Weekly Update

31-January-2024
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- The Fed and Earnings make a nasty combination
- Not *as many* bonds being issued and some ugly bank assets help treasuries
- Outlier moves are starting to creep up
- Inflation ticks up
- Business Spending is still steady
- Labor market showing signs of cracking?
- GDP strong or manipulated?
- Quick Hits
- Where did all the crypto money go?
- We have reached the bottom of the internet. No Chart Crime this week!

	Last	5d %	YTD %	1yr %
S&P 500	4,846	-0.5%	1.6%	22.5%
QQQ	$416.95	-2.1%	1.8%	44.6%
US 10 YR	3.93%	4.18%	3.88%	3.42%
USD/DXY	103.6	103.3	101.3	101.2
VIX	14.6%	13.1%	12.5%	17.9%
Oil	$75.76	0.9%	5.9%	-3.8%

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

It was a busy week with the Fed, Treasury, economic data, and Earnings all converging. Ending with the Fed today, chairman Powell dropped the hammer on rate expectations for March: "Based on today, I don't think it's likely for a rate cut in March." To be clear, the bond market was not caught offsides. The probability of a March rate cut was 40% yesterday and is now 35% (it was much higher a month ago). And bonds across the yield curve rallied…their yields dropped sharply. There was some curve steepening as the 2yr bonds rallied more than the 10yr and 30yr. Equities, however, were not pricing in this "no action" probability from the Fed. It surely did not help that Google and Microsoft were already down (Google much more so) after good earnings (the bar was set extremely high). An oddball bank blew up after its earnings miss. It just so happens that New York Community Bank was the "winning" bidder for many of Signature Bank's "good" assets when it became insolvent last spring (it was insolvent well before this, but this is when it became obvious). Apparently, getting to pick from the remains of a rotten carcass is not necessarily a good thing. But this mostly idiosyncratic implosion drove

treasury yields lower. Maybe it was a flight to quality. Or maybe it was a message to the Fed that not all banks's balance sheets are not out of the woods yet. (These are pretty much one and the same.)

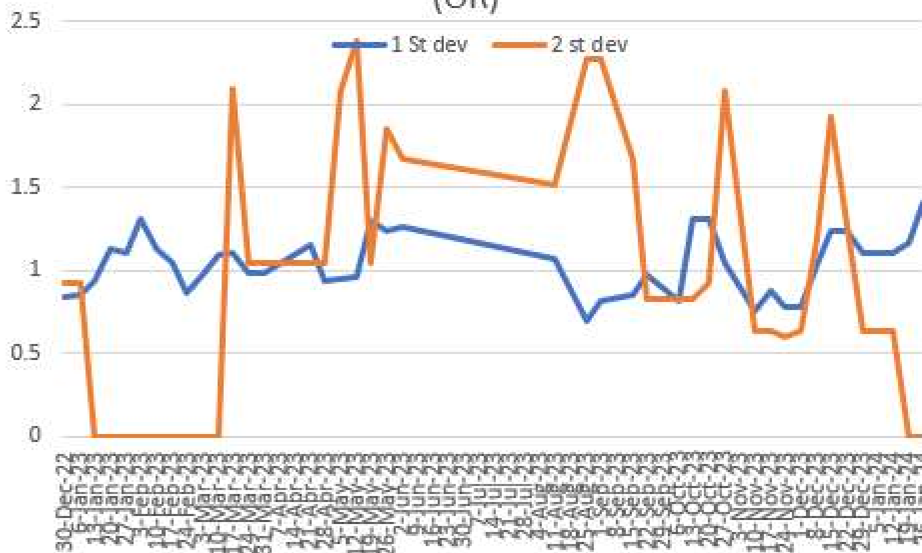
Before all this unfolded, government bond yields had already started to fall after the announcement from Treasury that it did not have to borrow as much money as first thought. And despite inflation ticking a bit higher, economic data continues to be strong. Other than the "no cut in March" line, this was Powell's central message. The economy is strong but will likely moderate some. Inflation is well with the Fed's target range when looking at the Core PCE over the last six months. But the FOMC will be gradual in reversing course. None of this was shocking to us…and probably not to the market. Profit taking is a normal thing. We have not been buyers into this recent ramp. But we will look to add on any meaningful weakness (our barbell strategy concentrating on Quality).

- Treasury is not issuing *as much* debt

Treasury's quarterly refunding announcement (QRA) surprised the market on Monday. The total amount of debt the Treasury intends to issue in 1Q2024 is $760b. This insanely high number was down a touch from the $816b that was the original forecast back in late October. The breakdown of the debt across maturities has been met with mixed reactions…the market does not want a lot of long-term debt issued at these interest rates levels. The assumption is that rates are coming down, so the Treasury will be better off waiting (we all know how it can go when you do something when you can vs when you have to). One thing many agree on is that this issuance schedule likely means that Quantitative Tightening will proceed. Recall there had been talk about the Fed reversing course (they would start to buy bonds again). But even Powell said this has not been seriously considered yet.

- Outlier moves are starting to creep up

Using ARKK as our proxy for junk stocks, we see that 1-standard deviation outlier moves are starting to move higher. There is some seasonality in this data given earnings seasons. But we think it makes sense…even the junk bulls are a little more skiddish. We still want to avoid any stocks that have challenging business models or do not have cheap and available access to capital. If nothing else, we do not want the added volatility! (We might have to remove the 2-standard deviation data from our charts. Single outcome moves are altering the output too dramatically).



- Earnings expectations are still far above reality

124 of the S&P 500 have reported earnings (as of a few days ago), and 78% are beating expectations. The revenue beat is not as sharp at 62%. Earnings growth is tracking 4.9% (a combination of reported and expected). This is a marginal improvement from the 4.7% expected on Jan 1. This is *way lower* than the 11% growth expected as recently as October 1. And the actual growth is only 1.1%. So that 4.9% blended expectation seems optimistic...to say the least. While there are still pockets of strength, today was a reminder that expectations matter (see Google, Microsoft, and AMD all falling on good earnings).

- Inflation ticks up

December inflation (as measured by the growth in the Personal Consumption Expenditures index or PCE) accelerated a touch to 0.2% on both the headline and the Core (stripping out Food & Energy). These monthly rates in November were -0.1% and 0.1%. On an annual basis, the headline remained the same at 2.6% with the Core dropping from 3.2% to 2.9%.

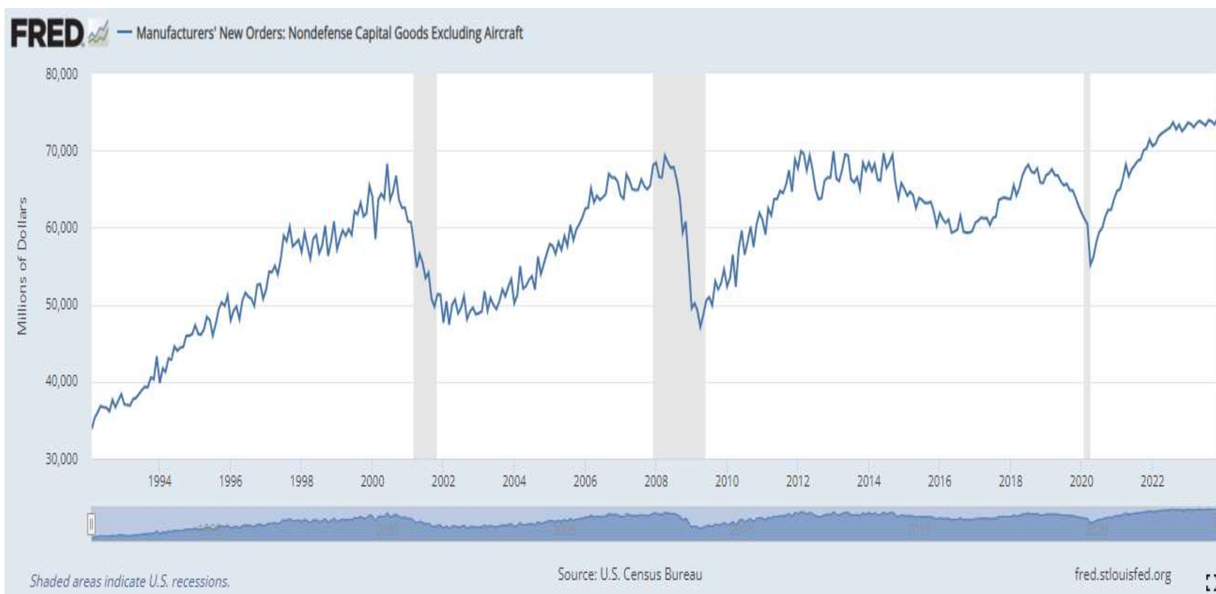
Prices on Goods fell 0.2%. Durable Goods prices fell 0.4%. Non-Durables were better at -0.1%. Services increased 0.3%. The long-awaited reprieve in housing inflation has yet to materialize. It increased 0.5% on the month. It has been around this level of increase since March. Notwithstanding, the Core Services ex-Housing (it is a silly carve-out, but the Fed uses it) has trended higher the last few months.

Personal Spending increased at a 0.7% rate. Personal Income only increased at 0.3%.

BTIG highlights the divergence between consumer inflation expectations and market expectations. In the last six months, the market has priced a 1-yr breakeven (inflation expectation) from 2.1% to 2.35%. But the University of Michigan (cheaters) consumer survey on 1-yr inflation expectations has fallen from 3.5% to 3%. One could argue these are just converging. And consumer expectations are always higher (more emotion). But we think the consumer is more right than the market (we will dig for some concrete evidence of this assertion).

- Business Spending is still steady

Durable Goods Orders in December were flat versus November. Ex-Transportation they grew at 0.6%. The important Core Capital Goods (aka business spending) increased 0.3%. This data has traditionally been volatile on a monthly/quarterly basis. But it continues to be steady. The three previous recessions saw this spending drop off a cliff.



- Labor market showing signs of cracking?

The job Openings and Labor Turnover Survey showed an uptick in Openings on the headline: 8.93mm in November (which was revised up from 8.79mm) to 9.03mm in December. Job Openings per Unemployed Worker remained unchanged, but this metric's trend can still be considered a crash since early 2022 (a 2.3 standard deviation move according to Jason Furman). Job Quits, probably the best sign of job market health, decreased again. Quits have been in decline since the beginning of 2022 and are now below their pre-Virus Fear level. Job Hires did tick up a bit, but the trend is still obvious (down).

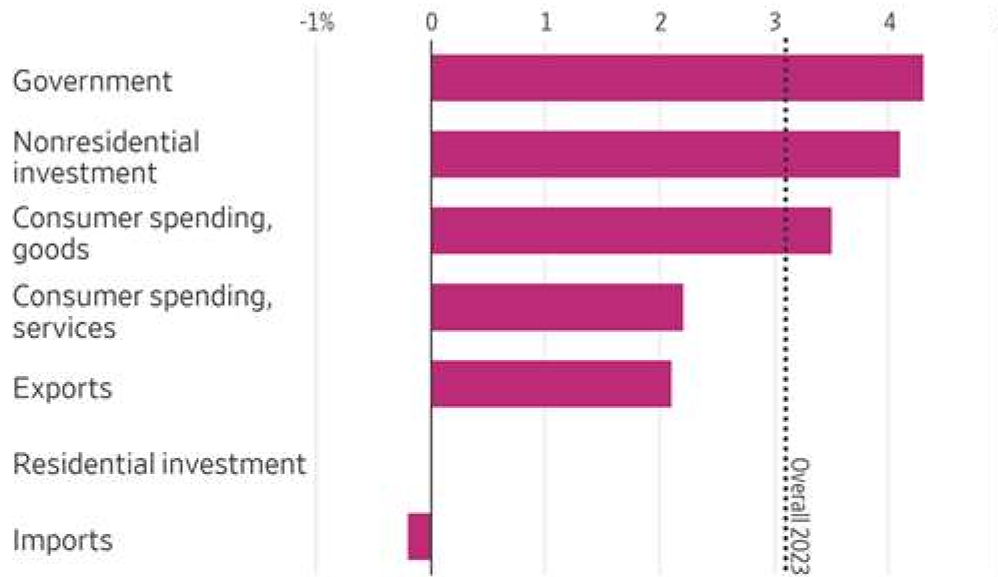
ADP's guess for the change in Private Payrolls (ahead of the government data on Friday) was weak at 107k down from 158k (and 145k expected). The Unemployment rate which comes out Friday is also expecting about a 160k new Private Payrolls. Given that ADP has been a better guesser than usual lately, we would not be surprised to see the BLS (Bureau of Labor Statistics) data be soft, as well.

Jeffrey Gundlach (the so-called "bond king") noted another strange anomaly in government data. Despite federal unemployment remaining steady around the 3.7%-3.8% level, 85% of states are showing their unemployment figures are marching higher. We want to add that Gundlach also threw out a valuable non-sequitur: When he hears "Goldilocks," he gets nervous. He also said the JOLT Survey is not worth anything anymore because the response rate has fallen from over 70% to around 30%. We think the JOLT survey has lost significance because it is full of fake news (duplicate, stale, and outright made up job listings).

- GDP strong or manipulated?

Real GDP grew 3.3% in the 4Q of last year (GDP is one of the few datapoints always adjusted for inflation…more on this shortly). This is the growth compared to the previous quarter on an annualized basis. This is down from the robust 4.9% growth in 3Q. This is obviously backward-looking data. But it is just another example of the

economy slugging its way through the headwinds. Of course, this has been driven by debt-fueled government spending. GDP = Consumption + Investment + Government + Net Exports. Also, it is worth noting that the skeptics out there (not a judgement, we are biased towards them) are pointing to the calculation of the inflation component of Real GDP. That is, if the government had used the market CPI for inflation instead of its own internally generated GDP Price Deflator, Real GDP would have been about 1.2% *lower* than the headline 3.3% (according to Hedgeye).



- Other economic data is better except for surveys
  - Retail and Wholesale Inventories both increased in December. This was the first time these have both been positive in over a year.
  - Weekly Redbook Retail Sales increased by 5% (steady for 5 weeks).
  - New Home Sales in December bounced back from November's bad number.
  - Pending Home Sales in December jumped 8.3%.
  - Weekly Mortgage Applications fell, but the index level is still better than where it has been for six months.
  - The Kansas City Fed Manufacturing index fell further into negative territory.
  - The Dallas Fed Manufacturing index also fell further into negative territory. Services remain negative, too.
  - China's official Manufacturing PMI ticked up to 49.2 in January from 49.0. This was the fourth straight month in negative territory. Services ticked up to 50.7 from 50.4.

- Some one-liners from Fed chairman Powell
  - Expect growth to moderate as we have for some time
  - The pace of job growth has narrowed (slowed)

- Don’t need to see weaker growth for inflation to come down
- Unexpected weakening in the labor market would make us cut rates sooner
- Could we see inflation below target? Looking for it to settle out at 2% not to tap it.
- Will the first rate cut be the beginning of a rate cut cycle? “The committee will proceed carefully.” Data dependent. Based on today, it is unlikely to for a cut in March. Data dependent again
- Higher productivity is being seen with above-average growth with falling inflation
- Housing: rent and OER will come down eventually as rents are already coming down
- Balance sheet runoff has gone very well so far. Planning to begin more in-depth discussions in March. Plausible to cut rates and keep QT
- Core PCE has been running at 1.9% over the last six months. But the inflation forecast is 2.4%
- Powell acknowledged high prices not just inflation.
- The labor market has largely healed its way back to pre-Virus Fear levels (he did not say pre-Virus Fear!)

➢ Oil supply constraints are still no match for demand fears

The supply side of the oil market continues to point towards tightness despite all the headlines about US production. Saudi Arabia announced that it was bailing on its plan to increase oil production capacity to 13mm barrels/day by 2027. It currently has 12mm bpd capacity. It is only producing about 9mm bpd after all the voluntary production cuts to spur on compliance from other OPEC members.

The Houthi drone offensive appears to be expanding. Obviously, the fatal attack in Jordan ratchets up the tension. But the Iranian-backed terrorists are also attacking Russian tankers with an eye on their refineries. This is a weird development as these two global pariahs were natural bedfellows. And this twist has a more direct implication on global oil supplies.

The US has quietly reimposed sanctions on Venezuela. The sanctions that were lifted in October were predicated on the Maduro regime releasing political prisoners and holding fair elections. In a surprise to no one, the dictator did nothing of the sort.

On the demand side, the US government bought 3mm barrels in its slow-moving action to refill the Strategic (Tactical?) Petroleum Reserve (SPR). That is 20mm barrels done with about another 180mm to go.

Of course, the price of oil is not all that strong. It has moved off its lows. But it certainly is not reflecting the multiple crises around the globe. Clearly, oil fears a demand problem.

➢ Where did all the crypto money go?

Hackers have stolen $112mm of Ripple-based XRP cryptocurrency. Ho-hum. It has subsequently been laundered through Binance and Kraken. Again, ho-hum. But the meat of the story is that the fake money was stolen from the account of the Ripple co-founder! Some are speculating that the XRP tokens actually belonged to Ripple itself. What’s some comingling of funds amongst friends!

➢ Chart Crime of the week

We have reached the bottom of the internet. No Chart Crime this week!

➢ Quick Hits
  - Saudi Arabia accounts for only 3% of the global supply of natural gas.
  - Saudi Arabia generates a third of its electricity by burning oil.

- 10% of all full-time remote workers were laid off in 2023.
- 25% of young adults who live with their parents say their “sense of independence” has improved.
- There are approximately 1.5 billion empty apartment/condo units in China (some estimate this to be as high as 3b units).
- “Scientists” in the Netherlands have determined that the recent -44.6C temperature in Sweden would actually have been -51C without climate change.

Trading: We sold some of our Tesla Puts after the latest bad earnings report. But we added some back when the stock drifted higher a few days later. Ultimately, this was a profit-booking exercise as we rolled our strikes lower. But we also added some more time to the position, so we can capture the next earning miss. WE added a bit to one of Health Care longs. But as we think things have become a bit overextended, we remained mostly on the sidelines.

TSLAQ: It looks like Musk is following through on his plan to move the “technology” parts of Tesla into a new company. He is raising money for a new holding company to house some of his “AI” work. Of course, we know why this self-inflicted story came to be. Musk lost the shareholder lawsuit over his compensation. He is being forced to surrender $55b worth of stock…ouch! We think the board will just issue him more stock…and this time they will do it correctly (the bonus is being rescinded for not following the proper protocols). But since the company never accounted for the original plan appropriately (not illegal, just in a confusing manner), they will not be able to recognize a huge gain on its reversal. But the company will likely have to take a huge loss to issue more stock to Musk using the old stock prices. This is obviously a work in progress...and fixing accounting problems is a messy business. But if nothing else, this will annoy Musk and probably drive him away from the public markets (which ultimately will hurt Tesla stock).

The Cybertruck might be able to bypass Chinese regulations against trucks (they are not allowed in city centers, for example). It is being called an “urban traveling wagon” without the word “truck.”

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