Weekly Update

14-April-2021

Carlisle C. Wysong, CFA
Managing Partner

- Market rotation is back, but so is the rally
- Wall Street Strategists are getting more cautious
- The Earnings bar is set high
- Official Inflation has arrived
- Oil seems to have found its footing again
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
SPX	4125	1.1%	10.2%	51.8%
QQQ	336.5	1.5%	7.4%	66.8%
US 10 YR	1.63%	1.67%	0.92%	0.64%
VIX	17.0%	17.2%	22.8%	40.8%
Oil	62.92	6.0%	30.1%	214.0%

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

Recently, we declared that the end of the rotation was likely a positive sign for the market. This tied into a potential relief rally after the purging related to the Archegos implosion. Well, we got the market rally part right. But rotation is back and the Archegos puking continues to hurl. But we also noted that the other narratives were skewed positively. These persist as the market still loves the current fiscal (literal free money) and monetary (different kind of free money) policies. And even the bond vigilantes (the colloquial name for the bond market when it decides to hike interest rates) are taking a breather: interest rates have stabilized around the 1.65% level (10 year).

Much of the rotation was spurred on by the CDC and its bizarre take on the JNJ vaccine. We do not think the market actually thinks there is a vaccine problem. Of the 240mm vaccine doses administered in the US, only 7mm have been from JNJ (with only 10mm more in backlog). But the market knows traders are still jumpy, so it extracts the most short-term pain it can. Interestingly, market volumes have dried up - they are running about 20% below their 30-day average. This might be why the rotations are shorter now. But we think it is important to add that the headline rotations are a sideshow. Being in the right factor exposures and trading against these panicky traders is the way to go.

- Wall Street Strategists are getting more cautious

There are a few more Wall Street strategists that are getting worried about the stretched market. Both Canaccord and Morgan Stanley think the market has priced in much of the good news regarding the strength in the economy and Q1 earnings. And Merrill, one of the early strategists to start warning about the excesses, doubled down after its Fund Manager Survey showed positioning and optimism are still at peak levels. ML thinks the contrarian play is to sell Financials, Tech (still crowded despite the move higher in interest rates), and Commodities. They recommend buying Emerging Markets, Staples, and Utilities. We agree with these strategists that the market is overbought. This is one reason why we have shifted more exposure to stock specific positions in our Trading strategy. But we think ML is early on the "sell inflation" call.

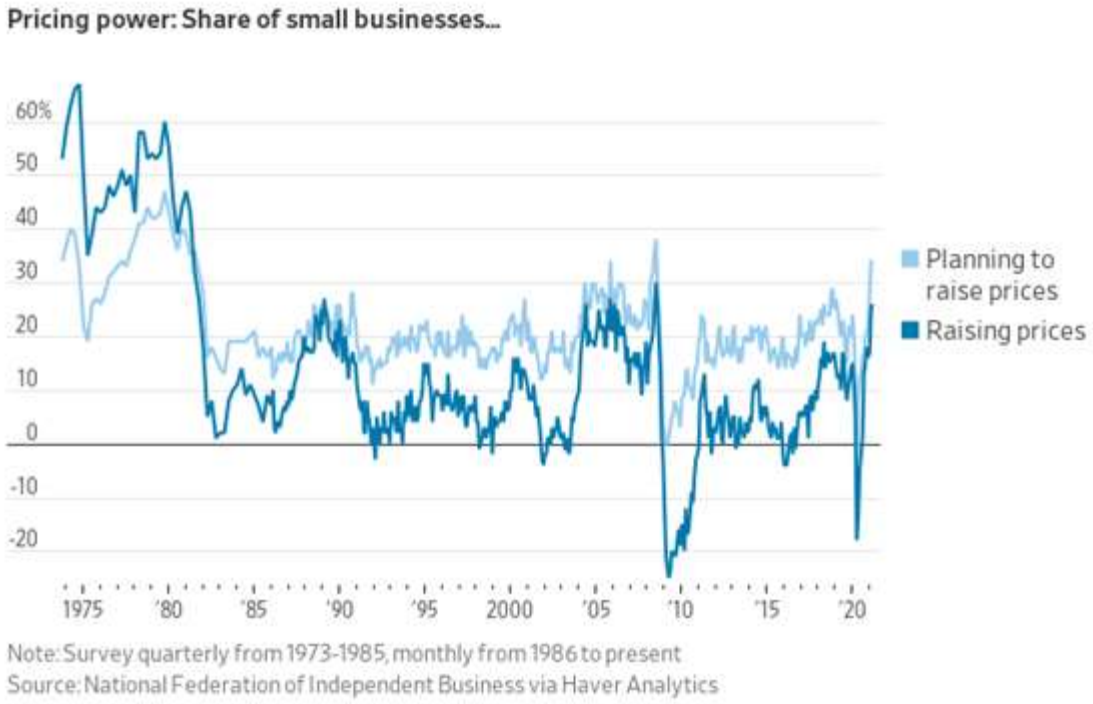
- The Earnings bar is set high

The bar is set extremely high for this earnings season. Upward revisions for estimates grew 6% during Jan-March which is the highest since the law around releasing estimates was changed in 2000. Q1 earnings are expected to grow 20% vs 1Q2020. But remember the 4Q2020's reaction to strong earnings (+15% growth vs 4Q2019) was lackluster. Companies that beat expectations on both the top (revenues) and bottom (earnings) lines *underperformed* the market (initial one-day reaction). We expect inflation to be one of the most mentioned topics on management conference calls. With the Financials starting to report, we are seeing this "high bar" in action. JP Morgan and Goldman Sachs both reported much better than expected earnings. But both stocks retreated from their highs. It is early yet, but we suspect this trend might continue.

- Official Inflation has arrived

We have been writing about increasing input prices as another sign of inflation (The PMI surveys all point to this). The official government Producer Price Inflation for March showed the same trend. February saw input prices climb 2.5% which turned into a 3.1% increase in March. Along the same lines, Wholesale Inventories slowed down in February vs the strong burst in January. Higher Input Prices, logistical slowdowns, and lower inventories are all occurring which all ultimately translate to consumer inflation. And this is exactly what we saw in the CPI (Consumer Price Index) for March. Prices jumped 2.6% vs 1.7% in February. The "core" inflation rate was lower at 1.6% (this excludes food and energy because they are "volatile"). But this is still up from February's 1.3% increase. "Reopening" items and services saw the largest price increases: car rental, sports tickets, hotels, etc.

Furthermore, small business owners (represented by a survey from National Federation of Independent Business, NFIB) say they have raised prices and will continue to raise prices:



Bloomberg brought up the discrepancy between lumber prices and timber prices (we wrote about this recently, the WSJ had a good piece about it). Their conclusion was that there was a labor shortage, but sawmill owners were reluctant to raise wages because they felt the boost in houses/lumber was temporary. Paying one-time bonuses could be the answer according to another Bloomberg pundit. The Fed would consider this a transitory price increase. But we think it would reset the expectations and turn into sustained wage inflation. Whatever the case, our bullish bet on Housing remains intact. The reduction of the excess capacity at the sawmills is likely to unlock one of the roadblocks for homebuilders (while perhaps perversely lowering lumber prices despite the wage inflation).

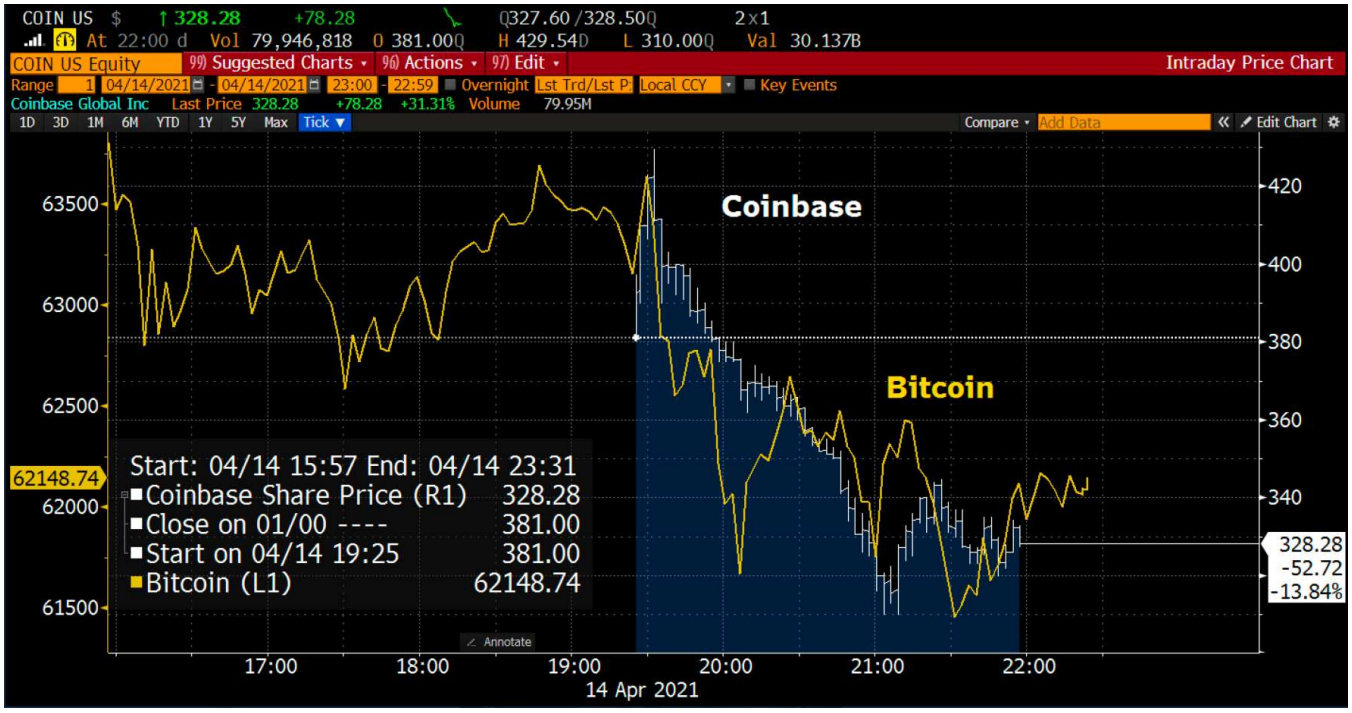
Used Car prices have become a hot commodity lately. Between the influx of consumer cash and the difficulty in making new cars (chip shortage, notwithstanding the recent news that GM is seeing some easing in the chip backlog), used car prices increased 13% in March vs last year. And the weekly price increases are accelerating. Other than being a sign of more inflation than meets the Fed's eye, it also means we might not be looking to short the auto-finance companies just yet. Last week we noted the large increase in subprime auto loan delinquencies. But this surge in prices means the value of the collateral is increasing. So theoretically the lenders are not in a bad situation (not that lenders want to repo cars and have to bother with selling them, but it is better than repo-ing cars whose values have fallen).

- Oil seems to have found its footing again

Oil seems to have found its footing again. After the demand worries stemming from Europe and excess supplies possibly coming from Iran (we doubted both, we actually thought it was just a natural bout of profit taking after a huge run), the narratives have flip flopped again. Both OPEC and the International Energy Agency (IEA) increased their demand forecasts for the rest of this year. And the supply data from the US's Energy Information Administration (EIA…not to be confused with IEA) showed a large draw in crude inventories (and a smaller build in gasoline and larger draw in distillates). We also noticed that crude oil barely reacted to the JNJ vaccine story. This was a good sign that positioning in crude is not overly stretched (ie panicky traders would have sold aggressively if they were loaded up on crude).

- Chart Crime of the week

Our German friend is back! This one is a three-hour price chart to show that Coinbase and the Nasdaq are correlated. No percentages. Disregards the official reference price for COIN of $250. Whatever…it is a three-hour chart!



- Quick Hits
  - There are 507 different shares in the S&P 500.
  - Some USC academics are alleging that Facebook is using illegal gender bias in its ad targeting for jobs. The study cites that men saw ads for pizza delivery jobs while women saw ads for shopper jobs. Oh, the horror.
  - Here is how the NY Times described a Smith College student's attempt at lying about a "racist" incident: "The story highlights the tensions between a student's deeply felt sense of personal truth and facts that are at odds with it."
  - Bitcoin rallied to new highs ahead of the Coinbase IPO (largest US crypto exchange). Even Fox Butterfield is confused about the cause and effect here. (It would be logical for Coinbase to rally on the coattails of Bitcoin but not the other way around.)
  - The IRS thinks $1T of tax receipts goes unpaid every year.
  - Alternative Accommodation (aka Airbnb and Vrbo) occupancy levels set a record in March for March. (Not a ton of history here, but still an impressive stat.)
  - Coinbase: Kevin Durant (NBA star) made 50x his investment and Nas (a rapper, apparently) made 600x his money.

Trading: It was a pretty quiet trading week. We did some small trades around the edges…buying weakness in Recovery stocks when the JNJ vaccine "news" broke. It is absurd to think that the reopening efforts will be derailed by a handful of blood clotting cases (six out of 7 million). Moreover, the governmental soothsayers admitted there could be plenty of other reasons for women to get blood clots. Generalissimo Franco is, indeed,

still dead! At the same time, we trimmed more of our long Tech exposure. We added to a speculative long Energy play. We increased our Put protection some more (covered the last bit of our Short Puts that originally were part of a Put Spread). And we bought more Puts on the silly Ark Innovation ETF. This is an easier way to play Tesla short.

TSLAQ: Musk finally unveiled his "hyperlink" mass transit system under the city of Las Vegas. It is a tunnel that goes from one end of the convention center to the other. You get in a Tesla Model 3 driven by an employee. In other news, dog bites man.

Here is the Villain's tweet of the week:

www.chalkcreekpartners.com

Carlisle's Twitter Financial List

Carlisle's LinkedIn