A Market Note: A Summer Rug Pull…

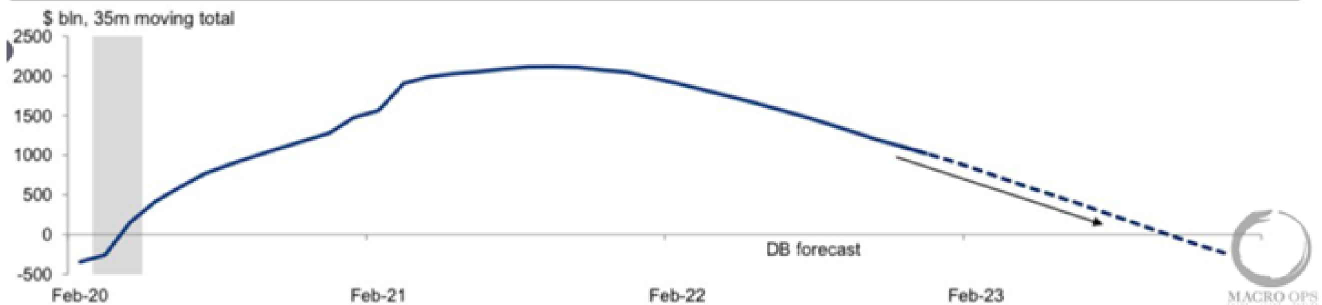
(1) The debt ceiling is expected to be reached by the end of June. Assuming Congress doesn't pull a Thich Quang Duc and they raise the ceiling, Yellen will need to begin refilling the Treasury's General Account (TGA) come July.

The TGA is the Treasury's checking account of sorts. And the Treasury has been running down its cash balance. This has provided ample liquidity to the market and economy, more than offsetting the negative impact of QT. The rebuilding of the TGA will have an equal but opposite impact (negative) on liquidity come Summer.

(2) The stimulus-born excess US savings have provided an additional demand boost of $1trn annualized in consumer spending, which is roughly 4% of GDP, not accounting for multiplier effects.

These excess savings are expected to be completely exhausted by September.

Excess US savings have and will continue to help the US economy. However, by Q3/Q4 '23 DB's Matt Luzzetti expects them to be fully eroded…



(3) The recent banking shock is driving a tightening of lending standards, as seen in the latest [SLO survey](). This is being exacerbated by the flight of capital from bank deposits into money market funds. Small regional banks are the engine of credit creation in the economy. A wrench has been thrown into this engine.

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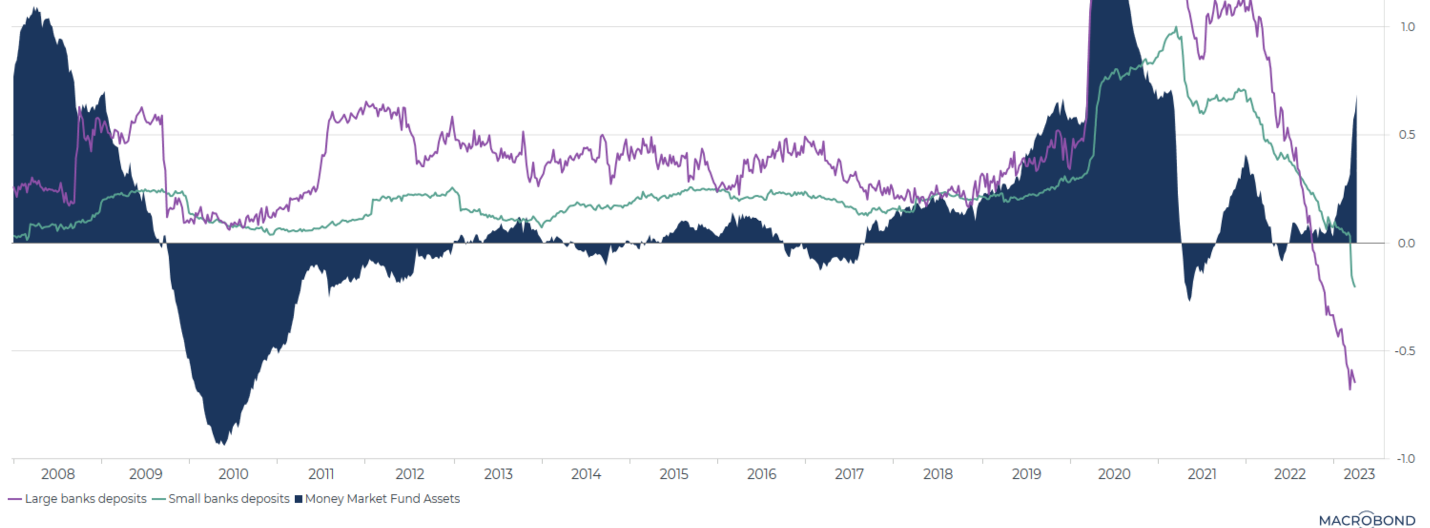


Tightening lending standards will lead to widening credit spreads, which will lead to less risk-taking/lending, which will lead to falling demand growth, and thus tighter financial conditions. This positive feedback loop of negative consequences will begin to materially accelerate by mid-summer.

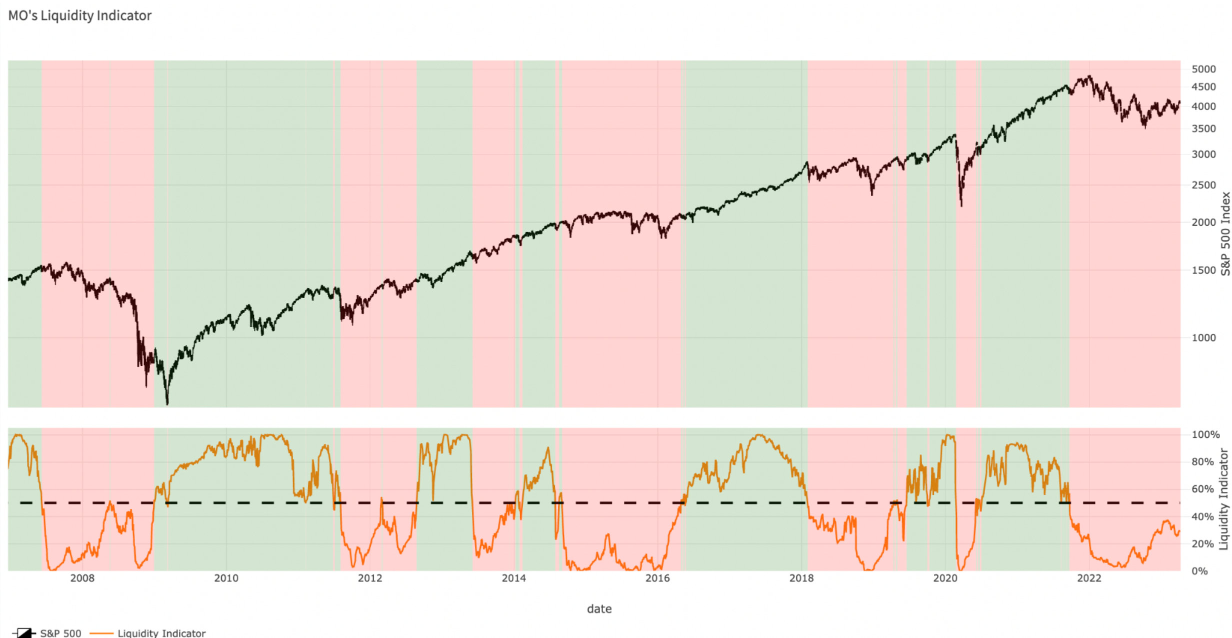
The below table is from Piper Sandler by way of [Knowlege Capital](). Piper performed an analysis comparing the impact of our recent banking shock to those of the past. The results show a slow but accelerating ripple effect as the shock works its way through the system.

Consumer Loan Willingness (-10% Shock)	1	2	3	4	5	6	7	8
	We are here!		Quarters Since Shock					
Consumer Credit Y/Y%	-0.08	-0.36	-0.65	-0.91	-1.11	-1.23	-1.29	-1.30
Revolving Y/Y%	0.13	0.06	-0.08	-0.35	-0.94	-1.40	-1.83	-2.13
Nonrevolving Y/Y%	-0.08	-0.30	-0.52	-0.70	-0.84	-0.93	-0.98	-0.98
Real Consumer Spending Y/Y%	-0.07	-0.28	-0.39	-0.45	-0.40	-0.30	-0.21	-0.11
Goods Y/Y%	-0.28	-0.69	-0.84	-0.79	-0.55	-0.34	-0.18	-0.04
Services Y/Y%	0.02	-0.04	-0.11	-0.16	-0.20	-0.22	-0.22	-0.21
Labor								
Initial Claims Y/Y%	3.71	5.95	6.53	5.82	4.46	3.01	1.83	1.03
Unemployment Rate (Level)	0.12	0.24	0.34	0.39	0.40	0.37	0.33	0.27
Inflation								
Unit Labor Costs Y/Y%	-0.19	-0.27	-0.30	-0.29	-0.26	-0.22	-0.19	-0.16
Headline CPI Y/Y%	-0.12	-0.19	-0.24	-0.26	-0.27	-0.26	-0.24	-0.22
Core CPI Y/Y%	-0.03	-0.06	-0.07	-0.09	-0.10	-0.11	-0.11	-0.11
C&I Tightening (+10% Shock)								
C&I Loans Y/Y%	-0.38	-0.55	-0.93	-1.42	-1.76	-1.97	-2.05	-1.99
Real Capex Eqp Y/Y%	-0.27	-0.74	-1.27	-1.77	-2.15	-2.39	-2.46	-2.38
CRE Tightening (+10% Shock)								
Real Capex Structures Y/Y%	0.57	0.03	-0.82	-1.54	-2.01	-2.22	-2.22	-2.06

Source: Piper Sandler, 3/28/23

*Estimated from impulse responses from vector autoregressions using data starting in 1985 (or later if history is limited) to 2019.

Liquidity isn't everything but it's pretty damn close… and the fact is that an already abysmal liquidity backdrop is going to get significantly worse in just a few month's time.



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The only proper reason to be bullish right now is that too many people were too quick to turn bearish.

The last couple of years can be characterized by unusual leads and lags in the data, due to the government's historic cash giveaway along with other COVID-driven anomalies, such as the Goods to Services convergence.

The TGA drawdown and excess savings spending boost is a case in point. It's extended the typical lag between rate hikes and economic impact. Many in the market have mistaken this anomalous lag as evidence that the Fed is threading the needle into soft-landing territory. A ridiculous idea…

The labor market is the last *Slope of Hope* domino standing — for more please read the note *How To Avoid Stinky Fingers…* The temporary but significant boost to liquidity and demand, via TGA and excess cash, is what's kept the labor market resilient. Much of the recent spending has gone into more employment-intensive sectors, such as travel/hospitality and services over goods.

In effect, it's temporarily immunized the economy to higher rates as there's a greater lag between cause and effect or tightening and impact.

And while this has been good for risk assets over the near term, it means a more painful eventual correction than would otherwise have been the case. The reason is that the Fed has raised rates more aggressively (higher and faster) than would have otherwise been the case.

They overcorrected their original error of being *too* slow to tighten and have compounded it by extrapolating out a demand impulse that was predestined to sputter.

The bond market knows this which is why the yield curve (one of the most effective leading indicators of recession) is inverted across the curve and to a degree that's quite rare.

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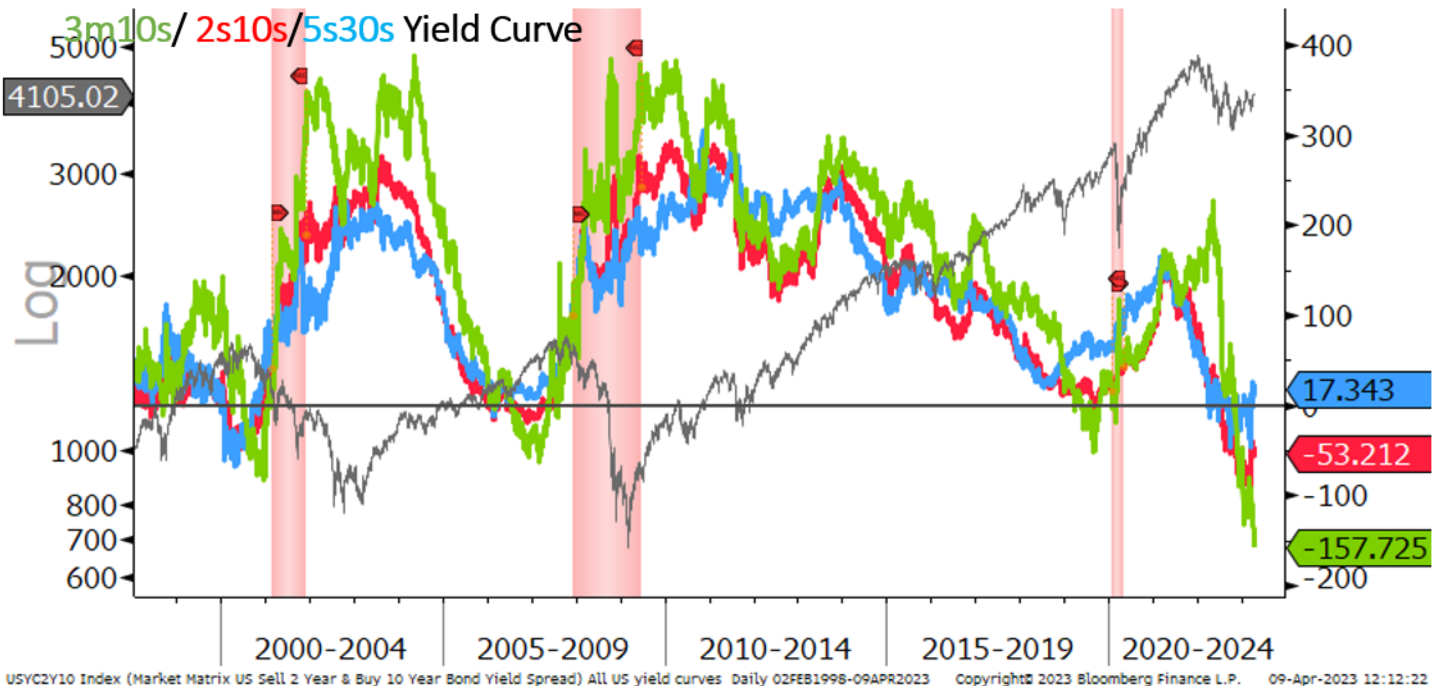

All this means that while we are tactically bullish… again, purely due to sentiment and supportive technicals… we remain clear-eyed that a major liquidity-driven rug pull is coming this summer. And try as I may, I don't see any credible scenario where the points above are somehow reversed.

Tactically Speaking…

Speaking of being tactically bullish. There are a few things to watch here as potential signals that this bear market retrace has grown long in the tooth.

Too quick to turn optimistic… when gauging sentiment it's not just the levels that we're interested in but the rate of change or the speed at which sentiment flips… ie, how fast does the market turn bearish after some weak price action and conversely how fast is it to flip optimistic on the back of some technical strength. It's all about sniffing out what the market's reaction function is… is there a dominant emotion… if so, what is it (fear, greed, apathy, euphoria, etc…)?

The best trends are the ones that are dominated by (dis)belief. The conversion of these disbelievers is the literal fuel that drives large price trends.

The more stubbornly held the consensus view. The more gas there is to go.

The quicker they are to flip, the less room there is to move.

I point this out because some of my favorite sentiment survey data points come from Sentix, which surveys over 5,000 private and institutional investors every week on a range of questions (market expectations, current risk levels, economic views, etc…).

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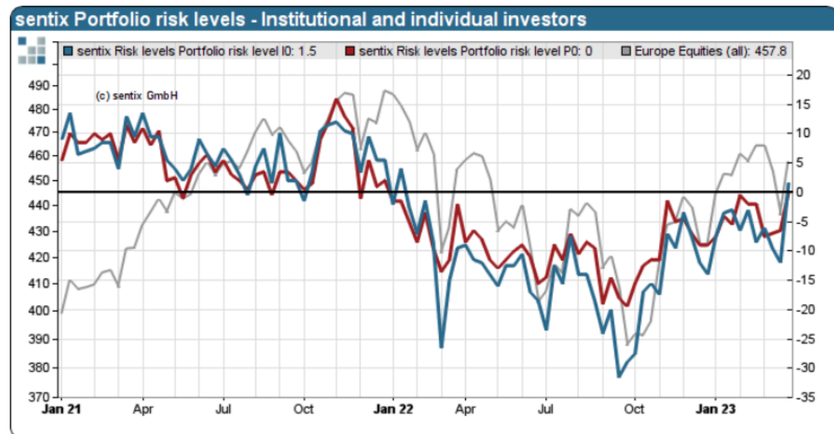
Their most recent survey shows a sizable jump in portfolio risk levels, the highest reading since February of last year. US Large Cap Sentiment also jumped to its highest point since November of 2021. Sentix calls the speed at which sentiment has flipped “extraordinary”. This is some food for thought…

Chart of the week

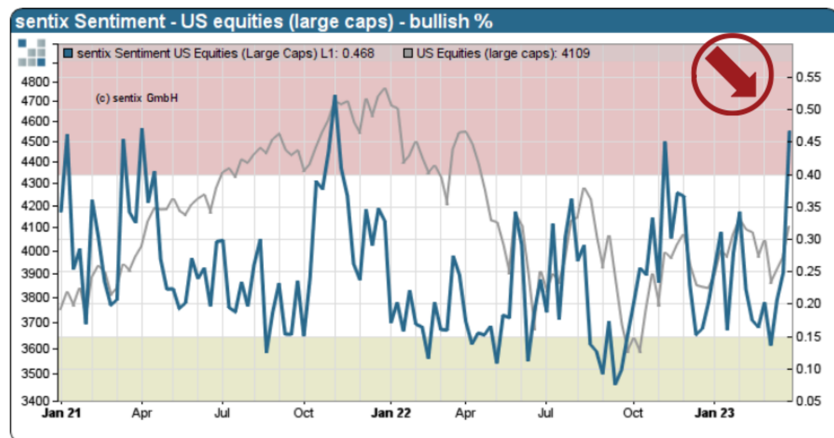
Whereas the previous week we noted an astonishing lack of emotion among investors, this week we have to report a real drumbeat in sentiment. The sentiment data are jumping sharply upwards, the bulls have fully awakened and are celebrating the markets. Short term. In the medium term, however, basic confidence is falling. A dangerous development. The data are more unfavourable for equities than they have been for a long time. Portfolios, on the other hand, have more risk than at any time in months.



sentix Portfolio risk levels and Stoxx 600 Index

US equities (1)

The number of bulls on the US equity market has soared. At 47% bulls have reached their highest level since autumn 2021. While such a high bull rate is not necessarily an immediate sign of falling prices, especially if medium-term expectations also improve, the extent of the increase in the bull rate within a week is extraordinary. The ratio has increased by a full 22 percentage points.



A Growing Divide…

Another interesting point that’s worthy of our attention, is the growing contrast in technicals between large and small caps.

The major indices are increasingly driven by what’s being popularly called “The Safety Trade”, which is narrative speak for a bunch of brainless lemmings piling into a small handful of mega-cap stocks, because *shrug emoji*. This has pushed index concentration to even more insane levels. A topic we explored in *A Mutant Selling Deformity…*

This could change but small (chart on left) and micro-cap indices are on the ropes and close to

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breaking through a significant level. If this occurs, it'll be a strong indication to begin lightening up on risk and upping short exposure once again.

Conversely, the action in the SPX is constructive. The chart looks like it'll break up and out from its 12-month consolidation zone (both charts are weekly).

SPX versus RTY

This trade has momentum behind it and looks like it'll continue to work in the near term. Eventually, and likely soon (next 1-2 months) this thing will burn out in what will likely mark the final major bull thrust in this cycle for the mega caps.

We're currently short TSLA and NVDA. There's decent odds we get stopped out of these positions but we have growing conviction on the eventual turn of this trend so we don't mind taking multiple swings at plunging to the short side here.

My precious…

Precious metals continue to be our favorite trade looking out over the next two years (here's our framework for analyzing PMs). This is an instance of a clear win-win where PMs will continue to perform no matter what the Game Masters do. If they ease, inflation becomes more entrenched, and gold and silver rip. If they continue to stay tight, risk assets drop and PMs catch the safety bid.

Technically speaking it's quite safe to say that the November bottom will mark the low of this congestion zone — something we pointed out as it happened in *A Golden Trap...*

Gold is a hair's breadth from taking out its August 20' high. Yes, it's overextended over the short term. But sentiment and positioning remain very constructive and there's plenty of pent-up energy from its 2yr+ trading range for PMs to rocket here.

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We're long silver as well as some DOTMs on miners. We'll be aggressively adding to our positioning on this thematic over the coming months when given the technical entry points to do so.

We'll be out with more during the week. Here's Brandon with some comments on PLL and VIST.

Your Macro Operator,

Alex

PIR (04.08.2023): PLL Short Report & Vista Energy (VIST) Update

Recent Trade Alerts

Trade	Ticker	Description	P/L (bps)	Date	Sector	Notes
Cut Full	ZLK2023	SOYBEAN OIL	-14	04-03-2023	FUTURES	HIT RISK POINT
Short Full	NVDA	Nvidia, Inc.	N/A	04-05-2023	TECH	TRIFECTA SHORT

YTD Monthly Gain/Loss

Portfolio Allocation

Before we dive into VIST, I want to discuss Blue Orca's latest short report on Piedmont Lithium (PLL). I hate sounding like the "BuT aCtUaLlY" guy. But still, the report demands an explanation as it's riddled with inaccuracies and strawmen.

Blue Orca's short report hinged on four central claims:

1) PLL used corruption to obtain mining licenses for American Lithium (ALL)
2) ALL's mining licenses will not be ratified due to corruption

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3) PLL's Tennessee facility will die without access to spodumene concentrate (SC6)
4) PLL's DOE grant in jeopardy for its Tennessee facility

Let's address each claim.

PLL Used Corruption To Obtain Mining Licenses for ALL

There are two ways to consider this claim. First, it wouldn't surprise me if most (maybe all) mining businesses in African nations involved some kickback to local government/related parties.

It happens here in the States, except we call it "lobbying."

However, Ghana's Sovereign Mineral Wealth Fund refuted Blue Orca's claims (see below):

Also, the license Blue Orca discusses isn't even a new mining license. It's an exploratory permit for land adjacent to their existing mining license.

In fact, ALL doesn't have a mining license yet. They have "reconaissance and exploration" licenses. The claim that ALL bought mining licenses via corruption are false.

This first claim is substantial because it acts as a domino that defeats the rest of Blue Orca's argument.

ALL Mining Licenses Will Not Be Ratified Due To Corruption

As mentioned above, ALL does not have a mining license, only exploration licenses. You cannot revoke licenses that don't exist.

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Additionally, Ghana has no incentive to revoke lithium mining licenses. The country receives a certain percentage of mining revenue via offtake agreements and royalty fees. Why would they revoke a potential revenue-generating license? Especially from a company that has six other exploration license approvals.

Blue Orca's first two arguments hinge on non-existent "corrupted" mining licenses. However, let's assume that Blue Orca is correct that there is corruption in buying licenses.

Using the "corruption card" as the main driver for a Ghanaian mining play is level zero analysis. Even if ALL obtained its licenses by paying a few extra million in royalties throughout a mining project, that's not worth a short report.

If anything, it's another COGS line on every mining company's income statement.

Then there are the final two claims.

PLL's Tennessee Facility/DOE Grant In Jeopardy Without Ghana

Blue Orca argues that "without Ghana, PLL's planned Tennessee facility is dead-on-arrival."

And that "without Ghana, PLL's $142M conditional DOE grant for the Tennessee plant is in peril."

No spodumene, no project. No project, no grant money.

Blue Orca claims that "Ghana is the lynchpin in PLL's valuation. Without it, PLL cannot produce lithium hydroxide for EVs in the near term, fulfill its vision of becoming a fully integrated producer, nor justify its $1.1B valuation."

However, Blue Orca completely missed PLL's investment in North American Lithium (NAL) via its JV with Sayona Mining (SYA.ASX).

This week, NAL announced that it successfully produced 70 tons of SC6 from its Sayona Quebec, mining operation. PLL expects the first shipment of saleable product by Q3 2023.

PLL has an offtake agreement with NAL to take the greater of 113K metric tons/year or 50% of the JV's production. As mentioned in the write-up, PLL has a price ceiling of $900/ton for SC6.

The company also has agreements with LG Chem and Tesla (TSLA) to provide SC6 starting in H2 2023.

Currently, SC6 trades at ~$8,000/t on the spot market. Even if we assume a 60% haircut in SC6 pricing, PLL will generate over ~$260M+ in annual profits from its NAL offtake agreement. **Anything closer to SC6 spot prices and PLL generates its entire market cap in FCF within two years.**

We estimated that Ghana's mine adds ~$1B in NAV to PLL. **Write down Ghana to $0. We still get NAV estimates between $5B - $13B (depending on the underlying commodity sales price).**

In other words, Ghana is *not* the lynchpin in PLL's valuation.

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Here's what matters for our PLL bull thesis:

- ➢ SC6 and Lithium Hydroxide spot prices
- ➢ Supply constraints and production
- ➢ EV/Electrification demand/transition
- ➢ Successful offtake agreement and SC6 sales from NAL

We will track these drivers and change our minds if any of the above refute our original thesis. However, Ghanaian "corruption" of mining licenses that don't yet exist is not a central driver to our bull thesis.

They are distractions meant to drive the price lower to fit a narrative for a short-biased research firm that has repeatedly attacked the Lithium mining space.

Lithium's supply/demand imbalance and the rising shift to electrification via EVs and ESG mandates dwarf the importance of any of Blue Orca's strawman arguments.

Now let's discuss VIST.

Vista Energy (VIST): Revisiting Our Most Profitable Investment

Vista Energy (VIST) is a Mexican-based oil and gas E&P operating in Argentina. The company has nearly all its assets in the Vaca Muerta shale basin in Southwest Argentina.

VIST has been one of our biggest winners in the MO Portfolio over the last 18 months. We bought our first stake in January 2022 at ~$5.77/share. The stock is up over 200% since our first entry (chart below is a weekly).

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We've profited by trading around a core position and currently hold a 7% notional position.

VIST was a $500M market cap company when we first bought shares.

Today, the company generates over $500M in pre-tax profits, has one of the most robust balance sheets in the industry, operates at low costs (<$35/boe), and is well-positioned to grow oil production to 60,000+ boe/d.

There are three main reasons why the opportunity exists:

- **Consensus believes a recession will destroy demand, yet ignores supply-side constraints.**
- **VIST is a Mexican-based company that operates in Argentina, which confuses investors.**
- **The stock has gained 200%+ over the past year, leaving investors thinking, "we missed the boat."**

It's normal to wonder how much "juice" is left in a stock that's risen 200%+ in the last 18 months. Let's examine the VIST bull case through our **Trifecta Lens Criteria.**

Fundamentals: VIST Trades at <2x 2024 Profits w/ Modest Oil Price Assumptions

VIST, like most E&Ps, has a simple profit algorithm with a few key variables:

- **Average price of oil**
- **Average operating cost per barrel of oil**
- **How many barrels VIST produces per day/year**

By 2024, VIST will produce **>50,000 boe/d** at the cost of **~$30 per barrel**. The company's current opex/barrel of oil is around $35. Still, recent lifting costs and development price reductions should help VIST reach $30 by 2024. Also, 50,000 boe/d is within VIST's current plans to reach 80,000 boe/d by 2026.

The next variable is average oil prices. We believe we're in the early stages of a decade-long energy bull cycle. A cycle that could see $100-$200+ oil. We're assuming that by next year average oil prices will hover around **$75/barrel**.

With our assumptions in place, we can construct our profit algorithm:

- **Oil Price:** $75
- **Operating Cost:** $30
- **Daily Production:** 50,000 boe/d (18.25M/year)

That gets us $820M+ in pre-tax profits or <2x VIST's current market cap. Remember, that's at $75 oil. If we avoid a recession and are directionally correct on our energy super-cycle bet, we could see $80-$90 oil by 2024.

Under that scenario, **VIST would generate over $1B in operating profits in 2024 alone.**

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We also have significant downside protection on a P1 (proven reserve) NPV basis. P1 reserves estimate recoverable volume with a **probability of recovery greater than 90%** under present technical & economic conditions.

VIST's P1 reserve NPV is over $3B, nearly 200% higher than the current market cap.

So you're buying an asset trading at a 50%+ discount to its P1 reserve NPV that will generate half its current market cap in pre-tax profits next year.

VIST will be a $40-$50 stock over the next 18 months as it generates over $1.3B in cumulative profits, reduces debt, buy back stock, and closes its P1 reserve NPV discount.

Macro/Sentiment: Pro-Oil Argentinian Government Bolsters VIST's Efforts

Argentina is the opposite of the US regarding supporting the oil and gas industry. Where US officials find ways to restrict investment and destroy profits, Argentina's government encourages investment and exploration and reduces costs via lower oil export tariffs (8% per year).

A pro-oil government will help VIST reach its target of 80,000 boe/d production in the Vaca Muerta basin while maintaining low-cost operator status of ~$30/boe.

These conditions allow VIST to remain highly profitable even at $50 oil, providing further downside protection should oil prices trade lower on recession fears.

This brings us to the final Trifecta Lens criteria, **Technicals.**

Technicals: Strong Relative Strength, But Chart Creates FOAMM

One of the most common pitfalls in investing is, "I can't buy it because it's gone up so much already" thinking. I call this Fear of Already Missing the Move (FOAMM).

Value investors are the worst culprits because buying at higher prices increases cost basis, akin to blasphemy.

VIST's past success is actually one of the reasons why the opportunity exists today. Value investors will avoid a chart like VIST, despite the fundamental dislocation. Who will risk buying something *this* overextended?

The beauty of Macro Ops is that we adopt successful strategies across many investing domains. Relative strength is one of the most vital leading indicators of future success.

So what's our game plan? We'll wait for **weekly reversals to the mid-line or 50MA**.

And since we already have a 7% notional position, we're OK to sit on our hands until then.

Your Value Operator,

Brandon

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