Weekly Update

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- The go-to narrative is back (again)
- Is the yield curve steepening a good thing? Nope
- Student loan relief is cranking back up (ugh)
- Momentum guys are too short
- There are way too many profitless companies
- Looking for jobs in all the wrong places
- Inflation is still out there
- The Fed states the obvious (mostly)
- The mirage of collapsing gasoline demand and geopolitics running amok
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,377	2.7%	15.3%	23.1%
QQQ	$371.22	3.2%	40.0%	40.3%
US 10 YR	4.57%	4.74%	3.75%	3.90%
USD/DXY	105.7	16.7	104.5	113.3
VIX	16.1%	18.6%	22.9%	33.6%
Oil	$83.17	1.0%	3.6%	-6.9%

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

The soft-landing narrative is back. The Jobs Report gave the markets cause for celebration with an economy still adding jobs with moderating wage growth – even if most of these jobs were part-time (or people adding second jobs…and thus no change in the Unemployment Rate). The "technicians" say the sharp reversal on Friday was the market giving the "all-clear" sign. The recent cause for concern has been based on the bond market pricing in higher rates for longer. But Lorie Logan of the Dallas Fed juiced the market (stocks and bonds) even more by saying the Fed might be done hiking rates because the bond market had done the job for them. We doubt that many investors could pick Logan out of a crowd of two. We guess that these same investors do not realize that higher rates are higher rates…regardless of whether the Fed pushes them there or the market does. We will add that Logan is one of the more market savvy Fed members (like all the Dallas Fed members seem to be). We would guess that she thinks her comments have been stretched too far. Perhaps the bond market was oversold in the short-term so a drop in yields was warranted. There have been a lot of new and loud voices decrying bonds…this probably led to some uninformed or panicky shorts piling on right at the wrong time. And perversely, the war in Israel could be driving some sort of flight to quality. And for all the talk about easing wage pressures, we are still seeing more striking workers (more UAW, more nurses, more LNG workers in Australia, more in general). We do not think this is sustainable; we think upward pressure on rates will remain.

Thus, our outlook has not changed much. We think stagflation is the economic condition of the day (combination of low growth and high inflation). Some Big Tech and Energy are good places to be long. Companies that have lost pricing power (margin compression) and/or rely on 0% financing are not things to own. And apparently the obesity/diabetes shots are going to cure every disease and ailment known to man.

- Is the yield curve steepening a good thing? Nope

Much of the market is looking at the steepening of the yield curve and claiming this somewhat reliable recession indicator has failed (the spread between the 10yr and 2yr Treasuries has climbed out of its negative 1% reading in July to about -0.40% today). But Schwab reminds us that it is not the initial inversion that signals a recession. But, rather, it is the steepening of the yield curve coming out of inversion that is the true signal of a recession coming. Quantitatively, the yield curve inversion leads the official recession anywhere from 12 to 24 months. It has been about 15 months since the curve first inverted (July of 2022).

- Student loan relief is cranking back up (ugh)

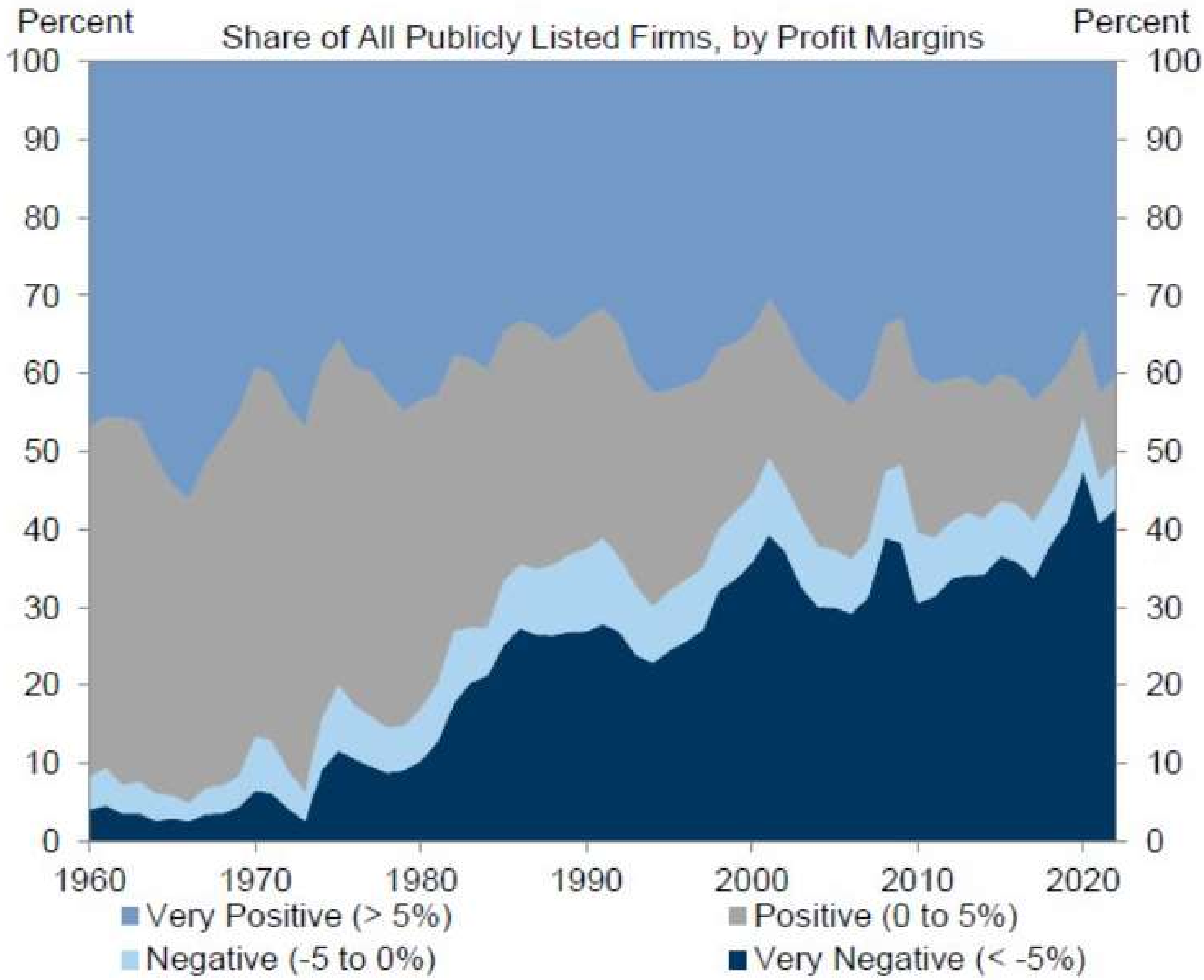
The Biden administration announced another targeted student loan relief program. Since the Supreme Court struck down his vision to vanquish all student debt, he has rolled out a more targeted programs aimed at doing the same thing. The latest waives $9b in student loans that were geared towards public servants and the disabled (125k people). A previously targeted relief was aimed at lower-income borrowers. A larger program is expected to be announced this spring (election season). All told, the small programs are starting to add up to huge numbers: About $127b in repayments will be halted by these programs. These will likely be challenged in court, as well. But payments will probably cease in the interim.

- Momentum guys are too short

We occasionally mention the cohort of investors known as CTAs. These Commodity Trading Advisors are purely momentum hedge funds. As you can see, they goosed the market higher into the July short squeeze. And since then they have turned tail put on their largest net short positions ever (of course, this chart does not account for market size, etc). It is no wonder we are seeing some support in the market. The same goes for the option positioning. Dealers are closer to flat vs being short gamma (they are still short gamma some, but the momentum pushing has been dialed way down).

- There are way too many profitless companies

Goldman put together a nifty chart showing the percentage of the market by company profitability as defined by profit margins. Almost 50% of all companies do not make money! Over 40% have margins worse than -5%. Goldman also points out that these unprofitable companies account for about 10% of the revenues. We do not see how this can persist (50% of companies being unprofitable).



- Looking for jobs in all the wrong places

The September Employment Report surprised to the upside with a gain of 336k jobs vs the consensus guess of 170k. But the actual expectation was probably lower after the ADP guess came in light at 89k (vs the 180k expected). And the August number was revised higher from 187k to 227k (this is particularly noteworthy because it is the first time this year that payrolls were not revised *lower*). But government jobs were a large source of the surprise (and they were all of the August revision). But Private Payrolls did expand nicely, too.

But the Employment Rate remained steady at 3.8%. Participation also remained steady at 62.8% with a high level among prime-aged workers. This means more people are working multiple jobs. And one of the sectors that bears this out is the strong growth in jobs at restaurants. More to the point, part-time jobs were a huge source of the gains…over 150k jobs. And double counting of jobs amounted to over 120k of the jobs gained. The total of new jobs in the Household survey, the survey that calculates the Unemployment Rate and strips out the part-time and double counting, was only 86k. And if the wonky economists (professional guessers) try to balance the methodologies of the two different surveys, the jobs gain is a paltry 7k. Maybe what sums it up best is Full-time Employment is down 692k jobs over the last three months.

The bright spot for the equity market (not the workers) is that wage growth is cooling. Wages increased only 0.2% to bring the annual change to 4.2%. The average over the last three months annualizes to about 3.4%. The WSJ thinks this is "compatible" with a 2% inflation rate.

- Inflation is still out there

The change in the Producer Price Index (PPI, wholesale and input prices) for September was a bit hotter than expected. The headline rate slowed to 0.5% from 0.7% in August. But this was higher than the 0.3% increase expected. The Core PPI increased to 0.3% from 0.2% and vs an expectation of 0.2%. The annual rates (2.2% headline, 2.7% Core) are still a touch above the desired level. And some past months were revised higher. The Consumer Price Index means a lot more, but moderating input costs are a positive.

Used Car prices ticked slightly higher in September. The move over the last year is a fall of -3.9%. But this is barely a drop in the bucket considering prices are still up about 30% since pre–Virus Fear. Of course, used car delinquencies are now about the pre–Virus Fear level and moving higher.

Consumer Inflation Expectations moved up to 3.7% in September. The falling trend from early 2022 might be reversing higher (early yet).

- Other economic data is mixed
    - The US trade deficit hit the lowest level in 3 years. It is still a whopping $58.3b, but this is down from over $102b in March of 2022. Exporters increased thanks to oil and pharmaceuticals. Imports declined thanks to fewer cellphones and semiconductors.
    - China Golden Week was not so golden. Tourism and consumer revenues only showed a slight increase from 2019 levels.
    - Mortgage Applications ticked up a hair from last week's all-time low.
    - The Weekly Redbook Retail Sales moved higher with a gain of 4% compared to 3.5% last week. Like the inflation expectations, this data has started moving higher.
    - Wholesale Inventories have fell slightly in August. They have not been positive since November of last year.

- The Fed states the obvious (mostly)

Mary Daly of the San Francisco Fed thinks growth and inflation are slowing. But she also seemed to intimate that monetary policy will continue to be restrictive. Maybe most importantly, she indicated that the neutral rate for interest rates may have risen to 3% from 2.5%. This neutral rate is more art than science. We also think 3% is still miles away from the current 5.25%.

Thomas Barkin of the Richmond Fed said that the recent surge in yields is "a return to a more normal rate seen in prior years."

Raphael Bostic of the Atlanta Fed thinks we are done with rate hikes and there will not be a recession. Bostic has been one of the more optimistic Fed members for a while now.

Lorie Logan of the Dallas Fed spoke about inflation still being the main focal point of the Fed. And she highlighted that the market was doing some of the work for the Fed.

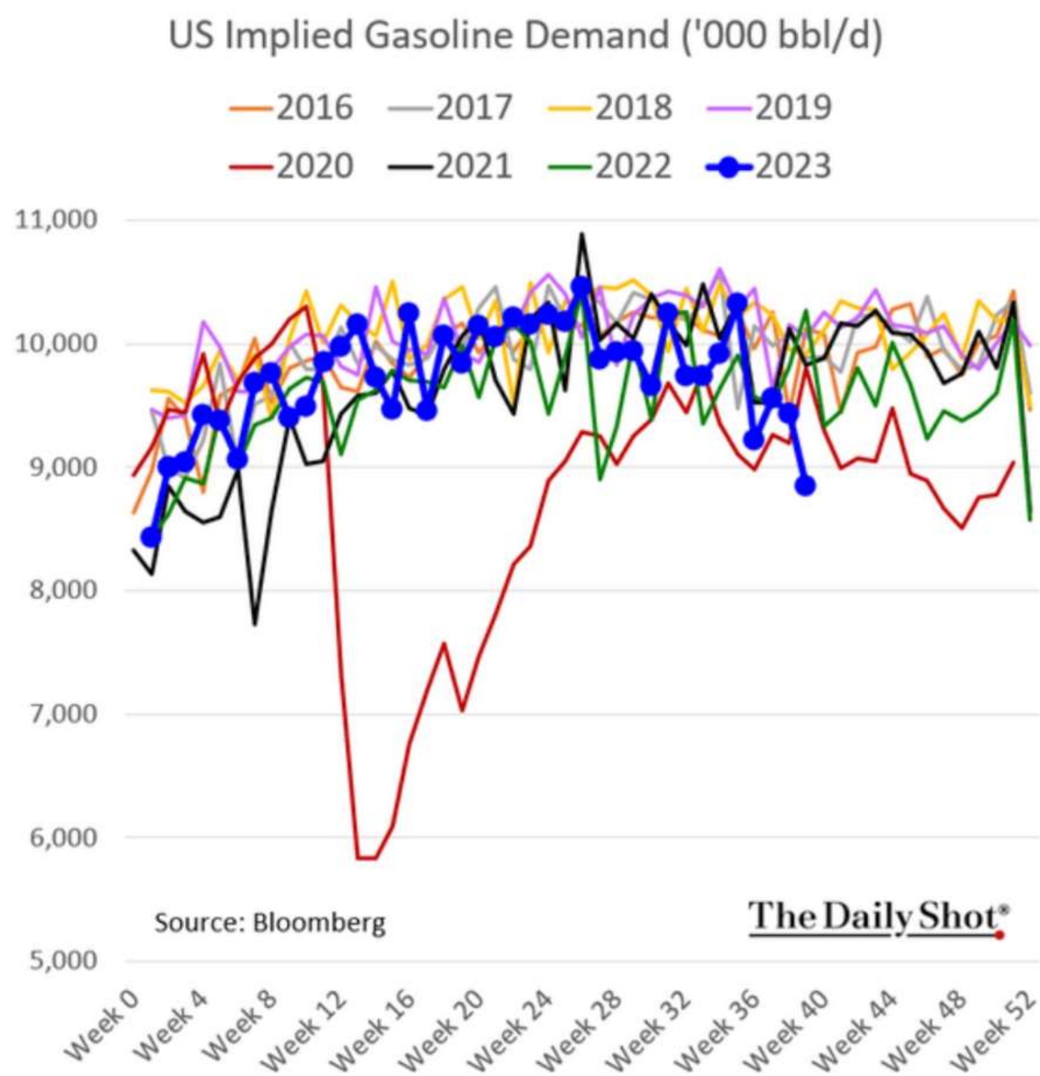
Phillip Jefferson, a Fed governor, is in the camp of those that think the bond market has done some work for the Fed.

Another Fed governor, Christopher Waller sounds more resolute in the fight against inflation, "we will stay on the job to achieve our objective."

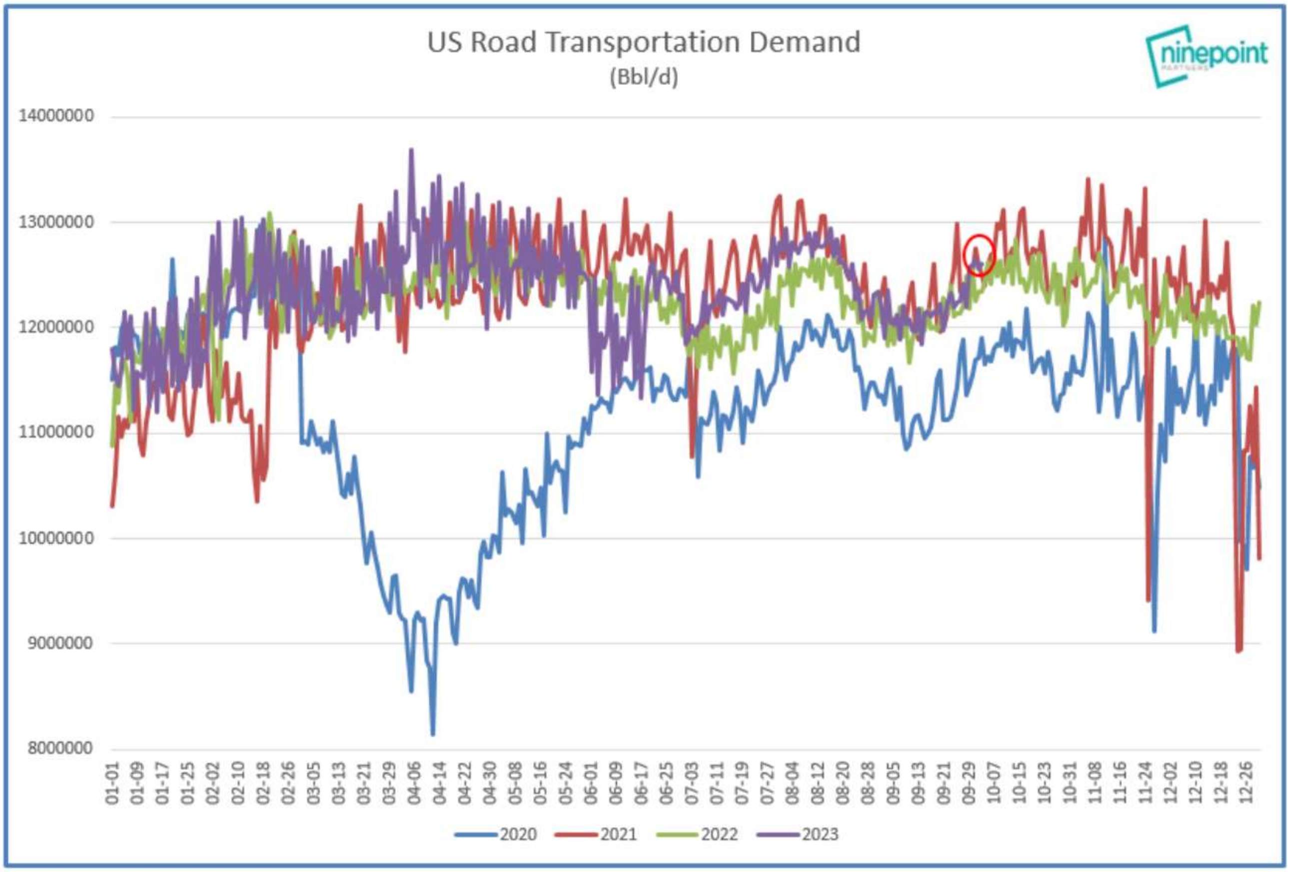
Neel Kashkari of the Minneapolis Fed, he makes Bostic look like a screaming hawk, thinks the Fed is likely done hiking rates given the bond market decided to front run the Fed and jack rates. To be fair, he did note that there is still a chance that the Fed would need to hike rates again in order to match the expectations of the market.

- The mirage of collapsing gasoline demand and geopolitics running amok

Gasoline crack spreads have collapsed. This is largely due to the extreme move in crude combined with a unplanned refinery outages late in the summer. The financial implications of this are that people have to unwind their long crude oil positions (speculators were betting on these spreads staying wide). Some are extrapolating this dynamic to mean end-demand for gasoline is dropping. This is from the Daily Shot (notorious for good looking charts that are often misleading if not completely wrong):



But this chart shows the relationship between wholesalers and retailers. Retailers are putting off big purchases because they knew the crack spreads were artificially high, and they will be able to buy their product cheaper in short order. They are being proven right as we speak. Here is a better way to look at gasoline demand:



Source: Rystad RealtimeCube

Of course, geopolitics are taking a larger role in oil prices now, too. The renewed war in Israel probably has more implications than normal for the region (since Israel does not have any real oil production capacity but it is rich in natural gas). The key here is that there were rumors of some "mega deal" being negotiated. This alleged deal would see Israel make some concession to Palestinians in the West Bank. Saudi Arabia would get nuclear energy capability from the US. And Saudi Arabia would start pumping oil like crazy. Before this weekend, we were skeptical. Now, it is fair to assume this deal is dead on arrival. There is some talk that if the Saudi/Israel deal did not happen, then Saudi would try to connect with Iran. We think this is unlikely (absurd really) given the hatred between the Shia and Sunni sects. We obviously do not want to get into politics…especially not from a religious angle. There is nothing more difficult to predict. But our point stands: We doubt there will be peace any time soon, and Saudi will keep holding back on its oil production to reap higher prices.

Back at home, we obviously had the US government's thumb on the scale with its dumping of the Strategic Petroleum Reserve down close to its minimum (being a net exporter has alleviated many potential problems, but it is still a complex web). Now we have the US government outsourcing its pressure on the markets by allowing Venezuela to reenter the US scene, turning a blind eye to the sanctions on Russia, and outright allowing the smuggling of Iranian oil (Iranian crude exports during August are estimated to be 1.7mm bpd compared to 0.8mm pre-Biden). The Chinese and the Indians are the buyers.

Russia is apparently lifting its diesel export ban, too. The Russians initiated this alleged ban to put downward pressure on domestic gas prices as inflation is running rampant. Of course, by not selling the country's only desired product, the government coffers are suffering for dollars/income.

For us, we think this is a buying opportunity for our Energy names which have pulled back as crude has retreated. Demand in the US (and elsewhere) will likely only moderate (mild recession or sluggish growth). Supply will remain constrained.

- Where did all the crypto money go?

Just in case Michael Lewis still thinks SBF did not steal the money, the WSJ reports that the secret code allowing SBF's hedge fund to "borrow" from FTX was discovered and reported to FTX management in the summer of 2022. That person was subsequently fired. And now we are hearing a string of trial witnesses testifying to SBF's blatant use of this backdoor (theft). Moreover, and most hilariously (apologies to all the bagholders), an FTX insider testified that the total reserves displayed to "depositors" (speculators) was literally created from a random number generator. Yes, literally.

- Chart Crime of the week

We stumbled across a new take on one of our all-time favorites. We have seen the giant distortions among females across the globe (those poor Indians). We were about to post one with males. But we found one with fat and skinny people!

- Quick Hits
  - A Pittsburgh firefighter has been arrested for arson. He must not have finished Backdraft.
  - Pakistan is limiting gas for home fuel to eight hours a day come wintertime.
  - Al Michaels, the great sports broadcaster, has never knowingly eaten a vegetable in his life.
  - The Sphere in Las Vegas adds a 23% service charge to all tabs. Guests assume it is a tip. It is not.
  - Facebook is allegedly paying Snoop Dog $1mm for a few hours work. Snoop will be one of the faces of Facebook's chatbots (Tom Cruise and Paris Hilton are also rumored to be getting this effortless windfall.)

- Peeps and red velvet cake are illegal in California now.

Trading: We are still running and adding to our barbell portfolio construction. We added to our Big Tech names. We took some profits in some shorts and reloaded into new positions.

TSLAQ: Tesla chopped prices for the model 3 and Y in the US again. This brings the prices 17% and 26% lower this year for the company's only two models (since they no longer are pushing the X and S…the last quality cars the company made). Selling fewer cars at lower prices. We cannot wait for earnings next week.

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