



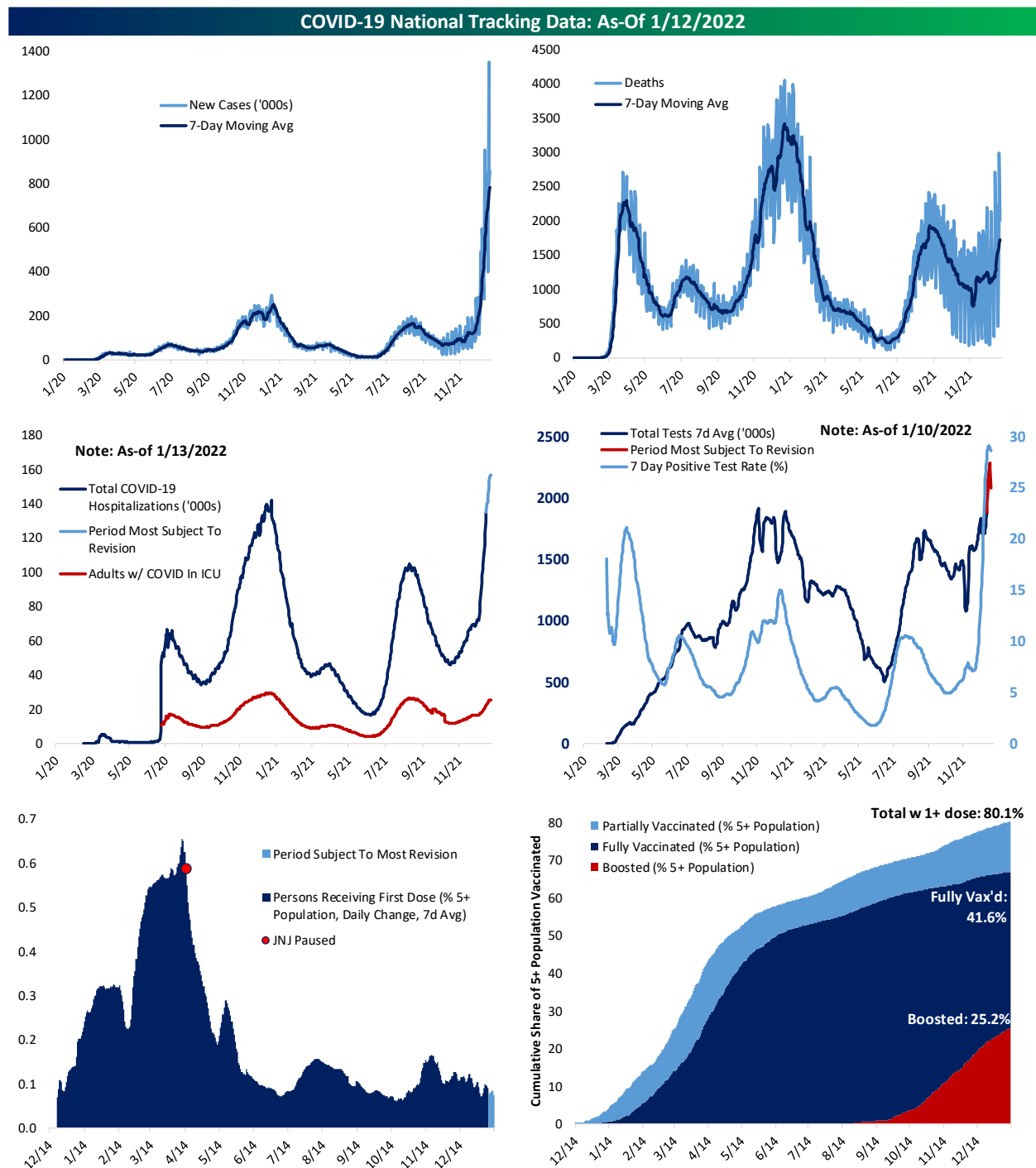
The Bespoke Report

The Fed Versus Growth

- While oil is still in the \$80s, credit spreads are still tight, and the dollar is falling, the macro landscape has changed dramatically since one month ago, when the FOMC held its final meeting for 2021.
- At that meeting, the median forecasted FOMC dot for 2022 reflected three hikes; a year before, *there had been no hikes expected until 2024!*
- Clearly, the backdrop has shifted dramatically, and with it so are market prices.
- In the 22 trading days from that Fed meeting through Friday's close, the Morgan Stanley Growth versus Value index (which tracks the relative performance of quantitative growth versus value) has fallen 14.6%.
- That's the worst performance for that index in the month following a Fed meeting since at least 1999, and while it's silly to blame every market folly and economic wobble on the Federal Reserve, we have a hard time believing the shift towards a very hawkish Fed and the collapse in the most dramatically over-valued areas of the market aren't connected.
- Over the same span of time, the **ARK Invest Innovation ETF (ARKK)** has dropped 18%, the **Renaissance IPO ETF (IPO)** is down 14%, the IPOX SPAC has fallen 6.5%, bitcoin has dropped 12%, and the total market cap of crypto assets has fallen 7.7%.
- There have, of course, been winners: the **MSCI US Value Factor ETF (VLUE)** has gained 8%, the S&P 500 Energy sector is up 18%, the **S&P Bank ETF (KBE)** is up 11%, and the NYSE Steel Index is up 11%.
- The short-term interest rate market has gone from pricing 15 bps of tightening in 2022 to 82.3 bps of tightening since September 21st, and that pricing surged 21 bps in the wake of the FOMC meeting in December.
- Fears over inflation made a March rate hike seem all but certain until this Friday, when a huge miss in retail sales joined decelerating producer and trade prices (all discussed later in more detail) to suggest that maybe consumer demand *isn't* as strong as it looks despite a very strong labor market.
- It's hard to not feel contrarian and bet that having gotten behind the curve with respect to Fed tightening, the market is now behind the curve for a pending dovish pivot in the face of a much less robust economy than previously expected.
- Regardless of the path of rates, the bond market is clearly waking up; like last year, Q1 has been all selling so far as the 10 year yield has hit 52-week highs.
- But unlike last year, real yields are leading the charge instead of inflation risk premiums: the ten year Treasury Inflation Protected Security (TIPS) yield has risen 38 bps YTD, while shorter-term TIPS yields are at 52-week highs.
- After being absent as a market risk—and indeed, typically acting as a positive catalyst—in 2020 and 2021, the Fed is now hurting stocks; for now, it's only the most aggressive sectors, but investors are rightfully wondering whether that damage will spill over more broadly in the coming months.

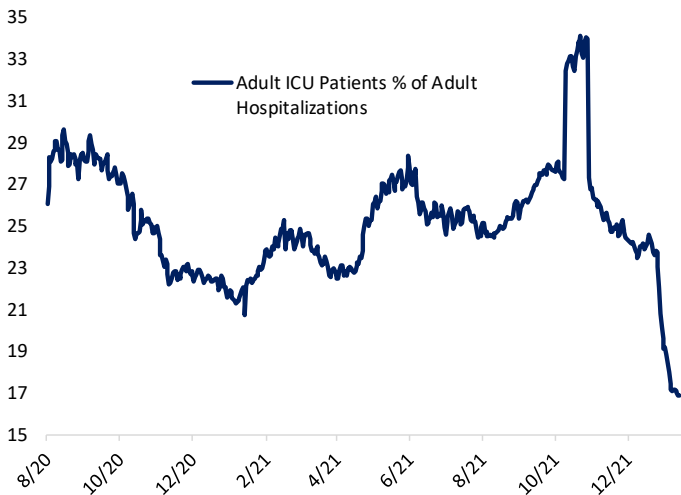


- Unfortunately we'll yet again start with a recap of basic COVID data from the US.
- Omicron has driven an absolutely enormous surge in infections, which given record high positive rates are arguably *understated* to a significant degree.
- Hospitalizations have also soared and ICU COVID patients are also ramping up, while deaths have started to inflect higher.





ICU Patients Are A Very Low Share of Total



- So far this latest huge surge in cases has led to much less intensive health care outcomes than prior waves.

- The easiest way to show this is the chart at left, which shows the percentage of adults who are positive or suspected positive in hospitals that are currently in ICUs.

- As shown, the surge in hospitalizations has not been matched by a surge in ICU admittances; while those could be coming at a lag, there's a lot of ground to be made up in the meantime.

- While ICUs are not overflowing, hospitals are reporting an increase in staffing issues.

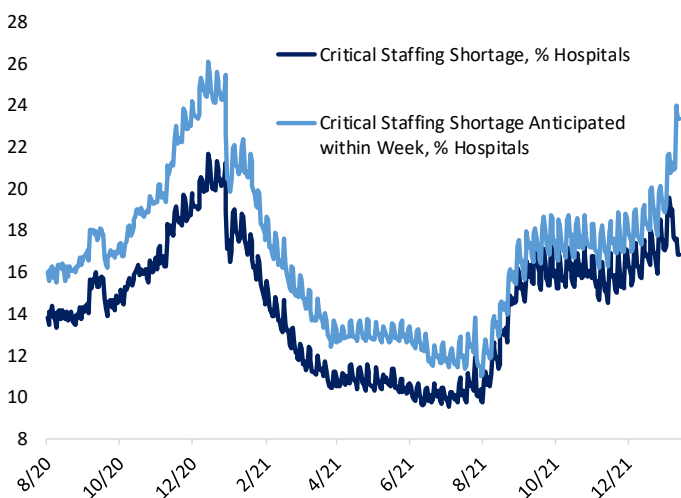
- As shown at left, the percentage of hospitals reporting a critical staffing shortage on a given day recently rose to the highest levels since last winter, and the percentage of hospitals anticipating a critical staffing shortage soon has also risen.

- This wave is milder, but still putting plenty of stress on the hospital system.

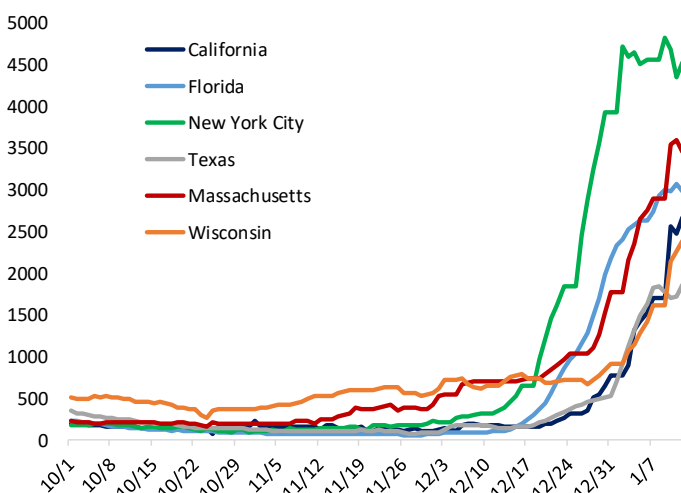
- As for when cases will peak, New York City (the epicenter for Omicron in the US) is experiencing peak cases at present, with the positive test rate peaking in late December and gently dropping as well.

- That suggests the rest of the country will see cases peak some time this month on average, though of course the actual case count timing will vary widely by region as will the impact on hospitals.

Hospital Staffing Issues Are Ramping Up

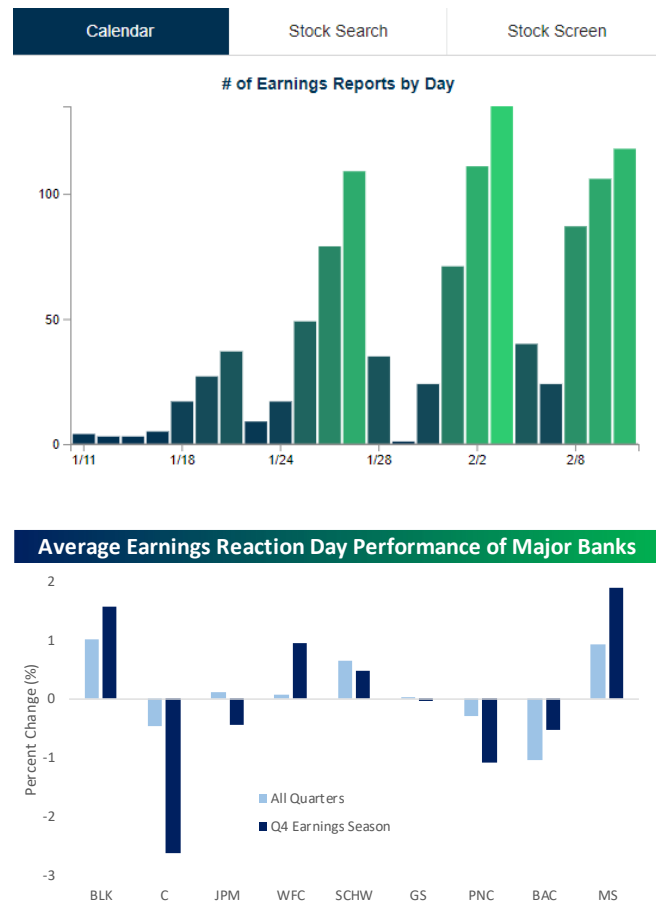


New York Cases Appear To Be Peaking (7d Avg Cases/mm)





- Here we go again. After a slow period for data and especially earnings reports, earnings season is right around the corner, so get ready for the onslaught now! This week and early next, the pace of reports will be on the light side, but the pace will start to pick up at this time next week before reaching a peak in early February.
- The major reports this week were on Friday when the major banks and brokerages started to report. As far as the mega-caps are concerned, the first to report will be **Microsoft (MSFT)**, **Tesla (TSLA)**, and **Apple (AAPL)** in the last week of January, while **Alphabet (GOOGL)**, **Amazon.com (AMZN)**, and **Meta (FB)** will all report the following week.
- For a more detailed rundown of the earnings schedule for the upcoming season, please see our [Earnings Explorer Tool](#) (available to all Institutional clients) on the [Tools](#) section of our website.
- With any endeavor, the goal is usually always to put your best foot forward. When it comes to earnings season and the Financials leading the way, though, that hasn't necessarily been the case.
- In the chart to the right and table below, we summarize the performance of the major banks/brokers on their earnings reaction days for all quarters and Q4 specifically. In terms of EPS beat rates, with the exception of **Wells Fargo (WFC)** and **Charles Schwab (SCHW)**, these companies have topped forecasts three-quarters of the time or more, but their share price reactions haven't been particularly strong as **Blackrock (BLK)** and **Morgan Stanley (MS)** have been the only stocks to consistently trade higher following all quarterly reports and Q4 earnings reports specifically.



Major Large Cap Banks/Brokerages Reporting Through 1/21										
Ticker	Company	Date	Time of Day	Beat Rate (%)		Raised Guidance (%)	Stock Reaction (All Quarters)		Stock Reaction (Q4 Earnings)	
				EPS	Sales		Full Day (%)	% Positive	Q4 Full Day (%)	% Positive
BLK	Blackrock	1/14	AM	78	64	2	1.02	63	1.58	75
C	Citigroup	1/14	AM	77	56	0	-0.47	41	-2.62	30
JPM	JP Morgan Chase	1/14	AM	83	61	0	0.11	44	-0.45	55
WFC	Wells Fargo	1/14	AM	53	56	0	0.08	37	0.96	45
SCHW	Charles Schwab	1/18	AM	56	76	0	0.66	50	0.48	56
GS	Goldman Sachs	1/18	AM	88	77	0	0.02	40	-0.04	20
PNC	PNC Financial	1/18	AM	74	71	2	-0.29	52	-1.08	50
BAC	Bank of America	1/19	AM	78	55	0	-1.05	41	-0.53	40
MS	Morgan Stanley	1/19	AM	79	77	0	0.93	68	1.89	67



- Before we get into where analyst sentiment stands heading into this earnings season, below we wanted to highlight a few charts from our *Earnings Explorer* which summarize where the three-month trends of companies reporting stands headed into this earnings season.
- Starting off at the top, the first chart to the right shows the three-month rolling EPS and revenue beat rate for companies reporting. Both measures have pulled back considerably from their peaks last year, but they are also still well above their historical average readings. At 69.52%, the current 3-month rolling average beat rate is still ten percentage points above its historical average, while the 68.41% average revenue beat rate is about 12 percentage points above its long-term average.
- We've seen a similar trend play out with respect to guidance. After peaking near +40% last summer, just under 16% of companies reporting earnings over the last three months have raised guidance. While less than half the rate of the recent peak, the current level is still nearly 19 percentage points above its long-term historical average reading. As 2022 progresses, we would expect earnings and sales beat rates as well as instances of raised guidance to continue pulling back towards their historical averages.
- As far as stock price reactions are concerned, companies have seen an average earnings reaction day performance of +0.17% over the last three months which is also better than the long-term historical average.
- More recently, companies reporting over the last month have reported relatively weak results. Of the 52 companies that have reported, just 60% have topped EPS forecasts while 71% have exceeded sales forecasts. In terms of their outlooks, a net of only 5% of companies reporting have raised guidance. Lastly, regarding stock price reactions, investors have been pushing the sell button. On their earnings reaction days, companies reporting earnings have gapped down an average of 0.98% at the open, followed by an additional decline of 1.58% from the open to close.

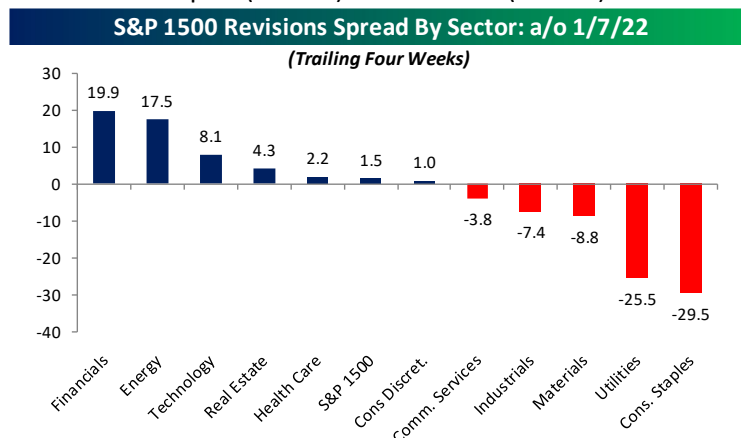


Aggregate Stats

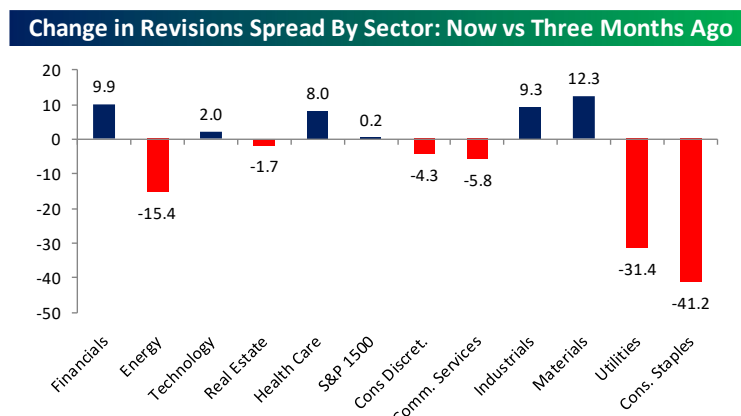
Count	Beat Rate		Guidance		Average Stock Price % Chg			
	EPS	Sales	Raised	Lowered	Opening Gap	Open to Close	Full 1 Day	Volatility
52	60%	71%	15%	10%	-0.98	-1.58	-2.52	6.79



- One of the hallmarks of the last five earnings seasons has been that analysts have been very optimistic on the companies they cover heading into the reports. Using analyst estimate revision trends from Bloomberg, we track the aggregate number of companies by sector with positive and negative revisions to their earnings and revenue estimates. Beginning with the Q2 2020 earnings season and spanning the next five earnings seasons, the net percentage of companies where analysts raised estimates in the month heading into earnings season was positive by double-digit percentages each time.
- Unlike those five earnings seasons, though, analysts were not nearly as optimistic heading into last earnings season, and it's a similar setup for this earnings season as well.
- On a net basis, positive revisions have only barely outnumbered negative revisions (+1.5%), and only two sectors (Financials & Energy) have revisions spreads that are above 10%.
- At the other end of the spectrum, analysts have been the most aggressive in cutting forecasts on companies in the Consumer Staples (-29.5%) and Utilities (-25.5%) sectors.



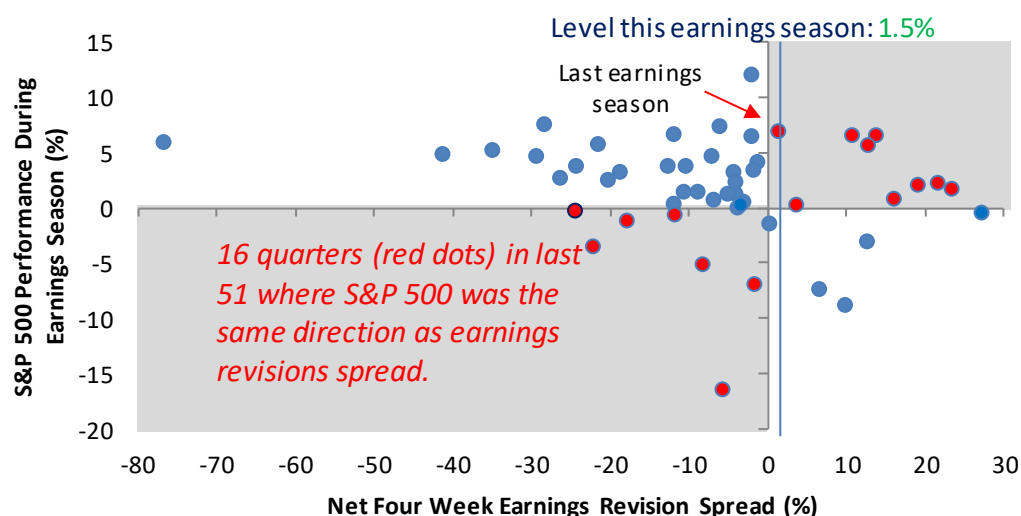
- Comparing where revisions spreads stand now relative to where they were three months ago, it has been a mixed picture.
- Defensive sectors like Consumer Staples and Utilities have seen sharp declines in their revisions spreads, and despite its strong performance YTD, the pace of positive revisions in the Energy sector has slowed considerably. On the upside, Materials has seen the biggest improvement, even as its revisions spread remains negative.





- We compared the net EPS revisions spread for the S&P 1500 (four week spread between companies with positive analyst EPS revisions and negative EPS revisions) at the start of earnings season to the performance of the S&P 500 over the ensuing six weeks - a period that roughly encapsulates the entire earnings season. More often than not, when the analyst expectations bar is set low for earnings season (negative spread), the S&P 500 rallies. Conversely, when the bar is set high heading into earnings season (positive spread), the market's performance has been more uneven.
- To illustrate the inverse relationship, the chart below compares the net four-week earnings revisions spread for the S&P 1500 heading into each earnings season since the end of the Financial Crisis (x-axis) to the performance of the S&P 500 during that same earnings season (y-axis). Of the 51 quarters, there are only 16 (31%) where the earnings revisions spread was the same direction (positive or negative) as the performance of the S&P 500 during that earnings season (red dots in non shaded boxes).
- In the chart, we note last earnings season with the red arrow where the analyst EPS revisions spread was +1.3% heading into earnings season, and the S&P 500 surged 6.98% for its best earnings season performance since the Q4 2018 reporting period. That was also the sixth straight quarter where the revisions spread was positive heading into earnings season and the market rallied. This current period also marks the longest streak of a positive revisions spread heading into earnings season (7) since at least 2008.
- While the inverse relationship between the direction of earnings revisions and market performance during earnings season hasn't held up well recently, over the longer term, positive revisions heading into earnings season haven't been a tailwind for equities during the reporting period.
- We have also included a vertical line in the chart showing the revisions spread heading into this upcoming earnings season, and at +1.5%, you can't get much more neutral. Since 2008, there have been 15 prior reporting periods where the revisions spread was greater than -5% and lower than 5% (between -5% and +5%). In those fifteen periods, the S&P 500's median performance during earnings season was a gain of 1.15% with positive returns 13 out of 15 times (87%).

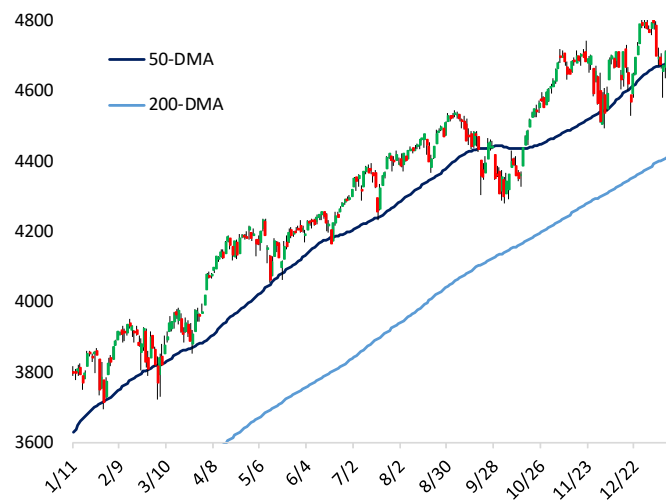
S&P 500 Performance vs Earnings Revisions Spread: 2009 - 2021



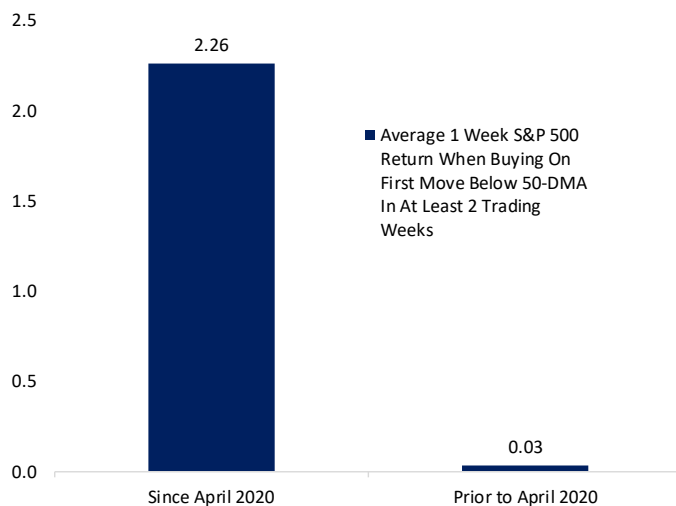


- Midweek this week the US equity market found willing buyers below its 50-DMA.
- After five days of losses took the index below its 50-DMA Monday, mid-week the S&P 500 rebounded above its 50-DMA but that was brief as Thursday and Friday saw it dip back below its moving average.
- As shown at right, buying around the 50-DMA has been an incredible strategy over the past year or so.
- Quantitatively, short-term returns when stocks leg below their 50-DMA for the first time in at least two weeks have been very poor, averaging just 3 bps from 1928 to April of 2020.
- Since, it's been a very different story.
- Of the 5 instances since April of 2020, forward returns have averaged 2.3% over the next week.
- In other words, dip-buyers have been amply rewarded since the pandemic lows with any chance to get stocks on sale eagerly snapped up.
- The flip side to this trend is that simple momentum-based trading rules have been less useful. From 1928 to 1975, simply liquidating longs and going to cash whenever stocks closed below their 50-DMA delivered truly spectacular outperformance over time.
- But since, virtually all of that outperformance has been given back, and as shown at right, dip-buying has been far more profitable than pre-cautionary market exits.

Stocks Bid Back Above Their 50-DMA Once Again



Buy In An Uptrend Produces Sub-Par Returns Since 1975

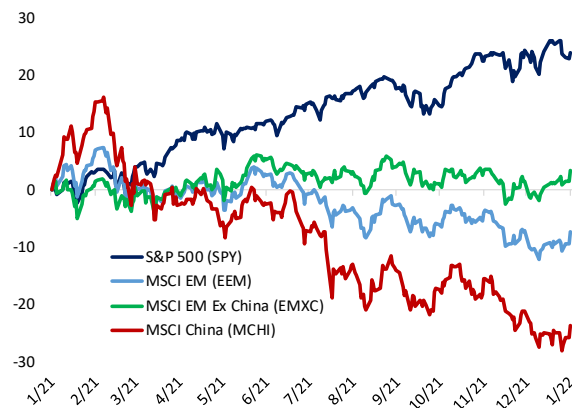


Buy In An Uptrend Produces Sub-Par Returns Since 1975

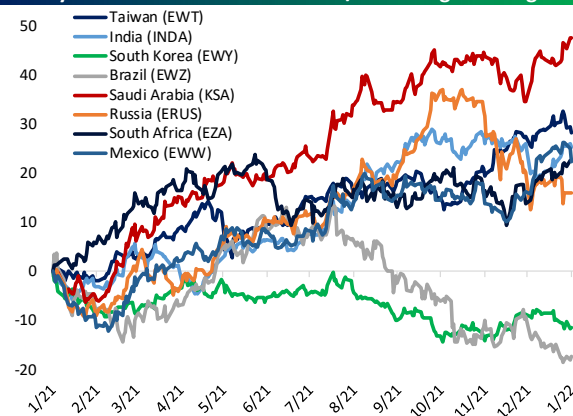


- EM is starting to turn after a brutal year led primarily by underperformance from China.
- As shown in the top chart left below, excluding Chinese stocks, EM is a bit better than flat over the past year, while Chinese names are down almost 30%.
- Within the ex-China EM space, 10 countries have weights of 3% or more, and only two (South Korea and Brazil) have materially lagged EEM overall.
- Saudi Arabia is the real stand-out performer, beating overall EM equities in the MSCI index by nearly 50% over the past 12 months.
- Most of that outperformance comes from oil prices, which have been closely correlated to Saudi stocks' relative performance versus the rest of EM.
- With Taiwan, India, and South Korea the largest weights in the MSCI EM Ex China index, it won't be a surprise that their indices tend to dominate the list of highest single-name weights in the index.
- **Taiwan Semiconductor** (ADR **TSM**) is almost 10% of the index on its own, while Samsung is close to 6% of the index.
- No other name stops 2% of total index weight, though a number of Indian names are combined close to that level.
- Rounding out the top 10 are Brazilian miner **Vale** (ADR **VALE**) and Russia's **Gazprom** (ADR **OGZPY**).

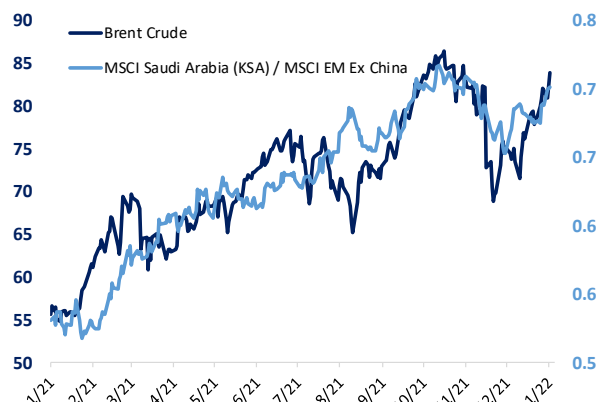
EM Starting To Rally After A Brutal Year Driven By China



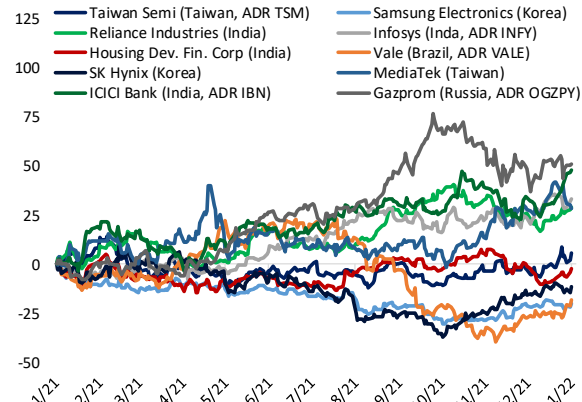
1y Returns vs EEM: Countries w/ 3% or Higher Weights



Saudi Surge Is All About Oil



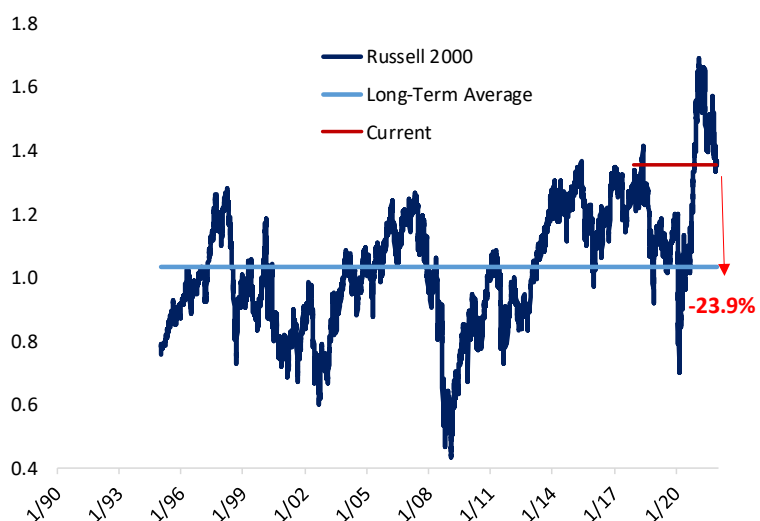
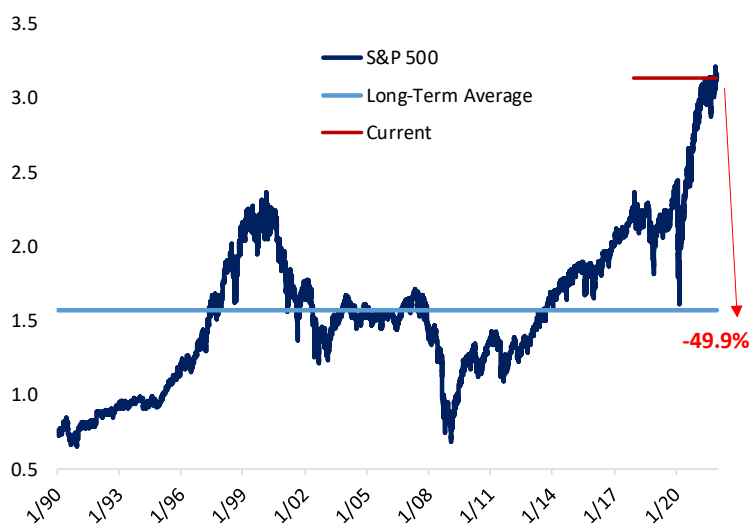
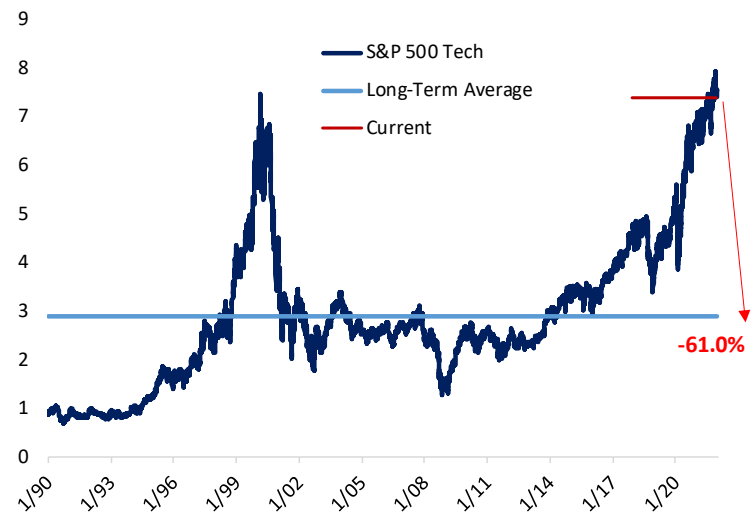
EMXC Highest Weights: Performance Past Year (USD %)





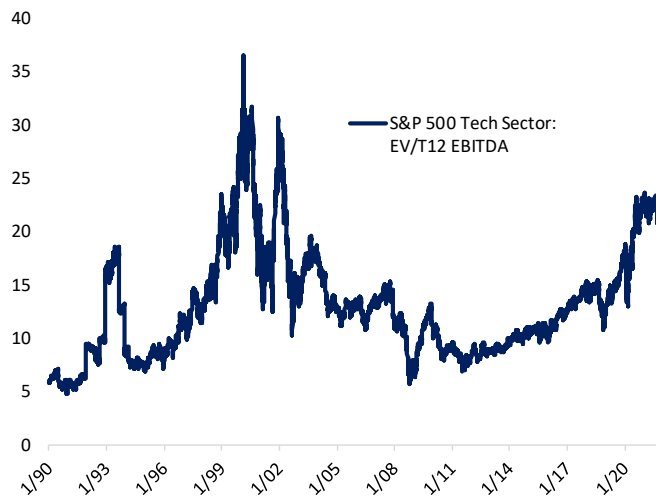
- With the huge gains for value stocks and the collapse in growth names, valuations in aggregate across indices are starting to come back to earth.
- The best example of extreme multiple is probably large cap tech, which as shown at right hit a higher P/S ratio than it did during the tech bubble (on a trailing basis at least) in December.
- Since, it has retreated amidst a 7.2% pullback for the sector since 12/27 all-time highs.
- But what if its P/S multiple were to retreat to long-term averages?
- Hypothetically, that would mean a 61% decline in the price of the index; of course, there's no reason to assume that Tech should mean-revert to long-term averages.
- We'll make some arguments why on the next page.
- As for the rest of the market, similar (if somewhat smaller) drops would take place if broad indices returned to long-term price-to-sales multiples.
- The S&P 500 would fall 50% if it was to return to its long-term average of 1.57x price-to-sales without further sales growth.
- Small caps are less dramatically extended versus long-term average multiples but nonetheless would face a 24% drop if they fell to their average multiple.

Major Indices Are Trading At Shocking Price-To-Sales Multiples

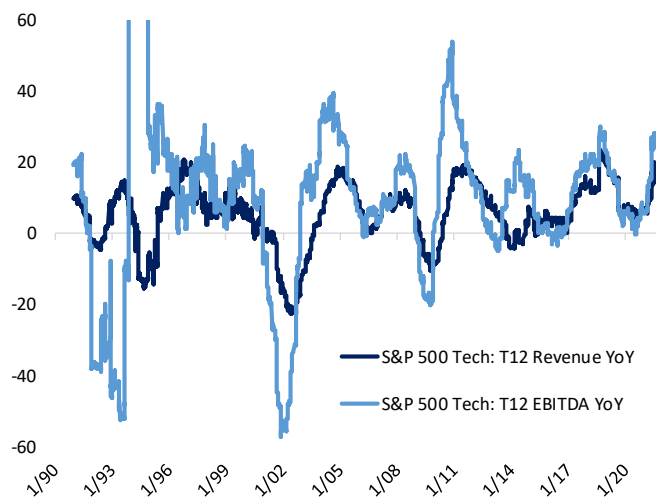




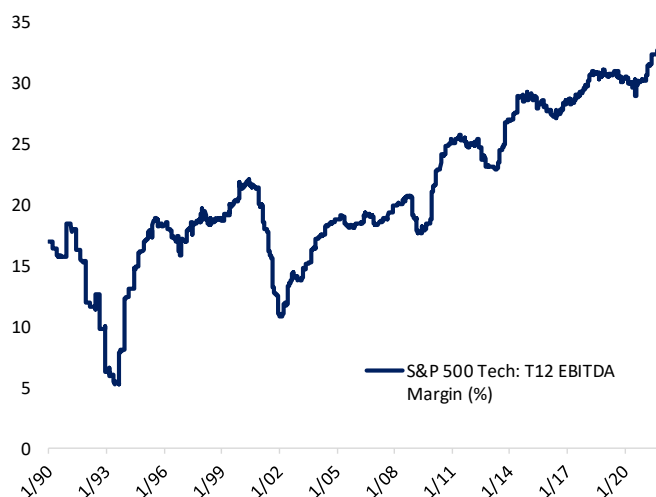
Versus Profits, Tech Is Less Extreme, But Plenty Extreme



Revenue & Profit Growth Is Solid



Margins Are 50% Higher Than Last Tech Bubble



- While Tech is absolutely ludicrous on a price-to-sales or enterprise value-to-sales basis, things are a bit more nuanced when we look at operating profits.

- EBITDA (earnings before interest, taxes, depreciation, and amortization) multiples are the highest since the last tech bubble, but are much less over-the-top than the sales multiple.

- Of course, that doesn't mean that 25x EBITDA is the right price to pay for the capital structure of US-listed tech firms, and we aren't making a judgement that the sector is some sort of value play.

- That said, revenues are growing on the order of 15% year-over-year, and EBITDA growth is even higher.

- The Tech sector today has very fast growth, high profitability, and earns about 40 cents of EBITDA for every new dollar of revenue it brings in.

- Moreover, that growth has been reasonably consistent over time.

- The best single justification for the increase in multiples for tech is its astounding profitability.

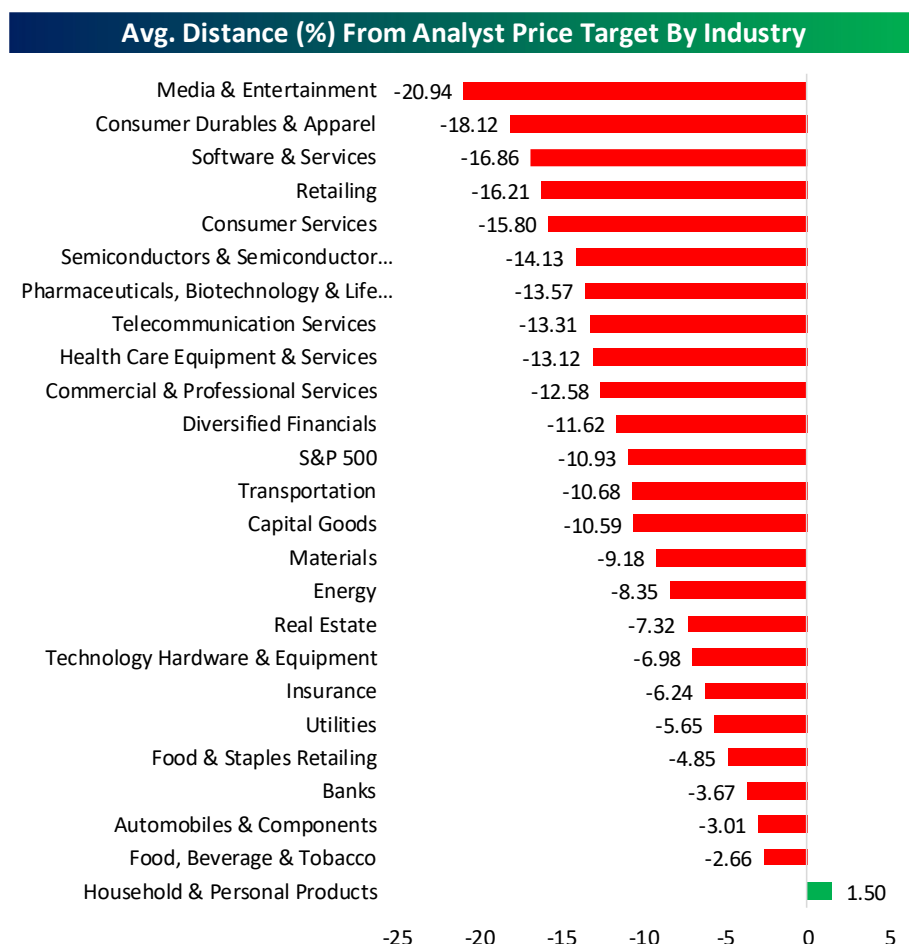
- In aggregate, the S&P 500 Tech sector has turned each dollar of revenue into 32.6 cents of EBITDA over the past year.

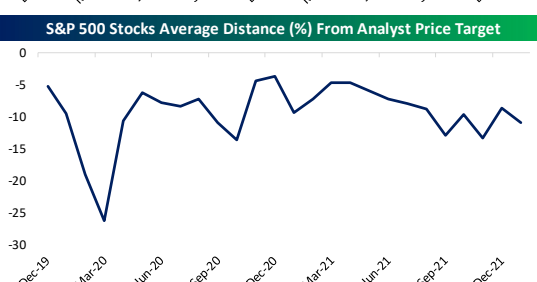
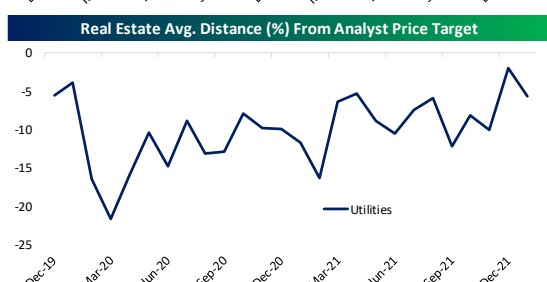
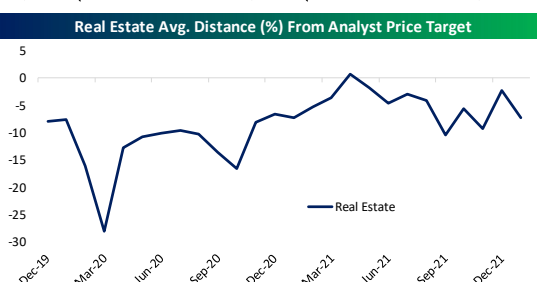
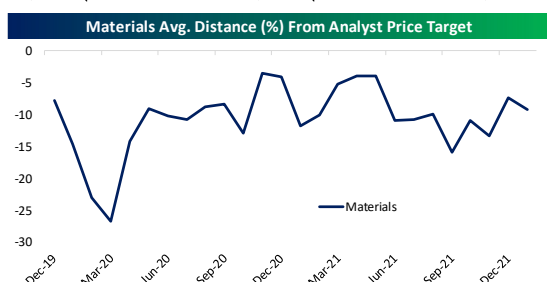
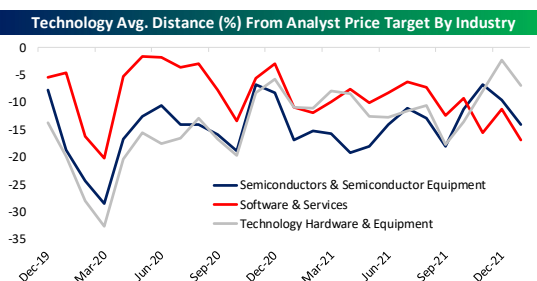
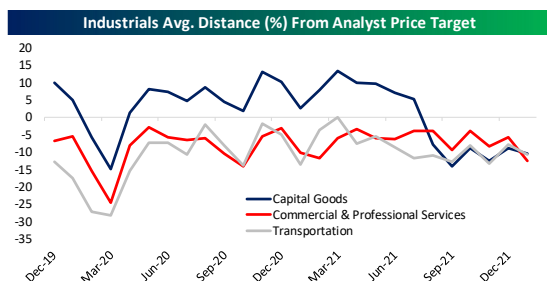
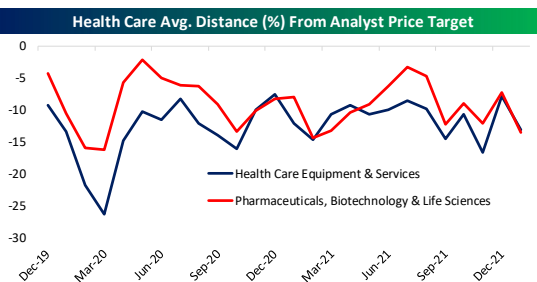
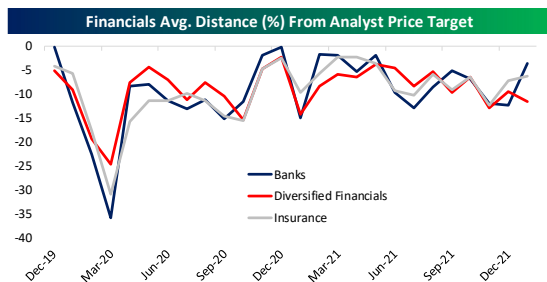
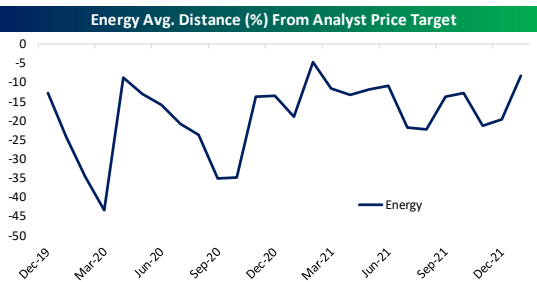
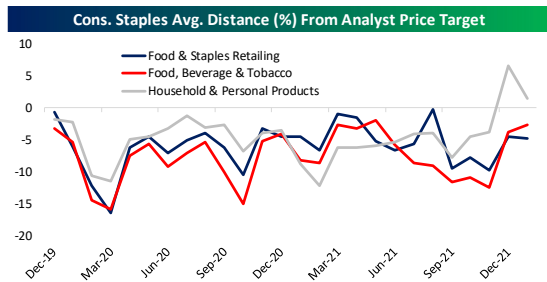
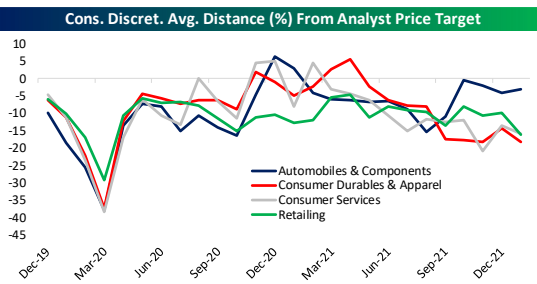
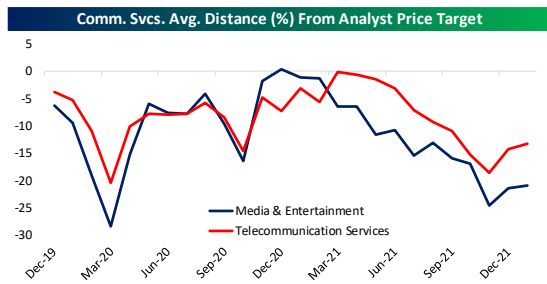
- That compares to less than 20% in the late-1990s and only about 22% at the Tech bubble peak.

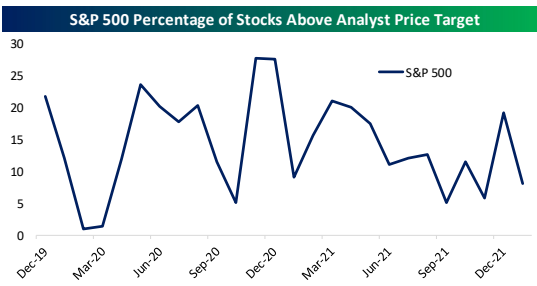
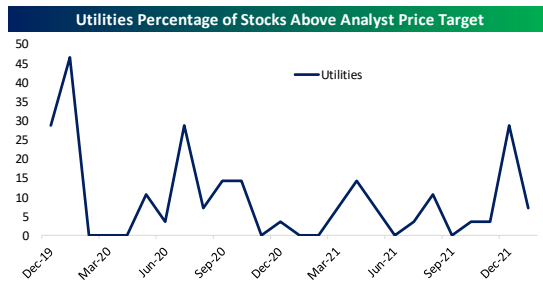
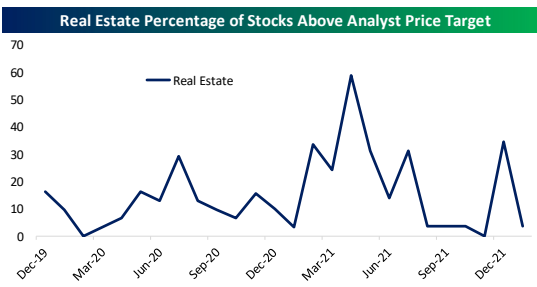
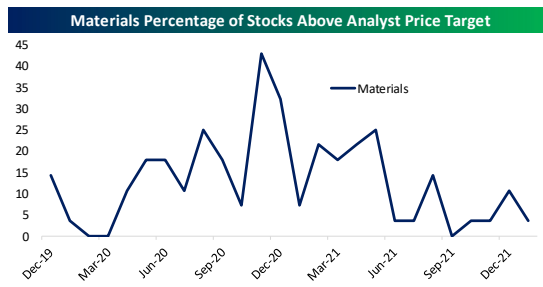
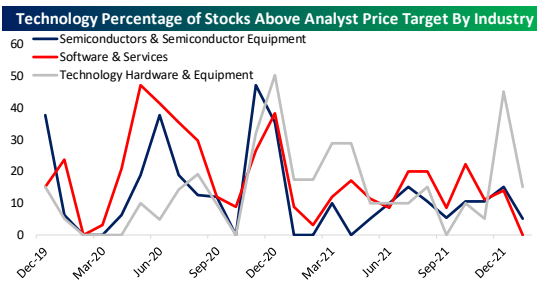
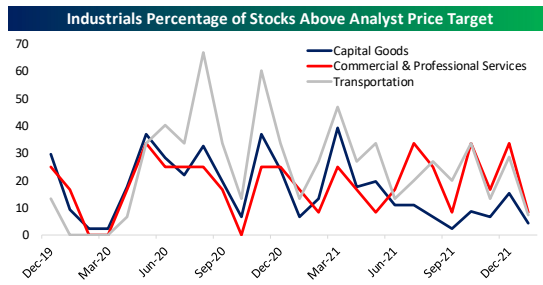
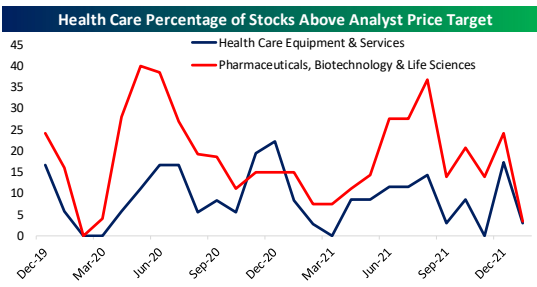
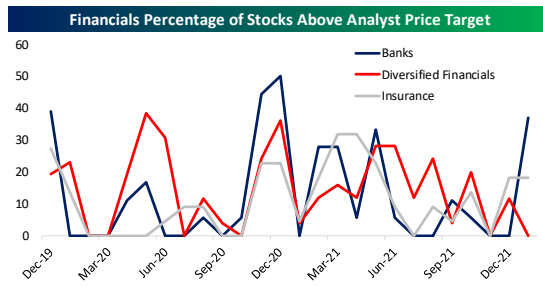
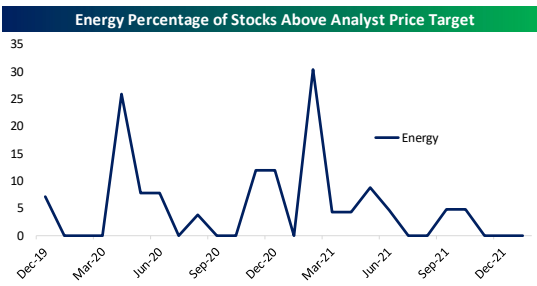
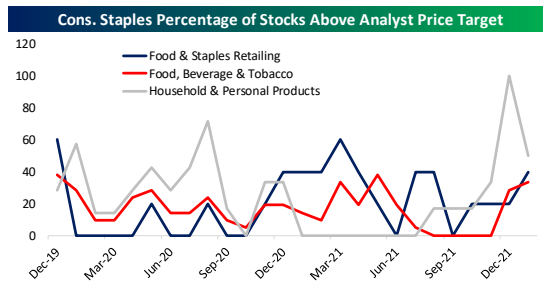
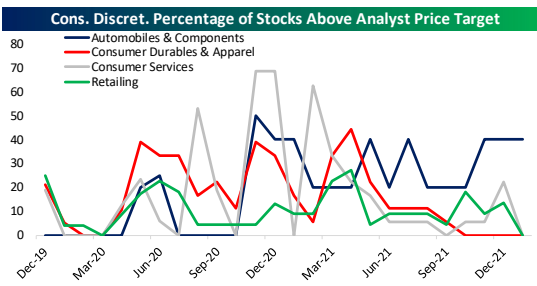
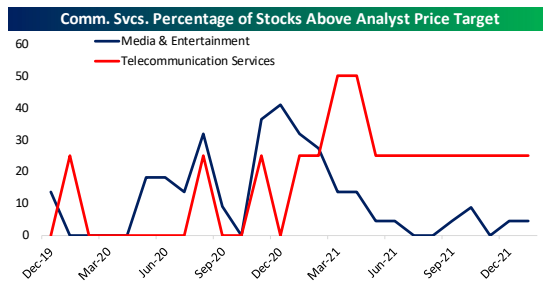
- Of course, this growth in margins cannot by definition continue forever, but with top-line growing rapidly and incremental EBITDA margins still well above total margins, there's lots of profitability for the current extreme valuation picture to grow in to.



- Below we show how far the average stock is trading versus its consensus analyst price target by S&P 500 industry group.
- As shown, Media and Entertainment stocks are currently the most depressed versus price targets with the average stock in that industry nearly 21% below its target. That would indicate analysts either need to revise their targets far lower or those names need to rebound to catch up with expectations.
- On the other end of the spectrum, after a massive run for Consumer Staples stocks in the final months of 2021 and the first few days of this year, the average stock in the Household and Personal Products industry is actually above its price target. That is the only group in which that is the case, but Automobiles and Components, Food, Beverage, and Tobacco, and Bank stocks are all low single digit percentage points away from their price targets on average.
- On the following couple of pages, we show the how the average distance from analyst price targets and the percentage of stocks trading above analyst price targets have changed over the course of the past two years.
- We would highlight how recently, Software and Services have seen a big drop in these readings while other Tech industries have held up slightly better. Meanwhile, Household & Personal Products has dropped following very strong readings and Banks also have readings flying into earnings.







**Economic Scorecard: 1/10 - 1/14**

Date	Time	Release	Period	Estimate	Reading	Last
1/10	10:00	Wholesale Inventories MoM (Final)	Nov	+1.20%	+1.40%	+1.20%
1/10	10:00	Wholesale Trade Sales MoM	Nov	+1.00%	+1.30%	+2.20%
1/11	6:00	NFIB Small Business Optimism	Dec	98.7	98.9	98.4
1/12	7:00	MBA Mortgage Applications WoW	Jan-7	--	+1.40%	-5.60%
1/12	8:30	CPI YoY	Dec	+7.00%	+7.00%	+6.80%
1/12	8:30	Core CPI YoY	Dec	+5.40%	+5.50%	+4.90%
1/12	8:30	Real Average Hourly Earnings YoY	Dec	--	-2.40%	-1.90%
1/12	14:00	Monthly Budget Statement (bn USD)	Dec	-5.0	-21.3	-143.6
1/12	14:00	Fed Releases Beige Book				
1/13	8:30	PPI YoY	Dec	+9.80%	+9.70%	+9.60%
1/13	8:30	PPI Ex. Food and Energy YoY	Dec	+8.00%	+8.30%	+7.70%
1/13	8:30	PPI Ex. Food, Energy, and Trade Services YoY	Dec	+6.90%	+6.90%	+6.90%
1/13	8:30	Initial Jobless Claims ('000s)	Jan-8	200	230	207
1/13	8:30	Continuing Jobless Claims ('000s)	Jan-1	1733	1559	1754
1/14	8:30	Retail Sales MoM	Dec	-0.10%	-1.90%	+0.30%
1/14	8:30	Retail Sales Ex. Auto MoM	Dec	+0.10%	-2.30%	+0.30%
1/14	8:30	Retail Sales Ex. Auto and Gas MoM	Dec	-0.20%	-2.50%	+0.20%
1/14	8:30	Retail Sales Control Group MoM	Dec	0.00%	-3.10%	-0.10%
1/14	8:30	Import Price Index YoY	Dec	+10.80%	+10.40%	+11.70%
1/14	8:30	Export Price Index YoY	Dec	+16.00%	+14.70%	+18.20%
1/14	9:15	Industrial Production MoM	Dec	+0.20%	-0.10%	+0.50%
1/14	9:15	Capacity Utilization	Dec	77.00%	76.50%	76.80%
1/14	10:00	Business Inventories MoM	Dec	+0.30%	-0.30%	+0.70%
1/14	10:00	U. of Mich. Sentiment (Prelim)	Jan	70.0	68.8	70.6
1/14	10:00	U. of Mich. Expectations (Prelim)	Jan	67.0	65.9	68.3

- It was an end loaded week of economic data in terms of volume of releases and misses.

- Wholesale inventories and trade sales, and small business confidence were the only releases on Monday and Tuesday with each reading coming in above estimates.

- CPI was inline with expectations at the headline level while core CPI was hotter than expected.

- Although consumer prices accelerated in December, real wages fell 2.4% year over year.

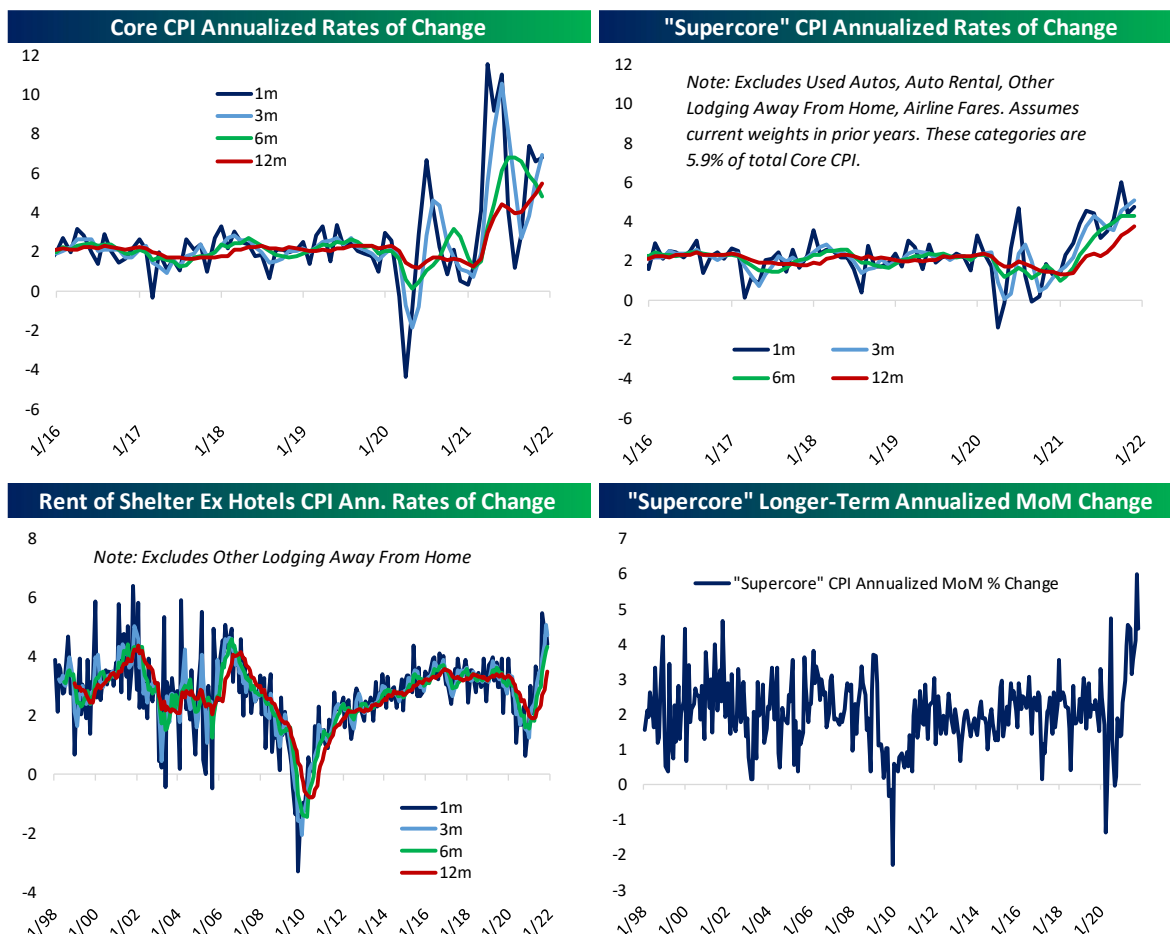
- PPI followed up on Thursday in addition to weekly jobless claims which saw weaker than expected initial claims and better than expected continuing claims.
- Friday saw a slug of data, all of which came in worse than expected.
- The retail sales report was a dud with misses across both core and headline measures.
- Industrial production, trade prices, and preliminary consumer sentiment also all missed forecasts.
- Turning to next week, given Martin Luther King Day on Monday, there will be no releases until Tuesday with the Empire Fed's manufacturing report.
- Homebuilder sentiment and TIC flows will also be out that day.
- Housing data will be the focus of Wednesday with weekly mortgage apps and starts and permits all on the docket. Existing home sales will follow up on Thursday.

Economic Calendar: Week of 1/21

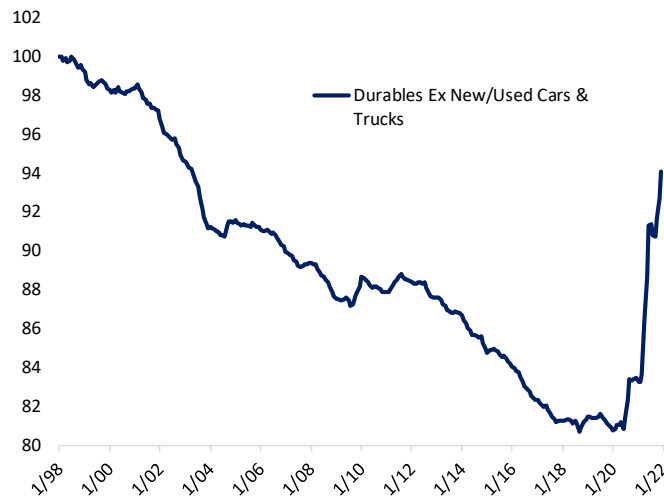
Date	Time	Release	Period	Estimate	Last Reading
1/18	8:30	Empire Fed Man'f Index	Jan	25.0	31.9
1/18	10:00	NAHB Homebuilder Sentiment	Jan	84.0	84.0
1/18	16:00	Net Long Term TIC Flows (bn USD)	Nov	--	+7.1
1/18	16:00	Total Net TIC Flows (bn USD)	Nov	--	+143.0
1/19	7:00	MBA Mortgage Apps WoW	Jan-14	--	+1.40%
1/19	8:30	Building Permits ('000s SAAR)	Dec	1710	1712
1/19	8:30	Housing Starts ('000s SAAR)	Dec	1650	1679
1/20	8:30	Initial Jobless Claims ('000s)	Jan-15	220	230
1/20	8:30	Continuing Jobless Claims ('000s)	Jan-8	1514	1559
1/20	8:30	Philly Fed Business Outlook	Jan	20.0	15.4
1/20	10:00	Existing Home Sales (mm SAAR)	Dec	6.41	6.46
1/21	10:00	Leading Index MoM	Dec	+0.80%	+1.10%



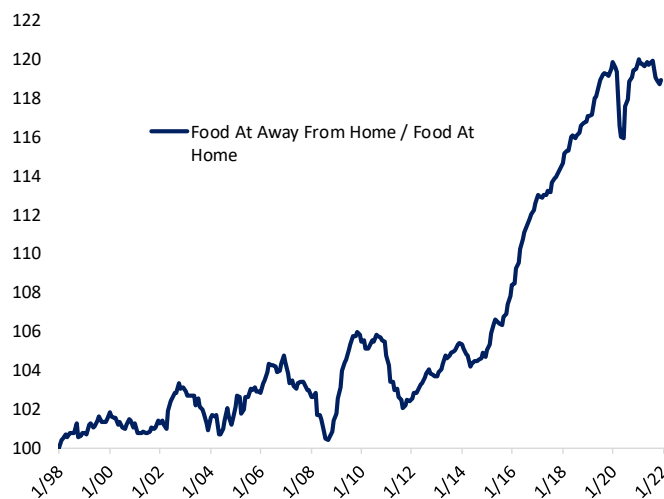
- The big economic data point of the week was CPI, which came in broadly on-expectations from analysts.
- Weaker energy prices helped to push core inflation back above headline inflation, while year-over-year core CPI was up 5.5% versus 7.0% for headline.
- Monthly core CPI ran at a 6.8% annualized pace, after 6.6% last month and 7.4% the month prior; as shown, core CPI is far above pre-pandemic norms.
- Much of the volatility in CPI of late has been driven by pandemic-sensitive categories, but even stripping those out via our “Supercore” metric shows inflation up 4.8% annualized in December versus 4.4% MoM annualized in November and 6.0% MoM annualized in December.
- As shown bottom row right below, supercore inflation remains extremely high versus history.
- A major factor lately has been rents, which rose 5.5% annualized in September, 4.8% in October, and 5.0% in November; that number was 4.4% in December.
- The deceleration in rents is a good sign, but they are unlikely to soften all the way back to pre-COVID norms any time soon given the lagging nature of CPI rental index construction.
- Leading indicators of rental market tightness suggest the worst spot market inflation is behind us but it will take time for that easing to feed in to rental price indices like those in CPI.



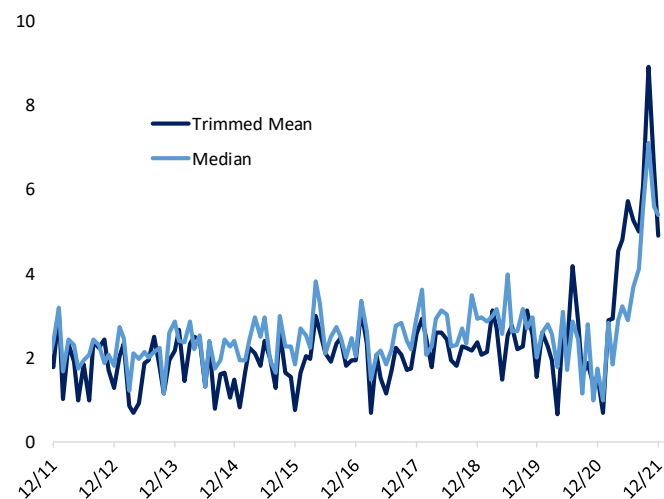
Durable Goods Inflation Is Very High (1/98 = 100)



High Wages May Not Be Driving Inflation Much (1/98 = 100)



Massive Surge In Broad Inflation Cooling (MoM Ann. %)



• Regardless of the outlook for inflation, what we can say is that the vast majority of the recent surge in prices appears tied to the pandemic's effects on consumer demand rather than the labor market.

• The best example of this is durable goods, which have unwound two decades of deflation over the course of the last two years...and that's without including the effects of car prices in both the new and used market!

• In other words, the huge increase in spending on durable goods of all kinds (non-auto vehicles, home furnishings, appliances, etc) have created huge price effects, exacerbated by supply chain shortages.

• While labor markets are certainly tight, it's not clear that they're feeding directly into higher consumer prices for services.

• As shown at left, the relative cost of eating out versus at home has actually improved in recent months despite very strong restaurant wage growth amidst tight labor markets.

• In other words, demand is more important than the supply side of restaurant food in setting prices (for now).

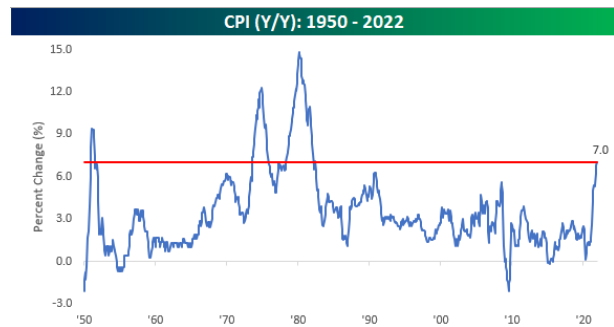
• At least inflation appears to be narrowing somewhat.

• Trimmed mean and median CPI seek to identify the price change at the middle of the distribution, rather than weighted by consumption.

• As shown at left, their MoM readings are both decelerating after setting records north of 7% in October.



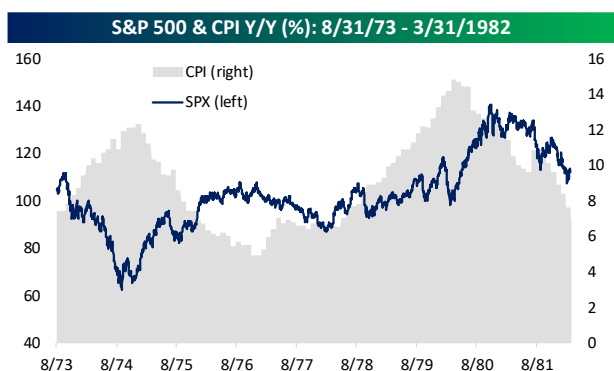
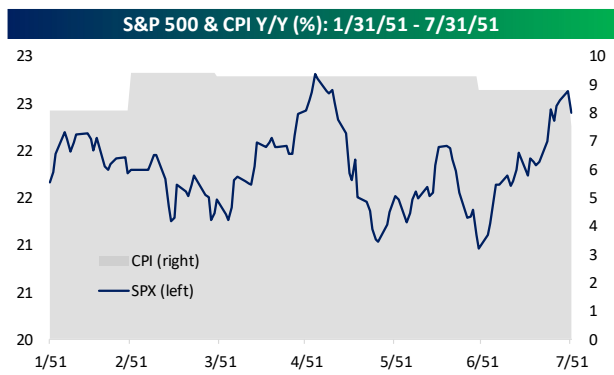
- The consumer price index (CPI) rose 7.0% year over year in December, the highest rate of increase since 1982. Consumers across America are paying higher prices for everything from bread to gas due to supply chain constraints, labor shortages, easy fiscal and monetary policy, and robust demand.
- There have only been four other periods since 1950 that y/y CPI reached 7.0% or more (1951, 1973, 1977, 1978). Overall, returns were mixed. In January 1951, the S&P 500 was just 0.4% off of its 52-week high when CPI first eclipsed 7%. During the seven months in which CPI remained above 7% on a y/y basis, stocks rallied 3.4%, and one year later, the S&P 500 was up 11.4%.
- The longest streak of 7%+ y/y readings occurred between 1978 and 1982 and spanned 46 months. During this streak, the S&P 500 gained just 15.1% over the course of almost four years and just 1.8% in the year following the first reading over 7.0% in May 1978.
- the S&P 500 has acted differently each time CPI topped 7.0%. In the first half of 1951, it appeared to trade independently of the elevated inflation readings, moving sideways as CPI readings remained elevated. For much of the 1970's, CPI and the S&P 500 tended to move in opposite directions. Nonetheless, much of the gains experienced in the 70's were in periods when the rate at which prices were increasing was on the decline.
- Inflation has typically been considered a negative backdrop of equity prices but a key factor behind that performance is how long-lasting the inflation is. In the early 1950s, when the elevated level of inflation was short-lived, equities, which were already near 52-week highs, performed fine. In the 1970s, though, when inflation was more entrenched, the backdrop for equities was negative.



S&P 500 When CPI Y/Y is at Least 7%: 1950 - 2022*

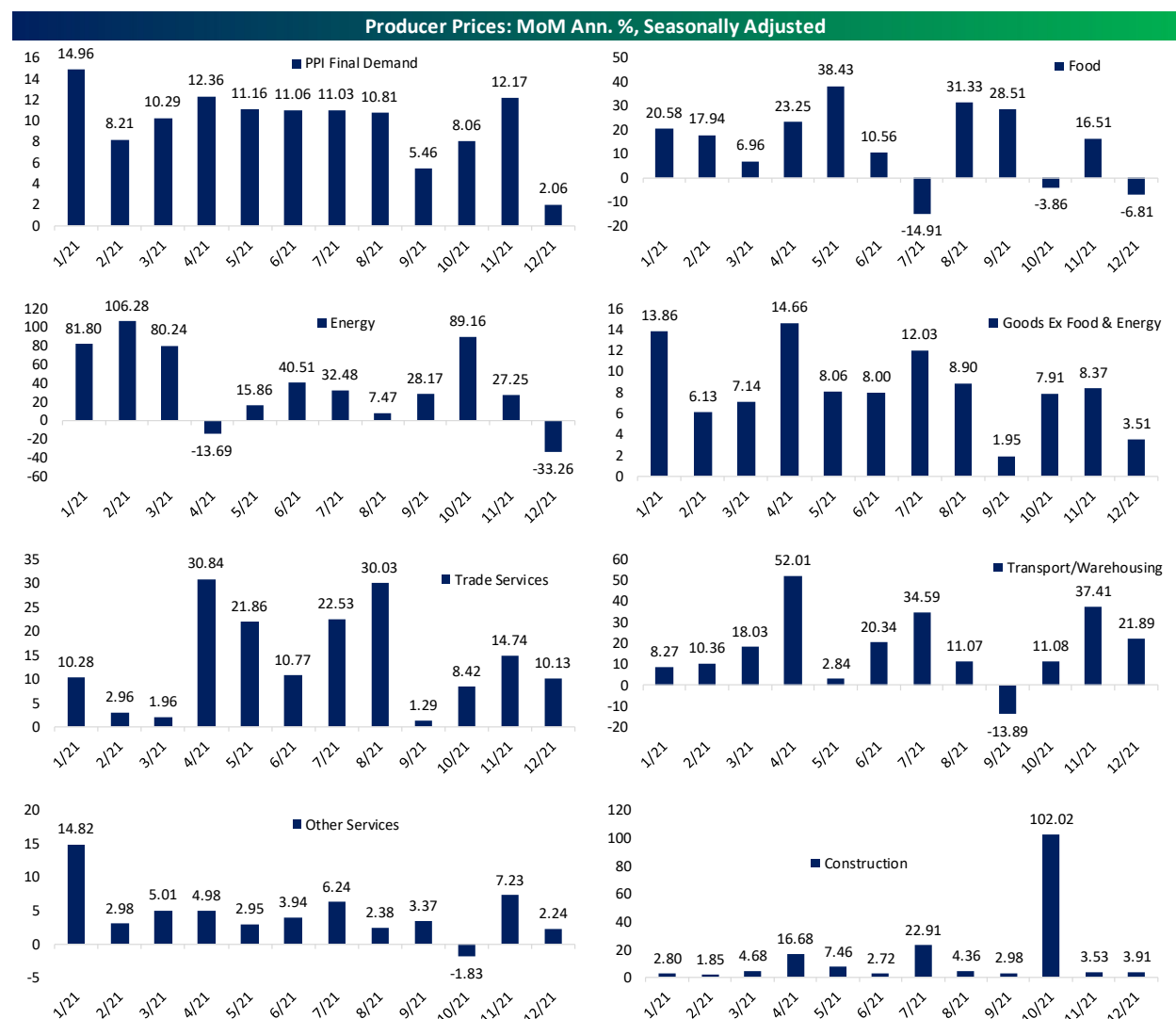
Date	CPI (Y/Y, %)	Months Above 7%	S&P 500 vs 52-Week High (%)	S&P 500 Performance (%) During Streak	One Year
Jan-51	8.1	7	-0.4	3.4	11.4
Aug-73	7.4	28	-13.3	-13.5	-30.8
Apr-77	7.0	1	-8.7	-2.4	-1.6
May-78	7.0	46	-4.4	15.1	1.8
Dec-21	7.0	?	-0.6	?	?
Average		20.5	-6.7	0.7	-4.8
Median		17.5	-6.6	0.5	0.1
% Positive				50	50

* For the first time in a year



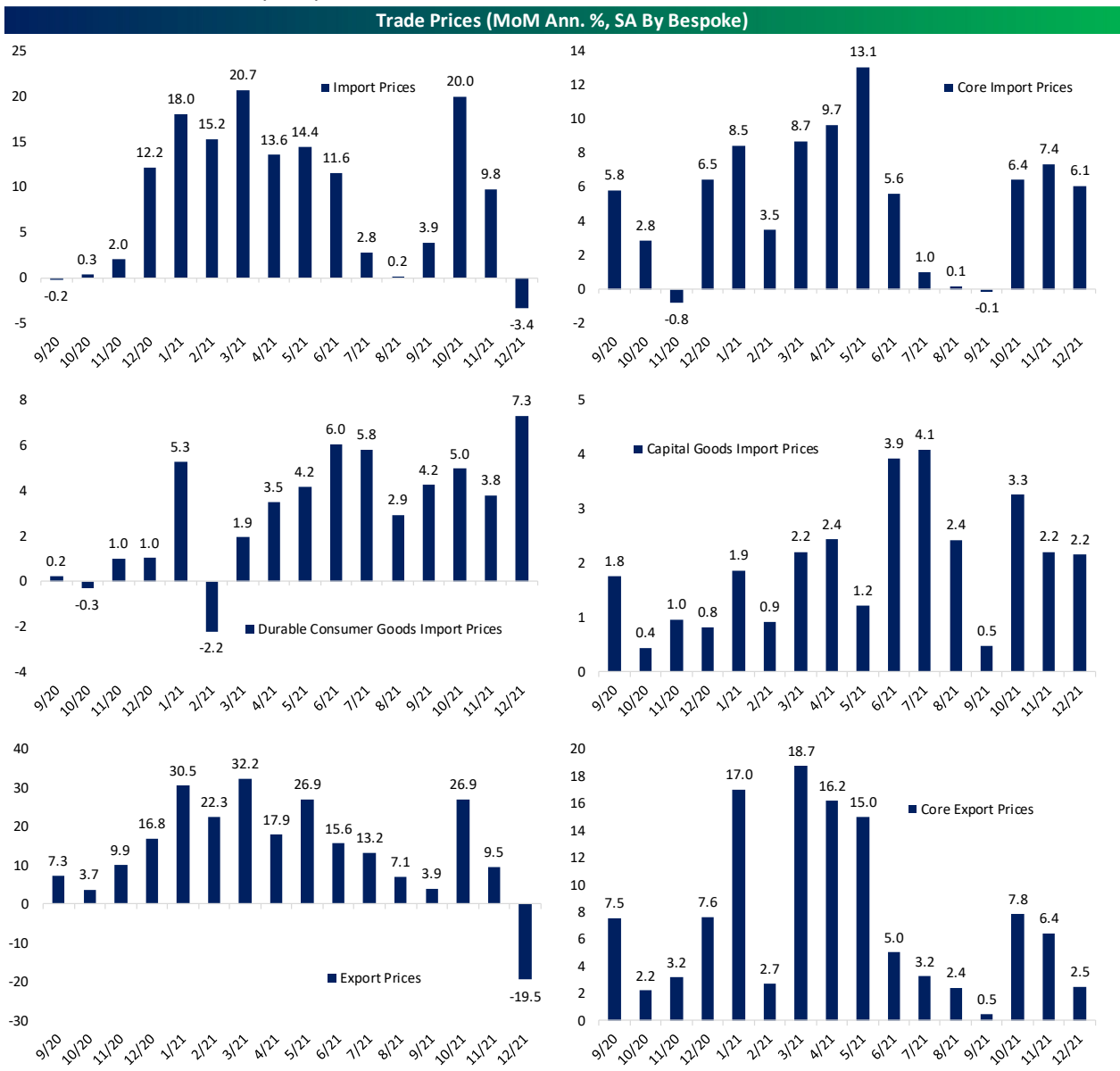


- Thursday's producer prices report for December showed a very sharp disinflation versus the high prints of the past year.
- Total PPI was up only slightly faster than 2% annualized, with prices for Food and Energy both down sharply thanks to the less dramatic commodity price pressure in December.
- Excluding Food & Energy, PPI was up 3.5% annualized, the second-slowest pace of the past year and a rate consistent with a return back towards 2% core inflation.
- There are still pockets of relatively high price pressure: retailer and wholesaler profit margins (trade services PPI) were up rapidly while logistics jams are driving up the Transport/Warehousing segment.
- But "other services" (excluding trade and transportation/warehousing services) were up 2.2% after deflating in October; that 2.2% just isn't consistent with services inflation being too high for comfort overall.
- Finally, construction inflation is near 4%, but not extreme.

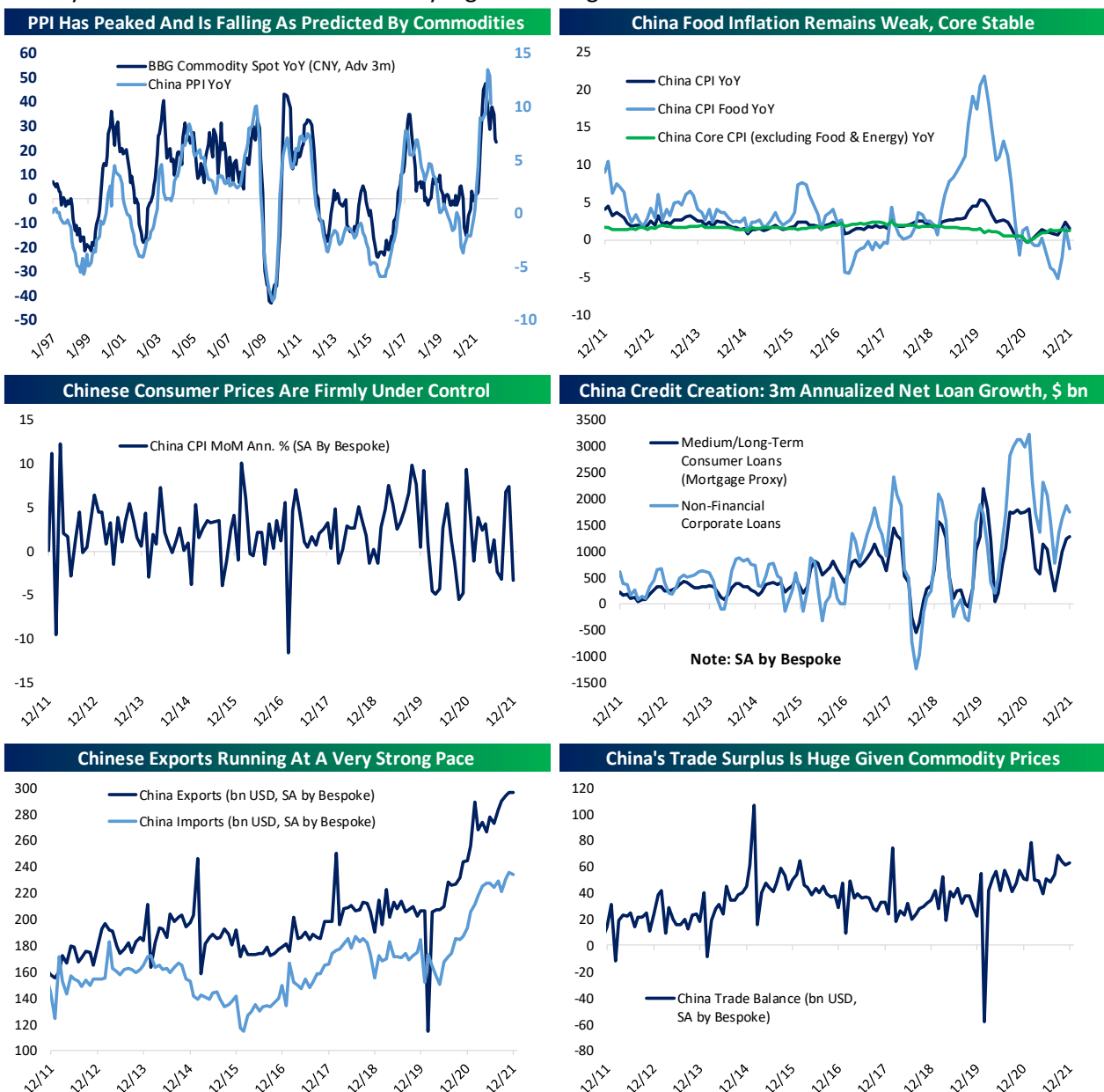




- On top of CPI and PPI, the Census also released trade price data this week that showed a deceleration in the price of both imports and exports, driven primarily by weaker commodity prices in the month of December.
- Core import prices were still up at a very robust 6.1% annualized rate, in the 92nd percentile since that series begins in 2011.
- Consumer durable goods inflation is clearly being boosted by import durables inflation, which rose at a 7.3% annualized pace in December (fastest since 2008 and fourth-fastest since at least 1992); import capital goods price was more modest.
- On the export side, huge US exports of commodities make the headline numbers highly sensitive to oil prices, and the headline was down almost 20% annualized in December.
- Meanwhile, core export prices rose a reasonable 2.5% annualized.



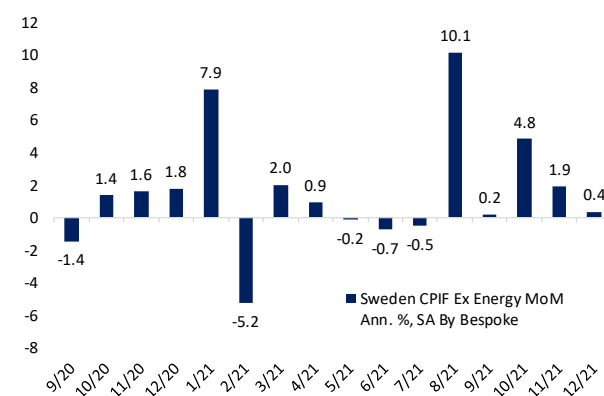
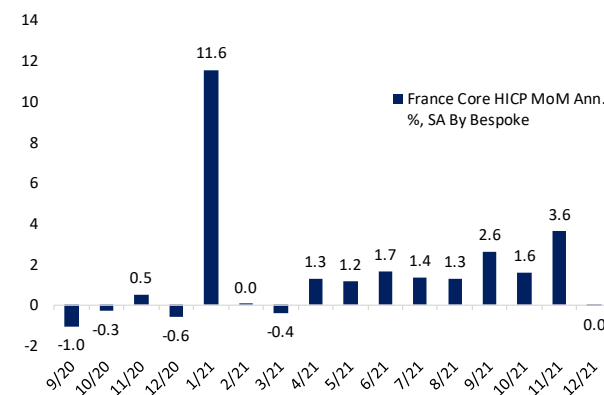
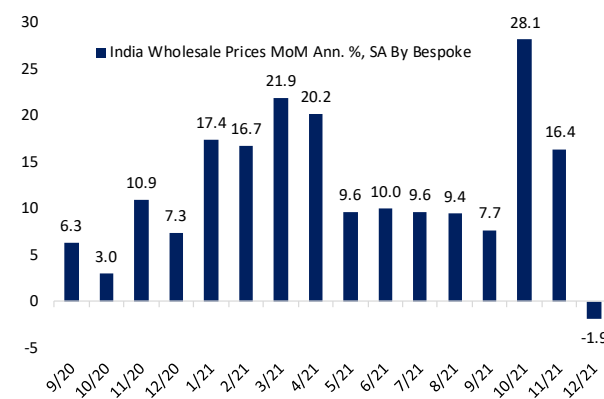
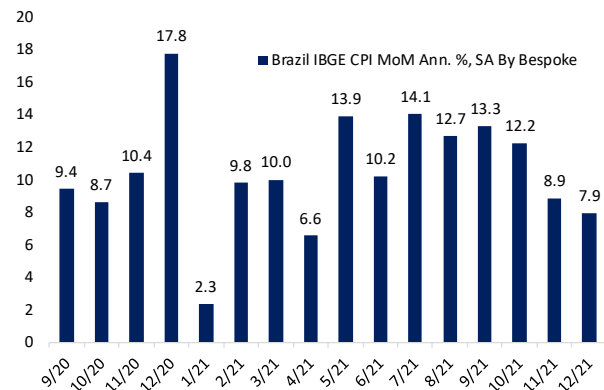
- This week we got inflation, credit creation, and trade data from China.
- High commodity price inflation is starting to roll off and as is typically the case that has led to a deceleration in producer prices.
- Chinese CPI is also modest thanks to weak food inflation; headline CPI after seasonal adjustment actually dropped 3.3% annualized in December.
- We've also seen a slowing of Chinese credit growth, though with various policymakers urging easier credit as a way to stimulate the collapsing property sector, that might not last for long.
- Finally, Chinese exports were roughly flat in December (after seasonal adjustment), and despite extremely high commodity price levels which should reduce the Chinese trade surplus, the country's annual trade balance is still very high and rising.





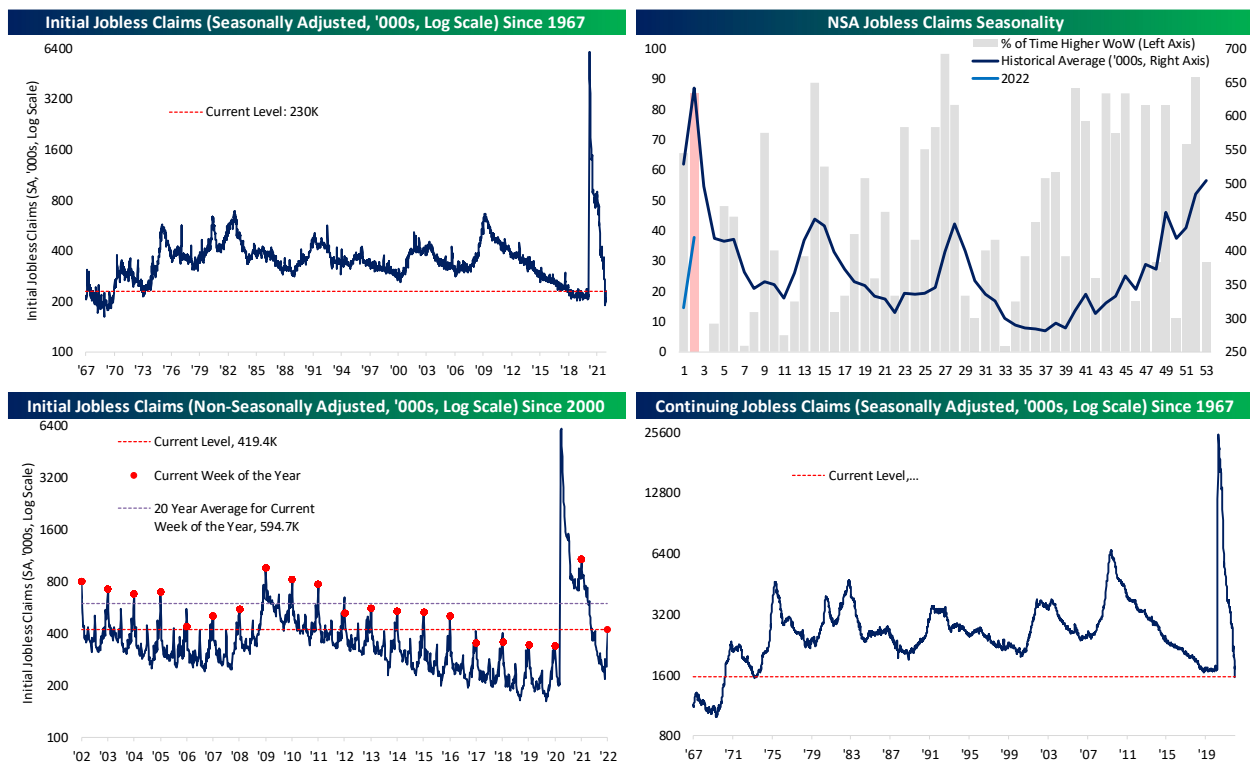
- In addition to the softening of Chinese inflation data, there were a range of December inflation releases from around the global economy this week that deserve mention.
- In emerging markets, central banks are rapidly raising policy rates to stem high inflation, with Brazil being the poster child.
- The BCDB hiked 7 times in 2021 for a total increase of 725 bps, amidst soaring inflation that was regularly above 10% annualized per month.
- As shown at right, though, headline Brazilian consumer prices updated this week rose less than 8% annualized in December, the second-slowest since hikes began.
- India had experienced more modest inflation as measured by headline wholesale prices all year, but those rose 28% annualized in October and 16% annualized in November.
- December finally offered some relief as declining commodity prices led to a 1.9% fall at annual rates.
- European core inflation data released Friday was much weaker than recent months as well.
- In France, core HICP inflation was over 3% annualized in November but was flat in December, the weakest pace since March.
- Swedish December inflation was also very weak after stripping out changes in mortgage rates and energy prices, with CPIF Ex Energy rising just 0.4% annualized in the last month of the year.
- Globally, then, this week was a big win for inflation bears, after a brutal year of accelerating headline and core prices across the global economy.

Global Inflation Readings Decelerated This Week





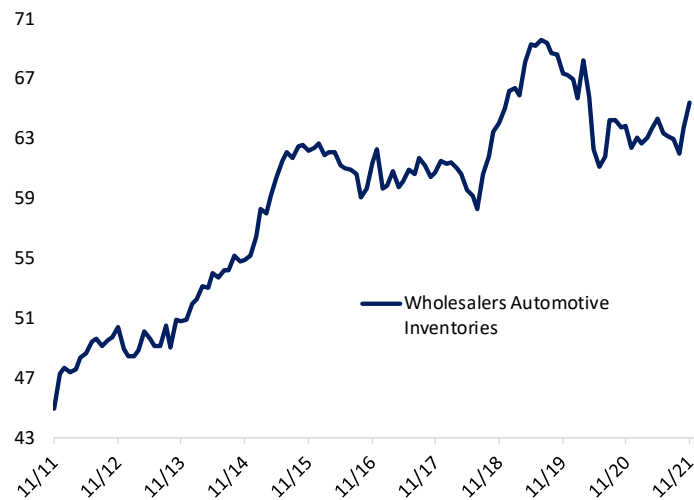
- After hitting multi-decade lows at the beginning of December, initial jobless claims have been on the rise with the most significant increase in that time occurring in the latest week. The seasonally adjusted reading increased by 23K to 230K this week which is the highest level since the week of November 12th. While there has not been much improvement in claims in the past month, current levels are still right around those from just before the pandemic. On a longer-term basis, these readings are also some of the strongest since the early 1970s.
- On a non-seasonally adjusted (NSA) basis, the current week of the year typically marks a seasonal peak in claims. In fact, the current week of the year has historically seen claims rise 85.2% of the time week over week. As such, NSA claims surged over 100K this week from 315.8K to 419.4K.
- In spite of that seasonal headwind alongside the additional issue of rising COVID cases—which we cannot parse out how much each factor is contributing to the rise in claims—that was actually slightly below the average weekly change of 111.6K for the current week of the year.
- Of course, the current level of claims is a major improvement from where things stood this time last year, but it is still decently above levels from comparable weeks of the few years prior to the pandemic. Assuming this week marks the seasonal high as it has in the past, claims will now have tailwinds combating any COVID headwinds in the coming months.
- Although initial claims were somewhat disappointing this week, seasonally adjusted continuing claims were very strong coming in at the lowest level since the week of 6/1/73.
- Claims by this measure are delayed an extra week to initial claims, but the most recent reading for the last week of 2021 showed only 1.559 million claims. The 194K week over week decline was the largest since mid-October when the reading fell by 241K.



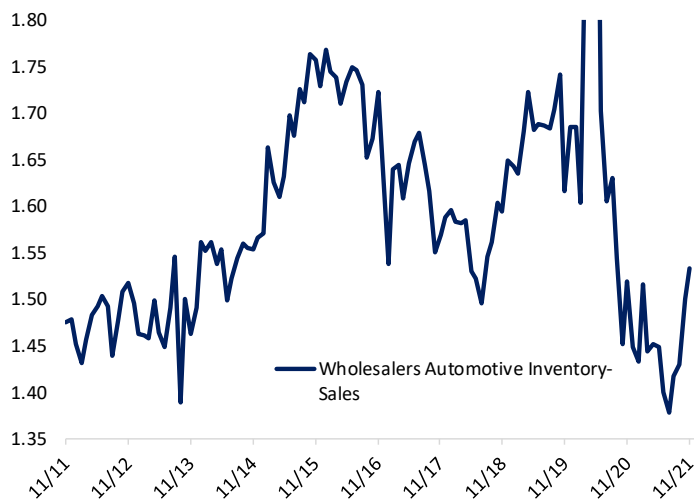


- Monday's only economic data was wholesale inventories and sales, which both come in above estimates.
- There were also revisions higher to October wholesale sales.
- One interesting piece of data within the wholesale sales report points to the supply and demand for automotive inventory.
- As shown at right, wholesale auto inventories rose over 2.5% for a second-straight month to the highest levels since before the pandemic hit.
- This nominal measure of inventories is influenced by prices, so it's also helpful to look at inventories in terms of prices.
- As shown at right, inventories have ripped from record lows in July to the highest levels since September 2020 relative to sales.
- Wholesale inventories are distinct from retail or manufacturer inventories, but all the same this uptick does point to a more normal wholesale used car market after over a year of extremely tight conditions.
- The reverse process appears to be playing out with lumber, where extremely tight inventories led to record prices last year.
- Now, more elevated lumber inventories are being drawn out as prices in futures markets are once again around \$1300/'000 board feet, over 170% of the pre-2017 record.

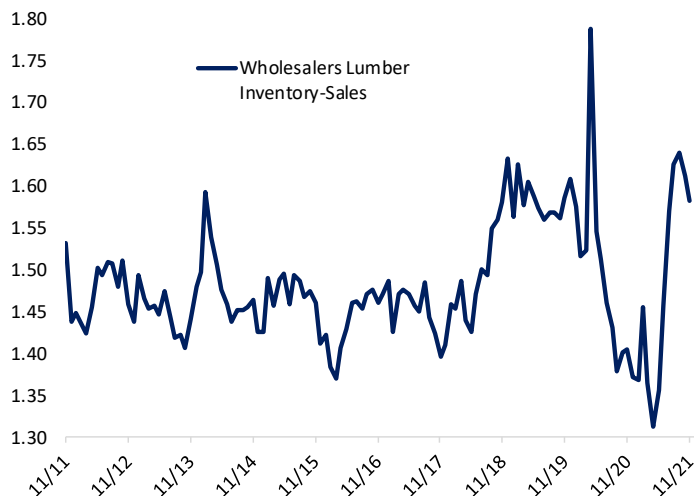
Wholesale Automotive Sales: \$ bn



Inventories Are Rising Rapidly Relative To Sales

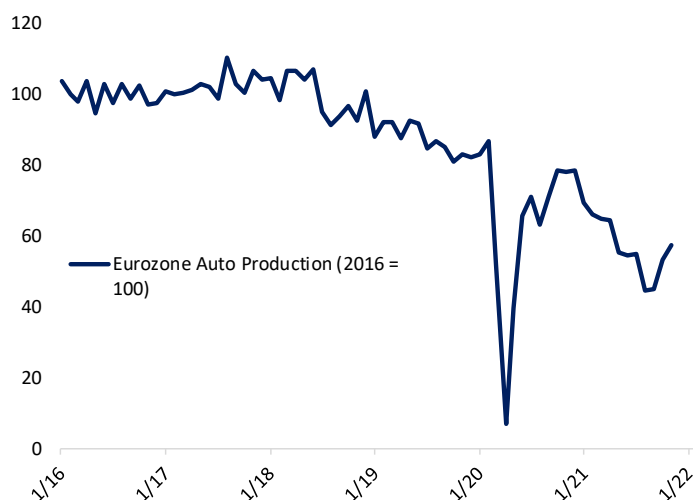


Lumber Was Extremely Tight, Loosened, Tightening Again

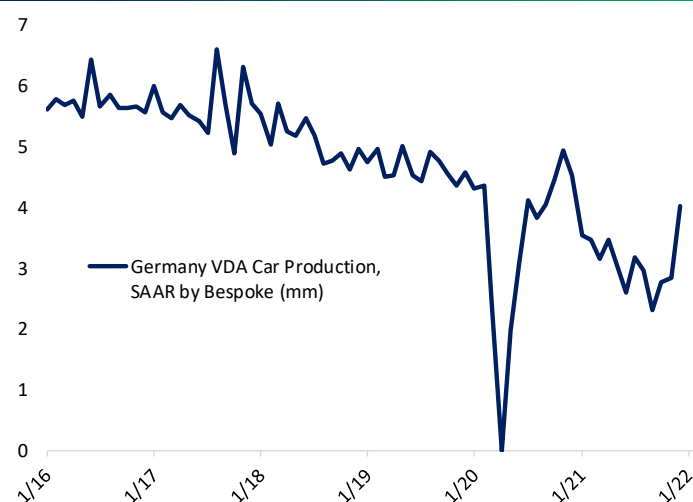


- One of the biggest drivers of inflation this year has been the used auto market.
- Since March of 2020, roughly 70% of the total increase in core CPI has come from used autos, which are less than 4% of the index!
- Part of that story is high demand from households flush with cash transfers and easily able to make low monthly payments thanks to low interest rates.
- But the supply side is a material factor as well, with auto production collapsing in 2021 thanks to the disruption of supply chains for semiconductors.
- Thankfully for both auto executives and prospective buyers, auto production is ramping back up again, with Eurozone auto output up 28% in three months through November per data released this week.
- After our seasonal adjustment, German auto production in December was the highest of any month since 2020, up 74% since September.
- In the US, production soared 25% from September to November but ebbed a bit in December per data updated by the Federal Reserve this week.
- It's not clear how long the semis supply constraints will be around, but they appear to be easing and helping support the supply of new vehicles to the market, which should help cap used auto prices.

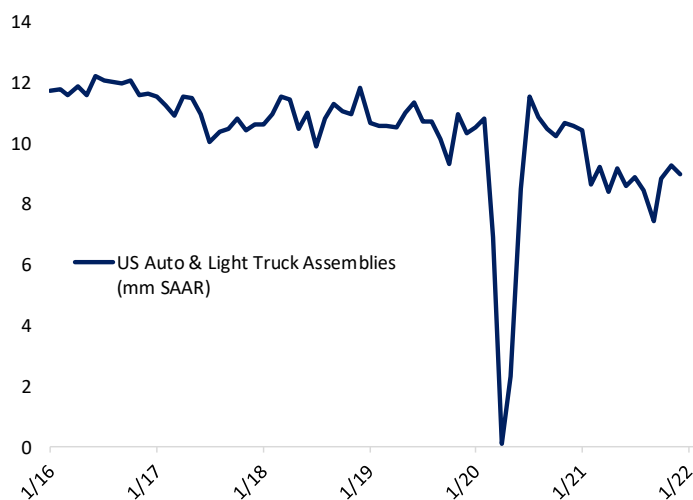
Eurozone Auto Production Has Started To Rebound



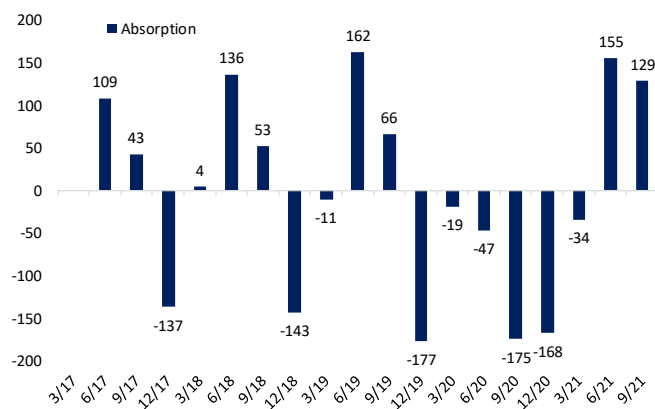
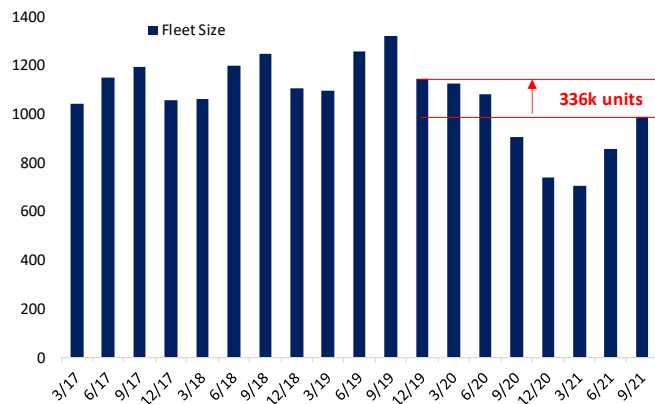
German Numbers Suggest Another Big Month In December



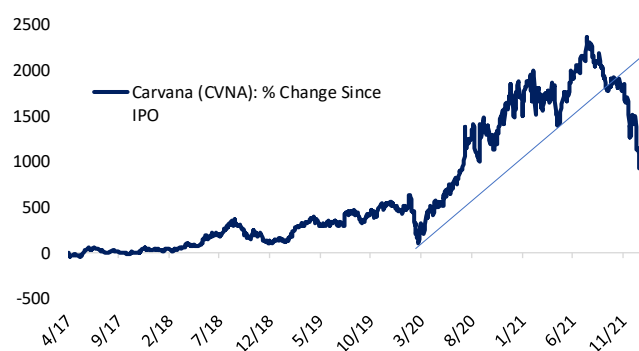
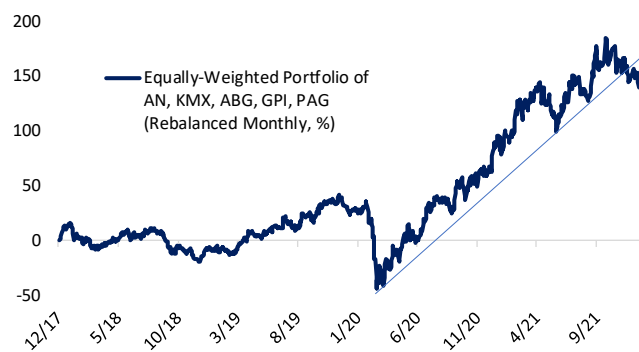
US Auto Production Is Also Up, But Paused In December



Avis Budget (CAR) + Hertz (HTZ) Total Rental Fleet Size



Used Auto Exposures Are Starting To Break Down



• Another huge factor for used autos is the rental car fleets, which we proxy at left with the publicly released data from **Avis Budget (CAR)** and **Hertz (HTZ)**.

• As shown, rental car companies liquidated their fleets in 2020, and over the middle of 2021 were busily re-stocking that inventory of rental cars amidst very high demand for rentals from domestic travelers.

• The problem is that there just aren't enough cars available (either new or used) to rapidly rebuild these fleets and the result is brutal price competition from these buyers on top of strong demand.

• We'll be closely watching CAR and HTZ results on February 16th and 25th respectively for evidence that they have rebuilt fleets, removing a large chunk of demand from the market.

• The stock market certainly seems to be sniffing out a topping in used car demand and prices.

• A basket of dealer stocks (which handle both new and used cars, but have generally benefitted from the tight used car market) has broken its post-COVID uptrend decisively.

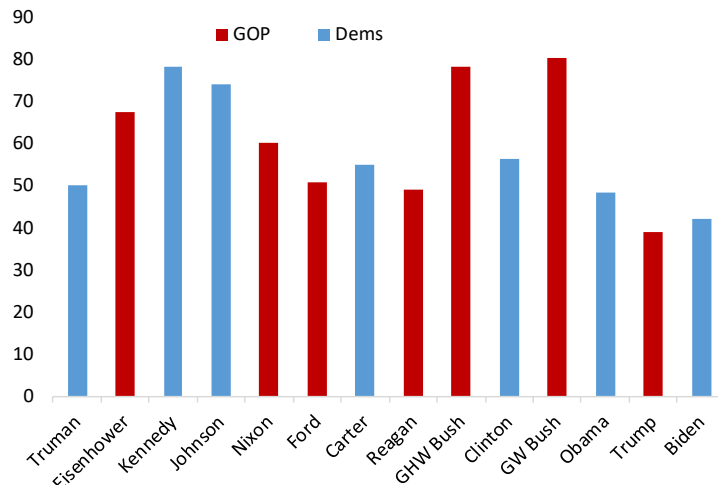
• These names are much lower beta than the highly volatile **Carvana (CVNA)**, a tech platform company for used auto buying and selling that soared in 2020 and 2021.

• As shown at left, that name is back to where it was about 18 months ago and continues to collapse amidst the broader selloff in growth names.

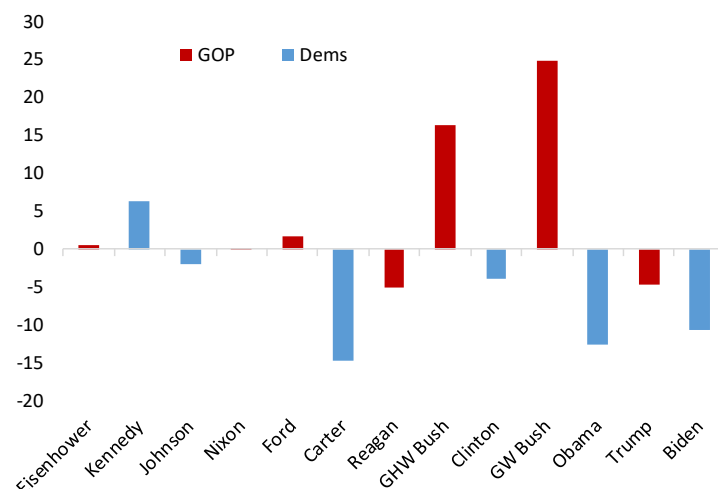
• Its tech and growth attributes have hurt the stock of course but this is a good sign that used autos are about to loosen up.

- It's no secret that the President has seen a major slide in approval ratings since he was elected per averages compiled by FiveThirtyEight.
- For the first four months of his administration, President Biden's approval rating was stable in the mid-50s, but from June of last year through October of this year it slid persistently to around 43.
- It's been roughly stable since, making him the least-approved President at this stage in his first term other than President Trump.
- Historically, there have been only two Presidents that have seen a swing against them as large as the current one Biden is suffering: Carter and Obama both saw larger declines in polling.
- Carter fell from a 69.8% approval rating to a 55.0% approval rating, while Obama went from 61.0% to 48.4%.
- Biden's fall has been from 52.9% to 42.3%, double the decline Trump suffered but from a much higher starting approval.
- As far as investors go, the current approval backdrop shouldn't be a huge concern.
- Historically, S&P 500 3-month returns are only outright negative on average at extreme approval rating lows, while middling approval rating levels generally suggest average or slightly better than average returns.

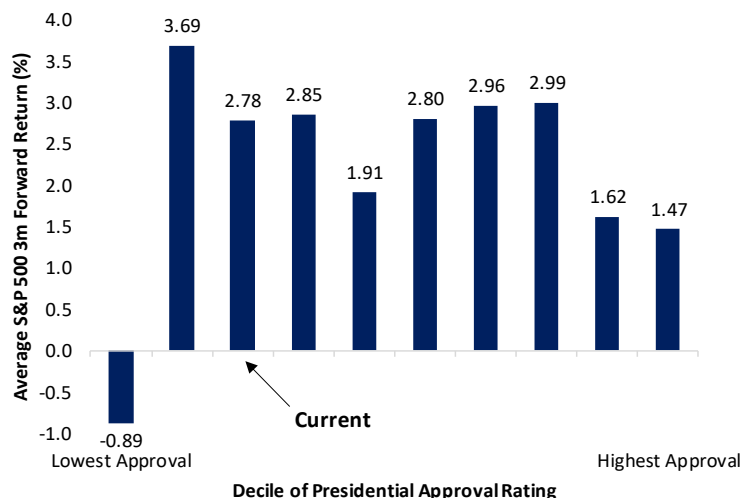
Presidential Approval On 354th Day In Office (% Approving)



Change In Approval: 6w In Office To 354th Day (%-pt Approving)



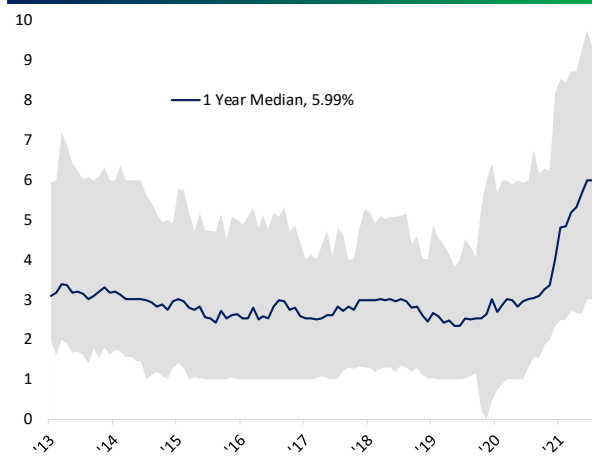
Decile Analysis: S&P 500 Returns By Presidential Approval Rating



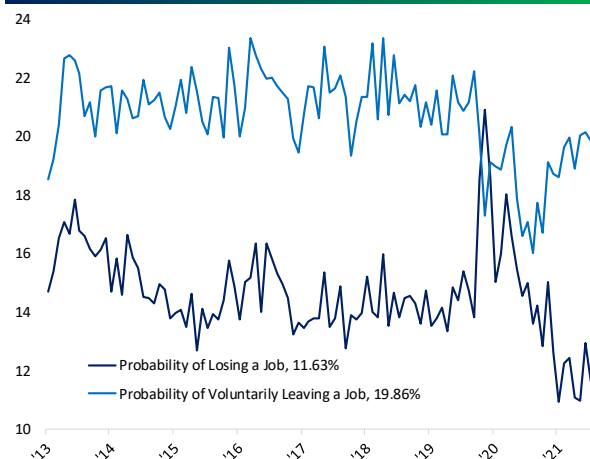


- The New York Federal Reserve updated their monthly survey of consumer expectations on Monday with data as of December.
- While the drop was hardly noticeable, the one year median inflation expectation finally peaked after 13 consecutive months of increases, falling from 6% to 5.99%.
- Longer run 3 year median expectations have fallen more significantly from a high of 4.21% in October to 4% in December.
- As for the survey's read on labor markets, expected income growth has continued to rise to record highs in the data going back to 2013. Meanwhile, respondents reported lower probabilities of both losing a job or leaving voluntarily.
- Although both readings are off the absolute lows, neither have returned to their pre-pandemic range.
- The share of respondents reporting that they expect their financial situation to worsen one year ahead has generally been on the rise over the past two years even as the economy has improved.
- In December, that reading fell for the first time since August while the percentage reporting expectations of a better financial situation fell for a third consecutive month.

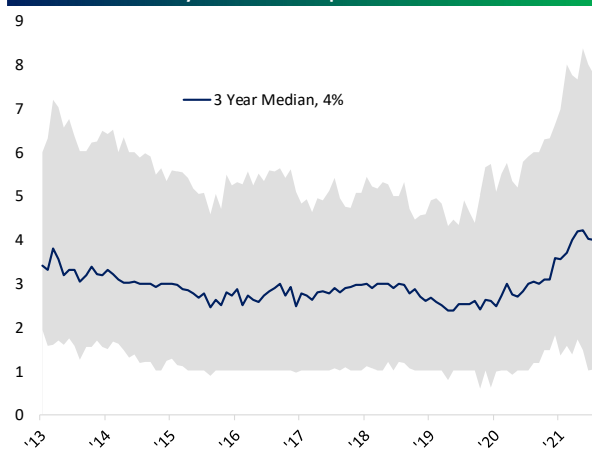
NY Fed Survey of Consumer Expectations: 1 Year Inflation



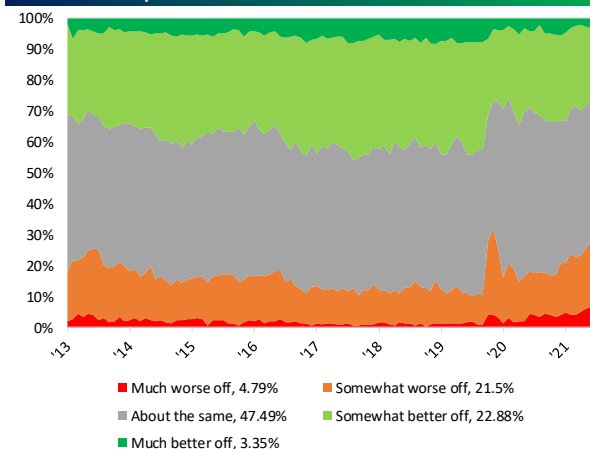
Probability of Losing or Leaving a Job in Next 12 Months



NY Fed Survey of Consumer Expectations: 3 Year Inflation

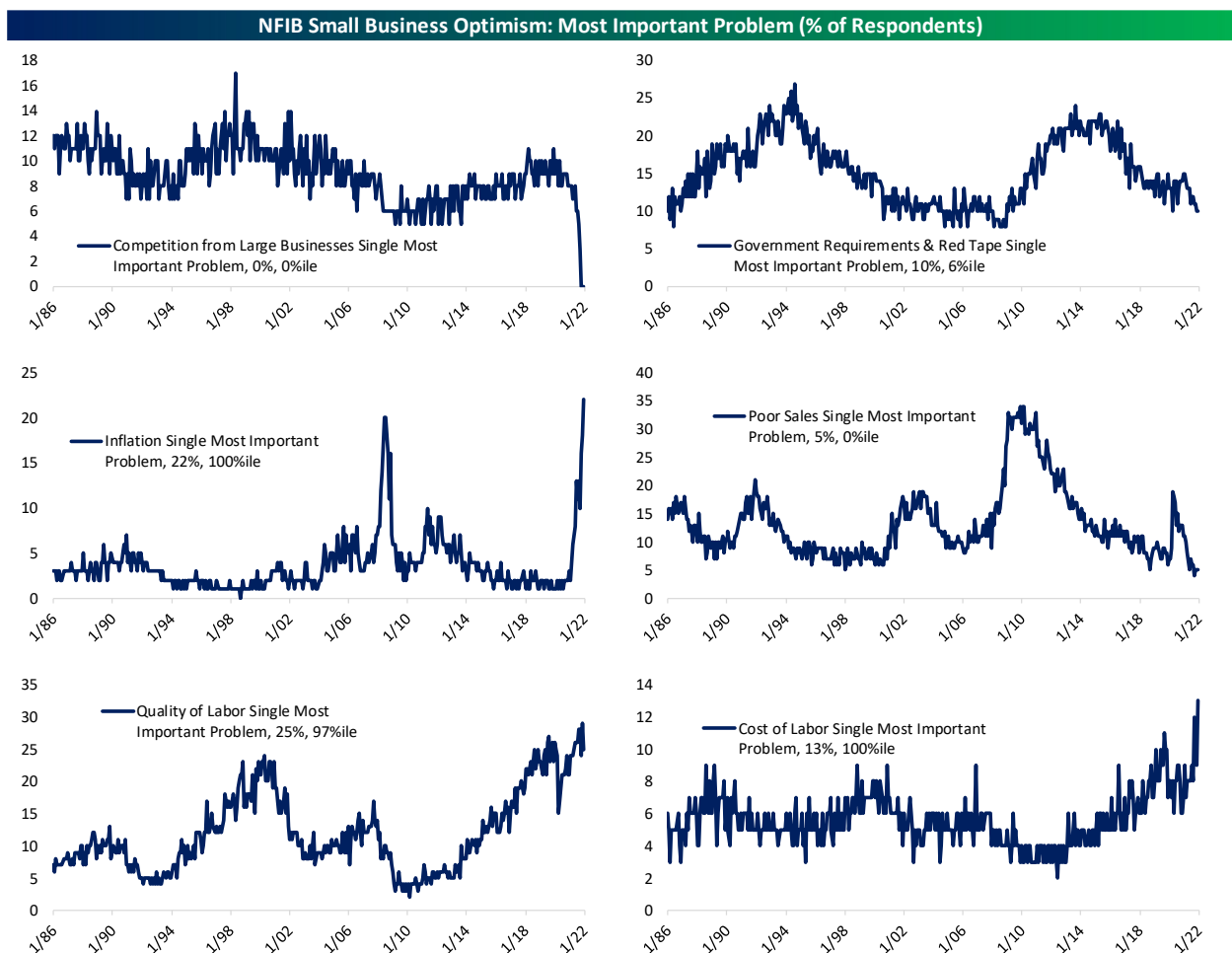


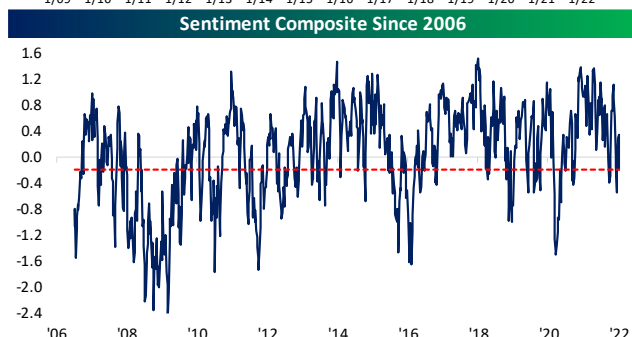
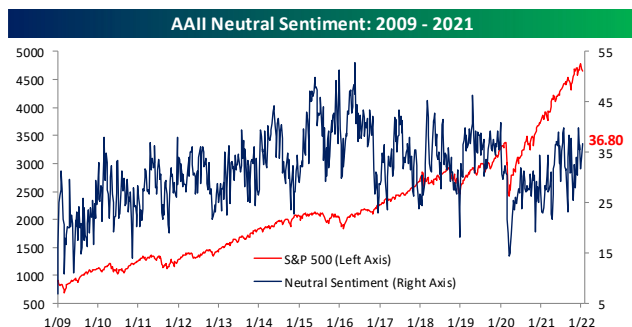
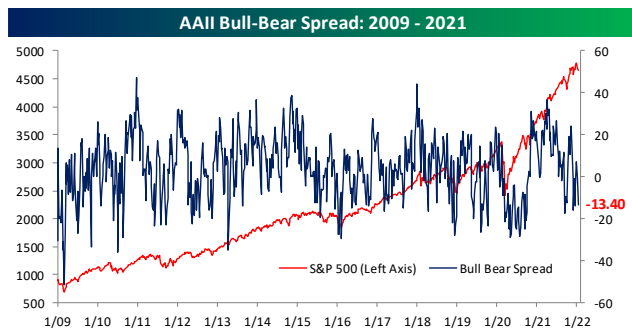
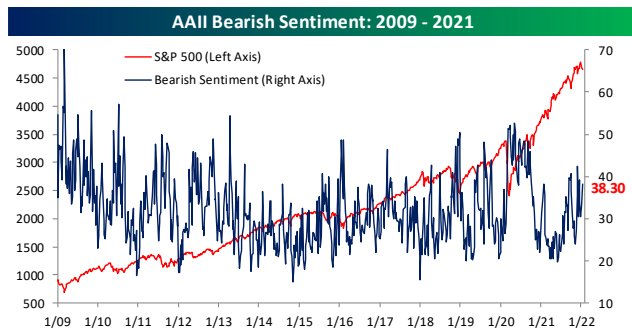
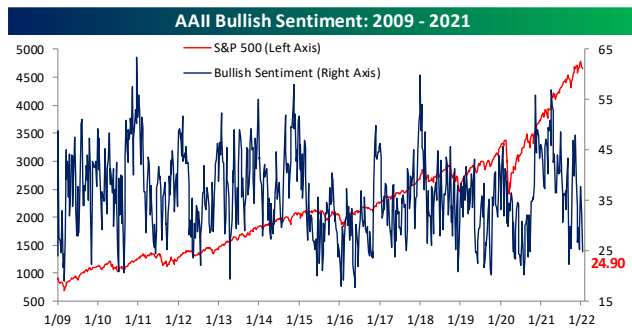
Expected Financial Situation One Year Ahead





- We don't try to put too much weight into the NFIB's monthly survey of small business optimism, but the data is still revealing about the overall state of the economy. For instance, over the last quarter of 2021, no NFIB respondents reported that competition from big business was their most important problem.
- Similarly, just 10% reported red tape or taxes as their most important problem, the joint lowest since the financial crisis recession and in the bottom 6% of all readings. Finally, the share of respondents reporting poor sales as their most important problem (which should run inverse to overall consumer demand) is near record lows.
- At the same time, concerns over inflation and the cost of labor are at record highs, with quality of labor also reported as a major headwind. While competition from big business and poor sales growth can be thought of as "demand-side" problems, "supply-side" problems (inflation and cost or quality of labor) are far more salient right now.
- The broad backdrop of the NFIB survey is clear: unlike the past 20-30 years, the US economy is not currently demand-constrained but is instead supply-constrained. With fiscal policy in full reverse now and slowing demand and Fed rate hikes about to begin, it will be interesting to see how long the current imbalance in the NFIB data remains.





- The past week has seen the S&P 500 pull back to retest its 50-DMA which has put a damper on investor sentiment. This week's AAIL survey showed that less than a quarter of respondents reported bullish sentiment. That is down from 32.8% last week and the lowest since 9/16.

- Bearish sentiment picked up most of the difference rising five percentage points to 38.3%. This brings bearish sentiment to a fairly elevated level relative to its historical average of 30.56%, though, it is still within a standard deviation of that reading. While higher, this week's increase was actually only the biggest uptick and highest level of bearish sentiment since the week of 12/16.

- Given those moves in bullish and bearish sentiment, the bull-bear spread has fallen deeper into negative territory. At -13.4, the spread is now at the lowest level since mid-December.

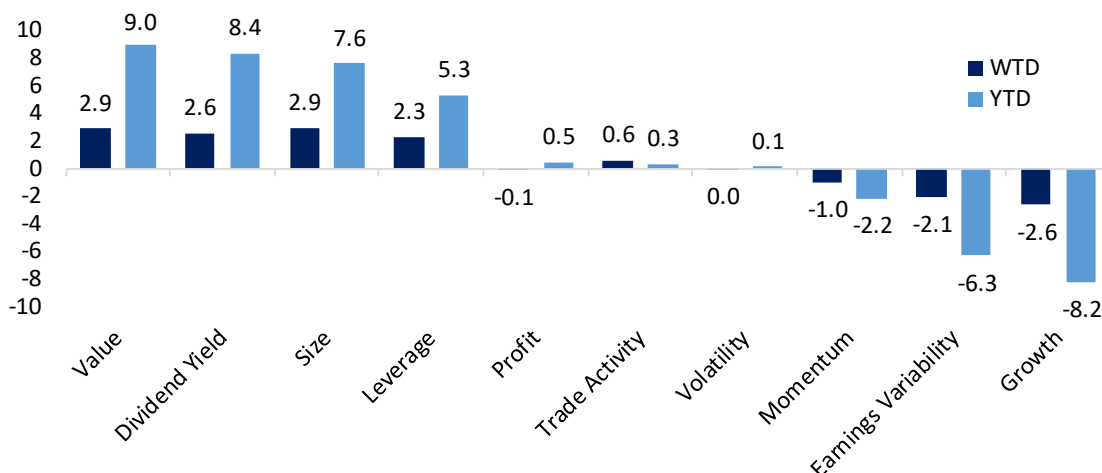
- Whereas bearish sentiment jumped 5 percentage points this week, neutral sentiment has gained 5 percentage points after the back-to-back increases over the past two weeks. Neutral sentiment now stands at 36.8% which is the highest level since 12/9.

- As for other sentiment readings, both the Investors Intelligence survey and NAAIM Exposure index took more bearish tones in the most recent week. As a result, our Sentiment Composite, which combines the bull-bear spreads of the AAIL and Investors Intelligence surveys with the NAAIM exposure index's reading, has fallen back below zero meaning overall sentiment is broadly bearish, but not to a degree in which it is outside the range of recent readings.

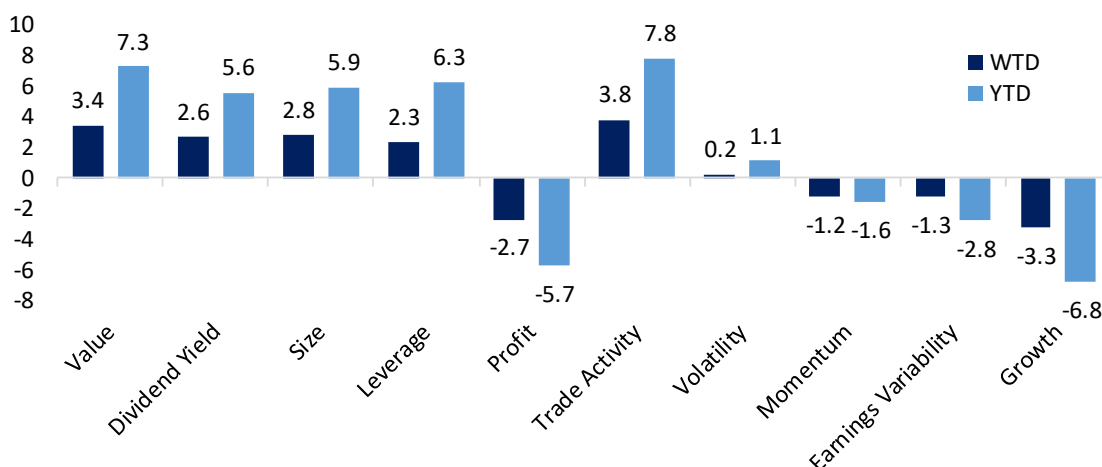


- The best way to sum up the week that was in markets is the long-short performance of various quantitative style factors.
- These measure the performance of the quintile of stocks which score highest versus the quintile of stocks that score lowest, within a given attribute and on a sector-neutral basis.
- As shown below, this week was much like the first week of the year in the US, as stocks with low valuations crushed those with high valuations, high dividend yields crushed low dividend yields, large stocks outperformed, and more levered companies outperformed.
- Growth was absolutely wacked, as long/short based on quantitative growth factors got hit for 2.6% this week and 8.2% YTD; names with higher earnings volatility and momentum were also sold aggressively.
- It's broadly the same story in Europe, though profitability and trade activity have been more dynamic as factors than in the US.
- Growth stocks have also been hit hard across the pond, though.

US Quantitative Factors: Long-Short Performance (%)



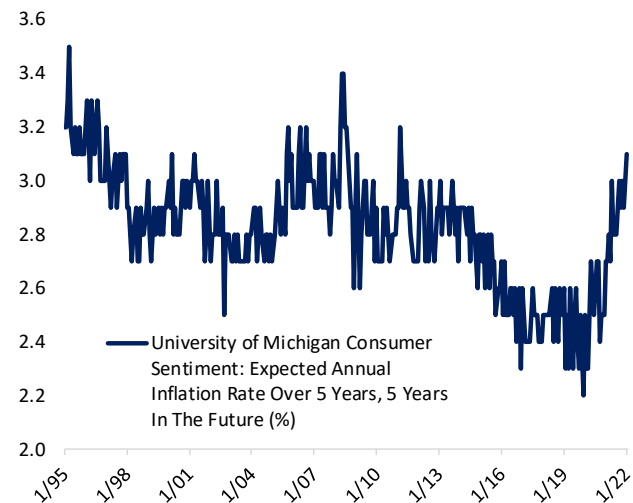
Europe Quantitative Factors: Long-Short Performance (%)





- It's understandable why the Fed is so closely focused on inflation given how hot inflation is and how strong the labor market looks.
- But balanced against that concern is the context that while inflation may be high now, there are good reasons to think it may come down soon.
- Consumers themselves aren't showing any real sign of expecting permanent, long-term high inflation, as University of Michigan data showed this week.

Inflation Expectations Have Risen, But Not Excessively



- While long-term inflation expectations are at decade highs, they're still well below peak levels from the past quarter century.
- There is a needle to be thread by the Fed whereby they tighten policy, but not too much, as inflation subsides and demand for goods and services revert to pre-recession norms.
- If the Fed moves too fast, the equity market—and the economy—is in deep trouble, while there aren't many FOMC members willing to not start hiking rates.
- That suggests that while certain areas of the market could fall substantially further, and that stocks overall are at some risk as the market adapts to the new tightening regime, a recession and large stock market bust brought on by the Federal Reserve shouldn't be the base case for now.
- Have a great weekend!

[Bespoke Growth Basket](#)

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