OTHER SIDE
ASSET MANAGEMENT

Surface Pressure...

"It's pressure like a drip, drip, drip that'll never stop, whoa
Pressure that'll tip, tip, tip 'til you just go pop" ~ Jessica Darrow (Disney Music, Encanto)

Surface pressure

Earlier this week, a select few visitors at Yellowstone National Park witnessed what's known as a hydrothermal explosion, which occurs when a massive buildup in pressure of nearly boiling water beneath the ground quickly turns into steam due to a rapid drop in pressure. This is often due to a blockage in the underground "plumbing" system that runs beneath the surface of the park.

Nearly 4 million visitors per year visit Yellowstone to see the infamous geyser known as "Old Faithful" which spews scalding hot midst between 90 to 120 feet roughly every 90 minutes or so.

This most recent explosion occurred in the Biscuit Basin, roughly 2 miles northwest of Old Faithful and while there is no set stopwatch to Old Faithful, the eruptions are fairly consistent due to "loops or side-chambers in their underground plumbing" (per recent studies from UC Berkely volcanologists).

However, this most recent activity came with little to no warning at all … which got me thinking?!

In 2021, Disney came out with the children's movie "Encanto" (I know, I didn't see this transition, either … it's just the way my brain works). At the time my girls were 7 and 9, and Disney had yet to go incredibly woke.

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While under lockdowns, we enjoyed the entertainment as a family.

Though, anyone who listens to a current "pop" radio station may recall, the marketing machine that is everything Disney polluted our brains with what became the radio hit, "We don't talk about Bruno" … like myself, you may still be scared from it to this day, though I digress…

While today's opening quote comes from the same production, it's from a much less popular song titled … "Surface Pressure" … *"(it's) pressure that'll tip, tip, tip, 'til you (it) just go pop"!*

For years we've described the plumbing of the financial system, and structural deficiencies due to market structure courtesy of passive investing … though, given our current economic environment, and the new data points that come with them each passing day, this analogy couldn't be more fitting.

Be it sticky inflationary pressures, crippling interest rates on too much debt/leverage or the pervasive and extremely troubling deterioration in employment … the list of *"drip, drip, drips"* that seem to never stop continue to be coupled with the *"tip, tip, tips"* that will very likely eventually make things pop!

As we've noted in the recent past, there is a collection of data that has begun to improve, both in the US as well as globally … but one theme has remained constant for some time … certain realities are not as they appear to be on the surface and the pressure continues to build.

No one knows when these hydrothermal explosions occur, yet Yellowstone is known for its geothermal activity and hot springs … something like this is not an "IF", but a "WHEN" … the same holds true with markets; the challenge, which should be risk managed accordingly, is when does a dip become a crash?!
At risk of sounding redundant, we're going to (re)highlight some areas we believe blockages to be, based upon the data, that's allowing pressure to build … that that being said we're going to start with:

Jobs

Earlier this month, BLS jobs data for June came in at +206k … stronger than Wall Street's anticipated 190k. Imagine that?! a jobs number that "beat" Wall Street expectations, I'm shocked I tell you … SHOCKED!

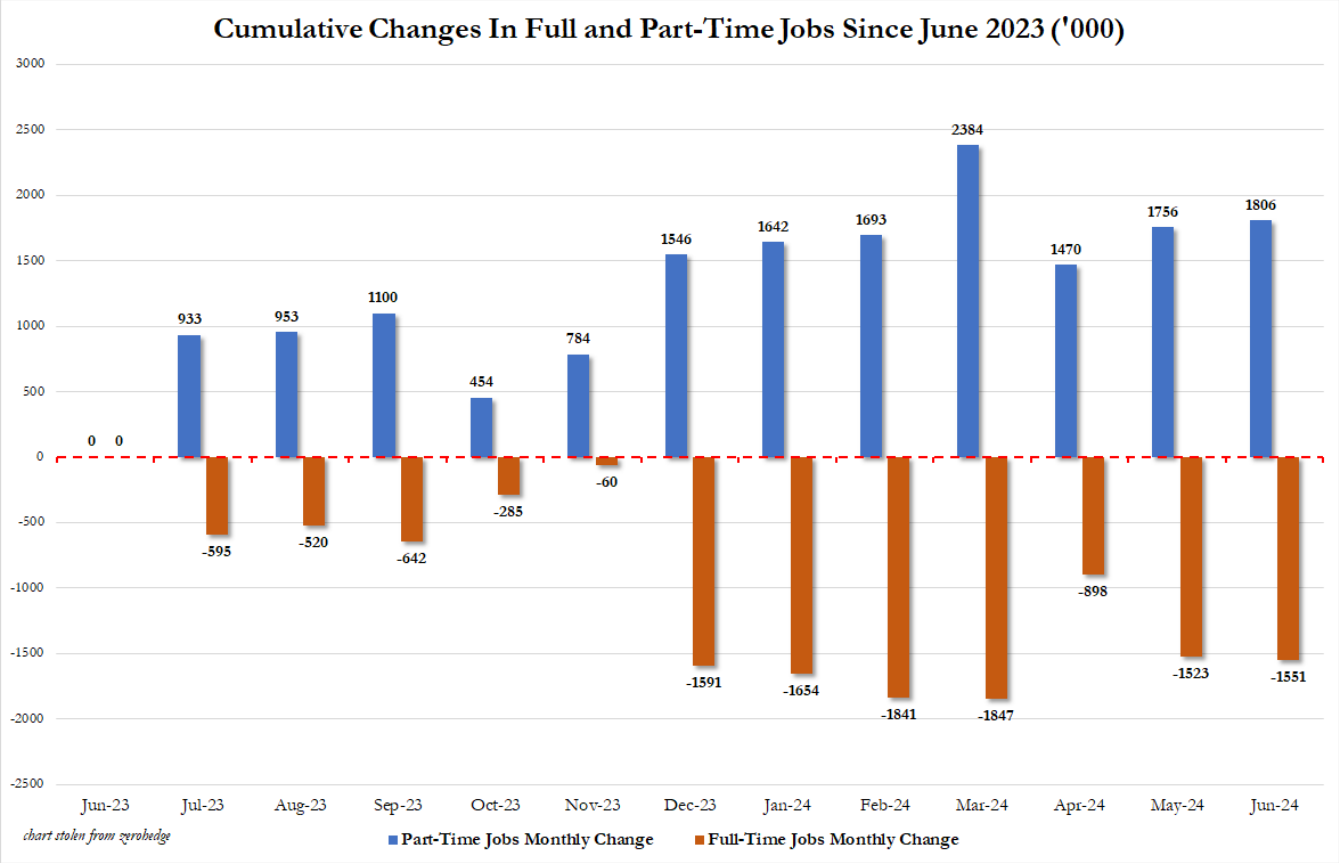
On the SURFACE, headline data once again appeared to be ok … so what could possibly be wrong with another "beat"?!

In what appears to be a monthly replay of the movie, Groundhog Day … headline data has been negatively revised lower 10 out of the last 15 months, most recently with BOTH APRIL AND MAY jobs data negatively revised by -57k and -54k jobs, respectively … with April now being reported as +108k vs. the originally released +165k, and May now at +218k vs. +272k.

Negative revisions of -34% and -20%, respectively are NOT minor revisions, it equates to a collective loss of nearly -111k jobs over a two-month time frame … this, combined with weekly Jobless Claims reporting their highest levels since August of 2023, accelerating from +223k to +243k WoW, drove the unemployment rate to its highest reading since November of 2021 … to +4.1%.

The constant (uncomfortably lower) revisions has been a pervasive and disturbing problem that joins the disaster that is the ever-growing chasm between full-time and part-time jobs … with full-time positions falling by another -28k jobs while part-time employment increased … AGAIN … by +50k jobs.

In a vacuum, this may not appear to be all that big of a deal, but when you consider this dynamic in aggregate over the last year the US has LOST -1.6 million full-time jobs vs. a gain of +1.8 million part-time positions, which can be visualized courtesy of a recent @zerohedge chart below.

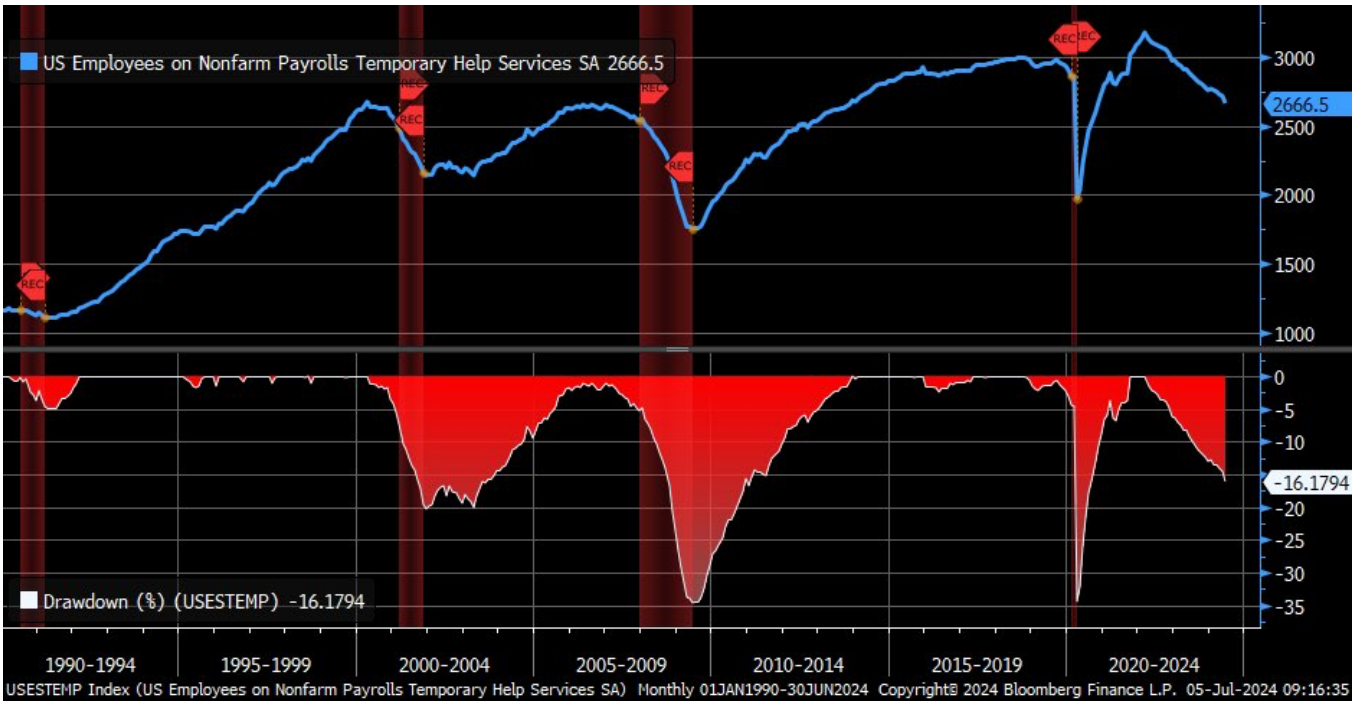


This is not indicative of a strong economy … it will not drive GDP growth over any period of time!

At the same time, as we've also been noting for some time, government employment continues to bail out the data as private hiring came in at +136k vs. expectations of +160k; down from an already negatively revised +193k from +229k, with government jobs payrolls, magically increasing again from +25k to +70k with virtually all current job openings reported a few day prior being government related positions.

74% of the jobs in the most recent report came from a combination of government, education and healthcare, which are all, in one way or another, being funded with copious amounts of deficit spending at excessively high interest rates.

If this doesn't speak to the pressure building under the surface and the strength/weakness of the US consumer, one of the best leading job market indicators is "temp jobs", which were down again … by -48k in this most recent report, now having lost 515k since March of 2022; which as Chief Investment Strategist for Charles Schwab, @LizAnnSonders recently noted, *the current decline is consistent with prior recessions*…



Adding insult to injury … of the 2.6 million payrolls "added" in the last 12 months… just about half of them have come at the hands of the BLS's perpetually poor and arbitrary Birth/Death adjustment metric (which we discussed here, at length, in August 2023).

The theme of negative revisions discussed above doesn't just apply to jobs, but also to available openings… as 14 of the past 17 months have seen job openings negatively revised as well.

Ah, and we almost forgot, hourly earnings also declined from 4.1% YoY to 3.9% YoY and to 0.3% MoM from 0.4% MoM.

The job market is about as dry as the Sahara while the cumulative effects of inflation remain elevated, and in turn … interest rates are stuck at prohibitively high levels.

So, let's dive into inflation and then discuss the knock-on effects and they continue to feed the pressure building underneath the surface…

Inflation

Earlier this month, we saw an acceleration in U.S. Producer Price Index (PPI) data, with June Headline data coming in at its highest level in more than a year at +2.6% YoY and +0.2% MoM. The previous month's data (May) was also revised higher from -0.2% MoM to flat. Again, this is what producers are paying for goods, which flows through into what consumers will eventually buy; which in turn is passed along to the consumer.

Core PPI, less food, energy and trade, slowed to +3.1% YoY, but was still one of the highest readings over the last year

This acceleration may come across as slightly contradictory or conflicting to the most recent headline CPI data which preceded it, with Headline CPI for the month of June decelerating slightly to +3.0% YoY, vs the previous report of +3.3% YoY; down -0.1% MoM … as Hedgeye Director of research Daryl Jones noted, *"this was the lowest MoM increase since May of 2000."*

On the surface, the report looked "dovish", though similarly to what we described above, things under the hood remain a sticky high.

For example, while Core CPI also decelerated slightly to +3.3% YoY, vs the previous report of +3.4% YoY, +3.3% remains well above the Fed's inflation target as is the Fed's ever so coveted Core Services Ex-Shelter which remains intolerably high at +4.9%.

We've been discussing the importance of base effects and their easing ***into the back half of the year***, thus a persistently higher inflation for longer … with the help of Hedgeye's Josh Steiner, we've also highlighted the August, September time frame to be the exception to this trend with base effects flat to mildly accelerating, paving the way for a mild easing of the data, which is what we've seen here in this most recent headline number (yet still a persistently sticky data point).

Wall Street continues to beg for rate cuts, and given the current set up, and given the likelihood that we see another deceleration in the August, and quite possibly September data, Wall Street is most likely going to get it?!

Though, don't be surprised when you have to jump back on that seesaw?!

In our December 2023 Monthly, we titled an important section, "D.I.S.C.O.N.N.E.C.T" where we detailed the absurdity of what Wall Street was begging for in relation to rate cuts vs. the reality of both Fed direction and the data … we followed up on that section the very next month in our 4Q2023 Quarterly titled, "They LIE", we wrote:

Before moving on, I want to circle back on the theme from last month's section titled D.I.S.C.O.N.N.E.C.T where we discussed Wall Street begging for rate cuts vs. the reality of what the Fed actually said; we wrote:

> *I want to repeat that for you again … the Fed is seeing the "possibility" of 3 rate cuts in the back half of the year (assuming inflation reaches their 2% target), yet markets are telling the Fed that they're cutting rates 7 to 9 times (between 175 and 225 basis-points) with the first cut coming as early as MARCH!*

As we closed out December, Wall Street had placed a 97% probability on the Federal Reserve cutting rates as early as March … which has precipitously collapsed to roughly 44% at last glance.

It's nearly August and we've yet to have a rate cut, which shows you how incredibly wrong Wall Street can be, while at the same time, how they also bully the "expectations" markets … had you placed your trust in what Wall Street continues to shill, things wouldn't have panned out well for you.

It is our belief that we're seeing a *'similar'* set up.

A quick reminder, but a 3.00% CPI remains 50% away from the Fed's 2% target while a 4.9% Core Service Ex-shelter continues to cause pain on a vast majority of Americans, given the commutive increase of more than 20+% over the last 3 years, though I digress…

Should we get the anticipated weakness in the August (and quite possibly the September) CPI data, the Fed may be able to get one, quite possibly even two rate cuts in before inflation reaccelerates; in both September and November?! However, this will more than likely come just before the CPI data reaccelerates, say it with me folks, "into the back half of the year," with the help of both the base effects as well as the lead/lag set-ups (as we've been discussing for months).

We wrote the below in LATE JANUARY:

> *This data (Oil) will flow through into the CPI data much* ***more quickly than the 100% MoM increase in shipping rates (which typically lags a good 8 months)****, but it's just one more pressure to consider for the U.S. Consumer who's struggling.*

That ("good 8 month") lag timeframe lines up with a reaccelerating Headline CPI. You'd love to think the Fed is considering both, the lead/lags in how the inflation data is calculated as well as uninterrupted pressure that continues to suck the life out of the bottom half of the 'K', in this current 'K' shaped recovery, but history suggests, neither the Fed, nor majority of Wall Street tries or cares to understand what we just wrote?!

Should inflation reaccelerate while the Fed is cutting rates, we believe a few things are more likely to happen than not. 1. Inflation reaccelerates at a faster pace into the Fed cuts, leading us to 2. rate cuts are likely to be few (and short lived) as the consumers ability to spend tightens even further … leading to more full-time layoffs.

We would also place a solid probability that we see some form of a hydrothermal explosion as the surface pressure explodes in the employment data. The *"tip, tip, tipping"* in government jobs, part-time positions and birth/death adjustments will eventually, *"just go pop"*.

Which brings us back to the similarities in the current set up to what we saw late in December into January of this year. While constantly moving, Wall Street has placed an 80-ish% probability on a rate cut from the Federal Reserve in September. Many in the financial world, including Wharton school of businesses professor

emeritus, Jeremy Siegal who dubbed July's CPI print as a … wait for it folks … a *"game changer"* (palm meet forehead).

Look, I don't make this stuff up, we just laid out the CPI, in RoC terms as they are reported above. To reiterate, Core CPI Ex-shelter remains at 4.9% while a 3.0% YoY headline number is still 50% higher than the Fed's 2.0% target rate … nothing about a 30-basis point move equates to "*a game changer*" or "*great news*"?!

But what's Siegal's true concern?! Just read the headline: *"**Stocks will struggle** and a recession is on the table if the Fed fails to cut rates by September, Wharton professor Jeremy Siegal says?"*

He's saying the quiet part out loud, shilling for all his elitest friends: who cares about nearly 42% of the country that doesn't own stocks?! Oh, and by the way … roughly 93% of ALL stock market wealth is held by the wealthiest 10% of the population.

Net net, Mr. Powell: Bail my buddies and I out, screw everyone else. I'm sure that's not what he meant, though (sarcasm)?! He probably really cares a great deal about all the little people losing their jobs as his CEO buddies continue to 'cut the fat' and lay people off … though, again … I digress.

Circling back … today's current set up is very reminiscent of late December 2023/early January 2024, where the Fed is currently guiding to a possible one or two cuts, while Wall Street (yet again) is pushing expectations for the Fed to cut between 5, even 6 times, starting this September and each subsequent meeting thereafter … which the DATA DOES NOT SUPPORT (if the Fed truly based their decisions off what they say they do).

Heads or tails?!

Look, I get it … Siegal's reasoning falls back to the deterioration in labor data as well as a contracting GDP. His fear is a stock market collapse, given a recession (gasp).

This is the game Federal Reserve officials and PhD economists entered into when they started to believe that they could 'centrally plan' their way out of anything and everything economics related … the reality is they can't and never have done so successfully … eventually the chickens come home to roost!

In the past, we've talked about the Fed being painted into a corner. Inflation has outpaced wage growth; layoffs continue to accelerate while the government is trying to hide this by 'printing' jobs.

The fed is trying to play two sides of a coin that can't be centrally planned as a collective. 'Heads' you have the data under the hood of the jobs markets deteriorating significantly … saying it's 'bad' would arguably be an understatement … at the same time, 'Tails' you have headline inflation data dangling a carrot in front of the Fed's nose, just before the carrot is pulled away from both their and the beggars of Wall Street's noses; which is also 'bad'.

No one wants to be the responsible party for what's most likely necessary, which is a significant credit default cycle, which should clear away the dead wood, which would then allow new companies to grow and innovate; it would foster new leaders to emerge.

Why do they fight so hard against this?! because the amount of debt to be cleared is enormous. Be it a collective of household balance sheets, corporate, government, private equity, CRE … systemic risk is very real.

High interest rates are crushing government's individuals and corporations, but the governments with shortfalls are jacking up taxes, and corporations are hiking prices, while the lower slant of the 'K', as a collective not making any more money or is losing their jobs as well as their benefits, while being expected to pay more for everything; Food prices – Property taxes – Health insurance – Homeowners insurance!

THE PRESSURE IS BUILDING AND IT'S UNSUSTAINABLE FOR THE MAJORITY OF AMERICANS & BUSINESSES!

Does it surprise you that U.S corporate bankruptcies have hit their highest mid-year level since 2010?!

Per the American Bankruptcy Institute: June 2024 YoY highlights: ALL CHAPTER bankruptcy filings are UP 7% YoY from 40,267 vs. 37,790 from June of 2023. Commercial chapter 11 filings are up and eye popping 70% to 987 YoY vs. the 582 filings recorded in June 2023.

We often speak to the NFIB data as it represents those small and medium sized businesses that we refer to as the 'Heartbeat of America' … and sadly, Subchapter V (of Chapter 11) small business elections INCREASED 78% to 309 YoY in June of 2024 vs. 174 in June of 2023.

Finally, individual filings are up 5% to 37,514 YoY vs. 35,636 in June 2023 … which brings us to:

Flow through

Higher input costs leads to more expensive products, while full-time job losses lead to lower paying part-time positions or no income at all. Higher revolving credit expenses equals less disposable cash; less to spend turns into shrinking corporate profits, which in turn, equals more layoffs.

While less disposable cash for individuals to buy things is concerning, we're seeing an increasingly ugly trend with something even more serious … as *"evictions filings over the past year in a half-dozen cities and surrounding metropolitan areas are up 35% or more compared with re-202 norms,"* as reported by the WSJ … **last month alone, Las Vegas, Houston and Phoenix landlords filed more than 8,000 eviction notices; that's more than at the PEAK of the 2008 crisis**!

And while some may point out that this doesn't appear to be the norm across all major cities, we'd counter (as we often do) … with the devil is in the details and lying with statistics is fairly easy to call out … like when certain cities make it nearly impossible to evict people!

For example, evictions may not be skyrocketing in Seattle, but overdue rent is, so says a recent report from the Seattle Housing Authority that states low-income tenants with overdue rent is up 322% since before the pandemic … while the Seattle low-income housing institute estimates it's up closer to 559%. Uh, Houston, we have a BIG problem!

It's estimated that nearly half of renters are already what's considered 'cost burdened'; meaning they spend more than 30% of their income on housing/rent and utilities where 1/3rd spend more than 50%.

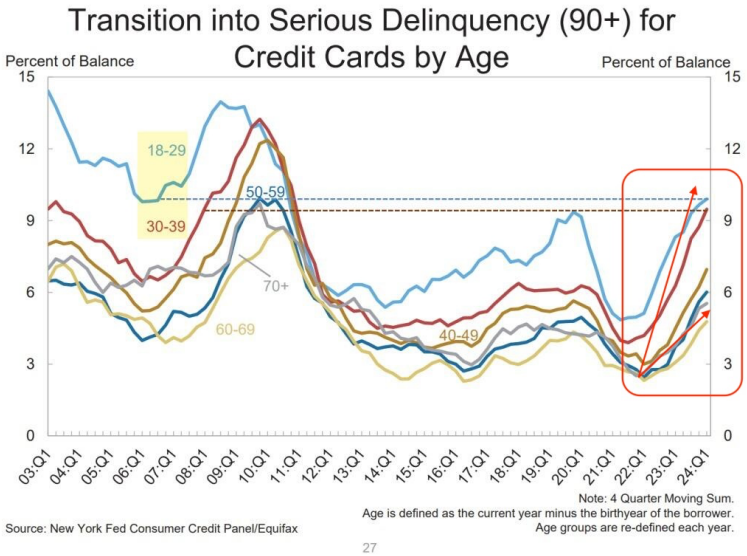
The bottom line is we're seeing an extremely large sub-set of Americans that aren't able to pay their rent; which in turn means, an expanding pool landlords who can't evict them and won't be able to pay their bills, employees, lenders, etc … someone will eventually take/absorb those losses.

More signs

As it often goes with cycles, some move at a faster pace than others… In our current cycle, we mentioned auto loans as early as 3Q2022 and credit cards at an even earlier point in time when discussing what the collateral damage would be given the higher cost of capital:

> *Today, with every tick up in rates it equates to a higher cost of capital (borrowing cost) up and down the entire borrowing vertical in an obscenely over leveraged WOLRD.*
>
> *Everything from an individual's credit cards, auto loan and mortgage to the capital/debt structures of corporations and sovereign countries*

We then highlighted the deterioration in credit regularly throughout most 2023 notes. Today, we'll briefly touch on credit card delinquencies for, as the saying goes, *a picture is worth a 1,000 words*; and as you can see from the graphic below shared by @LanceRoberts, chief strategist at RIAAdvisors.com, delinquencies amongst ALL age groups are trending much HIGHER! I'm sure it's probably nothing though (insert sarcasm) …



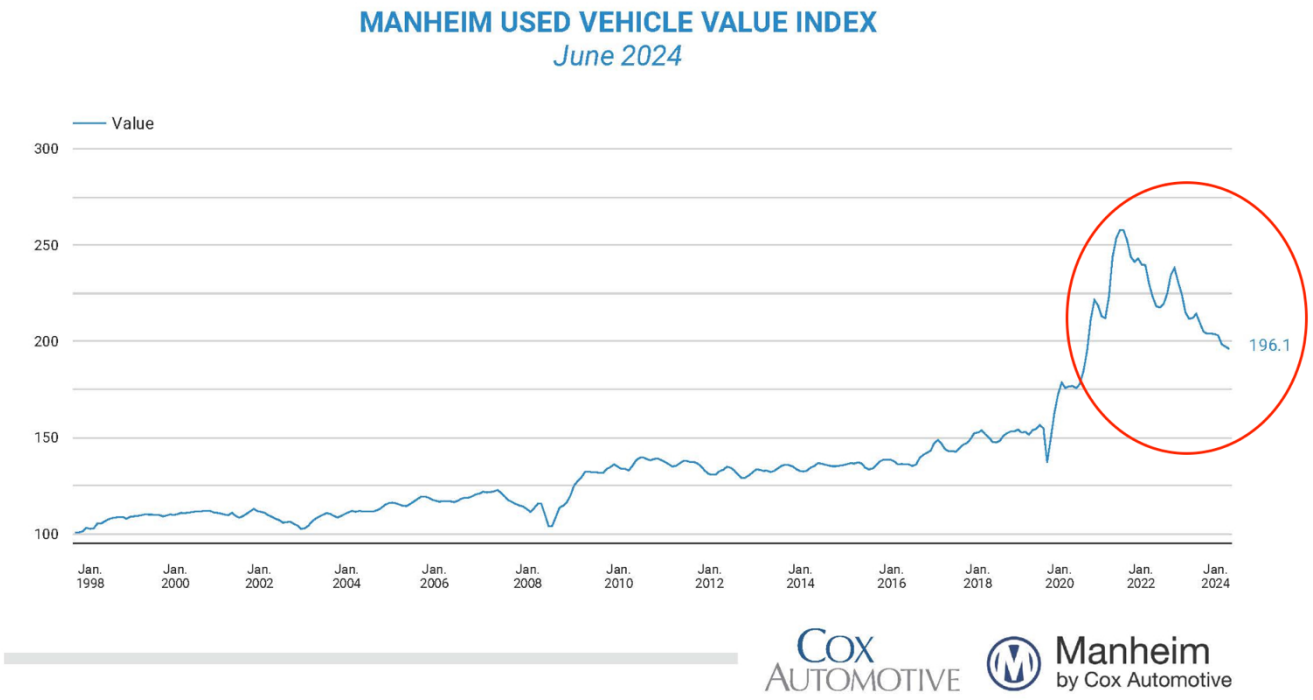
If that weren't bad enough, in 2Q2023, we highlighted that things were getting so bad in the auto lending space that the, *"Auto loan rejection rate skyrocketing relative to loans being applied for."*

Regular readers may recall that when we describe cycles, in the words of Hedgeye CEO Keith McCollough, they need *"time and space"* … so now that more time and space has elapsed since 2Q23, what do you think is happening with auto loan delinquencies that have gone unpaid for too long?!

If you guessed repossessions, you were right. According to a recent July 2024 Cox Automotive report, repossessions are up 23% compared to last year, and 14% higher than the 2019 pre-pandemic levels. It's almost as if it were predictable … and preventable?!

Making matters worse, many of these cars were bought at a time auto prices were screaming higher, as of late, U.S. wholesale prices for used vehicles have declined for 22 consecutive months.

Per the report, the Manheim Used Vehicle Value Index (MUVVI) fell to 196.1, a decline of 8.9% YoY, falling 0.6% MoM.



The majority of these loans were made with the collateral backing them, on average, 17.5% higher; with (EVs or Electric Vehicles) getting hit the hardest, some of which have fallen upwards of 40% … which means the recovery rates/losses to those who made or own the loans will be higher given a current loan to value ratio that's very upside down.

Again … Higher input costs for producers (PPI) combined with higher borrowing costs across everything interest rate sensitive, equals higher payments in just about everything! Add in significant losses in full-time

employment and the lower slant of the 'K' is getting demolished to a point where they can no longer pay for their rent, vehicles or food… which brings us back to a question we asked a short while ago?!

"Does it surprise you that U.S corporate bankruptcies have hit their highest mid-year level since 2010?!"

The answer should be a resounding NO! If you're not making your rent or car payment, you're likely not going out to eat as much?! In the past few months, among numerous other businesses which have filed for bankruptcy protection, some very large, recognizable names have recently filed for Chapter 11, like Red Lobster, Tijuana Flats and EV auto manufacturer, Fisker. Please click here for a fairly good (but not perfect) collection of recent filings.

This brings us to the area where we believe the surface area is weakening/cracking the most, leaving it extremely vulnerable to the pressure it's being exposed to … and that's:

CRE plus…

Elevated interest rates have decimated the Commercial Real Estate or CRE market, which continues to deteriorate at an alarming pace. The opaqueness of this market is very dangerous. On the surface, buildings don't have to be sold until the liquidity is needed which then, FORCES them to be sold.

But as we learned well over a year ago, private funds like BREIT and SREIT, as we've described since our 4Q22 note, can outright gate redemptions for as long as they want. Additionally with lenders being unequipped to handle these massive buildings given they don't have the infrastructure to become landlords, they will often bend over backwards to re-work terms on a loan that's in default or headed that way.

And still … we're witnessing more buildings being foreclosed on, sold at massive losses or with borrowers literally just handing back the keys at a precipitous pace. A recent example of this would be MetLife foreclosing on the Starwood/Artisan's building located at 1960 East Grand Avenue in El Segundo. MetLife's foreclosure deal amounted to a 45% discount vs. it's 2020 sale price. -45%!

To our point above regarding lenders attempting to work things out, as Real Deal Real Estate News reports:

> *Many office owners have chosen to hand back the keys on properties … Few buildings across Los Angeles County have actually gone through a non-judicial foreclosure — other landlords and lenders have agreed to deeds-in-lieu of foreclosure or receiverships.*

These are NOT small deals; a recent appraisal just exposed a more than 1-billion-dollar loss in value in the largest and 4th largest hotels in San Francisco since 2016, that's more than 65% of their value … as reported by ALM/Globest:

> *The value of the Hilton Union Square and Parc 55 hotel complex was assessed at $1.56B when the mortgage originated in 2016. An appraisal last month by Kroll Bond Rating Agency pared that down to $553.8M, a drop of 65%.*

And as I'm in final edits, my close friend who likes to remain anonymous, brought my attention to a very recent deal which had 100 Wall Street being sold for $116-million dollars, which is 57% LOWER than where MassMutual's investment arm, Barings purchased it for in 2015. At the time, also as reported by The Real Deal real estate news, $528 per square foot was a record for an office building in the Financial District east of Broadway.

Elevated interest rates are crippling landlords, buildings are turning up empty all over the country and lenders are trying anything they can to hide reality in an already obfuscated market.

In the residential markets as well as multi-family, realtors are saying that they are being "besieged" with BPO requests … A BPO or (Broker Price Opinion) is a request sent by a mortgage company to realtors local to an area where a property owner is more than 3 months behind on their payment obligations.

This process provides an independent outside opinion from a collective group in an effort to see what condition the delinquent residence is in. Is it occupied?! is there damage?! What would be the 'ballpark' price the broker would put on the property using exterior visuals alone, in order for the mortgage servicing company to estimate what type of risk mitigation may need to take place given the current value of the underlying collateral on their outstanding loan.

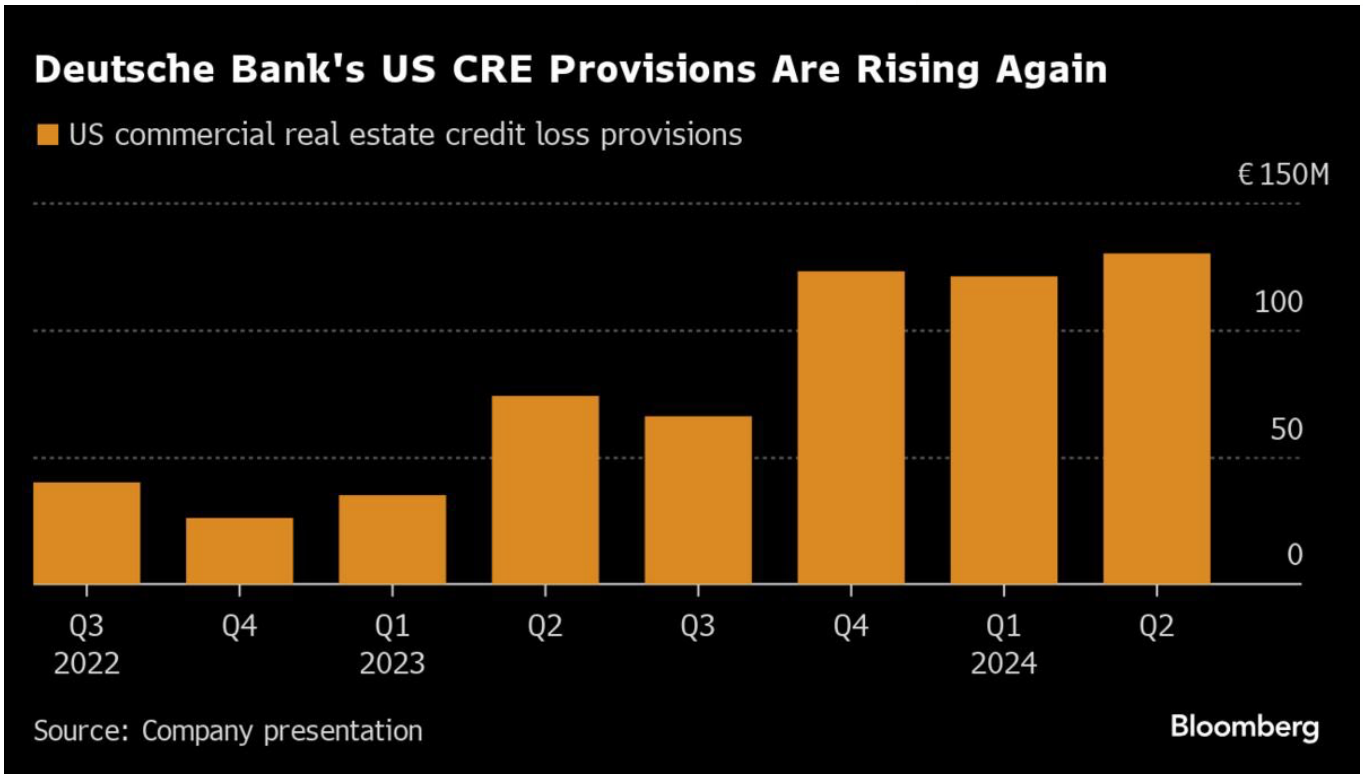
Massive multi-billion dollar losses on commercial properties plus residential markets being "besieged" with BPO requests isn't a sign of a strong economy … nor is what's brewing beneath the surface pertaining to mortgage foreclosures … it's a BIG FLASHING RED telling everyone that many, especially those at the bottom slant of the 'K' are deteriorating at a faster pace than the obfuscated data suggests!

At the same time, no one really knows who's taking these multi-billion-dollar losses either. Over the last decade, private equity (who may be the face of the investment) has siphoned ungodly sums of money from private asset managers, family offices, state pension plans, even retail brokers as many investors found out the hard way when #BREIT and #SREIT gated investors from redemptions over a year ago, and still are (thank you David Auerbach for the heads up! @DailyREITBeat

What happens if/when state pensions report catastrophic losses as they handed money to private equity that invested in these commercial properties that could implode?! Any chance Americans on fixed pensions may be included in the bottom slant of the 'K'?!

As QI research CEO Danielle DiMartino-Booth recently noted:

> *"More than $94 billion of U.S. CRE is currently distressed, according to MSCI Real Assets, with another $201 billion at risk of slipping into that category."*



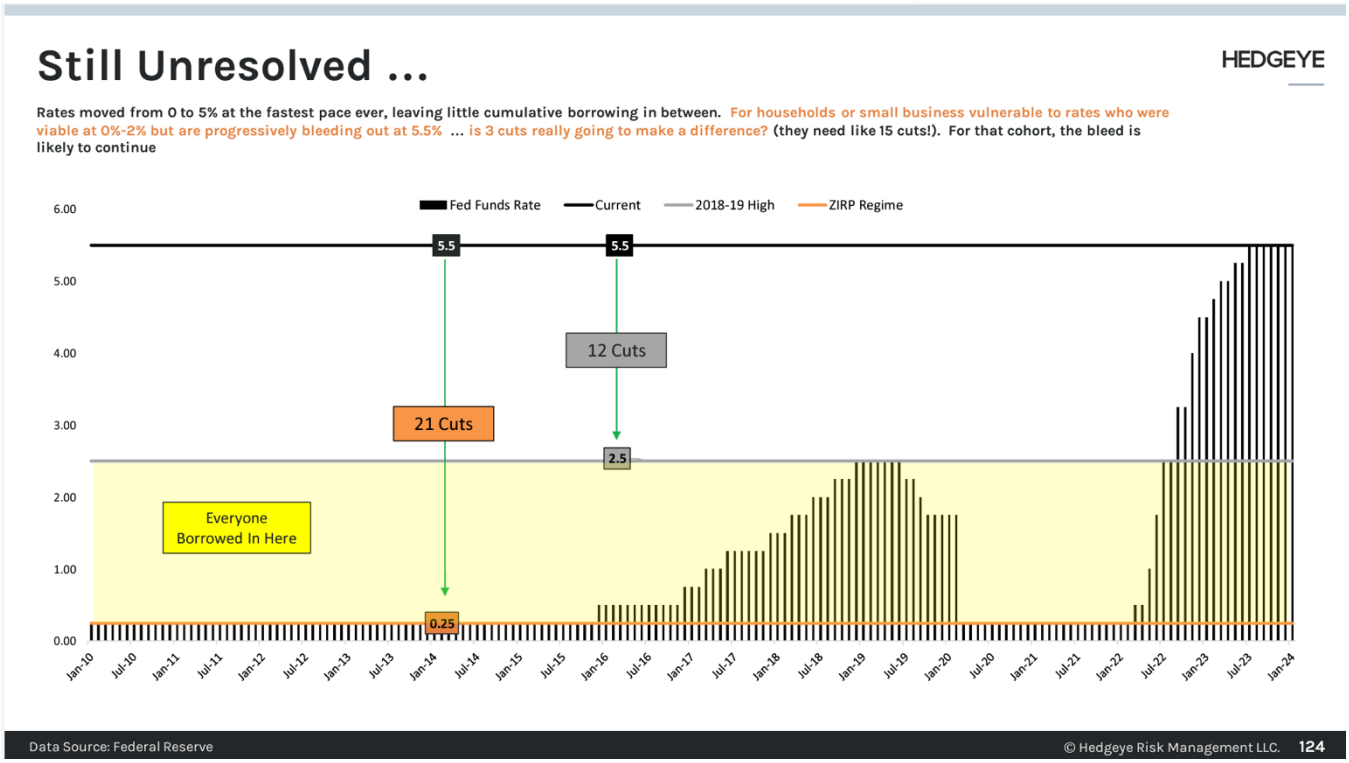
My thought, given the nearly 29 years I've been in this business is that any estimate made by any mainstream service like MSCI is likely to be extremely LOW in terms of what any true loss might actually be if/when the geyser blows.

Final thoughts

As described in this piece, given the current set up, we don't know how many rate cuts the Fed will be able to implement before inflation reaccelerates into the back half of the year?! Our best guess is one to two at most, though whatever it may be, it remains a drop in the bucket relative to what those in serious pain actually need given the mountains of debt so many people buried themselves under, given the Fed's irresponsible decade plus long ZIRP world … As we reminded readers last month:

> *"With this in mind, the first time the EFFR eclipsed the 2.4% level since March of 2008 (not shown) was September of 2022 … that's roughly 14 years of borrowing with the EFFR below 2.4% and near zero for nearly a decade."*

With the help of a visual from @Hedgeye:



So, again, everyone with a pulse, who had the ability to mortgage, refi and take out fixed loans, did so and is rate locked MUCH lower and those who couldn't refi, still can't and are buried in debt at levels MUCH HIGHER than anything two 25 basis-point rate cuts over a two month time span would help with … DROP MEET BUCKET!

In a recent paper, Nouriel Roubini and Steve Miran argue the U.S. Treasury, *"is actively "manipulating" the ratio of short vs long term debt issued to reduce long rates and ease financial conditions, a backdoor form of QE that runs counter to the Fed attempt to cool down the economy"*

Basically, that Secretary Yellen is doing everything she can to artificially prop 'stocks' up, while offsetting the Fed's tight credit stance! Yellen came out and publicly disagreed of course, recently stating, *"**Issuance isn't intended to** ease financial conditions"*.

Full disclosure: I don't like Roubini, I think he's a pompous ass, in the same breath, regular readers know I think Janel Yellen is a danger to our country and has been a clueless, lying shill willing to do or say anything for advancement within her party since she came on my radar during the GFC.

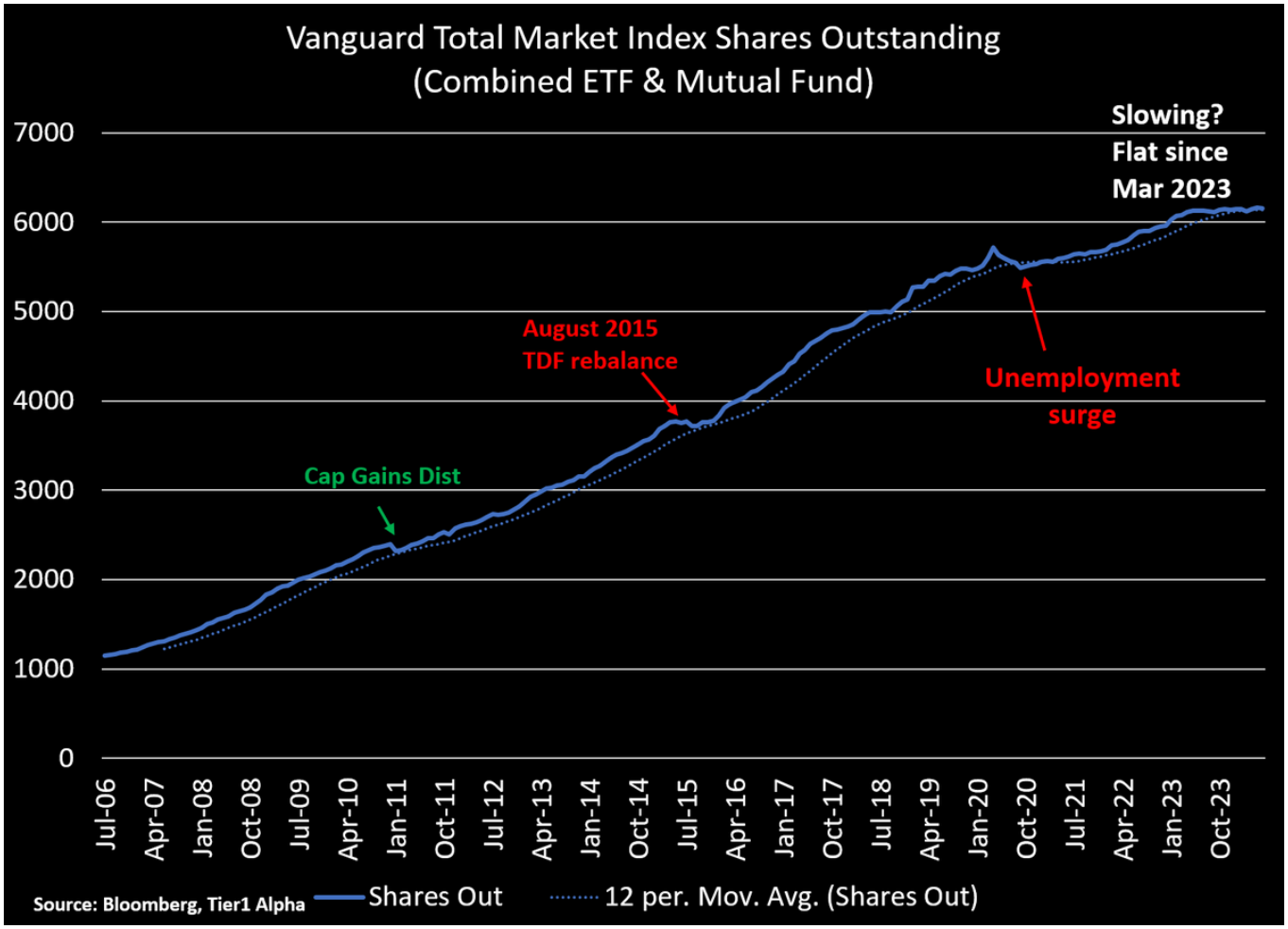
With a healthy dislike of them both, Roubini is without question more intelligent IMHO and Yellen is a liar. Note Yellen's words … Issuance isn't intended to ease … she didn't say it's NOT easing … she's lying.

That being said, it's important to remember, markets are not the economy, and we believe equity markets are being propped up largely by the hand of the passive bid we frequently speak of; this is perpetuated by monthly 401k contributions that buy the 'the market' without restriction or reservation. However, we're in the midst of

an unprecedented time frame here as well, for contributions have not grown while labor markets continue to weaken.

Per Mike Green, Chief Investment Strategist, Simplify Asset management, whose work on the subject is unparalleled:

"Net inflows into Vanguard total market complex (VTI/VTSMX/share classes) have been ~ZERO for almost 15 months… unprecedented. Some has been a rotation, tech, etc…. but still a notable change."



So, to overly simplify things … outside of what Yellen is doing to manipulate/mask things, roughly the same about of money has been rotating around the system, shifting back and forth between different asset classes and factor exposures based on the RoC accelerations and decelerations in economic data. Given the inelasticity of markets, those rotations bring underperformance and outperformance in different names, sectors and factor exposures, which is what our evolved primary model has been picking up.

At this point in time, the weakness in inflation comes at a time when the economy from a growth perspective is also slowing, which often ends poorly for equities. That being said, we just don't know what will happen … now one really knows for sure.

If you've gotten this far, we're going to refer back one last time to our very first sentence:

"It's pressure like a drip, drip, drip that'll never stop, whoa … Pressure that'll tip, tip, tip 'til you just go pop"

Now we're going to add the very next line of the song, which goes as follows:

"A flaw or a crack, the straw in the stack that breaks the camel's back, ***what breaks the camel's back?"***

Which is literally the multi-trillion-dollar question?!

We don't know if it will be the nontransparent CRE market, or CCC credits whose yields are screaming higher?! We don't know if it will be multi-family housing or a combination of a Rate of Change slowdown in both growth and inflation, which leads to a RoC slowdown in earnings pushing layoffs to a breaking point?! OR if it's a combination of things that just drip, drip, drips and tip, tip, tips till it just goes pop that breaks the camel's back?!

After having been in this business for nearly 29 years, given the data, what we do know is that the pressure continues to build under the surface with each passing day, and central planners have NEVER executed on a soft landing.

Similarly with Yellowstone's geothermal activity, no one knows exactly when the markets hypothermal explosion will take place?! Anyone who tells you they know for sure is lying to you, but at the same time, we don't need to!

We do what markets are doing, our current models are strictly rules based. We know exactly where we're risk managing positions; be it trimming them to half positions or cutting them all together before they become problematic; while also getting us back to full positions, and telling us when we're adding new names and why!

While we do run the risk of gap downs, our risk is measured … and what our investors in the most recent iteration of our models have seen (at least those who pay attention close attention to our activity), is that more often than not, our drawdowns have been smaller than broader indices while upside, has been better than those indices on a risk adjusted basis. As we've said in the past, evolve or die … we've chosen life!

This is where we have to add our disclaimer: past performance is not any guarantee of future results, and again, everyone invested is exposed to some form of gap risk of, but what we have found that the internals of markets most often (but not always) provide a short window of execution allowing investors to risk manage accordingly based upon flows, the options markets, shorter dated vix curve, among other things.

While we could pull any up day this most recent week as an example of outperformance, I'm going to choose the worst day markets have seen in a few years … That being July 24th:

On total assets managed, we were down -1.16% vs. -1.25%, -3.64%, -2.31% and -2.14% for the DJIA, Nasdaq, S&P and Russell, respectively.

7/24/24	End of Day	Beginning of Day		
Account Value	$996,271.39	$1,007,931.88	1.16%	Loss on Total Account Value
Invested $$	$715,748.35	$727,408.84	1.60%	Loss on Invested Dollars
Cash	$280,523.04			
Daily Loss	$11,660.49			
DJIA			-1.25%	
Nasdaq			-3.64%	
S&P			-2.31%	
RUT			-2.14%	

Account Value	Cash & Cash Investments	Short Balance	Market Value	Value Day Change
$996,271.39	$280,523.04	$0.00	$715,748.35	-$11,660.49 (-1.60%) ↓

The short-term window giving us opportunity to risk manage I was referring to above were a handful of days where we were actually selling and trimming positions, especially our tech holdings, due to the weakening momentum and internals within the space and names we owned at the time. We entered the 24th with roughly 28% cash, that cash was protected from the larger broad market selloff while the other names we owned still outperformed all but the DJIA.

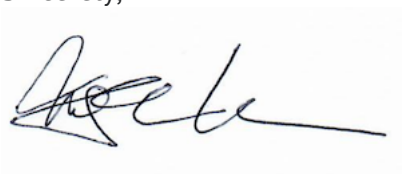
The models we're utilizing also gave us comfort to hide out in utilities … which has proven wise (See example below in appendix).

We reiterate, we don't know when things will pop, but the pressure is clearly building and we are surely going to risk manage in an effort to protect our clients' accounts, and in turn, putting us in an extremely strong position to compound money over the course of time.

When coupling our risk management process with our building of retirement/income/legacy plans, we believe we have the ability to help investors navigate away from those areas where the pressure has the greatest likelihood to break through the cracks forming on the surface!

As always, never hesitate to call with any questions or concerns!

Good investing!
Sincerely,



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Appendix:

7/30/24	End of Day	Beginning of Day			
Account Value	$1,019,219.00	$1,010,144.72	0.90%	Gain on Total Account Value	
Invested $$	$857,814.37	$848,740.06	1.07%	Gain on Invested Dollars	
Cash	$161,404.63				
Daily Gain/Loss	$9,074.31				
DJIA			0.50%		
Nasdaq			-1.28%		
S&P			-0.50%		
RUT			0.35%		

Updated 6:40PM ET, 07/30/2024 Actions

Group by security type

Totals	Account Value	Cash & Cash Investments	Short Balance	Market Value	Value Day Change
	$1,019,219.00	$161,404.63	$0.00	$857,814.37	$9,074.31 (1.07%)

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