Weekly Update

23-December-2021
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- Ignore the narratives, watch the Fed, market back to all-time high
- New York is the epicenter of fear, as usual
- Maybe Big Tech is not crowded after all?
- Small-caps have large discounts
- Insiders are buying and selling
- Housing trends continue
- Business survey data is slipping but still ok
- The consumer does not care about the virus (not yet anyway)
- Latest Inflation data is mixed
- Is Europe heading back into recession?
- China has been slowing, but monetary policy might turn the tide
- Central bank policies are mixed
- Europe's gas crisis continues
- Chart Crime of the week
- Merry Christmas

	Last	5d %	YTD %	1yr %
S&P 500	4726	1.6%	27.5%	29.9%
QQQ	396.9	2.7%	27.1%	28.8%
US 10 YR	1.50%	1.46%	0.92%	0.93%
USD/DXY	96.1	96.4	89.9	90.4
VIX	18.1%	19.3%	22.8%	23.3%
Oil	73.76	1.9%	52.1%	53.4%

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

It was another week of swirling narratives. We maintain that the Fed's stance is all that matters right now. And we like the chances that the Fed slows the liquidity injection and raises rates ever so slightly. This should allow for continued growth (albeit slowing) with cooling inflation. But that does not mean the media will not push the Omicron ruse as much as possible. Nor will biased pundits stop trying to blame any supposed economic weakness on Joe Manchin's refusal to feed the inflation machine. There are plenty of landmines out there to be sure. The Fed screwing up is at the top of the list. And we noted that governments are more prone to overreact than to analyze hard data (with respect to the virus-fear…actually on anything for that matter). But with economic data continuing to improve in the US (the world is more mixed…this is certainly a risk), it seems clear to us that people are going about their lives with normal if not elevated economic activity. Supply chains are easing and more people are going back to work (although supply chains are vulnerable to the whims of Asian governments). As we have stated, that is called Goldilocks (economic growth will cooling or mild inflation). But we are also quick to point out that much of the strong economic growth we are experiencing has been pulled forward (scrambling for inventories, early Christmas shopping) or is function of catch-up (travel, non-Covid medical treatment) all of which could slow if not reverse.

- New York is the epicenter of fear, as usual

This is purely anecdotal, but a research shop categorized its investor clients by either being afraid of Omicron and thus selling the market or not being afraid and thinking the fear was overdone. 100% of its New York-based clients were afraid of the virus and selling. 100% of its non-New York clients were not afraid and were looking to buy the dip. We doubt these percentages, but we believe the sentiment

- Maybe Big Tech is not crowded after all?

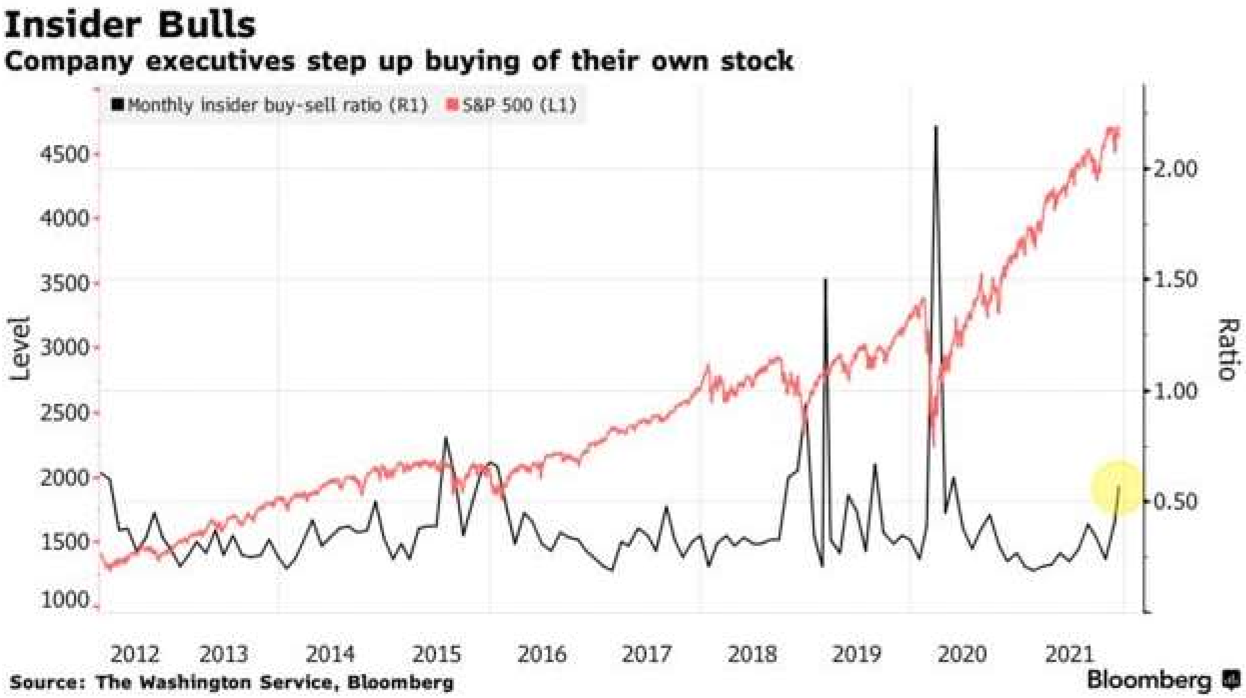
UBS has an interesting report showing that Big Tech is actually *not* overcrowded by investors. In fact, UBS calculates that the top five *least* crowded stocks are Apple, Tesla, Amazon, Microsoft, and Nvidia. UBS does a simple calculation in which it backs out the holdings from the total market-cap. We think there is room for slippage in their calculation. But we will assume they are close enough. This contrasts with the survey data (Merrill's is the most widely followed) that always has Big Tech as the most crowded space. Perhaps the nuance is that everyone thinks Big Tech is crowded so they are not wanting to join the crowd. Of course, they end up chasing the stocks anyway. Merrill Lynch reports that last week saw inflows by all client types (retail, hedge funds, institutions, and corporates).

- Small-caps have large discounts

Small-cap stocks are trading at a sharper valuation discount to large-caps than during the depths of the onslaught of the virus-fear. Large-caps are trading at about a 40% premium to their historical average. Small-caps are trading about flat to their average. The last time there was this big of a disparity between large-caps and small-caps was the dot.com bubble 20+ years ago. This should bode well for small-caps. But it also highlights the disparity between Growth and Value (since Growth dominates the large-caps). We still like some small-caps that are levered to an economic recovery (and they by and large make money).

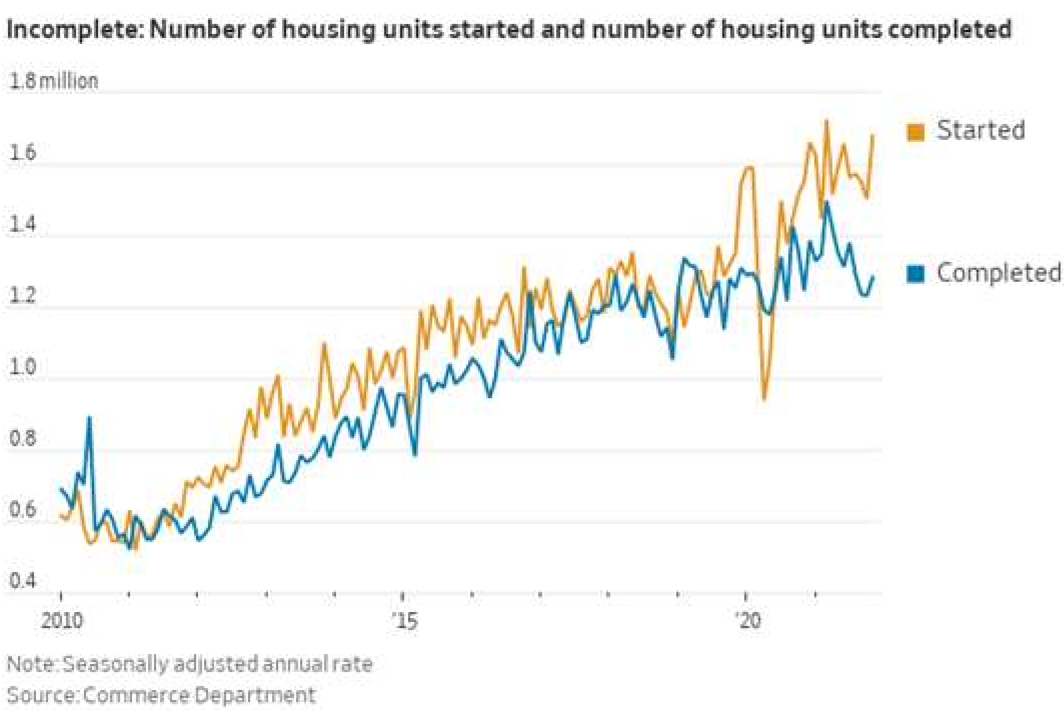
- Insiders are buying and selling

Last week we noted that a large number of founders/insiders have been selling giant chunks of stock (Musk being the poster boy of this selling). Bloomberg must have read the same Wall Street Journal article as us, because it ran a contrasting article. Despite these huge insiders sells, the number of insiders buying stock is on the rise. Selling still outstrips buying, but this will always be the case. We guess the takeaway here is to not trust profitless companies whose founders are dumping stock.



➢ Housing trends continue

Both Housing Starts and Permits surged higher in November. Starts are back approaching their virus-fear highs (still way below the 2006 peak). Permits are more volatile, but they are trending better, too. We keep writing about the shortages and rising input costs in Housing. Here is a chart that clearly shows the slowdown in the home building process. Builders are having an incredibly difficult time finishing the houses they have already started.



Existing Home Sales for November missed expectations slightly, but they increased for the third straight month. And they are approaching the peak from about a year ago. We started a small position in housing on the back of these trends.

- Business survey data is slipping but still ok

The early read on Markit's December PMI (the Flash) Composite Index was slightly weaker than expected on both the Manufacturing and Services lines. The momentum in this survey data has faded a bit. But the outright levels still point towards solid growth. New Business Growth was the strongest component of the survey

The Philly Fed Manufacturing survey sank sharply back to the low end of its 18-month range (post the huge initial, virus-fear dip). The Kansas City Fed Manufacturing survey did the exact same thing.

Industrial Production for November only increased 0.5% slowing from October's hot rate (1.7% monthly increase).

- The consumer does not care about the virus (not yet anyway)

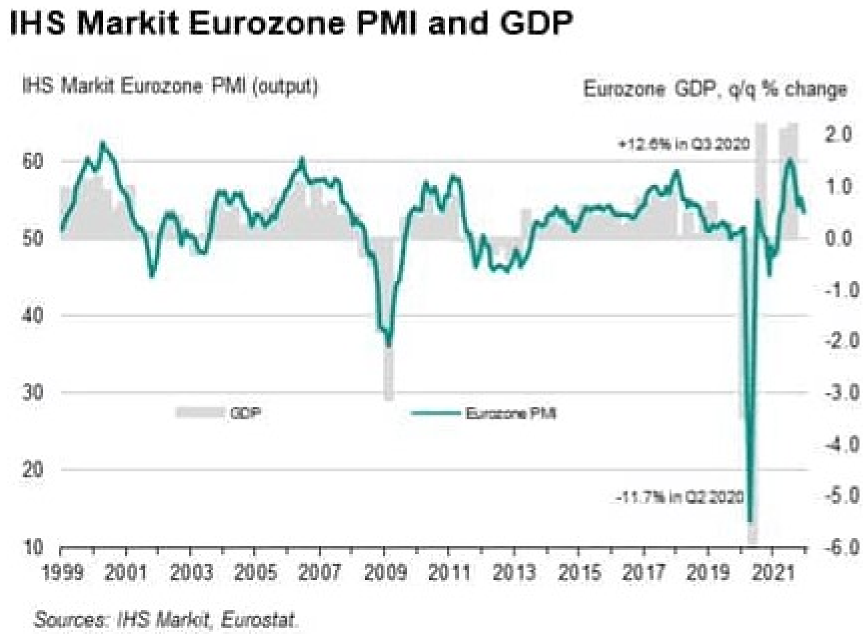
The weekly Retail Sales per Redbook showed an annual increase of 16.4% vs last week's gain of 15.7%. Normally this data does not grab our attention (other than longer term trends), but we think the consumer's indifference to the latest virus-fear speaks volumes. However, we would note that casual dining has started to slow a bit. Quick service and fast casual are both still steady. And the dip in casual is not near as severe as during August's delta variant fear. But the slowdown (and correlated uptick in delivery and to-go) is something to watch.**

- Latest Inflation data is mixed

The November PCE (Fed's preferred inflation gage, Personal Consumption Expenditures) showed inflation had a marginal downtick with a 0.6% increase vs October (which had a 0.7%% increase vs September). The "Core" inflation increased at 0.5% which is the same as last month's increase. The actual level of Personal Consumption Expenditures slowed. With inflation still increasing modestly, this means real expenditures are barely increasing. Overall, this data conflicts with our basic theme of continual economic growth with slowing inflation. Other data supports our thesis (Housing, Surveys, Retail Sales, Semiconductor chips, etc), but we will watch this data closely. The last thing we want to do is stick to a narrative that the data does not support!

- Is Europe heading back into recession?

There are many contrarian bulls out there that want to buy a beaten down/cheaper Europe. We point to this simple relationship between the European PMI and GDP. Rarely have sharp downturns in the PMI not led to weakening GDP.



But there is a ray of hope in that runaway input prices (PPI) in Germany have started to cool. Do not get us wrong, the 19.2% increase in November vs last year is eye-popping. But the monthly increase (Nov vs Oct) was only 0.8%. This is slowing compared to the 3.8% monthly increase in October (Oct vs Sept). Sept vs August was a 2.3% increase. Of course, the December business climate survey in Germany (known as the Ifo) deteriorated for the sixth month in a row.

- China has been slowing, but monetary policy might turn the tide

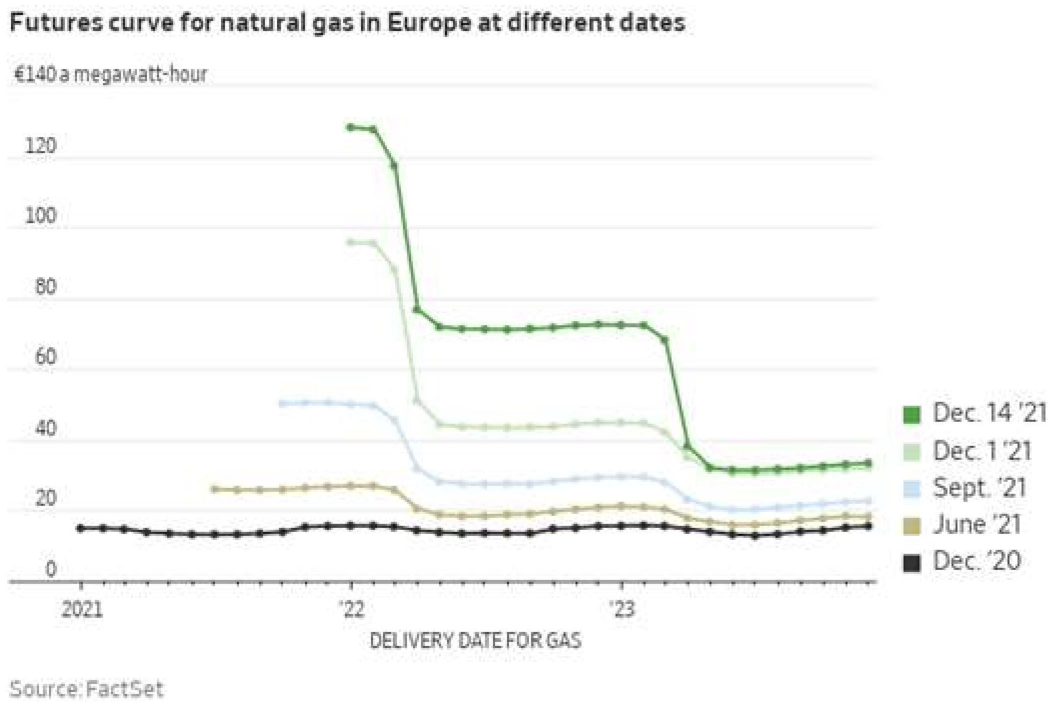
The latest economic data in China shows that manufacturing is back on the rise while consumption and investment continue to lag. This is a tried-and-true pattern whereby the communists force people to work but cannot force them to spend "their" money. However, we think the Chinese economy has been zigging while the western world zags. In other words, just as we might start to experience some slowing growth, China appears to have leveled off from its slumber. Or put another way, China is easing monetary policy while the rest of the world is tightening. We took a small long position in China local shares (not subject to the political quagmire that is China Tech…or at least not as politically vicious). But this is not for the faint of heart. According to JP Morgan, prices for Chinese property bonds (the high yield category) have an implied default rate of 37%.

- Central bank policies are mixed

Much of our attention is on the Fed and its tightening actions. But it worth adding that the Bank of England (BoE) hiked interest rates this week. And the European Central Bank (ECB) acknowledged inflation and the need to reign in some "stimulus" which is slated to end next March. But other bond-buying programs and low interest rates could last years. And the Bank of Japan (BoJ) reiterated its goal to keep short-term rates at 0% (they are -0.1% in the market).

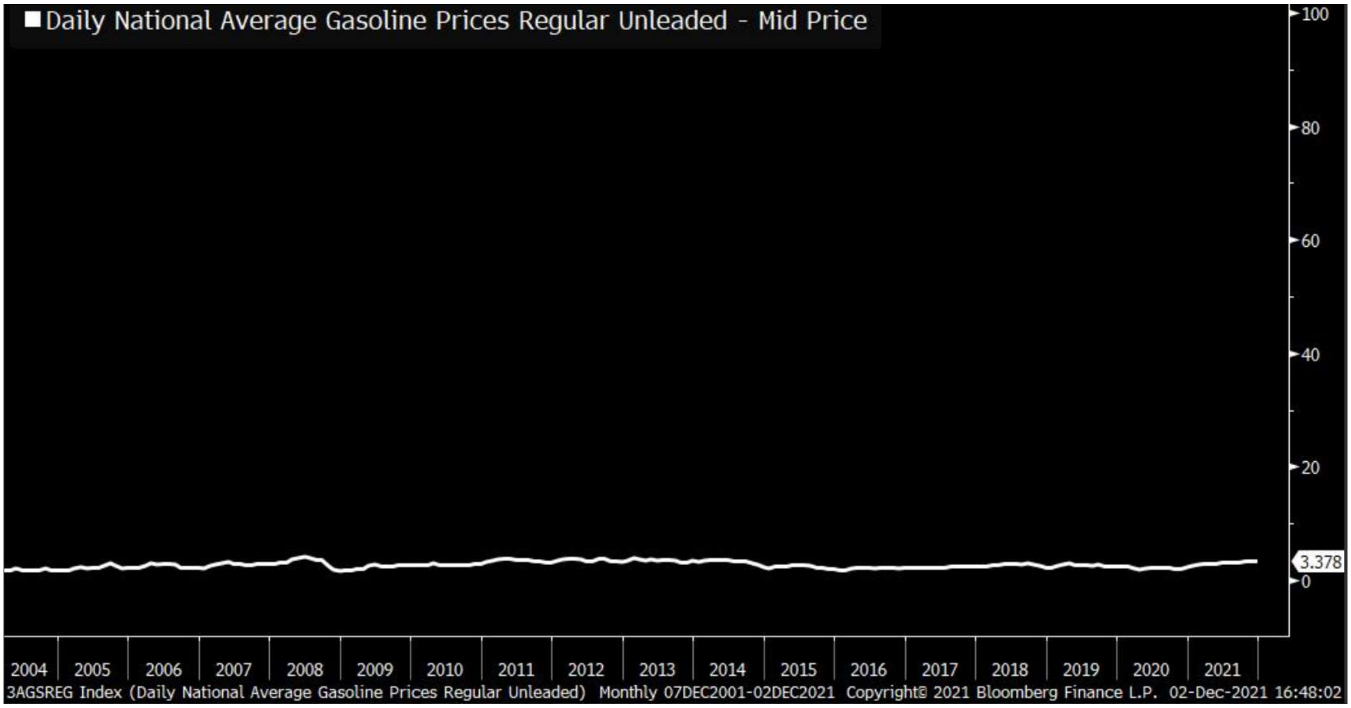
- Europe's gas crisis continues

We have frequently written about Europe's self-made energy crisis (paramount among the shortcomings are a reliance on just-in-time energy and the related reliance on the Russians). The good news is that the futures curve is showing a sharp reduction in the painful prices of today. The bad news is the painful prices of today. Ignoring the short-term noise from our perspective, the still-elevated outer years gives us comfort in our liquified natural gas exporter who stands to make the spread between US prices (approx $4) and European ($57). It is obviously far more complicated than this and there are plenty of risks. But it is clear that the US is the marginal producer of natural gas. The units below are different which is annoying, but we divide roughly by 3 to square them with the US measure.



- Chart Crime of the week

The op-ed writer at Bloomberg put together this gem. Recall he is the one that wants to call out chart crimes but usually commits more than he finds. As for the chart, we do not think he needs a scale of 100 for gasoline prices.



- Quick Hits
  - Concert “no-shows” have increased to almost 20% from the usual 1-3%.
  - California was experiencing about 50k annual departures from the state pre-virus. That has now more than tripled to about 175k.
  - The latest Spiderman movie recorded the third-highest opening box-office ever.
  - 0.01% of Bitcoin holders control 27% of the total Bitcoin in circulation. 1% of holders control 90%.
  - The US experienced the slowest population growth ever in 2021.
  - Citigroup tried to start a fund that would buy up coal mines with the intent of shutting them down. The project failed.
  - There is a new ETF geared towards alcohol, gambling, and cannabis. The ticker is BAD.
  - Russia wore CCCP jerseys in a national hockey game against Finland.
  - North Korea has banned laughing for 11 days.
  - The Coppin State basketball team forgot their game jerseys. They played in their opponents’s practice jerseys.

*This New York centric view of the world reminds us Whole Foods. The public company was struggling to get attention from New York analysts because it was a foreign concept to them. Whole Foods decided to open a store in NYC just so analysts could get a better feel of the store.

**While living in London, it befuddled us daily that restaurant employees could not understand what “to-go” meant. We had to say “takeaway.”

Trading: We trimmed more of our commodity exposure. This fits with our cooling inflation theme. It also provides us more cash to deploy on silly market panics. We restarted a small position in housing. We think the trends are favorable; and this sector does well with mild economic growth and cooling inflation. We added to one of our Retail longs (company specific growth and earnings power). We started a tiny long in China. As much as we have hated China for a while, we think the central bank is going to be pumping money into the local economy. We still want to avoid China Tech.

TSLAQ: Elon musk indicated he was done selling TSLA stock. The market cheered and the stock rallied 6-7%. The very next day, Musk disclosed in an SEC filing that he sold another $1b in stock.

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