The Transformation of Bubbles into Inflation

Dear Jorge,

1. Monthly Update Quadriga UCITS Strategies

1.1. Protected US Equity, Quadriga Aqua UCITS +1.4% Mar23, +7.8% YTD

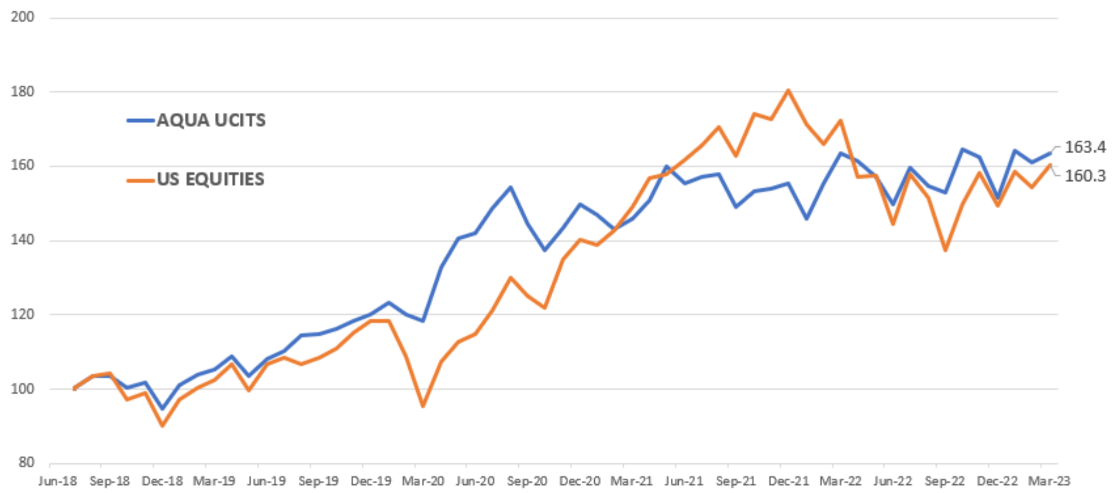
The enclosed Aqua UCITS Feb 23 Factsheet provides a detailed overview of the performance and positioning across the core equities and long insurance portfolios. The Protected US Equity Strategy combines the benefits of a core long 100% US Equities protected with a long-only Insurance Program where both components are rebalanced monthly to their neutral weights. The long only insurance has a target of 10% to 15% in **premium-at-risk** and is **managed pari-passu with Igneo UCITS.**

A switch from **Unprotected Equity to Protected Equity** is subject to a number of benefits and considerations, including:

- **Switch Unprotected Equity** for **Protected Equity** with **zero net cash-flow** requirement.
- **Remain invested** in US equities, but **enhance protection** at expense of potential basis risk and underperformance vs passive equity markets.
- **Reduce volatility** and enhance risk adjusted returns (**Sharpe Ratio** and **Sortino Ratio**).
- **Reduce "noise"**. One line item, instead of two. Less emotions during extremes tend to produce better decisions.
- **Embrace hostile markets**. Buy cheap equities financed by profits on insurance.
- **Embrace complacent markets**. Buy cheap insurance financed by profits on equities.
- **Monthly Rebalancing**. Incremental Returns from Negative Correlation and Mean Reversion.
- **Attractive Entry**. Current valuations in US Equities and Insurance offer attractive entry for protected strategies like Aqua.
- **Seeding terms** class A USD **ISIN LU1871084460** a 1.5% management fee, 0% performance fee, daily liquidity at NAV.

As per the graph below, Protected US strategies can help simultaneously enhance absolute returns (+10.9% p.a. vs +10.4% p.a.) and risk-adjusted returns, (both return per unit of average volatility, Sharpe 0.8 vs 0.5) and return per unit of "bad volatility" (Sortino 1.6 vs 0.9), whilst simultaneously enhancing capital preservation as Peak to Trough (-10.9% vs -23.9%).

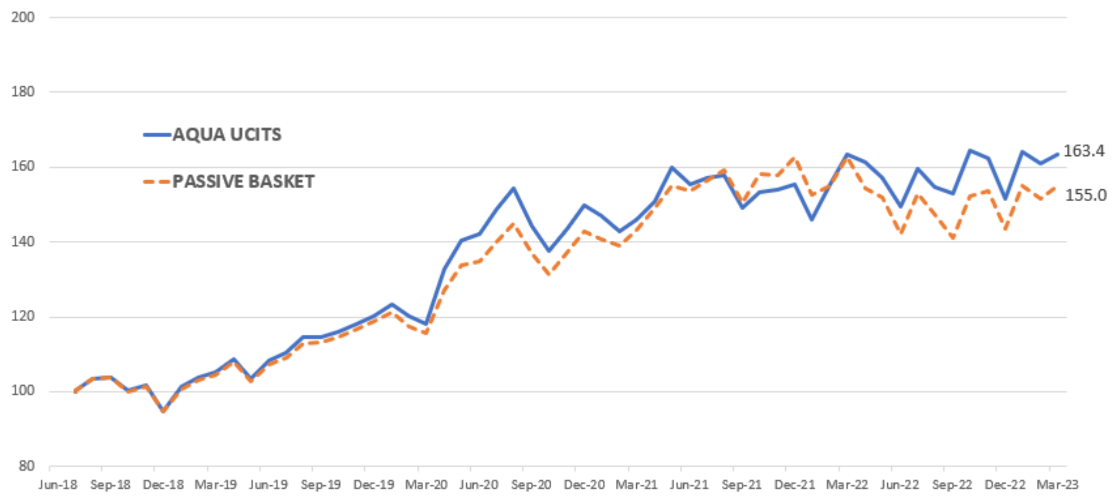
	Monthly (%)	YTD (%)	LTD (%)	LTD (% p.a.)	Vol (%)	Sharpe	Sortino	Peak Trough	NAV
SPX	3.8%	7.4%	60.3%	10.4%	19.2%	0.5	0.9	-23.9%	**160.2**
AQUA	1.4%	7.8%	63.4%	10.9%	14.4%	0.8	1.6	-10.9%	**163.4**
Difference	-2.3%	0.4%	3.1%	0.4%	-4.7%	0.2	0.7	13.0%	**3.3**



Passive Basket vs Rebalanced Basket

In addition to the contribution from the Equity and Insurance Portfolios, Quadriga Aqua UCITS Protected US Equity benefits from another important consideration: **portfolio rebalancing**, a mechanism that effectively behaves like a **good unemotional investor** that **systematically accumulates cheap insurance during complacent markets** (such as today) and **systematically accumulates distressed assets during hostile markets** (such as March 2020). Those investors managing the long equity and long insurance via separate legs tend to suffer from emotional distress and make the wrong decisions at the wrong time.

The following graph compares the performance of a passive basket vs monthly rebalanced basket, where the difference represents the value of **compounding capital preservation**. No crystal ball. No magic formula. Just unemotional systematic rebalancing, which in our view can be a valuable source of compounding and incremental returns in general, and during the high volatility regime we anticipate ahead.



1.2. Quadriga Igneo UCITS, +3.0% Mar 23

The enclosed [Igneo UCITS Mar23 Factsheet] provides a detailed overview of the performance and positioning, including closed, restructured, and new positions. The **Total Premium at Risk** for Igneo was **32.5%** as of the end of March, with a **diversified insurance portfolio 1) across asset classes** (Equity/Credit, FX/Rates, Commodity Inflation) **2) across maturities** (short dates directional gamma and long dates Vega and duration), **3) convexity and risk premia** (long vanilla bias and risk premia across the forward term-structure, volatility surface, and correlation matrix) subject to constraints on **premium at risk** (long only option) and **carry** (positive, neutral and negative), which altogether seek to generate **negatively correlated alpha** during **adverse, hostile and volatile** markets, as the strategy has consistently done since launch its launch (+12.7% 4Q18, +16.5% Aug19, +42.5% 1Q20, or +22.2% Feb22, amongst others) and as we hope to do during the hostile and volatile markets we anticipate ahead of us.

	2023	2024	2025	>2025	TOTAL
EQUITY & CREDIT	8.2%	0.0%	0.0%	0.0%	8.2%
FX & INTEREST RATES	0.0%	5.7%	0.0%	7.6%	13.3%
COMMODITIES & INFLATION	8.5%	0.6%	1.2%	0.8%	11.0%
TOTAL	16.7%	6.3%	1.2%	8.4%	32.5%

	CONVEXITY	RISK PREMIA	TOTAL
EQUITY & CREDIT	5.5%	2.7%	8.2%
FX & INTEREST RATES	13.3%	0.0%	13.3%
COMMODITIES & INFLATION	0.0%	11.0%	11.0%
TOTAL	18.8%	13.7%	32.5%

	2023	2024	2025	>2025	TOTAL
CONVEXITY	5.5%	5.7%	0.0%	7.6%	18.8%
RISK PREMIA	11.2%	0.6%	1.2%	0.8%	13.7%
TOTAL	16.7%	6.3%	1.2%	8.4%	32.5%

2. Preview Anti-Bubble Report March 2023: "The Transformation of Bubbles into Inflation"

Please find enclosed a "Preview" of The Anti-Bubble Report for March 2023, titled **"The Transformation of Bubbles into Inflation",** that I intend be sent from over the next few days from my 36 South email (details of the strategic partnership between 36 South and Quadriga Asset Managers available further below), which will provide an **overview of March 2023 ("What happened? What's new? What's changed?")** and an updated and expanded overview of our contrarian investment thesis **"The New Paradigm of High Volatility, High Inflation, and High Risk¨**, that in our view will dominate global markets for the foreseeable future, and total reversal from the previous decade, which was dominated by "Low Inflation, Low Volatility, Low Risk", or perhaps more accurately **"Artificially Low Inflation, Artificially Low Volatility, and Artificially Low Risk"**.

2.1 March 2023: What happened? What's new? What's changed?
- US Regional Bank Crisis. SVB, the second largest US bank collapse since Lehman.
- Signature Bank, the second piece of the Domino.
- Fed and Treasury implement "systemic risk exemption" to guarantee uninsured deposits.
- First Republic Bank, de facto bankrupt, currently in life support at the discount window.
- Commercial Real Estate ("CRE") under pressure.
- Credit Suisse, a 200 year old historic bank, forced take over by UBS.
- Change or rules in European credit markets, with equity holders getting paid and AT1 bond holders wiped out.
- ECB intervention contains risk, whilst all eyes looked at Deutsche Bank as "next in line"
- From extreme panic to complacency within days, many strategies suffering, large historic funds collapsing.
- Fed delivered 25bps, middle ground from 50bps priced after earlier in March, prior to systemic banking crisis.

2.2. The New Paradigm of High Inflation
- We are in the "Inflation Twilight Zone", transitioning from "Level 1" where inflation was negligible, to "Level 2" where inflation is no longer negligible.
- In the Inflation Twilight Zone, "Growth" is not enough. We must differentiate between "Nominal Growth" and "Real Growth". Massive difference.
- In the Inflation Twilight Zone "Recession" is not enough. We may avoid a Recession in Nominal Terms, but will not a Recession in Real Terms.
- The Damage from decades of Monetary and Fiscal policies without limits is already done.
- Central Banks trapped between Inflation and Bubbles, both their own creations.
- Systemic risks (such as the recent Regional US Banking crisis) will require more, not less, printing and debt, will keep inflation structurally high.
- Labour Strikes, Social Unrest, Populism, and Wars are unfortunately second order effects of Inflation.
- Labour Strikes are becoming structural, add to lower economic activity, and more of the bad monetary inflation (via more printing, more debt).
- Geopolitical Risks on the rise. Risk of China providing "lethal aid" to Russia. Risk of Israel attack following Iran nuclear enrichment.
- Investors focus will shift from Level 1 Capital Preservation (Nominal) to Level 2 Purchase Power Preservation (Real)
- When inflation expectations are low, Central Banks are in control. When they are high, Central Banks lose control. Watch out.
- Real Inflation vs Official Inflation. Investors and savers are not stupid. In our view Real Inflation is approx. 2x Official Inflation. Frogs on the move.
- Central Banks can can not print Energy, but can subsidize it (print EUR or USD), transforming (not solving) the problem into devaluations and inflation.
- Yield Curve Control, the mechanism that transforms credit bubbles into inflation. Beware of the end of YCC in Japan. LDI squared ahoy.
- From Level 2 to Level 3, make money in Real Terms after Taxes, in particular Wealth Taxes, how Central Banks and Governments "square the circle".
- The End Game. From a game theory perspective, the game is designed to end in Stagflation.

2.3. The New Paradigm of High Volatility
- Strong opposing forces (inflation and systemic risks) likely to result in high volatility.

- Fed dots Dec 25 showing massive divergence, high of 5.50% to low of 2.375%, consistent with impossible dilemma between systemic risk and inflation.
- Twilight Zone between Level 1 and Level 2 likely to translate in higher realized and implied volatility.
- Divergence of forecasts by analysts: from Hard landing to Soft landing to No Landing = volatility.
- Reflexivity of Bubble vs Anti-Bubble. Artificially low volatility = artificially high prices via virtuous cycle. Watch out for the vicious cycle.
- Realised volatility is the Speedometer of markets but does not compute the real risk of the portfolios. Watch out for spike in volatility.
- Chronicle of a Crisis Foretold: The triple whammy of Volatility vs Correlation vs Liquidity
- Disconnect between Macro Vol vs Equity Vol = Bear Market Rally, Short Squeezes. Will be wild.

2.4. The New Paradigm of High Risk
- High inflation expectations forcing Central Banks to hike, but faced with systemic risk they will always kick the can down the road via inflation.
- The US Regional Banking crisis in our view the tip of a giant iceberg.
- The domino effect of lower credit transmission will spread to Commercial Real Estate and beyond.
- What is left tail? In Level 2 we need to watch out for both Nominal and Real Left Tail.
- Nominal Left Tail (equity credit sell off). Loss of capital.
- Real Left Tail (inflation spike). Loss of purchase power.
- False Diversification = Hidden Leverage.
- Equity Risk Premia. Equities are expensive both in absolute and real terms.
- From TINA (There Is No Alternative) to TARA (There Are Reasonable Alternatives) to TAGA (There Are Great Alternatives) in nominal terms...
- From Bubbles too big to fail to Stagflation.
- Slow Motion Crash. Watch out for Credit Defaults.

3. Implications for Portfolio Construction
- The Football Team Analogy: the striker, the defender/goalkeeper, and the coach.
- Embrace Volatility. Don't fight it.
- Upsilon, Compounding on Capital Preservation.
- Unemotional vs Emotional Portfolio Rebalancing.
- Protecting Strategies vs Protected Strategies
- Long Only Options. V@R 100.
- Long Inflation Bias. Beware of assets that are short inflation.
- Equity divergence. Equity Margins vs Inflation: Price Power vs Purchase Power.

4. Additional Supportive Information
Previous issues of the Monthly Anti-Bubble Report available on request.

Live Webinar [Real Conversation with Hedgeye Keith McCullough] (recorded Mon 6th Feb 2023), where we discuss some important topics, including:

- The new paradigm of “**high inflation, high volatility and high risk**”. The next decade will be very different from the previous decade.
- Why Central Banks are **trapped between bubbles and inflation**, both their creation.

- Why **Central Banks will print more, not less**, as they will be forced to intervene to contain credit bubble collapse created by higher rates.

- **Yield Curve Control** is the mechanism that **transforms credit bubbles into inflation**. Watch out for Japan.

- The "**Frogs in boiling Water**" analogy. Implications for global markets and portfolio construction.

- How Currency wars has shifted from "beggar thy neighbour" to "**export inflation**" and thus why stronger USD is a wrecking ball for global.

- How the investment game has 3 levels: 1) nominal returns, 2) **real returns**, 3) real returns after taxes. We are now decisively in level 2.

- Why **China a credit time bomb**, likely to eventually implode via weaker CNH. Watch out for HKD peg.

- Energy subsidies another example how Governments don't solve problems, simply **delay, transfer, transform, and enlarge problems**.

- Why **Geopolitical risks remain high**. Mind the tail risk from miscalculation and nuclear escalation in Russia / Ukraine.

Additional information. In case of interest, please find enclosed additional information about our contrarian ideas and framework:
- Gold's Perfect Storm (Financial Times Insight Column, front page written edition 8th Aug 2016)
- The Energy World is Flat (Financial Times Insight Column, 18th April 2016)
- Real Conversation with Keith McCullough (Hedgeye, 6th Feb 2023)
- China is Running out of Options (Macro Trading Floor, 24h July 2022)
- How to hedge Inflation (Kitco News, 30th Sep 2022)
- Bitcoin: Bubble or Anti-Bubble? (The End Game Series, 9th Feb 2021)
- Portfolio Construction Masterclass (Real Vision, 3rd Aug 2020)
- Hmmminar with Grant Williams (Hmmminar #15, 21st May 2020)
- False Diversification (MacroVoices podcast, 11th June 2020)
- The Perpetual Search for Extreme Optionality (The Felder Report Podcast, 1st Sep 2019)

5. Positive News (re-send)

As announced in December, I am pleased to inform you of my appointment as **Member of the Management and Investment Committee** at **36 South Capital,** the $2 billion AUM industry-leading investment manager with a 21-year track record specialized in global macro, volatility, and tail risk. I joined 36 South in **January 2023** at the firm´s headquarters in **London**, reporting directly to **Jerry Haworth**, CIO and Co-Founder of 36 South, where, in addition to my new responsibilities, I will remain fully focused and dedicated to the management of **UCITS offering**, namely **Quadriga Igneo UCITS** and **Quadriga Aqua UCITS,** together with **Alfonso Torres**, Senior Portfolio Manager.

My appointment is a positive development for both 36 South and Quadriga, as **36 South** expands its investment team and range of investment strategies it manages and advises, and **Quadriga** continues to host and support **Igneo and Aqua** within its **Luxembourg UCITS umbrella**. For the avoidance of doubt, there are no operational changes to any of the strategies, which remain available via the Quadriga platform and with the exact same terms and conditions. Current investors do NOT need to do anything. Prospective investors continue their due diligence as normal. Any questions or clarifications, please contact me directly anytime. Thank you!

I hope the ideas and strategies will be of your interest and remain at your disposal for any additional information or clarification you may need.

Quadriga Strategy	**Class**	**MTD**	**YTD**	**LTD**	**Factsheet**	**Newsletter**
Igneo UCITS (USD)	A	+3.0%	-7.0%	-19.2%	**Igneo Mar23**	**Subscribe**
Aqua UCITS (USD)	A	+1.4%	+7.8%	+63.4%	**Aqua Mar23**	**Subscribe**

Best regards and much health to all!

Diego Parrilla