Weekly Update

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- Macro is dominating the markets
- Maybe student loan repayment will not be so bad?
- Earnings Risk Premium might need some recalibration
- Not everyone is bearish on the economy
- Small businesses are in rough shape
- Inflation is still being driven by spending without the corresponding income
- Housing has turned (not for the better)
- Is China showing signs of stabilizing? Too little - too late - probably.
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,264	-0.3%	12.3%	17.7%
QQQ	$359.75	1.3%	35.7%	32.4%
US 10 YR	4.74%	4.62%	3.75%	3.75%
USD/DXY	106.7	106.8	104.5	110.1
VIX	18.6%	18.2%	22.9%	28.6%
Oil	$84.45	-9.9%	4.9%	-2.7%

*10yr, DXY, and VIX are levels not changes

** Oil is front month futures, beware

Macro trading continues to dominate the markets. Interest rates are driving a lot of the action. The strong dollar is causing pain overseas which translates into higher global interest rates (notwithstanding the Chinese trying to keep their post-Virus Lockdown economy afloat with rate cuts and other stimulus measures). Even the Japanese are letting rates drift higher which has been hurting their equity market. We still think the consumer is quietly in trouble (excess savings gone, credit cards tapped out, student debt repayments, banks putting the squeeze on small businesses, etc). And the labor market is showing a few more cracks despite the proliferation of strikes (Vegas hospitality being on the cusp of what could be a crippling walkout). Inflation is still well above the Fed's desired level…not to mention the desired level of most Americans. These macro factors also manifest themselves in increased equity volatility. This in turn has knock on effects for quantitative traders. This cohort includes funds that manage equity exposure according to Volatility (the higher the Vol, the lower the equity exposure), some that follow momentum, and even more generic trading books like market makers who find themselves short gamma (whereby the must buy rallies and sell dips). Even the reliable month-end marking could not overcome this negative technical backdrop (the marking is where funds buy more of their long positions to help boost performance…this is obviously illegal and not exactly long-term thinking). We are also hearing of more hedge fund blow-ups. When these guys "de-gross" (reduce position sizing) or shut down their books altogether, they are as emotionless and ruthless as Arnold in The Terminator. However, we still believe there are things to own. Select Big Tech is performing very well. Energy has stumbled as of late, but we think the supply side is still constrained enough to overcome any weakening in demand (although we did note recently that oil near $100 should be sold).

- Maybe student loan repayment will not be so bad?

An interesting follow-up to our much-repeated worry about the student debt repayment: A recent survey of debtors shows that 25% will simply decide to not restart repayments. And another 23% will delay their repayments. We guess our faith in American integrity has been overstated. More to the point, if this were to happen, we would guess it would be from a position of weakness and not strength.

- Earnings Risk Premium might need some recalibration

Much has been made of the dwindling equity risk premium (ERP). This is the basic comparison between the expected return of equities vs interest rates. The higher interest rates are, the higher the necessary return on equities. Many use the earnings yield as the way to calculate this expected return. But there is some debate here (more art than science). But the concept is pretty simple. With the market trading at 20x PE, this would be a 5% expected return (using the earnings yield formula which is just the inverse of the P/E). Risk-free bonds look attractive at the same 5%. But Merrill tells us that we should be using the real interest rate of 2%…the nominal yield on bonds adjusted for inflation (5% -3%). Under this lens, the ERP might still be cheap (bad for equities) compared to recent times. But it looks attractive compared to the Reagan years all the way up to the World Financial Crisis (housing crash of 2008). We are not sold on this. But we do think this kind of framing could take hold with the passage of time (as people get more adjusted to "higher for longer").

Exhibit 2: ERP should be lower than post-Global Financial Crisis average of 540bp
Normalized equity risk premium (ERP) with BofA normalized ERP forecast (300bp), 1945-8/23

Source: BofA US Equity & Quant Strategy, Global Financial Data, Bloomberg
Note: Nominal ERP is calculated as the spread between the normalized earnings yield and real risk-free rate, where normalized EPS is based on a log linear regression of a blend of S&P 500 pro-forma EPS and operating EPS. The real rate is the difference between 1) 10-yr Tsy yield and 2) 10-yr breakeven, where prior to 1998, fwd 1-yr CPI was used as a proxy, which showed the strongest correlation to the 10-yr breakeven.

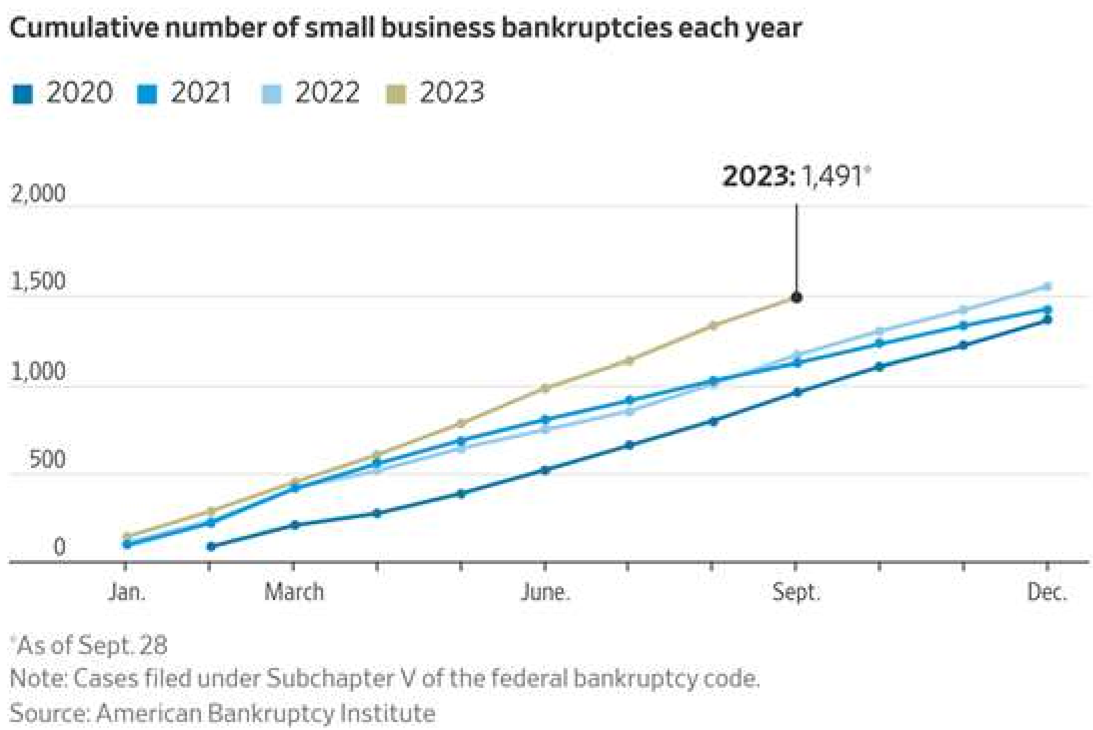
BofA GLOBAL RESEARCH

- Not everyone is bearish on the economy

We have been citing the tightening bank lending standards as cause for caution if not alarm. But Goldman is out saying they think most of the GDP impact from tighter lending is already behind us. It seems that Goldman's approach is a bit tautological. Because they think the economy is fine, they conclude that lending standards are going to ease (their dotted blue line in the left chart). And they expect the drag on the economy to be less severe because they expect lending standards to loosen!

- Small businesses are in rough shape

Here is an updated chart of small business bankruptcies. Goldman must be looking at a different chart when it says lending standards are easing.



- Inflation is still being driven by spending without the corresponding income

The increase in the Personal Consumption Expenditure Price Index (PCE inflation) was 0.4% in August vs July (and 0.2% in July vs June). This brings the annual increase to 3.5% from 3.3% (which was revised higher to 3.4%). The Core PCE increased 0.1% in the month. This reduced the annual increase to 3.9% from 4.3%. There is still a long way to go to hit the Fed's 2% inflation target. This is especially true considering the Fed will most likely have to see inflation undershoot its target (they have stated this in the past…who knows if they stick to their guns on this one).

Personal Spending and Personal Income data are also released with the PCE. This data is sometimes overlooked. Given that Spending increased 0.8% (up from 0.4%) and Income dropped to 0.2% (down from 0.4%), we think this is a good snapshot of the state of the economy. People have been spending beyond their means. We would add that some pundits thought the softer Real Consumer Spending was a sign that the Fed could reverse course sooner than thought. Alas, that was Q2 data.

- Housing has turned (not for the better)

Pending Homes Sales in August dropped sharply -7.1% vs the 0.5% increase in July. This brings the yearly move to -18.7%.

Mortgage Applications for the week fell 6%. The average on the 30-year mortgage is now over 7.5%.

Construction Spending in August increased 0.5% vs July. Residential spending outpaced nonresidential construction by a bit (0.6% vs 0.3%). This is a marginal positive for Housing data which has come under fire lately.

- Business Surveys are still mixed

Both private Manufacturing surveys showed increases in September. The S&P and ISM are still below the breakeven line, but the data appears to be stabilizing some. The ISM Services survey remains well above the breakeven point despite pulling back in September. However, the New Orders component was surprisingly weak as it fell almost 6 points. ISM Prices is still the highest subcomponent.

The regional Fed surveys are not improving. The Kansas City Fed Manufacturing Index in September fell back into negative territory. The Chicago PMI sank back, as well. PMI's had blips higher in August which now seem to be retreating.

- Other data is negative
  - The U Michigan Consumer Sentiment dropped a bit. The recent peak was in July…just when it looked like inflation was going away and the equity market was rallying.
  - The Job Openings and Labor Turnover Survey (JOLTS) showed an increase in Job Openings. It moved from 8.9mm to 9.6mm which is back to the May level. We still think this data is pretty useless given the staleness (fakeness) of much of it. Moreover, the response rate of this survey data is down to 32%. It was almost 70% a decade ago. The declining Hire and Quits rates mean more (and they are going south quickly).
  - ADP's guess for the Nonfarm Payrolls data (this Friday) came in about 90k below expectations 89k vs 180k).

- Is China showing signs of stabilizing? Too little - too late - probably.

China's official PMI (business surveys) remained in positive territory for the second month in a row. Obviously, this data is fake. But the communists can only distort things so much. So, perhaps things in China have stabilized a bit. And Factory activity, which has remained positive but falling, ticked higher in September. But we obviously need more improving indicators. And the Chinese might be experiencing a temporary sugar high given this is the Golden Week holiday. Even if the China economy improves, we do not think it will be enough to pull the rest of the globe out of its malaise.

- Where did all the crypto money go?

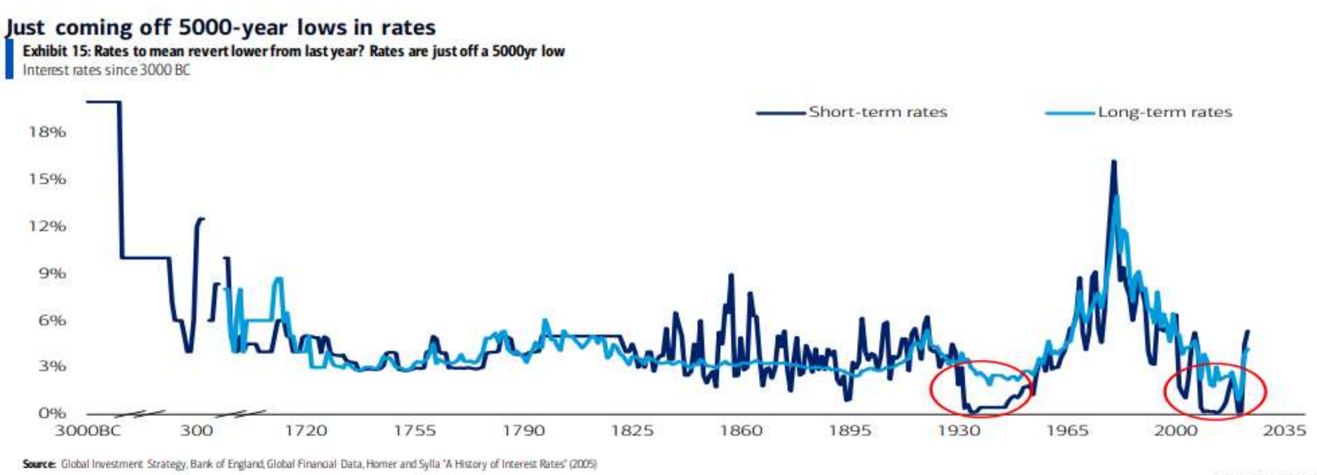
This one is pretty boring. Another crypto platform (do not call it an exchange!) has stolen all its customers' s money. The JPEX platform in Hong Kong has incinerated about $200mm from about 2000 people. The communists have arrested 11 people. But these are mostly the influencers and other semi-hucksters. The criminals with all the money have disappeared. This one is a little different, however, in that the HK regulators had put JPEX on an official alert list warning it could be a scam. They did this last year!

We would also add that the author Michael Lewis is a fool if he really thinks Sam Bankman-Fried did not steal the money. He stole the money.

- Chart Crime of the week

The Commonwealth cannot keep track of its former colonies. The map below is South Africa not Botswana.

And we will do a two-for this week…how could we not include a 5,000 year chart from Merrill!



➢ Quick Hits
- China owns all the pandas in the world.
- New Jersey Senator Menendez spent over $300k at Morton's Steakhouse in DC from 2003 to 2021.
- Curaleaf, a Canadian marijuana company (enough said), on Tuesday stated it would not be seeking to raise capital in this market environment. On Thursday, Curaleaf announced it would be raising capital.
- The brokerage Wedbush wrote that GameStop "will continue its path to oblivion with its new and unimpressive leadership" which happens to be the once-savior Ryan Cohen.
- Applebee's is selling a $1 margarita.
- In the antitrust trial against Google, the CEO of Microsoft testified that, "you get up in the morning, you brush your teeth, and you search on Google." Microsoft has spent over $100b on its Bing search engine.
- The word "moron" was created because some people were offended by the term "feeble minded."
- 41% of France is in favor of limiting everyone to four flights in their lifetime.
- The St. Louis Fed compiled some research showing that more males are janitors, and more females are maids. Generalissimo Franco…dead!
- An EV battery plant in Kansas has successfully lobbied a local government agency to keep a nearby coal plant open so its energy needs can be met.
- The financial regulator in the UK (the FCA) is running ads in movie theaters in which the GameStop movie is playing. The idea is to warn people that buying meme stocks can be risky (if not dumb).
- There will be a college or NFL football game on TV every day from today until November 22.

Trading: Following our playbook, we cut some more tag-end positions in Staples. We added to Energy as it was hit hard for no particular reason. We added some short exposure to the names that we think are vulnerable to "higher for longer" and a weakening consumer.

TSLAQ: The Equal Employment Opportunity Commission (EEOC) is suing Tesla for racial harassment in the marketplace. There have been various rumors of allegations and lawsuits. We are not ones to take the government and its typical overreaching statism seriously. But the accusations are startling. The Fremont factory employees were subject to repeated slurs. And the factory was riddled with graffiti including swastikas and nooses. Some graffiti was even drawn on new cars rolling off the production line.

And oh yeah, the company released its 3Q delivery and production data. In classic Tesla fashion, the "expectation" for 3Q deliveries was lowered the day before the release (friendly analysts were tipped off). But they still missed the spoon-fed expectation by 20k cars. Missing production and delivery figures after you have slashed pricing is not the best sign.

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