Weekly Update

15-Jan-2025

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- Volatile economic data leads to a volatile market
- UK rates are also causing trouble
- Volatility in not all the usual places
- A strong Employment Report with no hidden surprises
- Inflation cools, but expectations are moving higher
- Other economic data is mostly better
- The Fed likes its own research
- The threat of more oil sanctions appears to be working
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	5,949	0.5%	1.2%	26.0%
QQQ	$516.70	0.3%	1.1%	26.9%
US 10 YR	4.66%	4.69%	4.58%	4.07%
USD/DXY	109.1	109.0	108.5	103.4
VIX	16.1%	17.7%	17.4%	13.8%
Oil	$73.35	9.7%	11.6%	10.1%

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

The market action appears muted when looking at the weekly data. But the devil is in the Volatility details. With the market squarely focused on interest rates, each economic data point elicited a dramatic market reaction. The Employment Report was too strong. Yes, good news was bad again. With inflation having resumed its upward trajectory and expectations on the rise, not only were fewer rate cuts likely, but there were even rumblings of rate *hikes*. As we mentioned last week, even good corporate announcements were overshadowed by the specter of reliving 2022 (Nvidia, generally good news from the Healthcare and Consumer conferences, an increase in merger & acquisition announcements, etc). And just to confuse matters, the tragedy in Los Angeles was growing large enough to, perhaps, cast an economic pall over the country as a whole (Los Angeles County is the largest in the US in terms of GDP at almost $1t). Biden's slew of last-minute Executive Orders to-be also sewed confusion. (More export curbs on semiconductors? More offshore drilling bans?)

Alas, a cooler than expected CPI inflation report saved the day. Interest ates cooled. Stocks rallied. We even got peace in the Middle East (for now)! Earnings season also kicked off with the Financials. These economic bellwethers reinforced the idea that the economy is strong. Politically, it looks like Trump is going to get his cabinet nominees confirmed by the Senate. The relevance here is that the new administration will not have to waste time trying to find new candidates. It can get right to its stated business of cutting taxes and decreasing regulations (this is certainly not an endorsement of everything to come from Trump, but these major policy platforms are business friendly which is our focus here). In this realm, one area to watch closely is Musk and Vivek's DOGE recommendations. The American economy has been goosed by government spending the last five years. Any immediate reversal would be a shock to the system. But this medicine would be good for the body (and soul). The irony of ironies would be if we could match the feat accomplished by Milei in Argentina.

- UK rates are also causing trouble

The UK is suffering through another mini-crisis behind the scenes. The last time the UK was in the headlines for all the wrong reasons was during Liz Truss's ill-fated reign. That was when she tried to insert some common sense into the budget. The currency sold off, and the bond market tanked. It culminated in the implosion of the Liability Driven Investments (LDI) which the pension funds had leveraged to the hilt (or gilt as it were). This time around, it is the threat of Trump tariffs, accelerating inflation, and more budget skepticism that have the market on edge. Pundits are saying a more apt comparison was the crisis in 1976 which ultimately led to the Thatcher takeover. But this seems off to us since the power has already shifted from the Tories to Labor. And the dredged-up sexual assault cases over the last two decades might draw more attention. Ultimately, we think the US will drive the bus. But any bumps by the UK will make things worse.

- Volatility in not all the usual places

An increase in Volatility has been a focal point of the market in late December and so far this year. However, this dynamic is not manifesting in the usual corners of the market. In fact, realized Volatility has *decreased* in the junky stocks (ARKK is our proxy). The 30-day standard deviation is elevated above the 1-yr which can be a sign of stress. But this spike in short-term Vol appears to be concentrated around the election. It has been slowly cooling off since then. And the number of Outliers…a recent move outside the 1-year standard deviation… has been dropping. (We do not use this Outlier metric too much because it can be skewed with a small sample size. But when the data fits with other prevailing data, it has more efficacy.)

- A strong Employment Report with no hidden surprises

The headline Non-Farm Payrolls number showed a gain of 256k new jobs in December. This is better than the 160k estimate. Private Payrolls increased 232k which is better than the official expectation of 140k and the ADP guess of 122k. Government jobs increased and Manufacturing decreased

The Unemployment Rate ticked down from 4.2% to 4.1%. The Labor Participation Rate remained at 62.5%. Usually, we have to dig to get to the reality of this data…that there might be more jobs, but fewer people are working. But not this month! Employment swung from a drop of -273k in Nov to a gain of +478k in Dec. Moreover, both part-time and full-time employment gained in the month. This has not happened in nine months. The net numbers over time are still terrible, so the jury is still out on whether this new data is the start of a trend. It does match the recent survey results that show small businesses were holding off on hiring until after the election.

Average Weekly Earnings also remained in check. They gained 0.3% vs Nov. This was still a 3.9% gain on the year. But this is only marginally above the equivalent to 2% headline inflation (we want wage growth to outstrip broad inflation, obviously).

Challenger Job Cuts fell to one of their lowest levels in the last two years (this data is volatile).

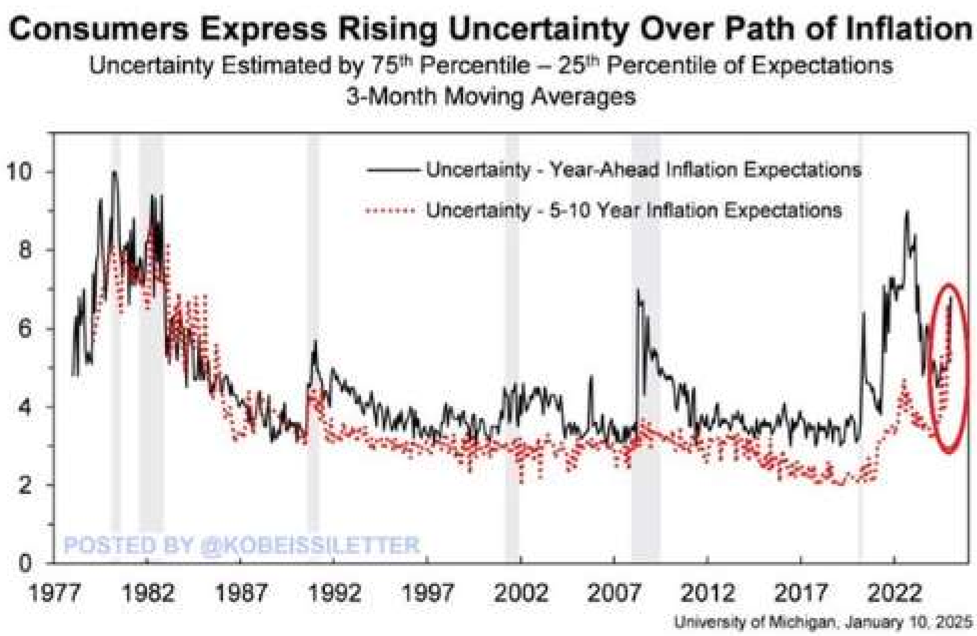
- Inflation cools, but expectations are moving higher

Inflation cooled in December. As measured by the "Core" CPI (change in the Consumer Price Index ex-Food & Energy), prices "only" increased by 0.2% vs November. This compares to the 0.3% gain in November. The market was expected a 0.2%-0.3% increase…so it is not a huge cooling. But people were fearing an acceleration higher even if not in the official consensus estimate (guess). This drops the annual rate to 3.2% from 3.3%. The headline CPI was hotter than expected at 0.4%. This is an acceleration from 0.3% in Nov. The annual rate moved higher to 2.9% from 2.7%. But Energy prices account for almost all this jump. As a whole, they moved 2.6% higher on the month with gasoline moving 4.4% higher. Food prices increased 0.3% both At Home and Away from Home. While not great, the At Home increase fell from the 0.5% jump in November.

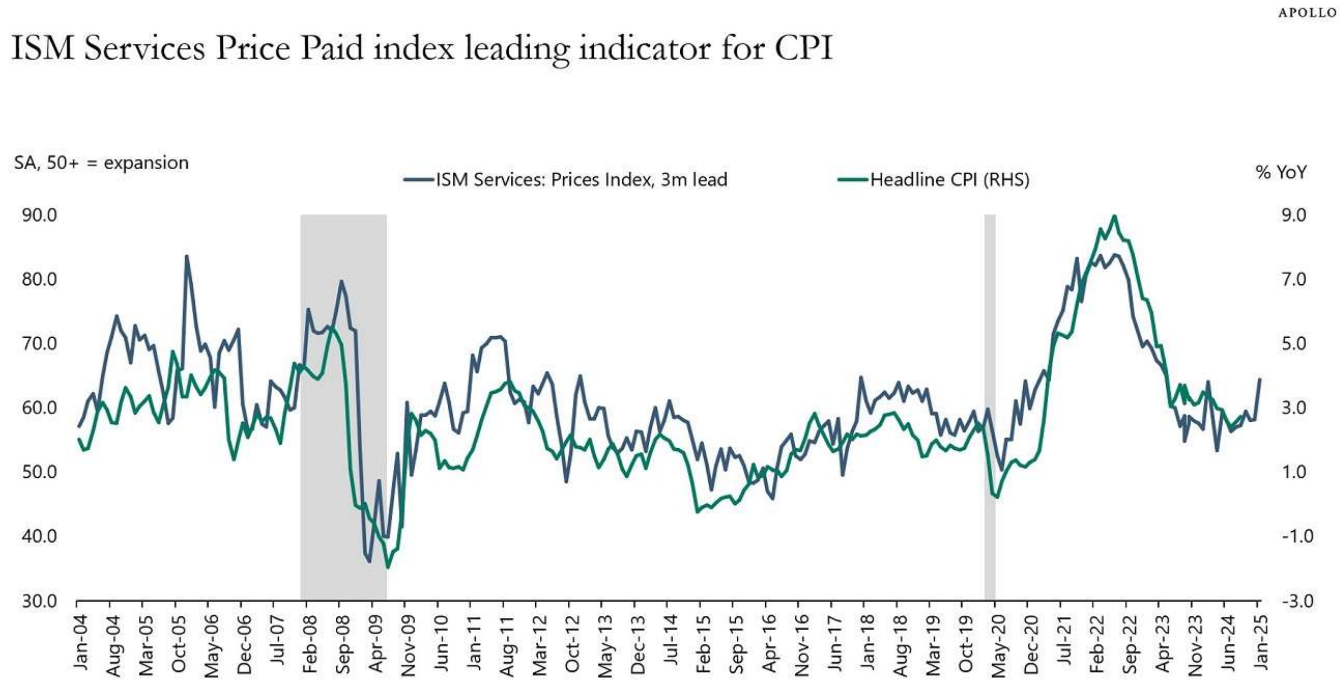
Shelter prices remain sticky. They had started to show some cooling with drops in October and November. But both Rent and Owners's Equivalent Rent (the quirky stat based on the estimated rent value of your house) ticked higher to 0.3% increases. The Fed has said it largely ignores this current Shelter data as it expects prices to fall with a lag. That is fine as long as there is a predefined sense of that lag (dare we go back to the "inflation is transitory" days). Not to mention, the Fed's preferred inflation gauge (the PCE) has a smaller Shelter weighting in its calculation (convenient!).

Other notable price increases include Used Cars (+1.2%), Airfares (+3.9%), Meats, Poultry, Fish, & Eggs (+1.9%). Notable decliners include Nonalcoholic Beverages (-0.4% in the Food category) and Alcoholic Beverages (-0.3% which is in the ex-Food category).

As you can see, notwithstanding this last inflation print, the recent uptick in observed inflation has filtered into people's expectations. Will this latest report soothe these fears? Probably not right away. But it certainly helps (this ties back to shelter…rents have to start dropping for people to really feel better).



Here is another survey-based indicator of inflation expectations. It is the Prices Paid component of the ISM Services business survey. While it is not framed as an expectation per se, how managers feel about prices now does tend to be a good leading indicator for future prices. Apollo uses a 3-month lead in the chart below. If the relationship holds, we should see the green line (CPI) follow the blue line (ISM Prices paid) higher.

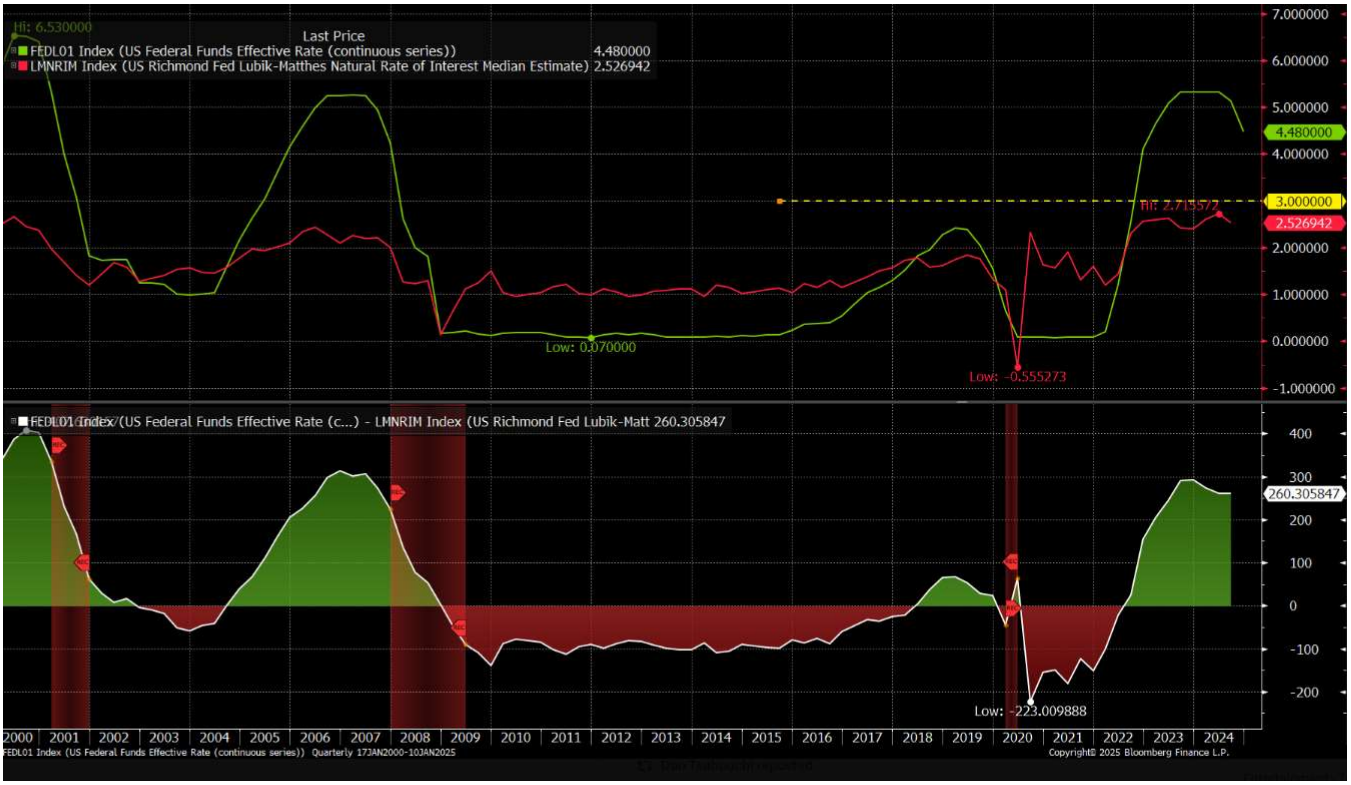


The PPI (Producer Prices aka wholesale or input prices) showed a notable decrease in prices. Some say this is another leading indictor for prices. We do not put too much weight on it (although it tends to be a more accurate indicator in China).

- Other economic data is mostly better
  - Shipbuilding Orders in 2024 reached their highest level since 2008.
  - The average 30-yr mortgage hit 7.09%.
  - Mortgage Applications actually surged higher.
  - The NY Fed's Empire Manufacturing survey sunk into negative territory.
  - The recent boost in small business optimism (NFIB Business Optimism index) continues with another 5-yr high.
  - U-Mich Consumer Sentiment for January dipped a touch vs the strong December.

- The Fed likes its own research

This chart underscores the tug-of-war going on with interest rates and the Fed. The green line is the Fed Funds rate (the rate at which the Fed targets overnight lending between banks). The red line is the Richmond Fed's calculation of what the neutral interest rate should be right now. This is the more-art-than-science (although the Fed is trying to make this science) level of interest rates that neither juices the economy nor restricts it. The idea is simple: The Fed will follow its own research and push rates closer to its perceived neutral rate (which could change with a change in the data…but it has been steady for about two years).



- ➢ The threat of more oil sanctions appears to be working

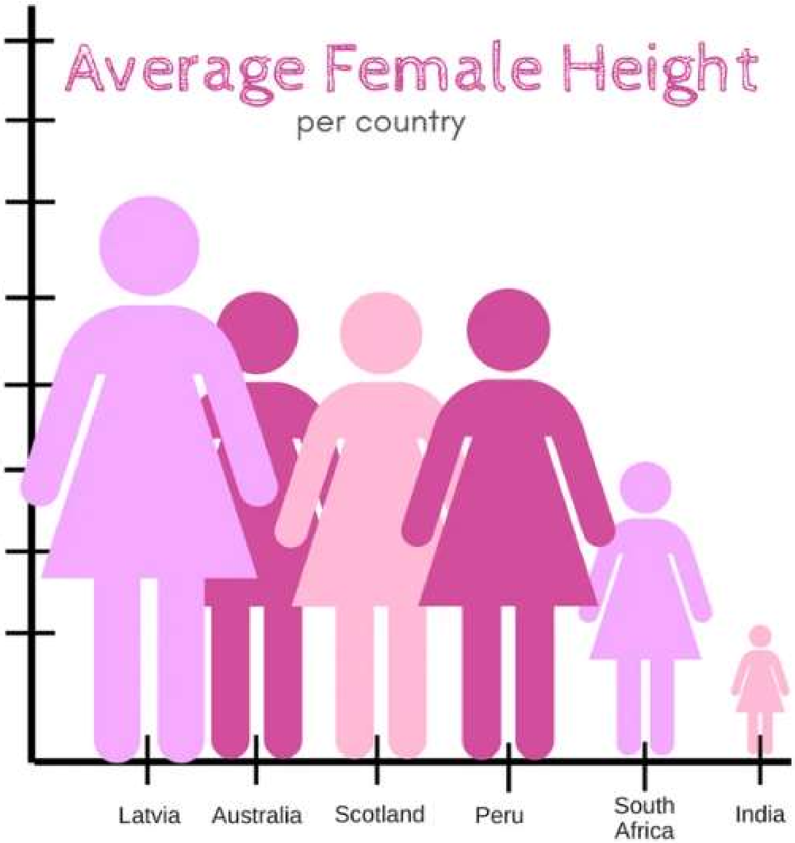
Last week we talked about China's impending attempts to stop importing oil from Iran, Russia, and Venezuela. It turns out this came right before the news the US was turning up the heat on Russia. India is even thinking about turning away exports now...India has never met a sanctioned barrel of oil it did not want to buy on the cheap. Europe has feigned an intention to also crack down on entities willfully skirting the sanctions on Russia…and they might even add to the sanctions. We doubt this will happen. But it does seem that much of the world is getting in line. This might be a rare instance of Biden and Trump working together (perhaps the Israel/Gaza situation, too…but we remain skeptical there). It obviously does not change the demand side of the oil equation (China and Europe are basically in recession), but it certainly helps the supply side (helps = lower).

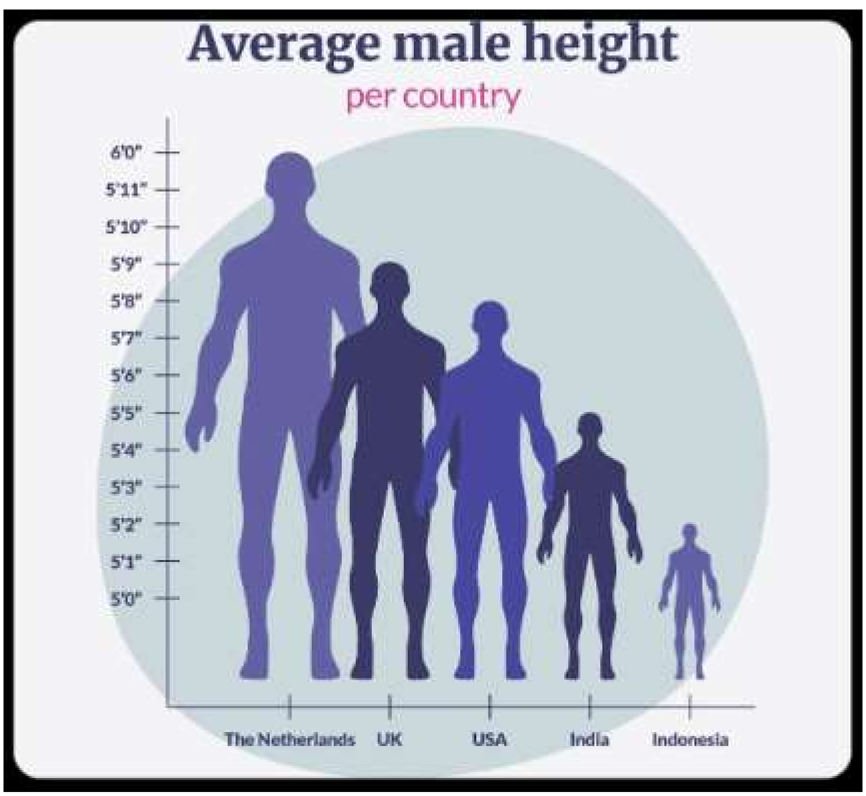
- ➢ Where did all the crypto money go?

There is a guy in the UK that claims to have thrown away 8,000 Bitcoins in 2013. Actually, he blames his "partner" at the time for tossing out the hard drive containing the numeric keys. He has tried to get the backing of a hedge fund to pay for the cost to dig up the dump where he suspects the bounty lies. Unfortunately for as all, another court has struck down his request/suit to enter the city dump. His suit alleged that he was entitled to $500mm if he were not allowed to proceed with his digging. To be fair, the lost Bitcoin would be worth about $760mm today. We really want to see this guy get the go-ahead.

- ➢ Chart Crime of the week

It has come to our attention that some of you do not have the proper chartcrime foundation to fully appreciate the genius of the recent female-singer-by-height chartcrime. So here you go (we try not to repeat things, but these are always worth a refresher).


Average Female Height
per country
5'7"
5'6"
5'5"
5'4"
5'3"
5'2"
5'1"
5'0"
Latvia
Australia
Scotland
Peru
South Africa
India


Average male height
per country
6'0"
5'11"
5'10"
5'9"
5'8"
5'7"
5'6"
5'5"
5'4"
5'3"
5'2"
5'1"
5'0"
The Netherlands
UK
USA
India
Indonesia

- Quick Hits

- Almost 6% of all workers in Virginia and DC are employed by the federal government.
- South Dakota has the lowest percentage of workers that are federal government employees.
- The federal government owns about 80% of the land in Nevada.
- The federal government owns less than 2% of the land in Texas.
- US bought the US Virgin Islands from Denmark in 1917.
- Greenland's population is 57k.
- The toll for the largest ships to pass through the Panama Canal is $100k. This is up from $80k last year.
- Scorigami! Houston's drubbing of San Diego 32-12 was the 1091st unique score in NFL history.
- The Consumer Financial Protection Bureau wants to regulate Robux (the pretend money inside of the video game system Roblox).
- There is an arcade in New York that has a "claw" machine. It costs $50 to play. You can win an Hermes Picotin bag worth $3600.
- When we used to walk through Harrod's London on rainy days on our way home from work, we always noticed an uptick in security when we walked near the Hermes bags.
- One of the popular markets on the betting/prediction site Polymarket is if New York City will abandon its congestion pricing regime by this summer.
- Over half the cigarettes smoked in California, New York, and New Mexico are illegal.

Trading: We executed another bit of our recent rotation. We added to some longs in Big Tech and Financials. We think these will be beneficiaries under Trump (the big question mark here is if the current ring-kissing from the likes of Google, Meta, Apple, Microsoft, etc will be enough to make Trump forget the past…we think it will be). Energy has had a surprising run recently. We think people are misinterpreting "drill baby, drill" as being good for Energy stocks. We took some profits. We also took some profits in a long-running short…Moderna...after a 20% drop on an earnings implosion. This will likely be a zero one day, so we will look to reenter the next time someone is dumb enough to believe the company has a vaccine for cancer. We also trimmed some of our India long. We like this long-term, but we wanted to fund some higher growth opportunities in the near term.

TSLAQ: For all of Elon Musk's faults, he does seem to work incredibly hard. He is the CEO (or whatever title he has given himself) of at least five legitimate companies under his control with a few more illegitimate ones, too (brain implants, flamethrowers, whatever). His campaigning for Trump was a full-time job that looks to have morphed into a full-time aid job even before DOGE has been created. But apparently, he is also one of the world's greatest video game players. He claims to have conquered the game Diablo IV amongst other career "highlights" in front of the screen. He even posted a video of him playing Diablo while on a conference call with SpaceX employees right before a Starship rocket launch. Perhaps his employees were as bedazzled as the Sequoia employees were when discussing an investment with Sam Bankman Fried who was also playing a video game at the time. Hopefully things work out better for the SpaceX investors.

Of course, we have to note that the SEC just levied more charges against Musk. This time for filing the wrong disclosures ahead of his Twitter purchase. We have talked about this one for a while. He is guilty as sin, but we always assumed nothing would come of this. And nothing will come of this other than a splashy headline until a new head of the SEC takes over in a week.

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