.

Jason Buck: 22:43 Then you take your cash position. And if you use long volatility tail risk, to your point, that's a convex cash position. That's the way we kind of look at it. So if we go to Chris Cole's Dragon portfolios, as I said, it's 20% each basically: stocks, bonds, gold, commodity trend and long volatility tail risk.

Jason Buck: 22:59 And what you're doing is if you have 40% in stocks and bonds and 40% in long vol and commodity trend, those are basically balancing each other out. Because as you know, stocks and bonds are a convergent trade, and then their divergent trade is your tail risk and your commodity trend. And then you have this 20% gold, which I'll let other people argue about that.

Jason Buck: 23:19 But it's not anybody else's liability, so at least maybe you're taking away the fiat risk with gold. And I'm not going to get into whole gold bug argument. But that's the way we look at it, is more balancing out your implicit short volatility and your long volatility. The way to look at it is you just have short VOL or long VOL assets. You either have convergent trades or divergent trades. Really the world kind of breaks down into those segmentations.

Jason Buck: 23:40 The other way we look at it too, and this is a simplification, is you either have long VOL or short VOL style of trading, convergent or divergent. Another look at it is you have correlated, uncorrelated and negatively correlated. Correlated would be your equity beta. Negatively correlated is your tail risk options. They're structurally negatively correlated.

Jason Buck: 23:57 Then if you add commodity trend, which is uncorrelated, those are basically the three fundamental or structural correlations you have. Everything else is a statistical correlation that, as we know, changes over time.

Adam Butler: 24:08 Yeah, it's a derivative of those. I mean, I just love this idea of the... Why can't I ever remember? The Dragon portfolio. I played Dungeons & Dragons, so you think dragon would be at tip of my tongue.

Jason Buck: 24:19 Exactly.

Adam Butler: 24:20 I like the idea of the Dragon portfolio as just really an extension of risk parity. You're adding an extra dimension, maybe two, to how you think about risk. You invoked... I think it was Kaminski who describes trades as either convergent or divergent. I think that's a great framework, sort of an analog to positive or negative convexity.

Adam Butler: 24:40

So you sort of add this divergent, convergent, convexity type language or dimension to risk parity. And one of the things that we've learned as our understanding of risk parity has evolved is that risk parity really is not about your allocation to stocks and bonds. That's an example of risk parity, but really it's about trying to maximize your diversification across as many structurally diverse sources of risk as possible.

Adam Butler: 25:07

And so it's not limited to stocks and bonds or even stocks, bonds, commodities. It's not limited to commodity trend. Carry is a distinct risk premium. Skewness is a distinct risk premium. Seasonality is an anomaly. Low volatility is... You've got all this different value. All these different orthogonal sources of risk.

Adam Butler: 25:28

Some of them are sometimes correlated with one another. The one great thing about tail hedges is that they are by design negatively correlated with cyclical risk. That really is the only one you could count on. And I think certainly investors since the early '80s have been lulled into a false insecurity about the probability that treasuries will always act as a risk-off asset.

Adam Butler: 25:54

I mean, pretty well in every major equity selloff since 1982, treasuries have been a beautiful diversifier against equities. But if you go back to the 1970s and the other earlier period, there are long stretches where government bonds are positively correlated to equities and where they selloff together. They have their drawdowns at the same time so they cannot be counted on.

Adam Butler: 26:20

The '70s were particularly interesting, where you've got stocks and bonds have negative returns and they have real returns over a full decade or more. They have their worst drawdown at the same time. At the same time, commodities and gold produce double digit compound returns every year over that same period. And so just highlighting the importance of that sort of just general global risk parity diversity.

Adam Butler: 26:43

And where you really get into the value of some of these divergent type trades is specifically in some of these really abrupt drawdown periods, like we've just witnessed. Or even in the 2000-2003 period, or the 2008-2009 period, where longer term or intermediate term trend also deliver positive returns while stocks drew down. So I love this idea. Are you guys having a lot of conversations about specifically where your strategy fits into a Dragon portfolio type construct? I mean, we've been getting pinged on that pretty consistently.

Jason Buck: 27:17

The last number Sean had given me was like over 10,000 people had read the Dragon portfolio white paper. So we get pinged a lot via Artemis. And my partner, Taylor Pearson, wrote a great synopsis of the paper that I think is trending at number one, if you Google it, as far as the synopsis of the Dragon. So we try to be a little smarter about our SEO. So yeah, we get a lot of pinging about that, but I think it's a high level discussion.

Jason Buck: 27:37

And I think part of that discussion and what we're building towards eventually is to do a lot of these strategies, it requires a lot of in-house maintenance and kind of managing the cross margins and the correlations and the cash efficiency in-house. You guys know this as well. We can say that our long volatility tail risk, is a ballast against your stocks and bonds?

Jason Buck: 27:57

But if the client is holding those stocks and bonds in a different account, in a different system, it makes you hard to balance those out. Eventually we're trying to offer those kinds of solutions. One of our next one we're rolling out is a 100/100 portfolio, where we offer you 100% Mutiny long volatility, balanced out with 100% S&P exposure that we rebalance monthly.

Jason Buck: 28:17

And so we're able to do that in-house with a lot more cash efficiency. And it's just a much better product for the client over time. So you build those out. To your point, it's really hard to have this tail risk piece. And so Taylor and I built that first, because it was so hard to have retail clients have access to tail risk or long volatility.

Jason Buck: 28:33

So we wanted to build out that piece of the Dragon portfolio first. The next thing we'll probably tackle is, what does it look like to build a basket of commodity trend managers, as you know, with different look backs? You guys are great about ensemble parameters and look backs, and that's the same way we think about commodity trends.

Jason Buck: 28:46

You need short, medium and long term. And you need a basket of those as well. But somebody needs to build that for the retail client to have access to, because it's incredibly difficult to have access. You pointed out something I think about a lot and it's so interesting. It's like people like to argue about the stock and bond allocation of risk parity, but they're forgetting about the other side: those ballasts of gold and cash.

Jason Buck: 29:05

And so the way we think about it that you touched on is, what happens if they correlate again with stocks and bonds? I'm going to need something a little bit better than gold or cash to offset that risk. The other way to move forward from that too, is I think about when you move from a risk-on environment that's great for stocks and bonds, and you then we move over to that 70's style environment that's great for commodity trend.

Jason Buck: 29:25

To get there is almost a paradox, because you need to go through a very violent phase shift. So that's the way we view it, is that tail risk or long VOL is going to make money in between. That shift is going to be so violent that we want to monetize that and then maybe roll with the commodity trend. I'm assuming I'm going to jump forward on this and you're eventually going to get there, but it's like the Asness-Taleb debate.

Jason Buck:	29:44	They're both actually right. I want to tail risk to monetize that sharp sell off. But then in a prolonged recession, I want to roll into trend and to CTA trend or managed futures. So it's not either/or, it's both. I know we both view the world that way. Going back to you guys, you were talking about the nuances of each sleeve of asset class you can be in, is at the end of the day they're all either short VOL or long VOL.
Jason Buck:	30:05	But I want to create a huge ensemble of that. So essentially I'm getting beta. What you're essentially doing the way I look at it, and maybe it's too simplistic. But if I have a beta of an ensemble of managers that are short VOL and an ensemble of managers that are long VOL, I have a much more robust signal with less volatility and less drawdowns. And I can balance those out against each other and rebalance it over time and compound wealth without sequencing risk for multiple decades, because we never know when the future...
Adam Butler:	30:31	Minimizing it.
Jason Buck:	30:32	Minimizing, yeah.

Carry

Adam Butler:	30:33	Without being specific, how do you think about the carry on this portfolio? I mean, I find it really hard to think that you can both effectively have very, very high confidence that you will be positioned to capture the tails and to be very specific about hedging the tails that everyone wants to hedge without expecting to have to pay a premium for that.
Adam Butler:	30:56	I mean, obviously you could have risk free returns, not withstanding that this is obviously what the Fed is trying to provide at the moment. There's got to be some kind of negative carry. And I know that... Well, my understanding is that you guys have an ensemble of different ways to manage or different managers that manage that negative carry in a variety of different ways, which I think is prudent. But just how much negative carry can you diversify away, do you think, while still having confidence in the hedge?
Jason Buck:	31:25	It's the key thing we worry about most. The way we construct the portfolio is we want to stuff as many options in there as possible. Because as we talked about earlier, you know that death by a thousand paper cuts of the options, but you don't know your upside risk. So that's more prudent for us as you don't have blow up risks if you're solely buying options.
Jason Buck:	31:42	The bulk of the portfolio is buying those tail risk options. And we use a variety of managers that create dynamic strategies for that, whether it's straddles, strangles, outright puts. We layer those risks in and we try to cover as many of those as possible. But then as you alluded to, you have that bleed typically of options.

Jason Buck: 32:00 So the way we try to cover that bleed of options is that's where we have our volatility arbitrage or our volatility relative value traders. And what they're doing is they're picking off the difference between implied and realized volatility or different structures in the VIX curve, which provides almost like a more stream of income trade that's hopefully offsetting that bleed of buying the options.

Adam Butler: 32:20 I see. So there's a portion of the portfolio that you pretty well know in advance has a fixed cost. So there is a fixed negative carry to a portion of the portfolio. But that's there for a purpose, and that purpose is to ensure that there's always a proportion of tail protection. You've always got some insurance on.

Adam Butler: 32:39 And then some other proportion of the overall portfolio will be positioned properly. Some other portion will not be positioned properly because they'll be trading around those hedges to try to offset some of the carry. But you're still guaranteeing a certain minimum amount of positive convexity from having the outrights.

Jason Buck: 33:00 Right. And not only do we have the dynamic managers that are managing the option strategy. But by dynamically managing the option strategy, you might not have full put protection on. That's why we brought back in the fixed relative value for not only that positive carry. But we also have our short term futures, which is intraday trend, that short futures.

Jason Buck: 33:17 Because as you alluded to, if you have a March-like event and implied volatility expands, those options become much more expensive. So that's why if we just have the Delta One shorts of futures, where they can just directly short the S&P or the world markets intraday, that allows us to go short without paying up for that higher premium.

Jason Buck: 33:34 So those are kind of the three buckets. But given those three buckets over a risk-on cycle and rebalancing those ensembles, we felt we had enough positive carry, where we added back in those very simplistic put ladders. I mean, they're not quite that simplistic, but that gives us a very definitive sleep at night portfolio, where if some sort of exogenous event were to happen on a Saturday or a Sunday and somehow all of our managers weren't positioned for it, we're sitting on those put ladders that we use a negative 20% attachment point to talk about your deductible again.

Jason Buck: 34:02 We feel we can maintain the bleed of that by the positive carry of the rest of our portfolio. Because at the end of the day, Taylor and I have our own skin in the game, we have our families skin in the game, so we have Thanksgiving risks. And so it keeps me up at night to make sure we're as covered as possible. The deeper problem that I think you're eventually hinting at is like, what happens after March? You get that sell off in March, implied volatility expands.

Jason Buck:	34:23	And even though volatility is crushed back down, we have dynamic managers that know that's going to happen where, like I said, we can short intraday those markets on a Delta One basis. But how do you get ready for the next leg down? And to your point, that's where fortunately and unfortunately I think you have to take a little basis risk.
Jason Buck:	34:38	You have to start thinking about interest rates, metals, treasuries. You have to start putting on some more dynamic hedges. And that's fine after that risk-off event has happen. The problem is when you have dynamic hedges before and you go from low VOL to high VOL. Historically, a lot of those spreads get blown out and those managers get taken away on stretchers.
Jason Buck:	34:55	But after that event, it becomes a little more prudent to put on some more option spread trades and maybe put long option spreads on treasuries, et cetera. So you do have to take, I think, a little bit of that basis risk to reduce some of that higher bleed that now you're going to experience, given what the market's giving you.
Adam Butler:	35:11	So one of the things that we've actually experienced in practice, because we've actually rolled out tail hedge strategies to our clients as line items on there because we also have a wealth book in Canada and the U.S.. So we have tried as a line item to have allocations to series of tail risk strategies. Like I mentioned, the Universa, for example.
Adam Butler:	35:33	And it has just been an enormous behavioral headwind for clients. We describe the merits of the strategy. We describe exactly what they should expect in terms of the constant bleed. We have no idea that it's going to pay off. We don't have a precise view of how much it's going to cost. In the meantime, we can kind of ballpark it.
Adam Butler:	35:55	But just having this item on the portfolio that decays to zero, then you need to re-up. And I know that's... You can correct me if I'm wrong, but I don't think that's how yours is structured. At least that's not the expectation of it. But having this sort of constant bleed and having to re-up. Constant bleed, re-up is just behaviorally intractable for clients.
Adam Butler:	36:14	And I think a lot of what happened, I'm just surmising here. But I suspect that a lot of what happened in terms of the CalPERS fiasco, the Alberta pension fiasco, where they had these tail hedged programs in place for many years and then they pulled them right in advance of this selloff was just boards or the CIO office saying this is a constant bleed.
Adam Butler:	36:38	I don't believe we're going to have one of these events. I don't have confidence that it's going to pay off as expected. Whatever it is, I'm a firm believer in the affective theory of decision making. So we feel, we act and we rationalize. And a lot of people sort of feel, and that feeling builds up over time as these constant losses.

Managing Tail-risk Pain

Adam Butler: 36:55

Those feelings build up. You want to act to eliminate that pain. You act and then you rationalize. Is there any number of different rationalizations that you can bring to bear? But ultimately, it's because you've experienced pain over a sustainable period of time. So how do you think about and how do you try to manage both in the structure of the product and through other means, whether it's messaging or education? How do you manage that risk?

Jason Buck: 37:21

I think the biggest piece is what you said at the end. It's education. It's the educational curve and this is what you guys do so well. But also, what we've learned from people like you is that negative carry sleeve is untenable for most people. Spitznagel and Taleb would say, you eat that 3% bleed in a 97/3 portfolio because you're better off over time.

Jason Buck: 37:39

And they just would say toughen up and eat that bleed. But as we found, nobody does that. We're happy to buy home insurance, car insurance, life insurance, but some reason we won't buy a portfolio insurance, no matter how good it is for us. So learning that from people like you guys, that was part of the initial structure that we set out.

Jason Buck: 37:54

It's like, great. We all know everybody needs some sort of portfolio insurance or tail risk protection. But if they're unwilling to hold it indefinitely, it's a moot point. So we have to figure out a way to not hurt any of that convexity or that return from risk-off, but try to figure out a way where we're at least slightly flat or slightly positive carry so people won't get rid of it right at the worst time.

Jason Buck: 38:14

So we think over the last five years, every back test is hypothetical, that we've been able to achieve a positive carry during a risk-on cycle, waiting for this risk off event to happen. But there are trade-offs. Even though we were positive carry over those five years, in 2019 our portfolio after fees would have been down like 6.5%. And so that's more than the 3% carry.

Jason Buck: 38:34

But the previous year we would have been up 25%. So you get trade-offs. And then you also have to then allocate maybe a little bit more to a strategy like Mutiny Fund, than you would have to allocate to that 3% sleeve or you'd have to use the cash efficiencies, the futures to overlay the strategies. And so there's trade-offs to everything.

Jason Buck: 38:53

I think both of us in general are fans of the 97/3 style of Universa and it's been proven untenable for clients. So we have to figure out a way to a spoonful of sugar helps the medicine go down.

Adam Butler: 39:05

The reality is you're going to pay somehow. You're either going to pay in terms of having a lower withdrawal rate because you need to withdraw less money over time in acknowledgement of the potential for a regular 30%, 40%, 50% drawdowns, or you need to just pay this premium upfront to be able to in theory withdraw more over time because you've just got less risk of this.

Adam Butler: [39:29] It's just like spreading risk through time rather than acknowledging that there's some unquantifiable risk in the future. And I just think some people are wired to internalize that. It's a no brainer. I mean, it's nothing to me to want to perform, pick a benchmark, the S&P or the TSX or global stocks or whatever for 10 years. It's irrelevant to me because I'm focused on trying to maximize my expected return above my required rate of return for the minimum amount of risk that I take.

Adam Butler: [40:00] But most people don't think that way. I love the term. I've never heard that before, Thanksgiving risk. But there's also cocktail party risk, which is you've got to go to the cocktail party and you got to talk about what your portfolio is doing. And if you are lagging your peer group year in, year out, because you bought this insurance, eventually the pain is just too terrible to bear.

Adam Butler: [40:22] So like you say, education is key. How are you guys trying to get the word out? I did go to your website. I know we correspond quite a bit over Twitter and you've got a podcast series. Tell me about the podcast series and any other material that investors can go to, to learn more about how you think about the problem.

Jason Buck: [40:40] At mutinyfund.com we have our Mutiny Fund podcast series, or you can find Mutiny Fund on any podcast player. What we tried to do in the podcast series, we'll probably rerecord the first four episodes because I think there's birds chirping in the background because we recorded outside of my house with Taylor and I.

Jason Buck: [40:53] But the first four lay out kind of the thesis, the way we think about markets and long volatility. And then our subsequent podcasts after that is interviews with actual managers we invest in, because we're a fund to fund. Like we've been alluding to, we invest in different managers in different path dependencies for tail risk and long volatility.

Jason Buck: [41:10] So we try to kind of deep dive as much as we can within regulations to talk about how those managers trade without quite giving up their secret sauce. So the podcast has been very helpful for us, for people to kind of deep dive into what we do. Right now we're in the process of getting the JOBS Act passed, which will open up a lot more marketing opportunities for Taylor and for him to pursue that. And he has an entire game plan for that.

Jason Buck: [41:31] Primarily, it came from Taylor's audience. And then what's been nice is a lot of our managers end up passing through a lot of clients to us because they can't handle those lower ticket sizes. So it's like a rising tide lifts all boats. We're all in the same space. It's a small space. We're all trying to help each other. So at the end of the day, we're more like their megaphone to their retail clients or their cheerleader.

Jason Buck: 41:51 And we're just trying to lift through the rising tide of that of long VOL boat, that tail risk boat. So it's kind of that reciprocity there is where we get a lot of those clients. A lot of people reading Chris Cole's work come to us. A lot of people at Logica with Wayne and Mike, they ended up... If they can't afford their ticket items, then it's much more interesting to have an ensemble approach at a lower ticket.

Jason Buck: 42:10 So that's where we've been so far. And I think over the next subsequent months here, and then going into the next year to 18 months, we're going to start rolling out a lot more marketing. And honestly, I wouldn't be surprised if we're going to steal a lot from you guys. Because between you and Meb, that's the high bar for what marketing should look like in the modern era. And it's always been shocking to us.

Jason Buck: 42:28 And maybe part of it with this JOBS Act is that previously none of these managers wanted to market. They know nothing about marketing. They don't want to market. A lot of them are QEP or QP minimums because they don't want to market at all. They don't even want to talk to clients. And so we think it's the Wild West, where there's enormous opportunity here for education.

Jason Buck: 42:44 To your point, it's really that education curve. You and I believe that over time you need to worry about your sequencing risk. We never know where we're going to need that money, so we need it to be there when we need it. And I think all this stuff with ergodicity these days and all that stuff, they're just fancy words for sequencing risk.

Jason Buck: 43:00 And I think as these words and all these things come into the Overton window or part of the Zeitgeist, it just helps all of us. And so I think that's where we all kind of feed off each other. It's because at the end of the day, we're trying to give the most robust portfolios to our clients as we can. So for all of us, it's not really competition, even though we're all competitive and we want to be the best.

Jason Buck: 43:19 We're all in the same boat and we're all just trying to do the right thing by our clients. And so I think it's always interesting to do these podcasts with you or to talk to Meb or talk to people that we may all be slightly different. But at the end of the day, we all have our clients' best interests in mind. And even though that education may be a longer slog than most people are willing to endure.

Adam Butler: 43:37 Those are really good points. I don't know if you've listened to Patrick O'Shaughnessy's most recent podcast with... I forget the guy's name who was on talking about bundling. You listen to that?

Jason Buck: 43:46 Yeah.

Adam Butler: 43:47 I sort of see what you guys are doing as a really great expression of this bundling concept. Obviously, there are super fans. There are super fans at Taleb and Universa and Logica. I think that's great. But I think there's also just a general perception of value. There's a nagging feeling of risk that can't be managed well using traditional portfolio tools. And so there are these sort of casual fans of tail hedging that they can't really put their finger on.

Adam Butler: 44:14 I don't really know how to evaluate which of these managers is right for me, but I'm a casual fan of tail hedging. And what you provide is sort of a bundling of tail hedge managers that captures the imagination of these sort of casual fans of tail hedges. And I think it's a really good concept and maybe a good way to think about it. How do investors... Actually, is it a Mutiny Fund? How do you get access?

Jason Buck: 44:40 Technically, we're at CPO, Commodity Pool Operator. So it's just a Delaware LLC for our direct investment. But we can also take, in the U.S., self directed IRAs. We've tried to work a lot with Canadian clients. There are some prohibitions there. But typically, any investor worldwide can do a direct investment as long as they self-certify that they're going to pay the taxes in their home country.

Jason Buck: 44:58 But basically it's a Commodity Pool Operator. A direct investment through a Delaware LLC. And then you have the same provisions as you have for any CTA or CPO where we have those. You have the CFTC, you have the exchanges, the FCMs, the prime brokers. We thankfully have zero access to your money. It passes through like Nav Consulting, our third party administrator, through CIBC. And then we just direct which managers it goes to.

Jason Buck: 45:19 And then like we said, we have the SMAs with those managers sitting on cash positions. And we have all those redundancies that we love about the future space. I wish people knew more about managed futures to offset some of those Madoff risks. As you can see, those daily trades. And you can have fat-finger protection against somebody hitting a button and trading 100 contracts instead of 10.

Jason Buck: 45:38 You have all these provisions and provisos as far as covered cash efficiency from those, the prime to the FCM to the exchange. And those cash settled liquid markets are key to us. That was at the end of the day, because it was a scratch our own itch, we wanted those cash settled futures markets. We don't want to take that OTC risk. I don't want to be worrying about an investment bank going down. But that also limits the trading sizes over time.

Adam Butler: 45:58 Are you able to access the concept through an SMA if you don't want to go through the fund?

Jason Buck: 46:04 Yeah, it's a function of ticket size.

Adam Butler: 46:06 Have you had any takers?

Jason Buck: 46:07 We're in talks currently for takers. Rodrigo was supposed to be our first taker, but he's got a team he's got to fight against. Wink wink. There's somebody at ReSolve that's not a huge fan of what we do.

Adam Butler: 46:18 That right. Well, I know I mentioned in advance that Rodrigo just has tail hedging to the core and the root of him. Not an investment conversation comes up that doesn't have Rodrigo focused on tail hedged strategies. And obviously, that is derived from his experience as a young person in a failing state in Peru. But it's good to have somebody with an eye on that ball. All right. Well look, this has been absolutely fantastic. I don't know if you have any other topics or issues that you wanted to make sure we covered today?

Jason Buck: 46:49 No, I think I'm good. I would probably just turn it around and just start asking you a bunch of questions. For the sake of time, yeah, it feels weird to be on the other end. I prefer asking the questions instead of answering them. As we know, none of us know the future. And so it's all pontification. And so you just try to build the most robust portfolio you can.

Adam Butler: 47:07 Well, I really like the way you guys have thought about the problem. I wish you guys every success. I'm intensely curious about how advisors and investors think about sizing and quantifying where Mutiny Fund fits in portfolios. I'm convinced there's a role. And I look forward to carrying on this conversation.

Adam Butler: 47:26 I mean, my views on this, they evolve even to the point in chatting with Mike Green and in chatting with Corey about some of the research that he's done and chatting with a variety of other managers on this thing. I'm still wrapping my head around it. It's uncomfortable for me in general because of the fact that I like to deal in large sample sizes.

Adam Butler: 47:46 So I think that's the major hurdle for me, that you've had a handful of regimes where this type of thing pays off. And then something we didn't even talk about, which is that the tails are not always expressed in the S&P. It's entirely possible that we're going to get a tail event in bonds. It is not expressed through S&P risk.

Adam Butler: 48:05 You could very well have a massive crash in treasuries, where stocks go up or stocks go down or stocks are flat. I mean, the episode in 2018, where we had this implosion in VIX and stocks barely moved, was an interesting example of this type of basis risk. And portfolios are not just composed of stock risk. So all of these are fascinating questions. I don't have good answers. But I'm very interested in continuing to learn more about it. So thanks again for leaning into that today, and I look forward to further conversations.

Jason Buck: 48:34 Thanks Adam. I appreciate the talk. It was great.

Adam Butler: 48:36 All right. You bet. We'll chat soon and best of luck.

Rodrigo Gordillo: 48:40 Thank you for listening to the Gestalt University podcast. You will find all the information we highlighted in this episode in the show notes at investresolve.com/blog. You can also learn more about ReSolve's approach to investing by going to our website and research blog at investresolvel.com, where you will find over 200 articles that cover a wide array of important topics in the area of investing.

Rodrigo Gordillo: 49:03 We also encourage you to engage with the whole team on Twitter by searching the handle @ InvestReSolve and hitting the follow button. If you're enjoying the series, please take the time to share us with your friends through email or social media. And if you really learnt something new and believe that our podcast will be helpful to others, we would be incredibly grateful if you could leave us a review on iTunes. Thanks again, and see you next time.