



Cloudy with a Chance of Meatballs...

~ *The Sequel*

The Sequel ...

We published our 4Q2017 note titled, "[Hero to heel in just under a week](#)", later than usual due to compliance restrictions as we opened our doors. I resigned from my previous firm the evening of January 25th, 2018 the day before markets "topped" as we headed directly into "#Volmageddon". By the time we had received approval to operate (with grateful appreciation to the many clients who had decided to make the leap with us), we were a few weeks into the volatility firestorm.

Late November into early December of 2017, some clients may recall we introduced the idea of buying "hurricane insurance" in the form of out-of-the-money puts in an effort to hedge against a spike in volatility. Our opinion at the time was getting long volatility under \$13 (as measured by the VIX) was a form of "hurricane insurance" investors should consider carrying; when VIX was at \$10 or below, it was almost as if no one saw another storm coming for the next decade. This wasn't something we could do inside the models we were running at our old firm, which made this recommendation difficult to execute; it was one of the many considerations for eventually leaving and opening our doors at OSAM.

"Volmageddon" took place on February 5th, 2018; the VIX (volatility index) traded from as low as \$16.80 to as high as \$50.30 that day, eventually closing at \$29.06. In one trading session, arguably one of the most popular **trades** over previous years had been decimated: this being the "short vol" trade (as in, betting against volatility moving higher).

On this day, the **XIV**, which was the VelocityShares Daily Inverse VIX Short-Term note (ticker XIV), would blow-up spectacularly, shrinking from \$1.9 billion in assets to \$63 million in one session.

IN THIS ISSUE:

- The Sequel
- Short Memories
- Everyone has left their Umbrella at Home
- In the end, it's lose, lose
- A Solution

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The product lost 97% of its value and closed its doors. *It literally went to \$0.00 ... in a day.*

Short memories ...

If you didn't own the XIV you may have just experienced another BTFD (Buy the F*ing Dip) moment; just hold on, wait it out ... Things always go up. Many retail investors had NO idea that a leveraged derivative product could go to zero – let alone within hours.

We did a little something different in our [2Q2020 note](#), urging you to listen to, [The End Game w/ Grant Williams and Bill Fleckenstein featuring Mike Green of Logica funds](#).

What we didn't share with you about Mike Green is that in May of 2017, nine months **before** *Volmageddon*, both he and Artemis Capital founder Chris Cole, got into a rather heated, public argument at a derivatives conference in Las Vegas with Nick Cherney, the CIO and co-founder of Velocityshares – the index company behind **XIV**. Both Green and Cole emphatically warned Cherney that his product would go to **ZERO** on a 4% S&P drawdown. In contrast, Cherney argued his product could withstand a **Black Monday** 1987 type crash; the masses remained invested in XIV, Green & Cole – Lunatics!

History has obviously revealed the winner of this argument, and bystanders didn't have to wait terribly long to find out; Green's math was *spot-on* accurate as a 3.9% decline zeroed out the product. (Green's prediction, so uncanny in its accuracy, might cause you to revisit his warnings, via our 2Q2020 note. It might also have you think twice before dismissing well presented, thought out theses that may not be popular opinion at the time?!)

Green and Cole live in a different world than most... They are likely the foremost experts in the world of derivatives today and you should care about what they have to say, for multiple reasons... When Mike Green says that markets can go to zero based upon a collective of the passive industries influence on market structure coupled with regulatory folly (among other things), it's not something to be brushed under the rug as a crackpot theory, you should pay VERY close attention and understand the FULL story...

Both Cole and Green believe that markets could “break” in either direction; while I do NOT want to put words in their respective mouths, my understanding of Mike Green's bias suggests a **melt-up** thesis with a very real possibility for markets to breakdown with little to no warning (similar to a *Volmageddon* event); likely caused by a “miscalculation in structured products” ([which you could listen to in his own words uttered on a different podcast he was recently featured on, which aired November 6th - specifically minute 1:04:30](#))

He, like no one I've ever heard, explains what led to the housing crisis of 2008. He also states, “*there are an incredible number of opportunities like that that are out there.*” Again, we urge you to listen to Mike's full interview as to not cherry pick thoughts which may fit our bias.

Cole recently stated, prefacing with *if he was forced to guess*, which is not what he does; but he believes we see another very large deflationary down draft prior to what would lead to a *kitchen sink* approach from the Fed, which in turn would lead to a significant inflationary event for markets.

Humility suggests we are not smart enough to know exactly which direction the market *breaks* (up or down) or when; but it would be ignorant to ignore the downside risk; in effect, to ignore it means that you are discounting it to zero... We've written about an impending melt-up for years now, we've also cautioned about the embedded structural risks which pose massive risk the masses are ignoring.

In the aforementioned 4Q2017 note we also wrote -

If the weather report suggests a 20% chance of rain tomorrow, how many people would carry their umbrella? Be truthful – the answer is virtually no one. Human behavior suggests most people either round large probabilities up to 100% likewise, they round small probabilities down to 0%; but if it actually rained, most people would more than likely be upset with the weatherman! The weatherman told you it “could” rain, it was you who made the decision to leave the umbrella at home based upon your discounting the 20% as zero – or it was just a chance you were willing to take. So, is the weatherman to blame or the individual who discarded the small percentage?

The same often holds true with financial markets ... most investors leave their umbrella's at home.

Everyone has left their umbrella at home

As frequent readers know, it's extremely rare for me to discuss politics. By current demographic you run the risk of angering 50% of the population one way or the other. I emphasize that the statements which I make below are NOT wishes, hopes or dreams. They are NOT intended to do anything other than point out factual information and scenarios that most are overlooking yet pending its outcome it could have a significant impact on our country as well as financial markets. This is one of those **umbrella events**, where most have discounted a low percentage probability to ZERO and just about everyone's left their umbrella at home. While most are ignoring the event, we believe this to be a mistake; should it occur, I anticipate material damage.

Each individual reading this will naturally place a higher or lower probability on what I'm about to say based upon their own personal bias. I don't write based upon emotion or bias; not to anger or excite – I focus on process, probability, data and factual information. This note is NOT for or against “*a side*”, it's intended to be thought provoking as we risk manage our assets! The events below may or may not occur, but what is important is the **process** by which you manage the risks that you are exposed to.

*“Joe Biden should NOT concede under any circumstances because **I think this is going to drag out**” Hillary Clinton; August 25, 2020*

The above quote was Hillary Clinton's advice to Joe Biden in August, less than 3 months ago, only now Donald Trump is heeding her advice. Why would Clinton be so emphatic about NOT CONCEDING?! While I can't be 100% sure, my guess is that she understands constitutional law and knows there is a process to a “contested election”. So, what is the relevant process here?

You and I don't decide what constitutes a “contested election”, neither does the media. We can have an opinion, but that is separate from the legal process. In fact, there is a very real chance that the election itself can be rendered “null & void” where NONE of our votes matter.

While some are focused on the *certification of votes* and **recounts** currently underway in GA, AZ, MI, NV, WI and PA in the crosshairs, the Trump administration's PRIMARY attention has been voting machine fraud; specifically, the "Dominion & SCYTL" systems.

Again, while ~50% of those reading will flat out deny any wrongdoing took place, there is another ~50% who feel the exact opposite. We're not here to pick a side, but what we will point out is one doesn't need to jump down a rabbit hole to find reasonably credible information calling into question the Dominion systems accuracy **prior** to November 3rd:

The examiner reports identified multiple hardware and software issues that preclude the Office of the Texas Secretary of State from determining that the Democracy Suite 5.5-A system satisfies each of the voting-system requirements set forth in the Texas Election Code. Specifically, the examiner reports raise concerns about whether the Democracy Suite 5.5-A system is suitable for its intended purpose; operates efficiently and accurately; and is safe from fraudulent or unauthorized manipulation. Therefore, the Democracy Suite 5.5-A system and corresponding hardware devices do not meet the standards for certification prescribed by Section 122.001 of the Texas Election Code.

The above [findings come from the Secretary of State of Texas, JANUARY 2020](#). Over 11 months ago, Texas rejected the Dominion machines for the 3rd time based upon accuracy and security concerns. We're not following a trail of conspiracy theory breadcrumbs here; we are providing you with the hyperlink directly to the Texas Secretary of State's findings nearly a year before the election took place.

We're making a very conscience decision to omit inserting "claims", even filed "affidavits", our goal is not to *prove or disprove a side* – but show you that another side of a story exists and has more credibility than most are being led to believe. It will be the job of the courts to sift facts from fiction based upon what the attorneys present while following the proper **process** laid out by the **Constitution**.

There's more ...

On September 12, 2018, President Donald Trump issued [Executive Order on Imposing Certain Sanctions in the Event of Foreign Interference in a United States Election](#).

This Executive Order is still in effect today; our current election took place under a **National Emergency** this executive order declared. This EO (again, link provided above to the actual order) is directed at persons and entities located, in part, outside of the United States that could:

"interfere in or undermine public confidence in United States elections, including through the unauthorized accessing of election and campaign infrastructure or the covert distribution of propaganda and disinformation."

For those failing to see the importance and how it ties together, Dominion's international headquarters is located in Toronto, Canada while SCYTL is a nearly defunct company located in Barcelona Spain; BOTH with

servers IN GERMANY. Under this order, both are likely to be considered “foreign interference” of US elections per this EO.

More importantly, the EO also states that those entities which aided and abetted could have their assets confiscated:

(i) to have directly or indirectly engaged in, sponsored, concealed, or otherwise been complicit in foreign interference in a United States election

(ii) to have materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of, any activity described in subsection (a)(i) of this section or any person whose property and interests in property are blocked pursuant to this order; or

(iii) to be owned or controlled by, or to have acted or purported to act for or on behalf of, directly or indirectly, any person whose property or interests in property are blocked pursuant to this order.

Which brings us back to Hillary Clinton’s words about not conceding...

With Trump NOT conceding, should the certifications of votes be contested, OUR VOTES (those of the people) possibly become IRRELEVANT. Amendment 12 of the US Constitution provides the House of Representatives with the authority and duty to vote for the new President of the United States; with EACH STATE getting a SINGLE vote!

It’s important to understand this process has **nothing** to do with who controls more seats, and **everything** to do with who controls a greater number of states; currently 30 states are held by Republican, while 19 are controlled by Democrats. Our understanding, per the 12th Amendment, representatives MUST vote down party line.

Would the Senate then go through a similar exercise for Vice President?!

This is where constitutional LAW and process supersedes both popular opinion as well as that of any media news anchor “calling” an election.

Furthermore, [per the FBI’s website](#):

“Fair elections are the foundation of our democracy ... The U.S. government only works when legal votes are counted and when campaigns follow the law. When the legitimacy of elections is corrupted, our democracy is threatened.” (We Agree)

Among other offences ... *An election crime is generally a federal crime if:*

- *The ballot includes one or more federal candidates*
- *An election or polling place official abuses their office*

- *The conduct involves false voter registration*

For those who may believe this ends in state courts, the top bullet alone suggests federal courts and FBI involvement.

We agree with the former first lady, ***"I think this is going to drag out" ...***

Some may have a visceral reaction in me just discussing the above scenario, which is exactly why the evidence is to be judged in Federal Courts, NOT the court of public opinion.

These words are NOT personal, I'm not trying to change anyone's view on who should or shouldn't be the President of the United States of America. I'm not advocating for a side; not trying to ruin my career; in writing on this topic, providing you with this information (some you may or may not have already seen as it's taken me a week to get this note out) we're giving you a glimpse into our thoughts as to what's most likely transpiring behind the scenes right now – ZERO feelings embedded in any of my words.

However, this is a potential umbrella event for every US citizen.

We never claim to be the smartest in the room, though, we are confident in our understanding of the process and quite frankly are troubled by the media's lack of understanding, misrepresentation or flat-out omission of proper procedure as defined by the Constitution and historical precedence. IF, let me say that again, (IF, IF, IF) IF there was fraud, EVERYONE should be concerned regardless of political affiliation.

[On November 9th we tweeted](#), "WHEN PERSONAL BIAS SUPERSEDES THAT WHICH IS "PROCESS", and "CONSTITUTIONAL LAW" DEMOCRACY LOSES ON EVERY LEVEL.

History provides us with [three US elections](#) that have been **contested** given a candidate NOT **conceding** ... 1800, 1824 and 1876. The HOUSE eventually elected Thomas Jefferson in 1800, and the disarray led to the eventual passage of the 12th amendment in 1804. In 1824, Andrew Jackson WON a *plurality* of both the popular and electoral vote - YET - JOHN QUINCY ADAMS became president. In 1876, Samuel J. Tilden also won the popular vote and electoral count but after republicans contested, Rutherford B. Hayes became president via the path I've described above.

WITHOUT QUESTION, there are differences as well as similarities to how each scenario relates to current day, but as every one of us should know, attorneys CAN and WILL argue anything...

Admittedly, this note may not age well, by the time you read it, a concession may make it a moot point, however, given what we're currently observing, and the press conference I saw Thursday while formatting, I feel even more strongly that the current administration is following the above thought process, thus, I place a much lower probability on the concession scenario in the near term than others might.

Please consider the downstream risks that the above could trigger.

Defense Secretary Mark Esper was recently fired and, subsequently, Esper loyalists “resigned”. For those who may not recall, Esper broke rank with Trump in June stating he “did NOT support invoking the Insurrection Act” in using US troops on American soil to quell the “peaceful protests” that were taking place around the country at the time.

I WANT TO MAKE THIS CRYSTAL CLEAR, I AM NOT ADVOCATING FOR, NOR DO I SUPPORT VIOLENCE FROM EITHER “SIDE”. I am trying to manage risks. It is our opinion, however, should Trump retain the position of President via the path laid out above, we believe the probability of civil unrest would spike; the severity of which would make what we saw earlier in the year look like kinderspiele (child’s play).

It doesn’t take much of an imagination to envision a scenario where Republican Governors immediately call in the National Guard in response to turmoil. Democratic Governors, who were reluctant to do so earlier in the year, could see the Insurrection Act invoked by the President with US armed forces used to “quell” violence throughout those cities.

As mentioned last month, we often file politics under the “noise” category ... NOT THIS TIME.

Brining us to our thoughts on how this could impact markets. Investors have recently shifted their positioning in anticipation of a Biden administration, including a new Federal Reserve Chair. *Should* the winds shift, we’re likely see an unwind of what’s transpired over the last few weeks. Options dealers and investors will tack just as the captain of a sailing vessel would, quickly unwinding many of the hedges they have just initiated. In a massively passive world, buyers would likely remain constant where sellers *could* trigger a cascading event where forced selling begets more forced selling.

Last month we mentioned that many of the Treasury’s emergency lending facilities formed under section 13 (3) of the Federal Reserve Act needed approval to be extended beyond 12/31/2020 by Treasury Secretary Mnuchin. Feedback suggested we slow down our conspiracies ... Thursday night Treasury Secretary Mnuchin announced many of these programs would [NOT be extended](#).

Should enough doubt be cast on the accuracy and security of the Dominion machines, echoed by the Texas SOS prior to the election; given the possibilities of a government shutdown on December 11th, a cliff of forbearances and deferrals rolling off and many of the 13 (3) programs NOT extended past the 12/31/2020, while states are shutting down again, millions don’t have jobs and politicians can’t agree on another “bailout”, we think it prudent to focus more on protecting the downside.

While no one likes temporarily “underperforming”, we won’t blindly buy into markets with a hope and prayer mindset... If you believe markets always go up, as they say - Buy The Dip! We sincerely wish you luck. We will cordially remind you that **from ~January 2018 to ~July 2020**, equity markets showed NO increase, yet provided investors with tremendous volatility. Fluctuations over that 2-year time frame were enough to make anyone sick, especially those nearing the end of their working careers. Opportunities do present themselves over time, but it’s not always at quarter end.

From the onset of managing our discretionary models, our performance has fared very well against Wall Street's traditional quarterly barometers while carrying abnormally large stockpiles of cash and reduced volatility. We freely admit there has been greater variation at times when we've pulled out foot even further off the proverbial gas (currently). We recognize past performance is no indication of future results, though our focus is not Wall Street's heavily marketed quarterly snapshots in time (why not measure from the March 23rd low?!), especially given what appears to be an overlooked set up of a probable historic event most people are discounting to ZERO and virtually NO ONE is positioned for.

What is to come relies on exponentially more deficit spending, debt and helicopter money. We begin 2021 with a \$3.1 Trillion-dollar budget gap, more than \$27 Trillion in National Debt, a Federal Reserve Balance Sheet over \$7 Trillion and tens of millions out of work among other things?!

If we're wrong about this, we believe we have a very good idea as to what lies ahead, structural market deficiencies will get larger as passive ETFs suck up liquidity; in essence removing shares from the tradable float, thus pushing volatility higher (greater upward swings, greater downward spirals). MORE QE in a "**flows over fundamentals**" market should continue the **melt-up** pending exogenous shock. This shock could be anything from a government failure to provide more "stimulus" to unintended consequences from an obscure regulatory change ... It could be what we've described above?!

In the end, it's lose lose

When the dust settles, regardless of outcome, roughly 50% of the voting population believes the election will have been stolen in one form or another: one subset believing in a combination of voter fraud, mail fraud, dead people voting, multiple votes cast by the same individuals in different states, software malware, etc., etc., etc. While the other 50% will believe a tyrannical dictator will have circumvented the law regardless of process or constitutional law. Sadly, with the majority of both **sides** NOT really caring about the other's thoughts, feelings or concerns.

"You're wrong", "suck it up like we did", "you're a socialist", "he's a dictator", he's got dementia".

People, PLEASE... We need to re-learn how to be objective, how to respectfully debate, share thoughts, opinions and fears without visceral reactions. Everyone is screaming while NO ONE is listening...

If you listen to the news, most politicians or Biden's legal counsel, Biden has won, and Trump has no legal avenue to pursue; he should concede. To this we offer:

- a. Politicians always do what politicians do; they lie, cheat and steal in order to protect their ranks within their party (republicans and democrats); this is posturing or positioning...
- b. Do you really think Biden's counsel would suggest otherwise? Personally, I thought he would lay out the above case to the public showing how Biden could lose! (SARCASM) of course he's going to say there is no legal path – he's trying to win, not map out his opponents winning argument.
- c. As for the media – believe what you will, we suggest you do your own reading research. Please note, I have NOT pulled information from ANY "crack pot" "conspiracy" website. I've provided

documents from both [state](#) and [federal](#) governments – as well as the [Constitution](#); I urge you to read them, block out your emotions and process the information as presented for yourselves.

Hearing things second or third hand is hearsay. Over the next few weeks, the administration's attorneys will present their "evidence" in what *should be* an unbiased court, moving us closer to a final outcome. Respectfully, NONE OF US, not me writing or respectfully, you, kind readers have enough information to play judge and jury with the fragmented information we possess. Emotion and bias may suggest we do, but we don't. The final outcome of Bush v Gore was not determined until December 12, 2000; this process takes time.

A Solution

We don't know what the final outcome of all this craziness will be, though we will share a possible solution.

The validity of the Dominion and Scytal systems will likely be questioned for years to come, hopefully driving change. Clients may have noticed our position in Overstock.com. Without diving deeply into their financials in this medium, \$OSTK has invested in/created a fully secure, transparent, auditable, real time voting system built on blockchain technology, which would make this entire conversation moot, it's called [#VOATZ](#). We believe financial markets are placing little to no value on this technology. Ultimately, what's it worth?! Hard to say, but if voting fraud around the globe could be removed based upon this technology, the only people who wouldn't use this technology are those who want ambiguity.

We believe in FULL transparency and process ... Unless you have your umbrella. Is the above scenario a non-zero risk? If so, how do you manage it? We believe we can help! As always, we're happy to discuss our market thoughts along with strategies and more, never hesitate to reach out with any questions or concerns. Thank you for your continued trust and support!

Sincerely,

A handwritten signature in black ink, appearing to read 'Mitchel C. Krause', with a stylized flourish at the end.

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Disclosures

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