Weekly Update

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- Market is quiet except for the mindless rotation
- The pundits do not know how to define Inflation
- The economy is growing without jobs (again)
- Housing Data is still stagnating
- The Fed statement is hawkish, but Powell goes dovish
- Chart Crime of the week
- Click here for the full note

	Last	5d %	YTD %	1yr %
SPX	4224	0.1%	12.8%	40.0%
QQQ	341.0	1.2%	8.8%	43.7%
US 10 YR	1.56%	1.49%	0.92%	0.73%
VIX	18.2%	17.9%	22.8%	33.5%
Oil	71.86	3.0%	48.7%	88.0%

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

The market indices remain in summer-slumber mode. But this depressed Volatility belies the still ongoing sector and factor rotations underneath the surface. This is no surprise as the market is still trying to wrap its head around the inflation debate (more below). With this uncertainty, the rotations seem more random. This is likely short-term traders struggling to find their footing as the narratives remain flimsy if not absent. Biden is toiling around with the useless G7 gathering. The Fed is not about to change its policy framework, but hey, it is talking about talking about changing things. There is a lull in earnings. There really is not much for serious investors to digest.

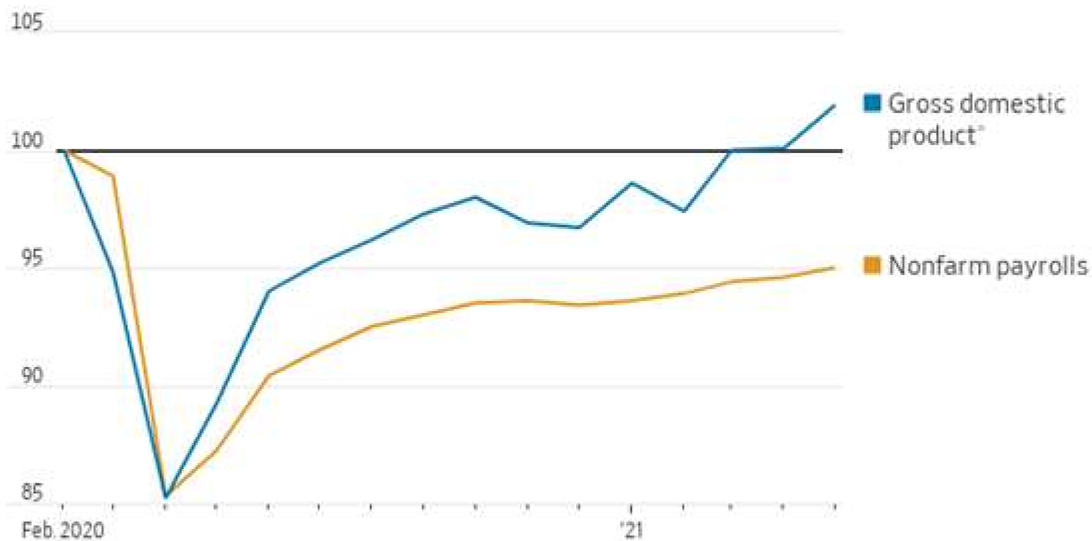
- The pundits do not know how to define Inflation

The media frenzy surrounding inflation hit a nadir with the higher than "expected" Consumer Price Index (CPI) which showed the "core" increased 3.8% in May vs last year (the headline was 5.0%). But the details of the report are hardly surprising: airline tickets, used cars (up over 80%!), natural gas, and apparel all surged. But as the economist David Rosenberg points out (super smart guy, has been wrong a lot, but might be onto something now), "inflation is a sequence of price increases, not a one-off shift in price level to protect profit margins from a short-term dislocation between demand and supply." Yes, we still maintain that these moves are mostly "transitory" and that bottlenecks will be relieved. And the flow of workers rolling off the government teat will

be deflationary. Of course, we expect some inflation to stick. This is only normal for an accelerating economy. We just do not think we are in the runaway train environment (not yet anyway). On the flip side, some have pointed to the last three months showing the quickest 2% jump in inflation since 1982. Below is a chart of the 3-month annualized "core" CPI. But these are annualized numbers…we are comparing abnormally tight conditions today vs deflation in the teeth of a global shutdown a year ago.

- The economy is growing without jobs (again)

An obvious disconnect is the growth in the economy vs the growth in payrolls. Here is a chart that shows it all.



Much of this can be explained by the sectors which have been growing. Software investment has grown more than 12% since the 4Q2019. Investment in physical structures has dropped about 17%. Obviously, these sectors have diverging levels of labor intensity and productivity. Statistically, the number of workers that have left their jobs voluntarily ("Quits") has hit a 20-year high. While many of these workers have not reentered the workforce, those that have switched have seen their wages grow by almost an extra 1% compared to those that stayed in their jobs. Of the workers not reentering the labor force, many are early retirements. This is likely a deflationary pressure as younger, less experienced workers will have to be hired to replace the more expensive retiring workers. All in all, we will see more balance in the labor market. We think this will dampen inflation risks but not derail the economy.

- Housing Data is still stagnating

The Housing Market Index (a survey of home builders) continues to hover in its six-month range. The pessimist would point out that the June number was the lowest since August of 2020. Unsurprisingly, higher costs and input shortages (lumber) are the worries sited. Housing Starts in May climbed from their levels in April, but they still missed expectations. Housing Permits sank a bit in May. Following our view on employment and inflation, we think the two short-term headwinds for Housing will reverse (cheaper input costs). And the demand side should remain robust with the medium to long-term narratives intact (migration out of the cities, migration to better climates, need for work-from-home space, etc).

- Retail Sales worse, Industrial Production better, NY Manufacturing ok

Retail Sales turned negative in May vs April. The overall level is still just below its all time high.

Industrial Production in May increased more than expected but April was revised lower.

The NY Fed's Empire State Manufacturing Index missed expectations and moved lower for the second straight month. The level of optimism (from survey respondents) is still on the high side.

- The Fed statement is hawkish, but Powell goes dovish

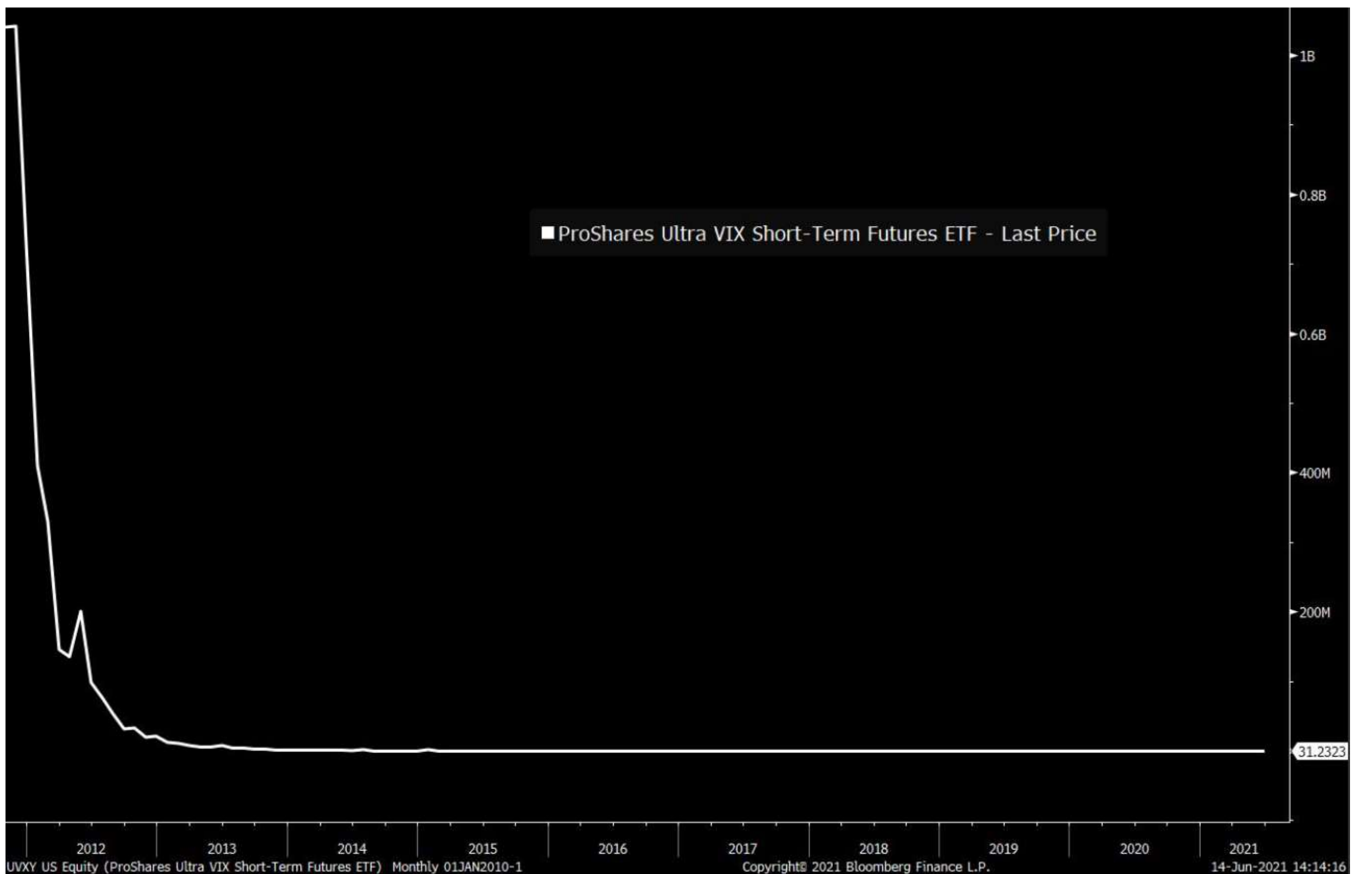
The Fed did not alter any of its policy positions. Overnight rates (Fed Funds target) are still effectively 0%. Asset purchases will continue at $120b a month ($80b in Treasuries and $40b in Mortgage-Backed Securities). And the Fed did not directly point to any future "tapering" of these asset purchases. But the Fed's in-house predictions for the economy improved along with its view of the labor market. The economy is expected to grow 7% this year from a previous guess of 6.5%. The Fed also boosted its guess for inflation in 2021 to 3.4% from 2.4%. Furthermore, three members of the Fed did move forward their expectations (the "dot plot") for the first interest rate hike to be in 2022 instead of 2023. This makes seven looking at 2022 and 13 remaining in 2023. Moreover, the committee now expects two rate hikes in 2023 not just one.

As much as we feel the need to explain the nuances of the "dot plot" and its moving parts, we know it is more relevant that chairman Powell tells us to basically ignore these predictions. And he did so again during his press conference. Powell addressed the fact that the committee started to talk about talking about tapering. But he reiterated his relative disdain for outlooks and predictions and pledged his allegiance to outcomes (hard data). He even went so far to be lightly dismissive of survey data since this can blow with the short-term winds. The media catchphrase is "Outcomes over Outlooks."

The Fed did modify its Interest on Excess Reserves by 5bps (0.05%) to 15bps and the Reverse Repo rate (a similar overnight cash-parking facility) from 0% to 5bps. These are mostly technical in nature. But they do serve the purpose to keep interest rates closer to the middle of the Fed Funds target range.

- Chart Crime of the week

This chart shows the performance of the UVXY ETF. While the shape of the curve is accurate, it is a wee bit disingenuous to use the y-axis range of $1billion down to $31. While we hate this ETF for betting on Volatility futures with leverage, we do acknowledge that it is meant to be a very short-term trading vehicle. A 10-year chart is pointless…unless you want to scare someone with the $1b mark.



- Quick Hits
  - Colorado bettors have been wagering about $10mm per month on ping-pong matches.
  - United Airlines says its stewardesses received 20,000 official compliments in 2020 and only 1,000 official complaints.
  - United Airlines is investing in a new in-flight, feedback technology.
  - A new academic study posits that lower Labor Participation rates have been caused by fewer people completing the employment surveys.
  - The male and female winners of the French Open won the same amount of money: $1.7mm.
  - A new study shows Environmental, Social, and Governance (ESG) funds charge higher fees, perform worse, and invest in companies with "significantly more labor and environmental violations" than companies in non-ESG funds.
  - "Green" bond issuance has exploded hitting over $270b in 2020.
  - Sample wording from a recent certified "green" bond program, "No assurances can be produced that allocation to projects with these specific characteristics will be made by us."
  - Mudrick Capital was long AMC stock and short Calls against it (a common and reasonable strategy). Mudrick sold its AMC stock but kept its short Call position for "insurance." Mudrick needs a lesson in insurance.
  - There are at least five different types of grass at the US Open golf site Torrey Pines. This is not intentional.
  - 83% of recorded-music revenue is from streaming.

- Saudi oil giant Aramco is borrowing money to pay its dividend (US companies do this all the time but not recent IPOs).

Trading: We started to unwind some of our inflation bets around the margin. We have been saying we want to be ahead of the crowd even if the crowd is right. If the crowd is wrong? We definitely want to be ahead of it! And as David Zervos of Jefferies likes to remind people, inflation is a lagging indicator. We still like some of our Reopening plays despite them performing poorly recently. We think this is mostly the aforementioned rotation-trading, so we are happy to buy the dips. ON the flip side, we are keen to increase our cash positon.

Here is a public service announcement regarding option trading. We tried to short one of the crazy meme stocks this week, Clover Health (CLOV). We think the research points to a challenging business model and the original sponsor Chamath (it was a SPAC) is likely to dump his stock on any rally (lock-up rules for SPACs are tricky and fluid). With the stock around $22, we wanted to buy the August $15 strike Put for about $4.50. Three days later, the stock price was down to $14. We knew it, we are geniuses!. But the option price was….wait for it…$4.50. Not so genius after all. This is a lesson in Implied Volatility. In other words, the time to buy options is when things are quiet. When things are crazy, you want to be selling options.

TSLAQ: One detail of the canceled Model S Plaid Plus supercar that has been overlooked is the canceled battery technology. The Plaid Plus was going to be the launch of the new battery cell. Chalk it up to another Musk promise haven fallen flat. And to cover up for this rather large misstep (remember it is a technology company not a car company as they say), Musk got back on Twitter and started ying-yanging about Bitcoin.

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