



The more things change: redux!!!

The more things change ... redux!

In [November of 2019](#) we opened with the adage, the more things change, the more they stay the same.

We wrote:

“Lately, I feel like I’m on a treadmill running up hill, for as different as the catalyst which pops a bubble always is, it’s as much the same (a bubble) ... and yet, we’ve learned nothing. The mindset and attitudes of investors tend to be very predictable.”

As was the case then, we had moved through a period of time in which the Federal Reserve attempted to increase rates off the “zero bound” ... this began in late 2015, with the Fed Funds Rate peaking in July of 2019 at 2.40%: only for the Fed to cut rates in August of 2019.

Long time readers may remember, this preceded the “repo market” mayhem of 2019 by a mere few weeks, which eventually led to the market crash of February 2020.

Not the forum to debate the cause of the 2020 market crash ... though, [through that period of time, we documented](#) the rate of change deceleration in both growth and inflation data as well as detailing the plumbing of the financial system ala [repo markets cracking December 2020](#); thus, our thesis until proven otherwise will be ... covid was an accelerant (there’s no argument there), but it wasn’t the cause!

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Rate of Change decelerations in both growth and inflation = @Hedgeye #Quad4 or deflationary economic investing regime (i.e. a market crash). The disinflationary data was without question, a predictive warning.

There are frequently times to use caution which is most often presented in the data... its why we track it as closely as we do ... yet over the years, given the rise of passive investing, CTAs, hedge funds, algorithms and the rules that encompass them (all of which influence the directionality of markets), we've embraced the evolve or die mantra (i.e., CHANGE) ... as to where market signals have increasingly become an even larger and necessary risk management tool.

It's the bridge between what we believe markets should be doing based solely on the data vs. what they are doing in the face of it.

For as much as things have changed over the last 4 years, everything from the Federal Reserve's archaic modeling to rate cuts at the wrong time to investor psyche remains eerily similar to previous market highs; while traditional Wall Street investment models have investors in some precarious positions (buy/hold/60/40 split/among others), which both the data and signals have allowed us to risk manage around!

As was the case in 4Q2019, the Fed just cut rates ... this time, under the guise that their war on inflation is nearing an end, while at the same time we've been predicting a reacceleration of inflation into the back half of the year SINCE FEBRUARY ... and now the data, and price action in the commodity space as well as the bond market is suggesting we're right!

Today we'll touch on some nuance and differences in data that has kept us primarily invested, while side stepping the negative price impact of the bond market!

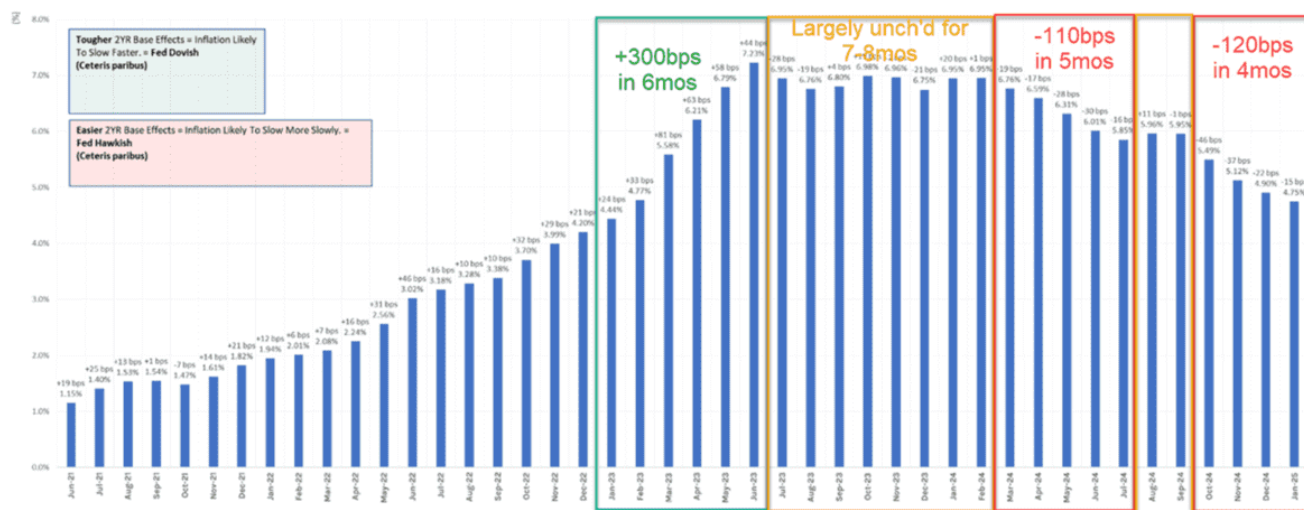
Inflation

"While we may see some softening into next month's print, also [per the work of Hedgeye's Josh Steiner](#) ... given the easing base effects into the back half of the year, and rising pressures in things like shipping (which is on an approximate 8-month lead/lag flowing through into the data), and other commodities, like meat, eggs, milk, copper, etc ... it becomes extremely difficult mathematically to get anywhere close to the Fed's 2% inflation target! Thus, we remain in the "higher for longer" rates camp ... UNLESS ... something "markets related" breaks bringing us much larger issues." ~ [OSAM February 2020 ... a higher for longer CPI ... below image hyperlinked above, in February's note and here Hedgeye 2/14/24!](#)

Framing The Inflation Outlook – A Three-Part Series

HEDGEYE

Beginning with the March print in April, Base Effects will ease (-110bps in 5mos), creating upside pressure/risk to inflation for the five months (March-July) reported over Apr-Aug. Then, there will be two months (Aug-Sep) of benign conditions. Then, four months of sharply easing Base Effects (-120bps in 4mos) (Oct-Jan) reported in Nov-Feb.



Data Source: BLS, Hedgeye Estimates

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The most recent Headline CPI data out of the BLS (Bureau of Labor Statistics) from earlier this month, came in HOTTER vs. Wall Street expectations, while at the same time decelerated MoM ... please ponder that thought for just a second ... markets digest empirical data, while Wall Street creates a narrative surrounding the data that was recently released.

CPI for the month of September came in at 2.44% YoY, which was roughly 14bps “HOTTER” than Wall Street expectations of 2.3% YoY (rounded), however, given the previous month was 2.53% YoY, this print was, in fact, an 11 basis-point deceleration MoM.

And just like that we’ve got Empirical fact vs. Wall Street narrative ... a relatively consistent deceleration in CPI data generating a 28-month headline cycle LOW!

That being said, we’ve been educating readers that this was a highly probable outcome while also telling you a shift in the wings was about to take place! No, we didn’t tell you the low of the cycle was going to be 2.44%, but we have been very clear over the last 6 months in stating August and September would likely be weak prints with a reacceleration in the data coming into the back half of the year large in part due to base effects as can be seen in this section’s opening quote (which again was written in February).

Hedgeye’s Josh Steiner has done impeccable work on CPI ... his granularity has been unmatched on the street! We cited him then; we credit him now!

So, the Fed rate cut was the right decision?! (rhetorical ... SEE: The more things change, the more they stay the same!)

And, right on time...

Just as we said it would many months ago ... CORE CPI (Ex-food and energy) ACCELERATED +0.31 basis-points MoM in September, which was hotter than expected at +0.20% MoM, reaching its highest level since May coming in at +3.31% YoY vs. +3.20% YoY!

We continue to see persistently high inflation from Core Services as shelter came in at 4.9% YoY, while Core Services EX-shelter remains elevated at 4.59% YoY ... a mild acceleration from last month.

We've frequently noted Shelter's input into the CPI carries a weight of roughly a third, which today, remains a mixed bag with shelter costs accelerating by +0.22% MoM, however showing a YoY deceleration in the most recently reported data of up +4.85% YoY vs. +5.23% YoY in the prior month (still uncomfortably high).

This MoM increase and mild YoY deceleration also presented in both Rent of Primary Residence and OER (Owners' Equivalent Rent) of +0.28% MoM and -0.19 basis-points YoY (+4.78% YoY vs. +4.97% YoY) and +0.33% MoM and -0.18 basis-point YoY (+5.19% YoY vs. +5.37% YoY prior), respectively.

Again, as is the case with all of the data, the cumulative effect over 3 years is troublesome.

Energy was the primary drag with prices falling -1.85% MoM and -6.85% YoY vs. -3.98% YoY in August. At the same time, Food prices accelerated +0.40% MoM and +2.27% YoY vs. August's +2.05% YoY (the 50th consecutive monthly increase).

Just as the Fed began cutting rates, commodity prices are now rising sharply in their faces!

Sugar, Wheat, Live Cattle, Corn, Lean Hogs and coffee are up between +3.5% and +12.5% over a month and a half time frame, while we've also seen increases in the prices of hard goods like Steel rebar, Copper, Natural gas (heading into winter), Aluminum, Platinum, Nickel, Lumber ... the list goes on!

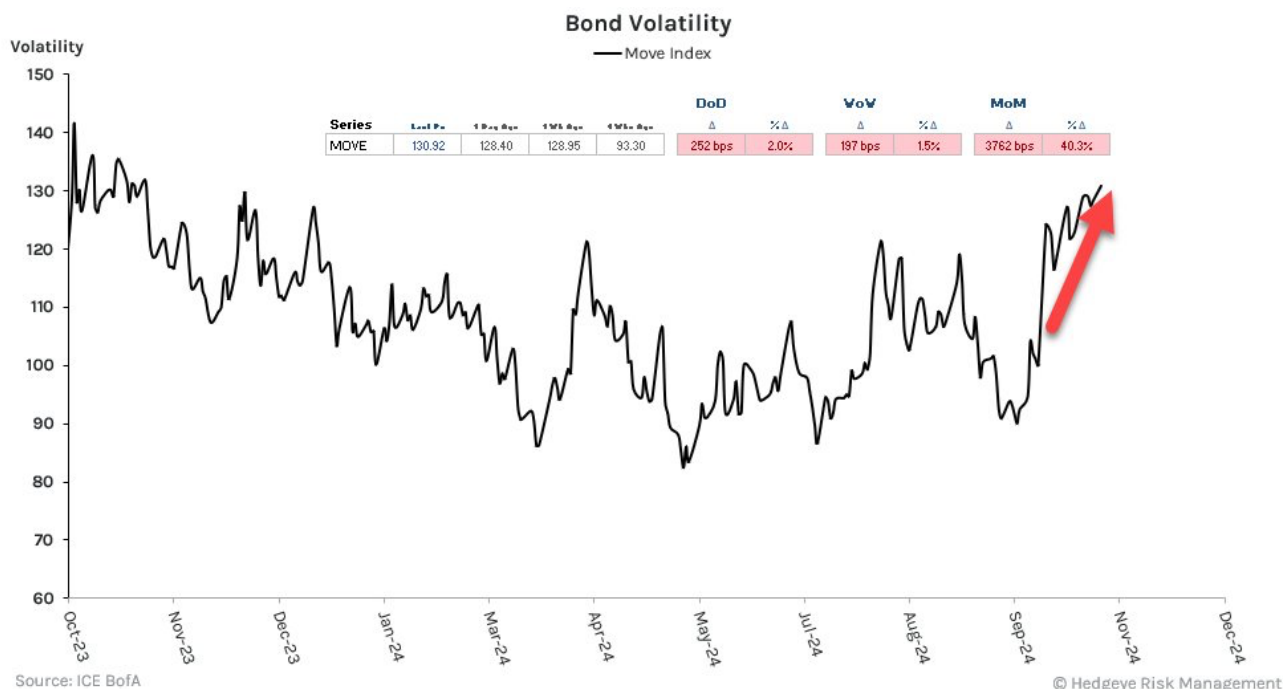
Given the increased commodity prices, CPI inputs in everything from Apparel (+1.79% YoY; +0.32% vs. prior reading) and Education (+2.17% YoY; +1.42% vs. prior) to Transport Services (+8.53% YoY; +7.89% prior) and Used Auto prices (-5.07% YoY; vs. -10.35% prior) have ACCELERATED vs. prior months, at the same time, has anyone gotten the license plate from that Medical Care or Car insurance bill that just ran me over?! Good Lord!

The Fed cut rates on 9/18/2024, sending bond yields through the roof from 3.61% to 4.29% (as of 10/30/24):

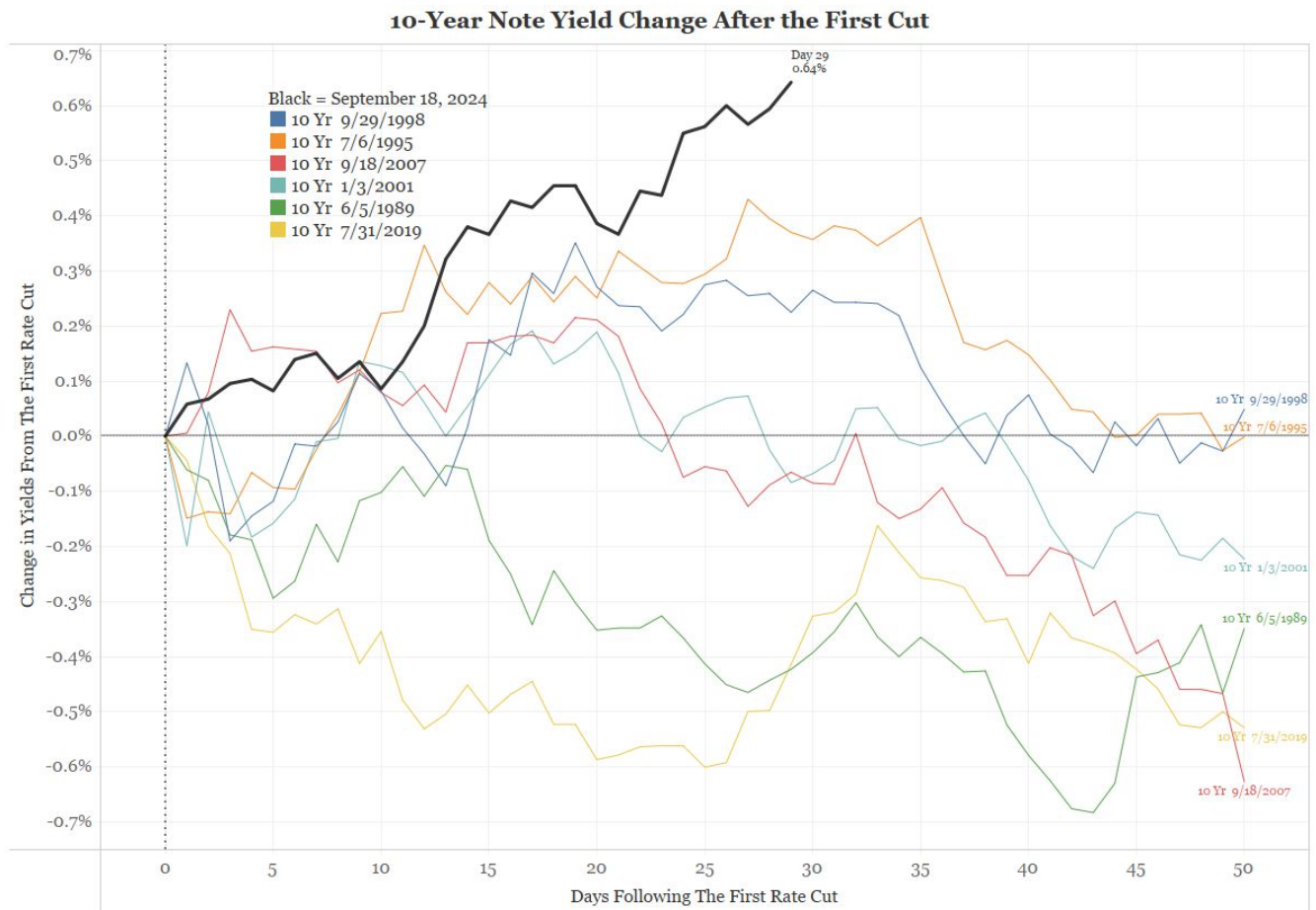
US10Y 4.271 % +2.5 (+0.59%)
Last Updated • Mon Oct 28 11:23AM EDT
Total Return (3M) 1.69% Total Return (1Y) -11.85%



While the MOVE index (which is a measure of bond volatility) has gone vertical up over 37.5% in a MONTH as recently noted by [@Hedgeye CEO Keith McCollough](#)!



Wall Street great, Jim Bianco illustrated what just happened beautifully in a recent chart he [shared on LinkedIn](#), noting this was: “The biggest rise in rates following a first cut since 1989.”



As much as things change, the more they stay the same! The Fed's timing on rate cuts has always been deplorable. Jim also notes Chicago Fed President Austan Goolsbee is looking for "hundreds" of basis points more to cut as we and markets already see inflation reaccelerating.

I can have a respectful and professional disagreement with Jim as to the why rates have spiked?! As we've mentioned in the past, market moves create Wall Street narratives – to Jim's thought re: a Trump win brings with it an abundance of fiscal and inflationary stimulus, the current administration has been spending like drunken sailors with the National Debt increasing by \$473 BILLION over the last 3 weeks alone.

At \$35.831 TRILLION, it's more than \$106k per American citizen and \$271k per TAXPAYER ... we're also nearing 125% debt to GDP ratio [per treasury.gov numbers](https://www.treasury.gov), we'd argue is substantially worse given the insane unfunded liabilities we've obligated ourselves to as a country (think unfunded Medicare and Social Security promises) ... some estimate the total bills to be north of \$125 TRILLION ... though, I digress...

In the face of all of the above: accelerating data, increased commodity prices, base effects, the bond market's reaction to the Fed cut, current Wall Street estimates remain in the 2.1-2.15% range for Q4 on CPI! Still, we

believe inflation will be moving higher for the foreseeable future and will continue to be a noose around the necks of both, Americans that fall on the bottom slope of the “K” in the “k” shaped economy; and more importantly ... small businesses (which employs the vast majority of the country).

As we mention small business, let’s take a look at the NFIB Small Business Optimism Index is telling us?!

NFIB

“Small business owners are feeling more uncertain than ever,” said [NFIB Chief Economist Bill Dunkelberg](#). “Uncertainty makes owners hesitant to invest in capital spending and inventory, especially as inflation and financing costs continue to put pressure on their bottom lines. Although some hope lies ahead in the holiday sales season, many Main Street owners are left questioning whether future business conditions will improve.”

While there were some definite “improvements” from Economic Outlook to Hiring Plans and Sales Expectations up +1, +2 and +9 points, respectively ... Capital Outlays, Job Openings and Inventory Plans declined -5, -6 and -2 points, respectively! With the index sitting at 91.5 in September; it remains well below its historical average of 98 and has for the last 33 weeks.

Admittedly, this report makes me scratch my head a bit ...

“The net percent of owners reporting inventory gains fell four points to a net negative 13%, seasonally adjusted, the lowest reading since June 2020. Not seasonally adjusted, 10% reported increases in stocks and 22% reported reductions.” ~ [NFIB press release](#)

If you were a business, and had the expectation that sales were going to improve, why would you allow your inventories to fall to extremely low levels heading into what should be the busiest time of the year (Holidays/Christmas?)!

If your largest fear and most important issue in the NFIB survey is, in fact, inflation ... which fell by another - 1 point to 23%, commodity prices are up and you’re outlook for Sales Expectations increased as much as it did, why wouldn’t you stock your shelves? One might objectively suggest that if sales came in at their lowest level EVER (non-recessionary), one might expect them to rise from there, but is that more hope than anything?!

Apparently, the economy and data has small business owners in a quandary, with the **Uncertainty Index within the survey increasing 11 points to a record high 103** ... as we’ve been saying for years ... “Hope is not a risk management process”!

Ordinarily

... we’d segue into labor markets, though we’ve covered them fairly extensively over the last 4-6 months and while long time readers already know we’re not convinced of the data set’s accuracy, given the massive disruption from Hurricane Helene, which crushed many small towns in both Western, NC, Northern, GA and Eastern, TN ... we think it’s best to see how things shake out in the aftermath of the destruction.

For now, initial jobless claims came in lower than anticipated earlier in the month at +241k vs +260k in the prior month, while the US added +254k new jobs in September vs. Wall Street expectations of +147k as the Unemployment rate ticked lower to 4.1% vs. 4.2% expectations, though weekly data softened into the back half of the month.

Ironically, in the spirit of trusting the data set, had the September 2023 seasonal adjustment been applied to the above report the number would have been 145k ... which, of course, is obviously lower than expectations; couldn't let that happen right before an election, could they?!

[MacroEdge Research](#) has tracked [nearly 100k job losses announced just this month alone!](#)

From [Boeing who will be cutting 17k jobs](#) or 10% of its workforce, to Denny's announcing their growth strategy includes [closing 150 stores](#) to TGI Fridays recently announcing they'll be [shuttering multiple locations](#). Bank of America has [closed over 132 branches this year](#), [Froot of the Loom plans layoffs](#) which include at their headquarters and [Stellantis plans a temporary shutdown](#) with 5k employees near Detroit ...

The list goes on ... from Spirit Airlines to Winnebago - but again, we'll see if/how things adjust in the next few weeks, though we would suggest as has been the case in the past, the economy is not as robust as those in a position of power are admitting.

Final thoughts

There are only so many ways to say certain things month in and month out, which is why we're going to keep this quarterly short and tight.

The proverb that we opened our note with (attributed to Jean-Baptiste Alphonse Karr in 1849) should be visible throughout the piece ... despite obvious changes or advancements in the investing world, at its core, patterns or fundamental human behavior remains constant over time.

Market price action literally ticks in milliseconds, data is absorbed into algorithms instantly, government regulation, passive investing and forced rebalancing, CTAs, ODTE options, even the way government agencies calculate and constantly revise their data (among many other factors) have changed how markets trade for the foreseeable future; at least until some other form of intervention shifts the winds in a different direction ... or something breaks structurally.

Yet, at the same time, investor psyche remains constant as they're sold the same old stories from their posh Wall Street firms which use the same tired, archaic DCF (Discounted Cash Flow), Sum of the Parts, or Valuation models.

As we've also noted in the past, the Federal Reserve employs over 22k people with countless overpaid PhD economists and too many bureaucrats at the FOMC who determine the fate of hundreds of millions of Americans!

We are a small little RIA in Raleigh, NC, whose been warning readers that inflation would reaccelerate into the back half of the year, while the unapologetic and consistently wrong highly paid 'experts' on Wall Street, remain firm in their stance that inflation is headed lower despite of the price of raw materials/commodities, lead lags and/or Base effects.

As we called B.S. on the Markets attempting to force the Fed's hand in [December 2023](#):

"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!

How's that for a disconnect?!"

At this moment in time, 98% of Fed funds futures traders are pricing in a 25-basis point cut at the November 7th meeting, along with another in early December ... this, as the data we've laid out above clearly suggests a reacceleration in inflation ... truthfully, nothing will surprise me at this point ... we believe markets are calling the Fed's bluff.

Wall Street is trying the same bully tactics, and I truly have no idea as to how they Fed is going to respond?!

Again, Wall Street was trying to force a rate cut in March and the Fed held out till September ... that being said, at the time they had cover from both CPI decelerating and bond yields falling. However, as we move into final edits, the 10-year U.S. Treasury bond closed at a 4.29% yield, which is a 27 basis-point increase over the last few weeks and 68 basis-point move from the low print on 9/17.

Commodity prices have rocketed higher, and we haven't even discussed housing in this piece (which has slowed ... AGAIN ... which is not a surprise with mortgage rates back over 7%!

Markets are telling the Fed to be careful, but labor markets are screaming for help ... eventually there comes a point where Uber drivers can't support the part time economy ... and once again, as much as things change, the Fed, as they have so many times in the past, find themselves painted into the same corner!

Typically, there are always signs, and as we've written for some time, we're at peace with whatever decision they make, for narratives are written based on market moves ... we'll continue to stick with signal and data.

One final extremely important note to close:

You couldn't pay me to buy a bond at this moment in time, for both the data and price action in markets, along with signals from our trusted partners in [@Hedgeye](#) and [@thousandairefx](#) have suggested the same!

As much as things change, they stay the same only applies to those who refuse to embrace change. For example, when every major Wall Street firm says, "buy bonds when the Fed is cutting rates, it's a no brainer trade", you don't have to listen ... especially to those who are consistently wrong.

When we say, “markets will tell us what to do” it means the price action, volume, volatility, look back windows, among countless other indicators screamed DANGER early on in this massive move in bonds.

The current larger cash position in our portfolios may be signaling more weakness ahead, or it’s just suggesting the large move in bond yields triggered a sell equity/buy bonds rebalance in ‘passive’ ETFs and we’ll find the new leaders heading into next month as momentum shifts from one asset class to another?!

No one really knows that answer for sure ... but I do know if internal weakness persists, we’re positioned appropriately and if strength comes back, we’ll be waiting to catch the uptrend and strength in those names presenting with the strongest signal.

Imagine me writing a note published on 10/31/2024 and the only mention of the outcome of the election was a single sentence on the trajectory of government spending and debt?! (Some things can change!)

Markets will tell us what to do on the upside as well as protect our downside!

There is a better way ... embrace change!

We have had great success coupling our risk management process with our holistic approach to building retirement income/legacy plans! We believe efficiencies and balance are imperative to a successful retirement!

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

Good investing!
Sincerely,



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