Weekly Update

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- The market got what it wanted
- Stable Employment, Inflation remains in check, and Powell backtracks
- Treasury auctions are not successes, but the market ignores them
- Another random Fed facility gets tapped
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	Last	5d %	YTD %	1yr %
S&P 500	4,706	3.4%	23.9%	19.8%
QQQ	$403.80	4.9%	52.3%	42.4%
US 10 YR	4.02%	4.12%	3.75%	3.48%
USD/DXY	102.9	104.2	104.5	103.8
VIX	12.2%	13.0%	22.9%	21.1%
Oil	$69.80	0.6%	-13.4%	-9.0%

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

The market got what it wanted this week. There was a stable Employment Report, Inflation remains in check, and Fed chairman Powell gave the all clear to continue with the everything-rally (except for commodities). We actually thought these important data points showed more economic strength than Powell would like to see. But he proved this theory wrong during his press conference following the Fed's interest rate meeting (FOMC). The highlight of the meeting (during which no change was made to the current 5.25%-5.50% Fed Funds target range) was a lower median expectation of interest rates next year. The so-called "dot plot" now forecasts

(Powell does not like to call it a forecast) a rate of 4.6% by the end of 2024. The market had been pricing about 50bps of rate cuts not 75bps. The highlight of the press conference was Powell proclaiming that the Fed will have to start reducing the restrictive monetary policy well before inflation hits the 2% target. Previously, Powell has stated that inflation will have to hit the target and stay there before policy can loosen. Along these lines, Powell admitted the committee has started discussing when it might be appropriate to start cutting rates. For all of Powell's protestations about misinterpreting recent Fed comments – specifically he warned about expecting rate cuts any time soon – he came out and said the opposite. Of course, he gave all the requisite disclaimers about having to watch the data and that there is always the possibility of a rate hike if things change. But for now, Goldilocks is the name of the game (not too hot, not too cold…just right).

Of course, even if we assume all is well from the Fed's perspective, there are still lingering sore spots in the global economy. Japan might be hiking rates sooner than thought, China's economy is suffering from deflation, and Europe is doing better but still poorly. Oil is still signaling recession. The US government is still chaotic. The appetite for new US debt is still less than ideal. The consumer's credit card balances (and increasing delinquencies and defaults) are becoming unsustainable on the lower end.

As we have been saying, our base case is mild economic weakness. And with time (and now the Fed) on its side, it can muddle through a little bit better.

- Treasury auctions are not successes, but the market ignores them

Treasury held three auctions this week (we recently lamented the unfortunate turn that the market must watch Treasury auctions). The 3yr and 10yr auctions were both considered fairly poor. But the 30yr auction was deemed to be strong (or at least not as bad as feared compared to the previous ones). Oddly, the 3yr and 10yr yields improved (moved lower). And the 30yr did the opposite. This mostly tells us we can go back to not watching every detail of every Treasury auction.

- Another random Fed facility gets tapped

The Fed's Standing Repo Facility (SRF) was tapped by banks this week. The amount was only $200mm. But if this emergency borrowing were to expand, that would be a worrisome sign. There is a chance this was a new bank to the system (you have to sign up for it) just doing a test run. The $200mm reduced back down to near zero the next day. But this is something to watch.

- The Bank of Japan cannot make up its mind

The macro story is becoming quite fluid in Japan. First, the Bank of Japan (BOJ) indicated it was going to tighten monetary policy. Then after a quick strengthening of the Yen (USDJPY weakened) along with a weaker Nikkei stock market, the BOJ leaked a story to the press saying inflation was probably under control and hikes were not yet necessary. This supports our theory that the BOJ was going to remain dovish (keeping rates low) and thus supportive of Japanese equities (especially those denominated in JPY, ie long USDJPY). Of course, the volatility in the BOJ's message gives us some pause.

- More detail on recent Japanese monetary policy

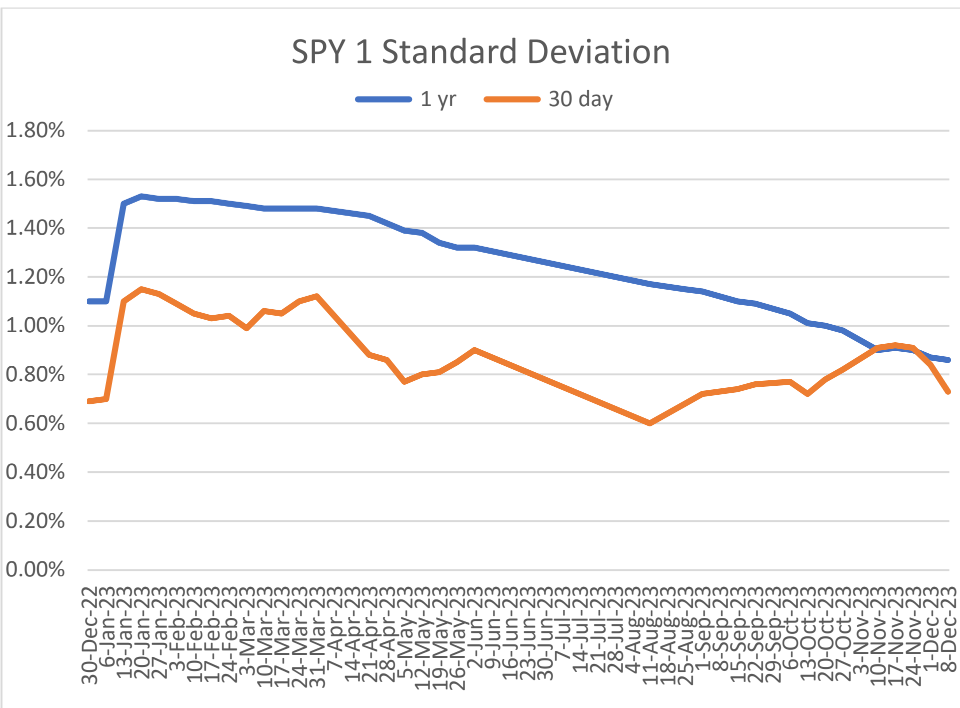
The BOJ has been nudging the market towards higher interest rates all year. And nudge might be an overstatement. But on Friday, the head of the Bank of Japan (the central bank, BOJ), Kazuo Ueda, said his job was going to be more challenging from the year-end. This was accompanied by one of his deputies playing down the effects of a rate hike. And the BOJ has been surveying market participants to get their feedback on potential rate hikes. The market quickly priced in a 45% chance that the BOJ would hike in December. Last week, this percentage was about 3%. Moreover, government bond (JGB) auctions have been doing poorly (lower demand and higher rates). But the apparent reversal in the BOJ's stance, at least for the December meeting, has slashed this probability back down to 8%. This is some manic trading! We would add that the BOJ's reversal makes sense. Japan inflation is largely impacted by the nationwide wage negotiations that take place in March and April.

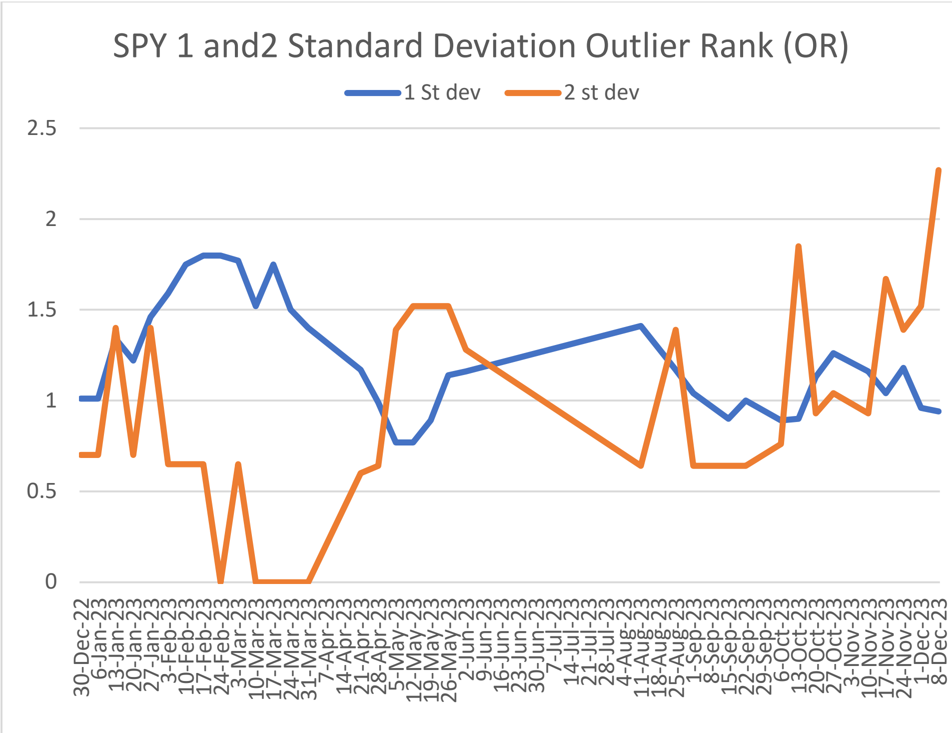
- Random market tidbits

A few noteworthy items: There is a proposed takeover of Macy's on the table. This is likely some sort of ruse to boost the stock price temporarily. Cigna is abandoning its pursuit of Humana. Oracle and Adobe both reported earnings that disappointed investors (both reflect business spending trends). This week's option expiration is going to be one of the biggest on record. It is thought that the dealers are long a lot of these options which is suppressing market Volatility (they are long gamma and thus sell rallies and buy dips…counter to their more manic and more common short gamma positioning).

- Short-term Vol reverses lower

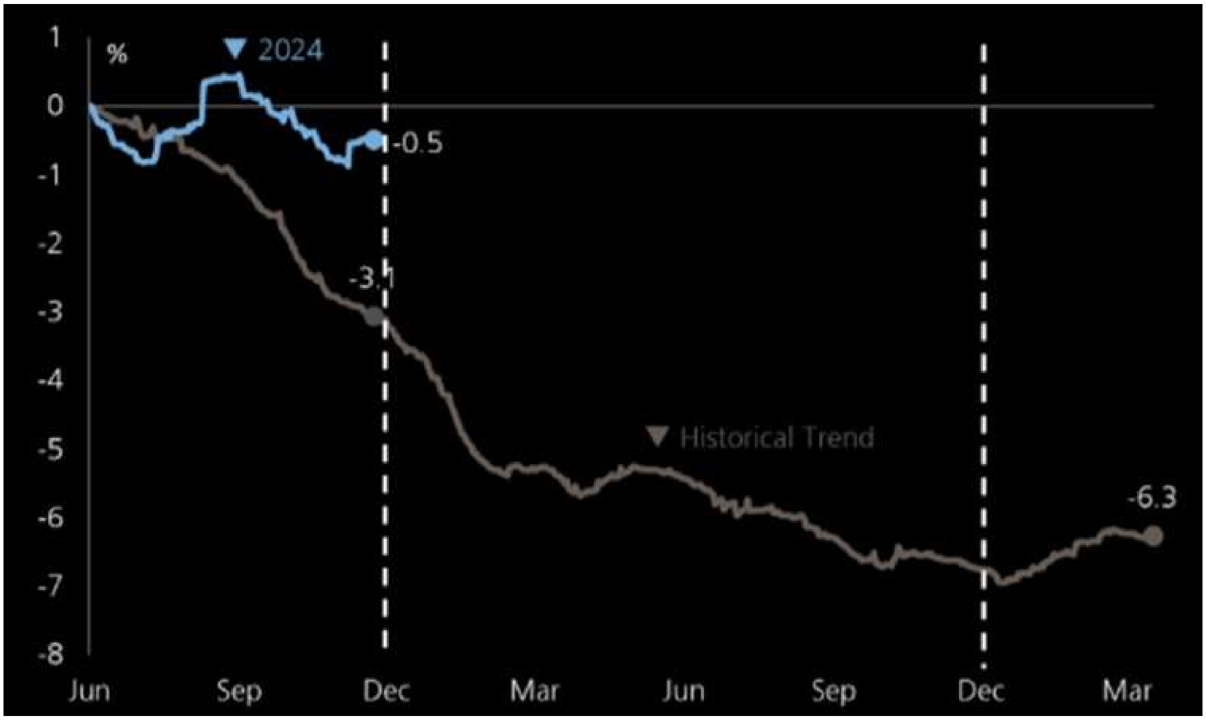
About a month ago we noted how 30-day Volatility had crept above 1-year Volatility. This was true for the broad index (S&P 500) and junk stocks (ARKK). This trend has now reversed (completely for the market and almost there for ARKK). This is not too surprising because Volatility always seems to sink in December. However, large Outliers (more than 2-standard deviations) are on the rise for both the market and junk. Our interpretation: It takes a lot to jaw investors awake during the usual sleepy December. But when it does strike (it=news), things move more than expected.





- Earnings estimates are better than usual

We have doubted some of the Earnings estimates for 2024 and beyond. But it appears that some of this is rooted in companies's projections. As you can see in this unlabeled chart from UBS (courtesy of themarketear), EPS revisions are remaining above the seasonal trend. That is, companies usually start to guide their earnings lower…they are always going for the UPOD (under-promise and over-deliver). But they have not done this recently. The cynics out there say to never trust management.



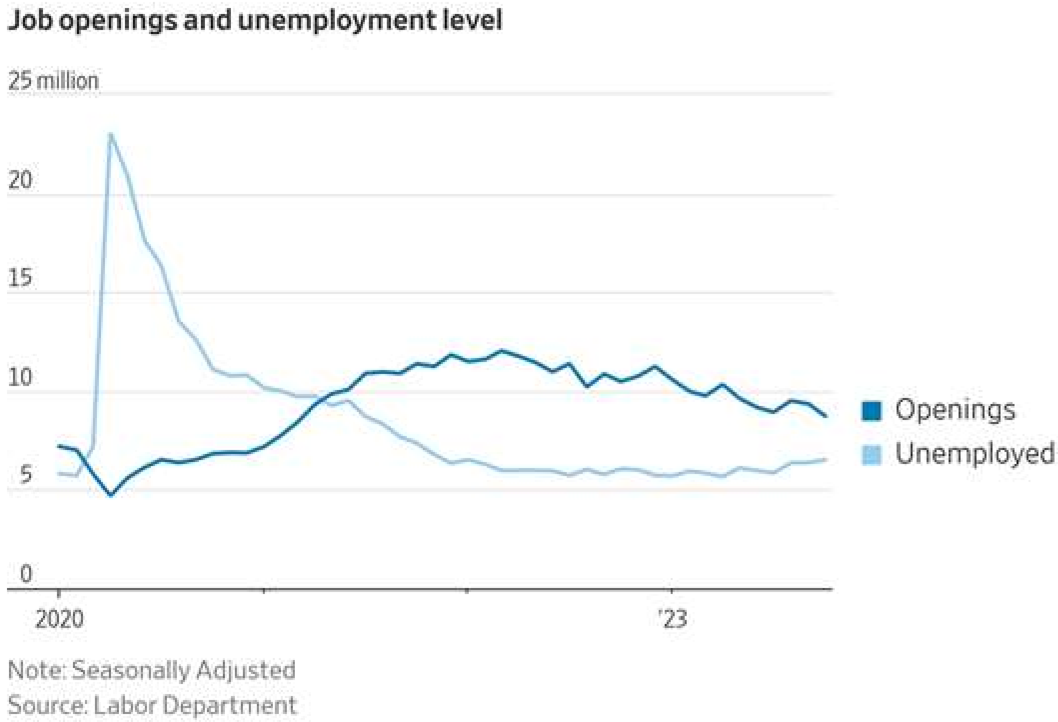
- Employment is hanging in there

The November Employment Report surprised on the upside with 199k jobs added. October added 150k. The official expectation was 180k, but this was probably seen as too high after the lower-than-expected ADP report earlier in the week. September payrolls were revised lower (what's new) by 35k, but October was left the same (for now). Private Payrolls were better than expected, but they were also revised lower in October. Government jobs decreased in November, but the October number was revised higher.

The Unemployment Rate dropped to 3.7% from 3.9%. This was a surprise. This equates to an increase of almost 750k more people working in November (recall that this survey counts people working rather than jobs…no double counting). Many having been pointing out the weakness in this Household survey as being more telling than the Nonfarm Payrolls data (us included). Even if we adjust the methodologies between the surveys, this is still an increase of about 480k jobs. 30k jobs were added thanks to the end of the auto worker strike. Healthcare, again, was the biggest gainer of jobs. The Participation Rate improved a tick to 62.8%. The rate for prime-aged workers (25-54 years old) held steady at 83.3% (which is near its all-time high).

Average Hourly Earnings increased in the month +0.4% versus the previous +0.2%. The annual change is the same at 4%. This is one area that has worried the Fed. They have stated that they think most structural inflation is driven by wages. This has likely been the driving force behind Fed chairman Powell's resistance to rate cuts. We are not sure what has changed his mind (some opine that it is the PPI).

And there is some peripheral data that is not as rosy: Wells Fargo points out, "There are signs that the margins of the labor market are deteriorating, with job gains being more narrowly driven, temporary help employment declining and laid off workers taking longer to find new employment."



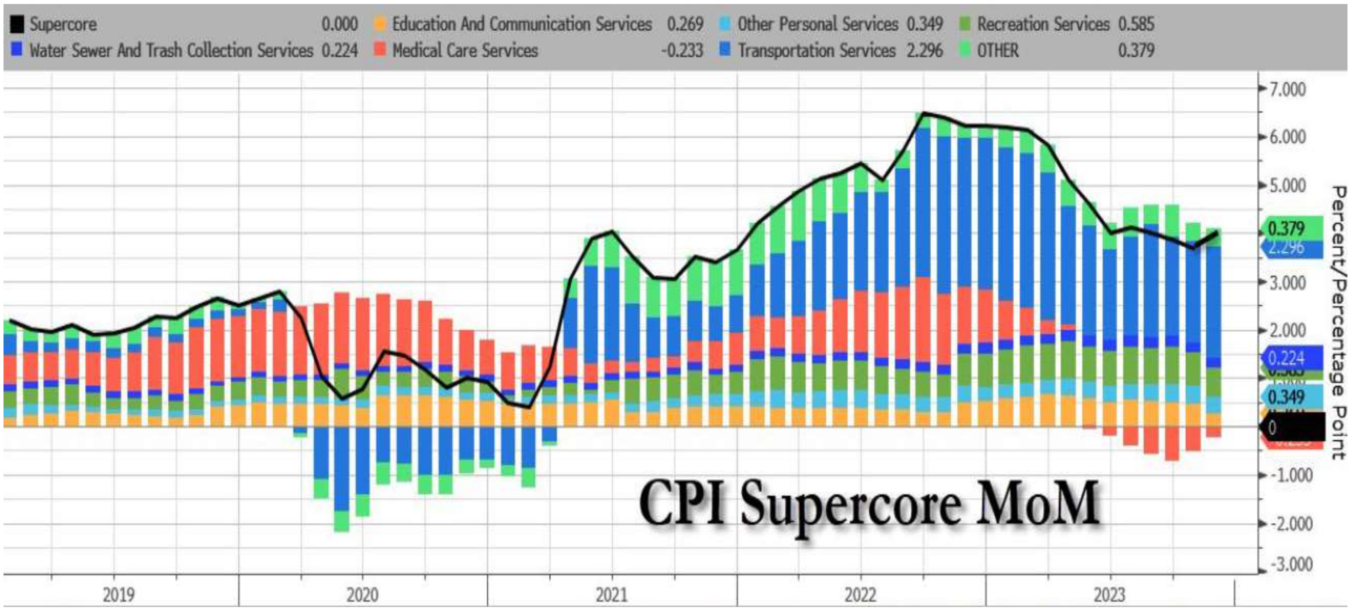
The Challenger Jobs Cuts data is an overlooked but often interesting set of data. In November, the number increased to over 45k announced cuts. This is up from almost 37k in October. This bump notwithstanding, the data appears to be trending lower (with the peak of over 100k being Jan of 2023).

Continuing Jobless Claims dropped last week after shooting higher previously. We will have to see is the march-higher trend is changing or if this was just a one-off.

- Inflation ticks higher

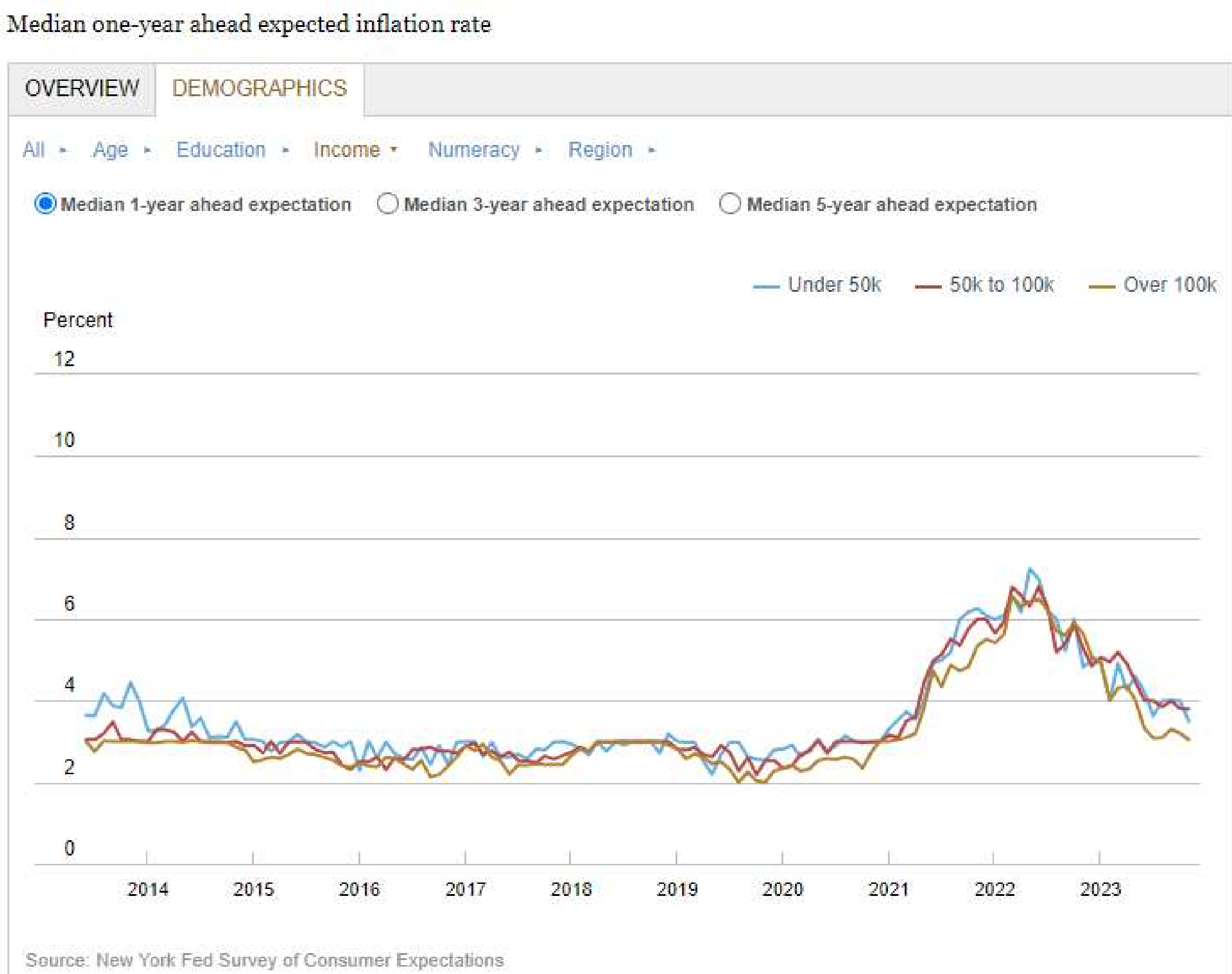
Inflation ticked up in November. The headline CPI (Consumer Price Index) increased 0.1% vs 0% last month and 0% expected. The Core was higher with a 0.3% increase vs the 0.2% move in October. The market was forecasting this 0.3% move. This brings the yearly rates to 3.1% on the headline and 4.0% on the Core. The largest gainers were Natural Gas (piped/utility gas service), Used Cars and Trucks, and Electricity. Gasoline, Fuel Oil, and Apparel dropped the most. Just outside of the top moves were Owner's Equivalent Rent and outright Rent. The components of Food are still diverging. Food Away from Home increased 5.3% over the last year while Food at Home only increased 1.7%.

We know one of the carve-outs that the Fed looks at is the SuperCore. This is Core Services ex-Housing. Whether you call this stable or slightly accelerating, it does not seem to be on a path to the Fed's 2% target. But It is worth adding that the Core PPI (input/wholesale prices) was flat on the month and are only up 2% on the year. PPI is thought to be a leading indicator.



- But Inflation Expectations continue to drop

Even with the slight uptick in infaltion (or at least a flattening out of the recent decreases), expectations continue to fall. The Fed explicitly looks at expectations (Powell made sure to highlight it today). This data shows that wealthier people (those in NYC etc might argue with a $100k salary being deemed wealthy) expect inflation to drop further than everyone else. This matches with credit card spending and other broad data. Nonetheless, expectations as a whole continue to drop.



- Other economic data is better
  - Mortgage Applications increased for the sixth straight week.
  - Wholesale Inventories in October fell -0.4% from flat in Sept.
  - Consumer Sentiment for December increased sharply. This is the survey more geared towards inflation (gas prices play a large roll).

- More deflation in China

The struggling Chinese economy is playing out with deflation taking hold. November was prices accelerated to the downside at a 0.5% clip (this is the monthly and annual rate). This is up (in negative terms) from the -0.2% fall in October. Core prices are still positive thanks to Energy prices. But we know where these are heading. The PPI (Producer Prices or wholesale or input) fell 3% vs last year.

- More notes from Fed Powell's press conference

- There is no imminent change to the Quantitative Tightening program (QT, Fed selling bonds). Reverse Repo Facility has been coming down quickly.
- The Labor market is in better balance (still remains tight). Claims are low. Shortage of labor has been alleviated. Openings are down, Quits are down. Participation up.
- This inflation was not the typical "demand overload."
- Real wages are now positive which might help consumer sentiment. But price stability is key.
- The dot plot: 4.6% end of 2024, 3.6% at the end of 2025 and 2.9% end of 2026

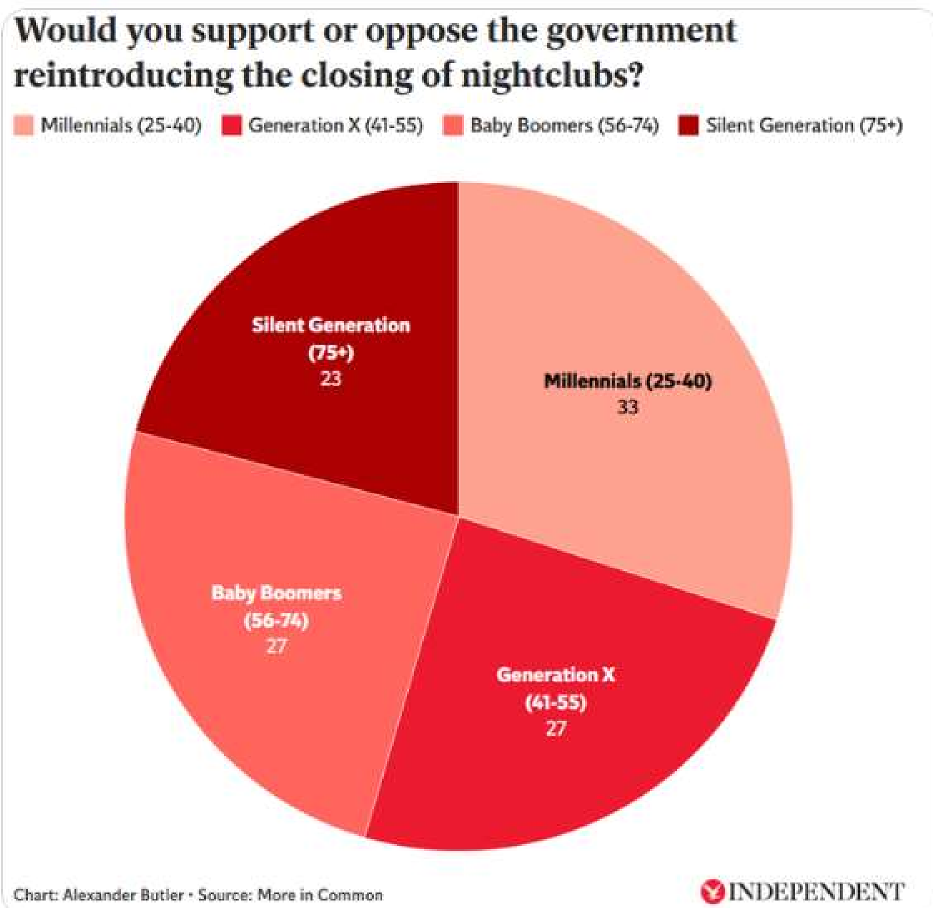
➢ Where did all the crypto money go?

Two weeks ago we described the nonchalant attitude of the criminal enterprise Binance with respect to its money laundering. We guess it should come as no surprise that the failings of "Know Your Customer" laws also include funding terrorism. The Chief Compliance Officer acknowledged in a chat with a colleague that Hamas normally sent "small sums" and that they could "barely buy an AK47 with 600 bucks."

Otherwise, it is worth noting that $1.7b was stolen from crypto companies in 2023.

➢ Chart Crime of the week

When will people learn that the slices of a pie must add up to 100! (The crime here is using a pie chart…the different response rates are all independent from each other.)



- Quick Hits
    - Two academians have written a paper declaring that there was insider trading before the Hamas attack on Israel.
    - The former CEO of Charter Communications, who is still on the board, sold $100mm of stock two weeks before the company reported crappy earnings.
    - After the bank KISS hangs it up at the end of their current tour, their avatar images will keep touring. ABBA has done this and makes $2mm a week.
    - Bitcoin mining uses more water in a year than New York City.
    - The US government is suing a moving company for age discrimination. It needs to hire more old people and fewer college students, apparently.
    - When NBC acquired NFL rights from ABC, Al Michaels was stuck in his contract with the latter. The two networks struck a deal for Michaels to move to NBC. ABC would get Ryder Cup coverage, increased Olympics highlights, and the rights to Oswald the Lucky Rabbit.

Trading: Not a lot of trading. We added a little to our Energy, Latam, and specialized Consumer Discretionary longs. Recently we said were going to tiptoe back into buying Put protection. We think we will put that back on hold given the momentum in the market. That is often the time to buy protection (when Vol is low and happy emotions are running high)…but we think the shift in Powell's message could be a tailwind for a while. Moreover, this euphoria tends to land squarely on the most shorted stocks. So, we will steer clear for now.

TSLAQ: The NHTSA (not to be confused with the NTSB) ruled that Tesla must recall 2mm cars to fix its dysfunctional "Autopilot" vaporware: "Automated technology holds great promise for improving safety, but only when it is deployed responsibly." Tesla claims this glitch can be fixed with an "over the air" software fix. The NHTSA will be monitoring the progress.

A Cybertruck fanboy posted a video praising the truck, "looks good out there in the snow and hauling that Christmas tree." Alas, the video was of a Cybertruck stuck trying to get back on the road. It had to get towed by a Ford F-150.

Speaking of fanboys, Morgan Stanley (the bank on the hook for Musk's margin loans and Twitter's junk bonds) thinks Tesla might lose money next year!

Tesla announced it is, indeed, losing the $7500 tax credit for most of its Model 3s. And Tesla cut the price of the Model Y by another $1k this week.

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