Weekly Update

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	Last	5d %	YTD %	1yr %
S&P 500	4,119	2.6%	7.3%	-7.3%
QQQ	$300.92	4.6%	8.1%	-16.5%
US 10 YR	3.42%	3.45%	3.88%	1.78%
USD/DXY	101.0	101.6	103.5	95.9
VIX	19.1%	17.9%	21.7%	22.1%
Oil	$76.86	-5.1%	-4.2%	-12.9%

The market traded sideways heading into the Fed's interest rate announcement today…or at least the 1% move over the previous four days was very tame compared to the rest of the January rally. The Fed hiked 0.25% as expected. But the market celebrated the balanced nature of Fed chair Powell's remarks during the press conference. Over the last year, any time there was a hint of an easing Fed, Powell did his bluntest best to spoil the party. But Powell did not "pick a fight" with the loosening of conditions in the market. He acknowledged that inflation had moderated recently. But the market overlooked him saying there was more work to do. Ongoing rate increases will be appropriate. And rate cuts would not be happening in 2023. Specifically, Powell

does not want to look up in six to 12 months and realize he made a mistake in not keeping monetary policy restrictive enough. Same-day Call option buyers hear what they want to hear.

We find this reaction odd. It was like a relief rally from the bowels of despair. But the market has had an incredible bounce (the notion being that most people believe the last year's reckoning was overdue). We expected the market to react wildly if Powell came out and veered in either direction. But then again rampant speculation is driving this market. The mere whiff of Powell not looking to crush the equity market was enough to drive it higher. We would add dealer gamma is sitting virtually flat. This is better than a negative gamma situation which would cause option market makers to chase stocks higher (just like they pushed stocks lower much of last year or pushed GameStop higher two years ago). But it also means that they are not sellers into rallies. There is no offsetting flow from hedgers (market makers, in theory, are always hedging their exposure).

None of this changes our view that we are in or heading into a recession. The worst time to invest is when growth is slowing (recession) along with decelerating prices. In other words, this market better be careful what for what it is wishing. Nonetheless, we are cognizant of the power of markets. There is a potential wealth effect (for the positive unlike last year) which could offset some economic slowness/monetary tightness. We will keep our outlier bets in check and aim to trade around the edges - keeping a moderate net long while still betting against the Fantasies and Frauds.

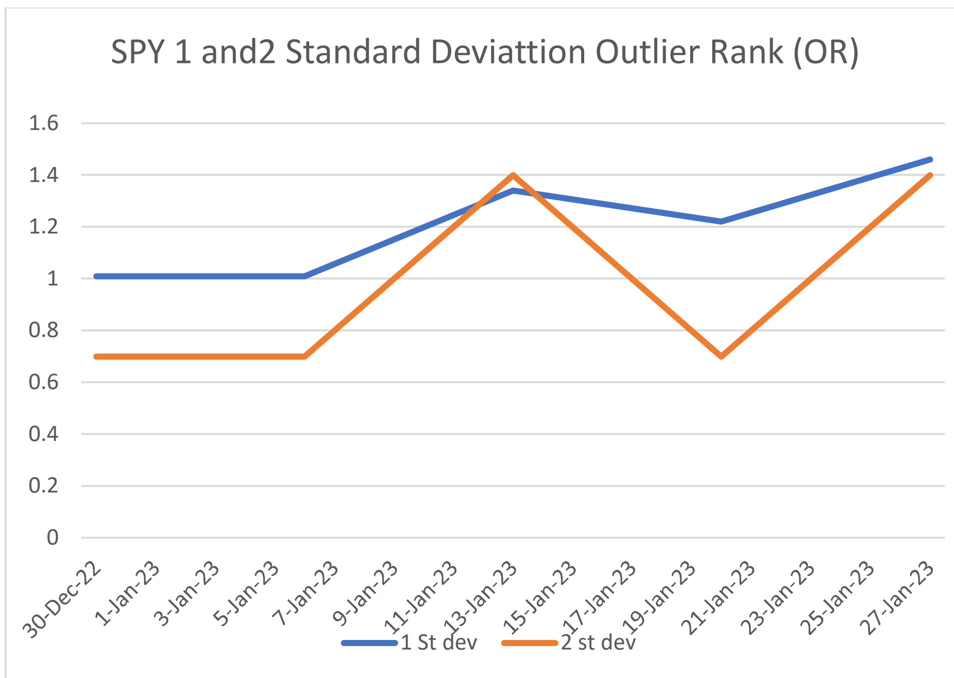
- Who is the dead man that threw the salt?

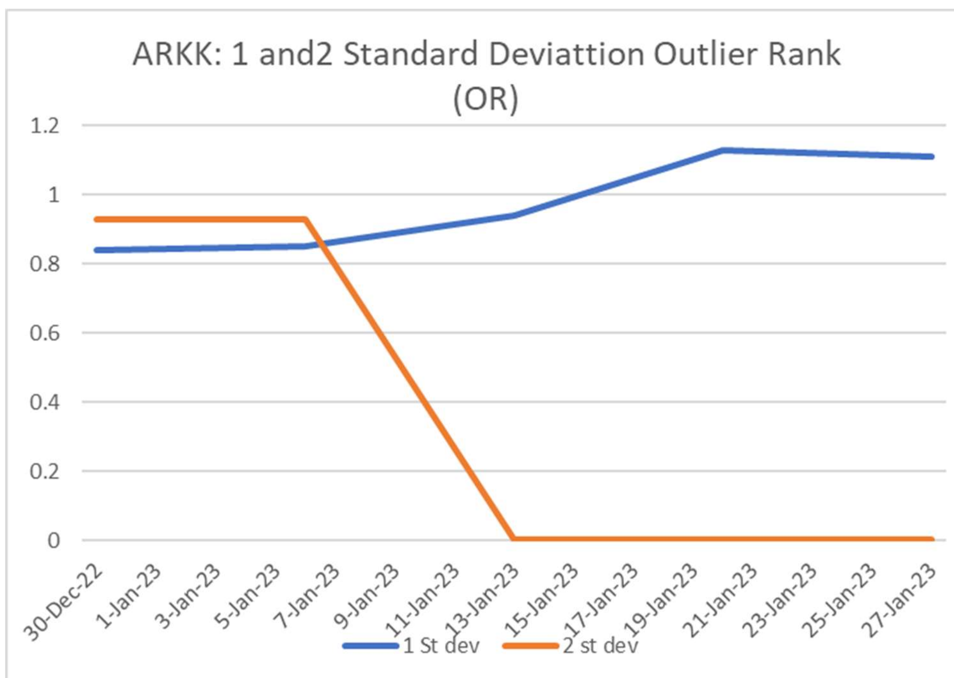
The NYSE glitch from two weeks ago, the one in which the opening auction process malfunctioned and caused wild swings in prices, has been pinned on a single employee in Chicago. Apparently, he forgot to reset the backup mode. The internal clock of the exchange was never reset. Thus, the opening auctions were never instituted. We do not talk that much about market structure…it used to be a focus of ours (hobby, pet peeve, whatever). But it is becoming important again as the regulators want to change the way retail orders are handled. Essentially, they want all of them to go into continuous, mini auctions. It seems to us that they have some work to do on this front. Cam Neely should be going after the NYSE and not the lone guy in Chicago.

- Outlier Rank (OR) is moving higher in the market but not in junk

One obscure quantitative metric we use is Outlier Rank. We picked up this concept from the oddly named Tasty Trade (a great retail options platform with strong quantitative research). We have enhanced the stat in isolation to make it a trackable view of current risk/volatility in the market. Mathematically, OR is the percentage of daily outlier moves by the market in the last month divided by the percentage of daily outlier moves in the last year. The output tells us if the market is having larger unexpected moves more recently than historically. We use the S&P 500 for the market. And we use ARKK (Crazy Cathie Wood aka The Wood Chipper) to get a view on the volatility of the junk segment of the market. We quantify an outlier in two ways: Moving more than one or two standard deviations.

The takeaway is that the market (SPY) is becoming more volatile with more outlier moves despite the lower level of Volatility. But the Fantasies and Frauds (ARKK) are not having any outlier moves at all! We are early in our data collection, but this will be good to monitor. This makes us want to add short exposure in the market vs ARKK. This is counterintuitive to say the least.





- Are pension funds going to rebalance?

Bloomberg reports that corporate pension funds that have defined benefits are now fully funded…their current assets are worth more than their future liabilities. This is a bit of an accounting quirk as higher interest rates discount their liabilities. With this fully funded status, pension funds will want to "de-risk:" Buy bonds and sell equities. JP Morgan thinks this rebalancing could be as large as $1t with a T. We find these types of studies usually miss something or they are exaggerated. But even doing a fraction of this expected size would be a huge drag on equities and a boon for bonds.

- Earnings are not as bad, but fundamentals do not matter

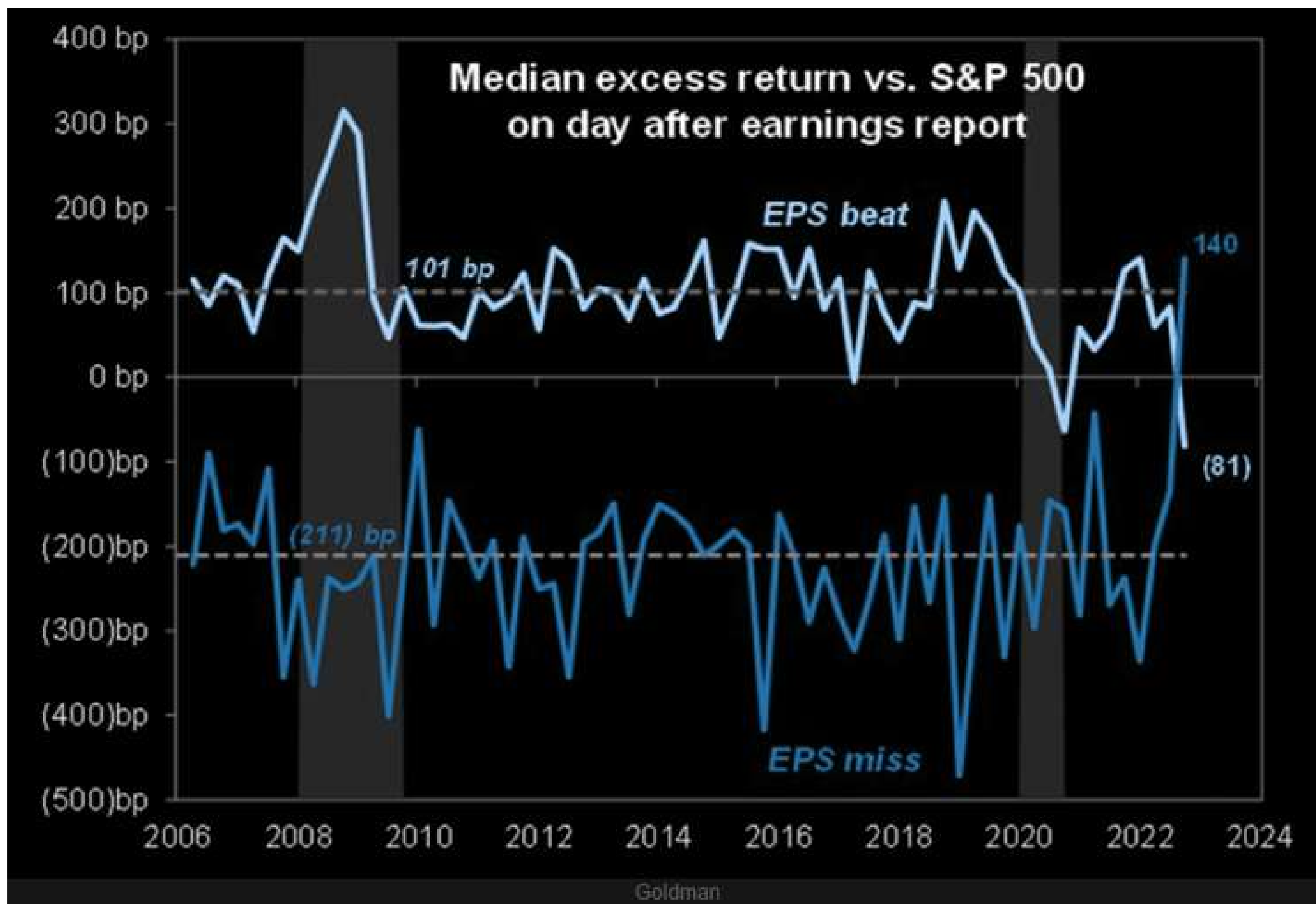
Earnings growth has improved, or rather earnings contraction has decreased, with about 40% of the S&P 500 having reported. Earnings are still negative along with missing expectations. Of course, the sectors reporting the largest drops in earnings are the ones doing the best in the market!

S&P 500 INDEX

Surprise | Growth

Sector (BICS)	Reported	Sales Growth	Earnings Growth
11) All Securities	149 / 500	5.70%	-1.39%
12) > Materials	8 / 29	-9.94%	-44.55%
13) > Industrials	27 / 68	13.48%	74.24%
14) > Consumer Staples	11 / 36	5.00%	-2.53%
15) > Energy	7 / 26	16.10%	81.09%
16) > Technology	23 / 78	-1.95%	-12.74%
17) > Consumer Discretionary	11 / 53	16.27%	31.01%
18) > Communications	5 / 24	-6.04%	-14.72%
19) > Financials	42 / 62	5.59%	-12.88%
20) > Health Care	9 / 64	6.50%	4.80%
21) > Utilities	2 / 30	21.62%	24.12%
22) > Real Estate	4 / 30	5.16%	10.66%

Here is a chart (thanks to Goldman via themarketear) that shows this same phenomenon differently. Earnings beats are being penalized and earnings misses are being rewarded. Needless to say, the spread between the two is crossed. The logical conclusion is that nothing fundamental is driving this market.



Here is another way to look at the market. Goldman research shows the breakdown in the market as simply US vs them with them being the rest of the world. US companies with predominant US sales exposure peaked last fall and are still down on the year while those with international sales exposure are leading the rally. This is still

a macro view (vs stock fundamentals, however there is certainly overlap). But at least there is a somewhat believable narrative behind it: The US will be in a recession while the rest of the world will muddle through a bit better (of course, the weakness in the USD ties in directly). We are not necessarily subscribers to this theory, but it is certainly plausible. (We cannot forget to mention that good weather has been a major contributor to the better economic sentiment in Europe.) Most of our Staples have a large international component to them, but this has been helping lately!

- Business spending and sentiment are not improving

Durable Goods Orders in December bounced back sharply vs the dismal November. This was expected, but the surprise was twice as large (5.6% actual increase vs 2.8% expected and -2.1% last month). Much of the strength was from a large Boeing order. Unfortunately, Core Capital Goods, aka business spending (which does not include transportation), dipped from a slight positive to a slight contraction. This data remains fairly resilient in light of the pull-forward to avoid higher taxes. But the data has stopped increasing. Some professional guessers (economists) say this slowing is a leading indicator of a recession.

- The Kansas City Fed Manufacturing index during January clawed back some, but it is still in negative territory. The same goes for the Dallas Fed Manufacturing survey. The Chicago PMI worsened slightly (moderately negative territory).
- The ISM Manufacturing index in January dipped further into negative territory. Prices are not as much of a concern…but their business prospects are still getting worse.
- The Markit Manufacturing PMI ticked up slightly. But it is still the second most negative reading since the onslaught of the Virus Fear.

- Construction Spending in December turned negative.
- Consumer Confidence declined slightly in January.

➢ Backward looking 4Q GDP was not as good as it appeared

The preliminary read on the 4Q GDP was an increase of 2.9%. This is better than expected but a little worse than 2Q. The headline was a bit misleading as the beat was driven by an inventory build. Personal Consumption Expenditures are slowing (or increasing at a slower pace of 2.1% vs 2.6% expected). And the trend worsened in December as the expenditures dropped again after a revised negative reading in November. Business Spending was flat. And Housing was terrible. And government spending was strong. We are not encouraged by any of this "soft-landing" report.

➢ Inflation is cooling in some places

The Fed's preferred inflation gauge, the Personal Consumption Expenditures Index (PCE), was a touch higher than expected in December. The "Core" accelerated to a 0.3% monthly gain vs 0.2%. This equates to a 4.4% annual gain. The headline is slower (0.1%) but a touch higher annually (5.0%).

The Employment Cost Index (wage inflation) grew at a slower pace in the 4Q (1.0% vs 1.2% in 3Q). The market likes this data…and Powell mentioned it directly. But we think this small improvement has a long way to go. We think Powell thinks this, too.

For what is is worth, we think too much is being made of headline inflation. Not that we should exclude Food & Energy like the Fed does. But rather, the pockets of inflation tend to be rolling from one to another. Moreover, prices remain elevated. This bodes poorly for the economy's health.

➢ The Labor market is still strong

Jobless Claims ticked lower again (190k to 186k). But Continuing Claims ticked 20k higher to 1.68mm. We have made the case that Continuing Claims moving higher is bad for the labor market. While we think this is true, it is not enough to dent the strength seen almost everywhere else.

ADP's guess at the Employment Report (out Friday) was 52k jobs lower than expected. The guess for Friday's data is about 80k higher than this.

The Job Openings and Labor Turnover Survey (JOLTS) showed surprising job strength. Openings jumped back above 11mm in December vs the 10.4mm in November. This is one of the datapoints that we maintain is fake news. Of course, the longer the fake news lasts, the stronger our position becomes on the Fed not backing down on high interest rates.

It is worth noting that the Bureau of Labor Statistics (BLS) revised its payrolls number for 2022. This was hinted at by the Philly Fed. 1.4mm jobs were never created as first reported. Just a rounding error (in the government's eyes).

➢ Housing seems to be stabilizing (yet still bad)

New Home Sales in December technically increased by 14k. But this is after a 38k downward revision to November's data. This certainly dampens the mood after the preliminary boost in November (October was 598k, November was 640k before being revised down to 602k, and December was 616k…FYI this data is annualized with seasonal adjustments). But this does reflect some stability in sales.

Pending Home Sales rose 2.5% in December vs November. This was better than the expected drop, and it was the sharpest monthly move in 15 months. Of course, it was still a 34% drop vs last year.

The one element in Housing that continues to show weakness is building permits. In particular, single-family is rotting. Permits are the best leading indicator for new housing. But we do not think this is enough to buck the current, improving trend.

Mortgage Applications declined for the week. This data is volatile, but we suspect the stabilizing trend is here to stay (especially if house prices start to get hit).

We closed out Housing short last week. It was doing terribly, and the data seems to be improving (spurred on by lower mortgage rates). We still think there is another shoe to drop re the nexus of accelerating sales at lower prices. And we will watch the Permits very closely. But as we have written recently, our main goal in monitoring Housing is to discern its effects on the consumer and its wealth effect.

- China might really be reopening

China's official PMI data surged during January. We always qualify anything Chinese by noting the communists lie (and cheat and steal) about everything. But the combination of the change in direction (from negative to positive) and the magnitude of the move is startling. Sentiment in Services jumped from 42.6 in December to 52.9 in January. This is obviously similar to the jumps seen in western countries when lockdowns were lifted there (but not as quickly). Manufacturing turned positive, but there are still a few soft spots (exports and output are still negative, but they improved). Late last year we thought the communists would pull the rug on the new-found freedom of their subjects. But the communists have been sticking with the reopening. The private Manufacturing PMI (Caixin…as far as anything can be truly private in China) was not as rosy. The most interesting element was inflation. Input costs are still rising, but output prices are cooling. This is a bad combination!

On balance, we think this is strong data. We decided to buy some China. But we are leaning on Tech and consumer names. Manufacturing may face more challenges with a weak global economy. And for the record, we have been very skeptical of the Chinese consumer and its ability to drive growth in China by itself. But we will certainly defer to the data (even if fake).

- The Fed has not really changed its tone

The Fed hiked 25bps to 4.50%-4.75% on the Fed Funds target range. This was telegraphed and expected. The Fed's statement was pretty much as expected, too. One noticeable change in language was that the Fed has changed the focus on the pace of rate hikes to the extent rate hikes last. This is another way of saying higher for longer. Moreover, the first words were on the emphasis to bring inflation back down to 2%. In addition to the higher rates, the Fed will continue to significantly reduce the size of its balance sheet.

Here are some other bullet points:

- Economy slowed significantly last year. Consumer spending is slowing. housing is weakening. But Labor market remains very tight. Job gains have been robust. The pace has slowed, and nominal wage growth has showed some signs of easing. Supply exceeds demand with very little change in Participation.
- No disinflation seen in core services ex housing
- Public Health is no longer a concern when assessing monetary policy
- No signs of a wage price spiral, but once you do see it, it is usually too late.

Two other side notes about monetary policy. Finance Secretary Janet Yellen said she thinks "persistently weak inflation is likely to return as a long-term challenge for the economy." Team Transitory is back!

And Vice chair of the Fed, Lael Brainard, is likely leaving the Fed this week to join the White House's National Economic Council (NEC). This is a political advisor to the president. Ironically, the more politically minded Jared Bernstein (who we admit seems very likeable) is being tapped to take over the Council of Economic Advisors (CEA). In other words, the supposed apolitical Fed governor is taking a political role in the government, while the proudly partisan economist is taking over the apolitical "think tank" outside the government. Other than being mildly amusing, the relevance is that Brainard is probably one of the more dovish members on the FED…she has been pushing the pivot story. Will the Fed be more hawkish without her?

- Where did all the crypto money go?

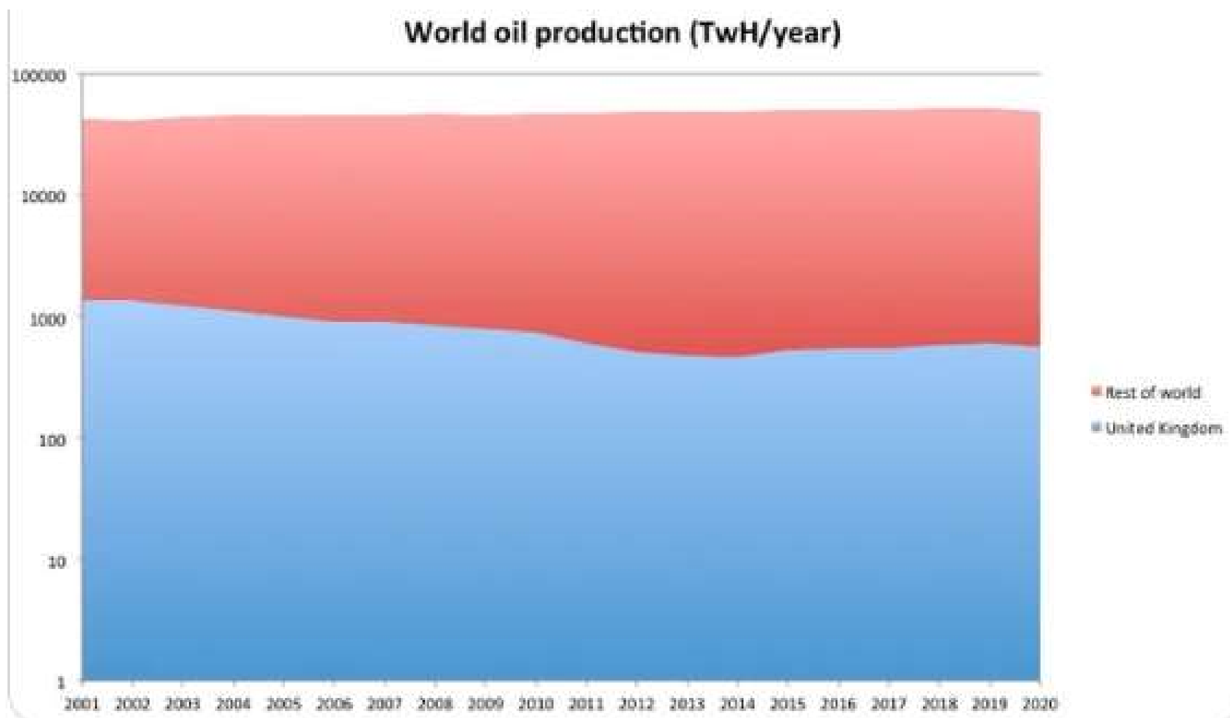
We thought this subject would have faded into obscurity by now. But fools and their money continue to be separated in moronic fashion. The latest involves the bankruptcy proceeding of Celsius. Recall this was one of myriad crypto platforms (not exchanges!) that lost all its clients's money by participating in the virtuous-turned-vicious cycle of borrowing customer money to buy make-believe crypto "tokens." Celsius is attempting to pay back creditors by issuing them new make-believe tokens. A bankruptcy judge in New York is reviewing this…it might actually happen. Hopefully the judge reads some of the discovery carefully. The CEO/founder of Celsius was selling his zero cost, make-believe tokens (CEL) back to the company. The company was using customer funds to buy the worthless pile of tokens from the rich CEO/founder. Some employees voiced some concern about this arrangement. Some email/Slack quotes:

> "We are talking about becoming a regulated entity and we are doing something possibly illegal."
>
> "We are using users USDC to pay for employees worthless CEL."
>
> "The company is the one inflating the price…to be able to sell back to the company."
>
> "CEL is worthless…its price should be zero."
>
> "Using customer stable coins…to buy CEL is very Ponzi like."

And these guys want to do be able to do it all over again (and be your latex salesman).

- Chart Crime of the week

The UK produces the majority of the oil in the world! Nah, check out that y-axis.



- Quick Hits
  - Microsoft's 10% intraday swing last week was equivalent to the entire company's market cap as recently as 2012.
  - Morgan Stanley is fining some of its employees as much as $1mm for doing business on WhatsApp.
  - MSG, the owner of Madison Square Garden, the Knicks, and the Rangers (of NY not Texas), has been using facial recognition technology to bar lawyers that are suing the company from entering the venue.
  - The high school son of Lebron James, Bronny, makes $7.5mm a year in endorsements (NIL).
  - A food delivery guy walked onto the court during a Loyola-Duquesne college basketball game. He was delivering McDonald's. He literally walked on the court aimlessly during play.
  - Ammonia prices in the US are benchmarked to the Tampa contract.
  - While doing some regulatory upkeep on the FINRA website, we came across this, "FINRA has adopted important changes…to train registered persons…particularly women and underrepresented minorities…"
  - Northwestern Christian has a college basketball player with one arm.
  - There is a new study on ESG funds. The more money the managers of the fund have in the ESG fund, the worse the ESG score. ESG fund managers, as a whole, do not believe in their own product. The defense is that these ESG hucksters believe in a different definition of ESG and thus do not adhere to the benchmarked ESG portfolio.
  - ESPN is going to start broadcasting pickleball.
  - Consumers spend about $6b a year globally on dating apps.
  - There are 50mm Catholics in the Democratic Republic of Congo.
  - When the fancy, new artificial intelligence wizbot, ChatGPT, was asked to construct a portfolio to beat the market, it answered, "It is not possible for me to design an ETF that will beat the US

stock market because the stock market is unpredictable and part performance does not guarantee future results."

- A member of the San Francisco city council (or its equivalent) is saying that the proposed $5mm reparations payment to black residents is "miniscule."
- The long Island Railroad misspelled Georgia O'Keeffe's name on the wall of luminary quotes.

Trading: We moved around some of our short exposure. We cut a few bets on real companies we thought were going to be anchored by the souring economy. But with the rally in the F&F's we rotated more into these. Of course, the market rally is making this more and more painful. We are happy we are small, but our overall positioning conservative. We did add a few longs like China and more Berkshire. And we started a small position in a whacky event driven trade.

TSLAQ: It was a shockingly quiet week in Elon's world. Perhaps he has figured out that the more he talks, the more people get mad at him. And the only recourse for the masses is to sell his only public stock.

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