Weekly Update

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- The Fed got what it wanted…is the market listening?
- The death of the capital structure, layoffs everywhere, where is the good news?
- These bank-runs were not organic
- Perfect bedfellows played a role in this banking mess
- Why QT is not impacting the market yet
- Markets go down after the last rate hike and still go down after the first rate cut
- Positioning appears counterintuitive (again)
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	Last	5d %	YTD %	1yr %
S&P 500	3,949	0.1%	3.2%	-11.0%
QQQ	$309.75	1.1%	16.5%	-12.6%
US 10 YR	3.41%	3.58%	3.88%	2.38%
USD/DXY	102.6	104.4	103.5	99.0
VIX	22.6%	23.0%	21.7%	22.6%
Oil	$69.30	1.4%	-12.8%	-39.1%

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

As we have been writing, the ever-increasing chorus of complacency around the impending recession and the Fed's actions will surely have an adverse impact. Little did we know that the next shoe to drop would be the failure of the 16th largest bank in America. Nor did we expect that this would trigger a tidal wave of panic across the banking system. But this is precisely what the Fed's actions were going to do. We have said the Fed was intent on breaking something…they succeeded. Even if the bank-runs were fueled by some vindictive venture capitalists, they were born out of recessionary behavior. Put another way, they were part of the unwinding of speculative manias. Of course, the market had already started to get another case of the jitters before the banking episode after Fed chairman Powell spoke about maybe raising interest rates 0.50% to 5.00% (on the low end of the Fed Funds target range). But the market assumed Powell would back away from this 50bps ledge to help calm the aftermath of its boneheaded actions (allowing these banks to get in such bad fiscal shape). This was clearly driving the relief rally heading into this week's Fed meeting. More to the point, the crazy 0-DTE (zero days til expiration) call option buying was back with a vengeance. This, probably more than anything, signifies the return of risk-on spirits. As the Fed hiked by 0.25%, the initial narrative was dovish…the Fed is afraid of the banking turmoil and will start to cut rates soon. Despite Powell saying the exact opposite (higher for longer), the futures market expects a rate cut by this July! As usual, the market is volatile in the aftermath of the Fed's action and comments. But we still think the market is fooling itself and ignoring the next round of credit tightening and earnings weakness.

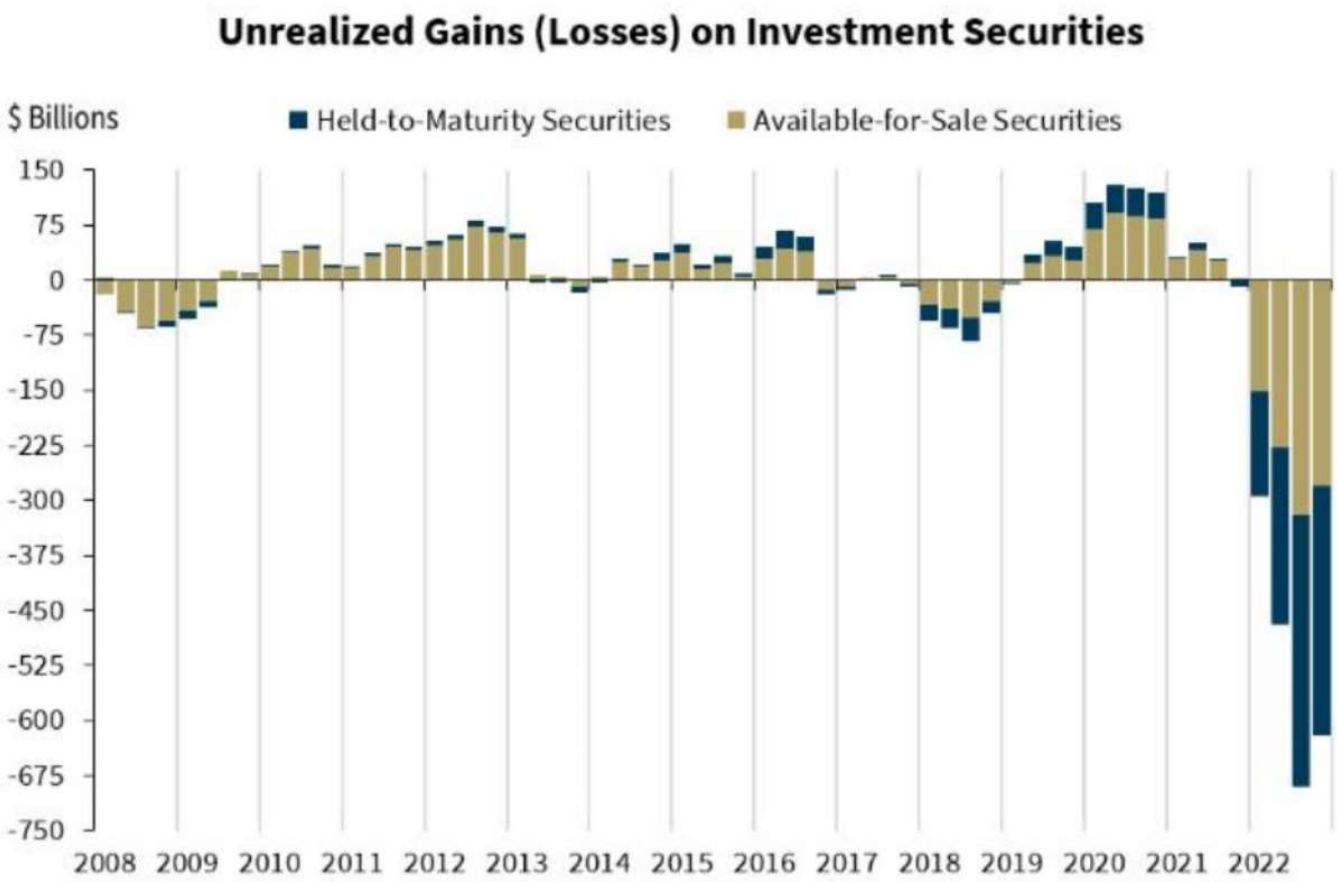
In Europe, the Swiss government decided to exercise its nuclear option to zero some Credit Suisse bond holders during its arranged marriage with fellow Swiss bank UBS. While this was legal and in the prospectus for these bonds, the fallout will include political distrust and an increased cost of capital. Elsewhere, geopolitical tensions are still on the rise with China cozying up to Putin again. Tik Tok is having another round as the political hot potato. Layoffs in the US are ongoing. Amazon grabs the headline with another 9k on the chopping block. But Accenture is cutting 19k jobs after adding 38k jobs last year. Walmart is reducing hours at some of its fulfillment centers (including in Fort Worth, ugh). Perhaps the best signal of the weakening job market comes from Indeed, the job listing platform. It is laying off 2,200 people! Another mega Burger King franchise has declared bankruptcy (118 restaurants). PNC is shutting down 30 branches. We are hard pressed to find anything bullish… unless we are talking about gold, treasuries (we prefer the curve inverting again with 10yr notes outperforming shorter term bills), and the USD.

- These bank-runs were not organic

The almost instantaneous collapse of Silicon Valley Bank was startling. It was essentially a run on the bank spurred on by the weak financial conditions of its deposit base: Tech and Biotech startups. The fact that SVB was considered a well-capitalized bank with low (good) loan-to-value (LTV) ratios before the debacle underscores the fragility of the system. Basically, the Fed raised rates. Tech Bros's start-up companies did not generate enough cash to sustain their businesses. Their avenues for funding dried up. They yanked deposits from SVB as their last lines of defense. And SVB was the bank for about half of all Tech/Biotech start-ups. It was a liquidity crisis and a solvency crisis rolled into one. Many are pointing to the natural prisoner's dilemma of a bank-run. But we still maintain that Peter Thiel and his cohorts somehow orchestrated the whole debacle. It is completely illogical to speak publicly about taking your money out of a bank unless you have already done so. In fact, it is illegal to egg-on a bank-run. And while we are at, we think the latest fiasco bank, First Republic, is a similar beast to SVB. Much of its depositor base was hedge funds. This is why JP Morgan and the other big banks stepped in with deposits to shore up the liability side of the balance sheet. JPM did not want to see its big trading customers go out of business! Of course, those hedge funds have long yanked their money from First Republic. They have probably opened accounts at JPM! And now JPM will likely gets its deposits back and roll them into equity of First Republic. Who knows, but JPM and the other big banks are still Too Big To Fail while many of the small banks are Too Small Not to Fail (as Danielle DiMartino Booth likes to say).

We would like to add that the regulators are complete morons. The Fed does "stress tests" on banks to ensure they have adequate capital ratios under different economic/market scenarios. One of these is called the "severely adverse scenario." Amazingly, this worst case scenario was defined as having interest rates ***DROP***. Even while the Fed was actively increasing interest rates and predicting more interest rate hikes, the Fed regulators thought the most adverse scenario was for rates to be going down! John Mauldin (the sharp economist we follow) points out that the Fed still had this assbackwards stress test in place last month. And remember Dodd-Frank…it was supposed to be the cure for all banking ills. It forgot to include interest rate risk. It specifically allows for banks to hold assets which are not marked-to-mark. This is fine as along as the banks's liabilities match the duration of these assets. Obviously, this was not and is still not the case.

This is the chart that details the allowed structure and what can happen when interest rate risk is not considered.



Source: FDIC.
Note: Insured Call Report filers only.

- Perfect bedfellows played a role in this banking mess

When we point to the unwinding of some speculative manias, we are talking primarily about SPACs, Profitless Tech, and crypto. Banks that were designed to either facilitate transactions or house money (obviously not profits but seed capital) for these entities have found themselves between a rock and a hard place. The explosion in deposit inflows had nowhere to go. So the banks bought bonds…another asset that was in an epic bubble (thanks to government action, obviously). Of course, bitcoin has been rallying as some sort of middle finger to the monetary system. But there is plenty of evidence pointing to the prices being completely manipulated and meaningless. Along these lines, Coinbase has been served a Wells Notice which means it is being investigated by the SEC.

- Why QT is not impacting the market yet

We listened to a great podcast by Danielle DiMartino Booth (ex Fed official, great macro analyst). She commented that the Fed's Quantitative Tightening schedule (selling of bonds, or actually just letting maturing bonds roll off for now) is being mitigated by Treasury and its handling of the looming debt ceiling crisis (haven't heard much about this lately). These so-called "extraordinary measures" involve swapping non-marketable debt for treasury bills. Getting out of the weeds, it means the government is not issuing (selling) new debt right now. This is buffering the Fed's selling of debt (not rolling over). But all of this comes at a cost…the cost will be massive issuance of paper when the debt ceiling gets resolved. Kicking the can…

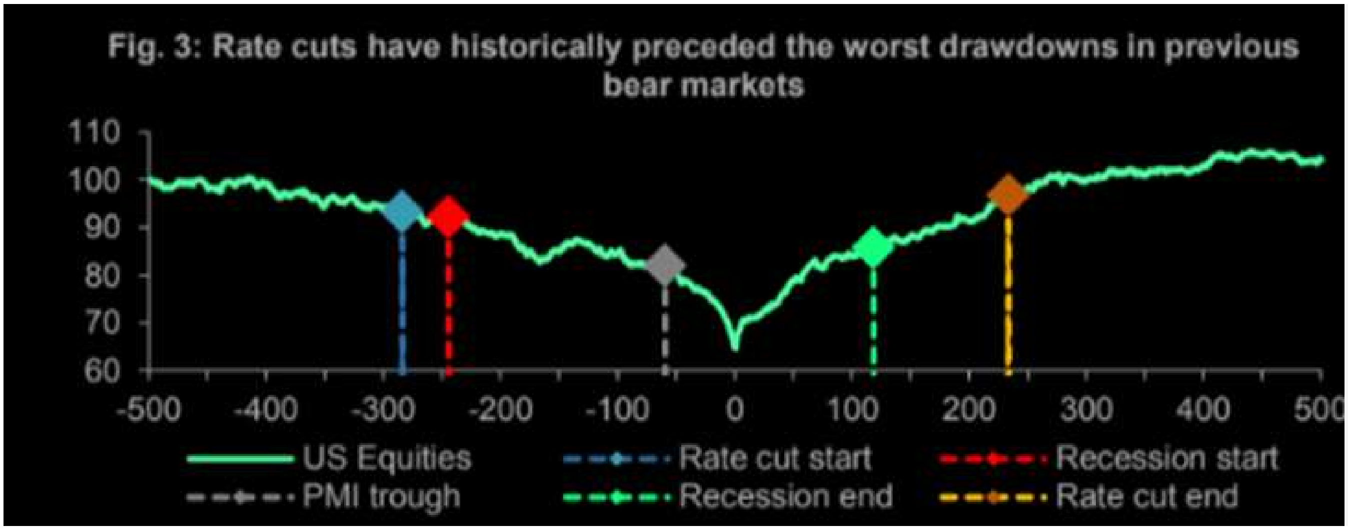
With the near implosion of the banking system, the Fed appears to be reembracing Quantitative Easing…at least that is what the pundits are saying. The Fed is lending money to banks who are able to post collateral at par. All of those giant losses on the chart above…the banks get to borrow as though those losses do not exist. And the Fed's discount window is open for business and lending at record levels thanks to some tweaking of the terms by the Fed. But do not confuse this with QE. A true expansion of the Fed balance sheet is the Fed buying a wide variety of bonds including long dated paper. This discount window lending is stop-gap funding (from one to 90 days with most of it on the shorter end). This is not a sign to encourage risk taking (like traditional QE). This is a sign of stress in the market.

- Markets go down after the last rate hike and still go down after the first rate cut

Here is a table from Merrill showing the performance of the Dow Jones 30 after the last Fed hike during a particular economic cycle (the Dow is our least favorite index but it works for this exercise givens its long history). Obviously, the hardest part is knowing the timing of the last Fed hike. Assuming we get this message, market performance depends on the current inflation. While we are currently in a disinflationary period technically speaking, we would argue today's environment resembles that of the 1970s and early 80's.

		Dow Jones return post-hike	
Date of last Fed hike	**Fed Funds %**	**3-mo**	**6-mo**
5/1/1974	13.0%	(10.3%)	(22.8%)
3/3/1980	20.0%	(0.4%)	9.2%
5/8/1981	20.0%	(2.4%)	(12.0%)
1/4/1982	15.0%	(5.0%)	(9.7%)
8/21/1984	11.75%	(4.4%)	3.4%
Average return - inflationary period		**(4.5%)**	**(6.4%)**
2/24/1989	9.75%	10.6%	21.8%
2/1/1995	6.0%	12.5%	22.2%
5/16/2000	6.5%	2.2%	(3.8%)
6/29/2006	5.25%	4.5%	11.8%
12/19/2018	2.375%	11.0%	13.5%
Average return - disinflationary period		**8.1%**	**13.1%**

And BNP Paribas notes that the trough in equities comes almost 10 months after the first rate cut. This surprises the younger generation of traders who have been accustomed to believing that rate cuts juice the market instantaneously. But traditionally, rate cuts mean we are in a recession and the economy is going to slump for 1-2 years. We know the sample sizes are small in these studies. But the long duration of the data in the samples lends credibility to the output. (Both the table and the chart are from themarketear).



- Positioning appears counterintuitive (again)

Merrill reports that its clients were net buyers for the third straight week. Financials experienced large inflows! Long-only investors have been selling while individuals and hedge funds have been buyers. This is exactly the opposite of what we would have expected! Energy also saw large inflows…the largest since 2008! We would not have expected this either given the lousy performance. Clearly Merrill data is not always representative of the broad market. But given its huge coverage of all the different segments (retail, long-only institutions, hedge funds, and corporates), it is typically representative (but see below).

Elsewhere in Merrill research, its Fund Manager Survey tells us that investors are still underweight stocks and overweight cash and commodities. Bank exposure has been "slashed" …so much for Merrill's own flows! European stocks are an overweight allocation. Staples and Tech are considered overweights, too. In choppy markets, we want to swim against the tide which gives us comforting in our positioning (except for our long exposure to Staples which was great last year and lousy this year.)

- More jobs added, but also higher unemployment, more layoffs, fewer quits, less pay

The Employment Report surprised to the upside again. 311k jobs were added in February. This compares to the 504k added in January (revised down slightly from 517k initially) and about 210k expected. Private Payrolls also beat expectations but fell from last month (265k actual vs 386k last month and 200k expected). The UE rate increased to 3.6% from 3.4%. The Labor Participation rate ticked up to 62.5%. The good news…err the bad news that could be good news for the markets…is that Average Hourly Earnings are slowing. They still increased by 0.2% vs January, but this is down from the 0.3-0.4% readings for the last six months.

Job Openings in January fell 400k to 10.8mm. This is still a huge number, but we maintain much of it is fake news. Inside of this report (JOLTS) was perhaps the real news: Quits are dropping…they hit their lowest level since early 2021. Job Cuts (by Challenger, a different data set) in February fell from their abnormally high level in January. But the February data is still elevated. And we have highlighted the anecdotal data around layoffs…these seem to be increasing. All this tells us the labor market is finally starting to slow. But we still think the Fed will act too slowly in reversing course.

- Houses are starting to sell…at lower prices

Existing Home Sales jumped by 580k from January to February (this is an annualized number, so it is misleading on the surface). This was the first monthly increase in over a year and the largest jump since July 2020. Inventory remains low at about 2.6 months of supply (same as Jan). But the real news is that prices dropped (annually) for the first time in over 10 years! The drop was miniscule at 0.2% to $363,700. But just like the drop in Hew Home prices two weeks ago, we think this is the start of a trend. Sales going higher leads to prices going lower. It is also worth noting that this lower median price is being influenced by the mix of homes being sold. More low-end prices are starting to sell. So, this is not an apples-to-apples price comparison. But we think more low-end transactions is a sign of weakness not strength.

- The Fed only cares about inflation

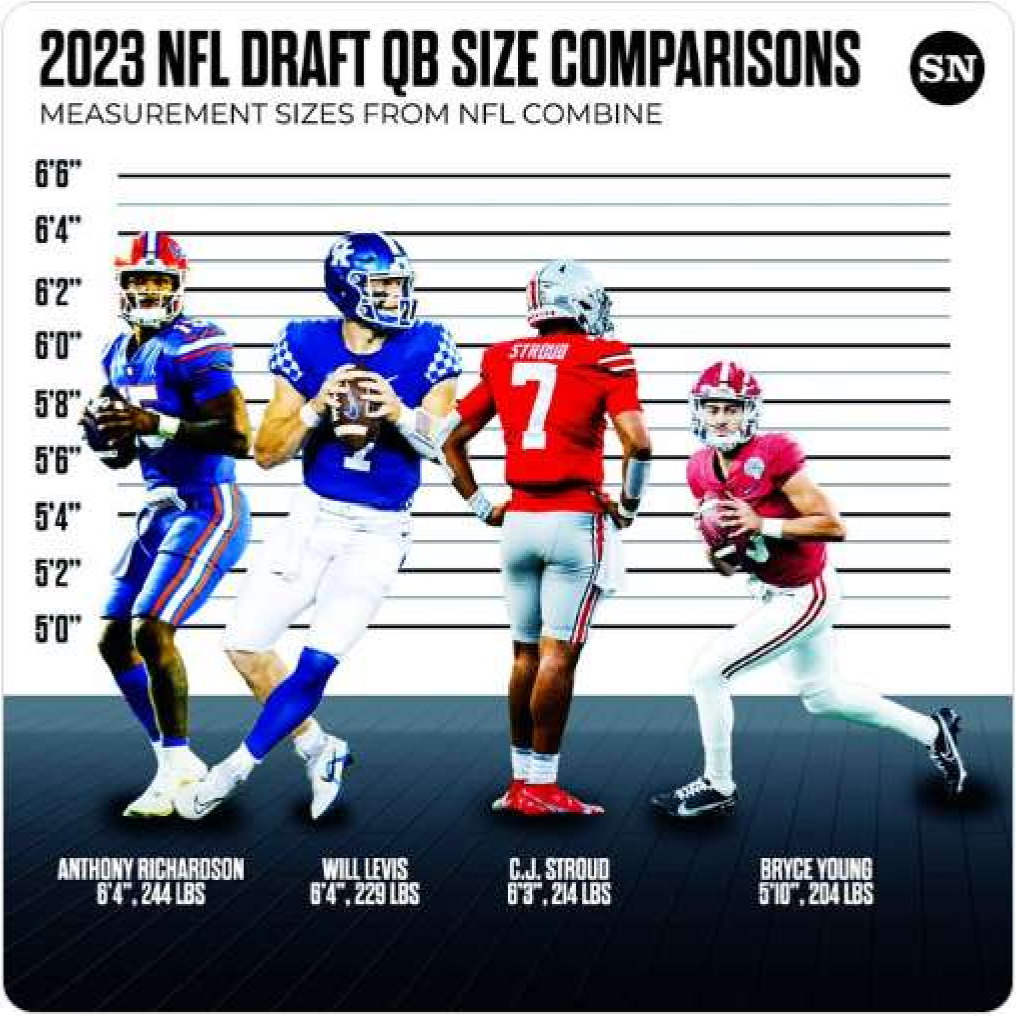
In line with the new market expectations, the Fed hiked 25bps. They changed the language a bit and now want to keep financial conditions "firm." Some parts of the market took Powell's comments as dovish…that the banking sector worries would be enough for the Fed to stop the hikes and perhaps "pivot." But Powell answered explicitly that "firm" meant more rate hikes are likely…he just did not want to use the singular or plural tense of the word hike. (These guys really do think about the degrees of their vagueness.) Powell tried to say most depositor money was safe. But Treasury Secretary Yellen's somewhat concurrent statement about *not* expanding FDIC insurance to all deposits threw cold water on Powell's attempt at comfort. When asked about potential damage to the labor market, he quickly pointed to the excess job openings (JOLTS), and then redirected the topic to fighting inflation. He reiterated the 2% inflation target explicitly.

- Where did all the crypto money go?

Multicoin Capital, a crypto-focused hedge fund, lost over 91% of its assets last year. The gamblers running the fund tell us that inception to date performance is still up about 1400%. Impressive! -Not really. These guys commit one of the biggest violations in performance reporting. They gloss over the fact that the fund had virtually no assets during 2011-2021 when its performance was stellar. But the fun took in billions in assets (real money) in the back half of 2021…just in time for the incineration. Crazy Cathie could not have done it any better.

- Chart Crime of the week

You would think Bryce Young was trying out for the midget leagues.



- Quick Hits
  - A report by the Philadelphia Inquirer alleges that six longtime members of the Phillies baseball team died from cancer caused by the turf in the old Veterans Stadium.
  - (The) Ukraine exported 190k tons of sunflower seeds in January vs 4k tons last January.
  - In this week's What Would We Do Without Academics, researchers have determined that using robots is bad for the employment of low-skilled workers.
  - Stripe, one of the last remaining "unicorns" in the private market, recently raised $3.5b to help pay off the tax burden incurred by its employees who have vested shares but are unable to sell them.
  - The daughter of a sanctioned Syrian spy chief has been working in a UN office in Damascus.
  - The WWE (wrestling) is in talks with state regulators (Colorado and Michigan) about allowing gambling on its fake/fixed matches.
  - Crazy Cathie Wood, aka the Woodchipper, has collected more than $300mm in fees while taking the chipper to $10b in investor money.
  - Here's a WSJ headline: "Thomas Lee, Private Equity Pioneer, Struggled to Reprise Early Successes." He died with a wealth estimated at over $2b.

- Fannie Mae, which underwrites about 40% of all US residential mortgages, has a chief climate officer.
- A radioactive capsule weighing 55 pounds went missing in Thailand.
- Some of the nickel that JP Morgan owned in a LME vault turned out to be bags of worthless rocks.
- Failed Credit Suisse was the leader in originating "debt for nature swaps." Third world countries can refinance some of their external sovereign debt in exchange for climate and nature pledges. What could go wrong.
- There are roughly $17trillion worth of bank deposits in the US. Over $10trillion of this is not insured. The FDIC has about $130b in its coffers.

Trading: Over the last two weeks, we have tried to reposition some of our shorts. We trimmed on some quick moves lower. We put on more as the market rebounded with relief. We cut some losers to refocus on the real froth in the market (Tech and Discretionary). This also includes crypto…this notion that equities related to it are a safe haven is absurd. On the long side, we cut some exposure to Utilities. This big winner last year has been terrible this year. It is simply too volatile for what it should be (boring and stable). We would rather have this allocation sitting in a money market fund while we wait for better opportunities on the long side.

TSLAQ: Tesla has long lauded its ability to limit recalls or warranty costs by issuing Over the Air (OTA) fixes. But this only works for software hiccups. Tesla latest recall issues have been more… structural, shall we say. One involves the back seats becoming unattached. The most recent is not technically a recall yet. But the NHTSA is investigating the car company ("but it is a tech company!") for the steering wheel coming off. Apparently, some 2023 model Y cars have their steering wheels attached via friction and not with a bolt.

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