

If the numbers are correct, eighty percent of Americans think the discord in our country is out of control. A full seventy percent of big money managers haven't believed in this rally. Unemployment is somewhere between 13% and 16% depending on whichever brilliant mathematician at the BLS is providing the numbers. And the foreclosures and small business shutdown wave is just kicking in. With that as backdrop, we are currently sitting on the greatest rally in stock market history. Thanks Mr. Powell, we have lots to be thankful for.

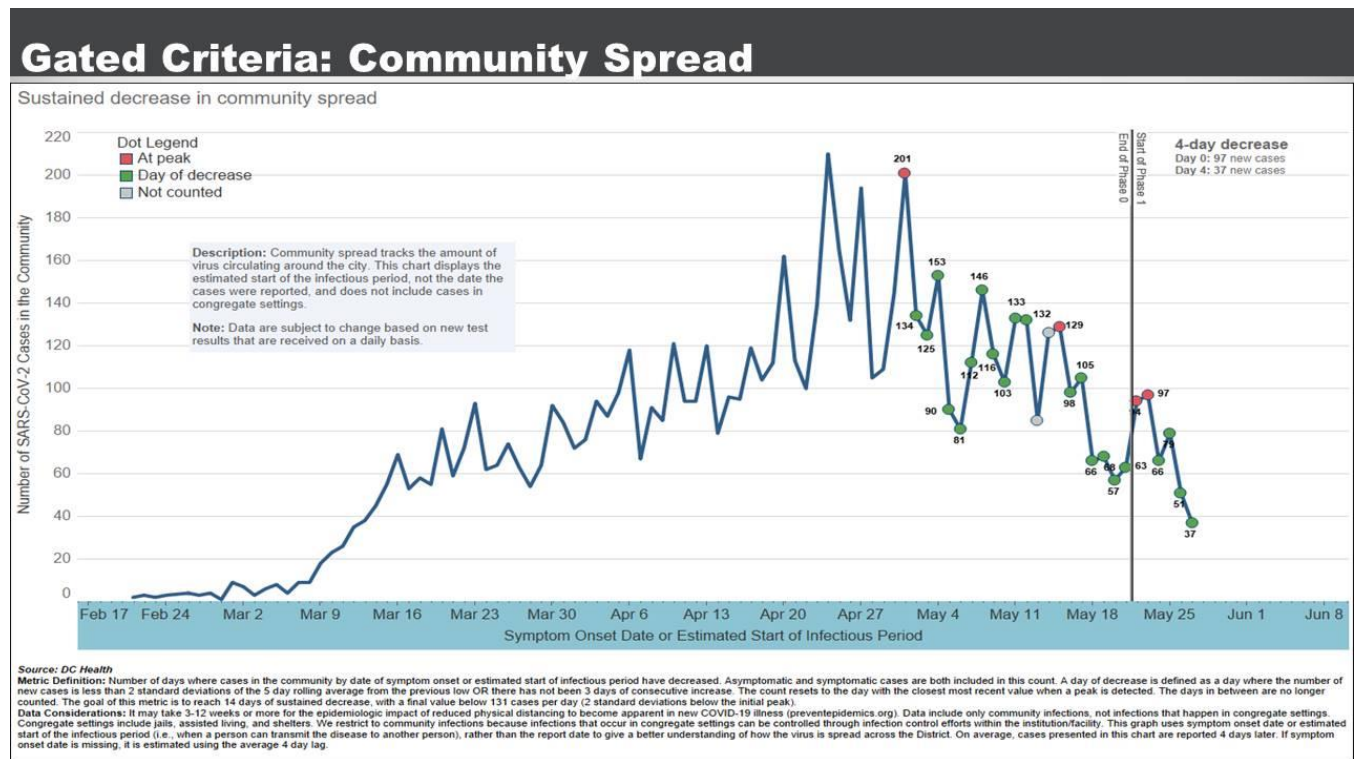
Thumbs Up, Jerry!



The Non-Virus, Virus 2.0

In January, we wrote a piece with the title, “Is this a non-virus, virus” market? The meaning of which was the Teflon nature of elevated stock prices seemed to indicate that the COVID-19 virus wasn't really a threat, and it was actually a ‘non-virus’, at least for asset prices. Thirty days later, in mid-February, the world took it seriously. With that as backdrop, we take you on a chart heavy look at the markets and the economy.

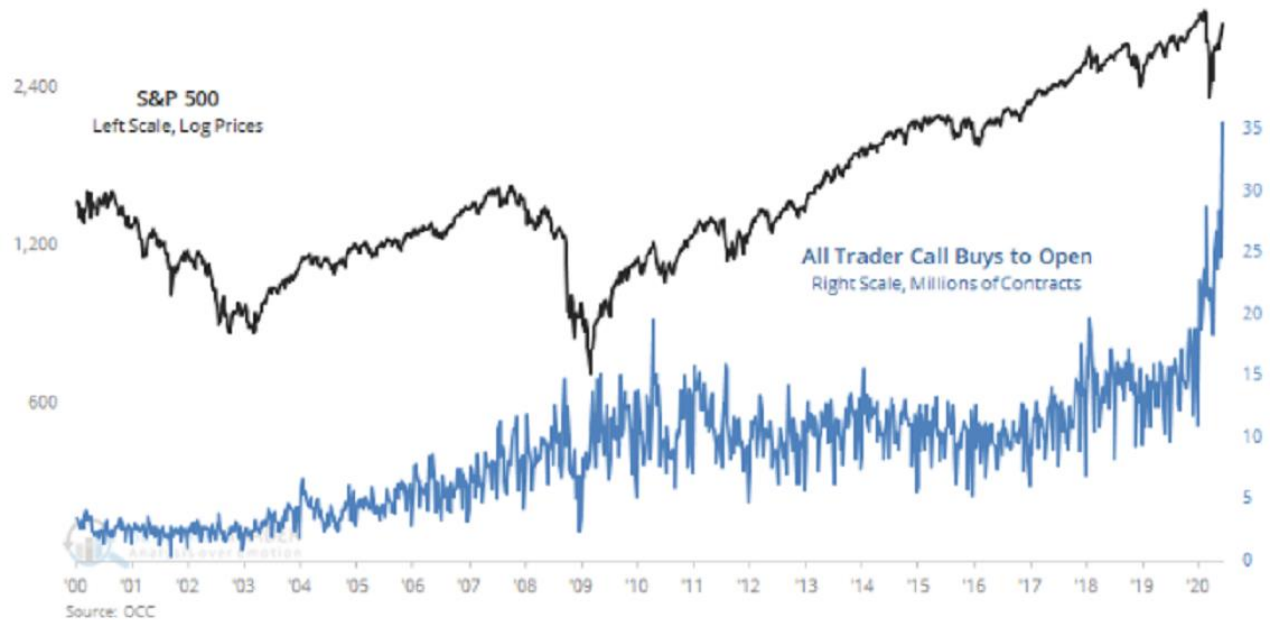
Spread Narrowing



A full roundtrip later, it's beginning to feel the same way as yesterday when the market turned positive on the year. Bloomberg had it right this morning, writing that 'speculative fervor' had reached stunning levels. But is the rally really 'doomed'?

Call Buying Goes Parabolic

Speculative fervor among pretty much everyone



For a month now, we have been on the wrong side of this trade. Having hedged down exposure and balancing out portfolios by being short junkier companies and industries while being long those with strong balance sheets and good dividend paying histories, this had been the right thing to do for most of the comeback. And all this, while CNBC's Jim Cramer says he has never seen so many games being played with stocks.

Good Trade While It Lasted

Blessed Are The Strong (Balance Sheets)

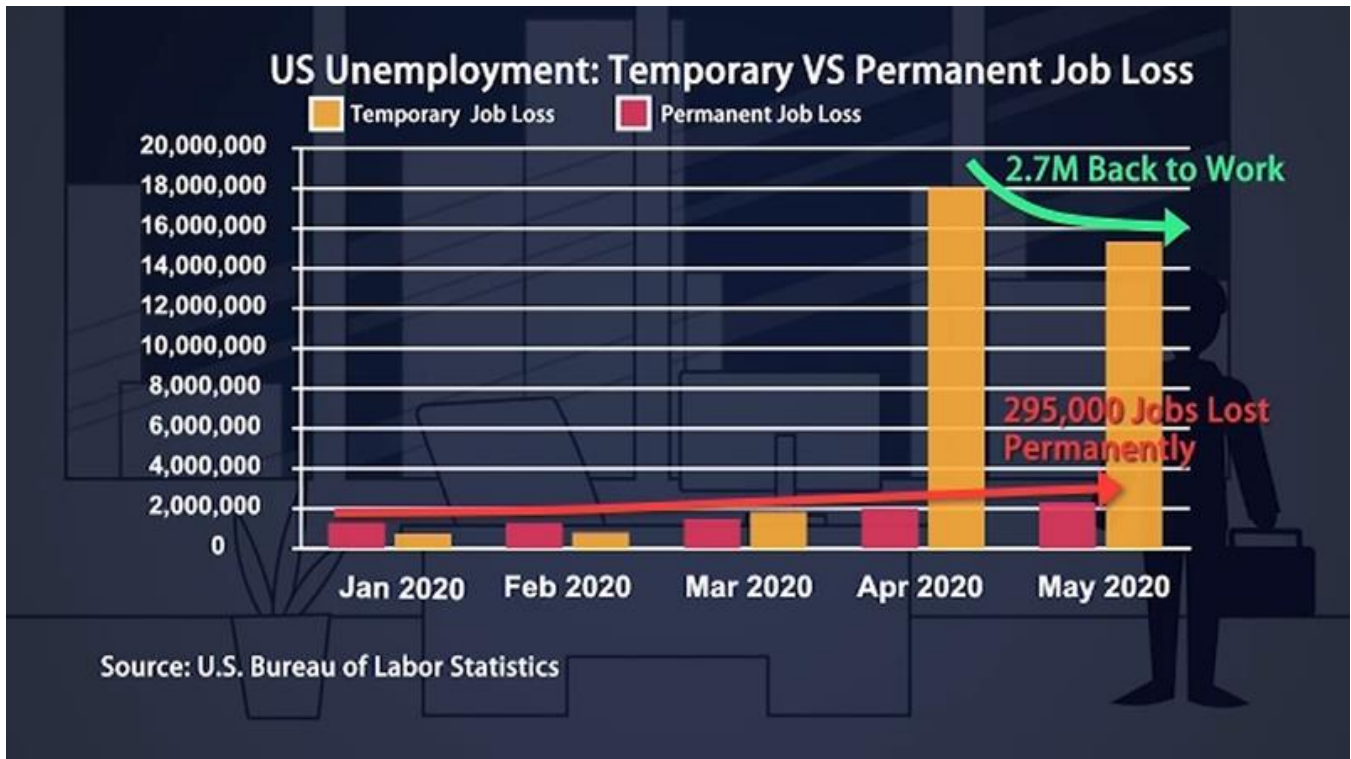
The market has punished companies with weak balance sheets this year



The Economy

To add insult to conservatively positioned injury, the Bureau of Labor Statistics released the May payrolls number last Friday with a technical error that put the unemployment rate at 13% and not the actual 16%. The market didn't care as it ripped higher on the 2.7 million jobs that had been 'created'. Note to anyone reading the headlines, these jobs weren't created, they were recovered from the sky-high pile.

Big Swing



The Jeff Bezos owned Washington Post covered the story, and the speculation that something sinister is at hand. Forbes also writes that past errors aren't corrected for fear of the report looking political. All we care about is that you get it right so we might be able to stop getting our tail kicked in on a daily basis.

Trump v. Bezos



Markets

Our written rule is that there are no crybabies in the casino as the market giveth, and the market taketh away without really caring how it makes you feel. And while we aren't allowed to cry, we certainly can grit our teeth, especially when the lion's share of the gains during this rally are driven by the positive performance of futures in overnight sessions. That's right, investors long the market are making most of their money when the market is technically closed. Just another reason to blame the black box quants for such a parabolic move.

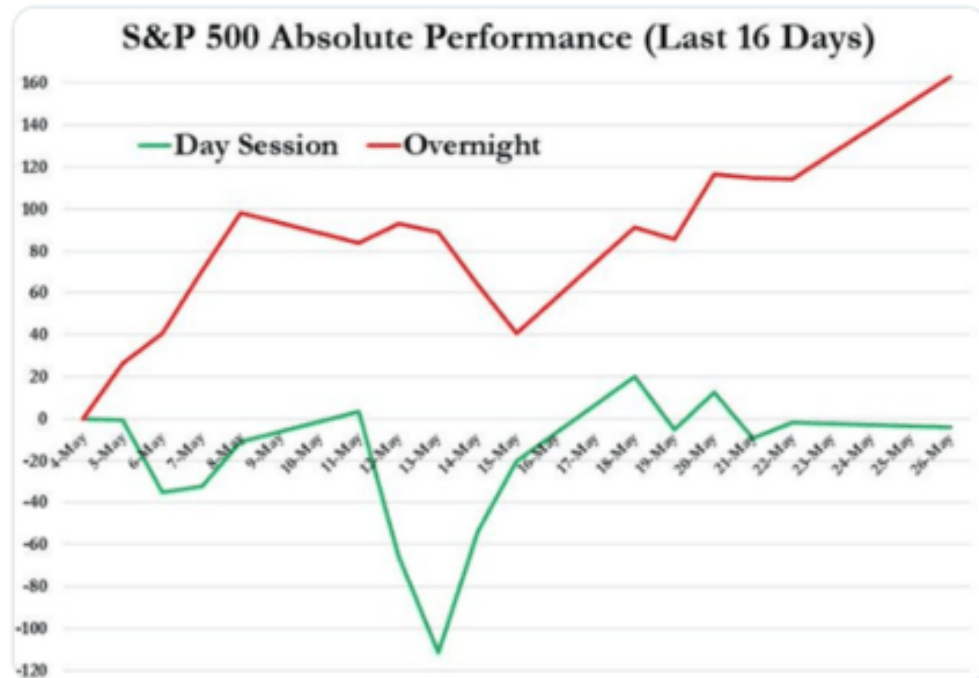
Up Overnight



Lobo Educa Massas
@cryptolobopt

Replying to @KeithMcCullough

Good Morning Keith! What kind of market only goes up when it's closed?



5:01 AM · May 27, 2020 · Twitter for Android

35 Likes 16 Retweets 8 Retweets with comments

Anthony ‘The Mooch’ Scaramucci opined last week that the ‘water wall’ of green money coming from the Fed was likely to keep stocks buoyant. Having been in the business for a long time with his Skybridge hedge fund allocation firm, he is worth listening to, as his Rolodex is one of the best. For those who might have forgotten, he was President Trump’s press secretary for ten days.

“Kiss Today Goodbye”



Another aspect of the market over the past few years leading into the COVID crisis, is the severe beating value stocks have taken at the expense of growth. The chart below shows a delta widening that would have any deep value manager crying at his performance page, versus the guys having so much fun over at the NASDAQ party. As of May, the outperformance of growth stood at 14% on the year, and is probably much higher today. Our condolences to AQR and Dimensional Funds, not to mention any other firms that ply their trade in the value bin. The last time this happened was just before the dot.com bust of 2001-2002.

Value Takes a Beating

Value Positioned for a Great Comeback

Over the last year, value has seriously lagged the market and the FANGs



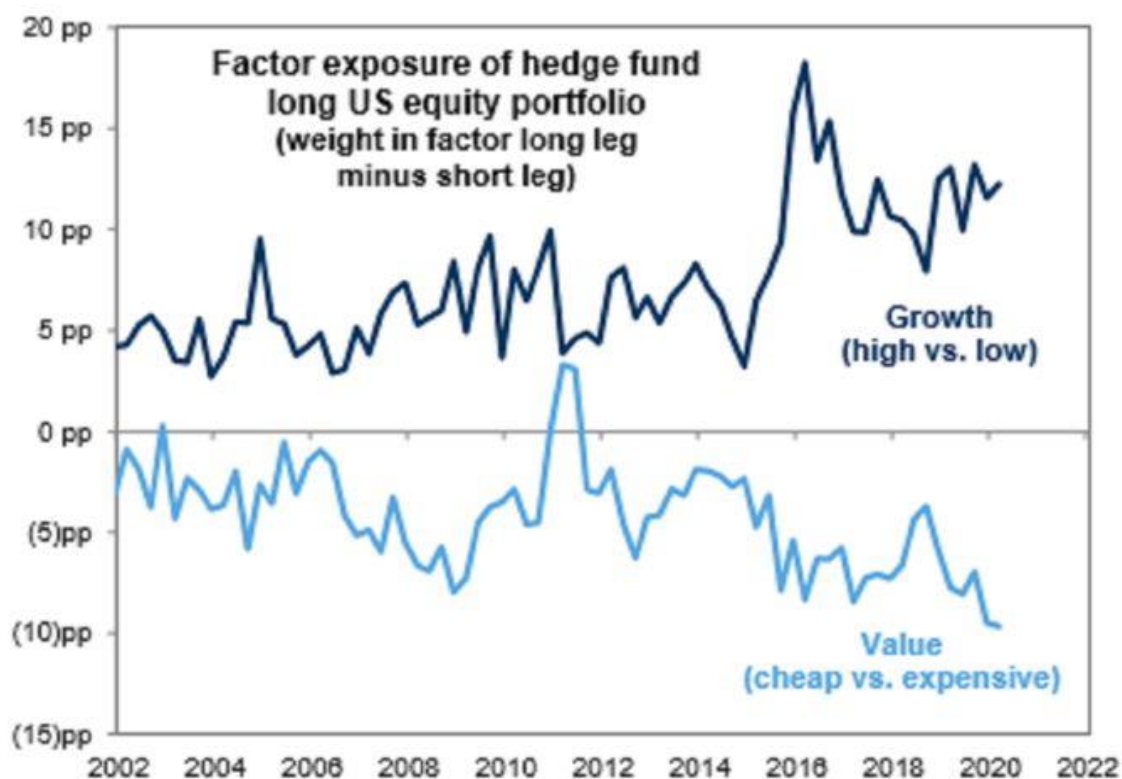
Source: Bloomberg

Hedge Funds

Because hedge funds are not afraid to jump on a good trade, they too have been getting longer the side that's working and short that which isn't. This chart dates to the end of March, but you get the idea. And again, the delta is probably wider today than it was two and a half months ago. This too doesn't auger well, as hedgies are particularly bad when it comes to piling into the one place that is working.

All Aboard

Exhibit 6: Hedge funds have increased their tilt toward Growth and away from Value
holdings as of March 31, 2020



Source: Goldman Sachs Global Investment Research

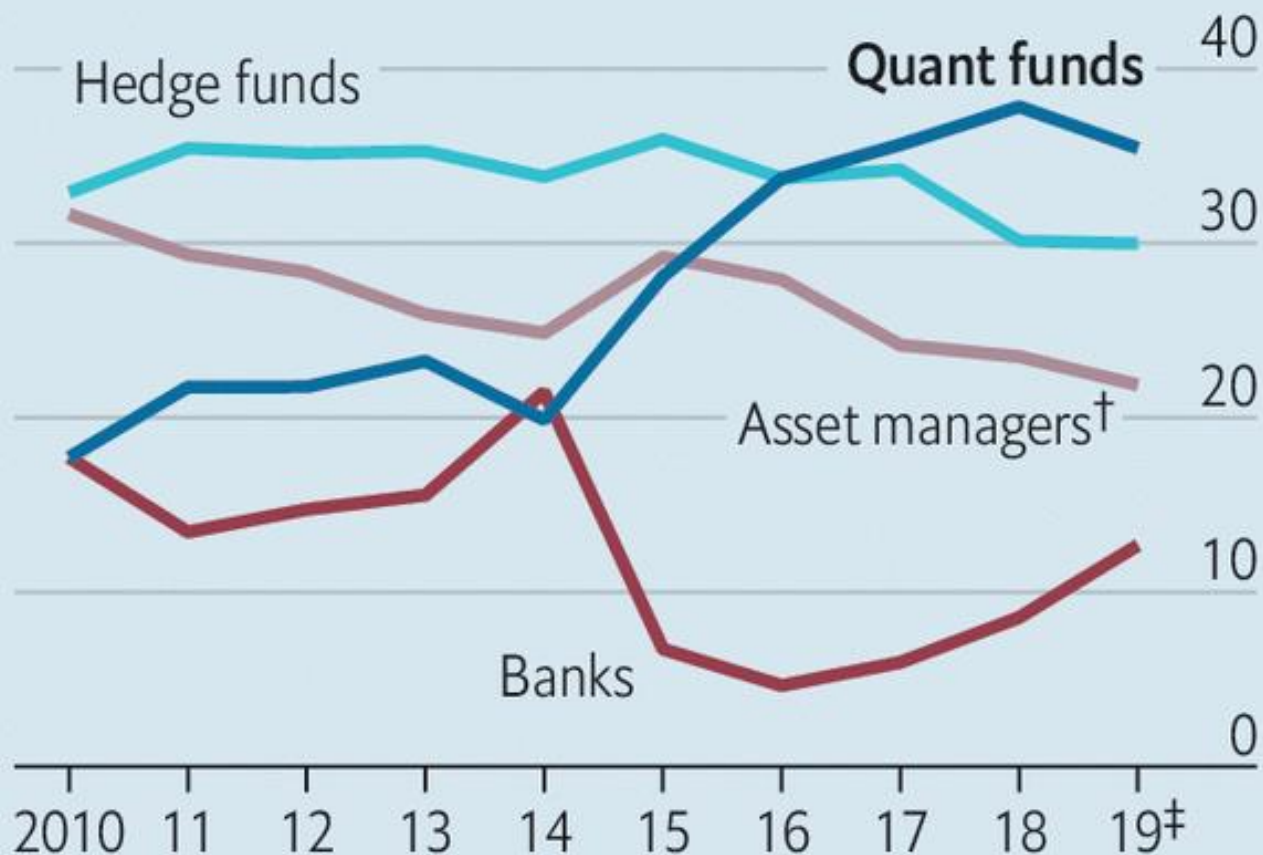
One thing that has to be pointed out at this phase of the game, is how much the movement of the market is now dictated by quants and ETFs. Of the many pithy descriptions of the trend, we most prefer ‘Rise of the Machines’, and it’s been going on for a while.

Meet the New Boss

Goodbye, Gordon Gekko

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United States, share of institutional trading volume of shares*, %



Source: TABB Group

*Excluding retail and high-frequency trading firms

†Institutions including pension funds, mutual funds and other money managers

‡Estimate

The Economist

Why is this important? Because quant shops build their special market trading machines to have no emotional bias. Simply follow the subtle signals the market is throwing off, and trade accordingly. We think that is a huge reason for the epic bull run we've seen in the past

couple of months. Because when these guys start pushing things around, they do so with derivative Howitzers and a boat load of leverage. For a fundamental, bottoms up, money manager to be successful these days, they need to at least think a little about what a quant machine would be doing. They also need to place monetary policy at the front of the line in terms of outside factors of influence. As we like to say, adapt or become one of these guys.

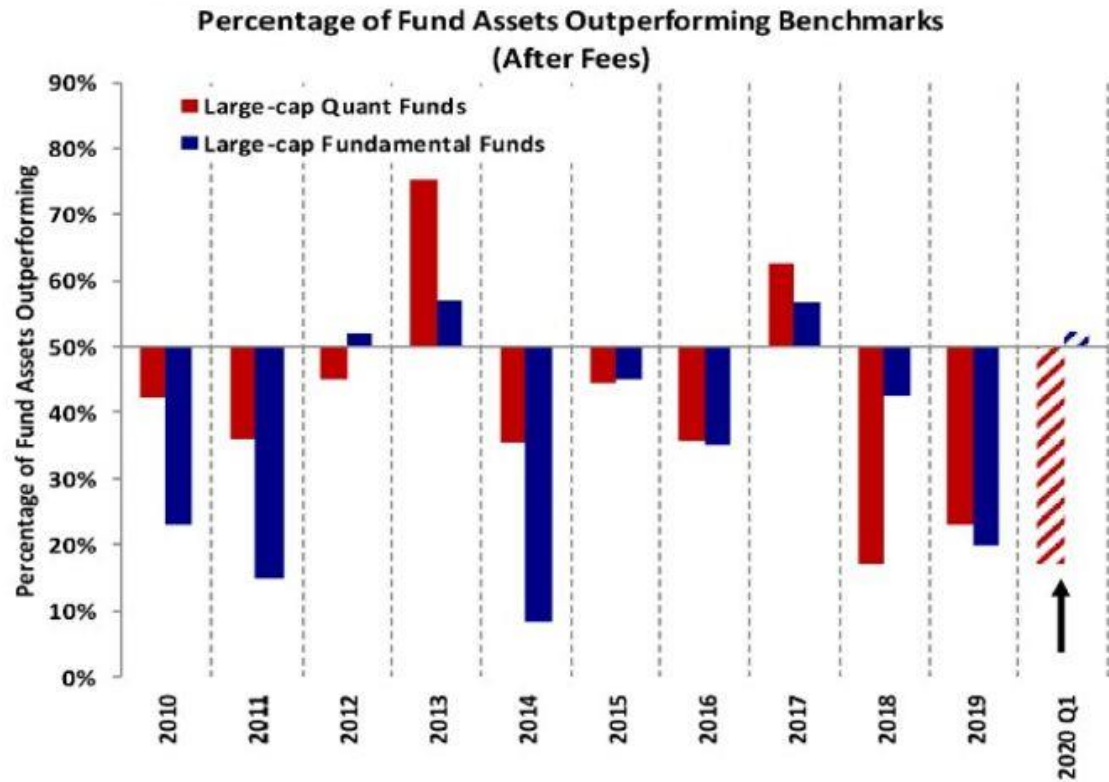
Good While it Lasted



But just because they are big and machine based, good results are by no means a guarantee. So much so, that after the market route in February and April, some funds started taking the axe to headcount. Tough news as there simply aren't that many seats at the Wall Street table anymore. Good luck out there guys. All we ask is that you please stop messing with the rest of us who think fundamentals matter.

Diminishing Returns

Fig. 9: Quant and Fundamental Fund Performance, 2010-2020



Note: Shows annual percentage of U.S. large-cap quantitative (red bars) and fundamental (blue bars) active mutual fund assets outperforming benchmarks after fees (except for 2020, which shows January-March). Period is from 2010 through March 2020. Quantitative and fundamental large-cap core funds are benchmarked to the S&P 500 index, growth funds are benchmarked to the Russell 1000 Growth index, and value funds are benchmarked to the Russell 1000 Value index.
Source: CRSP, Lipper, Russell, S&P, Bloomberg, Instinet analysis

Diversions

We can confirm from first-hand experience that dining out these days feels very liberating. For some reason, the food just seems to taste better and the experience a little more enjoyable, even with all the new rules and regulations. Our hometown of Santa Barbara closed off the central core of the city, State Street, to car traffic, and restaurants have begun setting tables in the newly available open space. Good for us, as we are probably never going back to earlier times.

New Vibe



With that as the backdrop, Stillwater gives you six newer restaurants across America to try in a post-COVID world. Our culinary tour starts off in Chicago with The Girl & the Goat. Opened a decade ago, Chef Stephany Izard's creation quickly hit the radar of those looking for a fresh, well edited, gastronomic experience. Izard landed a 'Best New Restaurant' award from Saveur magazine right out of the gate. My first-hand knowledge of the place says they got it right. Closed for now, The Girl and the Goat is currently offering meal kits, which by my admission I am a little dubious of.

Ingredients Galore



In every Californian's favorite city in Texas, Austin, there are two new restaurants worth taking a look at. While we don't want to look cliched, both are a combination of Texas and tacos. First up is Taco Bronco, which is the creation of pit master Tom Micklewait and sits behind Batch Craft Beer and Kolaches, and combines the old standard of smoked brisket into barbacoa tacos. Because Texas has been run amok with wild swine, there is also wild boar in taco form on the menu.

Taco Bronco



Out in the very gentrified air of Seattle, there are a bevy of newer Asian restaurants to compliment the plethora of seafood fare. That's right, bevy and plethora in the same sentence. Once such Asian offering that intrigued us was the Laotian offering from Taurus Ox. While the Corona menu is limited for now, there are still some pretty epic looking creations like the Thom Khem, with caramelized pork belly in an umami sounding broth. Another is the Lao Burger, because who doesn't like pork jowl bacon.

Taurus Ox



To round things out, we head to the Peoples Republic of Santa Monica. Locals joke, but a good one. At this stop, we find ourselves on Main Street at the old Omelet Parlor. First and foremost, pour one out for the OP. That place had staying power beyond what one would think, and was fun to take the kids to back in the day. The Bloodies made it palpable.

A Good Thirty Years



Back to our subject at hand, the very newly opened Pasjoli has taken over the space offering modern French cuisine, and this menu looks like it has the depth to keep the restaurant around for a while. Their signature duck press for two is complimented by a seafood cassalette and coq au Chablis. Dinner for takeout started up again this week. Bon Appetite!

Tableside Duck Press for Two



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