Making Rational Decisions

In uncertain times…

Preparation…

In an effort to calm nerves, I wanted to get a quick note out to clients and readers. It's not polished – but it's the best we have at this moment in time. In short – we've prepared for this; we were ready for today…

Information is moving at breakneck speeds; It's becoming increasingly difficult to write. By the time we've written and are ready to release a timely note, something new and outlandish has been announced…

Risk managing our portfolios will always come first, should you feel you need an update on our thoughts; a personal conversation, NEVER hesitate to reach out and call or shoot us an email! This is not the time to hide – like any other day, it's a time to learn.

Market volatility has NEVER been greater, which is likely to continue for the foreseeable future.

At the White House press conference this afternoon, the timeline provided for corralling the COVID-19 virus was June-July?! Granted it wasn't the timeline for how long current "restrictions" would remain in place, but still… That's 4 months?!

Having said that: as they have NO real idea on timing, extreme volatility doesn't have to equate to market sized losses.

As we witnessed today, while it was one many would like to forget, we believe we risk managed it well… By the numbers:

IN THIS ISSUE:

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Index/Model	Daily % Chg 3/16/2020
S&P 500	-11.97%
DJIA	-12.93%
Nasdaq	-12.42%
Russell 2000	-14.27%
MSDD^	0.90%

^performance varies slightly by account (unaudited)

You are reading that correctly - our primary model was UP just under 1% on the day...

Admittedly, we're still down on the year, however, we are greatly outperforming the traditional "Benchmarks" ... which are down roughly 27, 30, 24 and 37% respectively (as listed above). We have followed our disciplines and repositioned to copious amounts of cash & treasury holdings. We've remained firm with our gold positions and even initiated a position in the US dollar today.

There will be a time to buy stocks as an asset class, consumer staples, utilities, more gold (even technology as we move to a more virtual society) ... However, with the Volatility Index (VIX) over > 80 – in our opinion, now is NOT that time. We will pick our spots and be vigilant. We will not be afraid to miss large swings higher – we will look to be opportunistic, while still being prudent.

Take a deep breath - take care of what is MOST IMPORTANT, you, your family and their health. We are going to do everything in our power to take care of the wealth you hold with us.

We have the ability to work remotely and in "quarantine" for some time if the need and government decree arises.

For those of you not with us, but have been "readers" for a while now ... Today is over, we can't change the past, but the best time to make better risk management decisions is NOW. Hope, along with risk mitigation via "diversification" continues to fail in being a solid risk management strategy.

Having said that we had written a short piece prior to the Fed's emergency announcement last night that is still has some very pertinent messages... We hope you continue through the rest of the piece.

You just can't make this sh*t up

After one of the most volatile weeks in stock market history – compounded by today's debacle, I felt compelled to begin with one of the more reckless things I have seen in my 24-year career.

Upfront, this is NOT a political statement, it's hopefully a learning moment for us ALL. While most of us don't act this way, deep down – the vast majority of individuals do something very similar without even realizing they are doing it.

For those who don't know what you are looking at… It is a chart of Friday's Dow Jones Industrial Average signed by the President of the United States, Donald Trump as reported by Lou Dobbs here. The DJIA had a record DAY, closing up a record 9.3%. (Hubris often ages very poorly)

For those unaware… the same day the president signed that "chart", he also declared COVID-19 a NATIONAL EMERGENCY … of course it makes perfect sense that the broader equity markets ripped higher by 10% on this day (insert eye roll, forehead smack and sarcastic look here). For those who bought equities UP nearly 10% in the face of a national emergency being declared, you should consider finding yourself a new advisor?!

I'm just going to get this out in the open from the onset… While countless individuals are writing about COVID-19 claiming they know exactly how this will work itself out – we continue to believe there are too many unanswered questions coupled with misleading and outright dishonest reports.

In this note, our effort is to get you to think a little bit about daily narratives and how sifting through the BS allows us to place the odds more so in our favor; especially in these current turbulent times…

Controlling the Narrative

We've discussed for years the role mainstream media plays in what we believe to be harmful behavior in shaping the investing narrative. Knee Jerk, reactionary garbage is typically parroted rather than real noteworthy news being reported.

Leading up to this mess, it didn't matter how many times we screamed from the roof tops that multiple expansion was responsible for equity price gains; that earnings had been flat to negative for the last 5/6 quarters, that there was too much debt and leverage in the financial system, that the construct and point loads of the financial system were stressed to a breaking point, that the Fed had kept interest rates too low for too long inflating an asset bubble… and on… and on…

The media and Wall Street control the narrative – which is repeated over and over on the golf course, at the tee box, the country club, the card game, the water cooler, the bar, out at dinner with friends… The consumer is resilient, we're in the best economy in history, don't fight the Fed, Goldman Sachs saying the economy was near recession proof, Former Fed Chair Janet Yellen said we wouldn't see another crisis in her lifetime.

Regardless of the warnings… the repeated question was why am I not matching this index? Or statement, I need more if I am going to retire?

Equity markets and returns are always the primary focus while RISK and underlying fundamentals are brushed aside… Until times like, NOW.

Late last year I lost an account – a very good friend – a HIGHLY intelligent individual and someone I GREATLY respect… As many of you know we have been more "defensive since 4Q2018" which matters given part of the email exchange; though during the discussion he writes:

> *"Not looking for economic indicators…any other data points or factors…. specific to me, is this growth rate correct?"*

He didn't care one bit about the "Why" or the "RISK setup" … the account left missing our run-up through year end into February and wasn't around to watch our capital preservation strategies kick in to mitigate what we have just witnessed.

The focus – in similar fashion to our dear President in referring back to the above image – is misguided, we think in short term blocks of time, not in full investing cycled, large in part because of the narrative that people have been "taught" or "sold" over the years.

No more than 2 weeks ago we told you up days like Friday were to be expected; we said:

> *Make no mistake – we have entered an extremely challenging investing environment.* ***It is true that Rip-your-face-off-rallies do typically occur during extreme sell offs****. Though, as the majority of traditional Wall Street advisors and financial news network pundits (including the POTUS) have parroted, "COVID-19 is no big deal", "the Fed will save us", "the consumer is resilient"; let us remind you of a few things…*

We sent that note out 36 hours prior to the March 2nd rally… No sooner had we hit send, equity markets ripped short sellers faces off as with a near 5% moves on broader indices (March 2nd), excluding the Russell 2000 (our current short exposure) which was up approximately half that amount or 2.65%

The below table shows DAILY percentage movements in major US equity indices over the last 10 trading days (EXCLUDING TODAY WHICH ARE NOTED ABOVE).

Narrative	RYFOR	Emergency Cut	Biden Bounce				RYFOR		Fed Bazooka	Up oil reserves
	March 2nd	3rd	4th	5th	6th	9th	10th	11th	12th	13th
S&P	4.61%	2.82%	4.22%	3.38%	1.71%	7.61%	4.93%	4.89%	9.51%	9.19%
Dow	5.10%	2.96%	4.53%	3.59%	0.97%	7.81%	4.89%	5.87%	9.99%	9.30%
Nasdaq	4.49%	2.99%	3.85%	3.10%	1.87%	7.29%	4.95%	4.70%	9.43%	9.34%
Russell	2.65%	2.14%	3.02%	3.43%	2.00%	9.44%	2.83%	6.42%	11.20%	7.60%

Over the last 9 trading days the Federal Reserve has surprised markets with an "emergency" cut to their benchmark Federal Funds Rate; reducing it from 1.50-1.75% to 1.00-1.25%. They announced emergency Repo operations to the tune of Trillions on March 12th and yesterday, they literally threw a kitchen sink at our current situation. In spite of the Fed's emergency response, markets closed down on these days. ALL THREE ANNOUNCEMENT CAME AS AN EMERGENCY PRIOR TO AN ALREADY SCHEDULED FED MEETING FOR WEDNESDAY 3/18/2020.

A glimpse at the March 12th announcement; the Fed offered $1.5 Trillion dollars in repo operations over a 2-day time frame broken into back to back $500 billion dollar 3-month operations with a $500 billion dollar 1-month operation.

The 1-month and 3-month operations will be held weekly for the rest of the month (what's 3 trillion over 3 weeks?) while continuing to offer AT LEAST $175 billion in daily overnight operations AND at least $45 billion in two-week term repo operations twice per week over the same time span… Per the New York Federal Reserve's announcement:

> *Today, March 12, 2020, the Desk will offer $500 billion in a three-month repo operation at 1:30 pm ET that will settle on March 13, 2020. Tomorrow, the Desk will further offer $500 billion in a three-month repo operation and $500 billion in a one-month repo operation for same day settlement. Three-month and one-month repo operations for $500 billion will be offered on a weekly basis for the remainder of*

> *the monthly schedule. The Desk will continue to offer at least $175 billion in daily overnight repo operations and at least $45 billion in two-week term repo operations twice per week over this period.*

Again, following this announcement, equity markets closed down roughly 10% having one of the worst declines since October of 1987. I didn't see hear about any autographed equity market charts that day…

Friday, March 13th … President Donald Trump's "National Emergency" announcement regarding COVID-19, they stated the US government would step in to the Energy markets as a buyer of last resort; filling our national oil reserves "to the top", and in President Trump's "opinion", at a "very good price".

Again, CONTROLLING THE NARRATIVE…

Best day in history – who cares, it followed the most severe and fastest decline in history. Biden Bounce – seriously… Who makes these bullsh?*t, tag lines up?!!

- They didn't announce the number of COVID-19 cases in the United States are coming down (in fact they are moving higher).
- They didn't announce the death rate around the globe is plummeting
- They didn't announce earnings would be accelerating for 1Q2020…

They have announced exactly what we've said they would for the last 2-3 years… More stimulus, more printing and more interest rate cuts.

In the face of this, in our humble opinion, the narrative has been shifted AWAY from what matters most…

You don't make emergency announcements because equity markets are down 20% from their all-time highs… You don't cut rates to zero in under 2 weeks, you don't announce multi trillion-dollar repo operations, full on QE and the Fed buying up the treasury curve because of the stock market… You announce them because there is an underlying fundamental issue that is flashing RED warning signs… Usually, in the credit markets!

FRA – OIS:

If we've said it once, we've said it countless times… The Fed isn't as concerned with the equity markets as it is the Credit Markets. While equity markets are what most from the individual to the President focuses on – credit market disruptions are exponentially more important to the global financial system, period. FULL STOP!

A handful within the Fin-twit (financial twitter) community have been hammering on this, and to my knowledge, it's only recently been reported on by the likes of mainstream like BofA (Bank of America) and Bloomberg (article cited below).

An FRA (Forward Rate Agreement) is an agreement between two parties looking to protect themselves against future interest rate movements. "A forward rate agreement is a deal to swap future fixed interest payments for variable ones, or vice versa. The key rate for U.S.

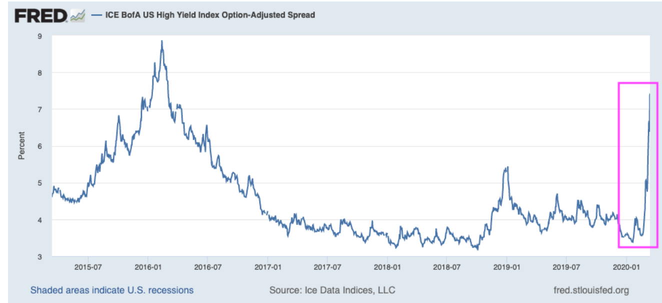
markets is the three-month London interbank offered rate, or Libor, in U.S. dollars." as described in this recent and short Bloomberg article (which I HIGHLY RECOMMED you read).

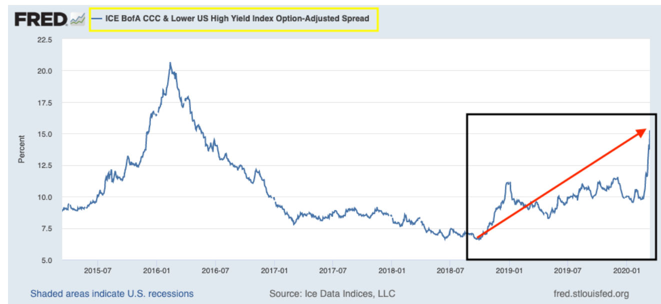
An OIS (Overnight Indexed Swap) is a financial contract between two parties which agree to exchange a payment at the end of a contract based upon the difference between a fixed rate (think Federal Funds Rate) and the overnight index rate.

The FRA/OIS spread is a reflection of credit and liquidity conditions in the funding markets… As the spread on the FRA/OIS widens, it shows an increasing risk of credit markets freezing. What the above chart shows is a virtual blow out in spreads to levels not seen since the Great Financial Crisis of 2008. This chart is more telling than any one day move in equity markets. As interbank lending and swap rates increase it shows banks are nervous to lend to each other (i.e. Counterparty Risk).

At the same time, credit spreads on bonds are blowing out… Should any of these companies need to refinance their debt, it would likely be at levels their balance sheets and cash flows would be unable to support; increasing default rate risk. Assuming they can even find the liquidity.

Additionally, given the widening of spreads, the excessive leverage on the balance sheets of many companies (as we've discussed ad nauseam in the past) and the enormous shock to the economy with the globe having virtually shut down, ratings agencies can no longer hide behind the mask of economic conditions looking favorable; one would think a MOUNTAIN of BBB rated paper will now fall into junk (which is exactly what we described over 2 years ago here and here). (i.e. Fallen Angel Risk)





The Perfect Storm…

We are now staring at papered over debt cycles, coinciding with the end of a business cycle, while staring at a global pandemic and structural deficiencies in the system we've discussed for over 2 years are being exposed (the construct of active v passive investing). Adding insult to injury, this is all colliding with a demographic shift in population (baby boomers retiring)- well, maybe not anymore if they are down 30%?!

"PRE-COVID-19", this information comes directly from the Board of Governors of the Federal Reserve System – it's Senior Loan Officer Opinion Survey on Bank Lending Practices…

Special Questions on Banks' Outlook for 2020
(Table 1, questions 27–39; Table 2, questions 9–15)

> *A set of special questions asked banks about their expectations for lending standards, loan demand, and loan performance as measured by delinquencies and charge-offs over 2020,*

> *assuming that economic activity progresses in line with consensus forecasts. On balance, banks reported expecting tighter standards and a deterioration in loan performance for most loan categories over 2020. With a few exceptions, banks expect loan demand to remain unchanged.*
>
> *Regarding the outlook for loans to businesses, modest net fractions of banks reportedly expect to tighten standards on C&I loans to large and medium-market firms and also on nonfarm nonresidential CRE loans. In addition, moderate net shares of banks expect to tighten standards on construction and land development as well as multifamily CRE loans. Meanwhile, banks expect demand to remain unchanged for all business loan categories other than multifamily CRE loans, for which modest net shares of banks expect weaker demand. Additionally, banks reportedly expect performance to deteriorate somewhat for all types of business loans surveyed except multifamily CRE loans, for which performance is expected to remain unchanged.*[6]

For those unfamiliar, this report reflects the thoughts of Senior Loan Officers for the *previous* quarter (which would have been 4Q2019). COVID-19 wasn't even a thought when this survey was taken… Loan officers were already expecting tighter lending standards and expected performance to deteriorate assuming things remained business as usual… We are now arguably facing a global pandemic; this is anything but business as usual.

In December we attempted to give a high-level understanding of how money flowed; we wrote about regulatory constraints colliding with Repo Markets (the markets that more or less allow our global financial system to function). Today, this system has never been more stressed and it's showing in places that we should be focused on, not where the daily narrative attempts to deflect or direct us.

Every day we have an ability to get better. To learn, to make better decisions than we made the day before.

We have remained disciplined, stayed true to our strategy and so far, it has paid off in spades. We are down, but not down nearly as much as broad market indices and the majority of asset managers. Famed Hedge Fund manager Ray Dalio has been hit over 20% this past month. When he said, "Cash is trash" we remained firm in our discipline, while others suspended their trailing stops, we remained true; and still, we continue to analyze our mistakes, mishaps, where we got it right and can do better.

Here is another narrative we're all led to believe on Wall Street. If markets are down X – so are you. Who could have seen it coming? If all stocks are losing, there is no way to make money?!

I never thought I would be learning/re-learning fractal math, calculus, rate of change (ROC), the volatility of volatility, etc.; all concepts NO Wall Street firm ever brought to my attention in over 2 decades. The guys at Hedgeye happen to be excellent at it – and while I was a bit late to their game, we are utilizing every bit of our ability to learn adopt and integrate their teachings and disciplines with the ones that have protected you better and find the asset classes that are making money during this challenging time… We ARE doing better than the vast majority of investors, however, as we go through these tumultuous times, we believe we can do even more.

We will never stop learning and fighting to better our process…
I could spend a day writing a section on our final thought, yet in an effort to get this out to you all

in a timely manner we will leave you with this: In December we wrote about a man named Zoltan Poszar. On March 3rd Mr. Pozsar wrote another timely and rather ominous note, which you can read by [clicking here…]

Our question… and it's a sincere one – is why Zoltan Poszar not running our Federal Reserve? The man knows more about our financial system than anyone I have ever read.

We NEED to get the right people in charge and stop throwing more of the same sh*t against the wall. Just as no one market crash is the same, as Central Bankers and regulators (who are not fully aware of the systems) have created ad hoc fixes, not every solution to the problem at hand is the same…

Our focus is to better risk manage our process for you - We'll get through this…

Family and health first – we've got your back here…

We will continue to mention, whether you know it or not, times like NOW are the reason you have hired us or consider doing so…

As always, we're happy to discuss our market thoughts along with strategies and more, never hesitate to reach out with any questions or concerns.

Thank you for your continued trust and support!

Sincerely,

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Disclosures

** We continue to work on getting our flagship model's numbers audited from a performance standpoint. In opening our new firm (OSAM), performance will only be able to be officially audited as far back as the complete sets of statements we receive from clients. This may remove data points from our official numbers upon audit completion affecting 2016's reportable performance number. Numbers reported are gross fees and commissions as we have a sliding fee scale based upon assets.

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