

The Fed's Beige Book, on the heels of a new record number of job openings, seems to be stoking inflation concerns at the Fed. Interestingly, the warnings we quote below from every Fed district are being ignored by the bond markets, as yields decline in recent days.

Pre-market trading is reversing yesterday's price action. Bonds are opening weaker while most stock indexes have recouped yesterday's declines. PPI will be released at 8:30 this morning. Investors will keep a close eye on the data as it can serve as a proxy for future profit margins. Higher than expected producer prices along with rising wages will prove troublesome, especially for the manufacturing sector.

[dmc]

What To Watch Today

Economy

- 8:30 a.m. ET: **Producer Price Index, month-over-month**, August (0.6% expected, 1.0% in July)
- 8:30 a.m. ET: **Producer Price Index excluding food and energy, month-over-month**, August (0.6% expected, 1.0% in July)
- 8:30 a.m. ET: **Producer Price Index, year-over-year**, August (8.2% expected, 7.8% in July)
- 8:30 a.m. ET: **Producer Price Index excluding food and energy prices, year-over-year**, August (6.6% expected, 6.2% in July)
- 10 a.m. ET: **Wholesale Inventories**, month-over-month, July final (0.6% expected, 0.6% in prior print)

Earnings

Pre-market

- **Kroger** ([KR](#)) is expected to report adjusted earnings of 66 cents a share on revenue of \$30.753 billion

Did They Leak Their Own Story To Not Spook Markets?

It is no big secret that members of Congress, major Wall Street firms, and the Federal Reserve have an uncanny ability to manage their investments, capitalize on opportunities (before they happen) and avoid major drawdowns.

Early this week, Richard Kaplan, President of the Dallas Federal Reserve, got much (*likely unwanted*) attention from the media over his disclosures of purchases or sales in excess of \$1 million in 22 different companies.

Reporting individual's Name Robert Kaplan		New Filer (Schedule Not Applicable) <input type="checkbox"/>		SCHEDULE B		Calendar Year Covered 2020		Page Number 3	
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Part I: Transactions None ☐

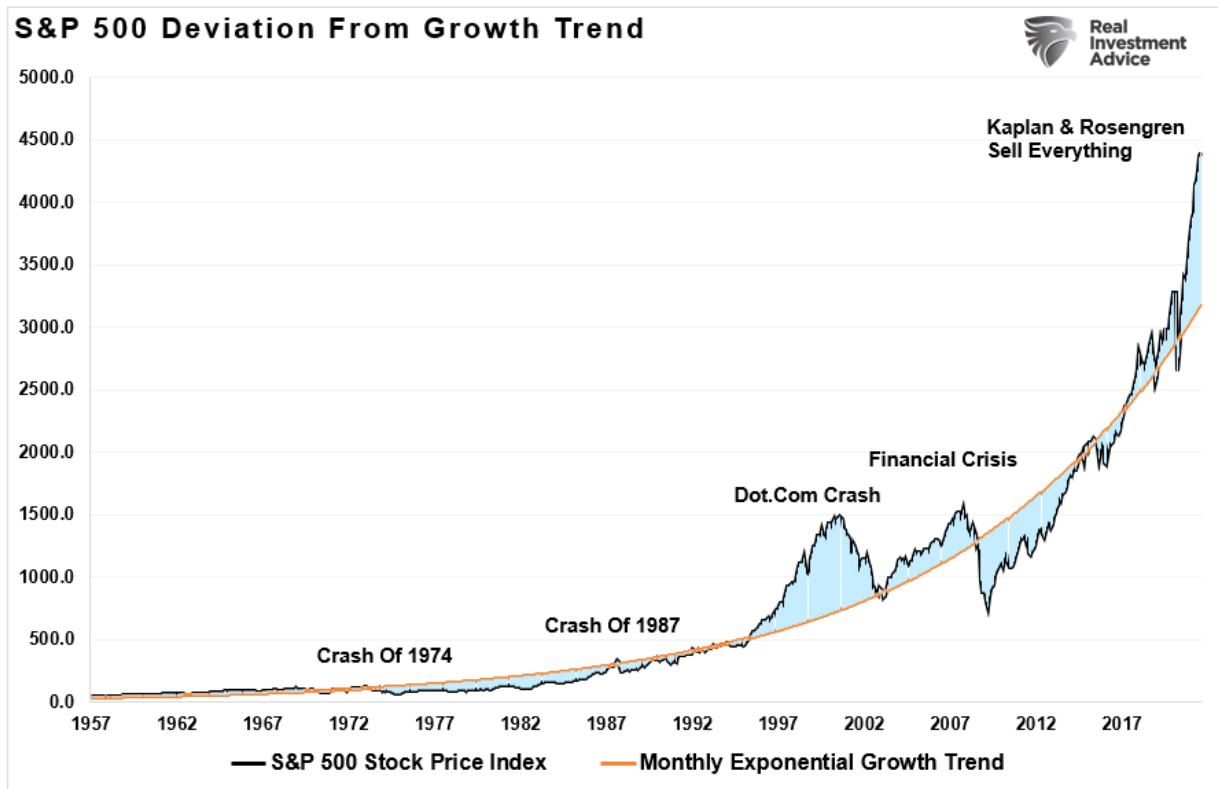
Report any purchase, sale or exchange by you, your spouse or dependent child during the reporting period of any real estate, stocks, bonds, commodity futures and other securities when the amount of the transaction exceeded \$1,000. Include transactions that resulted in a loss. Do not report a transaction involving real estate used solely as your personal residence (unless rented out), or a transaction solely between you, your spouse or dependent child. Check the "Required divestiture" block to indicate sales made pursuant to a divestiture required by the Bank.

Identification of Assets		O W N E R	Transaction Type (x)			Date (Mo., Day, Yr.)	Amount of Transaction (X)						Required divestiture
			Purchase	Sale	Exchange		\$1,000 - \$50,000	\$50,001 - \$250,000	\$250,001 - \$500,000	\$500,001 - \$1,000,000	Over \$1,000,000		
Example: Central Airlines Common		S	x			2/1/93	x						
1	Apple	E	x	x		Multiple					x		
2	Alibaba	E	x	x		Multiple					x		
3	Amazon	E	x	x		Multiple					x		
4	Chevron	E	x	x		Multiple					x		
5	Delta Airlines	E	x	x		Multiple					x		
6	Enterprise Products, L.P.	E	x	x		Multiple					x		
7	EOG	E	x	x		Multiple				x			
8	Facebook	E	x	x		Multiple					x		
9	General Electric	E	x	x		Multiple					x		
10	Google	E	x			Multiple					x		
11	Ishares Floating Rate Bond ETF	E	x	x		Multiple					x		
12	Johnson & Johnson	E	x	x		Multiple					x		
13	Latin America 40 ETF	E	x			Multiple	x						
14	Kraft Heinz	E	x	x		Multiple					x		
15	Magellan L.P.	E	x	x		Multiple					x		
16	Marathon Petroleum	E	x	x		Multiple		x					
17	Occidental Petroleum	E	x	x		Multiple					x		
18	Oracle	E	x			Multiple					x		
19	S&P 500 ETF	E	x	x		Multiple					x		
20	S&P 500 Value ETF	E	x	x		Multiple					x		
21	S & P Index Futures	E	x	x		Multiple					x		
22	Transdigm	E	x	x		Multiple					x		
23	TSLA	E	x	x		Multiple					x		
24	Valero Energy	E	x	x		Multiple					x		
25	Verizon	E	x	x		Multiple					x		
Alternative Assets: Redemptions/Private Sales													
1	GS Private Equity Fund 2000 Runoff	E		x		Multiple			x				

In a surprise twist, Kaplan and Eric Rosengren (Boston Fed President) liquidated all of their positions yesterday as noted in a [Zerohedge article](#).

*"Well, less than two days after the widespread public fury at this grotesque discovery, the presidents of the Federal Reserve banks of Boston and Dallas said Thursday they would sell their individual stock holdings by Sept. 30 amid "ethics concerns", and invest the proceeds in diversified index funds **or hold them in cash.**"*

Besides that obvious individuals with access to "inside information" should be disallowed from trading individual securities (i.e. Nancy Pelosi) there is a strange timing to all of this. Take a look at the chart below.



Given the Fed is now talking of *"taper,"* the question is what do Kaplan and Rosengren *"know"* that you don't?

Did they really decide to sell *"now"* for ethical reasons? If *"ethics"* were a concern, they should have sold when they took office, not when they got caught.

Or, did they intentionally leak the story to give them an excuse to sell without spooking markets prematurely?

Inquiring minds want to know.

Regardless, it certainly appears to be very auspicious timing for those on the *"inside."* Yes, the same insiders who also happen to control the monetary levers supporting asset prices.

Warning Signal Or Excessive Caution?

SocGen's proprietary Multi-Asset Risk Indicator (SG MARI) is based on investor positioning in futures and options markets. That indicator is currently hovering just above deep risk-off territory despite incessantly rising markets.

SG MARI moves through 20 years of market crises and less severe turning points

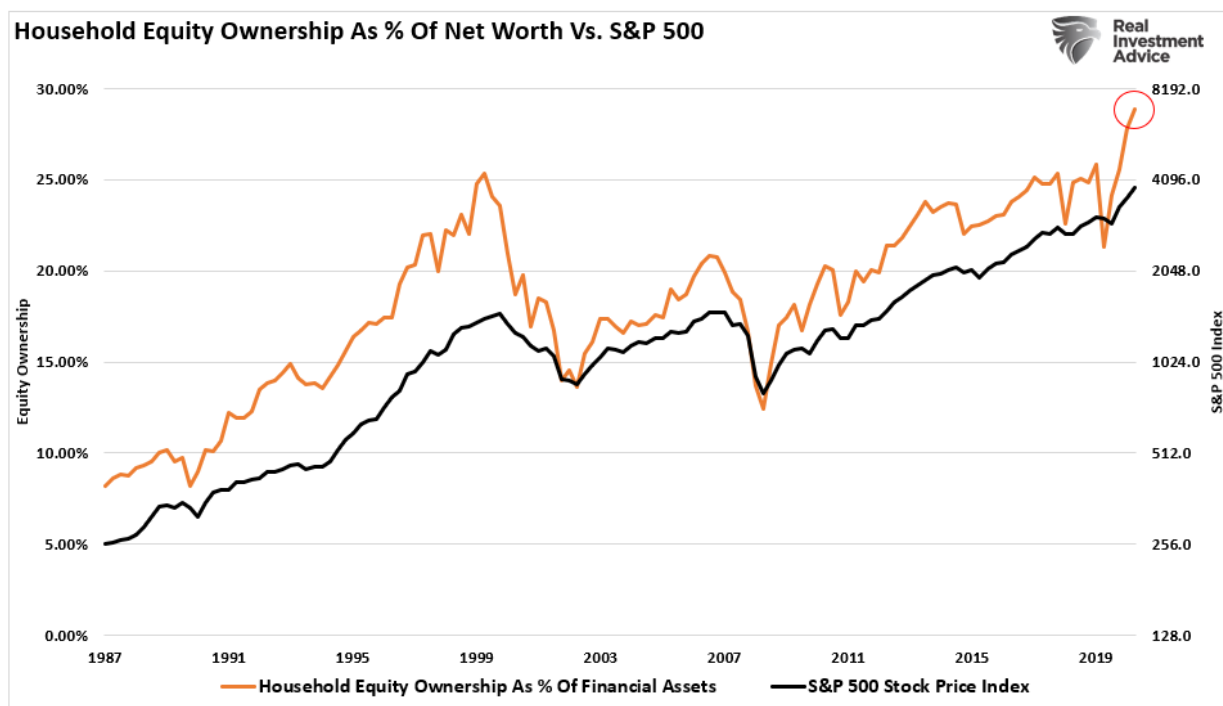


Longest available history of our Multi Asset Risk Indicator (SG MARI). The arrows indicate various financial crises. See left-hand legend.
Source: CFTC, SG Cross Asset Research/Global Asset Allocation

The indicator has seldom been at such a low level. As noted by Soc Gen:

"It has indicated ugly and even terrible things in the past (tech bubble, credit crisis, taper tantrum) when declining further. Conversely, whenever the indicator has bounced back from current levels, it has typically heralded the start of a more positive tone, which is good for equity and commodities but not for rates."

Given that retail investors are exceeding long equity allocations (below) and that options positioning is primarily driven by institutions, the question is really who knows what? This risk-off positioning is coming at a time when equity markets are up 20% for the year, economic growth is strong (on a relative basis), and interest rates are low. The only dynamic that would change the bullish backdrop for equities, given excessive valuations, is the Fed "taking away the punchbowl."



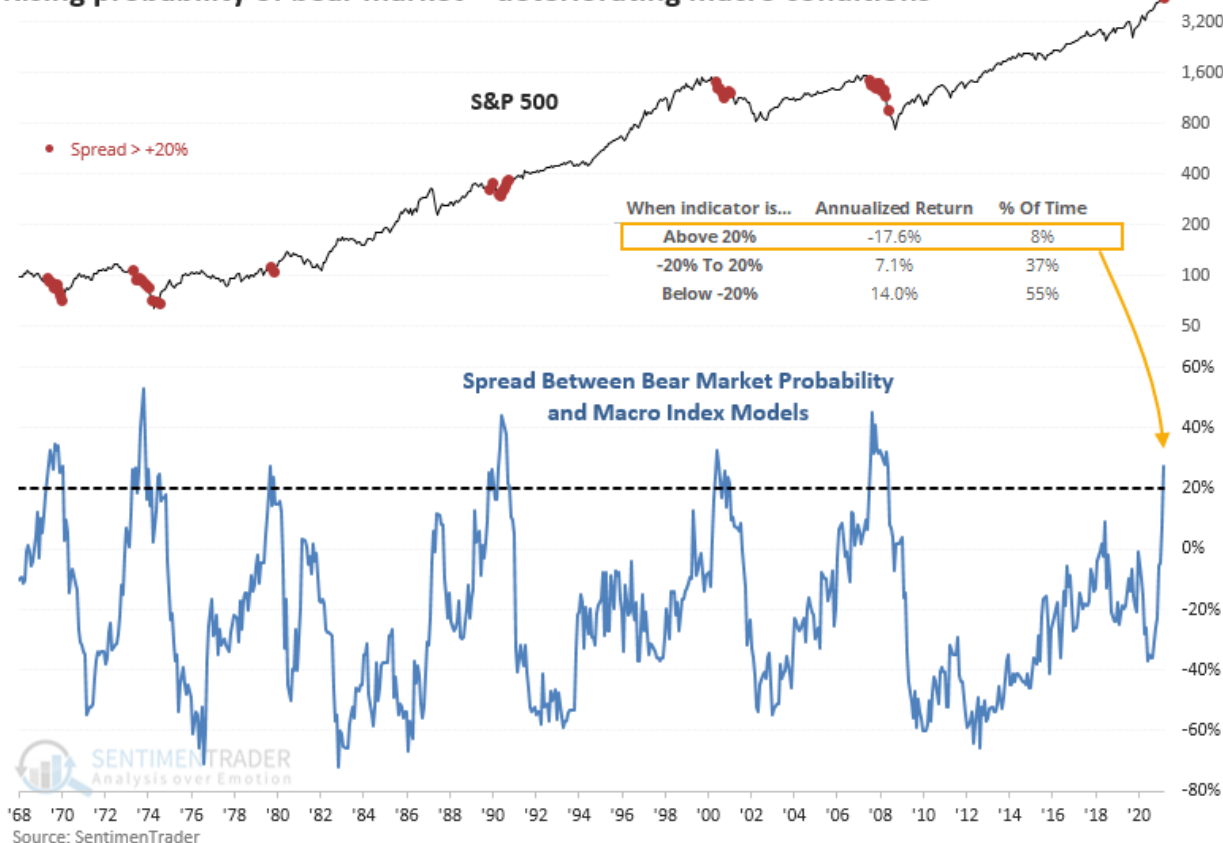
Maybe Rosengren and Kaplan know more than we think?

A Bear Market Signal?

Of course, the market and macro-economic data are confirming the need to be more cautious with equity risk.

*"The chart below shows the spread between the Bear Market Probability and Macro Index models. The higher the spread, the higher the probability of a bear market. **The chart shows that the S&P 500's annualized return is a horrid -17.6% when the spread is above 20% like it is now.**" - Sentiment Trader*

Rising probability of bear market + deteriorating macro conditions



Another Strong Auction

On the heels of yesterdays' strong 10-yr auction, 30yr bonds were very well bid. (**Another risk-off warning sign?**) The 1.91% yield on the bonds is nearly 2bps below where it was trading before the auction and the lowest auction yield in nine months. 30-year bond yields are down 10bps since peaking at 2% on Tuesday. Per Zero Hedge: *"Dealers were left holding on to 13.1% of the auction, the lowest Dealer takedown on record!"* Given there is little need for dealers to distribute what they own, selling pressure may be minimal in the days ahead. The bond is trading about 3bps lower in yield post-auction.

Fed's Beige Book- Labor Shortages

The [Fed's Beige Book](#) is a summary of economic conditions in the 12 Federal Reserve Districts. Before delving into each district's report, the document starts with a one-paragraph highlight from each district. As shown below, all of the summaries include a statement on labor shortages and or wage pressures. The topic is clearly top of mind at the Fed, as it should be. If there are widespread

job shortages and strong pressure to hire, as seen in the record number of job openings, wages may continue to rise and foster more inflation. Is it any wonder many Fed members are increasingly growing concerned with inflation?

Boston: "inability to get supplies and to hire workers."

New York: "businesses reporting widespread labor shortages."

Philadelphia: "while labor shortages and supply chain disruptions continued apace."

Cleveland: "Staff levels increased modestly amid intense labor shortages."

Richmond: "many firms faced shortages and higher costs for both labor and non-labor inputs."

Atlanta: "wage pressures became more widespread."

Chicago: "Wages and prices increased strongly while financial conditions slightly improved"

St. Louis: "Contacts continued to report that labor and material shortages."

Minneapolis: "hiring demand continued to outstrip labor response by a wide margin."

Kansas City: "Wages grew at a robust pace, but labor shortages persist."

Dallas: "Wage and price growth remained elevated amid widespread labor and supply chain shortages."

San Francisco: "Hiring activity intensified further, as did upward pressures on wages and inflation."

[How To Prepare For A Market Correction](#)

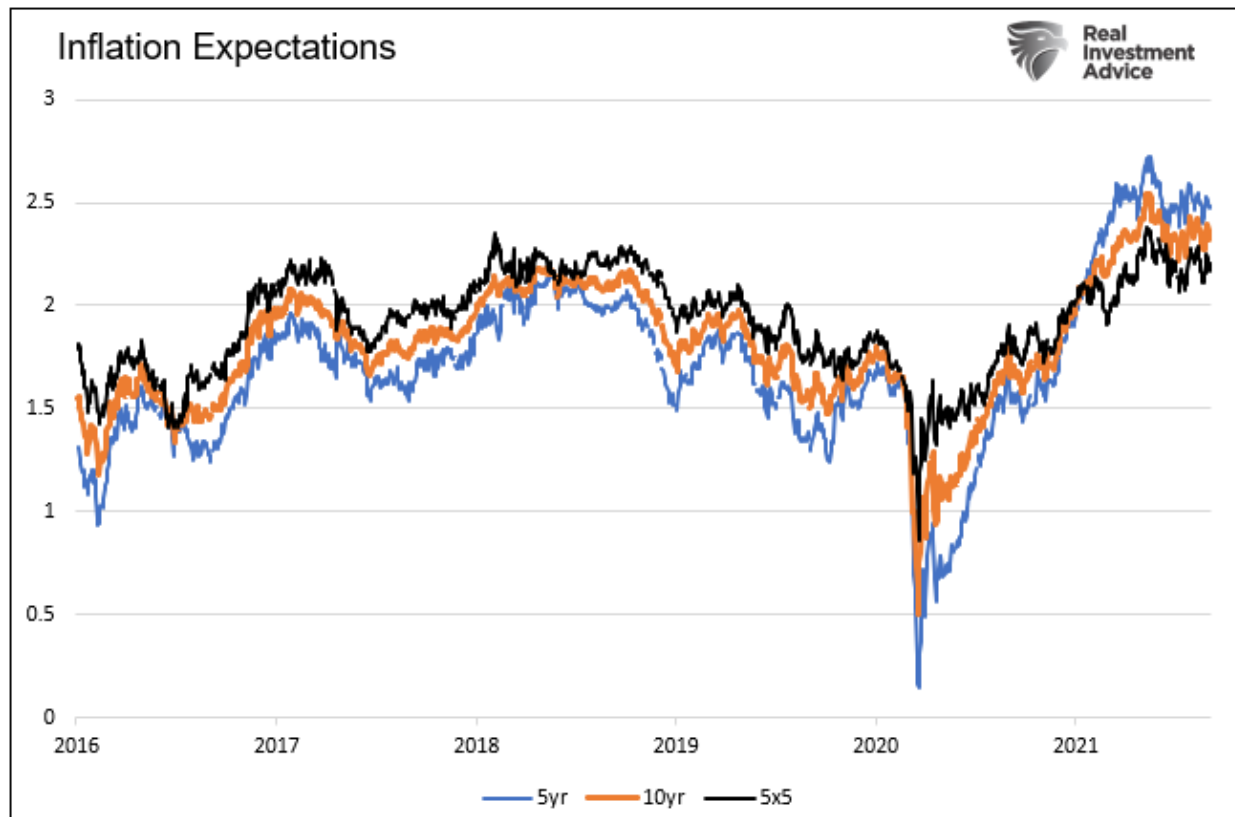


Jobless Claims Continue to Fall

[Initial jobless claims](#) fell to 310,000, a decline of 35,000 from last week. This is the lowest level for initial claims since March 14, 2020, when it was 256,000. In 2018 and 2019 jobless claims were steady in the low 200,000's.

Inflation Expectations

The graph below shows inflation expectations have stabilized after rising sharply in 2020. Expectations are probably more important than actual inflation figures like PCE, CPI, and PPI as the Fed tends to believe inflation follows expectations. Given the unprecedented supply line pressures along with pent-up demand, and massive fiscal stimulus, the Fed's reliance on the markets might be a trap this time.



The equity markets are affirming stable inflation expectations. Cyclical sectors, that traditionally benefit from higher prices and strong economic growth, are lagging while more conservative, less economically sensitive sectors are leading the way. The sector performance map below points shows where money is flowing to and from. It appears investors are seeking shelter in more conservative, lower beta sectors like utilities, healthcare, and REITs. Large-cap technology and communication, like Apple, Microsoft, Facebook, and Google, have also done well as their earnings are thought to be minimally affected by slowing economic growth. The cyclical sectors like energy, materials and industrials are lagging as growth prospects decline.

