Chalk Creek Partners LLC

Registered Investment Advisor

Weekly Update 21- October-2020

Carlisle C. Wysong, CFA *Managing Partner*

- Market cools as momentum fades
- Hedge fund positioning is extreme
- Earnings still beating improving expectations
- Housing remains red hot
- The Fed still seems a bit scared
- Chart Crime of the week
- Click here for the full note

	Last	5d %	YTD %	1yr %
SPX	3489	-1.5%	6.3%	14.3%
QQQ	284.2	-2.7%	33.7%	47.0%
US 10 YR	0.82%	0.73%	1.88%	1.77%
VIX	28.7%	26.4%	23.2%	14.5%
Oil	40	0.0%	-34.4%	-24.9%

*10yr and VIX are levels not changes

** Oil is front month futures, beware

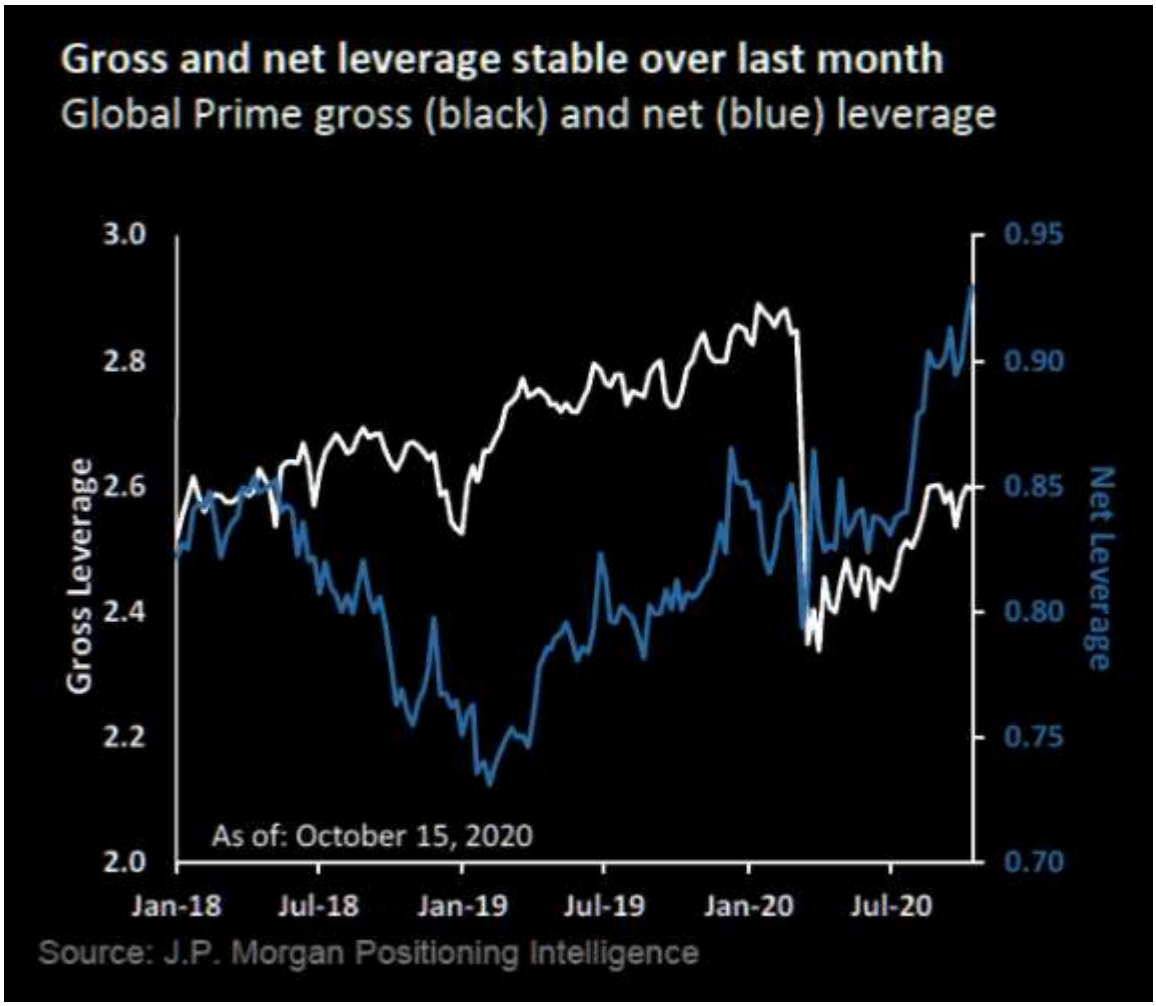
The market cooled a bit after the momentum chasers took it higher last week. There was more noise around the dueling narratives, so Volatility picked back up. The primary narrative is whether there will be another stimulus package. We are skeptical given Pelosi's reluctance to send out checks with Trump's name on them. And the virus news continues to escalate without much reference to facts. But as we always say, it is the fear of the virus that really matters when it comes to the stock market.

Obviously, the election is another driver of the market. But investors are coming to the realization that trying to predict the outcome is foolhardy. Blackrock noted that markets are almost always wrong in predicting the expected move for a specific political outcome. We agree. We think we are better off being defensive ahead of the election and reacting quickly rather than trying to position ahead of a random coin flip (not just who wins, but what the market does when someone in particular wins).

- Hedge fund positioning is extreme

Robinhooders (new retail traders) often gets a lot of the credit or blame for unusual stock movements. But interestingly, the most popular bucket of stocks for Robinhooders (the actual customers of Robinhood, not all of retail, but we suspect it is representative) are priced under $5. Other than the occasional whacky bankruptcy stock these maniacs chase, none of these stocks have anything to do with momentum. Conversely, the stocks in the Goldman Sachs Hedge Fund VIP Index (GVIP is an ETF for it) are almost all momentum names. This index tracks the most frequently owned stocks by hedge funds according to SEC filings. We like to make fun of the crazy retail traders as much as anyone else. But the reality is the same as it has always been…hedge funds drive the short term moves in the market.

Speaking of hedge funds, JP Morgan tells us that gross leverage is still way below the pre-virus level and net leverage is at a three-year high and climbing. The translation here is that hedge funds have dramatically covered their shorts and have maintained longs (a net leverage of 1.00 effectively means they have zero shorts). This matches the data from the Nasdaq Futures that shows massive short-covering in the last two weeks. Interestingly, there is separate hedge fund data (from Goldman) that shows selling across the FATMAAN stocks. What does this mean? Funds were overly long FATMAAN and they hedged with Futures. They have reduced this extreme position. But they also bought other sectors keeping their gross leverage high (a gross leverage of 2.6 means funds have $260 of longs and shorts combined for every $100 of capital). In general, we can expect less dip buying if the market heads south and more trimming of longs if the market moves higher. Yes, this sounds quite negative. But it is more of a short-term contrarian view against the every-which-way-but-loose traders. This is how we play our short-term index hedges (against the grain).

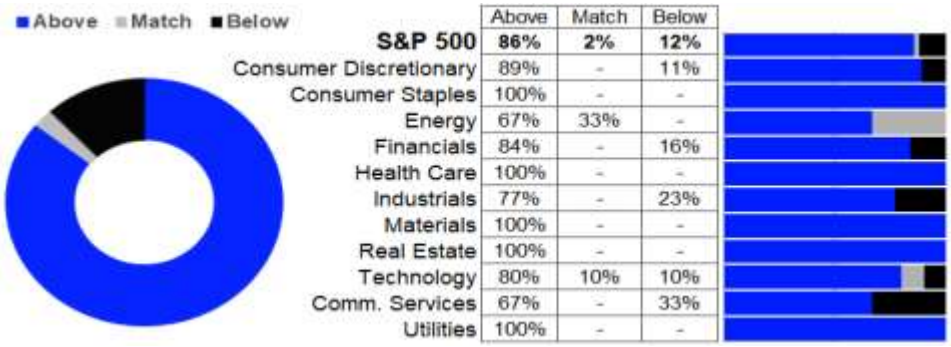


Along these same lines, Bespoke bundled some Yale surveys of investor confidence (they combine institutional and retail views). The below shows a combination of market optimism with the belief that the market is overvalued. Of course, using any market or confidence data from the last twenty years will look remarkably similar. And one could argue that the extreme pessimism was a better buy signal than extreme optimism has been on the sell side. But whenever investor confidence is super high along with a low confidence in the justification for that optimism…quick trigger fingers (selling) could be around the corner.

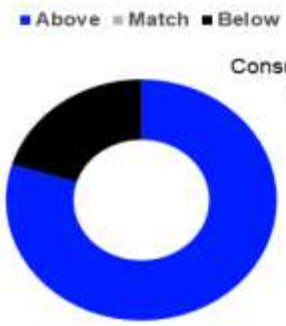
*Investor confidence that "market will be higher one year from now" minus investor confidence in "valuation of the market." Data from Yale Investor Confidence Monthly Surveys.

- Earnings still beating improving expectations

We notably did not include Earnings as one of the narratives driving the market. This seems odd, but it makes sense given the grip the political situation has on the market. Nonetheless, earnings and revenues have been better than expectations. And expectations have been improving steadily since July (earnings expectations have improved about 7% points and revenue expectations have improved about 3.4% points). The tables are from I/B/E/S.



	Above	Match	Below
S&P 500	**86%**	**2%**	**12%**
Consumer Discretionary	89%	-	11%
Consumer Staples	100%	-	-
Energy	67%	33%	-
Financials	84%	-	16%
Health Care	100%	-	-
Industrials	77%	-	23%
Materials	100%	-	-
Real Estate	100%	-	-
Technology	80%	10%	10%
Comm. Services	67%	-	33%
Utilities	100%	-	-



	Above	Match	Below
S&P 500	**80%**	**0%**	**20%**
Consumer Discretionary	67%	-	33%
Consumer Staples	100%	-	-
Energy	33%	-	67%
Financials	84%	-	16%
Health Care	100%	-	-
Industrials	62%	-	38%
Materials	100%	-	-
Real Estate	100%	-	-
Technology	90%	-	10%
Comm. Services	67%	-	33%
Utilities	-	-	100%

- Housing remains red hot

The Housing market continues to be the strongest part of the economy. The Housing Market Index (a survey of home builders, so the skew is cyclical = they feel very good in good times and very bad in bad times) for October hit an all-time high (est. 1985). Housing Starts (the first day of excavation for a new build) for September remained steady which means they missed the expectation for an increase. A lack of supply has been the constant theme leading to higher prices. But there was underlying strength in Single Family Starts vs Multi-family Starts which dropped. Moreover, Permits increased more than expected: builders are trying to catch up. Our bullishness on Housing (we have long exposure through the Home Improvement sector – we have been thinking about buying the Homebuilders directly but have yet to pull the trigger) is tempered by our fear of Unemployment increasing and leading to an uptick in houses for sale. Recall that most homeowners are above water on their mortgages, so they are free and clear to sell (and make a profit). We think this might ultimately overwhelm the migration-from-the-cities theme.

Jobless Claims remained in the same range with about 900k new Claims.

The Philly Fed Manufacturing Index showed surprising strength. But the Empire State Manufacturing Index fell short of expectations. Industrial Production slipped back into negative territory in September.

Retail Sales for September were stronger than expected. The bounce-rate has been slowing since May, so the 1.9% gain was welcome. Clothing, Accessories, and Home Improvement led the gains while Electronics were the only negative segment.

Business Inventories for August ticked slightly higher just as they did in July. These were the first positive months after extreme inventory drawdowns in the wake of the virus.

Consumer Sentiment remained relative flat in October vs September. While it is 15% above the April lows, it is still about 20% below the February level.

- The Fed still seems a bit scared

The Fed is still growing its balance sheet. The stated plan is to buy $120b a month in Treasuries and Mortgage backed Securities (MBS). The Fed bought $77b last week alone (as of 10/14). No wonder we saw the 10-year interest rate drop from 0.80% to 0.73% during this same time span. And now that the Fed is not buying this week, we have seen rates back up to 0.81% (hence our new trading long in Treasuries). But short term trades aside, the Fed is hell bent on keeping rates low.

Highlights from the Fed's Beige Book (notes collected before the next Fed meeting): Pace of economic improvement is slight to modest. Housing has steady demand but commercial RE is deteriorating. Auto sales remain strong. Slight uptick in tourism. Employment increased in all districts, but the rate is slowing. Labor markets remain tight but that is a function of people dropping out of the workforce.

- Chart Crime of the week

This week's edition is actually a Table crime. The Motley Fool published this one. No times or durations for when these occurrences happened. And no mention of how many occurrences there had been. FYI, the Unemployment rate has been over 9% three times in the last 75 years. And no hint at the obvious that in times of high unemployment, the economy and the market are usually at a bottom and start to recover. Said another way, we need to look at the market performance heading into the 9% Unemployment. Pro Tip: it is disastrous.

Unemployment Rate	S&P 500 Annualized Returns	Frequency
>9%	24.50%	8%
7% - 9%	15.10%	22%
5% - 7%	8.30%	47%
<5%	3.90%	24%

- Quick Hits
  - YouTube is the top destination for sports highlights.
  - Black market currency exchanges in Argentina are called "caves."
  - The Argentine Peso in the black market is worth half the official rate.
  - A CNBC talking-head muttered the phrase "when a stock breaks out to an all-time high, it has unlimited potential."
  - A GPS-tracked bar-tailed godwit (that is a bird nicknamed the "jet-fighter") flew from Alaska to New Zealand without stopping. That is 7500 miles, and it took 12 days.
  - Madrid doctors protested something by stripping to their underwear in the town square.
  - In the World Series, the Dodgers payroll is 3.8x higher than that of the Devil Rays.
  - The governor of Illinois has spent $56mm of his own money to promote a referendum that would increase taxes on the wealthy.

Trading:

We continued to trade around our index hedges. We added to our Puts early in the week. And we covered some of our short Calls later on. We plan on decreasing our net long exposure before the election – this is the defensive posturing we have discussed.

While we have been lowering our overall exposure, we have been adding to our conservative names (staples and pharma). We also bought some Treasuries for a trade with the 10-year yield back above 0.81%.

We added a new short to the portfolio. It is a legacy tech name that is still battling against the cloud. Its earnings are inflated by one-off items even though the company claims these are recurring. It is clinging to a dividend and has a large debt pile. Some liken it to GE. The good news is that it missed earnings and dropped 7%. The bad news is that we had not sized up the position fully. But we will never whine about a profit. We closed the short given the quick gain. We will look to reenter it on a bounce or if Volatility contracts (which would be normal post an earnings miss).

TSLAQ: Tesla reported earnings that were better than expectations on the surface. Of course, actual automotive earnings are still negative. Margins are the worst in the business (and that is saying something!).

And mgmt. wants to build and sell more cars…at a loss! But hey, revenues and "adjusted" earnings were better, so that is what the lemmings will follow. We will monitor the action to see if anyone feels like selling. We will pile on if so. If not, we will keep watching this giant fraud with neutral amusement.

www.chalkcreekpartners.com

Carlisle's Twitter Financial List

Carlisle's LinkedIn