The Damped Spring Report

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

9/2/2021

Based on our estimate of the flows of QE including those remaining after taper begins, private savings growth, and corporate retained earnings growth, and the continued extreme support these flows provide for at least this year , we are raising our equity target, covering our modest equity and gold short, and taking advantage of dollar weakness and going long USD vs both Yen and Euro. We maintain our short wings trade on long term bond futures. If the employment number is hot and our new recommendations go against us, we will double down to max size.

Over the summer we wrote the trilogy that ended with the Big Boss Battle. Liquidity crushed the Big Boss, despite extreme headwinds of.

- **Supply of treasuries**
- **Growth expectations falling due to the fiscal cliff which starts Monday**
- **Uncertainty around the debt ceiling**
- **Most Importantly much greater certainty that Taper is imminent by the Fed.**

Our reports indicated a likely modest selloff which would be extremely difficult to time and trade. This was an understatement! Nothing sold off. The Big Boss was killed by liquidity. Assets rule! Santa Claus Rally. New SPX year end target is an eye popping $5000

New SPX Target raised to $5000

In December 2019, the SPX was at $3300, long bond yields were 2.25% and 2020 expected earnings were $150. The economic outlook for 2020 was trend growth, below trend inflation and mild monetary stimulus. Today, the SPX is at 4524, long bond yields are 1.9% and expected earnings for 2022 are $210. The economic outlook for 2022 is above trend growth, modestly above trend inflation, and a fed that even with aggressive tapering assumptions will buy 800BN more UST and Mortgages and maintain zero interest rates for at least a year. Conditions are much much better for equities than in December 2019. However, assuming conditions are simply identical to December 2019 our valuation model which uses risk premiums values **SPX at $5000.**

The Flood of Money

The floods in NYC last night are nothing compared to the continued flood of money chasing USD Assets. Over the last 17 months the US government has handed $6Tn to the economy. That money was saved and spent. It's important to understand what happens when money is spent. But first let's set up a model.

If the Government hands money to its citizens and businesses and all that money is saved, nothing really happens to the economy. This is because the savers in aggregate buy the bonds that were issued by the government. If, however, while the Government pays out this money the Fed competes with savers and buys these bonds, savers now must bid up all assets until those who own assets sell them and consume in the real economy. This process stimulates growth.

In the current case the numbers have been enormous, and we have remarked frequently of the timing of each of these flows and whether assets are likely to be chased or sold. Introducing the fact that spending is also going on during this process is the next step.

Spending goes to three parties.

- Those who own the productive asset that is providing that good or service, largely corporations and private businesses
- The owner of the commodities that are used to create that good or service like energy and hard or soft commodities
- Wages to the people working to create the good or service

Businesses receives the portion of the spending which is profit. That profit, goes into, retained earnings where it is saved, paid out in dividend which itself most often gets reinvested in assets, or used to purchase the companies own stock or stock or assets of another business. All the profit is immediately saved.

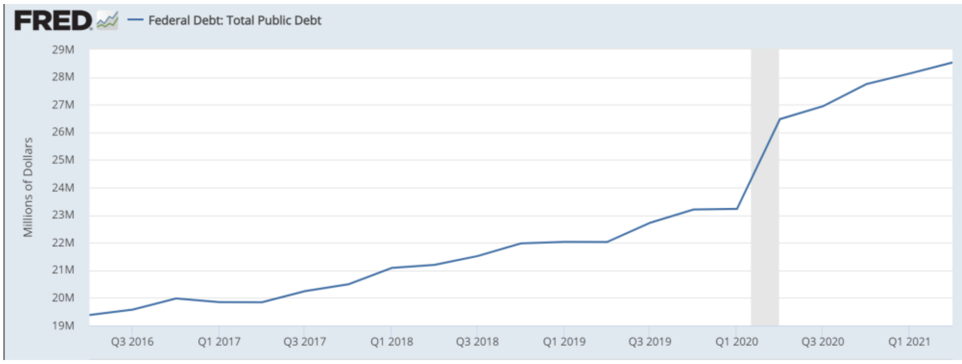
An owner of physical commodities exchanges those assets for cash which is then saved.

A wage earner saves some of her wages and spends some of those wages

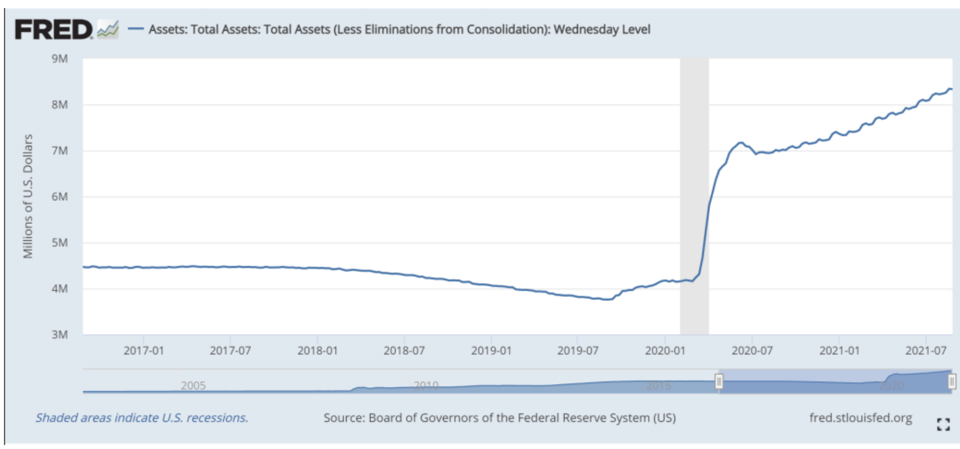
The spending from the wage earner is then looped up to the top and is split amongst the same three providers of services

We know that 100% of the fiscal spending was not saved but eventually will be saved this creates essentially an ongoing demand for assets that we have termed "Private QE" because it was funded by a government transfer and used to buy assets. The question is, when does the spent money settle in corporations, businesses, commodity owners accounts, and private savings. When that happens the chase for assets ends. It seems clear that this private savings growth won't last much past 2022. Also, QE won't likely survive the year. But, today, the government bonds have been largely issued, and yet the Fed and "Private QE" still have close to $2TN yet to invest.

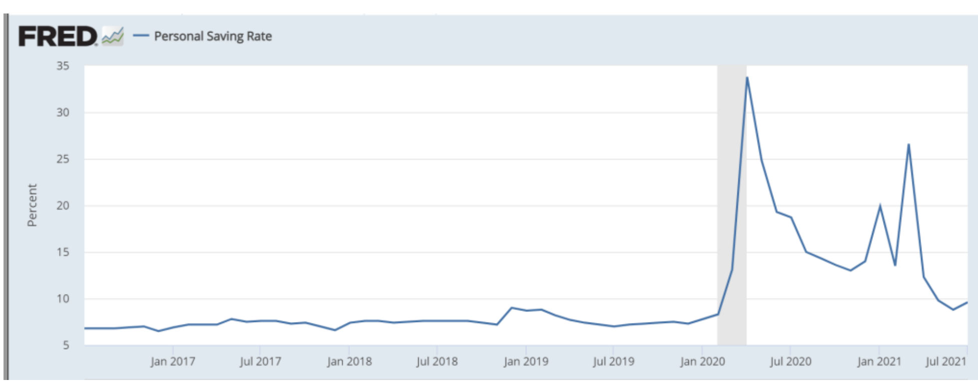
The Government has paid out $6TN of emergency payments and isn't planning on additional emergency spending

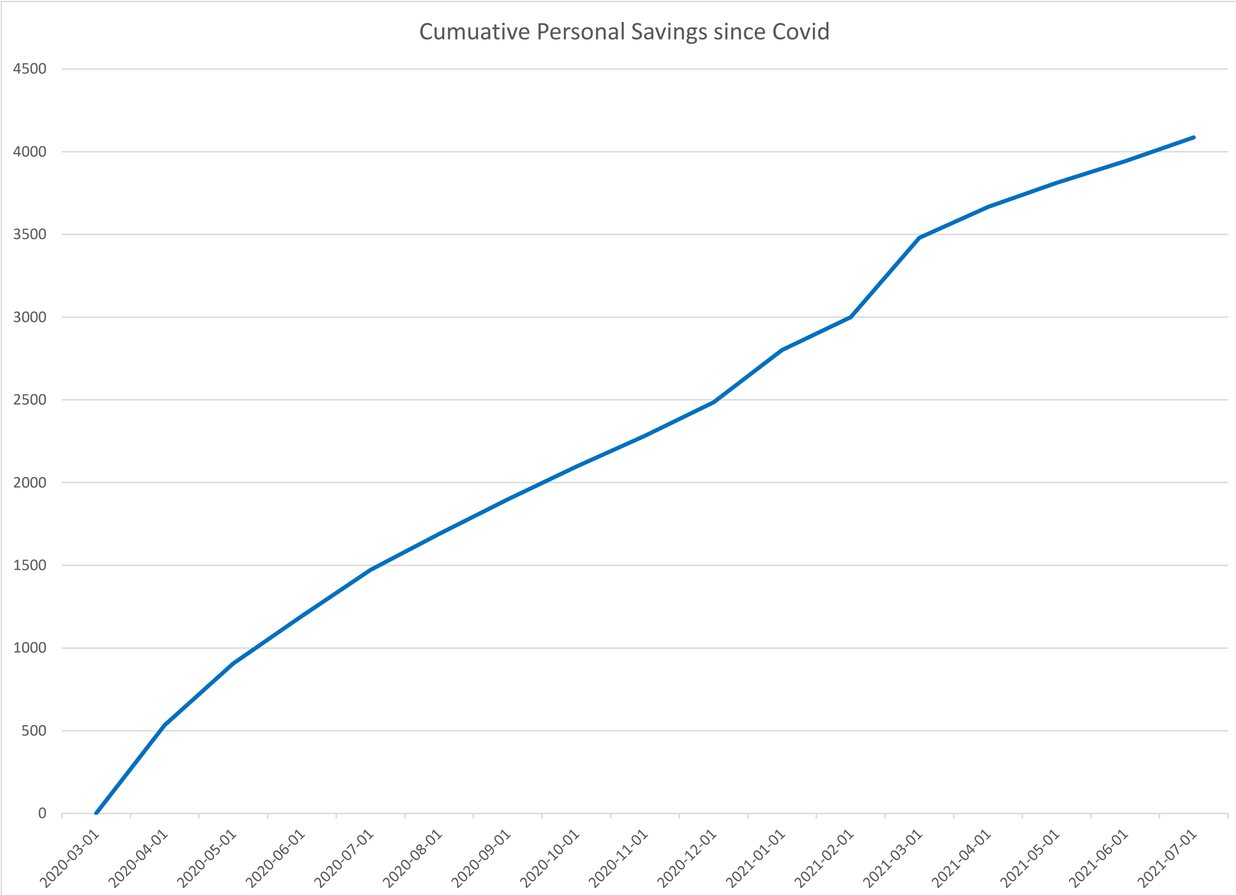


The Fed has bought $5TN and has 800BN at least more to buy

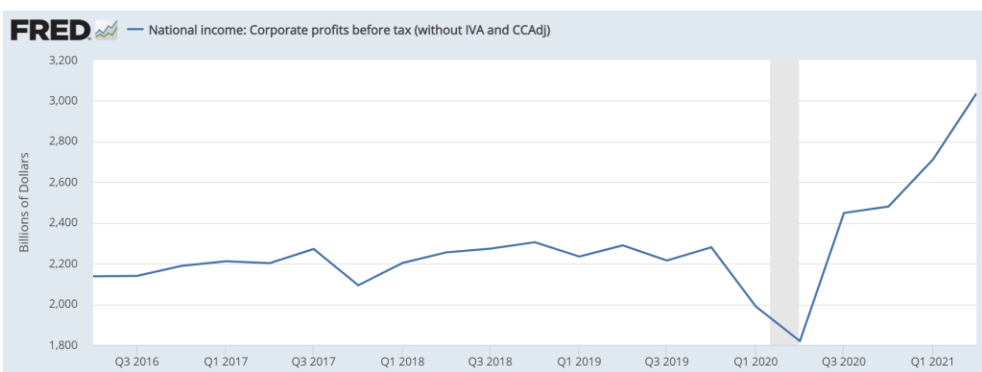


Personal savings have grown by 4TN with more to come. While clearly starting to slow as the government transfers settle into long term savings, the slope of savings growth remains high vs regular savings accumulation which can be seen in the personal savings rate remaining above trend.





Corporations have seen rapid gains in net income accumulating about $2TN in the pandemic era and importantly generating deficit reducing taxes



This wall of future investment dollars of both private QE and remaining Fed purchases will power asset returns higher. It is important to note that the debt ceiling is not yet resolved. That limits short term bond supply but also does have some impact on growth if a government shutdown occurs. We doubt it will come to that and the Treasury will build back the TGA immediately. However, with 1.2TN of RRP looking for T-Bills we expect the issuance to be on the short end of the curve and have little impact on long term assets.

Current Model Portfolio Performance and Recommendations

We are adding long call spreads in SPX and Gold today and covering shorts in both. It is a major call

	Assumed Portfolio size	$ 100,000,000					
	LTD P/L	$ 22,933,646					
	Total Return	22.93%					
	Today's Date	9/2/2021		Portfolio Created		4/15/2019	

Date	Position	Entry Price	Amount	Worst case l	MTM	P/L	Open/Closed
7/16/2021	USA Nov 160/158 Put Spread	0.734375	-790	$1,000,000	0.359375	$ 296,296	Open
7/16/2021	USA Nov 164/166 Call Spread	0.734375	-790	$1,000,000	0.75	$ (12,346)	Open
9/2/2021	SPX November 4600/4700	40	250	$1,000,000	40	$ -	Open
9/2/2021	GCA Dec 1900/2000	11	909	$1,000,000	11	$ -	Open