Episode 05

The Ryan Caldwell Hour: The Chiron 3D Report Q1 2021

Ryan Caldwell (00:00:04):

This is the Fireside podcast series, by FS. And today this is the Chiron 3D report for the first quarter of 2021. Today I'm joined by my four colleagues: Lara Rhame, Peter Bianco, Scott Sullivan and Brian Cho. Good morning, everybody.

Lara Rhame (00:00:27):

Good morning.

Peter Bianco (00:00:27):

Morning.

Ryan Caldwell (00:00:28):

By the way, Lara, I had to start here. We had to change the podcast name. As soon as Rhame gets involved, and marketing gets involved, we have new names, new things to do. They didn't like my Jocko, Chiron episode one, two, three... That was no good. So here we are.

Lara Rhame (00:00:47):

Sorry about that. Fingerprints all over it.

Ryan Caldwell (00:00:49):

No, you're not. You're not sorry at all. It's fine. It's fine. That's why we integrated you into the podcast. We needed to shake this up a bit.

Lara Rhame (00:00:57):

Happy to do it.

Ryan Caldwell (00:01:00):

So, I thought what we would do today is go through our... We wrote our quarterly, us being the Chiron Capital Allocation team and the Chiron Mid Cap Fund team. We wrote our 3D report to get through Q1 of 2021. And I actually, as I was writing it, it invoked a little bit of a bigger discussion. And so, what I thought we might do today is tear through that. And so, I think from a setup perspective, here's what I'm going to throw at you guys. And again, for our listeners, I didn't give everybody a lot of time to prep. Partially mistake, partially just to see what they're going to say.

Peter Bianco (00:01:41):

By design.

Ryan Caldwell (00:01:41):

By design. So, again, I thought we're at an intersection of a lot of things topically, and if I look at Q1 and how I tried to use this report was to talk a little bit about the cycle, and the cycle of the market, and the cycle of the economy, because I think that's one of the things we've been talking about for a while, and I know Lara has written about as well and looking at what markets we're anticipating versus the actual data and maybe updating where we're at in that, because, obviously, the first quarter, I thought, was a pretty violent realization of a lot of things I thought were actually fairly obvious toward the end of the year.

Ryan Caldwell (00:02:20):

But, 1Q was really, I would say, almost a hard realization in the market. But where I want to go to from there is where we're at. So, when I think about where we were at end of year to where we were at the end of the first quarter, like I said, it was this moment of acceptance and almost, to a degree, that by the end of March, the market had completely grappled onto the narrative that not only was growth going to be great, but we very well could be entering this period that was, the Roaring Twenties, because of all the stimulus and liquidity in the pipeline, how the consumer was going to res... US consumer, specifically, was going to respond.

Ryan Caldwell (00:02:59):

And again, I think when you look at what happened with rates in the quarter, equities in the quarter and all of this we're going to get into, I would say that consensus by the end of the quarter was really consensus and it was this macro narrative that inflation was here forever. And again, the consumer is going to power you through.

Ryan Caldwell (00:03:19):

So, I thought what we would do is maybe use this podcast to challenge consensus. And again, I'm a little skeptical that the narrative is so accepted, which is probably my own bias. And again, given where we've come from, a year ago where everybody was skeptical the other way. But again, there are some things lining up when you look at the cycle clock, you look at sentiment, they don't-look-normal relative to where you would expect to be a year into a recovery. And I want to vet that out and talk through it.

Ryan Caldwell (00:03:50):

So, I thought first, Brian, let's start quantitatively, again, so much of our process starts with starting points. And then, we branch out from there.

Ryan Caldwell (00:04:00):

Brian, I thought maybe what I would like you to do is do a couple of things. First, maybe talk us through, quickly, what you're seeing in the cycle clock, what happened in the first quarter, what it did to the cycle clock, particularly around things like spreads and sentiment, because those are probably our most real time metric for digestion of how people are thinking about the tape.

Ryan Caldwell (00:04:25):

And again, the aggressiveness versus defensiveness. I want you to talk a little bit about quality versus junk in the first quarter, because again, I think that was a big notable outcome in Q1. And then, lastly, I want you to maybe, if you could, and I'm going to make everybody do this as we go around the horn, is define where you think the starting point is now. Not where we were a year ago, but where are we right now, and if you are looking at a map, what would the map tell you? So maybe, Brian, let's kick off with you.

Brian (00:04:57):

Okay. Thank you for having me.

Ryan Caldwell (00:05:01):

You're welcome. I love having you every month, Brian. You're key to this, so you're absolutely welcome.

Brian (00:05:06):

Well, I know I'm well received. So here I go. When you look at our up-down indicator, the first one that I want to touch on is our domain reading. While on the surface, what we see is stock in value everywhere. So, at the end of last year, December 31st, we were there, and today, at the end of March, we saw the same thing. So, we continue to stay in a value domain, meaning that it's pointing to higher equity exposures and higher risky assets, [inaudible 00:05:45] pointing.

Brian (00:05:46):

And it's the same reading, basically, we see everywhere in US, outside US in developed markets, and even when you go to emerging markets. So, that's what we're seeing. So everywhere you see is very, very positive, in a way, in terms of risk. So now, let's take a look at, maybe, some of the things that we should think about from a dispersion perspective.

Brian (00:06:13):

So, when we measure dispersion, like how you would do it in quoted spread, what seems to be showing up now is this. So, year ago, March, we saw, basically, one of the biggest dispersion that we witnessed in our professional career. And in US, at that point, the reading was 6.8 in the interim month of March, in the March 23rd, when you saw the trough of the market, that was reading of 10.

Brian (00:06:45):

So, from 10 to 6.8, was the end of the March, and today, at the end of March of 2021, we're seeing the reading of 0.7. Now, let me also remind you where we were at the end of the year, last year, December 31st reading was two. So, let's simply put it this way, we travel a lot, very fast, and even within the last three months, so first quarter of this year, but, as all things, when you're moving big numbers, first, it moves a lot.

Brian (00:07:24):

And then because it move a lot, the incremental change to the numbers become smaller and smaller and smaller. So, while the move has been violent, even in the first quarter, now we're moving slower, that's one thing I want to point out. Another thing I want to point out is, just think about the number of 0.7. The reason why this number is interesting to me is now we're entering normal range. It's not... Well, this 0.7 meaning that is positive 0.7. So, it's above historical average, however, it's not materially different.

Brian (00:07:58):

You could say this could be average E2, another way to say it too is think about before trade war. Where were we? So, we're in that range in terms of dispersion. Another way to say it, at the end of the day, is the distinction between the cheapest to the market average, or average star, is now not that big. It's, statistically, not that big. And then one more thing I want to point out-

Ryan Caldwell (00:08:26):

So, Brian, right there, just right there, I want to interject just to highlight the point you just made, because I'm going to have Scott talk about this in a little bit, but I want to link the two together, which is, when you look at the level of where the cheapest decile, and this is the US market, where the cheapest 10% of stocks in the US are, it's back in the average range, which again, just to clean all this up, it got as widest 10 [inaudible 00:08:55] deviations, which look like the great depression, it's now back in the average range, which, again, would tell you that cyclical stocks are now somewhere around averagely valued.

Ryan Caldwell (00:09:07):

They're not yet expensive, they're a little bit cheap to average, but they've come a long way from being blown out, incredibly generational buying opportunity cheap. Is that a reasonable way to surmise what you just said?

Brian (00:09:21):

Absolutely. So, year ago, we saw a clear opportunity. It was once in a 20/30 years, maybe, even a hundred year event. So it was that cheap. Today, well, it's in the average cheapness, that's how you should think about it.

Ryan Caldwell (00:09:40):

Okay.

Brian (00:09:40):

So, this version has come a very, very long way. And so, market, at least for the tails, right side of the tail or the left side of the tail, in terms of valuation, that huge opportunity we saw, that fat tail even that we saw, is now only normal. So, all that is been used up. So, we have yet another cycle clock. So let me touch on that. We have this indicator called sentiment, which measures all bunch of different markets. So, what we're trying to assess is what CTA folks are trying to do with their readings.

Brian (00:10:21):

And so, we look at equity markets, to options market, to volatilities, and so on and so forth, to simply measure this market sentiment in the broadest sense. When you do that, the sentiment reading at the end of first quarter was 0.7. Last 0.7. So, the reason why that number is interesting to me is, to get to that number, you have to go back to last year before all this happened. In fact, at that time, December and January of... December 2019 and January of 2020, you saw the numbers around one.

Brian (00:11:03):

So, again, we came tremendously long way. Another way to say it is, in terms of sentiment, we're fully exuberant. We're happy. We're very happy as a investing public, as a whole, our happiness gauge, in a way, is in over 90th percentile, no matter how you gauge it.

Brian (00:11:25):

So, we're very happy and many of the numbers that we see are pushing up the sentiment. So, that's where we stand in terms of sentiment. So, when you do that...Now, I want to simply touch on, what Ryan called me for, which is this discussion about quality versus junk performance. What we saw last year, and even beginning of this year, was a huge revaluation of highly volatile mix names. So, you have highest beta stocks outperforming. You have highest idiosyncratic stats outperforming. You had the cheapest stocks outperforming, you had some of the growth companies that makes no money performing well.

Brian (00:12:11):

But, when you put it all together, what we saw was companies with high margins, or quality, have done poorly, in a way. It continued to do poorly. So, it's been doing poorly for past three months.

Brian (00:12:26):

In fact, if you think about how perverse it was... In order to look at how perverse it was, you have to go back to great depression, I shouldn't say great depression, great financial crisis. So, that was the last time we saw such an event where quality has been completely destroyed by the junks. So, that's the environment we're living in.

Brian (00:12:52):

So, let me stop there. And then, now, I just want to touch on, at least from a quantitative perspective, where we stand. The starting point. So where are all the numbers I see? Where do I think we are? I'm not saying we're at the end of the cycle. Clearly, we're not. But, clearly, all the numbers we see is we're on the other side of the mountain and big womb has already occurred, and, especially at a valuation dispersion, which is a clearest way of measuring how much opportunity you have in value. It's largely been used up.

Brian (00:13:33):

There's still some left. What does it mean? There's still some left, but most of it is used up. So, easy picking has been all used up. So, what does it mean to me quantitatively? Well, now you have to look at everything. quantitatively, value shouldn't be the only thing that's driving your score. You have to, not only look at value, but you have to look at the momentum, you have to look at the margins, meaning the quality, you also have to look at capital deployment.

Brian (00:14:02):

So, what I'm saying is, now on the quantitative tools, everything has to cancel. All the numbers we see must count. Another way to say it is, alpha that you're going to get from each of these inputs are now smaller. So, maybe you can still generate alphas, using quantitative tools, but the outcome that you should expect is smaller, now.

Brian (00:14:26):

So, finally, I just want to touch on one more thing, which is, because the signals are now much more muted, one more thing you have to think then is, this is when fundamental opinions and convictions matters more and more, because quants signals are winning in power. So, that's where I think we are at this point. So let me stop there.

Ryan Caldwell (00:14:52):

I think you brought up a couple of really good points and I'm going to pivot off a couple of them, but, I think first, to go back and look if… I was writing while you were talking. And so, when I think about the answer, quantitatively, the interesting thing to me is we have some of our indicators that are still, you would call, early cycle, although, to your point, the next move of them, given what's happened, is likely to start softening up or muting down.

Ryan Caldwell (00:15:20):

But again, at the end of the quarter, the reading was still risk on. And to remind our listeners, how we think about our process, what we try to do, and Brian just brought this point up is, when these spreads get blown out and our cycle clock goes to early cycle, that's where we want to take a lot of risk.

Ryan Caldwell (00:15:40):

And we jump up and down and say, "Beta is what you want to do." You want to go find the things that are sensitive to where the problem's at, you want to run into the burning building, you want to take a lot of risk because the power of mean reversion is massive at the beginning of the cycle. And so, that happened. But now when you look at your… We look at some of our quantitative inputs, they're becoming more of a mixed bag.

Ryan Caldwell (00:16:04):

So, again, there's less potency to just a straight value strategy. I think that was point one. Point two, and Brian just made this, is everything matters now. So, I'm going to get into this with Scott a little bit when we start talking about good news versus bad news and peak good news and how that gets manifested into investor behavior.

Ryan Caldwell (00:16:25):

But again, from your perspective, when you look at the sentiment reading, it's late cycle. I think that's one of the things that surprises me in the thing of what surprises you at the end of Q1, was, again, how extreme... You get this sentiment extreme end of cycle, because people really believe the economic outcomes, they really believe in the corporate outcomes, and so, to your point, Brian, everybody's happy.

Ryan Caldwell (00:16:51):

So, that is a weird indicator to be a year into a recovery and everybody already believes the recovery. So, I'm making that point for a reason. But again, our sentiment gauge tends to back that up. And then, to your point Brian, lastly, when you look at the performance of junk versus quality, again, you expect junk to win early. Because the economy's going to be good, that tide's going to raise all boats. You want to find the things that have low margins that can go up when revenue goes up because you make a lot of money.

Ryan Caldwell (00:17:22):

So, what you do is you avoid the things that already have high margins, because there's not going to be as much leverage in the system. So small cap performs, big cap value outperforms quality. We saw all that, I just wanted to draw out the point, that it got extreme already. So, when you look at the reading, it's about as extreme as it was at the end of '09, when the market rebounded out of the bottom in February of '09 to the end of '09, you saw the same thing happen. You threw out quality, you went to junk.

Ryan Caldwell (00:17:52):

We would expect to see that early cycle. But I think the point to make, from a starting point perspective, is it's extreme. So, again, I think that would be the point to highlight. So, Scott, now I'm going to pivot to you, because I think the next thought process and all this is... Okay, we got the quant tools, and the quant tools are giving you a signal, but fundamentally, you've really had to be on your front foot for a year because earnings were so destroyed because of the pandemic, how COVID was effective in shutting things down, or man-made shutdowns. And so, the earning sweep, the quant work with a four quarter lag and a quarter lag, wasn't going to be able to pick up what was going to come. So, you had to be able to anticipate that fundamentally.

Ryan Caldwell (00:18:39):

So, now looking at the fundamentals, I guess, what are you seeing? And let's start US, because I think the US is a little bit different... It's moving in a little bit different orbit because of policy, particularly, but what you're seeing, in mid, early, late cycle companies from just a fundamental perspective. Both valuation and earnings. What's the tape telling you?

Ryan Caldwell (00:19:03):

And again, we're about to start earning season here in a few days, so we're going to get an update to this, but again, I'm interested in the fundamental case in the US, and then, once you establish the baseline, I've got a couple of other followups, but I want you to, maybe, talk through mid, early, late and what you're seeing fundamentally.

Scott Sullivan (00:19:21):

Sure. So I think, Brian's point is right that we've come a long way in a really short amount of time from a relative perspective. So, as we head into 2021, the market's anticipating 25% earnings growth, the revisions on that, they've actually moved up about eight points year to date. So, to Brian's point, we were at 10, we got the two at the end of 2020, and now I've already come down to 0.7.

Scott Sullivan (00:19:49):

So, there's been a fair amount of movement there on the value side, I guess. And then, from a style perspective, value's supposed to grow earnings 26% and growth 18. So, that's where we're at. Nine months ago, it was, you're looking for just locations within the market, given what happened with this pandemic, and we were looking at areas that we thought weren't going to be zeros. So, things like airlines, made a lot of sense at that point. Things like gaming, made a lot of sense at that point.

Scott Sullivan (00:20:23):

And not that those don't make sense now, but I think that the conversation has moved to a little bit more of a nuanced situation. And so, I think what Brian said with the spread is all relevant and that fits into the narrative that you see was the way that a fundamental analyst would look at things from a PE perspective or an EV/Ebitda. So, the PE and the SNP, at 4100 is 21 times 21 earnings. That's not egregious for where the rate deck is, but it's not cheap either.

Scott Sullivan (00:20:55):

And the estimates for/or the multiple on the Russell's over thirties, that's not cheap. And I think what is on the come here, is a little bit more difficult environment for the cyclicals. We've seen what's happened with the early cycle orders for a lot of the different industrials Parker Hannifin's accelerating massively up into the 20s, and 30s, and 40s percent.

Scott Sullivan (00:21:22):

So, could next quarter be good? Yeah. Could the third quarter be good? Yeah. Those are going to be good. I think those are largely priced in, and we're having an argument about how long is this going to be really good for. So, I think that we've moved from a period of anticipating things getting better to a point where we're all expecting things to be really good. And that's a very different starting point.

Scott Sullivan (00:21:48):

So, to answer your question, I think that we're more in a mid-cycle environment. I think you had your big early-cycle moves, and I think what you're seeing is people are starting to shift. I think you've seen this over the last... Brian speaks about it in longer terms, but we're really grinded at the end of the day.

Scott Sullivan (00:22:07):

I think you've seen, in the last couple of weeks, that there is a little bit of a rotation back into this quality factor. And it's probably a little bit too short-term for Brian to mention, but, if things go the way we're thinking about, I think that becomes a more prevalent issue and quality continues to do really well here.

Scott Sullivan (00:22:26):

I think that's my viewpoint. And, by quality, I'm thinking about it from not only a margin perspective, but also a top line perspective from the standpoint of, who's going to accelerate earnings as we move out into 2022?

Scott Sullivan (00:22:41):

So, we've already talked about 2021, it's going to be a really good earnings year, some of these value names are going to have earnings up 50%. I think the financials in the first quarter, maybe, are going to be up 80. So, there's going to be really, really big numbers. Now, when we think about going out into 2022, now this isn't the only issue, but there is a comparison issue with 2021.

Scott Sullivan (00:23:01):

So, how far down did your earnings go in 2020? How far did they come back up in 2021? And then, what's the prospect for you to be able to grow out into 2022 and 2023? I think that's where the market's at right now. And so, as we think about that, I mean, you're thinking about things that could have a cyclical aspect, but also could have a secular aspect to it.

Scott Sullivan (00:23:24):

And you're trying to find things that have a secular aspect at the right valuation. It definitely becomes a lot harder, but, to what Ryan spoke about earlier, you're doing, to use a technical term, a little less dumpster diving in a little bit more moving to, what Brian would describe as, high quality.

Scott Sullivan (00:23:43):

So, I think that's the way thinking about it within things that could possibly do better out into 2022 and 2023, I mean, I think that the old playbook is still in play where you're going to have some later cycle things, big projects, oil and gas, energy, chemical, big plants, things like that, that's probably still in play. And then, I think the other piece that's going to be different this time is where the stimulus is directed.

Scott Sullivan (00:24:10):

So, obviously, there's a lot of talk around infrastructure, there's a lot of talk around energy, there's a lot of talk around automation, and so, those spots all make sense at the right price. And, I think, that's what Brian does a great job at, is we can look at things not just in the US, but globally. And also, within some of the conglomerates, which tend to be a little bit more mid to late cycle given they're bigger and more diversified, it enables you to value pieces within the conglomerate.

Scott Sullivan (00:24:44):

Some of them have automation pieces and different pieces of the business that you have to almost break out to see what you're paying for them. So, I spoke for a while there, to just get back to what I think... The net of it, for me is that, it's been a really good period, and as Brians's work was incredibly influential and helpful in knowing when to go all in and now I think that as we move more to a neutral reading, we're going to use his work in a little bit different way.

Scott Sullivan (00:25:15):

Probably, if the readings are neutral from a macro top-down level, we're going to be using the stock model in more detail, I would think going forward here is we're looking for more stable accelerating companies into 2022 and 2023.

Ryan Caldwell (00:25:34):

And Scott, do you see... One of the things you've pointed out to us and said, I'm going to ask you if you still see it, is that, there seems to be some regional differences and probably a lot of this is COVID and policy. High level stuff, between cycle clock, you talked about the US, when you think about Europe, for instance, which has clearly had stubbed it's toe 15 times on this vaccine rollout and immunization, and you look at... Do you see the same things from a earnings and valuation perspective in places that are, maybe, behind the US, and then, maybe, even contra places, like Asia, that may be ahead of the US, are there any regional nuances to the framework you're thinking about? Or does it all looks similar?

Scott Sullivan (00:26:27):

I think, from a regional standpoint, I think what's different... I mean, number one, in Brian's work, the UK is still got decent spread. So, that tells you a lot right there where those stocks just haven't moved as much. Now, I think the year point is exactly right. The things that have held back Europe a little bit, they haven't probably moved quite as fast on the vaccine and they probably haven't moved quite as fast or targeted on stimulus. And they've also got a little bit more exposure to China, which is in a little bit different cycle.

Scott Sullivan (00:26:58):

And so, I do think that my conclusion to that is that I do think Europe will catch up. It's messy, but the valuations reflect that. And that's certainly a place where I think that we'll be looking hard at over the next couple months.

Scott Sullivan (00:27:14):

So, I think that that is a geography that makes sense. And, just to go back to tie this all in, as we move into mid-cycle and we're looking at these, potentially, bigger companies, that's a generalization, but, just because they're domiciled than the UK and someone is domiciled than... They're all exposed to very similar markets and different geographies. And so, they're not that different.

Scott Sullivan (00:27:38):

So, if the valuations are different, you want to buy the cheaper one. And, I think that you're going to have, or currently, have the opportunity to do that in some spots in the UK. China is a little bit different and I think, from a longer term perspective for this particular fund and smacks, is a positive from the standpoint they are on a different cycle. They're, definitely, through early cycle.

Scott Sullivan (00:28:04):

To describe their cycle exactly would be difficult, but I mean, it seems pretty late. I mean, you can look at different things like excavator sales which... We played that China market through, even before the pandemic and thought it was mid-cycle. And so, now if you look at the data coming out of there, it's late-cycle and you're going to have to go through a little bit of a downturn, you're going to have to clear out some inventory around some of the cyclical thing.

Scott Sullivan (00:28:33):

So, I think that that's probably not an area where we're going to be running to right away. However, I do think, if those stocks continue to come in, or buy time, or we get some clarity on what the economic outlook is going to look like they're out in 2022/2023, as I was talking about earlier, I think that that is definitely a place where you're going to be thinking about, moving into some of those stocks, is their cycle is on a little bit different path than our cycle.

Scott Sullivan (00:29:01):

Which, like I said, I think is actually going to be a really good thing for global funds, is they're able to exploit, where we are in the cycle, because as we highlighted earlier, with Brian's work early-cycles when you're going to get the big returns and the ability to get early-cycle in different geographies at different times could be unique, and I think a real positive over the next three to five years.

Ryan Caldwell (00:29:27):

No. I think that's a really good point. And then, I think lastly, Scott, and I'm going to use this to pivot to Pete and Lara, which is one of the things you've been talking about on the fundamental side and hitting everybody over the head with, and I agree, is this concept of peak good news. And so, I wanted you to maybe talk about that for a second because one of the things I think that starts to happen at this point in the cycle is you should be getting good news. This is the part where the news better be really good because you've priced it, but, there's also this notion of, at the beginning of the cycle, good and bad news are both good news. The bad news is you're going to get more policy and fiscal support, good news is something good's happening.

Ryan Caldwell (00:30:12):

So, almost any news becomes good news, but you do make this transition at some point where good's got to be good and bad is going to be bad. And so, you made the point at the end of the quarter, like, "This feels like peak good news." Vaccination, all these different things. Can you maybe talk about that a little bit from a stock-picking perspective. How you think about changing your mindset from any news is good news, to you got to cipher out good versus bad.

Scott Sullivan (00:30:41):

Yeah. And I think that has changed. And I think there's actually two different ways to think about it. But on the stock-specific side, I think, if we just rewind to nine months ago, if Southwest best earnings, you didn't care about anything besides just a few things, like how are they controlling costs? What does the balance sheet look like? Oh, it's down so much that it has to be up next year. Easy comp thing.

Scott Sullivan (00:31:04):

So, to your point, basically, and the market went, basically, straight up because of where the valuations were. So, all news was, in some ways, good news. Now, I think, fast forwarding to today, where we're at, where the valuations are, where the dispersion is, all that stuff, I think that the companies better deliver good news. Bad news is not going to be tolerated. I don't think, at all.

Scott Sullivan (00:31:26):

And you're seeing it already. The revisions in the first quarter, what we've gotten, people that have reported, the stocks, they're not doing what they were doing in the last couple quarters and the magnitude of the beats is the same. So, you're already starting to say, "Okay. We got it. It's not that bad. It better be good." And so, I think on the stock-specific front, it needs to be good. And I think there's reasons why it may not be as good for some companies.

Scott Sullivan (00:31:52):

Look at the issue with the supply chains on a lot of these different companies. Look at what's happening with costs and employment and bringing people back. So, all those things are going to matter and they're going to matter more on the small cap side, I think.

Scott Sullivan (00:32:06):

But, a long way to say, yeah, I think, on the stock-specific side, without a question, it better be good news. And then, it's just a matter of, how good is it going to be. But, thus far, an earning season hasn't been great reactions to earnings. We'll see, we're very, very early. Now, on the macro front, it gets a little bit more tricky, I think.

Scott Sullivan (00:32:29):

I mean, in the current situation, you're a little bit worried about good news just from the standpoint of then the market thinks the Fed can go ahead. But I think you need enough good news to not have the stocks themselves fall apart. So, I think that that's just the tricky part of this right now, but I think, definitely, when I'm looking at an individual stock, I can't think of a situation where I'm rooting for bad news. And it's not always the case, but in this situation, I'm not interested in misses.

Ryan Caldwell (00:33:02):

So, that's my perfect segue into the macro segment. Lara, Pete. So Lara, I wanted to start with you and almost exactly off that tail. Which is... Okay, when I think about how far the consensus bar of the macro economist community moved in Q1, the notion was into the year, like, "Yeah. We thought '21 was going to be good. And we thought inflation expectations would be rising." And generally speaking, the market got, that we would get people vaccinated. But boy, it feels like in the first quarter the narrative turned harder, which was, "We're going to get all the stimulus. We're going to get all the Biden fiscal. We are going to get..." obviously the Fed is fighting the market to keep them from pulling rate hikes forward.

Ryan Caldwell (00:34:01):

That's the dynamic that's emerging in Q1, is the Fed versus the bond vigilantes on? When does the taper come? How hard are they going to hike rates? And there is also, and you and I have talked a lot about this, there is this notion that "It's going to be, the Roaring Twenties," because the consumer balance sheet's in great shape and you just transferred them a whole bunch of money, and so, everybody's going to feel good.

Ryan Caldwell (00:34:23):

And so, the narrative, again, by the end of the quarter was, it's really hyperinflationary, and it's likely going to stay that way, and you really need to reorient your portfolios. Now, again, we talked about this in the last podcast in October. You needed to reorient your portfolio in October. But what I want to get through from you, Lara, is the kind of think through these big things, because I do think the macro is really important.

Ryan Caldwell (00:34:51):

Again, we went through this seven or eight year period where the macro was really lulled, and slow, and deflationary, and hard. And now, we're in this rip roaring, it's more inflationary, so everything's moving faster. And that's one of the things I talked about in the 3D report is, and you and I have talked about this in the past, in deflation things move slowly, and in inflation they move fastly, or more quickly.

Ryan Caldwell (00:35:16):

So, I wanted you to maybe talk through some of these big points. A, are all the disinflationary forces that we've been worried about for the past two decades, are they gone? Was COVID enough of a game changer for policy makers to really move the bar? Change the outlook and change the long-term demographic production, or the long-term secular deflationary headwinds? So like, is that just over? And should we be thinking about... I even saw a comparison earlier in the week that said, this was going to be like the 70s, and I almost fell out of my chair.

Ryan Caldwell (00:35:48):

So, I'd love to have you talk through that? The next thing I would say too, is this whole inflationary argument and the Fed, do you look through it? Do you adopt their framework? Do you say that the next couple of quarters are going to be really inflationary? And then, it's all going to mean revert, so it's temporary? Or is this something more? Because boy, that feels like the big macro debate as to where the puck is with the Fed and how quick they got to move? Or will they move?

Ryan Caldwell (00:36:17):

And so, I'd love for you to get into that debate a little bit. And then, again, I think the last thing I wanted you to fetter out is, what is the thing about consensus that troubles you the most? Because, I am surprised how far the econ consensus bar moved. So, that's a lot, I know, I'm pinning a lot on you, again, like I like to do in these podcasts for discussion. So, let's see what you got.

Lara Rhame (00:36:44):

First of all, phenomenal discussion so far. So always eager to weigh in. I think this issue of, "Are we, the Roaring Twenties? Are we just, the roaring 2021?" To me, is really top of mind. I mean, when I think about 2022, to me, that really, and you are right, expectations have come so far at the start of the year, the consensus forecast... That's just three and a half months ago, the consensus outlook for 2022 growth was 3%. Now we're at 4%. And expectations for 2021 have gone from 4% to 6.2%.

Lara Rhame (00:37:25):

So, it is moving fast. It is moving in only one direction, which is higher. And that continues to be the case. These growth forecasts are astronomical. So, plug right straight to 2022, I mean, 2021 is going to be strong, put whatever number you want in it, ignore the 6% is the gimmie, some people are as high as 10%. Looking at 2022, to me it really is going to be a year of deceleration. I think growth above 3% is going to be a stretch, but the market's already up to 4%, that is still a deceleration to a strong economy.

Lara Rhame (00:38:07):

But, think about it, you've got the economy decelerating, probably at the second derivative, falling as fast as it has at any time, that I can remember, you've got the Fed, probably, starting to slow the pace of their quantitative easing, their asset purchases, you have M2 growth, which is going to come down hard. All of this speaks to deceleration. And none of those things are usually a comfortable place for markets. Markets don't like deceleration. So, that, to me, is the way to frame 2022, which I think everyone is still so excited about just the GDP number.

Lara Rhame (00:38:52):

So strong, given a lot of these boring things, like underlying potential growth. So, it's still exciting to have a growth rate that is significantly above that. But that is, I think, the way that I frame 2022, that a lot of people are missing. It's a year of deceleration.

Lara Rhame (00:39:14):

Inflation is just about as fascinating as it's been in a long time. First of all, ignore inflation over the next quarter. That's what we need to do. And we got CPI this morning for March, popped from one point, what was it? 1.7% to 2.6%. This is just base effects from energy getting crushed this time last year, that's going to go on for another couple months. So. ignore that. Beyond that, I think there are two really critical dynamics in play, that play right back to equity market.

Lara Rhame (00:39:52):

One of them is the fact that we may very well continue to get these supply side disruptions, and commodity price increases. What is fascinating is that they have typically not fed through to headline consumer price inflation or that PCE deflation, because one of the things we've witnessed, over the last 15/20 years, is, companies have lost the ability to pass the supply side cost increases over to consumers.

Lara Rhame (00:40:24):

So, they've lost that ability and it impacts, companies... Sector by sector, company by company, impacts their margins, but they can't pass it through. So, when you think about what the Feds' looking at, they're really looking at that top line number that's impacting households. They're looking at... We saw the same thing for wage inflation. We had the unemployment rate at multi-decade lows three and a half percent.

Lara Rhame (00:40:52):

You did, actually, see wages rising, but companies couldn't pass that along to... That was what the Fed got so, spectacularly, wrong in 2017 when they were raising rates, that companies couldn't pass it along. So, I think this is where inflation, to me, could have more significant impact for financial markets than it could, or the supply side part of it, could have more impact on financial markets than the Fed on the overall economy. If that makes any sense. Ryan, you should feel free to reframe what [crosstalk 00:41:30]

Ryan Caldwell (00:41:30):

Well, look, I think it makes... I can take the tail. I mean, I think that makes a ton of sense. So, I think it's at the heart of the argument, which is, is it margin pressure deflation? Or is it cost push pass through? And you got to make that call, because if it's margin deflationary, it's bad for multiples, and back to Scott's, "Bad news to stocks will be margin misses," because those will be earnings misses. And again, like the numbers don't contemplate that.

Ryan Caldwell (00:42:01):

So I think it's critical. But if your view is now companies, they have pricing power because the consumer is so good, well then that's a very different animal. And to your point, this is one of my checks in the deflationary camp, which is, to your point, in the last decade, companies particularly have had zero ability to pass on price increases to consumer. Zero.

Ryan Caldwell (00:42:25):

So, if you think that's changing, that's a really big deal. If it's not changing, it's a really big deal, because the market's priced that at least maybe someone on the margin it has looking at some of the cyclical companies, earnings, estimates, particularly, out into maybe 22. I think that's where these two things intersect, which is 22 numbers again. Is it a knock to 22 numbers?

Lara Rhame (00:42:53):

I mean, I think where I fall on that is, I won't believe things have changed until I see them change. I'm still in the camp that companies are going to have a lot of trouble passing off price increases. And that's, part of... We still have this global deflationary, demographically led, chronic slow growth coming from Europe, from Japan, from all of these, the countries that are really... I mean, China's demographics are horrible. All of these... The countries that are really driving growth are all facing the same demographic wall that's affecting potential growth.

Lara Rhame (00:43:31):

And, all of the things that failing Fed credibility, their long-term inflation expectations are now anchored firmly below 2%. So, they've got a way to go, in my mind, to regain the firm ground with which to significantly raise rates beyond renormalizing things.

Lara Rhame (00:43:52):

What was the third thing we were supposed to talk about? Consumption. The consumer and the stimulus checks.

Ryan Caldwell (00:43:59):

Yep.

Lara Rhame (00:44:01):

So here, I think, to me, it was what we needed during a time of Epic economic dislocation, but this is not enough to power growth for the long-term. I think this is out of criticism to households because they have behaved, to your point, very responsibly with leverage. But the reality is, you look at good spending it's through the roofs, you look at our trade deficit, it's just so wide now, the trade gap, I keep expecting Godzilla to crawl out of it. Now you know what I watch over the weekends.

Ryan Caldwell (00:44:43):

Keep it coming. It's a good legendary flick by the way, King Kong/Godzilla, sorry, shameless, plug for legendary.

Lara Rhame (00:44:57):

But, I think all of this points to the fact that the dollars, that households are deploying may not even be going entirely to the US economy. So, there's leakage there. So, this is, while it's greater stimulus than we've ever seen, past experiences with this type of stimulus shows that it's a positive pulse that fades. And I think that's why everybody is so eager.

Lara Rhame (00:45:25):

In fact, my concern is that we really need to wean households off of this money coming through the mail slot and not get them addicted to it. So, that, to me, is really the challenge. We need to spend on something, desperately, need to spend on anything but just giving houses these checks.

Brian (00:45:42):

Rach... Lara, sorry. It was interesting. I think when they passed the CARES Act, they were only expecting about a third of those transfers to end up back into consumer spending and consumption. And I haven't seen this term since college, but the New York Fed wrote a paper yesterday, their Liberty Street Economics team, which they writes a blog post, but they brought up the term Ricardian equivalence, which, again, for those who maybe haven't studied that topic in a while, basically-

Ryan Caldwell (00:46:20):

Or ever.

Brian (00:46:20):

Or ever.

Ryan Caldwell (00:46:21):

Or ever.

Brian (00:46:22):

When you have these big public transfers finance with government debt, it doesn't necessarily affect consumption because households will save them to pay for the eventual tax increases to repay the debt. Now that obviously there's been a lot of faults found with that concept, obviously, but, I just thought it was an interesting point because I haven't heard that term in a very long time.

Ryan Caldwell (00:46:48):

Little podcast, a little podcast drop-off.

Lara Rhame (00:46:53):

[crosstalk 00:46:53] got some education here.

Ryan Caldwell (00:46:57):

But, Lara, we haven't even touched on that yet, which I was going to tickle you on because you and I talked about this earlier in the week, which was, it does look like we're going to get tax hikes. I do think the market thought, it was going to get all the candy and get no beating. And, again, if we're going to do two reconciliation bills and the parliamentary has already changed the definition of what can get through reconciliation, then you're going to get tax hikes, it's going to happen.

Ryan Caldwell (00:47:27):

And I am a little surprised that, again, I've started to see Wall Street start to tickle that this is going to affect numbers. They're, start to throw out, "Well, if it happens, it could be seven to 12% off 2022 numbers." But what I haven't seen is any economist taking down any economic numbers on the tax side. Nobody's talked about that yet.

Lara Rhame (00:47:51):

I agree. And I think, add to that, the fact that 2022, we have midterms, the Democrats will, very likely, lose the House. And we could face a significant wave of fiscal austerity and the pendular swung so far in one direction that it could very well swing in the other direction. So, to your point, I mean, I see headwinds building in 2022 that I think could affect growth very much in 2023 and 2024.

Lara Rhame (00:48:25):

So, all that said, I think when we talk about the cycle, where we are on the cycle, I've always thought about the economic cycle in three portions. The very start of a new expansion is digging ourselves out of the hole. That's the first leg, which usually takes a year or three years.

Ryan Caldwell (00:48:44):

Yap.

Lara Rhame (00:48:45):

And then, phase two is growth, healthy growth. The unemployment rate slowly comes down, because in phase one, the unemployment rate usually stays sluggishly high and it doesn't... And it, actually, usually rises during phase one. So phase two is healthy growth, unemployment rate comes down, house prices start to rise, we get some more inflation. And then phase three, is an overheating phase where, maybe, we get the unemployment rate below full employment. We get some signs of wage growth.

Lara Rhame (00:49:24):

This is where we were when the Fed raised rates, now we know, prematurely, in 2017 or so, 2016/17. So, I think the question is, we seem to have bypassed, completely, phase one, digging out of a hole took us-

Ryan Caldwell (00:49:39):

A week.

Lara Rhame (00:49:39):

Couple of months. And we're already into phase two. And I think, to me, the real question is, do we similarly flip through phase two so fast that we enter the excess phase very prematurely. Because, phase two is two to seven years. Very long stretch. And the Fed, usually, at the beginning of all of this, usually responds to, "Okay. We're out of the crisis." So we renormalize a little bit. And then, everyone's now pricing when does the Fed raised rates to phase three. As you know, we've already talked about, we're already there pricing in when this happens.

Lara Rhame (00:50:25):

So, markets seem to anticipate us moving from this healthy phase of growth into accesses, and that's when recessions end. I mean, I think markets are prematurely pricing the Fed really doing anything more than just trying to wind down asset purchases, but, I think markets like to price a change in Fed policy, but it often is premature.

Lara Rhame (00:50:52):

But, all that said, the speed at which this has happened is extraordinary. So, I think it aligns very well with what's happening in markets. And I think, to the extent that we're still experiencing healthy growth, and I think the consensus is now weighing, when does that shift into excess or not. And I think that's where I have trouble really understanding how resilient things like business investments, things like whether we're going to get effective infrastructure, I just continue to think that's an enormous challenge.

Lara Rhame (00:51:38):

And whether or not that can really push us through phase two into phase three of this access world faster. That's where I have trouble seeing the acceleration in the cycle maintaining that speed.

Ryan Caldwell (00:51:53):

No. Look, I think you hit the nail on the head and I think you've exactly described, I think, why both fundamentally and quantitatively, the signal mixing is massive. To be talking about wage push, a year into a recovery, is shocking. That is a late-cycle phenomenon. If you're really talking about, and to your point, excesses, that's late-cycle. So, I think that's so well said in the fact that the market has just moved the argument on massive fast forward and said, "We already priced the outcome. We already know that this is how it's going to go." And so, the next thing to come is this hyper wage push inflationary phase, which will draw the Fed back into, shut it all down, yet, if you really believe that that's in the course over the next 12 months, you're getting out of the market now.

Ryan Caldwell (00:52:52):

That would be like, "Get out." That would start to be the signal that... If they've really got to accelerate because you're at wage push, then you're going to mark the end of the cycle. I think it's so perfectly cased that, and again, Lara, we've had this phenomenon where the economy, over the last decade, has moved so much slower than the tape.

Ryan Caldwell (00:53:12):

The tape is moved at hyper speed in the economy plotted along, which caught the tape wrong-footed multiple times. It wanted to promote a cycle, the cycle never really came to fruition and then the market would have to go back to buying FANG, because you never really got the cycle to start. And so, you went back to what worked.

Ryan Caldwell (00:53:31):

And so, I think there's a little bit of that going on now too, which was, "Hey, really, really good. It's going to run hot, but, not now..." And this is where I'm going to go with Pete next, because I said the macro economic community when talking to Lara, but when you talk about the macro hedge fund community, they're already changing hats and they normally do at a rate that's really extreme.

Ryan Caldwell (00:53:54):

And so, I'm going to tickle him on this next. But I think, Lara, your point about how this now unfolds is really important for the duration of cycle and risk, because your sediment lines up with the notion that we're going to get the wage push inflation really quickly. And I just, I don't know, that seems like a really hard U-turn.

Lara Rhame (00:54:17):

I don't buy it.

Ryan Caldwell (00:54:18):

I don't know that I buy that at all, which then gets you into that... That means you're going to get worse than good news, because that's the only way you get out. The incremental economic news isn't as grandiose as everybody thought it was. And then, that bleeds its way down. At the same time, you have some margin issues from supply shocks that are likely just supply shocks and not long-term inflationary supply chain problems. So, I think that... Again, your description makes a ton of sense to me. And again, when we circle back, I want to tie that together, but now I want to... No, go ahead.

Lara Rhame (00:54:56):

No. I think, Pete, this is where I'm so eager. I feel the very notion of consensus is so hard to gauge right now. I feel the band of forecast is still so wide and something that really occurred to me as we were all talking was, trading this becomes so difficult, because, you not only have to guess what you think is going to go on, but where consensus is and measure against that. So, yes, I am extremely eager to hear from Pete and understand where. I think that's going to be the big question for the next several months.

Ryan Caldwell (00:55:35):

So, Pete, over to you. I guess the question is, when you look at the three big regions, US, non-US, [DMNEM 00:55:42], where's the macro ball? Where do you think the macro community is in cycle clock? Where it's at, positioning? Those types of things.

Peter Bianco (00:55:53):

So, I think I'll start with Europe, first. Europe and UK. It's been really interesting what's been going on there, and at least from a monetary policy standpoint, it comes back to your traditional, there's the hock camp, which is your vibing crew and the frugal for and remember that camp was really dead set on not breaking the black zero and funding some deficit and was really harping on that hawkish budget versus the guard, and Philip Lane, and Schnabel the doves.

Peter Bianco (00:56:28):

And, I think, Lagarde, during the crisis was able to broker a truce with that vibing camp where they said, "Okay. We're going to run monetary policy easy, we're going to make this pep program sustainable," but the Hawks are starting to get a bigger voice and you're starting to see them pop up. We had Krause [Not 00:56:50] the other day, start to hint that rolling back stimulus from that pep program.

Peter Bianco (00:56:54):

And then, when you tie in, this is also an important point, when you tie in the vaccine news, there is a tinfoil hat community over there that says, they may be slow with the vaccine because that may affect monetary policy that Hawks may come back and say, "Well, look, it's all getting better. It's going by way of the US." So, you couple that with Brexit with AstraZeneca, there's a lot to really pass through, but it would not surprise me if Europe starts to roll back stimulus, maybe, before the US. And I think that's, Lagarde, in the last couple of weeks, she's made a point to say, "Let's front-load stimulus."

Peter Bianco (00:57:38):

I would say China has gotten really hard. And I think it started with when [inaudible 00:57:45] pulled their deal and with what's been going on with Jack Ma. We've been seeing ripple effects through their economy. One big thing that we've been really focused on is this decarbonization of steel and aluminum. They essentially stopped adding capacity and tension, the biggest steel producer almost in the world. So, this is something we're keen to determine whether, is this a real push to decarbonize the economy or is there something else going on beneath the covers?

Peter Bianco (00:58:24):

So, signs from China make, I think, the macro community, in general, a bit cautious and have, obviously, made us a bit cautious as well.

Ryan Caldwell (00:58:33):

Just to maybe tickle on that one for a minute, just to make the point. Back to the cycle clock, one of the things that we've been paying attention to, and particularly in the first quarter, and you saw it in March, and Scott touched on it as well when he was talking about fundamentals, was just how bad early cyclicals were in China in March. And the reason I bring that up is because, to Pete's point, they're doing a lot of things that they do when they tighten. They're already starting to slow liquidity injections, there's a really big, bad debt problem floating around there that's rearing its head every, call it, couple of quarters. Somebody gets in trouble, her wrong is obviously, and the big SME asset management company in China.

Ryan Caldwell (00:59:22):

And again, you're seeing it in things, like M2 fell dramatically last month. And so, they're tightening. So, back to this different strokes for different regions, to your point, we see these things shut-ins and you go all, "Maybe it's carbon footprinting." That's a nice excuse, but it's also, China's been adamant that they're not in a commodity supercycle, which, again, I wanted to take it with you. Because boy, the street believed that. And there's still some proponents that we're in this massive commodity supercycle... But to be in a commodity supercycle, you need big mama. I mean, China's got to be there for that to be the case. And boy, that's not the signals they're sending.

Peter Bianco (01:00:03):

No. That's absolutely right. I think on the commodity side, you can really make the case now that different, base metals and bulks may be in a supercycle, given that we have this massive push in EV, and we have the US fiscal spend, that's a whole other argument, whether that matters-

Ryan Caldwell (01:00:20):

Or not.

Peter Bianco (01:00:20):

Or not. But, when you look at China, what's so fascinating about right now is we have these problems, economically, but we also have issues with trade and geopolitics on top of that. And so, that's what makes China very hard right now. And then, this whole building of different supply chains for chips and rare earth metals.

Ryan Caldwell (01:00:44):

Yup.

Peter Bianco (01:00:44):

So, I would say, we really have to be very careful and look very hard when we're investing in that region.

Ryan Caldwell (01:00:52):

And, Pete, do you think, just because, again to Scott's point, there was a change in the tenor of the tape around quarter end. Right. Obviously. So, the macro community did pivot a bit on this argument of early cycle to something that maybe wasn't so early cycle. Again, given what we've seen in the tape. I mean, if you look at what's happened in Shanghai, Hong Kong, if you look at EV versus Nasdaq, which is another way to look at quality versus cyclical. Again, it's seven trading days. So, I'm not going to declare some massive trend, but, the tenor does start to feel a little bit different.

Peter Bianco (01:01:31):

It feels like the politics was really starting to bleed in. When we're talking about delisting Chinese ATRs and it makes it... When you guys look at fundamental risk premium in the equity valuation equation, you really have to rethink that number, when we're looking at China.

Ryan Caldwell (01:01:55):

A hundred percent. A hundred percent.

Peter Bianco (01:01:58):

And, on top of that, the currency, we're starting to see that weaken quite a bit. So, there's a lot of things happening in the mosaic that may make me very cautious right now.

Ryan Caldwell (01:02:07):

And Pete, maybe you touched on ARB, but anything else on the currency side, because, hey, Q1, it was a strong dollar quarter. You had real rates up dollar up. And so, again, consensus trade into the year was short dollar. And 1Q obliterated that, despite the fact that bonds were generally weak. So, you would have expected, with all the bonds selling, maybe the dollar wouldn't have been so strong, but it sure was.

Peter Bianco (01:02:37):

We had a massive quarter end which, I think, was important, which really dovetailed with Japanese year-end. But, my thoughts on the dollar, obviously, real rates are incredibly important and you've really hammered that home in the past. And also, fund flows. When you look at the US Treasury market versus the rest of the world, and if you're a non-US investor, if you look at currency adjusted hedges by purchasing US Treasuries, it's still the best game in town, given the macro backdrop.

Peter Bianco (01:03:08):

And if you look at the depth of, say, the European bond market, you look at, now, China, now people are invested in China. People are starting to re-think that. You look at JGBs I mean, US Treasuries, for all the chaos that's ensued, it's still a pretty good place to be.

Ryan Caldwell (01:03:25):

Now, that's super helpful. And we've seen some of that positioning come back on, as soon as you turn the calendar right. And that was something you were talking about. And then, Pete, the last one for you because I'll always like to pile it up in currency. I mean, obviously this was another bad quarter for gold and gold-related. Bitcoin was great. And we could have a two-day long debate about Bitcoin as substitute for gold. But, maybe, again, in the vein of currency real rates, does that explain the whole thing? Do you have to think about it any more than rates went up and real rates went up and dollar was stronger?

Peter Bianco (01:04:02):

I think that's pretty much it. Bitcoin entering the stage recently, I think that's important. It's very hard to properly frame Bitcoin sitting in the US with the world's reserve currency. If you're in a place like Turkey, if you're in a place like China, if you're in a place like, even North Korea, this is a really important tool that they're utilizing. Do I think it's going to take place in gold? This is on podcasts now. So we're going to look back on this [crosstalk 01:04:36]

Ryan Caldwell (01:04:35):

You're on the record buddy-

Peter Bianco (01:04:37):

I'm still a believer in gold. I think gold is going to be a fine place to park capital. I still look at Bitcoin as a trading vehicle. My question on Bitcoin, and I'll probably get hammered for this, but, what happens when the central banks start floating their own digital coins? Where is Bitcoins... Where is its place in the cosmos after that starts to happen? I think the technology's... It's a wonderful technology at blockchain, but those are the things I'm thinking about right now.

Ryan Caldwell (01:05:13):

All very fair. So, maybe just start to put the flaps down and start to drop this thing toward the runway. I thought maybe how we would end is this, which is, we're going to go around to each of you and what I want to get out of you is, what is the one thing you would tell somebody that's either picking stocks, or allocating assets, or thinking about risk, for the next 12 months? What's the thing that they should be thinking about? Whether it's economically, whether it's multiples market, if you're going to leave somebody with one thing to think about for the next 12 months, what is it?

Ryan Caldwell (01:05:56):

So I'm going to start with Brian, since you're the quant and you're our expert in starting points. What would you leave people with?

Brian (01:06:05):

Yes. I think the sentiment is very important, because I think it says we're fully, environment where everyone expects a continuation of good news. So, having said that, what I want to point out is, it's in a level where a lot of times market tends to go sideways from this. So, your teacher expect the return of the market should be there for smaller than before. I'm not saying corrections, I'm not saying entire year of data market, anything like that, what I'm suggesting simply is, it could still resolve in positive return environment. However, the return that we have witnessed so far, it's not something it's going to repeat, again, any time soon.

Brian (01:06:59):

Another point I want to point out is, our dispersion indicator is nice way of looking at opportunity set, especially, in terms of value. And when it comes down to that, a lot of it is used up. There's no other good way to say it. And one more point about that is, Lara pointed this out too, which is, when you have high number, moving down from high number, you have big changes. So you have this big doubt count.

Brian (01:07:26):

So, in terms of dispersion, because we moved so quickly from big number to, now, smaller number, the change that you can see down the road is getting smaller and smaller. So we going to see deceleration in dispersion compression. So, another way to say it, of course, is returns to value it should get smaller and smaller. Lastly, our domain says, the [inaudible 01:07:54], but you have to be a nuance. You want to look at the margins. You still want to keep an eye on free cash flow yield, but the margin is becoming more and more important to us because of all the reasons we said. So let me stop.

Ryan Caldwell (01:08:10):

Okay. Lara.

Lara Rhame (01:08:17):

Asking an economic miss to be prescriptive is uncomfortable. But I'm up to the task.

Ryan Caldwell (01:08:26):

Yes you are.

Lara Rhame (01:08:29):

So, I'm going to pivot just over to the income side of the balance sheet. I think what's been, really, remarkable is the fact that we've gotten through this cycle without the defaults, without the bankruptcies. And I also look at long-term treasuries. I just think we're kind of be stuck here for a while. Maybe we go as high as two 25, but that's where it stops.

Lara Rhame (01:09:01):

So, I think, you just need to be pretty aggressive on the credit side. And I think there's room for that to keep going as you reach deeper into credit. It's not, again, it's not something to be entered into lightly, but, as you get deeper into credit, it just gets very company specific. But, I think that's where, for returns, that's still a place where you can plumb some wins.

Ryan Caldwell (01:09:34):

Pete.

Peter Bianco (01:09:35):

Oh boy. I'm not going to say short credit. I'm just kidding.

Lara Rhame (01:09:43):

No. Feel free.

Peter Bianco (01:09:44):

I would be very careful in fixed income. And I'm not saying credit specifically, I would say just, generally, the sovereign side. I think the market right now, they are giving the Fed, actually, the benefit of the doubt just for their pricing and breakevens and spreads. So, I would just be a little careful there. But, I think in the next 12 to 18 months, we are going to set up in one of the greatest macro trading environments that we've seen in our career. So, it's an exciting time to be an investor. And again, I would just pay attention to the signpost, housing prices, liquid in the system, Bitcoin, that guy shining your shoes, telling you about whatever asset that they're invested in.

Peter Bianco (01:10:32):

So, just be very careful and cautious and-

Ryan Caldwell (01:10:35):

Scotty Saul, soccer, Bitcoin discussions. [crosstalk 01:10:39]. Those ones. Yeah.

Peter Bianco (01:10:40):

Just pay close attention to policy. There's a lot of gas in the tank right now.

Ryan Caldwell (01:10:46):

Scott.

Scott Sullivan (01:10:47):

You guys stole my thunder. I was trying to come up with a witty one-word answer, but mine was risk. And thinking about it, everything Pete just said around politics and monetary policy, I actually totally agree. I think this is going to be a really good trading environment, but I think you need to know, what you own. I think you need to know that from a sector perspective. I think you need to know that from a geography perspective, I think you need to know that from a balance sheet perspective. And I think all that stuff will, probably, present you with an opportunity to take advantage of dislocations as this thing moves through the cycle.

Scott Sullivan (01:11:26):

Because I think there will be hiccups, and I think you'll probably be able to take advantage of some of those, when things will dip that they shouldn't, and then they'll probably be things that'll just dip and not come back. So, I think risk is the most important thing to me at this juncture in the market. And I have gotten a lot of questions about Bitcoin at soccer games. [crosstalk 01:11:48]

Ryan Caldwell (01:11:47):

You are the King of soccer game Bitcoin.

Scott Sullivan (01:11:50):

So, you're making me a bit worried.

Ryan Caldwell (01:11:55):

I'm going to just... Trying to be witty with one word too. Mine was just going to be speed. I think the speed at which we're having to deal with the inputs and try to make heads or tails of them, given all these things like base facts and politics and policy, and again, coming out of a really hard backdrop and coming out of that really hard backdrop. And I think, Lara said it three times, the speed at which this is occurring, repairing, moving forward is just something we all haven't seen. And again, I can say that with somewhat of empirical evidence because we have Brian's work to kind of validate that, that the rate of change of these things is historically fast.

Ryan Caldwell (01:12:46):

And so, I agree with the notion that was laid on the table by everybody that, risk, dislocation, speed, policy, there's a lot of things coming to a confluence that just make you have to be on your toes. And I think, Scott's point's a good one. You better know what you own now.

Ryan Caldwell (01:13:09):

There's a time in the cycle where you can make a big characteristic bet. And that time in the cycle was a year ago where you could close your eyes and buy risk, and it would work out for you and it almost didn't matter what you bought, as long as it was risky, maybe disaffected or a beneficiary. The tape is telling you that you've got to start doing more work than that. And again, not that it was easy.

Ryan Caldwell (01:13:31):

Buying the characteristic in March of last year was awful. Trying to put risk on when you have no idea what you're looking at is not easy. So, I don't need to mention, like when we talk about easy money being made, it's never easy to make the behavioral decision to take risk, but now it's a different decision set. And I think trying to apply that decision set today makes no sense at all. And that seems to be where the strategists are. Is it risk-on or risk-off? And it's more nuanced than that.

Ryan Caldwell (01:14:02):

So, that would just be what I would leave people with is this is moving faster than anything you've ever seen. Again, it's really dislocated. You have different signals from different parts of the globe. So stay on your toes and know what you own.

Scott Sullivan (01:14:16):

In aviation we say, "Speed kills."

Ryan Caldwell (01:14:19):

Yeah. It does. And I think, Lara and I were talking about this Monday, and I'm going to steal her line in case she writes it, but, I think it's probably right, which is, "We just came off the slowest lumbering economic cycle we've lived through and this one might be the fastest." So, I think it's just not a bad way to frame the speed of what's occurring, how it's occurring, off of what just occurred. And how behavioral frameworks can really screw you up.

Ryan Caldwell (01:14:48):

Look, I appreciate everybody's time today, we put down a good hour and 15, but I think we're at a pretty big intersection to start having a discussion about doing different things. So Lara, Pete, Brian, Scott really appreciate the time. Again, we wrote about this briefly in 3D. If you read our quarterly report, it's geared toward this.

Ryan Caldwell (01:15:08):

I know Lara is going to be writing an awful lot about this, we'll be writing with her if possible as well. Because again, I do think this is the crux of the matter, and returns in the next 12 months to 24 months are really going to depend on getting a lot of this right. Again, I think it was good time for the discussion. I appreciate everybody's time and we'll let people get back to their wonderful days. So, thank you all very much. Really appreciate it.

Lara Rhame (01:15:35):

Thanks Ryan.

Speaker 6 (01:15:41):

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