Weekly Update

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- Market takes a pause likely from indecision
- Earnings continue to beat expectations
- The inflation debate rages on
- Housing supply is still tight
- PMI surveys still pointing to robust growth
- New Business formation is still on the rise
- The Fed is not changing a thing
- Oil supply discipline seems to be trumping demand worries
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
SPX	4183	0.2%	11.7%	47.7%
QQQ	339.0	-0.1%	8.2%	58.3%
US 10 YR	1.62%	1.56%	0.92%	0.63%
VIX	17.3%	17.5%	22.8%	31.2%
Oil	63.81	4.4%	31.6%	417.5%

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

The market had a quiet week. Even though we had some flare-ups in the narratives, volumes declined along with an absence of the standard rotations. This likely represents indecision more so than apathy. That is, will the surge in the virus fear in developing markets derail the global growth prospects? Is the split verdict on the vaccine in the US going to delay the pent-up-demand Recovery theme? Politically, Biden has introduced the anticipated tax hikes. We think the market could handle one or two of the tax prongs. But if the progressives succeed in hitting the quadfecta of hiking corporate taxes, individual taxes, capital gains taxes, and eliminating the step-up basis treatment for inherited capital gains…the market would be in trouble. But we think this is unlikely. We think Biden will focus his efforts on the endless fiscal giveaways. “Paying their fair share” does not resonate nearly as deeply as “free money for all.”

- Earnings continue to beat expectations

Earnings continue to beat across the board. 86% of companies have beaten expectations on the bottom line (net income) while 77% have beaten on the top line (revenues). Real Estate is the only sector to miss on the bottom line. It is also one of two sectors to have negative growth (Industrials is the other). Energy remains the only sector to have negative revenue growth. But the sector is still beating expectations. Blended earnings growth (combining those having reported and the expectations for those yet to come) is an eye-popping 39.2%.

Exhibit 3. 2021Q1 Blended (Reported & Estimated) Earnings Growth

Sector	Today	1 Apr	1 Jan	1 Oct	1 Jul	1 Apr
Consumer Discretionary	110.6%	99.0%	78.5%	71.7%	76.4%	33.4%
Consumer Staples	5.6%	0.3%	1.0%	1.4%	1.3%	7.8%
Energy	2.8%	-5.1%	-57.2%	-50.1%	-78.9%	-18.4%
Financials	128.5%	68.9%	48.7%	26.9%	31.0%	6.1%
Health Care	22.3%	17.9%	13.9%	11.7%	10.9%	13.7%
Industrials	-8.2%	-13.4%	-0.1%	3.2%	13.0%	34.0%
Materials	53.0%	47.0%	30.4%	21.1%	14.5%	23.8%
Real Estate	-0.3%	0.2%	-2.5%	-2.0%	2.0%	6.1%
Technology	31.0%	24.3%	13.1%	11.1%	10.1%	18.3%
Communication Services	37.4%	13.6%	6.1%	6.5%	8.8%	15.0%
Utilities	1.3%	2.6%	2.1%	2.9%	1.9%	4.2%
S&P 500	**39.2%**	**24.2%**	**16.0%**	**11.8%**	**12.3%**	**14.5%**

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

- The inflation debate rages on

Merrill notes that during earnings conference calls, management team's mentions of "inflation" have tripled since last year. Interestingly, sharp increases in "mentions" tends to lead increases in the CPI by a quarter. As we always say, inflation *expectations* are what really matter. Right now, we are hearing the warnings from economists and mgmt. teams. But the market is telling us that inflation is under control. Yes, lumber prices have quadrupled in the last year. But lumber futures are showing a 30% drop in the next eight months. The same kinda of "backwardation" can be seen in the Ags like the corn, soybeans, and wheat futures curves. And there is even a forward rate for inflation. It is sitting around 2.5% (this is called the 5yr-5yr Breakeven). Hardly 1970's stuff. We find ourselves at a bit of a mental crossroads here. We have shifted a chunk of our portfolio to more interest rate sensitive / inflationary stocks and sectors (Energy, Financials, away from long duration Growth, etc). But if the market is going to believe the Fed narrative that all of this current inflation is, indeed, transitory, then the market might start to reprice some of these inflation winners. We are still riding our longs for now.

- Housing supply is still tight

Existing Home Sales actually dipped a touch in March. They fell 3.7% vs February. This was still a 12.3% increase vs March of 2020. But February closings were delayed by the bad weather. Of course, it comes back the ever-shrinking supply of homes for sale. Supply stands at just 2.1 months of inventory. The continued strength in the market is reflected in the median home price: over $329k which is another record. And houses are only sitting on the market for an average of 18 days. And if there was any doubt, New Home Sales proved the naysayers wrong. The annualized sales rate in March was just over 1mm homes. This is back to the 2007 levels which was on the way down from the 1.4mm level in 2005. For perspective, Freddie Mac (one of the government-sponsored entities that buys mortgages in order to facilitate lending) estimates that the US is short 3.8mm houses currently. We are still long housing.

On the commercial real estate front, we heard landlords are starting to track utilization instead of just occupancy. This is entirely rational as landlords are fearful of tenants downsizing and/or leaving once their leases roll off. In New York City, the utilization is being counted in the 10-15% range. And this includes the large staffs that work in these buildings. We increased our NYC commercial real estate short.

- PMI surveys still pointing to robust growth

The early read on business sentiment in April from Markit, the Flash Composite PMI, hit an all-time high (started in late 2013). Services surged ahead back to their leading ways. For the last year, we have maintained that what the economy needs is for Manufacturing to carry the weight until Services can get going again…and this appears to have happened albeit with continued strength in Manufacturing!

The Chicago Fed National Activity Index for March increased to its highest level since last summer. The KC Fed Manufacturing Index jumped to an all-time high. Dallas Fed Manufacturing hit its highest level in three years. Optimism continues to outpace actual production – the supply/input constraint theme all over again. The Richmond Fed remained steady at a decent level.

- Improving Jobless Claims, still strong Durable Goods, better Inventories

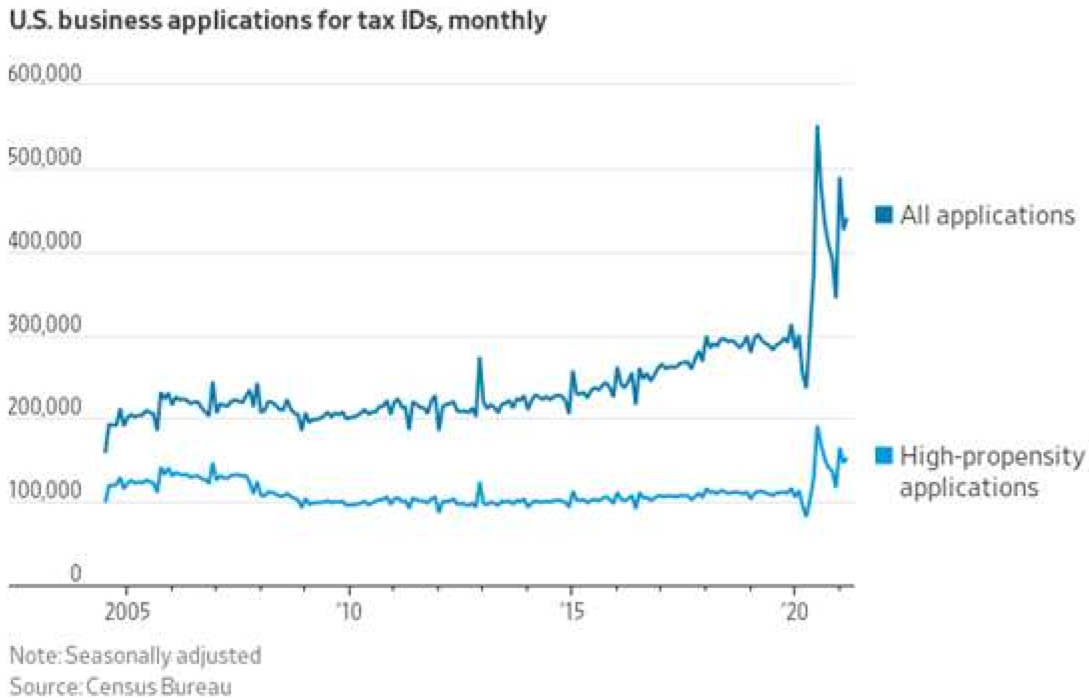
Jobless Claims improved again to under 550k. The 4-week moving average continues to fall, as well. It is now 651k.

Durable Goods continued their climb, but the numbers did miss expectations by a hair. But the bulls will rightly point out that the gross level of spending on Nondefense Capital Goods (aka Core Capital Goods) is at an all-time high.

Retail Inventories declined but Wholeslae Inventories increased (both March). This likely means that producers are able to produce goods, but getting them to the sellers is still problematic.

- New Business formation is still on the rise

The Wall Street Journal ran a nifty story on the increase in tax IDs that entrepreneurs need to start a new business. The High-propensity subset are businesses that are likely to hire other workers. Whatever the case, we enjoy this chart/stat as an indication of good ol’ fashioned American ingenuity and work ethic.*



- The Fed is not changing a thing

The Fed's FOMC left the target range for the Fed Funds interest rate unchanged at 0% to 0.25% (the Fed Funds rate is the interest rate banks use to lend to each other on an overnight basis…the Fed sets a target rate for banks to follow). More importantly, chairman Powell reiterated the message that the accommodative policy needs to remain in place. There should not be any fear of a "taper tantrum" (when the market freaks out over the possibility of higher interest rates). He harped on the Fed's message that it needs to see "substantial, further progress" in the economy. He flatly said they are not even close to seeing this. Powell also emphasized that the Fed looks at hard data and not projections. We think this is broadly smart. But we also think it sets up the Fed to be late to the party (or the last drunken sailor at the party as it were.) Specifically, he does not see wage inflation; he expects the labor force to expand. The droves returning to the workforce will keep a lid on wages. Of course, the government must stop paying people *not* to work for them to want to return to actual work.

When asked why the Fed is buying Mortgage-Backed Securities (MBS) when the Housing market is booming, Powell explained that the buying is not intended to provide direct support to the housing market. Rather, mortgages have one of the most direct relationships with interest rates, and they play an integral part in the financial plumbing. We have touched on this in the past, and we think he is right on the surface (bankers/dealers having to re-hedge themselves after large refinancings, etc). But we think it would be a good first step to wean the market off the Fed teat. Nonetheless, it is a positive for our long Housing position.

We should add that the Bank of Canada has officially started to slow its bond buying program. This is at odds with the intensifying lockdowns and restrictions across the country. Some point to a resilient economy. But the strength in commodities is what is sustaining the growth. Our point is that the US economy is in much better shape and is much better balanced, and yet the Fed is trying to thread the needle perfectly. Gulp.

- Oil supply discipline seems to be trumping demand worries

It looks like OPEC+ is going to maintain its discipline in easing production cuts. Cutting through the triple negative parlance, this means the cartel will follow its plan and only slightly increase production on May 1. Moreover, the group canceled its meeting to formally discuss any potential changes. Usually, this band of stepbrothers waffles and dallies into delays. And we thought this might continue as there was some concern about the virus surging in India (the world's third largest importer of crude oil). But the Russian Deputy Prime Minister put it simply, global "oil demand was recovering." Quite frankly, Russia was going to say this no matter what (they are the ones always wanting to increase production unreservedly). We might get some noise out of the current talks with Iran about reviving the nuclear "accord." But we think Iran is already exporting to China. And most experts expect Biden to move slowly (no joke intended).

- Chart Crime of the week

We sympathize with the creator of this Tesla chart. This economist (not sure why he is charting Tesla like this) is trying to explain why Tesla is in bubble territory. We think he just drew a bunch of nonsensical lines and threw in some catchy phrases like "Bull Trap."

- Quick Hits
  - One of Mark Cuban's keys to becoming financially literate is to…learn finance.
  - Rumor has it that Mark Cuban tells his basketball team to play better basketball if they want to win more basketball games.
  - Esports is now a varsity sport at U Michigan. Esports will be an academic minor in 2022.
  - A survey shows that 66% of Americans have an increased desire to buy an Electric Vehicle. The same survey tells us that 81% believe there are still barriers to actually purchasing one.
  - High-end restaurants in NYC are reversing a virus-fear phenomenon by eliminating delivery because of the high fees (and probably because they do not capture the tip which goes to the driver only).

- 25% of all venture capital funding during the last 10 years has gone into food delivery businesses.

*Random aside, an oldie but a goodie: Back in the day, we had a meeting in London with Phil Gramm, the longtime Senator and one-time presidential candidate from Texas. After Senator Gramm professed his admiration for and faith in the American spirit and work ethic, he commented about having a Texan in the office: "It is always good to have one on hand in case a gun fight breaks out."

Trading: Without the market rotations, there was not a lot of trading. We are comfortable with our exposures which are now biased towards Recovery/Reopening with some inflation. But we also will probably be early sellers of this trend. Along these lines, we sold our Dillard's long. It doubled since we first bought it. We added a bit to our small long in one of the domestic airlines. Google noted that ad spending as increased dramatically in travel. And we do not want international or business travel exposure. We trimmed a bit of our healthcare exposure. Even though Bernie Sanders did not get his drug price-cap nonsense jammed into the latest Biden spending bonanza (the America Families Act, just another $1.8t), we do think the goodwill earned by the drug makers because of their yeoman's work on the vaccines is long gone. We could see further pressure to restrict drug pricing. We rotated a little of our long Gold exposure into Silver (more functional utility with the same hard-asset financial quality). We added to our ARKK short. This is functioning as a hedge against our High Growth long (we embarrassingly have a few names that overlap with ARKK). We added a little to our old school Tech. And we are juggling some of our SPAC exposures (moved some to warrants instead of stock). We also trimmed some of our Staples. This was just clipping some profits on things that have had good runs. We also put back on our Tesla short just ahead of earnings.

TSLAQ: Tesla reported earnings. As usual, they made the headline look ok with a small profit. Of course, it takes about two seconds to peel back the first layer of the rotten onion. The company only made money by selling "zero emission" credits to other car manufacturers. The runway for this "business" is coming to an end very soon as every other car maker in the world is building EVs now (so no need to participate in this government sponsored shell game**). And the other source of positive income was from the company selling some of its Bitcoin. When The Villain pumped the crypto endlessly on his Twitter, it was under the guise of being a long-term investment and/or cash management vehicle. A month later…not so much. Of course, the pump got the desired result as it helped earn Musk an $11b bonus. Yes, that is $11,000,000,000.

We recently noted the heat on Tesla stemming from the driverless crash in Houston. But we omitted the trouble Tesla is encountering in China. The latest twist is that the government of Guangzhou (population 15mm) is prohibiting Teslas from driving on the highway because of safety concerns. Apparently, this was in response to Tesla not turning over the vehicle data that was involved in a crash last week. The Chinese government might be murdering, corrupt thugs, but they know how to deal with fraudulent liars!

We all know that the fanboys justify the extreme valuation of Tesla because it is "doing good" with Elon as their "leader." We are curious what they think about the company being served a notice from the EPA for not being compliant with hazardous pollution rules.

**Tesla's financial obfuscation gives "shell game" a bad name. The infamous shell game guys in Times Square back in the day were vindicated by the court system. The shell game or three card Monty was ruled a game of skill and thus legal.

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