

The Damped Spring Report

“Shifts in growth, inflation, risk premium and positioning all lead to opportunities in markets”

4/20/2020

Take advantage of a short term oil storage problem and go to max risk.

Recommendations

We are doubling the size of our recommendations made on 4/13/20. Please read below the reprint of the 4/13/2020 report for the rationale. At this stage our recommendations will have a max loss of approximately 6% of the AUM of the fund. The recommendations are long options only.

- Long call spreads on SPX - Sept 2800/3000 Calls
- Long put spreads on FV – Sept 124/122 Puts
- Long call spreads on Gold – Sept 1750/1850 Calls

Why?

We mentioned on 4/13/20 that we wanted to go to max risk on our view yet recognized that markets were volatile and subject to noise. Today the noise of the crisis in world oil storage for the front delivery month is hitting stocks and gold and rallying bonds. We simply look at market expectations for oil delivery reflected in the oil forward curve and believe that this noise is an opportunity.



In one month OPEC+ has agreed to limit production and the glut has caused a short term crisis. Notice that today's prices are higher across the entire curve except for the soon to be delivered futures contracts. Even July is higher month over month.

The storage crisis is a real thing. Longs in the front contracts are obviously screwed. Perhaps the storage crisis will last a few more contracts. Nonetheless for purposes of evaluating high yield credit and energy companies the front months are useless and conditions for all those assets have improved markedly in the last month.

So that's the rationale for doubling today. We will leave you with a teaser regarding our next larger scale report. We bet no analyst your read has suggested that SPX earnings could go to zero for two years. Are we right?



If you believe in P/E valuation then equities should be way lower given a forward earnings outlook of zero! However, if you believe that equities are simply a discounted cash flow of all future earnings AND you believe this incredibly bearish projection. Stocks should be only down 9% from pre covid voluntary shutdown, about 3100 on SPX. DCF you say? That depends on the discount rate. Well the risk free rate has fallen a ton. The risk premium expanded massively as volatility picked up and portfolio deleveraging took over. But volatility is dropping and the Money Tsunami is making cash finally trash. We will explore in the next issue the DCF approach. Spoiler alert. An incredibly conservative zero earnings period of two years with multiple forces impacting the discount rate both positively and negatively we are super bullish stocks.

Assumed Portfolio size	100,000,000						
LTD P/L	11,828,846						
Total Return	11.83%						
Today's Date	4/20/2020			Portfolio Created	4/15/2019		
Date	Position	Entry Price	Amount	Worst case loss	MTM	P/L	Open/Closed
4/13/2020	SPX Sept 2800/3000 call spread	104	96	1,000,000	111	67,308	Open
4/13/2020	GCU Sept 1750/1850 Call Spread	34	294	1,000,000	29	(147,059)	Open
4/13/2020	FV Sept 124/122 Put Spread	0.296875	3368	1,000,000	0.234375	(210,526)	Open
4/13/2020	SPX Sept 2800/3000 call spread	111	90	1,000,000	111	-	New
4/13/2020	GCU Sept 1750/1850 Call Spread	29	345	1,000,000	29	-	New
4/13/2020	FV Sept 124/122 Put Spread	0.234375	4267	1,000,000	0.234375	-	New

4/13/2020

A Money Tsunami far bigger than any expectations has crashed into the negative wave of the Covid19 virus just as the virus peaks.

We predict that the Money Tsunami is too strong and will leave in its path, as demand spikes and supply recovers more slowly, at least a short term inflationary spike. Assets are not prepared for the aftermath of the Money Tsunami

We certainly respect the notion that the return to normal will be extremely difficult and that the virus may spike again. Also, we recognize that all of us are flying blind somewhat. Nonetheless the Fiscal and Monetary response has been truly awesome. The US Fed is directly supporting all assets except stocks. As the Fed buys these assets, sellers with cash will look to reinvest in the equity market, invest in the real economy or consume. This flow will result in asset price inflation and possible price inflation in the real economy. Given the fragility of any recovery and the on-going presence of the virus, we predict the Fed will not remove its foot from the gas. December 2018 went poorly for the Fed and that's when the economy had few exogenous forces at play. We are not calling for a massive move in inflation expectations but expect an inflation scare to occur in 2020.



Prediction

- **In 2020 This chart will print above 2%**

For this reason, Damped Spring Advisors is now bearish bonds. Furthermore, despite significant earnings uncertainty we expect the contraction in risk premiums/expansion in multiples driven by excess money will result in a continued rally in the equity market. Lastly, we are bullish gold due to the potential that monetary stimulus has gone too far. We believe that the steps that were taken by policy makers were appropriate but are confident that getting it just right is

incredibly difficult in these uncertain times and too hot is preferable than too cold. Blazing hot is what we may have gotten.

Bonds do have some positive tailwind as they will be supported in price by purchasing and printing by the Fed and by growth that will take time to recover to pre-virus levels of GDP, but will be seriously impacted by an inflation scare and by Fiscal policy related supply.

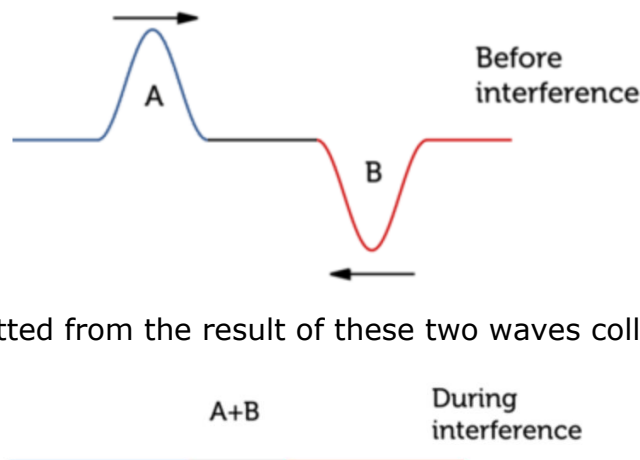
In March, the Damped Spring Portfolio was positioned based on our major post Covid predictions.

- The SPX has made its high and low for the year.
- The 10 Year note yield has made its low and high for the year.
- Gold has made its low and high for the year.
- Given the extraordinary level of implied volatility present in markets, options strategies that benefit from the 2020 ranges already having been set are extremely attractive.

We recommended to clients to be short OTM put spreads and OTM call spreads on all assets. This took advantage of our view that markets had established the range for the year.

We placed 10 separate bets in March. 9 out of 10 have been successful either decaying almost completely or expiring. One, short call spreads on gold, is ITM now.

We had this view because of spotting the Money Tsunami well offshore.



Our portfolio benefitted from the result of these two waves colliding

However, for the next few months the first wave of the virus will likely ebb, while the Tsunami which was bigger than anyone could reasonably have expected roars on. Hopefully we will not have a meaningful reoccurrence of virus cases but that may be too much to expect. It will take time for the real economy to reopen. It will take time for the virus to comeback if that unfortunate outcome occurs.

We think Equities will not test the high end of the 2020 range but expect significant upside from current levels. Gold however is likely to make new all-time highs. If we are correct regarding an inflation scare in 2020 where 5yr/5yr inflation expectations hit 2%, bonds will get near the 2020 high yield.

Current Model Portfolio performance and Recommendations

Our model portfolio is now 1 year old and has generated 12.12% Total Return since inception.

As we expect this increasingly unopposed Money Tsunami to have a large impact on market prices, we are today suggesting unwinding all positions and adding.

- Long call spreads on SPX - Sept 2800/3000 Calls
- Long put spreads on FV – Sept 124/122 Puts
- Long call spreads on Gold – Sept 1750/1850 Calls

Given the move in pricing since our last report we are not yet at max risk in any of our recommendations but on any opportunity to enter any of these positions at more attractive levels we will be going to Max risk.

Assumed Portfolio size	100,000,000						
LTD P/L	12,119,123						
Total Return	12.12%						
Today's Date	4/13/2020	Portfolio Created	4/15/2019				
Date	Position	Entry Price	Amount	Worst case loss	MTM	P/L	Open/Closed
2/26/2020	TY Apr 132.5/133.5 Call Spread	0.484375	-1939	1,000,000	1	(1,000,000)	Expired
1/15/2020	GBP 131/129 Put Spread 4/15/20209	0.5	(66,666,667)	1,000,000	2	(1,000,000)	Closed
3/10/2020	SPX April 2500/2400 Put Spread	25.5	-67	500,000	6.3	128,859	Closed
3/10/2020	SPX April 2900/3000 Call Spread	44	-134	750,000	7.3	491,518	Closed
2/26/2020	GCI April 1625/1575 Put Spread	13.7	-275	1,000,000	0	377,410	Expired
3/10/2020	GCI April 1700/1750 Call Spread	8	-119	500,000	0	95,238	Expired
3/10/2020	TY June 136/135 Put Spread	0.390625	-821	500,000	0.0625	269,231	Closed
3/10/2020	TY June 140/141 Call Spread	0.390625	-821	500,000	0.03125	294,872	Closed
3/16/2020	SPX April 2500/2400 Put Spread	43	-88	500,000	6.3	321,930	Closed
3/16/2020	GCI April 1500/1450 Put Spread	20	-333	1,000,000	0	666,667	Expired
3/16/2020	GCI May 1650/1700 Call Spread	14	-278	1,000,000	24.1	(280,556)	Closed
3/16/2020	TY June 140/141 Call Spread	0.203125	-627	500,000	0.0625	88,235	Closed
3/16/2020	TY June 136/135 Put Spread	0.4375	-889	500,000	0.03125	361,111	Closed
3/10/2020	SPX Sept 2800/3000 call spread	104	96	1,000,000	104	-	New
3/16/2020	GCU Sept 1750/1850 Call Spread	34	294	1,000,000	34	-	New
3/16/2020	FV Sept 124/122 Put Spread	0.296875	3368	1,000,000	0.296875	-	New