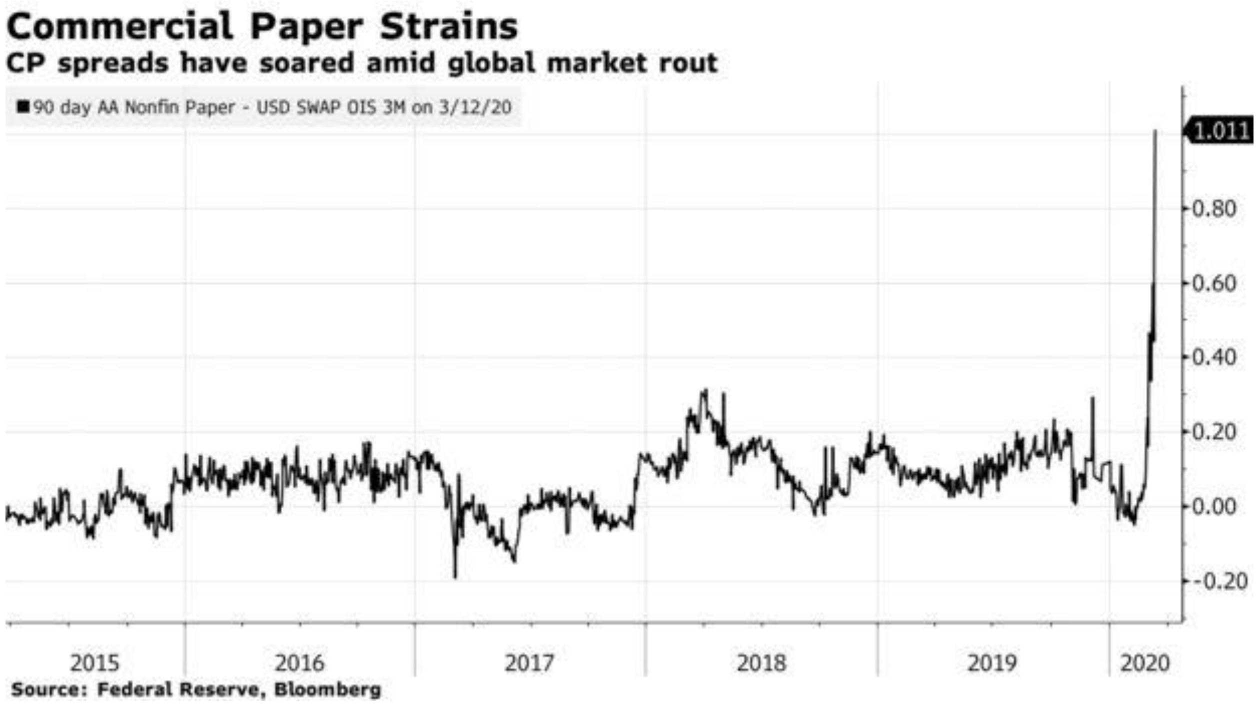
An Actuarial Disaster…

The Federal Reserve announced Monday morning that they are even more all in than they were before, by announcing that they would be using their balance sheet to buy any sort of debt they felt would help grease the credit market wheels, and keep us from slipping further into crisis.

'I Got This…I Think'

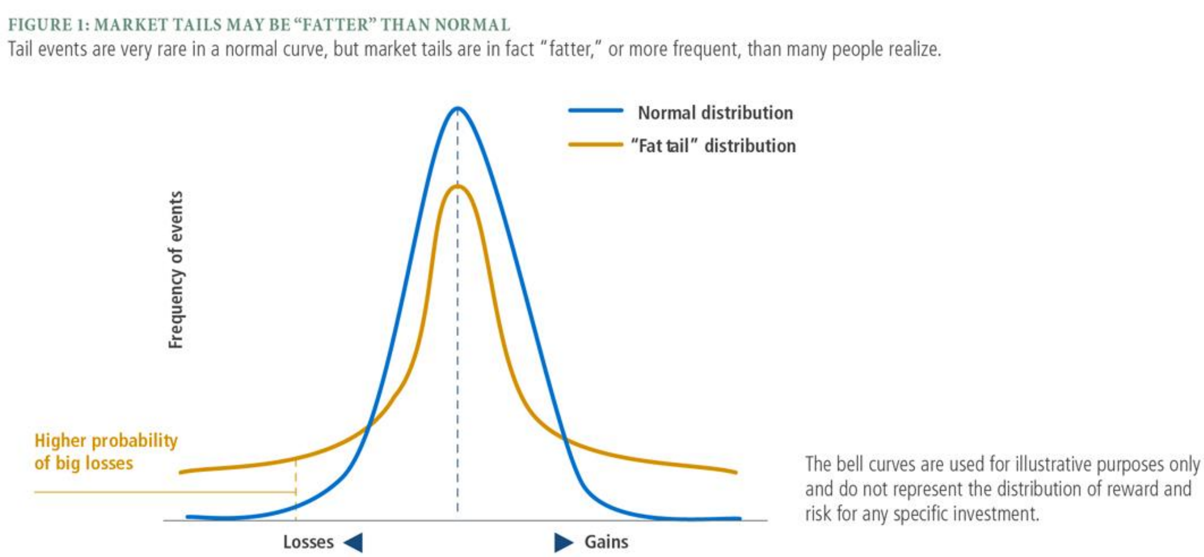
All of which is a good thing for confidence, as nobody wants to see a chart like this where the very basic, and very short term velocity credit tightens. This is almost unthinkable, as its worse than the time in 2008 when the then CEO of GE, Jeff Immelt had to call Treasury Secretary Hank Paulson and say he couldn't float overnight paper.

Crisis of Confidence



With hyperbole everywhere, and news flow coming fast and furious, we took a chance to step back and frame this in a way that seems to us to be coherent and helps to keep things in perspective. What we are sitting on right now is best described as an actuarial disaster sitting far out on the left tail of probabilities.

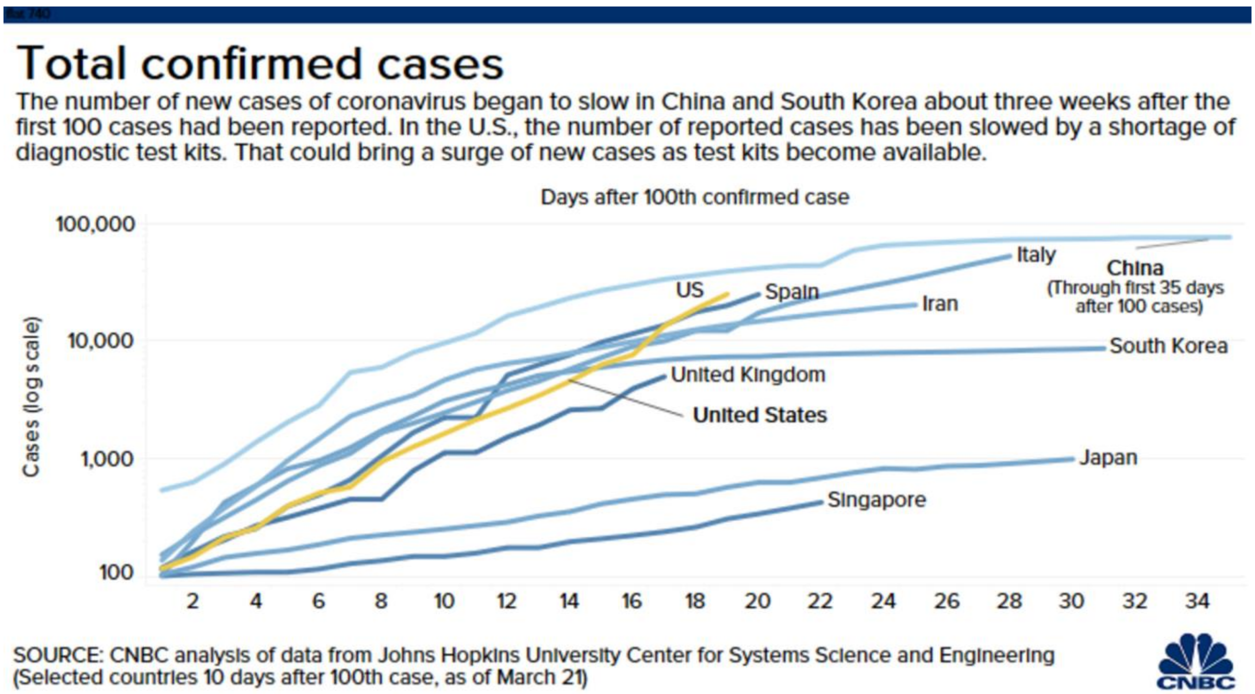
Living a Tail Risk Moment



The fact that coming into the year we were living in a world where it looked like the right tail was where we would be for a good long time, and valuation be damned.

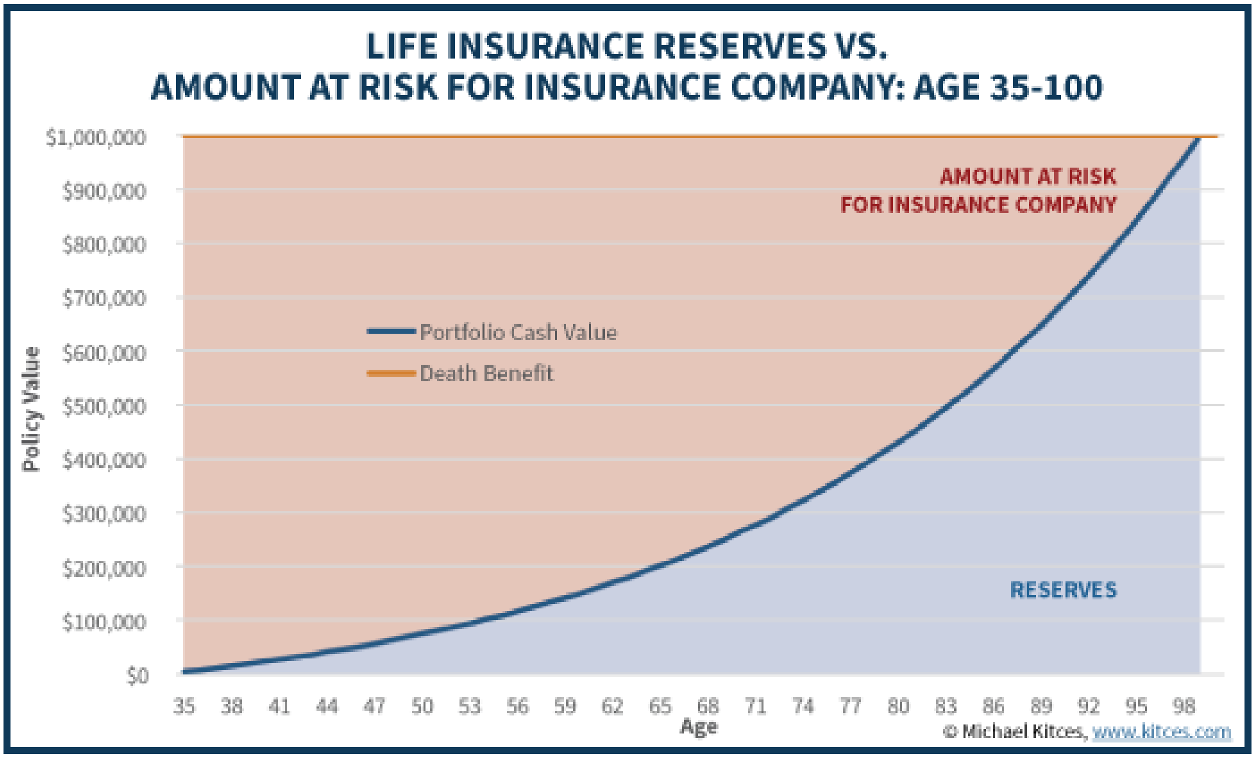
Smart guys, like really smart guys, including David Tepper, thought we had room to go. His now famous line '<u>I love a horse that's running</u>' was said on January 17th. The Covid-19 crisis was at that point in its infancy. Two weeks later he called it a '<u>game changer</u>' that 'ruined the environment' for stocks. Turns out he was right, and now his fellow hedge fund billionaire, Bill Ackman, has gone <u>end of days</u> and thinks "Hell is coming', though ironically he has started buying aggressively as he thinks a global effort of some significance will come together. CNBC provided their version of the <u>ten charts you need to know</u> to understand the spread of the virus, including this one.

Flatten the Curve



In the intro, we called this an actuarial disaster and here is why. When you float a bond, hold onto a basket of securities, or make well laid investment plans, you do so with a spectrum of probabilities in front of it. Most have positive results and are on the right tail. In this case, the events that are transpiring are so far off the left edge, they are barely even on the actuarial table. Insurance companies are now very clearly aware, and they are selling everything that isn't bolted down at 'bid wanted' prices. Imagine the chart below, only now the numbers are in the billions, if not trillions. If insurers have raised enough cash to stabilize the reserve level, then the selling will soon abate. A declaration that they have succeeded would help the very important cause of putting in a bottom.

Big Shift Left



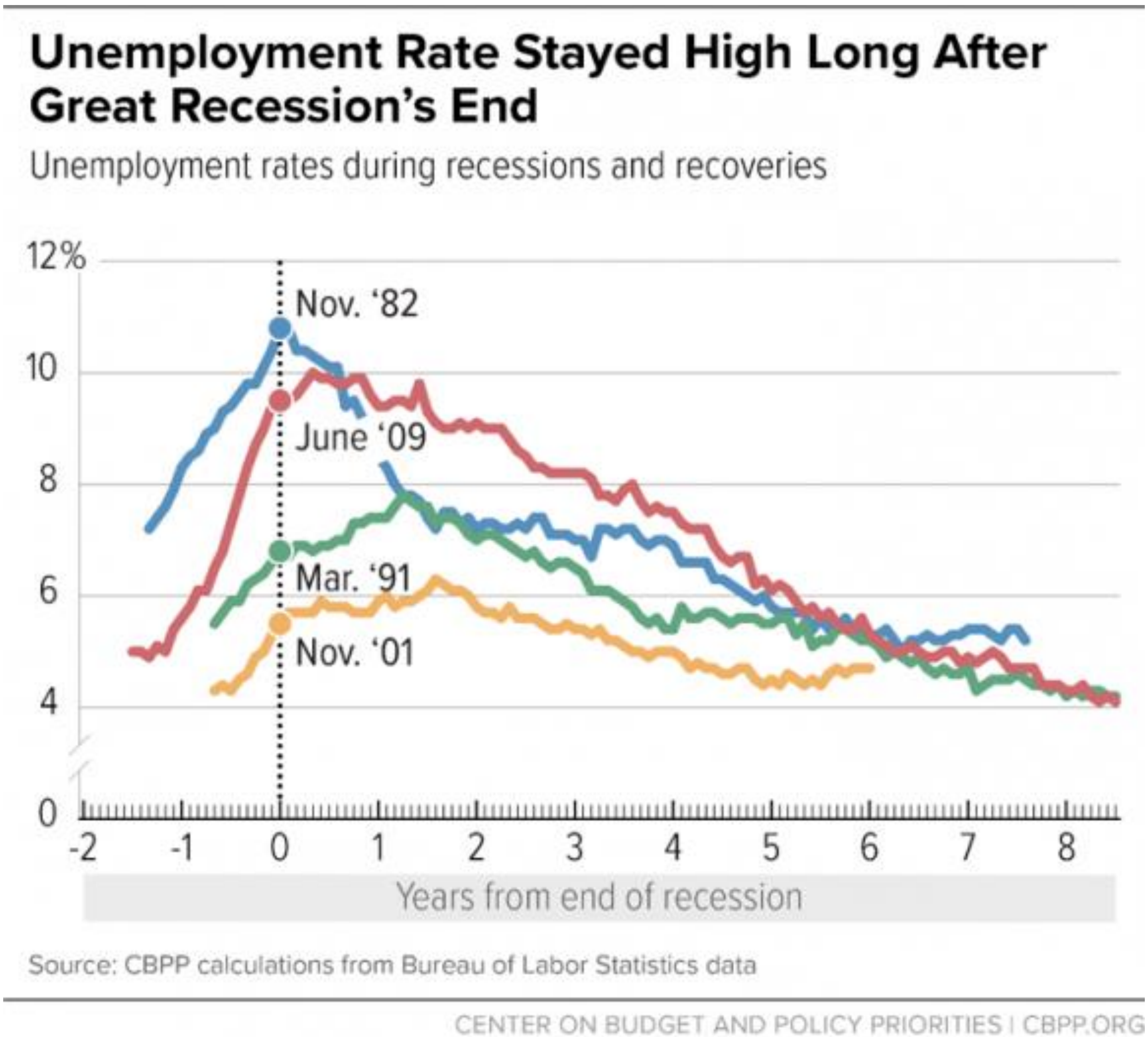
The last time we saw something at all like this was in 2008 when the world found out that Moody's didn't have the probability of real estate actually going down in value into their rating systems. You can see why that ended badly when the music stopped. These are true stories from the world of finance, and they should scare you.

Munchian Moment

The Economy

What can we say about the economy that hasn't already been said? Bottom line, we've got problems headed our way and they aren't small. St. Louis Fed President, James Bullard, made remarks over the weekend that were truly frightening if they become realized, but also included a game plan to start the process of getting us out of this disaster. The former was the belief that unemployment could go to 30%, a level not even seen in the Great Depression. And as this chart shows, recovery doesn't happen overnight.

Long Road to Recovery



In the same interview, Bullard gave his view that even the Fed was behind the curve in anticipating the impact the virus would have on the global economy. The silver lining here was his articulation of a plan that would help un-freeze things and get consumers and business owners looking forward again.

Match any lost wages.

Match any lost business.

No questions asked.

No arguments about bailouts or "moral hazard" - the sticky issue of publicly funded rescues of bad actors.

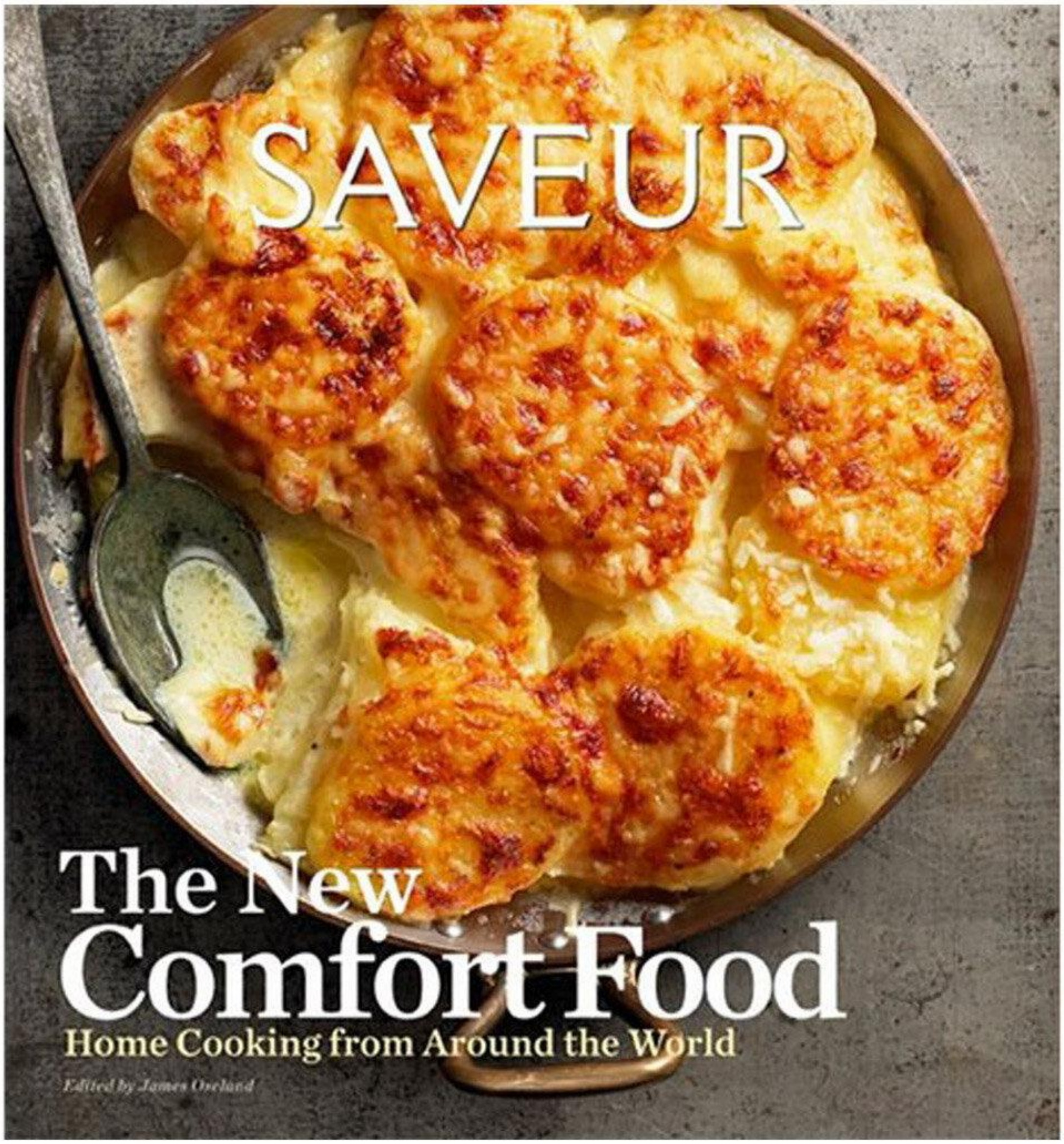
And, above all, when the losses are tallied, don't call it a recession. Frame this as a massive investment in U.S. public health.

James Bullard

We've done a fair amount of searching, as have you probably, to better understand the nature of the virus, how it got here, what it looks like, and how long we expect to have it around. One view that spoke to us regarding what the pandemic looks like compared to others, and what the outlook is, came from virologist David Ho from Caltech, who also sits on the board there. In the interview entitled 'Tip of the Iceberg'

Ho shared his view that we will turn the corner on the outbreak, but it will take far longer than is currently estimated. His best estimate is that the situation won't fully resolve itself for another 18 to 24 months. If that's going to be the case, might we counsel you to order up one copy of this, as we will be in it for the long haul.

For an Uncomfortable Time



Markets

Media outlets on Wall Street have been doing a pretty good job covering the volatility and downward pressure we have been seeing for the past thirty days. Over the weekend, CNBC's Mike Santoli wrote a piece that dove into the speed and velocity at which everything came unspooled. And then again on Monday, they reminded us of how bad it is by pointing out that this selloff was faster than the Great Depression. Meanwhile on Monday, the WSJ published an article that dissected the same subject. Neither of which is new news per se, but if it makes you feel any better after looking at your account balance, that perhaps is a good thing. Though we would caution anyone not to spend too much time doing so. While its bad out there, allowing intrusive thoughts to creep in won't do you any good.

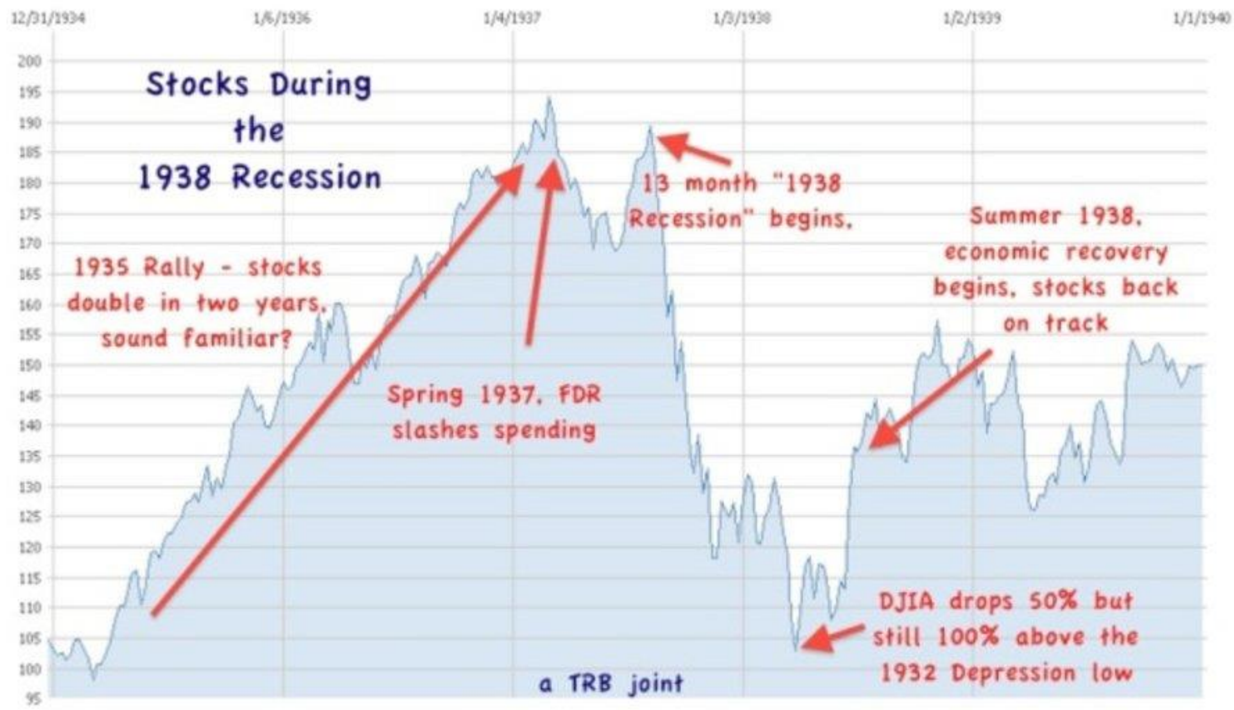
Gains Gone

In times like these, everyone on Wall Street feels the need to come out and opine on where they think the markets are headed, which is to be expected. I would only ask is to hold people you are willing to put on CNBC or Bloomberg to a high standard of transparency. It's one thing to get it wrong, as clearly many have, even the giants like Ray Dalio did recently. It's altogether another to say you saw this coming and then be down as much as the market. Or if you really want to see us angry, claim to run a hedged strategy and be down 65% in your long/short strategy. Which is actually a real thing, the manager of which shall be held in confidence until the outside fund board of directors shuts the thing down before anyone else gets hurt.

Step Right Up…Suckers

A voice we like to listen to, and one you should hear as well as well, is that of Mohammad El-Erian who is the Chief Economist at Allianz, owner of PIMCO. While he has never met a camera he didn't like, his prolific work on the subject of markets and economies validates the access he gets. Last week was a good one for him as his depth of knowledge was on high display. The piece that spoke to us the most was imbedded in a Bloomberg Opinion column, in which he described the 'Fog of War' that investors will be emerging from. Good news, we will indeed emerge and it looks like there are asset classes to buy now. Bad news, we will be in unfamiliar territory when we do, but as unfamiliar as this is yet to be determined.

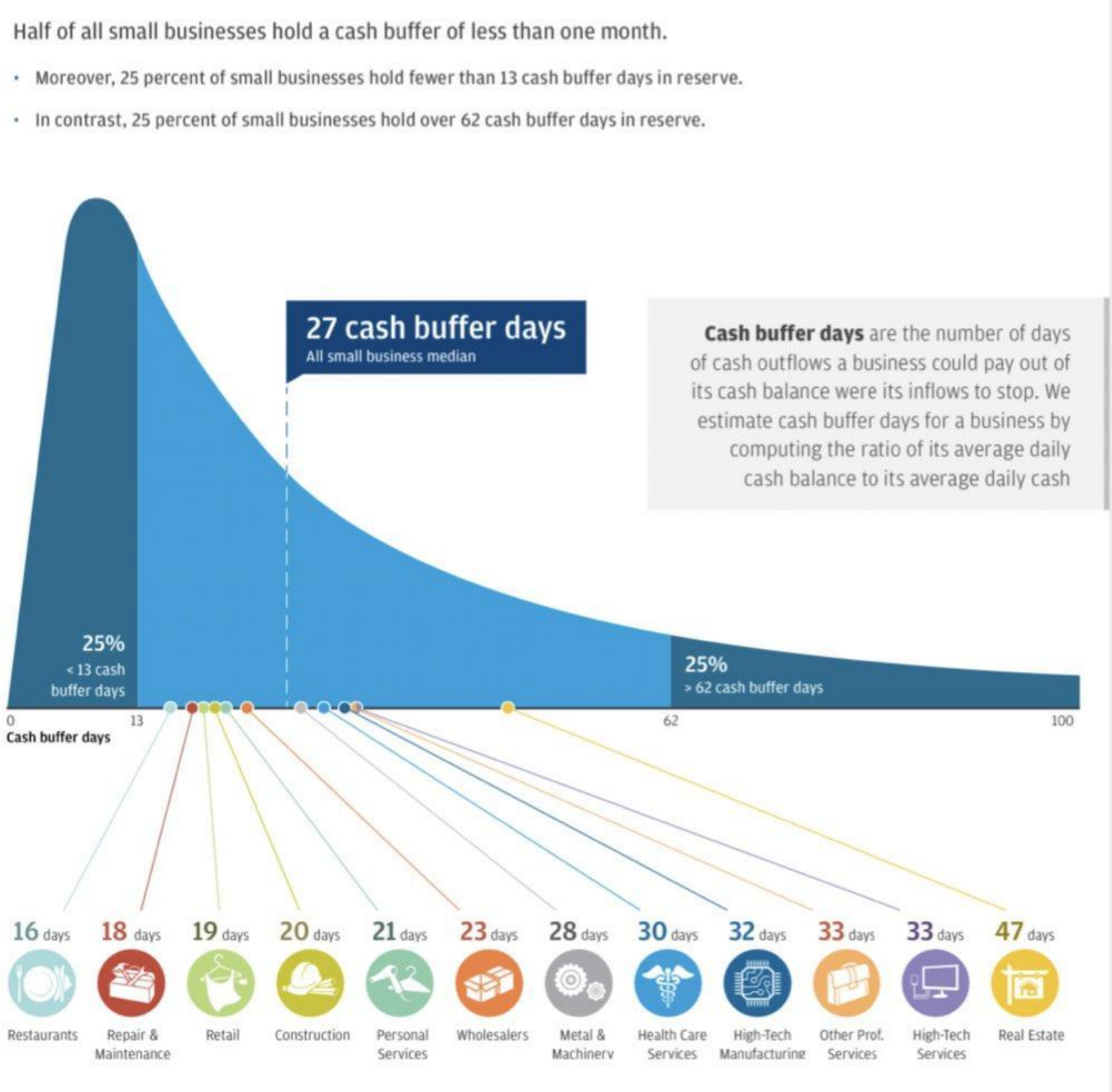
The 1938 Recession



Small Business

Over the weekend we came across a chart that exemplified the nature of this crisis, and how unprepared smaller businesses are prepared for it. As it turns out, cash balances in a whole host of industries are far lower than one would hope, given the freezing up of commerce. Combine this with the fact that we are indeed a paycheck to paycheck nation where 80% of workers hang on monthly, and you can see why there is ample room for concern.

Cash Crunch



Stillwater Performance

While we didn't come in perfectly setup for this crash, and to be clear, almost nobody ever is, client money was pretty well hedged coming in. We held short positions in many of the sectors hardest hit including a 10% allocation to energy that worked out as well, and we also had sold short Boeing and other aerospace suppliers like Spirit AeroSystems, the maker of 737 fuselages. The result has been an average of 55% downside participation and 70% upside capture on the few up days. That is what's called smoothing the ride at a time when it was needed.

Crash Before Takeoff

Earlier this year, Stillwater went out pretty hard offering short selling and hedging services. And while we may be through the first inning of the new normal, we will be playing a full game. If you are looking to smooth the ride, please connect and let's start a conversation. Likewise, if you are a hedge fund or allocator and need help on that side of the ledger connect as well. All short positions we had on heading into this crash are available for review. While we didn't mastermind the covers, we did manage to soften the blow to the long side of the book.

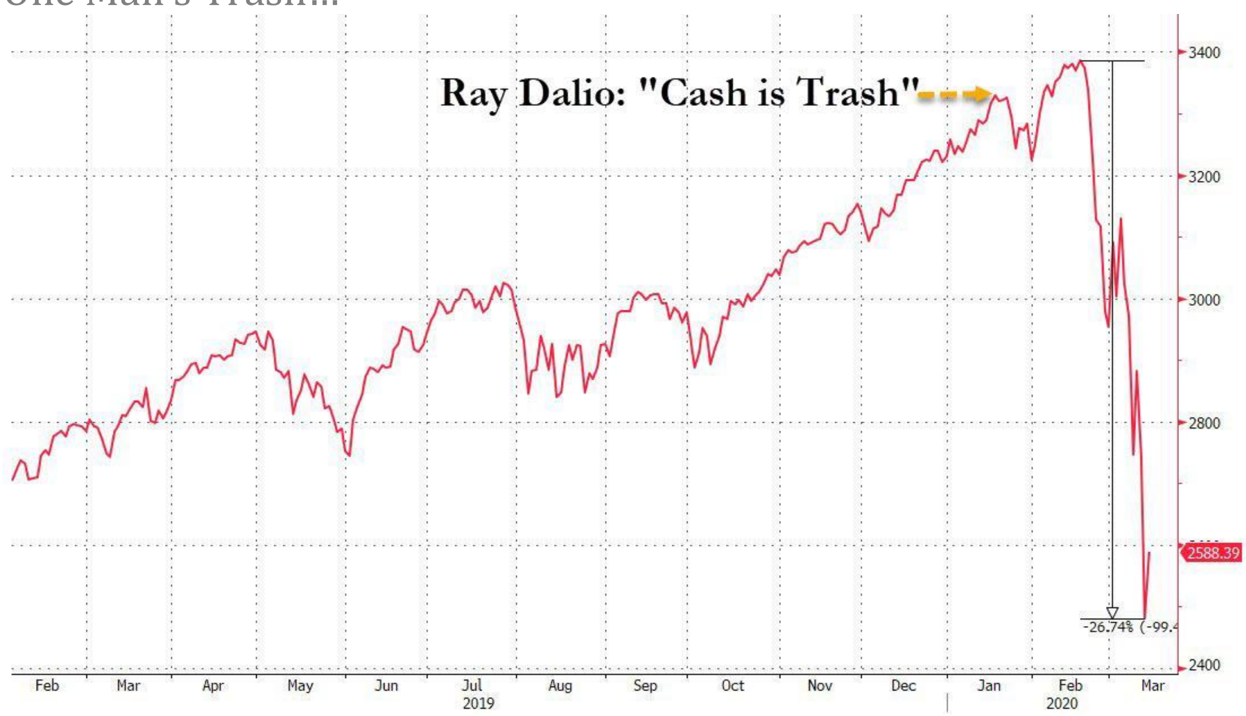
Hedge Funds

Hedge funds are reporting mixed results during this equity and credit crisis. As one might expect, merger arb funds are getting killed as deals all over the place are facing scrutiny of getting it done. The Financial Times has coined this moment 'arb-ageddon'. The article has a really good chart in it that gives a snapshot of the spread of most deals out there.

No Palace for Eldorado

We already know that Bridgewater is having a tough time, as last week Ray Dalio told us as much. The largest hedge fund in the world is down at least 20%, and probably more after last week's drubbing, by hanging out on the long side of the ledger too much going into this crash. Which of course hurts, as this is supposed to be the time for hedge funds to shine.

One Man's Trash…

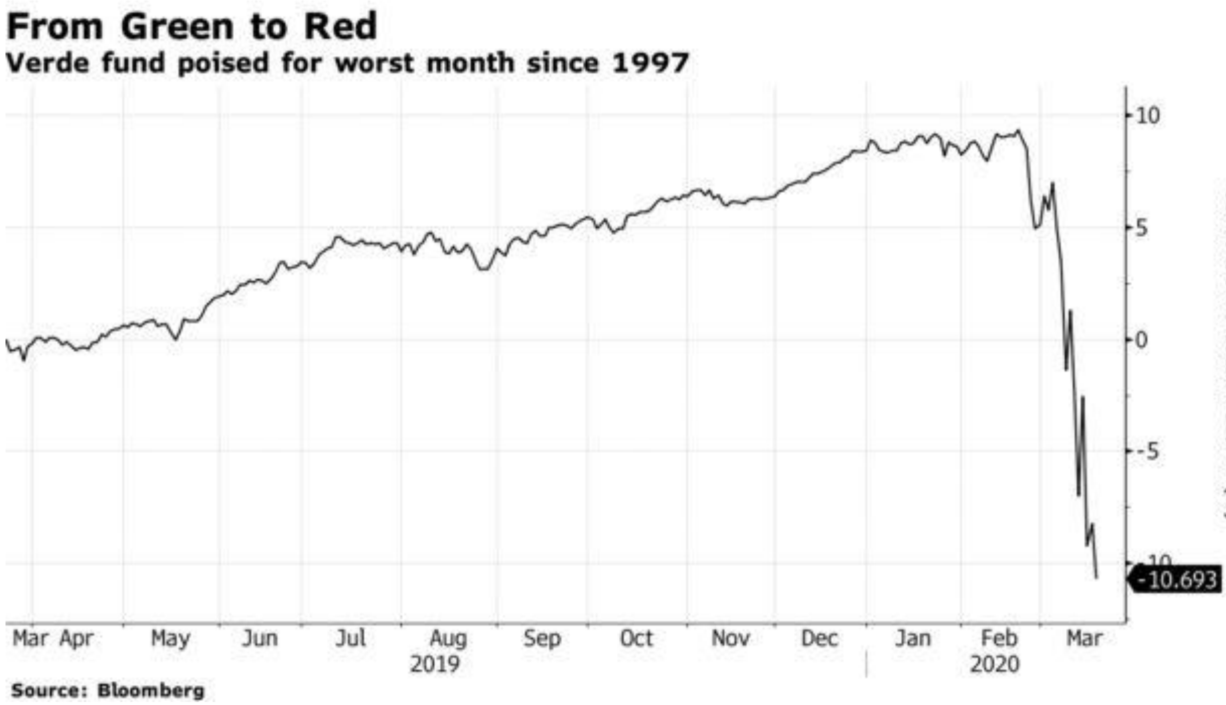


In these harrowing times, it's been interesting to watch some hedge funds open their gates and ask clients to commit more capital, as some see this as a moment in time unlike any other, which of course is slightly refreshing given how deep the wounds are right now. Most notable of the set is Seth Klarman, whose longtime bearish view hasn't seemed to help this year, as his Baupost Group was down 10% at the time the story hit the wires.

Doing Deals

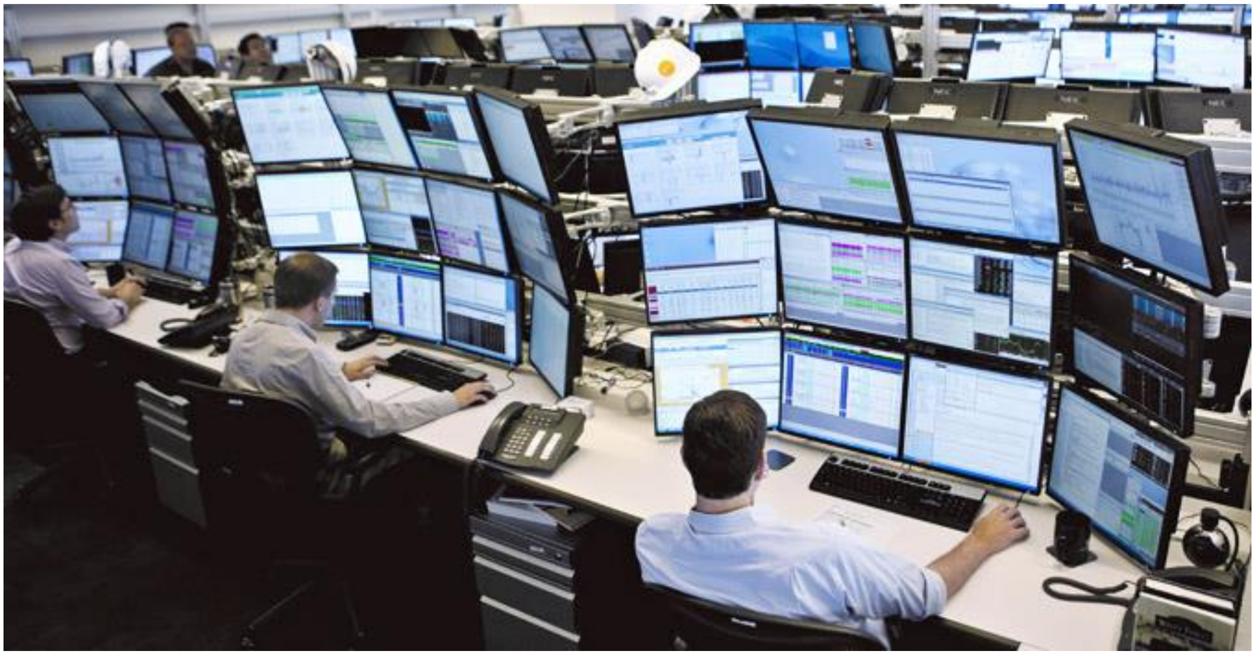
Way south of the border, Credit-Suisse backed Verde Asset Management is having troubles as well. Turns out they became buyers too soon, and have now suffered their worst loss since 1997. The $9 billion Brazilian fund didn't see the liquidity crisis coming as well, and has paid the price to the tune of a 20% drawdown. In a recent letter to investors they wrote, "The fundamentals of our mistake were added to the fact that global markets are going through a huge liquidity crisis" Those words will be repeated many times as this plays itself out.

Where Was the Hedge?



In news that is borderline unthinkable, Izzy Englander's Millennium fund has just done something that it rarely does, and that is lose money. For the month the fund is down 2.7%, and for the year it is now off almost 5%. The situation is so severe at the market neutral fund, that about ten of their 'trading pods' have been shut down. I've had the chance to see Millennium's performance, and its jaw-droppingly good. Before this moment, the fund has had one down month, and that was October 2008. Meanwhile it has three decades of 13% average annual returns. If that isn't enough evidence of how challenging this market has been, we don't know what is.

Millennium Trading Pod



Diversions

We started off last week with our 'shelter in place' must watch list. The first four were more of the serious and inspirational kind. Given the depths of despair seemingly everywhere right now, this week we are turning to comedy to provide some levity. And with that, four sleeper films to make you laugh a little.

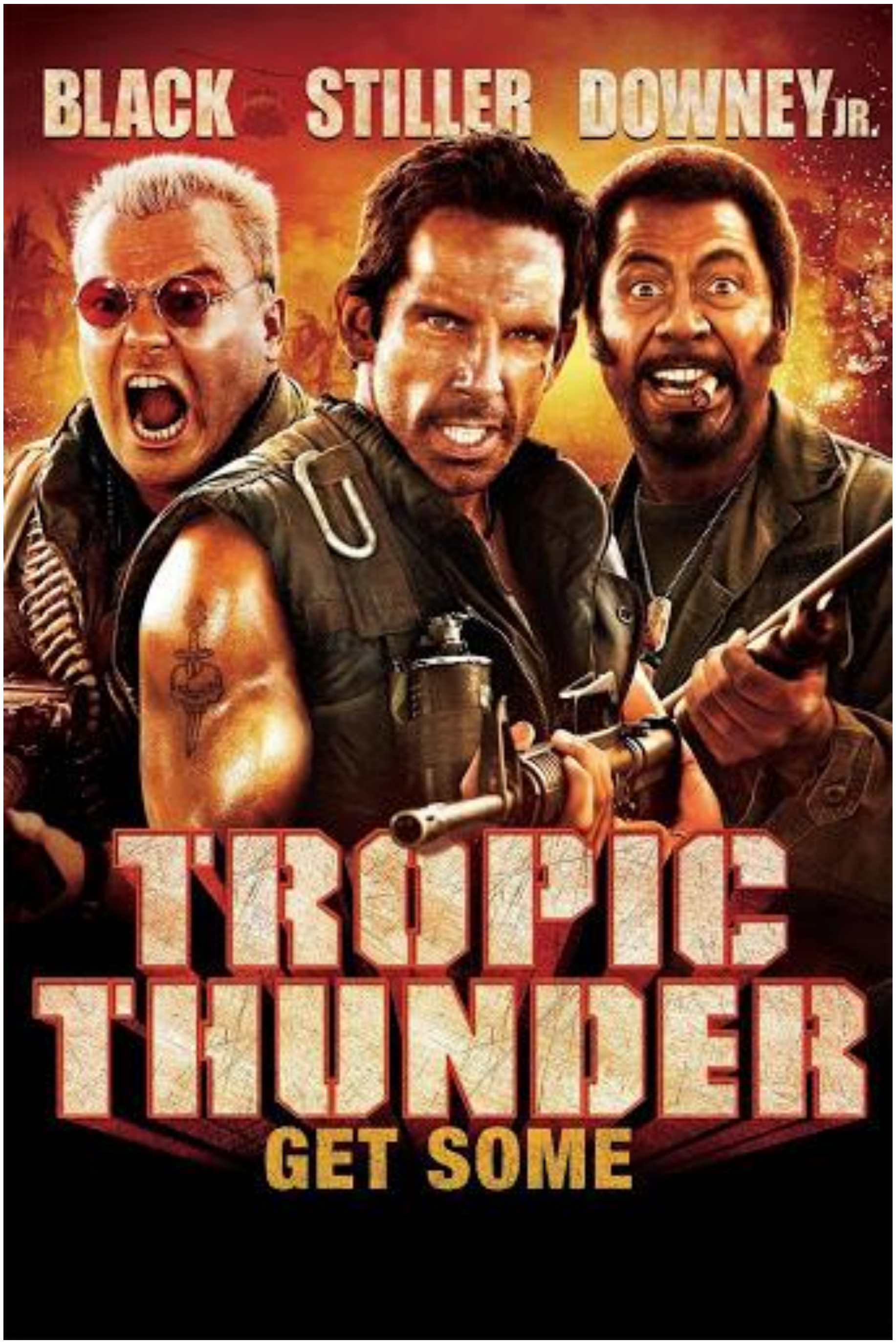
Super Troopers

This film debuted in 2002 at Sundance Film Festival and was Broken Lizard productions first film to gain true acclaim. Reviews have been mixed when I've introduced the movie to select others. For my more sophisticated and worldly friends, the content is spot on funny. To some of those who are a little more obtuse, the humor can be lost a little. What I do know is that after watching it, you will be keenly aware of what the 'repeater' is, and can use it on your cannabis smoking friends.

Ramrod in the Back Row

Tropic Thunder

Less sleeper than the previous film, Tropic Thunder leaves no doubt when it comes to humor. The cast includes Ben Stiller, Jack Black, Robert Downey Jr., Nick Nolte, and a cameo-ish performance by Tom Cruise that got him nominated for a Best Supporting Actor in 2008. Please be sure to make it to the end to watch his character Les Grossman perform his epic dance celebrating the film cleaning up at the Oscars.



Up in Smoke

For those who are fans of gummies and cannabis in its joint form, Cheech and Chong's Nice Dreams should be a huge winner. Like super huge in terms of your kind of humor about your kind of lifestyle. This trailer gives you an idea about what you are in store for.

Tommy Chong and Cheech Marin

Kingpin

Keeping true to our theme of 'sleeper' comedies, we present to you Kingpin, which next to the Big Lebowski, is the one of the finest bowling movies of all time. The cast includes a young Woody Harrelson, Randy Quaid, and the first ballot comedic all-star Bill Murray.

Ernie McCracken

With that we wish you good health, both mentally and physically, during what can only be described as one of the most trying times we should ever expect to experience. Loses and gains come and go. There will be brighter days ahead. For now, stay safe and enjoy the love of family and friends.