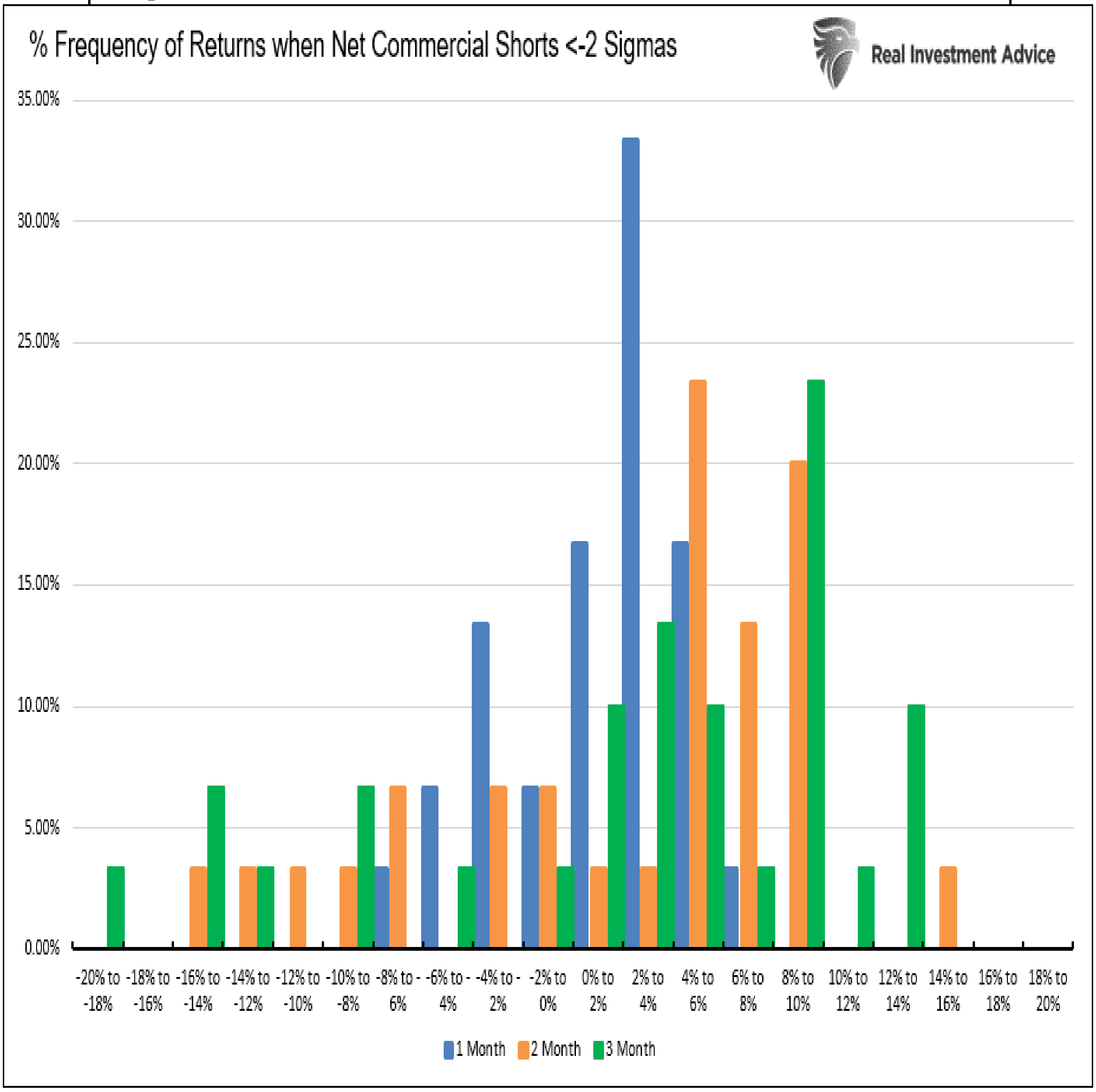
Hedge Fund Shorts Are Extreme

At the bottom of this Commentary, we share a popular Tweet warning that Hedge Funds collectively have their largest net short position in S&P 500 mini futures contracts in over ten years. The broad takeaway from most analysts is bullish. They presume hedge funds and CTAs (non-commercial traders) will cover their positions resulting in a short squeeze higher. While there is logic to their forecast, they fail to consider that banks and brokers are, by default, carrying equally aggressive long positions. The question, therefore, will hedge funds blink before Wall Street?

To contextualize how similar situations worked out in the past, we present the table and graph below. Over the last 20 years, there have been 30 instances when hedge fund net short positions were at least two standard deviations (sigmas) or more below average. We measured returns over one, two, and three-month periods following the short position. As we show, odds favor the market will increase over the coming months but only by two percent. Such a return is on par with the average return over the period. However, the minimum and maximum returns over the same time frames can be extreme.

	1 Month Returns %	2 Month Returns %	3 Month Returns %
Average	1.13%	2.27%	2.14%
Median	2.29%	4.91%	3.98%
Max	6.58%	14.49%	13.68%
Min	-6.03%	-14.12%	-19.11%
% Positive	70.00%	66.67%	73.33%
% Negative	30.00%	33.33%	26.67%



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What To Watch Today

Economy

Time	Event	Impact	Actual	Dev	Consensus	Previous
	WEDNESDAY, APRIL 12					
00:00	USD IMF Meeting		-	-	-	-
11:00	USD MBA Mortgage Applications(Apr 7)		-	-	-	-4.1%
12:30	USD Consumer Price Index (MoM)(Mar)		-	-	0.3%	0.4%
12:30	USD Consumer Price Index (YoY)(Mar)		-	-	5.2%	6%
12:30	USD Consumer Price Index Core s.a(Mar)		-	-	-	304.07
12:30	USD Consumer Price Index ex Food & Energy (MoM)(Mar)		-	-	0.4%	0.5%
12:30	USD Consumer Price Index ex Food & Energy (YoY)(Mar)		-	-	5.6%	5.5%
12:30	USD Consumer Price Index n.s.a (MoM)(Mar)		-	-	302.254	300.84
14:30	USD EIA Crude Oil Stocks Change(Apr 7)		-	-	-1.3M	-3.739M
17:00	USD 10-Year Note Auction		-	-	-	3.985%
18:00	USD FOMC Minutes				REPORT	
18:00	USD Monthly Budget Statement(Mar)		-	-	$-279.5B	$-262B

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Earnings

- *No notable earnings releases today*

Market Trading Update

Today is the big ?inflation? day with all eyes and many short positions anchored on the data. According to Goldman Sachs, there are 3-key component-level trends in the March report.

1. ***an increase in used car prices;&#2013266080;***
2. ***airfares to decline 2%;***
3. ***shelter inflation to remain elevated but decelerate on a sequential basis.***

		Feb. 2023	GS Bottom-up CPI Forecast Dec. 2023		Dec. 2024	
	Weight	YoY	YoY	Contribution to Change	YoY	Contribution to Change
Core CPI	**100.0**	**5.5**	**3.7**	-1.8	**2.7**	-2.9
Apparel	3.3	3.3	3.7	0.0	1.7	0.0
New Cars	5.4	5.8	-1.8	-0.4	-2.2	-0.4
Used Cars	3.2	-13.6	-9.2	0.1	-7.4	0.2
Medical Care Commodities	1.8	3.2	3.1	0.0	1.7	0.0
Health Insurance	0.9	-4.7	-29.8	-0.2	7.9	0.1
Medical Services ex Insurance	7.3	3.1	3.5	0.0	3.8	0.1
Pets	1.5	10.9	3.7	-0.1	2.3	-0.1
Household Furnishings + Ops.	6.6	6.1	3.6	-0.2	2.3	-0.3
Personal Care	2.8	5.9	4.5	0.0	2.9	-0.1
Rent + OER	41.4	8.2	6.1	-0.9	3.7	-1.8
Public Transportation	1.0	18.0	5.1	-0.1	3.5	-0.1
Private Transportation Services	6.3	13.5	7.3	-0.4	4.9	-0.5
Miscellaneous goods and services	18.4	6.6	5.3	-0.2	3.3	-0.6
Headline CPI	**100.0**	**6.0**	**3.9**	-2.1	**2.6**	-3.4
Core CPI	79.5	5.5	3.7	-1.4	2.7	-2.3
Food	13.5	9.5	6.0	-0.5	4.1	-0.7
Energy	7.0	5.0	3.8	-0.1	-0.8	-0.4

Source: Department of Labor, Goldman Sachs Global Investment Research

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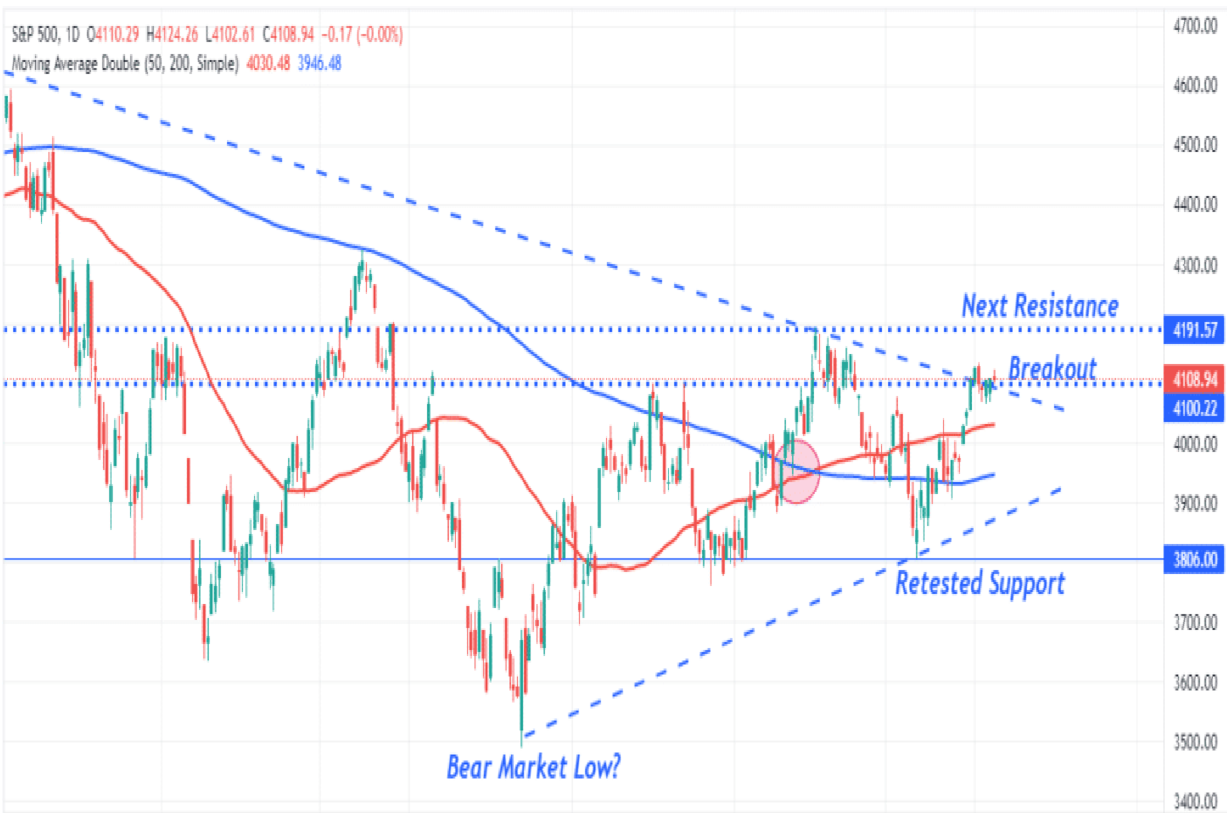
While Goldman sees Core CPI Inflation dropping to 3.7% Y/Y in December 2023 and 2.6% in December 2024, rates remain elevated, affecting the Fed?s next actions concerning monetary policy.

With the market holding near key resistance levels and buy signals in place, the bulls currently control the market narrative. However, Goldman sees four potential outcomes from this morning?s number.

- CPI **>6%: S&P sells off at least 2%** *(Fed will need to hike rates further.)*
- CPI between 5.2% ? 6%: **S&P sells off 1 ? 2%**
- CPI between 4.6% ? 5.1%: **S&P rallies 0.5 ? 1%**
- CPI **<4.6%: S&P rallies at least 2%** *(Fed will pause rate hikes)*

This will likely dictate our next allocation adjustments depending on today?s outcome.

TradingView

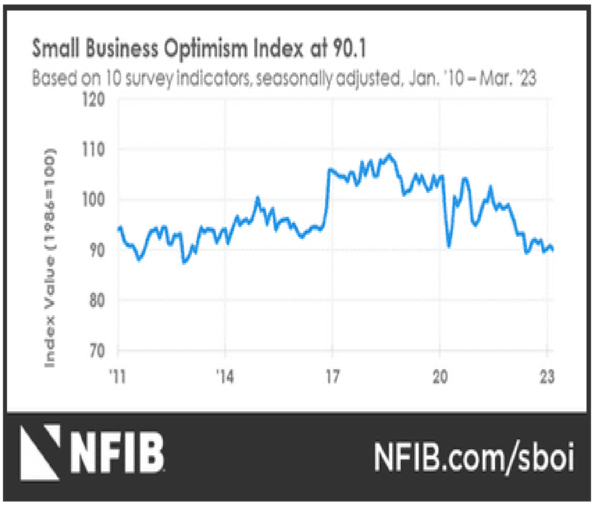


NFIB Small Business Survey

The NFIB small business survey fell to 90.1, below the fifty-year average of 98. The report leads with the following quote from its Chief Economist:

> *?Small business owners are cynical about future economic conditions,? said NFIB Chief Economist Bill Dunkelberg. ?Hiring plans fell to their lowest level since May 2020, but strong consumer spending has kept Main Street alive and supported strong labor demand.?*

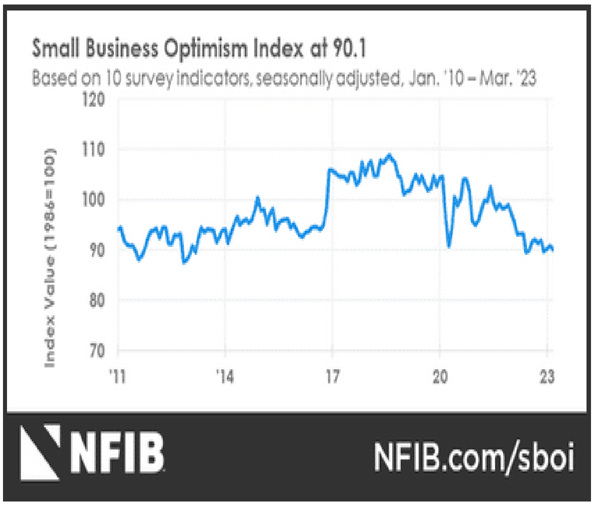
On the employment front, 15% of those surveyed plan to increase employment in the next three months. That level is now slightly below where it stood before the pandemic. Only 11% cite labor costs as their top concern. The labor shortage continues to fade, which will restrain wages and should help profit margins. The report does not mention or quantify if companies are preparing to lay off employees. The report also states that the ?immediate concern? is that banking lending standards will tighten.




Small Business Optimism

Index Component	Net %	From Last Month
Plans to Increase Employment	15%	▼ -2
Plans to Make Capital Outlays	20%	▼ -1
Plans to Increase Inventories	-4%	▲ 3
Expect Economy to Improve	-47%	▬ 0
Expect Real Sales Higher	-15%	▼ -6
Current Inventory	1%	▲ 5
Current Job Openings	43%	▼ -4
Expected Credit Conditions	-9%	▼ -3
Now a Good Time to Expand	2%	▼ -4
Earnings Trends	-18%	▲ 5

NFIB NFIB.com/sboi

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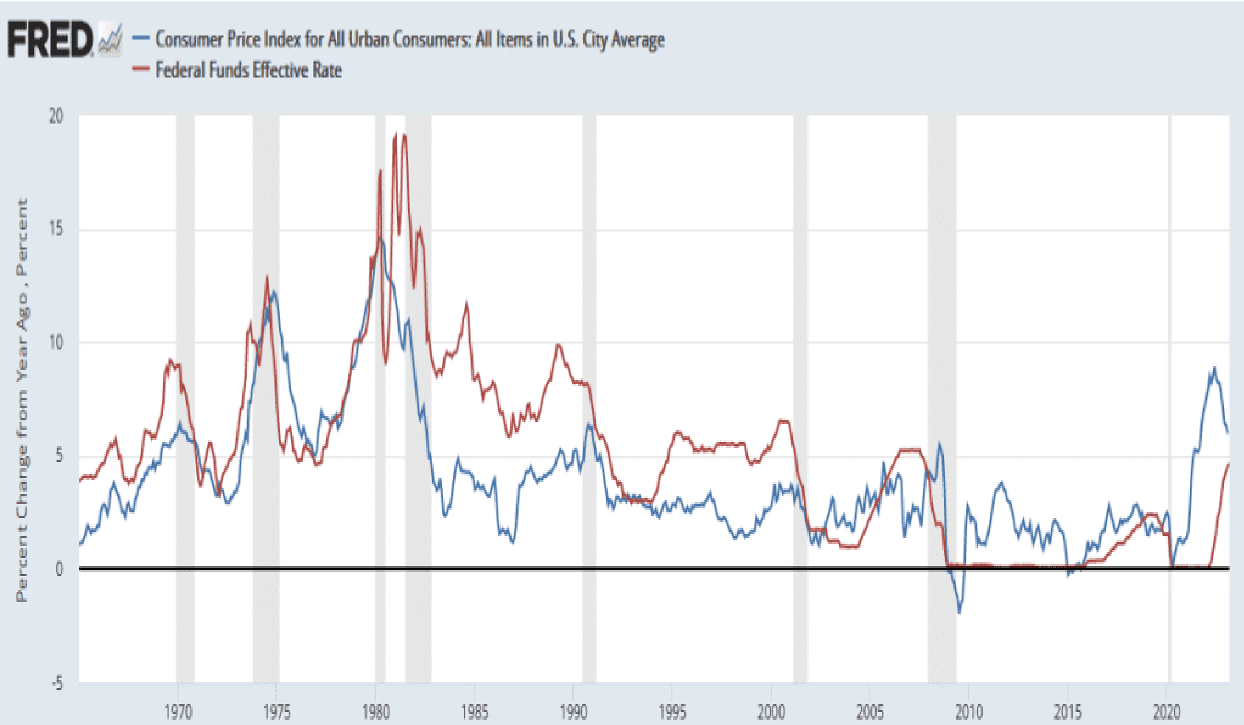
NFIB NFIB.com/sboi

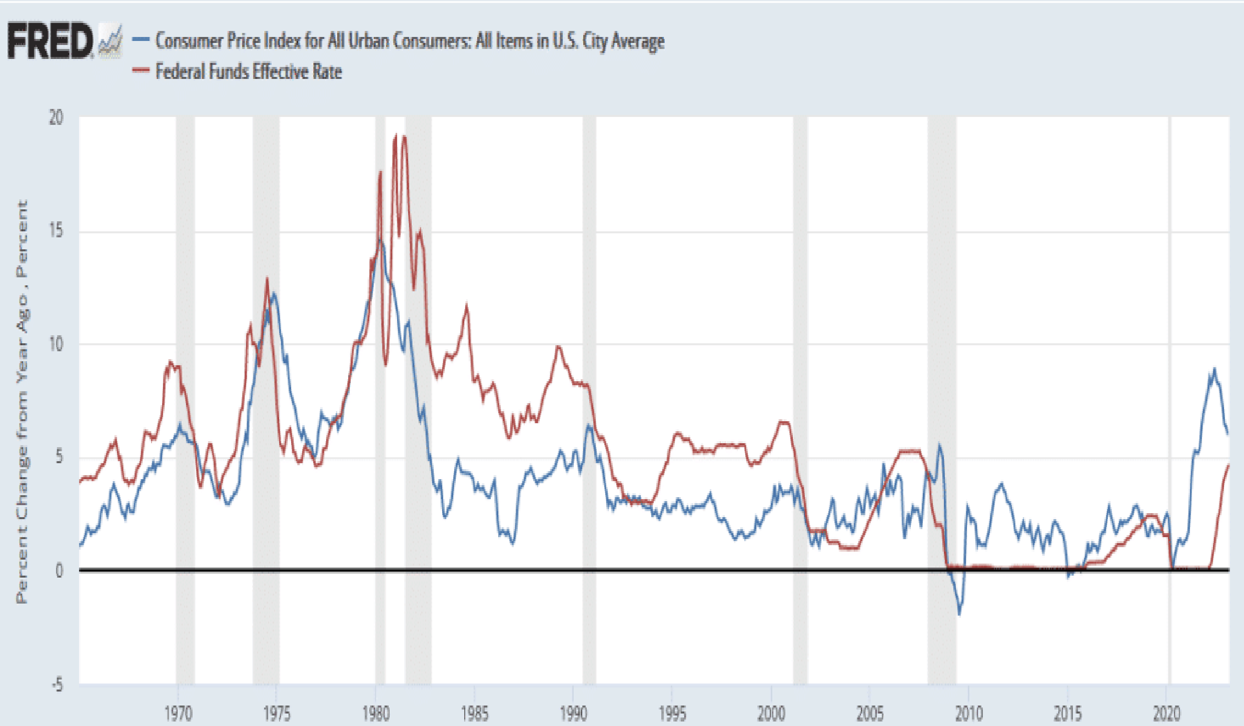
The Anchoring Effect ? Behavioral Traits Part IV

This is also known as a&#2013266080;*?relativity trap,?*&#2013266080;which is the tendency to compare our current situation within the scope of our limited and recent experiences. For example, I would be willing to bet that you could tell me exactly what you paid for your first home and what you eventually sold it for.&#2013266080;However, do you know exactly what you paid for your first bar of soap or your first pair of shoes? Probably not.

The reason is that the home purchase was a major&#2013266080;?life?&#2013266080;event. Therefore, we attach particular significance to that event and remember it vividly. If there was a gain between the purchase and sale price of the home, it was a positive event, and therefore, we are likely to assume that the next home purchase will have a similar result. Consequently, we may not consider forecasts for declines in home prices. When we become&#2013266080;mentally&#2013266080;?anchored?&#2013266080;to an event, we tend to base our decisions on it.

In the current environment, the anchoring effect can cause us to lose context that the current situation is far different from those of the prior forty years. Inflation is running at levels last seen in the 1980s. As a result, the Fed has been more aggressive in hiking interest rates in forty years as well. If we remain anchored on how the market reacted to Fed actions over the last twenty years, we may lose sight of the bigger picture. Keep in mind there are only a small number of investment professionals that were working the last time inflation was raging. Given how long it has been since we dealt with high inflation, we may all be susceptible to the anchoring effect.





Inflation Expectations

The New York Fed said its inflation expectations survey increased to 4.7% from 4.2%. However, the University of Michigan inflation expectation survey recently fell from 4.1% to 3.6%, and the Cleveland Fed?s one-year expectation is only 2.07%. Jerome Powell and other Fed members rely on inflation expectations as they correlate with actual inflation data. We presume this data will only cloud their ability to assess how sticky inflation may be.

Tweet of the Day

Liz Ann Sonders
@LizAnnSonders

Hedge funds currently sitting with largest net short position in S&P 500 futures since late 2011

6:19 AM · Apr 11, 2023 · **235.6K** Views

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