Weekly Update

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- The market hears what it wants to hear (per the new norm)
- The bond market/stock market relationship is inching back towards the free money days
- Investors are bullish
- Inflation is going higher while people expect it to go lower
- Retail Sales are strong on the surface, but we are not encouraged
- Sentiment is improving, but not with respect to their businesses and incomes
- Housing might be stabilizing (that is not necessarily a good thing)
- An Employment addendum highlighting the oddity of government statistics
- Do not bet on China bailing out the global economy
- Where did all the crypto money go?
- Quick Hits
- Chart Crime of the week

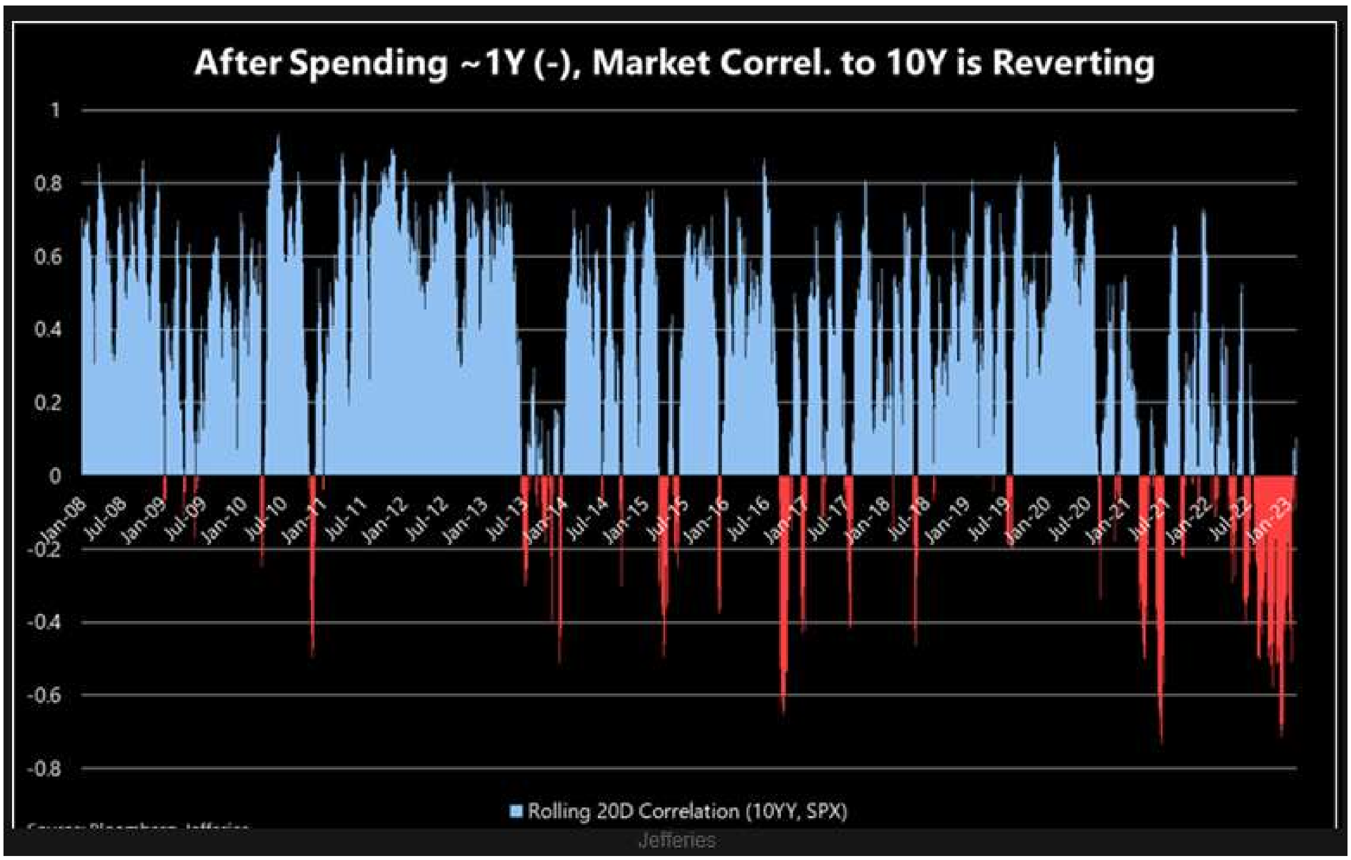
	Last	5d %	YTD %	1yr %
S&P 500	4,148	0.7%	8.0%	-4.2%
QQQ	$309.10	1.6%	16.1%	-10.4%
US 10 YR	3.80%	3.62%	3.88%	2.04%
USD/DXY	103.8	103.5	103.5	95.7
VIX	18.2%	19.6%	21.7%	24.3%
Oil	$78.54	0.1%	-2.1%	-14.6%

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

The market continues to exhibit selective hearing. After the January CPI report showed that inflation was reaccelerating, the bond market was screaming recession. Fed speakers have been attempting to convince the market that chairman Powell is not softening in hopes of a soft landing. The yield curve continues to invert - the 2-year yield has moved about 0.55% higher while the 10-year has moved about 0.35%. The USD has found some support and has started to move higher on the back of more rate hikes coming down the pipe. And gold slumped to its lowest level of the young year. But profitless companies whose livelihoods depend on free money aka zero interest rates? They sang like mockingbirds. Apparently, there are some circles that are pitching the idea that higher interest rates make goods and services more selective, so they (higher rates) actually spur inflation. Apparently, these people are subscribing to the Erdogan school of economics. Perhaps ESP is playing a role, too.* And we have no idea how this pertains to profitless companies that do not sell much stuff. Or maybe these people cannot read. Traders got excited when it was disclosed that Citadel (large, successful investment company) was an owner of more than 5% of the soon-to-be bankrupt crypto-bank Silvergate. But nobody bothered to read the press release stating that this was a market-making position to offset a large short position in Call options. Of course, this duped more into buying more Call options. This ties in with the 0-DTE (same day) option trading. It is all rampant speculation flying in the face of fundamentals.

- The bond market/stock market relationship is inching back towards the free money days

Here is the correlation between the stock market (S&P 500) and the 10-year yield. These two asset classes have been positively correlated since the Great Financial Crisis (correlated when using the bond price, not the bond yield, it can be confusing, but basically equities have gone up while bond yields have gone down). But this broke down during the second half of last year. We think this breakdown made sense…the Fed was hiking during/into a recession. But the narrative now is that the market has "digested" the rate hikes. In other words, it is the same old hope: The Fed will pivot and/or the economy will improve dramatically. Of course, what this chart really misses is the action of the skyrocketing 2-year yield.



- Investors are bullish

The Merrill Fund Manager Survey is full of contradictions as usual. The headline positioning has investors most overweight cash and most underweight equities. But the percentage of respondents that believe there will be a recession has dropped from 77% in November to only 24% now. Emerging Markets is now the big bull trade. And investors are underweight defensives vs cyclicals for the first time since April of last year (when the mad scramble into defensives began). Merrill does not categorize this positioning as overly bullish (and thus the contrarian would be bearish), but we sure do. (To be clear, Merrill is bearish on the market.)

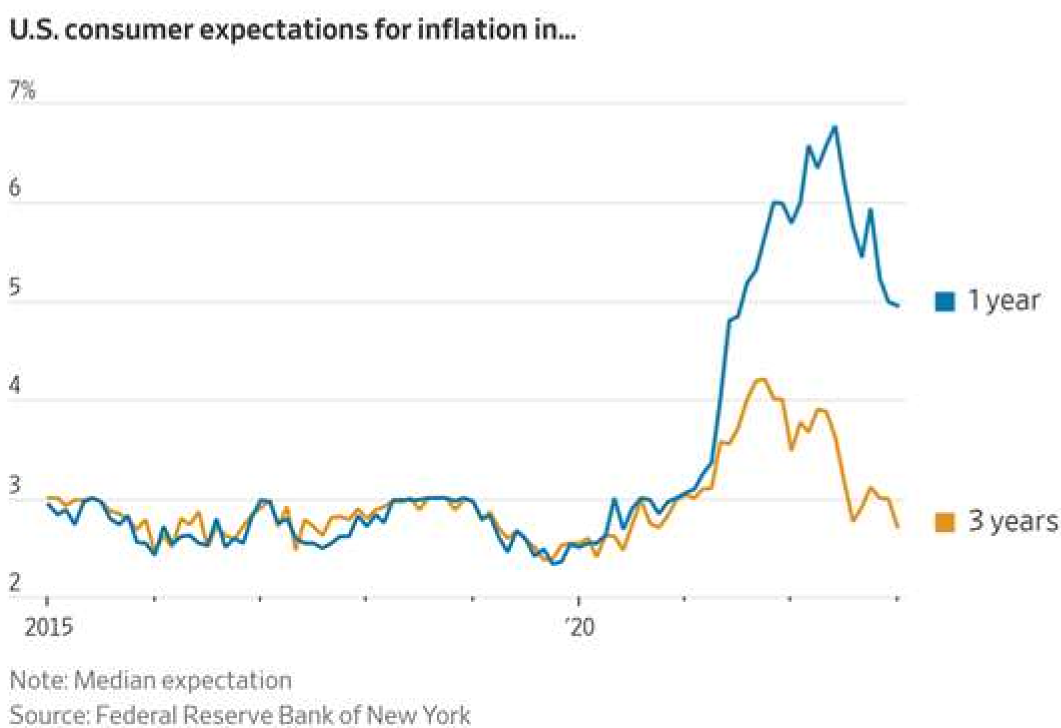
Goldman reports that hedge fund gross leverage is at its highest level in a year. Net leverage is trailing but still increasing. We think hedge funds are circling the carousel covering some shorts higher, adding to other shorts until they have to cover those, and round and round.

- Inflation is going higher while people expect it to go lower

Inflation reaccelerated after also being revised higher in December. The headline increased 0.5% in January vs the 0.1% increase in December (which was originally -0.1%). This is 6.4% for the year (down from 6.5%, but the monthly acceleration is what counts). Core inflation (ex food and energy) remained steady at 0.4% (5.6% on the year). The component breakdown is largely unchanged from the trends we have been seeing: Goods prices are slowing and Services prices are still accelerating. But context is important. Food prices are decelerating, but they still increased 10.1% vs last year. Used car prices are starting to tick higher again, but their annual change is a decline of 11.6%.

It is worth noting that the composition of the CPI has changed starting with this January report. This has been known for a while. The main takeaway is the new weights rely on a one-year time frame from two years ago instead of a two-year time frame. This means that whatever experienced the strongest inflation two years ago (January 2021 for this report) will now have an increased weighting. Given that things tend to normalize (and this is especially true from Covid years to now), this methodology change will have a dampening effect on inflation in theory. No surprise there…the government wants to look good and it wants to keep its own bill payments in check (many are tied to the rate of inflation). But this assumes the mean reversion. We are not there yet. Looking ahead, Housing has the largest increase in weight while Transportation is shrinking the most.

All told, consumers continue to think inflation is on a cooling trend. Below is the NY Fed survey data. It differs a bit from other measures (we have discussed the never-ending labyrinth of inflation metrics out there), but it still representative.



The Atlanta Fed's Business Inflation expectations dipped a touch in February to 2.9% from 3.0% in December.

➢ Retail Sales are strong on the surface, but we are not encouraged

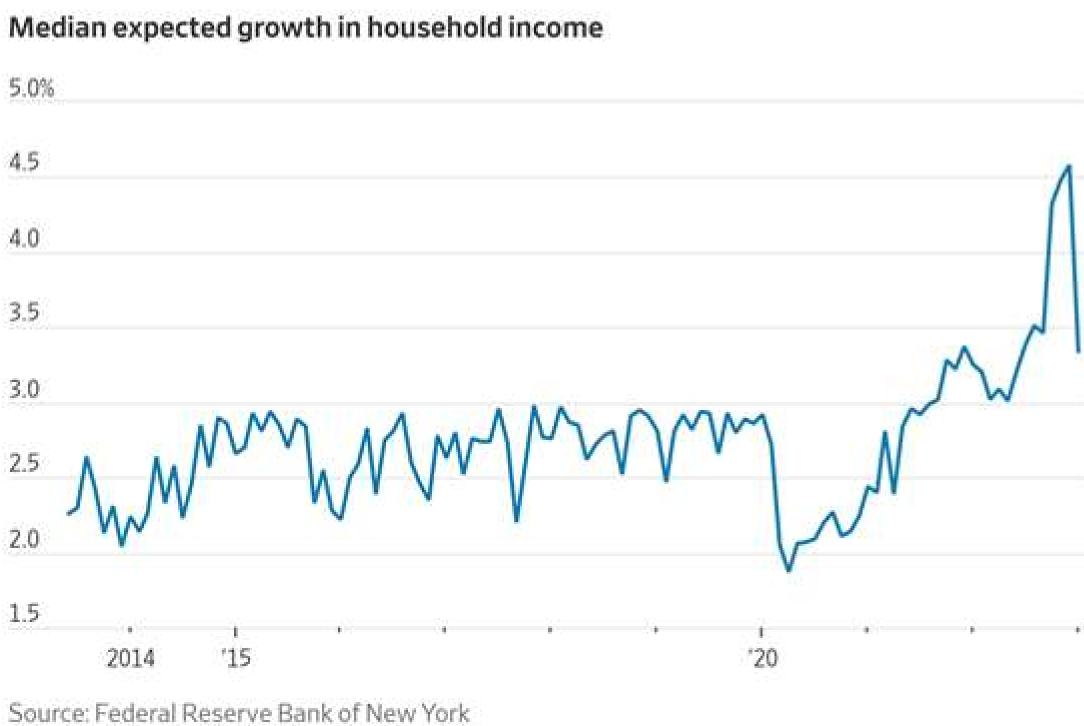
Retail Sales grew more than expected in January at 3%. But remember, this data is not adjusted for inflation. Moreover, the increase in spending was skewed towards autos and furniture. Neither of these typically have sustained strength. Moreover, this data tells us nothing about company margins. Discounts and clearances were widespread. Grocery Spending was only up 0.1% while restaurant spending was up 7.2%. It appears people have some misplaced priorities. The biggest surprise on the downside was in the broad e-commerce category.

➢ Sentiment is improving, but not with respect to their businesses and incomes

Consumer Sentiment (U Michigan survey which is more geared towards inflation) in February ticked higher again. This has been improving somewhat steadily since July. It is still 35% off its pre-Virus Fear level. And Expectations ticked lower.

Small Business Optimism was flattish in January vs December. But this has been declining since 2018 (it tends to move in long cycles).

But along with th improvement in inflation sentiment (U Mich), households are becoming much more worried about their income prospects.



➢ Housing might be stabilizing (that is not necessarily a good thing)

The Housing Market Index (aka homebuilder sentiment survey) improved in February for the second straight month. The headline still sits deeply negative, but it was still the largest monthly increase in 10 years. Of the sub components, Sales Expectations over the next six months increased the most and had the highest reading of 48. Buyer Traffic is still the weakest which is probably the most telling. The number of price reductions and incentives are falling, but they are still elevated. This data points to a bottoming in Housing…maybe. But even if so, continued improvement is unlikely in our view. Mortgage Applications are the most real-time data there is (weekly with only a five day lag), and they echo this (a possible bottoming but no acceleration higher).

We do not have any direct position in Housing. We still think it will be a weak spot for the consumer and thus the economy. Prices will likely fall as sales pick up out of necessity, and buyers will come to terms with higher interest rates (so it is a lose-lose). Home Value is the indicator with the highest correlation to consumer spending.

- An Employment addendum highlighting the oddity of government statistics

One quick follow-up to the strong Employment Report last week: The headline increase in jobs was 517k vs the expectation of about 185k. But the actual number of jobs *decreased* by 2.5mm. This is the dark art of seasonal adjustments at work.

- Other economic data is improving but still negative

Jobless Claims tick higher for the first time in a while.

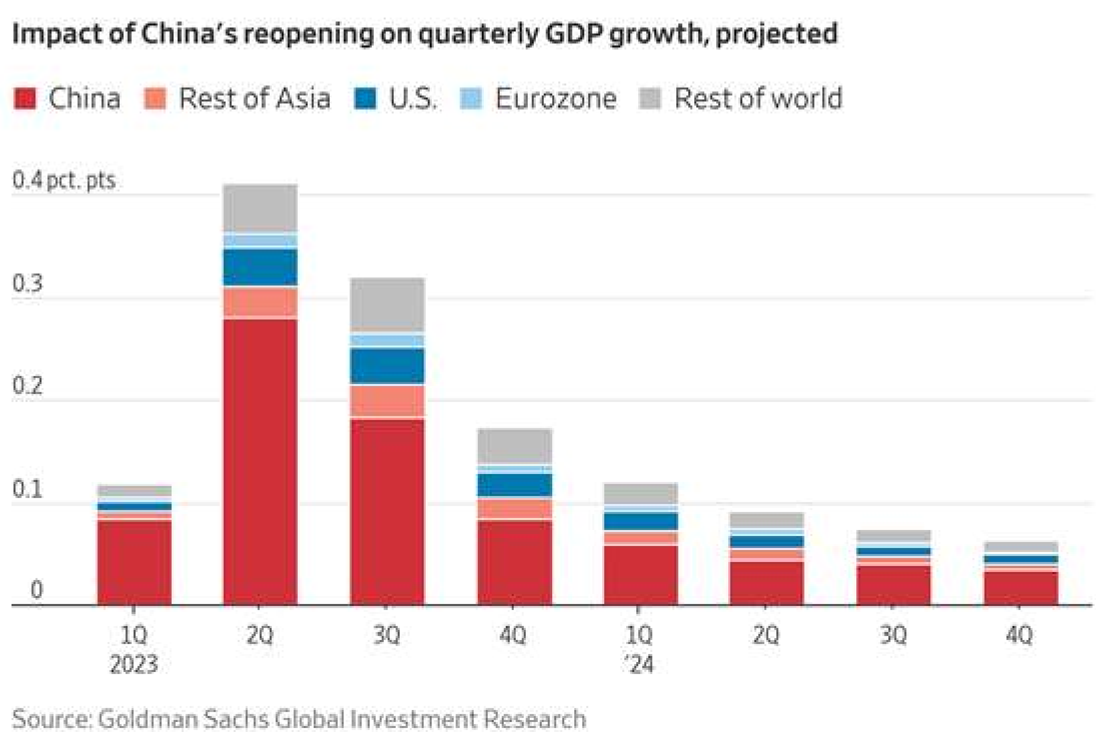
Empire State Manufacturing for February improved sharply…but it is still negative.

Industrial Production was flat in January vs December which was revised lower. Manufacturing was able to grow while utilities shrunk.

Business Inventories in December increased by 0.3% vs November (same as Nov vs Oct).

- Do not bet on China bailing out the global economy

China's Virus Fear reopening is expected to give a shot in the arm to the global economy. But most expect it to be rather short lived. Or rather, since most of the communist economy is reliant upon other countries buying their junk, the Chinese need a strong global economy to flourish. We still have a small long position for a trade. It is focused on local economy stocks. But we do not expect China's dead-cat bounce to drive any real growth.



- The Fed is losing a dovish voice among the hawks

The White House made it official in hiring Lael Brainard away from the Fed. She was probably the most dovish of the all the members. In other words, the consensus for higher rates for longer is becoming stronger.

- John Williams of the NY Fed thinks interest rates will need to remain high for a few years.
- Christopher Waller, a Fed governor, was a little less threatening, but the message was similar. He said the interest rat4es had already started to soften the economy. But “we have further to go.”
- Patrick Harker of the Philly Fed said rates need to go higher, but he emphasized the need to watch the data. But he thinks getting rates to 5% is a done deal (current range 4.50%-4.75%)
- Michelle Bowman of the Fed board of governors said rates need to go higher and remain there “for some time” to get inflation back down to the 2% level.

- Oil Volatility has plummeted despite the headlines

Russia announced it was going to cut 500k bpd because of the price caps put on its oil. We know that Putin will weaponize the cost of energy when and however he can. But we also know that this move is probably cover for his country’s inability to keep production running at a high rate thanks to an absence of maintenance capex. And even the willing buyers seem to come and go irregularly (India and China).

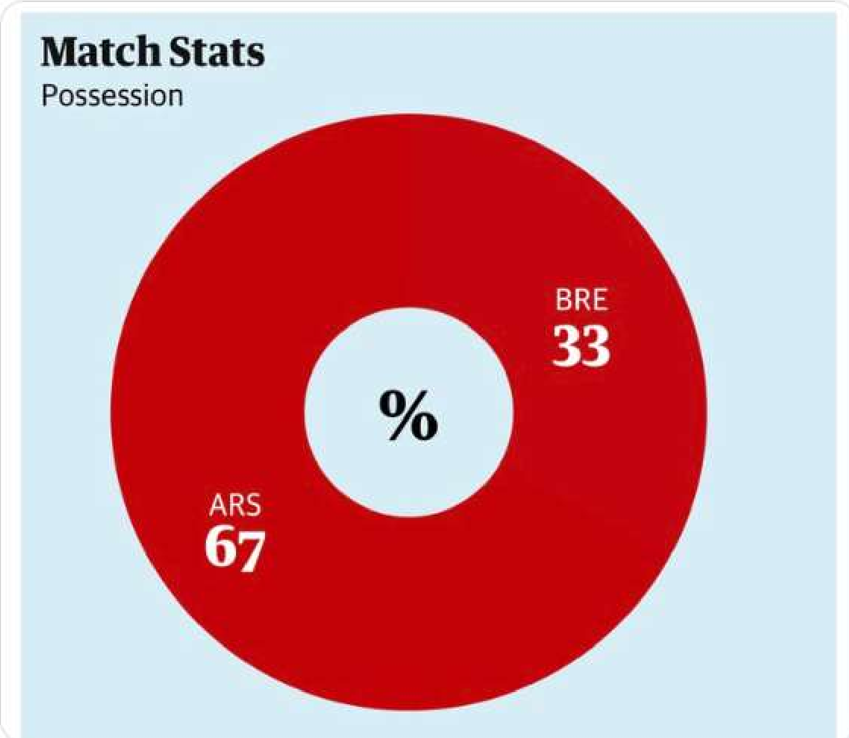
The US government is going to sell another 26mm barrels of oil from the Strategic (Tactical?) Petroleum Reserve (SPR). With WTI crude oil (front month) futures trading around $79 at the time of the announcement, this does not give the White House a lot of wiggle room to reload the SPR. Recall the government said it would be buying oil back around the $67-$70 area.

- Where did all the crypto money go?

We want to revisit one of the crypto scams we highlighted recently. It concerns a bankrupt crypto firm starting a new business. Three Arrows, a crypto “hedge fund,” went bankrupt as it was borrowing dollars (real money) collateralized by crypto tokens (fake money). It would then speculate wildly with your dollars. It lost all the dollars (or more likely lost some of the dollars and hid the rest). At first it was thought that the two hucksters were setting up an exchange (that word in crypto-land is so wrong) for people to trade bankruptcy claims on defunct crypto companies. The new revelation is that hopeless creditors will be able to trade their claims (on real money) into new tokens (fake money). These new tokens can then be used for collateral to trade more crypto! Not to mention the Three Arrows guys get to wipe their bankruptcy claims clean while taking another shot at ripping people off.

- Chart Crime of the week

This is from the Guardian in the UK. Apparently, it is a new twist on the pie chart. (Not that it matters, but the chart pertains to a soccer match between Arsenal and Brentford).



- Quick Hits
  - Webber (the grill maker) blamed its 42% drop in sales on "higher customer inventory levels."
  - Lisa Marie Presley's estate shows that the lone Elvis heir was highly indebted while spending $92k per month for living expenses. Somehow her ownership of Graceland and 15% of the Elvis catalogue and NIL was not enough to support her lifestyle.

*Do not forget that the president of Turkey believes that high interest rates cause inflation. And he believes in ESP.

Trading: We have slowly started to build a position in 10-year treasuries. We think the yield curve will remain inverted with most of the negative (price) moves on the shorter end. We reset some of our equity shorts. We basically salvaged what was left of some bad bets. We want to reload into this madness. But like we have been saying all year, we have to go slowly. The short squeezes in some of these names are violent. WE also bought more gold as it sold off with the USD strengthening.

TSLAQ: Musk has been puzzled by his declining "view count" on Twitter. When one of his three principal engineers suggested twitter users were perhaps losing interest in Musk's tweets, Musk fired him.

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