Weekly Update

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Carlisle C. Wysong, CFA
Managing Partner

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	Last	5d %	YTD %	1yr %
S&P 500	3,956	5.6%	-16.0%	-14.2%
QQQ	$285.44	8.4%	-27.9%	-27.2%
US 10 YR	4.10%	3.69%	1.51%	1.59%
USD/DXY	106.3	110.6	96.0	95.8
VIX	24.1%	26.1%	17.2%	17.1%
Oil	$85.28	-0.6%	13.8%	5.9%

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

The market has held onto its gains from last week's better-than-expected CPI inflation number. A better-than-expected PPI (producer prices) gave the hopes & dreams crowd more reason to peacock about an imminent "pivot" from the Fed. Traders even pointed to China as a source of bullishness. This was the ultimate tell for us. If people are buying Fantasies and Frauds because of the latest wiffle-waffle from the communists, we know our conservative stance is on solid footing. There was even some positive sentiment in the pundit circles when it was learned that the Russians were *not* the ones that bombed Poland. Nonetheless, we are still watching the USD carefully. As we have noted, this recent breakdown (about 7% off its highs from late October) is counterintuitive to what we think to be the proper framing. The same goes for the rally in the short-end of the

treasury curve. But then we look at the yield curve as a whole. The 2-10yr spread is hitting an all-time low. This basically means the Fed is hiking rates into a recession. And the slew of Fed speakers this week said exactly this. There will be no pivot nor a pause.

- China? We are talking about China?

Much of the new-found euphoria is based on China. There is the plan to ease some travel restrictions including quarantine periods. But virus cases are on the rise and sweeping lockdowns are still happening. Interestingly, one of the policy changes is a reduction in community testing. This would be a legitimate step towards getting off the Covid hamster wheel. But we suspect the gripping power of Covid is too much for the communists to yield. But they do not want to admit they are losing control – so they kill the testing. The second perceived boost is a slew of measures intended to boost the real estate sector. The details are sketchy, but it broadly reads like the communists are trying to stimulate the flagging economy in any way possible. Despite an oversupply of homes, developers will now be able to access capital more freely and buyers will have looser down-payment requirements. We have seen this movie before. And lastly, traders (surely not investors) got excited after Biden put on a Mao suit and met with Xi. Whether he was aiming for some James Bond villain intimidation or Chinese acclimation, who really knows (more of a Dr. Evil instead of Dr. No in our opinion…sorry for the slight injection of political humor!). But the net result seems to be like most of these talks over the years…nothing of consequence (or just more talks). The hope trade reigns supreme…again. And for some perspective, Macau gaming revenues jumped 37% this week compared to last week. The reopening is here! Uhh, this is still just 14% of the 2019 level.

- Now people are really reaching: The weather

Another odd source of optimism in the markets is the weather. Cold weather in the US (brrrrr in Texas) is spurring otherwise lackluster retail sales. But in Europe, some forecaster calling for a milder winter has cooled energy prices and instilled some consumer optimism. This is taking hopes & dreams to a whole new level of stupidity (predicting the weather).

- People say they are bearish, but are they?

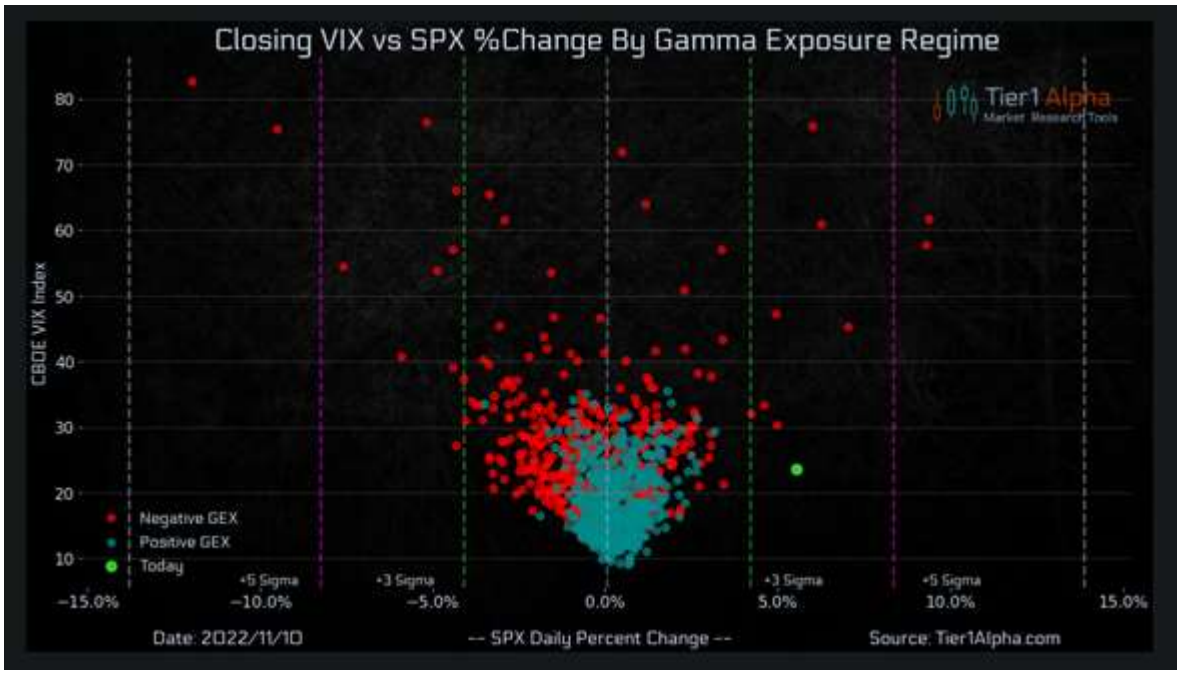
The most notable call-out in positioning this week is in options. We mention this frequently because option trading volumes are now larger than equity volumes. And, of course, the maniacs are back using short-dated contracts. According to Hedgeye, Friday was the fourth heaviest Call buying day ever. Thursday was the 10th heaviest. And the Put/Call ratio is at its lowest level of the year around 0.7. This means there are 7 Puts traded for every 10 Calls. This is about the historical average, but it has been closer to 1 all year. Getting into the weeds a bit here, but the Put/Call ratio for equities is higher (and climbing) than it is for indices. This means the YOLO/FOMO maniacs are concentrating their bets on option favorites like Tesla (and other junky stocks). This trade works until it does not. Then it evaporates instantly.

As for equity flows, Merrill reports that clients were big buyers of Tech and Consumer Discretionary stocks. In its Fund Manager Survey, Merrill relays a different story. The reported "cash level" (there is no such thing as a market-wide cash level – other than corporate activity – but the point is valid in a closed environment) has reached an "uber-bearish 6.2%." Allocations to Tech are the lowest since 2006. 77% say a global recession is coming (or already here). Literally 0% are bullish for 2023 (in terms of a "goldilocks" market which entails high growth and low inflation). Of course, these respondents usually say one thing and do another. In this case, they are saying one thing and saying another. They expect inflation to cool; they also expect stagflation (high inflation with low growth). The most crowded trade is perceived to be long the USD. That is bad for us (we

rarely want to be in crowded trades). The most overvalued trade is thought to be the USD. That is good for us (people usually misidentify value). We will trust the Merrill data (people are buying) over the survey.

- Volatility is confounding, maybe that is the real signal

Lately we have been writing about the breakdown of the relationship between Volatility and market direction. That is, despite the market rallying, the VIX (Volatility index) has remained relatively high. We have surmised that maniac Call option buying could be one source of upward pressure on Volatility. Of course, right as we note this, Vol starts to compress. And then we get last Thursday's giant move in the market: The SPX (S&P 500) had never rallied more than 5% while the VIX was below 30. While we are still trying to piece this together, we think this back-and-forth between normal market environments and upside-down relationships is just another form of Volatility. And as Hedgeye likes to say, Volatility perpetuates bear markets.



- Earnings can be summed up easily: Walmart vs Target

With earnings season drawing to a close, two reports this week tell us all we need to know. Walmart had a stellar report. It was able to whittle down its bloated inventory. It has maintained pricing power and is even starting to pressure its sellers. And it is seeing an increase in traffic (on top of price gains). Target, on the other hand, still has excess inventory and its discounts have not worked. To sum it up: The Staples segment of Walmart is doing great. The discretionary-focused business of Target is suffering. This is the economy in a nutshell. We remain long Staples and short Discretionary.

- Inflation might be cooling, but main street does not care

The bulls got what they wanted with another low inflation reading. The PPI (Producer Prices, input or wholesale) increased only 0.2% in October vs the 0.4% increase in September (annual increase was 8.0% vs 8.5% last month, but monthly changes are more important). The Core reading remained flat on a monthly basis (annual change was 6.7% vs 7.2%).

Interestingly, inflation expectations are starting to tick higher despite current prices starting to tick lower (not really, but the rate of change of increases is slowing). The NY Fed Inflation Expectations survey for October shows a jump in the one year forward expectation to 5.9% from 5.4% in September. The three-year expectation moved from 2.9% to 3.1%. The University of Michigan one-year expectation ticked higher to 5.1% (call it stable over the last six months). The Atlanta Fed's Business Inflation Expectations (one-year) remains steady at 3.3%. As we have written in the past, there is a never-ending amount of inflation data. And one could parse it anyway one wants (lies, damn lies, and statistics). But we think the bulk of the data is pointing towards people starting to worry about high prices despite the recent easing (remember, disinflation is not lower prices).

- Housing is still getting worse (just what the Fed wants)

The Housing Market Index (aka builder survey) for November dropped again. It is not quite as negative as during the housing crisis of 2007-2009. But the current decline is much sharper/quicker. This was the 11th straight monthly drop. All three subcomponents, Current Sales, Sales Expectations, and Buyer Traffic fell sharply. Buyer Traffic, the best leading indicator, is the lowest. The South registered the largest drop in sentiment. Mortgage rates are the obvious reason cited.

Somewhat surprisingly, Mortgage Applications increased on the week (purchases up, refi's down). The downward trend is still awful.

Here is a poorly labeled, 25-year chart of the Housing Market Index:

- Other data is mostly negative
  - U Michigan Consumer Sentiment in November (the preliminary read) reversed lower after a mini-bounce the last three months. June was the all-time low and we are pointing back in that direction.
  - Industrial Production in October slipped vs September.
  - Empire Manufacturing showed a strong rebound in November as it reversed from deeply negative (-9.1) to modestly positive (+4.5).
  - Retail Sales increased 1.3% in October vs September. Vehicles sales were notably flat. Recall this data is not adjusted for inflation.
  - Business Inventories are still growing albeit at a slightly slower pace.

- Japan's economy contracted in Q3 1.2% (annualized) vs Q2.

➢ No wonder China is trying to stimulate its economy

The monthly data dump in China for October highlighted the continued weakness. Retail Sales fell 0.7% on a monthly basis (vs September's increase of 0.4%). Industrial Production increased 0.3% (down from September's 0.8% increase). And Fixed Asset Investment (analogous to our Durable Goods data) only increased by 0.1% (vs September's 0.5% increase). China's House Price Index continues to sink. It has now been negative for six months straight. (The communists want to build more houses!) And China's Unemployment for people 16-24 years old remains steady at 17.9%. No wonder Xi is blaming everything on Covid. To repeat, we do not think tweaks to any policies will have any meaningful impact on the communist economy.

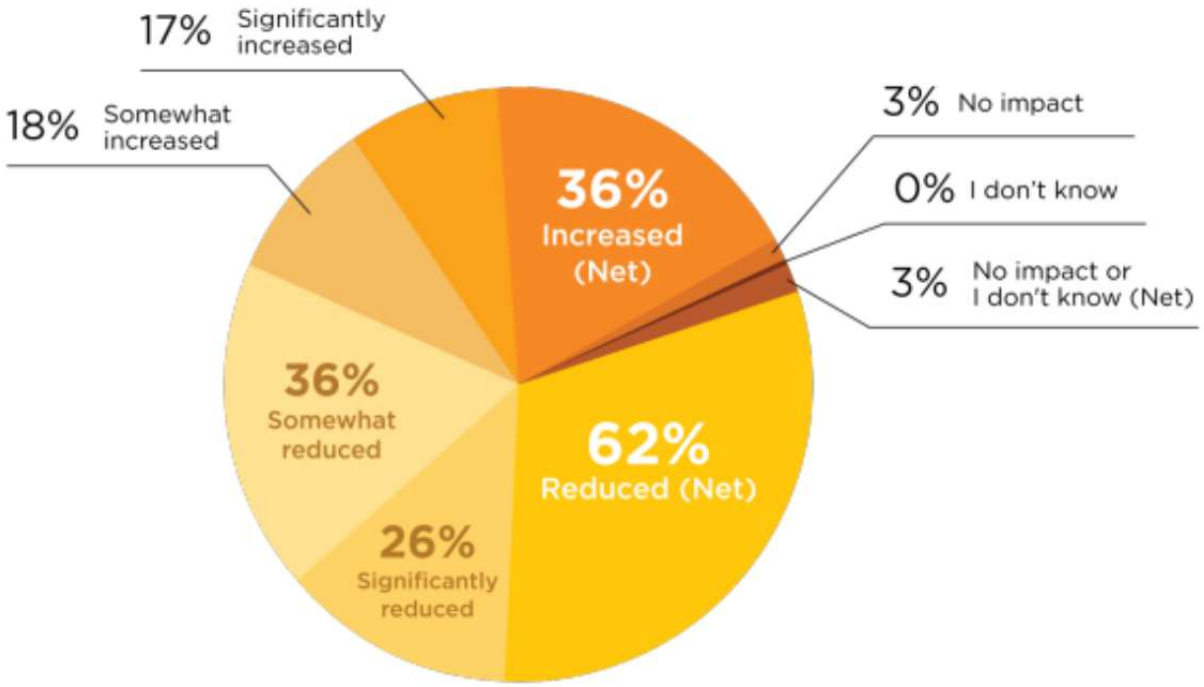
➢ The Fed is getting louder and louder

The most notable Fed speakers of the week was Fed governor Christopher Waller. He proclaimed, "The market seems to have gotten way out in front on this. Everybody should just take a deep breath – calm down. I just cannot stress this is one data point (referring to the CPI). We have a way to go yet." Lael Brainard, vice chairman of Fed, focused more on the pace of rate hikes. She signaled that the Fed would only be hiking by 0.50% (to bring the Fed Funds rate range to 4.25% - 4.50%) vs the previous string of four 0.75% hikes. But she did not mention the need for a lower terminal rate. She only wants more time to assess the damage done to the economy. This means higher rates for longer. A third Fed speaker, Mary Daly of San Francisco who usually flies under the radar, echoed the Waller sentiment, "One month does not a trend make." Esther George of the Kansas City Fed is worried about the overheated job market and wonders how "you continue to bring this level of inflation down without having some real slowing." Apparently, the market only listens when Powell says it. But we know they speak in unison (except for the occasionally outlier…which are nowhere to be found right now).

➢ Chart Crime of the week

We cannot claim to be well versed in "digital twin technology" (although it sounds like something in which Sam Bankman-Fried might have made billions of paper profits). But we do know we have never seen labeling quite like this. Not to mention the numbers don't add up to 100. And why is there a 0%?

- **Please fill in the blank with the response that best applies to you: Using digital twin technology has _____ maintenance and warranty costs at my organization.**



- Quick Hits – FTX edition
  - Tom Brady and soon-to-wife ex-wife Gisele supposedly had much of their multi-hundred-million-dollar fortune in crypto on FTX. Or perhaps they were direct equity investors in FTX itself. They certainly hold the worthless FTT coins. Whatever the case, we now know why they are divorcing.
  - FTX apparently has 134 subsidiaries all over the world.
  - FTX withdrawals, before they were halted, went to mostly brand-new crypto addresses (insiders created their own new addresses and jumped the line to get their money out).
  - Only Bahamian residents could make withdrawals at some point during this cascading chain of fraud.
  - Clever individuals found a loophole to withdraw frozen assets. They bought an egregiously overpriced NFT (nonfungible token, aka make-believe art) on the FTX NFT marketplace. They bought this NFT from themselves. The crypto was then delivered out of FTX, through the NTF exchange, and then into the buyer's/seller's non-FTX crypto wallet. Some was directed to Bahamian accounts when they could withdraw. (Legal schemes like this happen all the time with foreign equities when governments institute currency controls…think Argentina, Russia, Brazil, etc).
  - FTX was hacked for some of its remaining assets (after declaring bankruptcy and after freezing withdrawals). We will bet anything that it was SBF and gang behind the heist.

- Two of the more interesting entries on FTX's balance sheet aside from all the phony-baloney tokens: An asset of $7mm of "TRUMPLOSE" and some sort of weird negative equity entry of $8b called, "hidden, poorly internally labled 'fiat@' account." We are horrified at the grammar, spelling, and sentence structure alone even without the $8b fraud staring the world in the face.
- FTX did experience some *deposits* during the collapse. People were buying crypto assets that were selling well below their prices on other nonbankrupt exchanges. Either these arbitrageurs were extremely brave souls, or they were insiders knowing they could pull their money out unlike regular schmoes.
- One of the senior executives of FTX's trading arm, Alameda Research, was one of the executives of the now-defunct poker site Ultimate Poker. It was shut down because the executives were looking at the players's cards and playing against them surreptitiously.
- SBF created a "backdoor" into FTX's accounting system by which he could transfer out funds without alerting the compliance or accounting departments (there were these departments?).
- FTX's list of creditors was first thought to be over 100,000. That list is up to over one million (and counting if you ask us).
- The indominable Charlie Munger, the vice chairman of Berkshire who has warned about crypto for years, said, "There are people who think they've got to be on every deal that's hot…They don't care whether it's child prostitution or bitcoin."

➢ Quick Hits – regular edition

- The new gas-gathering pipeline rules (aka the Mega Rule) coming into partial effect now and fully implemented in 2035 stem from an explosion in 2010.
- In the dog-bites-man category, the WSJ reports that, "The key to avoiding mortgage rates? Buying homes with cash."
- The WSJ's other: "Mortgage rates are High (edit note: price down) because nobody is buying mortgages."
- Adding to our shrinkflation theme: Cereal, orange juice, and soap are three more items that draw the ire of consumers.
- Jeff Bezos has awarded Dolly Parton $100mm because she is a good person. (We agree. And the best concert we ever saw was Dolly at the Grand Ole Opry. That and Kiss at Dickies.)
- Dolly Parton is worth about $500mm.
- The Dallas Cowboys were 195-0 when leading by 14 points heading into the 4th quarter. Not anymore.
- Tesla has created a drinking glass that cannot stand up on its own.
- UK pensions funds are trying to alleviate margin and collateral pressure from existing derivative contracts on bond holdings by adding more derivatives in the equity holdings. (What could go wrong.)
- JP Morgan said it avoided costly leveraged-loan deals this year because it no longer has close ties to private equity firms.
- Thomas Edison invented the stock ticker.
- A study shows that attractive female college students got worse grades during remote learning.
- Target has lost over $400mm this year due to shoplifting.

Trading: We kept adding slowly to our short exposures. This is the hardest part of the game…staring into the abyss as the market rips against you (or as Lou Manheim once said, "Man looks in the abyss, there's nothing

staring back at him. At that moment, man finds his character.") While we are confident in our view, we must be careful stewards of capital. Slow and steady. We added to Fantasy, Frauds, China, and Housing. We also trimmed some of our longs. We do this more in tax exempt accounts, but it can be prudent to do the same in taxable accounts. Most of this trimming was in Energy. Our opinion has not changed we like Energy. But we know Energy will trade with the market, so we are happy to book some gains and wait for the inevitable dip.

TSLAQ: Longtime Tesla bedfellows might be finally learning what it is really like to do business with Elon Musk. Just two weeks after consummating the purchase of Twitter, Musk is warning about bankruptcy. Seven banks are on the hook for about $13b of debt. They are trying to syndicate the debt…sell it to the market. But having the CEO warn about bankruptcy is not the best way to entice bond investors. Some reports say the best bids for the paper is 60 cents on the dollar. The banks are not willing to swallow this big of a loss (yet). Otherwise, Musk is back in court. He is being sued for his astronomical pay package. The same judge that put him in his place in the Twitter trial is overseeing this one (hat-tip to WGAM for pointing this out). So far, she has remained quiet (unlike her continual slapping-down of Musk's lawyers during the Twitter trial). But the plaintiff's lawyers do seem to be gaining some traction in getting Elon to admit that Tesla is his company and that he answers to nobody. This is the crux of the lawsuit. While we do not think he loses…it is just too hard to prove that he coordinated the pay package without unlimited discovery…we do think it will be another unflattering light shining upon his dwindling persona.

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