# Weekly Update

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- What banking crisis?
- Fed lending is not a positive sign
- Is bad news bad again?
- More trouble in crypto paradise
- Sector rotation is back
- Large companies expect labor market weakness
- Disinflation is here but there is a long way to go
- Housing showing more cracks
- Mixed business surveys, Manufacturing is still lagging
- International data points to global recession
- The Fed thinks it can have its cake and eat it, too
- Oil production is falling
- Meme stock traders are pretty dumb
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

| | Last | 5d % | YTD % | 1yr % |
|---|---|---|---|---|
| S&P 500 | 4,101 | 3.3% | 7.2% | -8.3% |
| QQQ | $319.07 | 3.9% | 20.0% | -11.1% |
| US 10 YR | 3.34% | 3.56% | 3.88% | 2.55% |
| USD/DXY | 101.6 | 102.4 | 103.5 | 101.6 |
| VIX | 20.0% | 19.0% | 21.7% | 21.0% |
| Oil | $80.58 | 10.1% | 0.6% | -21.9% |

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

You would never know that the country was in the middle of a banking crisis. What seemed to shock the markets for a few days is a thing of the past. Whether it be the Fed's emergency lending, worsening economic data, Fed warnings about more rate hikes, and a slow start to Earnings season, every bit of news is somehow twisted into a positive. Or rather, these storm clouds are pushing people to run for cover in their favorite Big Tech stocks. The concentration in performance is startling. If one were to remove eight to 10 of the largest stocks, the market would be down on the year. We often dismiss the critics of too much concentration in performance data mostly because hypotheticals are irrelevant. But this is typically when markets have economic winds at their back and large caps benefit from the tautological nature of index construction (larger market caps beget larger market caps). When most indicators are negative and most stocks are down, the short-term rush to be the last man standing appears to be more of a last gasp to us.

Bank borrowing at the Fed's Discount Window exploded higher after the Silicon Valley Bank implosion. This was somehow deemed a version of Quantitative Easing (and a reversal of the current $95b a month Quantitative Tightening). But now that this Fed lending is starting to cool, pundits are saying it is a cooling of the stress in the banking system. We have said all along that Discount Window borrowing is not QE and certainly not a good thing. But you cannot have it both ways (QE when it is happening and stress alleviation when it is not).

One sliver of rational behavior is rising to the surface as recent economic data is not being misinterpreted. That is, a poor ISM Manufacturing number sent interest rates lower. But this time, equities barely budged higher despite a decent move lower across the yield curve. And speculative junk was hit hard. Some of this can be attributed to Tesla's poor delivery number for the Q1. But it is also worth noting that while Bitcoin rallied, bitcoin-related equities were hit hard again. Some of this can be the unwinding of the end-of-quarter marking we saw on Friday. But it is might also be the realization that a slowing economy is not good for stocks regardless of the short-term path for interest rates. Many had hung their hat on the Atlanta Fed's forecast for Q1 GDP (called GDPNow). The expectation just two weeks ago was for a 3.5% gain compared to the 4Q2022 (annualized). But now the expectation has dropped to only 1.7%. The Fed better be careful for what it is wishing.

- Crypto "exchanges" under attack again

The US government continues to crack down on the unregulated criminal enterprises masquerading as "exchanges" in the crypto space. The Commodities Futures Trading Commission (CFTC) is suing Binance for pursuing US customers for its wildly risky derivative contracts. Binance has long claimed that it does not market to US customers for these products. FTX also denied being involved in the US. While FTX bumbled its way around as it stole billions, Binance has a section of its website dedicated to circumventing the law: "A Beginner's Guide to VPNs." It adds, "you might want to use a VPN to unlock sites that are restricted in your country." (VPN stands for virtual private network…you mask your IP address.) This news is impacting the crypto related stocks as it should. We think crypto tokens are basically fake prices and not worth monitoring. But real US companies that endeavor to make money from crypto trading have a precarious road ahead.

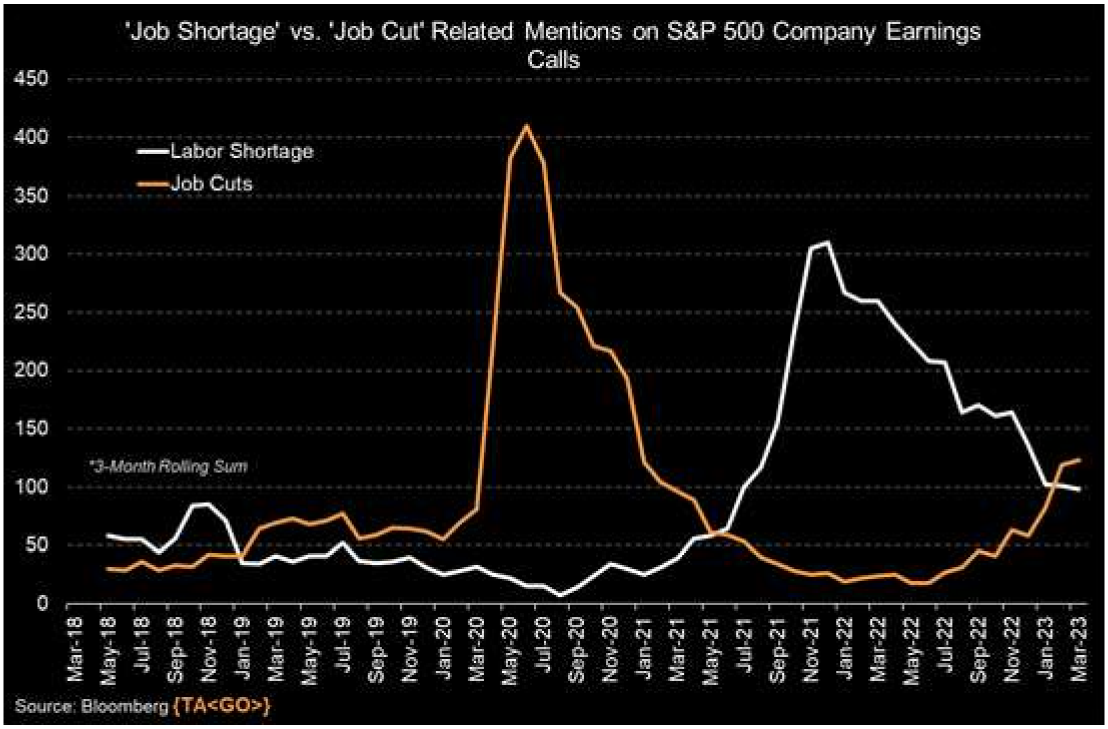
- Sector rotation is back

Merrill's cross section of clients finally sold stocks this week after buying stocks for four straight weeks. Last week there was $3.7b of new buys which was the largest since October. The targeted sectors (inflows) were a mixed bag with Tech, Healthcare, and Financials as the leaders. But both Tech and Financials reversed course this week. Healthcare was the standout in terms of a trend changing (it had very limited inflows recently). Energy stocks also reversed course as they were finally bought. To sum this up, the market seems to be rotating more quickly than usual. We also maintain that is a bad sign for the markets in general.

In other Merrill research, it's Sell Side Indicator is now the most negative since March of 2009…the point at which the Global Financial Crisis bottomed. Needless to say, this indictor is a contrarian one. It tracks the average allocation to stocks by Wall Street strategists (the kings of buying high and selling low).

- Large companies expect labor market weakness

The Job Openings and Labor Turnover Survey showed a large drop in available jobs.  The January number was revised down from 10.8mm to 10.6mm.  And the February number dropped to 9.9mm.  This hard data is supported by mgmt. teams's expectations.  Mentions of Job Cuts are on the rise while Labor Shortage mentions continue to collapse.




- Disinflation is here but there is a long way to go

Personal Consumption Expenditure growth (PCE inflation) seemingly cooled in February vs January.  The headline increase was 0.3% vs 0.6% in January and a 0.4% expectation.  But this 0.3% increase is in line with the last six monthly tallies.  The "core" reading also slowed to a 0.3% monthly gain vs 0.5% in Jan and 0.6% expected.  There are some past month revisions in this data which muddy the waters a bit.  And this monthly data is extremely volatile.  So, we are not yest celebrating any real move down in prices.  As we have stated, we are experiencing gradual disinflation.  But this is not the same as prices falling.

- Housing showing more cracks

New Home Sales increased in February.  This makes the third straight month (albeit with some weird revisions).  Sales in the Northeast fell 40%.

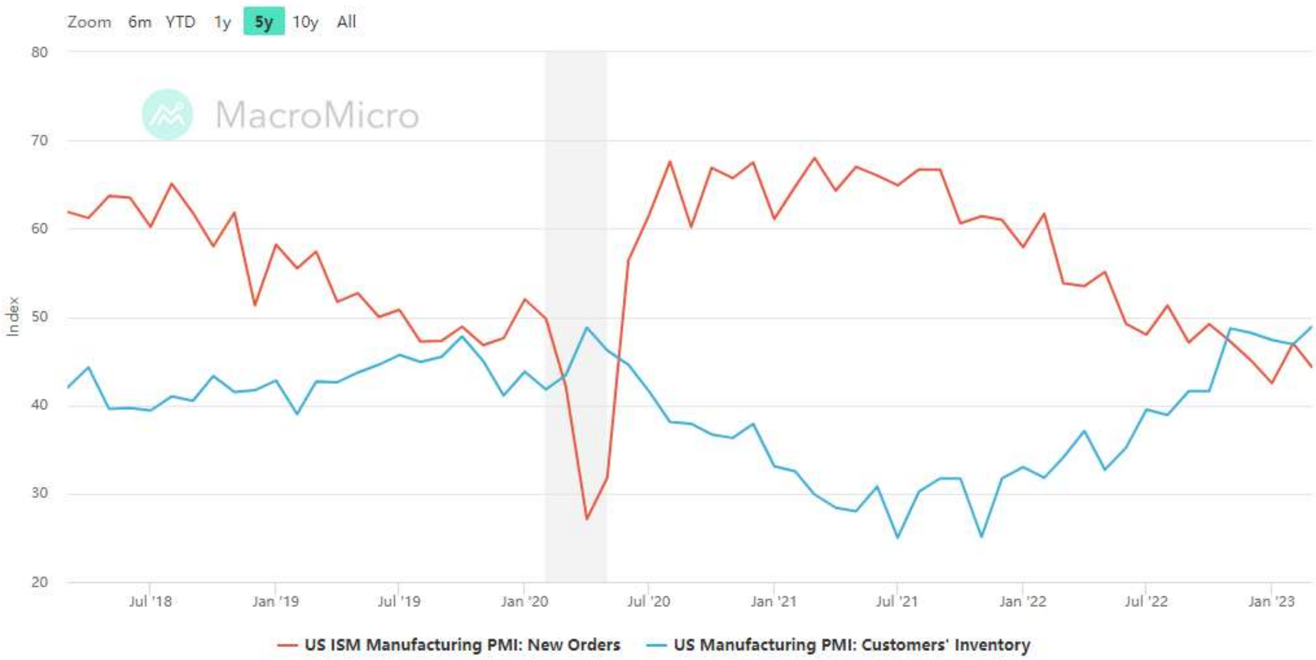
Yahoo reports that "Home prices soar."  It was a 0.16% increase in February after a few months of price declines.  Other than the absurdity of Yahoo using the word "soar," Housing price data is like inflation.  It can be sliced and diced a million ways.  The broad trend tells us House prices are still likely to fall further as sales increase.

Construction Spending remained in negative territory in February, but January data was revised higher. But the main takeaway is a continuing trend:  Single Family construction is falling quickly (-1.8% monthly) while multi-family construction increased 1.4%.

A good anecdotal bullet point:  The median house price in Aspen has fallen from $16mm a year ago to under $10mm today.

- Mixed business surveys, Manufacturing is still lagging

Markit's Composite PMI for March was much stronger than expected.  Both Services and Manufacturing had large jumps (+2.1 and +3.5 respectively).  Manufacturing is still slightly underwater, but services are back near the levels of last spring when the economy was still thought to be ok.  The Manufacturing ISM (PMI), on the other hand, retreated again after a quick blip higher in February.  Moreover, New Orders are going lower while Inventories are going higher.




The Kansas City Fed Manufacturing index surprisingly bounced back into positive territory.   The Dallas Fed Manufacturing survey sank deeper into negative territory.  This survey is heavily influenced by the oil and gas sector which saw activity plunge so far this year (more below).  The Chicago PMI (compiled by ISM) remained in deep negative territory.

- International data points to global recession

China manufacturing has started to decelerate.  The private Caixin PMI unexpectedly dropped from positive territory in Feb (51.6) to flat in March (50.0).  The market was expected a similar reding to Feb.  We have maintained that it will be hard for China manufacturing to rally with a global recession hitting (despite the accelerating consumption and mobility trends within China itself). We have no position in China currently.  We will wait for our next idea and probably do the opposite.

The Eurozone Manufacturing PMI barely improved in March.  It is still near the bottom of its 10-year range ex the Virus Fear plunge.  Eurozone inflation is cooling on the headline (8.5% in Feb to 6.9% in March).  But the "Core" rate is still climbing with about nine months in a row of increases (5.7% in March).

The UK is a bewildering economy right now.  It is experiencing 18% food inflation, but yet the Composite PMI (business survey) is still positive.  It is split with Manufacturing negative and Services fairly robust.  But food inflation is probably the scariest thing for a society.  Apparently the inflation is in fruits and vegetables thanks to a long list of problems (shortages from Spain and Morocco from bad weather, higher energy costs for produce grown in greenhouses, Brexit-related labor shortages, and trade barriers). This inflation is expected to fall in May. But with this long laundry list of problems, we have our doubts. We also doubt that the Services industry will remain optimistic in the face of this.

- Other data is negative
  - Durable Goods for February remained negative vs an expectation for a slight rebound. The important Core Capital Goods (aka business spending) did increase albeit at a slower pace (0.2% vs 0.8% in Jan). This data is not adjusted for inflation, so it is slowing in real terms.
  - Consumer Sentiment moved lower in March after three straight months of improvement. The level is still near the lowest in 25 years.
  - Factory Orders in February were still negative and lower than expected. And January was revised lower, too.

- The Fed thinks it can have its cake and eat it, too

Jim Bullard of the St. Louis Fed shed some light on how the Fed has been thinking about being pulled in different directions after the bank deposit crisis. Putting aside his hubris of thinking the Fed can accomplish anything, he clarified that the Fed can control inflation with monetary policy tools while at the same time controlling financial stress (bank deposit crisis) with "macroprudential policy." Vagueness aside, he is talking about lending through the discount window and taking collateral at par. He threw in the stinger "not all financial companies adjusted to the changing interest rate environment."

- Oil production is falling

The specifics from the Dallas Fed on the Energy sector (across Texas, Louisiana, and New Mexico) show the concern in the industry. The index level on business activity in the sector fell from over 30 in 4Q2022 to 2 now. Input prices remain high and output prices have plummeted. Bad combination. Specifically, the average breakeven price has moved higher from about $55 to $62. We are still long Energy for its new capital discipline, commitment to shareholder returns (extraordinary dividends), and the limited spare capacity globally (see next paragraph, to boot). But we also know the sector is staring into the abyss of the recession, so we are being cautious about adding more.

OPEC+ announced more oil production cuts. As always, nothing is straight forward with these guys. But assuming all the countries meet their voluntary commitment, the total would equal 1.6mm barrels per day. The real number is probably closer to 800k. Whatever the case, the market expected the cartel to keep production the same which would be off a base that was cut by 2mm bpd back in October. Saudi is doing the bulk of the cuts (500k). This is likely politically driven…the Saudis are more than a little dismayed that the US has not started to refill the Strategic (Tactical?) Petroleum Reserve yet. And the Saudis are also now monitoring the positioning by speculators. They know the market has turned bearish, so it timed its decision to exact maximum pain.

- Meme stock traders are pretty dumb

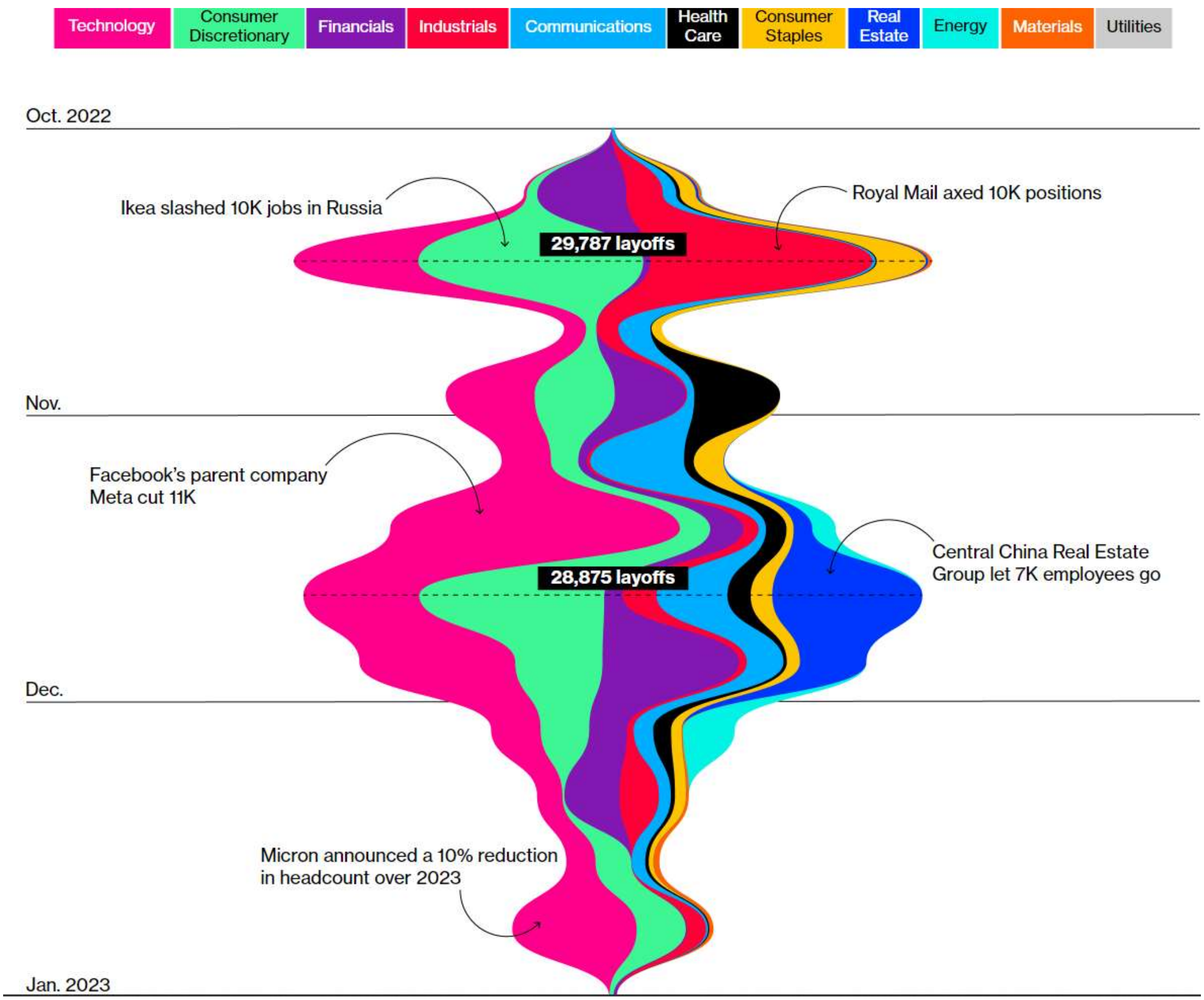
Normally this would be a quick hit, but we thought it deserved its one paragraph. AMC common shareholders sued the company to stop it from diluting common shareholders. The parties came to a resolution by which AMC would pay the common shareholders with more common shares…ie dilution.

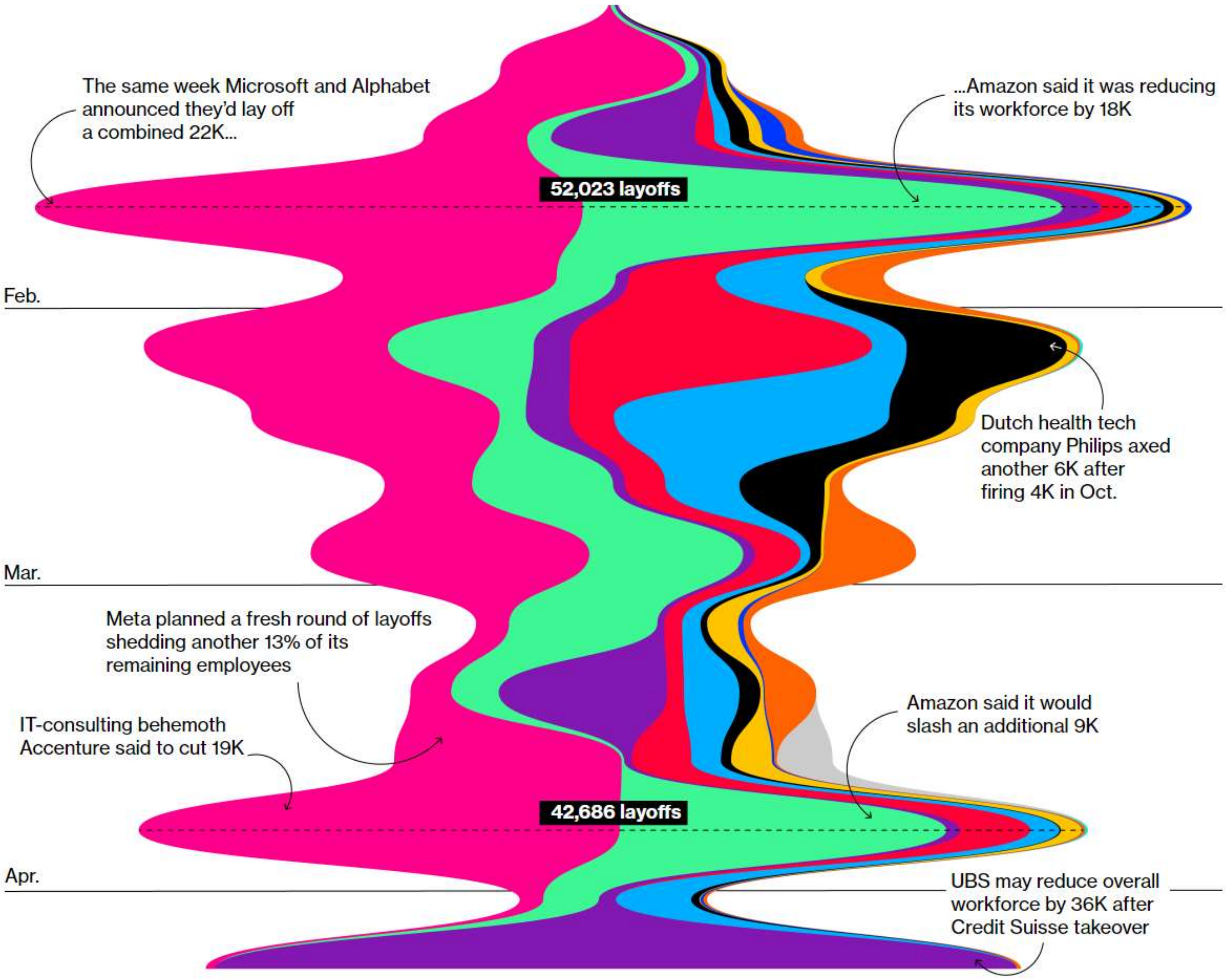
➢ Where did all the crypto money go?

Not much to report this week, but the WSJ did run a piece detailing how insiders of failed Signature Bank, one of the pioneers of crypto banking along with failed Silvergate, sold over $100mm of stock during the last couple of years.

➢ Chart Crime of the week

This masterpiece may not be trying to mislead or deceive, but it surely is one of the worst graphics we have ever seen.  The length/height alone…we had to cobble together two screen shots.






- Quick Hits
    - Zimbabwe has run out of currency coins, so businesses are using handwritten notes and slices of cheese.
    - Zimbabwe's annual CPI has "collapsed" in 2023 compared to 2020: from 850% to 230%.
    - The average home renovation now takes 79 days up from 22 days in 2019.
    - Stanford has 10,000 administrators for only 17,000 students (including 9,500 grad students).
    - The head of Saudi National Bank has been shown the door after his bad investment in Credit Suisse went to zero (basically) thanks to his comments about not willing to put more money in the bank.
    - The Ontario Mathematics Coordinators Association thinks the math truth "2+2=4" to be an act of "covert white supremacy."
    - March Madness Final Four ticket prices dropped 45% once Texas was eliminated. Some tickets for the championship game are going for $75.
    - Before Credit Suisse collapsed into UBS, it had plans to spin off its investment bank using the old name First Boston (we worked there for a short stint back in the day). CS was going to pay one of its directors $175mm to combine his company with the CS investment company. This director even got a $10mm advisory fee for coming up with the deal. This is better than the owner of the 'Skins getting paid $10mm to put the team's logo on his personal jet.

- The Swiss government is going to investigate the UBS takeover of CS which was put together by the Swiss government.
- McDonald's is forcing all its corporate employees to work from home this week so it can execute layoffs virtually.

**Trading**: We trimmed some of our long utility exposure. We basically substituted higher yielding cash for this defensive positioning. We added some gold and treasuries. We added very slowly to our short exposures. These were in Big Tech and regional banks. We are surely late to the party on the latter, but we think there is still some tail risk. When the Saudis juiced the Energy stocks, we reduced some exposure. Again, we like the long-term set up, but the recession headwinds might bring on more weakness.

**TSLAQ**: Musk is planning to pay some of his Twitter employees with stock options. The good news for them is the valuation being used is $20b. Musk paid $44b. This is bad news for any shareholder or lender in the recently consummated deal. Have no fear, Musk promises the company will be worth $250b in short order.

Tesla reported Q1 deliveries that fell short of expectations. So the company slashed prices and still could not sell enough cars. For what it is worth, one of the original Tesla fanbois, Gerbs, is a little worried, "there is legitimate competition and it is real."