Weekly Update

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Carlisle C. Wysong, CFA
Managing Partner

- The market continues to chop around
- Market flows are not following their historical trends
- The Jobs Report looks like Stagflation, but the data is confusing
- Job Openings decreased but they are still near the peak
- Non-pandemic inflation is picking up steam
- UK inflation is racing, but is it transitory?
- But is global Manufacturing starting to find some inflation balance?
- Are Houses that expensive? Maybe not in relative terms
- But Home improvement seems to be slowing
- The market does not believe the Fed will not be raising rates
- Chart Crime of the week
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	Last	5d %	YTD %	1yr %
SPX	4364	0.0%	17.3%	25.2%
QQQ	360.0	0.1%	15.2%	22.9%
US 10 YR	1.54%	1.58%	0.92%	0.73%
USD/DXY	94.0	94.2	89.9	93.4
VIX	18.6%	19.5%	22.8%	26.4%
Oil	80.61	4.1%	65.8%	100.1%

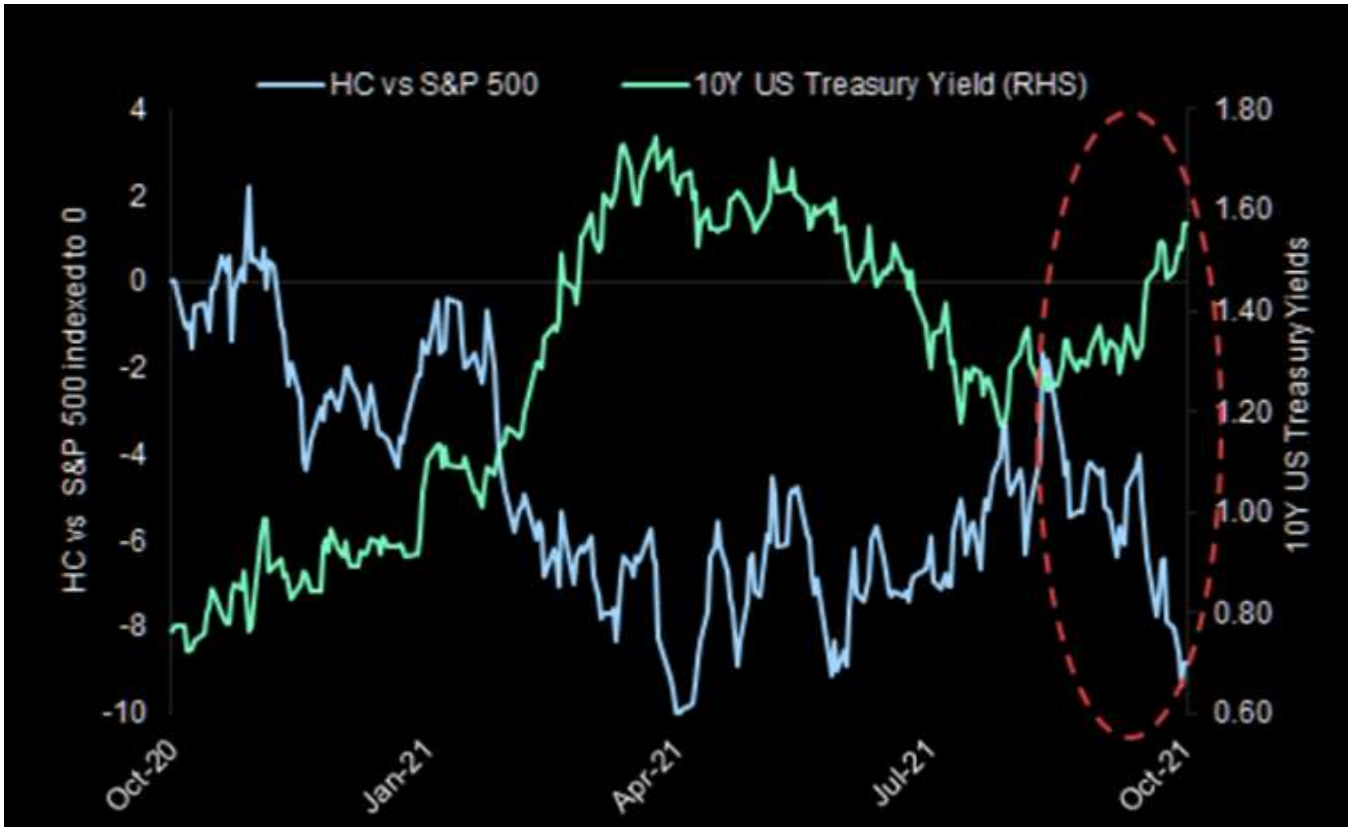
*10yr, DXY, and VIX are levels not changes
** Oil is front month futures, beware

The market continues to chop around. After last week's relief rally from the temporary resolution of the debt ceiling ritual, a few of the tried-and-true narratives took some steam out of the bounce. Logistics and the supply chain snafus are front and center. Apple had previously noted that hard-to-find semiconductor chips might slow production. Apple did not quantify the potential drag. But Bloomberg is reporting that it will be about a 11% (Apple bulls say this will nothing more than a small speed bump that pushes sales into next year). The Biden administration is no closer to any of its myriad money-pumping programs (some worthwhile, many crony capitalism at its worst). Regulation is still an albatross hanging around the market's neck. Inflation continues to run hot…even the Fed is slowing dropping the "transitory" from its messaging. Another China property developer is about to default on a bond payment. Modern Land has asked its creditors if it can defer a $250mm principal repayment. Its bonds had already collapsed from $0.72 on the dollar to about $0.25. Needless to say,

the residential property market is collapsing. Sales volumes have fallen approximately 25% in September vs last year. We still think the bagholders will be the USD debt holders who are being told by the Chinese, to paraphrase Otter, "you messed up, you trusted us." But we still think this economy is back in growth mode…at least for now.

- Market flows are not following their historical trends

We often note Merrill's customer's flows. We think their composition is important because their client base covers every segment of the investing population. ML research tries to put some context to the flows comparing them to other periods of similar economic statuses. Currently, ML calls this "Late Cycle" which seems reasonable to us. That is why we suspect one last push of the Reopening before the economy starts to cool. Oddly, or maybe not so much given the anomalous nature of the virus and its stuttering impact on the economy, ML clients have not followed the traditional pattern of buying Health Care, Real Estate, and Industrials. In fact, these sectors have seen outflows. Moreover, Big Tech has also seen strong selling (usually a winner in Late Cycle environments). It is hard to use the playbook when the game is different! Back to Health Care, here is a chart from Themarketear. It shows that HC has underperformed the S&P 500 when interest rates have moved higher. This move is telling us that we are not Late Cycle!

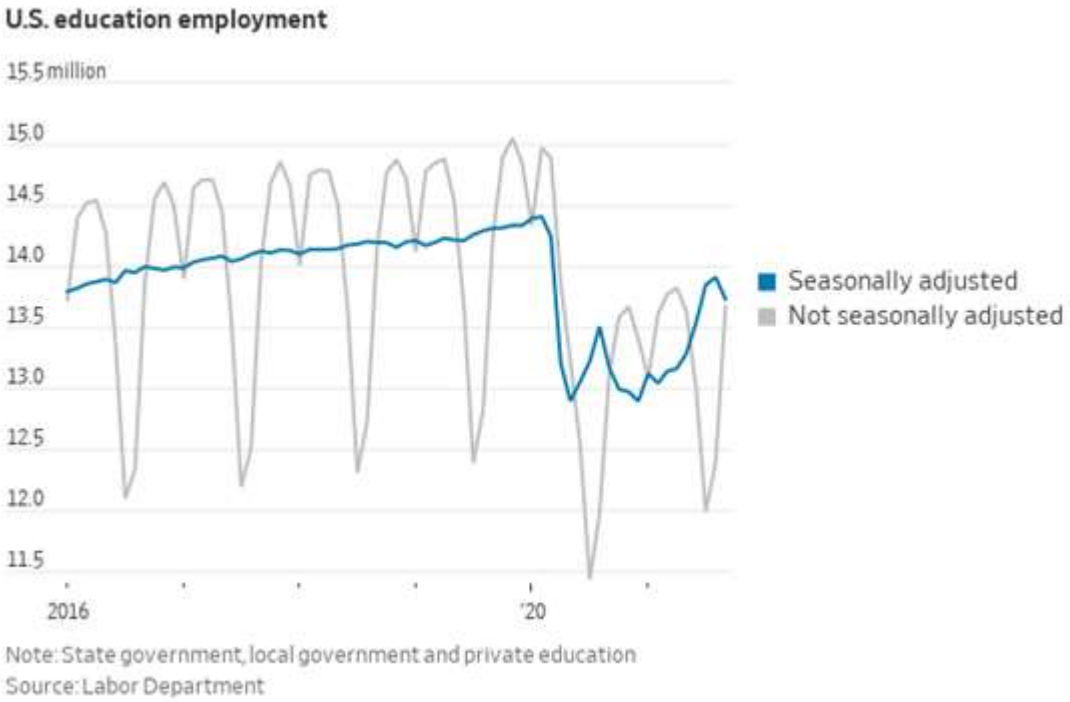


- The Jobs Report looks like Stagflation, but the data is confusing

Nonfarm Payrolls (NFP) only increased by 194k in September vs an expectation of over 500k. But August was revised up by 131k. And while Private Payrolls fell short, it was Government Jobs that really missed the mark. But as we have tried to explain before, this data is very convoluted. Technically, there was an increase of education (government) jobs. But because the increase was lower than the usual back-to-school period, this

increase actually registers as a decrease. This is one of the many "seasonal adjustments" that make economic data a minefield. The official Unemployment Rate fell to 4.8% from 5.2%. This is partially a function of actually counting the number of people at work (and not stripping out season adjustments). But the UE rate also fell because the Participation Rate dipped and is still lousy at 61.6%. Interestingly, almost of the workers leaving the labor force recently have been women. This is largely a result of the lack of daycare. 4mm people claim to not be working because they have the virus or are caring for someone with it (we call bs on this).

Average Hourly Earnings continue to increase. This is a double-edged sword: it is inflationary for businesses, but at least workers are getting paid so they can keep up with the other inflationary pressures. To sound like a broken record, we are still waiting for people to not take their jobs and shove them.



- Job Openings decreased but they are still near the peak

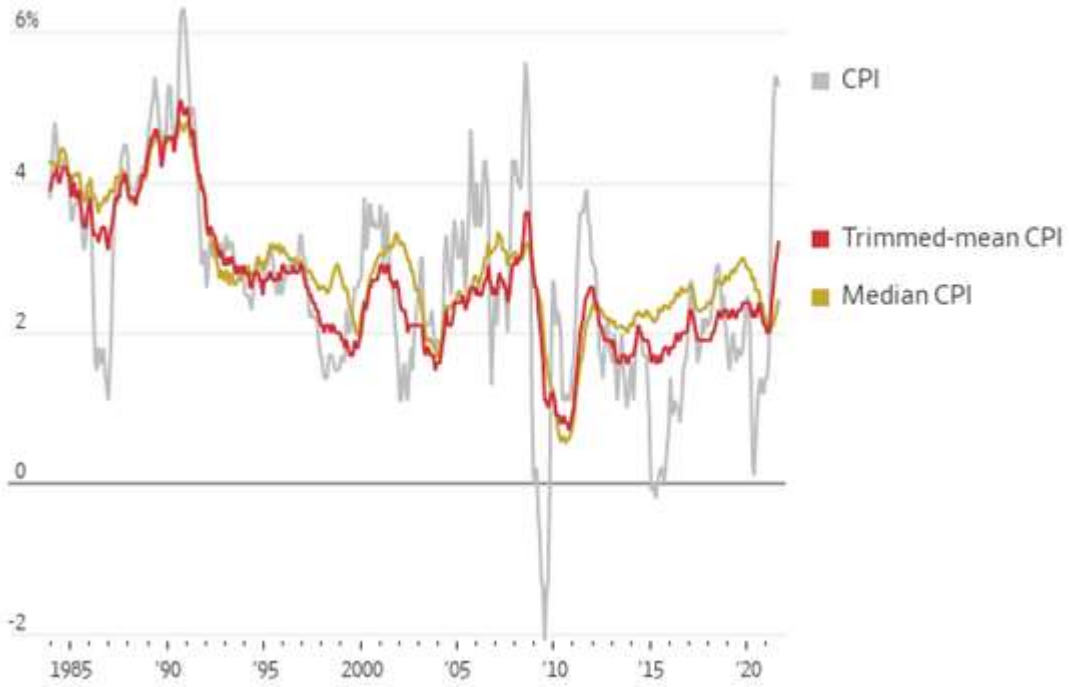
The number of available jobs per the JOLTS report from August (Job Openings and Labor Turnover Survey) slipped from 11.1mm to 10.4mm. But this downtick hardly registers when juxtaposed with the range of Job Openings from 2015 to 2020 which was 5mm to 7.5mm. Furthermore, a survey of small-business owners (by the National Federation of Independent Business) found that over half of them had job positions that they could not fill. Going back to the JOLTS, 4.3mm people quit their jobs in August! This is about 2.9% of the total workforce. Leisure and Hospitality workers led the quitting charge with about 6.5% of the total.

- Non-pandemic inflation is picking up steam

One of the reasons we have been changing our tune on inflation (not so transitory after all) is that the price increases are spreading. They used to be focused in certain sectors (used cars being at the top of that list). The various "trimmed mean" inflation readings showed that the middle of the pack price increase was still just average (that is, still very low). But these indicators that exclude the big price jumps have been ticking higher –

prices for every day goods have been increasing. These price increases still trail the headline (the grey line in the chart), but the trend is clear. A usually rosy economist accidentally let it slip that the only way out of this price spiral is a recession. We do not think it goes to that extreme, but unless Family Guy returns to works, we still think growth will slow after a near-term surge with the fall Reopening and a strong Christmas. One thing to note, today's CPI reading was 5.4% compared to August's annual rate of 5.3%. The "Core" inflation remained the same at 4.0%. And we still maintain that the expectation of future inflation feeds into today's inflation. The Atlanta Fed's Business Inflation Expectations survey predicts inflation of 3.1% in a year.

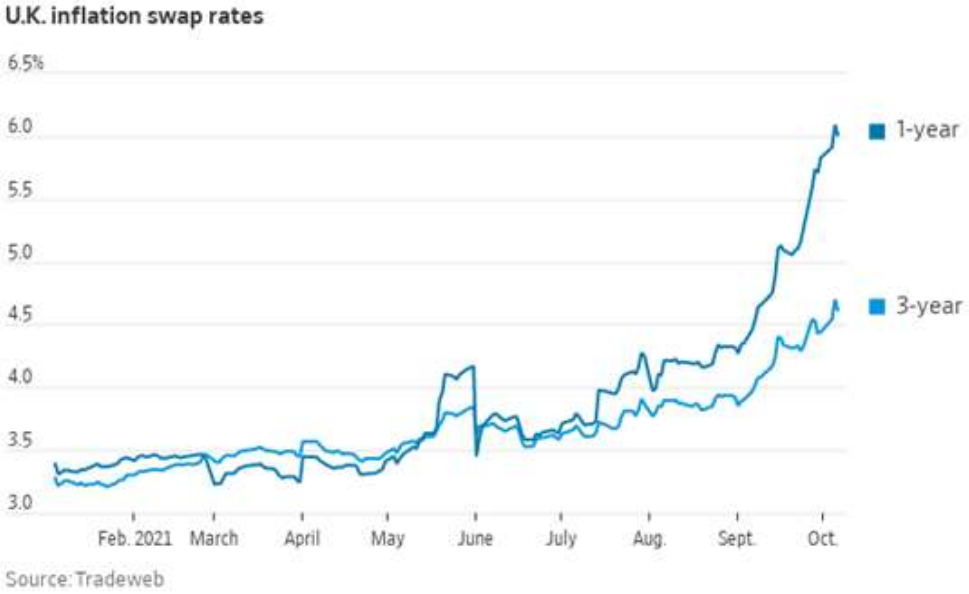
Consumer-price index, percentage change from a year ago, vs. Cleveland Fed's alternative measures



Note: Trimmed-mean CPI excludes most extreme price changes. Median CPI captures the median price change.
Source: Federal Reserve Bank of Cleveland; Labor Department

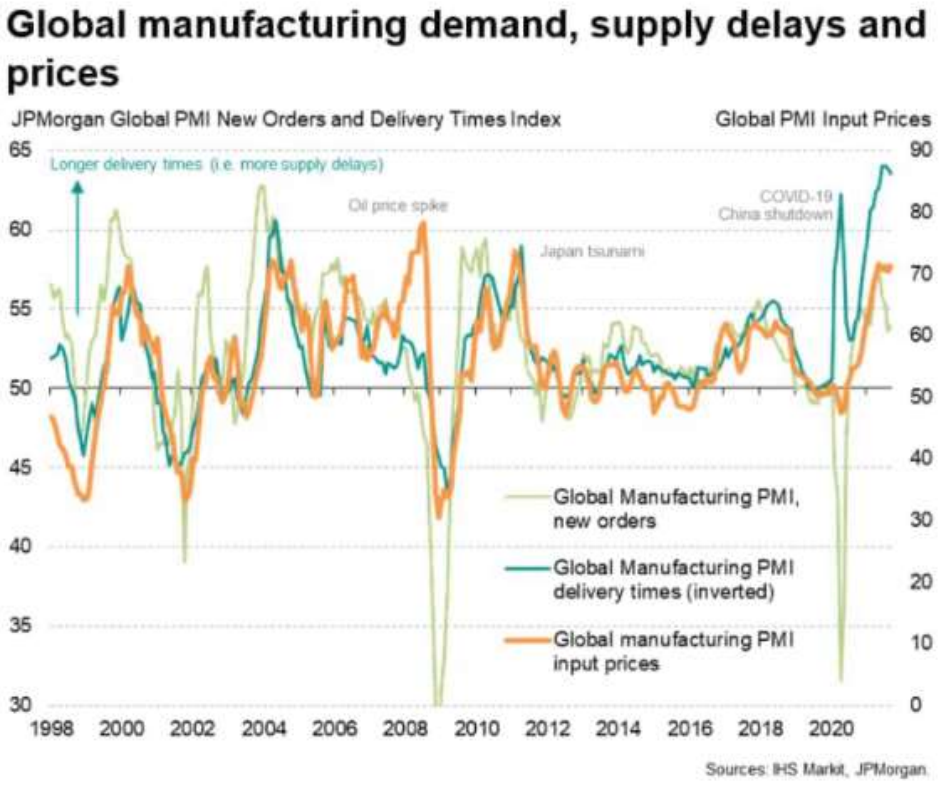
- UK inflation is racing, but is it transitory?

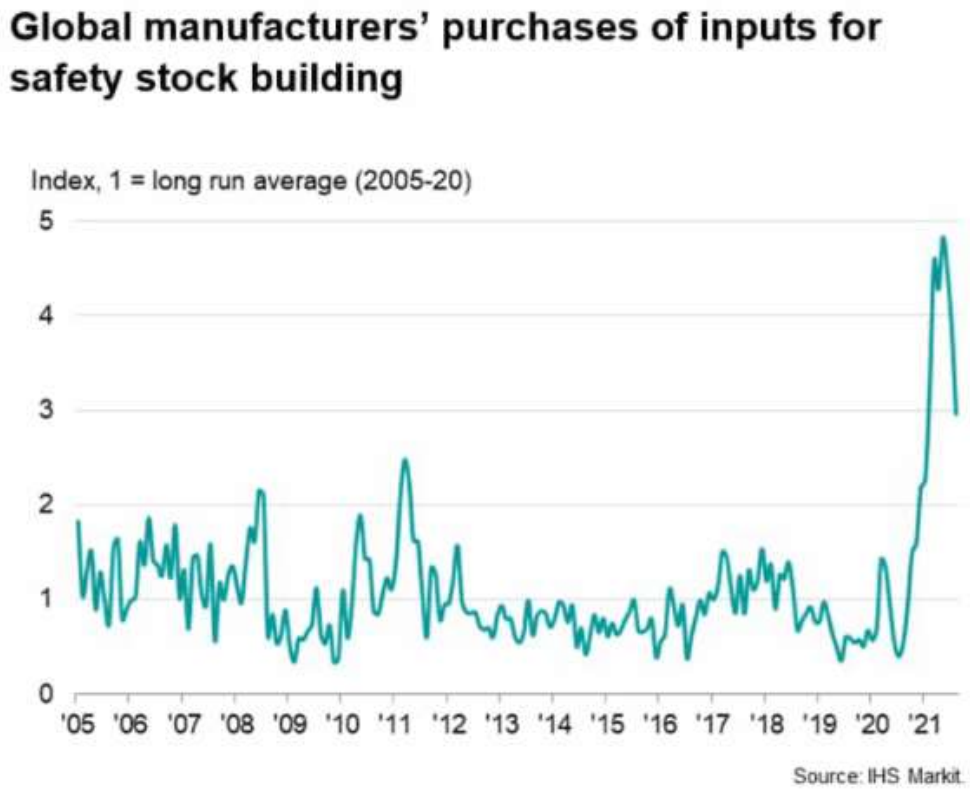
We think this chart of the different periods of inflation expectations in the UK is reflective of current inflation dynamics. We do not think the Fed mean late 2022 when they first introduced the term "transitory."



- But is global Manufacturing starting to find some inflation balance?

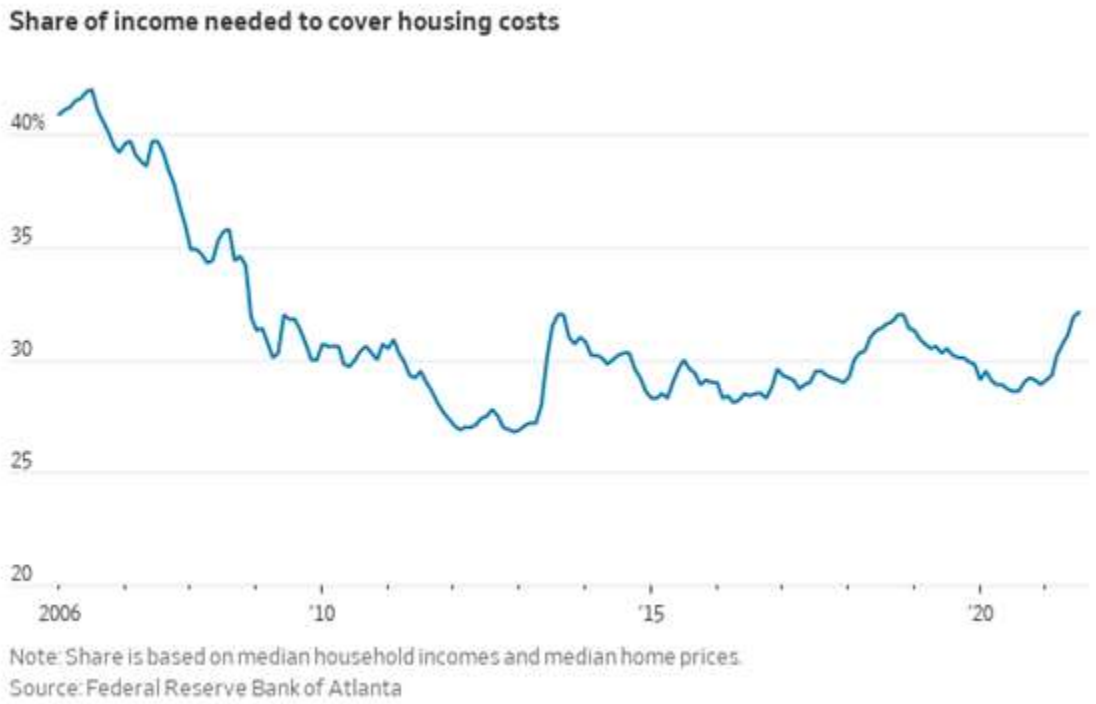
It appears that businesses are starting to dial back the race to restock or beat future price increases. Delivery Times are still slow. And Input Prices have only leveled off. But New Orders have turned south (in rate-of-change terms). And the second chart is even more clear. The purchase of inputs for "safety stocking" has reversed course. It still has a way to go. But it looks like the panic rush to buy stuff is over. We do not think prices normalize back to the sub-2% days, but we think the upward spikes cool. In the meantime, we still want long exposure to inflation.





- Are Houses that expensive? Maybe not in relative terms

The Wall Street Journal ran a story detailing the rising cost of homes. Ok we know that much. But the article's slant was on the relative cost of homes. It cites the Atlanta Fed's data showing the percentage of income it takes to cover the mortgage payment on a median priced home. Sure, the level has risen this year, but it still seems manageable looking at the last 15 years. We do not have any direct exposure to Housing right now. But we have slowly been turning positive on the sector (again). Higher interest rates are a real impediment to us getting long again.



- But Home improvement seems to be slowing

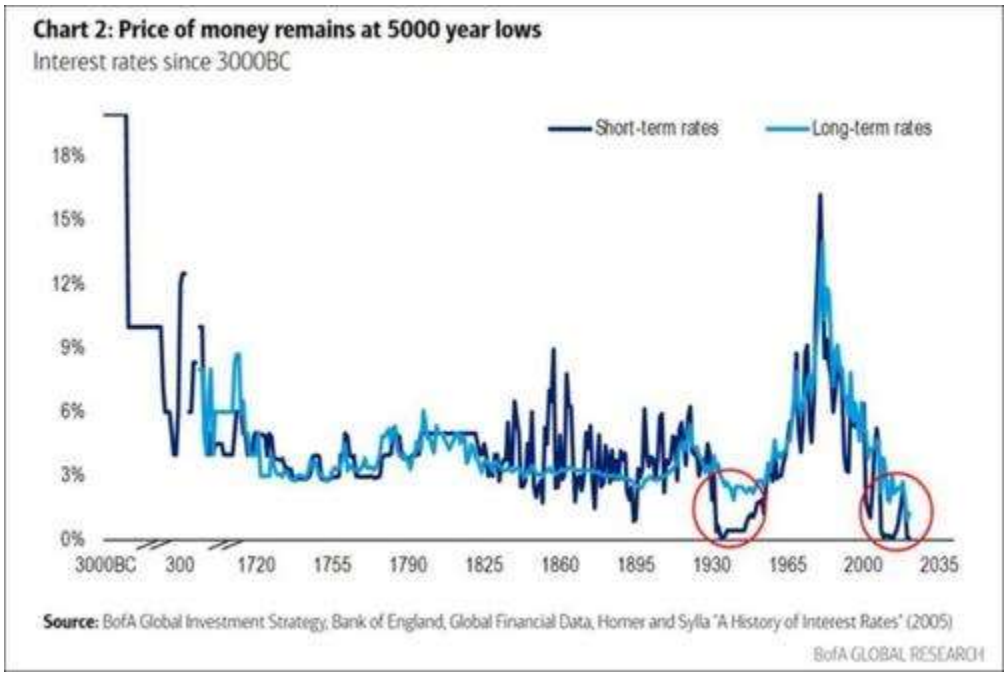
A US decking contractor survey (we guess there is a survey for everything) tells us that demand for decking slowed substantially in 3Q. Unsurprisingly, cost is cited as the number one reason for the decline in sales. While demand is expected to pick back up when/if prices cool, some in the analyst community think it will be tough to sustain the lockdown-induced frenzy of home improvement.

- The market does not believe the Fed will not be raising rates

The Federal Reserve's Open Market Committee minutes from the last meeting contained no real surprises. They will likely start the $15b monthly reductions around late November or early December. This amounts to eight months to eliminate the $120b in current bond buying. The Fed also reiterated that the slowing and eventual elimination of bond purchases does not provide any signal about interest rate hikes. Nonetheless, the committee does now see risks to the upside on inflation (Bostic of Atlanta just joined this chorus publicly). Surveys (like Merrill's Fund Manager Survey) have been telling us that investors think inflation is, indeed, transitory. And some of the out-in-time inflation market indicators for inflation have only been showing modest upticks in inflation expectations (these are tradeable securities not just professional guessers guessing). But the Fed Funds Futures are telling us a different story. A month ago, the market had the first interest rate hike coming in December (56% chance). But now September is the odds-on favorite (more conviction with a 64% chance).

- Chart Crime of the week

Ladies and gentlemen, we have a 5,000-year chart (with a scrunched x-axis to boot). Hat-tip to our old macro-guy Phillip for finding this one.

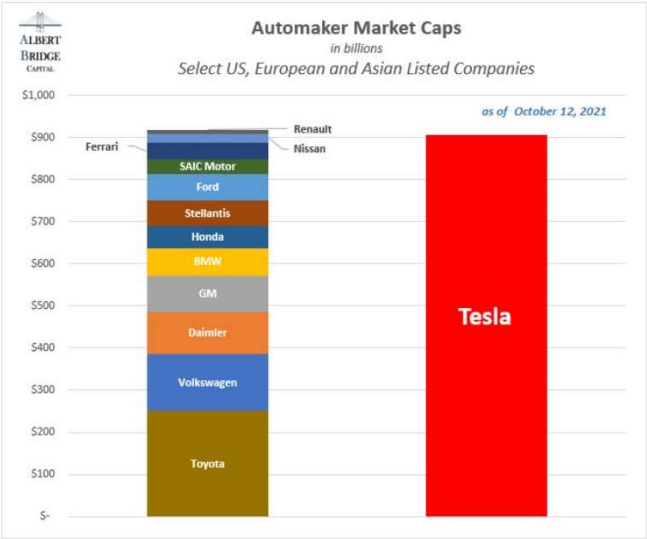


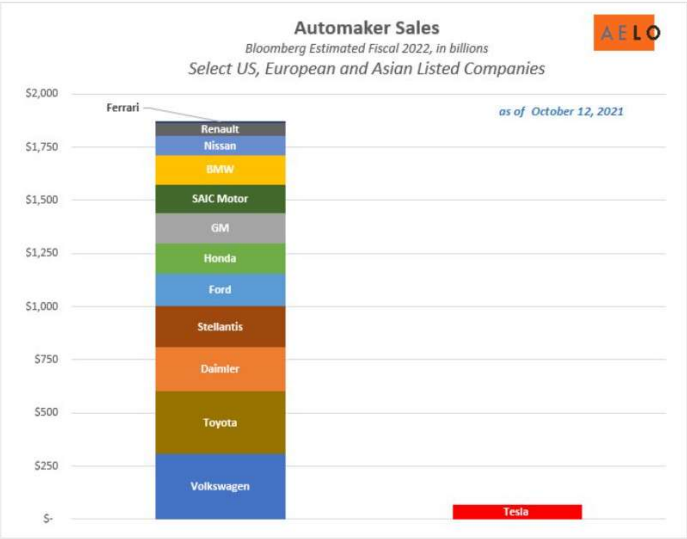
- Quick Hits
  - 57% of adults currently hold a job.
  - The Food Stamp Program benefits (or SNAP after Obama changed the name) are on track to double in 2021 vs 2019.
  - The NY Times ran a story saying child Covid hospitalizations reached 900k during the pandemic. The NYT ran a correction saying the real number was 63k.
  - The most followed college athlete on social media is gymnast Olivia Dunne.
  - With respect to the virus, the nationwide percentage of Total Recovered out of Total Cases is about 80%. In California, only 53% of infected people have Recovered.
  - California is banning gas-powered lawn mowers. When we were living in London, we had an electric lawnmower. Mrs. Chalk Creek accidentally mowed over the instructions. Yes, they were needed. And yes, she really was mowing the lawn.
  - Maybe the dumbest member of Congress does not know what the word "erased" means?

Trading: We find ourselves going back and forth on a lot of the narratives lately (the real ones like economic data and earnings). Ultimately, we think inflation is not transitory, but it will not be the 1970's all over again. Growth is near its peak, but that does not mean there is not more gas in the engine. But we still will have a quick trigger finger if we get that one more burst we are expecting.

We made a few small trades around the edges. We added a little broad market exposure. We bought a tiny slice of Japan (and long the Yen). We added to our short exposure (via Puts) in some of the wildly overvalued parts of the market. This stuff is always tricky…there is no telling when the market will come to its senses. Therefore, we are tip-toeing. We sold another slice of our long Energy exposure. We believe tin the inflation theme, but we also think we have to be booking some profits in this kind of choppy market.

TSLAQ: Tesla is officially moving to Texas. We are happy for the jobs, and it is a no-brainer for Musk personally. He will avoid paying local California taxes on approximately $25b worth of stock that he will be selling later this year. He has options vesting, and he will owe the taxes on them. He must sell since he is "cash poor" as he says. But this does not mean we are going to cut him any slack for his shotty product, dubious accounting, and fraudulent behavior (namely the vaporware he sells under the cover of "Full Self Driving"). Here is a simple refresher on Tesla's stock market value and sales compared to the rest of the world's car makers.





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