MARKET TRACTION

Powell Releases Animal Spirits – How Much More Overboughtness?

This Week's Trade Ideas:

Bullish Ideas: (View Webinar)

CAG > Conagra Brands > $22.09 Last. Buy the March 15th 21 Calls for $1.50 or less with a close or anticipated close above $22.25 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.

WMT*, TIF, ROST*, UA. *Earnings in near future.

Bearish Ideas: (View Webinar)

None at this time. Despite many stocks being overbought, very few stocks have shown any weakness.

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. Despite many stocks being overbought, very few stocks have shown any weakness.

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:

You guessed it, once again *Outlook* from last week's Outlook was on it, as it has been week after week for months:

This week we remain trapped between key levels which makes calling the next move difficult. ***We're sensing that the bulls have rested after not retreating so much and thus we'd expect them to try to push if at all possible.***

The FED reaction however, is likely to dominate whatever outcome Wall St.'s Players Theater has in mind pre-FED.

That's what we got! The Gang seemed ready to run pre-FED, after resting as we noted, and then Powell capitulated (again) and we were off to up, up and away!

This week, we're short-term overbought and have paused beneath the 150 and 200 SMA.

Do we test the 100 SMA on the downside or the 150 SMA on the upside?

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 not too bad but was nothing special at the same time. Our bear mentions were off the table due to market staying in upside mode. That left us with one bullish idea and one bullish mention.

AA was our idea and it did move up but failed by 1c to take out the key high of $30.28 we hoped it would when we *cheated* our way into it with a lower trigger level. It's up from where we spotted it, but below our trigger level as we write. Chalk it up as a mildly disappointing idea.

HD was the bullish mention and it broke out as hoped for and put a nice move together. **HD** moved up by over $7.00 at one point and we're quite happy with that follow-through given that the markets moved up in a controlled fashion.

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Market Overview

From last week's **MO** with emphasis added**:**

Since it's a tossup…What it comes down to for us this week is that the SPYs haven't given much of the gains of the past month back and they're still holding above support AFTER RESTING for a week. That would normally be a sign that they'll run with the slightest bullish reason imaginable supporting their efforts. ***We're willing to believe that they'll try to take a crack at $270.00 if possible, as LONG as they HOLD the 50 SMA on a closing basis and Powell doesn't dash Wall St.'s accommodative dreams!*** *We've given the bulls the benefit of the doubt for about a month save for last week when we went NEUTRAL and just couldn't discern what the tea leaves had to say. Fortunately, that turned out to be the right answer.* ***We're in a similar position this week but the bulls have gotten rest and that normally means another attempt at rallying, FED permitting!***

The markets have jammed back in a big way from deeply oversold conditions at the tail end of 2018. ***It's hard to believe that it's all over. We can see one more bull attempt as we noted above, but our confidence level as to what happens next remains 50/50.*** *New we cannot know will likely tell the tale of the tape.*

Powell's comments, or lack thereof, will likely take the importance prize but one can never know for sure.

And that was that. They were ready to run and gun stocks higher after resting and then Powell packed up his rate raising gear and the party went into overdrive.

Now, we have the SPYs in overbought territory but just below the 150 and 200 SMAs. The SPYs are also within a stone's throw of the critical $281.00 level.

1. Can they push that far NOW?

2. Will they pause/pullback and then try?

3. Will they test the $270.00 level near the 100 SMA before running higher?

4. Will they fail to hold $270.00 and drop to the $267.00 level?

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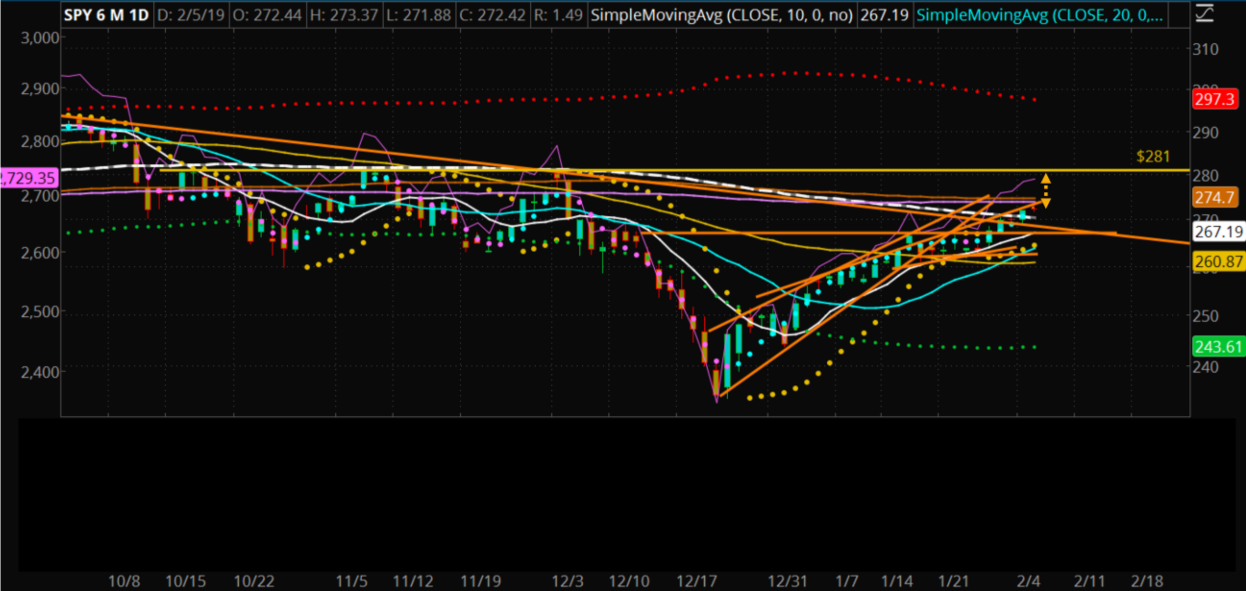
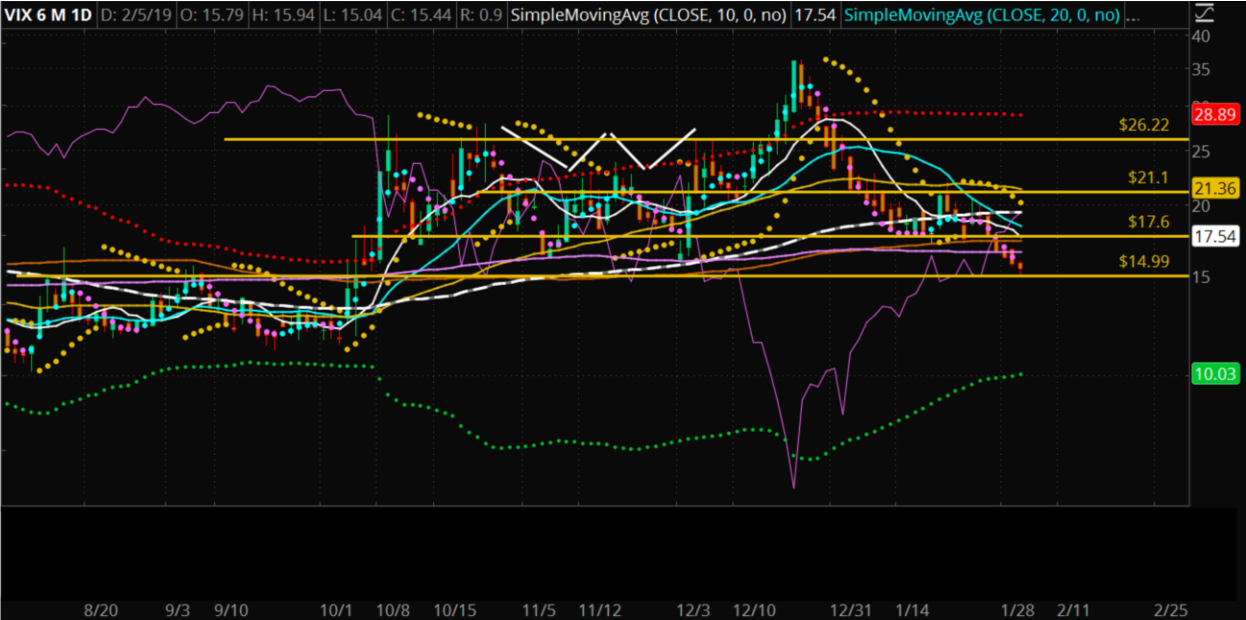


Getting as close to the 200 SMA (**purple SMA**) as they have and not surmounting that level will likely be taken poorly by the markets. There would seem to be quite a few support levels on the way down if the market suddenly slides but:

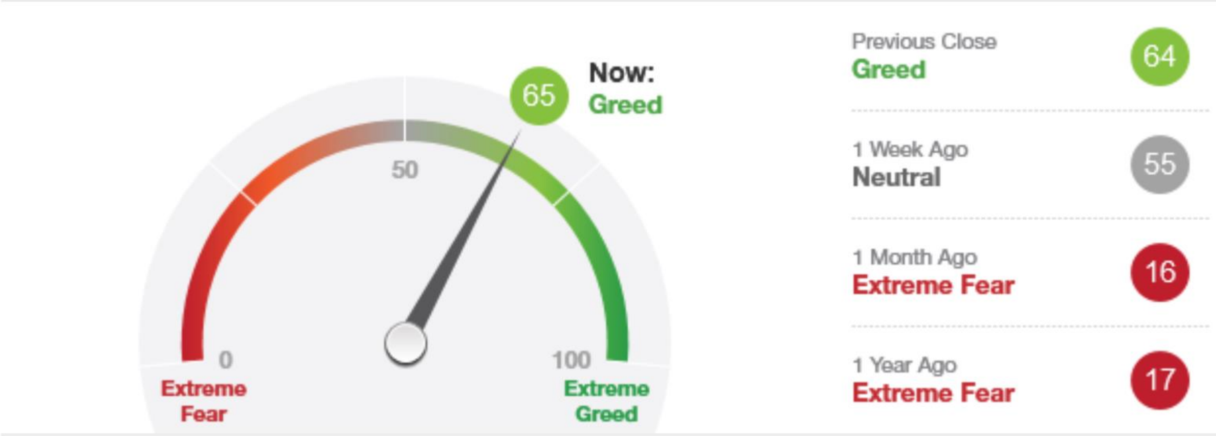
1. The VIX isn't selling us that scenario at the moment:



2. However, a new and concerning "rising wedge" may have appeared on the scene:

The **RED RISING WEDGE** could become an issue if we fall below the support it's providing. Do note though that there's a lot of congestion and "shelves" below $270.00 to $260.00 and that suggests that a drop would likely be cushioned much of the way down. Of course, we have to note that the modern technical downside breaks seem to ignore such support levels more easily than those of yesteryear.

The context now is that we have the highest GREED reading registered during this rally and we seem to be approaching possible resistance on that front. YET, there's still a little upside room before we get there, if we get there:



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There's quite a few earnings releases set for this week and next week has a respectable number as well, but we will see a tailing off after this week. That MAY mean that news cycle doesn't get too much better than it is now save for China trade news etc.

The improving news cycle we anticipated late in December did materialize and it undoubtedly helped the bulls levitate stocks much higher. What fuel is left to rally on?

> Powell's on Pause

> Revised Lower Earnings Estimates were Surpassed

> China is still in Limbo

Could DC shockingly provide more rally fuel in the nick of time? We doubt it but at the same time it would come as a shocker and shockers stoke markets.

Without a significant news driver(s), we have to believe that we're somewhere closer to the end of this rally than the start.

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It's a solid week for releases and FED speeches. Maybe the Gang will wring something out of something???

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. 4					
10 am	Factory orders (rescheduled) (Dec. report delayed)	Nov.	-0.6%	-0.2%	-2.1%
2 pm	Senior loan officer survey	Q4			
7:30 pm	Loretta Mester speaks				
TUESDAY, FEB. 5					
8:30 am	Trade balance	Dec.	DELAYED	--	N/A
9:45 am	Markit services PMI	Jan.	54.2	--	54.2
10 am	ISM nonmanufacturing index	Jan.	56.7%	57.4%	58.0%
9 pm	State of the Union address				
WEDNESDAY, FEB. 6					
8:30 am	Trade balance (rescheduled)	Nov.		-$53.7 bln	-$55.5bln
8:30 am	Productivity*	Q4	DELAYED	--	2.3%
8:30 am	Unit labor costs*	Q4	DELAYED	--	0.9%
6 pm	Randal Quarles speaks				
7 pm	Jerome Powell speaks				
THURSDAY, FEB. 7					
8:30 am	Weekly jobless claims	2/2		225,000	253,000
9:30 am	Richard Clarida speaks				
3 pm	Consumer credit	Dec.		--	$22 bln
7:30 pm	James Bullard speaks				
FRIDAY, FEB. 8					
10 am	Wholesale inventories (rescheduled)	Dec		--	0.3%

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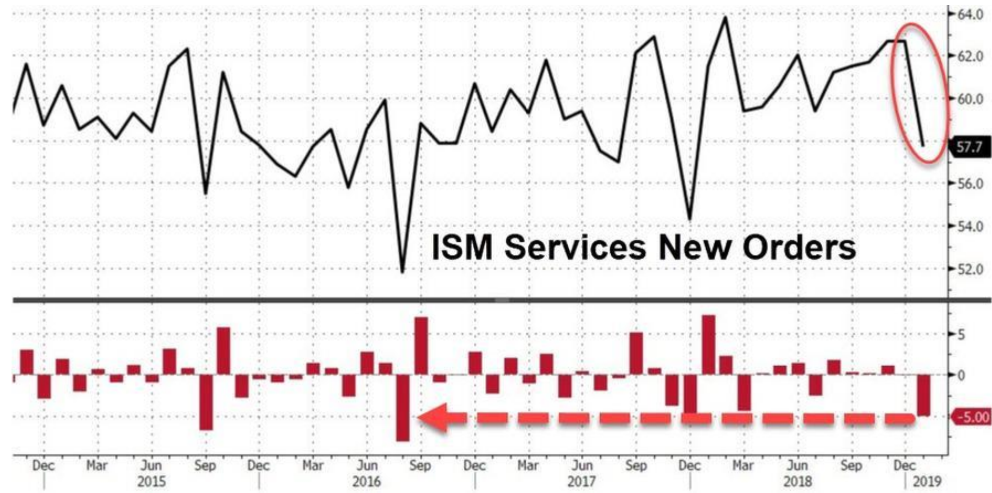
Below the Radar

The lightness persists for **BTR**. This rally seems to have sent bears into hibernation! Oh well…

The indices continue to shrug off weak economic data as they embrace backwards-looking earnings releases. That's to be expected. That's how the Gang and their water carriers in the media operate. However, there's no denying that we have more economic deterioration on our hands this week vs. last week:



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With that, and as to be expected, small business confidence is cratering!

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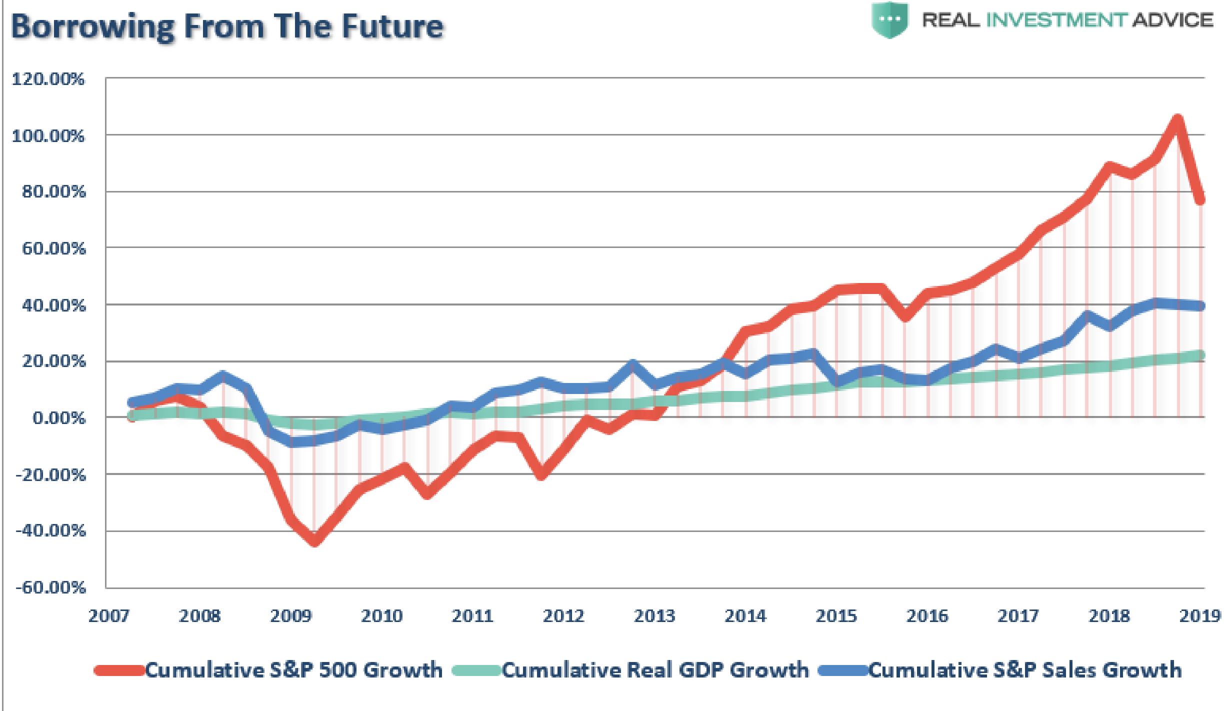
With equities continuing to levitate and waft higher despite such developments, another item popped up that puts said equities (*FEDgineered*) outperformance into proper perspective:



How can GDP and Sales Growth lag so far behind? Well…see the past decade's FED policy combined with the magic of buybacks explains it all (nearly)! How much longer can this divergence last? We're wondering that ourselves!

We're almost but not quite done with divergences! Another and a very curious one at that has appeared on the scene:

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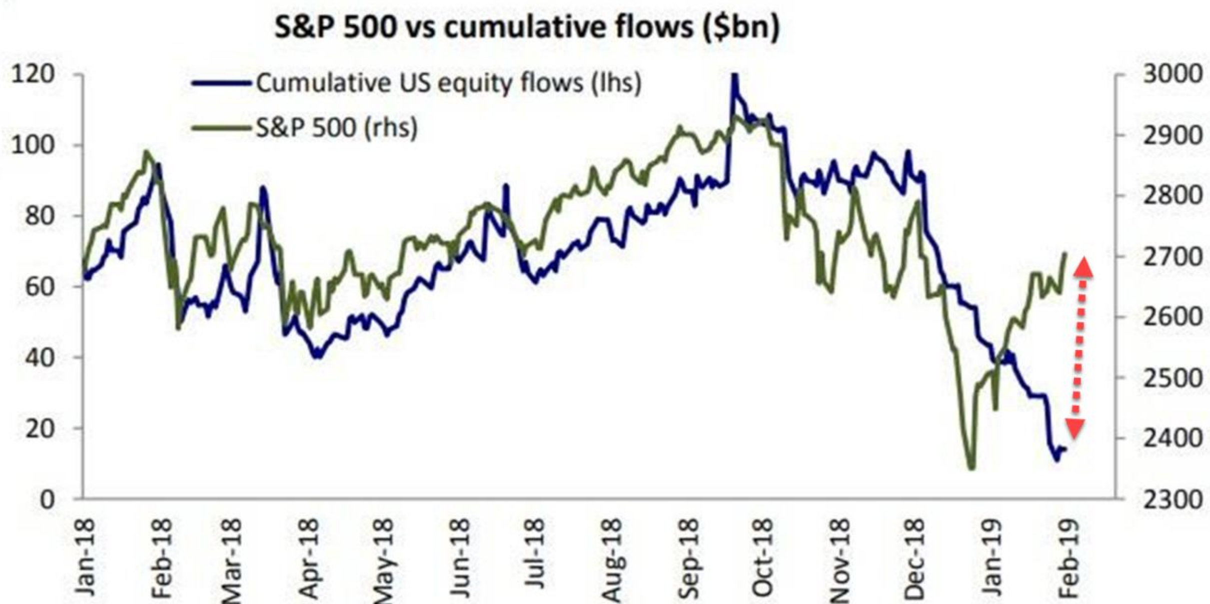

One form of money (as it's measured) is clearly flowing out of US equity markets while the Gang masterfully moves stock prices back up and then some! They're so good at their jobs! We'll see if the correlation above that was once fairly-tight, diverges even more or maybe not!

Unsurprisingly, with stock prices dramatically out of step in several ways from realities, various models, including Warren Buffet's, aren't very optimistic about the next 10 years being as bankable as the past 10 years:

Just recently, Brian Livingston, via Marketwatch, wrote an article on the subject of valuation measures and forward returns.

"Stephen Jones, a financial and economic analyst who works in New York City, tracks the formulas that several market wizards have disclosed. He recently updated his numbers through Dec. 31, 2018, and shared them with me. Buffett, Shiller, and the other boldface names had nothing to do with Jones's calculations. He crunched the financial celebrities' formulas himself, based on their public statements."

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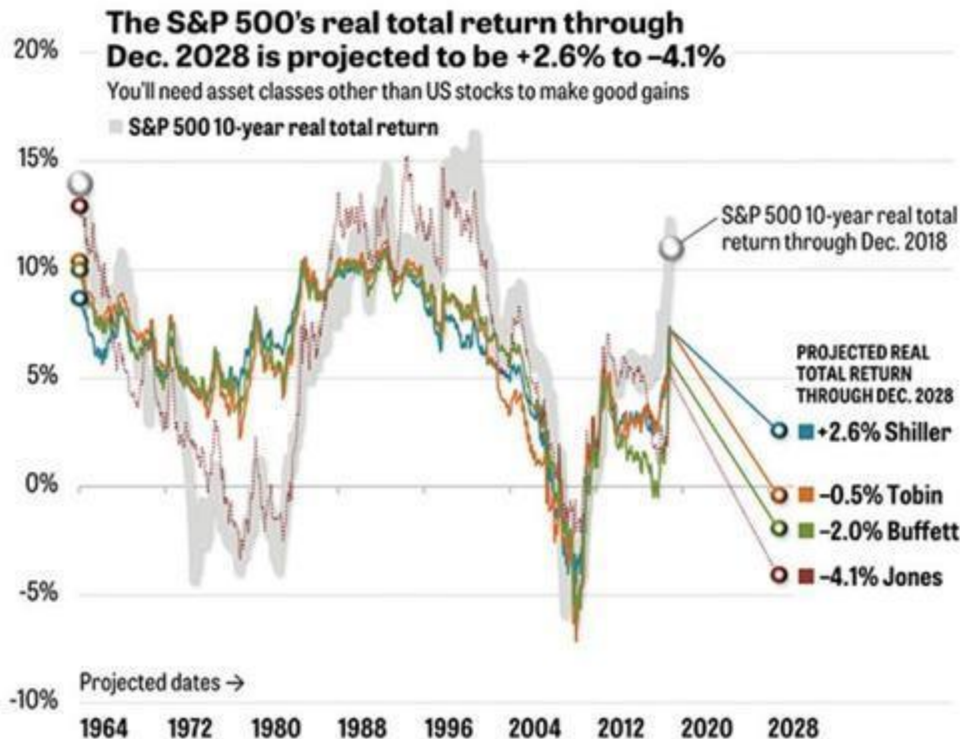

The magnitude of this rally and other factors, along with those above, seem to have left many investors feeling like Yves Lamoureux.

https://www.marketwatch.com/story/the-big-investor-who-called-a-panic-event-in-2018-says-the-next-one-should-be-here-soon-2019-02-05?mod=MW_section_top_stories

First, some background. In January 2016, Lamoureux predicted the Dow would top 25,000 within three or four years, which it did at the start of last year. The rest of 2018 saw the index moving back and forth across that big level. ***In October,*** *he predicted the Dow would eventually hit 40,000,* ***but forecast a big "panic event" would occur first, as he warned investors to stay out of stocks in 2019.***

His new call has to do with that "big panic event," round 2*: "The shock we had in November, December was the first shock and the market realizing that we're floating too high and [markets] have gotta come back down.* ***There's another drop to come, which will create tremendous opportunity,"*** *he said in a Monday interview with MarketWatch.*

Lamoureux thinks that second shakeout will happen in the next six months*, with China slowdown signs and/or a yuan devaluation a couple of things he thinks might trigger a pullback. He says 21,000 for the Dow would send him on a stock-shopping spree.*

Remain nimble my friends!

Bank and Roll!

Options Academy

Earnings season is still upon us and thus last week's discussion of the Calendar spread is still timely. We decided to bring back even more on it because although the VIX may be heading down for now, our perception of risk is rising. If our concerns begin to bear out in equity prices, then *playing defense* may become even more important than usual!

When discussing option's strategies, the emphasis is normally placed on how to utilize each strategy when going on offensive. The focus is mainly about making profits by employing a strategy in an appropriate environment on a suitable underlying stock. Strategies are covered in this idealized way to demonstrate how they can best be applied and under what conditions they'll deliver the best results. There is nothing wrong with this approach. It's an academic approach and it's probably the right way to get started when students are trying to learn about options theory and application. As many readers already know, there's a great deal to learn in the first place and that makes it very difficult to cover every nuance of every strategy the first time through. The reality is that there are so many possibilities that can arise in the real world of dynamic markets that covering every possibility in the "classroom" is simply not realistic to begin with. It's with this background in mind that we're going to briefly discuss playing "defense"

Playing "defense" when actively investing with options is a subject that largely goes under-discussed. Taking defensive measures when the markets aren't cooperating with currently held option's positions is something that professional contend with regularly. Many, when asked, would probably concede that their ability to play defense, aggressively when need be, may be the main difference-maker between success and failure. It may also be the main separator between how pros manage risk vs. individual investors. If we contemplate things for a moment, a few key thoughts should come to mind…

1. Even professional traders are on the "wrong side" of trades frequently
2. Pros do not remain idle and simply accept that they're "losing"

What follows is this: Active options investors can expect to be on the wrong side of trades just as the pros find themselves. HOWEVER, once the individual investor accepts this reality, they can then take the next step and begin to play smart defense when circumstances call for it. So, what is "smart defense" and how do we play it?

Let's look at the calendar spread. The calendar spread is typically taught as premium collection spread that can be employed with capital efficiencies. It's used to collect decay with a minimum capital outlay. It's normally covered in a way that suggests that the nearer term at-the-money option is sold and the same strike price a little further out in time is purchased as a hedge. Since the nearer term option decays more rapidly, the spread's prospects benefit from the passage of time as the investor remains hedged. All is well and good in this scenario except for the fact that the stock needs to remain relatively still for profits to accrue. This is because the calendar spread is worth the most when the stock price is at the strike price of the spread. Another way to understand this is to realize that if the stock price moves away from the strike in focus, the calendar spread begins to lose value for the owner.

There are other ways to use the calendar spread, however. We're interested in using it to our advantage so we're going to start out by NOT using it! Just as an entirely hypothetical example, let's assume that we're bullish on Apple (AAPL) with an investment horizon of a few months. AAPL stock is trading near $175.00 at the moment and a quick glance at the March expiration shows that we can buy the March 160 calls for a reasonable price while we acquire high delta exposure (approx. 88). In other words, the March 15th 160 calls are a good stock replacement type call. Assuming we buy 10, that would provide us with 880 to 900 long deltas in the aggregate. Obviously, just like a stockholder, we'd do very well if the stock price were to rise and we wouldn't be very happy if the stock price were to decline. But remember, we can play defense! So, to that end, let's assume that a story has just hit the newswire and it seems material and thus it legitimately concerns us. We still believe in AAPL over the next few months, but we also know how investors can overreact in the short run, especially in AAPL as they may have over the past several months. Just like a pro, we're not going to sit there and let the ensuing mini-panic "beat us up". We're going to hedge our long deltas for the time being. A quick glance at the AAPL February 22nd 160 calls shows that they have a higher delta, 97, vs. those of our long March 160s. Thus, if we sell 8 of those, we'll approximately add -900 deltas to our current +900 delta position obtained via owning the March 160s and we will thereby neutralize our delta risk, for the moment. In the process of doing this, we just backed our way into a calendar spread, albeit a ratioed one, and an in-the-money one at that. The interesting thing though is that, although we've, to an extent, capped our upside potential temporarily, we've now protected ourselves quite well even if AAPL were to experience a significant drop over the next month. In fact, we may actually profit somewhat if AAPL falls to $160.00. Why? Remember, calendar spreads are worth the most when the stock price is at the strike price in focus and we own the spread! Additionally, we've brought in capital and reduced decay instead of adding decay to hedge while outlaying even more capital!

Mind you, we could have sold 10 February calls at the 160 strike and that would have resulted in 10 "textbook" ITM long calendar spreads but it would have put us in a short delta position immediately. There's nothing wrong with that approach if you want to get a little more bearish but it will inhibit your situation if the stock price moves upward just as it will help a little more if your concerns are justified and Apple's stock begins a serious decline phase.

Another nice feature about this defensive maneuver is that we're not locked in to this forever! We can lift our hedge at any time and reestablish our long March 160 call position when the dust settles. This can be thought of as hitting the "pause" button if done correctly. Pause and Unpause!

Remember though, if AAPL were to fall to the 160 strike, that's where the calendar spread we backed into is worth the most and thus we'd sell out of it entirely to capture value and look to reestablish our AAPL bull play at a more suitable time.

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

Last Week's Options Academy

In this week's installment of **OA**, we're revisiting the Calendar spread because, well, earnings season is upon us and we know that some folks just can't help but to get involved! Applying the Calendar in the conventional way with earnings announcements looming may not be advisable. However, flipping it around just may…

Recall if you will that the Calendar spread is worth the most when the stock price is at the strike in focus. This means that the maximum value of the Calendar spread is seen when it is At-the-Money (ATM). If we "go long", that is, purchase the Calendar, we buy the longer-dated expiration and sell the nearer term. That allows us to take advantage of the faster rate of decay of the near-term option we've sold vs. the relatively slower rate of decay of the longer-dated option we purchased. SO… think about it, if we initiate a long ATM Calendar spread as described, where we "own time", we really want the stock price to remain still. If the stock price moves away from the ATM strike where we've initiated the spread, in either direction, the spread's value declines which hurts our position since we own it!

Now let's think about this in reverse. What would we want to happen if we SOLD instead of bought the Calendar spread? We'd want movement away from the ATM strike in focus since that would result in a decline in the spread's value and since we've sold it, we want its value to drop. This selling of the Calendar is really the opposite of how the Calendar spread is traditionally taught.

Most educators try to steer students away from playing with fire on the decay curve. The decay curve describes how shorter-dated options will lose their time value at faster rates than longer-dated options. So, naturally, instructors try to help newer options investors avoid becoming victimized by owning the shorter-dated options which is why the Calendar is covered from an overwhelmingly long-only perspective. This is the "way to go" when just getting started in options but when you take full command of options theory and application you realize that you can use those "tools" in other creative ways and that's exactly what we're covering here. Let's get into a little hypothetical nitty-gritty...

As we alluded to, many folks are intrigued with the concept of "playing earnings". This desire to speculate on post-earnings release stock price movement is only natural as most investors witness dramatic moves quarter after quarter, aided by media-build-up, and wish to benefit from it. The thing is, earnings movement can be very unpredictable along with being volatile, so naturally, this leads to higher options prices quite often. In fact, it can lead to extremely high options prices which means that the risks have really been ratcheted up if one were to buy a Straddle for example. The Straddle, buying the put and call at the same strike at the same expiration, might seem like a great idea since the owner could potentially profit if the stock moves significantly in either direction. Typically, though, the problem is that there's a lot of competition to own the Straddle and thus the price of it can be driven up a great deal thereby making it very risky if the earnings release produces a "dud", that is, a lack of volatility. Not only is it risky but it can also become cost prohibitive to the extent that it becomes unaffordable for many would-be speculators. It's for this reason that the "Poor Man's Straddle" can be attractive. The Poor Man's Straddle acts a great deal like a Straddle in its performance but it's much less costly. As it's less costly, it doesn't produce the practically unlimited profits that a long Straddle can but that's why it's referred to as the "poor man's" in the first place; less costly, less potential. However, it still let's one participate in earnings-style trading without breaking the bank. The thing is, you already know what it is... It's the reverse of the Long Calendar, it's the Short Calendar. If we sell an ATM Calendar and the post

earnings stock price movement is dramatic, this will cause the Calendar that we're short to lose value thus earning us profits in a somewhat similar fashion to the long Straddle. Now, there are many nuances that are associated with this type of trade and many considerations, but it's something worth exploring and considering.

We encourage you to model this type of scenario on your trading platform. Compare how this could work vs. a long straddle and note the similarities and differences. This is an unconventional arrow worth keeping in your quiver and dusting off when you anticipate significant movement but you're just not sure in what direction!

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