Chalk Creek Partners LLC

Registered Investment Advisor

Weekly Update 19-November-2020

Carlisle C. Wysong, CFA *Managing Partner*

- Market calms down, but rotation persists
- Positioning is as bullish as ever
- Earnings season wrapping up nicely
- Labor market still healing
- Inflation remains subdued to say the least
- The Housing Market continues to roar
- Chart Crimes of the week (double)
- Click here for the full note

	Last	5d %	YTD %	1yr %
SPX	3573	1.3%	11.7%	14.8%
QQQ	292.4	1.4%	37.5%	43.8%
US 10 YR	0.84%	0.98%	1.88%	1.75%
VIX	23.1%	23.5%	13.8%	12.8%
Oil	41.63	1.7%	-31.6%	-24.4%

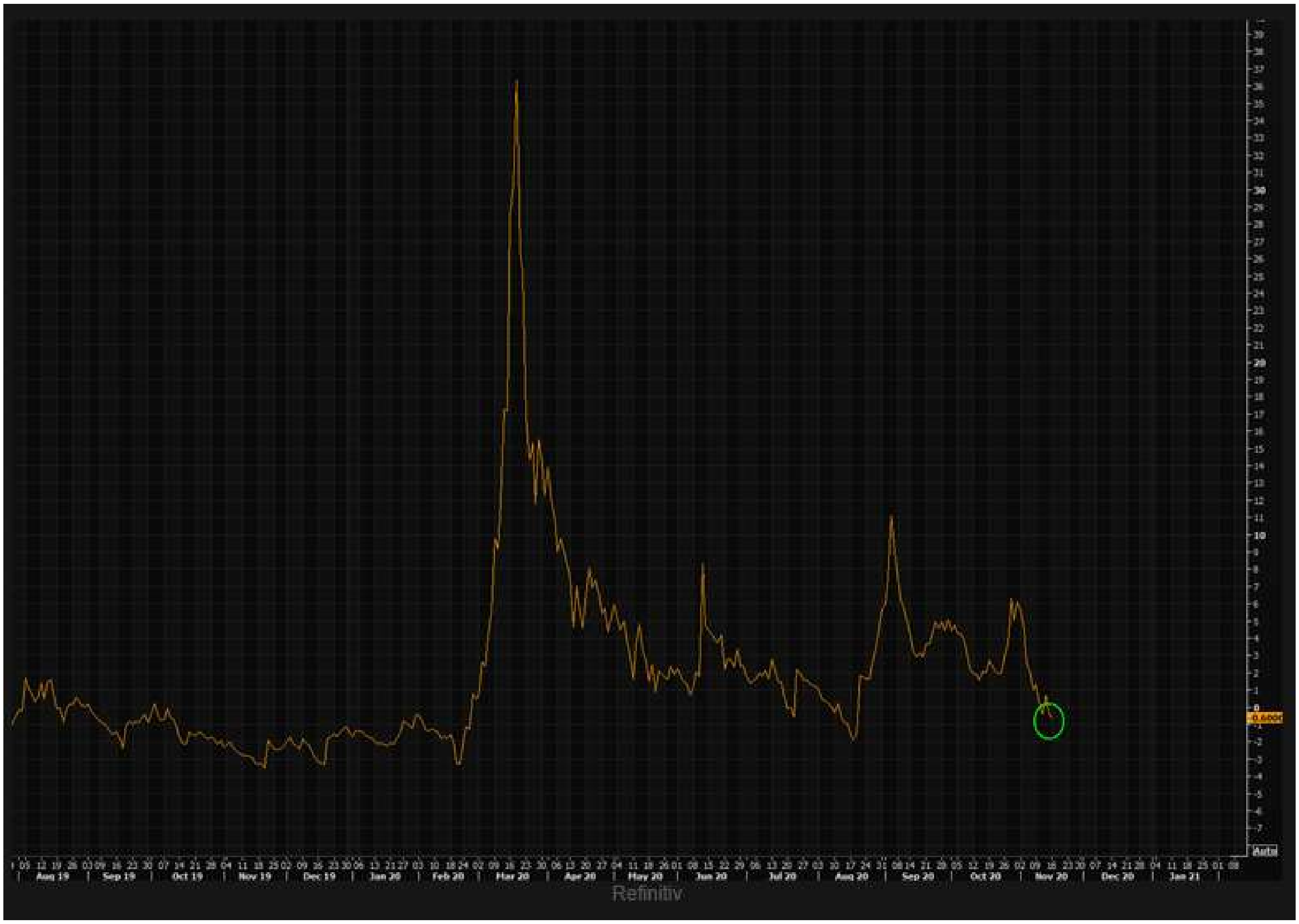
*10yr and VIX are levels not changes

** Oil is front month futures, beware

The post-election/vaccine euphoria has started to fade. However, the controlling theme is still the rotation between Work-From-Home and Recovery stocks. This translates into headline apathy with the indices not moving much and the market Volatility continuing to ease. Of course, beneath the surface is a different matter. Without a stimulus bill coming any time soon (Schumer's mild optimism notwithstanding) and as virus fear continues to increase, there is reason for caution. We even have some old-school political drama unfolding quietly as the government is due to shutdown on December 11 if congress does not take action. Traditionally, weakness on this front has been a great buying opportunity, but obviously the political landscape is a bit different right now.

Of course, the market is basically eschewing all the potential negativity as it remains within a whisper of all-time highs. Ebullient sentiment is evident across all the traditional indicators. For starters, the Merrill Fund Manager Survey showed that investors are about as close to "all-in" as they have been in a long while. Equity allocations are up. Cash allocations are down (despite there being no such thing as cash on the sidelines in aggregate). Global GDP growth expectations are at a 20-year high. The favorite trades call for a rotation in Emerging Markets, Small Caps, and Value stocks. None of this is particularly new or surprising. We typically like to fade these "profound" rotations as they usually just end up being fly-by-night trades. Merrill agrees with us. One twist is investors still hate oil stocks, but they love oil the commodity. We think this one makes sense as the former is held back by virtue signaling while the latter responds to supply and demand levers (and it is the best inflation hedge according to Goldman, but see below as to why not to worry about inflation just yet!).

Volatility is also telling us that everything is all clear. The Futures curve in the Vix (from marketear…they do great work, but their graphics stink) shows that the immediate term worries have subsided. Put simply, this chart just shows that the spread gets high when people are more worried about today vs tomorrow (figurately).



The options market has an indicator called the Put/Call ratio. It is just what it sounds like: This is the ratio of the volume of Puts bought vs the volume of Calls bought. This is a dumbed-down indicator because it ignores the "moneyness" of the option. That is, buying a deep-in-the-money Call that replicates stock has much more impact on the market than a deep-out-of-the-money option (the difference in "deltas"). It is also a bit murkier now that there are non-market-making sellers of options (like Chalk Creek at times). Therefore, it is much more difficult to distinguish between the buying and selling of options (this used to be easy). Despite this techno-ramble, the indicator still holds some value. And it is showing market complacency.

More on the position theme: Retail inflows into equity funds have surged. The AAII (American Association of Individual Investors) bullish/bearish indicator has jumped back to its recent peak in early 2018 (just after the tax cuts fueled the market higher…before being shocked by the Volatility explosion shortly thereafter). A Goldman Sachs Risk Appetite indicator is climbing the chart. Correlations between equity markets across the globe are back running high. Every strategist on Wall Street all of a sudden has a 10-15% rally booked for 2021. And on and on we could go. We might just have to sell this market more quickly than we planned.

- Earnings season wrapping up nicely

We are 94% of the way done through 3Q2020 earnings season. As you can see in the table below, the expectation as of July 1 was for a 25% drop in earnings. With only a 6.8% drop, this is quite a remarkable "beat."

Strong Retail earnings during the last week helped push this number. The present quarter (4Q2020) is expected to see earnings decline 11.2%. Next year is supposed to see a sharp acceleration given the easy comps (lousy earnings in Q1 and Q2 of 2020): +15% and +43%.

Exhibit 3. 2020Q3 Blended (Reported & Estimated) Earnings Growth

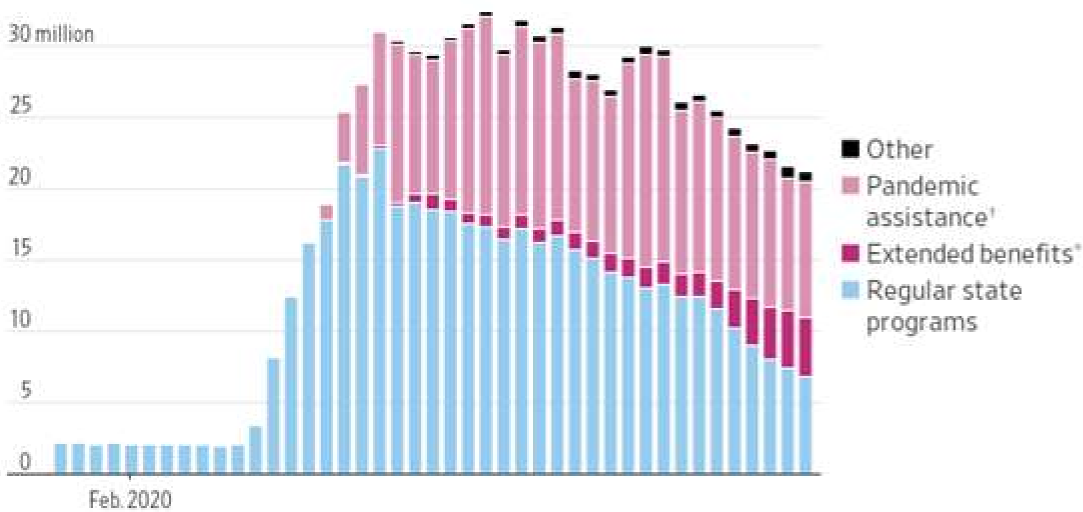
Sector	Today	1 Oct	1 Jul
Consumer Discretionary	-0.3%	-34.2%	-50.1%
Consumer Staples	6.0%	-3.9%	-5.0%
Energy	-108.2%	-111.3%	-120.4%
Financials	-2.8%	-21.6%	-31.9%
Health Care	11.2%	-2.2%	-3.5%
Industrials	-54.7%	-65.5%	-60.3%
Materials	-1.4%	-17.0%	-24.9%
Real Estate	-12.6%	-14.2%	-13.7%
Technology	7.6%	-0.6%	-3.5%
Communication Services	3.8%	-20.6%	-20.3%
Utilities	0.9%	-3.9%	0.2%
S&P 500	**-6.8%**	**-21.4%**	**-25.0%**

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

- Labor market still healing

Jobless Claims registered 709k last week with a slight uptick to 742k this week. This halts the improving trend. But we are seeing more evidence of the important theme of a slowing of permanent job losses. The WSJ highlighted the adaptability of many of the laid off workers to fine new careers in more stable confines. Despite our long running nervousness about a frayed workforce, we are seeing more glimmers of hope…and without the assistance of overwrought government programs. (chart below excludes today's data but it is close)

Number of people claiming continuing unemployment benefits, by program



Note: *Reflects Pandemic Emergency Unemployment Compensation for those who exhausted other programs. †Reflects Pandemic Unemployment Assistance for self-employed and others not typically eligible.
Source: Labor Department

- Inflation remains subdued to say the least

Inflation as measured by the CPI (Consumer Price Index) for October came in at 1.2%. This and the "core" which excludes food and gas both missed expectations on the low side. Recall the Fed's target rate is 2% (on the PCE not the CPI, but the point still stands). And the Fed has said it wants inflation to overshoot for a sustained period before it can think about raising rates.

Producer Prices (PPI) for October also came in a touch light at 1.1%. Import and Export prices for October both slipped on an annualized basis.

In the markets, the Treasury Inflation-Protected Securities (TIPS) have been for sale since the election. People were pricing in a "blue wave" which would have unleased massive stimulus and thus a more likely path to higher inflation. But the likely split government has eased those fears, so investors are selling their inflation protection (TIPS). They do not see inflation coming any time soon.

The one outlier on the inflation front: Atlanta Fed Business Inflation Expectations ticked up to 1.9% in November from 1.8% in October. Obviously, expectations for inflations are a bit higher than reality. And companies tend to be more cautious in their projections (expecting higher inflation just to be safe). This has been true for quite some time. Ultimately, we think inflation comes in the form of asset inflation just like it did at the onset of Quantitative Easing (Fed buying of bonds) 12 years ago.

- The Housing Market continues to roar

The Housing Market Index for November shot to another all-time-high. This one is a survey of homebuilders. As we have suggested before, this lot is always "short gamma:" They tend to buy high and sell low. We still believe in the housing renaissance thanks to migration and work-from-home trends, but we are cautious (hence our long position in housing is quite small).

Housing Starts for October followed the survey theme reaching a pre-virus level.

Existing Home Sales for October increased 26.6% vs last October. The annual run-rate is almost as high as the peak of the last housing boom back in 2005. Looking back a bit, 25% of homes sold in the 2Q this year were over $500k. The pre-virus percentage was 14%.

- Other Economic data

The NY Fed's Empire Manufacturing Index, Philly Fed Manu Index, and KC Fed Manu Index all fell in November.

Industrial Production for October improved.

Retail Sales for October missed expectations and showed tepid growth after a strong September which was revised lower.

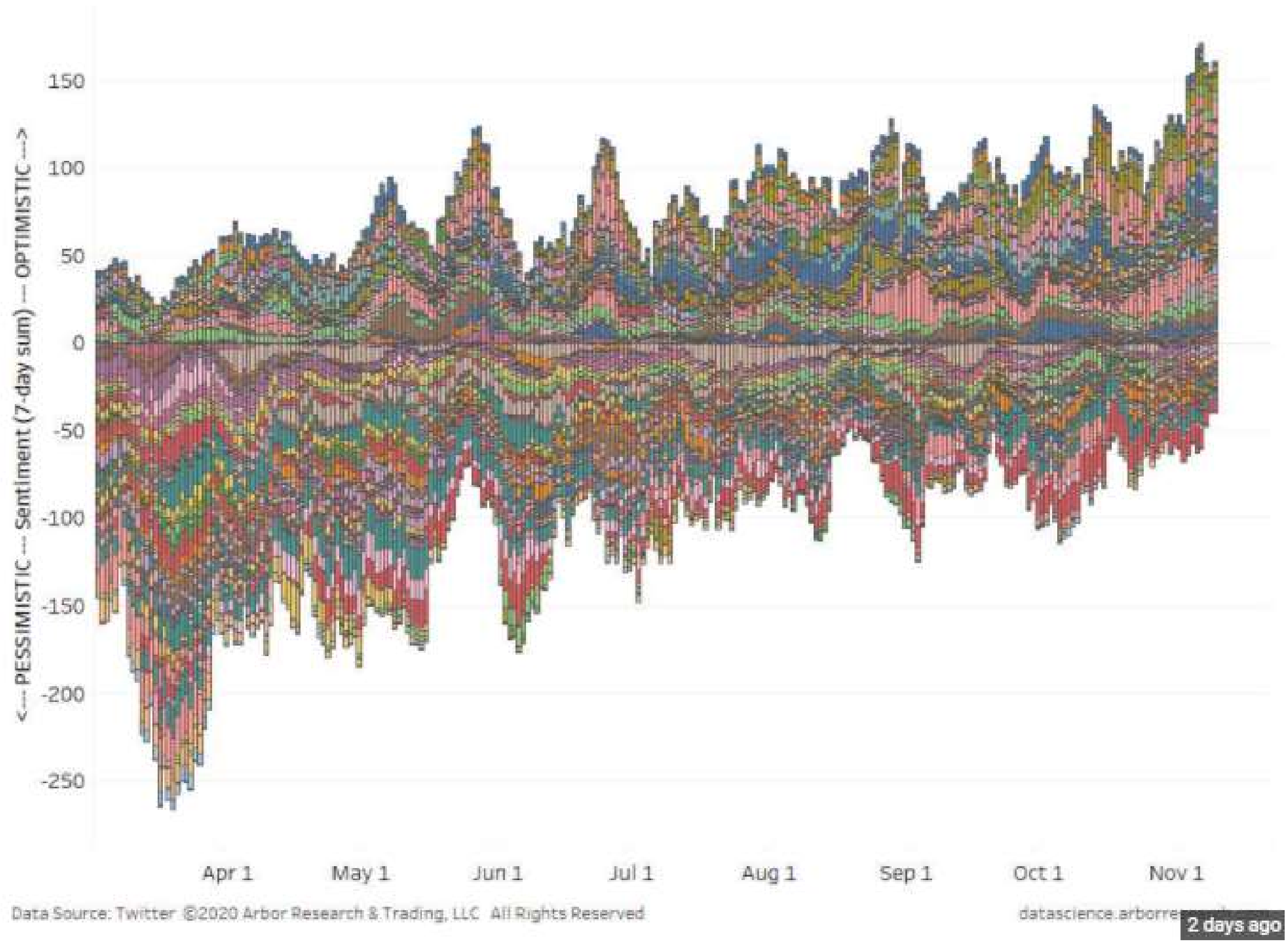
(Non-)Leading Indicators came in as expected. Considering this silly data-point's components have already been released…it better meet expectations!

Business inventories for September climbed a bit. This could cut both ways: is it business optimism or lower sell-through? We suspect the latter.

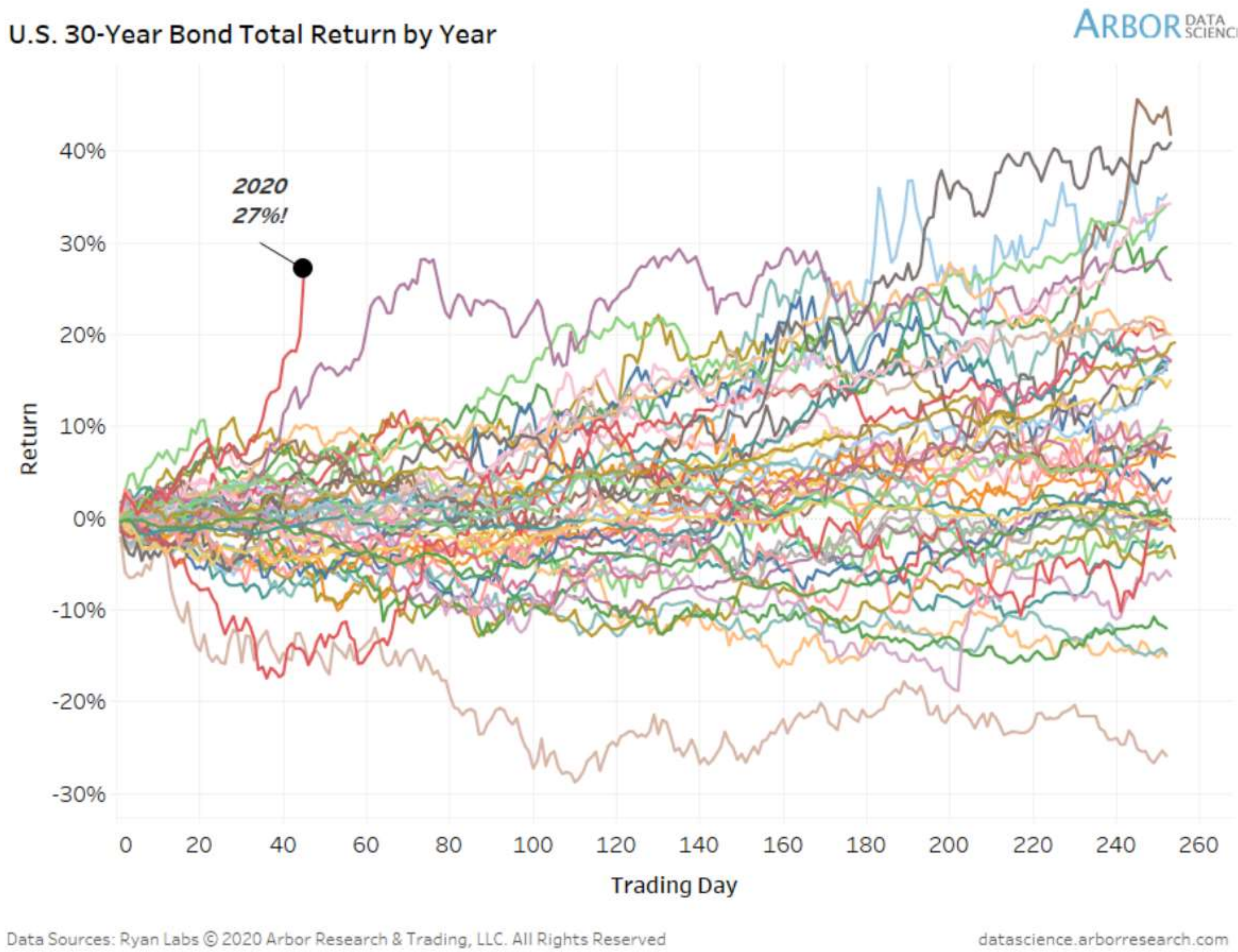
China Industrial Output rose 6.9% in October vs last October. Retail Sales in October rose 4.3% vs a 3.3% rise in September (albeit weaker than expected). Economists are pointing out that the strength in the consumer is starting to catch up to the strength in the industrial sector. Recall we have clamored countless times that the communists can make companies build things, but they cannot make people buy things. We maintain this is true and that even the relatively tepid rebound in the consumer is bogus (flat out lie).

- Chart Crimes of the week (double this week)

This is a chart from Arbor Research. It aggregates positive vs negative Twitter mentions about the stock market. It picks 80 prolific tweeters about the market…members of FinTwit, if you will. We like the idea of tracking sentiment, but we think our 7yr old daughter might have done this one in art class.



And this one might have been done by our 4yr old son:



- Quick Hits
    - Progressive is offering Thanksgiving turkey insurance through Whole Foods.
    - Lyft rides in 3Q were up 44% vs 2Q and down 44% vs 3Q2019.
    - Chipotle has opened a digital-only restaurant.
    - New York has a curfew for bars, restaurants, and…gyms?
    - Deutsche Bank thinks one should have to pay federal tax for the "privilege" of working from home.
    - In the "Generalissimo Franco is still dead" file, American Airlines says a top goal is be cash positive.
    - Kazakhstan's new tourism slogan: "Very nice."
    - Sunday Night Football ratings are down 16% vs last year.
    - Sunday Night Football is the most watched primetime show for the 10th consecutive year.
    - 300k people have moved out of New York City this year.
    - Jogging turns into Running at 6mph (10-minute mile pace).
    - Textbook publishers are proposing to install spyware into college libraries to track undocumented use of the publishers' s online material.

- Bitcoin afficionados are now claiming "escape velocity, network effect, social money, store of value, social construct" and all sorts of other buzzwords.
- Special Chalk Creek koozie goes to the person who can guess the image on the website for this week.
- China uses a different GPS system so mapping/coordinates do not sync.

Trading: As you can tell from our tone, we are becoming increasingly cautious. Much of this is rooted in contrarianism as there seems to be too much euphoria as we outlined above. But we also think the labor market has improved enough whereby it could sustain itself without further stimulus. This gives us comfort over the medium term. This leads us to buying protection to cover the short-term while being moderately invested for the medium term. We do not want to be overly long given the rich valuations in the market. Factor-wise, we trimmed some more of our Value names that benefitted from the vaccine stories. And we tilted a bit back toward work-from-home stocks. We are still relatively balanced, but we played against the rotation on the margin. And we almost went a whole note without mentioning the Fed. Needless to say, the super liquidity in the system is good fuel for the markets.

TSLAQ: The Tesla stars have realigned with it gaining inclusion into the S&P 500 index. After this expected news, the bulls came out and revised target prices higher etc. These comments always seem to miss the fact that the EV business is filled with competition. What this mostly means is that the days of Tesla being able to sell its excess EV credits to other car manufacturers are coming to an end. And the entirety of Tesla's "profits" over the last year have been because of these vapid credit sales. Going back to the S&P inclusion, it is likely to get a 1% weighting which will increase up to perhaps a 4% weighting (so the inclusion will be staggered). The Bond Villain, if he is smart and/or does not die from the Wuhan virus first, should do a huge capital raise under the guise of selling it to the index funds that will be forced to buy the stock. This does not mean much for the operating performance, but it certainly will allow the company to survive the next downturn (its balance sheet is solid and could get much stronger). But survivability does not mean it is not the most overvalued, low quality product company in the world. We will look to short this when the index inclusion is over (Dec 21).

www.chalkcreekpartners.com

Carlisle's Twitter Financial List

Carlisle's LinkedIn

The information presented does not involve the rendering of personalized investment, financial, legal or tax advice, and it is intended to be general market commentary. Information presented is believed to be factual and up-to-date, but we do not guarantee its accuracy and it should not be regarded as a complete analysis of the subjects discussed. All expressions of opinion reflect the judgment of the authors as of the date of preparation and are subject to change. Certain information has been provided by third-party sources and, although believed to be reliable, it has not been independently verified and its accuracy or completeness cannot be guaranteed. Past performance is not indicative of future results.