



To tack, or NOT to tack...

Is that the question??!

“Inflation remains elevated, with a short term set up to the disinflationary side over the next few months ... and growth is sending mixed signals, with quite a bit of uncertainty out of Washington, especially pertaining to labor markets ... what was most probabilistically a stagflationary investing environment has (at least for the short term) pushed into a disinflationary one.” ~ OSAM, February 2025

Recap

Last month we conveyed our thoughts on how to approach markets via sound risk management through sailing terminology and nautical analogies like luffing, tacking and heeling ... a theme which we will continue this month as it's fresh on the minds of those who took the time to read last month's piece, while also remaining extremely pertinent given recent market events.

First, let's start with a quick re-cap to provide a bit of perspective.

Our “higher for longer” inflation thesis has been on the table for well over a year. As Wall Street pundits were pricing in north of 9 rate cuts for 2024, we quickly argued against this stance in multiple notes starting [December 2023 in the section titled D.I.S.C.O.N.N.E.C.T.](#)

We maintained our view, which was supported by the data through the first half of 2024, though did note that we could see some weakness in

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said data come the July/August/September time frame (given the set up in year over year (YoY) comps and the base effects)?!

At the same time, we have always remained firm that inflation was poised to reaccelerate ***“into the back half of the year”***, giving the Federal Reserve a brief window to cut rates a few times just as it (the data) was set to re-accelerate ... only becoming visible to all those who choose to ignore rate of change math (including the Fed) after the fact.

We were very specific with our words [in July](#), stating:

*“As described in this piece, given the current set up, we don’t know how many rate cuts the Fed will be able to implement before **inflation reaccelerates into the back half of the year**?! Our best guess is one to two at most”*

In our [2Q2024 note we also wrote](#):

Should inflation reaccelerate while the Fed is cutting rates, we believe a few things are more likely to happen than not. 1. Inflation reaccelerates at a faster pace into the Fed cuts, leading us to 2. rate cuts are likely to be few (and short lived) as the consumers ability to spend tightens even further ... leading to more full-time layoffs.

So, what happened?!

Late July, early August saw a disinflationary investing regime sending the S&P down roughly -8.00% and the Nasdaq down north of -12% in a few short weeks (i.e., a temporary disinflationary environment). Though, right on que, the inflation data did begin to reaccelerate just as the Fed decided to cut rates on September 18th.

Not only did the inflation data reaccelerate heading into the back half of 2024, but, as predicted, it sent the 10-year US treasury ripping higher ... [we wrote](#):

“as we move into final edits, the 10-year U.S. Treasury bond closed at a 4.29% yield, which is a 27 basis-point increase over the last few weeks and 68 basis-point move from the low print on 9/17.”

Rates continued to rise with the data, as is typical in an inflationary environment, at one point rising nearly 118.5 basis point from mid-September (3.618% on September 16th, 2024), to its peak on January 13th, 2025, at a 4.803%!

Additionally, as we’ve noted multiple times in the past, *“markets are a forward discounting mechanism which chew through data in real time while looking at Rate of Change data and Year over year base*

affects” ... and when you couple this with the recent uptick in unemployment data (especially in the DC area), we quickly [noted a shift in the proverbial winds last month](#):

“With December and January’s data being reported in February, the next few months are now more likely to see a slight deceleration in inflation, before reaccelerating! Coupling this with a decelerating growth (GDP) figure, the oscillating “stagflation” (or quad 3) to “reflation” (quad 2) that we were anticipating appears to have turned into a mild “disinflation/deflation, monthly (quad 4), with March quite possibly flipping to a “goldilocks” (quad 1)?!”.

We continued:

“The last few weeks of February saw a shift in where the wind was coming from ... bond yields sank, and the model shifted us in(to) a “luffing” position, then positioned us overweighted in Utilities (a bond sensitive proxy) taking advantage of the decline in yields.”

For those unaware, this is much more a (quad 4) disinflationary positioning than quad 1 ... we’ve been “luffing” ever since, with the anticipation of tacking into more of a quad 1 (Goldilocks) environment ... which has clearly NOT transpired just yet.

As we’ve attempted to explain over the last few years, with the rise of passive investing, systematic flows, CTA accounts, vol control and hedge funds living and dying by a set of very defined and specific rules, market “signals” have never been more important! At the same time, this doesn’t mean you disregard the data (and throw the proverbial baby out with the bathwater).

In fact, we believe now more than ever, it’s imperative to have an even heightened sense of awareness to what the data is suggesting ... especially given the uncertainty surrounding housing, employment, future government spending and tariffs (which go into effect on April 2nd) in an effort to confirm market signals. To use an old football analogy, we’re “keeping our head on a swivel” making sure we don’t get blindsided while not paying attention.

With that in mind, let’s take a look at the data ... starting with:

Inflation/disinflation?!

While Headline CPI did increase for the 30th time in 31 months, +0.22% MoM ... on a year over year basis, February Headline CPI DECELERATED to +2.82% YoY vs. +3.0% YoY in the prior reading with CORE CPI (ex-Food and Energy) also slowing to +3.12% YoY vs. 3.26% in the previous month.

Energy prices, which flow into the data either concurrently or on a one-month lag was up +0.20 MoM, but decelerated as well, down -0.17% YoY which was a significant deterioration from the previous YoY reading of +0.97%, posing a drag on the data.

Sticking with the same theme, Shelter remained elevated BUT also deteriorated on a YoY basis, with the data coming in at +0.28% MoM though +4.28% YoY (down vs. the previous month's +4.40%)

Unfortunately, Food prices were up +0.16% MoM and 2.61% YoY, which was an acceleration against last month's +2.50% YoY input ... providing no relief at the grocery store in this data set, though this may change in the upcoming months as we have seen relatively large declines in some raw commodities as of late which wouldn't have shown in this data set.

On the Shelter front (which again, represents nearly 1/3 of CPI data) both Rent and OER (Owners' equivalent rent) accelerated MoM +0.28% respectively, while YoY data decelerated ... with rent coming in +4.09% YoY vs. +4.24% and OER coming in +4.41% YoY vs. +4.58% ... a de minimis deceleration off uncomfortably high levels, but a decel none the less!

From the producer's side, Headline PPI also slowed in February for the first time in 14 months, coming in down -0.01% MoM, while also decelerating on a YoY basis, to +3.17% YoY vs. an upwardly revised +3.70%.

Prices on "Goods" accelerated +0.32% MoM, but remains consistent with the theme thus far, decelerating on a year over year basis to +1.68% YoY from the previous data point of +2.30% YoY, while "Services" fell both MoM and YoY, -0.17% and +3.42% YoY vs. +4.04% in the previous month.

Food prices again, remain persistently sticky, increasing +1.71% MoM, while also accelerating off last month's +5.36%, coming in at +5.89% ... as Energy prices fell, both on a MoM and YoY basis, down -1.21% and -3.76% respectively ... the year over year deceleration was against a +0.07% prior reading, contributing to the softness in data.

All in all, Core PPI LESS food and Energy fell -0.05% MoM, while also decelerating vs. it's previous year over year reading of +3.83%, coming in at +3.45%

With more difficult comps in inflationary data lie ahead, coupled with global uncertainty out of Washington in the form of tariffs it has provided a window of decelerating inflationary data, which, when paired with the growth side of the equation "would" either provide a quad 4 (deflationary) investing environment OR, should growth accelerate, a quad 1 (goldilocks) environment?!

Which is why we were deliberate with our words [last month](#):

“The markets will either confirm a shift to Goldilocks in the days moving forward or they won’t?! To this point, we’ll look to follow the strength in markets while continuing to remove the weaknesses.”

Bringing us back to last month’s theme of luffing...

The models have done their job, running in lockstep with the “*forward discounting mechanism*” (Mr. market) ... more on this below! We aren’t in a race to find ourselves back to fully invested ... it’s to properly risk manage assets, losing less in an effort to compound faster when momentum and trend levels are recaptured.

For as much as we’re anticipating a quad 1 (goldilocks) environment to manifest given a reacceleration in growth against a decelerating inflationary backdrop, the signals are suggesting this isn’t the case just yet.

So, to answer the question in our opening title, “To tack or not to tack”?! Our answer at the moment would be NOT to tack ... while at the same time, do our best to understand why?!

Polar opposites

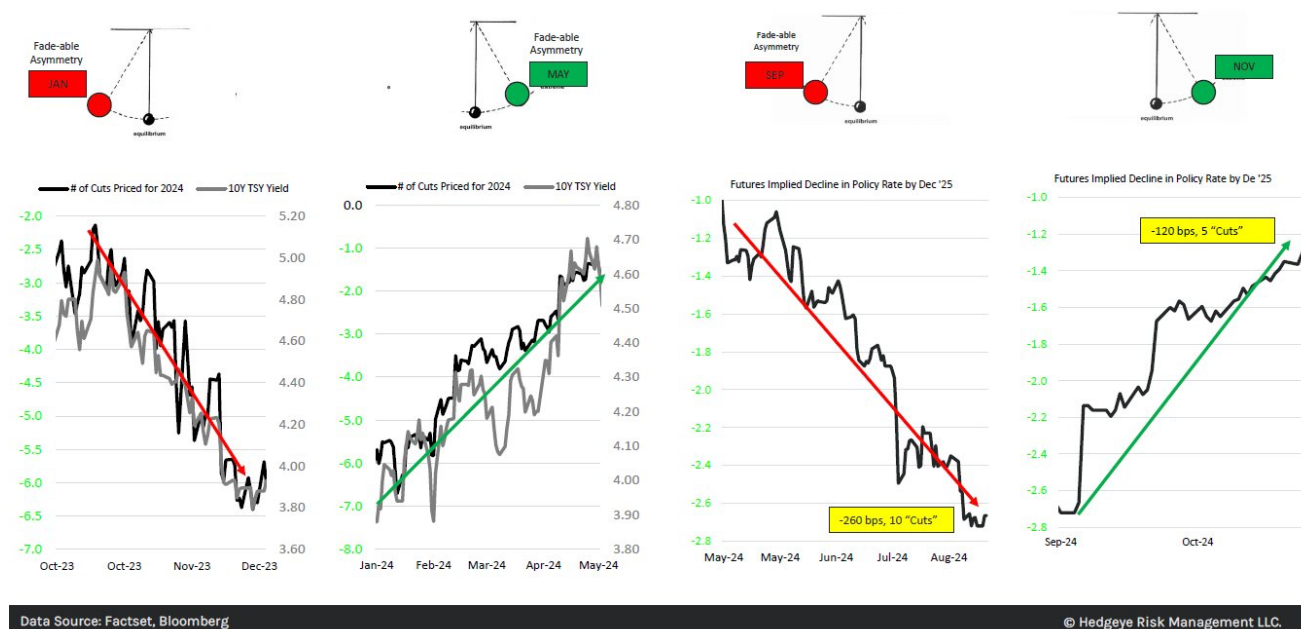
One of the ways to help us understand the “why” is to delve deeper into the data! The definition of “polar opposite” is the diametrically opposite point of a circle or sphere. Mathematically, when things directly oppose each other, they’re antipodal ... or as it relates to the Earth, the parts of the earth diametrically opposite!

When it comes to the accuracy of inflation forecasts, we would argue our friends at Hedgeye, and the Federal Reserve/Wall Street Consensus fall into that definition. We can’t think of a group which has been more wrong with their forecasts over the years (the Fed/consensus) vs. those who have been more accurate nailing the rate of change directionality in inflation than Hedgeye?!

The track record and timing of the Federal Reserve and Wall Street consensus has been perpetually wrong vs. that of Hedgeye and those who follow rate of change math in the data, as recently [illustrated by Hedgeye CEO Keith McCollough](#):

REDUX: THE CONSENSUS PENDULUM ENTERED SATIRICAL MODE

HEDGEYE



Most recently following the Fed's March meeting we've now seen the Fed:

- Cut 2025 GDP growth forecasts to 1.7% from 2.1%
- Raise 2025 Unemployment forecasts to 4.4% from 4.3%
- Raise 2025 Core PCE inflation estimates to 2.8% from 2.5%
- Raise 2025 PCE inflation estimates to 2.7% from 2.5%

As illustrated following the Fed meeting by [@ZeroHedge](#):

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, March 2025

Percent

Variable	Median ¹				Central Tendency ²				Range ³			
	2025	2026	2027	Longer run	2025	2026	2027	Longer run	2025	2026	2027	Longer run
Change in real GDP	1.7	1.8	1.8	1.8	1.5-1.9	1.6-1.9	1.6-2.0	1.7-2.0	1.0-2.4	0.6-2.5	0.6-2.5	1.5-2.5
December projection	2.1	2.0	1.9	1.8	1.8-2.2	1.9-2.1	1.8-2.0	1.7-2.0	1.6-2.5	1.4-2.5	1.5-2.5	1.7-2.5
Unemployment rate	4.4	4.3	4.3	4.2	4.3-4.4	4.2-4.5	4.1-4.4	3.9-4.3	4.1-4.6	4.1-4.7	3.9-4.7	3.5-4.5
December projection	4.3	4.3	4.3	4.2	4.2-4.5	4.1-4.4	4.0-4.4	3.9-4.3	4.2-4.5	3.9-4.6	3.8-4.5	3.5-4.5
PCE inflation	2.7	2.2	2.0	2.0	2.6-2.9	2.1-2.3	2.0-2.1	2.0	2.5-3.4	2.0-3.1	1.9-2.8	2.0
December projection	2.5	2.1	2.0	2.0	2.3-2.6	2.0-2.2	2.0	2.0	2.1-2.9	2.0-2.6	2.0-2.4	2.0
Core PCE inflation ⁴	2.8	2.2	2.0		2.7-3.0	2.1-2.4	2.0-2.1		2.5-3.5	2.1-3.2	2.0-2.9	
December projection	2.5	2.2	2.0		2.5-2.7	2.0-2.3	2.0		2.1-3.2	2.0-2.7	2.0-2.6	
Memo: Projected appropriate policy path												
Federal funds rate	3.9	3.4	3.1	3.0	3.9-4.4	3.1-3.9	2.9-3.6	2.6-3.6	3.6-4.4	2.9-4.1	2.6-3.9	2.5-3.9
December projection	3.9	3.4	3.1	3.0	3.6-4.1	3.1-3.6	2.9-3.6	2.8-3.6	3.1-4.4	2.4-3.9	2.4-3.9	2.4-3.9

ALL SINCE DECEMBER! Additionally, there are now 4 Federal Reserve officials who expect NO rate cuts in 2025 vs. 1 in December ... maybe DOGE can start cutting the waste at the Fed that is a bunch of overpaid PhD's and replace them with Hedgeye's team?!

We continue to harp on the understanding of rate of change math and base effects in the data for it works... [Last month](#) we started our final thoughts by saying:

"As we've noted in many notes, markets are a forward discounting mechanism which chew through data in real time while looking at Rate of Change data and Year over year base affects."

Then again, starting off this month's note, very early on in our introduction with:

... once again becoming visible to all those who choose to ignore rate of change math (including the Fed).

The importance of understanding rate of change data cannot be overstated. The Hedgeye graphic above shows the nature of the Fed and consensus's chase ... pushing a perpetually wrong narrative based upon headlines and how the majority of investors are positioned, along with what the larger investment banks need to happen vs what the economic data on a ROC basis suggests is happening.

After nearly 30 years in this industry, with legislation forcing market structure change with ZERO regard as to future knock-on effects, we've watched an investable market based on capitalism and fundamentals shift to one that's driven by algorithms and easily debunked academic white papers ... for those in the cheap seats, there is NOTHING PASSIVE ABOUT PASSIVE INVESTING!

Which in the end, will not end well for those who simply follow the consensus views. In the meantime, we'll risk manage around them, let markets show us where the strength exists and cut losers as their weakness is revealed.

But the anticipation...

With the rate of change of inflation decelerating, the difference between investable and often-times, outright un-investable markets becomes the directionality of growth as determined by GDP (quad 1 vs. quad 4 (depending on its severity)).

While we're anticipating a small reacceleration in growth, against a backdrop of decelerating inflationary data (quad 1, goldilocks), newly released data points always have the potential to shift the trajectory of markets with zero regard for our expectations and/or wants, holding markets in a quad 4 regime until proven otherwise.

This has produced a more negative to sideways “choppy” trading environment, which marries well with exactly what we’ve been writing since November, [but more recently, January](#):

“If narratives are what’s needed, when you put the data together with market action ... the choppiness makes sense. When you couple accelerating inflation with quite a bit of uncertainty with how numerous new policies may/will affect government spending, given who will be confirmed at what cabinet positions and how dollars will be allocated per the direction the new administration ... markets are unsure of which direction to break?!”

But we don’t need the narratives, just the shift in the directionality of the wind which will be the determining factor as to whether or not we tack or remain in luffing position.

Furthermore, the broader data isn’t confirming the need to tack yet, either...

While ISM Services modestly improved, up +0.7 points to 53.5 in February with improvements in Inventories (+3.1 to 50.6), Backlogs (+6.9 to 51.7), New Orders (+0.9 to 52.2), and Employment (+1.6 to 53.9) ...

Manufacturing data slowed with S&P Global US Manufacturing PMI’s falling to 50.2 from 50.9 in January with ISM New Orders and ISM Employment both falling from higher data points in January ... as new orders rolled over to 48.6 from 55.1, and employment weakening to 47.6 from 50.3.

ISM Prices paid jumped to its highest level in nearly 3 years, to 62.4 vs. 54.9 in January. Remember, markets are focused on a rate of change slowdown in the aggregate of data, but prices paid still reminds us that we’re in an elevated inflationary environment with signs of growth still slowing.

Given a slowing disinflationary environment, interest rates have fallen, bringing down mortgage rates which created an initial surge in Mortgage applications last month, rising by 14.1% WoW to 242.2, then +11.2% WoW to 269.3 to start the month, only to fall -6.2% WoW to 252.5 (seasonally adjusted).

The rise of DOGE also created an initial surge in unemployed individuals, though, this has begun to improve as well. The waters murky, winds are choppy ... nothing’s been sustainable.

Final thoughts

We’ve been doing our best to keep these monthlies shorter, and while we have the capacity to walk you through pages of data, in short ... inflation is decelerating, while remaining elevated due, large in part to tougher comps and base effects (whether or not they are transitory in nature will be revealed in time) with government uncertainty placing a dark cloud around both growth and labor.

As noted briefly above, the Fed recently cut their 2025 GDP growth forecast from 2.1% to 1.7%. with the Atlanta Fed's GDPNow forecast sitting at NEGATIVE -2.8% as of March 28th ... down from -1.8% on March 26th. Decelerating inflation coupled with decelerating growth = BAD, regardless of how bad the governments data may be?!

In the absence of good data points, the Feds (frequently) inaccurate and questionable ones do fill a void and have the ability to spook active managers (who also don't do rate of change math), which in-turn force rules-based managers into acting (a cascading effect if you will).

In looking at the data, we're not suggesting the markets are "wrong" with how they've been trading, it's often stated that markets are the "truth" (which, like love, can often be blind ... another discussion for a different time).

As things stand, we've been very well positioned for our newer models use market action as their truth. We are and have been positioned very well for how the markets have been trading. A very recent example of this would be from this past Friday's performance. (3/28/25)

ACCOUNT Down 43 basis points on invested assets, down 17 basis points on total account value vs the broader indices down -1.69%, -2.70%, -1.97% and -2.05%; DJIA, Nasdaq, S&P & Russell 2000 respectively Updated 6:04PM ET, 03/28/2025 Actions

Group by security type ☐ OFF

Totals	Account Value	Cash & Cash Investments	Short Balance	Market Value	Value Day Change
	\$2,651,728.19	\$1,617,231.72	\$0.00	\$1,034,496.47	-\$4,503.70 (-0.43%) ↓

Results: 20 Intraday Print Export Expand Filters Columns

Actions	Symbol/...	Name	Security Type	Quantity	Price	Day Cha...	Day Cha...	M
≡	ABBV	ABBVIE INC	Equity	292.0000	\$205.29	+\$750.44	+1.27%	
≡	ACGL	ARCH CAPITAL GROUP LTD F	Equity	575.0000	\$95.06	-\$1,081.00	-1.94%	
≡	AFL	AFLAC INC	Equity	160.0000	\$109.80	-\$156.80	-0.88%	
≡	ARE	ALEXANDRIA REAL ESTAT...	Equity	533.0000	\$95.60	-\$58.63	-0.11%	
≡	CB	CHUBB LTD F	Equity	189.0000	\$296.44	-\$362.88	-0.64%	
≡	COP	CONOCOPHILLIPS	Equity	533.0000	\$102.37	-\$239.85	-0.44%	
≡	CTRA	COTERRA ENERGY INC	Equity	1,844.0000	\$28.63	+\$202.84	+0.39%	
≡	DTE	DTE ENERGY CO	Equity	427.0000	\$136.57	+\$584.99	+1.01%	
≡	FAST	FASTENAL CO	Equity	705.0000	\$76.17	-\$1,099.80	-2.01%	
≡	FCX	FREEPORT-MCMORAN INC	Equity	1,277.0000	\$38.42	-\$1,992.12	-3.90%	
≡	HIG	HARTFORD INS GROUP INC	Equity	323.0000	\$122.22	-\$245.48	-0.62%	
≡	JNJ	JOHNSON & JOHNSON	Equity	336.0000	\$163.71	+\$194.88	+0.36%	
≡	MOH	MOLINA HEALTHCARE INC	Equity	163.0000	\$322.85	-\$101.06	-0.19%	
≡	NEE	NEXTERA ENERGY INC	Equity	747.0000	\$70.45	+\$313.74	+0.60%	

DJIA 41,583.90 -715.80 (-1.69%) NASDAQ 17,322.99 -481.04 (-2.70%) S&P 500 5,580.94 -112.37 (-1.97%) Russell 2000 2,023.27 -42.42 (-2.05%) Time 04:46:18 PM ET Refresh

While, this outperformance isn't guaranteed or the traditional disclaimer of past performance does not equate to future results, we could also point to another massive outperformance on 3/10/25,

falling roughly -0.12% on invested assets and -0.05% on total assets as broader indices in the DJIA, Nasdaq, S&P and Russell 2000 collapsed -2.08%, -4.00%, -2.70% and -2.72% respectively.

Since March 7th, we're down a fraction (roughly 30%) of what the S&P has fallen with significantly LESS VOLATILITY.

So long as we're in this extremely elevated volatility environment, and the majority of names within the S&P are below certain levels, we believe the broader indices are confirming a disinflationary investing regime, consisting of extremely high volatility. When vol compresses and winds shift, we'll gladly let a stiff breeze kiss our sails, allowing us to ride the next wave of momentum higher.

Again, we don't need to be first off the bottom, as we're preserved more of our capital, losing much less than most in this recent drawdown ... anticipation of what we believe should happen, will not remove us from our current positioning.

We will continue to luff until certain momentum and trend levels are reestablished with realized volatility falling ... then and only then will the answer to the question will be to tack!

As always ... Good investing!



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