Weekly Update

8-Sept-2021

Carlisle C. Wysong, CFA
Managing Partner

- Confusing news is good news
- California is in the spotlight
- Positioning is stretched, but how long will it last
- The Job Recovery continues to evolve slowly (as expected)
- PMIs (business surveys) continue to dip
- Will Rents catch up or Housing prices revert?
- China Imports and Exports surge
- Natural Gas is up 30% in the last two weeks
- Crypto is just a trading vehicle (unless you are a criminal)
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
SPX	4514	-0.2%	21.0%	33.7%
QQQ	380.8	0.1%	21.7%	35.0%
US 10 YR	1.34%	1.29%	0.92%	0.71%
USD/DXY	92.7	92.2	89.9	93.3
VIX	18.0%	16.4%	22.8%	28.8%
Oil	69.38	1.1%	42.8%	88.5%

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

The August Employment Report was reportedly going to be the pivotal datapoint in the Federal Reserve's decision as to when to start tapering the monthly bond purchases. While we disagree with this premise (the fall months will be more telling because of kids being back in school and the federal unemployment programs having ended), the number of jobs added missed expectations so badly (235k vs 750k expected) that the market did not know what to think. The Bullish slant is that the Fed will rethink its desire to tighten monetary policy or at least slow down the process. The Bears point to the Fed tightening in a slowing economic recovery. We think the middle ground can be reached by the Fed. Despite the TV pundits and some short-term gyrations in the stock market, it appears that the bond market believes this, too. The 2yr-10yr Yield Curve is basically unchanged compared to before the Employment Report. If the market feared an aggressive Fed move, we would have seen the curve flatten (short rates higher and long rates lower). If the market thought the Fed was going to not taper at all, we would have seen the curve steepen (long rates higher and short rates lower). It is worth remembering that the market has already signed on to chairman Powell's direction of a methodical taper. So, the middle

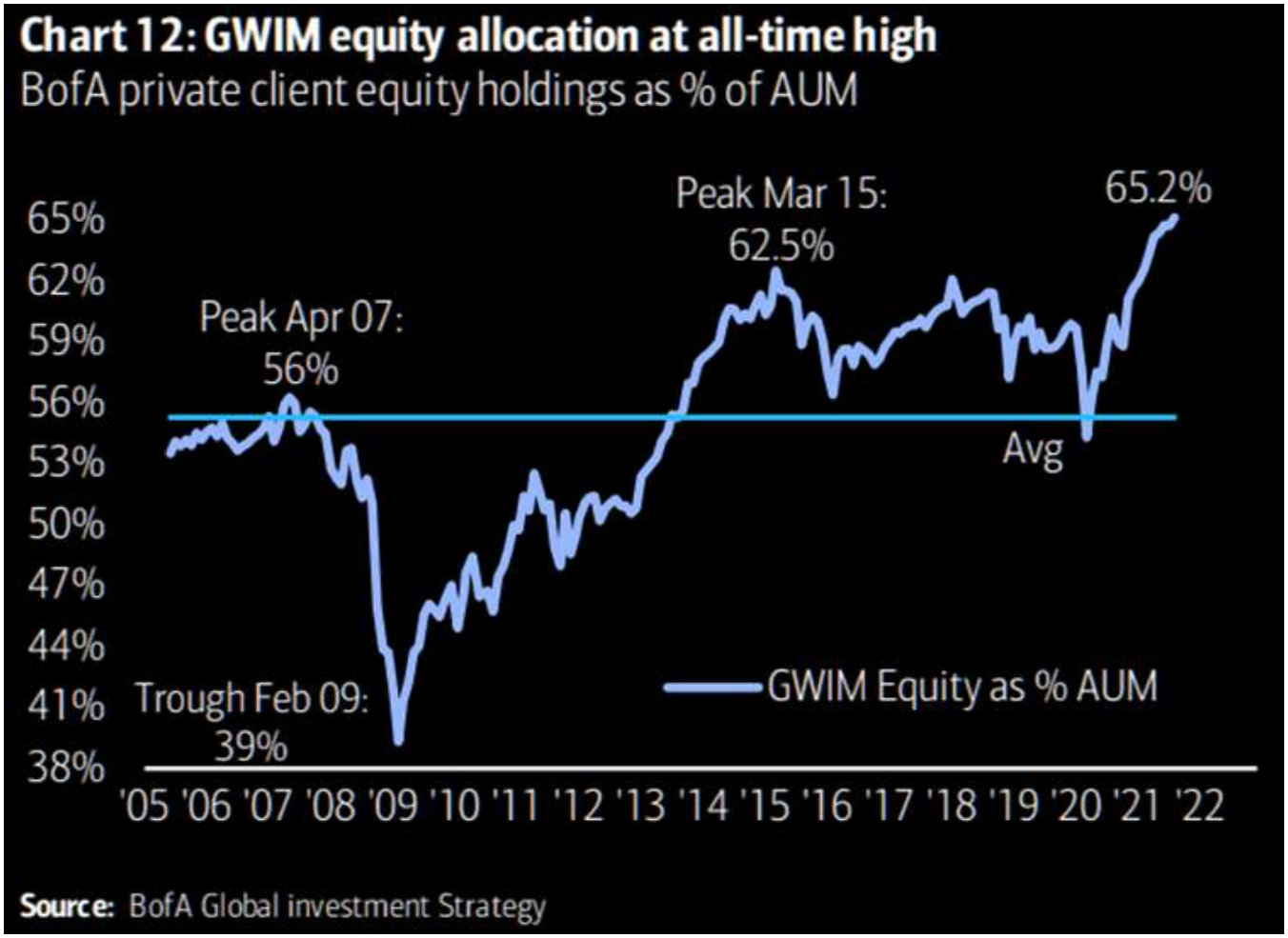
ground is actually leaning dovish. This tells us that the boat will not be rocked too much in the short term. More to the point as we have mentioned recently, the market has been absorbing a lot of bad news and then moving on.

One of the 'known unknowns" is the intensifying political atmosphere. And we are not talking about heightened vitriol on Twitter (if that is even possible). The California gubernatorial recall is front and center. The polls have Gavin Newsome keeping his job at about 57%. But many political insiders think the odds are closer to 50/50 (keeping his job was at 47% last week, so the polls are swinging). If he were to lose, the likely replacement would be Republican talk show host / pundit Larry Elder. On top of this being a huge signal to the rest of the country, it also could just tip the Senate back into Republican hands. Apparently current California Senator Diane Feinstein is struggling physically (not our assessment, of course, but a widely held opinion of DC insiders), so Elder would appoint her replacement if something were to happen. Even without California flipping, most pundits (for better or worse) do not think the $3.5t "Human Infrastructure" bill can pass without changes. But the Democratic opponents of the bill are pulling it in different directions. Joe Manchin wants to ratchet back the spending because of "inflation and the soaring national debt." But the progressives in the House think the bill does not go far enough. Save for a surprising landslide victory by Newsom, the political capital of Biden to unite his own party seems to be flimsy at best. To the point: We think the market will gladly accept gridlock. While the market will miss the government spending (however wasteful), it will breathe a sigh of relief escaping the accompanying corporate tax hike (the most likely common ground among democrats). Some analysts point to a 5% hit to earnings with the most basic corporate tax hike (21% to 25%). Not to mention, Biden has plenty of administrative levers to pull to keep the money pumping (the latest idea being a "pandemic preparedness" bill. Covid Forever, indeed.

- Positioning is stretched, but how long will it last

Positioning is back near extreme levels. The Gross Leverage is not too surprising because this typically represents more market-neutral strategies. Being at all-time highs with plenty of rotations is ripe for people trying to capitalize on both sides of the market (long and short). But the Net Leverage is surprising. It makes sense looking in the rearview mirror (best view of Lubbock)…after all that is how you get to all-time highs. But we would have expected some profit taking or more balance instead of everyone still being near their peak long position.

And it is not just hedge funds. Below is a Merrill Lynch chart showing the equity allocation by private wealth clients. And the Financial Times just ran a story about how Retail buying has driven the markets higher (JP Morgan is the paper's source).



- The Job Recovery continues to evolve slowly (as expected)

For all our talk of jobs coming back, the August Employment Report was pretty bad on the surface. Only 235k jobs were added compared to the 750k expected and the 1.05mm in July (which was revised up 110k). The Average Workweek dipped a touch which is not surprising (we have all seen shorter hours at restaurants and retail stores). On the bright side, Average Hourly Earnings had a strong jump of 4.3% on an annualized basis (led by Leisure & Hospitality…this same group, however, lost jobs in the month). For all the fear of inflation, the real killer is inflation without wage inflation (although we do expect wage increases to slow as workers return which will temper inflation overall). And the Unemployment rate dropped to 5.2% from 5.4% (recall that this is calculated from a different survey). And according to the Job Openings and Labor Turnover Survey (aka Jolts) in July, there are almost 11mm Job Openings compared to 10.2mm in June.

To be clear, our hopes were not super high. This Employment Report does not capture the effect of the federal employment benefits ending. Not to mention, many states do not return to school until mid-September which will provide huge relief to the once-working moms out there (we maintain this cohort has been the hardest hit for no fault of their own). Whatever the case, jobs are still returning. One argument against some people returning to work is their skills have been marginalized and are no longer suited for their old work. This could be a function of the supercharged adoption in work-from-home and other similar technologies. We buy this argument to a certain extent. But getting paid to "wait for something better or I like my old job better" is no longer an option.

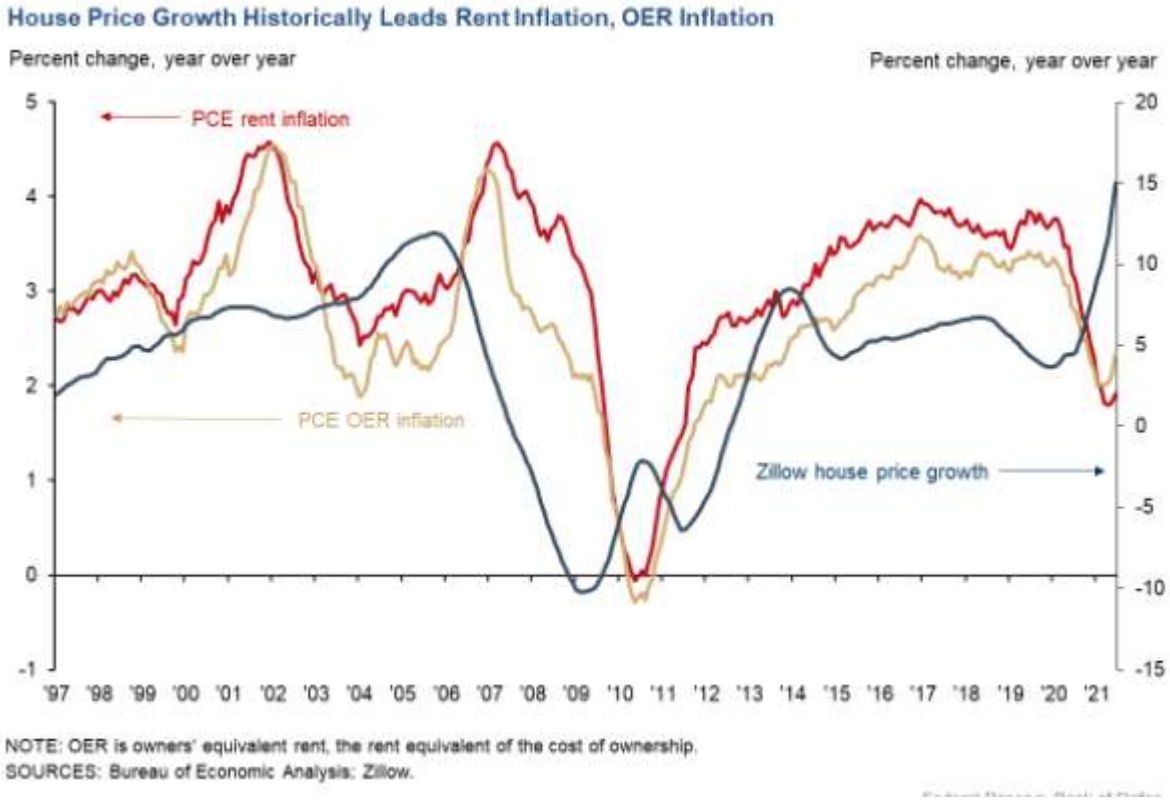
- PMIs (business surveys) continue to dip

The ISM PMI for Services for August dipped just like the other recent surveys. But it is still a decent reading particularly in light of the renewed virus-fear. We suspect there is some geographic disparity (we are digging for this info).

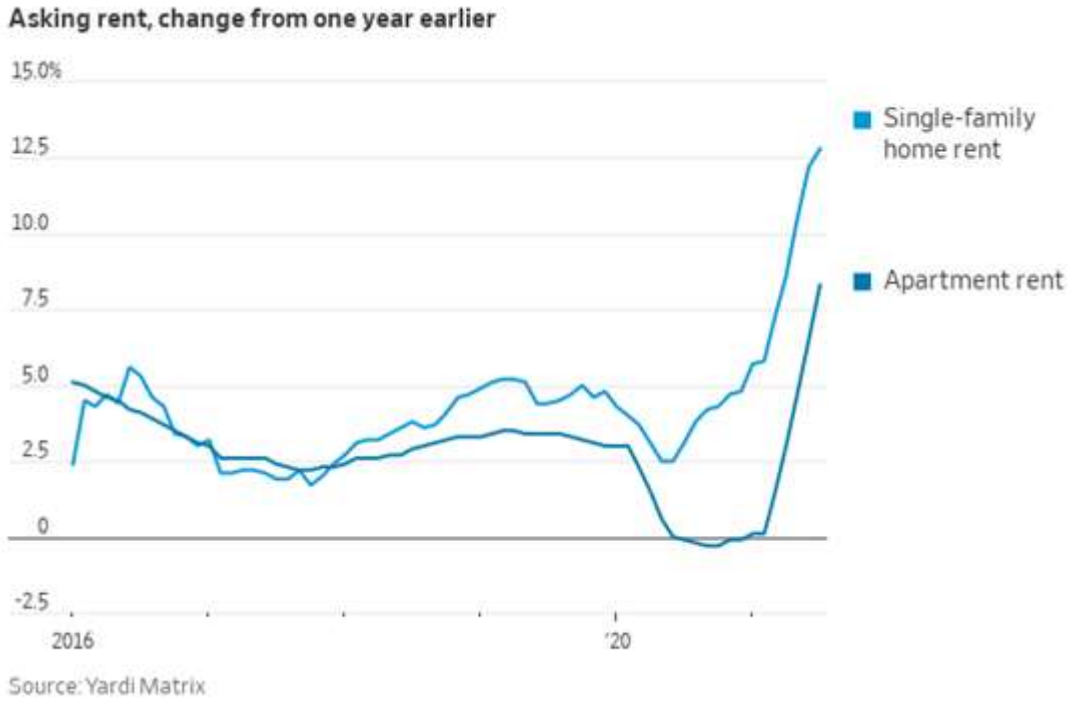
The Global Composite PMI (Manufacturing and Services) dropped three points in August vs July. This is back to its normal run-rate of moderate optimism.

- Will Rents catch up or Housing prices revert?

We have noted that rents prices have been slow to respond to the surge in home prices. Of course, this is structural by nature as leases have terms. The historical lag is about two years. The chart below is from the Dallas Fed which is sending out warnings about looming rent increases. Of course, the huge assumption is that house prices will stay elevated/growing. We think it is more likely that the blue line (housing prices) reverts towards its mean rather than seeing a surge in the red line (rents). Or they can meet in the middle.



Of course, to say rental prices are lagging is not to say they have not already increased dramatically. With many of the new homes being built recently being rental homes, this might be another point of relief for rents.



- China Imports and Exports surge

Giving some relief to global growth worries, China's Merchandise Trade data in August showed Exports and Imports both reversed recent slumps. As always, it is hard to take Chinese data at face value, but since Trade data has a counterparty, this is one we tend to believe.

- Natural Gas is up 30% in the last two weeks

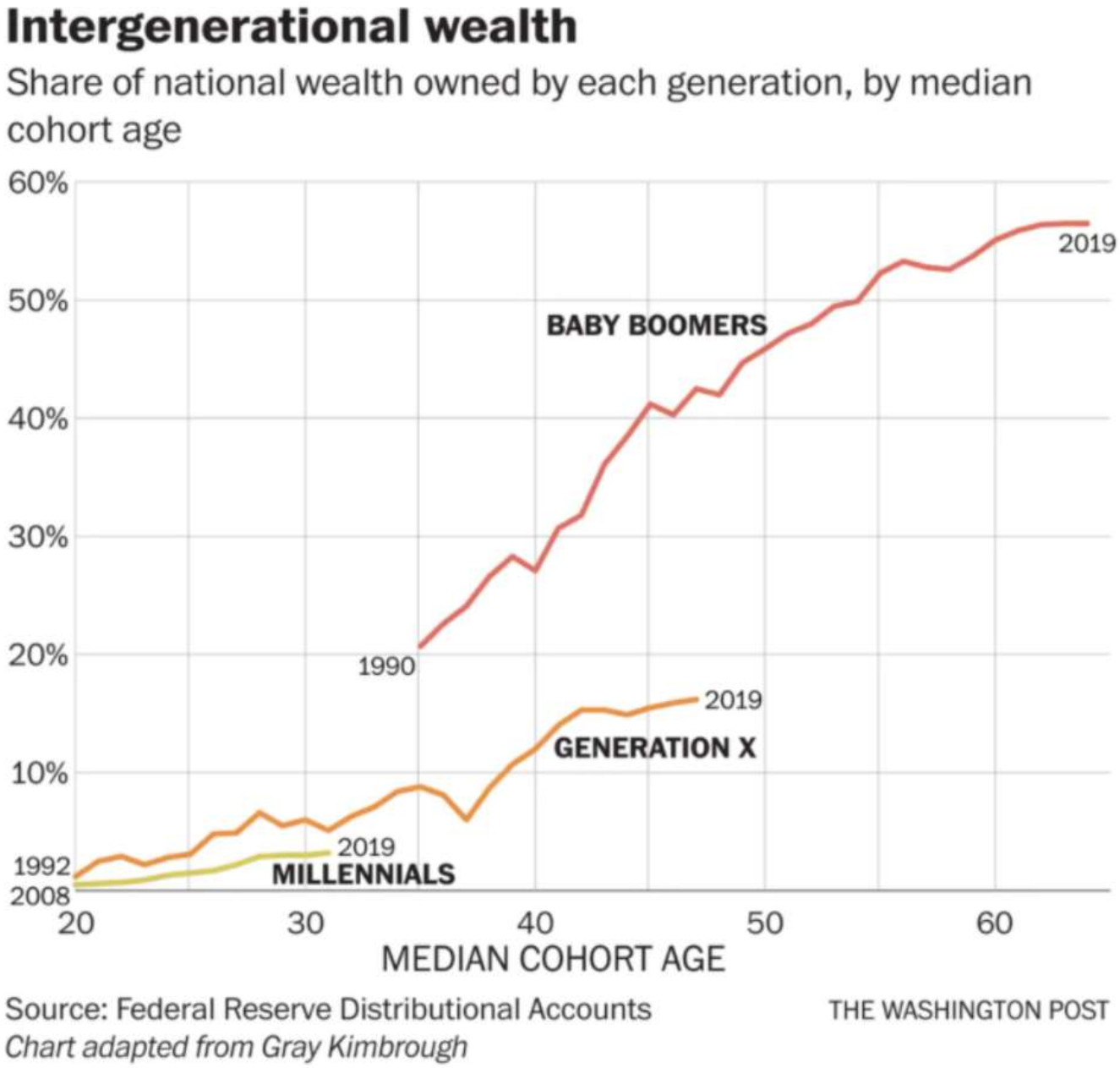
While much of the hurricane Ida focus was on crude oil and the relatively minor hit to refining capacity of 1.1mm barrels per day, natural gas has been on a rampage to a 7-year high close to $5/mmBtu (stripping out the February shock). We are seeing the usual "winter supply shortages" reports, but this year they are being taken seriously. And California is having another energy crisis as natgas prices are in the $20-$30/mmBtu range.

- Crypto is just a trading vehicle (unless you are a criminal)

The crypto world has been watching El Salvador as it was about to make Bitcoin legal tender in the country. El Salvador's plan was to buy about $20mm of Bitcoin and then give it away to its citizens. Since most of the country is against the adoption of Bitcoin as another means to pay for stuff (it is notably not a sovereign digital currency), residents that downloaded a digital wallet would receive $30 worth of Bitcoin. On top of the people not wanting to abandon their USD ways (the Salvadoran colon was the currency until 2001 until it was scrapped for the greenback), El Salvador has one of the lowest internet penetration rates in Latin America. It is about 35% compared to about 65% for the rest of Latin America. Reddit picked up on this $30 theme and tried to pump the crypto. In fact, they were successful until reality set in: Bitcoin will only be used for money laundering in El Salvador, and there is no real extrapolation to other countries adopting it as legal tender. Moreover, most purists do not own Bitcoin to spend it! They want to hold it forever and (hopefully) watch it appreciate. As we always say, Bitcoin is nothing more than a neat idea. Blockchain technology will be adopted across the globe. And trading Bitcoin can be profitable. Just beware of the pump and dumps. (We do not have a position right now, but we are not averse to buying a big purge.)

- Chart Crime of the week

This is one of those that is not necessarily a crime, but it sure is unnecessary to state the obvious. Time Magazine thought we needed to know that older people have more money than young people? And Baby Boomers were a bigger percent of the population (relative)? Not exactly breaking news here.



- Quick Hits
  - The Netflix and BBC are joining forces to promote dramas developed by "the deaf, disabled, and neurodivergent talent."
  - 70% of the flooded property in Louisiana does not have flood insurance.
  - Taliban "rule of law" reminder: most music is illegal.
  - Raw opium prices have almost tripled since the chaos in Afghanistan erupted.

- Women account for 60% of all college undergraduate students.

Trading: Pretty quiet week of trading. We continue to gently trim our net long exposure. And we trying to rotate to more Quality names. This entails abandoning some of our Reopening trades. We have also slightly increased our Put protection.

TSLAQ: The Bond Villain said he hopes to have a $25k car in 2023. It will not have a steering wheel or gas/brake pedals. In the same breath, he said the Cybertruck will be delayed over a year (which was already delayed). Of course, if Tesla were to have a $25k car, the negative margin would be crushing, so the company is surely better off with Musk failing on another promise. In other news, Musk apparently wrote an internal memo backing Crazy Cathie Wood's $3,000 price target. Not sure how this is news (other than being an obvious securities violation if it was leaked on purpose), but it is being cited as the reason for a recent rally in the stock. And the bulls are fired up about the company selling 13k cars in China in August. GM's venture sold 44k electric cars in China in August.

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