Weekly Update

10-Mar-2021

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- Market rotation continues
- Labor market is improving slowly
- We should be measuring mortgage rates in the grand scheme
- Current Inflation is tame, future expectations are still higher
- Oil supply and demand continue to shift
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
SPX	3899	2.1%	3.8%	44.6%
QQQ	310.9	0.6%	0.9%	61.8%
US 10 YR	1.52%	1.48%	0.92%	0.87%
VIX	22.6%	26.7%	22.8%	53.9%
Oil	64.44	5.1%	32.8%	87.5%

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

Last week we commented that one of the twists to the running themes in the market was that the Fed has "lost the narrative." This week, Fed Chairman Powell's lackluster response to "are you worried about the 10-year interest rate?" only reinforced the Bond Vigilante's belief that the Fed has, indeed, lost control of the Yield Curve (specifically longer-term interest rates). Even with a relatively stable 10-year rate around 1.5%, the lack of clarity on the Fed's future actions forced more factor rotation in the equity market (selling unprofitable High Growth to buy Cyclical/economically sensitive companies). Apparently, many people had expected Powell to assert his control over the entire yield curve (Yield Curve Control or another Operation Twist are the terms/mechanisms for lowering longer-term yields). But some positive economic data on Friday, the strong jobs report (see below), enabled investors and traders to further differentiate between Growth factors. As we have been writing, Growth companies with actual earnings and somewhat reasonable valuations (or at least not obscenely unreasonable) will benefit from a growing economy (the weak labor market has been the Achilles heel of the economic rebound). Stalwart names like Microsoft, intel, Cisco, and Oracle led the tech names higher (many argue that the latter three are not Growth companies now adays). Of course, Energy stocks kept raging thanks to constrained supply out of OPEC+ coupled with brighter demand prospects. Ultimately, we expect the Fed to act or at least be more assertive in its projecting. It might be too late for the speculative wing of the market but not for the market as a whole.

We have been beating the dead horse of crowdedness in equity positioning…everyone is leveraged and to the same names (except for that one team at JP Morgan who thinks people are underinvested). But it is worth noting that these rotations can last many months. Bernstein published some interesting research showing that Low Quality stocks outperformed High Quality stocks during the last two post-bubble eras. Quality can be somewhat subjective in nature, but for our purposes, it can be Growth vs Value. After the dot.com bubble burst (2000), the rotation into Low Quality stock lasted for 14 months and 40% points. After the World Financial Crisis (2008), the same rotation lasted 18 months and 41% points. The authors go on to assert that the current rotation has been ongoing since July of 2020. We are not so sure about that (but it could be that slippage in the definition of Quality). Whatever the case, the rotations might very well have more legs.

One relatively quiet topic that we think is contributing to the market mayhem is China's official growth expectations. Usually the forever-optimists (liars), the communists lowered their GDP bar considerable to only 6% growth this year. Most professional guessers (economists) expected around 8.5% for 2021. This considerable downgrade from expectations is rooted in the need to focus on "reining in debt, raising household incomes, investing in education and technology, and/or reducing carbon emissions." This effectively amounts to reducing monetary stimulus and having more targeted fiscal stimulus. Just imagine the crony capitalism in China in the "green" energy field. Actually, we do not have to imagine, just look at Tesla's factory there. It is on Tesla's books as an asset, but it is really leased from the communists who have a draw on revenues.

- Labor market is improving slowly

The Unemployment Report surprised on the upside with 379k jobs added vs the 210k expected (and the whisper was for a lower number than this). Most of the move/surprise was in the Services sector specifically Hospitality, Food Services, Retail, etc. Clearly confidence is improving, and people are going about their business. And we even got the added bonus of fewer Government jobs! We still have a problem with the low labor Participation rate. The Wall Street Journal claims the main deterrent for people reentering the workforce is still virus fear. We disagree…the largest impediment is not one at all: the government is still paying people not to work. And the Average Hours Worked dropped. Some of the new hires are coming in at the cost of total hours worked. Along these lines, Permanent Job Losses continue to mount while Temporary ones continue to fall. And total employment is still 9.5mm below where it was pre-virus fear. But we still view this report positively. We will add that the vaccine roll-out is going smoothly all things considered, so confidence should continue to improve. The Chicago Fed's Charles Evans said as much (not that we like to be in the same camp as central bankers these days).

- We should be measuring mortgage rates in the grand scheme

If you look close enough, you can see the itsy-bitsy move in 30-year mortgage rates. Sure, traders will always overshoot on the edges when things move fast. And there are plenty of knock-on effects in the markets. But to think this move will somehow spook people out of buying a house to get the heck out of their cramped, virus-infected, no-home-office apartment? We still like Housing.

- Current Inflation is tame, future expectations are still higher

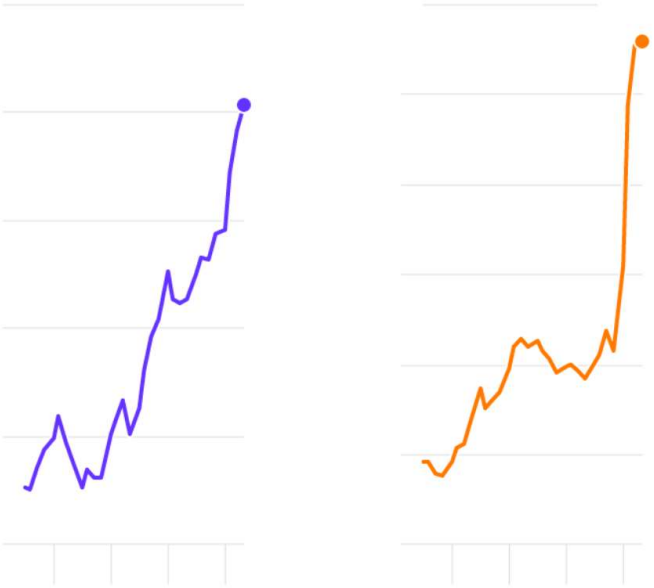
Inflation for February as measured by the CPI is still as tame as ever. The headline rate shows annualized inflation at 1.7% while the "core" for those that do not eat or use energy shows 1.4%. But inflation expectations continue to outpace the current readings. The Atlanta Fed's Business Inflation Expectation in March was 2.4% vs 2.2% in February. And the 5-year Breakeven Inflation rate is still at its highest level since 2011 at 2.41% (this means the market expects the average inflation rate over the next five years to be 2.41%). The 10-year Breakeven is still slightly lower at 2.21%.

- Oil supply and demand continue to shift

OPEC+Rogue decided to not increase production (or "not reduce production cuts" to use their triple-negative vernacular) which was in-line with the second rumor last week. In addition, tensions continue to rise in the Middle East as Yemen's Houthi rebels, backed by Iran, attacked a Saudi Aramco oil facility. Throw in a large drawdown in gasoline inventories (despite a still large build in crude inventory), and the supply side of the equation lined up perfectly. Of course, a stronger growth outlook is equally important.

- Chart Crime of the week

To paraphrase Rodney Dangerfield's character in Back to School when talking about Sam Kennison's character, this chart really seems to show something…about what we have no idea! We dug deeper and apparently these "charts" show the growth of Global Debt. But perhaps they could invest in some labels.



- Quick Hits
  - Rodney Dangerfield was the first celebrity to have his own website (1995).
  - "There are some activities that fully vaccinated people can begin to resume now in the privacy of their own homes." CDC statement
  - "CDC and other agencies implement public health ***laws passed by Congress***." CDC website.
  - The Bank of Japan (BOJ, the central bank) owns 7% of all the shares on the Tokyo Stock Exchange.
  - 15 states never had a "mask mandate."

Trading: We unwound some protection on Friday just as we anticipated. We set some orders "to close" with limits below the market levels (so our Put prices were higher). Specifically, we reduced our hedges in the Nasdaq and cut some shorts in Tesla. We added to our Energy and Financials long exposures when they experienced moments of weakness. We still believe in the long-term Growth narrative of the market leaders (FATMANN ex T and N). We also believe in some of the kookier High Growth names that are far from profitability. But we also like Cyclical Value names and Growth names that actually make money (and are not valued on obscene Price/Sales ratios instead of Price/Earnings). In other words, we are a broken record: we still like a balanced portfolio and we try to trade against the grain. Of course, this is all under the guise of a much smaller exposure to Nasdaq and other Growth names. Moreover, we have been skewing the portfolio to more individual names vs broad market exposure.

TSLAQ: Tesla has fully cemented itself as the bellwether of "high growth" stocks. While GameStop is causing some rotational battles (again, yawn), Tesla is driving the bus for much of the rotation. We will gladly use this as a barometer to flag contrarian trading signals for the market as a whole. As for trading, we closed the short that we entered in Tesla (via Puts) in late January. We used the deep sell-off in Tesla to book some profits on our Puts. We made out on the share price movement ($830 in and $650 out) and Volatility expansion (bought at ≈60% and closed at ≈100%). The news in Tesla is pretty quiet. We guess that is a byproduct of being a giant company now…specific news items do not really move the stock so they get lost in the shuffle. Again, that is why we use it as a risk barometer ("it is pronounced thermometer").

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