OTHER SIDE ASSET MANAGEMENT

"Wind of Change"!!!

"… for as many empty shelves as we may see in the coming months, there is an empty factory somewhere else feeling equal or more pain." OSAM – April 30, 2025

We've written for years of the importance of "shutting out the noise"!

Prior to shifting our writing style/format, this "observation" is how we opened our 1Q2017 note:

It been virtually impossible, to avoid the continuous stream of negative news that's been circulating out of Washington these days. Regardless of what news channel is on your TV or web browser, the first quarter of 2017 has been filled with mudslinging coming from all angles. Accusation after accusation of "alleged" scandal after scandal coming from both sides of the aisle; we've even witnessed internal strife within the Republican Party, while the POTUS and the media have quite the dynamic relationship.

I could have used nearly these exact words, merely substituting 1H2025 for 1Q2017, and not a single reader would have questioned whether or not it was written today or 8 years ago! We then followed it up with:

At the end of the day, much of this is simply "noise". In this age of "instant information" turning off your television and stepping away from the computer and "smart devices" could behoove us all at times. Instant doesn't always prove to be "right"; "knee jerk" reactions often proves to be the incorrect action. Through all the protests, the "unexpected" Trump victory, fighting over the inauguration attendance (Obama v. Trump), Russian hacking accusations, Trump's alleged "ties" to Russia, WikiLeaks and Vault 7, CIA and intelligence agencies being able to hack, well – just about anyone …

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Trump's failed 1st attempt at a new healthcare bill (repeal and replace), The Federal Reserve raising interest rates; heck, the US just launched an aggressive airstrikes against a sovereign nation (Syria) last week, tensions are tremendously high with North Korea; YET, the markets moved through the first quarter of 2017 with solid strength, and no significant sell off to speak of … Stepping away from the "noise" for a few moments and taking a view from 30,000 feet looking down may provide a different picture of the current scenario?

Outside of the first quarter of 2025 bringing with it a significant sell off, you could replace virtually every current event example we used in 2017 with an equal or larger conundrum (depending on which side of the isle you sit on)?!

Be it DOGE, ICE enforcement of deportations, the Ukraine/Russia war, Israel/Palestine war, USAID, ActBlue, US Intelligence using a "Signal Channel", district court judge's ruling on National cases and so on … I shouldn't need to map 2017 NOISE to 2025 for you to see the parallels and understand my point?!

The world is DRIVEN by noise, and since the vast majority of each individual's opinions are formed by our respective preferred "sources" … should it surprise us that we've become such a polarized nation at the moment?!

If only this chasm was reserved for politics?!

As we've been noting from the onset of the year, Wall Street's expectations for Federal Reserve "rate cuts" have dropped from 5 to 2 with countless investment banks flip flopping on US recession expectations, literally by the day!

While, from a timing and macroeconomic perspective, our notes over the last year, have been extremely timely and accurate, as has the model's signal … catching the acceleration in inflation into the back half of 2024 (as we wrote it would as far back as January 2024) helped guide our 2024 to a solid year, while it also, picked up the deceleration in both growth and inflation into the first quarter of 2025, allowing us to greatly mitigate the drawdown that began in the middle of December 2024.

As we wrote February 28th:

*With December and January's data being reported in February, the next few months are now more likely to see a slight decelerating in inflation, **before reaccelerating**! Coupling this with a decelerating growth (GDP) figure, the oscillating "stagflation" (or quad 3) to "reflation" (quad 2) that we were anticipating appears to have turned into a mild "disinflation/deflation" monthly (quad 4)*

We went on to say:

*"All this being said, **we DO expect inflation to reaccelerate alongside growth after a short disinflationary pause**, but we still have to risk manage the time and space between now and then. When we see a reacceleration in inflationary data, depending on the growth side of the equation, we'll either bear witness to a reflationary or stagflationary regime?!*

Regardless of which regime ultimately appears, the process is now the same … we'll more than likely "luff" until that clarity or confirmation of the directionality comes, revealing where the strongest trending momentum lies … at which point we tack, looking to fill our sails with a force strong enough for our ship to heel!!"

If you're wondering why I'm spending so much time talking about what we said in both 2017 coupled with reminders from earlier this year, it's because the NOISE is constant … regardless of year! And contrary to what Wall Street is waffling over, the signal of the models are front running the data, as we believed it would.

As has been the case over the last handful of months, we'll start with what's on the majority of small businesses minds…

Inflation

Earlier in the month, Headline CPI hit a new cycle low with the BLS's reporting a +0.22% MoM increase in April, though the 3rd consecutive deceleration on a Year over Year basis, coming in at +2.31% vs. the previous report of +2.39% YoY (March) (which was a deceleration off of February's +2.82% YoY, and January's +3.00% YoY print).

This month's report (2.31%) was better than Wall Street expectation of +2.36%, and a meager 2 basis points away from the street low number produced by Hedgeye Risk Management's CPI NowCast model of +2.29%.

As we often highlight the bigger ticket items in most notes, Energy moved higher by +0.67% MoM but slowed to -3.74% YoY vs. the previous month's report of -3.25% YoY. At the same time, we saw a slight deceleration in Food prices falling a de minimis -0.08% MoM, decelerating in rate of change terms, from +2.96% YoY to +2.76% YoY from March to April!

However, CORE CPI remains elevated and virtually unchanged coming in at +2.78% YoY vs. the prior month's +2.79% YoY, following a MoM acceleration of +0.24%.

Shelter remains elevated, and with the recent disinflation (of roughly 20bps per month) that we had been seeing from this component came to an abrupt halt in this most recent report, up +0.33% MoM and +3.99% YoY, FLAT vs. the previous month.

Rent of Primary Residence was also up +0.34% MoM and slightly lighter than flat on a YoY basis at +3.98% vs. +3.99% in March with OER (Owners' Equivalent Rent) increasing +0.36% MoM but decreased 7 basis-points from +4.37% YoY to +4.30% YoY.

In the February piece we've referenced above; we also reminded readers that:

"markets are a forward discounting mechanism which chew through data in real time while looking at Rate of Change data and Year over year base effects."

While the headline number came in "better than expected" on the surface, many of the CORE components remain sticky or have begun to re-accelerate … an example of this would be used car prices, which increased +1.52% YoY, a 95-basis point sequential acceleration.

When looking at PPI (Producer Price Index), as it can give us some insight as to what producers may plan on pushing through to the consumers! As was the case with CPI, the most recent PPI had similarities, falling -0.47% MoM (with an upwardly revised +0.02% MoM vs. -0.39% MoM the previous month).

Due to this revision, PPI slowed to +2.36% YoY vs. the upwardly revised +3.37% YoY … which saw "Services" prices decelerate -0.61% MoM, slowing to +3.32% YoY vs. the prior report of +4.49% YoY … while "Goods" prices increased a meager +0.01% MoM, also slowing +0.47% YoY vs. +0.83% YoY last month.

CORE PPI was down -0.44% MoM, decelerating to +3.05% YoY vs. April's report of +4.02%, (EX) energy prices which were down -0.37% MoM and -7.79% YoY … a further deceleration from the previous month's -6.56% YoY figure, as well as Food prices which fell -0.99% MoM, and a RoC deceleration on a year over year basis, FROM April's +3.77% YoY data point to +2.87% YoY in May.

PCE data also came in as I was in final edits, so I might as well include it as it's telling a similar story as CPI & PPI … with the BEA (Bureau of Economic Analysis) reporting Core PCE up on a MoM basis, +0.12%, while it decelerated to +2.52% YoY vs. +2.67% YoY in March … remember, May's report is telling April's story, so the data is slightly behind! The Headline PCE deflator also bumped slightly higher on a MoM basis, +10 basis points, but also showed a minimal deterioration to +2.15% YoY vs. +2.31% YoY in the previous report!

PCE for Durable Goods bounced +0.48% MoM, accelerating to -0.33% YoY vs. -1.04% YoY while 'Services' prices were up a tenth of a percent MoM and +3.32% YoY (which was also a minimal deterioration off of March's +3.51% YoY.

With the tariff conversations largely unsettled, coupled with the consideration of all data points vs their comps on a year over year basis (the base effect set up), along with the lead/lag time it takes for certain items to flow into the aggregated composite (which ultimately becomes the CPI) … Hedgeye's NowCast modeling suggests we've likely seen a cycle low in CPI … for now! Leading to what we believe is that reacceleration in inflation that we've been writing about (referenced above).

Tariff noise

Circling back to tariffs for a moment … we began this note with a quote from our April monthly:

"… for as many empty shelves as we may see in the coming months, there is an empty factory somewhere else feeling equal or more pain." OSAM – April 30, 2025

Using it as a gentle reminder that at the end of the day, the rhetoric that comes out of the mouths of politicians around the globe can only last so long before they either come to the table to negotiate OR impale themselves … even Donald Trump and China.

On May 12th, less than two weeks after we wrote the above words, the US and China placed a 90 day "pause" on their trade/tariff war in an effort to give the two sides some time to come to a more amicable agreement, before factories, shipping, freight and a host of other industries shut down for the second time in 5 years.

For the moment, the US has cut tariffs on Chinese goods to 30% from the most recent 145% while China agreed to slash its rate on U.S. exports to 10% from 125%.

The grand-standing that was triple-digit tariffs had every Tom, Dick and Harry, who claimed to be an expert on Ukraine over the last few years, and Covid before that, had now become negotiating tariff wizards overnight.

I do my best to prepare these notes as apolitically as possible, though, for reasons unbeknownst to me, negotiating "fair trade" has apparently become both and emotional AND partisan issue?! Can someone please point me in the direction of a coherent argument as to why it's ok for other countries to place tariffs on our goods, while it's unacceptable for the U.S. to merely match (or reciprocate) the tariff being placed on our goods?

While this is just one of countless examples, please cordially explain why it is acceptable for Canada to place a ~200%+ tariff on U.S. items like milk, cheese, butter, chicken, turkey, or eggs, but it's wrong for the U.S. to match them, like for like?! I'm truly looking for a response that sticks to facts, not emption … please feel free to comment back, we're always open to respectful discord!

Optics and public arguments suggests this has become a partisan issue?! The irony … and there is no debating this next sentence; most entrenched in the Washington machine, on both sides of the isle, have been discussing the lopsided trade agreements between the U.S. and the rest of the world (especially China) and the NEED FOR CHANGE … for DECADES!

And yet, over that time frame, NOTHING has been done to better the United States' positioning. The outcome has been a whole lot of NOISE! What's even more rich, is those who have had the opportunity to fix things are the ones screaming 'bloody murder' the loudest in regard to the efforts of the current administration to facilitate real structural change?!

With this in mind, we would suggest being prepared for the continued NOISE from the tariff/trade war saga to be with us for quite some time!

For now, markets will be navigating their way through the pull forward in inventory leading up to the tariffs with China, as companies ordered way more than they should have anticipating a prolonged trade war … to an inventory glut with the 90 day pause now allowing companies to order away with tolerable pain.

If that doesn't murky the waters (i.e. data) up enough, earlier this week, the U.S. Court of International Trade (CIT) ruled the administrations use of the International Emergency Economic Powers Act (IEEPA) to be unjust … and before you ask, yes … the appeals are already in the works, so… yeah, this is going to go on for some time.

Our guess is this gets appealed up to the Supreme Court, while possibly being argued under The Reciprocal Tariff act of 1934, signed into law by FDR, giving the sole power to the President of the United States the ability to enact RECIPROCOL tariffs on foreign countries without Congress … arguably above my paygrade, but my point is still valid … win in court, lose in court, ignore the court, this uncertainty remains with us for some time!

There are very few absolutes in life, especially when it comes to markets … on any given day, just about anything has the potential to happen! Markets can move up and down on any given day with noise/news, and while tariffs and surrounding news definitely has the potential to impact markets, in the end, the shorter-term momentum and longer-term trends are driven more by the Rate of change in economic data, as well as market structure.

As it relates to economic activity, the Rate of Change of both growth and inflation matter … and since Hedgeye began publishing their CPI NowCast on a monthly basis (last September), they have a 90% "success rate" when it comes to accurately determining the directionality of CPI … and market signals appear to agree with the reacceleration of inflation modeling.

The signal …

… suggests market action is confirming a reacceleration in inflation, which is in line with what our expectations have been (as cited above). Given the data, lead/lag and comps, we're confident in the directionality of where the inflation side of the economy is headed over the next handful of months.

However, with signals yet to fully confirm the current investing regime last month, we suggested exercising a little bit of patience … we wrote:

"We would cordially suggest exercising some patience, do your best to remove emotion from the situation … follow the data and signals. While the data may be muddy for some time, we'll rely on the signals. Market structure has modestly improved over the last week or so … still, we do NOT see any definitive signs of an "ALL CLEAR" just yet … there has (have) been very few firm confirmations that shorter term momentum and longer-term trends have been reestablished to the bullish side just yet … ***we're close…***

While we have added a little more equity exposure, given the recent firming in market structure, from an options/flow perspective, we would consider it more, "adding supplies to the vessel for the next journey" than "pulling up anchor and setting sail or tacking in a new direction just yet!"

We told readers that we were adding supplies to the boat (in getting more long) and held off on outright pulling up anchor as we awaited some further confirmation from market signals … but noted, "WE'RE CLOSE"!!

Wall Street's recession "calls" have flipped more in the last few months then a pancake being made by a short order cook on Adderall … yet the hold up in signal confirmation, has come from the growth side of the equation.

With inflation accelerating, a deceleration in growth as measured by GDP would place us squarely in a "Stagflationary" investing regime, while, accelerating growth would have us confirming a reflationary investing environment! With certain signals not confirming what we needed to see last month, we recommended patience … for there is a large difference in exposures to own between these two economic regimes.

However, with the strength of the S&P and Nasdaq over the past month (35 trading days), shorter term momentum being reestablished as have the longer-term trend levels of the broader indices … growth data has recently begun to support the signals.

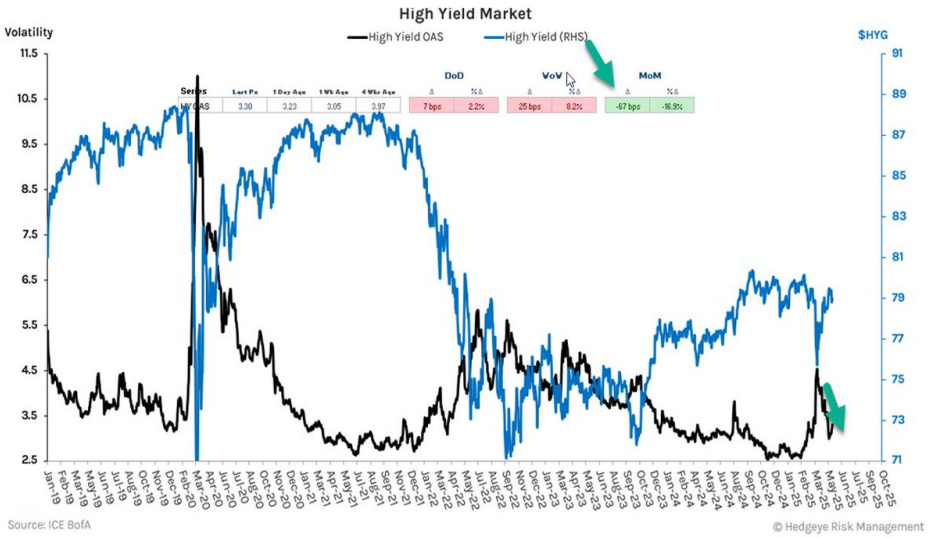
On Friday the 30th, U.S. Spending (PCE) came in up +0.23% MoM and +5.44% YoY vs. +5.47 % in the last report, with the Personal Savings rate jumping +59 basis points from +4.35% to +4.94%. Personal Income (Disposable) came in up +0.84% MoM and +5.15% YoY … an acceleration over the previous report of 4.41% (a +74-basis point acceleration) … aggregate Private Sector wage income and Government Sector wage income were both UP roughly +90 basis points (+4.5% YoY) and +17 basis points (+5.34% YoY) respectively.

At the same time, U.S. Goods imports fell -19.8% MoM … it's largest drop ever recorded! Which is POSITIVE for the growth side of the equation, i.e., GDP!

So, we've got a bounce in raw commodity prices off their bottom as noted above, paired with a +3.05% CORE PPI, a sticky CORE CPI, rising prices, positive PCE data, the implosion in U.S. Goods imports which is positive news for GDP, among other things … to say the Federal Reserve's hands are tied as they relate to rate cuts, would be an understatement … it would be irresponsible for them to cut rates at this point!

While wall street is warning that the political landscape and Fed is getting dangerously close to "losing the bond market" citing credit risk as they beg for said rate cuts (AGAIN), as equity markets rebound.
When we talk signals, we are discussing short term momentum and longer-term trends, but we also look to different markets in an effort to confirm signals are supported by data … these markets included rates, currency, credit, commodities, etc.

Rates are moving higher, but rates moving higher with markets is more likely a sign of economies reflating off lows than an implosion in the bond market … especially as credit spreads narrow, which is what we're seeing in the illustration to the right, presented by Hedgeye's @KeithMcCollough:



Final thoughts

Today's title, "Wind of Change", may have regular readers rolling their eyes … thinking, how much longer are we going to be utilizing our sailing analogies?! And while it definitely fits into what we've been discussing over the past 4/5 months, there was a slightly different genesis to our thought.

For those of you who grew up through the 1970-80's, "Wind of Change" may spark a different memory of the old German hard rock band, the Scorpions … for while they had quite a few popular songs, "Wind of Change" is arguably their most recognized.

While the nautical analogies we've used to describe market action relative to shifts in the empirical economic data (i.e., wind directionality), we thought this reference was a bit more prescient given the original meaning of the song and why the band wrote it?!

The band grew up under the backdrop of true, global structural change. Scorpions lead singer, Klaus Meine has stated that Wind of Change was meant to be a "peace anthem" as he and his bandmates watched the end of the Cold War, and the dismantling of the Berlin Wall in real time … they saw true structural changes that came about for the betterment of humanity.

At this moment in time, there are significant systemic shifts taking place globally, from a peace/war perspective as well as global trade standpoint and for the purpose of what we do, markets are attempting to digest all of this information in real time.

When the broader equity indices in both the S&P and Nasdaq were down -19% and -25%, respectively as of roughly a month ago, WE WERE NOT, and nowhere close. We bought ourselves time to pick our spots risk managing the 'Wind of Change', without getting rolled over.

Markets have been digesting quite a bit of both NOISE and REAL CHANGES since our last note, and the chop we've described (or winds) have continued to shift, and so have we! We've added even more supplies to the boat as the skies have further cleared … our anchors have been picked up and sails have been trimmed to catch the seismic shifts. Additionally, momentum and trend lines, in many cases, have been reestablished.

The initial "rally" was narrow at first, though has begun to broaden … allowing us to let our sails out in an effort to fill them more wind. Eventually, we hope our sails will be fully opened with a strong tailwind at our backs.

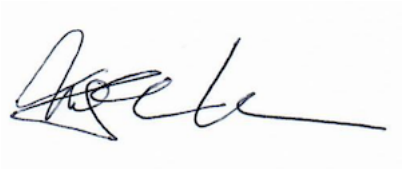
That being said, while improving, the growth data is still murky, for a host of reasons, which is why we rely on the signals both markets and the math are providing … if it becomes necessary to tack, luff, stall, turn back or even break our sails down and batten down the hatches, we're always prepared to do so based upon the signal, our process and rules.

Again… just because we believe something would or should happen, it doesn't mean that it will … which is what makes the signal is our guide, especially in choppy winds and murky waters markets recently experienced.

The Winds of Change are upon us, and while hope is not a risk management strategy that we use in our process, we do sincerely hope that peace and kindness finds its way back to humanity, allowing cooler heads to prevail and common ground both here at home and internationally to be found.

As the Winds of Change relate to investing … in the end, MARKETS are going to determine what's NOISE or not, for it will all flow through into prices. Some of these shifts and changes will be short lived, while others will become longer term trends ... and our process helps us risk manage around the noise.

As always … Good investing!



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