Weekly Update

20-April-2022
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- The Death Rotation might be back
- Input prices and Earnings are correlated? Nah…
- Equity Volatility is not following Bond Volatility (and it should)
- Retail Sales look ok…until you adjust for inflation.
- Housing demand is starting to crack
- Signs of disinflation (not deflation), but this will not stop the Fed
- Chinese economic data is ugly
- Fed commentary is not perfectly in sync, but directionally there is no doubt
- Oil Volatility mimicking the bond market's Vol
- Quick Hits
- Chart Crime of the week

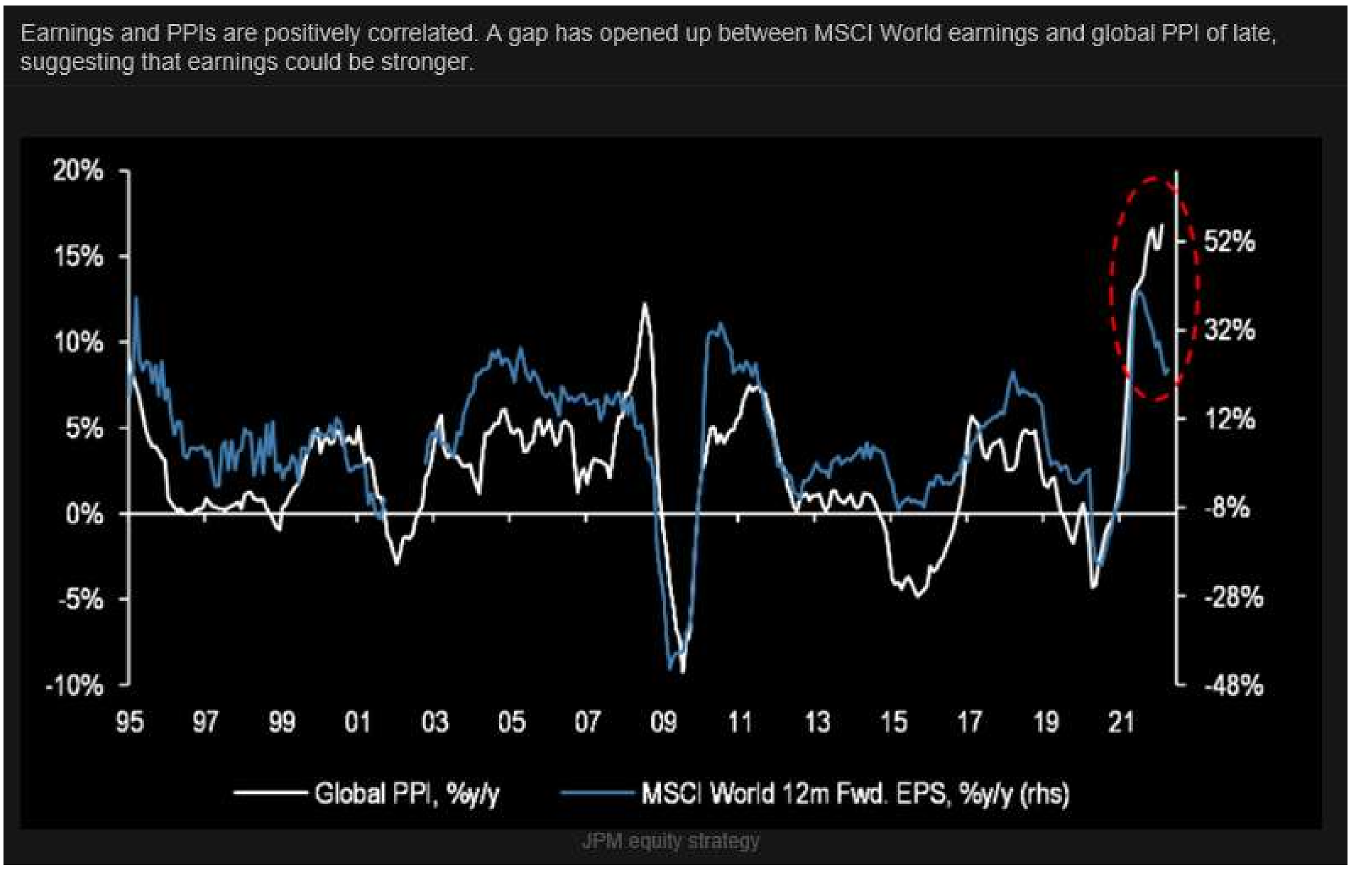
	Last	5d %	YTD %	1yr %
S&P 500	4,481	0.3%	-6.1%	8.5%
QQQ	$341.21	-1.2%	-13.9%	1.5%
US 10 YR	2.92%	2.84%	1.51%	1.56%
USD/DXY	100.3	99.8	96.0	91.2
VIX	20.3%	21.8%	17.2%	17.5%
Oil	$102.56	-1.6%	36.6%	64.6%

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

A drop in the headline equity Volatility indicated by the Vix is obscuring continued uneasiness in the market. In other words, we are starting to see the aggressive rotation symbolic of troubling times (we often call this the Death Rotation as it ultimately leads to hedge funds imploding because they cover their shorts and sell their longs at the exact wrong times and thus the virtuous becomes the vicious). Some of this is driven by earnings debacles (see Netflix and Carvana). Some is driven by the fear of earnings debacles to come as inflation erodes margins and a slowing economy erodes top lines (revenues). Most of this ultimately comes back to the Fed's thumb on the free markets (suppressing interest rates), and the government's profligate fiscal policy. With all of this coming to an end, it is only natural for investors to rethink their playbooks from the last 13 years. An easy way to view this is the outperformance of Value stocks over Growth stocks. It is 2.3% over the last week, 4.3% over the last month, and a seemingly whopping 14.7% year-to-date. Of course, Growth has still outperformed by over 50% over the last five years and by 290% over the last 13 years. Point being, there is more unwinding to go!

- Input prices and Earnings are correlated? Nah…

We came across this chart from JP Morgan which is befuddling to us. The premise is that Earnings and PPIs (Producer Price Indices…input prices) are positively correlated (there is a 12-month lag on the EPS chart below). JP Morgan concludes that "earnings could be stronger." Ignoring the chartcrime of the dueling axes, we think there is evidence that a sharp increase in the PPI actually leads to lower earnings. A smoothed out 27-year dataset might show the two are correlated because most inflation (CPI or PPI) has been so tame that companies have been able to navigate any changes. But this latest shock, while obvious, did happen very quickly. We conclude that Earnings will likely not be stronger. And when we see PPIs turn lower, it will likely be too late (after demand destruction and the inevitable recessions).



Earnings and PPIs are positively correlated. A gap has opened up between MSCI World earnings and global PPI of late, suggesting that earnings could be stronger.

- Equity Volatility is not following Bond Volatility (and it should)

We always write about equity Volatility, but the bond market Volatility is the real story lately. How VXN, the Nasdaq Volatility, has not exploded higher with the increase in bond volatility (MOVE Index) is a mystery. Some expect it to happen when the Fed starts selling its massive portfolio of bonds (Treasuries and Mortgage-backed Securities or MBS). This does not make much sense to us as the market never waits for something to actually happen. But perhaps it will serve as the wake-up call that the Fed is being serious (not sure how one would think otherwise).

- Retail Sales look ok…until you adjust for inflation.

Retail Sales in March ticked 0.5% higher compared to February. This is about a 7% increase vs last year. Restaurants, department stores, and grocery stores had the strongest growth. Home improvement was barely up. None of these figures are inflation adjusted. The Ex-Autos number was much stronger at 1.1%.

- Housing demand is starting to crack

Redfin, an online real estate listing company like Zillow, says homebuying demand is starting to falter. Here are some of their stats along with a few others:

- Its Redfin Homebuyer Index fell 3% in the last four weeks compared to a 5% increase last year.
- House touring activity fell 23% year-to-date vs last year.
- Mortgage applications were 6% vs last year. Although they did experience a 1% increase on a weekly basis.
- Google searches for “homes for sale” fell 3% during the April 9 week.
- The average 30-year fixed mortgage rate is above 5%.
- The median asking price is almost $400k.
- The average mortgage payment (for recent purchases and new listings) is up 35% vs last year.
- 13% of new listings had their prices reduced in the first four weeks. The recent average is around 9-10%.

But supply remains super tight.

- 58% of homes that went under contract had an accepted offer withing two weeks of hitting the market. This is a record.
- 44% of homes that went under contract had an accepted offer within one week of hitting the market. This is also a record.
- The average closing price is selling for 102.4% of its asking price. Another record.

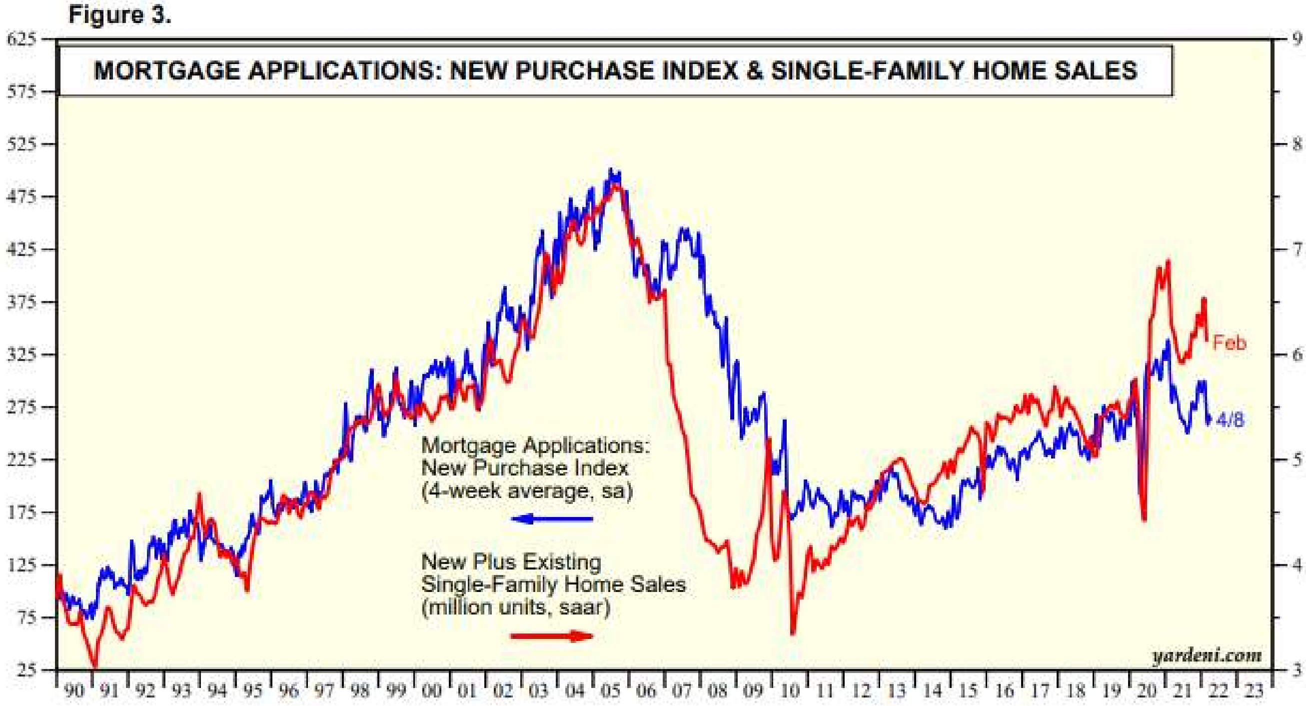
As for the larger data points, the Housing Market Index for April (home builder sentiment survey) slipped for the fourth straight month. It is back near the lows seen last summer when the delta variant spooked people. Current Conditions and Buyer Traffic both slipped. But Sales Expectations increased. This is a small rebound (three points) from the sharp drop in March (10 points).

Housing Starts and Building Permits in March both increased from February levels. Moreover, these are levels last seen during the housing crisis (on the downslope of that circa 2007). But the underlying data tells the real story. Single family home starts declined 4.8% while multifamily increased 10.9%.

Existing Home Sales for March matched the underlying trend in New Housing Starts: they fell 4.5% on an annual basis and 2.7% on a monthly basis.

Mortgage Applications often get overlooked because it is weekly data which can be noisy. But clear trends can still be gleaned from the data. Below is a chart juxtaposing Mortgage Applications against Home Sales (New plus Existing). You can see it is very rare for Home Sales to remain strong when Mortgage Apps fall or lag. Something has to give. And with the average 30-year mortgage rate at over 5%, we have an idea which one will move (the average monthly cost is now up 35% from last year).

Figure 3.



Source: Mortgage Bankers of America.

➢ Signs of disinflation (not deflation), but this will not stop the Fed

Used car prices are starting to slow…right on schedule. April of 2021 was when car prices really started to spike higher. It is only a matter of math that price increases will be smaller when compared to a higher base. The popular Manheim index shows prices down over 6% in April vs January. The annual increases are dropping slowly, too. January prices increased 45%, February 36%, March 24%, and April 14%. May will likely be flattish. And recall that used car price increases have accounted for about 15% of total inflation. And while we did cite raging home costs (above), we think these high prices will do what they typically do…kill demand which then hits pricing. But we know food prices are staggering and energy prices are remaining elevated (actually, exhibiting some disinflation). We have noted before how the impacts on inflation from different goods and services keeps rotating. This makes the Fed's job that much more difficult.

- Other Economic data is mixed
  - The NY Fed's Empire Manufacturing came roaring back after its miserable negative -11.8 reading in March. The April number was 24.6.
  - Industrial Production grew at the same pace in March as February (both 0.9% monthly increases). Durable Goods and mining were the strongest components. Utilities, perhaps the best indicator for overall economic health, only increased 0.4%. On the plus side Capacity Utilization continues to steadily climb.
  - Business Inventories increased 1.5% in February vs January.
  - University of Michigan's Consumer Sentiment bounced from its all-time lows, but it is still a terrible number representing extreme pessimism (or at least an utter lack of optimism). The inflation expectation component remained steady at 5.4% which, like inflation itself, is at a 40-year high.
  - Jobless Claims ticked higher to 185k.

- Chinese economic data is ugly

Chinese GDP grew by 4.8% in Q1. This is up from 4.0% in 4Q2021. Industrial Production, on the other hand, slipped to just a 5% increase in March compared to the 7.5% gain in January and February (on average). Fixed Asset Investment increased 9.3% in March. But this is down from a gain of 12.2% in January and February. And Retail Sales fell 2% in March vs February. As always, remember that these are all lies. The direction of the lies is what we watch. China is in trouble especially if it keeps up the politically motivated 0-Covid insanity.

- Fed commentary is not perfectly in sync, but directionally there is no doubt

As for the Fed party coming to an end, Jim Bullard of the St. Louis Fed upped the ante on hiking interest rates. He says the Fed should be moving towards 3.5% on the Fed Funds target rate (it sits at 0.25-0.50% right now). Recent conventional wisdom had this "neutral rate" somewhere around 2.5%. Bullard also thinks a 75bps hike to try to crack inflation is in the cards, "I wouldn't rule it out." He thinks the market has already priced in the Fed tightening (true, as long-term real interest rates are back to positive territory). This means the Fed can comfortably continue with its tightening course if not accelerate it. The Chicago Fed's Charles Evans and the Atlanta Fed's Rafael Bostic were less dramatic and showed more of the original Fed colors. That is, Evans thinks the Fed does not need to go beyond the theoretical "neutral" rate of 2.50%. Bostic said slowing global growth shows that the Fed does not need to rush beyond this same neutral rate. But oddly, Neel Kashkari of Minneapolis, the perma-dove always calling for more free money, thinks the Fed might need to do more if supply chains do not improve. Ultimately, we think the inflation hawks will win the day and hike the economy into growth oblivion.

- Oil Volatility mimicking the bond market's Vol

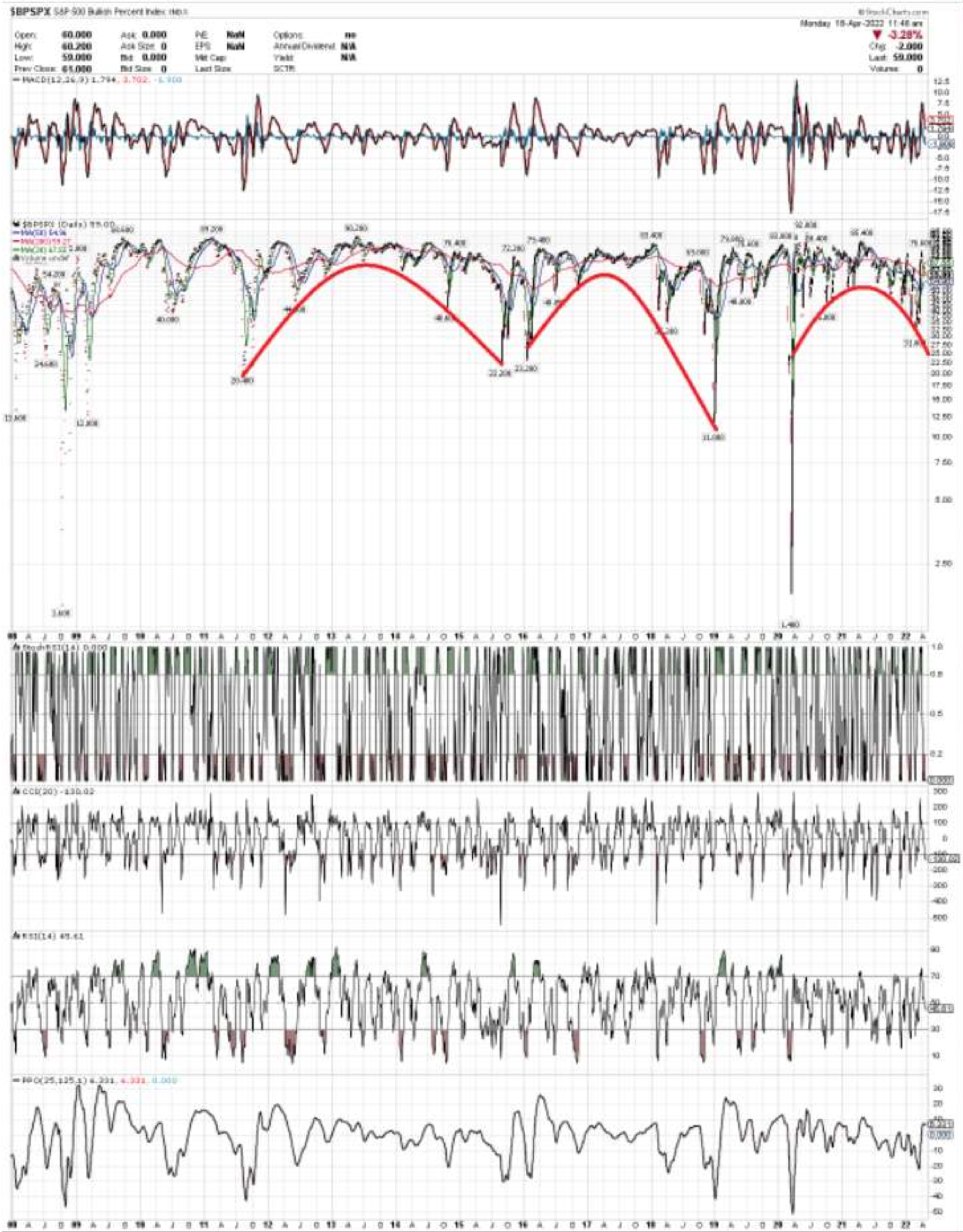
The onslaught of news in the commodity space continues apace. Here are the bullet points:

- Domestic leisure travel continues to rebound. TSA checkpoint data shows passenger volume is back to just 10% below the 2019 rate.
- Permian drilling permit issuance reached an all-time high in March. Private companies, which account for a third of the production, are responsible for half of the new permits. Public companies are still heeding the call from investors to be prudent and prioritize returning capital to shareholders over production growth. This likely means the trove of permits oil companies have been sitting on maybe not hold the best prospects for production. CEOs said as much to Congress last week (they highlighted supply chain issues in certain permitted areas).
- The WH announced it was lifting the ethanol blending cap to 15% from 10%. This is classic "be careful what you wish for" as this will obviously impact corn prices (which impacts food prices across the spectrum).
- The Department of Energy (why does this exist?) expects thermal coal production to increase over 7% this year. Since the coordinated announcement of 240mm barrels of oil to be released from government reserves, forward oil prices (June 2023) have increased 7%, natural gas prices 20%, and coal prices over 30%.
- China is starting to cut refinery "runs" evidenced by decreasing exports of refined products.
- Libya has closed its largest oil production facility as well as its largest port. The standard civil unrest (militia attacks) is the reason.
- Hungary and Armenia are the only countries to buy Russian gas with Rubles.
- Experts (real ones, not TV phony baloney) are reporting that once Russia oil is taken off line, it could take years to turn it back on thanks to an insufficient storage infrastructure.

Ultimately, we still think there is virtually no spare capacity in crude oil. China's lockdowns are the real wildcard as they can destroy a lot of demand very quickly. But we think the path of least resistance in the short to medium term is higher for oil & gas and related equities.

- Chart Crime of the week

This was posted by a so-called expert challenging someone else's assertion about the economy. (Yes, the fuzziness and sizing are replicated accurately.)



$BPSPX S&P 500 Bullish Percent Index
Monday 18-Apr-2022
▼ -3.28%

➢ Quick Hits

- The latest subprime lending fiasco is dog leasing in Massachusetts.
- Goldman is advising Twitter and has recommended that the board not endorse a sale to Musk. Goldman has a Sell rating on the stock.
- Jack Dorsey, one of the Twitter founders, sold an NFT (fake art) of his first tweet. This was last year, and it sold for $1.9mm. It was recently put up for sale. The maximum bid was $280.

Trading: We closed a few small shorts in the semiconductor space. We will look to put these back on if the market rallies. We added a bit to our Health Care long. We still think this is one of the sectors to be long going into a slowing economy. We added to our Gold long as it sold off a bit after a strong run…we think the strong run will resume.

TSLAQ: We got our answer about the Villain's intentions with Twitter. He is going hostile in his attempts to buy the company. Of course, we are guessing it is all a lie, and he just feels slighted by the Twitter board. In Musk's defense, he owns over 10x what the board members own (once Jack Dorsey's term is up), so his voice should be heard. Of course, intentions only go so far. Reportedly, Musk is not having much luck getting the financing to complete the deal. He has already pledged huge amounts of his Tesla stock to fund his lifestyle and other business ventures (like digging tunnels under Vegas). And private equity funds have not shown much appetite to join in a vanity project without much planned detail for how to make money. As for the car company itself, earnings came out tonight and were lauded as a "Cinderella story of earnings" by one fanboy analyst. We are not sure what this means. The earnings were ok…we think. Most of the growth came from the "Other" category. So, as usual, who really knows what is happening there. We still have a small short for the inevitable blow-up one day.

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