CHALK CREEK PARTNERS

Weekly Update

16-August-2023

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- Sell the rally instead of by the dip?
- Credit Card spending…"somebody's got to pay, and it ain't gonna be me"
- Volatility is shrinking, but not really
- Softbank is always trying to manipulate somebody
- Main Street inflation vs Wall Street inflation
- Uk inflation is worrisome
- Retail Sales appear strong on the surface
- The fake job openings are finally disappearing
- New Housing might be cooling a bit
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- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,518	-1.4%	15.6%	4.2%
QQQ	$362.54	-1.5%	36.5%	9.6%
US 10 YR	4.26%	4.01%	3.75%	2.90%
USD/DXY	103.4	102.5	104.5	106.6
VIX	16.8%	16.0%	22.9%	19.9%
Oil	$82.48	-6.1%	-1.1%	-8.3%

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

** Oil is front month futures, beware

The market mindset slowly seems to be shifting to "sell the rally" from "buy the dip." It has only been a couple of weeks, but the swerving narratives seem to be coalescing around a harder economic landing than previously thought. Moody's and Fitch are turning negative on the credit quality of the banks. This is no great surprise, but the often-backward-looking rating agencies are reminding investors that an inverted yield curve (and a matching lopsidedness on the balance sheet) is bad for business. Along these lines, pressures on interest rates (higher) continue. The Fed's message is hitting home – the fight against inflation is not over (not to mention the realization that mildly softening prices from high levels is not real relief for the average consumer). We can see this most directly in the recent issuance of new Treasuries…the auctions have been going very poorly. Even when some economic data looks positive like the headline number for Retail Sales, the market worries about more Fed rate hikes (not just pushing back rate cuts). Some fears are creeping into the labor market – not just confusing economic data but real companies warning about real labor problems (Zip recruiter, see below). Credit card delinquencies are moving higher (even before student debt must start being repaid in the coming six weeks or so). Bad news is bad and good news is bad.

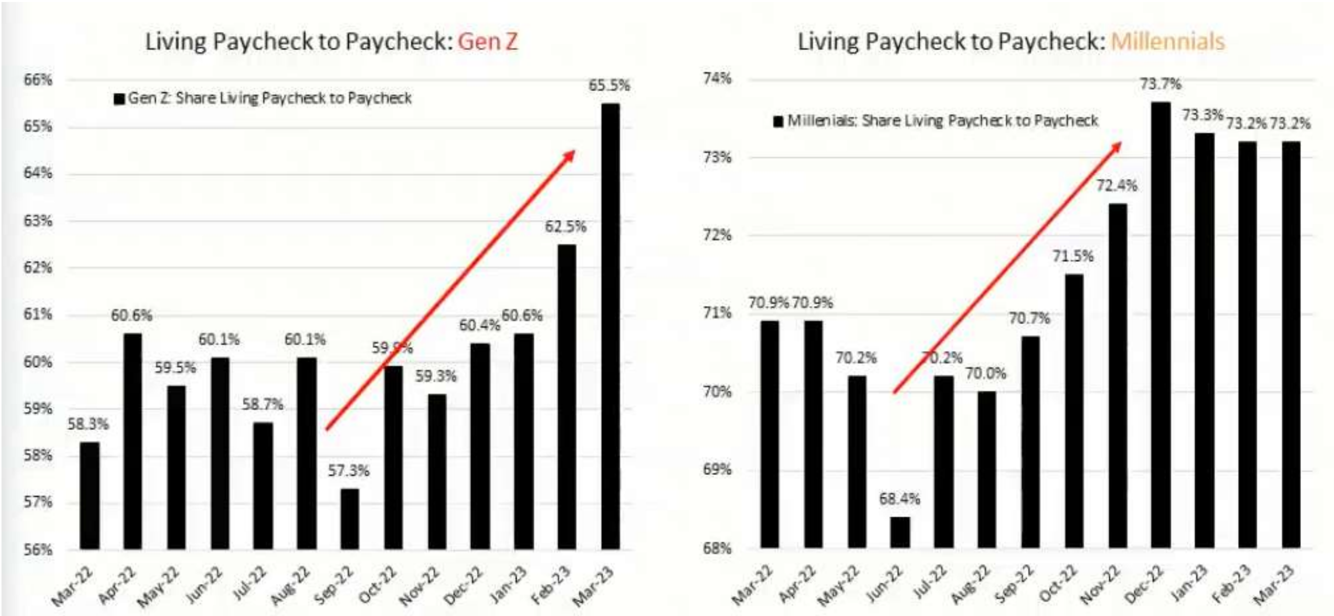
The weakness in China is finally being considered a negative for global growth. Some data in Europe has improved, but inflation is still hotter than here, and growth prospects are dimmer. It does not help when governments keep trying to intervene in precisely the wrong fashion (Italy and its boneheaded attempt at taxing banks' s "extra profits" comes to mind).

We are also seeing a slowdown in the risk-fueled short squeezes. Profitless companies without much hope should not have been rallying 2-3-4x over the last two months. Some of the poster children for this hopeless cohort are starting to deflate: Carvana (basically defaulting on its debt in a restructuring to stave off death), Plug Power (still has negative gross margins), Beyond Meat (their guidance for profits later this year proved as fleeting as the appeal for a fake burger) and Virgin Galactic (space tourism…enough said) are all good examples. Of course, there is still some lunacy out there. VinFast, a Vietnamese EV maker, went public via a SPAC (oh boy). It has sold 16k cars this year. It reached a valuation of $85b.

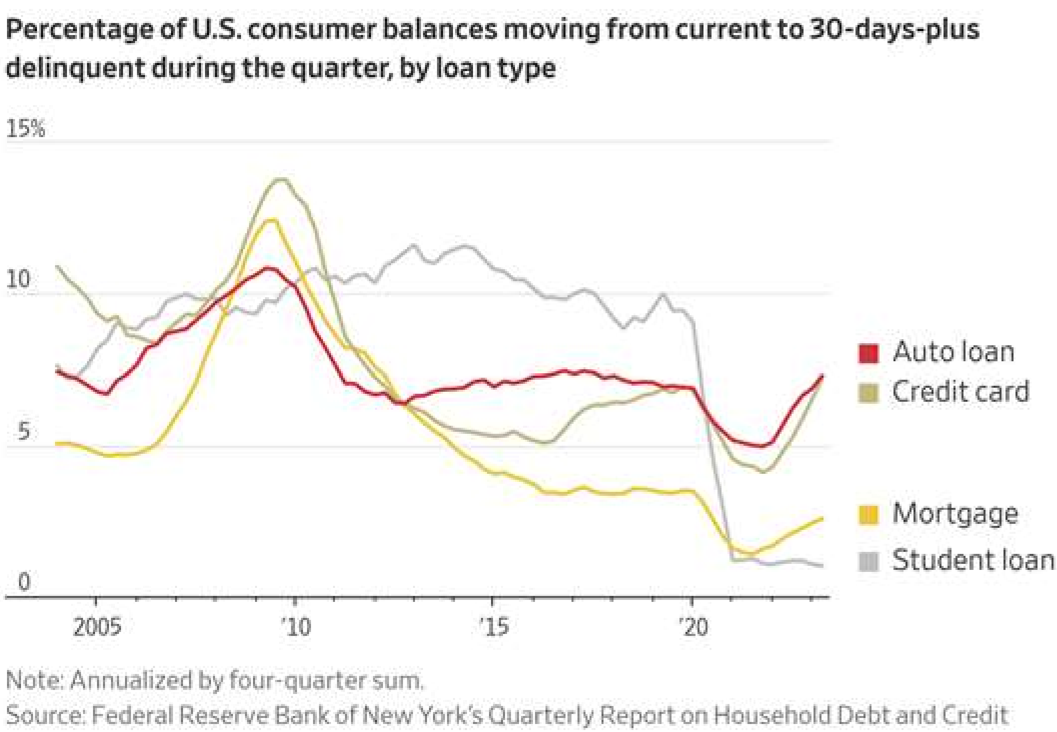
Whatever the case, it is too early to call any sort of sea change in sentiment or market action. There have been a countless number of head fakes this year. And as we have stated recently, there are some reasons to be bullish (some pockets of earnings growth and a resilient labor market despite tiny cracks). But we expect the correlation in the market to continue to drop. Winners and losers might get their respective just deserts.

- Credit Card spending…"somebody's got to pay, and it ain't gonna be me"

One area of concern remains credit card spending. The consumer hit the not-so-magical $1t mark in June (total balance due). The first half of this year saw the two highest quarterly accelerations for this accumulated debt of 17.2% and 16.2%. The question has been, how long can the consumer keep spending money it doesn't have? There has been anecdotal evidence of the dwindling "excess savings" which is not a real stat, of course (that is not to say fair estimates of it are not valuable…it is just more art than science). But incomes have been growing and jobs are plentiful (lagging indicator!). But June saw its first decline in credit card spending in 25 months. And the Personal Savings Rate has been ticking higher. Maybe, just maybe, people are coming around to the reality that credit cards are not bottomless pits for spending. Also, we have noted that credit card spending on Staples has increased dramatically. Paying an extra 23% for your kid's GI Joe with the Kungfu Grip adds up quickly (yes, this is a Staple!). The monthly credit card data for July spells this out: Delinquencies and charge-offs are on the rise and are above 2019 levels (for the lower end of the credit card quality spectrum). And we must mention that the student loan repayments go back in force at the end of August. Here is a chart from Hedgeye. It is a bit of a chartcrime since the y-axes start so high. But the point is still valid. Living paycheck to paycheck is becoming more common for the youngsters.

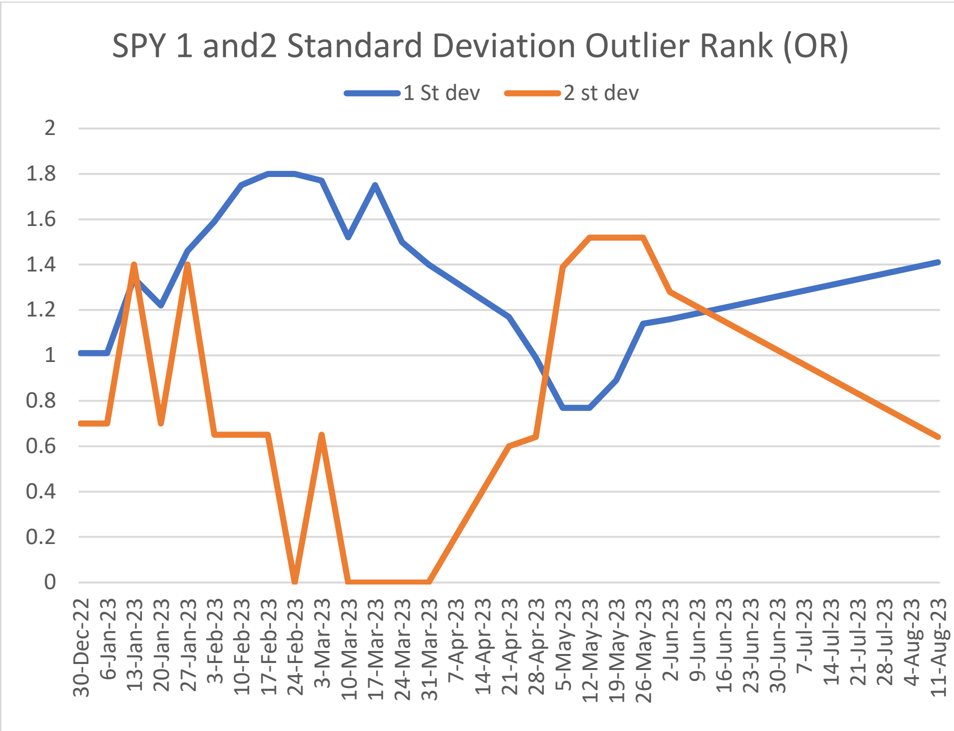


And here is the trajectory for delinquencies across consumer debt (that student loan aberration is about to change).



- Volatility is shrinking, but not really

Market Volatility has been compressing all year (even with a recent uptick, Vol is still down sharply from last year). But Outlier moves have started increasing again (our data/chart below). But not huge Outliers. That is, moves beyond 1-standard deviation have been increasing since May. But moves outside of 2-standard deviations have been decreasing since May. Anecdotally, intraday Volatility has increased lately…more so than the mild increase on the headline. We would also add that the crazy 0DTE option market (same day option expirations that fueled much of the rise earlier in the year) has flipped. Put volume is now routinely outweighing the Call volume.



For the junkier segment of the market (using ARKK as the proxy), 1-year Volatility (both 1-standard deviation and 2-standard deviation) has been decreasing all year. But 30-day Volatility has been increasing. The anecdotal and logical explanation for this is the recent return to trouble for the aforementioned Carvana, Upstart, Affirm, etc (not that these are all ARK names, but they fit the bill for this analysis).

- Softbank is always trying to manipulate somebody

Softbank is up to its old shenanigans again. This time it involves some self-dealing of its ownership in chip maker Arm. Softbank owns 75% of the company and plans on selling it to the public via an IPO (it tried to sell it to Nvidia, but the regulators squashed that). The other 25% is owned by Softbank's giant Vision Fund. Softbank wants to buy this 25% stake from its fund right before it commences the IPO. We do not know the terms of these transactions yet. But we would be willing to bet that Vision Fund and its Saudi and Dubai backers make out like bandits while schmucks that own the public equity in Softbank get stuck footing the bill of pleasing the higher fee-paying, private investors.

- Main Street inflation vs Wall Street inflation

The July Consumer Price Index (CPI inflation) ticked back higher on the annual number. It was a monthly 0.2% increase (same as June) with a 3.2% annual rate (vs 3.0% in June). Stripping out Food & Energy, the "core" also increased 0.2% with a 4.7% annual increase. These monthly rates are not sequential accelerations. But that is just fancy Wall Street talk. High prices are staying high. Moody's says the average household is spending $709 more per month on the same basket of goods and services compared to two years ago. According to Moody's, relief is likely to come in Used Cars, Electricity (the bills are brutal in the summer!), and Shelter (when rents finally start to rollover which should also add more pressure to the housing market). Of course, higher oil and food prices can spoil the party. We think inflation will stay elevated and above the Fed's target. Both Main Street and Wall Street will not like that!

Producer Prices in July increased more than expected. These wholesale or input prices increase at a 0.3% clip compared to June's flat reading. "Core" prices also hit 0.3%. The annual numbers are still very low (0.8% and 2.4% respectively).

- Uk inflation is worrisome

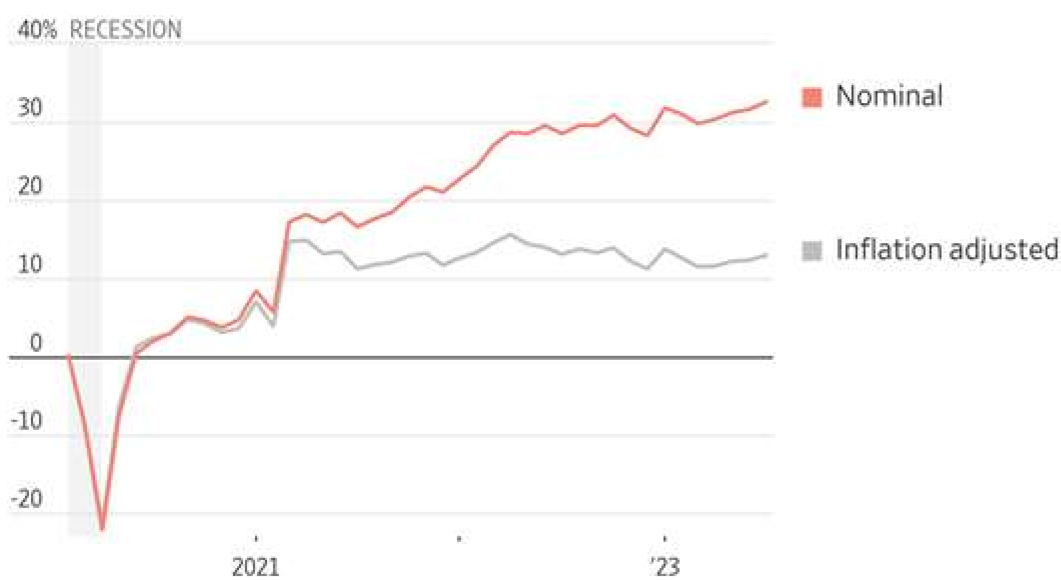
Inflation data in the UK garnered more attention than normal. Wage data was released on the same morning as the stronger than expected US Retail Sales and the Moody's warning about the banks. So perhaps the market was extrapolating a bit too far. But Average Earnings in the UK did accelerate from a 6.9% annual rate in June to an 8.2% increase in July. But headline inflation cooled from 7.9% to 6.8%.

- Retail Sales appear strong on the surface

Retail Sales in July increased more than expected on top of an upward revision to June. Motor Vehicles (and parts) and Health & Personal Care were the standouts. Sports and Restaurants were also strong. But the strongest pocket was e-commerce (Nonstore Retailers category) which was led by Amazon and its Prime Day. Furniture/Home Furnishing was the weakest spot. Home Depot earnings were interesting in that the company saw strong demand in "smaller projects" but "continued pressure in certain big-ticket, discretionary categories." Electronics and Appliances were also weak.

As usual, the narrative is that the consumer is thriving. But inflation is a major driver of this "strong" spending. We suspect the Main Street inflation (high prices staying high) will take its toll eventually.

U.S. retail and food-services sales, change from February 2020



Note: Seasonally adjusted values deflated using the consumer-price index
Sources: Labor Department (CPI), Commerce Department (sales)

- The fake job openings are finally disappearing

Zip Recruiter withdrew its guidance because of the “macroeconomic backdrop” and the “reduced demand for recruiting services.” All those fake job openings are coming home to roost. The shares of Robert Half, the temporary worker placement agency, are another easy lens through which to view the job market.

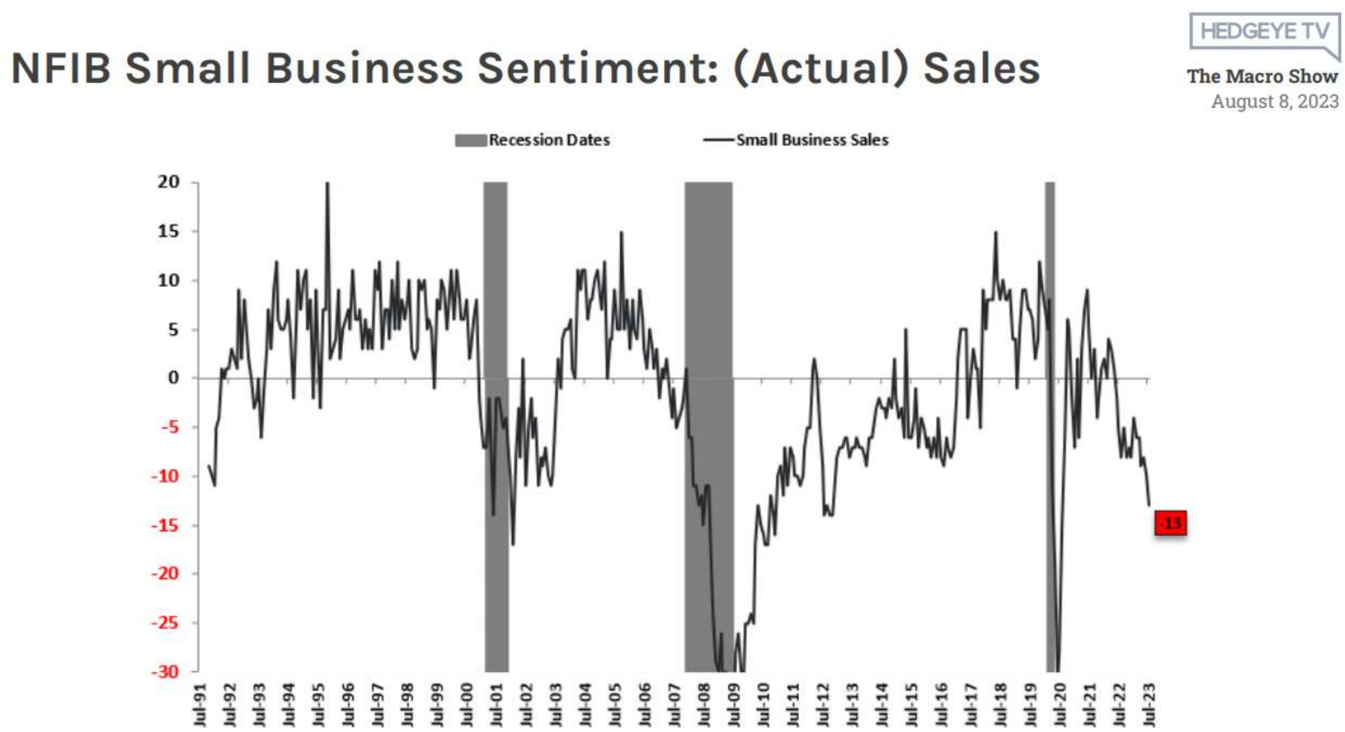
- New Housing might be cooling a bit

The Housing Market Index (home builder survey) in August fell a sharp six points to 50. This is still the third highest reading for the year and well above the depths of December of last year (31). But it does break a seven-month winning streak (increasing confidence every month of 2023). All three categories dipped about the same amount (Current Sales Conditions, Sales Expectations, and Buyer Traffic). Buyer Traffic continues to lag the other categories badly. Obviously, high mortgage rates are the largest hurdle to overcome. To try to jump start more activity, builders are using more incentives (25% of builders are using price cuts and 55% are using some sort of incentive).

Housing Starts bounced back a bit in July (contrary to the builder sentiment, but that data is more forward looking). This data has been volatile month to month. Permits have been a little steadier. Both numbers are off their Virus-Fear peaks, but they are above the trend back in 2019. Builders are doing what they can to rectify the supply shortage. But demand is not there given interest rates. Mortgage Applications hit a new all-time low (on Purchases, Refinancings are not quite there). The average 30-year mortgage rate is about 7.4%.

- Surveys can be misleading

The NFIB Small Business Optimism index ticked a bit higher for the third month in a row (after the recent low reading in April). But as Hedgeye points out, the actual Sales data reported in this survey is still declining sharply.



- China is a disaster

China's Trade Surplus dropped to $80.6b in July. This is down from almost $103b last July. Both exports and imports fell dramatically (-14.5% and -12.4% respectively). But the surplus with the US expanded more than $1.5b to $30.3b. Also, prices have officially started falling. The rapid disinflation has turned into deflation on an annual basis (-0.3% in July vs last year). The PPI has been negative for 10 months in a row now. Industrial Production, Retail Sales, and Fixed Asset Investment (collectively known as the monthly data dump) were all weaker than expected. And the slight reprieve in Unemployment is reversing with it ticking higher again. There is no Chinese reopening! And oh yeah, the communists are still in charge…they have stopped reporting youth unemployment. They know what to hide.

Country Garden, a Chinese property developer, missed some bond payments. Obviously, these were USD bonds…foreign investors holding the bag on these upside-down Chinese ventures. But there are also more troubles brewing in the wealth management industry as another company failed to make payments on its high-yield investment trusts. Many of these quirky structures were tied to real estate investments (unknown t to the actual investors who dumped their money in these). Apparently there are protests popping up in Beijing.

China cut interest rates on its medium-term lending facility. This is the second cut to the one-year loan rate since June. The press is reporting this as a surprise. But everyone knew this was coming. And it just so happened to come right before the government announced the bad economic data (above). The market has not been impressed with the piece-meal stimulus measures. The communists even did one of their tried and true interventions in the market. They "asked" the large investment managers to not be net sellers of equities. Meanwhile, the Yuan sank to its lowest level against the USD in 16 years.

- ➢ Other Economic data
  - Wholesale Inventories were negative again with a 0.5% monthly drop.

An Economic Optimism Index shows sentiment sinking back near its 10-year lows. Last summer is the actual low point…right when stocks were plunging.

- The Empire State Manufacturing Index sank back into deeply negative territory for August.
- Business Inventories in June remained flat.
- Industrial Prodution had a strong rebound in July thanks to Manufacturing.

- ➢ The Fed is still committed to fighting inflation

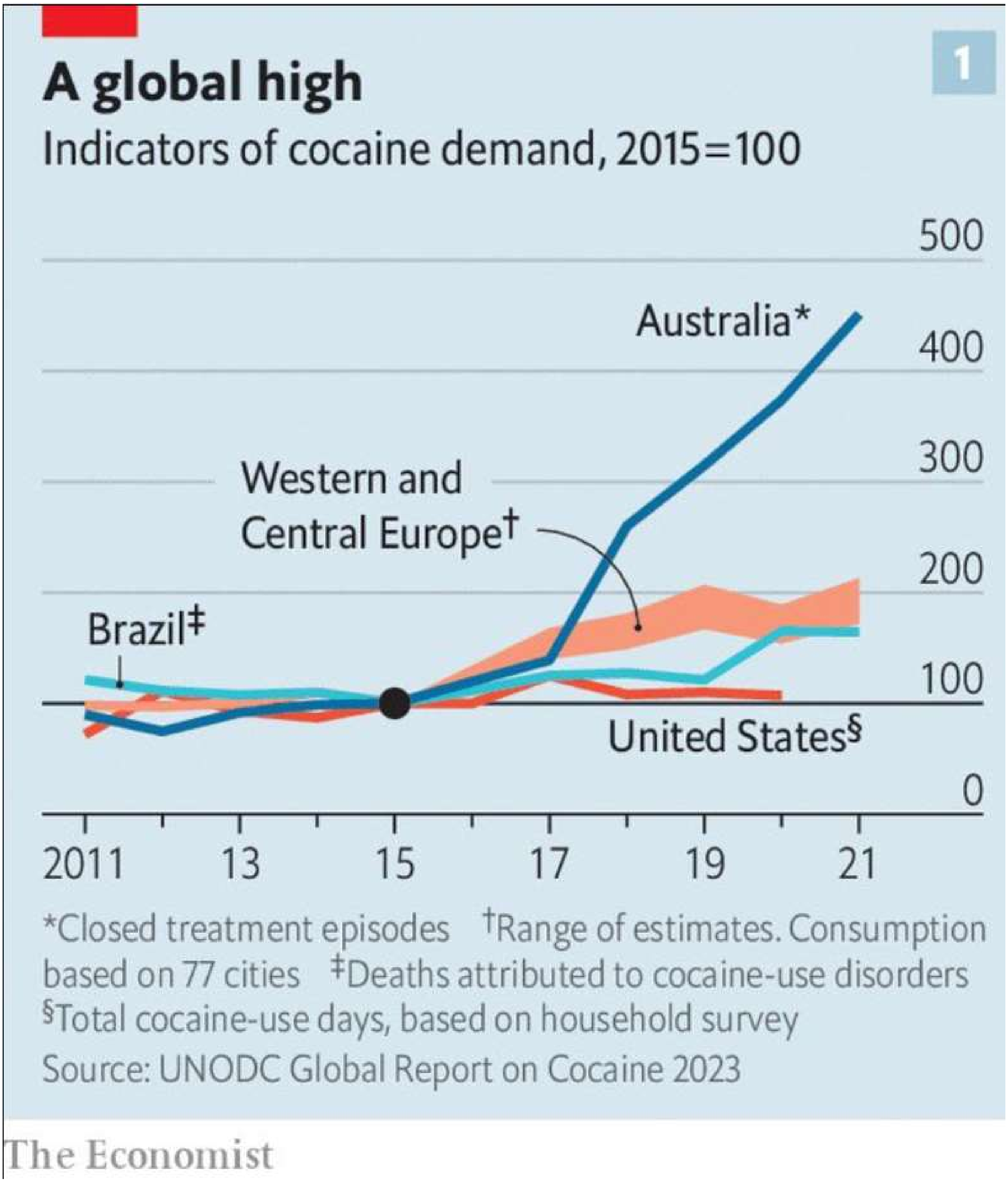
The FOMC Minutes (Fed's rate-setting committee) can be summed up with this statement from the official summary, "With inflation still well above the Committee's longer-run goal and the labor market remaining tight, most participants continued to see significant upside risks to inflation, which could require further tightening of monetary policy." As we have been saying, there might be some squeaky wheels on the committee calling for a change in policy. But the vast majority of participants think otherwise.

- ➢ Where did all the crypto money go?

Old Sam Bankman-Fried could not keep well enough alone. Instead of living at his parents' s home under house arrest, he has been ordered to jail for witness tampering (leaking love letters from Caroline Ellison, the other criminal moron from FTX). He is at the Metropolitan Detention Center in Brooklyn which is apparently a hell hole even by New York City standards. At least he has all the Adderall and depression meds he needs (a judge ordered so).

- ➢ Chart Crime of the week

Just another reason to never read the biased drivel spewed by the Economist. Each line on the chart is a different measure: Treatments, Consumption, Deaths, Use-days. We are not even sure what the point was supposed to be. Drivel.



- Quick Hits
    - Yellow, the bankrupt trucking company, has borrowed $142mm to keep the lights on while it tries to sell its assets to pay back its previous debt. The new debt carries a 17% interest rate.
    - TopGolf Calloway blamed its earnings miss on smoke from the Canadian fires.
    - The Barstool Sports founder, Dave Portnoy, is buying back his company from Penn Gaming. He sold it to Penn for $550mm. He is buying it back for $0.
    - Portnoy has a long way to go to catch the all-time king in this department, Adam Newmann of We Work. He bagged $2.1b from the about-to-be bankrupt company. (This is an unfair comparison for Portnoy as Barstool was never a sham given cover by the idiots at Softbank. Perhaps distasteful, but not a sham.)
    - Brinks, the security company with armored trucks, missed earnings because of a robbery.
    - The Women's World Cup has $300mm in TV sponsorships. The men's tournament had $1.7b.
    - Phil Mickelson's long time betting partner says Phil bet over $1b during a 10-year stretch and lost $100mm.
    - 1956 Masters Champion, Jackie Burke, once bet Mickelson $10k that Phil could not make 100 two-foot putts in a row. Phil missed his second attempt. Burke told us this story at his Champions golf club in Houston.
    - A job recruiter in the UK says Gen Z "workers" (mid to late 20's) are looking for jobs with high salaries, low stress, and more flexibility that leads to a better work-life balance. Good luck.
    - Dallas/Fort Worth experienced a record 380 hours in a row of temperatures above 80 degrees.
    - DFW's recent 21 straight days of high temperatures over 100 degrees was only the sixth longest streak.
    - Cable and Broadcast market share (combined) dipped below 50% for the first time (49.6%). 20% of all TV viewing is still done via the traditional "Broadcast" without cable.
    - Some of the co-conspirators in Georgie's indictment of Trump include Kanye's publicist, a bail bondsman, and ex-MMA fighter.

Trading: We have slowly been adding to the cheap versions of Quality Tech and Banks. But we have also added to some shorts to balance our exposures. We are not more bullish, but we acknowledge the market can twist and churn the different factors and narratives. That is, Quality companies might be the recipients of flows when people realize the junky stuff they have been riding might suffer more during economic weakness.

TSLAQ: The CFO of Tesla, Zach Kirkhorn, has left the building. After 13 years at the company and four in the c-suite, Kirkhorn mysteriously resigned two Fridays ago. The company waited to announce it on Monday. We cannot remember a time when a company did not announce a leadership resignation immediately. Something is afoot…as usual.

This leads us to Tesla's sales performance in July. Deliveries in China dropped a cool 31% vs June. Meanwhile, BYD, the homegrown EV seller in China, saw its sixth monthly increase in sales. Merrill says what is obvious. The sweeping price cuts have pulled forward demand. They have not created a new wave of buyers. Even Tesla agrees with this. In a rare bit of truth telling, last month Musk warned that there would be more price cuts. This week, more cuts were announced in China (model Y) and in the US (models S and X…these are not just price cuts but new variants with fewer/worse features like range and speed). On the plus side for Tesla, it announced another charging station deal with Fisker. Of course, there are more charging stations than Fiskers on the road.

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