MARKET TRACTION

Holiday Week Action or True Read on a Real Bounce?

This Week's Trade Ideas:

Bullish Ideas: (View Webinar)

TGT > Target Corp. > $66.09 Last. Buy the Feb 1st 63 Calls for **$4.90** or less with a close or anticipated close above $66.20 in an up market with expectations for continued strength in the stock.

Bullish Mentions: **(View Webinar)**

Based upon closing prices and all assume an up market with expectations for continued strength in the major indices.

FIVE.

Bearish Ideas: (View Webinar)

None at this time. Nearly EVERYTHING emerged from historically oversold conditions and few stocks have yet to demonstrate any weakness… yet.

Bearish Mentions: **(View Webinar)**
Based upon closing prices and all assume a down market with expectations for continued weakness in the major indices.

CAR, COG.

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.

MARKET TRACTION

Outlook:

Last week's Outlook is pertinent again as it has been week after week for months:

"As for present conditions, December is shaping up as possibly the very worst month since the start of this bull market nearly 10 years ago. We can see extremely oversold (short term) conditions nearly everywhere we look. We don't know how, but one has to believe that authorities et al. will try to step in to prevent even more crashing sometime soon as the US markets seem hellbent on tracking world equity markets which have plunged even more than we have here."

The past week's action delivered just that. We witnessed a 7% move higher from the lowest lows. That move was made easier in holiday style trading which can be very light and thus it becomes easy to push stocks around. A group, say like the PPT, would find it easier than usual to levitate markets right back up. We have a sense that the PPT did step in and managed to effectively walk the SPYs back to that key $250.00ish level with help from momentum and algo players. If it weren't a holiday week, we'd expect even more upside fireworks. That's probably what we should still expect but the fact that the march higher was accomplished in thin *last week of the year trading conditions* give us a little less confidence than we'd have otherwise.

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:

Last week was a light week for ideas and is light on "recap."

This comment was a part of our "bullish idea" summary:

Virtually EVERYTHING IS DEEPLY, DEEPLY OVERSOLD.

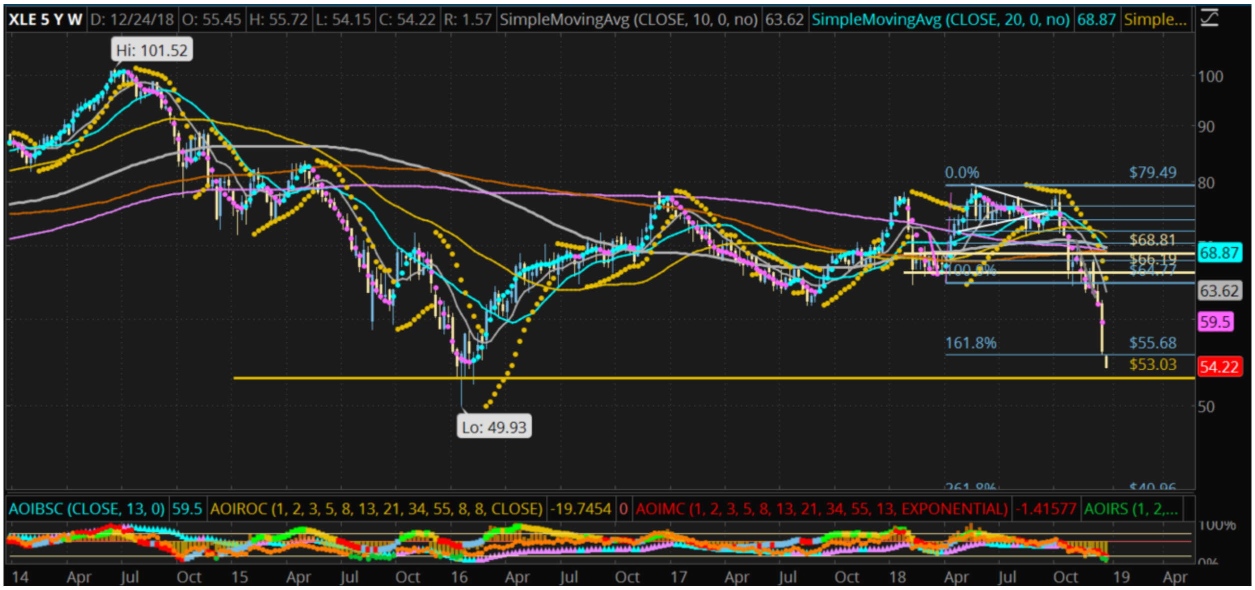
Of course, that dovetails with last week's "expect the authorities" to try to rally equities theme.

We had **AEM**, **NEM** and **CTRP** as bull ideas. **AEM** and **NEM** were what we thought they'd be. They were both dormant with stocks rallying. Remember, they're metals space members and that's what we expect them to act like if "normal" stocks are rallying. **CTRP** did rally somewhat but finished the week poorly.

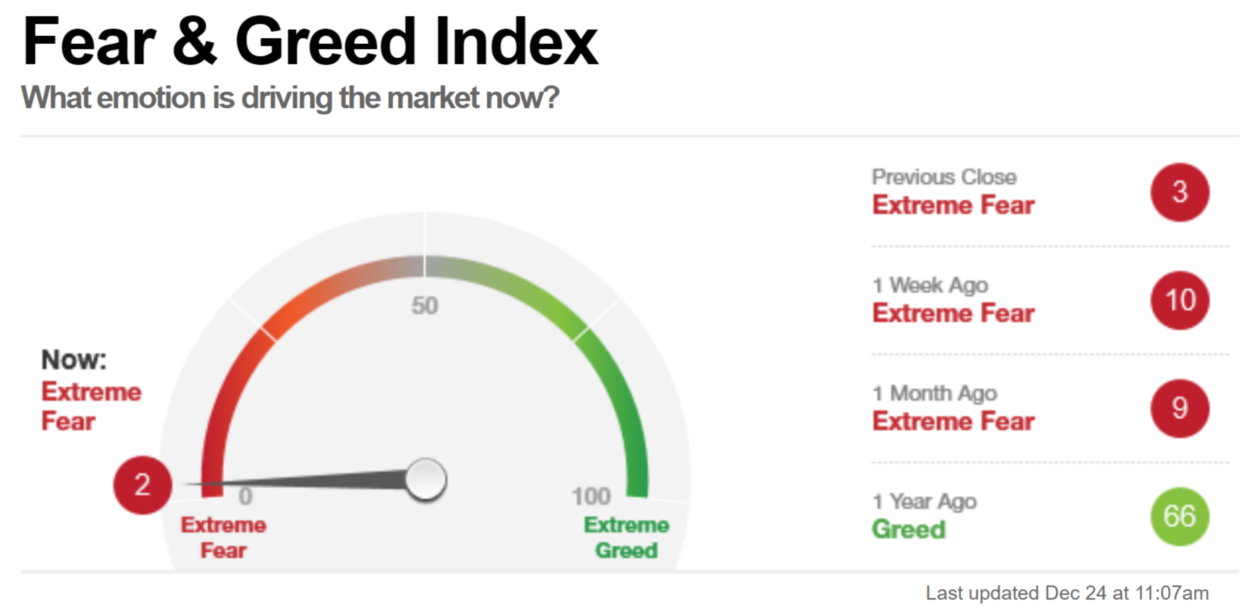
Our lone bear was **HCA** and it was as a mention as it had gap-filling potential if the selling rout continued to spiral. We had no chance to even look at this name due to the post-Christmas buying euphoria. The selling spiral was abruptly interrupted the day after Christmas and that was it for any bear considerations.

Market Overview

We must review last week's **MO** yet again to see where we left off:

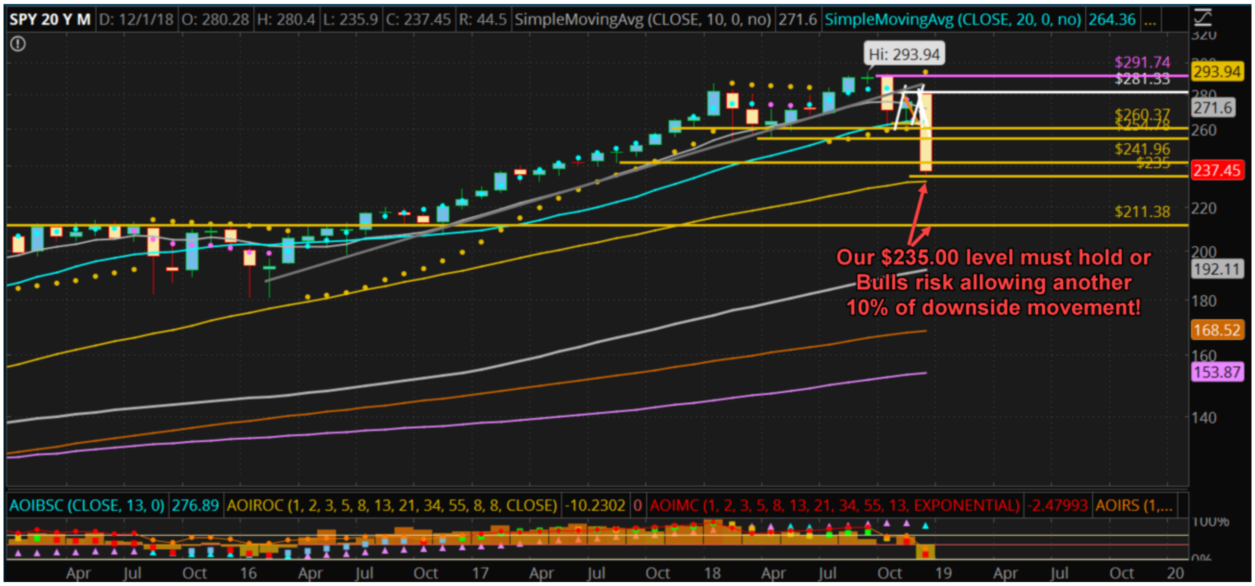


*There can be no doubt that we find ourselves in a very challenging market environment. It literally doesn't get too much worse than this as all 7 measures within the index are in **EXTREME FEAR** territory:*



MARKET TRACTION

It's crazy now but it's also clear. ***<u>Bulls must find a way to rally here</u>*** *and now or much more downside is likely:*



<u>We don't yet see what could bring about a rally, but we know that they'll try to float something!</u> *Does it work when they do, work at all? No idea! When things unravel to this extent the ugliness permeates and can infect many areas which causes even more negative spillover. KNOWING that these market phases can become as this one has, is EXACTLY why nearly 3 months ago we began harping on being prudent and being risk-averse which is not fun but allows us to sidestep the disaster that so many others court.* ***<u>We'll see in the coming days and weeks if $235.00 holds.</u>*** *It's that simple now because correlations are all going to "1" and* ***<u>mostly everything is being trashed by sellers.</u>***

MARKET TRACTION

<u>"…We're not sure how much they'll matter as the FED and the Plunge Protection Team likely matter infinitely more at the moment."</u>

That's where we left things last week and once again, we're sticking with the value that was in that content. We scrambled to find the $235.00ish support level in the SPYs a few weeks back and despite it not being an obvious support level, it did hold. Our take is that the authorities and others did intercede and then marched the SPY more than 7% above the recent $235.00ish low. As we noted, that was about the most oversold we've seen the S&P 500 during the entire bull market so a rally, any rally, of any kind, was certainly due and was only aided by thin holiday trading conditions and the President's Working Group in our estimation.

As for now and being at risk of reading too into holiday-influenced action, we have to believe that the odds favor more rallying. Often times after a major break of support or resistance, the action moves back towards that break to confirm. If that scenario were to play out, we'd expect 2 to 4% more upside in the SPYs for starters:

If the SPYs can remain above last Friday's low, we'll have to continue to give them their due and expect that they try to push to $255.00, $260.00 or $263.00 as those are our resistance levels/targets if we move more to the upside. The SPYs are really all we need in the form of an index for evaluation as correlations remain very tight among them all, theSPYS, the DIAs and the QQQs.

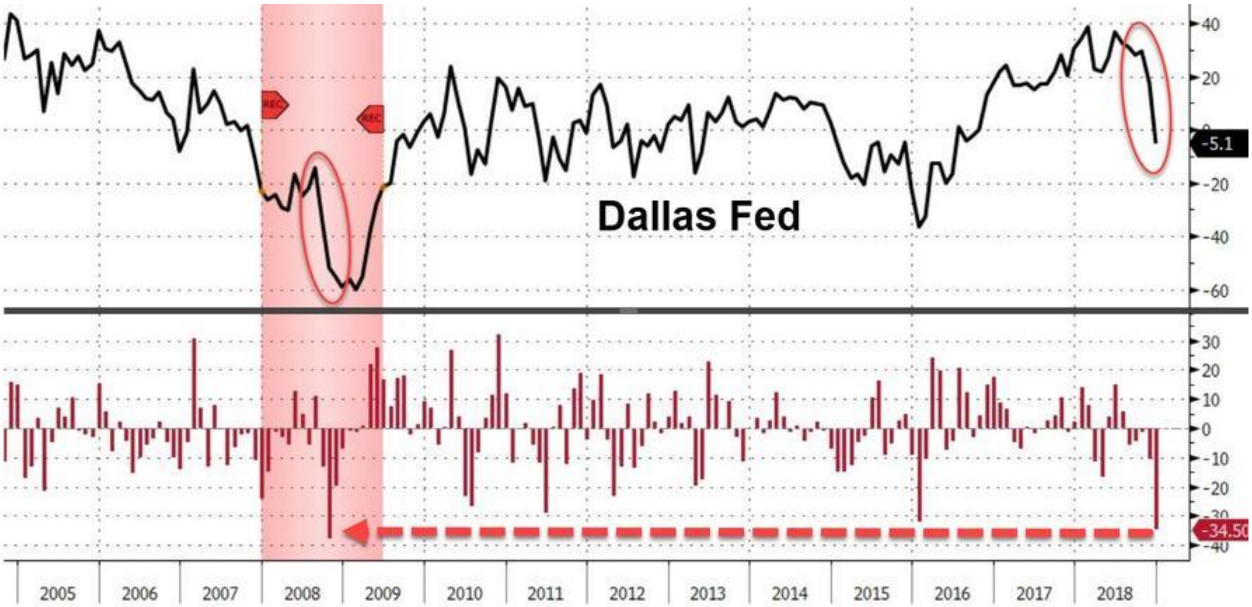
Our "bottom line" is that the *pancaking* of the market was extreme from a historical perspective and thus we should expect more from this *trampoline* bounce especially given that the authorities would undoubtedly prefer that and the fact that *2019 buyers* may be about to launch their *positioning spree* almost immediately.

This Week's Economic Calendar

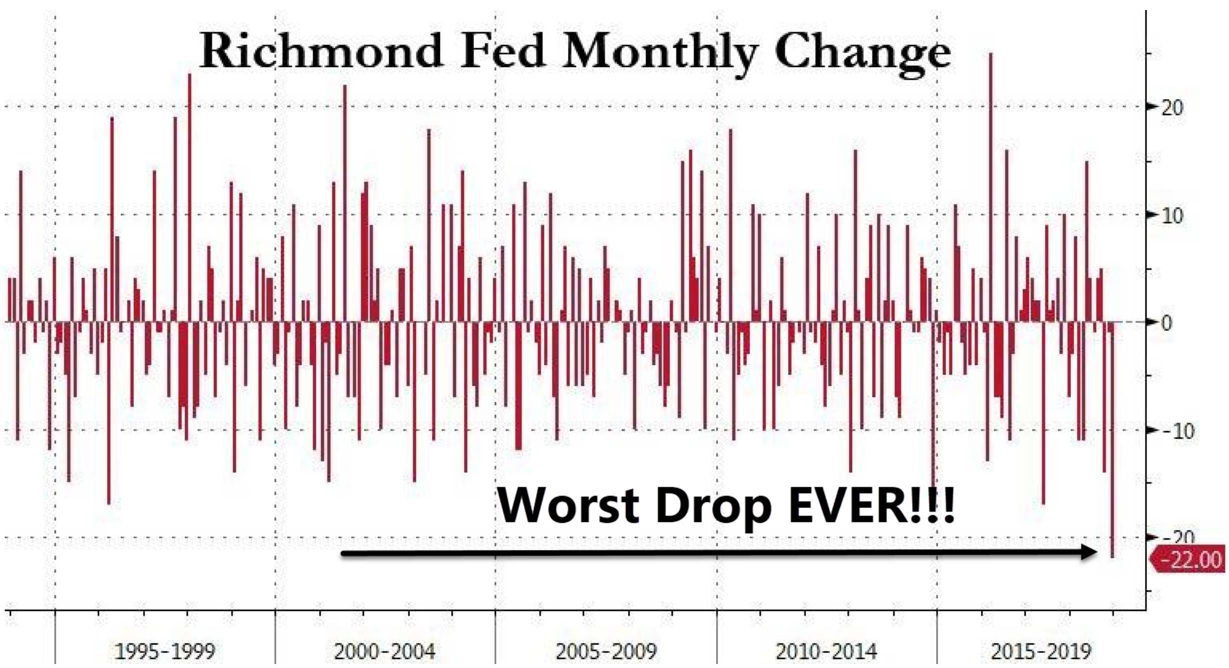
GOVERNMENT SHUTDOWN COULD DELAY THE RELEASE OF SOME INDICATORS THIS WEEK.					
MONDAY, DEC. 31					
	None scheduled				
TUESDAY, JAN. 1					
	None scheduled New Year's Day				
WEDNESDAY, JAN. 2					
9:45 am	Markit manufacturing PMI	Dec.			53.9
THURSDAY, JAN. 3					
8:30 am	Weekly jobless claims	12/29		N/A	N/A
10 am	ISM manufacturing index	Dec.			59.3%
10 am	Construction spending	Nov.			-0.1%
Varies	Motor vehicle sales	Dec.			17.4 mln
FRIDAY, JAN. 4					
8:30 am	Nonfarm payrolls	Dec.			155,000
8:30 am	Unemployment rate	Dec.			3.7%
8:30 am	Average hourly earnings	Dec.			0.2%
9:45 am	Markit services PMI	Dec.			53.4

Below the Radar

And now, this:



That's the very latest from the Dallas Fed's business survey and YES, that's the worst plunge since the very dark days of the Great Recession. It came on the heels of this:



If you've been worried like most clear-thinking market watchers that Powell is overdoing it a wee bit, then you should worry even more! Those two readings are atrocious, and his (intentionally?) *tin ear* may need to be kicked at this point to avert a recession. Like so many others, we just can't help but marvel at the rush to continue to raise rates with data like this showing up. It becomes all the more curious when we look back and see how long Yellen left rates at near 0% when she could have justified raising them.

MARKET TRACTION

Oh well, maybe this is why we shouldn't have our money supply centrally-planned and designed in such a way that we become indebted just to bring our currency into existence.

https://www.zerohedge.com/news/2018-12-30/goldman-slashes-us-growth-forecast-now-sees-just-12-rate-hikes-2019

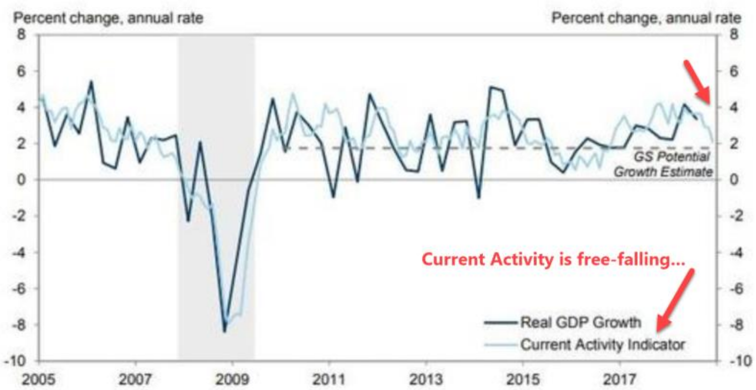
The link above is one of the best pieces we've seen regarding 2019. We're going to cover the "lowlights" from it as the past week was light (again) on **Below the Radar** material.

"We have revised down our US growth forecast for the first half of 2019 from 2.4% to 2%; we continue to expect growth of 1¾% in H2."

To justify its abrupt reversal, Hatzius presents three "strong" reasons why we should expect slower growth in 2019 vs recent years.

- "**First, a slowdown is already evident in the numbers**. As shown in Exhibit 1, both real GDP and our current activity indicator (CAI) were running at 3½-4% over the summer, but the pace has recently fallen to the 2-2½% range."

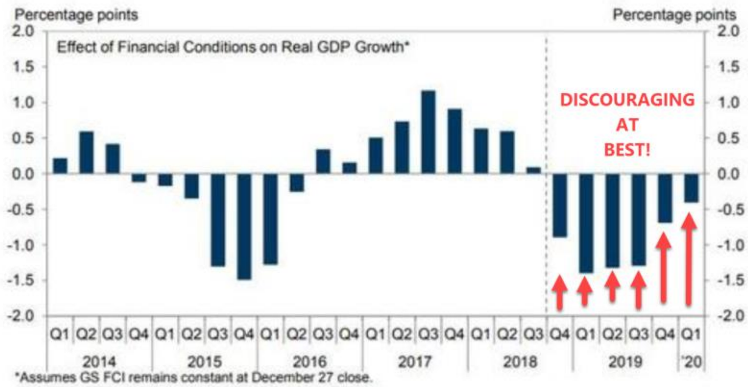
Exhibit 1: Growth Has Already Slowed Somewhat



Source: Department of Commerce, Goldman Sachs Global Investment Research

- "**Second, the impulses from fiscal policy and financial conditions are turning more negative**. In the second half of 2018, fiscal policy contributed nearly ¾pp to growth via lower taxes and higher spending, but this number will gradually diminish to roughly zero by the end of 2019. In addition, **financial conditions have turned into a significant headwind and could take more than 1pp off real GDP growth in the first three quarters of 2019**. This means that the demand-side case for above-trend growth is weakening significantly."

Exhibit 2: A Significant Near-Term Headwind from Financial Conditions

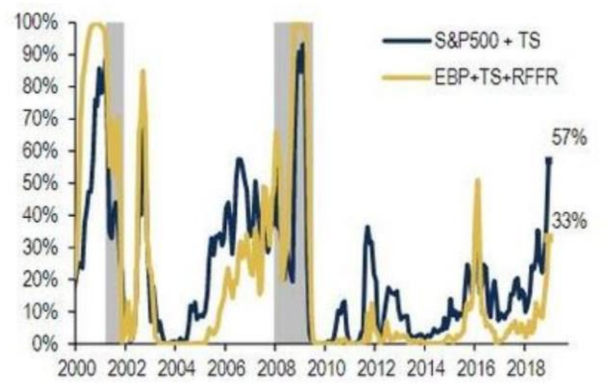


*Assumes GS FCI remains constant at December 27 close.

Source: Goldman Sachs Global Investment Research

Of course, that's precisely what other forecasters, specifically Bank of America thought as well... until the bank laid out a chart showing that according to at least one of its models, the odds of a recession in 2019 have soared from less than 30% heading into December, to a whopping 57% as of last week.

Chart 3: Probability of recession has risen (% probability of recession in next 12 months)



Note: Probit model used to estimate 12-mo ahead recession probability. S&P 500 is the 6-mo % change in the S&P 500, TS is the 3-mo 10-yr Treasury spread, EBP is the excess bond premium, and RFFR is the real fed funds rate. See A recession indicator you don't want to miss for more on the EBP.

Source: BofA Merrill Lynch Global Research

It's not just Goldman that's taking a somber view of 2019. Here's the wrap for now. The sentiment among the "experts" is rather gloomy. We especially like the Gundlach quote because our focus for the past 3 months has been to avoid getting smoked in this market. It's not what anyone wants to hear but it is the smart way to approach things as we and he see it. We repeat, NOT LOSING is winning in a market like the one we've been in through all of Q4:

MARKET TRACTION

PIMCO's nemesis, bond king Jeff Gundlach, suggested simply avoiding United States stocks and corporate debt altogether, as well as steering clear of long term treasuries (just in case there is any wonder he is feuding with Jim Cramer). Gundlach believes that the best bets for 2019 are in high-quality, low duration, low volatility bond funds.

During his December 17 interview on CNBC he stated: “This is a capital preservation environment. Unsexy as this sounds, a short-term, high-quality bond portfolio is probably the best way to go as you head into 2019.”

Richard Turnill who works for the world's biggest asset manager BlackRock, said that quality should be the focus in equities: look for companies with good cash flow, sustainable growth and clean balance sheets. **He also conceded that a slowdown was inevitable**, stating: "We see a slowdown in global growth and corporate earnings in 2019 with the U.S. economy entering a late-cycle phase".

Meanwhile, Bill Stromberg of T. Rowe Price believes that emerging markets could be the ticket for 2019. **"Emerging market stocks are starting out a lot cheaper and have a higher dividend yield. You could get 8 percent to 10 percent returns over the next 10 years. If the U.S. dollar weakens you could get more as a U.S. investor," he stated.**

Joseph Davis of Vanguard Group also says to "expect an economic slowdown". He believes growth in the U.S. will slow to about 2% and he puts his outlook for equities over the next decade in the 3% to 5% range.

The dour sentiment was shared by the CIO of equities and multi-asset strategies at Schwab, Omar Aguilar. He says to sell small cap equities and securities with high debt ratios. Instead, he also suggests emerging markets due to their relative valuations.

“Decelerating global economic growth, increased attention to trade-related development -- particularly with China -- tighter monetary policies, reduced liquidity, and a mean reversion toward historically average volatility levels are likely to set the tone for equity markets in 2019,” Aguilar said.

Remain nimble my friends!

Bank and Roll!

Options Academy

Understanding Beta for your Portfolio – Creating a Diversified Portfolio with Beta

This week we decided to further illustrate a few points that we didn't provide much detail on over the past few weeks and further decided that this was the week to do it given that we're starting a new year. Many investors will be positioning themselves for this year over the next few weeks.

Investors will usually choose an investment that has less risk with the same expected return. For example, if Stock A and Stock B both have an expected return of 15%, then investors will choose the stock with the lower Beta (volatility). In doing so, the addition of the lower beta stock will reduce the overall risk of the portfolio. This can be the final deciding factor between two stocks with similar potential.

Unfortunately, making selections within a self-directed portfolio isn't this easy. First off, we need to have a good projection of expected return or what we think we can make by owning stock in the upcoming year. This may be based off of fundamental or technical calculations or both of course.

However, if you are comfortable with options, then they can become another factor to consider in your projections for the upcoming year's potential. The implied volatility of options that expire in January of the following year can be used to extrapolate how far up or down the stock's price is expected to move. These are known as "LEAPs" options. "LEAPs" is an acronym for Long Term Equity Anticipation Security. If you buy into IV based projections, this can play a major role in position sizing (if so inclined) and helping with the mix of stocks you plan to hold in your handpicked portfolio. A mix of low, high and intermediately volatile stocks in your group will help to balance out your stock-specific volatility risk. Let's take a little closer look at how to project a stock's expected range and thus annual volatility expectations based on the IV.

17 JAN 20	(381)	100						
32.49%	34.97%	.75	21.60	X	22.85	X	17 JAN 20	85
31.68%	37.64%	.73	19.70	X	21.10	N	17 JAN 20	87.5
31.14%	40.62%	.70	18.00	X	19.45	N	17 JAN 20	90
31.66%	44.29%	.67	17.15	P	17.85	N	17 JAN 20	92.5
30.87%	47.17%	.64	15.65	X	16.10	X	17 JAN 20	95
30.36%	50.25%	.61	14.20	X	14.65	N	17 JAN 20	97.5
29.93%	53.37%	.58	12.85	X	13.30	N	17 JAN 20	100
29.25%	59.59%	.51	10.45	X	10.90	N	17 JAN 20	105
28.58%	65.56%	.45	8.35	X	8.80	N	17 JAN 20	110
27.94%	71.18%	.39	6.60	X	6.95	N	17 JAN 20	115

Above we see MSFT LEAP options that expire next January, a little more than a year from now. MSFT is trading near $101.50, so, it's very close to $100.00 which makes our math easy. Note that the Implied Volatility for the 100.00 strike call (the ATM option) is 29.93%, just under 30.00%. If we're willing to buy into idea that the options markets can reasonably reflect how much movement we should expect from a stock over a certain period of time, then we can do this…

MSFT is near $101.50 and the IV expectations for the next year are just under 30.00%. Thus, we can multiply $101.50 x .30% which equals 30.45. This effectively means that the options markets are expecting MSFT to be up or down $30.45 from the current price by January of 2020 expiration date.

MARKET TRACTION

Another way of stating this would be to note that the markets expect MSFT's price over the next year to range between $71.00 on the downside and $132.00 on the upside, roughly speaking.

This approach isn't perfect or all-knowing, but this is one way you can use actual numbers to decide between a few stocks based on the marketplace's expectations for volatility in each which can be helpful when narrowing your selection process down to the best-suited stocks for you.

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