Weekly Update

7-April-2021

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- Market narratives are all positive all of a sudden
- Positioning is still stretched but there are signs of more balance
- Tough quarter for corporate bonds, but there is a silver lining
- Auto loan delinquencies are accelerating
- Archegos pulled the plug on themselves
- Dividends are increasing
- Labor market is still rebounding albeit with some snags
- PMIs are still strong, Construction Spending temporarily froze, Housing remains on fire
- OPEC is trying to keep Russia in check
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
SPX	4080	1.8%	9.0%	55.6%
QQQ	331.6	3.9%	5.8%	69.8%
US 10 YR	1.67%	1.75%	0.92%	0.77%
VIX	17.2%	19.4%	22.8%	43.4%
Oil	59.38	0.0%	22.4%	151.4%

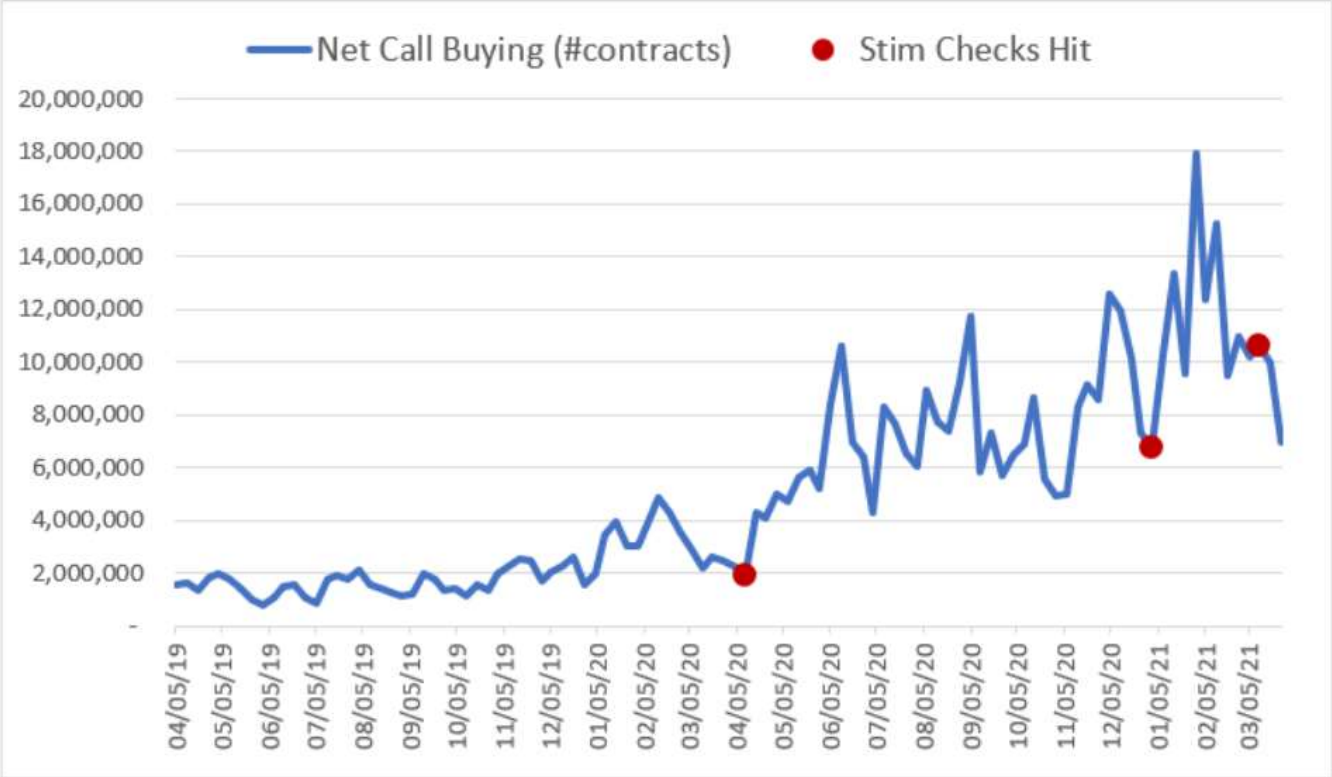
*10yr and VIX are levels not changes
** Oil is front month futures, beware

First, we had the S&P 500 back to making an all-time high. Right on its heels, the Nasdaq (Big Tech) has kicked into high gear as it approaches its own record close. The positive Employment Report (more below) was the strongest catalyst. But seemingly all the negative narratives have been flipped on their heads. The vaccine rollout continues to be fast and furious. The Fed, while acknowledging the economy is improving, still favors being cautious in keeping interest rates low. The 10-year Treasury rate sits range bound. Politically, it looks like the Dems will be allowed to use the Reconciliation process to push through more loosely defined budgetary measures (the 1974 law that created Reconciliation intended for it to be used only once a year for the budget). This likely includes the so-called Infrastructure bill. Interestingly, infrastructure stocks have stalled out a bit. Perhaps the market has picked up on this “infrastructure” bill not really being about infrastructure? Nonetheless, the market knows that more government spending is usually a short-term boon for stocks. The Archegos implosion seemingly reset some of the risk in the market. And the fears about inflation have turned into optimism about growth. Of course, positioning is still extremely stretched along with sky-high valuations.

We want to ride the positive momentum, but we are also trimming some long exposures and adding slightly more protection.

- Positioning is still stretched but there are signs of more balance

We have talked about how the market was looking for another round of Retail buying, but most data have showed us otherwise (ML client flows, e-commerce spending trends, Robinhood volumes, WallStreetBets mania, etc). Here is a simple chart showing when the Stimmy checks hit and how stock option volumes trended. (This is obviously a small sample size and the chart excludes any other potential influences. But we will take it at face value.)



The caveat to this is that margin balances have continued to increase (investors taking loans against their stock positions – they do not have to buy more stocks with these loans, but that is the normal use). Perhaps the Retail crowd is back to buying stock on margin as their preferred choice of leverage in the market? And perhaps they are just sitting long which would pair up with the overall volumes being lower? (Options cannot be bought on margin, but they obviously have leverage imbedded in them.)

Positioning typically and obviously refers to actual positions by investors. But the concept also applies to brokerage analysts and strategists. Currently, the average recommended equity allocation by Wall street brokerages is at its highest level since 2007. Moreover, the speed at which the allocation has increased from the virus-low has happened at 3x the average recovery speed (post-recession).

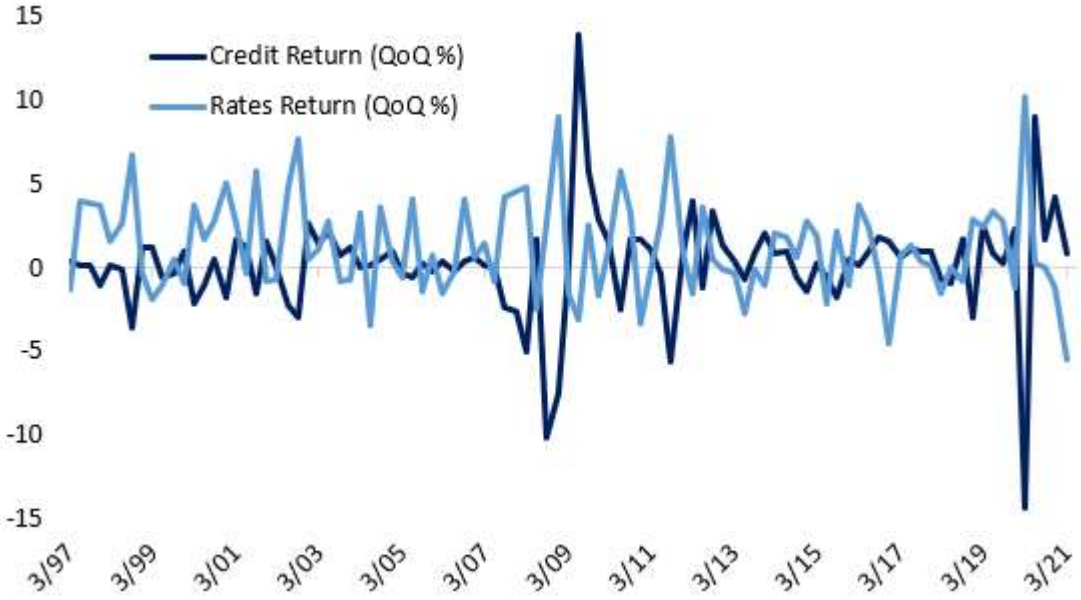
There are a few outlier opinions to this strong-like-bull strategy positioning. Merrill has been signaling that we are near the peak of investor enthusiasm. And Citigroup is out this morning writing that "sentiment is in very worrisome territory" and "we are in bubble territory." They present this Price/Sales chart for the market as a whole:

Figure 1. S&P 500 Market Cap as % of Sales

Of course, Citi acknowledges the "huge fiscal stimulus and supportive central banks." We think most people agree with Citi in that we are in bubble territory. But most people either have FOMO or they believe the richly valued companies can grow into their valuations. The first is foolhardy. The second is foolhardy in the medium term. But it might make sense in the short and long terms. Talk about trying to thread a needle.

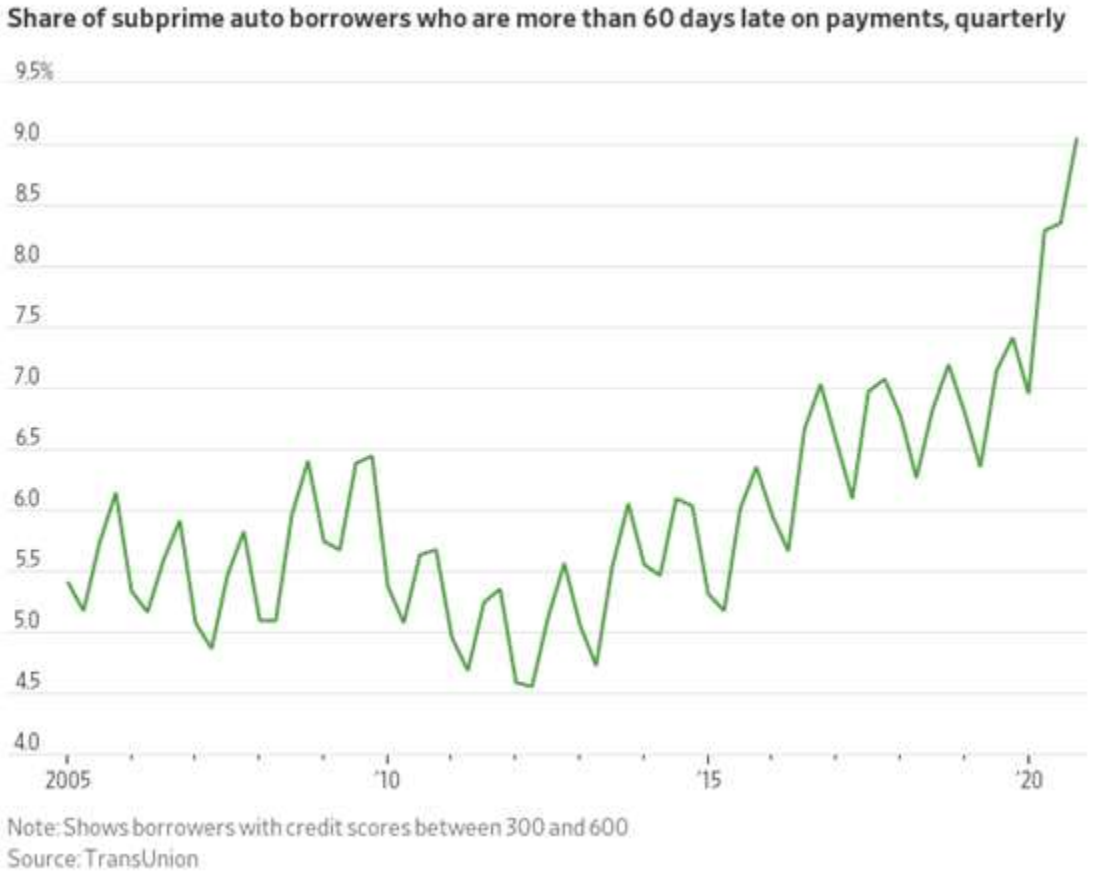
- Tough quarter for corporate bonds, but there is a silver lining

Investment grade corporate bonds had their second worst quarter in the last 30 years. They fell 4.5% in value in Q1. Bespoke put together a nifty chart showing the breakdown of the decline. Credit was still positive while the increase in interest rates accounted for the entire drop in value. We think this is a bullish reflection on the economy (credit is typically the more fundamentally based input while interest rates are more technical).



- Auto loan delinquencies are accelerating

We made an ill-fated bet against auto-loan providers a few years back. Perhaps we are nearing a reentry point.



- Archegos pulled the plug on themselves

As we described last week, the only way for the reverse-Ponzi scheme at Archegos to continue was for Archegos to keep buying. And we noted that it was Viacom's decision to sell stock itself that reversed the momentum. However, it now appears that Archegos had committed to buying 10% of the Viacom shares being offered by the company, but then it changed its mind and backed out. With the biggest buyer of the stock not buying the stock, the deal "failed" (= did not raise enough money for the company and sent the message to the market that demand had dried up).* Having written this, we are still long Viacom as it looks like the puking is now mostly dry heaving.

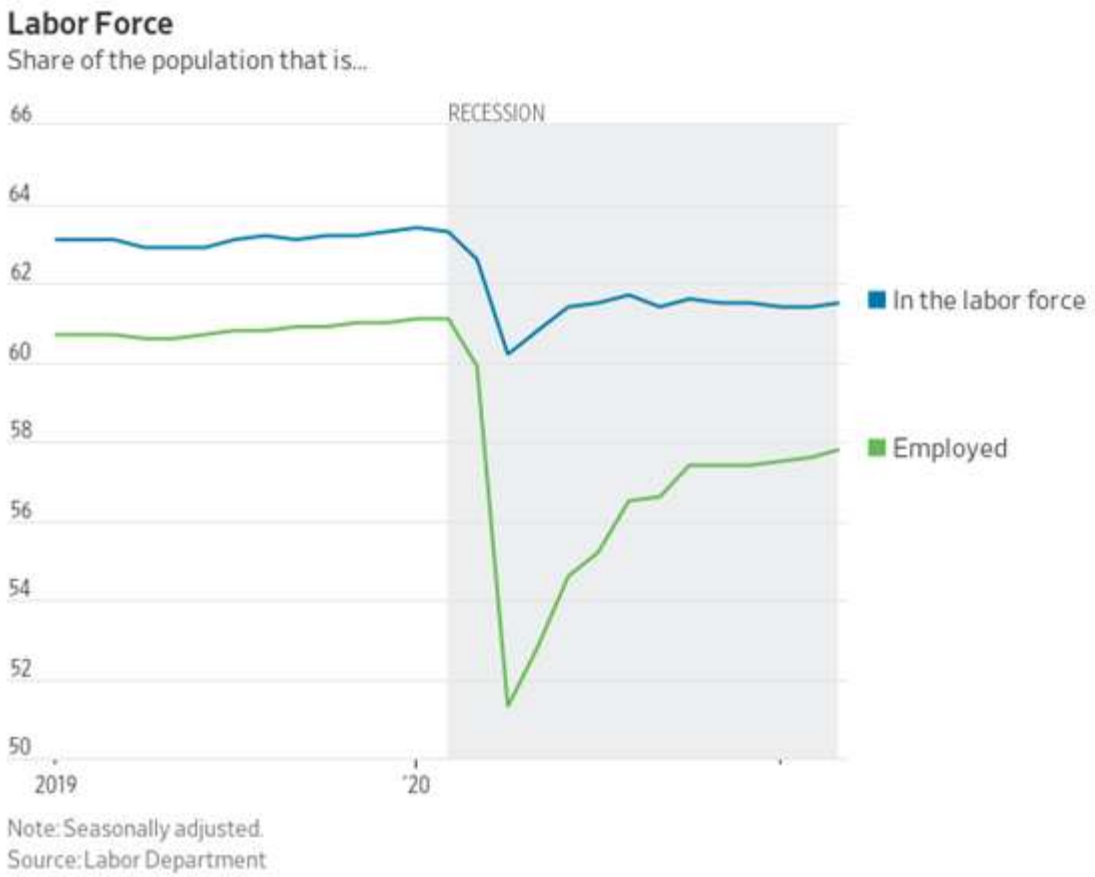
- Dividends are increasing

We have highlighted the increasing buybacks in the market. Now we have some data showing us that dividends are increasing, too. During Q1, the net increase of dividends paid (dividend increases minus dividend cuts) amounted to $18b. The increases reached over $20b which is growth of about 47% compared to 4Q2020.

- Labor market is still rebounding albeit with some snags

The Unemployment Report surprised strongly with 916k jobs added compared to the 660k consensus guess. The boost in Private Payrolls was the pleasant surprise as 780k jobs were added vs the 550k expected. Leisure and Hospitality were the obvious beneficiaries of more states reopening. Manufacturing payrolls increased more than expected, too. Of course, the touch of grey is that many of these jobs were just rebounds from the cold weather in February. Nonetheless, like Housing, we needed to see this rebound. Government added 136k jobs which normally would elicit an "ugh" from us. But since most of these jobs were teachers and others school jobs, we will celebrate it for the kids (and the single/working moms, etc). The Unemployment Rate dropped to 6%. Labor Participation is still lousy at 61.5%. Average Hourly Earnings dipped on a monthly basis (still +4.2% vs last year). Hours Worked ticked up slightly (one of the few indicators that remains on a strong trajectory overall). There was also a February JOLTS report (Job Openings and Labor Turnover Survey) that showed the highest number of job openings since January of 2019.

All in all, this was a strong report which bodes well for the recovery. But we are still seeing the same trend involving temporary job losses (good/decreasing) countered by permanent job losses (bad/not improving). Moreover, the number of people unemployed for longer than six months has increased 11 straight months. In fact, over 41% of Unemployed have been so for longer than six months. The US still has 8.4mm fewer jobs today than pre-virus. Of course, some of this can be attributed to the government paying people not to work. And just like the positioning of market strategists, the average economist cheered this Employment Report and expects more job gains. The only group with more of a herd mentality than market strategists is economists. Here is a simple chart showing the spread between people in the labor force and those employed:



- PMIs are still strong, Construction Spending temporarily froze, Housing remains on fire

The ISM and Markit Manufacturing surveys for March both reached near all-time highs. Strength was seen across the board led by a surge in new demand for Consumer Goods. Supply shortages and extended delivery times continue to plague most manufacturers. Logically, input prices rose and the "cost of inflation was the steepest since March 2011."

Construction Spending fell in February. But this is just another freezing-weather datapoint that should roll off.

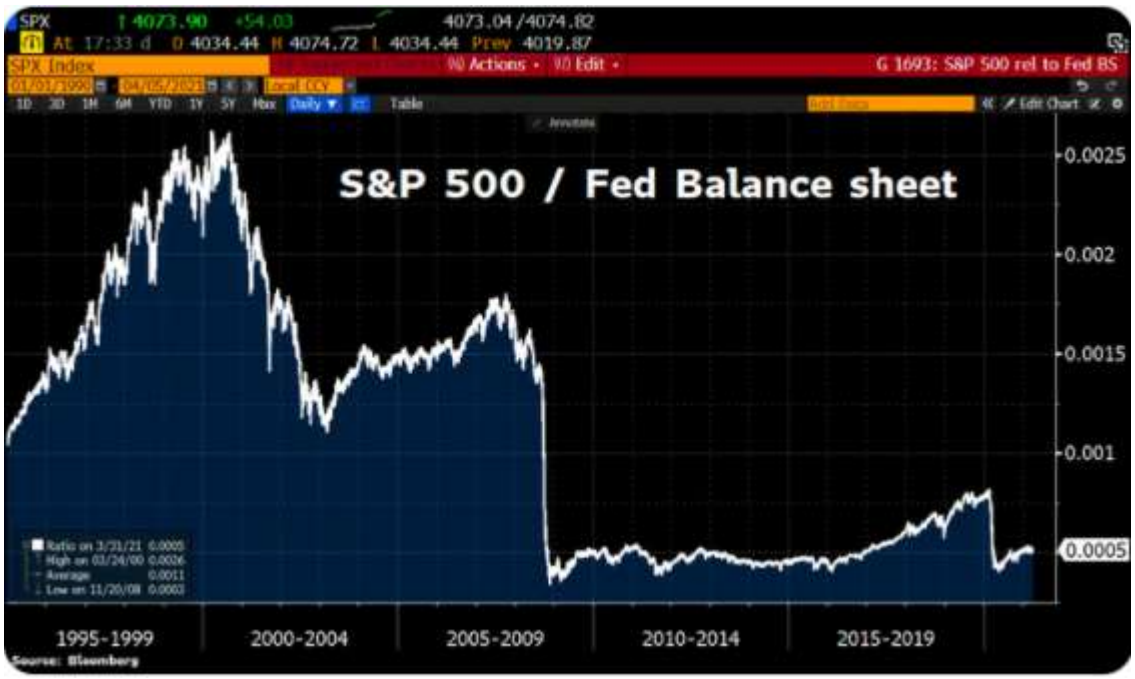
Housing remains on fire. The real estate brokerage Redfin reports that 40% of homes sold in late March went for more than the asking price. Over 60% of the homes sold in this period were listed for less than two weeks. And active listings fell 42% vs the same period last year.

- OPEC is trying to keep Russia in check

OPEC and Russia will start to ease production cuts (increase production) starting in May. Production will be scaled higher in June and July, as well. Russia was the driving force behind the increase in supply as it thinks "the oil markets were undersupplied by some two million barrels a day" according to its Energy Minister Alexander Novak. While Saudi has warned that the "sea remains rough" for the oil markets, it still will increase its productions outside of the OPEC+ agreement (Saudi recently committed to cut an additional 1mm barrels per day to placate Russia). We always write how trader-driven the oil market is and we advise most to ignore the short-term noise. Having the largest production bloc (cartel) do its own monthly waffling only increases the short-term noise and price volatility. Simplistically, we believe the Saudis over the Russians (a Sophie's Choice if there ever were one).

- Chart Crime of the week

One of our favorite criminals is back at it. The German financial reporter at Welt came up with this chart to explain that the S&P 500 has "traded sideways since 2008." We surmise that he has not been long the market.



- Quick Hits
  - $20b of Biden's "infrastructure" bill (aka the tax-increase bill) is earmarked to *destroy* roads and bridges that have been deemed *racist*.
  - A new academic paper suggests an increase in misdemeanor prosecutions leads to higher crime overall.
  - Under pressure from the SEC, Robinhood is eliminating its "digital confetti" which celebrates trading milestones. No word if the SEC cares about family offices using 10:1 leverage.
  - A Portland high school is rethinking using the new nickname "Evergreens" because it is racist.
  - All four members of a northern California school board resigned after being caught on a "hot mic" on Zoom during which they were mocking and threatening parents.
  - Ark, the momentum-fueled "growth" investor, has launched a Space ETF that includes John Deere. The stated rationale is Deere uses drones for farming applications.
  - LG Electronics, once the third largest maker of smartphones, is quitting the business after six years of losses totaling $4.5b.
  - Pre-virus in 2019, people in the US ate about 50% of their meals at home. Post-virus in 2020, this number jumped to about 85%. Currently, the number has only nudged lower to about 75-80%.
  - After a Bloomberg article exposed the fallacy behind carbon credits/offsets, the Nature Conservancy is reviewing the way it calculates credits. Crux: Green groups have been selling credits on land that was not in danger of being deforested.
  - An Independent Director of Coinbase is a founder of the company who owns millions of shares.
  - The SEC allows "Independent Directors" to be on the Audit Committee.
  - Bitcoin trades at a significant premium in Korea. This stems from the Korean Won currency (KRW) being restricted - Koreans are willing to pay more for Bitcoin to get rid of their Won.

*We contributed to a similar deal collapse back in the mid 1990's while working for the old Barings Bank. We were large holders of a Mexican steel maker named Grupo Simec. After a nice rally, circumstances had changed; we were looking to sell. Coincidentally, the company announced it was doing a large stock offering. Morgan Stanley was running the deal. When approached if we wanted to buy on the deal, we politely told them we were sellers. We offered to participate in the deal with MS. They could manage our disposal along with the capital raising of the company. MS said no thanks. We proceeded to sell stock into the deal, on the deal, and after the deal. Morgan Stanley regretted not managing the deal better as the stock collapsed.

Trading: Our long exposure has increased organically – through market appreciation. That is always a good thing. But we are still leery of the overcrowded nature of the positioning. We increased our Put protection (we actually covered the short leg of our Put Spread). And we trimmed some more of our broad market longs. But we also increased our stock and sector specific bets. We increased our Recovery exposure including brick and mortar Retail, Materials, Financials and Energy. We still have a good amount of Big Tech exposure, but we have been trying to tilt it towards old Tech vs High Growth Tech.

TSLAQ: The Villain is fighting back against the National Labor Relations Board. Does the ever-escalating spat involve crashes, unsafe labor conditions, or something else worthy of management's time? No, Musk is fighting the order to delete from single tweet from 2018 that was deemed to discourage union voting. We agree with Musk that workers are better off not unionizing at Tesla. But wasting the time, money, and focus on a long-since forgotten tweet?

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