Weekly Update

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- There are all sorts of rotations happening
- Positioning has cooled
- Real Earnings Yield turns negative (ominous)
- Housing Data still slumping a bit, but it is still a supply issue
- Survey data is still surging
- Should the European Central Bank be hiking rates?
- Chart Crime of the week
- Click here for the full note

	Last	5d %	YTD %	1yr %
SPX	4201	1.0%	11.8%	38.4%
QQQ	332.9	1.2%	6.1%	44.6%
US 10 YR	1.61%	1.67%	0.92%	0.69%
VIX	16.7%	22.1%	22.8%	28.6%
Oil	66.86	7.8%	37.8%	103.8%

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

In case you blinked, apparently the cascading inflation is now nary a worry in this schizophrenic market. The market is now pricing in a *drop* in inflation. The 10-year Breakeven (the market's expectation for inflation in 10 years) experienced the biggest one-week drop in nine months. The 5-year/5-year Forward (the expectation of inflation for five years starting in five years) dropped the most since the virus-fear first struck. In lockstep, the 10-year Treasury yield dropped to a two-month low. Have people really changed their minds about inflation? Are they starting to believe the quasi-psychobabble from the Federal Reserve and its use of "transitory" to describe inflation? Maybe…many agricultural and industrial commodity prices have started to ease. But probably not. To bang our usual drum, we think it is just another market rotation. We usually talk about Value outperforming Growth or some other equity-factor (Value has outperformed Growth by 9% despite a 2% outperformance by Growth over the last two weeks, by the way). But market rotations certainly apply to interest rates and other macro factors. And with the volatility in economic data, we have seen a natural impact on interest rates (macro traders can be like equity day-traders…momentum based with itchy trigger fingers to cut losses). The obvious knock-on effect is the equity-factor rotation. It is all tied together.

We heard a succinct if not humorous recap of the current equity market sentiment:

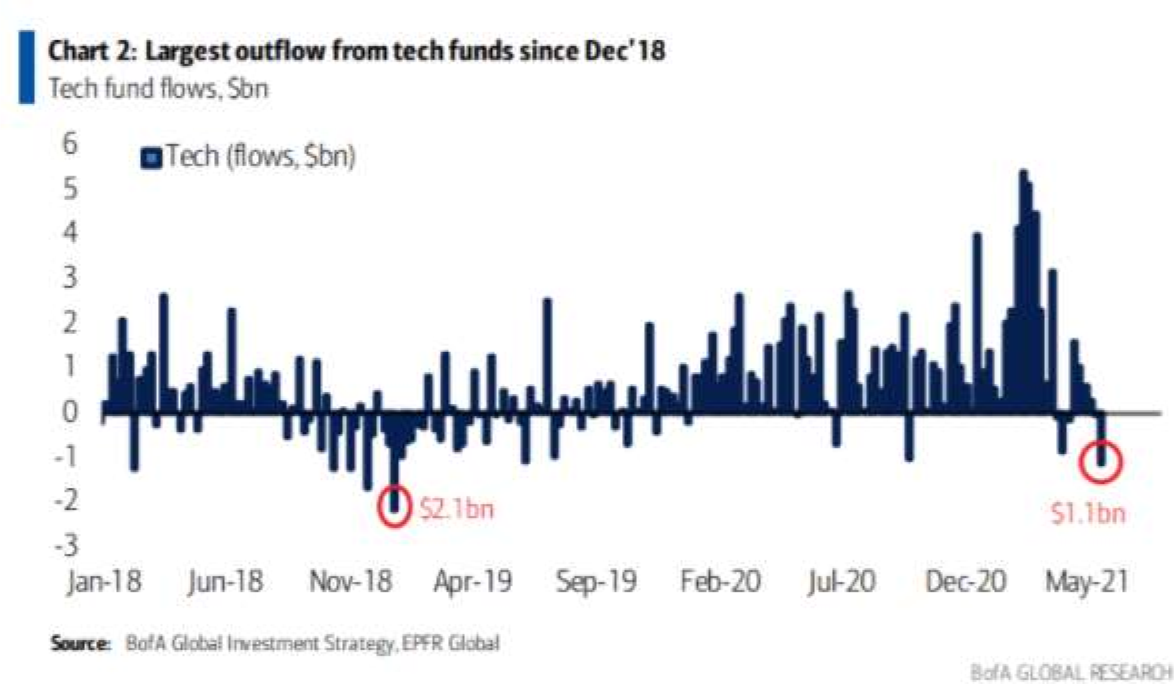
Bulls: Rate pressures easing. Earnings still improving. Modest tax hikes at worst.

Bears: Peak everything!

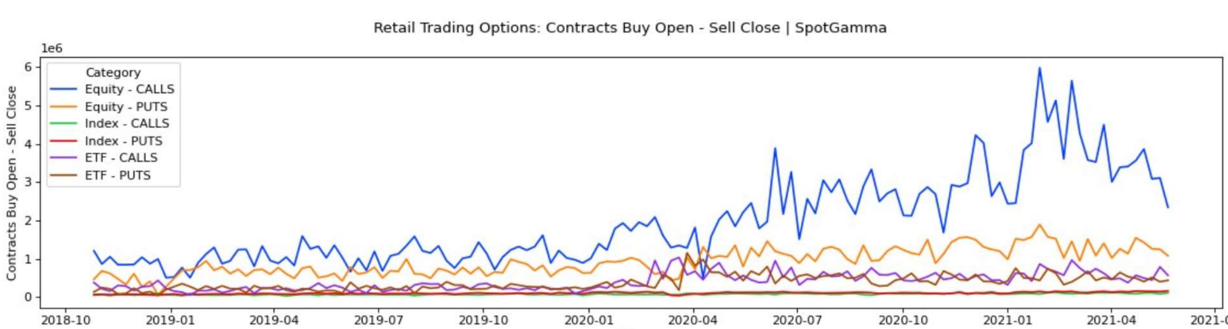
We like this synopsis. We think it fits nicely with the rotation theme…the theme that the narratives keep changing. However, we would add that Mary Daly of the San Francisco Fed revealed the first chink in the Fed's armor. She said, "we are talking about talking about tapering (reducing bond purchases)." Kaplan of the Dallas Fed has called for the need to taper, but Daly is the first to admit the Fed is considering it. Surprisingly, the market did not even twitch. The Bulls say this proves the Fed has things under control. The Bears say (know) that the Fed may have things under control until they spin wildly out of control.

- Positioning has cooled

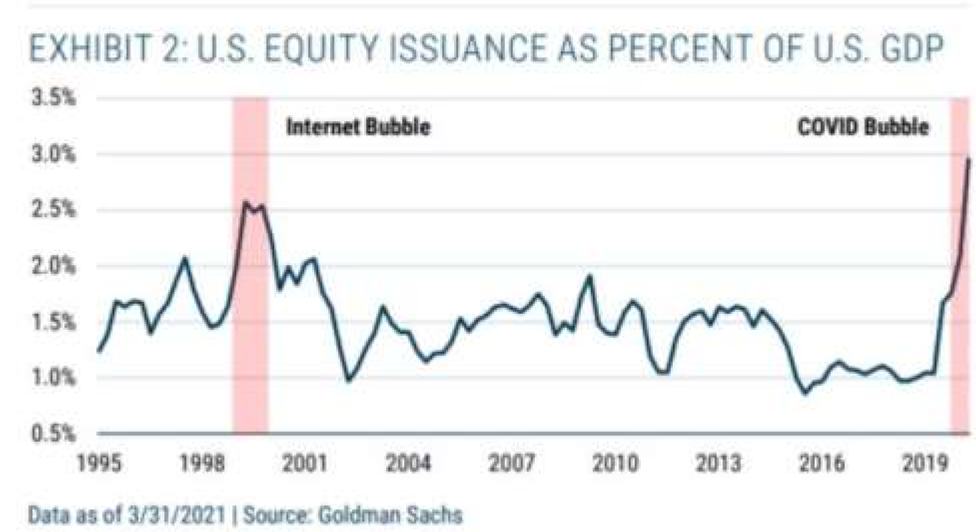
Here is a simple chart showing the weekly inflows/outflows for tech funds. This recent burst of selling jibes with what has been an overcrowded space.



We have also seen Retail option buying start to dip. Recall, this was a favorite M.O. of the Robinhooders and Reddit crowd (be it in GameStop, AMC, Tesla, etc). The blue line is the declining single-stock equity Calls being bought:



And another simple chart. Companies are being rational and selling equity when they can and not when they must. Of course, the flip side to this is what kind of bagholders have been buying?

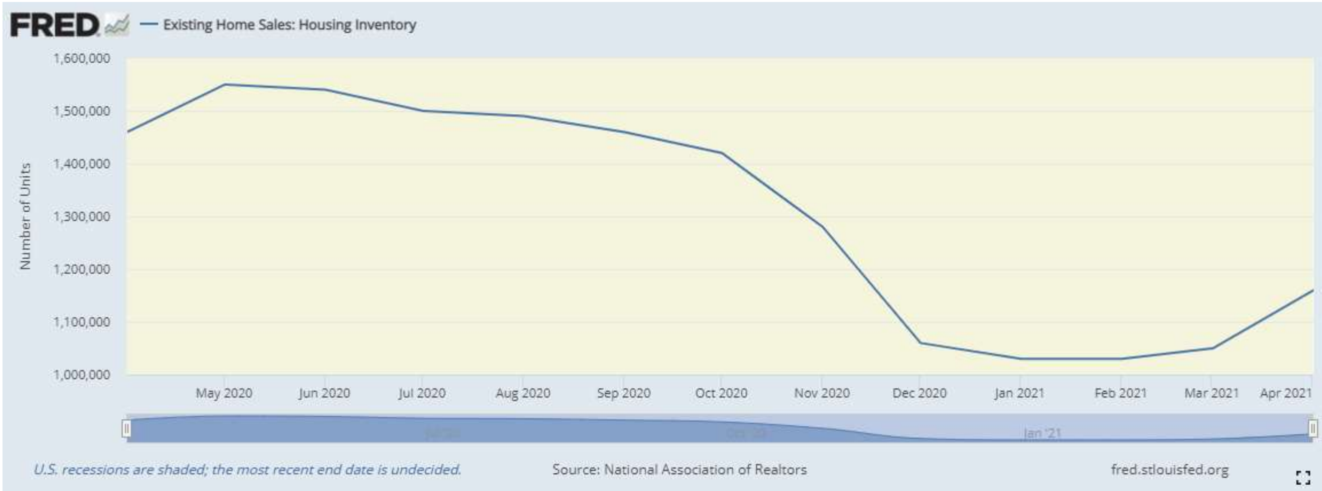


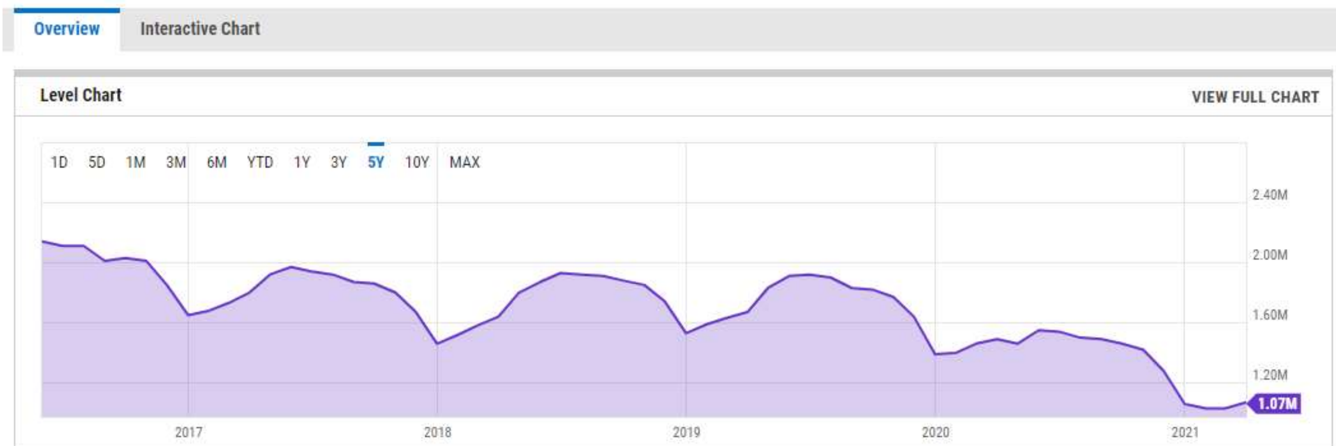
- ➢ Real Earnings Yield turns negative (ominous)

The growth in Earnings is grabbing some headlines. But one thing overlooked is the Earnings Yield for the market. In particular, the Real Earnings Yield (REY) is now worrisome. Quantitatively, the REY is just the Earnings divided by the market Price (inverse of the P/E ratio) minus inflation. The logical idea is that you want earnings growth to outpace inflation. Like most metrics, this one is fraught with assumptions (will earnings and inflation remain the same). And the occurrences are few and far in between. Nonetheless, over the last 40 years, each of the three times the REY has gone negative, the S&P 500 has experienced quite the negative shock (and this chart below is great because it uses a log scale which essentially adjusts for percentage changes).

- Housing Data still slumping a bit, but it is still a supply issue

Existing Home Sales in April fell shy of expectations. The annualized rate has now retraced all the way to July's rate. This is not all bad because July was the first big jump last year from the depressed levels in the spring. Prices hit another record with the median hitting over $341k. Inventory ticked up a bit. More vaccines are helping showings. And a drop in mortgage forbearance is freeing up more homes for sale. But as you can see, the uptick is still miniscule in the grand scheme (we are using two different chart schemes because the National Assoc of Realtors rules their data with an iron fist).





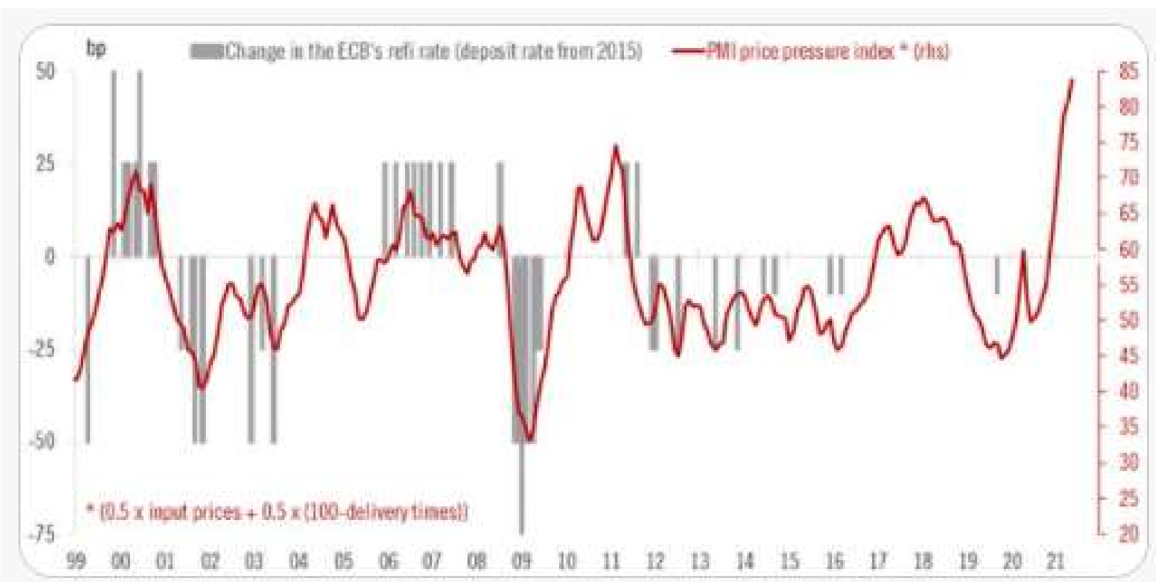
New Home Sales also fell short of expectations in April. The annualized rate fell 5.9% vs March. The 863k is one of the lowest levels in the last year. But it is also about 35% higher than the pre-virus-fear range. We never like to see a rate of change decline. But the overall level is still strong, and we know that logistics and external supply factors are slowing things down.

- Survey data is still surging

The PMIs surged to another all-time high. While this data is incredible (V-shaped recovery in the chart which is missing labels, ugh), we do reserve some judgement since this is a diffusion index which in theory resets every month. That is, it is a measure of forecasted change vs outright levels. But considering all of the regional Fed surveys have been showing similar strength (Richmond Fed this week), we still believe there is more GDP growth ahead.

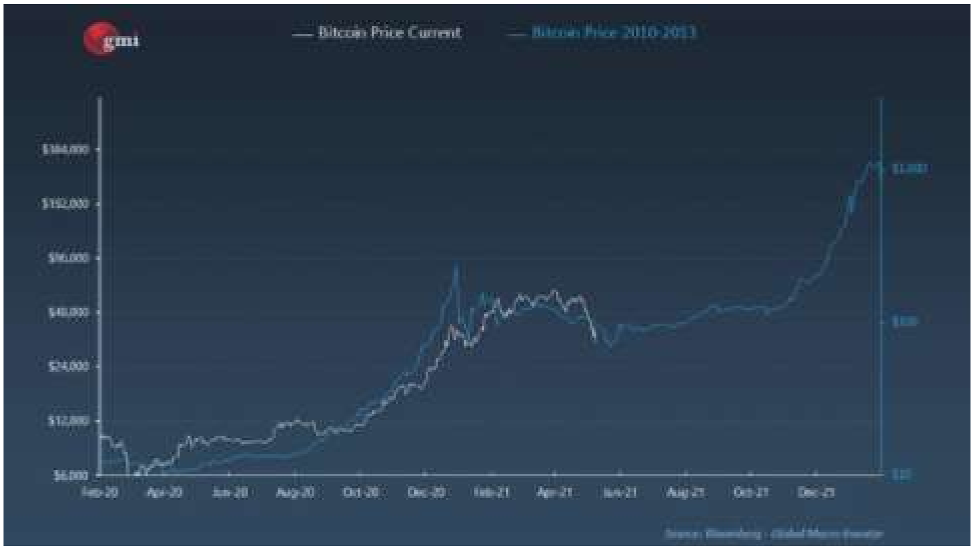
- Should the European Central Bank be hiking rates?

The European Central Bank has no plans to tighten monetary policy (either through rate hikes or slowing the bond purchases). But this contrasts with what the ECB has done during the last 20+ years when the PMI Price Pressure Index accelerates. This index is a combination of prices and delivery times. We cannot say we have taken this apparent correlation down to the studs…but it sure appears to be as solid as it gets. Of course, it all comes back to whether these pricing pressures are "transitory" or not.



- Chart Crime of the week

The world of crypto is filled with chart criminals (actually all kinds of criminals). But when the make-believe asset wobbles (fine to trade and make money with, but there is no intrinsic value), the criminals come out with charts like this. They just make up random overlays with no comparative basis and say, "look what could happen!"



- Quick Hits
    - MLS teams (soccer) are selling for about $400mm. The entire league had revenues of $90mm last year. There were 27 teams last year.
    - DFW news ran a story about a man getting stung by a bee in Austin.
    - MGM Resorts (the casino company) rallied after reports of Amazon potentially buying MGM Studios (nothing to do with the casino company).
    - California is aiming to eliminate accelerated-math classes in middle school because of the "inequity of mathematics tracking in California." Virginia has already done this!
    - Amazon is being sued by the attorney general for Washington D.C. Allegedly, Amazon has been fighting to keep prices higher!

Trading: We started to put back on some of the protection we recently took off. We effectively just rolled our protection "up and out" (higher strike prices and further out in time). But we mixed up the composition a bit. We added to our small-cap protection because we increased our underlying long exposure to small-caps (mostly our Reopening plays in Retail). We put on some protection in Big Tech. We like the play on the profitless growth stocks better (we are long some for the long haul, but we think they will remain under pressure in the short-term), but we already have decent protection here. We tweaked our short on NYC commercial real estate. The theme here is that the sector will be fine in the short-term. But when leases start to roll off and are faced with declining utilizations and thus rents, the sector should suffer. And oh yeah, we added a small slice to our small short in Tesla (more below).

TSLAQ: It is rather ironic that the two most destabilizing forces on the crypt world are Elon Mush and the Chinese communists. Neither understands the laws of economics. As far as increasing our short, there will be plenty of pumps, but we think the cat is out of the bag: new EV competition is fierce. And the Chinese are not going to make things easy for the car maker. That is right…it is a car maker.

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