Weekly Update

20-September-2023
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- Is the equity market listening to the Fed now?
- Japan Earnings look the best
- Credit Card data delinquencies hitting where it hurts
- Housing data is mixed but still turning negative
- Obviously, it is the government doing it!
- Retail Sales follow-up
- Is China turning? (We doubt it)
- Are the Chinese stockpiling oil and refined products?
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,402	-1.1%	15.9%	14.7%
QQQ	$364.54	-2.4%	37.5%	26.1%
US 10 YR	4.41%	4.26%	3.88%	3.53%
USD/DXY	105.4	104.8	103.5	110.6
VIX	15.1%	13.5%	21.7%	28.0%
Oil	$90.27	2.0%	12.5%	-1.8%

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

Just when the market lulls you back to sleep, it decides to change its mind (and act rationally). Last week we commented that some bad economic data was being ignored by equities but not bonds. The toxic combination of higher rates and a slowing economy was lost on the stock market. We are still seeing some high-profile earnings disappointments. But these have not translated into widespread worries (Adobe was the latest this week after Oracle last week). The Chinese stock market cannot get out of its own way despite another barrage of mini-stimulus measures. (There was some improvement in economic data in August. But the real estate market is still in disarray. And this sector accounts for about 30% of the economy.) In the US, worker strikes are obviously a problem at a company level, but they rarely amount to much on a larger scale. But when Big Labor channels its inner Lenin, inflation fears are stoked. Strikes resulted in 4.1mm days of missed work in August. This is the largest monthly total since August 2000. The usual monthly rate is anywhere from 0 to 500k. Not to mention, the US government might shutdown (a gentle reminder that not many of our lives change when this happens…but the short-term result is a drag on the economy). The much-hyped IPO market is turning into a dud unless you are one of the elites that gets stock on the deal. Of course, the ones hyping the deals are the ones selling the deals.

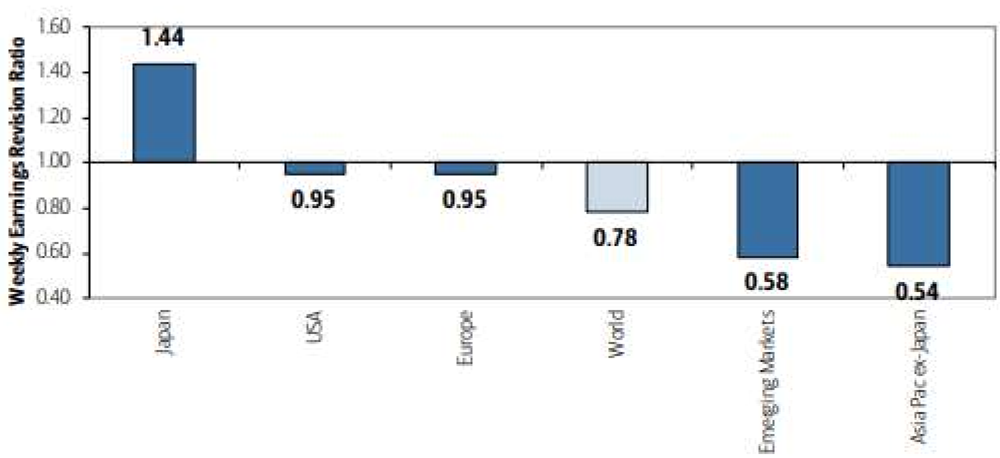
But along comes the Fed. Jerome Powell delivered the message they have been broadcasting for some time. Interest rates will be higher for longer. The operative word here, which we have tried to emphasize, is *longer*. Even with another likely 0.25% hike coming, the Fed's "dot plot," which is the aggregation of their admittedly flawed forecasts, now only shows a slight cutting of interest rates next year (0.25% vs 0.75% previously…and the market was around 1%). The good news is that Powell played up the strength in the economy. By extension, the more defined path for rates (lower volatility in rates) could provide a smoother landing for the economy (smoother does not necessarily mean "soft" and it certainly does not mean "no"). Unfortunately, the Fed did not lower its forecast for inflation, so that should keep the dial turned up to 11 in terms of tight monetary policy. And do not forget about the Fed's balance sheet. They have chipped away about $800b from its peak of $8.9t. The bad news is they have $4trillion or so to go.

Through all this, it is worth repeating that the bond and currency markets have been forecasting this correctly. It is the equity market that has been standing on its own. We are positioned for a pullback. But we are not expecting a crash. We still think stagflation can take root. But Big Tech and Energy are two areas that typically do well in this backdrop. We will use our large cash position to slowly add to Quality companies that can weather any potential storm. And we will still bet against those that cannot.

- Japan Earnings look the best

Merrill's Earnings Revision Ratio shows that analysts are most bullish on Japanese equities. This ratio does not quantify the amount of the revisions, but this high of a ratio shows the breadth of Earnings strength. This is another reason we like broad exposure to Japanese equities. The improving economic data is impacting companies across the board (this makes it easier for a US investor who can just pick a basket/ETF instead of trying to nail stock specifics).

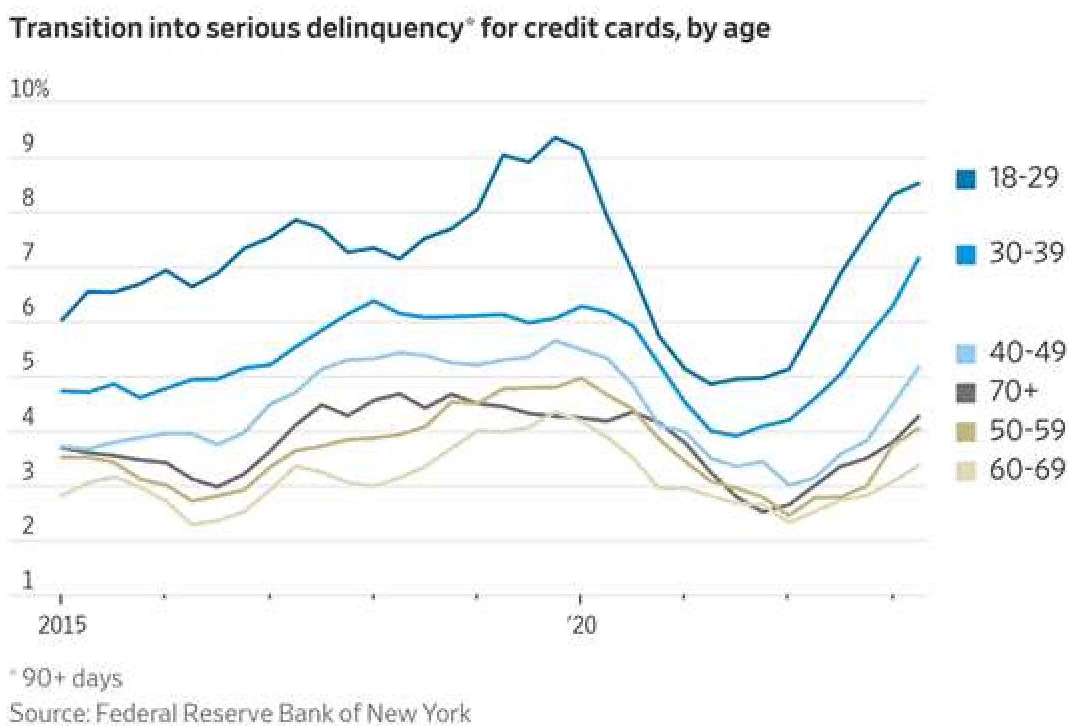
Chart 19: Global Regions Earnings Revision Ratio - Weekly
Asia Pac ex-Japan has the weakest earnings trend



Source : BofA Global Quantitative Strategy, MSCI, IBES

➢ Credit Card data delinquencies hitting where it hurts

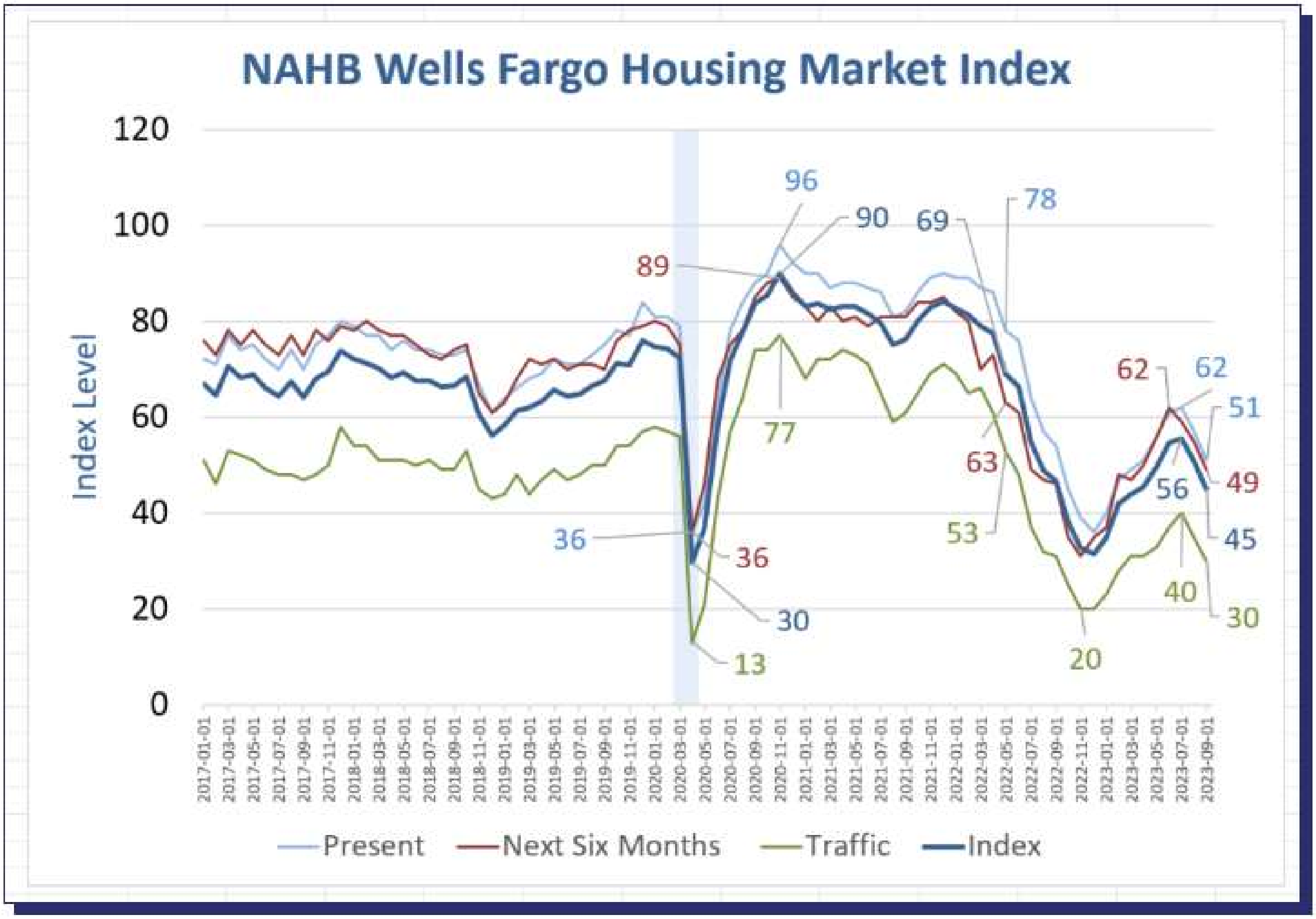
We have written repeatedly about the $1t in credit card, increasing delinquencies, and student loan repayments restarting. Some ivory tower types have dismissed this data because disposable income is seemingly higher. This might be true in aggregate, but tell that to the ones struggling to pay back their debt. Here is a WSJ chart showing that the ones with the most student loan debt (we are extrapolating this from younger people) are starting to fall behind the most on their credit card debt.



➢ Housing data is mixed but still turning negative

Redfin reports that almost 60k contracts to buy a house were canceled in August (buyers doing the canceling). This is 15.7% of all homes under contract (with an average loss of earnest money of about 1%). This is up from 14.3% last August. It is the highest cancelation rate in about a year. Conversely, Zillow reports that home listings increased about 4% in August vs July.

The Housing Market Index (aka homebuilder sentiment) fell for the second straight month after improving January through July. The 45 reading means sentiment is back in negative territory. Incentives offered by builders continue to climb. Prices were cut on 32% of homes listed for sale versus 25% in August. Prospective Buyer Traffic remains the weak point. But all of the subcategories have turned south.



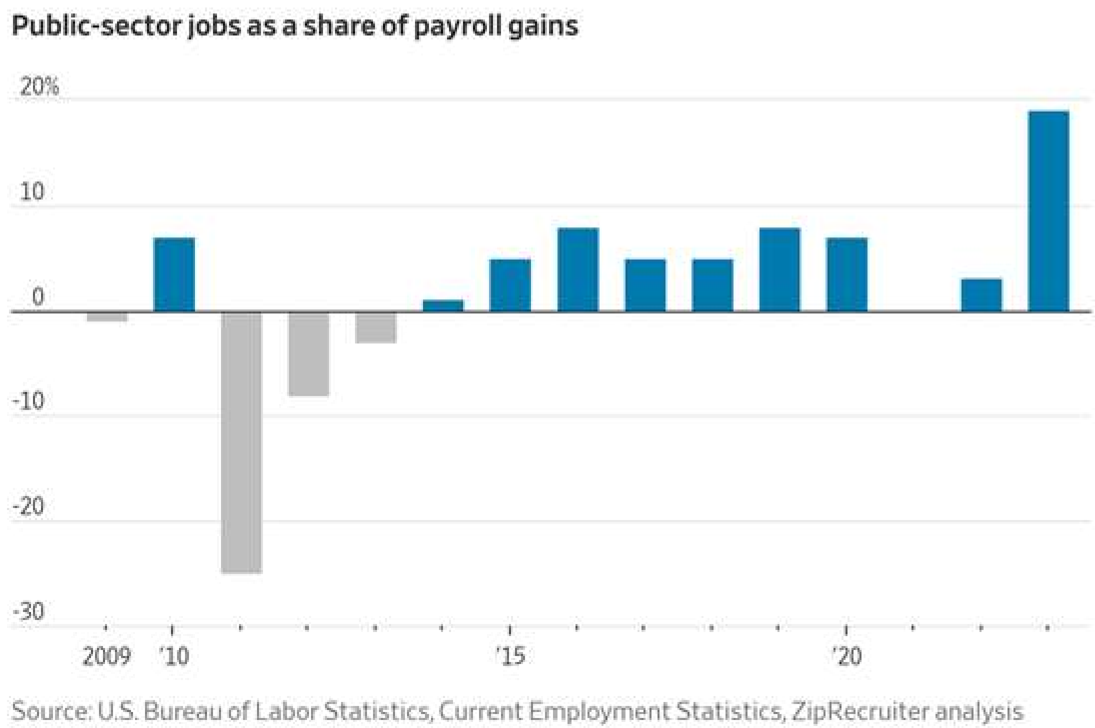
HMI data courtesy of the NAHB, chart by Mish

Housing Starts and Building Permits diverged in August. Permits increased vs July and beat the expectation. Starts dropped and badly lagged the expectation. This Starts data hit its lowest reading since the early recovery to the Virus Fear (summer of 2020). Permits are almost back to their level from a year ago. This data usually and logically correlates with some lags. But they appear to moving in opposite directions now. It is only a blip for now. And while much of the Housing data has been showing some weakness, we will side with Permits and call this data positive on the margin.

Overall, Housing data is slowing worsening: More buyer cancelations; souring builder sentiment; weakening Housing Starts. Only Permits (a good leading indicator) have turned higher.

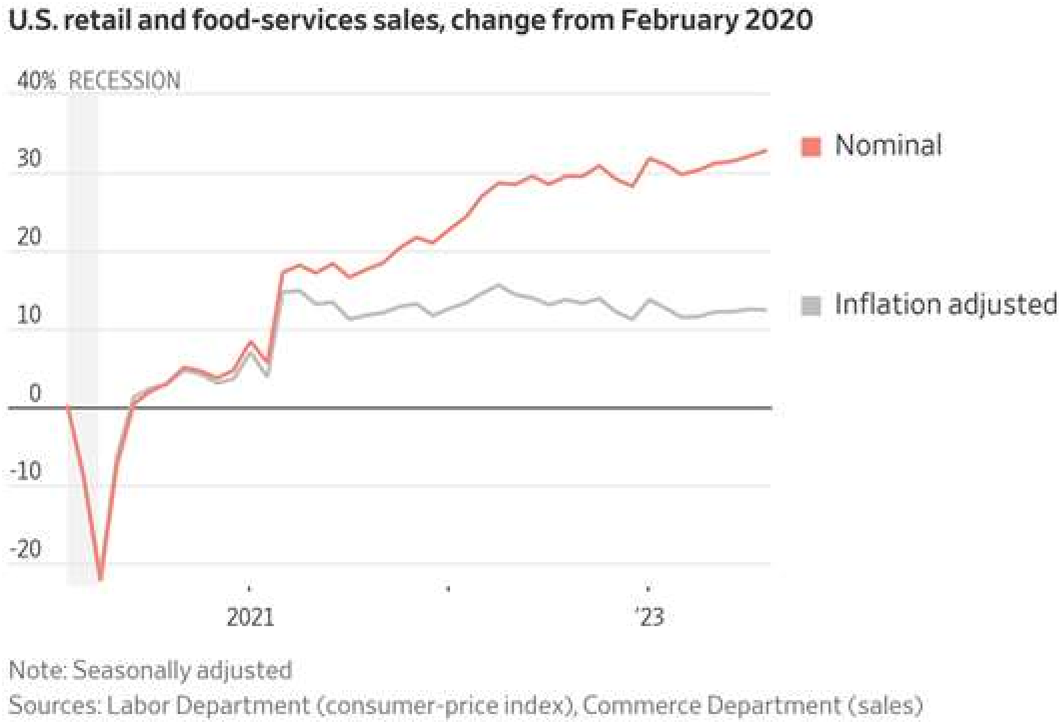
- Obviously, it is the government doing it!

The WSJ reports that job growth this year has been skewed by the government. Typically, the government accounts for 5-6% of the jobs created in a year. But this year…it is 19%! Some of these are refilling positions that were abandoned during the Virus Fear. But it is still the silent stimulus at work.



- Retail Sales follow-up

We need to add some more color on last week's strong Retail Sales. Specifically, gasoline prices were a major contributor! We always note that this data is not adjusted for inflation, so it has looked much stronger in nominal terms vs reality. But we did not mention this last week when it was probably most important! So, Retail Sales are still stronger than we would expect. And they are still a pocket of relative strength. But do not be fooled by the stagflation dynamic at play.



It is worth adding that the weekly Redbook Retail Sales data appear to be rolling over. We will need more data. Some of the categories that stand out (on the potentially slowing side) are Beauty, Home Improvement, and Consumer Electronics.

- Is China turning? (We doubt it)

The Chinese economy showed a glimmer of growth with stronger than expected Retail Sales (4.6% vs last year compared to 2.5% in July). Urban unemployment ticked lower to 5.2% in August from 5.3% (the communists still will not release youth unemployment statistics). And Industrial Production increased 4.5% in August vs the 3.9% expected. Of course, most of this is fabricated by the communists. We will reserve judgement until we have more concrete evidence of a turnaround (including data on western companies selling in China).

- Are the Chinese stockpiling oil and refined products?

The latest narrative pushing the bull case in oil is a supposed economic resurgence in China. The better-than-expected economic data (be it legitimate or not) is making people think China is a new source of demand for oil. While we do not believe the Chinese economy is doing any better (export and import data and private PMIs are the only semi-reliable data and they still stink), there are reports that refinery runs (lingo for oil consumption by refineries) in China have reached an all-time high of 15.2mm barrels a day. We would tend to believe that this means the communists are stockpiling refined products. Put another way, the old school Xi regime is just doing busy body work to keep the masses happy. The skeptics out there might say it's the Chinese preparing for war.

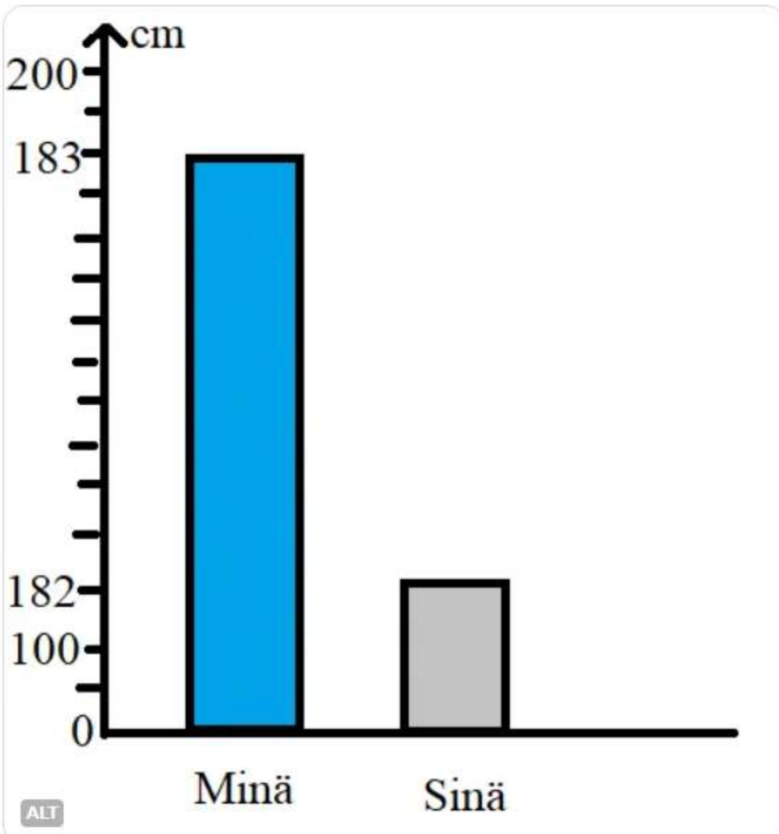
There are also some rumors/reports that a single trader (a unit of Total Energy of France) "is fueling a price runup for US barrels." The story is light on details. We suspect that is telling. Nonetheless, historically high refining margins are surely contributing to traders speculating.

- Where did all the crypto money go?

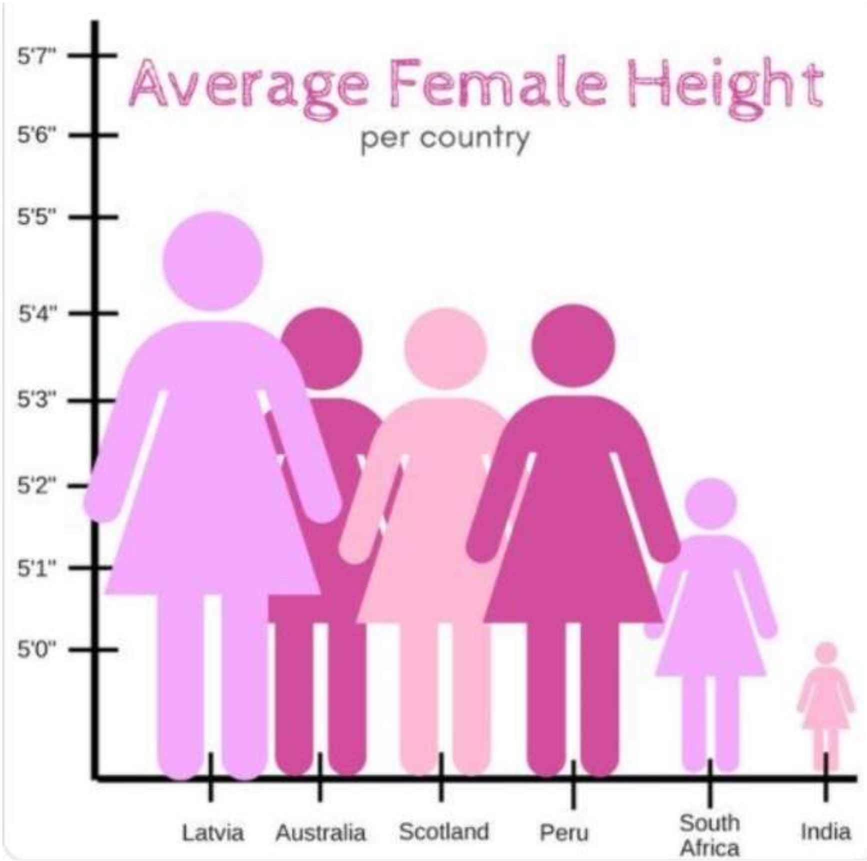
Byju, an Indian tech/education company, is being sued by its creditors to recover over $500mm that has been misappropriated. Allegedly (probably), the company hid the money in a Miami "hedge fund" that was based out of an IHOP. We cannot confirm that crypto played a role in this heist, but we bet there is a connection when more details are revealed.

- Chart Crime of the week

This is a chart of some guy in Finland comparing his height (mina) to his friend's height (you). We are not quite sure why this was posted or what it really means. Perhaps it is a joke.



Then again, this does remind us of one of our all-time favorites which was most definitely not an itentional joke:



- Quick Hits
    - Lyft agreed to pay a $10mm fine because of some slippery action by one of its directors before it went public. This director "received millions of dollars in compensation" as he arranged for the sale of pre-IPO shares from one investor to another. The buying investor was a Special Purpose Vehicle he set up acting as an investment advisor.
    - Property insurance in Louisiana is about 3x as expensive as the national average. Some blame global warming. (We suspect corruption plays a role.)
    - The Colorado-Colrado State football game on Saturday night was ESPN's most watched late primetime game ever.

Trading: We are still trimming our Staples and adding to some select Big Tech. We also bought some more Put protection. This has been small bits. But, we are being more targeted in our approach. That is, we are adding an element of long/short or relative value to the book. Instead of just looking for shorts in crappy companies (etc), we are looking for crappy companies in an industry in which we already have a long position. We have utilized this portfolio construction throughout our career. It typically becomes more important during phase or cycle transitions…which we think we are entering.

TSLAQ: Musk announced that the first human patient will soon receive one of his Neuralink devices. We will cut to the source with the gobbledygook:

Elon Musk
@elonmusk

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The first human patient will soon receive a Neuralink device. This ultimately has the potential to restore full body movement.

In the long term, Neuralink hopes to play a role in AI risk civilizational risk reduction by improving human to AI (and human to human) bandwidth by several orders of magnitude.

Imagine if Stephen Hawking had had this.

In typical Muskian fashion, he is just making up stuff with nonsensical wording.

What is not nonsensical is Musk's timing. This story was published right on the heels of the revelation of another Musk scandal. He is being investigated for misappropriating Tesla money for personal use. Well, no kidding…he has pilfered the company for a quarter of a trillion dollars. This would normally be so low on the Musk criminality totem pole it would hardly be worth mentioning. But the report tells us that it is Tesla's recently resigned CFO who is spilling the beans. This guy was once considered the heir apparent to Musk at Tesla. If he is indeed turning state's evidence, Gummy and Fat Sam will be proud.

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