Weekly Update

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- The rallying beat goes on
- Is waning corporate optimism foreshadowing weaker earnings to come?
- GDP lull, jobs slowing coming back, it is all about the Savings
- Housing not yet picking back up
- Services are picking up steam again
- The Fed's inflation is not as high as everyone else's inflation
- Is the Labor market stronger than the economy?
- Fed's Powell walks the tight rope
- An energy crisis of Europe's making
- Mexican oil bonds
- Chart Crime of the week

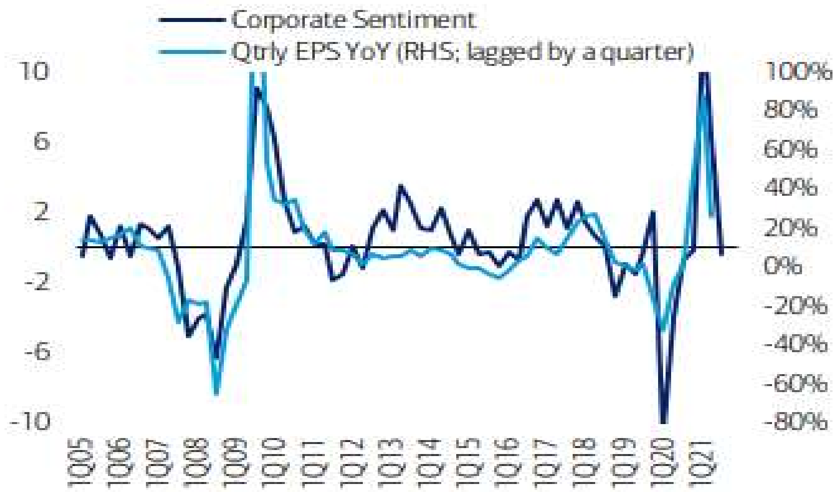
We find it funny that the market needed some good news for a relief rally…while it sits at an all-time high! But that is what we got with today's Federal Reserve announcement. The Fed will slowly cull its bond purchases as expected, but it is not thinking about interest rate hikes right now. To be fair, we have noted that the recent flattening of the yield curve (difference between 10yr and 2yr Treasury yields) was suppressing some aspects of the market. We thought it might be fears of an economic slowdown induced by higher short-term interest rates. But we suspected it could just be market positioning twisting and turning as it is wont to do. Whatever the case, the market was, indeed, relieved when Powell made it clear that the Fed was not going to follow down the path of the Bank of Canada, the Reserve Bank of Australia, or the Bank of England (all central banks that have indicated interest rate hikes just around the corner). Of course, the market had already started to show off some of its typical resiliency after the less than hoped for earnings from Apple and Amazon. So maybe the market was not looking to be relieved with good news…it was just looking to eschew any mild hiccups. That is certainly what it has done since the virus-fear hit (and since the World Financial Crisis before that).

- Is waning corporate optimism foreshadowing weaker earnings to come?

As of Monday, 3Q Earnings (55% of the S&P companies but about 75% of S&P 500 earnings) are beating consensus expectations by 7% according to Merrill (consensus is always more art than science). But management guidance and future earnings estimates (typically based on management guidance!) are not as rosy. Estimates for 2022 have remained virtually flat to those before earnings season. Earnings tend to lag sentiment by one quarter. We counter this historical relationship (which we agree looks compelling) by highlighting the central cause for concern: supply chain problems. Demand continues to be robust.

Exhibit 13: Weaker corporate sentiment points to slowing earnings growth ahead

S&P 500 avg. negative sentiment score YoY vs. quarterly EPS YoY with a quarter lag (r-sq=53%; 1Q05-3Q21)



Source: BofA Global Research, FactSet

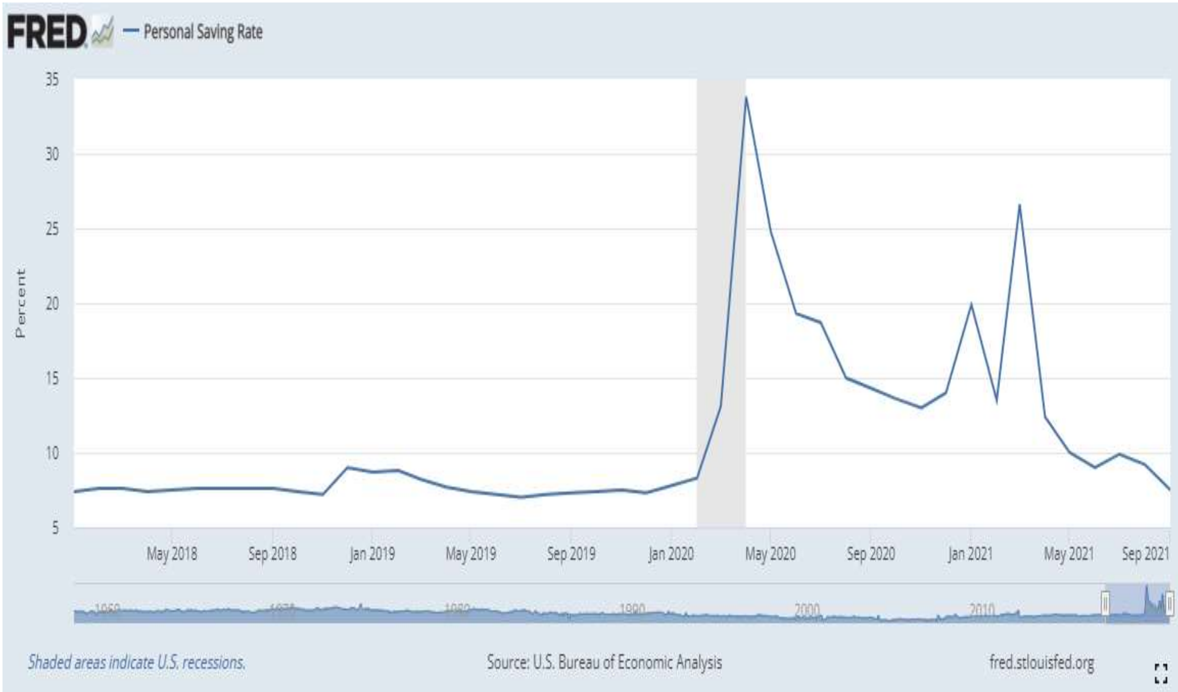
BofA GLOBAL RESEARCH

- GDP lull, jobs slowing coming back, it is all about the Savings

The first read on GDP growth during the 3Q disappointed. After 2Q's strong 6.7% growth, the professional guessers (economists) were looking for 2.7% growth. The number came in at 2.0%. This is not terribly surprising given the delta-variant hit to Services. To this end, Personal Consumption Expenditures increased more than expected at a 1.6% clip. But this pales in comparison to the 2Q's 12.0% growth. Obviously, this data is backwards looking. But this sharp slowdown just reinforces our view that it was a virus-fear shock and not a beginning to slower growth. Looking ahead, 4Q GDP is expected to grow around 4.75%.

Jobless Claims fell slightly to 281k. ADP's early look at this Friday's October Unemployment Report shows a nice jump in jobs gained. ADP thinks Private Payrolls (not including Govt jobs) will increase by 571k vs an earlier guess of 400k. September's gain was 317k.

The data is telling us that the economy is picking up steam after the delta variant-induced lull, but workers are hardly going back to work (there are still roughly 8mm people out of work). (Oddly, this contrasts with the Consumer Confidence breakdown; we chart it below.) We have suspected that Johnny Paycheck has been living off of savings (after the pandemic unemployment benefits ran out). And we are now seeing this in the data. The Personal Savings Rate in the US is now back to pre-virus-fear levels (7.5% in September).



Perhaps we will see a lot of these "retired" people come back to the workforce when the Savings run out?

- Housing not yet picking back up

Pending Home Sales for September slowed vs the sharp increase in August. But the index level is still above the pre-virus-fear level, and it seems to be in a steady range. Pending Home Sales are for Existing Homes with contracts signed but have not closed yet. We need to see this datapoint pick up if we are to gain more confidence in the Housing sector. We surely will not take any queues from the buffoons at Zillow. The company with the great website just disclosed taking huge losses on their “house flipping” business which they also claimed was “market making.” Sorry, but neither flippers nor market-makers ever put illiquid assets into inventory with the hopes of selling them later.

- Services are picking up steam again

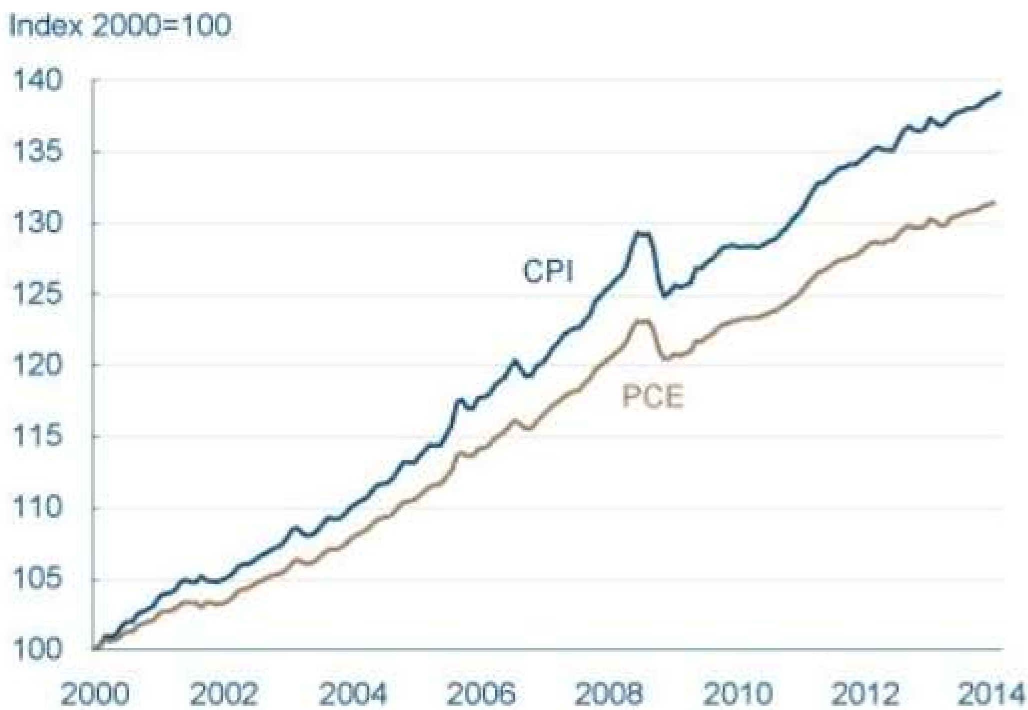
The final Manufacturing PMIs for October slipped a bit (both the Markit and ISM surveys). But Services showed a rebound (much more so for the larger-cap ISM index). Again, this follows the Reopening path we are banking on.

Construction Spending in September slipped 0.5% vs August. This is still a 7.8% increase vs 2020. And we had the delta variant-fear still circulating in the first weeks of the month. And it is worth noting that the only two subsets of Construction have been increasing during the last two years: Singla-family homes and commercial warehouses.

- The Fed’s inflation is not as high as everyone else’s inflation

The PCE inflation gage (Personal Consumption Expenditures) for September was 4.4% and 3.6% on the “Core.” The Fed likes this PCE measures instead of the more commonly referenced CPI (which shows headline growth of 5.4% and Core at 4.0%.) The Cleveland Fed flatly notes that the CPI has run hotter than the PCE since 2000. The basic explanation is that the CPI is calculated using goods that people buy, and the PCE is calculated using the goods that businesses sell. It is probably government economist gobbly-gook. All we know is that the Fed purposefully watches the lower inflation.

CPI and PCE Levels



- Is the Labor market stronger than the economy?

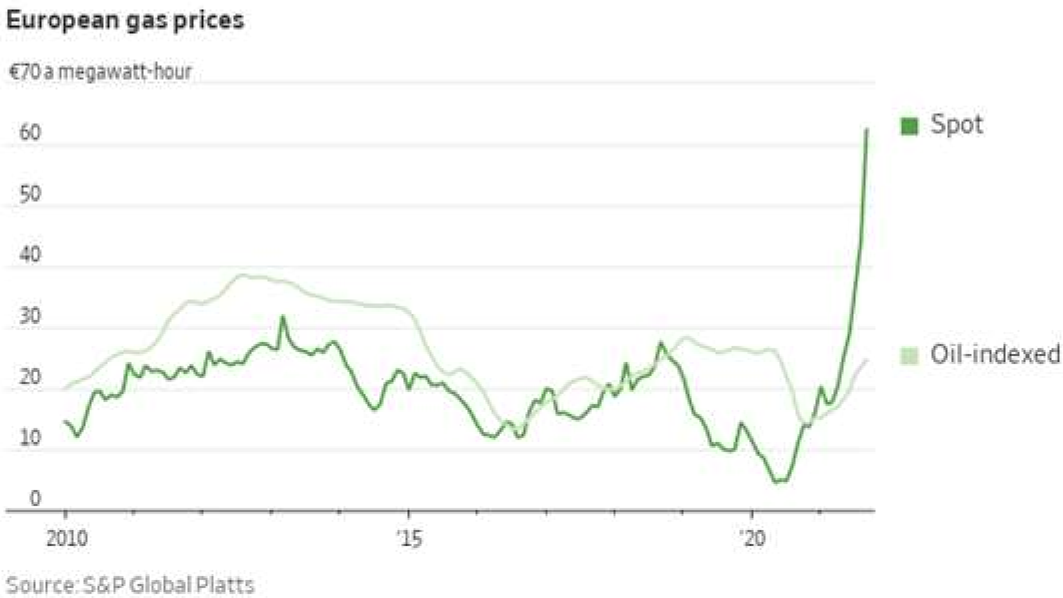
Here is an interesting chart (with a little crime in there using different axes, but it is still ok) showing a new gap between American's views on the job market and the economy: The job market is still hot, but people do not feel so strongly about the economy.

➢ Fed's Powell walks the tight rope

Fed chairman Powell delivered a message that cut right down the middle. While the taper is going to start this month and it will most likely last for the expected eight months, the Federal Reserve will be patient when it comes to hiking interest rates. This is what the market wanted to hear. Accordingly, the Fed's FOMC (Federal Open Market Committee) official statement reintroduced "transitory" back into the inflation conversation. During Powell's press conference q&a, he pushed back against the notion that the Fed was "behind the curve." While the economy had strengthened with "strong demand," the delta variant had held back the recovery. Moreover, the economy is not at maximum employment yet despite some obvious tightening. Of course, he did give the Fed some wiggle room to maneuver as he saw "higher inflation persisting." Nonetheless, Powell made it clear that the tapering of bond purchases and interest rate hikes were not interconnected.

➢ An energy crisis of Europe's making

Many of the root causes of the energy crisis in Europe were homemade. We have discussed the UK's disastrous decision to reduce its own natural gas production and storage to move to a "just in time" energy plan. Well, Europe did something just as foolhardy with its primary energy source, Russia. That is, Europe negotiated for years to get off long-term contracts that were tied to the price of oil. Somehow, the Europeans thought it would be smart to want their main energy source tied to real-time spot prices. Some people in Texas learned the pitfalls of similar decision making this past winter. Europeans have joined the fray by essentially selling a Call option on natural gas prices when they were at their lows. The International Energy Agency (not to be confused with the EIA inside the DOJ) maintains it was worth it because of the cost savings during the recent years. And some in the modern-day Neville Chamberlin wing of European government are pointing to a more accommodating Putin. Supposedly he has signaled that more gas deliveries to Europe will start in the coming weeks. To be clear, Russia is filling its own storage facilities first and then will look to the German and Austrian storage tanks. We will believe it when we see it.



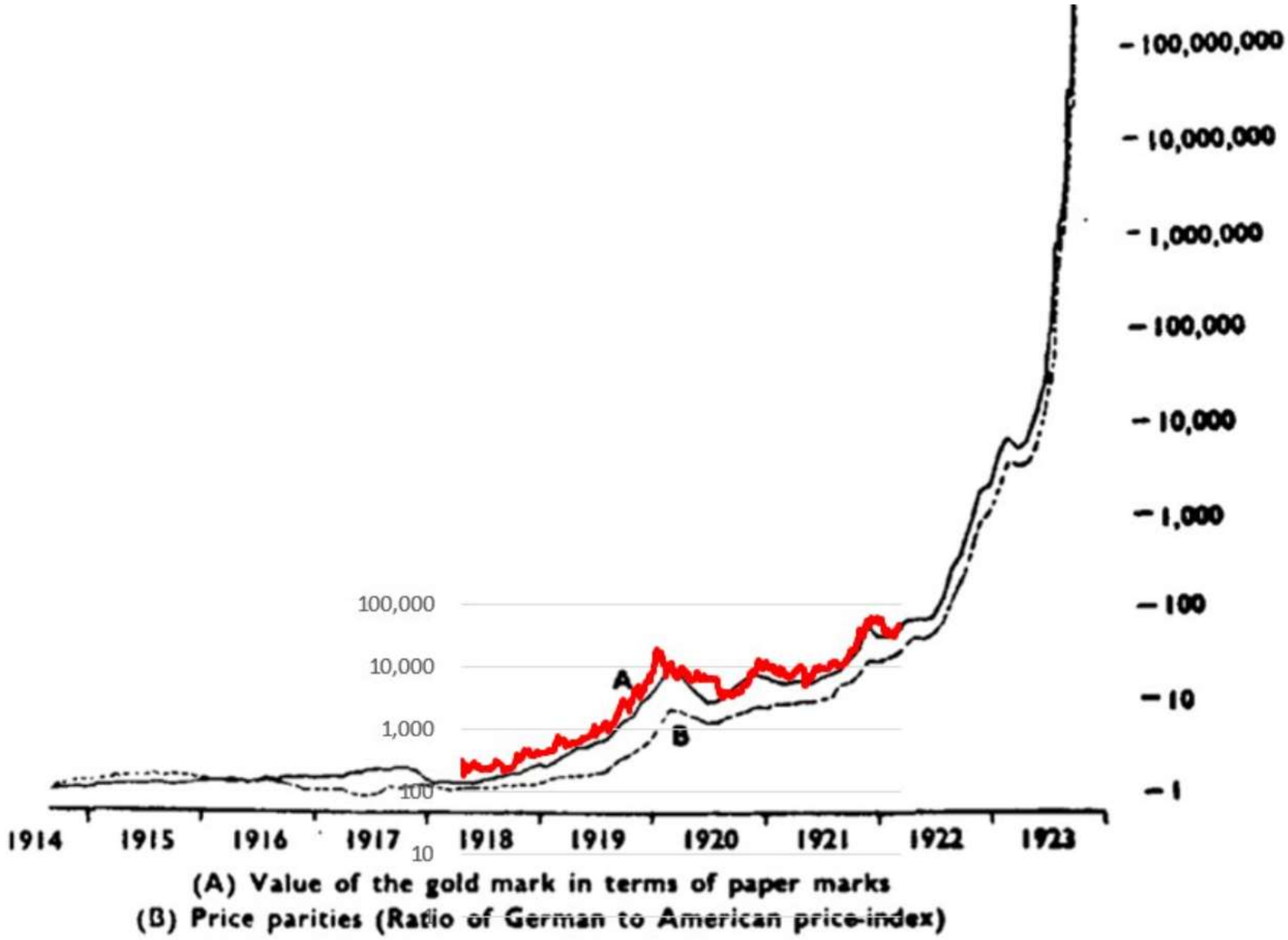
One more newsworthy bit, Germany has asked the European Union to consider natural gas a "green energy." German pragmatism will surely be denied.

- Mexican oil bonds

Elsewhere in the oil capital markets, the head of PEMEX, the national oil company of Mexico, asserted/implied that the federal government (aka Hacienda) would be taking over the responsibility of paying PEMEX's debt payments. The most heavily indebted oil company in the world saw its bonds rally on the supposed backstop (it has $115b in debt, it has no public equity). If we were in the game of shorting bonds…we are not…we would sell the heck out of these bonds. We love Mexico (good people, strong ally, nice beaches, etc), but since when does more government intervention result in a good thing for a "company" trying to overcome decades of corruption and underinvestment?

- Chart Crime of the week

You know you have a chart crime on your hands when it looks like Chalk Creek Jr. (the 5yr old) drew the chart. If you can move beyond the aesthetics, you will see this criminal forgot to label his red line as that of Bitcoin. Nonetheless, he is comparing Bitcoin's 12 year history to the first four years of the German Papiermark during its inflationary spiral after World War I.



- Quick Hits
  - A "Crypto punk" NFT (nonfungible token…make believe art) sold for over $500mm. Of course, it was a wash sale. The seller and the buyer were the same person.
  - New Castle County in Delaware is going to force new homes to have an EV car charger.
  - After the Chinese locked almost 34,000 people inside of Disney over the weekend because of a single case of Covid, the state-run press reported that the move was "met with calm."

Trading: We added a small slice to the Industrial long that we mentioned was poised to capitalize on American reshoring via its automation products. We unwound two Vol trades (the option market had overpriced moves on FB and GLD). We added marginally to our long Big Tech exposure. We reduced a touch of a growth basket that is more "lofty" in valuation as some things continue to run wild. We sold some losing index Put Protection and added a stock specific short (via Puts) on a junky restaurant stock that should get killed by inflation.

TSLAQ: While we applaud Elon's challenging of the UN's World Food Program (he is asking for the world's most corrupt entity to open-source its accounting), we are often reminded that Elon is a grade-A, classless jerk:


Elon Musk
@elonmusk

Massachusetts has MIT
California has CIT
Texas has TITS

1:52 PM · 10/29/21 · Twitter for iPhone

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