Porter & Co.

Investment Chronicles

Issue No. 6

September 2023

Porter & Co.

Porter & Co. Investment Chronicles

Welcome to *Porter & Co. Investment Chronicles*, our guide to the most important and interesting stories from the worlds of investing, finance, and economics that's available exclusively to Partners and *Big Secret* Elite members.

Each month, my team and I share the most valuable insights we come across from the hundreds of sources we regularly read and review – hedge fund letters, annual reports, SEC filings, investment newsletters, newspapers, X threads, conferences, podcasts, and more – and digest them into one carefully curated, easy-to-read resource.

With the *Investment Chronicles*, you'll have your finger on the pulse of the markets without having to spend hours scouring the internet each day.

You can navigate through each issue using the hyperlinked Table of Contents below. All content also includes links back to the original source when possible, so you can easily click through for more details, to see a larger version of a chart or image, or to learn more about accessing paid content.

We hope you'll come to think of our *Investment Chronicles* as being a highlight of your subscription with *Porter & Co*. We think it is the most comprehensive expression of our goal as a business: to give you the information we'd most want if our roles were reversed.

Porter Stansberry
Stevenson, MD
September 2023

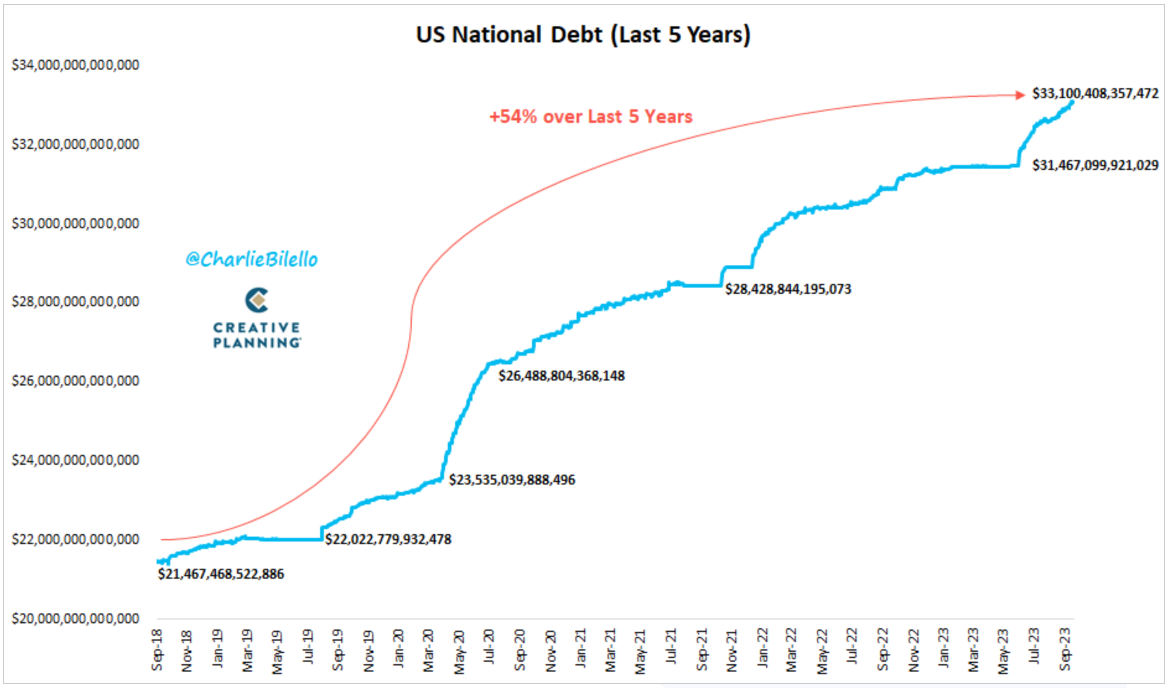
Note: All quotes, transcripts, and excerpts are reproduced exactly as they appear in the original.

Table of Contents

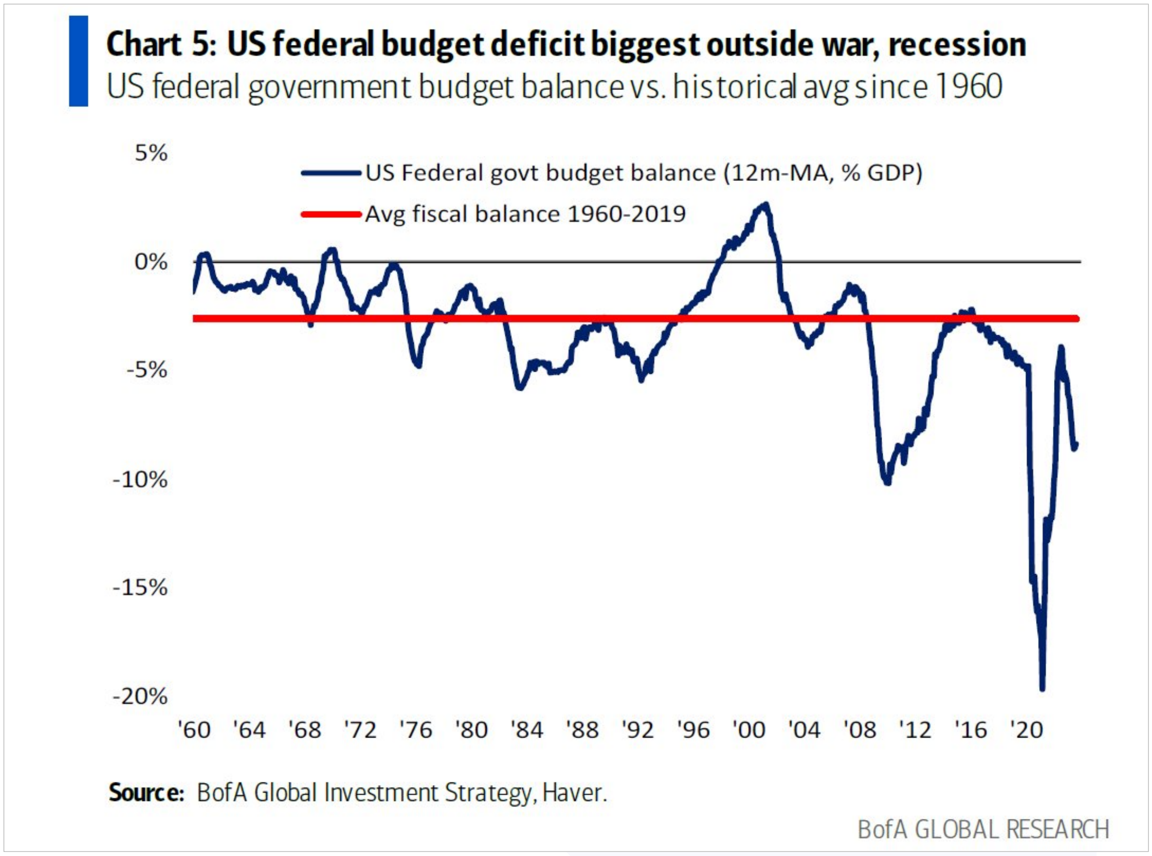
The Five

The Most Important Charts We're Watching This Month

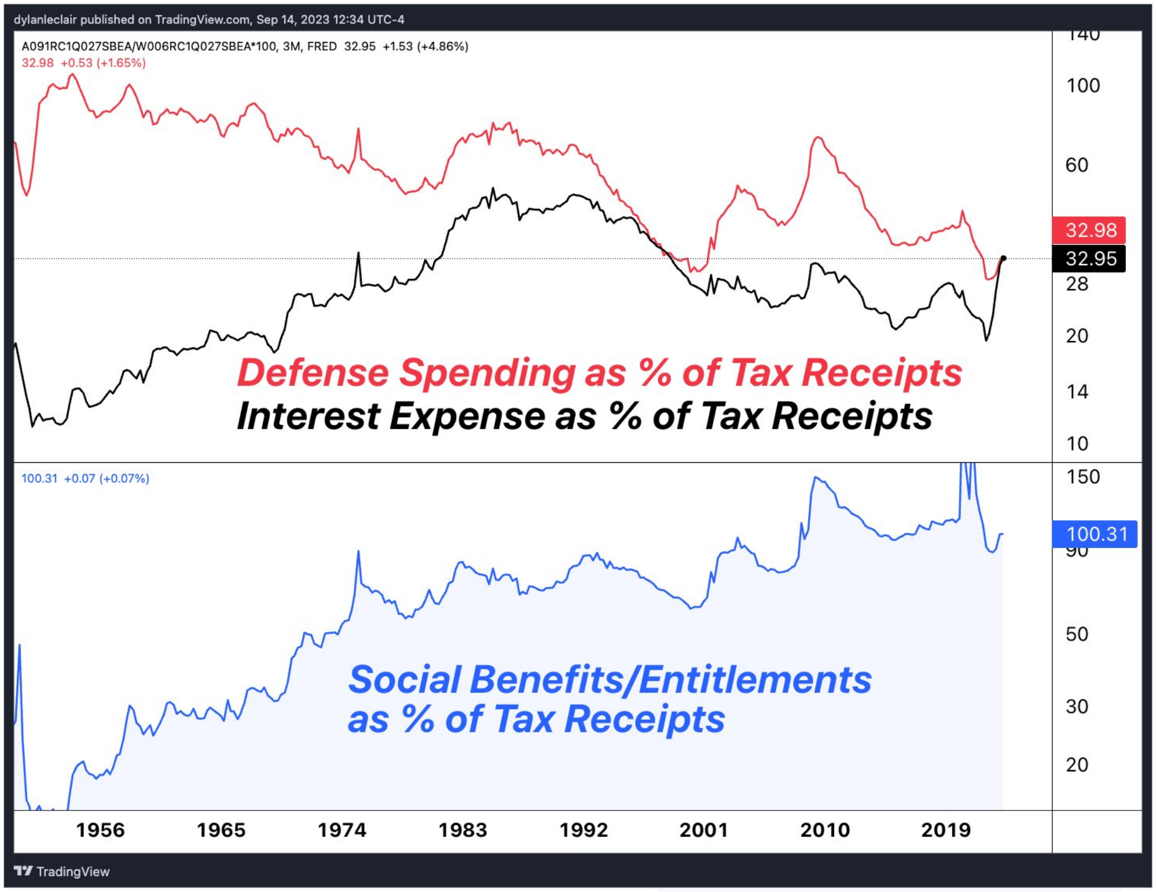
The big story this month was the deteriorating fiscal health of the U.S. government. Total federal debt crossed $33 trillion in September – representing a massive $1.6 trillion increase (18.5% annualized) since Congress lifted the debt ceiling just a few months ago (from Charlie Bilello via X)...



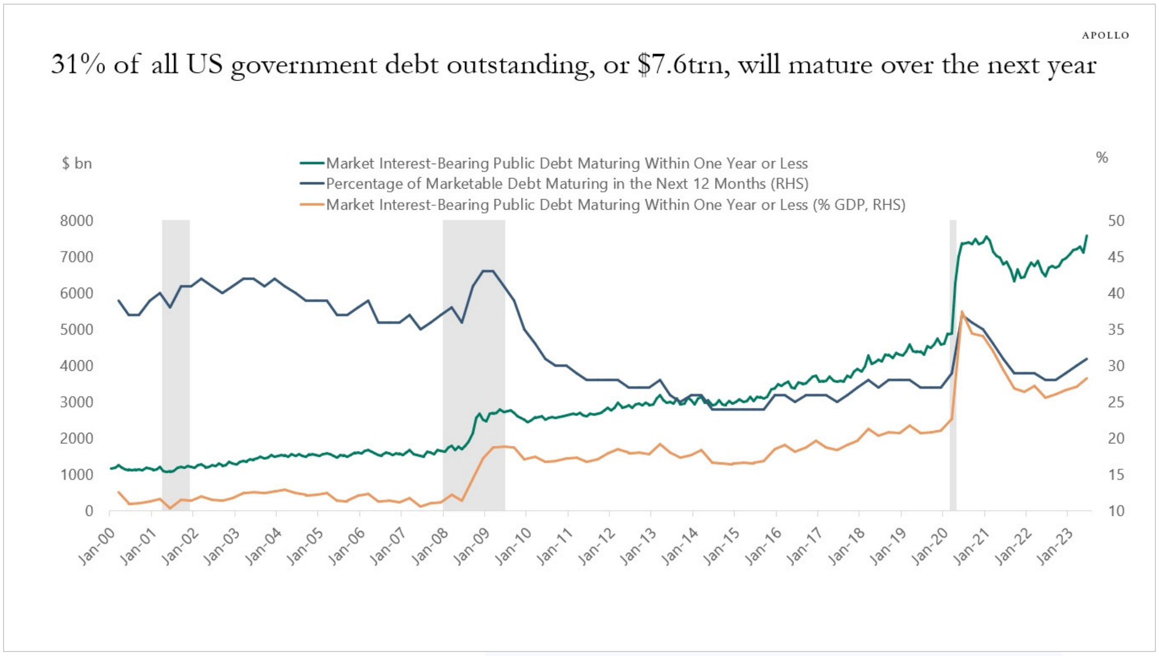
This rise in debt is being fueled by the government's soaring budget deficit, which is currently the largest in history as a percentage of gross domestic product (GDP) outside of wartime or recession ([from BofA Global Research/The Kobeissi Letter via X](#))...



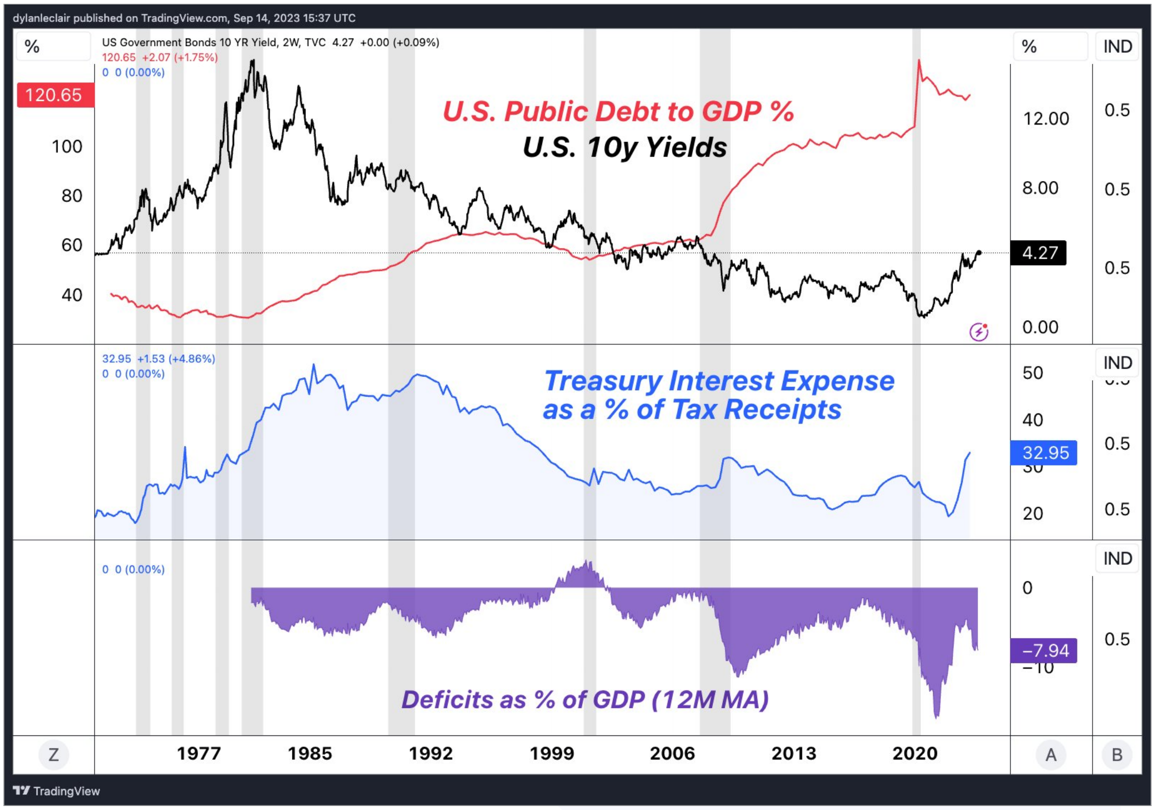
The largest share of this spending goes toward entitlements, which currently account for more than 100% of the "revenue" the government brings in through taxes. However, the sharp rise in interest rates since early 2022 has caused the government's interest expense to surge from around 20% of tax receipts up to nearly 33% today (from Dylan LeClair via X)...



The government's interest expense – and therefore deficits – could quickly spiral even higher as the U.S. Treasury is forced to refinance nearly one-third of its existing debt at vastly higher interest rates over the next 12 months ([from the U.S. Treasury/BEA/Haver Analytics via The Daily Spark]())...



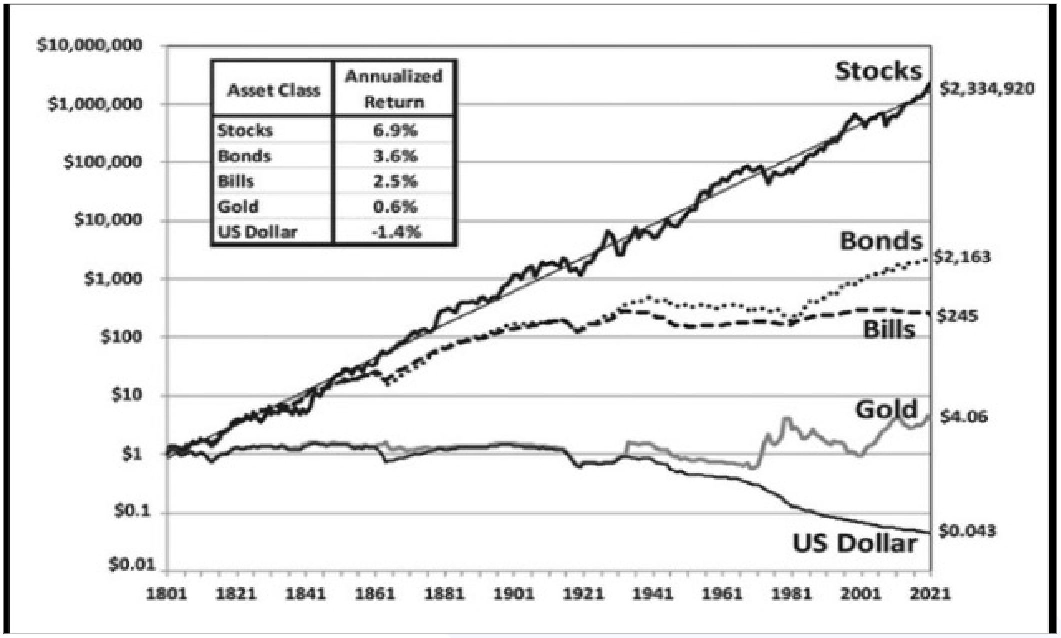
And this dire situation doesn't include the very real possibility that the economy enters a recession in the months ahead. Historically, recessions alone have caused a dramatic increase in both deficits and total debt as a percentage of GDP (from Dylan LeClair via X)...



Economics and Markets

A look at the performance of major asset classes over the past 200-plus years (from Markets & Mayhem via X on September 2)...

> A dollar from 1800 is worth just over $0.04 today, but that same dollar invested in stocks would be worth $2.3 million now after 223 years. Gold would be worth just $4.06.



The U.S. government has officially entered into "fiscal madness" (from First Trust Economics Blog on September 5)...

> Back in the 1980s, President Reagan took enormous political heat (Sam Donaldson comes to mind) for being fiscally irresponsible. His offense? Presiding over a budget deficit that peaked at 5.9% of GDP in Fiscal Year 1983.
>
> But at least Reagan had an excuse. Actually, multiple excuses. The unemployment rate averaged 10.1% in FY 1983, which pushed up spending, while reducing revenue. The Reagan tax cuts were phased-in, so many people pushed off income (and taxes) into future years. Finally, the US decided to bury the USSR under massive defense spending.
>
> The reason we bring this up is that we estimate the budget deficit for this year (FY 2023, ending September 30) will be $1.74 trillion, or 6.5% of GDP. That's larger relative to GDP than the largest budget deficit ever under Reagan. Worse, this is happening when the unemployment rate will average about 3.6%, the lowest average for any fiscal year in more than fifty years.
>
> But the current budget situation is even worse than these numbers suggest. Last year (FY 2022), the budget deficit came in at $1.375 trillion. But this deficit was artificially boosted by government accounting. President Biden's plan to forgive student loans lifted the deficit by $379 billion, the present value of the extra future losses estimated on the forgiven debt. The government's budget accounting rules included it as extra spending last year, even though it didn't affect the government's cash flow.

In other words, without the Biden loan forgiveness plan, the budget deficit would have been about $996 billion last year, or 4.0% of GDP. Not good, but not horrible, either.

But this year the Supreme Court struck down most of the loan forgiveness plan. As a result, extra future loan repayments are now being added back into the budget. The government counts this as a "negative outlay," and this change results in a one-time artificial reduction in the deficit of $330 billion. Without the Supreme Court ruling we estimate the budget gap this year would be about $2.07 trillion, or about 7.8% of GDP.

These government accounting rules might make sense in normal times, but right now they are leading to a bizarre result that hides a massive increase in the "cash flow" deficit of the US government. The result is a much bigger change than the "official" numbers, which will show the budget deficit going from $1.375 trillion (5.5% of GDP) to $1.740 trillion (6.5% of GDP).

There is no economic justification for expanding the "cash flow" deficit by 3.8 percentage points of GDP (from 4.0% to 7.8%) unless there is a recession or World War III. We never had a budget deficit greater than 6.5% of GDP in any year from 1950 through 2008. Not one. Reasonable people can disagree about the size and scope of the budget deficits we should have run in the aftermath of the Great Recession as well as during COVID Lockdowns. But running a budget deficit this high right now is madness!

We are supply-siders. We think the key to long-term economic growth is removing barriers and disincentives to work, save, and invest. We do that with lower tax rates, smaller government, and less regulation. We think institutions matter, like democracy, property rights and freedom of contract. We are not Keynesians. But even John Maynard Keynes must be rolling over in his grave. No serious or intellectually honest Keynesian can support a deficit at 6.5% of GDP (much less 7.8%) in a year when the US is at peace and unemployment is averaging 3.6%.

And just so everyone knows, we are not attacking one party over the other. TARP, multiple rounds of quantitative easing, COVID lockdowns, unprecedented fiscal stimulus during COVID, and repeated failures by both parties to address entitlements have all paved the way to the current deficit bubble.

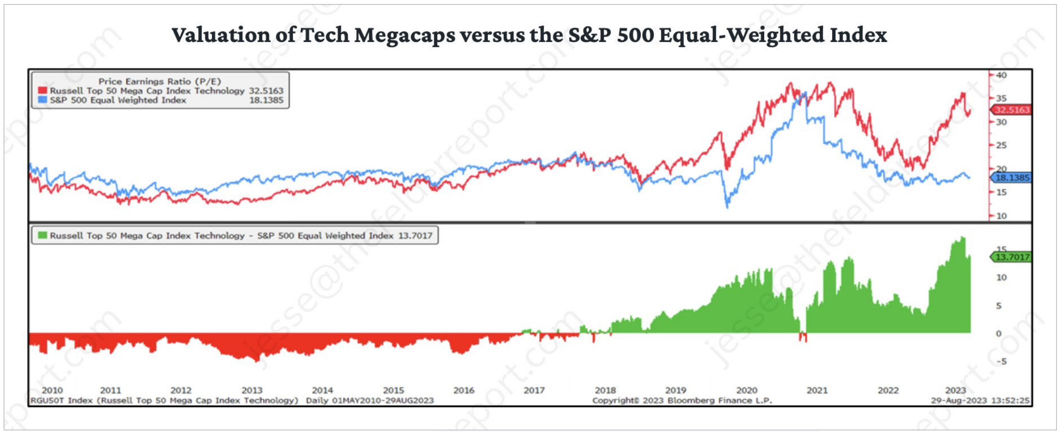
We realize the US had bigger deficits right after the Financial Crisis and during COVID, but given low unemployment and peacetime, we don't think we're overdoing it when we say that this year's budget is the most reckless and irresponsible in the history of the Republic.

We think that the unprecedented surge in the deficit this year is a key reason why a recession has yet to materialize. A surge in the deficit this large can sometimes artificially maintain growth in the very short-term. But, given higher interest rates on government debt, this kind of support can't last. The party continues for now, but a hangover looms in our future.

Continue reading here.

Big tech is more expensive relative to the broad market than it has been in years ([from Jesse Felder via X on September 6]())...

> "The tech megacaps command a 78% premium which is even larger than the peak logged during the COVID lockdowns - this despite the increase in long-term yields that should be most damaging to expensive growth stocks." by @VincentDeluard



Walmart's recent pay cuts suggest the jobs market is softening ([from The Wall Street Journal on September 7]())...

> Walmart is paying some new store workers less than it would have three months ago, a sign that employers are seeking to cut labor costs as the once-hot market for hourly staff cools.
>
> The country's largest private employer changed its wage structure for hourly workers in mid-July, according to documents reviewed by The Wall Street Journal and Walmart employees.
>
> Under the new structure, most new hires will earn the lowest possible hourly wage for that store. In the past, some new hires, such as those who collect items for online orders, would have made slightly more than other new staff members, such as cashiers.
>
> The wage-structure change comes after Walmart and other large employers have for years steadily raised wages and added benefits to attract workers in a tight labor market. The retailer's latest move suggests that the stresses companies are facing in trying to find employees are easing and that they need to find ways to offset those wage increases.

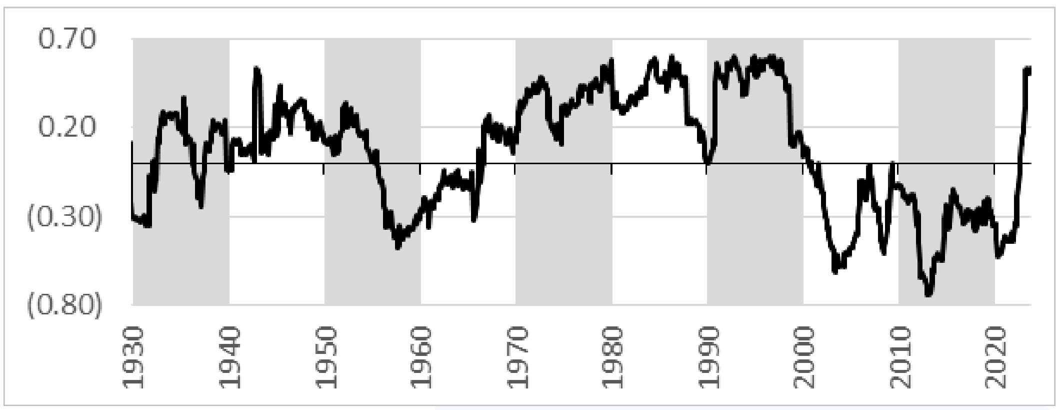
[Continue reading here (subscription may be required).]()

An update on the correlation between stocks and bonds (from Verdad Weekly Research on September 11)...

Investors tend to think of stocks and bonds as negatively correlated, with stocks doing well in positive growth environments and bonds doing well when growth slows or declines. And that was largely true for the last quarter century.

But earlier this year, the trailing three-year correlation between stocks and bonds turned positive for the first time since November of 2000, a development we wrote about at the time. Over the last eight months, the stock-bond correlation has been 0.61, and three-year trailing stock bond-correlations are now as high as they have been since last century.

Figure 1: 3Y Trailing Monthly Stock-Bond Correlations, 1929–2023



Source: Bloomberg. SBBI Ibbotson US Large Stocks and US LT Govt prior to 1989.

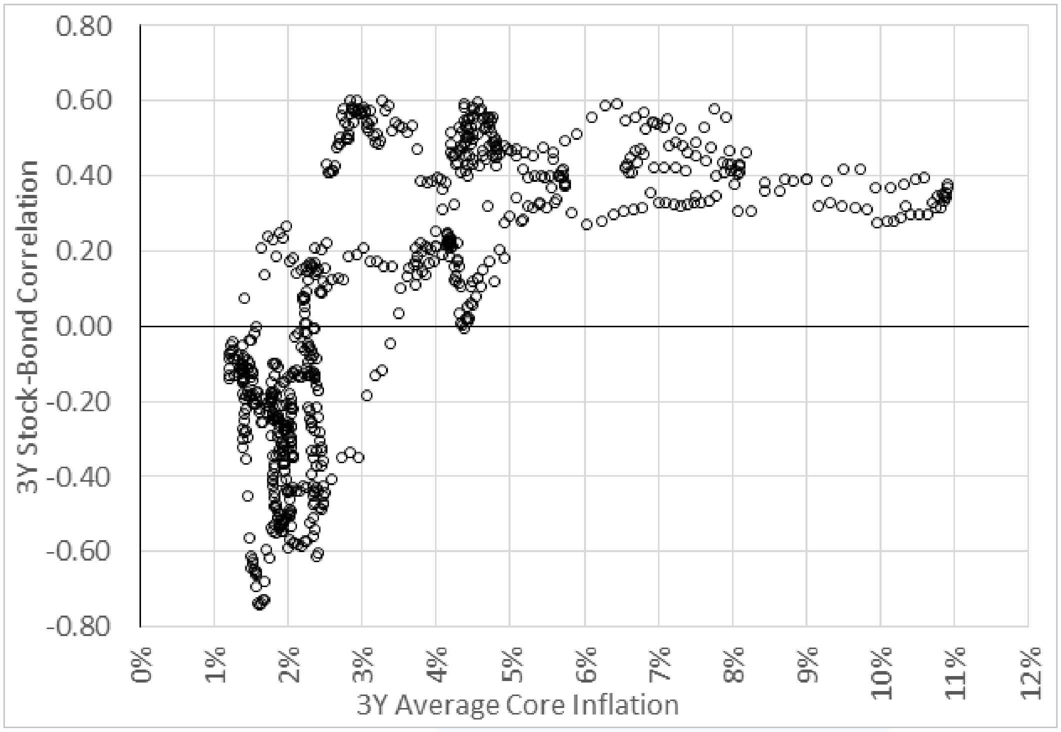
This shift has prompted a surge in research on the stock-bond correlation.

AQR published a study at the end of 2022 that showed that a key determinant of the stock-bond correlation is the relative dominance of growth uncertainty and inflation uncertainty. Stocks and bonds react to growth shocks in opposite ways: stocks go up and bonds go down. But stocks and bonds react in the same direction to inflation shocks: stocks go down and bonds usually go down more, in our opinion.

Now researchers at Robeco and the State of Wisconsin Investment Board have published another valuable paper on the stock-bond correlation (Molenaar et al). In it, they explore what characterizes periods in which the stock-bond correlation is above or below zero. Like AQR, they find that higher expected inflation and higher uncertainty around inflation drive higher stock-bond correlations.

One of the most eye-popping charts from the paper is recreated below. When the core inflation rate averages above 4%, the stock-bond correlation has been positive with few exceptions. Core inflation has averaged 4.5% for the past three years and is currently 4.7%.

Figure 2: 3Y Trailing Monthly Stock-Bond Correlation vs. Avg. Core Inflation Rate over Same Period



Source: Bloomberg. SBBI Ibbotson US Large Stocks and US LT Govt prior to 1989.

While both papers note that high levels of inflation are associated with high stock-bond correlation, both papers forcefully argue that it's not so much the level of inflation that is the driver of the correlation but the uncertainty around inflation. Both papers come to this conclusion using different data: AQR uses the trailing volatility of inflation while Robeco and the State of Wisconsin use the divergence of inflation survey expectations. As it happens, inflation uncertainty is highly correlated with inflation, meaning uncertainty is higher when inflation is higher, but even when untangling this relationship through statistical means, inflation uncertainty remains important.

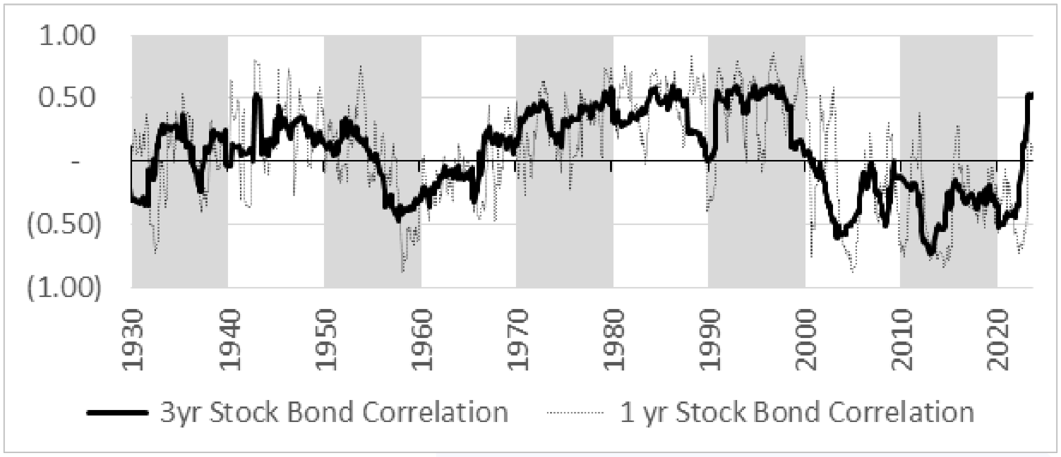
How might uncertainty around inflation lead to a more positive stock-bond correlation? One reason is simply that, to the extent uncertainty is associated with greater variance of inflation, the movement of inflation is more likely to be the dominant driver of change in both debt yields and equity discount rates. Higher yields drive debt prices down, and higher discount rates drive equity prices down.

But that ignores equity growth, which matters greatly to equity price. There is a second pathway that includes growth: inflation as a leading indicator of counter-cyclical monetary policy. When inflation is uncertain, the Fed and the market are more likely to be focused on inflation. Upward surprises lead to upward revisions of expected Fed policy rates, and downward surprises lead to downward revisions of expected Fed policy rates. Not only do these move yields and discount rates in the same direction, but they change growth expectations in a reinforcing way: either growth expectations fall in combination with expected higher policy rates and rising inflation, or growth expectations rise in combination with expected lower policy rates and lower inflation. Each of these pushes stock and bond prices in the same direction.

The theory is that, if inflation is the primary driver of the Fed reaction function, then stocks and bonds are likely to be more highly correlated. When inflation is not a concern, then growth becomes the primary driver of the Fed reaction function, and policy rate moves become driven by growth concerns. Adjustment to lower rate expectations comes with lower growth expectations. This drives stocks and bonds in opposite directions. In this context, it makes sense that high stock-bond correlations exist when inflation is the focus, which happens most often when inflation is high. By contrast, it makes sense that positive stock-bond correlations require quiescent inflation and happen most often when inflation is low and contained. It is also intriguing that Robeco and the State of Wisconsin find that their regressions become much more significant after 1952, in the era of independent central banks and counter-cyclical monetary policy.

In this context, the stock-bond correlation can be seen as an indicator of what is the dominant risk—inflation or growth—and how it is changing. This is perhaps why we have found it is an important leading indicator in our own work. It is important to note that the charts we have shown have been smoothed over three years. Over shorter time horizons, the stock-bond correlation is constantly shifting as expectations in the market update. Below we add the one-year stock-bond correlation to the chart we showed before.

Figure 3: 1Y and 3Y Trailing Monthly Stock-Bond Correlations, 1929–2023



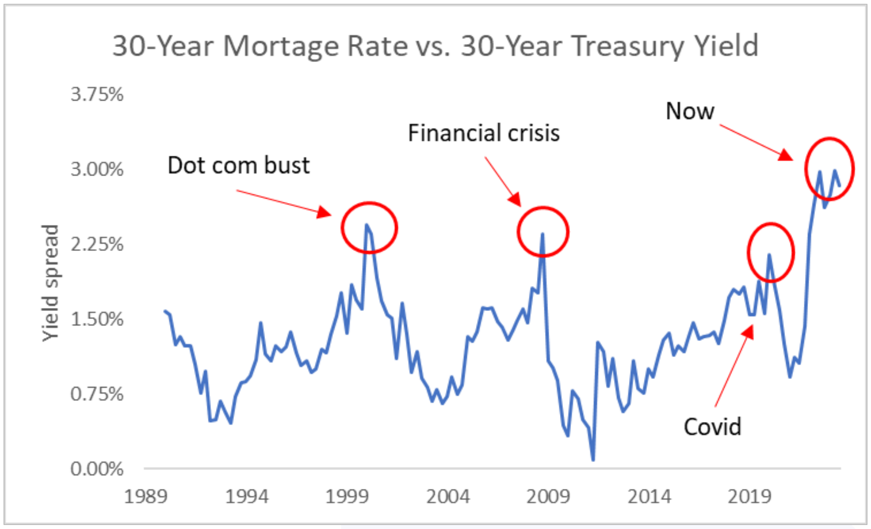
Source: Bloomberg. SBBI Ibbotson US Large Stocks and US LT Govt prior to 1989.

Even in periods of high stock-bond correlations, stocks and bonds can be negatively correlated over shorter periods. In fact, over the first eight months of this year, stocks and bonds moved opposite one another in May, June, and July. This also helps explain how in the 1970s during a period of sustained positive stock-bond correlations, Treasurys still had positive returns in recessions, as we noted here. We believe a high and sustained stock-bond correlation is certainly a reason for investors to revisit their strategic allocations, but it does not mean Treasurys are to be avoided altogether. For the tactical asset allocator, the more important message comes from how the stock-bond correlation is changing.

Continue reading here.

The record spread between 30-year mortgage rates and the 30-year U.S. Treasury yield could be a bearish signal for stocks ([from C. Scott Garliss via X on September 11](#))...

> Keep an eye on the spread between 30-year mortgage rates and the 30-year U.S. Treasury yield. Since 1990, it has only been this high three other times... 2Q 2000, 4Q 2008. and 1Q 2020. Each of those marked a major inflection point for the S&P 500 Index...

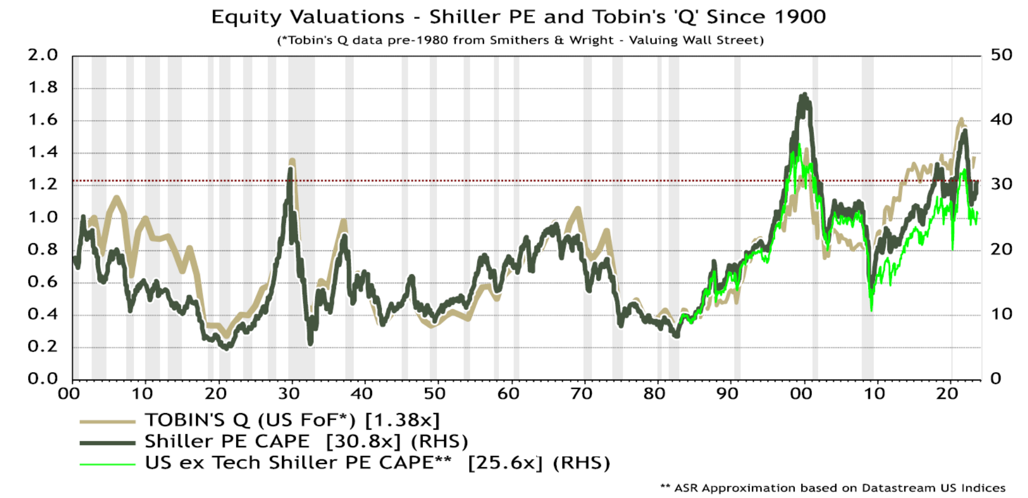


Today's near-record high market valuations suggest that stocks could suffer dramatic losses if inflation remains sticky ([from Bloomberg on September 11](#))...

> In straightforward absolute terms, without comparing to bond yields, equity valuations are again getting hard to ignore. In the 12 months to the end of August, the S&P 500 managed a price return of 14%. Of that, increasing price/earnings multiples accounted for 12.4 percentage points, according to a decomposition by Patrick Palfrey of Credit Suisse AG. Earnings themselves accounted for 1.4 percentage points. So valuations have boomed.
>
> This tells us nothing about timing, as any valuation can always become more extreme in the short term, but a lot about likely future returns. For valuations like this to make sense, investors must be assuming that bond yields are going to tank, which can only happen if inflation is not only beaten but totally trashed. To quote Lerner again, equity valuations are now at levels "consistent with the post Global Financial Crisis (GFC) era of loose monetary conditions where aggressive central bank intervention dulled the ups and downs of economic cycles."
>
> If inflation comes down and stays down, and rates aren't "higher for longer," that might be accurate. But the rising bond yields and rate expectations of the last few months suggest exactly the opposite.
>
> In much longer context, this chart from Ian Harnett of Absolute Strategy Research offers the two most popularly cited long-term valuation metrics for US stocks — Shiller P/Es or "CAPEs" (for Cyclically Adjusted Price/Earnings multiples), which compare stocks to average earnings in real terms over the previous 10 years, and Tobin's Q ratio, which compares stocks to the total replacement value of their underlying assets.

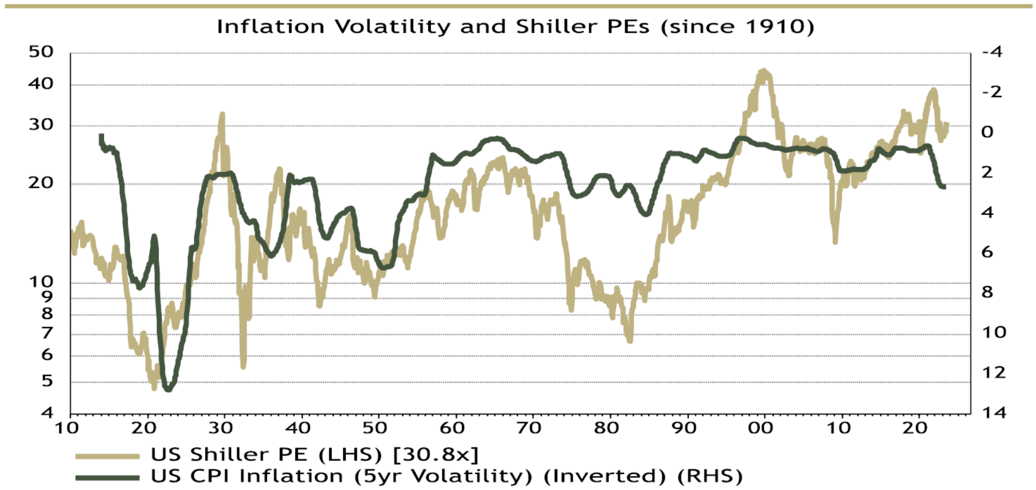
Even if tech stocks, obviously generating excitement at present, are excluded, these measures suggest that stocks are historically expensive, at valuations comparable to the eve of the Great Crash in 1929 and of the GFC in 2007:

Chart 2: US 'Fundamental' Valuations: Tobin's Q and Shiller PEs



Over periods of 10 years or more, these indicators prove to be strongly predictive. The all-time record for the Shiller P/E in 2000 was followed by a terrible decade; the 50-year low it touched in the early 1980s was the signal for a fantastic bull market. A high Shiller P/E functions like a low implicit equity risk premium; it only makes sense if you think inflation will be tame, and hence bond yields can come down. This is explored in the CFA symposium; here is Harnett's illustration, going back to 1910:

Chart 3: High US Shiller PEs Tend to Occur When Inflation Volatility is Low



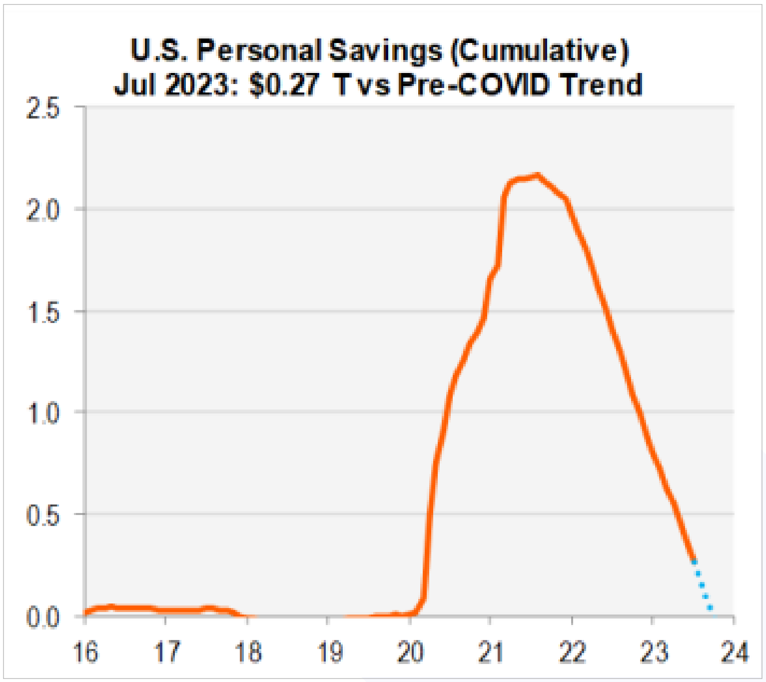
Source: ASR Ltd. / Robert Shiller / LSEG Datastream

High valuations will have no effect on how the stock market performs next week or next month. But they do tell us that the market has baked in an assumption of calmly quiescent inflation, and that the losses if that doesn't come true will be painful.

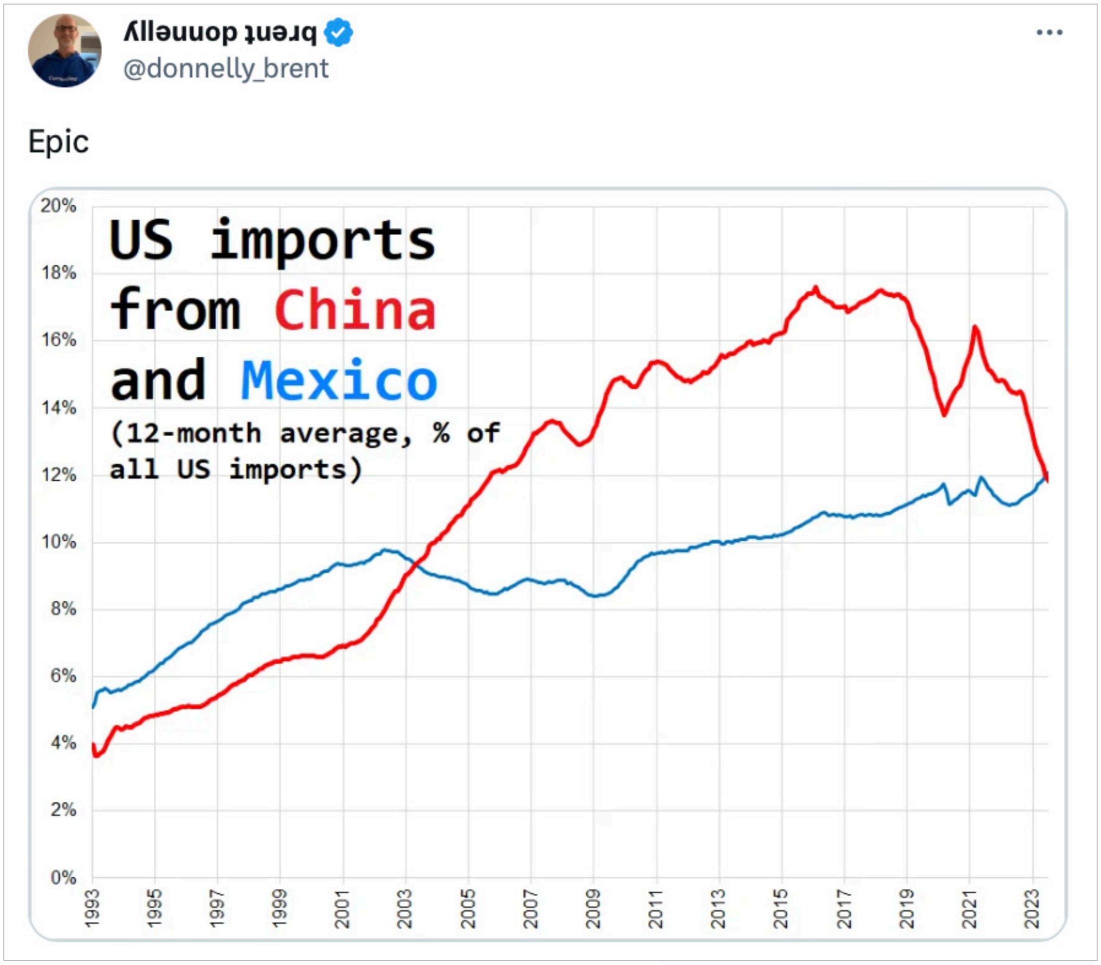
[Continue reading here (subscription may be required).]

U.S. consumers' post-COVID "excess savings" have nearly run out ([from Matthew Miskin, CFA via X on September 11]())...

> Great chart from @NancyRLazar1 of @Piper_Sandler this morning.
>
> Excess Savings. "They've already declined sharply, set to hit $0 by Halloween. Surging student loan interest payments will hasten that drawdown."



U.S. imports from Mexico have officially surpassed those from China for the first time in decades ([from Brent Donnelly via X on September 12](#))...



Goldman Sachs warns of three upcoming "hits" to the economy this year (from Joe Weisenthal via X on September 12)...

> From Goldman, potentially three big hits coming to economic activity. Student loan resumption, UAW strike, and government shutdown.

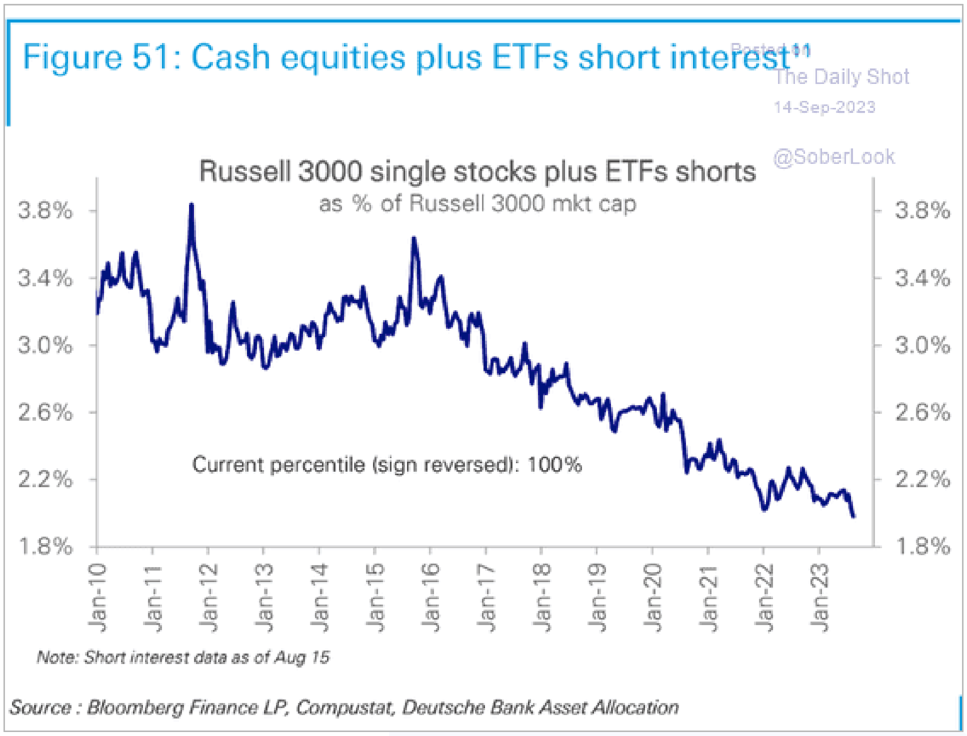
US Daily: The Q4 Pothole: Student Loans, Shutdown, and Strikes (Walker/Phillips)

12 September 2023 | 4:50PM EDT

- Three developments are set to temporarily slow growth in Q4. First, we expect the resumption of student loan payments to subtract 0.5pp from quarterly annualized GDP growth. However, the risks lean toward a smaller effect, as some borrowers might not resume payments right away and some are likely to qualify for the Biden Administration's income-based repayment plan.

- Second, the federal government looks more likely than not to temporarily shut down. A government-wide shutdown would reduce quarterly annualized growth by around 0.2pp for each week it lasted after accounting for modest private sector effects. Our baseline is that a shutdown could last for 2-3 weeks, although a shutdown is not a foregone conclusion and the timing is uncertain.
- Third, we estimate that reduced auto production from a potential UAW strike would reduce quarterly annualized growth by 0.05-0.10pp for each week it lasted, if all three companies currently undergoing contract negotiations are impacted. In both the case of a government shutdown and the case of a UAW strike, growth would rise by the same amount it declined in the quarter following their end.

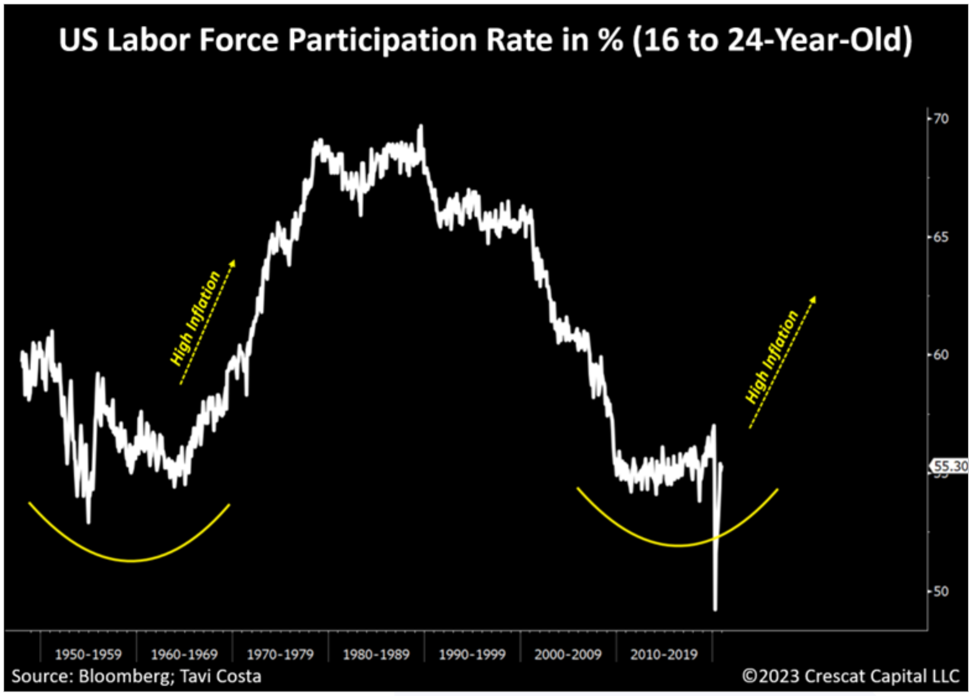
Short interest in stocks and exchange-traded funds (ETFs) continues to fall to multi-year lows (from Deutsche Bank Research via The Daily Shot on September 14)...



This labor market indicator suggests inflation remains a problem (from Otavio Costa via X on September 14)...

> The resurgence of labor market participation is yet another indicator of potential inflationary problems in the system.
>
> A similar pattern occurred back in the 1970s when rising living costs compelled households to rejoin the labor market.
>
> The term "The Great Resignation," frequently highlighted by the media, is fundamentally rooted in looking at the past.
>
> We believe the labor force participation rate is likely in the process of bottoming.
>
> While some policymakers may interpret this as a positive development, we see it as further evidence that we could be entering a period characterized by stagflation.
>
> This trend is evident across all age groups, but it is particularly noticeable among individuals aged 16 to 24.
>
> Younger individuals have significantly reduced their participation in the labor market since the peak of inflation in the early 1980s.

As long as inflation remains higher than historical norms, this demographic, along with others, is likely to become a substantial addition to the job market.



A tell-tale sign of exuberance in artificial intelligence (AI) (from Peter Atwater via X on September 14)...

Move over Long Island Iced Tea turned Long Island Blockchain...

h/t @TedHZhang

And, yes, there's a sentiment indicator in here somewhere...

Selected By Virtual Peter

Cola from the future? Coca-Cola reveals AI-generated drink

The first-ever soda drink created by artificial intelligence (AI) is here. Coca-Cola's Y3000 Zero Sugar, a limited edition drink that hit the shelves earlier this month, is what future tastes like, said the company in a statement. After all, it's been created with the combined prowess of "human intelligence and AI together for an uplifting expression of what Coca-Cola believes tomorrow will bring."

Email Tweet

This pandemic program has been handing out billions of dollars in bogus tax credits for years. The IRS may finally be shutting it down (from The Wall Street Journal on September 14)...

> The Internal Revenue Service made its biggest moves yet to stop what officials say is a wave of fraudulent and overstated claims for a pandemic-era tax break, including an immediate halt to processing new refund requests.
>
> New claims for the employee retention credit, or ERC, won't be processed until at least 2024, the IRS announced Thursday. The tax agency also plans to give tougher scrutiny to an existing queue of more than 600,000 requests. The IRS will allow employers with pending claims to withdraw them and will let many repay their refunds if they no longer think they qualify.
>
> Congress created the credit in 2020 as an incentive for businesses to keep employees attached to their jobs during the pandemic, but the refunds accelerated after business closures ended. The ERC's cost has far exceeded the expectations of lawmakers and administration officials.

The IRS is trying to disrupt a pop-up industry that encourages small businesses and nonprofits to claim the once-obscure credit and receive up to $26,000 per employee. The Wall Street Journal has reported that aggressive marketing by such firms is driving a flow of ERC refund claims that has overwhelmed the tax agency.

“We are taking these dramatic steps because the IRS is increasingly alarmed about honest small-business owners being scammed by unscrupulous actors,” IRS Commissioner Danny Werfel said in an interview. “We could no longer tolerate growing evidence of questionable claims pouring in following the onslaught of misleading marketing from promoters.”

Firms that promote the tax credit say they help small businesses and nonprofits get money they deserve under the law, and some pitch it as a lifeline for struggling employers. Lawmakers have at times pressured the IRS to move quickly through the backlog of requests for the credit.

The IRS and many accountants, however, say ERC claims are often filled with errors and filed by employers that aren’t eligible. To receive the tax credit, an employer must show a significant decline in revenue or that a government order fully or partially suspended their operations.

The credit technically expired nearly two years ago. Since then, ERC consulting firms such as Innovation Refunds, Bottom Line Concepts and Synergi Partners have encouraged businesses to submit amended tax returns, which they can do until April 2025 under the tax code. Innovation Refunds and Synergi didn’t immediately provide comment.

A Bottom Line spokeswoman said the company is informing its staff and clients about the IRS changes and will assist employers who want to withdraw, at no cost. The spokeswoman said the company shares the IRS concerns about unethical firms.

“We are also concerned that clearly eligible employers who kept their employees on payroll during the pandemic may be adversely impacted by this delay, or even discouraged from filing,” the spokeswoman said.

Claims have continued pouring in to the government, despite the IRS including ERC claims on its annual “Dirty Dozen” list of common tax scams. Over the life of the credit, the IRS has received 3.6 million claims for it, about 15% of them in the past 90 days.

The IRS says it is still receiving 50,000 claims each week, more than twice the average volume since March 2020.

As of March 2023, the IRS had paid more than $150 billion in ERC claims. Treasury data suggest that the figure is now $230 billion, or roughly triple the original congressional estimates, according to an analysis by investment banking firm Piper Sandler. The ERC will cost the government more this fiscal year than the mortgage interest deduction and charitable deduction combined.

Continue reading here (subscription may be required).

“Picking up dimes in front of a bulldozer”: A new ETF looks to capitalize on the popularity of zero-day options (from Reuters on September 14)...

> An exchange-traded fund (ETF) that started trading on Thursday offers investors a new way to participate in the hot market for short-dated equity options, a risky trading strategy that has enthralled markets over the last year.
>
> Miami-based ETF sponsor Defiance ETFs LLC launched the Defiance Nasdaq-100 Enhanced Option Income ETF on Thursday, the first ETF to use daily options income generation, the ETF sponsor said in a press release.
>
> The ETF seeks to tap into the dual popularity of short-dated options contracts and the heightened interest in ETFs that seek to generate income through a combination of selling options and investing in U.S. large cap stocks.
>
> Short-dated options contracts, with a day or less to expiry - dubbed 0DTE (zero days to expiry) options - have grown popular with investors over the past year, often making up as much as half the daily trading volume in the options on major ETFs and indexes, including the S&P 500 (.SPX) and the Invesco QQQ ETF.
>
> Their increased usage has sparked concerns about their risks and the potential for a volatility shock that could ripple out to the broader stock market.
>
> Investors have also flocked to ETFs that look to generate income and reduce portfolio volatility by selling options against stocks.
>
> One such ETF - the JPMorgan Equity Premium Income ETF (JEPI.P) - has grown its assets to about $29.5 billion from about $12.4 billion a year ago. Assets at another, the Global X Nasdaq 100 Covered Call ETF (QYLD.O), have grown to $8.1 billion from $6.9 billion a year ago.
>
> "If there is one thing that investors are eager to receive, it is a steady stream of income, and we hope to provide just that," said Defiance ETFs' Chief Executive Officer Sylvia Jablonski.
>
> The new actively managed ETF, QQQY seeks monthly yield for investors by combining Treasuries and short-dated Nasdaq-100 index options. The fund will seek to generate income by selling 0DTE put options looking to capture the premium in these highly volatile derivatives contracts, the ETF sponsor said.
>
> "QQQY is attempting to timely scratch two itches, potential income from an asset that doesn’t typically generate income and exposure to the sudden popularity of trading ODTE options," said Lois Gregson, senior ETF analyst at FactSet Research Systems.
>
> Gregson, however, warned the ETF's reliance on the highly volatile 0DTE options could leave it vulnerable to losses.
>
> "The fund is 'betting' the market will rise more often than fall," Gregson said, noting that the portfolio manager would have to buy back the short put options potentially at a loss.
>
> "The strategy is similar to picking up dimes in front of a bulldozer. The income potential is there, but there are times you could also get run over," Gregson said.

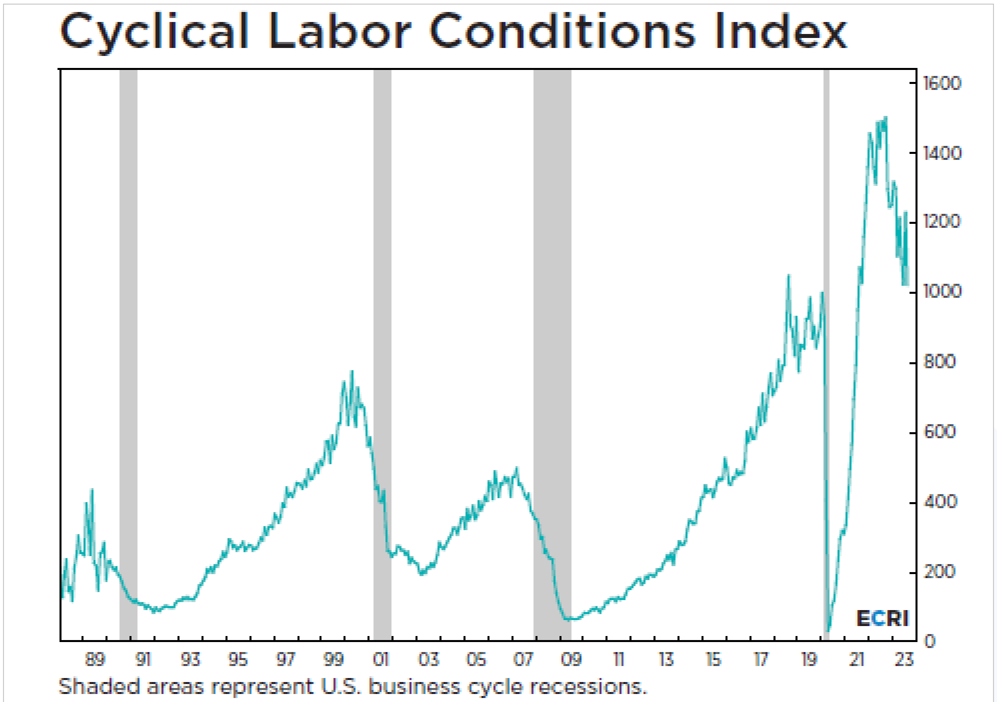
Continue reading here.

The labor market is showing recessionary signs beneath the surface (from the Economic Cycle Research Institute on September 15)...

Our research questions the complacency surrounding employment growth, suggesting an impending downturn as cyclical job losses loom. This counters the popular belief in a soft-landing, underpinned by the expectation of job market stability. To resolve the contradictions, we delve deeper into the U.S. employment outlook.

Evaluating ECRI's insights

To understand the state of the labor market, we turn to our Cyclical Labor Conditions Index.

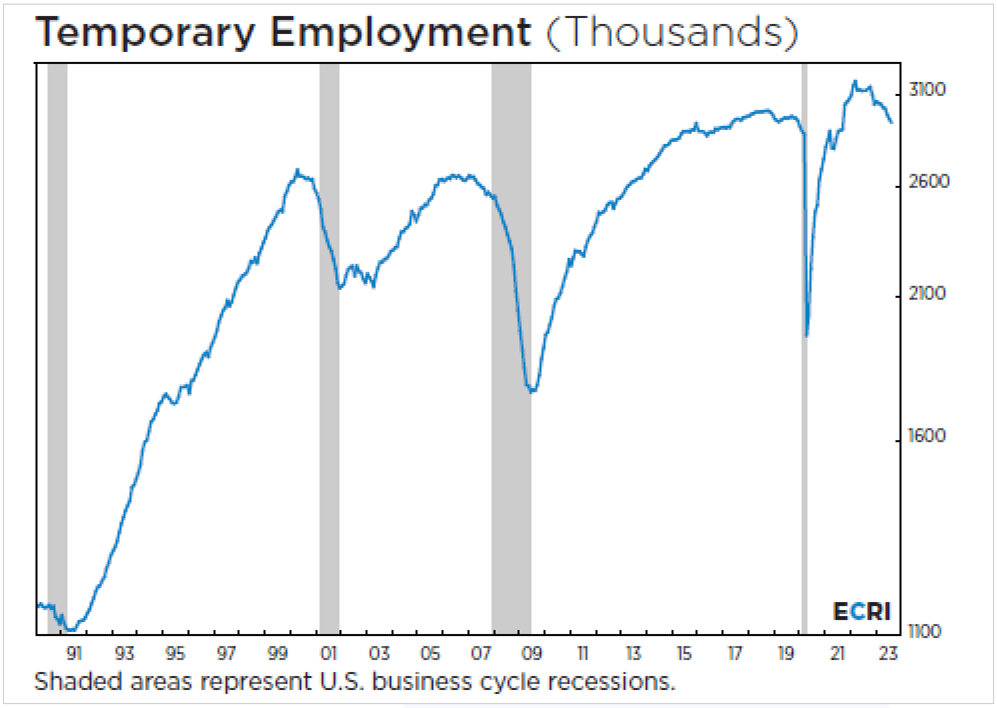


This index has always turned down decisively before recessions, and its substantial decline since last year is highly significant. Cyclical labor conditions are weakening the way they do around recessions, despite non-cyclical factors like labor hoarding bolstering employment.

The question is, how long can these non-cyclical forces hold up in the face of this cyclical hollowing out of the labor market?

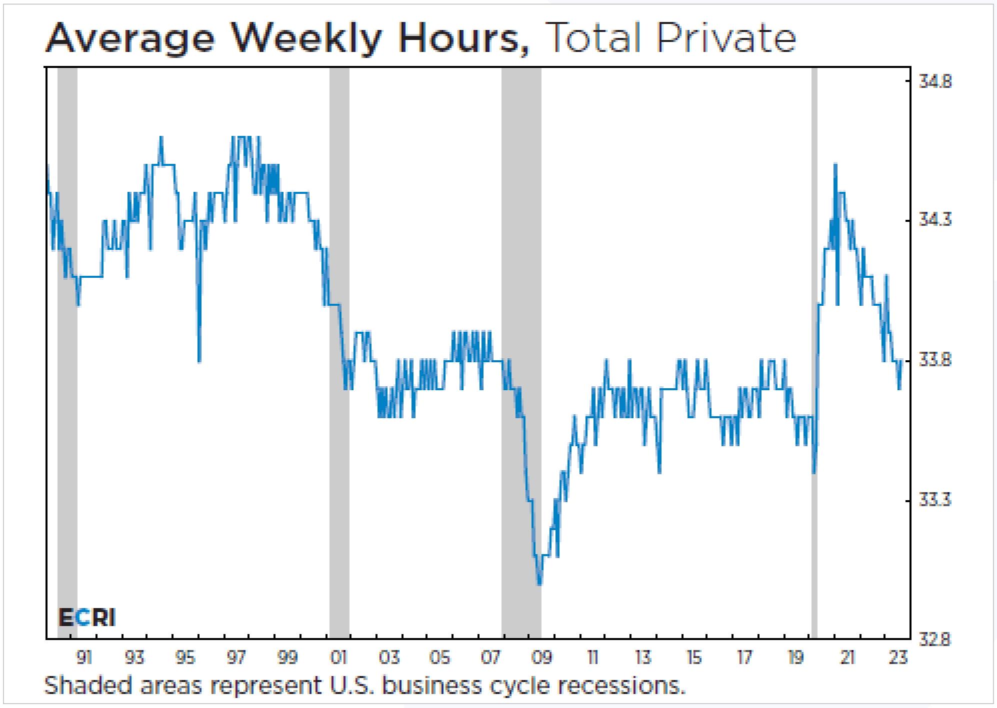
Telltale signs from temp jobs

Cyclically sensitive indicators are increasingly showing recessionary trends, despite seeming strong headline jobs data. A case in point is temporary employment, which has fallen 7.6% from its early-2022 high, as typically seen after the onset of a recession.



Worsening workweek

Another concerning trend is the sharp decline in average weekly hours since early 2021. Such weakness is generally observed in the lead-up to recessions. When the workweek shrinks to this extent, a recession is typically unfolding.



Understanding the paradox

So, why is employment still rising despite these recession flags? A labor shortage, fueled by a plunge in legal immigration and a post-Covid labor force exodus, has led to labor hoarding by employers. Loath to let go of the workers they've been able to hire with great difficulty, businesses are letting temporary workers go and overall work hours decrease due to insufficient demand. In other words, idiosyncratic and structural factors that came to the fore in the backwash of the Covid crisis have propped up job growth despite growing cyclical weakness.

Continue reading here.

The “Great Moderation” is over: Why the low-inflation, low-volatility environment of the past few decades probably isn’t coming back (from Liz Ann Sonders and Kevin Gordon at Charles Schwab on September 18)...

It's human nature...or perhaps investor nature...to be myopic at times and focus on the short-term; especially recently with hyper-sensitivity to all things inflation and the labor market, given uncertainty regarding Federal Reserve policy. Every day, the probabilities around what the Fed will do at the next one or two Federal Open Market Committee (FOMC) meetings are pored over by investors trying to gain an edge. If only the Fed would ease its foot off the economic brake, we might assume the inflation dragon had been slayed and we could return to something resembling the pre-pandemic era. How likely is that?

Let's widen the lens and ponder the possible transition we're in the midst of, to perhaps a different secular environment. The secular era that preceded the pandemic is often referred to as the Great Moderation; one during which disinflation reigned, economic volatility was subdued—save for the global financial crisis—and there was a steady tailwind associated with the epic decline in interest rates.

The Great Moderation era doesn't have an official start point, but in general it's seen as kicking in during the 1990s, although some references date as far back as the early 1980s. The era was punctuated by a number of key characteristics in addition to low economic volatility and disinflation; including longer economic cycles with less frequent recessions, a Fed quick to press the easy policy button all the way to zero, profits representing an outsized share of gross domestic product (GDP), and a positive correlation between bond yields and stock prices.

The era that preceded the Great Moderation and started in the mid-1960s—which we've been calling the Temperamental era—had a very different set of characteristics. They included heightened economic volatility with more frequent recessions (but sharper expansions), as well as greater inflation and geopolitical volatility. It was also an era when labor, via wages, represented a much larger share of GDP relative to profits, and when there was a consistent negative correlation between bond yields and stock prices.

Two very different secular eras

Temperamental Era

- Heightened economic volatility
- More frequent recessions, but more robust expansions
- Heightened inflation volatility
- Heightened geopolitical volatility
- Policymakers faced tougher trade-offs between inflation and growth
- Labor with elevated share of GDP
- Negative correlation between yields and stock prices

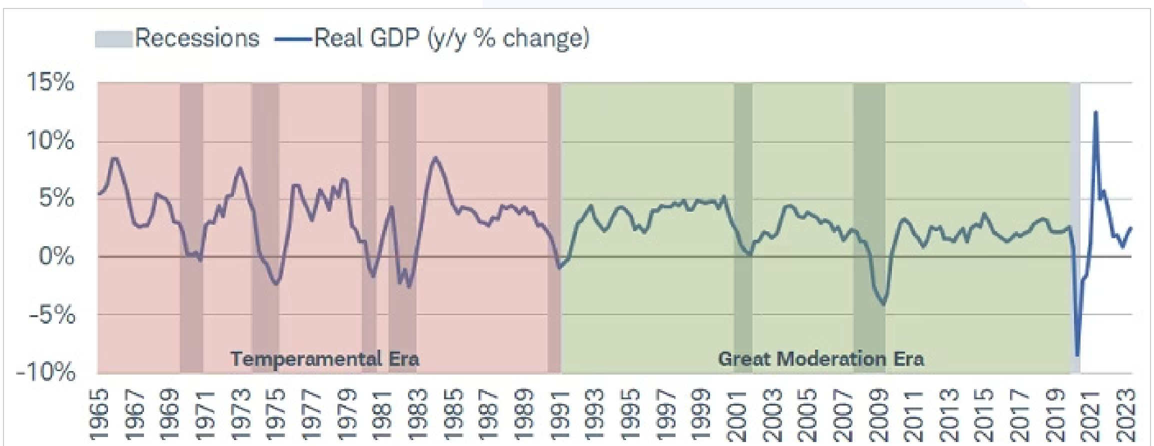
Great Moderation Era

- Suppressed economic volatility
- Less frequent recessions, but less robust expansions
- Disinflation
- Globalization "GELed" with cheap/abundant access to Goods, Energy and Labor
- "Fed put"
- Profits with elevated share of GDP
- Positive correlation between yields and stock prices

Source: Charles Schwab. For illustrative purposes only.

Let's have a look at some of these relationships. Looking at GDP, shown below, the swings were larger and recessions—via the gray bars—were more frequent during the Temperamental era; but there was also more robust growth during expansions. Once the inflation dragon was finally slayed in the early 1980s—and following a mild and brief recession in 1991, the U.S. economy became much less volatile, with only two recessions prior to the pandemic. But as you can also see, both the economic highs and lows were lower than during the Temperamental era.

Economic volatility comparison



Source: Charles Schwab, Bloomberg, as of 6/30/2023

Moving on to inflation, during the Temperamental era, inflation volatility was on a tear—punctuated by the extreme peaks during the mid-to-late 1970s, as shown below. Those extremes were exacerbated by the Fed's decision on both occasions to declare victory early and ease policy, only to see the inflation genie let out of the bottle again. That led to the insertion of Paul Volker as Fed Chair, who "pulled a Volker" by aggressively raising interest rates to get the inflation genie fully back in the bottle. That directly hit the economy, with the famous double-dip recessions in the early 1980s; but it laid the groundwork for the Great Moderation era to come.

Inflation volatility comparison

Source: Charles Schwab, Bloomberg, Bureau of Labor Statistics, as of 8/31/2023.

Disinflation during the Great Moderation was aided by a number of forces that were "GEL'ing." We've been using the GEL acronym in reference to the abundant and cheap access to Goods, Energy and Labor; courtesy of globalization, the U.S. energy boom and China ascendence into the World Trade Organization (WTO) in 2001. For the most part, all three of those ships are sailing.

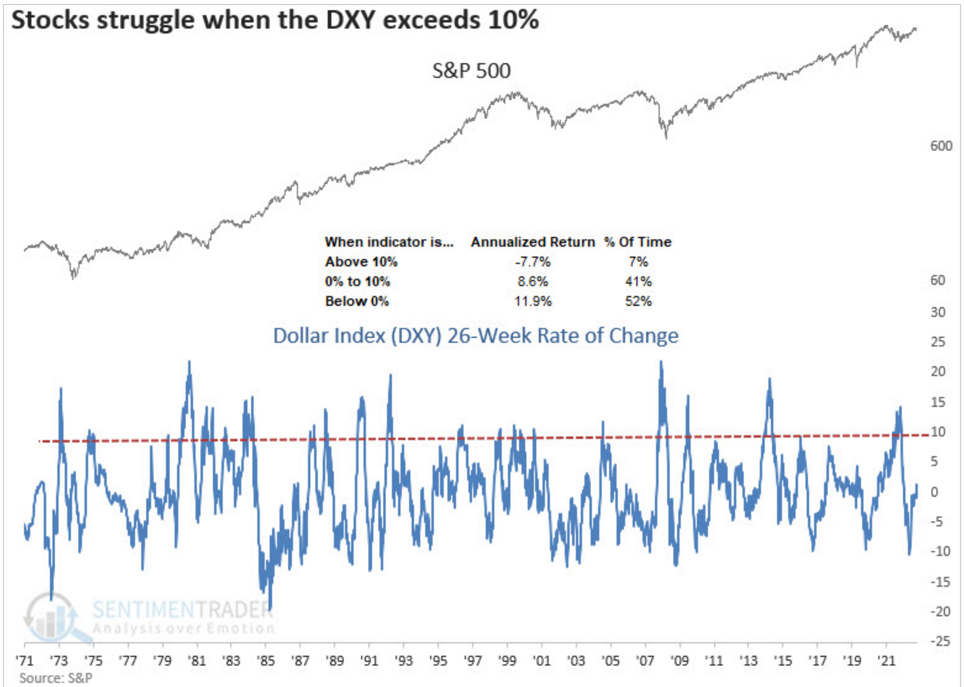
We don't ascribe to deglobalization in its simplest form, but instead believe what we're seeing is a combination of regionalization and supply-chain rationalization/ diversification. In large part due to the ravages of the pandemic, companies have shifted from a just-in-time to a just-in-case inventory mindset. Add climate change and geopolitics into the mix, and you have the brew for a more volatile inflation era. By the way, that's distinct from saying it's going to be a perpetually high inflation backdrop. We continue to believe in the near-term disinflationary trend; but we expect more inflation (and yield) volatility looking longer-term.

[Continue reading here.]

History suggests the recent strength in the U.S. Dollar Index (DXY) could continue – and that could be bad news for stocks ([from Dean Christians, CMT via X on September 18])...

A breakout system triggered a new buy signal for the Dollar Index. After similar alerts, the DXY rallied 79% of the time over the next three months.

The dollar becomes a problem for stocks once the 6-month ROC shows a gain of 10% or more.



Why private equity (PE) could be one of the biggest casualties of rising interest rates (from Kelly Evans at CNBC on September 18)...

> Of all the surprising casualties of the Fed's massive rate hikes--regional banks! SVB!--could the private equity industry find itself on the list?
>
> After all, the industry's massive growth--from less than $2 trillion to $4.4 trillion in size as of last year--came during the past nearly-fifteen years of "ZIRP," or zero interest rate policies. Ultra-low interest rates make the economics of using cheap debt to buy small companies at a low valuation and selling them at a higher one look pretty attractive. But high interest rates undermine that whole model.
>
> Indeed, last year ended with a "sudden reversal" of the "up cycle" that "has endured since 2010," wrote Bain in its annual review--and that was without even fully knowing how bad fourth-quarter returns were. Returns were down 10% through the first three quarters, according to Goldman.
>
> And that underperformance is already threatening the funding status of public pension funds, which have invested heavily in this asset class in recent years--in some cases, up to 40% of their portfolios. The "funded ratio" of public pensions as a result is expected to drop from nearly 84% to just 77% on average, according to Equable--which is "lower than the funded ratios in 2007 and 2008, just before the global financial crisis," as Pitchbook notes.
>
> Was 2022 just an unusually bad year, because private equity as an industry is overexposed to software companies, and tech was the worst-performing sector? If so, that would be an easier pill for investors--which also include many college endowments--to swallow. But there are worries that its troubles could run deeper, and be more persistent unless interest rates return to ultra-low levels.
>
> For starters, the superior returns that private equity could claim to have generated (in order to justify its lofty fees) versus investing in the public markets appears to have evaporated. "In the decade leading up to 2022, surging values of U.S. public equities had closed the historical gap with private equity returns," Bain has acknowledged.

Secondly, the characteristics of many private equity portfolios are similar to owning small-cap U.S. stocks--traditionally the most volatile and least desirable part of the equity market for many institutional investors like pensions. The average deal size for a target company last year was $964 million, according to Bain; almost identical to the median market cap of a company in the Russell 2000, of $922 million.

So how has private equity outperformed--if indeed it has? "The data is clear: private equity returns have come largely through multiple expansion in recent years, rather than from revenue and margin growth," Bain warns. "But [they] won't have that luxury going forward, as higher rates continue to put downward pressure on asset prices."

Proponents would argue that private equity is not apples-to-apples with the Russell 2000 because it overwhelmingly invests in technology (especially "sticky" software companies), and healthcare, whereas the Russell has more exposure to sectors like industrials and financials. But industry watchers also admit that absent cheap debt and growing multiples, the only path to higher returns from here lies through growing market share--which may be difficult (and much costlier) for all portfolio companies to try and do at the same time.

Some critics have even gone as far as Cliff Asness (and Warren Buffett) in accusing the industry of "volatility laundering," or in other words, hiding the real volatility of owning what are basically often just small-caps behind the "smoothed" quarterly returns the industry is allowed to provide.

One thing is for sure: we are starting to see some signs of desperation emerge. "Private equity funds have started to borrow against their funds to backstop overly indebted portfolio companies," the Financial Times reported last week. Such moves to "defend the portfolio" come "as many older private equity funds run low on cash just as the companies they own struggle with their debt loads," the piece noted.

Private equity firms hope these loans can be a bridge to a more profitable market in which they can sell, or "exit," their investments. "They have remained loathe to sell at cut-rate valuations," but the loans themselves "could be a big drag to overall (future) performance," the FT warns.

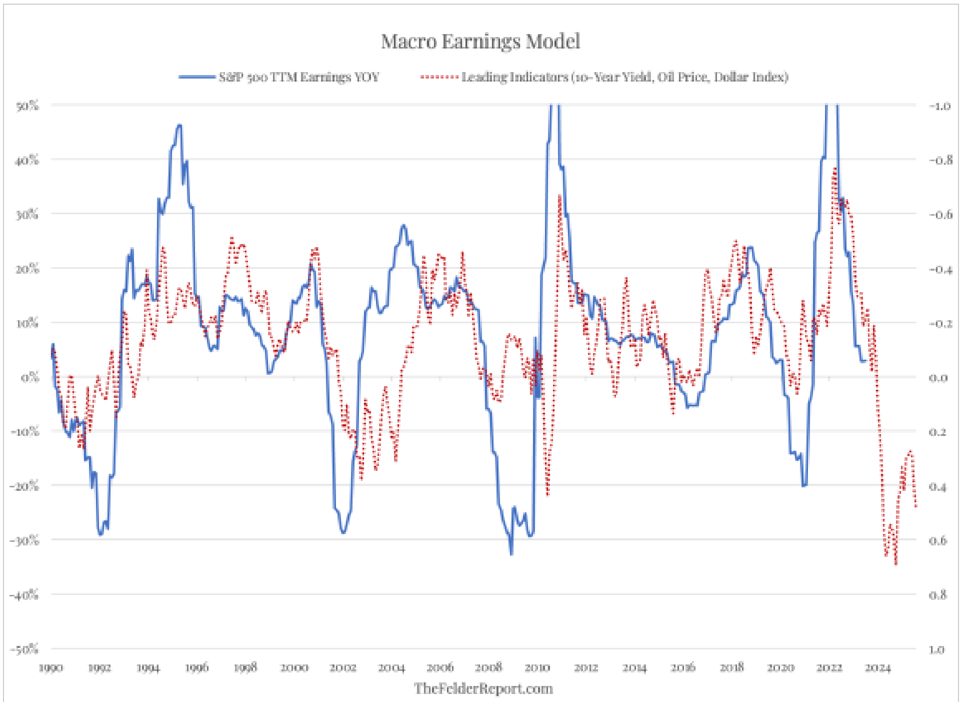
The private equity business may yet figure out how to weather this storm, but its challenges are mounting unless "ZIRP"--or IPO euphoria--soon returns.

Leading indicators suggest broad market earnings are likely to continue to fall sharply in the months ahead (from Michael Kao via X on September 18)...

Kudos to @jessefelder and @ErikSTownsend on an excellent MacroVoices podcast/chartpack recently.

Two charts stand out to me:

1. Jesse's amalgam of Leading Indicators predicts a SIGNIFICANT earnings cliff coming.



2

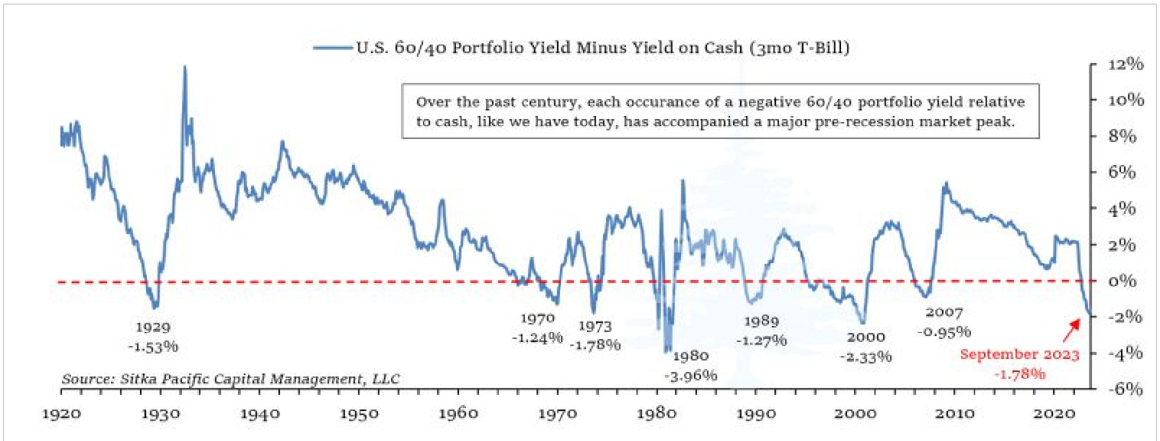
2. This second chart shows the ratio of Reported Earnings: NIPA Profits (as reported to BEA).

Corporations are using every financial gimmick they can (like extending out depreciation lives) to window-dress declining fundamentals. Note the last times this ratio hit 40%.

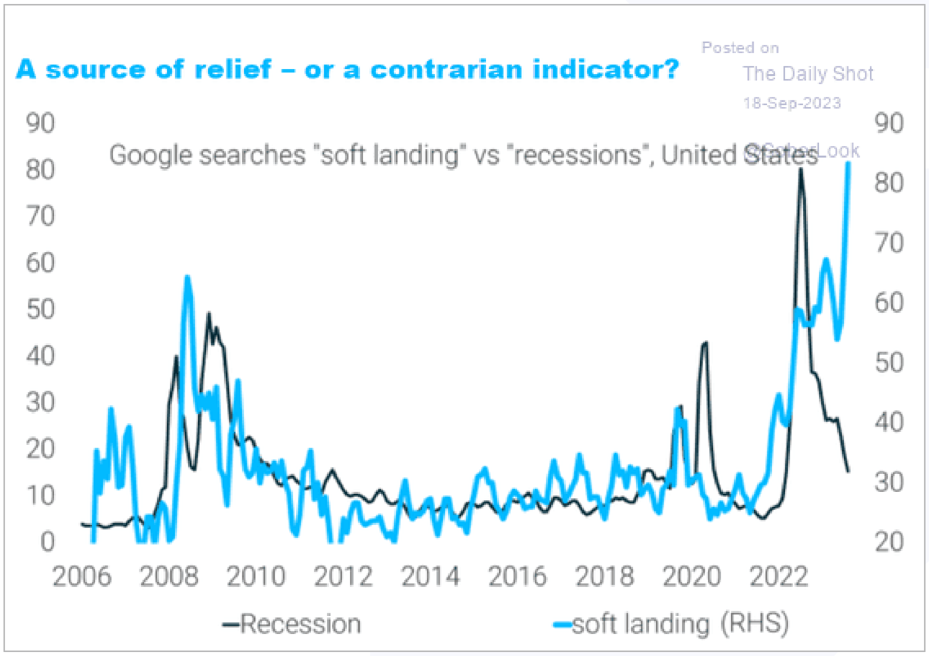
3

The yield on a 60/40 portfolio has now fallen significantly below the yield on cash. This has historically been a bad omen for stocks ([from Brian McAuley/Sitka Pacific Capital Management via LinkedIn on September 18]())...

> This is only the 8th time over the past century that the underlying yield of a standard 60/40 portfolio of stocks and bonds has fallen significantly below the yield on cash.
>
> As those with a good memory of market history can see in the chart below, each of the seven occurrences prior to this year - 1929, 1970, 1973, 1980, 1989, 2000, & 2007 - has marked a major pre-recession peak.
>
> There are few moments when informed planning is more important than it is now...



Economic sentiment shows worrisome similarities with 2008 ([from The Daily Shot on September 18]())...

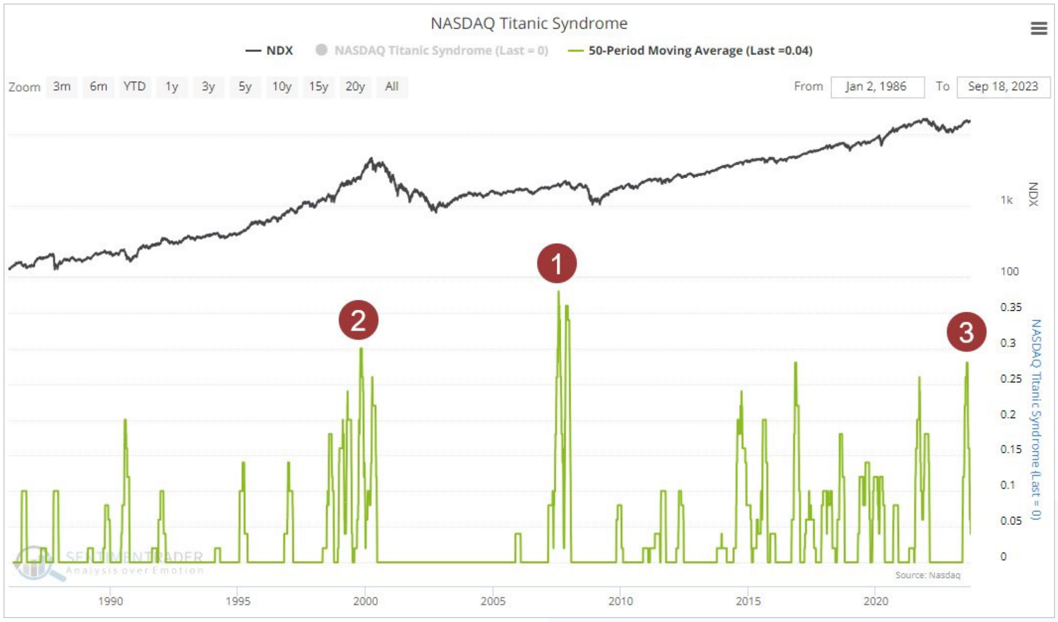


A cluster of “Titanic Syndrome” signals triggered in the Nasdaq 100 Index this month – similar instances have preceded significant declines in the past ([from Jason Goepfert via X on September 19]())...

There are nascent signs the market is splitting.

Since May on the Nasdaq, there has been a cluster of days with too many split conditions.

The 50-day average is coming off the 3rd-highest reading in history. 2nd highest was 1999. Highest was 2007.



The indicator signals days when the index was at a 52-week high, quickly followed by a day when there were more stocks at 52-week lows than 52-week highs.

It's not perfect - it triggered a dreadful false positive in late 2016. But it does tend to precede weak returns.

How stock market gamblers are turning $1 investments into $1,000 bets with zero-day options ([from Bloomberg on September 19]())...

There’s an invisible force driving the most popular options trade of the year — one that gives Wall Street pros and day traders alike the power to turn a $1 investment into a $1,000 stock bet.

Investors are wagering on the daily gyrations of American equity benchmarks by dashing in and out of trading contracts that expire within 24 hours — known by the “0DTE” moniker — with less upfront capital than meets the eye. The hidden fuel for the frenzy: Quirks in the ecosystem of the derivatives marketplace that makes these zero-days-to-expiry options look cheap.

The best way to observe the phenomenon is in the difference between how much investors are actually spending on 0DTE and the notional value of those options — that is, how much exposure they are getting to the underlying asset via the contracts.

> On the latter, the notional trading volume of 0DTE for the S&P 500 currently averages a beefy $516 billion a day, according to data compiled by Cboe Global Markets. Yet the actual amount of money paid out for them, or the premium, is only $520 million.
>
> Put another way, traders are getting $1,000 of stock exposure for every dollar they spend on 0DTE. They would need to spend 10 times that to get the same equity position using derivatives with a longer lifespan, a Bloomberg analysis on Cboe's data shows.
>
> "They are the fantasy football of option trading," said Dennis Davitt, co-manager of the MDP Low Volatility Fund. "You spend a dollar and you see if it goes your way. Then you're done at the end of the day."
>
> No wonder these zero-day options are fast becoming a popular tool for retail investors to speculate en masse — sparking concerns among the likes of JPMorgan Chase & Co. that the strategy risks fueling volatility in the broader marketplace.

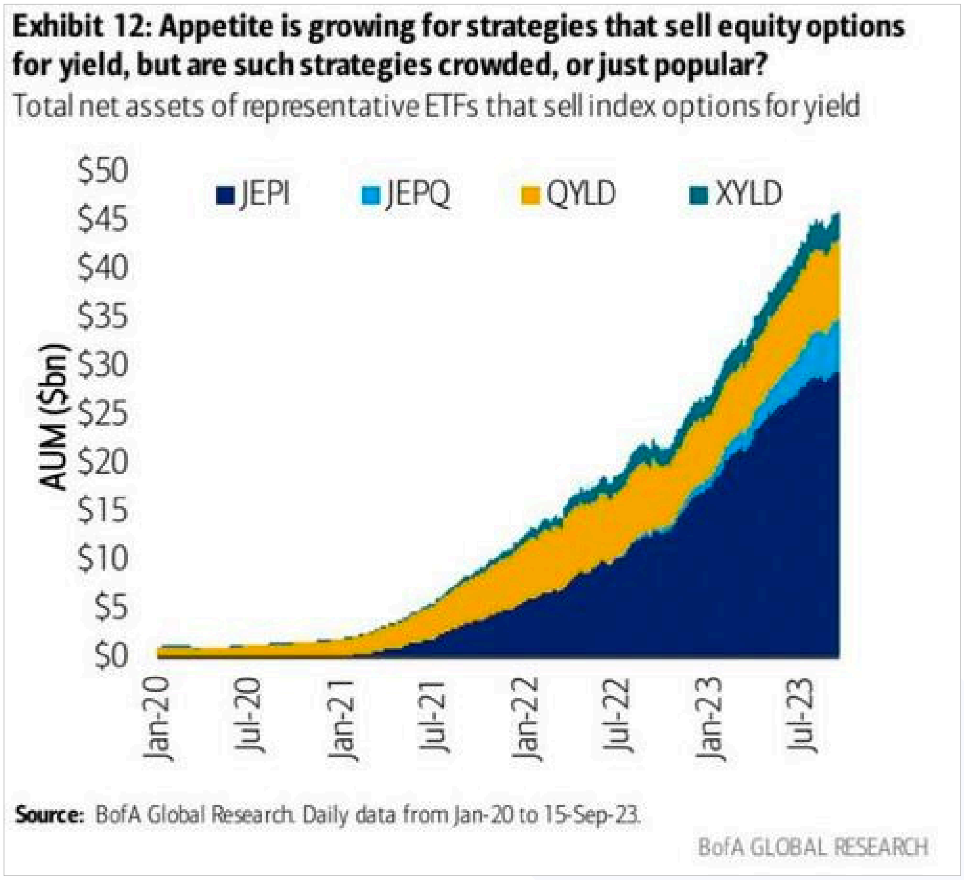
Continue reading here (subscription may be required).

Here's the key takeaway from last week's Federal Reserve September policy meeting (from The Kobeissi Letter via X on September 20)...

> BREAKING: Fed futures now no longer show rate CUTS beginning until September 2024.
>
> To put this in perspective, three months ago futures were expecting 4 rate CUTS in 2023.
>
> Now, interest rates are expected to PAUSE for at least 1 year.
>
> The Fed has made it clear, higher for longer is here to stay.
>
> They would rather send us into a recession than risk inflation spiking again.
>
> Higher rates are the new normal.

Equity options selling strategies have become extremely popular (and some might say crowded) over the past couple of years ([from Noel Smith via X on September 20](#))...

#Volmageddon 2.0 brewing? chart via @zerohedge



Details on a controversial new plan to save Social Security ([from Barron's on September 22](#))...

Don't look now, but there's an interesting attempt quietly under way in Washington to deal with Social Security's massive financial problems.

Presidential candidates Joe Biden and Donald Trump talk about leaving Social Security intact—but don't talk much about how to pay for the fixes the system needs to keep its trust fund from being tapped out in about 10 years. A recent Social Security trustees report put the shortfall at $22.4 trillion in today's dollars.

A tapped-out trust fund would require benefits to be cut by more than 20% across the board. That would badly hurt the two-thirds of beneficiaries age 65 and up who get at least half of their income from Social Security—and really clobber the one-third of beneficiaries who rely on it for 90% or more of their income.

We've seen a lot of simplistic proposed fixes over the years. Progressives have sought to eliminate the cap on wages subject to Social Security tax (currently $160,200) without compensating the highly paid for the extra tax. Conservatives have argued for substantial benefit cuts. But this as-yet-unnamed plan, currently being worked on by a bipartisan group of 14 senators, seems reasonably balanced.

This little-publicized proposal is different from what I've gotten used to seeing in the decades that

I've been writing about Social Security. It features a clever attempt to bet on the stock market to close most of Social Security's funding gap.

I found out about this plan when a Wall Street person who has read my Social Security articles over the years recently introduced me to the proposal's primary Republican leader, Sen. Bill Cassidy of Louisiana.

We've seen a lot of simplistic proposed fixes over the years. Progressives have sought to eliminate the cap on wages subject to Social Security tax (currently $160,200) without compensating the highly paid for the extra tax. Conservatives have argued for substantial benefit cuts. But this as-yet-unnamed plan, currently being worked on by a bipartisan group of 14 senators, seems reasonably balanced.

This little-publicized proposal is different from what I've gotten used to seeing in the decades that I've been writing about Social Security. It features a clever attempt to bet on the stock market to close most of Social Security's funding gap.

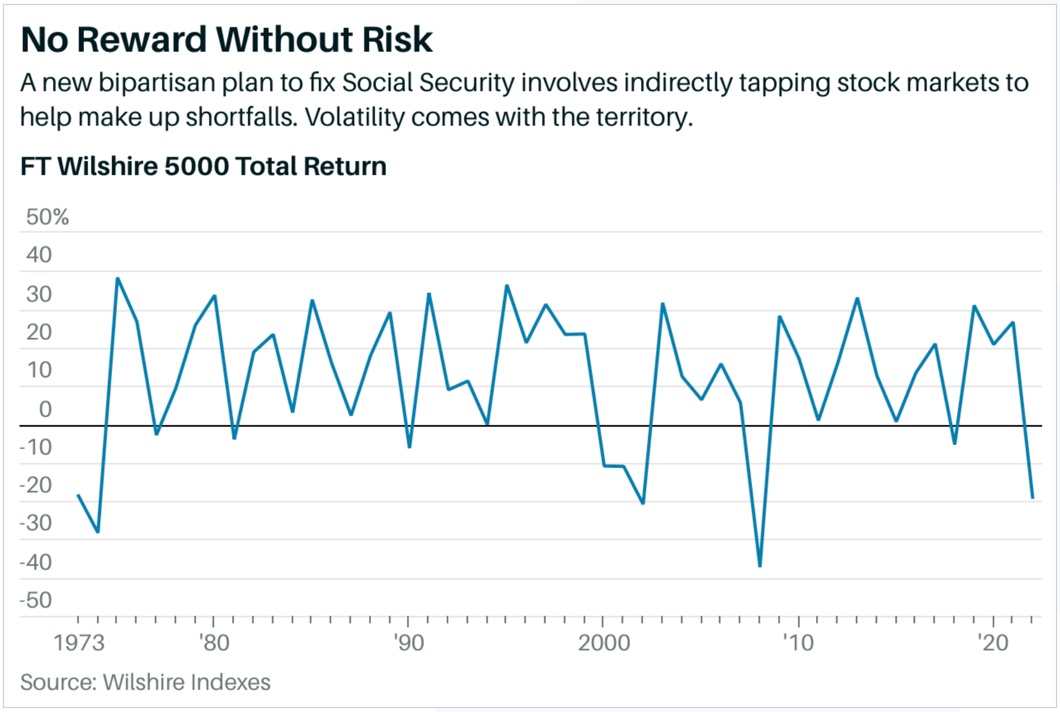
I found out about this plan when a Wall Street person who has read my Social Security articles over the years recently introduced me to the proposal's primary Republican leader, Sen. Bill Cassidy of Louisiana.

The plan's most interesting and controversial element is that it would use massive federal borrowing to indirectly tap the stock market to help cover Social Security's shortfall.

Yes, it's a form of what I call "magic money." But it might actually work.

Cassidy and crew aren't talking about having the Social Security trust fund, which is confined to owning ultrasafe Treasury securities, put money into the stock market. That has been proposed—and rejected, as it should have been—many times.

After all, can you imagine the fear among current and future beneficiaries that would have been generated in 1974, when the U.S. market lost 28.4%, according to Wilshire Indexes? Or in 2008, when the market lost 37.3%? (Both of these numbers include reinvested dividends.)



The new idea is to set up a fund run by professional managers selected by the Senate, the House of Representatives, and the president that would borrow a total of $1.5 trillion over five years at the U.S. Treasury rate. The fund would invest the money in ultralow-cost index funds and similar stock investments, and profit off a predicted 3.5-point spread between the Treasury's borrowing cost and the market's return.

At first blush, putting $1.5 trillion into the market looks like it would goose stocks artificially higher. But I don't think so. That's because the U.S. market, which Wilshire Indexes says was worth $43.4 trillion as of Sept. 18, is more than big enough to absorb five annual $300 billion investments with little or no distortion.

The U.S. market has returned 10.3% a year in price gains and reinvested dividends from 1926 through this past July 31, according to Morningstar Ibbotson. If that continues, the projected profits from the difference between stocks' return and the new fund's interest cost would cover about 75% of Social Security's shortfall.

The rest would be covered by standard Social Security cost-cutting, such as increasing the full retirement age from the current 67 to 69½ over 20 years, raising the wage cap a bit, and reducing (but not eliminating) the benefits that high-income payers earn on their increased contributions.

However, there are progressive ideas here, not just benefit cuts. That's a big reason that I find this plan interesting. The bottom 20% of Social Security taxpayers wouldn't be subject to the age increase to qualify for full benefits. Also helping low earners, the minimum payment for retirees would rise.

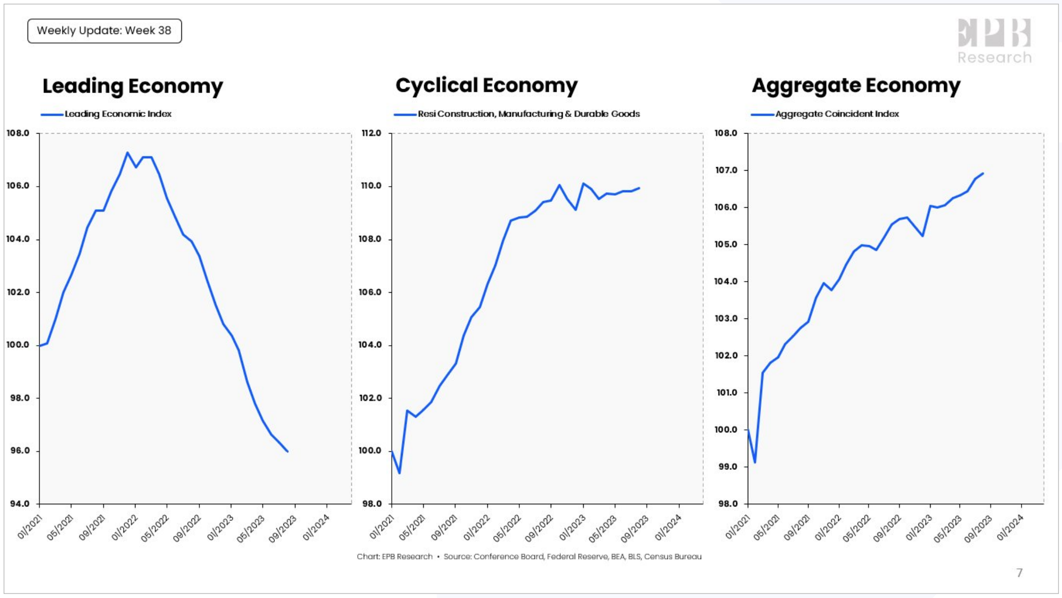
Continue reading here (subscription may be required).

Data continue to suggest the economy is moving slowly but surely toward recession (from Eric Basmajian via X on September 23)...

This was the most important chart from our last Weekly Update.

Leading Indicators have been in decline for well over a year.

Cyclical sectors have flattened out and are starting to roll over but are not yet contracting strongly.



Five clues to where the United Auto Works strike is headed next ([from The Wall Street Journal on September 23]())...

The auto workers strike is filled with wildcards.

A new union boss. Carmakers navigating a costly transition to EVs. Car dealers and auto-parts suppliers caught in the middle. And it is all happening amid a period of drastic change in how cars are made—and how we buy them.

These are some of the key factors driving events as the fight escalates, with the union striking at 38 additional locations on Friday. The UAW has never before conducted walkouts at all three Detroit automakers, Ford, General Motors and Stellantis, at once. United Auto Workers President Shawn Fain is driving that strategy, and has broken with the Detroit union's traditions in other ways as well.

The union is seeking a 40% pay increase over four years, while the companies are offering 20%. Fain also wants the re-establishment of benefits lost in previous negotiations. Is he asking too much? Detroit's three car companies are outspending nonunionized rivals on labor costs amid an expensive technological shift, and the UAW's demands risk pushing those costs higher.

Auto suppliers and car dealerships have been rebuilding their inventories after the Covid-19 pandemic ravaged the supply chain, but more cutbacks in orders and payments could create financial blows that could topple some companies.

To make sense of the unfolding situation, here are five areas to watch out for.

1. A Ford deal first

The company likely to reach a new labor deal with the UAW first is Ford.

The UAW's decision Friday to spare Ford while calling more strikes at the other two automakers signaled that a tentative agreement could be close, although both sides said significant gaps remain on key issues.

Ford and the UAW have historically had a relatively positive relationship, in part due to some key differences with crosstown rivals GM and Stellantis. For one, Ford employs more hourly unionized workers in the U.S. than its competitors.

Ford also builds its brand around supporting its factory workforce. William Clay Ford Jr., the executive chair of the company and great-grandson of Henry Ford, plays ice hockey with UAW members.

The company has also historically dodged strikes—its last nationwide strike before Fain's recent targeted walkout was in 1976.

While it has endured a single-factory strike in this round of talks, the company has been somewhat shielded from Fain's ire.

Ford executives are negotiating with Chuck Browning, who was recently re-elected to the role and has built a relationship with the company before this round of talks. Other companies are confronting new union bargaining leaders that were elected in the past year.

The UAW has filed complaints against GM and Stellantis with the National Labor Relations Board, accusing them of not bargaining in good faith. Ford hasn't faced the same action.

2. The wild-card carmaker

The UAW could confront its biggest challenge at Stellantis, a company with a globe-trotting chief executive, Carlos Tavares, who has shown he is willing to play hardball in negotiations and has the leverage of a diversified manufacturing business that spans five continents.

Stellantis, created out of the merger of Fiat Chrysler Automobiles and PSA Group in 2021, is the world's fourth-largest automaker and is less reliant on North American than Ford and GM, which generate the bulk of their sales in the U.S.

Last year, it was the most profitable of the three car companies in North America—a change from Chrysler, which had historically been the smallest and most financially challenged of the Detroit rivals. That gives the union some leverage to argue that it can afford to give back more to the workers.

Still, Stellantis also has excess manufacturing capacity in Mexico and Canada, giving it flexibility to consider moving some work to those countries if labor costs in the U.S. get too high.

The Portuguese-born Tavares is mostly based in Europe, where he has developed a reputation as a hard-nosed negotiator and adroit cost-cutter. He is used to dealing with Europe's powerful labor unions, and this is Stellantis's first go at bargaining a contract with the UAW. He also doesn't have strong ties to Michigan, like his peers at GM and Ford.

Earlier this year, he idled a Jeep plant in Illinois, angering the UAW. He cited the high costs of shifting to electric vehicles, and the factory's fate has become a focal point during talks. Stellantis has additionally proposed selling its North American headquarters, where some UAW members are based, and closing 18 other parts and distribution facilities.

The UAW has taken aim at Stellantis, accusing it of not bargaining in good faith and holding a mock picket line outside the Auburn Hills, Mich., headquarters on Wednesday. Fain himself also started his union career as an electrician at a Chrysler plant in Kokomo, Ind., where he grew up. That plant was absorbed by Stellantis in the merger.

3. Parts suppliers

Automotive suppliers could be more vulnerable to a prolonged strike than the carmakers.

While rising car prices have fueled record profits at automakers, the same hasn't been true for their parts suppliers. That is because parts makers sign up for long-term supply contracts at a fixed price, which means they have been squeezed by rising prices for raw materials and labor with little ability to pass along those higher costs.

"The supply base is not in good shape going into this," said Sheldon Klein, a Troy, Mich., based attorney at law firm Butzel Long, who represents auto-industry clients.

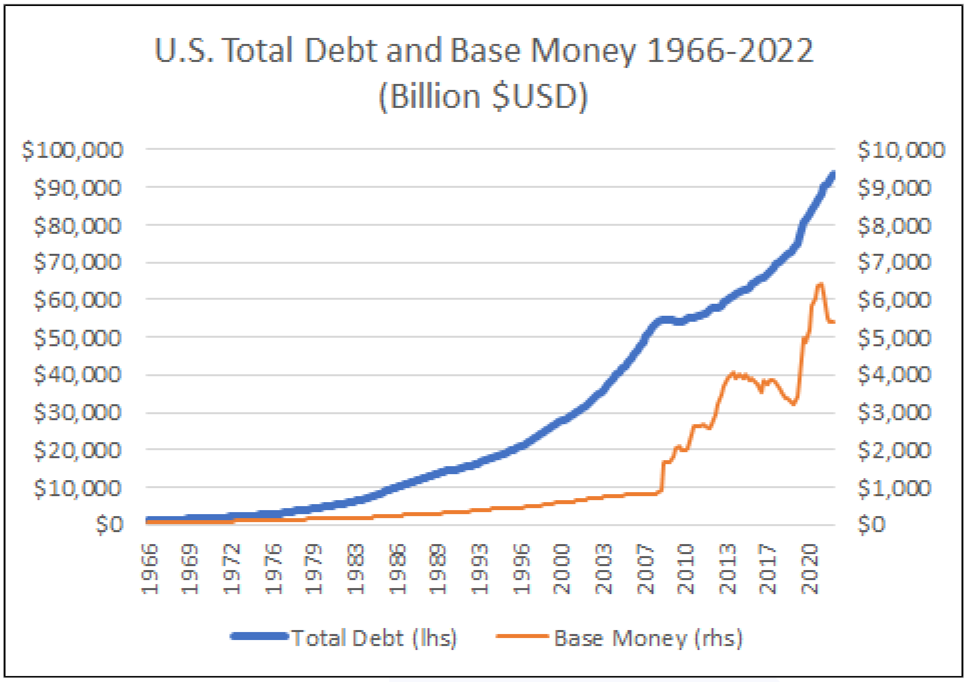
Continue reading here (subscription may be required).

Deficit-driven inflation is likely here to stay (from Lyn Alden via X on September 23)...

Generational financial crises occur when the number of debt claims reaches extraordinarily high levels and interest rate cuts can't paper over it anymore.

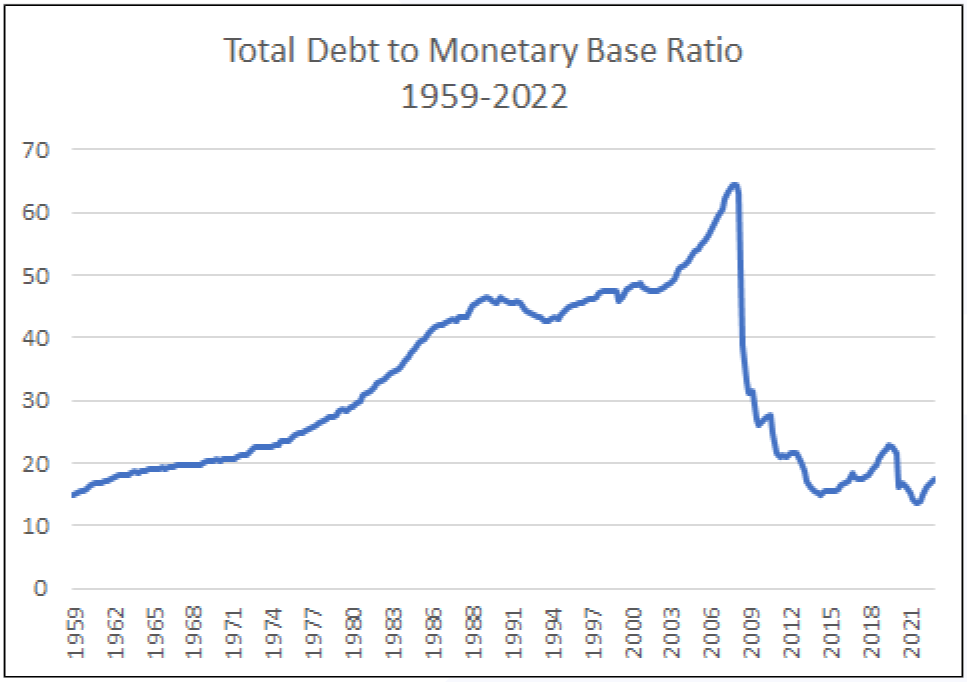
In 2008, either the number of debt claims had to collapse, or the amount of base money had to go up.

They chose the latter.



In 2007, there were 64 contractual claims for dollars (debt securities and loans) for every one dollar in base money.

They collapsed that ratio by printing a lot more base money.



The same basic thing happened back in 1929.

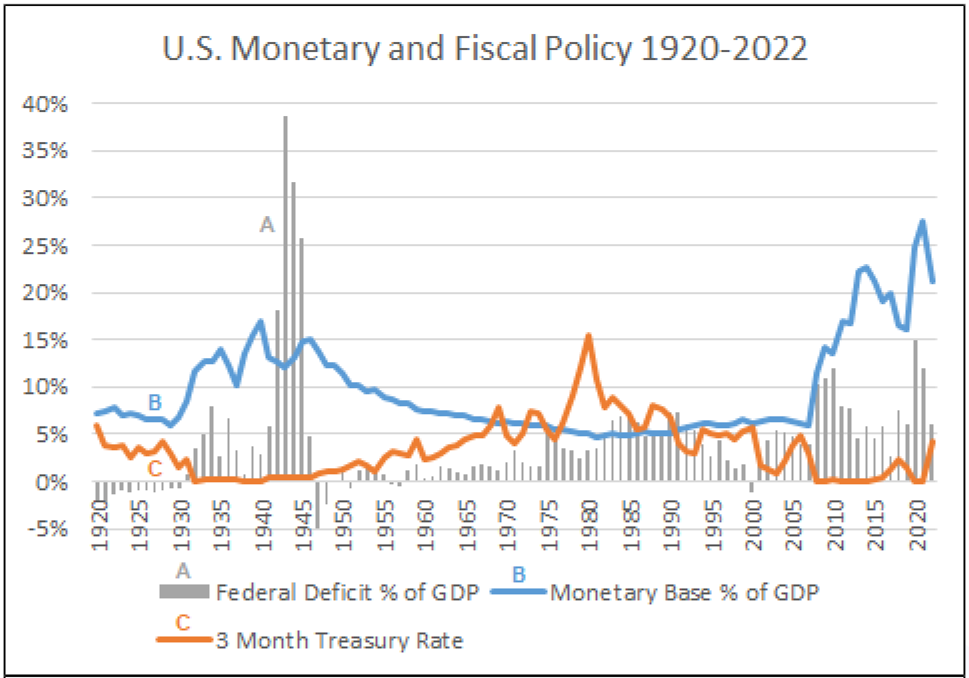
Roughly speaking:

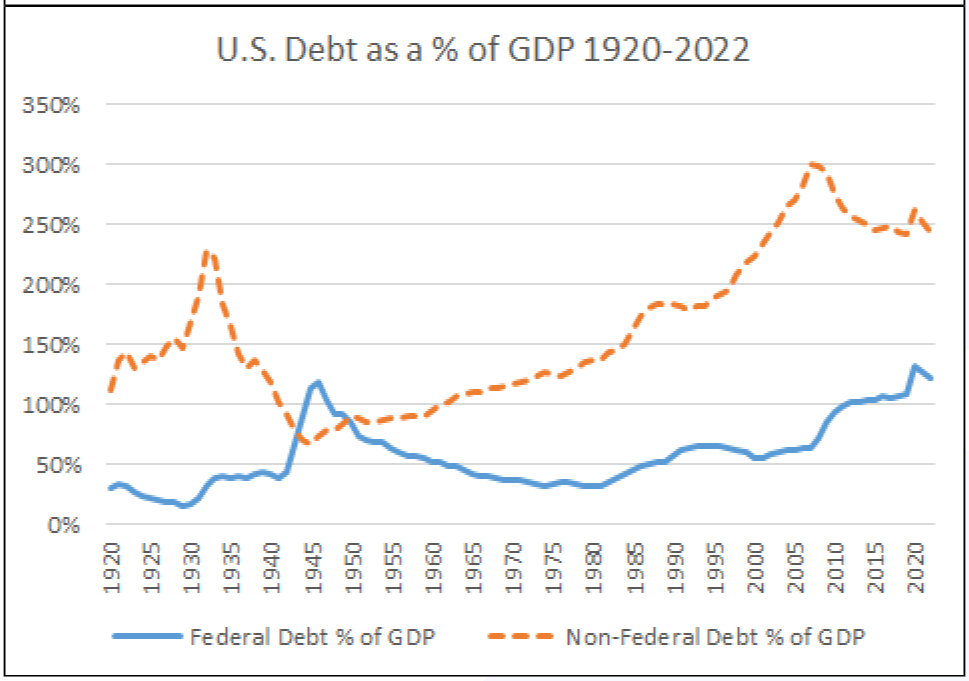
1920s = 2000s (credit boom)

1929 = 2008 (banking crisis)

1930s = 2010s (stagnation)

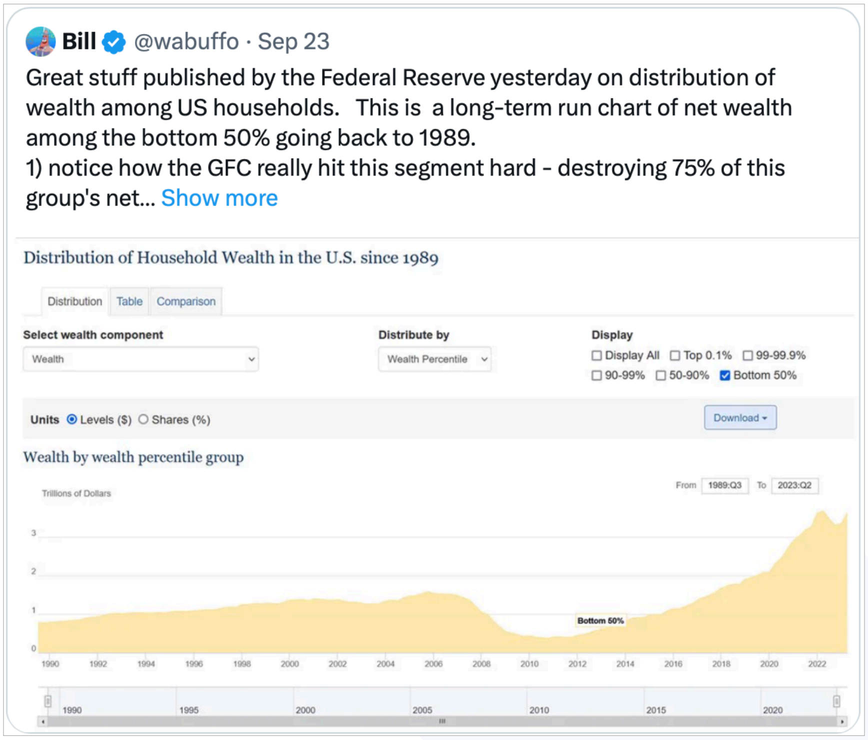
1940s = 2020s (deficit-driven inflation)



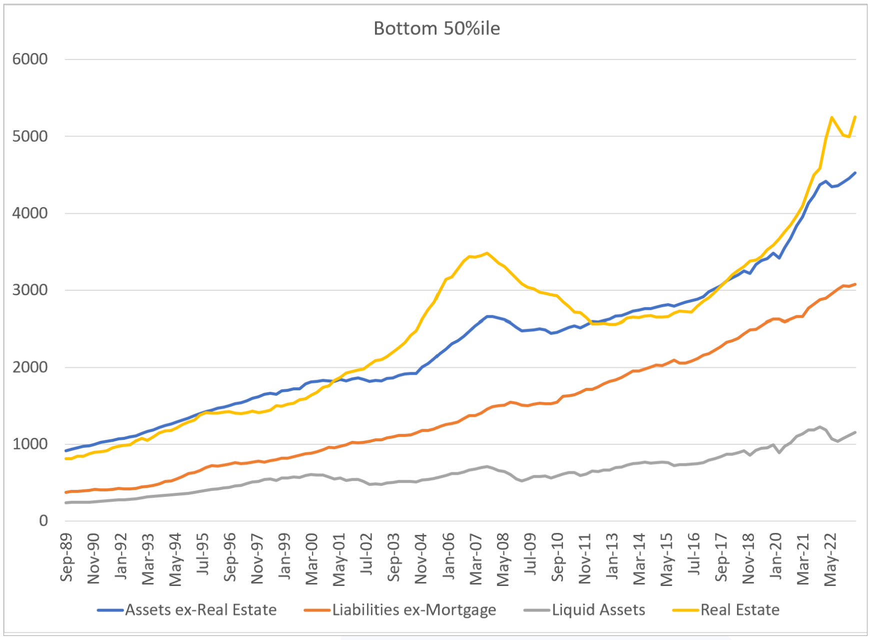


A thorough explanation of why low-income households are not, in fact, “in great shape” today ([from Michael Green via X on September 25](#))...

1/n It's always a bit sad to see posts like this proclaiming the low-end household is "in great shape." One, talk to them. They're not. Two, the analysis is just wrong. Let's dig in.



2/n The Fed data is misleading when aggregated. Several will proclaim, "it's real estate" or "of course, stock markets are higher." But neither is really the driver here. Remember in the bottom 50% of households by WEALTH, home ownership is low and few own stocks.



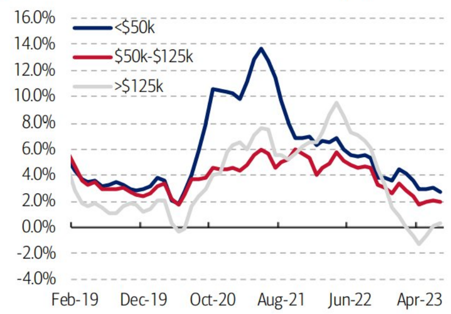
3/n And so while it turns out that the Bottom 50%ile has indeed seen the value of its real estate rise, and this does account for the majority of the gain, this is small comfort to the 2/3rds of this cohort, mostly young, who do not own homes. In fact, as shown above "Liquid"

4/n assets, which would include stocks/bonds/retirement/savings has barely budged. In fact, other than real estate where about half the asset value gain is matched by an increase in mortgage debt, the only real growth is in Consumer Durables. Cars, washing machines, etc.

Bottom 50%ile Wealth	
	Chg from Q4-2019
Total	$ 2,705,782
Real estate	$ 1,665,577
Consumer durables	$ 638,195
Corporate equities and mutual fund shares	$ 60,777
DB pension entitlements	$ 14,074
DC pension entitlements	$ 82,832
Private businesses	$ 45,008
Other assets	$ 199,318

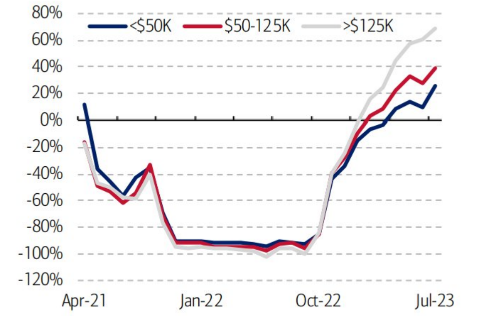
5/n I don't know about you, but when unemployment rates start to rise, I give thanks for my high auto payment and somewhat new washing machine... 🙄

Exhibit 5: After-tax wages and salaries growth by income group, based on Bank of America aggregated consumer deposit data (%YoY, 3-month moving average, SA)
Higher-income households continue to see slower wage growth



Source: Bank of America internal data

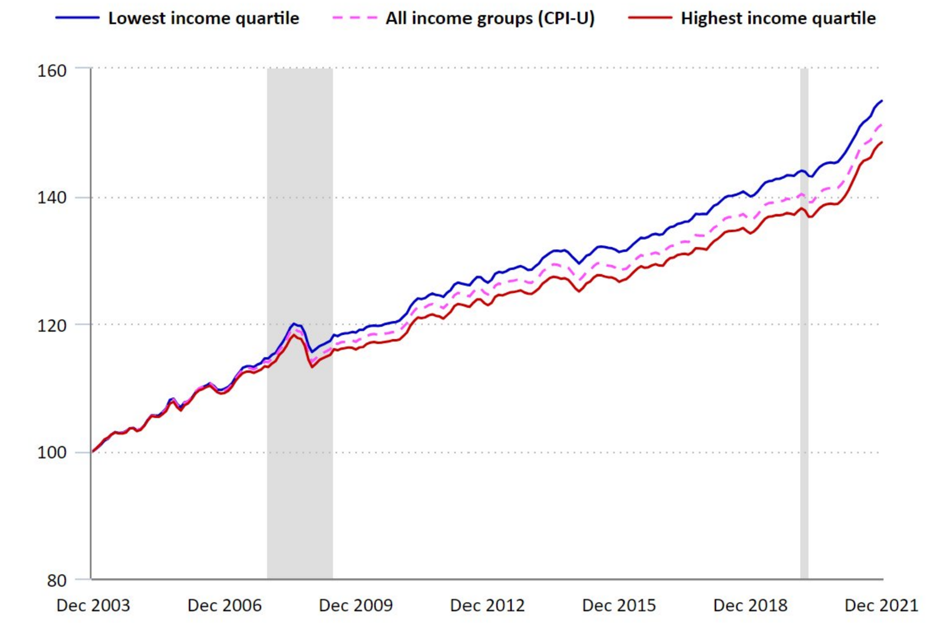
Exhibit 6: Number of households receiving unemployment benefits through direct deposit (monthly, %YoY through July 2023)
Unemployment payments appear to be rising fastest for higher-income households



Source: Bank of America internal data

6/n And all of these numbers are expressed in NOMINAL terms. The unfortunate reality is lower income consumers are MORE exposed to inflationary pressures, particularly in an environment where pricing power for consumer staples is high. Those liquid assets are DOWN in real terms.

Consumer Price Index for lowest and highest income quartiles, December 2003–December 2021
December 2003 = 100.000



Click legend items to change data display. Hover over chart to view data.
Shaded areas represent recessions as determined by the National Bureau of Economic Research.
Source: U.S. Bureau of Labor Statistics.

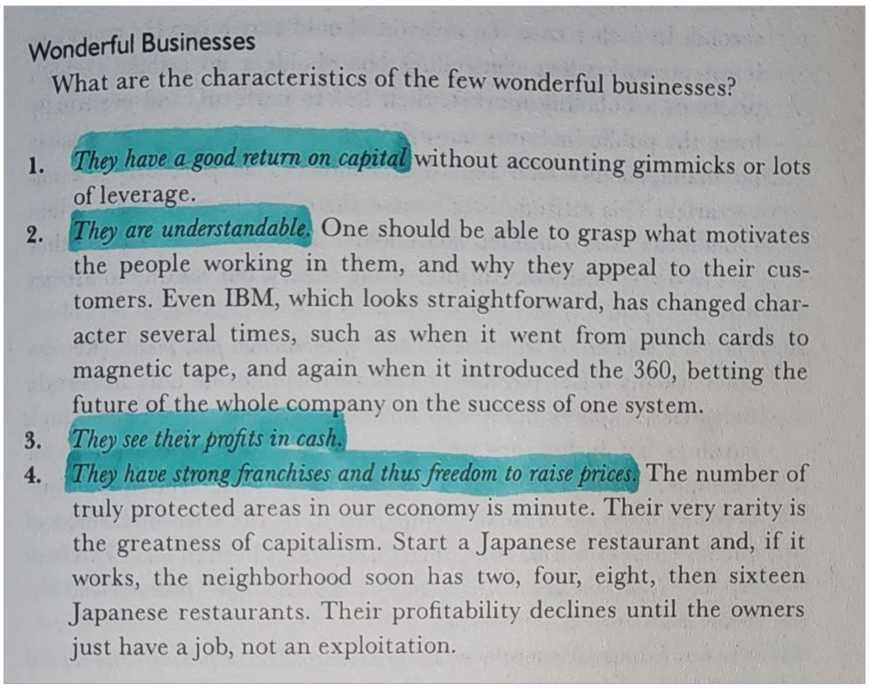
7/7 So, no man, they're pretty f'in far from OK.

The Legends Speak

Wisdom and Insight from the World's Greatest Investors

Warren Buffett's four characteristics of a "wonderful" business (from Thomas Chua via X on August 23)...

Buffett on the 4 characteristics of a wonderful business:



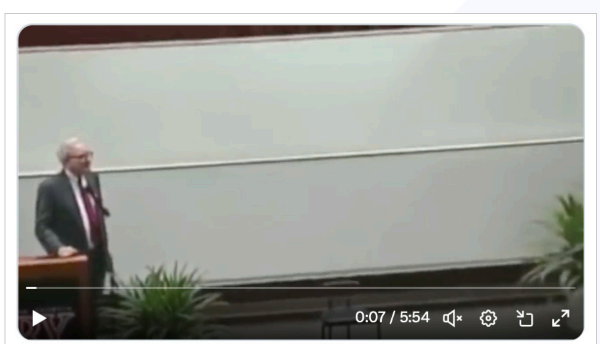
Wonderful Businesses

What are the characteristics of the few wonderful businesses?

1. *They have a good return on capital* without accounting gimmicks or lots of leverage.
2. *They are understandable.* One should be able to grasp what motivates the people working in them, and why they appeal to their customers. Even IBM, which looks straightforward, has changed character several times, such as when it went from punch cards to magnetic tape, and again when it introduced the 360, betting the future of the whole company on the success of one system.
3. *They see their profits in cash.*
4. *They have strong franchises and thus freedom to raise prices.* The number of truly protected areas in our economy is minute. Their very rarity is the greatness of capitalism. Start a Japanese restaurant and, if it works, the neighborhood soon has two, four, eight, then sixteen Japanese restaurants. Their profitability declines until the owners just have a job, not an exploitation.

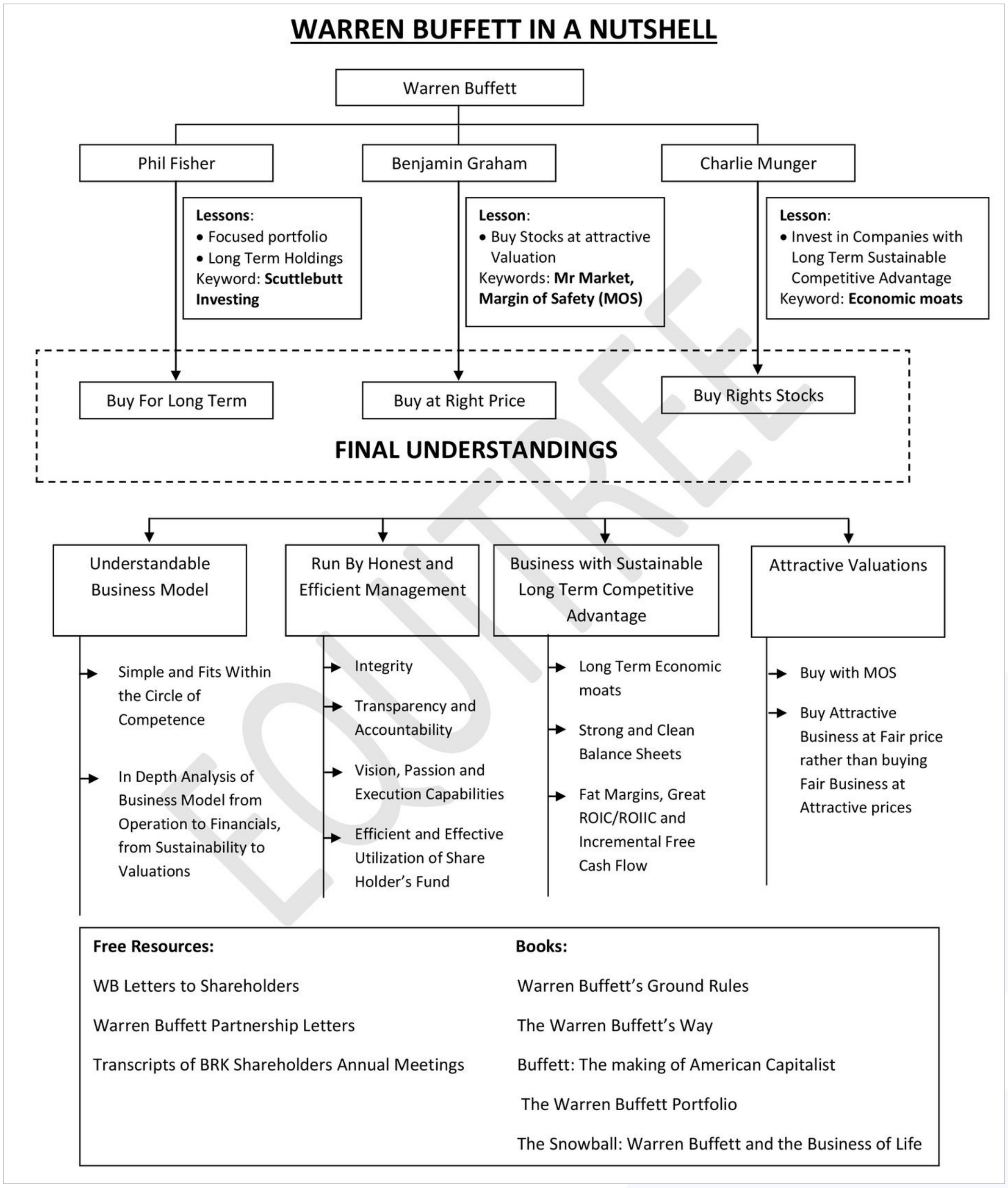
Take five minutes and watch this video now (from Brian Feroldi via X on August 26)...

Warren Buffett: How to calculate intrinsic value



A simple one-page summary of Buffett's investment approach (from Invest in Assets via X on September 3)...

Who made this? It's brilliant.



Five key investment strategies from famed fund manager Bill Miller (from Daniel via X on September 6)...

Bill Miller is the only Investor who beat the S&P 500 for 15(!) consecutive years.

He also achieved more than a decade of 20% annual return!

He might be the most “modern” value investor of our time and the answer for future value investors.

Here is his Investing Approach 👇

1. Low-Expectation Investing

The stock price implies the future expectations for a business. Miller’s most successful investments all started with investing at “low-expectation points.” Ask yourself: “Is this company on track to outperform the current expectations?”

2. Flexibility

Miller never rules out opportunities because they don’t fit certain investing labels. He focuses on return. Whenever he sees the potential for outperformance, he will consider that opportunity.

3. FCF-Focus

Critics of Miller often blame him for buying companies at high P/Es or other so-called “value metrics.” Miller does this because he only cares about Free cash flow. His main focus is assessing future FCF potential. To him, FCF yield is the most important metric.

4. Nontraditional Thinking

Miller likes to look at things from different angles. He is curious about new ideas and bases his investment approach on creativity and adaptive thinking. This reminds me a lot of Charlie Munger’s different mental models.

> **Nontraditional**
>
> Intellectual curiosity, adaptive thinking and creativity are important parts of our investment process. Our team stays current with numerous nontraditional resources, such as academic and literary journals in the sciences. We have also been involved in the *Santa Fe Institute* for more than 20 years and recently became involved with the *London Mathematical Laboratory*. Incorporating nontraditional inputs into our research and process allows us to view businesses and situations from perspectives that others may not.

5. Growing Industries

His investment record was primarily from companies and assets in new and growing industries. He understands to avoid value traps by avoiding dying industries. Instead, he focuses on companies with high FCF potential in industries with tailwinds.

Following Buffett's simple "three bucket" system can make you a vastly better investor (from Kyle Grieve via X on September 9)...

Today, Warren Buffett is worth $120.3 billion dollars. His success has come from understanding what makes a wonderful business.

He categorizes businesses into 3 simple buckets. Here's a breakdown of each (and why you only need to focus on one to become financially independent):

The Bad Business

This is the type of business you should stay away from at all costs. It has 2 major characteristics:

1. It requires significant capital to operate or grow
2. Earns low returns on invested capital (<8%)

In other words, they're money pits.

Examples include...

Airlines. They require a tonne of capital and do not earn significant returns on that capital.

Businesses with a commodity-like product, no barriers to entry, and a tonne of competitors generally make bad businesses.

Avoid these and look more at 👇⤵️

The Good Business

Good businesses are where things get interesting. These businesses:

• Require some capital to operate and grow
• Earn solid returns on invested capital (~10%)

They still require capital, but at least your returns justify ownership.

In other words:

The business isn't perfect, but it can provide the owner with a nice and steady cash flow. The business has a less commodity-like product and some competitive advantages. If you have the capital to spend, you can grow it at reasonable rates.

And now, the optimal biz 👇🏽

The Wonderful Business

This is where you want to park as much of your money as possible. These businesses have:

• High Returns
• Sustainable competitive advantage
• High returns on invested capital >15%
• Little to no capital needed to operate or grow

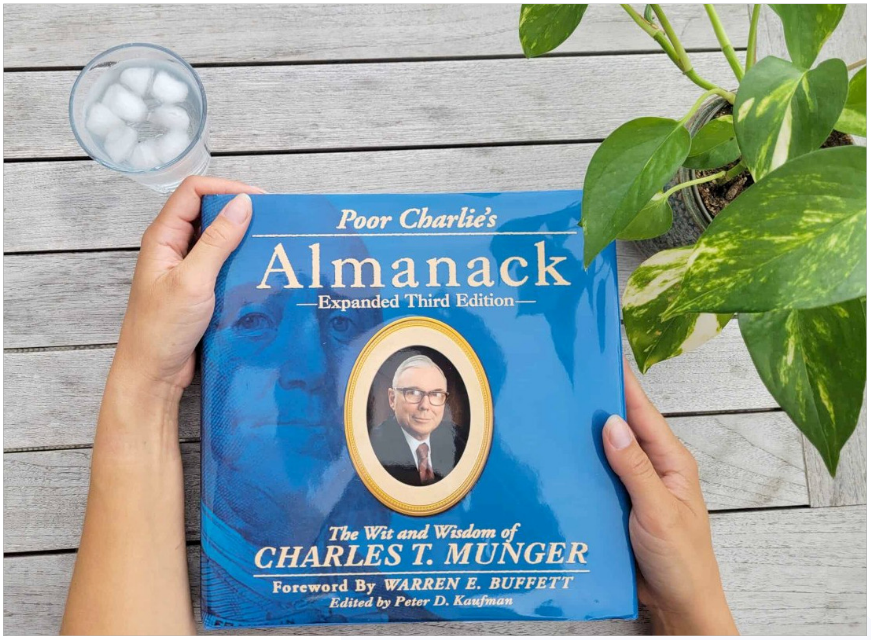
A great example? See's Candies.

Warren's invested ~$32 million dollars of incremental invested capital in this business since he bought it. Yet it's produced well over $2.3 billion in profits. This has a lot to do with its brand and pricing power.

Find a few of these, and you'll do VERY well.

Here are 12 of the top life and investment lessons from Buffett's "right-hand man" Charlie Munger (from Compounding Quality via X on September 23)...

Poor Charlie's Almanack is my Life and Investment Bible. Here's are 12 things I learned:



1. Take a simple idea and take it seriously:

- Doing a set of pushups is a simple idea
- Saving 10% of your income is a simple idea
- Investing in stocks every single month is a simple idea

2. Look for great mentors

Only work with people you admire. You'll become the average of the 5 persons you spend the most time with.

3. Swing hard when the odds are in your favor

Good ideas are very rare. When you find one, bet heavily.

4. Incentives matter

Show me the incentive and I'll show you the outcome. "Well, I think I've been in the top 5% of my age cohort all my life in understanding the power of incentives, and all my life I've underestimated it."

5. Read as much as you possibly can

The brightest people in the world are learning machines. Try to become a bit wiser every single day.

6. Avoid stupid mistakes

You don't have to be brilliant, only a little bit wiser than the other guys, on average, for a long, long time? Consistently performing slightly above average is a serious competitive advantage.

7. Avoid bad habits

Chains of habit are too light to be felt until they are too heavy to be broken. Your habits define you.

8. Always invert

If you want to solve a complex problem, invert. Always invert. Turn the problem upside down.

9. Envy is your worst enemy

The world is not driven by greed, it's driven by envy. Don't be jealous and focus on yourself.

10. Focus on financial independence

Financial independence is being able to do what you want to do, whenever you want to do it. It's the ultimate source of freedom.

11. Find your passion

If you are passionate about something, you can't help but become very good at it. You'll never have to work one day in your life when you love what you do.

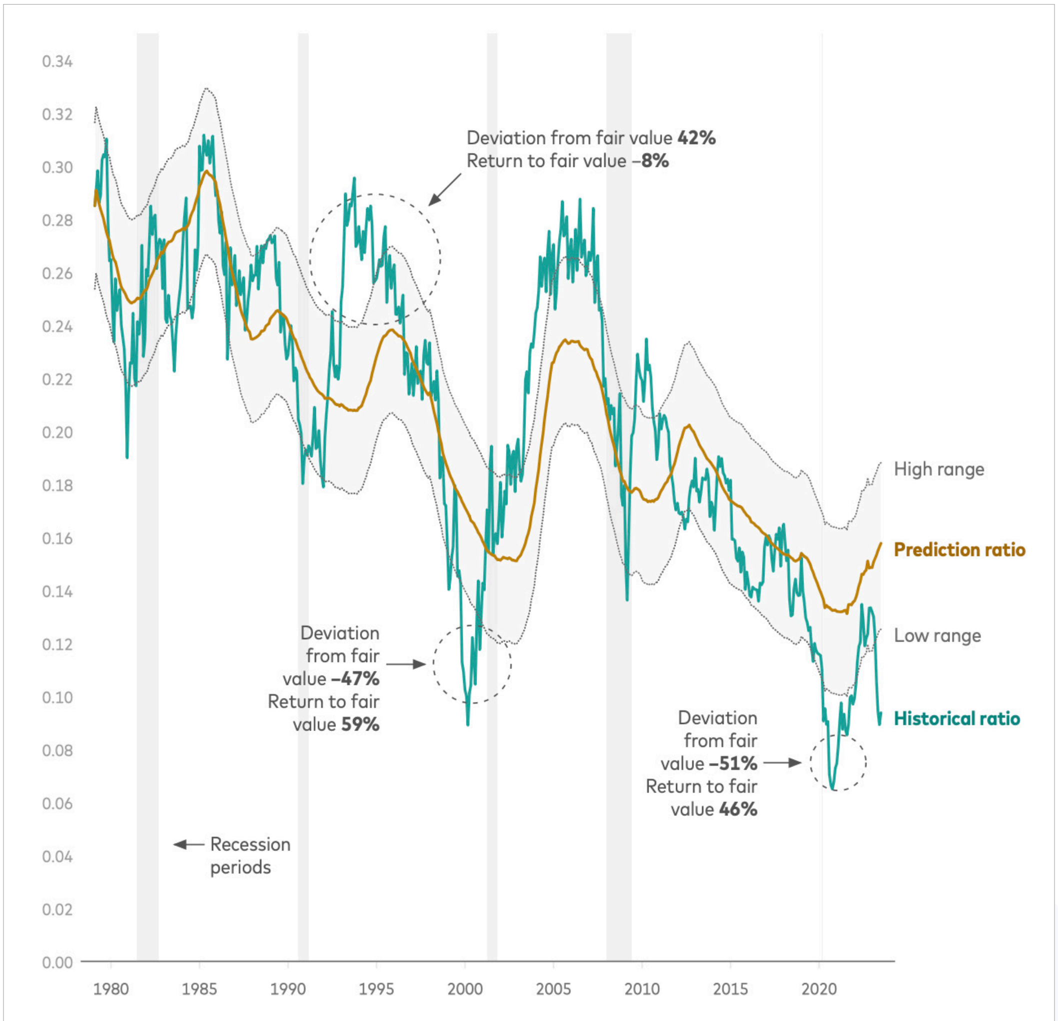
12. Stop multitasking

People who multitask pay a huge price. Focus relentlessly on one task.

Investment Ideas

Research suggests value stocks could be set to outperform again (from Vanguard on August 23)...

> As measured by the Standard & Poor's 500 Index, U.S. stocks have risen more than 20% since they hit a trough in mid-October 20221—a dismal year that brought the S&P 500's worst calendar-year decline since 2008 but just its second loss in 14 years. They've roughly doubled in value since the pandemic-induced low of March 2020 1. The extent and pace of the gains are enough to make the wary equity investor wonder: Where is there opportunity in the U.S. stock market?
>
> Once again, Vanguard research suggests opportunity in value stocks—shares marked by lower prices in relation to their enterprise book or accounting values, lower expected and historical growth rates, and relatively high dividend yields.
>
> **We've been here before—not long ago**
>
> "The value/growth relationship is at an extreme very similar to 2020," said Kevin DiCiurcio, CFA, head of the Vanguard Capital Markets Model® research team. "Now, as then, investors in aggregate are very enthusiastic about growth stocks—notably, technology shares—and seem to have limited interest in value stocks, including financial, industrial, and health care companies."
>
> The interactive chart that follows presents our estimates of the fair value of value stocks relative to growth stocks.2 When the historical, actual ratio exceeds the upper limit of our estimated fair-value range, the chance for market-beating returns appears to be larger in growth stocks. When that ratio is below the lower limit of the range, such opportunity appears to be larger in value stocks.
>
> **Value stocks appear depressed, even in the context of a long-running decline in their relative value**
>
> Value stocks' aggregate price/book ratio divided by growth stocks' aggregate price/book ratio



Notes: To assess the performance of investable value and growth portfolios, we constructed market-capitalization-weighted indexes of companies in the bottom and top thirds of the Russell 1000 Index, sorted by price/book ratios and reconstituted monthly. The valuation ratio is projected based on a vector error correction model (VECM) describing the statistical relationship between cointegrated time series. The VECM is a dynamic model of the first differences of the variables used in the cointegrating regression that includes a disequilibrium term to correct deviations from the long-term equilibrium. Monthly data begin with January 1979 and end with June 2023.

Sources: Vanguard (methodology and calculations, based on data from FactSet Research Systems) and the National Bureau of Economic Research (for U.S. recession dates).

The chart highlights the returns that value stocks recorded, relative to growth stocks, in the wake of a trio of their most extreme valuations.

Following an overvaluation in 1993, value stocks underperformed growth stocks by a cumulative 8 percentage points on their way back to our predicted ratio (the median of our estimated fair-value range). It took three years to get there.

An undervaluation near the peak of the tech bubble in 2000 preceded an instance of value outpacing growth by 59 percentage points before reaching fair value in about a year.

In 2020, another undervaluation preceded a return advantage of 46 percentage points in about 20 months. Value stocks never quite got back to our median fair-value estimate before sagging again to a similar state of investor apathy.

It's well-known, as our chart suggests, that asset prices can stray meaningfully from perceived fair values for extended periods. However, as we explained in research published in 2021 [11-page PDF], deviations from fair value and future relative returns share an inverse and statistically significant relationship over five- and 10-year periods.

Our outlook for value stocks—a solid relative performance edge

Since we issued our 2023 economic and market outlook [61-page PDF], our forecast of the return advantage for U.S. value stocks over U.S. growth stocks has risen by more than 1 percentage point, to 3.8 percentage points, annualized, over a 10-year period.3

Our expectation for a performance edge for value reflects a rotation back to growth stocks this year. Indeed, following a rebound in the relative performance of value stocks in the latter stages of 2021 and 2022, value stocks have lagged growth stocks across the U.S. market's capitalization spectrum in 2023. The Russell 3000 Growth Index, for example, returned 32% year-to-date as of July 31—more than three times the 9% return of the Russell 3000 Value Index.

There may be an economic case for value stocks beyond valuations

Market performance across the dozen U.S. business cycles since 1980 suggests another potential reason for optimism on value, DiCiurcio said.

"On average, value has outperformed during economic recoveries, historically speaking," he said. "So, if you believe that the Federal Reserve may have engineered a soft landing—that we're going to sidestep a recession and that the economy's next move is an acceleration—the case for value is strengthened."

Continue reading here.

A look at the investment strategy of one of the world's top hedge funds (that you've probably never heard of) (from Sahil Khetpal via X on August 26)...

There's a $13 billion fund that you likely have never heard of that has tripled the returns of the average hedge fund over the last 20 years.

The most surprising thing is that their investment strategy involves buying and selling the same few hundred stocks.

Let's dive in!

Greg Poole founded Echo Street Capital in 2002 at the age of 28 with less than $10 million in assets under management.

Echo Street manages $13 billion as of June 2023.

It's a fascinating story of learning and continuously improving one's investment process.

Greg Poole graduated first in his class from the University of Western Ontario.

He began his career at Goldman Sachs in 1996. By 2001, Greg had become the sole portfolio manager of the Goldman Sachs Waterside Opportunity Fund, a real estate focused long/short equity fund.

He launched Echo Street Capital in 2002. The firm was also initially a long/short hedge fund with a focus on real estate strategies.

However, what's remarkable is that Greg has reinvented the fund several times over the last 20 years.

For example, during the 2008 crisis, Greg was willing to shift focus to credit opportunities.

The biggest reimagination of the fund came in 2010 when Greg introduced the term GoodCo to his investors. GoodCo has been the foundation of their strategy ever since.

The next big evolution came in 2013 when Greg hired a young quant, Andrew Yang.

The two created the System which was a quantamental approach that automated idea generation of GoodCos and allowed the fund to run equity market neutral.

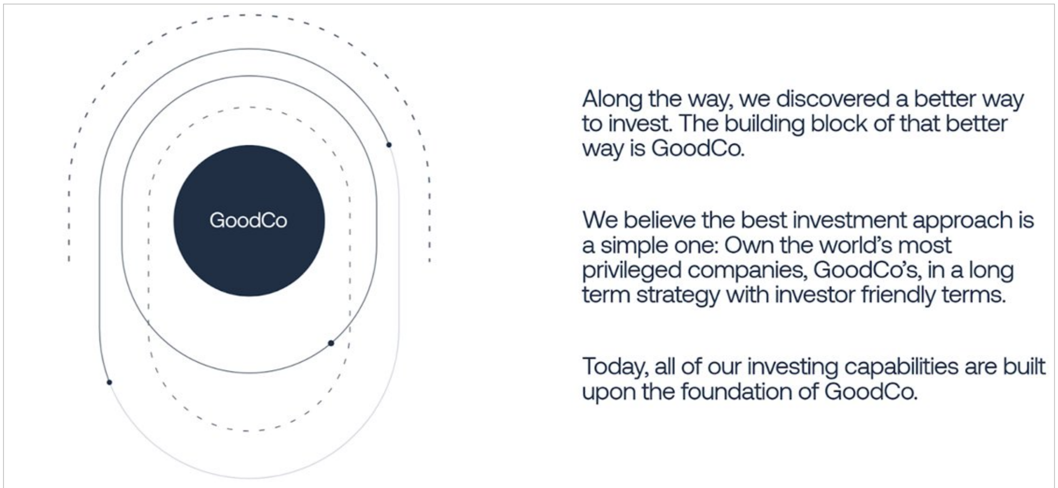
With each reinvention, Echo Street Capital extended its success.

Echo Street tripled the returns of the average hedge fund over 20 years.

Even more impressively, they beat the S&P 500 net of fees while running with 20% net equity exposure and single digit volatility.

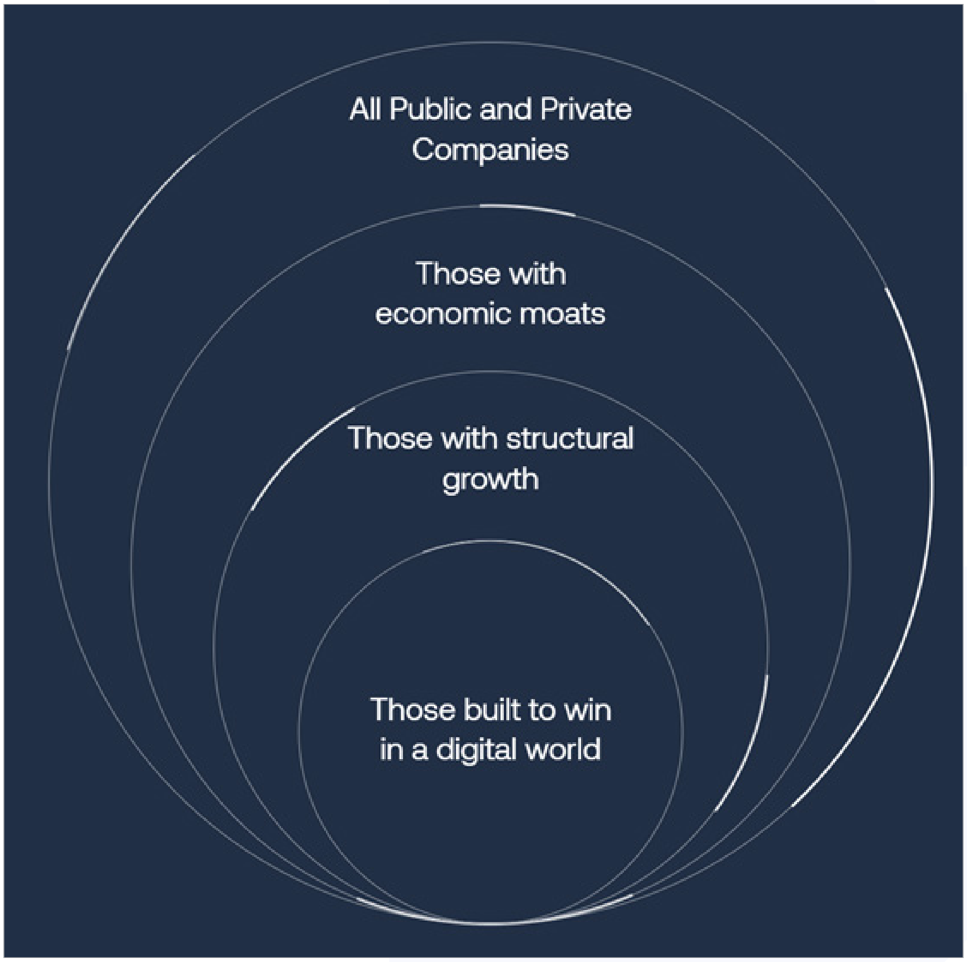
So what is GoodCo?

Echo Street describes GoodCos as "structurally superior to other companies. They occupy a privileged seat at the economic table and from that seat, enjoy higher organic growth & unusual reinvestment opportunities. These are the companies we partner with."



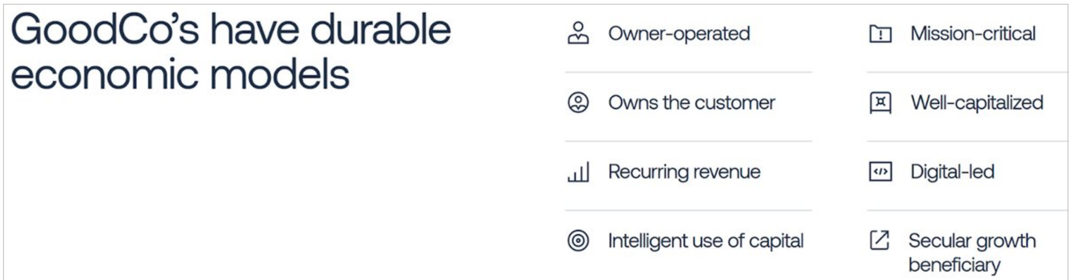
Echo Street invests in a universe of companies chosen for the consistency and durability of the earnings streams and their ability to compound value at higher-than-average rates.

Out of 60,000+ companies, only a few hundred are GoodCos.



GoodCos have the following characteristics:

1. Owner-operated
2. Own the customer
3. Recurring revenue
4. Intelligent use of capital
5. Mission-critical
6. Well-capitalized
7. Digital-led
8. Secular growth beneficiary



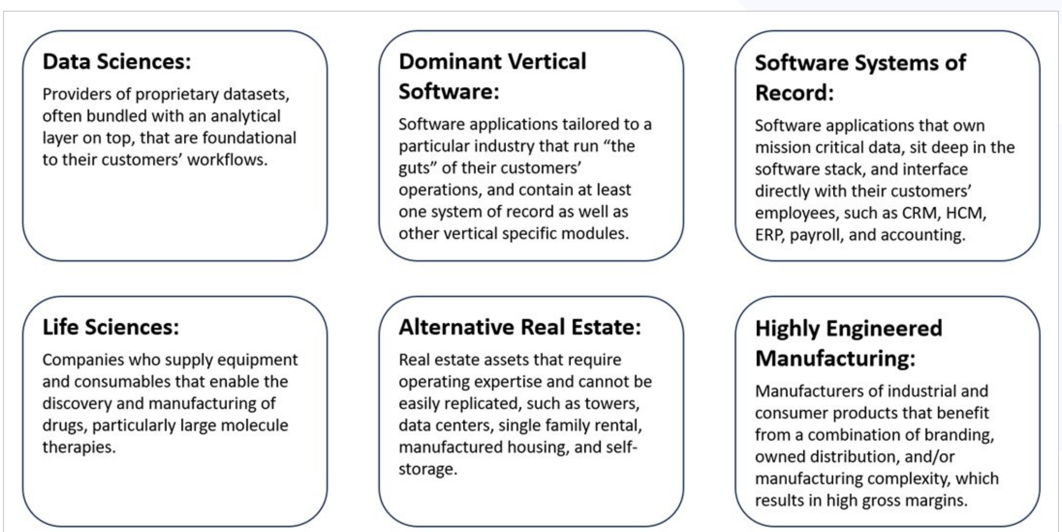
The 2 most critical criteria for GoodCos are:

Durable economic moats: entrenched within customers' workflows and difficult to displace.

Structural Growth: enjoy competitive advantages and secular tailwinds that allow them to compound value faster than the broader market.

What are examples of GoodCo's that Echo Street tracks and invests in?

- Data Sciences
- Dominant Vertical Software
- Software Systems of Record
- Life Sciences
- Alternative Real Estate
- Highly Engineered Manufacturing



Echo Street's top 10 stocks (@thetikr):

1. Microsoft ($MSFT)
2. Visa ($V)
3. Linde Plc ($LIN)
4. Sage Group ($SGE)
5. Marsh & McLennan ($MMC)
6. Paycom ($PAYC)
7. Avalonbay ($AVB)
8. Ceridian ($CDAY)
9. Appfolio ($APPF)
10. Danaher ($DHR). I wrote about Danaher in my pinned post

Echo Street Capital Management, LLC Investments

Company Name	Ticker	Reported Value of Shares Held (MM)	This Holding as % of Firm's Portfolio	# Shares Held	Change in # of Shares Held	% Change in # of Shares Held	% of Shares Outstanding Held	Holdings Date	Filing Type
Microsoft Corp	MSFT	$1,016.5	8.21%	2,984,953	(238,155)	(7.39%)	0.04%	6/30/23	13F
Visa Inc	V	$640.6	5.17%	2,697,367	221,137	8.93%	0.17%	6/30/23	13F
Linde PLC	LIN	$504.5	4.07%	1,323,878	(50,564)	(3.68%)	0.27%	6/30/23	13F
Sage Group PLC	SGE	$465.2	3.76%	39,598,861	1,400,775	3.67%	3.86%	6/27/23	UK Registers
Marsh & McLennan Companies Inc	MMC	$387.7	3.13%	2,061,367	1,190,966	136.83%	0.42%	6/30/23	13F
Paycom Software Inc	PAYC	$347.4	2.80%	1,081,346	434,467	67.16%	1.79%	6/30/23	13F
Avalonbay Communities Inc	AVB	$296.8	2.40%	1,568,286	292,385	22.92%	1.10%	6/30/23	13F
Ceridian HCM Holding Inc	CDAY	$289.6	2.34%	4,324,534	2,264,118	109.89%	2.78%	6/30/23	13F
Appfolio Inc	APPF	$278.4	2.25%	1,617,413	(49,664)	(2.98%)	7.73%	6/30/23	13F
Danaher Corp	DHR	$265.5	2.14%	1,106,405	44,748	4.21%	0.15%	6/30/23	13F
Fiserv Inc	FI	$254.5	2.05%	2,017,082	2,017,082	100.00%	0.33%	6/30/23	13F
Agilent Technologies Inc	A	$248.1	2.00%	2,063,342	402,300	24.22%	0.70%	6/30/23	13F
Mastercard Inc	MA	$244.0	1.97%	620,335	26,622	4.48%	0.07%	6/30/23	13F
Equinix Inc	EQIX	$242.0	1.95%	308,749	9,956	3.33%	0.33%	6/30/23	13F
DR Horton Inc	DHI	$241.8	1.95%	1,986,697	(635,132)	(24.22%)	0.59%	6/30/23	13F
UnitedHealth Group Inc	UNH	$228.7	1.85%	475,798	207,625	77.42%	0.05%	6/30/23	13F
Tyler Technologies Inc	TYL	$227.5	1.84%	546,370	(68,806)	(11.18%)	1.30%	6/30/23	13F
Alphabet Inc	GOOGL	$203.7	1.64%	1,702,085	1,001,165	142.84%	0.03%	6/30/23	13F
Apple Inc	AAPL	$201.3	1.62%	1,037,550	461,441	80.10%	0.01%	6/30/23	13F
Moody's Corp	MCO	$193.9	1.57%	557,706	(112,523)	(16.79%)	0.30%	6/30/23	13F
CoStar Group Inc	CSGP	$193.9	1.57%	2,178,712	(520,927)	(19.30%)	0.53%	6/30/23	13F
Intuit Inc	INTU	$187.0	1.51%	408,060	2,088	0.51%	0.15%	6/30/23	13F
NVIDIA Corp	NVDA	$180.7	1.46%	427,276	427,276	100.00%	0.02%	6/30/23	13F
Paylocity Holding Corp	PCTY	$171.0	1.38%	926,582	195,506	26.74%	1.66%	6/30/23	13F
IDEXX Laboratories Inc	IDXX	$162.2	1.31%	322,872	(65,552)	(16.88%)	0.39%	6/30/23	13F

Rows per page: 25 1-25 of 200

What also makes Echo Street's strategy unique is its quantamental approach.

For example, they classify & score economic moats and secular growth trends.

Fundamental research is augmented with charting & cyclical analysis + quant tools.

Echo Street shorted stocks with the following characteristics:

1. Business unfavorably positioned relative to ongoing secular changes

2. Management team that is unlikely adequate to respond to those changes
3. Over-leveraged balance sheets
4. extreme valuation

Beyond the specific strategy that Echo Street has executed on, what's most impressive has been Greg's willingness to keep an open mind and reinvent the fund.

He's been able to help Echo Street navigate multiple market transitions and regime changes.

Most recently he shut down the L/S hedge fund in late 2020 to focus on the long-only strategy.

"The workflow involved in finding investment ideas is joyful... the workflow involved in smoothing the ride is increasingly a soul-sapping one"

From 2002 - 2020, the L/S hedge fund returned an annualized 9.4%. It beat the S&P 500 with half the volatility.

But the firm's long-only fund returned ~21% annualized since 2015.

Mitigating short-term volatility is expensive, which is likely why they shut down the L/S fund.

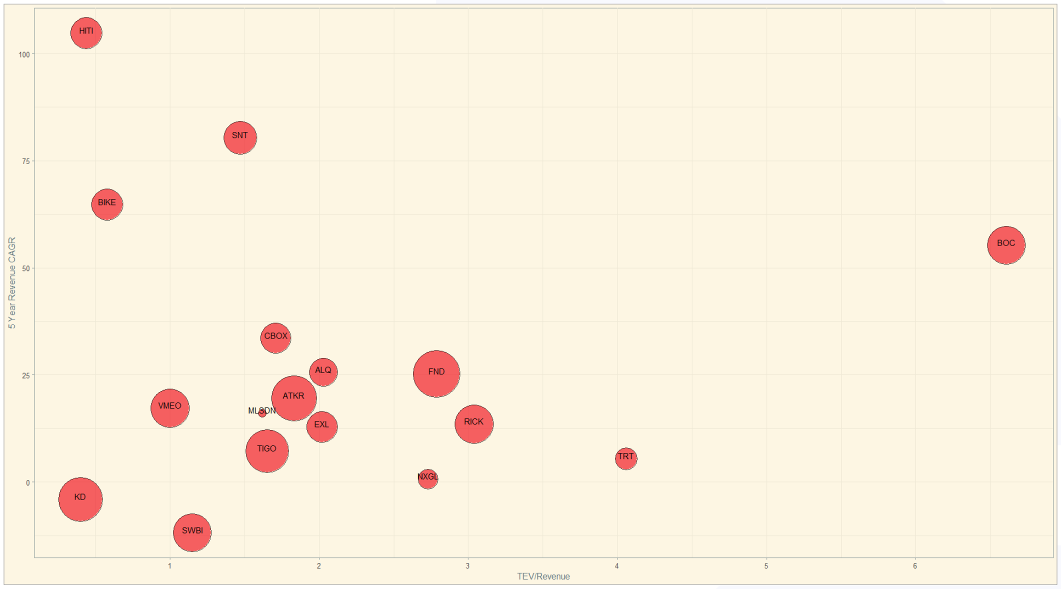
Echo Street believes they have the ability to continue to outperform.

Only time will tell if they can continue to adapt to changing market conditions!

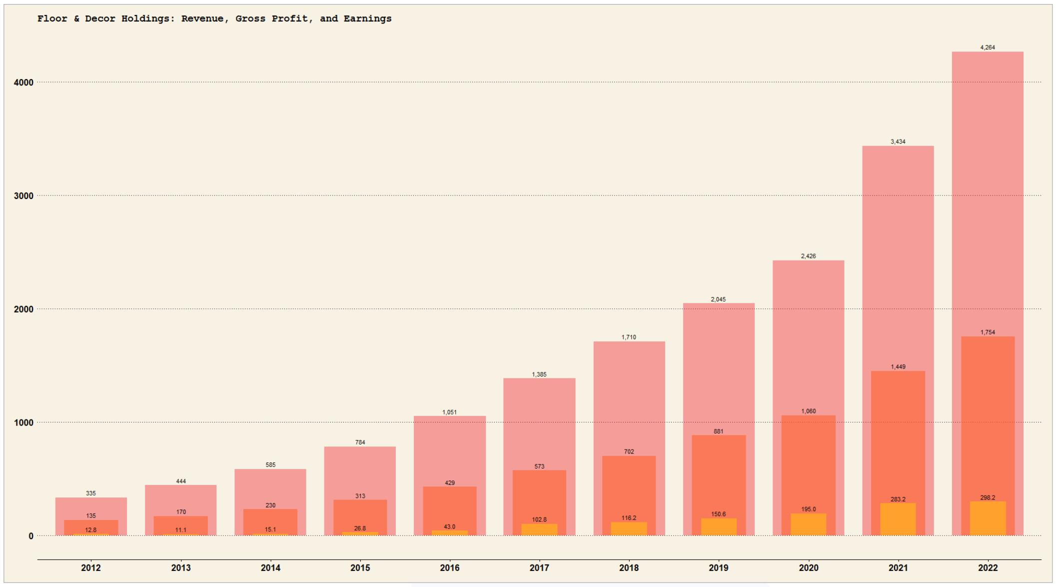
Five stocks with 10x potential or more ([from Iggy on Investing via X on September 5](#))...

Thanks to everyone who suggested possible 10-100 baggers yesterday. I charted 17 of these possible multibaggers below. To compare their growth and valuation.

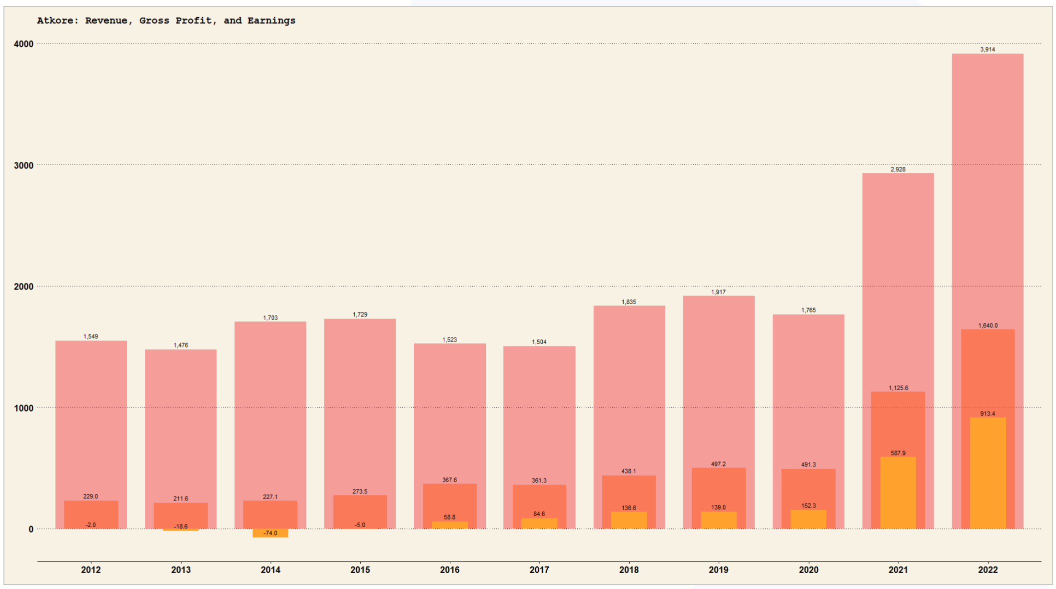
I also charted some of the financials of 5 of the companies below. 👇🧵



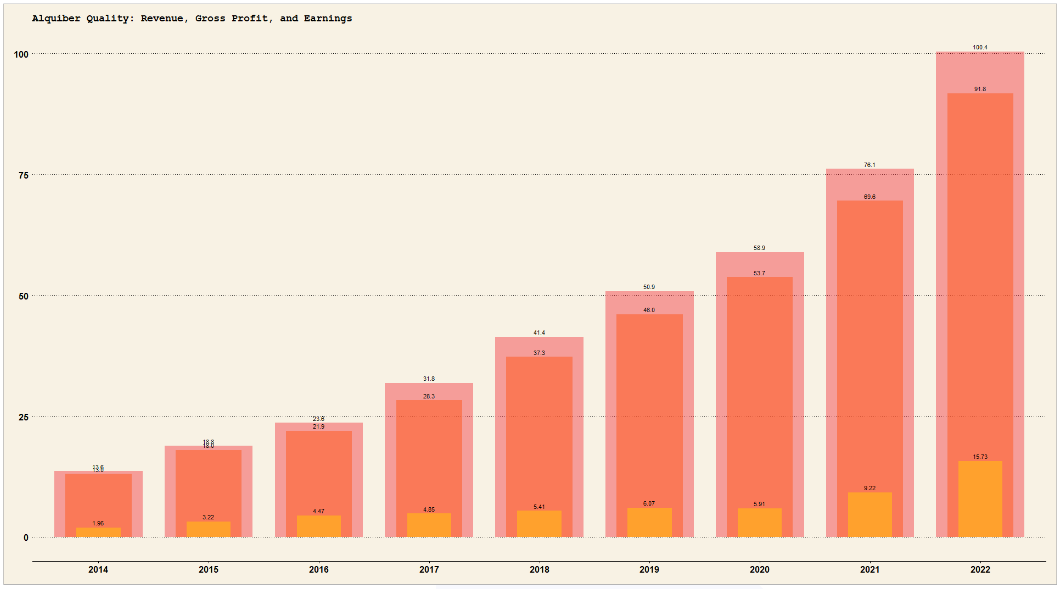
$FND Floor & Decor Holdings is an absolute beast of a company. At a P/E of 36x, it is not cheap, but if you are going to P/E 36x, you do want the financials to look exactly like this:



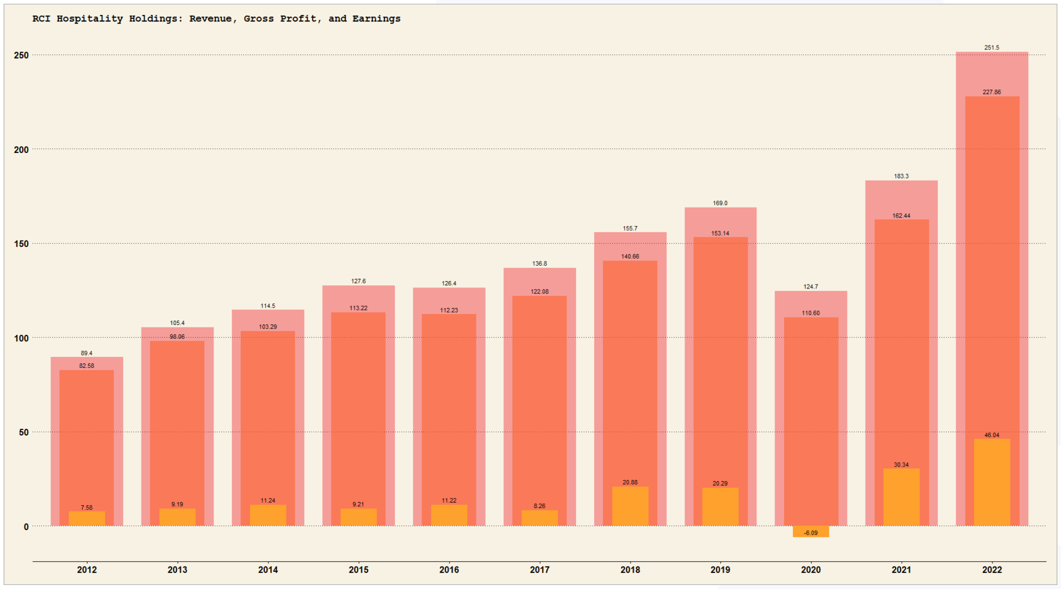
$ATKR was pitched as well. If recent trends keep up, the stock is extremely cheap at 10x FCF.



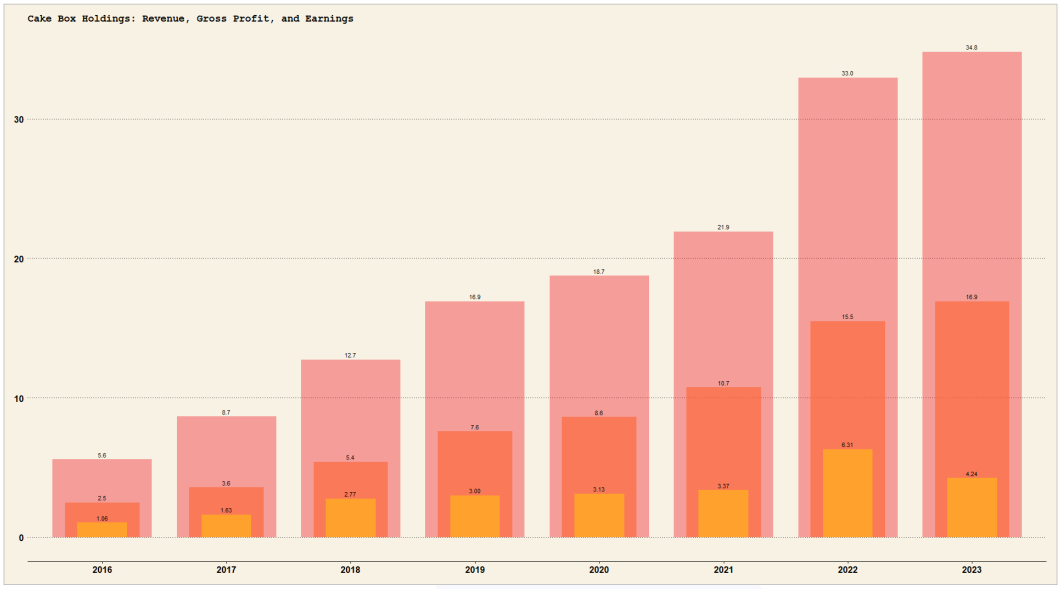
$ALQ Alquiber Quality, is a Spanish car rental company and it's an absolute beast. At a P/E of 6 it seems like an absolute steal.



$RICK RCI Hospitality is not an unknown name to FinTwit, and not without reason. The company has a great track record in an unconventional industry:

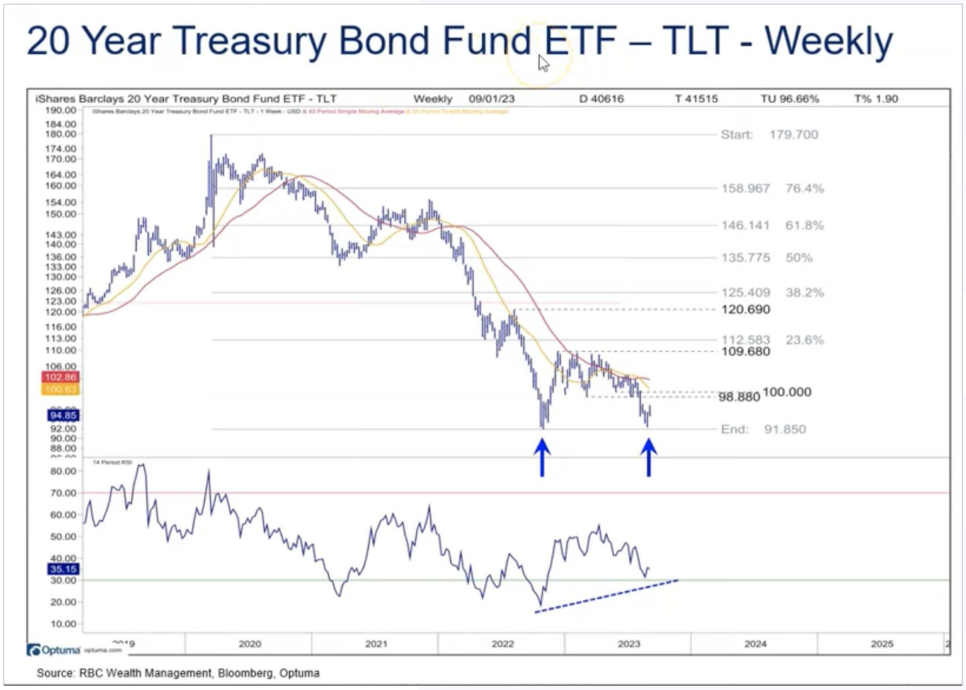


Lastly but not least, $CBOX, the egg-free cake empire in the making. With a near-cult following and an enviable franchise model, this stock could be a world-beater:



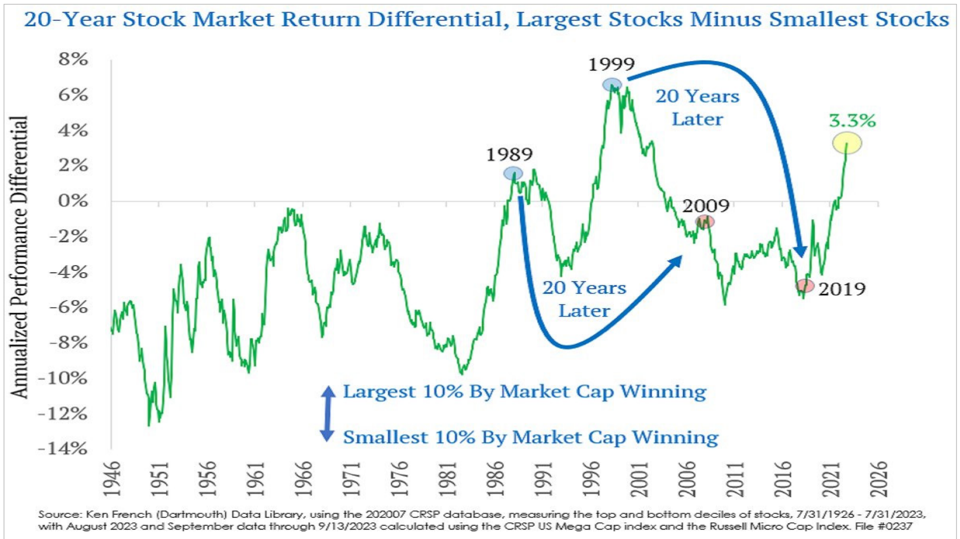
The long-term fundamental outlook for U.S. government bonds is certainly worrisome. However, the chart below suggests the iShares 20 Plus Year Treasury Bond ETF (TLT) could be setting up for a sharp relief rally (from Seth Golden via X on September 8)...

> One of the most compelling momentum divergences I've seen in a while, as yields hover around 10yr+ highs...



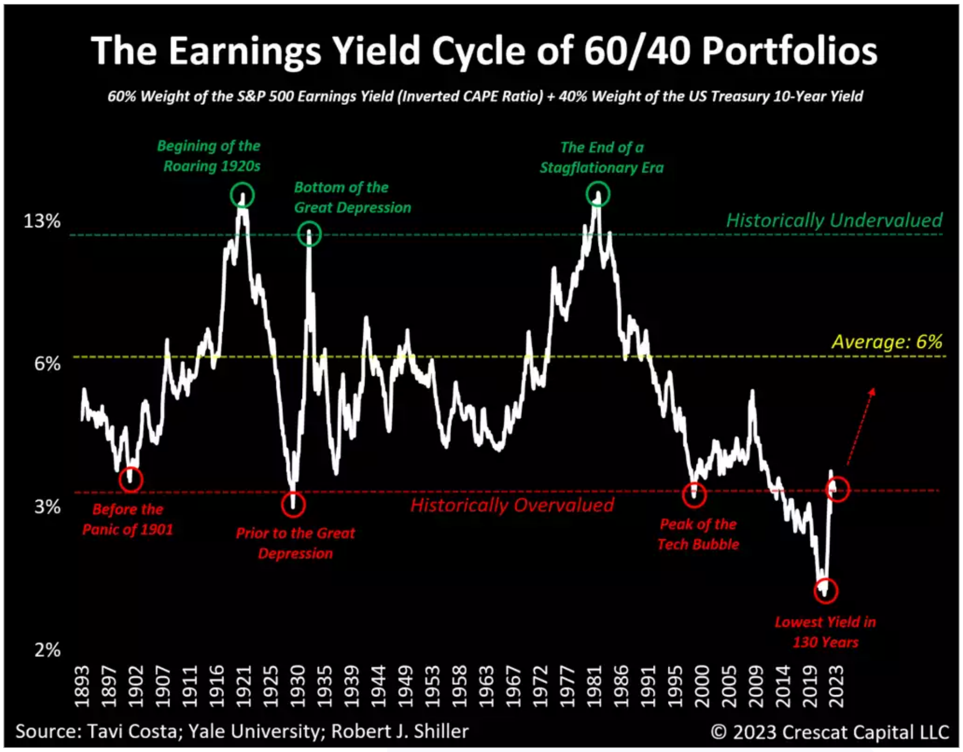
History suggests small-cap stocks could be set to dramatically outperform in the years ahead (from Jeff Weniger via X on September 14)...

> There is only one other period in the historic record where the largest companies beat the smallest companies by so much over a 20-year timeframe. That was the 20 years to 1999. The 20 years after that witnessed the total opposite: Large Caps got crushed by Small Caps.



Why it could be time to reconsider the traditional "60/40" portfolio (from Crescat Capital on September 16)...

> We believe conventional investment strategies are poised to undergo a significant restructuring, placing a prominent emphasis on investments in hard assets. As illustrated in the accompanying chart, the valuation history of 60/40 portfolios unfolds through extended cycles, and we are currently experiencing another critical juncture in this dynamic.
>
> In August 2021, the combined valuation of overall equities and US Treasuries had reached its most expensive level in 130 years. To put the current valuation imbalance into perspective, its recent peak was a staggering 61% higher than its previous peak in the early 2000s. Although prices have corrected somewhat, particularly in the Treasury market, today's elevated multiples still bear resemblance to periods that preceded significant economic downturns, such as the Great Depression of 1929 and the Tech Bust of 2001.
>
> The rise in popularity and the success of these traditional investment strategies in recent decades can be credited to a period characterized by disinflation, fostering one of the most speculative environments in the history of financial markets. It is highly unlikely that equities and bonds, given their current inflated prices, will together yield substantial returns over the next decade. This is particularly the case in a world where structural inflationary forces continue to evolve in the system, while the cost of capital is expected to exceed historical norms.



Treasuries: No Longer the Safest Alternative

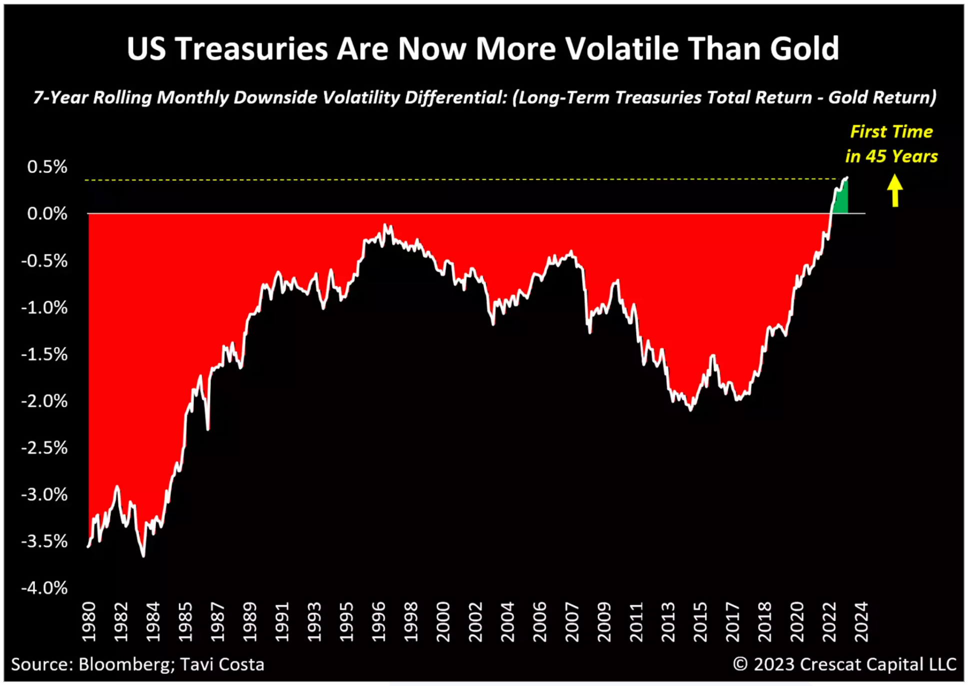
The shifting dynamics of capital moving away from crowded equity and fixed-income holdings, as investors seek new investment opportunities, could have profound implications in financial markets. This is where gold and overall commodities are poised to play a significant role during this transitional phase.

As is widely recognized, the 40% segment of these conventional portfolios, mainly comprised of fixed-income assets, has been facing substantial challenges. This has led to fundamental questions about the potential need to restructure these allocations. The main reason why investors include this portion in their portfolios is primarily because they are in search of safe-haven assets with minimal downside volatility, especially those that tend to perform well during economic downturns. Nevertheless, institutions should deeply reflect upon this crucial analysis:

For the first time in 45 years, US Treasuries have exhibited higher downside volatility than gold.

It's noteworthy that global central banks have already begun to accumulate gold for their own reasons. This effort is essential in order to elevate the standard of quality for their international reserves after enduring an extended period of imprudent monetary policy decisions. Rather than loading their balance sheets with debt instruments from another economy that is already burdened by a history of indebtedness, it is imperative for global central banks to hold a neutral alternative with centuries of proven credibility as a hard asset to become the cornerstone of their monetary systems.

We anticipate that these policy changes will exert significant influence on other major institutions, which are likely to gradually adopt gold as a haven alternative over time.

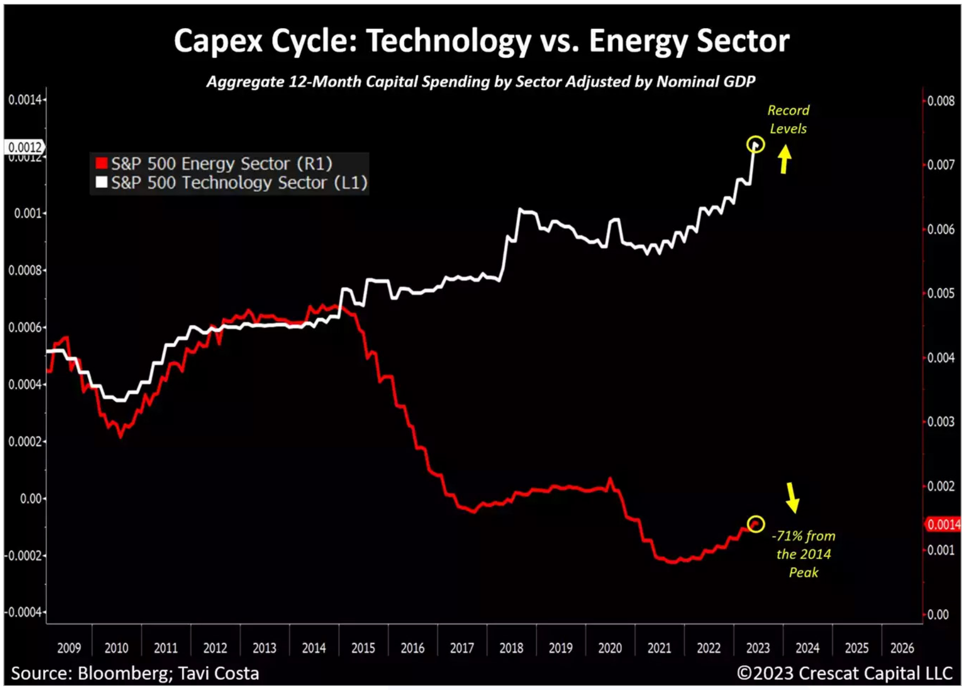


The Neglected Essential Part of Our Economy

Another reason why inflationary forces persist so prominently today can be attributed to the striking disparity in capital allocation between technology and resource industries, a problem that remains historically notable. This is indeed a concerning matter, emphasizing the prevailing investor concentration on one sector of the market, often at the expense of businesses that remain fundamental to our economy today.

It's crucial to remember that resource industries necessitate sustained, substantial capital investment to ramp up production ahead of a period of growing demand. But capital markets are often not in sync. This is why we have business cycles and the primary reason why commodity bull markets tend to begin with sharp price increases due to supply shocks. Moreover, when a sector-wide lack of investment has occurred over a long period of time, commodity bull cycles are also likely to play out over extended trends.

The rise of deglobalization and challenges in housing affordability are likely to further drive the need for infrastructure development, ultimately creating upward pressure on the demand for materials and natural resources to meet these evolving requirements.



Japan: A Compelling Case Study

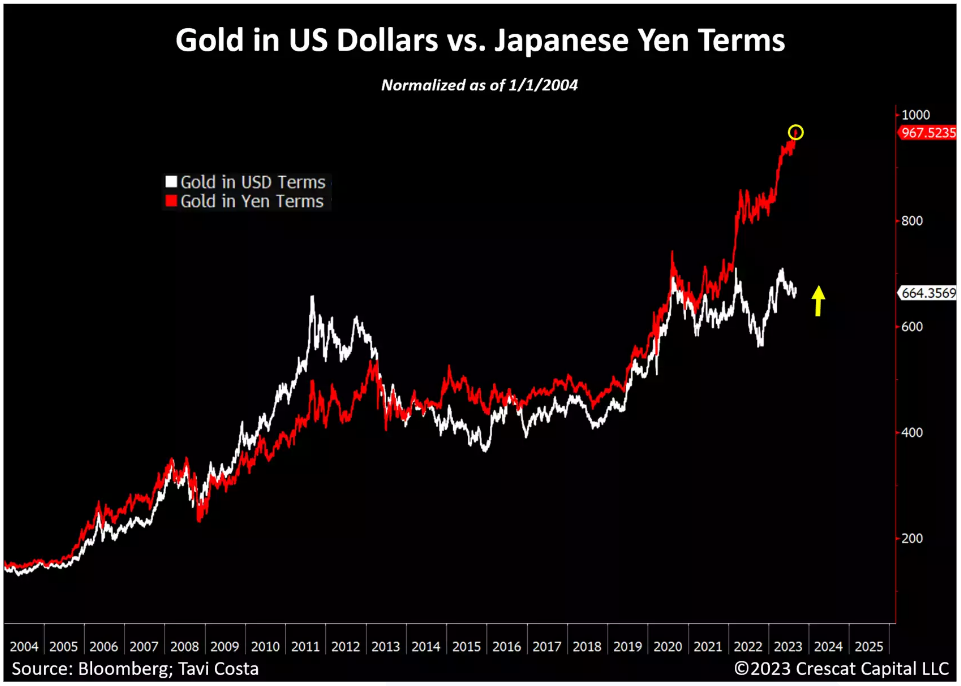
It can be challenging for most people to grasp the idea of hard assets becoming a reliable alternative to traditional portfolios, especially when looking at their underperformance during the Global Financial Crisis in contrast to the strong performance of US Treasuries. To fully comprehend this concept, one needs a deeper understanding of historical patterns, acknowledging that different asset correlations emerge during inflationary periods.

Developed economies are currently facing a chronic debt crisis, with deeply entrenched inflationary pressures propelled by escalating deglobalization, reckless fiscal spending, worsening inequality, and limited access to essential natural resources.

The Japanese economy is a compelling case study of a country that has suffered from a prolonged period of monetary and fiscal indiscipline. The fact that the Bank of Japan has made repeated attempts to alleviate the mounting cost of debt, even with 10-year interest rates at a mere 0.7%, arguably stands as one of the most significant macro events in recent times and is a roadmap for the broader global economy. Their economy's reliance on continuous government intervention vividly underscores the magnitude of the present debt crisis. It is no surprise that gold prices in Japanese Yen terms persistently reach record levels.

Make no mistake; this situation is not exclusive to Japan. The Fed, the European Central Bank, the Bank of England, the People's Bank of China, and others are on the brink of confronting the very same predicament.

In a world burdened by historical levels of debt, it's important to remember that over time, all paper currencies should lose value against hard assets. In our strong view, the yen is just an early mover.



Introducing Hard Assets to 60/40 Portfolios

Another popular argument against the idea of investing in tangible assets in today's economic environment, particularly gold, is the challenge posed by rising interest rates, as it may seem less attractive to hold an asset that doesn't yield anything. However, historical examples contradict this notion. Gold delivered some of its strongest performances during the 1970s, despite the backdrop of increasing interest rates.

This trend isn't limited to that specific decade; you can find similar instances in the 1910s and 1940s. While gold prices may not have been freely floating during those periods, other tangible assets, such as commodities, demonstrated remarkable performance.

There is a clear and compelling reason why the current price of gold remains impressively resilient despite the pressure from real rates. The weakening of the correlation between inflation-adjusted yields and precious metals is becoming more apparent. With inflation running hotter than historical standards, gold is highly likely to decouple from Treasury prices, much like it did during the 1970s.

Who would have thought that in such an intricate macro environment, there would be so many skeptics about owning hard assets?

Continue reading here.

Three top resources for identifying stocks with the potential to soar hundreds or thousands of percent (from Kyle Grieve via X on September 17)...

> Multibagger stocks are available 365 days of the year IF you know what to look for.
>
> Here are the top 3 resources that will help guide you to know what to look for:
>
> **Global Outperformers by @dede_eyesan**
>
> My favourite quote from the book:
>
> "As expected, a large part of global outperformers was concentrated within the nano caps segment (63%), which was significantly higher than nano caps representation within the broader global public stock market (46.5%) as of 2012. Nano caps were the only segment overrepresented relative to the overall market. Large caps, on the other hand, were the most underrepresented segment as only seven companies delivered outperformance."
>
> Another great insight was how powerful expanding margins are to prices.
>
> The market pays up for high operating margins. If you can find a business with operating leverage trading for a good price, you'll get multiple expansion over time.

Multiple EV/ Revenue	Number of subset companies	% of subset	FY 2012 Median EBIT margin	FY 2012 3-Year Revenue growth (CAGR)	Median Earnings growth (T 3 years
0 - 0.5x	99	24.6%	4.4	9.8	-
0.5 - 1x	105	26.1%	7.6	11.3	11.0
1 - 1.5x	62	15.4%	9.5	12.8	-
1.5 - 2x	41	10.2%	14.3	9.0	11.0
2 - 3x	35	8.7%	14.4	15.9	7.7
3 - 4x	16	4.0%	17.0	18.0	17.0
>4x	45	11.2%	21.2	26.5	21.8

100-Baggers by @chriswmayer

My favourite quote from the book:

"When you get lots of growth and a low multiple you get the twin engines of 100-baggers. That's where you really get some great lift, with both factors working in your favour."

A major insight that this book taught me was how important it is to hold onto your investments. It's rare a multi-bagger will have a stock price that moves up linearly. You must be prepared to weather the storm of price fluctuations.

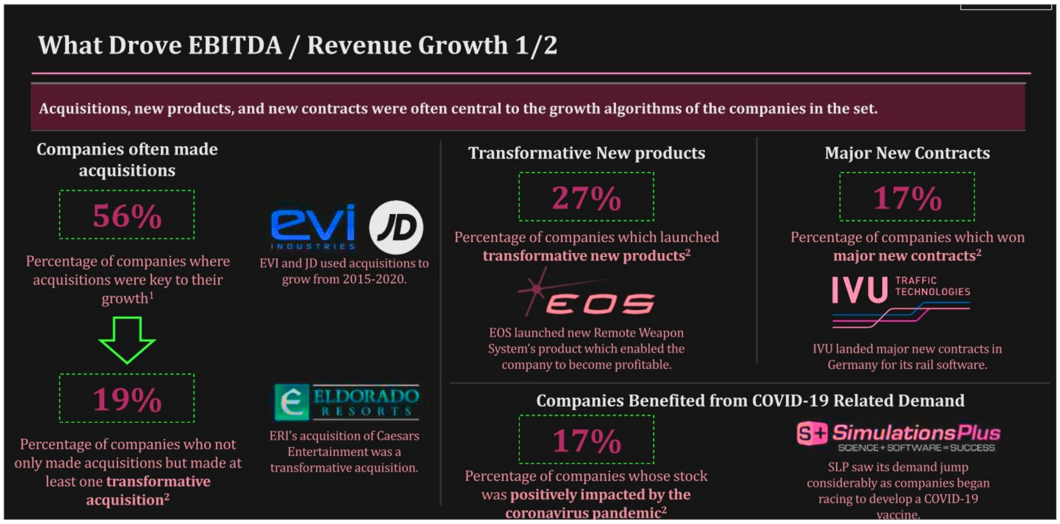
Making Of A Multibagger by @AltaFoxCapital

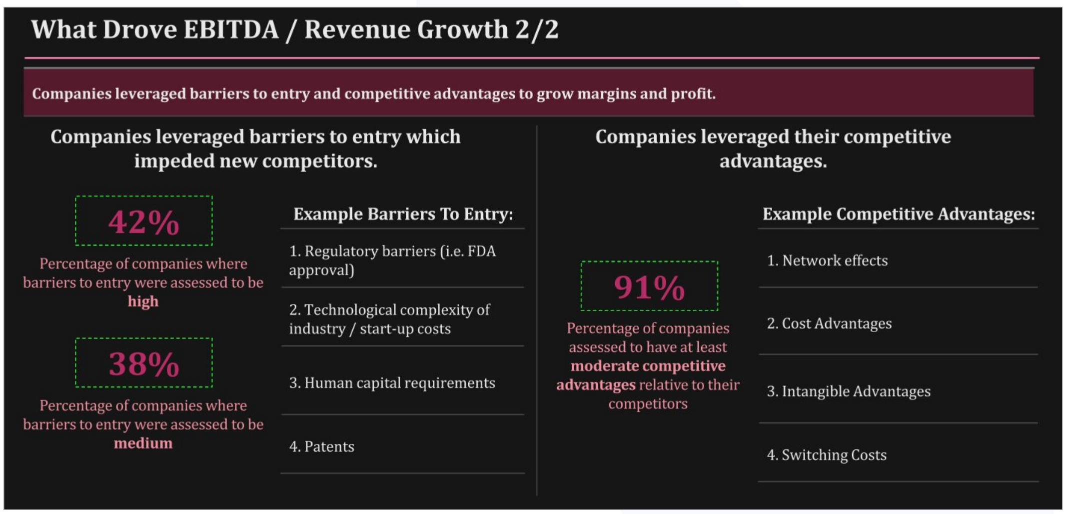
One quote that stood out to me was how little emphasis we should place on dividends:

"Dividends seldom made a major impact and only drove >10% of total shareholder returns for 2 companies."

I really liked the section in the study that discussed what drove growth:

• Acquisitions
• New Products
• Major New Contracts
• Competitive Advantages


What Drove EBITDA / Revenue Growth 1/2
Acquisitions, new products, and new contracts were often central to the growth algorithms of the companies in the set.
Companies often made acquisitions
56%
Percentage of companies where acquisitions were key to their growth1
19%
Percentage of companies who not only made acquisitions but made at least one transformative acquisition2
evi INDUSTRIES
JD
EVI and JD used acquisitions to grow from 2015-2020.
ELDORADO RESORTS
ERI's acquisition of Caesars Entertainment was a transformative acquisition.
Transformative New products
27%
Percentage of companies which launched transformative new products2
EOS
EOS launched new Remote Weapon System's product which enabled the company to become profitable.
Major New Contracts
17%
Percentage of companies which won major new contracts2
IVU TRAFFIC TECHNOLOGIES
IVU landed major new contracts in Germany for its rail software.
Companies Benefited from COVID-19 Related Demand
17%
Percentage of companies whose stock was positively impacted by the coronavirus pandemic2
SimulationsPlus
SCIENCE + SOFTWARE = SUCCESS
SLP saw its demand jump considerably as companies began racing to develop a COVID-19 vaccine.


What Drove EBITDA / Revenue Growth 2/2
Companies leveraged barriers to entry and competitive advantages to grow margins and profit.
Companies leveraged barriers to entry which impeded new competitors.
42%
Percentage of companies where barriers to entry were assessed to be high
38%
Percentage of companies where barriers to entry were assessed to be medium
Example Barriers To Entry:
1. Regulatory barriers (i.e. FDA approval)
2. Technological complexity of industry / start-up costs
3. Human capital requirements
4. Patents
Companies leveraged their competitive advantages.
91%
Percentage of companies assessed to have at least moderate competitive advantages relative to their competitors
Example Competitive Advantages:
1. Network effects
2. Cost Advantages
3. Intangible Advantages
4. Switching Costs

Here's a crowdsourced list of the most promising small-cap investment ideas (from Clark Square Capital via X on September 19)...

> Here are the responses to the question: "What's your favorite idea with a market cap below $500m USD right now?"
>
> Thanks to everyone who contributed! 🙏

Ticker	Description
TRST.LN	High-quality SaaS business trading at ~1.6x EV/ARR that will breakeven this year and likely re-accelerates from a mid-teens top-line growth to >20%. UK market already v. profitable.
CBD	CBD Stub. Classic "buy assets, sell earnings" play. Trading at ~0.15x EV/sales while comps trade at >0.5x. Selling off Cnova shares soon and real-estate. Holders dumping post-spin, so some technical weakness that likely subsides soon.
NR	Classic good co / bad co setup. Industrial manufacturer and leaser of mats used in construction sites. Has a fluid sytems biz for o&g that is currently under strategic review / will likely be
LFCR	In midst of strategic review with a potential deal above $20/sh on an $8 stock today.
TBLD	Highly asymmetric bet. Well capitalised with a strong net cash position. Could 5x from here and still be cheap. Potential for substantial growth. High insider ownership.
ECOR	Mining royalty company focused on future facing commodities like Cu, Ni, Co, and U, that trades at 50% of a conservative estimate of NAV (which has plenty of upside).
FSTA.LN	Premium pub chain based in and around London trading at around 50% of the value of its Freehold estate (and historical valuation multiple). Majority family owned.
517.HK	Shares trade at 3 HKD while net cash is 4 HKD. 100% payout ratio and doing buybacks. Dividend yield >10%. Majority of cash in USD earning 4-5%
ASPN	They make high performance insulation products, have been scaling up in the energy, shipping and transportation sectors but now they're getting into autos and recently announced partnerships with $GM and a large German OEM (they won't say which one yet) plus energy storage systems.
LOGI.B	$150m Swedish Ind/Logistics PropCo, was overleveraged, just did dilutive rights issue to repay floating rate bonds. Trades at an 8% cap rate / ~50% disc. to NAV at mid 6% market cap rate. Swedish RE manager bought out Ilja Batjan, now largest SH, take private candidate
VMD	Capital light non invasive vent company. Fast growing but slowed down by Covid. Focused on adoption of NIVs, with regulatory barriers to entry.
TVK	Compounder acquiring boring businesses in fuel containment and related industries for cheap. High ROE, trading at 10x FE
RAVE	Microcap pizza franchisor that used to have a large presence in the southeast. Ran into trouble but has new CEO (involved in dominoes turnaround). Already growing at >20%, with plans to expand to prior presence and take advantage of large fan base in south. Very cheap.
ONEW	Extremely cheap (4-5x multiple) boat dealership rollup play. Industry running into headwinds, but future path for acquisitions still wide open even if industry slows down. High roe with experienced ceo (insider ownership). Local monopolies with dealerships acquired.
CTLP	#1 POS provider in unattended retail in US. ~70% of revs repeatable (subscription + transaction). Mid-teens grower, software growth driving margin. Their FY26 target puts them on 6x EBITDA, 9x FCFE. 1.7x sales crntly. Think they can grow + expand margins for a long time.
CSUD3	CSU Digital, traded under the ticker #CSUD3 on the Bovespa Stock Exchange. It is a more mature fintech with net income of R$85 million (US$17m) and MCap of R$664m (US$135m). EPS is growing high-single, low-double digit, with 50% dvd payout.
4384.JP	Japanese stock growing revenues organically +30% y/y, producing +20% ROE, and trading at 24x NTM earnings. The moat is durable, and the company anticipates a further +20% gross profit CAGR thru '25 at a 20% ROE. Buying back shares as well.
KLXE	Oil service company, closing in on $1bln in revenue and trades at 2.5x ebitda. Bonds traded up from distressed levels to par and when refinancing of the 11.5% will occur this will be a major catalyst to rerate stock much higher
SMCRT	Oslo based vertical SaaS focused on the construction sector - offers digital solutions to SMBs aimed at replacing pen & paper, therefore increasing efficiency & reducing costs / delays. Highly acquisitive w/ management pursuing industry consolidation by buying other players at low multiples
DJCO	Growing journal technologies which will benefit as more and more courts switch to online services and databases. Los Angeles uses them currently.
PBI	~500M - special situation play with 2 really stable businesses that generate ~500M ebitda and 1 that needs to be divested (gec). Entrenched board and ceo needs to be ousted to unlock value. Activist investors already won 4 of 10 board seats this summer.
EGAN	$200 mil MCap, ~ $100 mil rev runrate, ~ $75 mil cash, CEO hasn't sold a share since 2000.
EGHT	High flier left for dead, 90% retention Saas at <1x sales / <5x FCF, accelerating to 10%+ growth, -20% this month on index deletion. Downside is m&a @30 % premium (sylebra pushing for $RNG but PE more likely) and upside is 15% growth for a few years + re-rate to 3-4x sales
MITK	Slowly declining cash cow + growing identify verification SaaS.
BHM	REIT trading at a market cap less than it's cash balance.

Ticker	Description
NGS	Rent natural gas compression equipment. Industry is acutely short supply. Undertaking large investment cycle with good contracts; new equipment just rolling out now. Trades huge discount to $AROC, $USAC and $KGS (bigger, very leveraged peers). Might get sold
SIGA	Currently trading at a forward p/e of less than 4. The next 3 q's will be highly profitable and seem to be gaining government customers around the world with their live saving small pox
MORE.LN	Cheapest restaurant chain in the world. some hair of course..
HQI	Staffing company roll up, sold off due to expenses from an acquisition, possibly an expectation of labor slowdown
CLFD	Fiber equipment manufacturer. Government incentives should increase rural fiber buildout, which is CLFDs core customer base.
AEP.V	Roof/floor trusses engineer/manufacturer in mainly rural Canada. Business is cyclical since it's residential construction - but they have good capital allocation. They acquire other plants in rural areas where they have little/no competition at very reasonable multiples.
DUR.AX	Duratec: Is placed within the E&C industry, however, it's typical operations involve remediation & restoration on existing assets to some tier 1 clients
JRNGF	Canadian oil E & P company, undervalued compared to competition. Also has power generating plants to make use of gas that might otherwise be flared off.
BLND	Going through it with mortgage apps at generational lows, but a huge value add for banks. They make banking software for consumer banking and mortgage processes.
PLCE	Significantly lower cotton/freight prices will help them generate significant earnings 2nd half of the year and into 2024. Should be able to generate atleast $6 of eps in 2024 which at 8-10x is around $50-60 share price
SUP	Despite artificially low production of cars, co has fundamentally improved their EBITDA/wheel from stock peak. Cycle normalization + secular tailwinds of ev transition gives it huge
JOE	170k acres in northwest Florida, 2% developed, no net debt, acreage value growing 20% per year with current price at 20% of NAV
TWM.CA	SOTP. TWM enterprise value is ~$450mm, if you take out the market value of the 69% LCFS (a public entity that TWM spun out) of ~$200mm, the value attributed to the midstream assets is only $250mm against ~$120mm EBITDA = ~2.0x.
EDAP	US reimbursements doubled in January making the core product attractive to hospitals and patients. Revenue accelerating as a result, trades at left for dead multiple due to large seller (idk), transforming into a sexy medtech co with potential earnings + multiple upside.
HARVIA.HE	World leader in saunas, heaters and accessories. Did 8x during Covid, then came back to Earth. Now pretty decent entry price. Top notch management, expanding worldwide, especially US,
AIMFF	Holding company deploying cash in profitable industries, still seen as dead money but bigger cash flow is coming on line. Some overhang from recent governance battle that seems to be
CACO	In the international shipping business, just posted revenue and earnings that dwarf their market cap. This was a warrantless SPAC last year that got into some filing trouble but is now
SENEA	Trading at low FCF, repurchasing shares, and will remind you how LIFO vs FIFO accounting works.
TBL	Taiga Building Products $TBL. Well run Canadian building products at low FCF multiple totally delevered during COVID and controlling shareholder might make a play.
NLST	lawsuits against micron and Samsung for patent infringement of AI relevant ram storage
SNV.JO	Santova, a global logistics solutions provider with 20%+ growth over the last 5 years with further runway.
QIP.AX	IP legal firm with a 6% yield and underlying international software division just getting started.
5078.JP	Negative EV (net cash+investments-cust deposits is larger than market cap), profitable, 3% yield, room to expand to much larger size but lumpy. Builds (using LSF construction), operates
NLCP	11.6% dividend yield. No debt - net cash makes up 12% of market cap. Share repurchases. Catalysts in play to boost tenant credit quality. Focuses on limited license states.
CDON	Market seems focused on declining revenues (current macro environment) and past management hick-ups, while in fact they have new owner operators with exceptional skill and focus as the new management team since April and underlying profitability is improving substantially
ORGN	Trading at almost cash on hand after recently changing to a more capital efficient build plan.
KEYS.LN	Lawyers firm in UK. They provide a platform and services entering into a contract with principals and their pods. They deal directly with the clients and take a % of the billing.
ALTO	Ethanol producer. Market finally looks balanced (after 15 years). Current margins are nuts (earnings surprise coming) and will probably hold at decent (but not here) levels after this spike. Long-term opp in SAF. Will likely get added to Russell next rebalance
AMRK	Owns a few leading precious metals bullion retail brands in US/Canada. 5x PE, strong growth trajectory. Strong margins, whenever demand goes down in volume, they raise margins. Long play on continued retail purchases of precious metals

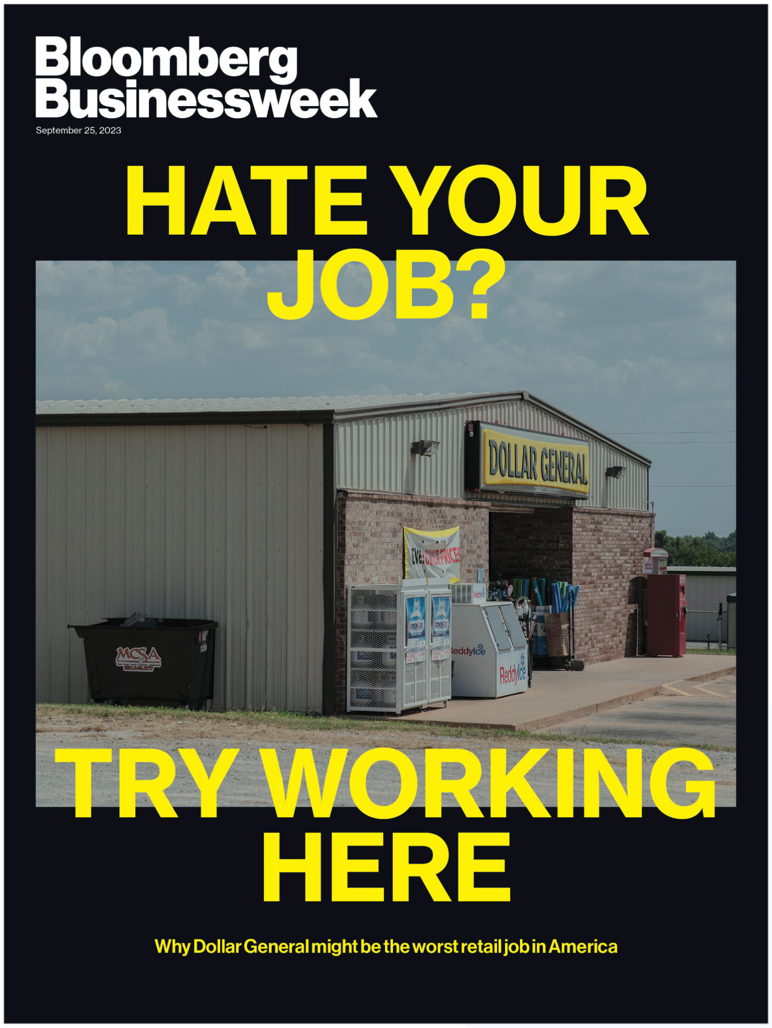
Ticker	Description
THRY	Classic melting ice cube inside a growing, high ROIC SaaS biz for SMB's (targeting 2-25 employees). High Insider ownership, CEO owns 7.7% of S/O. Profitable + very FCF generative, trading at <5x P/FCF. Asset light w/ LT focused mgmt.
ZZZ.TO	Over earning but <10x normalized FCF. Good BS, finite replacement cycle of mattresses and ZZZ is mkt share leader. Cptl light business, good CROCE, demonstrated ability to maintain
EOLS	Market cap just above 500. Produces product that competes with Botox, but at a cheaper price. Strong YoY revenue growth. Play on the anti aging trend.
596.HK	Software sub of Inspur (SOE). 1 of 3 ERP software players in China (Kingdee, Yonyou). Growing +25% riding substitution of SAP/Oracle with domestic players + digitalization of large enterprises (well below US/EU). 20x LTM PE, CF positive.(-) Low liq, audit
FTEK	Gross margins of 40%, earnings getting close to positive, trades at well under 0.5 EV per 2025 EBITDA. Product works, isn't anything sexy, but has good growth potential (remediation and
GIFI	Downside is protected by a healthy cash balance, assets that have meaningful value, and no debt. Company is trading at half of book & right about at current assets minus all liabilities. I expect about $10-15mm in net income in 2024 at least, with 10x PE has share target of ~$8

The outlook for the U.S. cannabis industry is more bullish than ever (from Jeff Schultz via X on September 20)...

> We have literally never had a better stretch of good news for the US cannabis industry like we've had over the past few weeks.
>
> ✅ HHS Schedule III Recommendation
>
> ✅ SAFE Banking headed for a Senate vote
>
> ✅ NY finally opening their adult use market to all participants
>
> If you're not super bullish on this industry, you need your head examined.
>
> #cannabisindustry
>
> $MSOS
>
> 🇺🇸🌱💪🏼

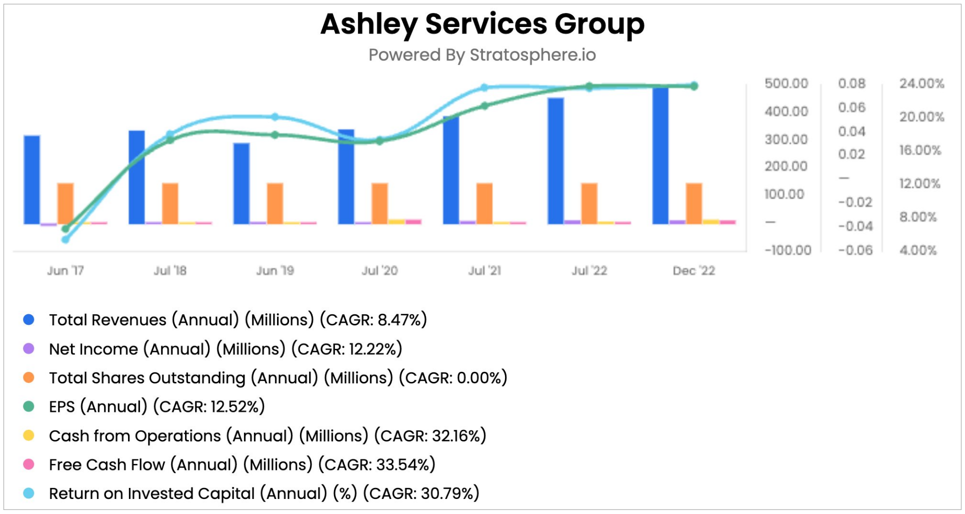
Sentiment toward discount retailer Dollar General appears to be extremely bearish (from Carl Quintanilla via X on September 20)...

> $DG makes an ugly cover — on the same day it gets slapped with a "Sell" at JPMorgan.
>
> NEW COVER: Rat infestations, blocked fire exits, expired food and machete-wielding shoppers — the stories from Dollar General employees are the stuff right out of a retail nightmare.

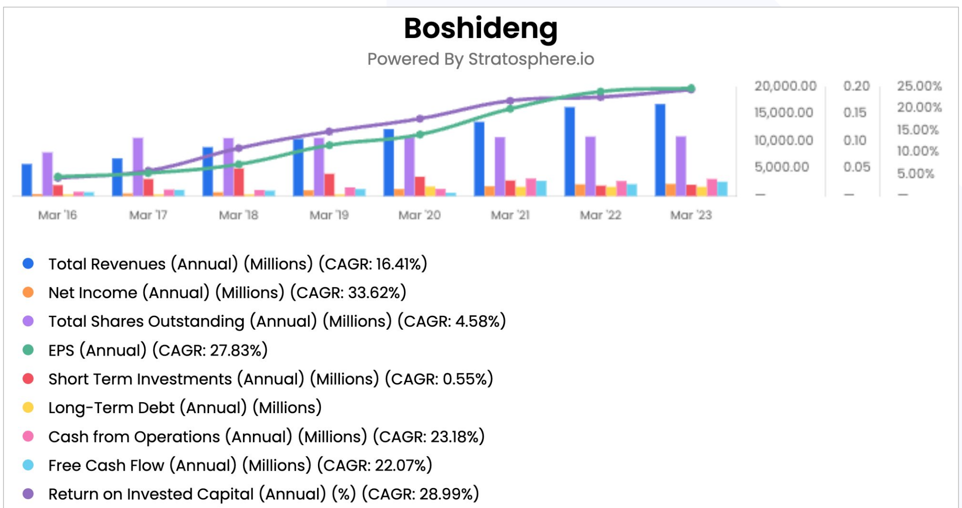


Here are four little-followed businesses with strong and growing returns on invested capital (ROIC) – one of the common hallmarks of the Buffett-style "Inevitable" stocks we love here at Porter & Co. (from Kyle Grieve via X on September 20)...

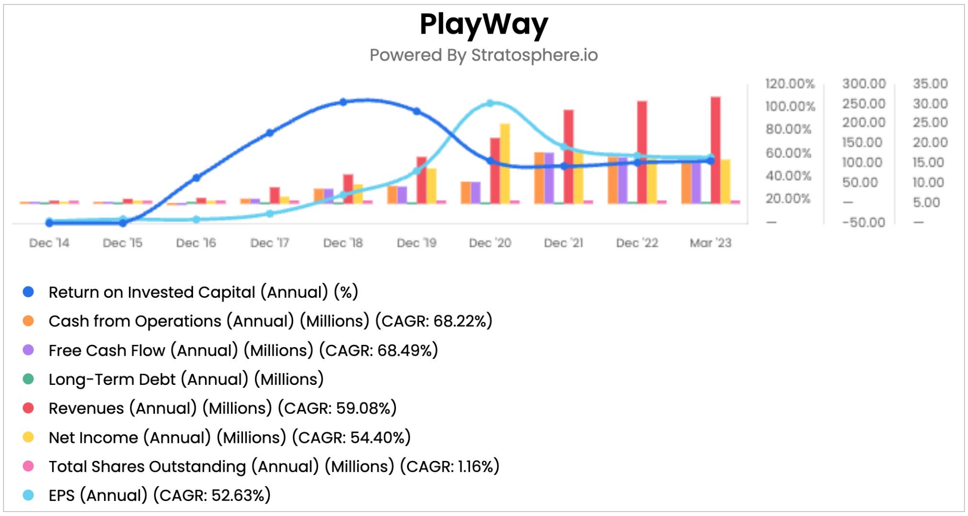
> I love businesses with improving returns on invested capital.
>
> Here are 4 growing businesses to research further:
>
> **Ashley Services Group $ASH.AX**



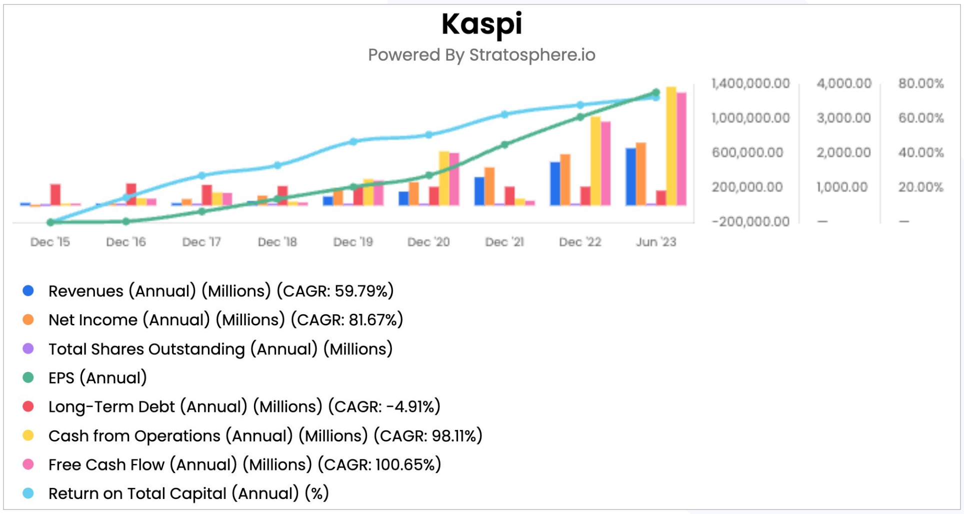
Boshideng $3998.HK



Playway $PLW.WA



Kaspi $KSPI.IL



The uranium industry was a big winner in September (see Energy below). Here's a review of some of the most promising uranium mining stocks today (from Anders via X on September 23)...

> People start noticing what is going on in the #uranium space. Some new uranium investors have been contacting me the last days wanting to know which companies to invest in. Here are some comments about companies to choose from for new investors.
>
> Safe cards: producing companies or companies with large proven reserves and higher market values such as $CCO, $UEC, $UUUU, $URE, $EU, $NXE, $FCU, $ISO, etc. They have a relatively high share in the ETFs, which means that there has been a lot of buying pressure on them and they have all risen sharply lately. Disadvantages: the high market values may mean that the upside potential is limited. Some of them, e.g. CCO and the EU have locked in contracts at lower prices and will not be able to take full advantage of soaring uranium prices. However, UEC has refrained from signing contracts at

these prices and I think that is the smartest thing. Among the above, I currently only own ISO, which sits at just over 50 million pounds and has a very "tight float", i.e. most of the shares are owned by insiders and institutions, which means that when the ETFs are forced to buy, there can be stronger gains than for others due to the low number of shares outstanding.

Then comes a series of companies with a medium size market capitalization where I can comment on a few:

$FUU has the latest ultra-high grade uranium deposit in the Athabasca. According to estimates, they have now drilled out about 30 million pounds of uranium. In my opnion they need one more massive hit outside the current zone for it to really take off. Each hole costs about 240,000 CAD, which means that it is important to get continued good results to continue rising instead of diluting too much.

$FSY is sitting on 90 million pounds in Namibia, which may soon be slightly increased. Very low valuation per pound. The problem is that it will cost like half a billion dollars to start a mine and they don't have an investor yet. An obvious takeover candidate for China, they like Africa and has the necessary capital.

$WUC is a personal favorite where I have a fairly large holding, a company that stands out and differs from the crowd because they have a producing mine where they are already mining ore with uranium and #vanadium. Very low valuation because they didn't spend any money either on advertising or proving their reserves even though drilling is now supposed to be underway. The downside with WUC is that they don't have a mill to process their uranium. They have plans to build one, but I see it more likely that UUUU will buy ore from them when they start up their mill. Or they might take over the entire company. UUUU will not want their mill to be half idle and nearby WUC has just the ore they need. This news shows what is going on for WUC, high grade uranium in the US, which is something very unusual: https://finance.yahoo.com/news/western-uranium-vanadium-corp-operations-133200542.html

$SUU is very exciting, low mcap with three good projects in Wyoming. The plan is to drill on two of them this autumn, the third one, Beaver Rim, will have to wait because the roads are too bad at the moment. Agathe is very interesting for ISR and will be valuable, but I have the highest expectations for the Night Owl, a unique project where you can use a Geiger meter directly at the surface to measure high levels of radioactivity. Was previously a producing mine completely without today's modern methods of exploration. Permission to drill is still pending and is now a few weeks late compared to previous expectations, but they have everything else they need to start drilling. I emailed CEO Dev Randhawa yesterday about this, but he replied that he can't say anything about the permit because the information he has is not public. Hopefully news next week about that. My biggest holding right now, think it will explode if they get out drilling there.

Last but not least, I want to mention the #smallcaps companies. There are a few like $PEGA and $OBRN. Here's the thing, because they're so small, they simply have a lot of leverage. Just look at OBRN where I chose to enter at 0.03 CAD. The share price during the last year has fluctuated between 0.01 and 1.04 CAD. Although they currently have no cash at all, they do have assets: an option to take over a uranium mine this November, all they need to do is issue another 250,000 shares, which is a next to nothing at this point. Then last spring, with shares valued at just over 4 MCAD, they bought a large project in Uranium City in northern Saskatchewan, which will also be interesting at higher uranium prices. They also have an exploration project in the Athabsaca in a very promising area. The mcap today is 1.56 MCAD and I see no reason why it could not be valued at least 30-40 MCAD when uranium prices are above 100 USD. I think they will need to take in some fresh cash within 1-2 months, but if we continue in this direction on the uranium market, there shouldn't be any problems.

So there you newcomers have some suggestions, a good idea is to put together a portfolio. There can always be a company that fails with drilling, doesn't get a permit, does a large financing, etc., while other companies become space rockets, and you don't want to miss those. Anyway, please be aware of the risks and do your own DD.

The recent Russian ban on diesel and gasoline exports (see Energy below) could be a bullish tailwind for oil refiners like Valero (VLO) (from Norman Levine via X on September 23)...

You want to own the shares of refiners like Valero under these circumstances. $VLO

Markets & Mayhem
@Mayhem4Markets

A reminder that the global diesel fuel shortage is not likely to end anytime soon

That's a problem because diesel touches every part of our lives

It is the most widely used transportation fuel

It's used for agriculture

It rose 41% in price just last month

Inflation is back

Russia imposed an indefinite ban on the export of diesel and gasoline to most countries, a move that risks disrupting fuel supplies ahead of winter and threatens to exacerbate global shortages.

In a government decree signed by Prime Minister Mikhail Mishustin, the Kremlin said Thursday that it would introduce "temporary" restrictions on diesel exports to stabilize fuel prices on the domestic market.

The ban, which came into immediate effect and applies to all countries apart from four former Soviet states, does not have an end date. The countries exempt from the ban include Belarus, Kazakhstan, Armenia and Kyrgyzstan, all of which are members of the Moscow-led Eurasian Economic Union.

Russia is one of the world's largest suppliers of diesel and a major exporter of crude oil. Market participants are concerned about the potential impact of Russia's ban, particularly at a time when global diesel inventories are already at low levels. Oil prices jumped as much as $1 a barrel on the news on Thursday, before settling lower for the session.

Bonds and Credit Markets

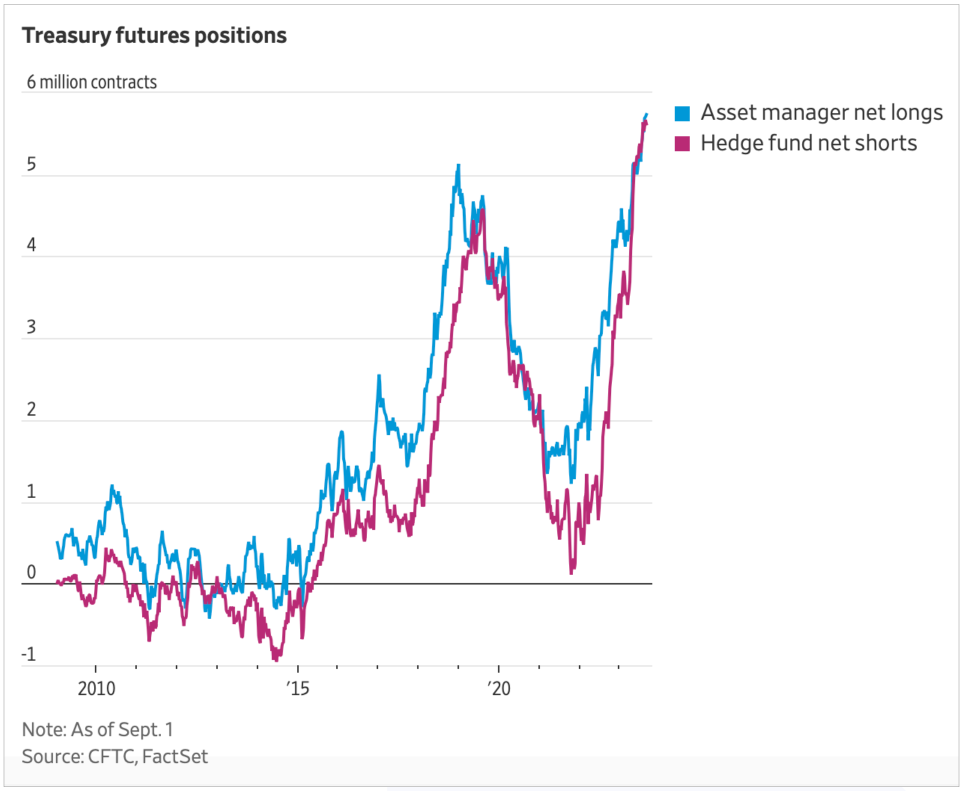
Sovereign/Government Bonds and Credit

Aahan Menon – founder of Prometheus Research – shares his current macro outlook, including why he believes the massive upcoming wave of debt issuance is likely to be bearish for U.S. Treasury bonds (from the BlockWorks Forward Guidance podcast on August 30)...

> 00:00 Introduction
> 00:27 Progressing Through A Tightening Cycle
> 07:57 How To Measure Liquidity
> 15:51 A Wave Of U.S Treasury Issuance Is On The Horizon
> 24:09 Is The Fed Behind The Curve?
> 29:10 Inflation
> 38:25 Credit Is Contracting, Just Not Enough... Yet
> 43:17 When To Shift From Short Stocks & Bonds
> 50:44 Private vs Public Sector Liquidity
> 59:41 Prometheus Research

An explanation of the popular Treasury bond "basis trade," and why regulators are sounding the alarm (from The Wall Street Journal on Sep 13)...

> The basis trade, an innocuous-looking practice at the center of some of Wall Street's historic blowups, is back.
>
> A popular way for hedge funds to profit from bond trading while minimizing their exposure to swings in the market, the basis trade exploits the price difference between Treasurys and Treasury futures. The resurgence is attracting fresh scrutiny from Wall Street because previous meltdowns have rattled global markets.
>
> Here's what traders say is going on now:
>
> **How the basis trade works**
>
> Hedge funds buy Treasurys, then bet against Treasury futures by selling contracts promising delivery of a bond on a specific date at a preset price. Instead of betting on the direction of bond markets, the trade seeks to take advantage of small differences in the securities' prices.
>
> The trade works because large asset managers like pension funds often prefer buying Treasury futures that require less up-front cash than actual bonds. That tends to make the contracts slightly more expensive than the bonds, creating a window for speculators to take advantage. Futures prices typically converge toward bond prices as their settlement date approaches.
>
> The differences are small, so hedge funds juice returns by borrowing from big banks in the overnight funding markets—often putting little, if any, cash up front. Leverage can reach extreme levels: Hedge funds had more than $550 billion of Treasury trades at the end of last year backed by just $10 billion of their own money, Fed research found.
>
> That worries some on Wall Street. Unexpected shocks can force hedge funds to rapidly exit from their positions, sending shock waves through financial markets.

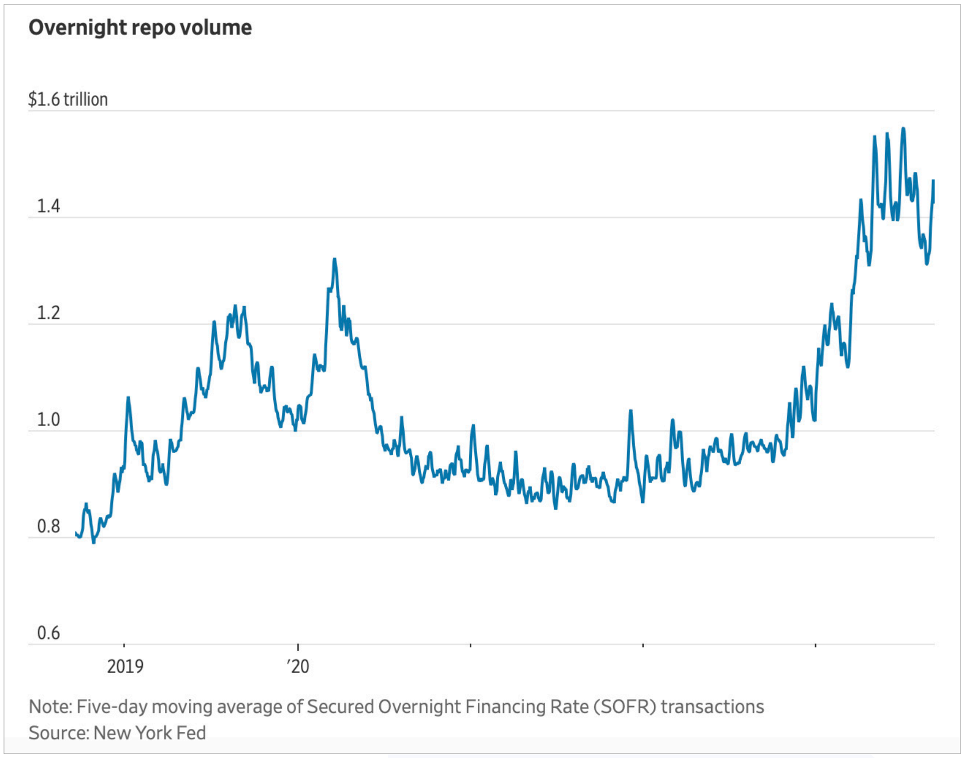


What's happening now

The basis trade had been subdued since a dash for cash in March 2020 forced hedge funds to rapidly unwind their positions, straining the market for Treasurys—meant to be the world's easiest investment to buy and sell.

Now, a flurry of activity suggests it has rebounded. Speculators are shorting 5.6 million futures contracts tied to Treasurys, CFTC data show, representing roughly $715 billion of bonds.

At the same time, repurchase agreements, where speculators borrow daily from large banks using Treasurys as collateral, have surged. Roughly $1.4 trillion of overnight repo transactions are taking place each day, New York Fed data show, breaching previous highs.



What sparked the surge in Treasury trading

The Fed's fight against inflation and the U.S. government's wave of borrowing reignited the trade, analysts say. Higher yields and worries about a recession have asset managers scooping up long-term bond futures.

Investment in Treasury futures has never been higher at CME Group, one of the world's largest derivatives exchanges. A record 19.8 million contracts were outstanding in August, up from 14.3 million at the start of the year.

At the same time, the continuing influx of debt issuance has weighed on short-term Treasury prices, widening the gap between them and long-term futures. Inflation remains far from the Fed's 2% target and the central bank is paring its bond book, adding pressure to the market.

Given those uncertainties and with a potential recession up in the air, "it's natural to see record hedging in the Treasury market," said Agha Mirza, global head of rates and OTC products at CME Group.

Watchdogs' warnings

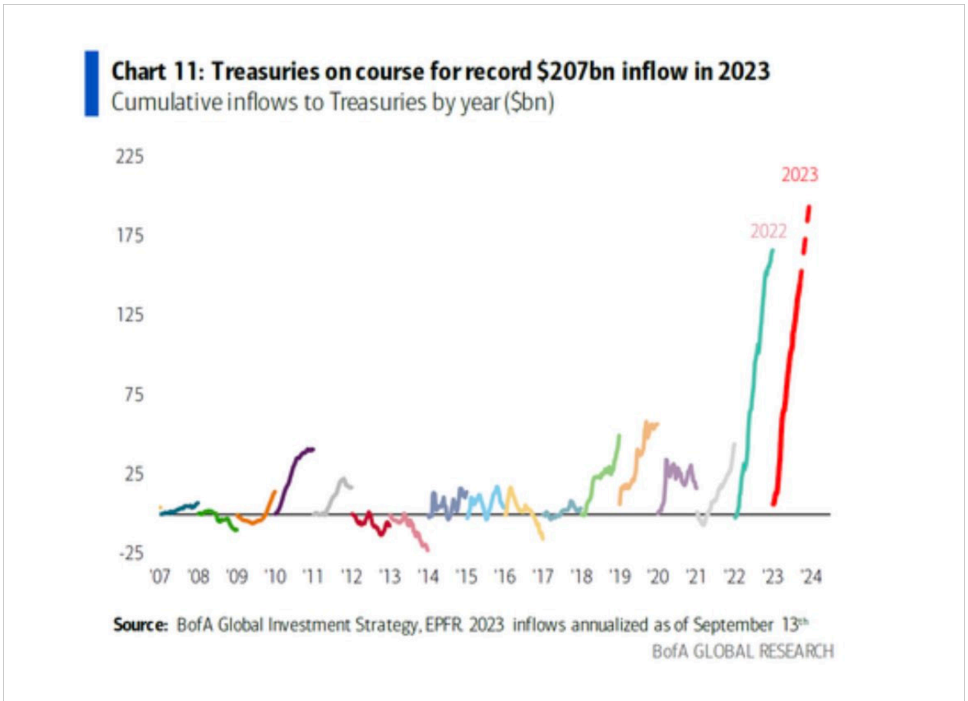
Regulators and others have sounded alarms this year that an unwinding of the basis trade could spark market tumult.

The Switzerland-based Financial Stability Board warned last week that hedge funds were building up worrying amounts of "hidden leverage," risking a blowup. During the 2020 Covid market crash, hedge funds' unwinding of leveraged strategies including the basis trade spilled across markets, helping send the Dow Jones Industrial Average to its worst losses since 1987 and forcing the Fed to step in.

Continue reading here (subscription may be required).

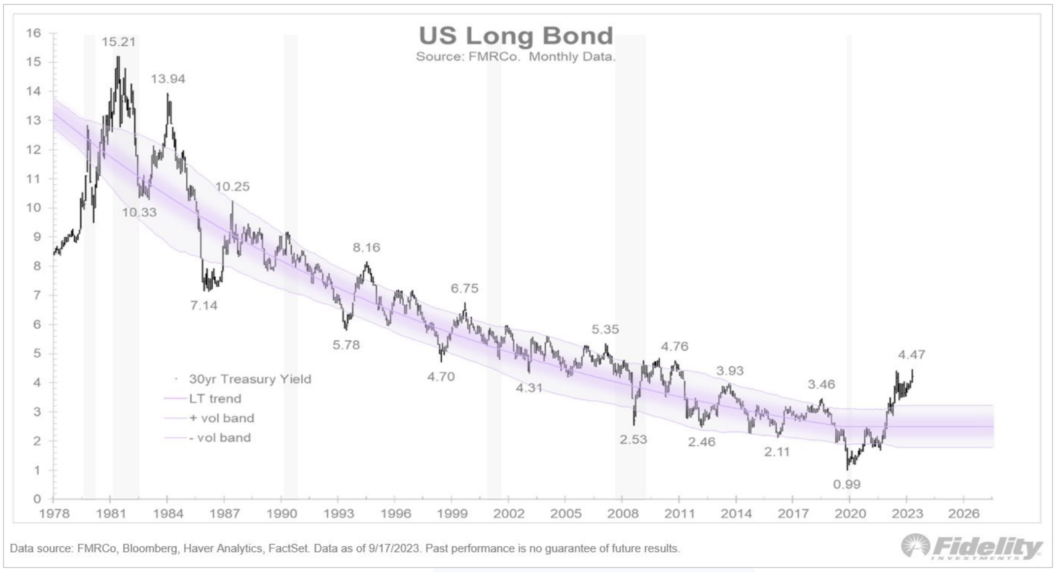
Despite the worrisome fundamentals, U.S. Treasury bonds are on pace for record inflows this year (from Santiago Capital via X on September 16)...

The "boycott" of US Treasuries in living color...



This long-term chart of 30-year Treasury bonds suggests the 40-year bull market is over (from Jurrien Timmer via X on September 19)...

Today's bond market hinges on three assumptions: a negative term premium, low inflation, and a stagnant neutral rate. Yet, from a chart perspective, it seems obvious that the secular bull market for bonds ended in 2020. That puts all the assumptions to the test.



Hedge fund manager Bill Ackman – who has never been shy about "talking his book" – recently explained why he remains bearish on U.S. Treasury bonds (from Bill Ackman via X on September 21)...

> I believe that long-term rates, e.g, 30-year rates, will rise further from here. As such, we remain short bonds through the ownership of swaptions.
>
> The world is a structurally different place than it was. The peace dividend is no more. The long-term deflationary effects of outsourcing production to China are no more. Workers and unions' bargaining power continues to rise. Strikes abound, with more likely to come as successful walkouts achieve substantial wage gains.
>
> Energy prices are rising rapidly. Not refilling the SPR was a misguided and dangerous mistake. Our strategic assets should never be used to achieve short-term political objectives. Now we must refill the SPR while OPEC and Russia cut production.
>
> The green energy transition is and will remain incalculably expensive. And higher gas prices will raise inflationary expectations. Just ask your average American. They see the prices at the pump and in the grocery store and don't believe inflation is moderating.
>
> Our national debt is $33 trillion and rising rapidly. There is no sign of fiscal discipline by either party or by the presumptive presidential nominees. And each debt ceiling is an opportunity for our divided government and its most extreme actors to get media attention, and for our nation to threaten default. This is not a good way to recruit the many new buyers we need for our bonds.
>
> The government is selling hundreds of billions of bills, notes and bonds weekly. China and other foreign nations, historically major buyers of our debt, are now selling. And the QT unwind experiment has barely begun. Imagine trying to do a massive IPO where the underwriter, insiders and short sellers are all selling at once, competing to hit every bid on the way down while the analysts downgrade their ratings to 'Sell.'
>
> Our economy is outperforming expectations. Major infrastructure spending is beginning to contribute

to economic growth and the supply of additional debt. Recession predictions have been pushed out beyond 2024.

The long-term inflation rate is not going back to 2% no matter how many times Chairman Powell reiterates it as his target. It was arbitrarily set at 2% after the financial crisis in a world very different from the one we live in now.

I bumped into the CIO of one of the world's largest fixed income asset managers the other night and asked him how it was going. He looked like he had had a tough day. He greeted me by saying: 'There are just too many bonds' — a veritable tsunami of new issuance each week. I asked him what he was going to do about it. He said: 'The only thing you can do is step away.'

I have been surprised at how low long-term rates are. I think the best explanation is that bond investors thought of 4% as a high rate of interest because rates hadn't breached 4% for nearly 15 years. When investors saw the 'opportunity' to lock in 4% for 30 years, they grabbed it as a 'once-in-their-career opportunity,' but today's world is very different from the one they have experienced up until now.

The long-term inflation rate plus the real rate of interest plus term premium suggests that 5.5% is an appropriate yield for 30-year Treasurys. And query whether 0.5% is a sufficient real long term rate in an increasingly risky world.

And the technicals could cause yields to go even higher, particularly in the short term. We saw the beginnings of that today.

It wasn't that long ago that a previous generation thought five percent was a low rate of interest for a long-term, fixed-rate obligation.

But I could be wrong. AI might save us.

The government is planning a U.S. Treasury "buyback" program to boost market liquidity (from Bloomberg on September 21)...

The resilience of the world's biggest bond market is top priority as US debt officials prepare to start buying back government debt, according to Josh Frost, the Treasury Department's assistant secretary for financial markets.

"Buybacks can play an important role in helping to make the Treasury market more liquid and resilient," Frost said Thursday in a prepared speech during a forum on the Treasury market in New York. Our goal is to "ensure that the Treasury market remains the deepest and most liquid market in the world."

The Treasury is expected in 2024 to start regularly purchasing its bonds for the first time in more than two decades, a move that comes after years of increasing scrutiny on Wall Street about the $25 trillion market's underlying fragility. The programs have two separate objectives: to bolster liquidity in some pockets of the market and to smooth the volatility of bill issuance as it manages its cash balance.

Officials had been exploring the buybacks for at least a year and unveiled additional details on the structure last month. But market liquidity has drawn scrutiny since at least October 2014, when Treasuries convulsed — with no apparent trigger — in what was dubbed a flash rally. Some measures pushed through since 2014 include boosting public reporting on daily Treasury transactions.

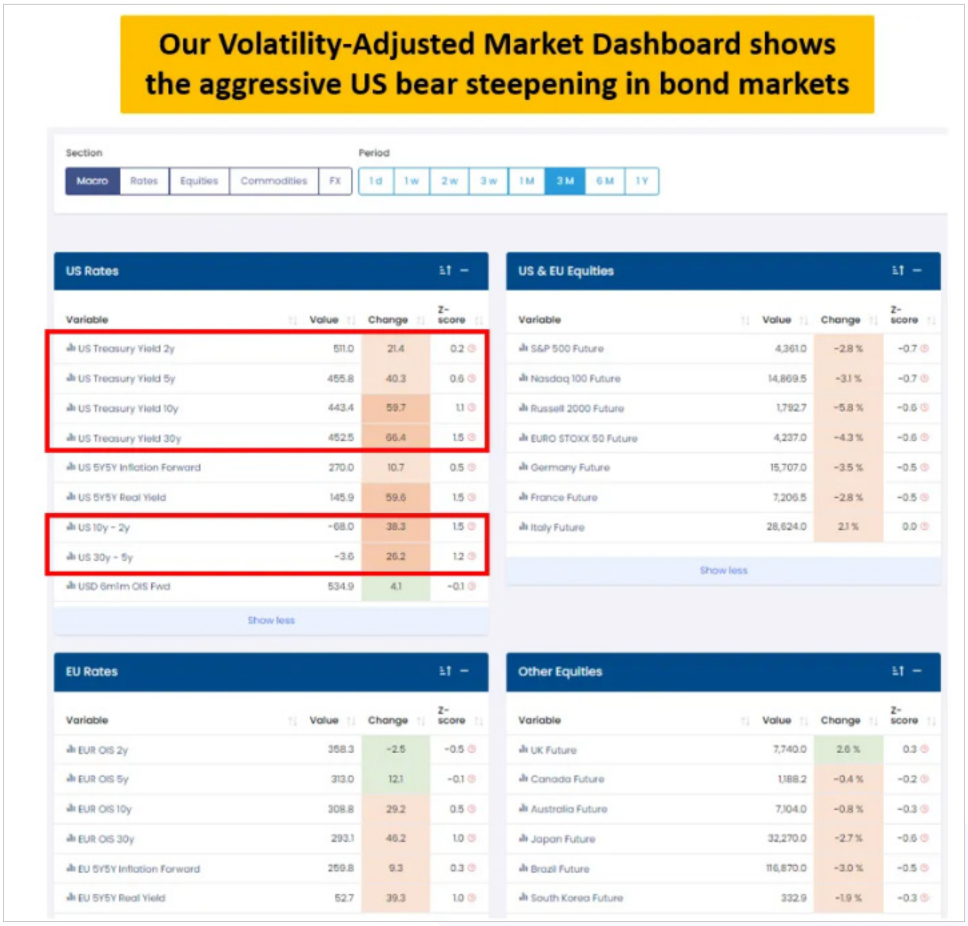
More recently, a near freeze of the market in March 2020 forced the Federal Reserve into massive purchases to prevent wider financial disruptions. That shock and other disruptions have led various regulators to seek improvements through an inter-agency working group.

> Frost said the Treasury's liquidity-focused buybacks were not intended to address periods of acute market stress, a responsibility that falls under the Fed's mandate to ensure financial-market stability.
>
> Instead, dealers should feel the bump from buybacks in their intermediation capacity in normal times, as well as when there's outsized trading activity, said Frost, who spoke at an event co-sponsored by the International Swaps Derivatives Association and the Securities Industry and Financial Markets Association.
>
> The department intends to be more "price sensitive" as it chooses the buyback offers to accept — and therefore may end up purchasing "materially" less then the maximum, he said.

Continue reading here (subscription may be required).

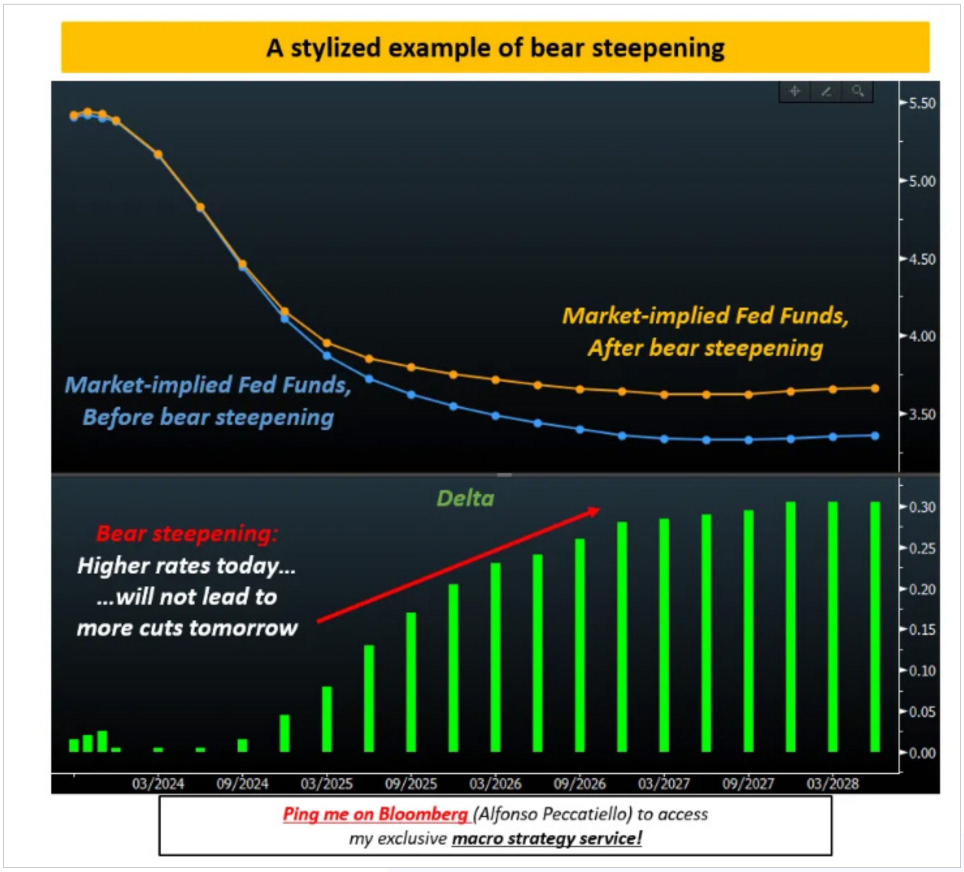
The recent "bear steepening" in the U.S. Treasury yield curve could be an ominous signal for the economy (from Alf via X on September 23)...

> There is a rare and powerful trend occurring in bond markets.
>
> History shows that if left unchecked, it can cause serious damage to equity markets and the economy.
>
> A thread.
>
> Over the last 3 months, US bond markets are in an aggressive and prolonged period of bear steepening of the yield curve.
>
> The TMC VAMD shows and color-codes volatility adjusted moves across asset classes: the darker the color, the more outsized the move in historical context.



Let's cover the basics: what is a bear steepening of the yield curve and why does it matter in the first place?

Bear steepening happens when interest rates move higher but it's long-dated yields that take the lead, hence shifting the entire curve higher but also steeper.



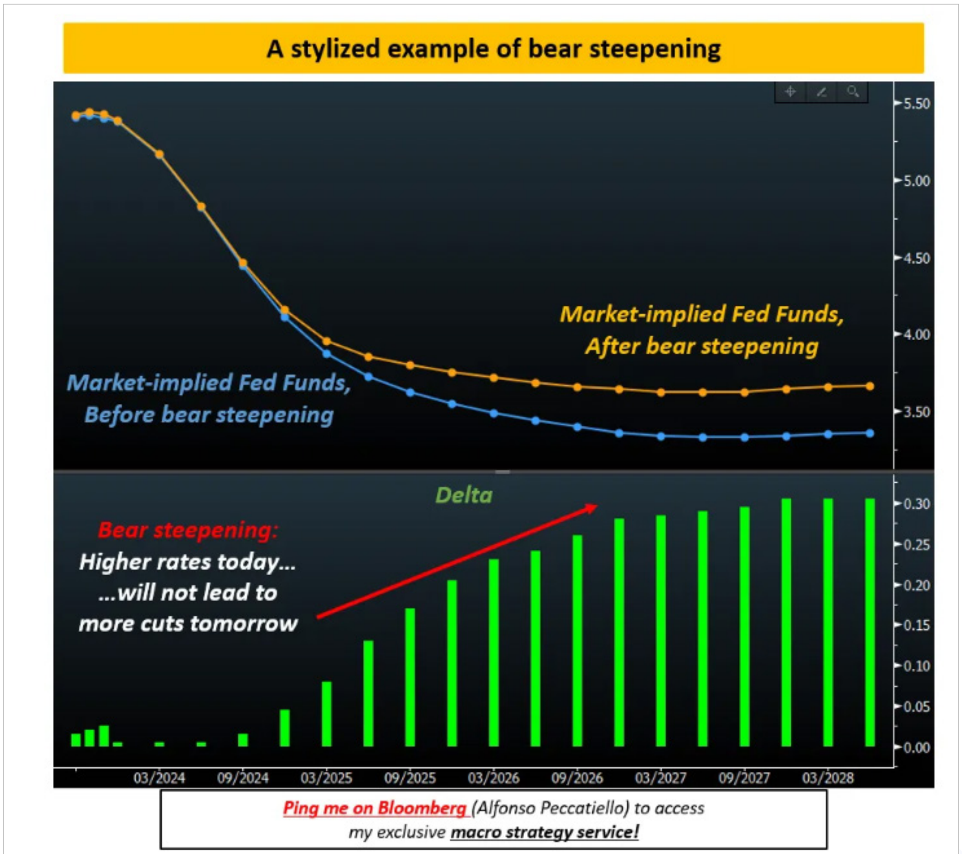
The chart above shows the 10-year market-implied path ahead for Fed Funds before and after bear steepening and the net change in the box below.

To understand it, think of 10-year yields like a strip of all future Fed Funds for the next 10 years discounted to today.

The reason why we didn't see 10-year Treasuries breaching 4% until recently is that the prevailing yield curve regime was bear flattening: the Fed would impose higher yields in year 1-2 of the chart above, but the market would discount damage to growth and inflation down the road and price materially lower Fed Funds from year 3-10 with a convergence towards a "neutral" of 3% over time.

But over the last 3 months the music has changed with the bear steepening.

Recently markets priced away cuts in 2024 but while in the past that meant more cuts would be priced in immediately after, the bear steepening move implies that markets believe the economy can handle higher rates for much longer (red arrow).



In a nutshell according to markets not only Fed Funds at over 5% for quarters on end aren't going to generate a recession, but actually the economy will barely budge (?)

But why is bear steepening such a rare and dangerous occurrence?

Bear steepening regimes cause long-dated yields to rise rapidly, and this has a large and rapid tightening effect on the real economy: 30-year borrowing rates rise rapidly, financing becomes even tougher and negative mark-to-market effects (see regional banks) are amplified.

All business models which make large use of long-dated instruments and leverage are vulnerable if their risk management wasn't done properly: pension funds, insurance companies, shadow banking, real estate, and more.

But the key point is this.

Bear Steepening + Weakenining Economy = Damage

Higher yields and bear steepening aren't a problem per se: if the economy is running hot it's actually healthy to have long-end rates reflect the increase in nominal growth.

That's not the case today.

The chart above shows the underlying trend in US nominal growth (blue, LHS) against the US Treasury 2-10y yield curve slope (orange, RHS): notice how in 2021 the yield curve steepened reflecting rapidly accelerating growth from fiscal stimulus & reopenings.

No problem there.

But now look at today: US nominal growth is falling and yet markets are staging a prolonged bear steepening

It's a very late cycle attempt by bond markets to find out where the breaking point is - after all the Fed is preaching higher for longer so let's go test if it works

Very similar macro regimes with below-trend growth but recessions failing to materialize and markets pushing a bear steepening regime as people become convinced that "economies can handle higher rates" were seen in:

- Sep to Nov 2000

- May to Jun 2007

- Sep to Nov 2018

In all three cases above rapid late-cycle bear steepening trends marked the end of the "this time is different" experiment and ended up causing severe distress to economies (2001-2008) or markets (Q42018).

I don't think this time will be different.

2018 was a prime example of late-cycle bear steepening breaking something.

The curve bear steepened (red boxes) for about 7 weeks straight until early October despite a weakening economy.

This sustained late-cycle bear steepening was "it" for markets...

...with equities peaking in early October and tanking 23% in less than 3 months.

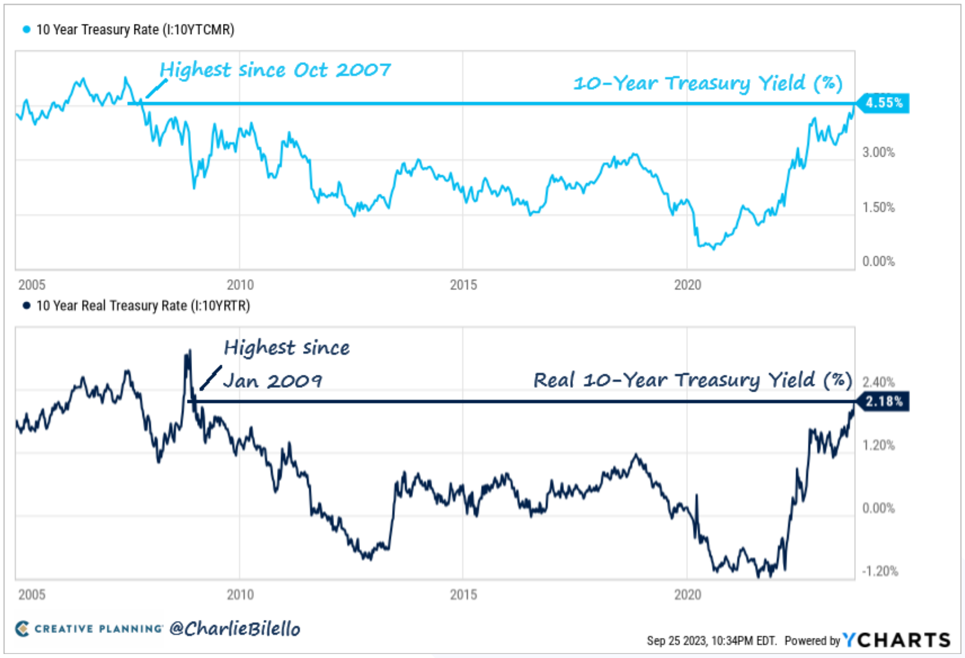
You want to know why today the bear steepening is even more dangerous?

Back then inflation was 2% and the Fed could rapidly pivot in early 2019 hence repairing the damage: rates fell and the S&P500 returned over 30% in 2019.

This time inflation is much higher and the Fed's hands are tied...

The 10-year U.S. Treasury yield hit a new 16-year high above 4.5% this week (from Charlie Bilello via X on September 25)...

> 10-Year Treasury Yield moved up to 4.55% today, highest since Oct 2007.
>
> Real 10-Year Yield (adjusted for expected inflation) of 2.18% is the highest since Jan 2009.
>
> Good times for new bond investors, bad times for existing bond investors.

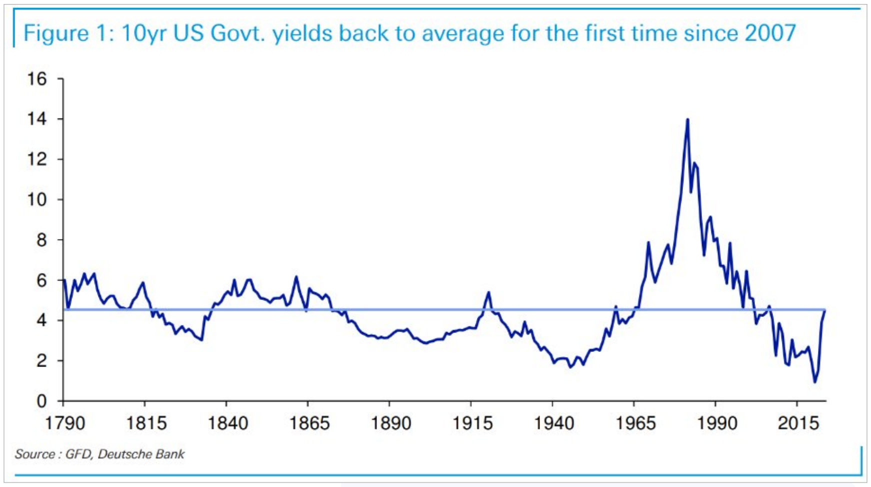


Yet, despite the huge move higher recently, yields are only now back to their long-term historical average ([from Katie Greifeld via X on September 25](#))...

from Deutsche Bank --

10-year Treasury yields have averaged 4.5% in 233 years of data

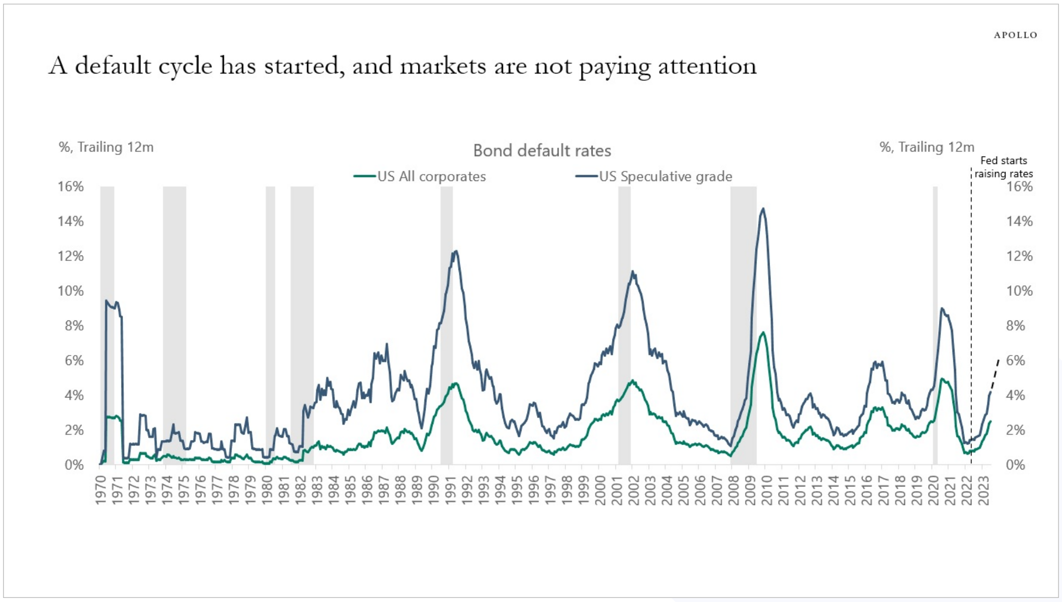
we're back to normal baybee



Corporate Bonds and Credit

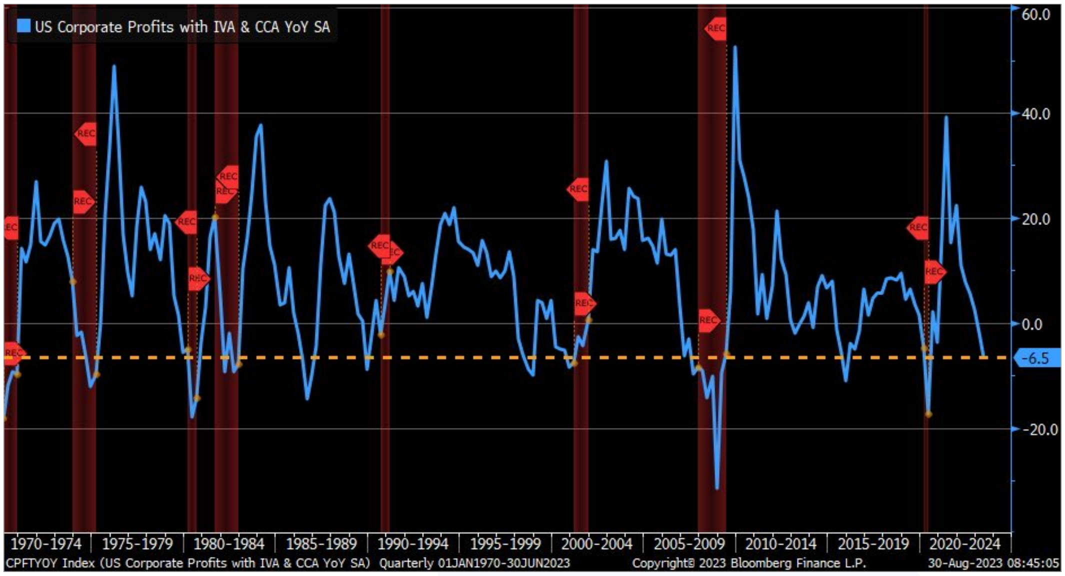
Torsten Slok, chief economist for alternative asset manager Apollo Global, believes the credit default cycle is now underway ([from The Daily Spark on August 26]())...

> Since the Fed started hiking in March 2022, default rates have been moving higher, and every day there are companies that cannot get a new loan or refinance an existing loan.
>
> This is how monetary policy works. A higher cost of capital makes it harder for firms to get financing.
>
> With the strong uptrend in defaults over the past six months, and the Fed keeping interest rates at elevated levels, the HY default rate could reach 6% by the end of 2023, see chart below.
>
> The bottom line is that a default cycle has started, and markets are not paying attention.



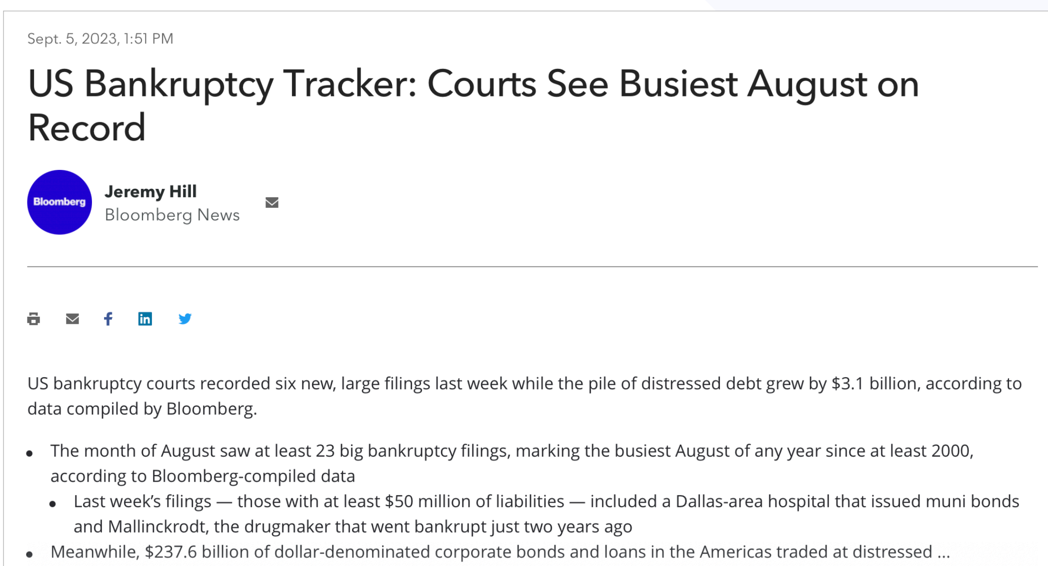
Corporate profits continued to weaken last quarter ([from Liz Ann Sonders via X on August 30](#))...

> Corporate profits contracted by 6.5% year/year in 2Q23 ... acceleration to downside from prior quarter's 1.8% decline; worst drop since pandemic



Last month was the busiest August for corporate bankruptcies on record ([from Steph Pomboy via X on September 5](#))...

> I've been a broken record on the forthcoming corporate credit bust--and the CERTAINTY that it would be worse than the GFC-- for a year and half. It's now starting to unfold... Busiest August for Bankruptcy filings ON RECORD


Sept. 5, 2023, 1:51 PM

US Bankruptcy Tracker: Courts See Busiest August on Record

Jeremy Hill
Bloomberg News

US bankruptcy courts recorded six new, large filings last week while the pile of distressed debt grew by $3.1 billion, according to data compiled by Bloomberg.

- The month of August saw at least 23 big bankruptcy filings, marking the busiest August of any year since at least 2000, according to Bloomberg-compiled data
  - Last week's filings — those with at least $50 million of liabilities — included a Dallas-area hospital that issued muni bonds and Mallinckrodt, the drugmaker that went bankrupt just two years ago
- Meanwhile, $237.6 billion of dollar-denominated corporate bonds and loans in the Americas traded at distressed ...

Billionaire distressed debt investor Howard Marks expects defaults to keep rising (from Bloomberg on September 6)...

> Oaktree Capital Management co-founder Howard Marks said he expects more companies to default on their debt as higher interest rates make it harder for struggling companies to raise capital.
>
> "When you go through a period when it's super easy to raise money for any purpose or no purpose, and you go into a period when it's difficult to raise money, even for a good purpose, clearly many more companies are going to founder," Marks said in an interview taped for an upcoming episode of Bloomberg Wealth with David Rubenstein.
>
> Oaktree, founded in 1995 as a distressed-debt specialist, now manages roughly $180 billion in assets. Marks made his name in distressed debt, having spent 10 years at TCW leading teams that invested in the asset class. Over the years he's gained a wide following for his investment memos, which cover the markets, international affairs and other topics.
>
> When asked whether he expects more defaults in the buyouts or real estate industries in the next three years, Marks told Rubenstein that the combination of having less money and a higher cost of capital will leave a "hole" that some firms can't fill.
>
> Asset managers and real estate investors are contending with the toughest borrowing environment since the 2008 global financial crisis. A sharp rise in interest rates starting in March 2022 has made it costlier to refinance existing loans or fund acquisitions.
>
> This partly contributed to an increase in defaults on commercial real estate among large players such as Blackstone Inc., Brookfield Corp. and Goldman Sachs Group Inc. this year.
>
> The Fed funds rate was roughly zero for much of the period between 2009 to 2021, which Marks said is an "inappropriate" level because it subsidizes borrowers and punishes lenders and savers. He thinks the US Federal Reserve will keep rates between 2% and 4% once inflation abates, which he views as a suitable range.
>
> "You can't live on a shot of adrenaline every morning for 13 years," he said. "I would like to see the Fed get to a neutral position, which is neither stimulative nor restrictive."

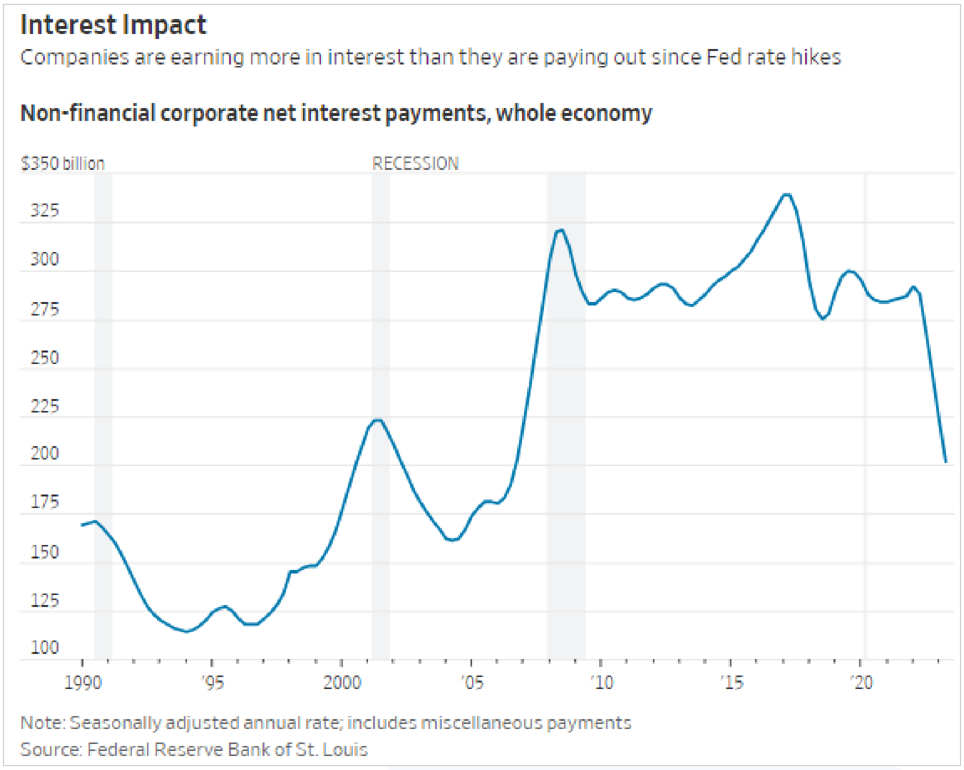
Continue reading here (subscription may be required).

Despite plenty of reasons for concern, the spreads between high-yield corporate debt and U.S. Treasuries have been falling for most of the year (from David Dierking via X on September 18)...

> How in the world are high yield spreads going DOWN right now?
>
> Consumers are running out of money to spend. Consumer credit is through the roof. Defaults are rising. Bankruptcies are rising. We've got a de facto recession in Europe. China is imploding. Student loan payments just restarted.
>
> Yet investors are demanding LESS return for low quality bonds?
>
> I don't get this at all. This looks like a setup for the end result gets really ugly.

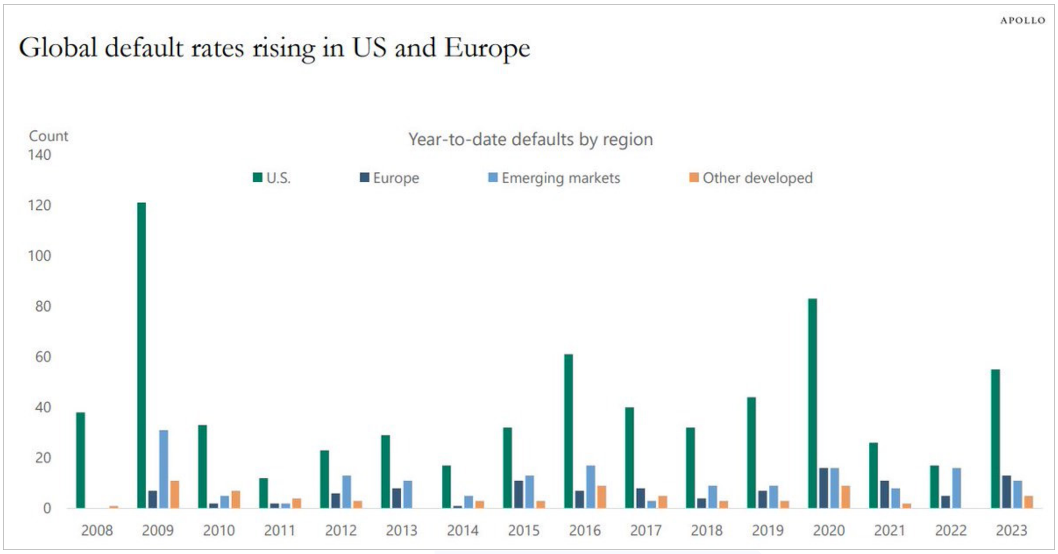
The average company's net interest payment has actually fallen over the past couple years (from Charlie Bilello via X on September 19)...

> The Fed has hiked rates 525 bps since March 2022 but the net interest payments of corporations has actually declined. Why? Many companies locked in low interest rates on their debt in 2020-21 and are now earning much higher yields on their cash.



Global default rates are on pace to exceed 2008 levels ([from The Kobeissi Letter via X on September 23](#))...

> Year-to-date default rates in the US and Europe are already above 2008 levels.
>
> Interestingly, this is barely getting any attention.
>
> We are on track to see more defaults in the US and Europe than all years back 2009, other than 2020.
>
> Default rates have nearly tripled since 2022 when the Fed started raising interest rates.
>
> If higher rates for longer is true, more bankruptcies are coming.
>
> Higher rates are the new normal.



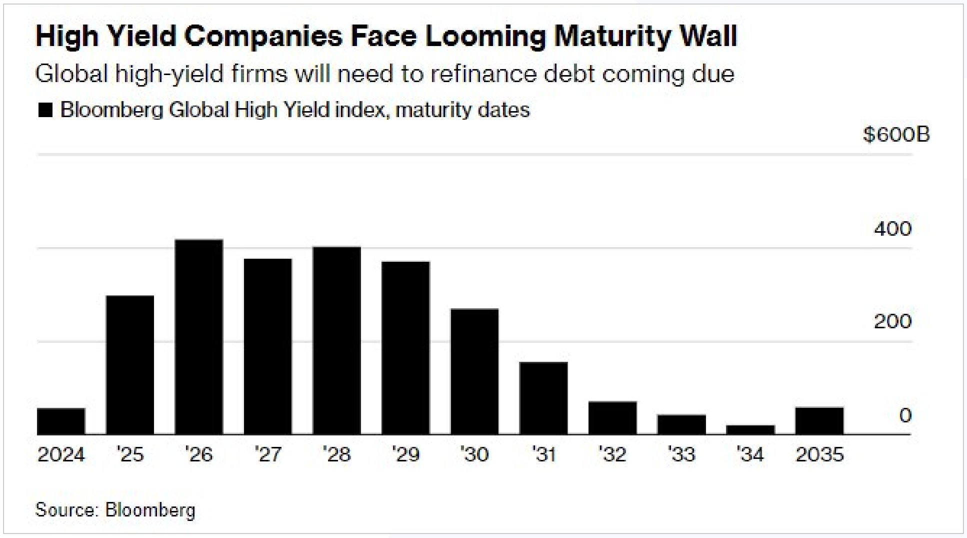
The level that rates rise to is no longer the primary driver of markets.

Rather, it's how long rates remain around current levels.

Adjusting to higher rates is going to be difficult for many corporations.

Why there's likely no escaping a wave of corporate defaults at this point (from Michael A. Arouet via X on September 24)...

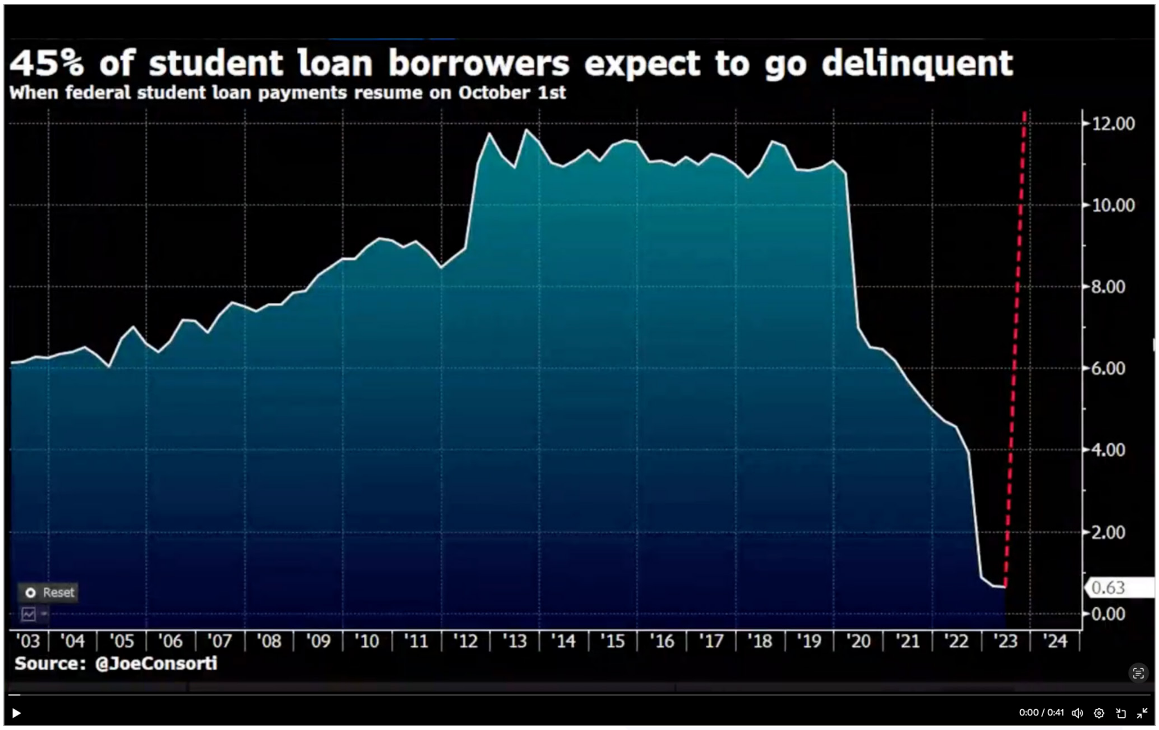
There are two options, higher for longer or recession will hit and interest rates go down, but credit spreads go up. Both scenarios would trigger delinquency wave.



Consumer Credit

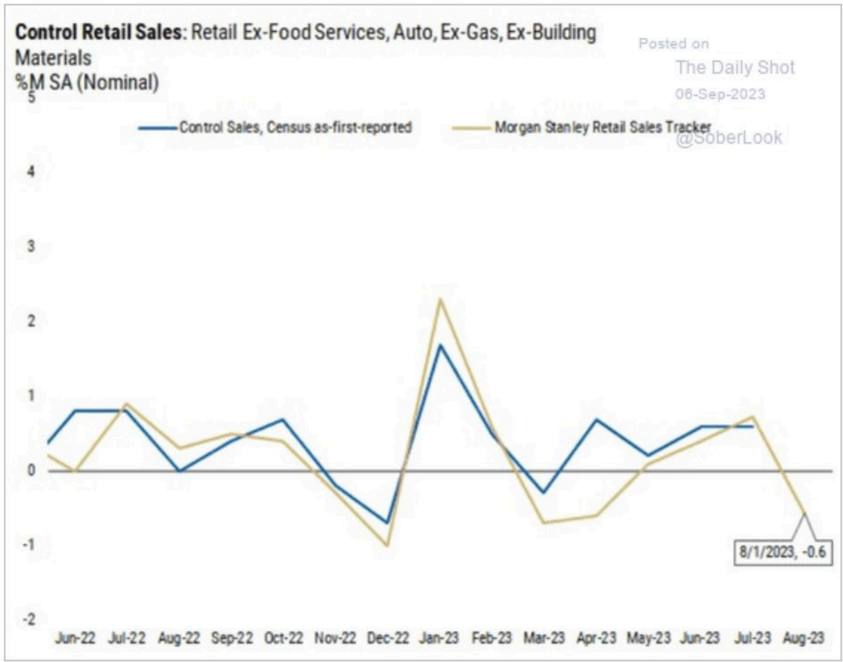
Nearly half of student loan borrowers expect to go delinquent when payments resume next month (from Joe Consorti via X on August 28)...

> 45% of student loan borrowers expect to go delinquent when payments resume on October 1st.
>
> That's not good.



Consumer spending appears to have weakened significantly in August (from Bob Elliot via X on September 6)...

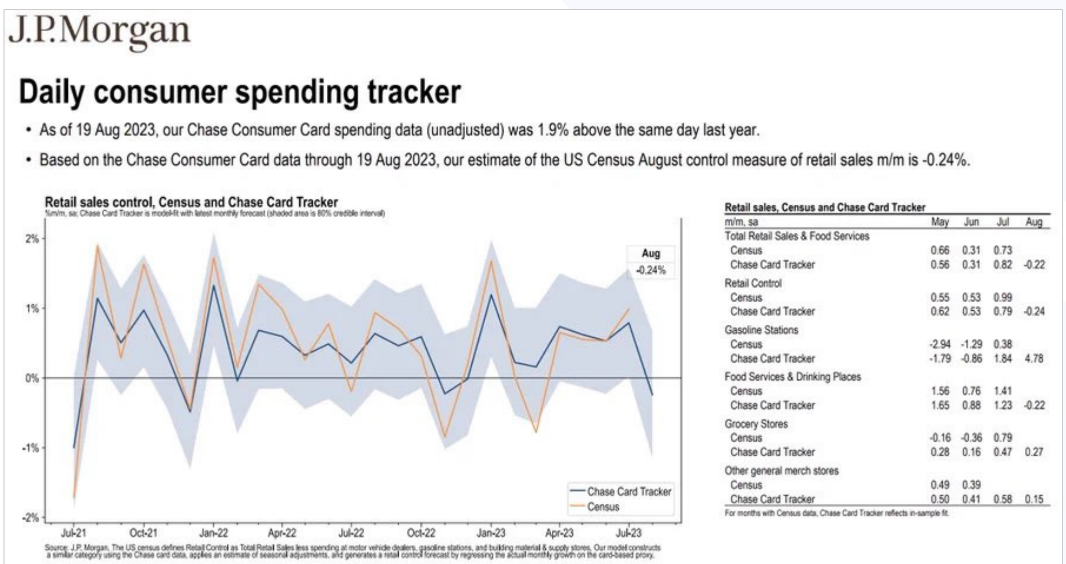
> Bunch of data points suggest a substantial weakening in consumer spending in August. If the consumer is actually fading, very hard for equities to hold these levels.
>
> Morgan Stanley, Chase, and Citi retail sales trackers all weakened a lot in Aug. Short thread.



Source: Morgan Stanley Research

Chase credit card spending tracker also showing some weakness: h/t @Econ_Parker

This was from mid-month. If anyone has updated figures pls add in the comments.

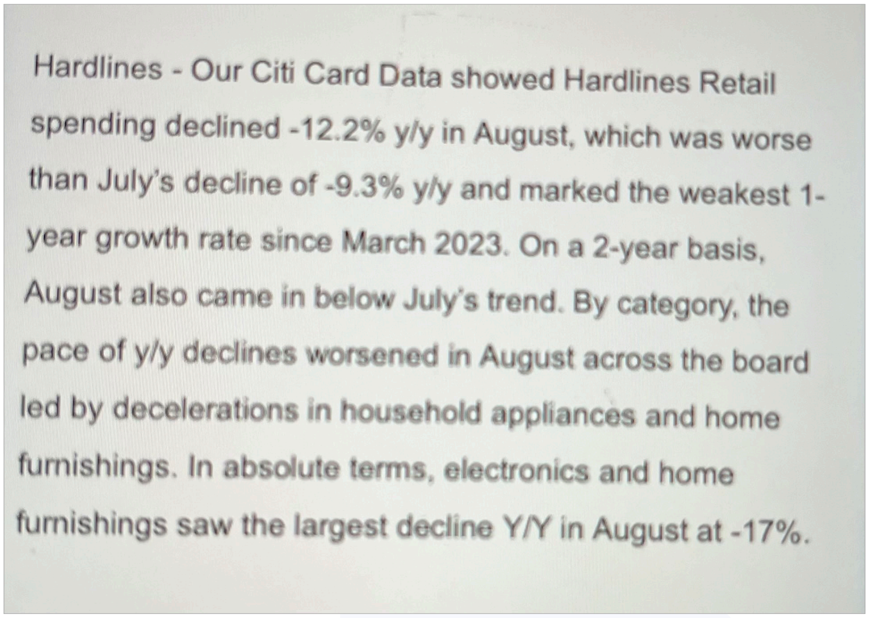


Retail sales, Census and Chase Card Tracker

m/m, sa	May	Jun	Jul	Aug
Total Retail Sales & Food Services				
Census	0.66	0.31	0.73	
Chase Card Tracker	0.56	0.31	0.82	-0.22
Retail Control				
Census	0.55	0.53	0.99	
Chase Card Tracker	0.62	0.53	0.79	-0.24
Gasoline Stations				
Census	-2.94	-1.29	0.38	
Chase Card Tracker	-1.79	-0.86	1.84	4.78
Food Services & Drinking Places				
Census	1.56	0.76	1.41	
Chase Card Tracker	1.65	0.88	1.23	-0.22
Grocery Stores				
Census	-0.16	-0.36	0.79	
Chase Card Tracker	0.28	0.16	0.47	0.27
Other general merch stores				
Census	0.49	0.39		
Chase Card Tracker	0.50	0.41	0.58	0.15

For months with Census data, Chase Card Tracker reflects in-sample fit.

And the latest citi card data for August as well. Any time series charts would be appreciated as well.



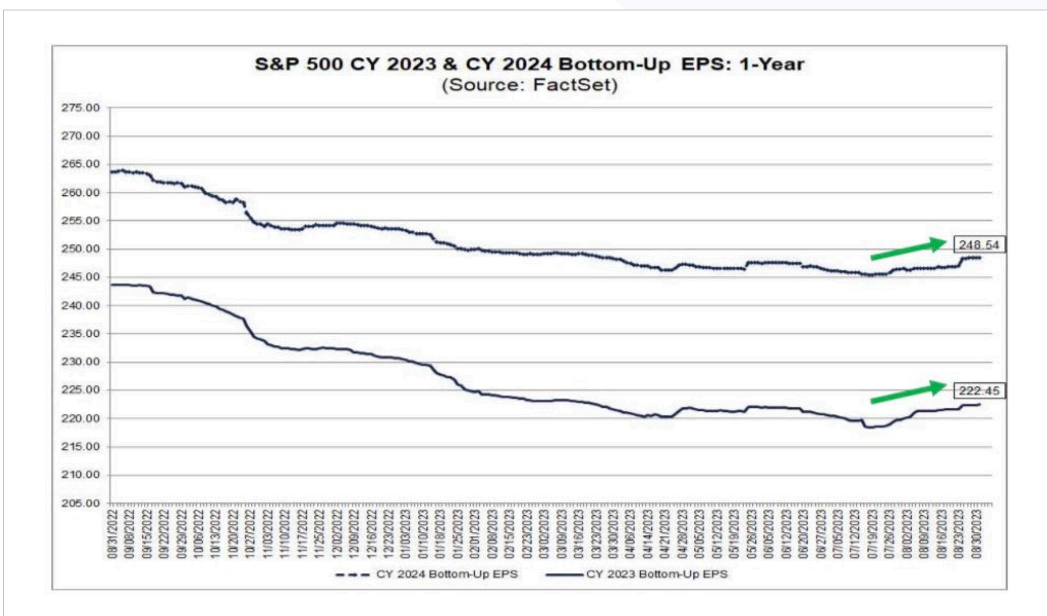
Hardlines - Our Citi Card Data showed Hardlines Retail spending declined -12.2% y/y in August, which was worse than July's decline of -9.3% y/y and marked the weakest 1-year growth rate since March 2023. On a 2-year basis, August also came in below July's trend. By category, the pace of y/y declines worsened in August across the board led by decelerations in household appliances and home furnishings. In absolute terms, electronics and home furnishings saw the largest decline Y/Y in August at -17%.

Consumer spending has held up stronger and longer this year than most folks expected. How long will it persist given high rates, softening employment, and increasing need to spend on debt service (like student loans)?

These timely reads suggest the downturn may have started.

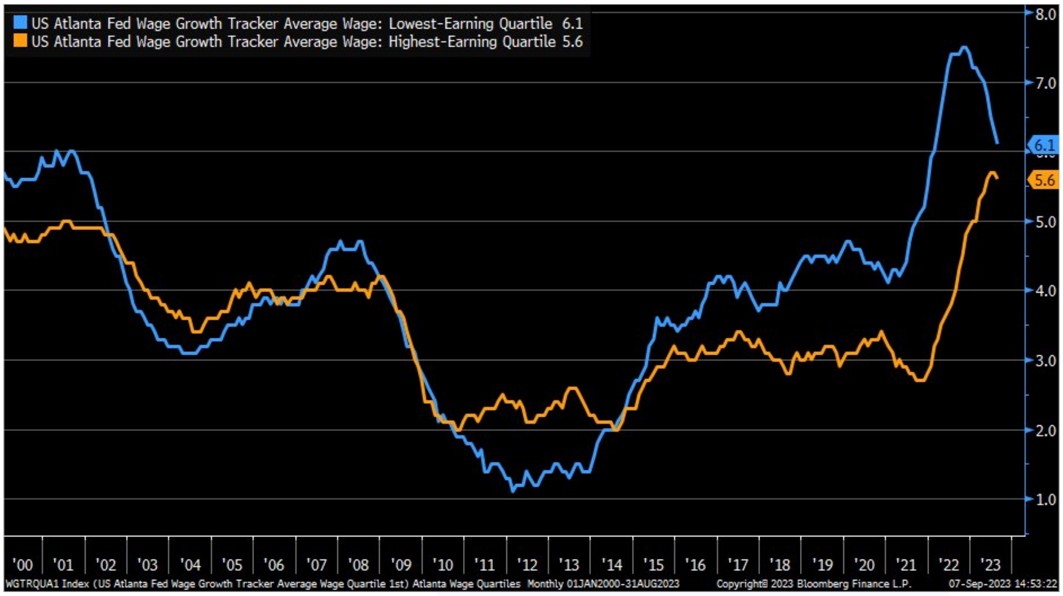
A softening consumer would represent a major transition for the cycle.

Without the consumer keeping demand up, it's gonna be pretty hard for those expectations of 12pct earnings growth in '24 to come true.



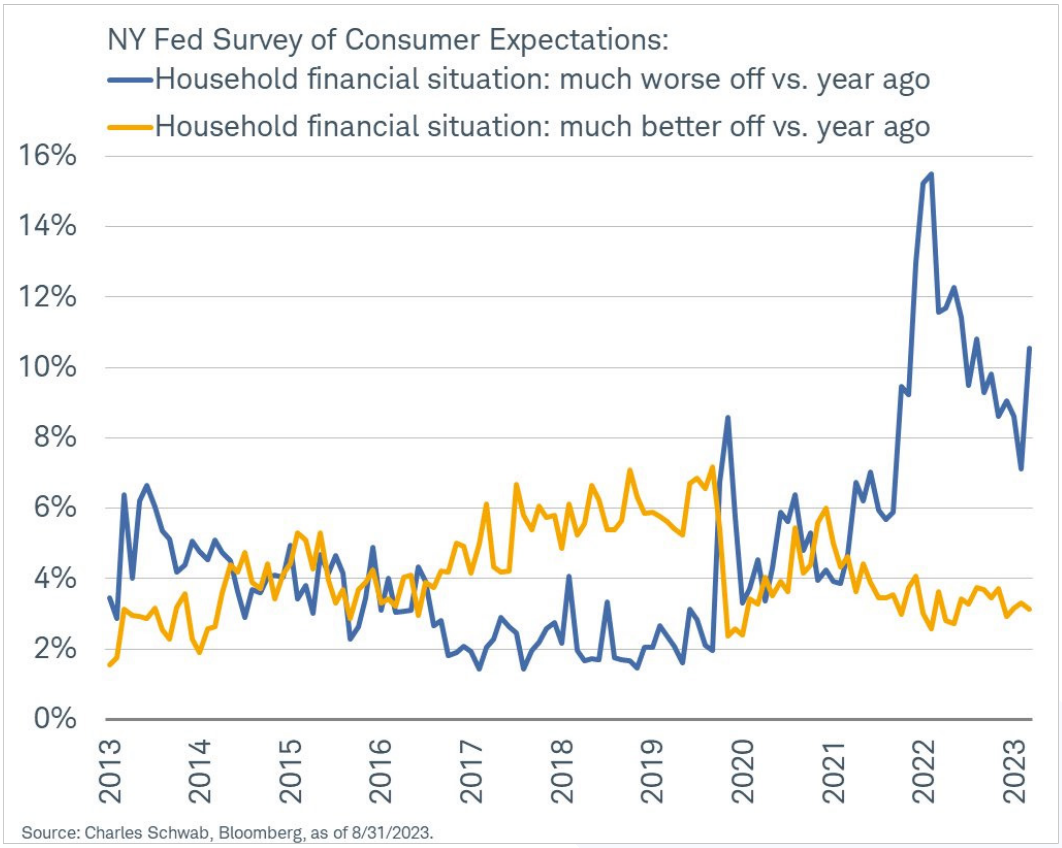
Wage growth isn't falling for high earners, which could explain some of the unexpected resilience in consumer spending this year (from Liz Ann Sonders via X on September 8)...

As tracked by Atlanta Fed, much of slowdown in wage growth has been concentrated in lowest-earning quartile (blue)... highest-earning quartile (orange) has seen growth roll over but barely.



Data suggest many households started running into financial trouble this summer ([from Liz Ann Sonders via X on September 12]())...

> As of August, massive uptick in % of households saying they're much worse off vs. a year ago (blue) per NY Fed Survey of Consumer Expectations



Student loan repayments could create a $100 billion hit to consumer spending ([from The Wall Street Journal on September 16]())...

> The restart of student-loan payments could divert up to $100 billion from Americans' pockets over the coming year, leaving consumers squeezed and some of the nation's largest retailers fearing a spending slowdown.
>
> Starting Oct. 1, tens of millions of student-loan borrowers will need to make payments averaging between $200 and $300 each month. The payments will mark the first time that borrowers have had to make good on their loans since the Education Department instituted a pause in March 2020. In the interim, they spent the money on televisions, travel, new homes and thousands of other products. That spending is one reason the economy has remained resilient in recent years, despite a surge in interest rates.
>
> What the resumption of loan payments means for the broader economy, however, is up for debate, and at least two groups watching closely disagree. Target, Walmart and other retailers that depend on discretionary spending are concerned. Economists, on the other hand, say the renewed payments are a relatively small problem for the more than $18 trillion in annual U.S. consumer spending.

Inside Americans' homes, the debate doesn't matter. Borrowers say they are curtailing their spending in meaningful ways. Making the payments will add another financial obligation to rising credit-card bills, gasoline prices and other costs, and they say uncomfortable cuts will be necessary.

'That'll absolutely have to go'

Colin and Jessica Evans have been moving numbers around in their budget spreadsheet to see where they can free up $300 a month for their loan payments this fall.

Colin Evans, a 33-year-old postdoctoral researcher in Owego, N.Y., said the couple is about to start shaving $50 off their monthly grocery bills, primarily by cutting out small luxuries such as freshly baked bread and seltzer water.

He also zeroed in on two costly staples that propel him through his day: gasoline and coffee. He plans to save on fuel for his 45-minute commute by requesting one additional work-from-home day a week. And he will stop buying a cup of coffee every workday. "That'll absolutely have to go," he said.

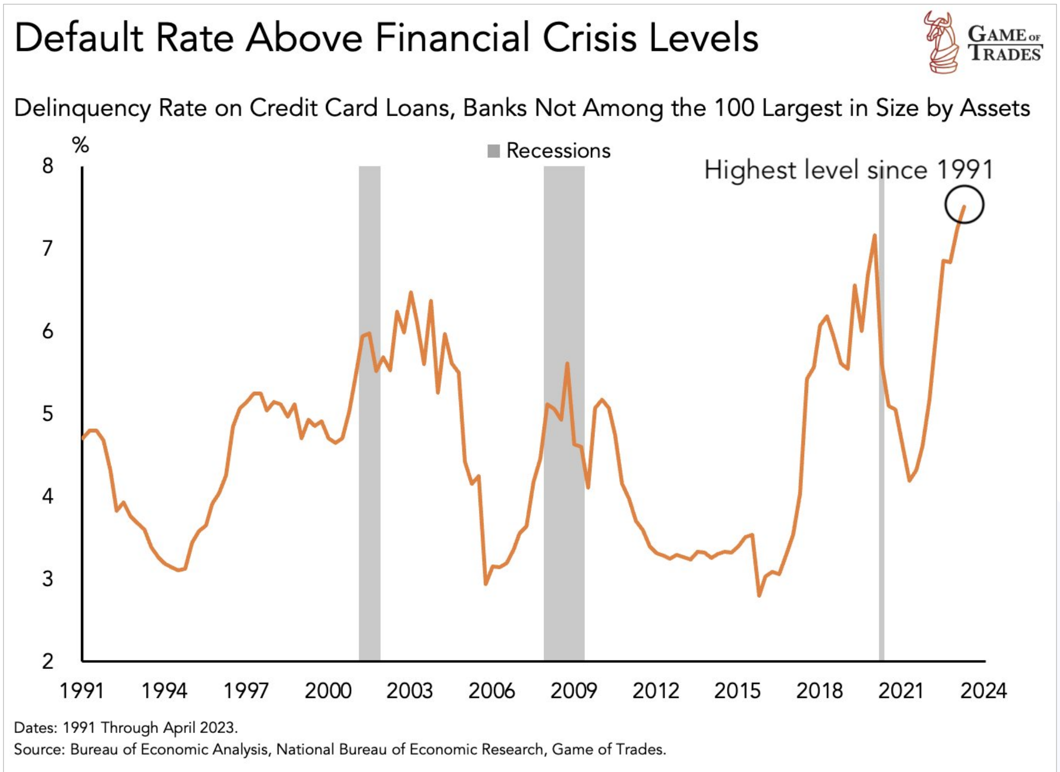
Consumers finding spots to squeeze their budgets worries some large retailers.

"The upcoming resumption of student-loan repayments will put additional pressure on the already-strained budgets of tens of millions of households," Michael Fiddelke, Target's chief financial officer, told analysts last month. "Against this backdrop, we remain cautious in our planning."

Continue reading here (subscription may be required).

Default rates on credit card debt from small lenders are already higher than prior crisis peaks ([from Game of Trades via X on September 21](#))...

> Default rate on credit card loans from small lenders has now surpassed the highs of:
>
> - Dot Com bubble
> - Financial Crisis
> - Pandemic
>
> This won't end well



Credit card losses are rising at the fastest pace since 2009 ([from CNBC on September 22](#))...

> Credit card companies are racking up losses at the fastest pace in almost 30 years, outside of the Great Financial Crisis, according to Goldman Sachs.
>
> Credit card losses bottomed in September 2021, and while initial increases were likely reversals from stimulus, they have been rapidly rising since the first quarter of 2022. Since that time, it's an increasing rate of losses only seen in recent history during the recession of 2008.
>
> It is far from over, the firm predicts.

Losses currently stand at 3.63%, up 1.5 percentage points from the bottom, and Goldman sees them rising another 1.3 percentage points to 4.93%. This comes at a time when Americans owe more than $1 trillion on credit cards, a record high, according to the Federal Reserve Bank of New York.

“We think delinquencies could continue to underperform seasonality through the middle of next year and don’t see losses peaking until late 2024 / early 2025 for most issuers,” analyst Ryan Nash wrote in a note Friday.

What is unusual is that the losses are accelerating outside of an economic downturn, he pointed out.

Of the past five credit card loss cycles, three were characterized by recessions, he said. The two that occurred when the economy was not in a recession were in the mid ’90s and 2015 to 2019, Nash said. He used history as a guide to determine further losses.

“In our view, this cycle resembles the characteristics of what was experienced in the late 1990s and somewhat similar to the ’15 to ’19 cycle where losses increase following a period of strong loan growth and has seen similar pace of normalization thus far this cycle,” Nash said.

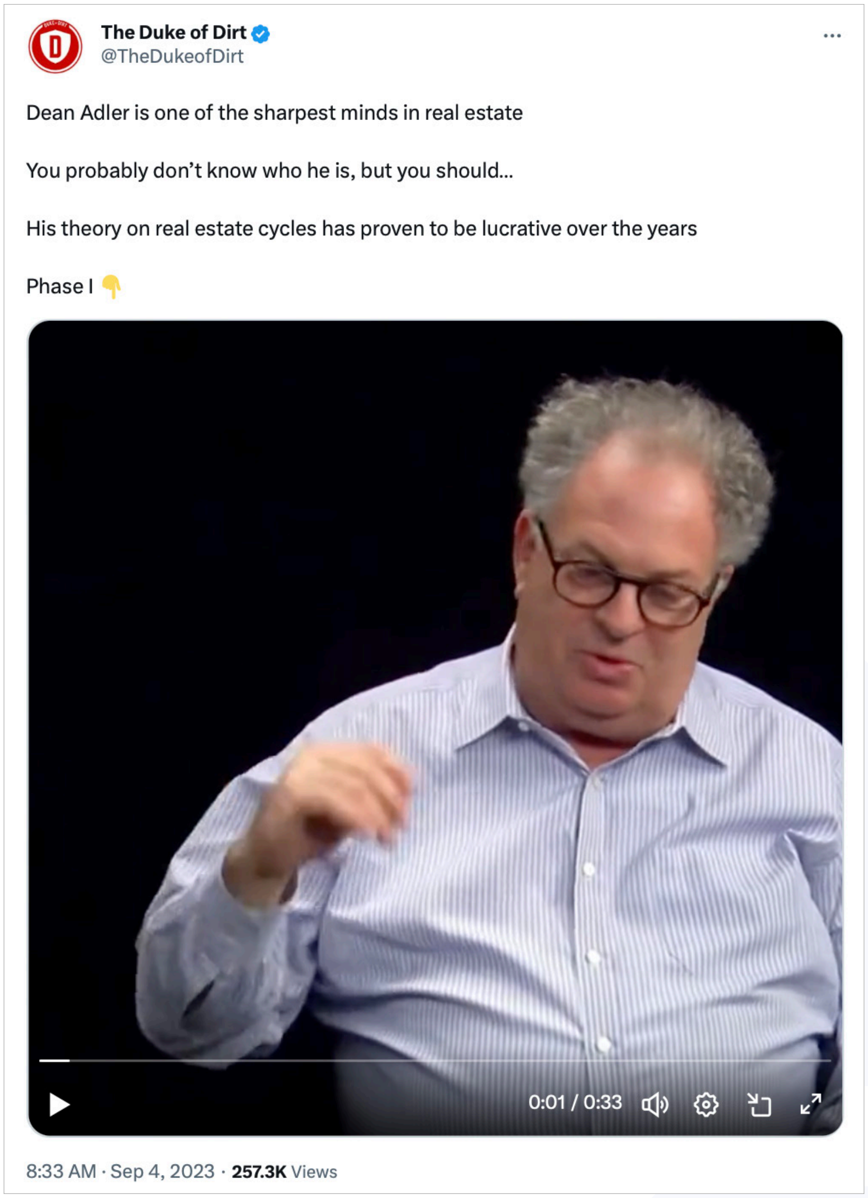
Continue reading here.

Real Estate

Here's a fantastic "deep dive" interview into the commercial real estate (CRE) market, which includes office, multifamily housing (apartments), hotels, data centers, malls, and more (from Blockworks Forward Guidance on August 30)...

> Jack welcomes John Toohig, Head of Whole Loan Trading at Raymond James, Thomas LaSalvia, Head of Commercial Real Estate Economics at Moody's Analytics, and Victor Calanog, Manulife's Managing Director & Global Head of Research and Strategy, Real Estate Private Markets, for a wide-ranging discussions on the challenges and opportunities within CRE, with a focus on how the recent interest rate shock has impacted property values, cash flows, interest expense, and other key metrics in the CRE world.
>
> 00:00 Introduction
> 08:15 Payment Shock For Real Estate Funded With Debt Before The Fed Raised Rates
> 11:02 Maturity Defaults Are On The Rise
> 13:25 Office Sector Is By Far Facing The Biggest Challenges Vs. Other CRE Components
> 19:22 Who Owns The Equity In These CRE Deals?
> 22:25 Gap Between Private Valuations and Public Valuations
> 25:51 Higher For Longer Is Exponentially Increasing Debt Costs For Real Estate
> 30:03 State Of The Secondary Market For Real Estate Loans
> 35:14 Cash Flows Matter More Than "Loan-To-Value"
> 40:08 There's A Hesitation Right Now For Institutions To Take Losses
> 42:27 Odds Of A True Recessions vs. A "Slow-Cession" (and Soft Landing & No Landing)
> 45:35 How Common Is Interest Rate Hedging Among Leveraged Real Estate Investors?
> 48:01 Slowdown In New Originations For CRE Loans
> 52:46 Fundamentals Of Multifamily (Apartment Buildings)
> 01:01:05 Negative Leverage In The MultiFamily Market
> 01:07:31 Insurance Costs Are Skyrocketing
> 01:10:54 Retail (example: Malls) And Hospitality (example: Hotels)
> 01:16:45 China
> 01:20:28 Closing Thoughts On U.S. Banking System
> 01:22:52 Conclusion

Billionaire investor Dean Adler shares a video masterclass on navigating real estate investment cycles ([from The Duke of Dirt via X on September 4](#))...

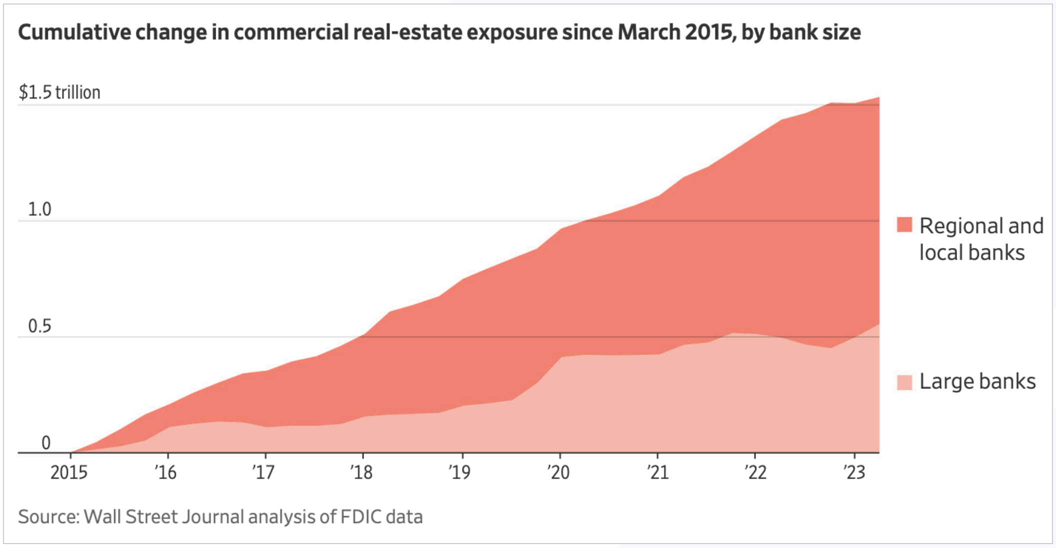


You can watch the full video on Youtube via the timestamps below:

- How Do Real Estate Investors Invest over a Cycle: 0:30
- Real Estate Cycles: 0:36
- The Perfect Investing Period: 1:28
- Core Investing: 5:33
- Cost Basis Advantage: 8:58

America's banks are facing a real estate "doom loop" (from The Wall Street Journal on September 6)...

> Bank OZK had two branches in rural Arkansas when chief executive officer George Gleason bought it in 1979. The Little Rock lender today has billions of dollars in commercial real-estate loans, including for properties in Miami and Manhattan, where it is helping fund the construction of a 1,000-foot-tall office and luxury residential tower on Fifth Avenue.
>
> Regional banks across the country followed a similar playbook, gorging on commercial real-estate loans and related investments in big cities over the past decade.
>
> With the commercial real-estate market now in meltdown, those trillions of dollars in loans and investments are a looming threat for the banking industry—and potentially the broader economy. Banks' exposure is even bigger than commonly reported. The banks are in danger of setting off a doom-loop scenario where losses on the loans trigger banks to cut lending, which leads to further drops in property prices and yet more losses.
>
> Bank OZK hasn't pulled back from lending, but it has started to see some signs of market trouble. In January, a developer defaulted on a roughly $60 million loan from Bank OZK after construction costs escalated, the bank said. The loan was considered relatively safe because it was far below the building site's value of $139 million in 2021. In December, a new appraisal put the property's value at $100 million.
>
> The bank is effectively stuck with the property. "Buying land in the current unstable environment is not something that a lot of people will do," Gleason, the CEO, said during an April earnings call. Bank OZK declined to comment.



> Today's troubled market, fueled by rising interest rates and high vacancies, follows years of boom times. Banks roughly doubled their lending to landlords from 2015 to 2022, to $2.2 trillion. Small and medium-size banks originated many of those loans, and all that lending helped push up property prices.
>
> Bank OZK's success over the years allowed Gleason to build himself a 27,000-square-foot French

chateau-style mansion in Little Rock, which he filled with a vast collection of European art. "I've never said that what we do is risk-less," Gleason told the Journal in 2019. Still, he added, he considers OZK "probably the most conservative" commercial real-estate lender.

Over the past decade, banks also increased their exposure to commercial real estate in ways that aren't usually counted in their tallies. They lent to financial companies that make loans to some of those same landlords, and they bought bonds backed by the same types of properties.

That indirect lending—along with foreclosed properties, trading portfolios and other assets linked to commercial properties—brings banks' total exposure to commercial real estate to $3.6 trillion, according to a Wall Street Journal analysis. That's equivalent to about 20% of their deposits.

The volume of commercial property sales in July was down 74% from a year earlier, and sales of downtown office buildings hit the lowest level in at least two decades, according to data provider MSCI Real Assets. When deals begin again, they will be at far lower prices, which will shock banks, said Michael Comparato, head of commercial real estate at Benefit Street Partners, a debt-focused asset manager. "It's going to be really nasty," he said.

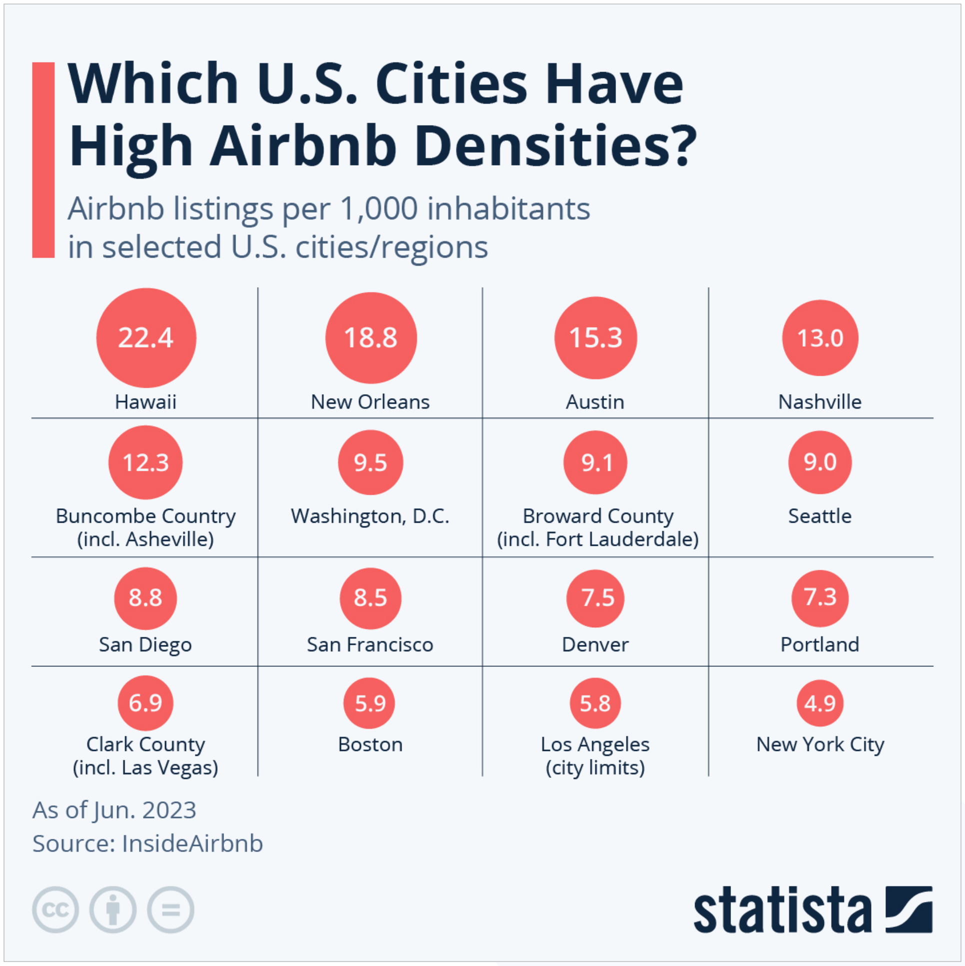
Continue reading here (subscription may be required).

These cities are most at risk of a short-term rental meltdown (from Statista on September 6)...

With 32,597 Airbnb listings for an estimated 1.4 million inhabitants, the island state of Hawaii has the highest Airbnb density out of all U.S. cities and regions analyzed by InsideAirbnb as of June 2023. The project, which scrapes publicly available data from Airbnb's website, was founded by activist and artist Murray Cox and has seen contributions by data journalists and researchers. As our chart based on InsideAirbnb data shows, popular tourist spots don't always have the highest amount of rental listings per 1,000 inhabitants.

New York City, for example, recently passed Local Law 18, which requires short-term rental businesses to register with the city, limits guests per property to two and requires the owners to live in the space they're renting out. In practice, this scales back a booming business model rivaling hotels to an approximation of a paid version of traditional couch surfing. A lawsuit by Airbnb to prevent the law was dismissed in August. Interestingly, New York City only has a density of 4.9 Airbnb listings per 1,000 residents. Other popular tourist destinations analyzed include Broward County (9.1 listings per 1,000 inhabitants), San Francisco (8.5), the city of Los Angeles (5.8) and Clark County, which includes Las Vegas (6.9).

While InsideAirbnb provides details of the prevalence of Airbnb listings in selected cities and regions, it can only show part of the whole picture. The overall importance of the U.S. market for Airbnb can be seen in the company's financial results. In 2022, $4.2 billion of the vacation rental provider's total revenue of $8.4 million was generated in North America, $3.9 billion of which was in the United States. The EMEA region was responsible for $2.9 billion, while the company generated $643 million and $622 million in Latin America and Asia-Pacific, respectively.

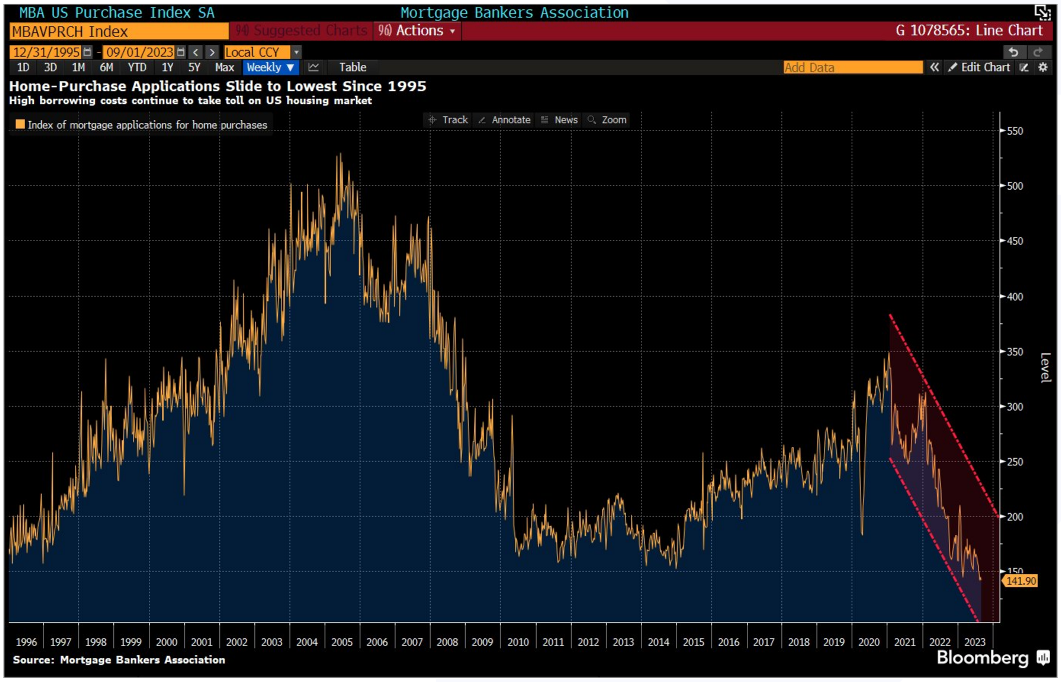


Mortgage rates are surging again ([from The Kobeissi Letter on September 7)]...

> JUST IN: Average interest rate on a 30-year mortgage rises to 7.62%, the highest since 2000.
>
> Mortgage demand just hit a 28-year low and existing home sales are at their lowest since 2010.
>
> Why are rates still rising if the Fed is done hiking?
>
> A lot of it has to do with US deficit spending.
>
> The US is spending so much that they are going to issue $1 trillion of bonds this quarter ALONE.
>
> Q3 and Q4 combined will total $1.9 trillion in bond issuances.
>
> As bond prices fall, rates are rising.
>
> Deficit spending is becoming even more expensive.

Soaring rates have “paralyzed” the mortgage market ([from Lisa Abramowicz via X on September 7](#))…

> As mortgage rates surge to the highest levels since 2000, the mortgage market is going deeper into a state of paralysis. A gauge of US mortgage applications for home purchases fell to a 28-year low last week.



Michael Gayed – publisher of The Lead-Lag Report and portfolio manager at Tidal Financial Group – believes the resumption of student loan repayments next month could also be a super-bearish catalyst for the housing market (from Nasdaq.com on September 21)...

> Investors, beware: The stock market is at a high-risk juncture and a credit event could be just around the corner. One more risk – and potential trigger – that's looming is the restart of student loan repayments.
>
> 
>
>
> The "butterfly effect" is the idea in chaos theory that a small change can trigger a series of larger changes.
>
> When it comes to the housing market, the butterfly effect goes like this: As student loan payments resume, individuals may have less disposable income for discretionary spending, including travel and rentals. This could lead to a decrease in income for owners of second, third, and fourth homes who rely on rental income. As a result, these property owners may be compelled to sell, potentially solving the inventory problem plaguing the housing market and causing prices to decline.
>
> It's not as farfetched as it seems when I first floated the idea on X in mid-June.
>
> **How Student Loan Repayment Trickles Down to Housing**
>
> Student loan debt has been on a vertical trajectory for some time now. As it stands, it's the second-largest consumer debt category (mortgages are the first). The total amount of student loan debt is nearing an astounding $1.8 trillion. Borrowing has become a necessity for many who pursue higher education.

During Covid-19, the Department of Education instituted an automatic pause on federal student loan payments in 2020. During this pause, interest on these loans was suspended, providing much-needed financial relief for borrowers. This policy has been extended multiple times, affording borrowers over three years of relief from loan payments. This pause is set to end in October 2023, reintroducing a significant financial burden to millions of individuals.

The resumption of student loan payments could have a domino effect on the housing market. As borrowers grapple with this reintroduced financial obligation, they might need to cut back on discretionary spending. This could lead to less spending on travel and rentals, potentially impacting homeowners who rely on rental income from properties listed on platforms like Airbnb.

This decrease in rental income could strain homeowners, particularly those who own multiple properties. They might be forced to sell their additional properties. In turn, this could increase the inventory of homes available for sale. An increase in housing inventory could alleviate some of the current housing market pressures, possibly leading to a decrease in home prices.

The potential for an increase in housing inventory due to the resumption of student loan payments comes at a time when the housing market is already strained.

Brace Yourself for a Housing Market Crash

Over the past few years, the housing market has faced limited inventory and skyrocketing prices. The median home price in the U.S. has seen a significant increase, making homeownership increasingly unattainable for many. If the resumption of student loan payments leads to an increase in housing inventory and a decrease in home prices, it could potentially make homeownership more attainable for some. However, for those grappling with student loan debt, the prospect of homeownership might still be out of reach.

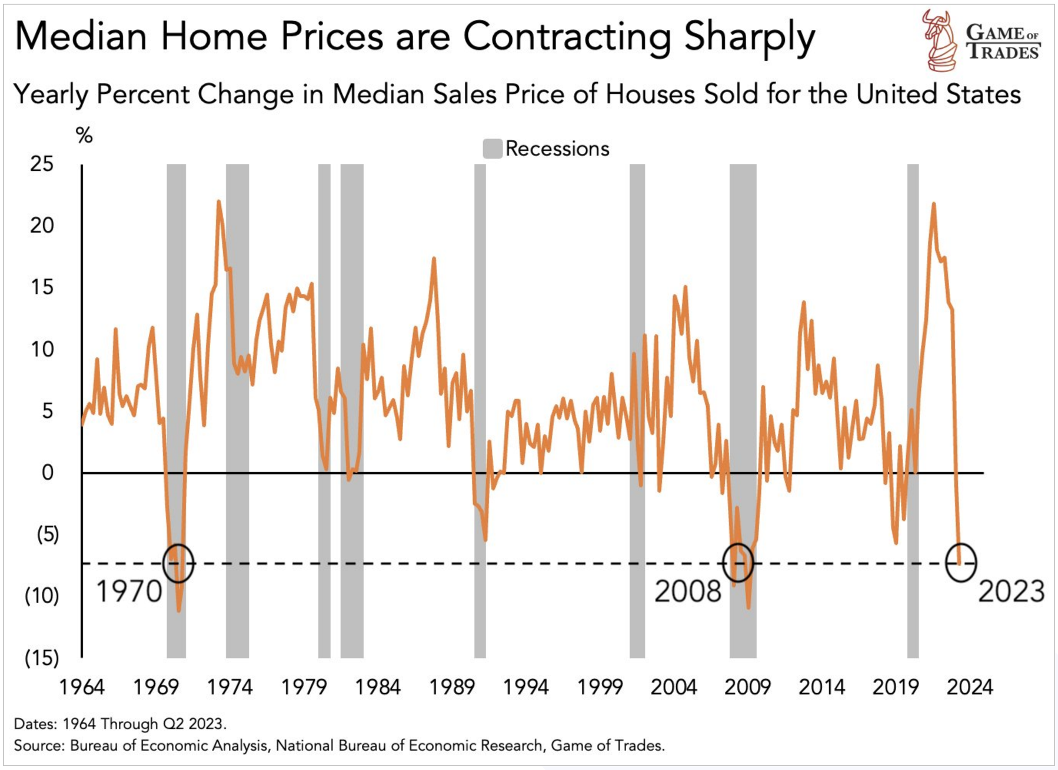
For borrowers, the resumption of student loan payments means that a significant portion of their income will once again go toward debt repayment. The average student debt payment is substantial, with borrowers paying hundreds of dollars per month. Down payment? Good luck. With the resumption of student loan payments, many borrowers might find their debt-to-income ratios negatively impacted.

This could hinder their ability to qualify for a mortgage, further complicating their path to homeownership.

I think that student loan repayments could be the very catalyst the housing market needs to break. And if I'm right, that's a long cycle that will take time to play out.

Home prices are now falling at one of the fastest rates in history (from Game of Trades via X on September 23)...

> Home prices are now contracting at levels only seen 2 times.
>
> Both ended in deep recessions.



Special Situations

Activist Investing, Spinoffs, Arbitrage, Mergers & Acquisitions (M&A), and More

A handful of hedge-fund special situations that are still actionable today (from Dalius - Special Situation Investments on September 16)...

> Finished going through all hedge fund pitches made on this account over the last 4 quarters.
>
> Below, you'll find a list of my top 10 favorite picks that are still actionable. 👇
>
> **1/ $CLBT pitch by @GreenhavenRoad**
>
> CLBT is SaaS for law enforcement agencies in the US and EU with 90% of revenue coming from gov sources and the rest from large corporations. Most importantly, these agencies are forced buyers as they cannot develop the expertise themselves.
>
> CLBT has been profitable and self-funded in its 20+ years of life. Trades at 4x EV/ARR despite 3y avg NRR of 125%+, 80%+ GM, and 30%+ ARR growth. One of its much smaller peers just got acquired by TB for 10× 2023 revenues.
>
> Updated pitch:
>
> https://static1.squarespace.com/static/5498841ce4b0311b8ddc012b/t/64cd0af1b79159412cd52282/1691159281559/Greenhaven+Road+-+2023+Q2+FINAL+-+PUBLIC.pdf
>
> **2/ $DK pitch by Maran Capital @Dan_Roller**
>
> Holding firm with 4 refineries, 250 gas stations, and a majority stake in its publicly traded midstream oil and gas MLP, $DKL. Currently, DK's position in DKL covers 75% of its EV, valuing the refineries and gas stations at sub-$500m.
>
> The stub is likely worth between $1.8bn to $2.4bn. Most importantly, mgmt seems determined to unlock the SOTP discount expressing its intent on multiple occasions. The key risk is capital allocation outside of SOTP unlock strategy.
>
> Q1 letter (no updates): https://mcusercontent.com/4522df4fcbfa5be002117f260/files/ca2913bb-4efd-1777-0c7e-cb95676e9da1/Maran_Partners_Fund_LP_2023_1Q_Letter.pdf
>
> **3/ $OSW pitch by @Mc_Partnerships**
>
> Provider of spa services on cruise ships. Set to benefit from continued recovery of cruise travel. Moreover, OSW is a quasi-monopoly with 90%+ market share, a strong growth outlook and high barriers to entry simply due to its unreplicable scale.
>
> At full capacity by FY23 and historical EBITDA margins, OSW should be generating about $0.75-$1.10/share in FCF. Putting a 15-20x multiple on that makes OSW a $11-$22/share stock.
>
> Full $OSW pitch: https://mcvalue.blog/2022/10/27/our-q3-2022-letter/
>
> **4/ $GFF pitch by @GreystoneCap**
>
> A high-quality building product business that has been mispriced due to the unaligned governance

structure. A couple of months ago, Capital Voss, the activist, managed to secure a board seat and push GFF to explore strategic alternatives.

Review ended without the sale due to a tough macro environment. Yet GFF is undervalued and the activist continues to overlook the affairs. A high-quality garage door biz with a 50% mkt share in the US is likely worth the entire Mcap of GFF.

Updated pitch: https://greystonevalue.com/_files/ugd/47fd79_4bc7a737390344ceb68d07367503b878.pdf

5/ $ALOT pitch by @AtaiCapital

Primarily a manufacturer of airplane cockpit printers plus a provider of label printers. Cockpit business is an actual monopoly protected from larger peers due to a small and niche enough market on top of the FAA's expensive regulatory framework.

Crux of the thesis centers around the expected increase in airplane production to pre-Covid levels leading to continued growth in revenues and earnings. At 10× 2024E EBITDA multiple vs. peers at 15x, ALOT is $24/share stock.

Original pitch: https://static1.squarespace.com/static/635cafa2259a125cc55eae33/t/64387c7cf1e5c4626d787d38/1681423485063/Atai+Capital+-+Q1-2023+Letter.pdf

6/ $FTLF pitch by @alluvialcapital

Health and fitness supplements retailer recently completed a transformational acquisition likely to double its sales and increase income by 50%+. A highly profitable, fast-growing, and well-managed firm trading at just 12-14x PE ex-cash.

This is also a "Jockey" bet on the CEO/controlling shareholder to continue executing. Thus far, the CEO has built a strong distribution channel, nine portfolio brands, and a healthy e-commerce presence.

Original pitch:

https://alluvialcapital.com/wp-content/uploads/2023/01/Alluvial-Capital-Management-Q4-2022-Letter-to-Partners.pdf

7/ $BELFB pitch by @AtaiCapital

Dirt-cheap electronic components manufacturer - a good business with sticky long-term customers, solid organic growth, and strong end markets. Yet it trades at just 6× 2024E EBITDA vs. peer multiples at 13x-18x and LT industry average at 10x-12x.

EBITDA expected to almost double by 2025 driven by secular industry tailwinds, restructuring efforts and a new CFO, who is highly focused on expanding margins. Valuation disconnect will gradually narrow down as margins continue to expand.

Original pitch:

https://static1.squarespace.com/static/635cafa2259a125cc55eae33/t/64aeb0347a63bf404bec0f6f/1689169973044/Atai+Capital+-+Q2-2023+Letter.pdf

8/ $LGT.B pitch by @alluvialcapital

A small-cap operator of irreplaceable infrastructure assets exploring a sale following the controlling family's announcement of their intention to sell. Given the robust demand for port-related assets, finding a buyer shouldn't pose an issue.

Divesting env. seg. complicates matters, but a suitable buyer can no doubt be found. If the sale occurs, there is at least a 40% upside. In a no-deal scenario, the downside is limited by a modest valuation and a "for sale" tag on LGT.

Original Pitch:

https://alluvialcapital.com/wp-content/uploads/2023/07/Alluvial-Capital-Management-Q2-2023-Letter-to-Partners.pdf

9/ $LFCR pitch by @LaughingH20Cap

Since the original pitch, quite a bit has changed here. LFCR has divested an underperforming business, refinanced debt, and started to explore strategic alternatives. Today's thesis centers around a likely sale of a pure-play CDMO business.

This is a highly strategic asset with growing end markets and an active M&A space. If sold within the next couple of months, Laughing Water Capital estimates a buyout price 40-200% higher than today.

Updated pitch:

https://static1.squarespace.com/static/5d93ed0b59166652b0d66427/t/64b57923ed8b3a51b97625fb/1689614627342/LFCR+LWC+Top+Idea.pdf

10/ $LNA.P pitch by Palm Harbour Capital

One of the leading care home operators in France. The stock is down 40% mainly due to a scandal at their much larger peer Orpea. However, the situation over at LNA is completely different and thus LNA share price reaction is undeserved.

Family-owned and operated, high-quality business with significant barriers to entry. Trades at FCF yield above 12% on 2024 numbers. Strong pipeline of additional beds and demographic tailwinds from the aging population.

Original pitch:

https://palmharbourcapital.com/files/PHC_Letter_Q4_2022_FINAL_EN.pdf

---

Jason Wild – Executive Chairman of U.S. cannabis firm Terrascend (TSNDF) – appears to be bullish on the company's stock (from Todd Harrison via X on September 19)...

The never-ending gobstopper.

@JasonGWild continues to buy his own stock.

🇺🇸 #cannabis 🌿 position/advisor $TSNDF

Filed **2023-09-19** 04:42 Tx date 2023-09-18	$TSND TerrAscend Corp.	Wild, Jason 3 - 10% Security Holder of Issuer, 4 - Director of Issuer **Holder: JW Growth Fund, LLC (Control or Direction)**	**Common Shares** 10 - Acquisition or disposition in the public market	**$51,600** **+25,000** vol **$2.06** each	2,337,404
Filed **2023-09-18** 06:49 Tx date 2023-09-15	$TSND TerrAscend Corp.	Wild, Jason 3 - 10% Security Holder of Issuer, 4 - Director of Issuer **Holder: JW Growth Fund, LLC (Control or Direction)**	**Common Shares** 10 - Acquisition or disposition in the public market	**$185,138** **+85,000** vol **$2.18** each	2,312,404

An Advance Auto Parts insider just made a big purchase of the company's stock (from Barron's on September 22)...

> A stock is seeing yet another year of sharp declines, but the retailer's interim executive chair stepped in and bought a large block of its shares on the open market.
>
> Advance Auto stock (ticker: AAP) has lost about 60% of its value so far in 2023, following a 39% drop in 2022. A string of disappointments would probably require more than a pit stop to fix. Quarterly reports have been disappointing, the dividend has been cut, the CEO plans to retire, the finance chief was ousted, the company's credit rating was lowered, and it was removed from the S&P 500.
>
> Still, Director Eugene I. Lee paid $500,000 on Sept. 13 for 8,670 Advance Auto shares, at an average price of $57.65 each. He made the purchase through a family trust that now owns 19,430 Advance Auto shares, according to a form that Lee filed with the Securities and Exchange Commission. He owns another 68,838 shares through a personal account.
>
> Advance Auto didn't respond to a request to make Lee available for comment. Lee had been serving as Advance Auto's chairman, but in late May he assumed an expanded role as interim executive chair as Tom Greco, president and CEO, prepares to retire at the end of the year.

Continue reading here (subscription may be required).

Three recent spinoffs that are potentially undervalued today (from Barchart on September 24)...

> I look for value anywhere, but one space that I have devoted a lot of my years to with investing is the Spinoff space. It is the most lucrative hunting ground for great companies that are in some way dislocated from the market and do not garner much attention.
>
> In a Spinoff corporate transaction, a parent company separates one of its business entities or divisions into an independent, stand-alone company. By distributing shares of the Spinoff company to the current owners of the parent company, two distinct publicly traded entities are created. The new business that results from a Spinoff is frequently referred to as a "Spinoff company". Spinoffs can increase shareholder value by enabling separate companies to concentrate on their core competencies and by releasing hidden value in particular business divisions. In addition, it allows investors to invest in a variety of companies according to their investment preferences and risk tolerance.
>
> More importantly and where part of the value is, Spinoff companies are rarely covered by the mainstream. They are usually very different businesses to the parent business they were spun off from and so they are frequently referred to as 'orphan securities.' They can have extreme dislocation from the wider market for several reasons. The main ones are:
>
> Misunderstanding of the market: Investors may not completely comprehend the business, strategy, or growth prospects of the Spinoff company. Consequently, they may undervalue or overvalue the company, resulting in a gap between the market price of the stock and its true value.
>
> Spinoff companies, particularly lesser ones, may not receive as much analyst coverage as larger, more established companies. This limited coverage can result in an absence of information and analysis for investors, thereby contributing to price anomalies.
>
> In some instances, shareholders who receive shares of the Spinoff company because of the separation may not desire to hold on to them and may sell them quickly. This can cause an oversupply of shares on the market, resulting in a technical price decline.

Particularly in these three instances, the market may provide an opportunity for you to invest and it's important to keep track of the 35-40 situations that become investable throughout the year. Three I currently own that tick the boxes above are here:

Cerence Inc. (CRNC)

The company was founded as a division of the well-known provider of speech recognition and natural language processing technologies, Nuance Communications. It specializes in providing voice recognition solutions to numerous industries, including the healthcare and automotive industries. In October of 2019, Nuance Communications announced that its automotive division would be spun off as Cerence Inc. This action aimed to establish a distinct, specialized entity that could better satisfy the market's particular requirements. Cerence, as an independent company, shifted its primary focus to the automotive industry, offering AI-powered solutions to facilitate voice commands, natural language comprehension, and conversational AI in vehicles. Its technology is designed to enhance the driving experience, increase safety, and enable hands-free operation of in-car systems.

Two years after Spinning off CRNC, NUAN was bought for $19.7bn (including debt) by (MSFT) in one of the largest acquisitions ever made by MSFT (who previously spent $26bn for LinkedIn in 2016). While this acquisition was announced in April 2021, the deal was fully cleared and finalized in Q1 2022 at a +23% premium and NUAN was up more than +200% since its break-up at the time it was acquired.

Longer-term, CRNC is a takeover candidate for companies leaning towards increasing positions in tech mobility, such as (CON.D.DX) , which aims to secure its long-term position in the market. On the other hand, there is rapid growth and cutthroat competition across AI. Some automobile companies like (GM) , (NSANF) , (VOLVB.S.EB) , (VOW3.D.DX), (F) and EV startup (RIVN) are partnering with companies like (GOOGL) and (AMZN) to integrate virtual car software. We believe other big tech companies are also looking to enter this space by acquiring companies operating in virtual assistants, like CRNC. The big plus point on this company is that the Spinoff is through its two-year tax-free rule and a recent study by The Edge Group suggests that 35% of Spinoff names are likely to be taken over around this point.

In addition, relatively newly appointed EVP & CFO Tom Beaudoin (joined May 2022) recently bought 5,000 shares of CRNC at $18.80 for ~$94,000 in December 2022, making this the only insider purchase since CRNC's Spinoff on October 1, 2019. While this is not the strongest insider buy/indicator that I have seen due to this being Mr. Beaudoin's first open-market purchase ever, his strong takeover background speaks volumes.

Valuing CRNC by applying a 15.7× 2024 EV/EBITDA multiple (discount of 10% to its peers) to the 2024E adjusted EBITDA forecast of $99.3m. A 15.7x valuation multiple was reached based on the average multiple of Auto Tech and Vertical Software companies; historically, CRNC has traded at a discount of ~35% to peers. CRNC's strong software position in AI-based virtual assistants for mobility and a strong future growth will reduce these peer discounts by 10% to 15%. The key trigger is CRNC is set to benefit from the increased fixed contracts and its license business remaining strong. The Base case target price is $30, implying an upside of +50%.

Phina Inc. (PHIN)

PHINIA is a Spinoff of (BWA), a global automotive supplier. The Spinoff was completed on July 3, 2023. PHINIA, Inc. possesses a wide range of original equipment in its portfolio, consisting of advanced fuel injection systems, fuel delivery modules, canisters, starters, alternators, sensors, and electronic control modules. With a global presence, the company operates 17 major manufacturing facilities and seven major technical centers strategically located to cater to its global customer base. Post Spin, PHINIA is anticipated to emerge as a prominent leader in fuel systems, starters, alternators, and aftermarket distribution.

The company aims to achieve this by maintaining a balanced and synergistic presence across various end markets, including Commercial Vehicle, Light Vehicle, and Aftermarket. PHIN's focus would be to excel as a leading provider in its product categories while catering to diverse customer needs across different regions. In addition to serving original equipment manufacturers (OEMs), PHIN also manufactures and sells its products to prominent participants in the aftermarket segment. This includes independent retailers and wholesale distributors who rely on PHIN for high-quality automotive components. The company offers both new and remanufactured products, including diagnostic equipment, ignition coils, smart remote actuators, exhaust gas recirculation valves, brakes, steering, suspension, and various other automotive components.

During their investor day 2023, PHINIA's management emphasized their primary focus on expanding their commercial vehicle and independent aftermarket businesses. These sectors are expected to be less impacted by electrification trends and are poised to benefit from the transition to carbon-neutral and carbon-free fuels. The belief is that carbon-neutral fuels offer the most favorable overall performance and utility for many applications, whether in liquefied or gaseous form. This is especially true for scenarios that involve high power requirements, heavy loads, long-distance travel, off-highway operation, and high uptime demands.

These fuels' energy density, portability, and practicality become essential in such cases. There are some regions focusing on carbon-neutral fuels as their pathway to carbon neutrality rather than BEV. This strategic choice is driven by several factors, including ample renewable power sources, infrastructure development challenges, and national security and independence considerations.

The aftermarket market is experiencing substantial growth and holds significant potential. This expansion is driven by two key factors: (i) the increasing number of vehicles on the road and (ii) the increasing average age of vehicles. However, the commercial vehicle market still faces challenges in terms of electrification. Many electrification efforts are concentrated on lighter vehicles with lower mileage. Given this landscape, PHINI focuses primarily on larger, higher-power, long-haul, and off-highway applications. For PHIN, the aftermarket segment is expected to contribute long-term stability to the overall business. One primary reason is the sustained growth of this market, driven by the significant increase in new car prices, which has raised concerns about the affordability of new vehicles. As a result, more individuals are opting to extend the lifespan of their cars, leading to a greater demand for after-sales products and services.

PHIN also stands to benefit significantly in the event of any setbacks to the electric vehicle transition. This includes potential uncertainties surrounding EV demand, challenges related to supply chain feasibility, or traditional OEMs adopting a slower approach to EV volumes due to concerns about margin impacts. In this context, PHIN can be viewed as an attractive form of hedge for investors who are anticipating a rapid and significant transition toward EVs. By maintaining a focus on technologies and solutions that cater to larger, higher-power applications, as well as off-highway and industrial sectors,

PHIN is well-positioned to thrive even in scenarios where the EV transition faces obstacles or delays.

This strategic positioning allows the company to mitigate potential risks associated with the pace and scale of EV adoption. As a result, investors who want to avoid risk exposure to the EV market can consider PHIN an appealing investment option that offers diversification and resilience against uncertainties surrounding the EV transition.

PHIN is valued by applying a 4.7× 2024 EV/EBITDA multiple (in-line with peers) to a 2024 adjusted EBITDA forecast of $527 million. A 4.7x valuation multiple is reached based on the view that PHIN has lower leverage compared to its peers and has a reasonable margin profile. The management has set a target leverage of around 1.0x, which is lower than the industry average of 2.2x. More importantly, the comfortable valuation is supported by an FCF yield of ~13%. PHINIA is expected to report a free cash flow of $200 million in FY2023E.

When considering the implied market capitalization of $1.5 billion for PHIN and the FCF yield works out to around 13%, based on this analysis and applying the 4.7x multiple, the Base case target price for PHIN is $41.07, implying an upside of +57%.

Sphere Entertainment Co. (SPHR)

MSG announced its intention to Spinoff its live entertainment and media assets into two separate entities in 2023. MSG Entertainment will have ownership of Madison Square Garden, Radio City Music Hall, and MSG Networks. The second entity, MSG Sphere, will own the MSG Sphere Las Vegas, a new, state-of-the-art venue slated to open on September 29, 2023, when rock band U2 debuts the first of 25: UV Achtung Baby Live performances. The MSG Sphere at The Venetian, also known as The Sphere in Las Vegas, is an entertainment venue currently under construction in Paradise, Nevada, adjacent to the Las Vegas Strip.

The goal of the Sphere is to revolutionize the entertainment experience by constructing an immersive environment using cutting-edge technologies. It is the future, and investors should contemplate investing in it for potentially huge returns. The goal of The Sphere entertainment is an immersive, multisensory experience. It is poised to transform live entertainment as we know it, and investors have an opportunity to be a part of the journey.

The MSG Sphere is more than a venue; it is a technological marvel. With an enormous LED exterior in the shape of a dome and an even larger interior screen, it promises to provide visuals that encompass the entire venue. The cutting-edge beamforming technology will immerse you in a world of sound where each note and beat are directed precisely at your hearing. Using haptic technology, you will "feel" the music through the floor, generating an unparalleled sensory experience.

Continue reading here.

Subtitling and dubbing provider Zoo Digital could see shares rise significantly if the ongoing Hollywood strikes are resolved (from ToffCap via X on September 25)...

> This could rerate really quickly... $ZOO

BY ANDREW DALTON
Updated 5:21 PM GMT+2, September 25, 2023

Share

LOS ANGELES (AP) — The union representing screenwriters reached a tentative agreement with Hollywood studios to end a historic strike after nearly five months, raising hopes that a crippling shutdown of movie and television filming could be near an end.

Actors remain on strike, but the deal with writers might help them find a resolution soon as well.

The Writers Guild of America announced the deal Sunday in a joint statement with the Alliance of Motion Picture and Television Producers, the group that represents studios, streaming services and production companies in negotiations. The agreement must be approved by the guild's board and members before the strike officially ends. That could happen this week.

ToffCap @ToffCap · Sep 21 ·

$ZOO pitch on VIC. I was (probably) going to write this one up but someone beat me to it.

Super easy thesis: if you believe that the Hollywood strikes will get resolved over the next year... multi-bagger potential.

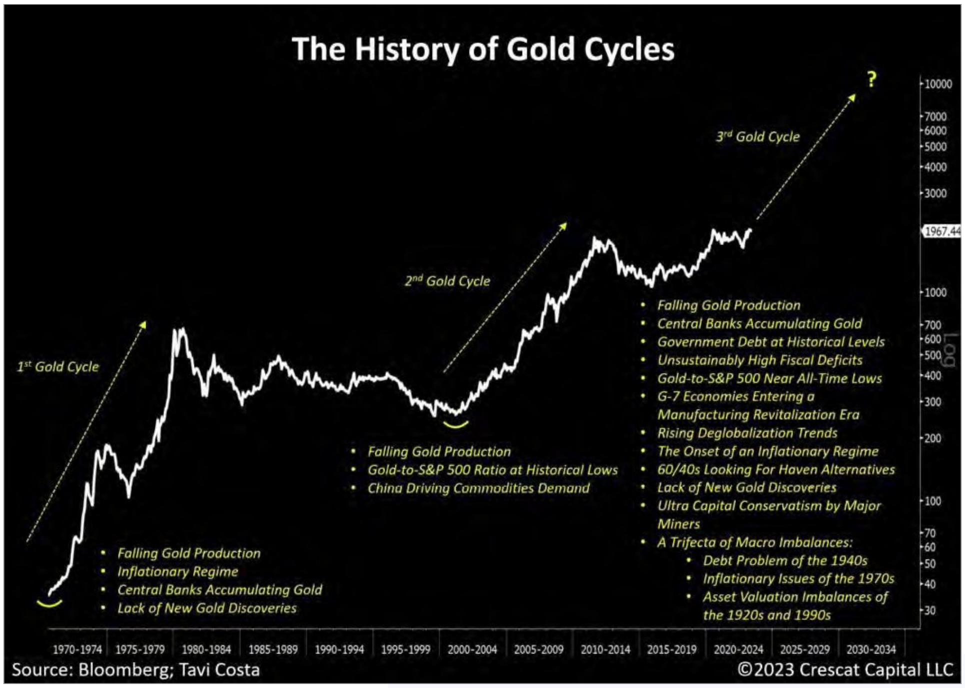
Precious Metals

Silver appears to be working on a massive, long-term bullish breakout ([from Northstar via X on September 8](#))...

#Silver - eyes on the prize

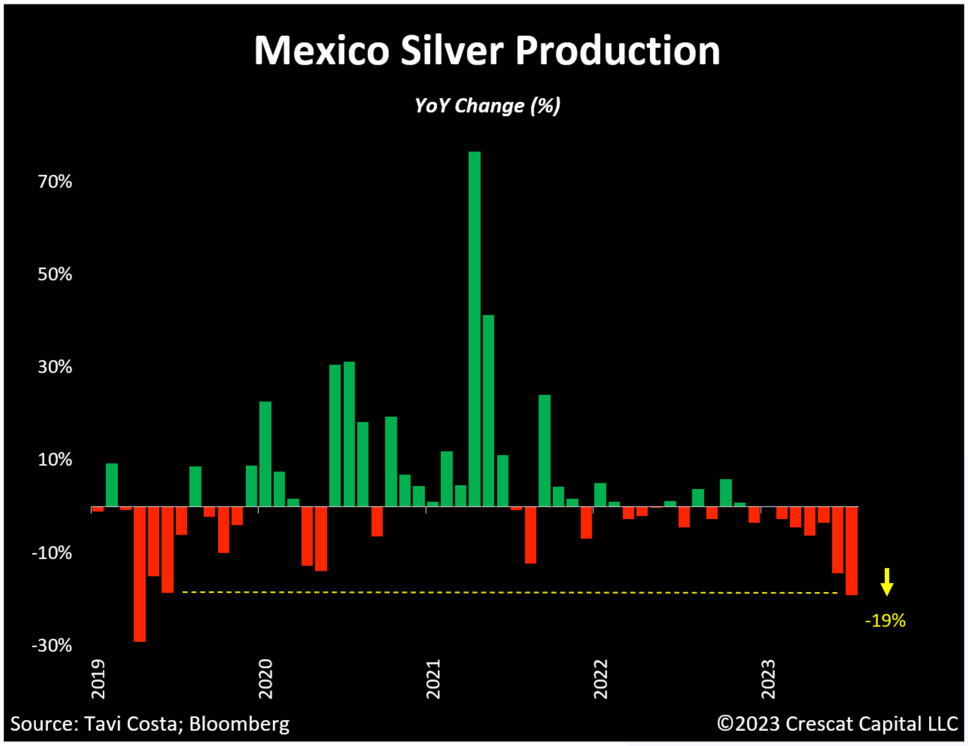
This is where the next gold cycle could end (from Ronnie Stoeferle via X on September 19)…

> Another great chart by my buddy @TaviCosta



The world's largest silver producer just reported its sharpest production decline in years (from Otavio Costa via X on September 22)...

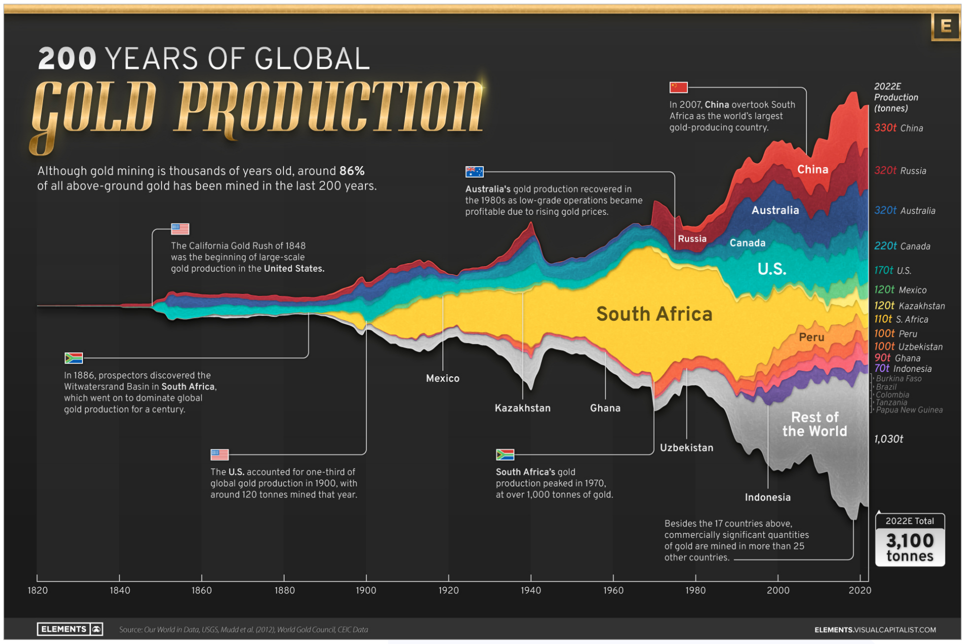
> Mexico just reported its steepest decline in annual production of silver in 4 years, which is notably worse than during the covid lockdowns.
>
> Let us not forget: That is by far the largest producer of the metal in the world today.
>
> The supply of silver remains remarkably constrained, and if this is indeed the beginning of another gold cycle, the metal could be worth multiples of its current price.



Gold also appears to be close to a significant long-term breakout (from TheGoldPrairie via X on September 23)...

> #gold is SO CLOSE to breaking out and leaving sub 2000 forever

Visualizing 200 years of global gold production ([from Visual Capitalist on September 24](#))...



Click here to see a high-resolution version.

Energy

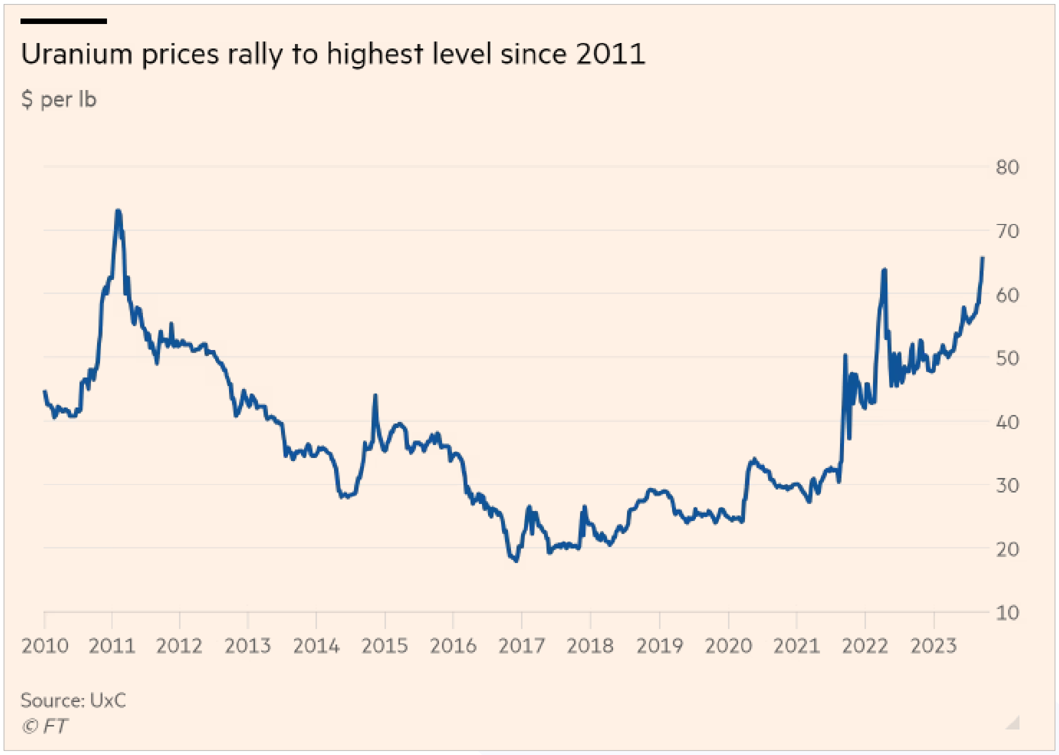
America's wind-farm "revolution" is broken (from The Wall Street Journal on September 7)...

> Offshore wind farms should be one of the best solutions to the climate crisis but are turning out to be a lousy business. Getting the struggling industry back on its feet will require a new approach from companies and politicians alike.
>
> The public face of the dilemma is Ørsted, a former oil and gas producer that became the world's largest offshore wind-farm developer. The Danish company's stock has lost more than $10 billion, or a third of its market value, since warning last week that it may take impairments of up to $2.3 billion on its U.S. projects. On Tuesday, ratings provider Moody's downgraded the stock, a further challenge for a company that, like a property developer, needs debt to fund its plans.
>
> Ørsted won contracts to develop wind farms off the coasts of Connecticut, New York and New Jersey in late 2018 and 2019. Since committing to sell the power from these projects at a fixed price, permitting delays, rising costs and higher interest rates have torched the returns it expected to make.
>
> The Biden administration wants to have 30 gigawatts of offshore wind capacity by 2030, from less than 50 megawatts today. Generous subsidies in the Inflation Reduction Act are meant to turbocharge investment. Ørsted hoped bonus tax credits in the climate bill for using locally produced components would paper over financial cracks, but now says its wind farms may not qualify.
>
> The company says it will abandon projects if it doesn't get more government support, and rivals are also rethinking their U.S. plans. Shell and Avangrid face multimillion-dollar fines for calling it quits on offshore wind-farm developments in Massachusetts that they can no longer justify. There is trouble further up the supply chain, too. Siemens Gamesa and Vestas, which together make roughly 80% of all turbine blades and nacelles for projects outside China, are losing money.
>
> Of all renewable energy projects, offshore wind farms may be the most vulnerable to rising interest rates as they take longer to build and have higher upfront costs. According to George Bilicic, global head of power, energy and infrastructure at Lazard, building a U.S. offshore wind farm can cost $4,000 per kilowatt at the midpoint of estimates, compared with $1,360 for onshore farms and $1,050 for solar facilities. Average costs to build an offshore wind farm have shot up 36% since 2019, compared with 5% for land-based ones, in part because of pricier debt.

Continue reading here (subscription may be required).

Uranium broke out to a new 12-year high this month (from Barchart via X on September 15)...

URANIUM PRICES have surged to highest level in more than a decade 🚨



The U.S. Strategic Petroleum Reserve (SPR) has now fallen to its lowest levels since 1985 ([from Disruptor via X on September 19](#))...

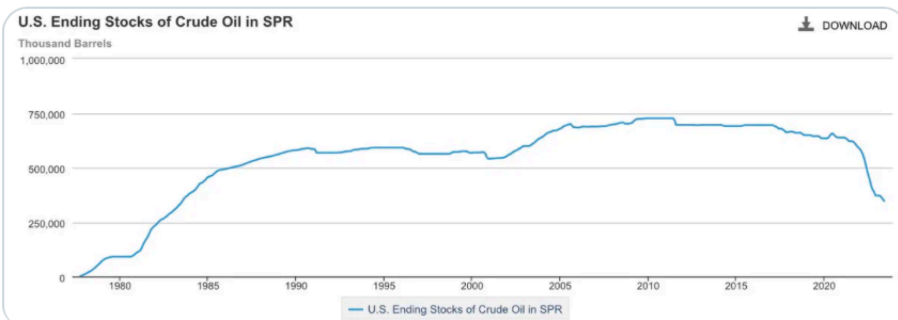
> Biden willing to risk it all and empty the SPR tanks in Hail Mary bid for re-election.
>
> Disgusting.
>
> We could have refilled so much cheaper too.

Dillon Evans
@realDillonEvans

This is a chart of the SPR. In March 2020, the US could have filled the SPR with over 100M barrels at $24/barrel.

Chuck Schumer and his Senate colleagues laughed and called it a "bailout for oil companies".

I wonder if he is still laughing.



U.S. shale oil production is expected to decline again next month, led by the Permian ([from Tracy via X on September 19](#))...

> Annnd quietly under the radar ....in yesterday's EIA drilling report, they estimate that US shale production will decline in October, led by the Permian.
>
> In fact, this is the third month they are showing declines in Permian production.
>
> Talked about declines in US shale production showing up in Q4 weeks ago for
>
> @complete_intel's podcast The Week Ahead.

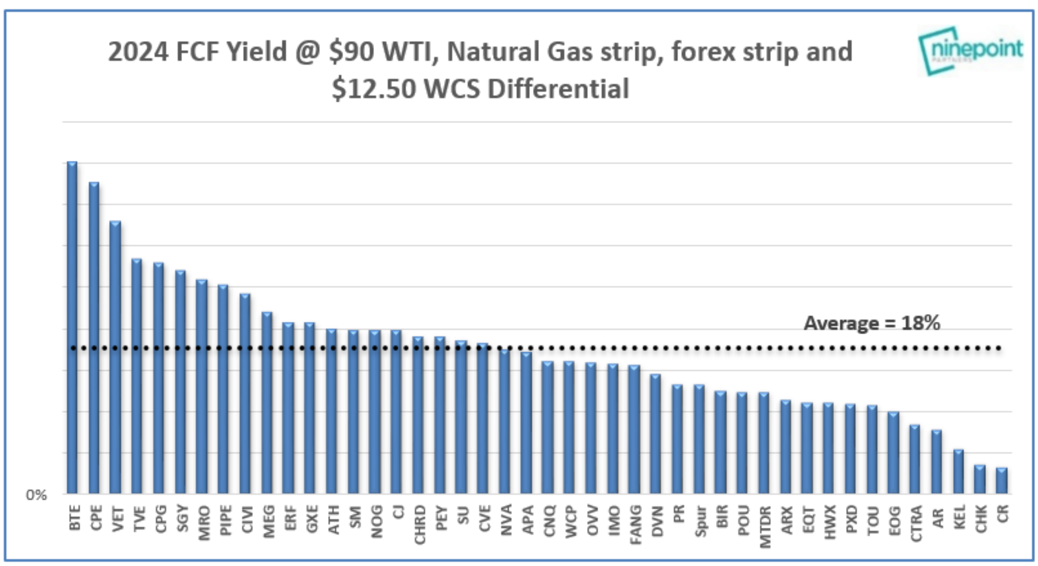
Region	Oil production thousand barrels/day			Gas production million cubic feet/day		
	September 2023	October 2023	change	September 2023	October 2023	change
Anadarko	423	420	(3)	6,687	6,610	(77)
Appalachia	148	146	(2)	35,855	35,718	(137)
Bakken	1,224	1,227	3	3,367	3,390	23
Eagle Ford	1,126	1,109	(17)	7,612	7,542	(70)
Haynesville	36	36	-	16,302	16,196	(106)
Niobrara	677	682	5	5,148	5,165	17
Permian	5,799	5,773	(26)	23,734	23,745	11
Total	**9,433**	**9,393**	**(40)**	**98,705**	**98,366**	**(339)**

NOTE: The *Drilling Productivity Report* (DPR) rig productivity metric *new-well oil/natural gas production per rig* can become unstable during periods of rapid decreases or increases in the number of active rigs and well completions. The metric uses a fixed ratio of estimated total production from new wells divided by the region's monthly rig count, lagged by two months. The metric does not represent new-well oil/natural gas production per newly completed well.

The DPR metric *legacy oil/natural gas production change* can become unstable during periods of rapid decreases or increases in the volume of well production curtailments or shut-ins. This effect has been observed during winter weather freeze-offs, extreme flooding events, and the 2020 global oil demand contraction. The DPR methodology involves applying smoothing techniques to most of the data series because of inherent noise in the data.

Oil stocks don't necessarily need higher oil prices to do well from here (from Eric Nutall via X on September 20)...

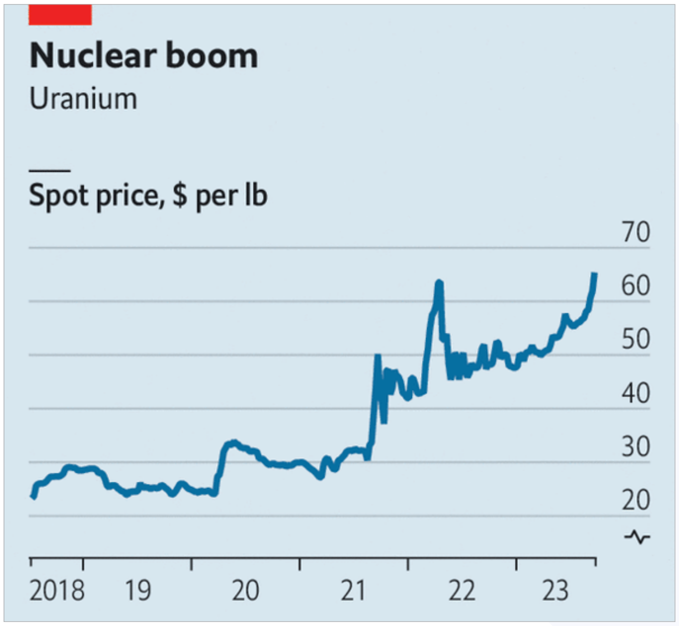
> Allow me to reiterate: we DO NOT need a higher oil price for oil companies/energy stocks to do very well. Inevitably I believe, aided by lower volatility, "seeing" will = "believing."

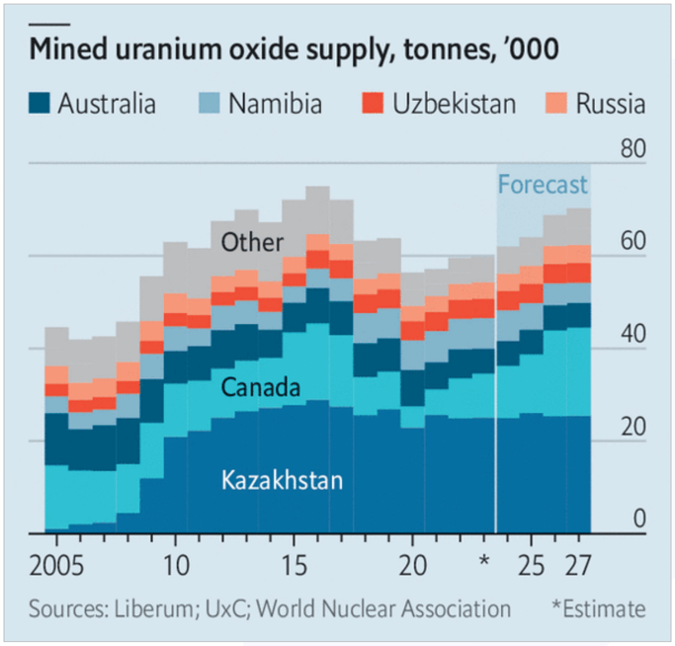


Source: Bloomberg, Ninepoint Partners
For illustrative purposes only
EV calculation uses year-end '24 value to account for multiple compression from share buybacks

Why uranium prices are soaring (from The Economist on September 21)...

> When Russia invaded Ukraine, panic gripped Europe's nuclear experts—the civilian variety, that is. Ukraine, where 15 reactors relied on Russia for their uranium, rushed to sign an unusually long 12-year deal with Canada. European utilities, also reliant on Russia, drew the maximum they could under other contracts. Most exposed were operators in Finland and eastern Europe that owned Russian-made reactors, which only Russian firms knew how to feed. Finding an American rival that could bundle uranium rods into the hexagonal blocks such plants demand took a year. Now they are searching for the metal needed to restart the atomic Tetris.
>
> Such last-minute procurement of uranium is very rare, notes Per Jander of wmc, a trader. Utilities usually take deliveries two to three years after signing a contract. The scramble is just one illustration of the fallout of the war on a once-sedate market already squeezed by rising demand, supply shocks and speculation. In the week to September 18th uranium's spot price hit $65 a pound, its highest since 2011, reports uxc, a data firm. At the industry's yearly shindig in London, which drew a record 700 delegates this month, some warned it could reach $100. The two largest producers are sold out until 2027; some utilities are thought to be short for 2024.





Just 85,000 tonnes of uranium are used each year. This compares with 170,000 for niche metals like cobalt and many millions for industrial ones like copper. Unlike coal or gas plants, nuclear reactors cost a lot to build but little to run, so utilities mostly opt to keep them going regardless of, say, the economic cycle, making demand for fuel predictable. It also means that utilities cannot afford to run out, which is why they buy the stuff via long-term contracts.

Most supply comes directly from mines. Canada and Kazakhstan, two reliable exporters, account for 60% of such "primary" supply. A quarter of total global supply arrives from "secondary" sources. Exhausted fuel blocks, replaced every three-to-four years, are re-enriched and re-used. Fuel is also made by diluting weapons-grade uranium, which contains more than 90% fissile elements, to concentrations of just 3-4%. In the two decades following the cold war the dilution of just 30 tonnes a year displaced 10,000 tonnes of annual mine output. More supply is regularly released from stockpiles. America, China, France and Japan hold a combined stash worth years of global use, which can be drawn from when prices are high.

This tranquil trade is now being rocked by two forces. One is resurgent demand. For years after the Fukushima disaster in 2011 the closure of plants in Japan, Germany and elsewhere pushed the market into surplus. But the search for steady sources of low-carbon power, and Russia's war in Ukraine, have led governments back to nuclear energy, which emits about the same as wind power and can operate even if pipelines are shut. Some 60 new reactors are under construction, which should add an additional 15% to the world's nuclear-power-generation capacity over the next decade, reckons Liberum, a bank. Small "modular" reactors—cheap and easy to build—could turbocharge demand for fuel. The World Nuclear Association, an industry body, forecasts that they could make up half of France's nuclear capacity by 2040.

Uranium's glowing prospects are not lost on financiers. In recent years several listed funds have launched. Sprott Physical Uranium Trust and Yellow Cake, the two biggest, have bought 22,000 tonnes in the past two years, equivalent to over a quarter of annual demand. Both are set up for the long run, with no fixed date or target price at which they will liquidate their holdings.

Meanwhile, supply is looking precarious—the second reason why prices are soaring. Early panic aside, Russian ores can still be obtained. But a coup in Niger in July has put 4% of mined supply in jeopardy. Last week Orano, France's state-owned giant, said it had halted its ore processing there owing to a lack of critical chemicals. Logistical headaches are causing Kazatomprom, the leading Kazakh supplier, to ship less uranium than expected (it typically passes through Russia). Cameco, Canada's champion, recently cut its production forecast by 9% after hiccups at two mines.

All this will probably keep the market in deficit next year, as it has been since 2018. Outright shortages remain unlikely, however. Major utilities retain stocks. And the fuel blocks inserted into operating reactors have another one-to-three years of life left, with a year's extension possible at limited costs. Most also have the next block ready to go. Thus the risk of running out lies more than four years ahead.

Continue reading here (subscription may be required).

What Russia's recent ban on diesel and gasoline exports could mean for energy markets and the economy (from Bloomberg on September 21)...

Russia's decision to ban exports of diesel — and gasoline — risks disrupting fuel supplies ahead of winter, but how deep the impact will be depends on how long it lasts.

The nation shipped more than one million barrels a day of diesel-type fuel so far this year, narrowly making it the world's biggest seaborne exporter, according to data from Vortexa. That's an enormous chunk of supply for the market to lose at short notice — roughly enough to meet the entire demand of Germany.

The supply loss, and any subsequent price rise, won't just matter to oil traders and truck drivers. Diesel-type fuel is also used in ships and trains, as well as by the farming, manufacturing and construction sectors. In short, it powers vast swaths of the global economy.

"It all comes down to the duration," said Eugene Lindell, head of refined products at consultancy FGE. Russia's refineries "could probably go a month before they'd have to shut down again on storage capacity constraints."

Russia says it instituted the temporary ban to dampen rising fuel prices at home, but absorbing all those barrels domestically may be a challenge. Some can go into storage, and the situation will also be helped by many refineries undergoing maintenance work.

But at some point the country will have to resume exports or slash refinery output. And the latter option risks a domestic gasoline shortage.

"Even though the ban is indefinite, we don't expect it to last long," said Koen Wessels, an oil products analyst with consultancy Energy Aspects.

Market reaction

While the unexpected supply loss pushed key diesel market metrics higher, the moves were relatively subdued for such a major event, suggesting some skepticism among diesel traders about its real-world impact.

In northwest Europe, the premium of benchmark diesel futures to crude oil, known as the ICE Gasoil crack, jumped in response to the ban, temporarily surpassing $37 a barrel and hitting a five-day high, according to fair value data compiled by Bloomberg.

Futures for October delivery also gained relative to fuel for arrival the following month. The bullish structure, known as backwardation, neared $36 per ton, only a three-day high.

Bigger picture

Global diesel supplies were already under severe pressure before Russia's export ban was announced. Refiners' yields have been curbed by a combination of OPEC+ crude oil cutbacks and demand for other refined petroleum. Plant outages haven't helped.

Before the invasion of Ukraine, Russia's seaborne diesel exports barrels were primarily shipped to European nations. But the imposition of sanctions upended global trade flows — shipments to Turkey have jumped. Other recent destinations for cargoes include Brazil, Saudi Arabia and Tunisia.

That doesn't necessarily mean these countries will bear the entire brunt of Russia's supply cut. The diesel market is global: If Turkey, or Brazil, for instance, is unexpectedly short, cargoes from non-Russian suppliers may head there instead of Europe.

Continue reading here (subscription may be required).

This is the simple bullish thesis for offshore oil drillers ([from Kuppy via X on September 21]())...

> To be clear cars=offshore energy equipment. There won't be any more built. E-V-E-R...

Kuppy
@hkuppy

Biggest takeaway so far from the Pareto Conference, is that we're now in Havana. There won't be any new cars. What you see is what you get and they'll just keep buffing and repainting what's left of the fleet forever...

A new coal ETF is coming soon – and it could be another bullish tailwind for the industry ([from Nick Jones via X on September 22](#))...

> Jason is breaking news on this one.
>
> What happens when you add ETF flows into companies buying back gobs of shares every year?

Jason Polansky
@polan13

A coal ETF is returning to US markets. I am told the symbol will be $COAL

sec.gov/Archives/edgar

indxx
Range Global Coal Index
Portfolio as of 03/31/2023

S.No	Ticker	ISIN	SEDOL	Company Name	Exchange	weights as of 31st March 20
1	YAL-AU	AU000000YAL0	B84LB45	Yancoal Australia Ltd	ASX	10%
2	WHC-AU	AU000000WHC8	B1XQXC4	Whitehaven Coal Ltd	ASX	10%
3	BTU-US	US7045511000	BDVPZV0	Peabody Energy Corp	New York Stock Exchange	9%
4	NHC-AU	AU000000NHC7	6681960	New Hope Corp Ltd	ASX	8%
5	ARLP-US	US01877R1086	2478650	Alliance Resource Partners Lp	NASDAQ	6%
6	EXX-ZA	ZAE000084992	6418801	Exxaro Resources Ltd	Johannesburg Securities Exchange	5%
7	AMR-US	US0207641061	BMFND53	Alpha Metallurgical Resources Inc	New York Stock Exchange	5%
8	ARCH-US	US03940R1077	BLB8B95	Arch Resources Inc	New York Stock Exchange	5%
9	SMR-AU	AU000000SMR4	B4KDPZ6	Stanmore Resources Ltd	ASX	5%
10	CEIX-US	US20854L1089	BF4L070	Consol Energy Inc	New York Stock Exchange	5%
11	HCC-US	US93627C1018	BF2X272	Warrior Met Coal Inc	New York Stock Exchange	5%
12	CRN-AU	AU0000026122	BGV71W0	Coronado Global Resources Inc	ASX	5%
13	TGA-ZA	ZAE000296554	BM9HB13	Thungela Resources Ltd	Johannesburg Securities Exchange	5%
14	JSW-PL	PLJSW0000015	B6R2S06	Jastrzebska Spolka Weglowa Sa	Warsaw Stock Exchange	4%
15	SXC-US	US86722A1034	B3R0638	Suncoke Energy Inc	New York Stock Exchange	2%
16	NRP-US	US63900P6088	BYQ3QF7	Natural Resource Partners Lp	New York Stock Exchange	2%
17	METC-US	US75134P6007	BRXYZ91	Ramaco Resources Inc	NASDAQ	1%
18	TER-AU	AU000000TER9	BYSXBF0	Terracom Ltd	ASX	1%
19	BCB-AU	AU000000BCB5	BDGS4C8	Bowen Coking Coal Ltd	ASX	1%
20	HNRG-US	US40609P1057	2404978	Hallador Energy Co	NASDAQ	1%
21	LWB-PL	PLLWBGD00016	B543NN3	Lubelski Wegiel Bogdanka Sa	Warsaw Stock Exchange	1%
22	NC-US	US6295791031	2616977	Nacco Industries Inc	New York Stock Exchange	1%
23	CAD-CA	CA1956151098	B4RG1Y9	Colonial Coal International Corp	TSX Venture Exchange	1%
24	HSP-GB	GB00B0MTC970	B0MTC97	Hargreaves Services Plc	London Stock Exchange	1%
25	BRL-AU	NZBRLE0001S4	BBPKZ84	Bathurst Resources Ltd	ASX	1%
26	CKA-AU	AU000000CKA8	6228873	Cokal Ltd	ASX	1%
27	AREC-US	US02927U2087	BF2WFR0	American Resources Corp /In/	NASDAQ	1%
28	TIG-AU	AU000000TIG3	B6TMY17	Tigers Realm Coal Ltd	ASX	1%

Microsoft appears to be exploring a major investment in modular nuclear power ([from Data Center Dynamics on September 22](#))...

> Microsoft is hiring for a principal program manager of nuclear technology to "be responsible for maturing and implementing a global small modular reactor (SMR) and microreactor energy strategy."
>
> Late last year, the company procured Clean Energy Credits (CECs) from Canadian energy firm Ontario Power Generation (OPG) to power its data centers. The credits include power from traditional nuclear sources, but could expand to include CECs from an upcoming SMR deployment OPG is planning.
>
> The new job listing states that: "This senior position is tasked with leading the technical assessment

for the integration of SMR and microreactors to power the data centers that the Microsoft Cloud and AI reside on.

> "They will maintain a clear and adaptable roadmap for the technology's integration, diligently select and manage technology partners and solutions, and constantly evaluate the business implications of progress and implementation.
>
> The role will also be responsible for research and developing other precommercial energy technologies.
>
> The new hire would join the energy innovation team at Microsoft, working with P. Todd Noe, director of nuclear technologies engineering at Microsoft. Noe said on LinkedIn: "This is not just a job, it is a challenge. By joining us, you will be part of a global movement that is transforming the way we produce and consume energy. You will also have the chance to grow your skills, advance your career, and make an impact on millions of lives."
>
> With grids around the world struggling, power availability has become a critical bottleneck for data center builders and delayed projects around the globe - most notably in the sector's densest region, Northern Virginia. The lack of clean power is even more of a challenge as data center companies try to shift to renewable sources.
>
> While traditional nuclear power plants have often come in over-budget and long-delayed, small modular reactors are being pitched as a way to deploy smaller, cheaper, and faster modular reactors.
>
> Such systems could either be deployed at a power plant, which is what Ontario Power Generation plans to do, or even at the site of a data center.
>
> Rolls-Royce has begun pitching 470MW modular power plants to data centers, with a planned roll out of 2030, while Last Energy has already found customers in the UK for 20MW SMRs. Rival NuScale received regulatory approval for 50-77MW SMRs in the US this year, but it has struggled to keep its electricity costs in check. Sam Altman-backed Oklo is also planning 15MW+ SMRs, while Microsoft cofounder Bill Gates has backed TerraPower.
>
> Data center operators are looking to SMRs as a potential solution to power constraints, with Green Energy Partners planning to build multiple small modular nuclear reactors next to the 1.6GW Surry Nuclear Power Plant to support 30 new data centers in Virginia.

Continue reading here.

And here's what one energy strategist says is behind the move (from Mark Nelson via X on September 23)...

> Word is out: Microsoft is plunging ahead on nuclear energy.
>
> They want a fleet of reactors powering new data centers. And now they're hiring people from the traditional nuclear industry to get it done.
>
> Why?
>
> Lack of stable long-term power, whether clean or dirty, is constraining Microsoft's growth. They need to build big data centers that consume electricity all the time and the old assumption that somebody else's reliable plants will always be around to firm up your wind and solar is falling apart.
>
> It certainly helps that founder Bill Gates was one of the earliest big business converts to nuclear

energy, investing his own money to develop new reactors.

But Microsoft, like many companies, was held back by what we might consider "Enron-ism" infecting its energy thinking: renewable energy credits plus markets plus cute little lies to the public about how electricity works. Greenwashed fossil/hydro/nuclear with the ESG stamp of approval.

The problem? Eventually you run out of other people's cheap firm power.

So Microsoft has recently become a leader in openly asserting that nuclear energy counts as clean energy, as opposed to the ongoing cowardice we see from the other big tech companies who lie to the public about being "100% renewable powered."

Sure, the lawyers said it was okay to lie, but the lie doesn't give you a permanent supply of cheap reliable energy. That comes from nuclear.

A world is coming where only the tech companies willing to become nuclear power developers may get to keep expanding their cloud businesses, and only countries open to new reactors get to host this expansion.

A world where tech companies with 50% margins become the only survival hope for traditional industrial concerns with 5% margins who need someone else to bootstrap a proper electricity supply.

Where diesel backup generators are replaced with microreactors reliable enough to be trusted to keep a cluster of facilities secure in the case of public grid failure.

The race is on.

Harris “Kuppy” Kupperman – CIO of Praetorian Capital and long-time uranium bull – believes the energy metal may finally be starting a new bull market (from Kuppy via X on September 23)...

1) Assets sometimes undergo a sudden phase shift. Just like a liquid can become a gas when you add heat, the same can be said of public assets. It seems that uranium has now undergone a phase shift. The personality of the trading changed dramatically...

2) Think back to earlier this year. Uranium would rally a few dollars, then pull back. The spread stayed tight. It sometimes went weeks without moving a full dollar.

3) After WNA something changed. Someone panicked and stopped acting price conscious. Someone just wants pounds. Suddenly uranium is gapping a few dollars at a time. The pullbacks are rarely more than a few ticks and the bid/ask spreads are frequently a few dollars wide.

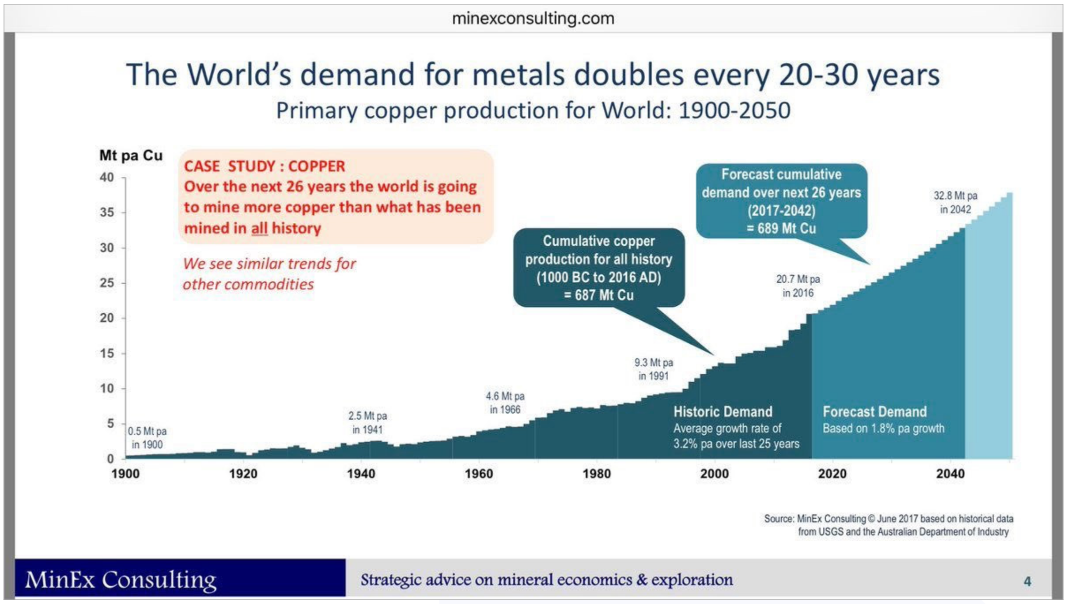
4) Phase shifts tend to precede big moves. They also signal much higher levels of volatility. There will now be surprisingly fierce pullbacks since the phase shift has happened. No more of this back and fill nonsense. It takes a long time for a gas to go back to being a liquid...

5) Seems to validate my thesis that at least one of the utilities woke up and realized that if they’re going to panic, they should panic first...

6) Think that after two years of slow grind, the pace of events is going to accelerate...

Other Commodities

Demand for copper is likely to soar in the years ahead (from Robert Friedland via X on August 27)...



However, more weakness is possible in the near term (from Bloomberg on September 18)...

> Copper demand in the world's biggest user of the metal is slowing down at a time of the year when it usually picks up.
>
> The copper market, traditionally a bellwether of economic health, is finding some support from the energy transition and Beijing's efforts to revitalize growth. But buyers lack conviction and the view from the factory floor remains cautious as margins are suppressed and profits wither.
>
> "Consumption is lagging the previous few years due to the macroeconomic environment," said Hai Jianxun, a sales executive at Henan Yuxing Copper Co., which makes pipes used in items like air-conditioners. "The whole industry is finding it very difficult."
>
> Copper prices have traded in a narrow range for months after China's recovery from the pandemic lost all momentum. The government's recent measures have just about stabilized the economy, but reports of lackluster demand will worry investors because the autumn is usually a busy period for fabricators of the metal in China's highly seasonal economy.

Copper's widespread applications offer a comprehensive view on the landscape faced by policymakers as they bid to restore China's economic fortunes, while at the same time pivoting the economy from investment to consumption-led growth and hastening the transition away from fossil fuels.

A quarter of China's copper demand comes from construction, according to Citigroup Inc., an industry that's been pummeled by the protracted crisis in the property market. Consumer goods account for 16%, another sector that's suffered as Chinese households have conserved cash due to economic uncertainty.

Power generation, transmission and storage take up 20%, and much of that segment, particularly around renewable energy and electric vehicles, has boomed as efforts to green the economy bear fruit.

Continue reading here (subscription may be required).

Investment bank Stifel believes a structural bull market in commodities is just getting started (from Willem Middelkoop via X on September 18)...

Stifel: Perfect Storm For Commodities

STIFEL

Canada - Portfolio Strategy

MARKET COMMENTARY/STRATEGY

August 28, 2023

The Structural Bull Market In Commodities Is Just Beginning

Summary

"All in All, It's Just Another BRIC in the Wall"
Pink Floyd

Key Points

After 13 years of underperforming both Fixed Income and Equities, Commodities and their related Equities have finally begun to outperform broader equity markets in the past year. That said, these sectors remain near historically low weightings in major market indices and ETFs leaving significant room for future investor demand. ***WE BELIEVE THIS IS JUST THE BEGINNING OF A STRUCTURAL BULL MARKET IN COMMODITIES THAT WILL DEFINE A SIGNIFICANT PORTION OF CAPITAL MARKET RETURNS OVER THE NEXT DECADE.***

In our view, the following ***STRUCTURAL AND IN SOME CASES SELF-REINFORCING FACTORS WILL SERVE TO CONTINUE TO DRIVE COMMODITY AND COMMODITY "EQUITY" OUTPERFORMANCE OVER THE MEDIUM TO LONG TERM.***

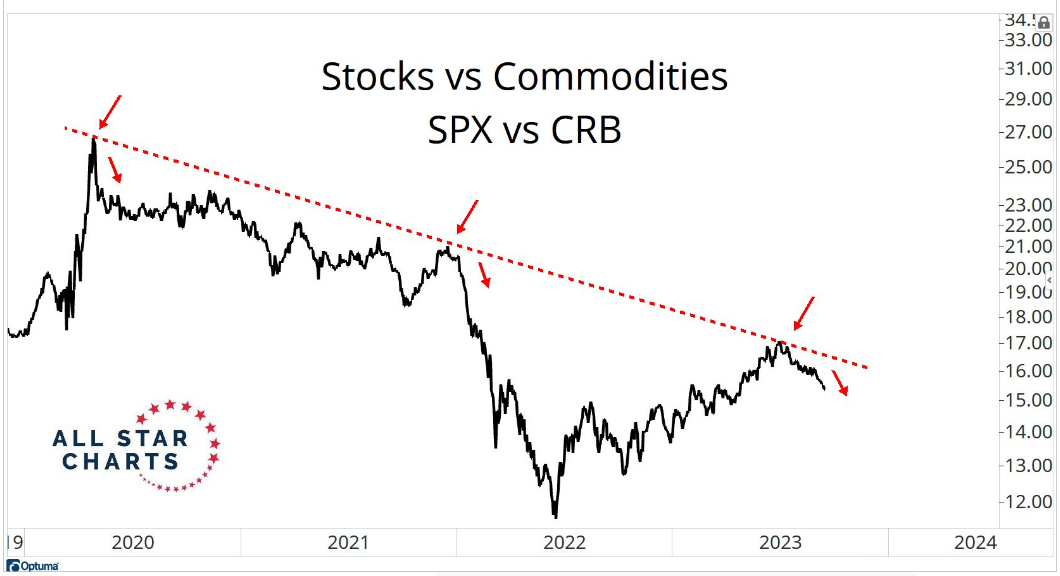
- ***THE RISE OF ESG INVESTMENT POLICIES***, both public and private, combined with significantly more difficult project permitting has led to an ***ARTIFICIALLY ELEVATED COST OF CAPITAL*** across the Commodity Investment Spectrum. Reminiscent of the Tobacco sector circa 30 years ago, we project this factor to lead to significant ***EXCESS TOTAL RETURNS IN COMMODITY-RELATED EQUITIES GOING FORWARD.*** Further, the decrease in Supply elasticity combined with this higher cost of capital, AND understandably conservative management decisions, has led to a dearth of Commodity growth capex, with significantly positive ramifications for long term Commodity prices.
- Related to ESG is the ***POLICY DRIVEN SHIFT TO ELECTRIFICATION of ENERGY GENERATION, TRANSMISSION AND USAGE***. While these lofty goals to stem potential Human Impact on Climate Change may be admiral, we cannot dismiss the ramifications on elasticity of Commodity demand, especially in the face of declining supply elasticity noted above. Further, while Nuclear power has the potential to narrow the gap, the cost for Renewables to reach Fossil Fuel Energy Equivalency will be considerable and thus pro-inflationary in of itself. In combination, these factors will mute the cyclicality of future commodity cycles with a structural upside bias.
- ***THE SHIFT FROM U.S.-LED GLOBALY OPTIMIZED SUPPLY CHAINS TO A MULIT-POLAR ECONOMIC MODEL LED BY THE BRICS + BLOC.*** This will contribute not only to future waves of inflation but structurally higher demand for Commodities as supply chains are duplicated regionally. This includes Precious Metals, which also face a decline in Supply Elasticity, AND as the BRICs+ continue to seek to diversify their reserves away from US Treasuries and ***POTENTIALLY*** toward a Gold-Backed Common Currency to settle trading through the BRICS Development Bank.
- ***ELEVATED LEVELS OF SOVEREIGN DEBT*** across Western Economies not seen since the Post WW2 period, will ultimately require looser monetary policies that will reduce the purchasing power of Fiat currencies vs. real assets. Recall the Yield Curve Control implemented from the early 1940's to 1951 that led to 3 Large Waves of inflation and a near 90% loss of USD purchasing power over a 10 year period.
- ***SELF-REINFORCING (REFLEXIVE) INFLATIONARY PSYCHOLOGY (See Inflation Psychology Pyramid Below)*** that, like the decades surrounding WW2, and the 1970's, will lead to ***MULTIPLE WAVES OF INFLATION*** with corresponding increasing in Commodity Prices over the next decade.

THIS PERFECT STORM OF FACTORS will drive a Structural Shift higher in both longer term Inflation, Commodity Prices, and Excess Returns to Commodity-related equities.

THE STRUCTURAL BULL MARKET IN COMMODITIES IS JUST BEGINNING...

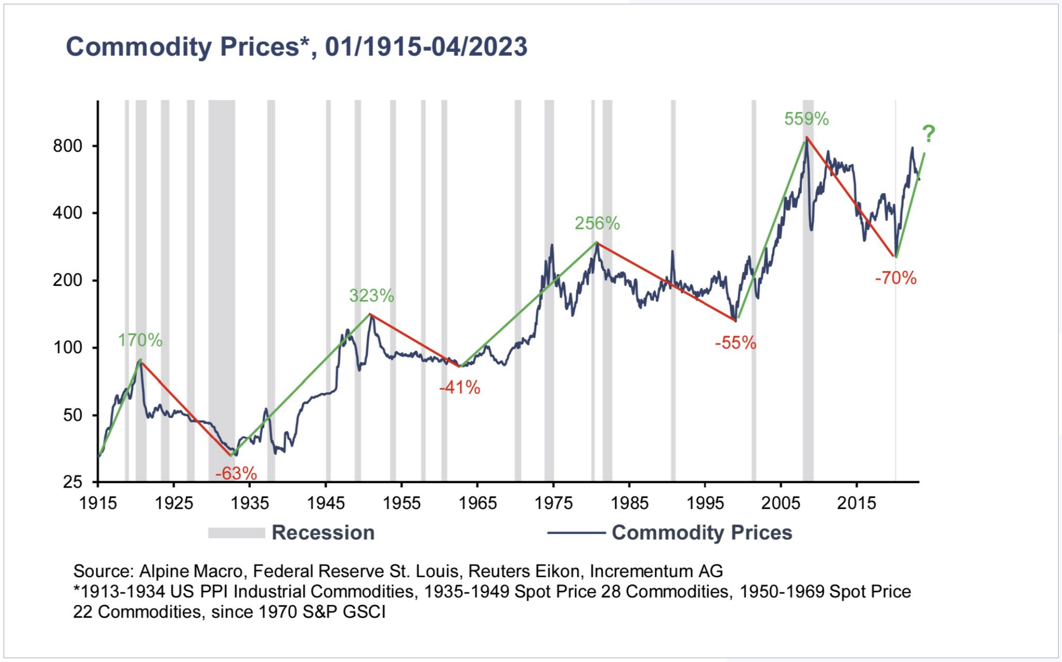
The stocks versus commodities ratio is sending a bullish message today (from All Star Charts via X on September 19)...

Is there a more important trend in the world right now?... Has the Commodities Supercycle resumed?



The fundamental backdrop also appears supportive of higher commodity prices in the years ahead (from Otavio Costa via X on September 20)...

> Since the 1900s we had four notable commodity cycles.
>
> Three of them occurred during inflationary periods:
>
> 1910s, 1940s, 1970s.
>
> The fourth cycle took place in the early 2000s, coinciding with China's entry into the World Trade Organization and its emergence as the manufacturing hub of the global economy, leading to one of the most extensive construction booms in history.
>
> Now, we stand on the cusp of witnessing these two macro tailwinds at once:
>
> 1) The onset of another long-term inflationary era
>
> 2) A global manufacturing revamp particularly from G-7 economies to reduce reliance on authoritarian regimes
>
> Another commodity cycle is underway.
>
> What a great chart from my friend @RonStoeferle from @IGWTreport
>
> Their latest report: https://ingoldwetrust.report/wp-content/uploads/2023/05/In-Gold-We-Trust-report-2023-english.pdf



Bitcoin and Crypto

The Grayscale Bitcoin Trust won its case against the Securities and Exchange Commission. Here's what it means (from Barron's on September 1)...

> Grayscale Bitcoin Trust (ticker: GBTC), the world's largest Bitcoin fund at about $16.3 billion under management, won a major court victory this week, increasing the likelihood it will convert into an exchange-traded fund.
>
> The market, on the other hand, is pricing the fund largely as it did before the U.S. Court of Appeals decision. GBTC for now trades like a closed-end fund, with a market price that deviates from the value of the Bitcoin it holds. On Aug. 24, GBTC closed at $17.68, a 24.6% discount to the underlying Bitcoin . On Thursday, it closed at a 20.6% discount.
>
> That doesn't make sense. If an investor can stomach the volatility and is looking for Bitcoin exposure anyway, it is worth betting the discount will close further.
>
> Grayscale for years has sought to convert GBTC into an ETF, which would completely erase the difference. The Securities and Exchange Commission consistently shot down the applications, along with those of other fund providers, arguing the Bitcoin market has insufficient surveillance to detect fraud and manipulation.
>
> After being rebuffed in 2022, Grayscale sued, arguing the SEC unfairly rejected its bid while also approving Bitcoin futures products such as ProShares Bitcoin Strategy (BITO), whose prices are tied to the same underlying market.
>
> In a unanimous decision on Tuesday, three judges appointed by presidents from both political parties agreed with Grayscale. The decision doesn't order the SEC to approve the application, but it does leave the agency with little room to reject it again.
>
> Analysts for Bloomberg Intelligence, for example, earlier this week put the odds of the SEC approving Bitcoin ETFs this year at 75% and the odds for such funds being approved by the end of 2024 at 95%...

Continue reading here (subscription may be required).

The Financial Accounting Standards Board (FASB) made a big change to its Bitcoin accounting rules this month. Here's what you should know (from Bitcoin Signal via X on September 6)...

> 🚨 EXPLAINED: Bitcoin Accounting Rule Change
>
> 📣Today we learned of a MASSIVE change to the way in which companies will be allowed to measure the value of their Bitcoin (and other crypto) holdings.
>
> The FASB is introducing new accounting rules that will allow companies to use the Fair Value Accounting method.
>
> **What does that mean?**
>
> Fair value accounting means that a business can measure its liabilities and assets at their current market value.

Why is this change important?

Michael @Saylor had this to say:

"Fair value accounting is coming to #Bitcoin. This upgrade to FASB accounting rules eliminates a major impediment to corporate adoption of $BTC as a treasury asset."

The long term effects of this change have yet to be seen, but let's examine the **Key Takeaways** from today's news:

New Accounting Rules for Bitcoin:

US accounting standard-setters have decided to introduce accounting rules for businesses that hold or invest in Bitcoin (and other cryptocurrencies).

Reporting at Fair Value:

Companies will be required to report their Bitcoin holdings at fair value, reflecting the most current value of the asset. This includes capturing value rebounds after price drops.

Implementation and Early Adoption:

These rules will be effective from 2025, but companies can choose to adopt them earlier.

Addressing Rulebook Gaps:

Presently, there's no specific US accounting rulebook guidance for how companies should account for their crypto assets.

Companies have been using the American Institute of CPAs practice guide which treats Bitcoin as an intangible asset, like trademarks or copyrights. This method does not allow for adjustments if the market recovers after a dip.

Fair-value reporting will give investors a more relevant view of a company's financial position regarding their Bitcoin holdings.

Mandatory Adoption:

All companies, both public and private, will have to adopt these rules for fiscal years starting after Dec. 15, 2024. This implies a 2025 adoption for companies that follow the calendar year.

Disclosure Requirements:

Companies must create a separate entry for crypto assets in their balance sheets.

They will disclose significant Bitcoin holdings and any related restrictions in their footnotes every reporting period.

They will annually disclose changes in their crypto assets' opening and closing balances, categorized by type. Immediate Bitcoin-to-cash conversions will be exempted.

Since Bitcoin will be measured at fair value, companies must adhere to disclosure requirements under the accounting rules, ASC 820.

Scope of the Rules:

FASB's rules cover assets on distributed ledgers based on blockchain technology, secured through cryptography, currently classified as intangible assets under US accounting rules, and are fungible.

Non-fungible tokens (NFTs), stablecoins, and wrapped tokens are excluded.

Despite several groups advocating for the inclusion of wrapped tokens, the majority of the board decided against it, stating the need for more market information.

Background and Future Scope:

FASB had previously declined to create crypto rules but changed their stance as major companies began investing in Bitcoin and other cryptocurrencies.

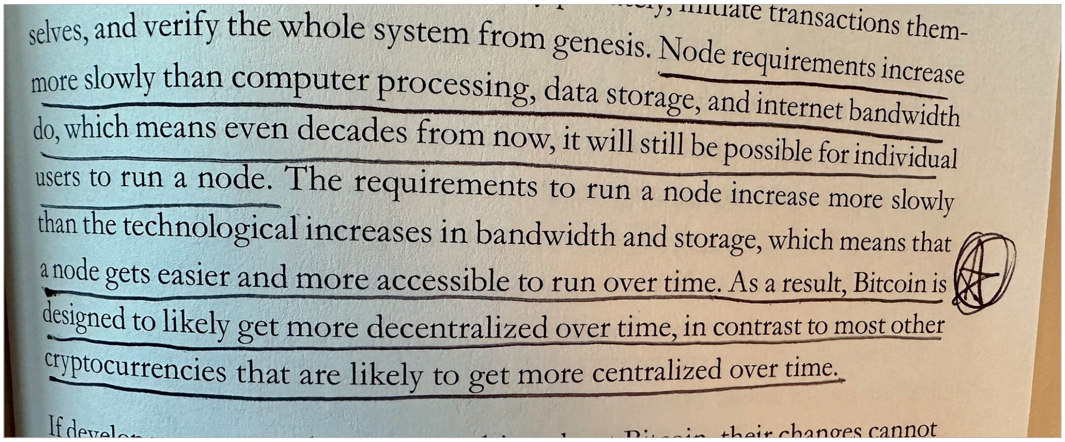
The board will continue to monitor the crypto markets and might introduce more rules in the future. This current move is seen as the "right first step" by industry players.

Overall, the introduction of these new accounting rules for Bitcoin and alternative cryptocurrencies is seen as a positive move towards mainstream adoption and provides clarity for companies holding or investing in Bitcoin.

This is undeniably GOOD for #Bitcoin.

Unlike most "cryptos," Bitcoin is likely to become more decentralized over time (from Caitlin Long via X on September 10)...

GUESS WHO TAUGHT ME something new today: @LynAldenContact. I hadn't thought of 👇 before but it's logical that #Bitcoin will become more decentralized over time bc it keeps getting easier/more accessible to run a node (p339 of #BrokenMoney). I ❤ reading engineers' explanations!



initiate transactions them-
selves, and verify the whole system from genesis. Node requirements increase more slowly than computer processing, data storage, and internet bandwidth do, which means even decades from now, it will still be possible for individual users to run a node. The requirements to run a node increase more slowly than the technological increases in bandwidth and storage, which means that a node gets easier and more accessible to run over time. As a result, Bitcoin is designed to likely get more decentralized over time, in contrast to most other cryptocurrencies that are likely to get more centralized over time.

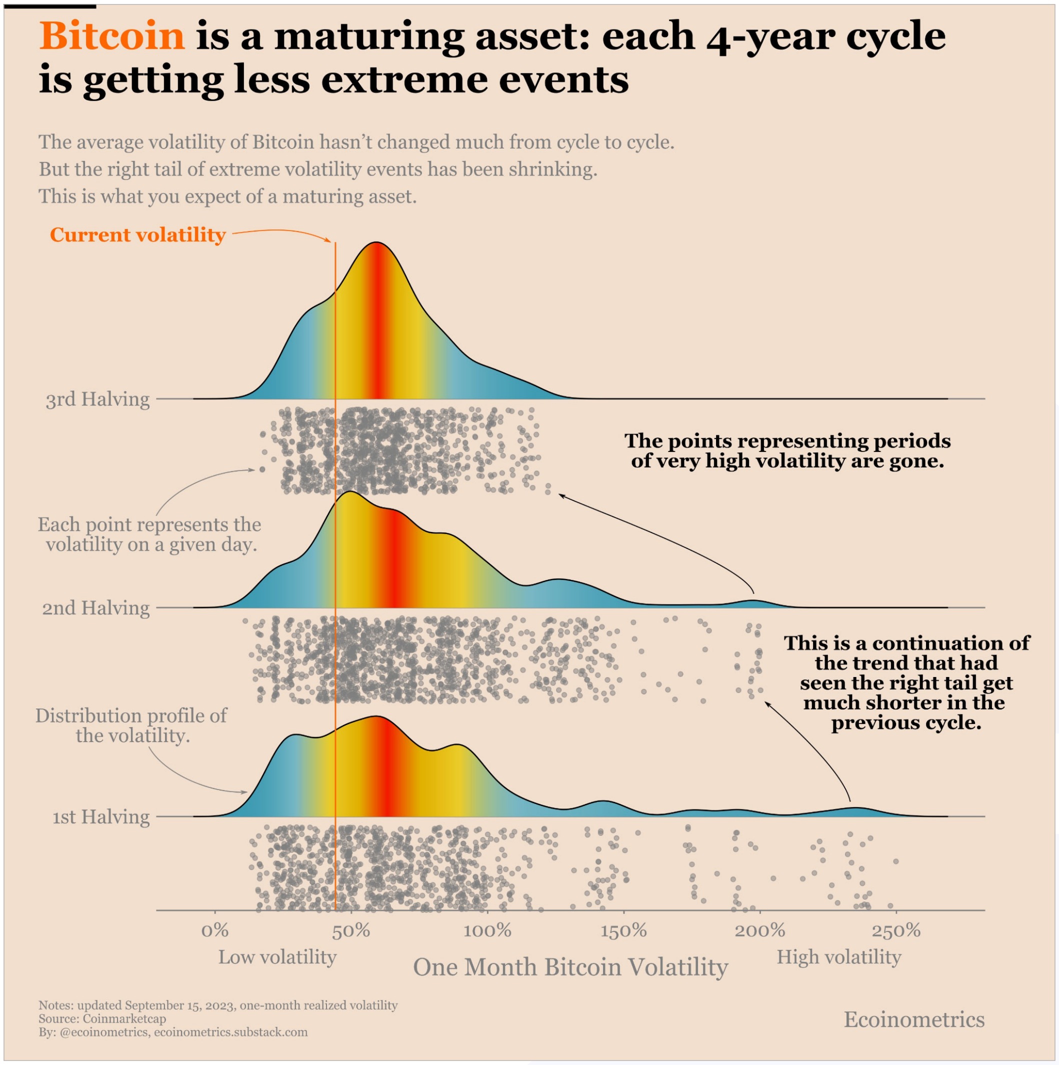
Crypto exchange Coinbase (COIN) announces plan to integrate the Bitcoin Lightning Network onto its platform (from BlockWorks on September 13)...

> After more than a month of public deliberations, Coinbase has finally decided to integrate Bitcoin's Lightning Network onto its exchange platform.
>
> CEO Brian Armstrong said Tuesday that his publicly-listed company would do its part to advance "faster / cheaper" transactions, made possible by the technology's design.
>
> "Bitcoin is the most important asset in crypto," Armstrong said in a post on X, formerly Twitter. A timeframe for the integration was not provided. Coinbase declined Blockworks' request for comment.
>
> Following in the footsteps of Jack Dorsey's Cash App and David Marcus' Lightspark, the development on Tuesday adds yet another step in the slow march toward the adoption of bitcoin payments — a core concept initially intended for the 14-year-old crypto.
>
> The Lightning Network is a layer-2 solution built on top of the Bitcoin blockchain that aims to enable fast and scalable transactions.
>
> In essence, Lightning allows two parties to open a payment channel between them, bypassing the need to record every single transaction on the Bitcoin blockchain.
>
> Read more: Binance boosts Bitcoin Lightning Network with promised integration
>
> It was originally conceived to address some of the scalability issues inherent in Bitcoin's design, such as high fees and slow transaction times during periods of higher network activity.
>
> Early last month, Armstrong flagged that his company would begin exploring how to best add Lightning, calling the idea "non-trivial" but "worth doing."
>
> "Not sure why you think we're ignoring Bitcoin — we've onboarded more people to Bitcoin than probably any company in the world," the CEO said at the time in response to public questions from Dorsey.
>
> "I'm all for payments taking off in bitcoin," Armstrong said last month.

Continue reading here.

Bitcoin is behaving like a "maturing asset" ([from ecoinometrics via X on September 15]())...

> Bitcoin isn't what it used to be.
>
> Over the last three cycles BTC went from being a volatile asset with long periods of extreme volatility to being about as volatile as NVIDIA or Tesla.
>
> The average volatility of Bitcoin hasn't changed much from cycle to cycle.
>
> But the right tail of extreme volatility has been shrinking. Shrinking so much it has completely disappeared in the current halving cycle.
>
> This is what you expect of a maturing asset.



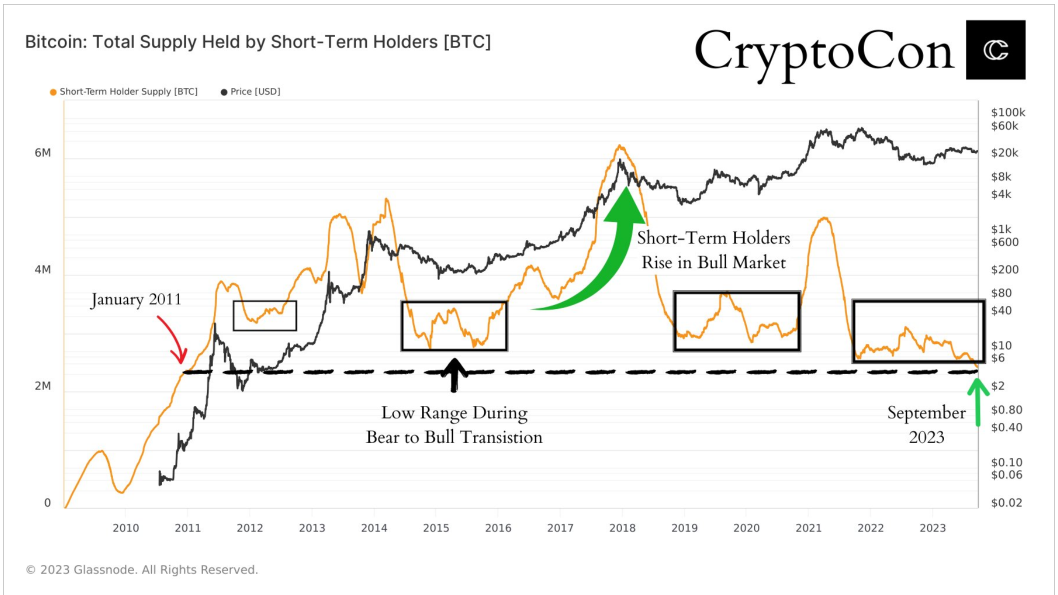
A new report shows that the non-fungible token (NFT) market has essentially collapsed, and nearly all NFTs are practically worthless (from PetaPixel on September 20)...

> As seen on Insider, dappGambl's study investigated 73,257 NFT collections, 69,795 of which have a market value of zero ETH.
>
> "The hype around NFTs peaked in the 2021/22 bull run that saw nearly $2.8 billion in monthly trading volume recorded in August 2021. From this, NFTs captured the collective imagination worldwide with multiple news reports of million-dollar deals for sales of certain NFT assets," writes dappGambl.
>
> NFTs were all the rage for a spell, and photographers were caught up in the whirlwind. When a single JPEG file created by the artist Beeple sold for nearly $70 million, photographers wondered how they might get a slice of the pie.
>
> "Bryan Minear, a landscape photographer based in Michigan, has always kept a close eye on the crypto space. On Tuesday, he did an NFT drop with Bitski featuring five photographs ranging from $200 to $2,500. Within 10 minutes, he sold out of nearly everything," PetaPixel wrote in 2021.
>
> Minear said he embraced NFTs when he realized crypto was "here to stay." Well, stay it did not.
>
> 2022 was a tough year for crypto. "In the future, 2022 may be regarded as a turning point for the world of virtual currencies, when they lost their luster and were cast out as a fringe product most people approach with skepticism and caution. Or it may simply be remembered as a stretch of excruciating growing pains for an industry still in its infancy," wrote NPR at the end of last year.
>
> Currently, Bitcoin is worth $27,223, and Ethereum is $1,630.99, a far cry from their all-time high values of more than $65,000 and $4,700, respectively. As for NFT, the news is dire.
>
> "The vast majority of NFTs are worthless," writes dappGambl. Based on its research, 95% of people holding NFT collections own an asset with no real value. DappGambl believes that this means that more than 23 million people's investments "are now worthless."

Continue reading here.

Speculative interest in Bitcoin appears to have fallen to multiyear lows (from CryptoCon via X on September 23)...

> The amount of #Bitcoin held by short-term holders has now been reduced to a fine powder.
>
> The lowest amount we have seen since January 2011.
>
> These are people that hold their coins around 155 days at most.
>
> In other words, there are more strong Bitcoin holders than ever before!



This summer's selloff has caused Bitcoin to become as long-term oversold as it was at the depths of the COVID-19 crash ([from TheGoldPrairie via X on September 23](#))...