Leveraging LedgerX to generate income from synthetic bitcoin exposure

FIRM:

Wakem Capital Management

SIZE:

$250mm+

THE CHALLENGE:

Gain long exposure to bitcoin in a diversified portfolio

LEDGERX SOLUTION:

Risk Reversals

THE CHALLENGE:

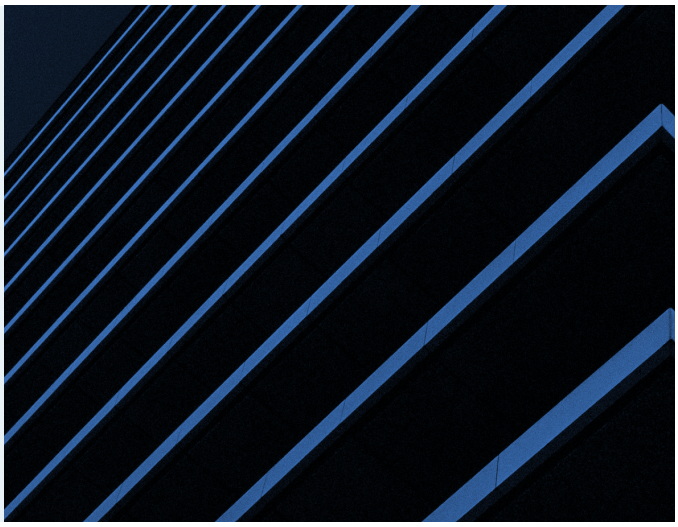
In early 2019, Wakem Capital Management Co-CIO Sam Jernigan was exploring regulated trading venues for a fund he was starting with his partner and Co-CIO John Vincent. Sam and John have 40+ years of global macro hedge fund experience at some of the most reputable firms on the street and combined have managed over $1B in AUM. Wakem is a discretionary global macro fund that targets absolute returns with low correlation to equity and fixed income markets and prioritizes liquidity. Wakem leverages macro-economic theory to analyze crypto-economic systems and are uniquely positioned to capture the global macro implications of decentralization.

Wakem's investment thesis requires there be an active and regulated derivatives market. Institutional capital allocators are not comfortable with unregulated exchange risk and only U.S. regulated exchanges can offer USD denominated contracts. In early 2019, Wakem was looking to use options strategies to obtain asymmetric exposure with defined risk. A regulated, cash-settled futures market was available, but they were seeking the payoff profile of options. ***LedgerX was (and still is) the only U.S. regulated venue for trading bitcoin options.***

THE SOLUTION:

In early 2019, Wakem was focused on gaining long exposure to bitcoin. Bitcoin was trading down 80% from all-time highs with implied volatility falling significantly (~40 from highs of 100+). When studying the global economic outlook and potential upcoming catalysts (US/China trade negotiations, FED/ECP pivots, upcoming institutional investments, etc.) they wanted to put on a long bitcoin position.

Wakem Capital Management was ***paid*** to be long bitcoin.



Common intuition suggests buying bitcoin and stashing it away with a custodian. But Sam and John, pulling from their years of traditional fund management experience, had another idea.

Wakem connected with LedgerX looking to execute a fairly straightforward options strategy: a risk reversal. Risk reversals are common in the FX, index, and commodities worlds and involve selling an out-of-the money put and buying an out-of-the money call. The combination of these two strategies allows the holder to be synthetically long the underlier (in this case bitcoin). With a risk reversal, the premium generated from selling puts is often able to fund the purchase of the calls.

Wakem took this one step further. In Wakem's case, the structure of the trade made it such that the premium generated from selling puts funded the purchase of calls and paid out a slight credit. Wakem was essentially paid to be long bitcoin.

THE RESULTS:

Wakem executed the risk reversal in early February 2019, when bitcoin's price was roughly $3,400. The firm sold Dec19 $3,000 strike puts generating ~$550 per contract and purchased Dec19 $5,000 strike calls for ~$510. This netted them a credit of $40 a contract (1 contract = 1 BTC) on the trade. They were now long a bitcoin position in their broader diversified portfolio. As bitcoin price ran up, Wakem was able to realize a significant gain on their long call position.

Lest we forget….they were paid to be long bitcoin too.