Weekly Update

7-Mar-2023
Carlisle C. Wysong, CFA
Managing Partner

- Stairs down and elevator up?
- More trouble in commercial real estate
- Sub-prime all over again?
- Consumer spending is slowing
- Which Inflation is important
- Business Spending is not keeping up
- Housing might be stabilizing, but pricing might be next to drop
- Watch how Canada reacts
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	3,986	0.4%	3.8%	-6.4%
QQQ	$296.34	0.9%	11.3%	-11.5%
US 10 YR	3.97%	3.92%	3.88%	1.84%
USD/DXY	105.6	104.9	103.5	99.1
VIX	19.6%	20.7%	21.7%	35.1%
Oil	$77.14	0.1%	-3.3%	-35.0%

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

The last two-plus weeks of the market embody the psyche of the current trader. Moves down in equities have been slow and steady, but rallies have been sharp and dramatic. The old adage is that markets take the stairs up and the elevator down. But this has been turned on its head. We think this underscores everyone's fear of missing out despite the paradox of fighting the Fed at the same time. Nobody wants to think the march higher in short-term yields is real. And the steeply inverted yield curve is, apparently, no longer a harbinger of recessionary times. There is a heavy dose of cognitive dissonance. The occasional good economic news is viewed as the unicorn-ish soft-landing. And the slightest equivocation from single Fed members is trumpeted as a new paradigm of monetary policy direction.

Morgan Stanley's long-time bear (and a good one) threw in the towel right at the top of Friday's rally. He talked with the typical strategist equivocations and timing differences. If only he had waited for actual news instead of reacting to the behavior economics gnawing away at him (or perhaps he is now listening to the chart gurus who are always right in hindsight). That news was Fed chairman Powell's testimony in front of the Senate today. Unlike his last public comments, his prepared testimony left little doubt about interest rates. Actually, the only doubt now is if the Fed hikes rates more aggressively and leaves them higher for longer.

- More trouble in commercial real estate

Trouble in commercial real estate is brewing. In a follow-up to private REITS limiting withdrawals, large property owners are starting to default on select properties. These defaulters include some of the largest investment firms (PIMCO, Brookfield, and Blackstone). Of course, they structure each property investment as a separate entity so there is no recourse to the parent company…at least not in the short term. But the reputational damage and bursting withdrawal requests will take their toll.

- Sub-prime all over again?

Delinquencies on subprime auto loans hit an all-time high at 6.05%. The data has only been kept since 2005 (seems strange). But this time series obviously includes the last credit implosion back in 2007-2009. The previous peak was in 2009 which saw this auto loan delinquency rate (subprime) hit 5.7%. Auto loans have not been packaged into countless CDOs (collateralized debt obligations) and the current frenzy has not included unbridled speculation. But that is not to say this is not a ticking timebomb.

- Consumer spending is slowing

Credit card spending among older consumers started to normalize lower in the back of February. Merrill thinks the January surge in spending can be attributed to the increase in social security payments thanks to a government COLA (Cost of Living Adjustment) of 8.7%. But it appears the pop has fizzled. We would add that this data is always choppy. And winter storms likely pinched some spending after unseasonably warm weather. Nonetheless, the theory makes sense (the early boost followed by the dip). We would add that government Food Stamps just got cut back drastically. Or rather, they have been cut back to their pre–Virus Fear boost. It also appears that SCOTUS is leaning towards striking down Biden's student loan forgiveness plan. The most telling comment came from Chief Justice Roberts when he said a $430b government expenditure might logically involve Congress "if you are going to affect the obligations of that many Americans on a subject that's of great controversy."

Here is total credit card spending per Bank of America. Ocular inspection tells us that the trend resembles the path of the stock market!

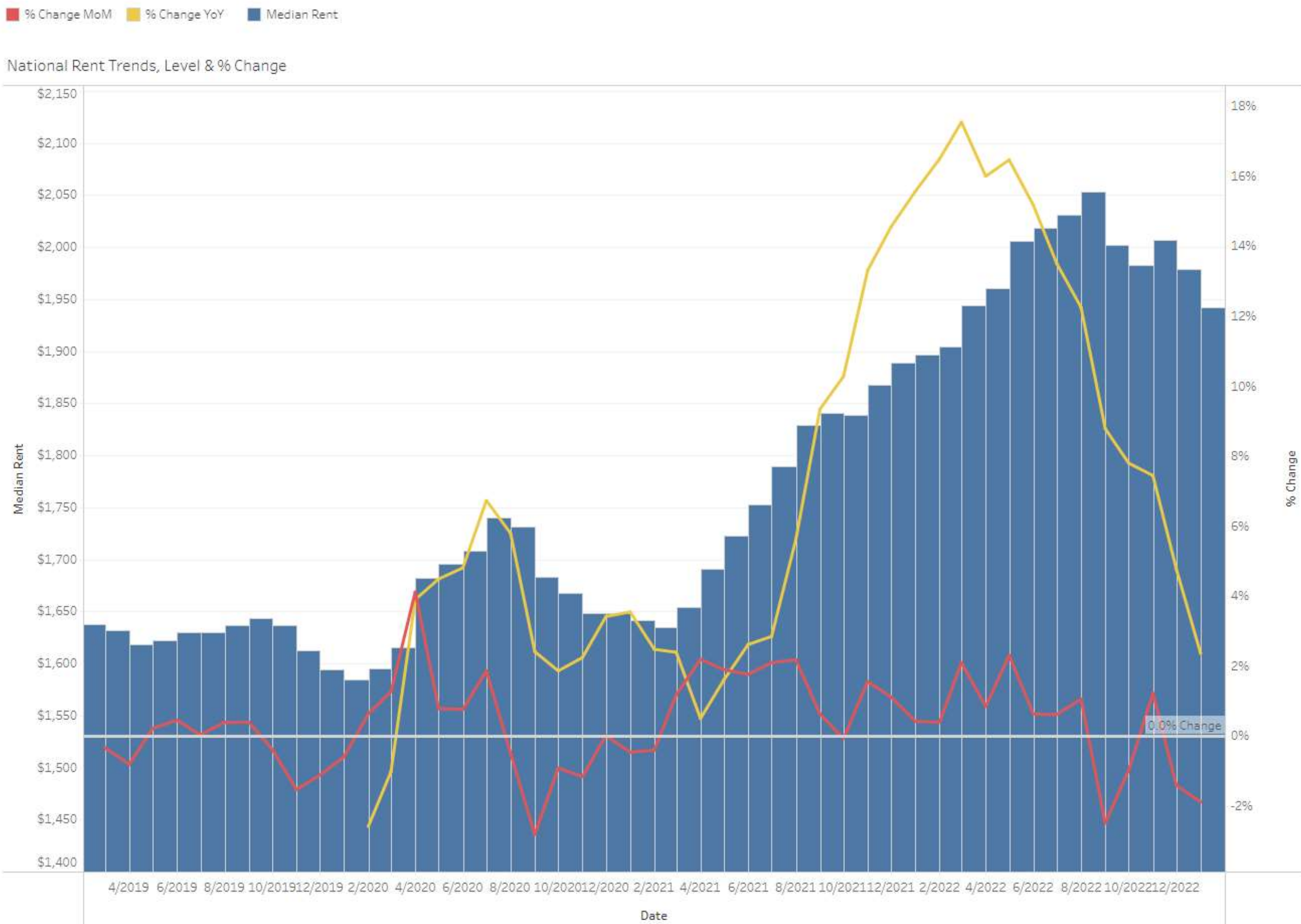
Source: BAC internal data

- Which Inflation is important

The growth in Personal Consumption Expenditures (aka PCE inflation) in January moved higher just like all the other inflation indictors we saw in the month. The headline increased 0.6% vs 0.2% in December which was revised higher from 0.1%. The "core" also increase 0.6% vs 0.4% which was revised higher from 0.3%. These increases are so strong that the yearly inflation numbers also increased (to 5.4% and 4.7% respectively). Anecdotally, Used Car prices jumped in February. This was the third monthly increase in a row.

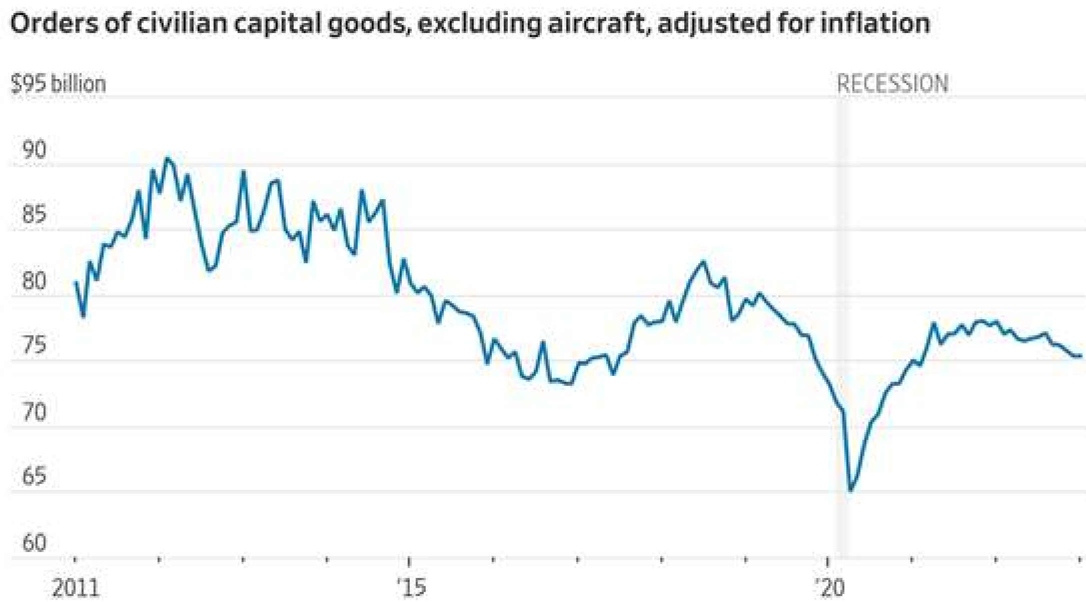
We often talk about the alphabet soup of inflation gauges. We are particularly critical of slicing and dicing the data to fit the narrative. But one trend that is likely to take shape is the relationship between the CPI and PCE. The CPI has been much hotter than the PCE, but this is likely to flip flop. The CPI has a much heavier weighting in Housing…almost two to one with the CPI weight being about 33%. Conversely, the CPI has a lighter weighting in Health Care. With Housing prices likely to be falling (rents recalibrating along with outright home prices falling) and Health Care prices on the rise, this CPI/PCE ratio will change. With the Fed looking more closely at the PCE, this could leave Main Street bewildered…why is the Fed still hiking even though inflation (the CPI in their eyes) is falling? We think this could lead to more market turbulence. We have submitted this economic and political conundrum to congressman Pete Sessions. If Sessions asks this question to Jerome Powell during his congressional testimony tomorrow, you will know from where it came!

Here is a chart of the median monthly rent. Jimmy McMillan would think rents are still "too damn high." But they are rolling over and will feed into a disinflationary sequence. But the Fed has made it clear that it is focusing on Services ex-Housing…wages. Higher for longer.



- Business Spending is not keeping up

Durable Goods Orders fell sharply on the headline in January. It was expected, but a drop from 5.1% monthly growth to -4.5% contraction is startling. However, the Core Capital Goods Orders, aka business spending ex-transportation, reversed back higher to a again of 0.8% from a decline of -0.3%. This is a good headline. But as we have been repeating, this data is not adjusted for inflation. Our theory that companies front-loaded their capex spending before they lost tax advantages seems to be playing out.



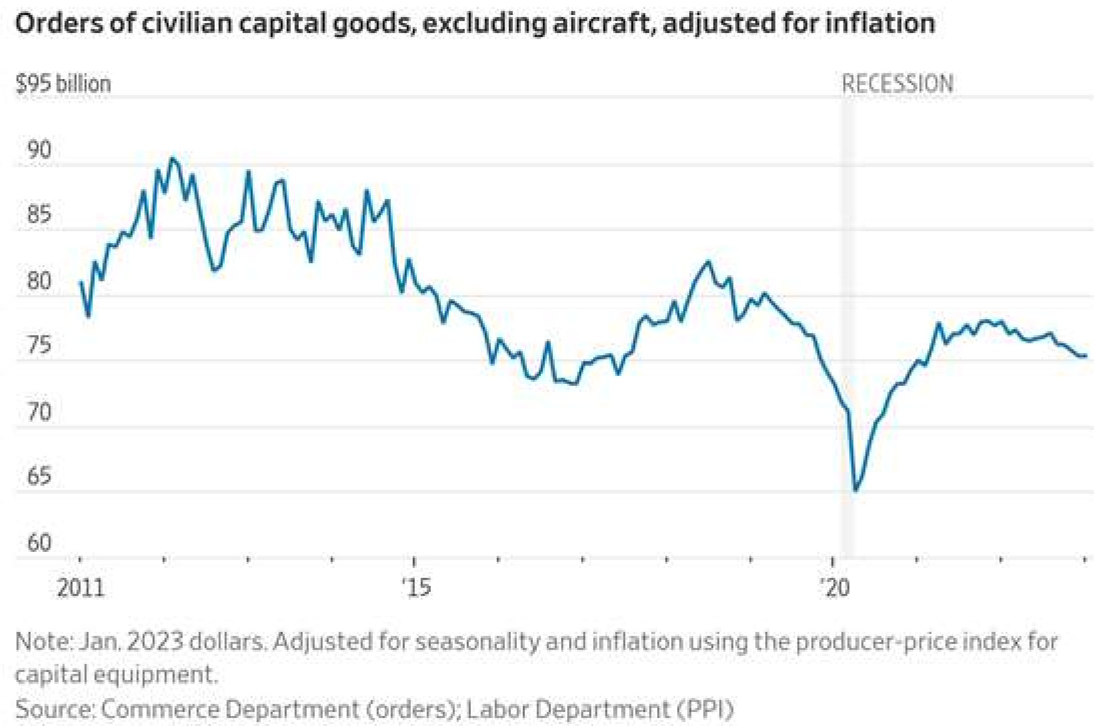
Note: Jan. 2023 dollars. Adjusted for seasonality and inflation using the producer-price index for capital equipment.
Source: Commerce Department (orders); Labor Department (PPI)

- Housing might be stabilizing, but pricing might be next to drop

New Home Sales jumped 7.2% unexpectedly in January vs December. And December was revised higher to the same 7.2%. The overall level of sales is still relatively low (670k annualized, down from about 1mm during the peak of the Virus Fear frenzy). The surprise in the sales is due entirely to the market in the South. Importantly and logically, home prices dipped for the first time since August of 2020. It was a small 0.7% drop. But this is what we have been predicting. Sales will start to accelerate as sellers start to capitulate on price.

Pending Home Sales (on Existing Homes) also surged higher at an 8.1% clip in January vs December. The overall level (this data is an index and not actual homes) is still very low…only the Virus Fear blip has been lower in the last 20 years. And many attribute this tick higher to the quick move in interest rates lower. We are not so sure that the housing market moves this swiftly. Then again, the historical correlation between Mortgage Applications and interest rates is strong (more so after quick moves in rates). And this week's reading is lower again (about back to the cycle lows seen in early January). Separately, the Case Shiller Home Price Index has now dropped six months in a row (lagged and slow, but it is turning). And obviously we could have inserted our rent chart from above in this section.

Construction Spending in January dipped slightly. This is an improvement, but the data was expected to turn outright positive. The outlier contributor (detractor) continues to be Single Family Housing which sank 1.7%. Multi-family housing construction continues to rise.



- Other economic data point to further weakness

There were four regional Fed Manufacturing surveys this week. All four sank to lower negative readings. Kansas City, Dallas, Richmond and Chicago (Chicago combines Services and Manu). The national surveys (Markit and ISM) remain in negative territory, also (they did show a slight uptick to be fair). Services, on the other hand, remain positive. There was not much improvement in the February numbers. And the US-biased survey (Markit) was weaker than the international one (ISM). Nonetheless, Services remain resilient (recall Housing is included here, so this data could be teetering).

Inventories continue to diverge. Wholesale have been dropping for a year and are now negative. Retail ones are still bloated and even increasing on a ratio to sales basis. This is a bad combination: Companies are not reloading inventory that they already cannot sell.

Consumer Sentiment ticked a little higher. This is the survey which has a heavier weight on inflation. Consumer Confidence dropped unexpectedly. This one is more based on housing.

Jobless Claims remain below the 2019 levels.

Factory Orders for January fell 1.6% vs the gain of 1.7% in December.

- Watch how Canada reacts

The Bank of Canada has signaled a rate pause at the current 4.5%. Canada is much more sensitive to higher interest rates. Its Housing market primarily has variable rate mortgages compared to the mostly fixed rates ones in America. Also, Canada did not have the free money give away like the US did, so its Excess Savings was never built up like ours. Along the same lines, Canada does not a Virus Fear induced labor shortage. All this means Canada is more vulnerable to a tightening cycle.

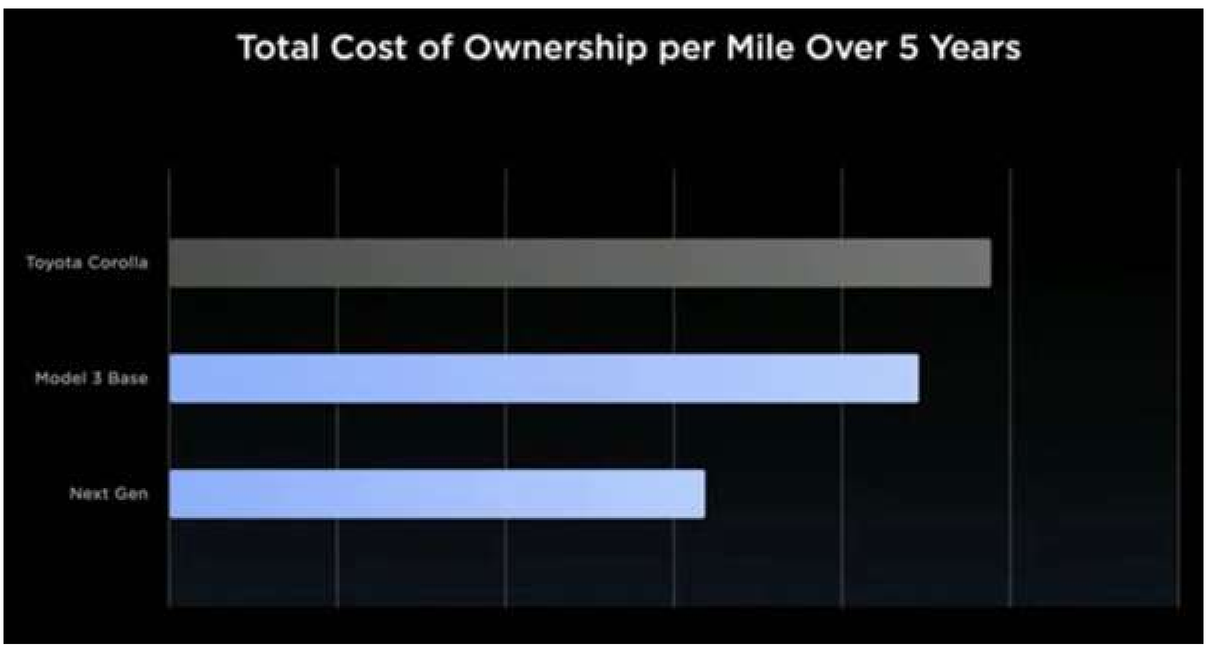
While close bedfellows, the two countries do not always move together in the short term. But the longer-term correlation is strong. We want to watch Canada to see if this pause is too late or if the economy is able to reaccelerate or at least stabilize without punishing inflation…that is always the goal.

- Where did all the crypto money go?

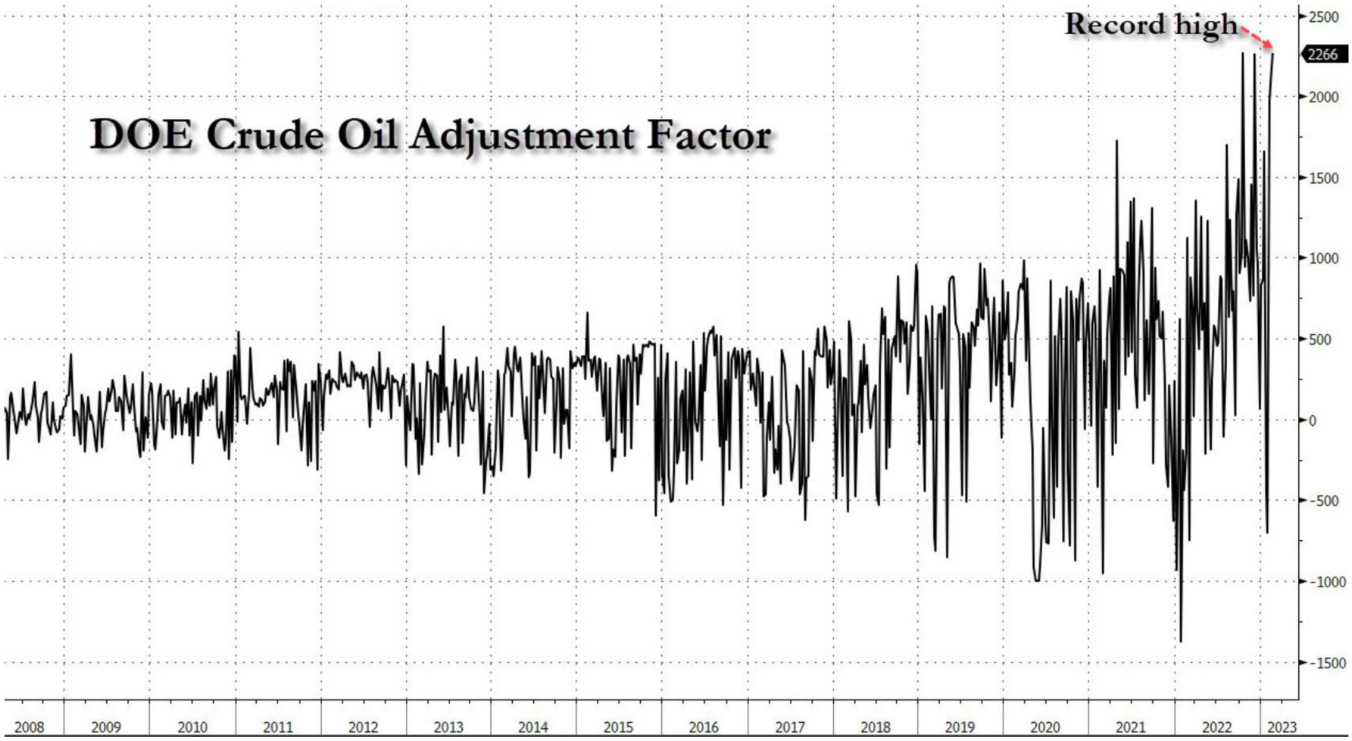
This week we will take a visit down memory lane to the world of NFTs…NonFungible Tokens. We actually like the concept of NFTs for the art world. They represent a way for artists/creators to be paid from secondary market transactions. And they can be a fun novelty. Of course, like everything crypto related, NFTs jumped the shark. A glaring example is the official marketplace for the NBA's "Top Shot" NFT collection, which at one point was one of the focal points in the NFT world. Dapper Labs, the NBA's partner who runs the marketplace, is no longer returning money to sellers when they request to cash out. This has come to light through a lawsuit alleging Dapper has been selling unregistered securities. The crux of the scheme/scam is that Dapper was propping up the marketplace (keeping the money) in order to get rubes to "invest" in Dapper's "Flow" token. Yep, another case of real money plummeting into the black hole of pretend money. The Flow token has gone from $8 to $40 to $1. Poof.

- Chart Crime of the week

Here is the kind of hard data that the genius of Elon Musk produces:



We are going with two this week. Muskismis are such low hanging fruit. The second one is more of an indictment of government data...the crime is that the chart must exist at all. It is well known that the weekly oil inventory data reported by the Department of Energy (Rick Perry was right even if he forgot it during the debate) is adjusted continuously. The less advertised monthly data is far more reliable. But it is the weekly data that gets the headlines and impacts prices in the short term. But what is less known is that these adjustments have ben skyrocketing lately. This means most of the weekly data we get is nonsense.



- Quick Hits
  - Moderna explained that its Q4 revenues dropped 30% because of lower demand for its products. (Sounds like something Musk who mutter.)
  - A morning newsletter from Bloomberg is sponsored by the country of Georgia's tourism board.
  - FedEx has warned its drivers not to draw "obscene or offensive markings" on packages.
  - Punxsutawney Phil has a 39% success rate in predicting the duration of winter.
  - The price for sending a shipping container box from China to Los Angeles has dropped from $15,600 a year ago to $1,238 now.
  - The Dallas Jackals are a professional sports team.
  - The owner of the Washington Redskins charged the team $4.5mm to put the team logo on his private jet. It was deemed an "advertising fee." The Skins have minority owners.
  - There are two new ETFs that track Jim Cramer. One is long his recommendations. One is short his recommendations.
  - Ford had a Model T in 1941 that was made of hemp and ran on biofuels.
  - Cocaine, methamphetamine, and MDMA are now legal drugs in British Colombia, Canada.
  - Four academics have published research telling us that long stretches of low interest rates can increase the odds of a financial crisis. Generalissimo Franco is, indeed, still dead.
  - The cost of a monkey used in science has jumped from $2,500 before the Virus Fear to over $30,000 today.
  - The media now refers to monkeys as "nonhuman primates."

Trading: Over the last two weeks, we have continued to reshuffle some exposures with the same themes intact. We cut some of our losing Put exposure as we salvaged a bit of eroded theta (time decay) during one of the market's mini-selloffs (it used to be mini-bounces?). We reloaded on some of our favorite shorts. This is a mix of our Fantasies & Frauds, Recession bets, and Crypto Crap. But we are a little wearier of the F&F baskets.

Many of the go-to's over the last year now must go to zero to make money…the price of Volatility and the idiotic short-squeezes make these hard bets. But there are still some that have flawed business models and yet lofty market caps. Telsa is the poster child of this arena. But it also has a devoted lemming-base, so that is hard to fight (ergo we pick our spots gently). In the Crypto Crap, Silvergate collapsed as we expected. We covered our short as we expect more volatility and probably some half-hearted, fake-news rallies. The space in general is hard to short, but we will keep rotating our exposure to find the next blind spot. As for real companies, we think the market will be choppy so we will try to trade around the range (more so for tax exempt accounts). But our base case of a softening economy with more earnings pain still holds. Energy remains a point of inner conflict for us. We maintain that the supply picture is bleak (positive). But the commodity and stock prices are following the recession theme (unlike Growth companies!).

TSLAQ: Tesla's Master Plan 3 focused on the company's future ability to cut costs. That is not typically what "Growth" companies tout. More importantly, no new models or products were introduced. One comment of interest was how Musk kicked off the investor day. With ever-brimming confidence, he stammered, "assuming the things I say are true." His other great comment: "We learned that price cuts have an impact on demand." Musk's full genius on display.

Check out our website to learn more about Chalk Creek Partners

Carlisle's Twitter Financial List

Carlisle's LinkedIn