Rates, Risk, and Taylor Swift

Ok, I have nothing useful to add about Taylor Swift, but I couldn't think of anything else to act as "clickbait" for today's T-Report.

With the holiday season upon us, it seems like a good time to review a few key drivers that will impact the performance (and our views) on rates and risk:

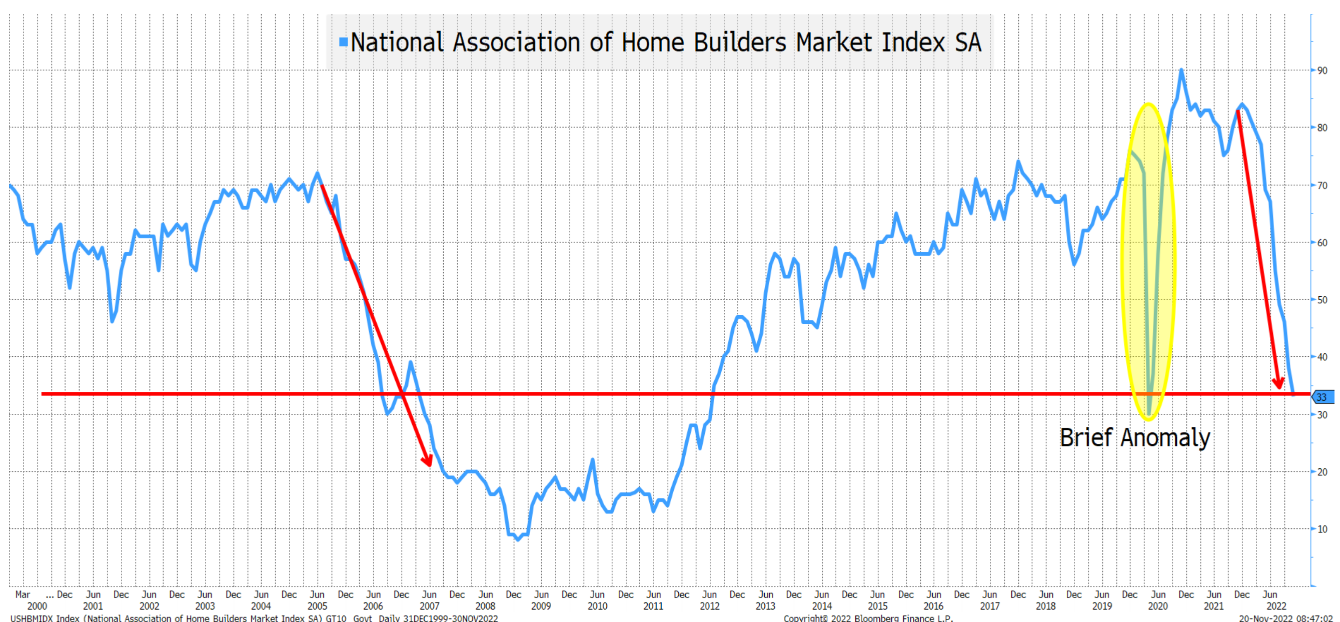
- **Inflation**. We will add some new bullet points to our "inflation has rolled over" narrative.
- **The Fed**. They will sound hawkish, but the data is likely going to betray them.
- **Jobs**. Sill strong, but I'm looking for cracks in the foundation to appear.
- **Russia and Ukraine**. It seems like we are at a potential inflection point.
- **China and COVID**. Are we just getting a "false positive" and hearing what we want to hear, or is there more to the story?
- **Crypto and Disruption.** The wealth destruction continues. We think that it will be an important issue, not just for those directly involved in the asset class, but because of the resulting drag on the economy.

Let's set up our views on risk for the coming weeks.

Inflation

Energy commodity futures took a beating last week with WTI down 10%. We are now starting to head into some very favorable year-on-year comparisons.

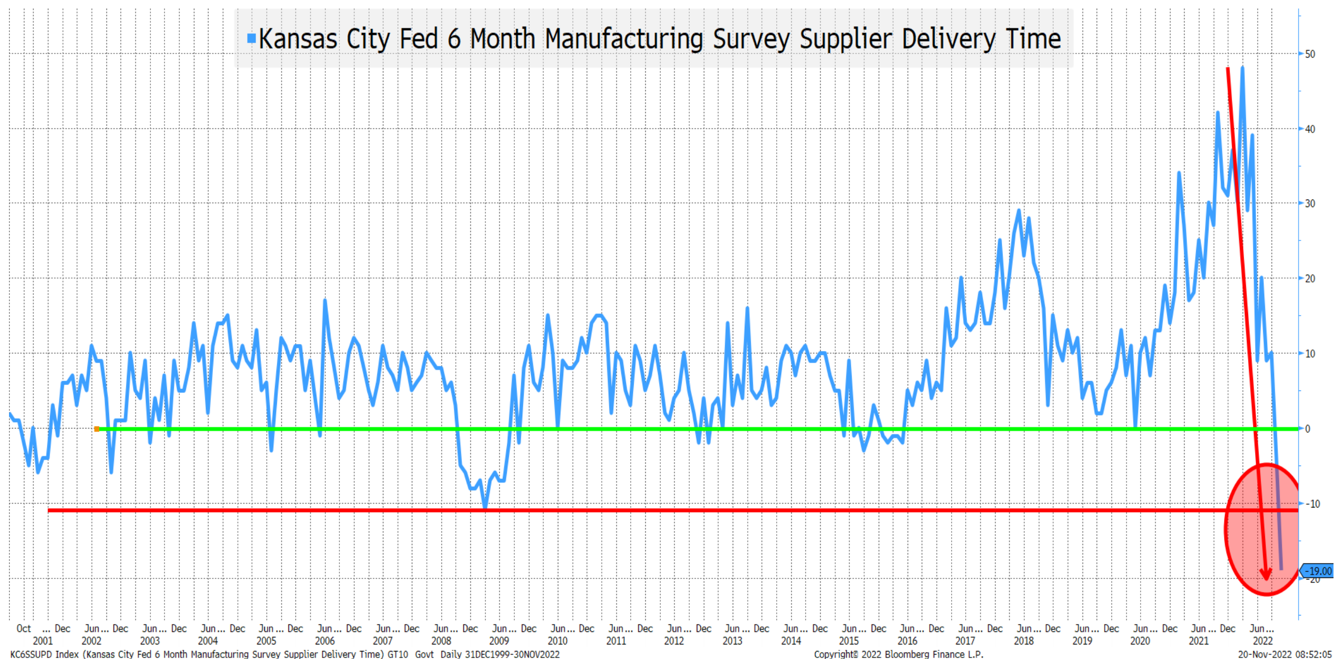
Housing data was weak again with the NAHB (which I view as an optimistic bunch) coming in at 33, which is the lowest reading (except for a brief plunge during COVID shutdowns in the U.S.) since the 2007-2012 period. This looks bad and I see no reason for optimism given where rates are.



Housing is such an important part of the economy and our own sense of net worth, which means this is somewhere between problematic and terrifying. A few of the "home supply" retailers are delivering

better sales than some other areas of retail, but **I'm highly suspicious that this is because many people are following up on what realtors said they should do to make their houses sellable**.

You can also peruse Inflation Dumpster Dive and More Inflation Dumpster Diving for thoughts that are laid out in more detail, but I also wanted to leave you with one new chart.



There was a certain degree of hesitancy to use this chart (since I'm not that familiar with it and it almost looks like a typo), but **it does fit my assertion that supply chain issues have been dissipating and are practically non-existent which will help keep inflation in check!**

Inflation data will generally drift lower, and we have more than 3 weeks before the December meeting and a "lifetime" of data ahead of the February meeting.

The Fed and Jobs

The Fed speakers will generally steer the market towards more hiking. They will point to higher stock prices as a problem. Why anyone still thinks that the stock market is an effective judge of anything over the short-term is beyond me. **I fully expect hawkish leaning rhetoric that markets will ignore more and more as they see the inflation (or even deflation) story developing along the lines we've laid out.**

On **jobs**, there is a large divergence between the Household and Establishment portions of the NFP surveys. Last month's report showed a surprisingly large number of jobs attributable to the birth/death model. **Finally, jobs are always a lagging indicator and will be more lagging this time around as HR departments will be extremely reluctant to fire people after spending 2 years struggling to hire people.**

Weakness will first show up in service providers as companies cut costs in a variety of ways other than letting people go. **Firing people will be an absolute last resort and pushing the economy to that point would be a huge mistake!**

Finally, we've been having a lot of discussions about the **Tchir Job Impact Index™**. Okay, there is no such index and presumably if I look hard enough, I will find one that gets me the information that I'm

looking for, which is:

- # of Jobs Lost.
- Average Wage of Jobs Lost.

I expect that the job losses we see will be smaller than in past recessions, but will hit at a much higher average pay level. The jobs that will be cut (and are already getting cut) aren't your basic minimum wage workers, they are more senior and better paying jobs. If economists make a mistake this time around, it will be focusing on the number of jobs rather than the types of jobs, because it takes far fewer higher paying job cuts to really hit the economy. The low-income job cuts also hurt those families that are impacted and that is awful, but from a broad economic standpoint higher paying job cuts are the key drivers.

If someone knows of an index that tracks that, please let me know, otherwise I will start playing with the Tchir Index – the data has to be there somewhere!

Russia and Ukraine

We had a moment of heightened fear of escalation this week as discussed in this SITREP. There is evidence that we are at an inflection point:

- **Putin** seems to be very weak and willing to make some peace or truce overtures (possibly at the request of China).
- **Ukraine** seems convinced that they can kick Russia out with enough weaponry. At the same time the infrastructure damage is mounting as we head into a season where you wouldn't want to live without heat!
- **NATO** seems torn between the desire to provide more and better equipment to Ukraine and the mounting costs of these operations, especially with no clear endgame that is acceptable.
- **The mass migration of Ukrainians** is impacting countries and there is an increasing risk that the longer the fighting lasts in Ukraine (causing more roots to get established elsewhere), the less likely Ukrainians are to return.
- **More energy sanctions are scheduled,** and it is increasingly difficult to see how that hurts Russia any more than it hurts us.
- **Frozen Rivers.** The Geopolitical Intelligence Group continues to point out that Russia's last best chance at making an east to west push in Ukraine is when the rivers (which flow north to south) freeze and they can cross at places other than easily defendable bridges.

Most of the GIG doesn't think a resolution is likely, but I'm leaning towards those who think it can be done. It will be difficult to convince **Zelensky** to give up anything, but the reality is that he is fighting with money that isn't his own.

Any peace would send energy prices plummeting!

China

For the past few decades, we seem to have had two issues with messaging from China:

1. They say what they think we want them to say because it works, and they don't care if they don't follow their own messaging.
2. They say what they mean, and we interpret it to be the message that we were hoping for, not the one they actually gave.

I must not be too cynical (especially around their Zero-COVID policy), because that seems to be in their own best interest to change, but I suspect their current negotiating stance is that they realize our attitude has shifted so much against them, that they should at least pretend to play nice. They know that if we think that they are playing nice in the sandbox we will back off and give them breathing room to do what they were going to do anyway.

Some nice rallies in Chinese stocks, but it is still un-investible to me!

China will alter their Zero-COVID policy, but that is a next year event, and despite the boost that it would give to commodity demand, it is likely to be deflationary as a whole. Supply chain issues are already minimal and turning their factories back on would just add to the supply (and inventory) glut.

China is in a resource accumulation "struggle" with us and is aligning with the autocratic/resource rich nations around the world. This is my overriding premise on China.

Crypto and Disruption

I have long said (half-jokingly) that **if the nuclear industry had just hired the crypto marketing people, we'd have more nuclear energy than we know what to do with**. The money spent on advertising, naming rights, lobbyists, and "influencers" of all shapes and sizes is truly shocking. I had a "funny" little tweet a few weeks ago – *"What is the difference between a #beaniebaby and a #FTXToken? At least you can hug a beanie baby as you cry yourself to sleep."*

I am coming to realize that the amount of money spent trying to pump up crypto is possibly orders of magnitude greater than what was spent on advertising for beanie babies and is likely a huge driver of ad spending and social media influencers. That is money that won't find its way into the economy right now, at least not on anything like the scale prior to that! However, there are some great spoofs on the Matt Damon "fortune favors the brave" commercial.

I see no way that the wealth destruction that has occurred doesn't hit the economy!

This week all eyes are on the Grayscale trusts that are now trading at large discounts to NAV and have hit retail investors hard – please read The Difficulty of Calculating NAV in the Crypto Space.

There are ways it could resolve itself positively and that is the hope, but there are a couple of scenarios that could occur that would give crypto another kick in the teeth.

Definitely tune into Academy's Crypto – A Brave New World webinar on Tuesday at 1pm ET! We are lucky to have Chris Perkins, President of CoinFund and an Academy Advisory Board member lead a discussion on the space. He knows the people involved very well and is a thought leader.

I do think there is a chance that if crypto takes another leg down, we will see miners start to disappear which would be bad for crypto, but great for energy prices!

Rates

I like rates and I like owning bonds.

Yes, it is a bet on weak data. It is a bet that if the data comes in weak, it reduces FX volatility and that will also help bond yields globally.

I'm definitely in the camp that the recession is coming sooner (January) and will be deeper and longer than consensus. As such, I have to be long Treasuries!

The road to hell is paved with carry (and I hate relying on carry), but you are finally getting paid to take rate risk for the first time in years!

I like bonds. It is a pound the table moment for me! I want to be long bonds (pretty much anywhere on the curve) from now to year-end unless something radically changes my view!

Risk

My face is red from pounding the table on bonds, but now I have to compose myself as the risk story is far more nuanced.

First stage, weaker risk assets for the moment (and I literally mean for the moment).

- I think **crypto and the disruptive space have one more leg down** and it will be difficult for risk to do well as that occurs.
- **Sentiment indicators** are moving too quickly! We seem to swing from overbought to oversold in record time. CNN is back to Greed. The AAII survey has more bulls than at any other time this year! While RSI charts (one technical I like) are not overbought, they are certainly not oversold any more.
- **The Fed wants to talk down the market and will take shots at stocks.**

I will be watching Wednesday very closely!

If we are going to get a nice "seasonal" bounce, we should get it coming into Wednesday. With my view on rates, I should be comfortable that we will get that seasonal rally, but it seems like such a consensus trade that I'm not sure it will happen.

Second stage, more "everything rally."

- I could be convinced that this should be the first stage, but I think:
    - The pressure on equities that started on Wednesday is not over.
    - Consensus is too bullish.
    - If we don't get a nice bump into Thanksgiving, my little "almanac" tells me that is bad.
- The "everything" rally into year end would be nice and I am convinced on the bond leg of that!

Final stage, "risk-off."

- If my current view on the economy is correct, then the data will start to come in bad enough that bonds rally and risk sells off. We aren't there yet, but to be honest, there have been a few more moments where it felt like the market is sniffing out this trade, and maybe we've already seen stage 2 and are heading into stage 3?

Bottom Line

I like bonds and steepeners.

I am slightly cautious on risk at the moment:

- I am most nervous about energy and any crypto related sectors. Anyone exposed to excess inventories is poised to underperform.
- I am least nervous about credit and "income oriented" equities. This week we saw that municipal bonds, for example, were well bid even when Treasuries were getting hit. The bond rally is powerful enough that it will help these areas outperform other types of risk (credit spreads may leak wider, but will still outperform general equities, for example).

From my perspective Russia and China have the greatest potential to be "game changers" to my forecast.

Maybe something will happen outside of those factors to change my tune on the economy, inflation, and jobs, but I think that the market will continue to move in my direction. Right now, there are too many people who got "transitory" wrong last year and are now in the process of getting it wrong in the other direction.

Good luck! Hopefully, my views on risk weren't too confusing and now we can get back to our hunt for cheap Taylor Swift tickets 😊.

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