

The Damped Spring Report

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

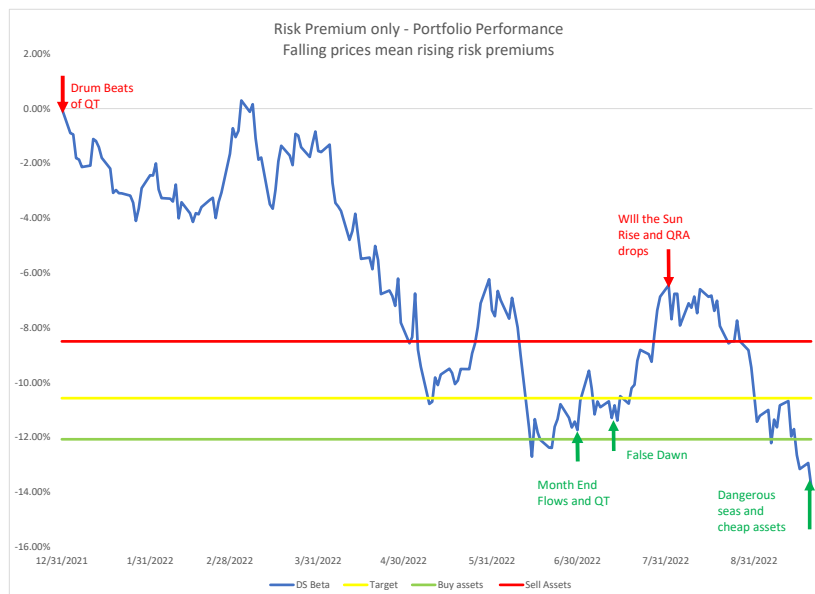
9/21/2022

The Fed will raise interest rates 75bp today and the SEP will leave no doubt that further hikes through 2023 are forecast. As the remaining crosswinds of September fade and the hurricane winds of QT remain steady, asset prices have now corrected such that they can navigate these dangerous seas. We are bullish assets of all sorts and expect a grinding rally until valuations are no longer able to resist the headwinds of QT. Until the economy responds to rate hikes, we expect rallies to be short lived resulting in a selloff, become oversold and then rinse and repeat.

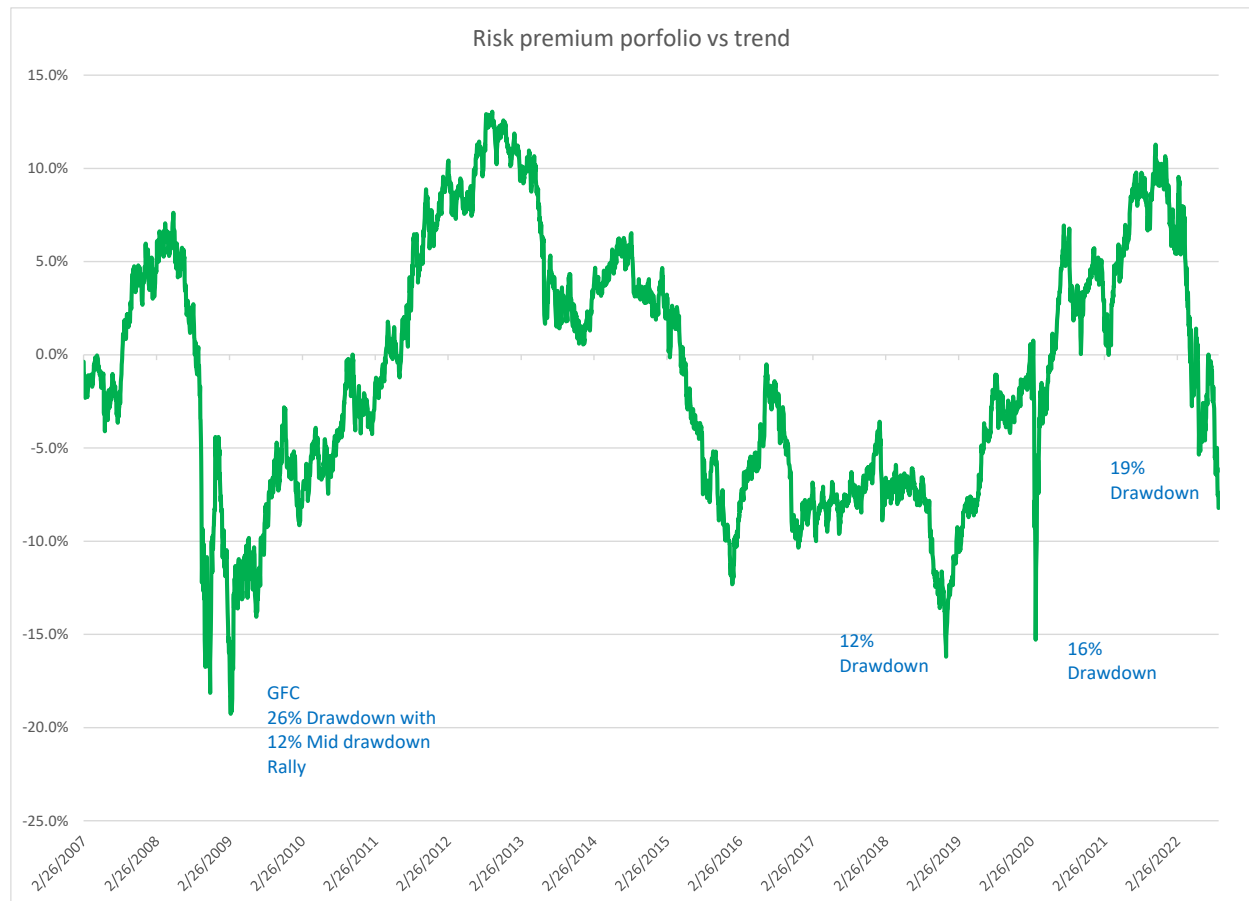
The crosswind which had the most impact last week was a hot cpi number which caused all assets to sell off sharply. Equities, Gold, and Commodities corrected eliminating the divergence between these assets and bonds

After the Fed announcement three remaining crosswinds exist. Month end flows, which will likely be a magnet for equities to 4000, pre-announcements like FedEx which will add to downward pressure on equities if they occur and the opposite if they do not, and large auctions.

The obvious power of the QT headwind has left a major mark on assets since 8/1. Assets have become cheap. Our metric for the full impact of QT through 2022 indicates that assets in are worth owning.



Looking at asset pricing through a somewhat longer lens



This rough heuristic shows asset prices not nearly as cheap as the GFC bottom, the QT pivot bottom of 2018, or the Covid bottom. So, some uncertainty exists for sure. However, the drawdown from peak is almost as large as the GFC and has been extremely rapid. In addition, just like in 2018 this drawdown is due to voluntary action from the Fed vs the Covid and the GFC where economic issues caused tight monetary conditions. We don't expect a pivot until the data is clearly responding and buying assets remains high risk. Perhaps we are early, more likely if we are correct assets will bounce before selling off through year end. We continue to think the QT headwinds cap a real asset rally. But valuations are the opposing force to QT. We like assets at this price.

Monetary Policy

Our expectations for the FOMC

- 75 BP Hike
- Hawkish statement
- Press conference that is unequivocally hawkish like Jackson Hole
- Mention of MBS outright sales in presser if not in the statement itself
- SEP Higher for longer as estimated in table below

Damped Spring Projected SEP				
	2022	2023	2024	Long Run
PCE	5.5	3.1	2.4	
June	5.2	2.6	2.2	2
Core PCE	4.6	3	2.5	
June	4.3	2.7	2.3	
Fed Funds	4.1	4.5	4	2.7
June	3.5	3.8	3.4	2.5

Clearly our expectation is for a very hawkish Fed. We also think that expectations are also extremely hawkish.

September Crosswinds

The remaining crosswinds impacting asset prices are

- Light auction schedule for the rest of the week
- FOMC Meeting
- Heavy auction schedule focused on the front next week
- Equity Earning Preannouncement window – volatility or not
- End of quarter rebalance and large 4005 equity call magnet

Equity and Bond markets converged

Last week we highlighted that bond markets had significantly underperformed stock markets and gold. Since the CPI number bonds continued to sell off but equity and gold caught up by falling sharply. The divergence in relative risk premiums between bonds, gold and stocks are now balanced.

Synthesis on market pricing

Assets in general are now on the cheap side in which overall risk premiums are priced below fair value by 2-3% on price on a vol weighted basis. Equities will likely drift higher getting sucked into the 4005 gamma hole by month end. Of course, more disruptive moves are possible if preannouncements occur or the large auctions of 2's 5s and 7's face difficulty. We have modest risk at the moment. We like assets and have added positions into the selloff, but the conditions remain uncertain and taking sizable bets seems to offer low risk adjusted returns. We will also sell risk assets into a rally. Our steady state view is to be short assets until QT and tightening are nearer the end than the beginning but are comfortable betting small on the long side based on current prices

Current Portfolio and Performance

Assumed Portfolio size	\$	100,000,000						
LTD P/L	\$	49,910,966						
Total Return		49.91%		YTD Return		18.62%		
Today's Date		9/21/2022		Portfolio Created		4/15/2019		
Date	Position	Entry Price	Amount	Worst case loss	MTM	P/L	Open/Closed	
9/9/2022	SPX Call Spread 4050/4100 9/30/2022	27	-714	HEDGE	3.8	\$ 1,656,480	Closed	
9/15/2022	CLX 10/17/2022 82/80 Put Spread	0.7	-385	\$ 500,000	0.8	\$ (38,462)	Open	
8/30/2022	SPX Call Spread 3950/4000 9/30/2022	28	357	\$ -	15	\$ (464,100)	Open	
9/2/2022	SPX Call Spread 3950/4000 9/30/2022	28	357	\$ -	15	\$ (464,100)	Open	
9/16/2022	SPX Call 11/18/2022	91.5	109	\$ 1,000,000	90	\$ (16,393)	Open	
7/7/2022	EDZ2EDZ3 50bp stop loss	-0.65	1000	\$ 500,000	-0.32	\$ 330,000	Open	
9/2/2022	TLT October 109/114 Call Spread	2.15	4651	\$ 1,000,000	1	\$ (534,884)	Open	
9/16/2022	GLD OCT 155/153 Put Spread	0.82	-4237	\$ 500,000	0.85	\$ (12,712)	Open	
9/13/2022	DS Beta Index set at 100 on initial execution	100	250,000	\$ 1,000,000	98.18	\$ (455,000)	Open	
9/16/2022	DS Beta Index set at 100 on initial execution	100	250,000	\$ 1,000,000	99.78	\$ (55,000)	Open	