Weekly Update

7-August-2023

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- The market narratives are as split as ever
- These guys are great contrarians
- The velocity of money is important and probably behind the rally
- Gen Zers are not impressing their perspective bosses
- Earnings are better than feared, maybe margins have turned, market does not seem to care?
- Jobs market is still strong but slowing
- Leading Economic indicators are still negative
- Housing is all about supply
- Durable Goods are positive on the headline but not the business spending
- International PMIs point to a global recession
- Some Fed doves are cooing, but the rest are not listening
- Oil is probably moving on staglfation
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,518	-1.5%	18.6%	10.6%
QQQ	$375.19	-2.2%	41.3%	16.5%
US 10 YR	4.10%	3.96%	3.75%	2.76%
USD/DXY	102.1	101.9	104.5	106.4
VIX	15.8%	13.6%	22.9%	21.3%
Oil	$82.48	0.9%	2.1%	-7.9%

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

It has been an eventful few weeks since our last triweekly missive. As seems to be the norm now, the news and narratives conflict and contrast more than delivering a cohesive message. Earnings have been bifurcated even among the market leaders. Microsoft warned about its AI business not making any money any time soon. Google is firing on all cylinders. Apple reported another quarter of declining sales with another slowing quarter to follow. Amazon has received the "all clear" signal from Wall Street with its AWS margins potentially bottoming along with its consumer business accelerating. Global central banks keep on their tightening

marches. The Fed hiked again. Europe is talking about more hikes than previously thought. And Japan eased its "yield curve control" some more which is monetary tightening (the BOJ had been pinning the top of 10-year JGB yields (Japanese Government Bonds) to 0.25%...then 0.50%...and now 1%.) Headline economic data keeps the soft-landing (or no landing) narrative alive. Inflation has cooled, and jobs are still being added. Other more leading data point to slowness. Bankruptcies are still on the rise. Alas, the two most noteworthy companies on the brink, Tupperware and Yellow (giant trucking company), have seen their stocks rise about 900% recently. US debt saw its credit rating downgraded by one of the three agencies (Fitch moved the US from AAA to AA+, S&P did this in 2011, Moody's is still at Aaa which is the equivalent of AAA). Treasuries got walloped as talkative hedge funds piled on to the slide. But Warren Buffet reminded everyone that Berkshire Hathaway still pumps billions of dollars a week into short term treasuries. Other than these voices, most market watchers are confused by treasuries (will the massive supply coming out of DC overwhelm the traditional flight to safety bid). China's economy still stinks, and the communists' s attempts to juice it are floundering. Despite this weakness (along with that in Europe despite ECB president Lagarde's comment that 0.9% growth is "encouraging"), oil keeps driving higher. And maybe, just maybe, scientists have finally uncovered the secret to the long-awaited "superconductor." Of course, there was also a nuclear fusion discovery in December. The flame on that hot news has since fizzled just like the superconductor story will.

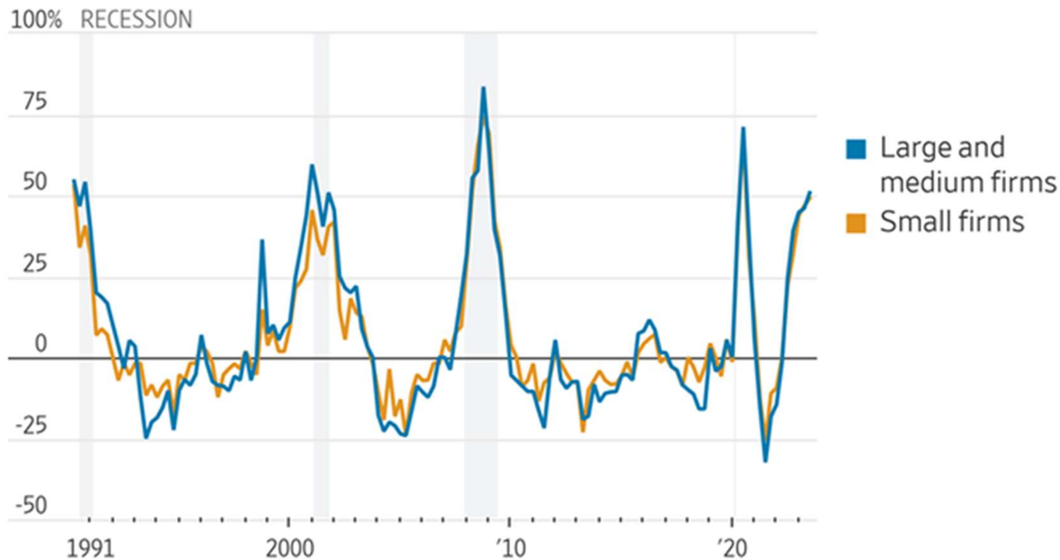
All told, we think there are nuggets of economic optimism. But ultimately, the long and variable lags to monetary policy will impact the market. But instead of everything getting hit in a wholesale fashion, there will likely be winners and losers. We are looking to recent earnings strength for the names we want to hold. Stagflation is likely. And perhaps we start getting a little more aggressive on the short side on those names which have ridden the market wave without any improvement in business prospects – never mind profits (we have mostly steered clear of shorts for a while now).

➢ These guys are great contrarians

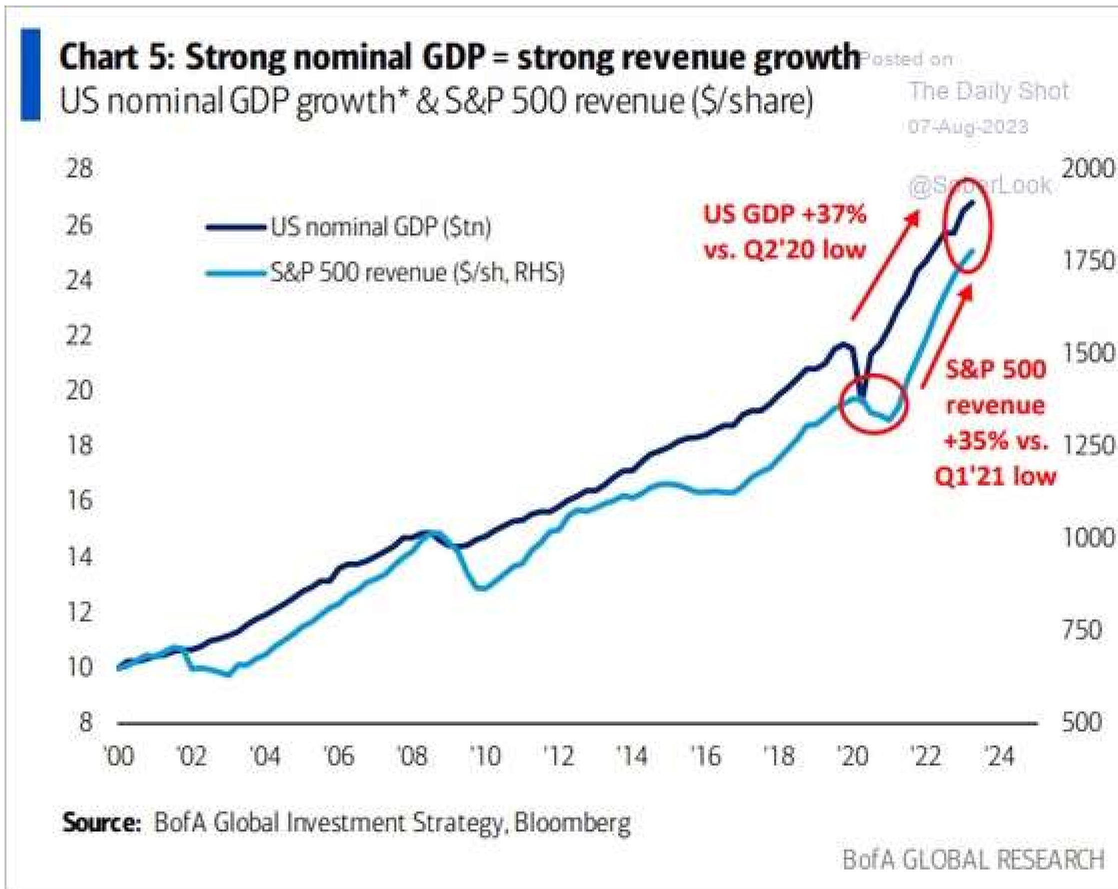
Perhaps the most telling sign of a market top could be the new-found optimism among Wall Street strategists. This cohort is traditionally a great contra-indicator: They chase rallies and puke bottoms precisely when the opposite should be done. We may have lost count, but the list of now-bullish prognosticators includes JP Morgan, Morgan Stanley, Merrill Lynch, Piper Sandler, Citigroup, and countless Twitter-talkers.

➢ The velocity of money is important and probably behind the rally

We have written a lot about the drying up of the money supply (Fed selling bonds instead of buying them, fiscal spending slowing from the breakneck Covid pace) and the tightening of the credit markets. Here is the latest bank lending survey data from the Fed.

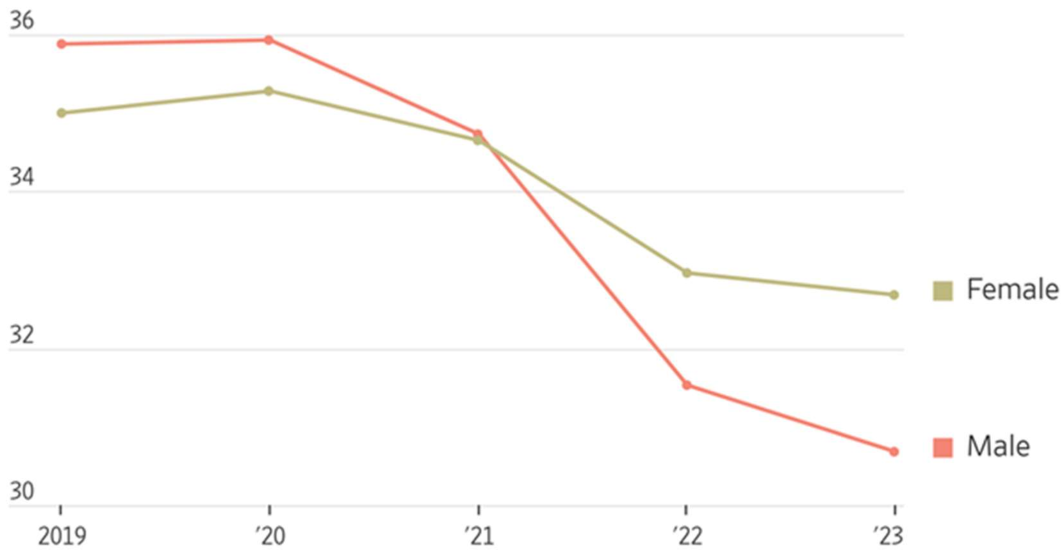


But a smart twitter follow (Bob Elliott, formerly of giant macro hedge fund Bridgewater) points out that nominal income and prices can increase the velocity of money enough to overwhelm the negative effects of contracting money supply and credit. Our new partners at Walnut Green Asset Management point out there is a simple way to explain this: Inflation. Rising nominal GDP can trump almost any hurdles. Of course, the real question is, does this continue? We think it can but perhaps only in a stagflationary way (low/no growth with high inflation). This will lead us to buying more top line centric companies (Tech, Industrials, Energy, etc). Staples were a beneficiary of inflation when companies could pass on price hikes to customers. This has probably run its course (especially if we get a consumer-led recession).



- Gen Zers are not impressing their perspective bosses

We do not know what this assessment entails. They are usually nonsense but at least consistent (dare we say analogous to official Chinese economic data). We are inclined to believe this one.



- Earnings are better than feared, maybe margins have turned, market does not seem to care?

The bulk of earnings season is behind us now with about 85% of companies having reported. The quick synopsis is that about 79% of companies beat their bottom-line expectations. Growth is still negative at -5.3% (if we use estimates for the remaining 15%, growth is expected to be -4.2%). Here is a breakdown of where expectations were over time across sectors. Interestingly, the losers deteriorated much more than originally expected (Energy, Health Care, and Materials). The winners remained relatively stable (expectations were close for Industrials and Comm Services) or improved (Consumer Discretionary).

Exhibit 3. 2023Q2 Blended (Reported & Estimated) Earnings Growth

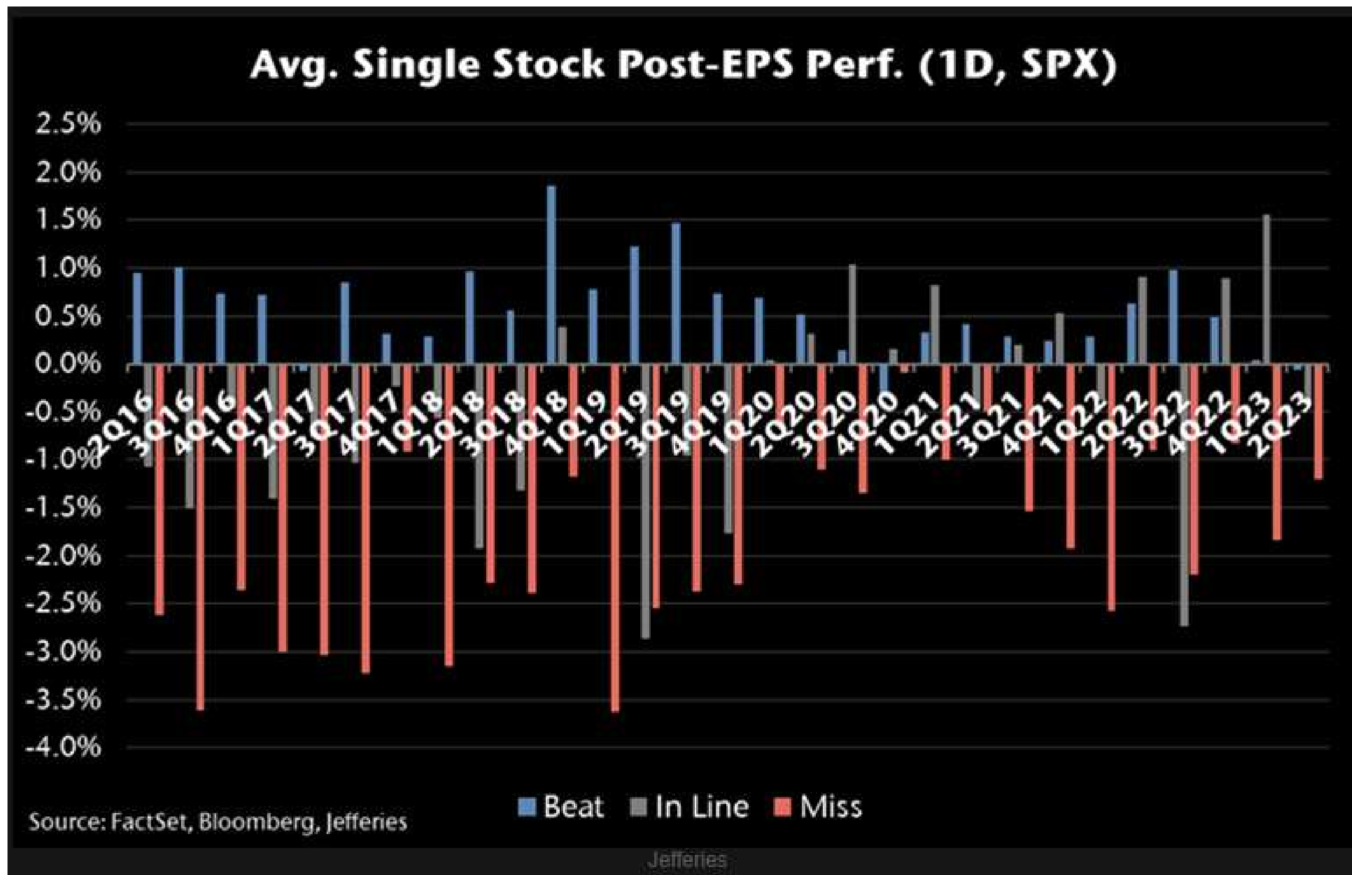
Sector	Today	1 Jul	1 Apr	1 Jan	1 Oct	1 Jul
Consumer Discretionary	52.1%	26.6%	26.0%	36.7%	49.6%	39.4%
Consumer Staples	7.4%	1.9%	8.2%	5.3%	6.5%	10.1%
Energy	-47.7%	-44.6%	-36.2%	-29.1%	-27.4%	-19.3%
Financials	7.3%	8.4%	10.3%	12.7%	16.4%	20.1%
Health Care	-26.6%	-15.8%	-12.4%	-6.9%	-3.1%	2.1%
Industrials	13.9%	6.7%	4.8%	6.5%	11.6%	18.0%
Materials	-26.1%	-28.0%	-22.1%	-20.0%	-10.3%	-6.8%
Real Estate	-2.1%	-5.1%	-3.6%	-2.3%	0.3%	7.9%
Technology	1.9%	-2.9%	-5.1%	0.6%	8.9%	15.2%
Communication Services	15.5%	9.3%	7.3%	6.0%	16.8%	18.3%
Utilities	3.7%	1.8%	3.1%	3.0%	-1.6%	8.4%
S&P 500	**-4.2%**	**-5.7%**	**-3.9%**	**-0.3%**	**5.3%**	**10.7%**

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

Sales growth has been about flat (-0.2% reported, +0.2% blended). The trajectory of expectations follows that of earnings. Both Merrill and SocGen say sales are lagging earnings which means margins are driving the

sequential improvement. We do not quite follow the observation (why they say sales are lagging), but if we take it on face value, it makes sense that margins are improving. And margin erosion has been one of the central themes for the past 16 months.

Despite this good earnings season, individual stock reactions have been poor. Jefferies summarizes this well. There are no positive reactions (not even for the good reports). We like to follow this reaction data because it usually gives insight into a developing market dynamic. But considering these 1-day reactions did not mean anything for the broad market until last week, the jury is still out. This is especially true since the market has continued higher (the last week's mild softness notwithstanding). We are more apt to believe the market will bifurcate further with more pronounced winners and losers (with the development of the aforementioned stagflation being the key).



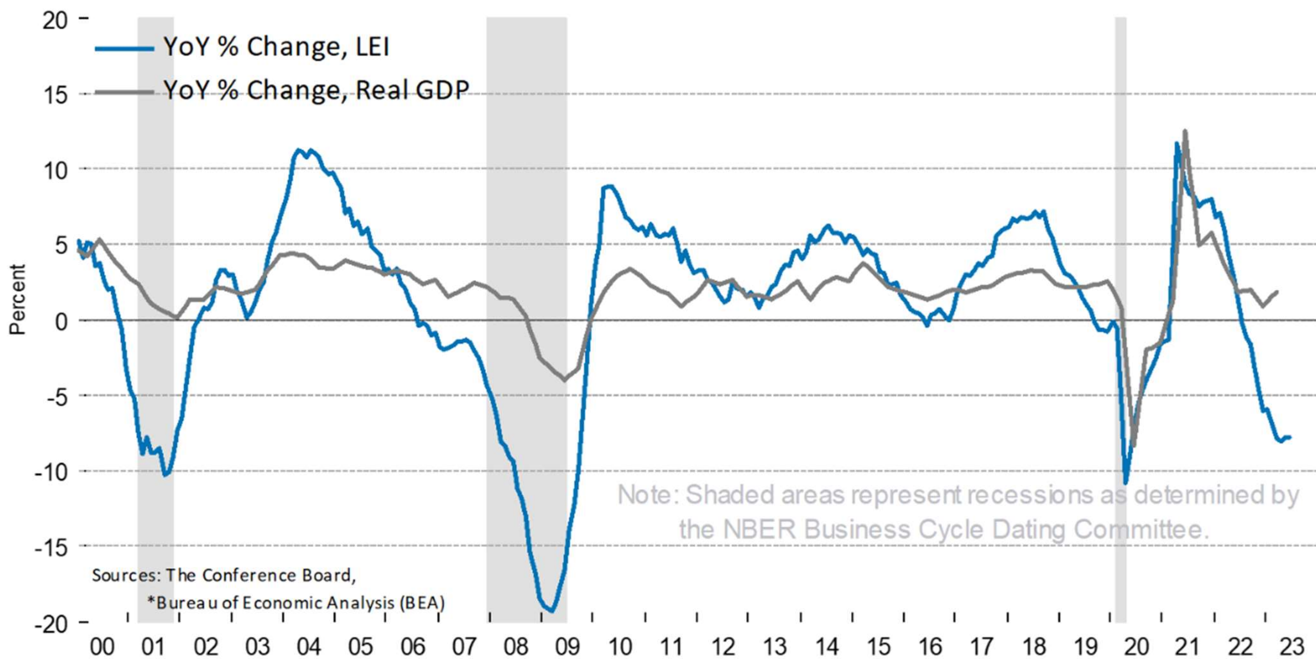
➢ Jobs market is still strong but slowing

The Employment Report shows continued stability in the jobs market with another 187k jobs gained in July vs 185k in June. On the plus side, Private Payrolls increased while Government jobs decreased (as an aside, the 2Q GDP was stronger than expected because of an increase in Government spending, so perhaps this is reversing a bit). The Unemployment Rate dipped to 3.5% from 3.6%. Participation remains stubbornly low. But this is split along demographic lines with 25–54-year-olds working at almost record numbers. While the early-retirement boomers are staying in retirement. The one hitch to the report was the Average Hourly Earnings. It remains

high at 0.4% monthly and 4.4% annually. This is great for workers…but not so much for the Fed's outlook on higher interest rates.

- Leading Economic indicators are still negative

The Leading Economic Indicators index was negative again in June (released July 20, so we are due for the next installment soon). This is the fifteenth monthly decline in a row. Consumer expectations and business New Orders were the main detractors, but almost all of the inputs were negative. Stock prices, the S&P 500 is an input, were obviously a boost to the index. It is pretty clear that this index indicates a slowing economy. But it also tends to overshoot.

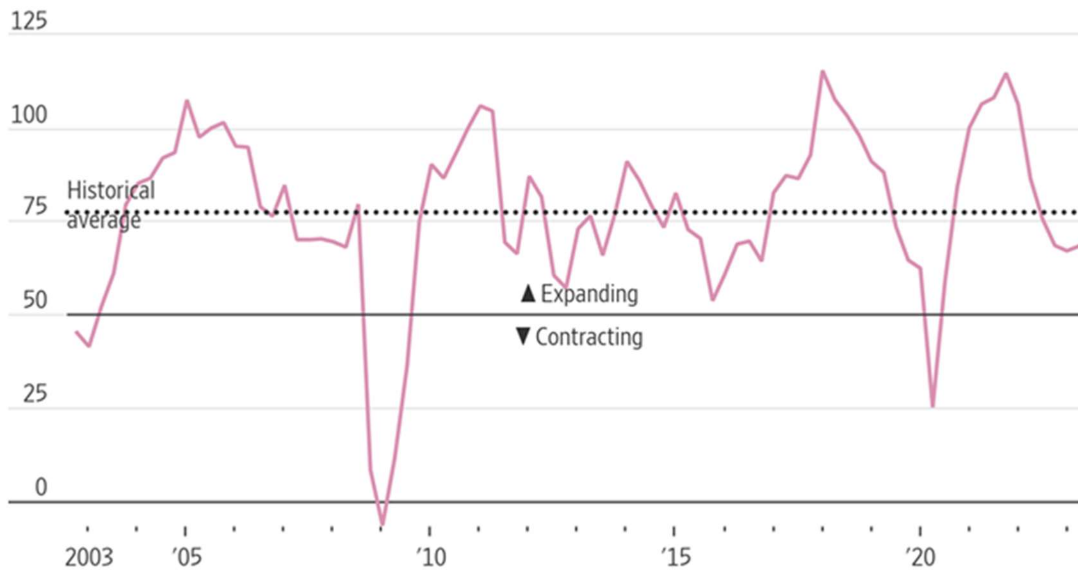


- Housing is all about supply

Existing Home Sales in June went negative on a monthly basis. Pending Home Sales posted a slight uptick with a 0.3% gain in June. Of course, the root cause of lower turnover with sticky prices is low supply. Buyers do not want to pay up in price (or mortgage rate) and sellers know supply is constrained! The homeowner vacancy rate is another stat showing this play out. Homebuilder stocks have mostly stalled out a bit. If they succumb to a pullback, they might be worth buying (no position currently).

- Durable Goods are positive on the headline but not the business spending

Durable Goods Orders for June surprised to the upside with a strong 4.7% monthly gain vs May's 2% gain. But the Core Capital Goods number (aka business spending) only increased 0.2% which was down from May's 0.5% (and April's 0.7%). The chart below shows survey results for corporate capital spending plans. Perhaps this data is pointing to an inflection higher. We would like to see a more definitive trend.



- International PMIs point to a global recession

China PMI's, the official ones, show no signs of a reopening. Manufacturing is still negative, and Services are just a bit above the breakeven line. The private Caixin PMI (not conducted by the government) fell back into negative territory,

Eurozone Manufacturing PMI fell again. Germany Manufacturing PMI sank to 38.8. This is only a few points away from the depths of the Virus Fear.

- Some Fed doves are cooing, but the rest are not listening

The two most dovish members of the Fed, Austan Goolsbee of Chicago and Raphael Bostic of Atlanta, both think the Employment Report shows the labor market is becoming more balanced (slowly softening). They both are urging the other members to consider cutting rates sooner versus later. Of course, the hawkish voices are still leading the charge. Michele Bowman, a Fed governor, wants to see more evidence that inflation is working its way towards the 2% goal (many pundits have expressed a desire for the Fed to shift its inflation target to 3%). And John Williams of the NY Fed expects the Fed "will need to keep a restrictive stance for some time." Tom Barkin of the Richmond Fed is considered one of the moderate voices. He says of the economy, "Further Slowing is almost surely on the horizon." Yet, he thinks the level of interest rates is appropriate since "inflation remains too high.".

- Oil is probably moving on staglfation

Some interesting headlines in oil recently. The Saudis are extending their extra production cuts another month. The US Gov is not going to buy the 6mm barrels for the SPR that it had previously announced (remember, it is never wise to announce the levels at which you would like to buy something before you actually buy that something). US inventories are starting to move lower with a massive 17mm barrel drop last week (despite

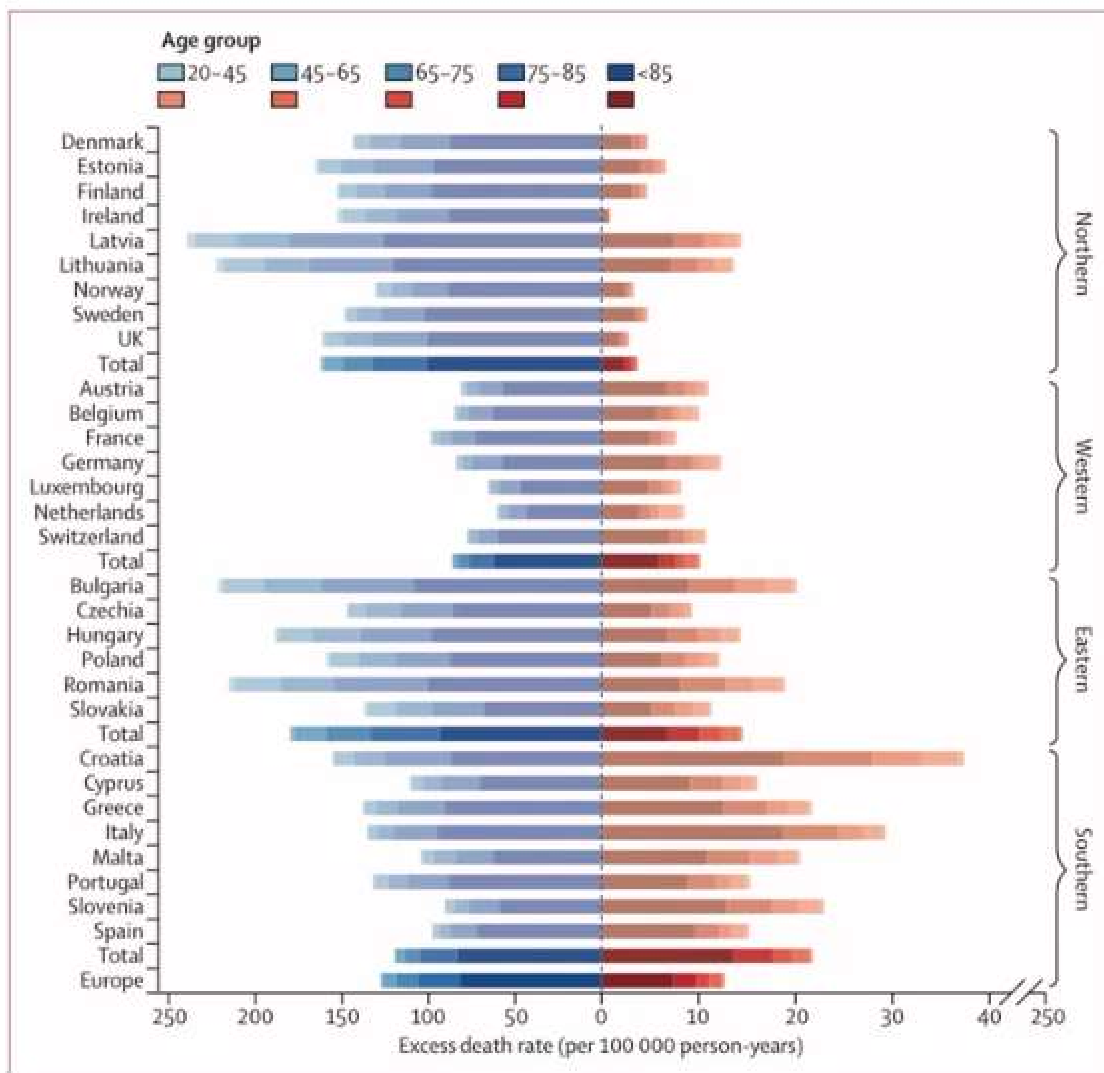
tighter refinery runs in the Midwest). But we think the real mover has been a combination of the "soft-landing" narrative and the return of inflation. Of course, we do not think these things go together. But given our leaning towards stagflation, we are going to stick with our Energy longs which have performed well recently (after having been terrible for most of the year). If we get a bonus "soft-landing" narrative in the meantime, we will take it.

- Where did all the crypto money go?

One quick follow-up to our recent missive on the criminally bankrupt Celsius. Recall this is the crypto platform (not an exchange!) that declared it could pay 18% interest not because it was riskier than a bank, but rather because it passed along most/all of its earnings to "depositors." (While we are dispensing with the term "exchange," we should also dispense with the term "depositors." These people were no less speculators than GameStop buyers.) At the time, the now-jailed founder of Celsius proclaimed with more than an ounce of bravado, "Somebody is lying. Either the bank is lying or Celsius is lying."

- Chart Crime of the week

This chart purports to show the relatively high number of excess deaths caused by heat in the world. But as chartcrime stoppers, you know to always check the axis. You will notice that the Cold Deaths axis is 5x the Heat Deaths. The worst part is not that this was found on Twitter, or some political hack is trying to push an agenda. This was published by one of the supposedly best medical journals in the world, the Lancet.



- Quick Hits
  - Europe's unemployment rate is at a record low: 6.4%. That is a record?
  - California has a new law mandating that pigs be given 24 square feet of pen space.
  - There is an estimated 172k homeless in California which is 30% of our country's homeless. At least the pigs have nice homes.
  - The number of foreign visitors to China is down 75% from 2019.
  - Incandescent light bulbs are now illegal to manufacture or sell.
  - According to the Pig Lobby, flickering lights increase stress levels in pigs. LED lights have a higher flicker rate than traditional pig lighting.
  - Michigan is the second largest producer of carrots in the US.
  - The highest survival from a fall without a parachute is over 33k feet.
  - Research in the Netherlands reports that health care workers that picked their noses were more susceptible to Covid.
  - Remember when Oberlin College lost a $36mm lawsuit to a local bakery it had defamed as racist (all because the bakery owner tried to stop a black student from stealing wine)? Oberlin is now

suing its insurance companies because they are refusing to cover the losses under their umbrella policies.

- China is trying to figure out ways to boost consumption. One of the ideas is to host festivals. We should send them Billy McFarland.
- Zoom is forcing its employees to return to the office.

Trading: We have been more active than usual for the summer dog days. We have kept adding to our preferred index longs of Japan and India. The Bank of Japan policy change gave us another opportunity to buy a mild dip (instead of just chasing this winner). We sold some gold as treasury yields dipped back in July. We bought it back when yields jumped recently. Of course, are small long position in treasuries got creamed. We sold some, but we still believe in the "flight to safety" bid so we will hold the balance. We sold some USD on its recent bounce. In general, we will continue to trade around these macro positions as they tend to be more reliably volatile. We have rotated a few stock names in the portfolio. We have trimmed some of our long-held Staples. And while we added some more risky stocks, we also added to our limited short exposure. As we have noted/lamented, this market has not been one for shorts. This is often the time for shorts, but this market has proved quite resilient. That said, some of the short squeezes have seemingly run out of steam.

TSLAQ: We forgot to mention another lawsuit involving Musk. No, this is not him being sued for his egregious pay package. It is not the company being investigated for falsifying charging distances. He already lost the recent suit about the other board members getting paid too much. There is no pedophile slandering or parking lot hit & runs (these are all real lawsuits from his recent past). This one has Musk being the instigator. New Twitter is suing Old Twitter's lawyer for getting paid too much to make sure Musk bought Twitter. New Twitter argues "there were not…difficult questions of law involved." In other words, Musk thinks the Old Twitter paid too much to force the New Twitter to buy the Old one because they should have known Musk's legal defense was bogus.

Elsewhere, Musk's private Neuralink has raised $280mm. The total valuation is thought to be around $5b. This is the silly company that wants to put a chip in your brain. It also claims it is on the verge of curing paralysis and blindness. Peter Thiel's Founders Fund was supposedly one of the lead investors. They have a history together at PayPal. Thiel has famously called Musk a "fraud" while Musk has called Thiel a "sociopath."

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