Inflation Growth

The Damped Spring Report

A synthesis of market drivers

Flow Risk Premium

6/12/2019

Later today the Fed will release its June statement and Chairman Powell will have a press conference. The statement and press conference will be decidedly dovish. The words will not be enough to turn the global economy back toward above trend growth. As we have said for a long time, and certainly in print since our recent founding, the global central banks are likely unable to stimulate adequately to avoid a prolonged slowing in the global economy. In the last week Chairman Powell's counterparts around the globe have continued to remain quite dovish with both Japan and China speaking of willingness and ability to ease if necessary. The ECB indicated no change to the policy rate until at least the summer of 2020. China has significant ammunition to ease but also must operate in the context of an increasingly bitter trade war. Ability? Yes, Willingness? It's complicated. The BOJ and the ECB seem willing, but they are absolutely unable to ease. The world waits for the US Fed bail out the global economy. That's a heavy lift. We suspect even significant rate cuts in 2019 will be inadequate stimulus.

Over the past 8 weeks long term global yields have fallen sharply. US 10-year rates fell 50bp bouncing just below 2.1%. We expected significant drops in growth expectations and risk premium contraction due to residual effects of the January Fed pivot and further dovishness. However, we were surprised by the fall in inflation expectations given the strong labor market and slowing but strong US economy. Equities are exactly where they were eight weeks ago which makes sense as falling growth expectation's bearish forces were offset by lower inflation expectations and contracting risk premiums. The US dollar was weak. The market is beginning to price in our second half of 2019 prediction of meaningfully weak dollar as the Fed attempts to lift the global burden and eases where others cannot or won't.

We expect the dovishness from the Fed's comments to be in line with what is currently extremely dovish expectations. However, we are confident that exceeding expectations given short rate levels is unlikely. For that reason, we expect most likely an asymmetric market reaction. If the Fed is dovish but **not enough** all long-term assets will struggle as risk premiums expand from quite tight levels. The dollar will strengthen temporarily. If more likely the Fed gets it just right market pricing still needs to fully discount falling growth expectations around the globe and a significantly weaker dollar which further Fed actions will deliver.

The Damped Spring Model portfolio has low absolute risk at this moment. We remain bullish the USD vs Gold and EUR and bearish European equities relative to US equities. Our view on long term bonds remains bullish but given pricing and the likelihood that offside short gamma investors have hedged to neutral over the last few days the market is likely to churn until news supports the already heavily discounted inflation expectations.

The balance of today's report will outline the investment approach we use in the Damped Spring Model Portfolio.

Damped Spring Model Portfolio Investment Approach

The goals of the publishing of the DSMP are:

- Generate uncorrelated Alpha with low drawdown
- Concretely relate the words and charts of the Damped Spring Report to real life trades
- Provide a way for our readers to hold firmly accountable for the success or failure of our recommendations

The DSMP positions developed markets in:

- Rates
- Currencies including gold
- Equity Index
- Crude Oil

The Risk management of the portfolio is structured around a maximum drawdown limit of the portfolio at any one moment no greater than 10%. At any one moment we have between zero and ten positions. None of those positions has a max drawdown of greater than 2% and a standard position has a 1% max drawdown.

We know our max drawdown because we express our views using:

- short 1x1 options spreads
- long options
- long 1x1 options spreads

We also limit ourselves to positions that have no carry and do not assume any inter-publication dynamic hedging.

We believe that a good portfolio can and should balance

- Transactions costs
- Liquidity
- Simplicity

We feel this sort of portfolio achieves these goals as of today the portfolio is up 4.53% since inception two months ago.

Current Model Portfolio performance and recommendations

	Assumed Portfolio size	100,000,000					
	LTD P/L	4,534,133					
	Total Returm	4.53%					
	Today's Date	6/12/2019		Portfolio Created		4/15/2019
Date	Position	Entry Price	Amount	Worst case loss	MTM	P/L
5/14/2019	SPX July 2800/2750 Put Spread	14	-278	1,000,000	9	138,889
5/14/2019	SX5E Sept 3200/3100 Put Spread	24	4167	1,000,000	16.5	(312,500)
5/14/2019	GCZ9 Dec 1325/1275 Put Spread	24.7	-395	1,000,000	20.7	158,103
5/14/2019	EURUSD Year end 1.15/1.2 Call spread	1.19	84,033,613	1,000,000	1.275	71,429