Weekly Update

24-Aug-2022
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- The market takes a breather from the bounce, we think it continues (lower)
- A little too late but we will say it anyways
- Yes, it was a short squeeze
- Merrill says fund managers are still bearish, but they are not really
- And Individual investors are back Chasing Amy*
- Merrill's rule of 20
- When the Diamond Hands crumble
- Labor is still a lagging indicator
- Inflation…0.6% improvement is not an achievement
- Business Surveys are still gloomy
- The Fed is getting what it wants in a slowing Housing market
- Other data is mixed, but the Inventory trend is ominous
- Oil tightness might be getting worse
- Trust but verify: Listen to what the Fed is saying!
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	Last	5d %	YTD %	1yr %
S&P 500	4,141	-3.1%	-9.3%	-6.7%
QQQ	$315.01	-4.1%	-20.6%	-15.1%
US 10 YR	3.11%	2.90%	1.51%	1.35%
USD/DXY	108.6	160.6	96.0	92.8
VIX	22.8%	19.9%	17.2%	16.8%
Oil	$95.31	8.2%	26.2%	40.5%

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

It has been three weeks since our last missive. We were last muttering about irrational markets, short covering, inflation leading to recessions, Job Openings disappearing, and the Fed's mission. But it seems like we just might have been right. Or at least the narratives have started to unwind with likely more market action to follow (that is our bias, of course). Of the upside-down narratives, the one that kept confusing us was the notion that the

Fed was going to pivot because the gains in inflation slowed about half a percentage point. And the lagging Employment Report showed continued job growth while every other labor metric was slowing. Just this week we got Ford slashing 3k jobs. At one point we had commented that it was only the struggling Tech companies that were slashing and burning. This has most definitely changed. The pundits also latched onto the idea that Consumer Sentiment was improving. It is still the near the bottom of the readings during the last 25 years. As for the short covering, well, look no further than idiotic meme stocks and worthless crypto crap for your top exhibits of ephemeral lunacy. Panic-stricken hedge funds threw in the towel and scrambled to forsake the misfortune of a repeat of last year's GameStop carnage (Melvin Capital, the biggest loser, is out of business now). As for the Fed, they have shown no signs of blinking…quite the contrary. As for us, we, too, fell somewhat victim to Behavioral economics. But our cowering was less painful. We merely were slow in adding shorts and trimming longs. But we did not give up the ghost.

➢ A little too late but we will say it anyways

Here are a few comments from the last few weeks that we were looking to cite as evidence of the cock-eyed market. Alas, this is all seems like woulda/coulda/shoulda/told-you-so since it is in the past. Nonetheless:

- The previous bubble winners are/were rarely (never?) the next cycle's winners. But the market thinks "this time is different" because of some new spending bill looking to crank up the crony capitalism.
- We remember a time if one of the largest and most widely held stocks in the world warned of badly declining revenues with the accompanying macroeconomic deterioration, the stock would crater and lead the market lower. But not this market. Nvidia's warning of a 17% drop in revenue (with a 33% slide in its Gaming division) had no effect on GameStop or Bed Bath & Beyond or any of the other crazy meme stocks. (Update: NVDA reported tonight, and it looks like more weak guidance.)
- Cineworld's warning of a liquidity crunch had no impact on AMC. A moronic share issuance called an APE tricked soon-to-be-diluted AMC common shareholders into getting excited. These fools have no idea what an ex-dividend pricing looks like. (Update: They do now.)

➢ Yes, it was a short squeeze

While we have tried to mute the often-repeated refrain that hedge funds have a huge impact on positioning, they certainly do when it comes to heavily shorted names. Or when panic consumes their empty souls. Here is the short-covering data from Goldman (courtesy of themarketear). This was the third highest bout of covering in the last 10 years.

Somehow JP Morgan still maintains that funds are positioned defensively. We suspect they are just looking at some of the quant funds that are momentum based. In other words, this subsegment is always under-positioned when things are flying. But as soon as the momentum reverses, they are suddenly over-positioned. This is analogous to the option gamma-chasers we often discuss (buy high and sell low crowd). Goldman put some numbers to these momentum chasers. In their view, if the market continues to rally strongly, these funds will have to buy $48b of equities. If the market reverses and moves sharply lower, this will trigger $147b in sales. Corporate Buybacks have also been in full gear which will slow in a few weeks (Sept 15). Seems like a bad risk/reward to us.

- Merrill says fund managers are still bearish, but they are not really

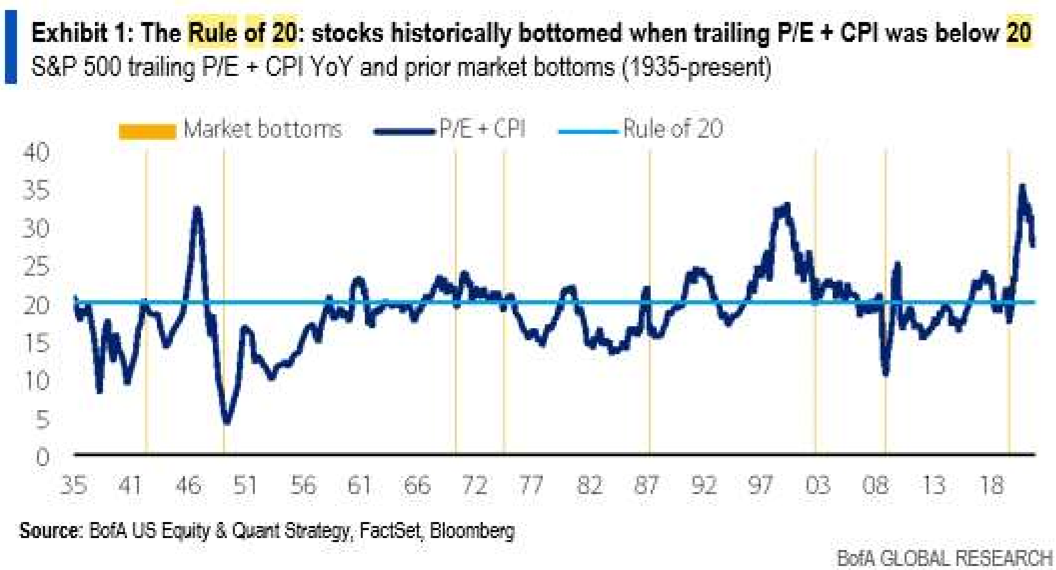
Merrill's Fund Manager Survey shows that respondents are still bearish with an outsized 5.7% held in cash (We do not believe in "cash on the sidelines" in aggregate but it can be telling for a specific group of asset managers). But this gross level of cash and the label of "bearish" is somewhat misleading because investors have rotated heavily from Utilities and Staples into Tech and Consumer Discretionary. We are positioned contrary to this which gives us some comfort. On the flip side, being long the USD is now the most crowded trade. We do not like this since we are long the USD!

- And Individual investors are back Chasing Amy*

And the true Merrill positioning, bullish, meshes with the latest AAII sentiment (American Association of Individual Investors) survey that just registered a new high of Bullishness for 2022. Of course, this is all relative as this high is still near the bottom of the long-term average. And Bearishness is still well above its average. But like Bullishness, Bearishness has started to reverse course quickly. Of course, this was all just in time for the market to start reversing.

➢ Merrill's rule of 20

Merrill has a pretty nifty stat/indicator they call the rule of 20. Markets have never bottomed until the sum of the trailing Price/Earnings ratio and the annual CPI increase is less than 20. Right now, we are at 28.5 (20 + 8.5). The math means inflation has to instantly fall to 0% or Earnings have to drop by 50%. Or the market must drop.



➢ When the Diamond Hands crumble

Just when we thought the stock HKD was the pinnacle of market froth (err manipulation), we got Bed Bath & Beyond. Ryan Cohen, founder of Chewy and savior of GameStop, publicly bought into BBBY. He was going to restructure the business etc. After having no effect…in fact the stock lost about 2/3 of its value from his purchases in Jan/Feb to August…the stock started to rally with the rest of the junk. Cohen piled on. He announced (via a public filing) that he was buying a load of out-of-the-money call options. This is typically a very bullish signal. Alas, Cohen used the pump to dump all of his 12% holding in the company. And to really put the icing on the cake, the very next day, the company announced it was hiring a bankruptcy lawyer/consultant to help the company understand its financing options. This sucker should be in jail. We are short GameStop and will remain so. The outrageous cost of borrow on BBBY made the cost of BBBY Put options ineffective. And Volatility is going to remain insanely high. Just today there is a report that the company might have new financing to avoid bankruptcy. But none of this excuses the aforementioned criminal behavior.

➢ Labor is still a lagging indicator

The Employment Report for July showed robust Job Growth with 528k jobs added. The expectation was for only 250k jobs. June's number was 398k (revised higher slightly from 372k). Of this 130k jobs gained, only about half were Private Payrolls. The other half came from government jobs. (Just wait until they start adding more IRS jobs.) The Participation Rate dopped a tick to 62.1%. Average Hourly Earnings climbed about the same rate as June at 5.2%. This is strong but still behind inflation.

This strong data, while we think lagging (and not as representative as the dwindling job openings, increasing Jobless Claims, and announced but not enacted layoffs), will only embolden the Fed to continue down its rate hiking path.

➢ Inflation…0.6% improvement is not an achievement

It seems like the July inflation report was ions ago (that is probably mathematically accurate in summer time). But it is worth revisiting. Back when the market was in full Fed-pivot mode, an 8.5% increase in prices was perceived as good. We are the kings of looking at the rate of change of data, and this 8.5% is certainly a slowdown from the 9.1% registered in June. But considering the Fed's inflation target is 2% (albeit with a different metric that is currently closer to 5-6%), we think a small tweaking of the number is meaningless in the Fed's eyes. Furthermore, the PPI (wholesale and input prices) climbed at 9.8%. Again, this is a slowing from the 11-12% jumps in the prior months. But this is no cause for celebration. And lest we forget the administration's latest illegal offing by canceling $300b in student debt. Robbing Peter (later) to pay Paul (now) is inflationary at its core. (Pelosi and Biden's Department of Education were the ones saying loan forgiveness was illegal.) And to be clear, we have written that we think inflation will start to moderate eventually (unless there are more of these Biden. But we think the Fed needs to see low prices not just slowing price increases.

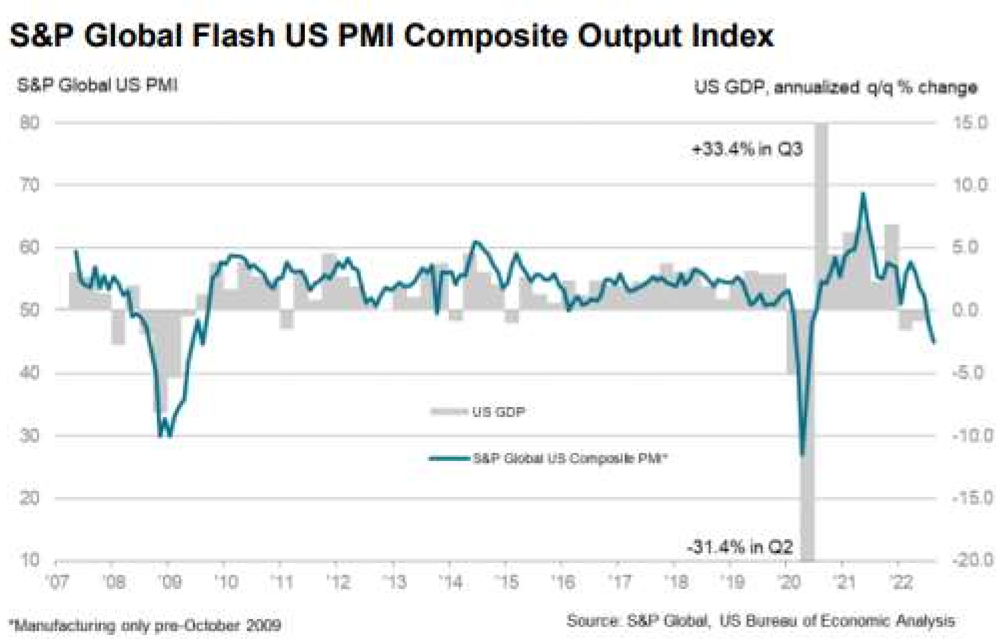
➢ Business Surveys are still gloomy

The NY Fed's Empire Manufacturing survey showed the biggest drop in sentiment in August. The headline crashed from +11.1 in July to -31.3. We always write that these diffusion indices can be volatile, and they are mean revering by definition, but this is taking this to the extreme.

The Philly Fed Manufacturing Index bounced back into positive territory in July from a poor, negative number in June.

The Richmond Fed Manufacturing Index dropped into negative territory in August from flat in July.

The private Markit PMI (composite of both Manufacturing and Services) sank deeper into negative territory. It is at its lowest level in eight years ex the virus-fear. Services continue to be the weak link. Manufacturing is still modestly positive (but sinking also). And for those resisting the recession calls, the correlation between the composite PMI and GDP is robust.



➢ The Fed is getting what it wants in a slowing Housing market

The Housing Market Index (home builder sentiment) in August fell for the eighth straight month. It is now in negative sentiment (sub-50). The obvious culprits for the fear are higher mortgage rates and inflated construction costs. 20% of builders says they are starting to lower prices mostly to cauterize the cancelations. Of the subcomponents, Current Sales remains in positive territory but is dropping the fastest. Sales Expectations have been weak and remain so. Buyer traffic is the lowest and sinking more. California is the worst place to be selling a new house. Toll Brothers reported decent earnings last night. But it lowered future guidance slightly for all the reasons listed here. But it also included a new reason for sluggish sales: "Unforeseen delays with municipal inspectors." Here is a poorly labeled chart of the Housing Market Index.

Housing Starts fell almost 10% in July vs June. Permits declined a smaller 1.3%. The trend is still down (or slowing, the nominal level of open Permits is still near a high), but it is less ominous than the Starts (-12% from the recent peak vs Starts off 20%).

Existing Home Sales fell almost 6% in July vs June. This is a drop of 20% vs last year.

New Home Sales in July hit their lowest level in six years. They fell over 12% vs June. The annualized rate is down about 50% from the virus-fear peak. The median price is still at record levels at over $439k. But the pace of increases is slowing.

Pending Home Sales also fell in July. The pace slowed to only -1% from down -9% in June. But this, too, is still a 20% drop vs last year.

And the most timely of data, weekly Mortgage Applications, continue to plummet. Purchases are moderately negative, but Refinancings are dropping like a stone.

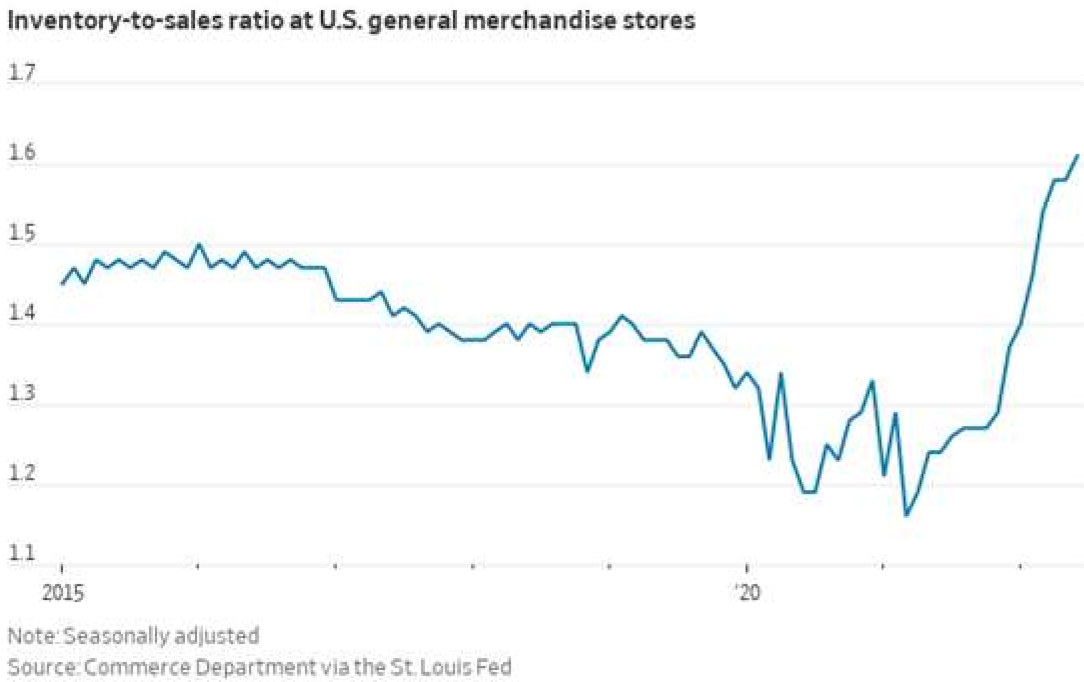
- Other data is mixed, but the Inventory trend is ominous

Retail Sales were flat in July vs June. This compares to June's 0.8% increase over May. But much of this decline was due to the price of gasoline falling. If nothing else, this is proof that consumers shift their spending habits on the fluctuations in gas. And E-commerce sales climbed 2.7% higher in 2Q. This is obviously a bit stale, but it reinforces the gasoline thing.

Industrial Production bounced back a touch in July after a negative reading in June.

Durable Goods were flat in July. The important Core Capital Goods component (aka business spending) increased by 0.4%. This is the one area that continues to grind higher. When the macro factors turn more bullish, buying Industrials might be the call.

Business inventories continue to climb with a 1.4% increase in June (May was 1.6%).



- Trust but verify: Listen to what the Fed is saying!

There have been lots of Fed speakers leading up to the over-hyped Jackson Hole Fed summit later this week. They seem to have all been quite hawkish in their desire to keep hiking rates to stamp out inflation. None of their comments remotely hint at a Fed "pivot." Moreover, their intended aggressive stance makes a soft landing more difficult in our view.

Charles Evans of the Chicago Fed expects them to still be hiking in 2023.

Michele Bowman, a Federal Reserve governor, thinks the Fed must continue hiking rates until inflation has slowed in a "consistent, meaningful, and lasting way." She thinks another 75bps hike is in the cards.

Mary Daly of the San Francisco Fed thinks a "rise and hold" interest rate policy is appropriate.

Jim Bullard of the St. Louis Fed wants another 75bps hike at the next meeting. He emphasized his desire to be aggressive now: "I don't really see why you want to drag out interest rate increases into next year."

Neel Kardashian Kashkari (that is not our nickname but rather that of former Dallas Fed chief Richard Fisher) of the Minneapolis Fed wants monetary policy to tighten further to "bring things into balance." He added that there is the possibility that inflation is stickier than the Fed and the market currently expect. Recall that Kashkari has been one of the most dovish (lower rates) members of the Fed for years.

To repeat, we are amazed that some think this the language of a Fed that wants to reverse course.

- China rate cuts do not really matter

Internationally, China cuts interest rates. But most think this is too little too late especially juxtaposed to the lockdowns/droughts/real estate collapse/communist rule. All economic data has been deteriorating rapidly. Perhaps the most startling statistic is Youth Unemployment which stands at 20%.

- Oil tightness might be getting worse

Dueling narratives have been moving crude oil prices around. Oil Volatility remains elevated despite the price swings having started to calm down. This means people are waiting for the next headline. Here is the current narrative breakdown:

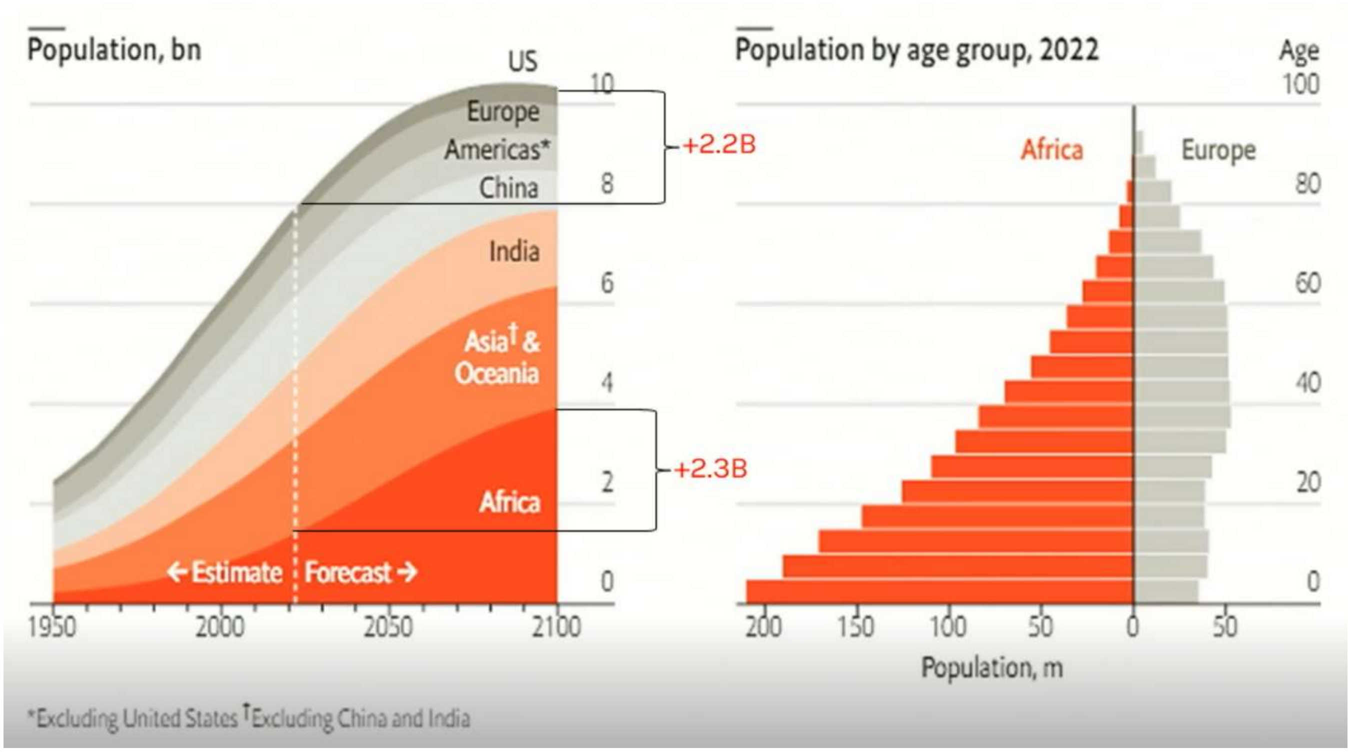
The bearish narrative is the same old: Recession is coming, and the Iranians will be pumping more oil. And China's lack of energy caused by severe draught is slowing down that already virus-policy-beleaguered economy.

On the bullish side, the market is still massively under supplied. And the Saudis proclaimed that they might start cutting production! OPEC+, led by Saudi, has been trying to increase production since June of 2021. No more. In the US, a federal judge has reinstated the ban on federal oil and gas leasing. Recall this was an executive order that was paused by a lower court. Inventories in the US have been declining steadily since the virus-fear spike in inventories (when the government did not allow us to move about). Lastly, the US government's Strategic Petroleum Reserve (or Tactical if you are a politician trying to move gasoline prices…see the chart crime below!) is only at 67% capacity with the hole due to be bought back by the government. We did not think it was a big deal when the government sold this oil primarily because we knew they had to buy it back!

Put together, we think the extreme tightness on the supply side will overshadow any demand destruction. We did not even mention the energy catastrophe that continues to unfold in Europe. Americans are freaking out about $9 natural gas. It costs $85 in Europe and $66 in Asia! People would be pumping oil & gas if they could!

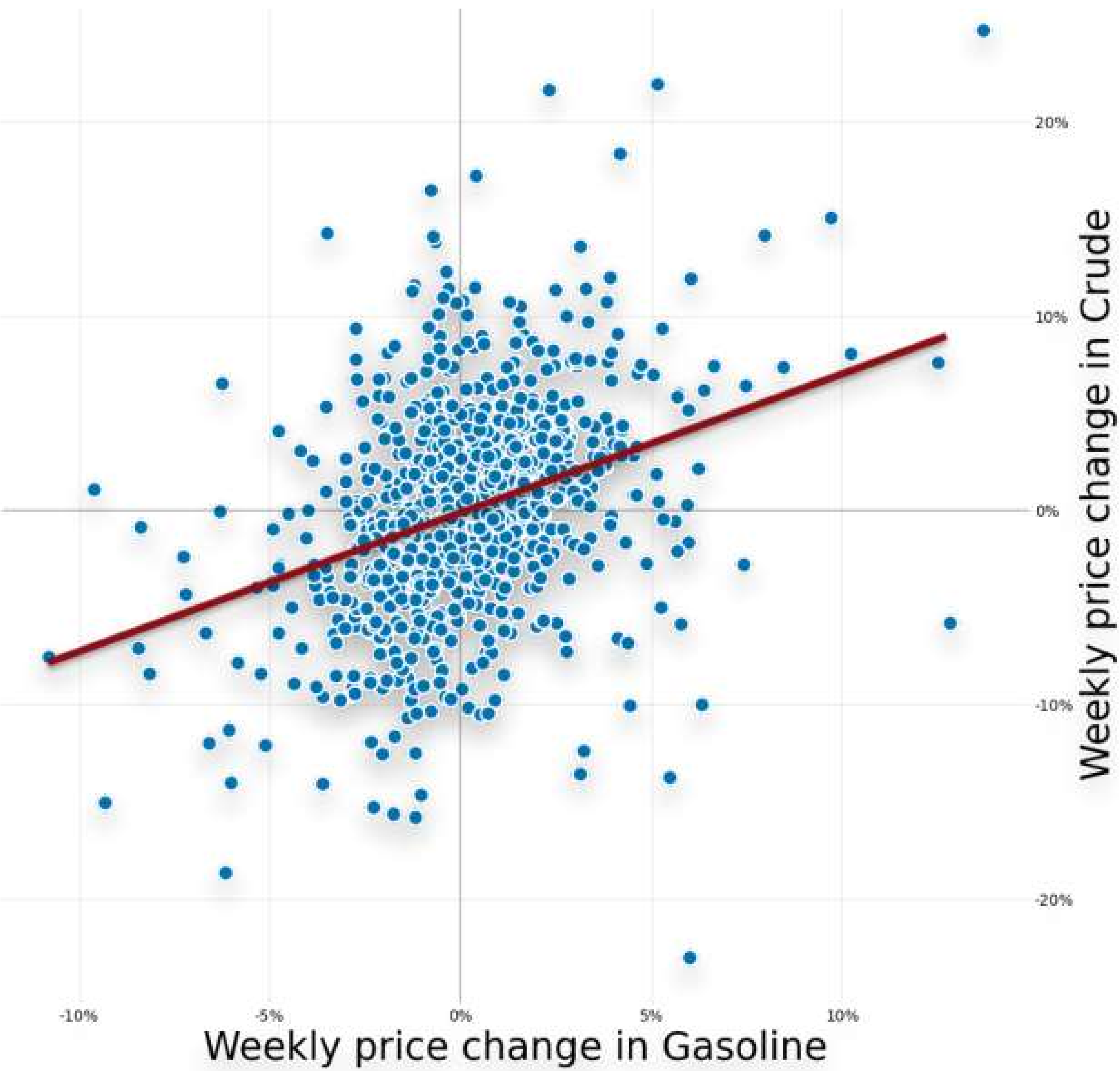
- Chart Crime of the Week #1

We almost got lulled into thinking that Africa is the next big thing! Its exponential growth would dwarf the rest of the world. But then we realized it was created by the United Nations. Nowhere is it mentioned that life expectancy in China is about 56 years. For comparison, China, which most certainly has demographics working against it, has a life expectancy of 77 years. The US is 79 and Europe is 80 (these are all pre virus-fear, we suspect declines since then are evenly distributed…or at least will be when the dust settles). Not to mention, any place (much less an entire continent) that values five $20 bills over one $100 bill because the former is easier to launder is no place for our money.



- Chart Crime of the week #2

This one might be a crime because it does not go far enough in highlighting its conclusion. The idea is to disprove all the phony-baloney rhetoric around gasoline prices. There is very little correlation between crude prices and gasoline prices. The chart below is for weekly prices. The correlation/R^2 is 0.13. This statistical measures's scale goes from -1 to +1. It is not quite 0.0 (dead in the middle with no correlation whereas negative readings imply inverse correlation), but it is pretty darn close.



➢ Quick Hits

- The latest EV subsidies will include cars priced up to $55k and for individuals who make up to $300k a year.
- Crazy Cathie Wood, aka The Wood Chipper, is pronouncing that ESG, (Environmental, Social, and Governance investing style which we have lamented for years) has led to "extreme capital misallocation."
- New York state is offering licenses to sell marijuana only to those with past marijuana offenses (criminals).
- Martin Shkreli, the convicted felon aka Pharma Bro, started a crypto coin/token. He sold his stake and it crashed 90%.
- Turkey cut interest rates (from 14% to 13%) despite inflation at 80%. Recall president Erdogan controls monetary policy. He thinks high interest rates cause inflation. He also believes in ESP.
- Price inflation for pharmaceuticals in the US has averaged 2% over the last five years.

- Indonesia is the world's largest miner of nickel with over 30% share.
- Over 30 members of Congress have visited Taiwan in an official capacity in the last year.
- In 2015, the Oakland school district eliminated teaching by phonics because it was, "dehumanizing and colonizing." The same leader of the district has just reversed her instruction. The NAACP was instrumental in overturning the failed Oakland experiment.
- This year's US cotton harvest will be the smallest in 150 years.
- Ford and Duke Energy are working on a plan to send stored electricity from the new F-150 Lightning back to the power grid during times of stress. We are not sure the soon-to-be owners of these trucks are on board.

Trading: We have been adding to our Energy longs on the dip (which did not last that long despite oil prices still hovering around $90-95). We also are starting to add to our recession positions again: Treasuries, Gold, and the USD. We rotated some Put protection. Basically, the massive rally rendered a lot of it worthless, so we had to reset the positioning. We still like our stance of being long the defensives (Staples, Utilities, Health Care) and Energy. We also still have our more idiosyncratic longs in Retail and Consumer Discretionary).

TSLAQ: Tesla had one of its sillily-named events before which it teased a lot of innovation and ultimately unveiled absolutely nothing. A few highlights include Musk talking about being on track to deploy Full Self Driving. Recall that Tesla has been charging for this vaporware for years. When he claimed to have put some numbers to the supposed feature, his conclusion was, "It could be that crazy." Of course, he did not disclose the numbers. He jokingly added, "this year I swear." Recall Tesla avoided bankruptcy (musk's words) by fraudulently raising money from investors based on his "robotaxi" pipedream. This was to be a network of Teslas running autonomously that would generate enough cash to save the company. Of course, this event (the current one) was all just smoke and mirrors so Musk could sell another $7b in Tesla stock. Just this spring, Musk vowed he was done selling. In Twitterland, apparently there is a whistleblower claiming Twitter was a poorly run company with all sorts of flaws. And said without irony apparently, this hformer head of cyber security blasts Twitter for being bad at cyber security. More to the point, the complaint specifically details how Twitter does **NOT** undercount "bots" or "spam accounts." And this is the crux of Musk's attempt to get out of buying Twitter. Somehow this got the Teslaratti excited and punished Twitter stock. With some more weakness, we will get our chance to buy Twitter. We think it is a homerun that Musk loses the court case, but we want the right payout to make the bet since Musk has probably bribed the judge.

*We know our tv and movie references are vague and leave them floating there like George's I Love You Matza ball. Ergo, we feel compelled to explain this one. Chasing Amy is a Kevin Smith movie following the sequence of grasping for the unattainable, actually getting it, then screwing it up.

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