Weekly Update

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	Last	5d %	YTD %	1yr %
S&P 500	4,314	-1.4%	13.6%	19.1%
QQQ	$363.04	-2.2%	36.9%	35.7%
US 10 YR	4.91%	4.57%	3.75%	4.14%
USD/DXY	106.6	105.6	104.5	113.0
VIX	19.2%	16.1%	22.9%	30.8%
Oil	$88.24	5.7%	10.0%	6.6%

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

The equity market has been refusing to listen to the bond market (again). We are still perplexed that traders have been ignoring if not rejoicing the bond market doing the work for the Fed (per Logan of the Dallas Fed and a whole chorus of other Fed members echoing this sentiment). It is not the Fed Funds target rate (that is the main Fed rate setting mechanism…a target rate for which banks should/might lend to each other) that sets the interest rates at which companies borrow money. The banks do not use some theoretical posturing of where bonds should be or might be. They base their lending off where rates are (obviously in conjunction with credit quality, their capital flexibility, etc). Perhaps the impetus for earmuffed equities has been the notion that the bond market will overshoot, and that the Fed knows best (ha!). But these soft-landing bulls got a dose of reality when another US Treasury auction flopped, and yields shot higher. It is going to be hard for the bond market to overshoot reality when the three main buyers have disappeared (the central banks of the US, China, and Japan) and more supply is coming down the pipeline. Notwithstanding today's move lower in the stock market,

equities remain resilient in the face of the highest 10-year Treasury yield in 16 years. We would also add that the equity market does not seem to care about the war in Israel despite its stagflationary impulses…slowing growth with high inflation. On the plus side (maybe), Retail Sales in the US are giving investors hope as there are still pockets of spending strength. But we are still cautious given the notional level of credit card balances, student loan repayments (even with the Biden exemptions), the tightening of bank lending, whack-a-mole labor strikes, a Housing market teetering on the edge, a Labor market showing cracks, sticky inflation, and chaos in DC (only 30 days until the next budget crisis hits…potentially with a lame duck Speaker of the House).

- Some stock fads might be reversing

Here is an interesting chart from Morgan Stanley (via themarketear). It shows how the AI trade has been reversing since early September. This gives us some comfort in trying to find some AI names to buy…now that some of the momentum has cooled and even reversed. We suspect we will see the same thing happen in the GLP-1 drug space. We do not have a particular view on Novo or Lilly in the short term. But we think some of the second derivate bets have run too far and might reverse. We saw the first inkling of that today when Abbot said its glucose device might be used in conjunction with the $1k shot.

- Earnings preview

Heading into this earnings season for 3Q, the expectations for EPS growth is 1.3% vs last year (y/y) and +2.8% vs 2Q (q/q). Revenues are expected to grow 0.9% y/y and 1.4% q/q. Nvidia, Amazon, and Meta are expected to have the largest growth in earnings.

- Inflation is still heating up in some spots

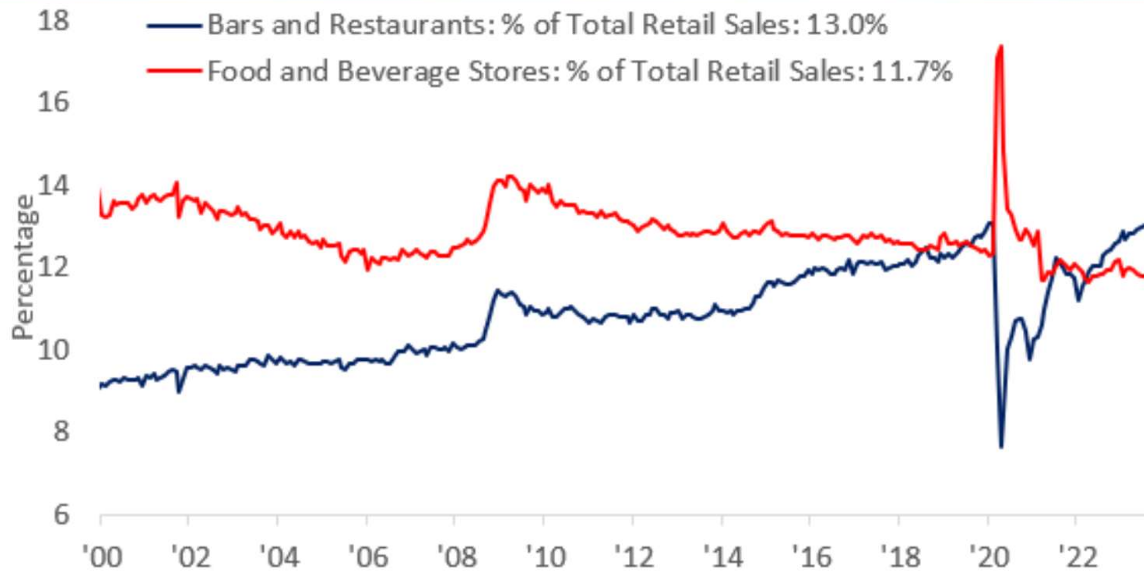
The Consumer Price Index (CPI inflation) was mostly unchanged in September. The headline CPI moved 0.4% higher vs the 0.6% move in August. The core CPI increased 0.3% which was the same in August. The annual numbers were 3.7% (headline) and 4.1% (core). 2% is still the Fed's target.

Shelter remains hot with an increase of 7.2% over the last year. Hotels and Motels accelerated higher from about a 3% gain last month to almost an 8% gain. And obviously oil is back rallying again.

- Retail Sales are still ok…when you do not account for inflation

Retail Sales in September decreased from August (+0.7% vs +0.8%) but beat expectations handily (+0.3%). Autos were a main driver of the beat vs expectations. Convenience Stores, Health & Personal Care, E-commerce, and Restaurants were all strong categories, too. As usual, Clothing, Furniture, and Electronics were the laggards with negative readings. The Redbook Retail Sales also increased at a nice clip of 4.6% over the last year (vs 4% in September). None of this data is adjusted for inflation. This go-to chart says it all:

And here is a chart from Bespoke showing the changing trend in eating out vs staying home. Our gut would tell us that Bars and Restaurants would get hit during a recession. But this does not seem to have happened back in 2008-09. But we think inflation is the differentiating factor now.



Business Inventories are starting to tick higher. This is always a conundrum…are businesses stocking up ahead of expected demand? Or are customers retreating? Looking at the Retail Sales numbers, we would guess they are split along industry lines.

➢ Housing outlook is worsening

The Housing Market Index (homebuilder survey) fell for the third month in a row and to its lowest level since January. Buy Traffic is dismal leading the decline. Unsurprisingly, builders blame high mortgage rates. They also note that input inflation is keeping prices high on top of the obvious short supply. It is not a coincidence that the stock market and housing market have mirrored each other this year.

Building Permits in September fell sharply. This data is pretty volatile month to month. Housing Starts, on the other hand, improved nicely after a dismal August.

Mortgage Applications made a new all-time low.

We have probably missed the bus on shorting these stocks. But they will be on the buy-radar if things really deteriorate (we still like the structurally short supply dynamic, but these names are too cyclical to buy and hold blindly).

➢ Other data is mixed
   - Industrial Production beat expectations with a decent 0.3% monthly growth. But this is still only 0.1% growth in the last year. The same trend holds for Manufacturing Production.
   - The NY Fed's Empire Manufacturing survey dropped back into negative territory.
   - The U Michigan Consumer Sentiment reading fell for the third month in a row. The index mirrors the resumption of inflation. Expectations are particularly glum.

➢ China might have bottomed, but it is unlikely to rebound

Inflation is still a problem in China…err, the lack of inflation that is. Disinflation has taken hold and deflation is right around the corner. The monthly rate increased at 0.2%, but this is still a flat reading for the year. And the PPI remains deeply negative (although to be fair, it has improved for four months now).

The Trade Surplus grew in September. But the main takeaway is that Exports fell for the 5th month in a row while Imports fell for the 7th month in a row.

But there is some good news. Industrial Production in September edged out expectations with a 4.5% gain. And Retail Sales increased 5.5% also beating expectations. 3Q GDP also beat expectations with a 4.9% increase. Alas, this is still down from the gain of 6.3% in Q2. But the quarterly growth was still better than Q2, so this is a positive. We think China might have stopped its slide. But we do not think it is poised to accelerate higher from here. The real estate noose around the country is tightening. And they car communists.

- India is growing and its inflation is cooling

We do not talk about India a lot (other than noting we are long), but some economic data stood out this past week. Industrial Production in August jumped 10.3% for the year compared to July's rate of 5.7%. Manufacturing Production increased at a 9.3% clip vs 4.6% last month. Meanwhile, inflation is cooling.

- The Fed wants the market to do its work

Susan Collins of the Boston Fed reiterated the belief that the market might have done the work of the Fed. But in a speech after the inflation report, she commented that it was too soon to be confident that inflation was moving back towards the 2% target. Specifically, she noted that "core services" inflation remains elevated and not much progress is being made.

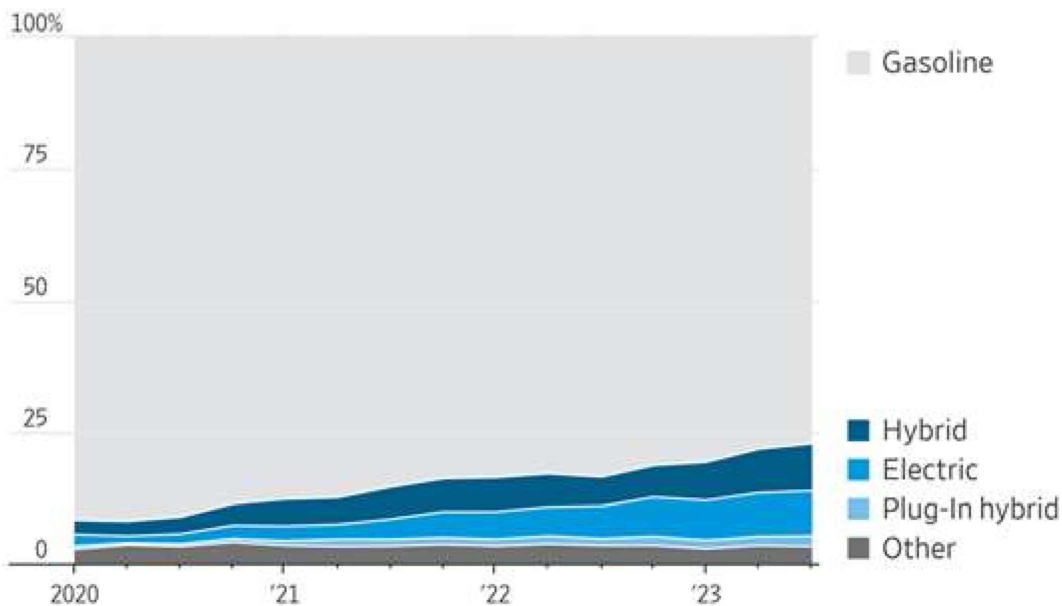
- Where did all the crypto money go?

This FTX trial is becoming more and more fascinating. Maybe not for the hopeless creditors. Caroline Ellison, the once-CEO of SBF's hedge fund and once-lover of SBF, is really spilling the beans. When one of FTX's lenders asked for a balance sheet, SBF asked Ellison to just make one up. Actually, she made up seven. Their methodology was ultimately simple: They started with the equity they wanted to show. They deleted the sketchy assets ("related party loans" sends up a lot of red flags). Then they just changed the liabilities to match that initial equity value that they had just made up in the first place! It took them seven iterations to find the perfect balance sheet. As usual, Matt Levine of Bloomberg lays this all out.

SBF's schtick that he's innocent and they were just young, dumb kids is proving to be an easy defense to crush. We hope Michael Lewis is following the trial.

- Chart Crime of the week

This might not have been an intentional chartcrime. But given it involves a highly politicized topic like electric vehicles, we bet it was on purpose. It will take you a second to spot the deception.



- Quick Hits
  - We were once invited to join the Screen Actors Guild. The union dues were more than our "acting" income.
  - A gambler in a California casino is suing MGM for losing $2mm after being drugged with a horse tranquiller (allegedly).
  - Used luxury watches have fallen in value by 35% in the last 18 months.
  - Approximately 25% of all drug prescriptions in the US are never filled.
  - Best Buy blamed slower sales on Taylor Swift.
  - The Millenium bridge in London has a bale of hay hanging from it to warn boats about the low clearance. This is mandated by law.
  - An analyst downgraded Colgate because of the GLP-1 drugs. Skinny people will not brush their teeth as much…apparently?

Trading: We are keeping on the same path with our barbell approach. We have added to our select Big Tech long exposure on down days. Our exposure in traditional defensive equities is minimal. We will buy more Energy on the next dip. We have been readjusting our shorts based on relative moves. Overall, we have increased our gross short exposures.

TSLAQ: Tesla reported lousy earnings as expected. It is no surprise that margins have collapsed considering the company has been increasing capex and lowering prices all while sales are stalling. Operating margin is down to 7.6%. This was 17.2% a year ago! And if you strip out the selling of credits/subsidies, the margin is only 5.3%. GM's margin is 7.6%. But it is a technology company! Of course, during the conference call, Musk only wanted to talk about AI, Full Self Driving, and "compute." But he was actually asked some tough questions…this is the first time I can recall that they allowed tough questions (instead of effusive layups from fanboy youtubers). Musk's best line of the call (not for the Tesla longs): "We dug our own grave with CyberTruck."

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