Weekly Update

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- Bloodbath where you expect, but not everywhere
- People are scared of interest rates going higher, but they are not going higher
- Vol is actually shrinking
- Do not be a bagholder
- Earnings guidance is still weak
- Employment improves, but for how long?
- Disinflation, but it sure does not feel like it
- China inflation is cooling but political dissent is heating
- Former Fed officials want to be hiking rates aggressively
- Oil news is volatile but not the commodity
- Quick Hits
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	3,935	-8.5%	-17.2%	-4.8%
QQQ	$329.60	-11.3%	-26.4%	-9.8%
US 10 YR	3.00%	2.96%	1.51%	1.70%
USD/DXY	104.0	102.5	96.0	90.7
VIX	32.6%	25.4%	17.2%	27.6%
Oil	$105.66	-1.8%	40.6%	61.9%

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

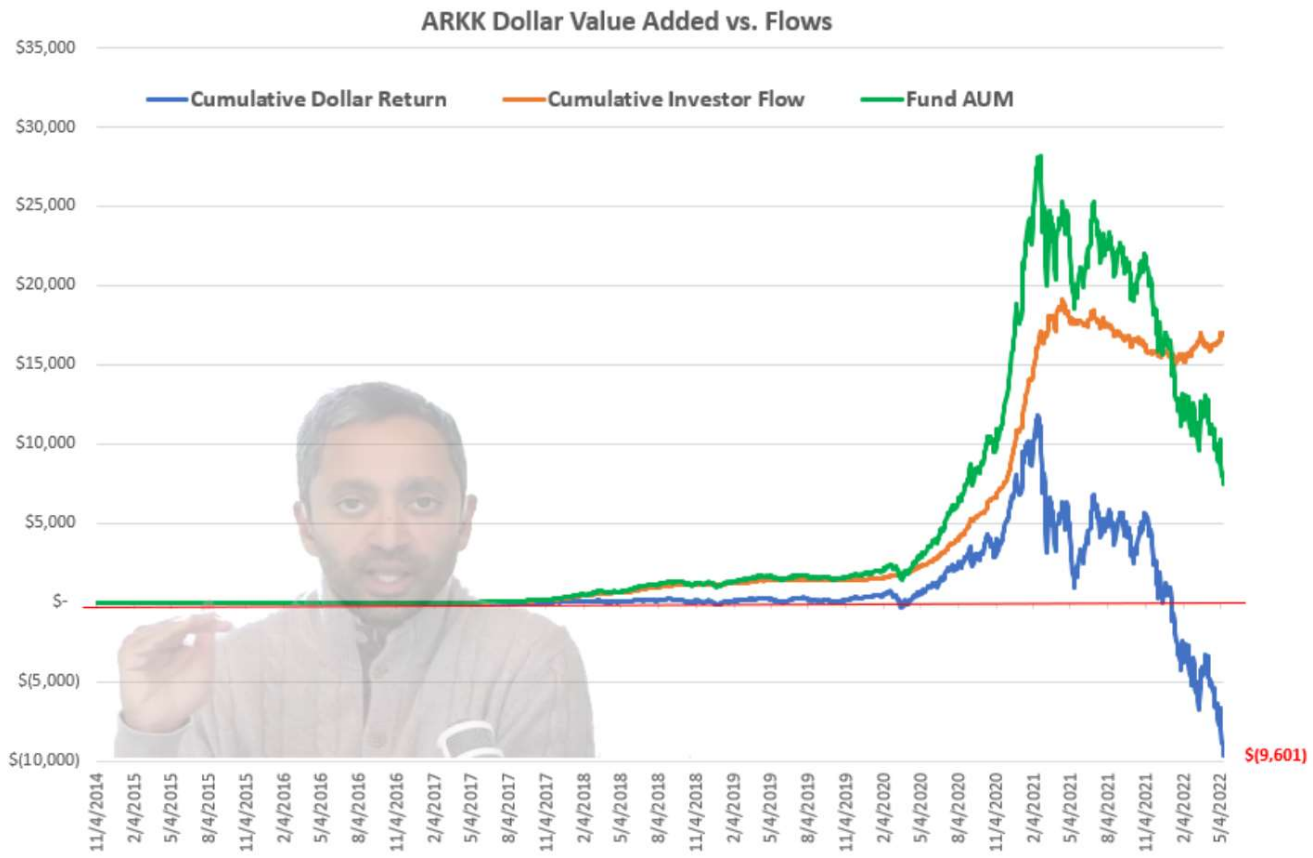
Well, that did not take long. Last week we questioned the market's interpretation of Fed chair Powell's comments about taking more aggressive (0.75%) rate hikes off the table. Other than looking foolish for taking anything off the table in this environment, we wondered how the Fed would be able to pull off the impossible and engineer the "softish" landing. The very next day, the market started to collapse all over again. The only thing the market hates more than uncertainty is pigheaded foolishness. The last time this happened was a 25% drawdown in the fall of 2018 when the very same Powell stated the Fed was on "autopilot."

A few things stood out to us during this shocking week. Firstly, there are still a lot of bagholders slumping around with profitless Fantasy Tech. Energy got slammed 8-10% on Monday. Some pointed to talks in Ukraine, but we think it was funds blowing up and being forced to exit all their positions (including their winning long Energy positions). Somehow, and we can say we told you so, people thought most NFTs and crypto were not

scams? (We still think blockchain is a valuable technology just like the internet. But we still don't want to own worthless domain names.) When anything predicated on a devout belief devoid of debate has its come-to-Jesus-moment, Jim Jones passes the cool aid and slips out the back door. And for all the chaos stemming from higher interest rates…interest rates were not higher! We think this is all logical. The market is pricing in higher odds of a recession and thus lower (or not higher) long-term interest rates. Defensive sectors continue to outperform. And many of the ongoing death spirals on Fantasy Island will result in the seemly demise of the junk companies that do not serve any real purpose other than to enrich their founders. This wealth (ever-shrinking) came at the expense of high-flying hedge fund hotshots and low-lying Retail rubes. Of course, the Chase Coleman's of the world have already minted billions off the make-believe perpetual-motion-machine that is now going in reverse (Coleman runs Tiger Global which is rumored to be one of the funds suffering massively).

Perhaps the most notable oddity was the behavior of Volatility today. Nasdaq Vol (VXN) behaved as one would expect. It remains near its 10-year high (ex the initial virus-fear spike). But the broad market Vol, that of the S&P 500 (VIX), actually *fell* today. The math of this means that investors were no longer buying Put protection on the broad market. Sure, they were heavy sellers as the market fell 1.6%. But this stabilization in Vol could be a sign of stability in the broad market. Do not get us wrong, we want to ride the profitless Fantasy to zero. And even Big Tech could still have a long slog ahead as its valuations might still be stretched. But broad, blind, panicked selling could be reaching a short-term respite.

Here is a rendering of Crazy Cathie Wood's (aka the Woodchipper) ARK Innovation fund (ARKK). She is the posterchild of the Greater Fool theory in finance. The orange line shows suckers are still buying the dip. And the number of shares outstanding (not on the chart) is at an all-time high. The blue line is the value destruction. That's Chamath, the SPAC con artist, in the background looking on waving goodbye to your capital (he is the one that said nobody cares about genocide in China). Twitter hero Keubiko is behind this one (he updates it somewhat frequently).

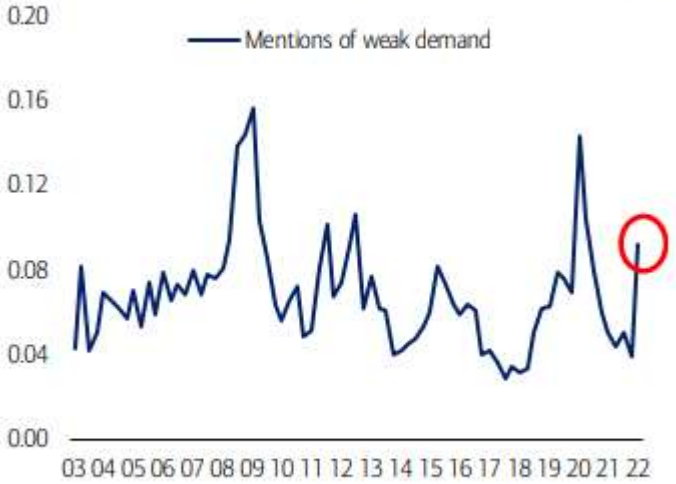


To sum it up, sell the rallies. Buy dips in Defensive/Quality judiciously. Do not be a bagholder. Macro always controls the medium-term narrative. With a recession coming (already here?), any stability we see could be fleeting. Peace in (the) Ukraine will be a good rally to sell. When the Fed blinks, which it is not close to doing, buy aggressively.

- Earnings guidance is still weak

Earnings season is about done with over 90% of the S&P having reported. The "beat" is registering at 6% vs expectations. Alas, the real story continues to be poor guidance by management. The chart below shows the sharp increase in companies's mentions of weak demand (the percentages are low historically…this is mgmt. not wanting to sound too negative. So, the relative change is important). As we have shown recently, corporate sentiment typically leads EPS growth (or contraction) by a quarter. That is the second chart. Interestingly, Merrill tells us that small-caps are giving much better guidance than large-caps. The idea is that small-caps benefit from large-cap capex (capital expenditures). We personally do not believe capex is going to remain strong. This is best seen in the Durable Goods Core Capital Goods number which has shown signs of starting to moderate over the last two months (plenty of equivocation in this phrase, but we think the rate of change is slowing).

Exhibit 15: Companies' mentions of weak demand jumped this quarter
Average mention of weak demand per company (2003-1Q22 as of 5/5/22)



Source: BofA Global Research
Note: mentions include "lower," "softer," "moderating," "weaker"

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Exhibit 14: Big sentiment drops points to earnings downside risk
S&P 500 avg. negative sentiment score YoY vs. quarterly EPS YoY with a quarter lag (r-sq=53%; 1Q05-1Q22)

Source: BofA Global Research, FactSet

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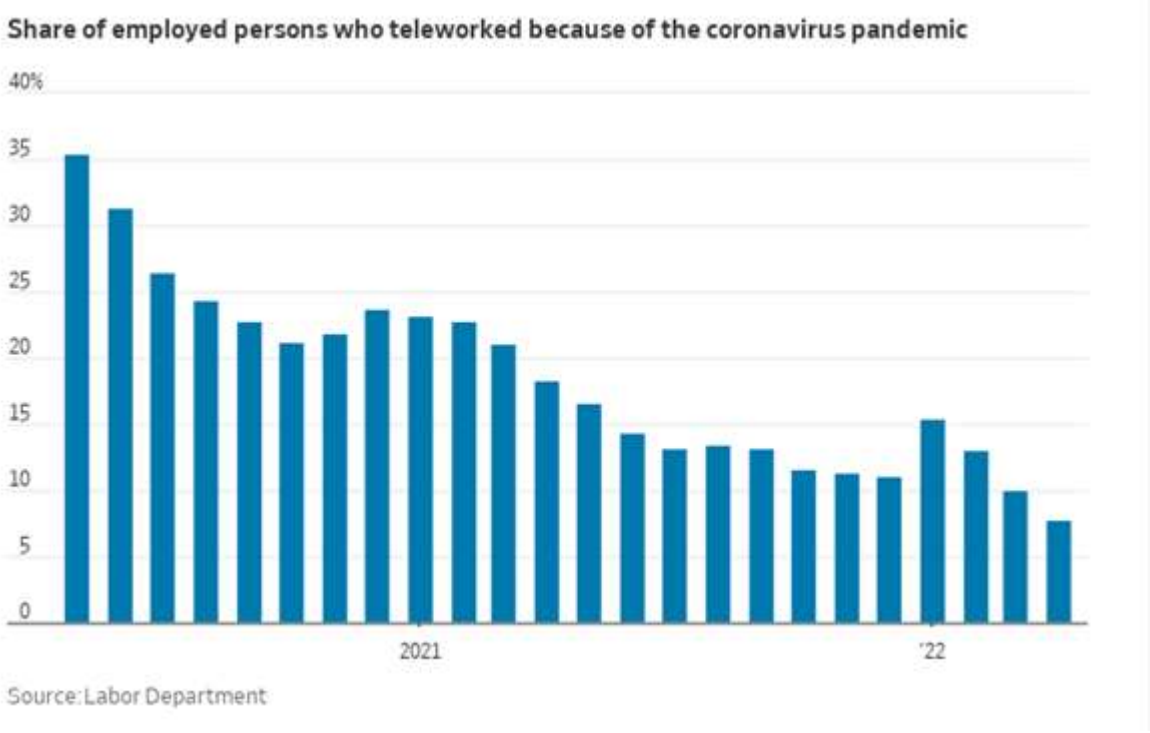
- Employment improves, but for how long?

The Unemployment Report was better than the poor ADP forecast. There was a gain of 428k jobs (nonfarm). Private Payrolls fared a touch better than expected. Leisure and Hospitality continues to lead with almost 80k new jobs. Manufacturing also did well. Notably, the March number was not revised higher. Recall that this was a theme for a few months as the Bureau of Labor Statistics was rejiggering its methodology (and it showed that fewer people were working multiple jobs on a relative basis). The Unemployment Rate remained steady at 3.6%. The Labor Participation Rate dipped slightly to 62.2%. But the important 25-54 age bracket has a Labor Participation Rate of 82.4% (chart below). This is above most of the pre-virus-fear era. This shows that despite some early retirement reversals, the older ages still account for a large share of people no longer in the work force. Average Hourly Earnings increased less, but March's increase was revised higher.

The once wave-of the-future, work-from-home trend continues to shrink like Costanza in the Hamptons. But 1.18mm people are still claiming to be sick.



The WSJ explains a new twist to the difficulty in filling new job openings: New-hire "ghosting." Companies are reporting that 15-20% of new hires are simply not showing up for work. We are not sure what to make of this except maybe it is residual laziness from people paid by the government to not work.

The WSJ oddly calls the job market a "contemporaneous indicator of the business cycle." We think this is wrong. The labor market is usually a lagging indicator. People hire at the top and fire at the bottom.

Nonfarm Labor Productivity declined 7.5% in the Q1 vs Q4 for 2021. This is essentially a ratio of economic output to hours worked. With output dropping (GDP -1.4% in Q1) and employment still on the rise, this is a drag.

We continue to think that Johnny Paycheck has to go back to work. But with productivity waning and high prices starting to crimp some of the previously robust hiring trends, it might be too late before we know it. We expect wage disinflation (probably not deflation as wage hikes can be sticky) to kick in. Again, this shapes up like a lose-lose situation.

- Disinflation, but it sure does not feel like it

The headline CPI inflation (Consumer Price Index) "slowed" to 8.3% vs 8.5% in March. This is "only" a 0.3% monthly increase. The Core CPI also "slowed" to 6.2% from 6.5%. This was a 0.6% monthly increase. It might not feel like it, but these slowing increases are how tops are formed (not a moment but a process as Hedgeye says). Even with continued supply side issues (China factory closures, shortage of truckers, war, etc), prices are easing because of weakening demand.

US Auto Sales continue to ramp back up. The April production run-rate was 14.3mm vs March's 13.3mm (autos are like houses when it comes to economic data, everyone talks in annualized numbers). 16-17mm was the range pre-virus-fear. Following suit, the used car price index (Manheim) continues to exhibit disinflation. It is down 6% from January with the toughest annual comps coming in the next few months. Used car prices are still up massively over the last year. But it appears the runaway prices are behind us. Of course, if the inputs for new cars reverse back higher, then this will drag used car prices higher with them. But most input prices are starting to cool, as well. Airfares moved much higher. This was expected as Reopening travel continues to increase. But we think this will be short lived as the economy weakens (and with the Personal Savings rate back below the pre-virus-fear level).

Business inflation expectations in May according to the Atlanta Fed dipped a touch to 3.7% from 3.8% in April.

- China inflation is cooling but political dissent is heating

China inflation figures for April remain well below global price increases. Consumer prices increased 1.9% (vs 1.5% in March), and Producer Prices increased 7.8% (vs 8.3% in March). Of course, we do not think these figures correlate to global prices since China still has its Covid-0 lockdowns. But the PPI is still telling.

On the political front in China, there is starting to be a little dissent emanating from other parts of the communist leadership. The cracking of the unified front is likely to have president Xi clamp down even harder. Self-anointed dictators-for-life do not go down without a fight.

- Former Fed officials want to be hiking rates aggressively

Richard Clarida, who just left the Fed in January, thinks the central bank will have to raise rates to at least 3.5% (Fed Funds target rate is currently 0.75%-1.00%). Former NY Fed president Bill Dudley thinks short term rates must go to the 4-5% level. And he said he would not be shocked to see them at 5-6%. Most sitting Fed officials think rates will go to about 2.5-3.0%. We would be willing to bet that the recently departed (not dearly) are more forthcoming in their views and not beholden to political winds.

But not all Fed officials want to take it slowly. Loretta Mester of the Cleveland Fed (aka Carol Burnett) said we have to be selling Mortgage Backed Securities (MBS) to cool the housing market (we assume she means prices and not transactions). Right now, the Fed is only letting Treasuries and MBS runoff (not reinvest the proceeds from bonds maturing). She also thinks a 75bps rate hike should not be ruled out.

The Bank of England (BOE) raised rates by 0.25% again. This is four rate hikes in a row to bring the short term lending rate, called the Bank Rate, to 1%. But the UK central bank indicated that it might be tapping the breaks (no more imminent rate hikes) out of recession fears. This is in direct contrast to the Fed. And the reaction in

the currency markets was expected: USD strength with GBP weakness. We remain long the USD (short a basket of global Fx) and will look to add on blips lower.

- Oil news is volatile but not the commodity

Oil continues to be range bound around the $100 mark on WTI crude futures. The headlines continue to jerk the price around, but ultimately traders know there could be another conflicting headline imminently, so nobody is making aggressive bets. This is odd in macro-land, the home of aggressive, leveraged bets. But it just underscores the uncertainty in the markets right now. Yes, volatility is reducing volatility (that is a first). Here are some bullet points:

- OPEC did not change much in its production targets in its monthly meeting. Of course, as we have been regurgitating, hardly any nations have the capacity to increase production.
- TSA checkpoint data finally slowed (a 1% decline) after some robust increases in traffic. We are still 12% below 2019 levels.
- Biden has already announced plans to refill the 60mm barrels of oil he is presently releasing from the Strategic (Tactical?) Petroleum Reserve. We knew he was obligated to do this. But it is pretty funny to completely undermine his own position so quickly (the refill is well down the road, but the market is smart enough to discount this).
- For all the talk of continued and extended sanctions on Russia, Japan announced that it will be increasing its natural gas imports from Siberia. Japan did sign on to the G7 pledge to stop Russian oil imports. Action vs Words.
- Oil company earnings are showing no wavering of mgmt. teams's commitments to production discipline much to the chagrin of politicians unversed in the basics of supply and demand. EOG (fka Enron Oil & Gas), Pioneer, Conoco, and others are still only showing modest production increases.
- Will Hungary sign off on the Russian oil embargo?

- Chart Crime of the week

This guy says ARKK (the ETF holding all the Fantasy/Profitless/Fraud Tech) is ready for a bounce but look out for a 70% decline after that. Actually, he says look for a "bullish bat for a 886 retrace…looks like Bitcoin 2017" etc. We prefer misleading charts…the one below just makes our head hurt.

- Quick Hits
    - A game-worn jersey of Diego Maradona sold for $9.6mm. It was from the infamous "Hand of God" game in the World Cup. it pitted Maradona's Argentina squad against the English in 1986. Just like in everything it does economically, Argentina cheated.
    - The above references soccer (just in case you find it as boring as most Americans).
    - Robinhood now charges $100 to transfer securities out of your account.
    - Lucid Motors sold 360 cars and lost $600m in Q1. Sounds like another Tesla in the making (without the mesmerized lemmings).
    - The Coinbase CFO, after terrible earnings, said the company is "not competing on price. We're competing on the experience."
    - Coinbase made $1.2b in Adjusted EBITDA last quarter in 4Q2021. It made $20mm in 1Q2022.
    - Adjusted EBITDA strips out stock-based compensation. For Coinbase, this was $350mm in 4Q2022.

Trading: Last week, we were too quick to cover some shorts (a quality problem, but it still stings to leave money on the table). But we continued to trim our short exposure this week. We also lightly added to some longs. We think the market selling is getting a little exhausted (signified by the reduction in Vol…a decrease in Put buying despite the collapse). We likely will get another fund-blowup headline or the Twitter deal will fall apart (oddly could help the market because it would alleviate pressure on Tesla). But we think a bounce is nigh. Depending on the data/news, we will be ready to sell this all over again. Again, the Fed blinking is the only sustained way out of this mess (which, of course, is predicated on sustained disinflation which is no sure thing).

TSLAQ: We maintain that Musk's call to force to recruit billionaires (Ellison and a Saudi prince) was born out of necessity as the banks balked on extending more margin loans on his stock. But Musk has still borrowed something like $25-50b dollars (estimates are all over the place because nobody knows how much cash was taken, but his last filing shows 92mm shares were pledged). And this money was dumped into his other profitless ventures with no cash flow. Musk's only way out of this is to back out of the Twitter deal. It will kill the TWTR stock, but it will likely save Tesla and perhaps the market (in the short-term).

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