Lessons from the Situational Awareness Collapse

The Thinking Man

August 3rd, 2026 | Series #119

Leopold Aschenbrenner's Situational Awareness hedge fund, which peaked near $45 billion and delivered returns north of 1,000% since inception, unwound within days in late July 2026 after a sharp AI stock selloff triggered margin calls. The fund was forced into a fire sale of public equities, and Ken Griffin's Citadel stepped in as the buyer. The episode is a modern case study in how leverage, concentration, and market structure conflicts of interest can turn a correct investment thesis into a catastrophic loss, even for a fund widely hailed as prescient.

BigSur does not invest in hedge funds, and we are not in the business of market speculation. We prioritize capital preservation and risk-adjusted returns, with little to no leverage. Still, this story offers a useful lens on how we think about risk, and the lessons are worth walking through.

Leverage Risk: Being Right Isn't Enough

Situational Awareness borrowed $3 to $4 for every $1 of capital, well above typical leverage for volatile stocks like semiconductors, and layered options on top to further amplify returns. This worked spectacularly on the way up: the fund gained roughly 270% after fees through May 2026 and 439% through June, and was up more than 1,000% since inception at its peak.

But leverage is symmetric. When the semiconductor ETF fell 27% between June 30 and July 29 while software stocks rose (the fund was long semiconductors and short software, so it was on the wrong side of both trades), the same borrowed money that fueled the gains generated devastating losses. Banks including Goldman Sachs, JPMorgan, Citigroup, and Bank of America issued margin calls demanding additional collateral.

Aschenbrenner himself had anticipated this exact risk in a 2024 podcast interview, saying that not blowing up is task number one and two. Yet the fund still blew up. The lesson for younger investors: a fund can be fundamentally correct on its thesis and still be wiped out on timing and financing structure, because leverage of 3:1 or 4:1 turns modest price swings into fund threatening losses.

At BigSur Partners, we tend to run at zero leverage with most clients, and very low leverage with a few. We see leverage as a tool for portfolio flexibility, for example to fund capital calls for illiquid investments when markets are down and we don't want to force liquidity, or to increase equity exposure during periods of a significant drawdown. Even then, it rarely exceeds 10% to a maximum of 20% of a portfolio. That is a very different posture from 300% to 400%, which is gambling, not capital preservation. As the saying goes, markets can remain irrational longer than you can remain solvent.

Concentration Risk: One Sided, Timing Exposed Bets

Situational's strategy was essentially a single concentrated wager: long AI hardware and infrastructure stocks (chips, energy, semiconductors) against short positions in software names viewed as AI "losers." This structure meant the fund was heavily exposed to a single macro rotation. When sentiment shifted in mid-July on fears that cheaper, open-source Chinese AI models were eroding value in the AI hardware supply chain, both legs of the trade moved against the fund at the same time. Chips sold off while software rallied.

Because the fund was so concentrated and so closely watched (its regulatory filings were dissected in detail by a large online following), rival hedge funds and traders were able to identify its likely holdings and place short bets directly against them, intensifying the squeeze as Aschenbrenner was forced to sell. This shows how concentration risk compounds with visibility: a fund whose positioning is public or easily inferred becomes a target for the broader prime brokerage and hedge fund community once it shows signs of distress.

At BigSur Partners, we build customized but always well-diversified portfolios. We will take some concentration risk on specific ideas, whether venture capital or something as volatile as Bitcoin, but we size those positions carefully. If that investment were to go to zero, a client would still be cushioned and protected: big enough to make a meaningful impact if our thesis plays out, but small enough to protect the portfolio if it doesn't. That is a fundamentally different posture from Situational, where leverage meant well over 100% of the portfolio was effectively at risk.

Options Risk: Amplification vs. Hedging

Situational used options to amplify its directional bets rather than to manage risk, which meant even small declines in individual names had outsized effects on the portfolio. This stands in contrast to more conservative institutional practice, where options are typically used defensively, for example protective puts to cap downside or covered calls to generate income against existing positions. The Situational case underscores that the same instrument can either dampen or dramatically magnify volatility depending on how it is deployed. A strategy that uses derivatives purely for leverage removes the very buffer that protective options are designed to provide.

At BigSur Partners, we use options actively for two reasons: hedging (buying protective puts or put spreads) and buy write strategies (to generate income while taking advantage of volatility). We do not speculate with options. They function as insurance policies against market downside, or as an income generator where we know our downside and our return going in. They are not used to amplify risk against us.

Investment Culture: The Manifesto and the Cult of Personality

Aschenbrenner built Situational's mystique on his viral 165-page essay, "Situational Awareness: The Decade Ahead," written after he was fired from OpenAI, which proclaimed that only a small circle of people, himself among them, truly understood where AI was heading. That manifesto helped him raise capital from a roster of prominent backers, including Stripe co-founders Patrick and John Collison, senior AI executives at Meta, and the quant trading firm Jane Street, which rarely allocates money to outside managers. Podcaster Tim Ferriss called him the "Nostradamus of AI," and his firm's routine SEC filings were reportedly followed like scripture by an online following.

This cult-like credibility helped attract minimum checks of $25 million and multi-year lockups. But it also meant capital flowed in based on narrative and charisma as much as on risk-adjusted underwriting, a dynamic that becomes dangerous when the underlying strategy is highly leveraged and concentrated.

At BigSur, our investment philosophy focuses on asset class, industry, and geographic diversification. Track record matters a great deal to us. We understand that some market segments or industries are new and at the frontier, but it is important to let market cycles play out and to see how a strategy performs across different environments. A very young manager with limited market experience may be brilliant, but experience and humility still matter. Not all that glitters is gold.

The Winners & Losers

Institutional capital chasing a risky strategy. Sophisticated allocators like Jane Street were drawn into a strategy that, in hindsight, combined extreme leverage with concentrated, one directional exposure. It's a reminder that even smart institutional investors can be attracted to a manager's track record and narrative without fully pricing the tail risk embedded in the position sizing.

Prime brokers as beneficiaries. Situational was reportedly one of the largest trading clients for its prime brokers, having signed up Goldman Sachs, JPMorgan, Citigroup, and Bank of America to finance and execute its trades. It was actively soliciting even more financing from additional banks earlier in 2026 to expand its buying power. These banks generated substantial fees financing the fund's leverage on the way up, and then were the ones issuing the margin calls that forced the liquidation on the way down, illustrating how prime brokers can profit from both the buildup and the unwind of client leverage.

Citadel as the buyer of last resort. Citadel has a long history of acquiring distressed hedge fund books at fire sale prices, having done so with Amaranth Advisors and Sowood Capital nearly two decades ago. It is worth noting this is a pattern for Ken Griffin: he is also known for having built out Citadel's energy trading team by capitalizing on talent and opportunity following Enron's collapse, another example of the firm growing by taking advantage of others' blowups. In this case, Citadel executives reached out to Aschenbrenner proactively once they became aware of his distress, and after an overnight bidding process that also involved Izzy Englander's Millennium, struck a deal just before Thursday's market open to buy the vast majority of Situational's public stock portfolio at a discount of more than 10% to market value. Many of the acquired semiconductor and AI shares rallied that same Thursday, turning the purchase into an immediate, outsized gain for Griffin's firm.

Conclusion

The lesson of Situational Awareness is ultimately about discipline, not just being right on market direction. In many ways, it is a modern Icarus story: a manager who flew brilliantly on the way up, only to get too close to the sun as leverage, concentration, and conviction compounded on one another.

It underscores the importance of diversification, the risks of crowding into a narrative, and the cost of failing to recognize when a differentiated thesis has become consensus. Above all, it is a reminder that preserving capital matters more than being right—because even a correct macro view can be undone by poor structure, sizing, or timing. Judgment, not just intelligence, is what endures.

Contributors

Ignacio Pakciarz

Co-Founder & CEO

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BigSur Wealth Management, LLC
1441 Brickell Avenue, Suite 1450
Miami, FL 33131
Office (Main): 305-740-6777
Fax: 305-350-9998
http://www.bigsurpartners.com