CHALK CREEK PARTNERS

Weekly Update

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Carlisle C. Wysong, CFA

Managing Partner

- Pushback in the Fed
- Economic data surprises to the upside
- Still pressure on Treasuries, equities still ignore it
- Are we seeing the Yen carry trade unwind in slow motion?
- More Volatility dynamics
- Employment stuns (to the upside)
- Retraining is the AI word
- K-shape is still around (always?)
- Quick Hits
- Where did all the green energy/pre-IPO/crypto/academic money go?
- Chart Crime of the week
- AI has no reason to scream like this guy

	Last	5d %	YTD %	1yr %
S&P 500	7,636	0.1%	11.6%	17.3%
QQQ	$716.31	1.2%	16.6%	23.4%
US 10 YR	4.85%	4.76%	4.17%	4.05%
USD/DXY	98.8	99.2	98.3	97.8
VIX	16.5%	15.3%	15.0%	15.4%
Oil	$96.84	6.4%	67.3%	53.4%

*10yr, DXY, and VIX are levels not changes

** Oil is front month futures, beware

A few of the narratives were turned upside down this week. Much of the focus has been on Fed Chairman Warsh and his hawkish tone dismissing the improvement in inflation (and thus more likely to want to rate hikes). But Fed Governor Waller made it clear that he was not in Warsh's camp. He thinks there has been progress made on inflation (NY Fed president Williams said something similar). Moreover, he does not think that higher energy prices are translating into higher prices elsewhere (food and diesel prices notwithstanding!). As for the economic data, we had started to worry about the cooling labor data. Right on cue, the August Employment report shocked to the upside…and with positive revisions to July! Despite zigzagging around a bit, Fed Funds futures ended the week where they started…about a 60% chance of a rate hike in September. The chances of two rate hikes by the end of the year stand at about 50%. Jim Bianco (a professional guesser we often cite) has the 12 voting members sitting at 6-5-1 in favor of doing nothing. We maintain that Warsh does not want to hike until he gets his house in order with respect to monitoring the right metrics (and after the midterms). As a qualifying aside, do not forget that former Fed Chairman Jerome Powell is still a Fed Governor. He is likely to exert as much pressure as he can to hike rates.

One narrative that has not changed is the pressure on Treasuries (higher long-term rates). The USD weakened a bit, as well. This is largely the government credibility trade (or USD debasement) back in action. It did not help when Treasury Secretary Bessent was talking a big game about his intervention into the Japanese Yen (selling USDJPY): "I am the house now." While not explicitly related to Treasuries, the market took it as an opportunity to test him on his support for long-term interest rates. And when it was announced that Treasury would only be buying back $6b in notes (up from the previous $2b but far short of the $10b expected), 10-year Treasuries pushed to their highest levels in almost three years. It is also interesting to see Japan sell Treasuries to fund its side of the Yen intervention. This could be quite the unintended consequence of the US helping Japan. Of course, equities are still ignoring this move! This is still a function of the great earnings across the economy. Artificial Intelligence is still leading the charge. A whole host of companies presented at a Goldman conference, and they all are still beating the drum. And we seemingly get a new and better AI model every week. (And we ignore the former OpenAI and Anthropic employees who are screaming like Wet Bandit Harry with his hair on fire.)

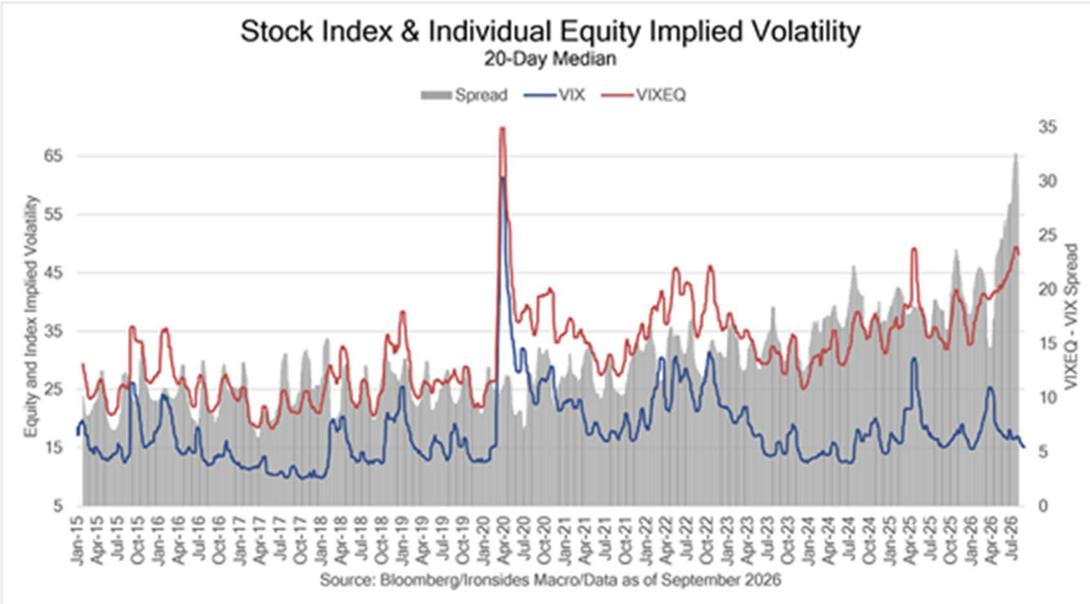
And the geopolitical narrative flip-flopped, too. Right when it looked like the Iran situation was cooling down with both sides reaching maximum pain (high gas prices and pre-midterm political pressure in the US; a collapsing economy in Iran), the missiles start flying again. We still think the equity market is mostly disconnected from whatever is happening in Iran. But $100 oil can change this blitheness very quickly. And we do not talk about (the) Ukraine much. But it seems that Putin is ratcheting up the aggression (probably feeling emboldened by the US's attention being elsewhere).

- Are we seeing the Yen carry trade unwind in slow motion?

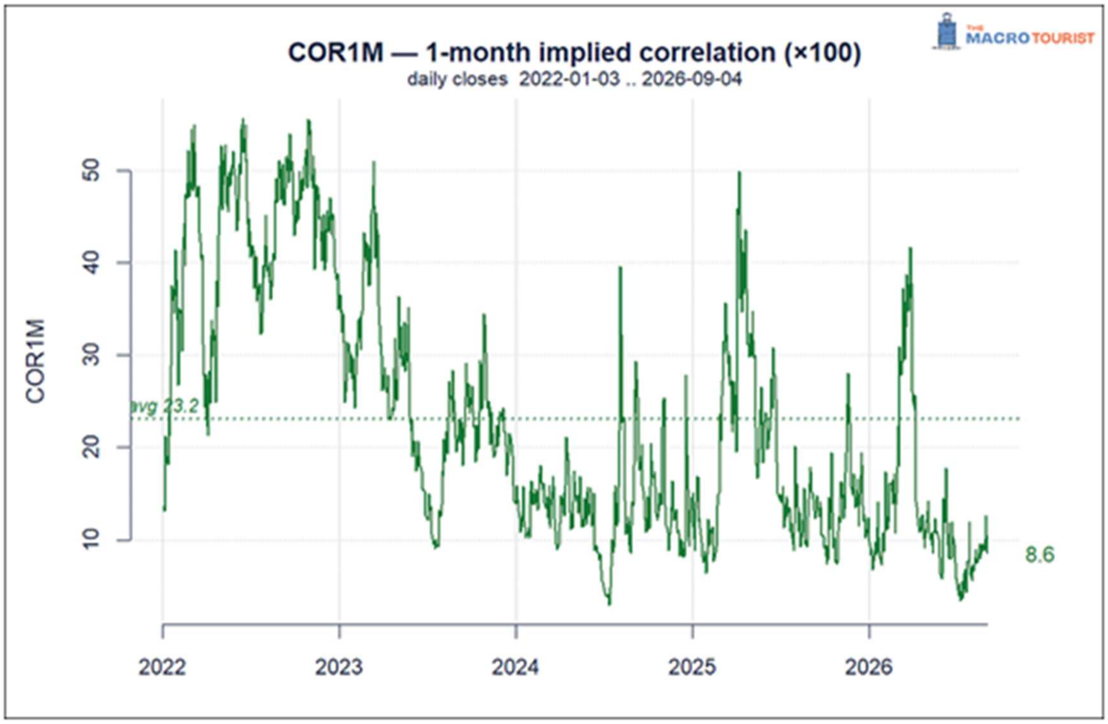
Pundits like to talk about the Yen carry trade (borrowing cheaply in Yen terms and buying higher yielding assets…including stocks). And we admit, so do we. With the Yen rallying aggressively, it would only be natural for this trade to feel the squeeze. But we are not sure the market is offsides presently. The internal battle between fiscal spending (Takaichi's 2027 budget is targeting Virus Fear spending levels) and monetary policy tightening (the market is pricing 100bps of tightening over the next year) is heating up. We suspect some market participants are pulling the plug on the trade because of the US's intervention. But if fiscal spending wins the day, the trade could be alive and well. We do not have a position as we recently sold our long equities / short Yen positioning. But if Bessent pulls back on the support, we might reenter the trade.

- More Volatility dynamics

Recently, we have been discussing the divergence between headline Volatility (VIX) vs that of individual stocks (VIXEQ). This chart is from Ironsides. You can see that the spread is at its widest point in over 10 years…and it is accelerating.



This divergence can be explained by the drop in the 1-month implied correlation of the stocks in the S&P 500. The Macro Tourist talks about this dynamic frequently (he is a long-time financial writer that does good work). Recently he wrote about what he calls the Shadow Vix. Basically, if correlation was anywhere near its average, then the Vix would be much higher. This overstates things a bit since correlation is typically very volatile! But the point stands. What will change things (correlation/Vix going up)? Obviously, the driving forces behind the set up are AI and Iran. While we could envision Iran fading from the headlines, we doubt the volatility in AI is going anywhere anytime soon! Of course, the worst-case scenario would be for correlation to remain low and Volatility to shoot higher (we would have violent factor rotations *and* large index moves). This is plausible but not likely in our view.



- Employment stuns (to the upside)

The August Employment report was much better than expected. Nonfarm Payrolls (NFP) jumped +162k. The official expectation was around 60k, but after the poor ADP guess, the whisper was closer to +40k. And the July number was revised higher from -23k to +21k (so was June, from +20k to +31k). Private Payrolls jumped +127k, and July was revised higher from +30k to +71k. Government jobs increased by +35k. And this was all local jobs (+42k). Private sector job creation was centered around Leisure & Hospitality (a much better read on consumer sentiment and spending than any biased survey) with +62k new jobs. Construction and Manufacturing added +38k.

Importantly, the Unemployment Rate remained steady at 4.1% while the Labor participation Rate increased from 61.4% to 61.6%. This combination means Total Employment increased by +569k with about 500k people reentering the Labor Force. This is the right kind of balance.

And Average Hourly Earnings increased +0.3% which is an acceleration from +0.2% in August (which was revised up from +0.1%). Average Weekly Hours also ticked higher to 34.4 from 34.3.

Rosenberg (usually right, always early) notes that August payroll data is often revised lower. He is probably right. But this was a great report right when employment started to deteriorate on the margin.

- Retraining is the AI word

The NY Fed asked Services firms that use AI about their employment plans: Hiring or Firing? Only 4% of the firms are firing. The largest subset is focusing on Retraining. We think this makes sense (with perhaps less Hiring in the future).

- K-shape is still around (always?)

This chart shows the relationship between the Fed's Beige Book and Real GDP growth. The regional Fed banks's business contacts are becoming more optimistic. Actual growth is lagging, but it tends to track pretty closely over time (the chart is not great, but BCA does throw in the disclaimer). While Services and Manufacturing both grew across most districts, consumption patterns across different income levels are still lumpy. Lower income consumers are more price sensitive than those with higher incomes. But we are not so sure this is not always the case.

- Other economic data

The NY Fed's survey of Consumer Expectations for August shows that Inflation Expectations remain largely unchanged. The 1-year is still at +3.6%. The 3-year dropped a touch to +3.2% from +3.3%. And the 5-year is unchanged at +3.0%. Of course, market-based inflation indicators (swaps) are all pegged right around 2.5% (1-year, 2-year, 5-year, and 10-year). "Core" CPI currently sits at 2.48%.

Used Car Prices fell -0.9% in August vs July. They are only up +0.4% over the last year.

Small Business Optimism (NFIB) ticked lower.

Weekly Redbook Retail Sales slipped to +8.3% from +9.6%.

Weekly Mortgage Applications fell about -3%. Refinancings continue to do worse than Purchases.

The average 30-year mortgage rate moved higher from 6.79% to 6.85%.

- Where did all the green energy/pre-IPO/crypto/academic money go?

We touched on this story two years ago, but it is back in the news now that the lawsuit is proceeding through court. A wood pellet energy company, Enviva, went bankrupt in 2024 after a disastrous trade in 2022. Enviva, thinking that there was an insatiable demand for burning trees to replace burning coal, decided to do a commodity swap with a large German energy company, RWE. Enviva sold RWE 340,000 tons of pellets but also agreed to buy 1.8mm tons from it. As is usually the case, this marked the top of the wood pellet market. The company was once valued at $3b. Bag-holding investors are seeking $2b in damages.

Pre-IPO trading is a relatively nascent business in the US. But with the proliferation of larger, more mature companies going public, this industry has blossomed. And with this growth comes the scoundrels. The former founder and CEO of pre-IPO platform Linqto has been arrested for ripping off his customers. For some reason, he thought it was legal (not to mention ethical) to charge 200% markups to his customers. 5-10% is generally considered the top of the threshold (per SEC guidance). The CEO liked to joke that pricing "would be set by a little Wizard of Oz…don't pay attention to that man behind the screen." Miraculously, this platform took in almost $500mm in 2024. It was on the verge of going public in 2024. But in 2025, the company filed for bankruptcy. And since all of the trades Linqto did were via Special Purpose Vehicles (the customers never actually owned the private stock…they just owned shares in an SPV entity that supposedly owned the shares), the customers are now creditors in the bankruptcy.

The crypto investor that convinced Trump to embrace crypto launched a Digital Asset Treasury company last year. It is down 99%.

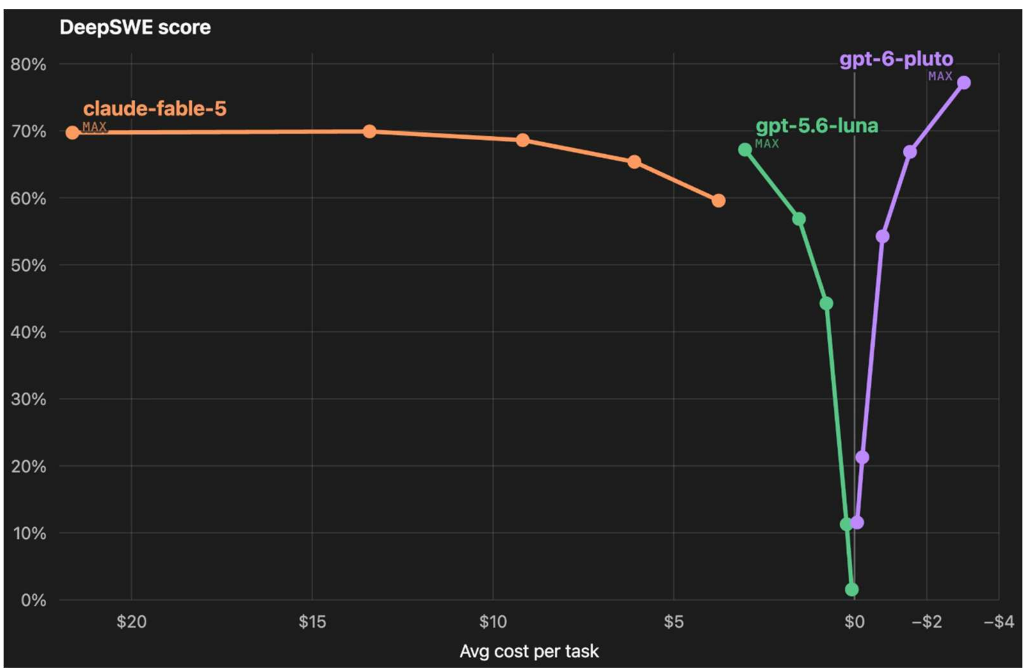
In 2022, the University of Washington instructed its professors to acknowledge that the school was occupying the land of the Coast Salish Indigenous people. This was to be stated in each course's syllabi. One professor decided to write, "I acknowledge that by the labor theory of property that Coast Salish people can claim historical ownership of almost none of the land currently occupied by the University of Washington." After four years in court arguing free speech, the University is settling and paying the professor $600k for his troubles.

Hunter Biden is creating a crypto memecoin called $LAPTOP. People who claim to have lost money on the $TRUMP memecoin will automatically get 10% of the coin float. Another 10% will go to subscribers of Hunter Biden's Substack.

Miami reminds of us crypto hence this stories placement in this section: The Wall Street Journal reports that having a helipad on your Miami apartment building is the new thing. This reminded us of a story from our time at Credit Suisse back in the 90's. We were on the Latin America trading desk in New York, and we were visiting the Latam headquarters in Sao Paulo, Brazil. One day, the trading desk was razzing the head trader, Ricardinho (Little Ricky). He was a legend in Sao Paulo…the locals say he "invented arbitrage." Nonetheless, he was struggling to drive his new manual (stick-shift) Ferrari. The clutch was slipping and he could barely go 20 yards in traffic without stalling. When Ricardinho arrived the next morning, the same guys commented that they did not see his slick Ferrari in his usual parking spot…where had he parked? With a wry smile, Ricardinho replied, "on the roof."

- ➢ Chart Crime of the week

Ok, so this one is a joke. But we like it as it makes fun of all the press-release noise being issued by the AI companies. The chart below shows how you *can get paid* to use the latest GPT model. The Luna model is real, and its chart is probably close to reality! It is a "budget-friendly" model which just means you get what you pay for. (To be clear, we think this AI stuff is real and getting better every day. But the hyperbolic nature of the "reviews" is exactly that.)



This was going to be a one-liner blurb in the Crypto section. Apparently, there is a UK "celebrity" named Katie Price. She was recently in the news for leaving her husband when she discovered that his $50mm worth of crypto was actually only worth, well, nothing.

When following up today to see if we could find anything more about this apparent celebrity, we have stumbled upon some sort of crime. It might not be a chartcrime…but it certainly is a crime. Here is a before and after montage of Ms. Price two days ago and yesterday.

- Quick Hits
    - The battle between the States and Kalshi over whether prediction markets should be federally legislated is heating up. One of the better lines so far: "People's inability to…wager on whether Taylor Swift will meet the Pope" does not create a market emergency.
    - The prediction markets have the probability of this case going to the Supreme Court at 45%.
    - The US Open gave media credentials to over 100 "influencers."
    - During Naomi Osaka's first round match, the chair umpire had to stop play to tell the influencers, "Guys, please, in the suite behind me…please take your seat."
    - The University of Chicago's football helmet sports a sticker that highlights the school's 101 Nobel Prizes. (We are no fans of the biased Nobel these days, but we do appreciate the historical standards necessary to be a Laureate in Economics, Physics, and Chemistry which comprises 80% of the prizes won by Chicago.)
    - The UN voted 164-1 to change the size of Africa on the global map. America voted No. The new map will better reflect the true size of Africa. But the old map better reflects the shapes and angles of Africa.
    - For you non-Texans, highway 130, the bypass around Austin affectionately called the Pickle Parkway, has the highest speed limit in the country: 85mph.
    - When Sam Darnold won the Super Bowl with the Seahawks last season, he earned a bonus of $178k.
    - When Sam Darnold won the Super Bowl with the Seahawks last season, he had to pay California $249k in taxes. (This is somewhat misleading because he had to pay taxes on a portion of his total contract…not just the Super Bowl bonus. But hey, it is California, and they really do tax athletes on a weekly basis, so we are running with it.)

- When Michigan fans stormed the field after their "win" over Western Michigan, it was statistically the most pathetic field storm since 2019. This mathematical determination is based on the 27.5-point spread by which UM was favored.
- The most deserving field storm occurred when Illinois defeated Wisconsin in 2019. They were 30-point underdogs.
- Of the 125 miles of shoreline on Martha's Vineyard, 77 miles are private beaches. You can buy a key for access. Keys rarely trade publicly, but they reportedly can be worth up to $400k.

TSLAQ: Tesla's Cybercab "launch event" fell flat as expected. We say as expected because Musk did not even show up for the invite-only event. 45 driverless cabs hit the streets of Austin. You can sign up to own a fleet if you want. We do not know how many people have taken the bait, but we suspect it will follow the trajectory of the CyberTruck. It had a wait list of about 2mm trucks at its peak. In about 3 years of production, Tesla has sold about 70k trucks. (We have ridden in a Cybertruck while the drive-assistance software was engaged. It is pretty darn cool. But we are nowhere near having loads of ghost fleets roaming the streets of every American city.)

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