THE ‘BIG SHORT’ OF THE CORONAVIRUS CRASH

WHY YOU SHOULD CARE

He predicted the coronavirus crash ... and now has a "macro trade of the century" up his sleeve.

By Nick Fouriezos

Coronavirus Central: OZY looks at the virus sweeping the planet and its impact.

Kevin Smith knew the math just didn’t add up. “U.S. large-cap stocks are the most overvalued in history, higher than prior speculative mania market peaks in 1929 and 2000,” the Crescat Capital chief investment officer warned in a letter to investors in November 2017.

And so Smith and his Denver-based firm took a huge gamble … and began shorting the longest bull run in history. As unemployment set new lows, Smith held a 50 percent cash position as a bet that a recession was looming. As President Donald Trump touted a stock market that delivered 23 percent returns in 2019, Smith’s firm took out significant stakes in precious metals such as gold and silver. And through it all, the investor remained skeptical of China, even as a market-boosting trade deal seemed tantalizingly close — an outcome that would have been disastrous for Smith and his three-decade career.

“It was a little scary,” the 55-year-old admits, adding that while he felt others agreed with him, he had to keep investors calm as they lost money while their friends captured record gains.

This now all feels like ancient history, even though the market was still riding high little more than a month ago. It was before coronavirus sent the stock market into a spiral and much of the world braced for an extended period of social distancing. And while
Burry, along the lines of Michael Burry, the famed hedge fund manager who faced mountains of criticism before ultimately correctly predicting the subprime mortgage crisis. For his trouble, Burry made $100 million and was played by Christian Bale on screen in *The Big Short*.

“This is just *The Big Short* again,” says Tavi Costa, a partner and co-portfolio manager at Crescat Capital, which manages around $197 million in assets. “I admire working for [Smith] and learning from him how to hold on to his convictions … You have to be able to be incredibly emotionally stable to hold a trade like this. Because it’s not easy. It’s very difficult, and emotionally, it’s just brutal.”

**SMITH BELIEVES THE BIGGEST OPPORTUNITY FOR SHORTING THE MARKET IS YET TO COME.**

The payoff, though, can be lucrative. When the stock market momentarily faced losses in 2018, Smith’s firm had two of the top three hedge funds in the world. The lurching market of 2020 presents a grander opportunity. From the Feb. 19 market peak to March 23, Crescat Capital’s top two funds (its Global Market fund and its Long/Short fund) surged 40.5 and 34.3 percent … even while the overall S&P 500 dropped 31.8 percent. The market rally last week likely wiped out a good chunk of those gains, though Smith declined to release an update at week’s end.
attorney, he told the seeds for his interest in investments by handing him a stack of Warren Buffett annual shareholder letters and telling him to get reading (Buffett, not coincidentally, holed away billions in cash as of last September). Peter Lynch’s *One Up on Wall Street* was another formative influence.

Smith attended business school at the University of Chicago, famous for professors like Eugene Fama, whose efficient market philosophy — that it is impossible to ‘beat the market’ and asset prices reflect all available information — Smith “didn’t buy at all.” Rather, Smith cites other Chicago professors, such as Campbell Harvey and Robert Aliber, as being his key influences. In fact, Crescat Capital’s name comes from the business school’s motto, *Crescat scientia*, meaning “let knowledge grow.”

Of course, for Smith, it was about seeing that green stuff grow. And through the University of Chicago, his family grew too: It’s where Smith met his wife, Linda, a fellow MBA student. After graduation in 1992, they both joined the Los Angeles office of Kidder, Peabody & Co., a mortgage-backed securities firm … right before the “bond market apocalypse” of 1994 in Orange County, California. “That was my introduction to risk management, when my firm blew up,” he says. It partly led the duo to move to Denver, where they eventually started Crescat Capital together (Linda now is chief operating officer, and their son, Trevor, a University of Colorado Boulder student, has also worked as an intern there).

Although he doesn’t like comparing himself to Buffett, Smith values working in Denver not just because he enjoys the ample skiing, golf and tennis opportunities — but because it’s far away from finance hubs. “Buffett built his empire in Omaha,” says Smith. “Not having that groupthink you might find in New York City is important.”

Of course, even if Smith is right that the market remains overvalued, his ability to make money will depend on how the “herd mentality” reacts, says James Angel, a Georgetown University professor and financial markets expert. “Even when you’re 100 percent right and the herd is wrong, you may get trampled.” If markets continue trending upward following last week’s gains, Smith’s big short may end up being a big nothing. “The big risk you take is getting your timing wrong,” Angel says.
Still, Smith isn’t done making big bets. In fact, he believes the biggest opportunity for shorting the market is yet to come. “We believe there is much more downside still ahead,” he wrote in a recent investor letter titled “Blood in the Streets,” a reference to 18th-century banker Baron Rothschild’s advice that “the time to buy is when there’s blood in the streets, even if it’s your own.”

After all, while Smith is buying up more precious metals as their values sink, he is still waiting for China to collapse under what he believes has been a massive overvaluation of the yuan and a “Ponzi scheme”-esque real estate and banking credit bubble. “It’s one of the three legs of the macro trade of the century that has yet to play out,” he says.

The China position is especially dangerous, and not just for financial reasons. “They had my picture on the front page of the major newspaper in Hong Kong saying I’m shorting the yuan, so I’m a target. It would be like going to the Soviet Union in the ’80s and shorting the Soviet ruble,” he says. Ultimately, the rewards are well worth it, Smith believes — for himself and for the investors who place their trust in him in these uncertain times. “We think it’s a once-in-a-lifetime opportunity.”
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