Weekly Update

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- Mega-caps and the strong economy power the market higher
- The Fed is not cutting, but the market does not care
- Commercial Real Estate worries are mounting
- Some improvement in bank lending, but the outlook remains choppy
- Earnings growth has accelerated
- Holding up or about to break down?
- So much for the cracks in the Labor market (but there still are some)
- Fed surveys are bouncing back (who cares?)
- European gas storage is keeping a lid on prices
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,995	3.1%	4.7%	23.4%
QQQ	$432.00	3.6%	5.5%	43.3%
US 10 YR	4.11%	3.93%	3.88%	3.62%
USD/DXY	104.1	103.6	101.3	103.4
VIX	12.8%	14.4%	12.5%	19.6%
Oil	$74.06	-2.2%	3.1%	-4.3%

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

Good news is good news again. Or at least that is true for the mega-cap, Quality/Growth equities. In other words, a strong economy with growing earnings outweighs any perceived headwinds from the Fed holding interest rates steady for longer than anticipated. A strong Non-Farm Payrolls number, a surge in business sentiment (PMIs), and muted inflation concerns form the bedrock of a stable economy. We obviously can and do quibble with this data. But as we have been noting, the longer the economy can muddle through higher interest rates, the more stable the economy will become (this includes shedding those companies and activities that cannot sustain themselves through higher interest rates). The Atlanta Fed's GDPNow forecast for Q1 growth is 3.4%. Yes, we lambast those that use this data point in isolation especially early in the quart - it is not predictive but rather only views the already-released data – but it currently meshes with the other data being released.

Magnificent 6 Earnings continue to sparkle. And now the stocks are reacting positively. It could be that the earnings of Meta, Amazon, and Apple were all better than Microsoft and Google. And the slight pullback after the Fed spooked the market helped recalibrate expectations. Whatever the case, impressive revenue growth and expanding margins hit the sweet spot. It is also worth noting that Meta has initiated a $4.4b annual dividend and a $50b buyback. This company with 98% of its business coming from ad revenues clearly is not worried about any slowdown (buybacks are easy to cancel, but it is still a relevant signal from management). Owners of Snap Chat might argue with this point (it fell 35% after its ad revenues disappointed), but as one pundit put it, "Snap has not proven itself to be a necessary business entity."

As far as the Fed backing away from any rate cut in March, the market is still pricing in some chance (about 19%). We think this is quite high given Fed chairman Powell's line-in-the-sand messaging which he and his colleagues have reiterated over the last week. But we do not think the recent rally is the market clinging on to the hope of a rate cut. While May is still squarely in the cards according to the futures market (63% chance of at least one cut), Treasury yields have backed up almost to the Fed's dot plot (when using the 2yr Treasury vs the end of 2024, not perfect optically but they do back-test well together). Of course, the Fed Funds market has only adjusted its expectation to one fewer rate cut on the year (down to five from six). Our point is that much of the equity market does not care when exactly rates get cut or by how much. A stronger economy outweighs the sugar high of a quick rate cut.

On the negative side, Commercial Real Estate worries are mounting. Last week NY Community Bank made headlines for the wrong reasons (its assets are not as good as they thought they were). This week, Japan's Aozora bank disclosed wide losses in its US commercial real estate portfolio. Deutsche Bank and another German bank also increased their loss provisions on US real estate. Most of this pain is centered on the Office market which is not surprising given the post-Virus Fear trends (despite work-from-home fading a bit, migration out of the city centers has continued). It is also worth noting that last week's press release by the Fed removed the statement calling the US banking system "sound and resilient." And the Energy market is still signaling a recession, too. And this manic government spending has to stop at some point (but who knows when).

- Some improvement in bank lending, but the outlook remains choppy

The latest Senior Loan Officer Opinion Survey (SLOOS, a quarterly Fed survey) shows that lending standards remain tight, and demand remains soft. But fewer banks are reporting this tightening dynamic in 4Q2023 vs 3Q2023. We can call this a small rate of change victory. The survey was tweaked as it now incorporates some forward-looking questions. These answers are not as hopeful. Commercial & Industrial and Residential Real Estate lending are expected to remain the same (tight). But Commercial Real Estate, Credit Card, and Auto lending are all expected to tighten further. Responding banks expect loan demand to increase across all these categories. But they also expect current loan quality to deteriorate across the board. Talk about mixed messages! The data can be sliced a diced a million ways, but one consistent theme is that larger banks are not tightening standards as aggressively as smaller ones. We suspect the deteriorating loan quality has a similar dynamic. And we will add that his survey data does not include the new realm of private credit which is dominated by non-bank lenders. This is probably another ticking time bomb (with a long fuse).

- Earnings growth has accelerated

Last week we lamented the poor *actual* Earnings growth versus the *still-projected* Earnings growth. That is, actual has been negative with projected still close to 5%. A week later and some mega-cap blowouts, and the actual growth has jumped to 6.6%. Projected growth is 7.8%. Revenue growth has accelerated, too. 3.3% is the actual so far (with a lower projection at 3.1%). This Refinitiv chart is a few days old, but it does incorporate Amazon, Meta, and Apple (and the theme has continued since). We are not quite back to the optimism in

October in the aggregate (+11.0% was expected then). But Consumer Discretionary (Amazon), Communication Services (Meta and Google), and Tech (Microsoft and Apple) are all above their October levels.

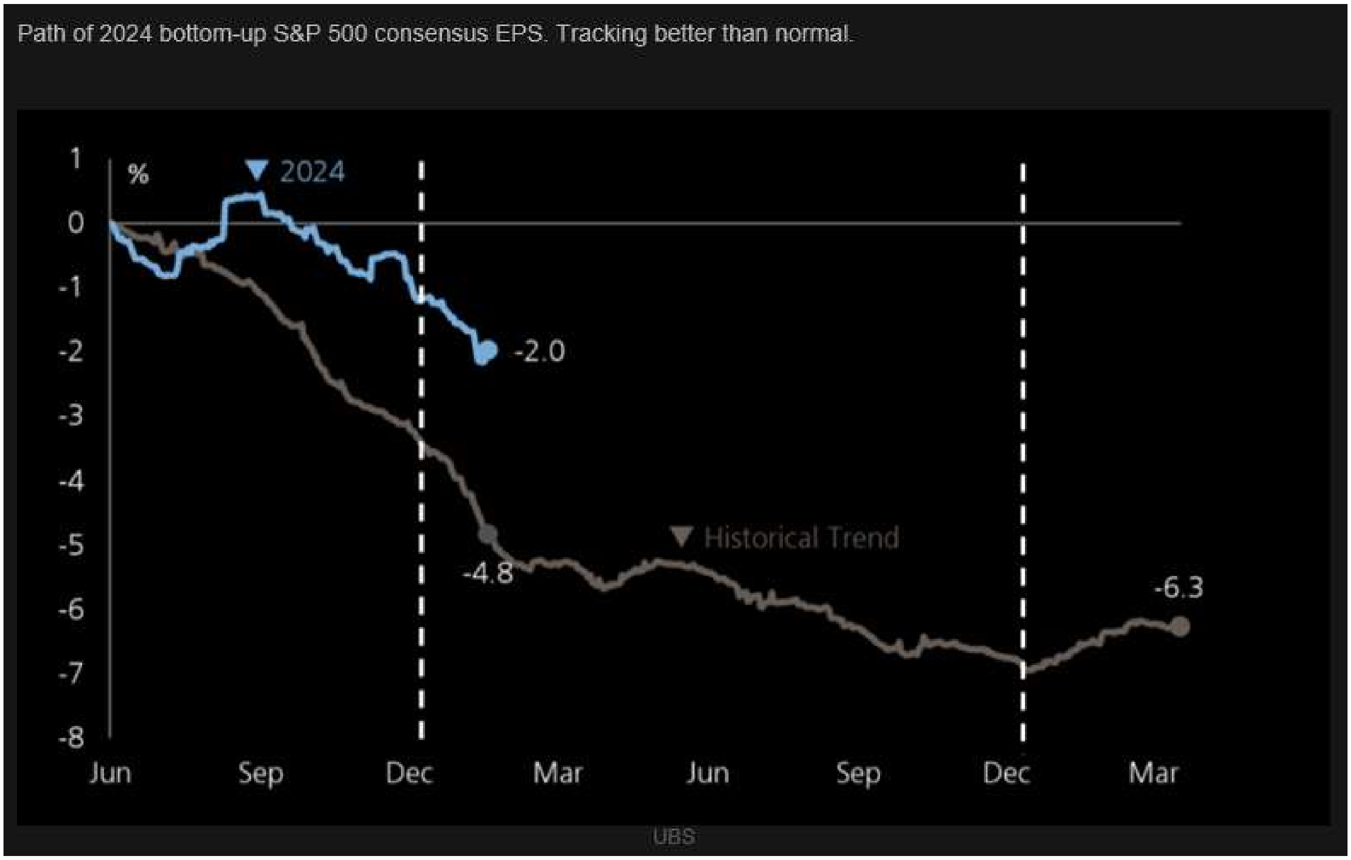
Exhibit 3. 2023Q4 Blended (Reported & Estimated) Earnings Growth

Sector	Today	1 Jan	1 Oct	1
Consumer Discretionary	30.2%	22.3%	28.5%	
Consumer Staples	3.6%	1.8%	5.2%	
Energy	-22.3%	-25.6%	-20.6%	-
Financials	7.5%	6.0%	11.7%	
Health Care	-15.9%	-18.9%	2.4%	
Industrials	2.9%	-1.6%	6.3%	
Materials	-20.1%	-20.9%	-7.6%	
Real Estate	10.9%	11.0%	14.3%	
Technology	20.9%	16.7%	14.7%	
Communication Services	52.4%	49.0%	49.5%	
Utilities	48.7%	49.1%	55.4%	
S&P 500	**7.8%**	**4.7%**	**11.0%**	

Source: LSEG I/B/E/S

- Holding up or about to break down?

Here is the path of Earnings expectations for the year vs the traditional slope. This has mostly been presented as a positive…Earnings are due to hold up better than the usual reality-sinking-in path. And we agree with this. But we also acknowledge it is setting the bar high.



➢ So much for the cracks in the Labor market (but there still are some)

Nonfarm Payrolls increased in January and almost doubled their expectations. 353k new jobs were added compared to 180k expected. And the real expectation was probably lower than this given the poor ADP number earlier in the week (so much for our claim that ADP had gotten better as a predictor!). Maybe most startling was December's number was revised *higher* by 117k jobs. The government has been revising Jobs *lower* for months and months. November saw a much smaller revision higher (+9k), but it was still higher. Private payrolls were the bulk of the boost. Government was only +36k jobs which is down from December's revised +55k.

The Unemployment Rate remained the same at 3.7% (notwithstanding the diverging data on the state level that we mentioned last week). The Labor Participation Rate was also steady at 62.5%. Average Hourly Earnings increased 0.6% which is sure to alarm the Fed (+4.5% on an annual basis). But Average Weekly Hours declined which might soothe their nerves a bit.

As usual, the Household survey (the one that spits out the Unemployment Rate) shows a *decrease* of 31k people working. As we have been noting, full-time employment continues to erode (down 1.4mm people in the last three months). And the ISM report a few days later showed only 3 of 18 service industries expanding employment: Construction, Accommodation & Food Services, and Public Administration (but it was still a strong report, more below). Challenger Job Cuts increased sharply back near its two-year high.

Even with these statistical anomalies and contradicting data, we think the labor numbers are strong enough to keep growth intact. The next stage of this "muddle through" economy will need to see this full-time job erosion slow if not cease. This obviously ties in with the sustainability of strong Retail spending and high credit card balances (more acutely on the low end of the income spectrum, the level of consumer leverage is not that bad in total).

- Fed surveys are bouncing back (who cares?)

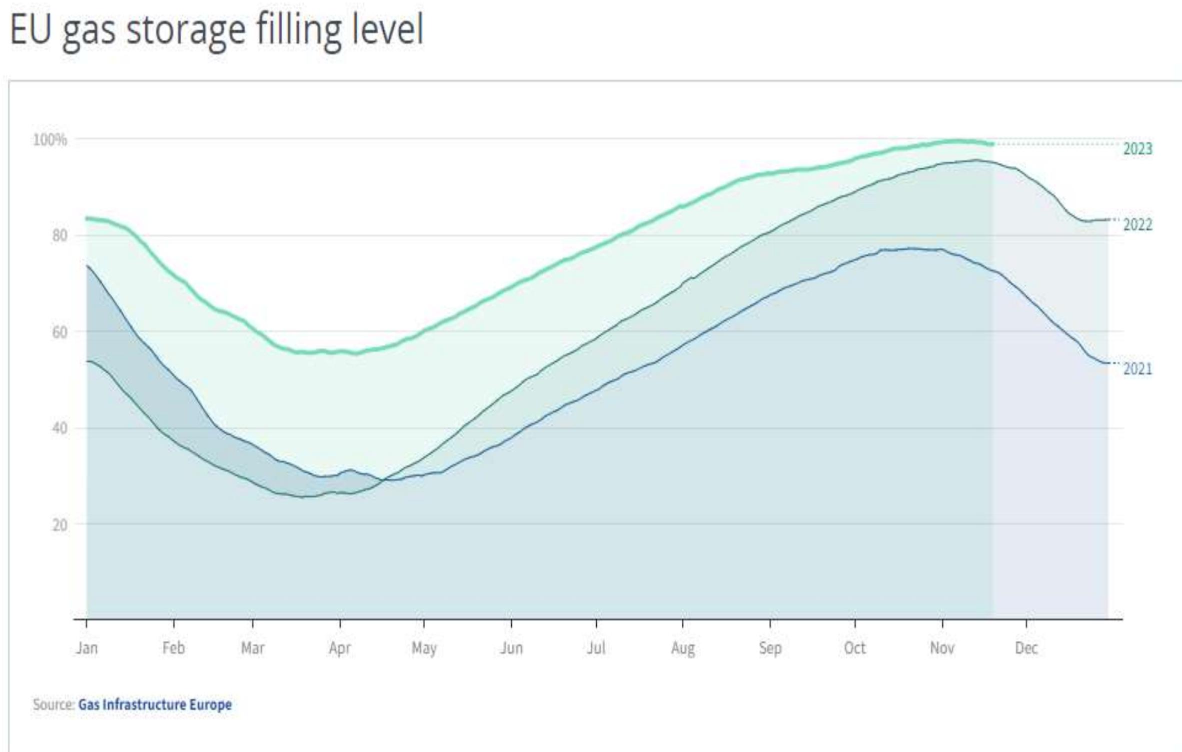
ISM's Manufacturing PMI increased 2 points. New Orders were strong...but so were prices (higher). Services were even stronger as the index jumped from 50.5 to 53.4. All components were strong: Business Activity, Employment, New Orders, and Prices. As we noted above, Employment was heavily skewed in three sectors (seven sectors were negative, and eight were flat). And higher Prices is certainly not a good thing.

We have been saying we have lost confidence in these surveys. Managers were clearly voicing concern but not acting with any concern. Is the opposite now true? They are voicing optimism but will not act on this newfound outlook? We doubt it. But we are not buying into their positive messaging whole hog. The value of these surveys was that they were leading. We will likely add some lag to our analysis as we weigh actual/hard data more heavily.

- Other economic data is strong
    - Construction Spending in December climbed at 0.9% (and Nov spending was revised higher from 0.4% to 0.9%). Residential Construction still leads especially single-family homes.
    - U Michigan's Consumer Sentiment rose as expected (this release has a preliminary one now). One-year inflation expectations remain at 2.9%.
    - Mortgage Applications bounced again. They have increased nine out of the last 12 weeks (and two of the down weeks were around the holidays).
    - Redbook Retail Sales increased 6.1% on the week (high end of the recent range which is about the same as pre–Virus Fear).
    - The US trade deficit widened a touch in December to $62.2b.
    - Used Car prices were flat in January vs December. The annual drop was 9.2%.
    - India's Composite PMI jumped to 61.2 from 58.5. 4Q2023 had started to show some cooling – still strong just not over the top. January's reading is back into the robust zone.
    - China's private PMIs remained flattish vs December. Manufacturing is just above the breakeven at 50.5 with Services better at 52.7. Recall that these private surveys are reading better than the official government ones which is anomalous to say the least.

- European gas storage is keeping a lid on prices

Natural gas prices continue to plummet in the US and around the world. One driver of this, on top of the rampant production in the US, is the storage levels in Europe. You can see throughout 2023, storage levels have been above the levels of the previous two years. This chart stops in November. But most models have it dipping to around 75% - 85% right now. Moreover, it is expected to be at 55% by April which is well above the previous two years. The warm winter of 2022-23 might be repeating itself in 2023-24.



- Where did all the crypto money go?

Our partners at WGAM pointed us towards a crypto "influencer" named BitBoy. His 1.5mm YouTube followers were encouraged to buy all the whacky coins and tokens. BitBoy was being paid $1mm a month by a single crypto/gambling platform (Stake). Ben Armstrong, the real name of the wrestling-like persona, started his own coin called BEN. He had a production studio for his shows. He bought a $350k Lamborghini as his net worth was over $40mm. Then crypto crashed. He lost his company. His wife is divorcing him. And he lost the Lambo.

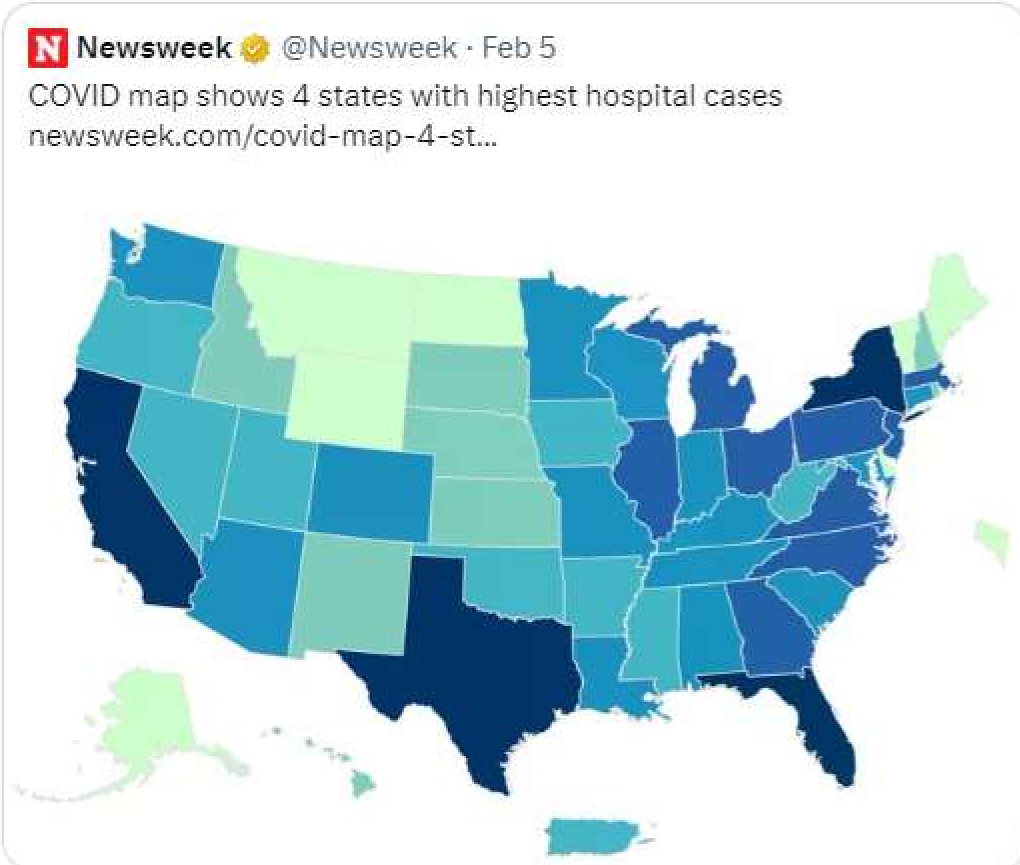
Update: The HyperVerse scam. This is the one with the mysterious CEO with the exceptional resumé that nobody seemed to know. It turns out that this CEO was a paid actor according to the criminal complaint. Perhaps Trevor Milton is moonlighting as a crypto consultant (from jail).

- Chart Crime of the week

After failing last week, we thought deep down…where could we find a good chart crime? Crypto? Non-log charts that date 100 years? A pie chart adding up to over 100%? Charts with Indonesian "little people?"

Covid!

We knew Covid people were never any good at statistics, but we thought they at least knew the concept of per capita.



➢ Quick Hits

- The British navy had more personnel in the Revolutionary War than today.
- US Bitcoin mining uses more electricity than the state of Utah (2.3% of the nation's).
- There is an upstart sports competition trying to take on the Olympics. It is called the Enhanced Games. There is no drug testing as it, "openly celebrates scientific innovation."
- A single software application, Geth, is responsible for maintaining the Ethereum network at the largest crypto platforms. Decentralized?
- Some blogger has an article in Ski magazine in which she subtitles, "the ski bum lifestyle is physically dangerous for black people."
- Six Michael Jordan sneakers sold for a total of $8mm at auction. They were sold as individual sneakers.
- On particularly windy days in England, the electricity regulator pays wind farms to not generate electricity as the grid cannot handle excess generation.
- The US has not implemented the changes from the 15% global minimum tax which was passed into law in 2021. Other countries are taxing US companies per this global agreement.
- The National Association of Realtors has trademarked the term "realtor."
- The National Association of Realtors is the second largest lobbying machine in the US (only behind the Chamber of Commerce).

- The 5-Hour Energy guy who bought the rights to Sports Illustrated only to put it out of business reportedly told the staff upon taking control, “The amount of useless stuff you guys do is staggering.”

Trading: We started two new positions in Growth stocks. Both have had good runs, but we think the businesses can keep up the momentum. We are weary of buying into a bubble, so we will be selective. We also added to our lone merger-arb position. The price action tells us the deal will break, but we think it is still on target to get done (our size is small, we never underestimate the government’s ability to make stupid decisions).

TSLAQ: We had a hodgepodge of headlines this week. Tesla is being sued by 25 counties in California for dumping hazardous waste. There are more reports that Musk’s drug use is impacting his role at Tesla. Tesla has sent all of its senior managers a query to determine which employees are necessary (literally a yes/no question for every person in the firm…we knida like this one). Musk has promised to pay for any Disney employee’s lawsuit against Disney for being fired (for being politically conservative).

It is worth repeating our refrain on Musk: Sometimes we love him. Sometimes we hate him. But Tesla is a car company.

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