

Chalk Creek Partners LLC

Registered Investment Advisor

Weekly Update

27-July-2020

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- Market trending flat with more worries
- Credit Risk Transfer (CRT) bonds are back in the news
- Busy week for earnings
- Housing remains strong
- Quick Monday note before we hit the road this week.

The market is trending flat, and it feels a bit shaky. China tensions are heating up again. VP Pompeo delivered a strong rebuke of the Communists and there is some tit-for-tat ongoing. Earnings seem to be disappointing even with good numbers being reported. We suspect the market will take a breather when the market leaders report this week. Of course, the Fed is still purchasing Treasuries with the Balance Sheet sitting above \$7t.

- Credit Risk Transfer (CRT) bonds are back in the news.

CRTs are the bonds that Fannie and Freddie issue as a form of reinsurance against their Mortgage-Backed Securities (MBS, which are pooled mortgages bought from lenders). The mortgage forbearance mandated by the Cares Act means CRT investors will suffer losses while Fannie and Freddie will not. CRT holders will not receive their interest payments and could potentially lose their principal. But since these “defaults” are just temporary, Fannie and Freddie will collect all of the interest and principal payments when forbearance ends. Of course, these temporary defaults might become permanent. Everyone loses in this case.

- Busy week for earnings

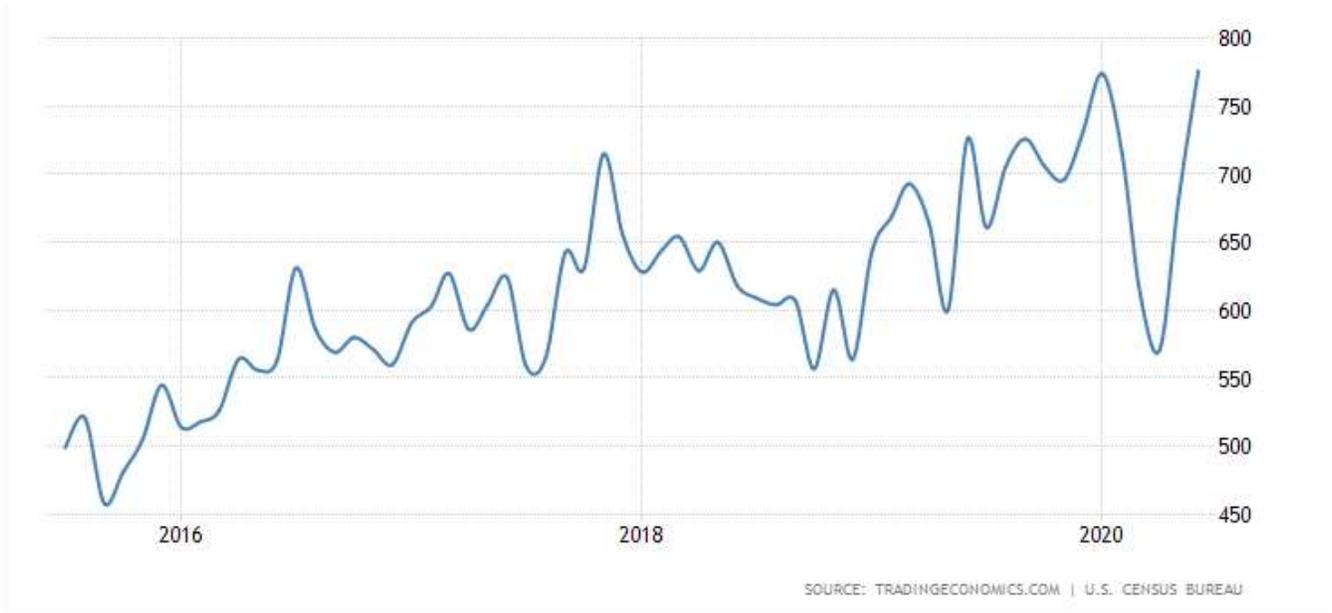
40% of the S&P 500 have reported and another 40% report this week. We are at a make or break point. As for what we have seen so far, earnings are beating the low bar 60% of the time. This is below the usual 70-75% pass rate. Companies are still reluctant to give guidance. When they do, it is slightly worse than the historical rate. Healthcare is slightly optimistic while Big Tech is slightly pessimistic. We think the most telling sign is that when companies do beat expectations, they are barely outperforming the market. This is a clear sign of an overbought market.

- Housing remains strong

Jobless Claims ticked higher for the first time since the government mandated the shutdown of the economy. But both state-level Continuing Claims and federal PUA Claims ticked lower (16.2mm and 13.2mm, respectively). The good news is the total Claims number has fallen below 30mm. The bad news is the benefits run out this week unless Congress acts. We think there is a good chance there is an extension of some sort.

Housing continues to be incredibly hot. And as we noted last week with the Housing Market Index, this is not just a relative bounce. Most numbers are surpassing pre-virus levels and showing growth on a year/year basis (Existing Home Sales are the exception – they are bouncing but still below pre-virus levels). The June read for New Home Sales blew away expectations with a 14% rise vs a 4% expectation (chart below). This June figure was up over 7% vs June last year. The total Sales was 776k, but this is an annualized number (housing and autos do this). May was revised higher marginally, too (676k to 682k). New Home Sales measure new builds with a

contract, so it is timelier (although contracts can fall through, obviously). Inventory is down to 4.7 months vs 5.6 in May. And prices continue to increase with the median price in June equal to \$329,200 vs \$311,000 in June 2019. Regionally, the Northeast had an 89% jump vs May! This is due to a deeper trough and flight from the cities. Interestingly, the price range with the most sales was the \$200k-\$300k. This is down from \$300k-\$400k. This tells us there are more first-time buyers. But to keep the median higher, there are also more high-end sales going through.



Actual	Previous	Highest	Lowest	Dates	Unit	Frequency	
776.00	682.00	1389.00	270.00	1963 - 2020	Thousand units	Monthly	Volume, SA

The early look at the July PMI (Flash) in the US showed a dead flat outlook compared to June. This is not too surprising as there is a mix of better and worse with lots of uncertainty. On the other hand, the Eurozone showed a nice bounce led by Services. The Composite (Services and Manu together) hit its highest level in two years.

➤ Quick Hits

- Japan has a criminal conviction rate of 99.4%.

Trading: We trimmed some Big Tech and rotated into some of the laggards. We still like the sport vehicles and gun makers for trades.

TSLAQ: The Bond Villain during the earnings conference call: “We are not trying to be super profitable...we are only trying to be slightly profitable.”

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