OTHER SIDE
ASSET MANAGEMENT

More of the same…

More of the same!

This month we're going to get right into things, for as the title of this section suggests … we're currently seeing similarities to what we've been writing month over month, so we're not going to bore you in being a broken record. At the same time, there are definitely some things worth noting … so, let's get right into things picking up with Inflation!!

January's CPI data accelerated +0.39% MoM, with the headline number coming in at +2.89% YoY vs. the previous report of +2.75% YoY. This was the fifth straight month of headline acceleration with Energy prices, leading the way (as we head into the heart of winter)! The panhandle of Florida just say nearly 10" of SNOW … what could possibly go wrong?!

Energy prices accelerated to -0.52% YoY vs. -3.18% YoY in the prior report while increasing +2.63% MoM.

Last month we reminded readers that "less bad" is equivalent to a Rate of Change acceleration … suggesting there were more inflationary pressures ahead of us, specifically pointing to "Energy" … while also noting pesky price increases from "Food", which along with "Shelter" were also large contributors to this month's acceleration … we wrote:

There was a slight acceleration in Energy prices, increasing +0.20% MoM, with YoY data being "less bad" coming in at down -6.20% YoY vs. -8.24% YoY in the prior data set (less bad = rate of change acceleration) with Food prices also higher +3.07% MoM and +5.02% YoY vs. the +2.57% previously! ~ OSAM 1.1.25

IN THIS ISSUE:

- More of the same!
- Seesaw
- NFIB/jobs
- Final thoughts

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Food prices continued to rise … up +0.31% MoM, with YoY increases from +2.38% to +2.51% … LED BY FOOD AT HOME, because, who wants to go to the grocery store and cook a nice, healthy meal at home these days?!

As for Shelter, given its extremely long lead/lag into the CPI data, it's been something we've been able to highlight with relative accuracy for some time now. Shelter costs remain persistently elevated at +0.26% MoM and +4.57% YoY … which admittedly, is a RoC deceleration vs. the previous YoY report of +4.73%, yet when combined with the perpetual, seemingly never-ending MoM increases as well as the base effects, this has kept roughly 1/3rd of Headline CPI elevated and should continue to do so into the foreseeable future!

In June we reminded readers:

housing's contribution to CPI is on a near 18-month lead/lag, which, in addition to the base effect set up, it's not likely to be a mathematical drag on CPI for some time (sorry Jay)! ~ OSAM 6.30.24

While poorly phrased at the time (we are NOT always perfect in word), when placed in context of our June note, "*it's not likely to be a mathematical drag on CPI for some time*" … what we meant was, it shouldn't be a mathematical drag "for much longer" as were anticipating the reacceleration and have been very vocal about it since our November/December 2023 notes … again, large in part due to the lead/lags and base effects.

"Core" CPI did decelerate by a handful of basis points YoY (-0.08) … down to +3.24% from +3.32% … while increasing +0.23% MoM in December, though be it +3.24% YoY or +3.32% YoY … inflation remains sticky (SEE: Core Services)!

This as mainstream media would like you to believe that PPI is slowing, given headlines like this one from Reuters: "US inflation still slowing as producer prices rise below expectations in December"

December PPI did accelerate to +3.31% YoY vs. an upwardly revised +3.0% YoY; and +0.22% MoM with Core PPI rising to +3.55% YoY from +3.47% YoY. As we've noted in the past … just because Wall Street would like you to believe PPI is slowing as the +0.2% increase "missed" Wall Street's +0.4% MoM estimate, we will remind readers that Wall Street expectations are wrong a majority of the time, and the most important thing that matters from an economic/investing standpoint is the RATE OF CHANGE in data … which as noted above … is ACCELERATING in aggregate!

We have little reason to believe that elevated prices at the producer level will do anything but continue to flow through to the consumer … which prompted our seesaw analogy from a handful of months back.

Seesaw

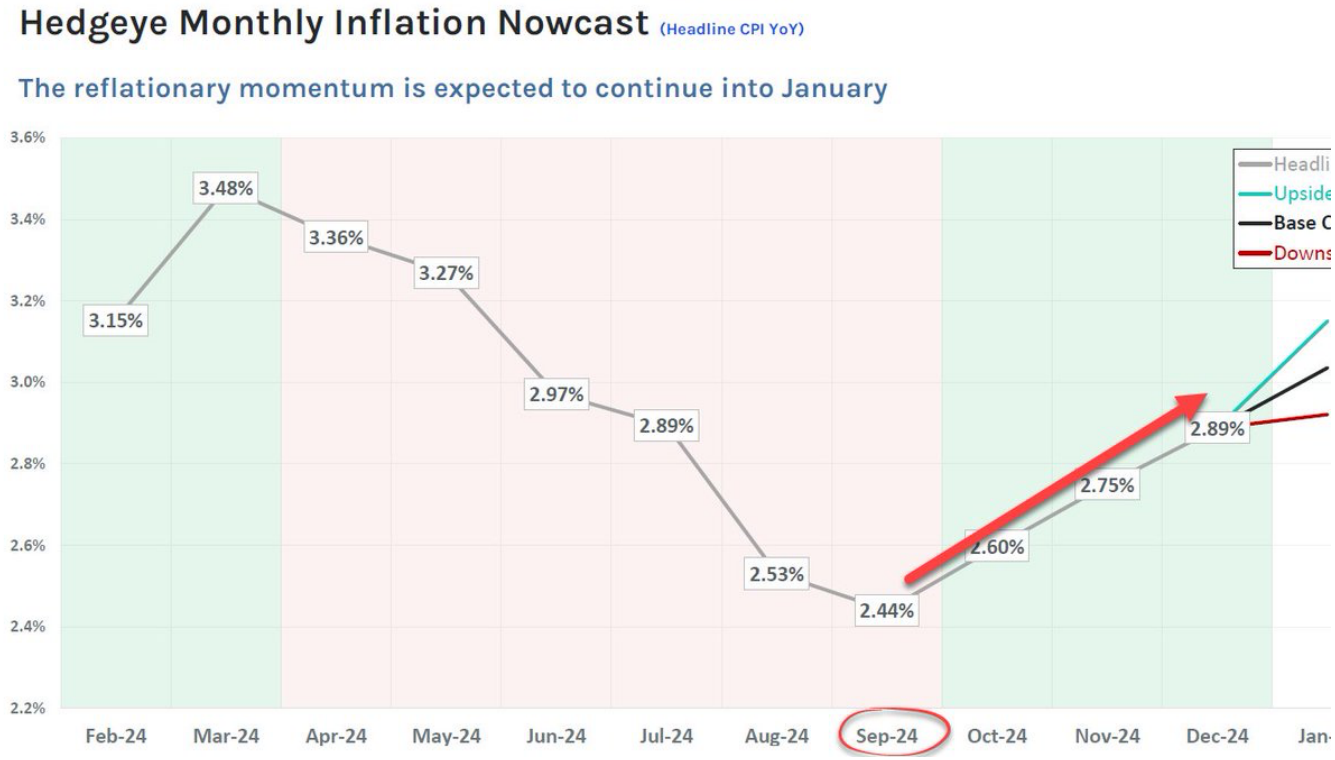
"*The economy is not sending any signals that we need to be in a hurry to lower rates*" ~ Federal Reserve Chairman, Jay Powell 11/14/2024

As we noted last month … when Powell "uttered" the above words, he was either lying or being insincere … either way and more importantly, as we wrote in December, *"he literally jumped back on that **seesaw** we spoke of in July … it was only a matter of time before he was forced to acknowledge the truth (if only half-heartedly)."*

The inflation data has been re-accelerating since it troughed in September and they had to know it …

We just laid out the most recent CPI/PPI data above, which anyone should be able to do, especially some overpaid PhDs at the Fed … though, as the saying goes, a picture is worth a 1,000 words, which Hedgeye CEO Keith McCollough just presented to anyone willing to pay attention.

It is an empirical fact that US inflation has done nothing but go up since September … it has REACCELERATED in Rate of Change terms!



The fact that side by side comparisons of Powell's most recent comments on inflation vs. the message the Federal reserve has been pushing has changed should be telling. Rather than their typical, *"Inflation has made progress toward the Committee's 2 percent objective but remains somewhat elevated"* … this month message simply reads, "Inflation remains somewhat elevated" … REMOVING the seemingly important part about making "progress".

Naturally, Powell attempted to brush this alteration off by stating, the Fed simply decided to "shorten" that section and it should "not be meant to send a signal"! Another words, it's not a policy shift!

If you believe that one, I've got a bridge to sell you… EVERY WORD out of the Fed is carefully selected and measured, EVERY SINGLE ONE OF THEM … they make any changes to merely shorten 18-20 pages of transcript!

We'd also argue the rise in inflation is why they've done their best to shift focus away from the traditional measures of Headline and Core CPI to more obscure metrics like PCE over the past few months … because the path of inflation reaccelerating is now visible and undeniable.

In presenting the data month in and out, what's occurred in rates expectations markets should come as no surprise to readers, yet up until recently the market was still anticipating roughly 4 to 5 rate cuts in 2025 … however, that changed on January 29th, 2025, as Jerome Powell held the line, taking a fire hose to Wall Street's rate cut expectations as he discussed the Federal Reserve's rates path moving forward.

"Inflation has eased significantly over the past two years but remains somewhat elevated relative to our 2 percent longer-run goal … We see the risks to achieving our employment and inflation goals as being roughly in balance. And we are attentive to the risks on both sides of our mandate.

Over the course of our three previous meetings, we lowered our policy rate by a full percentage point from its peak. That recalibration of our policy stance was appropriate in light of the progress on inflation and the rebalancing in the labor market. With our policy stance significantly less restrictive than it had been, and the economy remaining strong, we do not need to be in a hurry to adjust our policy stance. At today's meeting, the committee decided to maintain the target range for the federal-funds rate at 4 ¼ to 4 ½ percent." ~ Federal Reserve Chair Jerome Powell FOMC press conference 1/29/25

Markets subsequently adjusted very quickly following these statements to now only seeing the possibility of 2 cuts in 2025 with some rumblings of a possible hike should rates continue to accelerate (which is the current outlook for the next 5 to 6 months unless some major disinflationary event takes place … i.e., significant oil production reducing energy costs which flow through into the data either concurrently or on a 1 month lead/lag)?!

The Fed's nature is to obfuscate the data, cherry picking data points which support their narrative, they're never going to outright admit inflation is accelerating, but when Powell cites stickiness in Core CPI and tamps down rate cut expectations as they have over the past 3 months, they've communicated a shift through their actions.

So, if the inflation side of the equation is accelerating, this leaves the growth side of the calculation to determine whether we wind up in a stagflationary or reflationary investing regime (as we've been noting) … which is slightly less clear in our opinion.

NFIB/jobs

There's too much on the growth side of the equation to deep dive into without turning this into a dissertation no one wants to read, so we're not going to do this month. At the same time, it's important to note some positives and negatives, while slipping in some unknowns.

From the NFIB side, small business optimism has literally skyrocketed since November with the net percentage of owners that expect the economy to improve rising by 16 points to a net 52% (seasonally adjusted) … this is its highest level since the 4th quarter of 1983.

Business owners looking to expand reached its highest level since February of 2020, rising 6 points to 20% (seasonally adjusted), while 22% of small businesses are anticipating an expansion in real sales volume … with 6% (seasonally adjusted) planning to expand inventory (the highest percentage since December 2021).

It appears as if some of these small and mid-sized businesses are having some life breathed into them, which is without question a positive as they comprise in excess of 90% of businesses in the country … at the same time … optimism is one thing, reality and flow through is something completely different.

Many of these businesses may be looking backwards at newly elected Donald Trump's first term, their 'optimism' driven by hopes of what happened back nearly 8 years ago … but cycles don't always transpire or align as we hope.

Small businesses need consumers, consumers need jobs and purchasing power and currently, inflation is eroding purchasing power and while jobs continue to look stable, as we've been noting for well over a year … looks can be deceiving.

Do you remember the accuracy of those birth/death models we've been discussing for a few years now?!

Most recent data out of the BLS's Business Employment Dynamics Summary released on January 29th just stated:

From March 2024 to June 2024, gross job losses from closing and contracting private-sector establishments were 7.8 million, an increase of 639,000 jobs from the previous quarter, the U.S. Bureau of Labor Statistics reported today. Over this period, gross job gains from opening and expanding private-sector establishments were 7.6 million, a decrease of 17,000 jobs from the previous quarter. The difference between the number of gross job gains and the number of gross job ***losses yielded a net employment decline of 163,000 jobs in the private sector during the second quarter of 2024.*** *(See tables A and 1.)*

For those in the cheap seats … the economy actually saw a DECLINE of -163k jobs in the private sector during the second quarter of last year vs. the Birth/Death model which yielded a +951k INCREASE.

While job/labor data remains relatively muted and benign, with initial claims coming in down -16k WoW at +207k vs. 225k estimate … its lowest level since October. We remain skeptical as bankruptcies, store closures and layoff announcements continue to pour in. With this in mind, while also being mindful that outside of the

Birth/Death adjustments we screamed about last year, we also repeatedly noted that a significant percentage of the "strength" in labor markets last year came from government hiring, we offer you this...

The new administration just presented early retirement severance packages to nearly 2 million government employees (which would last all of 8-months), while they also recalled all Federal employees back to work in person by February 6th, or "THEY'RE FIRED"!

Initial estimates suggest a quick 10% reduction, but they have no idea exactly how this will turn out?! No one knows how tariffs will work out, or the floating of the removal of income tax, or no tax on tips or Social Security?!

A crack in labor markets coupled with cuts in government spending do not bode well for markets given how flows and market structure can and will adversely affect markets. Under certain conditions, markets can unwind much faster than they churn higher.

Has anyone considered why the number of borrowers making minimum payments on their credit cards are at cycle highs?! The cumulative effect of inflation is squeezing a LOT of Americans!

Final thoughts

We kept this month's note short and tight! While quite a bit of data is released monthly, the overall tone and theme of the data has remained similar to recent months. 'Inflation accelerating' remains the recurring theme, along with the Fed maintaining their newfound 'hawkish' behavior as well as choppiness out of the growth side of the investing equation.

Which brings us back to our final thoughts in November when we said:

"Muddy" may be a good way to describe the growth data?! Some accelerating, some decelerating … and until we get some clear signaling from the growth side of things, we may be in this environment for a little while?!

Markets haven't had a clear-cut, decisive direction since markets lost their momentum and broke trend back in early December, though bullish is currently how we're leaning with markets having recaptured certain levels and dancing on longer term trend lines, providing the bullish slant. Should these levels hold, onward and upward we may be … but if they don't, we know we'll react.

If narratives are what's needed, when you put the data together with market action … the choppiness makes sense. When you couple accelerating inflation with quite a bit of uncertainty with how numerous new policies may/will affect government spending, given who will be confirmed at what cabinet positions and how dollars will be allocated per the direction the new administration … markets are unsure of which direction to break?!

It's akin to what we wrote in November:

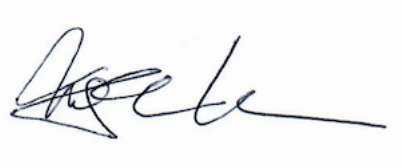
we've been shifting back and forth between a reflationary and stagflationary economic investing regime … described in @Hedgeye vernacular, #Quad 2 or #Quad 3. We know the inflation is accelerating, with the genesis of the choppiness coming from the growth side of the equation.

Regardless of the investing regime, as clarity comes … and markets are typically very good at sniffing things out, we'll continue to remain disciplined to our models.

Until next month (or you reach out in between) …

Good investing!!!

Sincerely,



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