The Damped Spring Report

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

7/10/2020 The summer equity market top is in. The market will need to test the Fed to trade higher

We have been wildly bullish since the bottom of the global equity markets. In our last report we pounded the table. The SPX rallied 100 points, The NDX rallied over 7%. Our view was that the market had finally grasped the importance of the Money Tsunami and would run ahead of the enormous wave.

Today we suggest taking profits on longs and adding a ½ max risk short in SPX. The rally in equities seems extreme in worrisome ways that indicate to us that markets have gotten too far ahead of the wave and are due to pullback. Timing a liquidity provided bubble deflation is dicey stuff but given our entire success in calling markets both pre and post Covid have been tied most often to this factor we press on and make this call.

Specifically, we are no longer bullish equities because we believe the liquidity wave will ebb out at sea if the economy and market continue hot. Hints of liquidity pullbacks include, fed comments on corporate bond buying, and the stalling of fiscal plans for another stimulus despite blown local and state budgets and cliffs ending on unemployment benefits, personal stimulus checks and PPP payments.

The market can go higher, of course, if both types of stimulus show up as expected and soon. But, more likely, the fiscal and monetary policy will only respond to weakness, instead of wade in, when markets are buoyant, and the economy is improving. We expect a relatively sharp correction led by stocks most sensitive to monetary policy driving the SPX through the most recent support of 3000. We do however expect the fiscal and monetary policymakers respond promptly after the correction. Our overall thesis remains in place, but we STRONGLY believe the next moves in the markets and the economy will put policymakers to the test.

Stepping back and examining the overall global economy and conditions we recognize:

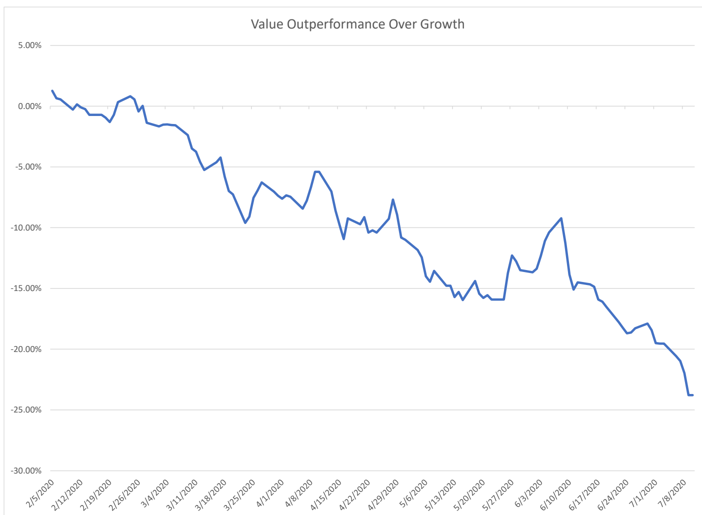
- All central banks are willing and largely able to buy unprecedented types and amounts of assets.
- Economic growth will be upward trending from a low level with moderate noise generated by Covid twists and turns on the way to a vaccine, and political machinations.

- Inflation remains subdued due to long term deflationary forces yet short-term spikes may show up as supply and demand recover at different rates

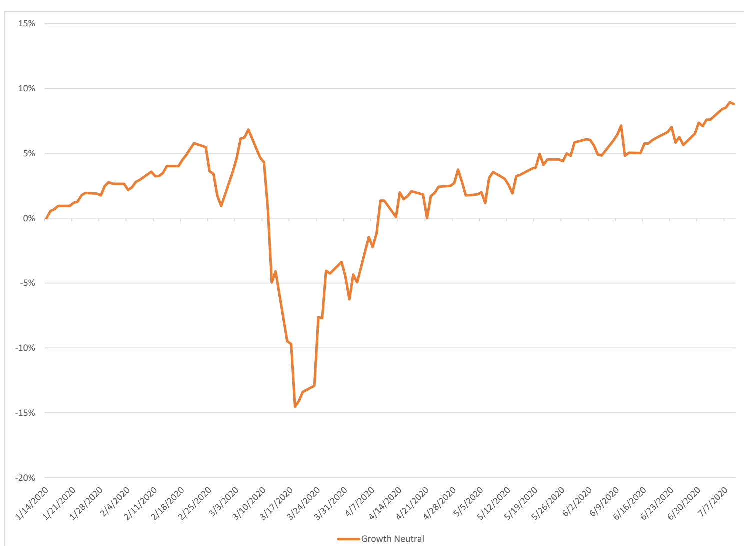
Long term this is very bullish equities and gold, and moderately bearish bonds. Nonetheless, worrisome price behavior and asymmetric central banks risk suggests a short-term deflation of the liquidity bubble.

There are many metrics for observing risk premium contraction. Our favorites all have gone somewhat parabolic of late in a way we believe to be unsustainable without further direct liquidity injections

Growth stocks are more sensitive to risk premium shifts while Value stocks are more sensitive to short term earnings shifts. Growth stocks outperformed parabolically since we pounded the table.



The growth neutral portfolio jumped to new highs, consistent with risk premium contraction.



And Gold “broke out.”

Perhaps those buying all these pro liquidity assets at current price are correct and the known wave will hit markets soon reinforced with unknown and large additional waves of fiscal and monetary stimulus. But to these investors finally getting around to this reality we say “Yours”

A short-term deflation of the liquidity bubble does not need a catalyst. However, we see much better chances of a catalyst for deflation of the bubble versus catalysts for further inflation of the bubble.

Current market pricing appears to place high odds on a stimulus bill before July 31, low odds of any central bank rhetoric that pulls back on liquidity, high odds that bad earnings will be ignored, and low odds that Sports, Schools, and State reopenings fail to materialize. Those all seem like potential candidates for a catalyst to deflate the bubble if the market is on the wrong side of any or all those bets.

Current Model Portfolio performance and Recommendations

Yesterday we sent a note closing our long SPX call spread and today we add a small long put spread

Assumed Portfolio size	100,000,000		
LTD P/L	11,514,798		
Total Return	11.51%		
Today's Date	7/10/2020	Portfolio Created	4/15/2019

Date	Position	Entry Price	Amount	Worst case loss	MTM	P/L	Open/Closed
5/18/2020	FV Sept 124/122 Put Spread	0.296875	3368	1,000,000	0.08	(730,526)	Open
5/18/2020	FV Sept 124/122 Put Spread	0.234375	4267	1,000,000	0.08	(658,667)	Open
5/14/2020	US Sept 175/170 Put Spread	1.015625	985	1,000,000	0.90625	(107,692)	Open
5/14/2020	US Sept 175/170 Put Spread	1.203125	831	1,000,000	0.90625	(246,753)	Open
7/10/2020	SPX Sept 3000/2700 Put Spread	62	161	1,000,000	62	-	Open
4/13/2020	SPX Sept 3050/3250 call spread	100	200	2,000,000	139	780,000	Closed