CHALK CREEK PARTNERS

Weekly Update

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- The Fed surprises the market
- Market is rethinking its "soft-landing" narrative
- New record credit card debt is not a good thing
- Inflation metrics are still confusing
- Oil does not go up on news, but it does go down on rumors
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	Last	5d %	YTD %	1yr %
S&P 500	4,343	2.5%	14.3%	18.6%
QQQ	$365.90	4.9%	37.6%	33.9%
US 10 YR	3.79%	3.80%	3.88%	3.29%
USD/DXY	103.0	104.1	103.5	105.2
VIX	13.9%	13.9%	21.7%	29.6%
Oil	$68.65	-3.7%	-14.9%	-42.6%

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

Today's Fed meeting was supposed to be a boring one with rates being left unchanged. On the surface, this is what the Fed delivered. But in a surprise move, the Fed increased its projection for rate hikes this year, and chairman Powell clearly stated that the risk to inflation is higher. Just last week, the market was celebrating the end to rate hikes with one of its Goldilocks narratives. But today, logically, the market unwound some of the recent rotation. That is, this was not the "soft-landing" that we have witnessed lately. Economically sensitive sectors (cyclicals) including Industrials, Financials, Energy, and Retail all retreated. We have posited that these have been rallying not just on the soft-landing narrative, but also in some sort of late cycle Death Rotation. Today's action supports this. Short covering and capitulation often come right before the fresh news that sets the (real) narrative straight. Mega-caps are still charging higher, so this will mask the headline index moves. However, these moves are mostly based on emotion (as we have said, Nvidia is a great company, but the valuation is driven by FOMO). But the Fed putting its thumb on the economic scale can move everything else in its natural direction. We think these are higher probability bets to make.

- Merrill's Fund Manger Survey points to the "soft-landing"

Notwithstanding the market's reaction today, there has been a "soft-landing" narrative prevalent in the market. According to the Merrill Fund Manager Survey, Investors have a more favorable view of earnings growth over the next 18 months. Inflations expectations are at their lowest in over 20 years. Large investors might be underweight equities on the headline, but they are overweight Tech, Discretionary, and Communications. In other words, investors sold their Staples, Health Care, and Utilities to buy Apple, Microsoft, Nvidia, Amazon, Tesla, Google, and Facebook.

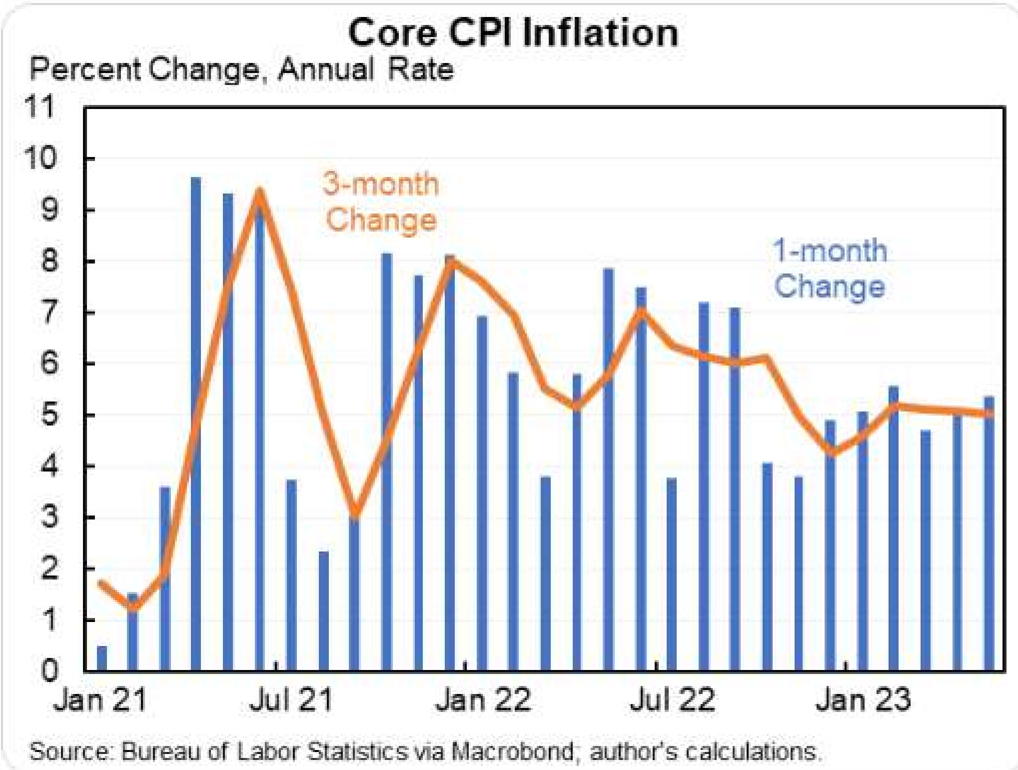
- New record credit card debt is not a good thing

US credit card debt stands at a new record just under $1t. This is up 17% from last year. Many of the bulls point to this data as a sign of the consumer being healthy. Or they at least discount it because it is not adjusted for inflation. But that is sort of the point…people are spending so much more because of inflation! The average debt owed per person in the US is now $5700. Most importantly, a greater portion of non-discretionary spending is winding up on credit cards. And the average APR is over 20%. For new cards, the average APR is about 24%. The good news is that delinquencies are about equal to the four years before the Virus Fear. But this rate of 2.5% is up sharply from 1.5% in the middle of 2021. Then again, the Great Financial Crisis culminated with rates of almost 7%. When we add on the student loan debt that will have to start being repaid come August 30, we think the consumer is going to feel the pinch. (One clarification: Student loan forbearance is ending on August 30. But the Supreme Court is still slated to rule on Biden's plan to eliminate some student debt outright. This case is expected to go against Biden according to the experts who listened to the oral arguments.)

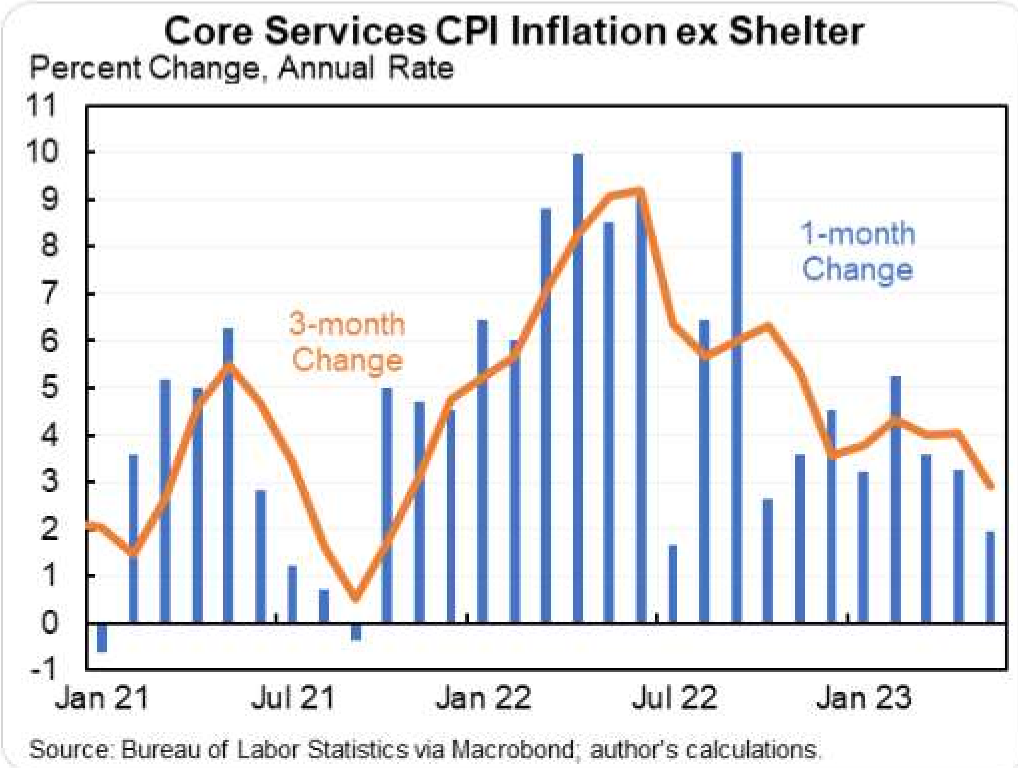
- Inflation metrics are still confusing

Consumer Prices grew about as expected in May. The headline was cooler at 0.1% which makes the annual change 4.0%. The "core" remained steady and higher at 0.4% which is a 5.3% annual change. Prices are dartig around which makes establishing a trend difficult. For example, in the Food category, Meat and Dairy prices are falling the most. Conversely, Fruits and Vegetables are increasing the most. But these have experienced the lowest inflation over the last year. Energy prices are down across the board. But Electricity prices are still the most resilient (still up 5.9% over the past year). Used Car prices ramped back higher this month.

Core inflation looks like it has leveled off and remains well above the Fed's 2% target.



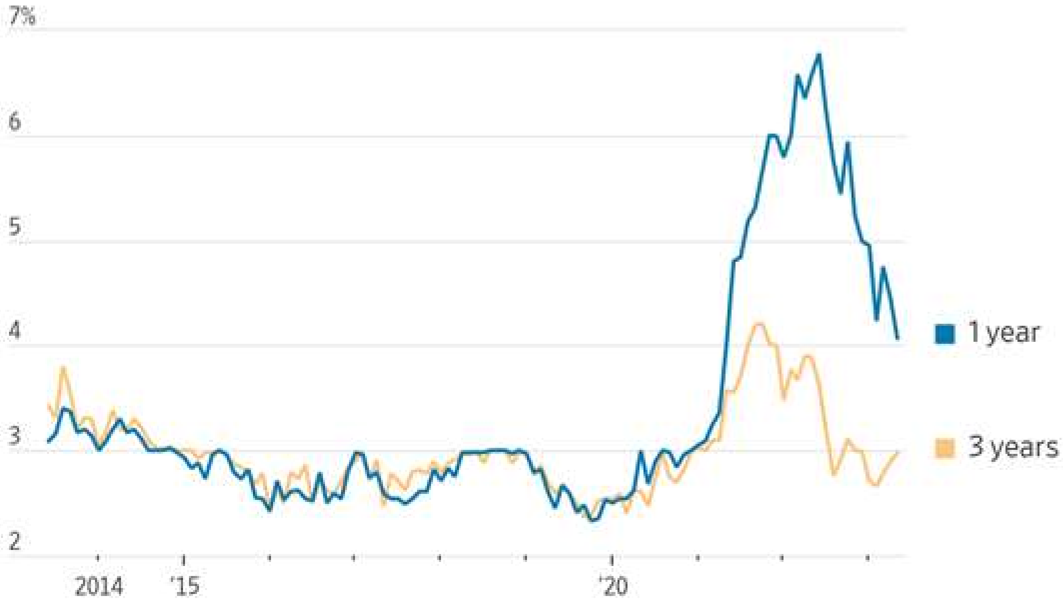
But the Fed also likes to look at a sliced and diced version of inflation, Core Services ex-Housing. The idea is Services dominate the economy and Shelter pricing has severe lags (rents obviously do not rollover immediately, and Owner's Equivalent Rent is based on surveying homeowners on their monthly ownership costs). And if we were to strip out Used Cars, the downward trajectory would be even more severe.



This is confusing to us. Powell is worried about inflation. But one of his preferred gages is showing inflation coming down quickly. Not to mention, Producer Prices (PPI) are experiencing deflation. The Atlanta Fed Business Inflation Expectations dipped to 2.7% from 2.9% (1-year forecast). The New York Fed inflation survey has a similar trajectory for the 1-year expectation. Perhaps the 3-year expectation starting to rise again is worrisome.

Zervos of Jefferies probably said it best in that he thinks Powell wants to overshoot inflation (to the downside) to make sure it is stomped out (more below).

U.S. consumer expectations for inflation in...



Source: Federal Reserve Bank of New York

- Other economic data is mixed
  - Small Business Optimism ticked up slightly, but it still sits near its 10-year low.
  - Jobless Claims shot back higher to 261k. continuing Claims are trending lower. This could be claimants running out of eligible weeks.
  - Mortgage Applications moved higher this week.
  - Eurozone Industrial Production for April moved higher as expected.

- The Fed surprisingly surprised the market

Fed chairman Powell did what he said he did not want to do. He surprised the market. While the pause in interest rates was right in line with the 99% expectation, the Fed's forecast took many by surprise. Instead of wondering if the Fed would hike rates again this year, the median expectation of the Fed members is for another 0.50% of hikes (to bring the target rate to 5.60% from the current range of 5.00-5.25%). Maybe most importantly, there appears to be some division among the Fed ranks. Two members of the Fed see rates staying at the current level for the rest of the year. Two members see hikes of 75bps. And one thinks another 1% is appropriate. And the rest think 50bps is the number. The only thing worse than rate hikes is the uncertainty around rate hikes.

During the press conference, most of the questions revolved around the idea that if inflation is coming down, why is there still the need to hike rates. Does employment necessarily have to come down if inflation is cooling? Powell answered by saying he does not want to make the mistake of thinking inflation is absolutely gone. And history shows us that projections are usually wrong. And the historical path of inflation is that it does not dissipate without a countervailing force (higher rates/lower growth). Like Zervos said, he is going to err on the side of overtightening.

For what it is worth, Canada and Australia both resumed hiking rates after recently "pausing." China cuts rates surprisingly so more stimulus programs are expected (hoped for). But many consumers and businesses are already carrying high debt levels and do not have much appetite for growth. In other words, tiny, symbolic rate cuts will not do much to boost economic activity.

Back to the US: Ultimately, Powell thinks the Fed can thread the needle in getting inflation down to 2% without causing any major labor market disruption. The market has believed this. We shall see if today's change in direction shakes this belief.

- Oil does not go up on news, but it does go down on rumors

Crude cannot seem to get out of its own way. As we have noted, it does not react to any Saudi production cuts (we think many simply do not believe the Saudis). Rate cuts in China were thought to be supportive of oil for all of a day (this is more of a statement on China's inability to stimulate the economy with small rate moves). But oil does react to rumors coming out of the Middle East. WTI fell below $70 on an Israeli report that the US and Iran are closing in on a new nuclear deal which would loosen sanctions against the terrorist regime. Basically, the recession backdrop is controlling the narrative. And all news is bad news.

- Where did all the crypto money go?

The New York Times did a follow up on Three Arrows Capital. Recall this is the crypto "hedge fund" that lost obscene sums of money betting on things like the Luna/Terra coin debacle. 3AC was also one of the drivers of the Grayscale Bitcoin Trust (GBTC) arbitrage we have talked about. This was the trade in which 3AC bought bitcoin and deposited them into GBTC at the net asset value (NAV). And then six months later they could sell their GBTC at the premium to bitcoin. This was a genius plan…until bitcoin traded at a discount to GBTC.

Nonetheless, the NYT caught up with the founders in Bali and asked them about their ill-gotten riches and if they had any regrets. The answer: "Remorse for what?...You eat very fatty pork dishes, and you drink a lot of alcohol, and you go to the beach and just meditate. You have these magical experiences."

- Chart Crime of the week

While perusing the Twitter verse, we stumbled upon an advertisement from Predictagram. Apparently, this software can predict the closing prices for stocks on a daily basis. You just watch the green and red lines. This might not be the purest form of a chart crime. But it certainly should be a crime.

- Quick Hits
  - Salesforce is trying to woo employees back to the office by tying in-office attendance to the company's charitable giving. Alas, the company will make the same donation for each virtual attendance.
  - Jeff Bezos pays $600k in rent for his Malibu home. Kenny G is the owner.
  - US imports from China (us buying their junk) recently hit a 16-year low. About 15% of all imports come from China now.
  - Netflix is opening a pop-up restaurant in LA called Netflix Bites.
  - Modelo Especial is the top selling beer in America.
  - AB InBev, Bud's parent company, has increased its leading market share in the US to 40.4%.
  - A former regional manager of Starbucks was awarded over $25mm for being fired for being white.
  - One analyst thinks the best use case for AI will be in government. We can only dream.

Trading: We have remained mostly on the sidelines as the mega-cap and junk-cap rally persists. We added a small bit to some international exposure in markets we think are showing improving economies. These include Japan and India which have expanding bank lending and improving economic growth (both markets have done very well recently, so we prefer to add on any dips). After the Fed meeting today, we added to some short exposure. But these are in the old economy stuff that we think succumbs to the recessionary forces. And they do not have super-momentum like the aforementioned Tech and Junk. Time will come for these. But we will be patient. That said, we realize this segment of the market (the Tech, not the Junk) has garnered the coveted Quality status. So we might get long some of these names before we bet against them.

TSLAQ: Tesla has been on fire lately (yes literally, but we mean figuratively in this case). The likely driver for the rally is the news of GM and Ford signing on to the Tesla charging system. Interestingly, Musk thinks this is bad business for Tesla. It is basically going the open-source route instead of being able to monetize it optimally. But it is the “morally right thing to do” according to the man with no morals. (But we have to admit, he has been very funny on twitter lately as he lambasts much of the moronic virtue signaling of the day.)

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