Weekly Update

20-July-2022

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- Fantasies and Frauds lead the market bounce
- Are Earnings helping the market? Nope.
- Positioning is bearish, but history tells us that's smart
- Housing: The worst-case scenario is forming
- The China data rebound is slowing, Real Estate is still a ticking time bomb
- Oil stocks look cheap compared to oil
- Quick Hits
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	3,960	4.2%	-16.3%	-5.7%
QQQ	$303.03	6.1%	-23.6%	-14.1%
US 10 YR	3.03%	2.93%	1.51%	1.29%
USD/DXY	107.0	108.4	96.0	92.8
VIX	23.9%	26.8%	17.2%	17.9%
Oil	$99.81	3.6%	32.7%	48.5%

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

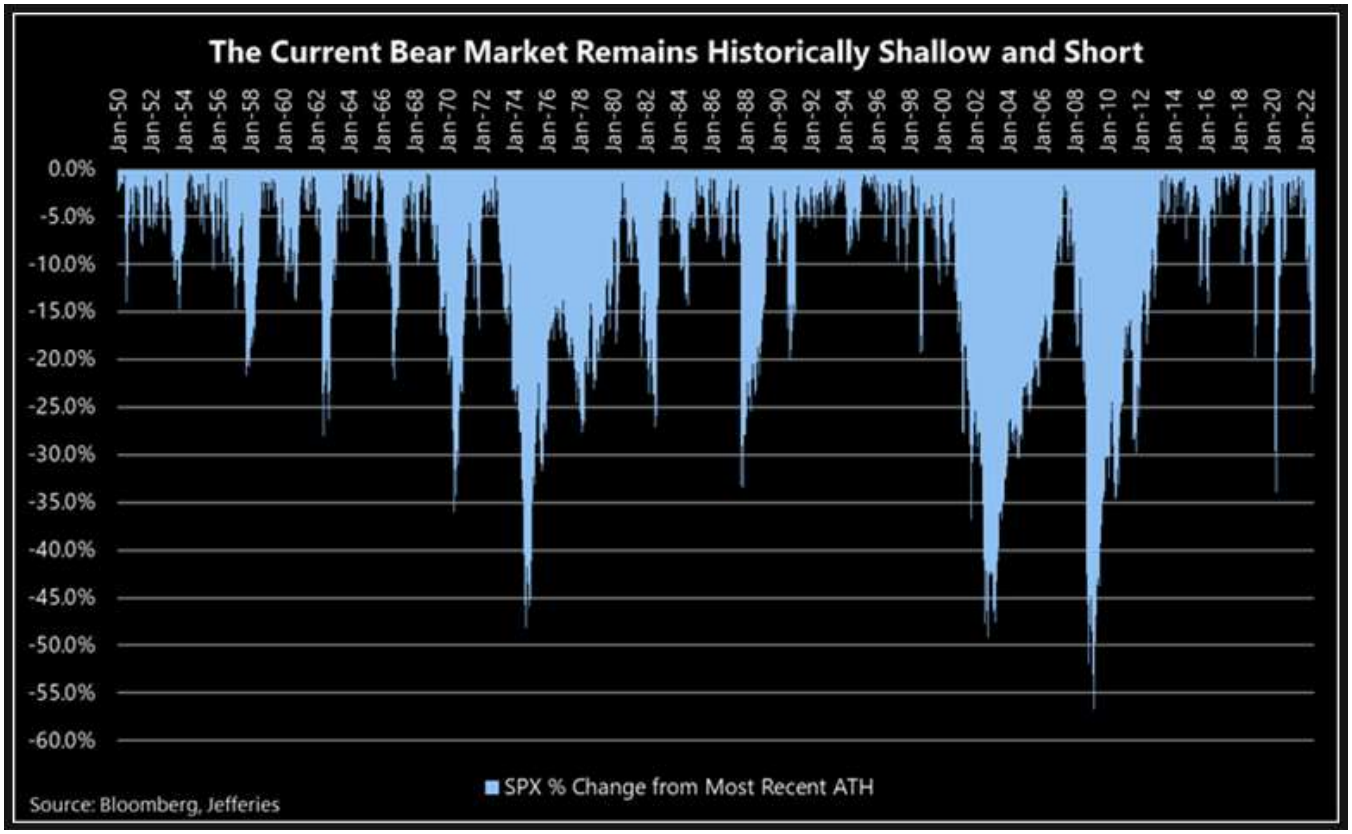
The market has finally "broken out" of its recent trading range and burst higher. Much of the motivating force continues to be the narrative that pulling forward the recession is a good thing. More to the point, the Federal Reserve will be able to supremely navigate its current tightening cycle followed immediately by a monetary easing cycle next year. Ironically, this would not be a sign of the Fed's prescience but rather of it screwing up the economic cycle…again. Needless to say, we are not believers. And we need look no further than the market's leaders. The biggest movers this week were the Fantasies and Frauds. These profitless companies are heavily shorted. And the panicky hands of hedge funds with already miserable performance are ruling the day (and perhaps soon to be ruing, as well). We thought a clear-worded warning form Apple would rattle the market. instead, the CNBC pundits raved about the technical mumbo jumbo (50 day moving averages and other gages with zero fundamental or statistical meaning). And to be clear, the economic data is worsening. From business/Fed surveys showing reticence to spend to a slowing Housing market to depleted Savings, there is not much to highlight on the bright side. We expect this to be another bear market rally head-fake.

- Are Earnings helping the market? Nope.

Perhaps we are missing the point and Earnings have been driving the market higher? The Cramers of the world have lauded the results from the early reporters…the Financials. Alas, a 30% decline in earnings (for the sector as a whole) and a 4% drop in revenues is nothing to cheer. For the market as a whole, Earnings expectations are still robust with 10% growth expected over each of the next four quarters. Of course, the current quarter's expectation is for growth of 6% despite the quarter-to-date growth of -9%.

- Positioning is bearish, but history tells us that's smart

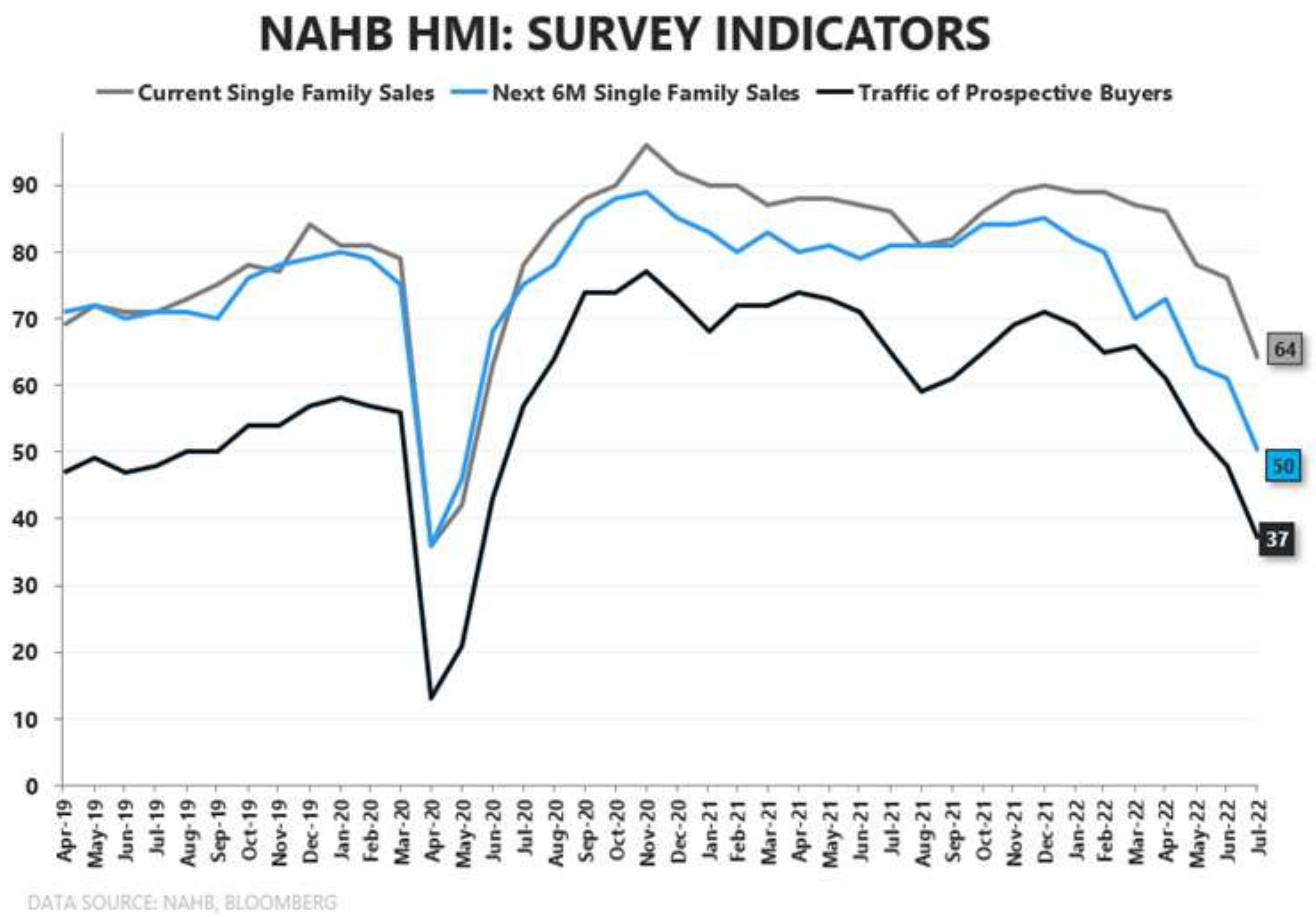
Here is a chart (courtesy of Jeffries via themarketear) showing that the current bear market is relatively benign in terms of historical context. Its drop is relatively average (nowhere near the big blowouts). And its six-month duration is relatively short compared to the average never mind the years-long troughs.



But the Merrill Fund Manager Survey says positioning is at extreme bearishness and this bounce has been justified. JP Morgan says Big Tech positioning is at the lowest in five years (they, too are bullish at least short term). HFR (Hedge Fund Research which mostly provides tracking and performance figures for hedge funds) says macro funds have not been this short equities since the beginning of the virus-fear. And there has been a lot of commentary about futures positions being the most negative on record (much of this could be for hedging or other nondirectional purposes). But the point here is that we think panicky hedge funds are feeling the burn of FOMO. We expect this to end up like every other "rally" in the past six months…painful for the chasers.

- Housing: The worst-case scenario is forming

The Housing Market Index for July (home builder sentiment survey) fell dramatically…again. It is now back to the low end of the range before the virus-fear. Current Sales are bad. Next Six-month Sales are worse. And Traffic of Prospective Buyers is ugly. (Chart below is courtesy of Hedgeye)



Housing Starts in June missed expectations but did manage a slight increase from May data. Permits were the mirror image with a slight beat vs expectations but sequentially worse than May. Single Family Starts and Permits, however, both dropped about 8% vs May reaching levels not seen since the onslaught of the virus-fear.

Existing Home Sales fell for the fifth straight month. The monthly drop was 5.4% and the annual drop was 14.2%. And inventories continue to creep higher. They are now at about three months' worth which is a two-year high. Prices have yet to crack as the median hit $423k.

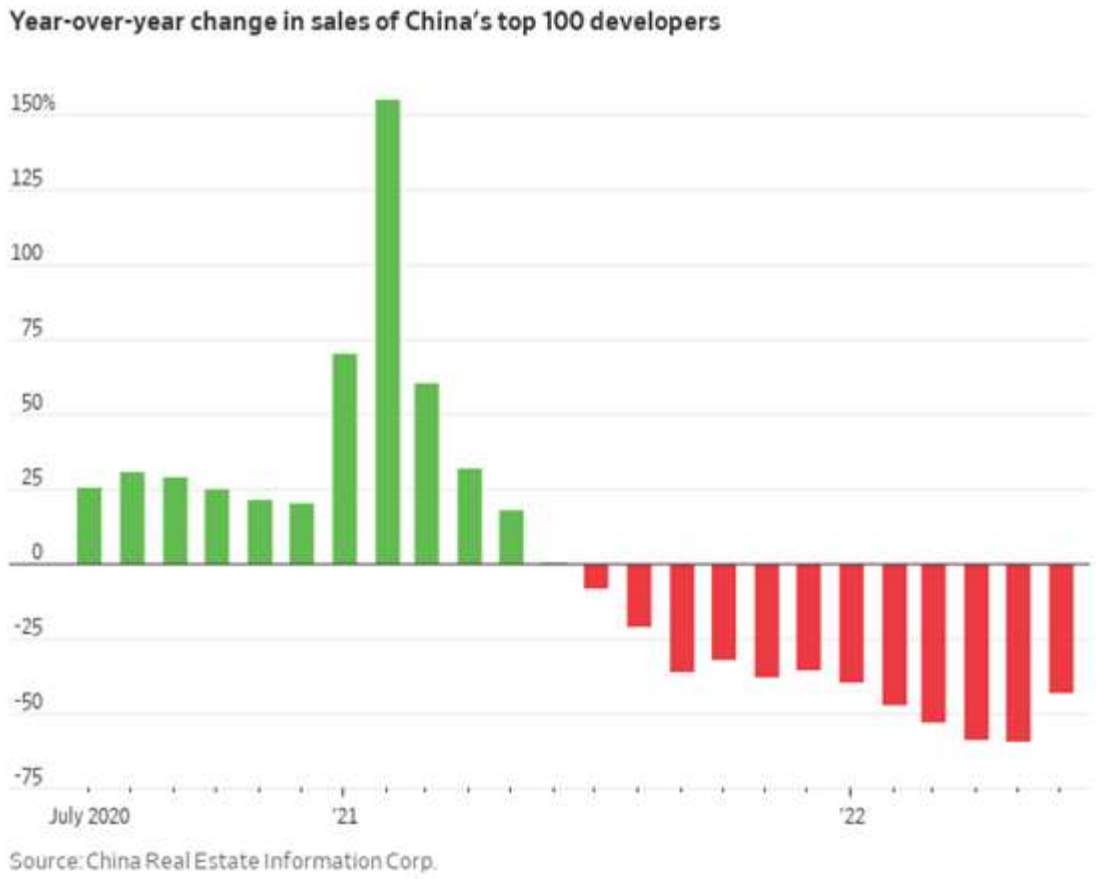
What we are seeing is probably the worst-case scenario. Housing prices are still pushing inflation higher (Owner Equivalent Rent is the metric which has long lag times), but all other Housing data is quickly worsening. We have been waiting to short the sector. We might be close.

- Other Economic data is lousy
  - Producer Prices (input or wholesale) increased at an accelerating pace in June at 1.1% vs May. The May increase was 0.8%. The Annual increase was 11.3% vs 10.8% in May. But this data is a little stale since we saw such dramatic pullbacks in commodities in late June and early July.

- Retail Sales in June increased by 1% vs May. The market took this as a sign that the economy was still going strong. But this data is not adjusted for inflation. Considering inflation was 1.3%...adjusted Retail sales were *negative.*
- Empire Manufacturing bounced back into positive territory. But this survey has bounced around all of 2022, so we do not put much faith in it (until there is a trend).
- Industrial Production in June fell despite Capacity Utilization ticking higher.
- Business Inventories increased in May by 1.4% vs the 1.2% increase in April.
- U Michigan's Consumer Sentiment gage ticked up a hair in July (preliminary reading). But it is still sitting just above the all-time low. Recall that this Sentiment gage more closely reflects consumer spending habits especially as they relate to inflation.

➢ The China data rebound is slowing, Real Estate is still a ticking time bomb

China had one of its broad data dumps on Thursday night. Data was mixed (which means ex-lying it was weak). The House Price Index fell 0.5% in June. Fixed Asset Investment ticked up on a monthly basis. Industrial Production fell from 5.6% growth in May to 0.8% in June. Retail Sales increased 0.5% vs a flat May. And to cap it off, GDP in 2Q grew by only 0.4%. This compares to Q1 growth of 4.8%. Communist lockdowns do, indeed, have an impact on an economy. And here is a look at the real estate market which has been bubbling up a witch's brew for a while now. When the China Evergrande default situation first started, we surmised that it would be locally contained, and foreign bondholders would be penalized. With Xi potentially losing his grip on power, real estate could be front and center again.



- Oil stocks look cheap compared to oil

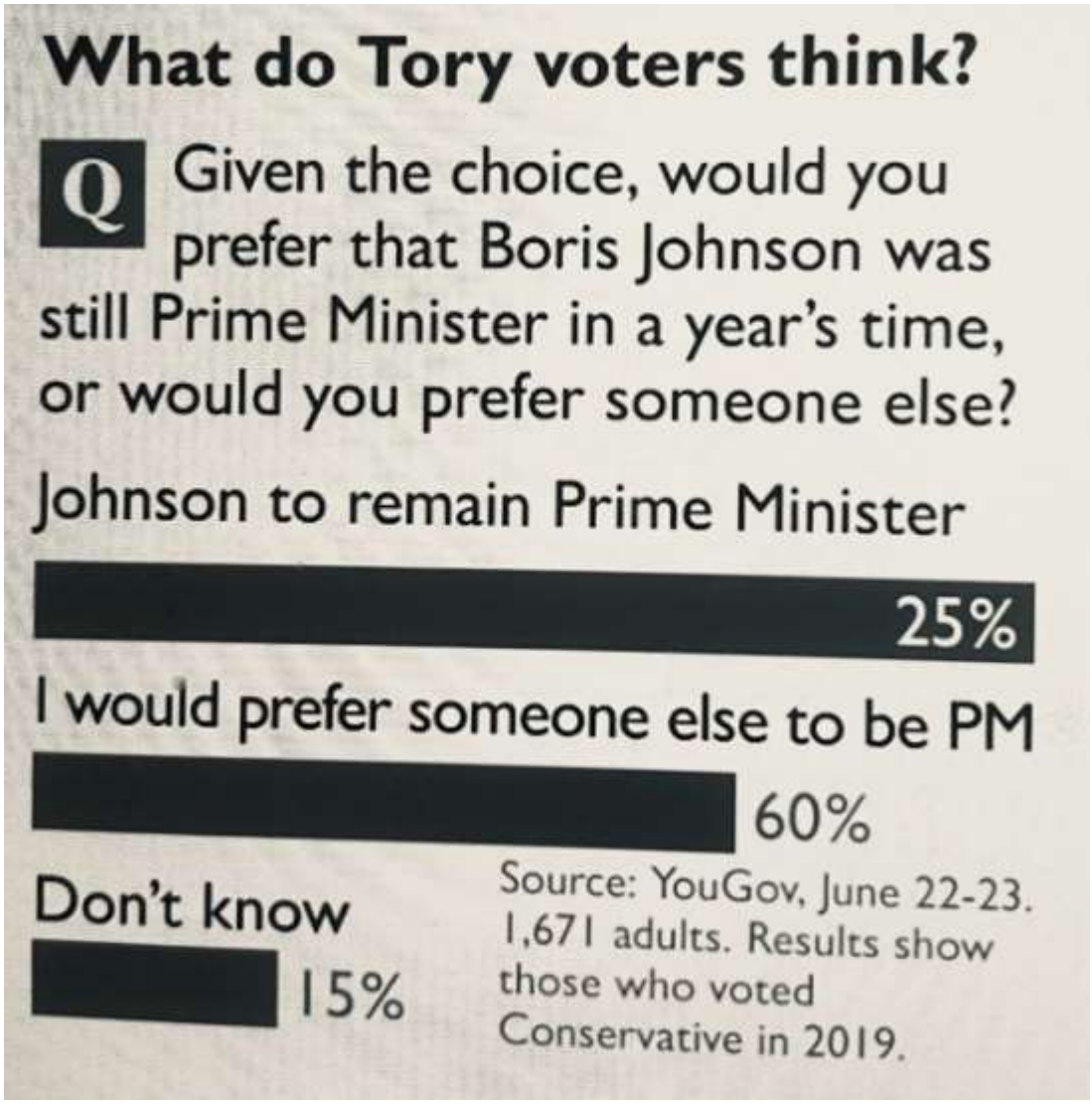
Last week we touched on the forward curve in oil futures. We noted this was a more reliable lens through which to view oil especially from a commercial/producer's perspective. One thing we left out is that this backwardation (forward prices lower than today's spot prices) disincentivizes producers to pump more oil (or rather to expand capacity to pump more than they are capable of pumping now). This, of course, pressures oil prices higher or at least keeps them from falling. So we are ignoring the macro trader noise in the oil markets and are focusing on company specific production discipline.

Biden left Saudi without a deal to lower gasoline prices. This was always a political stunt, and we expected some conciliatory words from the Saudis. Instead, they said, "Oil productions decisions to be made by OPEC."

We have ben espousing the "cheapness" of oil stocks with oil around this level ($100 ballpark on the spot price). Here is a pretty cool way to look at it courtesy of Haver (via themarketear again). It basically tells us that oil stocks (XLE) have been underperforming relative to the S&P given where two-year oil prices are trading. Obviously this does not mean much if fundamentals are worsening. But we think fundamentals are improving (production discipline, enhanced drilling techniques, much better midstream infrastructure…and oh yeah the energy crisis in Europe).

- Chart Crime of the week

Biased “reporters” are some of the slimiest chart criminals.



- Quick Hits
  - The Netherlands is creating a law protecting a worker’s right to work from home.
  - China is stealing Taiwan sand via dredging.
  - BMW now offers a subscription service to heated seats.
  - Jordan Belfort, the original Wolf of Wall Street, thinks Bitcoin fundamentals are “really strong.”
  - The National Highway Traffic Safety Administration (NHTSA), not to be confused with the National Transportation Safety Board (NTSB), has a unit named the Office of Defects Investigation (ODI).
  - Crazy Cathie Wood, aka The Wood Chipper, is closing her ARK Transparency Fund. It has $12mm in assets.
  - Bankrupt Voyager Digital is planning to offer creditors “tokens” to be used in its referral program for future business development. “Hey mom, I get more rewards points if you sign up to trade crypto at this bankrupt crypto firm!”

Trading: More of the same. We are using the weakness in Staples and Utilities to add to our positions. We added some more long Energy. We are trimming some of our Healthcare inflation long. We added to our long USD position. We also added to our long Gold position…this one continues to be a real stinker. We cut some Put protection (woulda/coulda/shoulda cut more last week). And now we are adding some back slowly into this rally.

TSLAQ: Tesla reported earnings tonight. As usual, it is impossible to know what is really going on at that company. Earnings were better than expected, but margins were worse. Somehow Capex was down despite Musk warning that the new factories were incinerating money. And to add to the Bond Villain files, he who has declared his undying loyalty to Bitcoin sold 75% of the company's position. Oh yeah, this counted for about a third of its earnings. And in Twitter world, Musk lost his first ruling, and the trial will be expedited.

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