

Global Markets Forum

An exclusive, interactive, live forum managed by experienced Reuters journalists.

Stephen Aniston, Stephen Aniston, President & CIO at Black Peak Capital LLC



Stephen joined us to discuss VIX, stocks, economy and the tax reforms.

On Monday, October 23, Global Markets Forum welcomed Stephen Aniston, President & CIO at Black Peak Capital LLC, to chat about stocks, volatility index (VIX) and gave his rationale as to why the fear index is trading lower and what to expect in the coming months.

Stephen said "Next year we will definitely get a 10-15 percent correction."

HERE'S THE TRANSCRIPT OF THE CHAT

Manoj Rawal Thomson Reuters Alright folks.. time to welcome our guest for the day - Stephen Aniston, President & CIO, Black Peak Capital LLC

Jeffrey Hall Thomson Reuters Good Morning GMF

Manoj Rawal Thomson Reuters Hello Stephen, welcome back

Hello Jeoff, welcome you too :)

Stephen Aniston Black Peak Ventures Hi, Manoj and everybody else

Michael Connor Thomson Reuters Hello Jeoff and Stephen

Manoj Rawal Thomson Reuters Hi Stephen... nice to see you again here

Stephen Aniston Black Peak Ventures My pleasure to be here :)

Manoj Rawal Thomson Reuters That too when stocks are at all time highs and VIX seems to have no plans to rocket?

Stephen Aniston Black Peak Ventures Well, I don't know is everybody tired of winning yet?

Manoj Rawal Thomson Reuters Question is... Is everybody winning?:d

Stephen Aniston Black Peak Ventures Good questions. Passive ETFs certainly are. We have had 12 consecutive positive months for the SPY and the SPX total return index.

Unprecedented streak of winning and that includes the bull markets in the 50s, 60s, 80s, 90s and 2000s

VIX is averaging 11.2 which is by far the lowest ever. Before that mid 12s was the lowest annual average in 1995 and 2006.

Manoj Rawal Thomson Reuters and this one is perhaps the most hated bull market in the history...

Member 1 Hi Stephen... Please help me with this - Is VIX even an indicator? Or is it just a measure - of the number of puts being bought by market participants? Apologies if this seem dumb...

Manoj Rawal Thomson Reuters Hello Member 1

Member 1 Hey Manoj!

Stephen Aniston Black Peak Ventures The VIX is a measure but it is also an indicator. It also has been remarkably accurate.

This year we have had a low volatility bull market. Only 4 -1% days the entire year which is almost a record. This is something that happens only once every 20 or so years. Once in a generation

Member 1 Nice!

That's an incredible statistic!!

Stephen Aniston Black Peak Ventures So low VIX has predicted the fairly steady melt up of the SPX this year very accurately

Saqib Ahmed Thomson Reuters I feel like just because the VIX is in uncharted waters people think that it's stopped working. Truth is we ARE in uncharted waters when it comes to equity market volatility. What do you think Stephen?

Manoj Rawal Thomson Reuters Speaking of accuracy... how does one even know if the trend is reversing? I mean people usually say if VIX is at lows it's time to be cautious and start bailing out of your longs; but this time it just hasn't budged!

hello Saqib, welcome and thanks for your question

Stephen Aniston Black Peak Ventures We are definitely in uncharted waters. Before this year, in the previous 27 years the VIX had spent a total of 9 days in single digits. This year? 34 such days. Truly remarkable



Saqib Ahmed Thomson Reuters Hey Manoj

Member 1 So how is VIX to be interpreted?

Stephen Aniston Black Peak Ventures Technically speaking it is very difficult for the VIX to stay a long time in single digits because such low VIX precludes normal 10 to 20 point daily moves in the index. Remarkably, however this has been the case the entire year

Right now if you have -20 to -25 point day, the VIX should get to about 14 in a hurry. But every tiny dip gets bought very aggressively. The volumes in the market are very low. There is nobody willing to sell their stocks ahead of tax reform and while earnings are rising 20%. So every dip gets bought. I think algorithmic trading is the reason for the ever more aggressive buy the dip behaviour.

Manoj Rawal Thomson Reuters interesting...

Saqib Ahmed Thomson Reuters When I ask people why volatility is low, the answers I hear most often are 1. Central banks have got investors' backs 2. Earnings are good.

Manoj Rawal Thomson Reuters Should that mean we won't see so called healthy correction in stocks at least till tax reform is either passed OR disappoints?

Stephen Aniston Black Peak Ventures Yes, I agree. Fundamentally speaking 20% rise in earnings has been the biggest reason for such low volatility. Basically every purchase of the SPX is done at a 5% discount.

I disagree with the Central Bank assessment. Central Banks can't keep the VIX this low. But earnings can

Manoj Rawal Thomson Reuters Speaking of earnings, isn't it intriguing... growth and inflation is hard to come by, capex is negligible at best and still companies are coming out with excellent set of numbers?

Stephen Aniston Black Peak Ventures On the issue of tax reform, the market this year is up about 15% which is trailing the 20% earnings growth. So I don't think tax reform was priced in. I think last week when we got news about the Senate passing the budget resolution, the market is starting to price in tax reform. We are in the middle of it now.

Member 1 I agree with you on the pricing of tax reforms... it's much lesser than what one might think

Michael Connor Thomson Reuters Thomson Reuters analyst David Aurelio, who has been tracking the S&P 500 results all year, said nearly all companies were making earnings forecasts without taking and tax benefits. at least so far in 2017

Stephen Aniston Black Peak Ventures Yes, Manoj earnings are not going to continue to grow in 2018 the way they did in 2017. Statistically, on average there is no growth of earnings after a 20% year during a mid-cycle year (i.e. we are not coming from a recession or a bear market)

Manoj Rawal Thomson Reuters Hmm... that's interesting stat to beware of

Stephen Aniston Black Peak Ventures And right now we are seeing signs that companies will not be able to grow earnings next year so much (absent tax reform). Average Hourly Earnings (AHE) were up 2.9% - a big jump - and are now heavily outpacing the CPI (which is what companies charge).

So we are getting to a point where wage growth will start to compress profit margins. Companies will be able to grow sales but not profits (opposite of what has been happening for the past few years)

Michael Connor Thomson Reuters Stephen, do you worry much about the age of the current recovery in the United States. It is one of the longest ever.

Stephen Aniston Black Peak Ventures @Michael, that is correct. I think the market and corporation have been sceptical of tax reform passing after the health care debacle

Manoj Rawal Thomson Reuters Would that mean, by the end of this year or early next - you would start cashing out of your longs? If yes, how much of a correction you would label as healthy?

Stephen Aniston Black Peak Ventures But fear not, the VIX will rise again! In 2018

We think 2018 is what I call a "Volatility Normalization" year. A period when volatility rises but it is not super high like during a bear market.



Manoj Rawal Thomson Reuters 20-30s type VIX that is?

Stephen Aniston Black Peak Ventures Normally you need a 5% discount to earnings to get value buyers to come into the market. So once earnings growth stops, we will start getting 5% corrections every few months. Next year we will definitely get a 10-15% correction

Saqib Ahmed Thomson Reuters @Stephen I had an unrelated question. Investors are awaiting the nomination of the next Federal Reserve chair

Is there anything in the equity options space that I can look at to get a sense of how people are preparing for a change of guard at the Fed?

Manoj Rawal Thomson Reuters 10-15% looks good... should make lot of 'left out bulls turned bears' happy! :)

Stephen Aniston Black Peak Ventures Historically volatility rises after a 2 year decline and we are just about at the 2 year mark. In Feb of 2018 is when we mark 2 years since the last major VIX spike.

Manoj Rawal Thomson Reuters and by Feb Trump would also have completed his one year of Presidency... he would certainly be judged!

Stephen Aniston Black Peak Ventures @Manoj 13-18 VIX range with brief spikes to the 20-25 area (consistent VIX above 20 is lead up to a bear market)

Manoj Rawal Thomson Reuters hmm... interesting that!

Stephen Aniston Black Peak Ventures @Michael In my opinion, economic growth doesn't die of old age but of bad policy and economic conditions

Michael Connor Thomson Reuters are we in a good place in terms of policy and economic conditions?

Member 1 why should that not apply to bull runs?

Stephen Aniston Black Peak Ventures @Saqib I think low VIX is a pretty good indicator that investors are not worried about the transition. It appears that Jerome Powell will be either Chair or Vice Chair and that the transition will be smooth.

In terms of policy, I think Tax Reform if it is passed in its current form will kill the bull market.

Saqib Ahmed Thomson Reuters cool. Thanks

Stephen Aniston Black Peak Ventures Repeal of SALT deduction is a political and economic tinderbox. SALT repeal is a Bull Market killer.

If Trump Tax Reform passes in its current form, the US economy will be in a recession within 2 years. SALT repeal will lead to Blue State bankruptcies at the city, county and state levels.

It will put pressure on the housing markets in New York and Washington DC which are in the middle of a major rebuild.

I think we are about to make a major political and economic mistake.

Manoj Rawal Thomson Reuters whoa!

Its bold of you to say that... we'll watch this space closely

Stephen Aniston Black Peak Ventures @Manoj Yes, Trump will be judged and if Tax Reform as presently constructed is passed, he will have a lot of problems :)

Member 1 I don't think Congress will do away with SALT altogether

Michael Connor Thomson Reuters isn't it almost a form of economic warfare by the GOP on the blue states, if they did repeal SALT?

Stephen Aniston Black Peak Ventures @Member 1 The latest discussion is for keeping the property tax (300 billion tax break), but still remove SALT (1 billion tax break). Taking 1 billion out of Blue State economies will be a problem.

I mean to say 1 trillion



Member 1 Yes... they have to raise a lot of money... and something would have to give...

Stephen Aniston Black Peak Ventures @Michael that is exactly what it is and it will plunge some of these economies into a recession. The US economy is not going to just sidestep that - economic growth will suffer.

Michael Connor Thomson Reuters in the end, I expect it will just add to the deficit.

And will that scuttle all the talk of infrastructure rebuild?

Stephen Aniston Black Peak Ventures @Michael which is yet another problem. Higher deficit and I am not sure how much growth we will get out of it. If this was straight corporate tax cut in exchange paid by repatriation money, that is one thing. Removing SALT is big mistake.

Member 1 How would repealing SALT actually play out according to you?

Michael Connor Thomson Reuters it may be a trial blown, like the talk this week past of doing away with 401(k) deductions on taxes. Trump today ruled that out, 401(k) changes

trial balloon*

Member 1 I was of the opinion that it would lead people to other less expensive states... Is that right?

Stephen Aniston Black Peak Ventures @Member 1 Repealing SALT will put pressure on the housing markets in New York and Washington DC which are in the middle of a major rebuild.

Michael Connor Thomson Reuters and they are in the middle of a rebuild because that's where the better jobs are they have the schools, the infrastructure, the mass transit

Member 1 And the argument is that those who are invested in those projects would have to file for bankruptcies... But what % of the US economy is that?

Stephen Aniston Black Peak Ventures So we will have a mini housing crisis (housing prices in Blue States are very high) within 2 years. Illinois and Connecticut are on the verge of bankruptcy at the state level and some cities.

Member 1 Also, if wealth moves out to other states, won't it create raising prices there?

And offset some of those losses?

I am just trying to understand how this plays out

Michael Connor Thomson Reuters maybe over the long term but not in any time that matters to investors in current markets

Member 1 and how large a problem are we looking at

Stephen Aniston Black Peak Ventures Once state & local revenue dries up as people and business moving out to low tax states, you will have lots of layoffs - which are all middle class people. Those states will go into a recession and will need a bailout.

Michael Connor Thomson Reuters to my eye, Member 1, the change in the salt deductibility is a very very big shift in taxes for much of the country.

Member 1 Fair points...

But wouldn't it also lead to a boost in activity in other states is my question?

Thereby reducing the overall impact?

Michael Connor Thomson Reuters Government in the United States is relatively decentralized, with a lot of things such as schools, police, much transport decided and funded local levels. That is why you have such big differences between places like Mississippi and California, in terms of infrastructure

Changing the salt deductibility on the federal level you rattle all these flows that these things depend on. It is much more than just changing rates or enlarging general deductions

Manoj Rawal Thomson Reuters interesting insights Michael

Member 1 Of course... Any change that forces people to move geographically is likely to have a big impact



Michael Connor Thomson Reuters if you look at the Amazon story running at the moment, in which the company has different states and cities, dangling incentives for their new headquarters, you will see some of the internal dynamics America's tax system

Stephen Aniston Black Peak Ventures Well, Member 1 once California secession movement picks up speed over the SALT issue, I think you will discover that the impact is a little bigger than it seems today :) When New York and Illinois threatens to stop transfer payments, believe we will have a financial crisis on our hands.

Member 1 He he

Michael Connor Thomson Reuters one city in the south as suggested changing its name to Amazon, as an Amazon Mississippi or Amazon South Carolina, if the company will invest there

Member 1 I am certain that if the risks are so large, changes won't be...

Manoj Rawal Thomson Reuters crisis is a dreaded word Stephen... we don't use them in calmer times

Stephen Aniston Black Peak Ventures I am such a party buster :)

Saqib Ahmed Thomson Reuters @Stephen. The proponents of SALT... don't they see what this will lead to... or don't they care? What is the upside for them?

Member 1 There are a few Republican opponents of repealing SALT as well

Because that's the only reason we are even having this discussion...

Democrats are not even needed anymore for tax reforms... So that implies, that if all Republicans could agree on something, we would have it - eZ pZ lemon....

Stephen Aniston Black Peak Ventures @Saqib I am really befuddled that the GOP has ventured there. This is something that has been in the tax code since 1913 when the income tax was invented and is crucial balancer for the transfer payment setup.

Member 1 The only reason tax reforms still seem difficult is that Republicans disagree amongst themselves on a few issues - SALT repeal being one of them..

So I am a little more hopeful that a full repeal won't take place...

Stephen Aniston Black Peak Ventures If SALT removal passes on a party line vote like Obamacare did, the GOP will suffer electorally just like the Democrats did. But maybe they don't envision this.

I think the GOP see this as a way to break the Blue State wall. But I think it backfires in ways they don't currently conceive.

Member 1 isn't Trump from New York?

And Mnuchin and Cohn?

Stephen Aniston Black Peak Ventures In the immortal words of Luke Skywalker "This is not going to go the way you think!":)

Member 1 well said :)

Michael Connor Thomson Reuters and it also, Stephen, plays well with the ideologues inside the party that are more influential than any time I can remember.

No one is really in control of the GOP

it's a stew pot on full boil

Stephen Aniston Black Peak Ventures Back to the VIX, we think once Tax Reform passes or doesn't pass, VIX will be going up. I would be selling into this SPX rally here because I think we will get much better opportunities next year.

Michael Connor Thomson Reuters what size drop do you envision?

Member 1 this is where it will also get complicated with the Fed...

Right around the March meeting!

Stephen Aniston Black Peak Ventures 10-15% correction.

Manoj Rawal Thomson Reuters GMF - Any final questions for Stephen?

Saqib Ahmed Thomson Reuters Nope. am all set. Thanks Stephen

Manoj Rawal Thomson Reuters Stephen, any final thoughts for us before we let you go to your other important tasks?

Member 1 Thanks Stephen!

Stephen Aniston Black Peak Ventures @Member 1 Yes, the FED change will affect the markets but in the latter part of the year. The transition period is usually not a problem.

Thank you everybody. Great discussion! And thanks for having me, Manoj!

Manoj Rawal Thomson Reuters

Thanks much Stephen... great insights(y)

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