MARKET TRACTION

Will the FED Continue to Pave Easy Street with Gold Leaf?

This Week's Trade Ideas:

Bullish Ideas: (View Webinar)

None. Will rescan **Post-FED**. Most stocks are overbought and have ever so slightly weakened at this juncture.

Bullish Mentions: **(View Webinar)**

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

ATVI.

Bearish Ideas: (View Webinar)

***CSCO > Cisco Systems Inc. >** $53.31 Last. Buy the April 18th 54.5 Puts for $2.00 or less with a close or anticipated close below $53.07 in a down market with expectations for continued weakness.
***Reversal/Counter-Trend Trade! Post-FED trade**.

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

None. Will rescan on weakness if any should ever appear again in our lifetimes.

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:

Bulls are currently in control and eyeing our resistance level dead ahead. It seems improbable but we've seen worse!

They just keep on chugging! The breakout hasn't been all that strong but new highs have been made. It appears that bulls are confident that more Mother's Milk will flow from the FED this week. We're not so sure. We will all know soon enough.

Technicals:

Will be discussed in-depth in the **Morning Call** webinar.

Fundamentals:

These trade idea(s) and mentions are technically-driven.

(Editor's note: These trade ideas may be updated periodically, in keeping with market conditions. It is intended solely for educational purposes.)

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Recap of Last Week:

Last week was a fairly-good week. We were only bullish which was fortunate as the Gang simply won't let stocks fall…at least thus far. **WMT** was our official bull idea and it moved up modestly just as the SPYs did. **WMT** is up over $2.00 as we write and hopefully can do more good work.

The brighter part of last week was in the bullish mentions and prior week's bullish names as well. We include them <u>ONLY</u> as a reminder to keep one's eye on names that aren't too stale. Many times, the full movement that's expected will take longer than the one week's time in which we cover them.

Last week's bullish mentions (***Speculative**) – (All comments are *as we write*)

TTWO – Jumped by over $7 since last Tuesday and hit the 50 SMA/our resistance line.

SIRI* - Disappointingly, remains listless. Down a little.

MRO – has moved up but just a little.

DK – moved up by about $2.00. OK move for mid-$30.00 level stock.

ACB* ($8.35 trigger level) – Very nice > 25% move since last week. Not big $ move but remember that it is easy to play big in a small sandbox such as this one.

Nearly all names moved up save for **SIRI** and we had no bears. So that's welcomed. We'd have liked more from some but **TTWO** and **ACB** did quite a bit. With the **SPYs** sort of just meandering higher, we could expect much more zoom from a name like **WMT**.

As has been the case, other recent bullish names continued to work as the market continued to not go down in a meaningful way and tries much more to go up.

AAPL has continued to push up. **EEM** and **VWO** (a webinar mention) have moved higher too.

Naturally the **QQQ, MOMO** and **BTI** all moved up as tech and emerging markets / international stocks continue to power up.

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Market Overview

From last week:

*With the dismal economic developments not mattering to this point, along with earnings being revised lower and lower along with GDP expectations, **it seems to us that the large and committed bulls out there must know something or think they know something because this market is a whisker from at least an attempt to push towards the all-time highs.***

That's what we've seen since last week. The NDX/QQQ has broken out and has tried to work to the ATH levels. The SPYs have also tried but more mildly. The DIAs have been hampered by Boeing's plight. Now we're at the critical decision point. Have the bulls dialed into the FED's plan prior to tomorrow's decision? Have they "guessed right" in buying stocks incessantly since Christmas? If Powell is legit, he'll seek to temper the animal spirits he unleased with his late 2018 about face. Just as he needed to personally chill then, he needs to chill the *animal algos* or he could have a problem on his hands in the near future as stock prices continue to diverge from earnings and economics.

In short, this week's outcome and those that follow are likely to result from whatever the FED sends our way. We'll chart a little, but we know from experience that it can all be blown up if the FED moves rates or utters comments that aren't in line with current expectations.

First off, let's confirm that the VIX has finally dropped as we've recently noted that it likely would:

Sizing things up today is almost futile. It's the FED, FED, FED and the FED's brother. That's what it is all about for the next few days barring out of the blue news.

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Here's an example as to how this juncture could be argued both ways:

We finally surmounted the $281 level. That's good!

Yeah, but look at the weak follow through thus far! Today delivered a weak finish!

That's true but you can't expect a big push with FED risk looming!

True but why worry? The FED rigged us back up, didn't they?

Yes, they did but maybe they think it has gone too far! Wait, aren't you a bear? Are you counting on more FED rigging?

I'm not sure, wait, I thought you were a bull???

Wait, I thought I was a bull too! Now, I'm not sure…

No wait, I am sure, the FED will keep the spice flowing! I mean, they normally do. The only time they didn't the markets got smashed in October into the end of the year…

EXACTLY! So, you admit that it's all about the FED?

(Ignoring the ?) This is just a pullback to convert $281.00 to support!

I think it's a sign of a weak and perhaps false-breakout. The NDX really broke out but it's way overbought now.

I guess we'll see who's right after the FED speaks its piece…

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The NASDAQ is even more juiced as it has produced a true breakout:

If the FED sings the right notes then it would seem the long-awaited challenging of the All-Time-Highs could commence and if not, the first stop lower would likely be a test of the 200 SMA in the SPYs.

It's PURE FED now and the charts are likely to be overwhelmed by FED FALLOUT.

The calendar is lighter than it has been but the FED's decision and Jerry Powell's comments that will follow it will most likely be the focal point of the week. Clearly Powell could push the market either way. Will he send it soaring towards all-time highs or will he trigger a false breakout scenario? Guesswork isn't our thing…

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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, MARCH 18					
10 am	Home builders' index	March	62	--	62
TUESDAY, MARCH 19					
10 am	Factory orders* (new date)	Jan.	0.1%	0.4%	0.1%
WEDNESDAY, MARCH 20					
2 pm	Federal Reserve announcement			2.25-2.5%	2.25-2.5%
2:30 pm	Jerome Powell press conference				
THURSDAY, MARCH 21					
8:30 am	Weekly jobless claims	3/16		225,000	229,000
8:30 am	Philly Fed index	March		3.0	-4.1
10 am	Quarterly services survey* (new date)	Q4		--	--
10 am	Leading economic indicators	Feb.		--	-0.1%
FRIDAY, MARCH 22					
9:45 am	Markit manufacturing PMI (flash)	March		--	53.0
9:45 am	Markit services PMI (flash)	March		--	56.0
10 am	Existing home sales	Feb.		5.12mln	4.94 mln
10 am	Wholesale inventories* (new date)	Jan.		--	1.1%
2 pm	Federal budget* (new date)	Feb.		--	-$215bln

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Below the Radar

Gary Shilling has resurfaced and he's seeing what we've been seeing, most of it courteous of Morgan Stanley. But don't worry, he's only forecasting an 18% hit:

Gary Shilling has a knack for predicting turns in the economy. The former chief economist for Merrill Lynch did it in the 1960s. Again in 1991. And then, leading up to the financial crisis in 2008, he consistently warned the housing boom would turn to bust. We all know how that one turned out.

Now, he's making another call.

"I give a business downturn starting this year a two-thirds probability," he wrote in a Bloomberg News op-ed. "The recessionary indicators are numerous."

Shilling, portfolio manager and president of A. Gary Shilling & Co., pointed to factors such as the near-inversion in the Treasury yield curve, the nasty December for stocks, weaker housing activity, soft consumer spending, etc.

<u>*"Then there are the effects of the deteriorating European economies and decelerating growth in China as well as President Donald Trump's ongoing trade war with that country," Shilling said.*</u>

None of that is news to any of us here but it's nice to see through another's eyes that we've been on it. About that slowdown, factory orders have slumped for the 3rd month in a row:

Wit that in place, we can broaden and spring. We'll broaden into aggregated data and springboard into the "hard" vs. "soft" data issue that's back again:

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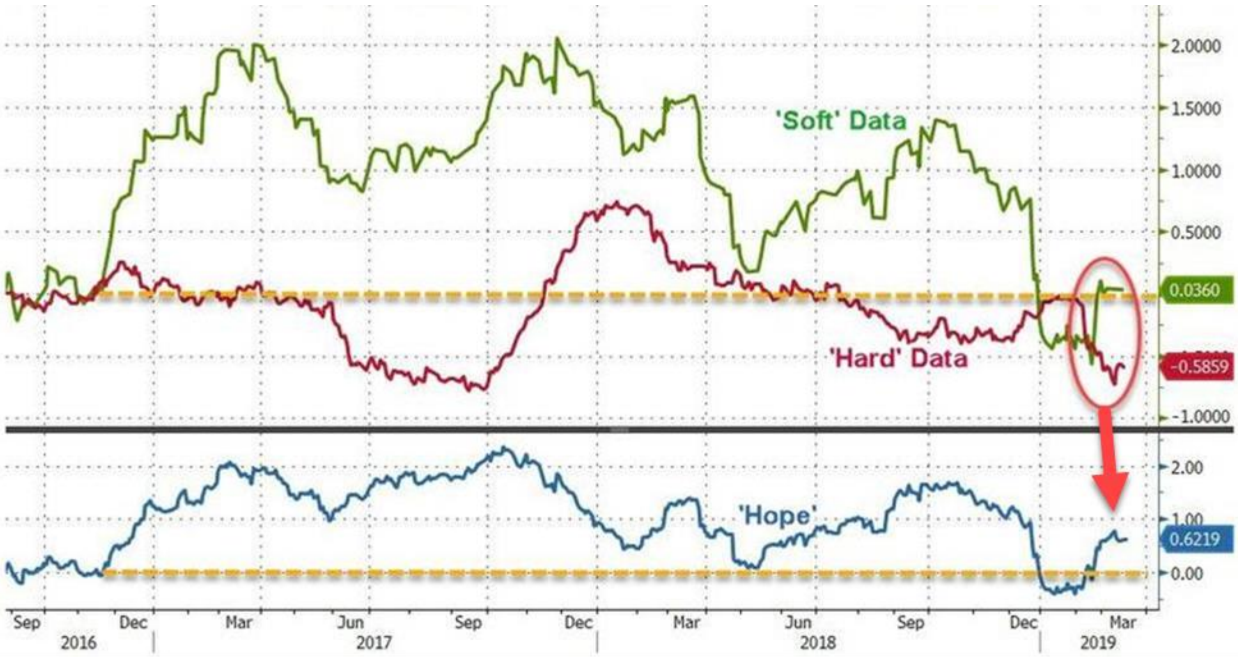
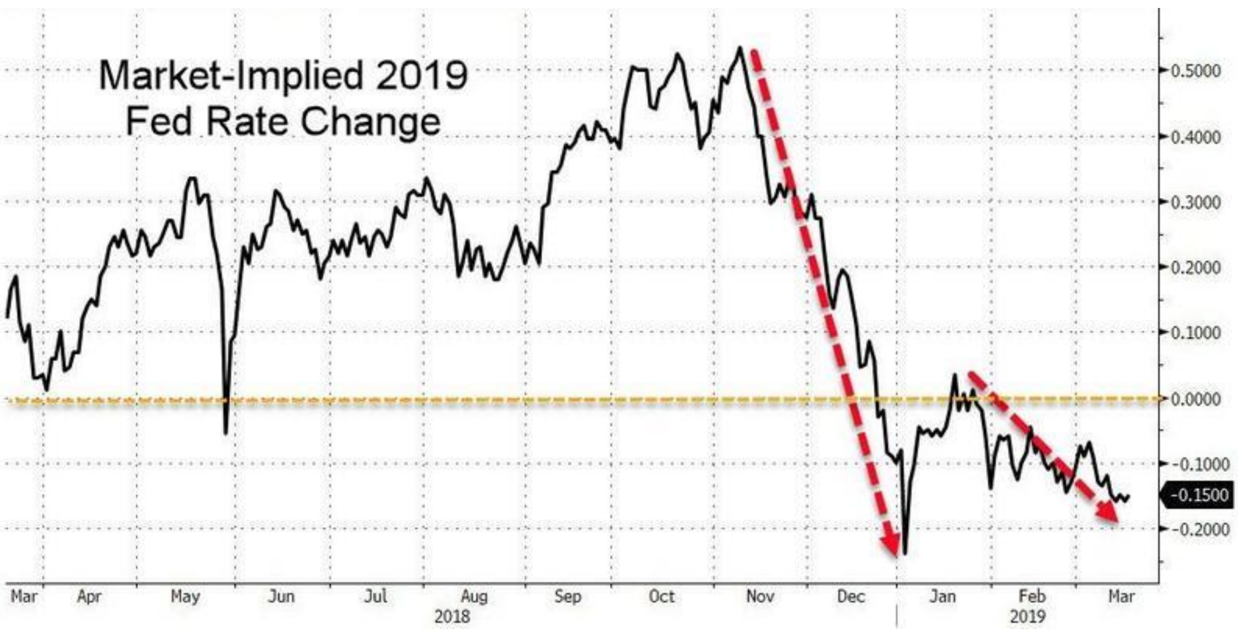


Please note that "Hope" is essentially the divergence between expectations and reality. Hope spiked back up dramatically along with stock prices but thus far, hard data has barely budged off the lows.

Another divergence we've read about a few times of late is centered on the gap between the FED lowering rates or raising rates this year. Now, overwhelmingly, rates are expected to drop by most:



What if they don't? What if rates actually rise?

*Making precisely that case on Monday afternoon was **former NY Fed president Bill Dudley** who said that the **Fed's tightening may be "back in play" later this year**.*

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"I think what is going to happen is we are going to have a pretty weak first quarter, and that's going to cause the Fed to wait for even more information," *the former New York Fed President said during a Bloomberg TV interview with Scarlet Fu and Caroline Hyde.*

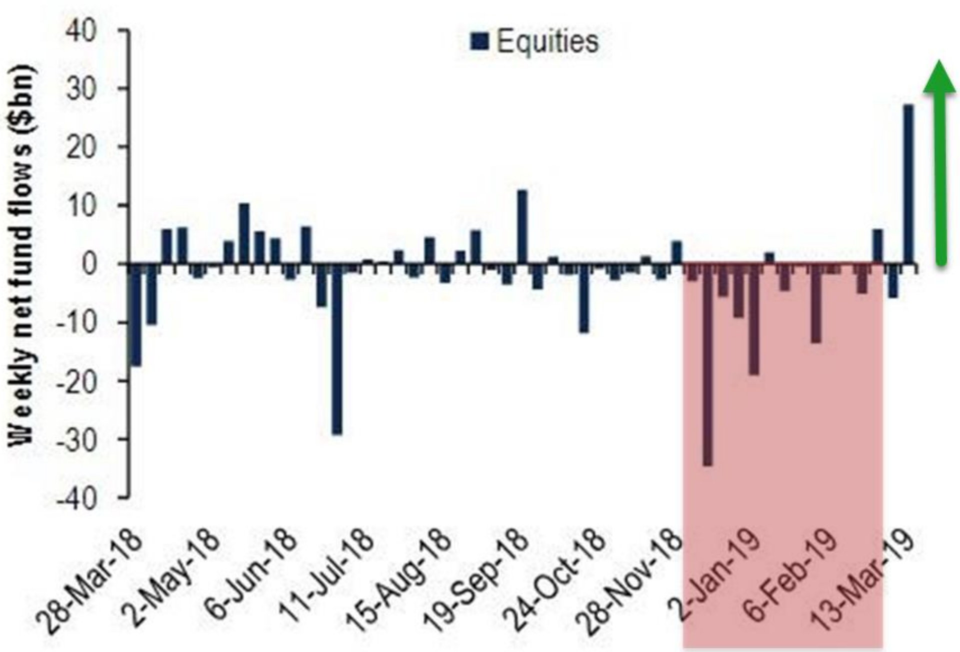
"But if the economy picks up speed again, as I expect will happen, and inflation starts to drift higher" as Morgan Stanley predicted it will last week ***"then the Fed will be back in play, maybe as early as the second half of this year," Dudley said****, effectively echoing Morgan Stanley's 2019/2020 forecast.*

Have to think that would shock most market longs right about now! They seem to believe that the FED is most certainly done with the "tightening cycle" which was more like a tightening blip! Still though, we can't fault them for pausing as we were calling for them to do just that. We still maintain that the FED waited WAY too long to raise rates. The problem they have now is that stocks have bounced into the stratosphere and any hint of the FED backing away from engineering higher stock prices will likely trigger something akin to last October! That's how hair-trigger it has all become. The FED can only blame themselves for the situation, but it is what it is.

To recap, under great pressure and after having waited far too long and desperately wanting "ammo stockpiled" for the next slowdown, the FED capitulated, and stocks have done nothing but rise relentlessly. But, has there been "real buying"? The answer is: NOT REALLY!

https://www.zerohedge.com/news/2019-03-18/buyback-blackout-period-begins-just-bears-capitulate

Figure 12: Weekly equity fund flows, $bn



That is, until recently. Notice that March finally shows that money flowed into stocks again and in a big way. But is that a good sign? NOT if you play probabilities!

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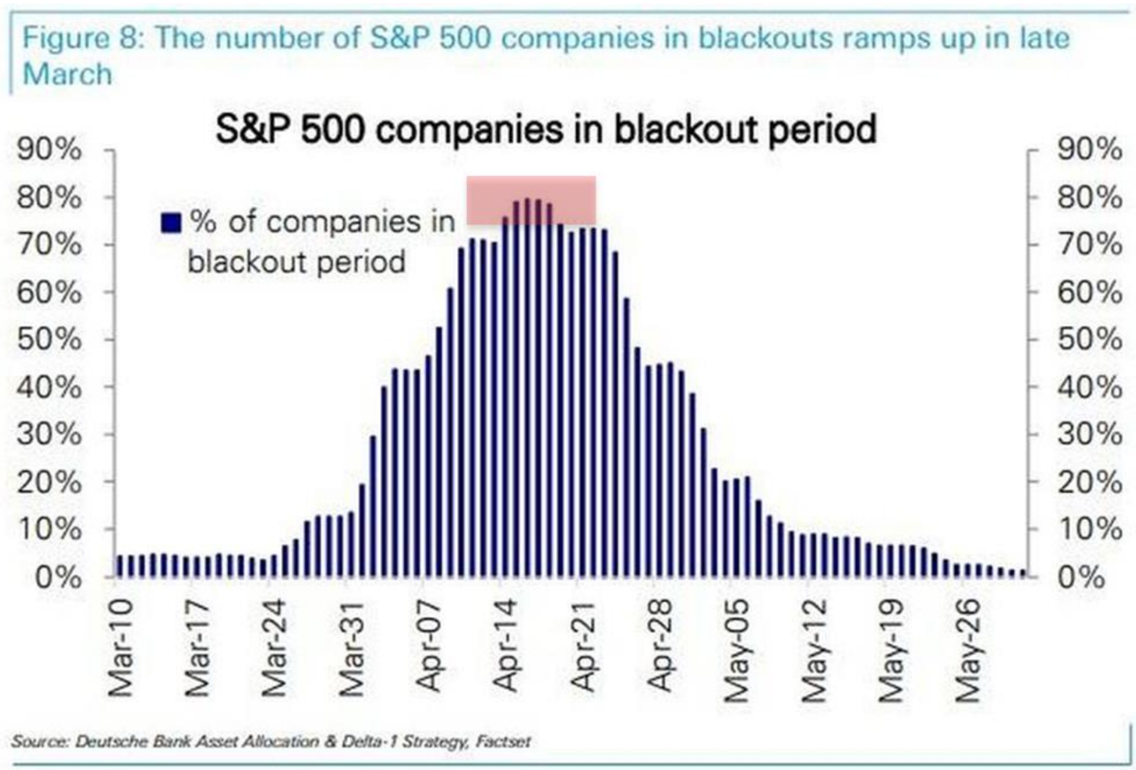
In a majority of episodes surging inflows were a contrarian indicator. 6 out of the 9 episodes saw the S&P 500 fall an average of -5.9% over the course of the following one month, accompanied by outflows.

Could it have been that the indices breached key resistance levels and that forced bears to capitulate? Has short-covering been the main driver as we've asserted? The article suggests that to be the case. Interestingly, a main driver of stock levitation is about to be nearly shut down for a while:



We're not too far away from the earnings reports rolling in and thus we'll know if corporate America's CFO's were able to turn the trick one more time…or not. With the market having priced in much better times in the future despite widespread deterioration in the present and near-past, what happens if CFO's shrug?

Well…given the lack of concern out there at present, it seems that many will be caught by surprise and they'll be caught nearly everywhere because they're long nearly everything:

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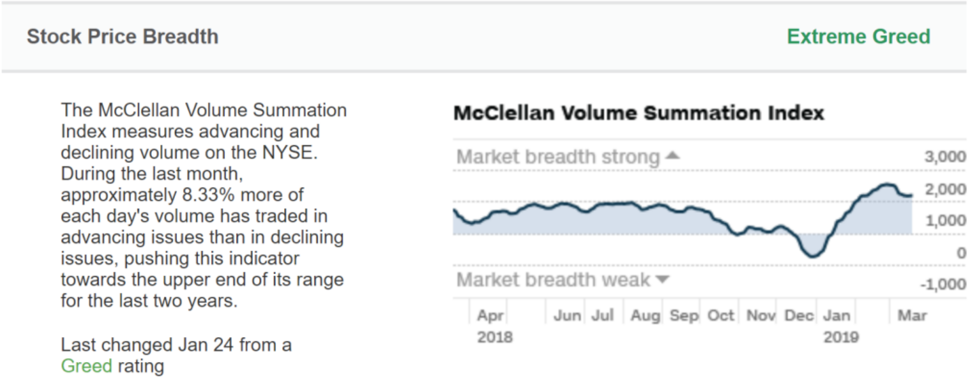

And they are getting more complacent as we expected. Mind you, this is just in front of the FED meeting an about 3 weeks before earnings reports begin to trickle. In other words, if the FED again issues an *all clear*, there's likely little to worry about for a few weeks and the VIX could be sent even deeper into the watery depths…

We'll start to conclude with recent commentary from the ever-reliable Lance Roberts who we feature in **BTR** frequently:

There is currently much debate about the health of financial markets. Have we indeed found the <u>"Goldilocks economy?"</u> ***Can prices can remain detached from the fundamental underpinnings long enough for an economy/earnings slowdown to catch back up with investor expectations?***

The speculative appetite for "yield," which has been fostered by the Fed's ongoing interventions and suppressed interest rates, remains a powerful force in the short term. ***Furthermore, investors have now been successfully "trained" by the markets to "stay invested" for "fear of missing out."***

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The increase in speculative risks, combined with excess leverage, leave the markets vulnerable to a sizable correction at some point in the future. ***The only missing ingredient for such a correction currently is simply a catalyst to put "fear" into an overly complacent marketplace.***

In the long term, it will ultimately be the fundamentals that drive the markets. ***Currently, the deterioration in the growth rate of earnings, and economic strength, are not supportive of the current levels of asset prices or leverage. The idea of whether, or not, the Federal Reserve, along with virtually every other central bank in the world, are inflating the next asset bubble is of significant importance to investors who can ill afford to, once again, lose a large chunk of their net worth.***

To sum up this week's **BTR**:

1. Bulls are growing more and more complacent

2. Bears are capitulating in a big way

3. Nearly everyone expects the FED to continue to save/levitate this market

4. Economic statistics here and abroad have swooned

5. The FED is imminent and Blackout Season in nearly at high moon/noon

Remain nimble my friends!

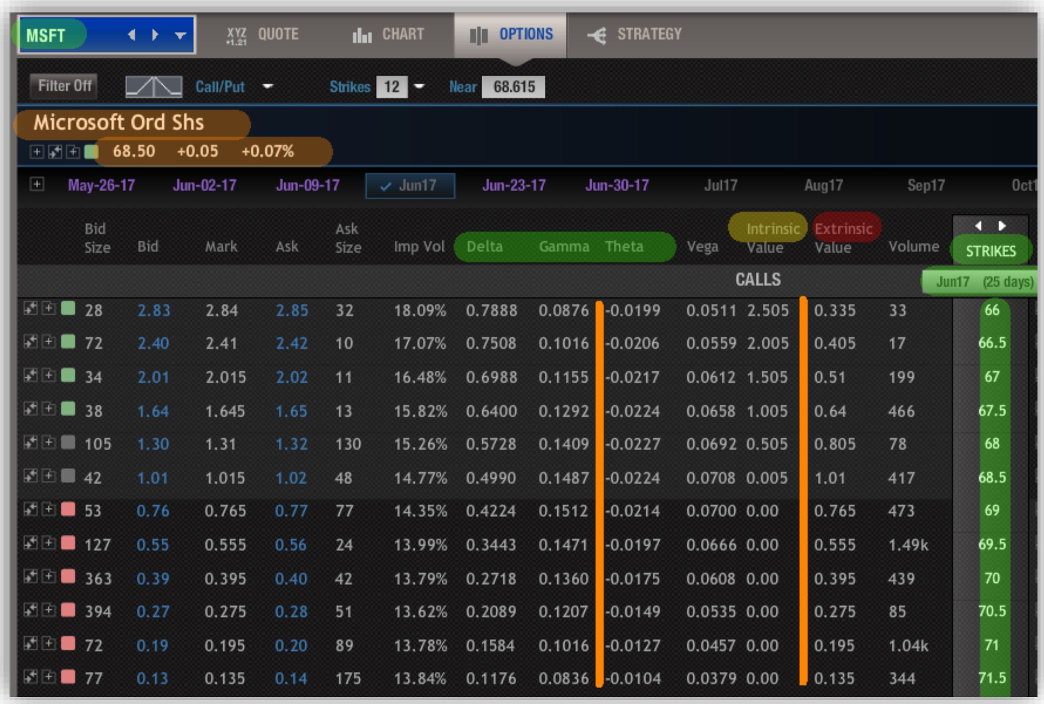
Bank and Roll!

Options Academy

In OA, we frequently focus on options selection because we receive so many questions on the subject. Once folks have started to process the Greeks-focused part of the equation, we like to build from there by suggesting that the stock chart should be considered along with the Greeks. For instance, buying strikes that are very near to key support or resistance can allow the option to serve as a stop of sorts just in case the opportunity to exit an adversely moving trade does not appear. It's another layer of protection that we're able to build into our trade, at times… Naturally, folks have more questions once we open that *can of worms* and they often sound like this: "What if there's no close by support or resistance, then which "*slightly in-the-money*" should I go with? Let's see if we can help with this dilemma….

There's another lesser known Greek that's referred to as "Alpha". Alpha is the ratio of Gamma to Theta, or Gamma/Theta. Utilizing Alpha allows us to see which options provide the *best bang for our buck.* That is, we can know which option will provide the most profit from stock movement (greatest gain in option's value over the next dollar) relative to the daily theta that it costs to own said option. It depends on where the stock price is and its proximity to specific strikes, but the at-the-moneys will typically have the greatest amount of Gamma but at the highest theta within the expiration. Still though, they can have the greatest Alpha of all options but remember, they're almost entirely EXTRINSIC value since they're not ITM. Also, they're very close to 50 Deltas. With *slightlys*, we're able to maintain high Alpha but we can slide into much more intrinsic and much less extrinsic value. This allows us to lose much less to the effects of Theta should the stock not move much once we're in the trade.

We'll use this trusty graphic we unearthed from days-gone-by to highlight things:



Bid Size	Bid	Mark	Ask	Ask Size	Imp Vol	Delta	Gamma	Theta	Vega	Intrinsic Value	Extrinsic Value	Volume	STRIKES
28	2.83	2.84	2.85	32	18.09%	0.7888	0.0876	-0.0199	0.0511	2.505	0.335	33	66
72	2.40	2.41	2.42	10	17.07%	0.7508	0.1016	-0.0206	0.0559	2.005	0.405	17	66.5
34	2.01	2.015	2.02	11	16.48%	0.6988	0.1155	-0.0217	0.0612	1.505	0.51	199	67
38	1.64	1.645	1.65	13	15.82%	0.6400	0.1292	-0.0224	0.0658	1.005	0.64	466	67.5
105	1.30	1.31	1.32	130	15.26%	0.5728	0.1409	-0.0227	0.0692	0.505	0.805	78	68
42	1.01	1.015	1.02	48	14.77%	0.4990	0.1487	-0.0224	0.0708	0.005	1.01	417	68.5
53	0.76	0.765	0.77	77	14.35%	0.4224	0.1512	-0.0214	0.0700	0.00	0.765	473	69
127	0.55	0.555	0.56	24	13.99%	0.3443	0.1471	-0.0197	0.0666	0.00	0.555	1.49k	69.5
363	0.39	0.395	0.40	42	13.79%	0.2718	0.1360	-0.0175	0.0608	0.00	0.395	439	70
394	0.27	0.275	0.28	51	13.62%	0.2089	0.1207	-0.0149	0.0535	0.00	0.275	85	70.5
72	0.19	0.195	0.20	89	13.78%	0.1584	0.1016	-0.0127	0.0457	0.00	0.195	1.04k	71
77	0.13	0.135	0.14	175	13.84%	0.1176	0.0836	-0.0104	0.0379	0.00	0.135	344	71.5

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We stowed this away for a future date because we were lucky enough to find MSFT trading right at a strike price so we know that we can label the 68.5 strike as the dead-on ATM strike. Notice that it has virtually ZERO Intrinsic value and thus all of its value is Extrinsic value. This is one reason we tend to favor *slightlys*. Notice how the ratio of Intrinsic to Extrinsic value moves sharply in our favor once we're slightly in the money. Once we get to the 67.5 strike calls, we can see that Intrinsic overtakes Extrinsic value. That's putting us in a good spot relative to the ATMs should the stock's movement stagnate and also with respect to total risk with respect to Vega risk (Implied Vol falling). The 67 calls have a little less but a similar level of Alpha (Gamma/Theta), they put us right near 70 Delta, and they have a solid 3 to 1 ratio of Intrinsic vs. Extrinsic value. Still though, the 67.5 calls have the best Alpha of all the *slightlys* though their Intrinsic vs. Extrinsic ratio is a little worse. BUT they expose us to only 13c more of Extrinsic in total. So, what's the best pick here? A very tough call because 64 Delta calls aren't bad either and they're less costly on a dollar basis. It can come down to other factors such as available capital, confidence in the trade (perceived riskiness), etc. When it's this close and there aren't technical factors at work, the higher Alpha option might be the pick which in this case would be the 67.5 calls by a slight margin. After all, they only have 13c more Theta to lose in the end and within $1 of positive movement they'll be about 77 Delta.

In stocks that do not offer so many strikes for our selection, consider calculating Alpha to help narrow down what slightly-in-the-money strike may work best for you.

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