Weekly Update

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- Maybe the equity market gets that the Fed will keep hiking rates?
- The bond market certainly gets it
- A Fed pause is still a tightening
- Global liquidity does not support a stock market rally
- Retail Sales are still just flat
- Homebuilding is the hottest part of the economy
- Other economic data is still middling at best
- China data continues to worsen
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,366	0.2%	14.6%	20.7%
QQQ	$361.90	-1.0%	36.3%	32.9%
US 10 YR	3.73%	3.79%	3.88%	3.16%
USD/DXY	102.1	103.0	103.5	104.4
VIX	13.2%	13.9%	21.7%	29.0%
Oil	$72.49	6.2%	-9.6%	-34.5%

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

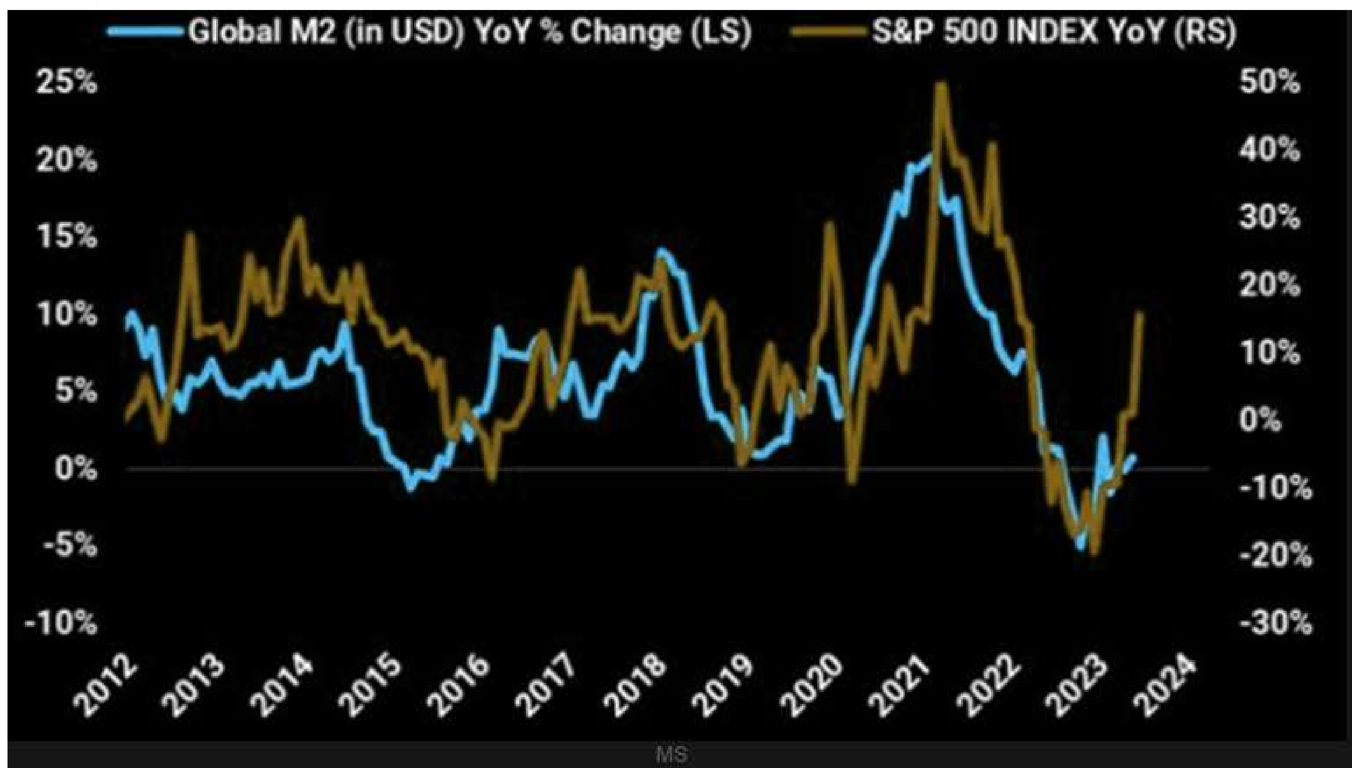
This week was full of mixed headlines resulting in two distinct narratives. The bulls were rejoicing in the Fed's rate hike "pause." Housing data is strong and improving so the economy as a whole must be on solid footing. China cut three different interest rates in an attempt to jump start the dead reopening. A tentative deal was reached with the already obscenely paid dock workers in southern California. And even the hot "AI" narrative was overshadowed by the flashy debut (IPO) of a small-cap restaurant chain, Cava.

Of course, the reality of more rate hikes finally sunk in a bit (they were bad, then good, and now bad again). It took an appearance in front of congress from Fed chairman Powell to hammer home this point. Specifically, he said, "the process of getting inflation back down to 2% has a long way to go." A still-hot inflation number in the UK (8.7%) also spooked the bond market a bit. The 2-10yr yield curve inverted to almost 1% which is back near the highs reached back in March. This is the recession playbook: Short-term rates are hiked to cool inflation. Long-term rates sink (at least relatively) reflecting slower growth. As for the China rate cuts, these were all just

symbolic at 0.10%. That market had been expecting greater monetary stimulus as well as new fiscal stimulus (nothing yet). And the ECB hiked rates and indicated more were coming along with more Quantitative Tightening next month. (For what it is worth, they appear to have some dissent on their committee, too.) As for the improving economic data, it is hard to find this outside of Housing. Credit card delinquencies and net charge offs are on the rise. And the lower-tier credit cards are faring far worse than higher credit quality ones. The only notable earnings report this week was FedEx. It guided poorly. This company is as cyclical as it gets.

- A Fed pause is still a tightening

One angle to the "soft-landing" or "no-landing" argument that is often missing is that if the Fed keeps rates flat (at these levels), then the market will become accustomed to these higher rates and eventually start paying them. While this might be true for someone looking for a house (of course, they will end up buying a cheaper house), the broad economy does not work this way. Keeping interest rates unchanged while inflation is falling is an explicit tightening of monetary conditions: Real interest rates are increasing while nominal interest rates are flat. Morgan Stanley points this out under a similar lens: Global liquidity is flat. And this is before the $1t in Treasury issuance that is coming down the pipeline (a huge drain of liquidity). And Quantitative Tightening is ongoing. There are still some emergency lending avenues in place at the Fed for troubled banks. But these measures are just stemming trouble…not acting as any stimulus. And the ECB continues to drain its various QE programs.



- Retail Sales are still just flat

Retail Sales for May surprised to the upside with a 0.3% monthly gain (a drop was expected). As has been the case lately, the shopping was split. On the plus side (no, not Victoria's Secret), Health & Personal, Food services, and Online all showed +6-8% growth. Home Furnishings and Electronics exhibited -5-6% drops. The market cheered this data…the consumer was alive and well. But we are more skeptical. A 0.3% increase is still a

deceleration from the 0.4% increase in April. And other than during the Virus Fear shopping mania, this data historically hovers around 0.0% (with monthly moves higher and lower). We have a small short in the electronics sector which we are likely to grow. Not only are sales falling, but the business is skewing more towards online (where the margins are lower because the attachment of high margin warranties is much lower).

- Homebuilding is the hottest part of the economy

One of the biggest paradoxes of the economy right now is the red-hot housing market. Or rather, the red-hot market for *new* houses. The Housing Market Index (homebuilder survey) reached its highest level since July of last year. It was the sixth straight monthly increase since bottoming in December of last year. All three components of the index gained in June: Present Conditions, six-month Expectations, and Traffic of Prospective Buyers. This last category is the best leading indicator, and it continues to trail the others (but improving).

As good as the Housing Market Index was, the Housing Starts and Permits data blew it away. Starts had their largest monthly increase since 1990. They surged to their highest level since April of last year. Permits experienced a more tempered increase. The Starts data is so strong that it will likely be revised lower (and it appears there is a strong seasonal adjustment baked in). But it still underscores the power position the homebuilders hold. This is still a holdover from the Virus Fear times. Migration and work-from-home are still dynamics at play. And of course, the low supply of existing homes for sale only helps new sales.

We do not have a position in housing. We expect the market as a whole to suffer with increasing unemployment and a generally weaker economy. But new housing might remain robust until the supply imbalance is overcome.

- Other economic data is still middling at best

The Philly Fed Manufacturing Index for June sank further into negative territory. The Empire State Manufacturing index bounced back into positive territory after being deeply negative. Industrial Production in May fell into negative territory.

Business Inventories moved back into growth territory. Sometimes this can be a positive if businesses think there is going to be an uptick in activity. We doubt this is the case.

The U Michigan Consumer Sentiment for June was better than expected. This index has been steady all year still sitting just above its all-time low (made in December 2022).

Jobless Claims remained flat at the elevated level of 262k.

- China data continues to worsen

The monthly China data dump showed what we all know. Industrial Production in May slowed to 3.5% from 5.6% last month (the monthly rate was higher but not as much as expected). Retail Sales slowed to 12.7% from 18.4% (slower on a monthly basis). Fixed Asset Investment also fell. Small, symbolic moves in interest rates will not rectify this situation.

- Where might more crypto money go?

Blackrock announced it was applying for registration of a Bitcoin ETF. Aside from this being the exact opposite of what the true believers want…there is not much more of a centralized and institutionalized sponsor than Blackrock, HODLers (what the true believers call themselves…Hold On for Dear Life) were overjoyed. But the registration statement has some interesting risks. Bitcoin and the functional use of stablecoins “may be involved in laundering money.” And the ETF’s custodian…the entity that actually holds the bitcoin…, “could restrict or

curtail the services it offers" if the SEC complaint against it were to shut down its business. As Matt Levine writes, "'Our custodian might be illegal' is an unusual risk factor."

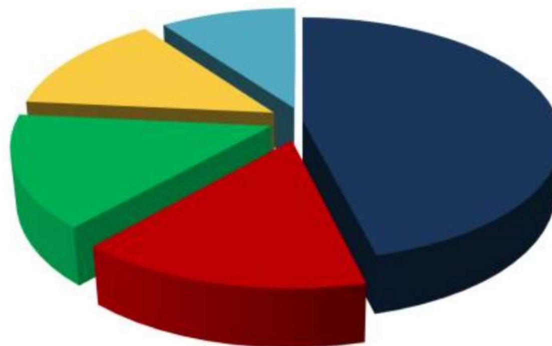
We will look to Matt Levine for a two-for this week. FTX is telling its creditors…the people from whom it stole billions of dollars…that they must pass FTX's KYC checks (Know Your Customer) in order to be paid back any of their stolen money. It is a fine time for FTX to find regulatory religion…when it might have to pay people back.

- Chart Crime of the week

We were initially drawn to this as the factors can clearly overlap at times. Smoking can cause high blood pressure, etc. But then we saw the small print: "Total may not add to 100 because of rounding." These numbers add up to 88.2.

Causes of Cardiovascular Disease Mortality
United States - 2014

High Blood Pressure, 40.6%
Smoking, 13.7%
Poor Diet, 13.2%
Insufficient Physical Activity, 11.9%
Abnormal Glucose Levels, 8.8%



Total may not add to 100 because of rounding

- Quick Hits
    - California is in the process of passing a law that will criminalize parents that do not "affirm" the desired gender of their minor children. This will play a large part in custody battles, as well.
    - LA Country Club's property in the heart of Beverly Hills is valued at $8b.
    - The CEO of the NASDAQ is described by the WSJ as "a second-degree black belt in taekwondo and a ferocious pickleball player."
    - 60% of crude oil produced in the US is exported (either as crude or refined).
    - The American Medical Association has deemed the Body Mass Index "racist."

Trading: We maintain our defensive positioning. We trimmed a bit of our more speculative longs. We added to our long international equities based on macro factors (Japan and India are growing). We are slowly adding to some shorts in the economically sensitive parts of the market. We are still on the sidelines with regards to Tech.

TSLAQ: Morgan Stanley has chimed in with one of its infamous valuation assessments of an ancillary business. With Ford and GM lining up with the Tesla supercharger system, Morgan Stanley wanted to prove that the move

makes Tesla money. The assumptions MS makes are awesome: Tesla can consistently produce electricity at zero marginal cost. And this electricity can be stored at the charging site with stationary batteries. MS has a few scenarios. The "reasonable" case is that EV's represent 10% of miles driven. Telsa has a 50% share of the charging system. And it has a 30% net operating profit. This is worth $3 for the Tesla share price. Even though Musk thinks opening up the supercharging business will be a net loser, we think $3 per share is reasonable. But MS thinks Tesla can reach a "monopoly" position. EV's represent 50% of miles. Tesla has 100% share of the charging system. Operating margins are 80%. This is worth $78.

Barclays research chimed in with a great line: "We have at times been willing to be more generous with our target multiple given the belief that TSLA is far more likely to get the "more than a carmaker" treatment by the market." It does not sound like Barclays is overly convinced with its own research. They downgraded the stock.

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