Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2019			0.1%	0.3%	4.3%	-4.2%	0.1%	-0.1%	0.9%	-4.1%	7.5%	6.0%	10.5%
2020	-6.2%	-2.0%	2.5%	12.4%	3.6%	-6.6%	19.6%	12.1%	-3.0%	-7.1%	2.8%	14.5%	46.0%
2021	1.1%	3.7%	-0.4%										4.5%

- **The Cypress Fund generated net returns -0.4% in March and year-to-date returns of 4.5%. Gains in nuclear, shipping and oil and gas were offset by declines in basic materials and hedges**
- **We discuss the Ever Given incident in the Suez Canal and the impact on insurance markets. Marine transportation costs are going up**
- **Archegos Liquidation: we share our experience with prime brokerage; they are equivalent to the credit department in a casino**
- **Comparing Archegos to LTCM and Amaranth. A unique cocktail of concentrated bets, high leverage and exposed positions likely contributed to their demise**
- **Overview of the themes we are invested in, their upside potential as well as risks**

Dear fellow investor,

The Cypress Fund returned negative 0.4% for the month of March. Year-to-date, the fund generated net returns of 4.5%. Positive contributions to the portfolio this month included our exposure to uranium and uranium producers (+1.6%), shipping (+0.9%) and oil and gas (0.3%). The main detractors to the portfolio were basic materials (-2.0%) and hedges (-1.1%). Note that our return in March is preliminary and subject to confirmation by our fund administrator.

March was a continuation of the themes we discussed in our last note, including rising interest rates in the US and market gyrations as investors rotated out of growth into value names. While commodities stayed buoyant this month, some of our related exposures gave back gains, including Adriatic Metals (ASX: ADT) and Alphamin Resources (TSX: AFM), two names that we have written about in previous letters. These are fundamentally strong companies with attractive valuations, although more volatility ahead is always possible. Hedges ate away at returns this month as well, given the relatively muted market reactions to the Suez Canal blockage and the Archegos blowup. Going forward, we think there is a good chance that our shipping names will rally, especially given the recent increase in OPEC+ production by over 1 million barrels starting in May.

Given the headline developments in March, we wanted to share with you some observations.

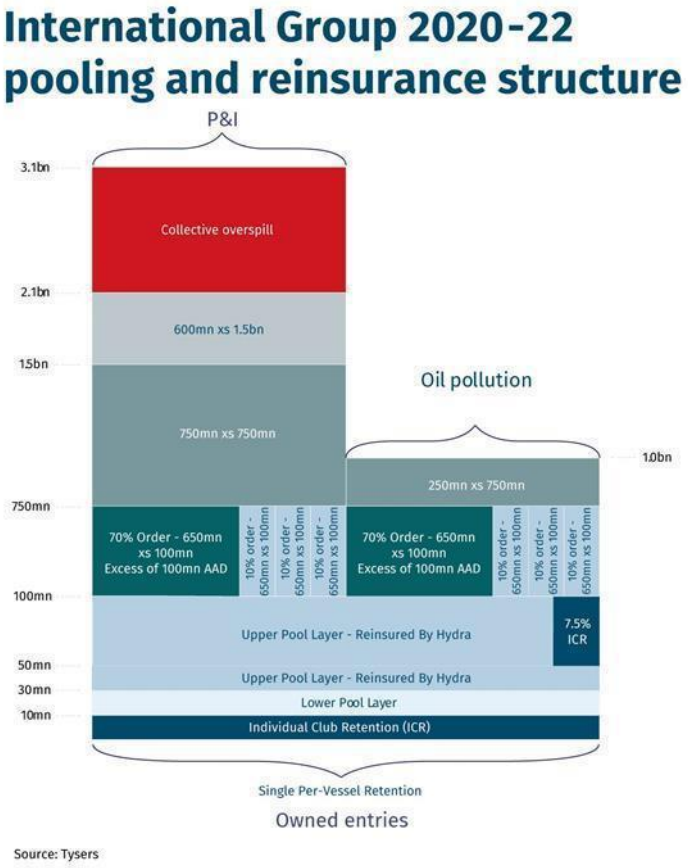
Ever Given Incident in the Suez Canal – Shipping Costs Are Going Up

Much has already been written about the recent blockage of the Suez Canal by the containership Ever Given – the direct impact on cargo delays and spikes in shipping rates, what it means for a world built on just-in-time supply chains and even longer-term geopolitical relevance of maritime chokepoints like the Suez. While it may take a while to ascertain the full financial costs of this incident, it is safe to say that the impact on the cost of marine transportation is going up, with downstream effects on prices and inflation.

First, which party is even liable for the grounding of the Ever Given? This is a complicated topic considering that the ship's captain is Indian, the canal pilots who took over command of the ship in the Suez are Egyptian, the owners and shipbuilders are Japanese, the operator is German, the insurance company is British, the charterer is Taiwanese, the cargo is Chinese, the salvors are Dutch, the ship is Panamanian, and the ship classification society is American (source).

Second, marine insurance comes in varying forms, in particular hull and machinery (H&M, insuring the vessel), protection and indemnity (P&I, insuring against third party claims), cargo and freight (insuring against damages to cargo, depending on insured party). Owners of goods on board the Ever Given and other ships stalled because the fastest waterway connecting Europe to Asia is closed will seek payment from their insurers, if they have one. These insurers will in turn file claims against Ever Given's owners, who will turn to their insurers for protection. Ultimately, it appears that most of the costs will have to be borne by the ship's P&I insurer, the UK P&I Club.

Third, UK P&I is a member in a group of P&I Clubs called the International Group, whose members come together to share loss exposures and buy reinsurance coverage in order to socialize losses and protect against catastrophic outcomes. The chart below is a representation of the risk-sharing arrangement in the group. More information can be found here, including an informative video about how this arrangement works.



End users will have to pay more because shippers need to pay higher insurance premiums which are going up because insurers themselves need to pay higher club fees since reinsurance rates are also going higher. All of which is to say – *it's complicated, but costs are going up*.

What does this mean for us? We think it is directionally accurate to say that input costs (charter rates, insurance, port congestion and demurrage, inventory build-up, redundancy planning) are on the rise, with knock-on effects on end product prices. More directly, the recent spate of new containership orders in response to high charter rates also mean that many large shipyards are booked out for years, which means new tanker builds will necessarily be limited and hence a positive for our positions.

Ending this section on a lighter note, we came across this interactive simulation of what it may be like to steer a vessel through the Suez. It is harder than it looks – it took me 10 tries before I succeeded!

Archegos Liquidation – Securities Dealers are Casinos; Prime Brokerage the Credit Department

Archegos Capital, a US$10 billion family office managing the private wealth of Bill Hwang, was wiped out in March when highly levered bets went sour. Prime brokers had lent massive amounts of money to Archegos; when losses mounted, they exercised their right to liquidate collateral seized from the fund to protect themselves, accelerating the collapse of the company.

We spoke to prime brokers, including at Goldman Sachs and Morgan Stanley, during the set-up of Cypress and have an idea of their business model. In a nutshell, security dealers are like casinos and prime brokerage is the credit department. Casinos make the most money when clients i) bet frequently, ii) bet in large size and iii) stay at the table.

- Securities dealers take a cut from every transaction. The more frequently clients trade, the greater the transaction volume, the higher the fees. Maximizing turnover is key.
- Prime brokerage provides credit which boosts transaction sizes. Instead of trading $100 of Apple, why not trade $300; prime brokerage will lend the difference. More fees to the dealer.
- Prime brokers earn interest on the money they lend; the larger the loan, the greater the fees.
- Keep clients at the "table" by offering perks – access to research, capital introduction, headhunting services, etc. Whatever it takes to keep business from going to a competitor.

This is obviously an over-simplification, nor do we mean to vilify dealers and prime brokers. However, when considered in this light, it is not surprising the huge amount of leverage provided to Bill Hwang or the actions taken when he started losing money. For what it is worth, we did not go with any of the large prime brokers since we are not their ideal clients anyway – our investment strategy is not built on high trading volume or copious leverage.

Archegos vs LTCM vs Amaranth – A Potent Cocktail of Concentration, Leverage and Exposed Positions

Over the years, countless funds have blown up, including prominent ones like LTCM (US$4bn) in 1998 and Amaranth (US$9bn) in 2006, but none collapsed so swiftly and destroyed as much personal wealth

as in the case of Archegos. We believe a combination of concentrated positions, very high leverage and positions exposed to the market contributed to their demise.

Concentrated Bets

Archegos: Bill Hwang was known to take very concentrated bets when he worked for Julian Robertson and when he ran Tiger Asia. It is rumoured that Archegos had US$20b of exposure just to one company, Viacom. On 22 March, Viacom announced a US$3bn offering of new common and preferred shares, which caused the share price to drop by 9%. This one-day move alone would have erased 1.8bn from Archegos, or nearly 20% of the fund's assets (not taking into account hedges).

LTCM: LTCM managed a relatively diversified portfolio, with exposures to fixed income, equities, EM and other asset classes. However, it turned out that many of their investments were arbitrage or convergence trades that were highly correlated to one another. The final straw was Russia's default in 1998, which led to contagion across other financial markets. LTCM's diversified portfolio basically became one concentrated bet as correlations across markets went up.

Amaranth: Amaranth was a multi-strategy hedge fund but had outsized exposure to their natural gas trading business. The natural gas trading team led by Brian Hunter was responsible for nearly all of the firm's P&L in the previous year, which they did by amassing enormous positions in the natural gas markets. According to the US Senate's report in the aftermath, his team "controlled between 25 and 48% of outstanding contracts in all NYMEX natural gas futures contracts for 2006; about 30% of the outstanding contracts for 2007; between 25 and 40% of outstanding contracts for 2008; between 20 and 40% of outstanding contracts for 2009; and about 60% of outstanding contracts for 2010".

High Leverage

Archegos: The portfolio was levered 6 to 10 times, ie US$10-15bn of capital was supporting US$80-110bn of gross exposures. In fairness, Archegos almost certainly had short exposures offsetting their longs, so their net exposure is probably closer to 250%-300% (500% longs offset by 250% shorts for 750% of gross exposure). Even then, this still a lot of leverage.

LTCM: LTCM was famous for using massive amounts of leverage, with a debt-to-equity ratio of 25:1 (they borrowed US$125bn against equity of US$5bn). Note that these are not apple-to-apple comparisons because LTCM traded more sovereign bonds and swaps which are less volatile and therefore could be levered to a larger extent.

Amaranth: Reports state that Amaranth's portfolio was levered 5 to 8 times, and as in the case of Archegos, will encompass offsetting long and short positions.

Exposed Positions

Archegos: The problem with having the market know your position is that one could attract speculative attacks, for example in the case of the GameStop short squeeze. For the most part, Archegos was able to hide their outsized positions in names like Viacom and Discovery from the market. However, the prime brokers lending to Archegos knew about these exposures. When the music stopped, they must have been in a rush to offload or hedge their own risk, which would drive prices further against Archegos. It is

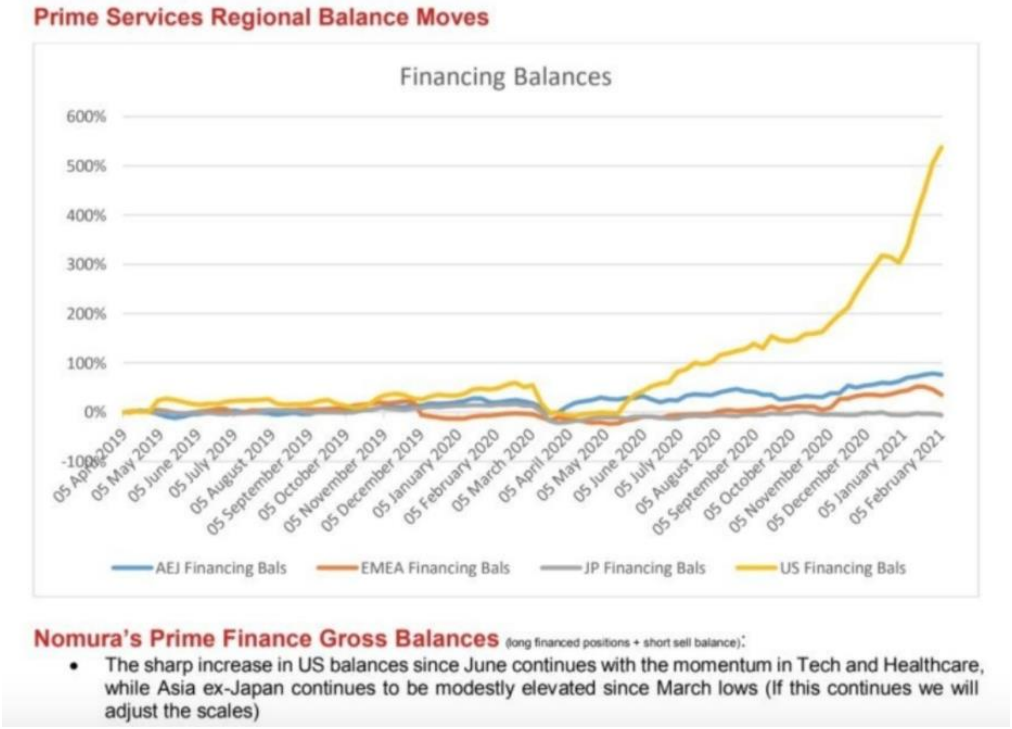
also likely that this information could have been leaked to other market participants, which would then pile in to try to force Archegos' hand.

LTCM: LTCM was possibly the most famous hedge fund in the 90s and did business with every large dealer on Wall Street. As word of their losses hit the street, it was in every counterparty's interest to reduce their exposures to LTCM by cutting credit lines to the firm, hedging same-way bets (which they knew in detail) and even taking outright opposite positions. This is a reflexive process leading to more losses for LTCM, greater urgency by counterparties to reduce risk and spiraling losses for the fund.

Amaranth: Brian Hunter was such a big trader that everyone in the market knew the positions that Amaranth owned. They were long the winter month natural gas contracts while short the summer months, betting that the spread will compress as it did every year. When the positions started moving against Amaranth, other funds piled into the opposite trade which exacerbated losses and eventually led to their liquidation.

To be honest, we are surprised that the market's response to Archegos has so far been relatively muted despite the losses sustained not just by the firm but also by counterparties like Nomura and Credit Suisse. We imagine that the risk departments in all prime brokers must now be working 24/7 to re-assess exposures to other funds. At the margin, this has to mean that leverage levels are going down, although this may take a while to percolate down the system. At risk of sounding like a hater, we would urge caution when it comes to growth-oriented ETFs like ARKK (which we discussed in our last letter), since they share the same traits of concentration, leverage and exposure.

Chart shows Nomura's lending balances spiking in the US, likely concentrated in Tech and Healthcare



Conclusion

As investors, we are like navigators from the past. Our expedition may lead to incredible discoveries, yet danger lurks around every corner. Just as it is our responsibility to learn from the best investors in the business, so it is our duty to avoid the mistakes that others committed (*via negativa*). We write about Archegos, LTCM and Amaranth not to gloat at them; instead we try to learn the lessons from their experience, so that we may do better. While we may run a relatively concentrated portfolio in the Cypress Fund (70% of portfolio in top 10 positions), it is nothing close to what these funds managed. Neither do we employ such high levels of leverage (100-150%), nor are our positions so well known or large enough to be attacked by adversaries. For Cypress, the asset-backed businesses we invest in offer large enough upside that we do not need to employ high levels of leverage. And by building a portfolio with 7-10 different investment themes, we try to minimize concentration risk. At the end of this letter, we provide you with a table highlighting the themes we are invested in, the potential upside we see as well as the risks to our theses. Let us know if you have any questions and we would be happy to explain in greater detail.

As always, thank you for your support. We hope you had a good Easter break and look forward to connecting again soon.

Sincerely,

Yongchuan Pan
7 April 2021

Theme	Thesis	Upside	Risks
Nuclear/Uranium	• Growing acceptance of nuclear as source of carbon-free energy • Growing demand and falling supply for uranium • Priced below marginal cost of production	300-500%	• Larger amounts of secondary inventory than expected • Another Fukushima
Shipping	• Extremely favourable supply dynamics for tankers and LPG vessels (old fleet, few new build orders) • Stocks trade at deep discounts to already-depressed NAVs with large dividends (>10%)	100-200%	• OPEC+ production cuts • Recession
Basic Materials	• Adriatic Metals trading at substantial discount to NPV • Heavy insider ownership with likely takeout by current shareholder • Leverage to silver price without paying for it	200%	• Country risk • Construction risk • Lassonde curve
Computing Power	• Surging chip and tin consumption due to increasing demand for compute – automobiles, IoT, defence • Demand not priced in at all at current multiples; huge exploration upside for free	100-300%	• Recession • Idiosyncratic company risks
Precious Metals	• Protection against inflation and fiat debasement • Under-owned by official sector/central banks • Potential alternative to bonds – producers trade at high and growing free cashflow yields	100-300%	• Strong economy with low inflation • Regulatory risk • Challenge from crypto
Clean Energy Transition	• Climate change is driving energy transition; this shift to cleaner energy will rely heavily on electrification • Own highest quality copper producers levered to higher prices with exploration upside	200-300%	• Recession • Idiosyncratic company risks
Oil & Gas	• Energy transition will take longer than expected; fossil fuel use will remain for decades to come • Own producers and mineral rights owners pricing in much lower crude oil and natural gas prices than in the market	100-300%	• Recession • Regulatory risk
Farmland	• Growing demand for food and improving productivity driving higher yield for farmland and hence valuations • Overlooked asset class, 20-30% discounts to fair value, dividend-paying	50%	• Recession • Poor harvests / climate anomalies
Financing	• Own equity in structured financing vehicles • Substantial upside with very limited risk	50-100%	• Opaque and hard to analyze • Narrative too complicated for most investors