



Weekly Update

15-December-2021

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- The Fed Put is alive and well
- Hedge funds are getting destroyed (supposedly)
- Merrill Fund Manager Survey scarily resembles our thinking
- Founders/Insiders are running for the hills
- Inflation is still high, some parts slowing, some parts accelerating
- More Inventory should help ease inflation
- Home builders still cannot build enough houses
- We repeat, the Fed Put is alive and well
- Saudi is reaching for any spare oil production it can get
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4710	0.2%	26.6%	31.0%
QQQ	397.1	-0.6%	27.0%	31.3%
US 10 YR	1.46%	1.52%	0.92%	0.92%
USD/DXY	96.4	95.4	89.9	90.5
VIX	19.3%	19.9%	22.8%	22.5%
Oil	71.45	-1.7%	46.1%	48.8%

*10yr, DXY, and VIX are levels not changes

** Oil is front month futures, beware

Heading into today's Federal Reserve Open Market Committee meeting, the market seemed to be doubting if not challenging the Fed on its telegraphed path for monetary policy. The markets had come under a little pressure, but the tail of high growth, profitless companies that thrive (and potentially survive) on ultra-low interest rates continued to crumble. Well, the Fed delivered the message that the market wanted to hear. There would be interest rate hikes to combat inflation, but the Fed will be flexible enough to allow for continued economic growth. The Fed Put is back! (The Fed Put is lingo for the notion that the Fed will backstop the market when needed). And off to the races. If nothing else, today's reaction proved that the recent volatility was all about Fed uncertainty. Well, that and hedge funds continue to blow up. Other than some short-term trading noise, the virus-fear seems to be losing its impact on the market. And the market expects absolutely nothing from Washington DC now that the debt ceiling extension has passed. And the China property crisis? The defaults are adding up, and that stock market is finally doing better.

We continue to like most of the Big Tech companies that have been leaders. Some call this a potential point of weakness...the market has been too reliant on these mega-cap stocks. Some even make the argument that “the market would be down if not for those six or seven names.” (And the Patriots would have been bad without Tom Brady or Bill Belichick...so what?) The other half say that the unraveling of the ARK stocks (the fanciful ETF that continues to buy these names in freefall) shows the vulnerability of the market. We think these stocks should get destroyed and there is no reason for that to have any material bearing on the quality names. There can be short-term dislocations...this often happens when people lose money. But it is no cause for real alarm.

- Hedge funds are getting destroyed (supposedly)

There is a lot of scuttlebutt around the water cooler that hedge funds are getting hurt by the market gyrations. We have commented on the macro funds that have been burnt by the sharp reversal in the yield curve (funds were betting it would continue to steepen, but it has reversed to flattening). Apparently, equity hedge funds have been shutting down “pods” after poor performance (pods are quasi-independent groups inside of hedge funds...they obviously lose all independence when they get fired). And most likely single-manager funds have been unwinding positions, as well. Below is data from JP Morgan (courtesy of themarketeer). The downturns in the positioning do not seem to be huge, but they are sharp and quick. This is bullish if true.



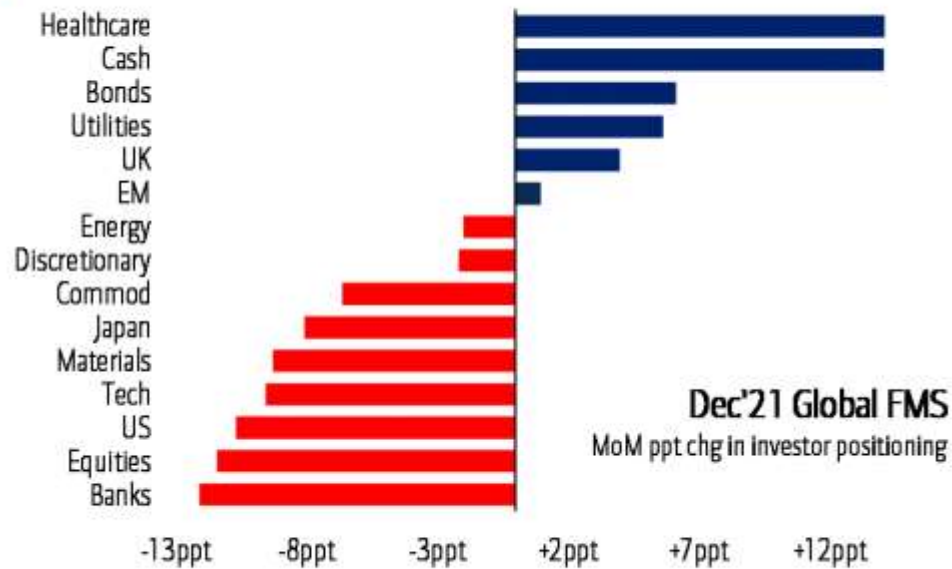
- Merrill Fund Manager Survey scarily resembles our thinking

For the first time since May of 2018, investors think the number one risk to the market is an overly hawkish Fed...it aggressively hikes interest rates as soon as it stops buy bonds in the market. But these same investors are barely positioning for the tail risk. In a nutshell, the consensus believes the Fed will tighten just enough to stamp out inflation but not enough to hurt growth. We are less bullish on growth, but otherwise we agree with this sentiment. We think Powell & Co have learned their lesson from 2018 (the same 2018 when investors were last worried about the Fed) when they hiked rates too aggressively (or rather, signaled a continuation of rate hikes with the term “auto-pilot”). And we think there is pent-up demand to keep the economy going (assuming governments do not lose their minds over the next virus-fear variant...maybe a big assumption). But we also think growth will revert back to the ~2% when the sugar rush from free money subsides (take your pick on free money, Fed policy or congressional spending).

Here are the asset allocation changes in from November to December.

Chart 1: Investors v cautious but few outright bearish

Month on Month change in FMS investor positioning



Source: BofA Global Fund Manager Survey

BofA GLOBAL RESEARCH

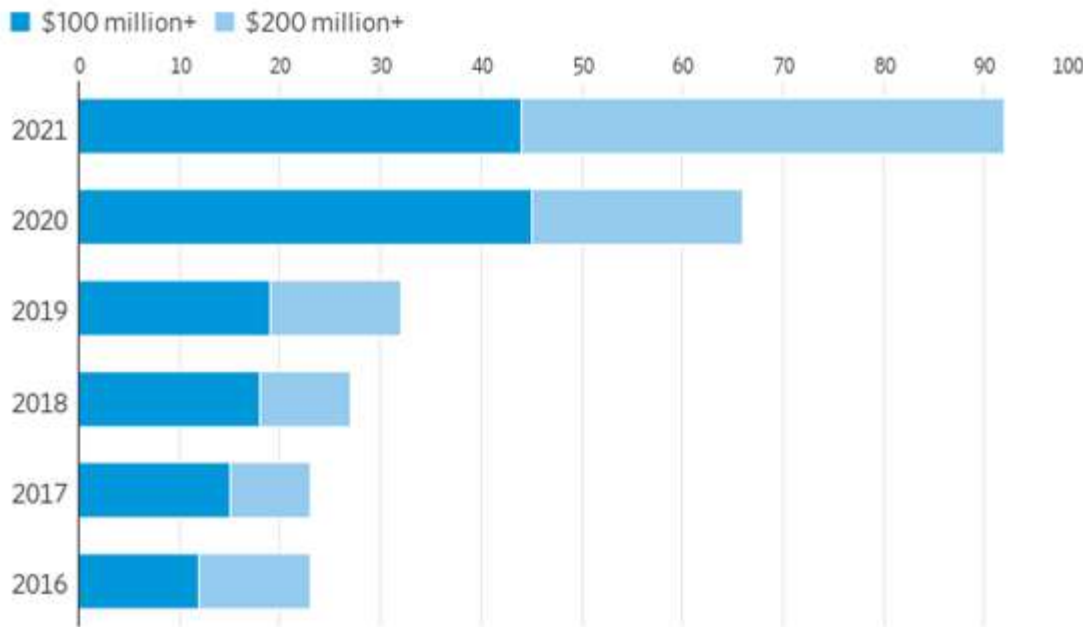
➤ Founders/Insiders are running for the hills

The number of company insiders selling at least \$100mm of stock is making a record. This data is a bit skewed because nowadays there are way more company officers that have at least \$100mm of company stock to sell. But nonetheless, it shows that Musk is not the only one cashing out.

Sales Figures

Number of public-company officers selling at least \$100 million in shares, by year.

Sales Figures



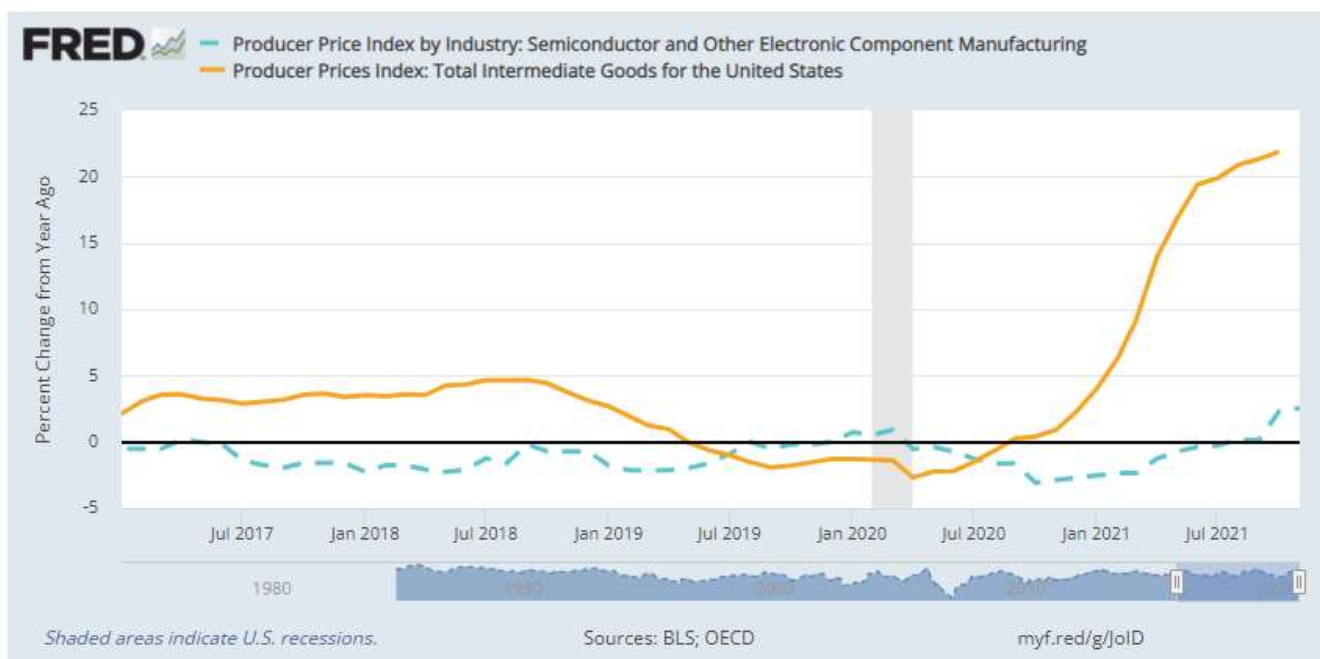
Note: 2021 through Nov. 30. Excludes sales or withholding marked as solely for tax purposes.

Source: InsiderScore/Verity

- Inflation is still high, some parts slowing, some parts accelerating

November inflation (as measured by the CPI) showed prices increasing 0.7% vs October. This is down from the 0.9% gain in October vs September. That is the good news. The bad news is this is still a 6.8% jump vs November last year. The “core” reading which excludes food & energy has similar readings: its monthly increase slowed to 0.5% from 0.6%, but the annual increase is still 4.9%.

The PPI for November (Producer Price Index aka wholesale or input prices) was unequivocally higher. It was higher on a monthly basis (+0.8% vs 0.5% last month) and an annual basis (+9.6%). The “core” was similar with a monthly increase (0.7% vs 0.4% last month) and an annual increase (+7.7%). However, for all the media hype about semiconductor shortages (we noted last week that there are reports of inventories starting to build), wholesale prices of chips are not increasing. We know there is demand as there are end-product shortages. But if prices are not increasing? That could be the definition of transitory (or earlier one-off increases). Looking at China, its PPI decelerated for the first time this year.



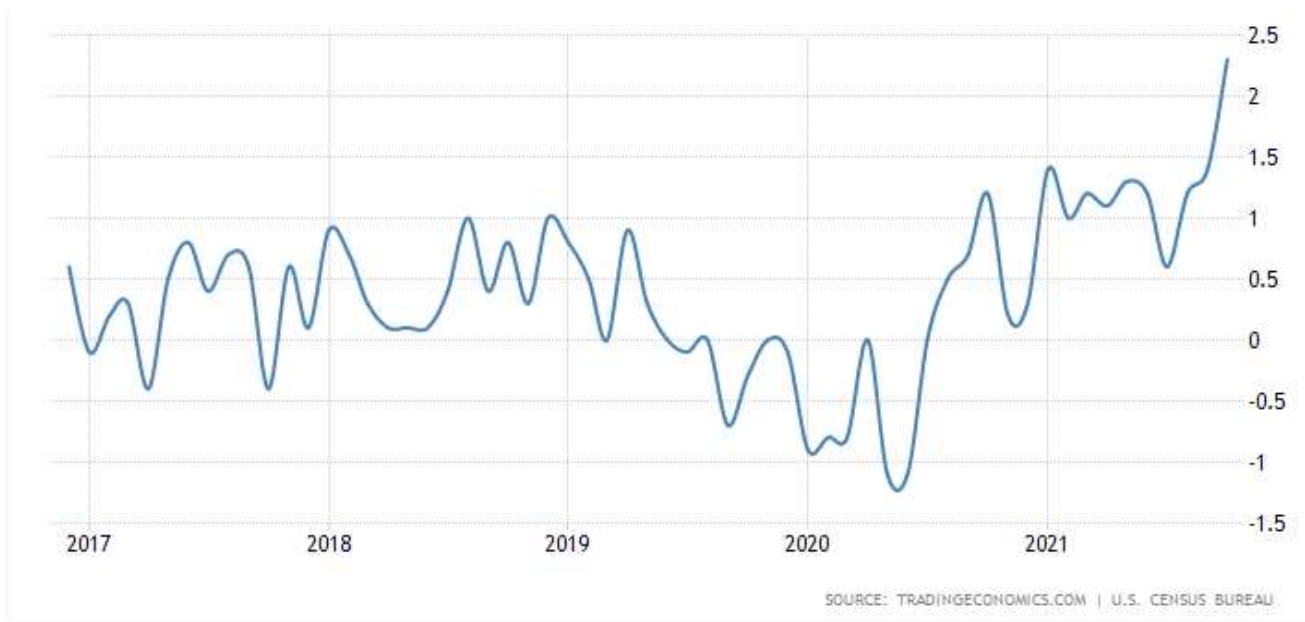
The Atlanta Fed Business Inflation Expectations increased slightly in December to 3.4%.

Increases in Import and Export Prices (a standalone data set) slowed in November. Obviously, the annual increases are turbocharged, but the trend is slowing. And at least Export prices are far outstripping Import prices (18.2% vs 11.7%, but don't tell this to the importers).

We still think inflation is slowing. The increases are starting to slow or round off. That is not to say we are out of the woods yet...the broad PPI is still very alarming. But we think the process (it is never a single point in time) has started.

- More Inventory should help ease inflation

Wholesale Inventories increased 2.3% in October vs September. This is up from the 1.3% increase in September vs August. This is the largest increase in the data's 25-year history. And Total Business Inventories increased at an accelerating rate. Alas, this inventory build is not keeping pace with the even stronger Sales growth (1.2% vs 2.1%). Hence, the Total Inventories to Sales ratio slipped a touch. Moreover, these are just US numbers; much of the logistics problems stem from southeast Asia. Nonetheless, we think it bodes well for inflation (to help cool it with the combination of moderating growth and better supply).



Business Inventories

- Home builders still cannot build enough houses

The Housing Market Index for December, the survey of builder sentiment, had its fourth straight month of improvement. It basically has recouped the delta variant fear that struck in the late summer. The trends remain the same with strong demand trying to find the scarce inventory. Input costs (materials and labor) are expected to increase about 18-19% this year. New home prices have increased about 24%. And just tonight, Lennar has reported earnings that slightly missed expectations. The reason? Supply and labor shortages. If the market punishes homebuilders for having demand that outstrips supply...this could be the entry point for which we have been waiting.

- Other economic data remains strong and beating expectations
 - The U Michigan Consumer Sentiment index increased to 70.4.
 - Jobless Claims hit the lowest level since 1969.
 - Small Business Optimism remained steady (but well below pre virus-fear levels).
 - Retail Sales for November only managed a small increase after the big jump in October (but still a 19% increase annually).
 - Empire Manufacturing (NY state) increased in December, and it remains strong/elevated.

- To repeat, the Fed Put is alive and well

As we noted, the market had started to think that Powell's discarding of the word "transitory" would lead to an aggressive tightening of monetary policy. Some even surmised (and asked Powell directly) that he had come under political pressure to slam the brakes on inflation pronto. But Fed chairman Powell delivered exactly what he had telegraphed. The tapering of bond purchases would be accelerated and completed in March – this is twice the speed of the initial announcement but right in line with the November "pivot." And the Fed will likely hike rates three times next year (to take it from the current target range of 0-0.25 to 0.75-1.00). Most importantly, Powell overtly declared that the "Fed Put" was alive and well. When asked about inflation, he said

there was concern, but he knows that “markets can be sensitive” to tightening monetary policy! And voila, the false notion that the Fed does not care about the market was dispelled.

As an aside, we find it curious that Powell reacted with some indignation to the suggestion that the Fed should have told Congress to tap the brakes on the fiscal spending, “it is not our job.” Of course, last year Powell repeatedly implored Congress to do more “stimulus” via fiscal policy.

We would also add that Treasury’s issuing of bonds is likely to slow commensurately with the tightening of monetary policy. This could reverse with a change of heart from Joe Manchin. But it appears as though there will not be a huge increase in the need to issue more debt.

- Saudi is reaching for any spare oil production it can get

A couple of weeks ago, we relayed some research that indicted Saudi Arabia’s (or OPEC+’s in total) spare capacity to produce more oil was thinner than most believed. Since then, the DOE (Dept of Energy) and others (Citigroup among them) have estimated the Saudi surplus at close to 7mm barrels per day. This is contrary to OPEC+ not being able to produce enough oil to keep up with their tightened quotas. And this week we got news that Saudi Arabia and Kuwait are thinking of increasing production at their joint venture in the so-called “Neutral Zone.” This tract of land produces low grade crude (heavy and high sulfur) that trades at a steep discount. The two countries drastically cut production the last time oil plummeted (2015), and they never cranked it back up. Given that the production can only be increased to about 300k bpd (to be split between the countries), this move sure does not seem to be coming from a position of strength (in terms of plenty of spare capacity).

- Chart Crime of the week

We know the chart crimes that purport to tell us exactly how to trade are old hat. The on-chart sketchings are not ours. The label sizing is ridiculous. And the lines remind us of the Catherine Zeta Jones and Sean Connery movie, *Entrapment*. But all you need to know is this chartist wants you to buy gold miners!

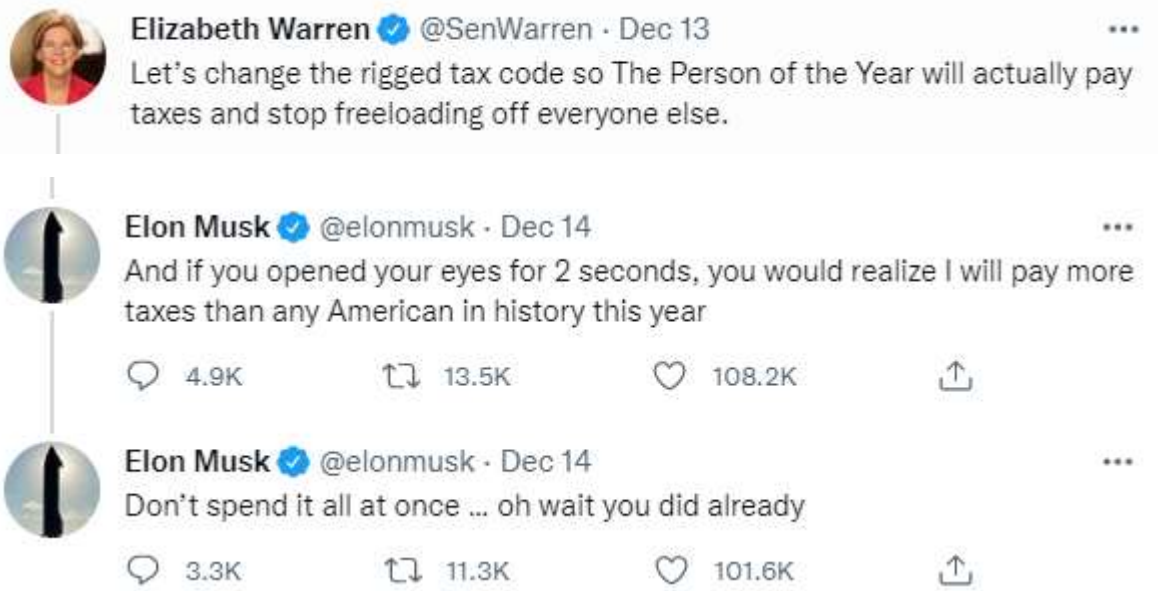


- Quick Hits

- There is a bill being proposed in the Oklahoma legislature that would rename the last three inches of the western most state highway (325) after Lincoln Riley, the recently departed OU football coach (who moved west).
- Venezuela is paying oil service companies in scrap metal.
- High fertilizer prices have spilled over to manure prices which are up about \$10 per short ton (\$50 vs \$40 last year).
- New York City will allow noncitizens to vote in municipal elections.
- Peloton issued an official press release after a Sex and the City character died riding the bike on the show (not in real life).
- Vasectomies are now forbidden in China.
- The Zambian Kwacha is the best performing currency this year (relative to the USD, remember all currencies are relative to another currency).
- NY state has ordered former Gov Andrew Cuomo to return \$5.1mm in book profits that he earned while using state resources.

Trading: We trimmed some more of our commodity exposure as we think inflation is slowing. We added a small short on Brazil as its inflation is looking to accelerate. We cut some of our old school Tech and added to our small-caps that can benefit from continued economic growth (they are mostly idiosyncratic names in nature, but we are not naïve to think that labeling holds true in bad markets).

TSLAQ: It takes a politician for us to side with The Bond Villain. But Elizabeth Warren is just that politician.



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