Weekly Update

27-April-2022

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- The market does not believe the Fed can do what it says it can do
- Equity Vol (VIX) lags Fx Vol
- We still think Positioning is still stretched
- Earnings have been ok, but guidance is disappointing…especially where it hurts most
- Mixed bag for Durable Goods
- Housing continues to soften
- Workforce stabilizing and slowly growing
- E-commerce is not changing the world
- Disinflation can still be painful
- Regional Fed surveys point to weakness ahead
- Oil Vol is settling despite the daily, dynamic, news flow
- Quick Hits
- Chart Crime of the week

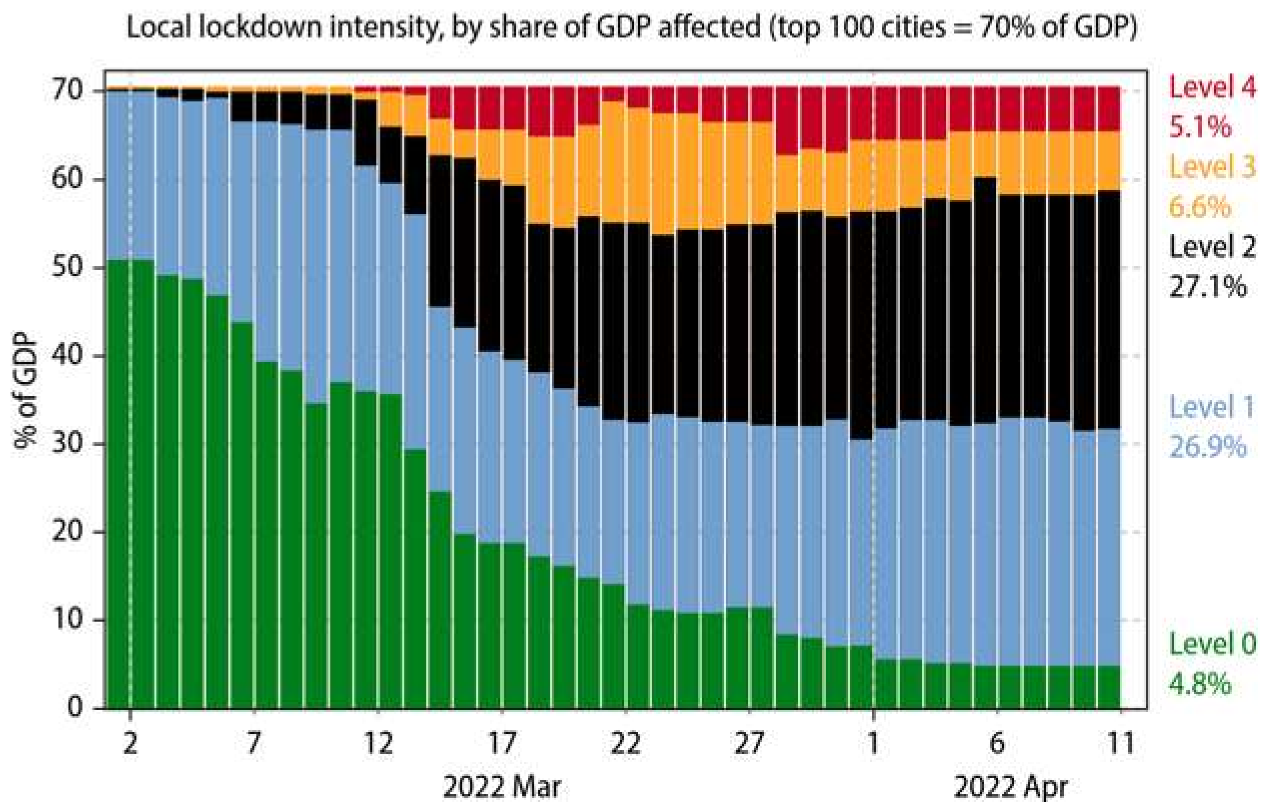
	Last	5d %	YTD %	1yr %
S&P 500	4,184	-6.2%	-11.9%	1.2%
QQQ	$316.76	-7.2%	-20.3%	-6.8%
US 10 YR	2.83%	2.92%	1.51%	1.61%
USD/DXY	103.1	100.3	96.0	90.6
VIX	31.6%	20.3%	17.2%	17.3%
Oil	$101.51	-1.0%	34.9%	61.3%

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

We have been commenting that the market narrative was starting to shift towards a looming recession instead of just a rate shock. The practical matter of this being that now everything in the market is vulnerable…not just Fantasy Tech or high valuation Growth stocks. And this whack-a-mole approach is what has started happening. The most simplistic view of this is the similar performance between the S&P 500 and the Nasdaq. Ironically, interest rates have stopped moving higher…they have even hinted at coming down a bit. The logic here is that the Fed will realize it is a mistake to blaze ahead with interest rate hikes into a slowing economy that can only crash the economy. Are bond traders giving the Fed credit in realizing that with China's economy shut down for political reasons (they may tell you it is for Covid…do not fall for commie rhetoric), inflation might not be as bad as feared? Of course, the Fed is signaling the exact opposite of this. Chairman Powell basically moved the

interest rate-hiking bar to 50bps in the coming meeting in May. Moreover, it sounds like he thinks a series of 0.50% hikes are in the cards. And thus, the conundrum has effectively flipped on its head. The Equity market was relatively resilient while the bond market feared rate hikes. And now the bond market is ok with current interest rates while the equity market is getting whacked left and right. Paradoxically, we think both can be right. We do not think the Fed will reverse course (mostly out of fear of losing credibility) in the short-term. But we do think after enough damage is done, we might see the bond market was right but just six months early.

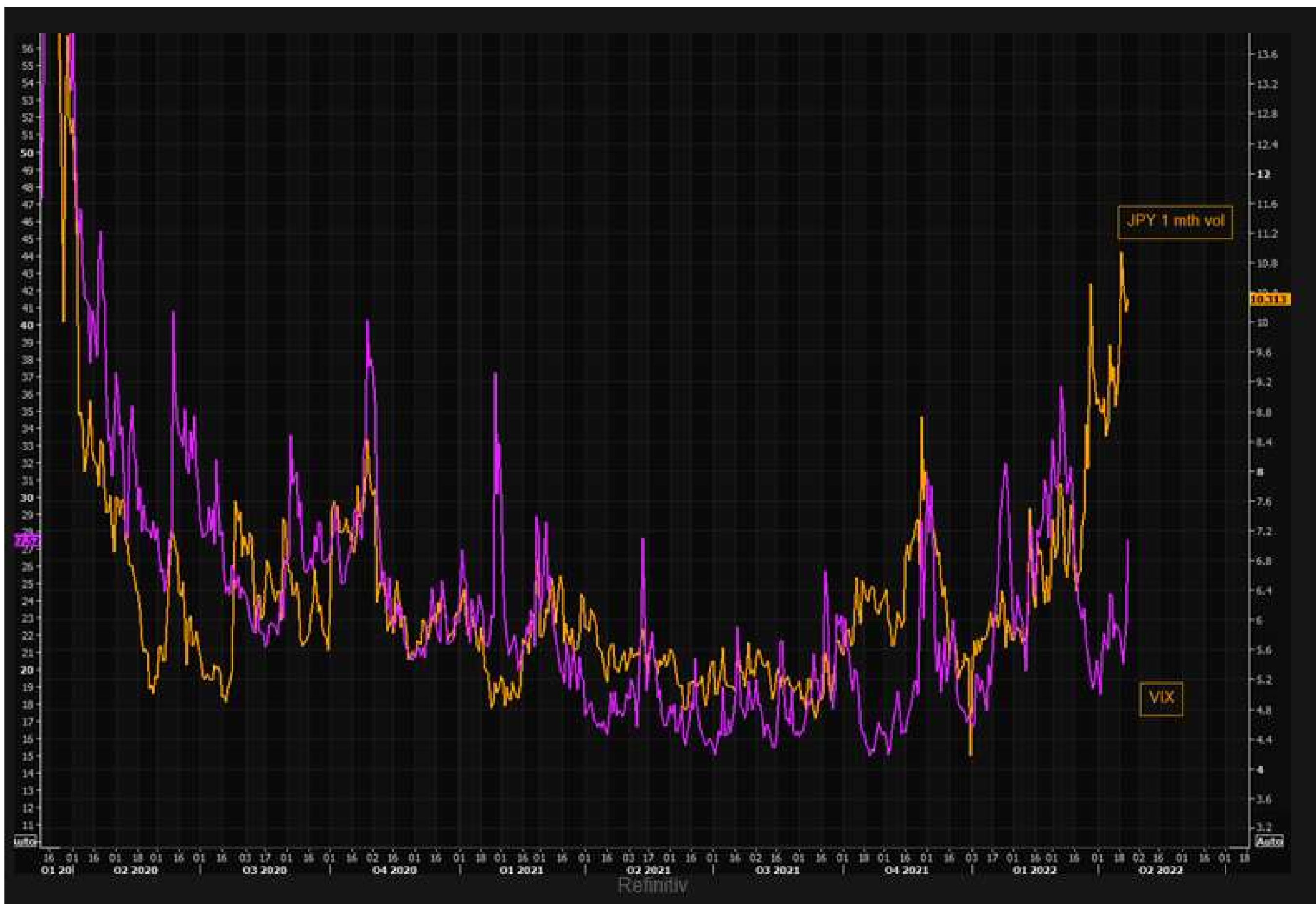
Here is a chart of China's lockdowns. What is not evident in this data is the targeting of cities and other locales with "elites" and others not wanting to take China back to an agrarian economy with equal misery for all.



Source: Gavekal

- Equity Vol (VIX) lags Fx Vol

Last week we showed the divergence between bond Volatility (MOVE) and equity Volatility (VIX). Here is another of the same ilk: equity Vol trails Fx Vol (Japanese Yen vs USD in this case). This chart is a little outdated as the VIX is now almost 32. But there is still more to go. While we believe in owning a small slice of bonds (thinking that gap has finally started to close), we want to remain long USD (which means short a basket of FX which means this Vol will remain elevated).



- We still think Positioning is still stretched

Goldman and JP Morgan both are saying hedge fund positioning is at 52-week lows. But this data seems out of place. That is, of course leverage is going to look low compared to that of a manic bull-run fueled by leverage. Shorts are increasing (outnumbering new buys 3.6:1 over the last month - Goldman). Some macro positioning has been unwound (this usually just means it has found a new home…see long USDJPY, which means short JPY, above). TMT mega caps are out of favor but still owned (we think Goldman is trying to replace silly acronyms like FANG with the old tried-and-true Tech-Media-Telecom abbreviation).

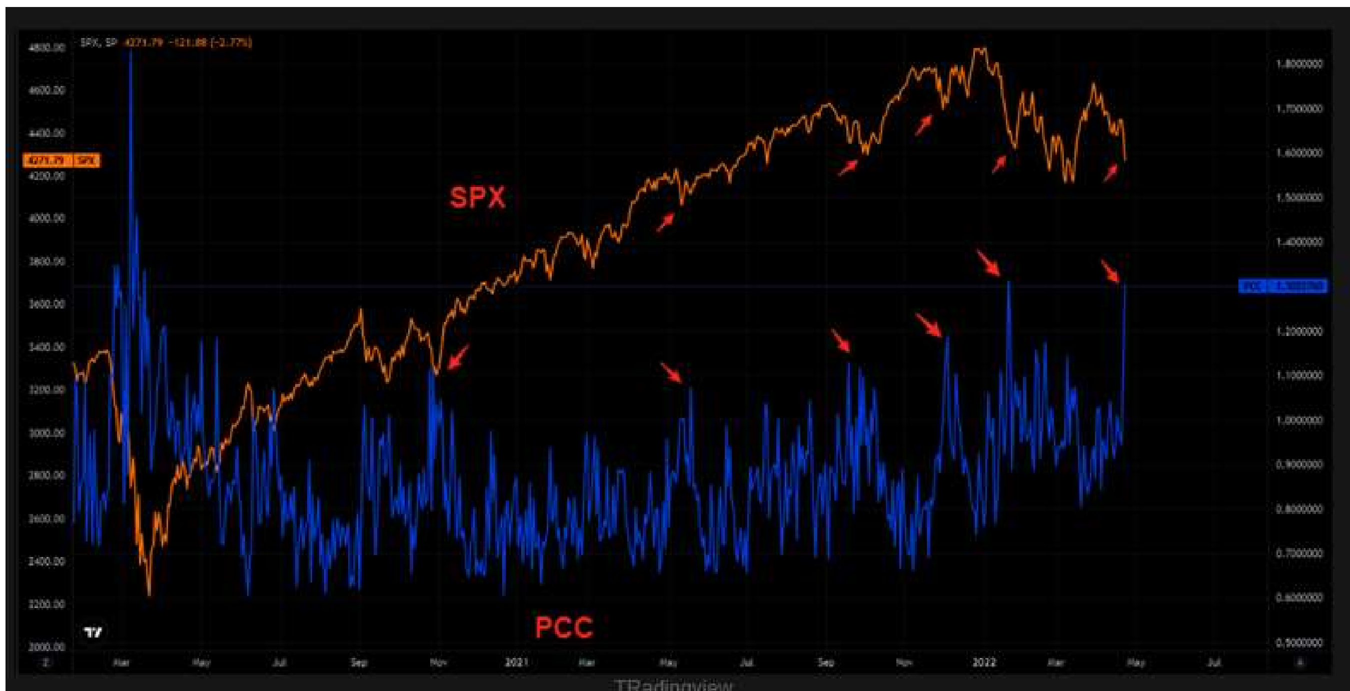
We think a simpler way to look at positioning is the direction of cumulative flows into or out of large funds/indices. The dark blue line tells us that investors went “all in” during the virus-fear period. Nary a share has reversed out of these funds which is astonishing. We suspect this will not hold, and thus we have not reached real capitulation in the market yet.

Chart 16: Everyone bearish, but redemptions just starting
Cumulative global equities flows vs MSCI ACWI Index

Source: BofA Global Investment Strategy, EPFR, Bloomberg

BofA GLOBAL RESEARCH

Here is a pretty cool chart that shows how people tend to buy Puts (Put/Call ratio spiking higher, blue line) precisely when they should be selling them (after market weakness, orange line). Then again, if people are not going to Buy-the-dip in stocks this time (orange line keeps going lower), the Put buying might not be late! We have trimmed some of our Put positioning ever so slightly. Since they are not tax-efficient to begin with, we are ok being a little quicker to book some gains (with the idea to put the short exposure back on…Sell-the-rally mentality).

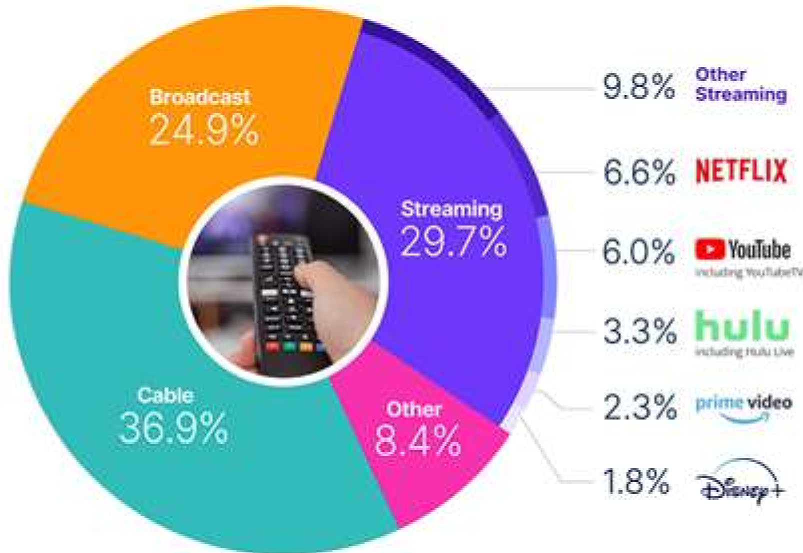


- ➢ Earnings have been ok, but guidance is disappointing…especially where it hurts most

With more than a quarter of companies having reported, Earnings are showing a 1% beat vs expectations. About half the companies are beating on Earnings and Revenues. This is equal to last quarter at this stage. But

the big miss comes on Guidance. And Merrill shows us that TMT (they used the term also!) guidance is faltering more than the broad S&P. On top of the rate environment potentially clamping down on these dreamers, ML cites a noticeable increase in competition.

Speaking of competition, here is Nielsen's measure of TV share. Yes, Cable is still the number one.



- Mixed bag for Durable Goods

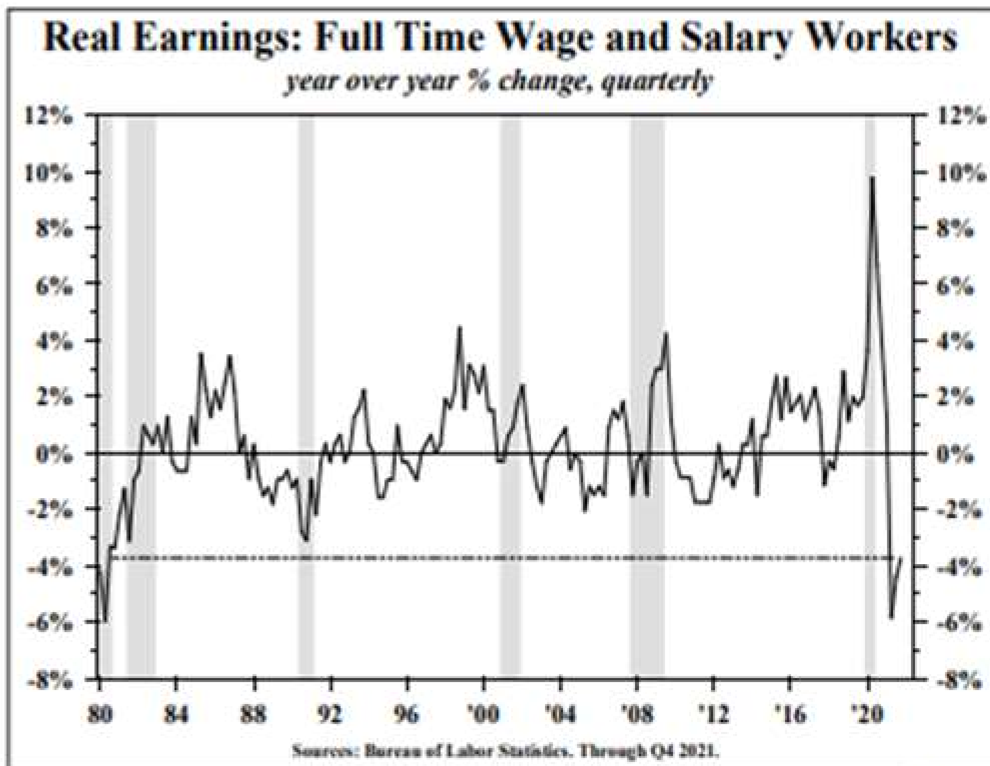
Headline New Orders of Durable Goods increased in March but fell short of expectations. But considering February was a terrible month (although its drop was revised to a smaller drop), the report was ok. The Core Capital Goods component, aka business spending, surprised on the upside with a 1% gain. But some recent earnings reports give us a different picture anecdotally. Whirlpool said demand for appliances is slowing after two years of robust growth. The same goes for Polaris.

- Housing continues to soften

Housing data picked up right where it left off last week (which had a poor Housing Market Index, slowing Housing Starts for single family homes, same for Existing Home Sales, slumping Mortgage Apps, and loads of other crappy data from Redfin). New Home Sales in March fell for the third straight month. On the plus side, February sales were revised much higher. But high prices, high mortgage rates, and long wait times are killing demand. Pending Home Sales (for Existing Homes with signed contracts but not closed) also fell in March. This was the fifth monthly decline in a row.

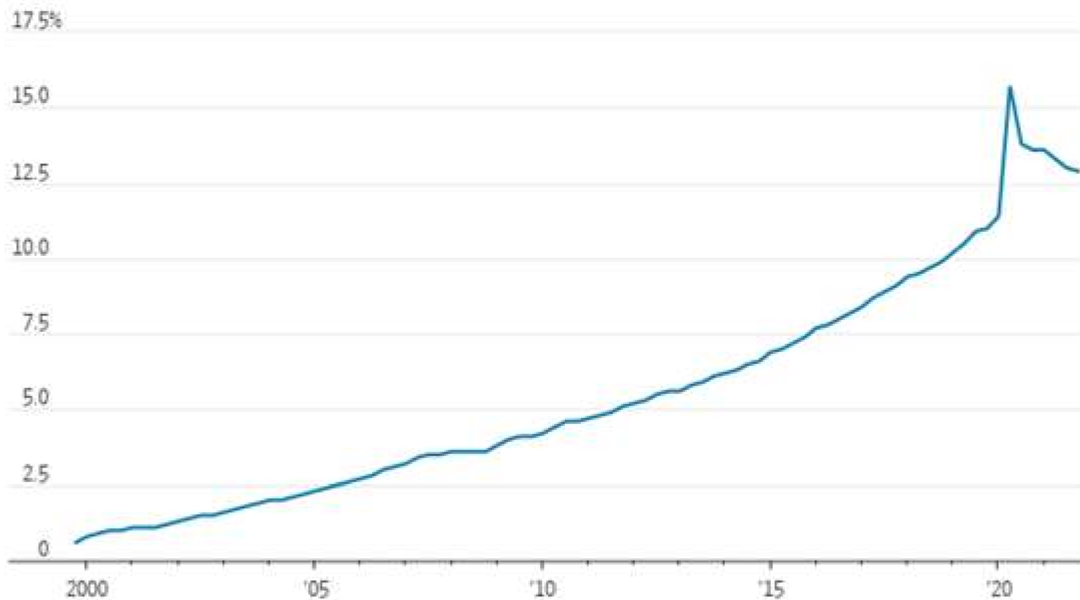
- Workforce stabilizing and slowly growing

Job Quit Rates have seemingly peaked. This is most notable in the Leisure and Hospitality space. And Quits almost always come with higher wages at the new job. This is that double-edged sword we have discussed. Businesses need wages to stabilize, but if wages as a whole cannot keep up with inflation…that is bad all around. And here is the chart of Real Earnings (wages adjusted for inflation). Part of the downward pressure is surely coming from the slowly enlarging workforce. There are now "only" 2.4mm people out of work because they were sick or caring for someone sick (or lying about either).



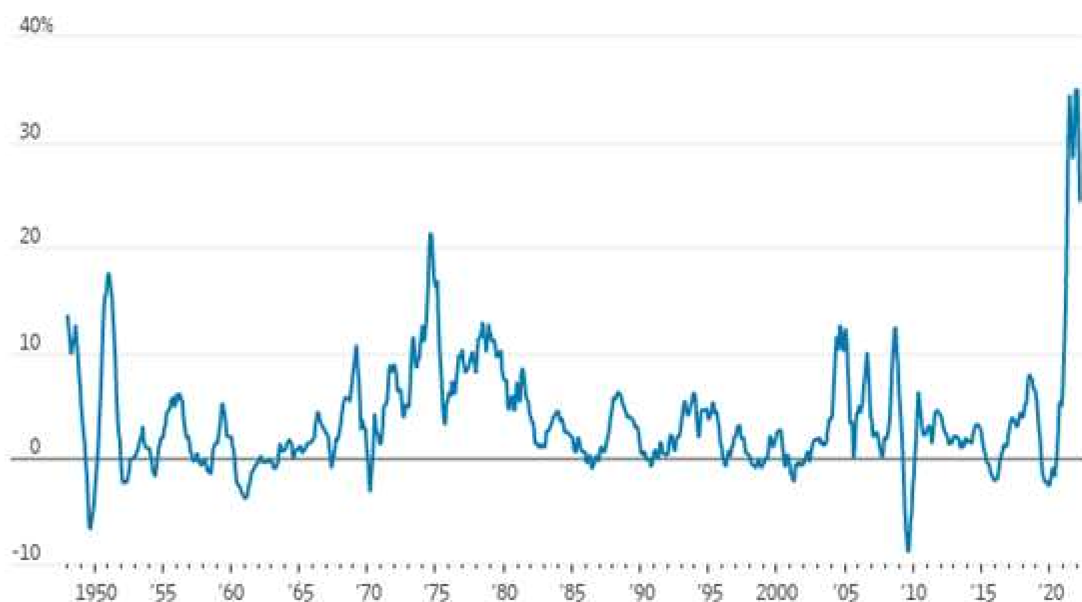
➢ E-commerce is not changing the world

E-commerce stocks went to the moon during the virus-fear. Many said the world had changed. Obviously, that was wrong. Or at least the speed of the change was wrong. This underpins one of the ideas in our Short-only portfolio: E-commerce is coming back to earth.



➢ Disinflation can still be painful

We have been highlighting some easing of the inflationary prices. Last week we saw that monthly used car prices continue to fall. Here we have the PPI for construction materials. The data appears to have peaked, but that does not mean prices are not still sky-high. We maintain our stance that whether we have deflation, disinflation, or stagflation…the equity market is in trouble if the Fed keeps hiking (which it pretty much has to do).



➢ Regional Fed surveys point to weakness ahead
- The Richmond Fed looked ok on the surface, but New Orders and Employment were negative inputs.
- The Dallas Fed continued its slide back to "neutral."
- The Philly Fed Manufacturing Index normalized lower in April after a burst higher in March.

➢ Other Economic data marginally negative
- Retail Inventories for March increased 2% vs Feb (slowing demand?)
- Wholesale Inventories for March increased 2.3% vs Feb (fearful of slowing demand?)
- Consumer Confidence remained flat. Recall this survey is more geared towards the job market (vs the Consumer Sentiment survey which is more geared towards inflation…and why that one is so much uglier).

➢ Oil Vol is settling despite the daily, dynamic, news flow

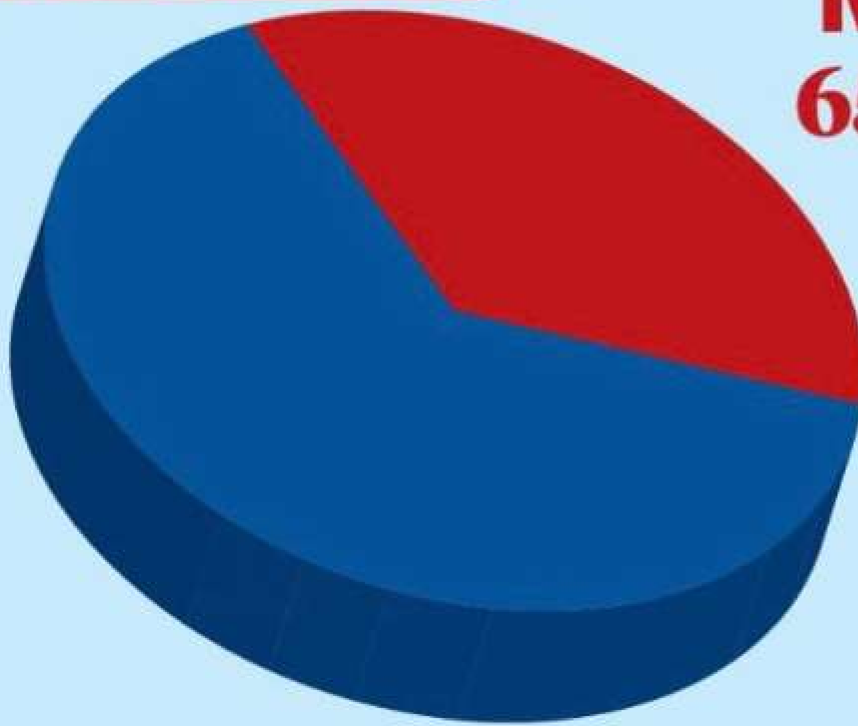
Oil has seemingly settled in a relatively tight range around $100 (WTI front month futures) despite the constant barrage of news. We think the overriding theme should continue to be that the market is structurally undersupplied. And incremental news is only likely to exacerbate this. The major wildcard here is China.

Continued lockdowns will sap global energy demand. This will play into our theory that the global economy is weakening. But it will hit our long Energy stocks along the way. Here are the news bullet points:

- Drilled but uncompleted wells (DUCs) have steadily declined since July of 2020 (from about a peak of 9,000 to under 5,000 today). This is just another example of why and how oil & gas producers are not chomping at the bit to get new or use old federal leasing permits. They have unfinished business.
- China's oil product demand is expected to fall 20% in April y/y according to Bloomberg.
- Italian oil demand is back above 2019 levels for the first time.
- Norway oil production missed targets by 181k bpd.
- Russian exports have not completely collapsed thanks in part to Russia changing the manifest destination to "uncategorized". But as we mentioned last week, refinery "runs" are following dramatically.
- Russian oil, Urals, is trading at a $35 discount to Brent.
- Despite the recent comments from the White House arguing for more oil & gas exploration, the administration's actions speak louder than its words. The Interior Department (why does this department exist?) is planning to block oil and gas leasing on 11mm acres in Alaska. And the approval process for new pipelines is becoming more onerous (as well as for highways and power plants…how are these even controversial?).
- Russia has cut off gas supplies to Poland and Bulgaria both of whom refused to pay for gas in rubles. This is a shot at Germany and Italy.
- The Kremlin came out and said it expects oil production to drop by 1.8mm bpd this year. This is out of about 10.5-11mm bpd of production before the invasion.

➢ Chart Crime of the week

First it was the Spanish. Then the French. Australian TV is raising the stakes.



- Quick Hits
    - The US Capitol was evacuated when a small aircraft approached the airspace. It was a US army plane carrying parachutists to the Washington Nationals baseball game.
    - Lululemon is starting a "Like New" program for used clothes. It is being pitched with the tag, "sustainability-oriented."
    - Melvin Capital, the fund that got killed on its GameStop short last year, is considering closing its fund in June only to relaunch a new fund in July. It was also considering charging performance fees despite being down 52% since last January. Investors have not gone along with this.
    - The area in Alaska in which Biden is stopping oil production is called the National Petroleum Reserve.
    - TelevisaUnivision was the #2 ranked television network in the US in February.

- Musk will be banned from tweeting disparaging tweets about Twitter during his purchase of Twitter according to the merger agreement.
- S&P will downgrade the debt of insurance companies if they hold securities that S&P does not rate. S&P gets paid to rate securities.
- A local Chamber of Commerce in Missouri held two seminars for telecommuting: one virtual for those in favor and one in person for those opposed.
- The "Beanstalk stablecoin project" was hacked and drained of $182mm. They need a new name for these not-so-stable coins.

Trading: Not much has changed in our playbook. We have been slowly adding to Energy. We have rotated around some of our Put protection while keeping most of our exposure (we did trim a little, but this was after the price drops, so effectively it remains the same). We added to some other defensives like Health Care. We did buy a touch of Big Tech, but this was only because we own so little of it.

TSLAQ: We might have to rename this segment **TWTRQ**. We think there is a good chance that Twitter is bankrupt in a few short years…if not sooner. While we actually applaud Musk's quasi-altruistic endeavor in opening up free speech, a $44b novelty project might prove to be too much…even for the world's richest man (ex-Putin). And this is highly relevant to the markets at large because Musk has pledged another slug of his Tesla shares to fund it (on top of his other margin loans to fund his other pet projects like rockets, tunnels, and flame throwers). Even well-intentioned hubris can kill the best of 'em.

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