



Weekly Update

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- Volatility is back
- Are tariffs back? Probably not (at least not for the markets)
- Stress in the credit markets is likely isolated
- The first rule of Fed speak is to not talk about tightening liquidity
- We still have a government shutdown (“there was one?”)
- Artificial Intelligence margins are better than rumored
- There are plenty of warnings flashing (not enough to move us, yet)
- Here come the AI revenues
- People are eating out more often
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	6,664	1.7%	14.3%	15.5%
QQQ	\$603.95	2.5%	18.6%	23.7%
US 10 YR	4.01%	4.04%	4.58%	4.08%
USD/DXY	98.4	99.0	108.5	103.5
VIX	20.9%	21.7%	17.4%	18.0%
Oil	\$57.66	-2.1%	-19.8%	-18.6%

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

** Oil is front month futures, beware

Volatility returned to the markets this week. We knew it was going to be a Trump wildcard that did it, we just did not know when. But we are also having a mini credit scare as the First Brands / Tricolor frauds are being reported in bank earnings. On the macro side, Fed Chairman Powell inadvertently spooked the market by declaring that liquidity had tightened. And there does not appear to be an ending in sight to the government shutdown. (The table above starts at the close of last Friday...the low point during the last month, so the volatility is not as evident...trust us, it was volatile!)

- Are tariffs back? Probably not (at least not for the markets)

Trump the Tariff Man is back, but we are not sure what his aim is right now. We would submit that he is not sure either. The headlines have oscillated from soybeans to port fees and even cooking oil. The Chinese have

fought back by clamping down on rare earth minerals and technology export licenses. We think it is the usual posturing ahead of the Trump-Xi meeting later this month. Even though Trump walked back some of his bluster, since it has been a while since the last bout of tariffs on – tariffs off, the market reacted like it was Liberation Day 2. Interestingly, some have dissected Trump's choice of words this time around. He is using hypotheticals with words such as "potential" and "considering." Moreover, much of the tension involves different negotiators on the Chinese side. The Foreign Affairs Minister has been affable and wants to get deals done. The Commerce Minister is much tougher. We do not think there is too much to read into this other than it will come down to Trump and Xi.

- Stress in the credit markets is likely isolated

The heightened tensions over banking losses related to bad loans is a more tangible threat to stable markets. JP Morgan first rattled the cage by disclosing a large write down of bad debt. CEO Jamie Dimon, in his usual pessimistic tone, noted that there is never just one cockroach. But it was the regional banks that followed suit that started to send shock waves. Even though there has been some stress in business development companies (BDCs, which are seen as a proxy for private credit which some think is more opaque), the actual write-downs/losses have been very small. And as we commented before, these are cases of fraud and do not appear to be systemic or bad underwriting (mortgages with alligators in the pools). Although, in Tricolor's case (the auto dealer/lender that went belly up), it is worth noting that its participation in the CDFI program probably caused its lenders to lower their due diligence standards (CDFI is a government program which aims to increase lending to "underserved and low-income communities.") A clear lesson here is to not trust the government's supposed seal of approval. But it was still fraud just like First Brands; Tricolor double-pledged its collateral on its borrowings. But this mini-panic is deflecting from the data: Bank earnings have been very good! Nonetheless, everyone has March of 2023 on their brains when the regional banks all imploded at once (resulting in the demise of Silicon Valley Bank and Signature Bank). Of course, holding too many US Treasuries was the problem then! We would add that there might have been some takeover premium priced into these banking shares lately. Adding a little uncertainty to the credit quality (fraud or not) rightfully removes some of this premium.

- The first rule of Fed speak is to not talk about tightening liquidity

Fed Chairman Powell is probably regretting talking about lower liquidity in the financial "plumbing." The tried-and-true way to heighten concern about tight liquidity is to talk about tight liquidity. We think Powell was actually trying to be dovish...talking up the prospect that the Fed will ease monetary policy by slowing or even stopping its Quantitative Tightening program (reducing the size of its balance sheet). The recent strains on the reverse repo market and declining bank reserves at the Fed are likely technical in nature...tax payments, month-end/quarter-end squaring of books, etc. But this bears watching. If the Fed does ease policy and conditions normalize, that would be bullish. We would add that this Powell comment was made during an interview with Crazy Cathie Wood! The Woodchipper does it again!

- We still have a government shutdown ("there was one?")

The government shutdown might be turning into real layoffs. It is interesting to note that the media is getting tired of this story already. Perhaps people are starting to recalibrate the meaning of "essential government employees." Despite this long-term positive (less federal government waste), a longer shutdown with permanent layoffs (no back pay) will shave some growth from GDP.

- Artificial Intelligence margins are better than rumored

As for Artificial Intelligence, we are still getting the headlines about more joint ventures and/or two-way contracts for data center infrastructure (see the separate section below about enhanced productivity and future revenue expectations). But perhaps the biggest headline of the week came from Oracle. It refuted recent reports that its margins on its new AI business were going to be below 15%. Oracle said it expects this segment to have margins in the 30-40% range (while citing a specific project reaping 35% margins). As we have been saying, some Hopes & Dreams (Cocktails & Dreams) might be elusive. But the technology and infrastructure use-cases are becoming more apparent every week.

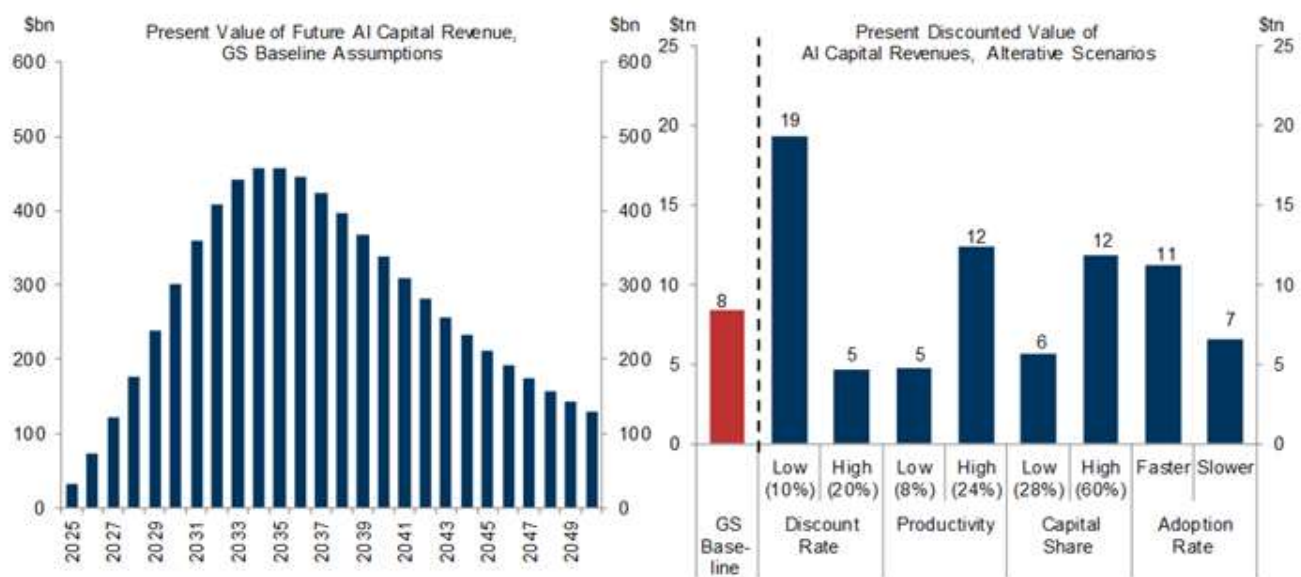
- There are plenty of warnings flashing (not enough to move us, yet)

With all our optimism comes some warning signs. Bitcoin cannot get out of its own way. Whatever one's take is on Bitcoin, it is surely a good barometer of risk appetite in the market. Gold, on the other hand, continues to be a market leader along with silver. Many think this is a safe-haven trade especially in light of the "debasement" theme emerging (this is a new buzzword). Said another way, gold is the new Bitcoin! Despite everyone wanting the Fed to cut short-term interest rates, longer-term rates moving lower can signal growth worries. Before this week, single name equity options have been showing elevated volatility, but the index has not. Much of this was driven by very short duration Call options. Overall, Retail Call buying has outpaced Put buying for 24 straight weeks. Some dismiss this crowded risk-taking since most of this volume is concentrated in Tesla and Nvidia. We think fast, sharp, and large losses will hurt the market no matter the underlying security.

- Here come the AI revenues

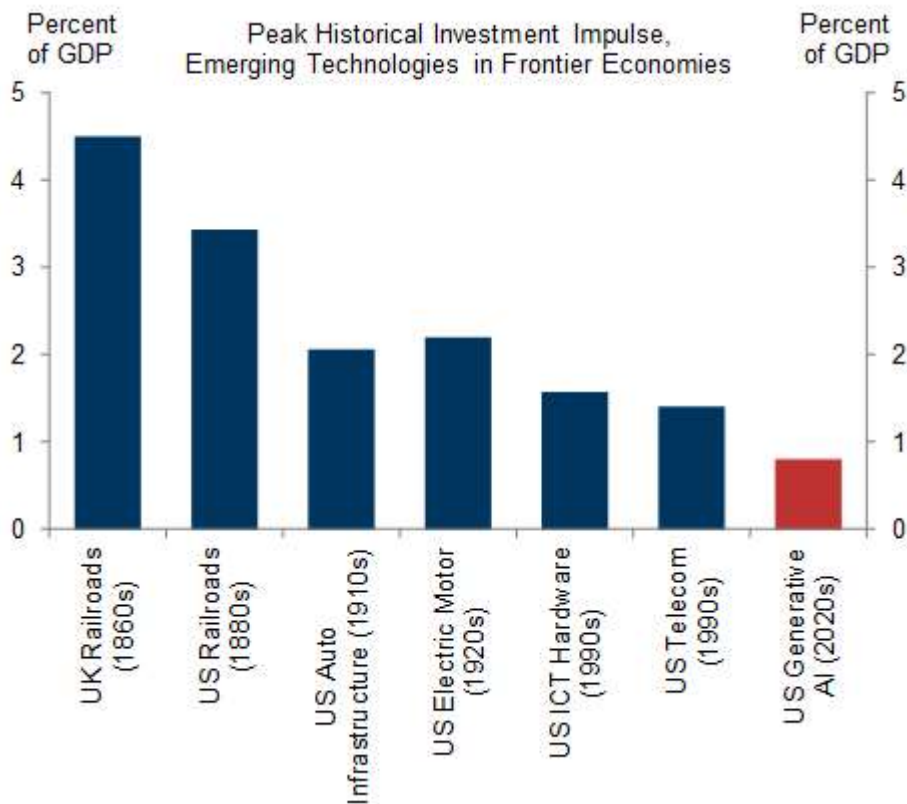
When and how much are the big questions everyone is asking about AI. We see some anecdotal evidence from the likes of JP Morgan, Walmart, Eaton, Salesforce, and others. Goldman goes a step further and estimates the eventual total return of AI applications. This kind of exercise is full of assumptions and extrapolations (dare we say chart crimes!). The crux of the estimates revolves around the uplift to productivity and thus GDP (we have been repeating this as much as possible). GS lands on \$8t in AI related revenues!

Exhibit 1: The Expected Present Discounted Value of Capital Revenue from AI Exceeds Capex Projections



Source: Goldman Sachs Global Investment Research

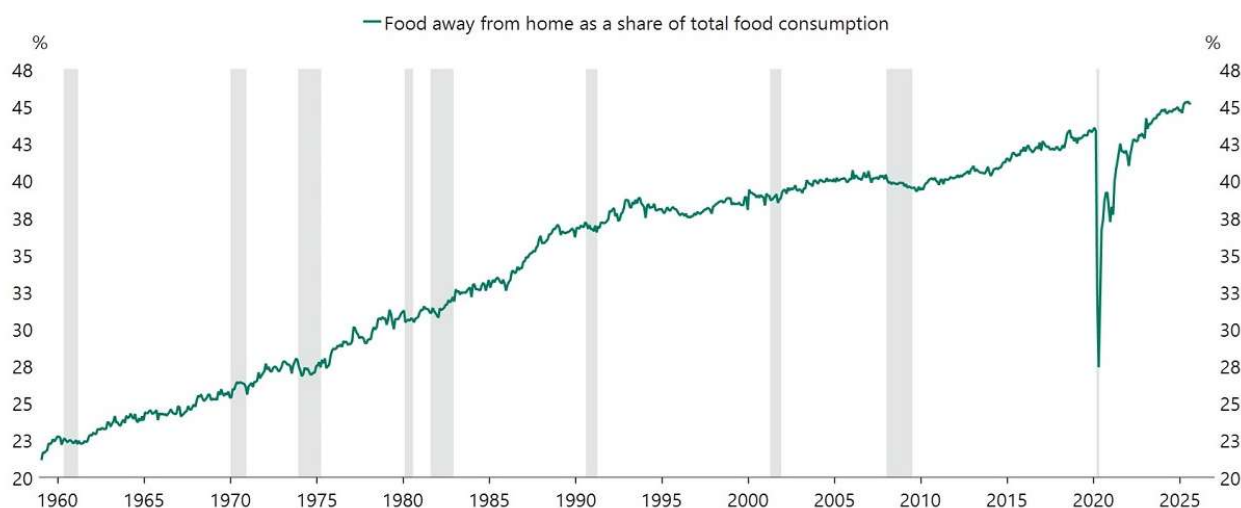
Furthermore, GS says the current annual run-rate of AI spending is only \$277b. “Only \$277b” sounds funny, but GS explains that this is less than 1% of GDP. This falls well short of previous investment impulses. Who knows if the current trends continue (where will OpenAI get the money?). But we do believe that enhanced productivity will be a huge tailwind for future GDP.



- People are eating out more often

This chart from Apollo seems crazy to us. Perhaps it is based on outings and not dollars spent. Then again, the \$20 Chipotle burrito has replaced the \$1.99 enchilada dinner at El Fenix, so it might not matter (meaning there are no cheap food options anymore...although Chili's would argue that!).

A rising share of household food consumption is food away from home



➤ Economic data (what there is of it) has been mixed

U-Michigan Consumer Sentiment remained steady (at a bad level). Even though this survey is worthless on the surface, we weep watching it as a gage for the political split with respect to the opinion of the economy. The flawed survey's Inflation Expectations were largely unchanged at 4.6% (vs 4.7%) for one year and 3.7% (unchanged) for five years.

Small Business Optimism (NFIB) in September ticked down to 98.8. It has been range-bound around 100 for five months (big jump post-election, then cooled off post-inauguration, and now steady).

Weekly Redbook Retail Sales ticked up to 5.9% vs 5.8%. The moderate strength continues. Conversely, JP Morgan thinks the Retail Sales data that was not released (government data) would have been closer to 0%.

The Housing Market index (aka homebuilder survey) for October bounced a little bit from 32 to 37 (after wallowing near five-year lows for five months). Current Conditions and Buyer Traffic remain terrible (38 and 25). But 6-month Expectations jumped above the breakeven level (45 to 54).

Weekly Mortgage Applications fell slightly. The strong bounce in mid-September has slowed, but the overall activity is still well above the 3-year average (still way down from the crazy activity in 2021).

The average 30-year mortgage rate edged down to 6.42% from 6.43%.

The NY Fed's Empire Manufacturing index (business survey/PMI in Oct) rebounded nicely flipping from -8.7 to +10.7. But the Philly Fed Manufacturing index sank sharply from 23.2 to -12.8

Jobless Claims likely increased to 235k. This is up from 224k. This is from the cobbling together of state data.

China is still experiencing deflation. In September, consumer prices (CPI) dropped -0.3% over the last year. Monthly prices did tick up +0.1%, but they were expected to move +0.2%. Producer Prices were flat on the

month. “Core” CPI rose +1.0% on the year. The big driver here is Food prices which fell 4.4% (“Core” strips out Food and Energy).

➤ Where did all the crypto money go?

The chairman of one of Cambodia’s largest companies has been charged with fraud by the US. The once legitimate business was running the standard “pig butchering” scam whereby the fraudsters convince the targets to invest in a crypto token controlled by the fraudsters. This Cambodian conglomerate had over 100 legitimate businesses, but it could not resist the temptation to steal \$30mm a day. The gruesome part of the story is that it ran concentration camps housed with trafficked foreign workers. If they did not participate, they would be tortured. The company also ran a phone-bank scam with 76k phones texting images of women that were “not too beautiful” so the “scheme would seem legitimate.” All in all, the US government seized \$15b worth of Bitcoin which was held in private wallets. The US government has not disclosed how it was able to gain control of the Bitcoin. The chairman is on the lam.

Back closer to home, someone got the tip that Trump was going to announce new tariffs on China. A crypto wallet made a \$100mm short bet 20 minutes before the tariff announcement. 40 minutes later, the short bet was closed for a cool \$192mm profit.

In unrelated news, Coinbase recently increased its max leverage on perpetual futures from 20x to 50x. Ok, it is entirely related to the insider trading case (people in the crypto world still use insane amounts of leverage with volatile/flimsy collateral). We have a small long in Coinbase, and headlines like this scare us.

➤ Chart Crime of the week

This graphic (ok not a chart) is apparently being used to show that there is housing affordability in New York City. We are not sure of the political angle or the overall assertion (we chose to not go down that rabbit hole). But pointing to 710 units being available for rent under \$2k a month in a city of 8.5mm people is a little silly. Not to mention, you probably will get killed in some of these neighborhoods.



➤ Quick Hits

- The University of Chicago has a Department of Comparative Human Development.
- Amazon in the UK has altered cover photos of James Bond movies. He no longer holds a pistol.
- Philadelphia sports set a record this week. No city had ever seen its NFL team lose, its NHL team lose, and its MLB team be eliminated from the playoffs on the same day.
- A Lakers fan is suing LeBron because his silly Decision 2.0 announcement "made him think LeBron was retiring and caused him to spend \$856 on tickets to his last game."

- Princeton is going back to mandating standardized test scores for admission. The school concluded that it “found out that academic performance at Princeton was stronger for students who chose to submit test scores than for students who did not.” Generalissimo Franco...dead.
- It is legal to own a racoon in 14 states.
- U-Michigan’s survey tells us that “sentiment lifted for consumers with large stock holdings and fell for non-stockholders.” Generalissimo Franco...still dead.
- There is a PGA caddie with the nickname Crunchy Pete.
- The Jets had -10 net passing yards this week.
- We once bought heavily discounted “obstructed view” tickets to the Jets game in London. The view was obstructed by the goal post.
- Polymarket called the winner of the Nobel Peace Prize. The winner’s probability/price went from 3.7% to 73.5% within minutes once the outcome had been determined but not officially announced.
- The town of Rockport, MA has banned Halloween yard-skeletons that are posed in “seductive, suggestive, or scandalously straddling positions.”
- Rockport’s animal control officer has been tasked with enforcing the ordinance. Her response, “Now I have to decide if a pelvic tilt is suggestive? This town needs therapy.” There is a “Skeleton Watch” hotline to assist in cracking down on “problematic posing.” A Macarena-dancing skeleton has been exempted.
- Stellantis has a commercial that says something along these lines, “For the Superbowl, we have a jump ball that involves pitches.”
- The governor of Illinois won \$1.4mm gambling in 2024 according to his IRS return. Apparently, this was from playing blackjack on a single trip to Vegas with his wife.

Trading: We used the volatility to add to some of our core positions. We think a few bad loans to crooks is no reason to sell credit card stocks. We think the AI trade is alive and well, so we added there, too. We started a new position in a software name. We think it can work in concert with companies deploying AI (and not be replaced by it). We also added to our European defense names as we predicted. To fund these purchases, we sold some Staples with slowing growth.

TSLAQ: Musk has been very quiet as Tesla is in court still fighting to get his pay package reinstituted. He is fighting to get his new trillion dollar pay package approved, too. Naturally, he is talking about rocket launches and free speech in the UK...anything but the current state of Tesla sales (but it is not a car company!).

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