MARKET TRACTION

Real Bounce in the Books…Too High too Fast?

This Week's Trade Ideas:

Bullish Ideas: (View Webinar)

EQT > EQT Corp. > $20.35 Last. Buy the Feb 15th 19 Calls for $2.45 or less with a close or anticipated close above $20.63 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.

YUM, OKTA, TWLO, TEAM. (All have really remained stout during the market selloff and are listed in case we experience more melt-up**)**

Bearish Ideas: (View Webinar)

None at this time. Very few stocks have "rolled over" to this point.

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. Very few stocks have "rolled over" to this point.

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:

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

"If it weren't a holiday week, we'd expect even more upside fireworks. <u>That's probably what we should still expect</u> but the fact that the march higher was accomplished in thin last week of the year trading conditions give us a little less confidence than we'd have otherwise."

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.

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:

Bearish Ideas:

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

That snippet is from our Ideas section last week. We found it hard to be a bear last week, even after Apple single-handedly tried to pull the market back down in a big way. We had CAR and COG as possible bears and they did pullback around "Apple Meltdown Day" but they didn't come close to make a new low which shows how difficult it was to find bearish names.

We had 1 bull idea, **TGT**, and one bull mention in the form of **FIVE**. Fortunately, both did move to the upside. As is often the case, **FIVE**, which we noted had better technicals (in our Morning Call webinar), really jammed up nicely for us. In fact, it almost made it to our highest target level of $120.00 and thus far it has popped by about $15.00. **TGT** made it to target level 1 at $70.00ish. It could still go further, we'll see. For the record, we didn't make **FIVE** an official bullish idea **<u>ONLY</u>** because it had less than stellar options liquidity in the expiration, we wanted to own calls in as of last week.

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Market Overview

Again, we'll start with last week's MO to pave the way for this week's updated view:

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

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

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

The *2019 Shopping Spree* did seem to launch last week as we thought it could. It seems to have more room to run if it would like to do so. The SPYs have bounced strongly, as have the other major indices, but only target level 1 of ours, $255.00 has been exceeded so far. We still believe that $260.00 - $263.00 is possible and could provided stout resistance. Our question now is, do we have a brief pause before more rallying or do we just keep rallying? OR, do we sell off more substantially first?

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Correlations remain very high so we're sticking with the SPYs which have served us well. Many scenarios are possible but in the absence of news, we favor more bullishness but maybe after a brief pause. Many methods and techniques suggest that a likely destination could be the low to mid $260.00s. A "gap fill" would also occur there which is right near $264.00. The big question for us this week is: "What now?" We're in "mid-stream" or so it would appear. With the rally being so sharp in some stocks especially, we're wondering if a brief pullback needs to happen before the rally is refreshed. We're thinking about stocks like **FIVE,** for example, that became very vertical very quickly:

Additionally, we're all aware that stocks that move up "too vertically" can give a lot back in a hurry. That's the lesson of 2018's stock market!

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. We also must not forget that the US-China trade deal news could emerge sooner or later (or never) and that could still produce the ***mother of all short-squeezes*** to the moon!

One final note is that we plan to play the bull-side gingerly due to the vertical nature of the ascent. And, let's not forget, that we're still way below the long-term bullish trend. Until that's solved, we have to treat this market with a great deal of respect in terms of downside risk potential.

There's a very solid calendar scheduled this week with Wednesday and Thursday being HUGE due to the number of FED speeches including old Powell himself. The only member of the FED not speaking is the head greenskeeper apparently…

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. 7					
10 am	ISM nonmanufacturing index	Dec.	57.6%	58.7%	60.7%
10 am	Factory orders DELAYED*	Nov.	--	-0.2%	-2.1%
12:40 pm	Raphael Bostic speech				
TUESDAY, JAN. 8					
6 am	NFIB small-business index	Dec.	104.4	--	104.8
8:30 am	International trade DELAYED*	Nov.		-$54.0 bln	-$55.5bln
10 am	Job openings	Nov.		--	7.1 mln
3 pm	Consumer credit	Nov.		--	$25 bln
WEDNESDAY, JAN. 9					
8:20 am	Raphael Bostic speech				
9 am	Charles Evans speech				
11:30 am	Eric Rosengren speech				
2 pm	FOMC minutes				
THURSDAY, JAN. 10					
8:30 am	Weekly jobless claims	1/5		227,000	231,000
8:35 am	Tom Barkin speech				
10 am	Wholesale inventories*	Nov.		--	0.8%
12:20 pm	Jerome Powell speech				
12:30 pm	James Bullard speech				
1 pm	Charles Evans speech				
5:30 pm	Richard Clarida speech				
FRIDAY, JAN. 11					
8:30 am	Consumer price index	Dec.		-0.1%	0.0%
8:30 am	Core CPI	Dec.		0.2%	0.2%
2 pm	Federal budget*	Dec.		--	-$23 bln

Below the Radar

Last week **BTR** focused on as much *doom and gloom* as we could lay our hands on! That's the role BTR is supposed to play most of the time even if we're bullish on the market due to the chart complexion at that given time. Some news was pretty bad last week but as we always argue, the Street of Schemes and their water-carriers in financial media ran with what positive headlines they could to assist Wall St.'s battered bulls in marking stock prices back up so they could offload shares they'd been forced to buy at lower prices. That's what happens in historic selloffs. Stock specialists and market-makers are forced to buy, and in big ways, when the selling is ferocious, and their hope is to liquidate those purchases for profits after prices have wafted higher in the not-so-distant future. And, they almost always do! What a racket! Anyway, if you thought that the rally would end the *doom and gloom* for the time being, think again! This is **BTR** where we believe that it's better to know about *even distant potential issues* well before everyone else. That's our main focus but this week we have a real doozy for readers! Paradoxically, it's mostly a look back but readers soon realize that it could be the way forward as well! We **LOVE** this piece from Sven Henrich and wish we'd have written it ourselves. When we come across something that expresses our own views so closely, we feel a compulsion to print it! This essay is WELL-WORTH the time to read it in its entirety. If you want to know just how much of an "easy money shell game" we've all been playing in this bull market, read on:

Here's the link and the highlights for now: https://northmantrader.com/2019/01/04/the-ugly-truth/

"For years critics of central bank policy have been dismissed as negative nellies, but the ugly truth is staring us all in the face: Market advances remain a game of artificial liquidity and central bank jawboning and not organic growth and now the jig is up. *As I've been saying for a long time:* ***There is zero evidence that markets can make or sustain new highs without some sort of intervention on the side of central banks. None. Zero. Zilch.***

And don't think this is hyperbole on my part, I will present the evidence of course.

In March 2009 markets bottomed on the expansion of QE1 which was introduced following the initial QE1 announcement in November 2008. Every major correction since then has been met with major central bank intervention. QE2, Twist, QE3 and so on.

When market tumbled in 2015 and 2016 global central banks embarked on the largest combined intervention effort in history to the tune of over $5 trillion between 2016 and 2017 giving us a grand total of over $15 trillion in central bank balance sheet courtesy FOMC, ECB and BOJ:

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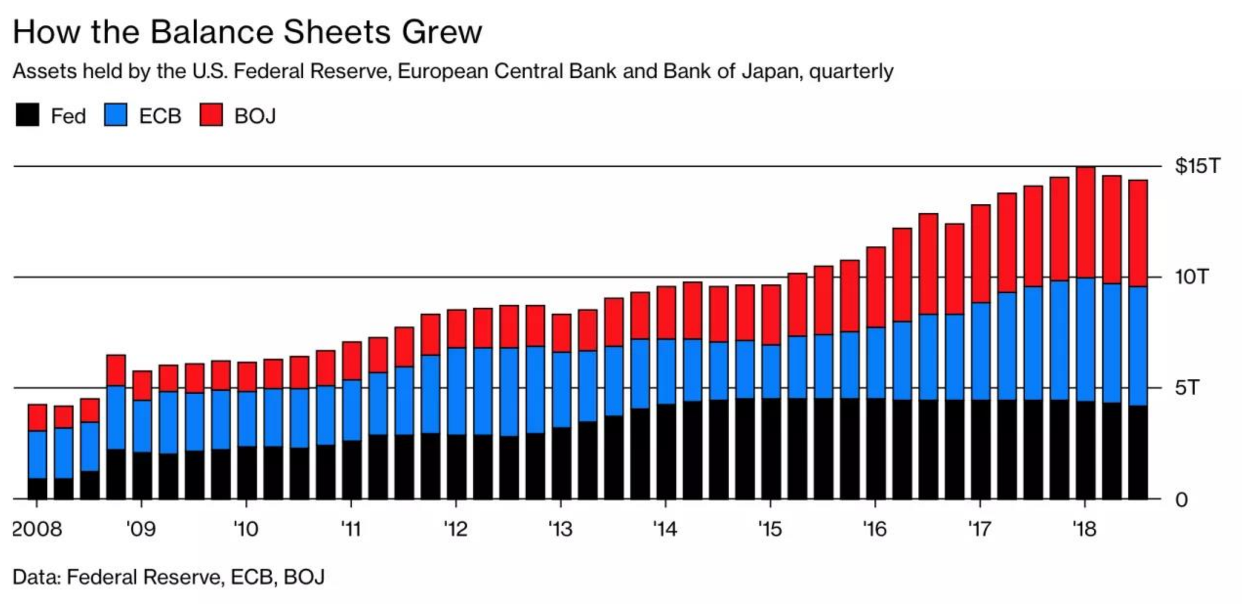


<u>When did global central bank balance sheets peak?</u> Early 2018. <u>When did global markets peak</u>? January 2018!"

"…And guess what changed? 2 things.

In September 2018, for the first time in 10 years, the FOMC [removed one little word]() from its policy stance: <u>"accommodative"</u> and The Fed increased its QT program. When did US markets peak? September 2018.

<u>And with the sugar high of the tax cuts fading it was too much. Add trade wars and global growth slowing it was more than markets could handle.</u>

And so yes, the timing was perfect, and you can see it in the chart:

And so here we go again:

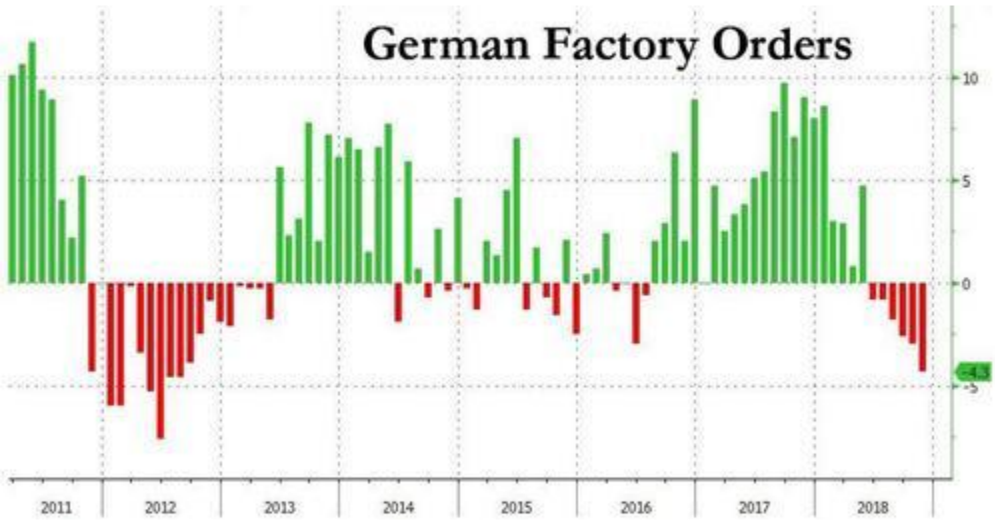
And central banks have already begun to react.

What's the larger message here? Free market price discovery would require a full accounting of market bubbles and the realities of structural problems which remain unresolved. ***Central banks exist to prevent the consequences of excess to come to fruition and give license to politicians to avoid addressing structural problems. And by preventing these market forces from playing out at each sign of trouble the can gets kicked further and further down the road. Each successive recovery keeps the illusion alive, but the jingle is getting tighter and tighter each time around and requires ever lower rates before the monsters return.*** *In the meantime, debt keeps expanding while each recovery produces less and less organically driven growth, but ever higher wealth inequality. This is what this system produces.*

And that's the ugly truth. But you won't hear it from the Fed."

Today (Tuesday), high-profile Bill Blain has said that this relief rally is too dependent on the FED. Referring undoubtedly to the more dovish commentary we've heard from them (the FED) over the past 2 weeks but demonstrating that market players still do depend on the FED as their main reason to buy stocks! Now, it hasn't gotten too bad in the USA, but even in Europe's largest economy, it's already ugly:

https://www.zerohedge.com/news/2019-01-08/shocking-german-industrial-production-drop-raises-possibility-recession-europes

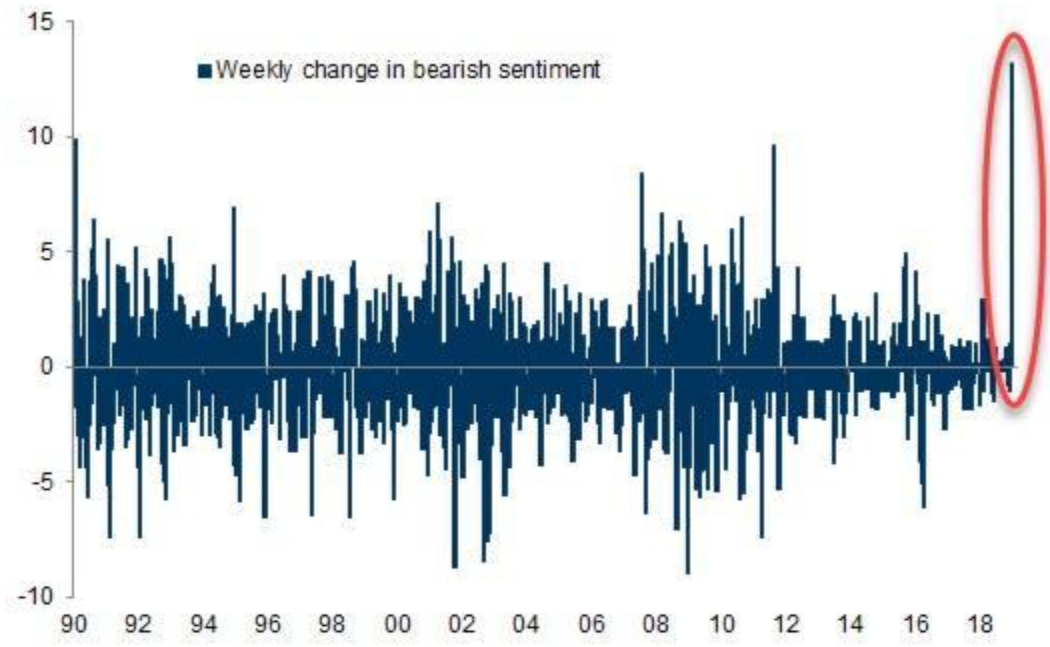


Bulls must be thinking that the ECB and then soon-after the FED, will AGAIN be riding to the rescue. How can they think otherwise as they've been conditioned to think that way from the very first rally attempt that this bull market made! The ONLY reason not to think that way would be based on the more-hawkish comments that Powell made prior to all the dovish comments that emerged recently.

So, let's look at this…

The economy seems to be sending early warning signs of slowing here. We KNOW that the world economy has definitely slowed and in a meaningful way. When the FED was hawkish, and we saw signs of slowing, the equity markets imploded. When we got hints that he FED would be open to more economic and stock market levitation, we've gotten at least a relief rally. It's all still about the FED as Henrich (and 😉) maintain. Powell, however, doesn't seem to want it to be all about the FED anymore. This concoction should make 2019 a very interesting year.

Quick aside, why the surge to start the year? We noted that stocks had been very oversold and that the sentiment was too bearish. Turns out that was true! Our guess was on target! Just kidding! We weren't guessing but here's another view of how dim it was to close out 2018:



If you're reading that as the worst weekly surge from the bears in nearly 30 years, you're reading it correctly! Now you know why we keep referring to it as "historic."

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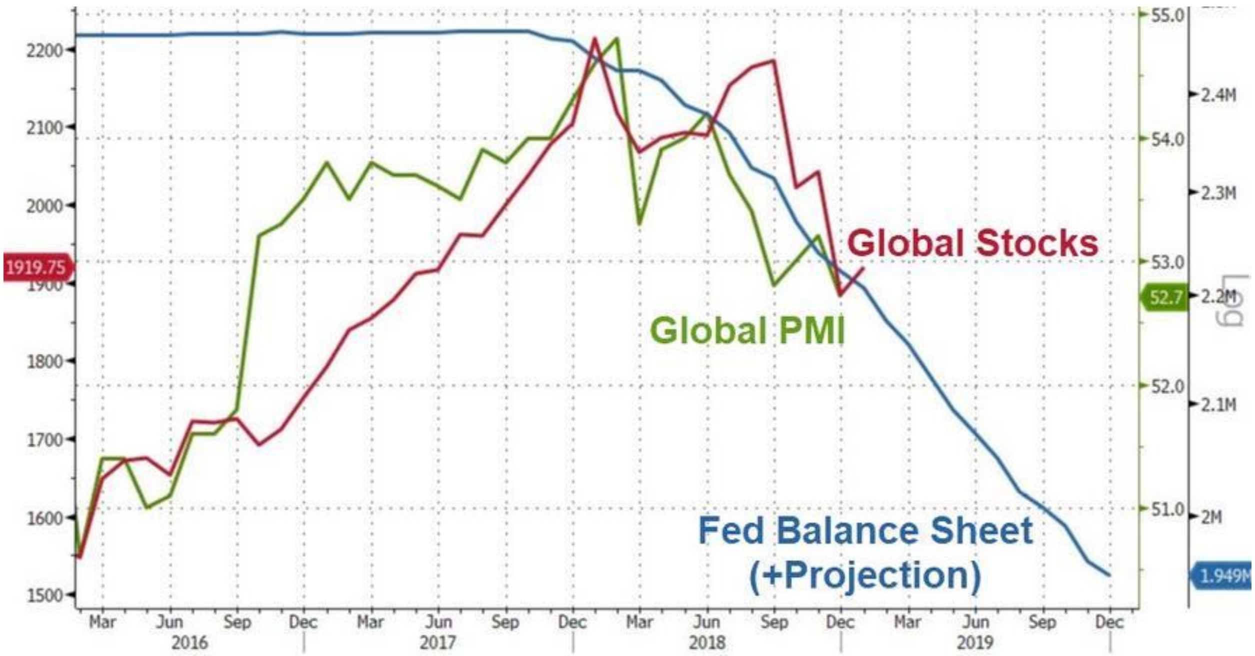
Getting back to the FED because we can't let it go nor should we let it go:



There's the FED's dovish talk of late and then there's the plans to reduce their balance sheet and those plans haven't changed to our knowledge! Which means, if they stay on that path, they'll be pulling liquidity out of the markets in droves! That hasn't been good for equities as can clearly be seen!

We don't think it will help another important area: Housing. We're not alone there and here's another dismal entry to back that up:

https://www.bloomberg.com/news/articles/2019-01-07/housing-bear-who-called-2018-slowdown-sees-worst-yet-to-come

James Stack, who predicted the 2008 real estate crash and nailed last year's housing slowdown with uncanny timing, is back with some bad news for 2019.

"Housing could be heading for its worst year since the last housing crash," Stack, 67, said in a phone interview. "Expect home sales to continue on a downward trend in the next 12-plus months. And there's a significant downside risk to housing prices if a recession takes hold."

Last January, Stack was practically alone when he warned rising mortgage rates would expose housing's affordability problem and "the risk that today's highly inflated housing market will again end badly." The day after Bloomberg published his comments on Jan. 22, homebuilder shares began a 10-day slide, and ended the year down by more than a third.

Even if mortgage rates level off or ease slightly in 2019, we are unlikely to see the psychology turnaround," Stack said. "Homebuyers have woken up to the fact that affordability is a major issue. Can they afford the home?"

In summary, stock market progress would seem to be challenging in the near future aside from a short-squeeze/relief-rally. The auto industry is struggling. Housing is struggling. Europe, Japan and China are struggling. All are expected to continue to struggle. Rates are not headed lower and liquidity is being withdrawn by central banks. Profits may have peaked and the leadership sector (tech), has yet to get its mojo back. It would seem a lot to ask stocks to rally in a big way and sustain it until the complexion changes significantly.

If you haven't gotten enough doom to go with 2018's gloom, we have one final read for you. Some folks, such as high-profile types by the name of Ambrose Evans Pritchard, are wondering if this is the year it all ***hits the fan***:

https://www.smh.com.au/business/markets/the-dystopian-view-is-this-the-year-the-world-falls-apart-20190108-p50q3t.html

Remain nimble my friends!

Bank and Roll!

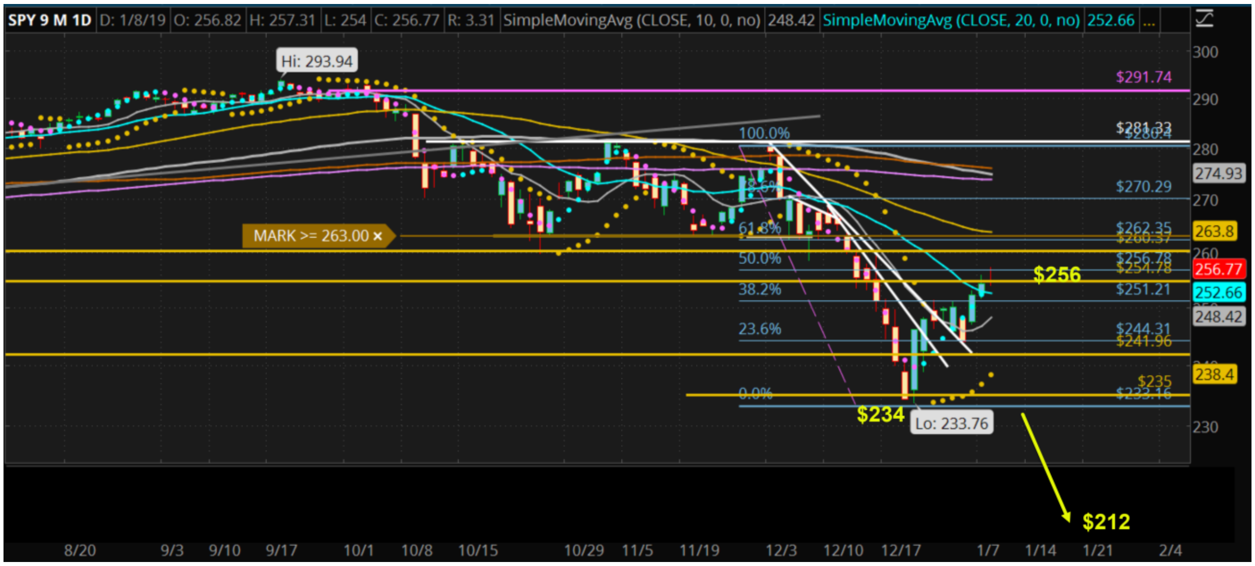
Options Academy

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

We've delved into Beta Weighting for several weeks in **OA**. It can help in a variety of ways from stock selection to hedging your portfolio. Understanding your portfolio risk and how it is weighted is important in helping you to construct and maintain a stock portfolio that fits within your risk tolerance/spectrum.

To complete our exercise, we must first have calculated each stock's Beta when compared to a market gauge like the S&P 500 (SPX). We can then use options on the ETF that very closely tracks the S&P 500 performance, the SPYs. This SPYs are 1/10th the price of the S&P 500 index. But more importantly, they are also one of the most highly traded ETFs. Due to so much interest, they offer high liquidity, and thus the options markets are very tight (bid-ask spread). This allows for very low slippage when trying to protect your portfolio which is always a plus. In other words, we can enter and exit efficiently if using SPY options.

With the Betas in hand for each stock, we can then try to estimate how our portfolio will fare based on movement expected in the market, which, in this case, the SPYs will serve as our proxy for the market.



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Current Market Price	256	(1)	Note:Market moves can be in either direction	
1stTarget Market Price	234	(2)	Pot. Move = Beta * Market Movement * Stock Price	
2nd Target Market Price	212	(3)		
1st Market Move %	-8.69%	(4)	1st Target P&L	(29,729.20)
2nd Market Move %	-17.19%	(5)	-11.19%	2nd Target P&L (58,816.76) -22.13%

STOCK	STOCK QUANTITY	PRICE	BETA	1st Target MOVE	POTENTIAL 1st Target PRICE	1st Target P&L	2nd Target MOVE	POTENTIAL 2nd Target PRICE	2nd Target P&L	
AAPL	100	122.57	1.125	-11.98	110.59	(1197.93)	-23.70	98.87	(2370.01)	12257
AMZN	100	1656.5	1.61	-231.69	1424.81	(23169.26)	-458.38	1198.12	(45838.46)	165650
JPM	100	100.47	1.15	-10.04	90.43	(1003.76)	-19.86	80.61	(1985.85)	10047
CAT	100	129.97	1.3	-14.68	115.29	(1467.85)	-29.04	100.93	(2904.02)	12997
FB	100	142.2	0.63	-7.78	134.42	(778.28)	-15.40	126.80	(1539.76)	14220
MSFT	100	102.92	1.22	-10.91	92.01	(1090.82)	-21.58	81.34	(2158.10)	10292
UPS	100	97.56	1.205	-10.21	87.35	(1021.30)	-20.21	77.35	(2020.56)	9756
WMT	100	95.36	0.35	-2.90	92.46	(289.95)	-5.74	89.62	(573.65)	9536
V	100	137.41	1.02	-12.18	125.23	(1217.62)	-24.09	113.32	(2408.97)	13741
XOM	100	72.32	0.89	-5.59	66.73	(559.17)	-11.06	61.26	(1106.27)	7232
				0.00	0.00	0.00	0.00	0.00	0.00	265728
				0.00	0.00	0.00	0.00	0.00	0.00	
				0.00	0.00	0.00	0.00	0.00	0.00	

The current SPY price level is around $256 .00 (**Point 1** on the graphic). A recent low on December 24th was $234.27 **(Point 2),** so we can use this as our first point of interest for estimation. Our next point could be down to $212.00 **(Point 3)** where there looks to be some additional support. These points represent drops of 8.69% **(Point 4)** and 17.19% **(Point 5)** respectively. By definition, a portfolio that has a higher average Beta (>1.0) vs. the market itself will lose more than the above percentages due to the nature of correlation to the market along with the volatility inherent within each individual stock. A portfolio with lower Beta than SPYs which would be <1.0, should not lose as much.

A few things must be taken into consideration when calculating the potential movement. Obviously, the share quantity for stocks is needed to estimate the proper dollar loss that would be suffered on a drop. With options positions, the Deltas of the options would be part of the calculations. If you are using stocks, then you always have the amount of shares you purchased or sold. If you are using options, then you need to look at how your option(s) react to the beta weighted price movement which is a little more complicated.

The simple formula for a potential move is the (BETA*Market Move*Stock Price)

This move is then multiplied by the quantity of shares held.

For this example, we set all shares totals to 100, so the numbers will be very clear.

This simple portfolio is over-weighted with 100 shares of Amazon (in dollar terms) which has caused the potential loss to increase significantly on the highest beta-weighted stock in the portfolio. This loss contributes $23,169 of the $29,729 estimated loss. If we looked at it on a percentage basis, removing this big risk , then we would only lose about 6.5% estimated loss if the SPX dropped 8.69 %. This is because we have a few stocks with lower Betas than the market itself: FB, WMT, XOM. This is the power of diversification that includes fewer volatile stocks (lower beta).

To hedge this portfolio, we can either adjust individual positions (like Amazon) to reduce risk or buy protective options (puts or put spreads). We could also sell options in the individual positions to collect premium to offset some of the downside risk (The Collar Strategy). Another way is to use the SPY ETF to buy a proactive defensive position that would address our entire portfolio risk. Effectively, this would mean that you we are actively trying to offset the potential loss with a position that would act opposite of our portfolio. Essentially, we could buy puts on the SPYs to offset the 11% loss. Which ones we buy and how many and if we do it as a spread etc., are all relevant questions but the main point for now is that by completing this exercise we CAN, at least in theory, readily find an indirect hedge very conveniently via the SPYs. Naturally, we wouldn't be alone in seeking protection from put purchases in the SPYs if we're late to react to market turbulence. It pays to hedge first as we'll get better prices and hedge from a higher level prior to a downdraft in the market.

There is a lot that goes into hedge selection, but hopefully this beta-weighted example gives you some ideas of what you may have to do in your portfolio when the time comes!

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