Weekly Update

7-Dec-2022

Carlisle C. Wysong, CFA
Managing Partner

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After last week's blip of stupidity, the market is back behaving rationally. Powell has not changed his mind about the trajectory of interest rates. Some hard data showed that the Fed has more work to do on cooling inflation (strong payrolls with higher wages, and some better soft data in the form of corporate optimism). Powell has repeatedly said that the Fed does not have a direct tool to alleviate tight Labor supply. With wage inflation setting up to the be most troublesome (came on with a lag, but it is picking up steam, and it is the hardest to reverse), this lack of Fed tool is particularly worrisome. The Fed's indirect tool is to create a recession which results in layoffs. The punditry declaring December would be the last rate hike was exposed for the foolishness that it is. Softish is, indeed, worse than soft when it comes to the (over-used) landing of the economy.

The other nonsensical narrative was that a reopening in China would boost the global economy. If this supposed change in 0-Covid policy were to take affect and life would somehow revert back to normal, this would still not translate into an increase in global aggregate demand. And this week's release of the November Merchandise Trade data speaks volumes. China's Trade Surplus shrunk from over $85b in October to under $70b in November…exports are shrinking at an alarming pace (imports were down, too). We are not believers in Xi returning power to the people. But even if he were to, it is likely predicated on the slumping economy (private PMIs have dropped for three straight months) and not some new view of the virus.

- Another shoe dropping in the real estate market

Blackstone, the giant private equity firm, has limited redemptions from its $70b BREIT fund. It owns real estate across the gamut (commercial to residential). Analysts note that BREIT was often the only bidder at real estate auctions. And now this paragon of real estate genius has closed off redemptions. It is the largest private REIT (not listed on an exchange). There has been some reporting lately that the prices of private REITS are much higher than that of their publicly listed peers. The logical conclusion is that they are marking their assets too high. We think this is a big story. Private Equity funds always do this…they inflate prices and refuse to mark assets to the current market. That is mostly an accepted way of doing business since the money in the funds is theoretically long duration with long lock-up periods. But when these practices are used in a more mass-market setting, that could spell trouble. It is the equivalent of borrowing short to lend long. And on the heels of the BREIT gate (the term for closing or limiting redemptions), Starwood Property Trust restricted redemptions from its SREIT structure. (For what it is worth, a publicly listed REIT, SL Green which focuses on NYC, cut its dividend this week.) On top of this, another Blackstone fund, its private credit fund (BCRED) is also limiting withdrawals. This is more focused on IT companies, but the same dynamic is at play. Investors with artificial gains across these mark-to-make-believe structures are starting to catch on. They are rushing for the exit…only to find the doors locked like Crazy Joe Clark did in Paterson, NJ. We are short private equity for this reason.

- Positioning semantics are important

Goldman is out with a note about hedge fund positioning in TMT stocks being extremely light (Tech, Media, Telecom). For starters, the grouping of these sectors has long passed since the likes of AOL and Nokia are no longer considered advanced technology. Nonetheless, the note describes hedge fund exposure as "underweight" compared to the S&P 500. This is even more confusing as no hedge fund benchmarks against the S&P (and surely not against an amalgamated, nonsensical, super-sector like "TMT.") Our valid nitpicking aside, this 5.2% "underweight" means hedge funds are *still long* Technology, Media, and Telecom. The total weighting of these sectors in the S&P 500 is currently 33.9% (Information Technology at 26.4% and Communication Services at 7.5% with the latter being the latest iteration with Media and Telecom combined). So the Goldman data is telling us that hedge funds are still extremely long "TMT!"

Merrill's update on positioning tells us that their customers have bought equities for four weeks in a row. Tech has been the aggregate winner. The biggest loser has been Communication Services (which is likely focused on META selling). We maintain that the market is not overly bearish (the last few days notwithstanding).

- Employment Report: The Fed can only do so much about it

The Labor market appears resilient despite all the layoffs, declining Job Openings (not to mention the fake openings), and now declining temporary jobs. Nonfarm Payrolls in November registered 263k new jobs. This compares to October's 281k jobs which was revised higher from the preliminary 261k jobs. The poor ADP guess from earlier in the week (127k) lowered expectations, so the 263k was seen in an even better light. But the majority of the surprise came in the form of government jobs. And there were fewer Manufacturing jobs added. On a sector level, Food Services and Healthcare gained the most jobs. General Merchandise Stores were the big loser. The Labor Participation Rate downticked to 62.1%. The Unemployment Rate remained steady at 3.7%. But beneath the surface, this was still a loss of 138k. This is that discrepancy between the two employment surveys. Most professional guessers (economists) now believe the Household survey (the one that determines the Unemployment Rate) is more accurate.

Ergo, we do not think this data is as strong as the headline suggests. However, as for strength in the data, the Average Hourly Earnings did increase at a faster clip (+0.6% vs 0.5% in Oct which was revised higher from +0.4%). The annual increase is 5.1% which is now above some measures of inflation (more below). To sum it up: The Labor market is not as strong as it seems. The Fed is likely focusing on the headline data (they probably

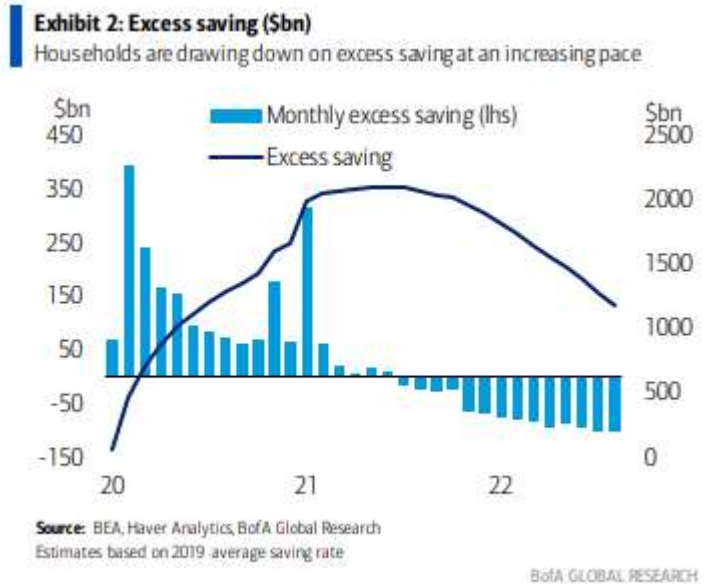
are not as jaded towards government jobs as we are!). And wage inflation is still running hot. The Fed will continue to hike rates into a stagflating economy (even if other inflation starts to cool, disinflation from a high level is not much solace to those losing their jobs).

- Inflation might be cooling, but prices remain painfully high, especially where it hurts (see above)

The Fed's preferred inflation gage, the Personal Consumption Expenditure Price Index (PCE), slowed in October. That is not to say prices went down – just the increases slowed. The Core PCE (excludes food and gas) moved 0.2% higher compared to the 0.5% increase in September. The annualized rate was 5.0% (down from 5.1%). The headline rate remained steady at 0.3%. The annualized rate dropped from 6.2% to 6.0%. But again, Average Hourly Earnings increased at a faster clip in November. This is the number to watch.

- Savings, Consumption, and Credit Card Debt: Bad all around

The burning of Savings is accelerating on the downside. This drawdown of Excess Savings is now running at an annualized pace equal to 3.5% of GDP. And as you can see from the first ML chart below, the spending is accelerating with the Excess working its way back to pre-virus-fear levels (not there yet, but it will not be long).



The Personal Savings rate (current savings as a percent of disposable income) is logically following the same trend lower. In fact, the rate is the second lowest in 80 years of data according to Hedgeye.

Exhibit 3: Personal saving rate (%)
The saving rate could go negative if excess saving is drawn down rapidly

Source: BEA, Haver Analytics, BofA Global Research

BofA GLOBAL RESEARCH

Revolving credit has been filling in the spending gap. That is, people are wracking up credit card debt to keep the spending dream alive. Delinquencies and Charge-offs are moving higher. They are still at moderate levels considering how low they were during the virus-fear times. But this is a trend to watch.

Auto Sales fell in November after having bounced sharply in October. The annualized rate slowed to 14.1mm from 14.9mm. Before last month (the 14.9mm), the average was about 13mm to 13.5mm with an upward trend. We suspect this rollover seen in November will continue. The backlogs that stymied sales (the semiconductor shortage was often blamed) has been cured. And inventories are on the rise (still well below 2019 levels, but they are trending higher).

Airline travel is starting to slow (although AmEx travel spending seems to be resilient). Of course, the airlines are starting to cave on pay demands at just the wrong time (Delta pilots signed for a 31% increase spread over four years).

And three big bank CEOs all voiced concerns about the slowdown of consumption (GS, JPM, BofA). And as for the credit card companies, Discover highlighted a slowdown in retail spending despite the surge in overall credit card debt.

- PMIs continue to signal recession

ISM Manufacturing for November fell below 50 for the first time in over two years. Employment and New Orders also sunk to their lowest levels post panic. The Prices Paid segment continues to fall…and this is good news. The other PMI (by Markit/S&P) remained steady, but this means negative. Globally, Manufacturing continues to shrink. As you can see from the chart, purchasing managers (the P and M in PMI) are rarely wrong about the direction of the economy.

The US Services data is split. The ISM, more global in nature, bounced higher and sits at about the average of the pre-panic average. Of course, this is still near the bottom of the post-panic period. Oddly, this is the PMI datapoint on which the market focused. We do not think it changes the Fed's thinking, but if makes the market wake up to the reality, then we will take it.

- Construction Spending: Housing is the still the drag

Construction Spending for the month of October fell again (two of last three months). The trend is squarely flat if not negative. The weakness was again driven by slow residential spending. Single-family homes are the drag while multi-family housing remains positive. Spending on Religious projects was the lowest on the non-residential side (we have no idea what this means…it just stood out to us).

- The NY Fed usually knows what it is talking about

John Williams of the NY Fed had the best line of the week:

> The latest reading showed the PCE inflation rate, the one that we're focused on, is at 6%. And we want it to be 2%. We need to get from 6 to 2. Honestly, I think this is going to take a couple of years.

It does not get much clearer than this. Obviously, Powell controls the Fed. But the NY Fed president always provides the most market-based data to the Fed as it does all of the market transactions. This is one reason why this role has a permanent vote on the Fed Open Market Committee (policy setting). The other regional presidents all rotate. We heed what Williams is telling us.

- Oil supply is tightening

OPEC+ has decided to keep its headline oil production cuts at 2mm barrels per day. There were some refuted rumors that the Saudis et al would reverse their recent decision and start increasing production. With oil prices much lower than when the Saudis announced the production cuts, this was a no-brianer.

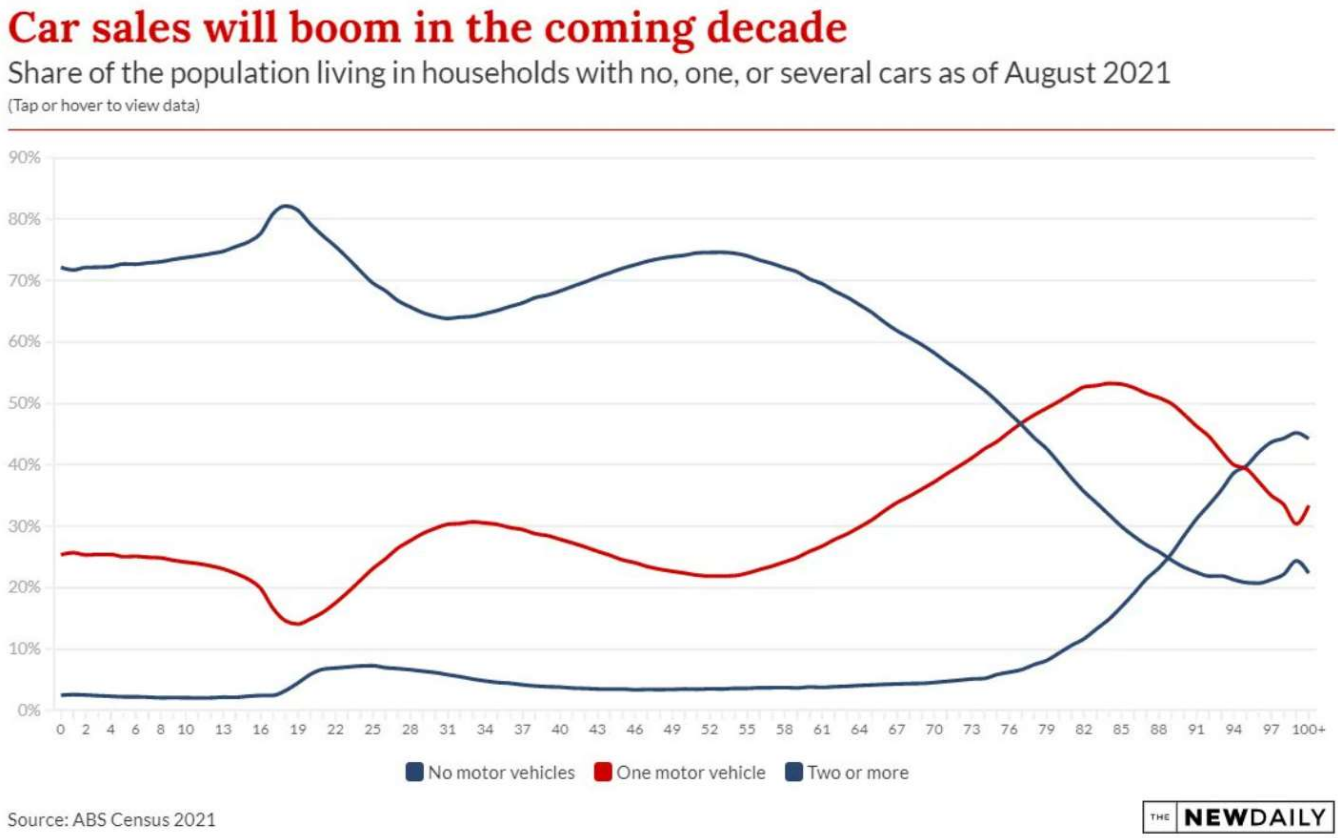
The much talked about price cap on Russian oil has been set at $60. Price-caps are silly even in a world of sanctions. But one benefit of the new system is the confusion it is causing for the logistical players in the space. That is, while Russia was frantically exporting as much oil as it could before the cap took effect (one of the reasons for weakness in global oil prices which we have discussed), shipowners are now backing away from providing tankers to the Russians. The resulting increase in shipping costs for the Russians to deliver oil to India or China has jumped between $20 and $25 per barrel. Russia will most likely not be able to sustain its level of exports nor its production since its storage facilities are not great. (The Us has roughly 1.4b barrels of capacity. Russia has about 285mm.) Again, the falling demand for oil is real. But so is the falling supply.

- Crypto…where did all the money go (again)?

Last week we discussed the losing Grayscale pseudo-arbitrage trade. The Financial Times lays out another great trade gone wrong. And by "great" we mean idiotic. We know that FTX lent its affiliate Alameda $USD (real money) with Alameda posting FTT tokens (fake money) as collateral. But other counterparties did this scheme against FTX, too! Last year, the fake money MobileCoin moved from $6 to $70 in a flash. And lo and behold, right at that peak price, someone was able to borrow $1b (real money) from FTX while posting MobileCoin (fake money) as collateral. When the artificially boosted price of MobileCoin crashed back to earth, the conniving borrower vanished with the real money and left FTX holding the bag (filled with fake money).

- Chart Crime of the week

This is a stylistic gripe. Why are the two blue lines almost identical in color?



- Quick Hits
    - Switzerland is contemplating various measures to conserve energy. The list includes: Temperature restrictions on refrigerators, shutting off the heating in "discotheques", streaming services limiting resolution to standard definition, banning gaming computers, and limiting the use of electric cars.
    - Switzerland usually imports electricity from France. But as we know, France is going back to horse and buggies.
    - Foreigners often get robbed of their clothes in Venezuela.
    - BlockFi, the bankrupt crypto "exchange" that is entangled with FTX through roundtrip loans and cross collateralizations, tried to draw down $125mm from a line of credit it had with FTX while FTX was imploding. Nice try, BlockFi. FTX said no.
    - Iran has abolished its "morality police."
    - New York state has a new law that censors and guides speech online.
    - Pabst sells a case of 99 beers. It is called the Family Pack.
    - As much as $4b of loans to crypto miners might be in default. The collateral is mostly the mining "rigs" (the computer equipment used) which have dropped about 85% in value.
    - Half of the men's World Cup soccer team prize money is going to the women's team.
    - The co-founder of Minorities in Shark Sciences think Shark Week is racist and discriminates against women.
    - The European Union, through its Trade and Technology Council, are upset with the US's future use of subsidies for "green" energy and how it could lead to "unfair competition." The irony is not lost on us, but it is perhaps on the EU.

Trading: We rotated some our short exposure out of Recession into Fantasies and Frauds. This goes back to our belief that the market is showing some signs of rationality at least in terms of rotations. We obviously still believe that Recession exposure will be right directionally, but the timing and magnitude are trickier. The F&Fs have much more downside with more actionable timing. We also trimmed a touch more Energy. This space is succumbing to the recession narrative which is rational. But we still think limited spare capacity and prudent mgmt. teams will be able to deliver high returns. So, we are lining up to buy this dip (not quite there yet and not necessarily what we sold). We also bought some more USD. The greenback has pulled back under the fake pivot veil.

TSLAQ: Musk has turned his attention back to his Neuralink project. This is the sci-fi that he claims can make blind people see and paralyzed people walk. And you can have a chip implanted in your brain that will more align your thinking with artificial intelligence. In the same vein, he sells Full Self Driving software which cannot drive by itself.

As for Tesla, Musk quietly snuck a $3750 discount into the list price of the model 3 and Y if you order and take delivery in December. Musk is the king of stuffing the channel (pulling sale forward). We are sure the bulls will claim this was born out of high demand. Speaking of demand, Bloomberg reports that Tesla Shanghai is cutting production by 20% because of decreasing demand. Tesla sorta denied this. In the past, even the wimpiest of denials would be enough to send the stock rallying. Not anymore.

And as for the much-ballyhooed Semi truck being delivered to Pepsi, it turns out it is another example of government subsidies. Pepsi is taking part in a zero-emissions freight project that was funded by the California

Air Resources Board. It amounts to over $15mm for electric trucks and tractors. Nobody is buying the Semi with their own money.

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