

Cirrus Alert: Here be dragons and other signposts for the Covid-19 experience.

Our Cirrus Research “Away” basket is off by 65% in three short weeks as of Thursday’s market rout. The market is down by 26.7%, the Small Cap market 33.7%. In addition, Smaller cap Energy shares are down by 56.1% in this time frame. Conversely, our CR Home basket is off by 17.1% in the same time frame. Below is a ledger of the signposts we are currently monitoring. In total, we find reasons to be constructive as critical indicators appear to be stabilizing. It is noteworthy that we could witness a reversal trade as investors chase after quality firms caught in the “away” basket. Conversely, our concerns going forward relates to the likely slow and dogmatic approach by analysts covering industries outside the epicenter of airlines, casinos and hotels.

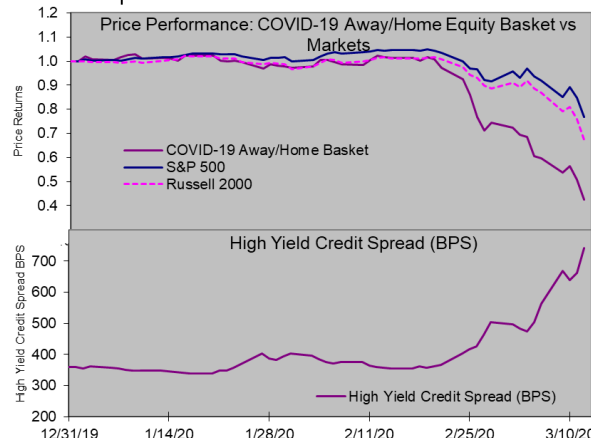
Signs of Optimism:

1. Our preliminary reading of our market crowding indicator has stabilized from a sell reading. See Fig 5.
2. If our 9/11 reference point holds, credit markets have hurtled near prior credit peaks. See Fig 2.
3. Our High Yield relative value model has stabilized from a sell reading to neutral as equities have sold down and high yield credit spreads have widened. See Fig 6.
4. Our Cirrus Research Away basket is down by 65% in a short three weeks; levels similar to 9/11 type pullback. See Fig 1 below.
5. AI/Big Data sentiment collapses for Away basket; the Stocksnips team shared their live sentiment signal for the CR Home & Away baskets. See Fig 4.
6. Small Caps just got interesting! Our oscillator for Small versus Large just triggered favorably into a constructive reading pointing to an oversold condition. See Fig 7.

Second-order Concerns are Real:

1. Credit markets still likely to remain locked; spreads post 9/11 peaked at 966; we are currently at 741.
2. Earnings expectations are always slow to adjust; this may be especially true in a pandemic. While sentiment for the Away baskets have come down sharply, the economic fallout on earnings expectations are about to spread across the real economy. In short, sell side analysts can be notoriously late.
3. Risk appetites will continue to decay, Cirrus Risk Score or CRX readings, are adjusting lower, but it is unlikely to have hit some contrarian bottom.

Fig 1: Firms linked to Consumer “Away” are off by 65% in three weeks! As the dust settles, investors will begin to look to a reversal of the Cirrus Home exposures.



Source: Cirrus Research

Please see Analyst Certification and Important Disclosures at the end of this report

Signs of Optimism:

1. Our preliminary reading of our market crowding has stabilized. The reading has subsided from 98% to 56% since the end of February. A reading north of 70% indicates increased volatility and downside risks.
2. If our 9/11 reference point holds, credit markets have hurtled to the prior peaks seen in the credit markets. While credit markets could widen further before this is over, it is notable that Energy High Yield bonds have collapsed to where the OAS is now 1740 bps over Treasuries. This is pretty much inline with the prior Oil bottom in 2016. See Fig 2.
3. With the adjustment in the high yield market, our High Yield Relative Value model has stabilized from a Sell reading to Neutral. In short, the collapse in equities adjusted for high yield markets seems more reasonably valued. See Fig 6.
4. Our Cirrus Research Away basket is down by 65% in a three weeks. Conversely the Home basket, or firms benefitting from consumer “quarantines”, has remained relatively stable, only beginning weakening in the last few days. It is off by 17.1% cumulative in three weeks. See Fig 1 below.
5. AI/Big Data sentiment collapses for Away basket; valuations also tumble to near 9/11 levels. The Stocksnips team shared their live sentiment signal for the CR Home & Away baskets; the away basket sentiment reading tumbled from 73.8 to 66.8 in a short few months. See Fig 4.
6. Small Caps just got interesting! Our oscillator for Small versus Large just triggered favorably into a constructive reading. This simple oscillator is contrary in spirit and flashes Buy when the small cap market breaks sharply from the overall market. As of this week, that reading was triggered. If we continue to witness a central bank support, a short term risk bounce should be more than likely. See Fig 7.

Second-order Concerns:

1. Credit markets still likely to remain locked; spreads post 9/11 peaked at 966 bps; we are currently at 741 bps. It is notable that while uncertainties abound, we refrain from drawing 2008 parallels. Both the consumer and banking segments were in a far more challenged state then.
2. Earnings expectations are slow to adjust. While sentiment for the away baskets have come down sharply, the economic fallout on earnings expectations are about to spread across the real economy. The demand destruction witnessed is not centered only to the “Away” industries, but instead spread across all 14 economic sectors. In short, sell side analysts can be notoriously late.
3. Our Cirrus Risk Score, or CRX readings, are adjusting lower, but it is unlikely to have hit a contrarian bottom.
4. Earnings estimates are being revised sharply lower for the mostly directly affected “Away” industries such as Airlines, Hotels, Energy, etc. That said, we think the sell-side will continue to move too slowly to account for the collapse in earnings growth likely to be seen in the next 2-3 quarters. While systemic equity risks maybe priced in a 27% correction in three weeks, fundamentals still matter and stocks prices are still likely to tumble as estimates continue to be pared back.

Key Observations

Fig 2 Credit spreads have corrected getting closer to a 9/11 moment for high yield bonds. Energy sector in High Yield just hit 1750 OAS; this is compared to 1972 back in 2016 peak.

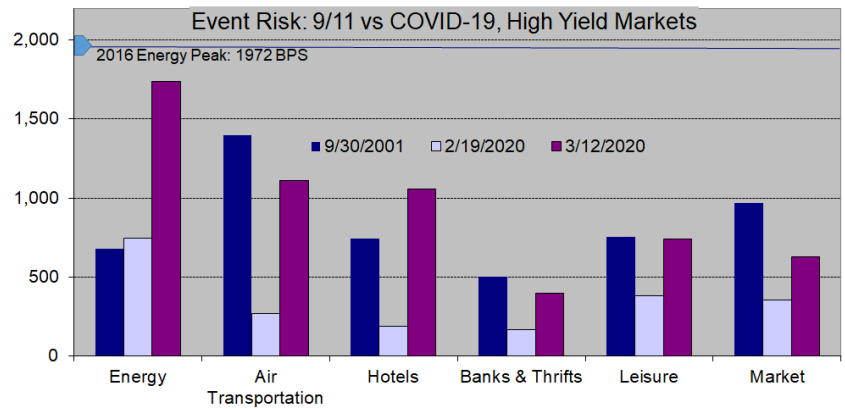


Fig 3 The Away basket relative to the Home has collapsed from a 58% discount to a 70% discount on an EV to sales basis.

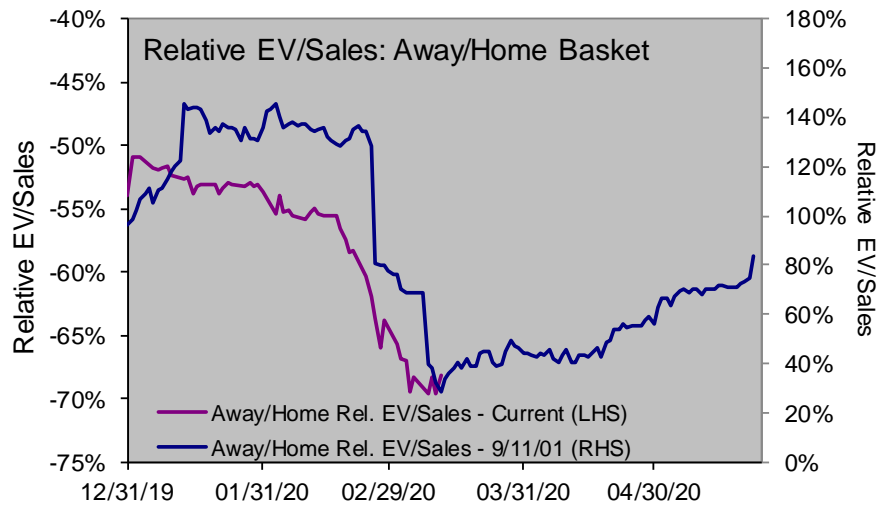
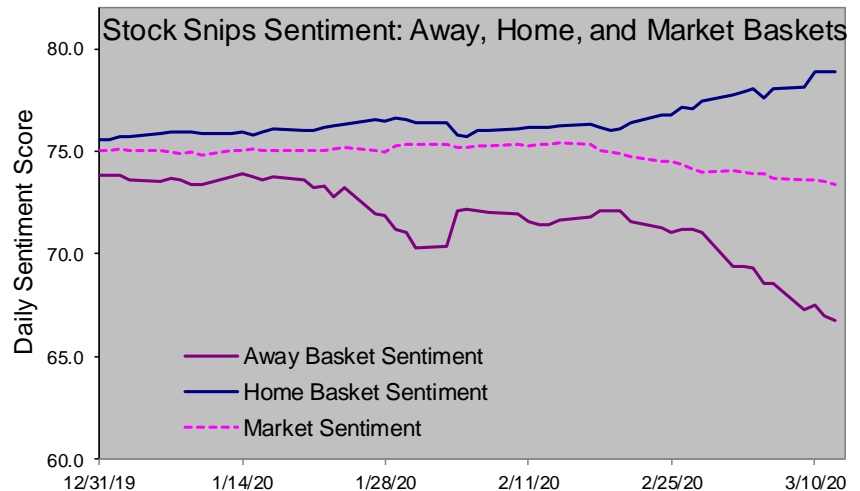


Fig 4 Bid Data/AI sentiment reading for the CR Home and Away baskets have diverged sharply. Ironically, the Away basket may have a more compelling floor on expectations as the sell-side is likely to be slow to adjust expectations for a pandemic across the overall economy.



Source: Cirrus Research

Fig 5 The correction seen over the past few weeks has pushed our measure market crowding or polarization to benign levels.

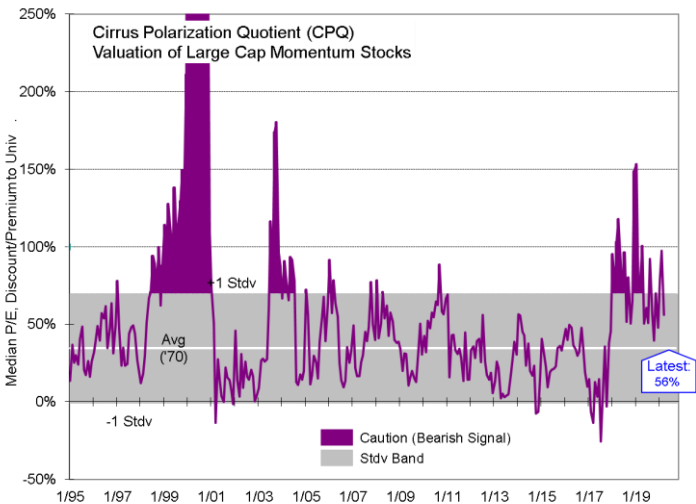


Fig 6 Equities have moved into Fair Value territory in our High Yield Relative Value Model after spending an extended period in Sell Equities territory.

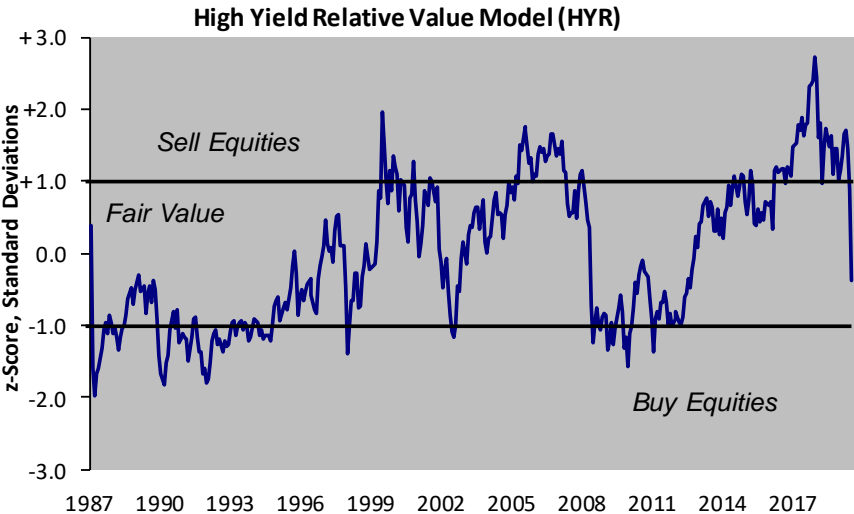
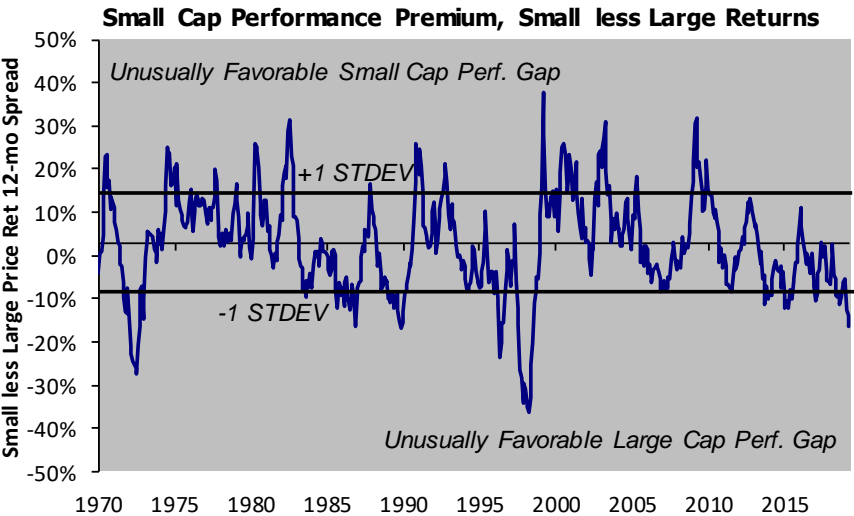


Fig 7 Small Caps extremes creates a floor. Our Small/Large Cap oscillator has finally retraced to an "oversold" condition favoring smaller firms.



Appendix

Cirrus Research Home Index (CRHI) and Cirrus Research Away Index (CRAI) methodology:

The Home and Away indices are each composed of 20 names that best represent each basket. Companies in the business of encouraging outdoor activities, including but are not limited to Airlines, Restaurants and Hotels, are considered for the Away basket. Within the basket, the 20 bottom performing names are then selected for the Away index, with performance measured since the market peak on February 19, 2020. The Home index follows a similar construction, with businesses encouraging indoor activities, such as companies in the Foods, Household Products and Broadcasting industries, under consideration for the basket. The top 20 performing names are then selected for the Home index.

The Away/Home stock betas were created by regressing the relative Away/Home index against individual stocks in the Cirrus universe using daily price returns from 12/9/2019 through 2/28/2020.

Stocksnips methodology:

In the spirit of searching out improved signals, we examine a new data series from StockSnips, a firm that delivers real-time news sentiment analytics taking advantage of Natural Language Processing, AI and advanced machine learning tool kits. The StockSnips data transforms unstructured textual data to quantified real-time sentiment signal using news articles from established sources and asserts the sentiment of each financially "oriented" sentence within an article. For more information see <https://stocksnips.net/>

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