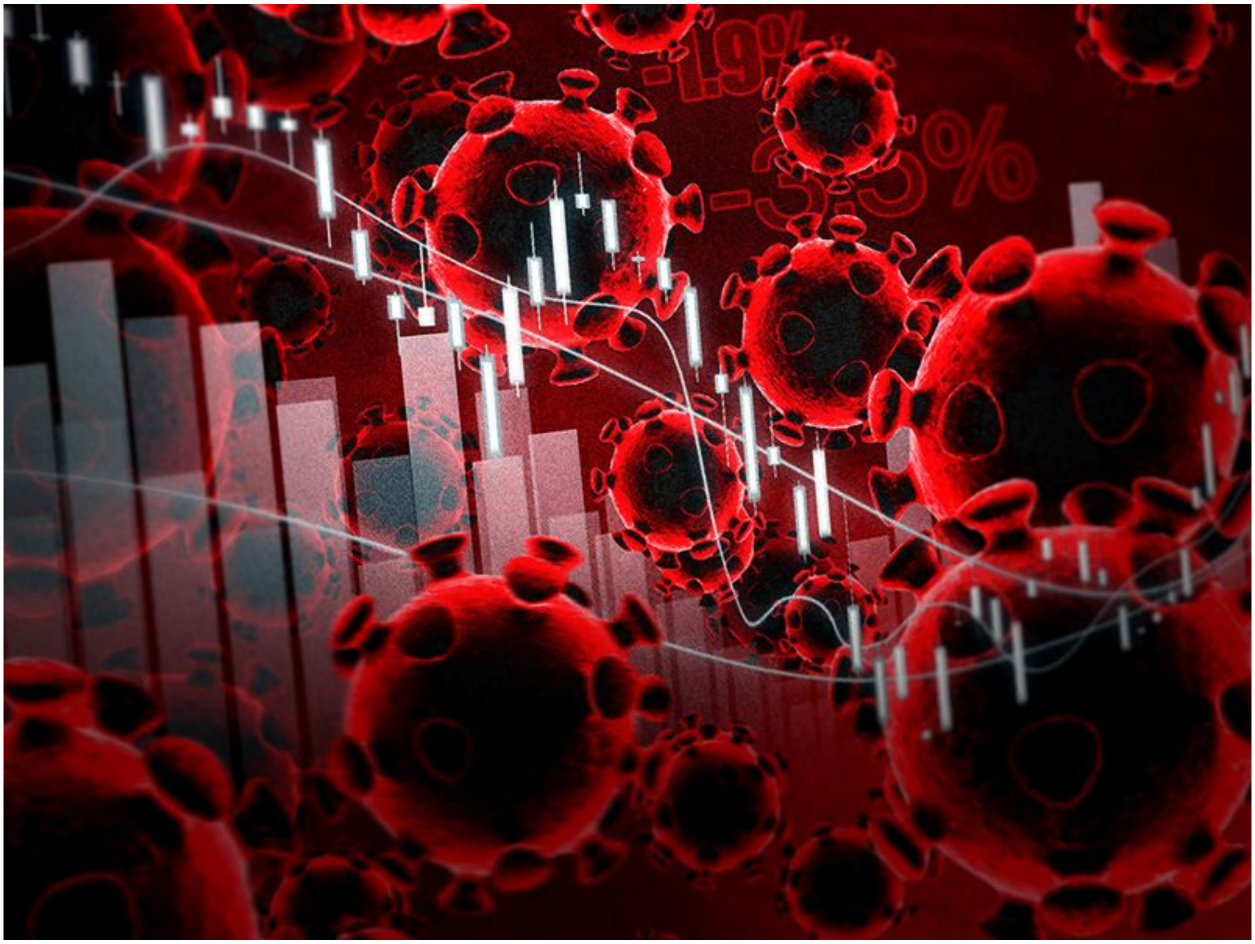
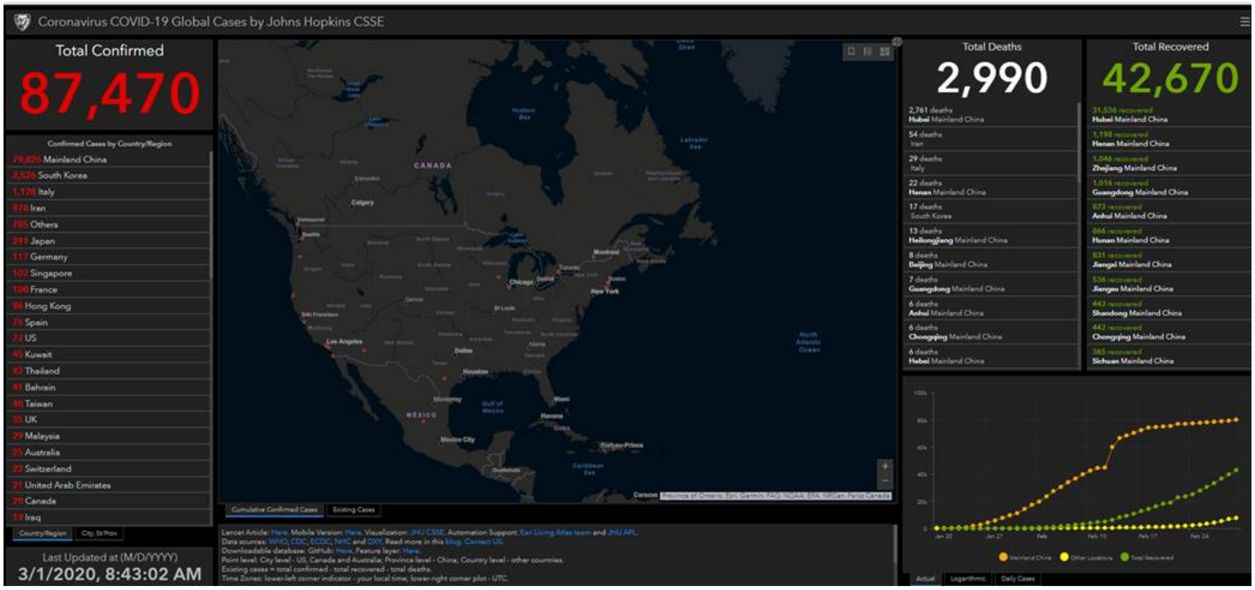
A World on Edge…



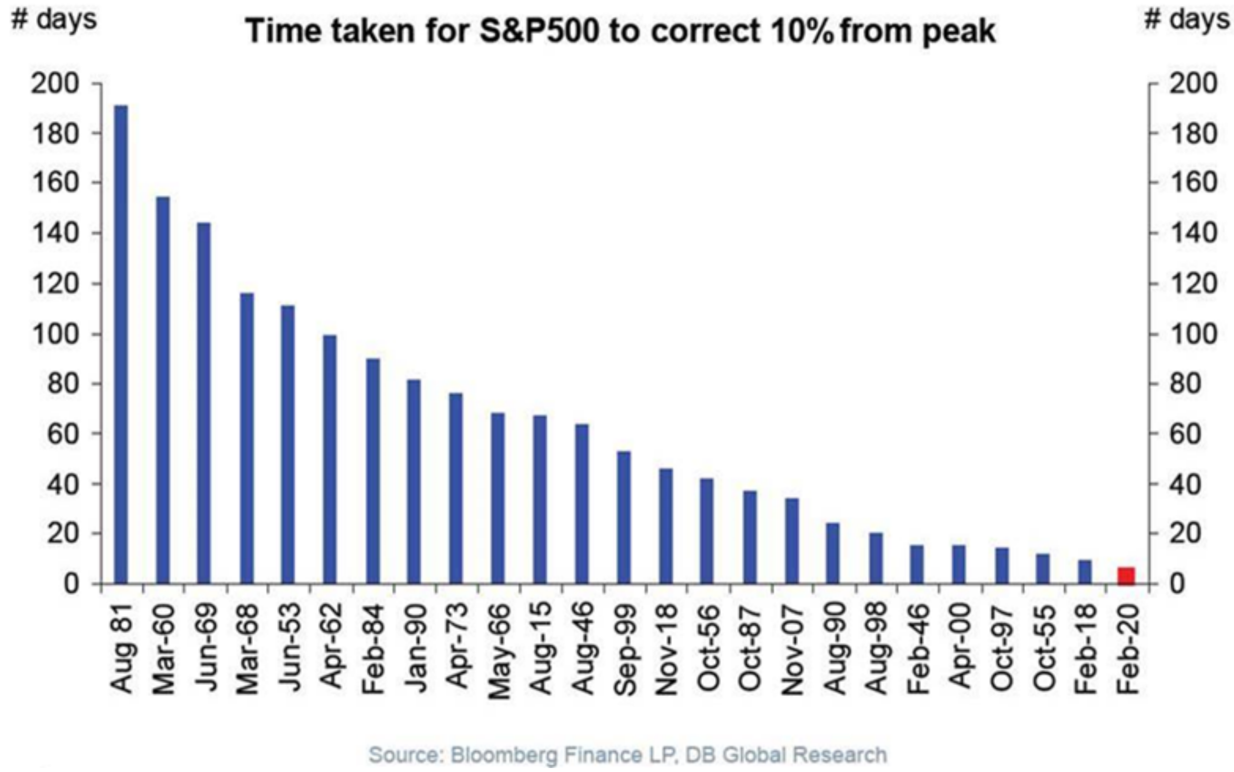
With markets coming unspooled last week, it has become exceedingly clear that global central banks are taking inventory of the weapons they have available to keep markets, the financial system, and the worldwide economy from seizing up. No small task given how on edge everyone appears to be. For those looking to keep up with the spread of Coronavirus, along with the ratios of contractions and recoveries, John's Hopkins provides an excellent and detailed dashboard that keeps track in real time.

Coronavirus Dashboard



As has been chronicled and explained many times, lasts week's selloff was the fastest and most extreme in market history, and not since the start of the global financial crisis in 2008 have we seen this kind of downward pressure on equities. Good news is that we are technically down just a little. Bad news, if this is the top, we have a long way to go to clear out the valuation conundrum.

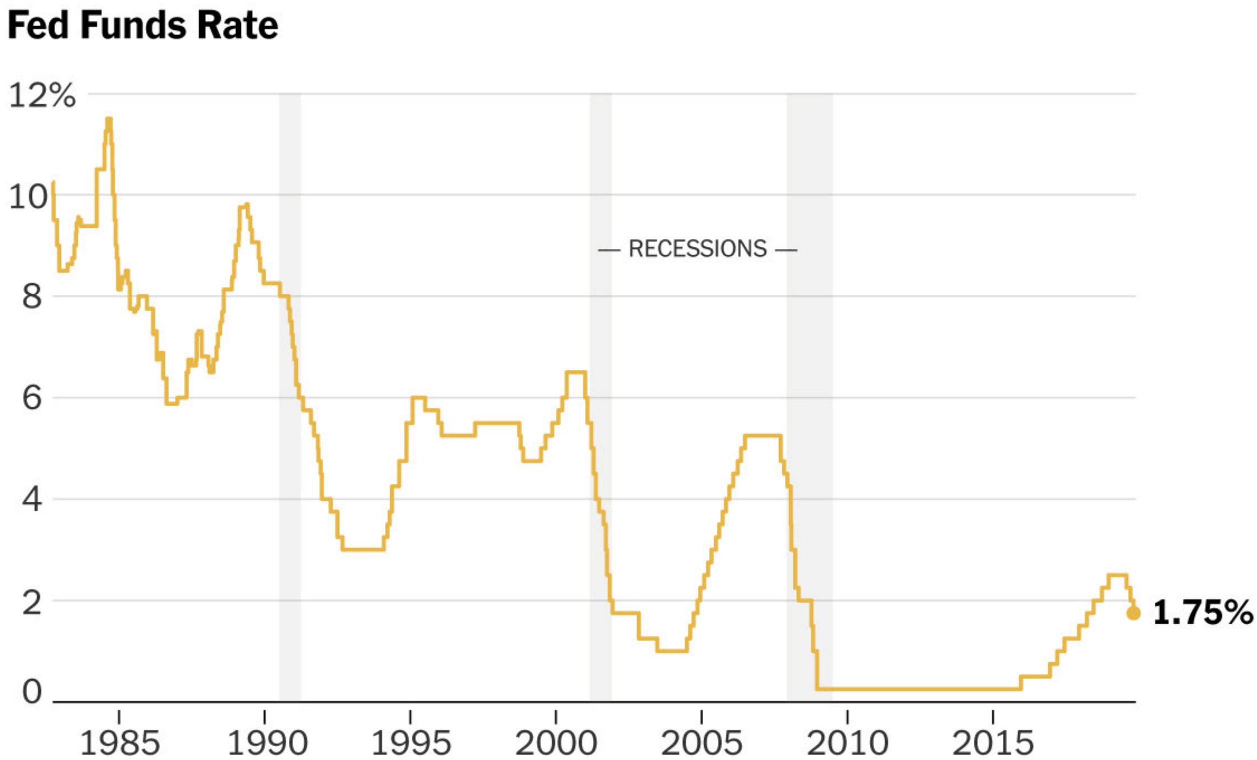
Fast & Furious



Notice how the second most severe drop in the market was dislocation that took place in February 2018. There were different reasons then, as there are now. Importantly, the markets did recover, and did so even more a year later when the Fed pulled a policy U-turn.

The question for the markets is, are we looking at a mid '90s environment where rates went sideways, and we avoided recession. Or are we following the pattern seen in 2002 and 2008. The former was fine for equities, the later not. The ever uplifting Sunday *New York Times* contained a commentary this week that talked about how hard it would be to ring fence a Coronavirus recession. 'Dr. Doom', Nouriel Roubini chimed in as well, warning of a flock of white swans approaching.

Flirting with Trouble



One of things we wondered about, and cautioned through some of our short selling, was the nature of both risk-on and risk-off assets rallying in unison. Looks like one was right, and one was wrong, at least for now. We shall see what this week brings, by our reasonable estimation we gain back some of what was lost, though 1,000-point swings in the DJIA could be the norm for a while, and headline risk runs rampant.

The Pain Trade

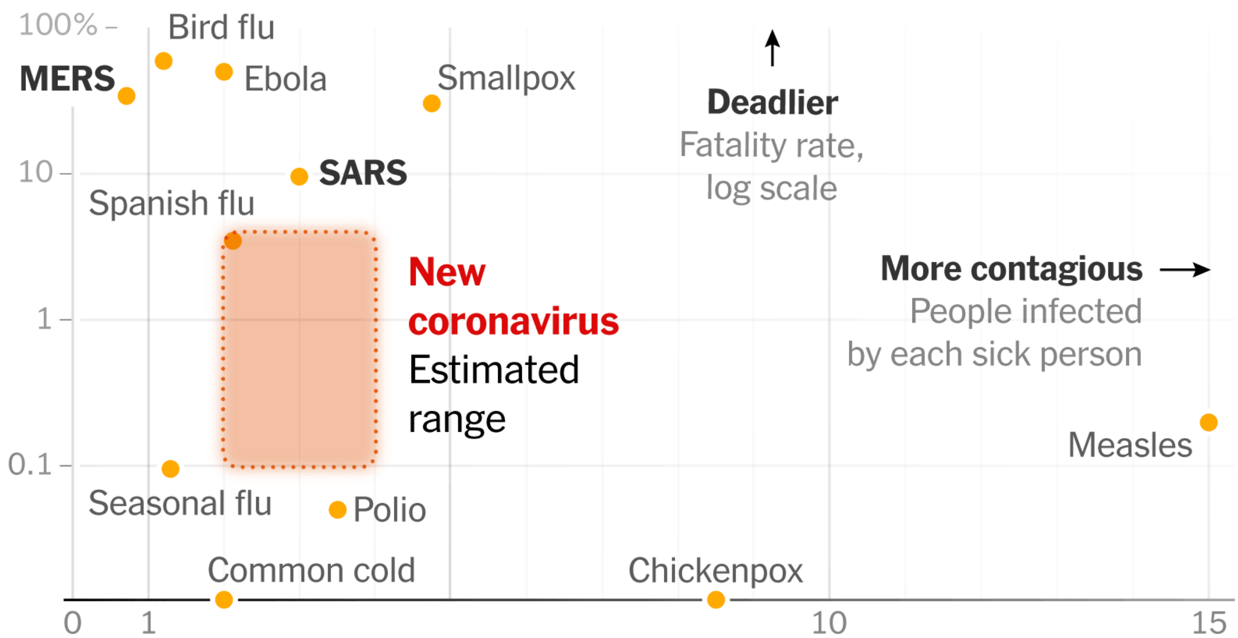
What to Expect Next

Two things are going to be driving the markets this week, and one thing is not. The two that matter are the waterfall of pre-announcements from companies who need to let investors know that they aren't going to make their earnings estimates. Stock reaction is going to tell us a lot about what news is currently baked in, and what isn't.

Unfriendly Trend

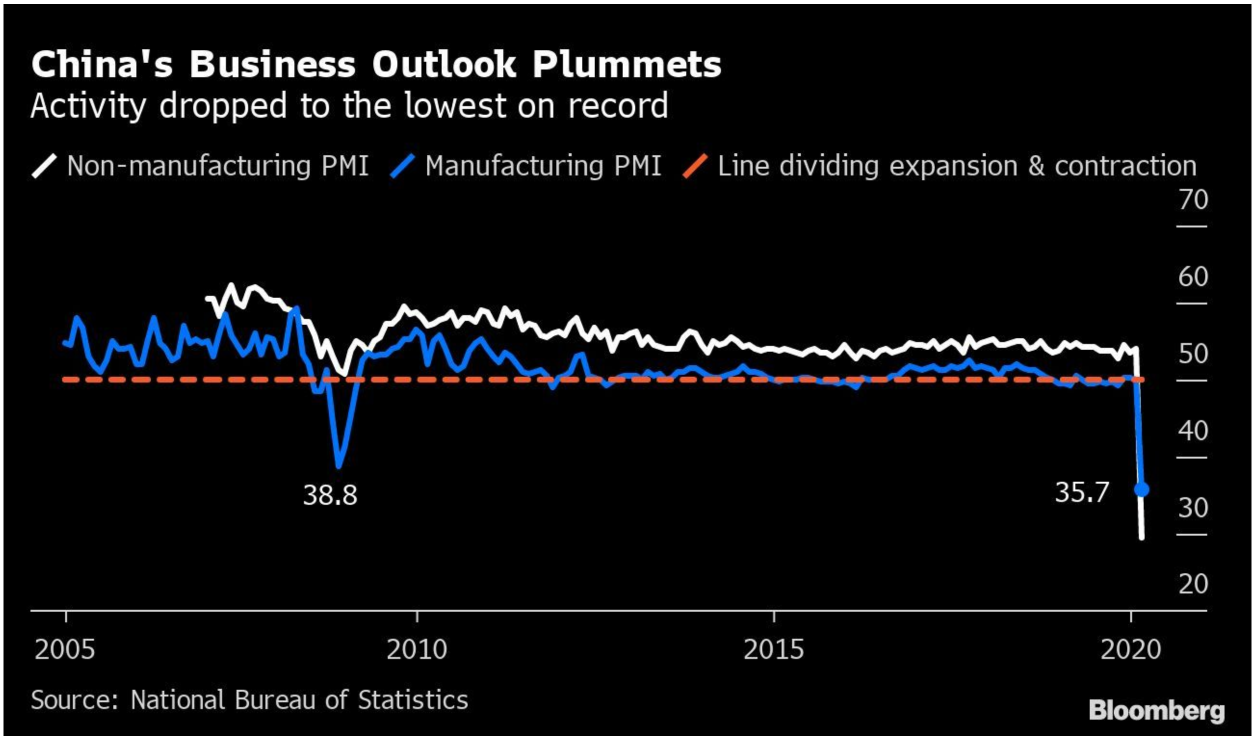
The second thing to keep a weather eye on is news concerning the spread of the disease. The truth of the matter is that the situation is going to get worse before it gets better and Bloomberg has a very good map that helps track the outbreak. The key will be if the narrative shifts to this being a strain of virus that is no worse than the regular flu, or if it becomes something closer to SARS. If we able to stay within the box below, then by all accounts it appears that this too shall pass.

The Grid to be Avoided



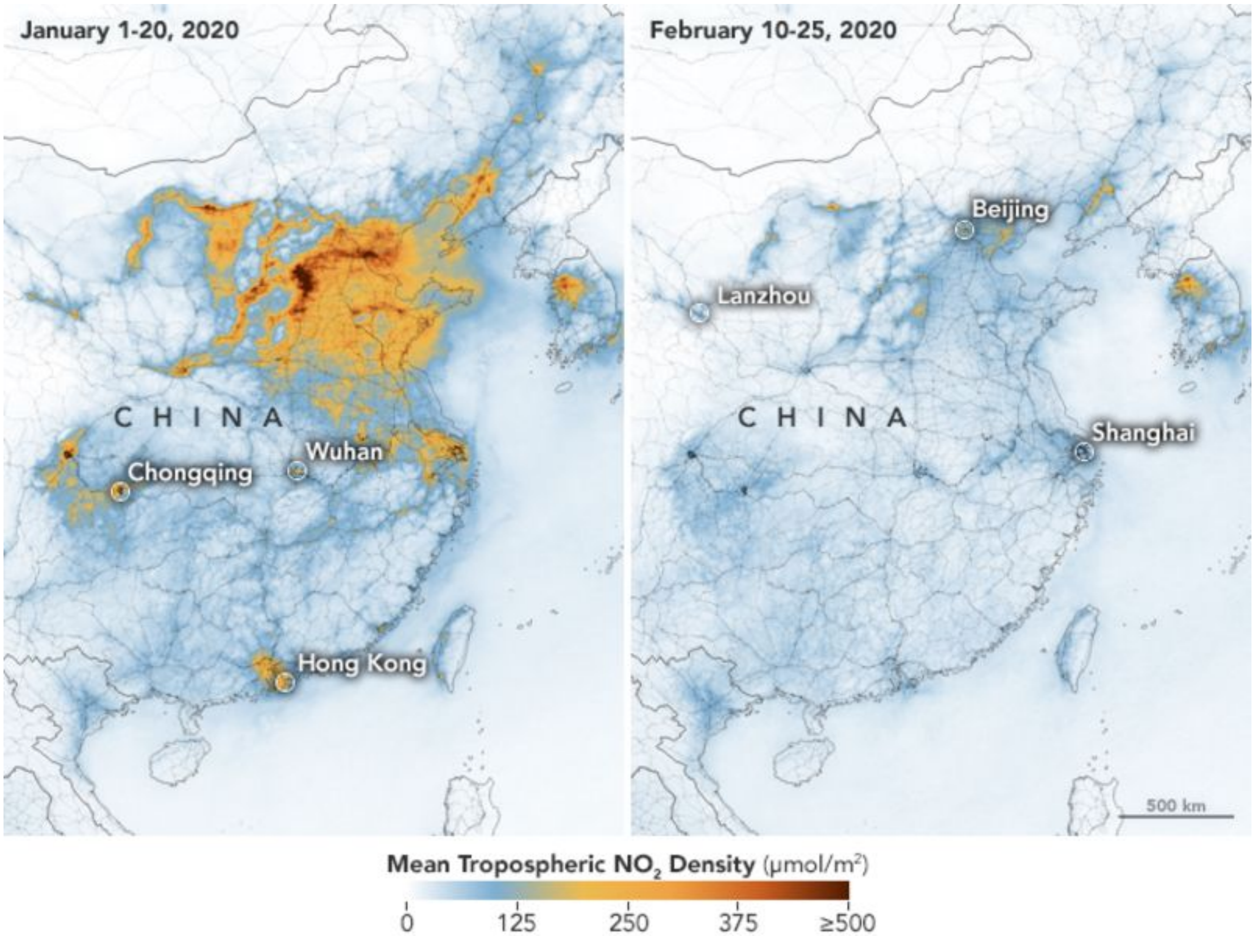
What we don't think will move markets this week is any of the real economic numbers on the calendar. For starters, the spread of the virus didn't pick up outside of China until late in the month, and therefore we won't get a clean look at its impact. Second, big things like employment aren't likely to be derailed in the long term. That said, the economic news coming out of China right now is awful and things like business sentiment and manufacturing are falling off a cliff.

This is Bad



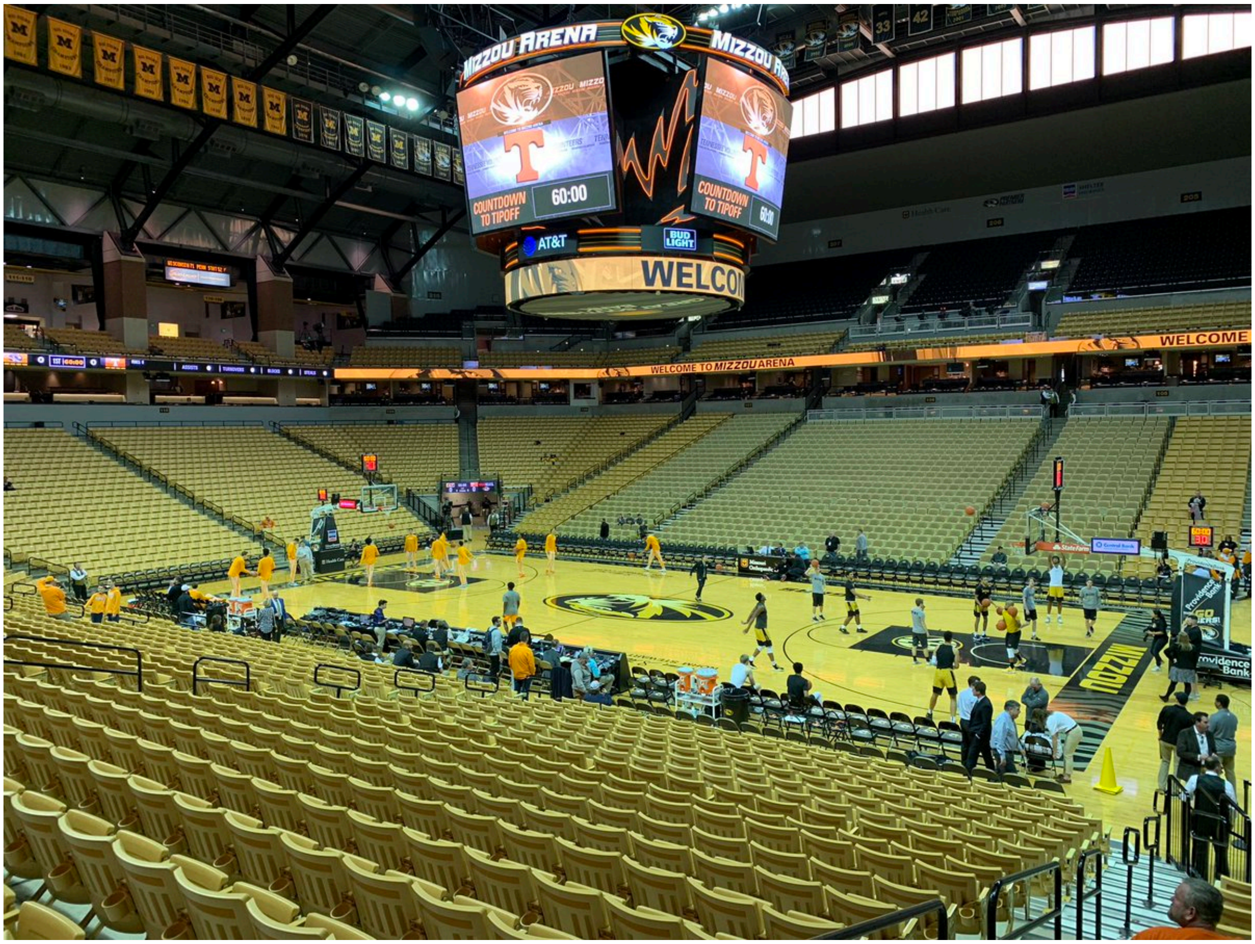
One of the most fascinating images we found over the weekend that indicates just how big the impact this has had on the Chinese economy was the one below which illustrates the drop-off in carbon dioxide levels across the industrial centers surrounding Beijing.

Clearing Trend



A factor we think is partially driving the markets lower right now is the sheer number of gatherings and events, business and otherwise, that are being cancelled or forced to be modified. There is now reasonable risk that 'March Madness' 2020 might be played in empty arenas to protect both players and fans.

Tough Loss



On Sunday, news hit that the world's largest energy conference, IHS CERAWeek was canceled. When these things happen flights empty out, hotel rooms that were previously booked get un-booked, and deals that would have gotten done over dinner at the Four Seasons don't. Add when that all adds up, suddenly Houston has a problem. But with oil probably going to $30, attendees would be needing to bring ample amounts of gallows humor to get through a four-day oil confab.

No Deal!

How Did We Do?

As you can imagine, we fielded a lot of inquiries this week about how our strategies performed last week. Up until Thursday it looked like we were going to book something in the top-decile or at least top-quartile performance category. The day started off well enough as we were down about one third of the market, which is what you want to be if you hedge. As the markets started to unspool, and eventually everything we were watching was hanging a bid wanted sign out, it became clear that there were no safe havens in the equity markets.

Floor of the NYSE

Keep in mind, the long side of our equity book is filled with things that people need regardless of what happens to the economy. Hand soaps, toothpaste, spices, and soft drinks get purchased regardless of virus risk. The stocks of these companies also throw off a nice 2%-3% dividend, which the last time we checked was pretty good given that the entire treasury market is trading with a one handle.

Who Will Give Me 150?

To put a bow on how we did, and how an A went to a B, we have to admit that we covered too much of the short book earlier in the week. That said, we got what we thought were gift prices for some of our positions, and this left us more exposed on the long side when the market really gave up. All in, we participated in about half to two-thirds of the downside, and have taken some serious profits off the table.

Vornado, Wells Fargo, BHP Billiton

The Winners

Not everything out there is taking it on the chin, most notably companies that can keep you settled and indoors. Some of the perceived winners so far are Netflix, Peloton, K!2, Zoom, and surgical glove maker Top Glove. As the largest maker of those in the world, once can see why the company has top honors.

Top Gloves

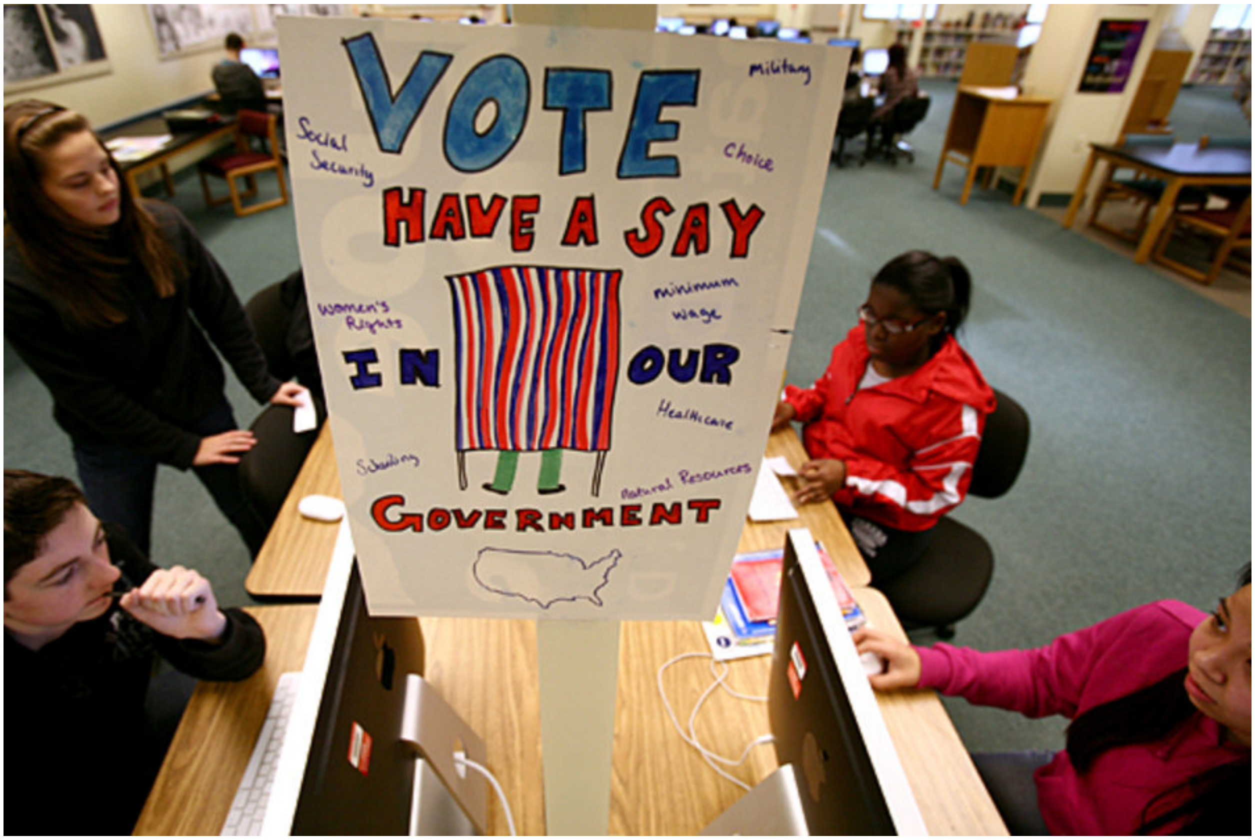
Politics & Markets

Another indicator that the market might be discounting something in addition to the Coronavirus is the rise of Bernie Sanders in the polls, as he is now the clear front runner for the Democratic nomination, especially with Tom Steyer and Mayor Pete out of the picture. As many analysts have said, if Bernie gets elected markets would indeed be 'feeling the Bern'.

'Pick Me, Pick Me'

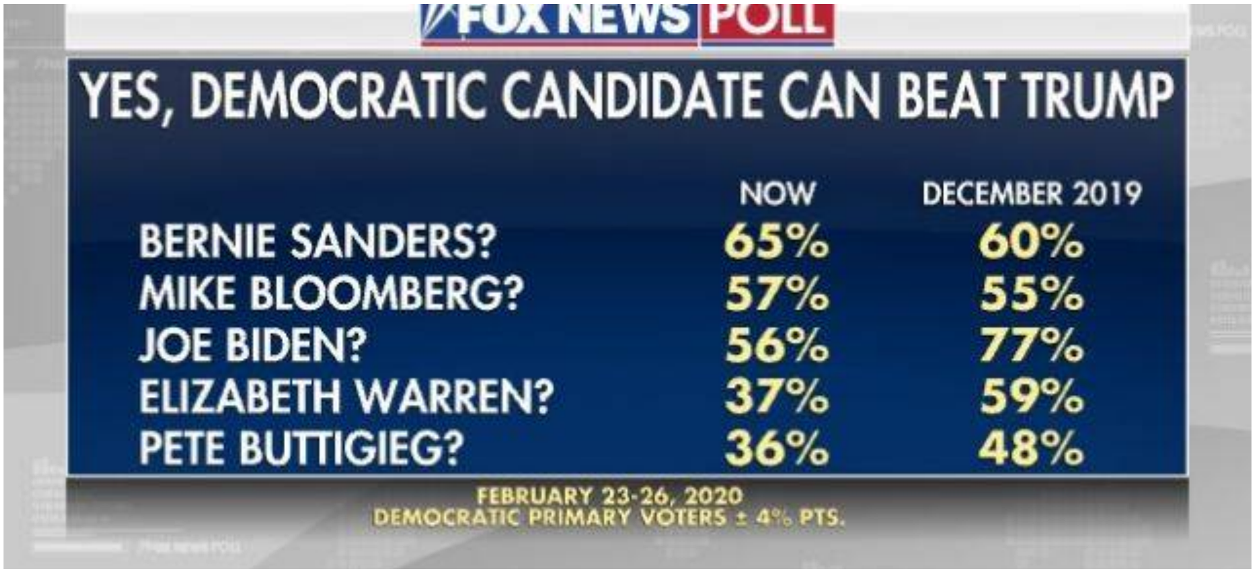
Out of the need for some comic relief last week we watched the Democratic candidates debate in South Carolina. What we saw astonished us. We say astonished because as the night went on it became clear that the process of debate after debate was diluting the Democrats brand, and from our estimation will do them reasonable harm going into the general election. This was the tenth round of painful back and forth of what seem to be questions born from a high school civics class.

'Tax the Billionaires'



As we said earlier, at this point we watch these things somewhat for entertainment value as neither party is speaking our language. If this keeps Bernie going strong and probably getting the Democratic party bid, but the process to get there will have lost because of its brokenness. I'll let you decide if you think Sanders can beat Trump. What I do know is that markets wouldn't like it if he did.

The Bern Rises



Diversions

This weekend the quite coastal town we call home, Santa Barbara, will play host to the World of Pinot Noir gathering to be held at the Ritz-Carlton Baccara. The event brings together the foremost producers of the delicate fermented grape juice, as well as chefs looking to pair it with multi-course meals. Event tickets range in price from $65 to $1,500. There are two Grand Tastings, one on Friday night, the other Saturday.

"Wine, Wine Everywhere…"

While fans of the game almost always like to hear the phrase 'pitchers and catchers report' signifying the return of baseball via spring training, for Major League Baseball there is a greater urgency as the league desperately wants to put the Astro's sign stealing controversy behind them. The Grapefruit League in Florida will have you on the east coast taken care of, while those of us out west can enjoy the Cactus League in Arizona. Given the roster moves over the past few months, it would appear that the Yankees and Dodgers are on collision course for a rendezvous in October, which we would like to see. What we don't want to see again is Dave Roberts draining of his bullpen starting in the fourth inning.

Play Ball