CHALK CREEK PARTNERS

Weekly Update

16-December-2020

Carlisle C. Wysong, CFA

- The market grind continues
- Positioning is still crowded
- Housing Data continues to cool from the peak
- Manufacturing doing better than Services, regional base matters
- Holiday shopping is increasing
- The Fed points towards yield curve management but not for a long while
- The ECB is singing the same song

	Last	5d %	YTD %	1yr %
SPX	3669	0.8%	16.2%	19.1%
QQQ	309.0	2.5%	46.0%	50.2%
US 10 YR	0.92%	0.94%	1.88%	1.88%
VIX	22.5%	22.3%	13.8%	12.3%
Oil	45.6	5.0%	-21.6%	-20.6%
*10yr and VIX are levels not changes				
** Oil is front month futures, beware				

The market got back to its grinding ways. While there is still some residual strain on the FATMAAN stocks stemming from the increased regulatory rhetoric, the other pillars of the market rally are intact. The stimulus talks are back on again. There have not been any snags in the early days of the vaccine rollout. Economic data might be calming a bit, but we are still seeing above-trend growth with an increase in growth expected in the coming months. And oh yeah, the Fed is not going to change course any time soon. Even though there is some rotation among sectors and valuations are beyond extreme, the short-term momentum remains intact. Of course, sticking to our playbook, we took the opportunity to trim some longs and rotate some sectors. But to be clear, we are still long. The Fed is easing monetary policy into a growing economy. That pretty much sums it up.

We have written repeatedly of the crowded nature of this market. This is the primary reason for our slight trimming. For those that rode out the summer fighting the rally, they jumped in headfirst when the vaccine news broke (along with the election resulting in a split government…presumably). This is highlighted by the

increase in Call Option volume as noted by Bloomberg (blue line below). This is not a perfect metric since it needs to be presented with the Put Volumes, so we took a quick glance at option open interest (more relevant than volume) in the March QQQ options. There are almost 2.3x as many Call option contracts outstanding (open interest) as Put option contracts. (As for the while line in the chart, this is just the relative amount of new highs vs new lows. It is pretty sill to include this when the market is at an all-time high.)

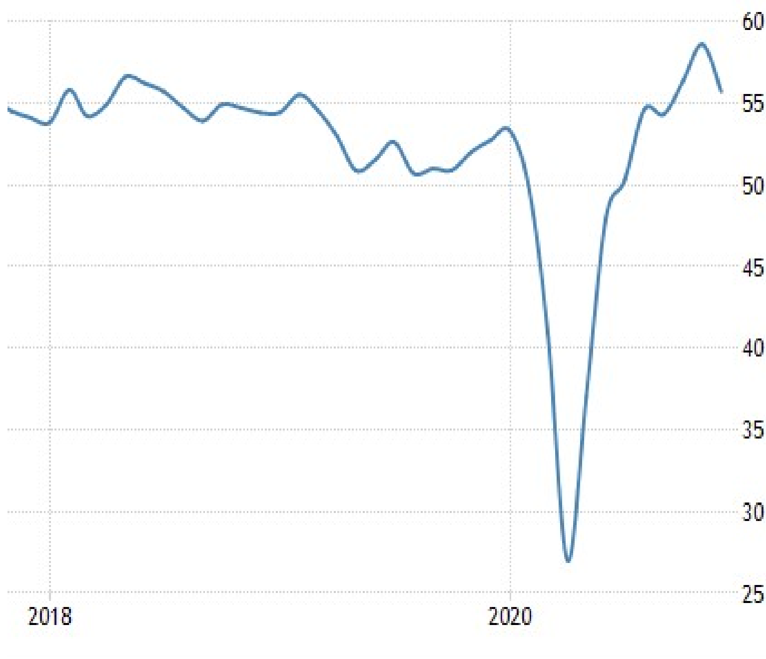
- Still on the Crowded theme…

The Merrill Fund Manager Survey reinforces what we know: investors are the most bullish they have been in years. The cringe-worthy "cash level" is at a seven-year low*. Equity and commodity allocations are the highest since 2011. And 89% of the participants expect stronger economic growth in 2021. The most crowded trades are 1) long Big Tech (yawn) 2) short USD (which helps a huge chunk of large cap stocks that are multinational) and 3) long Bitcoin! Merrill maintains its "sell the vaccine" call which we largely believe from a tactical perspective (but not strategic as the Fed will "buy" every dip).

- Housing Data continues to cool from the peak

We have recently cited the slowing Housing Price growth highlighted in the Toll Brothers earnings. We now have more survey data which points to a slowing (albeit moderate at most): The Housing market Index, a sentiment survey by the National Association of Home Builders, showed the first dip after seven straight months of increases. Granted, the index is still just off its all-time high. Elsewhere, the National Association of Realtors expects the median home price to "only" grow 8% in 2021 and 5.5% in 2022. Prices have increased over 15% in 2020. On the commercial real estate front, vacancy rates are expected to drop but remain elevated (i.e., office vacancies are expected to drop from 14% to 11% and hotel rates from 37% to 35%).

- Manufacturing doing better than Services, regional base matters



Markit's early look at the December PMI (the Flash survey) showed a relatively sizeable drop. The overall level is still in growth territory (55.7 compared to long-run average of about 55 with 50 being the flat-growth level – pardon us for the unlabeled chart). Services were responsible for the entire drop (and the miss vs expectations of a new high) while Manufacturing remained steady.

The only Fed survey /data of the week was the NY Fed's Empire Manufacturing survey. It came in slightly weaker than expected in December. This is the third month in a row of lower growth after the surge in the summer.

We think it is natural for these notable shifts to be occurring in light of the new lockdown restrictions in certain areas. These lockdowns are almost exclusively targeting Services (restaurants, gyms, bars, etc). Manufacturing is going about its business.

- Holiday shopping is increasing

Following on the theme of goods over services, Chinese exports surged 21% in November compared to last year's November. Exports to the US were even stronger at +47%. Readers know that we doubt the veracity of Chinese economic data. But export data is hard to exaggerate since there is obviously a foreign counterparty! And the data over time does match well. The takeaway: We might have a strong holiday shopping season after all despite the weak Black Friday weekend shopping. Here is a chart from Merrill. Along with it, they point out that credit card data shows strong spending on holiday items…but overall softer spending on non-holiday items. The November Retail Sales figure echoed this sentiment as it fell more than expected.

- Other Economic data
- Jobless Claims moved higher from 716k to 853k. Other than this relatively sizeable jump, the most noteworthy characteristic is our putting it in the "Other" category.
- Inflation as measure by the CPI remains as tepid as ever. The headline annual rate for November was 1.2%. The "core" (ex-food and energy for those that do not use these items) was 1.6%. Remember, the Fed wants to overshoot its 2% inflation target.

- The Fed points towards yield curve management but not for a long while

The Federal Reserve Open Market Committee (FOMC) left rates and its bond purchases unchanged as expected. All but one member think rates will not go up until at least 2023. For 2021, expectations for growth were revised higher and unemployment revised lower. As always, the members qualified their optimism by saying growth and labor market improvement had "moderated" recently. The Fed tried to clarify its timetable for its asset purchases (bond buying or lending as they call it). Actually, instead of using an explicit timetable, the Fed will use an outcome-based process. Novel thinking. Some believed this would result in a tapering effect which would steepen the yield curve: Short-term rates would remain at zero while longer-term rates would start to rise. We agree this will ultimately happen; it is not likely for another18-24 months at the earliest. In theory, this keeps the "long duration" assets like Big Tech in the sweet spot. Funnily, the Fed said that weak demand was holding down inflation. We guess they have not realized that the most direct recipient of Fed-induced inflation is the stock market.

- The ECB is singing the same song

The European Central Bank expanded its stimulus programs as expected. Its pandemic quantitative easing program, PEPP, was expanded by E$500b to E$1.85t. The asset purchases will also be extended by nine months until Mach of 2022. As a throw-in, the ECB will continue to buy E$20b of assets a month under its normal quantitative easing program, APP. There is no end date for this program. The ECB will also loosen the commercial paper market and continue to ease collateral requirements. Same stuff, different continent.

- Quick Hits
    - 14% of all credit card transactions in Germany fail.
    - Bob Dylan's music catalog is now reportedly selling for $350mm not $200mm.
    - Sellers of music catalogs only have to pay capital gains taxes unlike other artists whose royalty streams (collected or sold) are taxed as regular income.
    - NFL players and coaches cannot play golf with each other.
    - A vocal critic of the SPAC structure "accidentally" made $250mm on the QS SPAC.
    - The cost of moving the 2020 Tokyo Olympics to 2021 will likely be about $12b.
    - Blackrock's stock is the 8th largest holding in Blackrock's ESG fund.
    - BP (don't you dare call it British Petroleum) is now the majority owner of the largest "carbon offset" company in the US. Translation: BP will pay people to not cut down trees so it can produce more oil.
    - From our Delaware friends: Delaware public schools will have a "snow day" tomorrow. Delaware public schools are all virtual.
    - The USPS's new slogan is "Heroes Work Here" if they do say so themselves.
    - Regulators in Massachusetts are going after Robinhood for its use of screen fireworks when a trade is completed (among other allegedly misleading marketing tactics).
    - Wisconsin people eat raw, ground beef sandwiches.
    - Chinese airline crews have been told to wear diapers and not use the bathrooms (just on the flights…not all the time).
    - A reformed criminal hired by the Washington DC attorney general to help curb violence has been…arrested for murder.

*We have made clear that there is no such thing as a changing cash level in the market ex-corporate activity (new issuance, buybacks, etc.). But we still refer to this generally vapid metric since others *do believe* in it.

Trading: We delved into our first SAPCs. We actually own four of them now. Two are in the Fintech space; specifically, they focus on global payment processing (one has made its acquisition and one just recently listed in search of its acquisition). One is in Additive Manufacturing and the merger has completed. The last...is obviously in the EV space! Other than the last one, these should be solid businesses that are in industries geared towards the future. Alas, these are likely just short-term trades. We freed up some space to buy these by trimming some of our index exposure. On this note, we shifted some of our index exposure to individual stocks (the rotation to which we referred earlier). We still have a balance, and we will continue to sell the things running hot and buy worthy dips.

TSLAQ: There is one honest analyst left in the world. JP Morgan's Ryan Brinkman reiterated his bearish stance with a target price on Tesla pointing to 80% downside! He states the obvious and uses novel concepts like actual earnings and valuation. Assuming the company can sustain its sales of ZEV credits (unlikely since all automakers are starting to make their own EVs), the stock still trades on a trailing 1,235x P/E. But we know math and logic are dated if not silly tools to use. Tesla enters the S&P 500 this Friday night for Monday trading. Our base case is that this is a classic "buy the rumor and sell the news" event. We might dabble with some Puts on Friday. But we also expect the event to be a "Vol crush" so buying options is not ideal. We will tread lightly regardless.

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