Weekly Update

21-April-2021
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- Different kind of rotation
- Earnings Growth expectations have exploded
- Valuation still matters…even if only in the long run
- Retail Sales and Jobless Claims strong
- Is inflation really only transitory? Nah
- Housing bounced back from the cold in February
- Manufacturing Surveys are leading the hard data
- Are the lights off for crypto?
- Chart Crime of the week
- Click here for the full note

	Last	5d %	YTD %	1yr %
SPX	4173	1.2%	11.5%	50.2%
QQQ	339.3	0.8%	8.3%	60.5%
US 10 YR	1.56%	1.63%	0.92%	0.63%
VIX	17.5%	17.0%	22.8%	42.0%
Oil	61.15	-3.6%	26.0%	510.9%

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

It was another choppy week in the market despite the headline index gains. Virus fear has crept back into the narrative (new variant in India, cases climbing in Japan, the 0.00001% chance of blood clots with the JNJ vaccine, etc), so we are getting the Recovery vs Lockdown factor battles. Actually, the rotation has changed a bit. Growth and Cyclicals both sold off at the same time. And strength was seen in Quality Value stocks. This is a bit hard to square as Growth and Cyclicals have been ying-yanging against each other. But the rotation to Quality (loosely defined as positive earnings trends, steady return on equity, strong management, etc) is a way of threading the needle. That is, Value stocks that are less reliant upon a quick Reopening and Growth stocks that do not have to have a 10-year runway are the favorites. Merrill says this is typical of a mid-cycle rally.

One interesting twist we heard is that we are in a bear market. This seems silly considering we are just a breath away from all-time highs! But this declaration is accurate if we look at some of the more speculative subsets of the market. The obvious categories are SPACs, long duration High Growth, and crypto.

Interest rates remain a central theme and one which continues to confound investors and traders alike. We have had surprisingly robust economic data lately: Lower Jobless Claims, Inflation picking up, Incredible Retails Sales, and, of course, strong Housing. All of this should lead to bond market weakness – interest rates should be moving higher. This can be a reflection of future inflation expectations or just a better feeling about current growth. But we are seeing the opposite – rates have stabilized and even moved lower. There are various explanations for this anomaly: The Chinese are not selling as many US bonds, the Japanese are buying, US pension funds are back buying, etc. These are all feasible and logical (supply and demand, after all). But instead of trying to drill down on the granular holdings of different entities, we think a broader view does the trick: the market was heavily short Treasuries in January. This led to short-covering and even some traders going long.

- Another Archegos post-mortem

Morgan Stanley took a bigger loss than Goldman Sachs because MS felt an obligation to not sell its stake of Viacom along with the company as it was selling stock. Goldman was not a lead underwriter of the company deal, so it felt free to sell aggressively. In other words, MS took a $900mm hit so as to not blur the regulatory lines. MS maintains it could have sold its stock legally speaking, but it felt it was not the right thing to do. As an aside, we have seen it called Arch-Egos which is pretty funny.

- Earnings Growth expectations have exploded

We are about a third of the way through earnings season. Here is a look at the current earnings growth per sector (Today column). Recall that Blended means the combination of what companies have actually reported combined with the expectations for those yet to come. This table also shows the expectations going back in time. For example, last April (2020), the market was expecting Financials to have earnings grow 6.1% during the 1Q of 2021. Today's blended growth rate is 118.3%. While we think this bodes well for the market in the medium term…continued earnings growth is obviously key…we still think this high bar could prove tough to jump over in the short-term.

Looking at Energy, the still negative growth probably explains why the Energy stocks have cooled off lately. It was an en-vogue sector to capture accelerating earnings growth based on an expected pick up in the underlying price of oil (a main beneficiary of inflation). But obviously these earnings are yet to appear. We still like energy. But we are selective: we prefer toll-takers and captive audiences vs blind exploration and production.

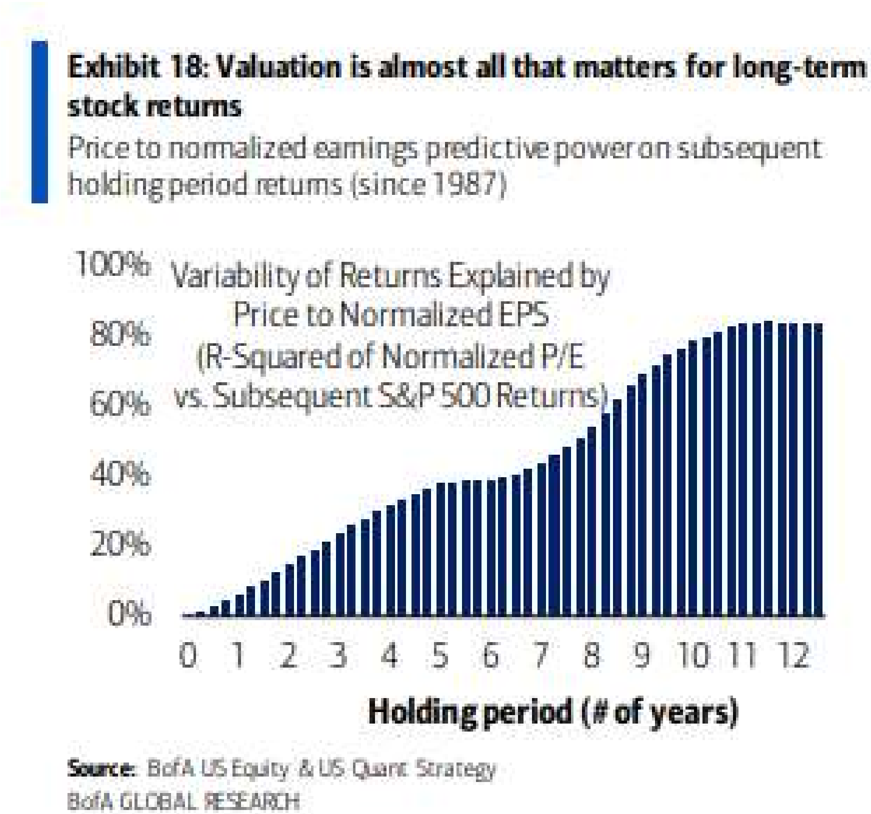
Exhibit 3. 2021Q1 Blended (Reported & Estimated) Earnings Growth

Sector	Today	1 Apr	1 Jan	1 Oct	1 Jul	1 Apr
Consumer Discretionary	99.7%	99.0%	78.5%	71.7%	76.4%	33.4%
Consumer Staples	4.3%	0.3%	1.0%	1.4%	1.3%	7.8%
Energy	-13.2%	-5.1%	-57.2%	-50.1%	-78.9%	-18.4%
Financials	118.3%	68.9%	48.7%	26.9%	31.0%	6.1%
Health Care	21.1%	17.9%	13.9%	11.7%	10.9%	13.7%
Industrials	-16.7%	-13.4%	-0.1%	3.2%	13.0%	34.0%
Materials	47.4%	47.0%	30.4%	21.1%	14.5%	23.8%
Real Estate	1.3%	0.2%	-2.5%	-2.0%	2.0%	6.1%
Technology	24.8%	24.3%	13.1%	11.1%	10.1%	18.3%
Communication Services	14.9%	13.6%	6.1%	6.5%	8.8%	15.0%
Utilities	0.2%	2.6%	2.1%	2.9%	1.9%	4.2%
S&P 500	**31.9%**	**24.2%**	**16.0%**	**11.8%**	**12.3%**	**14.5%**

Source: I/B/E/S data from Refinitiv

- Valuation still matters…even if only in the long run

Research by Merrill tells us that 80% of long-term stock returns (10 years) can be explained by valuation. While back-testing and extrapolating is always wrought with biases and assumptions, we think these results do have veracity. We have often cited the Bernstein research from the dot.com days. The basic crux is that the mega-Tech companies of then grew their revenues many times over, yet their stock prices were decimated for years. Times have changed and the Fed is intent on not letting this happen again, no doubt. But we do think the market can trump the Fed in the medium run (which will suddenly be the short-term when it hits!), so we still find comfort in having a reduced exposure to overvalued Tech.



- Retail Sales and Jobless Claims strong

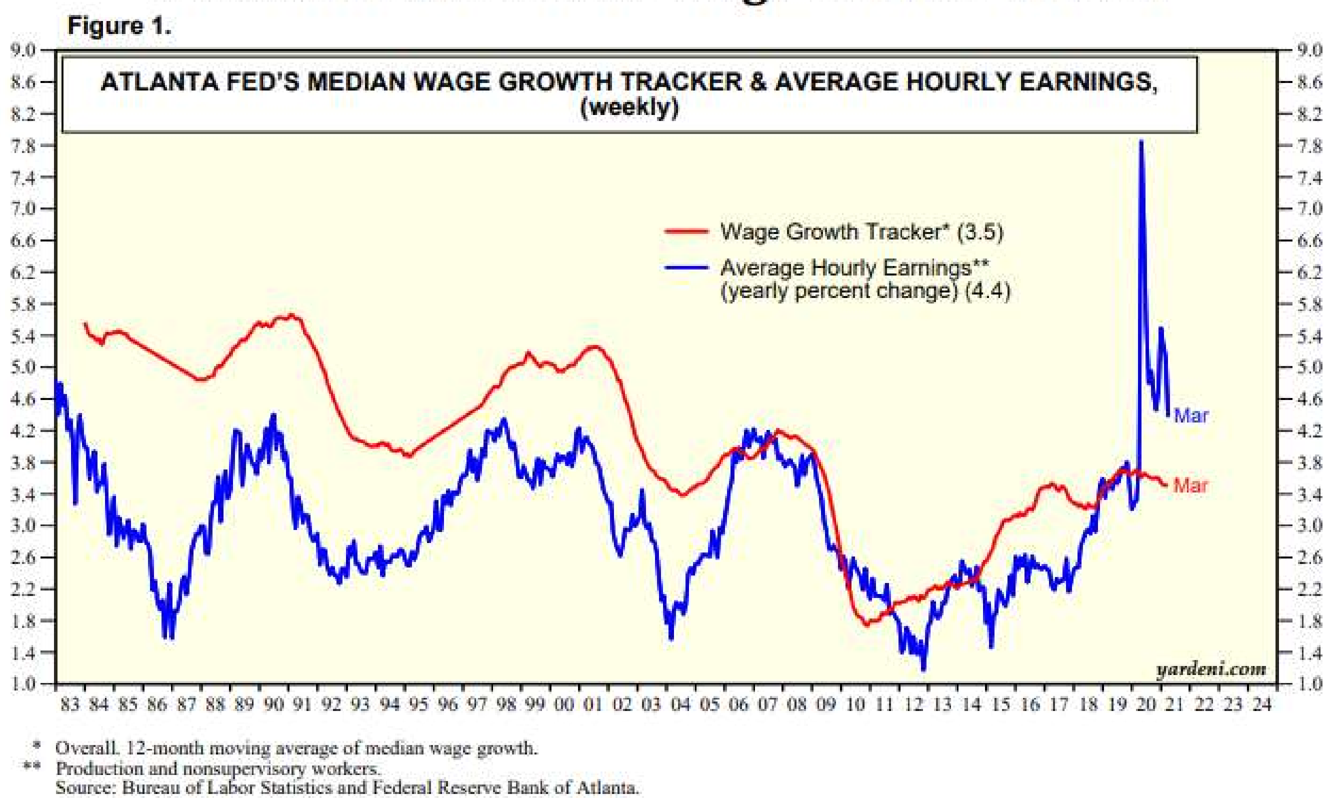
It was Christmas in March for Retail Sales. They clocked a 10% gain vs February. Vehicles only accounted for 1.4% of this, so there was strength across the daily shopping spectrum.

Jobless claims fell to 576k. This is a strong improvement compared to last week's 769k, the expectation for 700k, and the 4-week moving average of 730k.

- Is inflation really only transitory? Nah

Truckers are in hot demand. We know this from the logistical backlog everyone is experiencing. But we did not expected wages for newly certified drivers to be up 40% over the course of a few months. Part of the backlog in goods has been blamed on busy ports. But things are slowly normalizing: the number of cargo ships awaiting entry into the port has decreased from about 40 to 23 in a month. Nonetheless, earnings season is telling us that companies are hiking prices: Kimberly Clark, Procter & Gamble, and Coke have all recently stated that they will be increasing prices. However, there are some skeptics out there. David Rosenberg (an economist/strategist we used to write about quite often, our refrain typically has been “super smart but often wrong”) has been hitting the airwaves saying not to be fooled by the inflation narrative. Other than temporary blockages in logistics, he says labor inflation is actually declining. He cites the Atlanta Fed’s Wage Tracker. We guess the red line below is slightly rolling over. But what about the Average Hourly Earnings? But we qualify our doubt by noting that once the government stops paying people not to work, we could see some wage deflation.

Atlanta Fed’s Median Wage Growth Tracker



- Housing bounced back from the cold in February

The Housing Market Index for April (the survey of homebuilders) remains at its elevated level. Recall these guys shrugged off the marginally poor Housing data in February because of the bad weather. And it looks like they were right. Housing Start jumped to another post-Housing Crisis high (15 years). Starts in March were 19% above those in February. Single Family homes were strong while the multi-family segment lagged a bit. Input prices are still the concern. Permits rebounded from their February slump, but they are still off their January peak.

- Manufacturing Surveys are leading the hard data

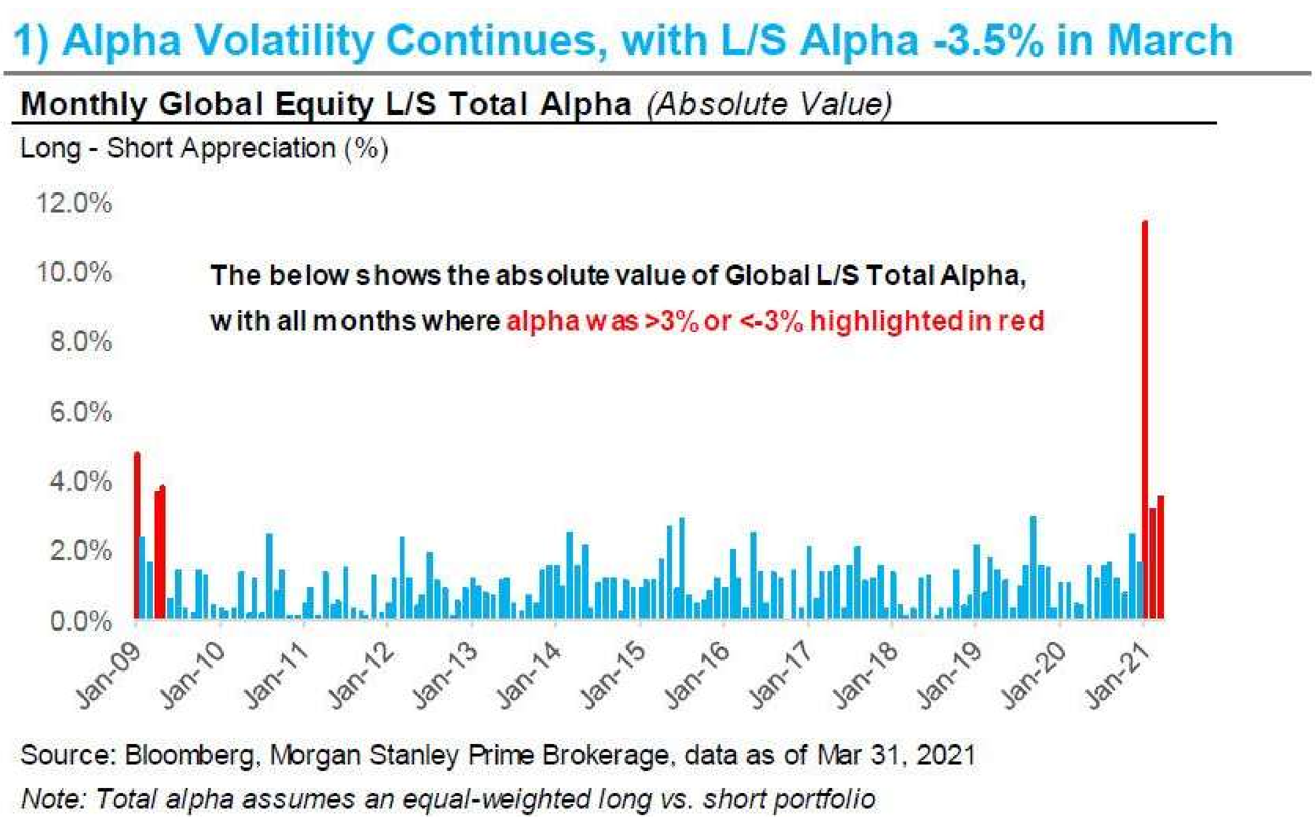
The regional Fed manufacturing surveys (soft data) for April continue to show optimism. The Philly Fed was expected to dip below the 50 breakeven level, but it held the line in April. The Empire State respondents were supposed to say things remain the same (good), but the outlook got even stronger. In fact, it hit its highest level in over three years. However, the hard data in March does not look quite as strong. Industrial Production and Manufacturing Output both rebounded from the February freeze but below levels expected and still well below the pre-virus-fear levels. The same goes for the Capacity Utilization (how much of the production capacity of a factory a company is using…we learned last week that the sawmills are running at a low-Capacity Utilization because they do not want to pay their workers more despite missing out on potentially large volume gains).

- Are the lights off for crypto?

Cryptocurrencies were slammed roughly 15% over the weekend. It appears there was an electricity blackout in a Chinese province in which a chunk of the world's crypto "mining" occurs. So, the "hash rate" grinded to a halt. The hash rate is the aggregate processing power of the Bitcoin network (or any crypto). The market tends to fear large and/or quick declines in the hash rate because it fears the Chinese are up to no good. (Or it could mean that the centralized network might be more centralized with fewer miners. Or people just freak out when they see the gears grind slower.) We have always maintained that this is one of the major flaws in the "decentralized money" theme…the Chinese control the network through state-sponsored mining operations (if not directly then indirectly through subsidized electricity). On top of this rattling, there was a rumor about the US Treasury cracking down on the money laundering which is so rampant in crypto (despite what the true-believers say). Nothing came of this, but the combination was enough to spook the market. And there are some loonies out there who own crypto on margin. Some estimates have $10b worth of crypto being liquidated because the account holders could not meet their margin calls. One of the more vulnerable exchanges, Binance, offers up to 125x leverage. We bought the dip!

- Chart Crime of the week

This is a chart of hedge fund performance in Q1 according to Morgan Stanley. The crux of the article (in Bloomberg and ZeroHedge) was to show the performance of hedge funds against the market. But the chart shows *absolute returns*. This might be helpful in assessing the volatility of hedge fund performance. But it is useless for the actual measuring of performance since it is left to us to guess whether the performance was positive or negative!



- Quick Hits
    - There is a public equity (HWIN whose single asset is a deli in New Jersey with about $15k in annual sales.) The media reports it is worth an absurd $100mm. it is actually worth over $2b when all of the outstanding options and warrants are counted.
    - Who needs Bitcoin to launder money when you have a deli in Jersey!
    - The WallStreetBets Reddit forum has banned all discussions related to crypto.
    - We occasionally search the world wide web for new financial streams, podcasts, etc. This one was listed second on google. Yikes:

Live Video - Financial News - MarketWatch
https://www.marketwatch.com/livevideo
Jun 08, 2020 · Latest **News** /**news**/latest; 4:08p. My wife drinks and gambles our money away, and my adult stepchildren are deadbeats who do drugs and play video games.

Trading: We did a little of our trading around the rotation edges. We added a touch to our long Financials position when they sold off for no apparent reason. We trimmed a little Gold as it tries to rally from a months long slump. We bought a small slice of an airline (domestically oriented). This is just another addition to our Recovery theme. We added a bit to our broken SPACs. We might be too early here.

TSLAQ: Another Tesla "Autopilot" crash. Another shameless denial by the Villain. Witnesses say there were no passengers in the driver's seat. Musk claims the car did not have "Autopilot" functionality. Musk also claims that the Autopilot feature would not have turned on if there were no lane markers like at the scene of the crash. Multiple curious Tesla owners have tweeted out videos of the opposite being true. We think Musk might be in a little hot water on this one. Despite his ability to lie and threaten his way out of every bit of trouble in the past, this episode might have a bit more bark. We bought some Puts.

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