Weekly Update

31-Aug-2022

Carlisle C. Wysong, CFA
Managing Partner

- The market finally believes the Fed!
- The Fed balance sheet has not even begun to shrink
- Was the summer the peak?
- Volatility is shifting higher
- Positioning is not bearish!
- Beyond criminal and beyond stupid
- Inventories are still building
- Sentiment is improving, we suspect it will be fleeting
- Jobs are still to be had…in theory
- Durable Goods correction (by us) tells a more accurate story
- Other Fed speakers join the chorus…and so does the ECB
- Do not get distracted by the oil noise, look at the numbers
- Quick Hits
- Chart Crime of the week

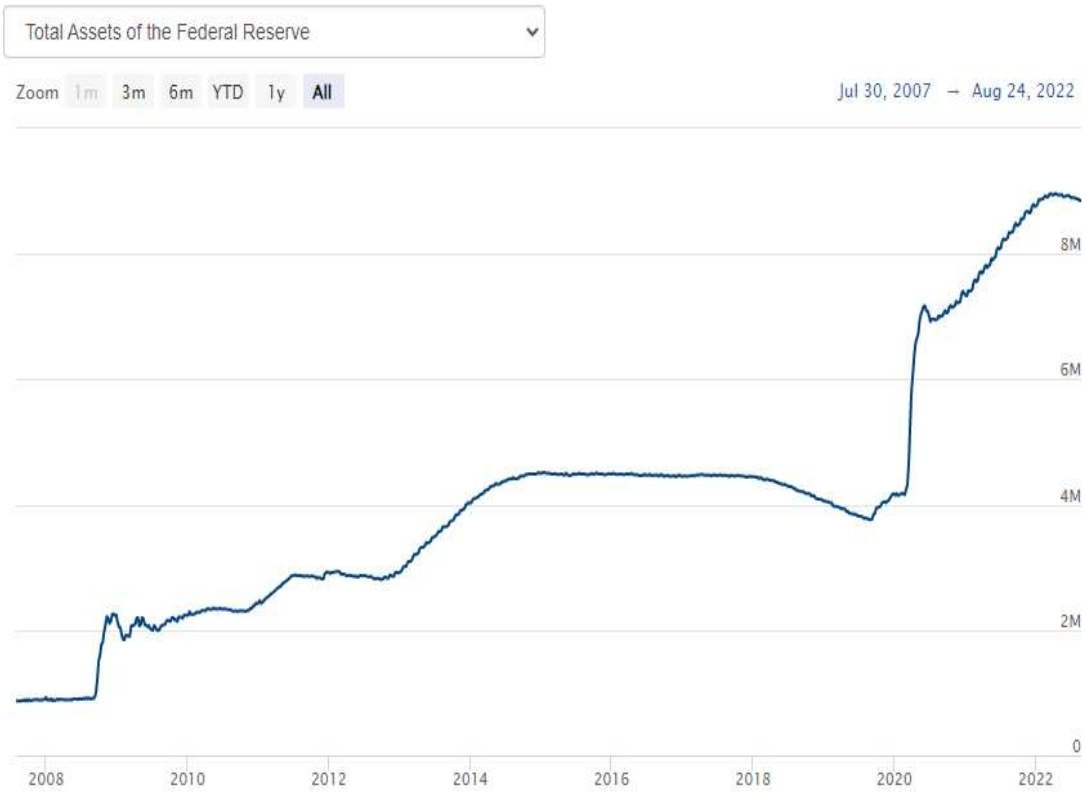
	Last	5d %	YTD %	1yr %
S&P 500	3,955	-4.5%	-16.4%	-11.4%
QQQ	$299.27	-5.0%	-24.5%	-20.9%
US 10 YR	3.21%	3.11%	1.51%	1.35%
USD/DXY	109.0	108.7	96.0	92.5
VIX	25.9%	22.8%	17.2%	16.1%
Oil	$89.18	-3.6%	-18.6%	30.2%

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

The market finally believes the Fed! It took a resolute and plainly worded speech by Fed chairman Jerome Powell. But the message finally registered with the market. Powell's emphasis, again, was on the fight against inflation: "Failure to bring down inflation would bring far greater economic pain." He acknowledged that July inflation was better, but, "A single month is not nearly enough." He thinks, "Neutral is not the place to pause or stop." And he cautioned against slowing the fight prematurely: "We will have a restrictive stance for some time." We think Powell has sufficiently painted himself into a corner. Good news is now bad news: The Fed will be emboldened to hike rates more. Bad news is, well, bad news…recession is here. The only way out would be for inflation to crater. And despite our pointing to some inflation relief here and there, we do not think we are

anywhere near any meaningful change. And contrary to recent opinion, we know that Powell's monetary mindset would fit nicely in the daily routine of Phil Conners in Punxsutawney (Woodstock for the real enthusiasts): It is not changing any time soon.

Of course, the Fed's Quantitative Tightening has barely started. It is supposed to be shrinking the balance sheet, but it expanded last week. And one of the backstops used when the markets needed a little extra juice, the Fed's Standing Repo Facility, is unlikely to be used (the banks are supposedly unwilling to use it now as it carries the stigma of *needing* to use it). Below is the Fed's Balance Sheet.



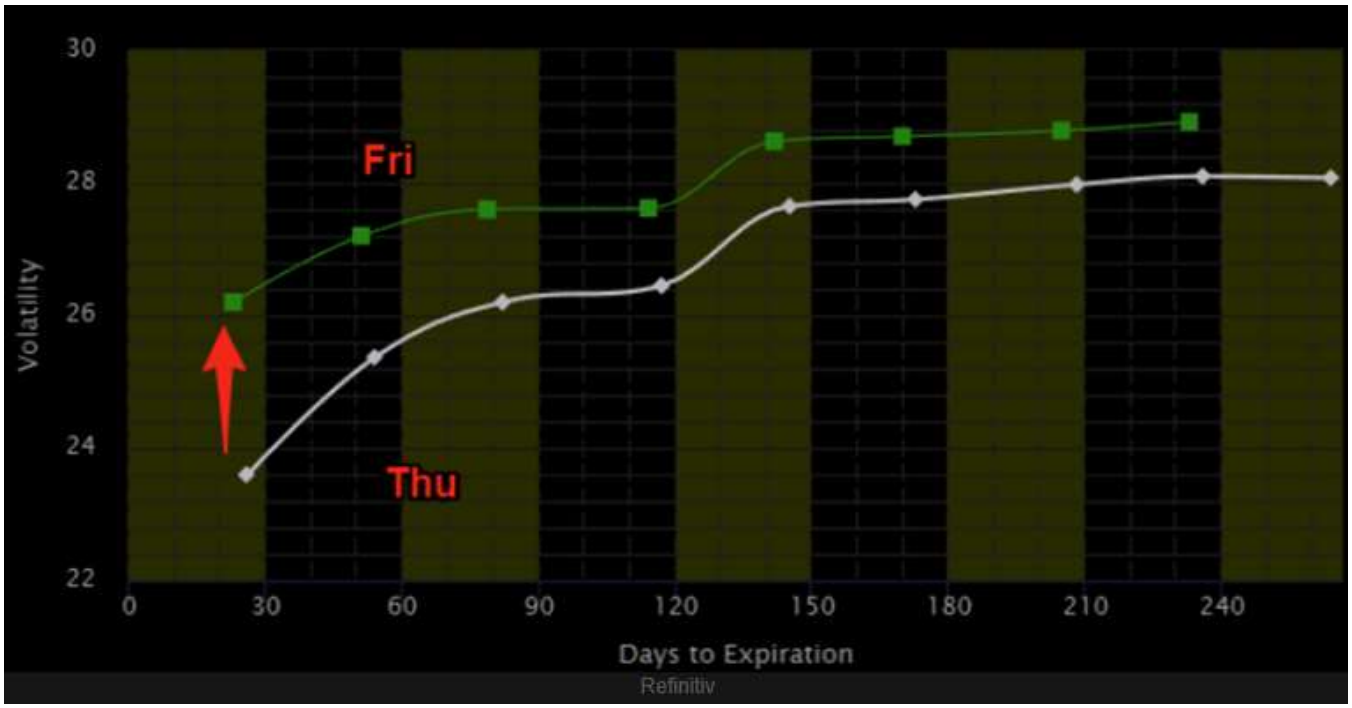
And we guess we should mention the runaway energy crisis in Europe, severe drought in China, more Covid lockdowns in China, the looming earnings recession in the US, the bullish positioning of investors, etc. Of course, we expect heightened Volatility so we will be prudent with our entry and exit points.

- Was the summer the peak?

Despite all the recession talk, airline bookings have been robust. People are getting back to normal! Alas, airline bookings for the week dropped 23.6% vs 2019. Last week bookings were only down -0.3% vs 2019. An active hurricane season might have changed the bookings timeline in 2019 (seems like a stretch to us). Whatever the case, if we see another couple of weeks with this trend, then one of our overarching, economic themes will be playing out: A busy summer followed by a gloomy fall (and winter, and spring, etc).

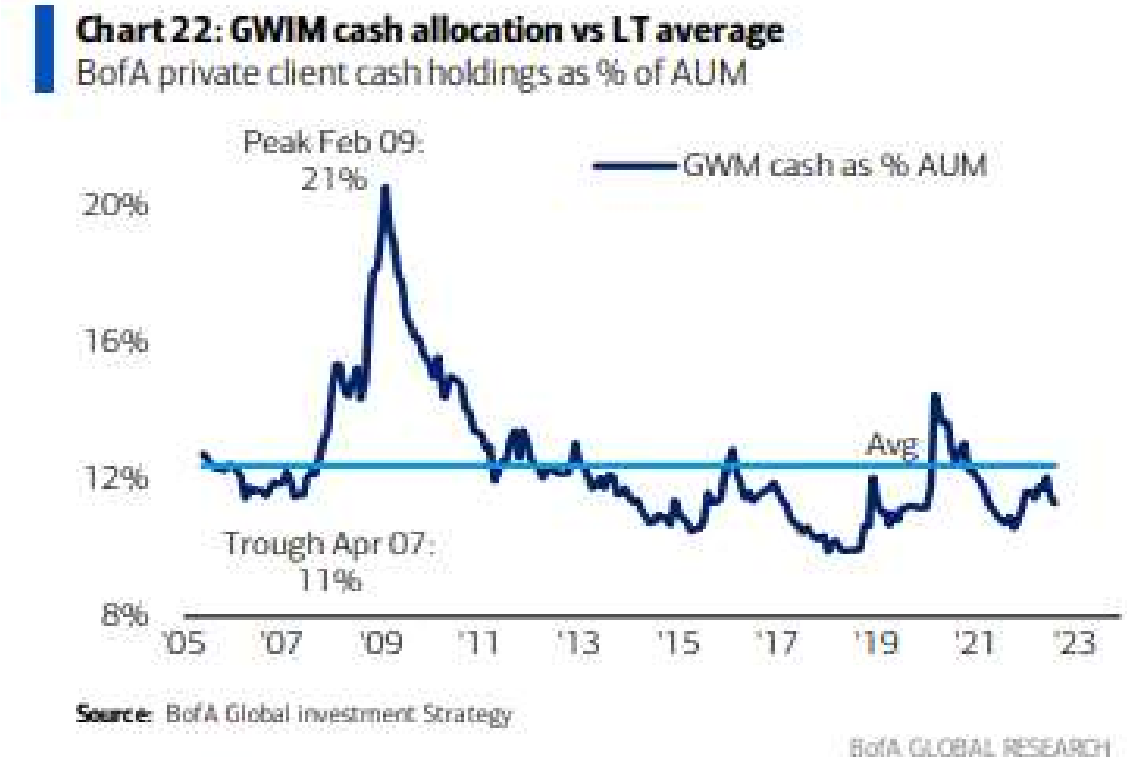
- Volatility is shifting higher

Obviously, Volatility jumped higher after Powell's inflation-buster speech. But investors priced this Volatility to last. That is, it was not just perceived as a short-term phenomenon (like most headlines), but the medium-term points on the Volatility futures curve also shifted higher.



- Positioning is not bearish!

Merrill claims that investors now want the Fed to be hawkish and raise rates aggressively. But just like every declaration of bearishness we come across, the facts say otherwise. Here is the latest cash allocation for Merrill's private clients:



- Beyond criminal and beyond stupid

Last week we noted that pump and dump in Bed Bath & Beyond by meme savior Ryan Cohen. As a refresher, Cohen filed with the SEC a purchase of BBBY Call options right before he dumped all of his stock and right before the company disclosed it was on the financial ropes. What we missed was that this filing was referencing Calls he bought in February. It was a technical matter that many argue did not need to be filed. Of course, if you are looking to dump 12% of a company, it is beneficial if your lemmings think you are buying more. Actually, this part might not be true. Apparently the memesters were justifying their bagholdings with lines like, "Ryan must know what he is doing, he is still operating in the best interest of the company." And this gem, "Cohen is getting ready to merge BBBY with GameStop." Nonsensical mutterings aside, BBBY announce an equity sale…not a round of debt. How many times can the same people be ropa-doped?

- Inventories are still building

Retail Inventories in July kept increasing (+1.1% vs June) but this is a slight slowdown (2% in June vs May). Wholesale Inventories also increased at a slower pace (0.8% vs 1.9%). We know that the Inventories to Sales ratio has been rapidly increasing (see last week's letter). But maybe the retailers are finally starting to have some right-sizing relief. Of course, inventories are still building. We need to see a negative inflection before we get too optimistic.

- Sentiment is improving, we suspect it will be fleeting

Consumer Sentiment moved higher again in August. It is still near all-time lows. But at least there is a trend starting to take shape. Inflation Expectations are also starting to moderate with the one-year at 4.8% down from 5.2% in July. Remember, this sentiment gage tends to follow inflation trends like falling gasoline prices.

The separate Consumer Confidence index also moved higher. This one tends to follow Housing and the broad economy. This one is more perplexing to us. In aggregate, the message seems to be that most people think their specification situation stinks while the broad picture is ok. We think these two will merge on the downside.

- Jobs are still to be had…in theory

The Job Openings and Labor Turnover Survey (JOLTS) for July tells us that there are 11.2mm Job Openings which is up from June's 11mm. We still side with Goldman in not believing these numbers. GS thinks there is a lot of double-counting and stale listings. Or there are a lot of jobs that will simply never be filled with the new lazy America (our theory, not Goldman's). And we have been pointing to the steadily worsening Jobless Claims. However, Claims have improved slightly or at least flattened out over the last month. We think this is a just a pause considering all the layoff headlines we are seeing (today's was SNAP dumping 20% of its workforce). We get the Unemployment Report this Friday. We have been saying this report is lagging. But at some point, it has to turn for our theory to be right. If today's ADP guess is any indication (not a great track record), we will see job growth start to slow.

- Durable Goods correction (by us) tells a more accurate story

Last week we noted that Durable Goods Orders, in particular Core Capital Goods for businesses, continue to steadily move higher. But we left out a very important qualifier which we are usually quick to highlight: This data is not adjusted for inflation. In other words, businesses are cutting back on spending…finally.

- Other data is mixed
  - GDP for the 2Q was revised slightly higher. But it is still negative.
  - The Kansas City Fed Manufacturing Index fell 10 points to 3. The Dallas Fed Manufacturing Index improved by 10 points…to still be deeply negative. The Chicago PMI remained steady marginally above the breakeven level (52 vs 50).
  - Inflation ticked a little lower. Inside of the Personal Income and Outlays report for July, the PCE inflation gage (the Fed's preferred measure) slowed to 6.3% from 6.8%. The "core" number slowed to 4.6% from 4.8%. You know the inflation story is becoming mundane (academically, not for those suffering under it) when it barely gets a mention.

- Other Fed speakers join the chorus…and so does the ECB

Three more Fed speakers picked up the baton after Powell's Jackson hole speech.

Raphael Bostic of the Atlanta Fed: I want to get to that restrictive stance and stay there.

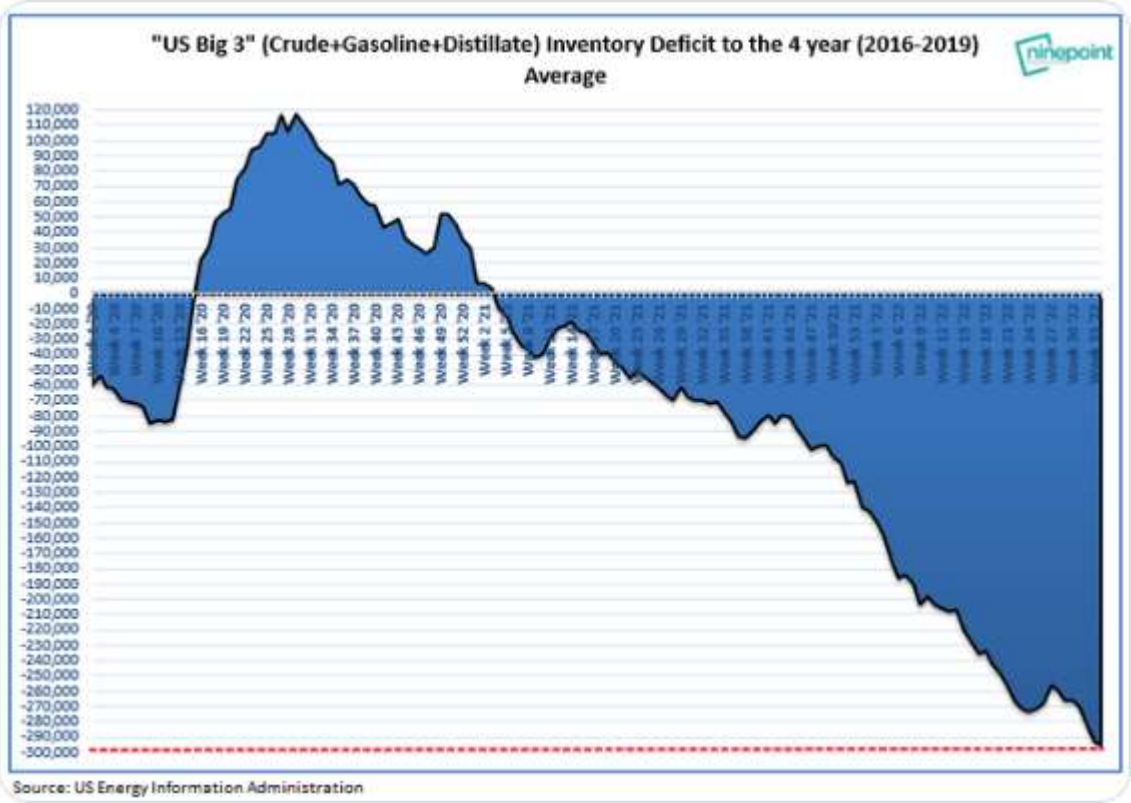
Loretta Mester (aka Carol Burnett) of the Cleveland Fed: We have to curb inflation even it means a recession.

John Williams of the NY Fed: Inflation is the top goal even if it means restraining the economy.

Even the European Central Bank is getting in on the hawkishness. A member of the ECB's executive committee, Isabel Schnabel, said central bankers need to "err on the side of risking weaker growth and higher unemployment" to avoid higher inflation. If the squishy ECB is opting for recession, we know it is serious. Of course, Europe's inflation is unequivocally accelerating with PPI (wholesale/input inflation) readings in the 35% area!

- Do not get distracted by the oil noise, look at the numbers

We recently mentioned that oil price Volatility was elevated despite the price changes being somewhat muted. We suspected the market was weary of headlines or even actual news coming. Well, the headlines are starting to pick up again. The latest is that OPEC+ is not, indeed, looking to cut oil production. We got the story just last week that they were considering cutting. The best part of the new story is that it is the Russians who are saying it! Of course, the heightened recession talk stemming from the Fed is a more logical source of crude price anxiety. Even with this backdrop, we still like some of the oil stocks for their massive cash generation and commitment to returning this cash to shareholders. And we think the oil & gas market as a whole is still undersupplied. Just look at Europe! (We will keep writing this until it is no longer true.) Or just look at the US inventory situation. We use this data a lot, and we like to mix up the presentation.



- Chart Crime of the week

The Bitcoiners are really grasping at straws now. This baghodler has drawn up an hourly chart that covers all of two days. And the mathematical proof is that Abbot Labs exhibited a similar pattern over the course of three months. Six years ago.

- Quick Hits
  - NBC is considering dropping an hour of prime-time television.
  - One of the founders of Three Arrows Capital, the bankrupt cryptocurrency hedge fund, used to work shirtless as a 24-year-old employee at Credit Suisse.
  - The two co-founders of Three Arrows, after abandoning the firm's arbitrage strategy and deciding to go levered-long crypto, borrowed more crypto from "whales" to pay off loans taken from the mafia.
  - MCD is coming out with the Chicken Big Mac.
  - The US did not have a named hurricane in August.
  - A Mickey Mantle baseball card sold for $12.6mm at auction. It was bought for $50k in 1991.
  - Within the same week, California decided to ban gas powered cars and asked EV owners to not charge their cars because of the electricity shortage.

Trading: We continue to follow our playbook. We added some put protection on the Nasdaq. We added a Put on a company that resides at the nexus of Fraud and Fantasy. We reduced some of our very small index long and added to more of our defensives like Staples and Health Care. We are taking our sweet time when we add any longs. If the market is able to bounce, we will likely trim our exposure again (selling longs and buying more Puts).

TSLAQ: The judge in the Tesla-Twitter case ruled that some of Musk's data requests were "absurdly broad." The same could be said for most of Musk's Tesla proclamations (Semi, Robotaxis, Full-Self-Driving, Cybertruck, $30k model 3, Tesla insurance, Tesla warranty service, etc). We are still waiting to buy Twitter. We think the "whistleblower" will prove much ado about nothing other than the revelation that Twitter is a poorly run company.

Check out our website to learn more about Chalk Creek Partners

Carlisle's Twitter Financial List

Carlisle's LinkedIn

The information presented does not involve the rendering of personalized investment, financial, legal or tax advice, and it is intended to be general market commentary. Information presented is believed to be factual and up-to-date, but we do not guarantee its accuracy and it should not be regarded as a complete analysis of the subjects discussed. All expressions of opinion reflect the judgment of the authors as of the date of preparation and are subject to change. Certain information has been provided by third-party sources and, although believed to be reliable, it has not been independently verified and its accuracy or completeness cannot be guaranteed. Past performance is not indicative of future results.