MARKET TRACTION

Oversold but with Risks Ratcheting Higher!

This Week's Trade Ideas:

Bullish Ideas: (View Webinar)

TSN > Tyson Food Inc. > $62.15 Last. Buy the Nov. 9th 61.5 Calls for $2.05 or less with a close or anticipated close above $62.60 in an up market with expectations for continued strength in the major indices. Earnings 11/13*

Bullish Mentions: **(View Webinar)**

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

GIS, LRCX, HRB, VIRTU.

Bearish Ideas: (View Webinar)

NRG > NRG Energy Inc. > $36.18 Last. Buy the Nov. 2nd 37 Puts for $1.70 or less with a close or anticipated close below $35.65 in a down market with expectations for continued weakness in the major indices. Earnings 11/8* (Reason for near-term options selection)

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

NLSN* (Earnings 10/25), **UAL, DISCA*** (Earnings 10/31), **MTDR*** (Earnings 11/1), **VEEV, GDDY*** (Earnings 11/6).

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.

MARKET TRACTION

Outlook:

One more time, from last week's Outlook:

"Having watched the games they play for so long, we can believe that a relief rally attempt will be launched soon aided by fresh short squeezing. How long that lasts and how far it carries, assuming it does transpire, is tough to say at this stage. ***It's too early to assume that the volatility spike is already over.*** *Clearly, this isn't a market we can take our eyes off at this time."*

And that's where we remain. Today's rally seemed forced, but it was powerful. Still though, the indices finished off for the day. It could be, but our *gut* still isn't buying that it's over.

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 easy but disappointing because we couldn't find any fresh and safe bearish names. Again, and undoubtedly, no bullish names could be considered last week with us publishing as we always do on Tuesday. By Wednesday, the short squeeze effects were dissipating, and Thursday and Friday brought no real bullishness and only more bearishness. That was our fear on Tuesday as was discussed in our webinar. We found many bullish names that were primed if a rally could be mustered, but few non-oversold bearish names if any. We could sense that our bulls would likely not have a chance while still in the webinar. **BKE**, was our lone bearish mention and it did fall lower to near our first target level before somehow rallying back up to start this week.

Being safe can be a sorry place to be at times. Looking for ideas with little risk when risks really ramp up can be very difficult. That's essentially what we faced last week. We're not joiners without good reason when volatility rockets up. It can be a two-way street as today alone proved.

Market Overview

With so many areas breaking down, the situation is very fluid, and will best be covered in our webinar. With the indices so highly correlated again, as happens in selloffs, we'll focus mainly on the S&P 500.

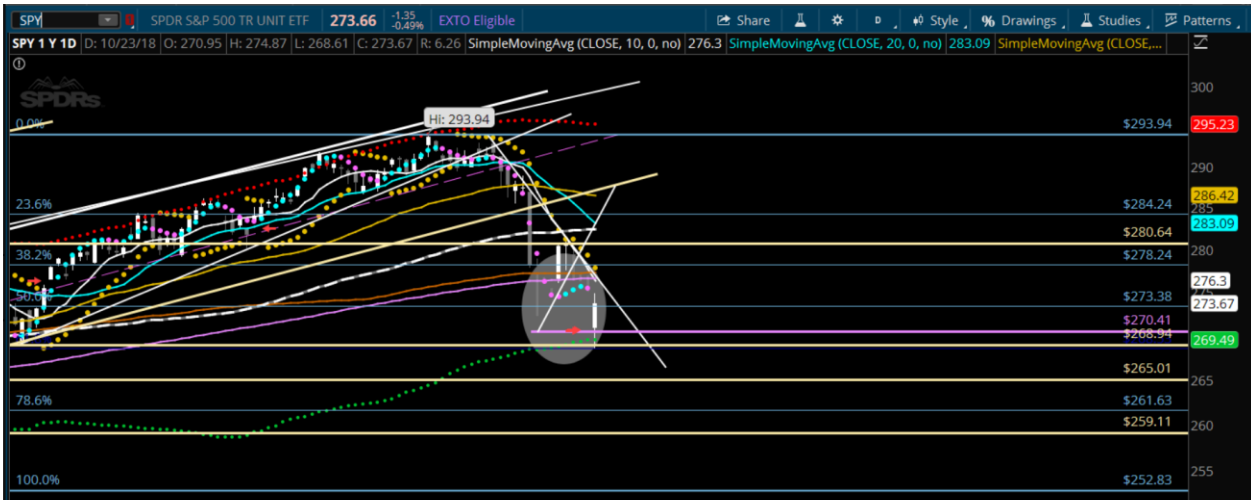
Last week's short squeeze burned off quickly and bulls put up a fight as the week closed out. They tried to prevent more technical selling from kicking in by holding stocks (SPYs) above the 200 SMA. It worked only for so long as Monday saw a close lower than that level and Tuesday morning brought an instant downside crush to a new recent low. Volatility has kicked in, and we may see some wild days in both directions for a while.

We're going right to the BKX, the banking index chart:

As we note inside the graphic, the BKX looks awful. Yes, it is oversold at the moment, but the ease with which it fell and sliced through support has to be concerning. The financial system is often the source of panics that are far more destructive than initially believed possible. Let's hope that's not the case this time.

A big rescue attempt was made today AFTER letting the SPYs make a slightly lower intraday low, thus likely chasing out the weakest of hands, inducing new shorts, and setting up those along with existing shorts for another ruthless squeeze:

MARKET TRACTION



In our update that went out earlier this morning, we noted that the retest could be produce the start of a double bottom pattern. With the SPYs finding not only flatline support, but a FIB level and being outside our Bollinger bands, we're not surprised that the Plunge Protection Team and company may have stepped in, at least for the time being. We'll see how lasting this effort will be soon enough, but we can also note that they managed to close the gap that greeted us this morning with this massive rally by days end.

All major indices are oversold, and most are registering "positive divergence". "PD" occurred when we made a lower low but with oscillator readings that are improved vs. the first low that was made two weeks back. This is also a sign that a bounce, at the very least, could be attempted here. With the decline being so steep, it won't take much to make it back to our resistance line. However, to return to better footing the SPYs will need to reclaim the 150 and 200 SMA levels above. Until then, more player will be jittery when viewing the charts because bull markets shouldn't allow stocks to remain below the 200 SMA for very long.

Let's also not forget that big drops can produce big pops even if they're just relief rallies. Additionally, we can't completely abandon historical trends quite yet. The mid-term election year performance pattern is most certainly on the ropes or worse with only 1 week remaining in October, but it's not over year.

As we noted last week, we will err on the side of prudence. Not losing, not getting chopped up and sliced and diced during these periods is far better than the alternatives. Despite today's furious rally, we can't say that the selling is over yet. With financials under assault and rates rising and the FED still generally believed to be too hawkish and maybe politically motivated by some, we're no where near being in the clear. Earnings could be used to lift prices and from there we could get boosts from other news drivers. Certainly, both China and the USA most be a little more motivated at this point, due to pressures building, to remedy their trade dispute. If that we're rolled out with little notice in this charged environment, we expect to see a short squeeze that would take everyone's breath away and maybe even that of those that would know that news prior to us! That's not expected to happen and supposedly looks very remote, still:

https://www.cnbc.com/2018/10/22/chinese-official-tells-us-investors-at-meeting--we-dont-fear-trade-war.html

MARKET TRACTION

POLITICS

WHITE HOUSE | POLICY | DEFENSE | CONGRESS | ELECTIONS | EUROPE | CHINA

Chinese official tells American investors at a meeting: We don't fear a trade war with the US

- In a meeting with U.S. business leaders, a leading member of a key Chinese committee gives a strong warning to the Trump administration.
- "China never wants a trade war with anybody, not to mention the U.S. who has been a long term strategic partner, but we also do not fear such a war," the government official says.
- The strong words come just a month after Trump imposed $200 billion on Chinese imports on top of the $50 billion levy the administration piled onto the country earlier this year.

Brian Schwartz | @schwartzbCNBC

Published 1:24 PM ET Mon, 22 Oct 2018 | Updated 19 Hours Ago

CNBC

Continuing, today's market rally really picked up steam when our old schoolyard playmate, Raphael Bostic of the FED, gave a speech wherein he implied that maybe a "pause" in the rate hikes may be considered. This week there's plenty more FED speech(es) where that came from, and many economic releases to boot! Earnings are ramping up too, so keep your helmet on!

MARKET TRACTION

This Week's Economic Calendar

TIME (ET)	REPORT	PERIOD	ACTUAL	MEDIAN FORECAST	PREVIOUS
MONDAY, OCT. 22					
8:30 am	Chicago Fed national activity index	Sept.	0.17	--	0.27
TUESDAY, OCT. 23					
2 pm	Raphael Bostic speech				
6:15 pm	Charles Evans discussion				
8 pm	Esther George speech				
WEDNESDAY, OCT. 24					
9:45 am	Markit manufacturing PMI flash	Oct.		--	55.6
9:45 am	Markit services PMI flash	Oct.		--	53.5
10 am	New home sales	Sept.		620,000	629,000
1:10 pm	Loretta Mester discussion				
2 pm	Beige Book				
7 pm	Lael Brainard discussion				
THURSDAY, OCT. 25					
8:30 am	Weekly jobless claims	10/13		210,000	210,000
8:30 am	Durable goods orders	Sept.		-1.9%	4.4%
8:30 am	Core capex orders	Sept.		--	-0.9%
8:30 am	Trade in goods advance	Sept.		-$76.2bln	-$75.8bln
10 am	Pending home sales index	Sept.		--	-1.8%
12:15 pm	Richard Clarida speech				
7 pm	Loretta Mester speech				
FRIDAY, OCT. 26					
8:30 am	Gross domestic product	Q3		3.4%	4.2%
10 am	Consumer sentiment index	Oct.		99.0	99.0

MARKET TRACTION

Below the Radar – Even less left BELOW!

We don't often include Michael Snyder's writings in **BTR** with the main reason for that being that it's a constant drumbeat of bearishness upon bearishness. Many of his arguments are valid but extremely early, many, many years early. However, in an update last week, we included this:

http://theeconomiccollapseblog.com/archives/is-the-federal-reserve-trying-to-sabotage-trump-stocks-fall-again-as-investors-are-rattled-by-fed-comments

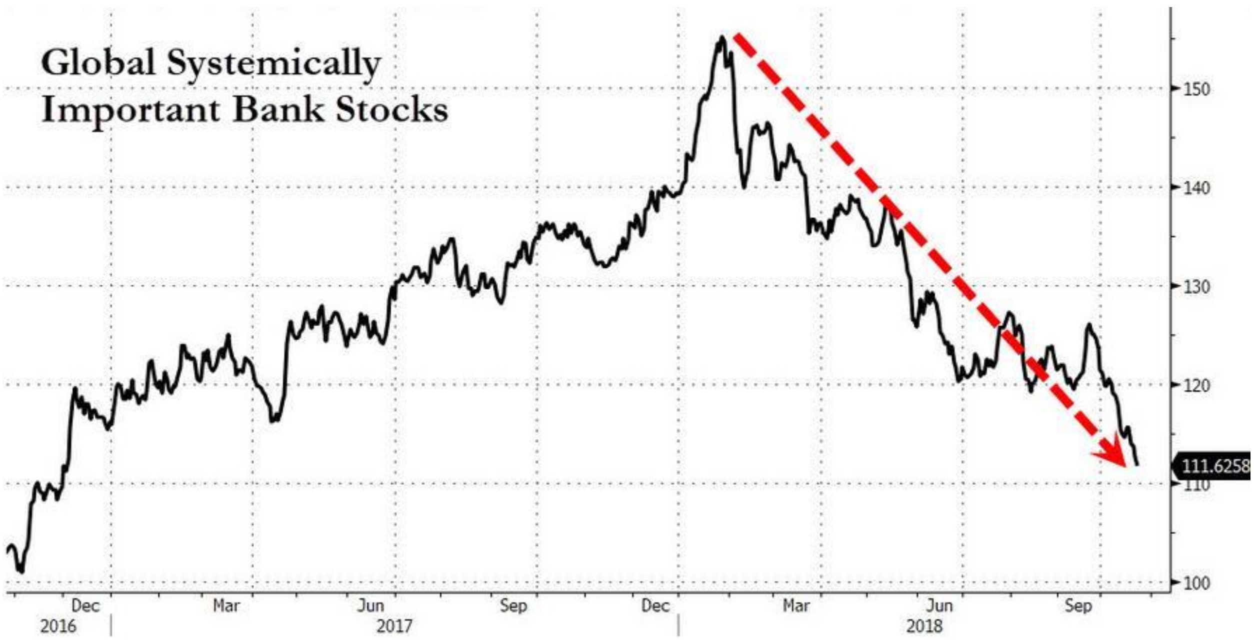
With the market still under great pressure, we're going back to Snyder's poison well again. Why? Because the topic this time is banking issues and banking issues always get our attention, especially European banking issues!: http://theeconomiccollapseblog.com/archives/global-banking-stocks-are-crashing-hard-just-like-they-did-in-2008

We suggest reading the entire entry but here's the summary that cuts to the quick:

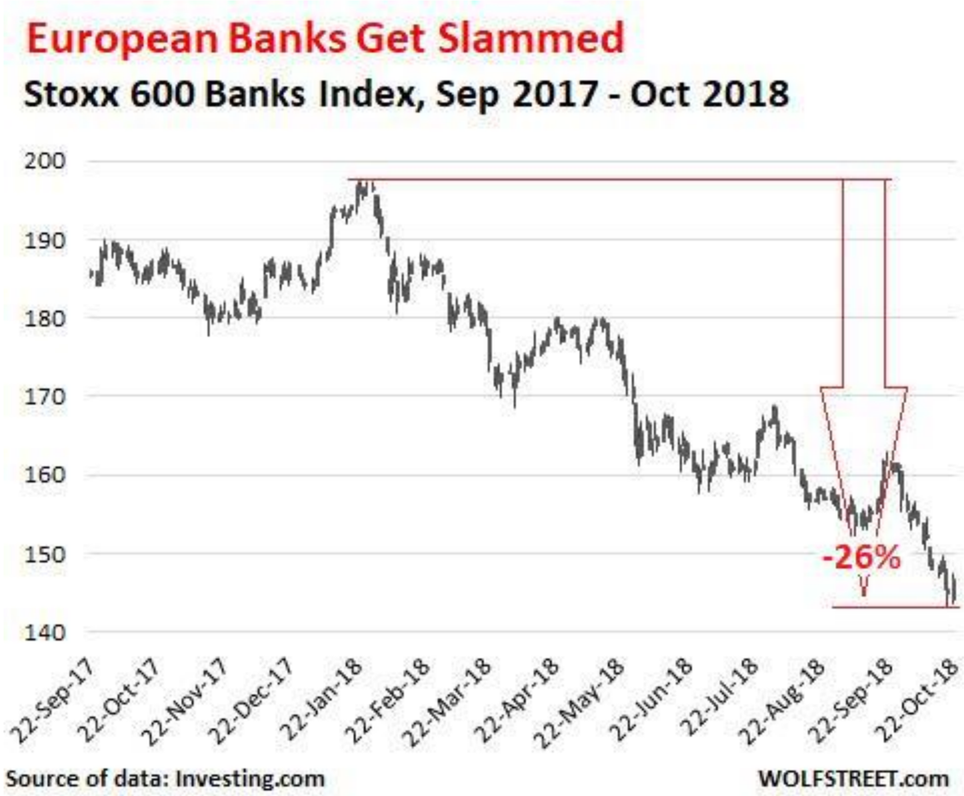
We are entering a time when the economy was likely to slow down anyway, but if stocks continue to crash and global banking woes escalate, that is going to spread fear and panic like wildfire.

And when there is fear and panic in the air, lending tends to really tighten up, and a major credit crunch is just about the last thing that we need right now.

It's been a really bad October for global markets so far, and more trouble is brewing. Hold on to your hats, because it looks like it is going to be a bumpy ride ahead.



And now, Europe specifically:



I wish that we didn't have a global economic system that was so dependent on the "too big to fail" banks, but we do.

If they aren't healthy, nobody is going to be healthy for long, and it is starting to look and feel a whole lot like 2008. As Wolf Richter concludes,

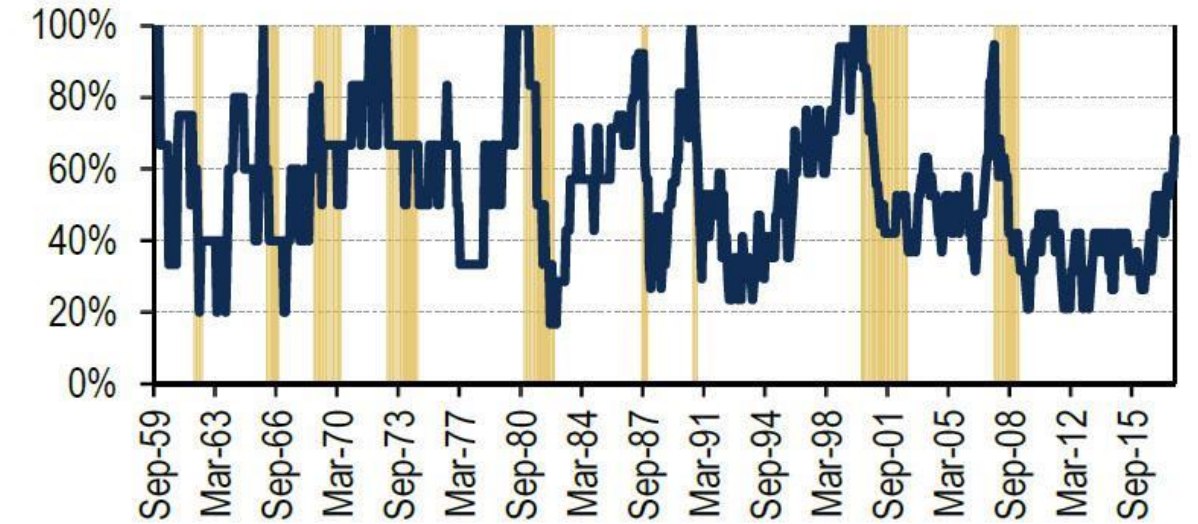
***It's not exactly a propitious sign that the banks in the US, after nearly recovering to their pre-Financial Crisis highs – "Close, but no cigar!" – are once again turning around and heading south as the Fed is "gradually" removing accommodation**, which results in higher funding costs for banks and greater credit risks on outstanding loans.*

And the European banks remain a mess and have an excellent chance of getting still messier.

In addition to the banking system-focused issues, we were able to locate an update on BofA's bear market trigger/metrics that we discuss frequently. With the action unfolding as it has for the past 3 to 4 weeks, this update is a timely one but do recall that it typically takes about 20 months for a bear market to ensue after 14 of the 19 measures are hit. First up, is the percentage of signals triggered is now at 74%:

MARKET TRACTION

Chart 8: Percent of bear market signals triggered



Source: BofAML US Equity & Quant Strategy

Here's where they all sit:

Table 1: BofAML bear market signposts

Indicator	Category	Current value	Trigger	Triggered	Triggered at time of latest peak (9/20/18)	Data since[d]	Hit rate[b] %	Notes	Type of trigger[f]
Fed raising rates	Credit	200bp	>75bp	☑	☑	1983	100%	Bear markets have always been preceded by the Fed hiking rates by at least 75bp from the cycle trough	Stays on
Tightening credit conditions	Credit	-16%	>0%	☐	☐	1990	100%	Each of the last three bear markets has started when a net positive % of banks were tightening C&I lending standards	Resets
Trailing S&P 500 12m returns	Returns	10%	>11%	☐	☑	1936	92%	Minimum returns in the last 12m of a bull market have been 11%	Resets
Trailing S&P 500 24m returns	Returns	36%	>30%	☑	☑	1936	92%	Minimum returns in the last 24m of a bull market have been 30%	Resets
Low quality outperforms high quality (6m)	Returns[e]	+5ppt	>0ppt	☑	☑	1986	100%	Companies with S&P Quality ratings of B or lower outperform stocks rated B+ or higher	Resets
Momentum outperforming (6m/12m)	Returns[e]	+4ppt/+11ppt	>0ppt	☑	☑	1986	100%	9m price return (top decile) vs. S&P 500 equalweight index	Resets
Growth outperforming (6m/12m)	Returns[e]	+4ppt/+7ppt	>0ppt	☑	☑	1986	100%	Consensus projected long-term growth (top decile) vs. S&P 500 equalweight index	Resets
5% pullback over prior 12m	Returns	3	>0	☑	☑	1928	92%	In the preceding 12m of all but one (1961) bull market peak, the market has pulled back by +5% at least once	Resets
Low PE underperforms (6m/12m)	Returns[e]	-5ppt/-5ppt	<0ppt	☑	☑	1986	100%	Forward 12m earnings yield (top decile) vs. S&P 500 equalweight index	Resets
Conf Board consumer confidence	Sentiment	138	>100	☑	☑	1969	100%	We have yet to see a bear market when the 100 level had not been breached within the last 24m	Resets
Conf Board net % expecting stocks higher	Sentiment	20.1	>20	☑	☐	1988	100%	Similarly, we have yet to see a bear market when the 20 level had not been breached within the last 6m	Resets
Lack of reward to EPS & sales beats	Sentiment[g]	+0.41ppt	<1ppt	☑	☑	3Q00	100%	Companies beating on both EPS & sales outperformed by <1ppt within the last three quarters of the prior bull market	Resets
Sell side indicator	Sentiment	56.9%	>62.0%	☐	☐	1988	100%	A contrarian measure of sell side equity optimism; sell signal trigged in the prior 6m	Resets
FMS cash levels	Sentiment	5.1%	<3.5%	☐	☐	2001	100%	A contrarian measure of buy side optimism	Resets
Inverted yield curve	Sentiment	30bp	<0bp	☐	☐	1962	88%	Doesn't lead/catch every peak and of all inversions, all but one (1970) has coincided with a bear market within 24m	Stays on
Chg in long-term growth expectations	Sentiment	+4.2ppt	+0.6ppt	☑	☑	1987	100%	While not always a major change, aggregate growth expectations tend to rise within the last 18m of bull markets	Resets
Rule of 20	Valuation	23	>20	☑	☑	1961	100%	Trailing PE + CPI (y/y%) >20 within the last 12m	Resets
VIX rises over prior 3m	Sentiment	25	>20	☑	☐	1986[a]	100%	Market peaks have come amid the VIX >20 at some point within the last 3m	Resets
ERR rule	Growth	Yes[c]	See footnote	☑	☑	1987	100%	Based on 1- and 3-month earnings estimate revision trends; see footnote for more detail	Stays on

Source: BofAML US Equity & Quant Strategy, BofAML Global Investment Strategy, FRB, S&P, Conference Board, BLS; [a]Based on VXO 1986-1989, [b]% of bear markets where signal was trigged either before or during a bear market, [c]ERR rule: Within six months' window 1) the 1m ERR is below 1.0 for two or more months, 2) the 1m ERR drops from 1.0+ to below 1.0 and, 3) the 3m ERR is under 1.10, [d]Data that first became available during a bear market was not analyzed for that respective bear market, [e]Relative to equalweight S&P 500 price index, [f]Indicator either resets when the trigger criteria no longer holds or stays on for the duration of the bull market once triggered; [g]based on latest completed quarter until 50% or more companies report in the new quarter

MARKET TRACTION

Some may not buy this type of approach but as the information below indicates, it's pretty hard to argue with the track record:

> While some have dismissed BofA's bull/bear model as too rigid, empirical evidence shows that this particular indicator has been remarkably accurate in predicting not only the size of the upcoming drop (-12% on average) but also the timing. Also notable: its uncanny accuracy: **it was correct on 11 out of 11 previous occasions after it was triggered.**

Table 1: BofAML Bull & Bear sell signals

			Global equities (MSCI ACWI)			
Start	End	B&B	Max upside foregone*	Max (3m) drawdown	Max (2m) drawdown	Max (1m) drawdown
4/23/2002	4/30/2002	8.1	0.0%	-21.5%	-8.8%	-3.4%
1/14/2004	2/10/2004	8.1	1.3%	-6.6%	-4.3%	-2.4%
1/25/2006	5/15/2006	8.0	9.3%	-10.4%	-10.4%	-9.5%
12/29/2006	3/5/2007	8.0	3.8%	-6.4%	-6.4%	-6.4%
10/31/2007	11/8/2007	8.0	0.0%	-17.8%	-8.6%	-8.6%
10/21/2009	12/1/2009	8.0	1.1%	-7.3%	-5.3%	-5.3%
4/7/2010	5/18/2010	8.7	2.1%	-16.3%	-16.0%	-15.0%
10/20/2010	12/14/2010	8.3	3.7%	-5.8%	-5.8%	-5.8%
4/19/2011	5/26/2011	8.0	4.9%	-16.8%	-8.5%	-5.9%
3/13/2012	4/3/2012	8.1	1.1%	-13.6%	-11.3%	-4.9%
1/9/2013	3/12/2013	8.6	4.2%	-2.3%	-2.3%	-2.3%
	Backtested	Median	1.7%	-12.0%	-8.5%	-5.9%
	Actual	Median	4.2%	-2.3%	-2.3%	-2.3%

* Upside return measured from start date of "Greed" signal to market peak. Backtesting is hypothetical in nature and reflects application of the screen prior to its introduction. It is not intended to be indicative of future performance. Source: BofAML Global Investment Strategy

With all those, 14 of 19, falling into place, don't forget "who" bailed out of this market in a big way a way this year (at all-time high levels!), and who bought in (hint: "the little guy")

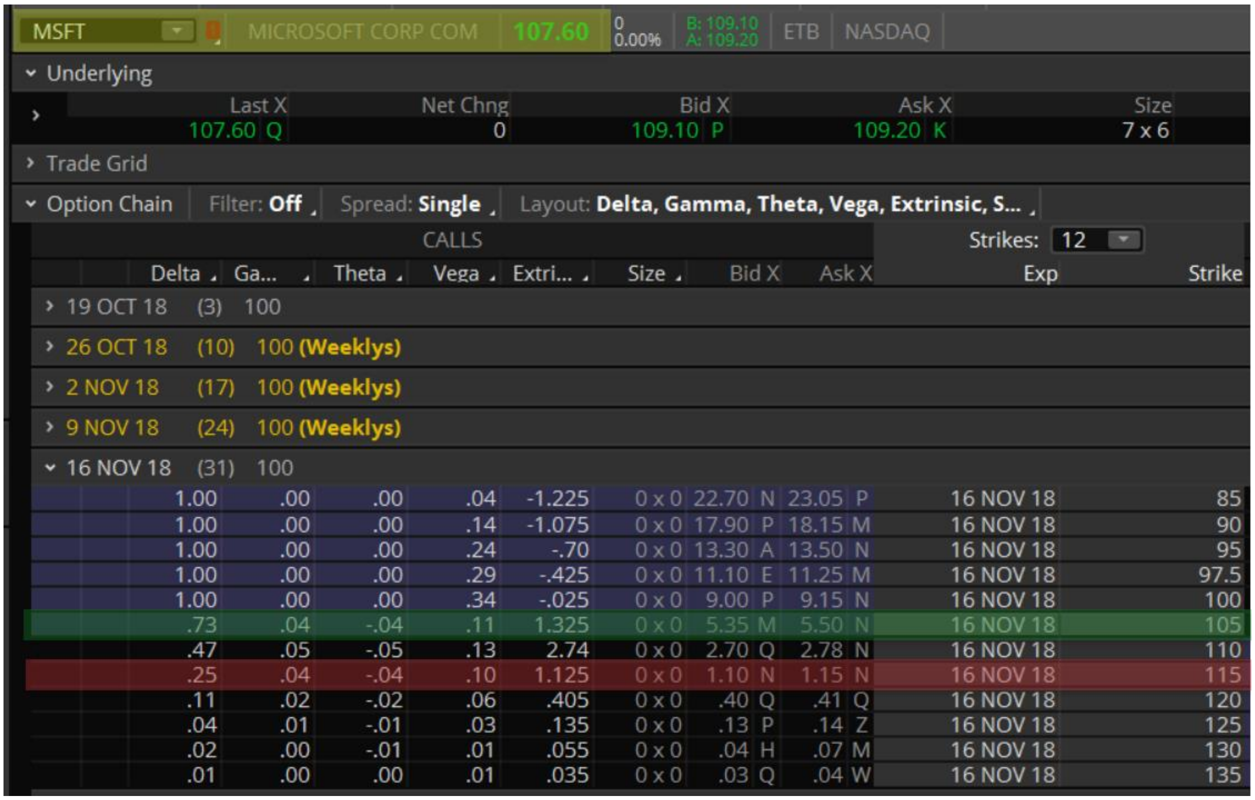
Bank and Roll!

Options Academy

Last week we concluded by noting that this week we may go a "little further" with last week's Greek's discussion. Well, we meant it! We're going only a little further so that "NET Greeks" are better understood in the case of a spread.

As many know, a "spread" in options parlance is when we buy one option and sell another option against it.

Let's go back to our MSFT options quote page from last week so that we home in on a few appropriate options:



Delta	Ga...	Theta	Vega	Extri...	Size	Bid X	Ask X	Exp	Strike
1.00	.00	.00	.04	-1.225	0 x 0	22.70 N	23.05 P	16 NOV 18	85
1.00	.00	.00	.14	-1.075	0 x 0	17.90 P	18.15 M	16 NOV 18	90
1.00	.00	.00	.24	-.70	0 x 0	13.30 A	13.50 N	16 NOV 18	95
1.00	.00	.00	.29	-.425	0 x 0	11.10 E	11.25 M	16 NOV 18	97.5
1.00	.00	.00	.34	-.025	0 x 0	9.00 P	9.15 N	16 NOV 18	100
.73	.04	-.04	.11	1.325	0 x 0	5.35 M	5.50 N	16 NOV 18	105
.47	.05	-.05	.13	2.74	0 x 0	2.70 Q	2.78 N	16 NOV 18	110
.25	.04	-.04	.10	1.125	0 x 0	1.10 N	1.15 N	16 NOV 18	115
.11	.02	-.02	.06	.405	0 x 0	.40 Q	.41 Q	16 NOV 18	120
.04	.01	-.01	.03	.135	0 x 0	.13 P	.14 Z	16 NOV 18	125
.02	.00	-.01	.01	.055	0 x 0	.04 H	.07 M	16 NOV 18	130
.01	.00	.00	.01	.035	0 x 0	.03 Q	.04 W	16 NOV 18	135

Let's again assume that we buy 1 Nov 16th 105 call, we'd have 73 long deltas as a result but also, and simultaneously, we'll assume that we sell 1 Nov 16th 115 call against it to construct a vertical spread. This is often referred to as being "long the 105-115 vertical" or having on the "105-115 call debit spread" (since capital was put out to acquire the package.) Now note that the 115 call has 25 deltas associated with it. Well, we need to account for that in our *spread equation*.

While we're long 1 73-delta call thus having 73 long deltas, that is offset by the being short 25 deltas thus resulting in a NET LONG delta on the read of 48 deltas.

People often wonder why they don't make as much as they expected when a stock price rises, and they own a spread such as this one. Normally, the part they miss is that they're no longer only long one option with it working for them with nothing working *against* them. A spread is a package deal that brings positives and negatives to the picture vs. a simple long option. For whatever reason, probably human nature, people fail to appreciate the "net effect" that spread trading produces. They want to take the reduction in cost and risk and roll with those while ignoring the fact that they've capped their potential and altered ALL THEIR GREEKS.

When spread trading as we've outlined above, all Greeks must be netted out against each other just as the options are positioned against each other, thus the NET GREEKS of the spread would be as follows:

.73 - .25 = .48 Net Long Deltas

.04 - .04 Gamma = No Net Gamma at this price/time juncture.

.04 - .04 Theta = No Net Theta at this price/time juncture.

.11 - .10 Vega = .01 Long Vega exposure at this price/time juncture.

So that's that but unfortunately those NET Greeks are not set in stone. Perhaps we'll explore that topic next week.

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