Weekly Update

4-May-2021

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- Market gets jolted by Yellen
- Great Earnings, not great reactions
- Strong GDP, inflation everywhere but in the Fed data
- Jobless Claims still improving, Construction Spending split, Housing still strong
- International Growth is slowing
- Some refreshing Fed dissent (if you hear it before it is drowned out)
- Oil Speculators are not long yet
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
SPX	4165	-0.5%	11.2%	49.5%
QQQ	330.1	-2.9%	5.4%	56.2%
US 10 YR	1.59%	1.62%	0.92%	0.66%
VIX	19.5%	17.3%	22.8%	33.6%
Oil	66.15	5.1%	35.4%	222.2%

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

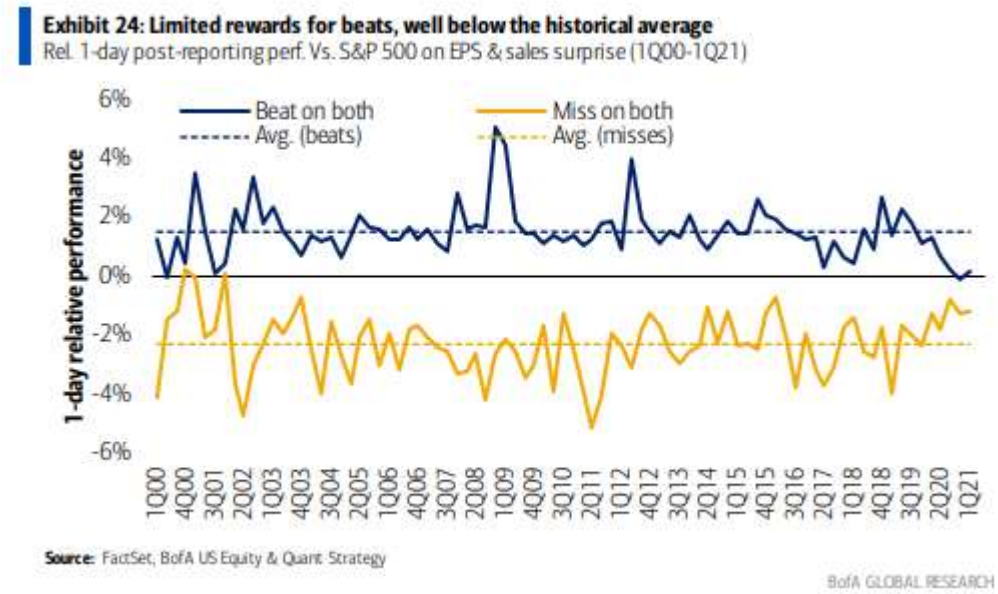
The indecision in the market quietly continued until some of the narratives were jolted. Primarily, Janet Yellen, current Treasury Secretary and former Fed chief, accidentally broke stride with Jerome Powell's "lower rates forever" mantra. She offhandedly quipped that "interest rates may need to rise modestly" to counterbalance all the fiscal spending from the government. This rattled the cage of the long-duration equities: Growth stocks. But the nuanced selling of Growth we have been seeing fell by the wayside: all Growth stocks got hit. This includes the profitless High Growth names which rely on low rates to extend their economic runways. But the real surprise was that Big Tech also got slammed. And this comes on the heals of amazing earnings! And for all the talk about interest rates, the yield on the 10-year Treasury actually *decreased* after Yellen's comments. The answer to this conundrum is really quite simple: The bar for earnings was incredibly high, and the market was ripe for some profit taking. The slightest of flames easily lit the tinder box. However, there was some extra fuel added to the fire when Jamie Dimon, the CEO of JP Morgan, said he was canceling all his Zoom meetings and he was getting back to in-person life. This was said in jest, we suppose, but the message was clear. And it is worth noting that a long-time and vocal bull on Apple (Morgan Stanley) trimmed her growth estimate for the Services

division because of weaker App Store trends. Lost in the shuffle was the minuscule effect this tweak had on her overall numbers and still bullish position.

We still think the Fed will keep rates low and bond buying high. We think Yellen will likely walk back her comments rather soon. But we still think Volatility might remain elevated. This should provide some opportunities to trade against the rotation. But ultimately this party comes down to monetary (Fed) and fiscal (govt spending) stimulus. Sure, the Repubs might make it hard to pass new legislature, but the free-money train will likely keep chugging along.

- Great Earnings, not great reactions

Earnings continue to blow away expectations. The percentage of "beats" is record breaking: 88% of companies have beaten on the bottom line (net income) and about 79% have beaten on the top line (revenues/sales). And the amount by which companies are beating is even more impressive. The average beat since 1994 is about 4%. So far this quarter, the average beat is around 20%! (There is always a little slippage when comparing against estimates because these are never uniform.) Unfortunately, stock reactions are less than stellar. Of the mega-cap stocks, Apple, Amazon, and Microsoft reported amazing earnings, but their stocks closed down on the day. Google and Facebook also had incredible earnings. While their stocks closed in the black, they were all well off their highs. Obviously looking at one day returns is silly. But the exercise is important in showing the "crowdedness" of the market. And we have been talking about the incredibly high bar set ahead of this earnings season. It looks like we are eclipsing this high bar…but still failing to rally. Below is a chart from Merrill showing the historical reactions to earnings surprises. ML also says corporate optimism is running hot both on actual guidance and the qualitative nature of their word parsing.



- Strong GDP, inflation everywhere but in the Fed data

GDP increased at a 6.4% annualized pace in the Q1 compared to 4Q2020. This is up from 4Q's growth of 4.3%. Personal Consumption Expenditures (PCE) drove the growth with a 10.7% gain. This is not surprising given the strong trends we have seen in Reopening activities (Retail Sales, Travel, etc). The March pricing data for PCE shows an acceleration with a 4.2% monthly gain. Personal Income jumped over 21%! Of course, government stimulus is still contributing to this. The yearly change in the "Core" PCE remains subdued at 1.8%. This gives the Fed cover to stay its course.

Used car prices continue to rocket higher. After March's 2.5% weekly gains, the first two weeks of April showed a 7% increase vs March. Compared to last year, prices are up over 52%! Obviously, that was the forced low (travel was shut down). But with rental cars in high demand (fleet cars a natural source of used car supply) and the production of new cars stymied by the semi-chip shortage, we do not see this pricing trend as "transitory."

- Jobless Claims still improving, Construction Spending split, Housing still strong

Jobless Claims remained steady at 553k. This moves the 4-week moving average lower to 612k. As for worker compensation, the Employment Cost Index tells us that wages, salaries, and benefits as a whole increased 2.6% in 1Q vs 1Q2020.

Construction Spending remained unchanged in March (+0.2%) after dropping in February (-0.6%). But as usual, Housing was strong (10 straight monthly increases). Nonresidential spending is what took down the headline as it hit its lowest level in two years.

Pending Home Sales reversed higher in March compared to the drop in February. But the bounce back was softer than expected. This is an index and not an outright level. It sits right at the level before the virus-fear hit. But the National Assoc of Realtors (they compile the data) repeats the refrain: low supply and high prices are slowing transactions.

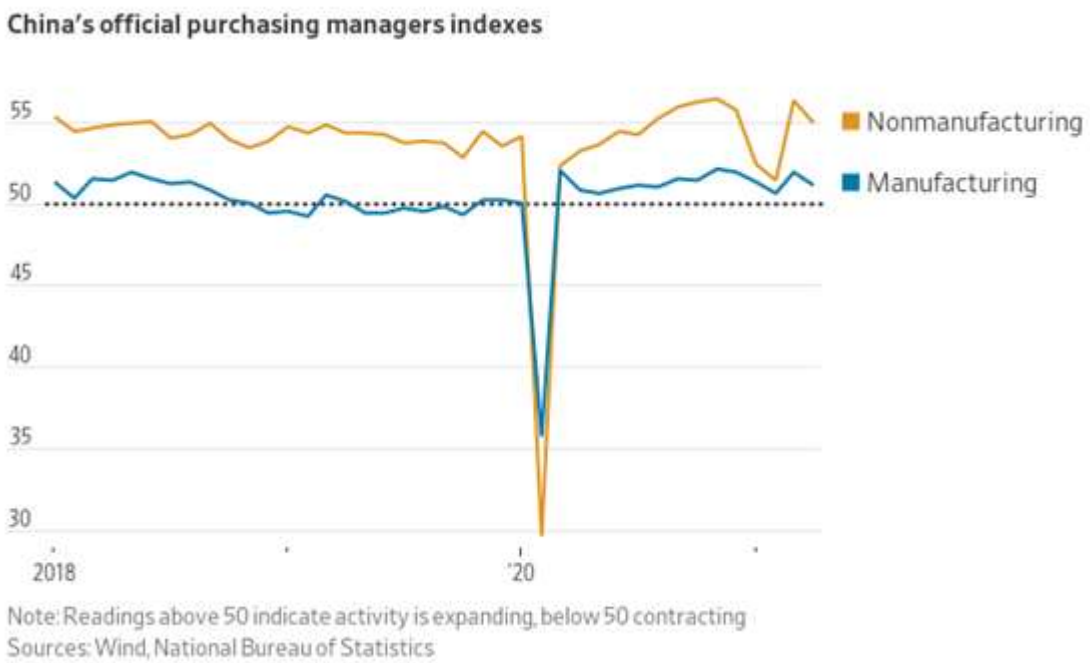
- PMIs still showing strength

The final Manufacturing PMI for April was unsurprising yet still record 60.5 level. The media pounced on a lower ISM Manufacturing report. But it is important to remember that the Markit reading is more accurate for pure US growth. The ISM has a much larger bias towards international growth. Whatever the case, the ISM is still sitting just off the all-time high! And the Chicago PMI blows off the top with a 72.1 reading. This is the highest since the early 1980's.

- International Growth is slowing

The Eurozone fell back into recession after its second straight quarter of economic contraction (negative growth).

We know not to trust official Chinese data. So, when the PMIs start to turn south? Of course, the market has been telling us this for a while. Whether that was based on increased regulatory scrutiny or a slowing economy (or a combo)…who knows. For us, it just means to wait on buying any dips in China (we have no direct exposure and very little indirect exposure).



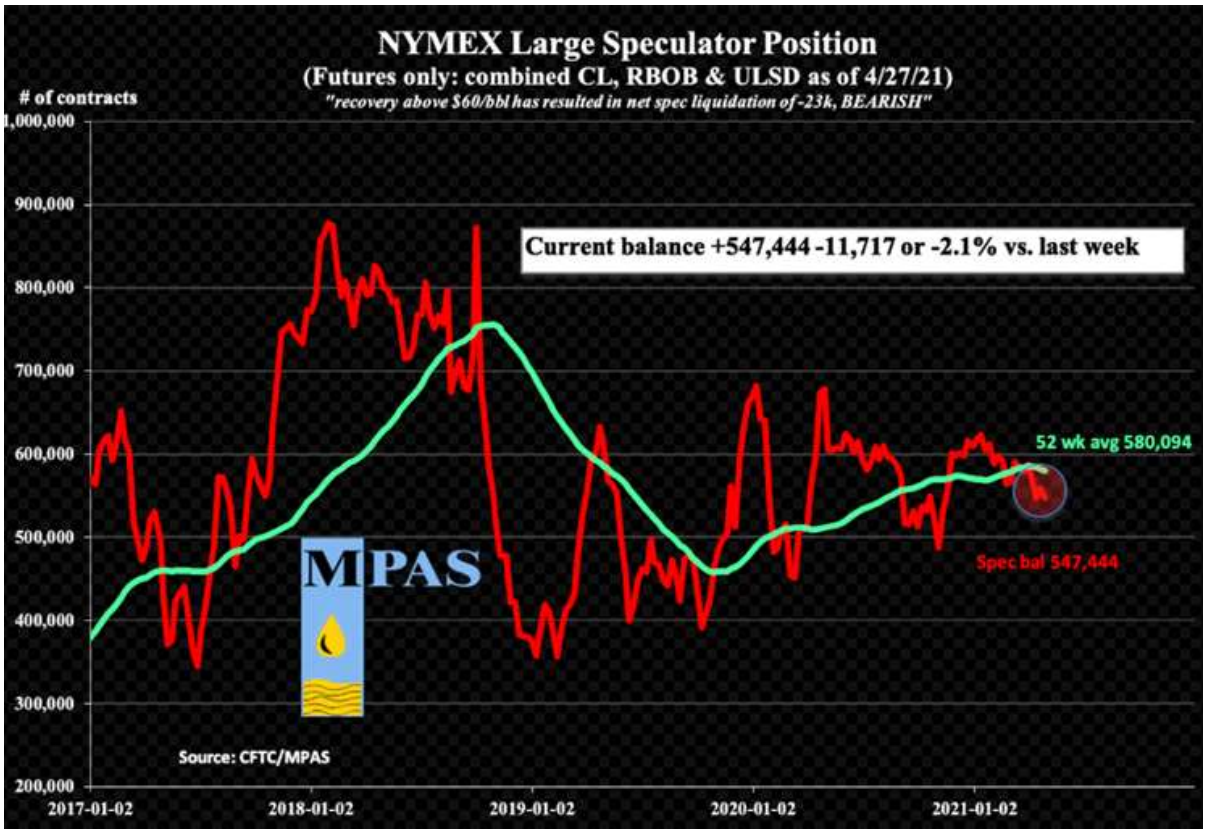
- Some refreshing Fed dissent (if you hear it before it is drowned out)

We saw a contrast in Fed opinion this week. The Dallas Fed chief, Robert Kaplan, jumped on Fed chairman Powell's comments last week about the markets being "frothy." Of course, Powell said despite this condition, the Fed was not thinking about "tapering" bond purchases any time soon. To the contrary, Kaplan said "We are now observing excesses and imbalances in markets…and at the earliest opportunity, I think will be appropriate for us to start talking about adjusting those purchases." Unfortunately, John Williams of the NY Fed felt the need to throw water on Kaplan's comments by changing the narrative, "Strong asset prices reflect a spirit of optimism." Williams has a Fed Open Market Committee vote while Kaplan does not.

There are many voices now shouting at the Fed to be more proactive and less reactive: If the Canadians can start trimming asset purchases, so can we. We find ourselves in that camp. Alas, a random twitter comment resonates even more loudly. Why try persuading the Fed to change its course when Powell is more resolute than ever in staying the course? Some point to the back half of 2018 when Powell was viewed as being overly hawkish (hiking rates too quickly/much). Soon after the Christmas Eve market plunge, Powell reversed course. Meaning: Perhaps Powell can listen to the voice of the market if it shouts loudly enough. But pundit shouting will surely have no impact. And to be fair, last summer we fell victim to rational thought. No way would the government continue to pay people not to work. Or maybe they would! We can shout form the mountain tops that we hate wasteful government spending. But the reality is it is happening.

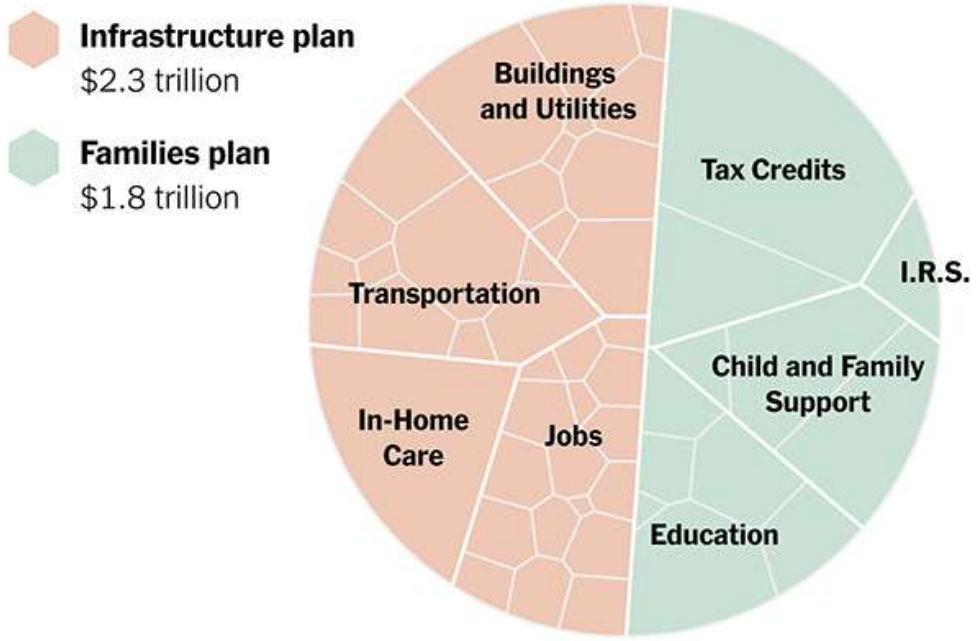
- Oil Speculators are not long yet

The MarketEar ran this chart to show that oil speculators are not overly long publicly traded futures contracts (we will ignore the fact that many contracts are traded in the over-the-counter market – we assume they reflect the same positioning). The Ear's conclusion is that this does not mesh with the bullish calls on oil (like Goldman's $80 target vs approx $66 now), and thus we should not be bullish just yet. We like the Ear, but this is crazy. You always want to buy *before* others buy!



- Chart Crime of the week

This comes courtesy of the NY Times. Pie charts are supposed to be easy to read with relative slices. This pie looks like something we baked on a Thanksgiving morning back in the 1990s.



- Quick Hits
  - A St. Mary's College (Maryland) research paper purported to prove the pandemic had a disproportionately negative impact on research published by women and "people of color." The author cited a study that shows women faculty submitted *more* work being published.
  - "Contrary to the interests of civilization." Charlie Munger, vice Chairman of Berkshire Hathaway, on crypto currencies.
  - A clothing survey done by Haggar reveals that most people now only wear sweatpants when traveling within two miles of their home.
  - Marijuana companies cannot deduct many traditional expenses when calculating their taxes. These includes rent and labor.
  - The National Association of Homebuilders estimates that the surge in lumber prices has added about $36k to the median home price.
  - Verizon sold AOL and Yahoo for a combined $5b. They bought them for about $10b six/four years ago. These two media relics had a combined peak valuation of approx. $325b back in the day (not exactly apples to apples, but you get the picture).
  - Eleven Madison Park, a swanky NYC restaurant that charges $500 a plate, is going all vegan. The only exceptions are milk and honey which can be served with coffee and tea.
  - Shootings in NYC are up 81% vs 2019.
  - Virtual Signal of the Week (we are not sure if this will become a category unto itself): The world's largest retail jeweler, Pandora of Denmark, announced it will stop selling mined diamonds. Pandora basically sells Disney charms and other cubic zirconia trinkets.

Trading: With some of our QQQ and other Put protection kicking in, we added a bit to our longs. We sprinkled the field with some quality/defensive names that were performing well along with some Growth names getting hit hard. We bought a busted SAPC that we think has a good underlying business. We sold a pre-merger SPAC that at best would evolve into a High Growth name. We added to our small longs in Retail, Materials, and Airlines on the Reopening theme.

TSLAQ: One of the more entertaining exercises after Tesla earnings is to read the updates on all The Villain's promises. With the failing "Autopilot" in the news, this is an easy place to start. In late 2016, Musk started charging for "Full Self Driving." Musk proclaimed, "All you will need to do is get in and tell your car where to go." This included driving from "Los Angeles to New York City with no human intervention." This was promised by the end of 2017. Funnily, tucked into the current 10-Q SEC filing is this wording, "There is no guarantee that any incremental changes (to the FSD functionality) …will perform…***at all***." Tesla also slipped into its filing an accounting change which boosted net income by $150mm (a one-off). But we have saved the best for last. When discussing the sale of Bitcoin to boost its earnings, Tesla posted this line as an image in the doc. This makes it impossible for search engines (like CTRL+F) to find the word Bitcoin. Yep, Tesla was trying to cover up their profit in Bitcoin.

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