



Weekly Update

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- Now the market punishes the believers!
- Bad days are riddled with narratives
- Good days are driven by economic growth and Earnings
- Tariffs still do not matter
- Small businesses are not benefiting from lower rates (yet)
- Free Cash Flow vs Earnings
- What is the options market telling us about Earnings?
- Labor market is probably improving, but it is not clear yet
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	6,720	-1.5%	15.3%	17.6%
QQQ	\$611.58	-2.3%	20.1%	24.9%
US 10 YR	4.10%	4.09%	4.58%	4.34%
USD/DXY	99.7	99.5	108.5	104.5
VIX	19.5%	16.9%	17.4%	15.2%
Oil	\$59.54	-1.7%	-17.1%	-16.9%

*10yr, DXY, and VIX are levels not changes

** Oil is front month futures, beware

Last week, we wrote that the market knows how to punish the doubters. This week, the market knows how to punish the all-in believers! From August until mid-October, the S&P 500 experienced zero days with a loss greater than -1%. We have had three in the last six sessions. The headline Volatility index (VIX) is back near the 20 level...this is where people start to get a little scared (a 20 Vix roughly means the daily market standard deviation will be 1.25%). We noted that most of the mini-narratives had already blown over (tariffs, credit worries, government shutdown, AI monetization, Fed policy). What has changed? The pundits jumped on some comments made by the CEOs of Goldman Sachs and Morgan Stanley indicating the market might be in a bubble (despite their own strategists declaring we are not in a bubble). Apparently, everyone wants to be like Jamie Dimon. Michael Burry of The Big Short fame disclosed that he held Put options on Nvidia and Palantir (the posterchild for a richly valued real company...not a Fantasy & Fraud, just insanely overvalued). But this means

nothing in the absence of knowing his full positions (he could have offsetting positions or even be out of the position entirely). There was a random Bloomberg headline proclaiming that the market had doubts over the recent Trump-Xi trade truce. With no supporting evidence or even anonymous attribution, we suspect this was politically motivated drivel. Regarding Artificial Intelligence, some off-handed comments from OpenAI and Nvidia made investors do a double take. OpenAI's CFO explicitly said she was in favor of a government backstop with respect to any debt funding in the AI ecosystem. Nvidia's CEO said China was winning the AI war. Both executives quickly backtracked. While we believe Huang of Nvidia likely misspoke (or was misspeaking intentionally for effect), it is hard to trust anything coming from OpenAI.

Notably, the strongest trading of the week centered around strong economic data. A good private payrolls number from ADP and positive business surveys (PMIs) knocked yields higher and pushed the probability of a December rate cut lower. But equities cheered on better economic growth and the yield curve steepened (a sign of future growth typically). And while the market fretted over the flippant comments from OpenAI, the CEO was sure to make clear that revenues were rapidly expanding. The recent \$13b run-rate is now more like \$20b. And he expects this to hit \$100b very soon (who knows). Overall, Earnings are still great. Obviously, the reactions to Earnings have been bifurcated with the bar for success being very high. Even with the volatile reactions, year-end estimates for the S&P 500 are still climbing higher (revised +2% during this reporting season).

On the tariff front, it is looking more likely that Trump might lose his Supreme Court case defending some of his tariffs. It was clear that many Justices were confused by the arguments made by the Solicitor General. Even though this might cause some fiscal stress (having to repay much of the tariff money collected...likely to be about \$140b by the time the case is decided which is thought to be around December) and the market had more than come to terms with the tariffs, the market is still hoping some of them go away (which we think is short-sighted considering Trump will just restart them using a different legal justification). Ultimately, we do not think anything tariff related should be market moving at this point (assuming the baseline of 15% tariffs are applied to most pain points).

It is worth adding that garbage stocks have come back to earth. Many of these names (quantum, crypto, flying cars, whatever) led the charge higher. But with market valuations getting stretched and Volatility increasing, these are the easy victims to take the brunt of a correction. We think these are more symptomatic of the market mood rather than causing it. Lastly, merger and acquisition activity (M&A) has picked up lately. Some of this can be attributed to weak companies trying to come together (Kimberly and Kenvue). But most of it is pushing growth and looking for synergies (an overall positive indicator). Of course, IPO activity has grinded to a halt because of the government shutdown (there was one?).

➤ Small businesses are not benefiting from lower rates (yet)

We usually do not spend too much time on the NFIB Small Business survey. But David Rosenberg (super smart, usually right, always early) points out that the average interest rate for small business loans is still at 8.8%...this rate has not come down this year, and it is still near the high end of the range of the past 20 years. He also points out that the number of companies with an investment grade bond rating whose debt is on "negative outlook" by the rating agencies is a 10-year high. We think this data is important to monitor. But at the same time, we think it is natural for there to be transmission delays in interest rates (the banks have had lots of uncertainty with which to deal). And we do not put too much faith in ratings agencies (in either direction).

➤ Free Cash Flow vs Earnings

The MacroTourist raises a good point about how Free Cash Flow has fallen compared to Earnings Per Share over the last five years. The obvious rebuttal is that companies are reinvesting in their businesses (that is the

definition of Free Cash Flow vs Cash Flow...after capital expenditures). So, the normal refrain is still pertinent: When will the AI investment pay off? On the bear side, the short seller James Chanos frames it, “What happens to earnings when the usable life of the stockpile of GPU chips is only two or three years? Currently, Meta uses a depreciation schedule of 11-12 years for the chips it has bought.” And we would add that Microsoft said it has GPUs just laying around with no use case...they are waiting on data centers. On the bull side, Google reiterated that its AI Overview is already monetizing at the same rate as traditional search. Furthermore, Google also said that half of all its internal coding is being done by its own AI. Even OpenAI, which we have casually doubted its ability to ever generate profits, says it has over 1mm business customers. We have not liked OpenAI’s prospects because we think the real money will be made in the enterprise not with silly chatbots. But OpenAI is saying they are heading in that direction (we shall see).



S&P 500 free-cash-flow and EPS from 2013 to 2025 (courtesy of Bloomberg)

➤ What is the options market telling us about Earnings?

We wrote last week that stocks with positive earnings beats are underperforming the market. We surmised that this data was incomplete because it did not drill down to the level of the beat nor the performance heading into the release. But the option market sheds some light on this. Last quarter, earnings-day moves surpassed option implied expectations for the first time in 18 years according to Goldman. Stocks moved +/-5.3% in Q2. Logically, this quarter saw the options market juice higher its expected move to +/-5.8%. Alas, this overshot. The actual moves so far is only +/-4.8%. In other words, the performance was already baked into stock prices. This tells us not to worry about short-term earnings reactions since the broader picture of the earnings is still positive.

Earnings day moves			
Sector	Realized (Avg)	Implied (Avg)	Realized - Implied
Materials	7.5%	6.8%	0.6%
Real Estate	3.6%	3.5%	0.1%
Energy	3.9%	4.1%	-0.2%
Health Care	6.0%	6.4%	-0.4%
Utilities	1.8%	2.5%	-0.7%
Consumer Discretionary	7.0%	8.1%	-1.1%
Financials	3.5%	4.7%	-1.2%
Communication Services	4.3%	5.8%	-1.4%
Industrials	4.6%	6.2%	-1.6%
Consumer Staples	3.6%	5.3%	-1.7%
Information Technology	5.8%	8.9%	-3.1%
All Stocks	4.8%	5.8%	-1.1%

Source: Goldman Sachs Global Investment Research, Goldman Sachs FICC and Equities, Refinitiv Eikon

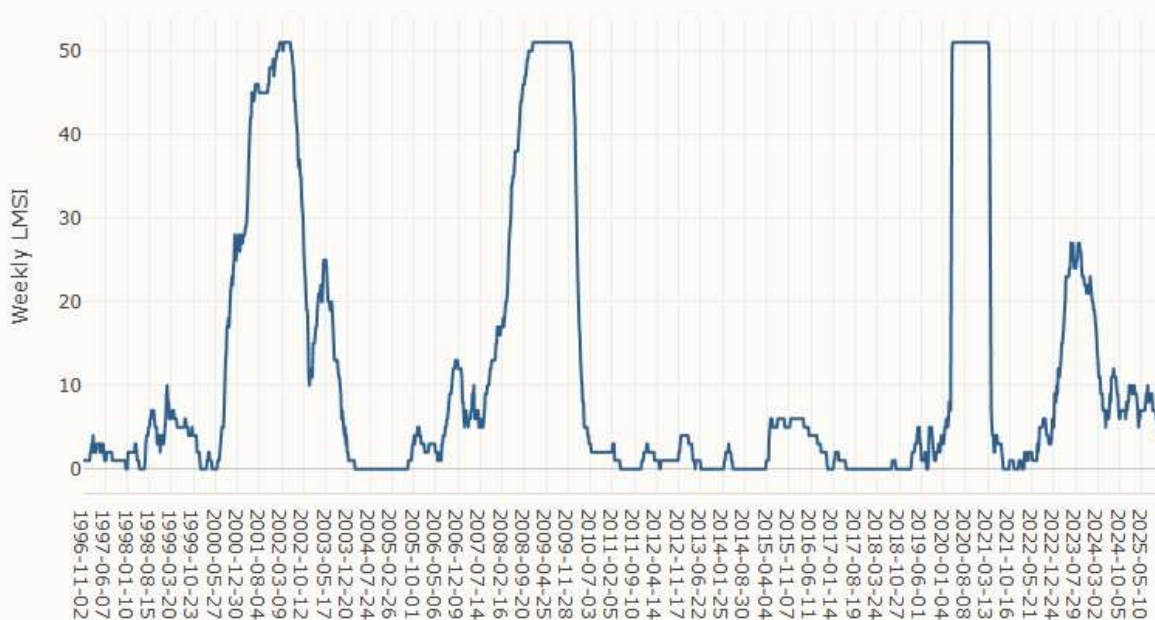
- Labor market is probably improving, but it is not clear yet

ADP's guess at private payroll additions in October hit 42k. This is a pretty good number with the estimates around +25k. Most job gains were in companies with greater than 500 employees (+74k). The last official Private Nonfarm Payrolls number was +38k in August. (ADP started a weekly Payrolls number. After the first report of +14.25k as of Oct 11, we are yet to get another report...weird.) The professional guessers say about +30k is the breakeven level for GDP growth.

Anecdotally, we have been getting lots of layoff announcements. And the data is now supporting this. The Challenger Job Cuts in October jumped to 153k which is up from 54k in August. 50k is probably the 10-year median (or average after stripping out Virus Fear and Tariff knee-jerks). Of course, this data is one-sided...it literally only shows the job losses (announced...they might not even come to fruition) and not any job gains.

The San Francisco Fed has put together a Labor Market Stress Indicator. We have not dug into the composition/methodology just yet, but the stress seems to be fading despite what the Fed talking-heads are saying (and despite all the doomsday commentary around trucking and shipping).

Figure 1: Weekly Labor Market Stress Indicator



- Other economic data is better (not much of it)

The average 30-year mortgage rate remained steady at 6.31%.

Mortgage Applications dipped slightly. Activity is near a 3-year high...but lightyears away from the post-Virus Fear surge.

Business Surveys accelerated in October. The S&P Composite PMI went from 53.9 to 54.6. Most of this was Services. And the ISM Services moved to 52.4 from 50. Both of these increases were slightly lower than expected, but the upward trend is what matters. On the ISM, Business Activity and New Orders were the strongest. Employment only ticked up and is still in negative territory. Prices remain elevated.

China's private Manufacturing PMI (the RatingDog!) declined in October to 50.6 down from 51.2. Exports are the weakness.

- Where did all the crypto money go?

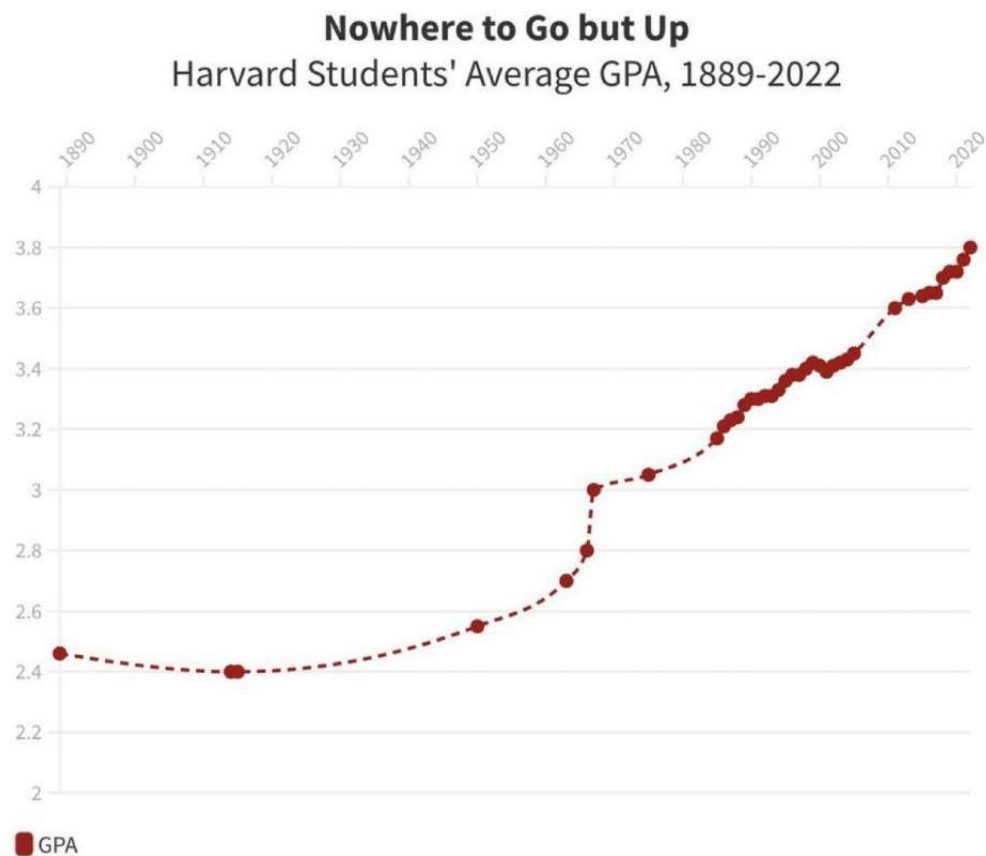
A new trading platform, Architect Financial Technologies, is looking to launch perpetual futures contracts on traditional securities such as stocks, commodities, foreign currencies, interest rates, etc. These are the structures made famous by the crypto world. They typically offer insane amounts of leverage with dubious collateral. Regulators are yet to approve these "perps." We find some comical irony in this term the crypto world uses...considering it is the ex-head of FTX US that is trying to launch the product! To be fair, this guy was never charged with any criminal wrongdoing. But we know there is a difference between not guilty and innocent.

Last week we wrote about ETHZilla and how it was selling Ethereum coins (ETH) in order to buy back shares that had dipped below its net asset value (NAV). As crypto unravels more, Bitmine has come back into focus. This is the largest public company holder of ETH who wanted to mimic (Micro)Strategy's (name change!) playbook of

duping fools into paying a premium for an asset that is otherwise readily available. And it worked for Bitmine for a while. Its roughly \$10b of Ether was valued at over 5x. It is not almost back to par to NAV. Bitmine itself has lost over \$1b on its recent Ether purchases. The rubes that paid 5x have lost a lot more.

➤ Chart Crime of the week

We are not sure if Harvard has been overrun with grade-inflation or a host of crappy professors with crappy curricula. Either way, as Flava Flav once said, don't believe the hype. And why is there no data from 2006 to 2009?



Source: Gradeinflation.com, TheCrimson.com • Note: Dashed lines denote years for which data was missing.

➤ Quick Hits

- Applications to law schools are up over 28% this year vs last. They are up 73% vs two years ago.
- Car repossessions have surged to their highest level since 2009.
- It is speculated that Diane Keaton left \$5mm to her dog Reggie.
- Kalshi, a federally regulated prediction market in the US, is looking to hire “tarot card readers, palm readers, psychics, fortune tellers, oracles, wizards, and individuals born with divine intuition.” The one stipulation is that “YOU HAVE TO BE UNEMPLOYED.” (Emphasis theirs!)
- The CEO of Coinbase concluded his quarterly earnings conference call with, “I was a little distracted because I was tracking the prediction markets about what Coinbase will say on their

earnings call. And I just want to add here the words Bitcoin, Ethereum, Blockchain, staking, and Web3 to make sure we get those in before the end of the call.”

- The football Cardinals are 4-10 lifetime on the road on Monday Night Football. All four wins are against the Cowboys in Dallas.
- QB Josh Allen has more rushing touchdowns than the great Earl Campbell.
- The Danish National Chamber Orchestra once performed after eating ghost peppers.
- Fecko Stinko was the name of an immigrant to the US in 1892. (Yes, this is completely random).
- Tomatoes growing in the Galapagos are experiencing what scientists are calling “reverse evolution.”
- The story of the Auburn football coach being fired was broken early because some local sleuths discovered that his standing tee-time at the Auburn University Golf Club had been canceled.
- The Motion Picture Association is suing to stop Instagram from using its PG-13 classification as it is a registered certification mark.

TSLAQ: Elon’s \$1trillion dollar battle has dominated the Musk world as of late. And it worked. With overwhelming support, the world’s richest man stands to make a trillion dollars if he can reinvigorate the car sales, build a robotaxi business to scale, and make a humanoid business.

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