Weekly Update

18-Jan-2023

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- Option Volume is a ticking time bomb
- Muni bond funds are ticking also
- Kuroda's last dance will not be a tightening
- Merrill's Fund Manager Survey has more mixed messages
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	Last	5d %	YTD %	1yr %
S&P 500	3,929	-1.0%	2.3%	-14.4%
QQQ	$277.88	0.1%	4.4%	-26.3%
US 10 YR	3.37%	3.54%	3.88%	1.87%
USD/DXY	102.4	103.2	103.5	95.5
VIX	20.3%	21.9%	21.7%	23.9%
Oil	$79.14	2.2%	-1.0%	-7.0%

Not much has changed from last week until today's mild reversal lower. The slightly better than expected inflation data and the worse than expected economic growth data helped spur on the "Fed pivot" narrative which has morphed a bit into the "soft landing" narrative. The China reopening helped the "risk-on" sentiment. And we cannot forget the good weather. There is no energy crisis in Europe if they never experience winter. Further to this rekindling of the bubble spirits, call option volume has exploded all over again. But not all of this positive sentiment has been rooted in bullishness. The leaders of the market continue to be the members of the various "most-shorted" baskets. And we have heard multiple reports of hedge funds closing down or pod shops de-grossing (funds with multiple managers running their own independent books with the fund company controlling risk management). In plain English, this means funds are being forced to sell last year's winners (Staples, Health Care, Utilities, etc) and cover this year's losers (Fantasies and Frauds). We still hang our hat on the notion that the Fed is going to keep monetary policy restrictive until we are back at 2% inflation…the

economy and employment be damned. And for the "soft landing" crowd, earnings reports from banks have been telling us that they will have lower revenues and higher expenses this year. We suspect we will see more of this as earnings season unfolds. As for the "consumer is resilient" crowd, we point to deteriorating Retail Sales along with worsening credit card data (higher delinquencies and charge-offs). And we cannot forget the looming debt ceiling crisis in US politics. We usually dismiss these manufactured crises as just that. But if the Republicans can barely agree on a House leader, we think we could see more acrimony that usual when dealing with Democrats.

- Option Volume is a ticking time bomb

Goldman reports that over half the volume is on options that expire that same day (0DTE, or Zero Days Til Expiration). Tier 1 adds that institutions are playing this game as a form of leverage arbitrage. That is, collateral (sometimes called buying power reduction or BPR) does not have to be posted for options that expire immediately. Of course, this only works as long as the market goes up. On days like today, the premium spent buying these instant gratification lottery tickets vanishes like a crypto deposit account. Tesla, of course, has seen the largest volume in the single stock universe. The expiration for these is Friday, not 0DTE. But this is not exactly long-term investing.

- Muni bond funds are ticking also

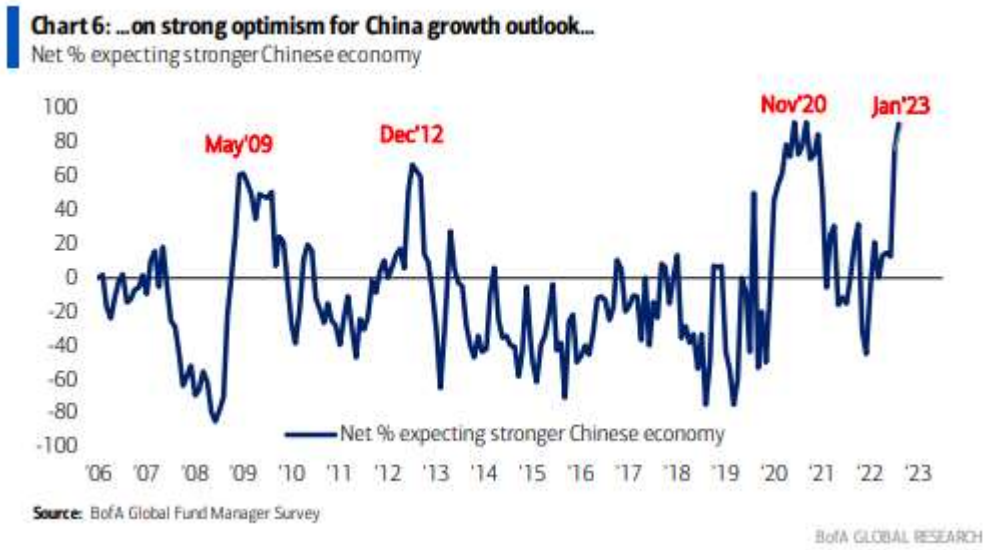
Muni bond funds might be another example of a credit event. There are likely to be plenty of municipalities that feel the pain of a slowing economy. But we are referring to the structure of some of the funds that invest in municipal bonds. Specifically, many of these funds (the closed-end funds usually) borrow money to juice up returns. We know what happens when rates go higher. Those juicy distributions to investors get slashed.

- Kuroda's last dance will not be a tightening

Haruhiko Kuroda, the head of the Japanese central bank (Bank of Japan - BOJ), surprised the markets by sticking to his guns on monetary policy. Back in December, Kuroda showed the first sign of cracking and tightening monetary policy. But with him about to retire in two months, he made the markets pay for doubting his resolve. Not only did the BOJ not move the band on the 10-year government bond (JGB), but it also left short -term rates negative. And the central bank promised to keep buying an unlimited amount of bonds. We find his almost deadpan commentary quite funny: "There is nothing unusual about market players forming different views from the central bank." Japanese equities rallied, bond yields dropped, and the Yen weakened. A trifecta in squashing speculators. On top of being a sign of diminishing global liquidity, it is good for our long USD position.

- Merrill's Fund Manager Survey has more mixed messages

The Merrill survey is starting to take the turn to "investors are not as bearish." While the headline shows investors are the most underweight US equities since late 2005, the specifics say otherwise. The majority now thinks the Fed will, indeed, pivot with rates going lower. Optimism on global growth is back to even as recession fears are fading (lowest in six months). And weaving in another factor, 91% expect China to have a "full reopening" with decades high growth expectations.



One aspect of the survey that we always find misleading is the views of what people think other people's positions are. Respondents claim the number one most crowded trade is long the USD. But the futures data shows that investors are overly bearish the USD. The Euro (long EUR/USD) positioning is two standard deviations long. The Japanese Yen positioning is about 1.5x standard deviations long (short USD/JPY). The other most traded currencies are more mixed. And futures data is not a complete data set (far from it). But it is more than representative for us to believe that people are bearish, not bullish, the USD. We are still long the USD and it has been a bad trade as of lately (after being great for nine months last year). We still think the Fed has more resolve to raise rates than other central banks. And generally poor growth and inflation have historically been good for the USD.

- Ryan Cohen, meet the communists

Ryan Cohen could have his own category after making outrageous profits off the backs of dumb "meme" traders. While he was successful in tricking loads of innocent (or innocent enough) speculators in following him into GameStop and Bed Bath & Beyond, his latest venture might be a bit more ambitious. Apparently, he has bought hundreds of millions of dollars of Alibaba in the hopes of being an "activist" investor in communist China. While it would not take much for us to think convincing the Chinese of anything would be a tough bargain, we think it is more problematic now given the communists just changed the capital structure of BABA. They gave themselves a "golden share" to effectively control all decision making. We would wish Ryan good luck, but he is a criminal that deserves to be in jail.

- An up market does not preclude downward pain at times

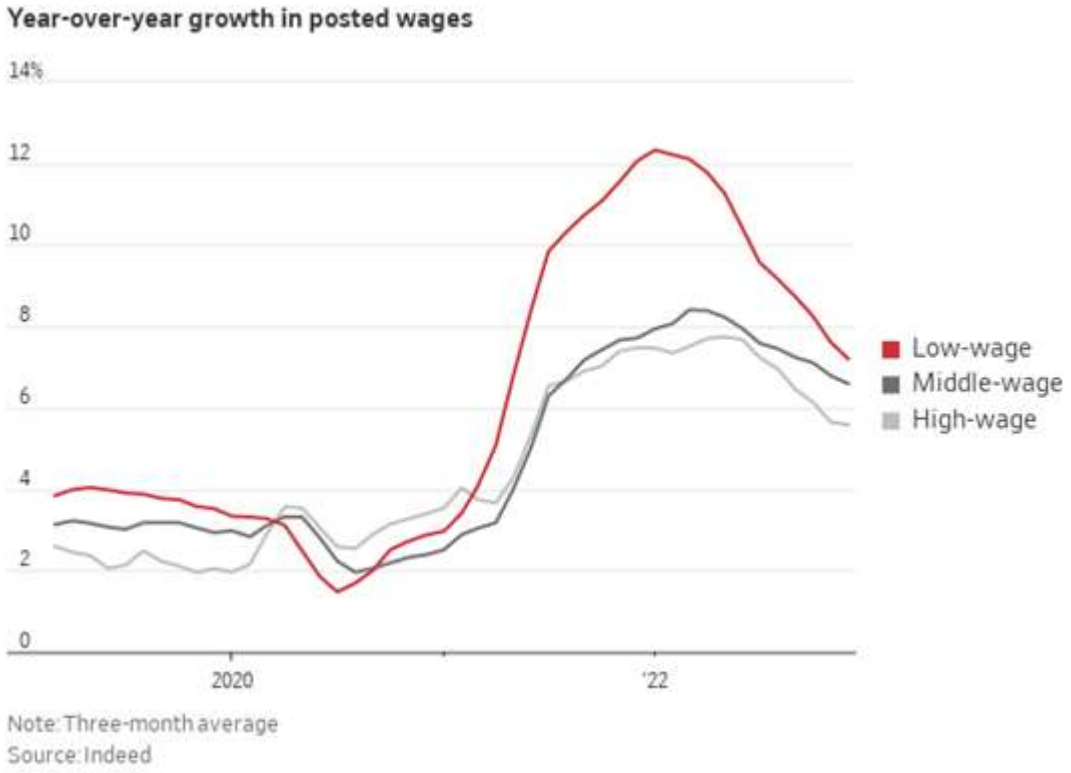
We picked up some interesting datapoints from Strategas Research. When earnings growth (contraction) is negative for a year, the S&P 500 usually finishes up – nine out of 11 times. But the most interesting part is that during those nine positive years, the average drawdown was 14%. Volatility is the name of the game.

- More evidence of inflation cooling (but not so fast)

The latest over-hyped Consumer Price Index report (CPI inflation) showed a monthly drop in prices of -0.1% …deflation. The annual rate dropped to 6.5% as expected. The Core rate moved higher from 0.2% to 0.3%. This cooled the annual rate to 5.7%. We do not think this changes much in the eyes of the Fed. Wage inflation is sticky. Volatile Food & Energy prices do not contribute much to their calculation. And 2% is a long way away.

We have recently described the ever-increasing number of metrics and methodologies to calculate and monitor inflation. We think much of this is beneficial. But we also think some corners of the macro research and punditry circles have jumped the shark. The WSJ had a piece describing the new-fangled "supercore" inflation. We have long laughed at the concept of "core" inflation…as though food and energy prices do not matter (but we have acknowledged the volatility in these goods and services can distort one-off data points…another reason to look at trends and not single points in isolation). Apparently looking at "core" Services excluding housing and medical care is a thing now. Even the Fed's Powell has emphasized "core" Services ex Housing. We find this all somewhat exasperating…it is seemingly just the manipulation of statistics for the good of the narrative. Mark Twain was right.

As for wage growth, here is a chart from Indeed. It is a three-month average of wages segmented by low, middle, and high. But it is important to remember this is the annual change. Just because wages are increasing at a slower pace, that does not mean wages are falling. This is somewhat contradictory to our repeated claim that rate of change matters the most in economics (and its impact on the market). But it is mostly a matter of time frame. Wages are sticky and tend not to decelerate quickly. Of course, this theory falls apart come recession time.



- Housing data sentiment improves slightly, but the hard data is alarming

Mortgage Applications jumped sharply last week. We think this is a function of some seasonality reversing (homebuying go quiet during the holidays…this is supposed to be seasonally adjusted but that does not always work right). Additionally, ReMax reports that some demand is reforming as mortgage rates are restabilizing. We still think the real shoe to drop will be when home selling picks up after more supply comes on the market and prices start to drop.

On the new home front, the Housing Market Index (builder sentiment survey) climbed a touch. But it is still near the Virus Fear panic low (but still above the GFC housing crisis from 2007-09).

On the flip side, KB Home's commentary after worse than expected earnings should ring some alarms: "While favorable demographics and a prolonged undersupply of homes give us confidence in the housing market's long-term outlook, current conditions remain challenging." The math is a little starker. KBH's cancelation rate stands at 68% vs 13% last year. And its net order book totals 692 homes. Last year it was 3,529.

- Other economic data continues to weaken
  - Retail Sales in December fell more than expected along with negative revisions to November.
  - Producer Prices are also experiencing deflation including Food & Energy. The core is still increasing at a 0.1% monthly clip.
  - The Empire State Manufacturing collapsed to one of the lowest readings in any regional Fed survey ever (ex the Virus Fear panic).
  - Industrial Production fell much mor than expected along with Manufacturing Output

- Where did all the crypto money go?

In the category "Are people really this dumb?": The founders of now-bankrupt Three Arrows Capital, a crypto hedge fund that went belly up for over-leveraging and thinking the Ponzi music would never stop, have a new business in the works. They are pitching a marketplace for trading distressed debt in the crypto space. For example, if the bankrupt Three Arrows owed you money, you could use the same guys that stole your money to help you recover a few more pennies on the dollar. These same founders are being accused by the advisors to the bankruptcy of not cooperating with the liquidation process. They have also not responded to a subpoena. Their whereabouts are unknown.

- Chart Crime of the week

Tweet crime of the week. This is one of the original fanboys. Besides this awesome display of financial illiteracy, He also was trying to recruit a random child to test Tesla's "Full Self Driving" breaking ability. He literally wanted a child to run in front of the moving car.

- Quick Hits
  - 60% of US propane production is exported.
  - Natural gas prices in California recently have been 5x the national price ($20 per mm/BTU vs $4).
  - JP Morgan is suing a company it acquired for fraud. The company, Frank, purported to have 4.5mm customers in its database. Email records show that it had 400k emails, and it manufactured another 4mm fake email addresses.
  - USC, UCSF, UTSA, and Johns Hopkins are all being investigated for racial discrimination at their medical schools. Violations of civil rights laws include offering stipends and scholarships only to non-whites and excluding whites from certain classes.

- The report that stoked the not-dead-yet proposal to ban gas stoves was funded by an environmental group that has the goal to reduce "greenhouse-gas" emissions by 50% in seven years. The report claimed gas stoves give children asthma.
- The Inflation Reduction Act subsidizes the purchase of electric stoves.
- 6,542 guns were confiscated at TSA checkpoints in 2022. Almost 90% of them were loaded. No word on Barry Switzer.
- The National Hockey League has changed its Pathway to Hockey summit in Florida by removing the minority-only qualifications.
- The city of San Francisco's African American Reparations Advisory Committee is proposing to pay black residents $5mm (each). Recipients must meet two of eight criteria including having been incarcerated by the "failed War on Drugs."

Trading: We slowly added to our short exposure into the teeth of this rally. As usual, we were going slowly. Nobody knows how long these bouts of hysteria can last. We also trimmed some of our speculative longs into the strength (yes, we do still own some lower quality stuff). And we added to our longs in Staples. But we still have a hefty cash position. We are still waiting for another flush of the system to add more meaningful long exposure.

TSLAQ: Tesla's demand just keeps driving prices lower…more cuts are coming in the 6% to 20% range. It is quite remarkable how the fanboys have been able to twist basic supply and demand economics on its head (Tweet of the week above). Some spin is that Tesla has the "margin flexibility" to gain market share.

A senior Tesla engineer testified in court this week that Tesla faked the "Full Sefl Driving" marketing video back in 2016.

Elon musk claims he was invited to the World Economic Forum (WEF) in Davos. The WEF claims he was not.

There were reports out of Shanghai that Tesla's planned factory expansion was put on hold. The communists are starting to worry more about Musk's Starlink and its potential to spy.

Apparently, Twitter's advertising revenue has dropped 40% from a year ago. This comes as about 500 advertisers have "paused" their activity on the platform since the world started to learn more about Musk. Musk owes a $1.5b coupon payment on the Twitter debt. He could use that advertising cash flow.

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