# Weekly Update

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- Nvidia, interest rates, and Retail have a common thread
- Everyone is long again
- Excess Savings no more
- Leading Indicators really do lead
- Student Loan Repayments starting soon
- Inflation is settling in (not a good thing)
- Jobs faltering slowly?
- The Housing market is locked up
- Business Spending is still elevated
- Business Sentiment is still souring
- The communists cannot, or maybe do not, want to fix this mess
- How many times does Fed chairman Powell have to say it?
- Oil companies are not drilling
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

| | Last | 5d % | YTD % | 1yr % |
|---|---|---|---|---|
| S&P 500 | 4,508 | 3.0% | 18.3% | 14.9% |
| QQQ | $377.89 | 4.6% | 42.3% | 26.4% |
| US 10 YR | 4.11% | 4.24% | 3.75% | 3.26% |
| USD/DXY | 103.6 | 104.0 | 104.5 | 109.7 |
| VIX | 13.6% | 17.2% | 22.9% | 25.6% |
| Oil | $83.58 | 5.7% | 4.2% | -8.8% |

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

The last two weeks have been dominated by Nvidia (again), interest rates (again), and the implosion of broad swaths of retail. Each of these has its nuances, but they all do tie back together. On Nvidia, earnings were spectacular. Interest rates are moving all over the place despite the imbedded volatilities of them falling. Of course, the market ignored the Fed chairman's warning about interest rates staying high for longer (yawn). But the market did consider some bad economic data as a sign that the Fed would do the opposite of what it had just said (the historically innocuous JOLTs data stands out as a new point of narrative). Meanwhile, the market pundits were arguing that the consumer was great, the economy was great, and the soft/no-landing narrative was back on. Never mind that large chunks of retail were suffering bad earnings, bad guidance, and lots of theft. So as usual, you just had to hang your hat on one narrative and ignore all the data to the contrary. This is where it ties back to Nvidia. The market seems to be coalescing around one theme: If there is going to be a recession, stick to the secular winners that can fight through it. And ignore (if not punish) the same, old boring stocks that protected capital last year. We think there is some logic to this. It is hard to argue that the Quality companies in the market are "cheap." But being impervious to a recession is worth the price of admission…or so goes the theory. While we have increased our long exposure to some parts of Big Tech, we have this balanced with some more shorts and a heavy cash weighting.

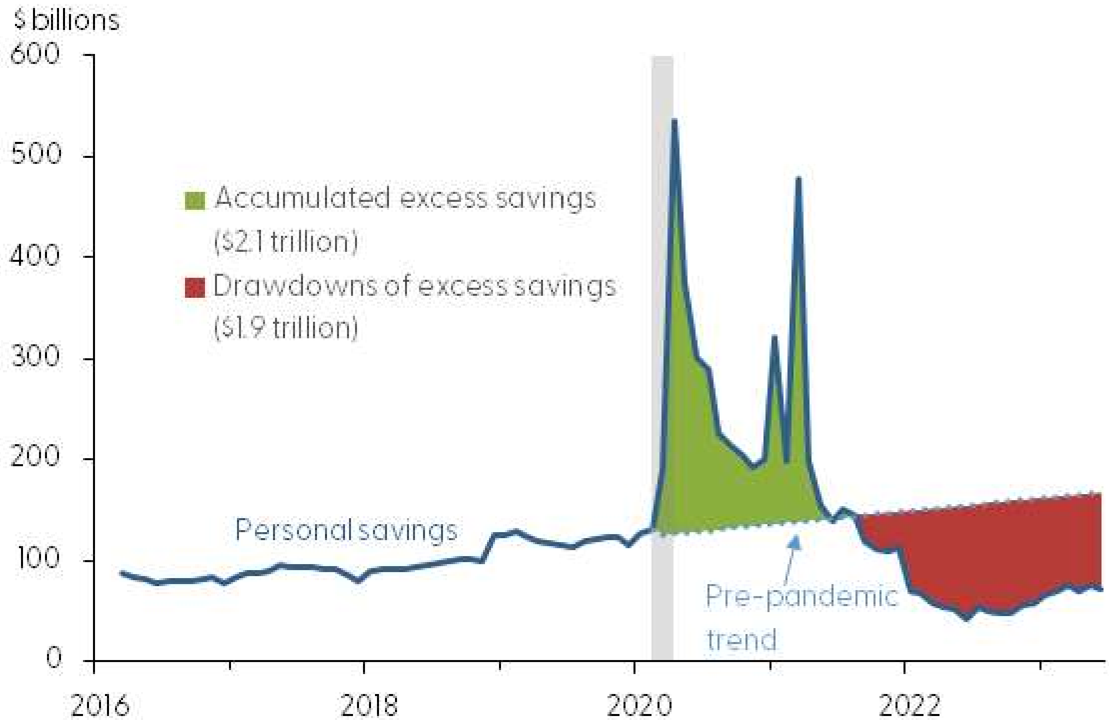
- Everyone is long again

The Merrill Fund Manager Survey shows large investors are the most bullish they have been since the end of 2021. Equities have the highest weighting since early 2022. Tech is the most overweight since Dec 2021. 75% expect a soft/no landing for the economy. EPS optimism is the highest since Feb 2022. While inflation is still considered the biggest tail risk, most respondents expect lower rates in 2024. Specifically, the "expectations for lower rates now are the highest since November 2008." Japan is a hot asset allocation now which scares us (we are long Japan). But it makes sense given that it is one of the few economies with expanding growth, the right mix of inflation, and a cowardly central bank.

- Excess Savings no more

Recently, we commented on the dwindling Excess Savings (however unrigorous that stat is). Well, the San Francisco Fed has stepped in and said it has dropped from a Virus-Fear high of over $2t to now just under $200b. And that is likely to be exhausted by the end of September (right when student loan repayments kick in). The chart is a bit tricky since the numbers are accumulated (and not points in time). But the trend is clear. And this is an obvious reason for the record credit card balances now. Oddly, Bloomberg writes that bloated debt costing 24% is a sign that the consumer is strong. To the contrary, JD power takes the negative spin when it says that more credit card borrowers are now rolling over their balances instead of paying them off. We will side with JD on this one.

Figure 1: Aggregate personal savings versus the pre-pandemic trend

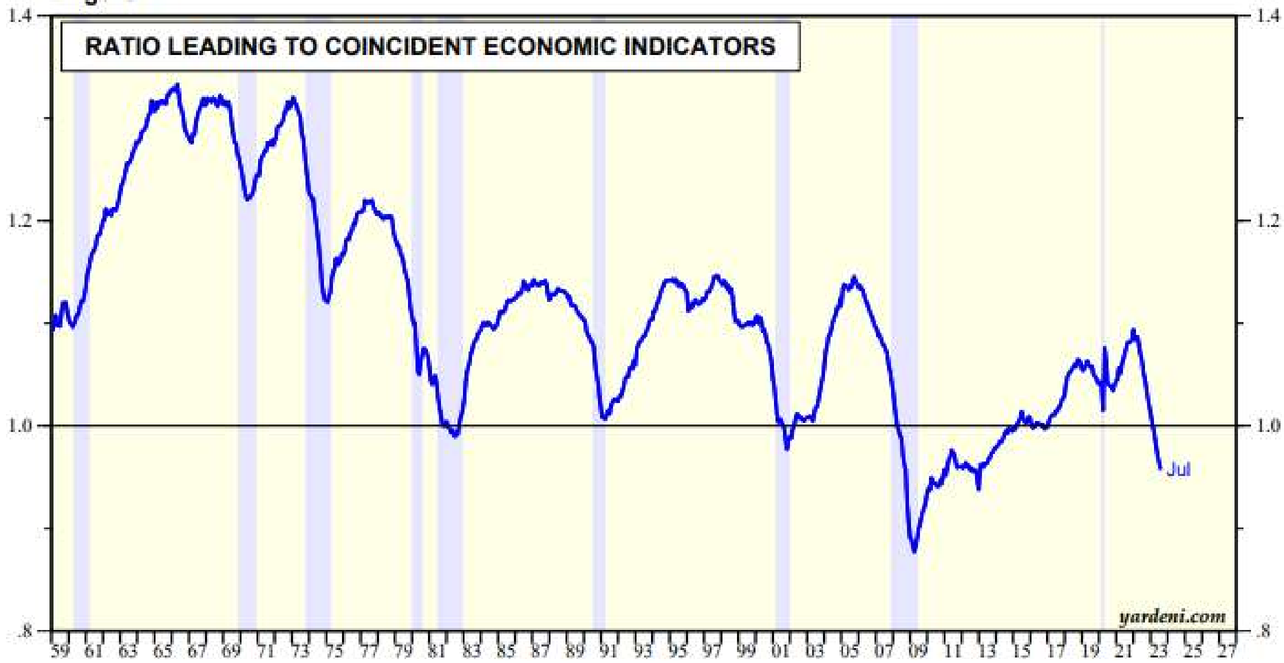



Source: Bureau of Economic Analysis and authors' calculations.

- Leading Indicators really do lead

The Leading Economic Indicators fell for the 16th month in a row in July. We have pointed out before how strong the correlation is between this index and GDP. But some pundits have tried to twist the narrative into watching the Coincident Economic Indicators instead of the Leading. But as you can see from the Yardeni chart below, the ratio between the two is just as robust at predicting recessions.

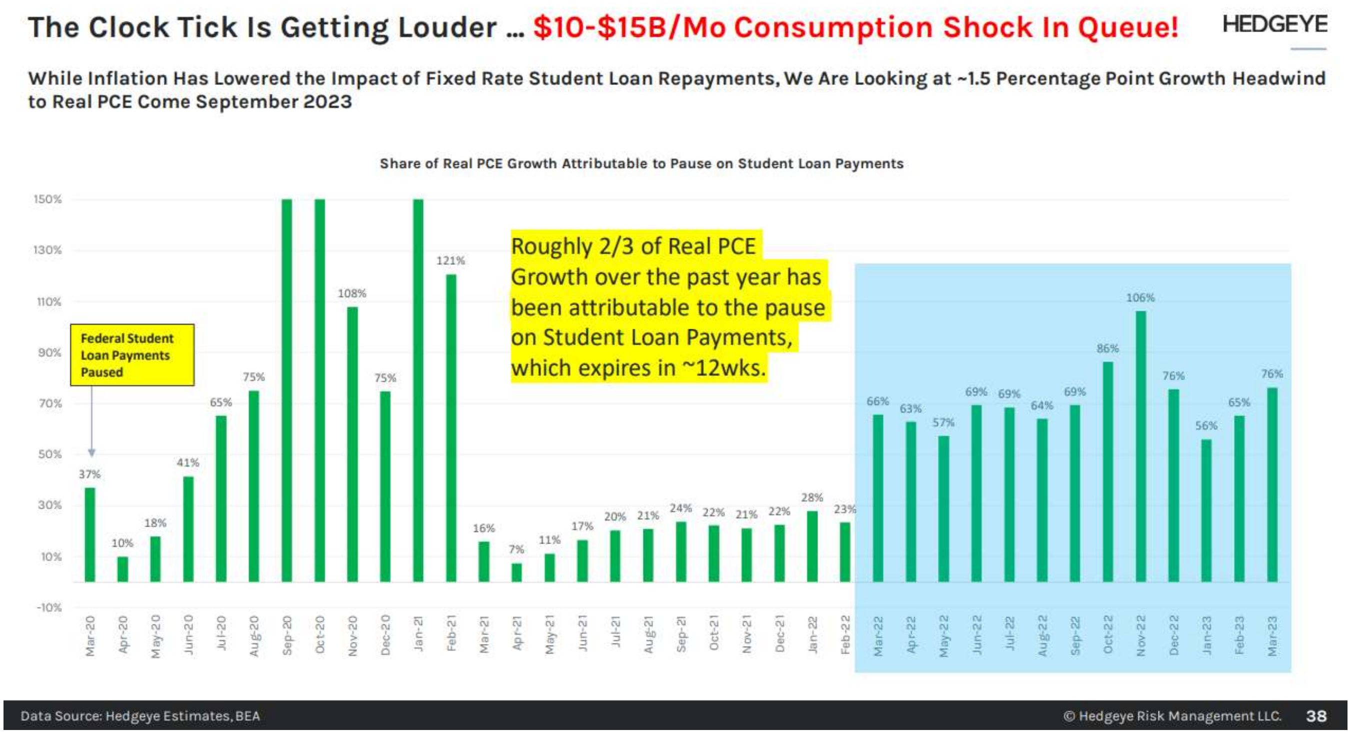
**Figure 2.**




Note: Shaded areas denote recessions according to the National Bureau of Economic Research.
Source: Conference Board.

- Student Loan Repayments starting soon

We have written repeatedly about the coming repayment cliff for over 40mm student loan borrowers. Notices have just been sent out as of today. Most repayments will start to be due in two to six weeks. This pause in payments has apparently had a much larger impact than we imagined (and we imagined a lot). Hedgeye puts the numbers in context (the chart is a bit dated, but it still tells the story). The total amount of consumption that has been tacked on is estimated to be $10b-$15b a month. Roughly 2/3 of the growth in Personal Consumption Expenditures (PCE) stemmed from this debt moratorium. The data below looks choppy…the moratorium accounted for a lot then very little then a lot again. This is a function of other government handouts and the level of consumption. But whatever the case, even assuming lots of slippage in these numbers, the net result has been a powerful tailwind for the consumer. Drilling down a bit, 47% of the total student debt outstanding is held by the top 12% of borrowers (top means higher income). Discretionary spending is due to take a hit.




➢ Inflation is settling in (not a good thing)

The Personal Consumption Expenditures price index increased as expected in July (PCE inflation). The 0.2% monthly increase is the same as in June. It moves the annual increase up to 3.3% from 3.0%. The Core inflation also increased 0.2% vs June. This brings the annual increase to 4.2%. Service prices moved higher while Goods prices decreased. On a related note, Personal Spending accelerated (0.8% vs 0.5%) while Personal Income slowed (0.2% vs 0.3%). That is a bad combo.

➢ Jobs faltering slowly?

We have been beating this drum for a long time…with the market not caring one iota. But the labor market is still showing some cracks. The ridiculously high Job Openings continue to fall (ridiculous = fake). The July reading fell to 8.8mm openings. This is down from the peak of 12mm in March of 2022. Quits, an obvious sign of a strong labor market, also fell sharply. They are down 21% in roughly the same period. As a percentage of total employment, the rate is back to pre-Virus Fear levels (2.3%, but this was the high end of the 20-year range leading up to that point). Here is a 10-year chart for the openings.


And oh yeah, the government very quietly reduced the number of jobs gained in the year from April 2022 to March 2023. In a normal course of revision, 306k jobs disappeared. Of course, government jobs were revised higher by about 50k. Logistics lost about 150k. We get the official Employment Report this Friday.

On the plus side, Jobless Claims are still trending lower. Some say this is due to the type of layoffs happening. That is, white-collar employees are less likely to file for unemployment benefits than the typical blue-collar worker. This seems random to us.

- The Housing market is locked up

New Home Sales increased in July. They hit the highest mark in a year. Since September, they have picked up from an annualized rate of 567k to the current 714k. This 26% increase contrasts with the 13% decline in Existing Home sales over the same period. Obviously, the extremely tight supply is driving this dynamic. The 980k Existing Homes for sale in July were the lowest number since 1982 (and this is not adjusted for population!).

Existing Home Sales fell 2.2% in July vs June. The total amount (recall this is an extrapolated annual number based off monthly data) is almost back to the January of 2023 number. (The chart is unlabeled, but the y-axis is 1000's of Existing Homes sold on an annualized basis.)

➢ Business Spending is still elevated

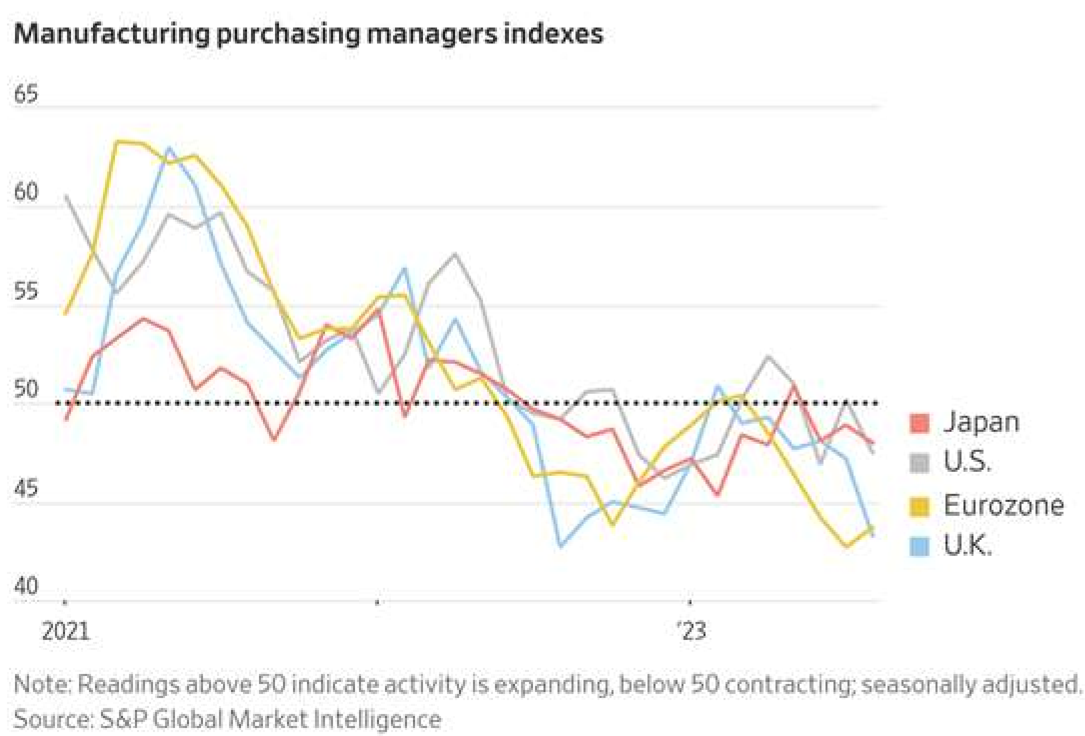
Durable Goods Orders for July fell more than expected. The 5.2% drop is the largest since April of 2020. But this was mostly due to a large drop in transportation goods (planes). And that is why there is a separate category of Core Capital Goods which strips out Defense items and Transportation. This proxy for business spending moved back just above the positive line with a +0.1% gain vs the -0.4% drop in June. This data is notoriously choppy month to month. And it does not account for inflation. But this is still a patch of strength.

➢ Business Sentiment is still souring

The early look (Flash) at the S&P Global PMIs (fka Markit) for August showed weakness as both the Services and Manufacturing fell. This marks the third month in a row of declines for the Composite which sits just above the breakeven line of 50.

The Philly Fed moved squarely back into positive territory for August. New Orders were strong. But so were Prices Paid. Employment and Capex are negative and getting worse. The Richmond Fed Manufacturing Index remains in negative territory. Its Services index did bounce back into positive territory. The Chicago Fed's National Activity index ticked back into positive territory. This one is pretty worthless as it hugs the neutral line 90% of the time. But it is those outlier moves that keep it on our radar. The Dallas Fed Manufacturing index improved slightly, but it is still in deep negative territory. The Dallas Fed also has an overlooked Services index. This is edging back up to the breakeven line which is the highest it has been in over a year. The Chicago PMI (a Composite index) in August increased sharply…to still remain in negative territory for the 12$^{th}$ straight month.

Here is a snapshot of some global Manufacturing PMIs. Hard to find a silver lining here. Although the decent Durable Goods data tells a different story.




➢ The communists cannot, or maybe do not want to fix this mess

Industrial Profits in China have fallen by 15.5% this year (through July) compared to last year. The private sector did better (-10.7%) than state-run companies (-20.3%).

China's official Manufacturing PMI staying in negative territory albeit with a slight uptick (49.7). New Orders moved back into positive territory. Services, on the other hand, slipped closer to the breakeven level (51). New Orders are lagging. The best part of the report is the Composite of the two segments was 51.3. Interesting math from the communists. (We are sure there is some overly complicated methodology explanation…but the obfuscation is obvious).

China Evergrande, the first embattled property developer to disclose problems about a year and half ago, had its shares resume trading in Hong Kong. They promptly fell 80%.

The communists continue to tinker around the edges with respect to stimulating the economy. But they have all been futile. Dictator Xi will have to abandon his attack on business and capitalism for any measures to truly take hold. That is a bet we are not willing to make.

- How many times does Fed chairman Powell have to say it?

Powell's speech in Jackson Hole had an overwhelmingly hawkish tone. He talked about the likelihood of the economy growing at "below trend" levels. He expects the labor market to ease further (many think 4.5% is the unemployment target up from the current 3.5%). Regarding inflation, he said the economy must cool to see any sustained reduction in prices (and not just the recent two months, he noted). This is obvious, but he made it quite clear…there is very little chance of the "no-landing" scenario. He squashed any notion that a cooling in inflation was evident. Core Services ex-Housing was a key topic. And he emphasized that interest rates do not have much of an effect on this segment of the economy. All in, he expects the Fed to maintain its restrictive policy for some time. Moreover, he thinks there could be more "drags" from past hikes.

- Oil companies are not drilling

The Baker Hughes Rig Count fell again. It has been a steady beat lower all year after rallying for two and a half years off the Virus Fear low (when crude futures went negative if you recall!). There has been lots of talk about Permian drillers "ramping up production" despite their stated intentions to constrain capex and to prioritize returns to shareholders. We think this increased production narrative is misleading. That is, production can be increasing slightly with the companies also maintaining fiscal prudence.

- Where did all the crypto money go?

The SEC has fined an investment advisor for marketing a 2700% annual return for its crypto product. Alas, this return was hypothetical. In fact, the return was a hypothetical three week return which the firm then extrapolated to a year. No word on how many suckers were duped by these fraudsters.

(For the record, hypothetical returns are allowed under new SEC rules, but we think it is obvious that the above fraudster took it a bit too far.)

- Chart Crime of the week

The Financial Times must be trying to garner this not-so-esteemed acclaim.


- Quick Hits
  - In arguing its case that buying Spirit Airlines will increase competition and reduce airfares, JetBlue's lawyers accidentally released some documents detailing JetBlue's plans to increase prices by around 40%.
  - Heineken sold its Russian business for $1.
  - ING bought Barings for $1 back in 1998.
  - El Paso is bigger than Boston.
  - Mesa (Arizona) is bigger than Atlanta.
  - Michele Obama spoke at the US Open tennis championship.  She implored equal pay for men and women in the sport.  The men's and women's champion will each earn $3mm.
  - The University of Nebraska volleyball game had 92k fans.  The team has sold out 306 straight games.
  - The average annual premium for the average home-owners insurance policy is up 20% in three years.
  - 12% of American home-owners do have not home-owners insurance.
  - Tokyo has the largest fire department in the world.

**Trading**:  We continued to buy some Big Tech.  We err to the cheaper side in most cases (we do not dare say cheap).  To counter this, we added to some shorts…very slowly and in small size.  And we trimmed some of our conservative positioning.  So our net exposure has not moved much (still a large cash weighting).  But we are going for more of the bar-bell approach.  We have been too conservative.  We acknowledge that the much awaited (and deserved) recession may only hit the weaker parts of the economy.

**TSLAQ**:  Musk compared the specificity of the parts and materials needed to produce the Cybertruck to that of Legos and soda cans.  We are not sure his comparison impressed a lot of people.

Hilariously, Microsoft Word's first autocorrect suggestion to Cybertruck is Cybercrook.

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