Weekly Update

6 – December - 2021

Carlisle C. Wysong, CFA
Managing Partner

- Rotation ruling the day
- Bankruptcies plummet, not really
- Growth has not all been thanks to low interest rates
- Manufacturing continues to grow
- Don't Believe the (Chinese) hype
- Oil breaks $50 thanks to supply and demand
- Chart Crime of the week
- Full note is attached (IT manager on an extended holiday break)

	Last	5d %	YTD %	1yr %
SPX	3748	0.4%	-0.2%	18.0%
QQQ	313.0	-1.7%	-2.0%	44.6%
US 10 YR	1.03%	0.93%	0.92%	1.82%
VIX	25.1%	22.8%	22.8%	13.8%
Oil	48.31	4.8%	4.0%	-20.2%
*10yr and VIX are levels not changes				
** Oil is front month futures, beware				

Before the presidential election, we commented that even if people could predict election outcomes, they still could not predict the market's reaction to an election result. This was more evident than ever today as all the sectors that progressives hate rallied massively after the democratic sweep in the Georgia senate elections. The theory goes that *another* stimulus is coming down the pipeline imminently. Ergo, economic growth will be back and thus Financials and Energy should rally. Throw in the rotation theme that higher interest rates are bad for Growth stocks (especially FATMANN ex Tesla, nothing is bad for Tesla) – and we had some powerful moves. Never mind that Elizabeth Warren will do all she can to cause trouble for evil banks – the theory goes that they will still benefit from higher interest rates (despite the Fed suppressing interest rates in the short end, more government spending should move longer-dated rates higher…this is the old Yield Curve steepening we used to discuss). And do not worry about the crony-capitalism behind eco-friendly policies which will try to snuff out old fashioned oil and gas – nobody needs plastic anyway. The price of oil should increase with the free money and increased regulations on new drilling. Sarcasm aside, we understand the energy theme a bit. We would not want to be a wildcatter prospecting or a fledgling pipeline company. But entrenched characters might be able to flourish.

To be clear, we are not advocating for one policy or another (at least not in this venue). It is our job to figure out the most likely course of action by the government and the most likely beneficiary of this action. Obama (and the Fed) made more billionaires than anyone else in history. Alas, one thing we will advocate for is lower corporate and capital gains taxes. Biden and his congressional majorities are not likely to venture down their tax path in 2021, but most experts (???) expect a rollback in the 2018 tax cuts at the start of 2022. The most difficult needle to thread will be when the free money train stops and when the tax attack starts.

- Bankruptcies plummet, not really

Bankruptcies in the US during 2020 fell to their lowest level since 1986. December saw the lowest monthly total since 2006, so the trend is still intact. Wow! But wait…of course, like most stories with splashy headlines, the real news is in the details. Business bankruptcy filings (mostly Chapter 11) i*ncreased* 29% in 2020. Personal bankruptcy filings (mostly Chapter 7 and 13) are the ones that have experienced sharp declines. Obviously, government stimulus checks, forbearance on rent, mortgages, and credit cards, a freezing of credit scores, and a general inclination to not collect debts owed have driven the decline. With three of these likely to roll off (forbearance, credit score freezing, and nice guy feelings), we would expect this artificial outlier to reverse quickly in 2021. This is bad for banks, needless to say. But the banks provisioned massively during the first two quarters of 2020, so they might have a buffer (the banks essentially pre-booked the losses). But that is not to say the market will not be spooked.

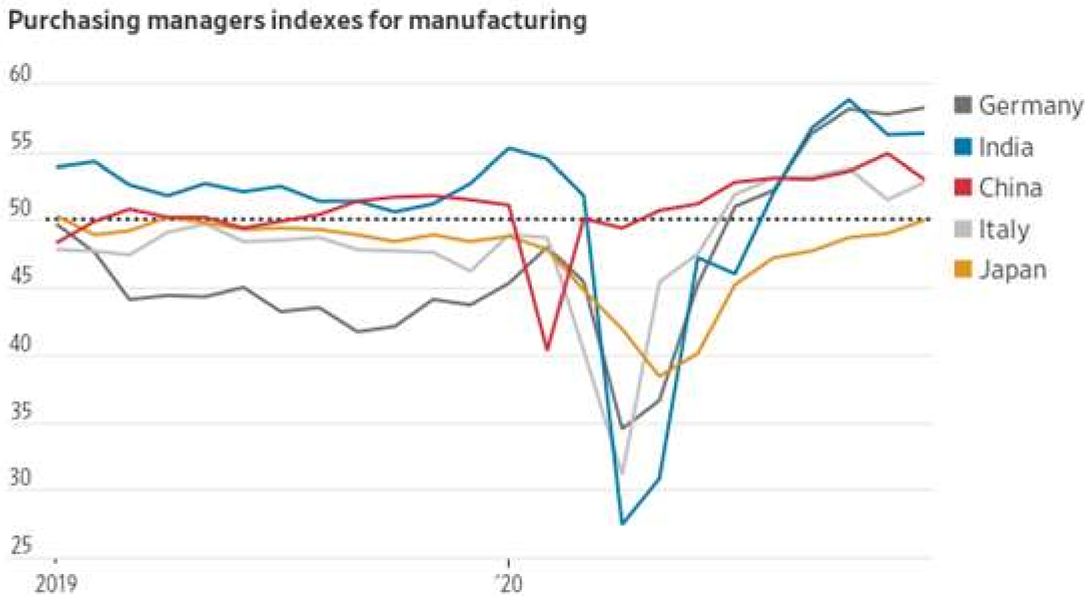
- Growth has not all been thanks to low interest rates

As we have discussed, many conflate Growth stock performance with low/zero interest rates. But what these skeptics forget is the incredible earnings power of these companies. Sure, low interest rates lead to easy money which can boost economic activity which can drive some earnings power…but rates alone cannot drive a non-financial company. The chart below shows earnings for the Nasdaq have flattened (during which stocks have continued to fly higher) …but they also have far outpaced anything else in the US or Europe (Stoxx 600). This gives us comfort in buying a prolonged dip (not there yet).

- Manufacturing continues to grow

One interesting angle to the increase in virus fear is the sustained increase in Manufacturing. While Services are still under pressure from lockdowns and capacity restrictions (not to mention personal decision making), other workplace environments are not. Some of manufacturing momentum can be attributed to the rebuilding of inventories. An increase in optimism is also apparent in the surveys. While there is obvious risk to both (inventories and optimism), keeping a part of the economy moving forward has been a major reason for continued stock market growth. As we said from the very beginning, what we really need is time. And being able to sustain some economic activity while we get the science (or lack thereof) sorted is paramount.

The December reading for the Markit Manufacturing PMI increased to 57.1 from 56.7. This is the highest reading since early 2014. The ISM Manufacturing surged even more with a 3-point gain back to near all-time highs. More to the theme, the Services PMI fell about 3.5 points in December. We are even seeing this trend play out in Europe and Asia. We have been worried about the stricter lockdowns and generally heightened sense of fear. But Manufacturing has kept improving.



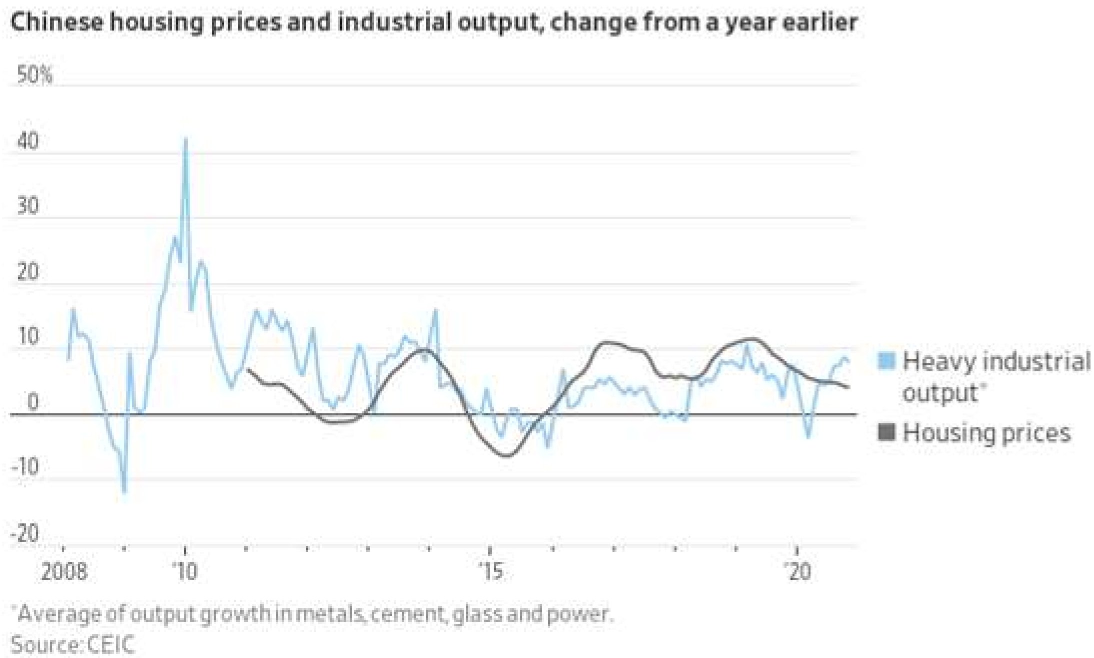
Note: Readings above 50 indicate activity is expanding, below 50 contracting
Sources: Caixin Insight Group (China), IHS Markit (India, Italy), IHS Markit/BME (Germany), Jibun Bank (Japan)

A close corollary to Manufacturing is Construction Spending. November saw 1% monthly growth along with an upward revision in October. This datapoint tends to mean revert because it is so broad. Underneath the surface, Residential Housing increased the most. Nonresidential spending on items like oil & gas projects and public construction fell during the month. We still like our relatively small long in Housing despite the higher interest rate theme working against it.

On the employment front, the ADP prediction for the official Unemployment Report surprised people with a drop of 123k private jobs vs an expected increase of 130k. We will get the official report this Friday including a Services/Manu breakdown. We suspect the recurring theme will, indeed, recur again.

- Don't Believe the (Chinese) hype

The Wall Street Journal had a good chart and blurb telling readers not to believe broad, macroeconomic data in China. Specifically, the WSJ noted the divergence between Heavy Industrial Output and Housing Prices. This is akin to our oft repeated assertion that the communists can make you build something, but they cannot make you buy something (industrial Production vs Retail Sales). The divergence is in the early onset, but we suspect it will continue/widen (or they will just change the data).

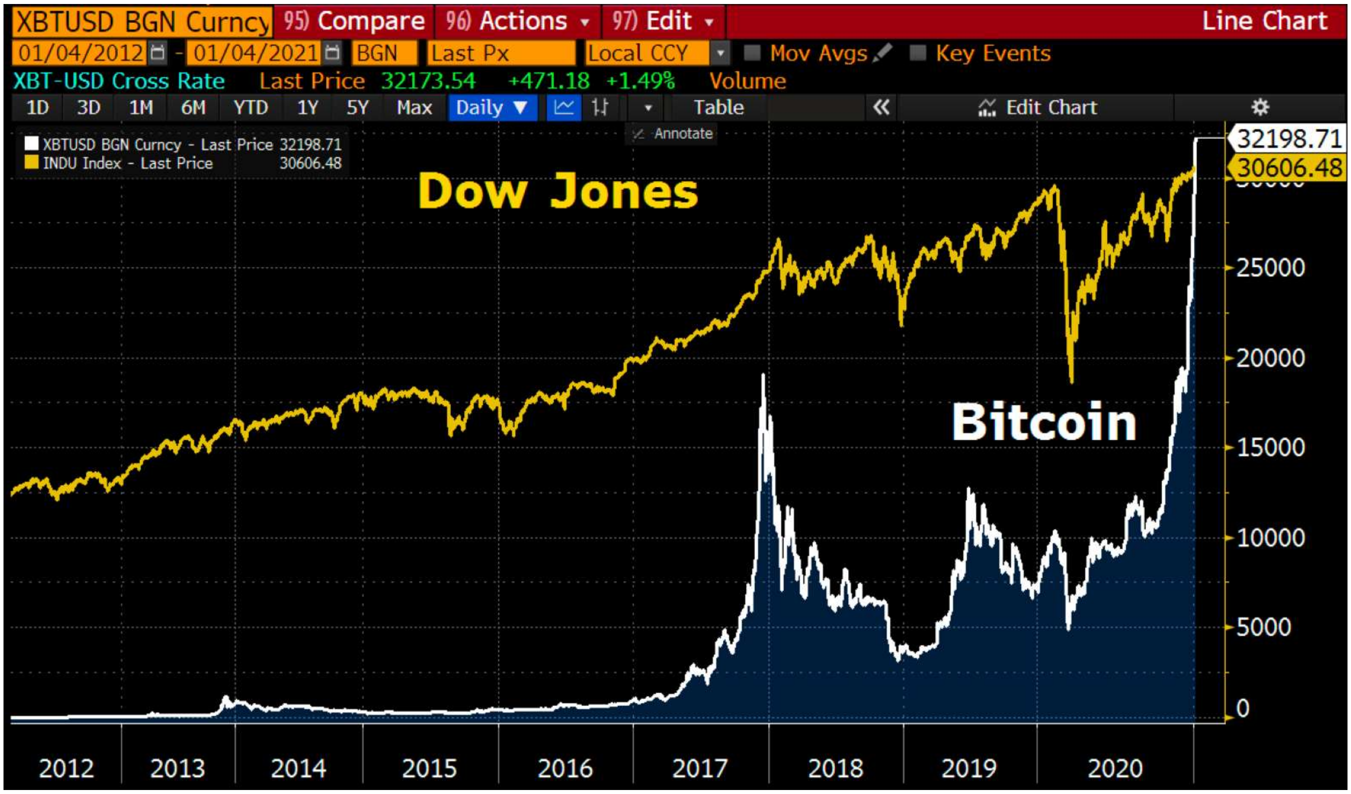


- Oil breaks $50 thanks to supply and demand

Oil has continued its grind higher thanks to early December's OPEC+Rogue production plans, macro views for higher inflation (being long oil is the best hedge for inflation), and an expectation of increased demand thanks to stimulus checks. But one headline that slipped through the cracks since it happened during Christmas week was that OPEC+Rogue would reevaluate its production every month (instead of every six months). Fast forward to the first monthly meeting, this past Monday, and we have Russia clamoring to boost production. But apparently Saudi was ready for the Russians this time. Saudi announced that it would cut its own production by an additional 1mm barrels per day starting in February. So, Russia (and the perpetual dissenters Kazakhstan) agreed to hold production steady in February. We will have to go through this song and dance every month now. But at least the Saudis know that the Russians are not their friends (of course it was the Russian and Saudi fighting that sparked the negative price plunge nine months ago). Oil also benefitted from some Iranian shenanigans in the Persian Gulf. Iran's revolutionary guard seized a South Korean tanker. Apparently, the mullahs are bitter about some funds that the South Koreans have frozen thanks to US sanctions. Moreover, Saudi's reconciliation with Qatar is likely to put more regional pressure on Iran. Qatar was seen as the only friendly state to Shia on the Arabian Peninsula (of course, the rebel Houthis in Yemen are backed by Iran, too).

- Chart Crime of the week

This might be the dumbest chart in the history of charts. It ticks all of the boxes of criminality: does not use percentages, arbitrary starting point, and compares a dollar gain in a security against a point gain in an index. It could be likened to saying, "I gained more weight than AT&T stock gained dollars."



- Quick Hits
  - The California utility regulator is allowing customers to pay *more* for electricity if they want.
  - China has suspended its top credit agency after a AAA rated coal miner defaulted.
  - Alibaba founder and Ant Group chairman Jack Ma has not been seen in public in two months…since he criticized the communist regulatory regime on TV. An anonymous source says he is "just laying low."
  - Apparently, there is a corner of the bitcoin world that only eats meat (perhaps raw beef sandwiches in Wisconsin?).
  - Morgan Stanley is worried about the exuberant speculation in the crypto market.
  - JP Morgan thinks Bitcoin can go to 141,000.
  - The University of Chicago "researchers" claim that a man who is 5'6" needs to make an additional $175k a year to be as desirable as a man who is 6'. No word on men 6'6"!
  - A House of Representative ended a prayer opening the 117th Congress with "Amen"…"Awoman."
  - 20-50% of healthcare workers in LA and Riverside counties are refusing the vaccine.
  - The House of Representatives are seeking to eliminate the words, "father, mother, son, and daughter" from the official rules.

Trading: We think we are prepared for any shifts in factor exposures…ie rotation. Our long position in High Growth stocks (another way to say this is High Valuation stocks) is tiny as we await a better entry point. We have reduced our long FATMAAN exposure substantially. We have some Energy and Financials. But we might need to add more. Our Tax Loss bucket is full of dogs which might ride this wave a bit longer. Of course, some of our consumer stocks are stuck in the mud. We are not sure if they are virus Recovery or Lockdown stocks. The narrative seems to swing back and forth. We suspect this will be a problem until earnings can convince one side. We have reduced our speculative SPAC positions, but we might buy these back on a solid dip. In general, we have added a few more "event-driven" names which should not dance with the market.

TSLAQ: The big news out of Tesla this week is that owners will be able to hook up their iPhones and keep their hands warm on the heated steering wheel. Seriously, the fanboys are celebrating these 1990 features. But hey, it is a technology company! The same group is also celebrating Tesla just barely missing the company's production goal. Nowhere else in the financial world does coming "within a hair" somehow mean beating the expectation. And with this "milestone" of 500k cars produced in 2020, the likes of Morgan Stanley are now forecasting 5-7mm sales for 2025. Of course, the stock rallied on the miss and the ebullient report from Musk's personal banker (Morgan Stanley)! We do not get earnings until early February, so might have to close our short and re-open it then. As our option live-stream likes to say when it comes to Tesla, trade small and trade often!

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