Porter & Co.

Investment Chronicles

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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, Securities and Exchange Commission ("SEC") filings, investment newsletters, newspapers, X (Twitter) threads, conferences, podcasts, and more – and digest them into one carefully curated, easy-to-read resource.

With *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 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 dig in 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 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
October 2023

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

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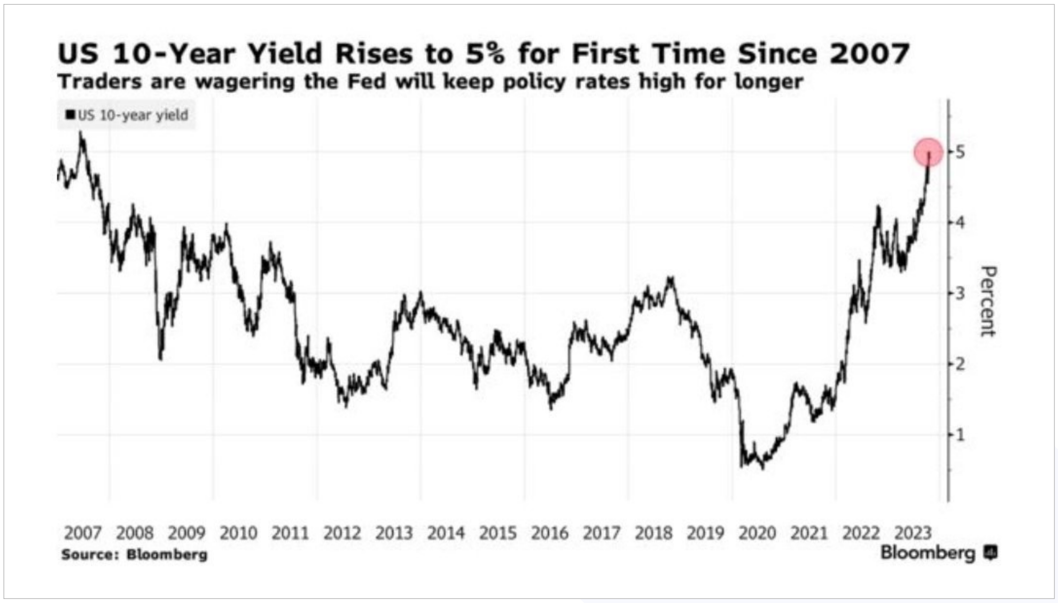
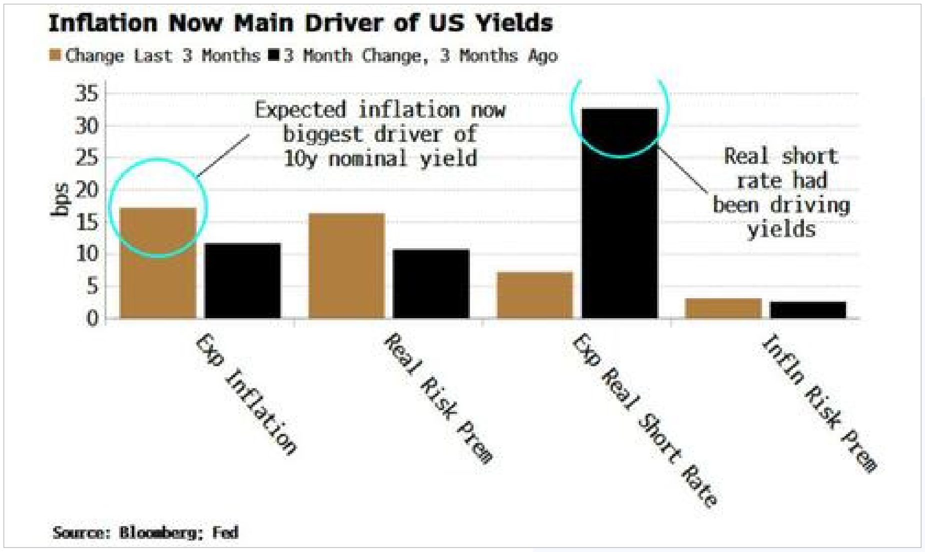
The Five

The Most Important Charts We're Watching This Month

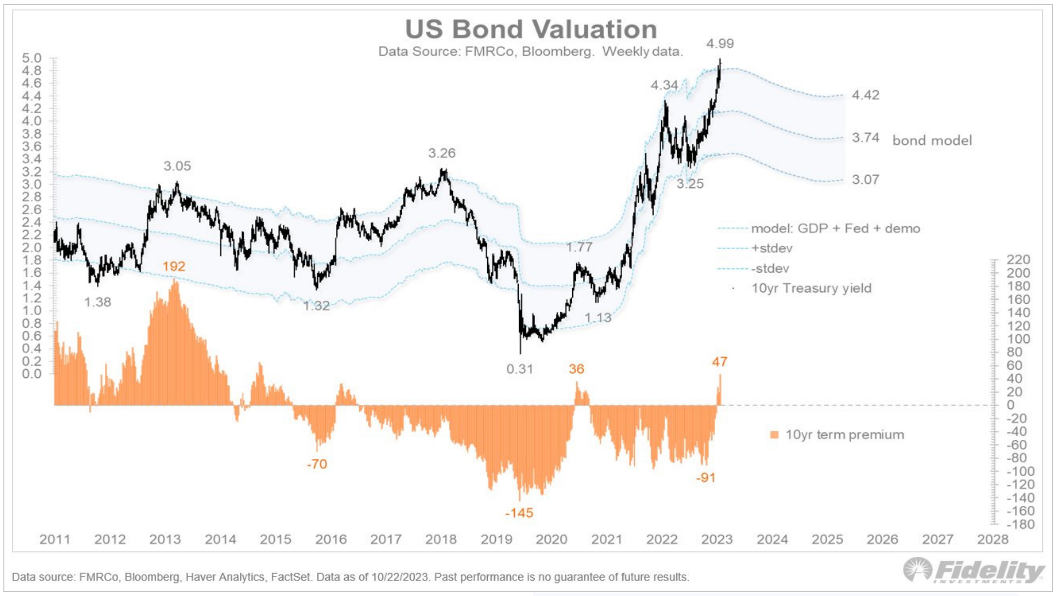
The big story this month was the continued rise in long-term U.S. Treasury yields. The yield on the benchmark 10-year Treasury note just touched 5% this week for the first time since before the Great Financial Crisis (from Bloomberg)...



However, unlike the rise in Treasury yields earlier this year, this recent rise isn't due primarily to expectations of higher short-term rates (i.e., the Federal Reserve). Rather, in recent months, yields have been rising due to expectations of higher inflation (from Bloomberg via ZeroHedge)...



… as well as rising “term premium” – a measure of the added compensation investors demand for holding longer-duration debt – as a result of out-of-control government deficits ([from Jurrien Timmer via X](#))…

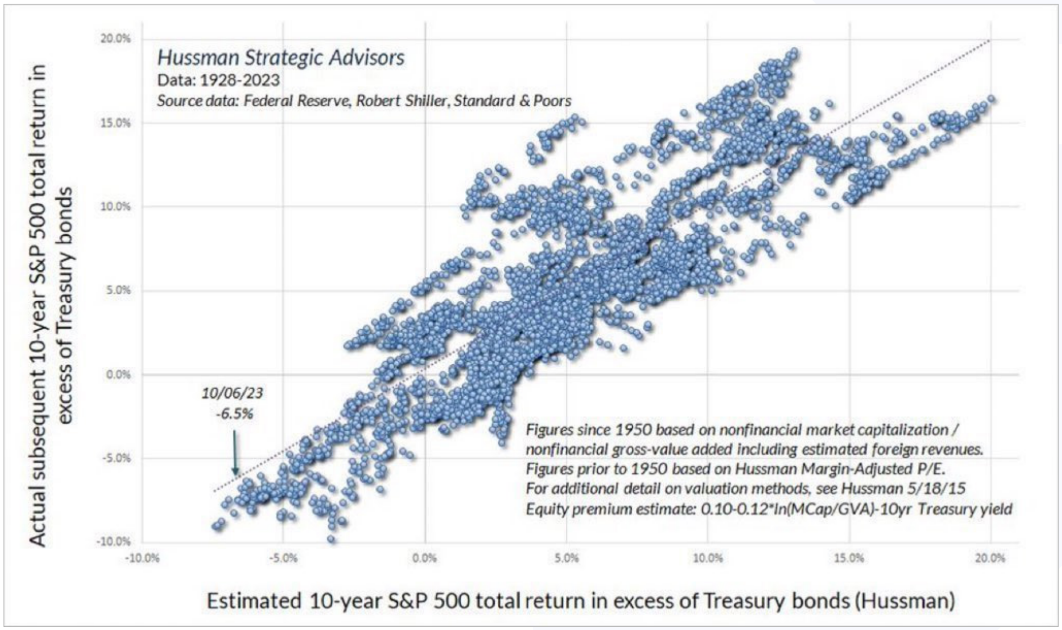


Data source: FMRCo, Bloomberg, Haver Analytics, FactSet. Data as of 10/22/2023. Past performance is no guarantee of future results.

This suggests the upward pressure on long-term yields could remain even if the Fed cuts short-term rates.

Unfortunately for equity investors, higher yields make stocks relatively less attractive. As you can see below, the "equity risk premium" – a measure of the difference between the expected return in stocks and the risk-free rate of return in Treasuries – has fallen to its lowest levels in decades (from The Daily Shot via X)...

In fact, by some measures, stocks are near their most expensive level versus bonds in the past 100 years. Previous extremes have led stocks to underperform bonds over the next decade, even if bonds themselves produced poor real (after inflation) returns (from Hussman Strategic Advisors)...



Economics and Markets

Rising interest rates mean deficits finally matter (from *The Wall Street Journal* on October 5)...

> The U.S. has long been the lender of last resort to the world. During the emerging-market panics of the 1990s, the global financial crisis of 2007-09 and the pandemic shutdown of 2020, it was the Treasury's unmatched capacity to borrow that came to the rescue.
>
> Now, the Treasury itself is a source of risk. No, the U.S. isn't about to default or fail to sell enough bonds at its next auction. But the scale and upward trajectory of U.S. borrowing and absence of any political corrective now threaten markets and the economy in ways they haven't for at least a generation.
>
> That's the takeaway from the sudden sharp rise in Treasury yields in recent weeks. The usual suspects can't explain it: The inflation picture has gotten marginally better, and the Federal Reserve has signaled it's nearly done raising rates.
>
> Instead, most of the increase is due to the part of yields, called the term premium, which has nothing to do with inflation or short-term rates. Numerous factors affect the term premium, and rising government deficits are a prime suspect.
>
> Deficits have been wide for years. Why would they matter now? A better question might be: What took so long?
>
> That larger deficits push up long-term rates had long been economic orthodoxy. But for the past 20 years, interest-rate models that incorporated fiscal policy didn't work, noted Riccardo Trezzi, a former Fed economist who now runs his own research firm, Underlying Inflation.
>
> That's understandable. Central banks—worried about too-low inflation and stagnant growth—had kept interest rates around zero while buying up government bonds ("quantitative easing"). Private demand for credit was weak. This trumped any concern about deficits.
>
> "We had a blissful 25 years of not having to worry about this problem," said Mark Wiedman, senior managing director at BlackRock.
>
> Today, though, central banks are worried about inflation being too high and have stopped buying and in some cases are shedding their bondholdings ("quantitative tightening"). Suddenly, fiscal policy matters again.

Continue reading here (subscription may be required).

Rising rates are beginning to weigh on corporate profits (from *The Financial Times* on October 5)...

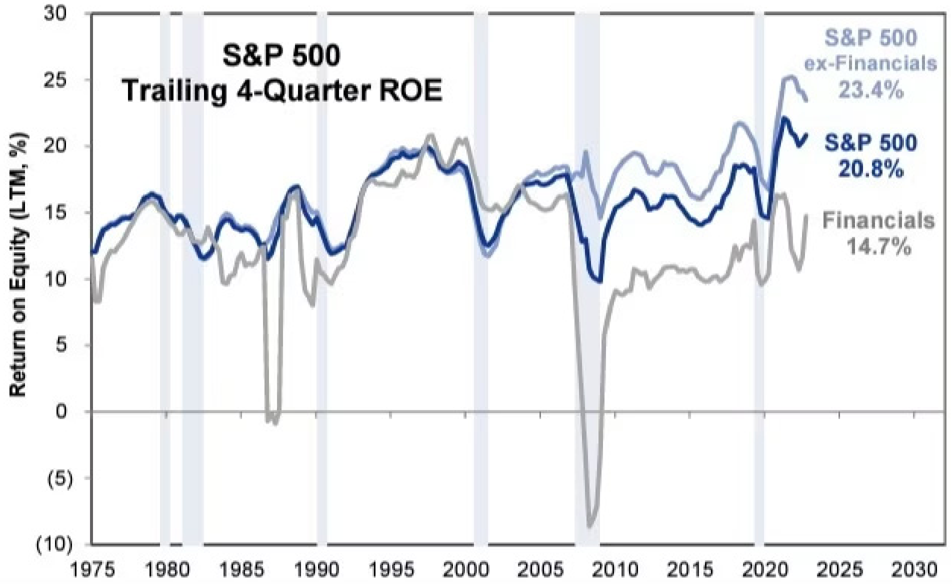
Naturally, the bond carnage has been feeding worries that something somewhere will somehow "break". MainFT ran a good rundown of the usual suspects this morning. But there's arguably one missing.

Thanks to resilient growth and the remarkable American consumer, listed US companies remain on average incredibly profitable, but the rising cost of debt is starting to become a small but noticeable drag on earnings.

Goldman Sachs estimates that returns on equity for the S&P 500 (ex financials, due to the distorting impact of Berkshire's investment gains) has shrunk by 69 basis points this year to 23.4 per cent — and 31 bps of the contraction is because of higher interest payments.

Exhibit 1: S&P 500 ex-Financials LTM ROE has fallen by 69 bp this year

as of 2Q 2023



Source: Compustat, Goldman Sachs Global Investment Research

This is obviously not a huge deal, and RoE remains at the 97th percentile since 1975. But it is a sign that one of the main drivers of US corporate profitability and stock market valuations over the past three decades is spluttering.

As a Fed paper pointed out earlier this year, lower interest expenses and tax rates explain 40 per cent of the real growth in US corporate profits between 1989 and 2019 (Alphaville wrote last month about an earlier version of the paper).

Many companies smartly locked in low rates in recent years with a splurge of fixed-rate, long-term bond sales. But Goldman's David Kostin reckons that rising rates is becoming a greater danger to US earnings. His emphasis below:

"In the new 'higher for longer' rates environment, the key risk for S&P 500 ROE will be higher interest expenses and lower leverage. Our rates strategists recently raised their forecast for the nominal 10Y UST and now expect rates to end 2023 at 4.3% and then rise to 4.6% in 1H 2024 before receding back to 4.3% at the end of 2024. Although the long-maturity, fixed-rate debt structures of S&P 500 companies generally insulate them from higher rates, borrow costs for S&P 500 companies have ticked up on a year/year basis by the largest amount in nearly two decades. If rates continue to rise or stay higher for longer, increased borrow costs would disincentivize companies to take on greater amounts of leverage."

Exhibit 4: Borrow costs for S&P 500 companies have ticked up over the past year

as of 2Q 2023

Source: Compustat, Goldman Sachs Global Investment Research

"A scenario in which interest expense and leverage persistently weigh on ROE would be a departure from the historical trend. The decades-long decline in rates has allowed companies to reduce their interest expense and utilize greater leverage to boost ROE. Since 1975, falling interest expense and greater leverage have contributed 18.5 pp of the overall 8.8 pp increase in S&P 500 ROE, while lower taxes have contributed 8.9 pp, higher EBIT margins contributed 5.9 pp, and lower asset turnover contributed -24.5 pp during the same period. A recent Fed paper similarly found that lower interest expenses and corporate tax rates explain more than 40% of the real growth in corporate profits from 1989 to 2019. Our own analysis of the long-term drivers of profitability found that declining cost of goods sold (COGS) has driven the remainder of the profit margin increases not driven by taxes or rates."

Continue reading here (subscription may be required).

"Bubble whisperer" Jeremy Grantham warns U.S. stocks could fall by more than 50% (from the Merryn Talks Money podcast via Bloomberg)...

"The great bubbles take their time. Quite a few years going up. Quite a few years coming down, and the market suffers from attention deficit disorder, so it always thinks every rally is the beginning of the next great bull market. My guess is that we will have a recession, I don't know if it will be fairly mild or fairly serious, but it will probably go deep into next year. Every bubble has been greeted with a chorus of 'soft landing,' and there's never been one. Each cycle is different, so each cycle, something else happens. It's always a surprise, but you always have a surprise, so the very idea of a surprise is unsurprising.

> "I would argue you have to be brave buying when prices are extended and high, because you're much more likely to lose money. The real bravery to buy when the market is smashed down to a bargain seems to me to be very little. That is not now. If you look at the most predictive measures, and Mr. Hussman does the best of those – very detailed historical record of which ones actually do the best – those measures are about as high as they've ever been, today. They're in the top 2 or 3 percent of all time. There's a spike in 2000 and a spike in 2021, and this is above 2000 but below the spike in 2021, but we are right up there.
>
> "In order to get the market down to where it would typically outperform the long bond by 5%, which you could argue it should, the market, just sheer arithmetic would have to drop by more than 50%. This is not my forecast. I have a very genteel forecast where anything below 3000 would make me think it was reasonable, and if everything works out badly, which it sometimes does, I would not be amazed if it went to 2000 on the S&P, but that would require a couple of wheels to fall off.
>
> "And wheels tend to fall off when the great bubbles unravel, but it doesn't mean they have to. It would be unlikely not to get to something close to 3000 on the S&P. You can't get blood out of a stone. Sooner or later, the simple arithmetic suggests that you'll either have a dismal return forever, or you'll have a nice bear market and then a normal return, and the nice bear market will hopefully be less than 50%."

You can listen to the full podcast here.

Why the BRICS nations – Brazil, Russia, India, China, and South Africa – don't need a single currency to disrupt the global financial system (from Luke Gromen via FFTT Tree Rings on October 6)...

> We have long said that we did not think BRICS would launch or even needed a single BRICS currency, but would instead pursue local currency trade, settled in goods and with any net deficits settled in gold that floated in all currencies.
>
> **This week, Putin voiced remarkably similar views in a speech at the Valdai Discussion Club conference, along with other provocative but unsurprising views around the monetary system and geopolitics:**
>
> > *BRICS doesn't need a single currency, yet. Instead, it needs to establish a settlement system in national currencies.*
> >
> > *NATO is, first and foremost, a tool of U.S. foreign policy.*
> >
> > *We will expand our interaction with China in the security sphere.*
> >
> > *Western influence over the world is a giant Ponzi scheme.*
> >
> > *The dominance of the dollar is already history – a new settlement system will emerge.*
> >
> > **-Putin at Valdai Discussion Club Conference, 10/5/23. Via SLK & EM**
>
> ***BRICS needs single settlement mechanism: Putin – 10/5/23***
>
> *BRICS needs single settlement mechanism — Putin – Business & Economy – TASS*
>
> Critically, this is not speculative on Putin's part... it is happening as we speak. This week, China and Brazil did their first end-to-end deal in CNY:

People's Daily, China
@PDChina

For the first time in #China-#Brazil trade, a Renminbi (RMB) letter of credit discounting transaction was completed for a Brazilian company at end of Sept, involving the closed-loop process of RMB pricing, settlement, financing and direct conversion of RMB to Brazilian real.

2:30 AM · Oct 3, 2023 · **6,210** Views

Additionally, last week the FT reported that CNY use is rising meaningfully in both China/Russia trade, and abroad (but off a far smaller base):

Russia is increasingly using China's currency to evade sanctions – 9/26/23

Russia is increasingly using China's currency to evade sanctions | Financial Times (ft.com)

> *Russia is using Chinese currency for at least a fifth of its imports, a new study has found, illustrating both Moscow's increasing reliance on Beijing and its efforts to evade western sanctions.*
>
> *Some of that increase is owing to increased imports from China itself, but the use of yuan to settle imports from third countries rose to 5 per cent, from just 1 per cent before the war was launched in February 2022. "Yuan is being used as a vehicle currency," said Beata Javorcik, the EBRD's chief economist and one of the paper's authors.*
>
> *"Russia is now the third-largest clearing centre for offshore yuan transactions." Asking trade partners to invoice them in yuan is just one way Moscow is evading sanctions, alongside tactics such as importing products through middleman countries or exporting its oil on tankers that sail without western insurance.*

While CNN reported last week that "trade between Russia and China is booming so much that shipping containers are 'piling up.'" **That is what happens when oil and bulk commodities flow in one direction, and smaller finished goods (and gold?) flow back in the other direction:**

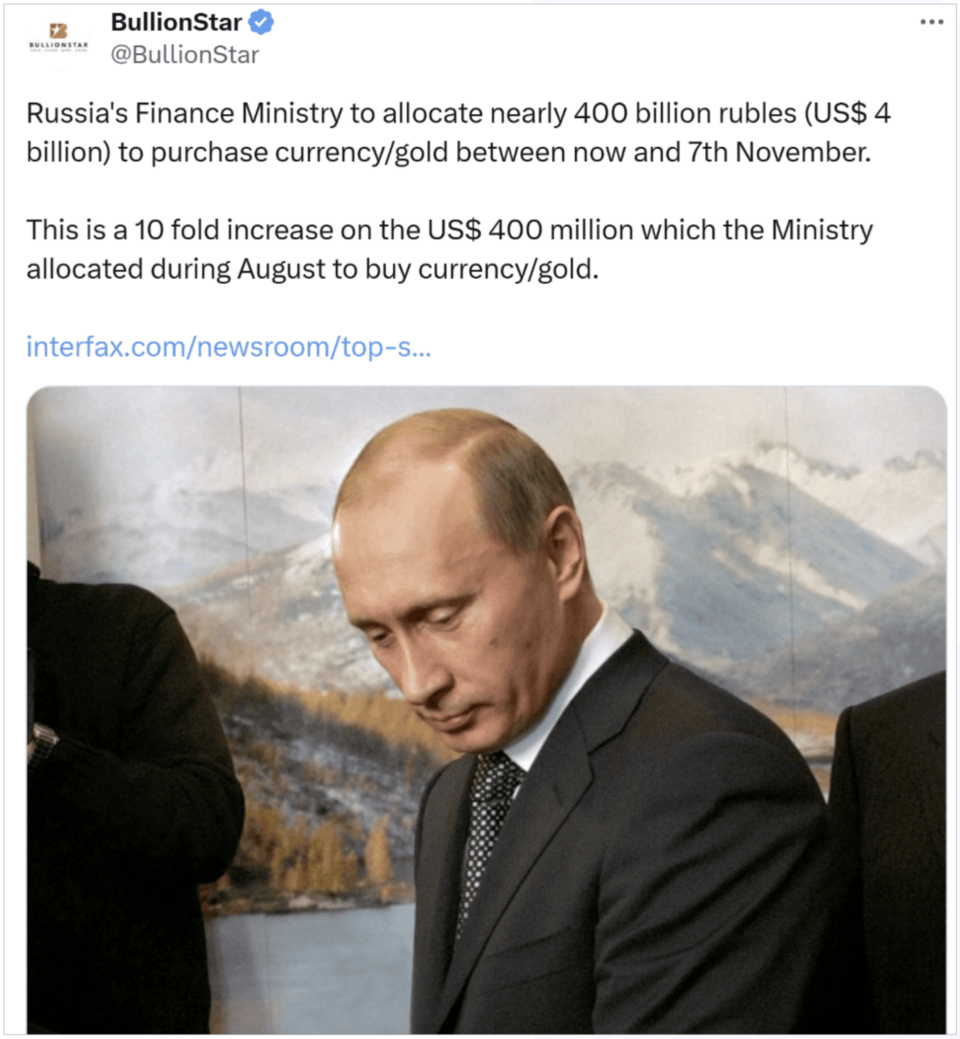
Trade between Russia and China is booming so much that shipping containers are 'piling up' – 9/29/23

https://www.cnn.com/2023/09/29/business/russia-china-trade-shipping-containers-intl-hnk/index.html

BullionStar highlighted this week that contrary to Western mainstream narratives around the RUB's weakness *(i.e., "RUB weakness will soon force Russia to sell gold reserves")*, Russia is accelerating its purchases of FX and gold in October versus August *(note that Russian Central Bank holdings of gold hit 2023 highs in August):*

Russia's Finance Ministry to increase funds available to buy FX and gold in October – 10/4/23

Russia's Finance Ministry to allocate 18.12 bln rubles per day as of Oct 6 to purchase currency/gold under fiscal rule (interfax.com)



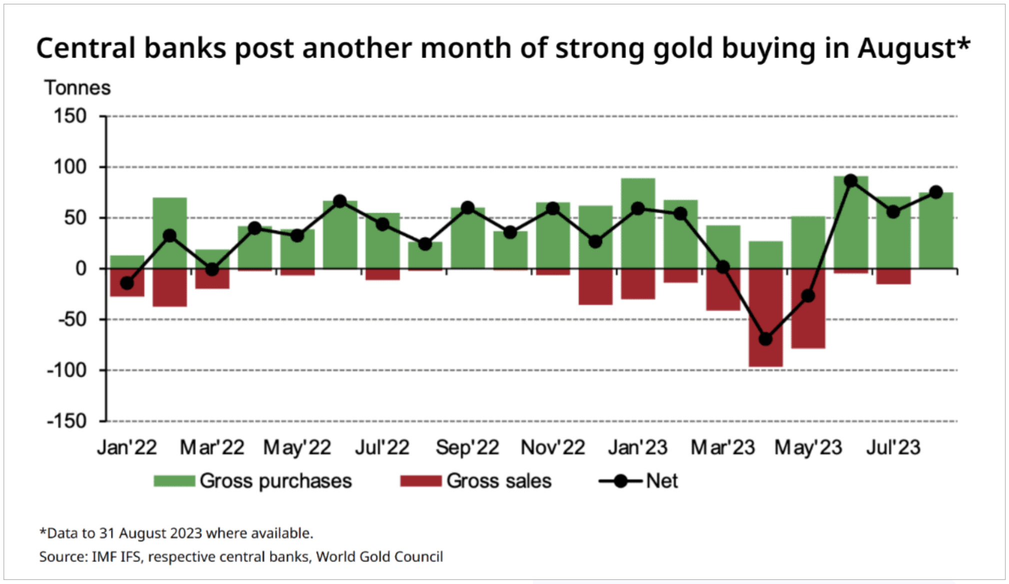
BullionStar
@BullionStar

Russia's Finance Ministry to allocate nearly 400 billion rubles (US$ 4 billion) to purchase currency/gold between now and 7th November.

This is a 10 fold increase on the US$ 400 million which the Ministry allocated during August to buy currency/gold.

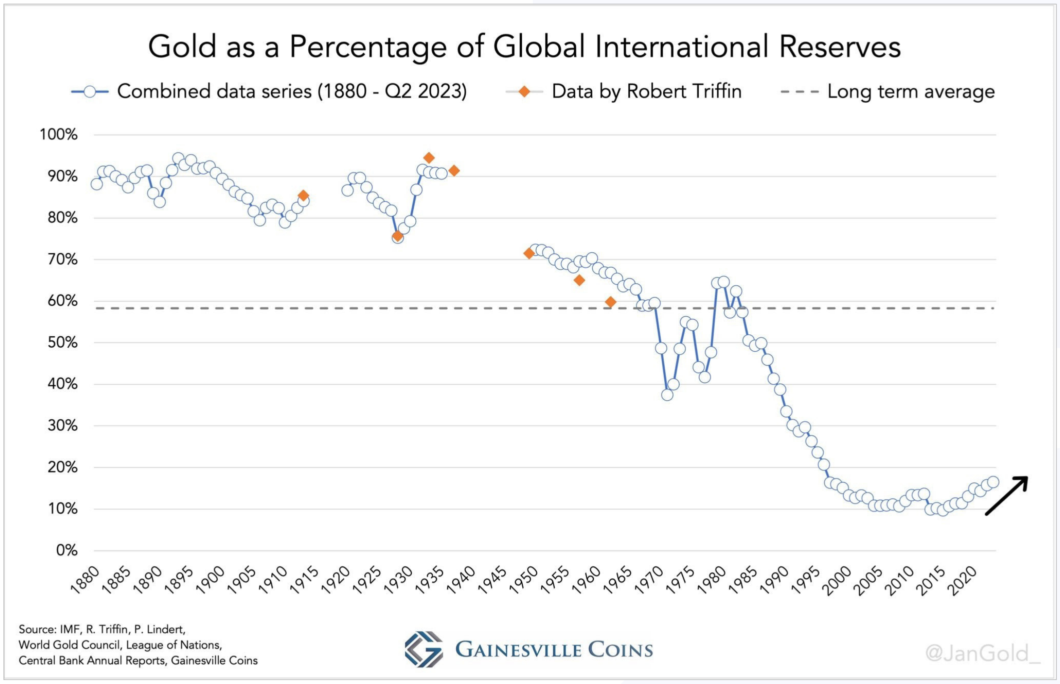
interfax.com/newsroom/top-s...

Russian CB gold buying contributed to another strong month of CB gold buying in August in the latest World Gold Council data released this week:



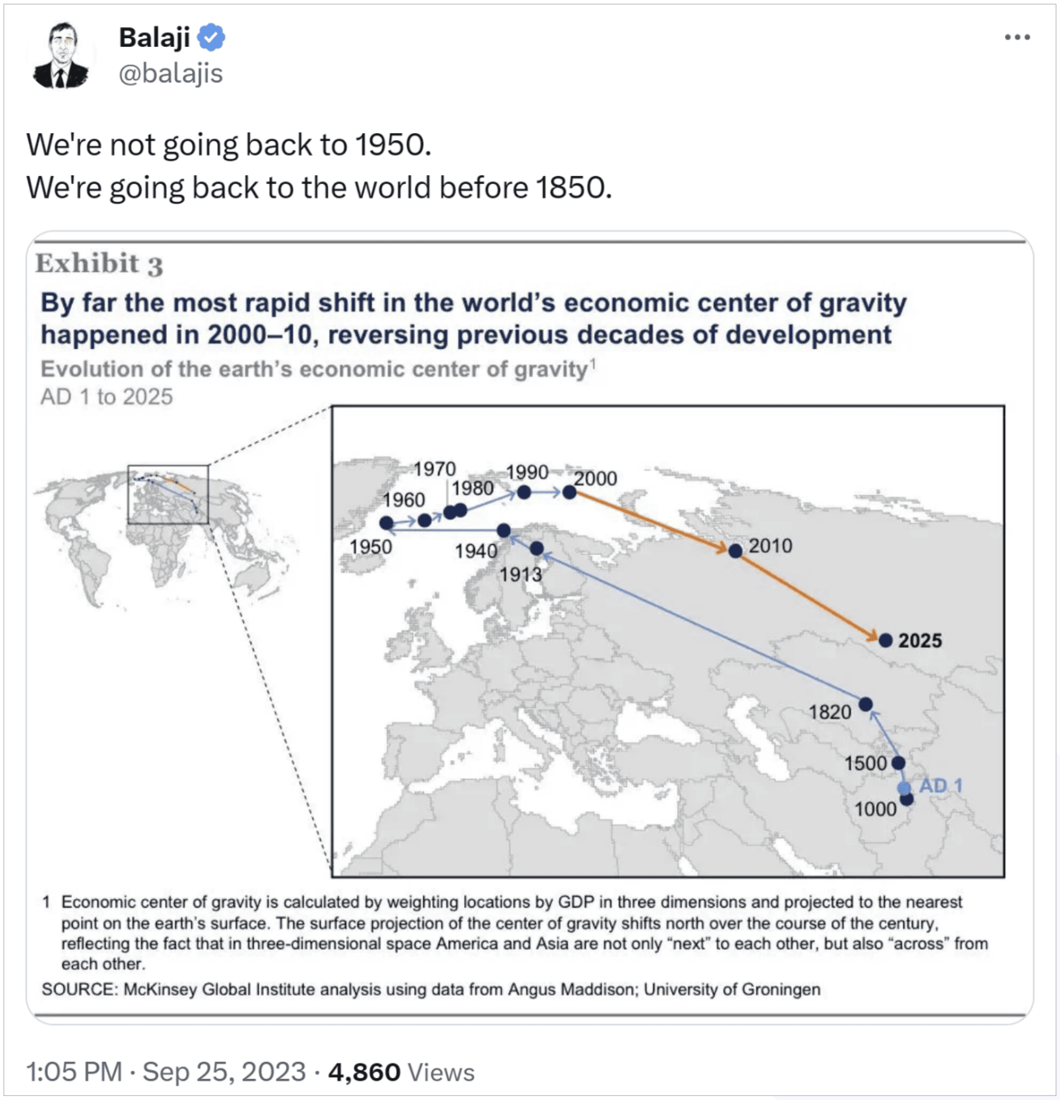
*Data to 31 August 2023 where available.
Source: IMF IFS, respective central banks, World Gold Council

… supporting what has now become a clear upward trend in gold's share of global international reserves that began a couple years ago:



Source: IMF, R. Triffin, P. Lindert, World Gold Council, League of Nations, Central Bank Annual Reports, Gainesville Coins

While most western investors tend to want a "big bang" announcement (and we think one will eventually occur), **investors should understand that organic factors are likely to drive gold's share of FX reserves and its price relative to USTs and in USD terms higher. The world's economic center of gravity is shifting to areas of the world that prefer gold to USTs as a primary reserve asset…**



Balaji @balajis

We're not going back to 1950.
We're going back to the world before 1850.

Exhibit 3

By far the most rapid shift in the world's economic center of gravity happened in 2000–10, reversing previous decades of development

Evolution of the earth's economic center of gravity[1]

AD 1 to 2025

[1] Economic center of gravity is calculated by weighting locations by GDP in three dimensions and projected to the nearest point on the earth's surface. The surface projection of the center of gravity shifts north over the course of the century, reflecting the fact that in three-dimensional space America and Asia are not only "next" to each other, but also "across" from each other.

SOURCE: McKinsey Global Institute analysis using data from Angus Maddison; University of Groningen

1:05 PM · Sep 25, 2023 · **4,860** Views

… and the key driver of the shift in the world's economic center of gravity is not only buying gold itself (China), but is reportedly encouraging her 1.5 billion citizens to buy gold as well. Ultimately, western paper gold markets do not stand a chance against the organic demand of 1.5 billion people who are becoming a greater portion of the global economy.

China sends ripples through the global gold bullion market, and no one notices – 6/7/23 (via JM)

China sends ripples through the global gold bullion market, and no one n – The Jerusalem Post (jpost.com)

> *Last week an event occurred which was completely missed by the mainstream media. The People's Bank of China (PBOC) took the next important step to encourage a wider and less wealthy section of Chinese citizens to purchase gold and silver bullion. The PBOC opened the facility for citizens to convert renminbi cash savings held in the public's own bank accounts to be converted into physical gold at the click of a button.*
>
> *As we saw back in 2010, the PBOC began sending a message to all global liquidity providers that they are going to defend the value of these gold positions for their own citizens. This*

> *freshly introduced gold savings program advises citizens to make regular monthly purchases with the expected return of these investments to rise solely from gold price appreciation. This sends a clear message that the gold price is going to rise from current levels. London bullion dealers are already increasing their gold bullion buyback rates above the spot price as they struggle to source enough stock at the current gold price due to a tight international market.*
>
> *This program is the next leg of a multi-decade incentivised gold purchase call to Chinese citizens. The last time China incentivised her citizens to buy gold bullion bars and coins was directly after China removed controls on precious metals in 2010. Some investors may recall when state-owned Chinese television channels began openly advertising investing in gold on mainstream television in conjunction with house-sized billboards with advertisements to encourage China's growing middle class to buy gold as an investment.*
>
> *China plans to enrich its citizens with the gold market and as seen in 2010, they are also sending a message that they will protect the gold price from a collapse given the gold price exposure its citizens will have. The movement of a few dollars here and there is irrelevant, it is the larger downside moves that will be bought into by Chinese institutions to support prices.*
>
> *For reference, the gold price was benchmarked in London at $1100 in 2010 when the Chinese government started to advertise gold investment to its population. By no coincidence, not once since then has the gold price traded below that level. In fact, since then we regularly see Shanghai gold trading at prices that are at a $50 premium to the gold spot price.*

The de-dollarization of BRICS trade with physical gold net settlement paradoxically means the USD will RISE further, not fall *(less USD supply created via trade, against a large and persistent bid for USD from offshore USD-denominated debt, v. more BRICS currencies' supply created via trade, against not much demand for those currencies from offshore denominated debt.)* **This counterintuitive dynamic remains poorly understood by many investors.**

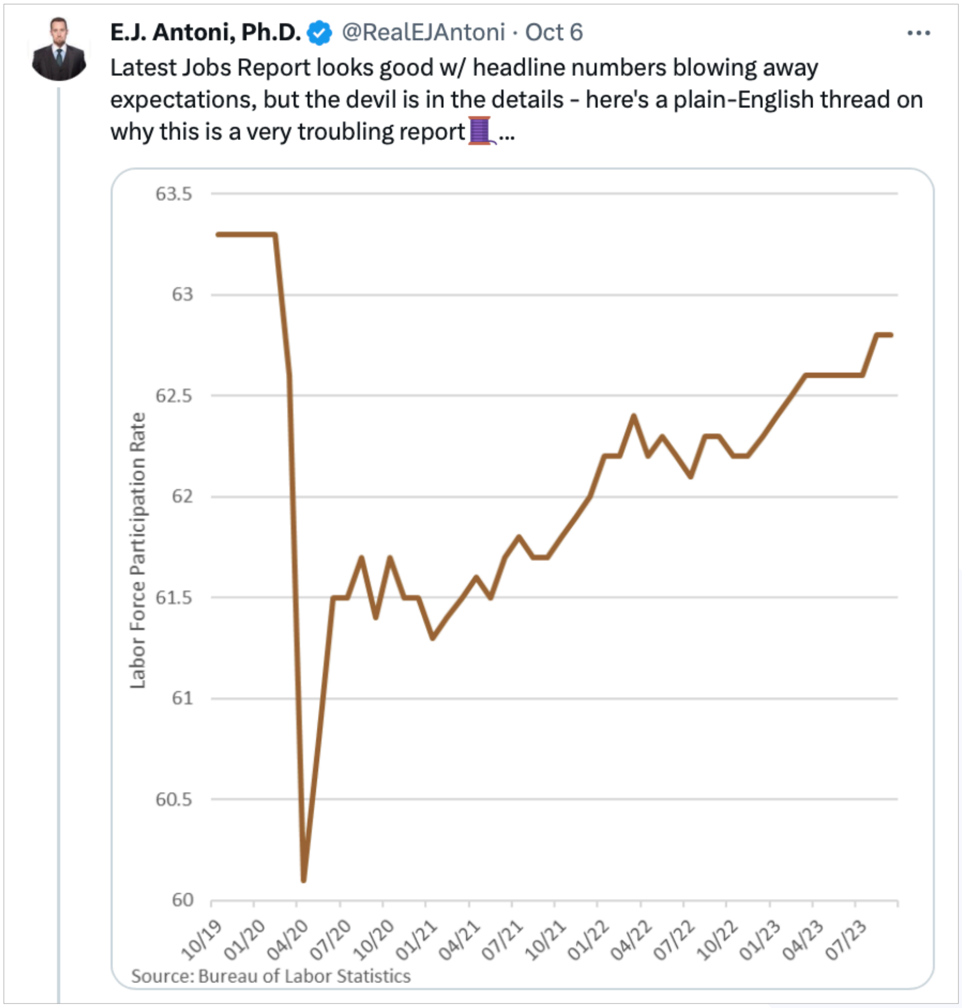
A further rise in the USD driven by commodity market de-dollarization above will further hurt the UST market, US banks, and US GDP in the manner we described earlier and in recent weeks and months (it accelerates the UST market feedback loop of less UST demand, higher rates, higher USD.)

Most of Washington and Wall Street believes the rising USD and UST yields mean that Washington and Wall Street are winning and that commodity de-dollarization isn't happening. This is wrong. What it really means is commodity de-dollarization is driving a higher USD that is accelerating the UST feedback loop, moving the US rapidly towards a debt crisis even as China and the BRICS reduce their USD needs to buy commodities and conduct trade.

This means China and Russia will not break before the UST market does, and it also explains why gold has completely separated from US real rates. That separation between gold and real rates will likely continue and accelerate. Let's watch.

Learn more about FFTT Tree Rings here.

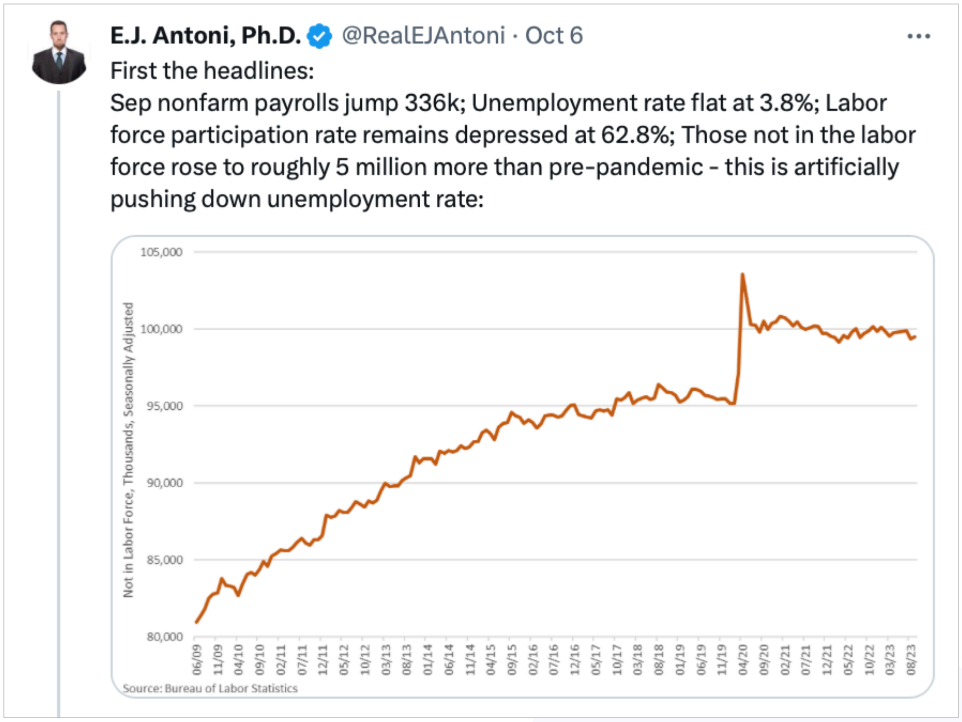
The latest jobs report was not as positive as it appeared (from E.J. Antoni, Ph.D. via X on October 6)…



E.J. Antoni, Ph.D. @RealEJAntoni · Oct 6

Latest Jobs Report looks good w/ headline numbers blowing away expectations, but the devil is in the details - here's a plain-English thread on why this is a very troubling report🧵...

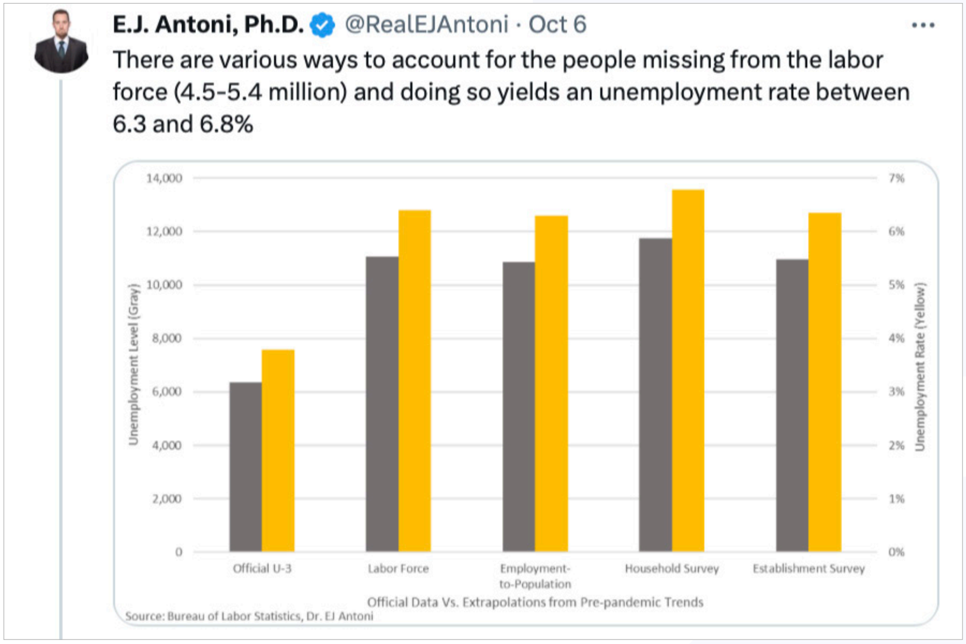
Source: Bureau of Labor Statistics



E.J. Antoni, Ph.D. @RealEJAntoni · Oct 6

First the headlines:
Sep nonfarm payrolls jump 336k; Unemployment rate flat at 3.8%; Labor force participation rate remains depressed at 62.8%; Those not in the labor force rose to roughly 5 million more than pre-pandemic - this is artificially pushing down unemployment rate:

Source: Bureau of Labor Statistics

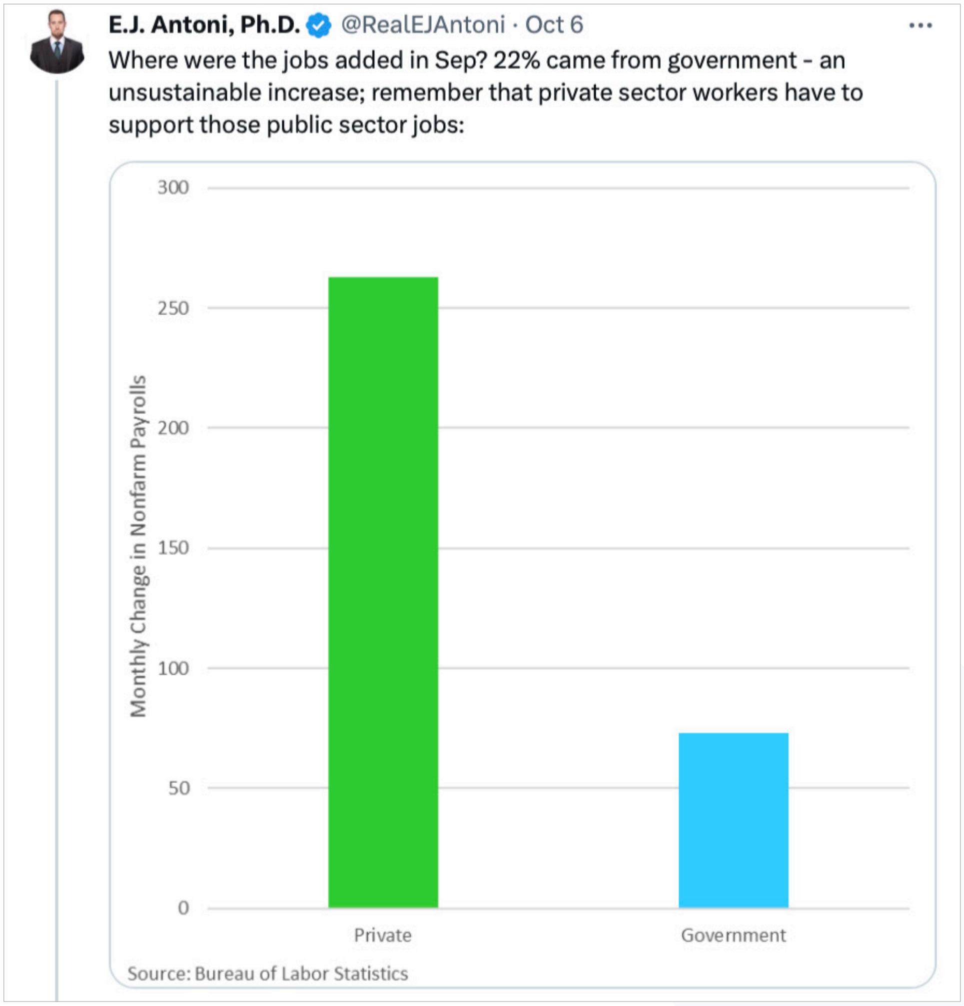


E.J. Antoni, Ph.D. @RealEJAntoni · Oct 6

There are various ways to account for the people missing from the labor force (4.5-5.4 million) and doing so yields an unemployment rate between 6.3 and 6.8%

Official Data Vs. Extrapolations from Pre-pandemic Trends

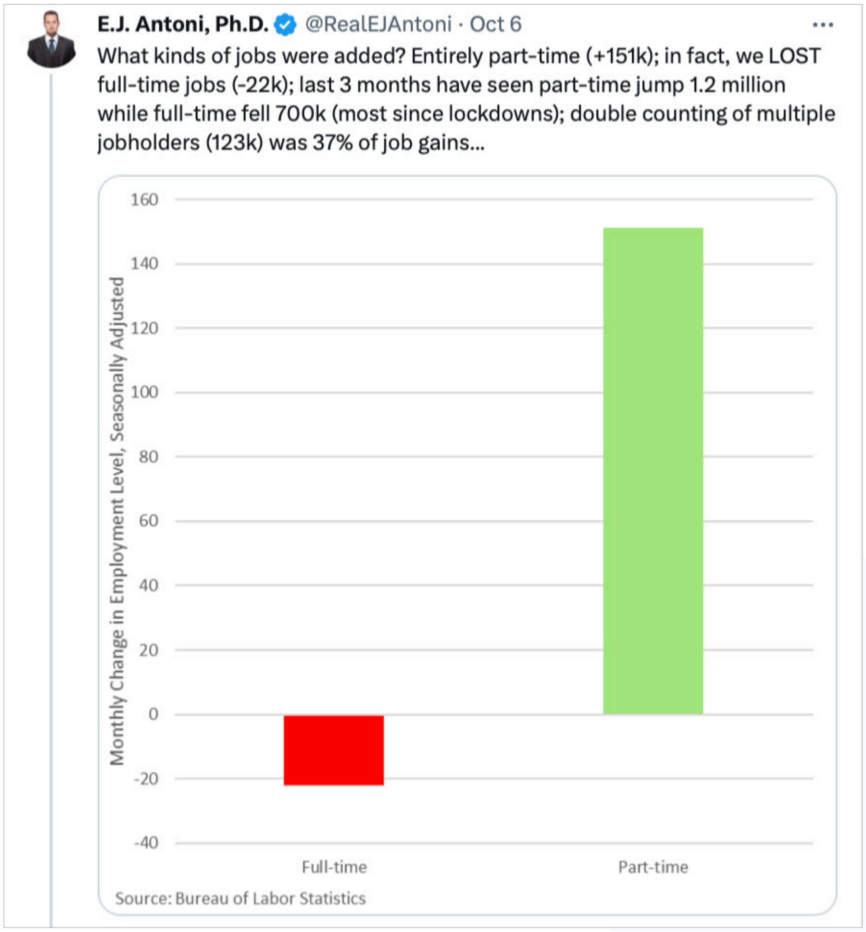
Source: Bureau of Labor Statistics, Dr. EJ Antoni



E.J. Antoni, Ph.D. @RealEJAntoni · Oct 6

Where were the jobs added in Sep? 22% came from government - an unsustainable increase; remember that private sector workers have to support those public sector jobs:

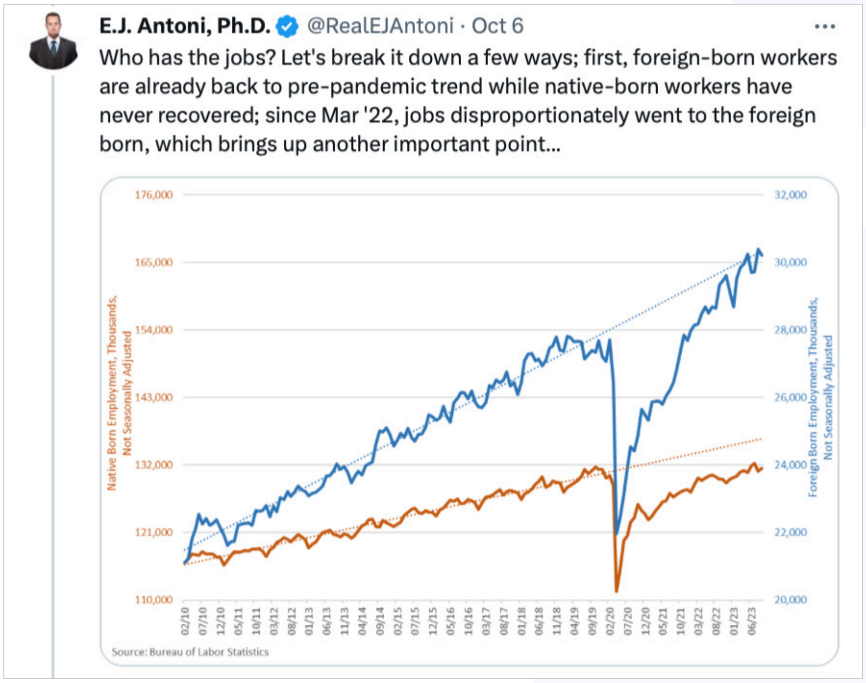
Source: Bureau of Labor Statistics



E.J. Antoni, Ph.D. @RealEJAntoni · Oct 6

What kinds of jobs were added? Entirely part-time (+151k); in fact, we LOST full-time jobs (-22k); last 3 months have seen part-time jump 1.2 million while full-time fell 700k (most since lockdowns); double counting of multiple jobholders (123k) was 37% of job gains...

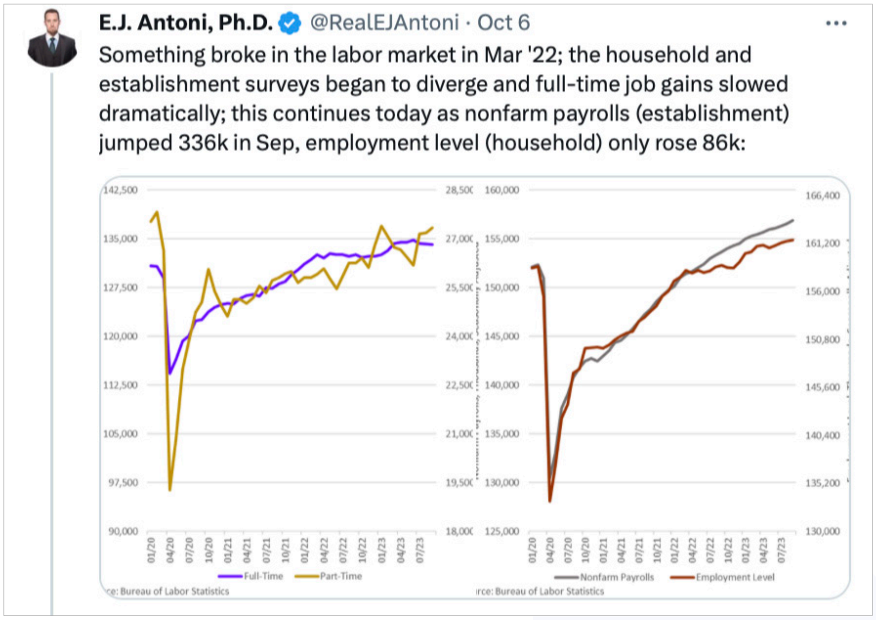
Source: Bureau of Labor Statistics



E.J. Antoni, Ph.D. @RealEJAntoni · Oct 6

Who has the jobs? Let's break it down a few ways; first, foreign-born workers are already back to pre-pandemic trend while native-born workers have never recovered; since Mar '22, jobs disproportionately went to the foreign born, which brings up another important point...

Source: Bureau of Labor Statistics

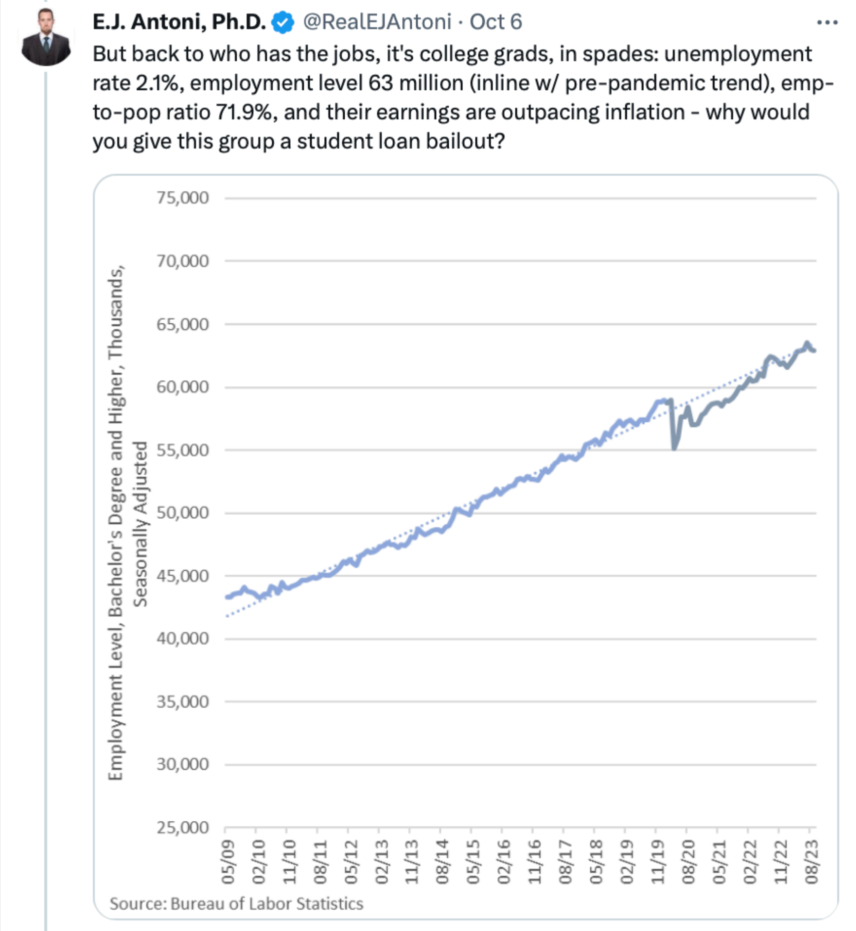


E.J. Antoni, Ph.D. @RealEJAntoni · Oct 6

Something broke in the labor market in Mar '22; the household and establishment surveys began to diverge and full-time job gains slowed dramatically; this continues today as nonfarm payrolls (establishment) jumped 336k in Sep, employment level (household) only rose 86k:

ce: Bureau of Labor Statistics

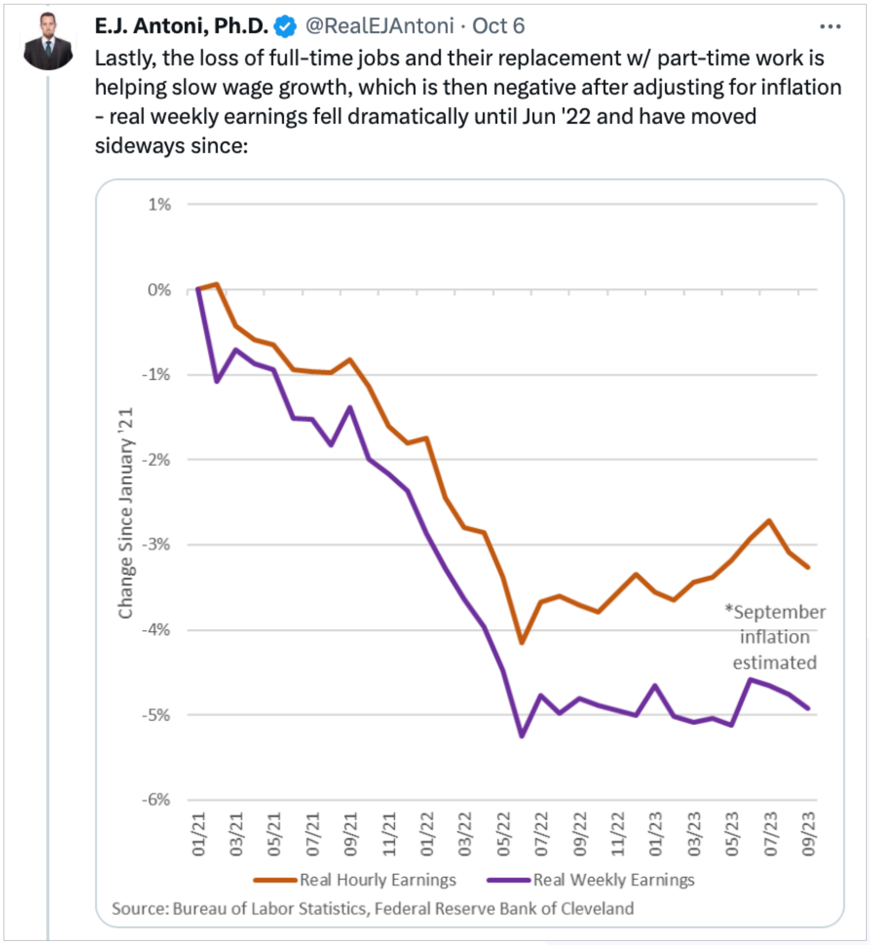
rce: Bureau of Labor Statistics



E.J. Antoni, Ph.D. @RealEJAntoni · Oct 6

But back to who has the jobs, it's college grads, in spades: unemployment rate 2.1%, employment level 63 million (inline w/ pre-pandemic trend), emp-to-pop ratio 71.9%, and their earnings are outpacing inflation - why would you give this group a student loan bailout?

Source: Bureau of Labor Statistics

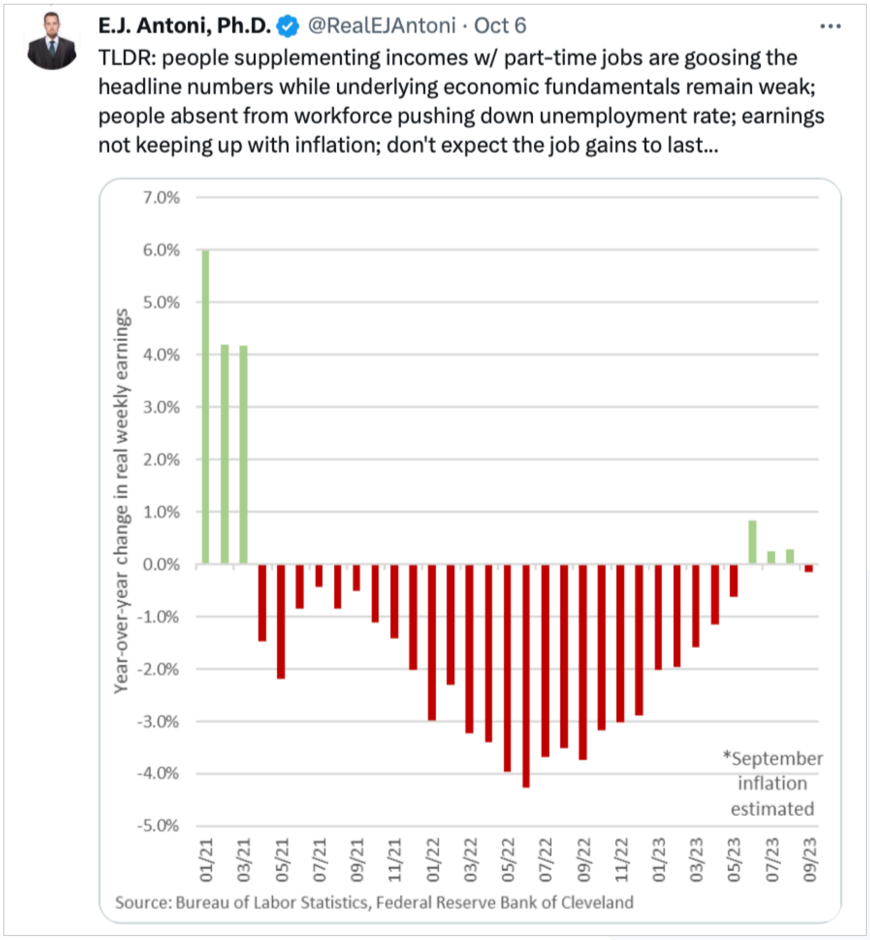


E.J. Antoni, Ph.D. @RealEJAntoni · Oct 6

Lastly, the loss of full-time jobs and their replacement w/ part-time work is helping slow wage growth, which is then negative after adjusting for inflation - real weekly earnings fell dramatically until Jun '22 and have moved sideways since:

*September inflation estimated

Source: Bureau of Labor Statistics, Federal Reserve Bank of Cleveland



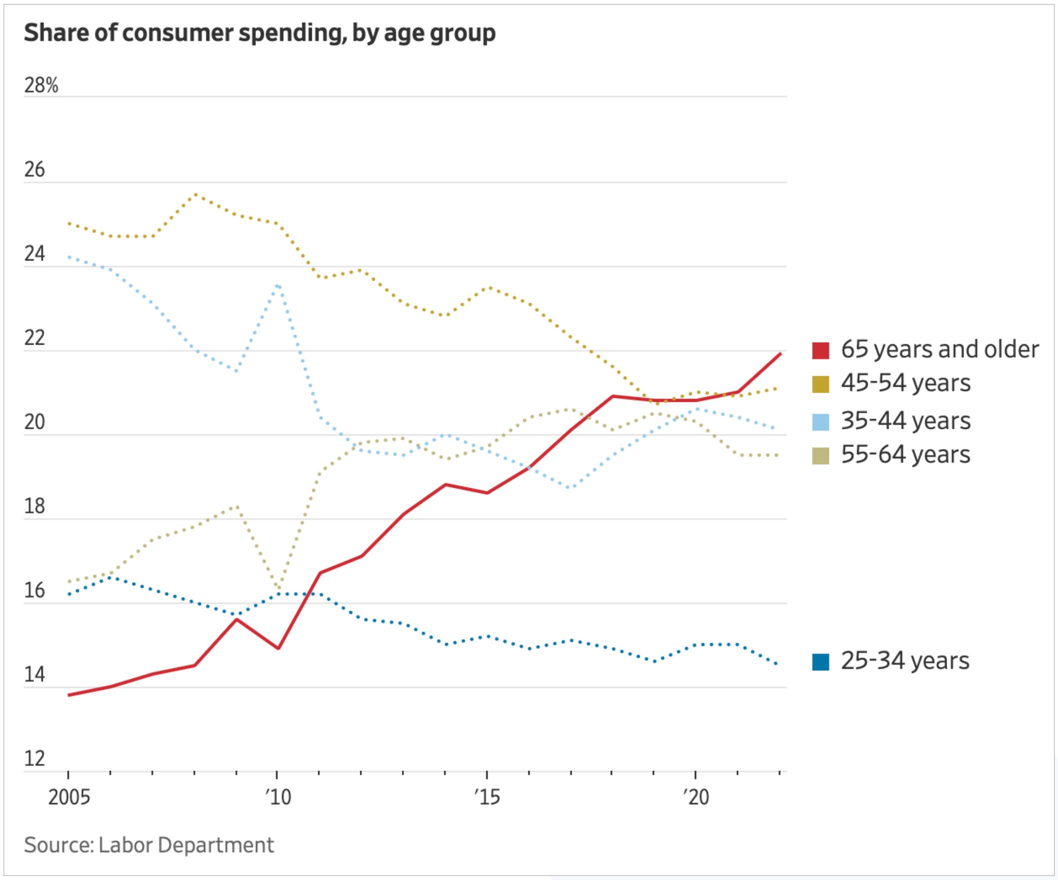
E.J. Antoni, Ph.D. @RealEJAntoni · Oct 6

TLDR: people supplementing incomes w/ part-time jobs are goosing the headline numbers while underlying economic fundamentals remain weak; people absent from workforce pushing down unemployment rate; earnings not keeping up with inflation; don't expect the job gains to last...

Source: Bureau of Labor Statistics, Federal Reserve Bank of Cleveland

Is this the "secret weapon" behind the resilient U.S. economy? ([from *The Wall Street Journal* on October 8](#))...

> Why has consumer spending proven so resilient as the Federal Reserve has raised interest rates? An important and little-appreciated reason: Consumers are getting older.
>
> In August, 17.7% of the population was 65 or older, according to the Census Bureau, the highest on record going back to 1920 and up sharply from 13% in 2010. The elderly aren't just more numerous: Their finances are relatively healthy and they have less need to borrow, such as to buy a house, and are less at risk of layoffs than other consumers.
>
> This has made the elderly a spending force to be reckoned with. Americans age 65 and up accounted for 22% of spending last year, the highest share since records began in 1972 and up from 15% in 2010, according to the Labor Department's survey of consumer expenditures released in September.
>
> "These are the consumers that will matter over the coming year," said Susan Sterne, chief economist at Economic Analysis Associates.
>
> "Our large share of older consumers provides a consumption base in times like today when job growth slows, interest rates rise and student-debt loan repayments begin again," she said.



Source: Labor Department

Seniors' high spending propensities reflect health, wealth and perhaps lingering psychological effects of the pandemic.

"All my life it was, save for this, save for that," said Maureen Green, 66, of Cape Cod, Mass. "Now there's money in the bank and I'm spending in ways that bring me closer to friends and family than I did before."

Green, a real-estate agent with four grown children living across the country, estimated she is spending 25% more and twice as much time traveling now compared with 2019. She recently traveled to Syracuse, N.Y., to catch a photo exhibit with friends, and toured Rhode Island with her son and his girlfriend.

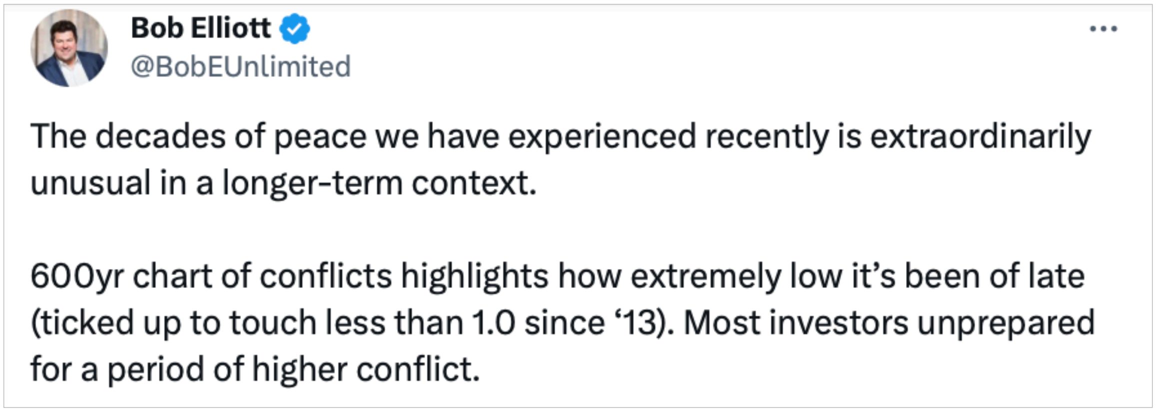
"The one million Americans who didn't survive Covid—that's part of it. That taught me not to let time go by because before I know it, that time won't be there anymore," she said.

Living better, longer—and larger

"The lifestyle of the senior has changed dramatically—they're more active than ever," said Marshal Cohen, chief retail adviser of Circana, a research firm specializing in consumer behavior. That has expanded the menu of recreation on which to spend, he said. "They're riding e-bikes, they're hiking, they're traveling. And they're doing these things for longer than they've ever been done."

Continue reading here (subscription may be required).

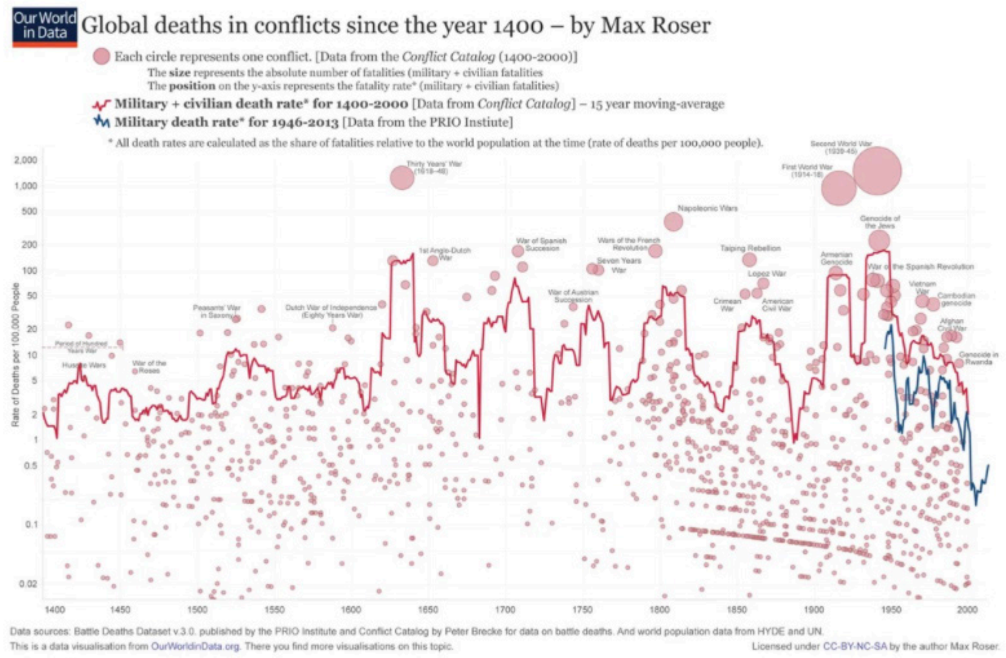
History suggests investors would be wise to prepare for a period of higher conflict ([from Bob Elliott via X on October 9](#))...



Bob Elliott
@BobEUnlimited

The decades of peace we have experienced recently is extraordinarily unusual in a longer-term context.

600yr chart of conflicts highlights how extremely low it's been of late (ticked up to touch less than 1.0 since '13). Most investors unprepared for a period of higher conflict.



Global deaths in conflicts since the year 1400 – by Max Roser

● Each circle represents one conflict. [Data from the *Conflict Catalog* (1400-2000)]
The **size** represents the absolute number of fatalities (military + civilian fatalities
The **position** on the y-axis represents the fatality rate* (military + civilian fatalities)

Military + civilian death rate* for 1400-2000 [Data from *Conflict Catalog*] – 15 year moving-average
Military death rate* for 1946-2013 [Data from the PRIO Instiute]

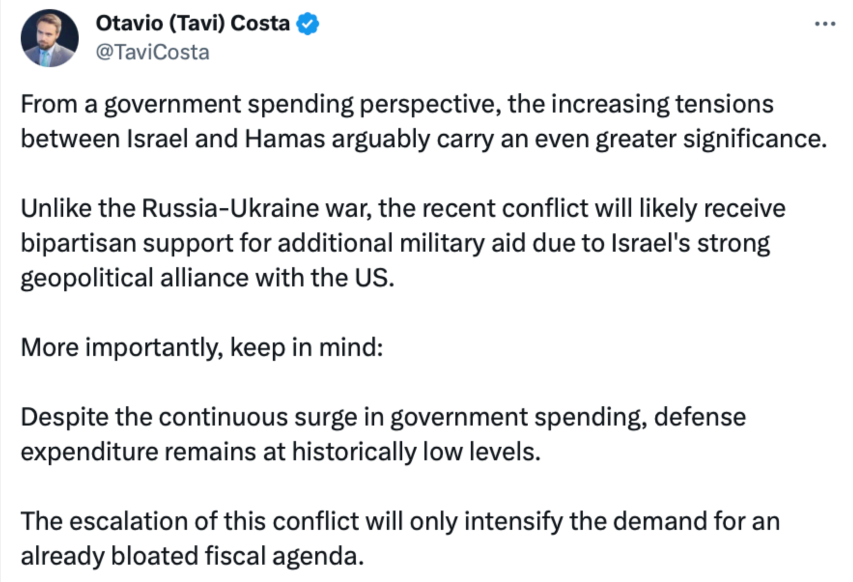
* All death rates are calculated as the share of fatalities relative to the world population at the time (rate of deaths per 100,000 people).

Data sources: Battle Deaths Dataset v.3.0. published by the PRIO Institute and Conflict Catalog by Peter Brecke for data on battle deaths. And world population data from HYDE and UN.
This is a data visualisation from OurWorldinData.org. There you find more visualisations on this topic. Licensed under CC-BY-NC-SA by the author Max Roser.

(Max Roser) | (Max Roser)

1:13 PM · Oct 9, 2023 · **162K** Views

Here's another reason to expect U.S. deficits to continue to rise (from Otavio Costa via X on October 9)…



Otavio (Tavi) Costa
@TaviCosta

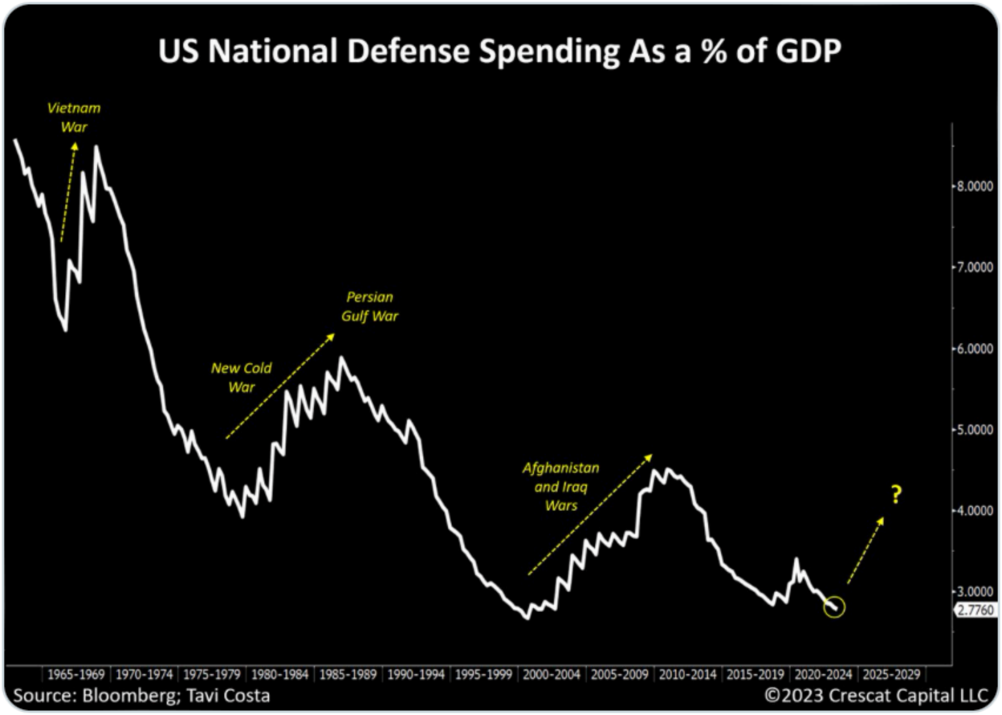
From a government spending perspective, the increasing tensions between Israel and Hamas arguably carry an even greater significance.

Unlike the Russia-Ukraine war, the recent conflict will likely receive bipartisan support for additional military aid due to Israel's strong geopolitical alliance with the US.

More importantly, keep in mind:

Despite the continuous surge in government spending, defense expenditure remains at historically low levels.

The escalation of this conflict will only intensify the demand for an already bloated fiscal agenda.



Source: Bloomberg; Tavi Costa

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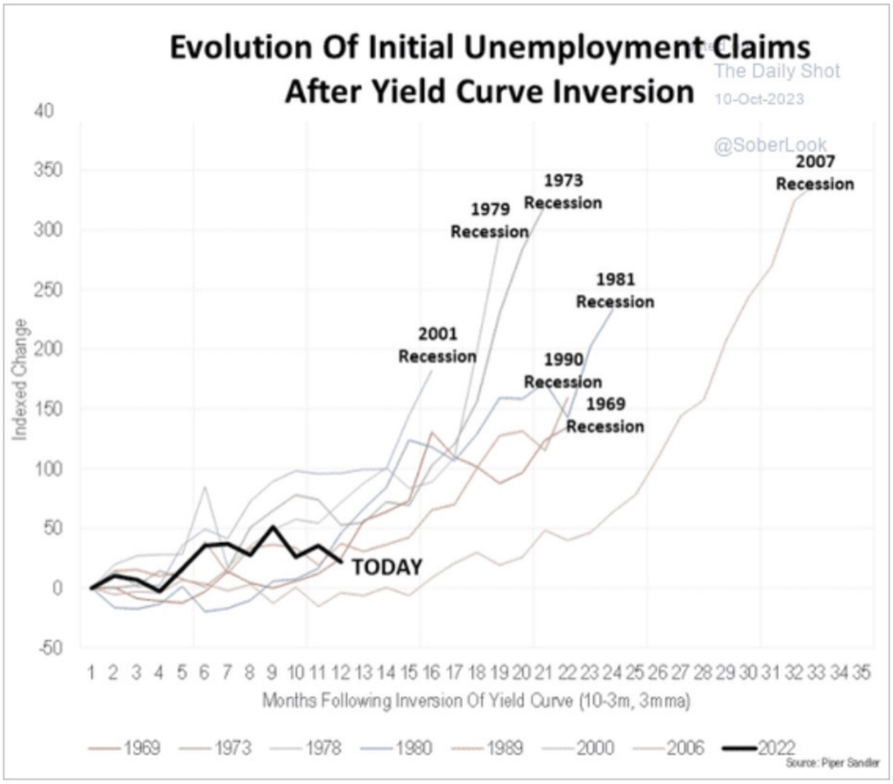
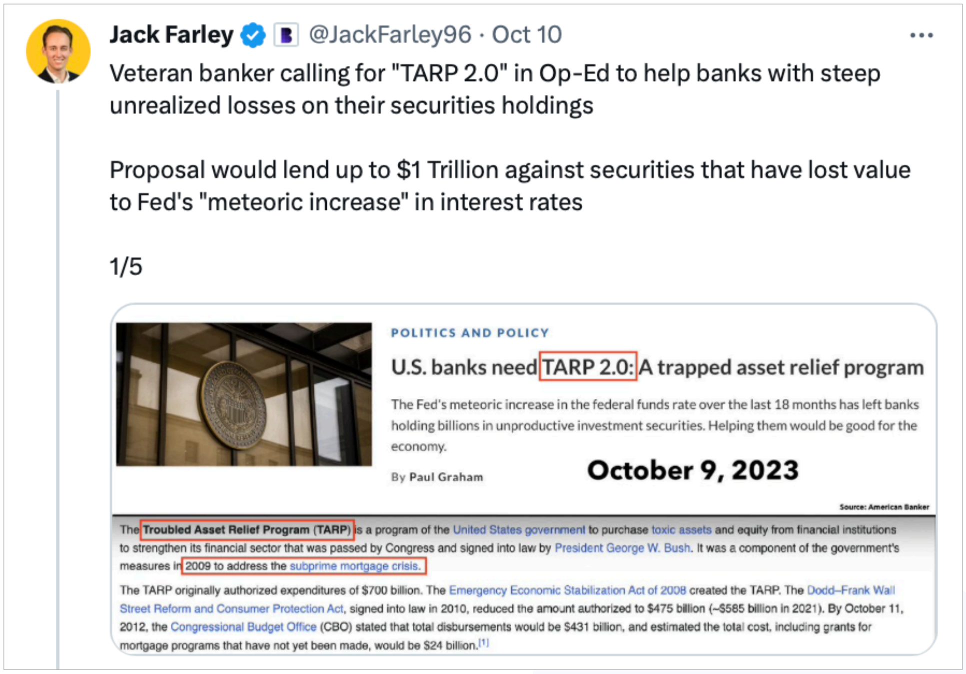
12:56 PM · Oct 9, 2023 · **69.9K** Views

Don’t be fooled by the modest increase in unemployment following last year’s yield-curve inversion. It doesn’t negate trouble ahead (from Piper Sandler via The Daily Shot on October 10)…



Source: Piper Sandler

Bankers are now begging for another bailout (from Jack Farley via X on October 10)…



Jack Farley @JackFarley96 · Oct 10

Veteran banker calling for "TARP 2.0" in Op-Ed to help banks with steep unrealized losses on their securities holdings

Proposal would lend up to $1 Trillion against securities that have lost value to Fed's "meteoric increase" in interest rates

1/5

POLITICS AND POLICY

U.S. banks need TARP 2.0: A trapped asset relief program

The Fed's meteoric increase in the federal funds rate over the last 18 months has left banks holding billions in unproductive investment securities. Helping them would be good for the economy.

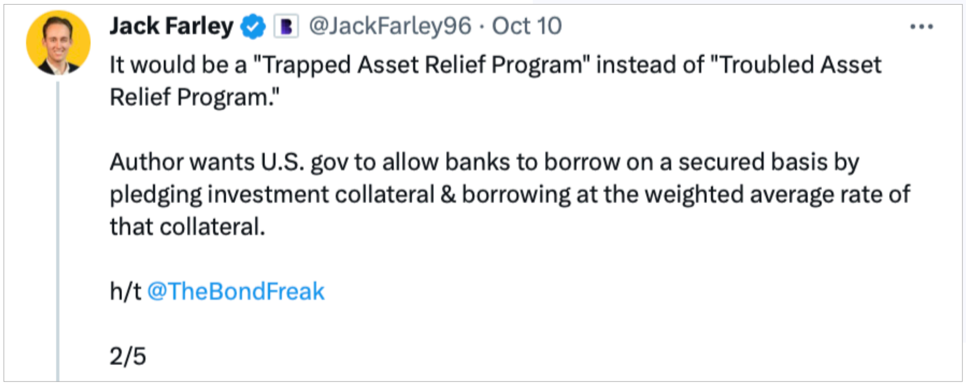
By Paul Graham

October 9, 2023

Source: American Banker

The **Troubled Asset Relief Program** (TARP) is a program of the United States government to purchase toxic assets and equity from financial institutions to strengthen its financial sector that was passed by Congress and signed into law by President George W. Bush. It was a component of the government's measures in 2009 to address the subprime mortgage crisis.

The TARP originally authorized expenditures of $700 billion. The Emergency Economic Stabilization Act of 2008 created the TARP. The Dodd–Frank Wall Street Reform and Consumer Protection Act, signed into law in 2010, reduced the amount authorized to $475 billion (~$585 billion in 2021). By October 11, 2012, the Congressional Budget Office (CBO) stated that total disbursements would be $431 billion, and estimated the total cost, including grants for mortgage programs that have not yet been made, would be $24 billion.[1]



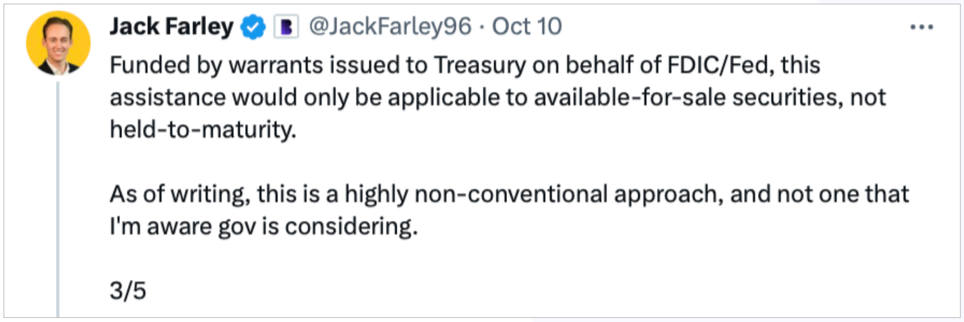
Jack Farley @JackFarley96 · Oct 10

It would be a "Trapped Asset Relief Program" instead of "Troubled Asset Relief Program."

Author wants U.S. gov to allow banks to borrow on a secured basis by pledging investment collateral & borrowing at the weighted average rate of that collateral.

h/t @TheBondFreak

2/5

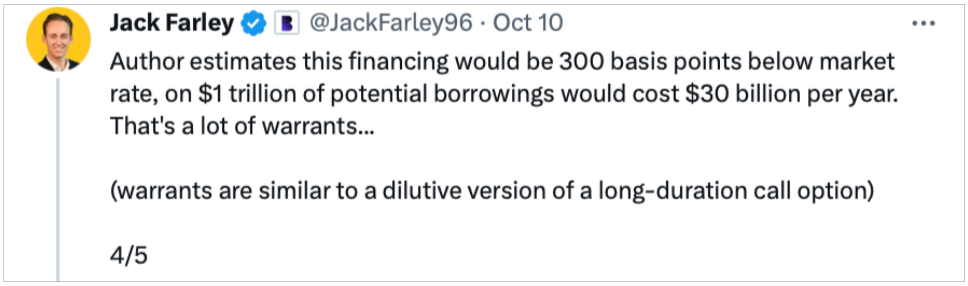


Jack Farley @JackFarley96 · Oct 10

Funded by warrants issued to Treasury on behalf of FDIC/Fed, this assistance would only be applicable to available-for-sale securities, not held-to-maturity.

As of writing, this is a highly non-conventional approach, and not one that I'm aware gov is considering.

3/5

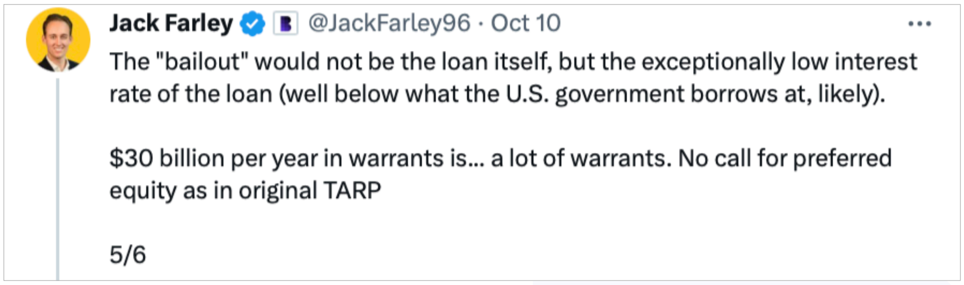


Jack Farley @JackFarley96 · Oct 10

Author estimates this financing would be 300 basis points below market rate, on $1 trillion of potential borrowings would cost $30 billion per year. That's a lot of warrants...

(warrants are similar to a dilutive version of a long-duration call option)

4/5



Jack Farley @JackFarley96 · Oct 10

The "bailout" would not be the loan itself, but the exceptionally low interest rate of the loan (well below what the U.S. government borrows at, likely).

$30 billion per year in warrants is... a lot of warrants. No call for preferred equity as in original TARP

5/6

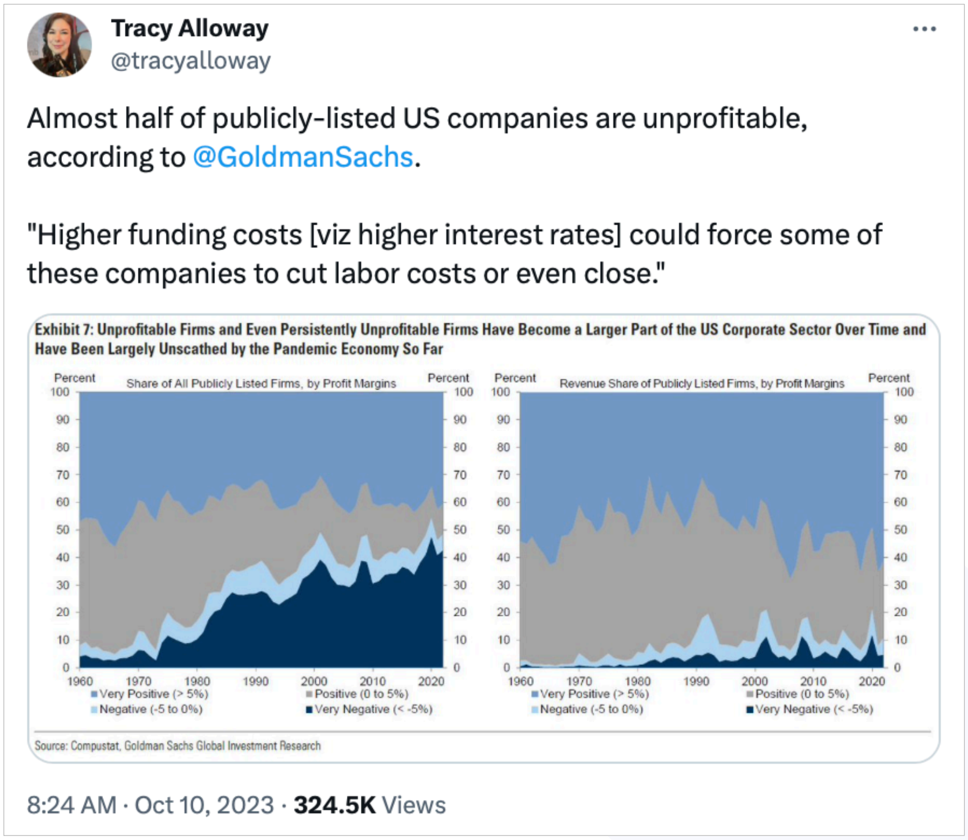
Jack Farley @JackFarley96 · Oct 10

Just want to re-iterate, as I indicated earlier in this thread, this idea is not a policy proposal coming from the government. It's a banker writing an Op-Ed in @AmerBanker

Here is full piece (paywalled):
americanbanker.com/opinion/u-s-ba...

6/6

Nearly half of U.S. public companies can't earn a profit today (from Tracy Alloway via X on October 10)...



Tracy Alloway
@tracyalloway

Almost half of publicly-listed US companies are unprofitable, according to @GoldmanSachs.

"Higher funding costs [viz higher interest rates] could force some of these companies to cut labor costs or even close."

Exhibit 7: Unprofitable Firms and Even Persistently Unprofitable Firms Have Become a Larger Part of the US Corporate Sector Over Time and Have Been Largely Unscathed by the Pandemic Economy So Far

Source: Compustat, Goldman Sachs Global Investment Research

8:24 AM · Oct 10, 2023 · **324.5K** Views

Yet those unprofitable firms account for a sizable percentage of capital spending and employment (from Jesse Felder via X on October 10)...

Jesse Felder
@jessefelder

'The number of unprofitable firms has risen in recent decades, reaching almost 50% of all publicly-listed companies in 2022. Unprofitable firms account for closer to 13% of capital spending and employment.' gspublishing.com/content/resear ht @RobinWigg

Exhibit 8: Unprofitable Firms Account for About 13% of Employment and Capital Spending, and Even Just the Persistently Unprofitable Firms Account for 5% of Employment

Note: Shares are of the universe of publicly listed firms.

Source: Compustat, Goldman Sachs Global Investment Research

10:31 AM · Oct 10, 2023 · **7,673** Views

New rules require hedge funds to disclose short sales (from *The Wall Street Journal* on October 13)...

> Traders will get a broader look at which public companies are being targeted by short sellers under rules the Securities and Exchange Commission adopted Friday as part of its response to the 2021 GameStop trading frenzy.
>
> The final rules come more than two years after that drama, when thousands of investors coordinated on Reddit to buy shares of GameStop and others—and punish hedge funds that had bet against the stocks. The turmoil captured headlines and left some traders with huge gains while others lost eye-popping sums.
>
> In a short sale, a trader bets against a stock by borrowing shares and then selling them in hopes the shares' price will decline before the trader must return them to the lender. In the case of GameStop, individual investors sought to create a "short squeeze" by forcing short sellers to buy stock to cover their positions, boosting share prices.
>
> A 2010 law passed by Congress in response to the financial crisis required the SEC to gather more information about short sales, but the agency had yet to implement it. Chair Gary Gensler joked Friday that the unfinished mandate was old enough to have a bar mitzvah.
>
> An SEC staff report reviewing the meme-stock trading phenomenon said regulators should seek better reporting of short sales as part of their response.
>
> SEC commissioners voted 3-2 along party lines Friday to adopt two rules—one aimed at large short

sellers, and the other at lenders of securities.

"These are two opaque areas of the market, short selling and securities lending," Gensler said. He added that the changes should promote greater transparency and efficiency in the market.

Republican SEC Commissioner Mark Uyeda said the changes could discourage short selling and, therefore, curb the market's ability to appropriately price assets.

Hedge-fund industry representatives criticized the rules, saying they would increase costs and wouldn't make investors safer.

"The final rule places burdensome and costly reporting requirements on investment managers instead of adjusting, consolidating, and leveraging data already collected," said Bryan Corbett, president of the Managed Funds Association, a group of hedge funds.

Continue reading here (subscription may be required).

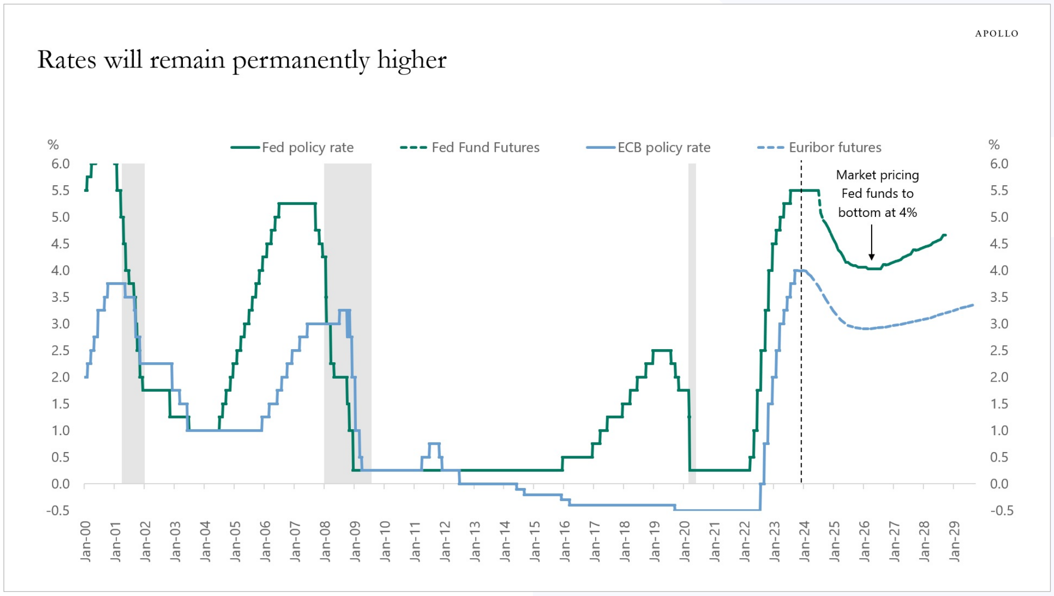
Fed funds futures are now pricing in "higher for longer" (from Torsten Sløk via The Daily Spark on October 14)...

Markets are pricing that the Fed funds rate will bottom at 4% in 2025 and then start rising again, see chart below.

The same profile can be seen for the ECB, where rates will bottom at 3% and then start rising again.

The conclusion is that long-term investors should plan on rates being permanently higher than they were from 2008 to 2020.

In other words, rates are not going back to zero.


Rates will remain permanently higher

This trend could put significant downward pressure on stocks (from Florian Kronawitter via X on October 16)…

Florian Kronawitter
@fkronawitter1

"BLACKROCK SEES 'SIGNIFICANT INTEREST' AMONG PENSION FUNDS TO CUT EQUITY EXPOSURE, LOCK IN YIELDS"

There is always enough demand for Treasuries. You just need to sell equities for it

When do you sell equities? When you think growth slows down (1/2)

6:03 AM · Oct 16, 2023 · **465.7K** Views

Florian Kronawitter
@fkronawitter1

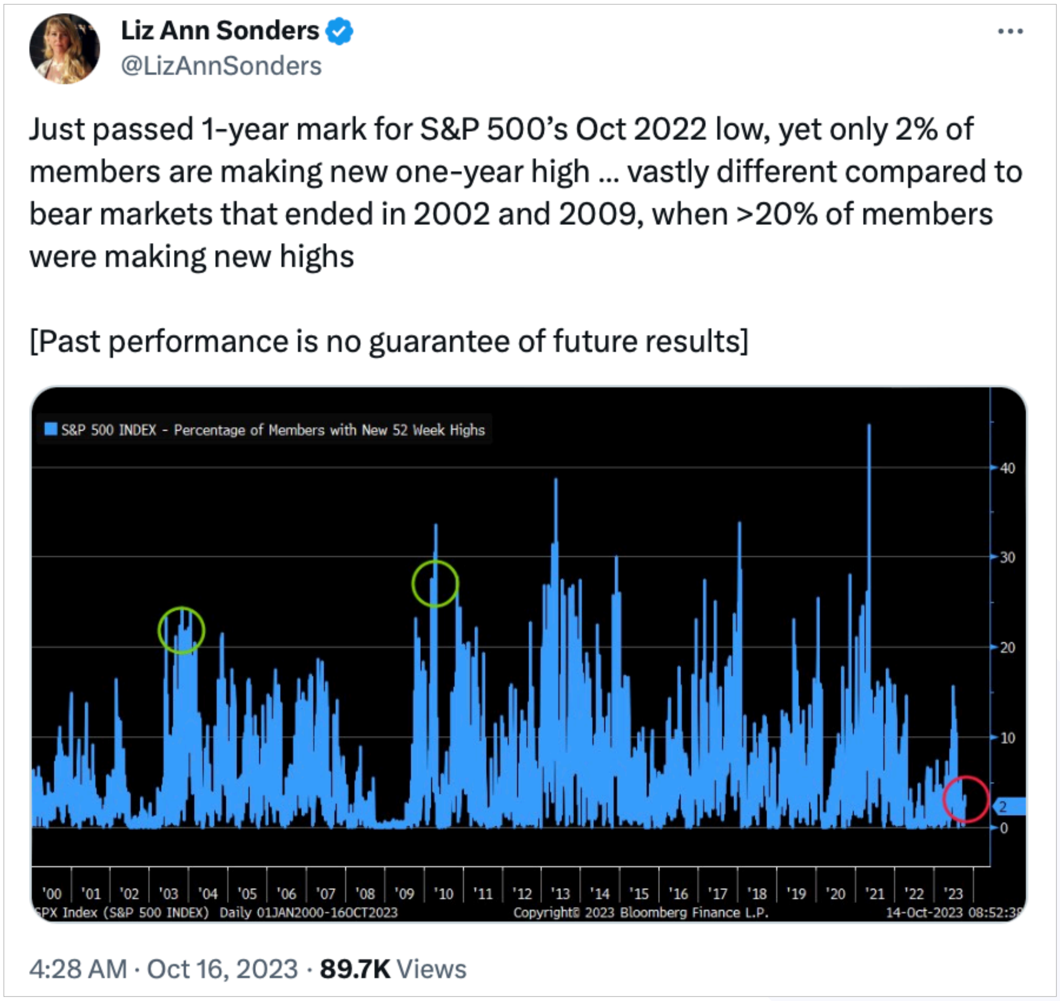
The risk?

Reflexivity gets to work. Equities sold to buy bonds. Lower stock prices get companies to cut. That slows the economy further. Etc.

This is why the endgame is *likely* more Fed liquidity. It creates additional Treasury demand - no one wants a downward spiral (2/2)

6:03 AM · Oct 16, 2023 · **17K** Views

The market's performance since last October's low suggests the final bear market bottom still lies ahead ([from Liz Ann Sonders via X on October 16]())...



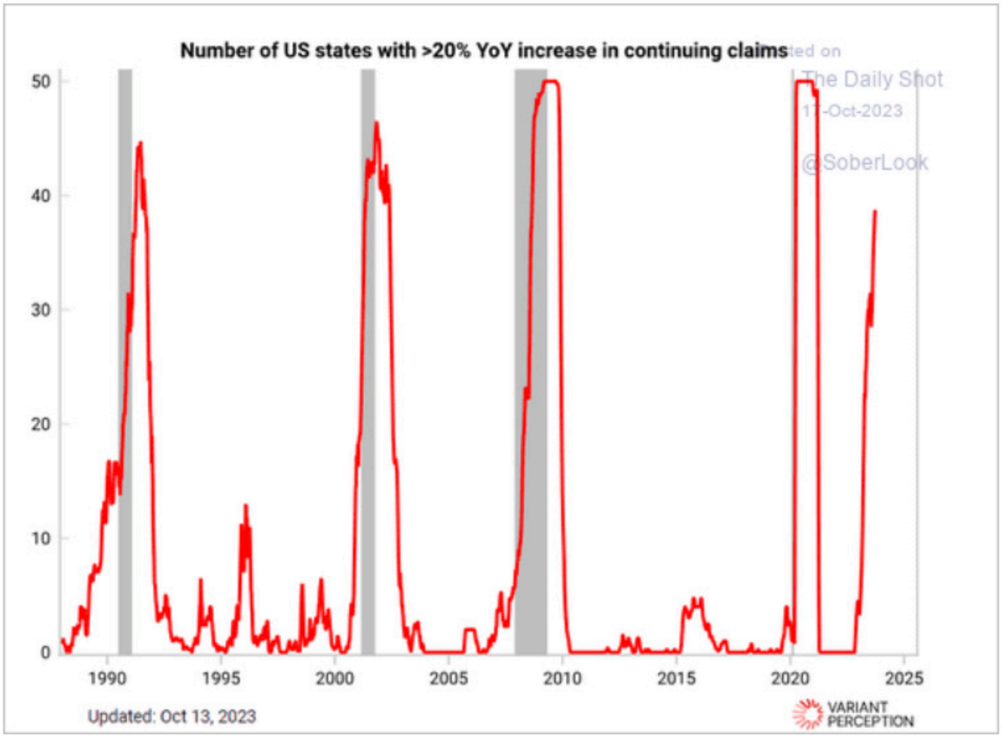
Liz Ann Sonders
@LizAnnSonders

Just passed 1-year mark for S&P 500's Oct 2022 low, yet only 2% of members are making new one-year high ... vastly different compared to bear markets that ended in 2002 and 2009, when >20% of members were making new highs

[Past performance is no guarantee of future results]

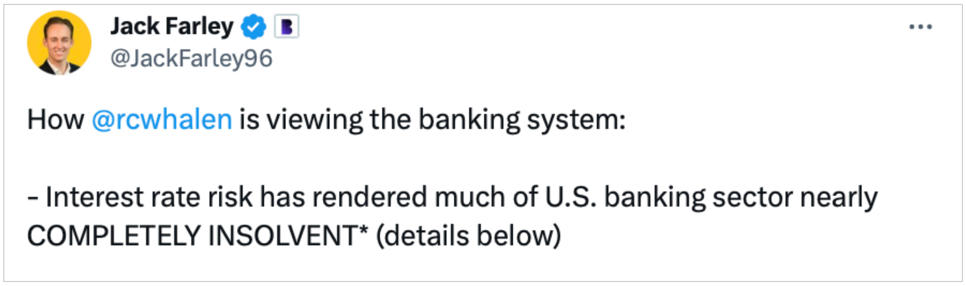
4:28 AM · Oct 16, 2023 · **89.7K** Views

The number of states with significant increases in continuing jobless claims has already reached recessionary levels ([from Variant Perception via The Daily Shot on October 17]())...



Source: Variant Perception

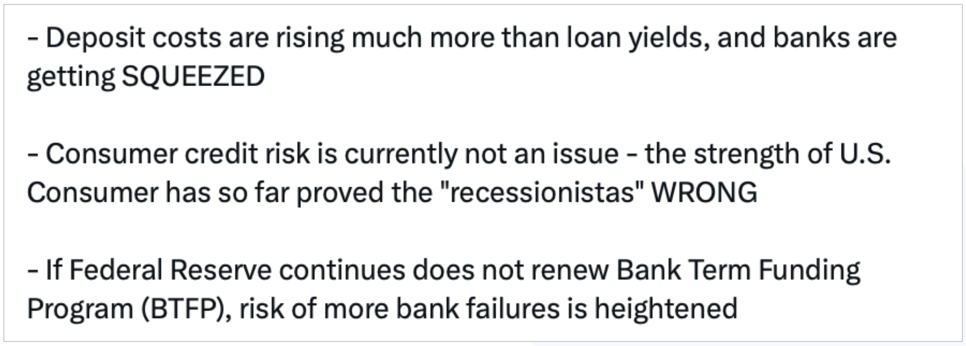
What top bank analyst Chris Whalen is thinking about the banking system today ([from Jack Farley via X on October 17](#))...



Jack Farley
@JackFarley96

How @rcwhalen is viewing the banking system:

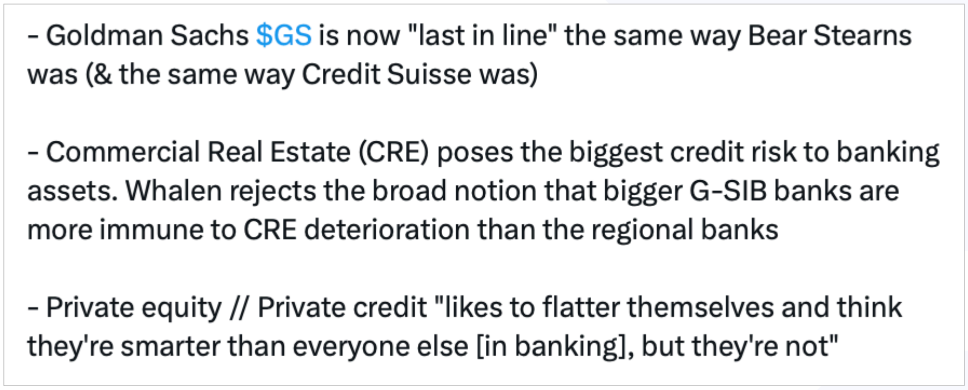
- Interest rate risk has rendered much of U.S. banking sector nearly COMPLETELY INSOLVENT* (details below)



- Deposit costs are rising much more than loan yields, and banks are getting SQUEEZED

- Consumer credit risk is currently not an issue - the strength of U.S. Consumer has so far proved the "recessionistas" WRONG

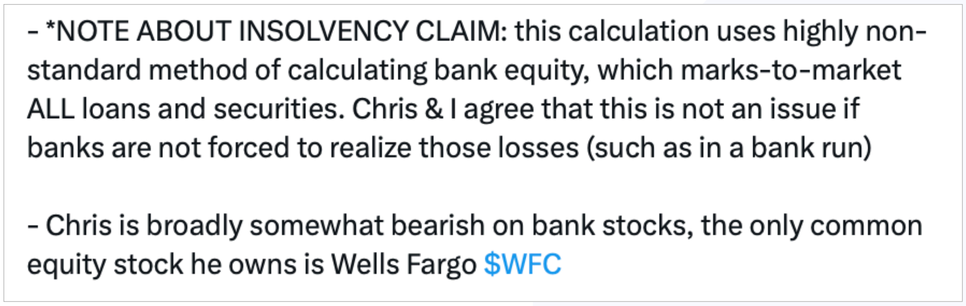
- If Federal Reserve continues does not renew Bank Term Funding Program (BTFP), risk of more bank failures is heightened



- Goldman Sachs $GS is now "last in line" the same way Bear Stearns was (& the same way Credit Suisse was)

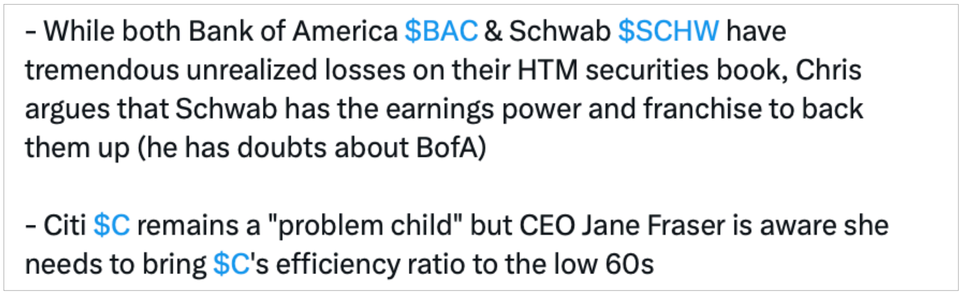
- Commercial Real Estate (CRE) poses the biggest credit risk to banking assets. Whalen rejects the broad notion that bigger G-SIB banks are more immune to CRE deterioration than the regional banks

- Private equity // Private credit "likes to flatter themselves and think they're smarter than everyone else [in banking], but they're not"



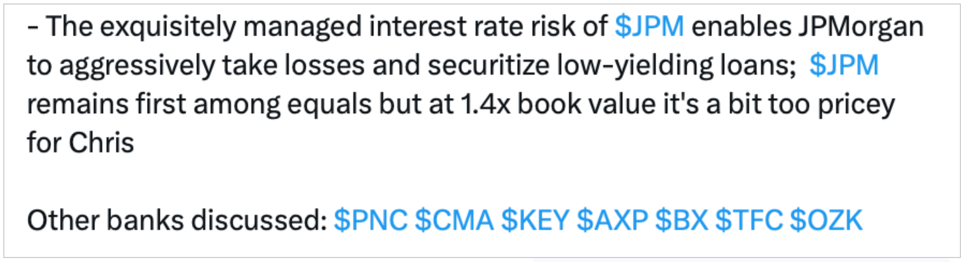
- *NOTE ABOUT INSOLVENCY CLAIM: this calculation uses highly non-standard method of calculating bank equity, which marks-to-market ALL loans and securities. Chris & I agree that this is not an issue if banks are not forced to realize those losses (such as in a bank run)

- Chris is broadly somewhat bearish on bank stocks, the only common equity stock he owns is Wells Fargo $WFC



- While both Bank of America $BAC & Schwab $SCHW have tremendous unrealized losses on their HTM securities book, Chris argues that Schwab has the earnings power and franchise to back them up (he has doubts about BofA)

- Citi $C remains a "problem child" but CEO Jane Fraser is aware she needs to bring $C's efficiency ratio to the low 60s



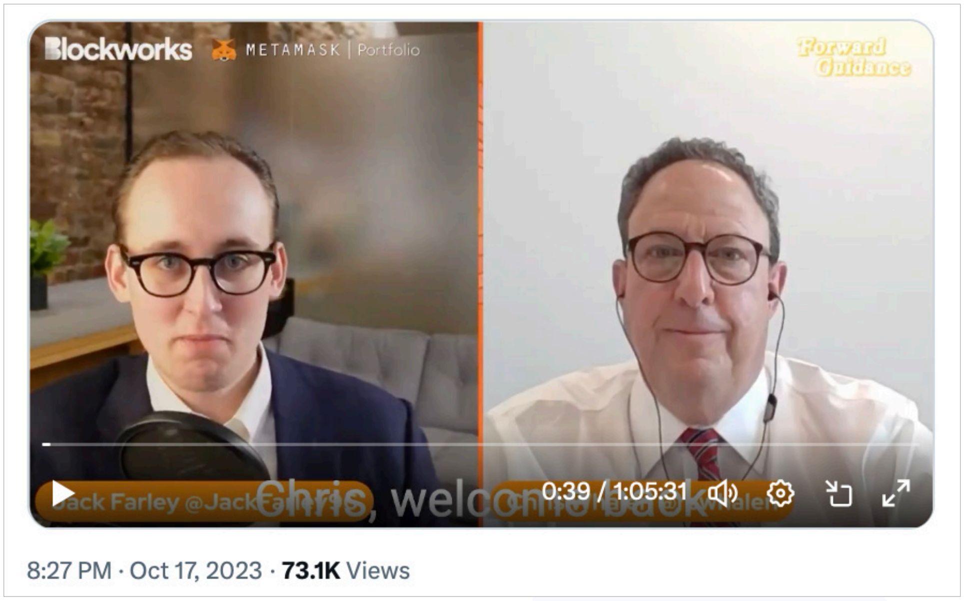
- The exquisitely managed interest rate risk of $JPM enables JPMorgan to aggressively take losses and securitize low-yielding loans; $JPM remains first among equals but at 1.4x book value it's a bit too pricey for Chris

Other banks discussed: $PNC $CMA $KEY $AXP $BX $TFC $OZK

As usual, interview available on @ForwardGuidance podcast and on " @Blockworks_ Macro" YouTube channel

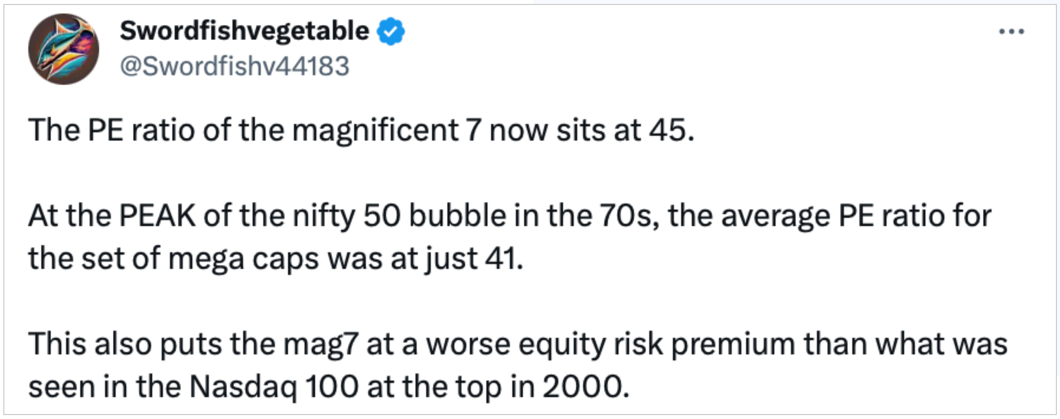
Lastly, a big thank you to @MetaMask Portfolio for sponsoring today's episode.

Enjoy! 🔥



8:27 PM · Oct 17, 2023 · **73.1K** Views

By this measure, the market is more expensive than ever before *in history* ([from Swordfishvegetable via X on October 18](#))...

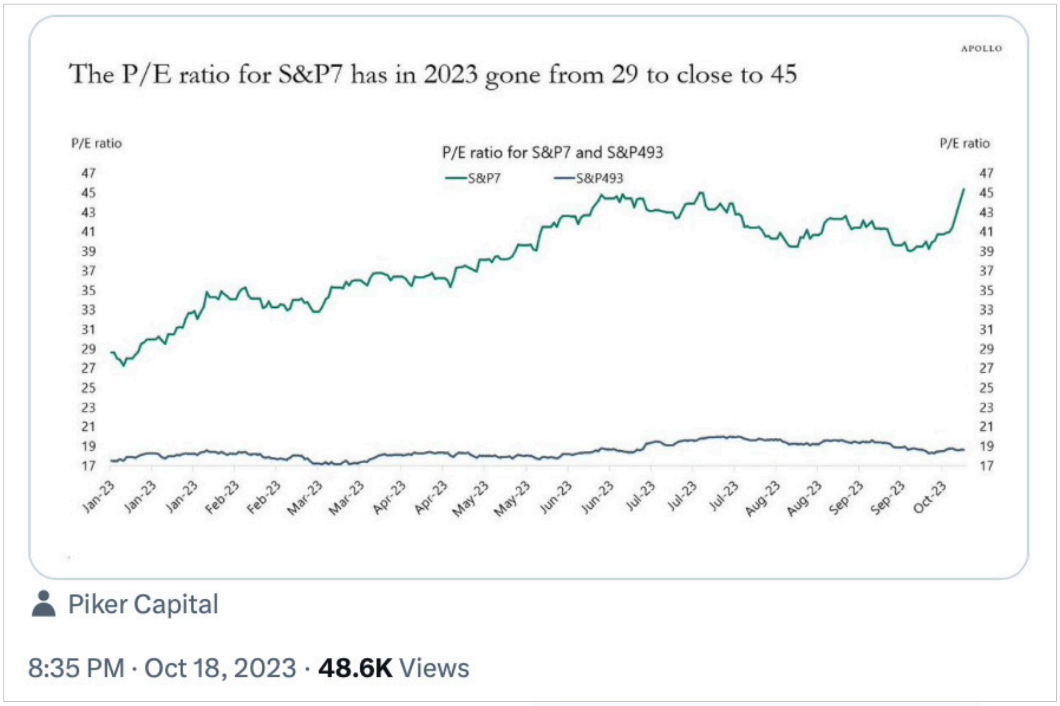


Swordfishvegetable
@Swordfishv44183

The PE ratio of the magnificent 7 now sits at 45.

At the PEAK of the nifty 50 bubble in the 70s, the average PE ratio for the set of mega caps was at just 41.

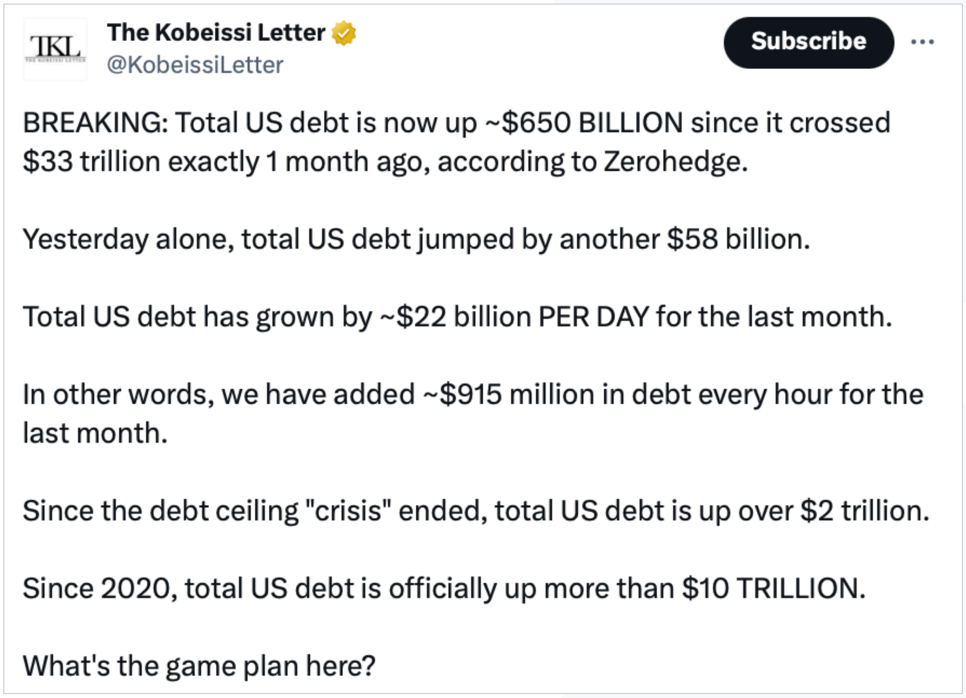
This also puts the mag7 at a worse equity risk premium than what was seen in the Nasdaq 100 at the top in 2000.



Piker Capital

8:35 PM · Oct 18, 2023 · **48.6K** Views

U.S. federal debt continues to set frightening new records (from The Kobeissi Letter via X on October 18)...



The Kobeissi Letter
@KobeissiLetter

BREAKING: Total US debt is now up ~$650 BILLION since it crossed $33 trillion exactly 1 month ago, according to Zerohedge.

Yesterday alone, total US debt jumped by another $58 billion.

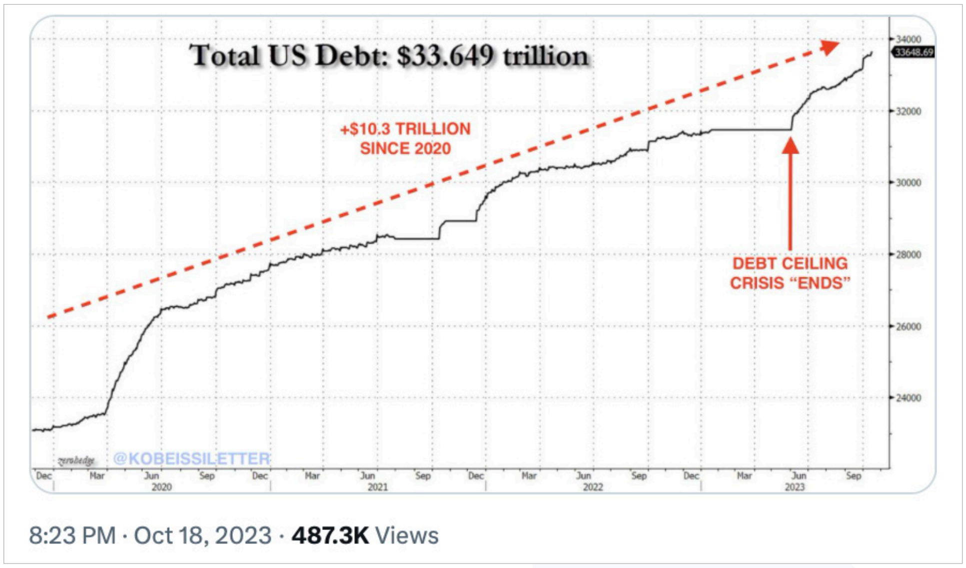
Total US debt has grown by ~$22 billion PER DAY for the last month.

In other words, we have added ~$915 million in debt every hour for the last month.

Since the debt ceiling "crisis" ended, total US debt is up over $2 trillion.

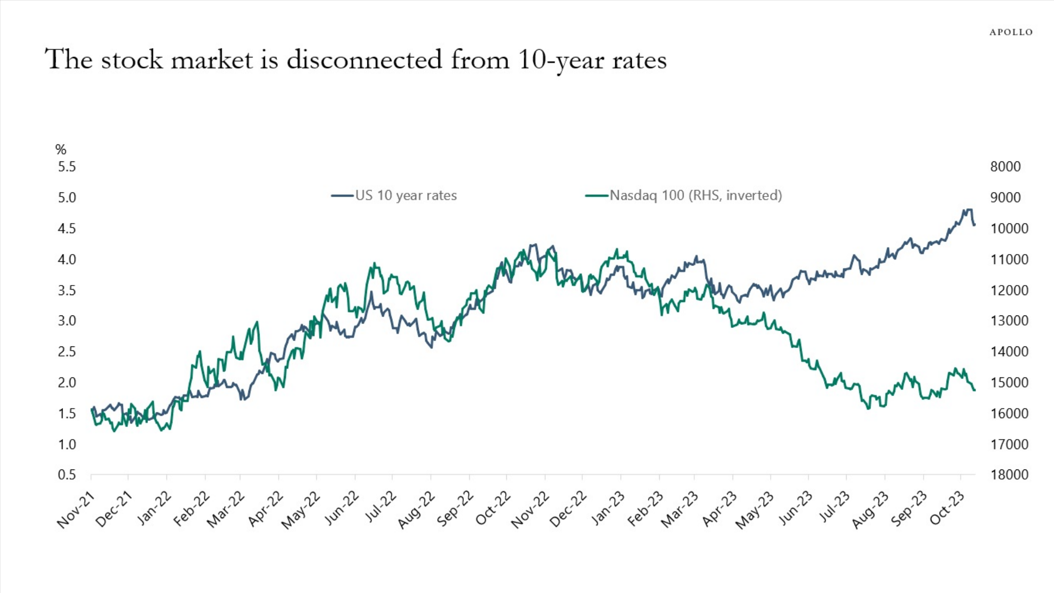
Since 2020, total US debt is officially up more than $10 TRILLION.

What's the game plan here?

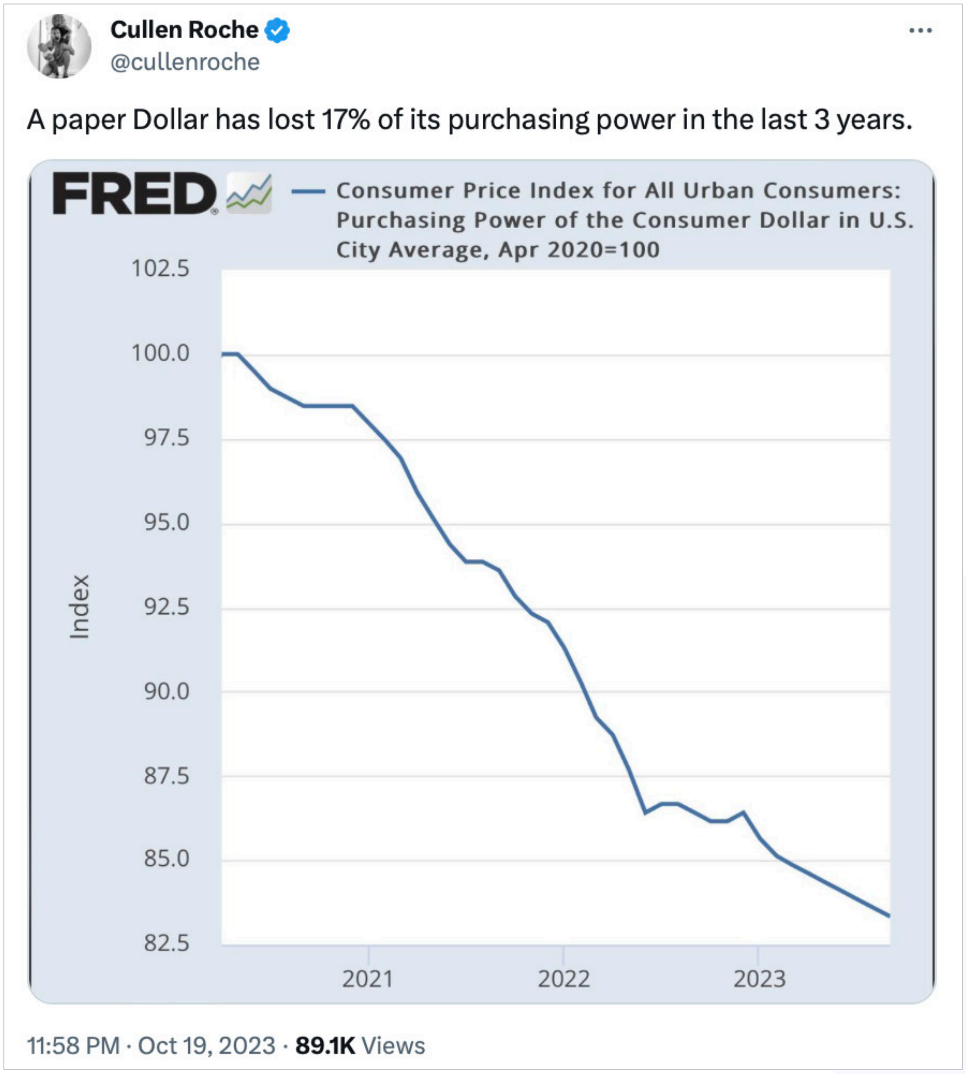


8:23 PM · Oct 18, 2023 · **487.3K** Views

The recent divergence between tech stocks and 10-year Treasuries is massive ([from Torsten Sløk via The Daily Spark on October 18](#))…



The U.S. dollar has lost nearly one-fifth of its value over the last three years (from Cullen Roche via X on October 19)…



Cullen Roche
@cullenroche

A paper Dollar has lost 17% of its purchasing power in the last 3 years.

11:58 PM · Oct 19, 2023 · **89.1K** Views

This year's equity rally is not behaving like a new bull market (from *The Wall Street Journal* on October 20)…

> We are now more than a year from the bear-market low of October 2022, and while the bull market isn't exactly raging, stocks are still up more than 20%.
>
> The markets, though, aren't behaving as they usually do at the start of long-lasting bull markets. In some respects, the past year looks more like the tail end of one than the beginning. This makes me worry it may not last.
>
> Here's the basic outline of what happens in the first year of a bull market, using the lows of October 1990, October 2002, March 2009 and March 2020 as a template:
>
> Everything goes up.

That is pretty much it. At the start of the past four bull markets, the rebound was led by banks and smaller companies. And in three out of the four bull markets, earnings forecasts rose, too. But investors took a simplistic approach to bullishness and bought almost everything. It was hard to lose money on stocks.

This time, large numbers of stocks went down, even as the S&P 500 went up. Banks did badly, and smaller companies worse, while earnings expectations have dropped. This isn't normal.

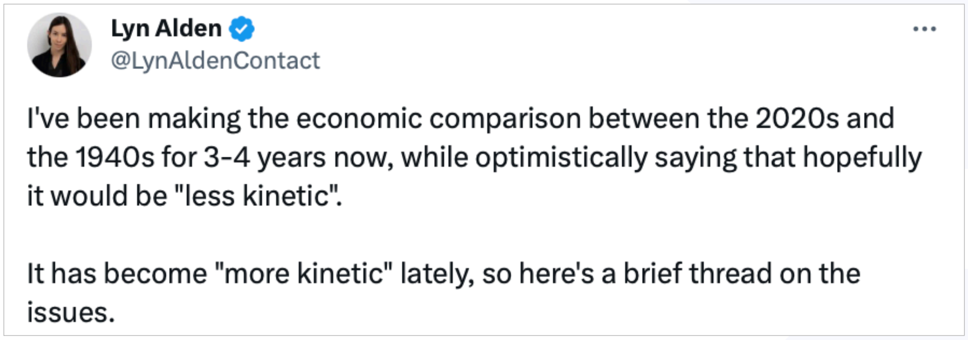
A few examples:

- Only two-thirds of members of the S&P rose over the 12 months, compared with 88%-97% in the first 12 months of the past four bull markets, according to S&P Dow Jones Indices.
- The smallest companies missed out on the gains entirely. The Russell Microcap index of the smallest 1,500 or so stocks is down, continuing last year's bear market. The Russell 2000 has gyrated but on Friday was roughly unchanged from the October closing low.
- Even within big stocks the concentration of gains in the very biggest has been extraordinary. Half the gains in the S&P came from just eight stocks; in the first year of the four previous bull markets it took at least 38 stocks to get to half the gains.

The concentration of gains among the biggest stocks is one of three features that distinguish this bull, and is something that typically happens at the end of bull markets, not the start.

Continue reading here (subscription may be required).

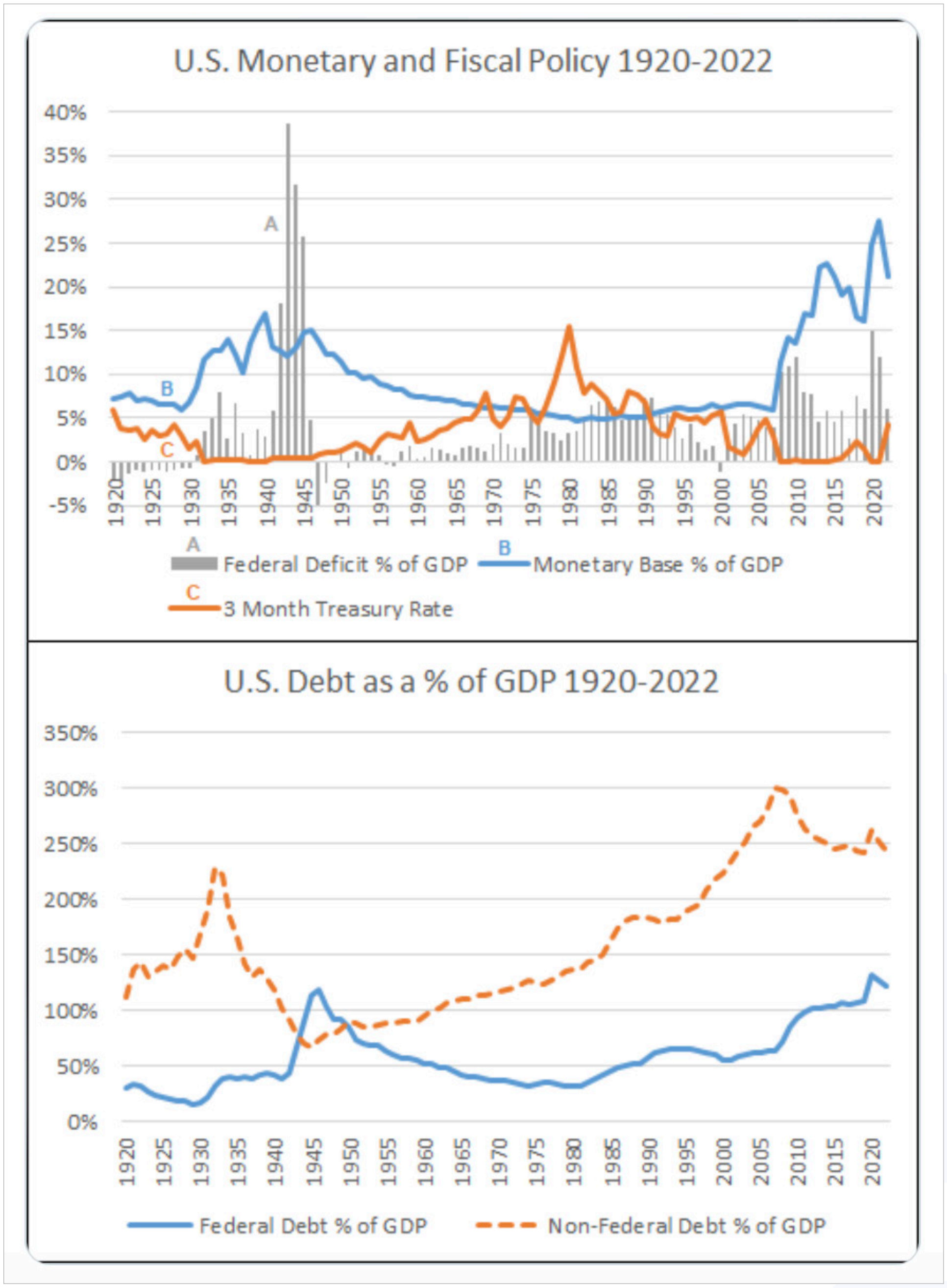
Today's macroeconomic environment looks increasingly like the 1940s (from Lyn Alden via X on October 21)...



Lyn Alden
@LynAldenContact

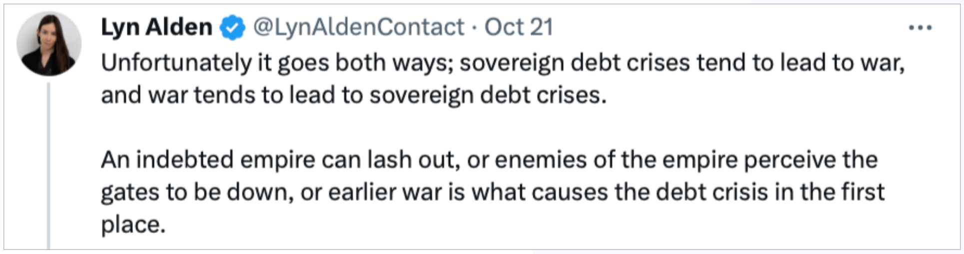
I've been making the economic comparison between the 2020s and the 1940s for 3-4 years now, while optimistically saying that hopefully it would be "less kinetic".

It has become "more kinetic" lately, so here's a brief thread on the issues.



U.S. Monetary and Fiscal Policy 1920-2022

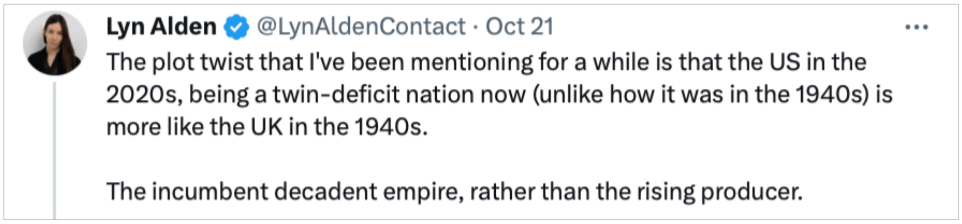
U.S. Debt as a % of GDP 1920-2022



Lyn Alden @LynAldenContact · Oct 21

Unfortunately it goes both ways; sovereign debt crises tend to lead to war, and war tends to lead to sovereign debt crises.

An indebted empire can lash out, or enemies of the empire perceive the gates to be down, or earlier war is what causes the debt crisis in the first place.



Lyn Alden @LynAldenContact · Oct 21

The plot twist that I've been mentioning for a while is that the US in the 2020s, being a twin-deficit nation now (unlike how it was in the 1940s) is more like the UK in the 1940s.

The incumbent decadent empire, rather than the rising producer.

Lyn Alden @LynAldenContact · Oct 21

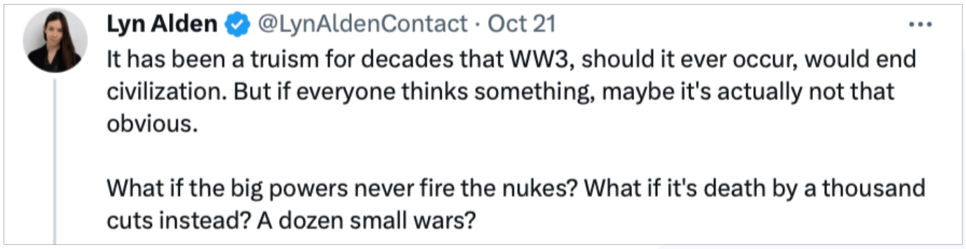
And we if we throw energy security into the mix... nations will absolutely go to war when they have an advantage or deficiency in this.

That's why the "degrowth" community was always unrealistic; a shrinking pie is a more violent pie. If this chart doesn't keep going up... bang.

Global primary energy consumption by source

Primary energy is calculated based on the 'substitution method' which takes account of the inefficiencies in fossil fuel production by converting non-fossil energy into the energy inputs required if they had the same conversion losses as fossil fuels.

Data source: Energy Institute Statistical Review of World Energy (2023); Vaclav Smil (2017)
OurWorldInData.org/energy | CC BY



Lyn Alden @LynAldenContact · Oct 21

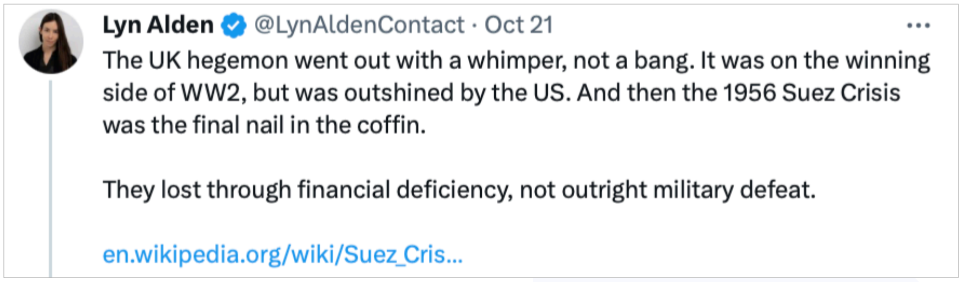
It has been a truism for decades that WW3, should it ever occur, would end civilization. But if everyone thinks something, maybe it's actually not that obvious.

What if the big powers never fire the nukes? What if it's death by a thousand cuts instead? A dozen small wars?

Lyn Alden @LynAldenContact · Oct 21

Trends are powerful. Order entices more order, and chaos entices more chaos, until something big causes a trend change.

If an empire has one border under attack, the risk/reward incentives for another group to attack another border increase, and then another.

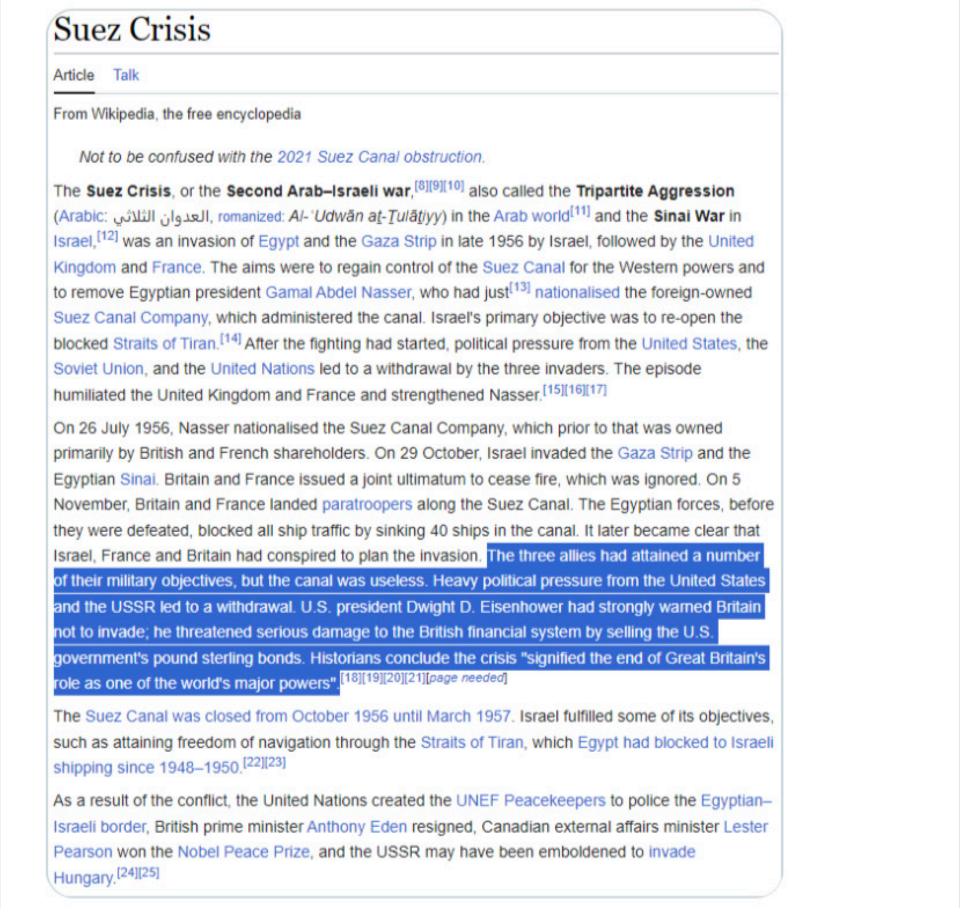


Lyn Alden @LynAldenContact · Oct 21

The UK hegemon went out with a whimper, not a bang. It was on the winning side of WW2, but was outshined by the US. And then the 1956 Suez Crisis was the final nail in the coffin.

They lost through financial deficiency, not outright military defeat.

en.wikipedia.org/wiki/Suez_Cris...



Suez Crisis

From Wikipedia, the free encyclopedia

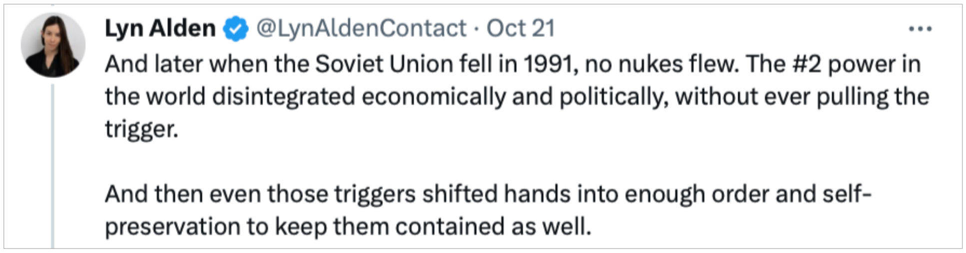
Not to be confused with the 2021 Suez Canal obstruction.

The **Suez Crisis**, or the **Second Arab–Israeli war**,[8][9][10] also called the **Tripartite Aggression** (Arabic: العدوان الثلاثي, romanized: *Al-ʿUdwān aṯ-Ṯulāṯiyy*) in the Arab world[11] and the **Sinai War** in Israel,[12] was an invasion of Egypt and the Gaza Strip in late 1956 by Israel, followed by the United Kingdom and France. The aims were to regain control of the Suez Canal for the Western powers and to remove Egyptian president Gamal Abdel Nasser, who had just[13] nationalised the foreign-owned Suez Canal Company, which administered the canal. Israel's primary objective was to re-open the blocked Straits of Tiran.[14] After the fighting had started, political pressure from the United States, the Soviet Union, and the United Nations led to a withdrawal by the three invaders. The episode humiliated the United Kingdom and France and strengthened Nasser.[15][16][17]

On 26 July 1956, Nasser nationalised the Suez Canal Company, which prior to that was owned primarily by British and French shareholders. On 29 October, Israel invaded the Gaza Strip and the Egyptian Sinai. Britain and France issued a joint ultimatum to cease fire, which was ignored. On 5 November, Britain and France landed paratroopers along the Suez Canal. The Egyptian forces, before they were defeated, blocked all ship traffic by sinking 40 ships in the canal. It later became clear that Israel, France and Britain had conspired to plan the invasion. The three allies had attained a number of their military objectives, but the canal was useless. Heavy political pressure from the United States and the USSR led to a withdrawal. U.S. president Dwight D. Eisenhower had strongly warned Britain not to invade; he threatened serious damage to the British financial system by selling the U.S. government's pound sterling bonds. Historians conclude the crisis "signified the end of Great Britain's role as one of the world's major powers".[18][19][20][21][*page needed*]

The Suez Canal was closed from October 1956 until March 1957. Israel fulfilled some of its objectives, such as attaining freedom of navigation through the Straits of Tiran, which Egypt had blocked to Israeli shipping since 1948–1950.[22][23]

As a result of the conflict, the United Nations created the UNEF Peacekeepers to police the Egyptian–Israeli border, British prime minister Anthony Eden resigned, Canadian external affairs minister Lester Pearson won the Nobel Peace Prize, and the USSR may have been emboldened to invade Hungary.[24][25]



Lyn Alden @LynAldenContact · Oct 21

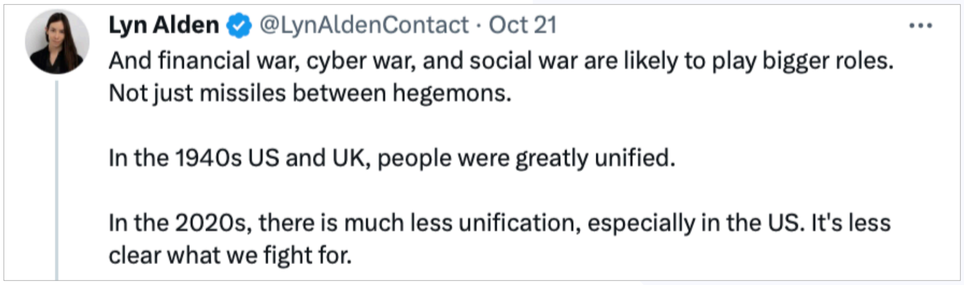
And later when the Soviet Union fell in 1991, no nukes flew. The #2 power in the world disintegrated economically and politically, without ever pulling the trigger.

And then even those triggers shifted hands into enough order and self-preservation to keep them contained as well.

Lyn Alden @LynAldenContact · Oct 21

As developed nations deal with sovereign debt problems, financial repression, and threats to their global imperial reach, it's unlikely to be smooth.

The optimistic case is to see a dozen small wars that challenge the maps, rather than one big total war (i.e. nukes).

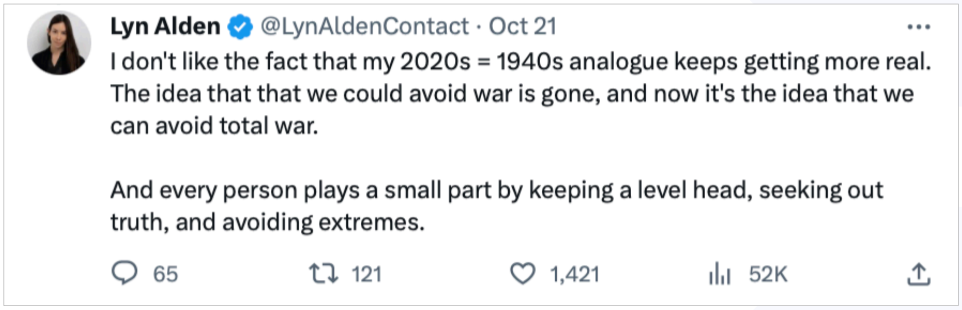


Lyn Alden @LynAldenContact · Oct 21

And financial war, cyber war, and social war are likely to play bigger roles. Not just missiles between hegemons.

In the 1940s US and UK, people were greatly unified.

In the 2020s, there is much less unification, especially in the US. It's less clear what we fight for.

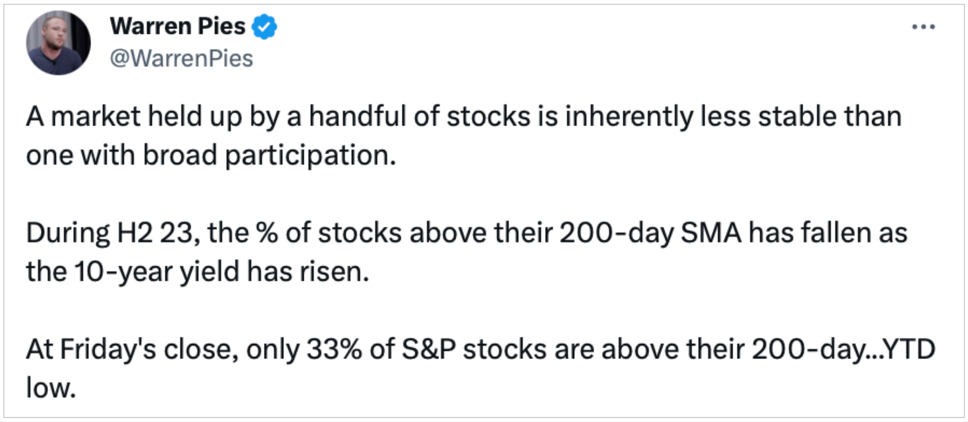


Lyn Alden @LynAldenContact · Oct 21

I don't like the fact that my 2020s = 1940s analogue keeps getting more real. The idea that that we could avoid war is gone, and now it's the idea that we can avoid total war.

And every person plays a small part by keeping a level head, seeking out truth, and avoiding extremes.

The stock market is becoming less stable beneath the surface ([from Warren Pies via X on October 21]())...

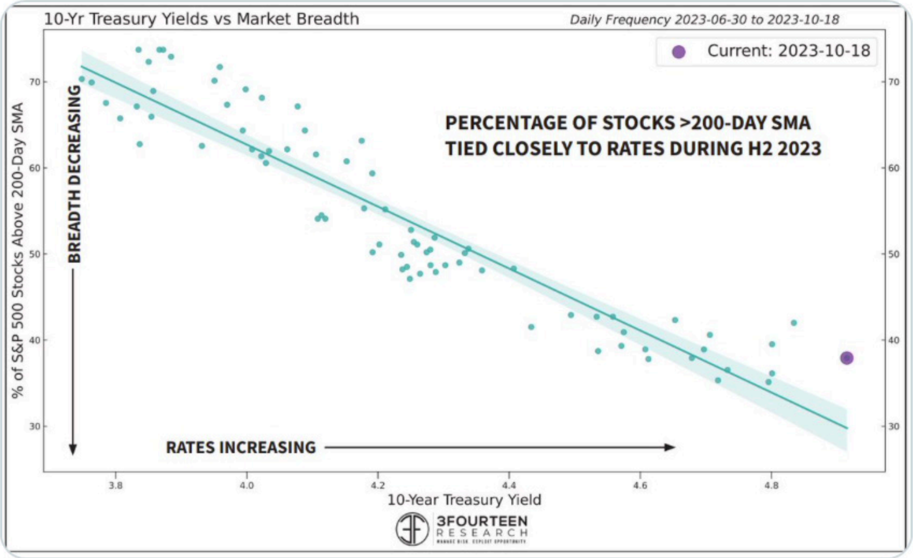


Warren Pies
@WarrenPies

A market held up by a handful of stocks is inherently less stable than one with broad participation.

During H2 23, the % of stocks above their 200-day SMA has fallen as the 10-year yield has risen.

At Friday's close, only 33% of S&P stocks are above their 200-day...YTD low.



6:28 PM · Oct 21, 2023 · **74.4K** Views

Bank credit is now contracting for only the second time in nearly 50 years (from Game of Trades via X on October 22)...

Game of Trades
@GameofTrades_

Warning: Bank credit has officially entered contraction territory

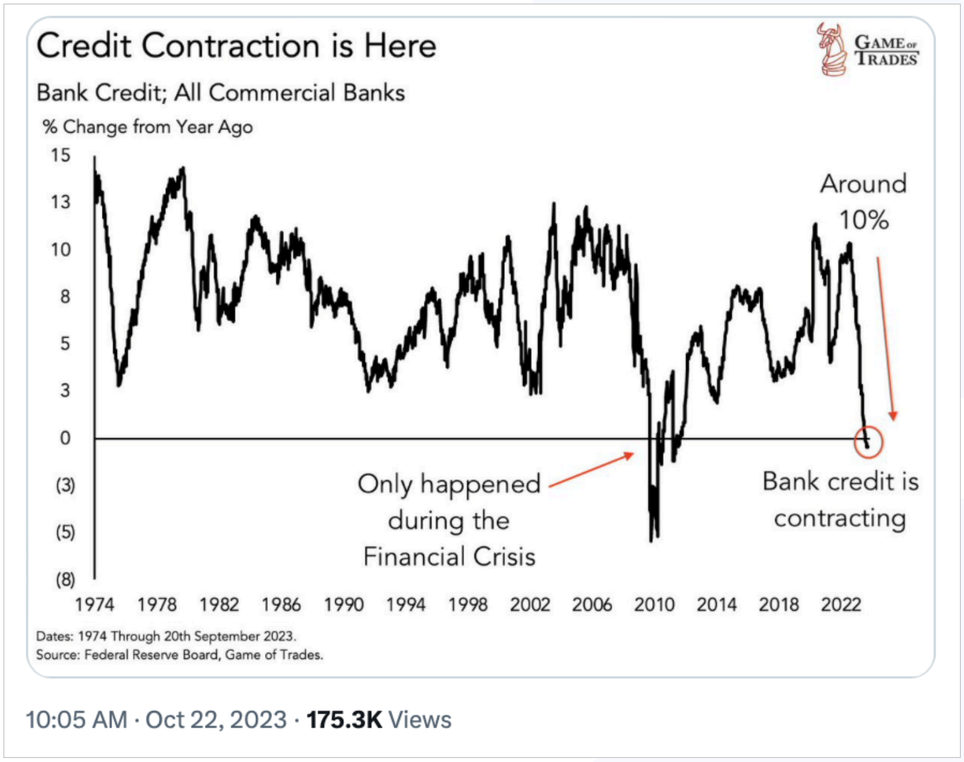
Credit has gone from 10% in Aug 2022 to -0.6% in Oct 2023

This is the result of tight monetary policy by the Fed

Since 1974, bank credit has contracted only once → Global Financial Crisis

Back then, this indicator dropped to levels around -5%

And everyone knows how the market responded...



Credit Contraction is Here

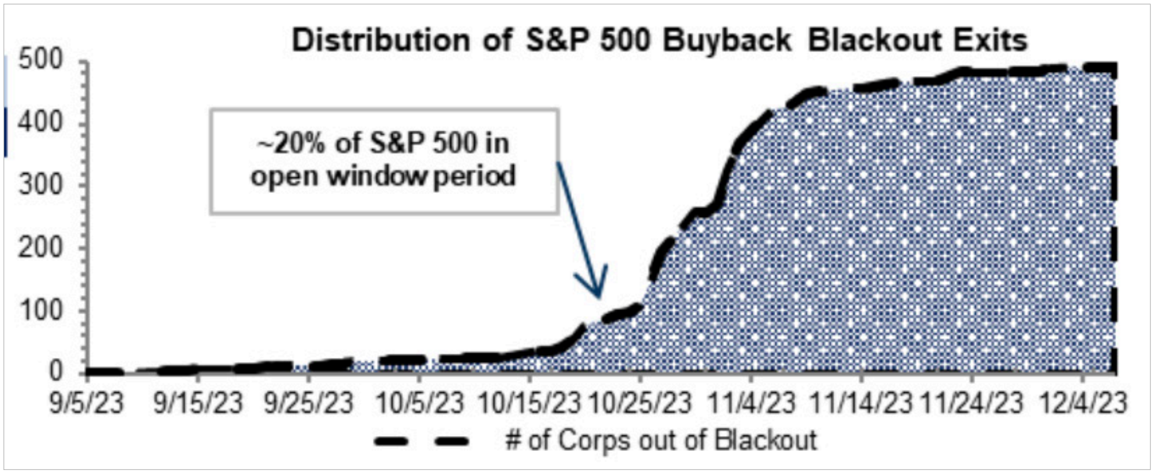
Bank Credit; All Commercial Banks

Dates: 1974 Through 20th September 2023.
Source: Federal Reserve Board, Game of Trades.

10:05 AM · Oct 22, 2023 · **175.3K** Views

The “buyback window” reopened this week (from ZeroHedge on October 23)…

> On Friday we said that in what may be a major reversal in sentiment (one which was subsequently echoed by both BofA's Michael Hartnett and Goldman's Tony Pasquariello), the "Fed blackout period begins after the close" just as the "buyback blackout ends."
>
> 
>
> **zerohedge**
> @zerohedge · Follow
>
> Fed blackout period begins after the close
>
> Buyback blackout ends after the close
>
> 7:44 AM · Oct 20, 2023
>
>
>
> So looking at this morning's note from Goldman trader Michael Nocerino, we get a fresh reminder that "**today marks the first day of the estimated open Buyback window period."** For those unfamiliar, Nocerino reminds that "companies roll into their open window period 1-2 days post earnings release" and as of today, **Goldman estimates that ~20% of the S&P 500 are in their open window period with ~40% in open window by the end of the week.**
>
> Some more details:
>
>> During open window, companies are permitted to enter discretionary repurchase orders. **We estimate open window ends ~12/08/23.**
>>
>> On our desk, **volumes finished 1.5x vs 2023 YTD ADTV** and 1.2x vs 2022 YTD ADTV **skewed toward Tech, Consumer Discretionary, and Energy.**
>>
>> With companies moving into open window, November tends to be a more active month on our desk. **In terms of authorizations, 2023 YTD authorizations stand at $833B, the fourth most active year YTD.**
>
> And visually:
>
> 
>
> GS Corporate Desk Trading Flow
>
> 2023 ADTV in terms of $notional as Multiples
>
> | Time Period | vs 2023 YTD | vs 2022 YTD | vs 2021 YTD | vs 2020 YTD |
> |---|---|---|---|---|
> | Week of 10/16 - 10/20 | 1.5x | 1.2x | 1.9x | 2.7x |
> | MTD | 1.4x | 1.2x | 1.8x | 2.6x |
> | QTD | 1.4x | 1.2x | 1.8x | 2.6x |
> | YTD | 1.0x | 0.8x | 1.3x | 1.9x |

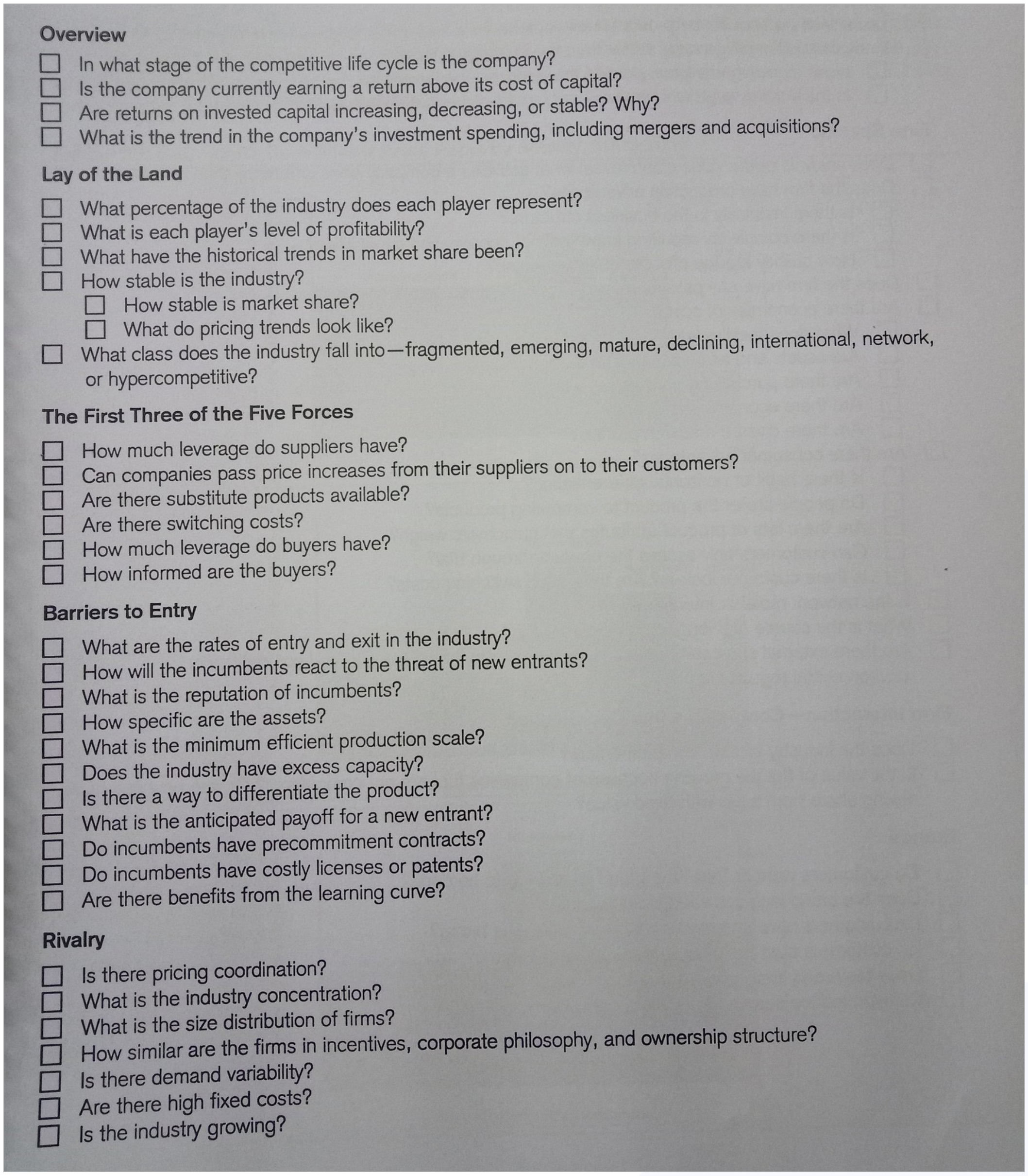


Continue reading here (subscription may be required).

The Legends Speak

Wisdom and Insight from the World's Greatest Investors

Wall Street veteran Michael Mauboussin's guide to identifying companies with strong competitive advantages (aka "moats") (from Compounding Quality via X on October 3)...



Overview

- ☐ In what stage of the competitive life cycle is the company?
- ☐ Is the company currently earning a return above its cost of capital?
- ☐ Are returns on invested capital increasing, decreasing, or stable? Why?
- ☐ What is the trend in the company's investment spending, including mergers and acquisitions?

Lay of the Land

- ☐ What percentage of the industry does each player represent?
- ☐ What is each player's level of profitability?
- ☐ What have the historical trends in market share been?
- ☐ How stable is the industry?
  - ☐ How stable is market share?
  - ☐ What do pricing trends look like?
- ☐ What class does the industry fall into—fragmented, emerging, mature, declining, international, network, or hypercompetitive?

The First Three of the Five Forces

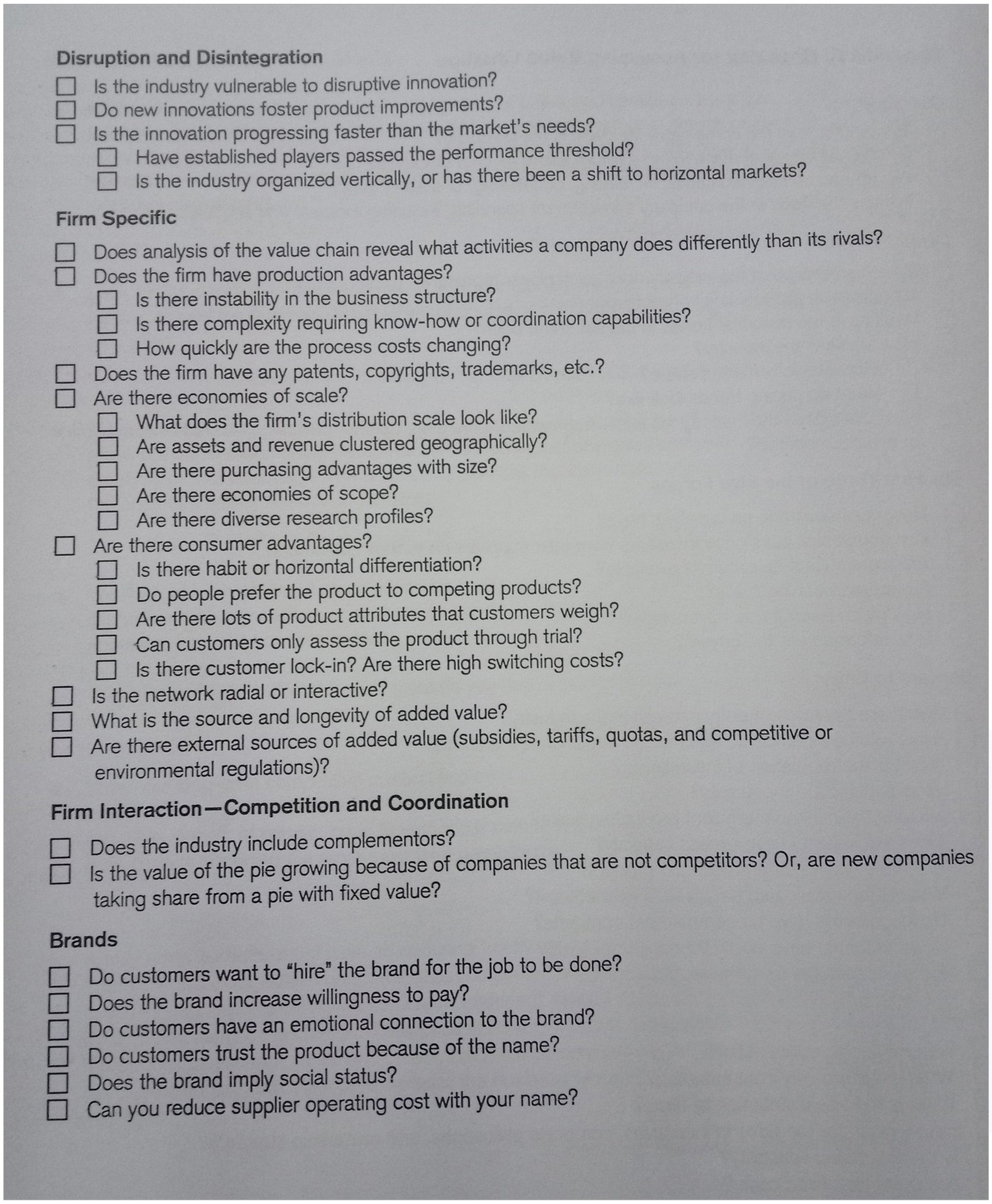
- ☐ How much leverage do suppliers have?
- ☐ Can companies pass price increases from their suppliers on to their customers?
- ☐ Are there substitute products available?
- ☐ Are there switching costs?
- ☐ How much leverage do buyers have?
- ☐ How informed are the buyers?

Barriers to Entry

- ☐ What are the rates of entry and exit in the industry?
- ☐ How will the incumbents react to the threat of new entrants?
- ☐ What is the reputation of incumbents?
- ☐ How specific are the assets?
- ☐ What is the minimum efficient production scale?
- ☐ Does the industry have excess capacity?
- ☐ Is there a way to differentiate the product?
- ☐ What is the anticipated payoff for a new entrant?
- ☐ Do incumbents have precommitment contracts?
- ☐ Do incumbents have costly licenses or patents?
- ☐ Are there benefits from the learning curve?

Rivalry

- ☐ Is there pricing coordination?
- ☐ What is the industry concentration?
- ☐ What is the size distribution of firms?
- ☐ How similar are the firms in incentives, corporate philosophy, and ownership structure?
- ☐ Is there demand variability?
- ☐ Are there high fixed costs?
- ☐ Is the industry growing?



Disruption and Disintegration

- ☐ Is the industry vulnerable to disruptive innovation?
- ☐ Do new innovations foster product improvements?
- ☐ Is the innovation progressing faster than the market's needs?
  - ☐ Have established players passed the performance threshold?
  - ☐ Is the industry organized vertically, or has there been a shift to horizontal markets?

Firm Specific

- ☐ Does analysis of the value chain reveal what activities a company does differently than its rivals?
- ☐ Does the firm have production advantages?
  - ☐ Is there instability in the business structure?
  - ☐ Is there complexity requiring know-how or coordination capabilities?
  - ☐ How quickly are the process costs changing?
- ☐ Does the firm have any patents, copyrights, trademarks, etc.?
- ☐ Are there economies of scale?
  - ☐ What does the firm's distribution scale look like?
  - ☐ Are assets and revenue clustered geographically?
  - ☐ Are there purchasing advantages with size?
  - ☐ Are there economies of scope?
  - ☐ Are there diverse research profiles?
- ☐ Are there consumer advantages?
  - ☐ Is there habit or horizontal differentiation?
  - ☐ Do people prefer the product to competing products?
  - ☐ Are there lots of product attributes that customers weigh?
  - ☐ Can customers only assess the product through trial?
  - ☐ Is there customer lock-in? Are there high switching costs?
- ☐ Is the network radial or interactive?
- ☐ What is the source and longevity of added value?
- ☐ Are there external sources of added value (subsidies, tariffs, quotas, and competitive or environmental regulations)?

Firm Interaction—Competition and Coordination

- ☐ Does the industry include complementors?
- ☐ Is the value of the pie growing because of companies that are not competitors? Or, are new companies taking share from a pie with fixed value?

Brands

- ☐ Do customers want to "hire" the brand for the job to be done?
- ☐ Does the brand increase willingness to pay?
- ☐ Do customers have an emotional connection to the brand?
- ☐ Do customers trust the product because of the name?
- ☐ Does the brand imply social status?
- ☐ Can you reduce supplier operating cost with your name?

What every investor should know about return on equity (“ROE”), one of Warren Buffett’s favorite metrics (from The Investing for Beginners Podcast via X on October 17)...

Warren Buffett loves Return on Equity (ROE).

But every ratio or formula has its pros and cons.

ROE is no different.

Here are 5 pros and 5 cons ⬇

Return on Equity (ROE) is a financial ratio that measures a company's profitability and efficiency by assessing how effectively it utilizes shareholders' equity.

We can measure it by dividing net income by shareholders' equity:

ROE = Net Income / Shareholders' Equity

Here are the pros and cons of ROE:

Pros of Return on Equity (ROE):

1. Indicator of Profitability:

ROE is a strong indicator of a company's profitability.

A high ROE suggests that a company is generating strong returns for its shareholders.

You can screen for potential investments by looking for a ROE > 15.

2. Performance Comparison:

ROE allows for the comparison of a company's performance against its industry peers or competitors.

It helps investors assess how well a company is utilizing its equity relative to others in the same sector.

3. Simplicity:

ROE is a straightforward and easy-to-calculate metric, making it accessible to investors and analysts.

We calculate it by using the formula above:

ROE = Net income / Shareholder's Equity

4. Historical Analysis:

ROE can be used to track a company's performance over time.

If a company consistently maintains a high ROE, it may be a sign of financial stability and efficient operations.

5. Investor Confidence:

A high and stable ROE can boost investor confidence and attract investment, potentially leading to a higher stock price.

Cons of Return on Equity (ROE):

1. Easily Manipulated:

Companies can manipulate ROE by repurchasing shares, taking on debt, or engaging in other financial engineering strategies.

This can make digging deeper into the financials necessary to understand the factors behind the ROE figure.

2. Dependent on Accounting Methods:

ROE can be influenced by accounting practices, such as the timing of revenue recognition or depreciation methods.

Different accounting methods can yield varying ROE figures for the same company.

3. Limited Perspective:

ROE doesn't provide a complete picture of a company's financial health or operational efficiency.

It should be used in conjunction with other financial metrics and qualitative analysis.

4. Volatile for Companies with High Debt:

For companies with high levels of debt, ROE can be very volatile.

High financial leverage can magnify returns but also increase risk, making ROE alone an incomplete assessment of a company's health.

Using a Dupont Formula when analyzing ROE is a best practice.

5. Industry Variations:

ROE's appropriateness as a benchmark can vary by industry.

Certain industries naturally have higher or lower ROE figures, and using it as a sole benchmark across different sectors can lead to misleading conclusions.

6. Not Necessarily Reflective of Shareholder Returns:

A high ROE does not necessarily translate to high shareholder returns.

Factors like stock price volatility, dividends, and market conditions also impact shareholder returns.

In summary, while Return on Equity (ROE) is a valuable financial metric for assessing a company's profitability and efficiency, it should be used in conjunction with other financial ratios and qualitative analysis to comprehensively understand a company's financial health.

Additionally, understanding ROE's limitations and potential manipulation is essential for accurate financial analysis.

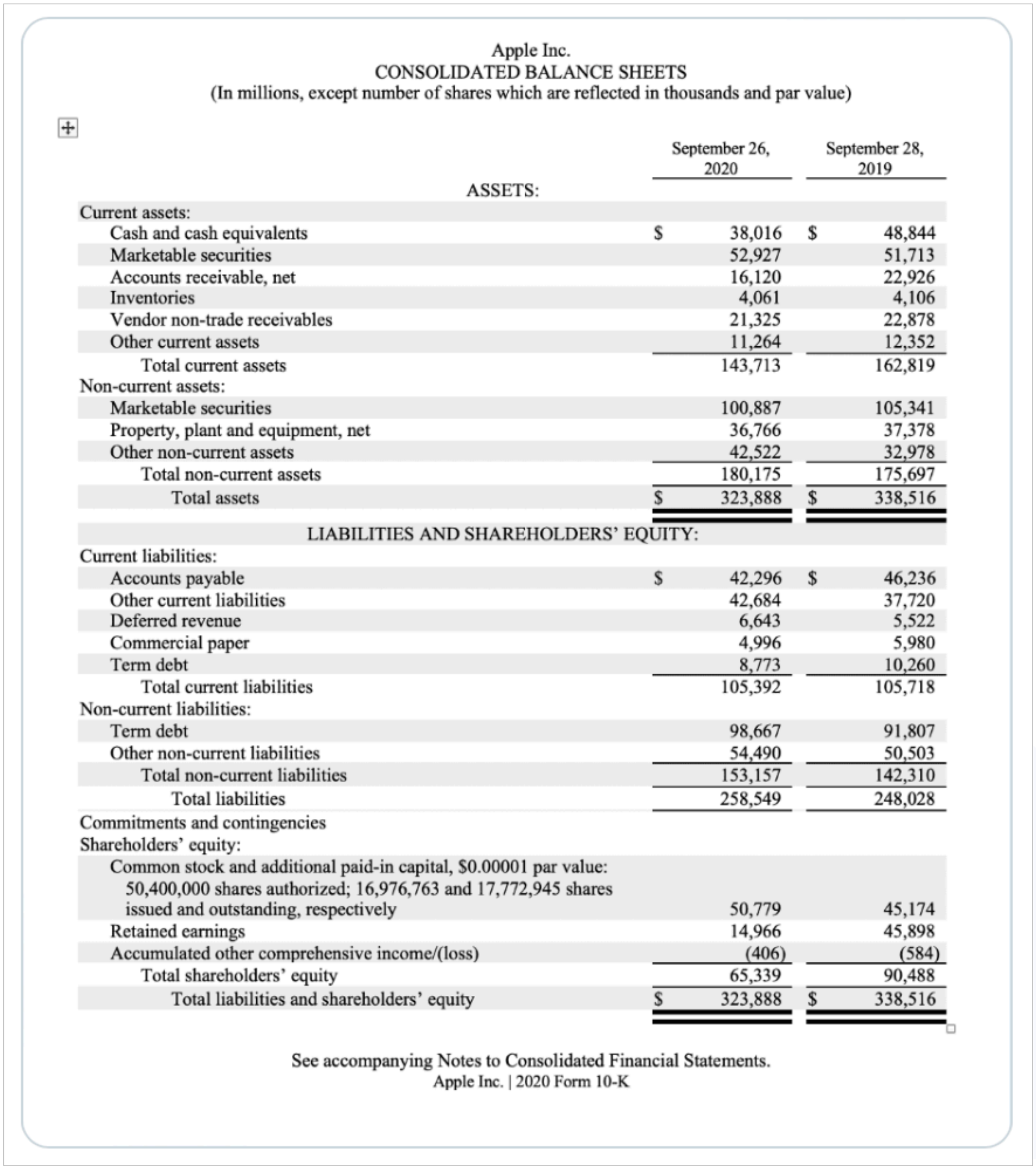
How to analyze a balance sheet like legendary fund manager Peter Lynch does (from Invest in Assets via X on October 21)...

Invest In Assets | Stock Market Investing 📈
@InvestInAssets

Peter Lynch once said:

«Never invest in a company without understanding its finances. The biggest losses in stocks come from companies with poor balance sheets.»

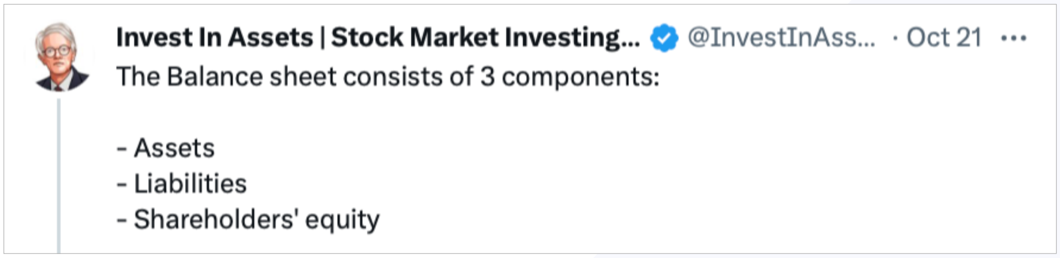
Here is a simple breakdown of how to analyze a balance sheet:



Apple Inc.
CONSOLIDATED BALANCE SHEETS
(In millions, except number of shares which are reflected in thousands and par value)

	September 26, 2020	September 28, 2019
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 38,016	$ 48,844
Marketable securities	52,927	51,713
Accounts receivable, net	16,120	22,926
Inventories	4,061	4,106
Vendor non-trade receivables	21,325	22,878
Other current assets	11,264	12,352
Total current assets	143,713	162,819
Non-current assets:		
Marketable securities	100,887	105,341
Property, plant and equipment, net	36,766	37,378
Other non-current assets	42,522	32,978
Total non-current assets	180,175	175,697
Total assets	$ 323,888	$ 338,516
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 42,296	$ 46,236
Other current liabilities	42,684	37,720
Deferred revenue	6,643	5,522
Commercial paper	4,996	5,980
Term debt	8,773	10,260
Total current liabilities	105,392	105,718
Non-current liabilities:		
Term debt	98,667	91,807
Other non-current liabilities	54,490	50,503
Total non-current liabilities	153,157	142,310
Total liabilities	258,549	248,028
Commitments and contingencies		
Shareholders' equity:		
Common stock and additional paid-in capital, $0.00001 par value: 50,400,000 shares authorized; 16,976,763 and 17,772,945 shares issued and outstanding, respectively	50,779	45,174
Retained earnings	14,966	45,898
Accumulated other comprehensive income/(loss)	(406)	(584)
Total shareholders' equity	65,339	90,488
Total liabilities and shareholders' equity	$ 323,888	$ 338,516

See accompanying Notes to Consolidated Financial Statements.
Apple Inc. | 2020 Form 10-K



Invest In Assets | Stock Market Investing... @InvestInAss... · Oct 21 ···

The Balance sheet consists of 3 components:

- Assets
- Liabilities
- Shareholders' equity

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Assets: What the business owns

Liabilities: What the business owes

Shareholders' equity: What the owners have invested in the business

The simple formula explains how these 3 components are interconnected:

Shareholders' equity = total assets - total liabilities

Invest In Assets | Stock Market Investing... @InvestInAss... · Oct 21

Assets can be categorized into 2 sub components

1. Current assets: Assets that can be made liquid within 12 months

Examples: Cash & Equivelant, marektable securities, accounts receivable

		September 26, 2020		September 28, 2019
ASSETS:				
Current assets:				
Cash and cash equivalents	$	38,016	$	48,844
Marketable securities		52,927		51,713
Accounts receivable, net		16,120		22,926
Inventories		4,061		4,106
Vendor non-trade receivables		21,325		22,878
Other current assets		11,264		12,352
Total current assets		143,713		162,819

Invest In Assets | Stock Market Investing... @InvestInAss... · Oct 21

2. Non-current assets: Assets that can't be liquidated within 12 months

Examples: Property, plant & equipment, Investment properties, Intangible assets, good will.

rrent assets:				
rketable securities		100,887		105
perty, plant and equipment, net		36,766		37
er non-current assets		42,522		32
Total non-current assets		180,175		175
Total assets	$	323,888	$	338

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Essential questions to ask yourself about the assets:

1. Does the cash cover the short term obligations? (Good sign)
2. Are inventories piling up over time? (Bad sign)
3. Are accounts receivables growing faster than sales? (Bad sign)

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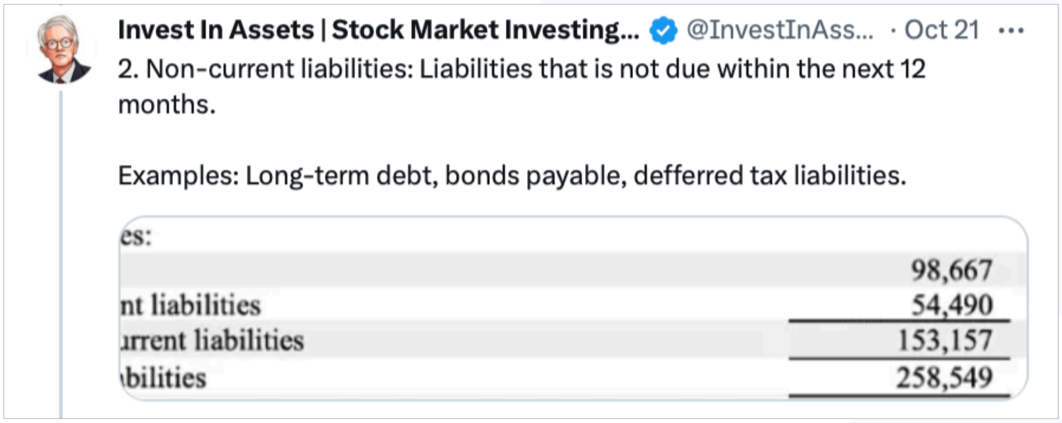
Component 2: Liabilities can also be divided into 2 sub components:

1. Current liabilities: Liabilities that needs to be paid within 12 months.

Examples: Accounts payable, accrued expenses, other current liabilities.

LIABILITIES AND SHAREHOLDERS' EQUITY:

Current liabilities:				
Accounts payable	$	42,296	$	46,236
Other current liabilities		42,684		37,720
Deferred revenue		6,643		5,522
Commercial paper		4,996		5,980
Term debt		8,773		10,260
Total current liabilities		105,392		105,718



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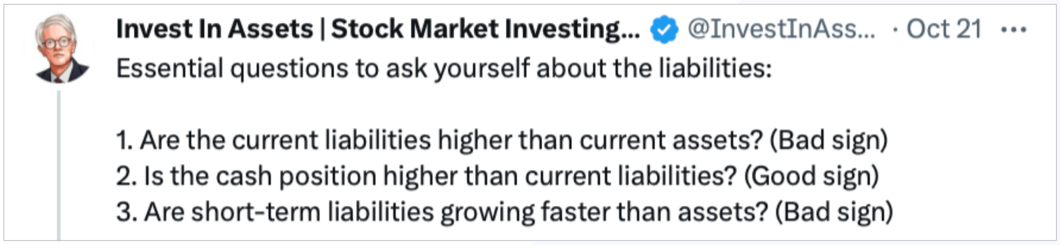
2. Non-current liabilities: Liabilities that is not due within the next 12 months.

Examples: Long-term debt, bonds payable, defferred tax liabilities.

es:	
	98,667
nt liabilities	54,490
ırrent liabilities	153,157
bilities	258,549



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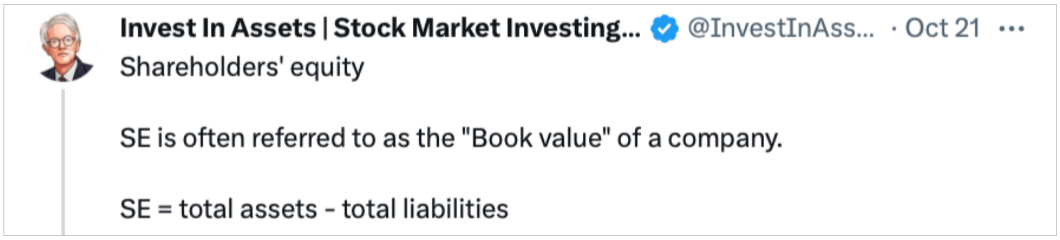
Essential questions to ask yourself about the liabilities:

1. Are the current liabilities higher than current assets? (Bad sign)
2. Is the cash position higher than current liabilities? (Good sign)
3. Are short-term liabilities growing faster than assets? (Bad sign)



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Shareholders' equity

SE is often referred to as the "Book value" of a company.

SE = total assets - total liabilities

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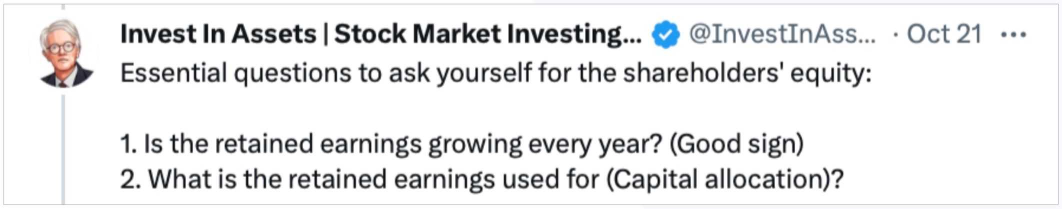
Examples:

Paid-in capital: Investments paid using equity

Treasury shares: Shares bought back by the company

Retained earnings: Earnings of the business minus the dividends paid



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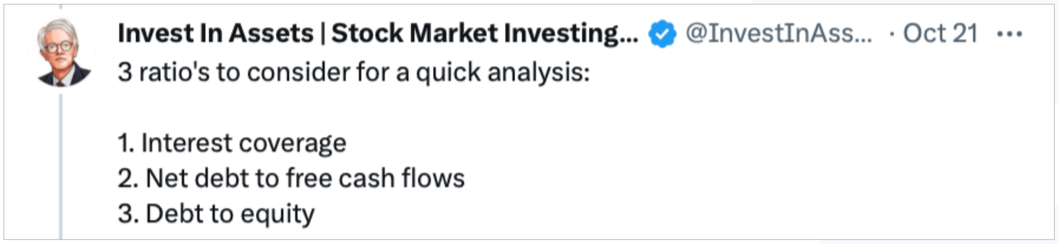
Essential questions to ask yourself for the shareholders' equity:

1. Is the retained earnings growing every year? (Good sign)
2. What is the retained earnings used for (Capital allocation)?



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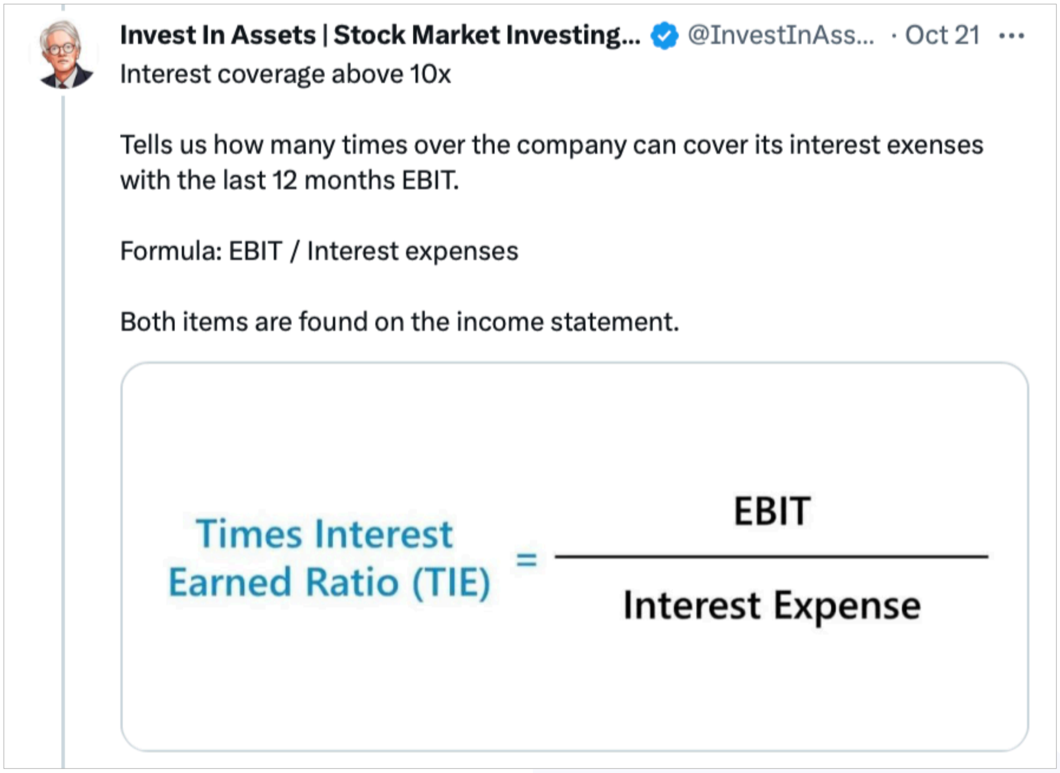
3 ratio's to consider for a quick analysis:

1. Interest coverage
2. Net debt to free cash flows
3. Debt to equity



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Interest coverage above 10x

Tells us how many times over the company can cover its interest exenses with the last 12 months EBIT.

Formula: EBIT / Interest expenses

Both items are found on the income statement.

$$\text{Times Interest Earned Ratio (TIE)} = \frac{\text{EBIT}}{\text{Interest Expense}}$$

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Net debt to free cash flow ideally below 3

This ratio tells us how many years worth of FCF it would take for the company to pay off its debts.

Net debt is short and long-term debt, minus cash - found on the balance sheet

FCF is cash flow from operations minus capex.

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Debt to equity ideally below 1.5

Total debt and shareholders' equity is found on the balance sheet.

Buffett is known to use the debt-to-equity ratio to quickly determine how leveraged the business is.

$$\text{Debt to Equity Ratio (D/E)} = \frac{\text{Total Debt}}{\text{Total Shareholders Equity}}$$

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A business with:

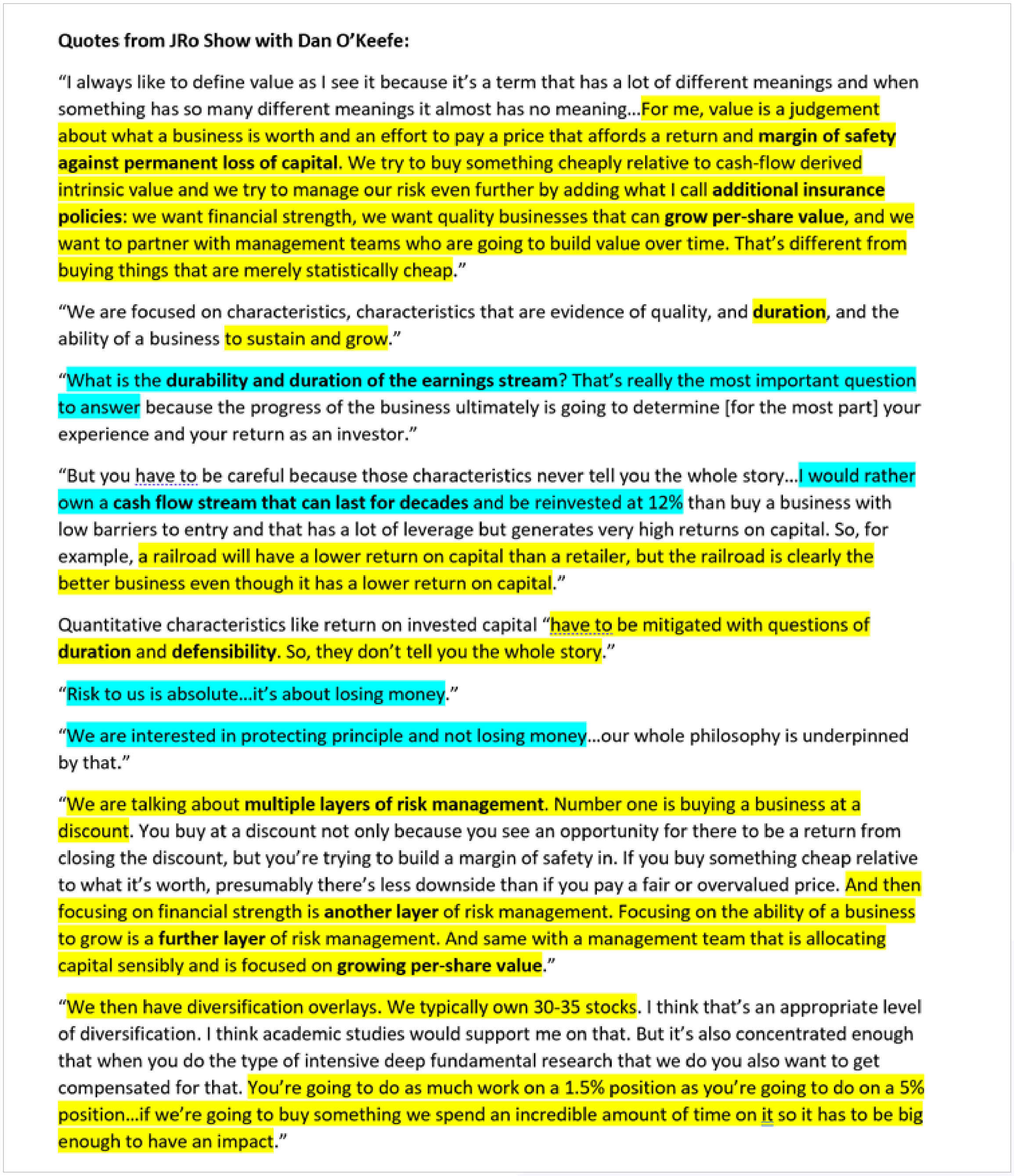
- Interest coverage +10x
- Net debt / FCF <3
- Debt to equity <1.5

Is likely to be a healthy company with low leverage and high solvency.

Note: You should always do your own due dilligence into the balance sheet to understand the business

Wisdom from top international value investor Dan O'Keefe (from John Rotini Jr via X on October 20)...

Here are 5 pages of quotes from my recent podcast with Dan O'Keefe (two-time Morningstar International Stock-Picker of the Year). Read them and let me know which one is your favorite...The one that resonates most with you or the one that is getting you thinking the most.



Quotes from JRo Show with Dan O'Keefe:

"I always like to define value as I see it because it's a term that has a lot of different meanings and when something has so many different meanings it almost has no meaning...For me, value is a judgement about what a business is worth and an effort to pay a price that affords a return and **margin of safety against permanent loss of capital**. We try to buy something cheaply relative to cash-flow derived intrinsic value and we try to manage our risk even further by adding what I call **additional insurance policies**: we want financial strength, we want quality businesses that can **grow per-share value**, and we want to partner with management teams who are going to build value over time. That's different from buying things that are merely statistically cheap."

"We are focused on characteristics, characteristics that are evidence of quality, and **duration**, and the ability of a business to sustain and grow."

"What is the **durability and duration of the earnings stream**? That's really the most important question to answer because the progress of the business ultimately is going to determine [for the most part] your experience and your return as an investor."

"But you have to be careful because those characteristics never tell you the whole story...I would rather own a **cash flow stream that can last for decades** and be reinvested at 12% than buy a business with low barriers to entry and that has a lot of leverage but generates very high returns on capital. So, for example, a railroad will have a lower return on capital than a retailer, but the railroad is clearly the better business even though it has a lower return on capital."

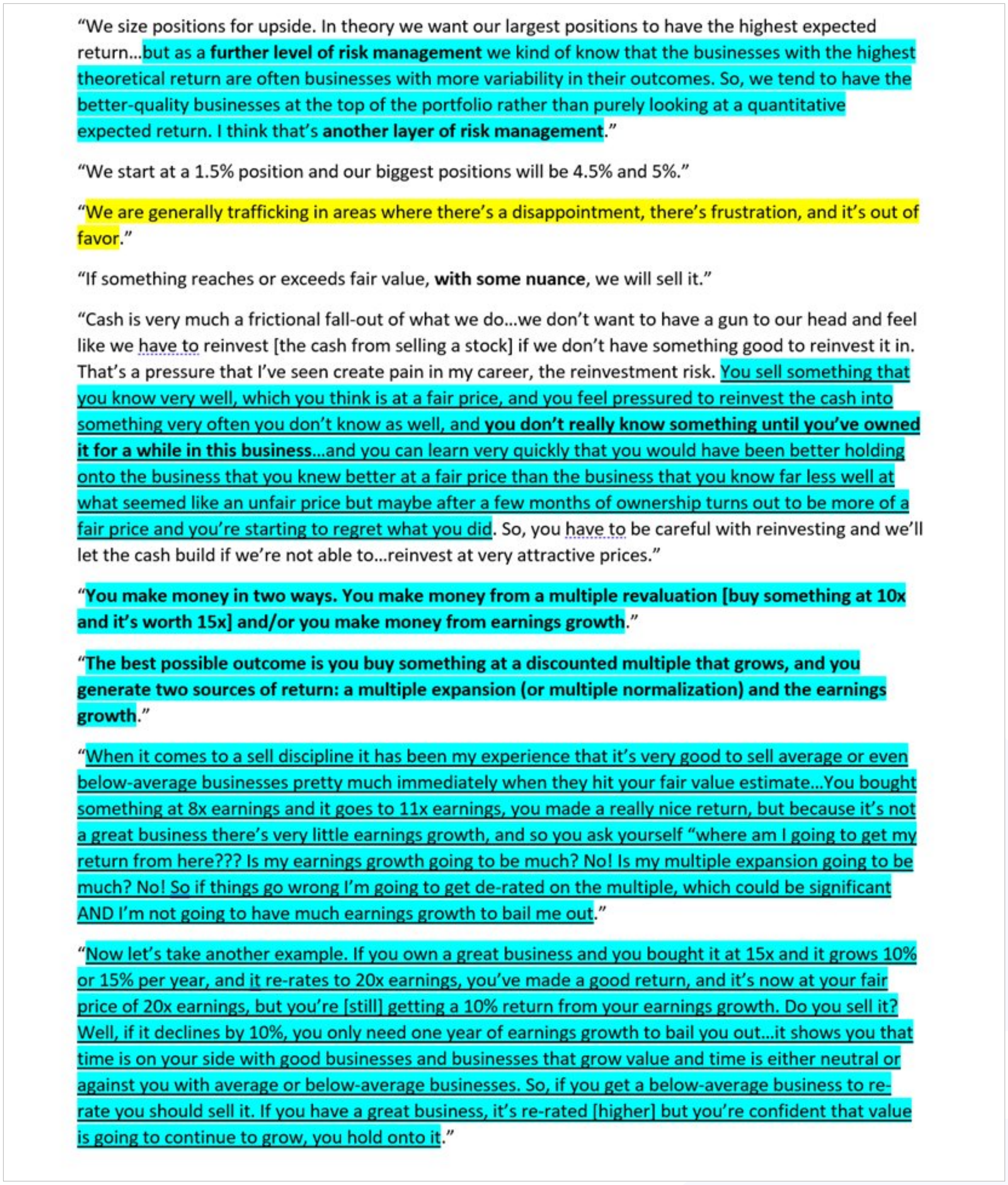
Quantitative characteristics like return on invested capital "have to be mitigated with questions of **duration** and **defensibility**. So, they don't tell you the whole story."

"Risk to us is absolute...it's about losing money."

"We are interested in protecting principle and not losing money...our whole philosophy is underpinned by that."

"We are talking about **multiple layers of risk management**. Number one is buying a business at a discount. You buy at a discount not only because you see an opportunity for there to be a return from closing the discount, but you're trying to build a margin of safety in. If you buy something cheap relative to what it's worth, presumably there's less downside than if you pay a fair or overvalued price. And then focusing on financial strength is **another layer** of risk management. Focusing on the ability of a business to grow is a **further layer** of risk management. And same with a management team that is allocating capital sensibly and is focused on **growing per-share value**."

"We then have diversification overlays. We typically own 30-35 stocks. I think that's an appropriate level of diversification. I think academic studies would support me on that. But it's also concentrated enough that when you do the type of intensive deep fundamental research that we do you also want to get compensated for that. You're going to do as much work on a 1.5% position as you're going to do on a 5% position...if we're going to buy something we spend an incredible amount of time on it so it has to be big enough to have an impact."



"We size positions for upside. In theory we want our largest positions to have the highest expected return…but as a **further level of risk management** we kind of know that the businesses with the highest theoretical return are often businesses with more variability in their outcomes. So, we tend to have the better-quality businesses at the top of the portfolio rather than purely looking at a quantitative expected return. I think that's **another layer of risk management**."

"We start at a 1.5% position and our biggest positions will be 4.5% and 5%."

"We are generally trafficking in areas where there's a disappointment, there's frustration, and it's out of favor."

"If something reaches or exceeds fair value, **with some nuance**, we will sell it."

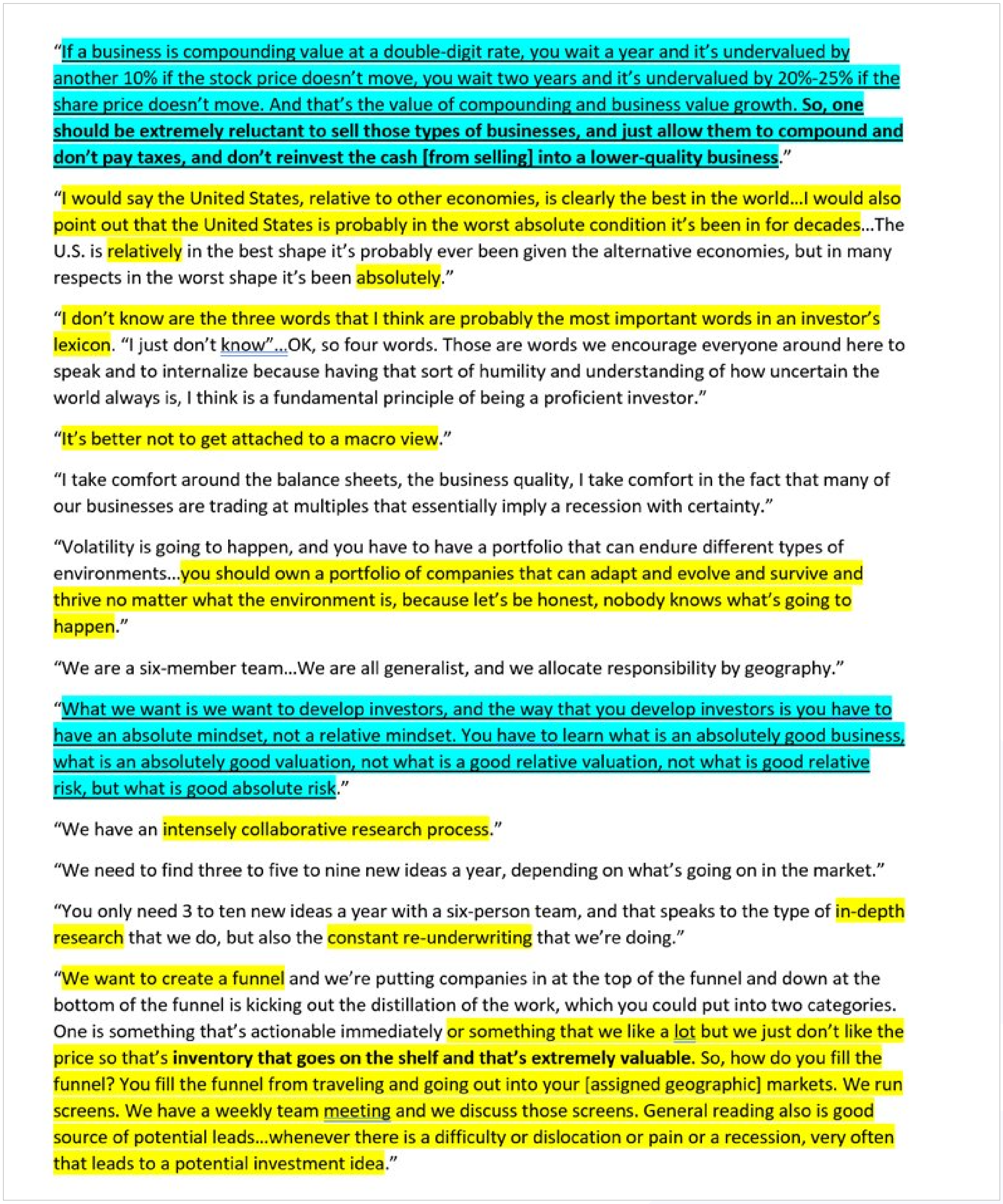
"Cash is very much a frictional fall-out of what we do…we don't want to have a gun to our head and feel like we have to reinvest [the cash from selling a stock] if we don't have something good to reinvest it in. That's a pressure that I've seen create pain in my career, the reinvestment risk. You sell something that you know very well, which you think is at a fair price, and you feel pressured to reinvest the cash into something very often you don't know as well, and **you don't really know something until you've owned it for a while in this business**…and you can learn very quickly that you would have been better holding onto the business that you knew better at a fair price than the business that you know far less well at what seemed like an unfair price but maybe after a few months of ownership turns out to be more of a fair price and you're starting to regret what you did. So, you have to be careful with reinvesting and we'll let the cash build if we're not able to…reinvest at very attractive prices."

"**You make money in two ways. You make money from a multiple revaluation [buy something at 10x and it's worth 15x] and/or you make money from earnings growth**."

"**The best possible outcome is you buy something at a discounted multiple that grows, and you generate two sources of return: a multiple expansion (or multiple normalization) and the earnings growth**."

"When it comes to a sell discipline it has been my experience that it's very good to sell average or even below-average businesses pretty much immediately when they hit your fair value estimate…You bought something at 8x earnings and it goes to 11x earnings, you made a really nice return, but because it's not a great business there's very little earnings growth, and so you ask yourself "where am I going to get my return from here??? Is my earnings growth going to be much? No! Is my multiple expansion going to be much? No! So if things go wrong I'm going to get de-rated on the multiple, which could be significant AND I'm not going to have much earnings growth to bail me out."

"Now let's take another example. If you own a great business and you bought it at 15x and it grows 10% or 15% per year, and it re-rates to 20x earnings, you've made a good return, and it's now at your fair price of 20x earnings, but you're [still] getting a 10% return from your earnings growth. Do you sell it? Well, if it declines by 10%, you only need one year of earnings growth to bail you out…it shows you that time is on your side with good businesses and businesses that grow value and time is either neutral or against you with average or below-average businesses. So, if you get a below-average business to re-rate you should sell it. If you have a great business, it's re-rated [higher] but you're confident that value is going to continue to grow, you hold onto it."



"If a business is compounding value at a double-digit rate, you wait a year and it's undervalued by another 10% if the stock price doesn't move, you wait two years and it's undervalued by 20%-25% if the share price doesn't move. And that's the value of compounding and business value growth. **So, one should be extremely reluctant to sell those types of businesses, and just allow them to compound and don't pay taxes, and don't reinvest the cash [from selling] into a lower-quality business**."

"I would say the United States, relative to other economies, is clearly the best in the world…I would also point out that the United States is probably in the worst absolute condition it's been in for decades…The U.S. is relatively in the best shape it's probably ever been given the alternative economies, but in many respects in the worst shape it's been absolutely."

"I don't know are the three words that I think are probably the most important words in an investor's lexicon. "I just don't know"…OK, so four words. Those are words we encourage everyone around here to speak and to internalize because having that sort of humility and understanding of how uncertain the world always is, I think is a fundamental principle of being a proficient investor."

"It's better not to get attached to a macro view."

"I take comfort around the balance sheets, the business quality, I take comfort in the fact that many of our businesses are trading at multiples that essentially imply a recession with certainty."

"Volatility is going to happen, and you have to have a portfolio that can endure different types of environments…you should own a portfolio of companies that can adapt and evolve and survive and thrive no matter what the environment is, because let's be honest, nobody knows what's going to happen."

"We are a six-member team…We are all generalist, and we allocate responsibility by geography."

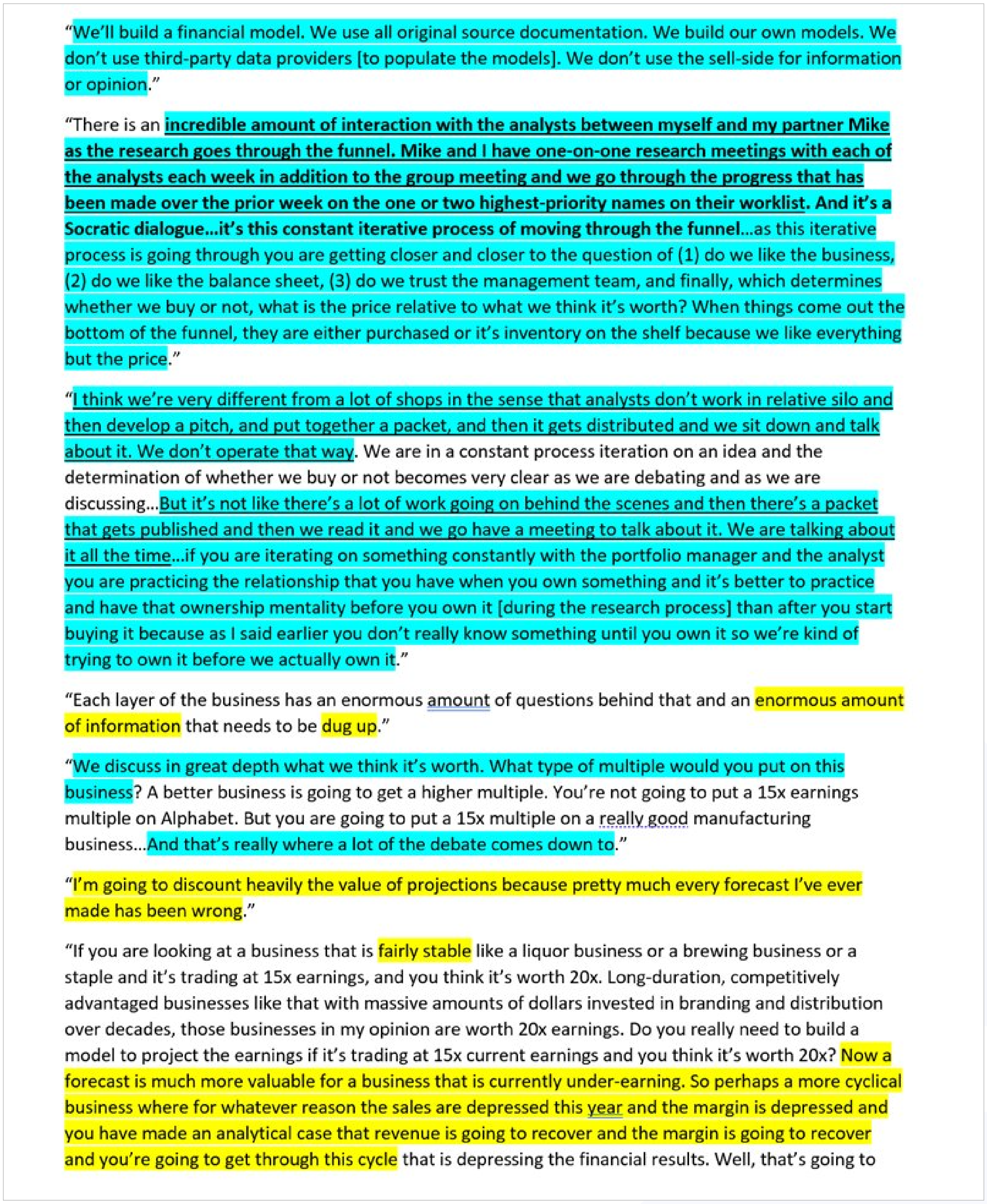
"What we want is we want to develop investors, and the way that you develop investors is you have to have an absolute mindset, not a relative mindset. You have to learn what is an absolutely good business, what is an absolutely good valuation, not what is a good relative valuation, not what is good relative risk, but what is good absolute risk."

"We have an intensely collaborative research process."

"We need to find three to five to nine new ideas a year, depending on what's going on in the market."

"You only need 3 to ten new ideas a year with a six-person team, and that speaks to the type of in-depth research that we do, but also the constant re-underwriting that we're doing."

"We want to create a funnel and we're putting companies in at the top of the funnel and down at the bottom of the funnel is kicking out the distillation of the work, which you could put into two categories. One is something that's actionable immediately or something that we like a lot but we just don't like the price so that's **inventory that goes on the shelf and that's extremely valuable**. So, how do you fill the funnel? You fill the funnel from traveling and going out into your [assigned geographic] markets. We run screens. We have a weekly team meeting and we discuss those screens. General reading also is good source of potential leads…whenever there is a difficulty or dislocation or pain or a recession, very often that leads to a potential investment idea."



"We'll build a financial model. We use all original source documentation. We build our own models. We don't use third-party data providers [to populate the models]. We don't use the sell-side for information or opinion."

"There is an **incredible amount of interaction with the analysts between myself and my partner Mike as the research goes through the funnel. Mike and I have one-on-one research meetings with each of the analysts each week in addition to the group meeting and we go through the progress that has been made over the prior week on the one or two highest-priority names on their worklist. And it's a Socratic dialogue…it's this constant iterative process of moving through the funnel**…as this iterative process is going through you are getting closer and closer to the question of (1) do we like the business, (2) do we like the balance sheet, (3) do we trust the management team, and finally, which determines whether we buy or not, what is the price relative to what we think it's worth? When things come out the bottom of the funnel, they are either purchased or it's inventory on the shelf because we like everything but the price."

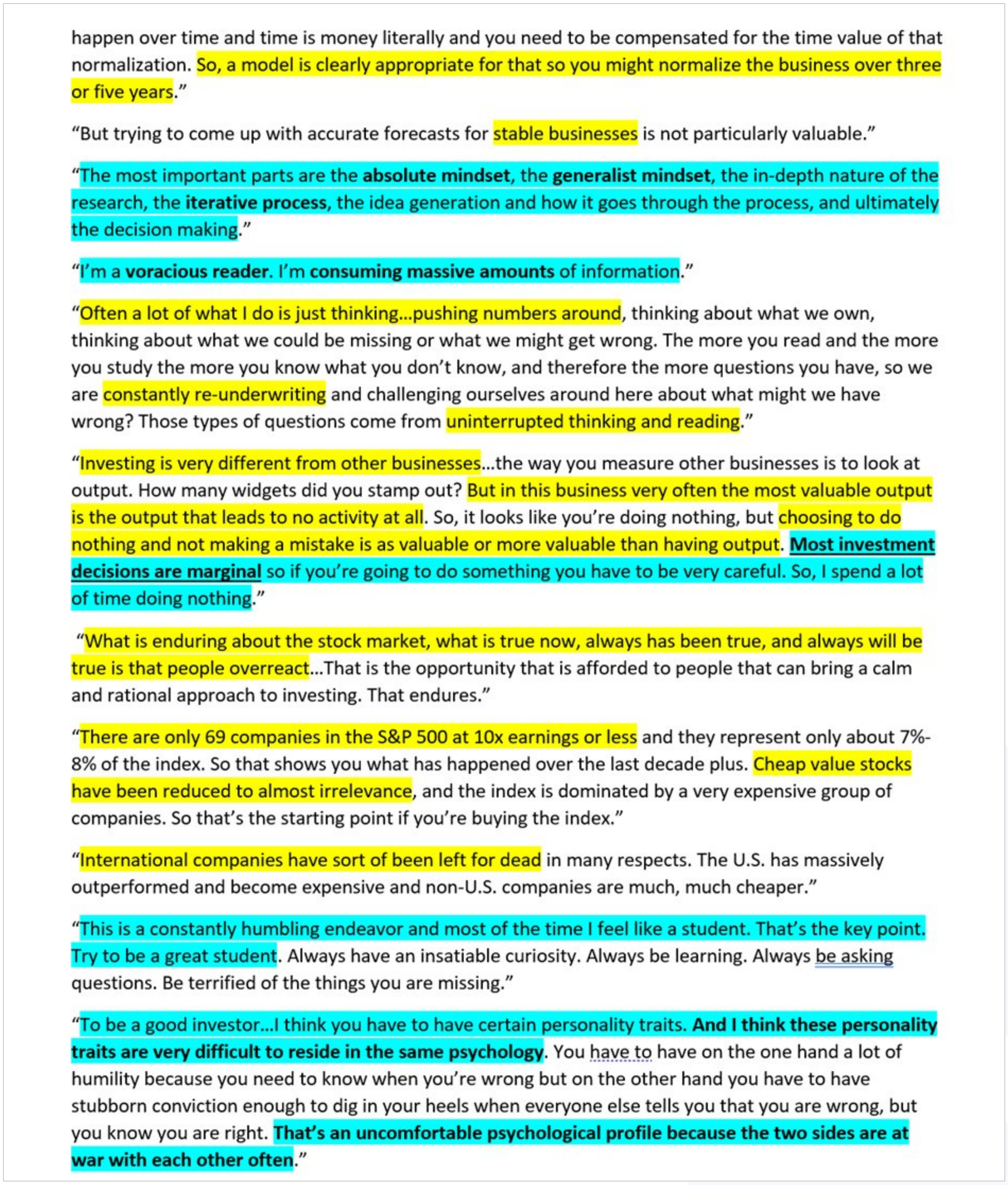
"I think we're very different from a lot of shops in the sense that analysts don't work in relative silo and then develop a pitch, and put together a packet, and then it gets distributed and we sit down and talk about it. We don't operate that way. We are in a constant process iteration on an idea and the determination of whether we buy or not becomes very clear as we are debating and as we are discussing…But it's not like there's a lot of work going on behind the scenes and then there's a packet that gets published and then we read it and we go have a meeting to talk about it. We are talking about it all the time…if you are iterating on something constantly with the portfolio manager and the analyst you are practicing the relationship that you have when you own something and it's better to practice and have that ownership mentality before you own it [during the research process] than after you start buying it because as I said earlier you don't really know something until you own it so we're kind of trying to own it before we actually own it."

"Each layer of the business has an enormous amount of questions behind that and an enormous amount of information that needs to be dug up."

"We discuss in great depth what we think it's worth. What type of multiple would you put on this business? A better business is going to get a higher multiple. You're not going to put a 15x earnings multiple on Alphabet. But you are going to put a 15x multiple on a really good manufacturing business…And that's really where a lot of the debate comes down to."

"I'm going to discount heavily the value of projections because pretty much every forecast I've ever made has been wrong."

"If you are looking at a business that is fairly stable like a liquor business or a brewing business or a staple and it's trading at 15x earnings, and you think it's worth 20x. Long-duration, competitively advantaged businesses like that with massive amounts of dollars invested in branding and distribution over decades, those businesses in my opinion are worth 20x earnings. Do you really need to build a model to project the earnings if it's trading at 15x current earnings and you think it's worth 20x? Now a forecast is much more valuable for a business that is currently under-earning. So perhaps a more cyclical business where for whatever reason the sales are depressed this year and the margin is depressed and you have made an analytical case that revenue is going to recover and the margin is going to recover and you're going to get through this cycle that is depressing the financial results. Well, that's going to



happen over time and time is money literally and you need to be compensated for the time value of that normalization. So, a model is clearly appropriate for that so you might normalize the business over three or five years."

"But trying to come up with accurate forecasts for stable businesses is not particularly valuable."

"The most important parts are the **absolute mindset**, the **generalist mindset**, the in-depth nature of the research, the **iterative process**, the idea generation and how it goes through the process, and ultimately the decision making."

"I'm a **voracious reader**. I'm **consuming massive amounts** of information."

"Often a lot of what I do is just thinking…pushing numbers around, thinking about what we own, thinking about what we could be missing or what we might get wrong. The more you read and the more you study the more you know what you don't know, and therefore the more questions you have, so we are constantly re-underwriting and challenging ourselves around here about what might we have wrong? Those types of questions come from uninterrupted thinking and reading."

"Investing is very different from other businesses…the way you measure other businesses is to look at output. How many widgets did you stamp out? But in this business very often the most valuable output is the output that leads to no activity at all. So, it looks like you're doing nothing, but choosing to do nothing and not making a mistake is as valuable or more valuable than having output. **Most investment decisions are marginal** so if you're going to do something you have to be very careful. So, I spend a lot of time doing nothing."

"What is enduring about the stock market, what is true now, always has been true, and always will be true is that people overreact…That is the opportunity that is afforded to people that can bring a calm and rational approach to investing. That endures."

"There are only 69 companies in the S&P 500 at 10x earnings or less and they represent only about 7%-8% of the index. So that shows you what has happened over the last decade plus. Cheap value stocks have been reduced to almost irrelevance, and the index is dominated by a very expensive group of companies. So that's the starting point if you're buying the index."

"International companies have sort of been left for dead in many respects. The U.S. has massively outperformed and become expensive and non-U.S. companies are much, much cheaper."

"This is a constantly humbling endeavor and most of the time I feel like a student. That's the key point. Try to be a great student. Always have an insatiable curiosity. Always be learning. Always be asking questions. Be terrified of the things you are missing."

"To be a good investor…I think you have to have certain personality traits. **And I think these personality traits are very difficult to reside in the same psychology**. You have to have on the one hand a lot of humility because you need to know when you're wrong but on the other hand you have to have stubborn conviction enough to dig in your heels when everyone else tells you that you are wrong, but you know you are right. **That's an uncomfortable psychological profile because the two sides are at war with each other often**."

Value legend Seth Klarman’s “forgotten lessons” from the 2008 Great Financial Crisis (from Farnam Street via The Idea Farm on October 22)...

In this excerpt from his annual letter, investing great Seth Klarman describes 20 lessons from the financial crisis which, he says, “were either never learned or else were immediately forgotten by most market participants.”

* * *

The Forgotten Lessons of 2008

One might have expected that the near-death experience of most investors in 2008 would generate valuable lessons for the future. We all know about the “depression mentality” of our parents and grandparents who lived through the Great Depression. Memories of tough times colored their behavior for more than a generation, leading to limited risk taking and a sustainable base for healthy growth. Yet one year after the 2008 collapse, investors have returned to shockingly speculative behavior. One state investment board recently adopted a plan to leverage its portfolio – specifically its government and high-grade bond holdings – in an amount that could grow to 20% of its assets over the next three years. No one who was paying attention in 2008 would possibly think this is a good idea.

Below, we highlight the lessons that we believe could and should have been learned from the turmoil of 2008. Some of them are unique to the 2008 melt- down; others, which could have been drawn from general market observation over the past several decades, were certainly reinforced last year. Shockingly, virtually all of these lessons were either never learned or else were immediately forgotten by most market participants.

Twenty Investment Lessons of 2008

1. Things that have never happened before are bound to occur with some regularity. You must always be prepared for the unexpected, including sudden, sharp downward swings in markets and the economy. Whatever adverse scenario you can contemplate, reality can be far worse.

2. When excesses such as lax lending standards become widespread and persist for some time, people are lulled into a false sense of security, creating an even more dangerous situation. In some cases, excesses migrate beyond regional or national borders, raising the ante for investors and governments. These excesses will eventually end, triggering a crisis at least in proportion to the degree of the excesses. Correlations between asset classes may be surprisingly high when leverage rapidly unwinds.

3. Nowhere does it say that investors should strive to make every last dollar of potential profit; consideration of risk must never take a backseat to return. Conservative positioning entering a crisis is crucial: it enables one to maintain long-term oriented, clear thinking, and to focus on new opportunities while others are distracted or even forced to sell. Portfolio hedges must be in place before a crisis hits. One cannot reliably or affordably increase or replace hedges that are rolling off during a financial crisis.

4. Risk is not inherent in an investment; it is always relative to the price paid. Uncertainty is not the same as risk. Indeed, when great uncertainty – such as in the fall of 2008 – drives securities prices to especially low levels, they often become less risky investments.

5. Do not trust financial market risk models. Reality is always too complex to be accurately modeled. Attention to risk must be a 24/7/365 obsession, with people – not computers – assessing and reassessing the risk environment in real time. Despite the predilection of some analysts to model the financial markets using sophisticated mathematics, the markets are governed by behavioral science, not physical science.

6. Do not accept principal risk while investing short-term cash: the greedy effort to earn a few extra basis points of yield inevitably leads to the incurrence of greater risk, which increases the likelihood of losses and severe illiquidity at precisely the moment when cash is needed to cover expenses, to meet commitments, or to make compelling long-term investments.

7. The latest trade of a security creates a dangerous illusion that its market price approximates its true value. This mirage is especially dangerous during periods of market exuberance. The concept of "private market value" as an anchor to the proper valuation of a business can also be greatly skewed during ebullient times and should always be considered with a healthy degree of skepticism.

8. A broad and flexible investment approach is essential during a crisis. Opportunities can be vast, ephemeral, and dispersed through various sectors and markets. Rigid silos can be an enormous disadvantage at such times.

9. You must buy on the way down. There is far more volume on the way down than on the way back up, and far less competition among buyers. It is almost always better to be too early than too late, but you must be prepared for price markdowns on what you buy.

10. Financial innovation can be highly dangerous, though almost no one will tell you this. New financial products are typically created for sunny days and are almost never stress-tested for stormy weather. Securitization is an area that almost perfectly fits this description; markets for securitized assets such as subprime mortgages completely collapsed in 2008 and have not fully recovered. Ironically, the government is eager to restore the securitization markets back to their pre-collapse stature.

11. Ratings agencies are highly conflicted, unimaginative dupes. They are blissfully unaware of adverse selection and moral hazard. Investors should never trust them.

12. Be sure that you are well compensated for illiquidity – especially illiquidity without control – because it can create particularly high opportunity costs.

13. At equal returns, public investments are generally superior to private investments not only because they are more liquid but also because amidst distress, public markets are more likely than private ones to offer attractive opportunities to average down.

14. Beware leverage in all its forms. Borrowers – individual, corporate, or government – should always match fund their liabilities against the duration of their assets. Borrowers must always remember that capital markets can be extremely fickle, and that it is never safe to assume a maturing loan can be rolled over. Even if you are unleveraged, the leverage employed by others can drive dramatic price and valuation swings; sudden unavailability of leverage in the economy may trigger an economic downturn.

15. Many LBOs are man-made disasters. When the price paid is excessive, the equity portion of an LBO is really an out-of-the-money call option. Many fiduciaries placed large amounts of the capital under their stewardship into such options in 2006 and 2007.

16. Financial stocks are particularly risky. Banking, in particular, is a highly lever- aged, extremely competitive, and challenging business. A major European bank recently announced the goal of achieving a 20% return on equity (ROE) within several years. Unfortunately, ROE is highly dependent on absolute yields, yield spreads, maintaining adequate loan loss reserves, and the amount of leverage used. What is the bank's management to do if it cannot readily get to 20%? Leverage up? Hold riskier assets? Ignore the risk of loss? In some ways, for a major financial institution even to have a ROE goal is to court disaster.

17. Having clients with a long-term orientation is crucial. Nothing else is as important to the success of an investment firm.

18. When a government official says a problem has been "contained," pay no attention.

19. The government – the ultimate short- term-oriented player – cannot with- stand much pain in the economy or the financial markets. Bailouts and rescues are likely to occur, though not with sufficient predictability for investors to comfortably take advantage. The government will take enormous risks in such interventions, especially if the expenses can be conveniently deferred to the future. Some of the price-tag is in the form of back- stops and guarantees, whose cost is almost impossible to determine.

20. Almost no one will accept responsibility for his or her role in precipitating a crisis: not leveraged speculators, not willfully blind leaders of financial institutions, and certainly not regulators, government officials, ratings agencies or politicians.

Below, we itemize some of the quite different lessons investors seem to have learned as of late 2009 – false lessons, we believe. To not only learn but also effectively implement investment lessons requires a disciplined, often contrary, and long-term-oriented investment approach. It requires a resolute focus on risk aversion rather than maximizing immediate returns, as well as an understanding of history, a sense of financial market cycles, and, at times, extraordinary patience.

False Lessons

1. There are no long-term lessons – ever.

2. Bad things happen, but really bad things do not. Do buy the dips, especially the lowest quality securities when they come under pressure, because declines will quickly be reversed.

3. There is no amount of bad news that the markets cannot see past.

4. If you've just stared into the abyss, quickly forget it: the lessons of history can only hold you back.

5. Excess capacity in people, machines, or property will be quickly absorbed.

6. Markets need not be in sync with one another. Simultaneously, the bond market can be priced for sustained tough times, the equity market for a strong recovery, and gold for high inflation. Such an apparent disconnect is indefinitely sustainable.

7. In a crisis, stocks of financial companies are great investments, because the tide is bound to turn. Massive losses on bad loans and soured investments are irrelevant to value; improving trends and future prospects are what matter, regardless of whether profits will have to be used to cover loan losses and equity shortfalls for years to come.

8. The government can reasonably rely on debt ratings when it forms programs to lend money to buyers of otherwise unattractive debt instruments.

9. The government can indefinitely control both short-term and long-term interest rates.

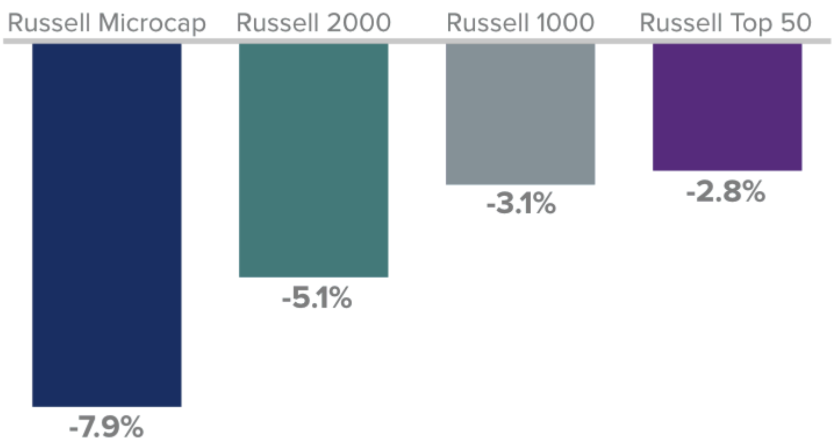
10. The government can always rescue the markets or interfere with contract law whenever it deems convenient with little or no apparent cost. (Investors believe this now and, worse still, the government believes it as well. We are probably doomed to a lasting legacy of government tampering with financial markets and the economy, which is likely to create the mother of all moral hazards. The government is blissfully unaware of the wisdom of Friedrich Hayek: "The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design.")

Investment Ideas

Small-cap stocks are becoming historically cheap ([from Royce Investment Partners on October 2](#))...

Equities Struggle as Yields Climb in 3Q23

The major U.S. stock market indexes were down across the board in 3Q23, thanks to a combination of revived recession warnings, rising yields, and a looming government shutdown. The 10-Year Treasury yield rose to 4.6% in September, climbing by more than 20.0% in 3Q23 to its highest rate since October 2007. And even with Google and Amazon facing anti-trust suits, small- and micro-cap stocks bore the brunt of the quarterly downturn. The Russell 2000 Index fell -5.1 % in 3Q23 while the Russell Microcap Index lost -7.9% compared to respective losses of -3.1% and -2.8% for the Russell 1000 Index and mega-cap Russell Top 50 Index. In fact, the Russell 2000 fell -10.6 % in August and September alone.



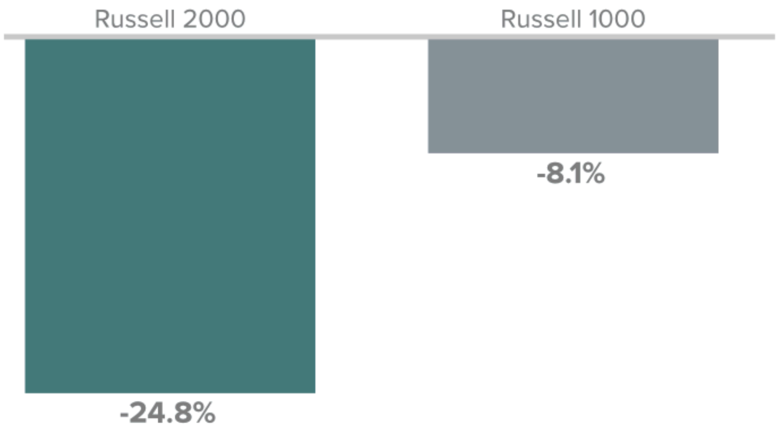
Larger Lost Less in 3Q23's Downturn

3Q23 Returns for the Russell Top 50, Russell 1000, Russell 2000, and Russell Microcap Indexes

Past performance is no guarantee of future results.

This reinforced a stubborn pattern of small-cap underperformance that has been in place for several years and has been consistent so far in 2023. For the year-to-date period ended 9/30/23, the Russell 2000 was up 2.5%, and the Russell Microcap was in the red at -5.8%, while the Russell 1000 was up 13.0%—and the mega-cap index nearly doubled that return with a year-to-date gain of 24.3%.

The Russell 2000 thus finished September 1,047 basis points behind its large-cap sibling. The end of September also marked the biggest 1-year spread between the Russell 2000 (+8.9%) and the Russell Microcap (-1.3%) since the latter's inception in June 2000. Equally important, the Russell 2000 slipped back into bear territory in 3Q23, down -24.8% from its last peak on 11/8/21, putting the asset class into a nearly 2-year bear cycle while large caps experienced only a minor loss through this lengthy small-cap correction.



A Bear Market for Small Cap, a Small Loss for Large Cap
Cumulative Returns for the Russell 2000 and Russell 1000 Indexes from 11/8/21-9/30/23

Past performance is no guarantee of future results.

Non-U.S. indexes did not fare much better, for understandable reasons—China and Europe remain in various stages of recession or markedly slower economic growth. However, the MSCI ACWI ex-US Small Cap Index lost only -1.7% in 3Q23 while the MSCI ACWI ex-US Large Cap Index fell -4.1%. For the year-to-date period ended 9/30/23, the two indexes were nearly even, with the non-U.S. small-cap index gaining 5.0% and its large-cap counterpart up 5.3%.

The Small-Cap Seesaw

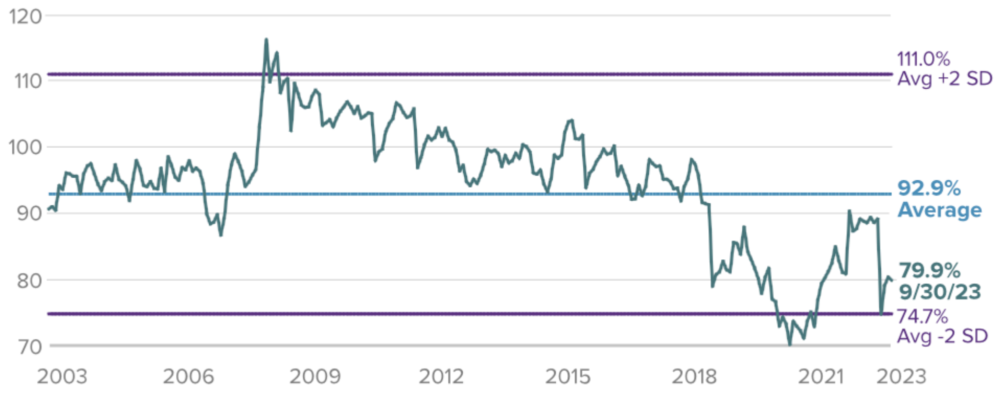
As might be expected in a down quarter, the Russell 2000 Value Index lost significantly less than the Russell 2000 Growth Index, down -3.0% in 3Q23 versus -7.3%. The small-cap value index still trailed on a year-to-date basis, down -0.5% versus a gain of 5.2%.

Over longer-term periods the relative advantage switched around a bit, with the small-cap value index winning for the 3- and 5-year periods while the growth index won for the 1- and 10-year periods ended 9/30/23. One element that has not changed, however, is the absolute and relative valuation of small-cap value. Using our preferred index valuation metric of enterprise value over earnings before interest & taxes (EV/EBIT), we can see that the Russell 2000 Value remained attractively valued at the end of 3Q23, particularly relative to the Russell 2000 Growth.

Relative Valuations for Small-Cap Value vs. Small-Cap Growth Remain Near Their Lowest in 20 Years

Russell 2000 Value vs. Russell 2000 Growth Median LTM EV/EBIT[1] (ex. Negative EBIT Companies)

From 9/30/03 through 9/30/23



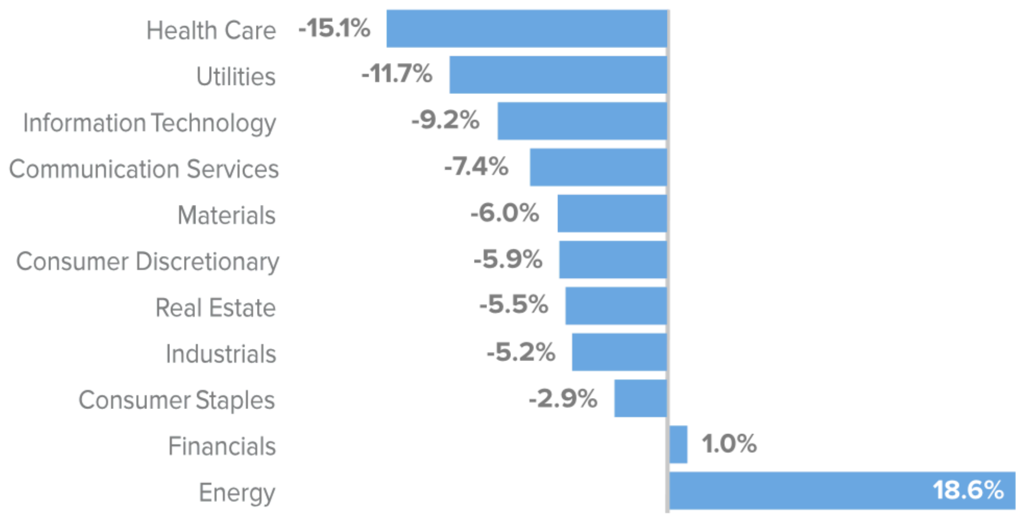
[1] *Last twelve months Enterprise Value/Earnings Before Interest and Taxes.*

Past performance is no guarantee of future results.

As might be expected, the Russell 2000 was far more attractively valued at the end of September than the Russell 1000, based on the same EV/EBIT metric.

The Small-Cap Sector Story

In light of the widespread attention on AI, as well as the coming impact of the CHIPS and Science Act, it was somewhat surprising to see Information Technology stocks hit hard within the Russell 2000 in 3Q23. Along with Health Care—another locus of innovation—the tech sector had the sharpest losses and the biggest negative impact on small-cap results in 3Q23. All told, only Energy and previously beleaguered Financials finished the third quarter in the black, though double-digit losses on a sector basis were limited to Health Care and Information Technology. Along with the U.S. dollar, energy and financial stocks offered one of the few attractive investments for 3Q23. These widespread sector declines created a number of interesting long-term buying opportunities.

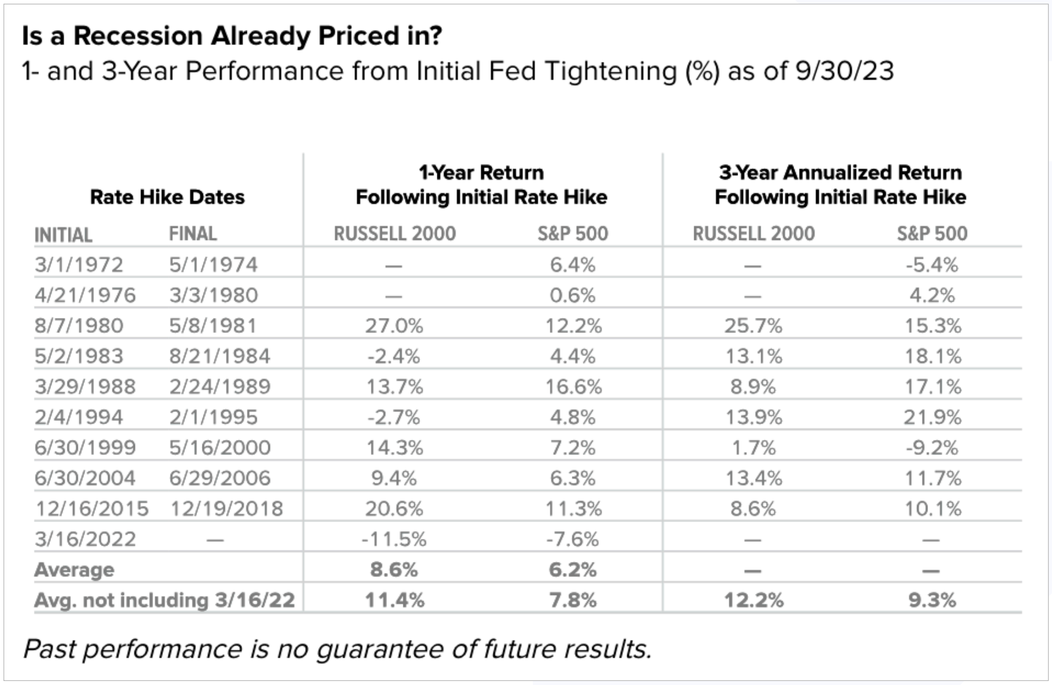


Small-Cap Sector Results Mostly Negative in 3Q23
Russell 2000 Performance by Sector

Past performance is no guarantee of future results.

The Active Opportunity

Of course, we view performance over much longer time periods than the just concluded quarter—and much of what we see skews positive over the long run. First, in the 18 months that followed the first Fed rate hike in March of 2022, the Russell 2000 was down -10.0% while the Russell 1000 was marginally positive at 0.3%. Yet history shows that 1- and 3-year returns for both indexes were mostly positive following the nine previous initial tightenings by the Fed. This recent departure from the historical pattern suggests to us that the market may have already priced in a potential recession—and that higher small-cap returns may be on the horizon.



Is a Recession Already Priced in?
1- and 3-Year Performance from Initial Fed Tightening (%) as of 9/30/23

Rate Hike Dates		**1-Year Return Following Initial Rate Hike**		**3-Year Annualized Return Following Initial Rate Hike**	
INITIAL	FINAL	RUSSELL 2000	S&P 500	RUSSELL 2000	S&P 500
3/1/1972	5/1/1974	—	6.4%	—	-5.4%
4/21/1976	3/3/1980	—	0.6%	—	4.2%
8/7/1980	5/8/1981	27.0%	12.2%	25.7%	15.3%
5/2/1983	8/21/1984	-2.4%	4.4%	13.1%	18.1%
3/29/1988	2/24/1989	13.7%	16.6%	8.9%	17.1%
2/4/1994	2/1/1995	-2.7%	4.8%	13.9%	21.9%
6/30/1999	5/16/2000	14.3%	7.2%	1.7%	-9.2%
6/30/2004	6/29/2006	9.4%	6.3%	13.4%	11.7%
12/16/2015	12/19/2018	20.6%	11.3%	8.6%	10.1%
3/16/2022	—	-11.5%	-7.6%	—	—
Average		**8.6%**	**6.2%**	**—**	**—**
Avg. not including 3/16/22		**11.4%**	**7.8%**	**12.2%**	**9.3%**

Past performance is no guarantee of future results.

Another historical pattern that has so far not materialized is the relationship between small-cap performance and high-yield credit spreads. When the latter contract, as they have been doing since peaking in July of 2022, small-cap stock prices typically rise.

High-yield spreads have fallen 2000 basis points over the last 14 months. From 7/31/22-9/30/23, however, the Russell 2000 fell -3.5%. The last time high-yield spreads experienced a fall from a similar level with a comparable decline was from 7/31/20-12/31/20—and the Russell 20000 climbed 34.1% over that brief five-month span.

While these historical patterns are of great interest to us, we are more encouraged by the combination of valuations and long-term opportunities. The Russell 2000 finished September 2023 with a 2.4% 5-year annualized return—a performance nearly identical to its year-to-date result through the end of 3Q23 and evidence of just how underwhelming recent returns have been for the small-cap index. (To be sure, we are very pleased that performance of our own disciplined and active domestic Strategies has been far better.) Yet the average price to earnings ratio for the Russell 2000 five years ago on 9/30/18 was 18.4x—close to its long-term average of 18.1x—versus 12.5x at 9/30/23. While returns have stalled, multiples have compressed, creating a considerable number of buying opportunities.

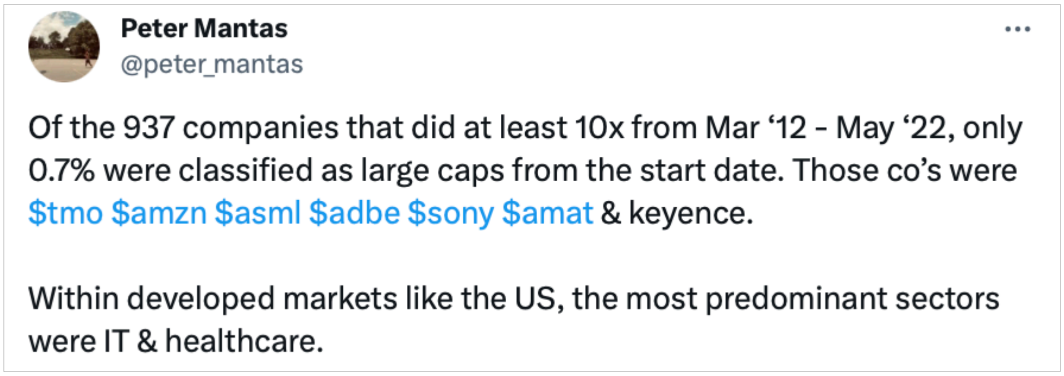
Small Cap P/Es Have Come Down Amid Lackluster Returns
Weighted Harmonic Average Price-to Earnings Ratio (Excluding Non-Earners) for the Russell 2000 from 9/30/98-9/30/23

Past performance is no guarantee of future results.

Combine the attractive valuations for small caps as a whole with the fact—which we have discussed before—that small caps enjoyed strong and lasting recoveries following prior periods with low 5-year annualized returns. Indeed, the Russell 2000 had positive annualized 5-year returns 100% of the time—in all 81 five-year periods—averaging an impressive 14.9%, which was well above its monthly rolling five-year return since inception of 10.4%.

This history takes on more relevance for us in light of the exciting long-term opportunities that our portfolio management teams are seeing in areas as diverse as semiconductors, electric vehicles, electrification, aerospace & defense, medical devices, electronics manufacturing services, banking, and retail. They are also seeing considerable potential in those small-cap businesses that look poised to benefit from the growth of AI applications, much of it in areas beyond tech such as industrial uses. Current challenges notwithstanding, we think it's a wonderful time to be invested in select small caps for the long run—and for active management to potentially shine.

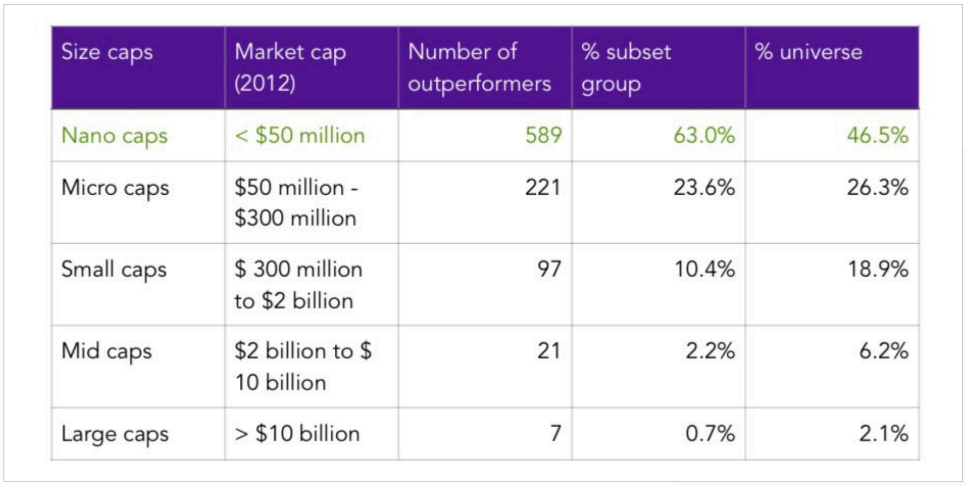
Where to find stocks with 10x potential (from Peter Mantas via X on October 3)…



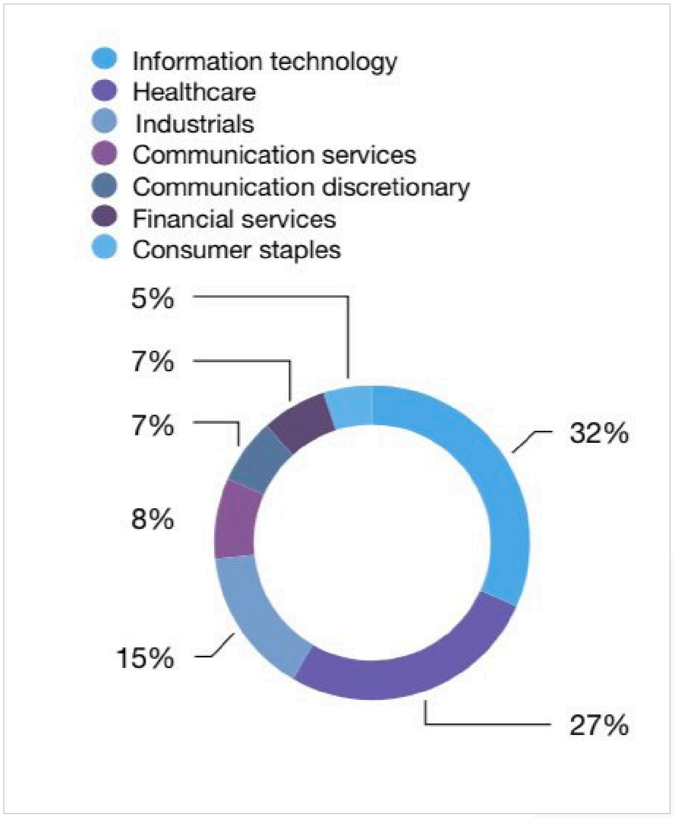
Peter Mantas
@peter_mantas

Of the 937 companies that did at least 10x from Mar ‘12 - May ‘22, only 0.7% were classified as large caps from the start date. Those co’s were $tmo $amzn $asml $adbe $sony $amat & keyence.

Within developed markets like the US, the most predominant sectors were IT & healthcare.



Size caps	Market cap (2012)	Number of outperformers	% subset group	% universe
Nano caps	< $50 million	589	63.0%	46.5%
Micro caps	$50 million - $300 million	221	23.6%	26.3%
Small caps	$ 300 million to $2 billion	97	10.4%	18.9%
Mid caps	$2 billion to $ 10 billion	21	2.2%	6.2%
Large caps	> $10 billion	7	0.7%	2.1%




Peter Mantas @peter_mantas · Oct 3

"The US outperformed in more technically advanced industries like healthcare and IT; 58% (35 of 60 companies) came from the two sectors. Industries such as utilities, materials and energy had an insignificant role; only one company came from all three sectors combined."

Billionaire distressed-debt investor Howard Marks believes it's time to invest in credit again (from Oaktree Capital's Memos from Howard Marks on October 11)...

> *In May, I wrote a follow-up memo to Sea Change (December 2022) that was shared exclusively with Oaktree clients.* In Further Thoughts on Sea Change, *I argued that the trends I had highlighted in the original memo collectively represented a sweeping alteration of the investment environment that called for significant capital reallocation. This memo was originally sent to Oaktree clients on May 30, 2023.1*
>
> This Time It Really Might Be Different
>
> On October 11, 1987, I first came across the saying "this time it's different." According to an article in *The New York Times* by Anise C. Wallace, Sir John Templeton had warned that when investors say times are different, it's usually in an effort to rationalize valuations that appear high relative to history

– and it's usually done to investors' ultimate detriment. In 1987, it was high equity prices in general; the article I cite was written just eight days before Black Monday, when the Dow Jones Industrial Average declined by 22.6% in a single day. A dozen years later, the new thing people were excited about was the prospect that the Internet would change the world. This belief served to justify ultra-high prices (and p/e ratios of infinity) for digital and e-commerce stocks, many of which went on to lose more than 90% of their value over the next year or so.

Importantly, however, Templeton allowed that things might really be different 20% of the time. On rare occasions, something fundamental does change, with significant implications for investing. Given the pace of developments these days – especially in technology – I imagine things might genuinely be different more often than they were in Templeton's day.

Anyway, that's all preamble. My reason for writing this memo is that, while most people I speak with seem to agree with many of my individual observations in *Sea Change*, few have expressly agreed with my overall conclusion and said, "I think you're right: We might be seeing a significant and possibly lasting change in the investment environment." This memo's main message is that the changes I described in *Sea Change* aren't just usual cyclical fluctuations; rather, taken together, they represent a sweeping alteration of the investment environment, calling for significant capital reallocation.

The Backdrop

I'll start off by recapping my basic arguments from *Sea Change*:

- In late 2008, the Federal Reserve took the fed funds rate to zero for the first time ever in order to rescue the economy from the effects of the Global Financial Crisis.

- Since that didn't cause inflation to rise from its sub-2% level, the Fed felt comfortable maintaining accommodative policies – low interest rates and quantitative easing – for essentially all of the next 13 years.

- As a result, we had the longest economic recovery on record – exceeding ten years – and "easy times" for businesses seeking to earn profits and secure financing. Even money-losing businesses had little trouble going public, obtaining loans, and avoiding default and bankruptcy.

- The low interest rates that prevailed in 2009-21 made it a great time for asset owners – lower discount rates make future cash flows more valuable – and for borrowers. This in turn made asset owners complacent and potential buyers eager. And FOMO became most people's main concern. The period was correspondingly challenging for bargain hunters and lenders.

- The massive Covid-19 relief measures – combined with supply-chain snags – resulted in too much money chasing too few goods, the classic condition for rising inflation.

- The higher inflation that arose in 2021 persisted into 2022, forcing the Fed to discontinue its accommodative stance. Thus, the Fed raised interest rates dramatically – its fastest tightening cycle in four decades – and ended QE.

- For a number of reasons, ultra-low or declining interest rates are unlikely to be the norm in the decade ahead.

- Thus, we're likely to see tougher times for corporate profits, for asset appreciation, for borrowing, and for avoiding default.

- Bottom line: If this really is a sea change – meaning the investment environment has been fundamentally altered – you shouldn't assume the investment strategies that have served you best since 2009 will do so in the years ahead.

Having supplied this summary, I'm going to put flesh on these bones and share some additional insights.

A Momentous Development

To promote discussion these days, I often start by asking people, "What do you consider to have been the most important event in the financial world in recent decades?" Some suggest the Global Financial Crisis and bankruptcy of Lehman Brothers, some the bursting of the tech bubble, and some the Fed/government response to the pandemic-related woes. No one cites my candidate: the 2,000-basis-point decline in interest rates between 1980 and 2020. And yet, as I wrote in *Sea Change,* that decline was probably responsible for the lion's share of investment profits made over that period. How could it be overlooked?

First, I suggest the metaphor of boiling a frog. It's said that if you put a frog in a pot of boiling water, it'll jump out. But if you put it in cool water and turn on the stove, it'll just sit there, oblivious, until it boils to death. The frog doesn't detect the danger – just as people fail to perceive the significance of the interest rate decline – because of its gradual, long-term nature. It's not an abrupt development, but rather a drawn out, highly influential trend.

Second, in *Sea Change*, I compared the 40-year interest rate decline to the moving walkway at an airport. If you stand still on the walkway, you'll move effortlessly; but, if you walk at your normal pace, you'll move ahead rapidly – perhaps without being fully conscious of why. In fact, if everyone's walking on the moving walkway, doing so can easily go unnoted, and the walkers might conclude that their rapid progress is "normal."

Finally, there's what John Kenneth Galbraith called "the extreme brevity of the financial memory." Relatively few investors today are old enough to remember a time when interest rates behaved differently. Everyone who has come into the business since 1980 – in other words, the vast majority of today's investors – has, with relatively few exceptions, only seen interest rates that were either declining or ultra-low (or both). You have to have been working for more than 43 years, and thus be over 65, to have seen a prolonged period that was otherwise. And since market conditions made it tough to find employment in our industry in the 1970s, you probably had to get your first job in the 1960s (like me) to have seen interest rates that were either higher and stable or rising. I believe the scarcity of veterans from the '70s has made it easy for people to conclude that the interest rate trends of 2009-21 were normal.

The Relevance of History

The 13-year period from the beginning of 2009 through the end of 2021 saw two rescues from financial crises, a generally favorable macro environment, aggressively accommodative central bank policies, a lack of inflation worries, ultra-low and declining interest rates, and generally uninterrupted investment gains. The question, of course, is whether investors should expect a continuation of those trends.

- Recent events have shown that the risk of rising inflation can't be ignored in perpetuity. Moreover, the reawakening of inflationary psychology will probably make central banks less likely to conclude that they can engage in continuous monetary stimulation without consequences.

- Thus, interest rates can't be counted on to stay "lower for longer" and produce perpetual prosperity, as many thought was the case in late 2020.

- Also in late 2020, Modern Monetary Theory was accepted by some as meaning deficits and national debt could be disregarded in countries "with control of their currencies." (We no longer hear anything about this notion.)

In *Sea Change*, I listed several reasons why I don't think interest rates are going back to that period's lows on a permanent basis, and I still find these arguments compelling. In particular, I find it hard to believe the Fed doesn't think it erred by sticking with ultra-low interest rates for so long.

As noted above, to fight the GFC, the Fed took the fed funds rate to roughly zero for the first time in late 2008. Macro conditions were frightening, as a vicious cycle capable of undermining the entire financial system appeared to be underway. For this reason, aggressive action was certainly called for. But I was shocked when I looked at the data and saw that the Fed kept the rate near zero for nearly seven years. Setting interest rates at zero is an emergency measure, and we certainly didn't have a continuous emergency through late 2015. To me, those sustained low rates stand out as a mistake not to be repeated.

Further, by 2017-18, with the fed funds rate around 1%, it had become clear to many that there wasn't room for the Fed to reduce rates if necessary to stimulate the economy during a recession. But when the Fed attempted to raise rates to create that room, it encountered pushback from investors (see the fourth quarter of 2018). I find it hard to believe the Fed would want to reimpose that limitation on its toolkit.

A recurring theme of mine is that, even though many people agree that free markets do the best job of allocating resources, we haven't had a free market in money in roughly the last two decades, a period of Fed activism. Instead, Fed policy has been accommodative almost the entire time, and interest rates have been kept artificially low. Rather than letting economic and market forces determine the rate of interest, the Fed has been unusually active in setting interest rates, greatly influencing the economy and the markets.

Importantly, this distorts the behavior of economic and market participants. It causes things to be built that otherwise wouldn't have been built, investments to be made that otherwise wouldn't have been made, and risks to be borne that otherwise wouldn't have been accepted. There's no doubt that this is true in general, and I'm convinced it accurately describes the period in question.

Many articles about the problems at Silicon Valley Bank and First Republic Bank cite errors that were made in the preceding "easy-money" period. Rapid growth, unwise inducements to customers, and lax financial management were all encouraged in a climate with accommodative Fed policy, uniformly positive expectations, and low levels of risk aversion. This is just one example of a time-worn adage in action: "The worst of loans are made in the best of times." I don't think the Fed should return us to an environment that has been distorted to encourage universal optimism, belief in the existence of a Fed put, and thus a dearth of prudence.

If the declining and/or ultra-low interest rates of the easy-money period aren't going to be the rule in the years ahead, numerous consequences seem probable:

- economic growth may be slower;
- profit margins may erode;
- default rates may head higher;
- asset appreciation may not be as reliable;
- the cost of borrowing won't trend downward consistently (though interest rates raised to fight inflation likely will be permitted to recede somewhat once inflation eases);
- investor psychology may not be as uniformly positive; and
- businesses may not find it as easy to obtain financing.

In other words, after a long period when everything was unusually easy in the world of investing, something closer to normalcy is likely to set in.

Please note that I'm not saying interest rates, having declined by 2,000 basis points over the last 40 or so years, are going back up to the levels seen in the 1980s. In fact, I see no reason why short-term interest rates five years from now should be appreciably higher than they are today. But still, I think the easy times – and easy money – are largely over. How can I best communicate what I'm talking about? Try this: Five years ago, an investor went to the bank for a loan, and the banker said, "We'll give you $800 million at 5%." Now the loan has to be refinanced, and the banker says, "We'll give you $500 million at 8%." That means the investor's cost of capital is up, his net return on the investment is down (or negative), and he has a $300 million hole to fill.

What Strategies Will Work Best?

It seems obvious that if certain strategies were the best performers in a period with a given set of characteristics, it must be true that a starkly different environment will produce a dramatically altered list of winners.

- As mentioned above in the recap of *Sea Change*, the 40 years of low and declining interest rates were hugely beneficial for asset owners. Declining discount rates and the associated reduction in the competitiveness of bond returns led to substantial asset appreciation. Thus, asset ownership – whether related to companies, pieces of companies (equities), or properties – was the place to be.

- Falling interest rates brought down the cost of capital for borrowers. As this occurred, any borrowing automatically became more successful than originally contemplated.

- And, as I also mentioned in *Sea Change*, the combined result of the above for investors who bought assets on borrowed money was a double bonanza. Think back to the first of the sea changes I mentioned in that memo: the advent of high yield bonds in 1977-78, which brought about the trend toward bearing risk for profit and the emergence of levered investment strategies. It's very notable that almost the entire history of levered investment strategies has been written during a period of declining and/or ultra-low interest rates. For example, I would venture that nearly 100% of capital for private equity investing has been put to work since interest rates began their downward move in 1980. Should it come as a surprise that levered investing thrived in such salutary conditions?

- At the same time, declining interest rates rendered lending – or buying debt instruments – less rewarding. Not only were prospective returns on debt low throughout the period, but investors who were eager to get away from the ultra-low yields on safer securities like Treasurys and investment grade corporates competed spiritedly to deploy capital in higher-risk markets, and this caused many to accept lower returns and reduced lender protections.

- Finally, conditions in those halcyon days created tough times for bargain hunters. Where do the greatest bargains come from? The answer: the desperation of panicked holders. When times are untroubled, asset owners are complacent, and buyers are eager, no one has any urgency to exit, making it very hard to score significant bargains.

Investors who profited in this period from asset ownership and levered investment strategies may overlook the salutary effect of interest rates on asset values and borrowing costs and instead think the profits stemmed from the inherent merit of their strategies, perhaps with some help from their own skill and wisdom. That is, they may have violated a basic rule in investing: "Never confuse brains and a bull market." Given the benefits of being on the "moving walkway" during this period, it seems to me it would have required really bad decision-making or really bad luck for a purchase of assets made with borrowed money to have been unsuccessful.

Will asset ownership be as profitable in the years ahead as in the 2009-21 period? Will leverage add as much to returns if interest rates don't decline over time or if the cost of borrowing isn't much below the expected rate of return on the assets purchased? Whatever the intrinsic merits of asset ownership and levered investment, one would think the benefits will be reduced in the years ahead. And merely riding positive trends by buying and levering may no longer be sufficient to produce success. In the new environment, earning exceptional returns will likely once again require skill in making bargain purchases and, in control strategies, adding value to the assets owned.

Lending, credit, or fixed income investing should be correspondingly better off. As I mentioned in my December memo, the 13 years in question were a difficult, dreary, low-return period for credit investors, including Oaktree. Most of the asset classes we operate in were offering the lowest prospective returns any of us had ever seen. The options were to (a) hold and accept the new lower returns, (b) reduce risk to prepare for the correction that the demand for higher returns would eventually bring, or (c) increase risk in pursuit of higher returns. Obviously, all of these had drawbacks. The bottom line was that it was quite challenging to safely and dependably pursue high returns in a low-return world like the one we were experiencing.

But now, higher prospective returns are here. In early 2022, high yield bonds (for example) yielded in the 4% range – not a very useful return. Today, they yield more than 8%, meaning these bonds have the potential to make a great contribution to portfolio results. The same is generally true across the entire spectrum of non-investment grade credit.

Asset Allocation Today

My thinking about the sea change materialized mostly as I was visiting clients last October and November. When I got home, I wrote the memo and began to discuss its thesis. And at the December meeting of a non-profit investment committee, I said the following:

Sell off the big stocks, the small stocks, the value stocks, the growth stocks, the U.S. stocks, and the foreign stocks. Sell the private equity along with the public equity, the real estate, the hedge funds, and the venture capital. Sell it all and put the proceeds into high yield bonds at 9%.

This institution needs to earn an annual return of 6% or so on its endowment, and I'm convinced that if it holds a competently assembled portfolio of 9% high yield bonds, it would be overwhelmingly likely to exceed that 6% target. But mine wasn't a serious suggestion, more a statement designed to evoke discussion of the fact that, thanks to the changes over the last year and a half, investors today can get equity-like returns from investments in credit.

The Standard & Poor's 500 Index has returned just over 10% per year for almost a century, and everyone's very happy (10% a year for 100 years turns $1 into almost $14,000). Nowadays, the ICE BofA U.S. High Yield Constrained Index offers a yield of over 8.5%, the CS Leveraged Loan Index offers roughly 10.0%, and private loans offer considerably more. In other words, expected pre-tax yields from non-investment grade debt investments now approach or exceed the historical returns from equity.

And, importantly, these are contractual returns. When I shifted from equities to bonds in 1978, I was struck by a major difference. With equities, the bulk of your return in the short or medium term depends on the behavior of the market. If Mr. Market's in a good mood, as Ben Graham put it, your return will benefit, and vice versa. With credit instruments, on the other hand, your return comes overwhelmingly from the contract between you and the borrowers. You give a borrower money up front; they pay you interest every six months; and they give you your money back at the end. And, to greatly oversimplify, if the borrower doesn't pay you as promised, you and the other creditors get ownership of the company via the bankruptcy process, a possibility that gives the borrower a lot of incentive to honor the contract. The credit investor isn't dependent on the market for returns; if the market shuts down or becomes illiquid, the return for the long-term holder is unaffected. The difference between the sources of return on stocks and bonds is profound, something many investors may understand intellectually but not fully appreciate.

It's been years since prospective returns on credit were competitive with those on equities. Now it's the case again. Should the non-profit whose board I sit on put all its money into credit instruments? Perhaps not. But Charlie Munger exhorts us to "invert," or flip questions like this. To me, this means allocators should ask themselves, "What are the arguments for not putting a significant portion of our capital into credit today?"

Here I'll mention that, over the years, I've seen institutional investors pay lip service to developments in markets and make modest changes in their asset allocation in response. When the early index funds outperformed active management in the 1980s, they said, "We've got that covered: We've moved 2% of our equities to an index fund." When emerging markets look attractive, the response is often to move another 2%. And from time to time, a client tells me they've put 2% in gold. But if the developments I describe really constitute a sea change as I believe – fundamental, significant, and potentially long-lasting – credit instruments should probably represent a substantial portion of portfolios . . . perhaps the majority.

What's the downside? How could this be a mistake?

- First, individual borrowers can default and fail to pay. It's the main job of the credit manager to weed out the non-payers, and history shows it can be done. Isolated defaults are unlikely to derail a well-selected and well-diversified portfolio. And if you're worried about a wave of defaults hitting your credit portfolio, think about what the implications of that environment would be for equities or other ownership assets.

- Second, by their nature, credit instruments don't have much potential for appreciation. Thus, it's entirely possible that equities and levered investment strategies will surprise on the upside and outperform in the years ahead. There's no denying this, but it should be borne in mind that the "downside risk" here consists of the opportunity cost of returns forgone, not failing to achieve the return one sought.

- Third, bonds and loans are subject to price fluctuations, meaning having to sell in a weak period could cause losses to be realized. But credit instruments are far from alone in this regard, and the magnitude of the fluctuations on "money-good" bonds and loans is constrained significantly by the magnetic "pull to par" exerted by the promise of repayment upon maturity.

- Fourth, the returns I've been talking about are nominal returns. If inflation isn't brought under control, those nominal returns could lose significant value when they're converted into real returns, which are what some investors care about most. Of course, real returns on other investments could suffer as well. Many people think of stocks and real estate as potentially providing inflation protection, but my recollection from the 1970s is that the protection typically takes hold only after prices have declined so as to provide higher prospective returns.

- Finally, the sea change could end up being less long-lasting than I expect, meaning the Fed takes the fed funds rate back down to zero or 1% and the yields on credit recede accordingly. Fortunately, by buying multi-year credit instruments, an investor can tie up the promised return for a meaningful period (assuming the investment provides some degree of call protection). Reinvesting will have to be dealt with upon maturity or call, but once you've made the credit investments I'm suggesting, you will at least have secured the promised yield – perhaps minus losses on defaults – for the term of the instruments.

* * *

The overarching theme of my sea-change thinking is that, largely thanks to highly accommodative monetary policy, we went through unusually easy times in a number of important regards over a prolonged period, but that time is over. There clearly isn't much room for interest rate declines from today's levels, and I don't think short-term interest rates will be as low in the coming years as in the recent past. For these and other reasons, I believe the years ahead won't be as easy. But while my expectations may prove correct, there's no evidence yet on which I can hang my hat. Why not? My answer is that the economy and markets are in the early stages of a transition that's far from complete.

Asset prices are established through a tug-of-war between buyers who think prices will rise and sellers who think they'll fall. There's been an active one over the last year or so as sentiment has waxed and waned regarding the outlook for inflation, recession, corporate profits, geopolitics, and especially a Fed pivot back to accommodation. The tug-of-war is ongoing, and, as a result, the S&P 500 is within a half percent of where it was a year ago.

I've been thinking lately about the fact that being an investor requires a person to be somewhat of an optimist. Investors have to believe things will work out and that their skill will enable them to wisely position capital for the future. Equity investors have to be particularly optimistic, as they have to believe someone will come along who'll buy their shares for more than they paid. My point here is that optimists surrender their optimism only grudgingly, and phenomena such as cognitive dissonance and self-delusion permit opinions to be held long after information to the contrary has arrived. This is among the reasons why they say of the stock market: "Things can take longer to happen than you thought they would, but then they happen faster than you thought they could." Today's sideways or "range-bound" market tells me investors possess a good amount of optimism despite the worries that have arisen. In the coming months, we'll find out if the optimism was warranted.

The positive forces that shaped the 2009-21 period began to change around 18 months ago. The higher inflation turned out not to be transitory. This brought on interest rate increases, concern that a recession would result, some resurrection of worry over the possibility of loss, and thus insistence on greater compensation for bearing risk. But while most people no longer see an outlook that's flawless, few think it's hopeless either. Just as optimism abetted a positive cycle in those 13 years, I believe a lessening of optimism will throw some sand into the financial gears in a variety of ways, some of which may be unforeseeable.

In this latter regard, it's essential to acknowledge that since we haven't lived through times exactly like the years that lie ahead – and since changes in the economic/financial environment limit the applicability of history – we're likely to encounter surprises. And if the environment is less favorable, the surprises are likely to be on the downside.

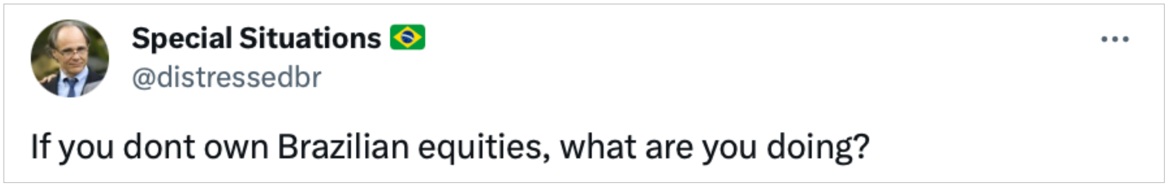
Please note, as mentioned earlier, that I'm absolutely not saying interest rates are going back to the high levels from which they've come. I have no reason to believe that the recession most people believe lies ahead will be severe or long-lasting. And with valuations high, but not terribly so, I don't think a stock market collapse can reasonably be predicted. This isn't a call for dramatically increased defensiveness. Mostly I'm just talking about a reallocation of capital, away from ownership and leverage and toward lending.

This isn't a song I've sung often over the course of my career. This is the first sea change I've remarked on and one of the few calls I've made for substantially increasing investment in credit. But the bottom line I keep going back to is that credit investors can access returns today that:

- are highly competitive versus the historical returns on equities,
- exceed many investors' required returns or actuarial assumptions, and
- are much less uncertain than equity returns.

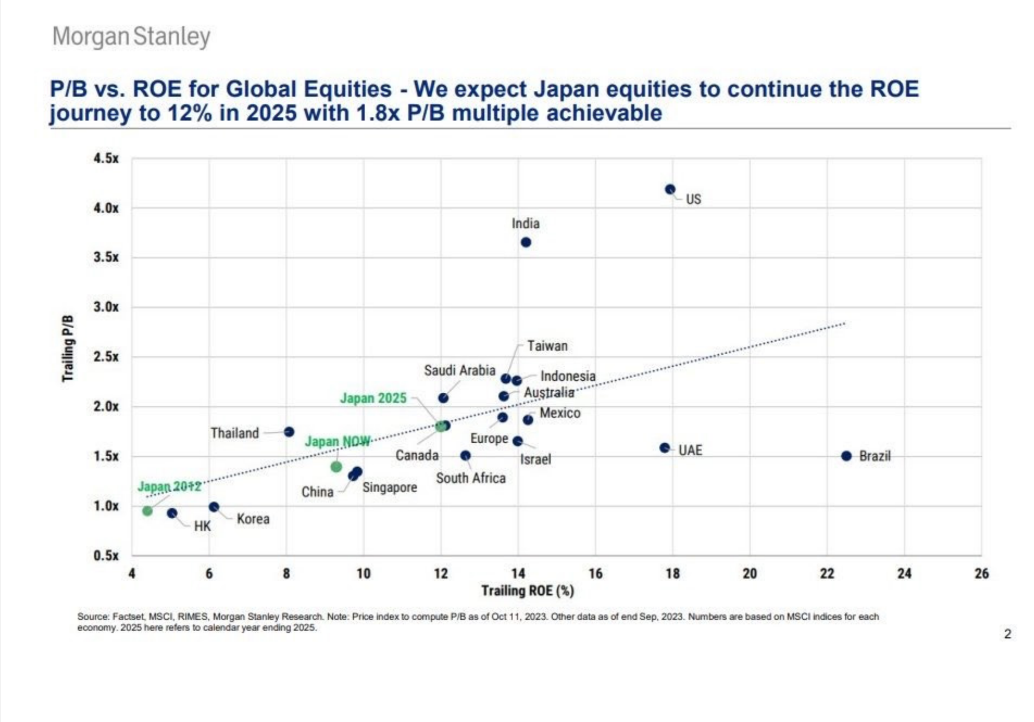
Unless there are serious holes in my logic, I believe significant reallocation of capital toward credit is warranted.

Brazilian stocks appear to be incredibly cheap (from Special Situations via X on October 18)...



Special Situations 🇧🇷
@distressedbr

If you dont own Brazilian equities, what are you doing?



Morgan Stanley

P/B vs. ROE for Global Equities - We expect Japan equities to continue the ROE journey to 12% in 2025 with 1.8x P/B multiple achievable

Source: Factset, MSCI, RIMES, Morgan Stanley Research. Note: Price index to compute P/B as of Oct 11, 2023. Other data as of end Sep, 2023. Numbers are based on MSCI indices for each economy. 2025 here refers to calendar year ending 2025.

2

Is it finally time to short Tesla... again? (from Motorhead via X on October 18)...

Motorhead
@BradMunchen

$TSLA Q3 operating margin only came in at 7.6% vs consensus of 9.6% and 17.2% in Q3 2022.

That's all you need to know about how bad things are at $TSLA.

4:08 PM · Oct 18, 2023 · **26.6K** Views

Bonds and Credit Markets

Sovereign/Government Bonds and Credit

Luke Gromen, founder of Forest for the Trees, joined the Forward Guidance podcast for a must-listen conversation on the current stress in the U.S. Treasury market (from Forward Guidance on September 28)...

You can watch and listen on YouTube via the timestamps below:

00:00 Introduction

24:37 Powell Is No Volcker - Luke Gromen

28:18 The Fed Has Broken The U.S. Energy Market

38:35 Will Demand Destruction Keep Oil Prices From Spiraling Out Of Control (Greater than $120)?

42:51 How Long Till The Fed Intervenes?

47:49 The Banking System

49:53 Not Worried About A U.S. Recession

53:06 High Interest Rates Deteriorate Financial Stability

57:44 Standing Repo Facility

01:05:00 Only Thing That Saves U.S. Fiscal Situation Is "Productivity Miracle"

01:07:26 The U.S. Is In An Argentina Situation

01:09:27 Luke Gromen's Views On Stocks

01:12:17 Gold & Bitcoin

01:16:55 U.S. Will Likely Maintain Status of World's Reserve Currency For A While

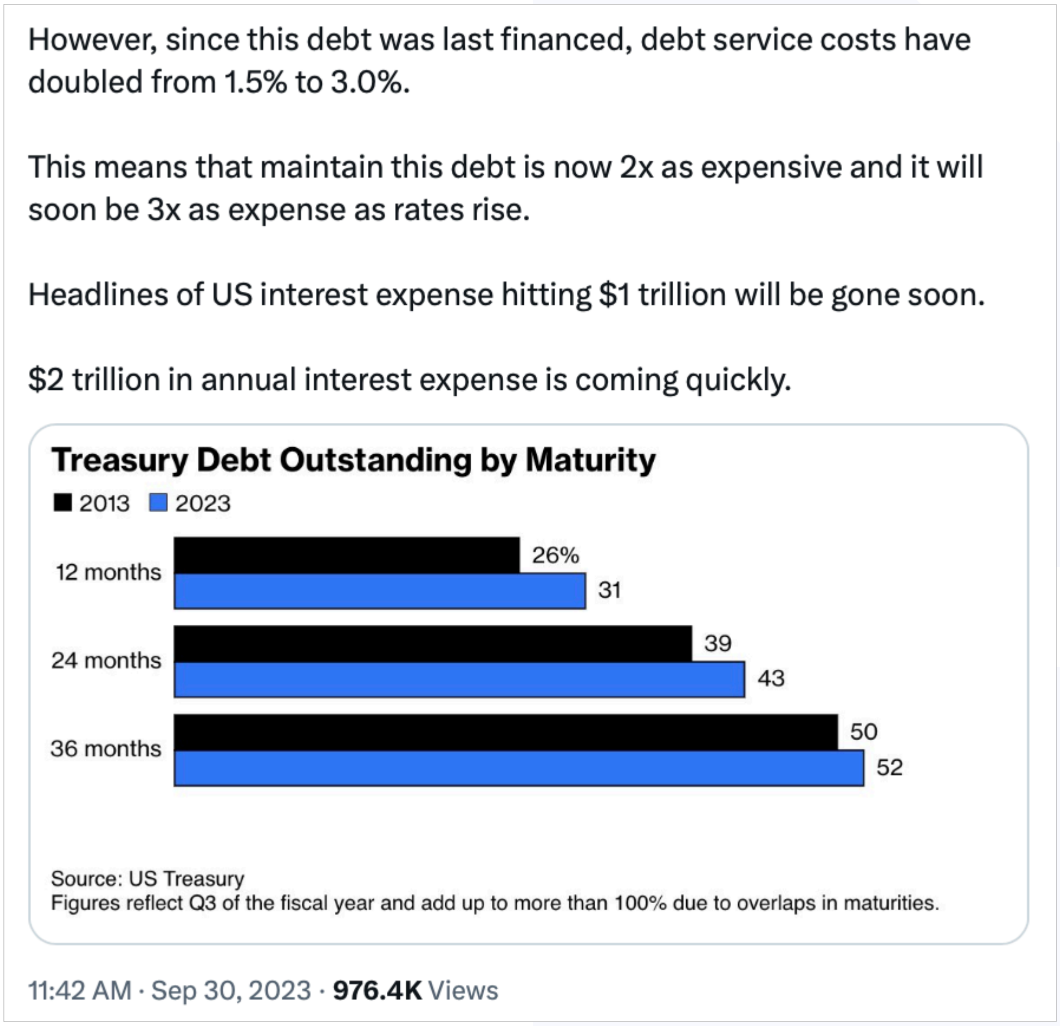
Nearly one-third of U.S. federal debt will need to be refinanced in the next 12 months (from The Kobeissi Letter on September 30)…

The Kobeissi Letter
@KobeissiLetter

Here's a topic that needs much more attention:

Nearly one-third of all outstanding US debt is set to mature over the next 12 months.

52% is set to mature over the next 36 months, meaning this debt needs to be refinanced.



However, since this debt was last financed, debt service costs have doubled from 1.5% to 3.0%.

This means that maintain this debt is now 2x as expensive and it will soon be 3x as expense as rates rise.

Headlines of US interest expense hitting $1 trillion will be gone soon.

$2 trillion in annual interest expense is coming quickly.

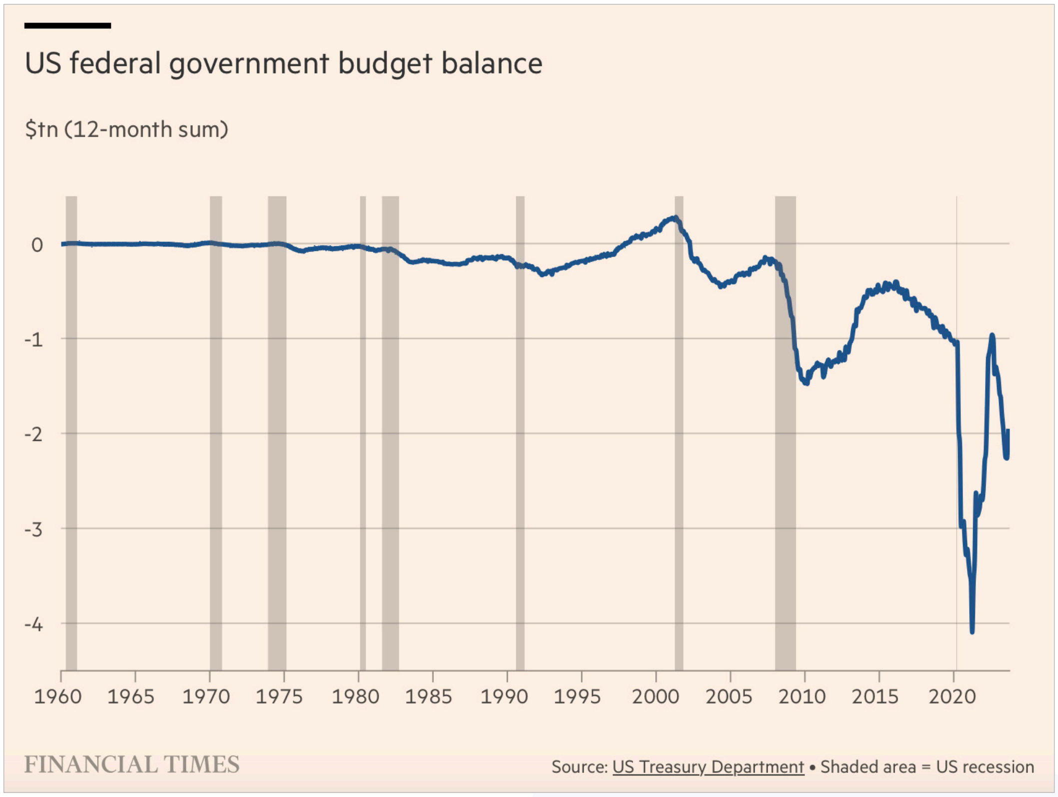
Treasury Debt Outstanding by Maturity

Source: US Treasury
Figures reflect Q3 of the fiscal year and add up to more than 100% due to overlaps in maturities.

11:42 AM · Sep 30, 2023 · **976.4K** Views

Veteran investment strategist Ed Yardeni warns the "bond vigilantes" are back (from *The Financial Times* on October 4)...

> I graduated from Yale University's PhD programme in economics six years after Janet Yellen did so in 1971. We both studied under Nobel laureate Professor James Tobin. Nevertheless, she is a liberal and I am a conservative when it comes to economic policymaking. I coined the phrase "bond vigilantes" four decades ago. Now, as the US Treasury secretary, Yellen should be very worried that the vigilantes will upend the best-laid plans of her boss, president Joe Biden, which she wholeheartedly endorsed and promoted.
>
> I first wrote about the bond vigilantes on July 27, 1983 as follows: "So if the fiscal and monetary authorities won't regulate the economy, the bond investors will. The economy will be run by vigilantes in the credit markets."
>
> Currently, monetary policy has been on the right course, with the Federal Reserve focusing on fighting inflation, which soared in 2021 and 2022 after Yellen's Treasury department provided a third round of pandemic relief cheques to millions of Americans in early 2021. That fuelled a consumer buying binge that was already under way in response to the first two rounds of cheques under the Trump administration during 2020. The buying binge caused prices to soar.
>
> The Fed reversed course in early 2022 and aggressively tightened monetary policy to fight inflation. That same year, the Biden administration succeeded in enacting fiscal spending programmes that significantly worsened the projections for the federal budget over the next 10 years. Nevertheless, the deficit narrowed briefly during 2022 and early 2023 because individual income tax receipts were bolstered by taxes on capital gains when lots of investors sold their shares during last year's bear market.
>
> This year, inflation caused the government's outlays on social security to rise more rapidly since they are indexed to inflation. More worrisome is that the Fed's interest rate increases in response to inflation are causing the Treasury's outlays on net interest to soar. Meanwhile, tax revenues have turned down following last year's temporary windfall. So the federal deficit has ballooned to $2tn over the past 12 months through August.
>
> And now the spending binge under Bidenomics is about to kick in. Needless to say, the Treasury secretary and I can debate whether the administration's Inflation Reduction Act is a misnomer. But there's no debating that the rising deficit will require the Treasury department to issue lots more Treasury securities.
>
> In recent weeks, the bond vigilantes have been challenging Yellen's policies by raising bond yields to levels that threaten to create a debt crisis. In this scenario, higher yields crowd out the private sector and trigger a credit crunch and a recession. Since the root cause of the problem is profligate fiscal policy, the government would have to cut outlays and boost taxes to placate the bond vigilantes, which would exacerbate the recession.

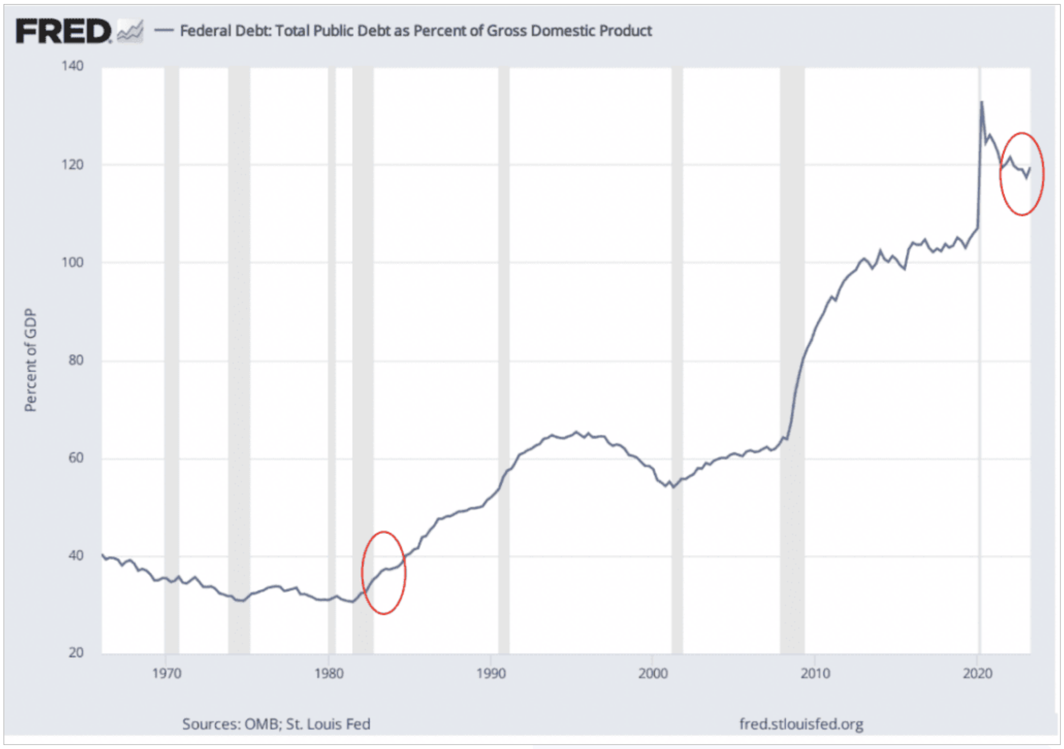


Source: US Treasury Department • Shaded area = US recession

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

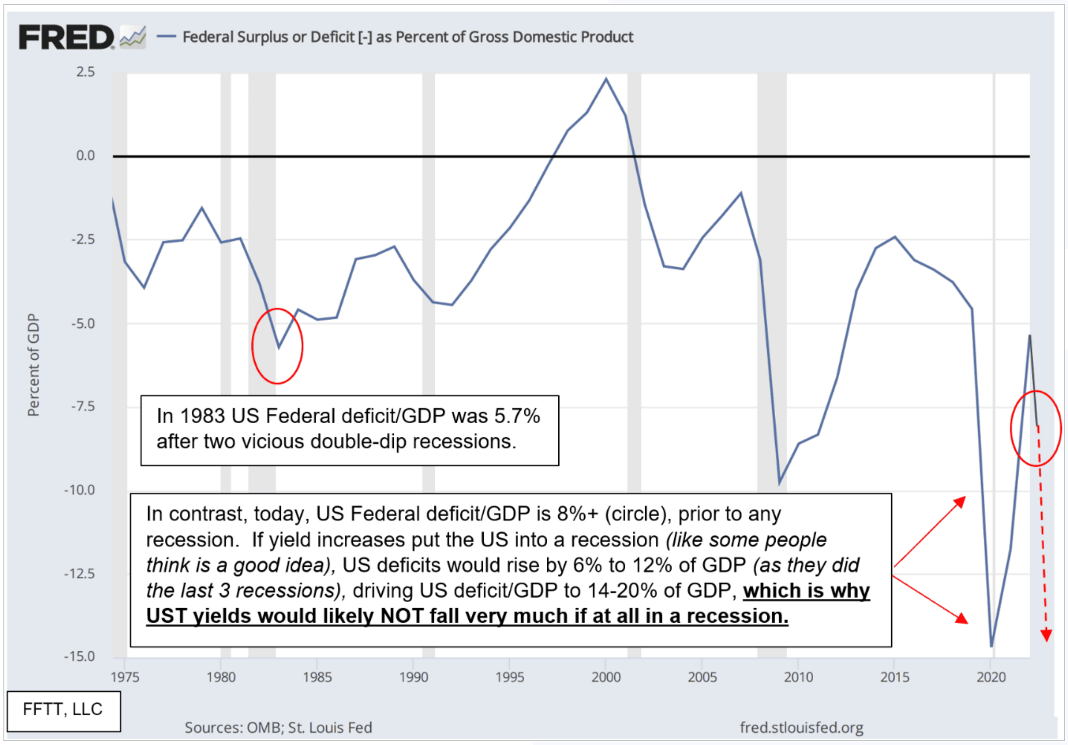
But Treasury-market risks today appear far greater than they were when Yardeni coined the term four decades ago ([from Luke Gromen via FFTT Tree Rings on October 6]())...

> Ed Yardeni's op-ed in the FT is an important signpost: **Credible, mainstream analysts are starting to see the US Treasury feedback loop/debt spiral, and the mainstream financial media is starting to report on it. However, they do not appear to realize two critical things yet:**
>
> 1. **The current set up is VERY different than the 1983 timeframe that Yardeni references.**
>
> 2. **The only thing preventing the bond market from the debt spiral was the very inflation the Fed has been fighting** *(i.e., positive real interest rates at 120% debt/GDP and 8%+ of GDP deficits is mathematically certain to trigger a debt spiral – the only question is how long it will take for that debt spiral to occur.)*
>
> With all due respect to Yardeni, things are WAY different than 1983. Here's US debt/GDP with 1983 and 2023 circled:



Sources: OMB; St. Louis Fed fred.stlouisfed.org

Here's the US Federal deficit/GDP, now v. 1983, with the red dotted line showing a median case recession:



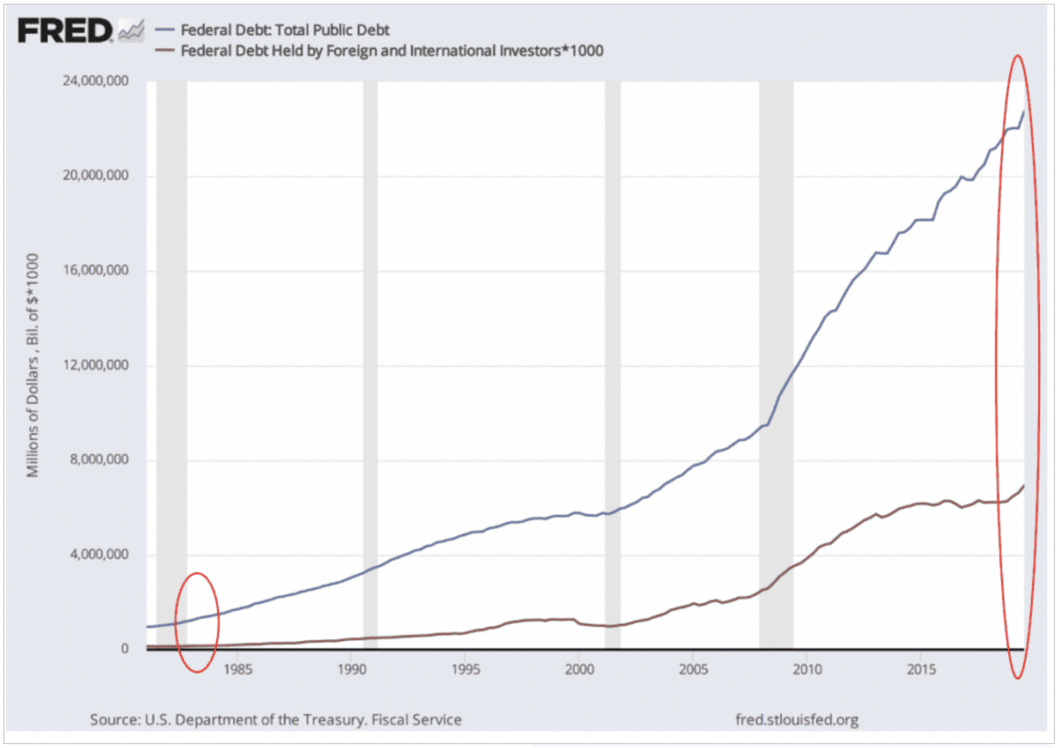
In 1983 US Federal deficit/GDP was 5.7% after two vicious double-dip recessions.

In contrast, today, US Federal deficit/GDP is 8%+ (circle), prior to any recession. If yield increases put the US into a recession *(like some people think is a good idea),* US deficits would rise by 6% to 12% of GDP *(as they did the last 3 recessions),* driving US deficit/GDP to 14-20% of GDP, **which is why UST yields would likely NOT fall very much if at all in a recession.**

FFTT, LLC

Sources: OMB; St. Louis Fed fred.stlouisfed.org

Here's total US Federal debt (blue) and the share of US Federal debt held by foreigners (red)…



Source: U.S. Department of the Treasury. Fiscal Service

Here's the US [Net International Investment Position], with block green arrows for 1983 and today.

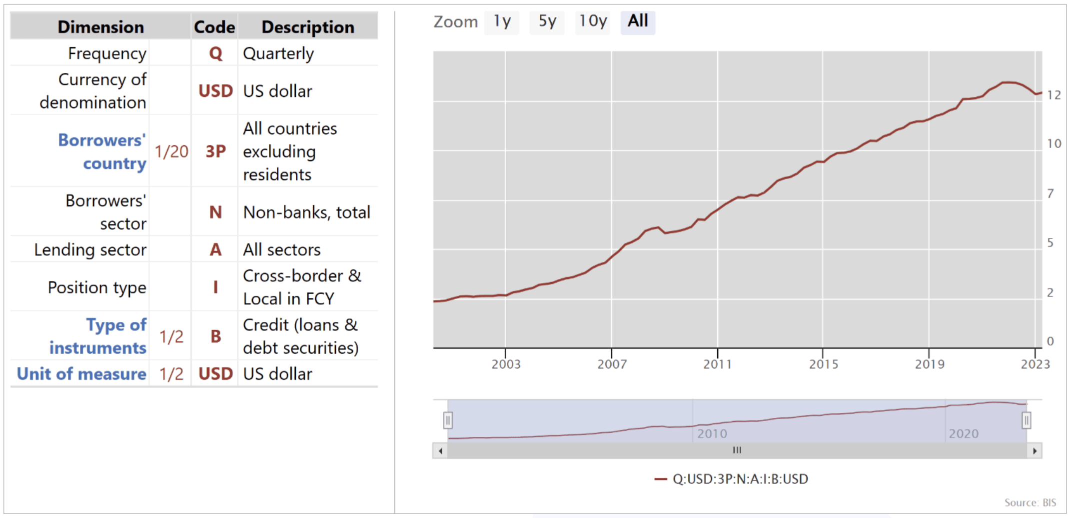
In short, **the US NIIP was POSITIVE in 1983, so the bond vigilantes would not and could not trigger a UST feedback loop… with US NIIP at negative 65% of GDP, now they can, and they are:**

Sources: Federal Reserve, FFTT

Running the "USD Wrecking Ball" with US NIIP at-50% to -70% of US GDP (2018-present) has repeatedly proven to be a VERY different proposition than running it with US NIIP at -20% to +10% of GDP (1976-2012). Most investors are still operating on a first principles basis as if US NIIP is like it was 1976-2012, rather than how it is now.

Foreigners are not "short USDs", because they are net long $18T in USD assets - including $7.5T in USTs - and they will sell those assets aggressively to raise USDs if needed.

And here is offshore USD-denominated debt from 2000-2023…we don't know what it was in 1983, but it was likely de minimus v. $13T now:



Dimension		Code	Description
Frequency		Q	Quarterly
Currency of denomination		USD	US dollar
Borrowers' country	1/20	3P	All countries excluding residents
Borrowers' sector		N	Non-banks, total
Lending sector		A	All sectors
Position type		I	Cross-border & Local in FCY
Type of instruments	1/2	B	Credit (loans & debt securities)
Unit of measure	1/2	USD	US dollar

Source: BIS Statistics: time-series details Q:USD:3P:N:A:I:B:USD

Here are the implications of these charts showing critical differences now v. in 1983:

1. In 1983, foreigners did not own enough USD assets to crash the UST market; they do now.

2. In 1983, foreigners did not have enough USD-denominated debt that would FORCE them to crash the UST market in their scramble for USDs; they do now.

3. In 1983, US debt/GDP was not high enough that a crash in the UST market would threaten the solvency of the US government itself unless the Fed printed whatever money was needed to finance the US government; this time it is.

The discussion of the UST feedback loop by Yardeni in the FT is an important signpost; next up will be the broader mainstream recognition of points numbers 1-3 above.

Learn more about FFTT Tree Rings here.

Why U.S. Treasury “term premium” is now rising (from *The Financial Times* on October 9)...

Unhedged has written several times about the rising term premium, an important, and concerning, attribute of the recent sell-off in long bonds. The term premium is the extra dollop of yield investors get for holding long-dated Treasuries, as compensation for taking on interest rate risk. Think of it as the difference in yield between a 10-year Treasury and rolling over the expected one-year rate 10 times over a decade.

Because the term premium can’t be observed, it is estimated. The main two methods both involve running regression models on different parts of the yield curve. One approach (called the ACM model, after its authors’ names) does so only using data on yields, and the other (the K&W model) mixes yields data with forecaster expectations of short-term rates. Results sometimes differ, but lately both approaches have told the same story. The term premium appears to be positive for the first time since 2017:


Premium paper

Standard estimates of the 10-year Treasury term premium, %

Source: Bloomberg

© FT

If the term premium reverted to its 30-year average, it could add something like 80 basis points to the 10-year yield, leaving it not far from 6 per cent. The ACM and K&W models may even be too sanguine on how far the term premium could increase, says Michael Howell of CrossBorder Capital.

So it matters why the term premium is rising right now. On Friday, we came up with several potential reasons, and over the weekend readers chipped in a few more (we’ve tried to keep them distinct but there is some overlap):

Expected rate volatility is higher, perhaps because expected inflation volatility is higher. Strong economic growth, (some) signs of sticky inflation and a Fed insisting on higher for longer all cloud the rate outlook. There is also the live possibility of structurally higher volatility in inflation, such as from climate-related supply disruptions or geopolitical flare-ups. Investors will want compensation for that volatility. “If there’s less certainty around long-term rates, that deserves more of a term premium,” says Gordon Shannon, investment grade portfolio manager at TwentyFour Asset Management.

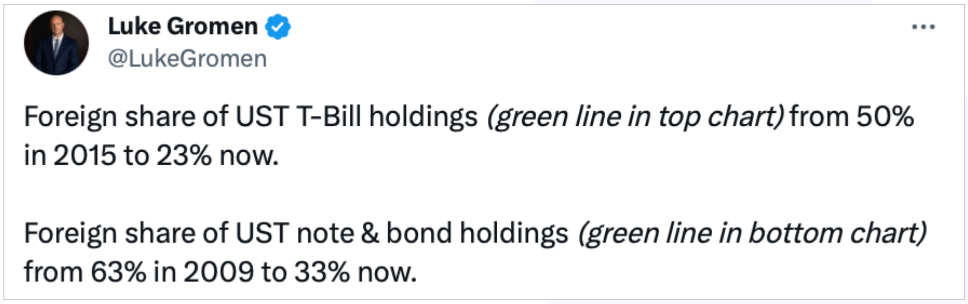
Uncertainty around US solvency and/or political stability is higher. In its US sovereign credit downgrade in August, Fitch blamed “a steady deterioration in standards of governance”, raising fears that political dysfunction might someday cause a missed bond repayment. As an explanation for a higher term premium, this is hard to believe. Given the global appetite for safe assets, as investments and as collateral, plus the US’s singular role in producing loads of them, the Treasury market is too big to fail. Unless and until a payment actually is missed, investors will probably look through hypothetical US credit risk.

Treasury supply has risen sharply, and will keep rising. Extraordinary peacetime fiscal deficits require extraordinary bond issuance. As our colleagues Kate Duguid and Mary McDougall report, net Treasury issuance so far this year is already the second-highest on record, though well short of the record Treasury flood in 2020. After some surprisingly chunky bond auctions in the third quarter, many market-watchers expect supply to continue growing fast next year.

Foreign Treasury demand is not rising. At least, not at a pace that can offset the surge in supply...

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

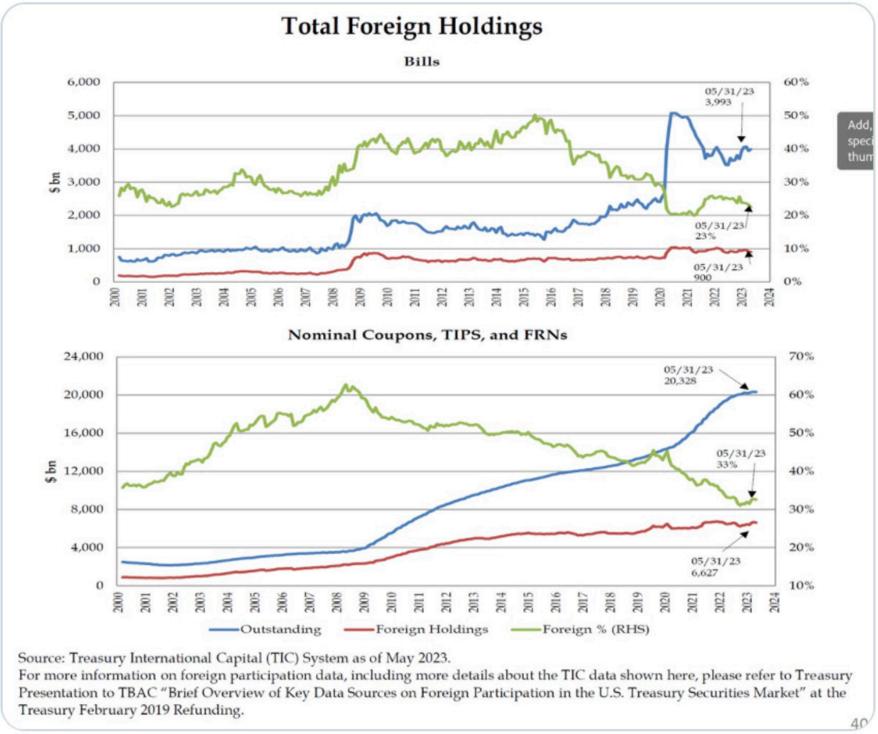
Foreign holdings of U.S. Treasury debt has fallen significantly over the past several years ([from Luke Gromen via X on October 17](#))...



Luke Gromen
@LukeGromen

Foreign share of UST T-Bill holdings *(green line in top chart)* from 50% in 2015 to 23% now.

Foreign share of UST note & bond holdings *(green line in bottom chart)* from 63% in 2009 to 33% now.



Source: Treasury International Capital (TIC) System as of May 2023.
For more information on foreign participation data, including more details about the TIC data shown here, please refer to Treasury Presentation to TBAC "Brief Overview of Key Data Sources on Foreign Participation in the U.S. Treasury Securities Market" at the Treasury February 2019 Refunding.

8:24 AM · Oct 17, 2023 · **176.2K** Views

Hedge-fund manager Bill Ackman announced he closed his widely touted short position in U.S. Treasury bonds earlier this week (from Barchart via X on October 23)...

Barchart
@Barchart

JUST IN 🚨: Hedge Fund Manager Bill Ackman has covered his short treasury bond position

Bill Ackman
@BillAckman

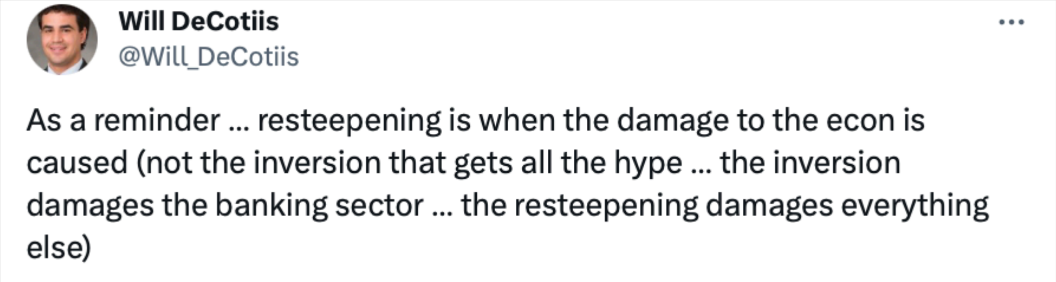
We covered our bond short.

8:45 AM · Oct 23, 2023 · **54.3K** Views

84 212 668

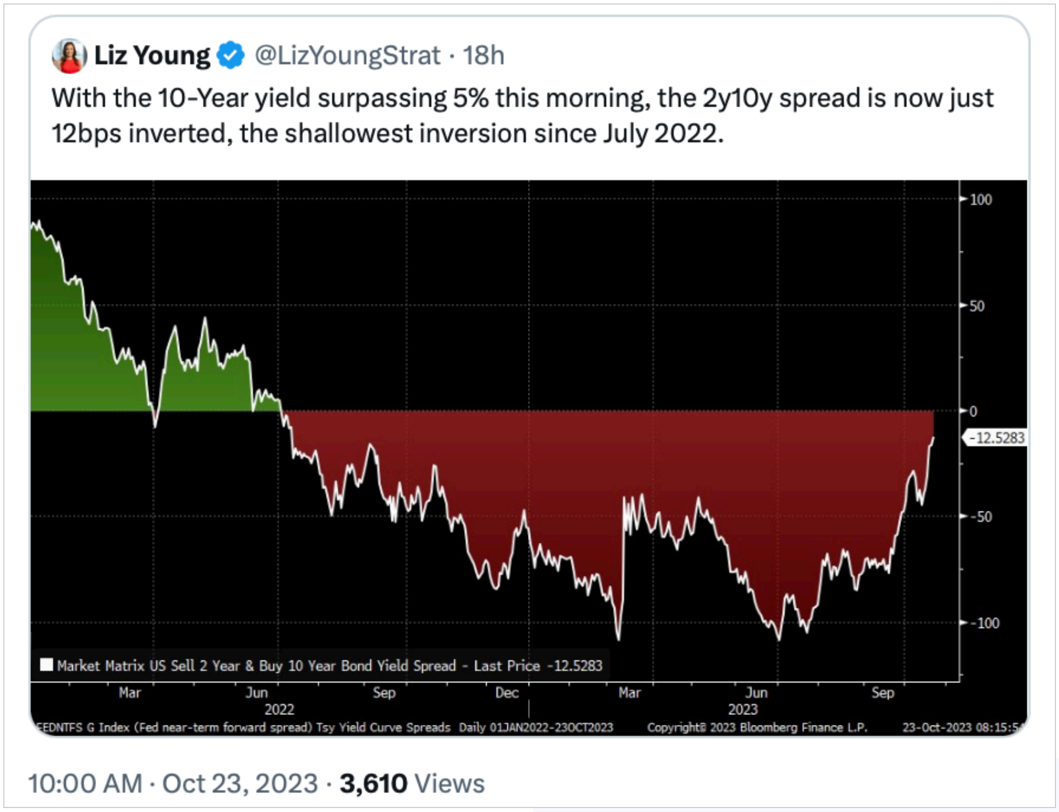
9:54 AM · Oct 23, 2023 · **163.5K** Views

The Treasury yield curve is dangerously close to "un-inverting," which has historically been a negative omen for the markets and the economy (from Will DeCotiis via X on October 23)...



Will DeCotiis
@Will_DeCotiis

As a reminder ... resteepening is when the damage to the econ is caused (not the inversion that gets all the hype ... the inversion damages the banking sector ... the resteepening damages everything else)



Liz Young @LizYoungStrat · 18h

With the 10-Year yield surpassing 5% this morning, the 2y10y spread is now just 12bps inverted, the shallowest inversion since July 2022.

10:00 AM · Oct 23, 2023 · **3,610** Views

Corporate Bonds and Credit

The number of large corporate bankruptcies surged in the first half of the year (from Cornerstone Research via JDSupra on October 4)...

> Increase in large corporate bankruptcy filings driven by companies in retail trade, services, and manufacturing.
>
> The increase in large corporate bankruptcies in the first half of 2023 marked a reversal from a gradual decline in filings since the start of 2021, according to a report released today by Cornerstone Research.
>
> The report, Trends in Large Corporate Bankruptcy and Financial Distress—Midyear 2023 Update, found that the number of bankruptcies filed by public and private companies with over $100 million in assets increased during the first half of 2023 to 72 filings, already surpassing the 53 bankruptcy filings in 2022. While the number of bankruptcies increased, the average assets at the time of filing, $780 million, were well below the 2005–2022 average of $2.05 billion and the 2022 average of $1.62 billion.
>
> Retail Trade, Services, and Manufacturing saw the most notable increases in bankruptcy filings in the first half of the year, while Mining, Oil, and Gas continued to decline. Manufacturing has already seen nearly twice as many bankruptcies as in the previous year (24 filings in 1H 2023 compared to 13 in 2022) and accounted for 33% of all bankruptcies filed in the first half of 2023.
>
> "The surge in large corporate bankruptcy filings in the first half of 2023 is consistent with economic conditions posing heightened bankruptcy risk for highly leveraged companies," said Matt Osborn, a principal at Cornerstone Research and coauthor of the report. "Along with a general rise in interest rates, credit spreads for highly leveraged corporate issuers compared to investment grade issuers began widening in mid-2022, a shift that generally persisted into the first half of 2023."
>
> The number of mega bankruptcies, those filed by companies with over $1 billion in reported assets, also increased. In the first half of 2023, the number of mega bankruptcies already matched the full-year total for 2022 of 16 and surpassed the 2005–2022 half-year average of 11. The largest bankruptcy was filed by SVB Financial Group, with $19.68 billion in assets at the time of filing. The largest non-financial-firm bankruptcy filing was by Bed Bath & Beyond Inc., with $4.40 billion in assets at the time of filing. Six mega bankruptcies were filed by companies in the Services industry.

Continue reading here.

Most corporate borrowers have yet to feel the full burden of higher rates (from Joseph Wang via X on October 10)...

> Good chart from [Fed Vice Chair] Jefferson's latest speech showing how many corporate borrowers have yet to feel higher rates.
>
> https://www.federalreserve.gov/newsevents/speech/jefferson20231009a.htm

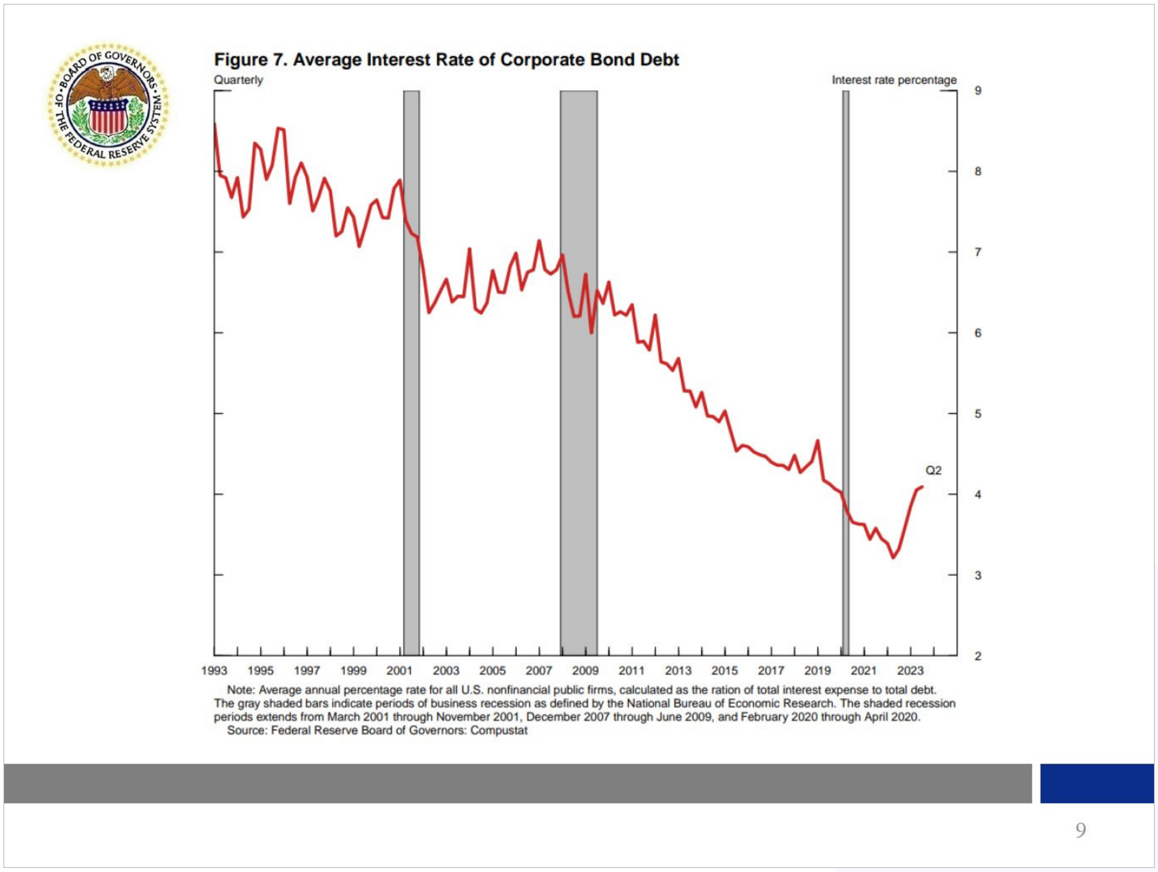


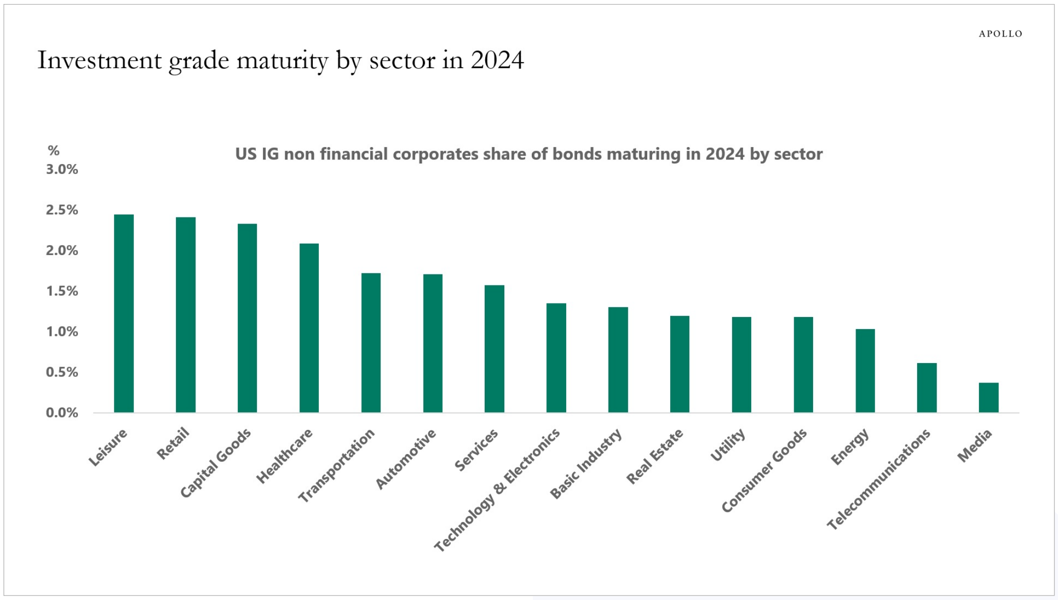
Figure 7. Average Interest Rate of Corporate Bond Debt

Note: Average annual percentage rate for all U.S. nonfinancial public firms, calculated as the ration of total interest expense to total debt. The gray shaded bars indicate periods of business recession as defined by the National Bureau of Economic Research. The shaded recession periods extends from March 2001 through November 2001, December 2007 through June 2009, and February 2020 through April 2020.

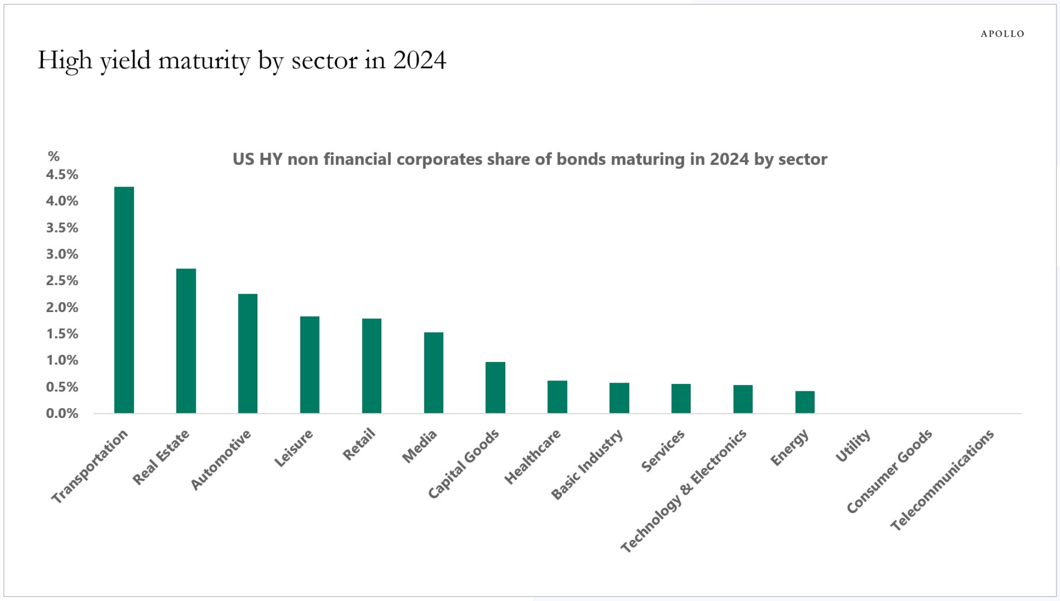
Source: Federal Reserve Board of Governors: Compustat

Here's a breakdown of the 2024 corporate debt "maturity wall" by sector (from Torsten Sløk via The Daily Spark on October 12)...

> The sectors that have higher refinancing needs in 2024 are Leisure, Retail, and Capital Goods in investment grade. And Transportation, Real Estate, and Autos in high yield, see charts below.



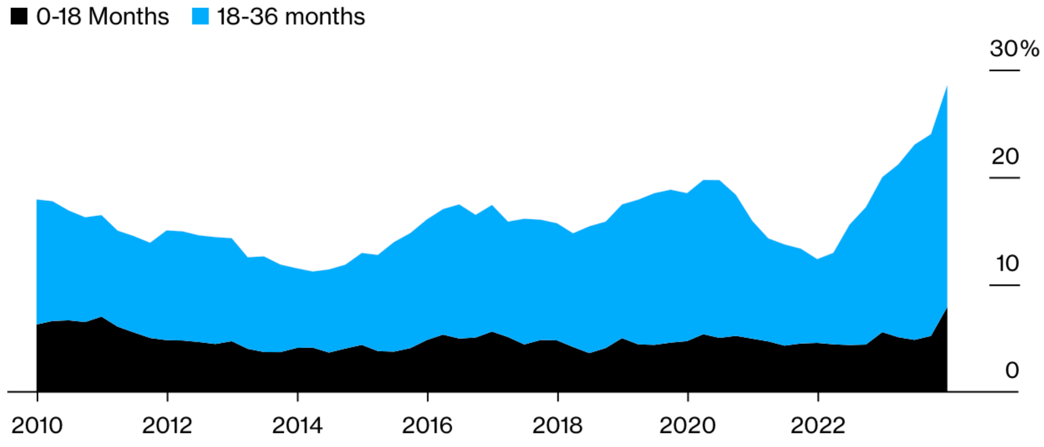
Source: ICE BofA, Bloomberg, Apollo Chief Economist



Source: ICE BofA, Bloomberg, Apollo Chief Economist

A huge wave of junk debt is coming due in the next few years (from *Bloomberg* on October 20)...

> US junk bond issuers are poised to unleash a new wave of refinancing activity after back-to-back years of low volume, as the share of debt with near-term maturities climbs to the highest level in over a decade.
>
> The amount of outstanding junk bonds set to mature in 18 to 36 months has soared to levels last seen in 2007, Goldman Sachs Group Inc. strategists including Lotfi Karoui wrote in a note. The figure stands at 19% of the total high-yield market as of the quarter ending Sept. 30, compared to 13% during the year-ago quarter and 9% over the same quarter in 2021.
>
> The growing near-term maturity wall as well as deteriorating balance sheet liquidity are likely to push corporations to issue fresh debt, even as borrowing costs remain elevated, according to the Goldman Sachs strategists. The spread on Bloomberg's US Corporate High Yield Bond Index stood at 423 basis points on Thursday, nearly 60 basis points wider than the lowest level this year of 366 basis points in early September.
>
> "It's kind of like an arm wrestling match," said Bob Kricheff, portfolio manager at Shenkman Capital Management. "They're trying to time the market — which we all know is difficult — on rates, versus being prudent and saying, 'I don't want this to become a current debt. I want to retire it a year before it matures. Let me bite the bullet and take it out now'."
>
> "That's why you're seeing people attacking 2024, 2025 and even 2026 maturities with some of these issues," he added.



The Near-Term Maturity Wall Grows

The share of outstanding junk bonds maturing in 18-36 months has reached its highest level since 2007

Sources: Bloomberg, Goldman Sachs Global Investment Research

Continue reading here (subscription may be required).

The gap between corporate credit spreads and yields hasn't been this wide since just before the Great Financial Crisis (from Torsten Sløk via The Daily Spark on October 21)...

Higher credit yields increase corporate capital costs.

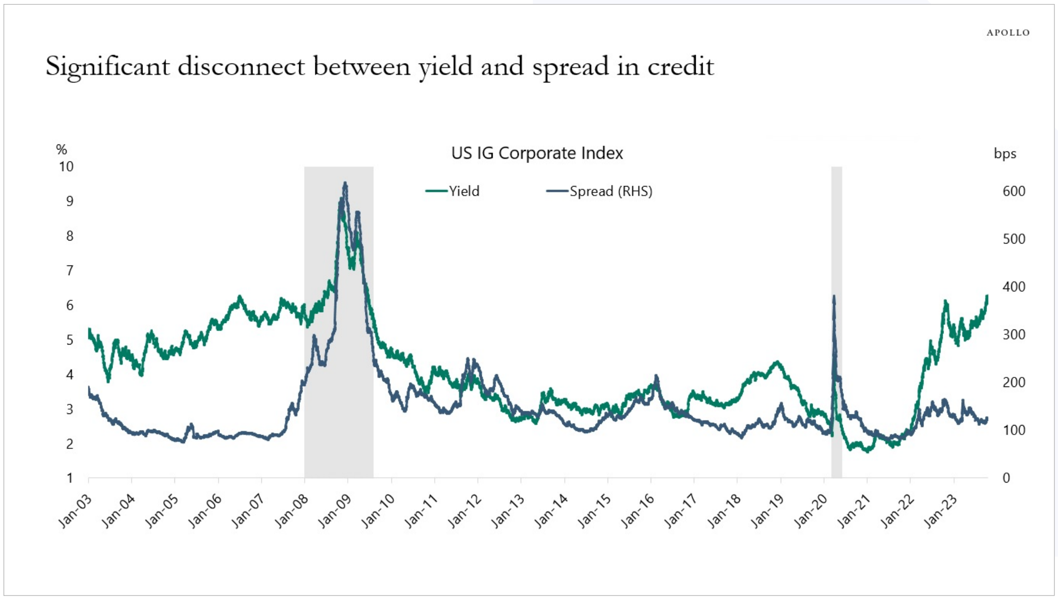
And higher cost of capital puts pressure on coverage ratios and corporate profitability.

With lower coverage ratios and lower profitability, credit risks increase, and the result is that credit spreads should go wider.

That is, however, not what is happening at the moment. **The current disconnect between credit yield levels and credit spreads is significant, see chart below.**

Maybe what is happening today is similar to what happened from 2003 to 2007, when yield levels kept increasing and spreads stayed very tight, see again chart below. Only when the economic data started weakening did credit spreads begin to widen.

With the Fed trying to cool down the economy to fight inflation, the risks are that credit spreads will widen once the Fed succeeds with pushing the unemployment rate higher.


Significant disconnect between yield and spread in credit

Consumer Credit

Credit-card default rates are soaring at smaller banks (from Game of Trades via X on September 27)...

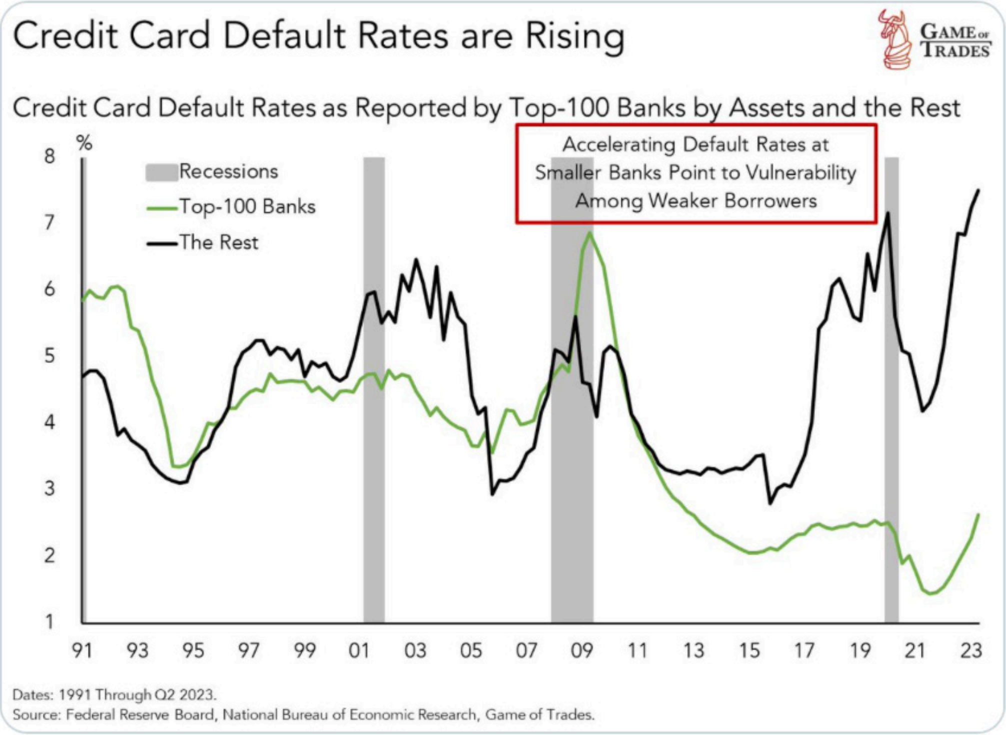
Game of Trades
@GameofTrades_

Credit card default rate has been rising rapidly:

Top 100 banks - 2.45%

The rest - 7.51%, highest level on record

This could get worse as interest rates continue to remain high



Credit Card Default Rates are Rising

Credit Card Default Rates as Reported by Top-100 Banks by Assets and the Rest

Accelerating Default Rates at Smaller Banks Point to Vulnerability Among Weaker Borrowers

Dates: 1991 Through Q2 2023.
Source: Federal Reserve Board, National Bureau of Economic Research, Game of Trades.

10:00 AM · Sep 27, 2023 · **52.2K** Views

Data show American consumers were still "spending like there's no tomorrow" through the summer (from *The Wall Street Journal* on October 1)...

> Consumers should be spending less by now.
>
> Interest rates are up. Inflation remains high. Pandemic savings have shrunk. And the labor market is cooling.
>
> Yet household spending, the primary driver of the nation's economic growth, remains robust. Americans spent 5.8% more in August than a year earlier, well outstripping less than 4% inflation. And the experience economy boomed this summer, with Delta Air Lines reporting record revenue in the second quarter and Ticketmaster selling over 295 million event tickets in the first six months of 2023, up nearly 18% year-over-year.
>
> Economists and financial advisers say consumers putting short-term needs and goals above long-term ones is normal. Still, this moment is different, they say.
>
> A tough housing market has more consumers writing off something they'd historically save for, while the pandemic showed the instability of any long-term plans related to health, work or day-to-day life. So, they are spending on once-in-a-lifetime experiences because they worry they may not be able to do them later.
>
> "It's not a regret-filled, spur-of-the-moment decision," says Michael Liersch, who oversees a team of advisers as head of advice at Wells Fargo. "It's the opposite of that, where I would regret not having done it."
>
> Liersch cautions that it's too soon to say whether the spate of spending is a fleeting moment or a new normal. And consumers remain frustrated about inflation as the price of many goods remains significantly higher than a few years ago.

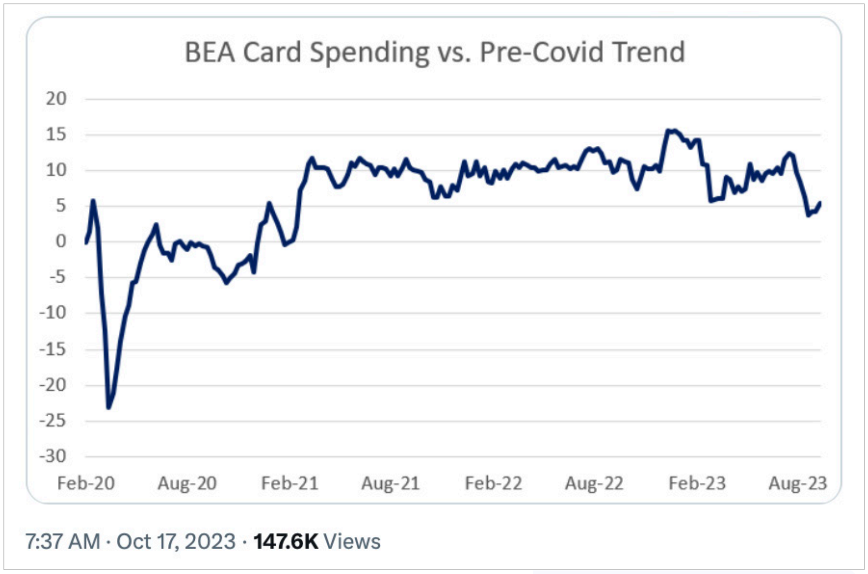
Continue reading here (subscription may be required).

However, there are some signs that consumer spending is beginning to weaken (from Bob Elliott via X on October 17)...

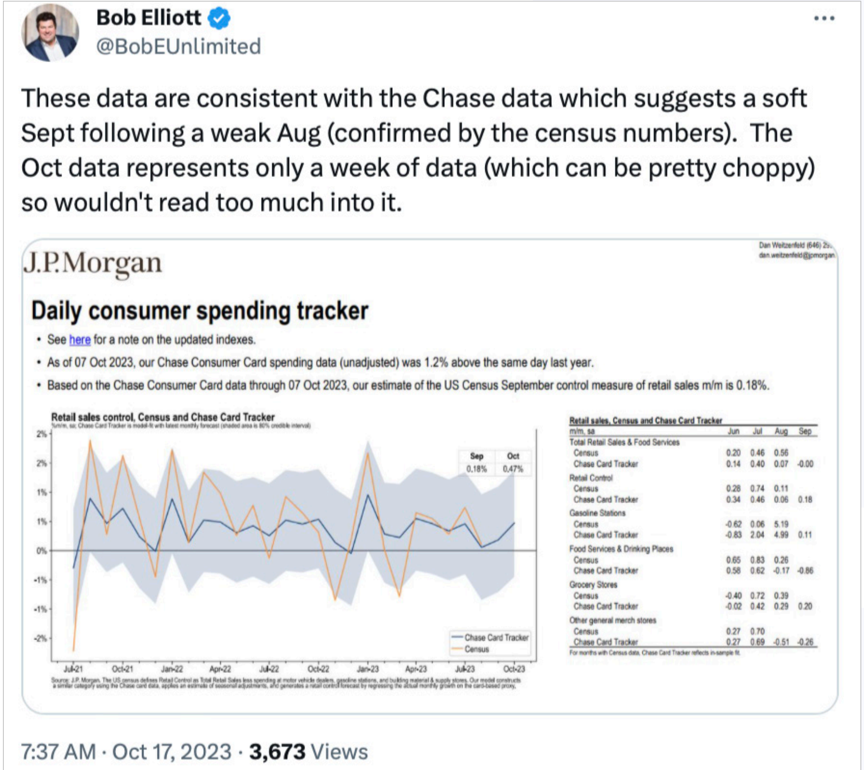
Bob Elliott
@BobEUnlimited

There are increasing signs that the US consumer is rolling over.

Spending was soft in Sept after a weak Aug. Confidence measures are rolling over. BEA card data shows it well, a leg down in Mar and again in Aug/Sept in spending vs. trend:



7:37 AM · Oct 17, 2023 · **147.6K** Views



Bob Elliott
@BobEUnlimited

These data are consistent with the Chase data which suggests a soft Sept following a weak Aug (confirmed by the census numbers). The Oct data represents only a week of data (which can be pretty choppy) so wouldn't read too much into it.

J.P.Morgan

Dan Weitzenfeld (646) 2
dan.weitzenfeld@jpmorgan

Daily consumer spending tracker

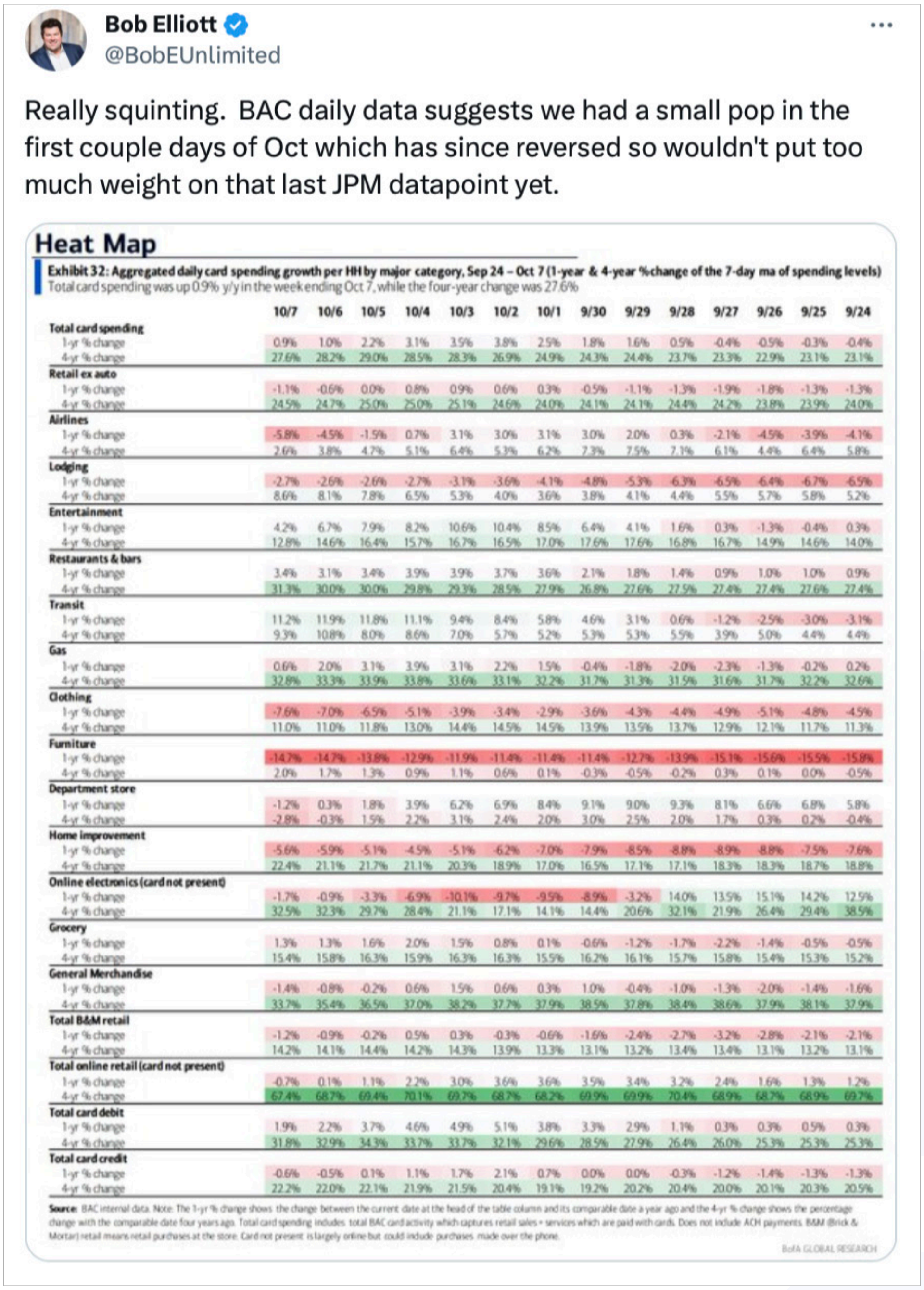
- See here for a note on the updated indexes.
- As of 07 Oct 2023, our Chase Consumer Card spending data (unadjusted) was 1.2% above the same day last year.
- Based on the Chase Consumer Card data through 07 Oct 2023, our estimate of the US Census September control measure of retail sales m/m is 0.18%.

Retail sales, Census and Chase Card Tracker

m/m, sa	Jun	Jul	Aug	Sep
Total Retail Sales & Food Services				
Census	0.20	0.46	0.56	
Chase Card Tracker	0.14	0.40	0.07	-0.00
Retail Control				
Census	0.28	0.74	0.11	
Chase Card Tracker	0.34	0.46	0.06	0.18
Gasoline Stations				
Census	-0.62	0.06	5.19	
Chase Card Tracker	-0.83	2.04	4.99	0.11
Food Services & Drinking Places				
Census	0.65	0.83	0.26	
Chase Card Tracker	0.58	0.62	-0.17	-0.86
Grocery Stores				
Census	-0.40	0.72	0.39	
Chase Card Tracker	-0.02	0.42	0.29	0.20
Other general merch stores				
Census	0.27	0.70		
Chase Card Tracker	0.27	0.69	-0.51	-0.26

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

7:37 AM · Oct 17, 2023 · **3,673** Views



Bob Elliott
@BobEUnlimited

Really squinting. BAC daily data suggests we had a small pop in the first couple days of Oct which has since reversed so wouldn't put too much weight on that last JPM datapoint yet.

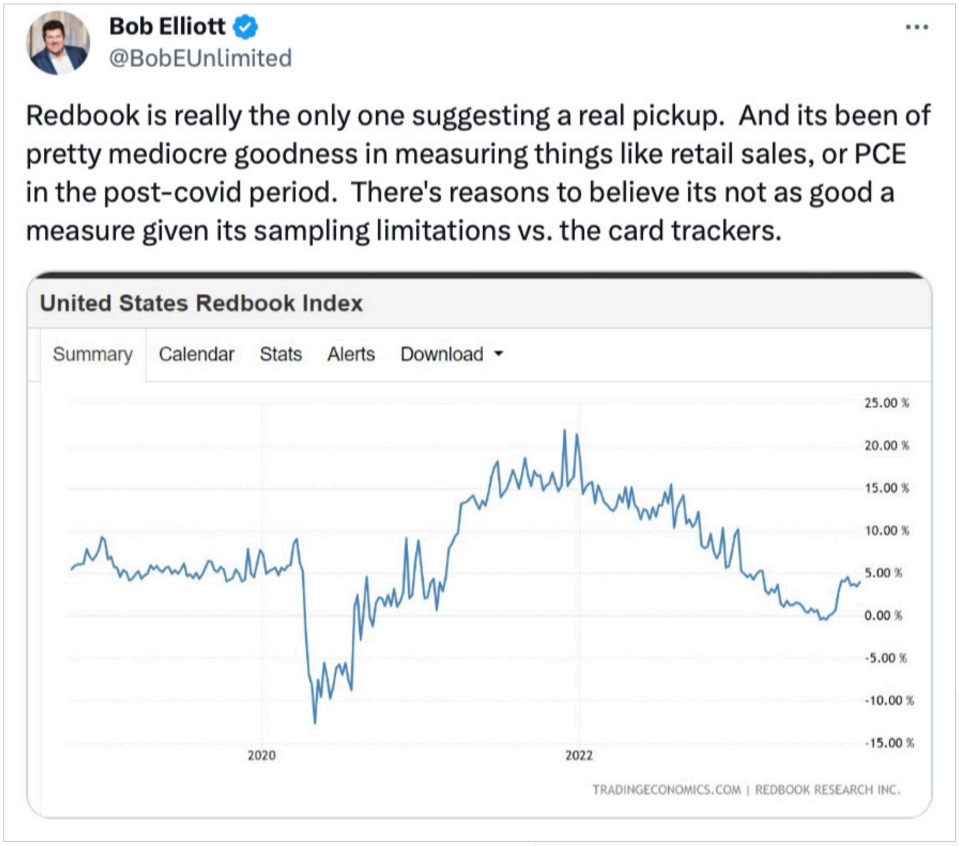
Heat Map

Exhibit 32: Aggregated daily card spending growth per HH by major category, Sep 24 – Oct 7 (1-year & 4-year %change of the 7-day ma of spending levels)
Total card spending was up 0.9% y/y in the week ending Oct 7, while the four-year change was 27.6%

	10/7	10/6	10/5	10/4	10/3	10/2	10/1	9/30	9/29	9/28	9/27	9/26	9/25	9/24
Total card spending														
1-yr % change	0.9%	1.0%	2.2%	3.1%	3.5%	3.8%	2.5%	1.8%	1.6%	0.5%	-0.4%	-0.5%	-0.3%	-0.4%
4-yr % change	27.6%	28.2%	29.0%	28.5%	28.3%	26.9%	24.9%	24.3%	24.4%	23.7%	23.3%	22.9%	23.1%	23.1%
Retail ex auto														
1-yr % change	-1.1%	-0.6%	0.0%	0.8%	0.9%	0.6%	0.3%	-0.5%	-1.1%	-1.3%	-1.9%	-1.8%	-1.3%	-1.3%
4-yr % change	24.5%	24.7%	25.0%	25.0%	25.1%	24.6%	24.0%	24.1%	24.1%	24.4%	24.2%	23.8%	23.9%	24.0%
Airlines														
1-yr % change	-5.8%	-4.5%	-1.5%	0.7%	3.1%	3.0%	3.1%	3.0%	2.0%	0.3%	-2.1%	-4.5%	-3.9%	-4.1%
4-yr % change	2.6%	3.8%	4.7%	5.1%	6.4%	5.3%	6.2%	7.3%	7.5%	7.1%	6.1%	4.4%	6.4%	5.8%
Lodging														
1-yr % change	-2.7%	-2.6%	-2.6%	-2.7%	-3.1%	-3.6%	-4.1%	-4.8%	-5.3%	-6.3%	-6.5%	-6.4%	-6.7%	-6.5%
4-yr % change	8.6%	8.1%	7.8%	6.5%	5.3%	4.0%	3.6%	3.8%	4.1%	4.4%	5.5%	5.7%	5.8%	5.2%
Entertainment														
1-yr % change	4.2%	6.7%	7.9%	8.2%	10.6%	10.4%	8.5%	6.4%	4.1%	1.6%	0.3%	-1.3%	-0.4%	0.3%
4-yr % change	12.8%	14.6%	16.4%	15.7%	16.7%	16.5%	17.0%	17.6%	17.6%	16.8%	16.7%	14.9%	14.6%	14.0%
Restaurants & bars														
1-yr % change	3.4%	3.1%	3.4%	3.9%	3.9%	3.7%	3.6%	2.1%	1.8%	1.4%	0.9%	1.0%	1.0%	0.9%
4-yr % change	31.3%	30.0%	30.0%	29.8%	29.3%	28.5%	27.9%	26.8%	27.6%	27.5%	27.4%	27.4%	27.6%	27.4%
Transit														
1-yr % change	11.2%	11.9%	11.8%	11.1%	9.4%	8.4%	5.8%	4.6%	3.1%	0.6%	-1.2%	-2.5%	-3.0%	-3.1%
4-yr % change	9.3%	10.8%	8.0%	8.6%	7.0%	5.7%	5.2%	5.3%	5.3%	5.5%	3.9%	5.0%	4.4%	4.4%
Gas														
1-yr % change	0.6%	2.0%	3.1%	3.9%	3.1%	2.2%	1.5%	-0.4%	-1.8%	-2.0%	-2.3%	-1.3%	-0.2%	0.2%
4-yr % change	32.8%	33.3%	33.9%	33.8%	33.6%	33.1%	32.2%	31.7%	31.3%	31.5%	31.6%	31.7%	32.2%	32.6%
Clothing														
1-yr % change	-7.6%	-7.0%	-6.5%	-5.1%	-3.9%	-3.4%	-2.9%	-3.6%	-4.3%	-4.4%	-4.9%	-5.1%	-4.8%	-4.5%
4-yr % change	11.0%	11.0%	11.8%	13.0%	14.4%	14.5%	14.5%	13.9%	13.5%	13.7%	12.9%	12.1%	11.7%	11.3%
Furniture														
1-yr % change	-14.7%	-14.7%	-13.8%	-12.9%	-11.9%	-11.4%	-11.4%	-11.4%	-12.7%	-13.9%	-15.1%	-15.6%	-15.5%	-15.8%
4-yr % change	2.0%	1.7%	1.3%	0.9%	1.1%	0.6%	0.1%	-0.3%	-0.5%	-0.2%	0.3%	0.1%	0.0%	-0.5%
Department store														
1-yr % change	-1.2%	0.3%	1.8%	3.9%	6.2%	6.9%	8.4%	9.1%	9.0%	9.3%	8.1%	6.6%	6.8%	5.8%
4-yr % change	-2.8%	-0.3%	1.5%	2.2%	3.1%	2.4%	2.0%	3.0%	2.5%	2.0%	1.7%	0.3%	0.2%	-0.4%
Home improvement														
1-yr % change	-5.6%	-5.9%	-5.1%	-4.5%	-5.1%	-6.2%	-7.0%	-7.9%	-8.5%	-8.8%	-8.9%	-8.8%	-7.5%	-7.6%
4-yr % change	22.4%	21.1%	21.7%	21.1%	20.3%	18.9%	17.0%	16.5%	17.1%	17.1%	18.3%	18.3%	18.7%	18.8%
Online electronics (card not present)														
1-yr % change	-1.7%	-0.9%	-3.3%	-6.9%	-10.1%	-9.7%	-9.5%	-8.9%	-3.2%	14.0%	13.5%	15.1%	14.2%	12.5%
4-yr % change	32.5%	32.3%	29.7%	28.4%	21.1%	17.1%	14.1%	14.4%	20.6%	32.1%	21.9%	26.4%	29.4%	38.5%
Grocery														
1-yr % change	1.3%	1.3%	1.6%	2.0%	1.5%	0.8%	0.1%	-0.6%	-1.2%	-1.7%	-2.2%	-1.4%	-0.5%	-0.5%
4-yr % change	15.4%	15.8%	16.3%	15.9%	16.3%	16.3%	15.5%	16.2%	16.1%	15.7%	15.8%	15.4%	15.3%	15.2%
General Merchandise														
1-yr % change	-1.4%	-0.8%	-0.2%	0.6%	1.5%	0.6%	0.3%	1.0%	-0.4%	-1.0%	-1.3%	-2.0%	-1.4%	-1.6%
4-yr % change	33.7%	35.4%	36.5%	37.0%	38.2%	37.7%	37.9%	38.5%	37.8%	38.4%	38.6%	37.9%	38.1%	37.9%
Total B&M retail														
1-yr % change	-1.2%	-0.9%	-0.2%	0.5%	0.3%	-0.3%	-0.6%	-1.6%	-2.4%	-2.7%	-3.2%	-2.8%	-2.1%	-2.1%
4-yr % change	14.2%	14.1%	14.4%	14.2%	14.3%	13.9%	13.3%	13.1%	13.2%	13.4%	13.4%	13.1%	13.2%	13.1%
Total online retail (card not present)														
1-yr % change	-0.7%	0.1%	1.1%	2.2%	3.0%	3.6%	3.6%	3.5%	3.4%	3.2%	2.4%	1.6%	1.3%	1.2%
4-yr % change	67.4%	68.7%	69.4%	70.1%	69.7%	68.7%	68.2%	69.9%	69.9%	70.4%	68.9%	68.7%	68.9%	69.7%
Total card debit														
1-yr % change	1.9%	2.2%	3.7%	4.6%	4.9%	5.1%	3.8%	3.3%	2.9%	1.1%	0.3%	0.3%	0.5%	0.3%
4-yr % change	31.8%	32.9%	34.3%	33.7%	33.7%	32.1%	29.6%	28.5%	27.9%	26.4%	26.0%	25.3%	25.3%	25.3%
Total card credit														
1-yr % change	-0.6%	-0.5%	0.1%	1.1%	1.7%	2.1%	0.7%	0.0%	0.0%	-0.3%	-1.2%	-1.4%	-1.3%	-1.3%
4-yr % change	22.2%	22.0%	22.1%	21.9%	21.5%	20.4%	19.1%	19.2%	20.2%	20.4%	20.0%	20.1%	20.3%	20.5%

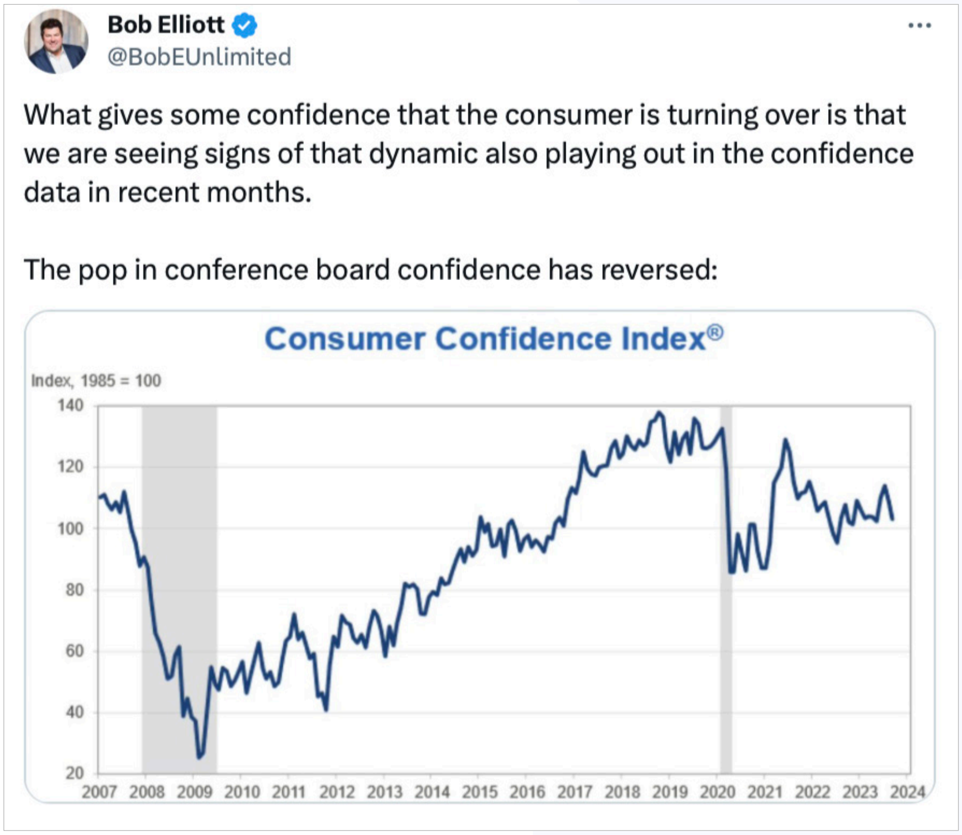
Source: BAC internal data. Note: The 1-yr % change shows the change between the current date at the head of the table column and its comparable date a year ago and the 4-yr % change shows the percentage change with the comparable date four years ago. Total card spending includes total BAC card activity which captures retail sales + services which are paid with cards. Does not include ACH payments. B&M (Brick & Mortar) retail means retail purchases at the store. Card not present is largely online but could include purchases made over the phone.

BofA GLOBAL RESEARCH



Bob Elliott
@BobEUnlimited

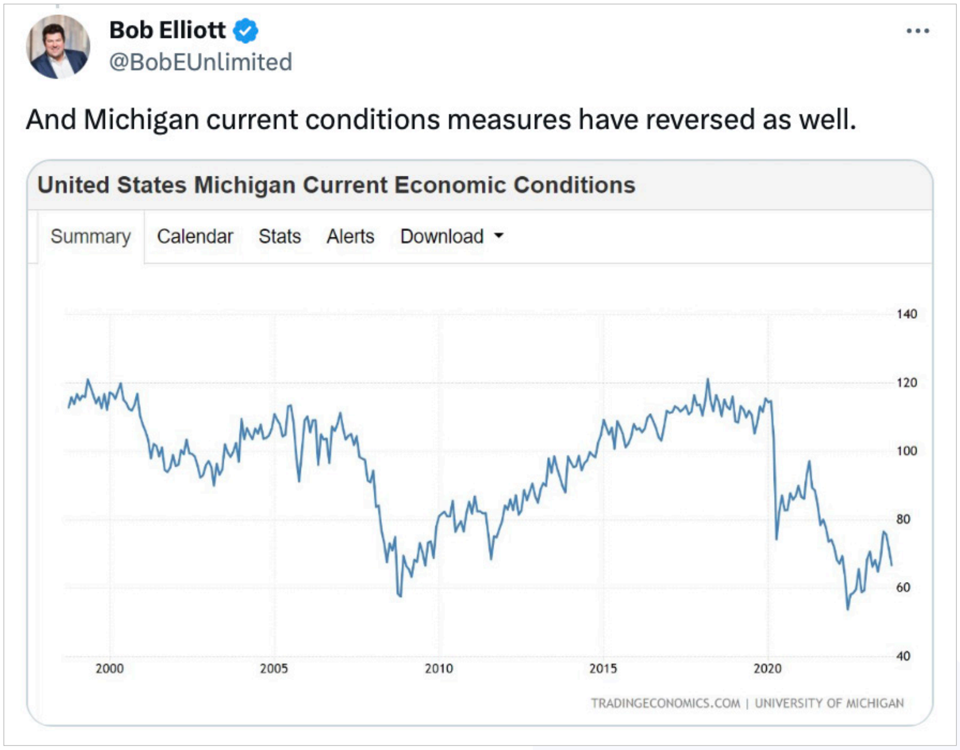
Redbook is really the only one suggesting a real pickup. And its been of pretty mediocre goodness in measuring things like retail sales, or PCE in the post-covid period. There's reasons to believe its not as good a measure given its sampling limitations vs. the card trackers.



Bob Elliott
@BobEUnlimited

What gives some confidence that the consumer is turning over is that we are seeing signs of that dynamic also playing out in the confidence data in recent months.

The pop in conference board confidence has reversed:

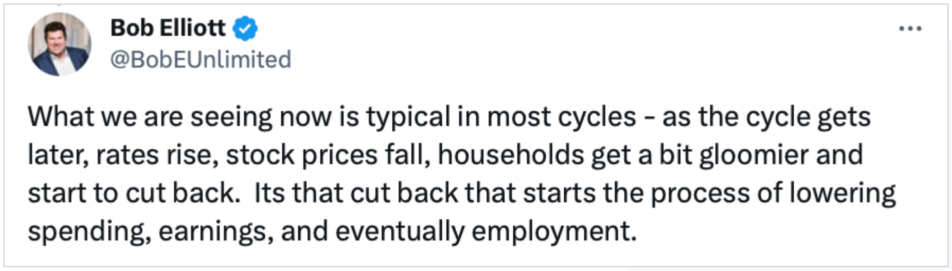


Bob Elliott
@BobEUnlimited

And Michigan current conditions measures have reversed as well.

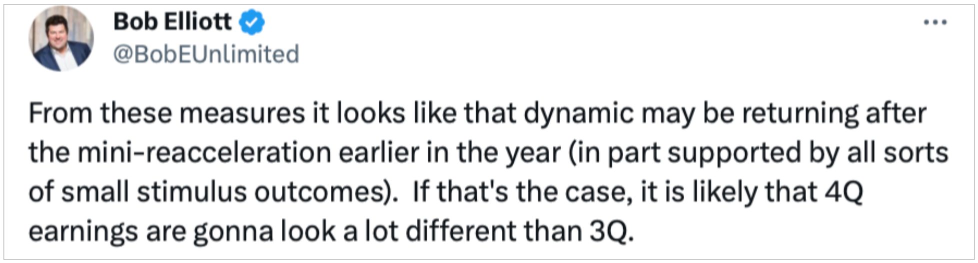
Bob Elliott
@BobEUnlimited

While these measures have their issues with partisanship depressing the levels, the changes are pretty good indications of how things are going and it points to a consumer that is seeing the world a little gloomier than just a couple months ago.



Bob Elliott
@BobEUnlimited

What we are seeing now is typical in most cycles - as the cycle gets later, rates rise, stock prices fall, households get a bit gloomier and start to cut back. Its that cut back that starts the process of lowering spending, earnings, and eventually employment.



Bob Elliott
@BobEUnlimited

From these measures it looks like that dynamic may be returning after the mini-reacceleration earlier in the year (in part supported by all sorts of small stimulus outcomes). If that's the case, it is likely that 4Q earnings are gonna look a lot different than 3Q.

Bob Elliott
@BobEUnlimited

Retail sales control group for Sept released this morning smashes any of the outcomes implied by the card data. And Aug revised higher too.

Pretty big outlier relative to other usually pretty decent triangulations of demand above.

United States | Browse | 08:30:52 | 10/17/23 - 10/24/23
Economic Releases | All Economic Releases | View ○ Agenda ● Weekly

	Date Time	A	M	R	Event	Period	Surv(M)	Actual	Prior	Revised
21)	10/17 08:30				Retail Sales Advance MoM	Sep	0.3%	0.7%	0.6%	0.8%
22)	10/17 08:30				Retail Sales Ex Auto MoM	Sep	0.2%	0.6%	0.6%	0.9%
23)	10/17 08:30				Retail Sales Ex Auto and Gas	Sep	0.1%	0.6%	0.2%	0.3%
24)	10/17 08:30				Retail Sales Control Group	Sep	0.1%	0.6%	0.1%	0.2%
25)	10/17 08:30				New York Fed Services Business Activity	Oct	--	-19.1	-3.0	--
26)	10/17 09:15				Industrial Production MoM	Sep	0.0%	--	0.4%	--
27)	10/17 09:15				Capacity Utilization	Sep	79.6%	--	79.7%	--
28)	10/17 09:15				Manufacturing (SIC) Production	Sep	0.0%	--	0.1%	--
29)	10/17 10:00				Business Inventories	Aug	0.3%	--	0.0%	--
30)	10/17 10:00				NAHB Housing Market Index	Oct	44	--	45	--
31)	10/17 16:00				Net Long-term TIC Flows	Aug	--	--	$8.8b	--
32)	10/17 16:00				Total Net TIC Flows	Aug	--	--	$140.6b	--

8:45 AM · Oct 17, 2023 · **15.9K** Views

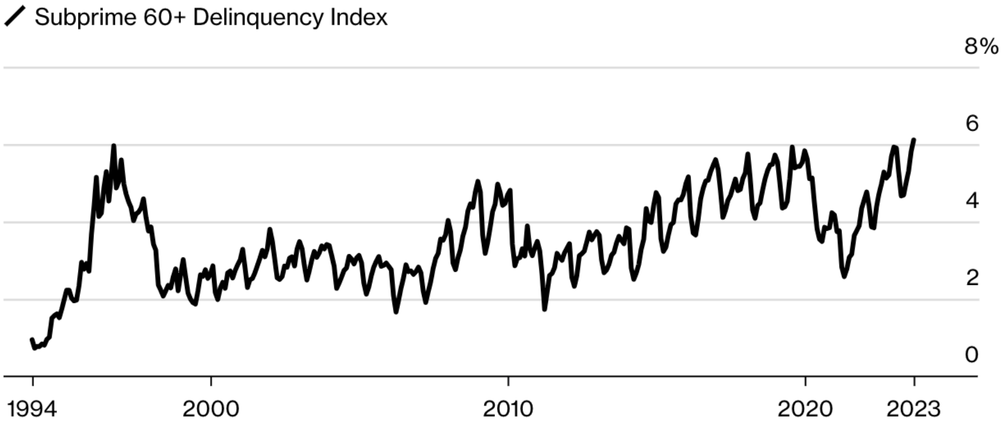
Americans are falling behind on their auto loans at the fastest pace in 30 years ([from Bloomberg on October 21](#))…

> Americans are falling behind on their auto loans at the highest rate in nearly three decades.
>
> With interest rate hikes making newer loans more expensive, millions of car owners are struggling to afford their payments. It's a clear indication of distress at a time when the economy is sending mixed signals, particularly about the health of consumer spending.
>
> The percent of subprime auto borrowers at least 60 days past due on their loans rose to 6.11% in September, the highest in data going back to 1994, according to Fitch Ratings. In April that figure slipped from a previous high of 5.93% in January. But after burning through tax returns, contending with a shakier job market and grappling with still-elevated inflation, more car owners have become delinquent.
>
> Behind the surge is both higher car prices and borrowing costs. And with the Federal Reserve indicating it plans to keep rates higher for longer, the problem is likely to persist, especially as millions of Americans recently started paying their federal student loans again.

“The subprime borrower is getting squeezed,” said Margaret Rowe, senior director with the asset-backed securities group at Fitch. “They can often be a first line of where we start to see the negative effects of macroeconomic headwinds.”

Americans Struggle to Afford Car Payments

The percent of borrowers at least 60 days late on their car loans is at the highest on record

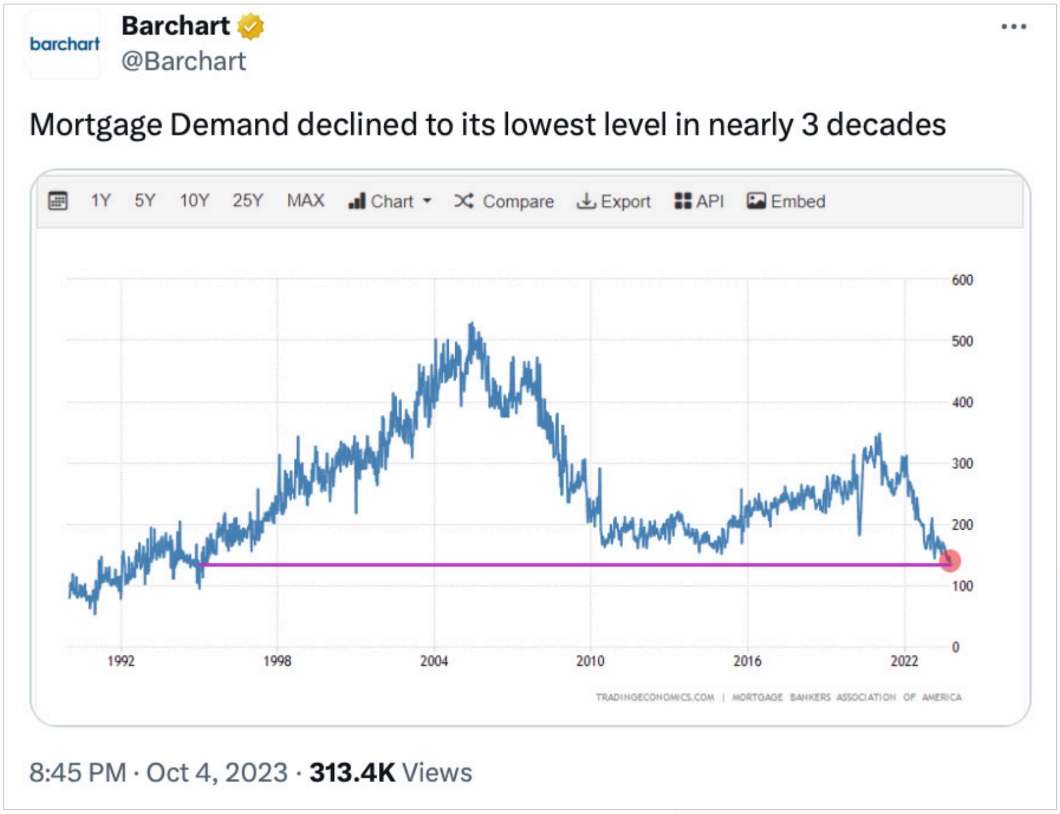


Source: Fitch Ratings

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

Real Estate

Home-mortgage demand has collapsed to 30-year lows ([from Barchart via X on October 4](#))...

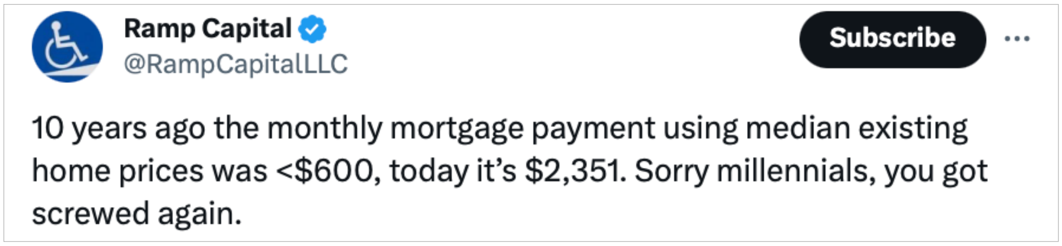


Barchart
@Barchart

Mortgage Demand declined to its lowest level in nearly 3 decades

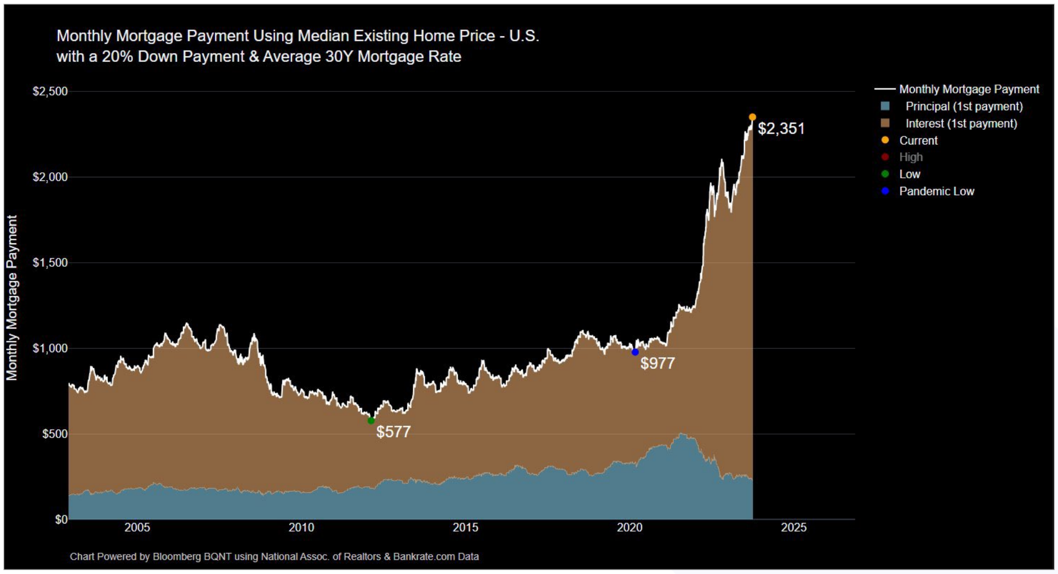
8:45 PM · Oct 4, 2023 · **313.4K** Views

That isn't surprising considering the average mortgage payment has nearly quadrupled in the last decade ([from Ramp Capital via X on October 5](#))...



Ramp Capital
@RampCapitalLLC

10 years ago the monthly mortgage payment using median existing home prices was <$600, today it's $2,351. Sorry millennials, you got screwed again.



Monthly Mortgage Payment Using Median Existing Home Price - U.S.
with a 20% Down Payment & Average 30Y Mortgage Rate

Chart Powered by Bloomberg BQNT using National Assoc. of Realtors & Bankrate.com Data

The U.S. has a housing shortage... even with 5 million vacant homes ([from *The Real Deal* on October 8](#))...

> The U.S. is in the midst of a housing crisis, but there's still plenty of millions of empty homes.
>
> Indeed, a recent analysis of the 2022 American Community Survey by LendingTree Inc. has unveiled a perplexing phenomenon in the United States — an estimated 5.5 million vacant housing units in the nation's 50 largest metro areas, amounting to an 8 percent housing vacancy rate, the San Francisco Business Times reported.
>
> This is at a time when the housing market is grappling with dwindling inventory and soaring prices, with the median price of new homes sold in August hovering around $430,300.
>
> The reasons behind the vacancy glut are multifaceted: about 26.6 percent of these homes are empty because they are available for rent, while 17 percent remain vacant as they are used only part-time, like vacation or second homes. Another 8 percent are in a state of repair or renovation.
>
> The presence of these 5.5 million vacant homes has prompted questions about their impact on the broader housing market. Jacob Channel, a senior economist at LendingTree, suggests that in theory, increasing housing supply should alleviate high home prices.

However, addressing the issue necessitates tailored policy solutions for each location where these homes lie idle.

Policy considerations range from imposing taxes on second homeowners, like the proposed pied-à-terre tax in New York City, to finding incentives to encourage the renting of vacant units to lower-income households struggling with market prices.

Among the markets scrutinized, New Orleans topped the list with a 16 percent vacancy rate, partly attributed to its post-Hurricane Katrina struggles and population decline. Miami and Tampa, popular vacation destinations, had a significant share of vacant units, primarily used for seasonal, recreational, or occasional purposes.

To add to the issue, many if not most of the vacant homes are not for sale. Richmond, Virginia, Austin, Texas, and San Antonio had the highest percentages of such homes. Foreclosures and abandoned properties were also found to be minimal reasons for vacancies in major housing markets.

Continue reading here.

Some in the housing industry are now begging the Fed for a bailout, too (from Lance Lambert via X on October 9)...

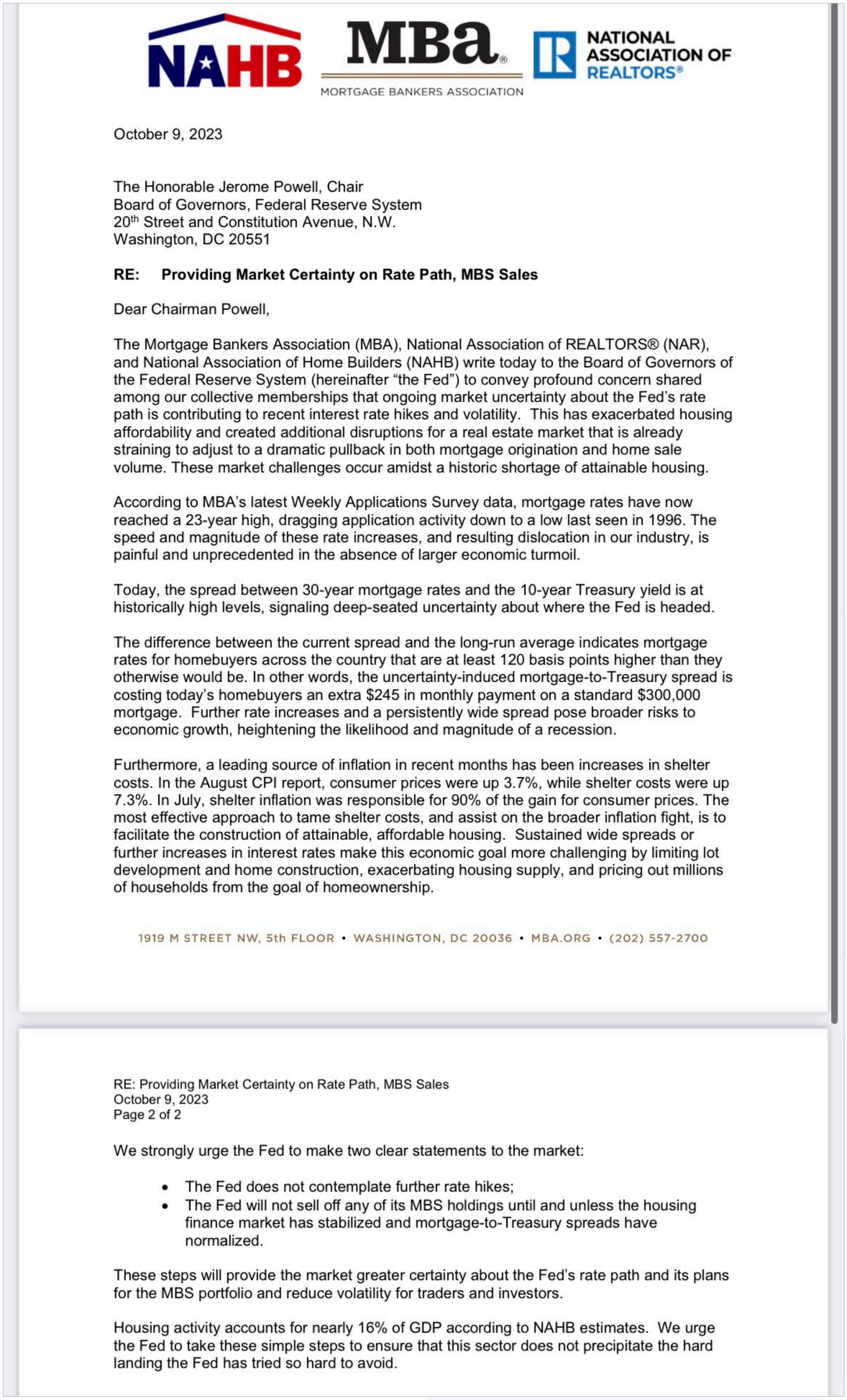
Lance Lambert
@NewsLambert

#NEW @MBAMortgage, @NAHBhome, and @nardotrealtor just wrote a letter to Fed Chair Jerome Powell.

They’re asking for...

1. No more rate hikes

2. The Fed to “not sell off any of its MBS holdings until and unless the housing finance market has stabilized”



NAHB
MBa
MORTGAGE BANKERS ASSOCIATION
NATIONAL ASSOCIATION OF REALTORS®

October 9, 2023

The Honorable Jerome Powell, Chair
Board of Governors, Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

RE: Providing Market Certainty on Rate Path, MBS Sales

Dear Chairman Powell,

The Mortgage Bankers Association (MBA), National Association of REALTORS® (NAR), and National Association of Home Builders (NAHB) write today to the Board of Governors of the Federal Reserve System (hereinafter "the Fed") to convey profound concern shared among our collective memberships that ongoing market uncertainty about the Fed's rate path is contributing to recent interest rate hikes and volatility. This has exacerbated housing affordability and created additional disruptions for a real estate market that is already straining to adjust to a dramatic pullback in both mortgage origination and home sale volume. These market challenges occur amidst a historic shortage of attainable housing.

According to MBA's latest Weekly Applications Survey data, mortgage rates have now reached a 23-year high, dragging application activity down to a low last seen in 1996. The speed and magnitude of these rate increases, and resulting dislocation in our industry, is painful and unprecedented in the absence of larger economic turmoil.

Today, the spread between 30-year mortgage rates and the 10-year Treasury yield is at historically high levels, signaling deep-seated uncertainty about where the Fed is headed.

The difference between the current spread and the long-run average indicates mortgage rates for homebuyers across the country that are at least 120 basis points higher than they otherwise would be. In other words, the uncertainty-induced mortgage-to-Treasury spread is costing today's homebuyers an extra $245 in monthly payment on a standard $300,000 mortgage. Further rate increases and a persistently wide spread pose broader risks to economic growth, heightening the likelihood and magnitude of a recession.

Furthermore, a leading source of inflation in recent months has been increases in shelter costs. In the August CPI report, consumer prices were up 3.7%, while shelter costs were up 7.3%. In July, shelter inflation was responsible for 90% of the gain for consumer prices. The most effective approach to tame shelter costs, and assist on the broader inflation fight, is to facilitate the construction of attainable, affordable housing. Sustained wide spreads or further increases in interest rates make this economic goal more challenging by limiting lot development and home construction, exacerbating housing supply, and pricing out millions of households from the goal of homeownership.

We strongly urge the Fed to make two clear statements to the market:

- The Fed does not contemplate further rate hikes;
- The Fed will not sell off any of its MBS holdings until and unless the housing finance market has stabilized and mortgage-to-Treasury spreads have normalized.

These steps will provide the market greater certainty about the Fed's rate path and its plans for the MBS portfolio and reduce volatility for traders and investors.

Housing activity accounts for nearly 16% of GDP according to NAHB estimates. We urge the Fed to take these simple steps to ensure that this sector does not precipitate the hard landing the Fed has tried so hard to avoid.

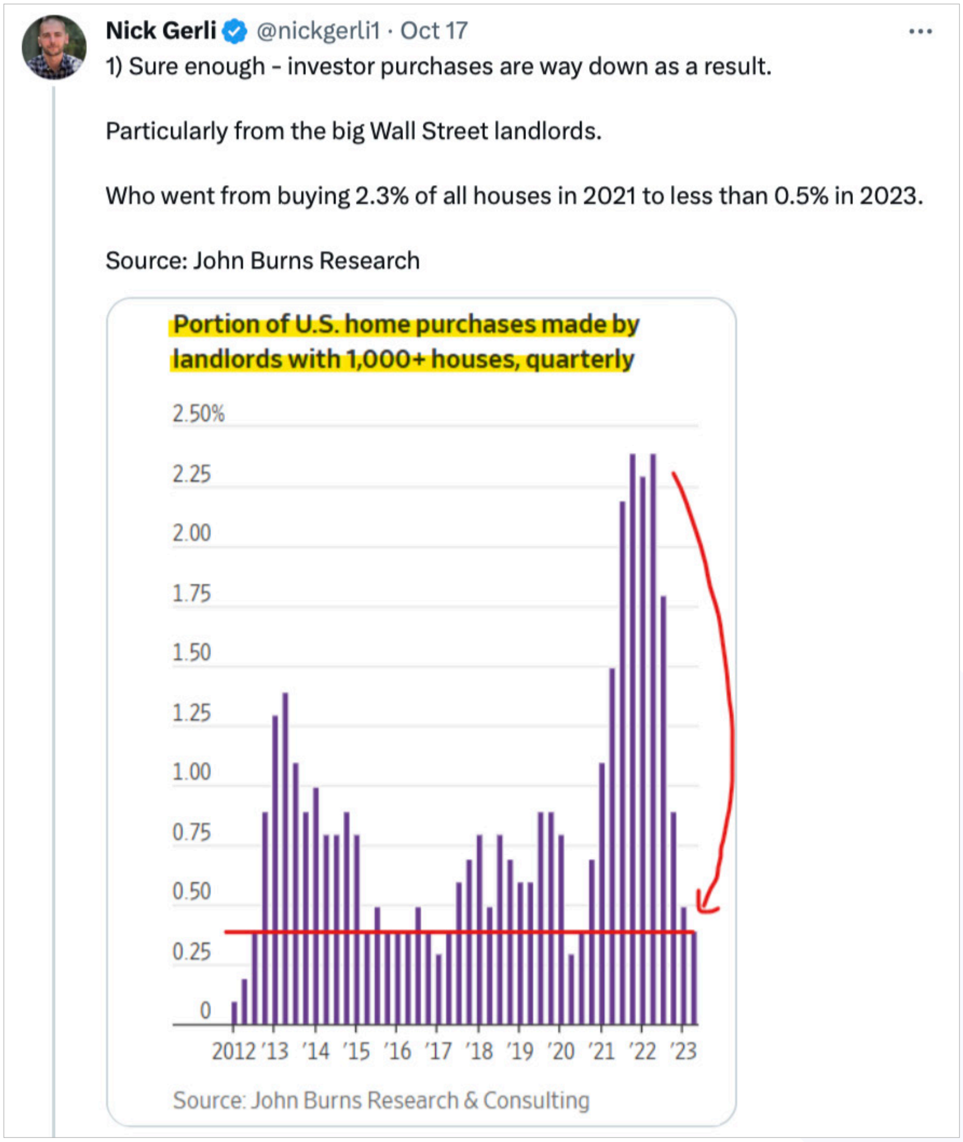
This critical shift could crush investor demand for real estate ([from Nick Gerli via X on October 17]())…

Nick Gerli
@nickgerli1

Here's an ominous indicator for the Housing Market.

The 10-year government bond now yields a higher return than the Cap Rate, or profit from operating a rental property.

No wonder real estate investor demand is collapsing. More profitable to buy bonds.



Nick Gerli @nickgerli1 · Oct 17

1) Sure enough - investor purchases are way down as a result.

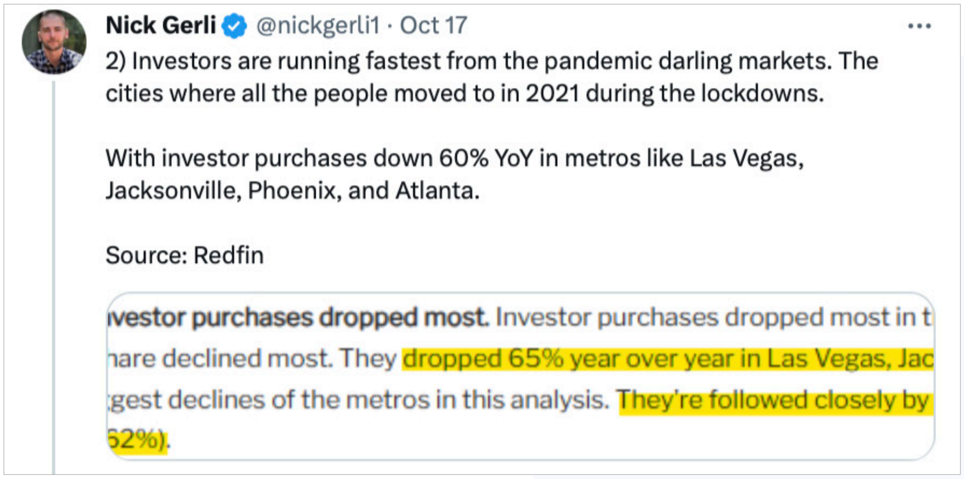
Particularly from the big Wall Street landlords.

Who went from buying 2.3% of all houses in 2021 to less than 0.5% in 2023.

Source: John Burns Research

Portion of U.S. home purchases made by landlords with 1,000+ houses, quarterly

Source: John Burns Research & Consulting



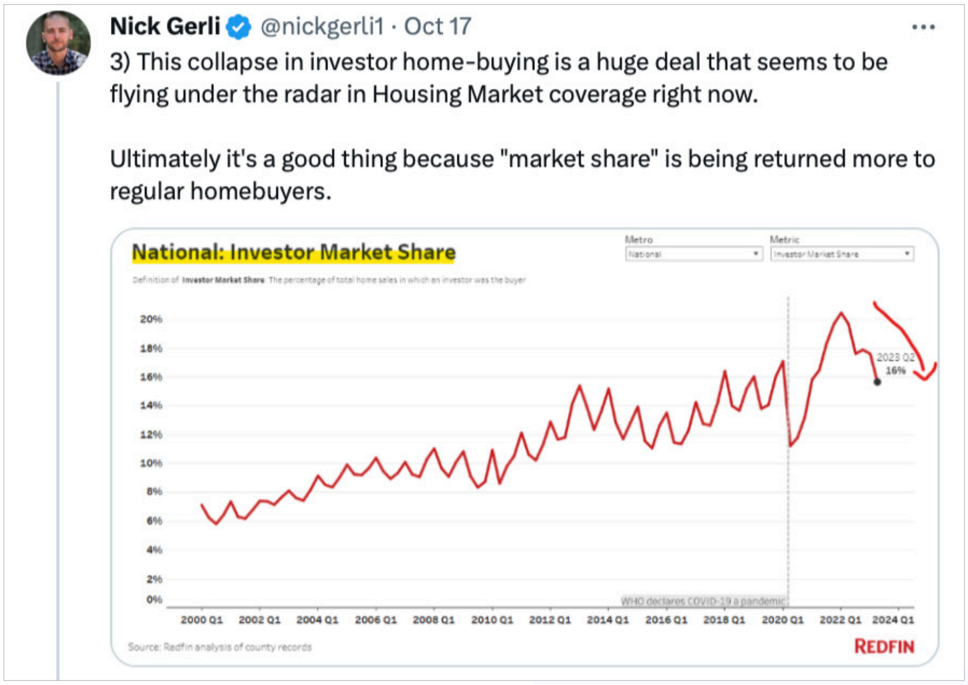
Nick Gerli @nickgerli1 · Oct 17

2) Investors are running fastest from the pandemic darling markets. The cities where all the people moved to in 2021 during the lockdowns.

With investor purchases down 60% YoY in metros like Las Vegas, Jacksonville, Phoenix, and Atlanta.

Source: Redfin

vestor purchases dropped most. Investor purchases dropped most in t
hare declined most. They dropped 65% year over year in Las Vegas, Jac
gest declines of the metros in this analysis. They're followed closely by
52%).



Nick Gerli @nickgerli1 · Oct 17

3) This collapse in investor home-buying is a huge deal that seems to be flying under the radar in Housing Market coverage right now.

Ultimately it's a good thing because "market share" is being returned more to regular homebuyers.

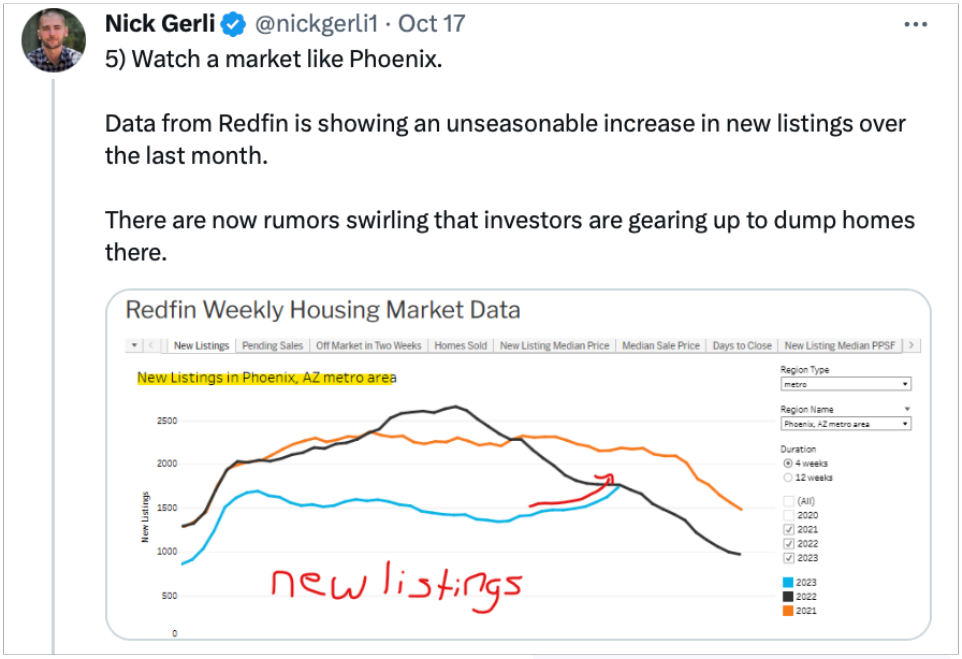
Nick Gerli @nickgerli1 · Oct 17

4) But the real question to ask is: when will these investors start selling?

The drop in purchases was Stage 1.

Stage 2 involves investors offloading properties they can't rent.

I believe "Stage 2" could happen soon.

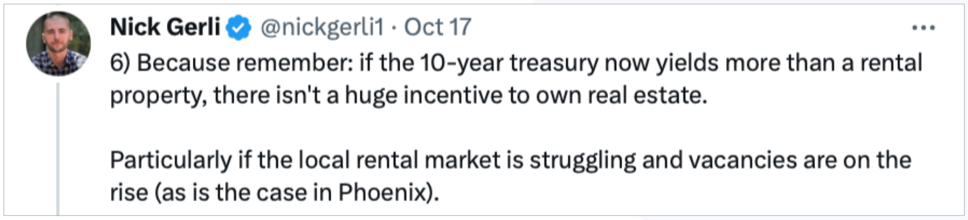


Nick Gerli @nickgerli1 · Oct 17

5) Watch a market like Phoenix.

Data from Redfin is showing an unseasonable increase in new listings over the last month.

There are now rumors swirling that investors are gearing up to dump homes there.



Nick Gerli @nickgerli1 · Oct 17

6) Because remember: if the 10-year treasury now yields more than a rental property, there isn't a huge incentive to own real estate.

Particularly if the local rental market is struggling and vacancies are on the rise (as is the case in Phoenix).

Nick Gerli @nickgerli1 · Oct 17

7) I'd like also watch a market like Nashville closely.

The rents there are now going down rapidly in the urban core, and even now dropping in the suburbs.

Vacancies are way up. Could we see corporate investors begin selling off some of their portfolio there?

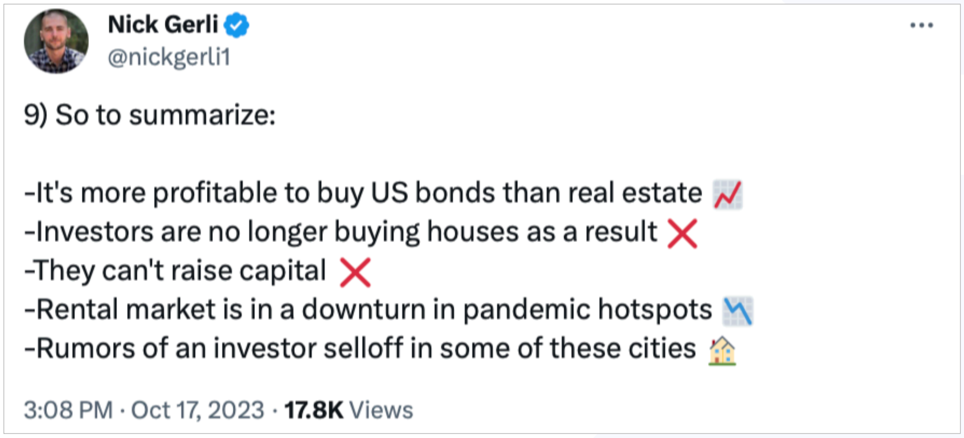
Nick Gerli @nickgerli1

8) Now theoretically the investors who sell could just sell to...other investors.

But there is a problem: a lack of capital going into the single-family investment space.

With MBS issuances for the big corporate investors only totaling $2.1B this year.

The lowest level of capital raised going back to 2015.



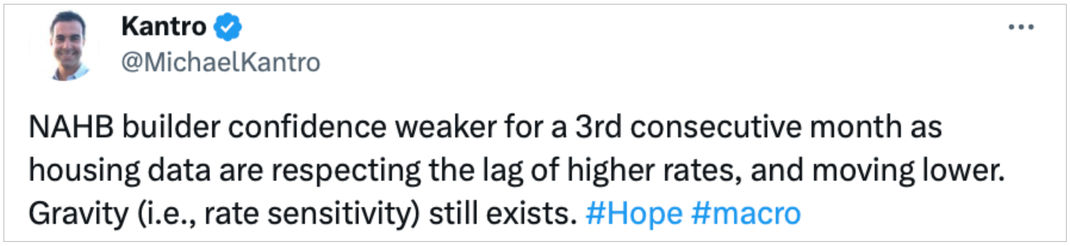
Nick Gerli @nickgerli1

9) So to summarize:

-It's more profitable to buy US bonds than real estate 📈
-Investors are no longer buying houses as a result ❌
-They can't raise capital ❌
-Rental market is in a downturn in pandemic hotspots 📉
-Rumors of an investor selloff in some of these cities 🏚️

3:08 PM · Oct 17, 2023 · **17.8K** Views

Homebuilder confidence continues to fall as mortgage rates surge (from Kantro via X on October 17)...



Kantro
@MichaelKantro

NAHB builder confidence weaker for a 3rd consecutive month as housing data are respecting the lag of higher rates, and moving lower. Gravity (i.e., rate sensitivity) still exists. #Hope #macro

10:18 AM · Oct 17, 2023 · **28K** Views

The outlook for commercial real estate continues to deteriorate ([from Genevieve Roch-Decter, CFA via X on October 18]())...

Genevieve Roch-Decter, CFA
@GRDecter

🚨JUST IN: U.S. Commercial Property Distress Hits 10-Year High

Value of distressed commercial real estate nears $80 billion.

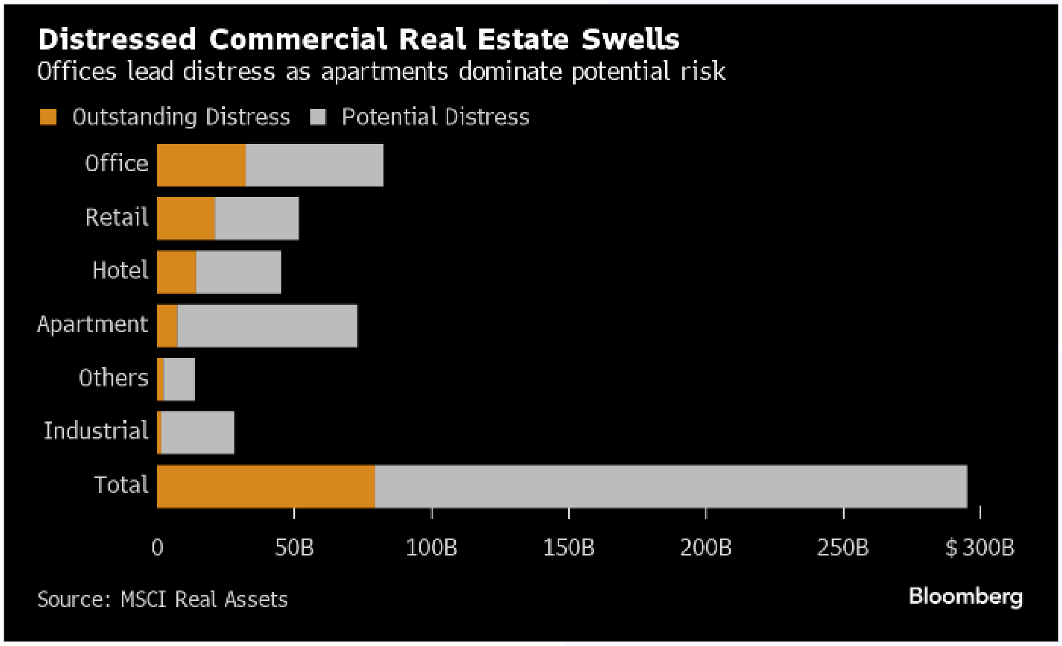
Now less than HALF the 2008 financial crisis levels.

Blackstone, Brookfield and Goldman Sachs have defaulted or relinquished offices to lenders this year.

Today, Pimco walked away from 20 hotels with +$240MM in debt.

Over $1.5 trillion of commercial real estate loans will mature over the next 3 years.

A reckoning is coming.

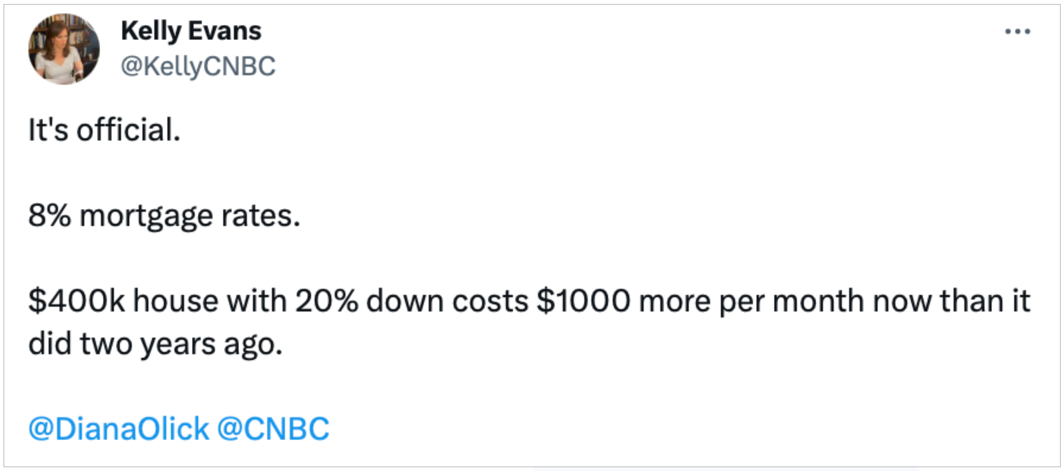


Distressed Commercial Real Estate Swells

Offices lead distress as apartments dominate potential risk

Source: MSCI Real Assets

Rising above 8%, mortgage rates hit a new multi-decade high last week (from Kelly Evans via X on October 18)…



Kelly Evans
@KellyCNBC

It's official.

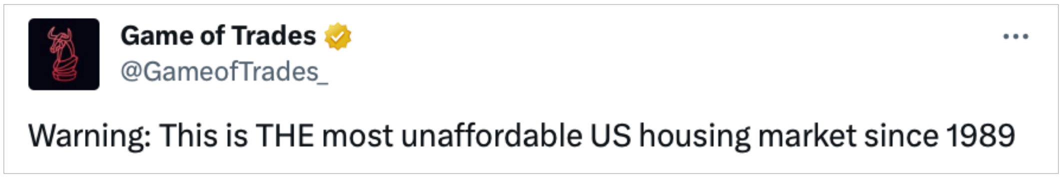
8% mortgage rates.

$400k house with 20% down costs $1000 more per month now than it did two years ago.

@DianaOlick @CNBC

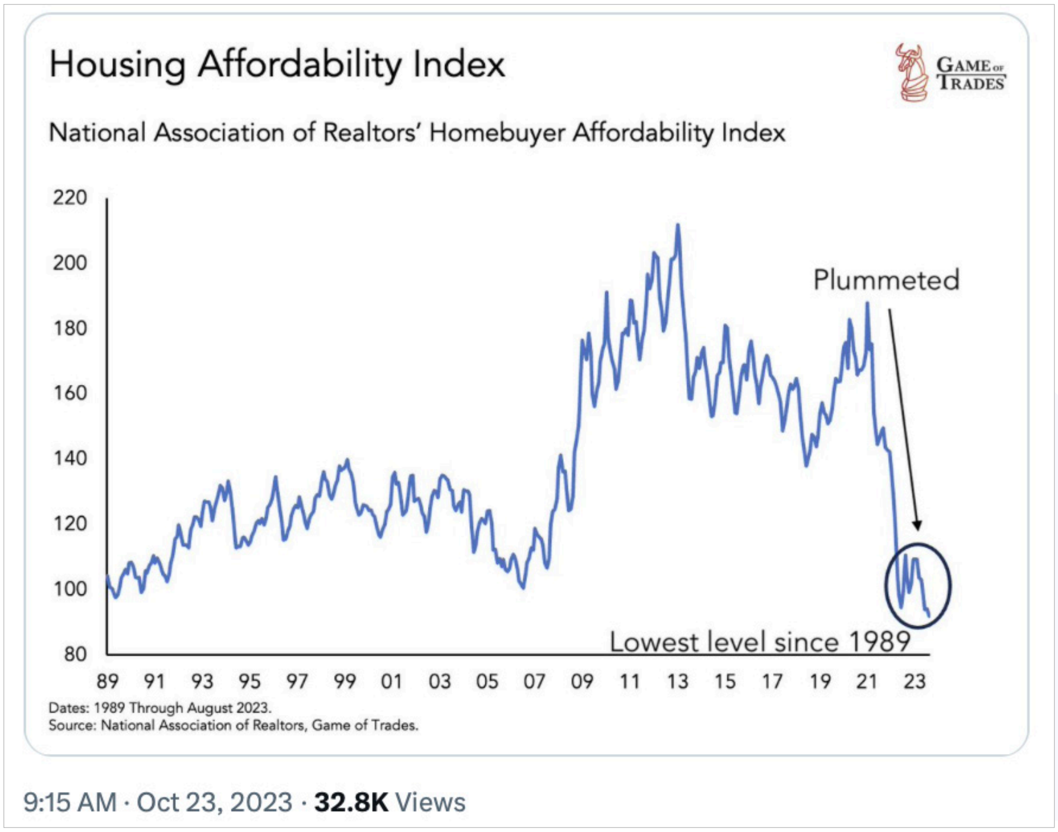
1:18 PM · Oct 18, 2023 · **1.5M** Views

The combination of near-record-high home prices and surging mortgage rates has caused housing affordability to plummet (from Game of Trades via X on October 23)...



Game of Trades
@GameofTrades_

Warning: This is THE most unaffordable US housing market since 1989



Housing Affordability Index

National Association of Realtors' Homebuyer Affordability Index

Dates: 1989 Through August 2023.
Source: National Association of Realtors, Game of Trades.

9:15 AM · Oct 23, 2023 · **32.8K** Views

Special Situations

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

Here's a potential turnaround opportunity in recent spin-off **WK Kellogg Co (NYSE:KLG)** (from Colin King via X on October 5)…

Colin King @valuedontlie

$KLG

Another spin getting whacked out of the gate… down ~40% since spun from Kellogg… I have this one trading right around 5x EBITDA at $11/share. Results have been erratic and margins way below peers…

Market Summary > WK Kellogg Co

10.80 USD

-6.20 (-36.47%) past month

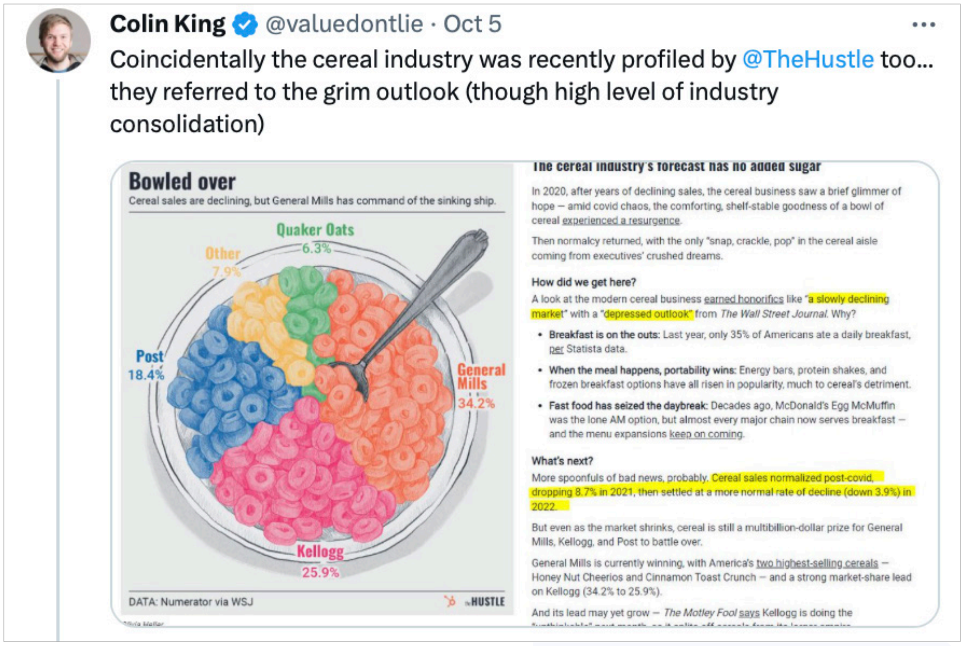
Closed: Oct 4, 7:53 PM EDT · Disclaimer

Pre-market 10.90 +0.100 (0.93%)

Colin King @valuedontlie · Oct 5

KLG taking a very different approach than $POST did when they spun back in 2012 (acquisitions)…

KLG attempting to organically grow EBITDA (targeting 25% CAGR from 2024-2026) up to peer margins. They'll need to outspend earnings to pull it off so leverage will be going up.



Colin King @valuedontlie · Oct 5

Coincidentally the cereal industry was recently profiled by @TheHustle too... they referred to the grim outlook (though high level of industry consolidation)

Bowled over

Cereal sales are declining, but General Mills has command of the sinking ship.

The cereal industry's forecast has no added sugar

In 2020, after years of declining sales, the cereal business saw a brief glimmer of hope – amid covid chaos, the comforting, shelf-stable goodness of a bowl of cereal experienced a resurgence.

Then normalcy returned, with the only "snap, crackle, pop" in the cereal aisle coming from executives' crushed dreams.

How did we get here?

A look at the modern cereal business earned honorifics like "a slowly declining market" with a "depressed outlook" from *The Wall Street Journal*. Why?

- **Breakfast is on the outs:** Last year, only 35% of Americans ate a daily breakfast, per Statista data.
- **When the meal happens, portability wins:** Energy bars, protein shakes, and frozen breakfast options have all risen in popularity, much to cereal's detriment.
- **Fast food has seized the daybreak:** Decades ago, McDonald's Egg McMuffin was the lone AM option, but almost every major chain now serves breakfast – and the menu expansions keep on coming.

What's next?

More spoonfuls of bad news, probably. Cereal sales normalized post-covid, dropping 8.7% in 2021, then settled at a more normal rate of decline (down 3.9%) in 2022.

But even as the market shrinks, cereal is still a multibillion-dollar prize for General Mills, Kellogg, and Post to battle over.

General Mills is currently winning, with America's two highest-selling cereals – Honey Nut Cheerios and Cinnamon Toast Crunch – and a strong market-share lead on Kellogg (34.2% to 25.9%).

And its lead may yet grow – *The Motley Fool* says Kellogg is doing the

---

Activist hedge fund Baker Brothers Advisors added to its position in beaten-down pharmaceutical firm **Madrigal Pharmaceuticals (Nasdaq:MDGL)** this month (from SAI via X on October 7)...

SAI TM @WallStSai

$MDGL Madrigal Pharma!
- **There are currently no FDA-approved therapies available for the treatment of NASH**
- NDA Acceptance and Priority Review of the New Drug Application for Resmetirom for the Treatment of NASH with Liver Fibrosis (**PDUFA 3/2024**)
- Baker Brothers bought $1.6 Million pre funded warrants at $151.69 just last week
- Baker Brothers added 400k stock last quarter boosting total stock holding to approx 1.9 Million shares
- **Stock bottoming out, MACD potential bullish crossover and Inside Day**

$IBB $XBI $AKRO $ICPT

5:56 PM · Oct 7, 2023 · **17.2K** Views

Here's a list of event-driven trade ideas for consideration (from ToffCap's Monday Monitor on October 16)...

- ***Teck Resources (TECK US)***. CEO indicated a decision on the future of the company's coal operations to be reached by the end of this year. CEO reportedly told the FT Mining Summit in London that the company is engaging with several groups that have expressed interest in buying all or part of the coal business.
- ***Euroapi (EAPI France)***. BIG share price reaction, dropping ~60% (!), on bad results and suspension of its medium-term target. Might be interesting to keep an eye on this one, given *relatively* high quality assets. Management will be performing a strategic review; we'll now more at FY results.
- ***Profrac (ACDC US)***. Evaluating strategic options for its Proppant Production segment, which operates through its Alpine Silica subsidiary. Options under strategic review include an IPO, sale or merger of Alpine Silica.
- ***Allfunds (ALLFG Netherlands)***. To explore strategic options, incl. sale, according to Vozpopuli. Hired Goldmand and Citi, looking for 5bn. Makes no sense for this company to remain public, in our opinion.
- ***Biote (BTMD US)***. Asset light, cash generative company. Founder and wife currently in divorce. Wife (25% owner) selling shares as (we understand) intention is to sell out. Share overhang might provide good entry point.
- ***Topcon (7732 Japan)***. Attractively valued company with new management and US activist (ValueAct Capital) with decent track record in Japan increasing pressure.

- ***Howard Hughes (HHH US)***. Ackman (Pershing Square) continues to buy HHH, now trading below $70. Company recently announced it would spin off its Seaport and other related assets. ~90% upside to NAV (according to HHH).

- ***Astra Space (ASTR US)***. According to Bloomberg, Astra is 'considering selling a 51% stake in its in-space propulsion business, among other strategic sale options'. The unit is to be valued at *>$100m* - compared to a current market cap of ~$13m. Might be an interesting option-like trade.

- ***WP Carey (WPC US)***. WPC will spin-off 59 office properties (Net Lease Office Properties NLOP). NLOP to begin trading on 2 November; 1 NLOP shares for every 15 WPC shares. WPC down c. -20% over the past few weeks.

- ***Delta Apparel (DLA US)***. Activewear maker received an unsolicited offer for its Salt Life segment and initiated a strategic review.
Clark Square Capital's Ultimate Value for a recent write-up.

- ***LL Flooring (LL US)***. Live Ventures (LIVE) offered $5.85 per share; LL shares are still trading <$4. LL previously rejected an offer of $5.76 ps. Our friend @ClarkSquareCap has some ideas of the offer.

- ***United Natural Foods (UNFI US)***. UNFI has a 'transformation program' in place. Insiders (CEO and CFO) have recently purchased shares. Shares are down ~60% YTD. Might be interesting to keep an eye on.

- ***Mallinckrodt (MNKTQ US)***. Planning to emerge from bankruptcy by end of year.

- ***Genetron (GTH US)***. Genetron to go private for $126m. Holders will receive $1.36 in cash per ADS. Closing Q1 2024. Genetron ADRs trading at $1.18.

- ***TSR Consulting (TSRI US)***. Reviewing strategic alternatives. Options include a sale of the company. Profitable nano-cap with net cash balance sheet. H/t @evfcfaddict for the idea.

- ***Summit Midstream Partners (SMLP US)***. Reviewing strategic alternatives. Alternatives include sale of assets, refinancing parts or entire capital structure, sale of the Partnership.

- ***Impel Pharmaceuticals (IMPL US)***. Reviewing strategic alternatives as company is running out of cash. Alternatives include sale of assets or all of the company. Goal of closing a transaction no later than early 2024.

- ***Rite Aid (RAD US)***. Reviewing strategic alternatives as highly levered. Reviewing alternatives to recapitalize, refinance or otherwise optimize its capital structure.

- ***Clean Air Metals (AIR Canada)***. Exploring strategic alternatives including strategic funding, strategic partnerships or joint ventures, full company sale.

- ***Ebix (EBIX US)***. Levered, cash flow generating software company, exploring strategic alternatives. Includes sale of assets.

- ***Aerwins Technology (AWIN US)***. Exploring non-core asset sales to finance production of XTurismo hoverbike.

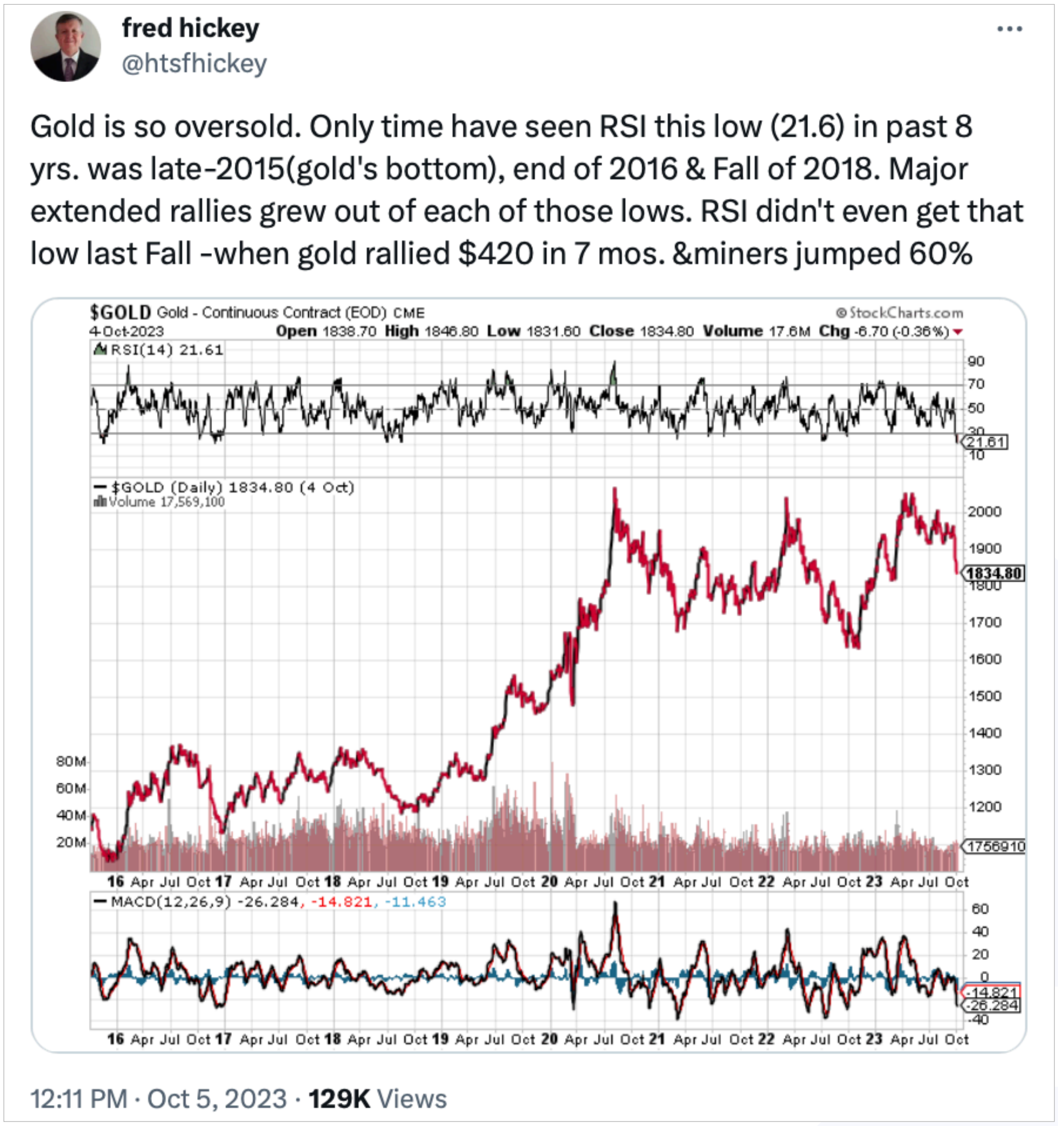
- ***Nuvation (NUVB US)***. Busted biotech SPAC with >$600m net cash on balance sheet, trading at negative EV. Currently pursuing last trials. If success, stock is cheap; if failure, NUVB becomes a cash-distribution play. To play out over next ~12 months.
UPDATE: **BIG insider buying recently, while share price under pressure.**

- ***Vista Outdoor (VSTA US)***. Will spin its outdoor segment. Recently filed a Form-10, intention to spin in Q4. Could be interesting given underlying free cash flow generation + ‘anti’-ESG character of part of the assets.
  ***UPDATE:* Outdoor Products segment to be called Revelyst, ticker GEAR.**

- *BlackBerry (BB US)*. Probable strategic review by November. Also lots of attention from Veritas Capital.
  ***UPDATE*: To separate IoT and Cybersecurity business units.**

Precious Metals

Gold became extremely oversold at its lows earlier this month, which has preceded significant rallies in the past (from Fred Hickey via X on October 5)…

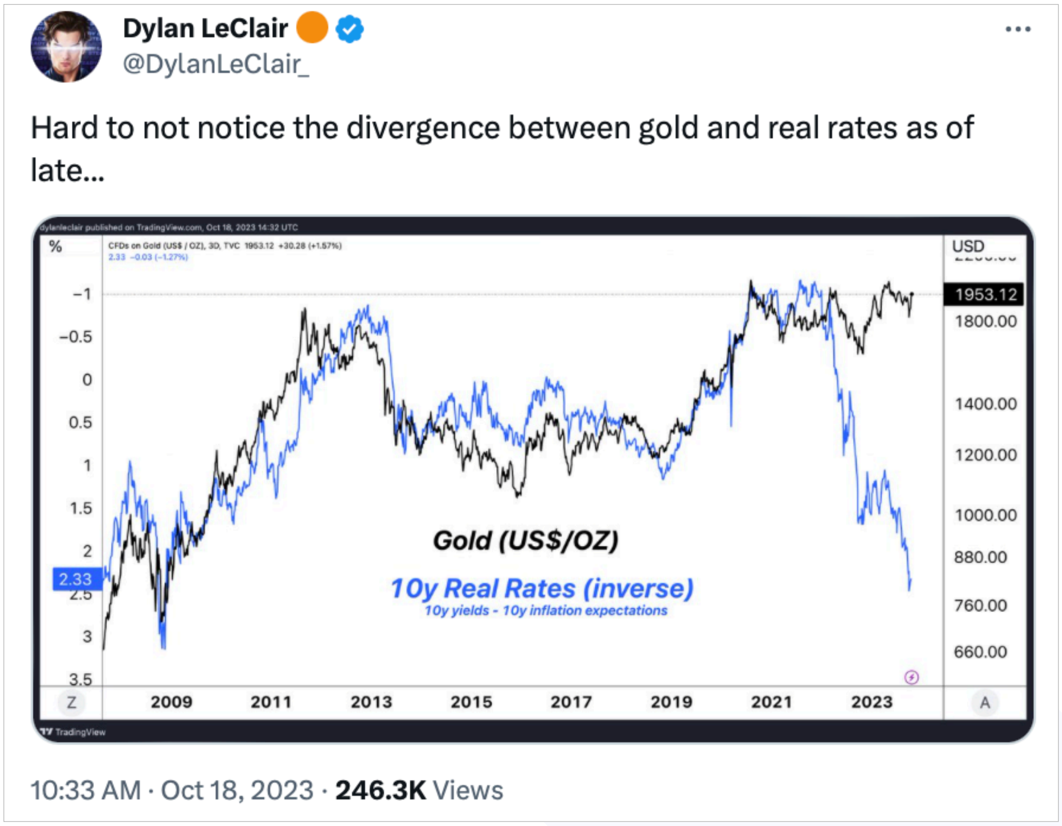


fred hickey
@htsfhickey

Gold is so oversold. Only time have seen RSI this low (21.6) in past 8 yrs. was late-2015(gold's bottom), end of 2016 & Fall of 2018. Major extended rallies grew out of each of those lows. RSI didn't even get that low last Fall -when gold rallied $420 in 7 mos. &miners jumped 60%

12:11 PM · Oct 5, 2023 · **129K** Views

Gold is decoupling from real interest rates ([from Dylan LeClair via X on October 18]())…

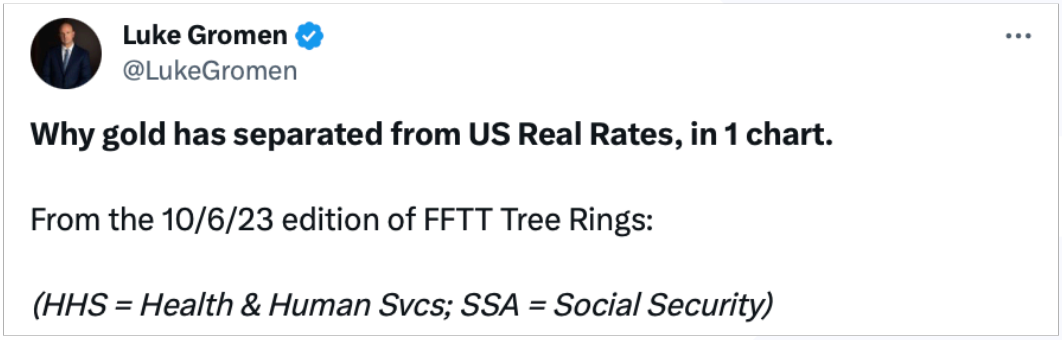


Dylan LeClair
@DylanLeClair_

Hard to not notice the divergence between gold and real rates as of late…

10:33 AM · Oct 18, 2023 · **246.3K** Views

And this is the likely reason why ([from Luke Gromen via X on October 18]())…

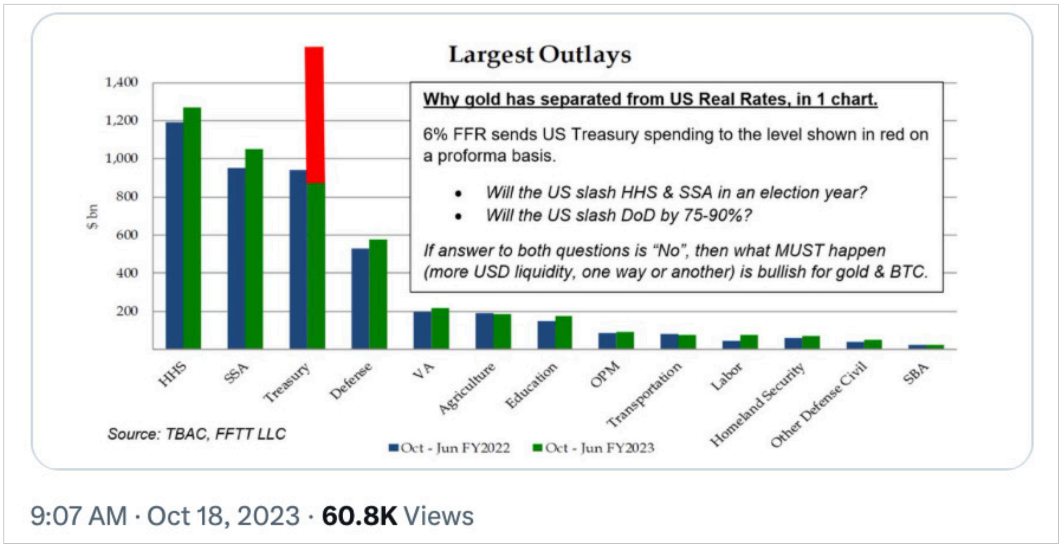


Luke Gromen
@LukeGromen

Why gold has separated from US Real Rates, in 1 chart.

From the 10/6/23 edition of FFTT Tree Rings:

(HHS = Health & Human Svcs; SSA = Social Security)



Why gold has separated from US Real Rates, in 1 chart.

6% FFR sends US Treasury spending to the level shown in red on a proforma basis.

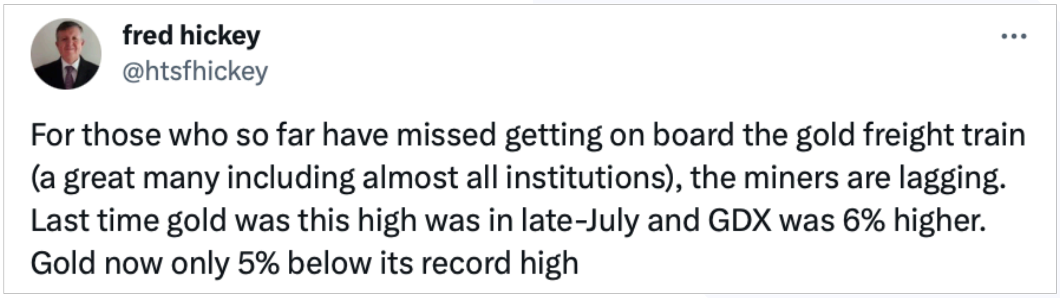
- *Will the US slash HHS & SSA in an election year?*
- *Will the US slash DoD by 75-90%?*

If answer to both questions is "No", then what MUST happen (more USD liquidity, one way or another) is bullish for gold & BTC.

Source: TBAC, FFTT LLC

9:07 AM · Oct 18, 2023 · **60.8K** Views

Gold-mining stocks appear relatively cheap versus gold today ([from Fred Hickey via X on October 18](#))...



fred hickey
@htsfhickey

For those who so far have missed getting on board the gold freight train (a great many including almost all institutions), the miners are lagging. Last time gold was this high was in late-July and GDX was 6% higher. Gold now only 5% below its record high

10:06 AM · Oct 18, 2023 · **23.2K** Views

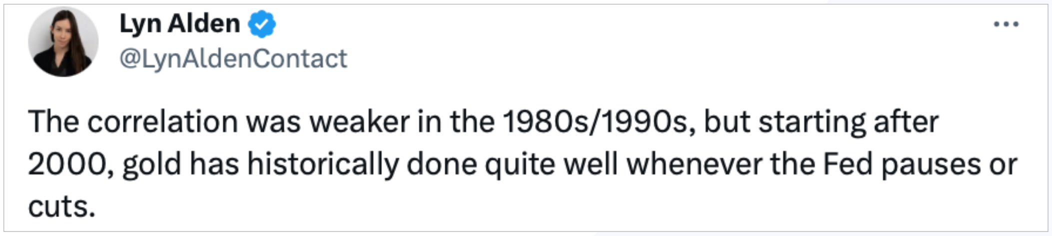
Gold may be on the verge of a massive long-term breakout (from Peter Brandt via X on October 20)...

Peter Brandt
@PeterLBrandt

Featured chart.
To date Gold is forming an engulfing sweeping reversal month.
This is one of the most bullish charts I have seen in 48 years of trading
$GC_F $GLD

11:52 AM · Oct 20, 2023 · **458.1K** Views

Historically, gold has performed well when the Fed pauses rate hikes or begins cutting rates (from Lyn Alden via X on October 21)...

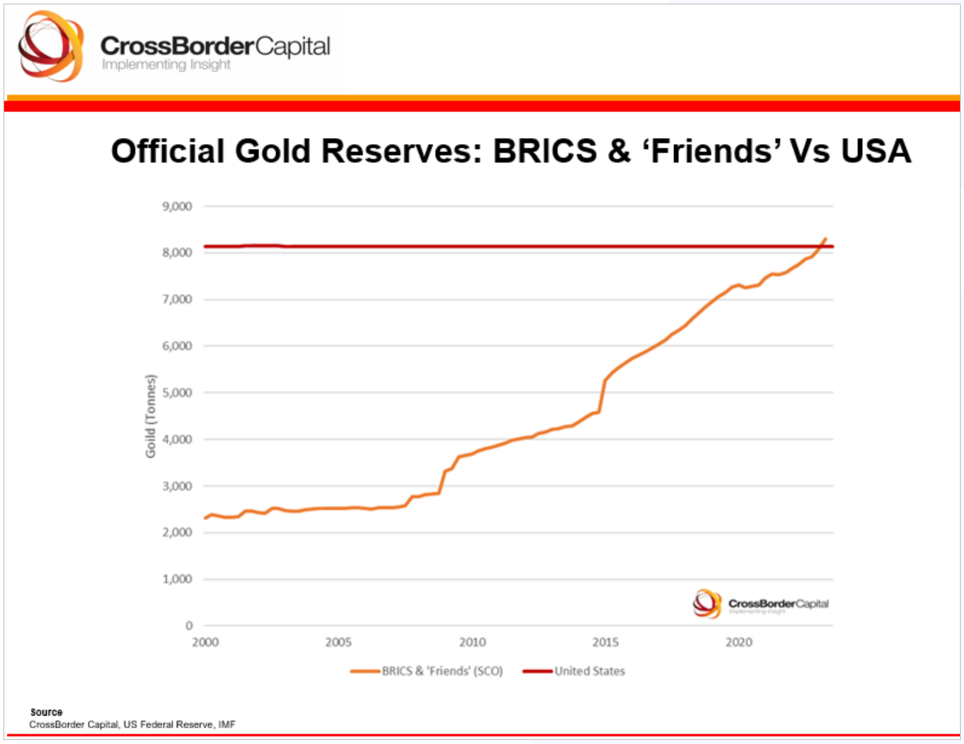


Lyn Alden
@LynAldenContact

The correlation was weaker in the 1980s/1990s, but starting after 2000, gold has historically done quite well whenever the Fed pauses or cuts.

11:01 AM · Oct 21, 2023 · **111.4K** Views

The BRICS nations (and “friends”) now have more official gold in reserve than the U.S. does ([from CrossBorder Capital via X on October 22](#))...



Source
CrossBorder Capital, US Federal Reserve, IMF

A legitimate reason gold could soar to $20,000 an ounce in the next few years (from Junior Mining Investor via X on October 23)...

Junior Mining Investor
@9KGOLD

$20k Gold will solve the depth problem for the US in no time.

We are closer then you think according to Luke Gromen ▶️

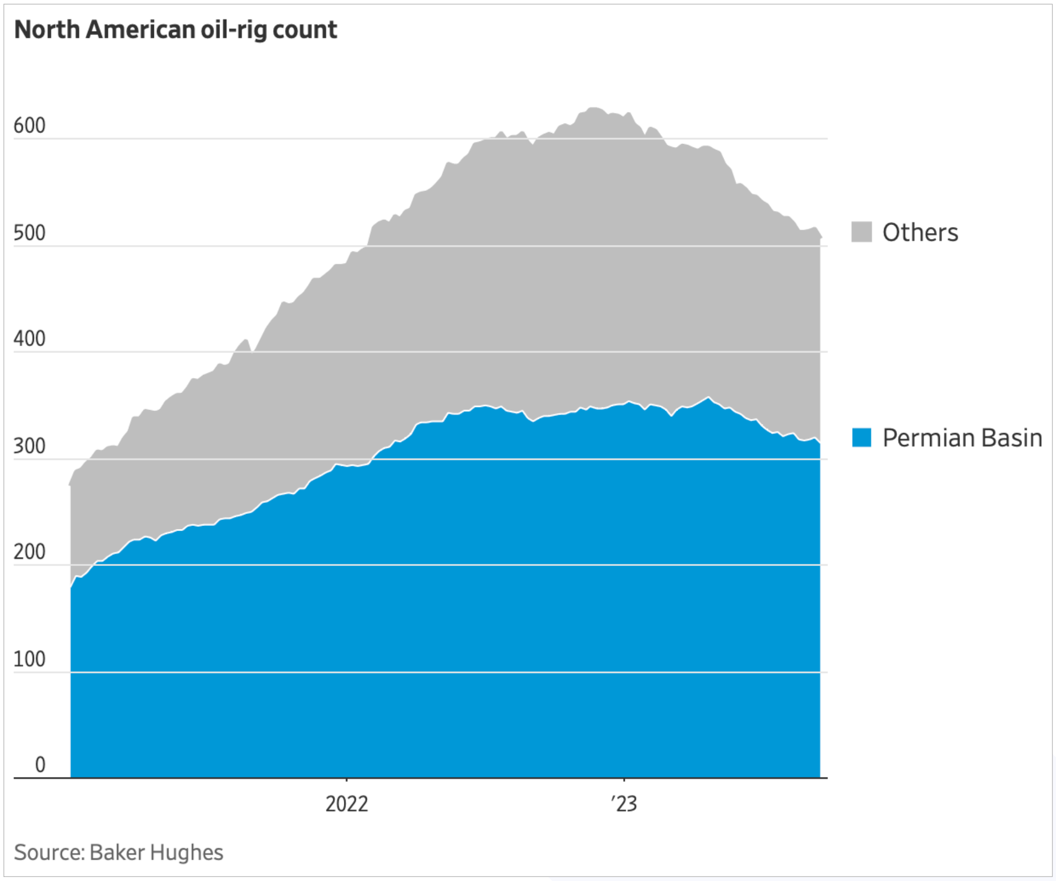
5:36 AM · Oct 23, 2023 · **33.4K** Views

Click here to watch the short video.

Energy

Don't expect shale oil to save us from higher energy prices this time (from *The Wall Street Journal* on September 28)...

> U.S. oil prices soared Wednesday to their highest level in more than a year. Most frackers plan to stay on the sidelines.
>
> Surging global demand coupled with output cuts by Saudi Arabia and Russia have sent crude prices to levels not seen since last August. The increase is hitting consumers at the pump, vexing policy makers' fight against inflation and posing new challenges for President Biden ahead of the 2024 election.
>
> Though some analysts say oil prices could soon hit $100 a barrel, U.S. shale companies aren't rushing to drill more. That means that unlike in past years when frackers flooded the market with crude and alleviated pressure, oil prices might remain elevated until someone else adds production or demand ebbs.
>
> In the Permian Basin of New Mexico and West Texas, the most active oil field in the nation, the number of rigs drilling for crude as of last week had declined by about 12% to 314 since the end of April, according to oil field services company Baker Hughes—even as U.S. oil prices jumped by about $13 a barrel over that same period.
>
> Some oil executives said most of the shale industry plans to stand pat even as global oil prices increase further. Most shale companies have vowed to hand over their winnings from high energy prices to investors via share buybacks and dividends. They also face pressure from inflation and high interest rates.
>
> "If you think about capital efficiency, and you want to make sure you're thinking long-term about your business, moving [drilling rigs] up and down a lot is not a good idea," said Jack Williams, a senior vice president at Exxon Mobil.
>
> Exxon, one of the largest shale drillers, cut its working U.S. drilling rigs down about two this year to 17, well below the 65 it had running in the Permian and other fields before a pandemic-induced oil downturn in 2020, according to energy-analytics firm Enverus.
>
> The oil giant collected a record $55.7 billion annual profit last year, as the industry recovered from the pandemic. But Exxon has kept drilling subdued, trying instead to coax more oil from fewer wells and boost shareholder payouts. It spent about $16.1 billion on dividends and share repurchases in the first half of the year, compared with $10.8 billion on capital investments, according to FactSet.
>
> On Wednesday, Exxon shares climbed to a historic high, closing at $120.20, up about 3% from the previous day, eclipsing the record it set in February.
>
> Its closest rival, Chevron CVX -3.69%decrease; red down pointing triangle, has increased its rig count by three to 18, though that is still fewer than its prepandemic fleet of 25, Enverus data show. The rig increase also reflects its acquisitions of smaller drillers Noble Energy and PDC Energy over the past three years.



Bruce Niemeyer, Chevron's president of Americas exploration and production, said in past years investors fled from U.S. oil companies when drillers dispatched new rigs in pursuit of high prices, which proved too costly to turn a profit. Niemeyer said the company's strategy under CEO Mike Wirth boils down to one word: discipline.

Continue reading here (subscription may be required).

Saudi Arabia is looking to buy more liquid natural gas (LNG) (from *Bloomberg* on October 2)...

Saudi Aramco is looking for more acquisitions in LNG following a first-ever deal in the industry last month, as it sees growing demand for the fuel.

Aramco last week announced its entry into the market with the purchase of a stake in a company that's acquiring interests in four Australian LNG projects. It will evaluate opportunities elsewhere too, said Aramco's Upstream President Nasir Al-Naimi.

"We see indications that the LNG market is positioned for structural, long-term growth," he said in written answers to emailed questions. "Aramco's intention is to become a leading global LNG player."

The giant oil producer is diversifying beyond its core business and pursuing significant growth in gas and lower carbon energy solutions, according to Al-Naimi. Europe is adding LNG terminals to replace

Russian pipeline gas, and in Asia, many nations are transitioning from dirtier fuels such as coal and fuel oil to cleaner gas.

Aramco may use mergers and acquisitions to build its LNG business, the executive said. The increase in global LNG trade from 100 million tons in 2000 to nearly 400 million tons in 2022 highlights why Aramco is interested in joining the growing market.

Its stake in MidOcean Energy, which it agreed to buy last week, is worth $500 million, with an option to further increases in its holding.

“This investment will enable us to meet the rising global demand for LNG, especially in key markets such as Asia and Europe where we’re seeing more infrastructure being established for LNG import,” Al-Naimi said.

Continue reading here (subscription may be required).

OPEC warns that the oil industry needs $14 trillion of investment by 2045 to avoid “energy chaos” (from OilPrice.com on October 9)...

The world needs $14 trillion in cumulative investments in the oil sector by 2045 to ensure market stability and avoid energy and economic chaos, OPEC said in its annual World Oil Outlook on Monday.

The annual investments need to be around $610 billion on average, the bulk of which should go to the upstream segment, the cartel said, rebuffing calls for a halt in investments in new supply.

The cumulative investments in the upstream need to be around $11.1 trillion by 2045 or an average of $480 billion per year. Downstream and midstream requirements are estimated at a total of $1.7 trillion and $1.2 trillion by 2045, respectively.

“If these investments do not materialize, it represents a considerable challenge and risk to market stability and energy security,” OPEC said in the annual report, in which it also raised its long-term oil demand forecast to 116 million bpd in 2045, up by 6 million bpd from the demand for that year expected in the 2022 annual outlook.

“Ensuring that these investments are made and sustained is a key challenge and of utmost importance to the stability of oil markets and security of supply,” OPEC said in the 2023 outlook.

This year, upstream investment is set to rise by 13%, to $360 billion, but this will only bring capital expenditure back to pre-pandemic levels.

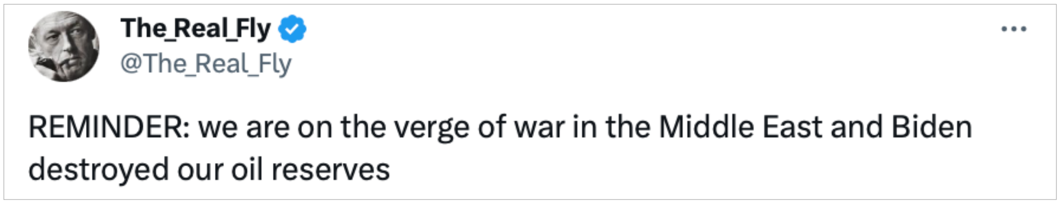
“Hurdles to upstream investment, or even calls to curtail investment, are not helpful in this regard, and raise the risk of supply shortfalls and market volatility,” the cartel warned.

OPEC Secretary General Haitham Al Ghais commented in the foreword to the report,

“Calls to stop investments in new oil projects are misguided and could lead to energy and economic chaos.”

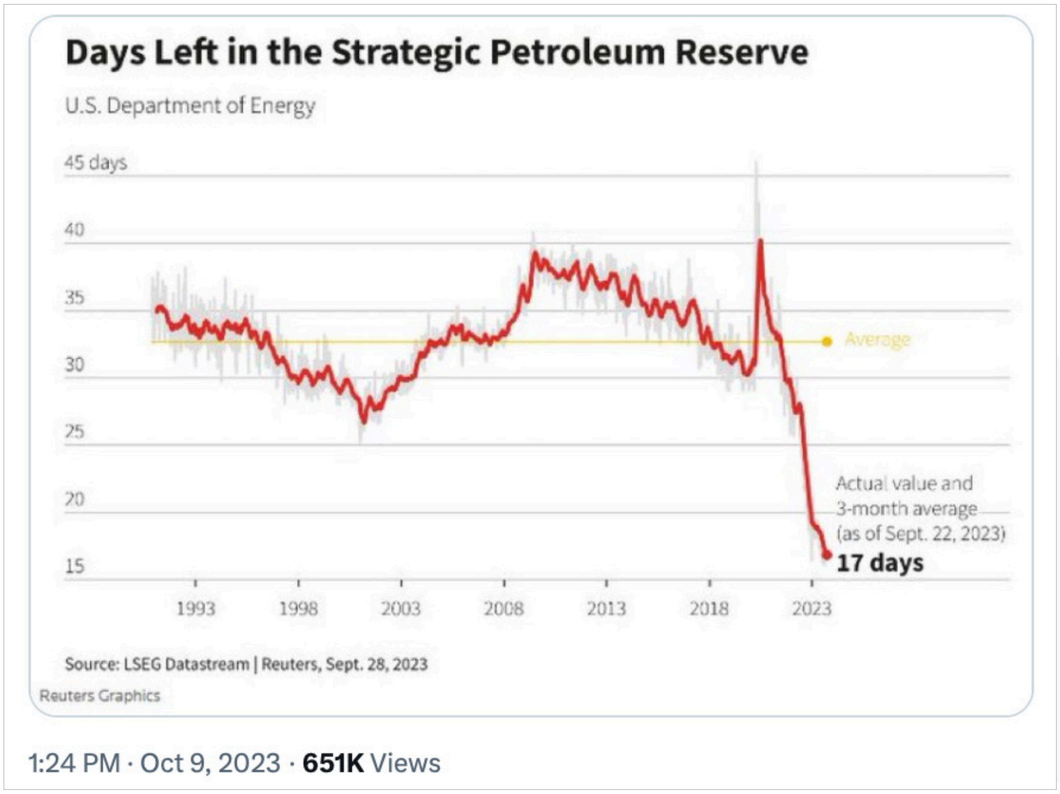
“History is replete with numerous examples of turmoil that should serve as a warning for what occurs when policymakers fail to acknowledge energy’s interwoven complexities,” Al Ghais noted.

The U.S. Strategic Petroleum Reserve ("SPR") has less than three weeks of supply left ([from The_Real_Fly via X on October 9](#))...



The_Real_Fly
@The_Real_Fly

REMINDER: we are on the verge of war in the Middle East and Biden destroyed our oil reserves



Days Left in the Strategic Petroleum Reserve

U.S. Department of Energy

Source: LSEG Datastream | Reuters, Sept. 28, 2023

Reuters Graphics

1:24 PM · Oct 9, 2023 · **651K** Views

ExxonMobil (NYSE:XOM) officially agrees to buy **Pioneer Natural Resources (NYSE:PXD)** for $60 billion ([from *Barron's* on October 11](#))...

> Exxon Mobil confirmed a deal to buy Pioneer Natural Resources on Wednesday, cementing itself as the dominant oil producer in the Permian Basin region of the U.S. The early assessment from several analysts is that Exxon is paying a reasonable price, buying a well-regarded producer at a modest valuation.
>
> After including Pioneer's debt, Exxon (ticker: XOM) will pay $64.5 billion in the all-stock transaction. It is Exxon's biggest acquisition since its merger with Mobil in 1999.
>
> The takeout price values Pioneer at 5.9 times its earnings before interest, taxes, depreciation, and amortization — a discount to Exxon's own valuation of six times Ebitda, according to Tudor Pickering Holt analyst Jeffrey Lambujon.

The deal values Pioneer shares at an 18% premium to where they were trading before The Wall Street Journal reported last week that the deal was close to being finalized. Exxon shares were down 3.5% in early trading. Pioneer (PXD) rose 1%.

"The deal was highly anticipated and we expect the 18% premium to be viewed fairly and do not anticipate rival bids," wrote TD Cowen analyst David Deckenbaum.

"Pioneer is a clear leader in the Permian with a unique asset base and people with deep industry knowledge," said Exxon Mobil CEO Darren Woods. "The combined capabilities of our two companies will provide long-term value creation well in excess of what either company is capable of doing on a stand-alone basis."

Acquiring Pioneer will jumpstart Exxon's U.S. production growth, more than doubling its output in the Permian to about 1.3 million barrels a day. Exxon's U.S. production has declined recently.

"U.S. production volumes have actually been negative for the past four quarters–a stretch not seen since 2018," noted Peter McNally, global sector lead for industrials, materials and energy at Third Bridge.

The combined company will be able to produce 2 million barrels per day in the Permian by 2027, Exxon said. Globally, Exxon is targeting 5 million barrels of daily production by 2027. That would represent about 5% of the total global oil supply. Pioneer's acreage in the Midland Basin, the eastern part of the Permian, has some of the U.S.'s largest untapped fields.

Continue reading here (subscription may be required).

The number of operating U.S. oil rigs declines for the ninth consecutive month (from Otavio Costa via X on October 18)...

Otavio (Tavi) Costa
@TaviCosta

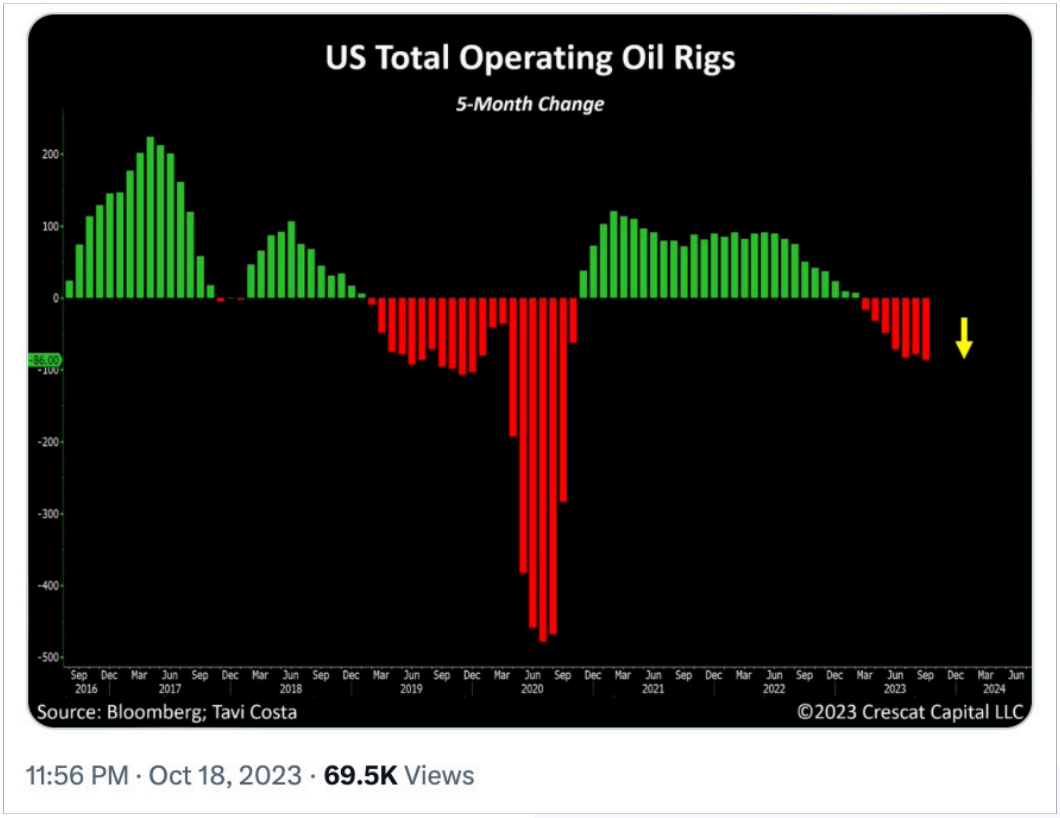
Meanwhile:

Total operating oil rigs contracted again, reaching new lows for this cycle.

This marks the 9th consecutive month of declines.

ESG policies continue to add pressure to these companies while oil prices are nearing $90 per barrel.

Keep in mind that strategic petroleum reserves are at 40-year lows as we simultaneously experience two wars unfolding.



US Total Operating Oil Rigs

5-Month Change

Source: Bloomberg; Tavi Costa

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11:56 PM · Oct 18, 2023 · **69.5K** Views

The Department of Energy's plan to begin refilling the SPR could be a huge bullish tailwind for small-cap energy stocks (from Josh Young via X on October 19)...

Josh Young
@Josh_Young_1

Is $79 the new "floor" for oil? If so, oil and gas stocks are very mispriced, particularly small caps.

> **Energy Headline News** @OilHeadlineNews · Oct 19
>
> BREAKING: In an effort to refill the SPR faster, the DOE has announced monthly solicitations to buy crude at $79 per barrel going out to May 2024, with hopes of buying up to 6 million barrels for Dec & Jan delivery.

4:15 PM · Oct 19, 2023 · **82.3K** Views

Hedge funds appear to be massively short energy ([from *Energy Headline News* via X on October 20](#))...

Energy Headline News
@OilHeadlineNews

"literally every hedge fund is neck deep in energy shorts. What can possibly go wrong." @zerohedge

"HFs sold US Energy at the fastest pace in 7 months led by short sales. This week's net selling in Energy ranks in the 98th percentile vs. the past five years." - GS PB.

6:14 PM · Oct 20, 2023 · **223.4K** Views

Chevron (NYSE:CVX) agrees to buy **Hess (NYSE: HES)** in the second blockbuster oil deal this month ([from Reuters on October 23](#))...

> Chevron (CVX) has agreed to buy Hess (HES) for $53 billion in stock to gain a bigger U.S. oil footprint and a stake in rival Exxon Mobil's (XOM) massive Guyana discoveries, the latest in a series of blockbuster U.S. oil combinations.
>
> The Chevron deal announced on Monday and a $60 billion acquisition by Exxon earlier this month will add years of oil and gas production to the two top U.S. producers' portfolios, much of it from U.S. shale. And the deals will leave European oil rivals that had shifted their focus to renewable energy further behind in fossil fuels.
>
> "This is great for energy security: It brings together two great American companies," said Chevron CEO Michael Wirth, who has bulked up the company's shale oil and gas holdings by acquiring U.S. rivals PDC Energy and Noble Energy.
>
> The combination of Hess, PDC and Noble will bring Chevron's total oil and gas output to about 3.7 million barrels per day (bpd). It will expand Chevron's shale output by 40% to 1.3 million bpd, putting it neck and neck with Exxon's projected shale output following its Pioneer Natural Resources (PXD) acquisition.

> The combined company will expand Chevron's oil production in less risky regions by adding to its output in the U.S. Gulf of Mexico and by bringing it into the Bakken shale in North Dakota.
>
> The deal gives Chevron a 30% stake in the Exxon and CNOOC (0883.HK) Stabroek oil block in Guyana, which is expected to triple to more than 1.2 million bpd by 2027.
>
> "This deal is all about the world-class Guyana asset, which is by far the crown jewel in the Hess portfolio," wrote Capital One Securities analysts in a note.
>
> Guyana has emerged as one of the world's fastest growing oil province following more than 11 billion barrels of oil and gas discoveries since 2015.
>
> CEO John Hess said the government of Guyana and Exxon would welcome Chevron's entry into the country's oil fields.

Continue reading here.

These oil and gas companies could be the next to strike a deal (from *Barron's* on October 24)...

> The oil industry looks to be embarking on a new wave of megadeals. After Exxon Mobil and Chevron's acquisitions, ConocoPhillips could be the next company looking to make a big purchase, according to KeyBanc analysts.
>
> Chevron's (ticker: CVX) planned acquisition of Hess (HES) means that both it and Exxon Mobil (XOM) have agreed deals worth $60 billion or more, when including debt, this year so far.
>
> ConocoPhillips is the biggest potential player in oil-and-gas consolidation which hasn't struck a major deal this year, according to KeyBanc analyst Tim Rezvan.
>
> ConocoPhillips (COP) is the No. 3 U.S.-based energy company but its market value is less than half that of either Exxon or Chevron. That could mean it would find it hard to take on the largest potential targets such as Occidental Petroleum (OXY).
>
> Instead, ConocoPhillips could seek incremental acquisitions in the Permian Basin, according to Rezvan. He cited Diamondback Energy (FANG) and Matador Resources (MTDR) as possible purchases which would meaningfully increase ConocoPhillips' production.
>
> Another option would be for ConocoPhillips to look at private companies such as Endeavor Energy Resources...

Continue reading here (subscription may be required).

In the inaugural issue of *Investment Chronicles* in April, we highlighted an interview with *Bear Traps Report* founder Larry McDonald (correctly) predicting that ExxonMobil's proposed deal to buy Pioneer could set off a massive wave of consolidation in the energy sector. If you missed it, be sure to check it out right here.

Other Commodities

Copper's price curve could be signaling a significant economic slowdown ([from OilPrice.com on October 2]())...

> The copper market is in a state of extreme contango—a state of the futures curve where futures contracts trade at a premium to the spot price and signal weak prompt demand.
>
> The cash to three-month contango on the London Metals Exchange (LME) jumped at the end of September to the highest since at least 1994 in data compiled by Bloomberg, as inventories pile up while demand seems to falter.
>
> Analysts say that increasing inventories signal weakening demand amid slowing global manufacturing and a weak Chinese property market, and are potentially anticipating recessions in developed economies.
>
> Due to the energy transition push, industry executives and analysts still expect high demand for copper in the medium and long term. But near-term demand and prices could continue to be weak amid an uncertain outlook for the global economy and copper market in China, the world's top commodity consumer.
>
> The faltering Chinese economic rebound after the reopening and the continued weakness in China's property sector have weighed on copper prices this year.
>
> Without a meaningful recovery and amid weaker economies elsewhere, copper prices could further slide in the coming months.
>
> Last month, copper inventories in LME-registered warehouses hit their highest level since May 2022, Ewa Manthey, commodities strategist at ING, wrote in a recent note. Copper stocks held on LME have more than doubled in just two months, which "shows clear signals of weakening demand," Manthey said.
>
> In the first three weeks of September, copper inventories rose by more than 50%, following a similar rise in August.
>
> Futures spreads are loosening, indicating ample supply, ING's Manthey said.
>
> "With rising LME inventories and loosening nearby spreads, more weakness may lie ahead for copper prices," according to the strategist.
>
> Disappointing recovery and a still struggling property sector in China have combined with the Fed's signal that interest rates will be higher for longer, further weighing on prices amid already weakening demand for copper, Manthey noted.
>
> "For copper, risks remain to the downside heading into the year's end on China's uncertain outlook for the property sector. We believe commodity-intensive stimulus is needed to support short to medium-term demand growth," she added.
>
> Globally, manufacturing slowdown and an annual decline in global trade not seen since the pandemic could be weighing on copper demand in the near term, too.
>
> Global trade dropped in July by 3.2% year-on-year – the steepest annual decline in three years since August 2020, according to World Trade Monitor published by the Netherlands Bureau for Economic Policy Analysis, CPB.

> "Global goods trade fell at its fastest pace since the pandemic in July and the timelier trade and survey data point to further declines in August and September," Ariane Curtis and Lily Millard of Capital Economics wrote in a note last week.

Continue reading here.

This year has seen far-above-average inflows into the global commodity market (from The Daily Shot on October 4)...

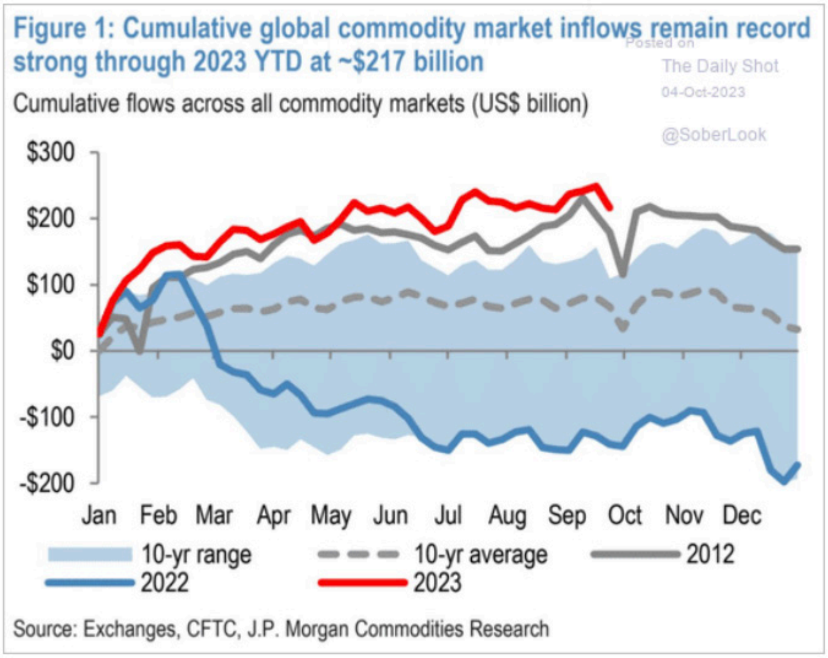


Figure 1: Cumulative global commodity market inflows remain record strong through 2023 YTD at ~$217 billion

Source: Exchanges, CFTC, J.P. Morgan Commodities Research

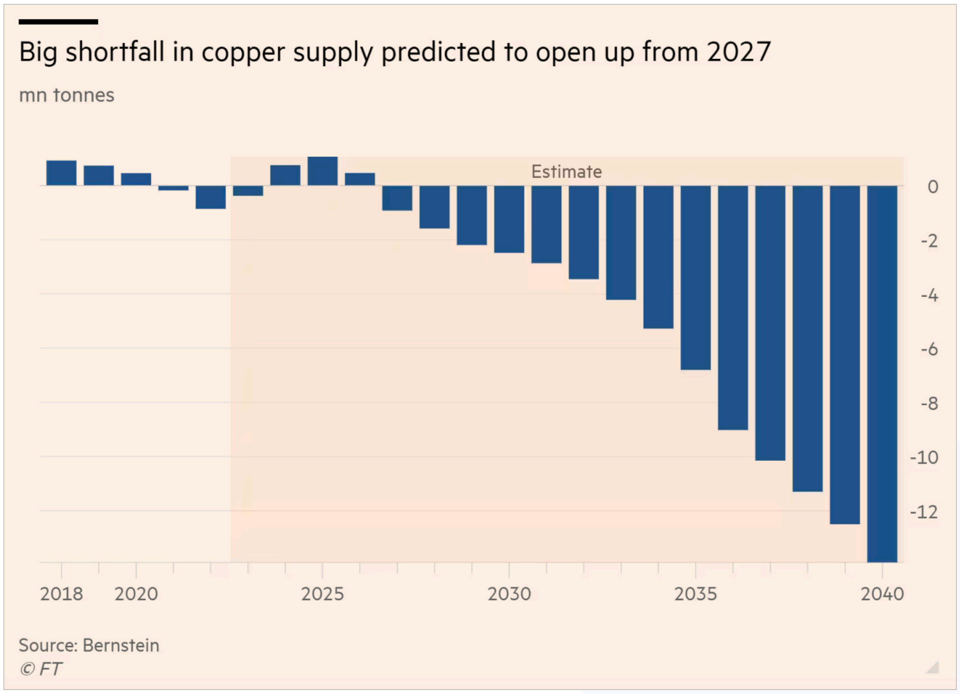
Source: JP Morgan Research; @dailychartbook

Despite weak near-term demand, copper producers are warning that there aren't enough mines to meet long-term expectations (from *The Financial Times* on October 9)...

> The world's largest copper producers have warned that there is a lack of mines under development to deliver enough of the metal to keep pace with the clean energy transition.
>
> The warning comes as miners struggle with falling metal prices because of the weakness of the global economy and cost inflation, which makes executives, investors and banks cautious over financing new projects.
>
> With labour shortages also holding back new supplies, there are worries over the switch to carbon-free power since copper is vital to manufacture electric cars and upgrade the electricity grid.
>
> Kathleen Quirk, president of Freeport-McMoran, the largest US copper producer, said that higher copper prices alone would not be enough to secure enough metal needed for the world to go green.

"Now it's not just price. It's these other factors that really are going to limit how quickly we can develop supplies," she said, speaking on the sidelines of the FT Mining Summit last week. "What may end up happening is that this [energy transition] gets extended out longer."

Copper prices have dropped 4 per cent this year to about $8,000 a tonne, down from more than $10,000 at their peak last year, as the growth in the world economy has cooled off and production at new mines in Peru and Chile has been increasing.


Big shortfall in copper supply predicted to open up from 2027

mn tonnes

Source: Bernstein
© FT

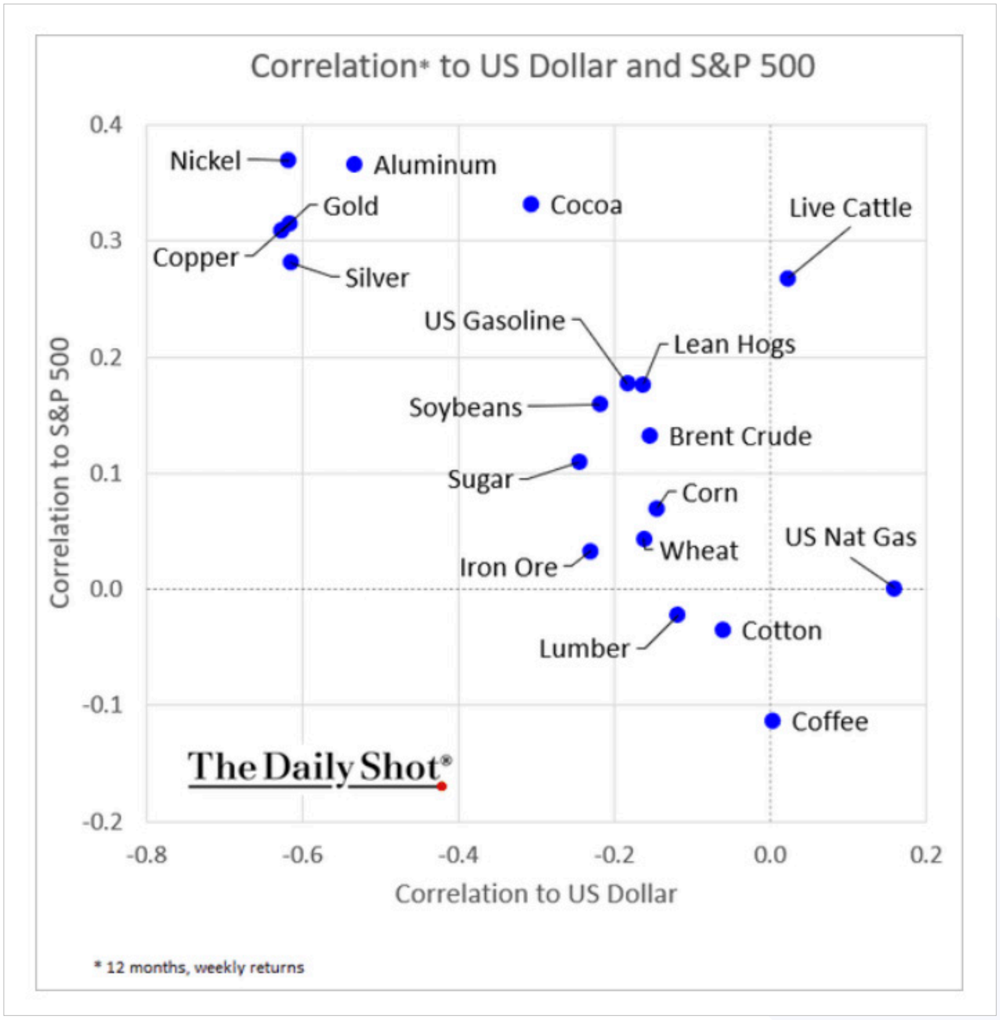
Yet demand for the commodity is expected to take off to supply the green economy, as well as to support the economic rise of India and other developing nations.

The living standards of the average westerner requires 200-250 kilogrammes of copper per person, versus 60kg on average globally, according to Anglo American, one of the world's largest miners.

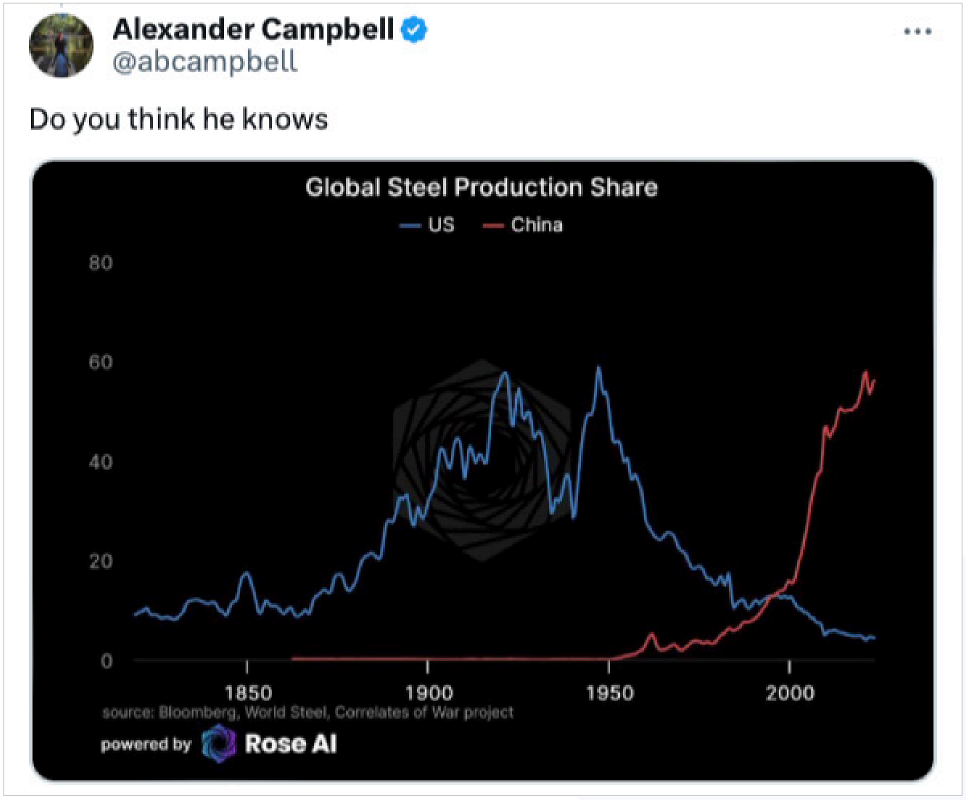
It is used in everything from electrical wiring and household appliances to infrastructure such as trains.

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

Not all commodities are highly correlated to the U.S. dollar (from The Daily Shot on October 16)...



During a speech last week, President Joe Biden stated that American workers were once again building the "arsenal of democracy" like they did in World War II. He clearly hasn't seen the chart below (from Alexander Campbell via X on October 19)...



Alexander Campbell
@abcampbell

Do you think he knows

Disclose.tv @disclosetv · Oct 19

NOW - Biden: "Just as in World War 2, today, patriotic American workers are building the arsenal of Democracy."

8:50 PM · Oct 19, 2023 · **2,070** Views

China is now restricting exports of graphite, which is critical in manufacturing electric-vehicle batteries (from Reuters on October 20)...

> China said on Friday it will require export permits for some graphite products to protect national security, springing a surprise with another bid to control critical mineral supply in response to challenges over its global manufacturing dominance.
>
> China is the world's top graphite producer and exporter. It also refines more than 90% of the world's graphite into the material that is used in virtually all EV battery anodes, which is the negatively charged portion of a battery.
>
> "This bold and unexpected move by China in graphite has taken us by surprise, arriving far sooner than anyone could have predicted," said Kien Huynh, chief commercial officer at Alkemy Capital Investments , which is focused on developing projects in the energy transition metals sector.
>
> Beijing requires the export permits at a time when many foreign governments are ratcheting up pressure on Chinese companies over their industrial practices.
>
> The European Union is weighing levying tariffs on Chinese-made EVs, arguing they unfairly benefit from subsidies. Also, the U.S. government earlier this week widened curbs on Chinese companies' access to semiconductors, including stopping sales of more advanced artificial intelligence chips made by Nvidia.
>
> U.S. President Joe Biden discussed critical minerals in Washington on Friday with EU officials as part of a wide-ranging set of negotiations.
>
> China's graphite curbs are similar to those imposed since Aug. 1 for two chip-making metals, gallium and germanium. The restrictions have slashed exports of those metals recently and pushed up prices outside of the country.
>
> The action is intensifying efforts among miners outside China to bring graphite projects to fruition while efforts to find alternatives will also be ramped up.
>
> "What China is saying to the West with this decision is that we are not going to help you make electric cars, you have to find your own way to do that," Northern Graphite (NGC.V) CEO Hugues Jacquemin said.

Continue reading here.

Bitcoin and Crypto

Why famed financial author Michael Lewis is "dangerously wrong" about FTX fraudster Sam Bankman-Fried (from David Z. Morris via Flesh/Markets on October 2)...

> Yesterday, Sunday, was the media coming-out party for Michael Lewis' "Going Infinite," the forthcoming book about Sam Bankman-Fried. Based on the rollout, the book is poised to be a disaster for the public's understanding of FTX, and for Lewis' reputation among actually informed finance watchers.
>
> The worst of this came during a 60 Minutes interview with Lewis that aired last night.
>
> "They actually had a great real business. If no one had ever cast aspersions on the business, if there hadn't been a run on customer deposits, they'd still be sitting there making tons of money."
>
> This is embarrassing because it's clearly based on nothing but Lewis' feelings. It is close to impossible to know whether FTX was in any way a successful business.
>
> That's because of the total lack of financial controls within FTX. There is absolutely no way of knowing how it really looked financially. That's especially true given that much of the exchanges revenue was directly and indirectly derived from trading by Alameda Research, which was conducted with misappropriated customer funds.
>
> Lewis gave a few other regrettable sound bites. Asked "Do you think he knowingly stole customers money?" Lewis replies: "Put that way, no ... so, there's another side of this."
>
> Lewis broadly characterizes the leakage of $8 billion dollars from FTX to Alameda Research (via the infamous "poorly labeled internal account") as merely an oversight by a doofus. This is obviously a tempting frame – but it doesn't withstand scrutiny, and it badly muddies the waters.
>
> Lewis also still seems, in a word, simply infatuated with SBF, and perhaps a bit dazzled by how close he got to the illusion of massive sudden wealth. Lewis was "embedded" with FTX for months before the exchange's collapse, and he had seemed fawning and credulous in his treatment of Bankman-Fried, for instance at an event detailed by Zeke Faux at Bloomberg. In the new interview, Lewis reveals that Bankman-Fried began consulting him for advice, which is ethically dicey and certainly seems to have clinched yet another of the seductions at which Bankman-Fried, in his odd way, excelled.
>
> Now we're seeing the result of a journalist getting too close to his subject.
>
> **A Sam-Shaped Hole**
>
> Lewis appears nearly obsessed with Effective Altruism, emphasizing SBF's stated intent rather than his actual actions at every turn. "There is still a Sam Bankman-Fried-shaped hole in the world that now needs filling," Lewis says. "That character would be very useful, what he wanted to do with the resources."
>
> 60 Minutes also highlights a related problem, saying in one of its ad breaks that Lewis' new book "leaves it up to readers whether Bankman-Fried was a crook, or just a guy singularly ill-equipped to run a business." In some abstract sense that's defensible journalistically, since SBF hasn't been convicted yet.
>
> But taken together, the whole distracts from Sam Bankman-Fried's alleged massive crime. Lewis seems to go beyond balance, and the 60 Minutes interview suggests why he might be not just neutral, but emotionally compromised.

Sam Bankman-Fried "started using me as a sounding board for decisions he was making," Lewis says.

Almost as disappointing as the 60 Minutes interview is this preview chapter of Going Infinite being offered at the Washington Post. Long and short, it's not very good. It's not interesting. I get that an excerpt like this is intended for the broadest possible audience, but the chapter has basically no new information for anyone who has been following the story, and amounts to a replay of well-known stuff about Sam Bankman-Fried's extremely weird personality.

It's also, unfortunately, another example of major omissions that color events. Specifically, Lewis fixates (in an entirely uninteresting way) on Sam's habit of playing the game Storybook Brawl during interviews – in this case, a February 2022 conversation with Anna Wintour of Vogue. But Michael Lewis – a financial journalist, mind you – omits the fact that in March of 2022, FTX bought the company that made Storybook Brawl.

This is relevant because gaming appeared again and again after that in SBF's media treatment, right up to the moment everything went bad. Notoriously, a hagiographic, now-scrubbed Sequoia Capital profile used SBF's playing *League of Legends* during funding calls as evidence of his brilliance. When Storybook Brawl surfaced in later coverage, there were suspicions that it was a marketing move. Andthe game shut down not long after FTX's collapse.

All of that seems relevant, but Lewis omits it in favor of the "color" of a megafounder addicted to gaming, and he too winds up making it seem like brilliance rather than a total lack of discipline.

The same gist suffuses the chapter. It details a man who seems completely disorganized, but frames it in terms of SBF's own mythology. The chapter is entered around Natalie Tien, Sam's scheduler and PR head, and describes how often he would simply skip meetings if he decided at the last minute that they weren't worth it.

"More often than not, it was Sam who had suggested some meeting or public appearance. And yet Sam treated everything on his schedule as optional. The schedule was less a plan than a theory."

The idea that there was a "theory" behind this sort of behavior speaks to the apparent issues here. Like Effective Altruism and most other forms of consequentialist decision-making, what's really happening is a post-facto rationalization of behavior that's not actually being guided rationally.

Lewis goes on:

"'He'll never tell you what he's going to do,' explained Natalie. 'You have to always be prepared it's going to change every second.' Every decision Sam made involved an expected value calculation. The numbers in Sam's mind were always shifting. 'There's a 60 percent chance I'll go to Texas tomorrow.' 'What does that mean, a 60 percent chance?' asked Natalie."

I love this moment, because it encapsulates how the stupid, shallow performativity of consequentialist philosophies, like Effective Altruism, play out in real life. Lewis here is regurgitating mythology about how Bankman-Fried was calculating "expected value," rather than just being a lazy, flaky guy with mental problems. But it's equally obvious that Bankman-Fried himself was fully bought in to the mythology himself. He thought he was actually calculating these percentages, somehow, but in fact he was just winging it at every moment.

A reasonable person would immediately intuit this is a terrible, untrustworthy leader and business partner. But by indulging the idea that SBF is constantly, madly calculating percentages in his head, Lewis seems to cosign SBF's own entirely fraudulent self-conception.

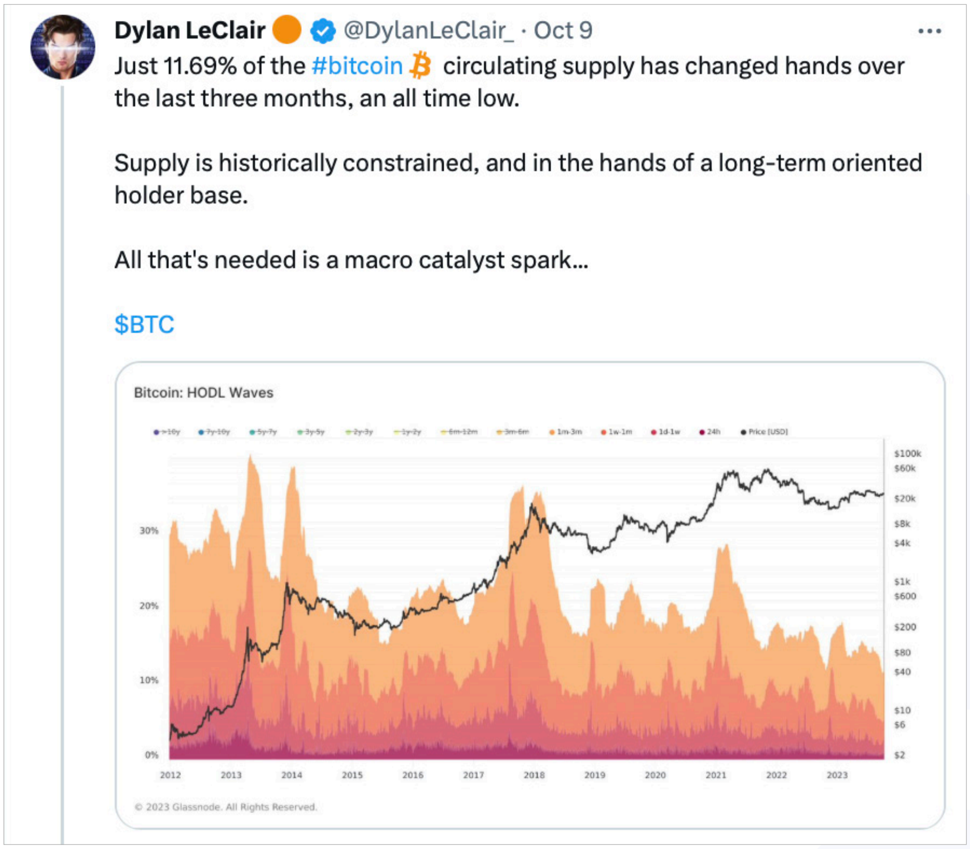
That's the deepest part of the con, worked by the self against what William Burroughs called "the mark inside." And in SBF and his parent's continued commitment to his innocence, we see just how effectively they worked their own internal marks, with plenty of help from surrounding yes-men.

But in reality, SBF was just a bumbling asshole, whose mistreatment of customers could have easily been foreseen by his mistreatment of literally everyone else.

"The cost this implied for others simply never entered his calculations. With him it was never personal. If he stood you up, it was never on a whim, or the result of thoughtlessness. It was because he'd done some math in his head that proved that you weren't worth the time," Tien tells Lewis.

The moral universe is far less complicated than many people – particularly Bankman-Fried's parents – would like us all to believe. A calculation that someone is dismissable or disposable because they're not tactically useful is not a moral judgment, but in fact the exact opposite.

The Bitcoin supply is "historically constrained" (from Dylan LeClair via X on October 9)...



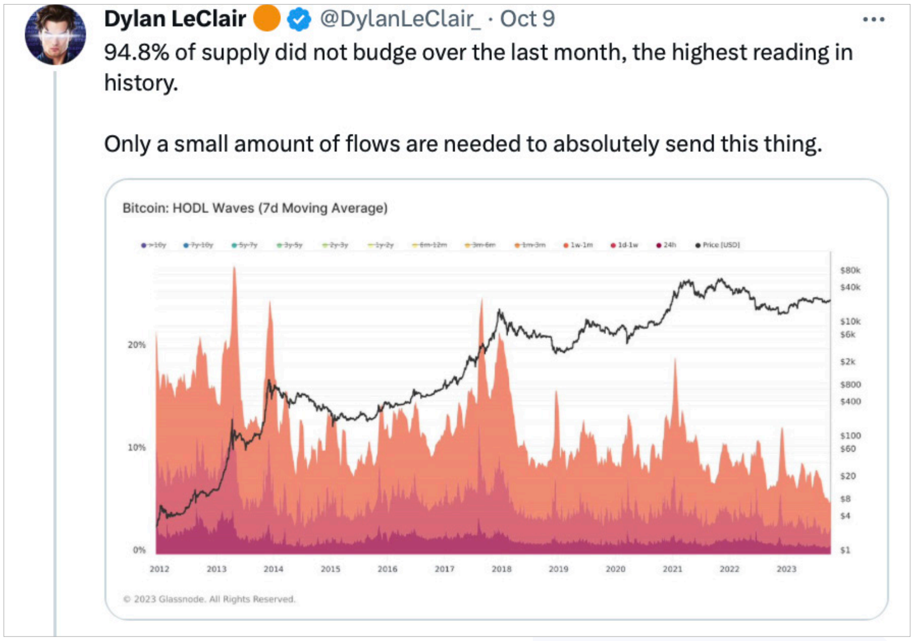
Dylan LeClair @DylanLeClair_ · Oct 9

Just 11.69% of the #bitcoin circulating supply has changed hands over the last three months, an all time low.

Supply is historically constrained, and in the hands of a long-term oriented holder base.

All that's needed is a macro catalyst spark...

$BTC



Dylan LeClair @DylanLeClair_ · Oct 9

94.8% of supply did not budge over the last month, the highest reading in history.

Only a small amount of flows are needed to absolutely send this thing.

Bitcoin: HODL Waves (7d Moving Average)

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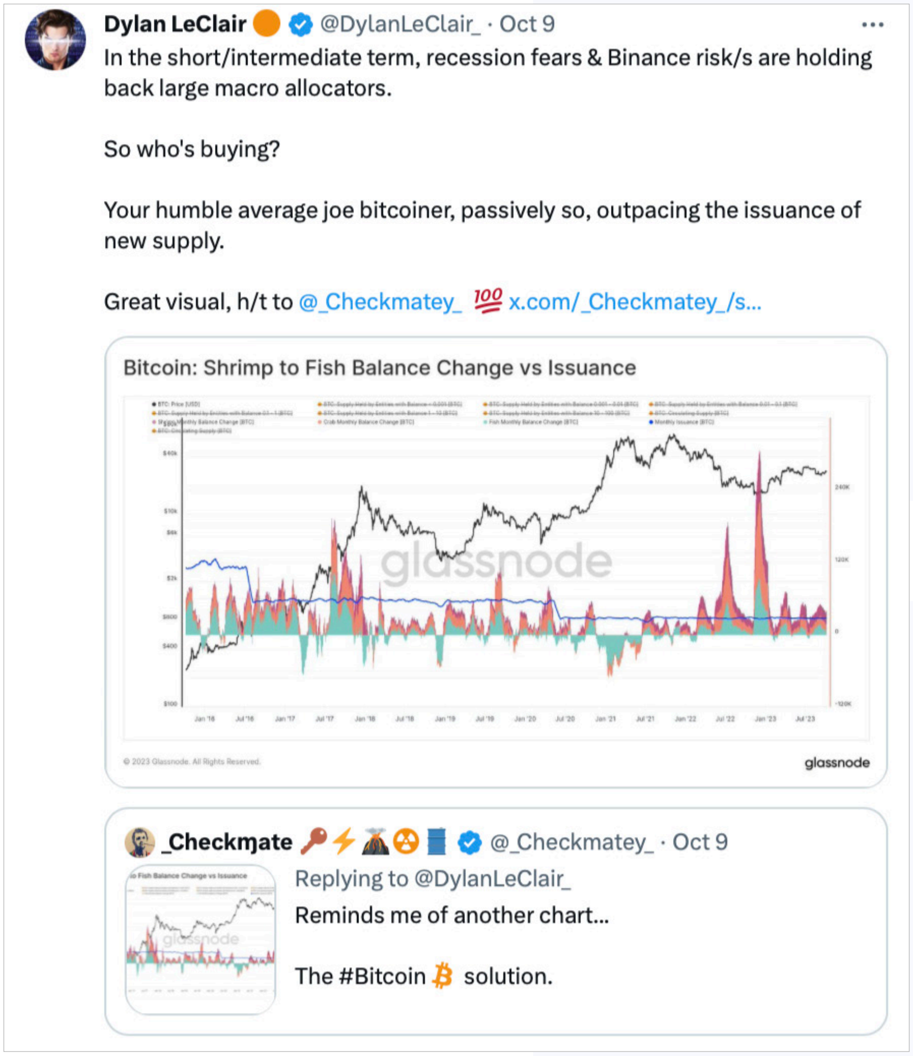

Dylan LeClair @DylanLeClair_ · Oct 9

In the short/intermediate term, recession fears & Binance risk/s are holding back large macro allocators.

So who's buying?

Your humble average joe bitcoiner, passively so, outpacing the issuance of new supply.

Great visual, h/t to @_Checkmatey_ 💯 x.com/_Checkmatey_/s...

Bitcoin: Shrimp to Fish Balance Change vs Issuance

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glassnode

_Checkmate 🔑⚡🌋☢️🛢️ @_Checkmatey_ · Oct 9

Replying to @DylanLeClair_

Reminds me of another chart...

The #Bitcoin ₿ solution.

Asset manager Fidelity Investments on why every investor should consider Bitcoin over any other digital asset ([from Documenting Bitcoin via X on October 10]())...

Documenting ₿itcoin 📄
@DocumentingBTC

Fidelity manages $4,500,000,000,000.

43,000,000 investors trust Fidelity.

Yesterday, they published new research explaining why investors should consider #bitcoin ₿

Here are 10 key points 🧵👇

Fidelity DIGITAL ASSETS℠

SEPTEMBER 2023

Bitcoin First Revisited:

Why investors need to consider bitcoin separately from other digital assets

Documenting Ƀitcoin 📄
@DocumentingBTC

2/ Fidelity finds #bitcoin ₿ is the best money.

"Bitcoin clearly possesses a lot of good qualities of money, combining the scarcity and durability of gold with the ease of use, storage, and transportability of fiat"

	GOLD	BITCOIN	FIAT CURRENCY	
DURABLE	+	+	—	While all are physically durable, fiat currency has not maintained purchasing power durability over time
DIVISIBLE	—	+	+	Physical gold is only divisible to small pieces; bitcoin is divisible to eight decimals
FUNGIBLE	+	+	—	Gold and bitcoin are fungible, but fiat currency is not fungible with other fiat (i.e. U.S. dollar is not fungible with Canadian dollar)
PORTABLE	—	+	+	Gold has a high value-to-weight ratio, but compared to the others, is still heavy and cumbersome to transport
VERIFIABLE	—	+	—	Both gold and fiat currency have been counterfeited; gold can be verified, but only through cumbersome testing
SCARCE	+	+	—	Gold is relatively scarce, bitcoin is scarce and finite; the only supply constraint on fiat currency is willingness of government or central bank
TRACK RECORD	+	—	—	Gold has the longest track record as money and maintaining purchasing power; bitcoin's history is the shortest; fiat currency has poor track record[2]

Documenting Bitcoin @DocumentingBTC · Oct 10

3/ Fidelity explains "Virtuous Cycle of Bitcoin"

"This #bitcoin ₿ network competition is likely to result in a winnertake-all scenario as the network grows and becomes more valuable"

Documenting Bitcoin @DocumentingBTC · Oct 10

4/ Fidelity compares #bitcoin ₿ to the wheel.

"The invention of the wheel represented an entirely new technology that, once invented, could never be reinvented. Similarly, never in human history had the problem of peer-to-peer electronic cash been solved until Bitcoin"

Any Subsequent Monetary Good Would be "Reinventing the Wheel"

The invention of the wheel represented an entirely new technology that, once invented, could never be reinvented. Similarly, never in human history had the problem of digital scarcity and true peer-to-peer electronic cash been solved until Bitcoin was invented. Solving this problem was not merely an incremental improvement, but a leap forward or an unlocking of the puzzle of how digital scarcity could exist.

Because Bitcoin is currently the most decentralized and secure monetary network (relative to all other digital assets), a newer blockchain network and digital asset that tries to improve upon bitcoin *as a monetary good* will potentially have to differentiate itself by sacrificing one or both of these properties, an idea we explore in more detail later (the "Blockchain Trilemma"). A competitor that tries to merely copy Bitcoin's entire code will also fail as there will be no reason to switch from the largest monetary network to one that is completely identical, but a fraction of the size.

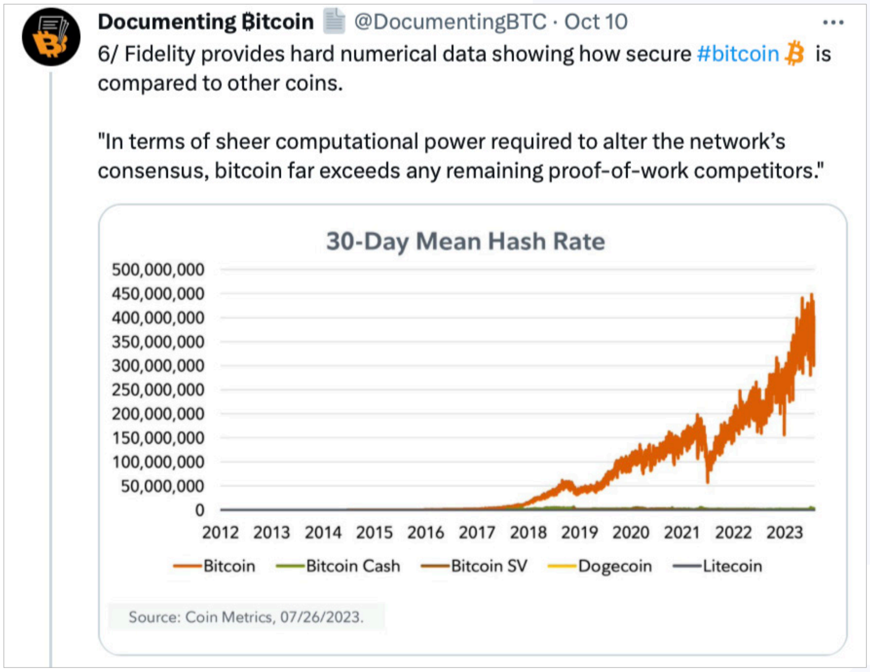
Documenting Ƀitcoin @DocumentingBTC · Oct 10

5/ Fidelity is amazed #bitcoin ₿ survived.

"Every minute, hour, day, and year that Bitcoin survives increases its chances of continuing into the future...people would probably underestimate all of the negative events that Bitcoin has already endured"

A non-exhaustive list of some of the negative events that Bitcoin has endured:

Created by an anonymous person(s) whose true motive or any affiliation is unknown	Some bitcoin tokens have been confiscated by the FBI	Multiple exchange hacks	Multiple large exchanges and service companies going bankrupt
Used on the dark web for illicit purchases	Endured a "civil war" regarding the core code (see section on blocksize war)	Price has suffered multiple 50%+ drawdowns, many larger than 80%	Banned in multiple countries
Has been labeled a fraud, ponzi scheme, speculative gamble	Remains primary form of payment for ransomware attacks	Has endured multiple forks in its code	Copied by competitors thousands of times



Documenting Ƀitcoin @DocumentingBTC · Oct 10

6/ Fidelity provides hard numerical data showing how secure #bitcoin ₿ is compared to other coins.

"In terms of sheer computational power required to alter the network's consensus, bitcoin far exceeds any remaining proof-of-work competitors."

30-Day Mean Hash Rate

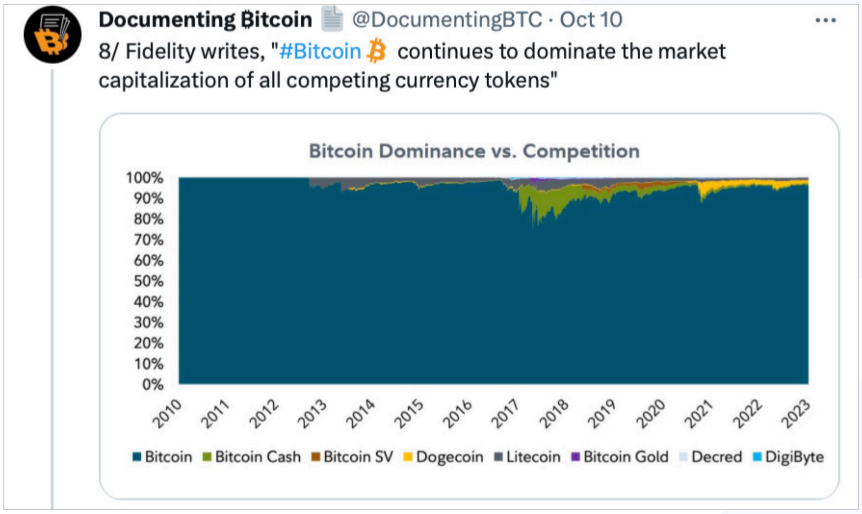
Source: Coin Metrics, 07/26/2023.

Documenting Ḇitcoin @DocumentingBTC · Oct 10

7/ Fidelity compares #bitcoin ₿ to internet.

"The internet protocol suite known as TCP/ IP is an open-source base layer...applications on top of which to be built."

Owning #bitcoin ₿ "would be akin to being able to own the base layer of the Internet"



Documenting Ḇitcoin @DocumentingBTC · Oct 10

8/ Fidelity writes, "#Bitcoin ₿ continues to dominate the market capitalization of all competing currency tokens"

Documenting Ɓitcoin 📄 @DocumentingBTC · Oct 10

9/ Fidelity agrees #bitcoin ₿ is useful.

"It appears at this point that Bitcoin has found a role in the digital asset ecosystem as a scarce, store of value asset at the very least."

Bitcoin is Aiming to Satisfy a Clear Market Need

Of course, we do not know what the new digital asset system will look like as it continues to mature, whether we will see a multi-chain world of different tokens with varying degrees of centralization, or if we will see a winner-take-all approach where more applications are built on the most secure and decentralized chain. However, it appears at this point that Bitcoin has found a role in the digital asset ecosystem as a scarce, store of value asset at the very least. The ability for most of the other digital assets to fulfill some other necessary use case still remains to be seen in our opinion, although there has been significant progress over the past few years in terms of other assets finding their product-market fit. The same can not be said for Bitcoin. This creates far different risk-return investment profiles between Bitcoin and all other digital assets and ultimately should impact how allocators consider incorporating each into their investment portfolio.

Documenting Ɓitcoin 📄 @DocumentingBTC · Oct 10

10/ Fidelity concludes "#bitcoin ₿ should be considered first and separate from all other digital assets that have followed it"

Conclusion

Traditional investors typically apply a technology investing framework to bitcoin, leading to the conclusion that bitcoin, as a first-mover technology, will easily be supplanted by a superior one or have lower returns. However, as we have argued here, bitcoin's first technological breakthrough was not as a superior payment technology, but as a superior form of money. As a monetary good, bitcoin is unique. Therefore, not only do we believe that investors should consider bitcoin first to understand digital assets, but that bitcoin should be considered first and separate from all other digital assets that have followed it.

You can read the full report here.

SEC Chair Gary Gensler confirms a spot Bitcoin exchange-traded fund ("ETF") is coming to market soon (from Good Morning Crypto via X on October 18)...

Good Morning Crypto
@3TGMCrypto

🚨🚀 MUST WATCH: #GaryGensler Drops a Bombshell on #BitcoinETF 💥

SEC Chair Today: "Yes, that's right. We didn't appeal last week. We are reviewing all the applications for ETF products. When approved, it will trade on Stock Exchanges"

With 8-10 filings under consideration, brace for a Crypto takeover on Stock Exchanges! 🚀🌐#CryptoRevolution #Grayscale #Ripple

2:17 PM · Oct 18, 2023 · **796.3K** Views

However, an ETF is just the beginning of the longer-term bullish case for Bitcoin adoption (from Stack Hodler via X on October 20)...

> **Some people will try to get cute and sell the initial Bitcoin ETF approval.**
>
> But that's merely the starting gun to BTC adoption.
>
> Passive 401(k) flows into Bitcoin ETFs are not priced in.
>
> Target date funds adding BTC exposure is not priced in.
>
> Asset managers recommending 10% BTC exposure as a counterweight to melting bonds is not priced in.
>
> The FASB rule change that enables corporations to create BTC endowments is not priced in.
>
> Full insurance and pension fund adoption is not priced in.
>
> Widespread nation state adoption is not priced in.

Sovereign wealth fund adoption is not priced in.

Energy being denominated in BTC is not priced in.

Think this sounds crazy?

Consider this: Sovereign debt has played the role of primary reserve asset for decades.

And it's now melting down in front of all of us.

The need for a new neutral reserve asset is now glaringly obvious to everyone.

Bitcoin made it to $30,000 mostly on the back of retail investors that saw the future we're now entering.

Big money has mostly treated BTC as a volatile play thing for now.

The people that stuck around were the long-term thinkers that see Bitcoin as the best protection for the sovereign debt crisis that the world is just now waking up to.

A finite asset without counter-party risk that can't be seized or debased.

A simple proposition that is starting to catch on.

But here's the problem: The majority of coins are already in *very* strong hands.

BTC is like a game of musical chairs, except you can sit down before the music stops if you want.

And many of us sat down a long time ago.

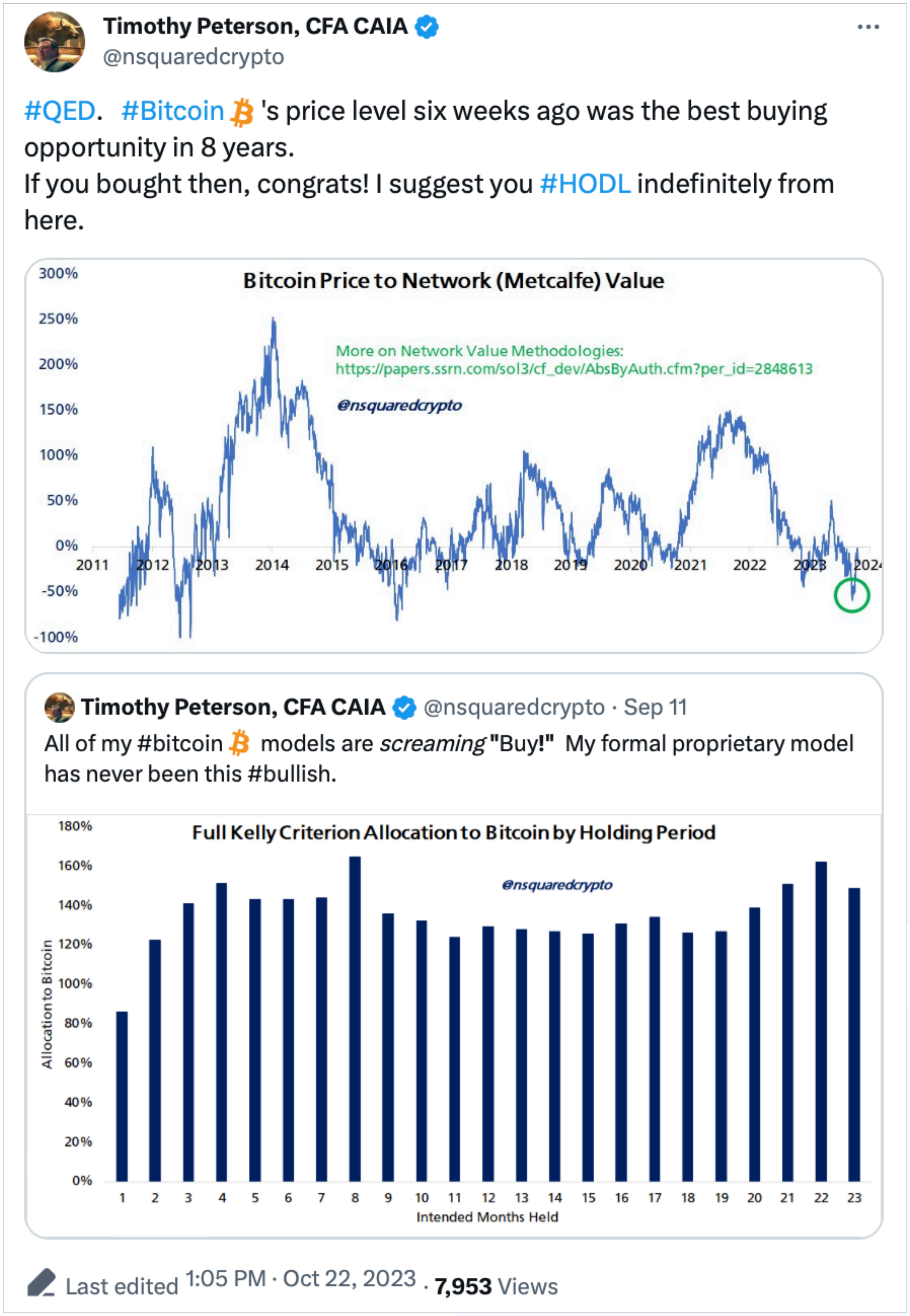
Now that the music is slowing, we aren't willing to give up our seat.

21 million chairs.

The vast majority are already occupied.

And we're about to witness a bidding war for the remaining seats.

This summer was arguably one of the best times to buy Bitcoin in years (from Timothy Peterson, CFA CAIA via X on October 22)…



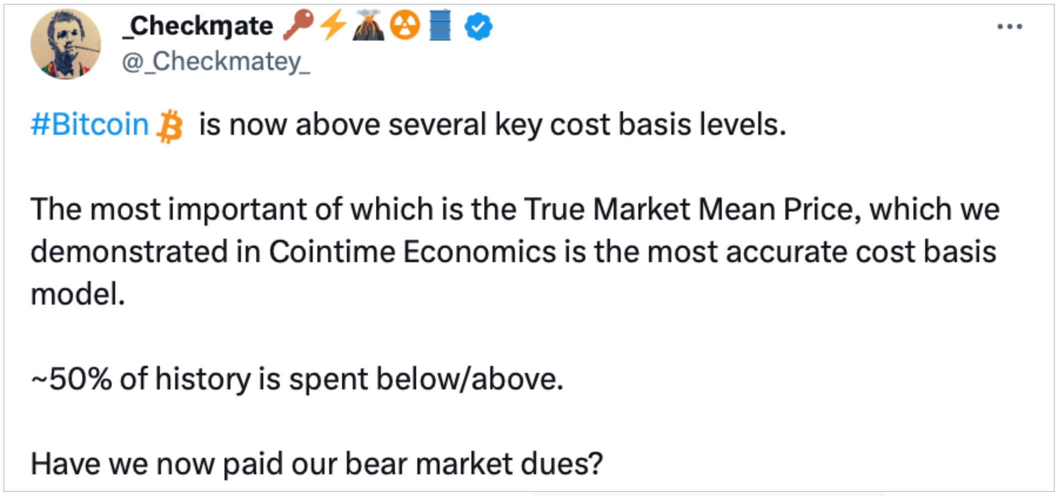
Timothy Peterson, CFA CAIA
@nsquaredcrypto

#QED. #Bitcoin ₿ 's price level six weeks ago was the best buying opportunity in 8 years.
If you bought then, congrats! I suggest you #HODL indefinitely from here.

Timothy Peterson, CFA CAIA @nsquaredcrypto · Sep 11
All of my #bitcoin ₿ models are *screaming* **"Buy!"** My formal proprietary model has never been this #bullish.

Last edited 1:05 PM · Oct 22, 2023 · **7,953** Views

Bitcoin is now back above some critical price levels (from _Checkɱate via X on October 23)...



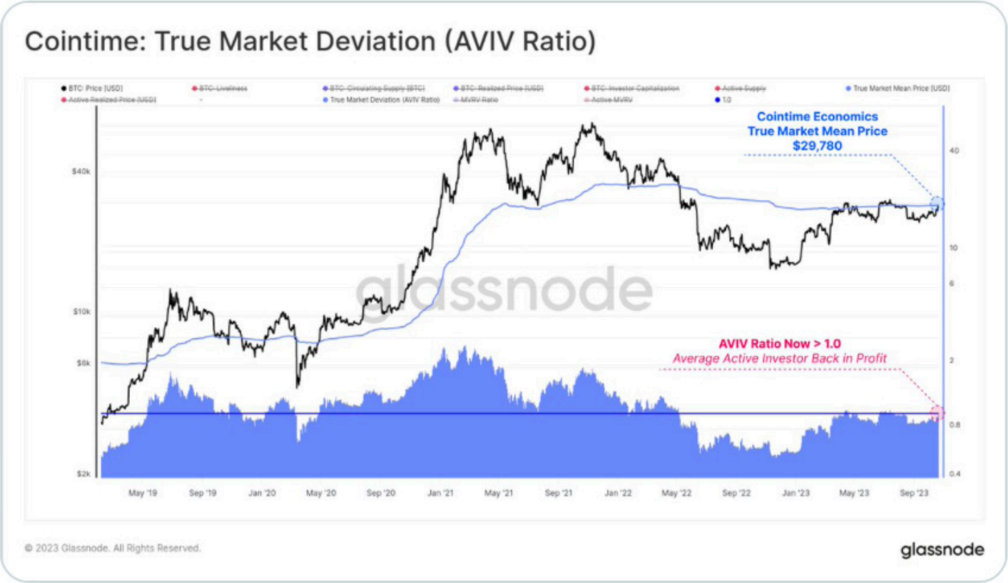
_Checkɱate 🔑⚡🌋☢️🛢️ ✓
@_Checkmatey_

#Bitcoin ₿ is now above several key cost basis levels.

The most important of which is the True Market Mean Price, which we demonstrated in Cointime Economics is the most accurate cost basis model.

~50% of history is spent below/above.

Have we now paid our bear market dues?



Cointime: True Market Deviation (AVIV Ratio)

9:26 AM · Oct 23, 2023 · **8,648** Views

Don’t believe the hype about Bitcoin funding Hamas (from No BS Bitcoin on Oct 23)...

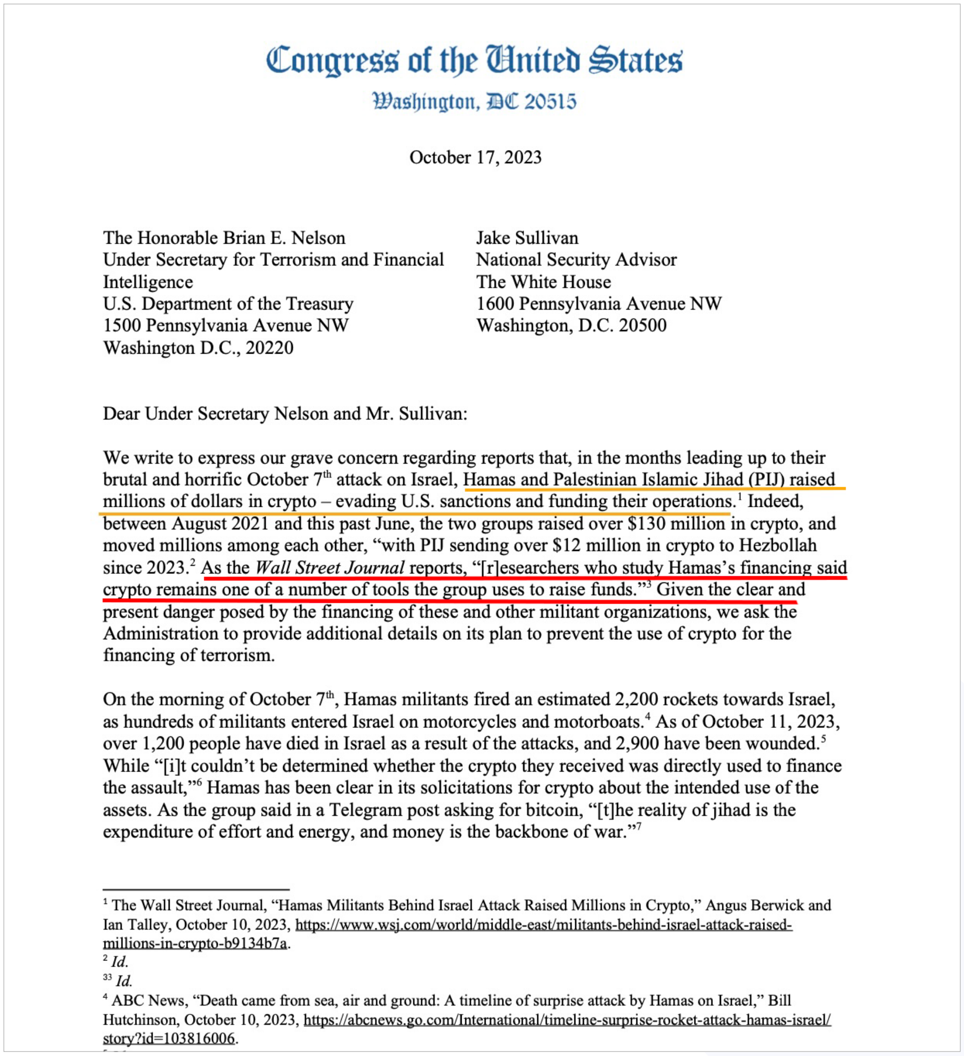
- Last week the Wall Street Journal published an article claiming that over $90 million worth of Bitcoin and cryptocurrencies have been used to fund Hamas - a claim that gained serious attention amongst multiple media outlets, noted Swan's Sam Callahan.

> "Digital-currency wallets that Israeli authorities linked to the PIJ received as much as $93 million in crypto between August 2021 and June this year, analysis by leading crypto researcher Elliptic showed. Wallets connected to Hamas received about $41 million more over a similar time period, according to research by another crypto analytics and software firm, Tel Aviv-based BitOK," was stated in the article.

- "In response to the article, anti-Bitcoin politicians directly linked the WSJ article as evidence in a letter to the White House and Treasury “to address the serious national security threats posed by crypto’s use to finance terrorism,” he added.

- One of the prominent anti-Bitcoin politicians, senator Elizabeth Warren, along with 28 other senators and 76 members of House of Representatives wrote a letter to the U.S. Treasury and the White House calling to “act to meaningfully curtail illicit crypto activity."

> “That the deadly attack by Hamas on Israeli civilians comes as the group has become ‘one of the most sophisticated crypto users in the terror-finance domain’ clarifies the national security threat crypto poses to the U.S., and our allies,” was stated in the letter, which also cites the WSJ article.



Congress of the United States
Washington, DC 20515

October 17, 2023

The Honorable Brian E. Nelson
Under Secretary for Terrorism and Financial Intelligence
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW
Washington D.C., 20220

Jake Sullivan
National Security Advisor
The White House
1600 Pennsylvania Avenue NW
Washington, D.C. 20500

Dear Under Secretary Nelson and Mr. Sullivan:

We write to express our grave concern regarding reports that, in the months leading up to their brutal and horrific October 7th attack on Israel, Hamas and Palestinian Islamic Jihad (PIJ) raised millions of dollars in crypto – evading U.S. sanctions and funding their operations.[1] Indeed, between August 2021 and this past June, the two groups raised over $130 million in crypto, and moved millions among each other, "with PIJ sending over $12 million in crypto to Hezbollah since 2023.[2] As the *Wall Street Journal* reports, "[r]esearchers who study Hamas's financing said crypto remains one of a number of tools the group uses to raise funds."[3] Given the clear and present danger posed by the financing of these and other militant organizations, we ask the Administration to provide additional details on its plan to prevent the use of crypto for the financing of terrorism.

On the morning of October 7th, Hamas militants fired an estimated 2,200 rockets towards Israel, as hundreds of militants entered Israel on motorcycles and motorboats.[4] As of October 11, 2023, over 1,200 people have died in Israel as a result of the attacks, and 2,900 have been wounded.[5] While "[i]t couldn't be determined whether the crypto they received was directly used to finance the assault,"[6] Hamas has been clear in its solicitations for crypto about the intended use of the assets. As the group said in a Telegram post asking for bitcoin, "[t]he reality of jihad is the expenditure of effort and energy, and money is the backbone of war."[7]

---

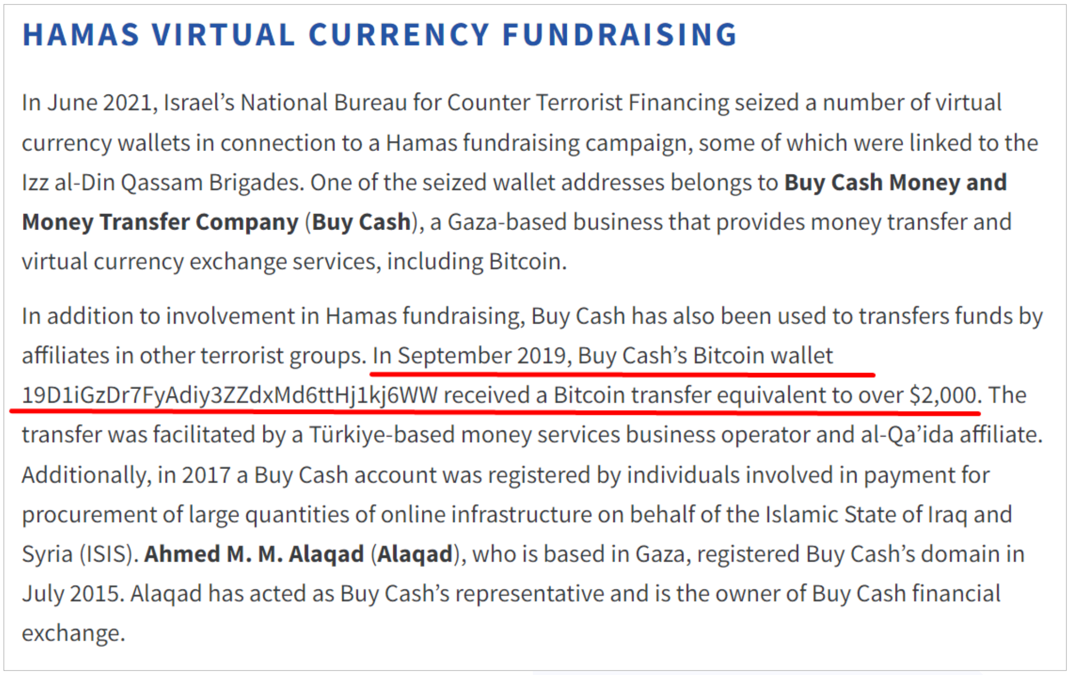
[1] The Wall Street Journal, "Hamas Militants Behind Israel Attack Raised Millions in Crypto," Angus Berwick and Ian Talley, October 10, 2023, https://www.wsj.com/world/middle-east/militants-behind-israel-attack-raised-millions-in-crypto-b9134b7a.

[2] *Id.*

[33] *Id.*

[4] ABC News, "Death came from sea, air and ground: A timeline of surprise attack by Hamas on Israel," Bill Hutchinson, October 10, 2023, https://abcnews.go.com/International/timeline-surprise-rocket-attack-hamas-israel/story?id=103816006.

- Following the report, the U.S. Treasury also announced new sanctions for Hamas operatives, which also referred to a single Bitcoin transaction of over $2000 as proof for Bitcoin being used by the malicious actors.



HAMAS VIRTUAL CURRENCY FUNDRAISING

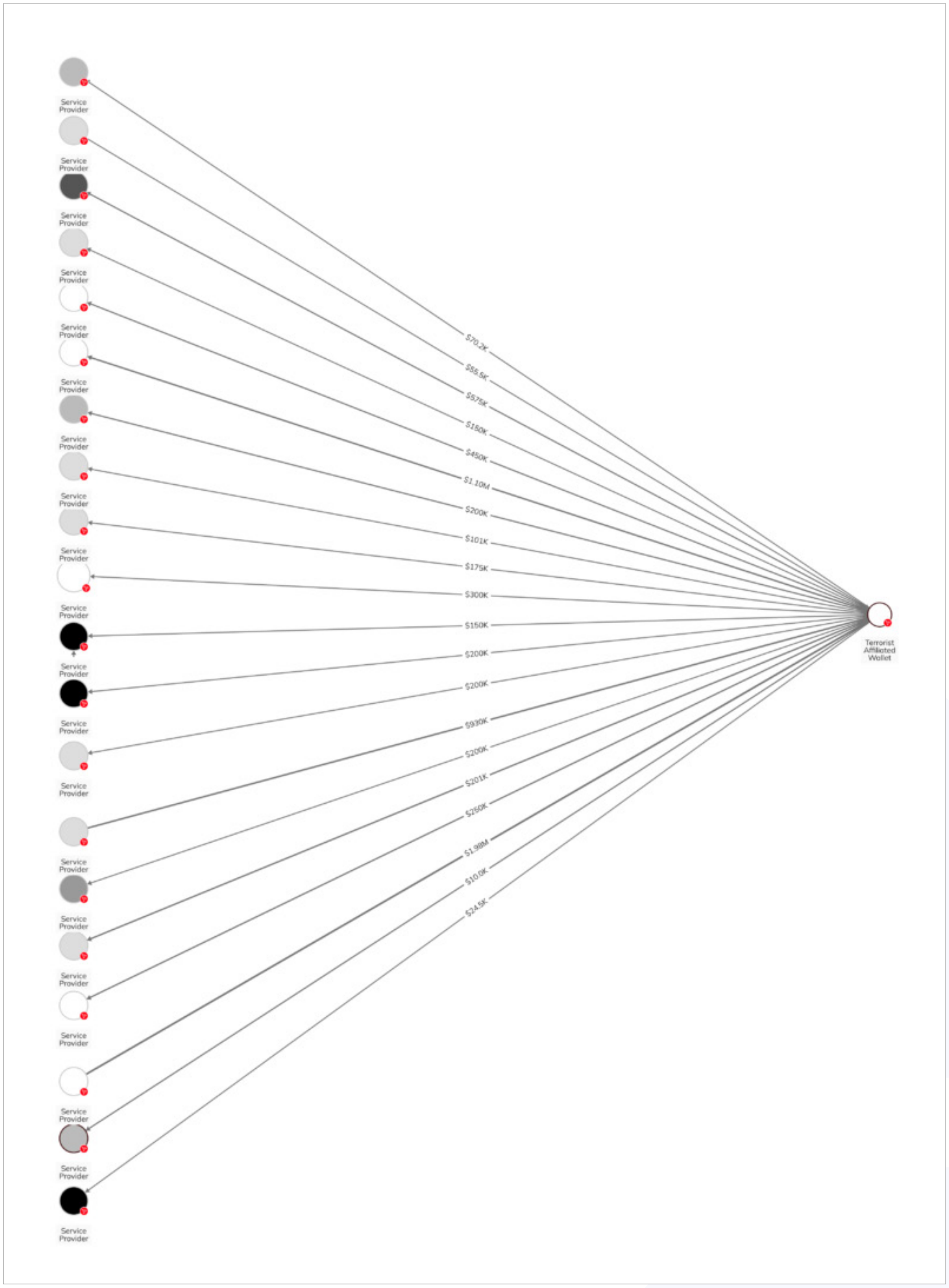
In June 2021, Israel's National Bureau for Counter Terrorist Financing seized a number of virtual currency wallets in connection to a Hamas fundraising campaign, some of which were linked to the Izz al-Din Qassam Brigades. One of the seized wallet addresses belongs to **Buy Cash Money and Money Transfer Company** (**Buy Cash**), a Gaza-based business that provides money transfer and virtual currency exchange services, including Bitcoin.

In addition to involvement in Hamas fundraising, Buy Cash has also been used to transfers funds by affiliates in other terrorist groups. In September 2019, Buy Cash's Bitcoin wallet 19D1iGzDr7FyAdiy3ZZdxMd6ttHj1kj6WW received a Bitcoin transfer equivalent to over $2,000. The transfer was facilitated by a Türkiye-based money services business operator and al-Qa'ida affiliate. Additionally, in 2017 a Buy Cash account was registered by individuals involved in payment for procurement of large quantities of online infrastructure on behalf of the Islamic State of Iraq and Syria (ISIS). **Ahmed M. M. Alaqad** (**Alaqad**), who is based in Gaza, registered Buy Cash's domain in July 2015. Alaqad has acted as Buy Cash's representative and is the owner of Buy Cash financial exchange.

- A day later, on October 18, surveillance firm Chainalysis published a report correcting numbers cited by Wall Street Journal.

- "Turns out the authors of the article mistakenly counted an entire exchanges' trading volume ($82 million) for a terrorist group's address. Rookie move! The actual funds that went to known terrorist-linked addresses was substantially less," wrote Sam Callaghan.

> "Of the roughly $82 million in cryptocurrency received by this address, about $450,000 worth of funds were transferred from the known terror-affiliated wallet. Given the activity of this address, the person or group of people controlling it is likely not the same person that controls the terror-affiliated wallet, but is rather a service provider that knowingly or unknowingly facilitated the terror financing activity," said the chain surveillance firm.



- Despite the contradicting evidence, on October 19, FinCEN released an overreaching proposal which calls for unprecedented surveillance of the entire Bitcoin ecosystem.

Elizabeth Warren
@SenWarren

Major announcement by @TreasuryDepSec Wally Adeyemo to crack down on crypto financed-terrorism.

I led 100+ lawmakers raising concerns, and the Biden administration is taking swift and significant action. Congress must also step up and close crypto money laundering loopholes.

Real Time Economics @WSJecon · Oct 19
The Biden administration is set to designate international "mixers," cryptocurrency exchanges that provide customers anonymity, as money-laundering hubs that threaten national security, a significant regulatory step on.wsj.com/3Q6lPND

12:19 AM · Oct 20, 2023 · **108.9K** Views

- "More broadly, the Treasury Department is aggressively combating illicit use of all aspects of the CVC ecosystem by terrorist groups, including Hamas and Palestinian Islamic Jihad," was stated in the announcement.

- As of today, WSJ's widely cited yet potentially grossly misleading numbers stand uncorrected. The gross numbers cited in the article also cannot be found in recent analysis of Hamas funding by surveillance firm Elliptic.

> "The extent to which this activity relates directly to terrorism financing is, however, unclear," noted the surveillance firm in its report.

- As reported earlier this year, Hamas stopped accepting Bitcoin donations due to privacy risk for donors back in April 2023.

Continue reading here.

BlackRock reportedly becomes the first firm to get a Bitcoin ETF ticker listed on the Depository Trust & Clearing Corporation (DTCC) website (from Blockworks on October 23)...

> The world's largest asset manager continues to prep its proposed bitcoin ETF as segment observers have pointed to potential bullish signs that such products will be approved.
>
> BlackRock's planned iShares Bitcoin Trust is now listed on the Depository Trust and Clearing Corporation (DTCC) website. The planned fund's ticker is IBTC, according to the listing.
>
> Bloomberg Intelligence senior analyst Eric Balchunas said Monday that IBTC is the first proposed spot bitcoin ETF listed on DTCC — a financial market infrastructure giant that processes trillions of dollars in securities transactions daily.
>
> A DTCC subsidiary — National Securities Clearing Corporation (NSCC) — has a process for clearing ETFs that includes "the ability to review...the ETF's portfolio constituents, which is also used to automate the creation and redemption of ETF shares and their subsequent settlement," according to the company.
>
> A representative for DTCC did not immediately return a request for comment. A BlackRock spokesperson said the firm was unable to comment due to "filing restrictions."
>
> The product's listing on DTCC's website comes after BlackRock amended its bitcoin ETF proposal on Oct. 18.
>
> Scott Johnsson, an associate at Davis Polk & Wardwell, noted the updated S-1 filing included a CUSIP for the product — a nine-character code needed to identify a North American security for the clearing and settlement of trades.
>
> The filing also contained language that seed creation baskets were to be purchased in October "subject to conditions" but did not specify a date or amount.

Continue reading here.