Weekly Update

4-May-2022
Carlisle C. Wysong, CFA
Managing Partner

- Wild week in the markets
- Earnings are ok, Mgmt guidance is not
- Q1 GDP slumps thanks to a larger trade deficit
- Employment, somehow, is still shaky in a tight labor market
- Multinationals are more fearful than domestic companies
- Inflation cools! Not really
- European economic data looks terrible
- China stinks, too
- The Fed hikes, fits in the middle of expectations, but the shorts covered anyway
- Oil capacity is still limited and going lower
- Quick Hits
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	4,184	2.8%	-9.5%	3.9%
QQQ	$329.60	4.1%	-17.1%	-1.5%
US 10 YR	2.96%	2.83%	1.51%	1.58%
USD/DXY	102.5	103.1	96.0	91.3
VIX	25.4%	31.6%	17.2%	19.2%
Oil	$107.55	6.0%	43.3%	64.1%

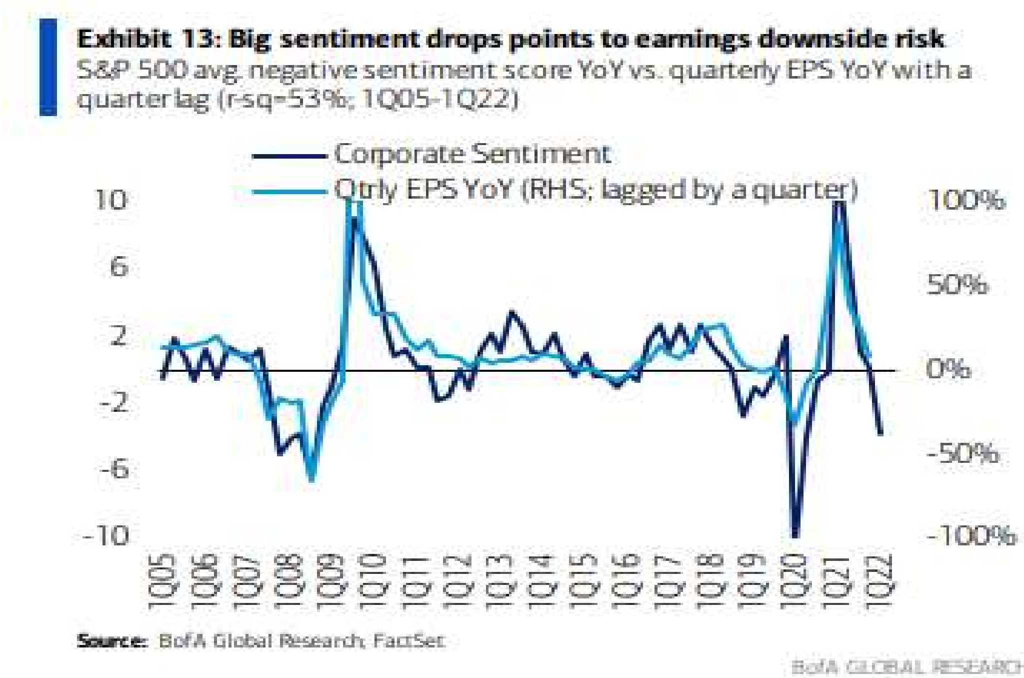
*10yr, DXY, and VIX are levels not changes
** Oil is front month futures, beware

It was a wild week in the markets. Fantasy Tech earnings have continued to be nightmares. Real companies like Amazon also continue to warn on the bottom line. Even Apple said it might experience some supply-chain snafus. Month-end saw a lot of capitulation selling. 10-yr Treasuries bumped up to the 3% level. Inflation continues to run hot. Economic growth shows more signs of cracking. And the Fed was hiking interest rates into this mess! Alas, the Fed did blink, and equities shot higher. Or at least that is how some of the pundits are interrupting today's press conference with Fed chair Jerome Powell. We think Powell laid out a middle of the road approach (continuing to hike rates to stamp out inflation). Just because he did not say the Fed was going to act irrationally and hike rates to oblivion instantaneously is no grounds for rejoicing. Moreover, does the market now believe that Powell can pull off the impossible and engineer a soft landing for the economy? When asked this question directly, his response was that it could achieve a landing that was "soft-ish." For someone who absolutely must tow the company line, this sounded less than convincing to us. We look forward to shorting the speculative garbage all over again.

- Earnings are ok, Mgmt guidance is not

With about 80% of the Earnings season done, EPS (earnings per share which differs from net income because of buybacks/issuance) has grown 9.7% (net income growth is about 7.3%). Revenues have grown 13%. But these numbers include Energy Earnings growth of 261% and Energy Revenue growth of 59%. The S&P 500 Earnings growth rate ex-Energy is only 3.8%. Revenues ex-Energy are 9.6%. Sure, it is not fair to exclude something relevant. But the obvious point is that this kind of Energy growth is not sustainable.

Management guidance for future Earnings is another story. Merrill says the guidance ratio (positive to negative) has slipped to 0.7 (more negatives than positives) which is the lowest in a year. Furthermore, Merrill uses some language tracking to extrapolate words into numbers. The result is that mgmt. sentiment has plummeted only previously seen during the World Financial Crisis and onset of the virus-fear. Changes in corporate sentiment have a strong correlation with lower EPS in the following quarter. This Merrill Chart is telling if not obvious (amped-up Earnings growth has to turn negative mathematically).



- Q1 GDP slumps thanks to a larger trade deficit

GDP for the 1Q in 2022 slumped into negative territory with a fall of 1.4%. The official consensus was for an increase of 1.1%. But most up-to-date Nowcasts had growth coming in more towards the flat level. In other words, -1.4% is pretty bad! Even though this is backwards looking, it is interesting to note that a large negative reading in Net Exports was the root cause. In English, this means the trade deficit expanded. In plain English, this means we imported more than we exported. This ties in directly to the most recent ISM-PMI data. Global growth is slowing.

- Employment, somehow, is still shaky in a tight labor market

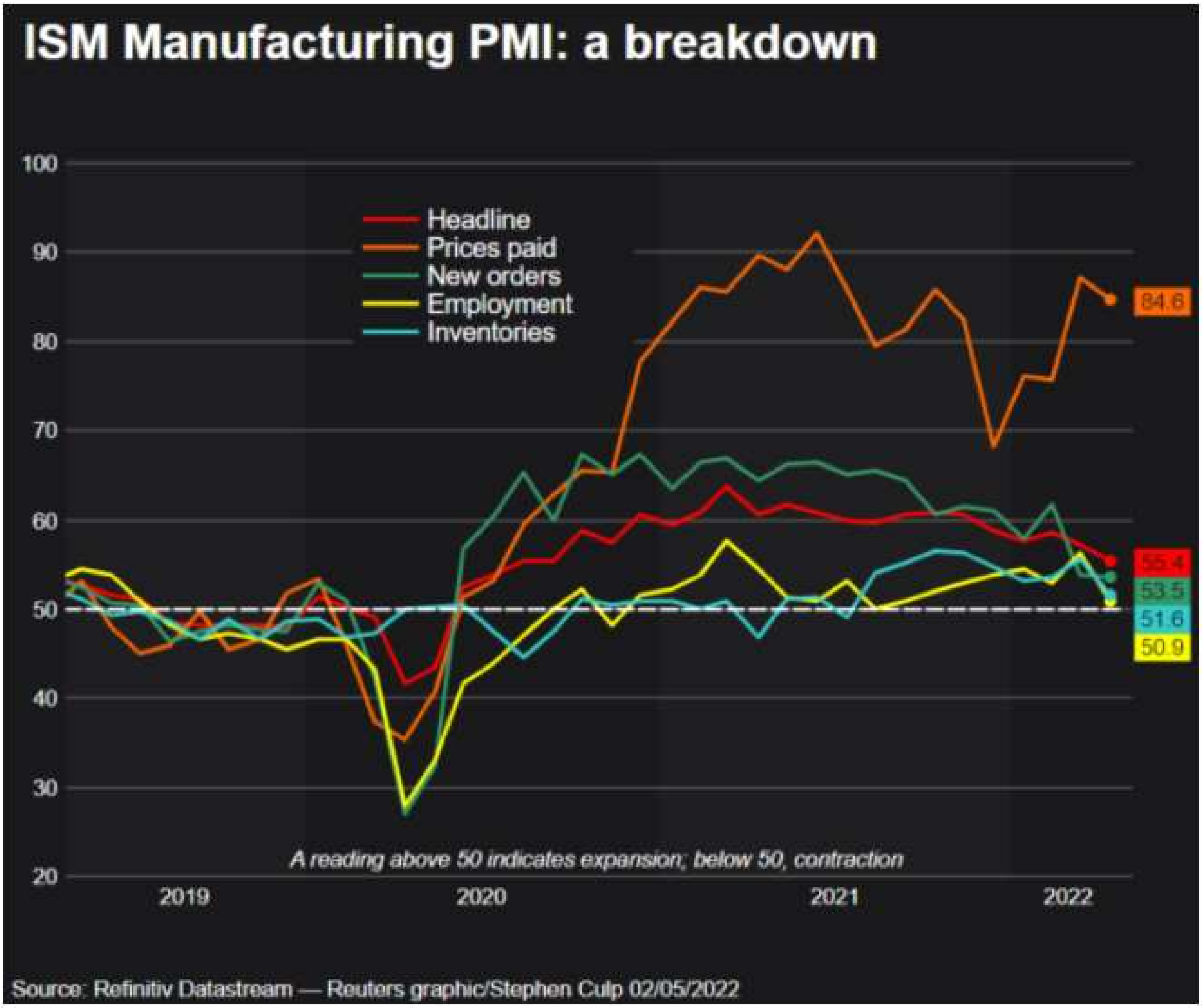
The ADP Employment report (the HR company's guess at Private Jobs added in April) missed the guess badly. The guess of the guess was for 400k new private jobs while the actual guess was 247k (yep, lots of guesswork in economics).

According to the JOLTS, (Job Openings and Labor Turnover Survey), Job Openings hit an all time high over 11.5mm. The same pattern holds: Some workers are having a hard time shifting careers. And some workers just do not care. Although, recall that the Covid-fakers number is falling, and many early retirements are reversing.

Jeff Gundlach, a smart bond investor with a decent track record, pointed out that a ratio of 11.5/6 Job Openings to Unemployed people should result in wage disinflation if not deflation. This was one of our theories last year: Family Guy had to get off the couch. While we have seen that steadily happen, there is still an inordinate number of Quits and Unemployed people. We have commented that the dislocations in the labor market might be more permanent than we (and apparently Gundlach) thought. But we still expect to see this ratio (Openings/Unemployed) to fall. Hopefully it falls before the recession hits. We will learn more on Friday with the monthly Employment Report.

- Multinationals are more fearful than domestic companies

Markit's Manufacturing PMI remained steady at a pretty good 59.2 level. But the ISM Manufacturing Index fell to its lowest level in 19 months and missed expectations. The weakness is blamed on a rise in workers quitting and a reduction in supply/inventory. This is a weird dichotomy: The former is being construed as a sign of economic strength (wages keeping up with inflation to a certain extent) while the latter reflects economic fear. As we like to remind ourselves, this is the conundrum we (and the Fed) face. The ISM Services index showed similar results. While the headline did not fall as much as Manufacturing, Employment fell back into contraction territory. And New Orders fell sharply. Recall that Markit's survey is more domestic and encompasses a wider swath of company size. The ISM is more global and thus focuses on larger companies.



ISM manufacturing PMI

- Inflation cools! Not really

The increase in Personal Consumption Expenditures in March was 6.6% vs the last year. The "core" reading was an increase of 5.2%. This "core" reading was a mild slowdown from the 5.3% increase in February. Unfortunately, Personal Income also slowed in March. Personal Spending, on the other hand, almost doubled its increase from February (0.6% to 1.1%). As for the PCE, this is another example of the math telling us that disinflation is around the corner. But the reality is prices are still high and harming the consumer. And oh yeah, the Fed tends to ignore Food and Energy prices. We will never understand that.

- Other data is mixed
  - Construction Spending in March barely increased from February. This makes it the lowest monthly increase since it was negative in early 2021 after a huge surge higher in January of 2021. Single-family homebuilding was the leader with nonresidential spending lagged (especially in oil & gas well drilling).

- On the bright side, Factory Orders actually grew by 2.2% in March. Autos seems to be the leader here thanks to an easing of the semiconductor supply chain. But we think the pessimism relayed in the ISM reports more than offset this data.
- The University of Michigan Consumer Sentiment in April bounced from its lowly March depths. We always point out that the stronger Consumer Confidence survey better reflects the housing market while this lousy Sentiment gage better reflects inflation. We picked up another discerning factor: The good Confidence is typically a view on the overall economy while the Sentiment survey is more about one's personal circumstances. We will stick with this Consumer Sentiment as the more important gage in this current economy.

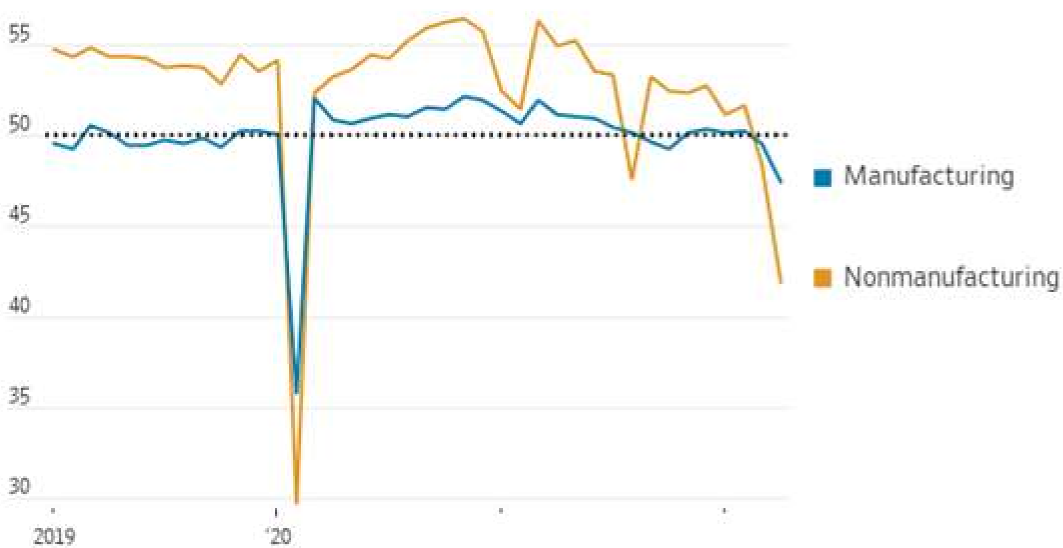
➢ European economic data looks terrible

- Manufacturing PMI for April fell to 55.5 which is the lowest reading since Jan 2021
- PPI (wholesale/input inflation) hit 36.8% in March. This is a 5.3% acceleration vs February.
- Unemployment in March remained elevated at 6.8%
- Retail Sales in March increased 0.8% annually. The increase in Feb was 5.2%.
- We remain short Germany and long Energy.

➢ China stinks, too

China PMIs contracted for the second straight month. Highlighting the decline in Manufacturing was Cement Production falling to less than 40% of full capacity. Services continue to decline thanks to the technology and education sector crackdowns.

China's official purchasing managers indexes



Note: Readings above 50 indicate activity is expanding, below 50 contracting
Sources: Wind, National Bureau of Statistics

➢ The Fed hikes, fits in the middle of expectations, but the shorts covered anyway

The Federal Reserve did its best to not rock the boat. But it might have temporarily done just that by planting some dovish seeds in the minds of jittery investors (those short…either directly or underweight their long benchmarks). It hiked the Fed Funds target range by 0.50% to 0.75%-1.00% (recall that the Fed does not explicitly set this rate – the rate at which banks lend to each other – but this range serves as the market guardrails). It provided guidance on how the gigantic balance sheet would be unwound. It will start on June 1. But for clarity, some are saying the Fed will be actively selling bonds. This is not true – the Fed will not reinvest all the Treasuries that are maturing. This is still a more restrictive monetary policy on a relative basis, but it is not as aggressive as some are indicating. For the record, we think they should be (and should have been for a while) selling bonds aggressively. The Fed will continue to support the overnight lending markets via repurchase agreements.

In Jerome Powell's press conference, he emphasized that Consumer and Business Spending remains strong. Job gains have been robust. The economy is positioned to handle tighter monetary policy. But he also said Ukraine is still a risk to global growth. While he said ongoing increases in rates will be appropriate, the big swing statement was that a 0.75% hike was not something the committee was "actively considering." He added that the trend of two months of core inflation being a little bit easier might be helping things, but he is not yet taking comfort in that. He needs to see real evidence (and not episodic variations…our words not his). But one phrase that we think was overlooked was, "We will not hesitate to go to levels above neutral (there is a sense of false precision)." He also lamented the fact that the Fed cannot help with supply side problems only on the demand side.

All told, we do not think this was some giant pivot back to accommodation (for the economy or markets). We suspect we will see some Fed members come out in the coming days/weeks and reemphasize the herculean task it will be to squash inflation without squashing the economy. We plan on selling any big rallies.

- Oil capacity is still limited and going lower

Now that Germany has signed on, it looks like the EU is going to stop buying Russian oil. In fact, Germany says imports of Russian oil have already dropped from 35% of total imports to now only 12%. Obviously, natural gas is the real pressure point.

OPEC was looking to increase its production for March by 254k bpd (barrels per day). It missed the mark by 85% as it only increased by 40k bpd. The excuses sound like the old "it's transitory" mantra from other parts of the world. But the reality is that OPEC countries are generally located in terrible places with plenty of strife. To assume Libya (et al) will never have supply disruptions is nonsensical.

Not to be outdone, the US has also missed production numbers. Or at least the data is proving the weekly guesstimates too optimistic. Specifically, weekly data has shown production to be flattish. But the more detailed monthly data shows that daily production had dropped by 450k barrels since November. This data is only good through February. But producers have indicated that they have no desire to change plans.

Our base case continues to be that supply will remain constrained (willfully in the US, by constraint everywhere else).

- Chart Crime of the week

We could not find another foreign television station with extreme biases displayed in their numbers. Ergo, we must go back to basics. This chart was presented as a nightmare move in the 2-yr yield. It is certainly true that the 2-yr UST rate has increased dramatically this year. But the yield has not quintupled in one day as the chart would mislead you to believe. The old y-axis-not-starting-at-0 trick.

- Quick Hits
    - The Central African Republic has declared for all to see and hear that the country will now accept Bitcoin as legal tender. The HODLers must be jumping for joy.
    - The average interest rate on Brazil credit card debt is about 350%.
    - Many Brazilians use post-dated checks as their form of credit.
    - Global IPO volumes year-to-date are down 72% vs last year.
    - The latest academic research in politics says that people with biases who watch programming with the same biases become more biased. In other news, dog bites man. (hat-tip to Walnut Green).
    - The World Health Organization called the opening of the Aspen Pharma vaccine plant in South Africa in October of 2021, “a transformative moment.” The plant has received zero orders. Zero.

Trading: We were pretty busy shifting our option positions this week. We added some short exposure to semiconductors, China, European banks, EV madness (not Tesla), and inflated E-commerce. But we also trimmed some of the Fantasy Tech we have been short. But given this (the ARKK ETF) was whipping around 5-10% in a day, we added some back! We are happy with our core portfolio of stocks (Staples, Energy, and Health Care primarily). We still have a large cash position along with some Gold. But we will continue to trade the volatility via the options market.

TSLAQ: The Musk-Twitter saga continues. Musk is now saying that he is exploring alternative financing options. Originally, some of the private equity money was going to be tied to the performance of Twitter. Some was cash from Musk (not sure how since he owes tax on his sales…but we digress). Some of the financing was going to be tied to Tesla. It is this latter portion that is seemingly changing. Musk said he wants some of the large existing shareholders to remain shareholders in the private company (and thus reducing the need for Musk to buy them). Jack Dorsey has apparently signed on to this. But his ~2% stake is not a needle-mover. Whatever the case, we are inclined to believe that the banks have balked at Musk using his Tesla shares as collateral since he has already borrowed something like $100b on the back of these shares (to fund his toy rockets and tunnel digging hobbies). The banks know that a Tesla margin call would implode the market. The latest twist is that Musk now wants to have Twitter be a public company again in just a few short years. Usually this is the plan for a private equity company who wants to do a quick turnaround and flip it for a profit. Musk's plan entails restructuring the whole company and how Twitter works. We have a hard time believing that can be done in that timetable. Whatever his plan, we are sure it will suck in plenty of bagholders and hemorrhage cash like every other venture he has ever heralded.

Check out our website to learn more about Chalk Creek Partners

Carlisle's Twitter Financial List

Carlisle's LinkedIn