Weekly Update

23-June-2021

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- The Fed adds to the confusion
- Market is still expensive, but the Fed does not care
- Inflation? Maybe not
- Housing is still slumping from its peak
- Other Rosenberg one-liners
- There is some dissention at the Fed, but not at the top (they will keep pumping the $)
- Is Bitcoin decentralized? A store of value? Ha!
- Iranian elections bad for mankind, but good for oil prices
- Work-From-Car?
- Chart Crime of the week
- No Weekly the next two weeks, so this one is extra long
- Click here for the full note

	Last	5d %	YTD %	1yr %
SPX	4242	0.8%	13.7%	38.1%
QQQ	347.7	2.1%	11.1%	41.7%
US 10 YR	1.49%	1.56%	0.92%	0.68%
VIX	16.3%	18.2%	22.8%	33.8%
Oil	73.26	1.9%	50.6%	81.0%

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

The aftermath of last week's Fed meeting (FOMC) was confusion (more so than usual). Some parts of the market took their cue from the official change in inflation expectations and the rate hike timetable. Commodities in particular were hit hard as the USD rallied under the prospects for higher rates (but not oil - it remained strong, see below). But equities followed the guidance from chairman Powell that no change in monetary policy is imminent. In particular, Growth stocks were the leaders as the long duration assets stand to benefit from their future cash flows (vs current cash flows from Cyclicals or other Value names). Even when the dust settled after a few days, it seems that investors are moving back to where they are traditionally comfortable. Hold on to Big Tech and avoid Value and Cyclicals. Small Caps were shunned, but this was more short-lived as they still represent the Reopening of the economy. And despite all the reshuffling and noise in the market, last week's Fund Manager Survey from Merrill lined up perfectly with Powell's message: 72% said inflation was transitory. And while we might have hit peak earnings growth, we are still mid cycle without a

recession expected until 2024. We hate to agree with the masses, but we do to some extent. We will use our diversification and trade against any short-term blips. We will ride our Reopening trades a bit longer as we think there are still some tailwinds. But if we start to see the Labor Participation rate pick up and more stagnation in congress, we will unwind these Reflation trades (because these are both deflationary and they will exposre the underlying weakness in the economy…much more on this below).

- Market is still expensive

Here is an interesting chart that combines four valuation metrics and compares them over time. The metrics are Price/Earnings, Price/Book Value (Assets-Liabilities), Price/Sales, and Enterprise Value (Equity Market Cap plus debt)/EBITDA (basically cash flow). The y-axis, the Z-score, is the number of standard deviations from the mean. Needless to say, the market is not cheap. The uber bulls will say these metrics do not incorporate revenue growth. Fair enough. While we side with the chart in isolation, we side with the Fed for now (ride market higher but have protection for the next hiccup).

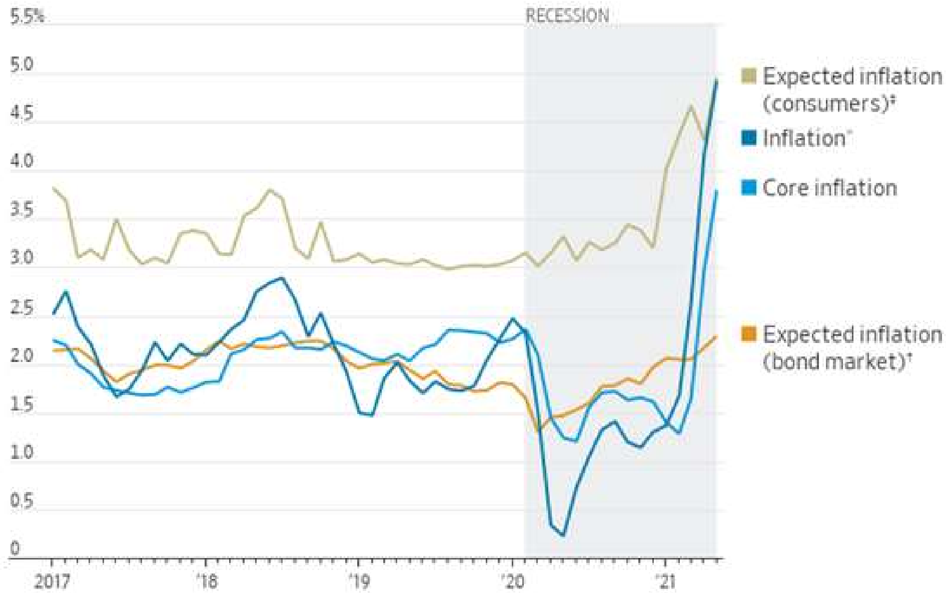
- Inflation? Maybe not

The inflation debate continues to rage. We still lean towards price increases being transitory (and we still shutter at being intellectually conjoined with the Fed). We still acknowledge price shocks (and delivery delays and quality decreases). But ultimately, we think the underlying economy in the US is not nearly as strong as the post-stimulus numbers reflect. At the risk of sounding repetitive (never!), when the special unemployment benefits start to roll off (next week), we might just start to see some deflationary pressures.

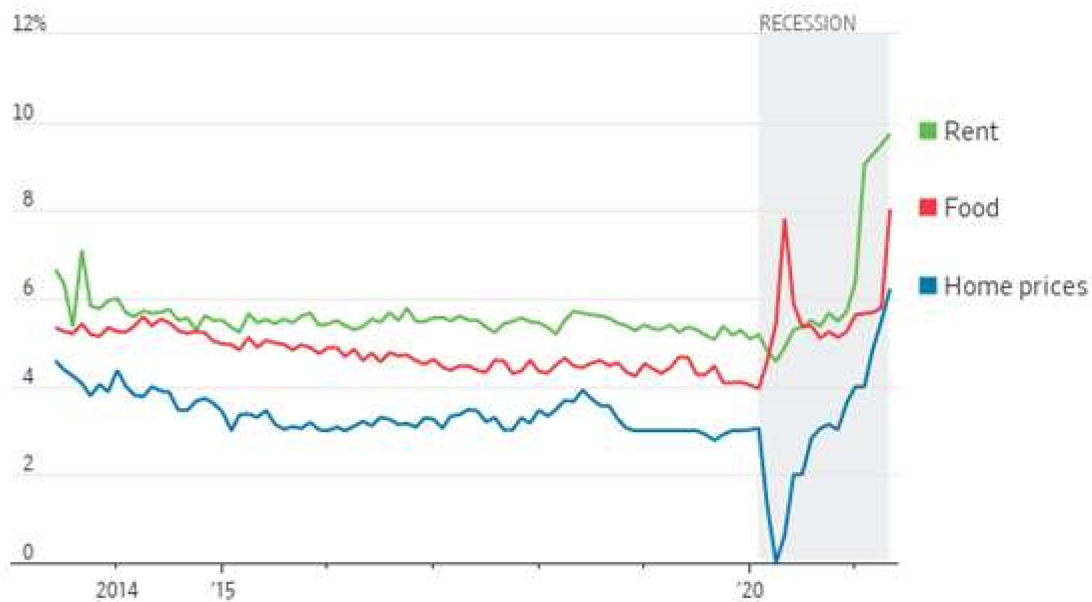
David Rosenberg (smart, usually wrong, maybe right this time) is one of the loudest voices in the deflationary camp. He claims we are still in a global pandemic (he is Canadian, after all). He says the global economy would have been extremely weak without the fiscal intervention: US GDP would be 6% lower. Vaccinations and

stimulus checks are still the driving forces behind economic activity. The supply side is still reluctant to keep pace with this artificial demand. That is, the logistics snafus are a direct result of companies not wanting to ramp up production only to see demand ultimately fade. Along these lines, the economic data has been 6x more volatile than normal. This elevated uncertainty fits with the supply side keeping a lid on things. On Inflation specifically, he thinks it is concentrated in just 20% of the index (CPI). All of these are born out of the pandemic (or the responses to the pandemic). The other 80% represent the underlying trend and not the shocks. The Cleveland Fed Median CPI is still only 2.1% which is actually down from 2.8% pre-virus! Household deleveraging is negative for Aggregate Demand (paying down debt instead of spending money…hardly something to decry). And the long end of the Treasury curve is telling us there is no inflation. Moreover, the flattening of the yield curve tells us that the Fed would be making a mistake by withdrawing monetary stimulus. The Fed can really only control the short-end. If the market disagrees with the Feds assessment, it pushes down long end rates in the face of higher short end rates. The market it not screaming yet, but it is certainly raising its voice.

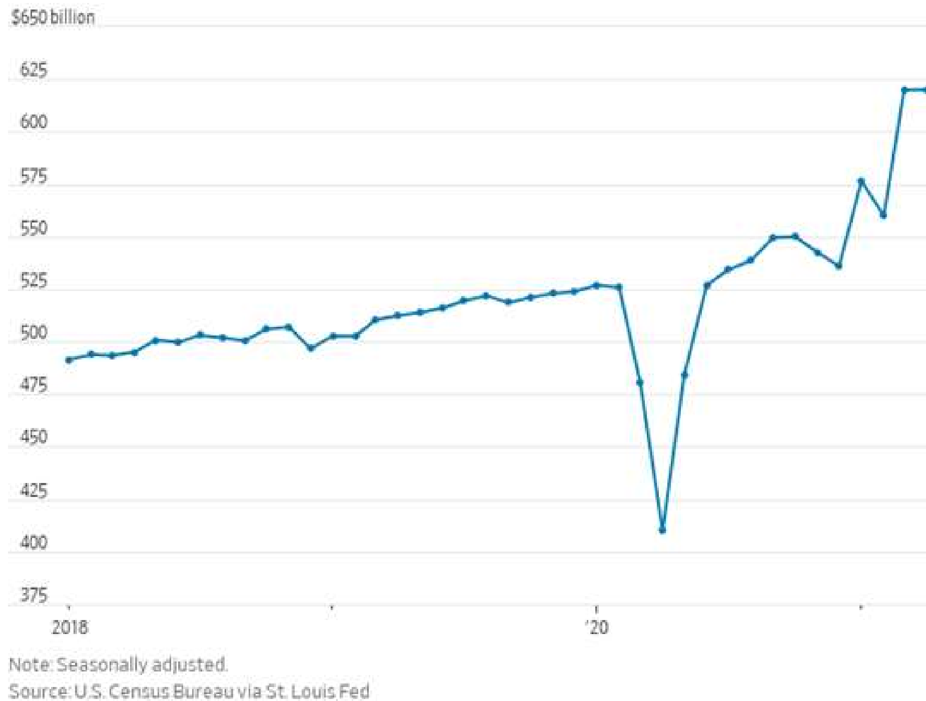
Here is the discrepancy in inflation measures. One-off shocks and panicky consumers are the high levels shown. The ultimate peer review in the market, the bond market, thinks things are just now back to normal.



Here are the categories that people expect to jump the most. Obviously these top almost everyone's list of importance. Again, if labor costs start to shrink, most pricing categories will experience some decompression.



We think it is fair to say that this Retail spending trend cannot last. We are long some select Retailers that we think are more geared towards a Reopening. These are the trades we will be looking to exit as the stimuli fade.



- Jobless Claims weaker, PMIs mixed, GDP proxy weaker

Jobless Claims ticked higher for the first time in months. 412k is still within a reasonable range.

The early look at the June Markit PMI (Flash) came in well below expectations. Services missed by five points which is very large. Of course, this just brings the index back down to the April level. But the trend is what is important in diffusion indices which tend to incorporate some recency bias (but we do ignore small blips at otherwise strong levels).

The Philly Fed Manufacturing Index ticked lower, but it remains at a decent level. The Richmond Fed Manufacturing Index beat expectations in June with its second highest reading since 2018. The Chicago Fed National Activity Index missed expectations in May. And the April number was revised down to a negative reading. This index is not survey based but rather it is an average of 85 datapoints. Chairman Powell has recently noted the overly optimistic nature of the surveys vs the underwhelming hard data. We typically value survey data more because they are forward looking. But obviously hard data can start to influence those forward views.

- Housing is still slumping from its peak

Existing Home Sales beat expectations for May, but they still dipped compared to April. This was the fourth straight monthly decline. The market has declined from an annualized rate of about 6.7mm homes during the recent peak (Oct-Jan) to about 5.8mm homes now. The average heading into the virus-fear was about 5.5mm. A lack of inventory is still to blame as it is down over 20% vs last year. Of course, prices are tempering demand as the median home price climbed to over $350k (record) which is up 23% vs last year (another record).

New Home Sales followed the same slumping trend. The May annualized number fell to 769k, and April was revised lower from 863k to 817k. Low Inventory has been cited during the last few months as one of the root causes of declining sales. However, supply ticked higher in May to about five months up from four months (this

is not a linear relationship because the declining sales trend increases the inventory percentage). Six months of supply is considered the equilibrium point. But prices are definitely still an impediment to sales: the median new home price hit $374k which is up over 18% vs May of last year.

- Other Rosenberg one-liners
  - Trump's second stimulus on Dec 27 reinvigorated the struggling economy.
  - Debt dynamics and bad demographics are tough obstacles to overcome.
  - Employment is coming back but with intense fiscal withdrawal. Productivity is key to keep National Income growing. Of course, increased productivity is deflationary!
  - Fiscal stimulus (checks) has no multiplier effect.
  - The Fed's quarterly report on the Flow of Funds shows that Household Savings are now overwhelming the deficits in the public sector. This dynamic is deflationary (government spending money but not the people).
  - People getting excited about the return of leisure should not…it is only 4% of GDP.
  - Durable Goods have been bought…but this cannot continue.
  - Home buying and auto buying intentions are at lowest point since 1982.

- There is some dissention at the Fed, but not at the top (they will keep pumping the $)

Adding to the confusion following the FOMC meeting last week were comments from James Bullard of the St. Louis Fed. Some paraphrasing: The economy is better than expected. It is natural that we have tilted a little more hawkish to contain inflationary pressures. The market was right to receive the hawkish tone put out by the committee.

Of course, the doves like John Williams of the NY Fed rebutted this message: Conditions have not progressed enough for the Fed to shift policy stance.

But what really matters is the message sent my chairman Powell. During his testimony in front of congress on Tuesday, he did just this. He emphasized the goal of low unemployment over guessing whether inflation was transitory or not. And yet he still drew a line (not a Syrian red line) that inflation was, indeed, transitory.

For what it is worth, the Bank of Japan (BOJ, central bank) was back buying ETFs in the market this week (first since late April).

- Is Bitcoin decentralized? A store of value? Ha!

China continued its regulatory efforts against Bitcoin and other crypto. The People's Bank of China (PBOC, the central bank) decreed that banks cannot support crypto transactions. And the province of Sichuan has ordered all crypto mining activities to cease. The communists do not like losing control over something. And this jibes perfectly with their intent to create their own national cryptocurrency.

Right on cue, the crypto guys are now talking about regulation being a good thing. CNBC trotted out Michael Novogratz who runs crypto funds and trading services (not exactly an unbiased source, but he seems likeable and can eat humble pie when he must) proclaimed the only way for large institutions to get on board with the asset class was to have greatly intensified regulation. Of course, he is right. But this is antithetical to what the Coiners champion – a decentralized market with no ties to any governments (the libertarian in us applauds the notion, but crypto is still just for speculation).

As far as Bitcoin being called a "store of value," we think we can dispense with this folly. It fell 30% in the course of seven days. Moreover, this year, it has dropped by over 10% in a single day five times. It always seems to

bounce, but not before margin calls flush out more leveraged suckers. Here is a great, random tweet with respect to Bitcoin, Doge or whatever:

Replying to @MarginCallMike and @saxena_puru

It's a viable hedge against wealth.

5:46 PM · Jun 21, 2021 · Twitter Web App

- Iranian elections bad for mankind, but good for oil prices

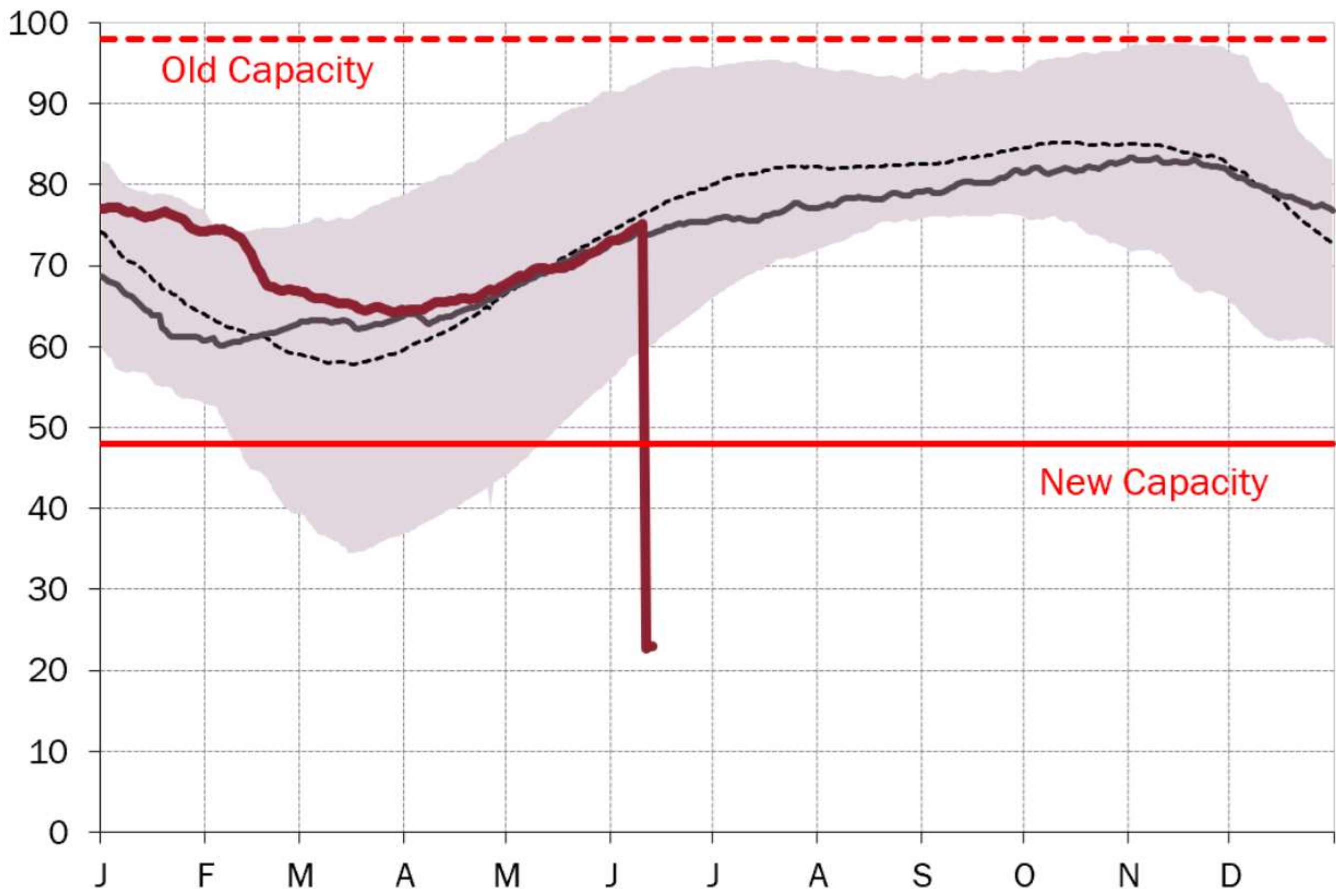
The perfect storm in oil prices continues. One of the worries about increasing supply has been Iran returning to the global scene. On top of Iran increasing its exports, this action would trigger other rogue OPEC+ countries into producing more oil (optimizing or beating the Prisoner's Dilemma is not a strength among these movie-villain countries). Alas, leave it to the Iranians to "elect" a hardliner to "president". Even if Biden (and the French et al) wanted to roll over for the terrorists, "president-elect" Ebrahim Raisi has already ruled out meeting with the West (specifically snubbing Biden). This week, when asked if he had any regrets about executing political prisoners since 1988, Raisi said, "I am proud of being a defender of human rights." Needless to say, we are not expecting a new deal with Iran. Estimates for what Iran could produce and export vary. But the export number is probably in the neighborhood of 3mm barrels per day from the current level of 1mm.

- Work-From-Car?

The one hitch to all the positive momentum in oil is all the positive punditry now surrounding oil. Case in point: Merrill Lynch is calling for $100 oil thanks in part to the soon-to-be trend of "work-from-car." The idea here is that people that work from home will be doing more errands in their cars during the day. This rationale escapes us. Merrill is likely just jumping on the momentum train and backing in reasons. We are still bullish on oil (pent up travel demand, pent up industrial demand, Biden clamping down on the industry will only help prices, US inventories falling, and Saudi keeping supply under wraps notwithstanding the recent rumor of supply increases in August…we think this expected), but this kind of blind research is befuddling.

- Chart Crime of the week

California. In our next lifetime, we might just write about California. Below is a chart of natural gas inventories according to PG&E, one of the six power utilities in California mostly known for burning thousands of acres out of incompetence. In the fine print (not included, it is that fine), California explains that 50Bcf of natural gas in storage has been reclassified as cushion gas from working gas. This just means that they wish to leave more gas in the storage reservoir to help with delivering pressure. Whatever the case, it does not change the amount of gas in storage. But hey, California can say it cut down in its gas storage!



- Quick Hits
    - Pennsylvania has hosted the most USGA golf events.
    - Mark Cuban "invested" in a stablecoin that went from $10 to $60 to $0. "Stablecoin!"
    - A new law in Colorado forces companies to disclose the expected salary for every open position for which they advertise.
    - A New York Times op-ed pushed for more economic supply to meet the current hot economic demand. Keep the party going forever!
    - The SEC's former head of an Oversight Board is being investigated for his handling of internal oversight.
    - HUD (Dept of Housing and Urban Development, Rick Perry should have added this to the wishful banishment list along with Commerce, Education, and Energy) wants to boost homeownership for buyers with high student debt. 2008 called…
    - The new CEO of rightly maligned Lordstown Motors said the company had "pretty binding preorders".
    - The IRS ruled that "bible teachings" are "affiliated with the Republican Party."
    - The College World Series is expected to have a $90m impact on Omaha.
    - The Philippines is looking to arrest people that refuse the vaccine.

- Two academics at the University of Sheffield published an article in the Oxford Journal of Legal Studies imploring society to criminalize hate speech against animals: "Some animals do seem to have their social confidence eroded because of their awareness of the risk of violence."
- California is asking residents not to charge their electric cars from 6-9pm.
- California is banning some manual transmission cars.
- 20% of Californians that have bought EV's have subsequently bought an old-fashioned gasoline car.
- Chicago's mayor defended the city's crime rate and safety record by saying "last night's…shooting happened in a house, not on the street." Phew.
- A leaked government document in England suggests that plexiglass screens (called Perspex in Brit-speak) actually increased the spread of the virus (not to mention the virus-fear) because they blocked airflow.

Trading: We started our exit from the reflation trade at the right time. We knew this would turn before the data actually turned. Of course, we did not completely get out of our reflation/inflation trades. But we will take it as a small victory anyway. The thing to do now is to pick up the pieces that should not have cracked. We think these include our Retail names. We are still skeptical of Housing. Financials might continue to get squeezed by the yield curve flattening (paying more for deposits but making less on loans). Energy and Materials will probably continue to be primarily trading vehicles. We think even the biggest bulls right now think these are short-term plays. This means we can make some money but it might be tenuous. We are keeping our Big Tech longs steady.

TSLAQ: Tesla mouthpiece and shareholder Electrek published this photo for an article entitled: "Tesla is getting closer to production at Gigafactory Texas as Model Y body is spotted on-site."

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