Weekly Update

13-July-2022

Carlisle C. Wysong, CFA
Managing Partner

- Market is range bound for all the wrong reasons (still)
- Student loan forbearance coming to an end?
- People are also buying the "no recession" narrative
- Employment is still strong on the headlines but not under the surface
- Peak Inflation? Not sure it matters
- Homebuilding souring further
- The Fed members continue to one-up themselves
- Oil maybe finding some support?
- Quick Hits
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	3,802	-1.1%	-19.6%	-12.1%
QQQ	$285.65	-1.1%	-28.0%	-20.7%
US 10 YR	2.93%	2.94%	1.51%	1.35%
USD/DXY	108.4	107.1	96.0	92.4
VIX	26.8%	26.7%	17.2%	16.3%
Oil	$95.73	-2.8%	27.2%	27.2%

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

The market has been range bound for about a month now as the narratives push and pull the indices. Leading the charge is this assbackwards notion that pulling forward the recession is a good thing. The Chinese are supposedly trying to stimulate the economy. But their version of stimulus is allowing local governments to borrow money, selling bonds, to use on infrastructure projects. We think the market likes it when stimulus comes in the form of governments *buying* bonds. And, of course, the communists are still doing virus-fear lockdowns. S&P 500 Volatility has compressed which has spurred some buying. But most Vol watchers think this has been driven by "hedged equity" mutual funds rebalancing their portfolios (these guys are short gamma…they always buy when things are calm and sell when things are choppy).

As far as the Fed hiking rates and the market somehow liking this, the Fed Funds futures market supports this asinine theory. There is now a 76% chance of a 1% hike at the July 27 meeting. There was only an 8% chance yesterday! And now the market is assigning some probability of a rate *cut* in February of 2023 (about 11% chance). It is about a 50/50 split that the Fed will have hiked by May. What this narrative misses is the damage

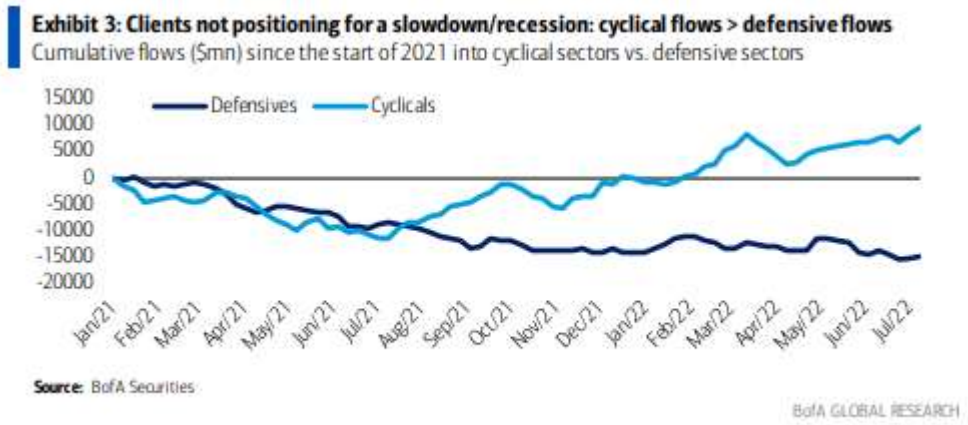
that could/will be caused in the meantime. The Labor market still looks strong now, but when the Titanic starts to turn…and we are seeing more and more proof in Tech layoffs and job offers being rescinded…the Fed might have to worry about disinflation as the economy slows. Moreover, this rate hike-then-cut theory is a pretty good explanation for why commodities have been crushed lately. They will suffer under a lower demand scenario (recession). And then they will not rebound without the inflation catalyst (the contribution from a weaker dollar after rate cuts notwithstanding). And while we acknowledge that we want to be buying when everyone else is fearful and thus in the teeth of a recession, we still have barely seen any earnings downgrades. Until this next shoe drops, no amount of short covering will alleviate our economic fears.

- Student loan forbearance coming to an end?

A random policy date to watch is when student loan forbearance is slated to end: August 31. We expect the administration to extend this charade at least until after the midterms. But at some point, somebody has got to pay ("and it ain't gonna be me.")

- People are also buying the "no recession" narrative

Merrill's recent client flows do not point to recession fears. Cyclicals have been the biggest recipients of new buying while defensive sectors are trailing. The below was Merrill's chart of the week. The same trend holds for Consumer Discretionary and Tech (receiving inflows) which is also counterintuitive (if everyone expects a recession, that is). Whether this buying is driven by the "recession is already here" or "there is not going to be a recession," we think it just reinforces our desire to avoid these sectors.

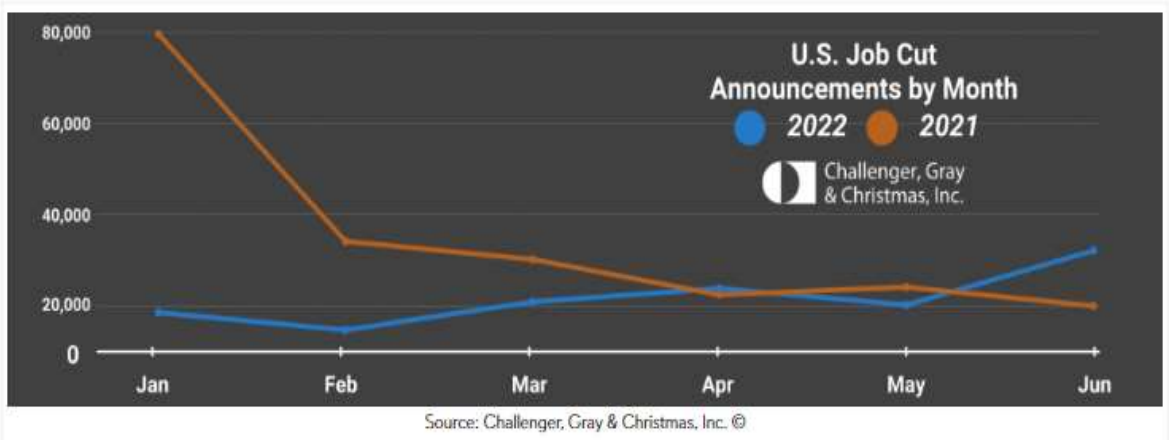


- Employment is still strong on the headlines but not under the surface

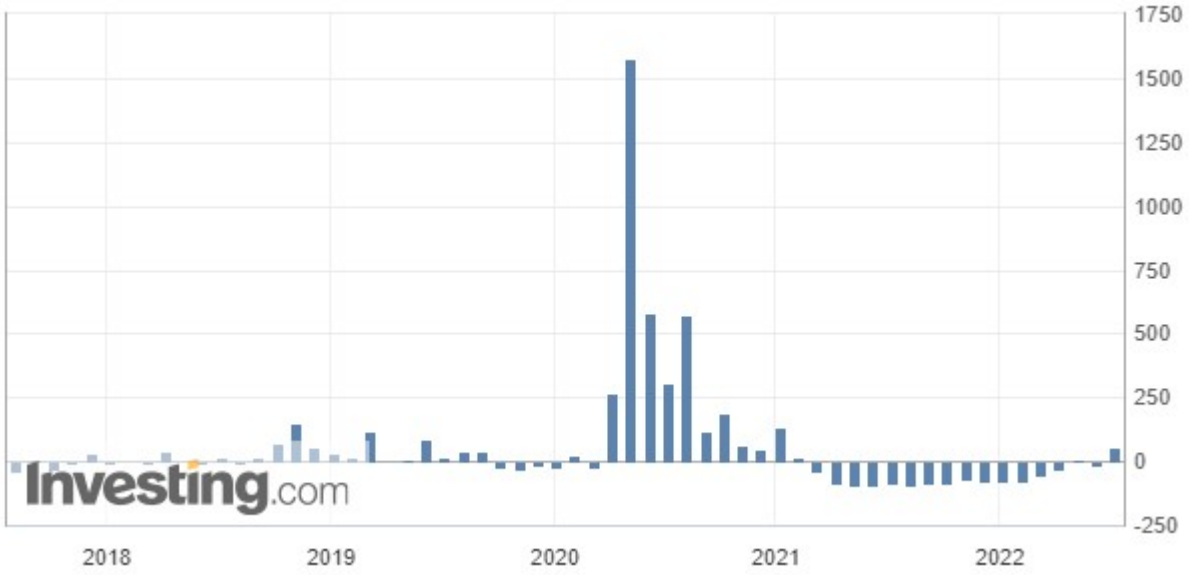
The Employment Report was lauded as better than expected with a gain of 372k jobs. The professional guessers had a range of 190k to 350k (consensus 270k). Revisions, often overlooked by the masses, totaled a drop of 74k over the last two months. Private Payrolls were the strength of the beat. Leisure & Hospitality was the strongest gainer along with Healthcare. The Unemployment Rate stayed steady at 3.6%. The Participation Rate dipped a tick to 62.2%. The Average Hourly Earnings annual increase was 5.1% which is a slight cooling from May's 5.3%.

Overall, we think it was the worst possible outcome. It appears as though the labor market is still humming along adding jobs. This incentivizes the Fed to keep their foot firmly on the economic brakes. But we think this is a lagging report with other labor metrics starting to crack. The chart below is the Challenger Job Cuts Report. The job outplacement firm sees job cuts increasing 59% in June from last year (and 57% higher than in May).

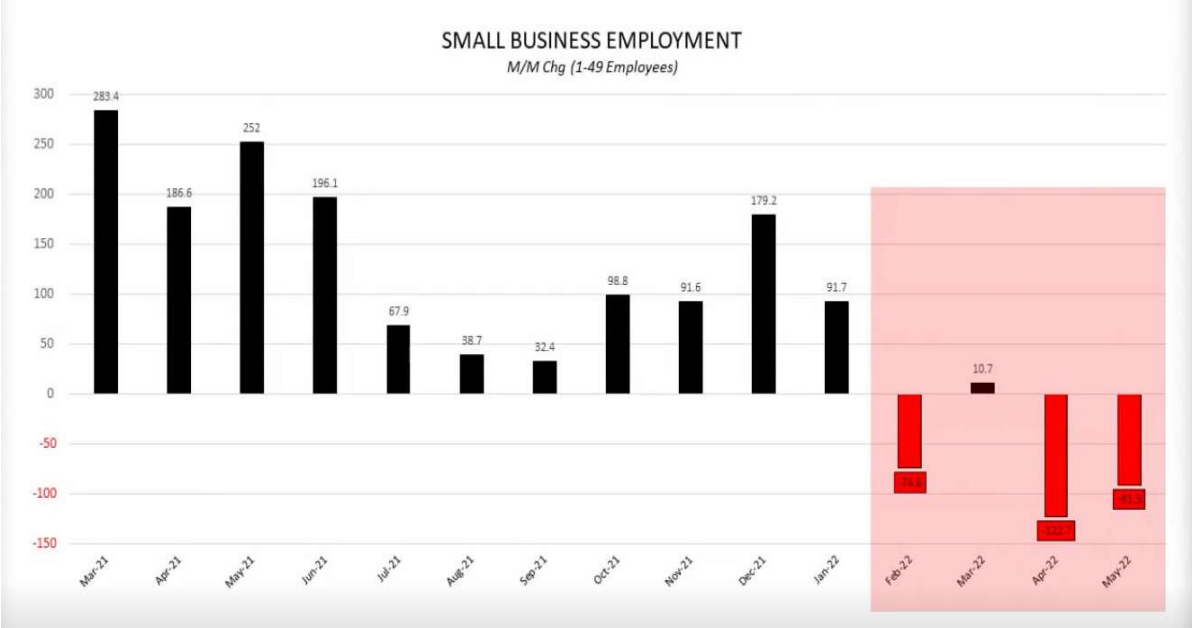
The numbers are still low, but you can see from the second chart (the poorly labeled one, ugh) that the trend is ominous.



The annual change in Job Cuts has turned from negative (good) to positive (bad):

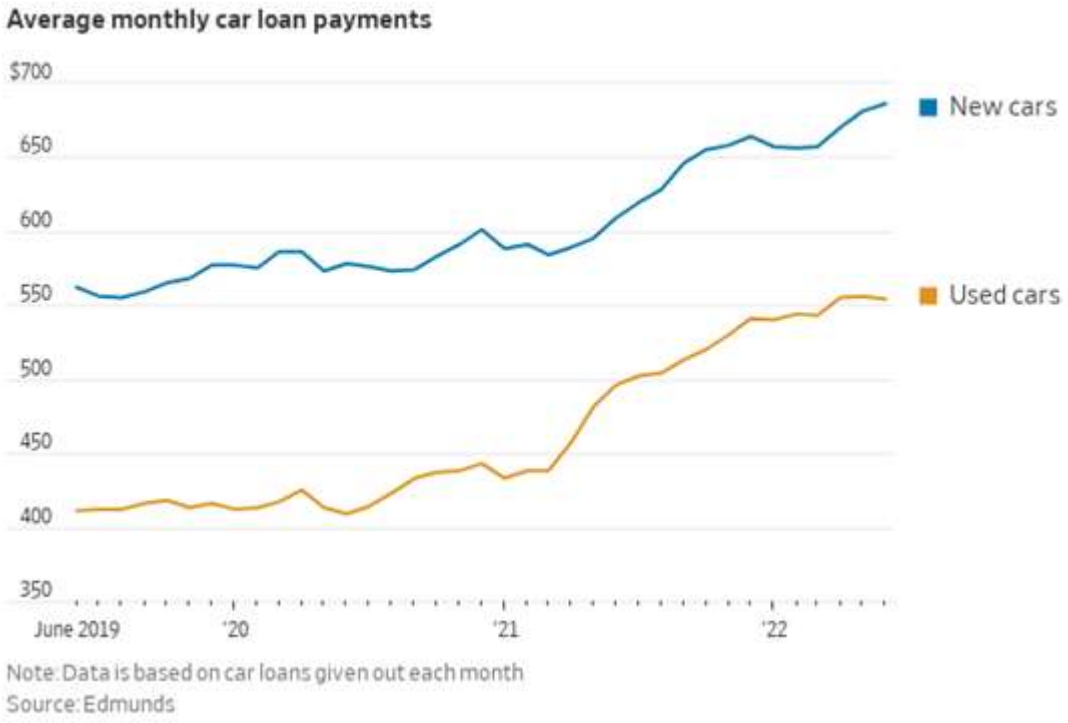


And small business employment (courtesy of Hedgeye) continues to shrink (albeit this is only through May).

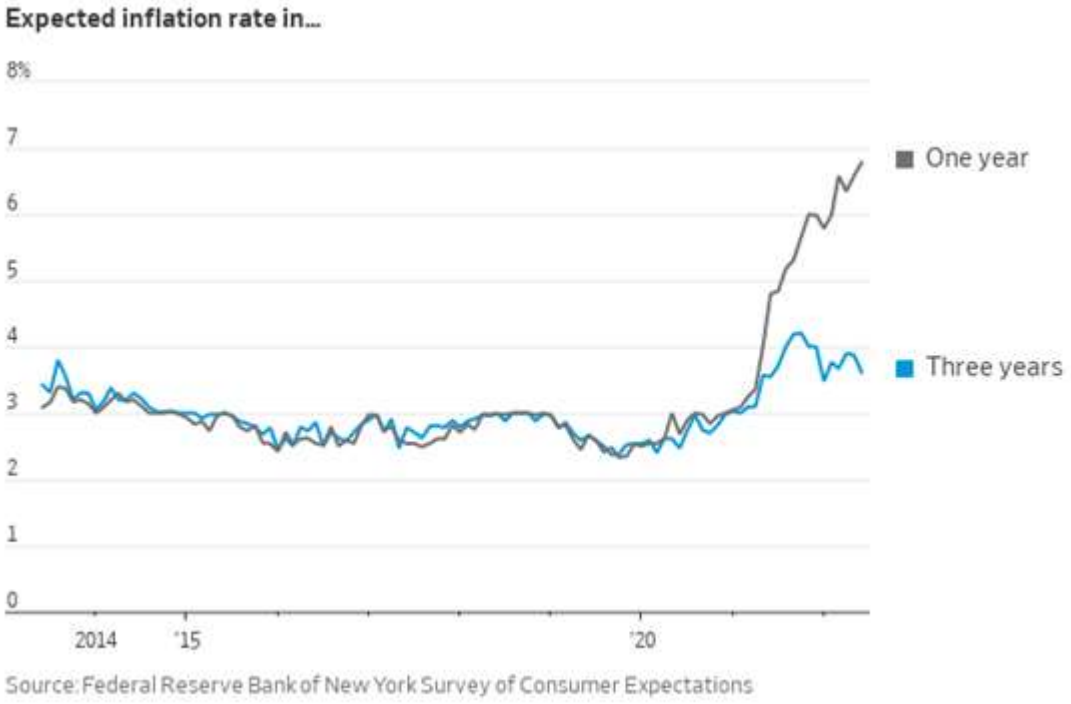


- Peak Inflation? Not sure it matters

Inflation continued to inflate on the headline number with a 9.1% annual increase in June. The monthly increase moved up to 1.3%. These are obviously middle-class crushing numbers (or rather, everyone but the rich gets crushed). But there is some relief in sight as the "core" number fell to 5.9% from 6.0%. And we have seen energy prices continue to fall in the last few weeks. Food commodity prices have crashed. But we do not think the new levels have found their way into the consumer prices yet (but we suspect they will). On the flip side, rent and Housing prices remain through the roof. We think the slowing demand for Housing will eventually feed into lower prices (along with lower commodity input prices). But it is a slow process. Whatever the case, we think this data just emboldens the now politically-minded Fed. The members do not seem to be looking at the real-time data (ie crude prices have fallen 20% and gas prices have fallen for approximately 25 days in a row). The Atlanta Fed's own Business Inflation Expectations remains subdued at 3.7% (it is a one-year inflation guess). But we say it does not matter for two reasons. Firstly, the Fed will keep hiking rates. And even if we get some disinflation, that does not mean prices will be low. Used cars have the been poster child for inflation and disinflation. But that small downtick in prices is not any sort of relief.



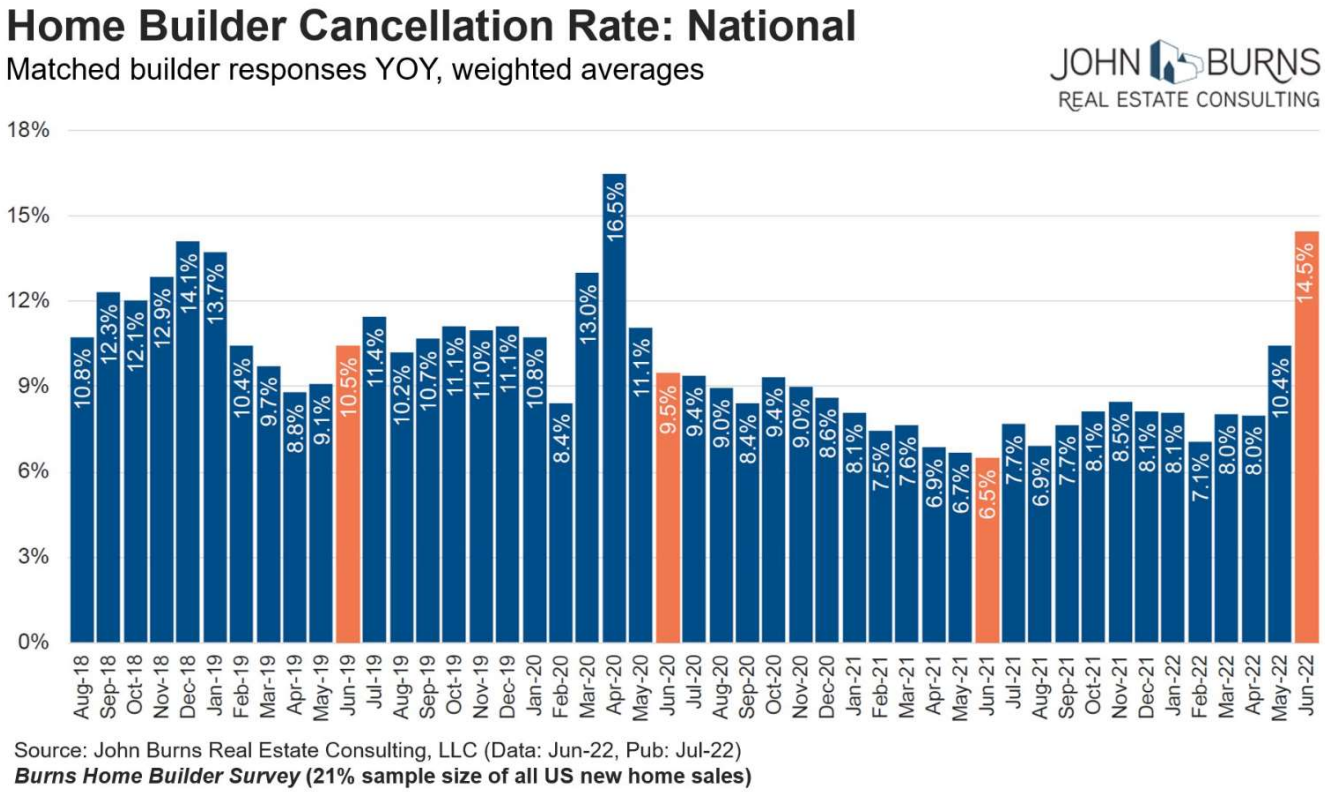
Here is the chart of inflation expectations falling looking out three years:



- Homebuilding souring further

We have noted that the Housing Market Index (homebuilder sentiment) has deteriorated for six straight months. Here is another datapoint reenforcing that view: The Homebuilder Cancelation Rate. This data is only

four years old, but the fact we are approaching the peak of the pandemic level is pretty telling. And Mortgage Applications are back to their contracting ways.



- The Fed members continue to one-up themselves

Fed speakers continue to make it clear that taming inflation is the number one target. Christopher Waller and James Bullard both voiced support for a 75bps hike at the next meeting (July 26-27). Moreover, Waller commented that he thought the fear of kicking the economy into a recession was "overblown." (On the flip side, Esther George did voice her fear of this.) Raphael Bostic of the Atlanta Fed also chimed in that the labor market was still strong, and the economy can weather higher interest rates. In a follow-up speech, he even indicated a 100bps hike was "in play" after seeing the 9.1% June inflation number (and hence the move int eh Fed Funds futures). Looking back at the last Fed minutes, Merrill summed it up with, "the Fed views a slowdown in aggregate demand as a central component of restoring price stability." The Fed knows it must slow the economy dramatically.

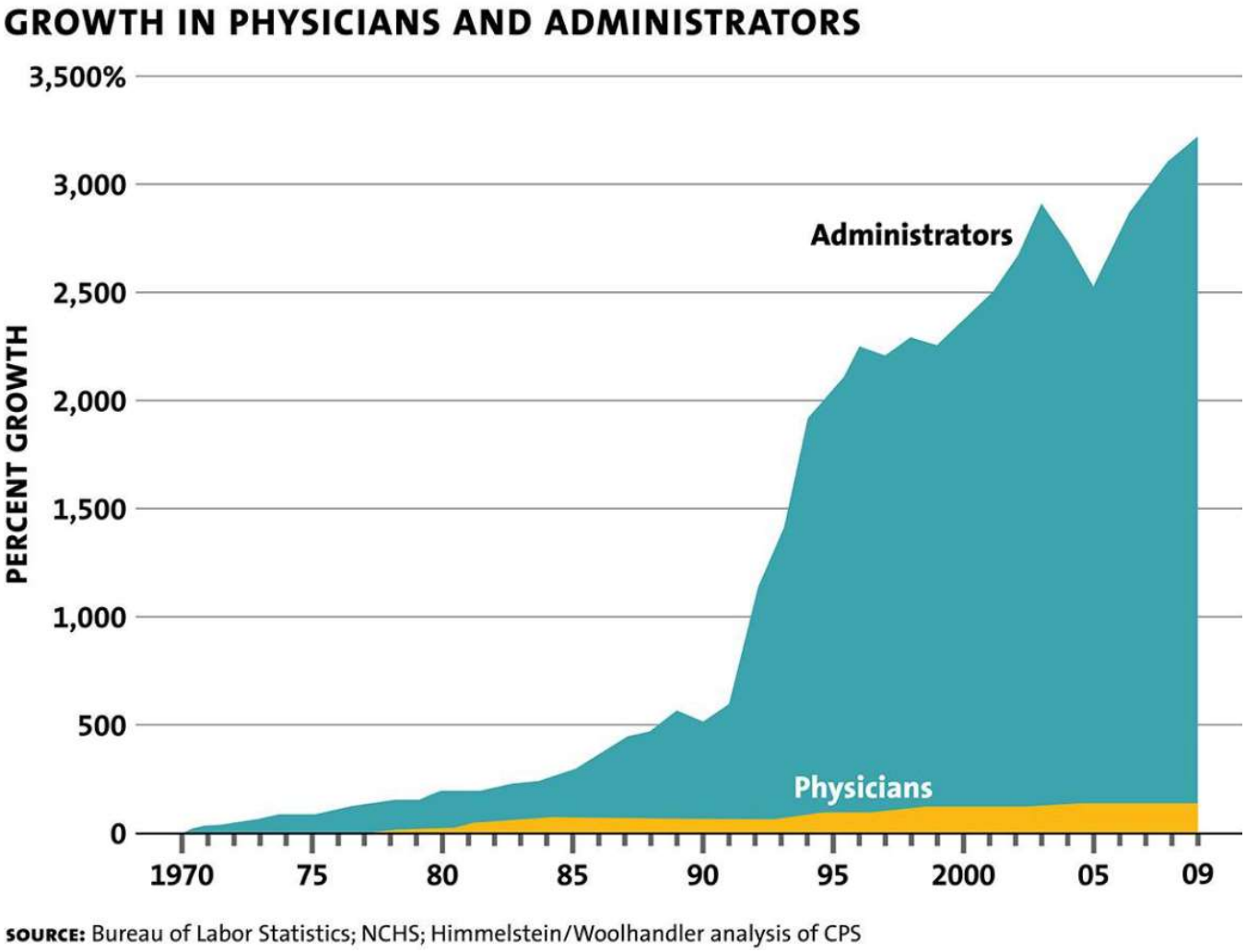
- Oil maybe finding some support?

Macro/momentum traders are keeping a lid on oil futures. Inventories have been building slowly. Many point to this being the first sign of a recession (possibly), but refineries are running at max capacity…so immediate term demand is still incredibly strong. Of course, the government will have to refill the Strategic Petroleum Reserve (not Tactical) later this fall. Speaking of government, we do not expect any revelations after Biden meets with the Saudis. Recall that Saudi recently increased its prices to Asia. So perhaps we will get some rhetoric pointing to stable prices to the US. But some Saudi officials have recently leaked that they have no intent on turning their backs on Russia. We guess this could be construed as Biden-friendly. For our Energy stock positions, the price of front month futures is largely irrelevant (the higher the better obviously, but that is

not to say that companies can instantly sell products at short term prices). Looking at June of 2023 prices, (around $82), we are about back to the level before the Ukraine invasion. It is likely we see a floor here (but that is not our bet).

- Chart Crime of the week

We are going to switch gears this week and show a chart that has been labeled as a chartcrime…but it is not. The defenders of bloated administrations everywhere (healthcare, academia, government, regular ol' businesses) claim that this percentage increase comparison is not fair. The implication being that they are dissimilar notional levels and thus percentages can be distorted (not many admin compared to doctors). Alas, the dissimilar notional levels are actually in the opposite direction. For every 16 healthcare workers, 10 are in admin, five are nurses or home health aides, and one is a doctor.



- Quick Hits
  - GameStop announced a stock split on Wednesday to much fanfare (at least from the dopes that like these uneconomic things.) On Thursday, It announced its CFO was leaving the company.
  - Newark airport terminated talks with Amazon to build a new air cargo facility. It would have created 1,000 jobs and injected $125mm. Unionization and a zero-emissions benchmark were the sticking points.

- The five most watched shows on YouTubeTV are Yellowstone, SNL, This is Us, 60 Minutes, and Grey's Anatomy. No word on the average age of these viewers.
- The court-appointed liquidators of the crypto hedge fund Three Arrows say they cannot find the founders of the firm. The founders deny this (perhaps from their beach front homes or mountain cottages).
- Heathrow Airport is asking airlines to limit ticket sales because of staff shortages. We once "missed" a flight because the TSA agent told us "the airport was too busy to let more people in."

Trading: We added a bit to our Energy longs as they continue to suffer under the recession theme (and ignore the supply constraint theme). We also added slightly to some Staples and gold. We trimmed some of our healthcare inflation long as it tends to bounce around without much rhyme or reason (not to mention healthcare inflation might be stabilizing). We cut one of our Put positions. We will likely cut some more while rotating into other areas for protection. We still think the market has more pain ahead.

TSLAQ: Musk has officially called off his purchase of Twitter. And Twitter has officially sued Musk for $16b in damages. Most legal experts think Musk does not have a leg to stand on. But then again, he has always gotten away with murder (or at least sexual harassment, intimidating witnesses, old fashioned securities fraud, etc). Most neutral Elon watchers think he did the whole thing as a joke…a "bit" to teach the Twitter folks a lesson. Or maybe he did it as an excuse to sell billions of dollars of Tesla.

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