Weekly Update

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- The narrative shifts again
- Poof, there goes more crypto money
- China is still locking down, just ask Apple
- Positioning was getting bearish again…just in time
- Earnings are still way above the trend
- Peak Inflation? Probably, but it does not really matter
- Employment is slowing more than it appears
- Natgas goes negative, seriously
- The Fed has not changed its tune
- Quick Hits
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	3,956	6.4%	-16.0%	-14.3%
QQQ	$282.75	8.5%	-28.6%	-28.0%
US 10 YR	3.82%	4.10%	1.51%	1.57%
USD/DXY	108.4	112.1	96.0	95.2
VIX	23.5%	25.9%	17.2%	17.7%
Oil	$88.45	-1.9%	15.3%	6.6%

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

Wow. The narratives are shifting gears faster than Bo Darville in route from Texarkana to Atlanta. Last week, the Fed "pivot" was gone, and the market was back to focusing on earnings misses and garbage companies incinerating cash. Economic data was decelerating but not fast enough to bump the Fed off course. Musk's empire was starting to show (more) cracks. We even got some new-fashioned fraud (shocker – in cryptoland) exposed which spooked the market (who exactly has exposure?). The midterm elections were probably a nonevent for the markets (gridlock with the possible exception of more regulatory headwinds). China sure does not seem to be easing back on the 0-covid policy…quite the contrary. But then came today's inflation number. It was modestly better than expected signaling we might be past peak inflation. The Fed pivot gang was back in full force. The pure junk of the market rallied 15-20% while the headline indices jumped 6-7%. These are epic moves for a pure hope-rally. While we are dismissive of this "pivot" rally, we are noting that the bond market did respond as though there was some merit to the hope trade (recall the 2yr Treasury did not rally

during the previous hope trades). The same goes for the USD weakness. Since we have been trimming some shorts lately, we have the capacity to add them back. But we will be patient and methodical as these knee-jerk reactions are impossible to judge.

- Poof, there goes more crypto money

One of the bigger frauds in history collapsed this week with the undoing of crypto exchange FTX. In a nutshell, the exchange was using customer deposits of cryptocurrencies as collateral for loans to its trading partner so it could buy more cryptocurrencies! Moreover, FTX was issuing its native token "FTT" to its trading arm to do the same shell game. This awkward arrangement was revealed in a Coindesk article. And it likely goes much deeper than this as the unregulated crypto world is up to its eyeballs in derivatives. Binance, the larger rival to FTX in the crypto exchange space, tweeted that they would be selling their roughly $2b worth of FTT (some have it reported as being only $500mm…exact size probably does not matter). FTT is highly illiquid. There is no reason to ever advertise your intention to sell something illiquid (especially something made up from nothing). Unless, of course, your intention is to drive that price lower and harm the ultimate holder of the tokens. FTX tried to put on a brave face, but the bank-run was on. Binance swooped into the rescue…it would be saving its rival for the good of the crypto "community!" Alas, after some "due diligence," Binance backed out of the deal. It is clear to us that Binance never had any intention of saving FTX. Its faux savior-gesture was only to dissuade any other potential investors from helping. And it worked. FTX's $32b market cap was down to $0 (according to private investors involved in the company). FTX's founder, the bizarre Sam Bankman-Fried (aka SBF), saw his $16b fortune (who knows what the exact number was) evaporate overnight. Of course, he probably has money tucked away where no creditors/investors can every see it. There is one report that he has 10 condos in the Bahamas worth $180mm. He used these as a barracks for some of his employees. Where were the warning signs?

The irony is that SBF actually earned his first billion through hard work and clever genius. He essentially discovered a geographic arbitrage in crypto (he would buy in the US and sell it in Asia at a premium…much easier said than done). And then when this arbitrage was gone, he realized the best way to make money in crypto was to be the toll-taker…not to take directional risk. Obviously, this lesson was lost somewhere along the way.

We have been short crypto-linked equities and will remain so until they are at their rightful place in history…the dustbin.

- China is still locking down, just ask Apple

Apple warned of lower iPhone shipments after the lockdown at the Foxconn plant (which we described last week as a risk/sign than China's 0-Covid policy was not wavering in the slightest). The company reiterated that demand is fine. But the skeptic in us thinks there could be some wishful thinking being projected. And as we stated last week, it is not a coincidence that a Taiwanese supplier of *the* US company was targeted. Along the same lines, we started a short in Big China Tech – the ones listed in the US. We can easily see Xi further cracking down on the communist-forsaken capitalism...especially if it hurts the US holders of the fictitious tracking stocks (recall these securities are just total return swaps, or Variable Interest Entities, that have no true equity claims on the companies's earnings).

- Positioning was getting bearish again…just in time

We wrote this section before today's bounce. We think it still fits.

Last week we highlighted that positioning in equities was no longer bearish. But we think this changed rather quickly given the immediate market reversal upon hearing Fed chairman Powell's hawkish comments (higher rates for longer). Merrill says last week had the largest outflows since April of last year. And Goldman says CTAs are short equities. (Commodity Trading Authorities which is a misnomer, these are just momentum funds that can trade any asset class). With renewed market weakness, these momentum investors will likely press their shorts exacerbating performance. The caveat is these guys will turn tale and cover feverishly if there is another fake "pivot" or whatever bounce.

One major contrarian indicator is that of the Wall Street strategists. This group, mostly being wrong all year, has collectively shifted to a much more bearish stance. Merrill notes that when this group is this bearish (measured by percentage equity allocation), equity returns were positive over the following year 94% of the time with a 22% median return! We wish their chart had an S&P 500 overlay, but ocular inspection tells us the strategists usually get it wrong.

Exhibit 1: Equity sentiment ticked down in October
Sell Side Indicator, 8/1985-10/2022

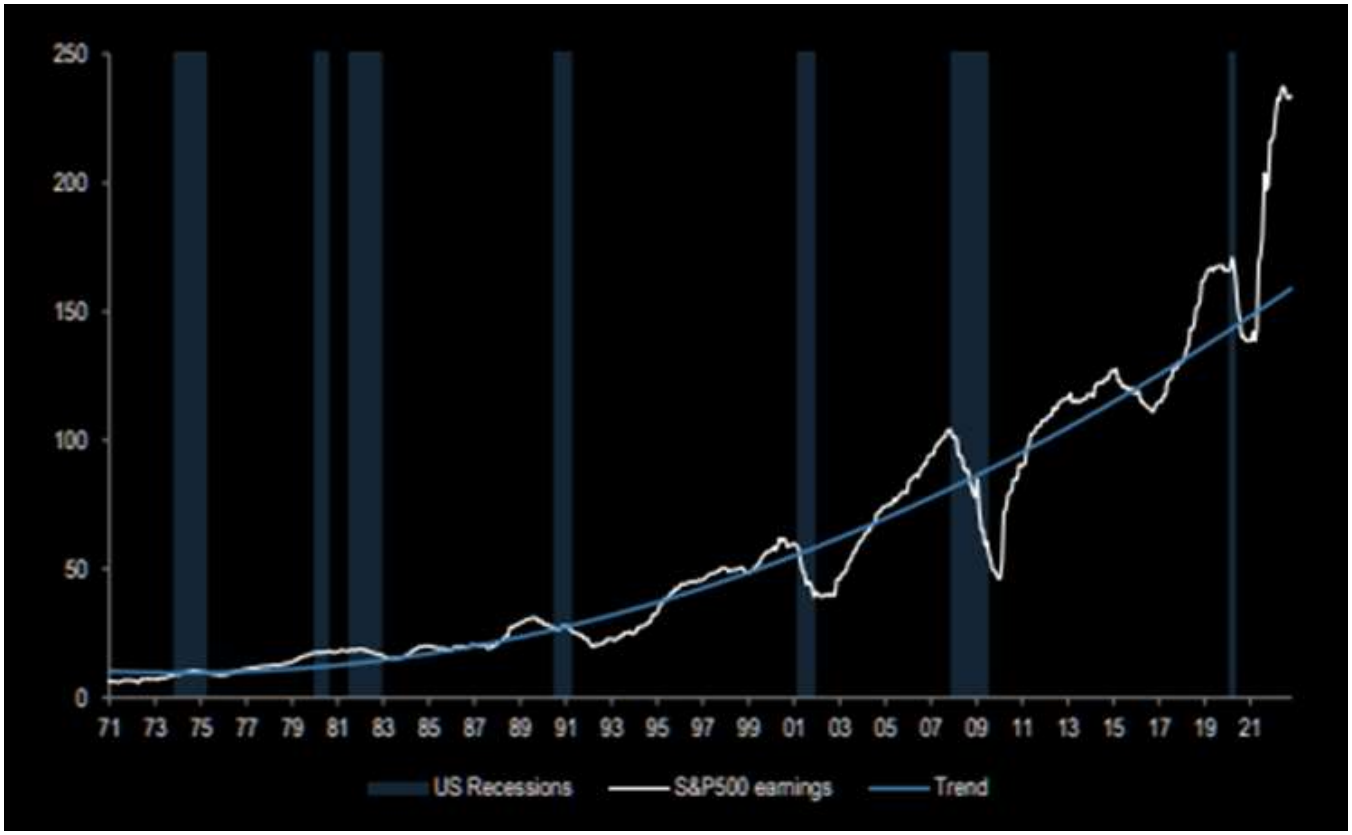
Source: : BofA US Equity & Quant Strategy. Note: Buy and Sell signals are based on rolling 15-year +/- 1 standard deviation from the rolling 15-year mean. A reading above the red line indicates a Sell Signal and a reading below the green line indicates a Buy Signal

BofA GLOBAL RESEARCH

Another potential contrarian indicator might be Tiger Global halting new investments in Chinese equities. We are bearish China, so we do not necessarily disagree. If nothing else, we find it humorous that this free-money fueled hedge fund must puke after an epically bad run. (Recall this is the hedge fund that would not conduct any due diligence when offering to provide equity to start-ups…in fact they would give better terms than companies were looking to give. Yeah, they invested in FTX.)

- Earnings are still way above the trend

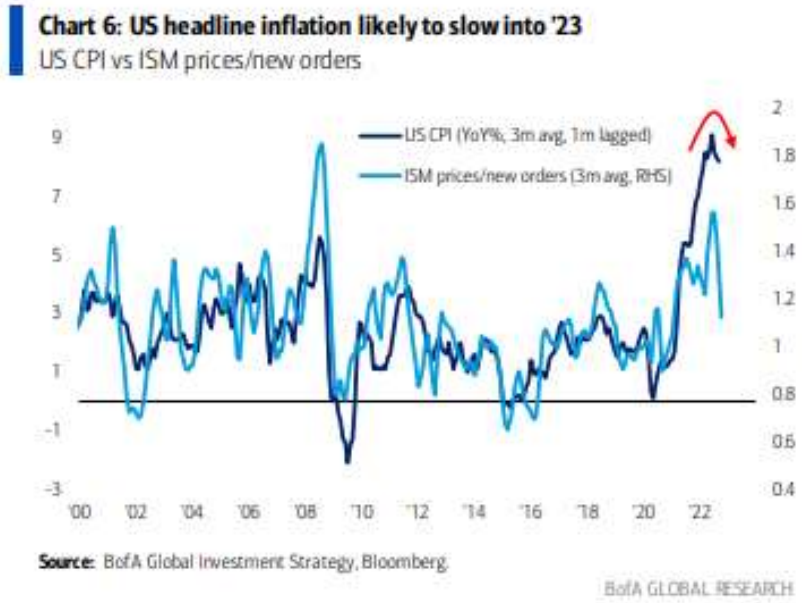
For all the talk about earnings having already corrected with the current/future recession, the chart below tells us there is a lot more to go if things are to revert anywhere close to the norm/trend. This quarter's 3-5% drop is literally just a dot. The y-axis units are aggregate earnings per share of the S&P 500. It should probably be on a log scale, but we think the point is still valid.



- Peak Inflation? Probably, but it does not really matter

The Consumer Price Index (CPI inflation) grew by *only* 7.7% in October vs last year. The annual rate in September was price growth of 8.2%. October was a 0.4% monthly increase which was the same as last month's increase. The "Core" rate increased by *only* 6.3%. This was a 0.3% monthly increase vs the 0.6% increase in September. Our view has been and still is that we will see volatility in prices in different segments of the economy. This month used car prices continued to plunge along with apparel (massive overstocking by almost every retailer is resulting in purges at any price). Energy prices continue to whip around (gasoline was up, electricity was up, natural gas down). Shelter was the largest contributor to prices on the upside. Considering the Fed focuses on the Housing market, this data is unlikely to alter the Fed's course. Moreover, the Fed does consider the state of the markets as part of their evaluation of "financial conditions." This manic bounce is tantamount to monetary easing.

More to the point, we have had data pointing to this slowing in inflation. The ISM Prices component has rolled over and it tends to lead by three months. But don't tell this to the hedge funds that were caught over-short and scrambled to cover.



- Employment is slowing more than it appears

The Employment Report was split again with the Nonfarm Payrolls (NFP, number of jobs not workers) increasing by 261k jobs in October. September was revised higher from 263k to 315k. While Private payrolls expanded more than expected (about what ADP's guess was), government jobs also surprised on the upside. Manufacturing jobs increased nicely, too (but 32k is still only a slice of the 261k total).

But the Unemployment Rate (workers not jobs) slipped higher to 3.7% from 3.5%. The Labor Participation Rate move lowered. Average Hourly Earnings had a monthly increase of 0.4% (vs 0.3% increase in Sept vs August). The annual increase ticked lower to 4.7% from 5.0%.

The real story might be another modeling quirk. The infamous Birth/Death adjustment to the NFP number accounts for the difference (recall the birth/death adjustment tries to account for new companies being formed and companies that have gone out of business). 183k of the 261k jobs are explained by this accounting gimmick. The 0.2% gain in the Unemployment Rate represents a loss of 328k full-time workers. The Fed obviously knows this discrepancy. But like most of their ideologies, they stick to their macroeconomic models like the Burdette men stick to their Coors beer.

- Other economic data is negative
  - Mortgage Applications fell again with a bias (weakening) towards refinancings
  - Small Business Optimism remains near its lows from the last 10 years
  - Factory Orders remain flat
  - ISM Services fell over two points
  - PMI Services fell over almost two points

- The Fed has not changed its tune

Lorie Logan of the Dallas Fed was the first Fed speaker after today's CPI. She said it was a "welcome relief, but there is still a long way to go." Logan is from the NY Fed's market desk. She might very well be the most

qualified member of the Fed system when it comes to the specific mechanics of the Fed. While she tried to put a smile on this data, it was clear to us that she is in no way thinking of a pivot.

Loretta Mester, aka Carol Burnett, of the Cleveland Fed said, "Given the current level of inflation, its broad-based nature, and its persistence, I believe monetary policy will need to become more restrictive for a while in order to put inflation on a sustainable downward path to 2%." 7.7% is a long way from 2% (our comment, not hers).

Here are some other Fed comments:

Susan Collins, the Boston Fed president, said slower rate hikes do not mean lower rates.

Tom Barkin, the Richmond Fed president, thinks the labor market remains tight, and so there is more work to do. Regarding wages, he said everything on the demand side is relevant and not just jobs.

Neel Kashkari of the Minneapolis Fed said, "We are going to get inflation back down. Any talk of a pivot is entirely premature."

Patrick Harker of the Philly Fed and Charlie Evans of Chicago both expressed concern about risks to the economy with higher rates. And Mary Daly of the SF Fed expressed the desire to slow the pace of hikes. She is maybe the most dovish member of the Fed…and she still wants rate hikes!

Again, we do not see any pivot from a single data point.

- Natgas goes negative, seriously

Natural gas prices in the Permian went negative last week. This is mostly due to the pipeline and refinery downtime/outages in the network. Future prices remain positive, but this is still an ominous sign.

- Chart Crime of the week

This one is not a chart, but the table has plenty of criminals listed (some literal, some figurative). We will be keeping a keen eye on Super Bowl advertisers in the future. Same goes for stadium naming rights.

If you spent $1,000 shorting the 2022 Super Bowl advertisers, you'd be a billionaire today:

- FTX
- Carvana
- DraftKings
- Uber Eats
- Meta Oculus
- Rocket Mortgage
- Coinbase
- Vroom
- Salesforce
- GM

12:23 PM · Nov 8, 2022 · Twitter Web App

- Quick Hits
  - The men's and women's winner of the NYC marathon each receives $100k.
  - The nonbinary winner of the NYC marathon receives $5k.
  - Mattress Mack won $75mm on a $10mm wager that the Astros would win the World Series (he runs a store promotion giving away mattresses if the Astros win, so this is a giant hedging bet).
  - Barclays, Citi, and DB lost $100mm after offering a free hedge to Prosus during its acquisition pursuit of an Indian company (BillDesk). Prosus canceled its bid and left the banks holding the rupee bag.
  - This NFL weekend had three games tied at 17-17 with under two minutes to play.
  - UN climate change talks are now centered around "climate reparations."

Trading: We were mostly covering shorts and selling some Energy longs over the last week. We woulda/coulda/shoulda done more! Whatever the case, we are happy we trimmed some so we can reload during this bounce. We mostly took off Fantasies and Frauds. We added to some old-economy shorts (like European financials and copper miners). But if this bounce continues, we will likely focus on the F&F again. Some (most) of these companies are structurally unprofitable regardless of the level of interest rates. We thought they had mostly run their course. But if the market is going to squeeze them higher, we will oblige it with more Puts.

TSLAQ: Elon has eliminated Twitter's monthly "day of rest" and its work-from-home policy. As we have sheepishly admitted, sometimes we really like Musk (but he is still a criminal-grifter-bad-guy writ large). He also

apparently fired a bunch of people that he now wants to bring back...and most are saying no thanks. And oh yeah, he also sold another $4b of Tesla stock. It was August when he last proclaimed that he was done selling stock. We suspect his merry cabal of co-equity investors in Twitter might be getting some alligator arms on the transaction. And those interest payments are gonna be about $1b a year. Musk knows the age-old maxim: sell when you can – not when you have to.

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