



30 January 2021

Dear Partners,

For the month of January, Aristides Fund LP lost 3.64% while Aristides Fund QP, LP lost 3.60%. On a net, dollar-weighted basis, we subtracted 279 basis points of alpha last month. Since the inception of Aristides Fund LP, August 15, 2008, the funds we manage have gained 453.65% cumulatively, or 14.67% annualized. As of 1 February, assets under management were \$122.4 million.¹

In case you haven't been as riveted to the market's movements as we have, the worst crisis since August 2007 just struck fundamental equity long-short hedge funds in late January. I'll try to briefly explain what happened. Here is the chart of the Goldman Most Shorted Rolling Index (GSCBMSAL), a basket of the 50 most heavily shorted stocks in the Russell 3000 index with a market cap of at least \$1 billion:



The moon-rocket at the far right of the chart is a +58.15% move from the beginning of 2021 (21 trading days ago) through this Wednesday, which represented the violent climax of a 97% move higher since the end of October, and a 379% gain since the March lows.

It's not surprising that there is a great deal of speculation in the market at present, given that households literally have an extra \$1 trillion sitting in bank and money market accounts compared to this time last year, but the sheer magnitude of the flows into certain highly-shorter stocks has been stunning. Online investment idea communities like Reddit's WallStreetBets have given investors a chance to collectively "focus their energy" on certain stocks and sectors.

¹ These data are preliminary and unofficial, and are net of fees and expenses, including accrued pro forma incentive allocation. Official figures will be reflected in statements from Perennial. Performance of partners' accounts will vary depending the timing of investments. Alpha calculations are constructed from position-level data. The Aristides Composite consists of (1) before the launch of Aristides Fund QP, LP in 2014: the performance of Aristides Fund LP from its inception in 2008 to the launch of Aristides Fund QP, LP, and (2) after the launch of Aristides Fund QP, LP: an average of the performance of the two funds weighted according to the assets under management of both funds.

Among their favorite recent plays, as you've probably heard by now, was a push to buy stock and call options to create a short squeeze in GameStop (GME).

GameStop is a legacy videogame retailer whose stock attracted an exceptionally high short interest—over 140% of its float—from hedge funds betting on the collapse of its physical retail business in a global pandemic. Most important among them was a \$12 billion firm named Melvin Capital, which is known for taking unusually large and concentrated short positions. At some point, beginning on or around January 13, investors broadened their focus from just making GameStop go up, to trying to make all of Melvin Capital's known short positions go up—including Chinese online education fraud GSX Techedu (GSX), unfortunately a favorite short of ours as well.

While we realized early on what was happening, and reduced our exposure to GSX as a result, we kept on a substantial portion of our position, as (1) we like GSX as a short; even if 70% of its revenue weren't fraudulent, the stock was trading at 12x this year's revenue with net margins of negative 20%, and (2) most of our position was structured as put spreads, meaning the most we could lose on those positions was 100%, rather than the 200%+ loss a straight short would have incurred. Fortunately, we traded around this move fairly successfully, and managed to only lose 35 bps in GSX, even though the stock doubled.



Unfortunately, it wasn't only Melvin Capital's short positions that investors started going after. On Tuesday and Wednesday of this week, investors (some retail, some professional) were devoting massive amounts of capital toward making dozens of highly shorted stocks go up. While we sensed this might be coming and trimmed some of our positions, we did not do it nearly fast enough. For example, I covered about 1/3 of our short position in cancer scam company Cel-Sci (CVM) prior to any squeeze. I hated doing that; while the company has completed its almost-certainly-failed phase 3 trial, it has been sitting on the data for months now, and once they release

the data and it becomes apparent that their drug does not work, the stock will almost certainly collapse. However, I knew looking at the chart that the stock might have a technical breakout soon, and I figured if it started to break out, I would cover another 1/3 of our short position. I didn't anticipate the breakout occurring as fast and sharp as it did. CVM ran from 15 to 40 in one day (!!!) on no news whatsoever, except for the company's CEO tweeting at serial SPAC-sponsor and pseudo-populist billionaire Chamath Palihapitiya. In a matter of minutes, Redditors were trying to make it the next GameStop. Afraid the stock might double yet again, I covered more of our CVM position at horrific prices, and we ended up losing 119 bps on that position this month.

Chamath Palihapitiya @chamath · Jan 26
Tell me what to buy tomorrow and if you convince me I'll throw a few 100 K's at it to start.

Ride or die.
12.9K replies · 1.4K retweets · 14.6K likes

Geert Kersten @GeertKersten1
Replying to @chamath

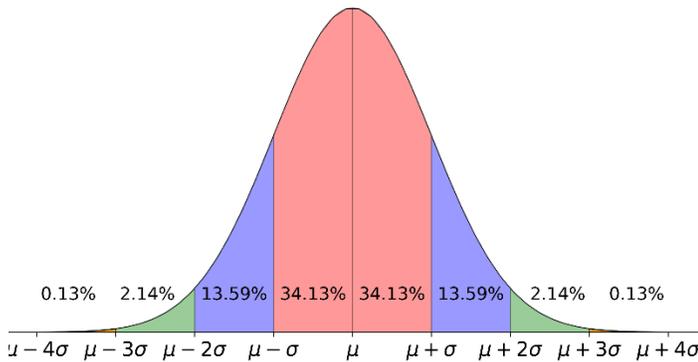
CEL-SCI Corp. [\\$CVM](#) We are at the end of a 9.5 year Phase 3 clinical trial of a cancer immunotherapy that is given before surgery, radiation and chemo have destroyed the immune system. The study took much longer because the required 298 deaths to end the study took longer to reach

7:09 AM · Jan 26, 2021 · Twitter for iPad

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Ultimately, it wasn't just Redditors and bored retail investors gunning at shorts this week. The retreat of long-short funds themselves contributed a great deal to the price action. By Tuesday, hedge funds were covering their shorts (driving the price up) and selling their longs to maintain a stable portfolio beta. This behavior is called "de-grossing," and it can turn into a feedback loop where losses turn into dramatic price movements. On Wednesday, the prime brokerage division of Goldman Sachs reported that funds recorded their sharpest single day de-grossing ever, including 2008, with a -10.9 standard deviation degrossing. In other words, if flows were distributed according to a normal distribution (they are not), Wednesday's move would be roughly half an inch off the left edge of this page.

The height of the histogram represents how frequently you would expect a given result to happen. Wednesday's short covering is 0.5 inches to the left of the arrow here. That's a very rare event.
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Anyhow, long story short: we survived this crisis. Despite considerable losses in our short book, the fund performed far better than last June, in spite of the market environment being far more hostile to our strategies.

Several things went well for us in January. The arbitrage book—stop me if you've heard this before—had a strong month, contributing 168 bps to performance; we made big money in three completely different kinds of arbitrage trades. Additionally, a single-factor quant trade that Caleb and Daniel first developed in 2019 worked well, adding 55 bps. Furthermore, our fundamental long book, aided by strength in smaller and less liquid stocks, gained 178 bps.

Our event-driven trading has been a huge focus the last two weeks. We added 71 bps on event-driven trades this month, and we've developed a new substrategy that is doing exceptionally well in the current market environment. I expect it to be a consistent contributor to return this year.

Our new quant, Sam, found a very underpriced index option contract, which gained 155% in less than a week as the market realized how cheap the implied volatility was and repriced it higher.

I continue to look tirelessly for underpriced options structures to express our trade ideas. There aren't always such structures available, of course, but if they are cheap and liquid, we will pursue them. We have more long options exposure as a percent of AUM than we have ever had in the history of our fund. Put spreads and butterflies enable us to try to profit from short ideas without risking massive losses from squeezes, and calls and call spreads enable us to try to capture some of the quick, incredibly sharp moves in this market. More complex option structures also allow us to take advantage of relative mispricing between different option strikes, or express an opinion on the change in volatility across the curve.

It perhaps feels odd to say after a significant down month, but having traded so intensely this month, I feel one with the market at the moment. Unlike last year, when my confidence was

shot, and I didn't have the conviction needed to take chances when my intuition said to, I'm feeling my oats a bit. I'm more attuned to sentiment and flow than I have been in months, and I've stopped missing the forest for the price-action trees. I'll even go out on a limb and make a bit of a market call: I think we're in the middle of a two- to three-week correction, and we've lowered our net exposure into the low 40s using attractively priced SPY and IWM put spreads as a result. After that correction is over, we'll likely look for ways to increase our net exposure, as although pockets of the market have been insane lately, and sentiment has gotten overstretched, it's doubtful that financial conditions can be this loose without it eventually bringing about a huge blow-off top. The chart at the end of this correction is likely to look like someone held a beach ball underwater and then let it go. It's not that "things are different this time"; they will likely end the same way that speculative booms always do; but, we probably aren't at the end yet. So long as liquidity flows into the system, stimulus continues, and consumer balance sheets remain strong; equities will likely continue to go up.

We've survived the last year largely on the strength of our arbitrage book (i.e. being good at math and knowing where to look for neglected opportunities). It's good to feel like we are starting to understand what the hell is going on in the big picture, too. If we can get both right at the same time, we are going to have a strong 2021.

One investor question which came up repeatedly this month is "Will current events change shorting forever?" I don't think so. There's quite a lot of dumb money flowing into certain corners of the market, and there will be for the foreseeable future. But the iron law of supply and demand ensures that large, continued flows of dumb money are eventually met with supply of new securities to buy: either a large shareholder sells, or a company itself sells more stock, or new companies in the same sector form and sell stock. This process takes time to play out, but à la Jean-Baptiste Say, "demand always creates its own supply." The de-grossing this week should be cleansing, at least for a little while; as funds have taken their shorts off, there are fewer stocks where short interest is egregiously stretched. With eye-wateringly high valuations at many companies, management teams will respond by selling stock as soon as they can file the SEC forms; some, such as AMC, already have. I doubt we'll see quite a "flow-pocalypse" into garbage equities at quite the pace we saw this week anytime again soon. But, as risk-aware short-sellers, we're going to be watching flows, and catalysts, very closely. This is not a market for "set it and forget it."

I doubt there will be serious negative legislative/regulatory change as the result of what happened this week, and there may be some small incremental positive changes. In a week full of hyperbolic takes, Senator Elizabeth Warren has had the most sober view of events, and she understands the importance of a well-regulated financial system better than most. It seems unlikely that the same misunderstandings (no, brokers did not change the rules in the middle of the game in order to help hedge funds) and populist fervor that has infected much of the discourse this week will be successful in infecting the minds of 60 Senators.

As always, thank you for your partnership!



Christopher M. Brown
Managing Member, Aristides Capital LLC

Aristides Funds January Performance Attribution

Strategy	# of positions	gain/loss (gross basis points)	alpha (gross basis points)
Arbitrage	29	+168	+186
Event Driven	49	+71	+82
Fixed Income	3	+1	+1
Fundamental Community Bank	11	+42	+52
Fundamental Other	70	+178	+207
Hedges, Beta Mgmt., and Macro	24	-31	-20
Traditional Quant	basket	-107	-105
Single Name Shorts	89	-651	-668

Top January Aristides Funds Winners & Losers (% represents gross % gain/loss as entirety of Funds)

Winners	Losers
+0.56% undisclosed arbitrage	-1.19% short CEL-SCI Corporation common stock; bearish options
+0.55% undisclosed single-factor quant strategy	-1.07% traditional long/short quant basket
+0.48% undisclosed arbitrage	-0.94% short undisclosed electric vehicle company; bearish options
+0.45% long ARC Document Solutions, Inc. common stock	-0.78% short undisclosed electric vehicle company; bearish options
+0.33% undisclosed cryptocurrency arbitrage	-0.75% short undisclosed consumer company; bearish options

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