The Stock Market Strategist

6.23.24

Summary:

This week, we explore some of the latest executive commentary on commercial real estate (CRE) which isn't quite as bad as the media might have us believe.

As it relates to stocks, I keep thinking of Old Turkey's comment in Reminiscences of a Stock Operator:

"It's a bull market you know" – Old Turkey

Executive Quotes

*TransUnion (TRU): …**the volume of activity in the space of advertising and marketing campaigns in general has been diminishing.** In fact, recently, Gartner released its annual survey of CMO sentiment. They talked to 400 different marketing officers, chief marketing officers for U.S. businesses. And over the past couple of years, their spending as a percent of revenue has gone from 11%-plus to 7.7%.*

*Thermon Group Holdings, Inc. (THR): …we are well positioned to capture the enormous opportunity tied to the energy transition and decarbonization while also benefiting from **secular growth trends in chemicals, power, onshoring and various forms of government stimulus.***

*Aon plc. (AON): …**there are many factors that go into why an insurance company might be raising rates right now.** And certainly, the increasing losses that they've experienced changes in the reinsurance market in terms of pricing and retention levels and then changes in the exposures that exist in high-risk areas that are seeing losses now and the vulnerability of those exposures all drive into those increased losses.*

*Ivanhoe Mines Ltd. (TSX: IVN): …**we have underestimated the supply of copper that the world will need just to maintain current growth profiles. So we have a date with disaster.** And net-zero is pulling the plug on America's electrical life-support system.*

*MSA Safety Incorporated (MSA): …**secular trends like the green energy transition,** as well as a shift to connected solutions, our detection portfolio is poised for continued growth and profitability.*

Exploration: Commercial Real Estate

There is a lot of negative commentary floating around as it relates to commercial real estate (CRE). Probably my favorite source for the latest and worst on CRE is TripleNetInvestor. Those of us who lived through 2008 (and/or studied history and credit crises) know that credit events can make the wheels fall off of markets. As such, I decided to explore some of the latest executive commentary on CRE this week. While 2008 taught us that crises can start small and gradual spread to infect everything, executive thoughts on CRE paint a slightly better picture compared to often daunting media coverage of late. Without further ado…

Blackstone Inc. (BX): So ***the first thing to understand about commercial real estate is there are like lots of different subcategories of real estate****, and they're all not correlated the way some of the media would have you believe. So on the unhappiness scale,* ***when they say commercial real estate has really got a problem, that's true in office. And in office, you don't have that problem with office buildings that are 10 years old or less****. You could see that on the west side here. Everything is sold out in Hudson Yards, high rates. It's the rest of office. So if you look at the rest of the office stock in the United States, it's roughly around 27% vacant. So office buildings can't really survive economically being 27% vacant. So* ***you're going to have very large losses in the equity for the office market.*** *There are a lot of investors who own office. Blackstone, in 2007, when we went public with Morgan Stanley as our lead, we owned -- 70% of our assets were office. When we went into the pandemic, we only had 2%. So basically, Blackstone pivoted and sold their office and bought warehouses. So* ***warehouses, one of the best categories of real estate****, our portfolio there is still going up, [rent] 6%. And so if you own a lot of warehouses, you're a happy investor. You read the headlines and you say, what are they talking about? It's the same thing with* ***student housing. It's in real shortage. Those are vibrant markets****. Even the affordable housing market has held up much better and has increases in rent. So that can't be what the world is unhappy about.* ***Retail has not worked.*** *At Blackstone, we don't own retail. So when we look at commercial real estate, we're actually quite happy. People not as happy as we were. But in terms of the world of problems and headlines, that's completely overblown. So* ***the other good thing that's happening in real estate is people have stopped building.*** *So almost every asset class is down somewhere between 40% new construction and 70%. So real estate is a simple business. It's just about supply and demand. And if you stop building and the economy keeps growing out a few years, which will get real shortages, and you'll have rents really pop and you'll make a tremendous amount of money. So I've only been in this movie numerous times. And so what also continues is the people who write articles about this, because they keep seeing these office problems, keep saying that real estate is an awful thing. And that continues on because you'll have problems with the debt in real estate for years to come, so you'll be manufacturing bad headlines. And in the meanwhile,* ***to the extent that people have a generalized feeling that real estate isn't so wonderful, it provides amazing opportunities*** *for us because we're the best-capitalized real estate buyer in the world. We have more money, and we're not shy to use it. When prices get beat down and the world asks the same question like, "Oh, my goodness.*

You're in real estate. Must be terrible." And we look at it now and say, "Well, geez, this is like bottom land." And ***we've been buying pretty aggressively now, particularly, oddly, in Europe.*** *And what happened in Europe, this is why finance is so much fun, that if you built a real estate empire and use debt in Europe when interest rates were negative, you were basically paying nothing to borrow. And so now you're paying roughly 6%. So when you get to refinancing time, people look at your coverages and say, "You've got to pay down debt for me to refinance you." And so what happens, there's almost nobody who's a buyer except us. And so we get phone calls from people in this position who say, "Would you like to buy this package of stuff?" And we usually say, "No. We only want to buy some of the things. We want your warehouses. We want your student housing. We want -- here's what we want. And we'll take as much of it as you want to give us at our price." And so what's happening is they go back into the cupboard, and they come out with like all kinds of wonderful stuff in effect at our price. So why wouldn't you buy this stuff? It's not troubled. What's troubled is the wrapper of the whole company, not the individual pieces of real estate. So half of what we're buying in real estate right now is in Europe. And what happens is these sort of discontinuities start happening all over the place. We've already done a number of big deals this year, and we'll be net buyers for some time. So* ***our attitude towards real estate is quite positive.*** *And can you imagine being down 60%, 70% in construction in good areas? I mean this is how you really make money in real estate.*

The PNC Financial Services Group, Inc. (PNC): Well, when you talk about commercial real estate, everybody quickly goes to the office component, which we should talk about a little bit. But outside of the office, multifamily, there's some stress around the higher rate environment, but we're fine there from a credit perspective. There's some geographic hotspots, but we feel good about that book. And we could conceivably see that grow. Hotels are doing well, as you know. ***So outside of office, CRE is fine.*** *Office is where the pressure is. And inside of that, and we've talked about this, and this hasn't changed. It's the multi-tenant office piece for us, where we see the most pressure and where we're seeing the losses that have occurred and where we expect charge-offs to continue. It's just under a $5 billion exposure. So not large in terms of percentages.*

Wells Fargo & Company (WFC): Where ***the issues are really institutional office space.*** *And it's a wide range of outcomes now. Some office buildings are doing really well. You go to Hudson Yards in New York City, they're doing really well. You go to Times Square in New York City, not doing as well, right? And so* ***older office buildings that are not renovated in certain areas of different cities are the places that you're seeing the most stress.*** *And we've had some charge-off. We have an 11% coverage ratio against that part of the portfolio. So we feel like we're appropriately reserved for a range of outcomes there.*

There isn't a direct way to invest in this except perhaps a Blackstone fund, but I believe the above is worth considering as, for now, the CRE trouble is contained, and the fear mongering media should be tempered with the executive comments above.

Listen to the Markets

A lot of people are comparing the current era to the late 1990s tech boom. A lot of people "know" that this ends badly. They point out the similarities to NVDA today and stocks like CSCO from 25 years ago. They point to weak breadth, the disconnect between various US stock indexes (QQQ and SPY vs IWM and DIA), weakness in various international stock indexes, and more. Yet, despite all of this, the S&P 500 (SPY) and the Nasdaq (QQQ) just keep on going.

While I admittedly think things are getting frothy, I know that any market can do anything. And while I imagine a big pullback is coming in stocks, I also know the "secret" is to follow price trends as stocks could rage much higher before coming down.

That said, one thing I do notice is the rotations beneath the surface. A certain industry or sector will shoot up only to roll over, but the aggregate stock indexes are not impacted as another sector takes its place. I think of it kind of like a team of horses pulling a buggy – the distribution of labor among the horses isn't always even but, in aggregate, the buggy keeps moving as various horses (sectors) take turns being the strongest.

In terms of how this relates to trading, as I've been writing for some time now, the easy money is being made following long-term trends in the stock indexes not trading often volatile/reversal prone single stocks. As such, I continue to focus on the tactical models.

Outside of stocks, I don't see much that is noteworthy in other "macro" markets.

Summarizing, while I'm fairly confident a pullback is coming, in line with my interpretation of what the market is telling me to do, I'm riding the trend higher in the indexes and trying not to overthink it.

Indicators

Trend: The long-term trend in stocks is up.

Volatility: Volatility remains conducive to owning stocks.

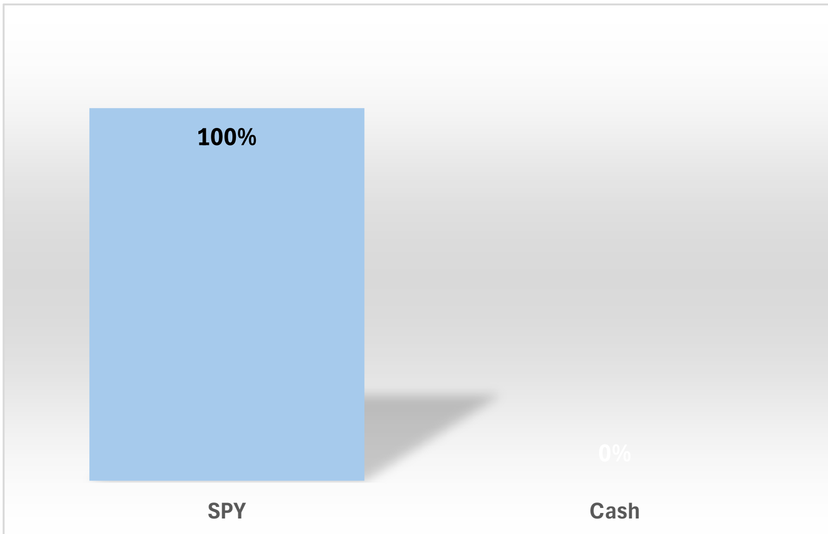
Rates: Short-term rates are around 5% which isn't bad but the relentless move higher in stocks is making 5% look pretty meh.

The Fed: The Fed is on hold pending incoming data on the economy and inflation but continues to view fighting inflation as the priority which, all else equal, isn't ideal for stocks – but the stock market doesn't seem to care!

Internals: No profound takeaways from looking at the inside of the stock market this week.

Tactical Stock Market Model

The tactical stock market model (details below) is currently 100% allocated to SPY.



The tactical stock market model represents a simplified version of Triangulated Capital Management's Tradexing approach which seeks to balance capital preservation with capturing long-term trends. The model tactically allocates between cash (money market funds) and stocks (SPY ETF). Please reach out if you are interested in money management services: info@tricapm.com

Stock Selections

The model portfolio was stopped out of Howmet Aerospace (HWM) locking in a loss of around -6.4%. While being stopped out is never fun, it pays to keep in mind small losses are the "secret" to legendary trading success if there is a secret. For more on this, read my free publication on Trader Principles: traderprinciples.com

This week, subject to entry rules below, the plan is to add one new name to the model portfolio: SPDR S&P 500 ETF Trust (SPY)

The rationale for adding SPY to the model is largely outlined in the LTTM section above. Subject to entry rules below, the initial stop loss point will be approximately $525.

Entries are subject to price action. If prices gap up or down by more than +/- 3%, trades will not be entered for model portfolio purposes per the logic that one should not chase stocks and should not catch falling knives. Subject to this +/- 3% rule, for tracking purposes, entry will be assumed on the open the day after publication of this letter.

Stops reference closing prices not intraday prices. The stock/ETF has to close below the stop price to be stopped out (aka intraday moves below the stop will not trigger a model portfolio exit). When a stock is stopped out, the exit will be assumed on the following open.

Trading Model Portfolio Positions

Company	Ticker	EntryDate	EntryPrice	CurrentPrice	StopLoss	%Profit
Micron Technology	MU	5/30/2024	$ 130.30	$ 153.45	$ 140.00	17.77%
Alphabet Cl C	GOOG	6/6/2024	$ 177.43	$ 176.45	$ 170.00	-0.55%
Boston Scientific	BSX	6/13/2024	$ 77.11	$ 76.31	$ 74.00	-1.04%
Logitech	LOGI	6/13/2024	$ 101.52	$ 99.05	$ 95.00	-2.43%

Sign up for The Stock Market Strategist here: mktstrat.substack.com
Learn more about trading principles: traderprinciples.com
Triangulated Research Legal: triinv.com/legal-1