Weekly Update

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- Mega-caps lead the market higher despite the macro headwinds
- Warn Notices lead to Jobless Claims
- Inflation trends remain volatile
- Tighter lending signals more bankruptcies
- New Housing is a bigger chunk of the inventory
- Deflation is hitting China (again, the reopening is dead)
- The Fed's tune is actually changing
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,198	1.6%	9.8%	4.4%
QQQ	$337.27	3.4%	26.9%	11.0%
US 10 YR	3.45%	3.34%	3.88%	3.00%
USD/DXY	103.5	102.1	103.5	103.5
VIX	16.1%	16.9%	21.7%	29.4%
Oil	$71.99	1.6%	-10.5%	-34.4%

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

We have been expecting this market to continue battling with itself. On the plus side, mega-cap earnings were strong (Walmart being the latest) while the rest were underwhelming but perhaps not as bad as expected. The regional banking crisis has seemingly calmed down as deposits have stabilized. And the debt ceiling crisis appears to be subsiding. But most economic data continues to forecast recession. The Fed language has shifted from one of balance and patience to becoming more antsy about persistent inflation. The regional banks are whipping around on every bit of granular data. The underlying problems of tighter lending, shrinking margins, and undercapitalization have not gone anywhere. Not to mention, the commercial real estate market had its first aggregate price drop in the first quarter since 2010. The price was small at 1%, but there are about zero buyers lined up at that price point (non-Blackstone experts have it pegged closer to -20%). And the debt ceiling worries never manifested themselves in the market, so we are not sure why there would be any relief! Internationally, the China reopening is sputtering. Who knows what is going to happen with the Turkish elections (perhaps someone should ask Erdogan to use his ESP powers to predict the outcome). And the war in

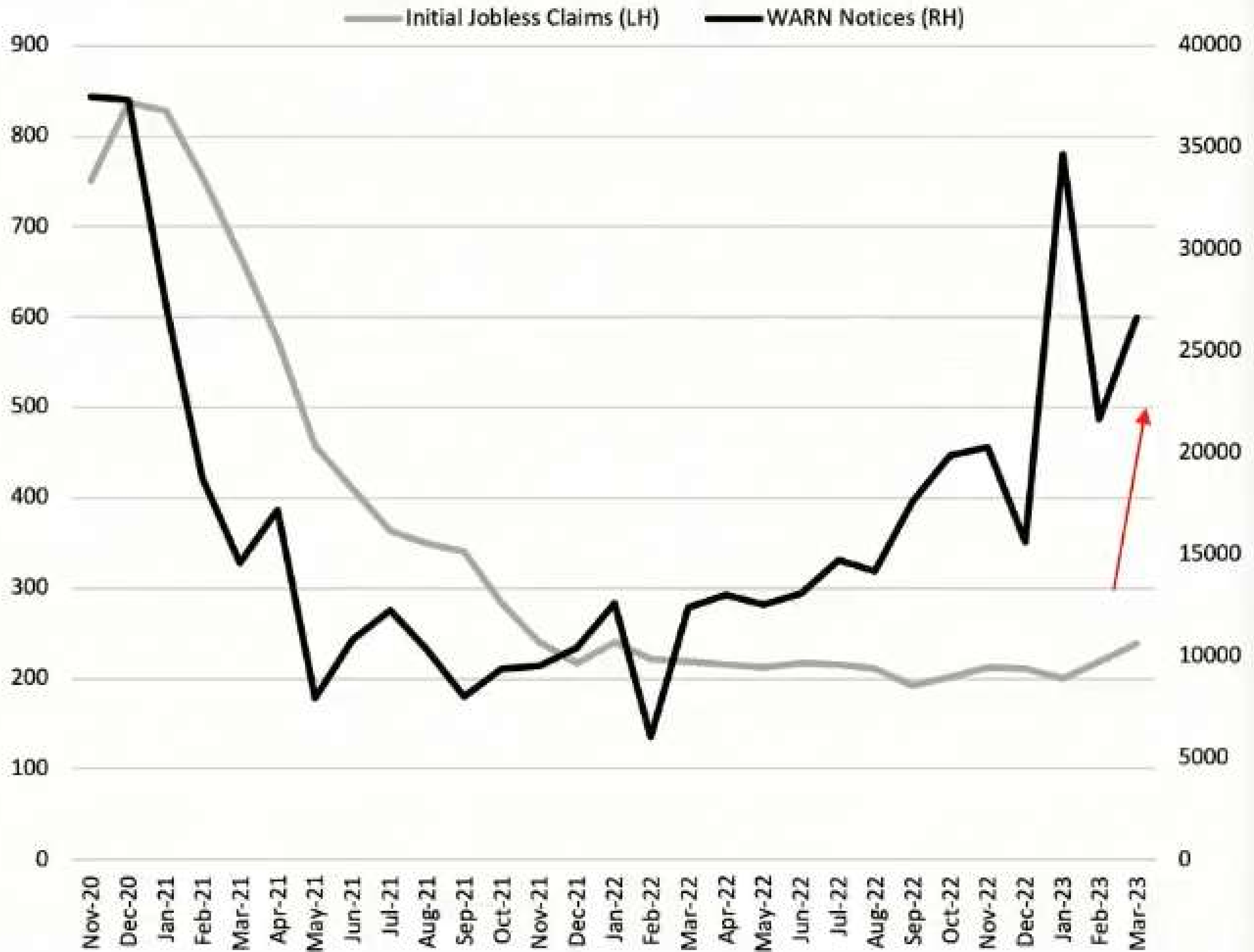
(the) Ukraine is only dragging out longer. But none of these negatives seem to matter. We still do not want to get in the way of this mega-cap train. But we do want to keep (slowly) increasing our bets against small-caps and Fantasies & Frauds.

- Credit Suisse bonds are still impacting the market

Credit Suisse's AT-1 bondholders were wiped out when the Swiss government brokered a deal with UBS back in March. Many of these "coco" holders (contingent convertibles) thought they should get paid – they did not. But the story continues as many holders of these bonds - and many speculators - had bought insurance on these bonds. These credit default swaps (CDS) pay out when a panel (11 members comprised of banks and asset managers) determines if there has been a default. Alas, this panel unanimously ruled that the CDS contracts were on senior bonds of Credit Suisse…not these subordinate structures. Other than being a quirky story, the ruling is important because it altered some positioning in the market. Dealers that had sold the insurance have been hedging with short positions in equities and high yield debt. But now that the insurance is not going to pay, the dealers had to cover their hedges. There was about $19b of CDS outstanding back in March.

- Warn Notices lead to Jobless Claims

Initial Jobless Claims increased to 264k last week - their highest level since the Virus Fear. They moved lower this week to 242k, but the four-week average remains the same at 244k. Warn Notices are also on the rise again. Warn Notices are given by large companies which are legally obligated to give 60 days advance notice before mass layoffs. Hedgeye notes that the Unemployment Rate will not meaningfully worsen until Jobless Claims start to eclipse the 300-350k level. But with Warnings on the rise, more layoffs are right around the corner (Hedgeye chart below). And for the first time since June of 2020, small companies are not expecting to increase head count (the % dipped below 50% down from about 65%-75% throughout 2021).

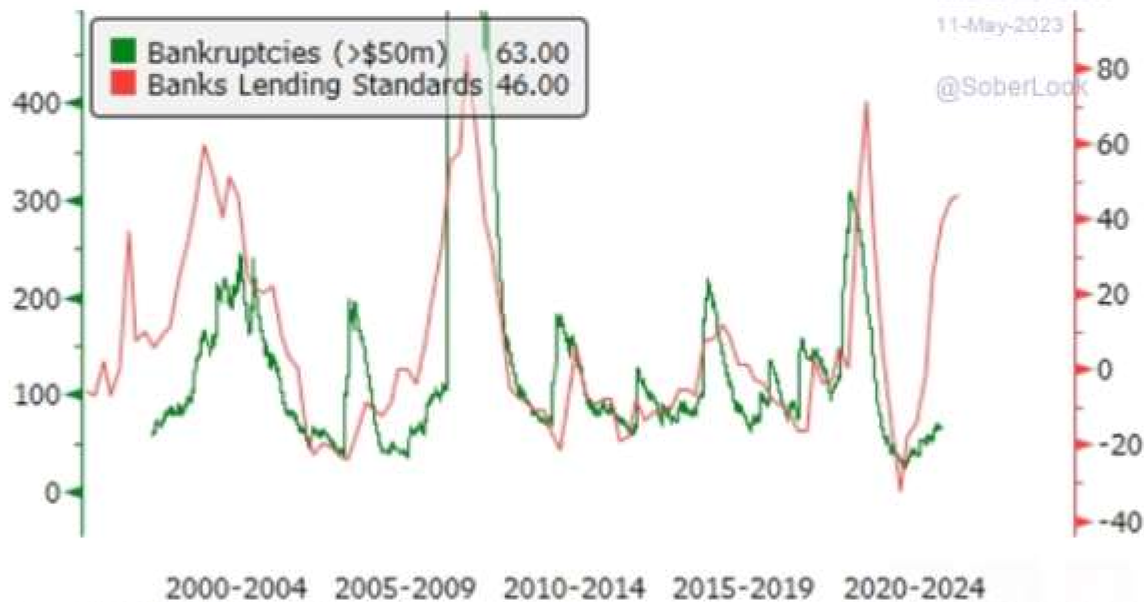


- Inflation trends remain volatile

Last week, we noted that business inflation expectations edged slightly higher. This week, we have consumers's inflation expectations: They jumped from 3.6% for next year to 4.6%. This matches the reemergence of some inflation in Goods while Services prices remain sticky. We will likely get some relief in Shelter CPI data (the government's Owner's Equivalent Rent (OER) is very slow to adjust). But this might not be enough if everything else "core" is on the rise or at least staying high. And despite some recent academic protestations that expectations do not feed inflation, we are squarely in the camp that they do. Perhaps the worst thing about our current inflation environment is the unpredictably and volatility across the spectrum.

- Tighter lending signals more bankruptcies

Last week we commented on the still-tightening of lending standards per the Fed's Senior Loan Officer Opinion Survey (SLOOS acronym). Unsurprisingly, when banks stop lending, bankruptcies follow. The x-axis isn't great with the odd grouping of dates. But the output is still clear. We read elsewhere that bankruptcies are already on the rise (236 YTD, the most since 2010). We think the discrepancy comes down to the size of firms that are counted. Combining the two: Current bankruptcies are bad and are going to get worse.



- New Housing is a bigger chunk of the inventory

The Housing Market Index for May (aka home builder survey) climbed back to the neutral 50 level from 45. This was the fifth straight monthly increase. The undersupply of Existing Homes is driving the New Sales market. In March, 33% of all homes listed for sale were New. The average from 2000-2019 was under 13%. The decline in prices of New Homes is moderating. The only subcomponent of the survey which remains in deeply negative territory is Prospective Buyer Traffic.

Housing Starts and Permits for April both experienced small moves from March. Starts were up a tick from March data which has been revised lower. Permits were down a bit from data which has been revised higher. The downward trends for both data series (obviously highly correlated on a rolling basis) are still negative.

Existing Home Sales in April fell more than expected (-3.4% monthly and -23.2% annually).

Mortgage Applications reversed last week's gain. The index has been treading water since October of last year when mortgage rates first got above 6%.

We still think New Housing can outperform the broad Housing market. We do not have any positions in the former. But we think the latter can weigh on the economy as a whole.

- Other economic data is still negative on balance
  - The Leading Economic Indicators in April were negative for the third straight month. Recall this has a hit ratio of 100% for predicting recessions.
  - Retail Sales in April rebounded to a positive number, but it was lower than expected. But when you back out vehicles and gasoline, Sales were better.
  - Empire Manufacturing crashed back to deep negative territory in May. April was a blip higher. But this May data reconfirms the terrible trend in sentiment. The Philly Fed Manufacturing index improved in May, but it is still negative.

- Industrial Production for April improved with Manufacturing turning positive (although March was revised to be more negative).
- Business Inventories in March turned negative. They remain elevated with this being just a blip to the downside.

➢ Deflation is hitting China (again, the reopening is dead)

China CPI slowed to +0.1% which is the weakest pace in two years. The "core" rate is still higher at 0.7%. Food price increases are slowing but are still positive (0.4% in April vs 2.4% in march). This leaves Energy prices as being deflationary. Along these lines, the Producer Price Inflation (PPI) moved into deflation at -3.6%. And this is a monthly move!

Fixed Asset Investment fell more sharply on a monthly basis. Industrial Production turned negative. Retail Sales were the lone bright spot with better April data.

This just reinforces our comment from last week that the China reopening is over. Of course, this does not mean there is a recession coming. Some aspects are still thriving (Macau for example). But on balance, the 2021-type move in the US is not likely to be extended in China. This could change if the communists decide to ease back on tightening regulations and/or reignite stimulus programs. Both are unlikely.

➢ The Fed's tune is actually changing

Somehow, the market is still pricing in rate cuts later this year. And this is happening even with the onslaught of Fed speakers calling for more vigilance. The most dovish member of the cabal, Austan Goolsbee of the Chicago Fed, still wants to see more progress on cooling inflation. Not to mention, it speaks volumes when the Fed member most thought to be in favor of cutting rates actually voted to hike rates at the last meeting. Raphael Bostic of the Atlanta Fed has been leaning towards softening the Fed's restrictive stance. But he said, "We haven't gotten to the hard part yet."

While some of the doves are not sounding so dovish, the hawks are sounding more hawkish. Michelle Bowman, a Fed governor, said the Fed would likely have to hike interest rates again if, "inflation and the labor market remains tight." This is the standard "data dependent" language. But it is the first Fed official in a while to sound this warning. Thomas Barkin of the Richmond Fed echoed this rate-hiking sentiment.

As we have noted, the market expectation for interest rate cuts might be rooted in the expectation that something is going to break thus necessitating emergency measures. But the futures market does not tend to price in this manner.

In England, the central bank (BOE) hiked 25bps to 4.50%. The central bank also indicated more rate hikes could be on the way especially if wage pressures persist throughout the summer.

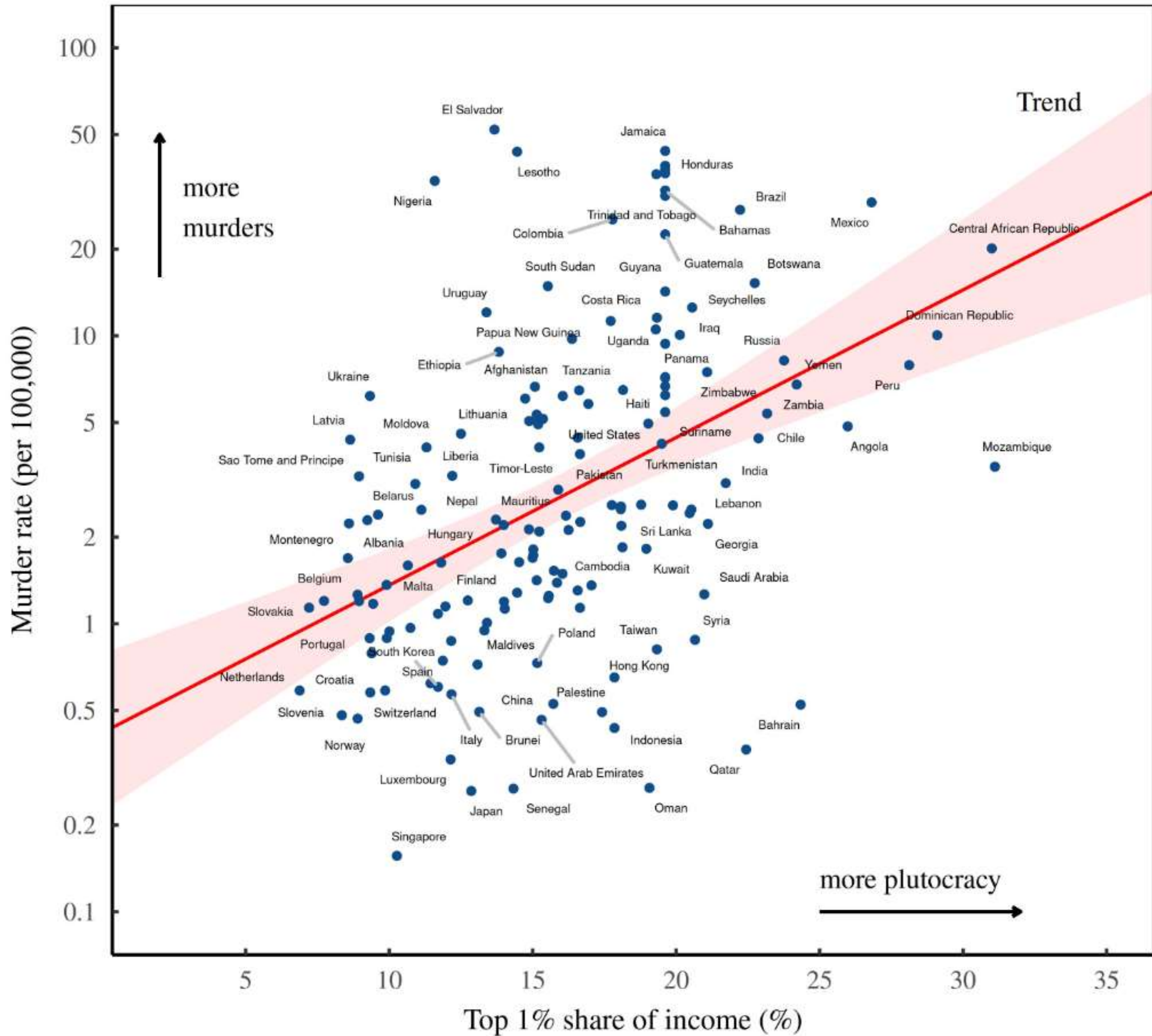
➢ Where did all the crypto money go?

One of the more interesting causes of volatility in the crypto world is related to one of the largest holders of bitcoins: The US government. It owns about 200k coins. Every so often we get rumors about the government selling these. These coins were confiscated from the Silk Road. Recall this is the now defunct website that explicitly facilitated crime…it also got hoodwinked out of $600k by the Georgia college student. The government will sell them at some point soon.

It is amazing how all these stories are always intertwined.

➢ Chart Crime of the week

A self-proclaimed "political economist" thinks the red line is somehow representative of the scattered data. His hypothesis is "when inequality rises, murders go up." Log scale on one axis but not the other. Blind assumption on what constitutes inequality. Thinking an R^2 of 0.2 is a strong correlation. Thinking correlation (particularly a weak one) is causation. Refuses to post the actual data. This "political economist" has it all.



➢ Quick Hits

- New Jersey and Ohio did not ratify the 14th amendment to the US Constitution until 2003 (they had rescinded their initial ratifications).
- BCA Research thinks there is a 50% chance that AI will "wipe out humanity" by 2050. He likened it to the spread of the Virus (Fear).
- Peloton is recalling 2mm bikes for faulty seats.
- Silicon Valley Bank paid employee bonuses the day the bank failed.

- Sam Zell, the billionaire real estate investor who just died, made money in high school by selling used Playboy magazines.
- In its report on Zell's death, Bloomberg highlights his biggest business failure. He sold his office real estate company for $39b. He then bought The Tribune company for $8b. He ultimately lost $300mm when it filed for bankruptcy. And Bloomberg considers this a bad trade?

Trading: We added some more of the Fantasies & Frauds as some continue their bounces higher. We still like being short small-caps instead of mega-caps. The exception to this is Tesla (see below). On the macro side, we sold some USD and bought some Treasuries and gold.

TSLAQ: Tesla is recalling every car ever sold in China. These 1.1mm cars have break and accelerator problems. The car company thinks it can fix this defect with an "over the air" fix…just by tweaking the software.

After Tesla's annual meeting, Musk gave an hour-long interview to CNBC. The highlight for us was Musk proudly proclaiming that he does not care about his customers or advertisers when it comes to his colorful tweeting. While we applaud his attempts at protecting free speech (despite cow-towing to the Turks and Chinese), his shareholders might appreciate a more balanced approach.

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