



The Perfect Storm...

“Luffing” is a tactic that can be used. Luffing is the act of turning the bow of the sailboat upwind (windward) in an effort to reduce speed! (one could also ease the sheet controlling the sail past “optimal” trim allowing air to flow over the sail creating the luff).

The more your vessel is positioned heading directly into the wind, the more the sails will “luff” ... or simply flap back and forth ... which will either bring the vessel to a stall or tack (the act of flipping your sails to the other side of the boat, filling them from a different angle, thus ... sending you off in a different direction?! ~ [OSAM, February 2025](#)

The last few months we’ve used nautical and sailing analogies to describe what we’ve been doing in markets and why?! In February we discussed, [luffing](#) and followed up in March with ... [To tack or not to tack, is that the question?!](#)

The underlying signals in markets have largely been suggesting a more measured approach towards markets to be prudent (since mid to late December). With each passing month of rising volatility, we substantially lowered our exposure to equities ... well before some of the most volatile trading days markets have ever seen.

Luffing in a stall for our signals to tell us whether or not we should tack has thus far proven to be a solid gameplan.

That escalated quickly...

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Other Side Asset Management
4141 Banks Stone Dr.
Raleigh, NC.27603
1-844-300-7344
www.othersideam.com

Managing Principal
Mitchel Krause

If we're sticking with nautical analogies, earlier this month broader indices took on some serious water ... only for a single tweet from President Trump (regarding tariffs) to provide the S&P 500 with its 3rd largest up day in the index's history (which was created in 1957) ... problem fixed I guess?!

Here's the thing ... the largest two up days for the index both occurred in October of 2008 (the 13th and 28th) ... I don't know if you remember October of 2008, but we do. From September 2008 to October 2008, a host of the most well-known financial institutions in the world were going bankrupt, being placed into receivership or were forced to merge.

Merril lynch is now Bank of America Merrill lynch for those tasked with risk managing your assets couldn't risk manage their own books. Lehman Brothers collapsed ... Fannie Mae and Freddie Mac were placed into receivership. Washington Mutual, Wachovia, Sovereign bank, Nat City, Commerce, all forced take-unders! UBS and Llyods were basically nationalized.

These were NOT good times where large rallies were to be celebrated.

Even larger up days have been had in the DJIA (which was around well before the S&P 500) ... the largest coming on October 30th, 1929, October 6th, 1931, March 15th, 1933, March 24th, 2020, September 21st, 1932, ... followed by the 13th and 28th of 2008... ([See: Images below](#))

Largest single-day gains for S&P 500

The percent change reflects the change from the previous day's market close to the current day's market close. The S&P 500 began in 1957.

Rank	Date	Closing level	Percent change
1	October 13, 2008	1,003.35	11.6%
2	October 28, 2008	940.51	10.8%
3	April 9, 2025	5,456.90	9.5%
4	March 24, 2020	2,447.33	9.4%
5	March 13, 2020	2,711.0	9.3%
6	October 21, 1987	258.38	9.1%
7	March 23, 2009	822.92	7.1%
8	April 6, 2020	2,663.68	7%
9	November 13, 2008	911.29	6.9%
10	November 24, 2008	851.81	6.5%

Table: Annie Jennemann/Hearst TV - Source: Yahoo Finance

Largest single-day gains for the Dow Jones Industrial Average

The percent change reflects the change from the previous day's market close to the current day's market close. The Dow Jones Industrial Average began in 1896.

Rank	Day	Closing level	Percent change
1	March 15, 1933	62.1	15.3%
2	October 6, 1931	99.34	14.9%
3	October 30, 1929	258.47	12.3%
4	March 24, 2020	20,704.91	11.4%
5	September 21, 1932	75.16	11.4%
6	October 13, 2008	9,387.61	11.1%
7	October 28, 2008	9,065.12	10.9%
8	October 21, 1987	2,027.85	10.2%
9	August 3, 1932	58.22	9.5%
10	February 11, 1932	78.6	9.5%

Table: Annie Jennemann/Hearst TV - Source: S&P Global

As recently as early last week, the Nasdaq was down roughly -25% from its cycle high with the Goldman Sachs high retail sentiment basket down over -35% ... that's some pain for investors who have been top-heavy to the MAG 7 (which, is the majority of retail investors chasing returns).

When volatility as measured by the \$VIX is elevated north of 20, let alone between 30 and 50 (as it has been recently), with Gamma being negative ... large market swings occur IN BOTH DIRECTIONS ... but it doesn't mean the seas have calmed ... it just means your boat can just as easily ride a 30 foot swell (wave) up as quickly as it can collapse into the depths of the 40 foot swell on the other side of that peak.

This month we keep it relatively short as we've remained in a luffing/stall position for some time and will continue to do so until the winds change, and while there have been some small signs of a shift ahead, there

has been very few firm confirmations that shorter term momentum and longer-term trends have been reestablished to the bullish side just yet ... we're close, but we're also staring at severely negative implied volatility discounts, which means investors are uncomfortably complacent.

This one's going to be a fight, between the data and the uncertainty that lies ahead for the data and flows, for as we look at the current investing landscape, we're staring at what appears to be the makings of the perfect storm brewing ... which is why we'll remain firm with our process ... understanding the data and following the signals!

Disinflation remains, but for how long?

The deceleration in inflation continued earlier this month with headline CPI falling for the first time in the last 9 months, coming in down -0.05% MoM and +2.39% YoY vs. +2.82% YoY in the previous report. Notably, Energy decelerated -2.29% MoM and -3.25% YoY vs. the -0.17% YoY prior, while Food prices accelerated, coming in +0.44% MoM and +2.96% YoY vs. +2.61% in the prior reading.

CORE CPI (less food & energy) accelerated minimally +0.06% MoM, while at the same time, CORE slowed to +2.79% YoY vs. +3.12% in previous reading ... also worthy of mention ... Transportation services decelerated -1.41% MoM and +3.10% YoY vs. +5.95% in the previous report.

Additionally, used car prices went negative, falling -0.69% MoM, decelerating to +0.58% YoY vs. +0.75%. Irony at its best, CarMax recently pulled guidance as a plethora of pundits suggest used car prices are about to once again skyrocket.

One might think the kneejerk reaction to increased tariffs would be for used car prices higher, but dealers need buyers who can qualify for financing, though during times of uncertainty, banks and finance companies (which include auto finance lenders) tighten their belts ... especially with input costs rising squeezing margins (which we'll discuss shortly).

With this in mind, just think about how many car loans have been put on the books over the last 4 years with an interest rate north of 12%?!

A 12.74% interest rate over the course of 84 months on a \$102,671.13 vehicle yields \$53,821.71 in finance charges bringing the total cost for the vehicle to \$156,492.84 (an \$1,863.01 monthly payment). But who would buy a \$100k car?! How many GMC Yukon's, Chevrolet Tahoe's, Cadillac Escalade's, BMW or Mercedes among countless other vehicles you see on the road today ... what cost between \$75k - \$110k?!

It's simply unsustainable.

The Producer Price Index also fell with prices declining -0.39% MoM in March, decelerating to +2.74% YoY vs. an upwardly revised +3.24% YoY in the previous report with both Goods and Services falling ... "Goods" prices fell -0.95% MoM and +0.88% YoY vs. +1.77% YoY in the prior report, while "Services" prices fell -0.17% MoM, also decelerating on a YoY basis from +3.83% to +3.53%

On the producer side of things, food prices did fall -2.15% MoM and dropped to +3.82% YoY vs. +6.04% with Energy doing the same, coming in down -3.97% MoM and -6.56% YoY vs. -3.53% YoY in the previous report. CORE PPI (again, less food and energy) fell -0.06% MoM and slowed to +3.31% YoY vs. +3.50% in the prior month's note. As we discuss the PPI it's important to mention:

Tariffs

Yep, we're going to go there for a brief moment! It's important to understand the Producer side of things in order to calculate margin compression and what the producers of goods are going to try to pass along to the Consumer!

To be very clear, I'm not arguing/advocating for or against tariffs, and our attempt is to address this will be as apolitical as possible (a near impossibility I know)!

We'll start with a fact: The vast majority of sitting politicians in Washington today, both Republican and Democrats alike, have ALL agreed at some point over the tenure of their careers that \$2 trillion-dollar annual deficits and a \$36 trillion-dollar National Debt is simply unsustainable ... as have the majority of economists (aside from a few staunch modern monetary policy theorists).

As we've discussed numerous times in the past citing the work of Lacy Hunt (including [May of 2020](#)) and his historical study of David Hume's published work in 1752, "Of Public Credit":

"when a state has mortgaged all of its future revenues, the state by necessity lapses into tranquility, languor, and impotence. And today, we know that it triggers diminishing returns and an insufficiency of saving to generate physical investment."

Unfortunately, and not so ironically, our political figures appear to change their position on a specific subject matter based upon the party that holds power ... for example, Senator Elizabeth Warren has recently been screaming that the Federal Reserve cutting interest rates now would likely spark inflationary pressures (which is more than likely accurate, mind you?!).

That being said she didn't seem to care all that much about stoking inflationary pressures a few years ago with inflation already sky high, through the roof as she strongly advocated for Powell to cut rates then!

The same could be said regarding tariffs! Be it a younger Nancy Pelosi, Chuck Schumer, Senator Biden, even President Obama ... they have all discussed the need to address the unfair global trade imbalance as well as tariffs in the past, specifically with the Chinese (while doing nothing about it) making the political theater of it all very unsettling ... though I digress!

Be it tariffs or the unsustainable path of our country's spending problem via debt, political "leaders" on both sides of the isle have argued, complained, and put on quite a show ... making the crux of the point even more poignant:

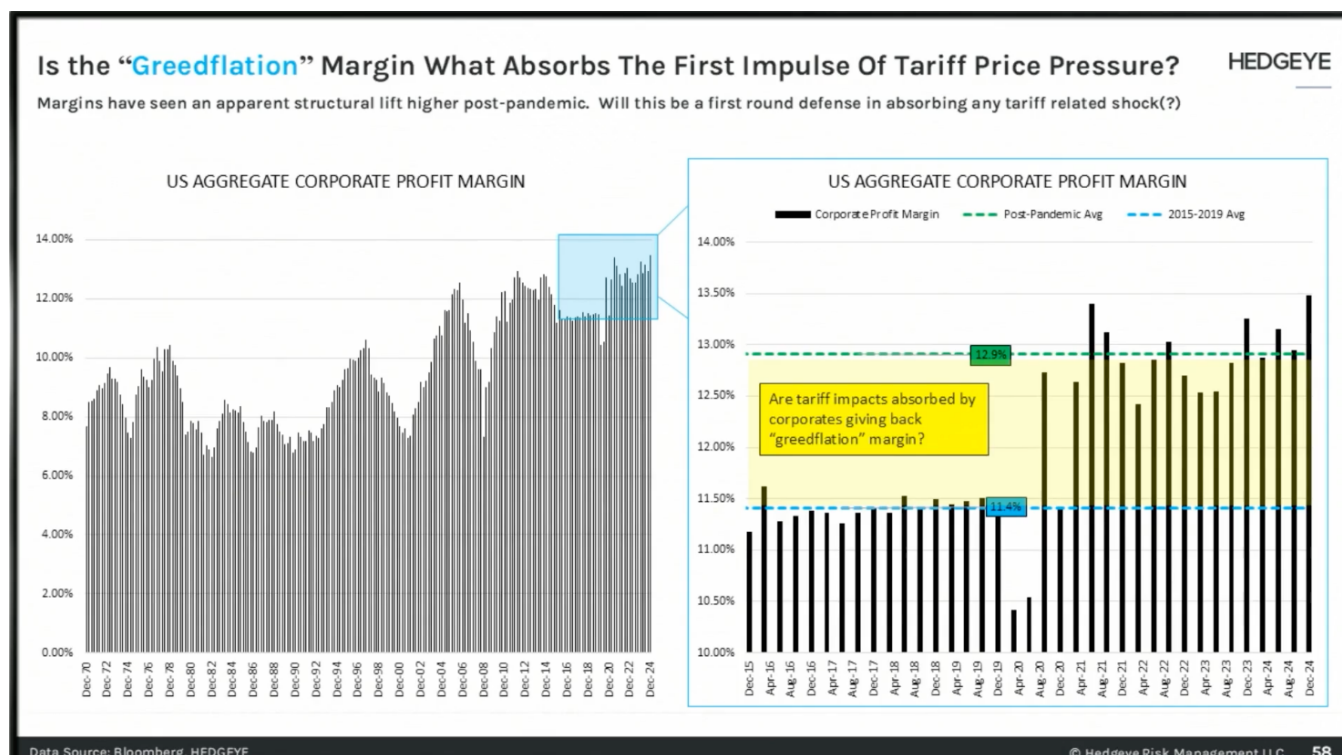
Indefinitely doing nothing about the problem is NOT an option ... at the same time, there is NEVER a good time to do it, especially if we don't want to end up like Hume suggests ... *“lapsing into tranquility, languor, and impotence!”*

Tariffs are likely to be inflationary in the short term ... and with the recent shipping/cargo/port information we'll discuss below, inventory will be thin ... prior to any deals getting done. It's important to remember that for every empty shelf, a closed or empty factory likely exists. Fair trade should exist, there is no reason why Canada places nearly 150% tariff on US butter that comes out of Vermont ... it's silly.

The current administrations reciprocal tariffs merely level the playing field to a point where both sides say, “ok, no tariffs, free/fair trade, let the chips fall where they may?!” Like him or hate him, it makes perfect sense and should be a good thing in the intermediate to longer term.

The 800lb gorilla in the room is what will China do?!

This undertaking comes at a time where there is a perception that government spending is being cut. And as we've written for more than 8 years ... any form of deleveraging, especially to this magnitude, has the *potential* to be extremely painful! A slowdown in growth through a reduction in government spending, as we simultaneously experience turbulence in the inflation data, and are already moving off of peak margins as noted by Hedgeye...



... could produce an extremely challenging disinflationary or stagflationary investing regimes for a period of time.

Especially with the bankruptcy cycle already up ~21% YoY PRE PRE-TARIFFS ... add a prolonged tariff standoff to the above and things have the potential to get ...

Extremely ugly, in a hurry!

While San Francisco Fed president Daly recently suggests, “the US economy is in a good place” ... container ships out of China are being cancelled at a pace faster than during the early months of the Covid pandemic as the world was shutting down!

They must breed “out of touch” Fed presidents in San Francisco, for a statement like this, at this moment in time is almost as clueless (if not more so) then Janet Yellen trying to extend IndyMac a loan the day the OTS was shutting them down when she was president of the San Francisco fed during the GFC in October of 2008 ... just clueless!

In May of 2020 there were 51 blank sailings (a blank or void sailing is one which the entire journey or a single port has been cancelled by the carrier). As it currently stands, there have been more than 80 blank sailings in April with more than 40% of the container ships leaving China being empty.

(Full disclosure, I have bought a few extra cases of toilet paper and paper towels (over-reaction or not))?!)

This many blank sailings will have west coast ports silent ... and last I checked, San Francisco is on the West coast. With little to nothing coming into the country out of China, trucking is about to freeze, starting with drayage (think short distance, from port to rail (or intermodal)), then followed by interstate traffic.

Is it possible “markets”, in this case, the Dow Jones Trucking Index was telling us something back when Donald Trump took office, with tariffs and trade being one of his larger campaign promises?!



For the moment, businesses have some inventory to chew through ... though, once businesses are through any inventory backlog, anything from China will become exponentially more expensive ... with a recent data point suggests that 71% of all products sold on Amazon are manufactured in China.

As I write, Amazon has just implemented a line item on their website showing what the “tariff” flow through is to any particular item.

We’re witnessing tectonic shifts in global trade, which, in the end, will ...

... more than likely prove to be a very good thing for all parties involved (EX-CHINA). However, getting to the other side of trade negotiations and the repositioning of where specific goods will eventually be manufactured will take time! During this period, there is likely to be some significant pain, especially for non-discretionary goods (you only need so many t-shirts)

As is the case with most market corrections, they've come during a period of disinflation (the simultaneous deceleration in both growth and inflation), that being said, we've been saying for months now, that after a noticeable deceleration in inflation, it was likely to reaccelerate largely due to the base effects.

And while current data remains disinflationary, we know that markets are forward looking ... with inflation already poised to reaccelerated PRE-tariffs and tariffs are very likely to add to these pressures, this could very well put us squarely into a stagflationary regime (which isn't as bad for markets as a disinflationary regime).

Though, we investors should be prepared to see margins squeeze, layoffs accelerate, lending contract and spending on anything outside of necessities crumble ... (good times, right?!)

To sum up ... recent disinflationary data from the BLS on PPI, CPI and a host of others come pre-tariffs, but it shouldn't be long until we see that flow through into the numbers from tariffs. As these data points are passed along, we will then have a better idea as to what producers are going to attempt to pass through to consumers ... assuming inventory makes it to the shelves at all?!

Collectively, this scenario is highly likely to adversely affect financial institutions, credit and the extension of!

[More 'Toys' to come](#)

We've discussed high-yield credit spreads losing their safety/warning signal as far back as 2016/2017 when we pre-emptively wrote about the near \$5 billion-dollar Toys R Us bankruptcy debacle in March of 2016, months before the actual filing.

In what used to be a very solid barometer for investors to lean on in an effort to gauge overall market health, is now much weaker today than any previous point in our career (which spans nearly 30 years).

With the rise of passive investing in the bond markets, extremely talented credit analysts who used to invest in the bonds of individual companies based on true risk reward setups, have ultimately been replaced by passive inflows and outflows (and the creation/redemption units they generate) as well as the opaque black hole that is private equity (the antithesis of transparency) ... NOT whether or not a company's credit is excellent, abhorrent or anywhere in between?!

Market structure, based on passive flows, creates an artificial bid beneath worthless names until ... lenders pull back and zombie companies can no longer hide their bleeding, which creates epic collapses like Toys "R" Us's epic fall from \$0.95 cents on the dollar to \$0.26 in less than a 36-hour time frame.

A recent example of this would be the overnight announcement from Zip car wash in March that they would be filing for Chapter 11 bankruptcy protection! At the time, the company had \$654 million dollars in debt on the books with ... \$1 million dollars in cash.

While the Toys “R” Us bonds traded publicly, in eerily similar fashion, the Zip bonds were marked on the books of private credit investors at anywhere between \$0.93 and \$0.95 cents on the dollar ... please think on that for just another second ... \$654 MILLION in debt ... \$1 MILLION in cash ... marked at \$0.93 to \$0.95 cents on the dollar ... PURE INSANITY!

Commercial bankruptcies are up roughly 20% YoY through the end of March and per Bloomberg, there have been north of 20 bankruptcies with \$50mm or more in liabilities ... several being multi-BILLION in size. So, not only have bankruptcies been accelerating, but they’re getting LARGER, at a time when lending to non-depository financial institutions is up roughly ~20% per year as CNI (Commercial and Industrial lending) is FLAT!

The next Domino

When cash flowing into the economy is obstructed, companies are left with few options ... and given the level of uncertainty that currently exists given overall market conditions, inclusive of the tariffs, coupled with the size and scope of corporate bankruptcies already accelerating pre-tariffs ...

We would expect this trend to continue at an even faster pace, especially for the countless zombie companies who are already crunched for cash as we enter a very difficult period for consumers who have already been squeezed given the compounding rate of inflation over the past 5 years (+25%), many of whom have also been laid off (birth/death rate be damned)!

The thing about corporate bankruptcies is ... they’re typically a leading indicator for household bankruptcies! As the cycle goes ... slowing sales and decelerating revenues first show up in layoffs (for those companies large enough to weather the storm):

For example, on April 22, Intel (\$INTC) announced they plan to reduce expenses in a \$1.5 billion dollar restructuring, while laying off up to 20% of its workforce (or about 20,000 employees) ... this comes immediately after they’ve just finished laying off nearly 15,000 employees which began August 2024.

If you think those 15k employees all found similar paying jobs, we’ve got a bridge to sell you ... none the less, here’s another 20k about to be handed their pink slips ... and for those following closely, as corporate bankruptcies lead to unemployment, so goes the passive bid artificially propping equity markets up.

Household bankruptcies always lag the corporate bankruptcy cycle, for its many of those who lose their job and can’t find a suitable alternative, while being overextended economically who are forced to file.

As has been the case with corporate bankruptcies, household bankruptcies have also been steadily rising ... all PRIOR to the reacceleration in inflation that we've been anticipating and writing about for the last few months ... again, which preceded any additional inflationary pressures that tariffs will bring!

This all comes, just as the repayment of student loans are to resume (as of May 5th, 2025) ... where some 5 million (out of nearly 42.7 million) student loan borrowers (that owe more than \$1.6 TRILLION DOLLARS) are already more than a year delinquent (some nearly 7 years delinquent) MUST start repaying their loans!

We would be remiss if we failed to mention an additional 4 million borrowers who are 3 to 6 months delinquent ... none of which has been collected on since March of 2020! We've written about this debacle for the last 4 years ... the consumer is tapped out!

This is where things get interesting

It's been said before that Federal Reserve Chairman Powell doesn't care about the stock market?! They staunchly defend his lack of equity market interest, stating he's a credit market guy. We don't think there is much of a distinction these days given that overall market structure, both equity and credit through rebalances and target date funds walk hand in hand.

Be that as it may, Powell knows he went too far in defending junk credit during the Covid crisis as he openly discussed the crossing of "a lot of red lines" when he opened lines of credit to just about every company under the sun (including Junk Bonds) when liquidity froze during Covid:

As he stated to the [Princeton reunion club of 2020 on Friday May 29, 2020](#), *"We crossed a lot of red lines, that had not been crossed before."*

Now, he tried to defend that position from an "act first, sort things out later" perspective, but he broke the law, and he knows it ... he allowed insolvent companies access to credit lines that they should NEVER have been allowed to tap.

Still, the Fed is technically the lender of last resort, and when credit freezes, he is supposed to step in and lend to SOLVENT companies who have no access to liquidity for whatever the reason. His resolve as to whether or not he saves both solvent and insolvent companies might be tested sooner than we'd like to think about?! And should he draw a line, what will he deem solvent today?!

Couple this with what many believe to be bad blood between Powell and President Trump, lord only knows what either are likely to do should the proverbial **** hit the fan?!

Insanity

The crux of our message has not changed over the years, in fact, it's only gotten worse. We are a society that irresponsibly spends ... be it the consumer or the government, uncontrollable spending has been fueled by artificially low debt, which creates boom bust cycles.

The last 4 years our government has deficit spent to the tune of \$2 trillion-dollars per year, while printing fake job reports fueled by government hiring and the arbitrary birth-death model (what could possibly go wrong?!)

The hard truth is everyone knows \$2 trillion in deficit spending is unsustainable ... our national debt has expanded from \$23.2 TRILLION to \$36.2 TRILLION over the last 4 years and we're getting lectured weekly by Janet Yellen about our national debt, and how strongly she dislikes the current administration's plan?!

This woman has literally overseen the largest expansion of debt the world has ever seen while tenured as Fed Chair, Vice Chair and Treasury secretary and the mainstream media continues to parade her around as an "expert"?! As we wrote in December's ["Absurdity remains"](#) section:

"Yellen recently stated: "I am concerned about fiscal sustainability, and I am sorry that we haven't made more progress. I believe that the deficit needs to be brought down." [Wall Street Journal's CEO Council's Summit](#) (December 10, 2024)

Immediately following this ridiculous statement, Zerohedge brought some perspective and TRUTH to the absurdity that is the Washington establishment.

"U.S. debt rose by \$8.2 trillion while Yellen was Fed Chair or Vice Chair, and by \$8.5 trillion while she was Treasury Secretary ... in other words, Janet Yellen has personally overseen \$16.7 trillion, or 46% of all the debt increase in the history of the USA ... but she is "sorry"!" ~@zerohedge 12/10/24

At the same time, even Yellen openly admitted at the WSJ's CEO Council's summit, *"I believe that the deficit needs to be brought down!"* ... she just doesn't like how the current administration is doing it?! Unfortunately for Janet, she had nearly 20 years to fix it and she did nothing but make things exponentially worse.

Seriously, the woman and her ilk have nearly destroyed the country, how anyone suggest she holds a single ounce of credibility is beyond me?! Asking her for her opinion on this subject matter would be akin to trying to rehabilitate a crack or meth addict, by seeking out the advice of the dealer who got them hooked on the drugs to begin with?! It's literally INSANE.

Everything mentioned above, from the corporate bankruptcy cycle (which leads to layoffs) ... to the resumption of the repayment of student loans, perpetuates personal bankruptcies. Which then flows through into the banking system, adversely affecting the economy even further ... as the extension of credit slows.

As bankruptcies accelerate, charge offs skyrocket, loan loss provisions jump, and lending comes to a screeching halt ... perpetuating the cycle lower ([SEE: OUROBORUS, April 27, 2023](#))

Unfortunately, what some might not like or want to hear is that all of the above PRE-DATES any moves from the current administration ... and while all cycles are different, this is very reminiscent of 4Q2019 where the data was already rolling over pre-covid, where covid was merely an accelerant (and an excuse to unleash trillions of dollars on to an already flailing economy).

Final thoughts

The Perfect storm was a movie based on the final days of the Andrea Gail and her crew; a commercial fishing vessel based out of Gloucester, MA in the late 80's/early 90's. After a "cold streak" of trips out at sea, owner Bob Brown, essentially guilted his crew into one last "late-season" trip in an effort to make up for the seasons poor catch.

They did this knowing that any excursion this late in the year placed both themselves and their vessel at greater odds of running into severe inclement weather. Spoiler alert: what do you think happened?! After an extremely successful catch is met with a, what can go wrong, will go wrong scenario, the worst of all things happens when their ice machine/freezer (which is required to keep their catch fresh) breaks and the only way to save their catch and capitalize on their good fortune is to navigate through two extremely powerful weather fronts and a Hurricane all converging on each other (which creates, The Perfect Storm).

Inflation per the data has been decelerating with inflationary pressures staring us squarely in the face. Discretionary spending in the CPI is DOWN ... while a significant number of layoffs brew under the surface!

Americans are at a point where many can only afford to pay for essentials, BEFORE what may transpire should these inflationary pressures reaccelerate with a vengeance due to tariffs.

Nearly every politician in Washington has agreed at one point in time or another that the spending path we were on was unsustainable but when rubber meets the road, and the two largest economies in the world have now collided, the blame game erupts and none of them are concerned about anything than getting re-elected ... the economic future of our country be damned.

This administration is going where no modern-day politician has gone, and there are a LOT of moving parts. A new global order of trade is the most likely product?!

Billions of dollars may flow into our country, or they won't, only time will tell?! At the moment, it appears as if the majority of countries are already at the negotiating table, from India, South Korean, Taiwan and Vietnam to the UK and nearly 100 other countries. The global economy needs the purchasing power of the United States, deals will be struck, the question becomes ... how quickly?!

Should these tariffs add fuel to an inflation fire that's yet to be put out, stagflation or Quad 3 could be what markets are pricing in?! Should some trade deals hit sooner than later and money flow directly into the economy, we could quite possibly be looking at an economic "quad 2", reflation?

Again, as noted above, for as many empty shelves as we may see in the coming months, there is an empty factory somewhere else feeling equal or more pain.

We would cordially suggest exercising some patience, do your best to remove emotion from the situation ... follow the data and signals. While the data may be muddy for some time, we'll rely on the signals. Market structure has modestly improved over the last week or so ... still, we do NOT see any definitive signs of an "ALL CLEAR" just yet.

Our defensive positioning has done a good job at protecting us over the past few months. In drawing down a fraction of what the majority of investor have lost, we've given ourselves the ability to remain luffing close to port for a while longer.

While we have added a little more equity exposure, given the recent firming in market structure, from an options/flow perspective, we would consider it more, "adding supplies to the vessel for the next journey" than "pulling up anchor and setting sail or tacking in a new direction just yet!"

As always, never hesitate to call with any questions or concerns!

Good investing!

Sincerely,



Mitchel C. Krause
Managing Principal & CCO

4141 Banks Stone Dr.
Raleigh, NC. 27603
phone: 919-249-9650
toll free: 844-300-7344
mitchel.krause@othersideam.com
www.othersideam.com

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