The Damped Spring Report

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

11/17/2020 When Fed Chair Powell used the term "lower" describing possible options for QE purchases on September 16, we got bearish on all assets. At the time we believe he was serious about a potential taper. We no longer believe that a taper is possible.

Our strongest belief since 9/16 that a taper was likely for 2021 as the Fed needed to be prepared for another crisis. Retaining some balance sheet growth capacity was the only tool they had left. Unfortunately, the crisis may have arrived already as the spike in Covid cases may slow the economy. We now believe the Fed will need to navigate a highly unusual path for policy. They will need to show incredible skill to deal with

- The current slowing of the economy
- The sizable issuance from stimulus
- The time it takes for the stimulus to generate economic activity to offset the slowdown

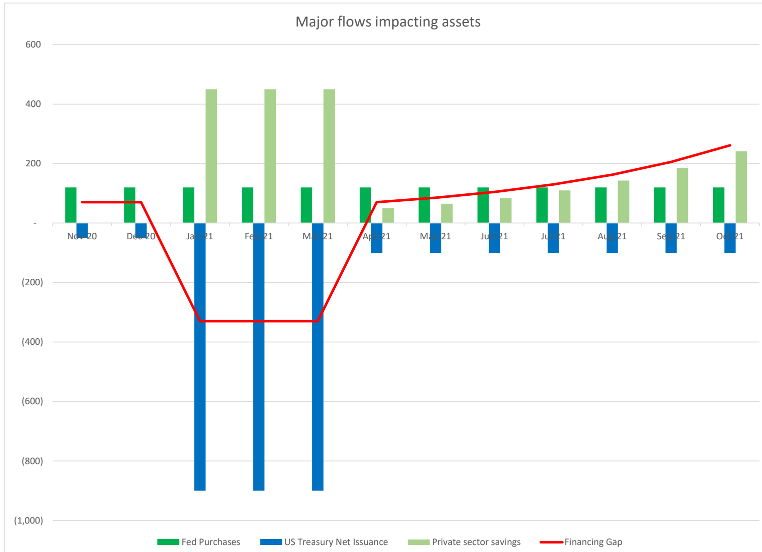
Conscious that

- Asset inflation and possibly price inflation will develop, as the economic activity generates wages and profits and ultimately savings and investments which add to the stimulus generated savings
- The economic impact of the vaccine will generate potentially surprising mismatches in supply and demand of goods, services, and labor and asset prices

We have shown our pre vaccine and post vaccine outlook for large money flows, and we now believe that the rise in Covid cases requires the Fed to smooth the financing gap further

Pre vaccine/Pre rise in infections we expected

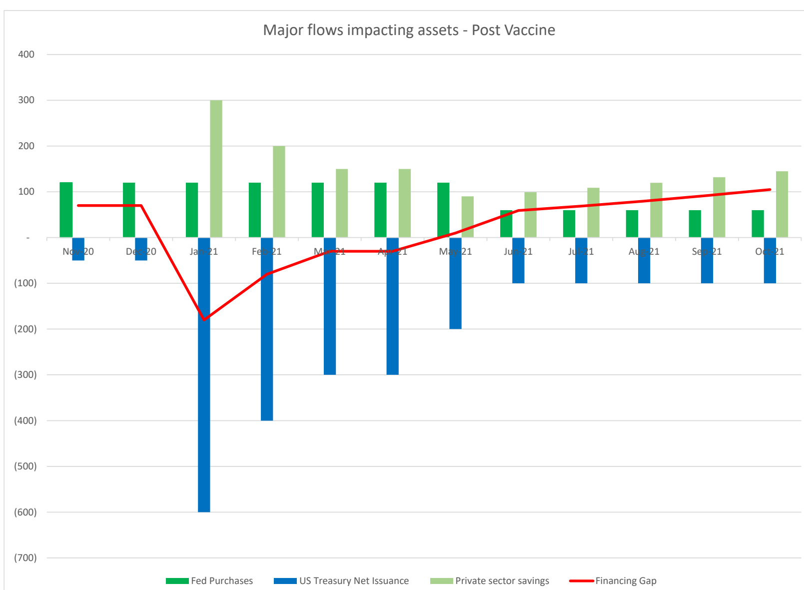
- A huge stimulus
- No further increase in QE
- Resulting in significant pressure on assets in Q1.
- We were in for a bumpy road



Since the election, vaccine news and before the parabolic increase in Covid cases and deaths we revised our view assuming

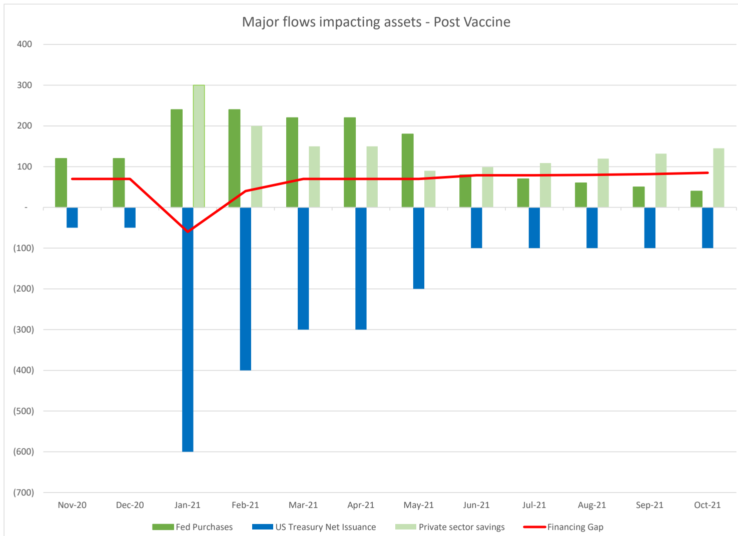
- Smaller and more spread out stimulus
- QE Tapering as the vaccine became available

We became short term bullish on assets and no longer were as concerned about the pressure on asset prices in Q1. Smoother road.



As a thought experiment this framework allows us to back into an "optimized" Fed policy. It is certainly a limited experiment and is most likely wrong in detail but worth considering as this is a unique environment. Consensus seems to be that the balance of Q4 and all Q1 will see an economic environment of struggling growth. Then as the vaccine is delivered a ramping of growth to a level that will well surpass economic activity in 2019. If you had the difficult job of the Fed perhaps you would think differently about the need for accommodation.

What if you solved for a further smoothing of the major flows of money and credit during this pandemic and its aftermath.



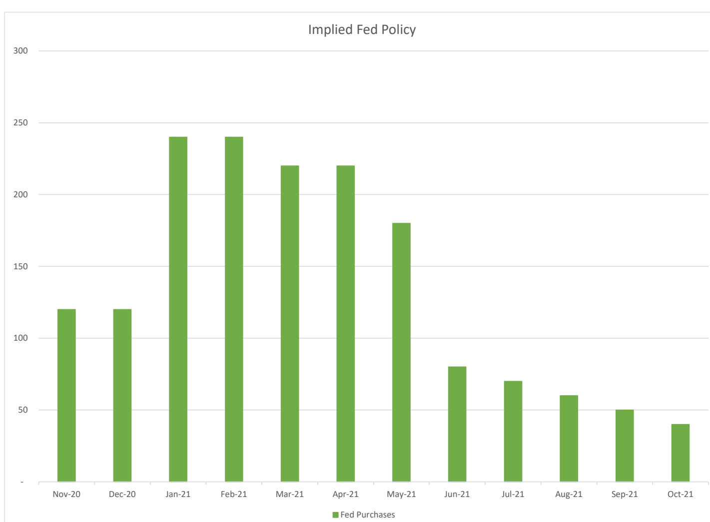
Pro’s

- Nice and smooth, good for asset prices, and asset price stability
- Accommodative throughout, good for growth and real economy inflation

Con’s

- Completely nuts regarding any past Fed actions
- Really hard to explain and message
- Really hard to avoid accusations of direct debt monetization

Isolating the QE projection from the thought experiment



Does this look crazy. Not to us. We are facing a known slowdown with a known end. Ramping up purchases to monetize the debt being issued and tapering makes complete sense. How would you message?

"We recognize the short-term risk of the virus spike and will double our asset purchase to provide support to markets and the flow of credit throughout the economy during this difficult time"

"We expect the vaccine will allow the economy to operate more normally and as this plays out, we will remove accommodation"

This is how we would run the Fed. Thankfully, no one is asking us.

Current Model Portfolio performance and Recommendations

Based on our expectations of short-term additional support from the Fed we are bullish assets overall but are being somewhat opportunistic for entry points. So far, we are:

- Long SPX
- Short the USD vs Eur
- Short the USD and vs JPY.

We are looking to buy long term bonds and gold and go max long equities on a dip.

	Assumed Portfolio size	100,000,000						
	LTD P/L	17,444,633						
	Total Return	17.44%						
	Today's Date	11/17/2020		Portfolio Created			4/15/2019	
Date	Position	Entry Price	Amount	Worst case loss		MTM	P/L	Open/Closed
10/28/2020	USDJPY Year End 103/100 Put Spread	0.64	156,250,000	1,000,000		0.43	(328,125)	Open
10/28/2020	EURUSD Year end 1.18/1.21 Call sprea	0.78	128,205,128	1,000,000		0.99	269,231	Open
11/12/2020	SPX Year End 3600/3800 Call Spread	51	196	1,000,000		82	607,843	Open