CHALK CREEK
PARTNERS

Weekly Update

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Carlisle C. Wysong, CFA
Managing Partner

- Volatility continues to surge
- The Bank of England bailout is a bad thing not a good thing
- Quarter-end is jacking up the Volatility
- Positioning might be getting there
- Valuation is no longer insanely rich (just rich)
- Sharp jump in New Home Sales…but do not believe the hype
- Quick Hits
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	3,719	-1.9%	-21.1%	-15.0%
QQQ	$279.94	-1.3%	-29.3%	-23.9%
US 10 YR	3.74%	3.53%	1.51%	1.52%
USD/DXY	112.8	111.4	96.0	94.0
VIX	30.2%	28.0%	17.2%	22.6%
Oil	$83.04	-1.6%	9.2%	9.1%

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

We had quite an array of contrasting data points and indicators this week. This probably explains the heightened Volatility. The craziest action of the week was the monetary policy reversal from the Bank of England (BOE). This resulted in the mild rally in the markets today (bond, equity, commodity, crypto, etc). But we think it is more of a bad sign than a good one (having to implement a stop-gap measure to curb derivate-derived panic). And while the Fed is keenly aware of what can happen when the mechanics of the market grind to a halt, it still firmly believes that the system is working properly (just ask Janet Yellen, no longer at the Fed but a synchronized voice). And right on cue, according to Hedgeye, Put Option buying on listed bond ETFs reached an all-time high this week without any underlying bond liquidity. We had the very odd dislocation between Apple and the market. An implicit warning about iPhone shipments had the world's largest company trailing the market by 3-4% today. To further mix things up, there is a giant hedge in the market which is distorting the already Volatile end of month/quarter. And who knows what the heck happened to the Nord Stream gas pipeline from Russia to Germany through the Gulf of Finland and the Baltic Sea. And we really buried the lead. Crazy Cathie Wood, aka the Woodchipper, is starting a venture capital fund taking $500 checks from retail investors. Naturally she is getting 15- minute blocks on CNBC to promote her latest sham. This is the opposite of a cleansing-moment that the market so desperately needs. But positioning does seem finally be catching up with the market action. While we are far from bullish, we will not be surprised to see some rallies (which we will fade mightily).

- The UK bond market nearly implodes, and the usual culprit is discovered

You only have to go back a few weeks for the background: the new Tory government in the UK wanted to institute new policies to help the energy crisis and the correlated sinking economy. But a confluence of contrasting measures only created more confusion and Volatility. The government is instituting price controls on energy, but it is also planning to spend more money on the much-need energy infrastructure. The government wants to spur demand in the economy by cutting taxes, but it needs to issue a lot of debt to do so (supply side economics aside). With an already-surging USD, the Great British Pound crumbled to its lowest level against the USD in 40 years. And this led to UK government bonds (10-year Gilts) tumbling from a yield of 3.5% to 4.5% in a week. So, the BOE reversed course and started buying bonds! It was QE (quantitative easing) all over again. Of course, the BOE is likely to go ahead and hike interest rates next week! The market did calm down a bit as the 10-year Gilt yield did drop back to around 4%. For what it is worth, the BOE says this is only a temporary measure and it will go back to selling bonds in due course. Nothing to see here.

We were a bit surprised at the speed at which things seemingly fell apart. That is, until we learned what was driving the panic. UK pension funds have loaded up on a derivative structure called LDIs - Liability Driven Instruments – which replicate Gilts but are supercharged with leverage. So, when yields start to rise quickly, these structures deteriorate quickly (and they take other assets with them as they must be sold to cover margin/collateral calls etc). Just what every pension fund should be doing, right? With over a trillion dollars of these financial landmines out there, it was only a matter of time.

- Quarter-end is jacking up the Volatility

Aside from the market rushing to hedge, this is shaping up to be a wild week in the options market. Much of the talk/action revolves around a large JP Morgan mutual fund (and its sibling and cloned funds) that provides passive exposure to the S&P 500 along with hedges. It resets these hedges at the end of every quarter. And depending on where the market is in relation to the strikes of the imbedded options (the fund sells a Call Option above the market and buys a Put Option Spread below the market), there can be a lot of hedging. This is the old short-gamma we discuss occasionally (or all too often). If the market is near the Put strike, dealers (or the ones that sold the structure to JPM) must sell more stock (index futures) to balance their long exposure (being short the Put is long market exposure). If they sell more futures and then the market rallies, they must turn around and buy back these futures.

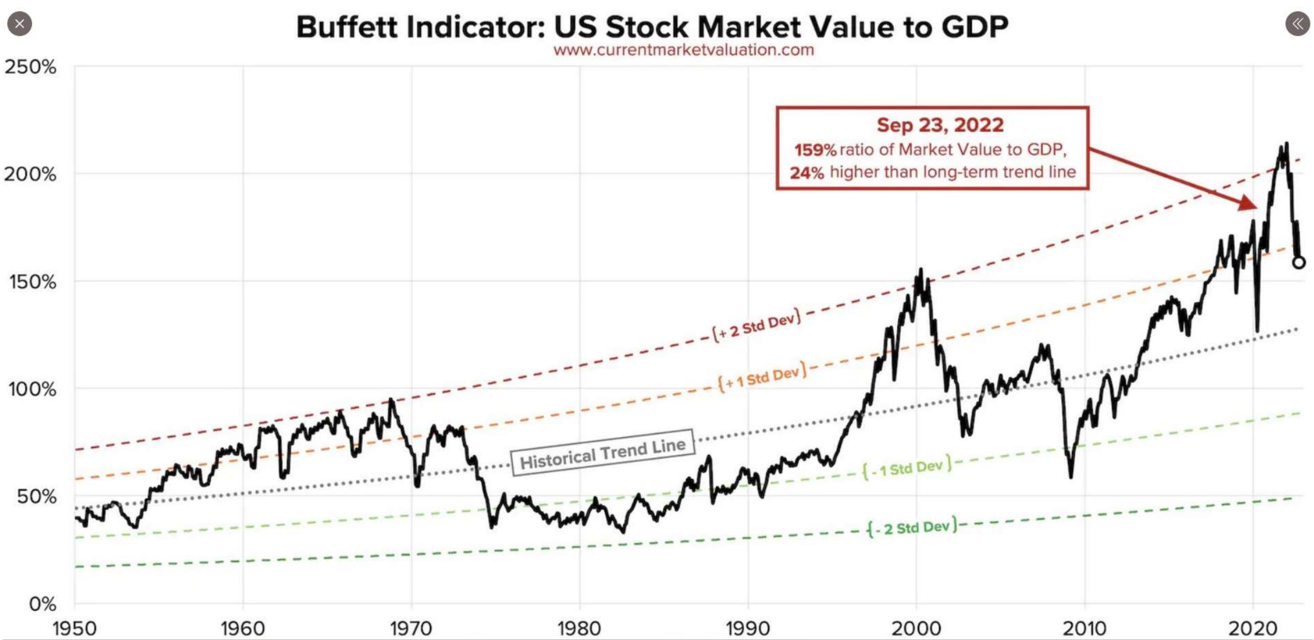
- Positioning might be getting there

For all our clamoring about the positioning in the market not *yet* being bearish, this might have changed. The retail investor sentiment gauge by AAII (American Assoc of Individual Investors) shows that pessimism has skyrocketed. With the survey question, "do you expect stocks to fall over the next six months," bearishness has jumped to 61% from 46% the previous week. This is the highest bearishness reading in 13 years.

Two weeks ago, we debunked the notion that Put option buying had surged. We pulled out the stealthy Nations SkewDex index to show that option buying was not providing tail-risk hedging but rather were just coin flip bets. Well, this past Friday, Put option buying really did surge: It hit an all-time high. The SkewDex moved higher, too. But it is still plumbing the lows. While we can discount the Put buying surge a bit (because the SkewDex is still very low), it was still a capitulation type of moment.

➢ Valuation is no longer insanely rich (just rich)

The classic Warren Buffett indicator, the ratio of stock market aggregate value to GDP, has normalized substantially. Or rather, it has gone from absurdly overpriced to just overpriced. Of course, for us, it is the rate of change of economic growth that matters the most. And with an Earnings recession lurking ahead, we think this Buffet indicator might need more normalizing. Mathematically, if GDP is shrinking, the stock market has to come down more to keep this chart looking good. Nonetheless, it does provide the backdrop for an eventual time to buy.



➢ PMIs, same odd divergence is becoming a little clearer

The Kansas City Fed Manufacturing Index remains just above the breakeven level. The Richmond Fed Manufacturing managed to inch back to the flatline. The Dallas Fed Manufacturing Survey dropped more deeply into negative territory. The PMI Composite (Flash=preliminary) for September showed a solid five-point improvement. Alas, it is still sitting in negative territory. Services were the bulk of the rebound. Manufacturing remains mildly positive.

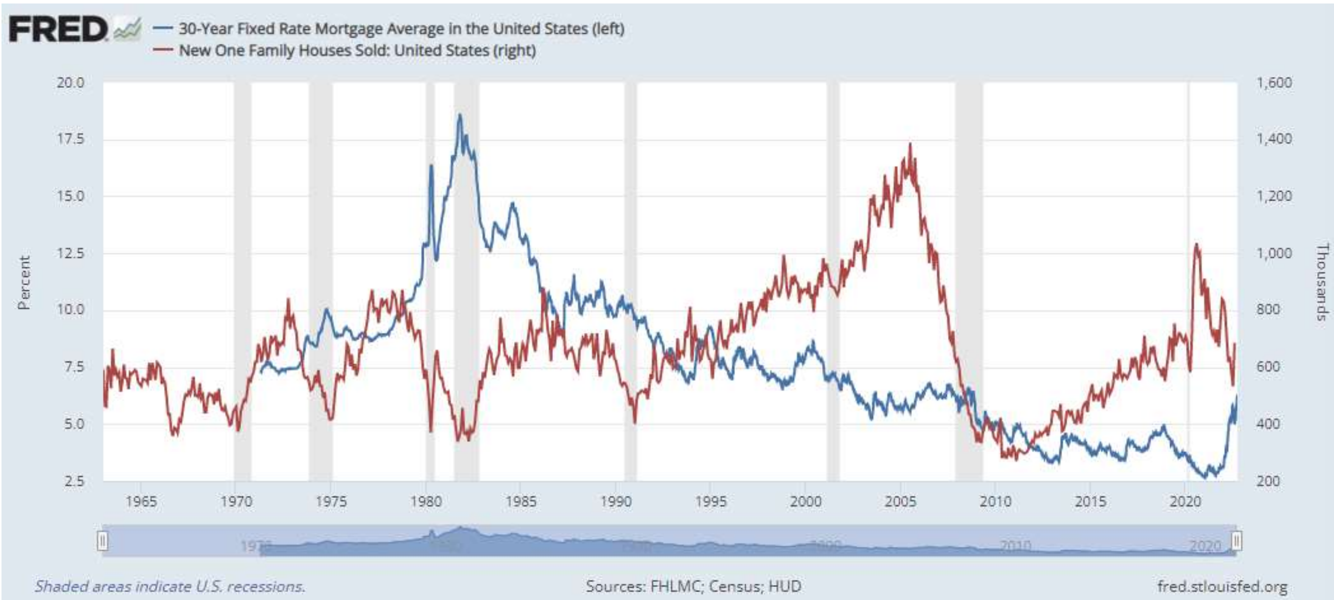
This is the same theme we presented in the Yardeni chart last week: Mildly better national surveys while still falling regional surveys. But the trend is becoming clearer insofar as the regional surveys typically cover Manufacturing. We expect the recent bounce in the Services data to be fleeting (recessions do that).

➢ Sharp jump in New Home Sales…but do not believe the hype

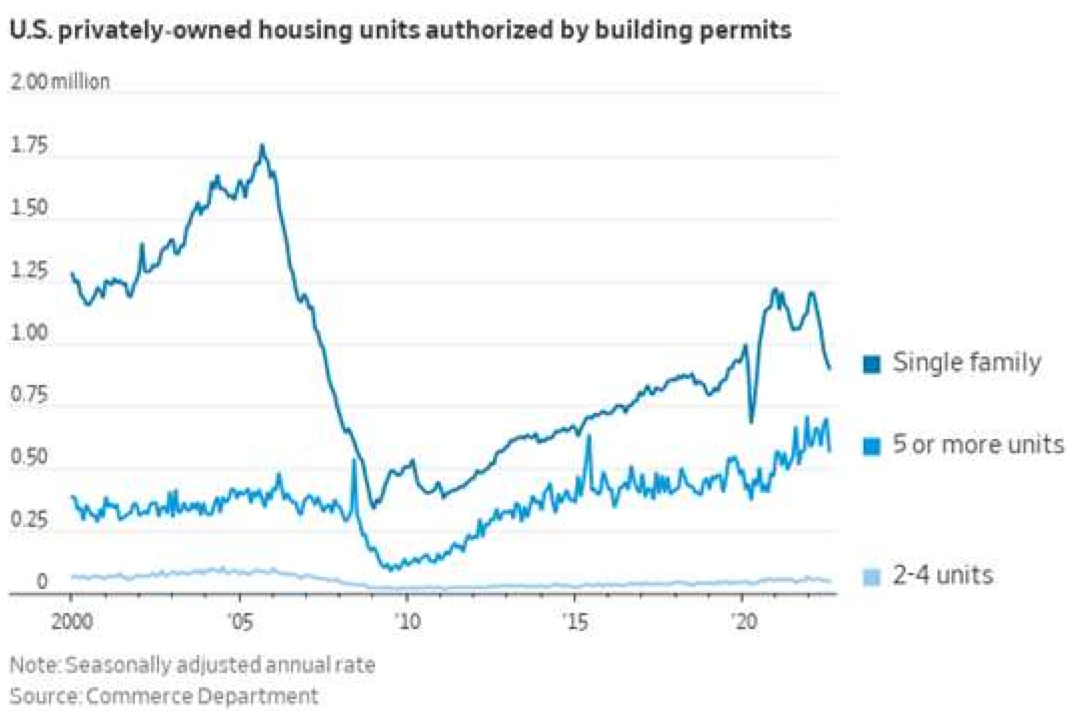
New Home Sales in August surprised on the upside. The seasonally adjusted, annualized rate jumped 29% to 685k homes. This was the third largest monthly increase since 1963 (when the data was first tracked). But Pending Home Sales continue to fall. The monthly decline was 2%. They are down over 24% annually. Mortgage Applications reversed back to their falling ways after a brief uptick last week (which means the week before).

Our read is that people already committed to their new house rushed to get the deal done before interest rates spiked higher (and they were right!). Forward looking data, Pending and Mortgage Apps, are both deteriorating.

This long-term chart (despite its many chartcrime flaws) shows that when 30-year fixed rate mortgage rates shoot higher, New Home Sales shoot lower. (Notwithstanding the 2005-08 Housing crisis which was driven by bad government policy and the subsequent lazy/greedy mortgage business exploding/imploding). With the blue line moving higher (or at least not retreating), the red line will surely not keep bouncing.



We meant to use this chart to show the collapse in building permits (August data out last week). While the headline drop is scary (8.5% monthly drop on the annualized figure), the Single Family drop is even more stark. We added to our Housing short (which has homebuilders but also home-centric retailers).



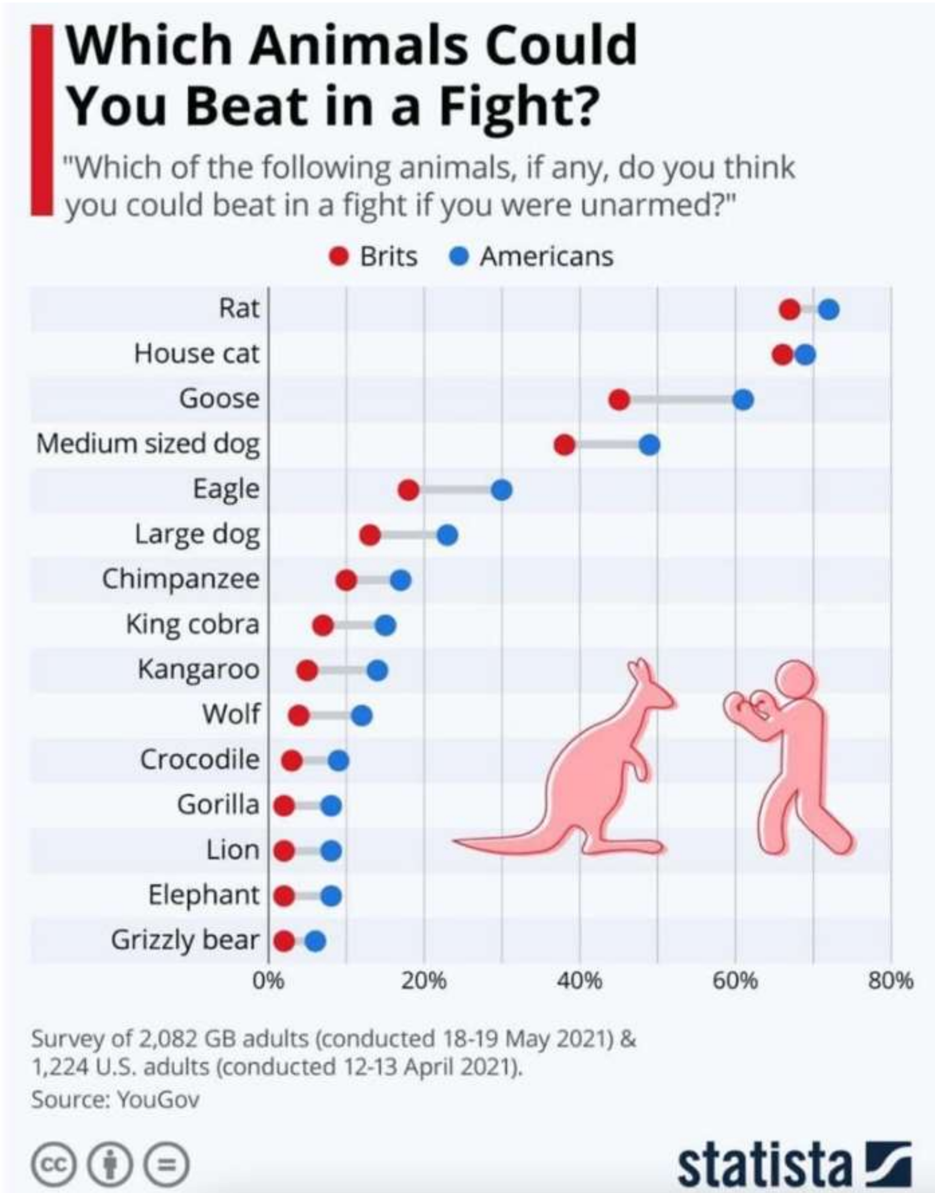
- Other data is still mostly weak
  - Retail and Wholesale Inventories both increased more than expected in August (preliminary data). Retailer discounting (not to be confused with broad Retail inventories) might be epic this holiday season.
  - Consumer Confidence moved higher in September. Recall this is one of the two main confidence/sentiment surveys. This one leans more heavily on employment. (The U Michigan Consumer Sentiment leans more on inflation.)
  - Jobless Claims continue to move curiously in the opposite direction (better) from other labor indicators (worse).
  - The Leading Indicators (the lazy data whose components have already been released) continues to be negative.
  - Headline Durable Goods Orders in August fell. But Core Capital Goods (aka business spending) remains robust. This has baffled us for a while. We have surmised it might be some reshoring away form China. It might be increased automation investment because of labor inflation. Whatever the case, business spending remains steady in the face of all the other headwinds.

- Fed speakers are not changing their tune

The first bounce of the week came when Charles Evans of the Chicago Fed gave what the market what it wanted. He said, "it is appropriate to slow the pace of rate hikes at some point." Of course, he also said we need restrictive financial conditions to curb inflation. At the same time, Loretta Mester of the Cleveland Fed (aka Carol Burnett) said inflation will stay elevated for some time. The market gave back its gains when reality sunk in. There were a host of other Fed speakers this week. ..including Jerome Powell. With plenty of chances to walk back the impending recession fears…no alleviating comments were made. We still believe the Fed will forge ahead and send us into recession.

- Chart Crime of the week

Even if we discount this survey to near-nonsense, we want to meet the 5-10% of Americans who say they can "beat in a fight" a bear, elephant, lion, gorilla, and crocodile (or the whole dang list).



- Quick Hits
    - Some academicians have written a paper proclaiming that Walmart workers value moving from a "low dignity" job to a "high dignity job" equal to a 20% wage increase. It is true that Woody Boyd once took a job title in lieu of a wage hike.
    - The leader of the government's Scientific Integrity Task Force has been suspended by the National Academy of Sciences for ethical violations.
    - "Decentralized" crypto exchange GMX promised to provide liquidity with zero slippage relative to the going average price on the other centralized exchanges. Another beautiful case study of how not to run a business. A savvy customer legally scalped them for $700k.
    - An Interpol "red notice" has been issued for Do Kwon, the founder and imploder of the ponzi scheme involving Terra and Luna crypto tokens. He claims to not be on the run. Yet nobody knows his whereabouts.

- US Representative Tlaib encouraged people to withdraw their money from JP Morgan because she did not like his answer on financing oil & gas projects.
- New England must import some of its natural gas from overseas (local politicians will not build out the pipeline infrastructure, and the Jones Act forbids intrastate commerce on non US ships).
- Elliott Mgmt (and partners) borrowed $15b to help fund its acquisition of Citrix. It was able to buy back some of the debt at 83.6 cents on the dollar. It essentially paid back its own loan for $164mm less than the borrowed amount. (But as Matt Levine at Bloomberg writes, "Elliott is probably not thrilled about owning Citrix" at the January price.)
- The NFL is replacing the Pro Bowl with a flag football game. According to the NFL, flag football is an integral part of the game "due to its highly accessible and inclusive qualities."
- This single cashew tree in Brazil is thought to be over 1,000 years old.

Trading: It was a busy week as we trimmed a bunch of hedges when we saw the positioning data start to turn. Of course, when some of the junky stocks rallied aggressively because of the BOE bond intervention (or more likely because they are heavily shorted and thus got squeezed), we started to lay back out some more hedges. We nibbled a bit on the long side on some of our names, but we also cut back some of our long passive exposure to keep the move neutral in terms of overall exposure. We regretfully still had a small long exposure to commodities (directly, not commodity companies). We cut this. We also trimmed a touch of our Energy long after having bought the dip. As we have been saying, we are being quick to take profits/sell the rally in tax exempt accounts. We are slower to buy the dips in taxable accounts. (This is how we marry the two strategies essentially.)

TSLAQ: The most recent ruling in Twitter's lawsuit against Musk (whether he will be forced to buy the company for a grossly inflated price or not) was one in favor of Musk as he pushed to have the whistleblower allegations added to his defense. In further proof that Twitter is playing chess while Musk clumsily plays checkers, the Twitter team quickly agreed to include the allegations as long as they could seek discovery on all communications between Musk and the whistleblower. Musk's team resisted this inclusion…but the judge ruled in favor of Twitter. We suspect the arrival of this whistleblower was not born out of altruism (nor the $7mm settlement from Twitter) but rather Musk had a helping hand. We eagerly await. And oh yeah, in another pre-trial discovery hearing, Team Musk seemed to intimate (accidentally?) that they never could find evidence of an inflated army of bots.

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