CHALK CREEK PARTNERS

Weekly Update

21-July-2021
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- The bond market is whipping the equity market around
- Fund Manager Survey: fund managers are fickle
- Rotation is not always that simple
- Earnings are rolling
- The Unemployment Benefits cliff is coming
- Mixed Fed surveys, Consumer Sentiment dips but Retail Sales growing
- Housing is still strong, but questions still lurk
- Inflation is transitory (redux)
- Saudi and UAE avoid another oil bloodbath
- Chart Crime of the week
- Click here for the full note

	Last	5d %	YTD %	1yr %
SPX	4359	-0.4%	16.8%	36.0%
QQQ	361.6	-0.4%	15.5%	36.3%
US 10 YR	1.35%	1.29%	0.92%	0.60%
VIX	17.9%	16.3%	22.8%	24.3%
Oil	70.22	-3.7%	44.9%	67.5%

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

For the old-timers out there, it is déjà vu all over again. The bond market, once the ultimate arbiter of the macro environment and thus the direction of the stock market, is back to ruling the roost. With the Fed talking about curbing its Quantitative Easing (QE – buying mostly short-term bonds), the yield curve started to flatten. Since the Fed will not be moving short term rates, the long end of the curve had to come down. This brought about the usual crowd that gets spooked for fear of it being a sign that a recession is coming. This was born out in the rout in Small-Caps. While we do believe that strength of the economy has been overestimated thanks to the bounce-back effect and government stimulus, we do not think we are heading towards a recession. The bond market apparently agrees (now) as its descent (in yield terms) came to a halt after an after a two-month slide. Adding insult to injury were the inflamed emotions of the virus-fear. Treasuries are a natural beneficiary of fear (and loathing). As for the stock market, we had the usual rotation back into Reopening stocks (Value and Small-Caps) with Big Tech lagging a bit. But rotations when the market is going higher are lost in the media shuffle. We do not think it is smooth sailing ahead. We think Volatility will remain elevated and rotations will be manic.

- Fund Manager Survey: fund managers are fickle

The Merrill Fund Manager Survey confirmed exactly what we have seen in the market over the last month. Investors have unwound their Junk over Quality, Small over Large, and Value over Growth trades. The inflation narrative is dead! And the yield curve is not going to steepen (long rates will stay anchored which is the bond market saying growth in the economy is slowing). But investors are still optimistic stocks. This goes back to the headline indices being dominated by Big Tech. Our portfolio is a mishmash of these views. We would like to be contrarian across the board, but we find ourselves agreeing with the inflation narrative (its transitory) and that Big Tech can ramble on. We disagree with completely shunning Junk, Small-caps, and Value. The last few days show us that balance is important.

- Rotation is not always that simple

Schwab pointed out that the performance dispersion inside of the 11 S&P sectors is counter to that on the surface of the sectors. That is, Energy is considered the ultimate Value sector. But the best performing Energy names this year have been the high growth names. And Communication Services is often thought to be a Growth sector (its heavyweights are Facebook, Google, and Netflix). But the cheaper valuation names with lower growth prospects have been the best performers.

- Earnings are rolling

Earnings Season continues to run hot in the early days of reporting. Of the 73 companies in the S&P 500 that have reported, 88% have beat on EPS and 84% have beat on Revenues. The absolute growth levels are absurd (75% growth for the index!). Of course, these are compared to last year's government-induced, economic abyss. But the earnings and revenue growth are expected to continue (and are improving from the beginning of July expectation). Of course, the rates will be slower but still impressive.

Exhibit 16. Estimated Earnings Growth for 2021Q3

Sector	Today	1 Jul
Consumer Discretionary	15.8%	15.0%
Consumer Staples	3.7%	4.7%
Energy	1285.3%	1233.5%
Financials	17.0%	14.8%
Health Care	13.4%	7.9%
Industrials	86.8%	85.2%
Materials	77.2%	70.2%
Real Estate	15.1%	15.5%
Technology	22.4%	22.1%
Communication Services	16.1%	15.7%
Utilities	2.0%	2.7%
S&P 500	**26.8%**	**24.7%**

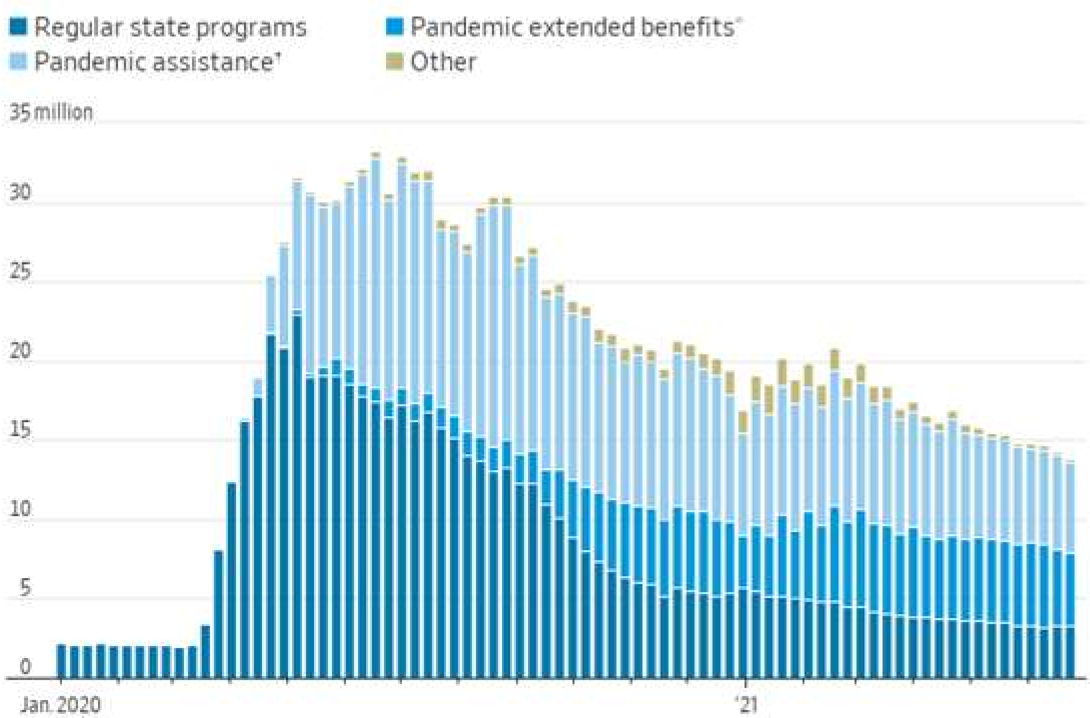
Source: I/B/E/S data from Refinitiv

As a whole, 2021 Earnings growth is expected to be over 40% with a strong but more normal 10.5% for 2022.

- The Unemployment Benefits cliff is coming

Jobless Claims are back to grinding lower. But with the end to the federal programs looming, we expect these numbers to accelerate lower. Yes, we are still beating this horse, but the evidence is mounting. Texas and Georgia showed the largest declines in Continuing Claims which just happens to coincide with these states dropping out of the federal programs. The relationship is not perfect on a weekly basis, but the aggregate drop in Claims from mid-May through July 3 tells the real story. States that have dropped out of the pandemic unemployment programs have seen their Claims drop by 19% while those states that are still clinging to the federal government teat have only seen a drop of 7%. Simple ocular inspection (a young analyst used this phrase back in the late 90's…we now love it for being intentionally obtuse) tells us that there are still mountains of people who will be looking for jobs come Oct 1 (or perhaps with a lag as many will not realize their benefits have ended). Johnny Paycheck will not be singing for much longer. This will depress any nascent wage inflation.

Number of people claiming unemployment benefits, by program



Note: * Reflects Pandemic Emergency Unemployment Compensation for those who exhausted other programs. † Reflects Pandemic Unemployment Assistance for self-employed and others not typically eligible.
Source: Labor Department

- Mixed Fed surveys, Consumer Sentiment dips but Retail Sales growing

Philly Fed Manufacturing Index drops sharply. Empire State Manu Index surges powerfully. Industrial Production for June underwhelmed with only a 0.4% increase while Manufacturing Output actually shrank.

Consumer Sentiment dipped in July. This is likely virus-fear creeping back into the narrative. When counties like LA reinstitute indoor mask mandates for the fully vaccinated, we know some people will fall for the political gesture instead of relying on facts.

Retail Sales for June accelerated vs May compared to an expected decline. The strongest categories were electronics and appliances, clothing, and restaurants. E-commerce was the weak spot with only marginal growth. All of this fits into our Reopening theme which the market has been questioning lately.

- Housing is still strong, but questions still lurk

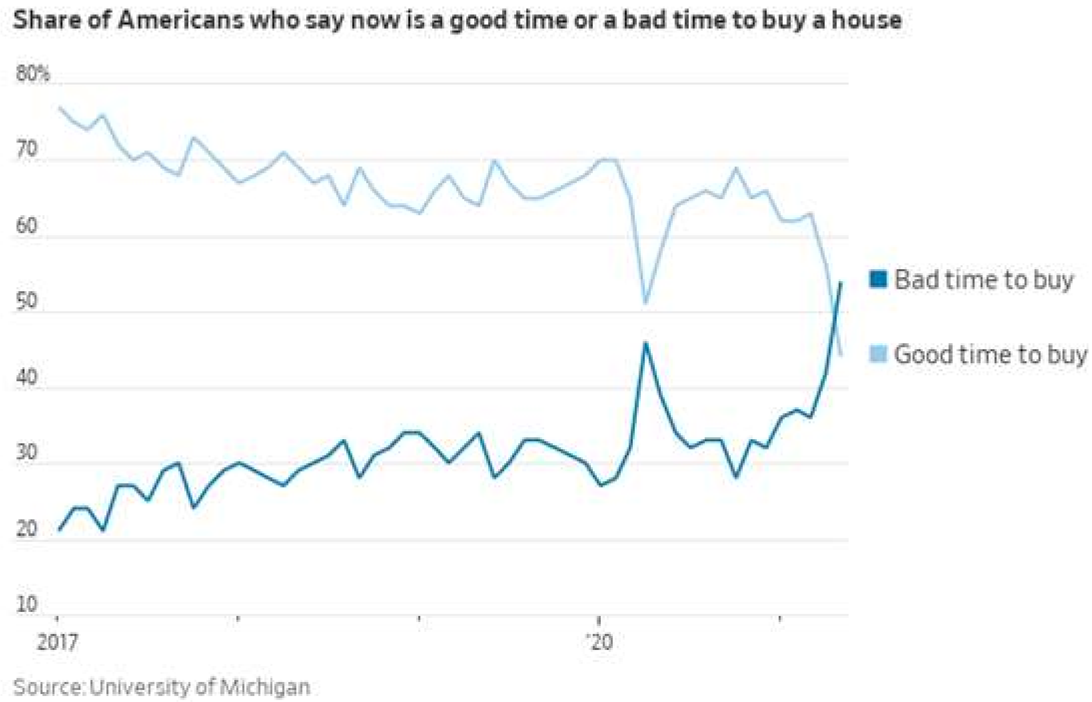
The Housing Market Index for July remains bullish (this is the home builder survey). But the trend is slowing with optimism fading across Current Sales and Buyer Traffic. But Sales Expectations in the next six months rose. This disparity stems from the same factors we see in the news: supply shortages and price increases. Sentiment fell everywhere except in the South where it was unchanged.

Housing Starts and Permits for June diverged. Starts jumped while Permits dipped. We think this makes sense as the logjams are slowing down new projects. We know lumber futures have fallen back to earth, but lumber prices int the stores are proving stickier. Logistics are to blame. Other simple items like paint are backed up for months (courtesy of my Boots-On-The-Ground research guy in South Carolina).

Here are some other Housing Market stats:

- 30% of current sales are all cash (20 year average is around 27% with a low of 22% and high of 34%)
- 56% of homes in June sold above their list price. June 2020 was 27%.
- The median sales price hit another record of $387k.
- Austin prices increased the most.
- San Francisco prices increased the least (no major markets have seen decreases).
- Not specific to Housing, but there were 21 container ships waiting to dock and unload in Los Angeles. There were 12 waiting last week.

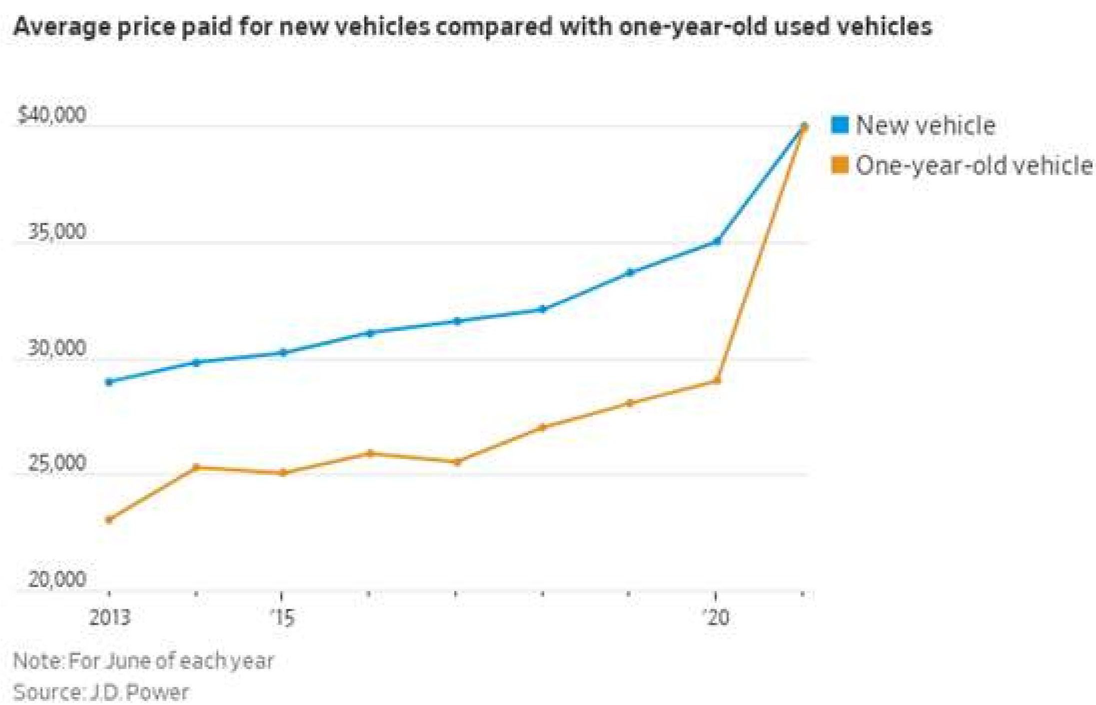
But this U Michigan Consumer Sentiment survey chart might be the most telling:



We think Housing will continue to do well, but we are not so sure the housing stocks will follow.

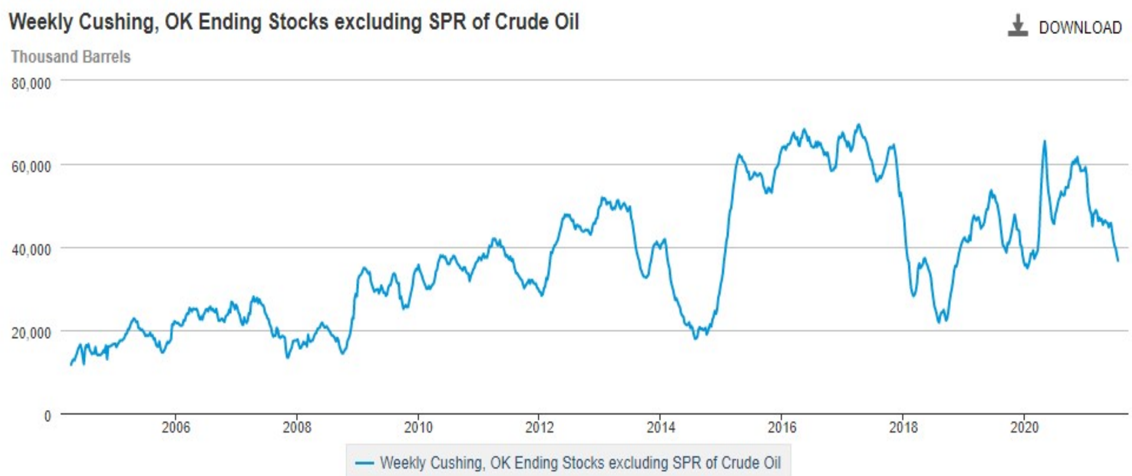
- Inflation is transitory (redux)

It is interesting when people cite the meteoric rise in used car prices as evidence of inflation. Does anyone expect a used car to remain the same price as a new car?



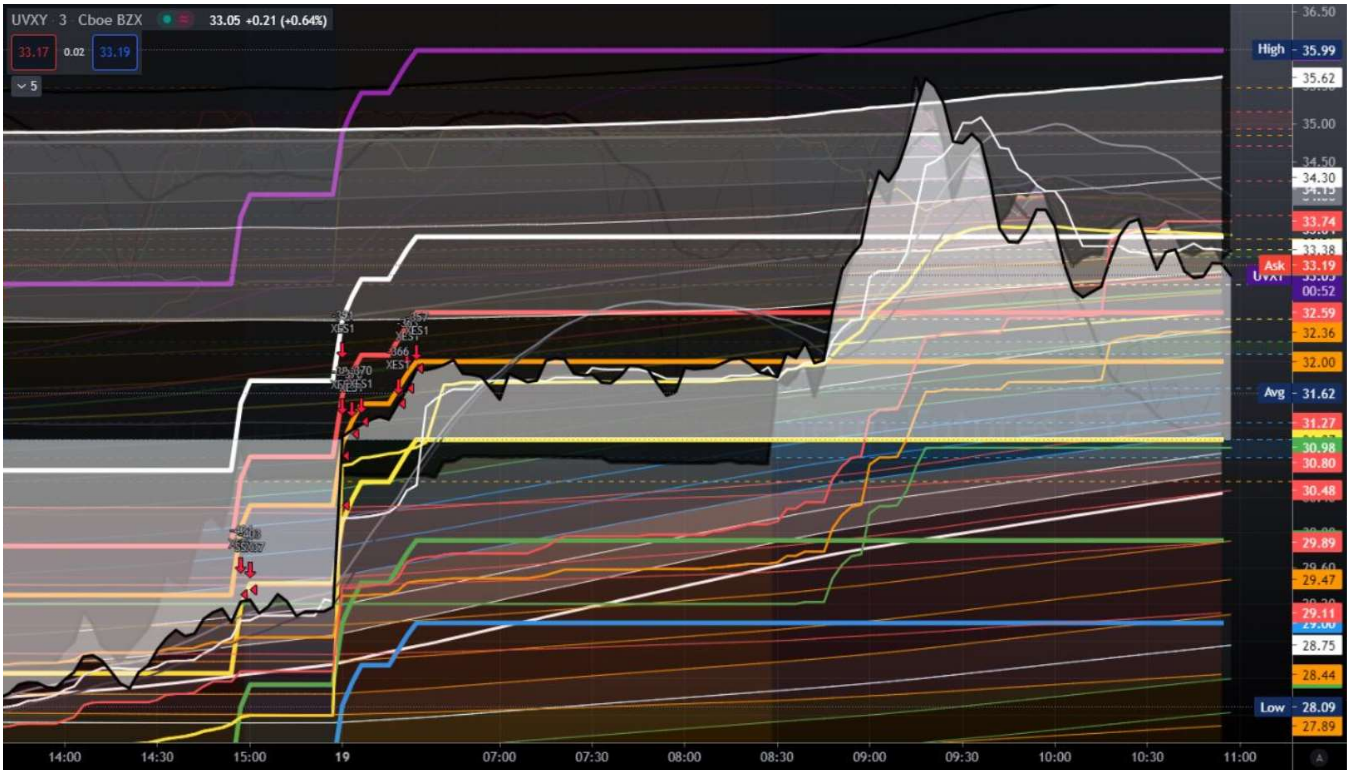
- Saudi and UAE avoid another oil bloodbath

Saudi Arabia and the UAE finally ironed out their differences in terms of increasing production. The two will meet halfway in their disagreement over the “baseline” to be used. That is, the UAE wanted a higher baseline from which increased production would be measured. The deal results in OPEC+Rogue resuming the production of the approx 5.8mm barrels per day left in the cuts. The reduction in cuts (increases) will be stretched until the end of 2022. This agreement happened over the weekend right before the global markets experienced their virus-fear anxiety attack. So, oil got pummeled out of demand and supply fears. But this was nonsense. Most analysts think the oil market is still tight. And the Cushing inventories in Oklahoma prove this as they continue to drop and are back to their pre-virus-fear level (Cushing is the delivery point for West Texas Intermediate futures and oil produced from West Teas, the Midwest, and Canada). Some analysts think inventories are headed back to around 20mm barrels.



- Chart Crime of the week

Some Chalk Creek swag goes to the first brave soul to explain this:



- Quick Hits
  - A University of Chicago study tells us that dictators lie about the growth in their countries. Generalissimo Franco is still dead, indeed.
  - Bananas are curved because they try to grow towards the sun.
  - Denver and New York are trying to ban natural gas stoves (Berkeley already has).
  - The FBI foiled an attempt by the Iranians to kidnap a dissident on US soil (NYC). This reminds us of our time in NYC. Mrs. Chalk Creek's office used to sublet space to the National Football League. It was actually the CIA who was keeping tabs on the Iranian mission to the UN which was in the same building.
  - The US was officially in recession from Feb 2020 to April 2020.
  - The National Bureau of Economic Research, NBER which is tasked with marking these dates.
  - NBER typically denotes a recession as a period of two successive *quarters* of economic decline.
  - Car accidents increased 47% this past 2Q vs 2Q2020.
  - The late singer James Brown's estate has reached a settlement after 15 years. The stepmom gets nothing because she was married to another man during her alleged marriage to Brown. A trust which was to get the vast majority of the estate's assets was to provide scholarships to underprivileged children. The trust has no assets now after all the money was spent on lawyers. The silver lining is the estate still owns the song catalog which can hopefully be monetized to fund the charitable trust.
  - The Alabama quarterback has secured nearly $1mm in NIL deals (name, image, likeness). He has never started a game.
  - Johnny Paycheck, he of "Take This Job and Shove It" fame, shot a man in a bar (1985) for asking him if he wanted to eat some turtle soup.

Trading: We used the virus-fear to add to our Reopening names. These included Energy and Retail. But as we have intimated, we were selective in trying to stick to our higher conviction names. We sold our lone bit of direct Chinese exposure. We moved our long in Materials to Energy. Our Healthcare recovery name continues to get pummeled. But we keep adding slowly. This flies in the face of a good rule of thumb to not add to losing Trading names. But we think this one can graduate to a long-term Alpha play. We need the early SPAC sellers to get out of the way and for more intuitional coverage to emerge. We think both are close.

TSLAQ: Morgan Stanley thinks Tesla will be dominant and profitable in the Urban Air Mobility business. That is flying cars. They model the market share and EBITDA margins for the year 2050. This is not parody. As a reminder, Morgan Stanley is the biggest creditor of Elon Musk. Back on planet earth, the Tesla Semi production "is really starting to move" according to the mouthpiece Electrek. The Semi was officially launched in 2017. On a comical note, this mouthpiece was blocked on Twitter by Musk! Talk about thin-skinned!

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