# Chalk Creek Partners LLC

Registered Investment Advisor

## Weekly Update 19-August-2020

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- Market rotation is over, higher it goes
- Fund Manager Survey is back to being bullish (surprise)
- Jobless Claims dip again but total Continuing Claims still running high
- Housing remains great on the surface, but watch out for Delinquencies
- Retail Sales increase again, but are they too concentrated?
- The Fed senses more economic weakness to come, maybe
- Chart crime of the week

| | Last | 5d % | YTD % | 1yr % |
|---|---|---|---|---|
| SPX | 3375 | -0.2% | 4.5% | 15.4% |
| QQQ | 276.1 | 1.6% | 29.9% | 46.5% |
| US 10 YR | 0.68% | 0.68% | 1.88% | 1.55% |
| VIX | 22.5% | 22.3% | 23.2% | 17.5% |
| Oil | 42.56 | 0.5% | -29.7% | -23.7% |

*10yr and VIX are levels not changes

** Oil is front month futures, beware

The rotation we saw last week is just like Lubbock – best viewed in the rear-view mirror. Big Tech, Work-From-Home, and other high-flyers resumed their ascent. From the speculative froth like Zoom (ZM) and, uh-hmm, Tesla (TSLAQ) to the quality stalwarts like Amazon (AMZN) and Alphabet (GOOGL), Nasdaq regained its footing and made new highs. The continued rally seems impervious to China tensions, Fed worries, and now lofty expectations. Of course, just like the Fed, investors are playing the momentum game. And that is always great while it lasts.

The much-anticipated, six-month review of the trade deal between China and the US was delayed because of "scheduling." This seemed like the routine hiccup until Trump declared he had backed out. We are not surprised Trump is turning up the heat on the Chinese. It seems to be one of the few common grounds among most Americans (not necessarily the tactics but at least the end goal of leveling the playing field). While the Chinese have increased their buying of American soybeans, equalizing the technology and intellectual property side of the relationship has always been the ultimate goal. Even though we have called the TikTok saga a sideshow, we have come to believe that it fits nicely with the desired endgame.

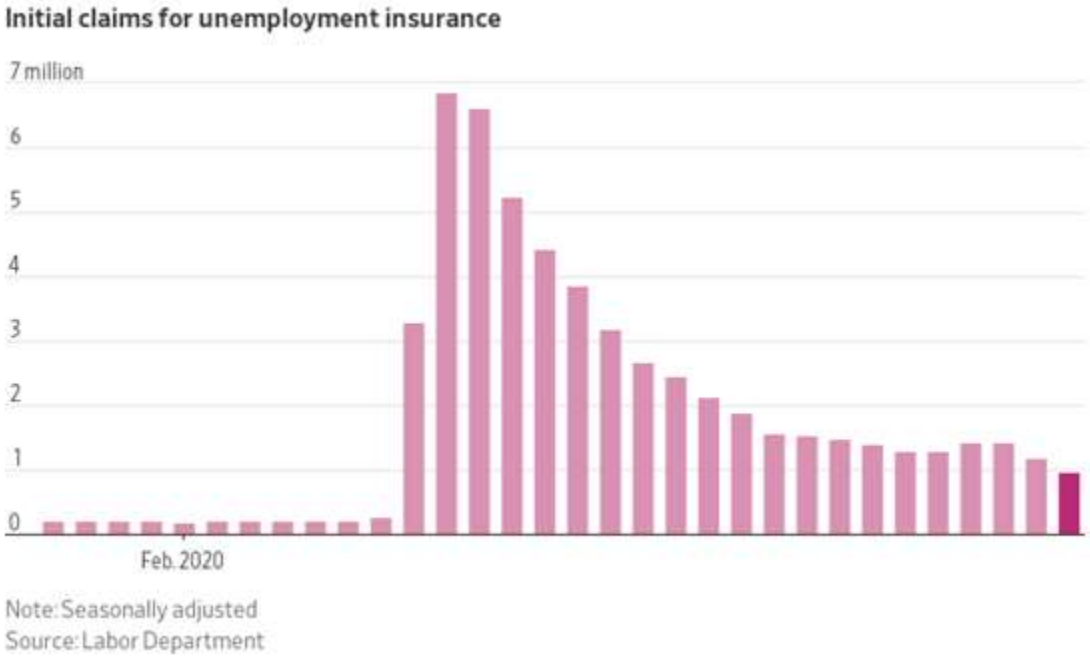
- Fund Manager Survey is back to being bullish (surprise)

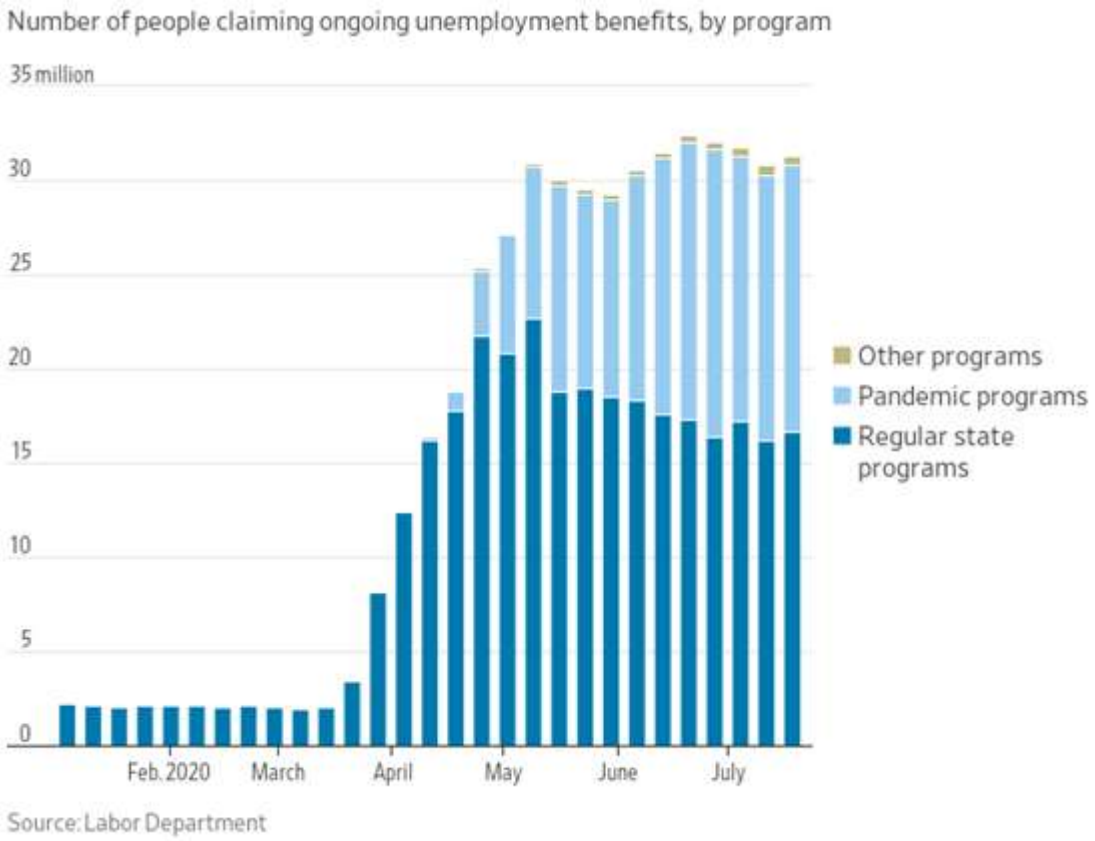
The fund managers in Merrill Lynch's monthly survey are the most bullish they have been since February. Merrill softens this by saying managers are not overly bullish. But we disagree. 79% expect higher growth. This is the highest reading since 2009. The magical vaccine is expected by early 2021. US growth stocks are still the most crowded especially Big Tech*. But the supposedly tempered bullishness is reflected in Gold which is the second most crowded trade. And despite the expected growth, most do not expect the so-called "V" shaped

recovery (this is a reference to the economic data charts and whether they rebound immediately or not). Politically, the biggest risk is the Senate getting flipped to Dem.

- Jobless Claims dip again but total Continuing Claims still running high

Jobless Claims dipped below 1mm for the first time since the government-mandated panic started. Of course, this is still 38% higher than the old record of 695k claims. Continuing Claims also dipped to about 15.5mm from just above 16mm. Federal Pandemic Unemployment Assistance Continuing Claims were about 10.7mm at the end of July. This is down from 13mm during the previous week (this program has officially ended now). As a random aside, these figures are always "seasonally adjusted." This is economist-speak for trying to smooth out the data. The reported number of Jobless Claims, 963,000 differs from the actual number of claims of 831,856.





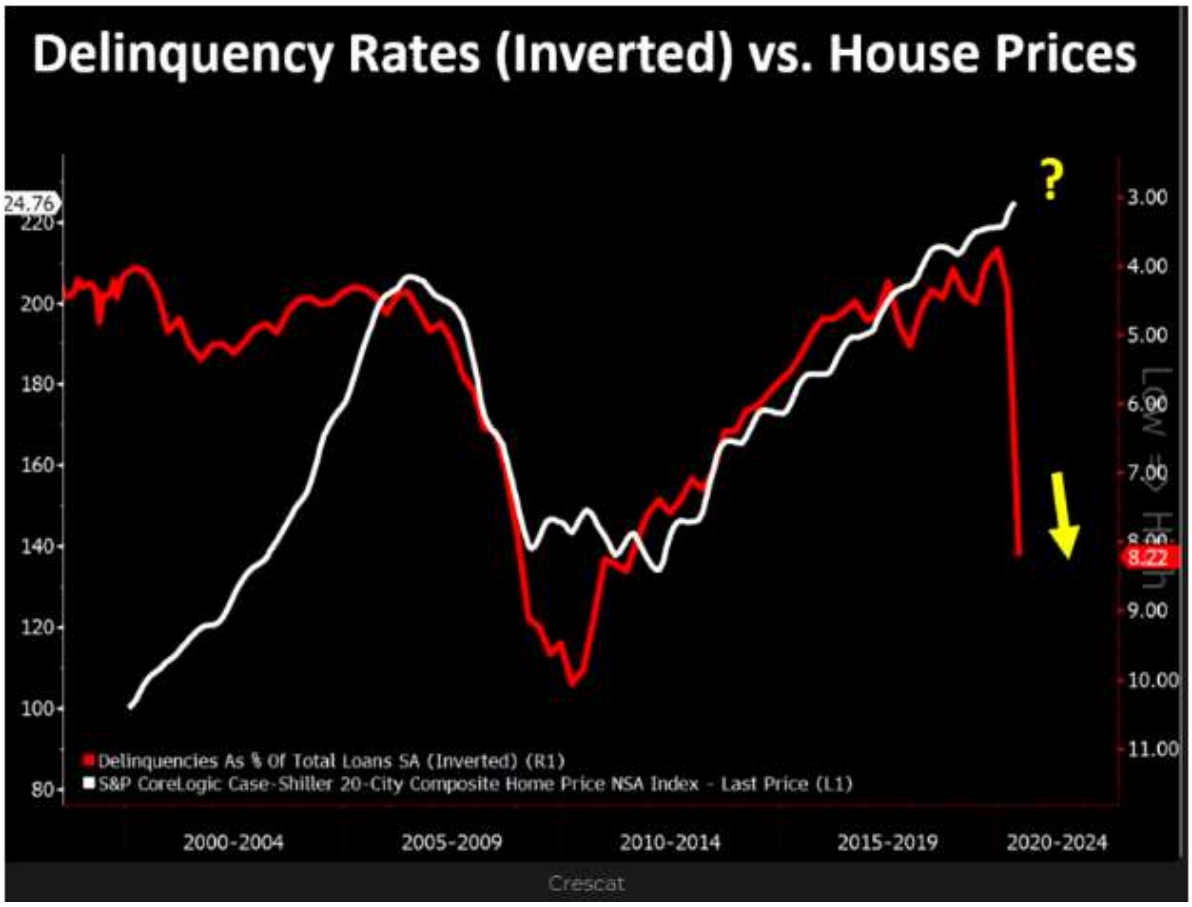

- Housing remains great on the surface, but watch out for Delinquencies

Zillow released a somewhat surprising report about urban home prices. The current narrative driving housing and homebuilding is one of urban flight. But Zillow reports that only San Francisco and New York are experiencing declining home prices. Other urban areas are holding up ok. We suspect there is a lag in other urban areas. That is, there was an urgency to flee the over-crowded and crime-ridden cities of SF and NYC. Moreover, this data does not incorporate people that are fleeing small rental apartments. To wit: The number of new leases signed in Manhattan has fallen 23% vs last year with rents falling 10%. There are 13k empty apartments in Manhattan. The average 1-bedroom rent is still $3500. There is still room to drop.

The Housing Market Index tied its all-time-high mark (+78). This is another diffusion index which tracks monthly changes with a 50 breakeven level (it surveys homebuilders on their views of the current and future market). Housing Starts followed this strong data with more strong data. The annualized rate in July jumped to 1.5mm houses vs about 1.2mm in June. Permits also jumped by 250k. Much of the strength was in multi-family housing (five or more units). Previously there had been conjecture that much of the strength in housing was being driven my speculative projects (construction without a buyer in hand). Given the strength in the Housing Market Index (builders are bullish by nature) and the dearth of supply, this could still be a factor.

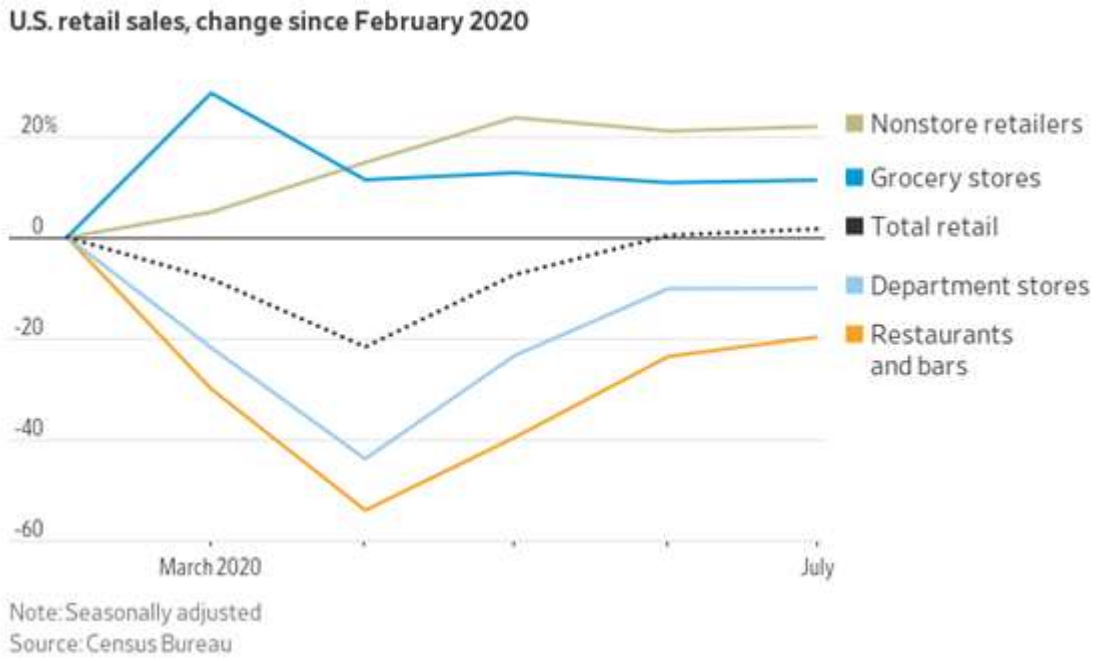
Of course, the one datapoint that has not been widely reported in the financial press is Mortgage Delinquencies. They shot up to over 8.2% which is a nine-year high. The delinquency rate on FHA mortgages (Federal Housing Authority which are for first-time buyers) jumped to 16%. This is one of the few data sets that exclude forbearance and other distortions.


And now for context, check out the next chart which shows this same delinquency rate along side housing prices. The two are not perfectly correlated (inversely correlated, actually, but that is why the delinquency rate is inverted below). But the breakdown seems to be when housing prices are cheap not when they are rich. Of course, as a friend points out, the giant caveat could be a dislocation in housing prices across different segments and regions of the country. But so far, the Zillow report seems to indicate this has not split yet.



- Retail Sales increase again, but are they too concentrated?

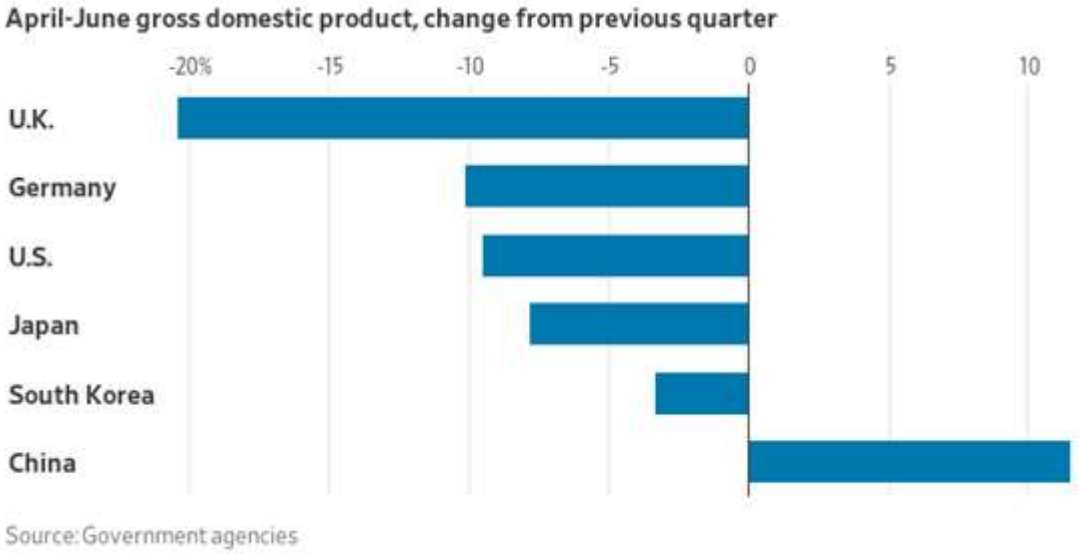
Retail Sales gained for the third straight month in July. Compared to pre-panic February, sales were 1.7% higher in July. Of course, federal stimulus money has run dry, so we could see these numbers dip again. Walmart said exactly this during its earnings call. Target, which had blowout numbers, commented that it was taking market share. This is great for Target, but that does not necessarily bode well for smaller shops. Home Depot (HD) and Lowe's (LOW) also reported strong earnings growth, but the allure of house projects might have come and gone.




The NY Fed's monthly report on Manufacturing (Empire) showed a decline in August. July was the first month to show a rebound, so this August data is a slight concern. We get more Fed surveys later this week along with some PMI data. They are expected to increase, so a faltering could lead to stock weakness (except for government stimulus, the Fed, stock splits, and all the other insanity driving the markets higher).

China's economic "data dump" for July was generally weak. Retail Sales stayed in negative territory vs an expectation of it to turn positive. Industrial Production remains strong on the surface, but it missed expectations (and this is the most easily manipulated data point). Fixed Asset Investment remains negative. Our interpretation remains the same: the communists can make companies make stuff, but they cannot make people buy stuff.

Here is a simple table showing 2Q GDP changes (measured against Q1). We know the virus hit China before anyone else, so its rebound came sooner. But nobody really believes this data.

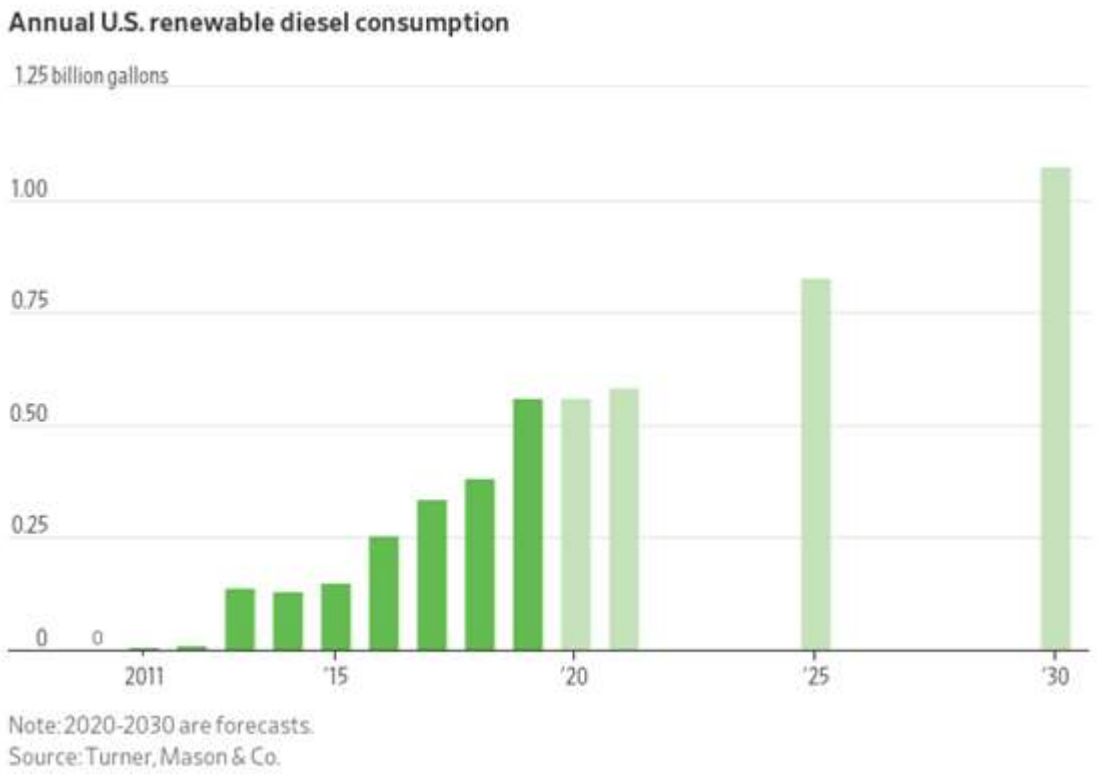



- The Fed senses more economic weakness to come

The Fed's FOMC minutes showed the usual confusion from its members. The general theme was the impact of the virus "would weigh heavily on economic activity, employment and inflation" in the near and medium terms. They did voice surprise at the strength in consumer spending. But overall, there was less improvement in the "business sector." The market reaction was just as mixed. The big mover was Gold which got slammed. Some slight US Dollar strength is being cited as the source of the gold weakness. But we think it is just a crowded trade (as evidenced in the Merrill Fund Manager Survey) that was ripe for some profit taking. We will buy more Gold if the dip continues.

- Chart crime of the week

Here is a classic chart crime. This was used in a Wall St Journal article describing a San Francisco based oil refinery switching to a "renewables" refinery. The chart is eye-popping…what growth! Of course, these are pie-in-the-sky projections based solely on California's regulatory trajectory. What if California continues its assault on business, and "renewables" keep growing like this chart suggests? Then vegetable oil and animal fat will account for just 2% of all diesel fuels.




- Quick Hits
  - Gold miners can extract 1.5 grams of gold per ton of rock extracted today. 10 grams of gold used to be the norm back in the 1970s.
  - US airfares were down 24% in July vs last year.
  - Citigroup accidentally paid Revlon's lenders $900mm. Citi wants the money back.
  - The average rate on a refinanced, 30-yr mortgage is 3.37%. The rate on a new 30-yr mortgage is 3.14%.
  - The TSA confiscated 15k guns in July vs 5k last July.
  - Barry Switzer did not fly during July.

*As a reminder, we use the term Big Tech to reflect reality. The S&P 500 classifies Amazon (**AMZN**) as Consumer Discretionary and Facebook (**FB**), Google (**GOOG** or **GOOGL**), and Netflix (**NFLX**) as Communications. Ergo, we use Big Tech as a catch-all for these tech-related businesses.

**Trading**: We have reduced our long exposure to the broad market and Big Tech. We have talked about this for a while, but we have held the line. But now we are starting to trim. But we are keeping our equity allocation roughly the same. We have added to our "trading" longs which include some of the big box retailers. We have

also added more to our conservative, quality companies that we think can thrive in the new environment while providing a cushion in the next downturn (Healthcare and conservative Consumer Discretionary). We have added a new factor exposure to our monitoring: a simple split between Recovery, Lockdown, or Agnostic. We have obviously been tracking this qualitatively. But now this added layer of specificity can let us know which way we are leaning at all times. The current breakdown is: Recovery 51%, Lockdown 41%, and Agnostic 8%. We fill pretty good about this diversification. We considered beta-weighting this (adjusting each position weighting for how sensitive it is to general market moves), but we think this will skew the data *away* from the current environment. Normally this would be a good thing. But we think having a skew *towards* the current environment is more important. We suspect these segments of the market will jump back and forth (in terms of performance), so we will use this as a rebalancing tool.

**TSLAQ**: Elon took to Twitter (TWTR) to once again promote Tesla's "Full Self Driving (FSD)." He said he hopes to have it rolled out in six to 10 weeks. Of course, he has been charging $5,000 for it for years now. He first stated FSD was a few months away back in 2017. But as usual, this is entirely irrelevant. The forthcoming stock split is driving the price action. We are still waiting for the S&P 500 to short this epic bubble.

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