



Weekly Update

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- All-time highs again
- Euphoria in Tech...but has it run too far too fast?
- Will AI ever make money? (token economics are getting there)
- Revenue growth is the focus
- Mixed Employment Report (more jobs, fewer employed, more underemployed)
- Inflation jumps slightly more than expected, energy is the driver
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week
- Is the market giving way to the “surreal nature of dreams?”

	Last	5d %	YTD %	1yr %
S&P 500	7,444	1.1%	8.8%	26.5%
QQQ	\$715.99	2.7%	16.3%	38.6%
US 10 YR	4.47%	4.35%	4.17%	4.54%
USD/DXY	98.5	98.0	98.3	101.0
VIX	17.9%	17.4%	15.0%	18.6%
Oil	\$101.32	6.5%	75.9%	58.7%

*10yr, DXY, and VIX are levels not changes

** Oil is front month futures, beware

The market continues to push to new all-time highs. Earnings and Revenues are still accelerating higher. Economic growth is still expanding even with noticeable inflation (arguably this is *helping* equities). Geopolitics are still a risk with the shaky ceasefire with Iran becoming more fragile. Political stress in the UK is heating up (the fear is Starmer will be replaced with someone much less market friendly). But the Trump and Xi kumbaya is providing greater stability. If China and the US can make more “trade deals,” then not much else matters (even if the “deals” are just the same old deals that have been talked about...Boeing is expected to sell more planes to the Chinese...the first such deal was announced in 2017). Kevin Warsh was confirmed as the new Fed Chairman. But the probability of a Fed cut is now nonexistent. And rate hikes are on the table. But as Zervos has been saying, this market has not needed rate cuts!

Of course, the narrow nature of this rally is concerning. Tech is dominating the performance with memory stocks and other semiconductor chips rallying like it is 1999. Even when South Korea floats the idea of levying

additional taxes on AI companies to pay a “citizens dividend,” the slight dip is nothing but a momentary lapse of reason. Energy is still eking out gains. But the only other sectors in the green over the last week are Health Care and Staples...these are not the typical sector winners in a growing economy with beneficial inflation (to companies...not to consumers). Despite the great Earnings trajectory, there has been some mounting commentary from companies warning about the health of the lower-end consumer (obviously not a new concern, but fast-food restaurants, airlines, gyms, and others are all pointing to the weakness).

But none of this really matters right now. Call option buying has eclipsed the meme frenzy from 2021. Citadel says this charge is being led by Retail investors. While the Put-Call ratio is not quite back to the lows seen in that crazy stretch, it is near the low end of the 10-year range excluding that extreme (a low ratio means there are fewer Puts than Calls). The option guys are also pointing out the abnormal condition of “spot up; vol up” which just means Volatility is increasing while stocks are going up. Of course, this is abnormal only because there is usually more Put buying than Call buying! Levered ETF volume is exploding higher. The chart gurus all point to a raging bull market (these guys have the best review mirrors). And guess what...the hedge funds are back buying Tech hand over fist. They have gone from selling the rally throughout April to now buying as fast as possible. We mean this literally. Gross exposure to Tech is in the 100th percentile over the last five years. And Net exposure is in the 99th. The mantra seems to be that the AI trade is “overbought but not over yet.”

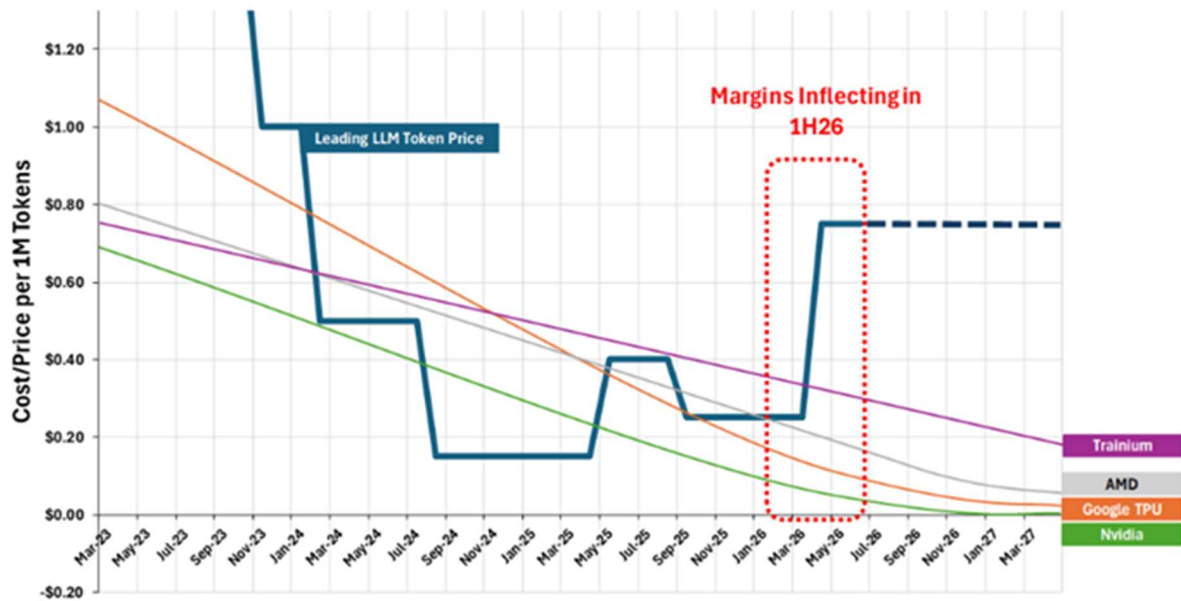
All this is great until the rug gets pulled. Hence, we have started to trim some of our highfliers. And we have rotated back into more of the mundane growth stocks. In other words, we still believe in the economy, its earnings, and thus the market, but we think some of the AI trade has run too far too fast (and/or other areas need to catch up). William Wallace can shout Hold for only so long.

➤ Will AI ever make money? (token economics are getting there)

The big question surrounding Artificial Intelligence is, of course, when will the ecosystem make money (not just the ones selling the chips)? Clearly there are different use-cases. JP Morgan, for example, says it is already saving \$2b by implementing smarter trade settlement systems and human resource enhancements. But we need to see the model makers turn their ability to raise money into profits. It appears that the worm has started to turn. The colored lines in the chart below show that the cost of creating the compute (these are the chip makers) has been falling steadily. Equally important, the cost per token (the amount of \$ the model runners can charge for their services) has stopped falling and has now inflected higher. We still have some doubts...will people really pay for glorified search when a free Google or Grok is already on your phone or desktop? But the point that many are making is the “agentic” AI work is going to skyrocket...programs and processes will be running in the background to help businesses (and consumers looking for automation). We think this is very likely.

Exhibit 2: Token economics are beginning to turn more favorable

LLM token pricing has fallen dramatically, but has now started to stabilize - while underlying compute costs continue to fall faster - creating room for positive margin inflection



Source: Data compiled by Goldman Sachs Global Investment Research

Additionally, Goldman breaks down the comparable costs between humans and AI. For coding, AI is about 5% of the cost. For Call Centers, AI is more expensive by about 2%. For Data Entry, AI is about 75% of the cost. This disparity shows up on both sides of the equation. Human coders are very expensive. Call center workers are cheap. Accurate voice command recognition is very expensive. But these are all trending in the same direction (AI will be cheaper).

- Revenue growth is the focus

Last week we mentioned the oversized earnings from one-off “other income” items. These are mostly investments in other companies that have appreciated markedly. These gains are highly concentrated in the hyperscalers (AMZN, GOOGL, META, MSFT) given their monster paper gains in OpenAI and Anthropic (and other smaller ones). It turns out, a third of the income from these companies was derived from this “other income” category. That is huge! Of course, it might very well turn into real money (not just paper gains). More importantly, net income growth would still be an eye-popping +16% in the quarter without these gains. (The headline is +28%!). Importantly, Revenues are still accelerating (now up to 11.0% vs 9.0% on April 1)

- Mixed Employment Report (more jobs, fewer employed, more underemployed)

The Employment Report headline surprised to the upside again. April NonFarm Payrolls increased +115k. This is a slowdown from +185k in March (which was revised up +7k). But recall this was a huge jump from the negative -156k in February (which was unfortunately revised lower -23k). The headline expectation was for a gain of about +65k. Private Payrolls accounted for more than the total at +123k. This was even better than the strong guess from ADP earlier in the week (+109k). This means Government payrolls dropped (-8k). But Manufacturing also dropped (-2k). Unfortunately, Health Care was the top sector gainer +37k. Transportation

and Warehousing gained +30k. Retail Trade gained +22k. TMT (old school lingo for Tech, Media, Telecom) dropped -13k jobs.

The Unemployment Rate remained steady at 4.3%. But the Labor Participation Rate ticked down from 61.9% to 61.8%. The math means total employment dropped -226k. The number of people working part-time jobs for economic reasons (underemployment) increased by 445k. The total is now 4.9mm. The total number of unemployed stands at 7.4mm. The number of newly unemployed (less than five weeks) increased by +358k.

Average Hourly Earnings increased +0.16% which was a mild disappointment. The good news is that wages for “production and non-supervisory” workers increased more (+0.34%). Average Weekly Hours ticked up to 34.3 from 34.2 (The employment bears often point to this number being below the pre-Virus Fear level. Perhaps this is better productivity. If nothing else, it has stabilized over the last year.)

Initial Jobless Claims increased to 200k. Continuing Claims dropped to 1.776mm

Challenger Job Cuts in April increased to 83.4k from 60.6k. Over 33k of these job-cut announcements were in Tech. It is the white-collar culling continuing (now that is some alliteration). (As a refresher, this datapoint collects publicly announced layoff intentions. Large companies, those with more than 100 full time employees, must announce layoff intentions with at least 60 days notice.)

The weekly ADP Employment Change increased slightly to 33k from 30k.

➤ Inflation jumps slightly more than expected, energy is the driver

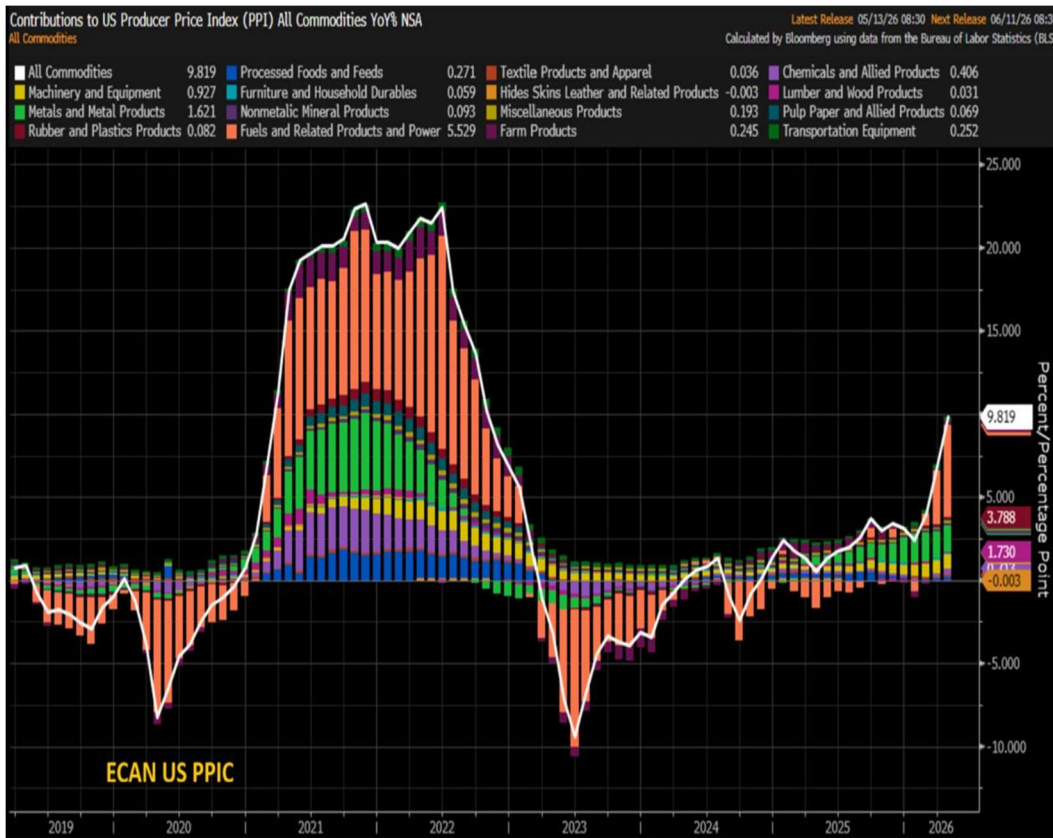
CPI inflation (change in Consumer Price Index) in April accelerated to +3.8% as expected (up from +3.3%). The monthly gain was +0.6%. The “Core” increased at a slower rate of +0.4% bringing the annual increase to +2.8% (up from +2.6%). Energy was the obvious mover. It increased +3.8% on the month which accounted for about 40% of the total increase in prices. Food prices jumped +0.5% with Food at Home moving +0.7%. Food away from Home only increased +0.2%. Shelter prices increased +0.6%. Rent and Owners’s Equivalent Rent (what you think you could rent your house for) both increased +0.5%. Hotel prices jumped +2.8% which skewed the category higher. The annual Shelter increase was +3.3%. But this number is slightly distorted because of the government shutdown from last October. The Bureau of Labor Statistics (BLS) had been using a 0.0% reading as a placeholder. The BLS does six-month adjustments, so “real data” replaced the 0.0%. Monthly outlier movers include airfares +2.8% (jet fuel), personal care +0.7%, and apparel +0.6%. Beer, wine, spirits, and whiskey (which has its own category) all fell in April. Book prices dropped -2.9%. Sewing machines prices climbed +3.4%.

The NY Fed’s Consumer Inflation Expectations (1-year) in April moved higher to 3.6% from 3.4%.

U-Michigan’s 1-year inflation expectation decreased from 4.7% to 4.5%. Its 5-year expectation also fell (3.5% to 3.4%).

The Producer Price Index (PPI, or wholesale or input inflation) jumped 1.4% in April. This brings the yearly gain to +6%. The “Core” PPI numbers also jumped (+1.0% monthly, +4.4% yearly). All of these are much higher than expected. The jump is obviously rooted in energy prices. But the spillover effects are happening. We will stick to the research that says the ultimate passthrough of energy costs is contained. Moreover, tariffs from last year (many of which have now been reversed) are leaving the calculation in the coming months, so annual inflation will be lower). Overall, we are still moderately concerned about inflation, but as long as it remains in check with growth accelerating, this is a good recipe for the equity (and commodity!) markets.

PPI is all about Fuel (and Metals and Machinery):



➤ Other economic data is better

Small Business Optimism (NFIB) in April remained flat.

Redbook Retail Sales accelerated to +9.6% vs +7.8% last week.

Construction Spending improved in March (+0.6%) after a weak February (-0.2%).

U-Michigan Consumer Sentiment fell again.

Existing Home Sales in April ticked up to a 4.02mm annualized run-rate. This is still not even close to the pre-Virus Fear average of around 5.5mm.

Weekly Mortgage Applications ticked up barely.

The average 30-year mortgage rate inched up to 6.46% from 6.45%.

➤ Where did all the crypto money go?

One leg of Ryan Cohen's compensation dream relies on TD Bank and its willingness to extend \$20b in debt to GameStop (or rather, the newly combined entity with eBay if it were to take hold). But one detail overlooked is that TD will only extend this leverage if the combined entity is investment grade. Moody's has already said that the chances for this are slim and none (and Slim just left town). eBay has laughed away the fake takeover bid.

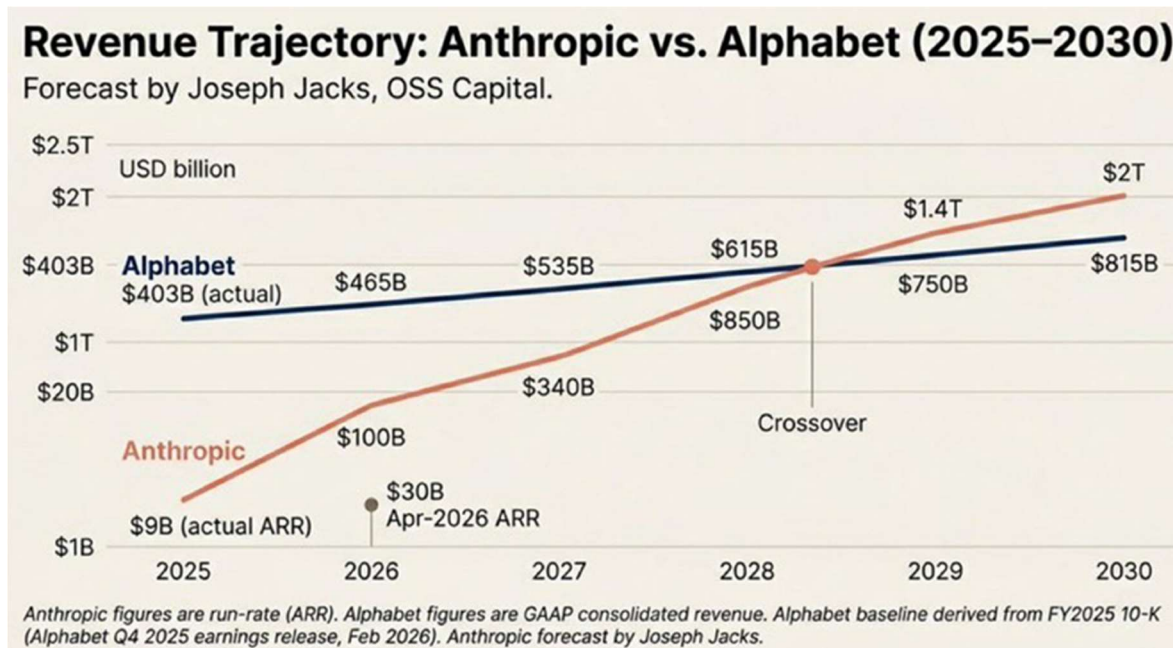
About five years ago, a Mexican billionaire was conned out of a lot of money. He borrowed \$115mm from someone representing to be part of the Astor family. The “lender” demanded and received \$450mm of shares in one of the billionaire’s publicly traded companies. The fraudster never had the money to lend. He took the collateral, sold the stock, and then lent some of that money to the billionaire! The kicker here...the billionaire wanted the money to buy crypto! (Matt Levine wrote about this one, but we have a lot of experience with this guy’s family of businesses...most of which were publicly traded at one time. Now, none of them are public as they are mostly distressed. Buying crypto was the way out?)

North Korea hackers strike again. The group (it is probably always the same government-sponsored group) stole from a platform called KelpDAO. Apparently, the allure of KelpDAO was that owners of crypto could put their crypto on this platform and get paid high “rewards” (interest). The weird catch was that the platform would not “lock up” the crypto. In other words, the crypto was ripe for the taking. The Nort Koreans swiped the tokens. But knowing they could not sell the tokens swiftly or at a good price, they approached another platform and borrowed real money using the fake money as collateral. The details are fuzzy, but reports say they stole \$290mm of fake money and were able to take home \$230mm of real money. Aave, the entity that lent the real money, must be crazy to lend at 80% loan-to-value (LTV) in the crypto space.

One of the crypto world’s largest conferences, Consensus, is hosted in Miami. This year, one of its official parties was held at a strip bar. No word if any Fidelity traders from the early 2000’s were in attendance.

➤ Chart Crime of the week

The trillion-dollar question. But this chart only seems to make it more confusing. The y-axis is nonsensical. The Crossover is even worse? We might be missing something, but our head hurts trying to figure it out. (h/t to JF for sending this one to us.)



➤ Quick Hits

- 300 different languages are spoken in China.
- Planet Fitness blamed an increase in membership cancellations on their marketing campaign which included the words “cancel anytime.”
- Lucky Strike is being accused of building a bowling monopoly.
- The Cocodona 250 is an ultramarathon through the Arizona desert. A woman just won it in a time of just over 56 hours.
- Arizona was once the most efficient shrimp producer in the US with the fastest growth in the world.
- In 1988, 1,864 companies changed their name.
- Early research shows that AI-driven stock picking is a money losing venture. In one test, 26 of 32 models lost money. (We think AI is great for streamlining research, and it might be really good at making money in the future, but we do not think we are there yet.)
- Bolivia has 37 official languages.
- French unemployment is over 8%.
- Pink Floyd’s *The Wall* was banned in South Korea during the 1980s.

TSLAQ: Much of the focus in Muskland has been on the trial involving OpenAI and whether Sam Altman “stole” the company from its nonprofit status. Altman testified that it was Musk that tried to steal 90% of the company. There is a good chance that both guys are guilty in this one.

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