Weekly Update

9-Feb-2022
Carlisle C. Wysong, CFA
Managing Partner

- Vol is still ruling the market
- Backward-looking earnings are ok, forward-looking guidance not so much
- Those weakening Employment numbers never happened!
- Used car prices have stopped increasing
- Household debt surged last year
- Used car prices have stopped increasing
- Household debt surged last year
- The bond market expects more Fed hikes, the BOE is hiking, and who knows about the ECB
- Oil is still supply constrained and demand driven
- Quick Hits
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,587	0.0%	-3.8%	18.7%
QQQ	$366.73	-0.5%	-7.8%	10.5%
US 10 YR	1.95%	1.78%	1.51%	1.13%
USD/DXY	95.6	96.0	96.0	95.6
VIX	20.0%	21.2%	17.2%	22.0%
Oil	$90.02	2.0%	19.2%	53.6%

*10yr, DXY, and VIX are levels not changes
** Oil is front month futures, beware

The market started the week with a whimper but ended with a bang. But we think the Volatility is more relevant than any short-term gains or bounces. That is, the Vol is emblematic of an uneasy market. And do not be fooled by an easing VIX. We still think economic data has started to roll over which means lower growth ahead (the strong January jobs report notwithstanding). We also think the Fed hiking interest rates into a weakening economy is a bad move (we wish the Fed had hiked rates last year so we would not be in this pickle). Basically, the Fed will be making policy decisions based on peak cycle economics which are behind us. Last week, we thought some softer comments from the Fed helped stocks. Today we had some hawkish comments that were largely ignored. The European Central Bank tried to walk back some of its recent hawkish commentary which boosted markets across the continent and spilled over to the US (we think a reversal in European markets should probably be a negative for US markets.) The Chinese communists were buying stocks aggressively in the market in addition to increasing monetary liquidity. But we think the Fed is committed to starting the hiking process at a minimum. Many close to the Fed (namely former Fed members) think the so-called "Fed Put," the point at which the Fed cries uncle and reverses course, is close to the 4,000 level. That is down over 12% from here. On the earnings front, companies continue to guide lower, but analysts are not following suit (setting the market up for earnings misses). We are not terribly concerned about the domestic political scene or geopolitical tensions. But the risks are larger to the downside than to the upside. We do not mean to sound overly bearish – we are still long the market. We think timing the market in a wholesale fashion is a fool's errand. But sitting on some cash and rotating some growth exposure to a more defensive posture is prudent. On the Volatility note, Thursday saw the largest market cap loss for a single company (FB) and the largest market cap gain (AMZN).

- Backward-looking earnings are ok, forward-looking guidance not so much

Earnings ticked higher last week. But this was driven exclusively by Amazon's monster beat (which itself was a bit engineered because of the mark-to-market of its stake in Rivian). Nonetheless, companies are reporting strong earnings for the most part with 71% beating expectations on the bottom line. But forward guidance from management fell again. The ratio of positive to negative guidance is back near the level seen in 1Q2020 (obviously a terrible period for corporate visibility). One caveat is that the number of companies issuing guidance in January is the lowest on record (for a January). But this does not give us much comfort…a lack of guidance is rarely a good thing. Moreover, qualitatively, management sentiment has been deteriorating with more talk of labor shortages and supply chain issues (Merrill grades these qualitative measures and puts them in a quantitative model). Oddly, analysts have not adjusted their earnings estimates despite this dip in guidance. This looks like a negative set up in the making.

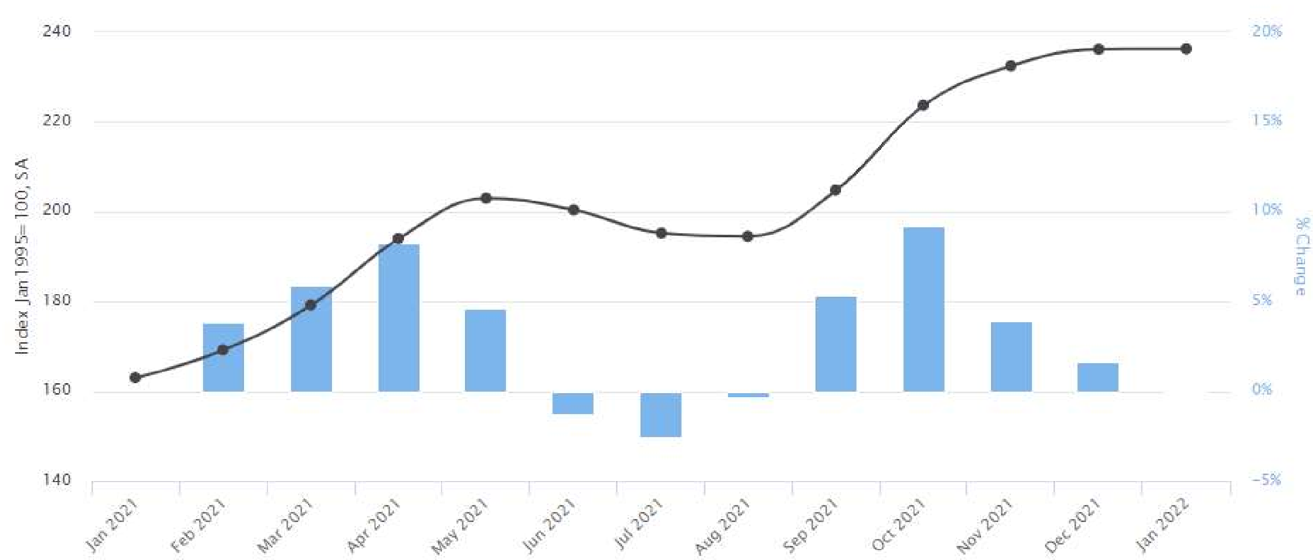
- Those weakening Employment numbers never happened!

The Employment Report showed a much larger surge in jobs than expected. January had an increase in 467k. This is especially true in light of ADP's prediction for a loss of 300k jobs. And December was revised higher by 311k jobs from 199k to 510k! And November was revised higher by almost 400k jobs! But June and July were revised much lower. Basically, the Bureau of Labor Statistics (BLS) changed some of their seasonal adjustments because of the virus-fear. Whatever the case, it means more jobs have been filled despite the virus-fear waves. To this end, the number of people sitting out work because they are sick or caring for someone that is sick is still an incredible number at over 8.5mm people. Countering this, temporary employment hit an all time high at 3.1mm people.

Private Payrolls were the root of the surge in January. The Unemployment Rate ticked higher from 3.9% to 4.0%. But this was driven by a resurgence in Family Guy getting off the couch: The Labor Participation rate had a relatively large jump from 61.9% to 62.2% (any increase these days is considered a relatively large jump!). Wage inflation persists with a 5.7% annual increase in Average Hourly Earnings. This is always a double-edged sword…if you are going to have goods/services inflation, your consumers better be able to afford the new prices. But higher wage costs are stickier than supply chain-induced product inflation. If the job trend continues (suddenly it is a good trend again thanks to the massive revisions), we will likely see a dampening of this wage trend.

- Used car prices have stopped increasing

Used car prices were flat in January vs December. The annual increase is still outrageous at about 45%. But this is the first sign of a potential slowing. March-April of 2021 was when prices started to soar, so that will likely be the first month that shows a true flattening of prices. Recall that used car price increases accounted for one 1/7 of all CPI inflation. On a related note, Ford and GM announced that they were going to start cracking down on dealerships that have been pricing new cars above the MSRP. Below is the Manheim index which measures wholesale used car prices. The chart is compelling. Then again, the chart was compelling (as far as looking like a slowing) back in June.



- Household debt surged last year

Total household debt rose by over $1trillion in 2021. This is a scary headline. But most of this new debt was for more expensive homes and cars. The other broad categories shrunk (student loans, home equity, and credit card). In fact, credit card debt is still $71b lower than where it was at the beginning of 2020. But the credit card banks have slowly started to hint at deteriorating credit quality. It appears that those who did not need to pay down their credit card debt did. And those that did need to pay it down did not.

- Other economic data
  - Productivity increased by 6.6% in the 4Q (on an annualized basis). This compares to slumping 3Q when it fell 5.0%. Unit Labor Costs only increased 0.3% vs the huge 9.3% increase in 3Q.
  - PMI Composite Final in January was better than expected after the Flash reading (midway through the month).
  - Factory Orders fell in December. Not very surprising, but at least November was revised higher.
  - ISM Services fell in January as expected.

- International economic data is weakening, too
  - Eurozone PPI climbed over 26% in December vs last year. Energy costs are crushing Europe.
  - EZ PMI for January held in at 52.3. This is still not a great level, but at least it is not dropping.
  - EZ Retail Sales in December slumped -3.0% vs November.
  - India PMI dropped from 56.4 to 52 in January. Services accounted for most of the drop.
  - China Composite PMI sits right at the breakeven level,

- The bond market expects more Fed hikes, the BOE is hiking, and who knows about the ECB

Loretta Mester of the Cleveland Fed (aka Carol Burnett) chimed in with some hawkish comments. She wants to do the trifecta of more rate hikes, faster rate hikes, and a quicker reduction in the Fed balance sheet. Above, we said the market was ignoring the hawkish comments and latching onto the dovish comments. But we should clarify: The bond market is now expecting six rate hikes this year (vs five last week and four a month ago). But the equity market seemingly is easing off on the hiking scenario. Typically, the bond market gets things right (or at least is less volatile in its prognostications…we thought the equity market was right two weeks ago!).

The Bank of England (central bank) hiked interest rates as expected. But many voted for a larger hike. This was the second-rate hike in a row. The BOE will also slowly reduce its bond holdings. And at the ECB, rates were kept unchanged, but ECB president Christine Lagarde intimated that there might be 50bps of rate hikes this year (this is new). But some in the ECB tried to walk back these comments. The Bank of France chief said, "I would not deduce from what has happened in recent days that there is an ECB calendar that corresponds to an underlying calendar of markets." And we thought Fed-speak was convoluted.

- Oil is still supply constrained and demand driven

Saudi Arabia increased prices again this past weekend. Prices to Asia increased about \$0.65 per barrel. The premium of Saudi oil to benchmark Asian prices is about \$5.15. The Saudis are talking advantage of the Chinese not being able to produce as much oil on their own given the ongoing virus-fear lockdowns. Moreover, the Saudis know that there is not any space capacity, so they are able to increase prices without fear of others jacking up production.

And good old Venezuela is floundering again. Its oil exports fell by about 33% in January vs December. One of the problems (the country being run by a socialist dictator is at the top of the list) is that buyers of the sludgy oil are returning the product because of the high sulfur content. No word if Joseph Kennedy is returning his bribery barrels to Citgo or not.

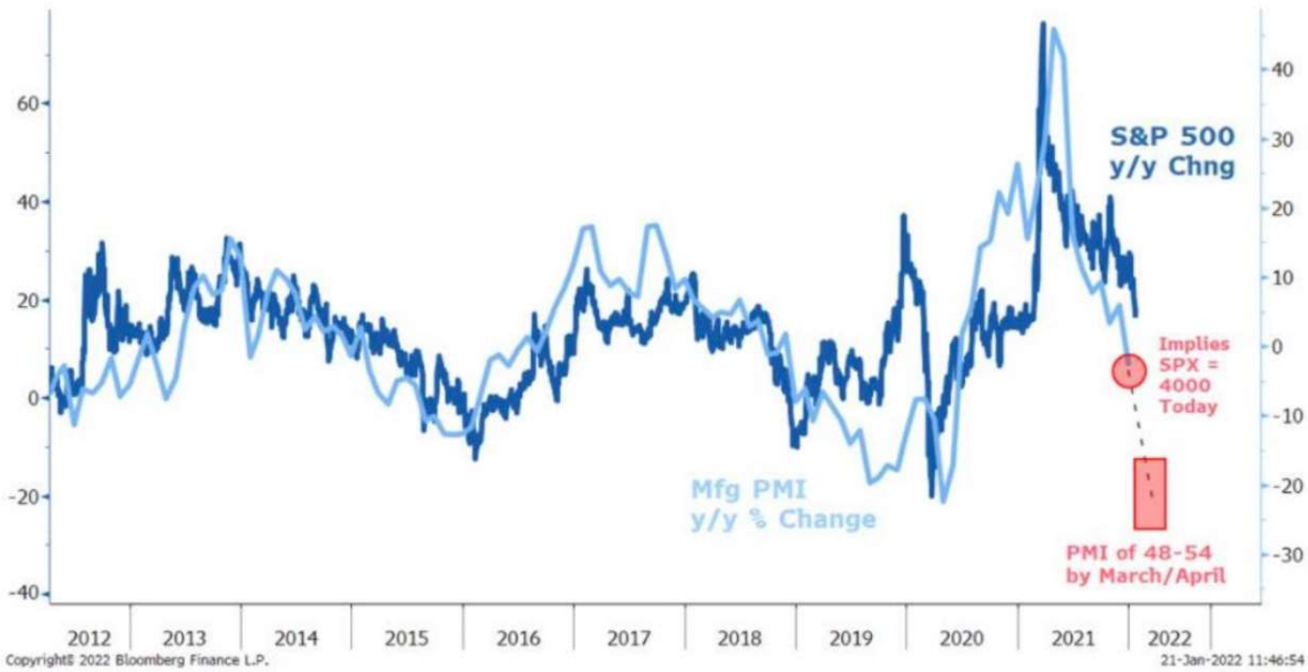
The one bit of bad news for oil (which barely saw it tick below \$90) was increased speculation of a nuclear deal with Iran. Other than this being an idiotic idea, the market is already discounting Iran returning to its full production capacity of 3.2mm barrels per day by the end of this year.

We are still bullish oil. There is a perfect storm of tight supply by OPEC+ and US Shale along with steadily improving demand as the world reopens. But the giant caveat here is if global growth has peaked and is starting to roll-over. Given the supply situation, oil will likely weather a slow hit to demand. But a larger shock could reset the deck.

- Chart Crime of the week

Morgan Stanley is trying to show the correlation between the Manufacturing PMI survey and the overall market. But an annual percentage change in the PMI is nonsensical. The PMI is a diffusion index which effectively resets every month. There is no connection between a reading now vs a year ago. (Apologies, this one is a little boring.)

Exhibit 1: It's fire AND ice, with slowing growth now the bigger issue rather than higher rates



Source: Bloomberg, Morgan Stanley Research

- Quick Hits
    - The Wall Street Journal reports that lithium-ion battery prices have fallen 90% which should make EV's more desirable. Fox Butterfield, is that you? (Perhaps the lack of demand is leading to a fall in prices.
    - John Deere plows were revolutionary because they were self-cleaning.
    - Ed Snowden thinks the arrested criminals behind the $4.5b (that is with a B) theft of cryptocurrency have been set up.
    - China's purchases of US exports declined instead of increasing the promised $200b.
    - Byron Allen, he of the bad TV from the 80's, is preparing a bid to buy the Denver Broncos.

Trading: We continued to slowly sell the bounce. We trimmed our speculative trading names (small-caps do very poorly during a slowing growth environment) and rotated into Staples and Health Care. We added some puts on the small-cap index (IWM).

TSLAQ: Two more recalls for Tesla cars. The SEC is opening an investigation into whether the company violated its settlement agreement from 2018. Nothing to see here.

Check out our website to learn more about Chalk Creek Partners

Carlisle's Twitter Financial List

[Carlisle's LinkedIn]

The information presented does not involve the rendering of personalized investment, financial, legal or tax advice, and it is intended to be general market commentary. Information presented is believed to be factual and up-to-date, but we do not guarantee its accuracy and it should not be regarded as a complete analysis of the subjects discussed. All expressions of opinion reflect the judgment of the authors as of the date of preparation and are subject to change. Certain information has been provided by third-party sources and, although believed to be reliable, it has not been independently verified and its accuracy or completeness cannot be guaranteed. Past performance is not indicative of future results.