Chalk Creek Partners LLC

Registered Investment Advisor

Weekly Update 2-September-2020

Carlisle C. Wysong, CFA *Managing Partner*

- Market euphoria and momentum
- The Rich are getting richer
- Economic Surveys are better, Housing is still on fire, but what about Employment?
- Shipping Freight prices are on the rise
- Speaking of Inflation, the Fed changes its plan

	Last	5d %	YTD %	1yr %
SPX	3581	2.9%	10.8%	22.4%
QQQ	302.8	3.7%	42.4%	61.5%
US 10 YR	0.64%	0.69%	1.88%	1.46%
VIX	26.6%	23.3%	23.2%	19.7%
Oil	41.63	-4.1%	-32.0%	-24.7%

*10yr and VIX are levels not changes

** Oil is front month futures, beware

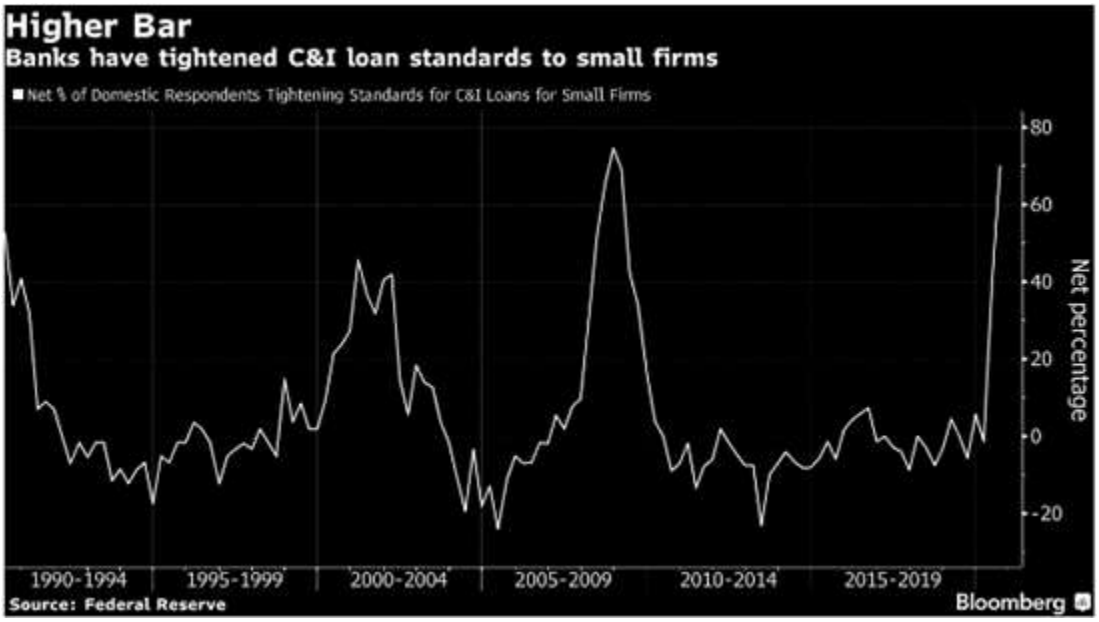
We think it is safe to say the market has hit the euphoria stage. And we are not just talking about Tesla. We are seeing shades (if not full images) of 2000 all over again with anything tech related "Zooming" higher. With a straight face, people are arguing that more supply leads to more demand. This line was used referring to the stock split mania as well as stock offerings. One strong earnings beat leads to a massive rally in a tangentially related company. We even have Volatility expanding as the market rallies. This old market paradigm – that Volatility only rises during market turmoil - has been turned on its head because of all the manic Call option buying. The game has never been easier if you have no clue as to what you are doing!

The traditional macro indicators we watch are all ok. The cold war with China continues, but people have cooled to its importance. The hopes for a vaccine are still helping the market, but most people have realized the virus lockdown drama is political. The economic data points to optimism but still with plenty of hurdles to overcome. And as we always recap our recap, as long as the Fed is buying assets (err, lending as they call it), momentum can remain in place.

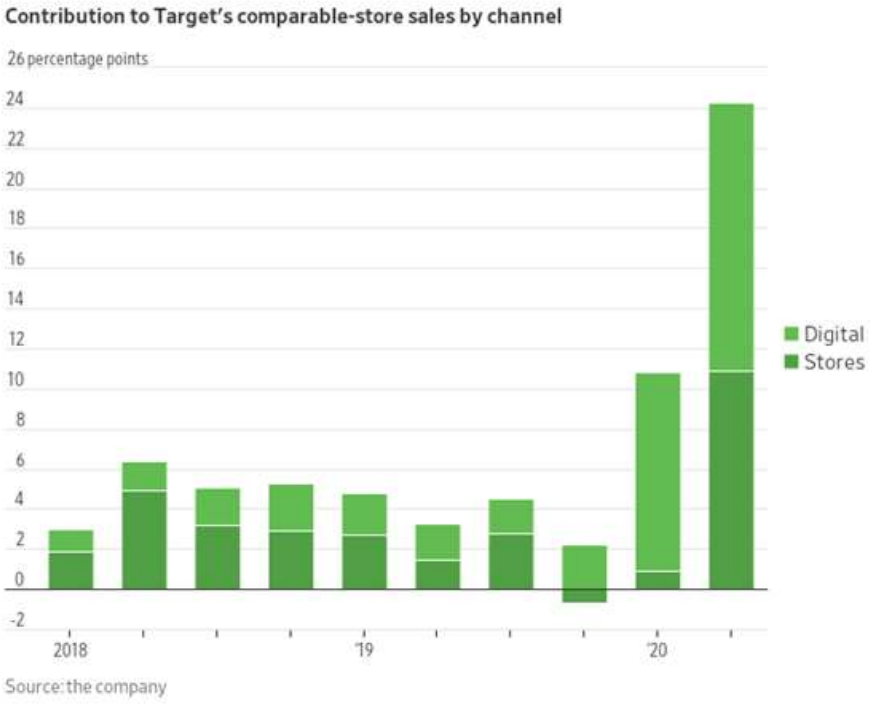
Looking at China, it is best to ignore the headline volatility. The best indicator to follow is the Chinese currency. The USDCNY rate is the strongest it has been in about a year. If you recall, the CNY weakens vs the USD as trade tensions worsen. This is the natural balancing mechanism by the Chinese as tariffs are placed on their goods (a weaker CNY means they get more USD for goods sold which compensates for the lower nominal price after the tariff is subtracted). Some apologists for the communists claim it is the strength of the Chinese economy that is driving the strength of CNY. This is ridiculous.

- The Rich are getting richer

Bloomberg had an interesting blurb about the correct letter convention to use in describing the direction of the economy. While we would have rather seen them dismiss the whole game as trivial and unimportant, we do like the letter "K." Whereas the overused "V" shows a quick bounce higher, the "K" shows a bifurcated economy. The big are back to their winning ways while the small flail and flounder. This has been our main trading thesis since the start of the virus panic. The chart below shows how this is playing out in access to Commercial & Industrial loans for small businesses:



Speaking of winners, here is an eye-opening breakdown of Target's (TGT) comparable-store sales courtesy of the WSJ. Obviously, the e-commerce growth has exploded. But this chart shows the massive growth in overall sales. The company accurately attributes a large chunk of this to market shares gains.

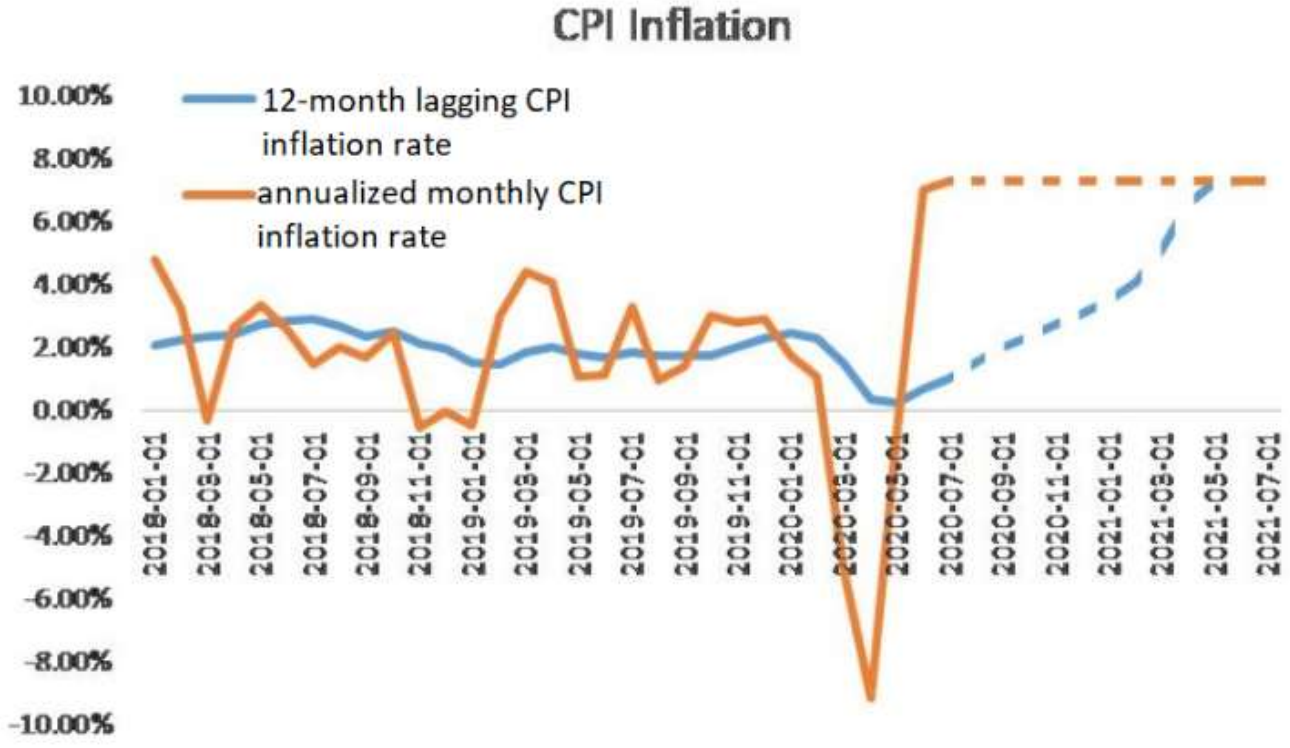


- Economic Surveys are better, Housing is still on fire, but what about Employment?

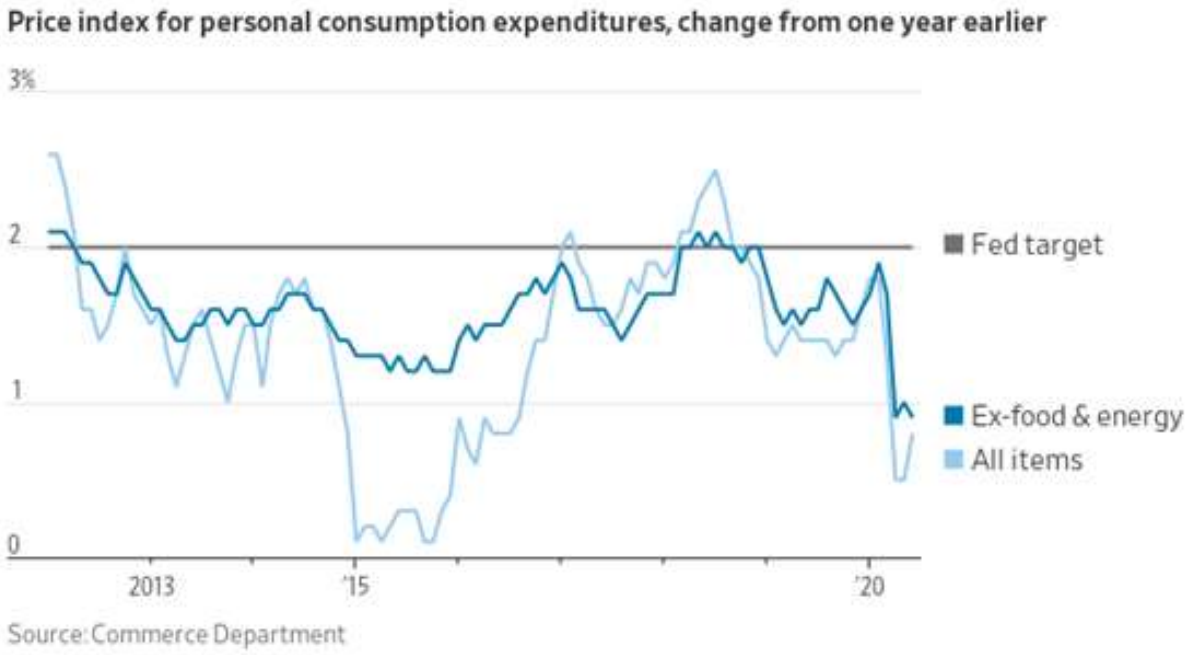
We recently warned about poor survey data following the surprisingly weak Empire Manufacturing survey. The Philly Fed Manufacturing Index followed suit with a poor reading. The Chicago Fed National Activity Index also fell. However, the broader PMI for August showed boosted optimism in Manufacturing (53.1 vs 50.9). The ISM Manufacturing Index for August was also incredibly strong at 56. The Dallas Fed also showed optimism with the General Activity Index reaching its pre-virus level. In contrast to this, Europe's Flash PMI fell sharply. Manufacturing actually ticked a little higher, but Services fell back to the breakeven 50 line from 55 in June. One common ground globally is declining Factory Employment. While Factory Output has been expanding, Employment continues to contract. The ADP Employment report also missed expectations by almost 500k jobs (428k vs 900k exp). This has not been a terribly reliable guess for the actual Employment Report coming out this Friday. But its likely we will still see more temporary layoffs becoming permanent despite overall modest job gains. Another way to look at this is we are trading high salary jobs for low wage ones.

Existing Home Sales in July rocketed higher by almost 25% vs June. This was an almost 9% increase vs July of last year. This is the strongest monthly gain on record. This data tracks closed contracts, so most of these houses went to contract in May or June.

The American Enterprise Institute (AEI, normally thought of as a political think-tank, has excellent, apolitical, economic views, as well) wrote a good piece on the quietly bubbling inflation. The CPI (consumer price index) we follow looks at 12-month lagging data. So recent spikes in inflation will be lost in the headline – and inflation will look muted. But if you look at the annualized rate of recent monthly data, you can see a potentially large spike coming. Of course, we should and normally do ignore short-term chart blips (chart crimes!). But it is also important to monitor them to see if a new trend starts to develop. For what it is worth, treasury yields and survey results are showing an increase in future inflation expectations, but the expected increase is rather subdued.



Staying on the inflation theme, the Personal Consumption Expenditure (PCE) Price Index for July was higher than expected. Or rather, the infamous "Core" inflation increased 1.3% on an annual basis vs the June rate of 1.1%. While we appreciate the AEI chart with the view to watch out for changing trends, the below chart makes the data a little less alarming.



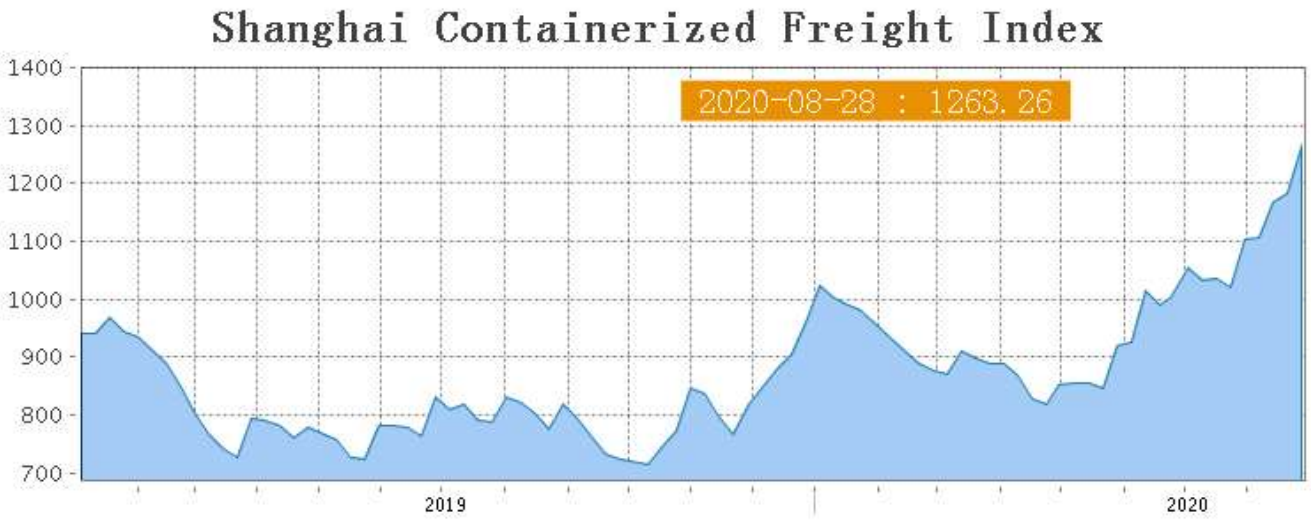
Two weeks ago, we mentioned the increasing delinquency rate on residential mortgages (8% overall and 16% for FHA loans - first time borrowers). Last week we got delinquency rates for hotels. Here is a breakdown by city:

- Houston 66%
- Chicago 54%
- New York 39&
- Dallas/FW 19%
- LA 14%

Durable Goods is another economic data point with mixed readings. The headline Orders number for July increased a whopping 11.2%. This was mostly driven my spending on cars and trucks. Unfortunately, Orders excluding Transportation only grew 2.4%. The more important Core Capital Goods Orders…aka business spending…only climbed 1.9%, as well.

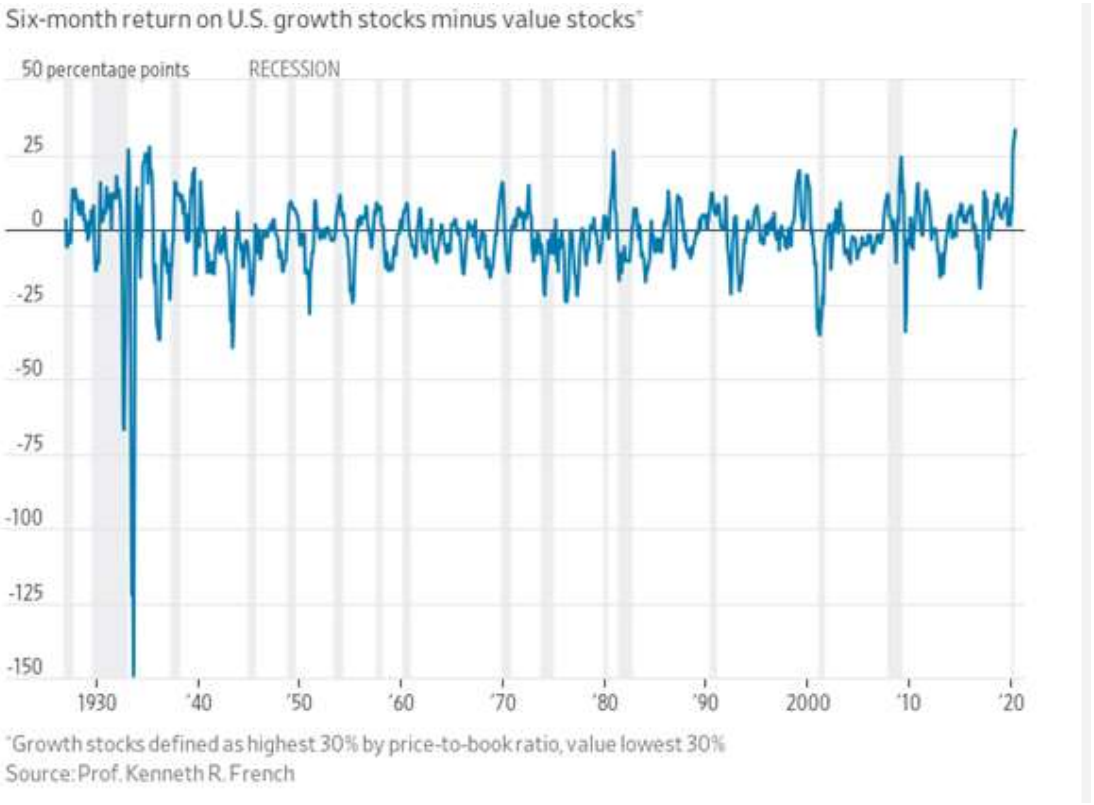
- Shipping Freight prices are on the rise

For all the conflicting economic data, we are surprised by the strength in the Shanghai Containerized Freight Index. This is a benchmark for global trade. The shipping rates for 15 different global routes compose the index. The current price is about 67% above the low during the last two years, and we are approaching the highs of the last 10 years. Alas, the Chinese government created the index. So, like everything else in China, we must bake in a good deal of lying and cheating.



- Speaking of Inflation, the Fed changes its plan

There has not been much to say about the Fed recently…other than its $7t balance sheet is still going strong. But we recently we were told of a new approach to addressing inflation. Instead of targeting 2% and trying to anticipate if it would start to run too hot, the Fed will now wait for inflation to materialize. The Fed members took a victory lap as though the problem to monetary policy over the last 100 years was the Fed acting *too quickly*. Quite to the contrary, the Fed has always acted *too slowly*. The Fed's logic rests on the lack of inflation in the labor market during the last mini-hiking cycle (2016-2019). It seems to us that what the Fed is really worried about is how the stock market views its actions. Interestingly, market interest rates went higher after Fed chairman Powell outlined this new approach. This apparent contradiction – rates went higher despite the Fed saying it would wait longer to raise rates – is a sign that inflation will become a real thing and the Fed will not be there to stop it. But it also comes from the Fed not saying that it would be trying to control the yield curve. That is, it would not suppress long-term rates. So, there is some logical behind the 10-year Treasury moving a touch higher. This is good for "inflation assets" like stocks and gold. The debate continues if inflation will be good for "long duration assets" like Growth stocks or if it will benefit old fashioned assets like Value stocks and commodities (recall Goldman says being long oil is the best inflation hedge). Here is a good snapshot of Growth's outperformance to Value courtesy of the Wall St. Journal:



- Quick Hits
  - Researchers in Finland claim to have discovered a cure for the hangover. The maker of the cure funded the research.
  - The hangover researchers admitted flaws due to some participants drinking more than they should have and some participants did not show any signs of being intoxicated.
  - In maybe unrelated news, Finland is home of the World Sauna Championships.
  - Commercial baby chicks in the US are delivered in the mail.
  - Most money-market mutual funds have eliminated fees to prevent yields from going negative.
  - There are 643 oil rig platforms in the Gulf of Mexico.
  - Golf equipment sales were up 51% in June vs the same month last year.
  - Hydrologically, there are only four Great Lakes (Michigan and Huron are the same body of water).
  - CBS is trying to sell Super Bowl ads for $5.5mm for a 30 second spot.
  - Research is pouring in now declaring that economy-wide lockdowns are bad and targeted restrictions are effective. In other news, Generalissimo Franco is still dead, indeed.
  - A Luka Doncic rookie card has gone from $1,800 to $80k in 18 months.
  - New York waived its 14-day quarantine mandate for participants in the Video Music Awards.
  - In New York, you are still not allowed to eat or drink standing up.
  - Palantir is coming to market. Its unlisted F shares will have variable voting rights (we love this company but hate this share structure).
  - Argentina is restructuring its 100-year bonds which were issued three years ago.
  - Robinhood is being investigated by the SEC for not disclosing its practice of selling its order flow to high frequency traders.

Trading: In years past, we have argued against the notion that having too little breadth in the market is a bad thing. We maintain this is still true on the surface…it is ok if Apple, Amazon, etc are the market leaders. But there are limits to our forgiving nature. We have thus reduced more of our long Big Tech exposure. But at the same time, we still acknowledge the insane momentum that persists. We continue to use options with the bet that QQQ (and others) will not just sit right here. Along these lines, we added to some of our single stock trading longs. This basket is mostly comprised of airlines, big box retailers, and work-from-home technology. These are still small positions. When they falter, they will likely crash spectacularly. On the flip side of this, we have added to some of our value names like financials and healthcare (most of healthcare is not value, that is for sure). This barbell approach fits the Growth vs Value debate we touched on earlier. And oh yeah, we finally dipped our toes back into the Tesla waters. A 70% run on the back of a stock split was just too much to stomach. So, we bought Puts with the stock right at $500. The Robinhooders seem to like and talk about round numbers.

TSLAQ: Tesla is having daily moves that are bigger than Ford's market capitalization. A Tesla driver in North Carolina was watching a movie on his phone when the car slammed into a cop car on the side of the road. Musk demonstrated his Neuralink brain-chip which he supposedly implanted in a pig. Apparently, this coin-sized chip is to be imbedded in the human skull and will connect to one's cell phone via Bluetooth. The Villain said this device could "help solve memory loss, strokes, addiction, depression, anxiety," etc. Uh-huh. The latest rumor is that the Chinese are behind the crazy Call option buying in Tesla. The theory goes that since they, the Chinese, effectively have equity ownership in the Shanghai factory, they are incentivized to make the stock perform as strongly as possible. Not sure we follow this logic. We do, however, still think that the old rumor of Musk buying his own stock options is plausible. Moving on, the stock finally had its split. It moved 70% from announcement through its first day. The day after the stock split, the company announced a $5b share offering. This is smart of the company, but they should have raised more. This is essentially free money for the company. If for no other reason, this creates more supply which obviously leads to more demand! (That's a joke…)

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