Weekly Update

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- The bond market will not be ignored
- Where did all the crypto money go? (ranked higher this week)
- Can higher interest rates really be helping the economy (no)
- Outlier Rank is telling us to pull a Costanza
- Inflation is proving sticky
- Housing stability might be fleeting
- The Fed: More rate hikes are coming
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	3,992	-3.8%	3.9%	-6.7%
QQQ	$294.25	-4.8%	10.5%	-13.2%
US 10 YR	3.93%	3.80%	3.88%	2.00%
USD/DXY	104.5	103.8	103.5	96.2
VIX	22.3%	18.2%	21.7%	31.0%
Oil	$73.86	-6.0%	-7.9%	-19.9%

*10yr, DXY, and VIX are levels not changes

** Oil is front month futures, beware

The equity market finally paid some attention to what the bond market has been signaling. With economic data pointing to more interest rate hikes (improved business sentiment along with sticky inflation) and more narrative-threatening commentary from Fed members, high flying equities finally felt the punch of bond yields approaching their cycle highs. That is, despite the new "no-landing" narrative and even some Fed caveats (higher rates for longer but not necessarily a recession), equities are waking up to the realization that a recession is a distinct possibility. As we have seen the goalposts for a technical recession get moved in the recent past, we are more concerned with the rate of the change of the economy. With a slowing GDP will come slowing Earnings (E)…as we are already seeing. And the double whammy is a slowing economy with higher rates results in lower equity multiples (P/E). This is a toxic combination (lower Earnings and lower multiples yield much lower prices). Add on more geopolitical tensions (US tanks to the Ukraine, Putin exiting the nuclear treaty, China disappearing a prominent investment banker), and we struggle to find the positive narrative.

- Where did all the crypto money go?

We are moving this entry up this week because we think a new round of market-wide contagion is possible. Increasing fraud is bad enough for risk appetite. But when it creeps into Main Street, system wide trouble could be lurking:

In case you thought FTX was alone in maneuvering in and out (mostly out) of customer accounts, Reuters reports that Binance has done the exact same thing. Apparently, the world's largest crypto exchange (Binance offshore) had secret access to the accounts at Binance US (onshore, which was supposedly completely ring-fenced from the offshore entity…SBF made the same claims). Moreover, CZ, the head of the crypto Triads aka Binance, surreptitiously operated as a market maker on Binance US under the name Merit Peak (there is some great irony in this name considering the absolute lack of merit). Tying this altogether is the soon-to-be bankrupt Silvergate. The crypto bank that has been hemorrhaging deposits after the FTX implosion gave CZ/Binance/Merit direct access to remove $400mm from US accounts.

- Can higher interest rates really be helping the economy (no)

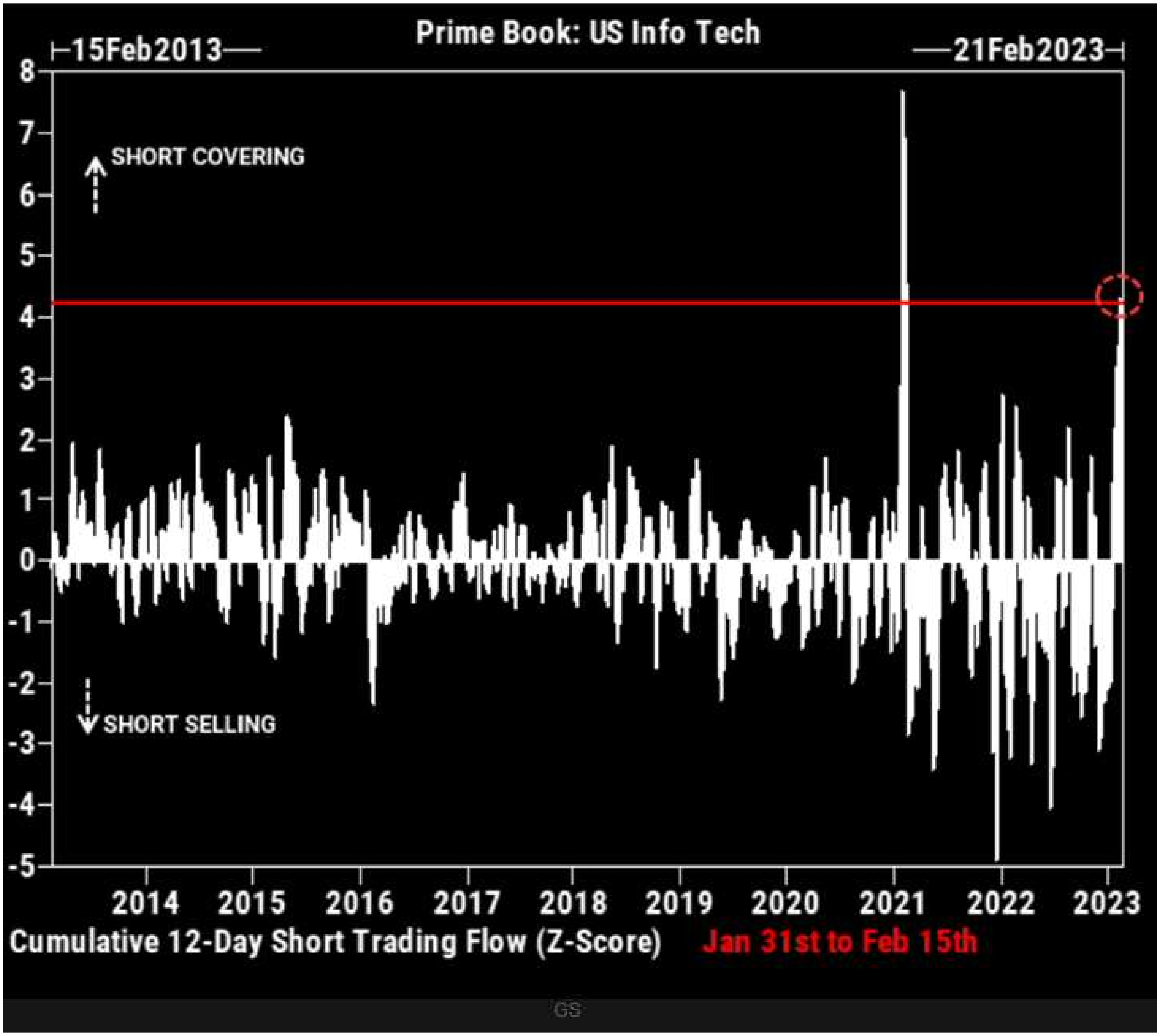
We touched on this last week, but there is more noise about higher interest rates potentially being a quixotic form of stimulus. David Zervos, one of the more market-oriented economists/strategists out there, framed the debate smartly. With the Fed's massive intervention in the bond market (quantitative easing, aka treasury and mortgage buying), the liability side of the ledger has been removed from the market's balance sheet. But the asset side is experiencing mark-to-market gains. If you have a mortgage struck at 2%, you are a big winner. Traditionally the loser against this transaction would be a bank or hedge fund or some other market participant. But now a giant chunk of the other side of these trades is the government. This has been widely discussed…the government is losing its ass on its balance sheet as interest rates move higher (all the bonds the Fed bought are worth a lot less now not to mention the fiscal government has to pay higher interest rates on new debt). But Zervos raises the question whether this matters in the short to medium term. If private investors have this wealth effect from owning a 2% mortgage, that filters through to the economy. Of course, all this ignores the government side of the ledger. This caffeine boost to the economy probably ends the same way as when Chalk Creek Junior snuck some Mountain Dew when he was a toddler.

- Outlier Rank is telling us to pull a Costanza

Our proprietary Volatility metric, Outlier Rank (Tasty Trade invented it as far as we know, but we have customized the data output) tells us that the broad market is continuing to have more outsized moves (one standard deviation) despite the headline Volatility staying compressed. But very large moves (two standard deviations) remain very subdued. ARKK (Crazy Cathie Wood's… aka The Woodchipper… flagship fund), our proxy for highly shorted junk in the market, exhibits a similar pattern with respect to large moves. There are zero occurrences outside of two standard deviations. But single standard deviation moves are infrequent and dropping.

The idea is to find a scenario where Vol is dropping but Outlier Rank (OR) is high. This is the best scenario to find shorts. Conversely, if Vol is high and OR is low, then this is when we want to be adding to our longs (or at least selling our Puts). Our data is young, but it is signaling to short the market and cover the junk. This remains counterintuitive (Costanza). But it has been right!

Speaking of covering shorts, Goldman says the panic in Tech is at the second highest level in 10 years.



- Inflation is proving sticky

The PPI (Producer Price Inflation, wholesale or input prices) jumped higher in January. This reinforces the idea we discussed last week that inflation is accelerating. On the headline, January prices moved 0.7% higher compared to December's *drop* of 0.5%. Core, ex Food & Energy, moved from 0.1% to 0.5%.

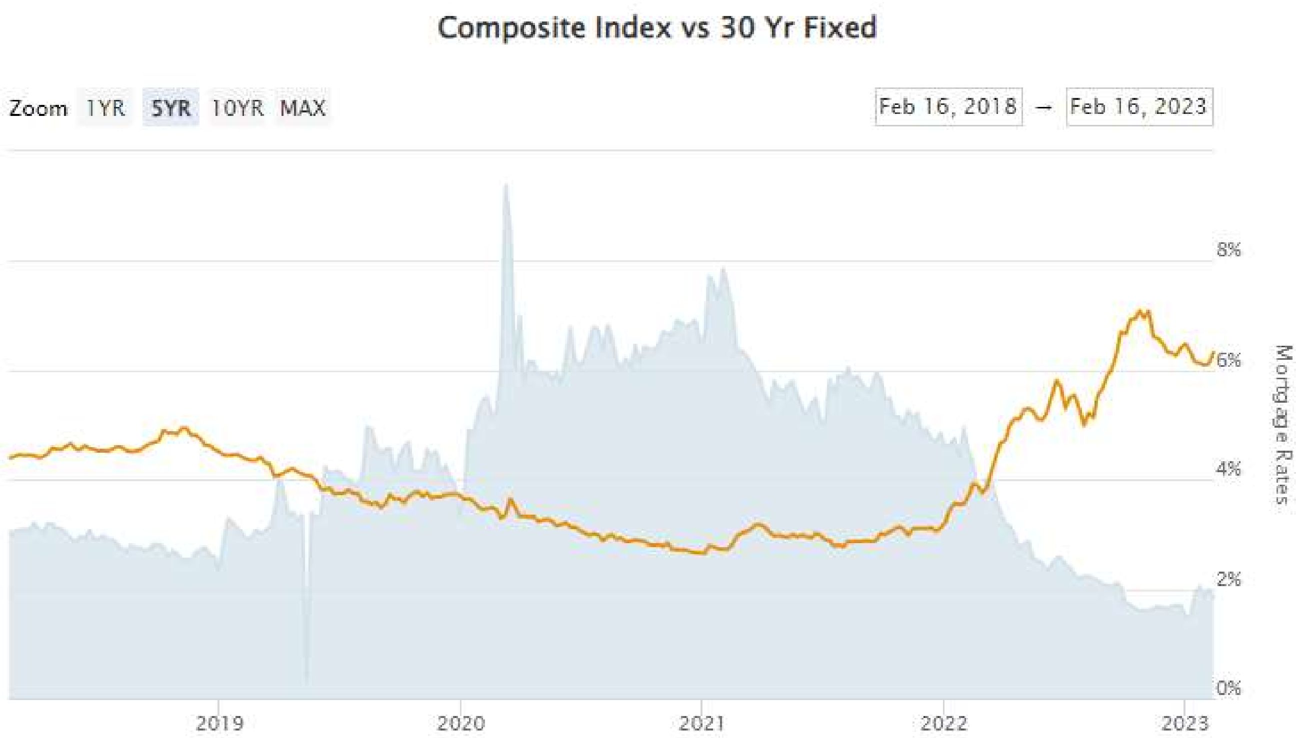
- Housing stability might be fleeting

Housing Starts dropped in January while Permits were flat. Permits have begun to flatten out looking at the last three months. Starts are still falling. Permits lead Starts.

Existing Home Sales slipped 1.5% in January vs February. This marks a 34% drop over last year. We are now below the trough of the Virus Fear. We are not far off from the Housing crisis low (aka Global Financial Crisis or GFC).

Investors continue to disappear from the home buying market. The number of purchases dropped by 46% in the 4Q of last year. This is likely to be negative for a while considering there was a huge influx of investor buying throughout 2021 and into 2022.

Mortgage Applications fell again last week. The mini-bump higher in January has flattened out as the data starts to retrace a bit. The chart below does not mean much until the 30-Year Fixed mortgage rate starts to climb (the mortgage apps index Is not labeled, but the trend is obvious).



Housing prices remain elevated. But if Home Depot is any indicator (weak forward demand expected), the Housing market might be ready to crack even with Permits stabilizing. And by crack we mean prices fall and sales increase which pushes prices lower again.

- Other economic data is poor other than the business sentiment surveys

Markit's Flash (early) read on the February PMI showed surprising strength in Services. It bounced back into positive territory. Manufacturing is still lagging in negative territory. This divergence reflects what is happening with employment and prices.

Jobless Claims registered 194k which is about the same as last week (-1k). Continuing Jobless Claims moved higher. We saw this number ramp higher in the 4Q of last year only to soften a bit this year. But that softening has started to reverse as claims get back near their high. We have said that this could be the data point to watch in the Labor market.

The Philly Fed Manufacturing index dropped sharply into deeper negative territory.

E-commerce Retail Sales fell 0.1% in 4Q vs 3Q (which was revised down from a gain of 3.0% to 1.6% vs 2Q).

The Leading Economic Indicators for December fell again which marks the 10th straight month of declines. Moreover, the fall of 1.1% was more than any of the 22 professional guessers guesses (economist models). We always point out that this data has already been released. So, it should not move the markets. But it does encapsulate the direction of the economy.

- The Fed: More rate hikes are coming

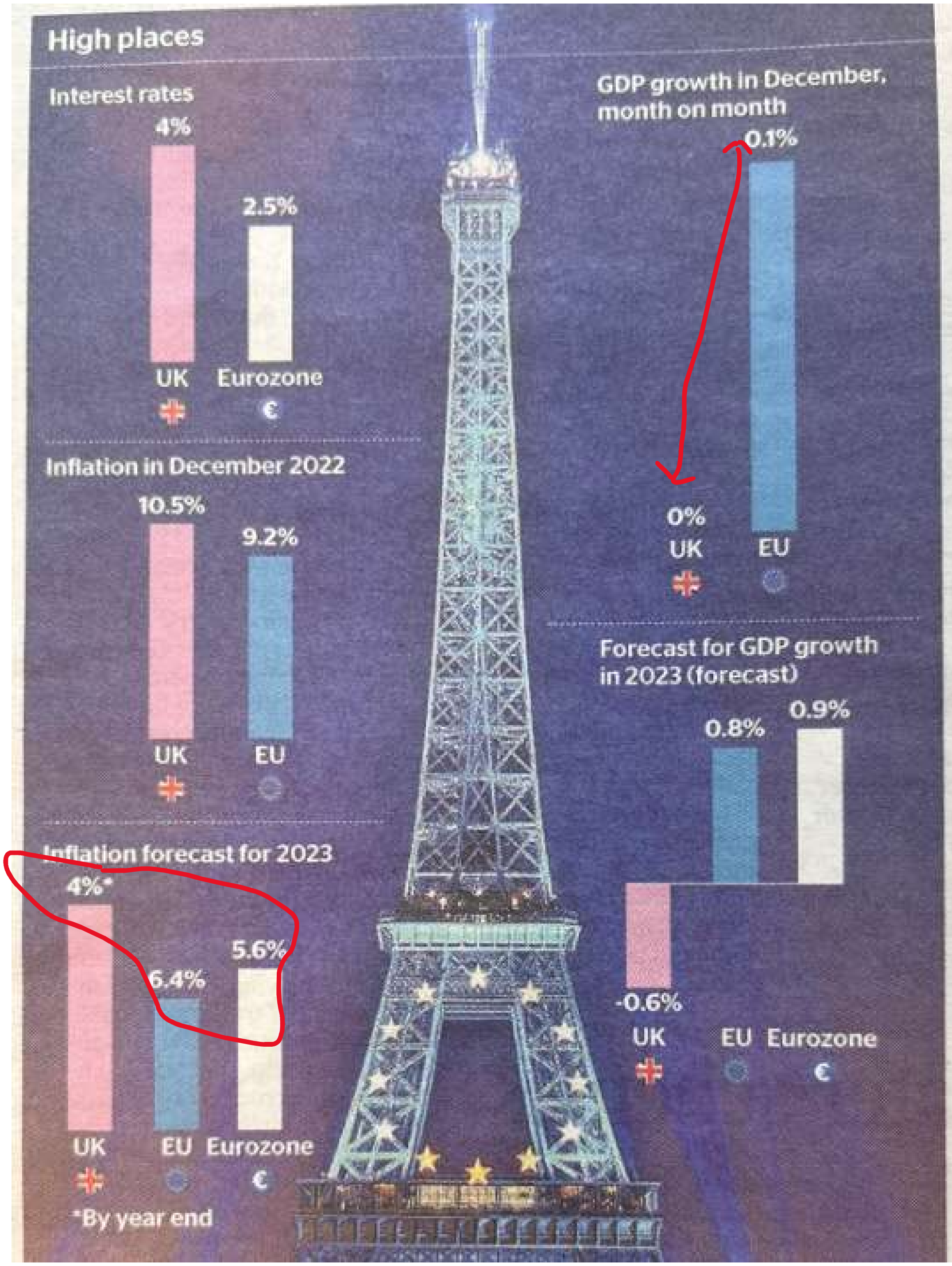
The two most notable speeches from Fed members were from the hawks Loretta Mester and Jim Bullard. Mester, aka Carol Burnett, thinks Fed policy could be more aggressive with more signs of inflation. She was on the fence during the last Fed meeting on whether hiking 50bps was appropriate (and not just the 25bps delivered). Balance sheet reduction will continue (which we note is not talked about very much.) Bullard echoed much of the same with an emphasis on speeding up the rate hikes.

The silver lining in these storm clouds is that both think the US can avoid a recession. The touch of gray is the reality of the Fed never having been able to avoid a recession after an interest rate hiking campaign.

More broadly, the FOMC Minutes can be wrapped up with a single quote, "Participants generally noted that upside risks to the inflation outlook remained a key factor shaping the policy outlook…until inflation is clearly on a path to 2%."

- Chart Crime of the week

This is a clipping from the Sunday Times in London. They are really trying to tell a story about the UK here. Check out the Inflation Forecast and the GDP growth.



- Quick Hits
  - The NBA dunk contest, which still somehow exists, had a G-league player participating.
  - The dunk contest has not had a player from the all-star game participate in six years.
  - The oldest restaurant in Fort Worth is closing because a judge invalidated a perpetual lease signed with the landlord.
  - Monday's holiday is officially named Washington's Birthday not President's Day.
  - AbbVie is being sued in the Netherlands for "breaching human rights" over drug pricing.

Trading: We added to our slowing-economy trades in macro land. We bought some gold and treasuries. These are contrarian right now. On the flip side, we trimmed a bit of our USD long. We still like this trade, but we want to lighten up after increasing our size recently. We added another touch to our long in China. We might have top-ticked this from the start…bad timing. The economic data remains buoyed by the reopening, but perhaps the stocks have already priced this. We added to our Energy longs. We still think the tight spare capacity scenario on supply will be more powerful than a US recession is on demand. We added to the Fantasies and Frauds on the short side (ever so slightly).

TSLAQ: Tesla currently has three areas that are profitable: Full Self Driving, China, and government subsidies.

- Tesla announced a recall of its "Full Self Driving" software. Apparently, intersections and speed limits are the cause. Currently, Tesla is under investigation for false advertising with respect to its "Full Self Driving" product which cannot drive.
- Tesla was the 16th best selling brand in China last week.
- Tesla is looking to buy lithium production for its batteries. Since none of these mines are in the USA, this would disqualify the company from receiving subsidies under the new scheme.

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