Markets in (Semi)Panic 2: Even more (Semi)Panic

Back in February, I wrote Markets in (semi)Panic. At the time, markets were down ~5% on the year and ~10% from their all time highs they had reached just a few weeks before.

That post marked the absolute bottom of the (semi)Panic, and it's almost difficult today to remember that people thought things were bad back then. Markets would go on to increase by ~20% from that post through late August, again reaching all time highs, before starting a just absolute epic collapse from late August till today. As I write this, stocks are down ~20% from their all time highs reached in late August and ~10% for the full year.

I wanted to write something quickly for two reasons

1. My last markets in semi-panic near bottom ticked the markets. I'm not saying my post caused the markets to turnaround.... but I'm not not saying it either.

2. Writing remains a bit cathartic, and putting thoughts down on paper helps clear your head a little / relief the stress of seeing your portfolio evaporate by 2% every day.

Last time I wrote, I noted that it was funny to talk about a (semi)Panic when markets were down just ~11% from all time highs. It feels a bit the same today; yes, we're down 20%, but it's off absolute all time highs. Is that really a panic?

I don't know the absolute answer, but it certainly feels a bit panicky to me. Every where I look, I see things trading cheaper than I've seen them trade in years. Consider:

- You can find tons of banks trading below well below book value. And not "all of our deposit are high interest online CDs and all of our loans are speculative construction in Miami" banks, but real banks like GS and BAC.
- Closed end funds are trading at gaps wider than I've seen them trade in years. EVV, a pretty vanilla closed end fund focused on mortgage backed securities and senior loans, has averaged a 10% NAV discount for the past 5 years. It started the year at an 8.5% NAV discount; today that discount sits at >15% (the widest in the past five years).
- Senior loan funds are getting hammered; AINV, for example, is run by a real manager (Apollo), buys back shares, and most of their portfolio is first lien debt. I'm not saying this is the greatest loan book in the world, but the stock trades at 70% of NAV and yields >13%; for most of the year it trades within ~10% of book. That's a mammoth increase in implied default ratio the market has priced into what is essentially the same portfolio as six months ago. (Just to show I'm not cherry picking, Oaktree has two BDC (OCSI and OCSL) that are trading for 70-80% of NAV and are down 10-15% over the past three months)

- Small caps are getting hammered even when they report seemingly positive news and often for no reason. To pick an example close to my heart, MEIP (disclosure: long) traded >$4/share for most of the summer. As mentioned here, they recently announced relatively positive results for all of their drugs and a licensing deal for *just Japan* for *just one drug* that equated to ~5% of their market cap. The stock's been cut in half.

There are plenty of other examples of this type of dislocation. I'm by no means a macro guy (my eyes glaze over the moment someone says the word "Fed"), and I can't tell you what's going to happen from here. Maybe we're heading into a recession. Maybe not. But, just based on the prices I'm seeing right now, it seems like the market is pricing in a really deep recession as its base case.

I'm willing to take the other side of that bet. I said it in February and I'll say it again now. There are plenty of bargains for investors will to stomach a little bit of noise.