CHALK CREEK PARTNERS

Weekly Update

11-September-2024
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- A volatile week, lots of negative narratives, but assets rallied
- Employment is softening in all the wrong places
- Inflation is still under control
- Global inflation is cooling, too
- Services are doing better than Manufacturing
- Small Business Pessimism
- Quick Hits
- Where did all the crypto money go?
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
S&P 500	5,552	0.6%	17.1%	26.3%
QQQ	$468.62	1.7%	14.8%	26.6%
US 10 YR	3.66%	3.76%	3.88%	4.29%
USD/DXY	101.7	101.3	101.3	104.7
VIX	17.7%	21.3%	12.5%	14.2%
Oil	$67.38	-3.0%	-6.1%	-22.9%

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

It was a volatile week with sharp intraday swings. The recession narrative is back after another weak Employment Report. But inflation is still cooling, perhaps providing some relief to the bottom leg of the K-economy (probably not yet). And last week's "scary" Manufacturing survey (which we did not view that badly) was followed with a strong Services survey. There continues to be a lot of quirky flows contributing to the swings. The Yen-carry trade from a month ago is still being unwound (not as aggressively, but still causing pain). More "pods" at large hedge funds have shut down thereby resulting in an automatic closing of their trading books (price be damned). And as much as it pains us, politics might be weighing on the equity market. And it seems to be a lose-lose game. The market is focusing on some negative sides of each presidential candidate (in terms of market impact…we are not going any deeper than that). Harris has dialed up her rhetoric on taxing capital gains. And Trump is perceived to be tougher on China which would hurt semiconductor earnings. Tariffs are also catching some blame…both parties have embraced them. These things move around with the polls, but clearly the negative sentiments are outweighing any positive ones (including potential spending increases…however short-sighted, and potential corporate tax cuts). And of course, there are no signs of peace in the Middle East or (the) Ukraine, and China is probably in a full-blown recession. Also, the moratorium on repaying student loans is finally coming to a close. In typical government fashion, technically these repayments resumed in October of 2023. But the debtors somehow were still impervious to creditors (and reporting by the bureaus) until October 1 of this year. We are sure the current administration will do what it can to extend this Dead Beats Society. About 25% of the 40mm student loan debtors are delinquent. 6mm of these are supposedly distressed. This could lead to some consumer weakness.

Despite all this, the market posted a gain on the week! We are still bullish despite the volatility (and knowing there will be more volatility). We think monetization is coming to Artificial Intelligence (most of the big players said so this week at a big conference). Negative comments like we got from JP Morgan are likely the management team being overly conservative (Bank of America said the consumer is fine). Interest rates are being cut to normalize monetary policy…the labor market is not in freefall (despite some definite weak spots, this is the data to watch). Although, you would not know what is going on from the volatility in the Fed Funds futures. They are whipping around manically. We are guessing there are some algos set to keywords which are driving much of the trading. In short, we always like to invest/trade against any weakness born out of political angst or machines trading blindly!

- Employment is softening in all the wrong places

The Employment report showed the underlining weakness in the labor market. The headline Nonfarm Payrolls (NFP) increased from 89k to 142k new jobs in August. The official expectation was about 160k, but this had surely come down after the poor ADP guess (99k vs 145k expected and 111k last month). July was revised down 25k (114k to 89k). June was revised down 61k (179k to 118k).

Private Payrolls increased 118k from 74k. But this is below the 145k expected (that ADP number). Manufacturing payrolls lost 24k jobs. Government gained 24k (mostly in local government which we view much more favorably than padding the halls of DC). If you strip out Education and Health Care, only 35k jobs were added (obviously Ed and HC are vital parts of society, but they are not exactly drivers of economic growth).

The Unemployment Rate improved from 4.3% to 4.2%. This equates to a gain of 168k. But the giant caveat here is that all of this improvement was from people being employed part-time. This group gained 527k jobs. The rolls of the full-time employed fell by 438k jobs. Moreover, the split between employment by age is going the wrong way. Employment of people over 55 gained 369k. Meanwhile, for those under 25, the number fell 383k. (This is fuzzy math due to the ever-changing labor force with a fluid immigration policy.)

The Labor Participation rate remained steady at 62.7% (female rate is increasing while the male rate is decreasing).

Temporary job layoffs slowed which contributed to the mild strength in the Household survey (which calculates the Unemployment Rate). But the trend in Temp jobs is still lower which is typically a leading indicator.

Average Hourly Earnings were a bright spot. They increased 0.4% in August vs July. This is 3.8% for the year up from 3.6%.

Jobless Claims ticked down to 227k.

There was an increase in announced job cuts per Challenger. The 76k is about in line with the recent trends, but up slightly from the pre-Virus Fear level (about 50k average). Notably, Tech layoffs are starting to be blamed on Artificial Intelligence (but still only 6k cuts). The last time companies blamed AI was in April.

Last week's Beige Book (the Fed's survey across its 12 regions as it prepares for its next FOMC/interest rate meeting) detailed the problem the Fed has in assessing the labor market. Employment levels were "generally flat to up slightly in recent weeks." The positive side is that layoffs are rare. This is supported by the low level of weekly Jobless Claims. But the negative is that "firms reduced shifts and hours, left advertised positions unfilled (we told you they were fake listings!), or reduced headcount through attrition." But as we have been saying (or rather, what Fed Chairman Powell has said explicitly), this all sounds like a normalization process.

- Inflation is still under control

Inflation (the change in the Consumer Price Index, CPI) remained unchanged in August at 0.2% vs July. The change on the year improved to 2.5% from 2.9%. The "Core" rate ticked up to 0.3% vs 0.2% in July. Its annual rate remained the same at 3.2%.

The largest contributor in the month was Shelter with a 0.5% gain (+5.2% on the year). Rent was slightly lower at 0.4%. Owners's Equivalent Rent (OER, the weird survey that asks homeowners the rental value of their houses) increased at 0.5%. Food price increases continue to cool with only a 0.1% bump. As usual, Food Away from Home outpaced Food at Home (0.3% vs flat). Energy prices fell 0.8%. Somehow Electricity fell -0.7%. We still think prices are still too high for the K-shape economy to converge.

- Global inflation is cooling, too

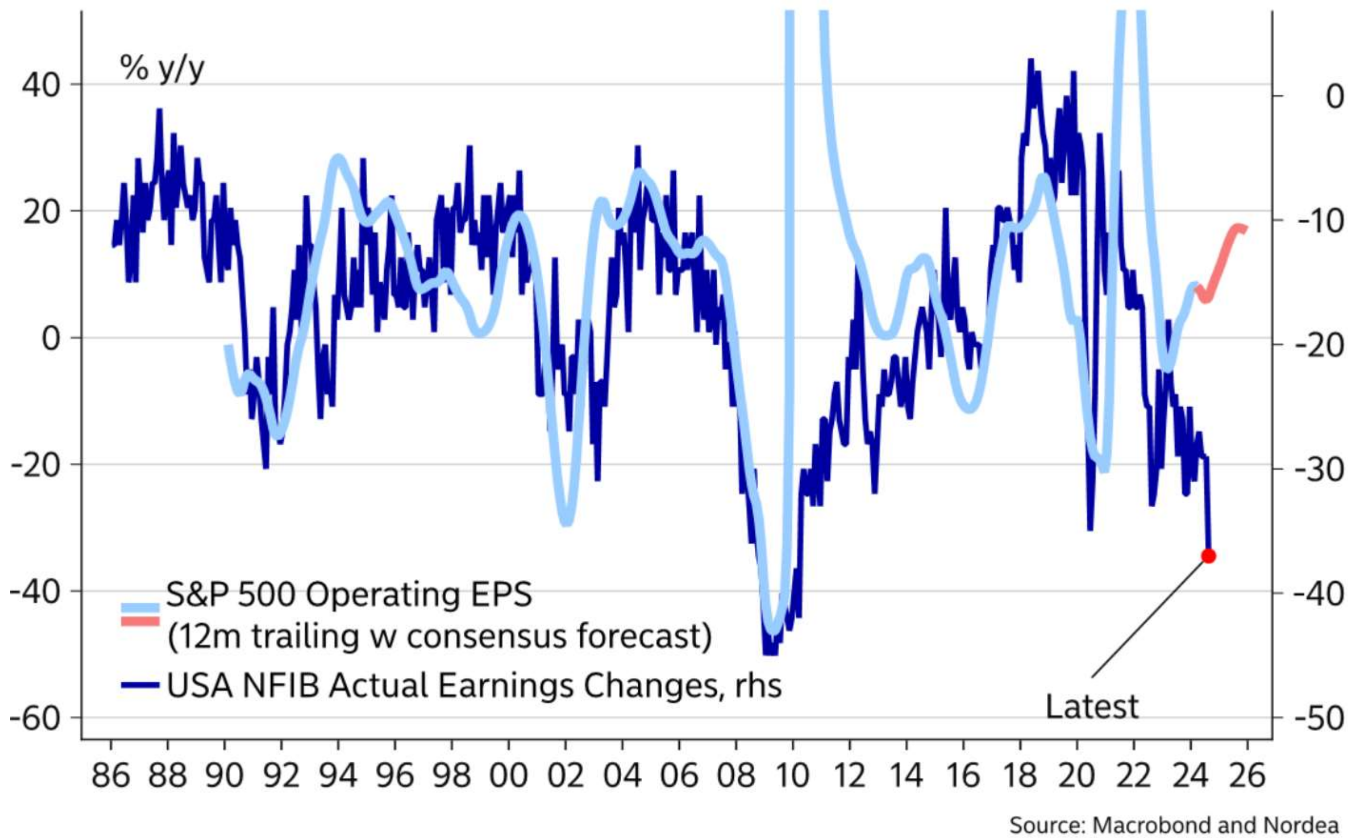
There has been some commentary that global CPI is still running higher than the US and much higher than the pre-Virus Fear level. But S&P Global notes that the Prices components of the global PMIs are trending lower and are now below the 2019 levels. Importantly, PMIs tend to lead official data, so we should be able to extrapolate a continued decline in price increases. Despite our deteriorating confidence in the predictive powers of PMIs, we think this one makes sense (lower global inflation coming). Of course, the touch of grey in the silver lining is that global *deflation* would not be a welcome outcome (but we are a long way from that currently).

- Services are doing better than Manufacturing

For all the fear about the weakish Manufacturing PMIs last week, the Services data should have provided some relief. The S&P PMI for August accelerated from 54.3 to 54.6 (and better than expected). And the ISM PMI ticked up from 51.4 to 51.5 (and better than expected). New Orders in Manufacturing were worrisome last week. New Orders for Services accelerated the most (52.4 to 53).

- Small Business Pessimism

The NFIB Small Business Optimism survey fell in August. It has been trending lower since 2018 (with plenty of blips higher). And looking at the Earnings component of the survey, this trend might continue lower. Interestingly, Earnings for the larger S&P 500 companies might be dragged lower, too. Part of this chart makes us cringe because of the difference y-axis scales and reference points. But we think there is still some correlation between the different sets. The real question is whether the S&P %00 leads the small businesses. This seems to be the case coming out of a violent shock (2008 GFC and 2020 Virus Fear).



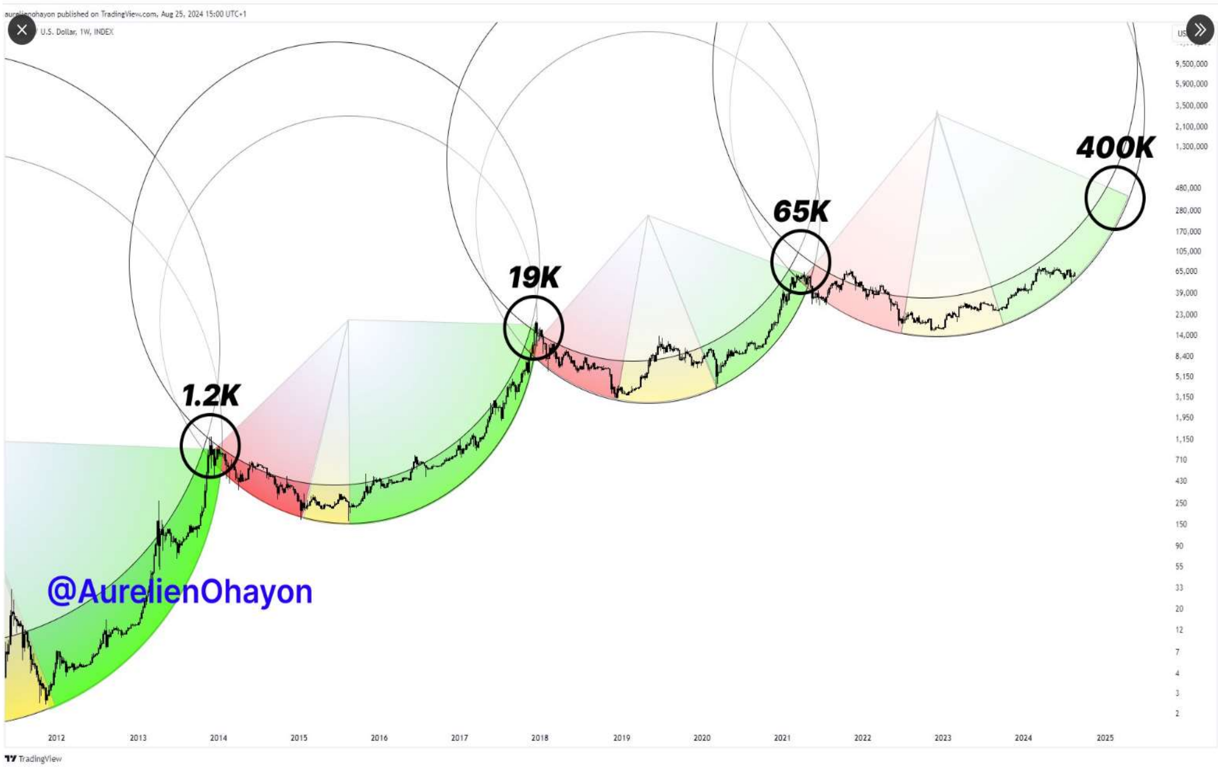
- Other economic data is mixed
  - Total Vehicle Sales in Aug slowed to an annual rate of 15.1mm. This is down from the pace of 15.8mm in July.
  - Used Car prices in August increased at a slowing pace of 1.2% (vs July). They are down -3.9% in the last year.
  - The weekly Redbook Retail Sales increased to 6.5% form 6.3%. This is the highest level since early 2023.
  - Weekly Mortgage Applications ticked up slightly.

- Where did all the crypto money go?

The crypto world was ready for another shutter when the X account of the NEAR Protocol appeared to have been hacked. The X account of the $4.2b token was tweeting that crypto was “all a lie” and tokens were all “scams” among other ominous postings. Alas, this was the real NEAR delivering these messages. Apparently, it was some sort of reverse-PR stunt. Tell that to the holders of the token who lost $630mm in a week when the stunt backfired and the price collapsed.

- Chart Crime of the week

Nobody can extrapolate a chart like crypto people. We have no idea how this works.



- Quick Hits
  - Scorigami! San Fran beating the Jets 32-19 was the first time that score has happened in the NFL. It is the 1085th unique score in NFL history.
  - New York state has a new law requiring large retailers to install panic buttons by 2027.
  - Shoplifting is still an unprosecuted crime in New York state.
  - The late, great Charlie Munger lauded Costco and its membership fee not for the incremental income but for the self-filtering of the customer base.
  - There were four winners on the Senior PGA tour last year who had their kids caddying for them. All four golfers are named Steve.
  - The Cleveland Browns have had 38 starting QBs since 1999.
  - A man has been arrested for allegedly misusing Spotify. He created over 100,000 songs using AI. He then created over 10,000 bots to stream these songs 24-7 on Spotify. He then collected over $10mm in royalites. The government says it is fraud. We say it is genius.
  - Adam Neumann received an ancillary bonus of $5.9mm from WeWork when he was CEO. This payment was for use of the name "We" which apparently Neumann owned. This reminds us of Dan Snyder getting paid to put the Redskins logo on his personal jet (no wonder his minority investors hated him).

Trading: Oddly a quiet trading week considering the volatility. This is mostly because things were not volatile enough! That is, we would rather add to long exposure on a strong flush…usually signified by a violent spike higher in the VIX. And we do not want to get caught up selling assets because of September seasonality or election emotions. These things can (and do) turn on a dime. If the defensive corner of the market struggles some more (barely a blip down so far), we will look to add to these sectors assuming growth and inflation are still cooling.

We opened a small short on China (old economy exposure, not the giant Tech companies). This is a hedge on slowing global growth. We also added a small short in the Real Estate sector. This is more of a Fantasy & Fraud play.

TSLAQ: Tesla announced that “Full Self Driving” would launch in China and Europe in early 2025. Of course, 2024 was the original Musk timetable. More importantly, the accompanying parenthetical was “pending regulatory approval.” Needless to say, this is easier said than done. This was good for a quick 10% in an otherwise crappy market. Some of the gain was attributed to the announcement that Musk would serve in a Trump presidency. This makes no sense as the last thing Tesla needs is for Musk to have more distractions. Then again, maybe that is why the stock rallied!

And there is more “FSD” news for Tesla this week. The WSJ reports that Tesla is now going to be sharing half of its “FSD” revenue with another of Musk’s companies, xAI. The idea is that Tesla will use Musk’s artificial intelligence company to build out FSD’s capabilities. Other than being told FSD was already perfect, we are not sure if Tesla shareholders will appreciate giving away revenue to an unaffiliated company (unaffiliated to them, obviously affiliated with Musk). For the record, Musk has denied this story. But given his track record of commingling assets, we suspect there is some truth to it. (Nvidia GPUs bought by Tesla for use at xAI, Tesla employees working at xAI, Tesla buying Solar City, Tesla shares backing Twitter loans, etc).

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