Weekly Update

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- Markets are still ugly with elevated Volatility
- Lots of short-term position adjustments going on
- Earnings are still underwhelming except for the good companies
- Business Survey's move sharply lower
- Johnny Paycheck is back
- Slight hiccup in Housing, but strong trend remains intact
- The Fed is trying to hold the line without stepping on (in) it
- The oil market is facing "triple deficits"
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,350	-4.0%	-8.7%	14.3%
QQQ	$344.57	-6.0%	-13.4%	5.5%
US 10 YR	1.87%	1.86%	1.51%	1.02%
USD/DXY	96.5	95.6	96.0	90.7
VIX	32.0%	23.9%	17.2%	37.2%
Oil	$86.98	0.5%	16.1%	66.0%

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

Not much has changed since last week. Volatility has remained elevated as the pain continues. Even the Fed's commentary after its policy meeting (FOMC) only seemed to confuse traders. At first the market was relieved that the Fed was not committed to shrinking the Balance Sheet in short order. But then the market feared that interest rate hikes could be coming more aggressively. We did not expect a lot of clarity from this meeting…and we certainly did not get it. Underscoring the anxiety in the market, traders are suddenly worried about Ukraine. Crimea was annexed almost eight years ago. And missile attacks by the Houthi in Abu Dhabi were somehow seen as bad for oil (at least this nonsense was discarded to the waste bin of financial journalism rather quickly)!

- Lots of short-term position adjustments going on

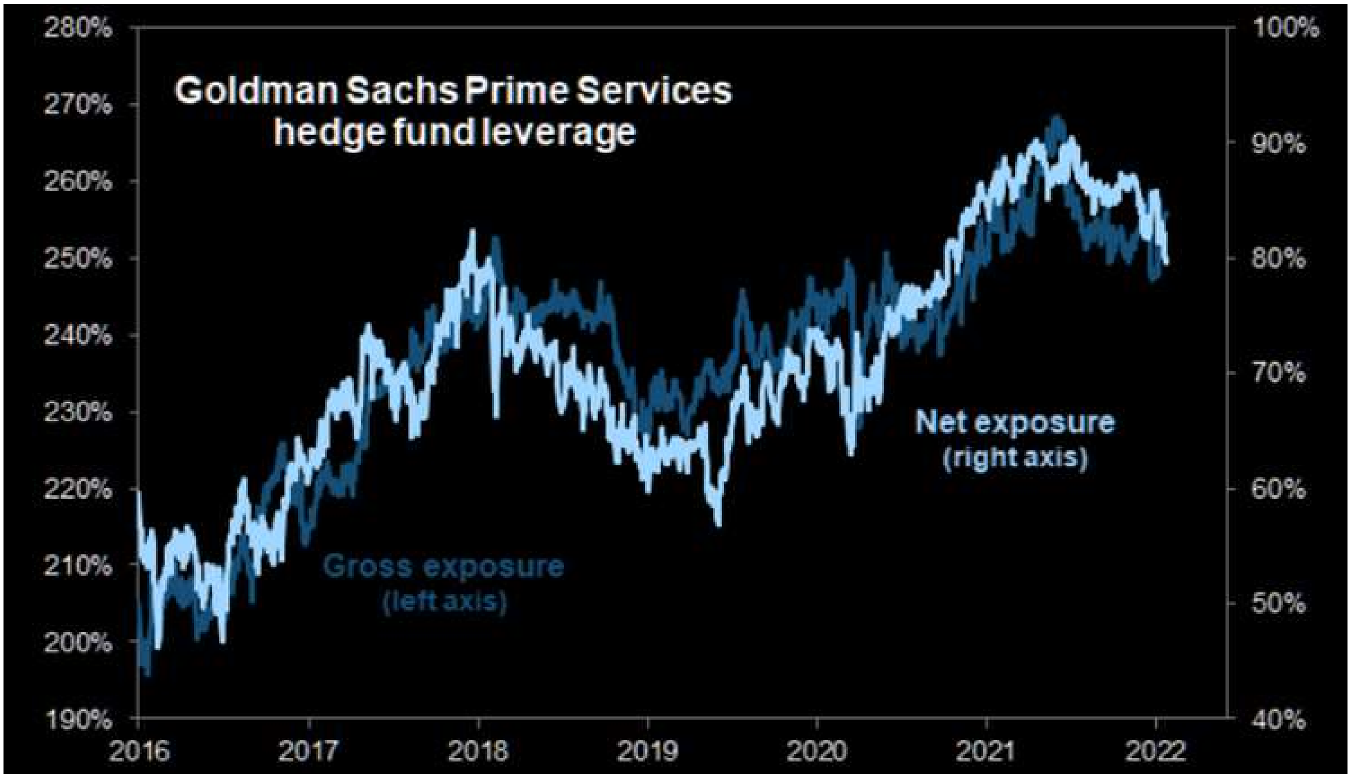
A recent and ominous trend in the market has been what can be best described by twisting a famous Mickey Gilley line into, "all the stocks get uglier at closing time." These late day sell-offs seem to be driven by margin calls for retail investors and option hedging for large trading books (either banks or hedge funds). With this trend being set, you have the professionals trying to front run this action which obviously only exacerbates it.

We started seeing the rumors that usually accompany this type of panic selling. One in particular was that Melvin Capital was down 25% this year. Recall that Melvin was the fund that was short GameStop last year and needed a bailout. So now Melvin is long all the garbage getting hit? On Monday, we finally saw "the dip" being bought. Some option gurus said the "gamma" had flipped which just means they panicked and sold too much at the low which led to panic buying. On Monday, indeed, the girls were all prettier at closing time. But this bounce was fleeting. Other bounces have since been sold. It seems the new mantra is to sell the rip instead of buying the dip. We suspect margin clerks and option hedgers will remain busy.

Obviously real selling has been happening in addition to the technical stuff (margin calls and option hedging). Wall Street's research "strategists" are all over the board with respect to the extent of this. According to the Merrill Fund Manager Survey only 7% of investors are underweight stocks (as of 10 days ago, so this could quite stale now). Moreover, 71% expect a "boom" in global growth and earnings expectations. Considering we have already seen earnings growth slow down (which is only natural after the huge contraction in 2020 followed by the huge expansion in 2021), we are not sure what these investors are seeing. There are some other contradictions in the data. Investors think inflation is transitory. But at the same time, they are overly long Commodities (record high weighting) and Financials…both of which do well in an inflationary environment.

There have been some reports that corporate buybacks have slumped a bit from early January levels. Some have been calling for corporates to "come to the rescue" in this current market downdraft. This has certainly not happened yet and for good reason. Companies have blackout dates before Earnings during which they *cannot* buyback their own stock. Buybacks are likely to pick back up as the Earnings season passes. Of course, this should mostly benefit the large, Quality companies with strong balance sheets that can actually buyback stock instead of being serial sellers of their own stock.

And Goldman's prime brokerage unit (fancy word for custodian for hedge funds) has data showing some deleveraging has been happening. Some even frame this chart as showing hedge funds have "ammunition" waiting to be deployed. It sure seems like there is more de-leveraging to go. Unshockingly, it is rumored that the most leveraged hedge funds were loaded up with the profitless growth companies (riding the Ark into the storm with nowhere to go).



- Earnings are still underwhelming except for the good companies

With about 20% of the S&P 500 having reported, only 50% of companies have beaten on Earnings Per Share (EPS). This is low compared to the virus-era average of about 67%. And Guidance has actually turned negative: More companies are lowering future earnings expectations than raising them. The sample size is still small, but Staples and Health Care are the only sectors to see guidance upgrades. More anecdotally, it seems to us that the more mature, Quality companies are showing better results. Some are even up during the manic downswings! This just reinforces our stance that we want to be long Quality and avoid themes or stories.

- Business Survey's move sharply lower

The early read (Flash) on Markit's PMIs was ugly and confusing. We have noted the slowing of this survey data. But January took a sharp decline back near the breakeven level. Manufacturing is still hanging in ok. Services took a big Omicron hit. But New Orders for Manufacturing were weak and strong for Services…exactly the opposite of the current conditions! And Inflation continues to confound. Here is the line from the report, "the rate of increase in costs (input inflation) was the slowest since last March, albeit sharper than any prior period in the series history." Whatever the case, the economic slowdown we have been expecting is coming to us sooner that we thought!

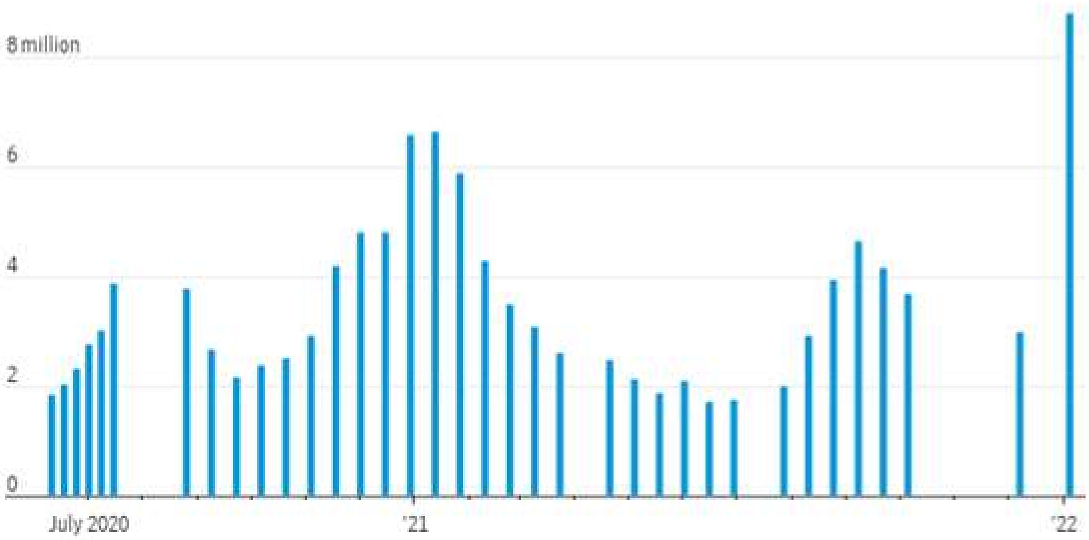
The Philly Fed's Manufacturing Index showed surprising strength in January. This counters the poor NY Fed's Empire Manufacturing from last week. These regional surveys need to be taken in aggregate.

European PMI's showed a similar pattern to the US with some strength in the Manufacturing segment. But Services were lousy (51.2). Rising costs are still the main concern…no surprise there. This was most evident in the UK survey.

- Johnny Paycheck is back

Right when people were starting to return to work, we saw a huge jump in “sick-out” behavior. Originally it was just the teachers and stewardesses that were not showing up to work. But the situation worsened. Alas, we think with the crumbling of the various political narratives around the virus (no more vax mandates, mask mandates falling, CDC questions about the efficacy of booster shots, people just sick of the illogical contradictions, etc), the ability for people to get paid not to work is coming to an end. Perhaps this is wishful thinking on our part. And it certainly has taken WAY longer than we first thought (we thought the end of pandemic employment benefits last fall would be the trigger). But with the wealth effect having eroded for much of the Family Guys on the couch (aka the Robinhooders and Cryptokings) along with higher wages, we might see a resumption of job gains.

Number of U.S. adults who didn't work because they were sick with, or caring for someone with, coronavirus symptoms



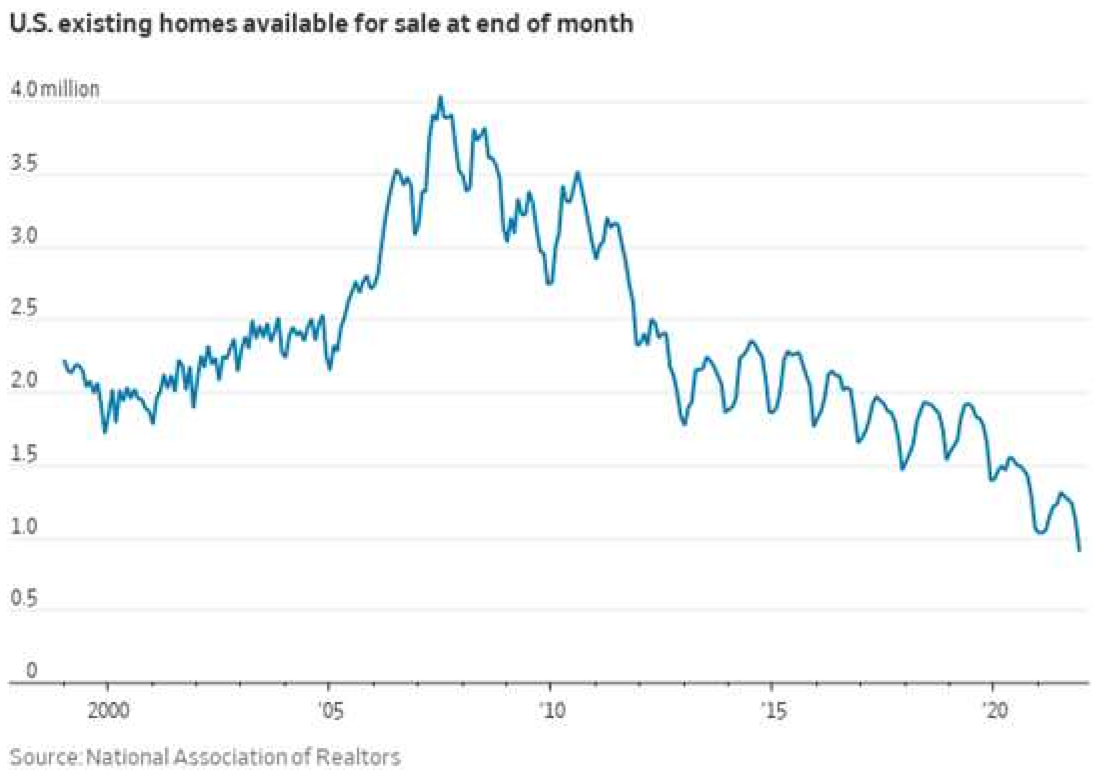
Source: Census Bureau

- Slight hiccup in Housing, but strong trend remains intact

Existing Home Sales in December slipped to an annual rate of 6.1mm from 6.5mm in Nov. This is a surprising downtick after last week's stable Housing Market Index (home builder sentiment) and robust Housing Starts and Permits. But New Home Sales in December were much stronger than expected rising back near the strong levels of the spring. The median price was $378k which is an 3% increase vs Dec 2020 (November's increase was over 18%). This relative slowdown stems from fewer high-end homes being sold.

One other stat we have written about is the number of homes under construction. These still far outstrip the number of homes being sold. This is the old supply-chain and labor disruption problems still. Demand is still robust. But considering the number of houses under construction is the highest monthly run-rate since 1973, there is some potential risk for builders if demand were to quickly evaporate (made worse if interest rates shoot up quickly). This data is chart crime-esque since it is not adjusted for population or housing trends. Even so, we do not think we are heading down this path: Owning a house is still cheaper than renting as we have reported, and we still have the migration theme. Nonetheless, it is worth watching.

And even if there are too many new homes being built, the inventory of existing homes continues to slink lower.



- Other economic data remains mixed

- Retail Inventories increased 4.4% in December vs Nov.
- Wholesale Inventories increased again with December up 2.1% vs Nov.
- Consumer Confidence slipped. Inflation expectations declined for the 2nd straight month.
- Redbook Retail Sales increased 15.6% (weekly vs 2021). The early Jan dip might be reversing.

➢ The Fed is trying to hold the line without stepping on (in) it

The Fed delivered the confusing message we expected. It will stop buying bonds in March (why are they still buying bonds????). Interest rate hikes will start at the same time. But there was a noticeable absence of commentary on the reduction of the balance sheet: there is not a plan to start selling bonds any time soon. Reemphasizing this, the Fed reiterated that the main monetary policy tool is the Fed Funds rate (and thus not the balance sheet). Some called the statement, “tame” as chairman Powell referenced the virus and the probably easing of bottlenecks. We think a better description is typically ambiguous Fed-speak. Unfortunately for the market, Powell’s press conference (as opposed to the released commentary) exposed more of the underlying feelings of the Fed. That is, inflation has persisted higher and longer than thought. And there is more risk to the upside on price increases. The market immediately priced in five hikes this year up from the expected four. There is even a 30% chance of six rate hikes this year.

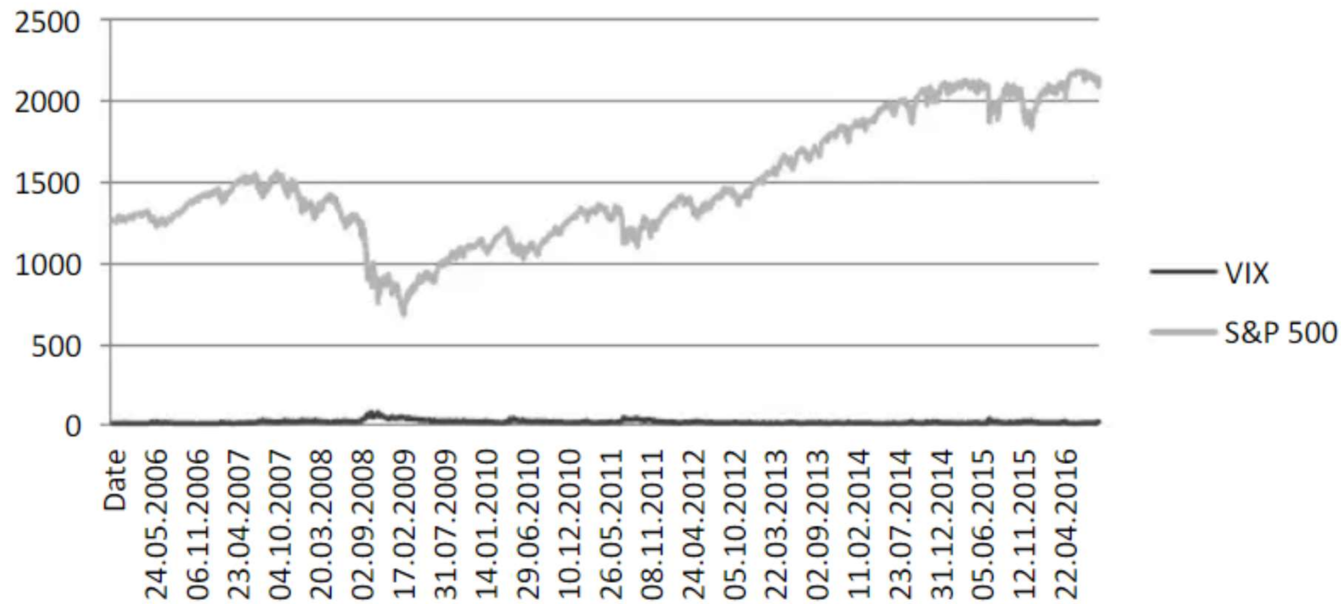
We still think the Fed has more bark than bite right now. if the economy slows (more) or the market drops (more), then Powell will likely ease off the brakes. But the Fed will never admit a mistake…or at least not quickly. We know this from the long-running persistence of the “transitory” term to describe inflation. So, they will keep talking about policy until they are forced to stop. (For the record, we still maintain that the Fed should have started raising rates a year ago. And there was no reason to continue buying bonds. But now it might be too late. Typical.)

➢ The oil market is facing “triple deficits”

Morgan Stanley summarized their bullish view on oil succinctly. They see “triple deficits” looming: Low inventories, low spare capacity, and low investment. This pretty much sums up our bullish view on oil. Oil prices and inflation clearly go hand in hand. And while we expect some moderation in inflation, we think this can happen (easing of supply chain issues, growing labor force, softening aggregate demand) without oil prices falling too much (they will likely be volatile just like everything else).

➢ Chart Crime of the week

This one is up there in the annals of chart crime idiocy. Comparing two data series that are thousands of points different? Comparing one data series that fluctuates by nature (market) vs one that is mean reverting (Vol)? Oh, the humanity!



- Quick Hits
  - The Fed owns 32% of all mortgage-backed securities (MBS).
  - King of the crappy SPAC, Chamath, ranted on a podcast that he does not "care about the Uyghurs in China."
  - According to an MIT research paper, the Paycheck Protection Program's (PPP) $800b in handouts when predominantly to business owners. Only about 27% of the total went directly to workers who would have otherwise lost their jobs.
  - The Queen of England is launching a line of condiments called the Royal Estate.
  - South Africa's unemployment rate hit 35% in 2021.
  - A hedge fund is trying to buyout the casino company Bally's. The hedge fund guy happens to be the chairman of Bally's.
  - 33% of public companies in the US use a foreign accounting firm to perform at least some of their internal audit.
  - The congressman bringing a cannabis bill says, "there are three things that really bring people together – animals, Britney Spears, and cannabis."
  - Some academic researchers claim to be able to make a car battery out of hemp.

Trading: Not much has changed. We slowly bought some Staples and the like. We lightened up on Tech on the small bounces. We are keeping are cash levels high. We will continue to buy dips very slowly…and we will indeed sell the rips. We also added some Puts (short exposure) on the ARK junk. This profitless stuff will have plenty of short-covering jumps. We will just increase our short exposure. The benefit of shorting ARK is the funds will have withdrawals so the manager will be forced to sell the assets.

TSLAQ: A tweet from a very serious CEO right before an earnings release (which was ok on the surface but loaded with the usual qualifiers and adjustments. It is still a house of cards no matter how many cars it sells).

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