



The move Everyone misread!

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In 1997, Garry Kasparov—the best chess player in the world—sat down across from a machine: IBM’s Deep Blue.

Kasparov wasn’t just a champion—he was the champion. The consensus from commentators, grandmasters, and analysts alike was clear: experience, intuition, and human judgment would ultimately win. Machines could calculate... but they couldn’t understand.

Then came Game 2.

Deep Blue made a move that stunned everyone watching. It didn’t follow conventional logic. It didn’t “look” right. Commentators scrambled to explain it—assigning deep strategic brilliance to what appeared to be a masterstroke.

Kasparov saw the same thing.

And that’s where things went wrong.

Instead of responding to the board ...he tried to interpret the story behind the move. He assumed there was something deeper. Something hidden. Something he was missing.

There wasn’t.

The move wasn’t genius ... It was just different. But that was enough.

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Because once he misread the move, every decision after that was made from the wrong position.

He didn't lose because he lacked skill ... he lost because he trusted the narrative over the board.

Markets punish that mistake the same way.

We didn't predict...

Last month, we said something simple—but uncomfortable:

We didn't know what would happen next.

In fact, we said it clearly: *“we weren't going to guess which way this would go—we were going to wait for the data to confirm it.”*

The Hedgeye Risk Management models suggested:

- Inflation was likely to reaccelerate
- Growth was leaning towards acceleration ... but questionable.

And depending on how those two resolved, we could see either:

- Quad 1 (goldilocks), or
- Quad 3 (stagflation)

So, we didn't guess ... we waited.

We followed the data ... We read the board ... And adjusted when the signals changed ... just as we said we would.

Because like Kasparov, the temptation is always the same:

Most investors and pundits want to try to explain the move ... instead of responding to it.

Again, last month, we didn't explain ... we observed and then executed!

For the “why” that everyone wants to explain away after the move is becoming less relevant with every passing day the “machine” or “passive investing” grows.

The data was already shifting

Markets don't change all at once ... they change gradually ... then suddenly. Heading into this month, the shift was already happening.

Inflation (Rate of Change)

- Core PCE: +3.06% YoY (↑)
- Headline CPI: +2.41% YoY (↑)
- Core CPI: +2.46% YoY (↓, but slowing its decline)

Underneath that:

- PPI accelerating:
- Headline: +3.39% YoY (↑)
- Core: +3.87% YoY (↑)

Energy flipped direction: From a drag → to a contributor

Real-time inflation (transportation):

+2.1% YoY (from +0.75%)

NowCast CPI:

- Early March: ~2.6%
- Mid-March: ~2.8%
- Latest: ~3.08%

That's not a headline, it's not noise ... that's a trend gaining momentum ... and this is where investors make the same mistake Kasparov did:

They focus on the move instead of the position. Remember, one data point doesn't particularly matter, but direction does.

And the direction was already clear ... inflation has been accelerating.

- Core PCE: +3.06% YoY (accelerating)
- PPI: +3.39% / +3.87% (accelerating)
- CPI NowCast: 2.6 → 2.8 → 3.08 (accelerating)

But inflation wasn't necessarily the question, It was already moving higher.

What we expected

Based on that trajectory, the setup was fairly straightforward:

- Inflation would reaccelerate into March
- Then likely moderate into April as shelter and base effects worked lower
- Growth would remain stable to slightly decelerating

In other words:

- A relatively mild, manageable Quad 3 environment
- With a path back toward Quad 1 still very much in play

That WAS the position.

Then something changed

Because markets don't move in a vacuum.

And every now and then, something hits the board that has the ability to shift the trajectory of the entire game that the signal picks up before those pondering the "why" only see after the fact. In this case it was geopolitical risk and the escalation in Iran.

Now to be clear:

Oil didn't wait for confirmation; it had already started moving higher prior to any escalations with oil moving from \$73 per barrel to \$79 prior to any "strike" ... because in markets ... someone always knows something.

But once escalation became reality, and more importantly, once the Strait of Hormuz became a real constraint ... that's when the move changed.

Not gradually, but decisively.

Initially it was an 8 to 12% move higher when the strikes began ... with a more decisive move north of \$100 p/barrel following the "closure" or "reluctancy" for tankers to move through the Strait of Hormuz.

Oil didn't start the move ... it confirmed it and then accelerated it ... what had already been a mild reacceleration of inflation has now shifted into something much more aggressive.

To be clear, this wasn't a new trend ... merely gasoline thrown on a trend that was already burning.

And this is where the impact compounds:

Oil doesn't just move inflation ... it compresses the system!

- It pushes CPI higher... quickly
- It reduces discretionary income... immediately
- And it pressures growth... almost simultaneously

So now, instead of:

Inflation rising modestly and growth holding steady

You get:

- Inflation → accelerating faster than expected
- Growth → more likely to decelerate further
- Growth: Losing Momentum

And we're already seeing it in consumption!

Retail Sales: -0.16% MoM

YoY slowed: 3.81% → 3.08%

Income vs Spending

Income: +4.41% (slowing)

Spending: +5.25% (accelerating)

Incomes are growing more slowly than what they're spending ... which means consumers are stretching.

Housing

- New Home Sales: -17.6% MoM / -11.3% YoY
- Permits: -5.8% YoY
- Construction: -9.6% YoY

Labor

- Payrolls: -92k
- 3-month average: +6k (down from +50k)
- Unemployment: rising

This isn't collapse ... but it's not strength either ... it's loss of momentum.

And when energy costs rise ... MOMENTUM MATTERS.

When the game changes

There's a moment in chess when the game changes. Not because of one move ... but because of what that move confirms.

This is where we are:

Before Iran/oil:

- Quad 1 (goldilocks) → still in play
- Quad 2 (reflation) → plausible

- Quad 3 (stagflation) → emerging

After oil:

- Quad 1 (goldilocks) → unlikely
- Quad 2 (reflation) → fading
- Quad 3 (stagflation) → increasingly probable... and potentially prolonged

To simplify:

- Inflation → accelerating
- Growth → decelerating

That's it. No debate required!

What markets are currently confirming is what was shaping up to be a temporary inflation bump ... is now much more likely to become a sustained period of rising inflation paired with slowing growth

That's not a forecast ... that's the direction of the data coupled with the signal from markets.

We didn't try to outsmart the market. we didn't assign meaning to every headline. we didn't predict ... we waited and moved with the signals. Because the goal isn't to predict the move ... it's to recognize when the position has already changed.

That being said, regardless of the shift that just took place, you NEVER take your eyes off the board (or the signal).

On one hand we know our history.

From 1973 peak to December 1974 trough, the S&P 500 saw a -48% drawdown through a similar bout of stagflation. Currently the S&P peaked a little less than 2 months ago and is down roughly -7%.

On the other hand, we know 1973/74 was PRIOR to the massive Federal Reserve interventions and the passive investing world reframing markets.

Long time readers know that I place very little credence on anything mainstream media reports. We have NO inside information as to how long the Strait of Hormuz will be closed down and avoided, ZIP, ZERO, NONE.

Though contrary to the gloom and doomers, the Hormuz crude issue, IN OUR OPINION, has the potential to resolve itself relatively quickly SHOULD the U.S. Navy begin to escort vessels with added air support.

It is our belief that the United States has the ability to control key coastal regions of Iran, potentially pushing conflict inland and allowing oil flows to normalize faster than most expect.

That would represent a very different outcome than what we saw in Iraq.

Couple this with a Federal Reserve policy shift:

- Inflation → accelerating
- Growth → accelerating (should the above occur and oil not weigh as long as anticipated)
- Quad 2 (reflation) → “possible”

The bottom line is no one with any shred of integrity knows how this plays out with any certainty ... it's the markets that will tell us which is why we'll continue to read the board and follow the signals.

Because in markets ... just like in chess ... the game doesn't end when the board changes. That's when it begins!

Final Thoughts

Kasparov didn't lose because the computer was better or he couldn't play ... he didn't lose because the move the computer made was too complex ... he lost because he misread it! He overthought something that didn't need interpretation.

Most investors are doing the same thing today as they ask:

- Is inflation temporary?
- Is growth still strong?
- Will oil matter?

These are the wrong questions ... they're interpretations. The data is simpler—and far less forgiving:

- Inflation is accelerating
- Growth is slowing
- The environment is shifting
- The board has already changed

The only question left is:

Are you positioned for what's happening ... or still listening to people explaining what already happened?

Because markets don't reward “interpretation”.

If your portfolio is still positioned for falling inflation and stable growth ... it may be time to take another look.

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As always ... Good investing!



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