Weekly Update

14-February-2024
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- Quality companies power through the "bad" inflation report
- Commercial real estate losses are mounting in lots of weird places
- Positioning might not be that stretched
- Earnings warnings are ticking higher (that's a good thing)
- Inflation heats up (sorta)
- Other economic data slips a bit
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	5,000	0.1%	4.8%	22.7%
QQQ	$433.20	0.3%	5.8%	43.3%
US 10 YR	4.25%	4.11%	3.88%	3.80%
USD/DXY	104.7	104.1	101.3	103.9
VIX	14.4%	12.8%	12.5%	18.2%
Oil	$76.51	3.3%	7.0%	-3.1%

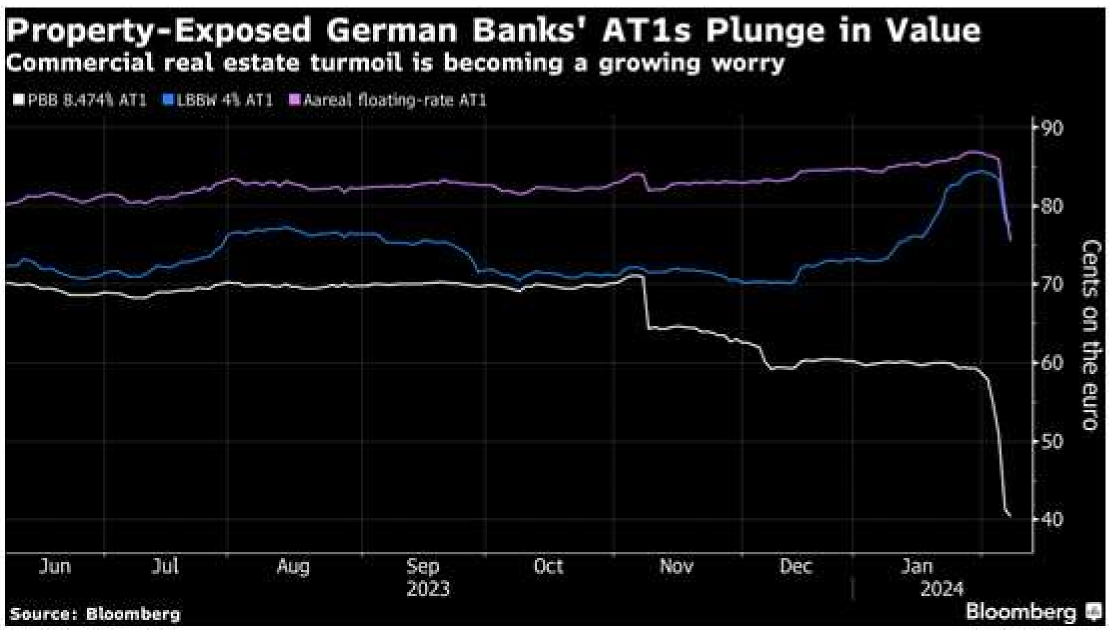
*10yr, DXY, and VIX are levels not changes
** Oil is front month futures, beware

If you blinked, you missed it. "It" would be the temporary fear from a mildly hotter inflation number for January. Of course, the markets had already started to discount the timing and number of Fed rate cuts this year (after finally listening to Fed chairman Powell say it in plain English). But the bond market was still clinging to hope as rates were still well below the Fed's own "dot plot." (The Fed says it is not a forecast, but it is an aggregation of opinions…sounds like a forecast to us.) But this hope evaporated quickly…interest rates shot higher. And while equities reacted negatively at first, the realization took hold that quality companies with earnings growth can weather short-term volatility in interest rates. Not to mention, most strong companies want growth *and some* inflation.

Of course, some of this momentum is becoming silly. But we are more comfortable riding this type of momentum (strong, quality companies) than other manias (think GameStop, AMC, cheese.com, profitless tech, fantasy crypto tokens, etc). That said, while we add to our long exposure, we might start to look at cheap protection just in case something rattles the cage. And there is a laundry list of potential land mines (which we keep repeating): Commercial real estate weakness, a slowdown in lower income consumption, higher credit card balances with increasing delinquencies, maybe an end to rampant government spending (we are not betting on this!), political turmoil – foreign and domestic, etc.

- Commercial real estate losses are mounting in lots of weird places

With commercial real estate being one of our main worries about the economy and the market, we are trying to keep an eye on any problems that appear to be bubbling under the surface. Here is a chart of the prices on debt (AT1 is the weird security that was wiped out in the Credit Suisse takeover last year) from three German banks that have exposure to the US commercial real estate market. We do not even know what these banks are. And that is exactly the problem. That is how the housing bubble came to be 15-20 years ago. Everyone from strippers to Icelandic banks piled into the Housing market. If the same has happened with commercial real estate, losses could be more painful than a few small (as yet unknown) regional banks failing (which is the base case now).



- Positioning might not be that stretched

We have not talked much about Positioning lately. Seemingly everyone is bullish and riding the momentum wave. So, we did not think much when Merrill delivered the headline, "FMS sentiment most bullish since Jan'22." And they say the percentage of respondents calling for a recession is down to 10% (lowest since early 2022). But the ranking of the bullishness is still rather tepid at the 41% percentile. And only 20% of respondents think we are headed for the "no-landing" scenario (no economic softness whatsoever). Obviously, sentiment has improved massively. But we have a hard time squaring Merrill's numbers with an overly bullish market. This gives us some comfort that the momentum can continue (but, of course, the market could get rattles easily like on CPI day).

Chart 2: BofA FMS sentiment most bullish since Jan'22
Percentile rank of FMS growth expectations,

Source: BofA Global Fund Manager Survey

BofA GLOBAL RESEARCH

➢ Earnings Warnings are ticking higher (that's a good thing)

Earnings warnings from companies are higher (outright) vs 4Q2023 (q/q) and 1Q2023 (y/y). The percentage is lower than a year ago, but that is a factor of more Positive pre-announcements (also more Negative). This is a good backdrop. We want lots of Negatives/warnings to reset the bar a little bit lower.

Exhibit 9. Earnings Pre-Announcements

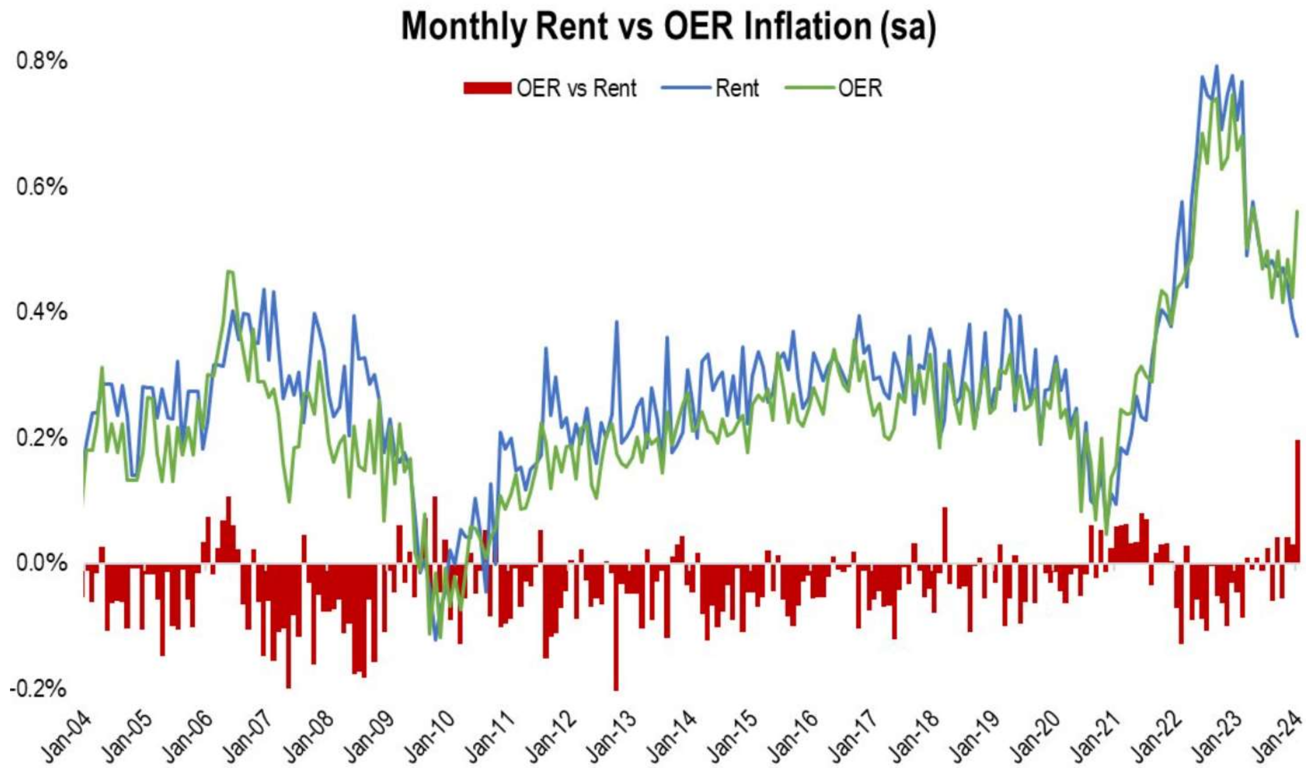
Type	1Q2024 Total #	1Q2024 Total %	1Q2023 Total #	1Q2023 Total %	4Q2023 Total #	4Q2023 Total %
Positive	15	21.1%	9	15.0%	24	30.4%
In-Line	4	5.6%	3	5.0%	6	7.6%
Negative	52	73.2%	48	80.0%	49	62.0%
Total	71		60		79	
N/P Ratio	3.5		5.3		2.0	

Source: LSEG I/B/E/S

➢ Inflation heats up (sorta)

Inflation in January (as measured by the change in the Consumer Price Index) surprised to the upside. The monthly rate increased to 0.3% vs 0.2% in December. The Core rate moved to 0.4% from 0.3%. The annual rates do not look so bad (3.1% down from 3.4% and 3.9% vs 3.9%). But this is a function of last January's strong inflation dropping out of the calculation. The market was expecting the headline rate to drop to 2.9% (and 3.7% on the Core). This uptick was particularly surprising given the BLS (Bureau of Labor Statistics) had just revised the December rate lower from 0.3% to 0.2%. (Of course, November was revised higher from 0.1% to 0.2%, but the market certainly has a recency bias).

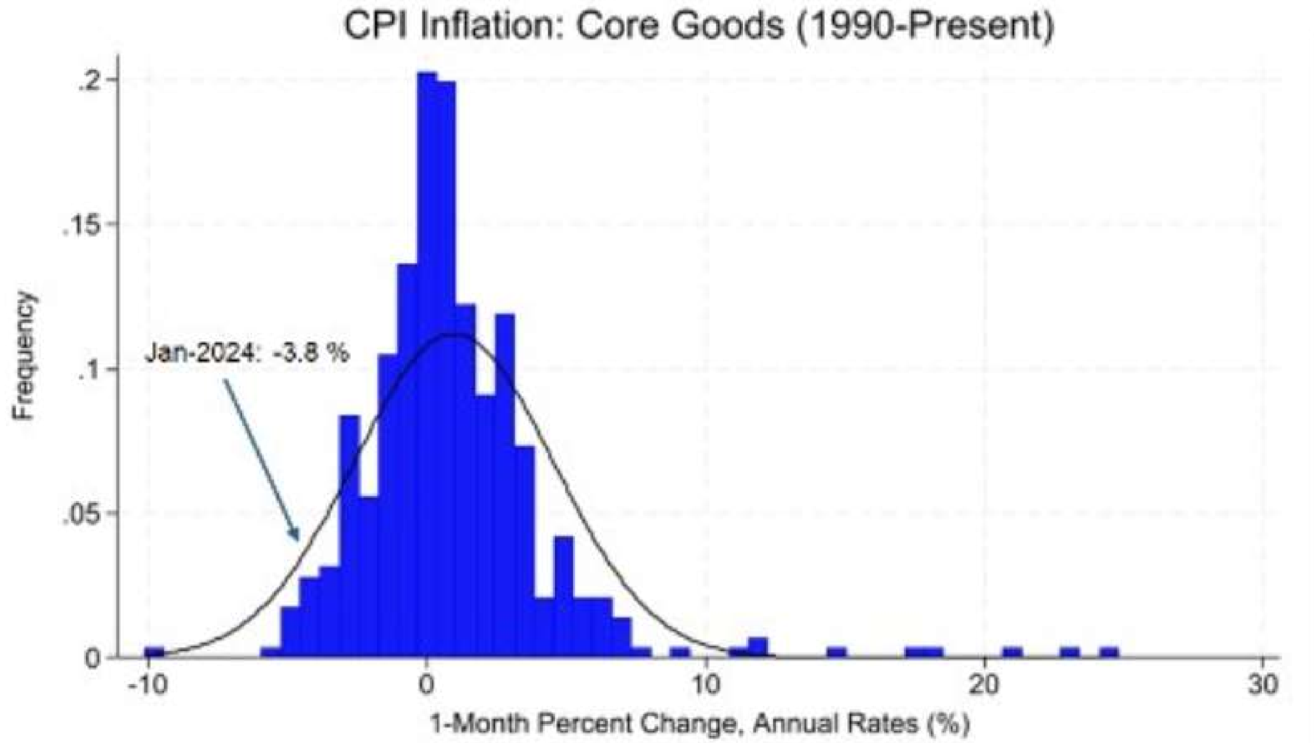
Shelter prices were the biggest driver behind the increase. Rent increases remained steady at 0.4%. But the nebulous Owner's Equivalent Rent (OER, the survey asking homeowners how they view the rental value of their houses) accelerated to 0.6% from 0.4%. Medical Services and Transportation prices also jumped. Here is the weird divergence in rents vs OER (from a good X follow Parker Ross):

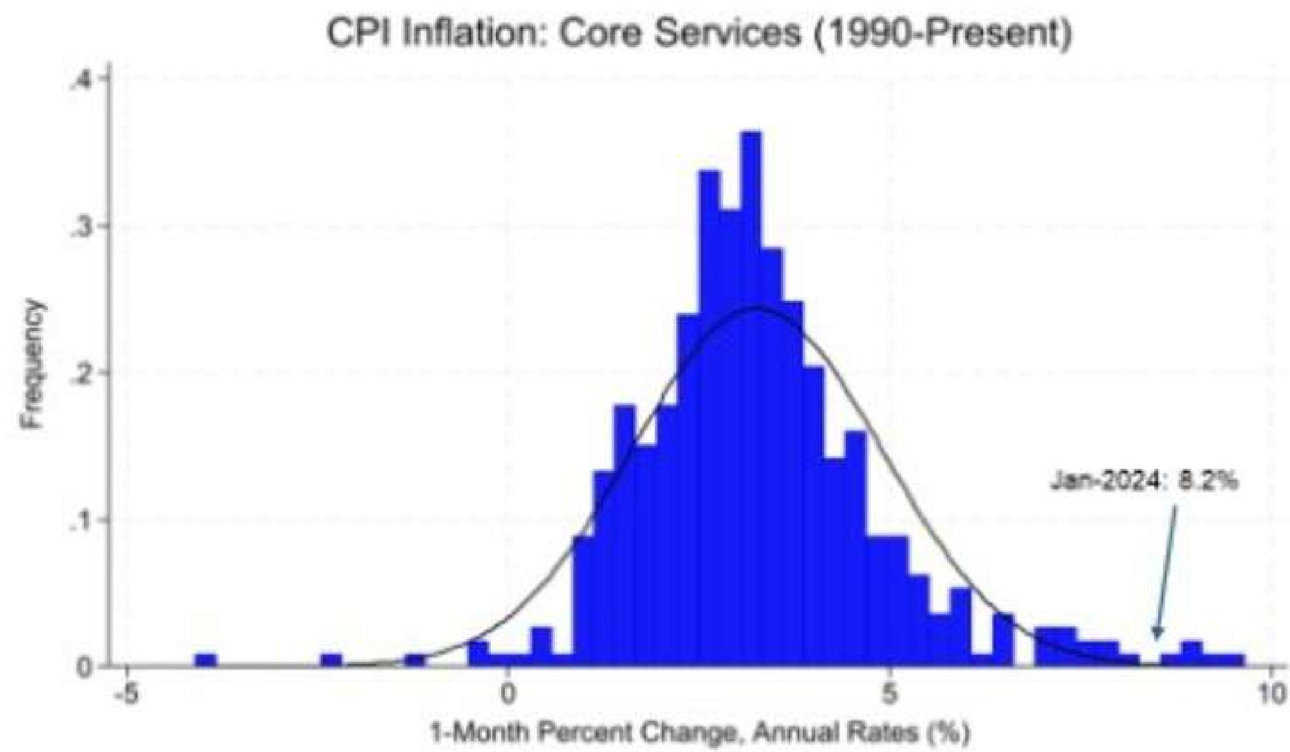


Food Away from Home is still outpacing Food at Home, but the latter is catching up. Electricity and Utility (gas) prices are also back to accelerating after showing a brief cooling the last two months.

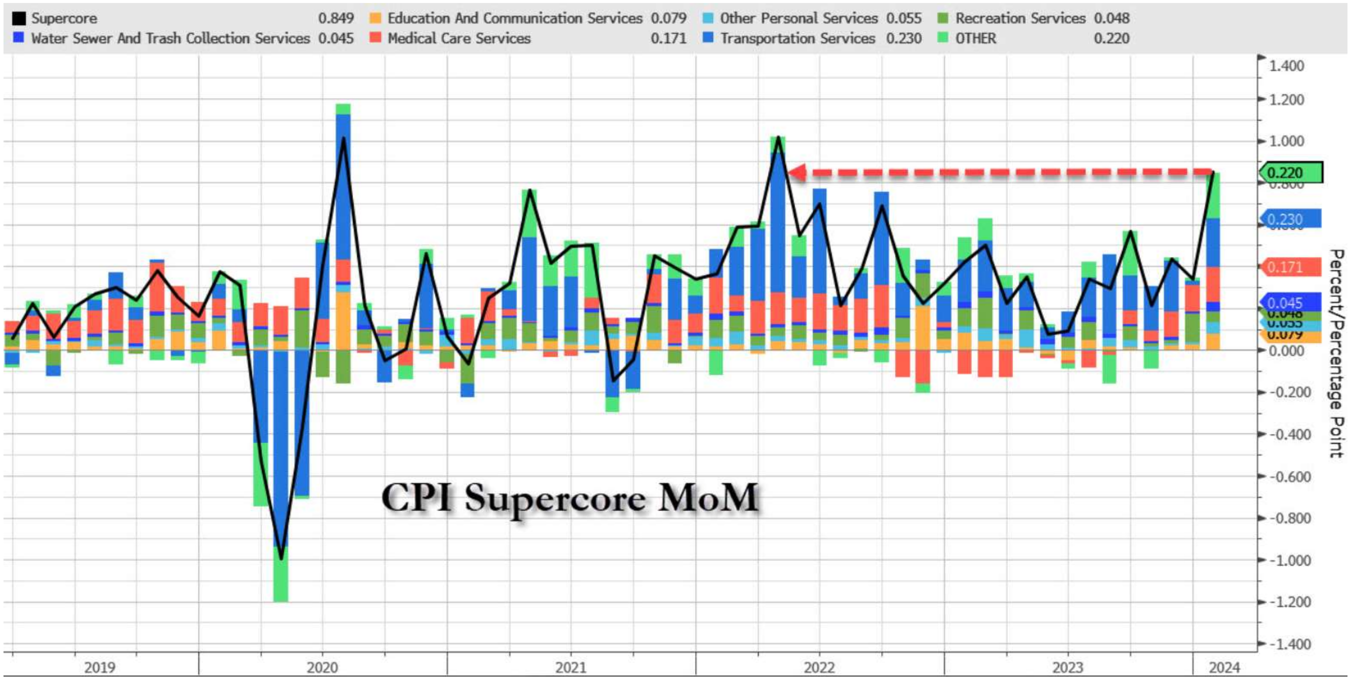
The change in Producer Prices (PPI, wholesale or input prices) showed deflation for the third month in a row. The Core also slipped into deflation after two flat months. This data surely tempered some of the negative psychology surrounding the CPI.

Here is a set of charts comparing the decrease in Core Goods prices and the increase in Core Services (using a bell curve to explain the abnormality of the diverging moves (away from the middle or cluster). Jason Furman (Obama politician, Harvard professor, seems like a nice with a tempered view) thinks there is some seasonal adjustments in the data that make these moves more extreme. Our takeaway is that Services that can imbed price increases are good investment opportunities. And we would avoid investing in companies that are losing pricing power.


CPI Inflation: Core Goods (1990-Present)
Frequency
Jan-2024: -3.8 %
1-Month Percent Change, Annual Rates (%)
.2
.15
.1
.05
0
-10
0
10
20
30


CPI Inflation: Core Services (1990-Present)
Frequency
Jan-2024: 8.2%
1-Month Percent Change, Annual Rates (%)
.4
.3
.2
.1
0
-5
0
5
10

Here is the view of the Supercore inflation moving higher. As much as this subset (and name) seems silly, the Fed has acknowledged it likes to use it.



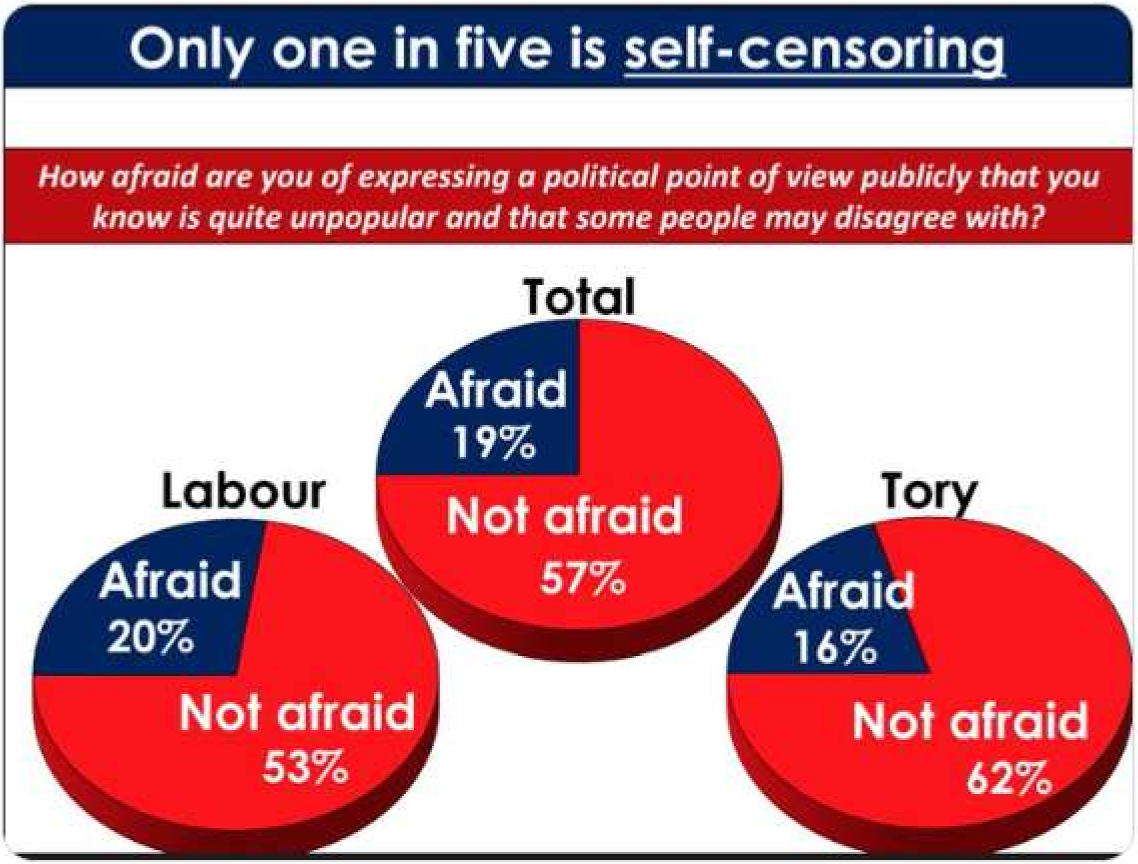
➢ Other economic data slips a bit
- Weekly Redbook Retail Sales fell sharply to only +2.5% (vs the 5-6% range we have seen for six weeks).
- NFIB Small Business Optimism index slumped back near its five-year low.
- Weekly Mortgage Applications slipped 2.3%. The index is still wallowing near 25 year lows.
- Jobless Claims were 218k, right in the middle of the recent range.

➢ Where did all the crypto money go?

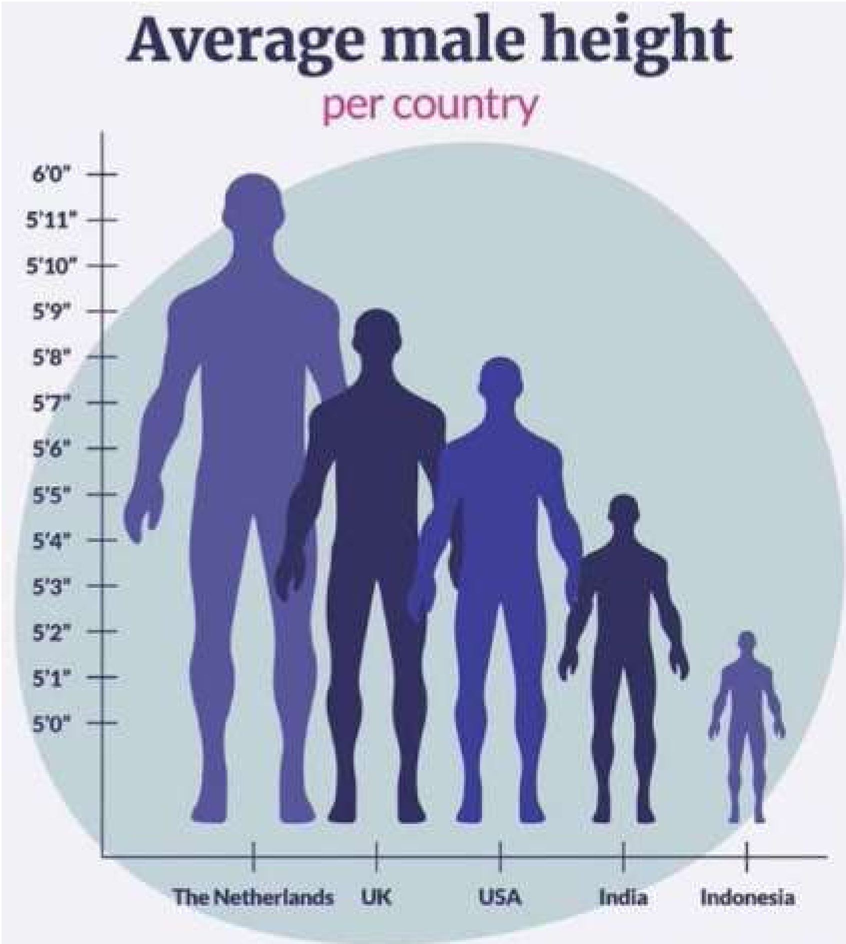
The American Bitcoin Academy. We really do not need to explain this one, but here we go. A fraudster named Brian Sewel was going to set up a crypto hedge fund. It would use "artificial intelligence" to generate crypto trading strategies. The marketing pitch for the fund was done through the American Bitcoin Academy. This online "school" was created by Sewel, and it encouraged its students to invest in the Rockwell Fund…the supposed fund that was going to make all the money. 15 suckers invested about $1.2mm (total) in the fund. Obviously, Sewel never started the fund, disappeared, and stole the money. When he was eventually tracked down in Puerto Rico (maybe not Miami, but close enough!), the stolen Bitcoin had been stolen from him by hackers.

➢ Chart Crime of the week

We find the Brits to be particularly bad at pie chart math:



Last week we alluded to the little people of Indonesia. To clear up any confusion (and to rehash one of our favorites):

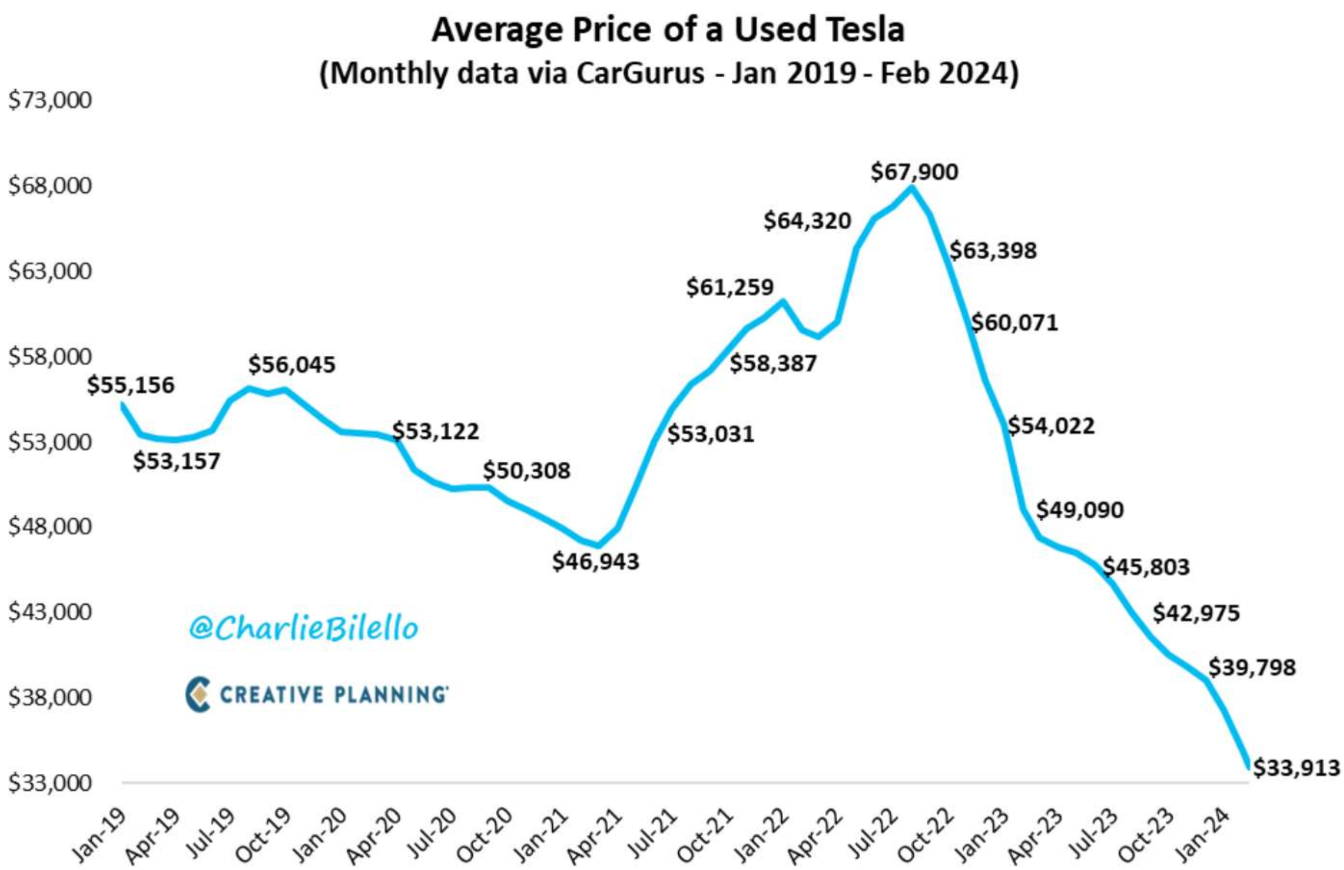


- Quick Hits
    - The first Super Bowl commercials in 1967 cost $37k for 30 seconds. This past game's price tag was $7mm.
    - The NFL spent $1mm to grow special grass for the Super Bowl.
    - U2 played at the new Sphere in Vegas two days before the Super Bowl. Tickets could be had for $70.
    - No Alabama football player has ever scored in the Super Bowl.
    - Walmart sells 37% of all televisions in the US.
    - New York state taxes online sports betting companies 51% of gross gaming revenues.

Trading: We were pretty active during the week (after being pretty quiet recently). We increased our net long. We rotated out of some lower beta stuff into some higher beta stuff (more sensitivity to the market). We added some new names (Tech and Pharma). We added to our long India exposure. We increased our long in Emerging Markets (other than India) slightly. Basically, we took the opportunity after the "bad" CPI report to add to our long exposure. We almost added to our Energy longs, but then we remembered that this space is challenged, and we have enough already!

TSLAQ: Just tonight, Musk submitted his annual 13G/A filing that details his holding in Tesla. Like all quarterly filings, it is 45 days after the quarter ends (updates to holders of 5% and 10% are updated timelier). Of course, the Tesla lemmings cannot read a filing correctly. They all jumped up and down on X (and they bought shares in the aftermarket) declaring that Musk had purchased over 7% of the shares outstanding to bring his holding to over 20% (from 12.91%). Of course, nothing has changed in Musk's holdings other than the Delaware Chancery court stripping him of $55b in options.

Otherwise, Tesla is cutting prices in the US. They are being called "temporary" price cuts. This used car price trend does not seem so temporary.



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