MARKET TRACTION

A Dicey Week – Make or Break Time for EOY Bonus Rescue Program

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This Week's Trade Ideas:

KR > Kroger > $30.04 Last. Buy the Dec. 21st 29 Calls for $2.05 or less with a close or anticipated close above $30.25 in an up market with expectations for continued strength in the major indices.

Bullish Mentions: **(View Webinar)**

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

UN, MDT, MNST, PFE, PDCO, AMAT, CREE.

Bearish Ideas: (View Webinar)

CHKP > Check Point Software > $107.85 Last. Buy the Dec. 21st 110 Puts for $4.40 or less with a close or anticipated close below $106.84 in a down market with expectations for continued weakness in the major indices.

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.

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:

After some volatility that amped up as we thought it may, that's what we've gotten. Now, we're almost in the same position as we were then. Selling could really pick up, even more, if the lows we've been focused do not hold. On the flip side, we must note another possibility that seems lesser at the moment. A rally from those lows could be the start of a double bottom pattern from which to launch an end of year rally (Save the Year!)

That was last week's Outlook. The lows have held so far and a rally from them could launch an EOY rally, that's where things stand now. Last week's less likely outcome has gained probability points as we see things now. The OPM (other people's money crowd) seems to be on the edge of igniting some kind of rally attempt. If they do not follow through, look out!

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 probably one to be avoided. The holiday gummed it up and we knew Powell was speaking this week along with FOMC minutes and Trump-Xi etc. Still though, even though we expected volatility, we put out names so here's the breakdown…

AMAT was our official bull idea and it hung on with the market down but hasn't broken out yet.

Bullish mentions, **A** and **ICPT** put a little upside movement together so far.

XOM was our official bear idea and it did drop nicely initially, but it has wafted back up some.

EPD was the first of our bearish mentions and it has done little.

V and **AXP** refused to truly breakdown.

About what we'd expect for a holiday week and thus nothing special. Sometimes it is better to step away during times like this and this year proved to be a move around but go nowhere affair.

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Market Overview

This week looks like a rather dicey one with FED chairman Powell speaking on Wednesday, FOMC minutes being released on Thursday, Trump-Xi in the news and equity markets already tarred and feathered and maybe for too long. Additionally, the holiday shopping season has officially begun and there is EOY bonus desperation flowing on the Street of Schemes. Despite that, the juncture we're at is an easy one. They seem to be priming for a launch attempt. If they don't, we're in trouble almost immediately. Here's a blast from the recent past:

It may have taken two months a few years ago, but the they got it done!:

What you see above is about a 9% gallop from low to high in the final two months of 2016 and most of the movement was done in about 5 weeks! So….

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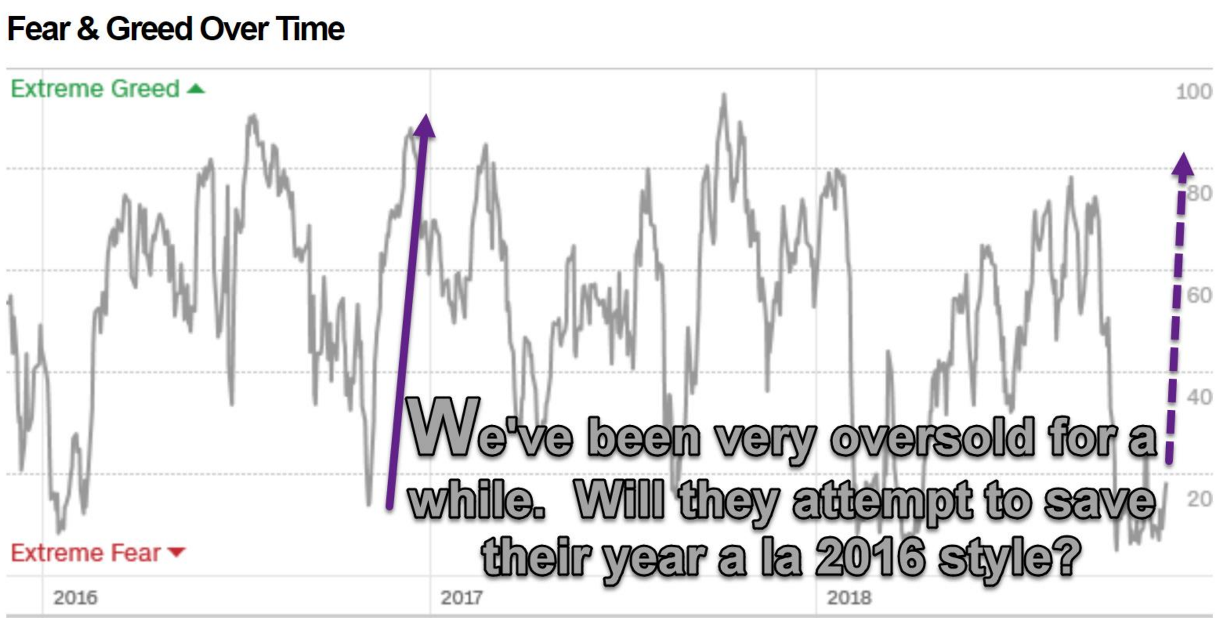
We can't help but think that the "fiduciary responsibility" throngs will at least try to get lathered up about buying stocks at least one more time! It's just not in their DNA not too.

FAANG is on the verge of producing a relief rally and nothing we can think of will help engender more buying and bonus-saving than a **FAANG** run:

With 5 weeks left in the year, can they pull a "2016" off? Borrowing from **BTR** here but we need to:



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We're close to the start of an attempt:

If they pass on rallying now, the lows seem to be so close as to all but lock in revisiting them.

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This Week's Economic Calendar

TIME (ET)	REPORT	PERIOD	ACTUAL	MEDIAN FORECAST	PREVIOUS
MONDAY, NOV. 26					
8:30 am	Chicago Fed national activity index	Oct.	0.24		0.14
TUESDAY, NOV. 27					
8:30 am	Richard Clarida (voter) speech				
9 am	Case-Shiller house prices	Sept.	5.5%	--	5.7%
10 am	Consumer confidence index	Nov.	135.7	135.8	137.9
2:30 pm	Bostic (voter), George, Evans discussion				
WEDNESDAY, NOV. 28					
8:30 am	GDP	Q3		3.6%	3.5%
8:30 am	Advance trade in goods	Oct.		-$77.7bln	-$76.0bln
10 am	New home sales	Oct.		589,000	553,000
12 noon	Jerome Powell (voter) speech				
THURSDAY, NOV. 29					
8:30 am	Weekly jobless claims	11/24		220,000	224,000
8:30 am	Personal income	Oct.		0.4%	0.2%
8:30 am	Consumer spending	Oct.		0.5%	0.4%
8:30 am	Core inflation	Oct.		0.2%	0.1%
10 am	Pending home sales	Oct.		--	0.5%
2 pm	FOMC minutes				
2 pm	Loretta Mester (voter) remarks				
2 pm	Charles Evans remarks				
FRIDAY, NOV. 30					
9 am	John Williams (voter) speech				
9:45 am	Chicago PMI	Nov.		--	58.4

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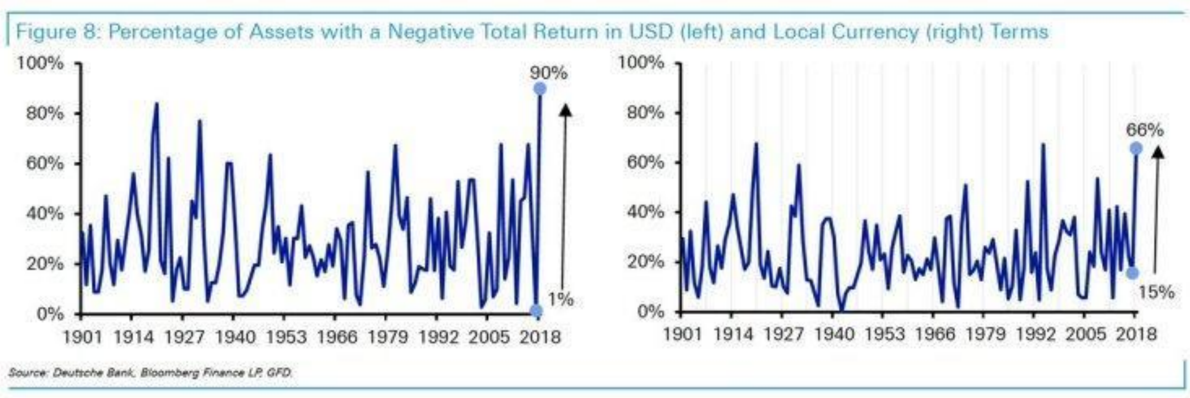
Below the Radar

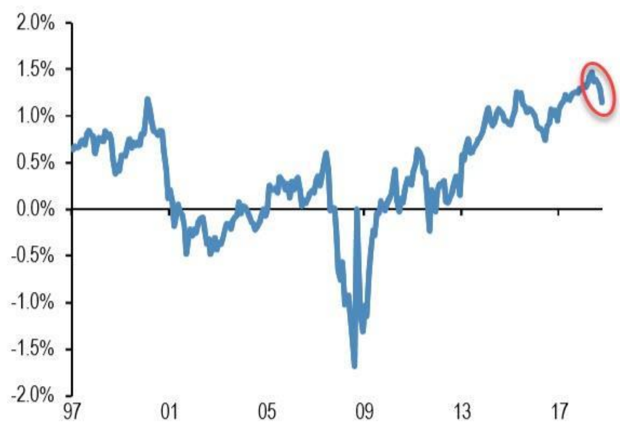
How's this year shaping up? Not well for nearly all assets!



JP Morgan is concerned that it's not close to over either. They're belief is that too many "little guys" got in too late in a big way in the big stocks and…wait for it…did so on margin:

Figure 12: Net Debit balances in NYSE margin accounts

The NYSE margin account Net Debit balance is equal to the margin debit balance minus the sum of total credit balances (cash account credit +margin account credit). The blue line is constructed by the Net Debit balance in $bn divided by the market capitalization of the S&P500 index. Last obs. is for Oct 2018.



Source: FINRA, NYSE, J.P. Morgan.

*So, our suspicion is that **these leveraged retail investors had contributed to the underperformance of FAANG stocks since the middle of the year** and the more severe underperformance of FAANG stocks in October. But despite the acceleration of deleveraging in October, NYSE margin accounts stood at still high levels at the end of October as shown in Figure 12.*

Critically, JPMorgan sees this as an ominous sign as opposed to a signal of support (and hope for the Powell Put's appearance):

*In our mind this means that **these leveraged retail investors have still plenty of room to deliver further from here, <u>which could act as a drag for FAANG stocks and US equities more broadly.</u>***
*In all, despite some deleveraging recently, **<u>there are limited signs of broad capitulation by either institutional or retail investors and in our mind equity markets look still vulnerable.</u>***

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This lack of capitulation is a sure signal to The Fed 'not to panic' with a dovish rate-hike in December, as Goldman more ominously concluded last week:

"We find that the Fed responds with more accommodative policy only when other financial conditions such as credit spreads also deteriorate substantially or when growth is below potential," Goldman economists wrote.

"Today, in contrast, credit spreads have widened only moderately, and growth remains significantly above potential, with limited recession risk over the next year."

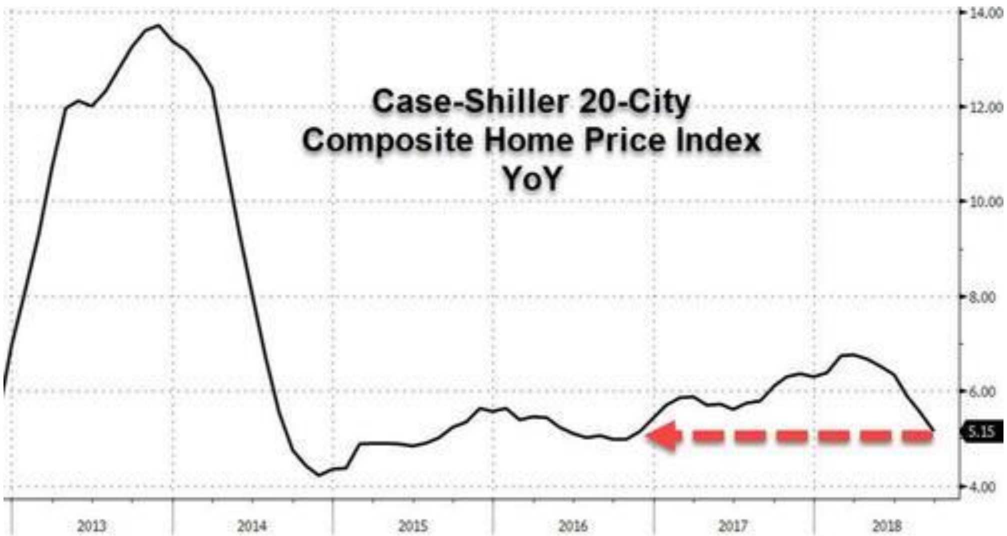
<u>In other words - there's a lot more pain to the downside before Powell switches horses.</u> *Trade accordingly.*

The "little guy" getting Shanghaied in margined FAANG stocks may just be the start of his problems as his biggest asset may be about to come under some serious pressure. The FED finally turning off the nearly-free-money-spigot seems to be the culprit as has been expected. That's right, housing may have entered "stage two": https://www.peakprosperity.com/blog/114196/trouble-ahead-housing-market

Stage Two's deluge of supply sets the table for US housing bubble Stage Three by soaking up the remaining demand and changing the tenor of the market. Deals get done at the asking price instead of way above, then at a little below, then a lot below. Instead of being snapped up the day they're listed, houses begin to languish on the market for weeks, then months. Would-be sellers, who have already mentally cashed their monster peak-bubble-price checks, start to panic. They cut their asking prices preemptively, trying to get ahead of the decline, which causes "comps" to plunge, forcing subsequent sellers to cut even further.

Sales volumes contract, mortgage bankers and realtors get laid off. Then the last year's (in retrospect) really crappy mortgages start defaulting, the mortgage-backed bonds that contain their paper plunge in price, et voila, we're back in 2008.

Here's a glance at the latest housing data where we can see that price appreciation may have peaked and is about to contract:



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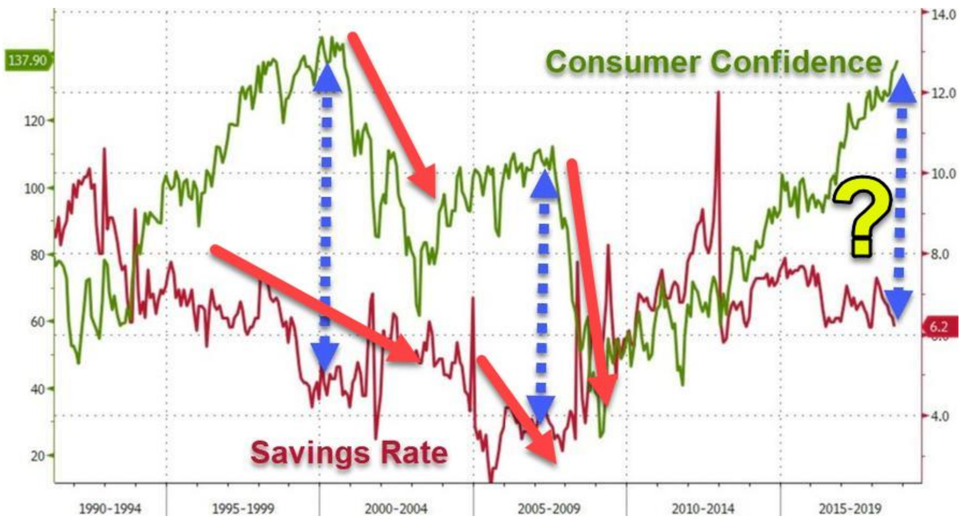
Still though, the "little guy's" spirits are holding up. How much longer will they hold? Not VERY if history is our guide:



With the FED hellbent on another rate increase in December, can we look beyond the USA in hopes of help on the horizon? It wouldn't seem so:

WTO Warns Global Trade Slowdown To Accelerate In Q4

by Tyler Durden
Tue, 11/27/2018 - 02:45

20 SHARES

Speaking at an event in Rio de Janiero last month, WTO Director General Roberto Azevêdo delivered an ominous prediction: As optimistic reports suggested that the two sides would soon restart substantive talks, Azevedo told his audience that the trade war between the US and China was far from over.

> *"To be honest, I don't think it's over. They have lots of ammunition and it can expand to other areas beyond just tariffs...and trade,"* he said.

And now, the WTO's forward-looking indicator is showing a similar conclusion. According to an update released on Thursday, the WTO's World Trade Outlook Indicator shows that trade is slowing again in Q4 for the second straight quarter.

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Once again, we see that things are bad, but could be on the verge of getting much worse:

Drivers of trade

	Level of Index	Direction of change
Merchandise trade volume (Q2)	101.5	
Export orders	96.6	
International air freight (IATA)	100.0	
Container port throughput	101.2	
Automobile production and sales	96.9	
Electronic components	93.9	
Agricultural raw materials	97.2	

So, things look bleak. But, won't those lower oil prices provide an immediate shot in the arm? Again, history suggests otherwise: https://www.themacrotourist.com/posts/2018/11/27/oiltaxcut/

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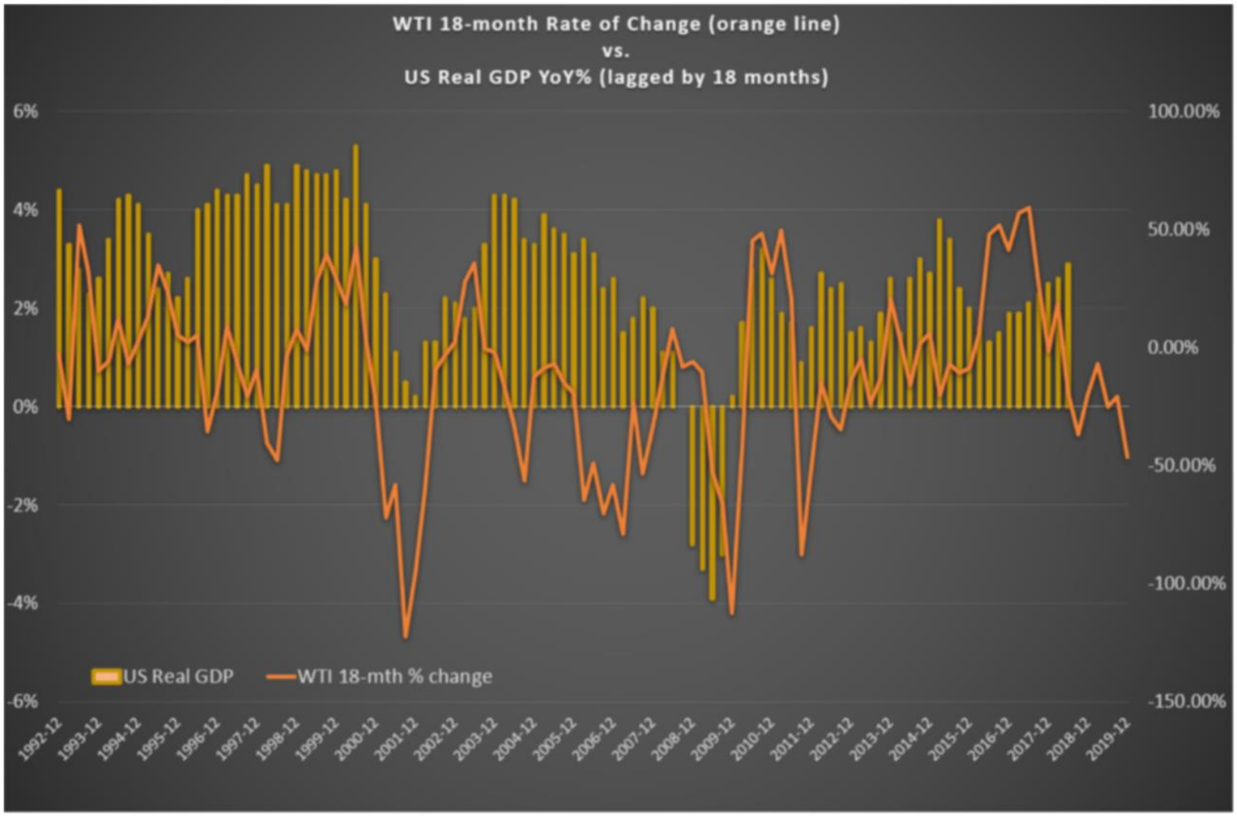
Groundhog day's worst outcome would be greatly preferable to this: 18 more months of misery!

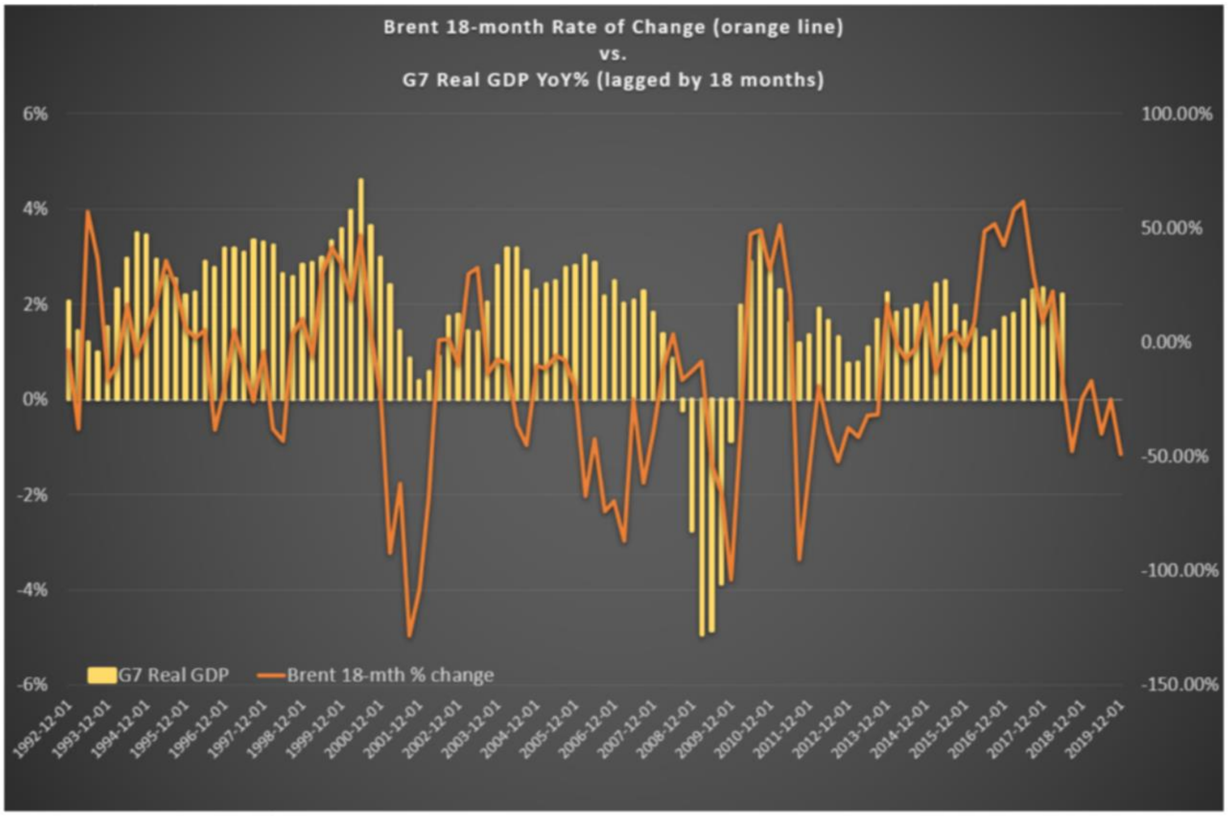


So what's this showing? The orange line is the inverse 18-month rate of change for WTI. So when it is going down, that means the price of WTI has been rallying for the past year-and-a-half. Look at the relationship between that change and the economy. Sure, there is a definite correlation, but the lag is... how would President Trump say it? Yuuuggggeeeee.

If this relationship continues, we should expect another 18 months of economic weakness before the benefits of the lower energy price kick in.

And far be it from me to question the President's tactical decisions, but Trump seems intent on applying as much pressure as possible on China to extract a more fair trade deal. Last I checked, China was the largest importer of crude oil in the world.

I will leave you with one last chart. This one is Brent lagged versus G7 growth.



It certainly appears like the next ticks in the global economy are lower, not higher.

Thanks for reading,
Kevin Muir
the MacroTourist

One thing we're supremely confident in is that the Wall St. boys will always put themselves first. Which is why we're having a hard time reckoning with the lack of evidence (yet) of a "Santa Claus/Save My Bonus/Short Squeeze" rally attempt. Our gut keeps telling us to expect at least an attempt at one soon. Who would want to buy stocks with both hands right now you ask? Those that are risking YOUR money, not theirs! Which are the same as those that want to levitate stock prices to wring out one more end of year bonus before we reach the hell and a handbasket stage! Think they're too short on time? Think again!

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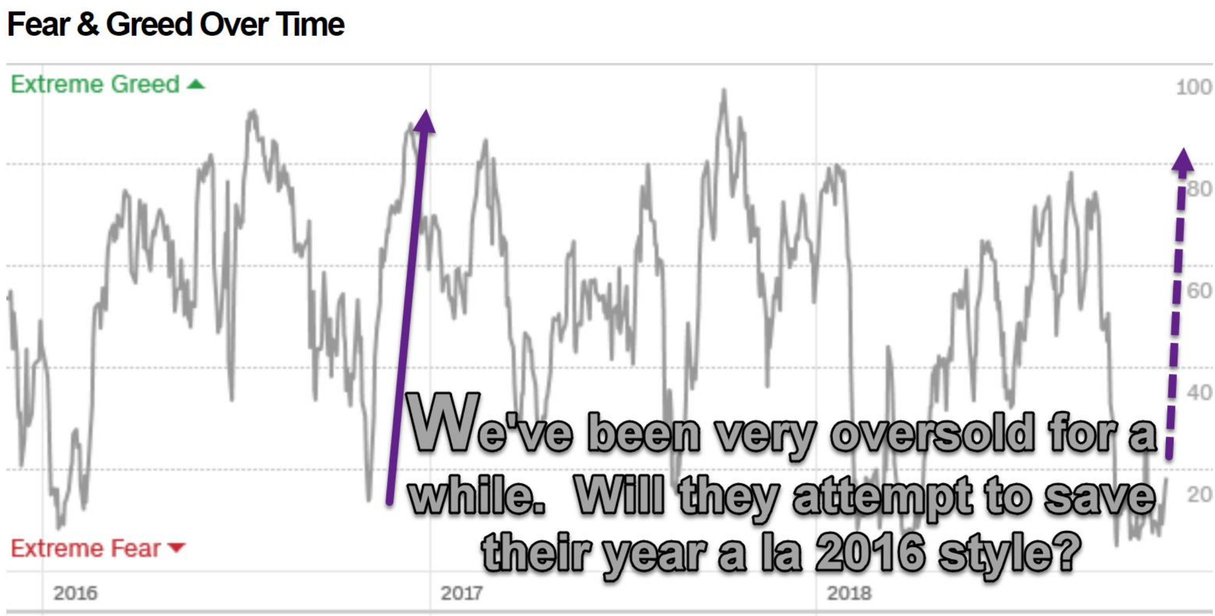
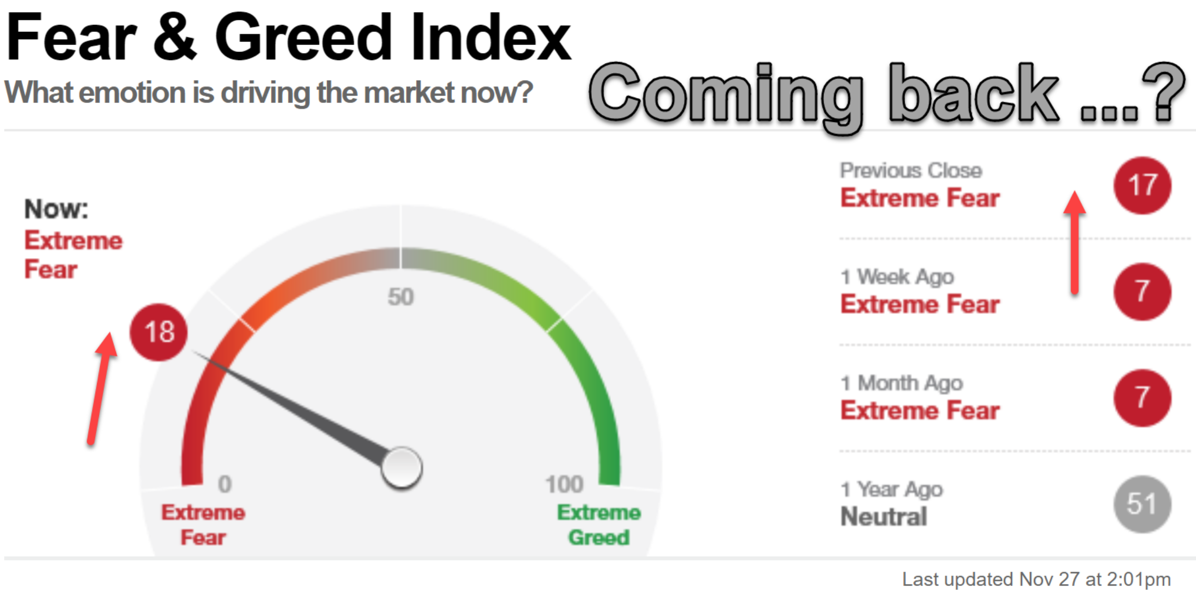


They've done it before and very recently! 2016 had a wonderful finish to it! Once more time for old time's sake? Why not! We're ripe for it:



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They've possibly put a "W" or double bottom pattern from which to launch from as of now.

We shall see…:

Bank and Roll with the Flow!

Options Academy

We received a few recent questions on the subject we're covering this week in **OA**, so we thought it may be a good idea to discuss Volatility Skew this time around.

"Vol Skew" as it's often called, is something we rarely touch on because we keep things simple and plan to buy calls and puts 99% of the time. However, knowledge is power and thus a shallow dive into skew can't hurt us!

Volatility and skew can be challenging topics when new to options. People often wonder about getting a "good buy" in options and want simple guidelines to follow. That's only natural, however, it's not that easy, it simply isn't. A "good buy" on an option varies a great deal from situation to situation, stock to stock, expiration to expiration, and option to option at various strike prices. And that's just a start! Where does it end? Good question but to make matters more confusing, consider this:

The corresponding put and call options (those at the same strike price in the same expiration on the same underlying stock) can even have different volatilities!

When options trade on differing implied volatility levels, we refer to this a "skew". The options markets can manifest many types of skews so let's cover the critical ones to understand…for now…

When viewing strikes in the same monthly expiration we can see that as we move away from the at-the-money strike price, the price of options (in implied volatility terms) increases. Implied (market) volatilities are typically the lowest ATM and rise as we move away from there in either direction, up and down, ITM and OTM. If we were to plot the implied volatility values graphically, it would resemble a "smile". The ATM would be the lowest and the IV would lift higher as we move toward OTM calls and OTM puts. This smile is normally more pronounced in the near-term option expirations and less so in the outer months.

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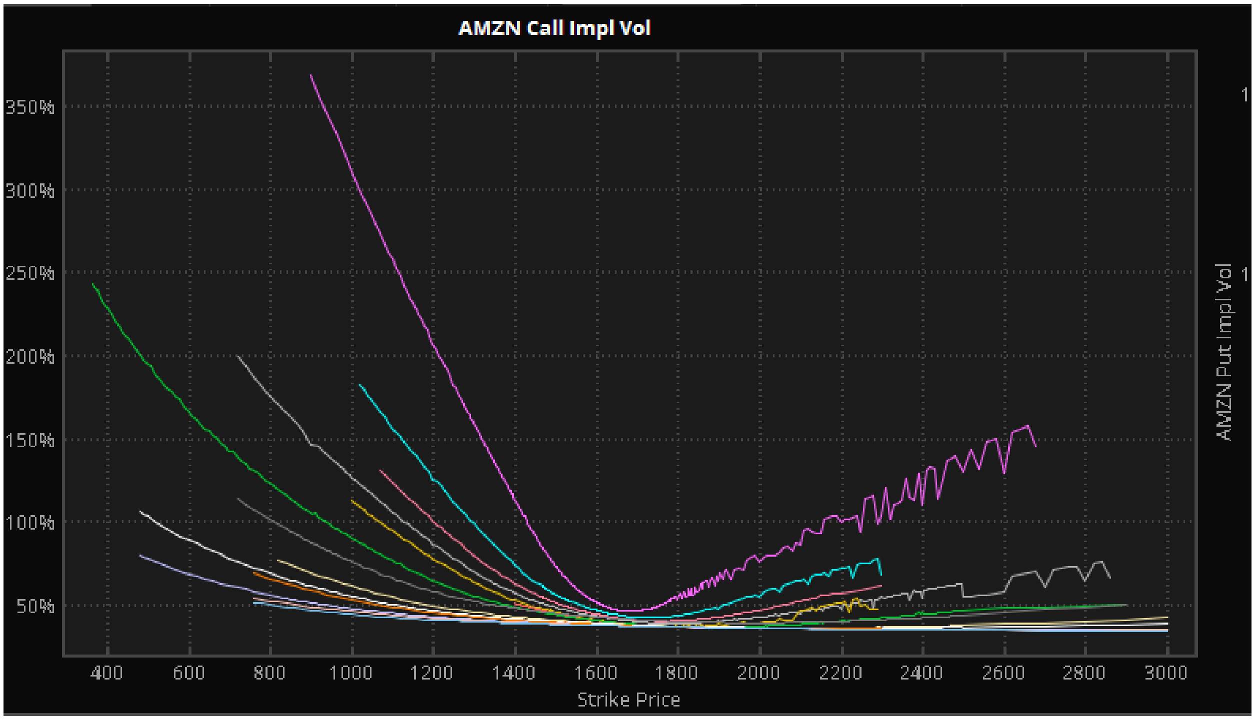

Another skew to consider is the skew of implied volatilities across time. This is often called the horizontal skew or is referred to as "tilt" by some. When evaluating horizontal skew, we're checking on how the same strike price is being treated, in implied volatility terms, across various options expirations (term structure) by market participants. Implied volatility levels can vary over time but typically the near-term expiration will trade at a higher IV level than the outer month expirations.

Then of course, there is the "put-call skew", something we've covered in the past in **OA.** If you think about it, given how the option pricing model works, a put and call set to expire on the same day at the same strike should trade at the same implied volatility level. That is, when we strip out other factors like intrinsic value, interest rates and the dividend stream, the corresponding call and put should be equally valued. This isn't always the case and is probably not the case the majority of time. Sometimes, the relationship between the two can vary more so than normally and there can be important information to glean when that's the case.

There is also "upside call/downside put" skew that's normally in place and it compares how each trades against the other. Again, when that changes dramatically from the norm, that information can portend significant future movement that's just around the bend.

It's important to keep an eye on skew in stocks that are your mainstay traders or if you want to get into more sophisticated spread trading. It can also be a good idea to keep an eye on the various skews while considering a trade or when already in a trade. Skews swinging around dramatically can be important news that appears in front of actual news as the smart and fast money typically strikes in the options markets.

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