



Incline Investment Management's Zephyr Cove Crypto Strategy

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Institutional investor's access to Cryptocurrencies via a typical hedge fund vehicle is hamstrung by the lack of track record of funds, the volatility of the instrument, the constraints around shorting and the lack of clarity around regulation. However, since the introduction of trading of Bitcoin futures by the CME in December 2017, CTA/Managed Futures Funds have been lining up to offer crypto exposure to investors desperate for alpha.

Incline Investment Management was founded in late 2009, and is named after Incline Village, the town in Nevada where the firm is headquartered. It launched its Zephyr Cove Crypto fund in April 2018 to fill that gap in the market, as Ted Parkhill, Incline's CEO, explains.

"The CME came up with their announcement that they were launching Bitcoin futures, so we thought that we'd treat that like we would any other futures market and drop it into our existing algorithm and see if it fits. Lo and behold, we do our modelling and sure enough, it fits."

Whilst the crypto futures market worked within their main fund, due to the embryonic nature of the cryptocurrency market, Parkhill felt it better to carve out the crypto strategy separately.

"Usually, we can add or drop a market whenever we want. However, it's Bitcoin. If we drop it into our existing programs, it changes the profile a little bit because then we have to answer the question 'do we have crypto', etc. We decided to leave it alone and not drop it into the main program and trade it as a standalone program. We tightened up the timeframe, to mitigate the volatility, and began trading."

Capacity-wise, Parkhill sees the fund topping out at a few tens of millions of dollars “not just because of our goals, but because it relates to the size of the market. Given the volume of the trading of the contracts, we think that the capacity for the strategy is in the \$50million range.”



Incline CEO Ted Parkhill

Crypto fund of funds taking notice

The firm is seeing initial interest from the crypto fund of fund industry, as opposed to their traditional futures investors wanting crypto exposure, but there is an education bent to their conversations.

“We have several crypto funds of funds watching us. They are attracted to the tax benefits of trading futures; they’re attracted to the ease in which we can go short. There are a bunch of reasons why it makes sense, and they’re just starting to come around to understanding what the opportunity is with us. In futures, we have inherent leverage embedded. That’s something we’ve had to explain to the crypto world because that’s not something they’re used to because it’s not like we’re borrowing the money. This is not your classic SEC leverage, reg D. We’re not margining the account. We’re just trading futures contracts, and one contract is good enough. In other words, you can get that extra exposure by the instrument itself and that’s what a lot of people in the crypto world don’t understand because they don’t have the experience.”

Parkhill feels that eventually the message containing the benefits will sink in.

“We think they’re going to get it; it’s just going to take some time.”

Interestingly, the typical requirement of a 3-year audited track record of returns for an investor to consider allocating to a 3rd party manager is not playing out in the crypto space.

“Usually, you’re looking at needing a 2-3 year track record to get an allocation, but for this it’s looking like 2-3 months because they have an urgency to make this happen and so we’re confident that they’re going to move faster than they would normally do.”

Business Development Associate Juan Luque adds some colour.

“What we do is explain that we have expertise in futures. Whilst the product doesn’t have a 3-year track record, the managers do. We are experts in futures.”

Due diligence

Hedge fund investors are known for their detailed due diligence process. Due to the nascent nature of institutional crypto trading, the conversations which Incline has with its investors go down a different path.

“Crypto fund of funds don’t have a standardised due diligence questionnaire, like we have had in the hedge fund space for the last 20 years”, says Parkhill. “The difference is that they have a new set of questions. However, they’re pleasantly surprised to find out what our attributes are given the fact we are regulated, given there is no counterparty risk. That makes it a more intriguing conversation because of that. We’re able to get through it pretty quickly because we’re used to answering the questions.”

Advantages of bitcoin futures trading

Advantages to investors provided by funds like the Zephyr Cove Crypto Strategy include the existing regulation around the futures industry, diversification and the ability to take a short position.

“We present an attractive alternative for portfolio addition because of our ability to go long or short. That’s something they don’t have, so one of the challenges we have in the due diligence process is the education part of it; teaching them that this is a good add. If you put 10% in us, you’re going to provide some good portfolio diversification that you wouldn’t otherwise get if there is a collapse.”

“We’re trading the futures contracts of both the CME and CBOE. We can go long or short, which provides us with a huge competitive advantage compared to the regular crypto funds out there, and it’s a regulated market already.”

Parkhill concludes by emphasising the ability of the fund to prosper.

“We’re directionally agnostic. If the Jamie Dimons’ of the world - who think it’s a hoax - turn out to be correct, that’s fine with us, because being systematic trend followers, we can ride it to the bottom and make a ton of money. If it’s going to \$700,000, like some people think it’s going to, that’s fine with us too because we’ll end up being net long.”

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