Weekly Update

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- Market unwind continues
- Earnings expectations are stretched
- Economic Data continues to be strong except for the Labor market
- Oil Volatility is back
- ESG continues to mislead
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
SPX	3820	-2.7%	1.7%	25.9%
QQQ	309.2	-4.6%	-1.5%	43.9%
US 10 YR	1.48%	1.53%	0.92%	1.06%
VIX	26.7%	28.9%	22.8%	32.0%
Oil	61.26	-3.6%	26.2%	29.8%

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

The market continued to unwind its leverage to the Lockdown stocks. Even with the 10-year interest rate stabilizing around the 1.50% level, Growth stocks continued to lag Value stocks. Over the last 10 days, the Growth underperformance is 7.3%. The "long duration" Growth stocks have been pummeled even more. The posterchild for this group, the Ark Innovation ETF (ARKK) which is nothing more than blind momentum chasing, has underperformed Value by 19% over this same period! Moreover, the unwind/rotation theme is evident in the SPAC space: pre-merger deals are trading below the $10 cash value (recall this was the original hedge fund SPAC trade, arbitraging the cash value of idle SPACs). And we would be remiss if we did not mention that the S&P 500 had one of its biggest gains in the last 11 months on Monday. Oddly, market Volatility as measured by the VIX is still almost 5 percentage points below the peak seen this past Thursday and Friday. Perhaps this means everyone has scrambled for protection already? Alternatively, the Nasdaq VIX has stayed more elevated. The mad scramble to rotate has manifested itself in the different Volatility markets. Putting it all together, the headline moves in the market are covering up the real pain underneath the surface (as usual). Throw in some Reddit madness (Rocket Mortgage RKT was up 71% on Tuesday and down 33% on Wednesday), and the market is ripe for further Volatility and rotation. We welcome this. We still have a hefty cash position. And for reference, about 1/3 of our positions were in the green today. And to cherry pick some data, we lost about 0.65% today with the S&P 500 down 1.3% and the Nasdaq 100 down 2.9%. Of course, our High Growth basket got decimated. Sizing is important!

As for the running themes, one bear slant to the interest rate environment is that the Fed has “lost the narrative.” That is, the market is dictating interest rates no matter how much the Fed suppresses the short-end of the curve. Of course, one of our long running beliefs has been that the Fed will do anything to keep the pump going. We think it is likely that they institute some sort of Yield Curve Control by shifting their bond purchases to more Treasuries away from MBS (Mortgage Backed Securities) or just extending the duration on their Treasury purchases. (But they will not call it Yield Curve Control.)

We also have the “stimulus” package which has hit a few roadblocks. The Dems having to use Reconciliation has torpedoed the $15 minimum wage as the senate parliamentarian has found that instituting pricing floors is not related to the budget. Also, the bill in its present form is likely to cut $126b in programs including $36b in Medicare. Ironically, these cuts would be triggered by an Obama era law known as Pay-as-you-go. A waiver can be passed with 60 votes in the Senate. Point being, there is a lot of negotiating left to be done. This undoubtedly is weighing on the market, too. Ultimately, we think some sort of package gets passed. Even if it is an actual “relief” bill, this should help stabilize the parts of the economy that need it most (labor in the Services).

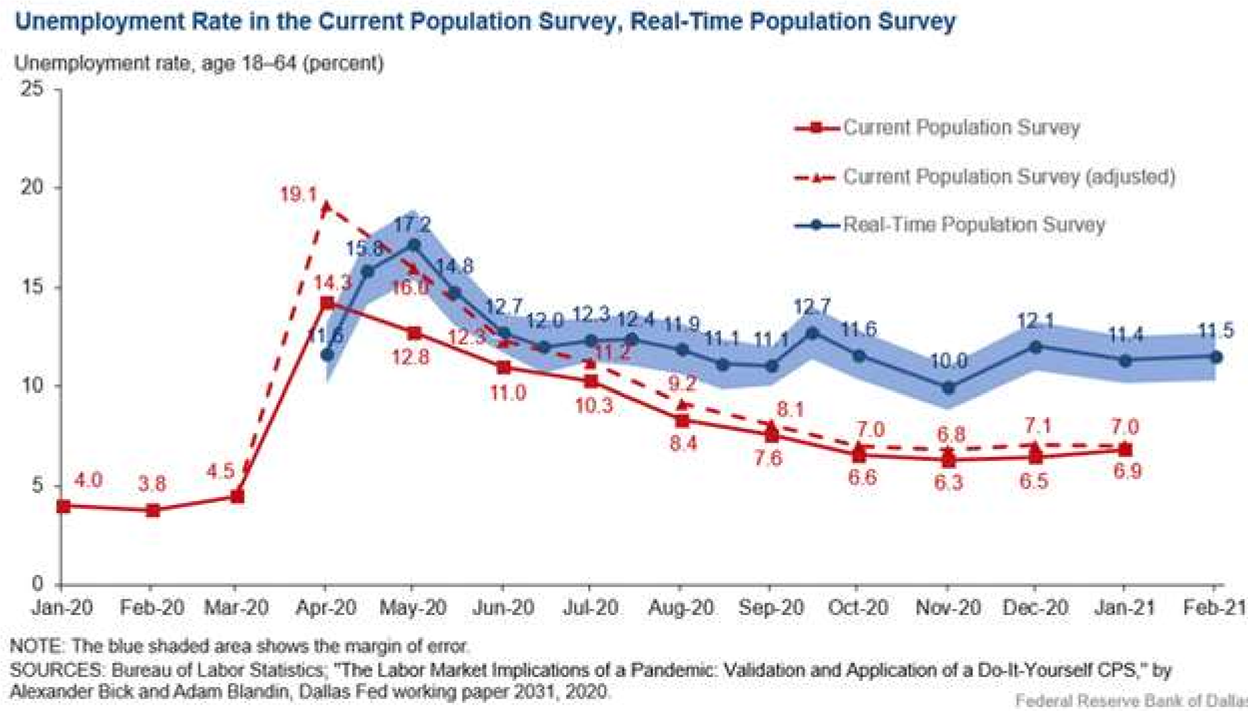
The third running theme has been the virus fear, of course. With vaccines rolling out and states loosening up based on hospitalization statistics (not silly case counts), it seems likely that this overhang might be lifted. Obviously there will always be an element of Covid-Forever.

- Earnings expectations are stretched

We have been writing a lot about Positioning lately. We can add earnings estimates to this idea of things being stretched. Last month we noted that January was one of the stronger first-months-of-a-quarter in terms of analysts revising estimates higher. With February in the bag now, we now know (according to FactSet) that this was the second strongest first-two-months-of-a-quarter since the data was first tracked in 2002 (as we noted before, the best period followed the recent tax reform). As a whole for the S&P 500, earnings estimates were revised higher by 5%. The average is a *decline* of almost 4%. Obviously much of this is catch-up for the huge earnings downgrades that persisted throughout much of 1H 2020. And the current 1Q2021 expectation is still about 11% below the pre-virus expectation. Nonetheless, we think the market has priced in a lot of perfection for this earnings season (which means it has set itself up for disappointment).

- Economic Data continues to be strong except for the Labor market

We stumbled upon this chart (from John Mauldin) that shows an alternative view of Unemployment. This is nothing new as the employment statistics are riddled with guesses and extrapolations (it is all survey data, after all). Nonetheless, this view courtesy of the Dallas Fed is probably closer to reality than the data published by the Bureau of Labor Statistics and spewed in the media. And looking ahead to Friday, ADP is predicting that the Payrolls data falls short of expectations (117k payrolls added vs consensus of 165k and 174k in January).



Source: Dallas Fed

Durable Goods showed surprising strength in January on top of upward revisions in December. Civilian aircraft orders led the surge, but even ex-Transportation orders were better than expected. Business spending lagged the headline a bit, but it did register its ninth monthly gain in a row. Some lamented the slowing of the growth, but we think this is overly pessimistic:

Personal Income continues to surge thanks to the rebounding economy and continued government stimulus (not relief). It increased 10% in January vs December. While Personal Consumption Expenditures (PCE) increased strongly at 2.4%, the PCE Price Index (inflation) still only mustered a 1.5% pick-up on an annualized basis. The forward inflation curves still show up a pick up in inflation over a five year period but then a dip back down during the to years out period.

The final tallies for the February Manufacturing PMIs continued to show strength. Both the Markit and ISM surveys sit just off the all-time highs with the ISM improving a bit more than the Markit (recall that the ISM focuses on larger multinationals). On the negative side, respondents continued to grumble about supply chain and labor constraints, low inventories, and longer delivery times. Along these exact lines, January saw Wholesale Inventories expand while Retail Inventories shrank. Inflation or not?

The Services PMIs were more split. Markit showed continued strength while the ISM lagged expectations.

Construction Spending in January encapsulates most of the main economic trends right now. There was continued strength led by Residential construction. Unfortunately, there was also a jump higher in government spending. Private spending on Manufacturing also increased.

- Oil Volatility is back

Oil Volatility is back with a 7% swoon this week before bouncing back mildly. We think the recent pressure is a function of two things. Firstly, the dreaded "positioning" strikes again. According to Rabobank, Commodity Trading Advisors (CTAs) have put on max positions in oil. These CTAs are basically momentum chasing hedge funds that operate in the futures space. We are not sure we could come up with this chart on our own (crime?), but we will trust Rabobank in its assessment.

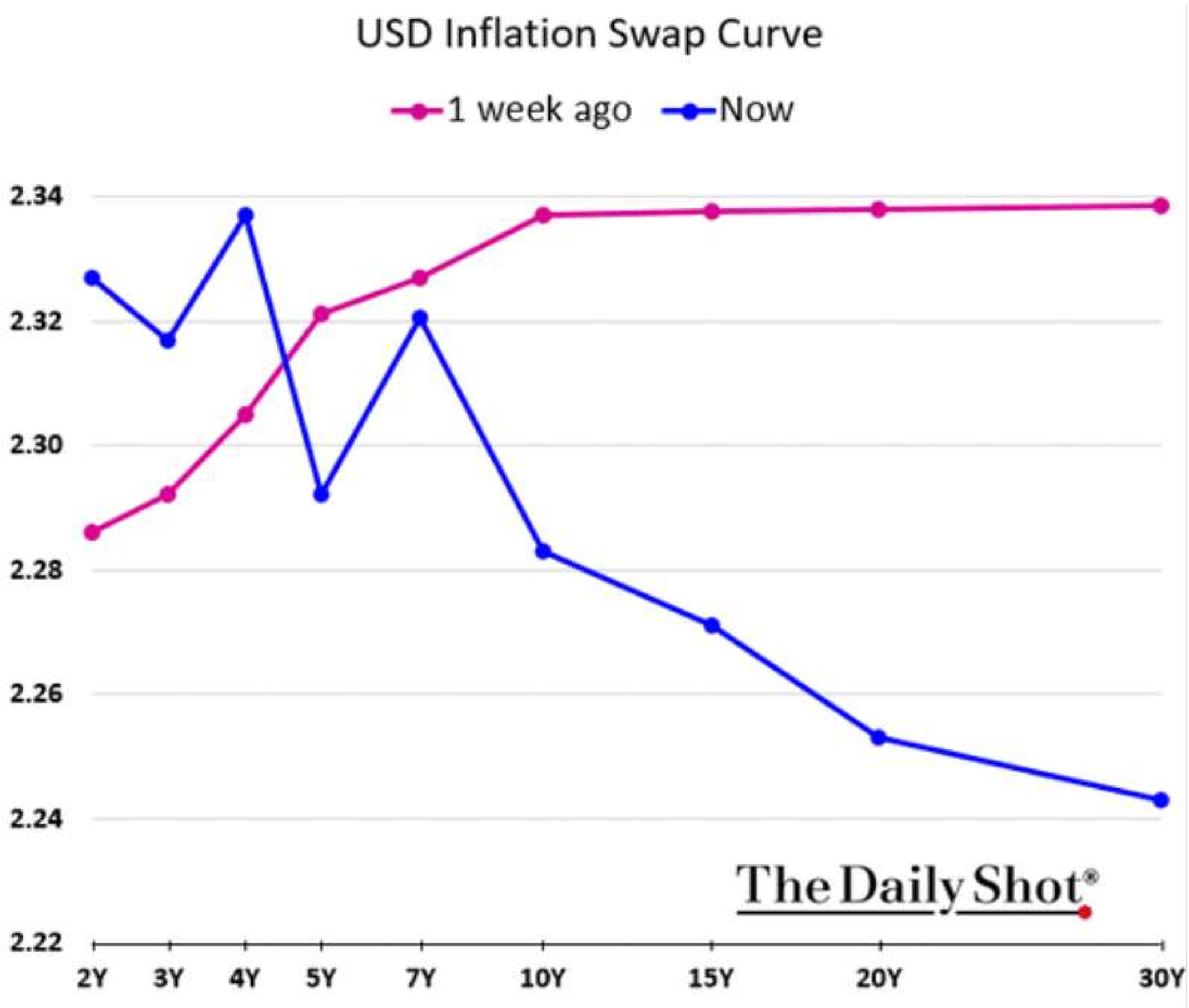
The other factor at play is the upcoming OPEC+Rogue meeting. Expectation was for the group to jack up production levels without the counterbalancing from Saudi Arabia (recall that the Saudis cut 1mm bpd more of production themselves to allow for other members to not cut production). Including this 1mm reversal, the rumor was for an increase of 1.5mm bpd. But this rumor flipped on its head and turned to an expectation of no change in production. Who the heck knows. But ultimately this is mostly short term noise. We think long oil is the best way to lay rising inflation.

- ESG continues to mislead

We have railed against the Environmental, Social, and Governance (ESG) fund industry often. As a refresher, our mild disdain is rooted in the reality of these funds and not the narrative. We have no problem with people wanting to invest their money in any way they choose. But these funds's largest holdings are the usual FATMAAN suspects. And they charge higher fees. And the only sub-sector they exclude is what is left of the coal industry. What really is at the heart of this cottage industry is it adds another revenue source for the otherwise struggling mutual fund industry. Another refresher: mutual funds are horribly tax inefficient when compared to ETFs (by law, ETFs are able to exchange low-cost-basis stock for high-cost-basis stock whenever they want). Right on cue, it has come to light that the fund companies are aggressively lobbying the White House to have ESG funds included in 401k platforms. One of their last vestiges of asset under management stability is being able to jam their funds into 401k plans (and insurance, pensions, etc). That is, most 401k plans force their employees (or policy owners) to buy certain mutual fund products. ESG managers desperately want this captive audience.

- Chart Crime of the week

We like the Daily Shot but doing a whole chart (a large one in that) on a week's change with no point of reference? Useless.



- Quick Hits
  - Mr. Potato Head is dropping the offense term "Mr."

- The GameStop option contract expiring this past Friday with the largest amount of Open Interest (this is the volume indicator for trades being opened) was the $800 Call. The stock was trading around $100 when these opened. Yes, they were 100% losers.
- A Czech diver set a world record by swimming 80 meters under a foot of ice.
- The number of people that make the minimum wage in the US: 247k.
- A California town has banned new gas stations.
- Environmental, Social, and Governance (ESG) funds are now looking for companies they call "improvers." Virtue is all relative, apparently.
- "Removing state mandates does not end personal responsibility." Governor Abbot.

Trading: We have been buying some of our favorite Growth stocks slowly during the carnage. Having said this, we are not adding to our High Growth basket just yet. Rather, we are adding to our Growth names that are profitable (novel concept) or have an immediate path to positive cash flow (novel). We still have our Put protection (mostly on QQQ). But we suspect we are a few percent away from monetizing some of this (selling the protection and buying cheaper protection).

TSLAQ: We are at a loss! We have nothing to add. We will just point out that our long Porsche exposure (they own VW) is crushing Tesla (11% outperformance today alone). Perhaps people are realizing that the legacy automakers can, indeed, make better electric cars than Tesla (now that Tesla no longer tries to make a high-end car like the Model S or X).

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