Weekly Update

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- This market does not need rate cuts
- Maybe the Fed is ahead of the game
- Tax receipts might be telling the story
- Some Positioning is overly bullish with a hint a skepticism
- Earnings are still improving
- Inflation persists, but it is still near the Fed's sweet spot
- Housing is slowly normalizing (very slowly)
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	5,092	0.1%	6.8%	29.8%
QQQ	$425.52	0.2%	7.2%	50.4%
US 10 YR	4.26%	4.33%	3.88%	3.99%
USD/DXY	104.1	104.0	101.3	104.5
VIX	13.4%	15.3%	12.5%	20.6%
Oil	$78.28	-0.4%	9.2%	1.6%

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

The market continues to tell us that it does not need rate cuts to survive if not thrive. Even though some economic data has slowed, and inflation has ticked higher, the markets are back near all-time highs. The expectation for a rate cut in May is now down to 24%. This was 88% one month ago. June is still likely with a 65% chance. But this is down from a 100% chance a month ago! (Never believe there is a 100% chance of anything!) Looking at this another way, heading into 2023, the market was expecting 50bps of cuts, and we got 100bps of hikes. And the market loved it! Of course, a resilient consumer (despite the mounting credit card debt and slower sales in Jan) and a new wave in Artificial Intelligence (we have lambasted this term and the notion before, but now we are seeing real money being spent by deep-pocketed customers) are powering the market and the economy. There are still plenty of potential landmines out there (sticky inflation, a lack of full-time employment growth, government spending problems, commercial real estate stress, geopolitical disruptions, general complacency, rich valuations, etc.), but the market and the economy should be able to keep chugging along. Of course, it is worth repeating that companies that are missing earnings or providing weak

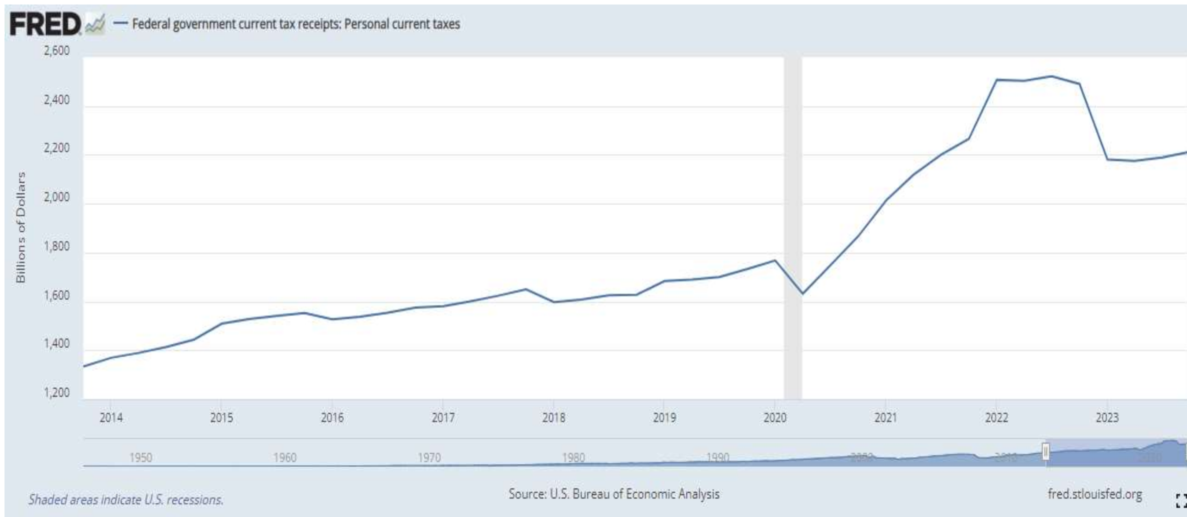
guidance are particularly vulnerable. So, while we own Nvidia and some other promotional companies, we are also balanced with some conservative management teams across different sectors (primarily Energy and Health Care).

- Maybe the Fed is ahead of the game

All the Fed members continue to rollback expectations for rate cuts. One angle as to why comes from Jim Bianco (a level-headed economist). He is making the argument that financial conditions are super easy right now. Here is his line, "Restated bluntly, a 5.5% funds rate is not restraining anything. So, cuts are not necessary." John Mauldin puts it similarly, "The Fed never really tightened in the conventional sense. They didn't constrain economic activity enough to reduce demand. Yet inflation dropped."

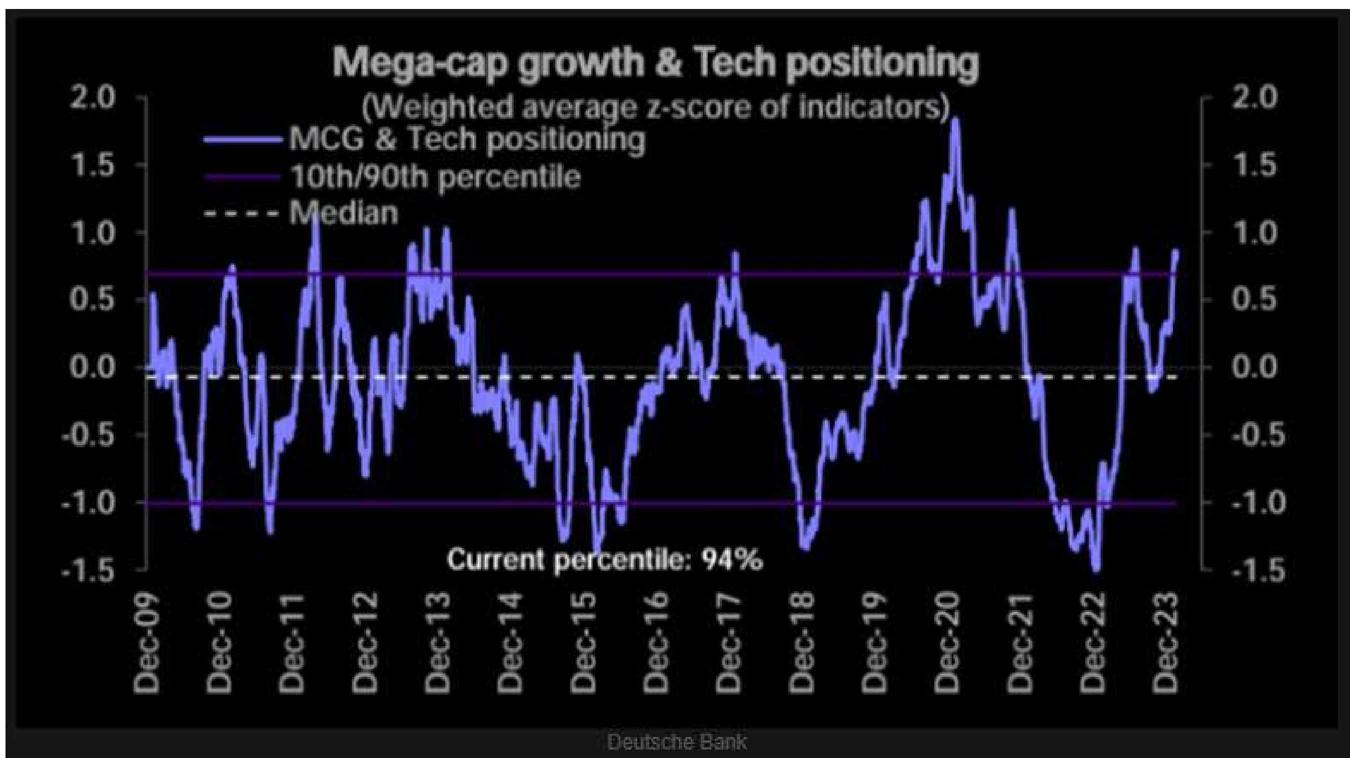
- Tax receipts might be telling the story

Our partners at Walnut Green like to look at the amount of tax a company is paying. If they are paying taxes, then they are making real money. The same intuition can be applied to the economy. If the federal government's tax receipts (we do not call them revenues) are increasing, then that is a good sign for the economy. Here is a 10-year chart. The Virus Fear was nary a blip. And 2022 was overinflated from capital gains from panic stock selling. But the trend certainly is not shouting any warnings.

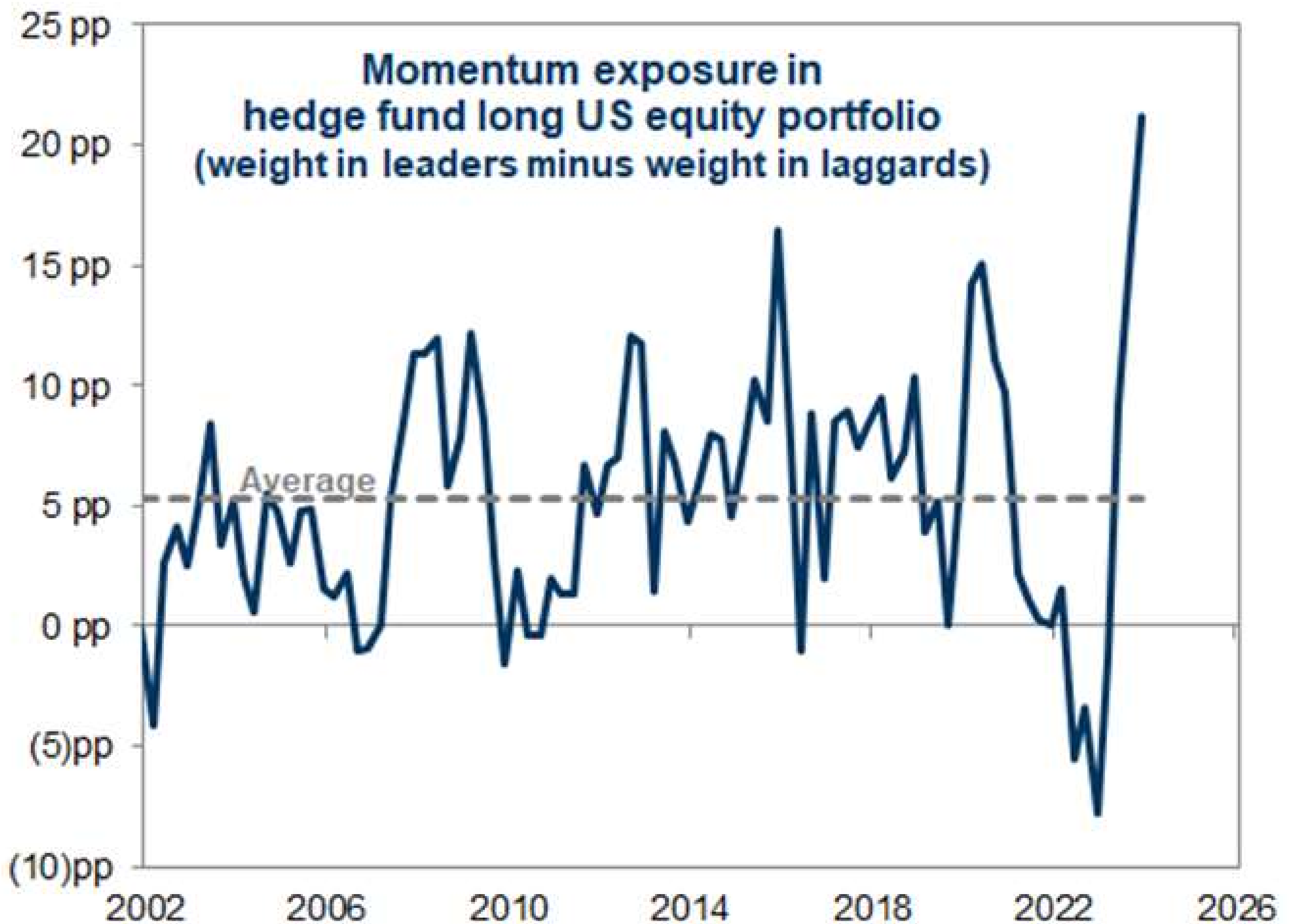


- Some Positioning is overly bullish with a hint a skepticism

We have recently noted a few indicators showing positioning is not that stretched. One caveat to this data is it has been focusing on the market as a whole. Mega-cap and Tech positioning, on the other hand, does appear to be getting lofty (which makes sense). Combined, exposure is in the 94th percentile.



Here is another way to look at it. Momentum (price, not earnings) is driving positioning. Nobody is trying to be contrarian. They are sticking with what is working (which works until, well, it does not).



Source: Goldman Sachs Global Investment Research

Schwab is telling us that retail traders are bullish and expecting strong returns in 1Q2024 and beyond. Tech is leading the charge. But this cohort is trying to hunt for some value as they are buying Health Care and Energy. But oddly, they are bearish on Consumer Discretionary.

Goldman does tell us that hedge funds are starting to trim Tech. And Schwab's retail army is worried about rates going higher (they are bearish Real Estate). We think it is reasonable to expect some Volatility given the huge run in some pockets of the market.

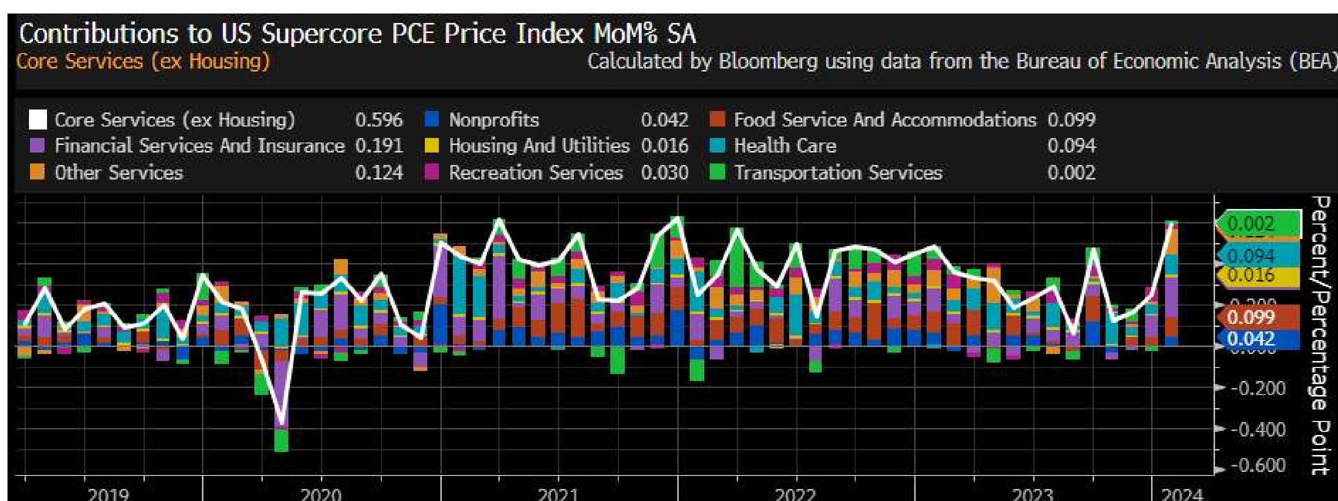
- Earnings are still improving

Earnings continue to improve. The quarterly "blended" growth rate bumped up to 10.0% from 9.6% last week (Nvidia beating expectations certainly helps!). The actual EPS growth moved to 9.2% from 7.3%. And actual Revenue growth has moved up to 3.7% from 3.5%. Energy, Health Care, and Materials are still going in reverse. Communication Services and Consumer Discretionary are two of the biggest growers (53.4% and 35.3%). Utilities have a surprisingly strong growth rate at 43.2% (but Utes are the third smallest Earnings segment of the market behind Materials and Real Estate).

The negative pre-announcements continue to climb. The ratio of Negative to Positive is now 3.7 which is higher than last year (3.3) and last quarter (2.1). This is a negative on the surface. But as we have been saying, we need the bar to be lowered.

➢ Inflation persists, but it is still near the Fed's sweet spot

Inflation, as measured by the increase in the Personal Consumption Expenditures index (PCE), increased 0.3% in January vs December. The Core inflation moved 0.4% higher. These numbers were not too surprising given the uptick seen in the CPI. The annual rates are 2.4% and 2.8%. These are down from 2.6% and 2.9%. Some are pointing to the increase in the "Super Core" which is Core Services ex-Housing. While it is true that this is near its monthly peak during this inflation cycle (end of 2021), the pundits overlook the composition of this increase. Almost a third of this 0.6% increase is Financial Services and Insurance. Yes, insurance premiums are pretty brutal now. But more inflation on Financial Services is merely a function of the market being higher!



Personal Spending slowed to a 0.2% increase in January vs 0.7% in Dec. On the plus side, Personal Income increased by 1% vs 0.3% last month. The Fed has indicated that it wants to start cutting rates before inflation gets to its 2% target (2.5% is a reasonable level). As we have been saying, rate cuts are usually a sign of economic weakness. And this market does not need cuts. But if we have continued growth and get a rate cut…just watch the momentum guys trip over themselves!

➢ Housing is slowly normalizing (very slowly)
- Existing Home Sales in January moved a touch higher (4mm annual run rate). If you squint hard enough, you can see an uptrend starting.
- New Home Sales in January ticked down. This trend is flat.
- Building Permits were revised slightly lower for January.
- The Case-Shiller Home Price index cooled for the eighth straight month (with the last two, Nov and Dec, being outright negative).
- New Home Sales in January increased to an annual rate of 661k (up 1.5% from Dec). This is about in line with the pre-Virus Fear levels. But it is still way down from the building frenzy that started later in 2020 (over 1mm).
- Pending Home Sales in January reversed course from the strength in December.
- Mortgage Applications have slowed for three weeks in a row.

One of our past fears was that layoffs would lead to a surge in Existing Home Sales at lower prices. This would further erode personal wealth as more people would rush to sell while they could. And New Housing would suffer. It would be a vicious cycle. But just like the broad economy, the Housing market has only been changing ever so slowly. Existing Home Sales are increasing slowly, and prices are just edging lower. This pace prevents any shocks to the system while things normalize.

- Other economic data is slightly weaker
  - Durable Goods for January fell more than expected -6.1%. Core Capital Goods Orders (aka business spending) were flat (+0.1%). December was revised down from +0.2% to -0.6%.
  - The February S&P PMIs diverged with Manufacturing improving (50.7 to 51.5) with Services decreasing (52.5 to 51.3). The regional Fed surveys are exhibiting the same trend. The Dallas and Richmond Fed's Manufacturing indices improved but they remain negative. The KC Fed improved and turned positive. Normally we would welcome this data as another sign that the economy is improving. But we need to see more from these surveys (which have lost some utility given how wrong they have been recently).
  - Weekly Redbook Retail Sales increased 2.7% vs 3% last week. This seems to be the new trend level.
  - Consumer Confidence in February was lower than expected. Both the Present Situation and Expectations declined. This is the gauge that more closely tracks Housing (rather than U Michigan's survey which is more inflation based).
  - Retail Inventories increased while Wholesale ones fell.
  - The second estimate for 2Q GDP was trimmed from 3.3% to 3.2%.

- Where did all the crypto money go?

We have written about Genesis Global Capital on numerous occasions. It was one of the platforms that borrowed fake money from unsuspecting rubes and gambled it away. Genesis is going through the bankruptcy process, so it is being managed by court-appointed advisors. In a weird twist, the parent of Genesis, DGC, is fighting the bankrupt company in bankruptcy court. DGC is aiming to have all the creditors get paid less while it reaps a larger lumpsum. There is some nuance to the argument. But the point is, even if you get swindled out of your crypto, your fiscal pain and suffering might not be over.

- Chart Crime of the week

On the lighter side of things, London is not in Spain. (Not to mention, Atlanta to Baltimore to London is not three flights!)

- Quick Hits
  - Texas has 15,300 wind turbines in operation.
  - Reddit is issuing its users shares in its IPO. But the company is warning them that their ownership might increase the volatility of the shares.
  - The ex-PM of Thailand faces prosecution for insulting the royalty.
  - The husband of a mergers and acquisitions manager at BP overheard his wife talking about a prospective deal. The husband bought shares of the target company and made a killing. He fessed up to his wife. She ratted him out to BP. BP fired her. She divorced him. He is going to jail.
  - A woman lost an $800k disability payment because she was busted participating in a tree-throwing competition.
  - Some desert landslides go up hill (a "retrogressive" slide).
  - Green was the most popular car color in the mid 90's.

Trading: We added a bit to our long in Financials. One is a re-shoring play, and the other is an event driven idea. Both provide decent differentiation. We also added to another emerging market name, this one in consumer discretionary. It reported earnings that we thought were strong, but a non-cash adjustment made the headline look weak. WE have talked about adding some protection. But we have yet to do that (but we still want to).

TSLAQ: OSHA is investigating Musk's Boring company for leaving pools of chemical slime in its tunnels. Workers are experiencing severe burns as they are forced to wade through them.

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