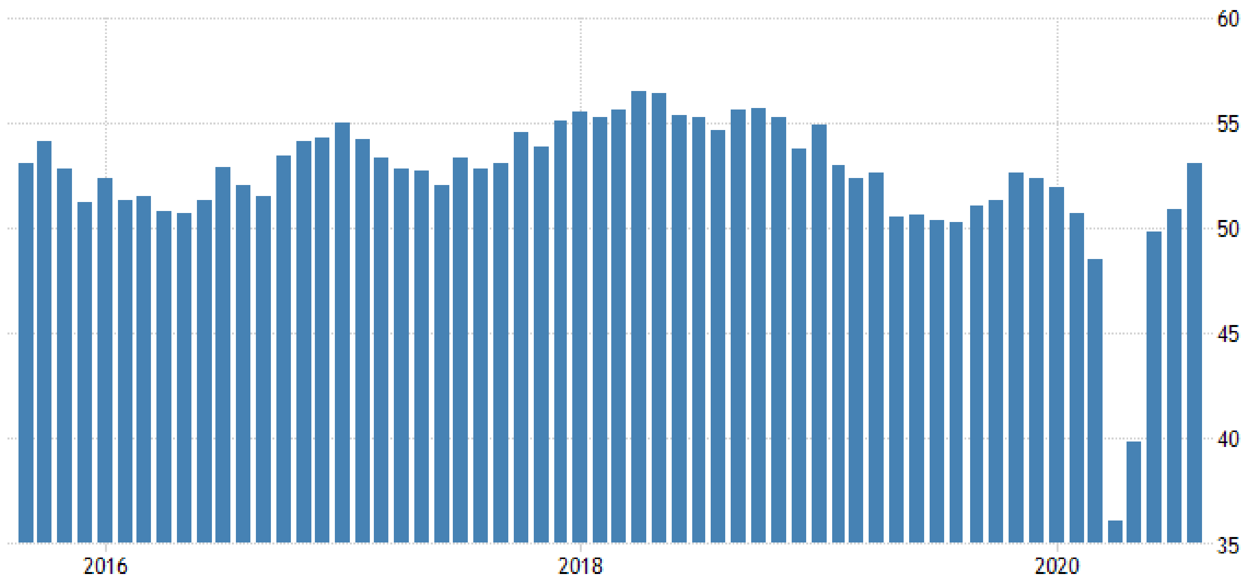
Not So Special

We have a new moniker to add to the various descriptions of what an economic recovery looks like, and it's the letter "K. The premise is simple and very relevant. The left vertical line represents the fall off, and the upward sloping part is the rapid recovery of the rich and those who own assets, while the downward line is for the rest of the schleps who are getting left behind. Our longtime contention is that you can't have the delta be that large between the haves and have nots, and still get a strong sustainable economy that broadens the base and ultimately benefits everyone. Legend of Wall Street, Stan Drukenmiller sees the current environment as a mania, but how's that been working out on the P&L?

The Economy

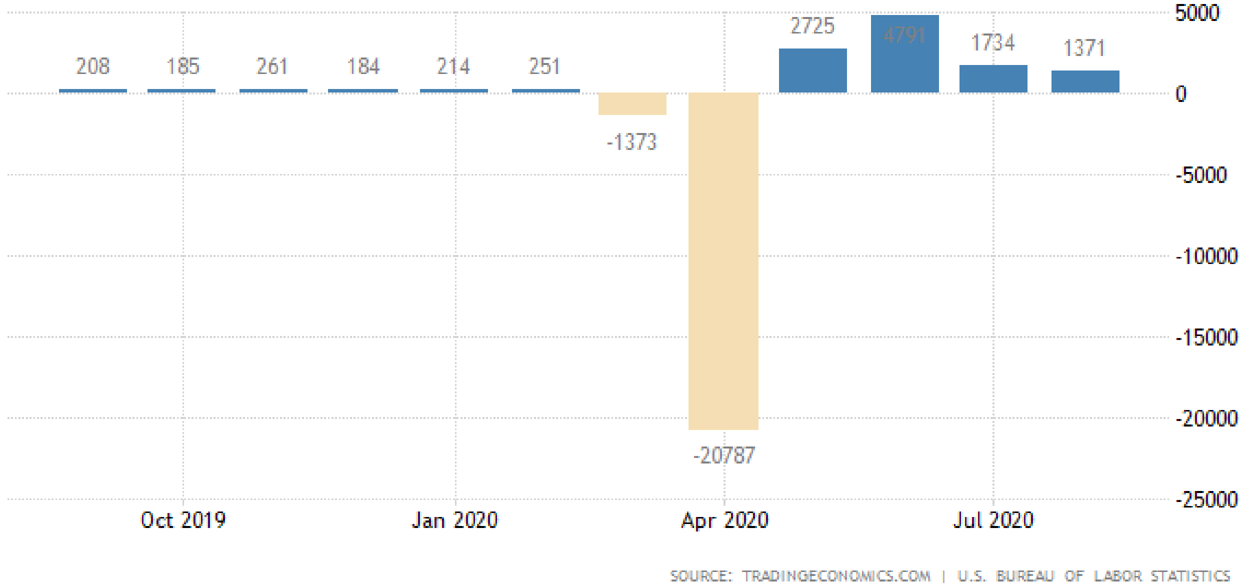
It’s been a while since we last looked at some of the more important economic readings. This was in part due to the fact that we, along with most everyone else out there, can’t figure out if bad means bad, or bad means good, given the Fed’s ‘lower forever’ mantra. So here we go with a quick whip around the economic calendar for the past week. First up, is the very important Purchasing Managers Index (PMI), which has rebounded nicely and says good things about the manufacturing side of the economy.

Purchasing Manager Index



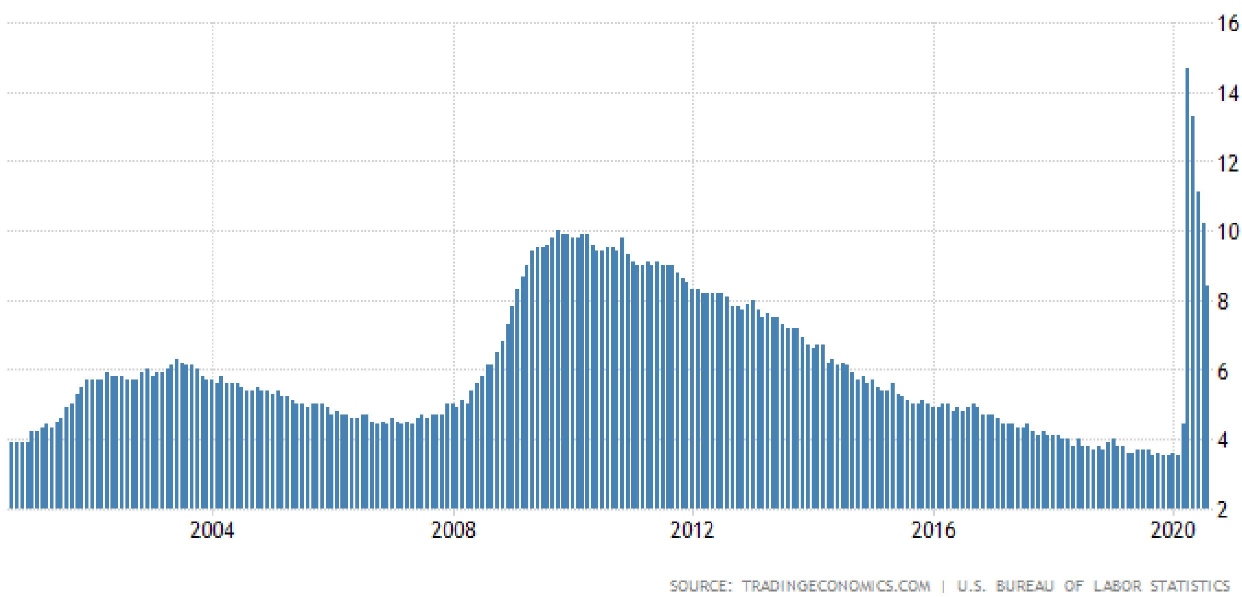
On the job side of the equation, the jury remains very out when it comes to predicting the level of “re-employment” and what that does for the economic recovery. The losses were so big in March, that this chart is barely decipherable in terms of what the longer-term trend is going to look like. From a two-month loss of nearly twenty-two million bodies, to a recovery of about eight of those ever since, if this trend keeps up, we won’t see a normalized world until well into 2021. Good luck figuring out what that means for the 70% of the economy that is consumer based.

Monthly Non-Farm Payrolls



In terms of the actual unemployment rate, that too is going to be tough to read for a good long time. From the massive spike higher to 15% when Covid first hit, to a more manageable 8.4% in August, this series too is going to be noisy for a while. Keep in mind, unemployment peaked out at 10% during the global financial crisis, and markets rallied hard when the news kept getting less worse, which is what we are also seeing today. As they say, while history doesn't repeat itself, it often rhymes.

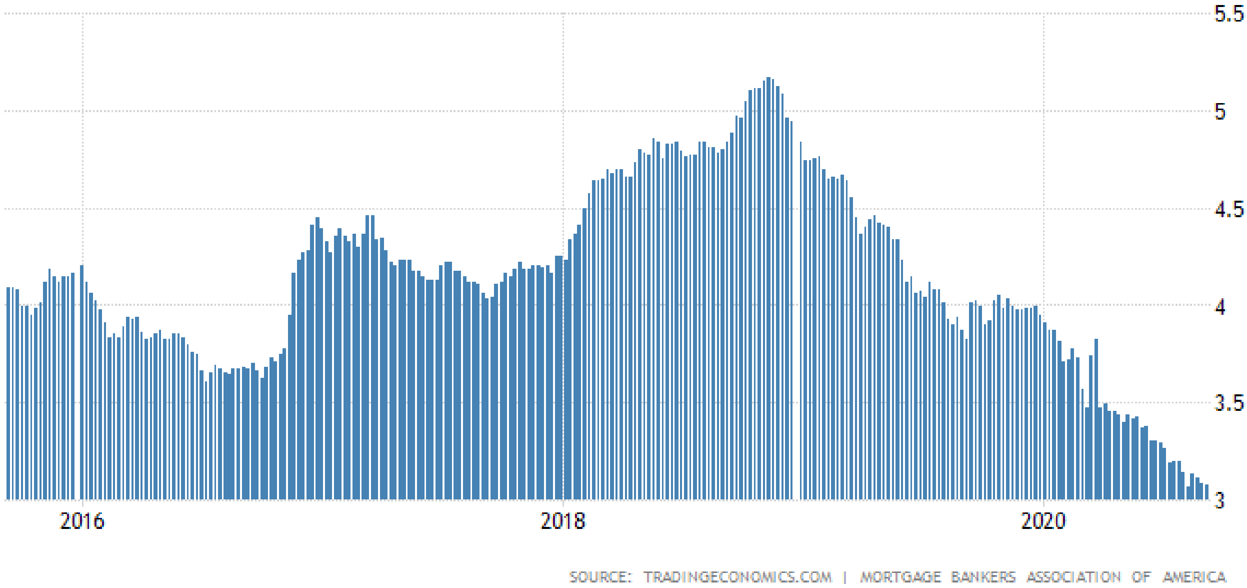
Unemployment Rate



Finally, we would be remiss if we didn't print the chart of mortgage rates over the past five years. The cost to borrow money is the cheapest it's ever been, and has actually dropped by

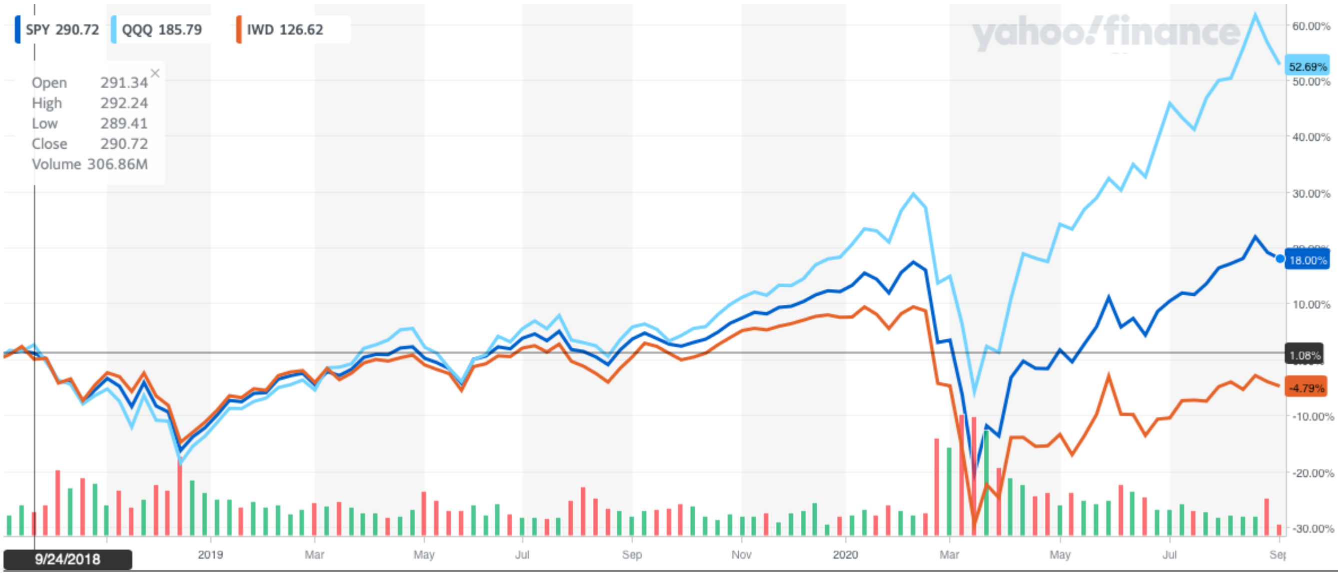
25% this year and almost 50% over the past two. With a trend like that, and the upper end buyers still flush with cash and appreciated stock market assets, it's no wonder residential real estate is white hot right now, especially in 'Zoom Towns'. Commercial space, not so much. Though there are a few tech related tailwinds for some types of offices and buildings

Thirty-Year Mortgage Rates



That's it from the world of economics. We have shied away from this part of the markets for the better part of the past few months. Bottom line, the trends are all positive for a world trying to figure out what the newest of our new normal will look like. That said, there are a freighter full of challenges ahead, and outside of five technology stocks that have finally broken their bullish fever this week, much of the rest of the market is saying we aren't really out of the woods yet.

S&P, Technology, Value



Markets

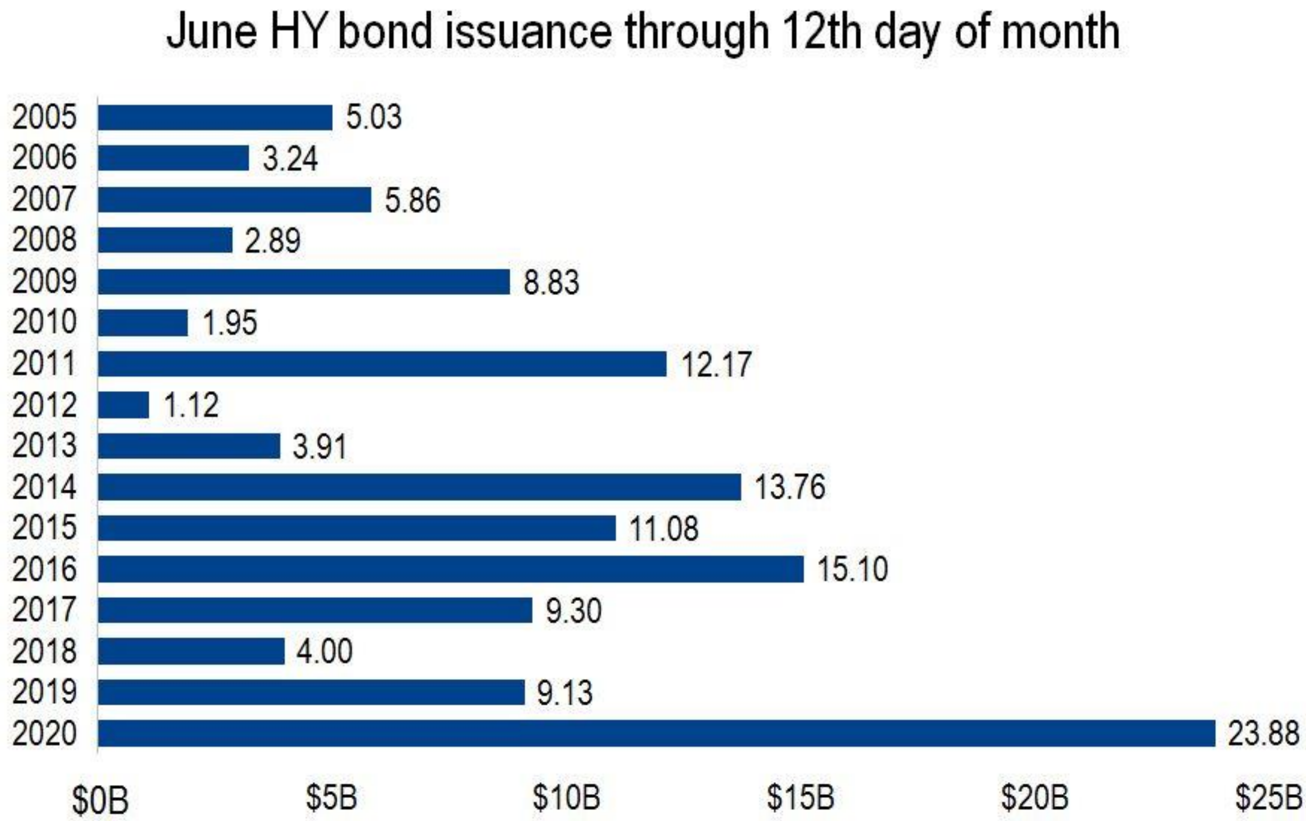
As we just mentioned, the tech stock rocket ship that has been throttling higher for the better part of six months, finally took a breather and the NASDAQ is down 10% from its all-time high. Given the massive outperformance, that's barely a blip on the radar. One thing we would caution at this point however, is the nature of who is moving the market on a daily basis. It's very clear that it's not the active money management crowd, and is more likely the quant machines and Robinhood style day traders. The former has no soul and will sell or buy anything without emotion. The latter is a different beast with raw nerves pulsing though it with gains feeling like a euphoric drug and losses like a rock bottom Monday after a bender of a weekend.

The Future of Finance

High Yield

The junk bond market has been at the epicenter of the new age Fed thinking about asset pricing in the modern world. Put another way, when Fed Chair Powell and his colleagues decided to step in and start buying high yield ETFs, the natural market discovery mechanism was sent to the sidelines. The refrain repeated itself again this week, DoubleLine's Jeffrey Gundlach opined that high yield bond defaults had the chance to double this cycle. Which makes perfect economic sense given the storm we are going through. But even if they default, there is still a decent chance that the associated bond trades well north of where it might in a more normalized market.

Firehose of Debt Issuance

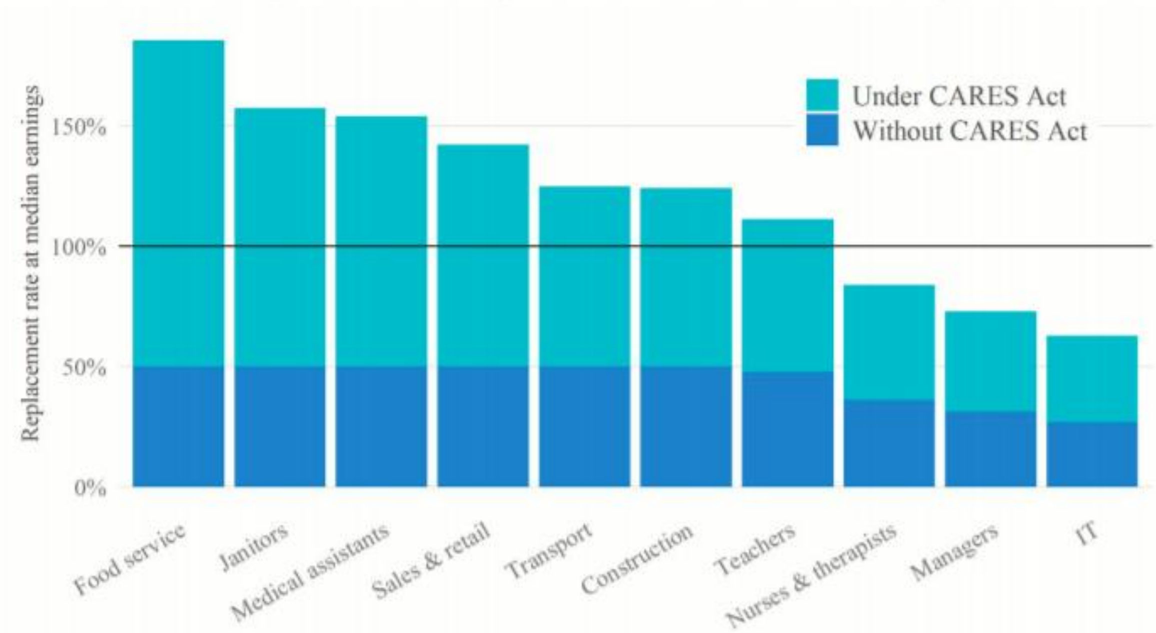


Source: LCD, an offering of S&P Global Market Intelligence

Aside from calling what's going on in the high yield debt markets foolhardy, Gundlach also pointed out that many laid off workers are doing better now on government assistance than they would be if still employed. This is another reason why the consumer discretionary sector has been flipping the bird to caution and is roaring higher. Bottom line, if you have more money and more time combined with Amazon Prime, chances are good you are still consuming well above what might be expected given the headlines.

Christmas in September

Figure 4 -- Benefit Replacement Rates for Common Occupations



Notes: This figure shows the fraction of earnings that are replaced by unemployment benefits for workers in ten of the most common occupations. Specifically, the figure shows the fraction of earnings that are replaced by unemployment benefits for a worker whose earnings are at the national median of each occupation. For each occupation, we calculate the UI replacement rate in every state and then define the national replacement rate as the population-weighted average of the state-level replacement rates. We compute this statistic for ten of the most common occupations. The horizontal line shows a replacement rate of 100%, which is where benefits are equal to earnings.

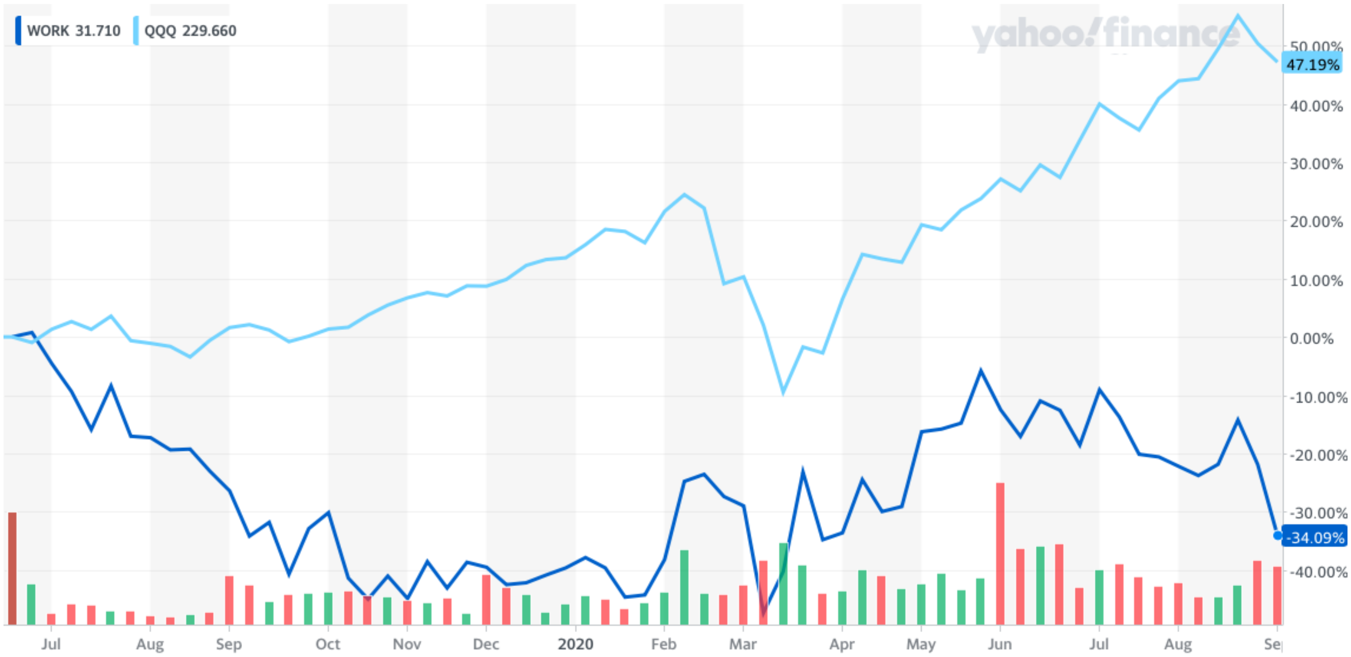
The Bottoms Up

We've been spending a lot of time this year focused on the top-down because when the asset reflation trade is on, nothing else really matters. This week we started to get news that has the wheat separating from the chaff. Interestingly enough, the two companies we are bringing to the table are in the technology sector. First up is Ciena, the longtime supplier of fiber optic equipment to the telecommunications providers, which last week finally caved and said that Covid-19 was putting the brakes on spending and the outlook wasn't good over the near term.

Arms in the Arms Race

In enterprise software news, cloud-based collaboration software provider Slack put up a punk quarter that didn't live up to the company's astronomical valuation. Part of the weakness was based on stiff competition from Microsoft with the other headwind being felt by adopters facing a wall of worry. CEO and co-founder Stewart Butterfield said on the earnings call, 'On the enterprise side there was also more budget scrutiny especially from new categories with longest adoption curves.' Following the news, shares dropped 20%.

Slack v. Nasdaq



While those are only a couple of data points, they are the ones we thought would play out during the pandemic. Which makes us right on the fundamentals, but wrong on equity pricing. Bottom line, as was highlighted by Bloomberg back in June, hedge funds and hedging in general have a tough time working when the Fed puts the hammer down on liquidity.

Painful Trade

As a sidebar, everyone in the investment world sits someplace on the capital lifecycle and venture capital is one of the best places to be. And we for sure are personally jealous of the financial gains one can aggregate being an early investor or employee of a white-hot technology unicorn, but that's not our place. We also think early, and outspoken Facebook executive Chamath Palihapitiya was right in theory back in 2018 when he called the venture capital cycle a 'bizarre Ponzi balloon'. But right in 'theory' doesn't pay the mortgage and that trade has blown up in a good way for those involved on the long side. Chamath also made a bold call earlier this year to short big tech 'right here right now' partly based on government breakup risk.

Poker Face

While *This Week in the Markets* is a publication open to all who want to read it, from time to time we like to make it a two-way street. If anyone on our relatively wide distribution list knows Mr. Palihapitiya and wants to make an introduction, we would be forever grateful. While he isn't the easiest to get in touch with, Stillwater wouldn't mind building some things around his ideas. Coffee for closers!

No Truer Words

Speaking of closing, embattled Softbank, founded and run by Masayoshi Son, has been outed as the 'Nasdaq Whale', buying billions of dollars in call options on the four horseman of the market; Tesla, Microsoft, Amazon, and Netflix. This move takes the firm further down the path of becoming a technology 'hedge fund', rather than a focused venture cap firm. Many of us rolled our collective eyes when Son announced he was starting one and his purchases were going to be the biggest of big in terms of market capitalization. Sorry to be the one to break the news, but that kind of 'edge' can be bought for free at any discount broker. And if it does warrant a performance fee, we will gladly start writing tickets and take in new money.

Masa Son

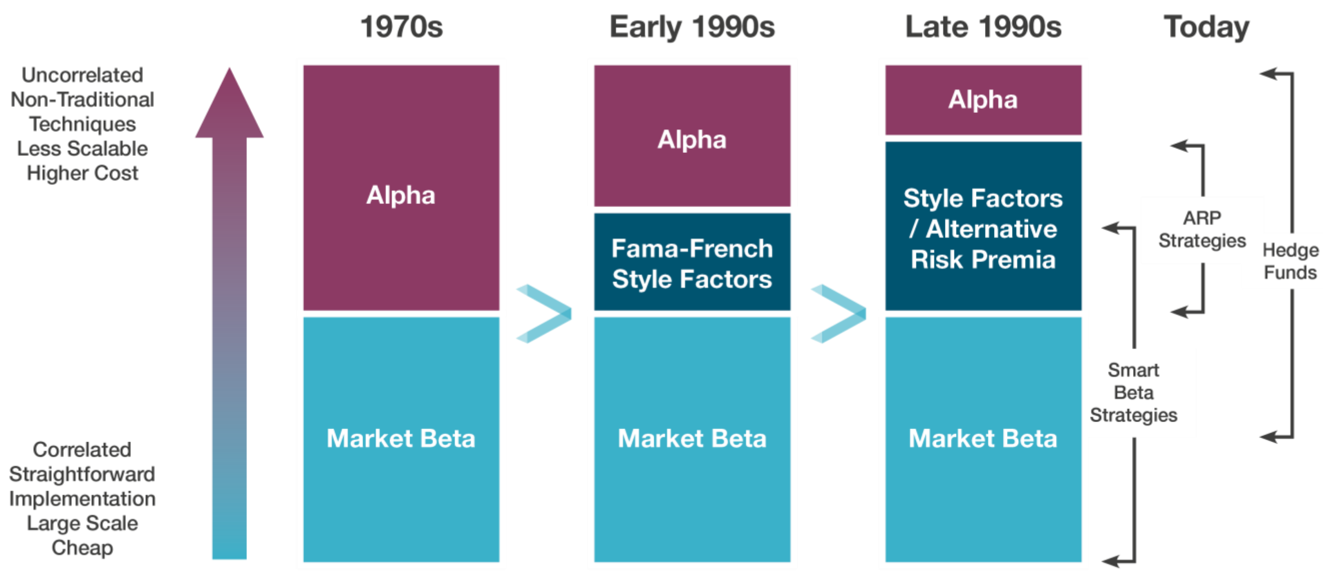
Hedge Funds

In a reckoning that we saw coming, alternative risk premia strategies are facing their day of reckoning according to Bloomberg. ARPs, as they are known, are the creation of pointy headed quants who used trends and correlations to develop strategies that could thrive in most any market condition. But truth be told, they haven't worked out so well as some of these trends are not as pervasive as once assumed.

Tough Trade 2.0

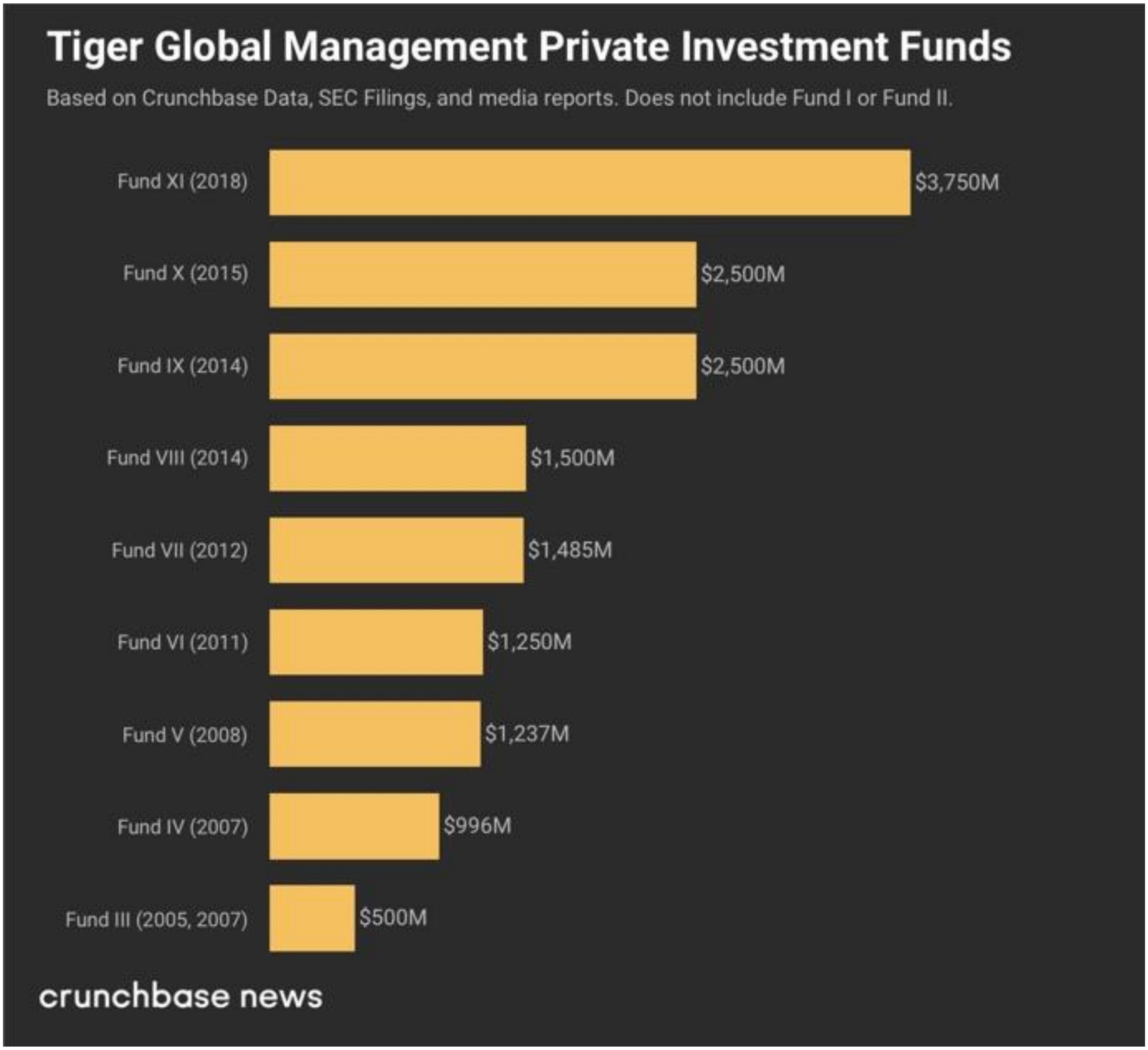
I said we saw this coming for decently good reason as far back as 2016, while at TCW trying to build a liquid alts business we interviewed several risk premia funds that we thought would be interested in doing a deal to get on our nascent platform. Through every interview I was involved with, the managers were all very long on theory, yet very veiled in terms of fact. It got to the point where all I was asking for is the position sheet and the chance to go through what each was supposed to do. It was a fruitless effort, and I finally concluded that these were more smoke and mirrors than something you could put in front of clients.

Diminishing Alpha



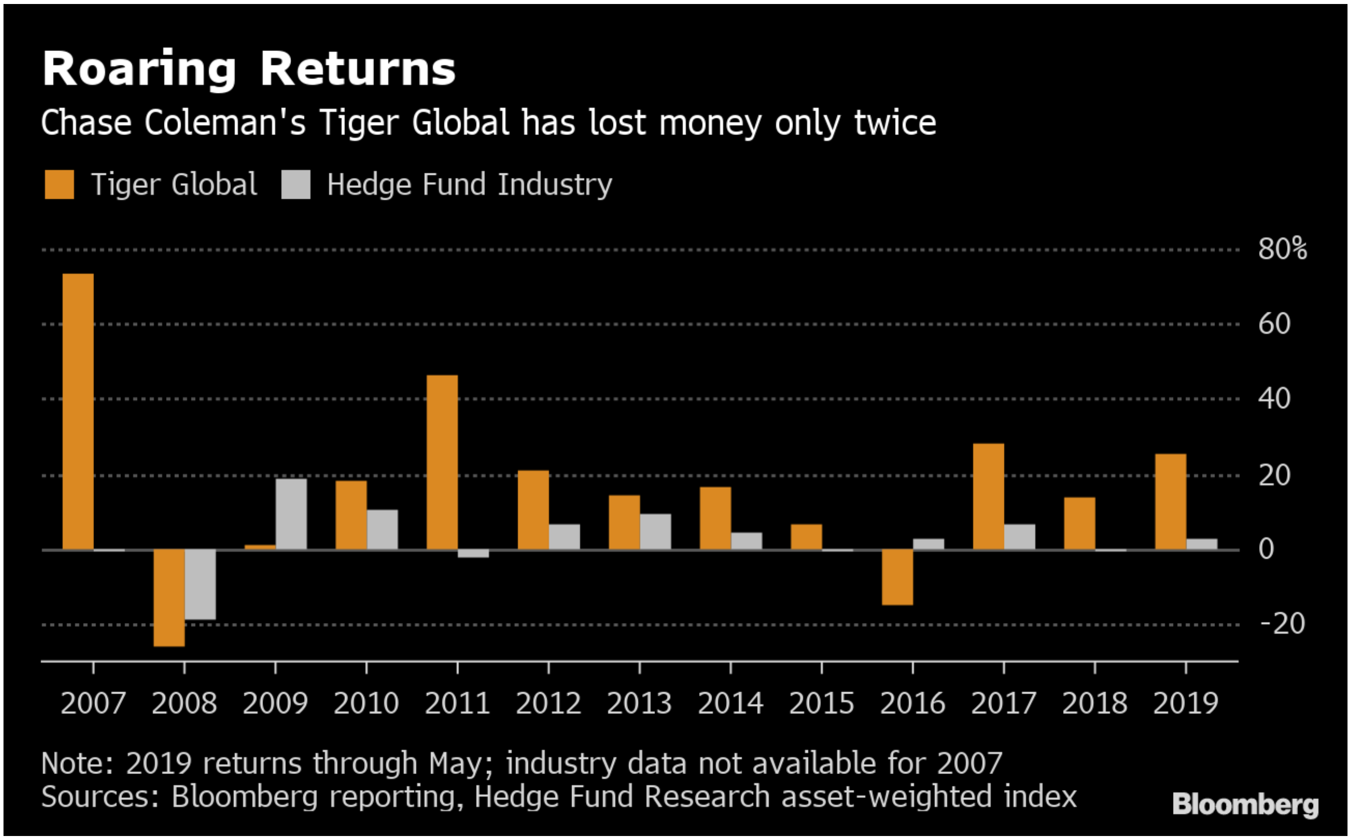
Someone who is not suffering this year, is wunderkind Chase Coleman and his Tiger Global fund. In June, it was reported that he was up a stout 17% and has probably added nicely to that number, as his focus is technology and he is on the cloud computing trade in a big way. The fund also traffics in the latter rounds of the hot venture capital market, and isn't afraid to be the last private round before companies are born into the public markets. Which is great work if you can find it. At last count, he had nine vehicles to take advantage of that trade.

Bonanza of Riches



The even better news for Chase, a guy who is very long success and all the trappings that go with it, is the fact that his hedge funds have put up the numbers to validate fees, and also shine a bright light on an industry that has had trouble doing so in the recent past. Two down years out of the past thirteen isn't too shabby.

Good to be the King



Diversion

As has been the case with many of my colleagues in finance, 2020 has been year of learning to live more remotely. I have been retreating to the wooded confines of the Beartooth Mountains on the Montana/Wyoming border. Up until Monday, it had been a pleasant year weather wise, with a high of 90 just last Thursday. Adding sprinkles to an otherwise freakish year, this also happened…

Powder on Labor Day

Regardless of the early winter cold front, it has been a great year in the Western Rockies. Resort towns like Jackson, Park City, and Sun Valley have been hit hard by waves of tourists, and newly interested home buyers. They have also been inundated with newly minted road warriors, and all the toys they have in tow. With that in mind, we give you the best things we have seen this summer that let you get out there into nature, wild or otherwise.

Grand Canyon of Yellowstone

First up, is this new age, yet old school land schooners, better known as recreational vehicles. This year, more than any other, the roads are jammed up with the biggest Class A hogs you can find. To each his own, but for our money, the new version of the old school trailed kind, is our idea of a good time. Outdoorsy, the platform that puts RV owners together with renters, put out their list of top 10 retro campers. While these run a little small than we are interested in, they do the trick. That said, this 1971 Airstream, renovated by Traverse Design + Build is our idea of a good time when it comes to taking it all with you.

The Classic

In sunny and smoky, Santa Barbara, everyone and their brother/sister/cousin/parents are getting in on the watercraft craze. We are seeing everything from ski and wakeboard boats, stand up paddles galore, and the burgeoning foil board. We know a few people who have gone from round to ripped as they cut through the water. While there are many out there, the MACKite eFoil lineup is pretty robust, as is the $12,000 price tag. That said, if it's good enough for Zuckerberg, it has to be good enough for us.

Zuck Zinked Up

Along the same lines, e-bikes have become quite popular, right along with the traditional kind. While non-scientific, the anecdotal evidence like the one month it takes to get a basic service, says the market is superhot. One of the reasons for the surge in demand, is that a motorized bike can make for a nice replacement on short trips around town that otherwise would have been an Uber ride back in January. Because everything that is in demand these days comes at a price, an e-bike worth investing in starts north of $1,000 and goes up, way up, from there.

The RadRover 5

While we were fading the idea of a surge in do-it-yourself home improvement, we have drastically changed our tune after spending an un-Godly amount of time 'futzing' around our mountain home hammering down every loose board, painting the unpainted, digging holes, and putting in new fences, along with cutting down every branch that showed even the slight hint of dying off. On top of the feeling of accomplishment, there was a Zen peace we found in the otherwise mundane. To further validate how hot the mountain rental market is, one of the properties we properly honed, the Rendezvous Cabin in Red Lodge, Montana just got booked for the next two months to be used by three teenagers in need of proper Wi-Fi for remote school. You can't make this stuff up in 2020.

Pure Americana

If for whatever reason, you are all binged watched out on your other programs, there is the now very popular *Yellowstone* for your consideration. In its third season, the shows plot lines center around the John Dutton's cattle ranch that bears his name, and how he fights developers to hold onto it. While we were dubious at first, Taylor Sheridan's writing and directing comes through as very genuine with the depiction of the 'Rez" being spot on, as well as what fast money coming into places like Bozeman and Flathead Lake have done to the Last Best Place. That said, prepare to surrender disbelief, as nobody cowboys in a Bell 206 helicopter, and the over under on how many people die per episode runs at about four, and the fictional Rip Wheeler is involved in almost every single one.

Darby Meets Dallas

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