Weekly Update

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- Volatility is ticking higher, but it appears to be mostly noise
- Earnings are growing, but are they too top heavy? (nah)
- Retail Sales starting to slip
- Credit Card debt is still K-shaped
- Builders are getting optimistic, but they are not building more (yet)
- The Fed is still focusing on inflation risks
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,982	-0.4%	4.4%	24.0%
QQQ	$425.52	-1.8%	3.9%	42.3%
US 10 YR	4.33%	4.25%	3.88%	3.93%
USD/DXY	104.0	104.7	101.3	104.6
VIX	15.3%	14.4%	12.5%	22.3%
Oil	$78.00	1.9%	8.7%	2.3%

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

Volatility is slowly ticker higher. The Vix at 15 is still well below the bottom of the post-Virus Fear range, but the trend higher is taking shape. On the surface, interest rates and Earnings drove sentiment. Comically, some in the market are now starting to contemplate a rate *hike* instead of a rate *cut*. Of course, the market is not pricing in any hikes this year (3.5 cuts), but Larry Summers and some others are banging the inflation drum loudly (the data shows there are pockets of stickiness, for sure). The minutes from the last Fed Open market Committee meeting certainly reinforced the no-cut stance in the short-term. As for Earnings, Nvidia was the most anticipated report (first blush looks like a strong revenue beat with positive guidance). Given the giant run it has had, it was only natural that it sold off into Earnings (almost -10%...some short-term hedge funds never want to take earnings risk). A reshuffling of Palo Alto Network's business plan had also spooked the Tech world, but this appears to be a thoughtful recalibrating of its internal business cycles (trying to make one platform for its suite of cyber security products instead of constantly selling patchwork products…we do not have a position). And Walmart delivered strong earnings with strong sales and better margins. Importantly, prices are still deflating but they are moderating. More broadly, we would add that some of the recent economic data has cooled

(Retail Sales, Housing), and other soft spots are not getting better (credit card debt quality, Leading Economic Indicators). But the government is spending like never before, so that will remain an economic tailwind (while the spending lasts).

- Short-term Volatility is increasing

Our Outlier Rank dataset shows some interesting twists. One year, 1-Standard deviation moves of the S&P 500 continue to compress. A year ago, the 1-std move was about 1.50%. This has dropped down to 0.77% (in a straight line for the most part). But the 30-day, 1-standard deviation has started to climb higher despite the obvious move higher in the market (from 0.5% at the end of 2023 to 0.67% now). And Outlier moves (the number of moves outside of this 1-std range) during the last 30 days vs the last year are increasing. Our takeaway is that the market can continue to grind higher (with Volatility/Std moving lower). But surprises (good or bad) will move with more variation.

- Earnings are growing, but are they too top heavy? (nah)

Earnings growth continues to accelerate (this data is before Nvidia). After 395 of the S&P 500, actual growth has improved to 7.3% (it was 6.6% two weeks ago). The blended growth (actual plus projected) has improved from 7.8% to 9.6%. We have talked about the improvement in earnings, yet they will likely still miss the October 1 expectation of 11%. But we are closing in on that once-lofty expectation! Revenues are also increasing albeit at a slower rate. They have gone from 3.3% actual to 3.5%.

Exhibit 3. 2023Q4 Blended (Reported & Estimated) Earnings Growth

Sector	Today	1 Jan	1 Oct
Consumer Discretionary	34.8%	22.3%	28.5%
Consumer Staples	4.7%	1.8%	5.2%
Energy	-21.8%	-25.6%	-20.6%
Financials	8.9%	6.0%	11.7%
Health Care	-15.1%	-18.9%	2.4%
Industrials	7.9%	-1.6%	6.3%
Materials	-18.9%	-20.9%	-7.6%
Real Estate	13.0%	11.0%	14.3%
Technology	21.9%	16.7%	14.7%
Communication Services	54.1%	49.0%	49.5%
Utilities	51.2%	49.1%	55.4%
S&P 500	**9.6%**	**4.7%**	**11.0%**

Source: LSEG I/B/E/S

Exhibit 4. 2023Q4 Actual Earnings Growth

	S&P 500
Today	7.3%

Source: LSEG I/B/E/S

However, and this is a big one, JP Morgan says Earnings growth would be negative (-4%) if you strip out the top performers (the largest mega-caps, again not including Nvidia). We are not sure their math is right as they have aggregate growth at only 5% vs the IBES data above. Moreover, it is silly to strip out the largest companies…they represent an enormous part of the economy. Whatever the case, it just reinforces the idea that these are the companies you want to own!

We also want to add that Earnings growth in Europe is on track to be negative 5.3% for 4Q2023. And 1Q2024 is worse at -8.6%. The latter part of the year is supposed to accelerate nicely. This explains why much of Europe is back towards all-time highs despite there being recessions all over the place. Our point is that we think there is less room for error in Europe.

- Retail Sales starting to slip

Retail Sales slumped in January (the data is adjusted for seasonality, so do not think January is slow vs holiday shopping in December). The monthly drop was -0.8%. There had been only one down month in the last nine (October 2023 was -0.3%). The winners and losers mostly remain the same. Electronics and Department Stores have been the worst over the last year. Sales in Grocery and Food & Drinking places are still growing. General Merchandise stores sit right in the middle with flat/no growth in sales. Furniture and Health and Personal Care stores are the outliers as far as trends. Furniture improved and Health and Personal Care worsened. We suspect both of these moves are fleeting and will revert to their previous trends.

The weekly Redbook Retail Sales increased 3%. This is up from 2.5% the previous week. But this developing trend is well off the 5-6% increases we saw in late December and January. And this data is not adjusted for inflation.

Many are dismissing the relatively weak Retail numbers because of bad weather. We think this is ridiculous.

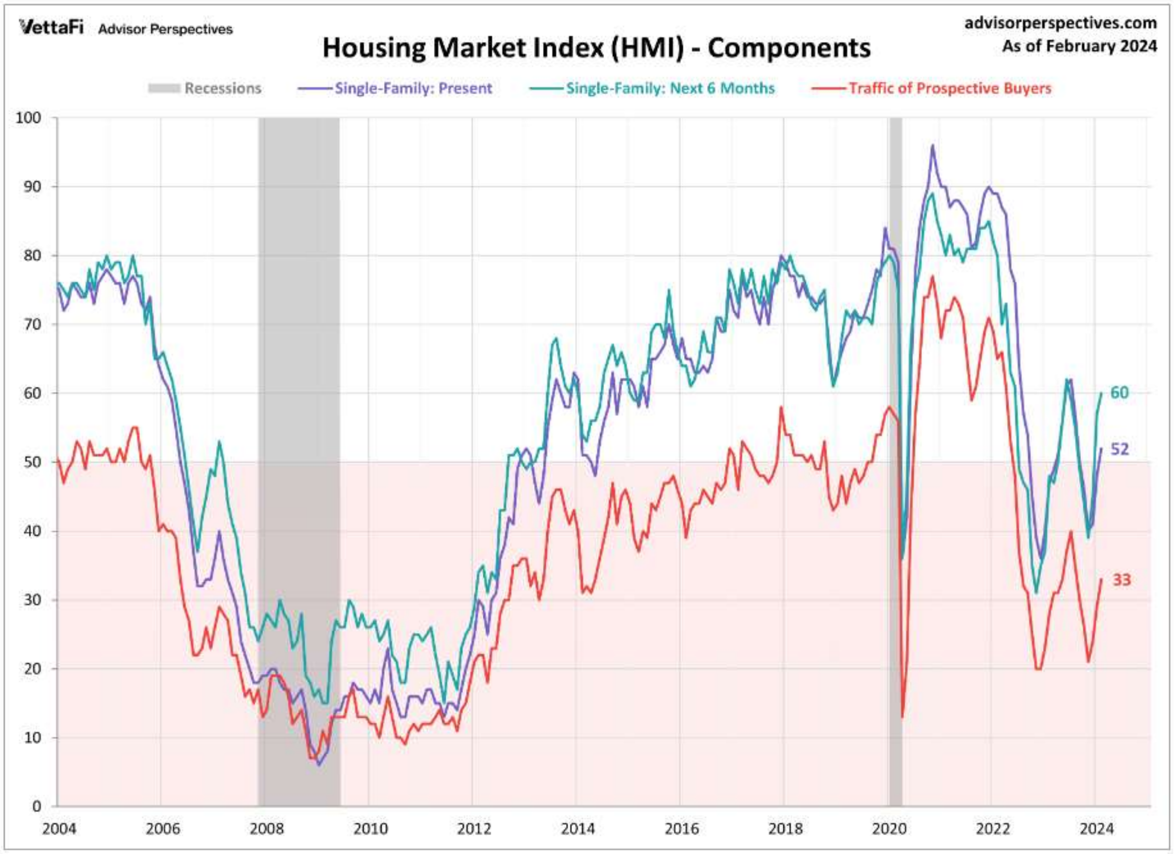
- Credit Card debt is still K-shaped

We like to reference this table outlining credit card delinquency and charge-off rates across eight large lenders. The two trends remain the same. The cards on the lower end of the credit spectrum are seeing their credit quality deteriorate (far right columns are large, positive numbers…that is bad). And the stronger credit quality cards are seeing their quality improve. Capital One and Discover just announced a merger. They know they need to right their ships. (It is more complicated than this as Discover also has its payment services business…a competitor to Mastercard and Visa.)

Company	Ticker	Type	Jan.	Dec.	Nov.	Jan.	3-month average	Jan. 2020	
Capital One	COF	delinquency	4.78%	4.61%	4.55%	3.65%	4.65%	4.10%	68
		charge-off	5.71%	5.78%	5.19%	3.81%	5.56%	4.31%	140
American Express	AXP	delinquency	1.50%	1.40%	1.40%	1.00%	1.43%	1.60%	-10
		charge-off	2.10%	2.50%	1.70%	1.50%	2.10%	2.30%	-20
JPMorgan	NYSE:JPM	delinquency	1.07%	1.00%	0.99%	0.83%	1.02%	1.14%	-7
		charge-off	1.72%	1.69%	1.75%	1.17%	1.72%	2.19%	-47
Synchrony	NYSE:SYF	delinquency	4.90%	4.70%	4.70%	3.80%	4.77%	4.50%	40
		adjusted charge-off	6.00%	5.60%	5.60%	4.30%	5.73%	5.20%	80
Discover	NYSE:DFS	delinquency	4.02%	3.87%	3.76%	2.67%	3.88%	2.65%	137
		charge-off	5.23%	4.90%	4.71%	2.81%	4.95%	3.45%	178
Bread Financial	NYSE:BFH	delinquency	6.80%	6.50%	6.50%	5.80%	6.60%	6.00%	80
		charge-off	8.00%	8.20%	7.90%	6.70%	8.03%	7.20%	80
Citigroup	NYSE:C	delinquency	1.51%	1.45%	1.47%	1.04%	1.48%	1.58%	-7
		charge-off	2.65%	2.34%	2.21%	1.50%	2.40%	2.49%	16
Bank of America	NYSE:BAC	delinquency	1.35%	1.42%	1.41%	1.09%	1.39%	1.61%	-26
		charge-off	2.23%	2.27%	2.24%	1.50%	2.25%	2.54%	-31
		Avg. delinquency	3.24%	3.01%	3.00%	2.49%	3.09%	2.90%	34
		Avg.charge-off	4.21%	4.05%	3.32%	2.91%	3.86%	3.71%	49

- Builders are getting optimistic, but they are not building more (yet)

The Housing Market index (aka homebuilder survey) bounced to 48 which is just below the diffusion index breakeven level of 50. All three components of the index moved higher. Notably, the next six months for Single Family had the strongest surge (perhaps a head fake like last year?).



But this increase in optimism did not translate into more immediate building. Both Permits and New Housing Starts fell in January. Permits were down just a touch. But Starts fell dramatically – their biggest fall since the onset of the Virus Fear. This is partially skewed as the November and December numbers were very strong. But the outright number of Starts fell to the low end of its four-year range (do recall this data is an annualized number, so monthly changes get extrapolated into bigger moves). We do not have a position in Housing, but we would prefer builders to furnishings.

- Other economic data was mixed
  - Correction: The PPI (Producer Price Index, wholesale or input prices) increased more than expected in January. We reported last week that PPI was still cooling…but this data was actually a revision for December.
  - Michigan Consumer Sentiment ticked up slightly. The same goes for the one-year inflation expectation which is logical following the slight move higher in prices. But the five-year expectation remains anchored at 2.9% (with very little volatility over the last year).
  - Weekly Mortgage Applications fell almost 11%.
  - Net Foreign Direct Investment in China in 2023 fell 82% to only $22b.
  - The NY Fed's Empire Manufacturing index bounced back dramatically. It was deeply negative and now it is just below the breakeven level.
  - The Philly Fed Manufacturing index had a similar bounce (was not as negative but is now more positive).
  - Industrial Production in January went negative. This data has been bouncing above and below the breakeven line for over a year. Manufacturing was the drag.

- The Leading Economic Indicators fell for the 23rd month in a row (this is shaping up to be as useless as the business surveys…which have heavy weight in the LEI index!)

➢ The Fed is still focusing on inflation risks

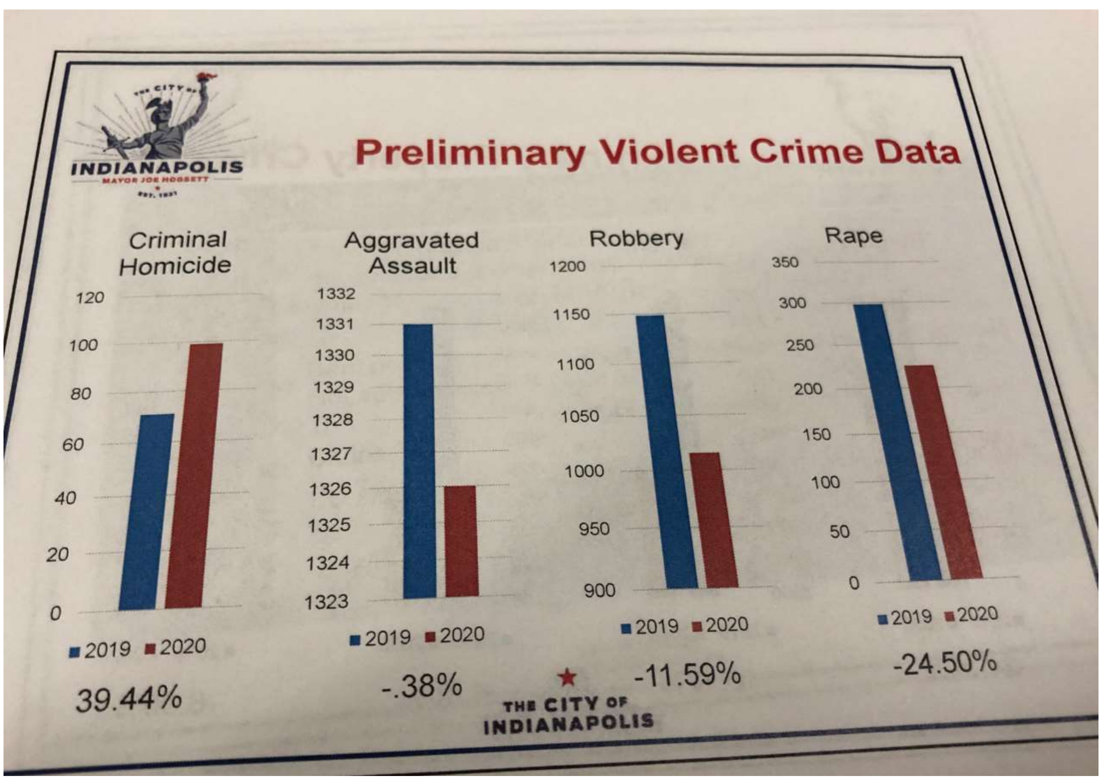
The minutes of the last Fed's Open Market Committee meeting (they set the rates and policy) reinforced what the chairman and other Fed speakers have been telling us: They are concerned with the risks of cutting rates too early. The Fed is worried that the progress on combatting inflation might stall. Of course, their reasoning behind the caution is mostly positive. They see stronger demand in the economy and loosening financial conditions. (They throw in geopolitical risks, too.)

➢ Where did all the crypto money go?

The story of Heartland Tri-State Bank involves all sorts of fraud and ineptitude (crypto and traditional). The crux of the story is that the CEO of this bank got hoodwinked in a crypto scam. Apparently, the only way to get his money back was to give the scammers more money. Hmm…wait a minute. Well, after this CEO had swindled the local church and local investment club (in a town of 1800 in Kansas), he was out of money again. His next source of funds was from the bank he ran. He had his bank tap the Federal Home Loan Bank system to the tune of $21mm. This is the same government facility that blindly lent money to Silicon Valley Bank, Signature Bank, and other mismanaged (if not fraudulent) banks. He then somehow wired these new funds to the scammers. Moral of the story: If you are dumb enough to get swindled in a crypto scam, stop giving them money.

➢ Chart Crime of the week

Bunny Colvin would not juice his crime stats, so he created Hamsterdam. In Indianapolis, they juice the charts.



- Quick Hits
    - Any Super Bowl bets not related to the actual game on the field are illegal (i.e. any bet involving Taylor Swift).
    - The top securities regulator in India, when asked about retail traders buying options, said "If you need diabetes and high blood pressure, then go into this market."
    - China issued more permits for coal plants in 3Q2023 than all of 2021.
    - The holiday we just celebrated is still technically Washington's Birthday… not President's Day.
    - Morgan Stanley is being sued after issuing a $1b margin call against a billionaire. The lawyers attribute part of the move to "snobbery."

Trading: It was a pretty busy week with Volatility starting to creep higher. We did not make as many strategic shifts as we have lately. We continued with our general barbell strategy. Most trades were incremental. We added to longs in Health Care, Emerging Markets, Financials, and Big Tech. We trimmed a touch of Energy in to this recent rally (many of the momentum guys are starting to buy Energy now…we will see if that takes hold)

TSLAQ: Cybertrucks are rusting. Despite fanboys posting pictures of the "freckling rust spots," a Tesla engineer rebuts this by asserting the spots are "just surface contamination." He goes on to give tips on how to clean the surface of the truck. Just apply some CitiSurf77 and then wipe with a Scotch-Brite pad.

Musk chimed in on his Neuralink company. He claimed that the patient with the brain implant has successfully moved a computer mouse just by thinking about it. Shockingly, there is no video of it, and the company had no official comment.

Elsewhere, Musk seems to be focusing his attention on posting nude photos of Hunter Biden on X.

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