MARKET TRACTION

A Very Thin Line - All That Remains in Preventing a Retest

<u>**This Week's Trade Ideas:**</u>

Bullish Ideas: (View Webinar)

CREE > Cree Inc. > $43.68 Last. Buy the Dec. 14th 42 Calls for $3.30 or less with a close or anticipated close above $43.70 in an up market with expectations for continued strength in the major indices.

<u>Bullish Mentions</u>: **(View Webinar)**

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

UNM, WYNN, SIX, ALV, TXT, AER, OC.

Bearish Ideas: (View Webinar)

T > ATT Inc. > $30.33 Last. Buy the Dec. 7th 31 Puts for $1.10 or less with a close or anticipated close below $30.27 in a down market with expectations for continued weakness in the major indices.

<u>Bearish Mentions:</u> **(View Webinar)**
Based upon closing prices and all assume a down market with expectations for continued weakness in the major indices.
PFE, APA, IBM, K.

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:

Here's last week's Outlook with added emphasis:

We aren't fully convinced that the corrective phase is over but still see that stocks want to rally at this snapshot in time. *That can change or* ***accelerate very easily*** *given the outcome of elections. Guessing is always tough, but these midterms seem to have many perplexed and unwilling to commit. We typically square up in front of unpredictable events because we feel that guessing is gambling instead of trading.* ***<u>In short, we believe that the election results will drive the markets for at least a short period of time.</u>***

And that's really what we got, mostly. They used the election for a relief rally and that did drive the action for a little while. It did however amount to gambling as the outcome that played out was supposed to produce a selloff and yet it produced a sharp rally, initially at least.

We then updated that the rally was showing itself to be dubious. Subsequent to those updates, the markets have remained under pressure.

The outlook this week is, barring something unforeseen, that the selling is on the verge of picking up again and if it does, beware!

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 is another simple recap. **SO** was our bullish idea. It popped up immediately and has hung tough even after the indices came under pressure. Not a huge mover but the markets have weighed many stocks down. The following were all bullish mentions: **V, MA, AXP, PYPL, HLF, LRCX, Z.**

Let's take all the credit and payment processors first. Essentially, they all did well initially, and then as the market itself started to give up the post-election gains, so did they.

HLF and **LRCX** never could get through our triggers and faded with the markets. **Z** was toast from the start due to an earnings release on the morning of our webinar.

LLY was our lone bearish mention as we couldn't find anything on that side of the equation, but it quickly moved away from our trigger level with the short squeeze in place in the indices and fell out of consideration.

Fortunately, we spotted what we thought was a fading sucker's rally and began to update ASAP. Those updates can be seen below in **Market Overview**.

All in all, not a bad week. We were all bullish to start, and most bulls tried to move higher and most did move up, save for earnings hostage **Z**. When we saw the technical complexion change, we got that likelihood out before the big reversal fully took hold.

Market Overview

FED speeches are always worth keeping an eye on, but this week that's likely more so the case than most and by far. Why? First off, there's several FED types speaking this week. Secondly, because this market has been so FED-dependent for so long, and if the FED remains hell-bent on possibly "overshooting", that's a much different message that's effectively the antithesis of the message and the actions they've put on display since 2009. The FED "cold shouldering" the market at a vulnerable time like this, is the last thing performance-chasing easy-money perma-bull money managers that are fully long want to hear right now. Here's a reprint with emphasis added from last week's **Market Overview**:

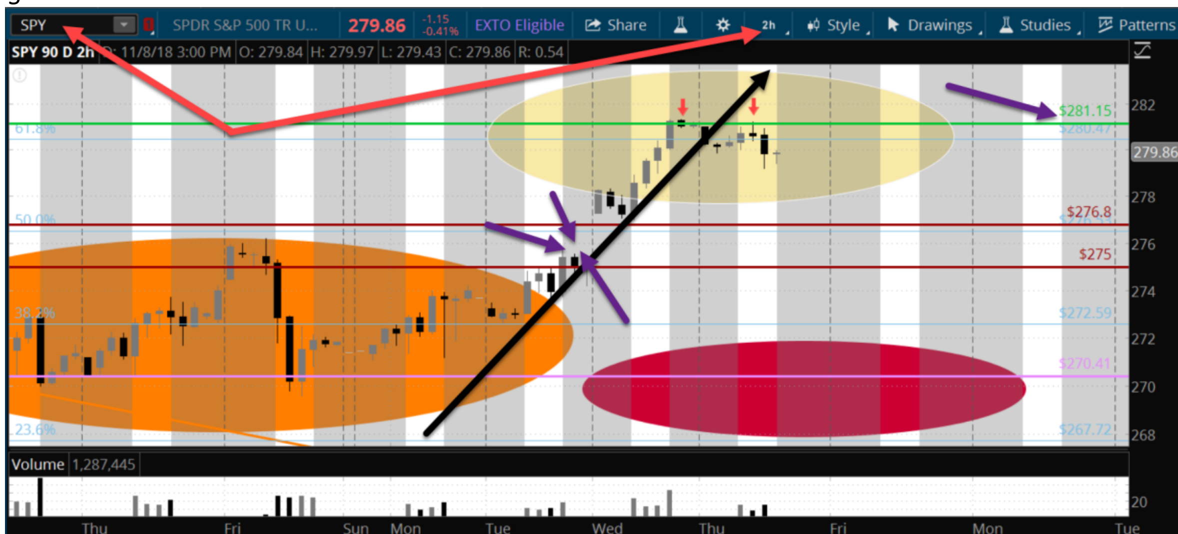
*"This week's **Market Outlook** is the easiest of the year: It's a guessing game. That's something we try to avoid as it is not so much trading as it is gambling. **If a gun were put to our heads, we'd guess that there's more upside to be had as the retracement from the lows hasn't been all that impressive (leaving room) and we think the bulls want to save their years with less than 2 months remaining until their end of year bonuses are determined. In their own self-interest, we'd expect them to muster more of a rally attempt than what they've put together so far.** They're in control at the moment too, and stocks are still emerging from oversold conditions. However, a gun is not at our heads and for that we're grateful! We don't have a gun pointing at us and thus we choose to remain prudent and that means avoiding guessing! Not being chopped up by news developments is winning from where we sit."*

There were a few good nuggets in there:

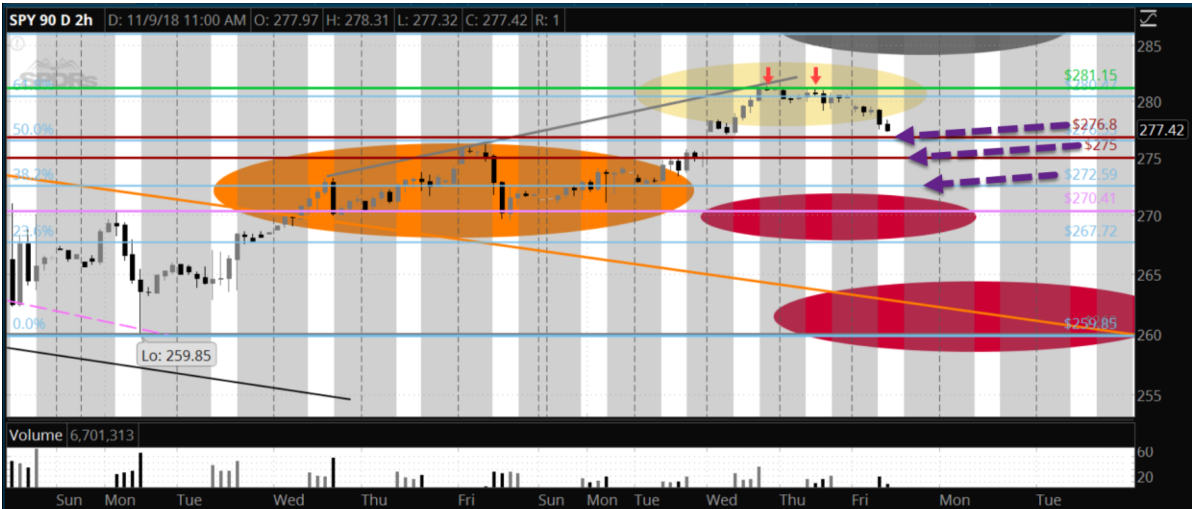
1. The bulls did remain in control and our "gun to the head" guess delivered early in the week in that even after an election outcome that most suggested would be bearish, we saw a big but ultimately empty initial rally.

2. There was chop. Fortunately, we spotted some issues on the sub-daily 2-hour chart and put out several updates related to those developments and fallout from them. Here they are for review:

"We don't often read too much into sub-daily 2-hour charts but a possible double top pattern with a break of support has shown up RIGHT AT our 61.8% Fibonacci retracement level near $281.00 in the SPYs. Coincidence? Maybe, but worth noting! Rolling is prudent. Rolling when a bounce goes too far, too fast and fails 2 days in a row at the same resistance level after putting in a big gap??? You be the judge!"

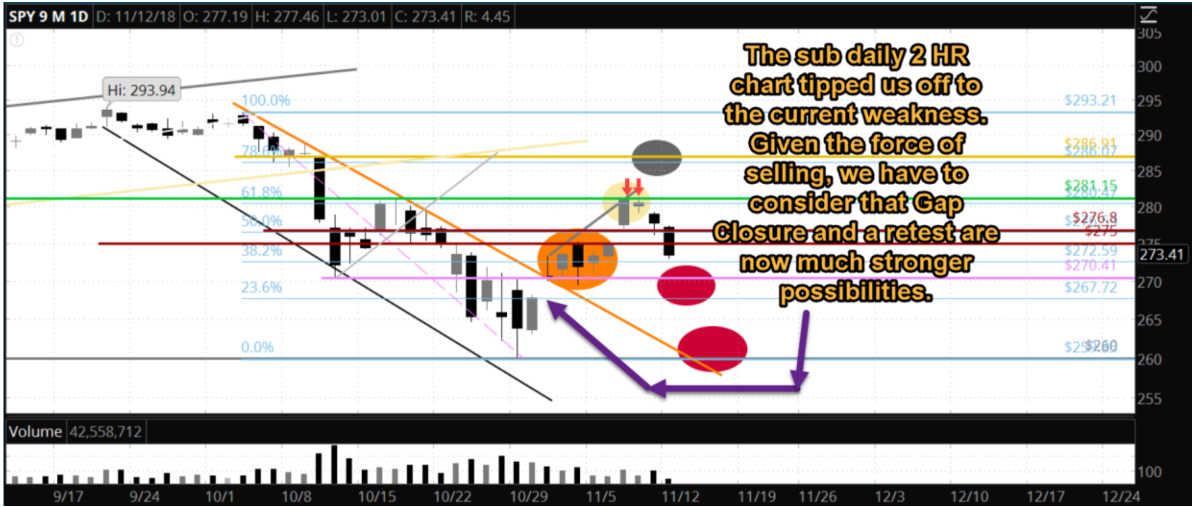


And then these updates followed:



After that intraday chart, we switched back to the Daily chart:

We're switching from the 2-hour chart back to the daily because a GAP closure is now a strong possibility due to the force of selling.



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Things simply don't look good and all indices, as we've been noting, are under serious pressure and correlations have headed towards 1.0. Thus, the SPYs:

Last week we had this to say regarding a final "whoosh":

The final "whoosh" we speak of during these periods has yet to happen, but it isn't a prerequisite or lock to happen each, and every time.

That remains true, but it seems we're on the eve of a whoosh. The market continues to act poorly and save for "surprise" good news, the technicals are becoming heavier as the fundamental clouds gather and loom.

There's possible FED news nearly every day this week and Thursday should be the "Biggy" because much of the week's news is set to be released that day. Additionally, FED Chairman Powell's Q&A is set for 6PM on Wednesday, which means the reaction, if there is one, will be seen on Thursday.

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This Week's Economic Calendar

TIME (ET)	REPORT	PERIOD	ACTUAL	MEDIAN FORECAST	PREVIOUS
MONDAY, NOV. 12					
	Veterans Day No indicators scheduled				
2:30 pm	Mary Daly (voter) speech				
TUESDAY, NOV. 13					
6 am	NFIB small-business index	Oct.	107.4	--	107.9
10 am	Neel Kashkari Q&A				
2 pm	Federal budget	Oct.		--	-$63 bln
2:20 pm	Patrick Harker discussion				
WEDNESDAY, NOV. 14					
8:30 am	Consumer price index	Oct.		0.3%	0.1%
8:30 am	Core CPI	Oct.		0.2%	0.1%
9 am	Randal Quarles (voter) testimony				
6 pm	Jerome Powell (voter) Q&A				
THURSDAY, NOV. 15					
8:30 am	Weekly jobless claims	11/10		210,000	214,000
8:30 am	Retail sales	Oct.		0.6%	0.1%
8:30 am	Retail sales ex-autos	Oct.		0.6%	-0.1%
8:30 am	Philly Fed	Nov.		20.0	22.2
8:30 am	Empire state index	Nov.		--	21.1
8:30 am	Import price index	Oct.		--	0.5%
10 am	Business inventories	Sept.		--	0.5%
10 am	Randal Quarles (voter) testimony				
3 pm	Neel Kashkari discussion				
FRIDAY, NOV. 16					
9:15 am	Industrial production	Oct.		0.2%	0.3%
9:15 am	Capacity utilization	Oct.		78.2%	78.1%
11:30 am	Charles Evans speech				

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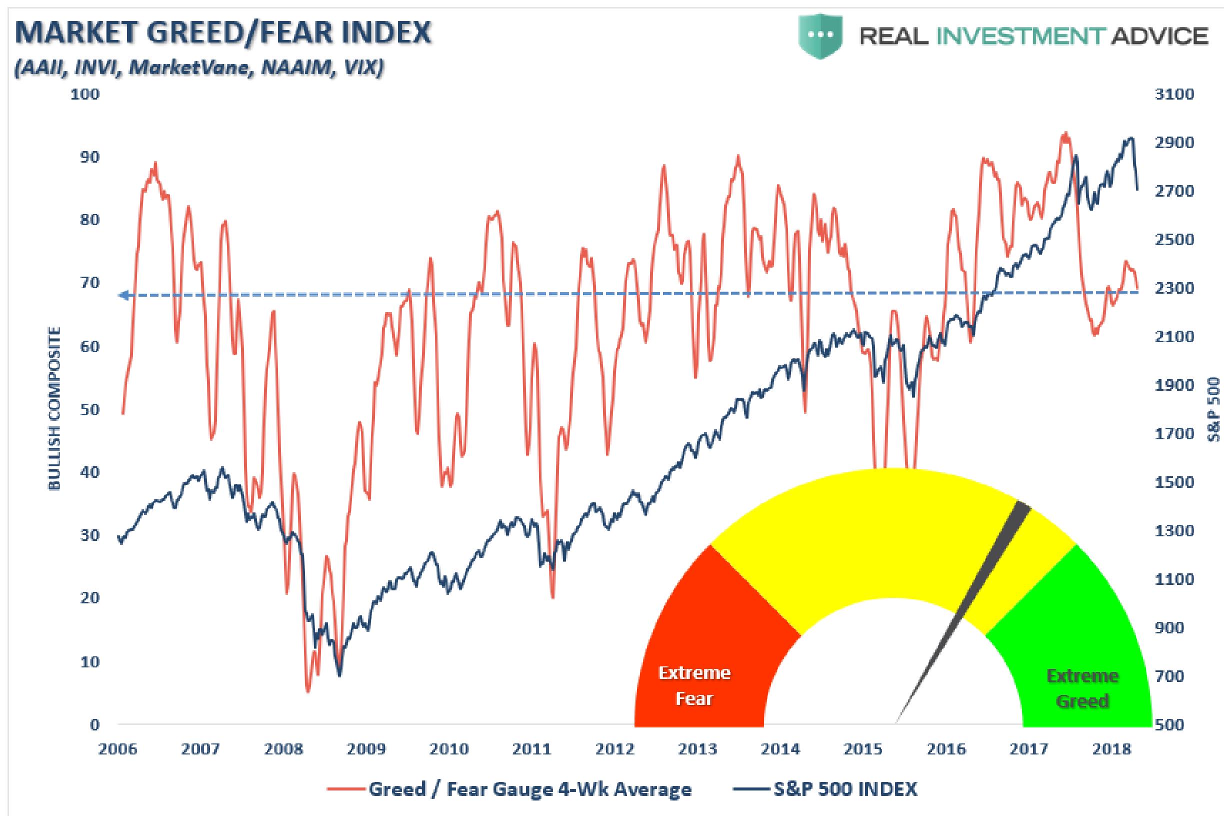
Below the Radar

As we were writing this morning, we noticed that the indices have jumped up from the morning lows based on just a whiff of progress between the US and China on trade. Larry Kudlow made a few comments on positive developments and away went stocks (higher). As readers know, we postulated that such fireworks could erupt if issues are worked out between the two countries, but if they're not, things could continue to deteriorate for both and the rest of the world by extension. If this, like all other recent rallies, ends up being simply a relief rally, the sellers will shortly return with gusto. Our way of staying on the right side has to do with the indices holding trend, which, they no longer are, at least at this writing.

As trend is no longer being held, and thus may be changing, we must be prepared and act accordingly. It's with this possibility in mind that we present this week's **BTR**.

To start things off, we checked in on Lance Roberts who never seems to have a shortage of bearish concerns. He recently noted that while short term sentiment had become very bearish, investors for the long term haven't yet positioned themselves that way:



This can be interpreted a few different ways, but the bearish takeaway would be that there's a whole lotta' sellin' that could still happen! If trying-not-to-panic bulls shift into panic-mode and selling that begets more waves of selling kicks in, which tends to do just that - cause panic, well, we may see stocks begin to plummet on the quick. So that's the backdrop, but here's Roberts' more immediate concern which is not unique to him as an analyst:

"As [I wrote previously](), the boost given to corporate earnings from tax cuts has, as expected, begun to fade starting this quarter.

"The market is digesting the fact that the tax cut last year has created a lower quality increase in US earnings growth that almost guarantees a peak rate of change by 3Q. *Furthermore, the second-order effects of said tax cuts are not all positive."*

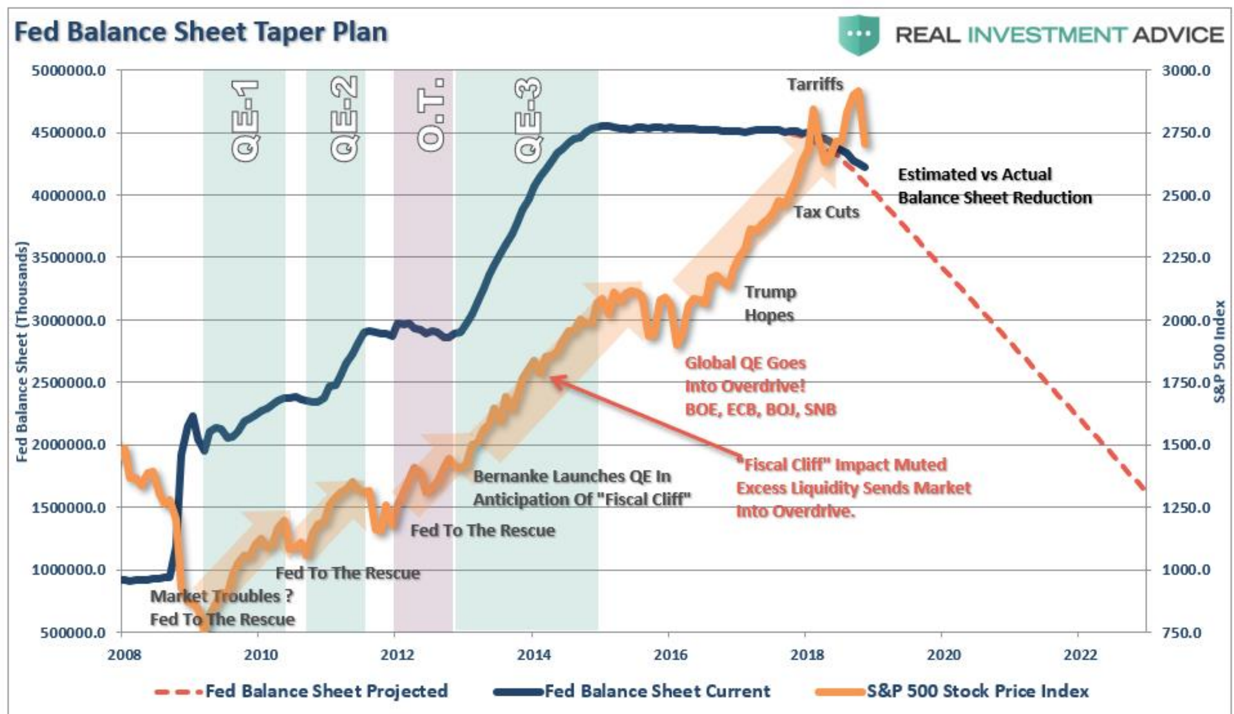
That has indeed been the case so far this earnings season as guidance has been littered with negative guidance, missed revenue expectations, concerns over rising costs of employment, and weaker than expected earnings growth on many fronts. Furthermore, the impact of tariffs has begun to weigh on companies who are changing forward expectations, CapEx spending plans, and other actions.

David Kostin from Goldman Sachs recently noted the same:

"In addition to concerns about economic growth, investors and managements have focused on margin pressures from rising wages and other input costs. ***FY2 EPS revision sentiment is negative for the first time since the passage of tax reform."***

It's looking quite possible that we may have reached "peak earnings" as of now and improvement, for many reasons, is unlikely to be seen for a while. The tax cut *lighter fluid* may be starting to burn off in terms of the initial boost it will provide to the economy and with Powell and the FED hell-bent on raising rates, and the world economy struggling, what's left aside from the beloved "buybacks" to keep stock prices rising???

But let's get back to Roberts for a moment. He recently pointed out that the FED's plans to step away, and further away, will only hurt the equities market and that this has already ratcheted up the volatility in equities markets:



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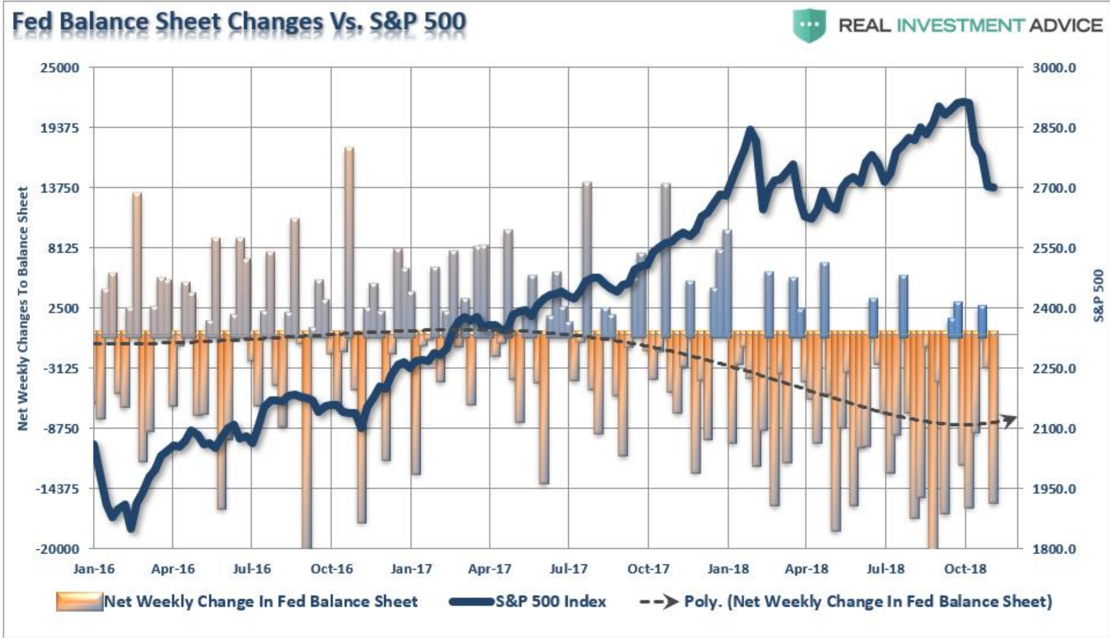
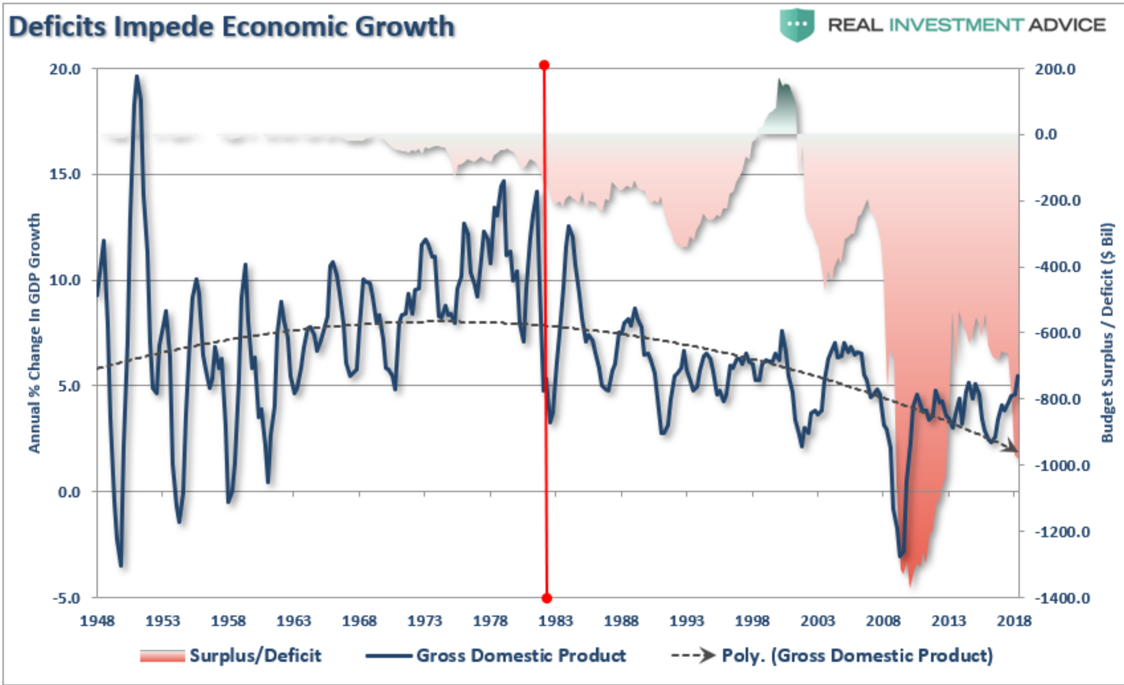
And the volatility jumps that have coincided with FED balance sheet drawdown:



Since we know just how instrumental the FED was in consistently helping to move equity prices higher from 2009-20017, it should shock us that the markets have struggled this year given what that graphic depicts. It's clear that on balance, the FED's balance sheet has shrunk much more this year rather than expanded as it had in years past.

Roberts also suggested that with all the various training wheels now having been removed, the struggle becomes real, but then even much more real when our substantial deficits are considered:



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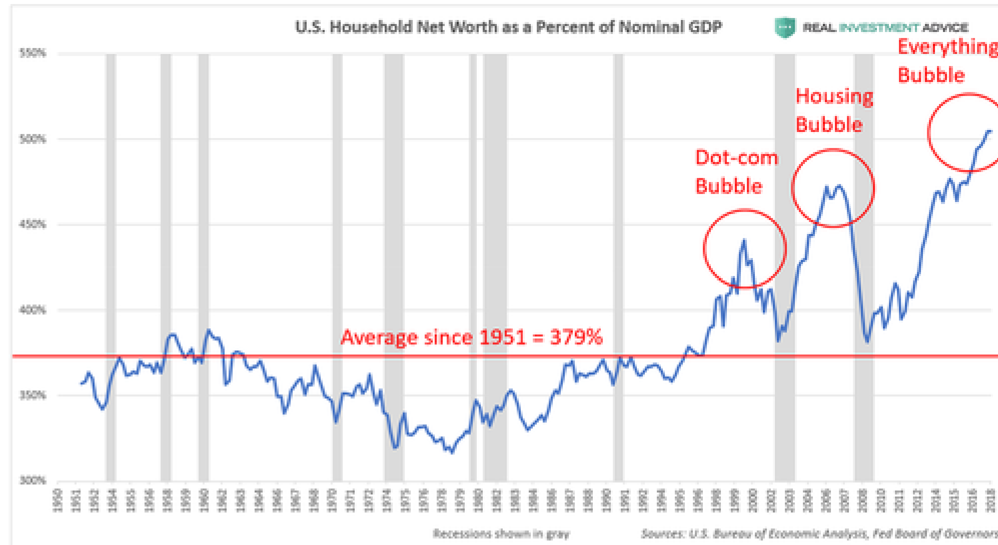
If you're wondering why the FED just won't stop the rate increases, check out this short piece from Nigam Arora: https://www.marketwatch.com/story/the-big-danger-to-the-stock-market-is-lurking-in-this-chart-2018-11-12

He has PPI spilling into CPI soon and thus possibly the beginning of a vicious inflation cycle. Who's to say for sure? However, we won't argue that after all these years of EASY EVERYTHING, it can't be a surprise that inflation can no longer be hidden, and this of course is happening just after many people finally got back on their fiscal feet-figuratively.

Once more, back to Roberts':



As can be seen above, he has us still very much near the highest high of the "Everything Bubble." Keep that in mind as we now swing to data that comes courtesy of those benevolent souls at Goldman Sachs:

Goldman agrees (with Roberts), high valuations in isolation do not provide much of a timing signal for investors ***but, again, when combined with other factors can indicate risks of a correction or possible bear market.***

Goldman aggregated these variables in a signal indicator and took each variable and calculated its percentile relative to its history since 1948. What it found is that, heuristically, ***the odds of a bear market at this moment, are in the 73% percentile.***

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Exhibit 7: Our Bear Market Risk Indicator
Current level of GS Bear Market Risk Indicator's sub-components

	Level	Percentile
Unemployment	3.7	94%
Shiller PE	30.9	93%
ISM	57.7	76%
Term Structure of Yield Curve	0.9	66%
Core Inflation	2.2	36%
GS Bear Market Risk Indicator		**73%**

** 100 percentile means these variables are at their highest level except for SYC and Unemployment where 100% means they are at their lowest.*

Source: Haver, Bloomberg, Goldman Sachs Global Investment Research

This should remind us of the question we and others have asked over the past several months:

"Is this as good as it gets?"

It could be. This graphic, indirectly, says "YES", this is likely to be as good as it gets!

Exhibit 8: GS Bull/Bear Market Risk Indicator
Average percentile (in US) for ISM, Slope of yield curve, core inflation, unemployment and Shiller P/E

Source: Shiller, Haver Analytics, Datastream, Goldman Sachs Global Investment Research

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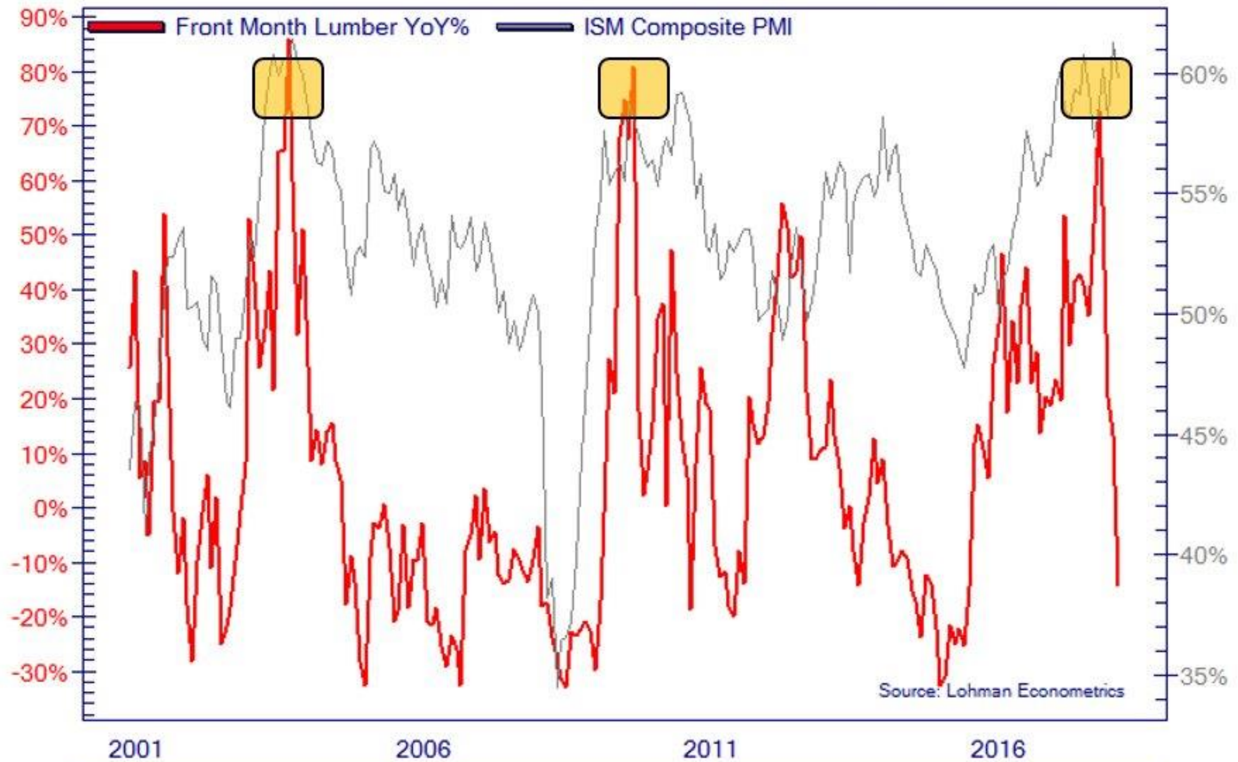
In the same piece we found this gem which argues that Dr. Copper rides Dr. Lumber's coattails:



And BOY there's a lot of divergence there! It's been no secret here or really, anywhere, that rising rates have put housing and autos into *full skid* mode. Lumber (above) only confirms that! In other words, financials conditions are much more-tighter now than they had been. Unfortunately, equities to seem to have not woken up to that and to price that in as aggressively as they have in the past…yet:

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Once again, we see a big divergence in what's been a fairly-tight relationship. So, while stocks haven't priced in all these bearish aspects, the SMART money most-certainly has:

Even though **BTR** isn't our technical section, we must conclude with a few lowlights/highlights that include some related to the charts:

Earnings improvement is unlikely

Earnings deterioration may be likely

The FED is not only raising rates but actively reducing their balance sheet and thus liquidity

The initial tax cut effect may be burning off

Denial seems to still exist among some large shareholders (fund managers)

While the SMART money has Run Like Hell

The SPX is below trend

The SPX is below the 50 and 200 SMA, and the 50 SMA is down-sloping with the 200 looking like it may follow in that regard

Rallies are being sold in a season that's historically very bullish

Another leg lower to at least a retest isn't unlikely and likely is likely. 😉

Here it is: In this newsletter, we went into “prudent” mode in late September and have been happy to remain there. There’s a lot of risks out there and that have yet to fully sort themselves out in any way, especially technically. We’re forced to, at the very-minimum, remain prudent as a result and are 100% comfortable in being so. Volatility has been here to stay and thus we must trade accordingly because even in selloffs and bear market turns there are sharp rallies just as there are deep selloffs. Quick, nimble hits with aggressive rolls or closures must be the order of the day. When the environment changes, which it clearly has, we must adapt to it, it’s that simple. We’ll continue playing the game more cautiously until further notice. If the recent lowest-low is taken out, it’s likely that the cascade selling we’ve yet to see, will be upon us and we’ll be left wondering what magic the FED has left to save us from what the FED has wrought…

Bank and Roll like your family depends on it!

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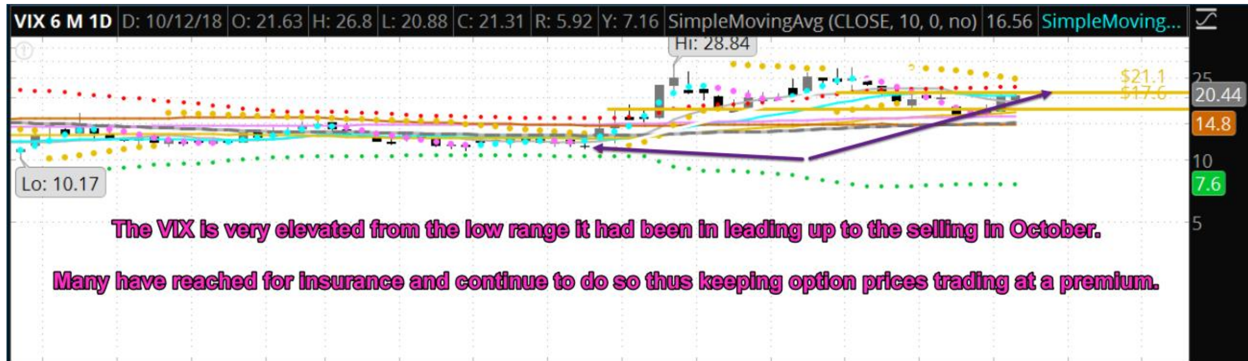
Options Academy

We're keeping this week's **OA** basic on purpose and with purpose. The time could be upon many where they'll be forced to recognize that possibly, just possibly, the trend has changed and that the so-called longest bull market of all-time is about to end. If that's the case, and especially if that recognition is arrived at in haste, it can be difficult to extricate oneself from their long-side exposure on a moment's notice.

So, in that vein, remember that we can reach for index options. But also remember that, at that point, we not be in the only ones reaching for index options (options on ETFs that track indexes in our case):



The price of insurance is much higher now than it was only a few months ago. So, we must remind ourselves of these:

1. Hedge early!

2. Remove the hedge early!

Those are easier said than done but as with other trading wisdom, they're true.

At this point, is it still worth hedging? YES, it is.

IF you believe you can't exit longs efficiently for whatever reasons, and are legitimately concerned, it's better to consider risking a little on a hedge (and losing on it) than taking a massive beating you'll come to regret if we're truly on the edge of a turn towards a bear market. It won't just be the initial smoking that people will endure and regret, the frustration only grows when you wait for just a little more bounce, before selling your holdings, from a rally that fails and then quickly rolls back to recent lows or worse. That experience *eats people alive* and it isn't long before they become apoplectic on their way to catatonic.

There are many ways to go about hedging with ETF options and we'll be happy to cover the general idea in our webinar this week but do remember this, a hedge is put on HOPING to lose money on it. Why? Because it's a much smaller commitment typically and we'd all rather have things play out that our main positions win out in the long run.

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