



Passing the torch!!!

Passing the torch...

"You are the accumulation of everything you have learnt from your mother and father, and a whole lot more you have added yourself. You now need to take that and lead the family. You've got this! It's shit. Do the best job you can do."

Last monthly (August 31, 2024) we shared with friends, clients, and readers that my father had been diagnosed with an *"advanced Leukemia and kidney failure ... with very little time left to live"*.

It is with an extremely heavy heart that I share his passing came 6 short days later ([September 6, 2024](#)) ... his pain and suffering is no more, God willing, he's now in a better place, reunited with my brother (his first born son and my brother, Michael who unexpectedly passed nearly 4 years ago come October)

The opening quote came from a close friend a few weeks before Dad's passing when he learnt about the severity of my father's condition.

He's an individual whose brain most often computes differently than most, he's not just one of the brightest minds in this business, but that I know in life. I often find myself asking him the same question multiple ways just to make sure I'm processing what he's saying correctly.

IN THIS ISSUE:

- Passing the torch...
- Jobs/labor
- Succinct
- Process
- Final thoughts

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Outside of his kindness, humility and soft-spoken nature, which are second to none, from the extremely simple to complex, the way his mind processes information makes him an incredibly special human being.

At the time, his above words had nothing to do with finance, investing or economics; they were simplistic in nature, with a deeper meaning to me personally.

In an effort to find my inner peace the past few weeks, I've re-read these words multiple times ... in turn, the metaphor "passing the torch" continues to surface in my head.

Per [dictionary.com](https://www.dictionary.com) the phrase is most commonly referred to when referencing an older generation transferring or "relinquishing" something to a younger generation, "*be it a tradition, responsibility, leadership, or knowledge.*"

My father (and his legacy) lives on; with every character trait and set of core values that he (and my mother) instilled upon me. It is now my responsibility to pass our traditions, knowledge, principles, ethics, etc. to our children, so that one day (hopefully in the VERY DISTANT future) my wife and I will have prepared them properly for us to eventually "pass the torch" to them ... to carry our legacy, while adding a "whole lot more" of them, thus ... creating their own.

It's one of life's most natural, and truest of cycles.

As we've written time and time again, cycles are ever present in both economics and investing ... data both peaks and troughs, as does most everything that ticks...

As always, we'll talk 'data', however, this month we're going to heavily skew the note towards labor markets. we'll follow with a brief discussion on the importance of a data driven process, while taking a bit of a dive into understanding the importance of both, when the torch is passed and whom?!

So, let's dive right into this month's data dump, as we did last month ... with:

Jobs/labor

August's ADP jobs report kicked the month off September off with a whimper of an increase of +99k, up a meager 1.3% YoY (unchanged vs. the previous month) ... which represents the smallest monthly gain since January of 2021.

Inside the data, small businesses lost -9k jobs, as Professional and Business services lost -16k, with Manufacturing and Tech losing -8k and -4k respectively. The positive side of the ledger remains Education and Health (+29k), as we've been highlighting for the last 8/9 months (see copious amounts of the government spending trillions of 'borrowed' money).

What was slightly surprising to us was the relative strength in Construction jobs, which were up +27k (more on this later) ...

Headline JOLTS (Job Openings and Labor Turnover Survey) data, which again, is provided by the U.S. Labor Department) dropped -237k MoM to 7.673 million with the prior month revised LOWER to 7.91 million vs. the previously reported 8.184 million; with the most recent data on the books, we've now seen declines in the last 4 out of 5 months.

Had we not seen yet another previous month's revision out of the BLS, we would have just witnessed a cratering of -511k job openings MoM. This is the same BLS who has skewed jobs data for the last 18+ months via their [broken Birth/Death adjustments](#), so we shouldn't be terribly surprised. It's also the same BLS we wrote about [last month](#) who just announced an over-reporting of 818k jobs created over the last year that Commerce Secretary, Gina Raimondo said, "***I, I don't (stutter) ... I'm not familiar with that?!***"

In speaking to skewed jobs data and outright manipulation ... for those paying attention, just know that last month's 8.184mm JOLTS report was, in fact a BEAT of expectations of 8.00mm; this month's revision to 7.91mm is clearly a MISS ... but algorithms and machines don't care about last month, they're programmed on headlines (nothing to see here, move along, as you were!)

This comes as Challenger, Gray & Christmas hiring data just posted its LOWEST year to date 'hiring plans' EVER! Per their most [recent report](#):

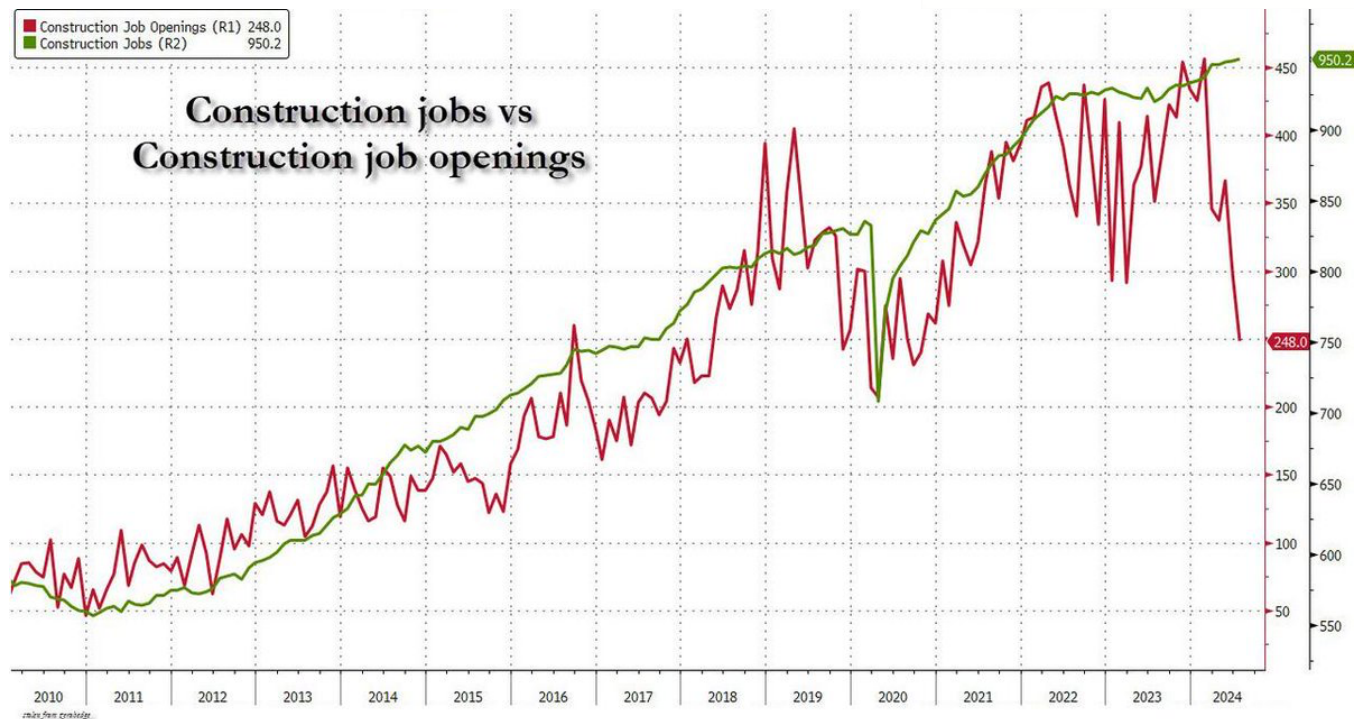
"The year-to-date total is the lowest since Challenger began tracking in 2005. The previous lowest total through August occurred in 2008, when 80,387 hiring plans were announced."

Circling back to housing for a moment ... we mentioned above our slight surprise to the strength; and one might wonder ... why?!

Most recent data out of the Census Bureau stated U.S. Construction Spending fell -0.3% MoM to \$2,162.7 billion SAAR in July and +6.7% YoY (vs +7.2% in the prior report) with Residential Construction falling -0.4% MoM and +7.7% YoY (a deceleration from the previous +9.3% YoY).

The JOLTS data discussed above shows Construction Job Openings at 248K, DOWN -177K MoM which, similarly to headline JOLTS declines, represents the 5th consecutive month of declines and more importantly ... the largest 6-month decline EVER ... as we've noted prior, EVER is a long time.

To this point, as noted by @zerohedge earlier in the month, we're staring at those working a Construction Job at all-time highs as construction job openings fall to a 4-year low



The Challenger data had construction job openings [down to 425 in July](#), a mere month after a fairly significant [decline of -4613 openings](#) in June; the largest decline since 2007/2008 ((GFC); making it larger than when the governments shut down their respective countries during COVID.

Yet, Unemployment claims remain muted ... with Initial claims coming in down -4k WoW to +218K and Continuing claims up +13k WoW with September also up +13K YoY; while up, this YoY trend is still, in fact a moderate improvement over the past few months.

If it's perplexing to you, I get it, you're not alone ... though we would cordially point you back to a section we wrote in our August 2023 note titled, "[Connecting the dots](#)":

A quick side note on the Birth/Death adjustments. Let's assume for the moment there is nothing nefarious going on (I place this probability as EXTREMELY LOW to ZERO) but, for a moment, let's just assume.

As a direct result of the American Rescue Plan Act of 2021, the IRS created a new rule which states anyone who now receives over \$600 of income for services needs to register (birth) as a "new business".

Prior to this Act, (for reporting purposes to the IRS) third-party transactions for business owners and those attempting to earn a little extra income on the side followed different thresholds: individuals only needed to report gross payments exceeding \$20,000 and report earnings if they had more than 200 such transactions ([according to the IRS](#)).

Now, regardless of number of transactions, the reportable figure is \$600. Which does beg the question?! How many uber drivers, Esty sellers, VRBO owners, etc... have had to "birth" as an "entity" due to this new law?!

In that note, among others, we highlighted previous work of Mike Green (@profplum99), however, in a note Mike wrote on 9/22/24 titled, "[Uber Alles: The gig economy sits at the heart of an impending scandal on government reporting](#)"; he yet again, provides the empirical data dismantling the BLS's birth/death statistical failures, while also places numerous studies and white papers together discussing, among other things ... the loss of higher paying tech workers and the rise of the gig economy/Uber drivers/part-time jobs skewing data ... which then, in turn, adversely affects other data which is derived from said, corrupted files.

It's the exact point we were attempting to drive home last month with our section titled, "[Garbage in, garbage out!](#)"

Succinct

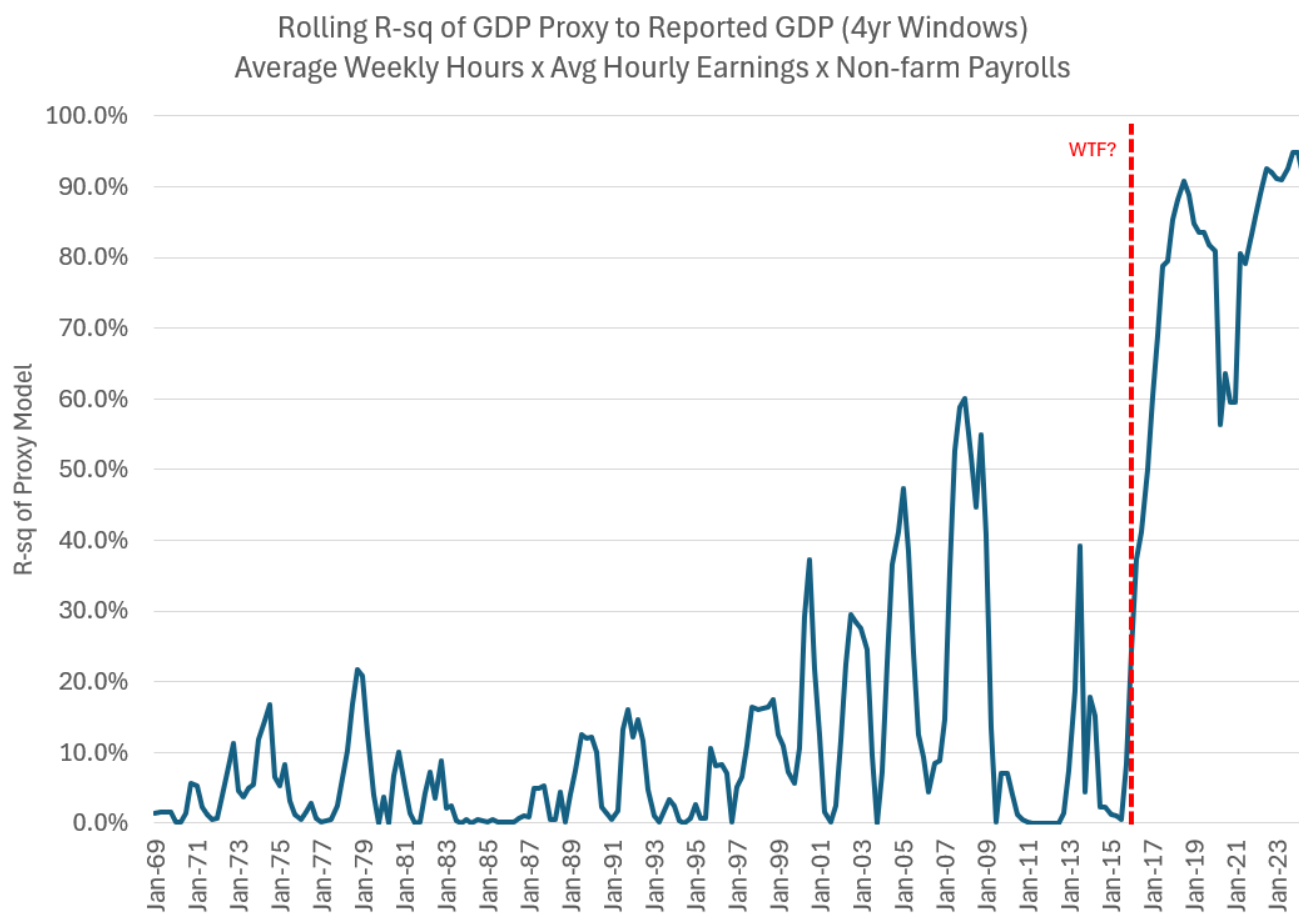
With his piece, Mike drops the microphone with charts and statistical data which largely backs much of what we've been discussing in regard to labor data and the strength of the consumer for nearly two years now.

While he specifically calls out much of the same government data we did just last month (as we note below), he does so much more succinctly, which is why we highly encourage you to read [Mike's entire note](#) which is a PhD masterclass on the BLS and jobs data; however, this month, we feel it much more important to highlight/quote some of Mike's work in regard to GDP as it ties in to something we merely glazed over a few short weeks ago ... he writes:

"... Fine, Mike, you've convinced me... the employment data is total BS and there are probably far fewer GOOD jobs than advertised. But still – LOOK AT GDP! It's growing.

*Ahh... you fell into one of the great blunders... land war in Asia, death match with a Sicilian, **assuming GDP is correct.***

First, a reminder. A few months ago, I highlighted a disturbing pattern of improved R-sq from simple proxy measures of GDP to GDP:



What was the possible driver? Well, it turns out that GDP calculations changed substantively in 2017. The NIPA Handbook notes that estimation methods play a key role. For example:

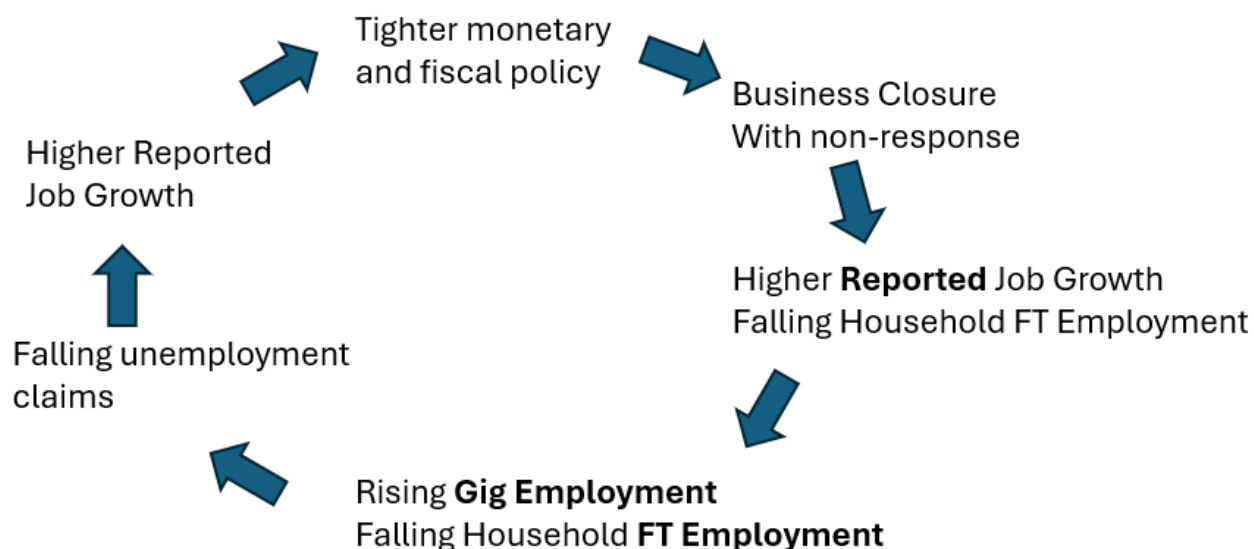
Current-Dollar Estimates

For most NIPA components, the current-dollar, or nominal, estimates are derived from source data that are “value data,” which reflect the product of quantity and price. For the estimates that are not derived from value data, separate quantity data and price data must be combined. For example, an estimate of expenditures on new autos may be calculated as the number of autos sold times expenditure per auto (at transaction prices—that is, the average list price with options adjusted for transportation charges, sales taxes, dealer discounts, and rebates). An estimate of wages may be calculated as employment times average hourly earnings times average hours worked, and an estimate of interest received may be calculated as the stock of interest-bearing assets times an effective interest rate. (The NIPA current-dollar estimates are expressed at annual rates; see the appendix to this chapter.)

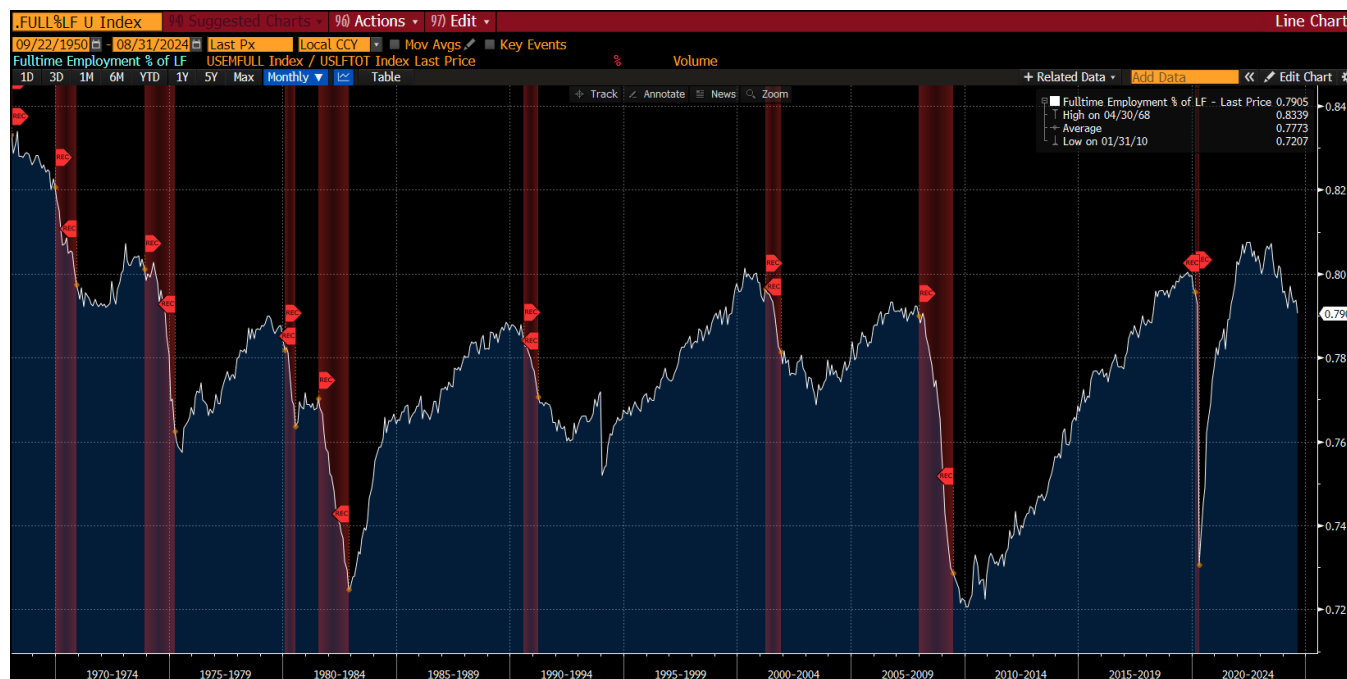
What is source data? You guessed it... non-farm payrolls.

*The data that BEA uses are collected from a variety of sources and **are usually collected for purposes other than for incorporation into BEA's estimates.** Data collected by federal government agencies provide the backbone of the estimates*

We've created a doomloop:

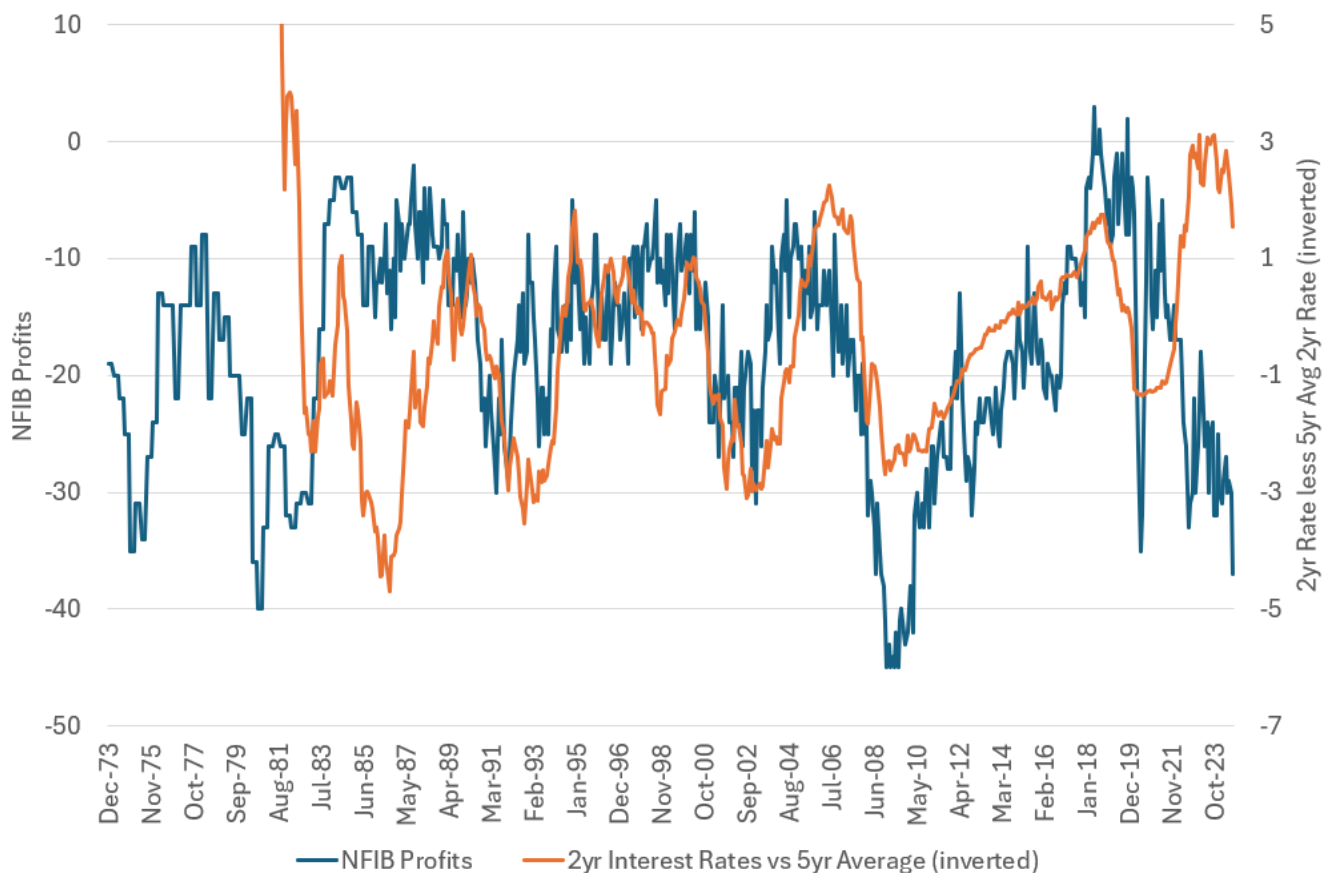


Which unfortunately matches the data. Sure, this looks like every other rapidly growing economic cycle:



With predictable outcomes when combined with central banker arrogance:

Change in 2yr Bond Rate vs NFIB Profits Survey



Source: Bloomberg, yesigiveafig.com

Powell has indeed brought out his inner Volcker. The data dependence of the Fed, combined with a “once in a lifetime” change to employment markets that has corrupted that data means we are in very dangerous territory. As I often say, “I hope I’m wrong, but I think I’m right.” As always, questions and comments very much appreciated.

The emphasis on Mike’s last paragraph comes from us, we suggest you re-read it a few times.

Remember, just LAST MONTH we wrote:

“... follow me here ... The Bureau of Economic Analysis (BEA) is an agency WITHIN the Department of Commerce (which she very department that Raimondo heads) ... that produces, “official macroeconomic and industry statistics, most notably reports about the gross domestic product (GDP) of the United States.

The BEA’s estimates of total employment and total wage and salary disbursements are DERIVED FROM THE BLS DATA! The departments have worked so closely in past years that [at one point, BLS data accounted for 95% of the wage and salary component of the BEA’s personal income estimates.](#)

Now the Secretary of the Department of Commerce, who works hand in hand with the BLS and their data is publicly stating that she is either NOT familiar with the BLS, the BLS's data or the BLS's 2nd worst revision EVER ... which directly impacts her agencies information?!

None of which are acceptable answers!

The takeaway should be the staggering level of incompetence that head of some of our countries most important agencies ... which produce the data our economy relies on!

Garbage in ... garbage out!!!

I shouldn't have assumed readers fully understood what "Garbage in ... garbage out" meant last month. So, should it need more clarity for those who weren't completely sure, it means if some of the largest data sets the BLS produces is so poorly constructed/computed, then any future data released that utilizes the inferior data as an input then becomes untrue, producing even more inferior data ... thus, garbage data used as an input = garbage data produced as an output.

Process

As is often the case, we would ordinarily discuss the underlying data that drives both growth (as measured by GDP) and inflation (as dictated by CPI), in detail at this point, though today, we're going to try and keep this one short and tight, finishing up with tying the above thoughts into our original metaphor of "passing the torch".

Recently, on more than one occasion, we've been asked: Do (we) still believe that data drives markets or does passive investing?!

Our answer to that question is yes.

When legislation forcibly passed the torch to the passive investing community in the early 2000's, it took time for David to best Goliath, but make no mistake, over nearly 2 decades, it has not only bested Goliath (active managers), but has now grown into a massive cancerous tumor feeding off of systematic 401k contributions and liquidity injections courtesy of the U.S. government, treasury, Federal Reserve, etc.

Additionally, the larger this cancer grows, one should expect significant volatility swings in both directions. These swings can be driven by both data as well as market structure. For example, say the Fed rapidly hikes or lowers interest rates creating large gains or losses in bonds which forces passive managers to rebalance from their bond allocations to equities of visa versa ... in an extremely inelastic investing environment the moves have the potential to be violent.

Markets are driven by a myriad of dynamics from regulatory shifts to the above referenced structural changes as well as the rate of change in economic data, which influences things like options positioning, seasonality and trend analysis which flows through to sector performance (driven by their underlying equities which

comprise multiple sub-sectors) ... which when analyzed collectively all provides a much more comprehensive picture into today's investing environment than any archaic Wall Street fundamental valuation model.

Something is telling both the money already in the system as well as all new money flows where to go ... which then sets off a game of chase.

Long-time readers know Hedgeye Risk Management focuses on the RoC (Rate of Change) in (and utilizes their NowCast models to proactively predict the most probabilistic outcome of growth and inflation ... they are without questions, the leaders in independent institutional research whose client's control over \$10 Trillion in assets.

As we described in our November 2021 section, titled, "[You adapt, evolve, compete or die](#)" quoting ~ Paul Tudor Jones:

As we adapt and evolve over time, we now more than ever allow the data to do our talking, focusing squarely on what specific economic investing regime we are currently in and which regime we are most probabilistically going. We've described these environments before as either "goldilocks", "reflation", "stagflation" or "deflation" (or Quads 1, 2, 3 and 4 respectively, in Hedgeye vernacular).

Again, stated as simply as possible, economic investing regimes are dictated by the simultaneous directionality (measured in rate of change terms) of both Real Growth (GDP) and Inflation; and whether they are accelerating or decelerating. (See: "[Why it All Matters](#)" from our July note for a refresher on the Quads)

Hedgeye's Quad format simplifies the complex, allowing them to map out and back test what sectors perform best under a specific set of conditions ... understanding the results of these back tests HELP predict the directionality most systematic passive programs, trend followers, CTAs and asset managers are likely to adjust their proverbial sails to. (i.e. what sectors or specific stocks **SHOULD** perform better given the economic set up.)

I italicize and bold **should** because as my good friend (who authored my opening quote) Chris Moir ([@thousandairefx](#)) often says (and has recently noted) ... back tests are more a "cleansed lab" scenario, "**NOTHING IS STATIC**" everything markets are "**CONSTANTLY MOVING**".

Hedgeye CEO Keith McCullough constantly preaches, his trade, trend and tail SIGNAL, which trumps the QUADs, for that's his was of picking up where the machine is shifting money to and from ... the signal more frequently than not, front runs the quad as ALL data is gathered in real time rather than a Quad which may shift based upon misleading/bad or outright manipulated data.

Hedgeye provides countless tools that allow all who subscribe to their work to measure and map flows. Be it their trade, trend tail models, top signal strength lists, Real time alerts, the list is vast and at times, can confuse some if they are trying to utilize everything provided.

Hedgeye CEO Keith McCollough is constantly reminding users of their system that investors should create a personalized risk management process that suits their investing style best based on which tools best suits their individualized investing personality.

Circling back to my friend Chris Moir, who recently wrote behind his paywall:

“The reality is that, just like different equity sectors go through periods of working or not working (and we’re all happy to play that game), various market factors also cycle through periods of greater relevance. They paint a more accurate picture of what’s happening in the market at any given time.

Then there’s another layer to consider.

A combination of seasonality, sector performance, options positioning, and trend analysis tells the most complete story.

Given that we don’t invest in a “cleansed lab” environment, and back tests are just that (historical data points), developing and implementing a signal into your investment process that looks at everything that ticks is paramount, for if we have the ability to increase the probability of our understanding who is ‘passing the torch’ and to whom, then we don’t have to necessarily play chase (as noted above), but we can front run and position ourselves into a specific name or take ourselves out of a certain subsector before those who have to, are forced to do so ... in either direction.

Final thoughts

While we won’t claim to have found the holy grail to investing, we are confident that value investing as dictated by fundamental analysis has become extinct due to the rise and evolution of the passive investing regime; driven by a myriad of dynamics from structural changes to (as referenced above) ... to regulatory shifts as well as the rate of change in data as it influences things like options positioning, trend analysis ... even seasonality which flows through to sector performance (and the underlying equities which comprise the different sub-sectors).

Analyzing all of the above provides us with a much more comprehensive picture into today’s investing environment than any archaic fundamental model ... that torch was passed some time ago ... just don’t tell Wall Street as they’d then have to admit their modeling has become largely irrelevant.

We are driven by the analysis of data and have become slaves to our process ... be it in our income and retirement planning process or our risk management process in our equity driven models; we are confident in our strategic alliances with those who understand that risk management is no longer found in the “diversification” equals “safety” modeling ... as DALBAR’s QAIB studies have been concluding for years ... traditional diversification most often “fails investors when needed the most”, for (I’m paraphrasing here) because when everything goes down, most falls together.

As we've quoted Paul Tudor Jones in prior notes, as well as above, in business as well as life, "**You adapt, evolve, compete or die**"!

Clients who have been paying attention have likely noticed that we have adapted to the ever-changing environment. Since doing so earlier in the year, we've outpaced broader indices with significantly less volatility and smaller drawdowns. We know what our risk levels are on each position we own is every day and risk manage accordingly.

In the past, we've noted "gap risk" is real, but it's real to everyone, that being said, we know what we will do at very specific levels and execute our process accordingly!

At the same time, what owning the names with the greatest strength of signal has shown us is that even on days of significant pullbacks, in general our portfolio has held more firm given we're in the majority of names money is flowing to in the moment.

This is where we're forced to insert the disclaimer ... past performance is no indication of future results, and returns are not guarantees, etc. etc.

That being said, if we're pulling back from an already elevated position, and our risk management process tells us where we are cutting both winners and losers making our drawdowns smaller, we have the very real potential to compound at a faster pace than those who wear a market crash the entire way through the cycle as they hope the torch is eventually passed back to the names they bag-held (which hasn't worked out for \$CSCO since the Tech crash of 2001-2003)!

At that point, our proactively preserved capital is likely already being deployed to the most recent and emerging market leaders we know the torch is being passed to at that time!

As always ... good investing!



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