Weekly Update

8-December-2021
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- Thanksgiving panic gives way to the Christmas spirit
- Monetary policy trumps all even in China
- What about those crazy valuations
- Always buy the Volatility rip (at least slowly)
- Employment might just be coming back after all
- The PMIs are back leading (business surveys)
- Is inflation cooling?
- European Inflation (or worse) is coming
- PMIs in Europe are masked by misleading Delivery Times
- Oil Volatility, do the opposite of global politicians
- Chart Crime(s) of the week

	Last	5d %	YTD %	1yr %
S&P 500	4513	4.2%	26.4%	29.1%
QQQ	399.6	3.2%	27.8%	30.8%
US 10 YR	1.52%	1.41%	0.92%	0.94%
USD/DXY	95.9	96.0	89.9	91.1
VIX	19.9%	31.1%	22.8%	22.3%
Oil	72.69	10.6%	49.1%	58.7%

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

The perfect storm of panic has seemingly faded into the Christmas spirit. We noted that Thanksgiving Friday's omicron panic and subsequent hawkish tone from the Fed was an overreaction, and it presented a buying opportunity. We followed through on this adding to our long exposure mostly in the form of companies levered to economic growth. While the debate about vaccines rages on in the twitterverse, we think the overriding theme is that people want to get on with their lives. And the economic data supports this (more employment, better business outlooks, more below). Moreover, it appears inflation is cooling (in rate of change terms, so it is not accelerating). We think this will give Fed chairman Powell the necessary backstop to not hike interest rates too aggressively. While the probability of Fed hikes has remained elevated (80% chance of a hike in June vs 75% last week), the yield curve tells us a slightly different story. We have commented that the flattening of the curve (higher short-end rates and flat to lower long-end rates) could be a sign that the market thinks a recession is

coming. But the more we read about this, we think a slowly flattening yield curve might indicate that the market thinks the Fed will remain measured in its rate hikes. The economy will keep growing, the Fed will start to normalize interest rates, and inflation will be ok. That, indeed, would be Goldilocks as they say on Wall Street. To sum it up, a great lesson to learn in the financial markets is to never trust price action on holiday-shortened trading sessions. Or the media.

- Monetary policy trumps all even in China

China has been back in the headlines (does it ever leave these days?). Evergrande and its smaller property sector brethren (Kaisa, and Aoyuan are the latest, and there is a total of $17b of offshore bonds maturing before April 2022) continue to walk the bond-default tightrope. As we have guessed all along, we think the only pain to be felt will be by those foreigners that trusted the communists (the companies will default on their USD external debt but not local debt and certainly not retail wealth management products). There is also more impending scrutiny by the Chinese on tech companies listing their shares abroad. This is more of a canard given that nobody ever actually had ownership of Chinese tech shares that were listed in the US. They have always been derivative structures meant to shadow the performance of the underlying company. Good luck explaining that in a Chinese court of law (insert the Animal House Otter joke here, "you messed up, you trusted us"). This does not have any direct impact on US stocks or the economy, but it can certainly cause more losses on US investors in Chinese names. But none of this matters as the central bank (People's Bank of China, PBOC) eased monetary policy. The communists injected $200b of liquidity by lowering the reserve requirement ratio.

- What about those crazy valuations?

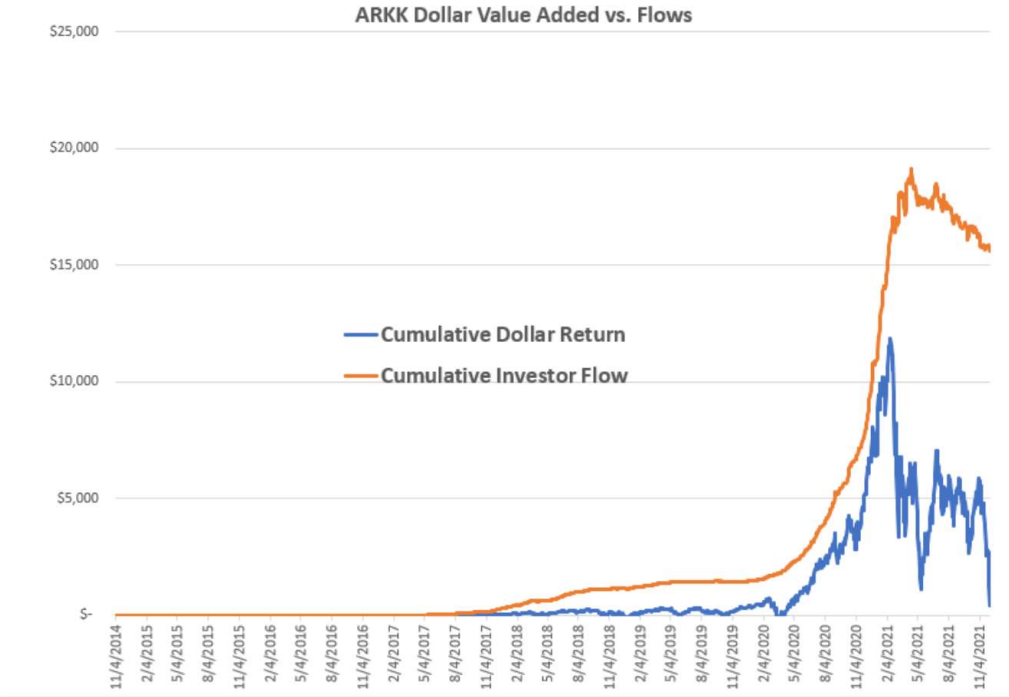
This is a pretty cool analysis (if not overly simplified). The Required Growth Rate in the middle column is the annual rate of growth these companies would have to achieve in order to "grow into" their current (very high) valuations. Amazon would only have to grow by 17% instead of its historical growth rate of 64% to be fairly valued. Microsoft looks similar (lower Required Growth Rate compared to Historic). Nvidia is about a wash. Tesla and Salesforce…not so much. (And this analysis obviously ignores the fact that Tesla has never made money selling cars…only EV credits which will be sunsetting). This analysis fits nicely with our view of the market in a changing interest rate environment. Strong, quality companies can sustain above average valuations. Others cannot (and we are not even talking about the lunacy of the profitless companies…except for Tesla of course).

Figure 4: Valuations and Growth

	P/E	Required Growth Rate	Historic Growth Rate
Amazon.com	56.8	17%	64%
Microsoft	37.1	8%	27%
Tesla	371.5	70%	45%
NVIDIA	76.7	24%	17%
salesforce.com	120.7	36%	20%

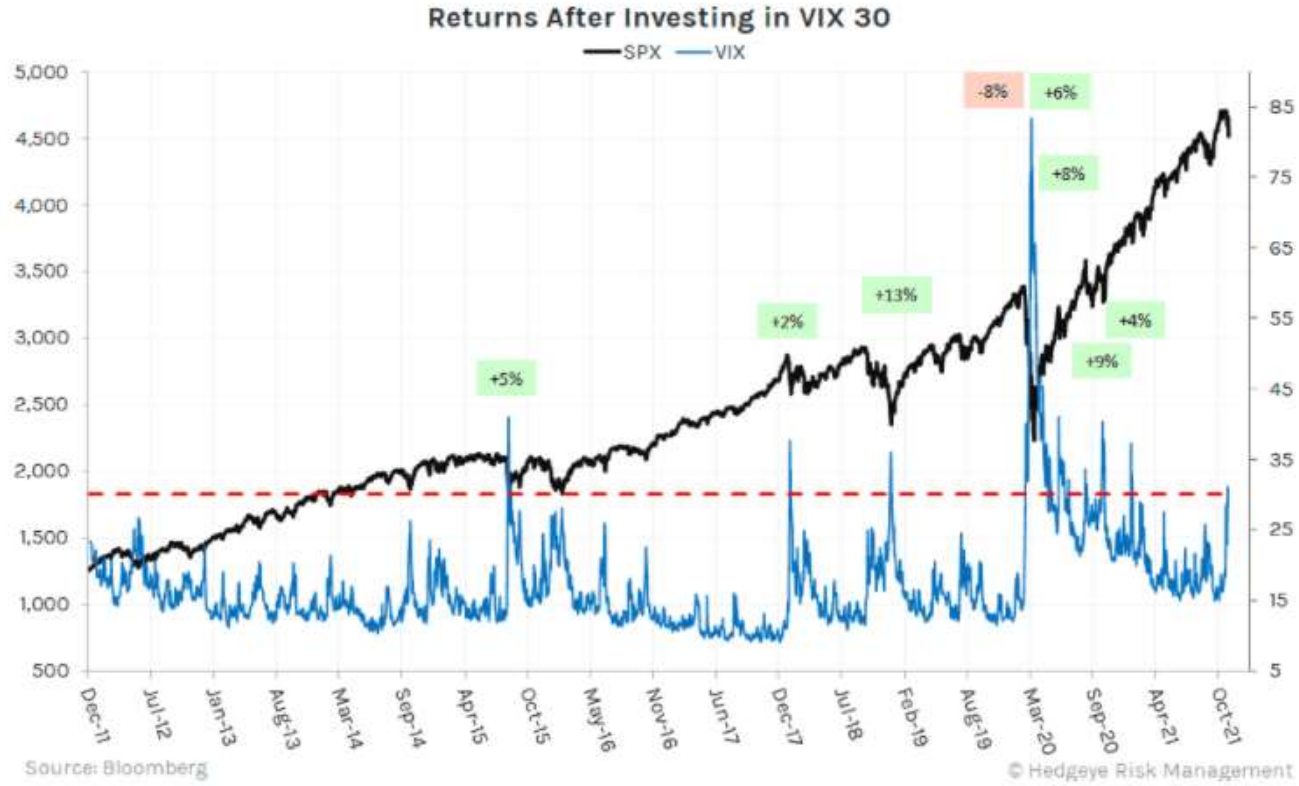
Source: Capital IQ, Verdad analysis

Speaking of profitless companies, here is a chart we sniped from Keubiko (one of our favorite follows on Twitter). It shows the cumulative $ inflows to the ARKK fund vs the cumulative $ value created/destroyed (ARRK is the posterchild for profitless companies). The point is that most people/money piled in at the top only to see instant value incineration..



- Always buy the Volatility rip (at least slowly)

Volatility always scares people. It turns out, it should not. We always want to play against the crowd. This is easier said then done. But the data below should give us comfort. Over the last 10 years, the Volatility index (VIX) has been above 30 just nine times. The market has bounced back eight of these nine instances within 30 days! In fact, the average return after 30 days is 6%. The skeptic in us says any old quantitative measure looks good over the last 10 years with the market on an epic run. But if nothing else, this data tells us not to sell the panic but rather to buy it. Of course, the onset of the pandemic would have been soul crushing if you bought the first part of the dip in earnest. This is why we never go whole hog on these kinds of signals regardless of the statistical history.

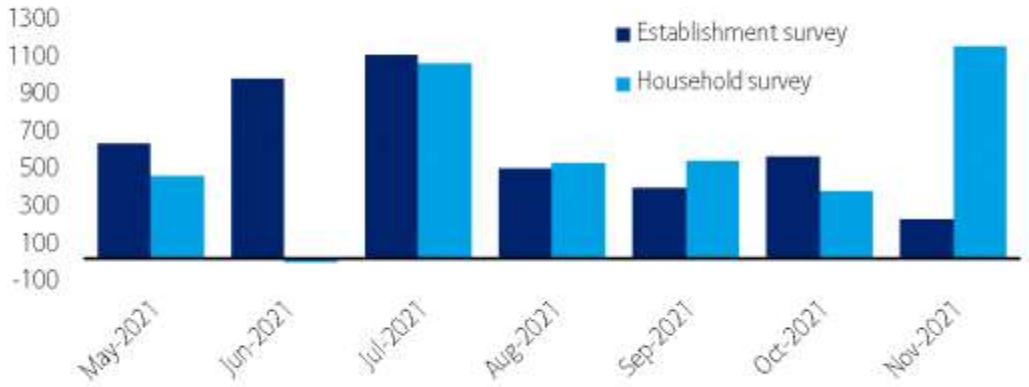


- Employment might just be coming back after all

The Employment Report was oddly mixed. The Payrolls data showed only 210k new jobs were created in November vs 546k in October (which was revised higher by 15k). The expectation was for around 550k. The miss came entirely from Private Payrolls. The Household survey (which calculates the Unemployment Rate) showed that the number of unemployed people declined by over 500k people, and the number of employed people increased by over 500k. This is the exact combination we need to see…Family Guy is getting off the couch, and Johnny Paycheck is not shoving his job any longer. The Participation Rate ticked higher to 61.8%. This is only 0.2%, but it has been so bad, any upticks are welcome. The headline Unemployment Rate dropped to 4.2% from 4.6%. Average Hourly Earnings grew 4.8% vs a year ago. This number is starting to level off (October was revised down from 4.9% to 4.8%). AS for the Employment Rate vs Payrolls debate, we will note that in this post virus-fear world, more people are self-employed and fewer are working two jobs. This lends more credibility to the Unemployment Rate vs the Payrolls.

Exhibit 1: Monthly employment growth: establishment survey vs. household survey (thous, SA)

Despite worse-than-expected growth in nonfarm payrolls, the household survey showed a 1.1mn gain



Source: BLS

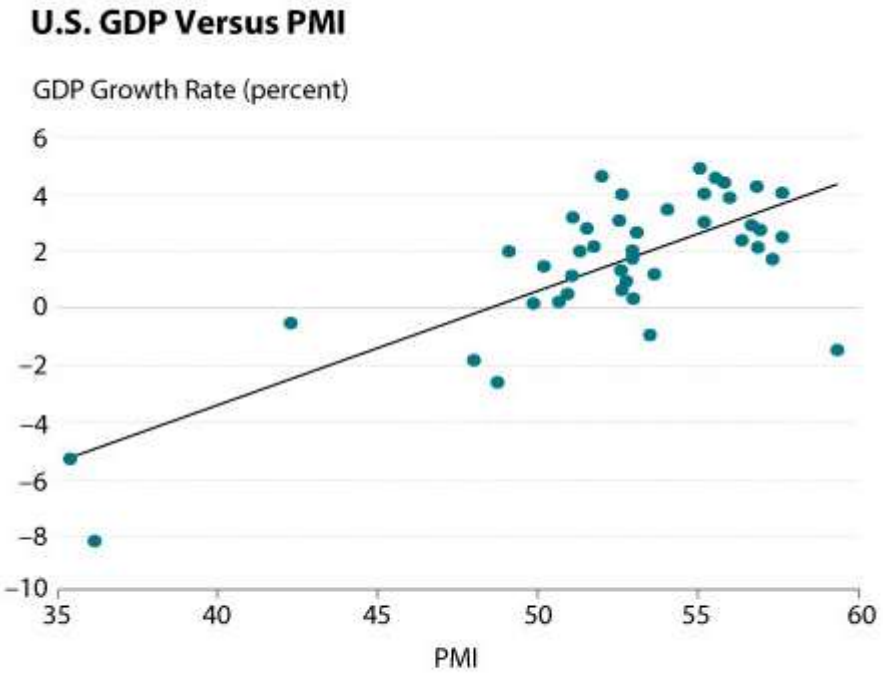
BofA GLOBAL RESEARCH

ZipRecruiter tells us that there are 11mm job openings in the US and only 6.9mm people that are out of work and looking for a job. That is the lowest ratio in the twenty-year history of the data. Other than from 2018 to 2019, there have always been more Unemployed than Jobs. (As an aside, the chief economist for Zip quizzically says this current condition is "contributing to unprecedented tightness in the labor market. We hope the Wall Street Journal has misquoted her, because having more Jobs than Unemployed should help ease the tightness in the labor market.)

Quits are also still on the rise. Accommodation and Food Services remains the sector that most are fleeing. But the JOLTS report shows a margin cooling in Quits.

- The PMIs are back leading (business surveys)

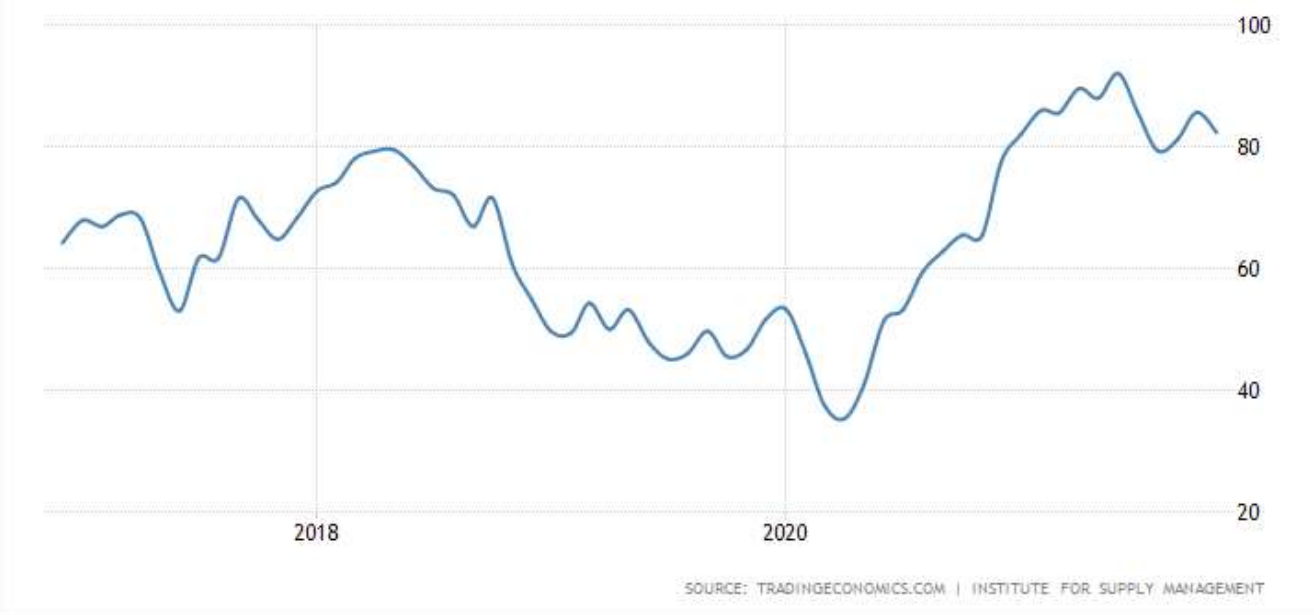
We often note that the different Purchasing Managers Indices (PMIs or business surveys) are leading indicators. Here is a good chart that shows the correlation between PMI levels and GDP growth. Like all statistics, there are outliers (the damn lies in statistics), but the upward sloping line is pretty clear.

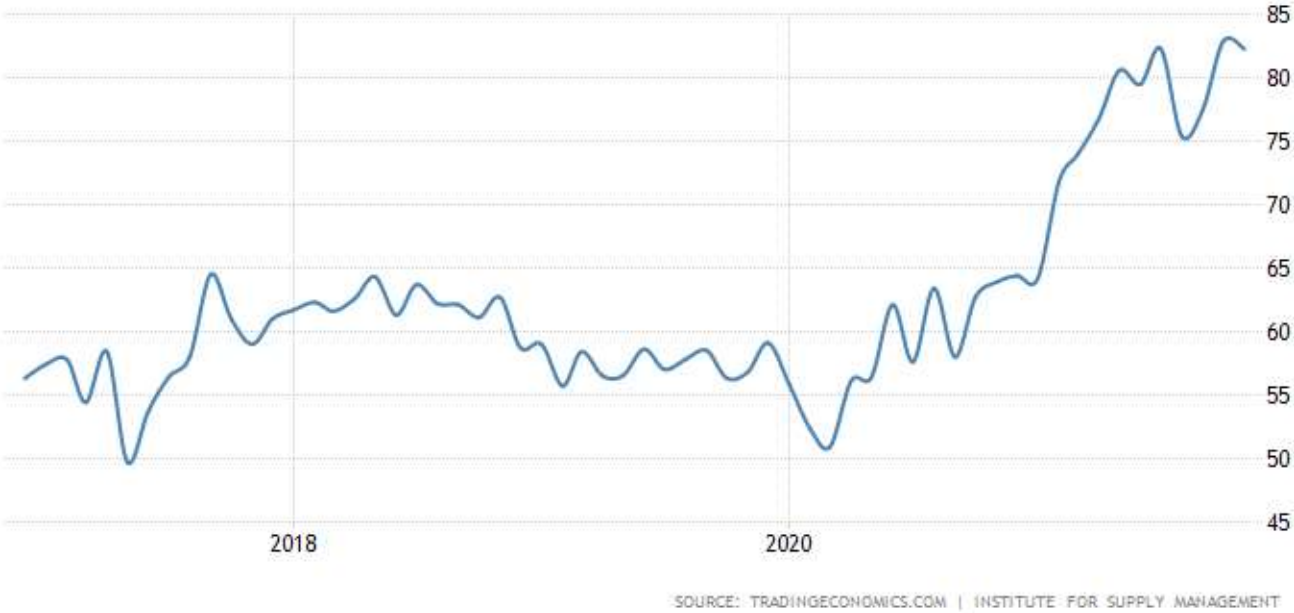


NOTE: The blue dots indicate quarterly values.
SOURCE: PMI: ISM and Haver Analytics. GDP: Bureau of Economic Analysis and Haver Analytics.

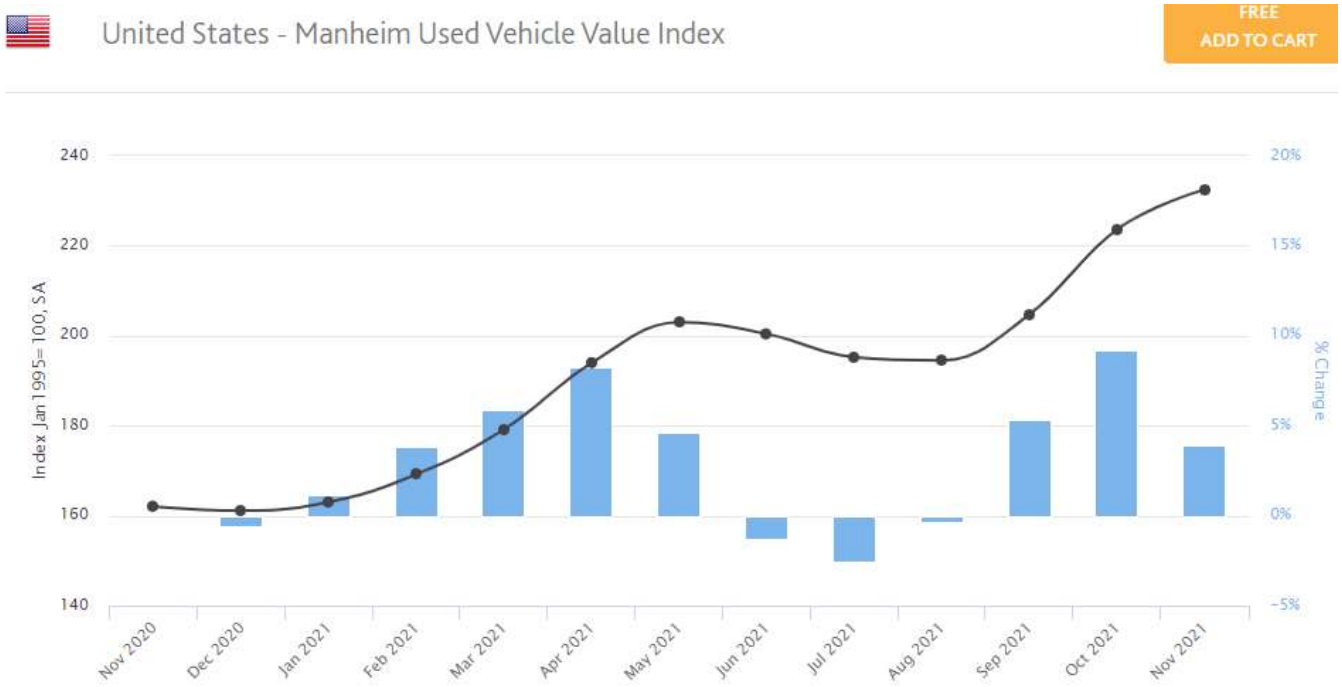
- Is inflation cooling?

Our view that inflation is cooling is certainly a work in progress. One mantra we have picked up lately is that tops are a process not a single point. This applies to the market, economic data, sports teams, whatever. The first chart is the Prices Paid component of the Manufacturing PMI (ISM's measure which is more global). The second chart is what the ISM calls Non-Manufacturing which is just Services (excuse the lack of labeling, shame on us). Are the prices rolling over? Perhaps. We well have to see. But the steep ascent seems to have slowed if nothing else.





It looks like used car prices are starting to slow. Or rather, again, the rate of change is starting to slow. Some inflation bears do not buy the slowing argument. We are reserving judgement here:



More anecdotal data pointing to the loosening of the log jams in logistics: The wait times at the LA ports are coming down. The "dwell time" for rail, the time containers sit waiting to be loaded, has dropped from 13 days to 2 days (over the last 30 days). Truck dwell time has dropped to 6 days from 10 days. The bear thesis is that container ships are merely waiting further out "beyond the horizon." We guess this could be true. But the director of the LA port system says the number of ships coming to dock is smoothing out (so he is not buying the horizon theory…he is obviously biased).

Maybe the most important inflation data point is that semiconductor inventories are starting to rise according to Nikkei news. Not all chip makers are seeing increases. But about five out of six companies are seeing backlogs start to thin. To be clear, the overall inventory improvement is tiny (+0.7% on the year through September\ with trends supposedly continuing.) But given the wide array of items that chips touch, this would-be easing could have a ripple effect.

- European Inflation (or worse) is coming

We need to add that our view on inflation does not hold for Europe. Producer Prices are running 17% hotter than Consumer Prices. They are all socialists at heart, so perhaps these input prices will not flow through to the masses. But that will just cause other problems (Argentina and Venezuela are your models for price controls).

Source: Pictet Asset Management, CEIC, Refinitiv

- Other data
  - Factory Orders in October increased at a 1% monthly clip. And September was revised higher to 0.5% from 0.2%.
  - The Trade Deficit shrank in October compared to September. It is still a huge number at $67.1b. But an increase in Energy and Agriculture helped boost exports to an all-time high. Some of this

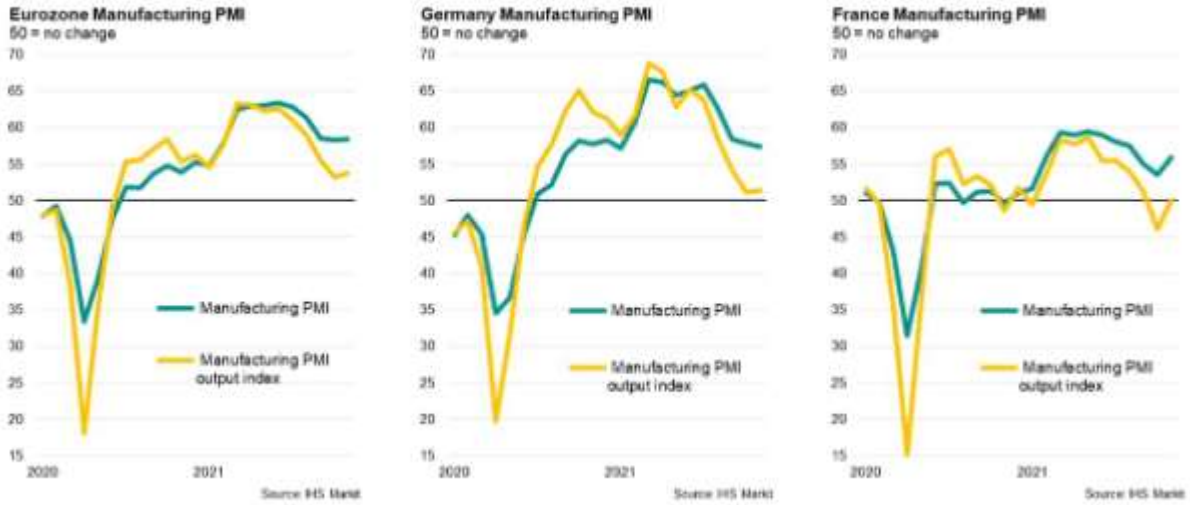
can be contributed to the restart of refineries after hurricane Ida. And the Chinese actually stepped up their soybean purchases as October was the last month under the "phase one trade deal." Unsurprisingly, China is going to fall short in every category.

- Productivity declined in the 3Q. This is largely a function of the Unit Labor Cost which was accelerating. But this data is stale. Nothing to see here (for real).

➢ PMIs in Europe are masked by misleading Delivery Times

The Global Composite PMI ticked a little higher to 54.8. This is a nice bounce back from a worsening trend. We are not back to the spring 2021 highs, but we are handily above the pre-virus-fear levels. But these indices can be misleading especially on an aggregate basis. Below are charts of the Euro Manufacturing PMI compared to the Output Index inside of the PMI. As you can see, Output has been lagging and worsening. The anomaly is rooted in the composition of the headline. Delivery Times are extremely stretched in Europe (recall some American politicians are saying America should be more like Europe when it comes to supply chain patience, we say no thanks). This mathematically makes the headline PMI *stronger*. Needless to say/write, this is not the kind of data strength we like. Recall that Delivery Times in the US are shrinking (still bad). This is just another reason we favor the US over Europe.

Chart 2: Diverging manufacturing PMI and output indices

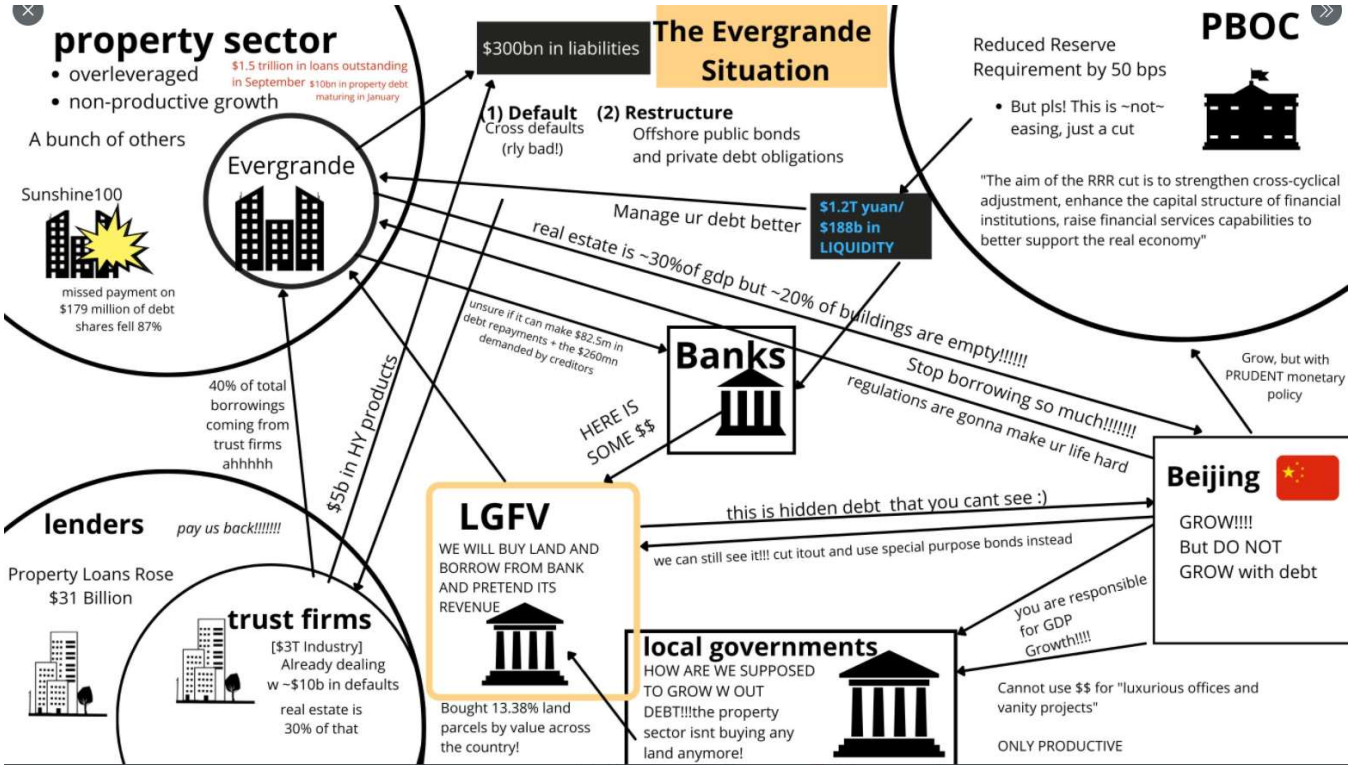


➢ Oil Volatility, do the opposite of global politicians

Oil prices continue to be volatile. OPEC+ decided *against* slowing their production increases. While we thought this was very surprising, the oil market did not move on the headline. We guess traders are hanging their hats on OPEC+'s intended "flexibility' in assessing the market. Importantly, there is speculation that OPEC+ is running well below its production targets (23mm of production vs 23.8mm of combined quotas), and its spare capacity is thinner than thought. What is probably the most telling of market forces, Saudi has raised prices to the US and Asia. The premium for Saudi oil in Asia is now $3 compared to a virus-fear low of -$7 (discount). And it is no coincidence that Saudi did not hike prices to Europe which is exhibiting the lowest/slowest economic growth right now (shown above and expected to continue).

- Chart Crime(s) of the week

This China Evergrande "flow chart" might as well be in Mandarin.



And on the flip side, here is the complexity of a start-up EV car company succinctly summarized:

Exhibit 1: Rivian Strategic Vectors

Source: Morgan Stanley Research

- Quick Hits
  - A Pennsylvania middle school's "drone camp" was only open to black students.
  - The two most common accidental deaths in London in the 19th century were burning and "falls from a height."
  - Here is how an investigation of a crypto scammer unfolded (Matt Levine of Bloomberg revealed this). In an open chatroom, the anonymous investigator asks, "Hello." The representative from "We Save the Moon" crypto-coin answers, "Let's PUMP and get this party started." Case closed.
  - George Clooney turned down $35mm for one day's work (an unnamed airline commercial).
  - Apparently, someone sold $500mm of cryptocurrency over this past weekend.
  - Lost hours per commuter per year: 2019: 99 hours; 2020: 26 hours; 2021: 36 hours.
  - Airline passenger traffic in Mexico is 5% above 2019 levels.
  - A pitch for a casino license in New York includes a cryptocurrency trading floor. Right where it belongs.
  - US coal prices hit a 12 year high this week.

- San Francisco has suspended its cannabis tax to help dispensaries compete with drug dealers. Fox Butterfield would be proud of this bastardized view of cause and effect.

Trading: It has been a busy week of trading. We trimmed some of our inflation bets. We added to our Big Tech longs. We added to our small-caps that are poised to benefit from a continued economic recovery. We cut some more of our (very tiny) long exposure to High Growth. We suspect we will add to these names in the future…but not the near future. We sold some Puts during the panic. We will look to add these back if this rally continues.

TSLAQ: We suspect 13 pages for a weekly newsletter is WAY too long already. And we have taken a few jabs at Tesla inside of the valuation section. So, as the ghost of Charlie Daniels says on twitter, "Guess we'll hang it up for the night."

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