Weekly Update

27-July-2022

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- Market bounce continues as the Fed keeps hiking
- Corporate Sentiment should lead Earnings lower
- Economic Data is worsening and missing expectations
- Are Jobless Claims the first crack in the Labor market?
- The Fed is going to slow its hikes, but will it reverse course?
- The European Central Bank joins the chorus
- Quick Hits
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,024	1.6%	-14.9%	-7.7%
QQQ	$306.81	1.2%	-22.6%	-16.3%
US 10 YR	2.79%	3.03%	1.51%	1.23%
USD/DXY	106.4	107.1	96.0	92.3
VIX	23.2%	23.9%	17.2%	18.3%
Oil	$98.12	-4.1%	29.3%	35.7%

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

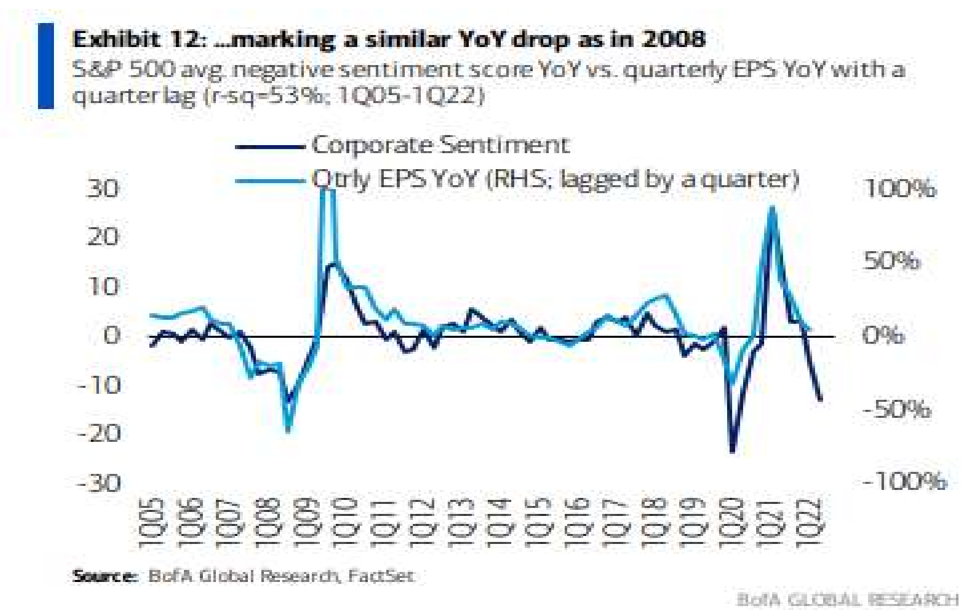
The market continues to make lemonade out of lemons. Be it earnings, economic data, overseas turmoil, or Fed-speak, the market is able to turn bad news into good. Normally this would be a powerful sign from the market. But we are still doubters given our oft-repeated refrain: The Fed is hiking into a weakening economy. We have stated that we do not care about the technical definition of a recession (we believe we referenced Potter Stewart knowing it when he sees it). But the continued onslaught of bad Housing data, bad Consumer Confidence, growing (and sitting) Inventories, etc sure does tell us what we need to know (the Durable Goods subcomponent Core Capital Goods aka Business Spending continues to be the bright spot). Earnings are bad and deteriorating with worsening corporate sentiment. Biden and Xi have a conversation tonight which should be interesting with Pelosi set to go to Taiwan next month. Speaking of Xi, the communists want to alleviate the depressed Housing market by forcing local governments to build more houses (this is almost as upside down as Turkish president Erdogan's view that higher interest rates cause inflation). And the Fed…somehow the market cheered on chairman Powell's resolute commitment to worsening the economy to stamp out inflation. And the European Central Bank even hiked rates back to 0%! (Cue the sarcasm, but it still is bold in ECB terms.) We wonder how the Germans feel about that with their first trade deficit registered since 1991. And closer to home, America is about to start another infamous "trade war." This time Mexico is in the crosshairs for favoring its own utility and oil companies. AMLO (as the president is known) will finally get to show his true socialist chops.

But have no fear, the government is riding to the rescue. Just tonight, Senator Manchin has agreed to the spending package that will raise corporate taxes, increase government regulation, and increase spending on climate nonsense (not a political statement, crony capitalism is bad whoever champions it). That is the government trifecta writ large. There is still a vote in the House, and perhaps the self-anointed "Squad" will sabotage their own party's agenda. Assuming it passes, we expect a "stimulus relief" type of rally in the market. That is, until the market realizes the government trifecta is usually bad for growth (lower) and prices (higher).

- Corporate Sentiment should lead Earnings lower

The aggregate statistics on Earnings show a 1.6% drop in Earnings Per Share (EPS) and an 8.4% increase in Revenues. But the market still expects the bottom line (EPS) to grow 6.4% for the quarter. And Revenues are supposed to be +11.6%. In other words, the back half of Earnings season is supposed to be a banner crop. And oh yeah, Earnings growth in Energy has been about 250%. People are talking about this skewing effect some but not enough in our view.

Merrill has a Corporate Sentiment gage which they compare against actual EPS changes. There are clearly periods of dislocation when one or the other gets overextended. But we think the lagging EPS change will catch up with the leading (and plunging) Corporate Sentiment.



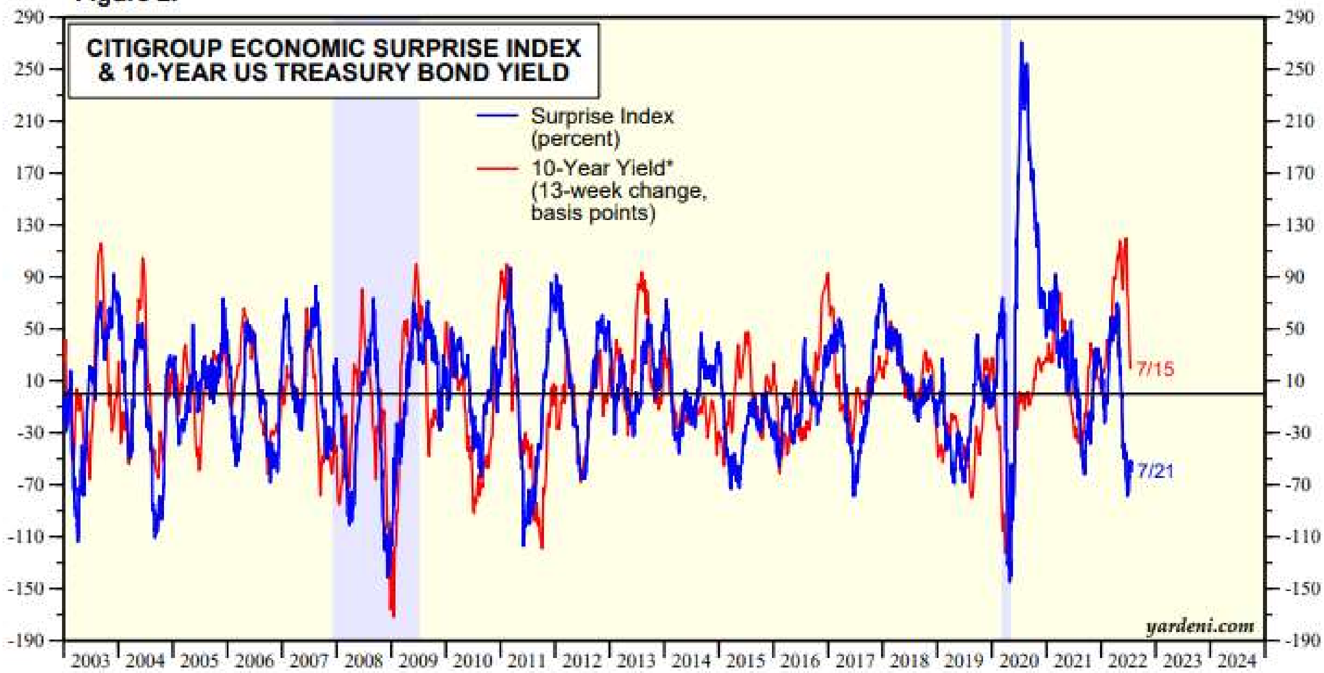
AT&T had one of the more interesting Earnings reports. It lowered its Cash Flow expectation (that is the number one thing going for T since it drives dividends). The main culprit: Customers are not paying their bills on time. If there ever were an economic tell, this is the one.

Of course, there have been some notable positive surprises on the Earnings front. Not the silly, "Google wasn't terrible" talk. But Microsoft did guide to good revenue and operating income growth. Alas, most of the Fantasies and Frauds continue to implode on paper. But the market is giving them a pass. We still think this changes (and thus most of our Put protection is against the junk in the market).

- Economic Data is worsening and missing expectations

Here is the Citigroup Economic Surprise Index plotted against the change in yield of the 10-year Treasury. For starters, for all the talk of the coming recession being priced into the market…the economic data keeps getting worse relative to expectations (although there is that slight uptick, but it is till is deep negative territory). Moreover, what really stands out is that the 10-yr usually tracks the ebbing and flowing of the data. While the yield has cooled off its 3.50% peak (which in hindsight was an easy woulda-coulda-shoulda-bought-bonds moment), it is still trailing the move lower in data. This is why we own bonds (not for the paltry yield).

Figure 2.



* Average for the week ending Friday.
Note: Shaded areas are recessions according to the National Bureau of Economic Research.
Source: Federal Reserve Board and Citigroup.

- Are Jobless Claims the first crack in the Labor market?

Jobless Claims keep ticking higher. The latest is 251k compared to the recent low of 166k in March. The average heading into the virus-fear was about 200k. This might be the beginning of the weakening labor market. Companies have been telling us it is coming despite the JOLTS report (the one that says there are still 11.25mm Job Openings…as of May…that could be the rub.). Interestingly, Jefferies tells us that most of the recent increase in Claims stems from Massachusetts. They also note that Continuing Claims have not increased along with the rising Initial. Their conclusion is that people being laid off are getting new jobs right away. This seems highly implausible to us. On top of the timing lag between the two data sets, we think many people have exhausted their 26 weeks of unemployment insurance (and thus are rolling off/out of the data set).

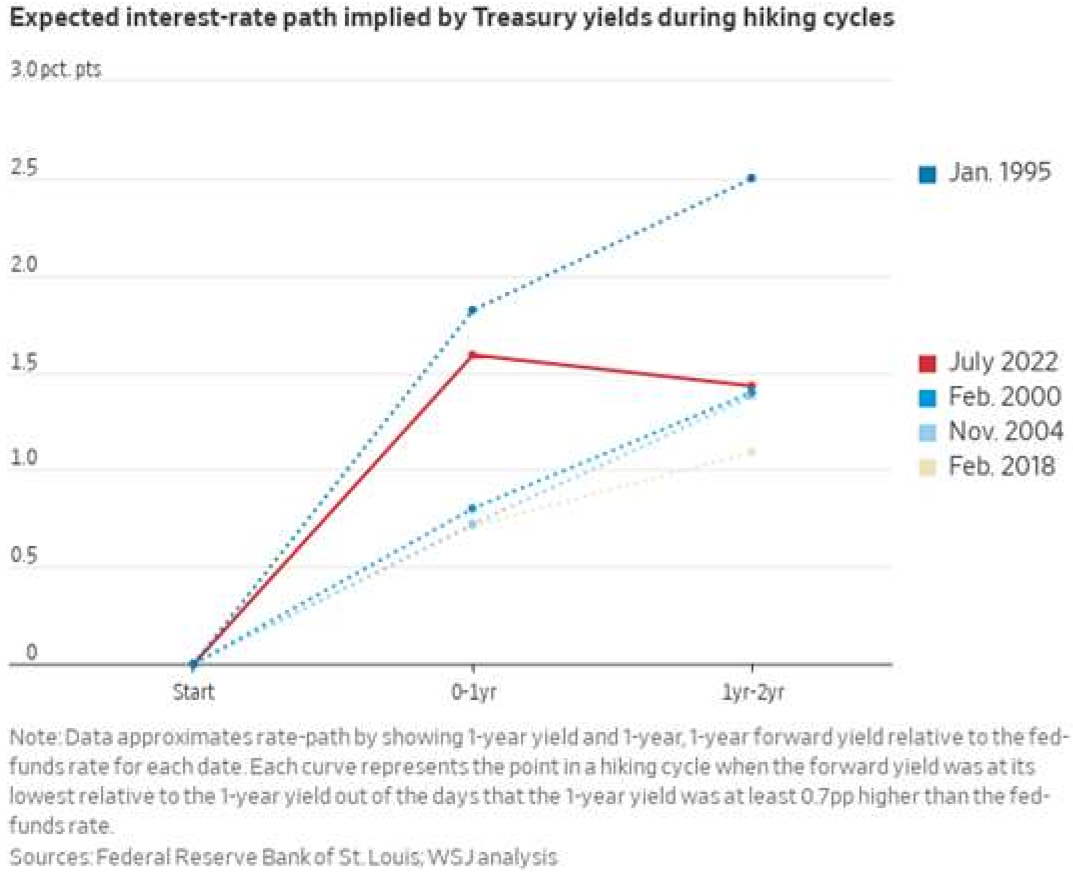
- Other Economic Data
  - New Home Sales in June fell to their lowest levels since the virus-fear struck. And the level is near the bottom of the range pre-virus.
  - The Pending Home Sales Index in June fell 8.6% vs May.
  - Consumer Confidence hit its lowest level since Feb of 2021. Recall this gage is heavily influenced by the Labor Market.
  - Fed surveys are worse on balance: Philly and Dallas sank further into negative territory. Richmond showed a surprising rebound…back to flat.
  - Durable Goods for June continue to defy economic weakness. We have submitted that reshoring could be a positive influence. Perhaps the Business Spending is coming ahead of layoffs? Who knows?

- The Fed is going to slow its hikes, but will it reverse course?

The Federal Reserve hiked the Fed Funds target range by 0.75% as expected. This brings the range to 2.25% to 2.50%. A few things stood out to us. On the bullish side, Powell emphasized that the year-end target was still in the 3.00% to 3.50% area. This means the size and pace of rate hikes will be slowing. He expanded on this by saying that another unusually large rate increase would be unlikely (yet, of course, data dependent). But on the bearish side, he proclaimed that we are now in neutral territory on rates. The implication being that more tightening will be overly restrictive on the economy. And not to leave anything to the imagination, Powell was explicit in saying that we needed Growth below potential to thwart inflation. This last bit is what resonates most with us. They want to slow inflation no matter what it does to the economy.

One of the more odd reactions to Powell's press conference was from David Zervos of Jefferies. Normally he is one of the more levelheaded and unbiased thinkers. But his synopsis leaves us puzzled: He thinks the Fed is committed to rate hikes and killing inflation…but the market is comfortable with this. We have never heard of a market comfortable with tighter monetary conditions.

As for the market at large, it still expects Powell to hike until year-end followed by cutting interest rates in June. The Fed has not done this type of pivot in recent hiking cycles.

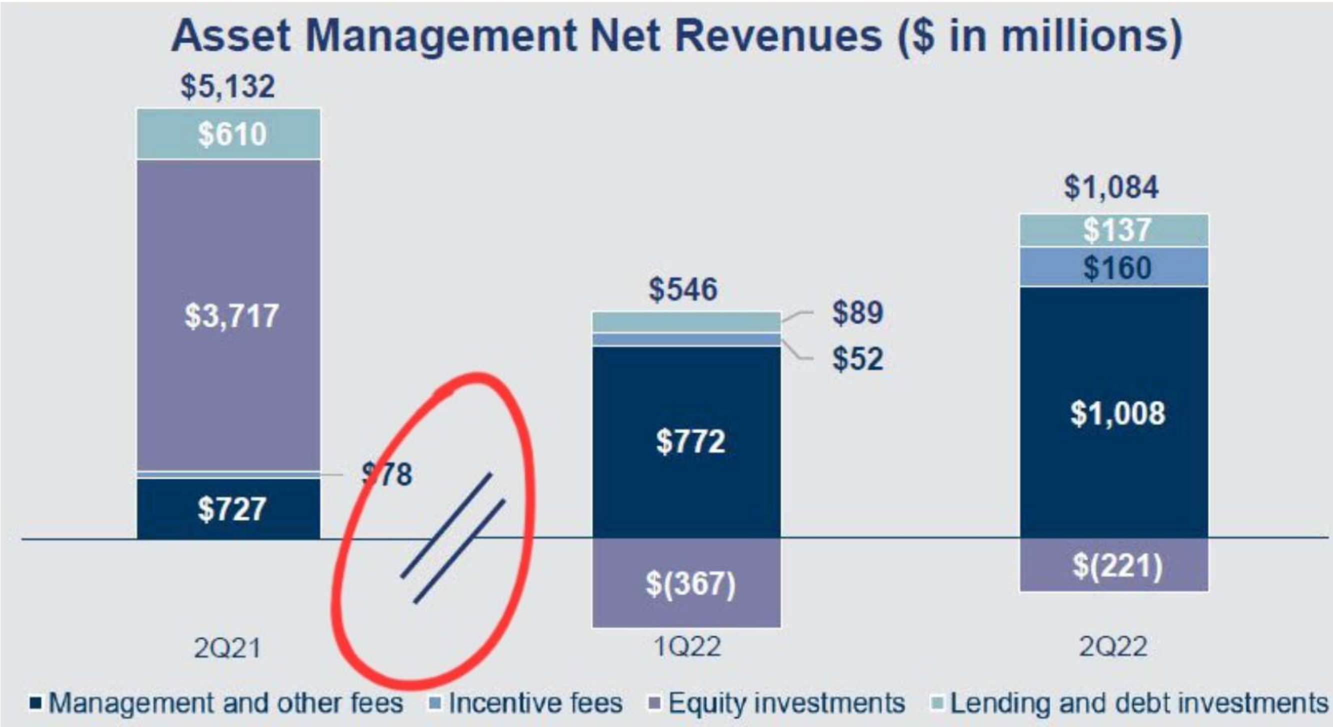


- The European Central Bank joins the chorus

The ECB hiked 50bps…from -0.50% to 0.0%. it was the first monetary tightening in 11 years. Some say the market was expecting only a 25bps hike, but the recent messaging suggested otherwise. Of course, the Fed has nothing on the ECB when it comes to being late to the party. Shortly after the rate hike, the Eurozone PMI turned negative

- Chart Crime of the week

This would be a routine chart crime in which the bars have vastly different scales. But for starters, this is from Goldman about themselves. And secondly, look, they have annotated the chart with the diagonal lines indicating things are not supposed to be equal scale. But why do it in the first place? And why are 1Q22 and 2Q22 still out of whack. We need more diagonal lines!



- Quick Hits
  - The SEC announced an insider trading case against an employee of Coinbase. The employee was buying "tokens" before they became available for trading on the Coinbase platform.
  - Disney+ now has rated-R movies.
  - Somebody knew Walmart was going to warn on its 3Q earnings. Somebody bought $900k of weekly Put options an hour before the warning. These moved to a $12.5mm profits within seconds. Somebody is going to jail.
  - Coinbase is under SEC investigation for selling unregistered securities (make-believe tokens and the like).

Trading: We added a bit more to our Energy, Utilities, and USD longs. We are also slowly adding to our Put protection. The upward momentum is seemingly strong, so we are being more delicate (the math says we are using lower deltas with more time). We have started a small short (via puts) in Housing.

TSLAQ: One follow up to the Tesla earnings: Some of the bullish analysts are now praising Tesla for being a manufacturing company. The whole point of people ignoring the insane valuation (the company still has net negative earnings) was that it was *not* a manufacturing company. Elsewhere, there are reports that Musk's whole game of pulling his Twitter bid was just to get a lower price. Most judges will push for a settlement if the parties indicate along these lines. But with the SEC tightening the noose, perhaps Twitter will put the screws to the Villain a bit (obviously different jurisdictions, but they can impact each other).

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