MARKET TRACTION

Still Waiting to See our mid-$260.00s SPYs Print…

Are we Asking for Too Much or Too Little?

This Week's Trade Ideas:

Bullish Ideas: (View Webinar)

***MSFT > Microsoft Corp. > $105.01** Last. Buy the Jan. 25th 103 Calls for **$3.05** or less with a close or anticipated close above $105.05 in an up market with expectations for continued strength in the stock.

***IMPORTANT NOTE**: Earnings are due out on 1/30/19 and as a result the Implied Volatility level in the Jan. 25th expiration is very cheap. We RARELY consider such short date options for the obvious reasons. HOWEVER, we want to play this gingerly (all potential news that's swirling etc.) and expect to see the pop higher, if there's to be one, very soon. If it doesn't' transpire by Thursday, we'd be forced to select another expiration further out in time should **MSFT** trigger on Friday or Monday.

Bullish Mentions: **(View Webinar)**

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

NKE, SQ, PYPL.

Bearish Ideas: (View Webinar)

None at this time. There's not yet been a technical break.

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. There's not yet been a technical break.

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.

Outlook:

Last week's Outlook was relevant again:

This week we're thinking that the rally has gotten a little "too vertical" and that a minor pullback would be more constructive than further rallying in the intermediate term.

In the week that's passed, we saw a little more rallying initially, then a minor pullback that may have refreshed spirits, and that makes our mid-$260.00's SPYs challenge more likely save for major news impacts we can't foresee. Effectively, the minor pullback or pause we often reference seems to have occurred. New recent highs are being made and at the moment we have to roll with our short-term bullish take on matters. If Brexit or some other news bomb doesn't interfere, we're still thinking that we move up another 2% roughly and we'll see what happens if we get there.

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 has been a relatively quiet one in the S&P 500 and we're feeling pretty good again for not being lured into bearish trades. We passed on those again, even after scanning again and again for them. We had a pause in progress towards the upside but we've yet to see a technical breakdown.

We had **EQT** as our official bullish idea. We spotted it the day it closed at $20.35 last week. Since, it dipped a little but finally closed above our trigger level on Monday and has made a new high of $21.27 today. We'll see what happens from here, but the stock is up over 4%, so that's not awful. We're hoping it can continue to power up to our $22.00 target level.

We had **YUM, OKTA, TWLO, TEAM** as bullish mentions with no Bears of any kind whatsoever! (whew)

Remember, though that we noted this: (*All have really remained stout during the market selloff and are listed in case we experience more melt-up***)**

The idea was that all had held up very well as the market got smoked and if the relief rally really took off, they may be able to make new highs and continue upward, so they were a little different than our typical mentions. The summary on these as that the market hasn't advanced much and as a basket, they just haven't done much. The market didn't breakout, so they've remained bottled up. They may still be worth keeping an eye on if the market powers up to our mid-$260.00's level in the SPYs.

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Market Overview

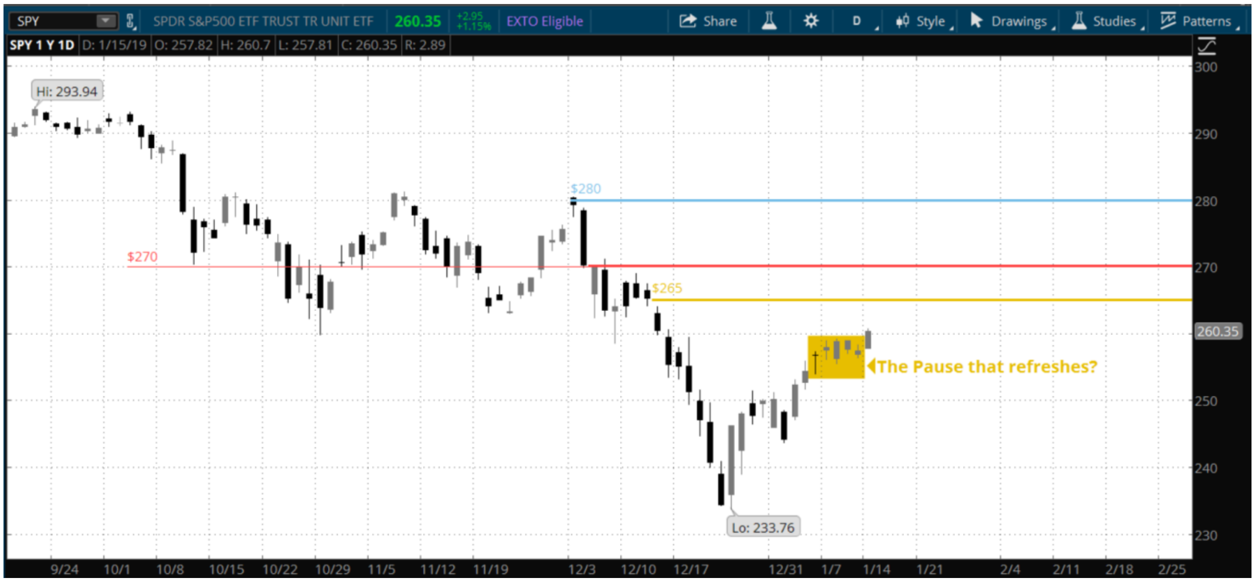
Once more to last week's **OA**:

The bottom line is that we believe there's still a little left in the tank for bulls. *Will they blow their gas rations all at once or will they savor more rallying after taking a little breather? That's what we struggle with this week.*

Our take was pretty-solid last week. Our struggle was whether we'd see more immediate bullishness, or after a pullback or pause. With this week starting out on a positive foot, it seems that our read has played out to this point. We wanted to play the bull-side gingerly because we just couldn't get that strong read on things. Matters now seem poised to move higher if news doesn't get in the way.

As it has been, the analysis this week is simple. Extremely simple. Barring news, we expect there to be an attempt at more upside push. The mid-$260.00's in the SPYs remains the BIG level for us. We think that's where they really want to get back to see how various market participants act near those levels. Once, or if we get there, and we'll see how we feel from there. The Wall St. Gang masterfully and effectively paused the action last week and they seem to be on the verge of resuming their bullish maneuverings more forcefully. We included our target levels which seem to perfect and simple, but they are what they are…

To be perfectly clear, we're in a mini-rising wedge, potentially, and as such much risk remains in the chart. They did build a nearby support level with the past week's activity but even with that we do not believe that it's time to fully relax as a bull despite expecting at least a little more buying to play out:



The calendar is colossal this week! This may be the *chock-fulliest* economic calendar for year (hard to say). However, it's certainly the weightiest we've seen this year and in quite a while. >>>

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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, JAN. 14					
~2 pm	Richard Clarida interview				
TUESDAY, JAN. 15					
8:30 am	Producer price index	Dec.	-0.2%	-0.1%	0.1%
8:30 am	Empire state index	Jan.	3.9	--	11.5
11:30 am	Neel Kashkari speech				
1 pm	Rob Kaplan Q&A				
1:15 pm	Esther George speech				
WEDNESDAY, JAN. 16					
8:30 am	Retail sales*	Dec.		0.0%	0.2%
8:30 am	Retail sales ex-autos*	Dec.		0.0%	0.2%
8:30 am	Import price index	Dec.		--	-1.6%
10 am	Business inventories*	Nov.		--	0.6%
10 am	Home builders' index	Jan.		--	56
2 pm	Beige book				
6:30 pm	Neel Kashkari panel discussion				
THURSDAY, JAN. 17					
8:30 am	Weekly jobless claims	1/12		220,000	216,000
8:30 am	Housing starts*	Dec.		1.256mln	1.256mln
8:30 am	Building permits*	Dec.		--	1.328mln
8:30 am	Philly Fed index	Jan.		--	9.1
10:45 am	Randal Quarles speech				
FRIDAY, JAN. 18					
9:05 am	John Williams speech				
9:15 am	Industrial production	Dec.		0.3%	0.6%
9:15 am	Capacity utilization	Dec.		78.6%	78.5%
10 am	Consumer sentiment index	Jan.		97.5	98.3
11 am	Patrick Harker speech				
***COULD BE DELAYED BY GOVERNMENT SHUTDOWN**					

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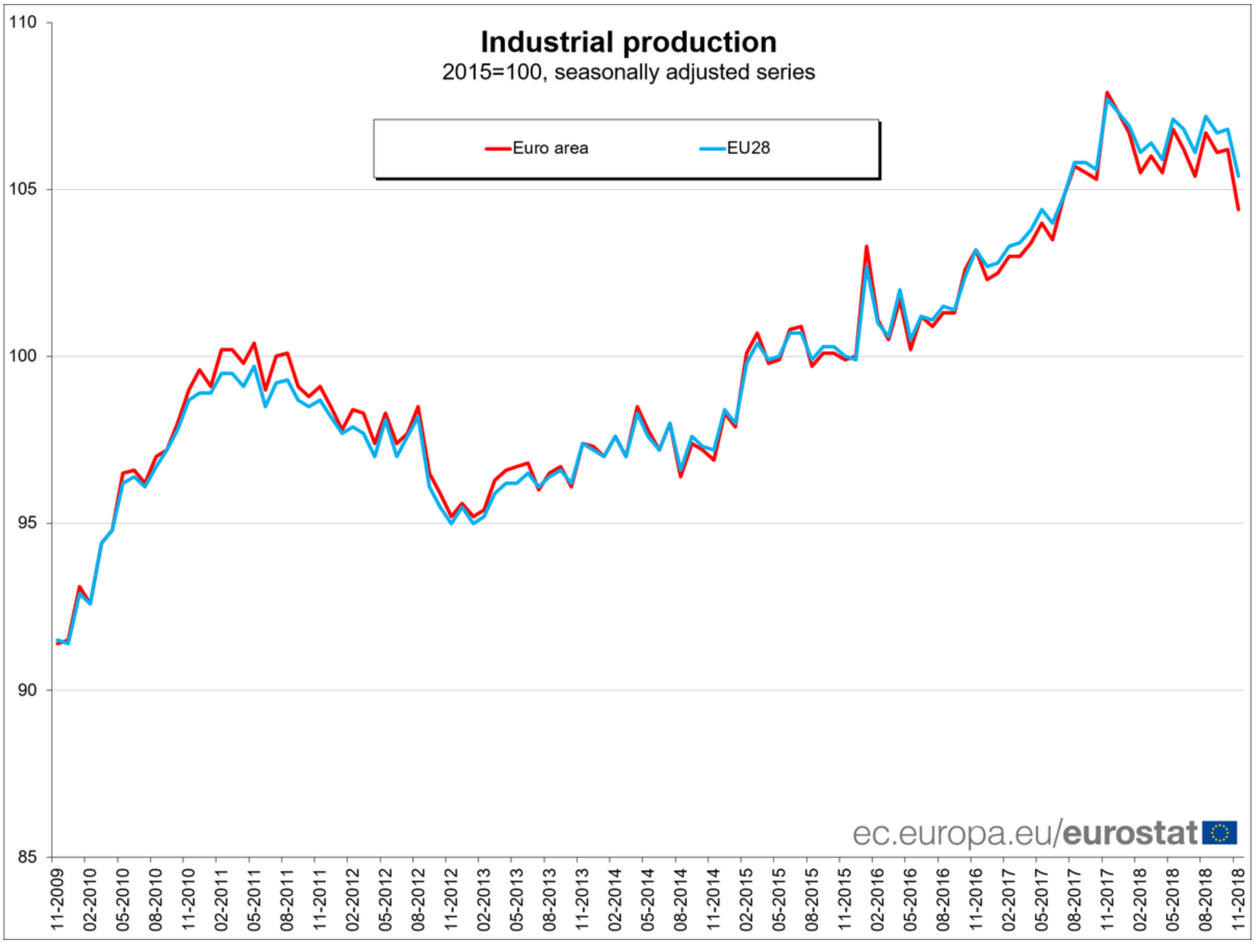
Below the Radar

Unsurpisigly, with the markets moving down big and then rebounding big, there's quite a few crosscurrents out there in Market Observer/Analyst Land. The gang that's never bearish has seized upon the rebound to tell us that "it's over" and their using the slightly improved news cycle that we anticipated to keep their spin on high spin. Others, however, like us, aren't so sure it's completely over yet as well. We'll feel better if and when the S&P 500 is able to regain trend and will treat this market with great respect until it does so. Here's a link to a relatively brief piece from one of our "go-to" commenators, Sven Henrich. He sees the same global headwinds that we can't seem to imagine away ourselves despite others doing so with relative easy:

https://northmantrader.com/2019/01/14/macro-clouds/

The simple core concept is that Europe and India are slowing dramatically in terms of industrial product, which is no small thing!:



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But "What of China?" you ask…We should probably include this:

https://www.zerohedge.com/news/2019-01-09/deflation-looms-china-factory-price-gains-plunge-most-2011

Deflation Looms As China Factory Price Gains Plunge Most Since 2010

by Tyler Durden
Wed, 01/09/2019 - 21:00

32 SHARES

Will "bad news" be "good news" for China's markets? Or does this confirm what ***'censored' economist Zhang Songzhou warned*** - that China's real (as in not made-up) economic growth is dramatically lower than the official data?

> *To the consternation of Chinese censors, a presentation delivered by an economics professor at Renmin University in Beijing sparked a controversy last month when **the professor claimed that a secret government research group had estimated China's growth in gross domestic product could be as low as 1.67% in 2018, far below the official rate.***

China *may* be freefalling!

*As Bloomberg reports, the sharply decelerating pace **brings back fears of a return of the deflation which ravaged corporate profits in 2012-2016**. A return of slow or falling factory prices in China would squeeze corporate profitability and put pressure on global inflation, as export prices usually follow those at factory gate.*

***"Deflationary pressures are on the rise in China, driven by weakening domestic and export demand,"** China International Capital Corp. economists Eva Yi and Liang Hong wrote in a note ahead of the data.*

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"Inflation tends to fall following an extended period of softening demand growth, which was in turn led by slower expansion of the broadly-defined credit cycle."

Of course, in the new normal, ***this may be seen as 'good' news as it opens the door for PBOC to unleash some more serious monetary malarkey*** *- because as we showed recently, stimulus efforts over the last six months have utterly failed...*

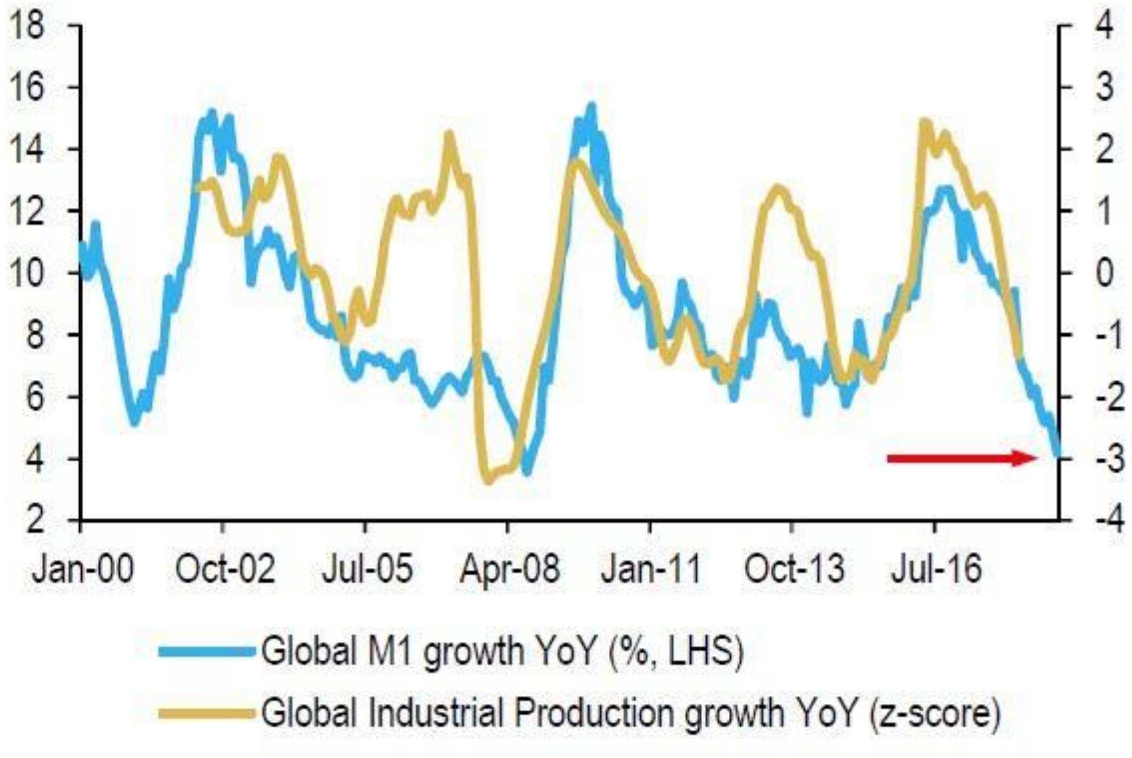
To sum up thus far, CHINA, INDIA, and EUROPE, are struggling mightily. But, how do things look when viewd monetarily or from a money flow perspective? **NOT GOOD!**

A look at M1 (a money supply measure) confirms that the globe is indeed slowing and industrial production appears vulnerable to more of the same:

Collapse In Global M1 Signals A Worldwide Recession Has Arrived

https://www.zerohedge.com/news/2019-01-14/collapse-global-m1-signals-worldwide-recession-has-arrived?fbclid=IwAR2Nzz8Jpuac0dU97qouxMeeNKYkd9TWAHywJctU0RDqBZY9dOkezu5AMD4

Chart 4: Global M1 growth has declined substantially (% YoY change)



Source: BofA Merrill Lynch, Bloomberg, Netherlands Bureau for Economic Policy Analysis. Average M1 for US, EA, Japan, Switzerland, China, Japan, UK.

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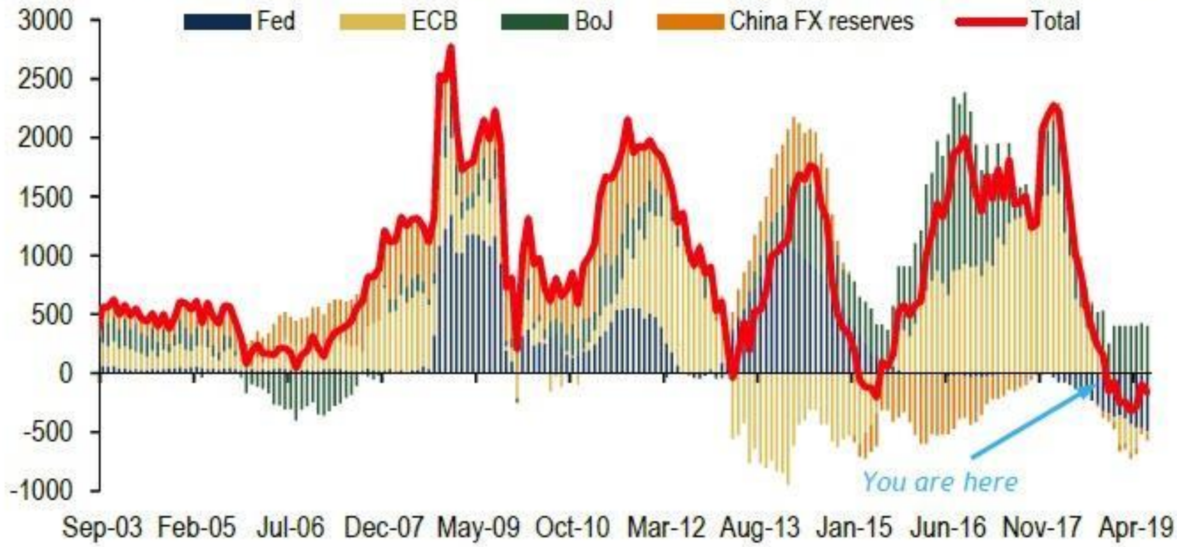
As we and countless other skeptics have noted many times over the year, with central banks now "normalizing," the main driver of equity markets over the past 10 years is now ever so slightly in reverse. That, unforutnately, may be enough to reveal just how dependt stocks have been on central banks maneuvering them higher!:

Chart 3: <u>YoY changes</u> in "Global QE", $bn (YoY CB balance sheet growth). Chart projected into '19.



Source: BofA Merrill Lynch, Bloomberg. Converting ECB and BoJ balance sheet numbers into USD equivalents. China FX reserves are reported in USD.

The *training wheels* should have been taken off equity markets many years earlier, but Yellen et al. didn't raise rates even by a little bit per year to normalize them and now Powell seems to hellbent to make up for past sins at just the wrong time! *Gotta* love those would-be central planners!

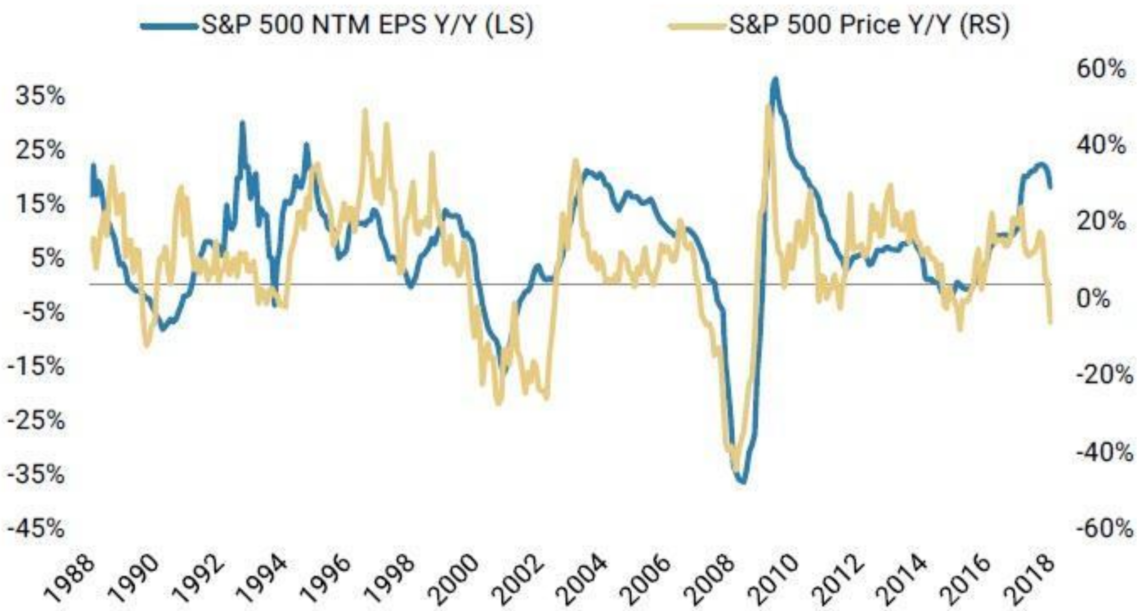
Possessing knowledge of all this is Morgan Stanley and they've decided, at least publicly, that it is time to sell again:

https://www.zerohedge.com/news/2019-01-14/morgan-stanley-its-time-start-selling-again?fbclid=IwAR0_xLVs6hJYmF7RUPV-l0O1WrrAqA2fREkG3LvQvZ4tCRdXcM0arvbjpfM

They're not liking the look of future earnings and the complexion of the charts:

Wilson suspects "such a rapid decline in forward earnings will provide a reason for stocks to revisit the December lows" but as he adds, "that's the trap and the time to buy, not sell."

Exhibit 2: Recent Decline in the S&P 500 Suggests A Steep Fall in Earnings Growth Is Imminent

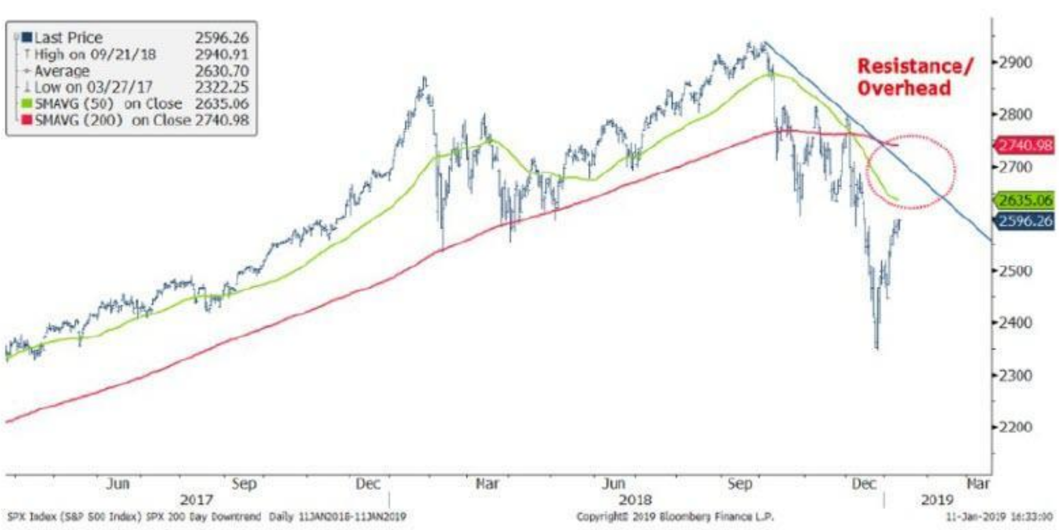


Source: Factset, Morgan Stanley Research

Finally, the bank is also wary of the ***"significant overhead resistance created by the 4Q sell off"****, and the lack of a weekly positive divergence during the December capitulation (Exhibit 1). As such, Wilson advises clients that* ***"2600-2650 on the S&P 500 is a good level to start lightening up as we enter what is likely to be a period of negative news flow on earnings and the economy."***

Naturally, we love that last line because those SPX targets correspond exactly with our past month's working SPY's target.

Exhibit 1: Nearby Technical Resistance/Overhead Is Formidable. We Did Not Get a Weekly Positive Divergence on December Sell Off, Suggesting a Re-Test Coming.



Source: Bloomberg, Morgan Stanley Research

We'll conclude with this piece that may offer a piece of the puzzle as to what lifts the SPX/SPYs etc. up another 2% or so. Those CTA's (Commodity Trading Advisors) may be at it again! Short squeezes are a bull's best friend when lower highs and lower lows are being made!:

https://www.zerohedge.com/news/2019-01-14/ctas-are-about-start-covering-their-sp-shorts?fbclid=IwAR36_85ssuzSFSyO2XoV-dVnZaviq3--tr9lZv78SJoT5u7Y1xp94ylESwE

Last Wednesday, as the US stock market was roaring higher on its way to a 10% rebound from the December 24 bear market lows, we laid out the latest calculation from Nomura's cross-asset strategist, Charlie McElligott, ***who showed that it was only a matter of days before the same CTAs who were blamed for the sharp selloff in mid-December, were forced out of their from "max short" level and started covering, in the process sending markets even higher!***

Are we on the verge of things getting bi-directionally very interesting again?

Remain nimble my friends!

Bank and Roll!

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Options Academy

In **OA** over the course of time, we haven't discussed stock dividend payments very often in relation to options trading. With that in mind, we thought it may be a good time to do so as we've seen more and more analysts suggest that 2019 and 2020 may not be banner years for the stock market even as they don't see a bear market on the horizon (they never do 😉). With that in mind, we realize that many may be tempted to head into dividend-paying stocks to eke out some level of respectable returns in the near-term whether it be in shares of stock or options. So, let's get into it shall we?

Options traders seek to profit from the changes in the price of the underlying stock which by extension causes an appreciation in value of the options contracts, assuming we're on the right side of the movement! Stock investors seek to profit from a rise in the stock price as well, but many hold on to dividend-paying stocks because of the quarterly income that that those stocks reliably provide which increase investors' returns on a consistent basis, at least that's how they see it.

So, how is options trading impacted on stocks that pay out dividends?

Well…, it can be a little confusing and can lead to larger than expected losses if the requisite level of care isn't taken. Let's first address the effect of dividends on option pricing and then we'll move on to how you can learn to profit or avoid losing money unwittingly. Let's have a look behind the **Dividend Curtain**…

Let's define what a cash dividend typically is thought to be and not over complicate it. From Wikipedia:

A dividend is a payment made by a corporation to its shareholders, usually as a distribution of profits. When a corporation earns a profit or surplus, the corporation is able to re-invest the profit in the business and pay a proportion of the profit as a dividend to shareholders.

Cash dividends are the type we'll focus on for our purposes but to be thorough, other types of dividends do exist. The other fairly-common type of dividend payment is a stock dividend.

A stock dividend is simply a dividend payment in which shareholders receive additional shares of the stock in lieu of a cash dividend. Now, we can get moving again…

But first (😉), let's cover the 4 distinct dividend dates you may or may not have heard of:

Declaration Date
Record Date
Ex-Dividend Date
Payable Date

The declaration date arises when the dividend is declared and announced by the company's board of directors and after they've done so, they must legally pay the dividend. When the board declares the dividend, they naturally announce the amount and the other dates that follow.

The record date informs investors as to when they must be shareholders of record and thus accounted for as such by the company to receive the dividend payment.

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A very important date for us to track as traders and investors is the Ex-Dividend date. The "Ex" date is typically one business day prior to the record date. If the stock is purchase prior to the *Ex-date*, the shareholder WILL receive the dividend payment from the company but if purchased after or even on that date, they'll not receive the dividend because they weren't "on the books" of the company in time.

The payout date is what you'd expect it to be. It's the date the company officially pays out the dividend to investors that were on the books as such by the record date.

Now we can tackle dividends and risks associated with them head on, at least as they relate to options. Quarterly cash dividends paid out by stocks can have a large impact on option prices. First off, we must note that when a dividend is paid out, the underlying stock price is expected to drop by the dividend amount on the ex-dividend date. This does occur in many cases but not all as supply and demand on the morning of the ex-dividend date ultimately has the final say as to where the stock price opens that morning.

Fortunately, popular options pricing models such as the Black Scholes and Put-Call Parity model have extended versions that account for the possibility of dividend payouts. What we learn from these models is that an upcoming dividend payment will reduce the time value (also known as extrinsic value) of a call option and boost the time value of a put option. This can also be argued from an arbitrage standpoint, where the underlying stock will fall by the amount of the dividend (at least in theory) on the ex-dividend date. Thus, had the options not been pricing in this inevitability, selling a call or buying a put prior to the ex-dividend date would yield a riskless profit.

Hint: Think it through a little and you'll see the logic applied here but don't worry, we've got a brief walk-through to follow.

At a high level, there are two important items to factor when discussing options dividend risk. The first relates to the aforementioned stock price adjustment made in the market when a company pays a dividend. To expand on that for further illumination, a stock's price is adjusted down on the morning of the ex-dividend date by the amount of the dividend. So, if stock XYZ is trading $90 per share and pays a $1 dividend with an ex-dividend date of September 1st, that means that all else being equal (no major news that dramatically sways the supply and demand for shares on the opening), stock of XYZ will open trading at $89/share on the open of trade on September 1st.

Obviously, options prices are based on where a stock price is currently trading and where it might trade in the future. So, it only makes sense that the price of the calls and puts in XYZ must account for this upcoming adjustment to the price of stock as a result of the dividend payment becoming official.

To go further, let's imagine that XYZ board decides to raise or lower their dividend payout. That will affect the expectations built into the pricing of XYZ's options. Those prices will need to be recalculated to account for the amount that the dividend has been adjusted by but not only for this quarter, it will need to flow through all future quarters as well. Typically, companies declare a quarterly dividend that remains consistent for each quarter so when they adjust the dividend amount, they effectively alter the entire dividend stream beyond that quarter as a result.

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In general, if a dividend payout is adjusted higher than was expected, put values will rise and call values will decline. The reverse will be true if a declared dividend payout is lower than expected. This means that a high degree of vigilance is required when trading options in underlying securities that have a somewhat irregular (or unpredictable) dividend histories.

The second type of options dividend risk that traders need to be aware of relates to the risk of assignment when short options contracts. We'll pick up on this risk in next week's installment of **OA**.

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