Weekly Update

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- The mini-rotation is over (for now)
- D.C. is back in the spotlight (ugh)
- The newest Fed bailout facility is not showing stress but rather stupid government policy
- Japan is back showing the right signs of life
- Headline Jobs look strong, under the surface not so much
- ISM Employment plummets
- Forward looking Inflation is seen cooling a touch (but not today's CPI)
- There is a new Fed member, and another pivots in a different way
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- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,782	1.6%	0.3%	24.7%
QQQ	$408.48	2.5%	-0.3%	52.0%
US 10 YR	4.04%	3.92%	3.88%	3.54%
USD/DXY	102.4	102.5	101.3	103.2
VIX	12.7%	14.0%	12.5%	21.1%
Oil	$71.28	-2.4%	-0.4%	-5.0%

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

The market got back to its grinding-higher ways after the mini-rotations we witnessed to start the year. We surmised last week that this was mostly just some flattening out of the year-end excesses (or delayed tax-gain selling). That seems to be the case especially given interest rates crept higher at the same time equities rallied. Moreover, the market-implied chances of a rate cut in March have dropped from 91% to 64% in two weeks. Of course, the Fed did its part by intimating there might be a slowdown in Quantitative Tightening (the Fed might start to invest coupons and maturing bonds back into more bonds). Even if the market does not get its outsized rate cuts, liquidity will still be injected into the system. The flip side to this is there might just be the need for more liquidity if the Labor market starts to deteriorate. The headline numbers from December looked good, but the rub is that most of the new jobs being created are part-time. We are still reasonably bullish…at least for the

Quality companies that have strong balance sheets and are not reliant upon the whims of thematic trading or meme madness.

- Random headlines
  - Household net worth is at an all-time high at $160t. This is the result of high stock prices, high house prices, high wages, and low unemployment.
  - Walgreens warning about the health of the consumer
  - Lilly going direct to consumer with its weight loss
  - Another Apple downgrade
  - According to Apollo (giant alternative asset manager), the forecasts for interest rates at the end of this year have the highest variation on record.
  - Shipping a 40ft container from Asia to northern Europe has increased about 170% in three weeks ($4000).

- D.C. is back in the spotlight (ugh)

We have to start watching D.C. again. The two Continuing Resolutions (CR) that were used as stop-gaps for Congress's inability to pass a budget are set to expire. January 19th is the first expiration. It includes funding for the FDA, Energy and Water departments, Transportation, Housing, and Urban Development (all useless, but we digress). But the spending does include some military and Veterans Affairs (should always be more). The two sides are talking and have actually agreed on the top line budget number. But there is virtually zero agreement on any appropriation bills. If we get passed this one, there is another deadline on February 2. This one includes the rest of government with things like Commerce, Justice, Homeland Security, Labor, Health and Human Services, Education etc (there is still plenty of useless stuff in here, but generally speaking it is more "necessary" than the first bill). The "experts" say that since the two sides are talking, there will probably not be a government shutdown. They will just kick the can down the road again. We suspect our old playbook will be back in force: If there is a negative market reaction to any political noise, it might be a buying opportunity.

- The newest Fed bailout facility is not showing stress but rather stupid government policy

Banks borrowing from the Fed's new lending program (Bank Term Funding Program which was created in the wake of the Silicon Valley Ban blowup) is at a high of about $140b. Normally this would be a bad sign. But the Fed is providing a free arbitrage. Banks can borrow from this Fed facility and immediately lend the money back to another Fed facility and clip 0.50%. No wonder Bobby Axelrod wanted a bank charter so badly.

- Japan is back showing the right signs of life

Services in Japan are accelerating according to the PMI trends. Most of this strength is domestic. And Manufacturing is still lagging (given it is highly geared to international). Paradoxically, the recent earthquake is helping the stock and bond markets. The BOJ (central bank) is not as likely to "normalize" its monetary policy. This is something we have noted the BOJ has already started to slow. Also, fiscal spending is a likely response. This is negative for the Yen (positive for USD/JPY) and positive for equities (which is the composition of our DXJ long). That said, we have been trimming into this recent strength.

- Headline Jobs look strong, under the surface not so much

The December Employment Report looked stronger than expected...before you dig into it. Nonfarm Payrolls increased to 216k. November was originally 199k, but as usual, it was revised lower to 173k. October was also revised lower by 45k. Private Payrolls increased by 164k which compares to 136k last month (which was revised lower from 150k). The ADP guess was exactly 164k…these guys might finally be onto something. 222k of the new jobs were second jobs. Perhaps the most startling stat is that part-time jobs increased by 762k while full-time jobs decreased by 1.5mm! (These numbers do not always add up perfectly on the surface…there are lots of quirks and overlaps in the data. But these tend to cover up weaknesses not add to them!)

Manufacturing fell from 26k to 6k. Naturally, government jobs increased from 37k to 52k. Health Care and Hospitality were also gainers as usual. As we have noted, these are not exactly drivers of economic growth (but they are still a form of stimulus however inefficient). On the plus side, Construction employment was strong. We have noticed this in the Construction/Manufacturing/Factory Spending numbers. The biggest losers were Admin Services, Warehousing, and Credit Intermediation (translation: bankers!). Industrial real estate (including warehousing) has hit its highest vacancy rate since pre-Virus Fear.

The Unemployment Rate remained steady at 3.7%. The Participation Rate fell from 62.8% to 62.5%. This is the lowest level in a year and one of the biggest drops since the Virus Fear (but it is still at a decent level in the Virus-Fear era). This means despite the Rate staying flat, the number of people employed actually declined by 683k.

Average Hourly Earnings increased 0.4% during the month (4.1% yearly rate) which is still outpacing inflation. 3.5% wage growth is thought to be a healthy growth clip that does not impact overall inflation (or at least does not drag other prices higher). The Fed will likely want to see some more wage disinflation. On the other hand, Average Weekly Hours fell a tick to 34.3. The Fed will weigh these two in tandem.

- Jobless Claims fell back to 202k from 220k.
- Challenger Job Cuts continue to trend lower.

➢ ISM Employment plummets

The ISM Services PMI for December was weaker than expected (52.7 falling to 50.6). On the plus side, prices are easing and are back at pre-Virus Fear levels. Business Activity was also strong. But New Orders were weak, and Employment was abysmal. It fell 7.4 points (50.7 to 43.3). It has only been below this level twice in the survey's history: The Global Financial Crisis in 2008-09 and the Virus Fear. Last week we noted that we have been losing faith in these surveys since they have been so wrong for so long now. But the magnitude of this move in Employment is eye-opening. If this repeats next month, we will be more concerned about the economy than we are now. (We have long argued that Employment is a lagging indicator and that high interest rates were going to impact jobs at some point. But recently we have come around to the thinking that the longer the economy can muddle through and adjust to higher rates, then a Housing or Labor crash is less likely.)

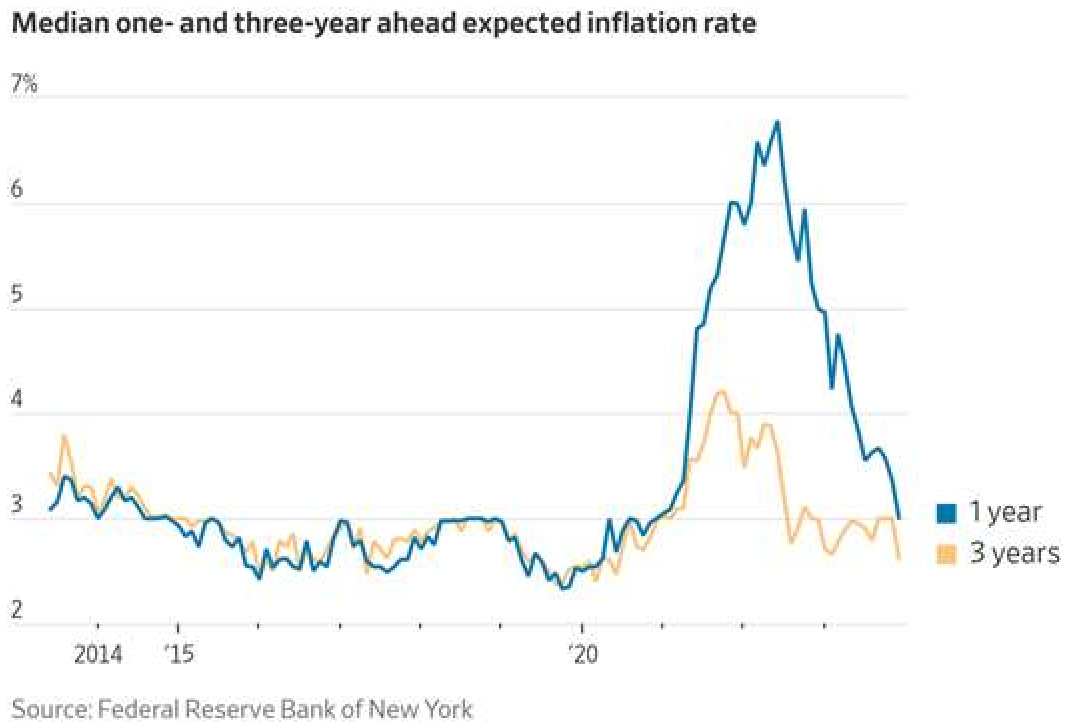
➢ Forward looking Inflation is seen cooling a touch (but not today's CPI)

S&P tells us that global PMIs are showing more disinflation is coming down the pipe. The thick blue line is the current global inflation rate (about 4.5%). The Selling prices for Goods and Services are showing declines to an aggregate level of about 3.7% (Goods around 3% and Services around 4%). Again, these business surveys have not been great predicators recently. But this one's recent data and projection jibe with other disinflationary themes continuing to take shape.

Just this morning, the CPI was a touch higher than expected (0.3% vs 0.2%) and higher than November's 0.1% increase. But the Core CPI remained steady at 0.3% which brings the year to 3.9% down from 4.0%. The headline CPI rate for the year is up to 3.4% from 3.1%. The big surprise in these numbers is the Owners' Equivalent Rent did not drop as expected.

In the US, Used Car prices continue to cool as December prices fell 0.5% vs Nov. This brings the yearly drop to 7%. Of course, your average F150 is still up over 30% in the last four years.

Consumer Inflation Expectations in December dropped from 3.4% to 3%. This one-year measure (a survey conducted by the NY Fed) is the lowest since the onslaught of inflation in early 2021. Three-year expectations are even lower at 2.6% (best since mid-2020).



- Other economic data is better
  - Factory orders increased 2.6% in November vs October's 3.4% drop. The building of factories is more important to monitor right now.
  - Weekly Mortgage Applications moved higher after the terrible holiday numbers. Not much to see here.
  - Weekly Redbook Retail Sales climbed 5.9% vs last week's 5.6% increase.
  - US trade data in November has both Exports and Imports falling a few percent from the October levels.
  - Wholesale Inventories fell 0.2% in November. These monthly moves have been negative for over a year. An eventual restocking could be a tailwind for the economy.
  - China's Services PMI (the private Caixin survey) grew to 52.9 from 51.5. This is the 12th straight positive reading and the strongest since July. We still find it strange that the private survey is stronger than the government one. Even if valid, there is no way we are touching China.

- There is a new Fed member, and another pivots in a different way

Alberto Musalem has been appointed the head of the St. Louis Fed. We do not know much about his specific stance on current interest rates, but he has an impressive and rare background in both monetary policy and financial markets. We suspect this will make him more hawkish than the current market pricing.

Lorie Logan of the Dallas Fed is honing her Fed-speak skills. In the same weekend speech, she floated the idea of needing to slow down the current pace of Quantitative Tightening (QT, selling bonds from the balance sheet). She is worried about the decline in the Overnight Reverse Repo balances (a mechanism by which the Fed injects liquidity into the system). But in the same breath, she said, "We can't count on sustaining price stability if we don't maintain sufficiently restrictive financial conditions." That is, in light of the recent easing in financial conditions (which is comprised of the stock market, the USD, interest rates, and corporate interest rate spreads of Treasuries (which have remained tighter than usual given the outright move in Treasuries), the Fed might not be as ready to cut rates as the market is expecting. But we think her idea to slow QT is more relevant. This directly impacts the economy and the markets, while the Fed Funds target range is more theoretical (as we are currently witnessing given the market's pricing of rates vs the Fed).

- Saudi cries uncle

Saudi Arabia cut its selling prices to all regions including Asia. Chinese demand is faltering. And increased global supply is outweighing the production cuts coming out of OPEC+. Specifically, Saudi cuts its Arab light crude by $2/barrel. It now only trades at a $1.50 premium to the regional benchmark in Dubai which is the lowest in over two years.

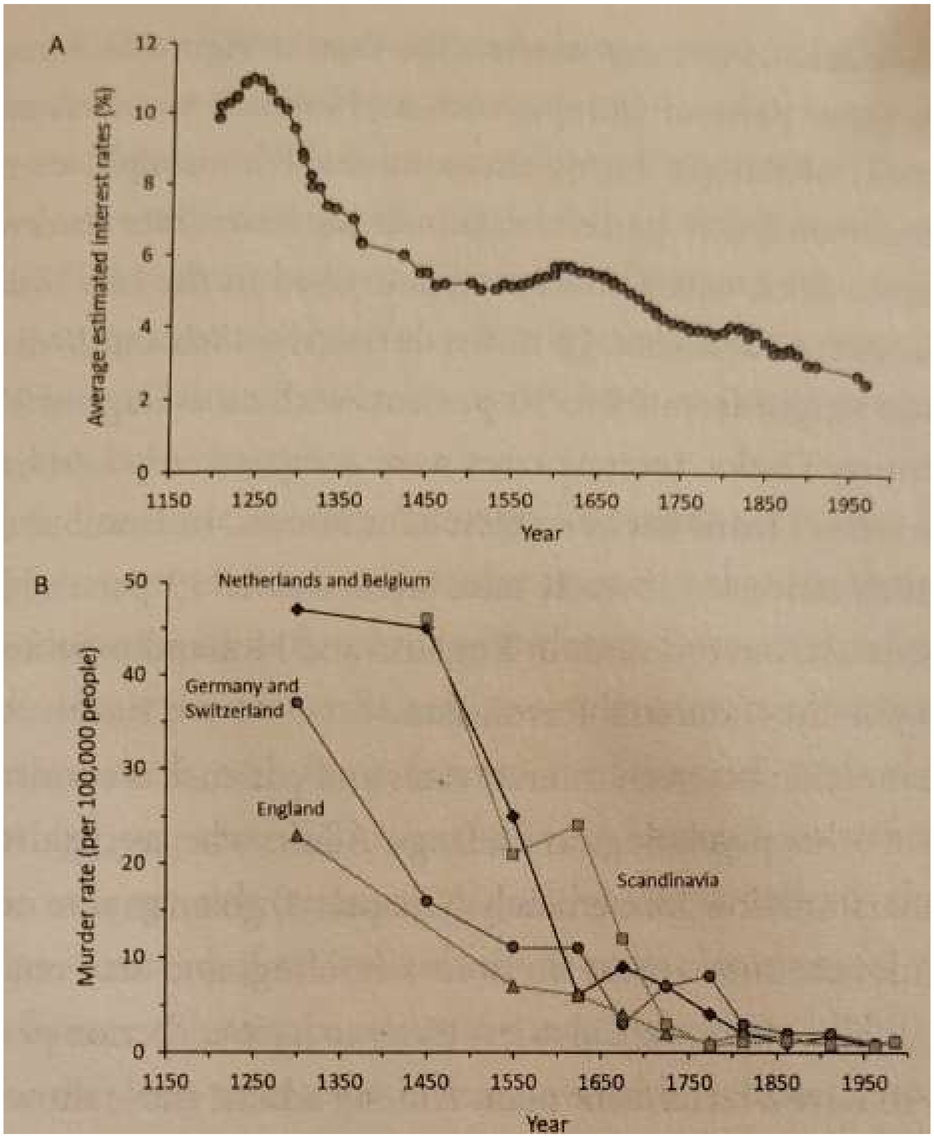
We are still a believer in Energy stocks. Company fundamentals are strong with increased efficiency and steady production. But obviously a weakening demand picture will outweigh global supply tightness (which the US is doing its best to upend on its own) in the short term.

- Where did all the crypto money go?

An Australian crypto scam, HyperVerse, is back in the news. The parent company, Blockchain Global, owes its creditors $58mm. As usual, the company is shrouded in mystery. The Australian media (The Guardian) has attempted to track down the CEO…or at least the man that was identified as the CEO at the scheme's launch in 2021. His resumé included Goldman Sachs, selling a company he founded to Adobe, the University of Leeds, and the University of Cambridge. None of these entities, nor any government agency, has any knowledge of the man the company claimed was its CEO. The company was meant to be a "decentralized metaverse platform with infinite possibilities." Just like the CEO, the money has vanished without a trace.

- Chart Crime of the week

We actually kinda like this one. Other than the obvious lunacy of any 800 year chart, we think there is something to the correlation between interest rates and murder rates. And we like anything from an actual book.



- Quick Hits
    - The NFL accounted for 93 of the top 100 TV broadcasts during 2023.
    - The first blue fin tuna auction of the season in Japan sold for $789k. That is a little over $1500 a pound. This fish is sometimes called Black Diamond…not to be confused with the black apples in India!
    - A 13-year-old beat the game of Tetris. He cleared 1511 lines in 40 minutes. The game then just ended.

Trading: As mentioned, we trimmed a good chunk of our Japanese long. Even with the tailwind provided by the BOJ, the slowing economy seems like a strong headwind. We increased our long exposure to India – it continues to grow with moderate inflation. We added to our long Mexican bank. We bought more of our few consumer discretionary names. And we bought back some of our lone Materials name. We added to one of our natural gas names. We are watching our E&P Energy names.

TSLAQ: The WSJ reported that Musk was going to enter drug rehab in Amsterdam in April. This is a weird story, but the root of it is that Musk is beholden to government scrutiny/rules because of his security clearance operating SpaceX. And supposedly the Tesla board is urging him to seek help, too. We doubt anything comes of it.

Perhaps another reason for his drug intake is the regulators are starting to clamp down a bit on his roughshod manners. On the heels of the investigation that Tesla ignored and suppressed customer complaints about physical defects, the EPA is instituting new EV driving range standards. This change stems from a Reuters report detailing how Teslas do not drive as far as claimed (again, owner complaints drove the reporting). Oddly, Tesla was not defiant and promptly changed its ranges on its website.

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