We Laughed, We Cried, It's Way Worse Than Cats

The market has become an exhausting and emotional roller coaster!

Just a glance at the T-Report titles in the past month is enough to depress you:

- Welcome to Thunderdome!!!
- The Not So Good, The Bad, and the Ugly
- Bad to the Bone
- Duck and Cover
- Nowhere To Run, Nowhere to Hide
- Traditional vs Disruptive Portfolios (we will come back to this one)
- The "R" Word Rears its Ugly Head.

Interspersed throughout we've had some calls for short-term market bounces that have enjoyed a modicum of success, but there has been a general theme, which unfortunately, the market has generally followed.

Exhausted

If I had to describe market participants right now, I'd use the word "exhausted." A few weeks ago, it might have been "shell-shocked." A few weeks before that, I might have dared to use the word "optimistic" or "fearful" (weird that both words come to mind). But right now, exhausted is about the best description that I can come up with for most people in markets!

Friday did little to make people more comfortable as we rose on the open, sold-off in the afternoon, only to rally strongly into the close! How much was OpEx (option expiration) related or not is anyone's guess, but it was another exhausting day of trading where it was easy to feel incredibly smart or incredibly stupid, or both, in a matter of hours.

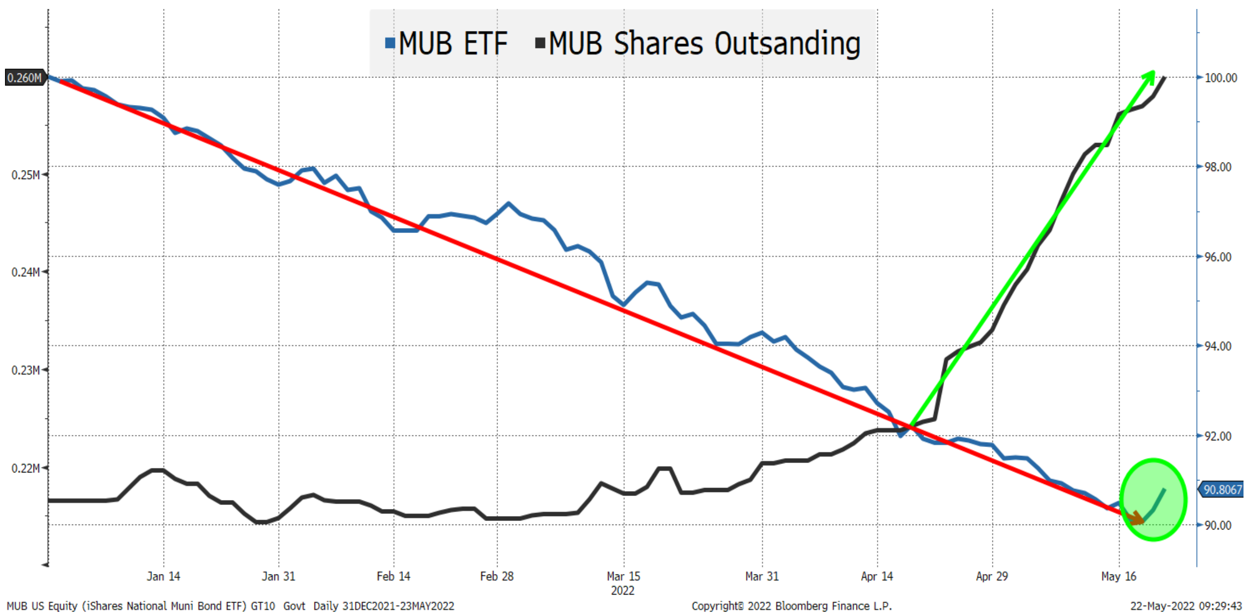
What's Next?

Who knows? I could make a bull case, a bear case, or an indifferent case, which tells me that I should probably be neutral, waiting for some clear signal. Here is what I'm watching and thinking about as we head into this week:

- **Weeks leading into holidays** are often good for markets! But if they are weak, the weakness tends to persist. Not much to look at here, at least until Thursday.
- **Bitcoin held its own last week.** I think crypto is a lynchpin for this market. We described the "disruptive portfolio" concept last week, so markets need crypto to stabilize. With the ECB coming after this market hard now (Lagarde has some strong words on the subject), bitcoin could face problems beyond those of its own making (like the unstable "stable" coins). **Positive for now, but this could turn on a dime.**
- The "**better than bank account**" stocks caught a strong bid on Friday into the close. These mega-cap stocks are key to index levels and the support seems good. The stocks are certainly "cheap" relative to a few weeks or months ago, so maybe they bottomed? Or maybe the stability in

crypto and OpEx was enough to provide a surge into the close that won't be followed through?

- **The stock vs bond relationship has "normalized."** Bonds tended to zig this week when stocks zagged, and vice versa. The 60/40 funds acted like they were supposed to, and risk-parity trades made sense again. I do think that shifting correlations are crucial in a market driven by around the clock/across the globe algo trading, so **this normalization of some major cross-asset correlations is potentially very positive.**
- **Recessions tend to take a long time to develop**. The jump to recession chatter seems premature. Yes, I'm in the "hard landing" camp. Yes, I think Europe will be in a recession soon, if not already, largely due to the ongoing and increasing number of issues related to the war in Ukraine. But the earnings that triggered so much of the recession talk seem to say more about the cost base rather than the consumer (unless you were building in to your model infinite spending capacity for the average consumer).
- **The 2 jobs for every person looking soundbite seems overdone**. I cannot remember how many times I heard that from bulls last week. Whether they were bullish on the market or on the economy, they kept trotting out this one line. It almost felt "manufactured" or like some "power" had pushed a bunch of people on this particular soundbite. **I am convinced that we have seen peak job availability (at least for the rest of this year).**
- **Munis caught a bid!!!!** Admittedly, a small bid, almost microscopic, relative to the 10% or more decline from the start of the year, but a bid nonetheless. Inflows actually started a month ago, which wasn't enough to stop the onslaught, but should help if this rebound is real. This is important as this could really mark a change in retail behavior (though if I'm correct in last week's report, we should see money shift from equities to bonds as the ability to get returns in fixed income that were unheard of a year ago, should encourage that shift to some degree).



- **Commercial Real Estate**.
  - **The Fed watches this closely**. Real estate feeds into the banking system faster than any other asset. Whether you are a local, regional, or global player, real estate (especially

commercial real estate) impacts your portfolio a lot! In any given area, there are only so many small businesses to lend to, so you get forced into real estate. The residential market is one thing, but it is the volatility in commercial that can impact banks quickly, which is why the Fed should be (and I suspect is) looking at this market closely.

- **Location, location, location**. We can all see the trends of where people are moving to and potentially working from (commercial real estate should do well where people are moving). But we can also see the cities (with some of the biggest commercial real estate exposure) that don't yet appear to be "normalizing." This is likely to be more of a regional issue than a national issue because of the importance of location.
- **The persistence of WFH**. It has been far more difficult than many senior managers thought to get people back to the office on a fulltime basis. Whether it is outright revolt (or the fear of revolt), workers hold the upper hand. Many companies are running short staffed already and are having difficulty filling open positions. They "know" that other employers are willing to allow more work flexibility to get or retain people so they are "handcuffed" in their ability to get people back in the office like they used to be (especially for jobs that don't require physical proximity). That has been occurring without a new wave of COVID (which is starting to seem like a real possibility) or the emergence of new reasons not to commute (from subway safety to monkeypox virus (no comment)). I am not sure how much longer this WFH trend can continue without impairing office valuations and higher interest rates are not helping. **Keep an eye on this sector for weakness, but be comforted that it is at the top of the list of what the Fed watches (they want nothing to impair the banks).**
- **Commercial Real Estate as an inflation hedge?** I've heard this a lot but cannot get there, partly because of the point above, partly because of what we are seeing in the earnings of retailers (who presumably have commercial real estate costs), and partly because the Fed hikes cannot be helping.

- **Bear Market Rallies are Vicious!** The March rally, which was more than 15% for the Nasdaq 100 was both vicious (and with hindsight) a bear market rally. The viciousness of these rallies may explain the relentless buying of some of the most aggressive ETFs. Who wouldn't want to make 20% in a couple of weeks? **But it may also be why we still don't seem to have experienced "capitulation."**

A lot to think about, but very few conclusions!

Bottom Line

Rates should trade in narrower ranges. Rates should move in the opposite direction of stocks as markets "normalize." The general trend is towards lower yields due to concern about the health of the economy and the Fed's ability to maintain their pace of hikes.

Credit should do well, but I'd be selling leveraged loans. They have outperformed too much and given the issuance in the past couple of years (where "tough" deals went to loans to get done) the "protection" relative to bonds is likely overstated. Add to that the potential total return if interest rates are low and I have to advocate heavily for BBB and BB bonds. I like owning them on a spread and an outright level (HY also showed some glimmers of hope). I like CLOs at the senior tranches and I'd buy the cheapest senior tranches because I continue to believe that it is easier to pick a perfect NCAA bracket than it is to create losses in a AAA CLO tranche (the same is probably true down to BBB, but I only want to seem a little crazy, not fully having gone off the deep end). CCC bonds are trickier - they will bounce massively on any rally, but with a recession being discussed, they aren't for the faint of heart.

Equities. A bounce would be nice and should maybe even be expected. Having said that, capitulation has not occurred and what looks "cheap" versus 6 months ago might only look "ok" versus a couple of years ago (and crypto concerns me). **I guess I'm still cautious but close to neutral and am happy to change my mind here as indications of sentiment, positioning, and data come in.**

It is too early for the Fed to change their messaging. They might start hinting at it as financial conditions have tightened and the negative wealth effect is real, but the shift will be subtle for now. I think in order of things they watch, equity prices are in the distance, while commercial real estate and short-term credit markets are front and center (short-term credit is performing very well and there is large demand to lend, so all good there, and CRE isn't a problem at the moment).

What I could really use is some rest! A day or two (or even five) of calm markets would be nice (beyond that, I'd get nervous again). Markets where you don't shake your head every time you spend 15 minutes away from the desk and can't believe where prices are now. That would be nice, and we'd all enjoy it (and quite frankly, need it)!

On the other hand, this is yet another T-Report being written from the road (Amtrak today as opposed to on a plane or in a hotel room) and it has been incredibly fun and informative connecting with you all in person again! Thanks for the ongoing support, thoughts, and help! And yes, even the criticisms 😊.

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