Weekly Update

27-October-2021

Carlisle C. Wysong, CFA
Managing Partner

- The market's grind higher continues
- Do Earnings correlate with market performance in the short-term? In normal times, no
- Business sentiment is improving
- Housing data continues to rebound
- The Fed is slowly backing away from its inflation call, the market did a while ago
- Do not let oil Volatility overshadow the fundamentals
- Chart Crime of the week
- Click here for the full note

	Last	5d %	YTD %	1yr %
SPX	4552	0.3%	22.4%	35.7%
QQQ	375.0	1.3%	21.5%	36.2%
US 10 YR	1.54%	1.66%	0.92%	0.83%
USD/DXY	93.9	93.6	89.9	93.4
VIX	17.0%	15.5%	22.8%	40.3%
Oil	82.11	-2.1%	70.4%	108.9%

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

The market's grind higher continues. Last week we commented that Earnings have been strong, and the negative narratives had all receded. Well, not much has changed. Total Earnings growth has accelerated from 33% last week to 37.6% this week. Just as importantly, some of the big misses and/or warnings seem to be stock specific (notably Intel has huge capital spending ahead and Facebook/SNAP will have to navigate Apple's new privacy settings). Politics are still a nonevent as more gridlock seems like the base case (the Dems cannot even agree on tax increases…that is a first). People are still fearful of credit in China. But most think any problems will be isolated. Inflation is still top of mind, but many companies have started to say either logistical problems are being resolved or pricing power is being maintained. The Fed's impending taper actions are fully telegraphed. And even interest rate hikes are starting to be discounted. The probability of a rate hike as early as June is now 50% (a month ago it was a 20% chance). But interestingly, the yield curve has flattened over the last week. Typically, this would point to a weakening economy. But most of the data still points towards a reigniting of growth after the delta-variant lull. We suspect this is just short-term trading noise. If anything, we will use any weakness on the back of this to add to our Reopening plays.

- Do Earnings correlate with market performance in the short-term? In normal times, no

Here is a table from Schwab/Ned Davis Research that shows trying to time the correlation of earnings strength and market strength is virtually impossible. Of course, we do have an active bet on earnings and economic growth right now. Our qualifier is that today's growth rate (in the top bracket) is from an almost standstill position, so they are not apples to apples. Otherwise, we would certainly agree with positioning against the flavor of the day (we are not momentum traders).

S&P 500 earnings* (y/y % change)	S&P 500 annualized gain (3/31/1927-6/30/2021)
> 20%	2.4%
10% to 20%	8.1%
-10% to 10%	8.6%
-25% to -10%	26.7%
< 25%	-19.0%

Source: Charles Schwab, ©Copyright 2021 Ned Davis Research, Inc. Further distribution prohibited without prior permission. All Rights Reserved. See NDR Disclaimer at www.ndr.com/copyright.html. For data vendor disclaimers refer to www.ndr.com/vendorinfo/, as of 6/30/2021. *Based on trailing 12-month earnings in accordance with GAAP (generally accepted accounting principles.). Past performance is no guarantee of future results.

- Business sentiment is improving

The Flash Composite PMI (early read on the business surveys) rose two points in October vs September (57.3 in Oct vs 55.0 in Sept). It still sits below the spring and early summer spike. But it seems to be rebounding from the late summer /early fall malaise stemming from the delta variant. Services had a stronger bounce which is not surprising.

The regional Fed surveys for Manufacturing echo this general sentiment. Activity is better but not where it was earlier in the year. The Philly Fed Manufacturing Index missed expectations and fell. But the Dallas Fed Manufacturing Survey jumped higher. It is still well below the spring/early summer levels. The same holds for the Richmond Fed Manu Index which climbed out of negative territory.

Durable Goods Orders slipped in September compared to August. And August was revised lower. Autos were the weak spot (obviously given the chip shortage). But Core Capital Goods, aka business spending, increased.

The Eurozone Flash Composite PMI for October dropped about two points vs September. It hit a six-month low. It is still soundly in positive/expansion territory (54.3). But it also is a clear laggard to growth in the US.

- Housing data continues to rebound

Existing Home Sales in September increased more than expected to an annualized run-rate of 6.29mm units. This is a 7% increase vs August. The median home price increased to about $353k which is up 13.3% vs last year (but still the smallest annual gain all year). Inventory dropped by 13% to 1.27mm homes which is just 2.4 months of supply. Million-dollar homes are leading the charge as home sales under $250k are lagging. This data is from signed contracts in July and August.

New Home Sales in September jumped to their highest levels (800k) since March of this year.

It seems to us that Housing has turned the corner from the brief summer pause. Supply chains and pricing are still impediments, but demand remains robust. If this trajectory continues, we will likely get off the sidelines (and buy some Housing stocks). But we will need to see the Housing Permits rebound. This leading indicator is still slumping.

- The Fed is slowly backing away from its inflation call, the market did a while ago

Even though we think the market has come to terms with the Fed's impending actions, that is not to say there will not be any Volatility. Powell spooked the market a bit when he said, "the Fed will raise rates if we see serious risks of higher inflation expectations." This is not news. But it does show the underlying nervousness of investors. Powell added, "it's time to taper…not time to raise rates." Of course, the market is seeing more inflation than the Fed.

The Fed line of the year belongs to Fed governor Randal Quarles. He said, "transitory doesn't necessarily mean short lived." But he held the company line with "longer-term inflation expectations are anchored, at least for now." Frank Drebin would be proud.

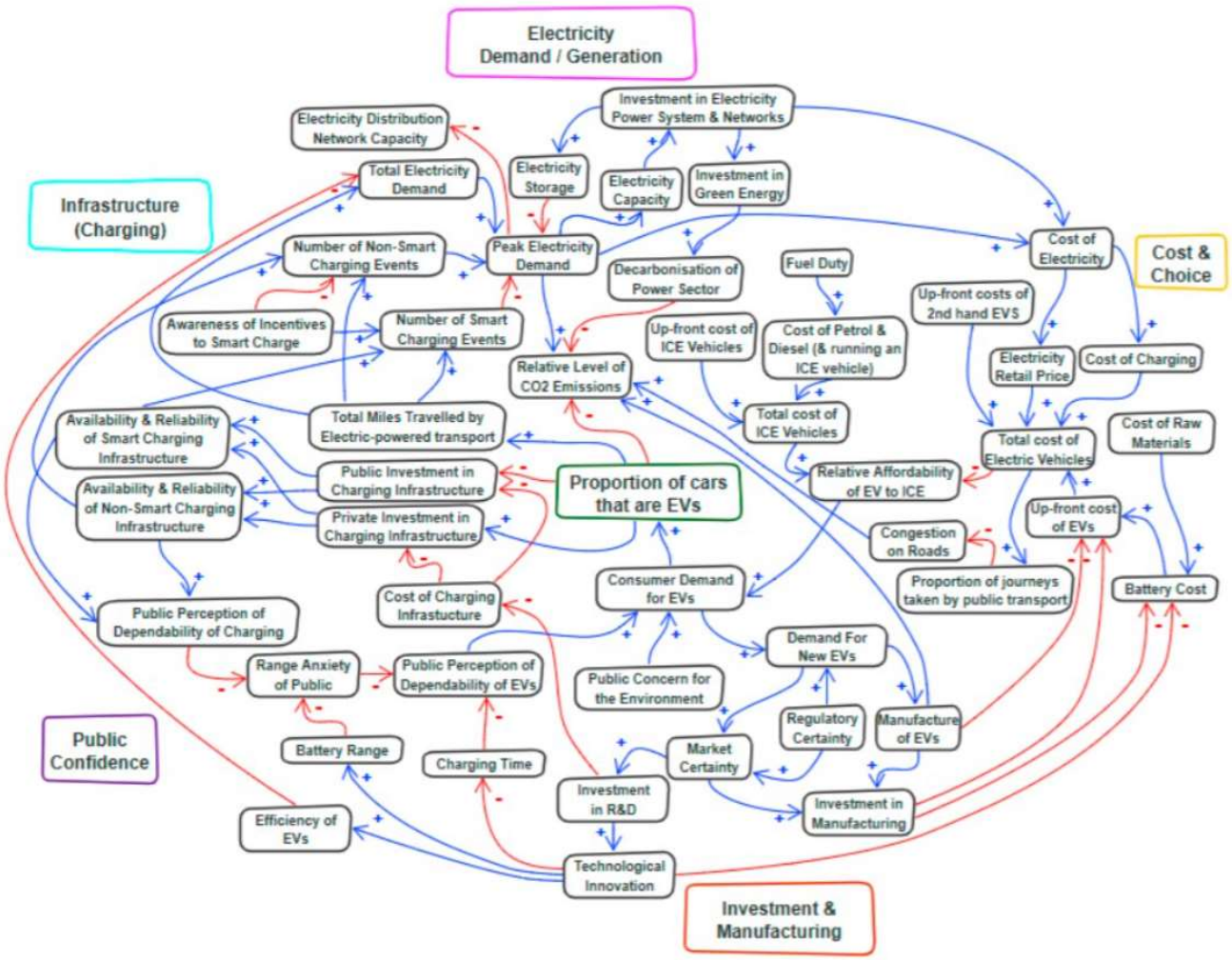
- Do not let oil Volatility overshadow the fundamentals

Oil pulled back from its recent highs. The short-term narratives are that Iran will be able to bring oil back onto the market in the coming months and crude inventories ticked higher last week. We think Iran production is already priced into the market (if not already literally on the market thanks to the Chinese and Indians). And a single week of inventory depletion does not rectify the ongoing struggle for oil at the Cushing storage facility. Some think Cushing could run out of oil in storage in the coming weeks. The facility has a total capacity of about 77mm barrels. Current inventory is about 35m. And the tanks are not supposed to go below 20mm to keep operating efficiently.

And while we think demand is strong, Merrill thinks this oil rally is strictly a supply-side issue. They base this on narrowing crack spreads (essentially refinery margins…if they are shrinking, then there is not enough demand for petroleum-based products). Goldman says this is explicitly a demand-side issue. This is an interesting debate. If ML is correct, then history tells us that the broad market will suffer. Conversely, the market will rally if GS is correct. We side with GS in the short-term. This jibes with our view of the economy (strong now with slowing around the corner). Of course, supply has been ratcheted back as we have discussed (oil companies now strive for profits and cash flow instead of growth at all costs). Below is the divergence we often site:

- Chart Crime of the week

This is from an official UK government paper about electric vehicles (EVs) entitled, "The Journey to Net Zero." Net Zero Common Sense?



- Quick Hits
  - Turkey cut interest rates by 1% to help with inflation (again, they have it exactly backwards)
  - Bloomberg ran a scary headline about an outbreak of salmonella in the US. It is about six people per state.
  - Roth Capital has a Neutral rating on Tesla. Roth's target price calls for a 75% drop in the stock. Neutral?
  - House leader Steny Hoyer, when asked about the estate tax vs a wealth tax, responded, "I am not a tax expert."
  - Bank of America wants to get out of the business of distributing unemployment benefits in California like it has in other states. California will not allow them to exit.
  - It is rumored that Jeff Bezos is building/buying a $500mm yacht.
  - A whistleblower in the bank scandal involving the rigging of interest rates (LIBOR) was awarded $200mm.
  - There have been 1000 interest rate cuts globally since the Lehman collapse in 2008. That is one every three trading days.
  - There is a Wall Street analyst name Mercedes Bent.
  - A juror in the Holmes/Theranos fraud trial was dismissed for playing Sudoku during testimony.

- The top five cities in the Emerging Housing Markets Index are Elkhart, IN, Rapid City, SD, Topeka, KS, Raleigh, NC, and Jefferson City, MO.

Trading: We were a little busier trading this week. We did not make any grand moves. But we put on some Volatility trades, added to some of our long-term names, trimmed some trading names, and tweaked our Put exposure slightly higher. We find ourselves right in the middle of the debate on our Protection. We think the market continues to grind higher and Protection is just a waste of money. Of course, tit is almost always in these moments when you need it most! So, we will start to slowly add back in what we took off over the last month.

TSLAQ: Tesla rallied $175b on Monday because of news of a $4b contract with Hertz. Never mind that fleet sales have traditionally been albatrosses around the necks of automakers (high services costs combined with low sales prices). And options contracts in Tesla accounted for more than 55% of the entire options market. Needless to say, the YOLO mania is back. Some option experts think much of this momentum will fade this Friday. Seems crazy to pinpoint a call that precisely, but the idea is that much of the Call buying has been focused on this week's expiration. Of course, these same gunslingers can just buy more options in the coming expirations. Who knows, this is not a game we have a high degree of confidence in playing. We have a tiny, direct short via Puts. We will not be adding until this lunacy slows. We are even tempted to get long! We actually have some long, indirect exposure via the broad market. Keeping this balanced makes the most sense to us right now (don't get us wrong, Tesla will collapse in spectacular fashion at some point…the question is when).

Check out our website to learn more about Chalk Creek Partners

Carlisle's Twitter Financial List

Carlisle's LinkedIn