

The Damped Spring Report

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

11/04/2020 A brief note on the implications of the election so far

This morning the outcome of the Presidential Election remains unknown. The odds slightly favor Biden, but the outcome will have to wait until possibly as late as Friday. However certain things are known:

- Senate is likely to remain in Republican control
- House is certain to remain in Democratic control

The implication of this likely divided government is fairly straight forward and given that in either Presidential outcome the actual legislative agenda will be similar. A Democratic sweep would have delivered some impactful policy shifts which would have had a short- and long-term implication on markets. Because that is likely off the table certain policy shifts can now be discounted.

- No shift in Capital gain tax
- No meaningful increase in corporate taxes
- Smaller than expectation stimulus and directed less to consumption

We are not experts about the election and of course we could be surprised and have a Biden Presidency AND a Senate flip. But markets are beginning to discount gridlock.

If we are right.

- Growth expectations will fall due to lower stimulus
- Volatility will fall due a less wide range of policy outcomes
- Supply of Government debt will still be huge but less so due to lower stimulus
- Those who receive stimulus payments will save more as less gets directed to consumption

The impact on markets of these outcomes are

- Stocks will rally as lower growth is more than offset by lower portfolio volatility, less issuance and more savings which will improve the financing gap, no increase in corporate tax rates which is worth 350 SPX points

- Stocks with significant gains in 2020 will benefit the most for the same reasons as above plus NO short-term selling pressure due to tax gain harvesting ahead of Cap gains increase.
- Bonds will benefit from falling growth expectations, lower portfolio volatility and better financing gap. We are short upside call spreads on the long bond futures and are comfortable with that position but may cover if the blue sweep truly is off the table particularly in a Trump victory
- USD will improve due to improvement in financing gap and lower volatility. We will add to our short USD long YEN and EUR if the USD strengthens meaningfully as we remain bearish USD as that will be a meaningful transmission mechanism for the financing gap which will be less but still huge

Perhaps we are premature in calling the Senate. As many of the moves that we suggest will continue have started already it is clear that very short term a shift back toward Blue Sweep will quickly reverse these odds and shift much of the above. Stay tuned.

Current Model Portfolio performance and Recommendations

| Assumed Portfolio size | 100,000,000 | | | | | | |
|------------------------|--------------------------------------|-------------|-------------------|-----------------|------|-----------|-------------|
| LTD P/L | 14,031,684 | | | | | | |
| Total Return | 14.03% | | | | | | |
| Today's Date | 11/2/2020 | | Portfolio Created | 4/15/2019 | | | |
| Date | Position | Entry Price | Amount | Worst case loss | MTM | P/L | Open/Closed |
| 9/24/2020 | G CZ Dec 1850/1750 Put Spread | 27 | 370 | 1,000,000 | 24 | (111,111) | Open |
| 9/24/2020 | SPX 3200/3000 Dec Put Spread | 65 | 154 | 1,000,000 | 60 | (76,923) | Closed |
| 9/24/2020 | 10 Year B/E swap \$50k per bp | 1.65 | -50 | 1,000,000 | 1.7 | (250,000) | Open |
| 9/30/2020 | USA Dec 176/178 Call Spread | 0.953125 | -955 | 1,000,000 | 0.5 | 432,836 | Open |
| 9/30/2020 | SPX 3200/3000 Dec Put Spread | 45 | 222 | 1,000,000 | 53.5 | 188,889 | Closed |
| 10/15/2020 | USA Dec 176/178 Call Spread | 0.984375 | -985 | 1,000,000 | 0.5 | 476,923 | Open |
| 10/28/2020 | USDJPY Year End 103/100 Put Spread | 0.64 | 156,250,000 | 1,000,000 | 0.64 | - | New |
| 10/28/2020 | EURUSD Year end 1.18/1.21 Call sprea | 0.78 | 128,205,128 | 1,000,000 | 0.63 | (192,308) | New |
| 9/30/2020 | SPX Year End 3600/3800 Call Spread | 19.5 | 256 | 500,000 | 19.5 | - | New |