Weekly Update

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- Economic data improves
- And yet this leads to a large rate cut
- More rate cuts are coming, Powell sounds like it is preemptive insurance
- But there are still some weak spots
- The Yen-carry trade might be over
- Europe might need to cut rates more briskly
- Retail Sales slow but maybe “not bad” is good enough
- Housing has an uptick
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	5,618	1.2%	18.5%	27.6%
QQQ	$471.76	0.7%	15.5%	28.1%
US 10 YR	3.71%	3.66%	3.88%	4.36%
USD/DXY	101.0	101.7	101.3	105.2
VIX	18.2%	17.7%	12.5%	14.1%
Oil	$70.15	4.1%	-1.0%	-22.5%

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

Just when the market starts to worry about another round of recession fears, economic data improves. Or at least growth seems more sustainable if only at a slower rate (which has other implications for some factor rotations). Improvement in the Services business surveys, Retail Sales, Consumer Sentiment, Manufacturing data, and even an uptick in Housing all helped the market breathe a sigh of relief. This fresh data has boosted the Atlanta Fed’s GDPNow to 2.9% from 2.5% last week (this is a nowcast and not a forecast, so it can be choppy). Oddly, with this economic improvement came a greater expectation for Federal Reserve interest rate cuts. This combo led to a market rally (equities, bonds, even commodities which face tougher global conditions). After all, this is the goldilocks scenario of which everyone dreams (if the market believes the large rate cut is not out of necessity!).

Right on cue, Powell delivered 0.50% of rate cuts bringing the Fed Funds target range down to 4.75%-5.00%. Maybe more importantly, this large rate cut came with the message from Powell: Normalization and not necessity. Actually, Powell changed the term to "recalibration" which he used nine times. He also inserted "risk management" into the Fed-speak vernacular. Despite his insistence that the Fed was still data dependent, it appears the Fed has a preordained path to lower rates. The Fed's dot plot (the aggregation of expectations from all the members) has the rate falling to about 4.40% by the end of this year. And it falls to 3.4% by the end of 2025. There are certainly some inconsistencies in Powell's declarations on the economy (shelter rent being a big one…these prices are not coming down, and part-time employment has driven all the job gains this year as full-time employment has shrunk). And the market expects rate cuts to 4% by the end of this year.

Of course, the market was volatile as always in the wake of Fed action. And it appears that the market is selling the news. Interest rates stopped rallying, equities cooled a bit, and the USD even rallied (rate cuts should weaken a developed market currency). It is too early to tell (we usually wait a full day or two to assess the market's reaction to the Fed), but perhaps the market is putting more weight on some of the soft spots in the economy. Or it could be the inherent contradiction in saying "all is good, but we have to do a large rate cut anyway" is adding uncertainty instead of clarity.

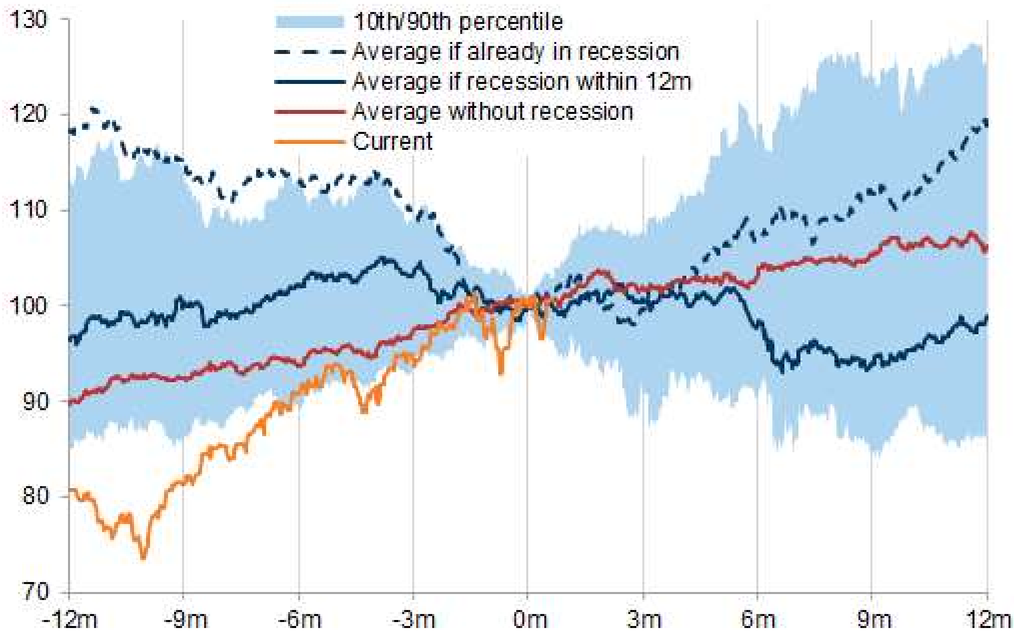
We also still have the political mess…and not just the election. But the government is trying to pass another Continuing Resolution to keep the government open for business (we say shut it down, but the odds of passing are very high). Despite some press reports that (the) Ukraine and Russia are close to peace talks, an ammunition factory close to Moscow was blown up. And the only thing surprising about the war in the Middle East is that apparently terrorists still use pagers and walkie talkies.

- Does 50bps matter?

Ultimately, we do not think this quibbling over 25bps or 50bps in rate cuts matters (nor the exact speed of future cuts). Despite the Fed's insistence, if the economy were heading into a recession, there is not much the Fed can do about it at this point. Goldman has a chart that shows equity market returns following a dis-inversion of the yield curve (which we use as the market's signal of looming rate cuts). Clearly, the worst returns are when the economy enters a recession after the rate cuts. This does not do us much good other than giving us the comfort to ignore a lot of the noise around the Fed. JP Morgan has a similar refrain. They say rate cuts *actually slow* economic growth at first because the market wants to wait for lower interest rates before progressing with capital formation. This sounds like a bit of a stretch, but the Goldman chart supports this theory. 3-month returns seem to be middling across the board.

Exhibit 5 : Equity performance following dis-inversion episodes was driven by the subsequent growth

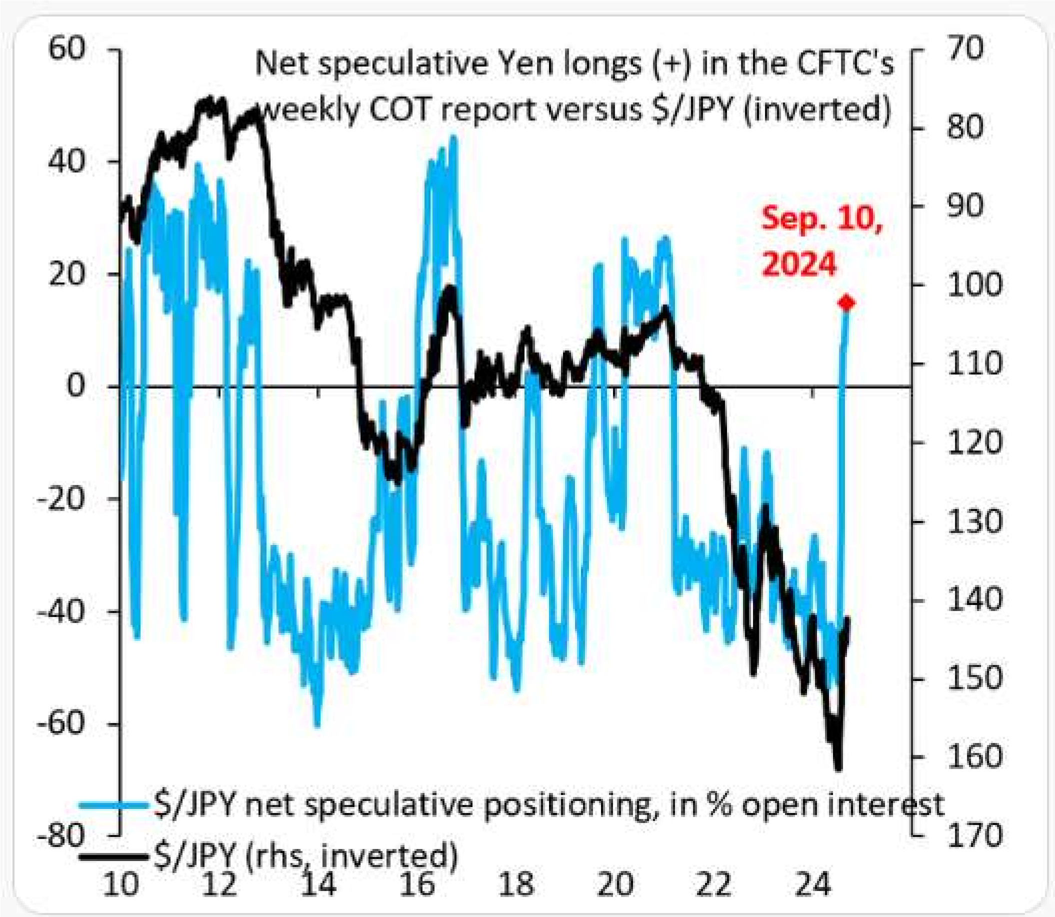
S&P 500 indexed to 100 around US 2s10s dis-inversions since 1950



Source: Haver Analytics, Goldman Sachs Global Investment Research

- The Yen-carry trade might be over

Japan had a large 3.5% rally after BOJ members said they would continue to hike rates. Of course, the details might be 1% over 18 months! And PPI inflation cooled while Manufacturing sentiment increased. Most importantly, hedge funds are now long the Yen (short the USD and the EUR). This datapoint is not the end-all-be-all, but it should provide some relief (until they get squeezed on something else).



- Europe might need to cut rates more briskly

The ECB cut rates 25bps as expected. This was the second cut of the year. ECB chief Lagarde tried to quell any optimism over more cuts…she defaulted to the standard data-dependent line. But the demand picture in Europe does seem to be declining…or at least not improving. Here are the last seven quarters of GDP growth in the Euro Area: -0.1%, 0%, 0.1%, 0%, 0.1%, 0.3%, 0.2%. European rate cuts might be more necessary than the "normalization" we talk about in the US.

- Retail Sales slow but maybe "not bad" is good enough

Retail Sales showed a surprise gain in August. The small 0.1% gain was sharp fall from the 1.1% increase in July. But it was better than the -0.2% expectation. This brings the growth for the year down to 2.1% from 2.9% last month. Many of the trends remain the same. Online Retailers and Miscellaneous Retailers grew 1.7% and 1.4%. Health and Personal Care sales increased 0.7%. Furniture Sales and Electronics fell 0.7% and 1.1% (the latter has been strong lately after lagging…in other words it has been volatile). The only Services included in the data are Food Services and Drinking Places. These were flat on the month. We are not as excited about this data as the market seemed to be. "Not bad" might be the target now.

- Housing has an uptick

The Housing Market Index (aka home builder survey) inched up to 41 in September from 39 in August. This is still a terrible level. And the internal components are extremely mixed. Current Conditions rose to 45, Sixmonth Expectations increased to 53…but Buyer Traffic increased to just 27 (50 is the breakeven). Price increases are slowing, and price discounts are increasing.

Housing Starts bounced back in August to an annual rate of 1.36mm. But this bounce is coming off the lowest month of Starts in four years. Building Permits also bounced, but this, too, was off a low base.

Weekly Mortgage Applications increased. The index has quietly moved to a two-year high.

According to the National Association of Home Builders (NAHB), regulatory costs make up almost 25% of the cost of a home. Baron's breaks this down to include building codes and zoning issues. This is an insanely high percentage. Even though there is some talk in the Trump camp about eliminating some of this regulatory burden, we suspect it is more of a local issue. And price relief is not in sight (unless there are massive layoffs, of course). On this note, the National Association of Realtors thinks first-time buyers are miles away from being able to afford the median home. They estimate that the cost of a home would have to fall by 32% (to $244k), mortgage rates would have to be cut in half (to around 3%) or incomes would have to jump 50%. None of these seem likely to us.

All in all, lower mortgage rates have helped the Housing market, but it has a long way to go. (Housing stocks, on the other hand, seem to be driven primarily by short supply and favorable demographics.)

- Other economic data is mostly positive
  - Jobless Claims are still stuck around 230k. Continuing Claims are stuck around 1.85mm. Powell seems to be focused on this data more than pother employment data (along with job openings).
  - The change in the Producer Price Index (PPI, inflation on wholesale or input prices) ticked higher a little more than expected. The headline increased 0.2% in August vs 0% in July. The "Core" increased 0.3% vs a decline of -0.2%. These are both about 0.1% higher than expected. This data should not move the needle.
  - U-Michigan Consumer Sentiment improved in September. Current Conditions and Expectations both increased. The latest inflation expectations diverge a bit. The 1-year drops to 2.7% from 2.8%. But the 5-year increases to 3.1% from 3.0%.
  - The NY Fed's Empire Manufacturing survey bounced back into positive territory (-5 to 11).
  - Industrial Production increased 0.8% in August. This was a rebound from the 0.9% drop in July (and better than the 0.2% expected increase). Manufacturing Production also bounced with a 0.9% gain vs -0.7% last month.

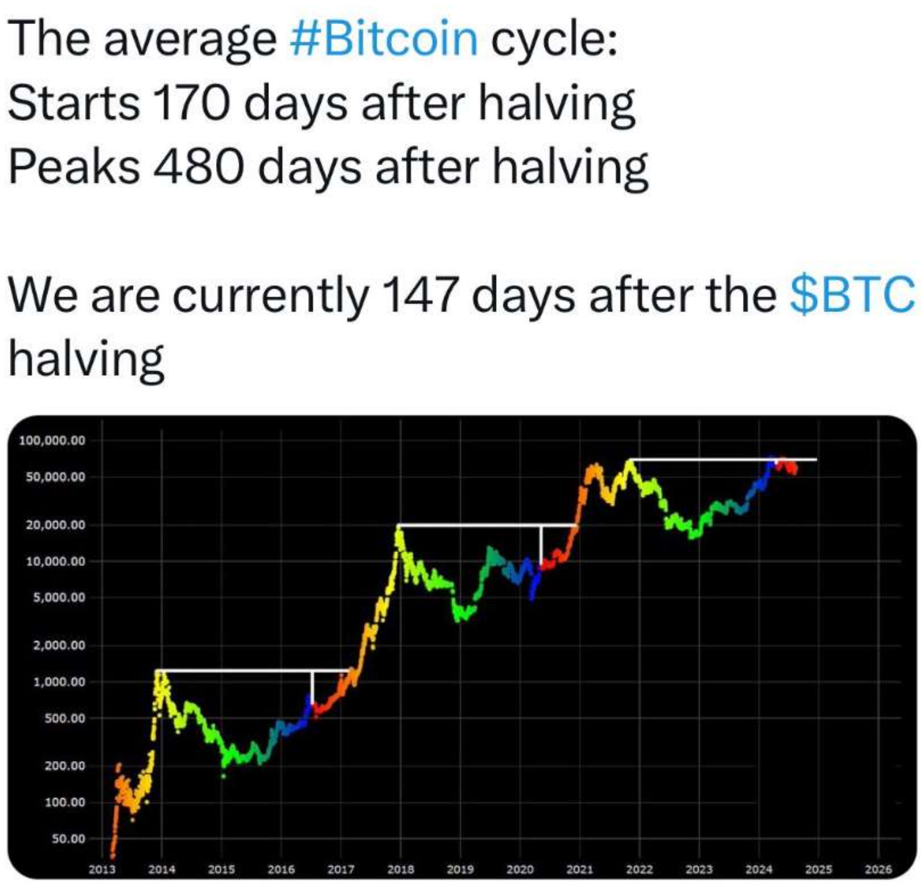
- Other Fed one-liners
  - Dual mandate is squarely back. They want to support maximum employment and continue to get "inflation to move sustainably down to our 2% goal." They have gained greater confidence in this trajectory.
  - The labor market has cooled from its formerly overheated state.
  - Economic activity continues to expand at a moderate pace.
  - Housing: investment fell back; supply conditions are improving
  - GDP to remain solid with a median projection of 2% for the next few years
  - 116k new jobs is a notable step down. Jobs to worker gap has narrowed. Less tight than just before the Virus. Not a source of inflationary pressure. Jobless Claims are a focus.
  - A good, strong start to this cutting. No rush to the process. This is not the new pace.
  - Balance sheet run-off will run concurrent with rate cuts

➢ Where did all the crypto money go?

The arrest of the found of Telegram made all the news (the traceless messaging app). Apparently, Telegram has a crypto token and blockchain associated with it. These things are used for "payments and blockchain-based games." Reality is probably not as innocent as that. The token, called Toncoin, had a market value of almost $30b (wow!). But when Pavel Durov was arrested, its value dropped 20%...$6b gone.

➢ Chart Crime of the week

Somebody else produced this cockamamie chart showing the Bitcoin "cycle." At least these guys tried to add some made-up context. As a reminder, we appreciate Bitcoin for certain things. The awesome math and computational power behind it. Its theoretical independence from governments (except it is mostly money laundering now). It can be a great asset to trade. But none of this means you can use charts that use weird axes and extrapolate an endless cycle from two datapoints.



➢ Quick Hits

- China is raising its mandatory retirement age from 60 to 63 for men (women are tiered and lower).
- 9% of US adults aged 18-35 do not want to have children because of global warming.
- Scorpions glow under UV light.
- The federal government owns 80% of the land in Nevada.

- Scorigami! The Sants's throttling of the Cowboys 44-19 is the 1086th unique score in NFL history.
- The number of full-time real estate agents in the US dropped 14% in 2023 (vs 2022) to 440k…the lowest number since 2014.
- There were 10mm people playing Roblox at 10am CDT this past Saturday.
- The average age of the frontline soldier in (the) Ukraine is 43.
- The length of freight trains in America grew by 25% from 2008 to 2017.
- The longest trains today routinely measure over 2.5 miles.

Trading: We trimmed some of our long in Big Tech. Our conviction in the medium to long-term has not changed. But we think the market will be choppy. And we increased our net long at a good time, so we will take some quick profits.We added to our long in European defense on the misleading headlines that there were peace talks in the works.

TSLAQ: We will get back to making fun of Tesla's lousy earnings and silly "Autonomous Day" in due order. In the meantime, we are enjoying him making fun of Gavin Newsom for plotting to ban free speech.

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