Weekly Update

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- Volatility under a quiet surface
- The market suddenly is worried about a slowing economy
- But Powell calms the nerves
- Labor market is weakening but maybe in a healthy manner
- Inflation has turned to deflation (for now)
- The consumer is still not optimistic
- Global PMIs in charts (the bad, the good, and the great)
- Housing affordability is still a real issue
- If all else fails, look to profits
- One-liners from Powell and his easing bias
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	5,615	0.9%	18.5%	27.3%
QQQ	$494.82	-0.3%	21.2%	33.6%
US 10 YR	4.19%	4.29%	3.88%	3.83%
USD/DXY	104.1	104.9	101.3	99.9
VIX	12.5%	12.5%	12.5%	13.3%
Oil	$82.19	-1.2%	14.7%	6.9%

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

You would never know it was a volatile post-holiday period just by looking at the headline indices and macro factors. Most notably, the notion that big spending would outdo interest rate cuts has been debunked. It took a weakish employment report and deflation, but the bond market is no longer worried about excessive deficit spending (at least not for now). Of course, that might mean that the stock market is finally worried about a slowing economy…the "be careful what you wish for" scenario. But Fed Chairman Powell did his best to say employment was not a problem…just it was in better balance now. He managed to say this while also ramping up his bias to ease interest rates. The futures market is now putting a 96% probability of a rate cut in September. This was 68% a month ago. For December, the market is pricing in a 99.8% chance of one cut (96% a month ago), a 94% chance of two cuts (71% a month ago), and a 54% chance of three cuts (25% a month ago).

This almost-goldilocks environment kickstarted some of the dormant parts of the market back to life. Indeed, people had been betting on Big Tech as the quality safe haven in an uncertain economy (labor market softening along with sticky inflation). But if the Fed was going to provide relief when it was not really necessary (certainly debatable, but we think the labor market is ok even with the fuzzy government statistics) …hallelujah…the small-caps rejoiced. The Russell 2000 small-cap index rallied over 3% on Thursday while the S&P 500 fell on the day. Bespoke tells us this magnitude of divergence has only happened once since 1979. That was in October of 2008…not exactly a screaming buy signal (the market dropped about 30% from October to March 2009). Actually, it was not just a small-cap rally. It was an everything-rally except for the previous winners (AI names were hit hard). Alas, cooler heads prevailed, and people bought the AI dip. Some are saying more hedge funds imploded this past week. Probably. But the prolonged death rotation has seemingly been avoided.

We will add that it was one of the quieter starts to Earnings season given the macro news and market swings. That is not to say there were not some notable reports. Pepsi reacted negatively to tepid guidance (consumers are no longer falling for or tolerant of shrinkflation), but this was very short lived. The banks mostly reported stronger revenues with good core earnings. But some higher credit provisioning (worries about future loan defaults) for JP Morgan dictated the reaction. The CEO Jamie Dimon did his best to warn about potential economic hurdles (including heightened geopolitical risks). But the market has become numb to his repeated cautions (however prudent they may be). Speaking of tensions, who knows what this assassination attempt on Trump will mean for the markets. Since Trump was a heavy favorite already, it likely will not change much.

- Labor market is weakening but maybe in a healthy manner

The June Employment Report was another strong one…at least on the surface. 206k jobs were added compared to 190k expected. But the last two months saw negative revisions of 111k (May went from 272k to 218k). And Government jobs were a third of all new jobs (70k). Logically, Private Payrolls were much lower than expected and down to 136k from 193k (which was also revised down from 229k). Healthcare had the largest increase with 82k. Manufacturing jobs fell 8k. But at least Construction jobs increased 27k. Temporary jobs fell 49k. Temporary jobs are usually the first to go.

The Unemployment Rate ticked higher to 4.1% from 4.0%. The Participation Rate also ticked higher to 62.6%. Average Weekly Hours remained the same (34.3). Average Hourly Earnings slowed (still positive at 0.3% but down from 0.4%).

This report clearly shows the labor market is cooling. And as we continually note, all the new jobs are part-time while all the job losses are full-time. Job Openings have been normalizing (even ignoring the fluff embedded in this data). And Jobless Claims have edged higher. But we still are not overly concerned. Businesses no longer feel the need to “hoard labor” for fear of not being able to find a replacement (oddly similar to the mortgage “rate lock” dynamic). The Powell “balance” is more evident which is certainly healthy.

- Inflation has turned to deflation (for now)

Inflation turned into deflation for the month of June. Headline prices fell 0.1% which was down modestly from the flat 0.0% in May. This brings the annual rate down to 3.0% from 3.3%. The “Core” prices ticked up only 0.1% vs the 0.2% increase in May. The annual rate fell to 3.3% from 3.4%. These were all slightly better than expected. Of course, mildly softer prices do no help the lower end consumers very much.

Some of the guys that get deep into the weeds on this data think annual inflation is going to tick higher in the coming months…mostly that base-effects thing. We think if this is true, it will likely be modest and brief (but we are still worried about shipping container costs as well as some other leading indicators).

Food prices increased 0.2%. As usual, the split between Food at Home and Food away from Home is the news. Food at Home prices ticked 0.1% higher while Away from Home prices increased 0.4%. For the year, Food prices have increased 2.2%.

Energy prices fell 2% on the month. Utility gas was the large outlier with a 2.4% gain.

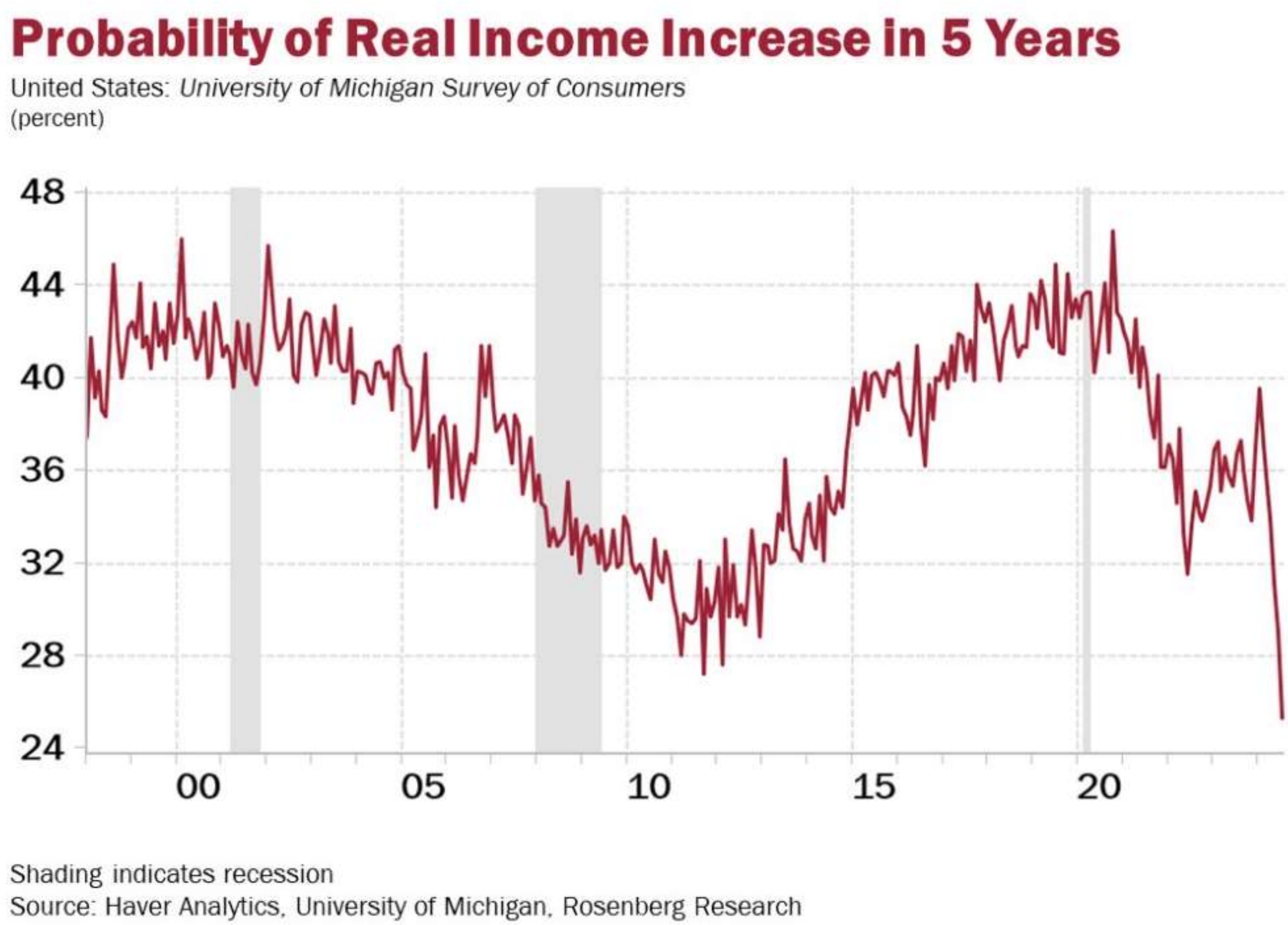
Shelter prices increased 0.2% which is a slowdown from the 0.4% increases in the last two months. Somehow, Rent and Owners' s Equivalent Rent both increased 0.3% (we need to dig into this weird math anomaly). The yearly increases are still elevated at 5.2% for Shelter with Rent 5.1% and OER 5.4%.

Producer Prices (wholesale or input) ticked higher in June to 0.2%. The "Core" PPI accelerated to 0.4%. The annual rates are 2.6% and 3.1%.

Consumer Inflation Expectations (its own survey) fell from 3.2% to 3.0% in June. The U Michigan expectation fell from 3.0% to 2.9%. The five-year expectation did the same.

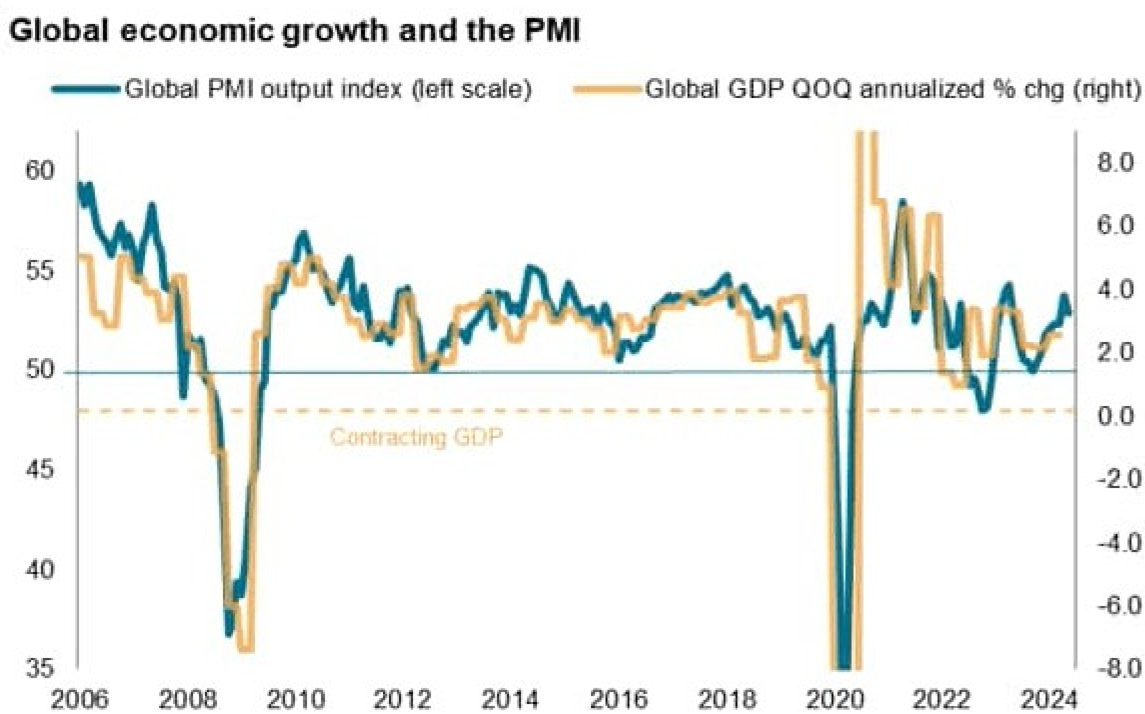
- The consumer is still not optimistic

For all the calmness surrounding inflation, it seems people do not expect the good times to last. Here is a chart highlighted by Rosensberg (super smart, usually right, timing is terrible). Even with inflation expectations cooling, people do not expect to make more money. This is likely the bottom of the K-shape (which makes it worse).

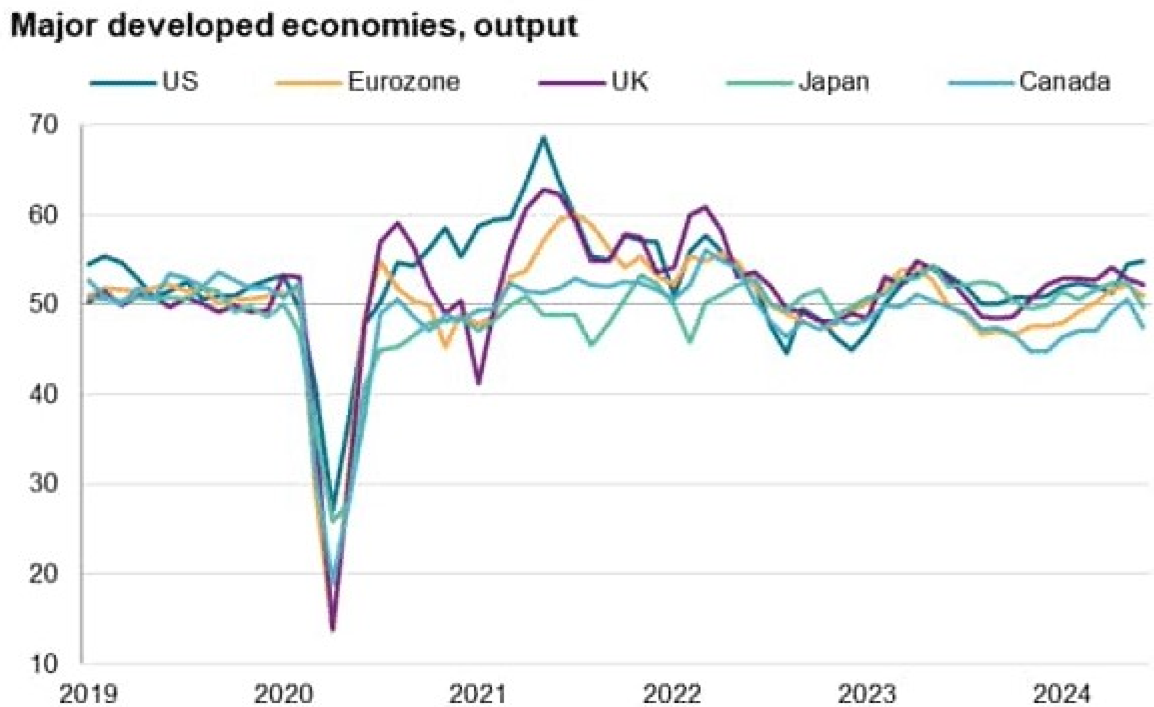


➢ Global PMIs in charts (the bad, the good, and the great)

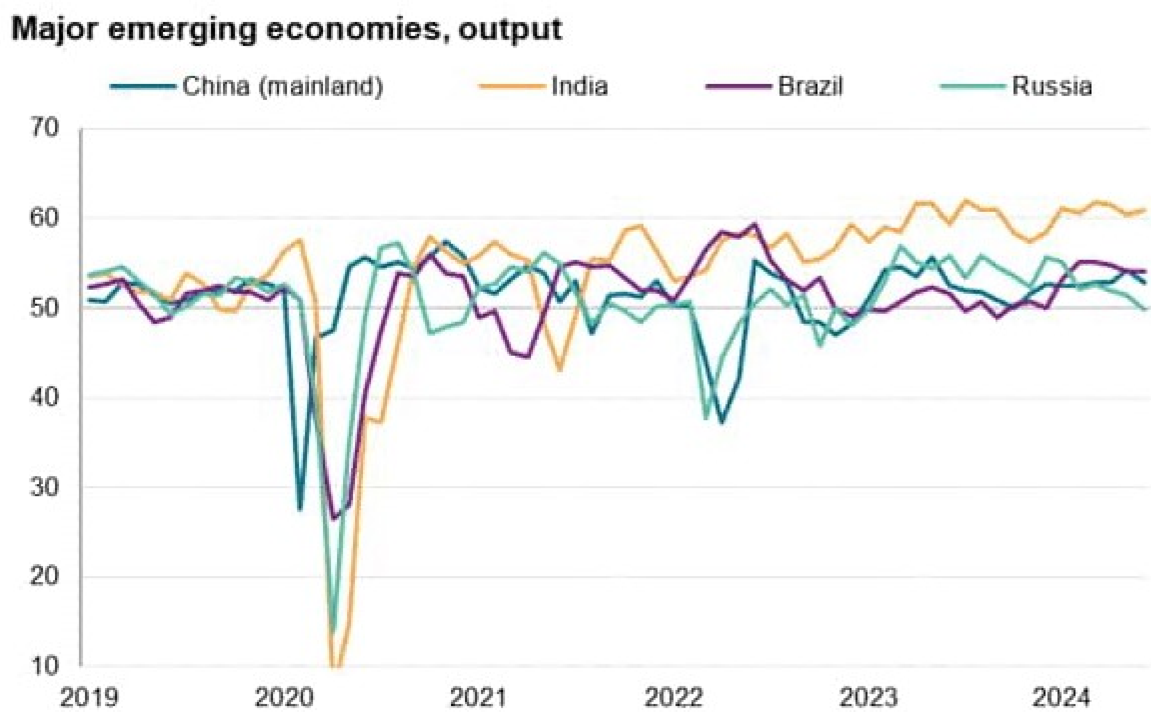
These are charts from S&P Global. You can see that the global PMI (not to be confused with S&P Global the company) has turned lower. And this is with GDP already lagging a bit (but this is typical…the PMI should be a leading indicator). This is not too surprising given China's troubles and Europe's malaise (although some countries have exhibited a turning of the tide notwithstanding the recent political upheaval).



But despite the new narrative that the US is slowing (something we believe on the margin, just not perhaps to the degree of the doomsdayers), it is still the best developed market economy.

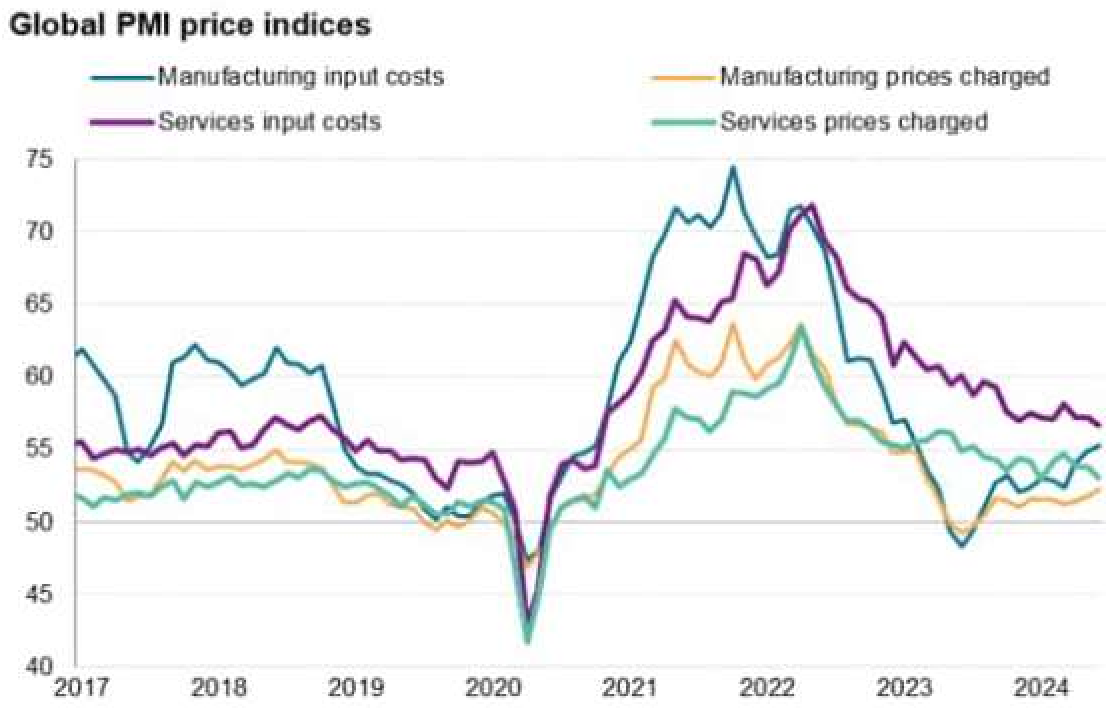


If we are looking for the best economy overall, that is India. We like India and remain long.



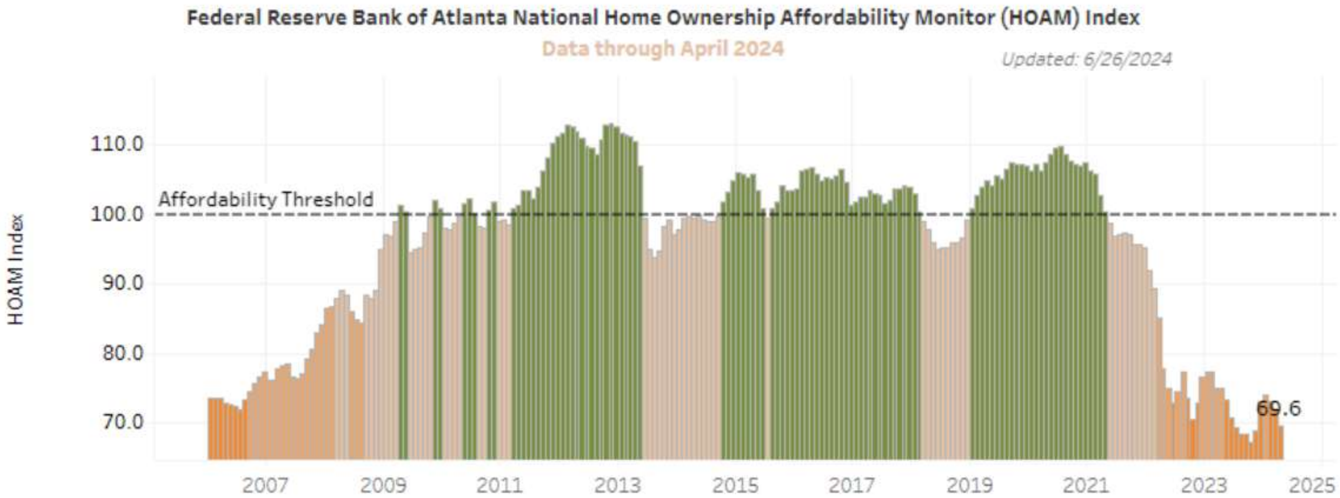
Of course, the giant caveat is that PMI's do not always predict GDP perfectly. We learned that in 2023 (when PMIs deteriorated most of the year, but the economy and the market were great). That said, we do think the

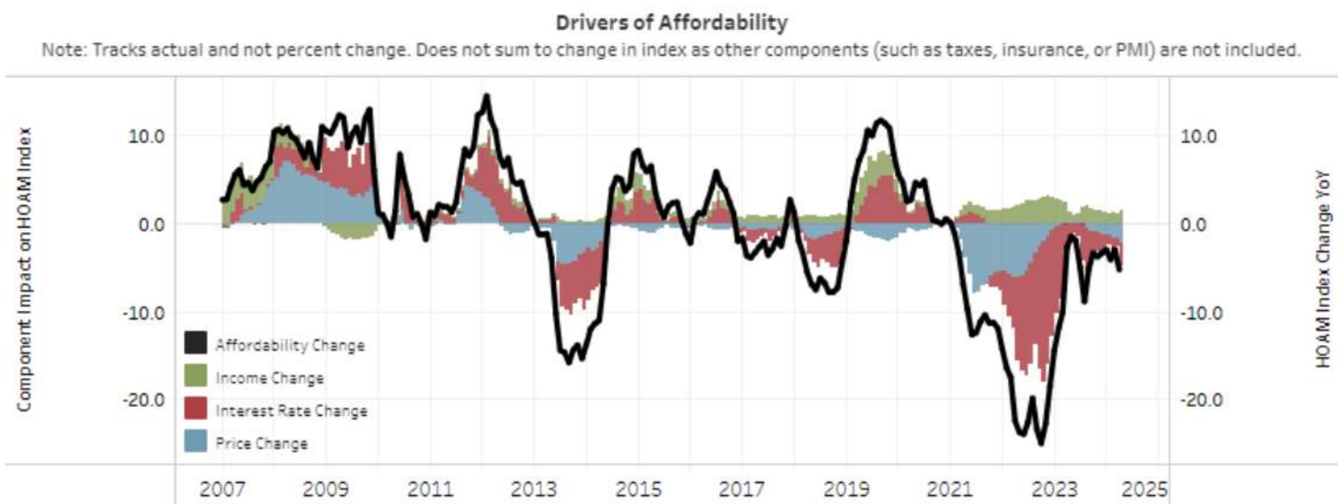
PMIs are useful. And if we include the Price Indices, we can get a better idea. Manufacturing input costs are the item to watch.



- Housing affordability is still a real issue

Housing affordability is weakening again. But as you can see from the second chart, the current level is not that far off the flat level in terms of rate of change. This does not make a house cheaper, but as we have been saying, people do get accustomed to certain price changes (this is more true for houses than it is food).





- If all else fails, look to profits

As we have noted before and is quite obvious, all these differing economic data points are often interconnected and yet still conflicting. Ultimately, we think it comes down to whether companies are making money. Here is a chart that shows corporate profits as a percentage of GDP. This is like an economy-wide profit margin. If businesses are making money with strong margins, there is no pressing need to reduce the workforce.

- Other economic data is mixed.
  - Initial Jobless Claims moved lower to 222k. The 4-week average is 234k. Continuing Claims ticked lower to 1852k.
  - Mortgage Applications fell 0.2% on the week.
  - Total Vehicle Sales dropped to 15.3mm in June from 15.9mm in May (this is an annualized run-rate number.)
  - Redbook Retail Sales moved higher on the week to a gain of 6.3% vs 5.8% last week.

- One-liners from Powell and his easing bias
  - This is no longer an overheated economy.
  - The labor market is back in balance. It is "considerably cooler."
  - We are well aware that we face two-sided risks. Balancing these two-sided risks is where the conversation is.
  - The likely direction is that we begin to loosen policy." (He demurred when asked about the timing of any rate cuts.)
  - He also warned about potential stresses in the commercial real estate market could persist for years. He thinks the trouble spots are limited and most banks have good capital buffers. But he did say the regulators are keeping a close eye on the banks with outsized exposures in CRE.

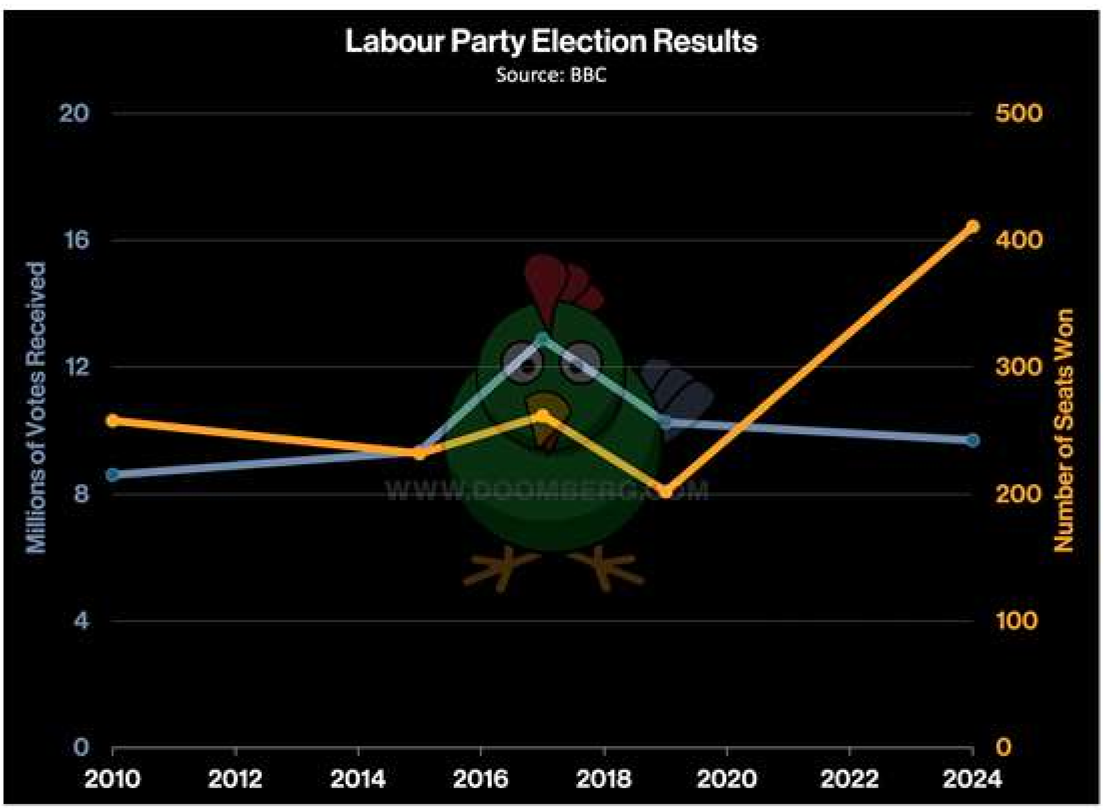
- Where did all the crypto money go?

Eclipse Labs is a crypto platform company that provides a quicker way to transact on the Ethereum network. It was looking to raise money. Fortunately, it came across Polychain which is one of the largest crypto venture capital firms. Polychain invested in Eclipse Labs pre-seed funding round and the subsequent Series A round (private equity likes ot have fancy terms for different rounds of funding). Unbeknownst to Polychain, its employee that spearheaded the investments was secretly getting Eclipse Labs "tokens." This non-equity monetization was worth $5mm. This was the same amount of tokens that Polychain received for its actual money investment. The employee refutes the story and has revealed a document showing that he and Polychain agreed to the side deal. This document is dated 18 months after the deal was struck and a year after he left the company.

(In all fairness, this underbelly dealing reminds us of SPAC investments in the stock market. Or of water vending machines…one company just got busted for running a Ponzi scheme that promised 28% annual returns! This story came to light because an individual investor in the company directed his hedge fund to invest in the company so he could get his money back!)

- Chart Crime of the week

This one is not a chartcrime. And don't be fooled by the silly chicken logo. This is from Doomberg which is a great research outlet (focusing primarily on energy). We highlight it mostly to show that most elections are not "fair."



- Quick Hits
  - Greece has introduced a six-day workweek. Greece!
  - There are more banks in the US than publicly listed companies.
  - In the recent UK election, the Reform UK party received about 14% of the total vote. It only won five of the 650 seats (about 0.8%).
  - CNBC commented that "it seems like these 100 point moves in the index keep getting easier."
  - Barcelona had 3k people protesting tourism this past weekend.
  - Tourism is responsible for 130k jobs in Barcelona.

Trading: We changed around our Big Tech exposure a bit. We trimmed the smallest amount of Nvidia. Again, this is just to keep it under our max position size (a quality problem). But we bought a chip manufacturer to replace it (not taking a huge risk here). And we added some generic long QQQ as a filler. We added to some Consumer Discretionary. We added to our long European Defense. We trimmed some Healthcare. We think this space struggles during presidential years no matter the political party in the lead. That and we are getting loads of conflicting data points especially in the labor sector (inside Healthcare). We did tiptoe into some protective Puts! We do not think the manic spike higher in small-caps makes a lot of sense other than the obvious short squeeze. We certainly do not want to step in front of a train, but we do not think it is a runaway one.

TSLAQ: When we recently reported that Musk thought Tesla's robot business would be worth around $25t (yes, trillion), we left out the best part. Other than this man-in-a-robot-suit doing household chores and working on his assembly lines, it would be a combination of "C-3PO plus R2-D2." Perhaps Musk has not seen any Star Wars, but maybe these are not the best robots to do manually tasks (unless you are trying to tap into the electronic garbage disposal).

And oh yeah, Bloomberg reported that Tesla was postponing its much hyped "Autonomy" day from August to October. This "self-driving" pipe-dream has been one of the catalysts for the recent massive rally. Musk was notably quiet on the news…usually he takes to X and blasts out some unrelated retort. In fact, the only real response from Tesla was to announce a new "variant" of its Model 3. It is just a tweaking of all-wheel to rear-wheel with supposedly longer range. Whatever the case, this is not the great reveal for which the fanboys were hoping.

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