MARKET TRACTION

We're a Whisker or One Night of Magic Away from SPYs $281.00!

Take your Pick!

This Week's Trade Ideas:

Bullish Ideas: (View Webinar)

X > United States Steel Corp. > $23.03 Last. Buy the March 22nd 21.5 Calls for $2.30 or less with a close or anticipated close above $23.32 in an up market with expectations for continued strength in the stock.

Alternative - Diagonal 1: Buy the March 22nd 21 Call for $2.50 while selling the March 1st 23.5 Call for $0.37. The spread would cost $2.13.

Alternative - Diagonal 2: Buy the March 22nd 21 Call for $2.50 while selling the March 8th 24 Call for $0.35. The spread would cost $2.15.

Bullish Mentions: **(View Webinar)**

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

OSTK.

Bearish Ideas: (View Webinar)

None at this time. The current short squeeze has left few stocks without earnings looming with bearish complexions.

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. The current short squeeze has left few stocks without earnings looming with bearish complexions.

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.

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Outlook:

Once again! Back to last week's Outlook:

Now they seem hellbent to manufacture a test of the 150/200 SMAs which are essentially in the same place and just a wee bit higher than current prices.

For this week but riffing on last week:

Now they seem hellbent to manufacture a test of **the $281.00 level in the SPYs but can they do it without taking a breather?**

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.)

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Recap of Last Week:

Last week we had nary a bear yet again, and only bulls, many bulls. We prefer to be two-way but as we noted, our scan ratio was overwhelmingly bullish. Here are the names we had:

MU (official idea**)**

Bullish Mentions: **MSFT, WFC, INTC (Diagonal?), ROKU* (Earnings 2/21), SLB, TSM, SCHW, V, JNJ, TXN, GIS, IBM, FDX, IP (Diagonal?)**

MU moved up nearly $3.00 from where we spotted it last Tuesday. Sure, that's good, a 7 to 8% jump in a week is nice but…it didn't stay there long and didn't continue to power up and it allowed the 150 SMA to keep it in check. We're kind of ticked about that but that's how it goes sometimes. It may go further still but the fact that it didn't ramp more strongly leaves us feeling disappointed.

MSFT - $3.5 of upside push. Milder than we hoped.
WFC – up very little. A dud.
INTC (Diagonal?) – Nice breakout and nearly made it to $52.00 level. Diagonal should have worked well.
ROKU* (Earnings 2/21) – Nearly a $6.00 move up and passed $50.00 easily. No complaints!
SLB – Moved up nearly 4% and may be on verge of more as hoped.
TSM – Down very small in $ terms but definitely a downer for our **mood** ☹
SCHW – Up small. We didn't expect much and we didn't get too much!
V – Moved up $3.00 so far…
JNJ – Up $2.00. Has yet to blast off bigger…
TXN - $3.5 of upside movement.
GIS – Small mover that made it to our $46.00 target.
IBM – Up a couple of bucks, hasn't filled gap yet.
FDX – Down a few dollars on news. Very disappointing.
IP (Diagonal?) – Up less than $1.00, the diagonal should have delivered the goods!

13 of the 15 bullish names moved up with only **TSM** moving down slightly and **FDX** dropping on news. That's a good batting average and some names did power for us quite niccely but we're left feeling that we should have gotten more from several of theses names. Maybe we'll see it in the next few weeks? Maybe the final MeltUp/Blowoff Top is about to launch? One can only hope…

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Market Overview

Last week we noted:

Instinctively, we'd love to fade this news-based buying and sell into it, ***but experience and the charts advise that we must be patient.*** *Many times, bogus news has launched what turned out to be a powerful and ultimately, a legitimate rally.*

This week's spin 'em higher maneuvers have made the charting picture a little clearer. We're using the SPX because our SPYs chart has gotten very crowded again. (As usual)

Here are 3 paths forward as we see them:

1. We have the ***RED*** *double top followed by a drop* ***scenario that seems unlikely given the "everything is wonderful" glow world equity markets are basking in…***

2. The ***YELLOW*** *arrow would bring about the push to the low $2800's level in the SPX which is right near and equivalent to the SPYs $281.00 target level we've had our eyes on for some time.*

3. Would bring us the ***ORANGE*** *arrow "push through" that level to the breakdown point near $2900.*

It probably comes down to this…can the Gang push through and close above the 150/200 SMA levels? If so, that might bring some money into the markets and boost technical confidence that the ship has been righted. We're not so "onboard" with that thinking ourselves but we do believe that many would begin to party again. ***If they can get a close above those levels, we have to believe they make it to the SPYs target near $281.00.*** *If that gets taken out, we have to believe that the irrational exuberance would then try to target $2900 in the SPX.*

We added our **emphasis** to last week's comments because a double-top was indeed unlikely and we're now in the midst of an attempt on scenario **2** which needs to happen before we can contemplate that **3** is underway. And that's really it. We're seemingly in an attempt of **2** that will try for $281.00 in the SPYs:

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With nearly all major indices tracking just about the same way, this is just about all we need. Please note the **Pink** and **Grey** ellipses that denote a downside gap and an upside target zone respectively. There's seemingly a lot of resistance awaiting the SPYs near $281.00. If a shocker pullback somehow arrives out of the blue, the $271.00 level would likely put an end to it, at least initially.

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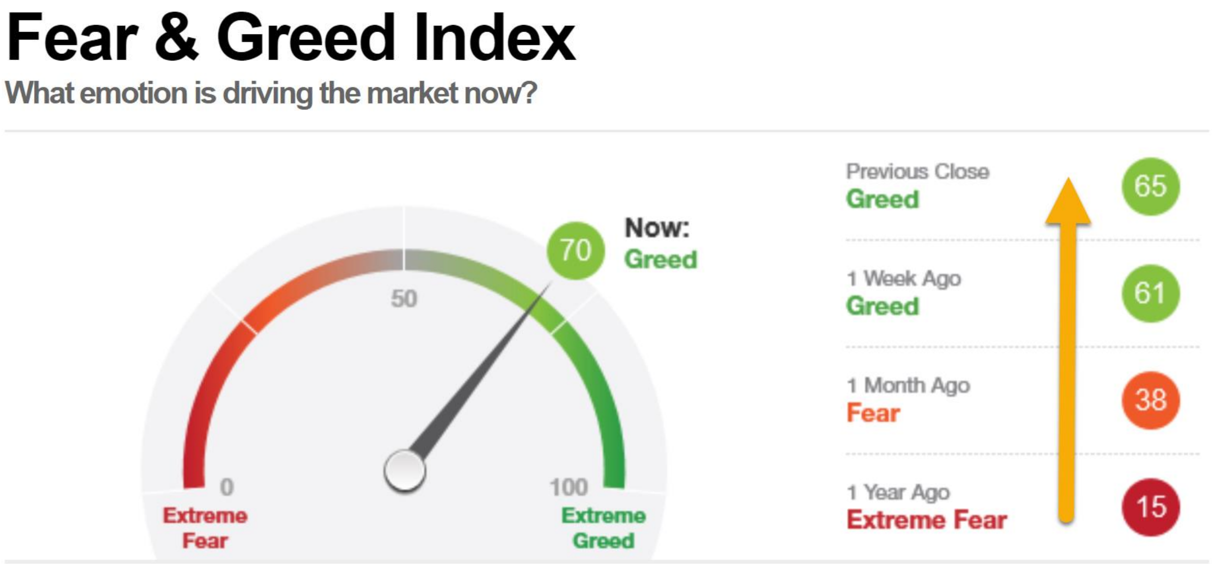
Another jam-packed calendar is set for the week. Plenty o' powder to gun stock prices with!

This Week's Economic Calendar

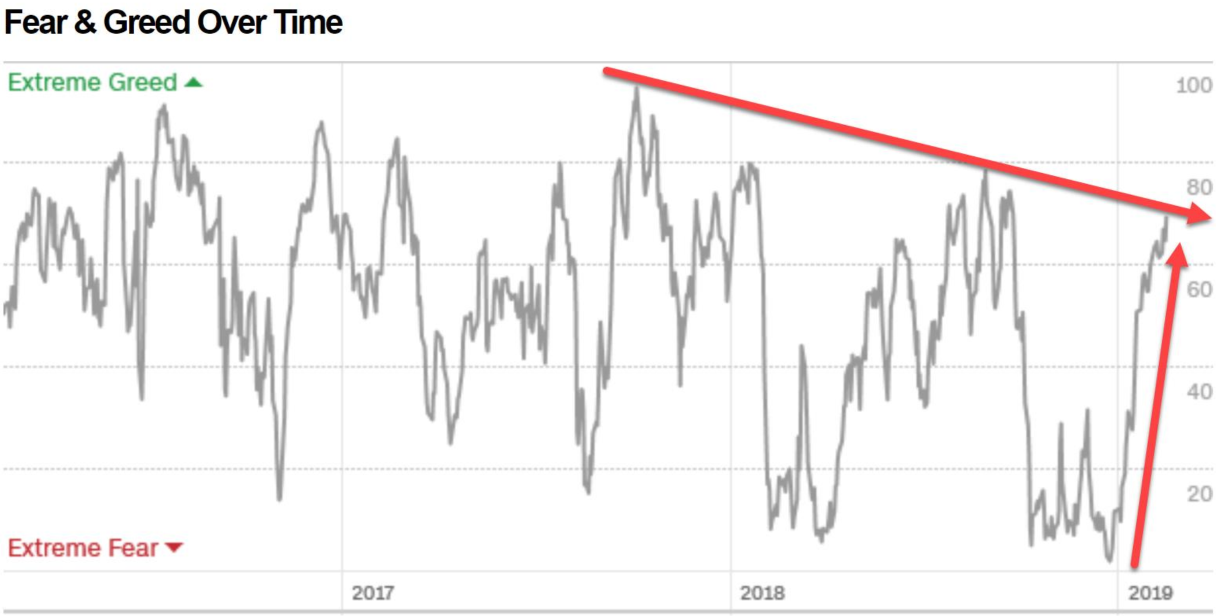
TIME (ET)	REPORT	PERIOD	ACTUAL	MEDIAN FORECAST	PREVIOUS
THE GOVERNMENT SHUTDOWN WILL DELAY RELEASE OF SOME DATA THIS WEEK					
MONDAY, FEB. 11					
11 am	Survey of consumer expectations				
11:15 am	Michelle Bowman speaks				
TUESDAY, FEB. 12					
6 am	NFIB small business index	Jan.	101.2	--	104.4
10 am	Job openings	Dec.	7.3 mln	--	7.2 mln
11 am	Household credit	Q4	3.0%	--	4.3%
12:45 pm	Jerome Powell speaks				
6:30 pm	Loretta Mester speaks				
7:30 pm	Esther George speaks				
WEDNESDAY, FEB. 13					
8:30 am	Consumer price index	Jan.	0.0%	0.1%	0.0%
8:30 am	Core CPI	Jan.	0.2%	0.2%	0.2%
8:30 am	Real earnings	Jan.	1.7%	--	1.3%
8:50 am	Raphael Bostic speaks				
8:50 am	Loretta Mester speaks				
12 noon	Patrick Harker speaks				
2 pm	Federal budget (new date)*	Dec.	-$14 bln	--	-$23 bln
THURSDAY, FEB. 14					
8:30 am	Weekly jobless claims	2./9	239,000	225.000	235,000
8:30 am	Retail sales (new date)*	Dec.	-1.2%	0.0%	0.1%
8:30 am	Retail sales ex-autos (new date)*	Dec.	-1.8%	-0.1%	0.2%
8:30 am	Producer price index	Jan.	-0.1%	0.1%	-0.2%
10 am	Business inventories (new date)*	Nov.	-0.1%	--	0.6%
11 am	Patrick Harker speaks				
FRIDAY, FEB. 15					
8:30 am	Retail sales*	Jan.	DELAYED	--	N/A
8:30 am	Retail sales ex-autos*	Jan	DELAYED	--	N/A
8:30 am	Import price index	Jan.	-0.5%	--	-1.0%
8:30 am	Empire state index	Feb.	8.8	--	3.9
9:15 am	Industrial production	Jan.	-0.6%	0.0%	0.1%
9:15 am	Capacity utilization	Jan.	78.2%	78.7%	78.7%
9:30 am	Raphael Bostic speaks				
10 am	Business inventories*	Dec.	DELAYED	--	N/A
10 am	Consumer sentiment index	Feb.	95.5	94.0	91.2

Below the Radar

This week we found another dearth of BTR-styled info out there in the vast reaches of the Internet. We'll get started with another snapshot of the Fear & Greed Index.



Note that we're nearly "there", right at the resistance line we've been drawing for some time:



Once again, there's no reason why the Greed level cannot ramp up through our line and beyond. However, now that we've arrived here, we can see that we've reached seriously high levels. Interestingly, THIS occurred too:

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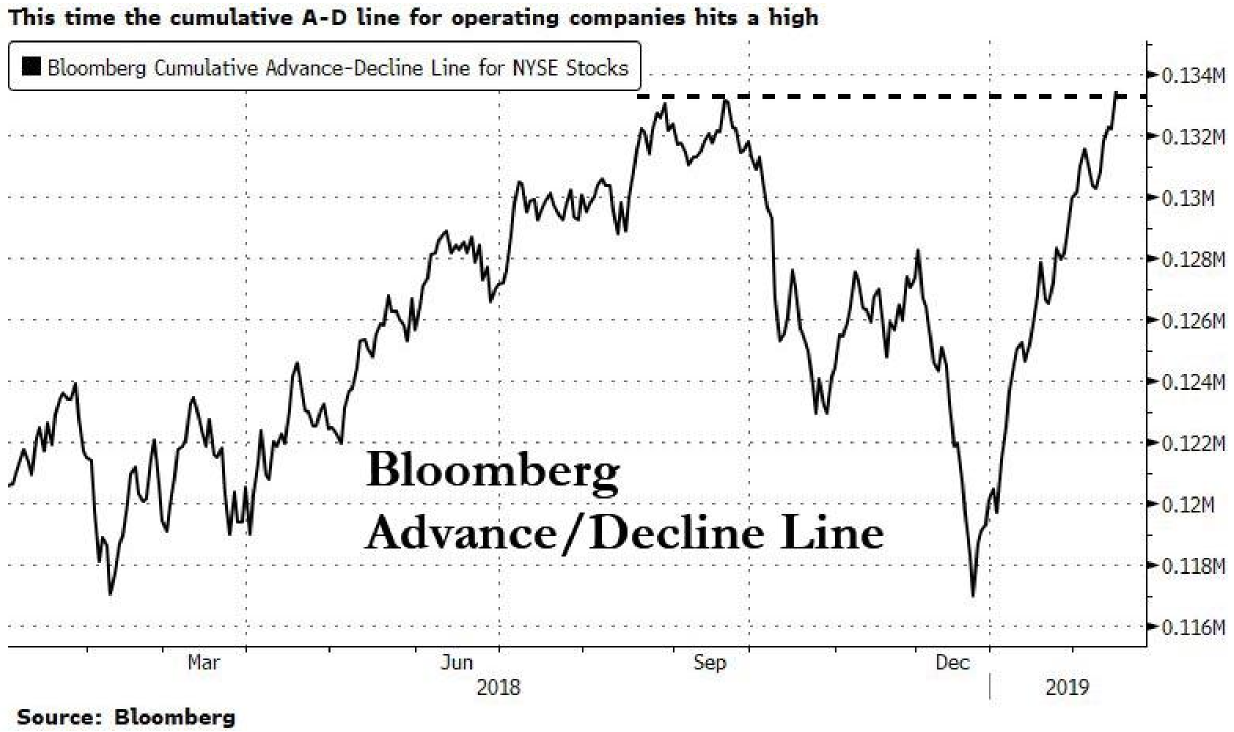
"…because as of Friday's close, Bloomberg notes ***that NYSE company breadth - advancing stocks over than declining - just hit a record****, joining* ***the S&P 500 cumulative advance-decline line and NYSE Composite A-D line at new highs.****"*



Record levels. New highs. Well into "Greed" territory. The question becomes: *"How much better can it get? Especially in the near-term?"*

Above is a chart of the SPYs that shows that are long-awaited $281.00ish level is just a whisker or an orchestrated overnight futures levitation away, take your pick!

Anyway, the *rampjob* has been very vertical and one has to become more concerned with that aspect the higher it rises. Plenty of resistance would seem to be just *North* of here. And with that, we're going to share a great piece we JUST came across that not only includes comments and concerns similar to ones we've recently expressed but EXPANDS greatly on them. For those reasons, we love this contribution from Sven Henrich of *North*manTrader.com. It is very much worth reading the entire essay.

https://northmantrader.com/2019/02/17/caution-2/

Here are the highlights with our emphasis added:

*Does this now mean the **bull trap** case is over, markets are safe and nothing but blue skies ahead for the rest of the year? This is certainly what is appears like at the moment after 8 weeks straight up.*

The complete lack of 2-way price discovery remains impressive. Yet the all clear cannot be rung. In my 2019 Market Outlook I had postulated the following:

*"Only a **sustained** close above the daily 200MA and the weekly 50MA can give investors comfort that perhaps a major low is in play and markets can head to higher pastures."*

I stand behind that and as of this moment this rally remains completely untested, indeed it's the most vertical and narrow rally in 70 years by some measures:

Did I mention magic?

*Before I go into technicals further below let me just make some statements of principle: This channel will not sustain for the rest of the year, it will break and it will get challenged. **Let me further suggest that the larger structure we are witnessing here is not that of a stable bull market. It's a complete mess, it's unstable, it's got all kinds of technical issues one of which being the mechanism by which price discovery is achieved and I want to address some of this today, both structurally, philosophically, but also technically, so bear with me.***

Let's talk valuation process:

In a former life during the Nasdaq bubble I was heavily involved in international M&A projects and greenfield opportunities (Asia, Europe, Africa, South America) for a multi-billion corporate entity. Our task was to not only identify and pursue value creating opportunities, but to develop a well founded *perspective on how to value these opportunities. We needed to know how much we could reasonable bid for these opportunities (in many cases these were multi-billion dollar opportunities), but also what our cut off point was. To that end we needed solid business plans founded not only on a solid understanding of future revenues, expenses, but also future EBTIDA, free cash flows, debt to equity, WACCs (weighted average cost of capital) and a whole host of valuation metrics. Yet, at the end of the day, no matter how realistic one thought a business plan was, there were unknowables and uncertainties. Worse, any final valuation could easily be changed by one variable, the terminal value multiple. Frankly it was a wag (wild ass guess), largely influenced by how confident or skeptical senior management was in regards to a specific opportunity.*

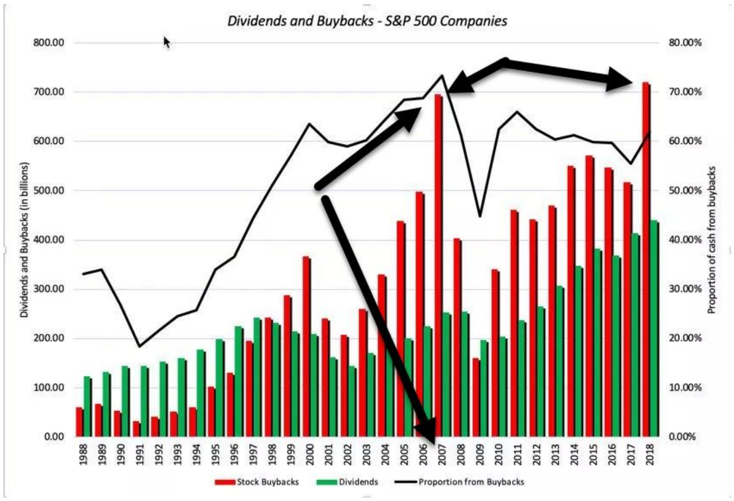
And before you knew it what was a months long rigorous valuation exercise, including on site and in country research, quickly became secondary to the terminal value multiple. We want in, or we don't want in, and in a competitive field of players playing the acquisition game valuations suddenly disconnected farther and farther from the original business plans creating a reality gap.

The point of all this? ***As I'm watching stock markets these days I sense a similar process of disconnect. How do you value what a stock should be worth? Earnings growth right? Which earnings? GAAP or non GAAP? GAAP accounting has long taken a backseat to non GAAP accounting. We don't account for bad news here, things we don't like are shoved into non GAAP accounting. It's just a one time thing. And the next thing is just a one time thing too. And so on. And hence things we don't like get pushed aside.***

When stocks report earnings prices often react favorably when stocks beat on EPS. What makes an EPS beat these days? Well, firstly it's all about expectations and Wall Street generally takes EPS estimates down during any given quarter, making it easier for companies to beat. "Oh look they beat EPS it's bullish", no matter that EPS estimates were originally much higher at the beginning of the quarter. That negative trend is not accounted for. What matters is that they beat lowered expectations.

But are we even get a real view of EPS these days? ***Fact is buybacks keep reducing the float and EPS look better and better by the simple virtue of math as the same earnings divided into fewer shares show a higher EPS result. Magic.***

And buybacks have been soaring again:



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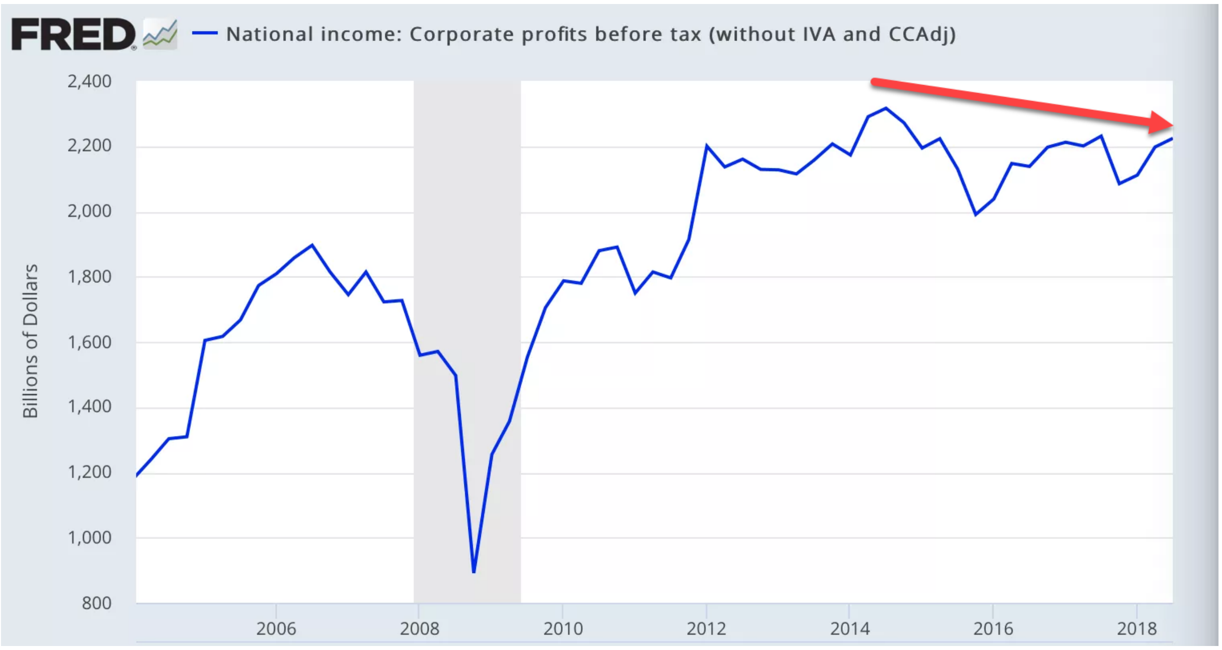
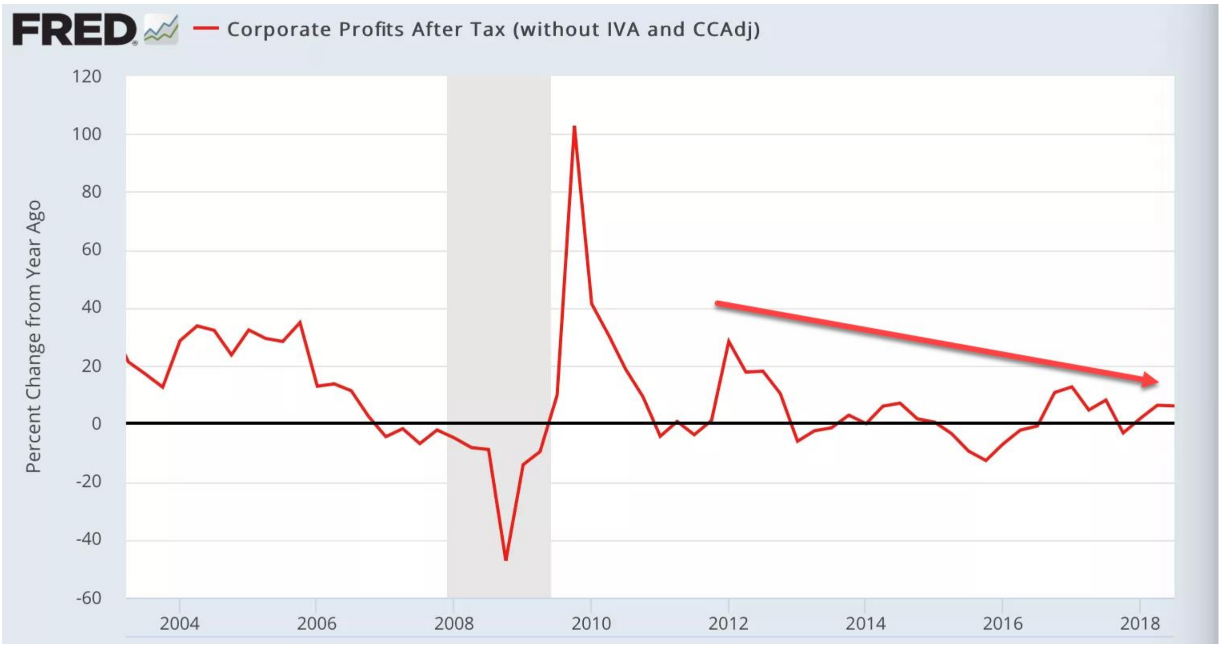
Earning growth can simply be driven by increased buybacks. CEOs look better, stock prices rise and shareholders are happy. Again, we are setting up a process where expectations and perception is managed.

For example, we've been told that profits were oh so awesome on 2018. Were they actually?



That's less than Q3 2014 from what I can see. *But tax cuts right, that must have made a huge difference in corporate profit growth?*

You tell me:



Doesn't look all that impressive to me. *But hey.*

Let's take our non GAAP results, add massive buybacks and throw in a whole bunch of optimism and let's justify very high valuations for stocks.

And that's what markets did twice in 2018, first in January 2018 and when that went off the rails buybacks gave the momentum to push the $DJIA to new all time highs in October. And then the bottom fell out. What changed? The valuation metrics changed. Growth started slowing down and suddenly confidence waned and high valuation multiples became smaller ones and nothing changes terminal value multiples faster than confidence right? ***Markets actually went through a price discovery mechanism once known as corrections.***

But it lasted only hours and days.

As of Friday's close $DJIA is right back to where it was in January 2018. Despite negative earnings earnings growth in Q1 and soon to be flat on the year, despite now negative GDP growth versus last year, despite everything having changed since January 2018. The terminal value multiple was suddenly adjusted upwards. Not because of earnings, or revenues or anything, only because of confidence, confidence that bad news no longer has to be accounted for.

It's the point i highlighted in **bears had been right about everything**. *And it's a point that Guy Adami clearly picked up on and articulated well on Fast Money on Friday (thanks for the shout out):*

https://youtu.be/pCsfxFVtBls

And, as a result, markets again have not been able to not account for the realities of the underlying fundamental picture and hence my urging of caution. As with non GAAP accounting, buybacks, etc, central banks act as a backstop disrupting again the price discovery process. Bad news is not accounted for, a few hours at best, hence markets become ever farther disconnected from reality and the price discovery process is left broken and further and further removed from an economic and fundamental foundation. So far it has worked time and time again:

Yet central banks went dovish for a reason and that reason remains very much active in the global economy: ***Slowdown.***

*Nothing here, so far, is unusual in context of an aggressive bear market rally, not even an untested overthrow above the 200MA. Why? Because of the nature with which prices are achieved. Just consider the last week…**Price levitation is almost exclusively achieved with overnight gap ups and open 30 min ramps. Gap, ramp & camp** we call it as price then settles in a very tight range of a few handles for hours on end. Friday's overnight low of 2728 is not even visible on the chart. Too powerful proved the headline driven environment turning futures positive before open and **causing yet another ramp to highs of the week on a Friday, a now repetitive program for 2019: Magic Fridays we call them.***

***Is there any evidence that this rally is associated with growth or expanding earnings? The answer is no**, yields have remained completely unimpressed by the levitation in equity prices. Technical reasons to be cautious here: Indices keep getting more overbought.*

As we noted last week, we're not buying the "all is well" and "happy days are here again" stories either. In the end, when it comes to short-term trading, we must go with what the charts tell us. That doesn't mean that we do it blindly! We can't yet rule out new All-Time-Highs later this year and we'll be happy to climb aboard the rallies that could take us there. We just won't be doing it while thinking that we "can't lose." Henrich's skepticism is a mirror image of our own and thus his argument is a compelling one. For the record, he had us at "magic."

Remain nimble my friends!

Bank and Roll!

Options Academy

Once again, we're sticking with volatility coverage this week. We're doing this because volatility is such a critical concept to fully understand. We're going to get into what's commonly referred to as "skew" again this time around.

Most students, having been foresighted enough to educate themselves properly in options theory, leave the "classroom" with a solid foundation as to how to make sense of options prices. The only thing is, the dynamics in real world options pricing often differ from what the theory would lead one to expect. Let's take a simple example…

Students in solid programs know that there are 6 inputs that are used by the OPM (Options Pricing Model) to calculate an option's value, 5 of which are known or easily ascertained. The only one that isn't *easy* is the volatility input. (We alluded to this last week)

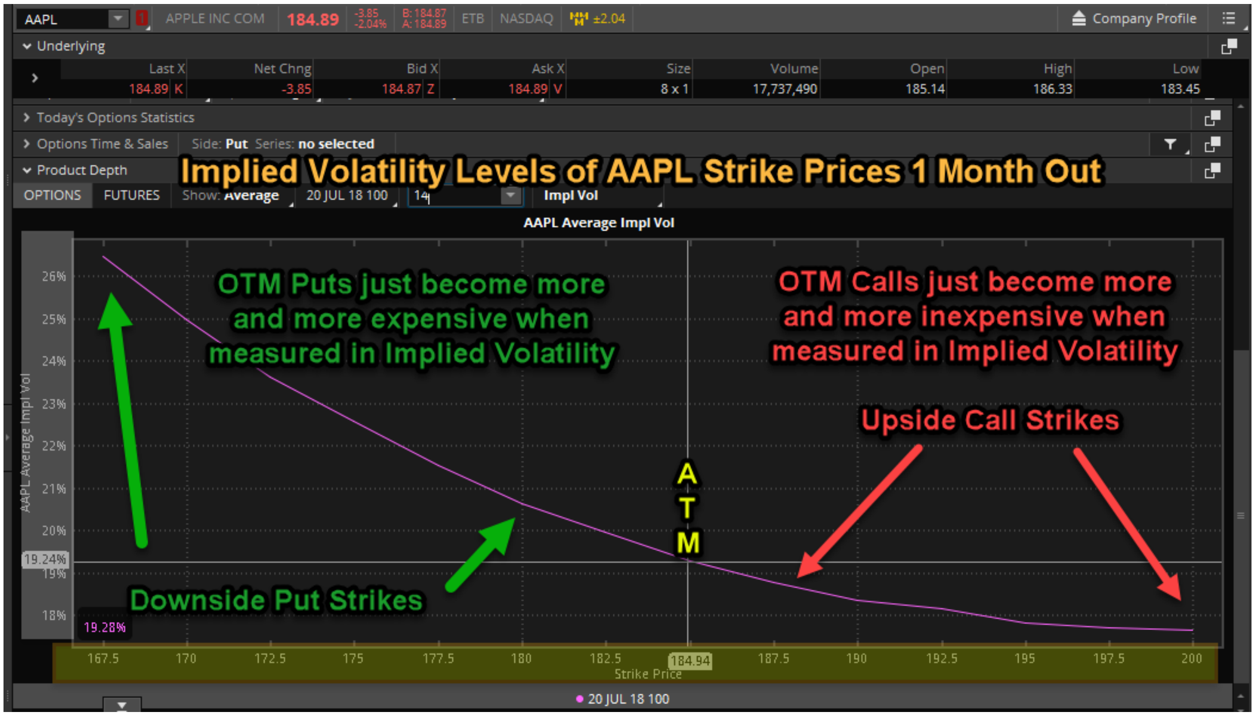
We'll cover them in a basic but methodical way to be thorough. Remember, the first 5 are essentially *known or givens*… Here they are:

1. Current Price of the Underlying Stock
2. Option Strike Price in focus
3. Days until Expiration of the Option
4. Current Interest Rate
5. Dividend Stream
6. Volatility Input

We do not want to get to deep into the *Vol Input* at this time, but instead want to focus on it in a basic way to reveal skew. Consider this example… let's assume that all the first 5 inputs are the same and that we're focused on what are known as the *corresponding call and put*. The corresponding call and put are options at the same strike price within the same expiration. Essentially, they're a pair. Now let's think back to what implied volatility really is. (see last week's coverage below) If we assume that dividends will not factor into our calculations, and that the interest rate we used for the corresponding call and put calculation would be the same, then we should arrive at the same value for each if we also assume that they are directly at-the-money. Give this a good think before moving on. However, they're not always valued at exactly the same price even under these assumptions. Why? Implied Volatility (IV), well, sort of. In the real-world it comes down to how the marketplace treats each option's price, which is how we arrive at IV in the first place. Sometimes the IV differs somewhat even within the tight relationship of the corresponding call and put. When there's a difference in IV levels from one option to another, that's typically referred to as "skew".

To further hit on this and to begin to wrap things up for now, think of a downside put that's 3% *out of the money* vs. an upside call that's 3% *out of the money*. All things be equal (same assumptions we used above except their both OTM instead of ATM), these options should trade at similar prices based on theory. They have identical 4 out of the first 5 inputs and their strike prices, the only one that's different, are equidistant from the current stock price. The normal distribution-based pricing theory that we learn would argue that they should be priced very similarly. In practice, they rarely are priced identically. This is much easier seen and understood rather than read and understood.

Here's a Call/Put skew view we pulled from Apple this past summer:



Check out OTM calls and puts that are equidistant away from the ATM's in some of the stocks that you trade in and you'll see that prices vary!

With the markets now veering into overbought territory, it may be worthwhile and telling to keep track of the Call/Put skew in your issues. If the skew becomes even more pronounced, we could be in for a pullback…

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

Last Week's BTR

We haven't discussed implied volatilities in some time and so we decided to revisit them this week. A very good and common question that we receive regularly when working with clients sounds a bit like this: *"How can I tell if I'm getting a good buy on the option I'm considering?"* It really is a great question actually because it gets to the heart of how options are priced. In our 1-on-1 consulting sessions we spend a great deal of time helping clients understand the outputs from the options pricing model, its various inputs and how various factors can influence option prices as they're quite dynamic. Before long clients realize that the Volatility Input, aka simply "volatility", is the most critical input needed to arrive at an option's value as all other inputs are readily available. The thing is, as is typical of academic discussions, the pricing model and the volatility input can be rendered all but moot! Why? Well…the

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MARKETPLACE has the final say as to what an option is worth. Supply and Demand determine option prices as they do so many other prices in a market-based economy. As the markets have the final say, wouldn't it make sense to take a good look as to how the marketplace has treated the options prices on a certain stock over the past year? It would certainly seem so! More important than what we believe something is worth, is what the markets have somewhat consistently determined it to be worth. We can access this type of data on many trading platforms and websites.

To help illustrate things more clearly, we doctored up the graphic above. This example shows 1 Year of Apple's stock price chart but in the subgraph below it we can see both the historical volatility levels (**in purple,** statistical volatility) over the past year along with those of implied volatility (the **blue** line). We're going to focus only on the **blue** line for now (IV). Remember too that this is a summary number. This summary of the IV level over time may be thought of as the general level of option prices in the marketplace (an indexed number.) Implied Volatility is actually the marketplace determining an option's dollar value and then that dollar value, which is normally the output of the options pricing model, is used to "reverse engineer", using the pricing formula, to deduce what volatility input would be needed to arrive at that dollar value for the option. In other words, we're backwards calculating what volatility level the marketplace is implying it is using to arrive at the dollar value of the option. Hopefully that clears that up! 😉

So how do we use this information to inform our decision-making? Unfortunately, it's all relative! BUT, that's another discussion for another time. In practical terms, observe where we've labeled the red and green horizontal lines 100% and 0%. Those are percentiles. We're pointing out the high of the implied volatility range over the past year (100^{th}), along with the low (1^{st}) with the large **H** and **L** notations. This provides us with a solid framework from which we can assess the current level as highlighted on the right where the volatility data stops in the **yellow oval**. We can see that the current level is closer to the for low of the past year rather than the high of the year. While there is no guarantee that IV cannot go lower, we can take some comfort in the fact that current IV levels are lower than they were and naturally that means that options prices in AAPL are on the cheaper side of things relative to the past year. However, observing the IV history informs us that IV levels in Apple can fall much further before the next earnings cycle and they typically do!

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These are just a few ways that researching implied volatility levels over time can aid us in our decision-making. We'll plan to cover other ways in the future when the market timing and subject matter guide us to that material.

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