Weekly Update

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Carlisle C. Wysong, CFA
Managing Partner

- The old bogey man is the new bogey man all over again
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- Metals and Miners might suffer
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- The divergent Philly Fed surveys say it all
- Housing remains sluggish with no supply and high prices
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	Last	5d %	YTD %	1yr %
SPX	4481	-1.6%	18.2%	35.9%
QQQ	378.1	-2.1%	18.2%	38.9%
US 10 YR	1.31%	1.30%	0.92%	0.68%
USD/DXY	93.4	92.5	89.9	94.4
VIX	20.9%	18.2%	22.8%	28.5%
Oil	71.96	-0.9%	48.9%	82.4%

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

The market has started to show a little bit of Volatility, and the old bogey man is the new bogey man all over again…China. With worries about the Communists's crackdown on free society seemingly fading to the background (unless you are still lugging shares of anything Chinese), China's largest property developer may or may not make a bond payment tomorrow (more on this below). But the real reason for the market turbulence is more likely rooted in all the other narratives that have been swirling and growing. The Fed is getting close to reducing the monetary accommodation. Earnings and Growth have likely peaked. Political gridlock is only intensifying in DC. And if the Dems do get legislation passed, it likely will not have the direct stimulus effect from the pandemic measures. But it will have the growing debt load which dampens growth along with a tax bite. The debt ceiling is about to be breached with little compromise in sight. Typically, we like to trade against short-term noise. But all these combined makes for a powerful force. And all this while the market is stretched long both in terms of Gross exposure (leveraged) and Net exposure (directional).

- China Evergrande is a mess, and so is China

China Evergrande and its potential if not imminent collapse has been making the headlines recently. Of course, this has been a developing story for months. The health of the giant property developer has been deteriorating with its bond prices reflecting this since June when it first started to crack. Currently, the company's bonds that are due in six months are trading with a yield of 650%. So yeah, the market does not expect this entity to continue without a restructuring. Of course, the Communists will surely bail out this company. The company is too intertwined with the masses. It has contracts (with down payments) to deliver 1.6mm apartments which it has not built. And in the spirit of American cross-selling, the company pitched and sold wealth management products to residents in its developments. Moreover, the company forced employees to lend the company money. But the company has squandered this money and is offering to deliver apartments to these investors/lenders/employees. The point: China will not let this company fail. Thus, there is not "systemic risk" like some pundits have posited. None of the standard interbank risk parameters showed any stress whatsoever (the rate at which banks lend to each other is the ultimate signal for stress in the financial system). That is not to say that the company's demise will not ruffle some financial feathers. Foreign hedge funds that lent to the company will surely find themselves at the back of the queue. Other Chinese property developers that foolishly chased riskless returns will find out that there was risk (and lots of it). And investors that have been overleveraged in general might have been or will be squeezed out of positions by internal risk managers or external prime brokers / custodians. Margin requirements can and do change at the drop of a hat without any rhyme or reason. So, there are certainly contagion risks. And China has been one big lie-filled bubble basically forever. But we do not think this causes a market crash. But it very well might play into the slower growth theme towards which we have been leaning. The other point here is to not trust the Communists.

- Metals and Miners might suffer

One quick takeaway from this China Evergrande mess is the pressure it puts on metals and mining companies. With some local Chinese governments disallowing fire-sales of properties to raise cash, the odds of continued residential property development are extremely low. In fact, China is now imploding unfinished high-rise apartment buildings. Add on to this the desire of the Communists to mask the pollution problem ahead of the 2022 Beijing winter Olympics, and the downward pressures will continue. We are long commodities, but not these companies.

- Some Dems are gunning for the ETF industry

Back to domestic tax policy, some Dems are targeting a new tax hike: eliminating the capital gains loophole that ETFs currently enjoy. We have discussed this topic before: mutual funds are structurally bad investment vehicles. Holders of record must bear the tax liability for realized gains even if they did not hold the fund when the gains were made. ETFs have a carve out that allows them to reset the capital gains without incurring any tax liability. (Vanguard is the lone exception in the mutual fund world…they somehow have a patent on doing "heartbeat trades" that also resets their capital gains.) We doubt this tax will gain any traction. But if it were to pass, it would wreck the ETF industry. This could make for some good short ideas. But it would also make the markets less liquid and more inefficient.

- Retail Sales surprisingly grew

Retail Sales surprisingly moved higher in August. They grew at 0.7% vs July compared to a 1.8% drop in July (vs June). The expectation was for Sales to continue to drop (-0.8%). Autos are still the drag as ex-Vehicles increased 1.8% vs July.

- The divergent Philly Fed surveys say it all

The Philly Fed Manufacturing Index for September surged higher to 31 from 20 in August. The Philly Fed Nonmanufacturing Index for September sank to 10 from 39 in August. This divergence fits the current narrative that physical goods are in high demand while some people are slinking away from civilization all over again.

- Housing remains sluggish with no supply and high prices

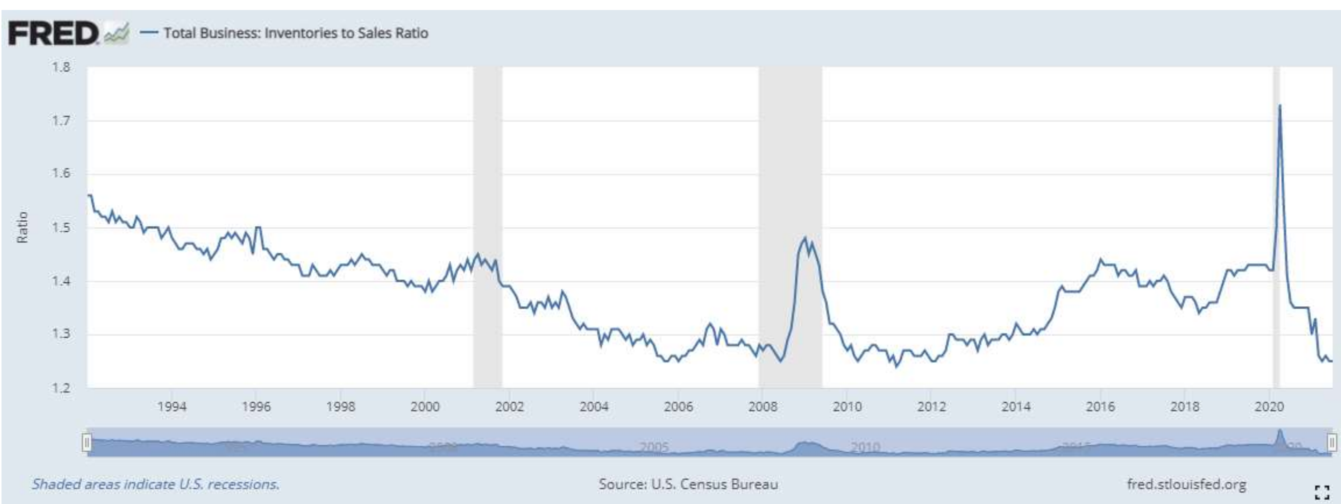
The Housing Market Index showed a tiny increase in September vs August. This is the homebuilder index. They see an increase in traffic as the strongest point of the market right now. But supply and price are still impediments to growth. The index is sitting right about where it was pre-virus.

Housing Starts and Permits both increased in August. Both data sets have been very choppy since the peaks earlier in the year. But the recent strength has come in the form of multi-family. Single family Starts fell 2.8% in August while the multi-family increased by almost 22%. The same relative trend shows up in Permits.

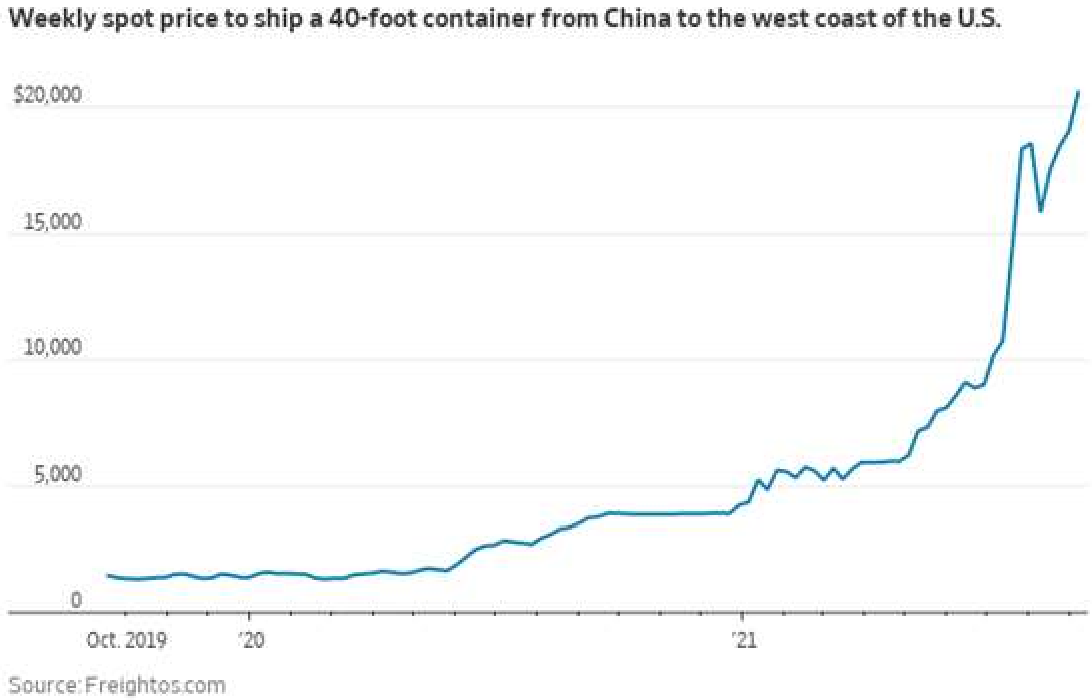
And the Housing trifecta was met with a 2% decline in Existing Home Sales in August vs July (and -1.5% vs August last year).

- Business Inventories remain Slim (and Slim left town)

Business Inventories remain at extreme lows. As a percent of Sales, the current level is back to the levels just before and after the World Financial Crisis (2007-2009). Some of the long-term trend of inventories shrinking is a function of just-in-time corporate strategies combined with better global logistics. Obviously, these have been thrown out with the bath water in the current supply chain backlogs. There are simply no goods to be had (and no way to deliver them). The ever-shrinking auto inventories exacerbate the data.



There is, however, some outlier data on the flipside of the auto shortage. The big box stores have been starting to stockpile inventories ahead of the Christmas shopping season. This only makes it harder on the small retailers who cannot keep up with their scale. Shipping container prices continue to skyrocket. This is a particularly acute squeeze on small business.

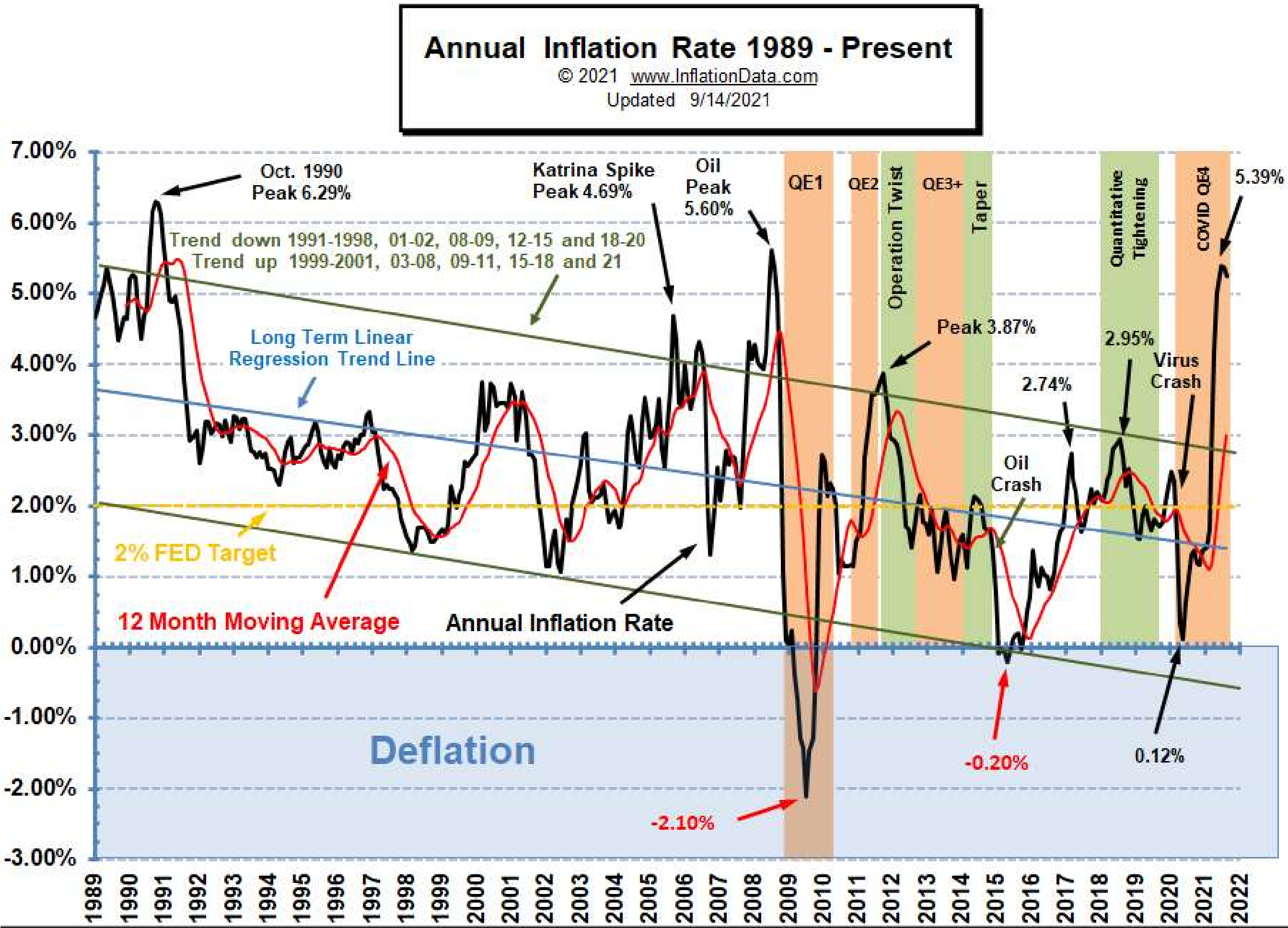


➢ Consumer Confidence is still lousy

Consumer Confidence in September (as measured by a U Michigan survey) remained below the depths of March 2020. The current reading is also near the 10-year low. Inflation expectations for the next five years remains at 2.9%. This is high compared to recent years, but it is below most other surveys and implied rates in the markets. The goods most thought of as expensive were homes, vehicles, and other durable goods.

➢ Inflation Math

We have tried to explain the difference between monthly inflation data and annual price increases. We have searched for the way to explain that both measures have their shortcomings…notably that they are just snapshots in time. This chart below shows the 12-month moving average of inflation. This is a much better representation of how prices are evolving. Throughout the last 30+ years, every time there has been a short-term surge in prices (black line), the trend has not taken hold (the red line has moved higher but ultimately collapses). Clearly this chart/data has its flaws, too. We could use some more historical perspective (namely the 70's and the unique circumstances around a highly deflationary virus-fear followed by a race to the top recovery resulting in shortages and blockages). And there is too much extraneous labeling for our taste, but the merits of visualizing the inflation trends trump the mild chart crime.



➢ Fed keeps banging the same drum beat

The Fed's Open Market Committee left rates unchanged as expected. More importantly, Fed chairman Powell continued to lay the groundwork for the impending "tapering" of bond purchases. Some perceived a slight hawkish tone (more inclined to remove accommodation) from Powell, but the market shrugged it off (although the USD did strengthen). Others labeled this modest change in tone as a natural progression: If Powell is going to tighten monetary conditions, he must sound the part. Moreover, with inflationary pressures persisting, he has to at least acknowledge the possibility that some might not be "transitory." The media tried to make a big deal out of a shift in the "dot plot." This is the compilation of each Fed member's (12 regional Fed presidents and six on the Board of Governors) individual projection/prediction. While half of the members "expect" rates to be hiked in 2022, Powell reiterated his stance that the importance of this dot plot should be minimized, and it is not a plan or a path. Regarding the mini-scandal that Fed members were actively trading securities, we think this could impact the Fed's direction somewhat. That is, with chairman Powell up for renomination in February, he is likely to kowtow to the ranking Senate members who can control his fate (this assumes he wants to keep his job…we have no idea why he would want to keep his job). And this means lower rates for longer.

➢ Chart Crime of the week

This must have been the silver chart that the Hunt brothers were using back in the day.

- Quick Hits
  - The Cleveland Browns game was the most watched game of opening week.
  - The US State Department is recommending citizens stranded in Afghanistan to go to US embassies outside of Afghanistan so they can leave Afghanistan.
  - The “head of product” at an NFT trading venue has resigned for insider trading.
  - Steve Ballmer, the owner of the Los Angeles Clippers basketball team, bought the Forum arena last year for $400mm just so the team could construct a new team arena nearby (a legal contract prevented the construction otherwise). The Forum last sold in 2012 for $23.5mm. Before that, the owner was the Faithful Central Bible Church.
  - Half of all new gun buyers are women.
  - The World Bank canceled the release of a report ranking the world’s countries with respect to business environment. It was discovered that the head of the World Bank pressured the report’s authors to move China into a better ranking.
  - Foreign made shoes sold in the US often have a “fuzzy fabric” on their soles to avoid a 25% shoe import tax (they are classified as slippers instead).

Trading: We used the market weakness to shift gears slightly. We unwound a small bit of protection and added to some longs. None of this was very meaningful. But we want to stay active around the edges. We expect more hiccups, but one of the pitfalls of using protection is time is always against you. So, you have to be tactical when you can.

TSLAQ: Surprisingly quiet in Tesla land. We will just go with a Musk tweet from yesterday:

[Check out our website to learn more about Chalk Creek Partners]

[Carlisle's Twitter Financial List]

[Carlisle's LinkedIn]

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