MARKET TRACTION

On the Edge of a Volatility Maelstrom?

This Week's Trade Ideas:

Bullish Ideas: (View Webinar)

INTC > Intel Corp. > $47.38 Last. Buy the Jan. 4th 46.5 Calls for $2.50 or less with a close or anticipated close above $47.90 in an up market with expectations for continued strength in the major indices.

Bullish Mentions: **(View Webinar)**

Based upon closing prices and all assume an up market with expectations for continued strength in the major indices.
ATHM, *QCOM, INTC, CSCO, JNJ, *DOCU, MHCP, *SWKS, DLTR.

Bearish Ideas: (View Webinar)

CIEN > Ciena Corp. > $31.59 Last. Buy the Jan. 4th 33 Puts for $3.05 or less with a close or anticipated close below $30.65 in a down market with expectations for continued weakness in the major indices.

Bearish Mentions: **(View Webinar)**
Based upon closing prices and all assume a down market with expectations for continued weakness in the major indices.
None at this time.

We strongly suggest viewing this week's **Morning Call** webinar for full details with respect to these idea(s), last week's and options education.

Special Note:

Remaining nimble is a focus in the newsletter and in our **Morning Call** webinar.

Outlook:

Outlook keeps working so here's last week's Outlook again and again!

Will we soon see downside gap closure and a retest, again???

We certainly saw the gap closure followed by a brief breach of the $260.00 in the SPYs. What came next was a massive short-squeeze / relief rally followed by another wild selloff! Whew!

So, what's next? There's a case to be made for both sides. Today's opening gap was sold into quite heavily yet the SPYs remain above the critical $260.00 level on a closing basis. Be prepared for anything as a news-driven move above $270.00 could open up more upside hijinks!

Technicals:

Will be discussed in-depth in the **Morning Call** webinar.

Fundamentals:

These trade idea(s) and mentions are technically-driven.

(Editor's note: These trade ideas may be updated periodically, in keeping with market conditions. It is intended solely for educational purposes.)

Recap of Last Week:

As part of our recap, we need to include Monday morning's update because it went out near the time when the lowest lows we've seen so far were registered:

*We were exclusively bearish last week and had many names aside from our official bearish idea in **SBUX.** The **SPYs** do have support in the lower $260s as we've mentioned. The could try to hold above there one more time but obviously they could plunge through and if they do and as we noted last week, that could deliver another 6 to 7% of downside movement. With nearly all our bear names lower to some extent, partial profit taking or partial rolling or even more aggressive forms of both could be warranted if the indices recover and begin to make new highs. The caveat is that when things get this volatile, nearly anything can happen and happen fast. Last week reminded us of that very clearly.*

Remember the old adage: Bulls make money, bears make money, pigs get slaughtered.

We had no bull ideas, so here we go…

SBUX – dropped exactly $2.00 from the trigger low, to this point.

SQ – fell by about $4.50.

FITB – has fallen by over 5% and could reach our $24.00 target.

BSX – fell about $1.50 but has rebounded.

UTX – dropped by nearly $4.00.

UAL – was down by nearly $5.00 at one point.

ROST – also fell by $4.00.

EMR – another that dropped by $4.50.

BLL – only fell about $1.20 so far.

HAS – fell by nearly $7.00 to the low.

XLNX – was down by just over $5.00 at one point.

MTCH – is actually up a little bit in this market. Tip of the cap…

ITW – another that dropped by a little over $5.00.

DOV – fell by almost $7.00 when at low.

CERN – dropped by $3.00 at one point.

We rarely are so one-sided with so many stocks named but last week simply shaped up that way and we had to go with it. Our update on Monday proved to be timely given what the Gang has done with stocks ever since. Volatility remains the order of the day, that's for certain. 14 of our 15 names dropped and most fell nicely. It's hard to complain other than the fact that we didn't get that washout below $260.00ish in the SPYs.

MARKET TRACTION

Market Overview

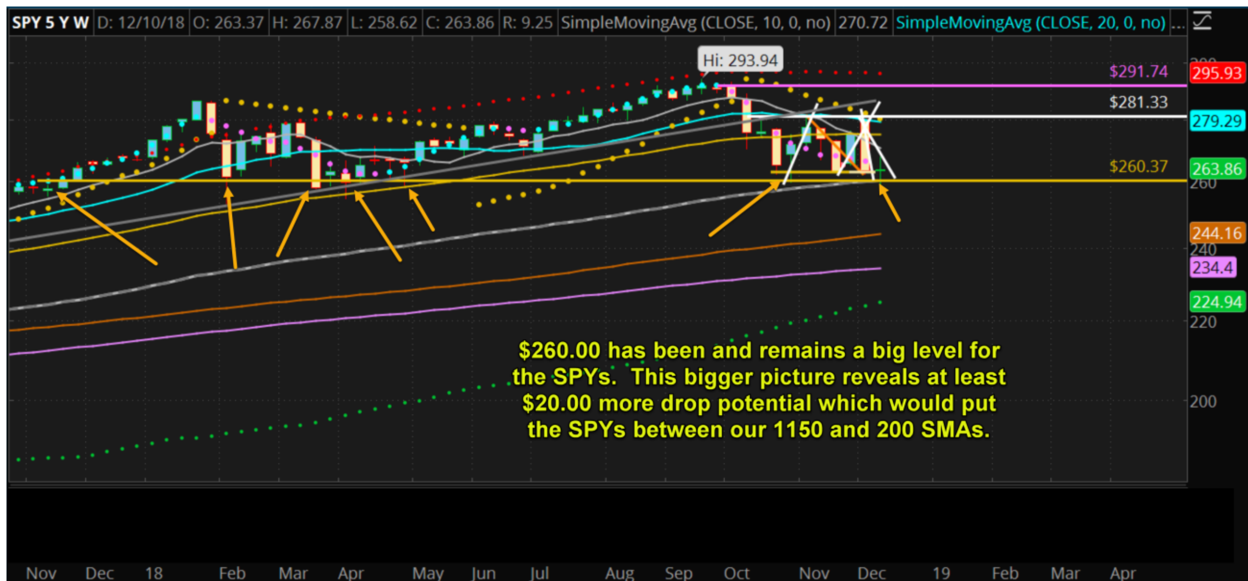
Again, we must visit last week to begin this week's **Market Overview** with emphasis added**:**

There's a lot to consider right now and NEWS can fly fast and furious without any warning. <u>The upcoming stretch of trading may require EXTREME AGILITY!</u> There's a lot on the line, and there's not a lot of time, but there are bushels of catalysts. We knew the market became very overbought in the short-term, hence our Monday morning update, <u>but it's fallen apart faster than we thought to a larger degree than we anticipated. Wednesday's closure may not have helped matters either.</u>

*We plan to remain, as we have now for 2 months, prudent to a fault and <u>that's even more true when trading the bull side</u>. **<u>The fact remains that we're below trend and have failed to regain the trend. We may have triple-topped just below trend. The low $281.00ish level in the SPYs has been a key for us for a while and we continue to see it "matter". If and until the SPYs comfortably reclaim the ground above that level, we'll not rest easy. A retest of the lows could be back on especially because a closing of the gap below is so close to that support level.</u>** Let's hope for a higher high than those lows for now but that's all it is: hope. <u>We have a sense that news will drive what happens next but until we see better action,</u> **<u>we must assume the bears have control for now.</u>***

MARKET TRACTION

AND NOW FOR THIS WEEK:



So, we can see that the $260.00 level may have more stout support than at first glance which also informs us to why a break of it is likely to produce serious selling. Moving on…

The DOW/DIA is trading nearly in-step with the SPYs but the Russell 2000 ETF is already looking worse. The IWM ETF tracks the Russell and thus this doesn't bode well for share prices of smaller companies:

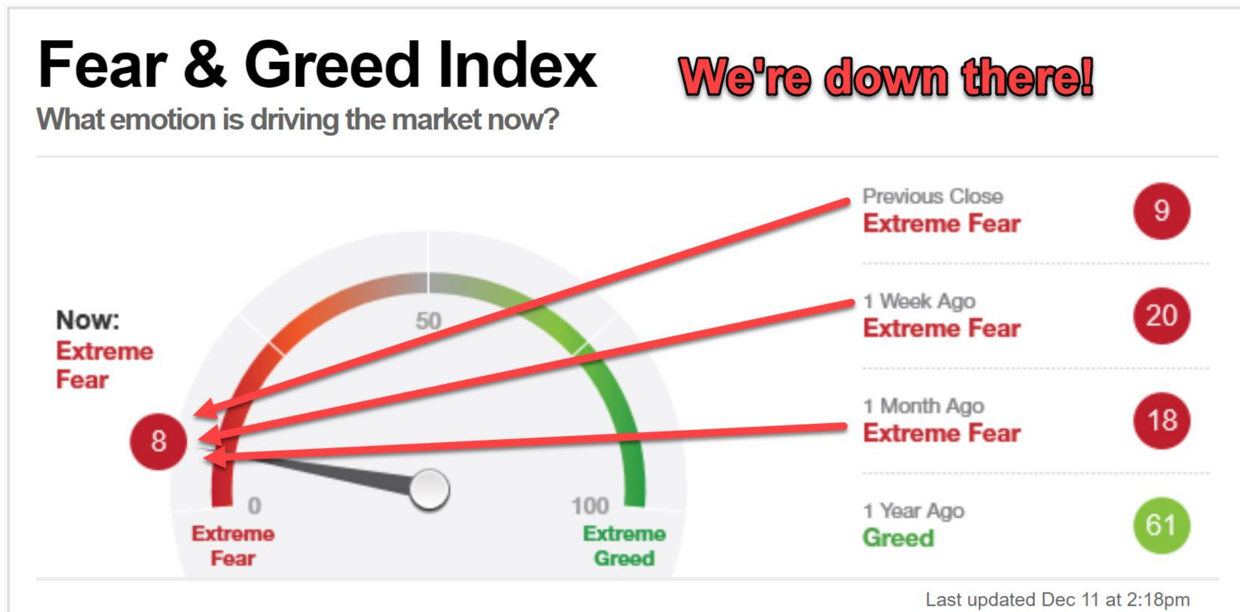
MARKET TRACTION

The NDX is hanging in there a little better than the SPYs at the moment, FAANG seems to be levitating a little better these days and that's what's keeping it looking a tad better than other areas of the market, technically speaking:

The market remains below trend, so we must remain concerned and give bears their due. A decisive close below $260.00 in the SPYs could bring about the assault on the next level down that we've been speculating about for some time. From $240 - $245.00ish should reveal some support if we get there. The technicals continue to look bad. Below trend, below the 50, 100, 150 and 200 SMAs with the 50 having crossed below the 200. We can add that most key SMAs are also negatively sloped. Still though, as we noted above, they're holding up KEY TECH and it could ignite and lift the markets. In summary, it remains a prudent roller's market! The problem with being "all bear all the time" at a moment like this is sentiment…

MARKET TRACTION

We're really down there:



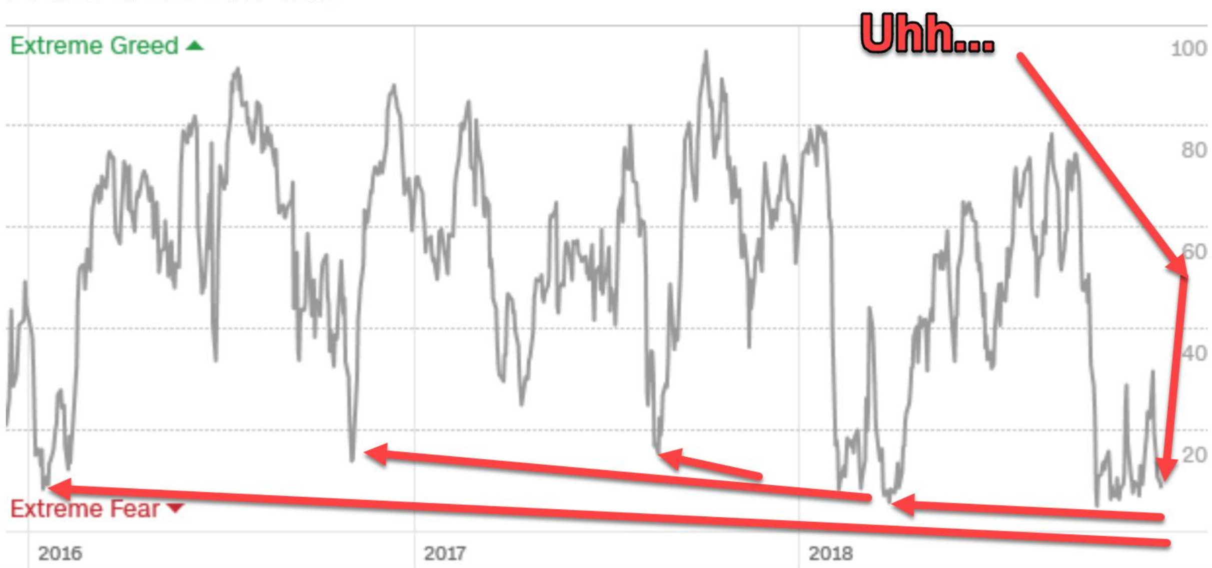
The "other people's money" mafia has their bonuses on the line and they've got only a little time left. Given how oversold/into extreme fear territory we are, we have to keep an eye out for an attempt to save the year…still. Below $260.00 is a big problem but don't fall asleep as a bear if they keep the SPYs above that level and trading becomes "boring." They could be lulling you to sleep at just the wrong time.

*****PLEASE SEE BTR BELOW** for a piece on how and when they'll get Santa at the reins if they can.

Below the Radar

With the markets on edge and on the edge of breaking down to new lows, a rally seems very unlikely to impossible at this juncture. But this is **BTR** and we have to keep our eyes open everywhere and at all times! We've speculated about the so-called Santa Claus Rally" being ignited to save the year. That's still lurking around in our minds as something we can't rule out with the SPYs still clinging to $260.00. So, that's the backdrop for what we're about to share. We like when we find pieces that back our seasonal hunches and this one does that!

Quick reminder as to where we are now (deeply into extreme fear) to properly introduce what we found from Michael Lebowitz. In other words, this graphic shows that this would be a perfect time to launch the festivities from a sentiment (contrarian) point of view:



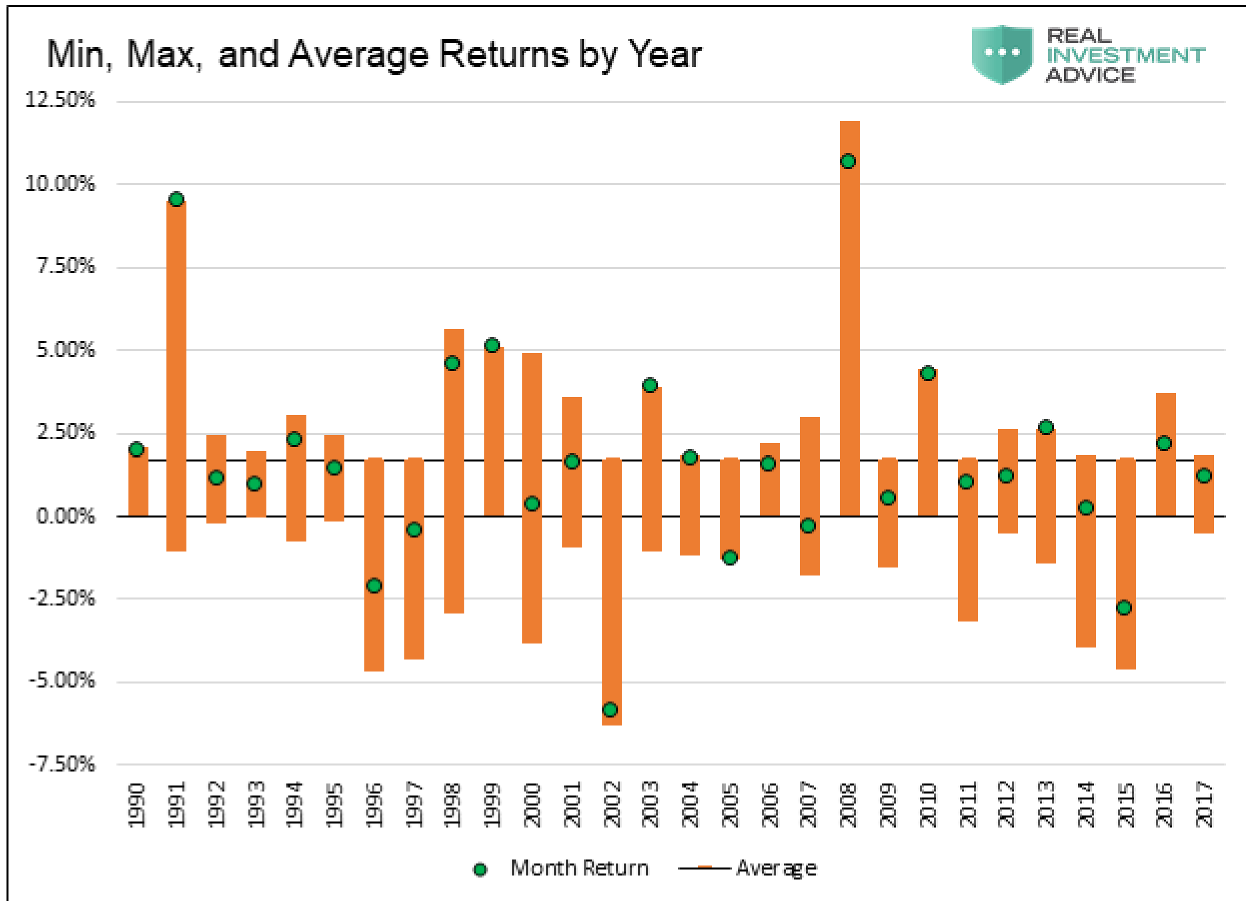
The Santa Claus Rally

The Santa Claus Rally, also known as the December effect, is a term for the occurrence of more frequent than average stock market gains as the year winds down. For longer-term investors, this article serves as a whimsical note on what might or might not occur this December. Traders willing to measure trades in hours and days, not months or years, might find useful data in this article to make a few extra bucks. Regardless of your classification, we use the traditional disclaimer that past performance is not indicative of future results.

For this analysis, we studied data from 1990 to current to see if December is a better period to hold stocks than other months. The answer was a resounding "YES." The 28 Decembers from 1990 to 2017, had an average monthly return of +1.70%. The other 11 months, 308 individual observations over the same time frame, posted an average return of +0.62%.

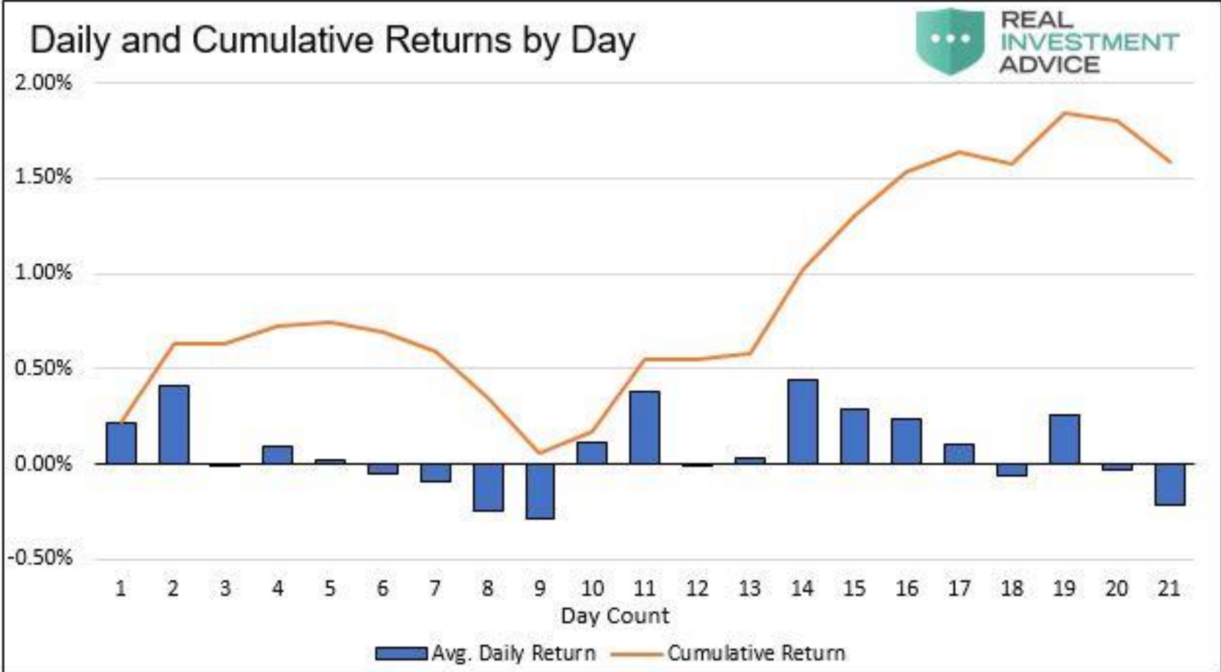
The following graph shows the monthly returns as well as the maximum and minimum intra-month returns for each December since 1990. It is worth noting that more than a third of the data points have returns that are below the average for the non-December months (+0.62%). Further, if the outsized gains

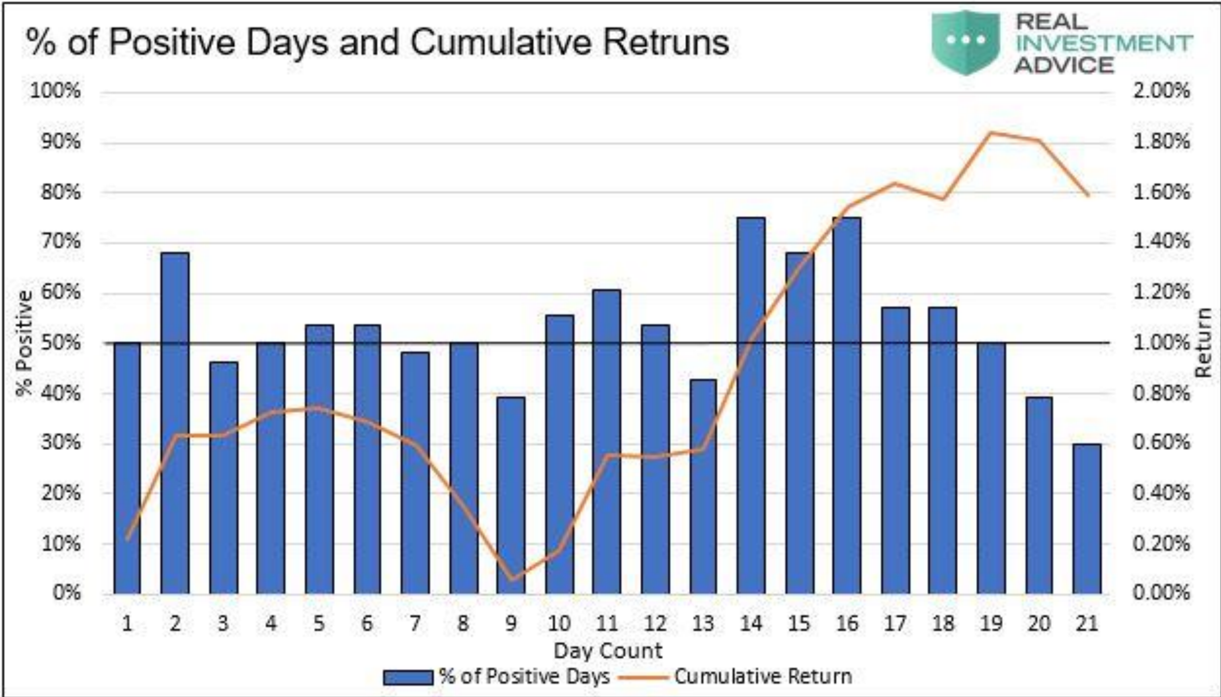
of 2008 and 1991 are excluded, the average for December is +1.05%. While still better than the other months, it is not nearly as impressive as the aggregate 1.70% gain.



Data Courtesy Bloomberg

Next, we analyzed the data to explore if there are periods within December where gains were clustered. The following two graphs show, in orange, aggregate cumulative returns by day count for the 28 Decembers we analyzed. In the first graph, returns are plotted alongside daily aggregated average returns by day. Illustrated in the second graph is the percentage of positive days versus negative days by day count along with returns.





Data Courtesy Bloomberg

Visually one notices the "sweet spot" in the two graphs occurs between the 10th and 17th trading days. The 17th trading day, in most cases, falls within a day or two of Christmas. The table below parses data for the aggregated Decembers into three time frames; early, mid and late December to highlight the "sweet spot."

MARKET TRACTION

Periods (Day Count)	Average Pct. Positive	Average Daily Returns	Period Cumulative Return
1-9	51.00%	0.01%	0.06%
10-17	61.00%	0.20%	1.58%
18-End	44.00%	-0.01%	-0.05%

Summary

This year, the 10th through 17th trading days are December 14th through the 26th. If 2018 plays out like the average of the past 28 years, there might be some extra goodies under the tree for those playing the Santa Rally. *We caution, as shown earlier, that there have been Christmases where investors relying on the rally woke up to find coal in their portfolio stockings.* *https://realinvestmentadvice.com/yes-virginia/*

We can see, courtesy of Michael Lebowitz's work that the time has come. The *OPM* crowd needs to make their move and make it soon. Historically speaking, we're about to hit their sweet spot!

So, that's the case as to why we must remain nimble in all ways especially mentally!

If that's not enough for you, we can add to that, this, and this is big, was big, and could be big again in providing the Santa Claus crowd with propellant:

https://www.zerohedge.com/news/2018-12-11/beware-crushing-move-higher-funds-are-trapped-massive-short-squeeze

"And just in case it was unclear - especially for various other Wall Street "quants" who have taken offense at McElligott's predictive success - ***he repeats that "the largest near-term catalyst for a crushing Equities move higher remains fund positioning, which is creating an enhanced-risk of positioning squeeze, as it builds "fodder" for a violent bear-market rally which nobody owns—ESPECIALLY into the final weeks of a horrible 2018 performance backdrop with zero appetite for further drawdowns—thus, negligible net length."***

Here are the details on why virtually all funds are now caught offside by what is now an almost 100 point swing higher in the S&P in less than 24 hours.

Fundamental strategies increasing their "net-down" in recent days via slashing longs while "pressing" / grossing-UP their shorts *(US Equities 1Y Momentum Shorts -8.8% in the past 5d), while CFTC data (through last Tuesday's trade) shows that* ***leveraged funds added to shorts in S&P Futures last week by a notional +$5.8B to grow the net short to -$15.1B***

The Nomura QIS Systematic CTA Trend model shows ***nearly consensual "Max Shorts" across global Equities now*** *(SPX, Russell, Estoxx, Nikkei, DAX, FTSE 100, CAC, Hang Seng CH, ASX, KOSPI) which is at risk of seeing forced-cover / deleveraging with "buy triggers" now in reach on this gap move higher from yesterday's lows*

Specifically with global risk bellwether S&P, ***trigger levels to flip from short to covering and turning outright long again are easily within reach, as the current "Max -100% Short" would pivot to "+26% Long" at the 2666 level*** *(as the longer-term 1Y model horizons turns from "short => neutral => long ")*

And with futures easily levitating above 2,666 following today's stronger than expected core PPI data, it appears that the next leg of the market's violent whiplash is upon us, as active traders scramble to reposition from being max short to as long as they possibly can... at least until the next flashing red headline unleashes the next panic selling round."

As for going with a flow that looks scary right now, here's a great Top Ten list from Lance Roberts but inspired by Doug Kass:

Here are the **Top Ten** reasons why we may be entering a **Bear Market**:

1. ***Markets Generally Move in Anticipation of a Change in the Rate of Economic and Corporate Profit Growth – That Path and Trajectory Are Deteriorating:*** *Since 1860 there has been at least one recession in each decade – representing 47 recessions since the Articles of Confederation was approved in 1781. We have not yet had a recession in the current decade but, my view is that this decade will not be spared and that we will likely be in a recession in the second half of next year. (See my 15 Surprises for 2019).*

2. ***President Trump is Making Economic Uncertainty and Market Volatility Great Again (#MUVGA).*** *Trump's more frequent and incendiary twitter utterances and behavior reflects badly on him, his office and our country. His conduct and policy (often seemingly written ad hoc on the back of a napkin) are arguably beginning to adversely impact our markets as his Administration's dysfunction and policy (conflated with politics), and have begun to reduce business and consumer confidence and is starting to negatively influence the real economy.*

We are in an unprecedented politically toxic and divisive backdrop – which was underscored during Wednesday's funeral for President George H.W. Bush. As my good pal Mike Lewitt ('The Credit Strategist') wrote over the weekend:

"The saddest thing is not that Bush passed – it was his time – but that his generation is succeeded by a bunch of greedy, narcissistic empty suits."

This is happening at a point in history where the world has grown more complex, interrelated, networked and flat. With these conditions in place, there are more dominoes today than yesterday and more yesterday than the day before. Again, from Mike,

"The next crisis is approaching and not only is it self-imposed but we are ill-equipped to manage it precisely bc there are few men like George H.W. Bush to lead us."

a. The United States is leaning more and more "purple" – moving to the Left at a time that the Right is feeling terribly insecure after 10 years of The Screwflation of the Middle Class (something I initially discussed in an editorial I wrote for Barron's in 2011). The schism between the "haves and have nots" has not been addressed by policy (and has been worsened by the trickling up from the tax bill, which was intended to trickle down and by such provisions as real estate tax and mortgage interest limitations which have served to dent the residential real estate market).Further neglecting or failing to narrow this split will likely have grave social, economic and market ramifications down the road (or sooner).

b. It is becoming increasingly clear that the 2016 election was materially a vote against Hilary Clinton. Trump's road to nomination in 2020 is growing more precarious and the odds, after barely winning the first time, are not favorable that he wins reelection (given the Wisconsin voting results as well as the outcomes in Michigan and Pennsylvania). It is hard to see markets prospering with Washington D.C. in

such a mess – preventing anything from getting done on deficits, debt, taxes, spending and infrastructure.

c. "The Orange Swan" has grown increasingly untethered in the face of divisive and extremely partisan midterm elections (that brought the House under Democratic control), the implicit threats of the Mueller investigation, the hostility of the Kavanaugh hearings, the controversy surrounding the Khashoggi killing, etc. The White House's dysfunction and repeated personnel changes would be laughable if they weren't so sad. Most recently, a hardline approach on trade (with China) seems to have tipped over the markets in recent days. Increasingly, short term solutions are being advanced in the face of long term problems. (A classic example is our burgeoning deficit, endorsed by both parties, that is unchecked and is running wild this year).

d. As we are move further from the midterm elections. my core expectation is that the President will likely be impeached by the House. Though there may be far less reasons for Senate Republicans to tie their political futures to such an individual – especially with a plethora of qualified Republican presidential hopefuls – the Senate vote on impeachment could be closer than many expect.

3. ***A Pivot in Monetary Policy:*** *For years a zero interest rate policy in the U.S. has served to repair the domestic economy as it came out of the Great Recession in 2007-09. Unfortunately it has had second order consequences like pulling forward economic growth – already seen in Peak Housing and Peak Autos. Artificially low rates have served to protect many corporations who have been temporarily resuscitated. Some of those should not have been permitted to survive – and they won't in the next recession. This served with liberal loan terms ("covenant lite") could produce a surprisingly steep economic downturn compared to consensus expectations.*

4. ***Economic Growth and Profit Estimates Are Substantially Too High:*** *With U.S. Real GDP forecast to fall back into the +1% to +2% range in 2019's first half and turning negative in the second half, the contraction in valuations (so apparent thus far in 2018) may continue in 2019. (See my 15 Surprises for 2019). Over there, matters are worse. England has never been more divided (Brexit), Italy (one of the largest economies in the EU) is on the economic deathbed, Deutsche Bank (DB) (and its monstrous derivative book, poor loan quality and systemic money laundering) is the most dangerous financial institution in the world and two of Europe's most important leaders (Merkel and Macron) are so unpopular that both may be on the way out.*

5. ***The Chinese Challenge to U.S. Hegemony Is a Battle For the Next Century – It Will Likely Be Long Lasting, Disruptive to Current Supply Chains and Costly to Profits:*** *We have likely started a lengthy 'Cold War in Trade' with China – a time frame measured in years not (three) months.*

6. ***The Apple Complex (its suppliers) Have Been Upended by a Maturing High-End Smart Phone and Weakening iPhone Market and The Social Media Space is Under Increased and Costly Regulatory Scrutiny****: These factors have a broad impact on the market leading technology stocks and for the market as a whole. Moreover, over the last decade technological progress has outpaced regulatory supervision – but this is now being reversed as the social media companies now face the existential threat of rising regulations. The costly imposition of regulatory oversight is something I have been writing about for over a year.*

7. ***An Avalanche of Debt:*** *The private and public sector are levered more than any time in history as, rather than addressing the flaws in our system, we tried to solve the last debt crisis with trillions of*

dollars of more debt. It is the existence of this mountain of debt that has delivered a fragile economic recovery despite a 2 1/4% Federal Funds rate. Given this, a rate hike of only 25 basis points today has about the same impact of 75 basis points a decade ago. As such that accumulated debt loads are vulnerable to a weakening economy and/or rising interest rates (there have been eight rate hikes since the 2016 election.

*8. **The Market's Structure Has Made Equities More Vulnerable Than At Any Time Since October, 1987** (see the Wall Street Week interview from October 16, 1987, above)**:** Passive products and strategies (which are generally agnostic to fundamentals) are the dominant factors in market trading. Like "Portfolio Insurance" 31 years ago, they "buy high and sell low."*

*9. **With Short Term Interest Rates Now Meaningfully Above the Dividend Yield on the S&P 500 Index – There Is Now an Alternative to Stocks:** The dividend yield on the S&P is about 1.8% compared to a one month Treasury note rate of 2.35%, a six month note yield of 2.54% and a one year note yield of 2.68%. Goodbye T.I.N.A. ('there is no alternative') to C.I.T.A. ('cash is the alternative'). In terms of valuations, too many look at Non GAAP earnings (15-16x forward EPS) and ignore the record difference between Non GAAP and GAAP which would move the price earnings ratio to close to 20x. As well price to book, price to sales, market capitalization to GDP and Shiller cyclically adjusted P/E ratio speak (graphic) volumes about the degree of overvaluation today.*

10. Technical Damage: Uptrends in place for nearly a decade have been reversed.

Just as with last week, we weren't able to find a lot but what we did find gets the job done. We had to close out **BTR** on a bearish note because we won't even begin to believe that the Santa Rally (which we've also speculated about) is underway until we see a close above $270.00ish in the SPYs at some point soon. Until then and as noted above, we must give bears their due.

Remain nimble my friends!

Bank and Roll!

Options Academy

Understanding Beta for your Portfolio - An Introduction

We decided that it was time to shake things up with a "Greek" that's not cited all too often by options players despite it being very important and useful. That of course, would be Beta. Beta is a "big deal" in most stock market circles, however it tends to get lost with options traders when they're discussing matters because they tend to be Options Greeks obsessive. Thus, this foray into Beta will be a three-part mini-series as we'll seek to understand it, and then put it to use to help us make better decisions when it comes to our investments. The fact is that Beta is used by professional investors every day to help diversify and protect their investment portfolios. It can and probably should be a driving factor in your investing process.

Beta is a measure of correlation and volatility when compared to the overall market. The first part we'll cover is correlation. Correlation can be thought of as how consistently an asset moves in sync with another asset. In this case, we are comparing an individual stock to the overall market, the SPX (S&P 500) for example. So, if a stock on average goes up 1% when the market goes up 1%, then the stock would have a positive correlation. If the stock went down 1% when the market went up 1%, then the stock would have a negative correlation. The correlation calculation typically takes into consideration about one year's worth of historical data on which to observe and calculate the relationship between the stock and the market.

The next part of the calculation we'll need to visit with is the volatility component. For this, we look at the percentage move that stock typically makes in relation to the percentage move the market delivers. If the percentage movement of the correlated stock is greater than the actual market movement, then the Beta will be greater than one. If the stock's movement is typically less than the move the market moves, then it will be less than one.

This is important to understand because you can now look at your portfolio in the same way that professional do. When it comes to diversifying your portfolio, there's a widespread belief that having a mixture of assets with different Betas makes a lot of sense as it should result in a decrease in risk in your overall portfolio (All your eggs are not in the Momentum Basket only). The ideal situation is to have a group of stocks that will outperform the market, hardly anyone disagrees with this sentiment. Naturally we want to outperform in both a bullish and bearish market setting. Some portfolios will perform very well in one environment and not too well when the environment changes. Professional money

managers seek to add assets to their holdings to decrease Beta (volatility of performance) while increasing the total return of the portfolio.

As you can imagine, stocks that outperform the market usually have the highest Betas. Think of names like the FAANG stocks, Amazon and Google. Stocks that have low Betas can often be stocks like pharmaceuticals and healthcare companies, names like Johnson & Johnson and Merck come to mind.

In the next part of our mini-series, we will discuss more in-depth how to create a diversified portfolio using Beta. The next part of the series after that will discuss how to Beta Weight your portfolio risk.

If you have questions, please ask away in our next **Morning Cal**l webinar. 😊