Weekly Update

25-Jan-2023

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- The market rally is taking its cues from the bond market in isolation
- Hedge funds have been panicking
- Earnings Expectations are getting worse
- Economic activity is not pointing towards a soft landing
- Housing weakness can have a bigger impact on the economy than Housing
- The future does not look so bright per the Leading Economic Indicator
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	Last	5d %	YTD %	1yr %
S&P 500	4,016	2.2%	4.6%	-7.4%
QQQ	$287.73	3.5%	8.1%	-18.0%
US 10 YR	3.45%	3.37%	3.88%	1.80%
USD/DXY	101.6	102.4	103.5	97.3
VIX	19.1%	20.3%	21.7%	32.0%
Oil	$80.44	1.2%	-0.1%	-6.4%

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

The market resumed its rallying charge after another change in narrative. The "Fed pivot" morphed into the "soft landing," but now the focus seems to be on the bond market and its signaling on inflation. The market has been cutting its expectations for inflation…it now thinks inflation will be a little over 2% in one year. What is missing from this equation is the trajectory of the economy. If inflation were to fall this drastically…which we find incredibly hard to believe… the economy would tank along with it...no soft landing. And the data is already pointing in this direction. From business surveys to industrial Production to Housing, weakness is spreading across the spectrum. Even the resilient Labor market has begun to show some cracks.

On the news front, there is another large private real estate fund closing off redemptions. Government assault on business is intensifying with the DOJ bringing another suit against Google (not that we think these lawsuits ever hurt business, but it is certainly a distraction in the interim and the signaling is bad). Speaker of the House

McCarthy and President Biden are already being petty in their attempts to discuss the debt ceiling. Ford and Google announced job cuts (Google was hiring as recently as the 3Q last year). Turkey is vetoing Sweden and Finland from joining NATO. The US is accusing the Chinese of providing economic assistance to Russia in its war against Ukraine. And for what it is worth, the weather in Europe and China is starting to look a lot like Christmas.

We would be remiss if we did not mention the renewed bull market in crypto. But the roughly 40% gains in Bitcoin and Ether are likely driven by nefarious characters "painting the tape." That is, the large holders and/or players with lots to lose have been posting fake trades. A recent study estimates that 70% of volume across the crypto space is fake news. And some people use crypto as an indicator for "risk appetite" and thus are enticed to buy Profitless Tech companies with no discernible path to profitability (never mind a discernible product). Perhaps the worse decision would be to buy a Profitless Tech company in the crypto space?

- Hedge funds have been panicking

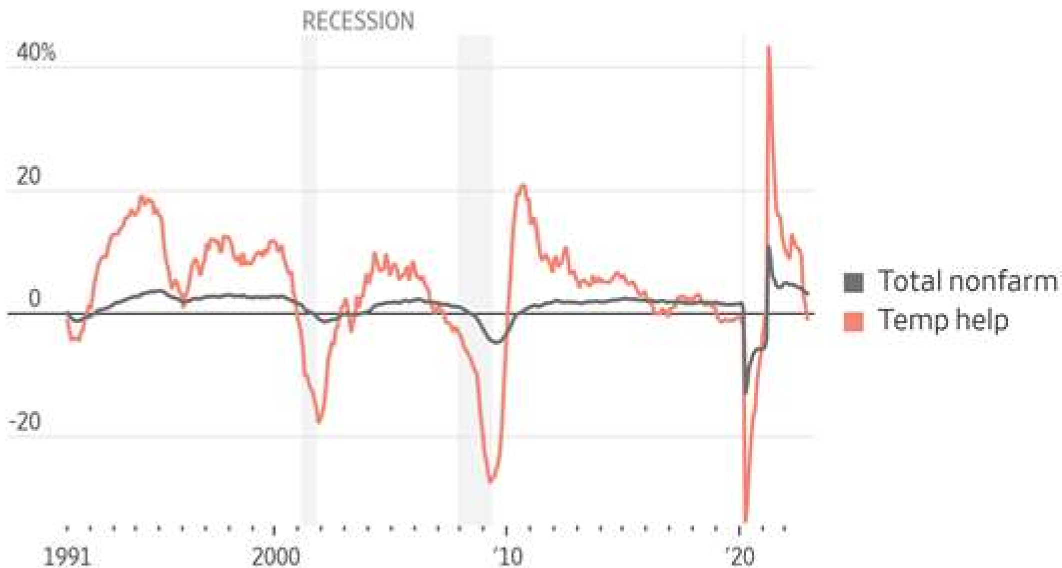
The data is starting to support our position that hedge funds have been feeling the squeeze. Merrill says these funds were the biggest buyers last week right at the peak. Moreover, it is the soft-landing/Fed pivot/inflation-is-gone sectors that are attracting the moths. Cyclicals experienced the largest inflows since August (the last big head fake higher). Tech and Communication Services had the largest outright inflows. Energy, last year's biggest winner, saw the biggest outflows. Morgan Stanley reports that net exposures have been increasing and are in the 77th percentile over the last year (much lower over longer time periods, but memories are short for this cohort). Interestingly and to our point, MS says the net exposures have been increasing because of short covering and not new long buying. Barlcays reports that "macro" hedge funds, funds that bet on swings in the economy without much bottom-up stock picking, are about at their peak long exposure over the last year. The only segment that seems "short" are the mutual funds that have a one standard deviation low in equity beta. Since this group does not use leverage and changes its equity allocation at a snail's pace (not a bad thing necessarily), this means that is has shifted to more defensive sectors and factors. We would also note that capitulation into China is happening in a large fashion. Emerging Markets debt and equity funds experienced their largest inflows ever last week.

- Earnings Expectations are getting worse

One of the strangest dynamics of this market environment is that earnings estimates have been falling while the market rips higher. In December, Earnings revisions by analysts were rebounding thanks to the Chine reopening theme. But the January revisions reversed the December improvement. And the same holds for Sales; the ratio is under one also (under one means more negative revisions than positive). Our point being that most bulls say the earnings recession has been priced into the market. But clearly this is not the case if revisions continue to deteriorate (worse earnings coming).

- Economic activity is not pointing towards a soft landing

We have discussed temporary workers and whether they are a leading or lagging indicator. The Wall Street Journal puts it into perspective. Declines in Temp help usually lead broad employment declines by about a year. The end of 2021 and early 2022 saw Temp job additions of about 30k a month. The last four months have seen declines of about 30k a month.



Jobless Claims continue to shrink with the latest weekly datapoint falling to 190k. Of course, Continuing Claims remain elevated or at least trending higher after the lows in the summer. We think one of the reasons for the low levels of Initial claims is that all the people being fired presently have severance. Once this rolls off, claims should tick higher again. Moreover, layoffs have only really been hitting Tech and Financial companies. The bad numbers will hit when Main Street succumbs. Of course, Walmart recently announced wage hikes…the opposite of layoffs. We suspect this underscores the strength in the "trade-down" economy and not the economy as a whole. Time will tell.

- Housing weakness can have a bigger impact on the economy than Housing

Housing Starts and Permits remain in their downward trends. This is not shocking given the cancelation data we have seen from the home builders.

Existing Home Sales in December ticked lower again. We are below the collapse seen during peak Virus Fear. And we are almost at the trough of the Housing collapse during the last cycle (2005 boom to 2010 bust).

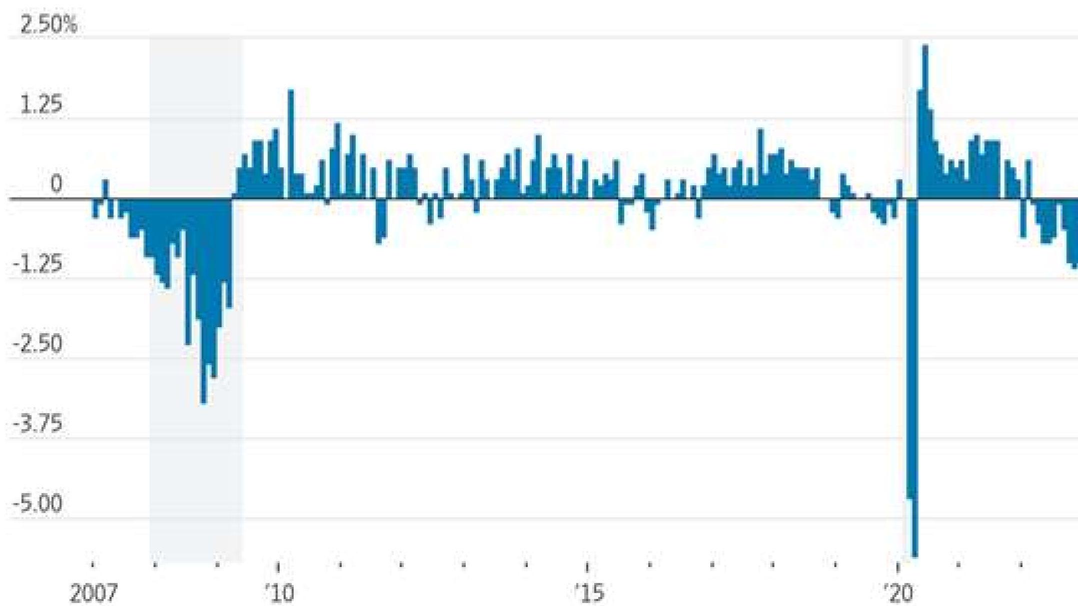
On the other hand, Pending Home Sales increased 3% in December according to Redfin. Of course, this is still a 31% drop vs last year. But the rate of change is slowing. Prices also fell (about 1.4%). So this is the ying-yang we have been expecting. These are small moves. We will see if they make a trend.

Mortgage Applications increased again last week after last week's large increase. We thought last week's increase might have been distorted because of seasonal factors (a pick-up from the holiday lull), but this appears not to be the case. Moderately lower rates seem to be driving activity. There is some anecdotal data that Housing stocks pick up during a recession as long rates start to cool. We think this cycle might be different because we have yet to see Housing truly get impacted (we hate thinking "this time is different.") Sales are down dramatically as we see every month in the data. But prices are still sky high. We have been reiterating that something has to break. Maybe the Redfin data is it. While we have a small short in Housing (including housing-related retailers), our view on Housing is mostly manifested in our call for a recession. The wealth

effect will be felt across the economy even if Housing stocks do not move much (seems like a weird contradiction, but that is what some back testing shows per Hedgeye).

- The future does not look so bright per the Leading Economic Indicator

The Leading Economic Indicator index for December contracted again. This was the 10th straight negative month. We do not always believe this indicator (and mock it for just being an amalgamation of already released data). But this trend is pretty clear.



- Other economic data: still negative

The Flash reading of the January Composite PMI ticked up slightly. But both Services and Manufacturing remain mired in negativity.

The Money Supply (M2) is finally starting to contract with a drop of $63.2b (still a long way to go).

The Survey of Business Uncertainty published by the Atlanta Fed shows a downtick in Sales growth expectations but an uptick in Employment growth.

The Philly Fed Manufacturing Index remained in negative territory despite a slight uptick. The Richmond Fed Manufacturing Index sank deeply into negative territory after staying above the positive line recently.

- The Fed is still hawkish despite what the media reports

Vice chair of the Fed, Lael Brainard, delivered some prepared remarks. The reporters declared that she was optimistic about the "soft landing." As usual, we read her actual comments instead of relying on someone else's interpretation. She noted that there was a "significant weakening in the manufacturing sector." There was "moderation in consumer spending." And the overall level of growth in 2023 would be "subdued." In case there were to be any confusion about her dire read on the direction of the economy, she added, "It is likely that the full effect on demand, employment, and inflation of the cumulative tightening that is in the pipeline still lies

ahead." She gave the caveat that it is "possible" that inflation could be tamed "without a significant loss of employment." This last bit would be more important if it were the main message delivered. But it appears to us that this is the outlier outcome and not her base case.

There are reports of some dissenting views developing among Fed members. Logan of Dallas and Harker of Philadelphia grabbed some headlines for speaking dovishly. Bloomberg even said they were laying out the "case for easing the Fed's hiking campaign." Yes, Bloomberg used the word "easing" to describe the slowing of rate hikes. But slowing rate hikes is in no way "easing" monetary policy.

St. Louis Fed president Bullard's comment about a possible soft landing was reported in isolation. Never mind that he also said he thinks rates have to be restrictive for longer.

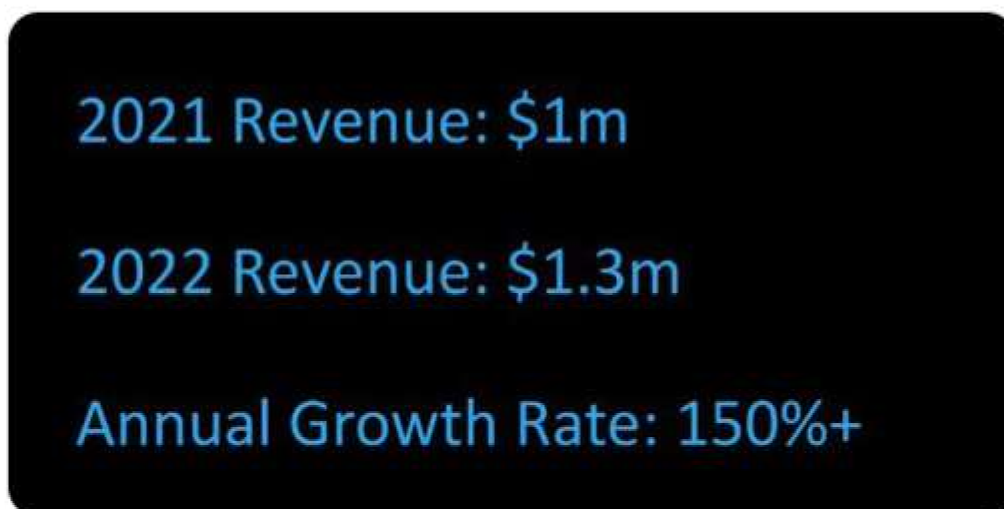
Nothing has changed for us. The Fed will slow their rate hiking, but they are still going to keep rates higher for longer.

- Where has all the crypto money gone?

In a follow up to last week's "Are people really this dumb?' edition, we have another entry this week. The temporary CEO of FTX, the one responsible for finding and liquidating assets and paying off creditors in the bankruptcy proceeding, acknowledged that FTX US might have a chance to be reopened. The disgraced founder, SBF, chimed in with an "I told you so" from his mom's basement while on house arrest. The current CEO also disclosed proof of what we all knew anyway…that FTX had hardcoded its risk management system to allow its affiliate, Alameda Research, to borrow as much money as it wanted. Moreover, it was able to withdraw as much money as it wanted even if it were incurring losses with this unlimited amount of borrowing (in actuality, the unlimited amount of money was technically limited at $65b). In case anyone was confused by Alameda's designation in the risk management system, it was entitled "God Mode." Which brings us back to the viability of FTX US being a thriving business again. Would you trust a self-appointed God?

- Chart Crime of the week

A venture capital firm was pitched a company with this in its presentation. Even if the math is a typo, touting a percentage change on a tiny base is criminal.



➢ Quick Hits

- Dictators exaggerate their countries's growth rates by about 35% a year. The research is based on night-time light activity gathered from satellites.
- Estimates for the total cost of that San Francisco reparations package we recently detailed are around $100b.
- An NFL bettor wagered $1.4mm to win $11,200 when the Chargers were up 27-0 on the Jaguars.
- An employee of a video game maker was fired for tweeting that she was looking forward to the next Harry Potter game.
- Half of food delivery customers make less than $49k per year.
- Hamburgers are the second most delivered food after pizza (14% vs 16%).

Trading: We continue to slowly add to our short exposure in the Fantasies and Frauds. Despite our slow-moving, we are still getting steam-rolled by the short squeeze. But we remain confident in our view. Even if the economy avoids a recession, Profitless Tech and other nonsense will not be the winners in any upcycle. We would like to think they are relegated to the dustbin of history for good. But we know that is not the case. Otherwise, we are sticking with the theme and are slowly adding to our longs in Staples and Health Care. We still like Energy, but we are a little more torn there given the push of China and the pull of US recession.

TSLAQ: Musk is in court again. This time it his trial over his fake takeover tweet, "Funding Secured." The odd part about this trial is that the judge has already ruled or determined that the tweet was not accurate. Musk lied. So the crux of the trial is whether shareholders were harmed by the lie. Just like in the Twitter case, the judge seems to be reprimanding Musk frequently. But this case revolves around the select set of shareholders over a ten-day period. We are guessing Musk will escape unscathed legally per usual (ex that $44b ego flex that got him Twitter). But we think the trial has done more damage to his already dwindling stature.

More importantly, Tesla reported earnings tonight. They seem to be in line with the lowered guidance. The stock was not really reacting…until Musk started promising that demand is great, there are new products coming out, blah blah blah. Facts speak louder than Musk's promises, but we will have to wait for more facts (namely, how bad margins are going to be because of the global price cuts instituted in January…not reflected in this earnings report). We will keep our small short (we reduced it in December) as Tesla remains at the epicenter of the not-yet-burst bubble.

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