Weekly Update

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- Mega-caps are still charging ahead
- Larger outlier moves are increasing in frequency
- Student loan repayment will be another drag on the economy
- Bank credit continues to tighten
- Banks might succeed in shifting more failure onto the taxpayers
- Services are still outperforming Manufacturing
- Housing is still being led by New construction
- The market expects rate hikes and cuts
- Easy monetary policy is driving Japan
- Oil markets are confused
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,151	-1.1%	8.5%	7.1%
QQQ	$339.72	0.7%	27.8%	19.2%
US 10 YR	3.82%	3.65%	3.88%	2.75%
USD/DXY	104.3	103.5	103.5	101.8
VIX	19.1%	16.1%	21.7%	27.5%
Oil	$71.87	-0.2%	-10.5%	-34.4%
*10yr, DXY, and VIX are levels not changes				
** Oil is front month futures, beware				

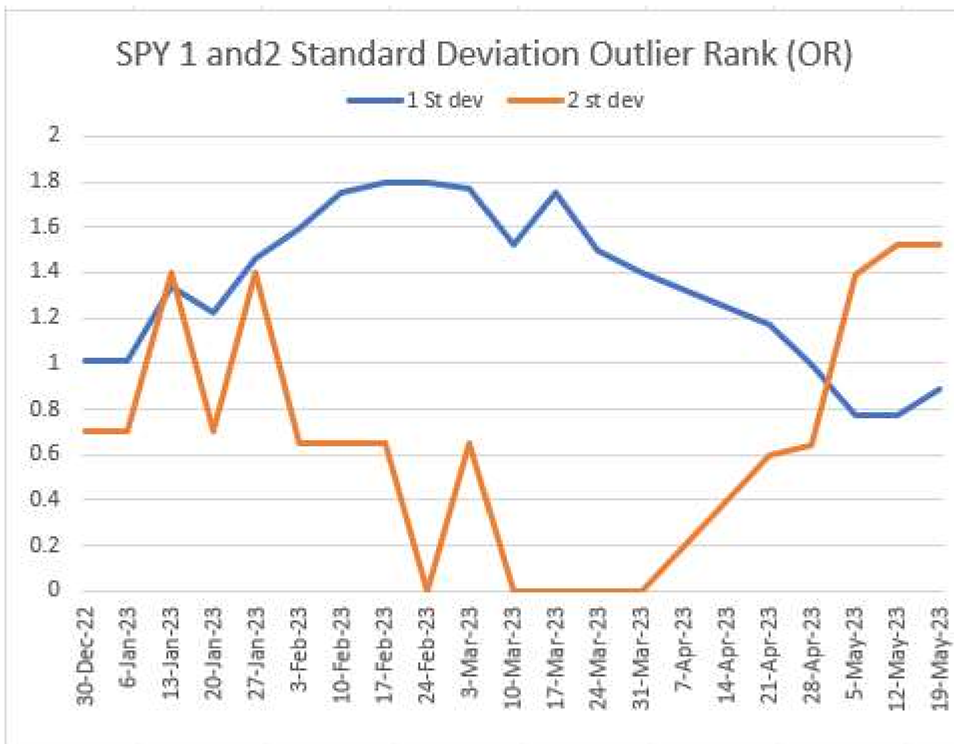
Lately, we have been discussing the various divergences in the market. The central theme has been the different signals being sent about the economy. Rather, the mega-cap stocks have been acting like the economy is on fire. Everything else points to the contrary. The bond market is expecting a recession with the yield curve inverting further. Commodities are expecting a recession with slumping demand. Small-cap stocks are expecting a recession. Economic data is still deteriorating along with persistent inflation. The stress around the debt ceiling fight is intensifying. Fed rhetoric is becoming more ominous. We have been clear that the China reopening is dead. And now we find out why…the Virus Fear is back! While most of the western world has moved on, the communists have not and will eagerly take the opportunity to grab more power. The Fantasies & Frauds have been behaving oddly with wild swings despite suppressed Volatility throughout the market (although Vol did move higher this week). Even the mega-cap stalwarts started to show signs of cracking.

Perhaps the cross-asset factors were coalescing around the recession theme. But then came Nvidia with strong earnings and even stronger guidance. This added to the main bullish narrative: Mega-cap earnings have been good and have positive trajectories (not just better than expected while still being bad). And these 5-10 stocks obviously dominate the market. Today's spread between the Nasdaq 100 and the Russell 2000 (small caps) was a gigantic 3.21%.

As for the debt ceiling, people forget that the outcome is a net-negative either way. If a resolution is not reached, well, that is bad. Even if we assume it will only be a short blip in payments, it will wreak havoc in the plumbing of the financial system (for one, Treasuries are used for collateral on the vast majority of short-term financings, so each of these agreements will have to be remarked with new collateral). If a resolution is reached, the government will be selling more bonds. This will turbo-charge the current Quantitative Tightening from the Fed. Usually, this sucking of liquidity is offset with deficit spending which is stimulative for the economy (government spending is the least efficient form of stimulus, but it can still be a positive). But this resolution will likely only lead to debt servicing. Of course, this is what the whole political fight is about (to cut spending or not).

- Larger outlier moves are increasing in frequency

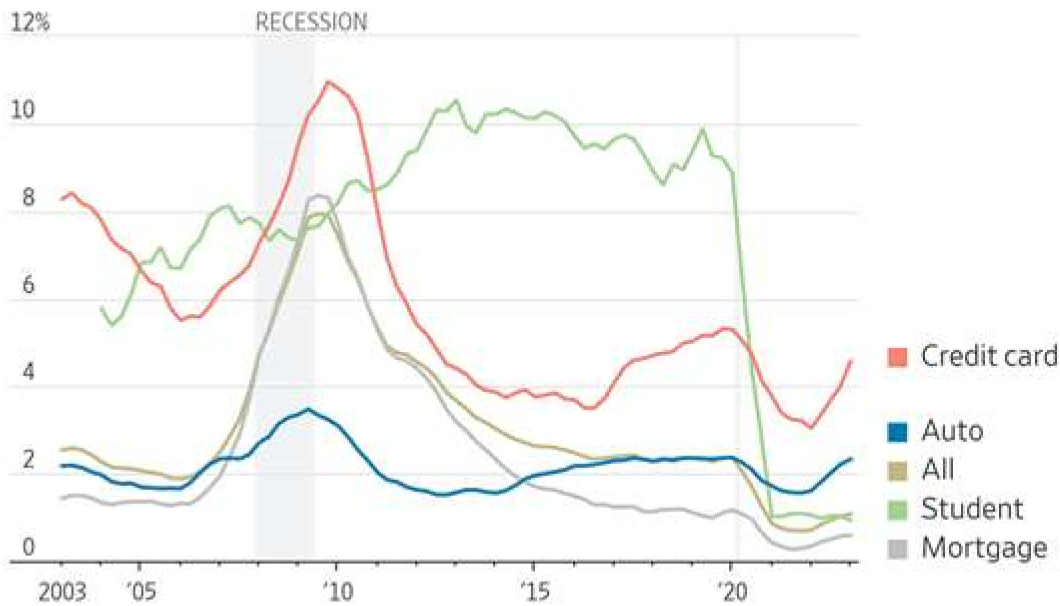
Three weeks ago, we pointed out that outlier moves were converging. Now, the 2 standard deviation moves have eclipsed the 1 standard deviation moves. Our proprietary data is not perfect, and we need more history. But large trend moves are noteworthy. And this one supports our theory that strange moves and correlations will be having an impact on the market.



- Student loan repayment will be another drag on the economy

We will hear shortly from the Supreme Court whether Biden's plan to forgive $400b in student loan debt is legal. Following the tone of the questioning by the justices, this free money train is likely to stop. The average student

loan payment is $393/month. 40mm borrowers will be back on the hook starting in 60 days after SCOTUS rules (or 60 days after June 30 if SCOTUS does not render a judgement). Watch for student loan delinquencies to catch back up to credit cards.



- Bank credit continues to tighten

As a follow-up to the recent Senior Loan Officer Opinion Survey (SLOOS) which showed lending standards continuing to tighten (quarterly data), the Fed's timelier H8 data shows the same trends. Commercial & Industrial loans stand out in April as they have moved from a slowing rate of change (yet still positive) to outright negative and worsening. Commercial Real Estate and Consumer loans are still positive, but both segments are slowing. Residential loans are the only segment that is stable and/or accelerating.

- Banks might succeed in shifting more failure onto the taxpayers

We have noted how the headlines surrounding the regional banking crisis are fading away despite the underlying problems still existing.   They own assets that have diminished in value, Treasuries and mortgage-backed securities, while the cost of their liabilities has burst higher (deposit rates). But PNC has floated an interesting solution…or at least an extra layer of help. PNC wants to pay its FDIC fees with Treasuries from its balance sheet. The idea is that any treasuries used for payment would be valued at 100c on the dollar. Banks can already borrow against their Treasury holdings as if they were at par. So why not just make the transfer of losses from the banks to the taxpayers official? We appreciate the ingenuity and the need to tweak some rules. But shouldering the people with more losses because of dumb banking is wrong.

- Services are still outperforming Manufacturing

The early read on the Markit PMIs for May show the same divergence we have been seeing. Not only is Manufacturing still trailing Services, but the gap widened. Manufacturing is back squarely in negative territory while Services pushed higher than expected.

The Richmond Fed Manufacturing Index dropped further into negative territory (and worse than expected). The Kansas City Fed Manufacturing index improved but is still negative.

The PMIs in Europe show the same divergence.

- Housing is still being led by New construction

New Home Sales in April of 683k (an extrapolated annual rate) were higher than expected. This continues the expansionary trend since the depths of last summer. Notably, prices are starting to fall. The April median price was about $421k. This is down from the October 2022 peak of 497k. Of course, this is still way above the pre–Virus Fear level of $330k.

Pending Home Sales (only Existing, not New) in April bounced back a bit but still missed expectations. The index was flat on a monthly basis. But this is still down over 20% on an annual basis -which is the best rate of change in nine months. However you want to slice the data, the index is still sitting near the lows of the last 25 years.

Weekly Mortgage Applications fell again.

- The market expects rate hikes and cuts

Last week we talked about how the Fed language was hardening on rate hikes rather than softening into rate cuts. Jim Bullard of the St. Louis Fed is taking this to the extreme. He rather bluntly said he wants two more rate hikes this year and “sooner rather than later.” And inside the Fed, there are increasing concerns about overall price levels and not just rates of change. All this talk is manifesting itself in the futures market. There is currently a 53% chance of a rate hike in June. This is up from 20% a month ago. There is a 73% chance of a rate hike by July. But the market still expects at least one rate cut by November – it is priced at an 68% probability. We have been trying to nail down what this means. Do people think the Fed will do a great job and hike enough with a perfectly cut afterwards? Or will the fed hike too much and break something and hence the need for a cut? Or is the market just confused? This makes the most sense to us. And despite the increased rhetoric, Fed chairman Powell is calling the upside/downside to monetary policy has “balanced.” This is probably the root of most confusion.

- Easy monetary policy is driving Japan

Japan continues to show strong economic growth. It posted its fifth straight month of expansion according to PMI surveys. Unlike much of the rest of the world, both Manufacturing and Services are positive and accelerating higher. April had strong GDP growth, and this recent PMI data reflects further growth in the 2% area. Employment is expanding. Inflation is still running hot albeit with some signs of cooling. We have been waiting for a pullback to buy the Japanese index (and be short the Yen vs the USD). We might have to keep waiting with this strong data.

- Oil markets are confused

The oil markets are just as confusing as the other markets. Crude oil prices have staged a mini rally. Some attribute this to calming fears of a recession…or rather people are looking to the equity market and not the bond market. But prices also got a boost from some financial saber-rattling from the Saudis. Their energy minister directed some comments towards those short selling oil, “Speculators, I keep advising them that they will be ouching.” Interesting choice of words, ouching. But he referenced the recent production cuts

announced in April. Of course, that boost to prices proved to be short-lived as we suspected. Oil is also being supported by tight gasoline supplies on the cusp of the "driving season." And Conoco's chief economist said global energy demand is back to pre-Virus Fear levels (our words). She also expects, "new peaks in demand for oil and natural gas and possible coal." Obviously, she is biased, but considering the major oil houses have tempered their optimism over the last few years, her strong message is noteworthy. Alas, all it took to derail the rally was some strength in the USD. This is one of the correlations that has broken down recently (usually its negative, has turned positive but is moving around). In other words, short-term traders are moving the price.

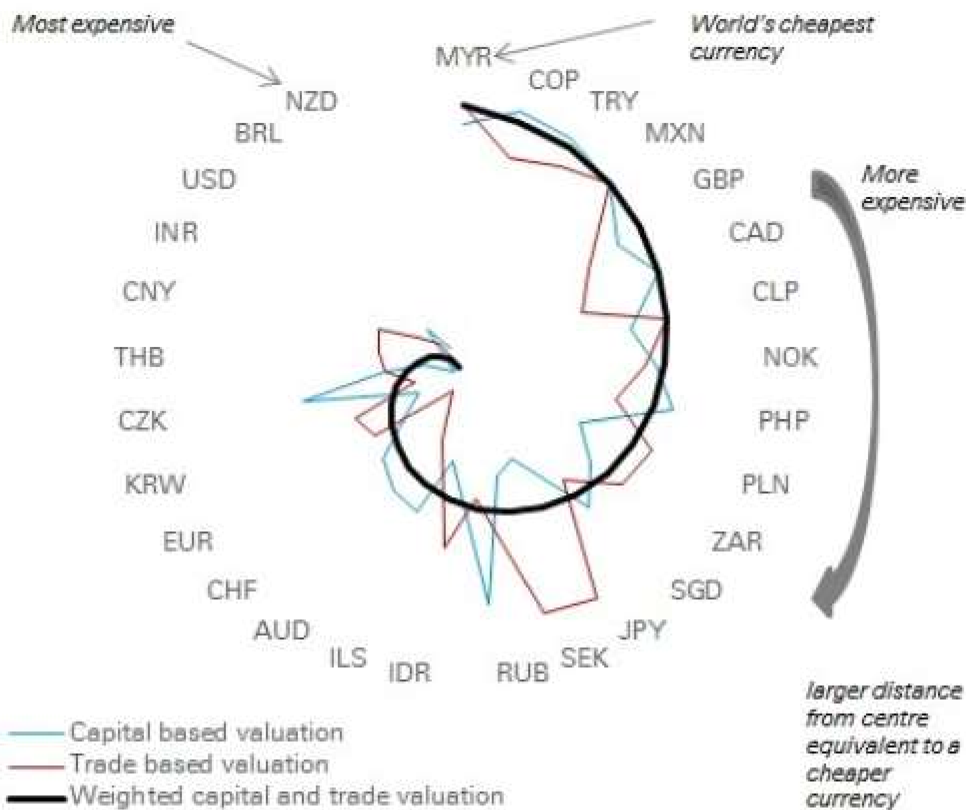
- Where did all the crypto money go?

Matt Levine of Bloomberg recently pointed out that the lavish Bitcoin conferences of yesteryear are a bit more pedestrian these days. But the "Sh*tcoin Conference," yes that is the real name, has fallen a bit more from grace. Also in Miami, it has gone from being held at a lavish hotel for multiple days to being a few hours at a co-working site. Other than the obvious reason of nobody cares anymore, the now defunct criminal enterprise FTX was once the sponsors of this conference. What better way to pump your own worthless "sh*tcoins" than to sponsor a conference supporting the whole "sh*tcoin" industry.

- Chart Crime of the week

A regular bar chart would suffice just fine. Not to mention, there would actually be a measurable y-axis instead of this nebulous "larger distance from centre equivalent to a cheaper currency."

Actually, using the British version of "center" is the real crime here (do not tell Chalk Creek Junior!).



- Quick Hits
    - “Researchers” claim the IRS disproportionately audits black taxpayers. The IRS does not track filers by race. The research uses names and addresses for race proxies.
    - “Salon makeovers” for goldendoodles can cost up to $250 in Los Angeles.
    - Bed Bath & Beyond’s stock is accounting for almost 10% of all volume in the over-the-counter market. It is still bankrupt.
    - One of the largest multifamily landlords with 7,000 units lost 3,000 to foreclosure in April.
    - Ford is reversing course and will be installing AM radio in its EVs.

Trading: We are glad we avoided trying to fight against the mega-caps. That is not to say we believe in the rally which is largely based on Artificial Intelligence mania (Hedgeye calls it Artificial Profits). But one logical line of thinking is that during times of confusion, the big get bigger. Another way of saying this is size equates to quality. Since some of the macro asset movements make more sense, we might increase our exposures here. These conclude being long Gold, expecting the inverted yield curve to remain if not worsen, moderate USD strength, and small-cap weakness. The one aspect of the market we find most confusing is the poor performance of the traditional defensive sectors like Staples, Utilities, and Health Care. Apparently every discretionary dollar in the market is going to the acronym bunch (FANG, FATMAAN, MAGMA…whatever you want to use).

TSLAQ: Musk just might be figuring out how to manipulate the YOLO, short-term option traders. When he opens his mouth and spouts nonsense about Tesla, holes are easily poked in the sails of his rudderless boat. And when he stirs the pot on Twitter, most of his customer base gets mad at him. Logically, Musk should just keep quiet and plow ahead. Last Friday, same-day options on Tesla were the most heavily traded in all the market…mor than even the broad index ETFs (SPY and QQQ). All this said, we do think it will be difficult for Musk to avoid controversy as he wades deeper into political waters (again, angering his core customer base).

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