State of Rhode Island
Office of the General Treasurer

Staff Recommendation: Ionic Volatility Arbitrage Fund IV LLC

October 2026
Asset Class: CPC – Long Volatility

Recommendation

- **Rhode Island Employees' Retirement System Pooled Trust (ERSRI):** Approve a $270m allocation (2.0%).

Allocation

Plan	Asset Allocation Approved June 2026	Current Allocation	Recommended Allocation
ERSRI	Long Volatility: 2.0% target	-	$270m (2.0%)

Portfolio Fit

Allocating to Ionic Volatility Arbitrage Fund IV LLC (the "Fund") accomplishes our 2026 priority to bolster the responsiveness of our CPC by introducing a long volatility allocation and reducing our allocation to long duration treasuries, aligning with recommendations from Meketa. Long volatility strategies provide greater portfolio protection in large equity market drawdowns, and provide a more reliable hedge than cash, gold, or long treasuries. The Fund will be established as a fund-of-one for ERSRI and will implement the same multi-asset long volatility strategy (the "Strategy") that Ionic has managed since 2014 on behalf of Ionic Volatility Arbitrage Master Fund II Ltd.

Firm and Strategy Overview

Ionic Capital Management LLC is a New York, NY based investment manager specializing in long volatility strategies. As of October 1, 2026, Ionic has 36 employees, including 17 investment professionals. Ionic manages $5.1bn in long volatility strategies, $3.3bn in equity overlays, and <$250m in other strategies (arbitrage, value equities, inflation protection).

The Strategy's investment objective is to deliver a return that is highly negatively correlated to equities, with potential for outsized returns in volatile markets and market crises (convexity), while limiting the cost of carry in calm or rising markets. The Strategy aims to return 50-100% when the S&P 500 is down 20-30% (a COVID-like event) and 100-200% when the S&P 500 is down 40-50% (a GFC-like event), with annual bleed targeted at roughly 12% on average in less volatile markets. The Strategy is intended to reduce the impact of equity market drawdowns and provide liquidity to redeploy into risk assets at attractive levels, improving overall portfolio performance.

The Strategy invests in medium-term options (6 months to 2 years) that will benefit from rising volatility. It "arbitrages" implied volatility (forward expectations) vs. realized volatility (actual): situations where future actual volatility is likely to be higher than implied by options prices today.

Merits

- **Multi-asset approach provides broader and cheaper protection than only investing in equity volatility.** The Strategy invests across interest rates, FX, equity, credit, and commodities markets, enabling it to purchase cheaper protection with higher payoff potential by comparing risk/reward across all major asset classes globally.
    - Asset allocation: 20-45% FX, 20-45% rates, and 0-25% each in commodities, credit and equity. Invests across 20-30 investment themes, which generally take 6-12 months to play out.
    - The Ionic team views equity volatility to be structurally expensive, due to persistent institutional demand for hedging purposes. Systematic volatility selling in other asset classes (for yield) creates cheaper options prices, which can create greater payoffs. In a large crisis, cross-asset correlations increase, generating higher returns for non-equity volatility, while in a smaller market decline, equity volatility is the best protection.
    - In 2022, the Strategy's multi-asset approach paid off with a 49% return, as it was able to capture interest rate volatility that was not captured by equity- and credit-only volatility strategies.

- **Experienced, aligned team with high continuity.** Founder and Portfolio Manager Dan Stone is one of the most experienced and well-respected long volatility managers, having run similar strategies at Highbridge Capital for 10 years, before founding Ionic 20 years ago. He is supported by a stable, senior team.
- **Ionic has delivered highly convex performance in equity market drawdowns, while reducing the cost of protection in recent years (post-COVID).** Track record demonstrates high convexity in crisis periods (+75% in January-mid March 2020 and +49% in 2022), creating opportunities to monetize gains and rebalance into risk assets when they are depressed. Splitting our 5% long duration treasury allocation into 3% long duration treasuries and 2% to the Strategy would have increased the returns of our CPC portfolio by 66bps annually since January 2019, driven by significantly higher returns during crisis periods of 2020 and 2022, without considering gains from rebalancing.
- **Robust investment process applied across assets:** Use systematic screening tools to identify statistically cheap volatility across assets, buying below long-term averages. Identify macroeconomic fundamentals that explain cheapness (non-economic sellers of volatility) and potential catalysts for mean reversion. Use historical and forward-looking risk scenarios to determine trade expression, and use delta hedging to reduce directionality of positions.
- **Monetization framework in place to take profits.** Begin to monetize a position when the volatility approaches its long-term average, often closing the position out in tranches if it continues moving higher. If a volatility event is more idiosyncratic rather than a broad-based macro event, monetization bands will be wider to take advantage of the volatility expansion.

Key Considerations

- **Volatile performance, with large drawdowns suffered in 2017 and 2019:** Drawdowns of 30-35% in 2017 and 2019, when volatility was artificially suppressed due to Fed's QE policies. The Strategy's high vega exposure at the time—reflecting significant sensitivity to implied volatility—contributed to these declines.
    - **Mitigant:** Post-COVID, the Strategy reduced the magnitude of potential drawdowns during benign market environments, while still preserving upside convexity, by lowering its vega (implied volatility) exposure. For example, a drawdown that might have reached 30% in the past would now be reduced to 18%. The Strategy moved from longer dated to shorter dated options, reducing vega sensitivity by 30-50% (shorter dated options have less time to expiry, and are therefore less sensitive to vega). This adjustment increased the Strategy's convexity and made it more responsive to realized volatility (actual market moves) in a crisis than implied volatility, but also increased theta (option decay or "bleed") of the Strategy.
- **Investor concentration – 74% of AUM from one sovereign wealth fund (71% pro forma for ERSRI investment):**
    - **Mitigant:** The Ionic team maintains a very positive 16-year relationship with the sovereign wealth fund. Despite an incoming new CIO (and recent exit of its CEO), the sovereign wealth fund's team describes their relationship with Ionic as integral to their defensive strategies and TPA approach, with full support from their hedge fund, strategy, and treasury teams as well as their board. Ionic brings them co-investment opportunities, and the teams speak monthly, visit each other quarterly.
- **Requires active ERSRI monetization and rebalancing plan to achieve best results:** To improve total plan returns, we should seek to monetize gains generated by this Strategy during stressed periods and redeploy into risk assets at depressed prices. During calm periods the Strategy will lose money when equity markets rise, requiring us to rebuild the allocation towards target levels to maintain protection for when market stress returns.
    - **Mitigant:** The Fund features monthly liquidity with 15 days notice, plus a performance liquidity trigger: clients can redeem 100% of net month-to-date ("MTD") gains when MTD net performance is >15%, within 2 days.
    - **Mitigant:** Together with Meketa, we established rebalancing guidelines that strike a balance between rebalancing benefits and the operational burden of frequent rebalancing decisions. These guidelines will be utilized in our existing rebalancing process.

Fees and GP Investment

Management fee is 1.5% and performance fee is 15% over the high-water mark. Ionic personnel have >$40m invested in volatility strategies and >$90m in all strategies.