Weekly Update

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- Inflation is here! No kidding
- Pundits are saying leverage has unwound, we are not so sure
- Small Cap valuations look attractive
- Terrible Jobs report, but not because there are not any jobs
- The Fed to taper next year?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
SPX	4063	-2.5%	8.5%	40.9%
QQQ	316.9	-3.7%	1.1%	40.6%
US 10 YR	1.70%	1.59%	0.92%	0.65%
VIX	27.6%	19.5%	22.8%	35.3%
Oil	65.68	1.5%	36.2%	156.3%

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

We have been harping on the mounting and/or impending inflation for months now. Last week Treasury Secretary Janet Yellen mistakenly muttered that all the government fiscal spending might lead to inflation. This week we noticed a marked increase in inflation commentary by the pundits. Moreover, it seems that inflation has entered the every-man's cocktail-party fodder. Lo and behold, we finally got some hard data showing us inflation is here! We must admit, our playbook has been to ride our Reflation theme until it becomes mainstream. If the Fed, the pundits, the retail crowd, and the Uber drivers (we used to call this class of investor the shoe shiners*) are leaning one way, it must be the wrong way. But we thought this realization or acknowledgement would take much longer. So, we find ourselves in a bit of a quandary. We still like our positioning with the biases towards Energy, Financials, industrial, Commodities etc. Not to mention, we have just a tiny slice allocated towards the High Growth stuff getting slaughtered (still stinks to lose). But we do not want to find ourselves riding a new, tenuous trend. Nonetheless, we are going to stick to our guns as we think most people will misinterpret how sectors and styles react to inflationary periods accompanied with robust growth. When they do figure it out, that will be the sell signal.

As for Janet Yellen, she immediately reversed course on her "interest rates need to rise somewhat" comment. She literally walked back the comment later the same day with, "Let me be clear, it's not something I'm predicting or recommending."

One interesting theme we are seeing is that the market is very selective in reacting to certain data points or headlines. We noted the Yellen headline having an impact on the equity market despite the bond market not even twitching. When the Labor Department released the worst Employment Report in its history (so sayeth the professional guessers), the market took it to be an aberration. Growth and Labor would get back on track, and the Fed would remain on the sideline to make sure of it. But when the first signs of inflation hit with the CPI release, the market proclaimed that it was here to stay, and the Fed would be acting imminently! Perhaps we should be giving the market more credit. Government might cause inflation while at the same time keeping rates low! This is not how it should work, but then again, Government has not acted rationally in…forever.

The market also had an odd reaction to the pipeline hacking. At first it was discarded as nothing (wrong response). But then it was taken to be a permanent hike in gasoline prices leading to a drastic reduction in Retail / Consumer Discretionary spending (wrong response)! This is one area in which we will likely be proactive. Consumer Discretionary should behave well in this macro environment (notwithstanding fools filling up garbage bags with gasoline). We want to be buying the irrational fear that others are selling.

- Pundits are saying leverage has unwound, we are not so sure

Merrill saw record selling by hedge funds last week. And they saw selling of Tech across all their client buckets. Goldman also is saying that hedge funds have unwound their large leveraged long positions. We beg to differ given the continued manic behavior in the market. At least they are not JP Morgan who just last week said the market was under-owned. To be fair, they did say the Value names would perform best. And we are beginning to think that the high levels of margin debt in the market might be a problem. We have traditionally eschewed this occasional headline because the writers do not ever mention that the total is high only in nominal terms and not in relative terms (the market has gone up over time, after all). But we suspect that this margin debt might be concentrated in all the risky wings of the market. Widows and Orphans do not typically borrow money to buy Coke and AT&T. But young Robinhooders and Redditt clowns do use leverage to buy Dogecoin and "pre-revenue" companies. We will try to find more data on this.

- Small Cap valuations look attractive

Merrill put out (another) interesting piece about valuation. This time they compared the discount of Small Caps vs Large Caps in the Consumer Discretionary sector. This is counterintuitive as the Small Caps are/should be the biggest beneficiaries of the Reopening trade.

Exhibit 2: Big relative valuation opportunity for small cap Discretionary vs. large cap Discretionary

Consumer Discretionary relative multiple vs. history within Russell 2000 and Russell 1000 (as of 4/30/21)

Source: FactSet, BofA US Equity & US Quant Strategy

BofA GLOBAL RESEARCH

- Terrible Jobs report, but not because there are not any jobs

The Employment Report disappointed. Professional guessers (economists) were looking for about 1mm new jobs. But +266k was the official number. Furthermore, March Jobs were revised down 146k. The Unemployment rate ticked higher from 6.0% to 6.1%. But this was mostly a function of the Participation Rate expanding to 61.7% from 61.5% (this is an extra 430k people in the workforce). About a third of this expansion was parents being able to return to work because their kids are no longer forced to learn remotely (although, counterintuitively, the gain was completely in males). Average Hourly Earnings jumped 0.7%. This shows that the weakness in new jobs was based on the short supply of willing workers and not the demand from employers (+0.7% is a lot). Companies are willing to pay more to hire, but getting people off their couches is proving futile (because the government is paying them). The cost of Manufacturing inputs and longer delivery times are also causing some reluctance to hire. To this end, almost the entire gain in Jobs was in the Leisure and Hospitality sector. There are still 8.2mm fewer jobs now than before the virus-fear.

Jobless Claims remained on a positive trajectory as they dipped below 500k. The 4-week average is down to 560k.

The Job Openings and Labor Turnover Survey (JOLTS) for March reinforced the trend (even though it is a month older). Job Openings hit an all-time high at over 8.1mm.

- Domestic business optimism hits an all-time high

Domestic business optimism continues to surge. Markit's survey of Services businesses about their current activity and future expectations (Purchasing Managers Index or PMI) for April was 64.7 beating expectations of 63.1. This brings the Composite (Services and Manufacturing) for April to 63.5 which is an all-time high.

The other PMI survey, released by the Institute for Supply Mgmt - called the ISM, came in short of expectations. April was 62.7 vs 64.2 exp and 63.7 in March. We always note that the ISM is more geared towards international companies, so this disparity is not too surprising.

- The Inflation drum beats on

The Consumer Price Inflation (CPI) increased more than expected in April. The "core" inflation increased 3% compared to April of last year. It was a 1.6% increase in March vs last year. We were surprised at the tame expectations given all the memes about lumber. The headline inflation increased 4.2%. But nobody eats or uses energy.

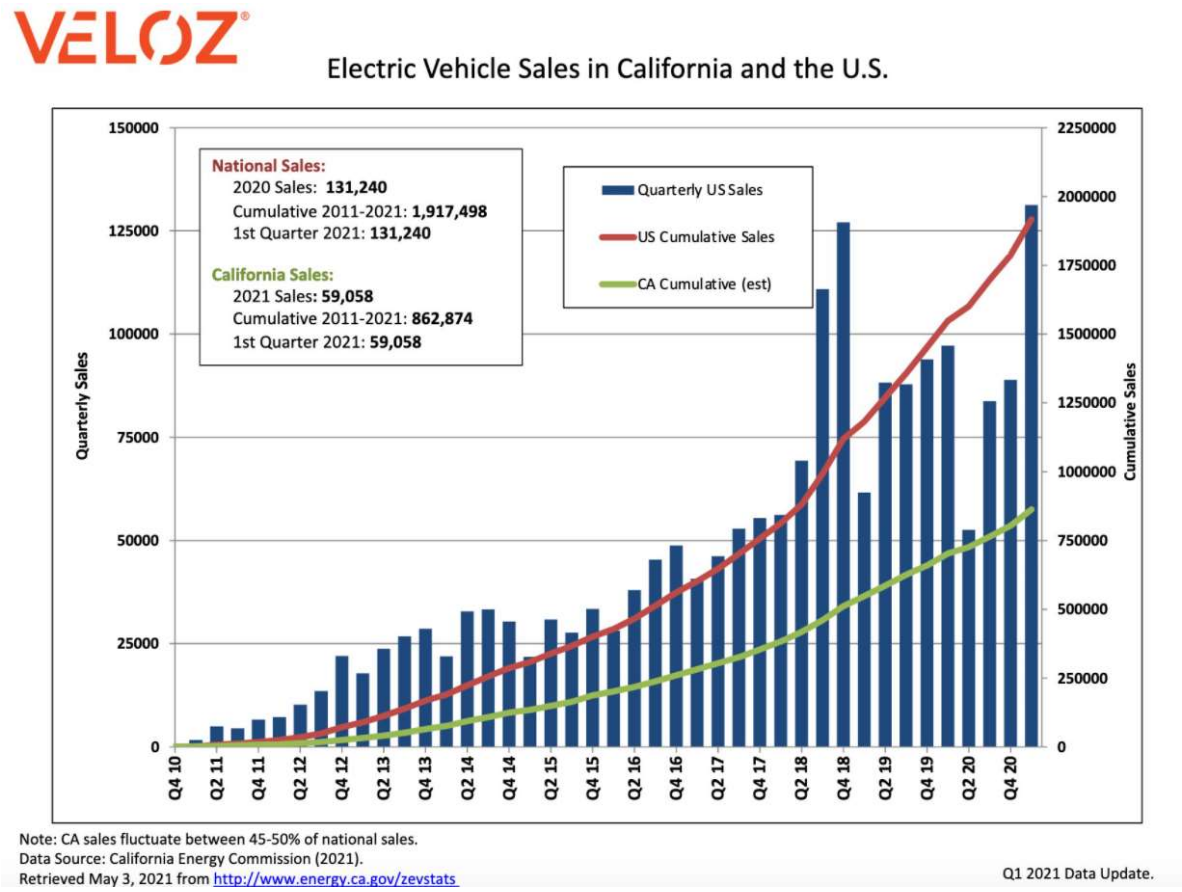
Atlanta Business Inflation Expectations

- The Fed to taper next year?

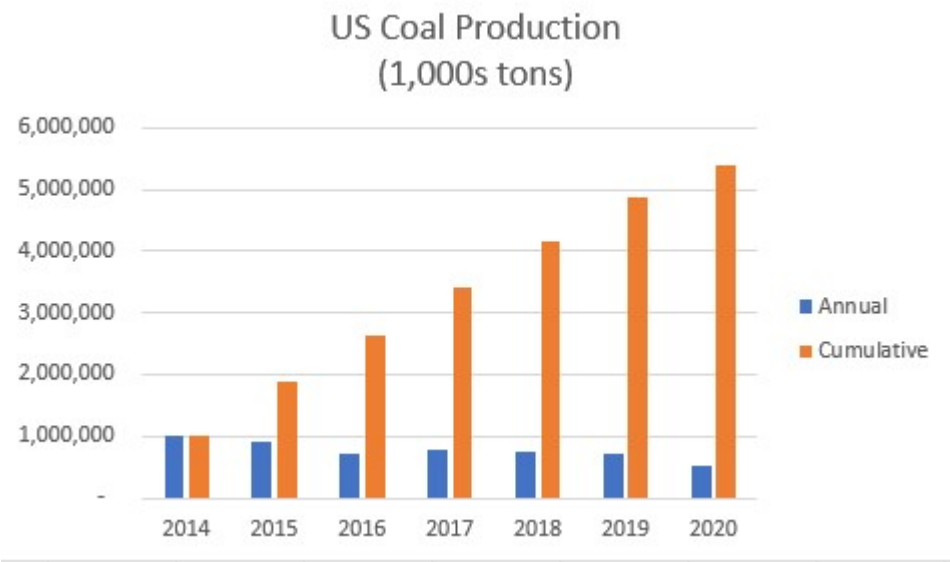
JP Morgan is predicting that the Fed will start to "taper" bond purchases this coming January. The asset mgmt. wing of the bank expects the talk to start this summer in August at the annual Jackson Hole confab. Ultimately, they expect a modest reduction of $15b split between Treasuries ($10b) and Mortgage-Backed Securities (MBS $5b) down from the current $120b a month ($80b and $40b respectively). These guys are obviously talking their book (biased). But we highlight the comments because it is the first real prediction. Many have clamored that the Fed *needs* to slow the asset purchases. But nobody has said when they *will* start.

- Chart Crime of the Week

Anything Electric Vehicle (EV) related automatically makes the CCW contender list. This one, like all the others in EV land, uses different scales on the left and right axes (yes, that is the plural of axis). And, of course, there is no relative scale to other auto sales. Most importantly, its foundation is useless data: Cumulative Sales?



For kicks and clarity, we quickly mocked up a similar chart of US Coal Production over the last seven years. Wow, look at that Cumulative Growth!



- Quick Hits

- Lyft's financials exclude insurance costs and some employee compensation in its Adjusted EBITDA calculation. Lyft's Adjusted EBITDA was still negative. There should be no such thing as Adjusted EBITDA (Lyft is not alone in using this abomination).
- The President and Vice President cannot hail from the same state.
- There are over 17b cells in a single excel worksheet.
- California is releasing over 100,000 inmates to make the prisons safer.
- A Belgium farmer accidentally moved a stone that marked the French border.
- US Footwear imports increased 60% from February to March.
- TaylorMade Golf just sold for $1.7b. The sellers bought it four years ago for $425mm (from Adidas).

*Shoe Shiners – no offense to them. In New York City, most offices had guys who walked the trading floors doing shines every day. These guys made a ton of money even after the requisite kickbacks…Thornton Melon would be proud. But their unintentional ability to call the top of the market by pitching ideas to the traders was uncanny.

Trading: It was a pretty quiet trading week all things considered. We added some short protection at a good time against our long Small-Cap exposure. We will hold onto our Tech protection for a while more, but we are not married to it. That is, our protection is mostly on the big, extremely profitable segment of the NASDAQ. We do not want to blindly ride this lower. Timing is hard, but we will pick a few spots.

We added a bit to one of our favorite Growth names, Chewy. This company now makes money with positive cash flow. And it has positive catalysts ahead. But it is getting demolished on the unwinding of Growth. We added a touch to "old school" Tech which does not rely on obscene valuations. We trimmed a touch of our long Energy position. But we will likely rotate into another segment of the Energy space. We dinged two names from our High Growth basket. These were once thought to have very little competition in their respective fields (or at least first-mover advantage). This does not seem to be the case anymore. Therefore, these were more of a change in story versus getting shaken out on dismal price. This does not make the loss any more palatable. in fact, it makes it worse since our thesis proved wrong. We also trimmed a bit of our Health Care long. It has done what we wanted (steady but not great). But with Biden going back to the old Dem playbook about bashing drug makers making money, we thought it was prudent to reduce. We might cut some more. And as we discussed above, we think adding to Consumer names that are getting sold in the inflation scare makes sense.

TSLAQ: If Saturday Night Live were a car, it would be a Tesla: Once great, now overhyped and falling apart. Elon Musk admitted his pumping of the intentionally worthless cryptocurrency Dogecoin is "a hustle" during his hosting of the horrendous show. We think this charlatan exposing himself (not literally) on live tv is contributing to the increased volatility in the markets. Then again, Tesla sales in China dropped precipitously in April vs March (-27%) as the communists continue to turn up the heat on the company. And the usual Villain leaks/pumps are falling flat. Fake-news lapdog Electrek is reporting that all Model 3 and Y cars are sold out for the quarter. But a quick perusal of the Tesla website shows that cars can be bought with 3–5-week delivery times.

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