MARKET TRACTION

Flip a Coin – What Should Happen vs. What Could Happen…

This Week's Trade Ideas:

Bullish Ideas: (View Webinar)

None at this time. Market extended and pausing at a critical level.

Bullish Mentions: **(View Webinar)**

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

AAPL, DOCU, PVTL, TLRY. *SPYs yet to break close by resistance.

Bearish Ideas: (View Webinar)

TWTR > Twitter Inc. > $31.01 Last. Buy the March 22nd 32 Puts for $2.10 or less with a close or anticipated close below $30.60 in a down market with expectations for continued weakness in the stock.

ZAYO > ZAYO Group Holdings > $25.06 Last. Buy the March 15th 25 Puts for $1.20 or less with a close or anticipated close below $24.75 in a down market with expectations for continued weakness in the stock.

LM > Legg Mason Inc. > $29.17 Last. Buy the March 15th 30 Puts for $1.15 or less with a close or anticipated close below $29.15 in a down market with expectations for continued weakness in the stock.

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

RSG, MXIM, SHOO*. *Earnings due tomorrow. Post-earnings trade if slips mildly and market weakens.

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 and will be so.

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Outlook:

Once again! Back to last week's Outlook:

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?

They finally got 'em there. Pullback then run to them again to retest? Through them on Try 2? Straight-up failure? Head fake above then failure? It's a coinflip. A pullback should occur, but news is the wildcard.

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:

The past week is easy to recap.

X was the official idea and any one of our trade plans would have worked out to a degree. It shot up a little too fast initially and did fall short of our $25.00ish target by about .26c. It happens. It was designed to be safe with only 1% more upside left before the SPYs would hit $281.00. As we all know, we finally got there on the SPYs and we're at "now what" status. **X** though, has pulled back to the 100 SMA at the moment and found support there. Maybe it will launch again if they initiate "Operation All-Time Highs Retest"???

OSTK was there as another name but it was disappointing and never even tried to challenge our $22.86 breakout level.

We did scan again for bears specifically but we have seen little "crack" of any support levels to this point and fortunately have avoided going short too soon.

Last week we wrapped up "Recap" this way:

*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 nicely, <u>**but we're left feeling that we should have gotten more from several of these 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…**</u>*

As a reminder > Prior Week Bullish Names: **MU, MSFT, WFC, INTC (Diagonal?), ROKU* (Earnings 2/21), SLB, TSM, SCHW, V, JNJ, TXN, GIS, IBM, FDX, IP (Diagonal?)**

Many of those names did continue to power higher after last week's less than desired upside. So, that was nice.

Market Overview

Last week we noted or reiterated the following snippets:

2. The … 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 … "push through" that level to the breakdown point near $2900.

*… 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.*

And really, that was really it!

The Gang finally delivered on our long-discussed SPYs $281.00ish target on Monday.

We remain at a very interesting technical juncture that combines:

1. A confluence of many resistance factors

2. An overbought but not too overbought market

3. A market that won't back off and has ground up slowly recently

4. A great propensity to exceed key highs ($281.00) even if temporarily

5. A Clearance Zone with seemingly little resistance above $281.00 to the All-Time-Highs

The **GREY** arrow points to the confluence of resistance within the **GREY** ellipse while the **YELLOW** arrow is the real breakout that probably puts MANY shorts in big trouble they never expected and when combined with the clearance zone, possibly produces manic buying. Could a major domestic or world news event serve as the catalyst?

So, YES, this is a tough one for sure. The VIX seems to be reading it that way as well. The GRIND up should have knocked the VIX back to lower/normalized levels YET it is still clinging to the base of elevated levels:

Our Options Academy installment this week discusses our rationale for using slightly ITM options. A juncture such as this one is the perfect time to consider our argument because our confidence in what happens next continues to drop to 50/50.

Normally, some sort of selloff would be expected after 2 months of levitation and a stall at a triple/quadruple top. But these aren't normal times and we'd be surprised if the bulls turn tail that quickly after hitting the $281.00 for only fleeting seconds.

Another super-heavy calendar this week with Powell's yapping as a possible highlight. There should enough here to provide cover for whatever's next!

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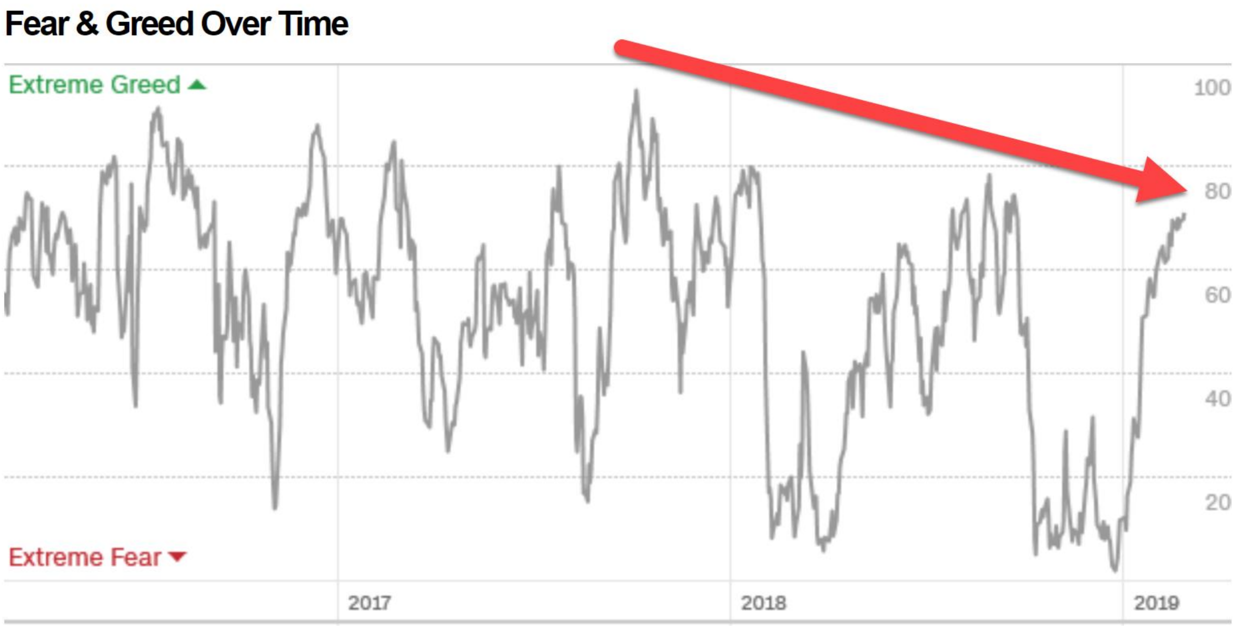
This Week's Economic Calendar

TIME (ET)	REPORT	PERIOD	ACTUAL	MEDIAN FORECAST	PREVIOUS
THE GOVERNMENT SHUTDOWN WILL DELAY THE RELEASE OF SOME DATA THIS WEEK.					
MONDAY, FEB. 25					
8:30 am	Chicago Fed national activity index	Jan.	-0.43	--	0.05
10 am	Wholesale inventories* (new date)	Dec.	1.1%	--	0.4%
11 am	Richard Clarida, Rob Kaplan listen				
6 pm	Richard Clarida, Rob Kaplan speak				
TUESDAY, FEB. 26					
8:30 am	Housing starts* (new date)	Dec.	1.078mln	1.256mln	1.214mln
8:30 am	Building permits* (new date)	Dec.	1.326	--	1.322mln
9 am	Case-Shiller home price index	Dec.	4.7%	--	5.1%
10 am	Jerome Powell testimony				
10 am	Consumer confidence index	Feb.	131.4	124.7	121.7
10 am	New home sales*	Jan.	DELAYED		
WEDNESDAY, FEB. 27					
8:30 am	Advance trade in goods* (new date)	Dec.		-$73.0 bln	-$71.6bln
8:30 am	Durable goods orders*	Jan.	DELAYED		
10 am	Jerome Powell testimony				
10 am	Pending home sales index	Jan.		--	-2.2%
10 am	Factory orders* (new date)	Dec.		0.5%	-0.6%
THURSDAY, FEB. 28					
8 am	Richard Clarida speaks				
8:30 am	Weekly jobless claims	2/23		223,000	216,000
8:30 am	GDP* (first & second estimates)	Q4		1.9%	3.4% (Q3)
8:50 am	Raphael Bostic speaks				
9:45 am	Chicago PMI	Feb.		--	56.7
10 am	Housing vacancies* (new date)	Q4			
12:15 pm	Patrick Harker speaks				
1 pm	Rob Kaplan speaks				
7 pm	Loretta Mester speaks				
8:15 pm	Jerome Powell speaks				
FRIDAY, MARCH 1					
8:30 am	Personal income* (new date)	Dec.		0.4%	0.2%
8:30 am	Personal income	Jan.		0.3%	N/A
8:30 am	Consumer spending* (new date)	Dec.		-0.3%	0.4%
8:30 am	Consumer spending*	Jan.	DELAYED		
8:30 am	Core inflation* (new date)	Dec.		0.2%	0.1%
8:30 am	Core inflation*	Jan.	DELAYED		
9:45 am	Markit manufacturing PMI	Feb.			53.7
10 am	ISM manufacturing index	Feb.		55.2%	56.6%

10 am	Construction spending*	Jan.	DELAYED		
10 am	Consumer sentiment index	Feb.		95.5	95.5
1:15 pm	Raphael Bostic speaks				
Varies	Motor vehicle sales	Feb.		16.8 mln	16.7 mln

Below the Radar

Another week of upward grind and thus another dearth of BTR-styled info for us to latch onto.



The CNN index hasn't moved up much since last week and we're still at "resistance" but notice the "fizzling" action of the past week or so. *Market Yahoos* seems reluctant to get more aggressively "yahooish" right about now in these parts!

So, what's going on besides the inner-workings or modern equity markets?: How about too much money chasing too few stocks, again!!! https://www.dlacalle.com/en/back-to-fundamentals/

Lacalle picks up on the heels of last week's stellar argument courtesy of Sven Henrich. That is, he's talking our book too!

*If we look at the list of key macroeconomic data published in recent weeks, we cannot use a better definition than "***disappointing***". **The slowdown in the eurozone is evident** and more pronounced than even the most pessimistic expected. Both industrial production, consumer confidence and indicators such as the trade surplus have deteriorated sharply. But there is growth. Despite the bad data, the Italian recession and the fact that the European Commission has had to revise down by more than 30% its own estimates from a month ago, Europe will likely grow in 2019. **China continues to slow down under the weight of its indebted and inefficient model**, but it also grows.*

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What has led to this period of market euphoria if the macro data and profits are not spectacular?

We also found Nomura's take and it's not comforting. All "4" are worrisome but 1 and 2 are most worrisome!:

Which brings us to the question du jour: what has driven the US Equities price action? According to Nomura's cross-asset strategist, the answer is four-fold:

1. ***US Corp stock repurchases,***
2. ***Short-Covering (Cash, Futs and ETFs),***
3. *Asset Manager Futures buying and*
4. *CTA Trend pivot from "Max Short" to "Max Long"*

So, there's that! Buying not based on the *old trieds and trues* but instead the money spigot overflowing and CFO's boosting EPS as early bears scramble for their lives!

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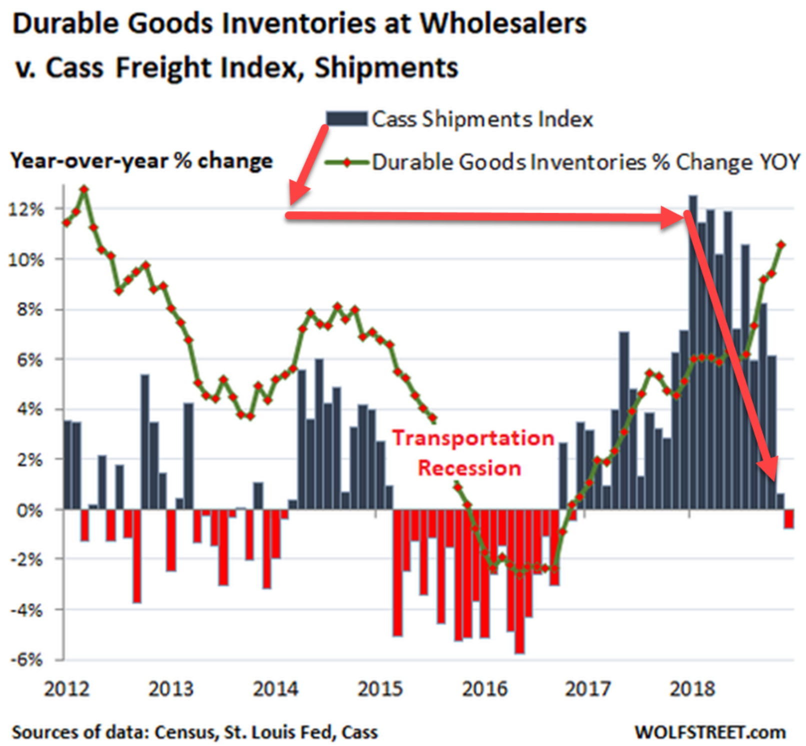
Then there are more tangible things, things like inventories. Here's a piece that confirms that inventories are piling up in a big way: https://wolfstreet.com/2019/02/25/inventory-pileup-sounds-alarm-for-goods-based-economy/

And, shipments are seizing up:

"In 30 years, I've never seen anything like this": CEO of warehouse operator Pacific Mountain Logistics.

***Sales** at merchant wholesalers (except manufacturers' sales branches and offices) fell 1% in December 2018, compared to November, to $497.2 billion on a seasonally adjusted basis, and inched up only 1% compared to December 2017, according to the Census Bureau estimates this morning.*

***But inventories at these wholesalers rose 1.1% from November and jumped 7.3% from December 2017**, to $661.8 billion. Over the two-year period through December, inventories have risen 11%. This includes inventories of durable and non-durable goods.*



The housing market surged strongly over the past few weeks as a topic of conversation. We'll start with a little confirmation that suggests we're really on the way back down and how, we just don't know it yet!:

US home price growth has slowed for nine straight months - up just 4.18% YoY - the weakest since Sept 2012, according to S&P Case-Shiller's 20-City Composite index.

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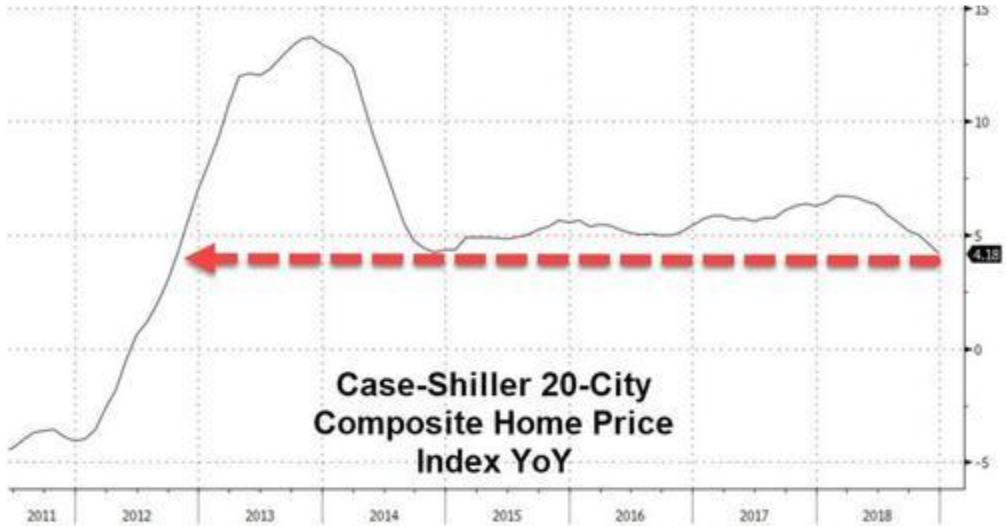

And then there was this:

https://www.zerohedge.com/news/2019-02-26/us-housing-starts-crashed-december

After surging in November, housing starts and permits were expected to relapse in December following shutdown-delayed dismal data from the US housing market.

*However, collapse was more appropriate than relapse as **Housing Starts crashed 11.2% MoM in December** (against expectations of a .1% drop). Building Permits managed a modest 0.3% MoM gain however (better than expected).*

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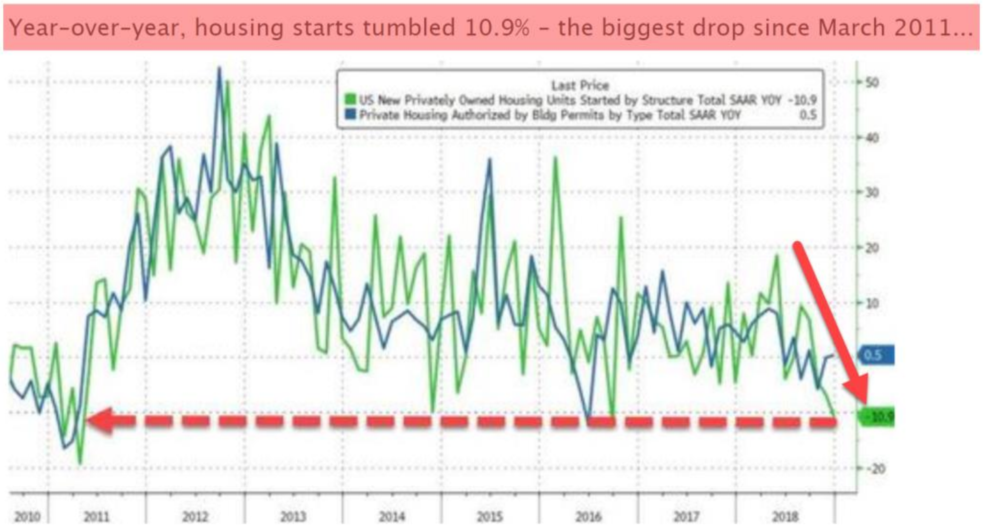

Millennials, apparently, can't be expected to ride to the rescue of the housing market as would normally be expected given their stage in life. Prices *are still too d@mned high* and the government has them behind the debt-servicing 8 ball:

Student loans make up the majority of the $1,005,000,000,000 owed by this cohort, followed by mortgage debt. New mortgages among young adults today remain quite a bit below levels incurred in the early 2000s. This may suggest adults are waiting longer to buy homes and may opt to rent for a longer period of time than previous generations. -[Bloomberg]

Things weren't looking so good for housing after having read those assorted pieces. But then, we stumbled upon more…more worriment.

We then came across this piece that argues that we should start worrying about the housing market again and for the same reason as last time. This may not be immediate and thus may be more of a long-term concern but then again… :

We have solid evidence that long-term delinquencies are simply not brought current by the deadbeat borrower. This means that the vast majority will eventually have to be liquidated by the lender's mortgage servicer.

https://www.marketwatch.com/story/why-bubble-era-home-mortgages-are-a-disaster-waiting-to-happen-2019-02-25?mod=MW_story_top_stories

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Serious Delinquency of Non-Agency RMBS Loans

Ten Worst States through February 2018
Percent of Loans Delinquent more than 5 years

STATE	AUG 2012	AUG 2014	AUG 2016	FEB 2018
US OVERALL	2%	21%	29%	25%
HAWAII	4%	33%	61%	67%
NEW JERSEY	3%	36%	54%	48%
NEW YORK	8%	37%	53%	55%
WASHINGTON, D. C.	3%	23%	50%	48%
FLORIDA	4%	39%	45%	33%
NEVADA	1%	17%	37%	43%
NORTH DAKOTA	1%	14%	35%	36%
MASSACHUSETTS	4%	21%	36%	36%
VERMONT	3%	20%	31%	26%
OREGON	1%	14%	33%	38%

Source: Fitch Ratings using Loan Performance Securities Data

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Serious Delinquency of Non-Agency Mortgages

Ten Worst Major Metros

MAJOR METROS	OUTSTANDING LOANS AS OF FEBRUARY 1, 2016	SERIOUS DELINQUENCY RATE
NEW YORK CITY	225,561	36.9%
MIAMI	130,335	24.9%
TAMPA	50,362	26.2%
ORLANDO	40,680	23.1%
HONOLULU	9,263	27.6%
PHILADELPHIA	99,332	31.2%
PROVIDENCE	17,692	27.9%
LAS VEGAS	42,421	23.1%
CHICAGO	108,408	24.4%
BOSTON	42,742	24.7%

Source: Black Box Logic

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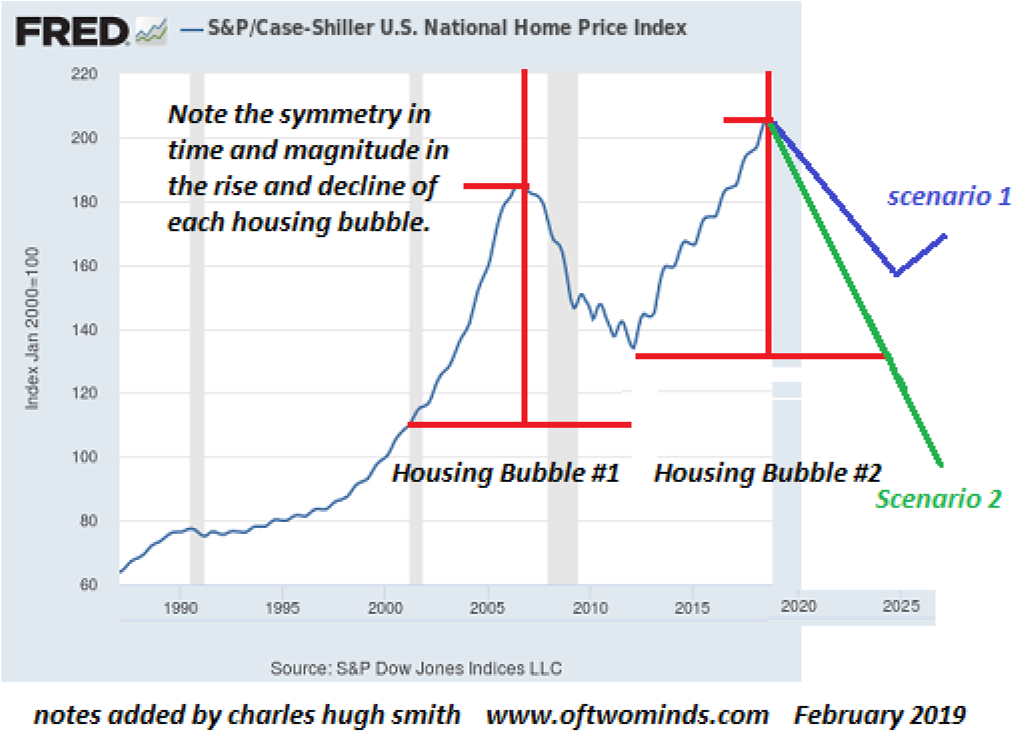
If we take the currently under-discussed mess in the housing market and extend it to its ultimate conclusion, we have Charles Hugh Smith!:

http://charleshughsmith.blogspot.com/2019/02/now-that-housing-bubble-2-is.html



Unless the Fed is going to start buying millions of homes outright, prices are going to fall to what buyers can afford. *As China's debt bubble implodes, the Chinese buyers with cash (probably not even cash, just money borrowed in China's vast unregulated Shadow Banking System) who have propped up dozens of markets from France to Vancouver will vanish, leaving only the unwealthy as buyers.*

Significant domestic slowing. Severe global slowing. Freight shipments becoming lighter. Inventories building in a big way. Loose money everywhere. Debt everywhere. The Reaper stalking housing, again. Stocks primarily being bought by the financial engineers and wounded bears.

Stock prices back into orbit on their way to the moon?

Remain nimble my friends!

Bank and Roll!

Options Academy

This week we're going to focus on options selection as the subject never gets old for those that are new. New-to-options investors understandably seek a blueprint or a series of guidelines that they can use to apply the proper strategy while using the right options to employ said strategy. This is only natural as they're operating in new territory that's much more nuanced than shares of stock or mutual funds and it certainly takes time *in the trenches* too before most people begin to feel comfortable. Quality options education programs normally steer new-to-options investors into using stock replacement options (SROs) and with good reason. This type of options selection is probably the most likely to keep an investor comfortable. That is, by using deep in-the-money options with high deltas and low theta, an investor will not be very far from stock-type performance, which is what they're already accustomed to experiencing. Thus, a level of comfort can be found quite quickly while using options as their new investment vehicle. This stock-to-ITM-options conversion process normally goes smoothly. It's the NEXT step that seems to throw the proverbial *monkey wrench* into the mix…

About 2 months ago, just after many of the major indices bottomed out, a historic rally was engineered into place and now we've breathlessly reached a critical technical level in the market. A major failure is possible but so is a 4% or more breakout/blowoff. When we arrive at riskier junctures, much like the one we may be at now, we like to remind everyone that will listen of our preference for utilizing the *slightly* in-the-money options. As implied volatility levels have remained quite subdued at this time, it remains an easy decision to make. However, as expected, several recent students have questioned this bias to "*slightlys"*. They've been wondering why we'd choose to leave all the positive qualities of stock replacement options behind since, well, they've become very comfortable in *theoretical-terms* with those types of options. The questioning is only natural and once they've heard the reasons as to why we favor them as we do, they're then ready to take the next step themselves. Let's get into the details courtesy of good old *compare and contrast*.

What do SROs bring to the table for us?

Recall that we get stock-like performance via high delta, low theta (low extrinsic value), in addition to much lower cost vs. stock ownership and we have an embedded "protective put" or "protective call" depending on if we buy a call or put respectively. That's quite a bit of very good stuff which is what makes options such a fantastic investment vehicle. Why would and why have we left such awesome benefits behind? Well, we didn't leave them entirely! Let's cover the *slightlys*…

Slightlys have lower deltas and higher thetas (greater than deep ITMs extrinsic value). This results in less initial payout on delta and greater theta each day. Again, many may be wondering: WHY???

Here's the thing, often times, *slightlys* can cost ¼ - 1/2 vs. SROs, which means that we only have about a quarter to half of the capital at risk. This is the main reason why they are intriguing to us nearly all the time and especially in marketplaces that we perceive to be of the higher risk kind. Additionally, their deltas may not be all that much less than those of SROs and if our expectations pan out, the high gamma that they often offer will have us enjoying SRO type performance in very little time BUT for a fraction of the initial capital outlay (dollar risk)! That's pretty good stuff too! And, if our forecast doesn't work out or news undoes us, we won't lose nearly as much since we have only a fraction of capital at risk vs. SRO players and even more starkly vs. stock players.

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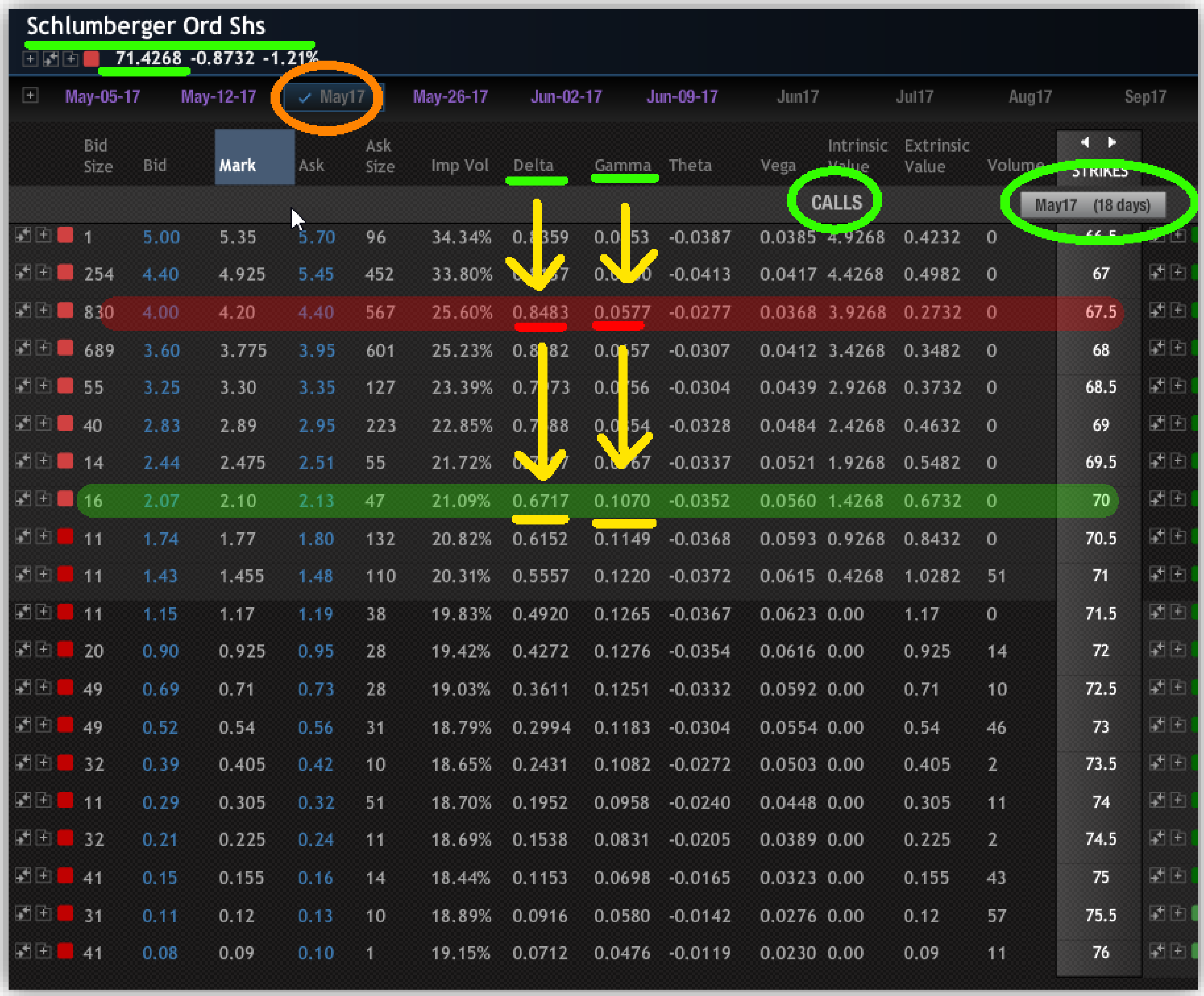
To summarize, our bias that favors *slightlys* invites a little more in the way of Greek risks, but it dramatically lowers our proceeds at risk in a market that we haven't felt comfortable in for just over one year's time. With *slightlys,* were able to continue to comfortably participate in a marketplace that remains challenging and lacking our full trust instead of sitting on the sidelines altogether.

Recall that the first trading day after Christmas produced something remarkable. Stock and futures operators managed to move the DOW up over 1000 pts from the low in 1 full session! Consider this hypothetical: If we'd held a deep ITM (SRO) put waiting for what post-Christmas would bring our way, we'd have lost a significant portion of our ITM value. With *slightlys,* there would have been a great deal less loss, yet we would still have been in the game in a significant way if our forecast for more downside had played out (hypothetical). Thank goodness we felt the opposite way at the time!

With the market at a potentially precarious juncture and this subject never being unimportant, we dug into our graphics archive for a good example of what we're getting at here!


Schlumberger Ord Shs
71.4268 -0.8732 -1.21%

May-05-17 May-12-17 May17 May-26-17 Jun-02-17 Jun-09-17 Jun17 Jul17 Aug17 Sep17

CALLS — May17 (18 days)

Bid Size	Bid	Mark	Ask	Ask Size	Imp Vol	Delta	Gamma	Theta	Vega	Intrinsic Value	Extrinsic Value	Volume	STRIKES
1	5.00	5.35	5.70	96	34.34%	0.[illegible]359	0.0[illegible]53	-0.0387	0.0385	4.9268	0.4232	0	66.5
254	4.40	4.925	5.45	452	33.80%	[illegible]	[illegible]	-0.0413	0.0417	4.4268	0.4982	0	67
830	4.00	4.20	4.40	567	25.60%	0.8483	0.0577	-0.0277	0.0368	3.9268	0.2732	0	67.5
689	3.60	3.775	3.95	601	25.23%	0.8[illegible]82	0.0[illegible]57	-0.0307	0.0412	3.4268	0.3482	0	68
55	3.25	3.30	3.35	127	23.39%	0.7[illegible]73	0.0[illegible]56	-0.0304	0.0439	2.9268	0.3732	0	68.5
40	2.83	2.89	2.95	223	22.85%	0.7[illegible]88	0.0[illegible]54	-0.0328	0.0484	2.4268	0.4632	0	69
14	2.44	2.475	2.51	55	21.72%	[illegible]	0.[illegible]67	-0.0337	0.0521	1.9268	0.5482	0	69.5
16	2.07	2.10	2.13	47	21.09%	0.6717	0.1070	-0.0352	0.0560	1.4268	0.6732	0	70
11	1.74	1.77	1.80	132	20.82%	0.6152	0.1149	-0.0368	0.0593	0.9268	0.8432	0	70.5
11	1.43	1.455	1.48	110	20.31%	0.5557	0.1220	-0.0372	0.0615	0.4268	1.0282	51	71
11	1.15	1.17	1.19	38	19.83%	0.4920	0.1265	-0.0367	0.0623	0.00	1.17	0	71.5
20	0.90	0.925	0.95	28	19.42%	0.4272	0.1276	-0.0354	0.0616	0.00	0.925	14	72
49	0.69	0.71	0.73	28	19.03%	0.3611	0.1251	-0.0332	0.0592	0.00	0.71	10	72.5
49	0.52	0.54	0.56	31	18.79%	0.2994	0.1183	-0.0304	0.0554	0.00	0.54	46	73
32	0.39	0.405	0.42	10	18.65%	0.2431	0.1082	-0.0272	0.0503	0.00	0.405	2	73.5
11	0.29	0.305	0.32	51	18.70%	0.1952	0.0958	-0.0240	0.0448	0.00	0.305	11	74
32	0.21	0.225	0.24	11	18.69%	0.1538	0.0831	-0.0205	0.0389	0.00	0.225	2	74.5
41	0.15	0.155	0.16	14	18.44%	0.1153	0.0698	-0.0165	0.0323	0.00	0.155	43	75
31	0.11	0.12	0.13	10	18.89%	0.0916	0.0580	-0.0142	0.0276	0.00	0.12	57	75.5
41	0.08	0.09	0.10	1	19.15%	0.0712	0.0476	-0.0119	0.0230	0.00	0.09	11	76

As can be seen above, we're going to use Schlumberger's May 19th expiration calls for our example. The standard approach when switching to options investing from stock investing calls for using stock replacement calls as we've noted. We've highlighted an idealized stock replacement call on SLB with the **RED** overlay, the 67.5 strike. They provide us with 85 deltas with an outlay of (mark column) $4.20 per share (x 100), so $420.00 per contract to control 100 shares of stock. This a good way to get stock-like performance but with the smart leverage that options provide. It should also help a stock investor to feel comfortable using options and helps new-to-options folks largely avoid options pitfalls (theta & vega risk). This is all well and good when the markets are on very solid footing but when things become riskier, as they've been since the end of January 2018 and may be about to shortly, we're again emphasizing using the slightly in-the-moneys instead. Our argument for doing so follows.

Notice the 70 strike that we've overlaid with a **GREEN** bar. It's marked at $2.10 so it's exactly half the cost (capital at risk) of the 67.5 strike referenced above. Remember, we're trying to stay in a market that we don't trust as much as we'd like to and by utilizing this type of *slightly*, we're able to do that but remain comfortable as we're risking half of what we normally would in solid bull market environments. In this case, we start out with only 67 deltas but notice the gamma too, it's nearly 11. This means that all other things being equal, if we were to get into this idea in SLB with this call option, and we're right for just $1.00 of upside movement, our gamma will help the delta of our call grow to about 78. That's right! After just $1.00 of being on the right side of this we will nearly be realizing the payout of the oft-mentioned stock replacement (80-90 delta) call. If we're right for another dollar of movement then our call will be approaching nearly 90 deltas, thus we will be receiving a payout from .85 to .90 per dollar movement in the stock price to the upside which is obviously stock-like performance but on the cheap! We are **OK** with waiting for gamma to give us the boost to that level of payout in markets we do not trust that are very news driven, overnight-futures-levitation-dependent and thus possibly less predictable.

On the other side of the coin is the downside. We will actually lose less if we have a poor entry on the trade. We start out with lower delta and higher gamma with our slightly than the stock replacement call player does so we simply lose less and ultimately can only lose half of what they would if all *Hades* were to break loose. Remember, we only paid $2.10 to their $4.20 outlay.

With options selection, there are many, many ways one could go, but we strongly prefer to key off the perceived riskiness of the market at a given time which can serve as good starting point for particular options and strategies to evaluate for deployment.

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