Weekly Update

30-Mar-2022

Carlisle C. Wysong, CFA
Managing Partner

- Short Squeeze turns into mania for no reason
- Positioning is rapidly changing (just like the markets)
- First crack in business spending?
- Jobs are still plentiful (but nobody wants them)
- Business surveys have strong headline readings but weak internals
- Trading tariffs for inflation relief
- Housing data softens again
- The Fed is going to keep hiking and the FOMC Dove-Hawk Scale
- Oil headlines galore, supply is still constrained
- Quick Hits
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,602	3.3%	-3.1%	17.4%
QQQ	$367.09	4.3%	-7.6%	16.8%
US 10 YR	2.35%	2.29%	1.51%	1.75%
USD/DXY	97.8	98.6	96.0	93.2
VIX	19.3%	23.6%	17.2%	19.4%
Oil	$107.47	-6.5%	43.4%	78.1%

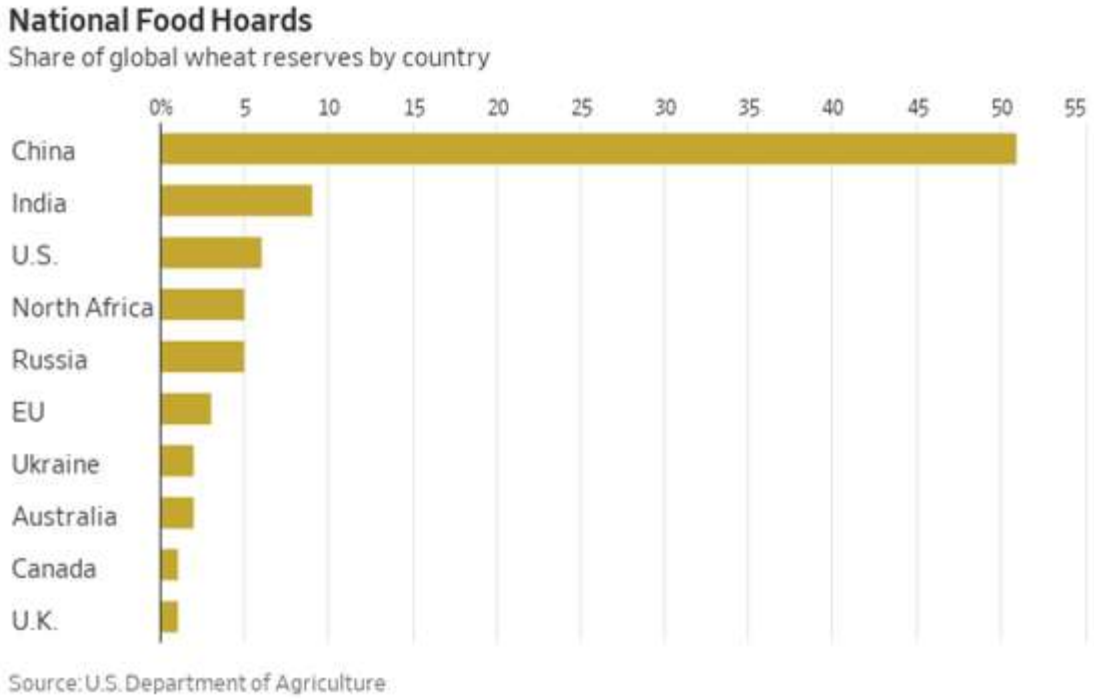
*10yr, DXY, and VIX are levels not changes
** Oil is front month futures, beware

The short squeeze turned FOMO (fear of missing out) rally continues with a vengeance. But we are not sold. Tensions in Ukraine have seemingly cooled. But most military experts think Putin is just changing his tactics after some embarrassing battlefield losses. And whatever happens in Ukraine, it does not really change our base case of slowing global growth and the associated decline in earnings growth. Actually, our base case is morphing into negative global growth. China is particularly vulnerable as its 0-Covid policy continues to wreak havoc with the city of Shanghai being the latest victim. We have noted that Foxconn, the main assembler of iPhones, has reopened in China. And we do think China will do its best to keep the machine rolling. But we think growth stumbles (their own and supply chain snafus trickling down to others) are far more likely than smooth sailing. Back to Russia, if Putin miraculously regains his sanity, that might help ease some of the recent inflationary spikes and extended growth hiccups (Western companies having to withdraw from Russia). But the underlying problems will not evaporate or reverse. The fact that the Treasury yield curve (10yr-2yr) continues to

flatten (went inverted briefly this week) tells us that more people are expecting a recession. Although we have learned that this is not a one-size-fits-all analysis. The 10yr-3month yield curve has been *steepening* (10yr rates are increasing more rapidly than 3 month rates). And the Fed is known to watch this yield curve more closely. But we think this will just serve to trick the Fed into complacency. The market cares more about the 2-10yr curve. And as most of you know, we favor free market expression more than academic "research."

We want to highlight the latest leg of the rally: Meme mania and Fantasy Tech are back in vogue. We have mentioned that Call option volume has surged (Goldman has a stat noting it has surged 1200%!). But it is now spreading into the more degenerate corners of the market (people buying Call options on AMC because it bought a gold mine might be the face on the wanted poster). There is a time and place for everything (we have been long this junk before). But profitless growth or rudderless mania heading into an economic slowdown with rising rates does not fit the bill for us.

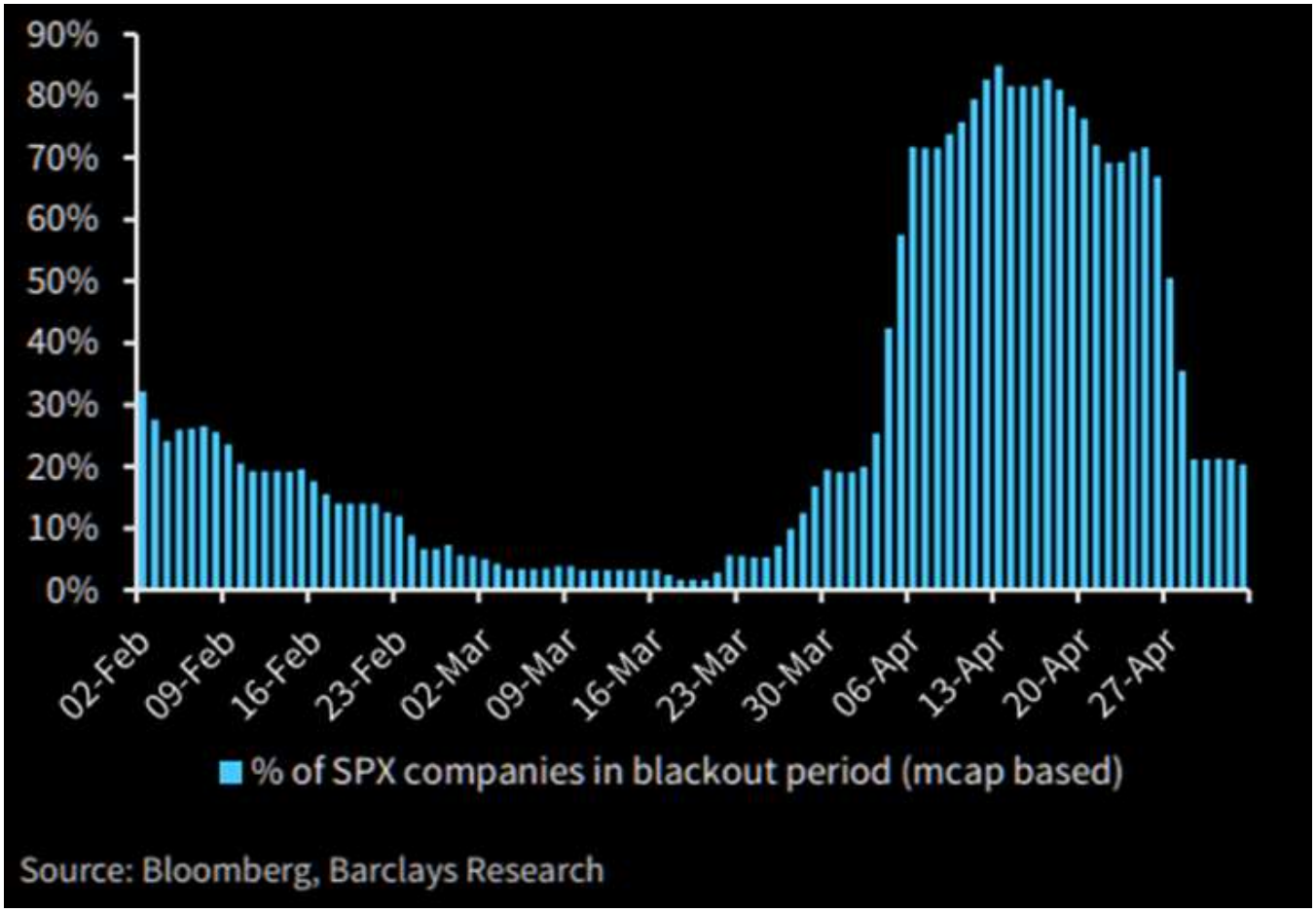
- Here is proof that China does not care what is going on in the rest of the world:



- Positioning is rapidly changing (just like the markets)

Merrill reports that Hedge funds are back to being sellers. Institutional (mutual funds and other long-only money managers) and Retail are now the buyers. Merrill claims that Retail flows have been a strong indicator of S&P 500 performance (and we believe it). But this data is heavily skewed since it only dates back to 2009: right when the epic bull market began fueled by Fed intervention. The opposite set-up is true now (Fed tightening). Paradoxically, the majority of buying is into Value stocks and funds. But Growth has outperformed Value by about 2.5% over the last month.

The other leg of positioning involves corporate buybacks. As you can see in the chart from Barclays (courtesy of Themarketear), the vast majority of companies will shortly be heading into their blackout periods which do not allow buybacks. Quarterly buybacks are about $210b which is about 60% of the average daily volume. Spread over a month, this is about 2% of the total volume. This is a meaningful amount…especially considering the market most likely needs new buyers after its rapid ascent from the war-lows.



- First crack in business spending?

Durable Goods fell more than expected in February. And the Core Capital Goods, aka business spending, turned negative (along with a positive revision in Jan). This data can be volatile month to month. And we have been lauding the resiliency of business spending (we keep expecting it to fall and it just keeps chugging along). We will see how the trend develops. But if this follows other economic data and starts to sour, that could be the straw that takes us from flat growth to negative growth.

- Jobs are still plentiful (but nobody wants them)

Jobless Claims fell sharply to 187k from 215k last week (previous week, actually). This is the lowest weekly tally in 53 years! The four-week average is 212k. The Continuing Claims fell to their lowest level since 1970. And these are nominal, unadjusted numbers. The workforce is now twice the size of back then (women working and population growth are the obvious answer, but this is still an amazing stat).

The JOLTS report (Job Openings and Labor Turnover) for February shows the same 11.3mm Job Openings as last month which is right at the all-time high. Health Care Job Opening total over 2mm which sits near the top of the heap. This is one reason why we are long Health Care staffing (closely associated Health Care inflation is the other macro theme supporting our trade). The total number of Hires continues to outstrip Separations (Layoffs and Quits primarily) by 600k (6.7mm vs 6.1mm respectively).

ADP's guess at Friday's Unemployment report calls for 455k Private Payroll additions. This is in line with the professional guessers's consensus of 438k new jobs.

- Business surveys have strong headline readings but weak internals

S&P's PMI (this used to be the Markit PMI…it is the one that is more US focused and encompasses a large range of company sizes) surprised on the upside in the early March reading. With a two-point jump in Manufacturing and three-point jump in Services, the Composite is a back to its highest level since July of 2021. Of course, input costs continue to run rampant. And the production outlook sits at a five-month low.

The Kansas City Fed's Manufacturing survey ramped to an all-time high. This headline is shocking. But the subcomponents dampen the enthusiasm a bit. Prices, Delivery Times and New Employees are all negatives. The Dallas Fed's Manufacturing survey in March missed expectations and fell from February. Its Expectations reading was the lowest in 21 months.

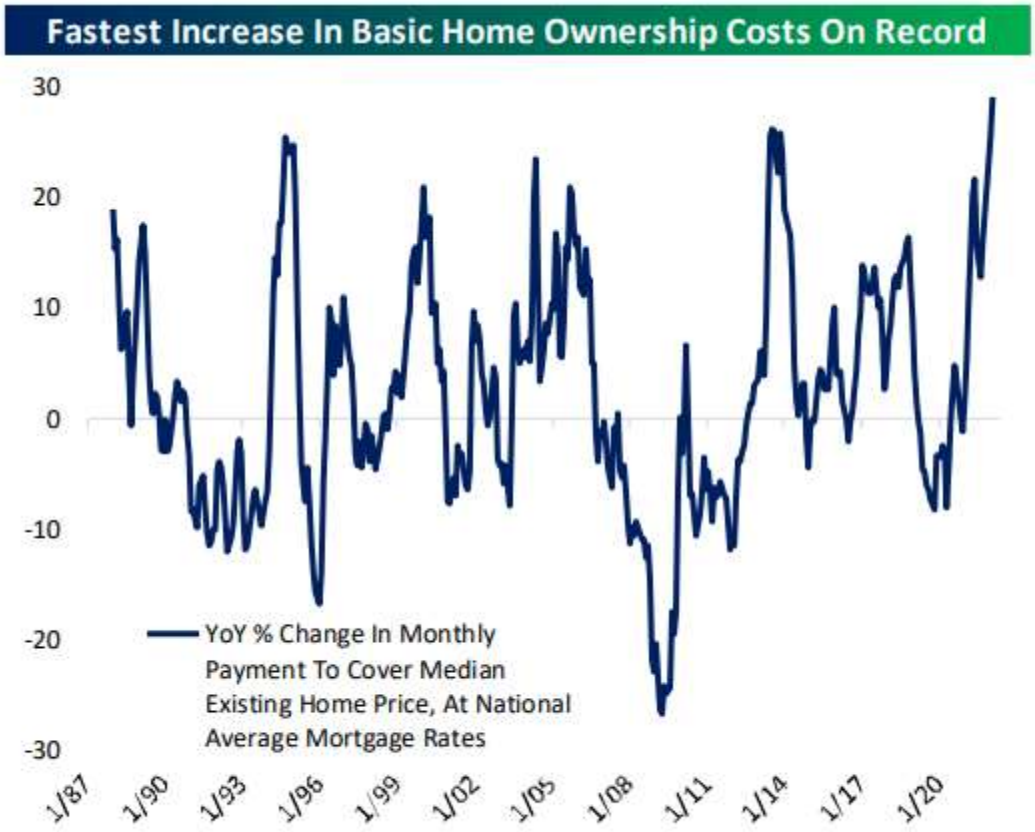
The Eurozone PMI Composite (the early read for March or "Flash" reading) improved across the board. The gains were moderate, but both Manufacturing and Services improved. Sentiment is still well off its highs from last summer, but any strength is positive. The UK had a similar bounce (and from a higher level).

- Trading tariffs for inflation relief

The Biden administration has extended some tariff waivers for a variety of Chinese exports (into the US). These tariffs range from 7.5% to 25%. This was done quietly to avoid political debate. But clearly it was done to help cool inflation any way possible. The amount of goods impacted equals about $370b which is about 85% of the total goods imported. We think this is a smart move. Now is not the time for artificial price increases. (We were always torn on this subject. While we are ardent believers in free trade, it was of paramount importance to force a reshoring of supply chains and to cut off the blatant theft of technology from our national champions.)

- Housing data softens again

The 30yr Fixed rate is up to 4.42% from 4.16% (weekly data). Recently, we explained that the increase in mortgage rates amounted to an 11% increase in the cost of a home. Bespoke takes this a step further and combines this increase in monthly payment with the increase in the cost of the house. It does not look good for continued demand. This is more of a comment about Housing and its impact on the economy. But we still are not touching Housing stocks, either.



Fastest Increase In Basic Homeownership Costs (Author)

Pending Home Sales continue to drop. The February reading was the fourth monthly drop in a row. The index is back below pre-virus-fear levels.

- Other Economic data
  - The University of Michigan's Consumer Sentiment survey continues to wallow near the lows since the post-World Financial Crisis (when US debt was downgraded by S&P). Recall the U Mich survey is more sensitive to spending patterns (particularly when impacted by changing gasoline prices).
  - Consumer Confidence in March ticked lower, as well. This sits in about the middle of the virus-fear range. Consumer Confidence is more sensitive to employment.
  - Retail Inventories and Wholesale Inventories for February diverged. The former shrank and the latter expanded. Our bias (slower growth) tells us that Retailers are not seeing the demand and thus are not restocking. This leaves Wholesalers holding the bag.
  - Weekly Redbook Retail Sales finally ticked higher after five straight declines.

- The Fed is going keep hiking and the FOMC Dove-Hawk Scale

Patrick Harmer of the Philly Fed underscored the dilemma the Fed faces. He wants to raise rates and start reducing the Fed's balance sheet (selling bonds they just got done buying). But he is worried about the renewed lockdowns in China and the war in Ukraine. He did not admit that the US economy is teetering. But he implied it was not on rock solid footing as he warned against more harsh tightening action like a 1% hike. Although he did add that killing inflation was the top priority at this point. Here's our FOMC Dove-hawk Scale we use to judge any change in tone by Fed speakers.

					Fed Funds Target Rate: 0.25% -0.50%							
	Turtle Dove		<=	Dovish		Neutral	Neutral		Hawkish	=>		Chicken Hawk
Governors				**Brainard**	**Powell**	**Bowman**				**Waller**		
Neutral Assumption*		2.00%		2.25%		2.50%						
Regionals	**Kashkari**	**Evans**	**Williams**			**Daly**	**Barkin**	**Bostic**	**Harker (in lieu of Boston)**	**Bullard**	**Mester**	**George**
Neutral Assumption*	0%?	2.00%	1.75%			2.50%			2.75%	3.00%	3.00%	3.25%
Votes												
*Neutral is arbitrary over the long term as it moves with the strength of the economy. And some use the Real rate which subtracts the rate of inflation. Art not science.												
And some are stated levels, some are inferred from the Fed's anonymous Dot Plot. Levels are a mix of pre-virus amd now.												
Dallas and Boston are not on the chart yet with their interim presidents												

- Oil headlines galore, supply is still constrained

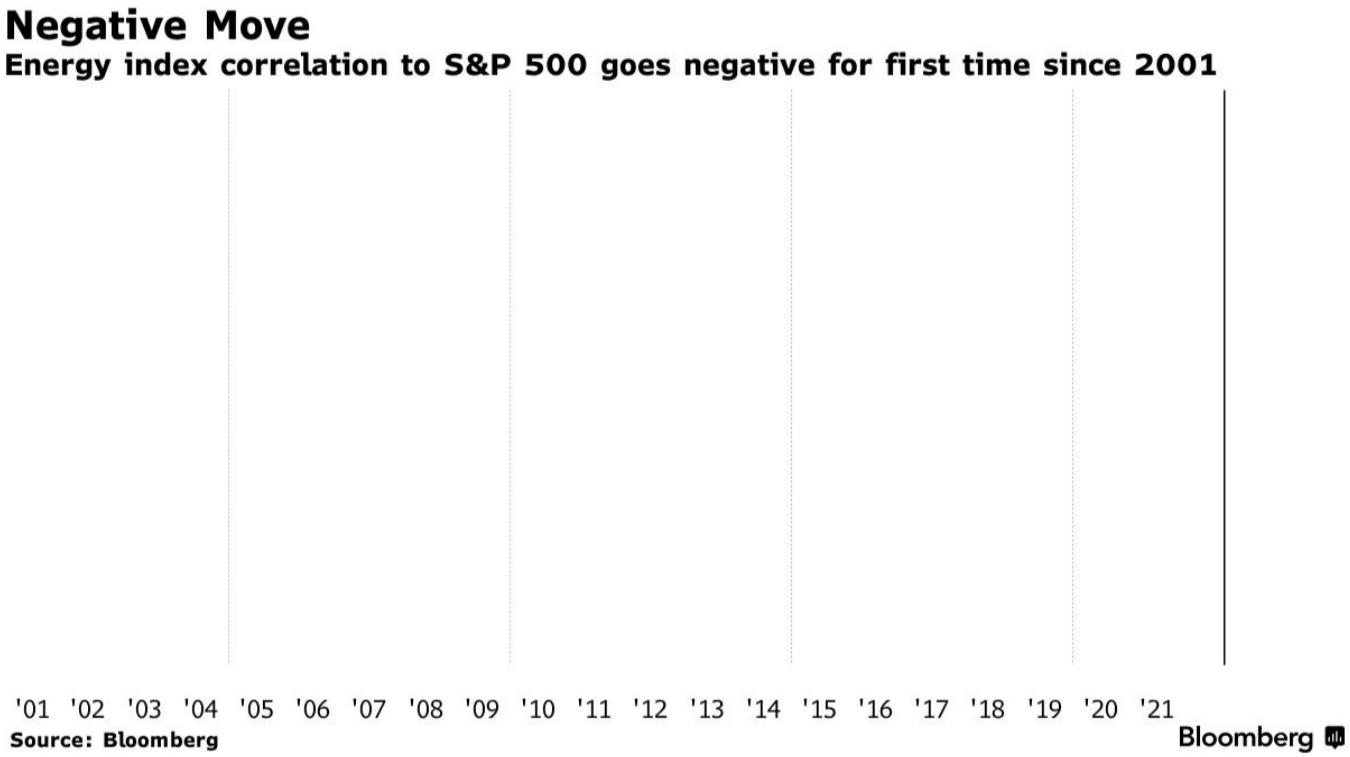
Oil continues its rollercoaster ride. China lockdowns kill the demand story. Then more Houthi attacks on Saudi Arabia (this time on an oil storage facility in Jeddah) bring the supply story back to the fore. The Iran nuclear deal has seemingly stalled. The terrorists are insisting that its terrorist organizations not be labeled terrorists. Supposedly Chevron has been given the green light to increase production in Venezuela. We think this is a fool's errand. It is unlikely that Chevron can overcome the lack of infrastructure maintenance in the country. And even if were able to do so, we do not think Venezuela will allow for a US company to "save the day."

OPEC is about to hold its monthly meeting to determine if it should continue increasing production like it has (or at least like it has been trying). Ahead of this meeting, the cartel lowered what it sees as the market surplus in oil. That is, it used to think the market was oversupplied by 1mm barrels per day. It now thinks this surplus is down to 600k bpd. We do not put a lot of faith in either OPEC's ability to judge the market or its faithfulness in reporting its faulty views honestly. This aside, many think this is bullish for oil since the world's largest producing cartel thinks there is more demand. Of course, this also means that OPEC will be more inclined to hike production. Alas, for us, it comes back to whether OPEC/Rogue has the *ability* to raise production. We do not think they do in any meaningful way.

There has been a lot of media reporting on the debacle in nickel (we highlighted it, too, calling it as essentially the big banks covering for their biggest customer). But other commodity markets are seizing up, too…including oil. The Intercontinental Exchange (ICE) has increased margin requitements by 19% for fear of heightened counterparty risk (futures trades are settled up at expiration…so you need margin in the interim). This makes trading more volatile. Sometimes it causes bursts higher in price because commercial producers who hedge will buy more of the underlying to satisfy a margin call. But it also removes otherwise willing buyers from the market…buyers who do not want to post the extra collateral.

- Chart Crime of the week

This "chart" is not the work of some hungover intern. It has been on the Bloomberg website for over a week.



- Quick Hits
  - The SEC is proposing that companies are forced to disclose their "carbon footprints" and other green dreams. While laughably silly and out of the purview of a financial regulator, we welcome the disclosure to uncover all the empty virtual signaling.
  - As a refresher, the creator of ESG thinks ESG is one giant fraud.
  - Jazz music has been banned in New Orleans schools since 1922 (until now).
  - The first US debt was payable in bales of tobacco.
  - Barclays Bank forgot to update an SEC shelf registration (a filing detailing how much of a security the bank plans on selling to the public), and it cost the bank $600mm.
  - Four Deutsche Bank employees were fired for trying to expense a "dinner" at a gentleman's club.
  - Patrick Harker, same Fed official as above, cited "whopping membership fees" at private golf clubs as evidence of inflation (not his golf club).
  - $600mm of crypto was stolen from a blockchain network connected to an online game.
  - Australia is the latest nation (California was first) to increase direct payments to consumers in an effort to combat the higher cost of living. Fox Butterfield, is that you? (Recall that the NY Times reporter was perplexed that crime rates were falling while prison populations were growing.)
  - A Wharton "professor" says cycling is bad for the environment because it leads to people living longer. Tobacco companies in the 1980's used the inverse of this logic.

Trading: We added more Put protection into the short squeeze. We are going slowly and methodically. As evidenced by GameStop last year and Tesla during the last three years, short squeezes can last a long time. In the same vein, we added some more Gold. We added back to our Energy long after trimming it ever so slightly

recently. We also added to some of our small-cap names. These are risky, but they seem to be exhibiting some predictable volatility. Bottom line: We are sticking to our guns that this market is in trouble with the Fed hiking into an economic slowdown. We are still long the market. But we will try to be nimble around the edges.

TSLAQ: Here's another sliver of Musk we kinda like: His public feud with Jeff Bezos of Amazon. When asked by the Washington Post for a comment about regulation, Musk replied, "For the 100th time, please give my regards to your puppetmaster." Bezos owns the Post. And Musk dislikes him for many reasons including his ostentatious lifestyle (there is some irony here, of course, but Bezos is way more enamored with yachts and sports team and the such.) As for the stock, Tesla caught another senseless rally because it is going to split its shares again. Many analysts are now trying to justify this silliness by pointing to the options market. Shares can be trading in fractions, so the notional amount of the price is largely irrelevant. But options are still trading in contracts consisting of 100 shares. Fine. But is allowing YOLO day-traders the ability to trade more options really justification for the stock to gain another VW worth of value in a week?

Check out our website to learn more about Chalk Creek Partners

Carlisle's Twitter Financial List

Carlisle's LinkedIn