Chalk Creek Partners LLC

Registered Investment Advisor

Weekly Update 25-November-2020

Carlisle C. Wysong, CFA *Managing Partner*

- Market continues its post-election/vaccine rally
- US Economy might wobble, but it looks better than Europe
- Housing, of course, continues to be strong
- Does the Fed have fewer tools in the chest? (No)
- Bitcoin is a frenzy driven by a new restriction on supply
- Chart Crime of the week
- Happy Thanksgiving!

	Last	5d %	YTD %	1yr %
SPX	3573	1.7%	14.0%	19.0%
QQQ	296.3	2.1%	40.0%	47.9%
US 10 YR	0.89%	0.84%	1.88%	1.75%
VIX	21.3%	23.1%	13.8%	11.4%
Oil	45.83	10.1%	-25.1%	-21.2%

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

The market continues its post-election/vaccine rally. The pundits are a buzz with proclamations about the quality of Biden's early cabinet decisions, better economic data, vaccine progress, political stability, etc. But the reality is that it is a full-on feeding frenzy. All of the idiot stocks and sectors are on fire. Be they EV charging stations, cruise liners without passengers, profitless software/cloud companies, or God-forbid cryptocurrency-linked platforms…lunacy has taken over the market. We try to look past this stuff…so turn off the CNBC. We are still seeing rotations amongst the more generic or original market factors like Growth and Value. This is where we are focusing our attention. We think continuing to rebalance the portfolio against what is happening as the flavor of the day is the best way to add some alpha on the margin. We submit this under the guise of continuing to run a balanced portfolio keeping these factors top of mind.

Last week we discussed the bullish positioning highlighted by the Merrill Fund Manager Survey. Merrill's conclusion was to "sell the vaccine" with which we agreed. This week, Merrill published some of the unattributed feedback: "Too early to sell, let's chat in the spring." "Buy the reopening." "On it, but we ain't selling tech." What this means to us is that there will have to be a negative catalyst to sell. This is probably stating the obvious, but the path of least resistance for stocks is still higher. Along these lines, there is a good Twitter thread asking what caused the dot.com bubble to burst. Needless to say, there was/is no straight answer. So, while we have added to our longs…we have even dipped out toes into some of the more speculative segment of the market…our leash will be short. More to this point, some of the traditional indicators of an improving economy are missing from this rally. Treasury yields have not moved higher (or more precisely, the yield curve, the spread between the 2yr and 10yr has not increased). And the Japanese Yen is still as strong as ever against the USD. And did we mention that people are celebrating Dow 30,000? We will relegate our riffing on the absurdity of these "milestones" to our [Glossary of Jargon section of our website.]

Random nod to politics: There is a quiet push coming from the Trump administration to create an alliance of nations to jointly retaliate against China when it deploys its usual, coercive tactics. Not that it matters what the Trump admin does right now, but this could be a great baton handoff to team Biden. Dare we say common ground?

Here is an interesting observation from Goldman Sachs. The quietest time of the market day is heading into the close. Traditionally, the close has been one of the most volatile periods of the day (along with the open). This might just be a function of increased volume…the more concentrated volume the more smoothed out the returns. But we also think it could be a function of investor fatigue. The boutique research shop Bespoke always points out that most of the market's returns happen from close to open…not from open to close. Perhaps investors realize this on a daily basis at the end of each day! For our purposes, this tells us to look for cheap Volatility opportunities late in the day. The late-day dip might not seem like a lot, but it translates into a a 20% discount.

Exhibit 3: Close-to-close SPX realized vol has been 20% in November - but would be as high as 29% if prices were recorded at an earlier time of day

SPX November calendar-month realized volatility based on daily prices from different times of day (NY time)

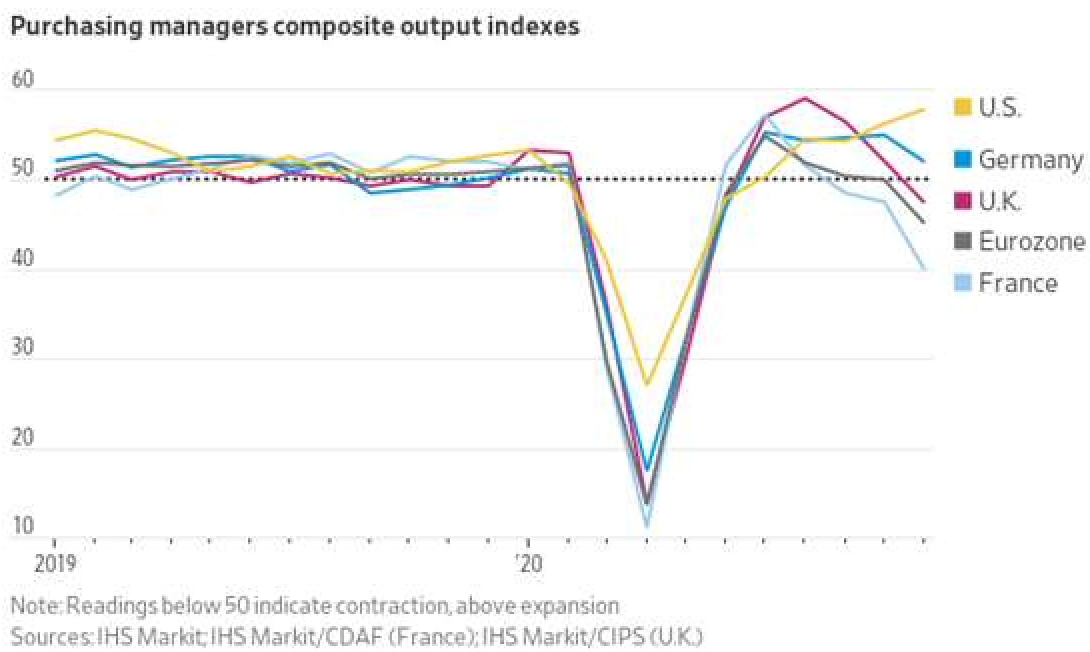
Source: Goldman Sachs Global Investment Research, Reuters

- ➢ US Economy might wobble, but it looks better than Europe

Economists are starting to downgrade US GDP growth expectations for Q1. JPM thinks the economy will slow to a 1% growth rate. Credit Suisse is in a similar boat with a 0.7% expectation. This compares to the +3% growth expected for 4Q of this year. Doing this comparison to the just-finished 3Q is pointless since GDP grew 33.1% after 2Q's 31.4% drop! (Remember, these are annualized numbers, so they are distorted.) This slowing is predicated on the drop-off in fiscal stimulus (handouts) along with a likely rise in governors clamping down their economies. But we think the likelihood of both happening concurrently is low. If businesses are being shuttered, governments will act with more stimulus. Or at least the Fed will act. Even with a blip lower, we think some of the core economic indicators are showing sustained strength (PMI's and Housing, below). On the flip side, it looks like Europe is going to contract in the 4Q thanks to the government shutdowns. The Flash (early look) Eurozone PMI for November registered a lousy 45.1. Oxford University has a Stringency Index for government lockdowns. While the recent policies are not as strict as those in the spring, they still register about a 65 compared to about 80. (This could almost be a chart crime since there is no history of government lockdowns, but we think it gives a decent relative view of now vs then).

In the US, the Flash (early release) PMI for November hit a five-year high at 57.9. The surprising strength was rooted in the Manufacturing sector as it almost equaled Services…which is rare. We find the strength in these PMI surveys odd when juxtaposed with the rather tepid regional Fed bank activity indices (Richmond Fed was another one that dropped). We suspect the surveys are more forward looking than they intend to be, so this translates into hesdline optimism.

Here is the notable discrepancy in survey trajectories:



- Housing, of course, continues to be strong

Housing continues to run. New Home Sales for October remained at their 15+ year peak. Prices according to the FHFA (Federal Housing Finance Agency which uses data from Fannie and Freddie which promote home ownership through buying mortgages from issuing banks) jumped 9.1% in September vs an 8% increase in August. A different housing price index (Case-Shiller which measures 20 large cities) showed a 6.6% jump. The difference between these price series is that the FHFA covers homes with mortgages under $510k while most big city prices are near the higher end. So lower end homes are moving the most. Whatever metric you use, housing remains on fire. There is even a report from Redfin saying demand for urban homes has finally started to tick higher, too.

- Other economic data

Durable Goods Orders for October continue to grow albeit at a slower pace. The same holds true for the more important Core Capital Goods…aka business spending. September's numbers were revised higher. Given this data can be lumpy with lags, we think it is still in a good spot.

The Fed's preferred inflation gage, the Core PCE (personal consumption expenditures), increased 1.4% in October. The headline figure (the one that includes all things on which we spend money) is even lower at 1.2%. Whatever the case, we are still nowhere near the 2% inflation target (with an expectation to run hot for a while before deciding to hike interest rates).

- Does the Fed have fewer tools in the chest? (No)

There are some headlines around a brewing feud between the Fed and Treasury. Basically, Treasury wants some of the money back that it had earmarked to the Fed for some of its emergency lending programs. It is much ado about nothing, really. The programs being "defunded" were not being used. And the Treasury can always send the money back in a flash if the need were to arise. The NY Fed president John Williams said as much.

The Fed's FOMC (Fed Open Market Committee) Minutes were bland on the surface with no signs of changing the accommodative policy stance any time soon. But the Fed members did indicate that they wish to extend more guidance in terms of the asset purchases. The hope here is that the Fed will be able to condition the market before the teat is removed. While the notion is worthy, this will never work.

- Bitcoin is a frenzy driven by a new restriction on supply

There is an obvious and renewed focus on Bitcoin as it races back to its all-time highs from a few years ago. Much of the move is being attributed to its growing acceptance evidenced by more hedge funds trading it along with the likes of PayPal and Square enabling their customers to buy and sell it. And it just fits the mold of investor euphoria. But, perhaps, the biggest driver of the price is a recent crackdown on Chinese Bitcoin miners. The communists have cracked down on money laundering facilitated through Bitcoin. The bank accounts of these miners have been frozen. This results in a double whammy: 1) The miners cannot physically sell their bitcoin. This removes the largest natural source of selling in the market. 2) Without the cash from Bitcoin sales, these miners cannot mine more bitcoin as they cannot pay their bills, namely the massive electric bill. With fewer miners, there is less competition to "solve" the blockchain which unlocks the bitcoin transaction. And the Chinese control 70% of the Bitcoin mining in the world.

- Chart Crime of the week

Its Thanksgiving, so we will take it easy on all of the silly, excess, misguided punditry put forth in the form of a bad chart.

- Quick Hits
    - The Fox Sports regional sports networks are being renamed the Bally Sports networks.
    - Sinclair bought these Fox RSNs for $9.6b in 2019. They are now valued at $4.2b.
    - Before Muddy Waters research concluded that JoyY (YY) in China was fraudulent, it suspected it was either a prostitution ring or a money laundering service.
    - Apple's security chief has been indicted for trading iPads for gun permits.

- Turkey raised interest rates 4.75% to 15% to match actual bank funding costs. President Erdogan will not allow any more hikes. Remember, he thinks high interest rates cause inflation (low interest rates do). And he believes in ESP.
- TJ Maxx is finally launching an e-commerce business after previously saying the virus changes to shopping habits were just temporary.
- Quick Hits Classic: TJ Maxx is called TK Maxx in the UK…apparently to avoid confusion.
- California has accidentally/fraudulently paid prison inmates $140mm in virus-related unemployment benefits. $400k has gone to serial killers and other death-row inmates.
- Norway, the virtue signaling capital of Europe, generates the most electronic waste per person per year at 53 pounds.
- A 51-year old California mother is serving as the surrogate mother for her daughter's baby.

Trading: We were a little early with out Put buying last week. The good news is we added protection in the form of a Put spread, so this gives us some flexibility. We will likely cover the short leg of the Put spred which will give us more protection. Moving on, we added our annual Tax Loss harvesting basket. This is where we buy all of the decent companies that happened to have terrible performance for the year. It is around this time of year when the tax loss selling kicks into gear causing even worse performance (it is impossible to time, so we do a few tranches), and these stocks tend to outperform on the backside. It just so happens that all of the bad performers are doing well right now, so this basket is working very well. We have added a few other trading names. We jumped on board the small caps with a long in IWM (as it was making all-time highs…this could be the sign of a top!). We took a small position in a European payment processor that is far from cheap, but it seems to be executing well (it is certainly a momentum play that the bulls say can work in any virus market climate). We also bought a recent IPO that has started to move…we were kicking ourselves for missing it. So, we decided to take a tester of a position. We think the theme is obvious now. With our increased protection, we have added to our long position with fringe positions. We think these have long-term durability…but the price is not cheap.

TSLAQ: Between the EV momentum, the S&P 500 inclusion, and euphoric markets in general, Tesla continues its meteoric run. Musk is now the third richest person in the world (because he makes toys for rich people and cons governments…oh the absurdity). Headlines are now talking about it becoming the next trillion-dollar company despite that meaning another 100% rally. And the Tesla absurdity has spilled over into all the speculative corners of the market. Close by, NIO, the Chinese competitor to Tesla, is now worth more than GM despite having only sold 63k cars in its history. It feels like we are firmly in a 2000 dot.com bubble (if we have not been there for a long while). Alas, we do not see any reason for it to stop in the near term. We still want to buy puts on all of these charlatan companies…but we will have to be delicate in our timing.

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