MARKET TRACTION

Early Signs of a Double Top? Or, is the Market Simply Resting Before Running?

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

Bullish Ideas:

(View Webinar) HAL > Haliburton Co. > $41.71 Last. Buy the Nov. 2nd 40 Calls for $2.60 or less with a close or anticipated close above $41.97 in an up market with expectations for continued strength in the major indices.

<u>Bullish Mentions</u>:

GLD, NEM, DE, MO, TSRO.

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

Bearish Ideas:

(View Webinar) GT > Goodyear Tire & Rubber Co. > $23.43 Last. Buy the Nov. 2nd 24.5 Puts for $1.80 or less with a close or anticipated close below $23.25 in an down market with expectations for continued weakness in the major indices

<u>Bearish Mentions:</u>
Based upon closing prices and all assume a down market with expectations for continued weakness in the major indices.

PFE, RTH, OKTA.

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:

With a negligible difference between where the **SPX** was last Tuesday and where we are this Tuesday, we're not impressed…not quite yet. The markets have held above key support and the new NAFTA news certainly got the week off to a strong start, but the past 2 candles have left us nonplussed. The market should be ready for a rally attempt but it's lacked enthusiasm so far this week. A watchful eye must be kept.

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:

EWY was our lone idea from last week and despite the market being under pressure last week, it could have been a trade that was taken as it did close above our trigger level with a weak candle in a weak market. It dawdled around as the market remained challenged but then gave way today when overseas risks caused markets abroad to take it on the chin. If anyone jumped in on this one, we'd just call it a day personally, given our currently prudent posture. This has to go down as a disappointment but within the context of the market holding it back last week when it preferred to work.

As for our bullish mentions, **X** couldn't breakout, but it did make one push before failing with a weak candle after it got to our level. **MOS** finally tried today but hasn't really done much of anything. **IGT** couldn't get through the resistance line we sketched out in our webinar last week and today it's downtrend resumed. **AEM** moved up solidly today but it had been slumbering like most stocks. **WYNN** never tried to move up. Not in the least. Our scans believed it could if it moved up a little from where we spotted it and surpassed a resistance, but it only dropped further. **Z** tried to move up, couldn't close above any highs in a weak market, and failed below the 20 SMA.

The wrap on the bulls is that without a supportive market, it is difficult to ride "turn around" bulls. We're not happy but we went "prudent" last week sensing that it was time to do so given what we've seen out there. Not getting bullish movement in a market that stopped delivering upside for the indices isn't a shocker.

As for the bearish mentions, **TSM** finally dropped today with the international selling that developed almost everywhere. Maybe we'll finally see more of the drop we envisioned as it cracked a level of support.

XLV has yet to drop.

GNTX dropped somewhat but it was a limited idea from the start.

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UNH would not crack below the 50 SMA, and as is typical with reversal names, it rallied from there thus demonstrating that playing games with reversal candidates can be risky business.

The summary is simple: Last week was boring as hell and since the SPX simply churned we didn't get much of anything out of anything.

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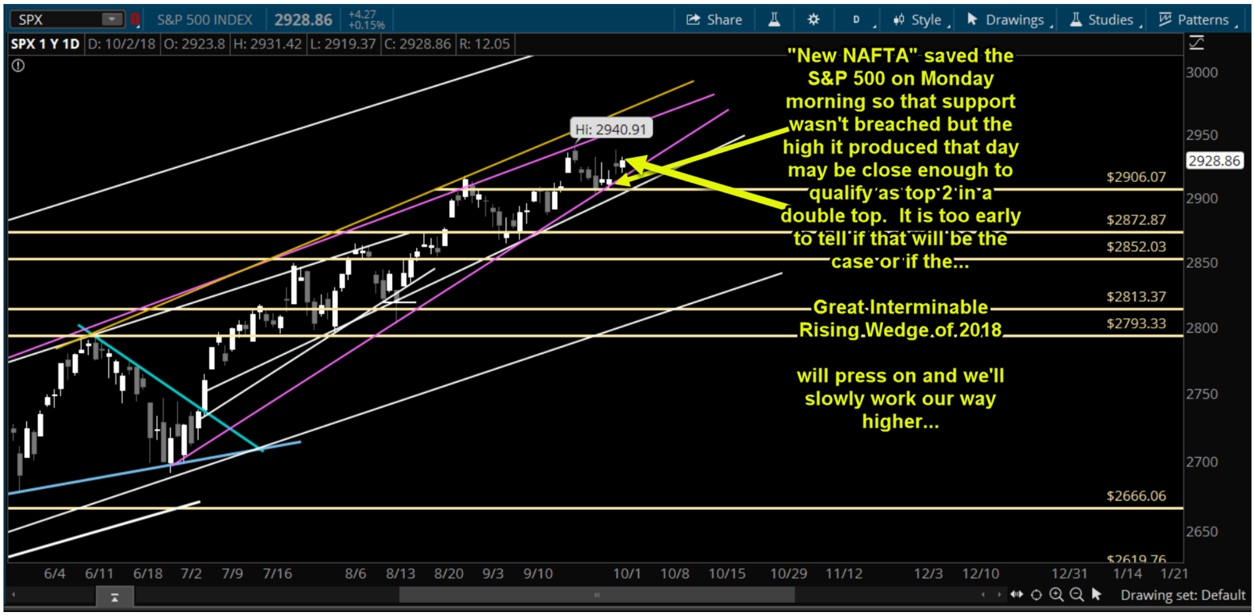
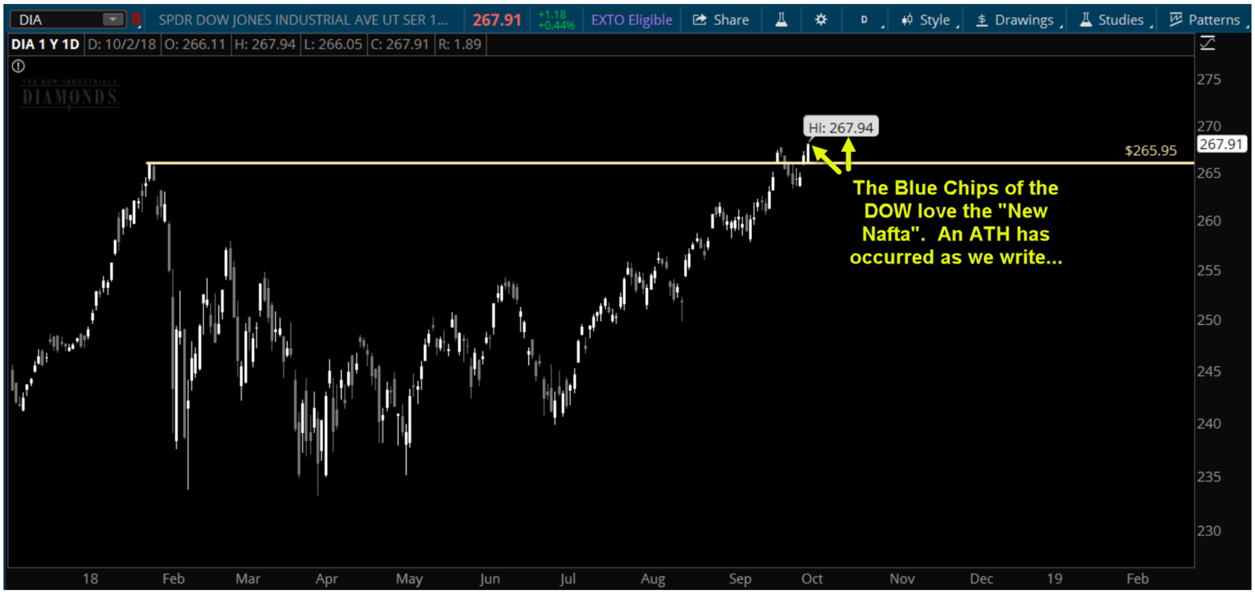
Market Overview

Last Tuesday as the newsletter filled out, the SPX closed near 2915. This morning, as the newsletter started to fill out, the SPX reached a low near 2919. As you can see, we've done very little since last week and thus we're feeling OK about heading into "prudent mode" and scaling back our aggression. We decided to play it that way due to the weakness that followed the new All-Time-High along with the "rising wedge" we've referred to again and again and we don't regret it. Many of our names from last week were lackluster and forgettable and that can often be the case when the major indices are that way as well as we noted in the recap above.

All we need are the pictures with the embedded words for this week:





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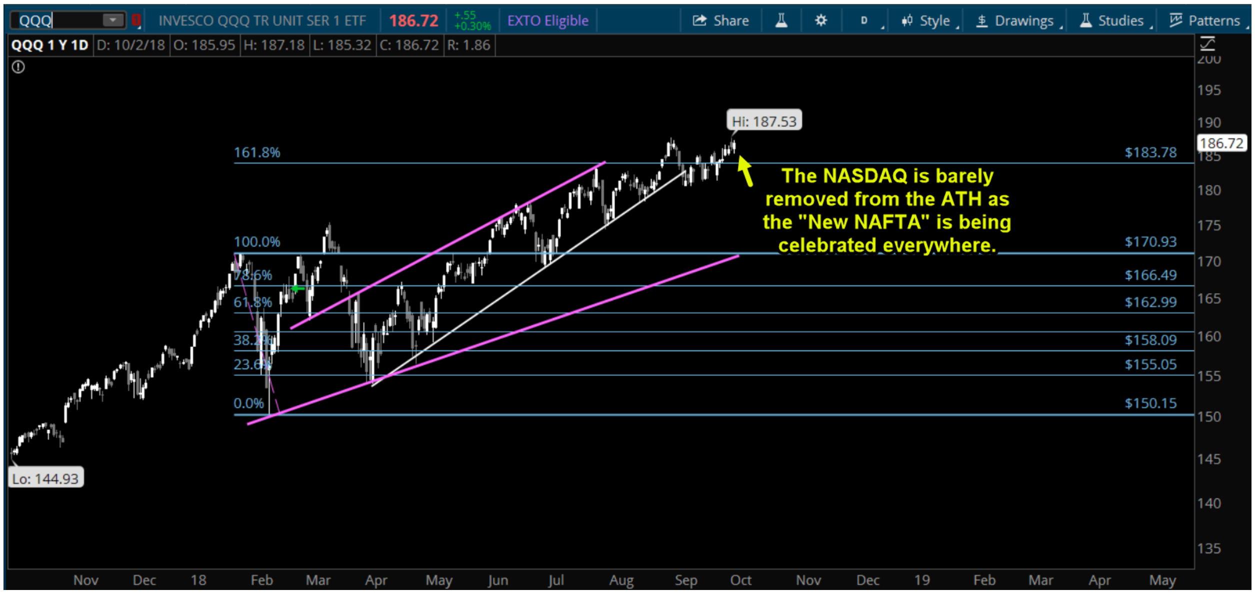

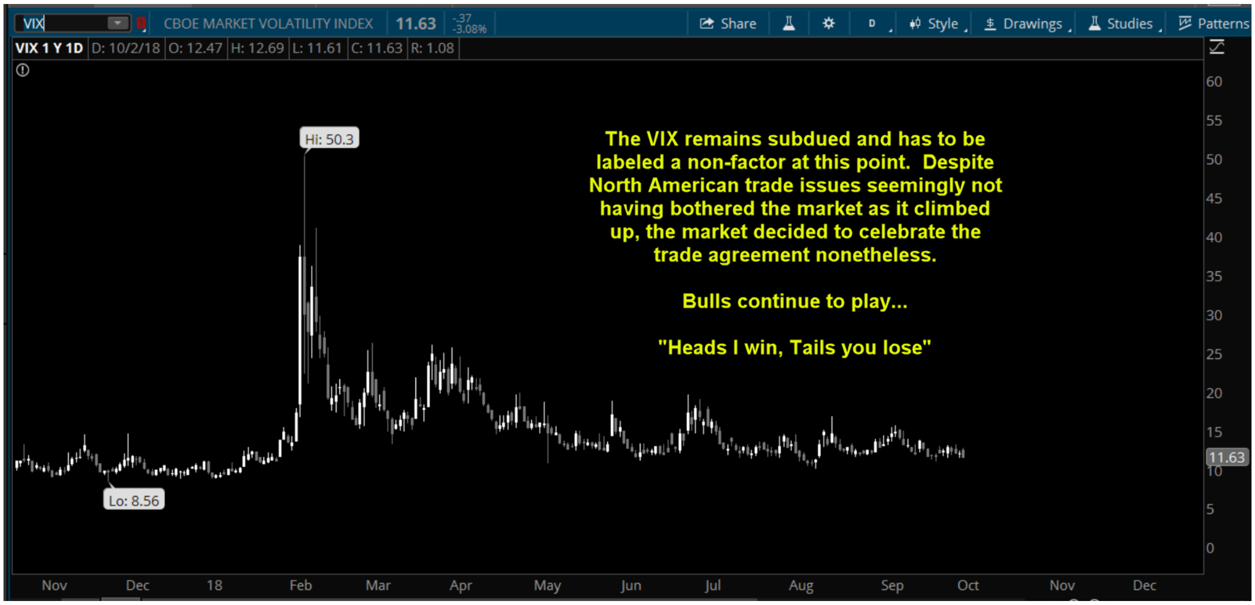

The graphics above do all the "talking" we need to at this point. The New NAFTA "sugar high" continues and how long it will last is anyone's guess. We think the FED speakers, of which there are many this week, could start to be keyed on as could DC political intrigue. All of which, is tough to predict. Maybe it is us, but we still sense some trouble here despite the surface being very placid, maybe too placid. We'd normally place material like this in our **BTR** section below but given our switch to "Prudence" last week we thought it warranted being featured here.

Think about this as you observe the graphic below: We're BARELY removed from ATH's and yet we're about as NEUTRAL as it gets: https://money.cnn.com/data/fear-and-greed/

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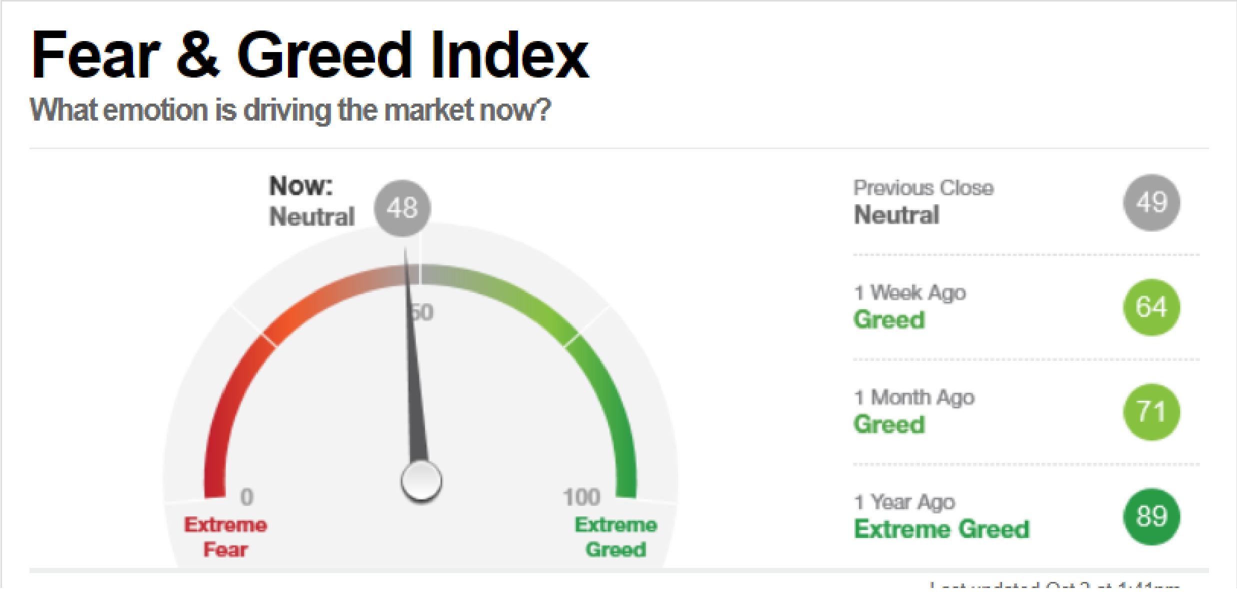
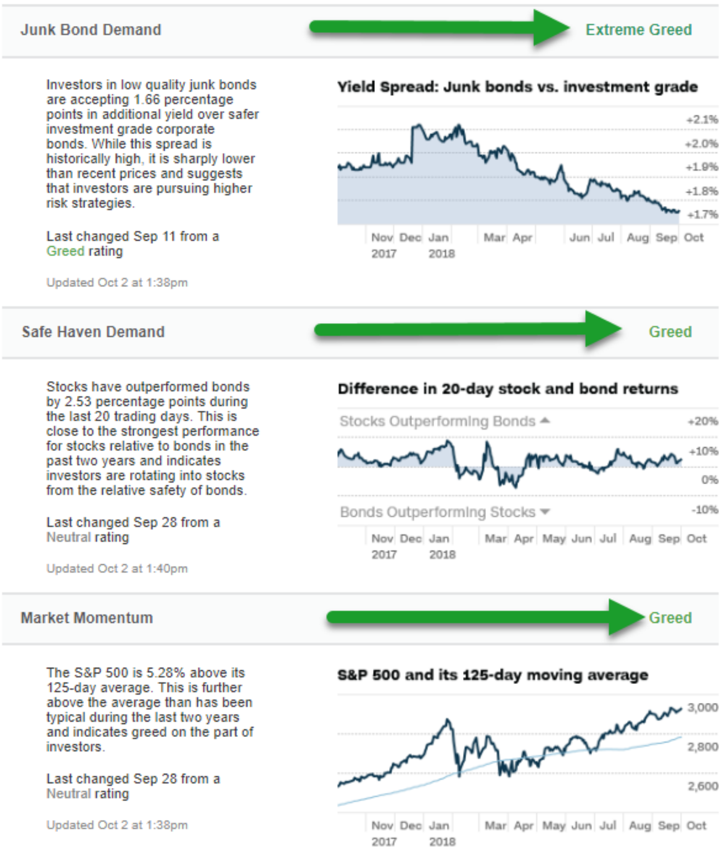


We became curious when we noticed that the F&G reading was so darn neutral, so we DELVED…

And… it turned out, that the Devil was hiding in the Details as the first 3 indicators were firmly into **GREED Land** and even slow-on-the-uptake players like us could see it for what it is:



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Notice how those readings and on important fronts. We began to ask: "Why is the reading so neutral with those that stretched?" and we soon found our answer:

Put and Call Options **Extreme Fear**

During the last five trading days, volume in put options has lagged volume in call options by 37.99% as investors make bullish bets in their portfolios. However, this is still among the highest levels of put buying seen during the last two years, indicating extreme fear on the part of investors.

Last changed Sep 26 from a Neutral rating

Updated Oct 2 at 1:40pm

CBOE 5-Day Average Put/Call Ratio

Stock Price Strength **Extreme Fear**

The number of stocks hitting 52-week lows is slightly greater than the number hitting highs and is at the lower end of its range, indicating extreme fear.

Last changed Sep 27 from a Fear rating

Updated Oct 2 at 1:40pm

Net new 52-week highs and lows on the NYSE

We highlighted what needed to be highlighted but this mix is really, really different right now. Greed readings are being balanced out with EXTREME FEAR readings that are masking something…potentially.

PUT BUYING is the highest it's been in 2 years which tells us that other option players have gone "prudent" along with us.

Many stocks making new 52-week lows informs us that weakness below the surface of the market continues to be masked by the big names getting Jamma, Jamma, Jamma'd upward!

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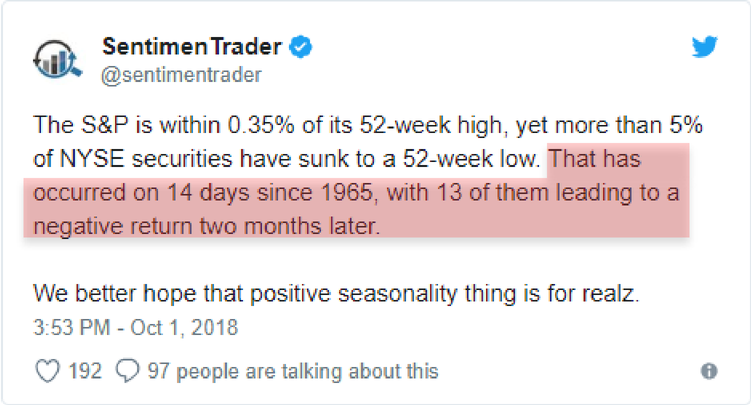
SentimenTrader
@sentimentrader

The S&P is within 0.35% of its 52-week high, yet more than 5% of NYSE securities have sunk to a 52-week low. That has occurred on 14 days since 1965, with 13 of them leading to a negative return two months later.

We better hope that positive seasonality thing is for realz.

3:53 PM - Oct 1, 2018

192 97 people are talking about this

Option players "insuring" themselves in a big way WITHOUT pushing the VIX up is very, very interesting to us. Some must be sensing what we're sensing and that's that all isn't right with this market. The "rising wedge" has been our technical driver in that vein but clearly that's only reflective of a potentially important factor that's lurking in the real world that those in the know are privy to and of course which we are not. Maybe this will turn out a lot like the curious-to-us VIX levels that seemed too high for late August and subsequently turned out to be. Or, maybe our ***Spider Sense*** will get one right! Whatever the case, we're sticking with prudence for the time being. See **BTR** below for more perspective because we're not alone: https://www.zerohedge.com/news/2018-09-26/insider-selling-soars-fastest-pace-september-sales-past-decade

We stated this last week and we'll do so again: The bulls are in control until they're not. We will still take trades in that direction, but we will do so gingerly. Our perception of risks has risen, and we'll act in accordance with that perception until further notice.

We have another "big" calendar this week with each day having it's *say*. Wednesday and Friday loom large but there's plenty o' FED speeches to go around too. This could really be interesting as a result and could key movement that will break us out of the slumber we settled into about 10 calendar days ago.

This Week's Economic Calendar

TIME (ET)	REPORT	PERIOD	ACTUAL	MEDIAN FORECAST	PREVIOUS
MONDAY, OCT. 1					
9 am	Raphael Bostic speaks				
9:45 am	Markit manufacturing PMI	Sept.	55.6	--	55.6
10 am	ISM manufacturing index	Sept.	59.8%	60.3%	61.3%
10 am	Construction spending	Aug.	0.1%	0.4%	0.2%
11 am	Neel Kashkari speaks				
12:15 pm	Eric Rosengren speaks				
TUESDAY, OCT. 2					
Varies	Motor vehicle sales	Sept.		17.0 mln	16.7 mln
10 am	Randal Quarles testifies				
12 noon	Jerome Powell speaks				
2 pm	Rob Kaplan speaks				
WEDNESDAY, OCT. 3					
6:30 am	Charles Evans speaks				
8:05 am	Tom Barkin speaks				
8:15 am	ADP employment	Sept.		--	163,000
9:45 am	Markit services PMI	Sept.		--	52.9
10 am	ISM nonmanufacturing index	Sept.		58.3%	58.5%
2 pm	Lael Brainard speaks				
2:15 pm	Loretta Mester speaks				
4 pm	Jerome Powell speaks				
THURSDAY, OCT. 4					
8:30 am	Weekly jobless claims	9/27		213,000	214,000
9:15 am	Randal Quarles speaks				
10 am	Factory orders	Aug.		2.2%	-0.8%
FRIDAY, OCT. 5					
8:30 am	Nonfarm payrolls	Sept.		168,000	201,000
8:30 am	Unemployment rate	Sept.		3.8%	3.9%
8:30 am	Average hourly earnings	Sept.		0.3%	0.4%
8:30 am	Trade deficit	Aug.		-$53.7bln	-$50.1bln
12:30 pm	Rob Kaplan speaks				
12:45 pm	Raphael Bostic speaks				
3 pm	Consumer credit	Aug.		--	$17bln

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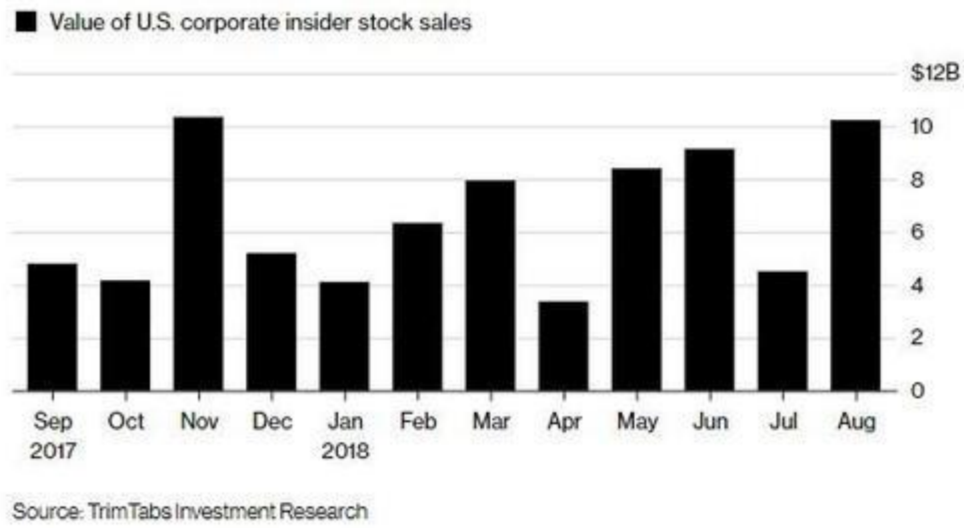
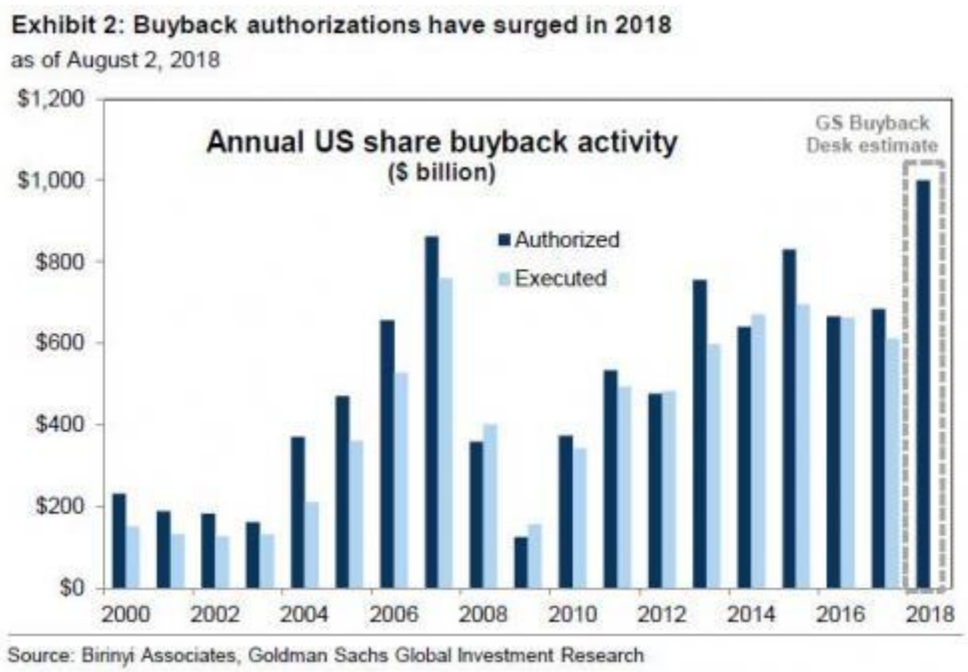
Below the Radar – And Now…Tough to Say!

First up, let's address the dangling link **from Market Overview** above**:**

https://www.zerohedge.com/news/2018-09-26/insider-selling-soars-fastest-pace-september-sales-past-decade



As they sell personally, they keep goosing the stock prices of the companies they "manage", because they're buying shares hand over fist via "buy backs"! And at a record pace! Are they selling out to themselves in some weird way? Ahh, who cares! Party on!



A racket only the government and Wall St. could get away with! And they are!

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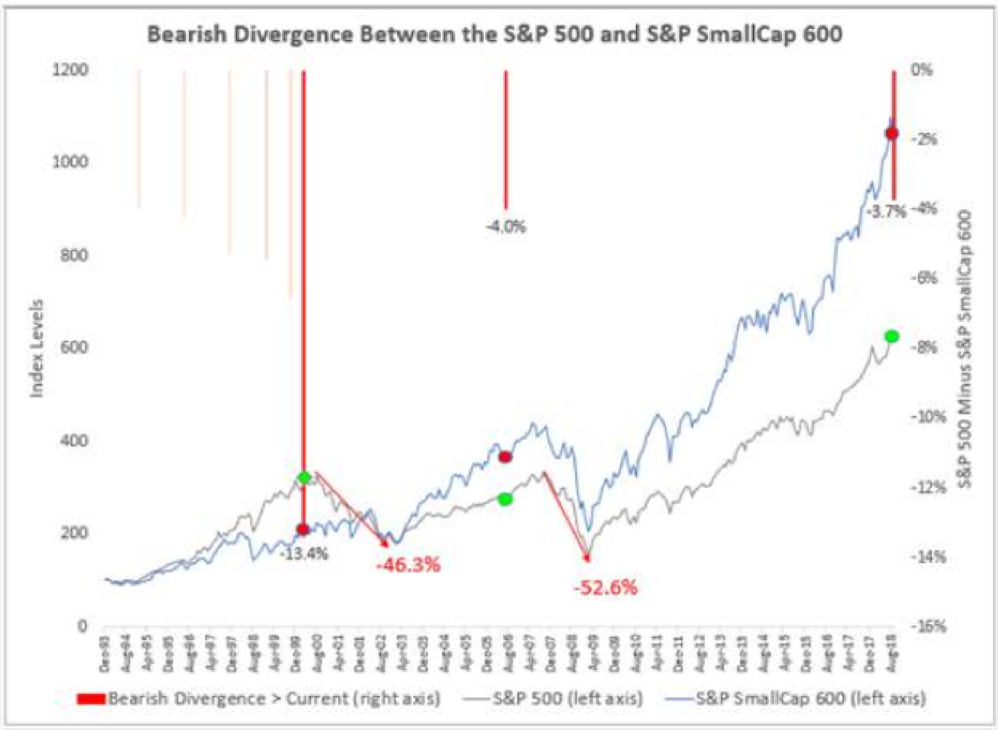
Source: TrimTabs Investment Research

One month later, TrimTabs is out with a follow up monthly report which finds even more of the same: according to the investment research company, **the "best-informed market participants" are selling their own stocks at the fastest pace in September in the past decade, even as stock buyback announcements have hit record levels.**

Following up again from material we seeded into **Market Overview**, we can further amplify on the masking of below-the-surface weakness in the market:

https://www.marketwatch.com/story/this-rare-divergence-in-the-stock-market-could-spell-trouble-ahead-2018-10-02

> "Not only is this the current scenario, but the bearish divergence has only been bigger seven times in history where two of those times preceded major stock market drops," wrote Jodie Gunzberg, managing director and head of U.S. equities at S&P Dow Jones Indices. She said that the 3.75% gap separating the performance of the two indexes was the largest monthly outperformance by large-caps in four years.



Next up, we have another sign that's seen near tops. The "little guy" hates cash and loves stocks. It doesn't get more contrarian than that for some folks.

https://www.marketwatch.com/story/the-chart-that-spells-out-the-danger-of-an-all-in-stock-market-2018-10-02

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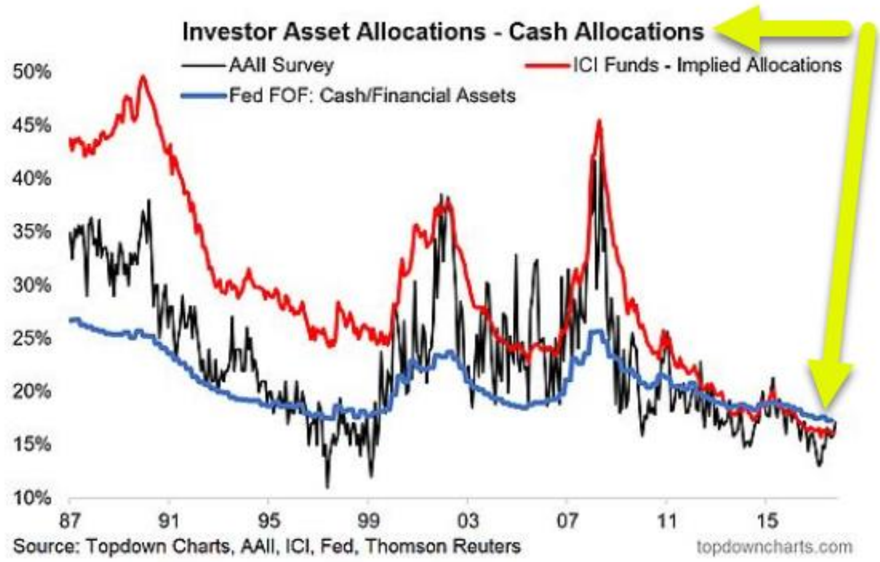
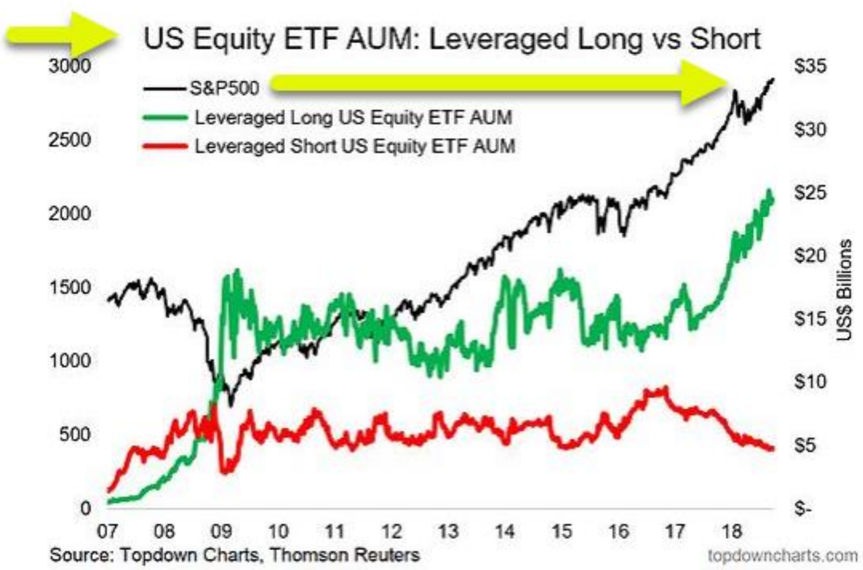
*Some investors can't shake the unease that comes with an "all-in" market. That is the gist of our **chart of the day** from Callum Thomas, founder of research firm __Topdown Charts__, which shows stock-loving investors have dropped their allocations to cash to "rock-bottom" levels:*



He prefaced that with another chart that shows how the money keeps flowing into U.S.-equity exchange-traded funds:



Thomas says "it would be without recent historical precedent that cash allocations would drop further than where they are now," he said.

*<u>"Basically where cash allocations are at this point is entirely consistent with the type of signs you see toward the end of a market cycle,"</u> said Thomas**<u>. "Long story short, U.S. investors are basically all-in. Good luck to them."</u>***

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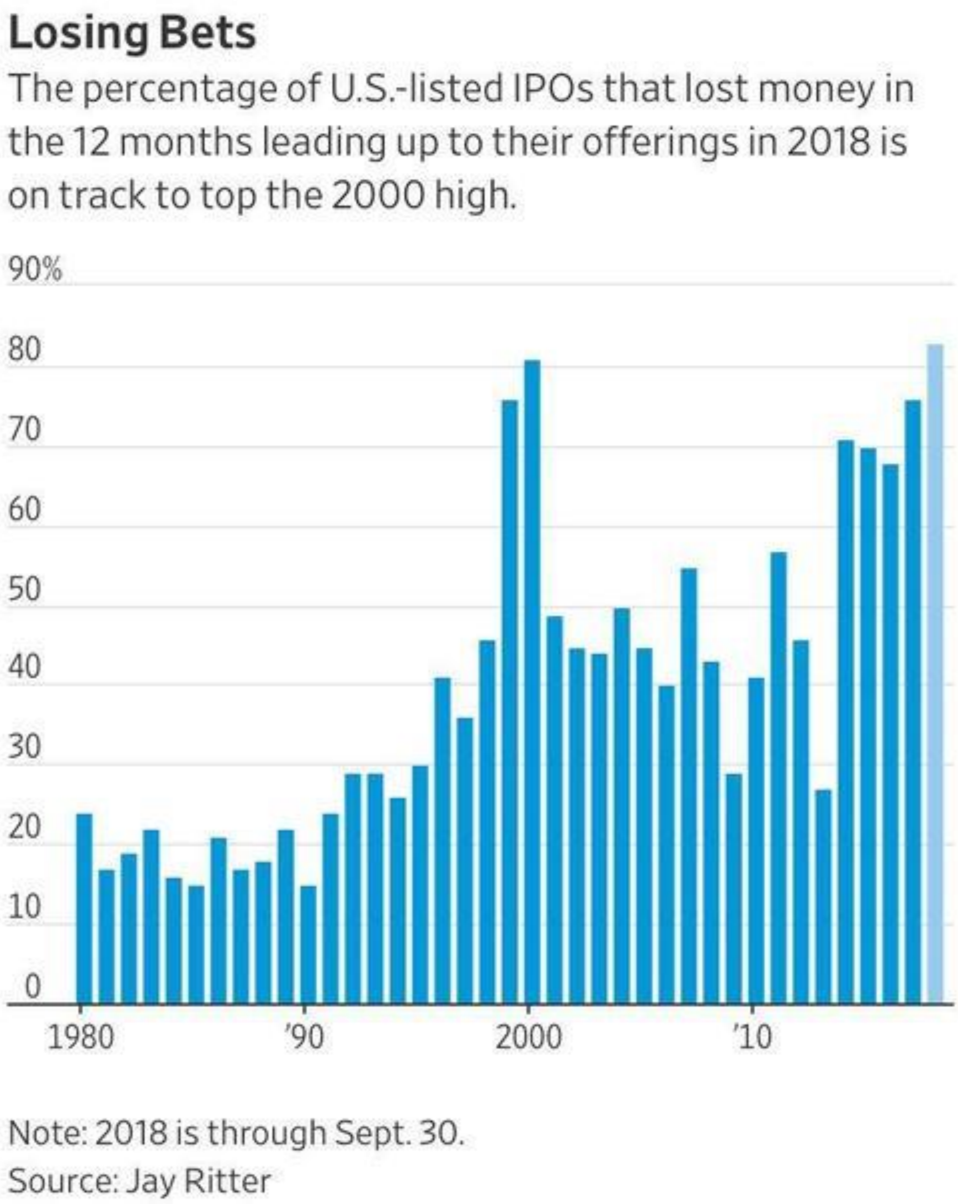
"It is really important that rational players know how to separate two things…risk & price, which can coexist indefinitely as they rise together. ***Until one day, they don't,****" says Rabbit Hole's Gary.*

So…the *little guy* is **all in (again)** and Wall St. can't wait to fatten him up with "junk food" IPOs which have set a new record and thus some are hearing the echo of the "DOTCOM" bubble:

https://www.zerohedge.com/news/2018-10-01/worse-dot-com-bubble-money-losing-companies-are-going-public-record-rate

According to a new report by the Wall Street Journal, ***a record number, or 83% of US listed IPOs over the first three quarters of 2018, were companies that lost money in the 12 month prior to their going public.***



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Kevin Landis, chief investment officer of technology-focused Firsthand Capital Management, had one message for the Wall Street Journal:

"The lesson from 2000 is don't chase what everyone else is chasing."

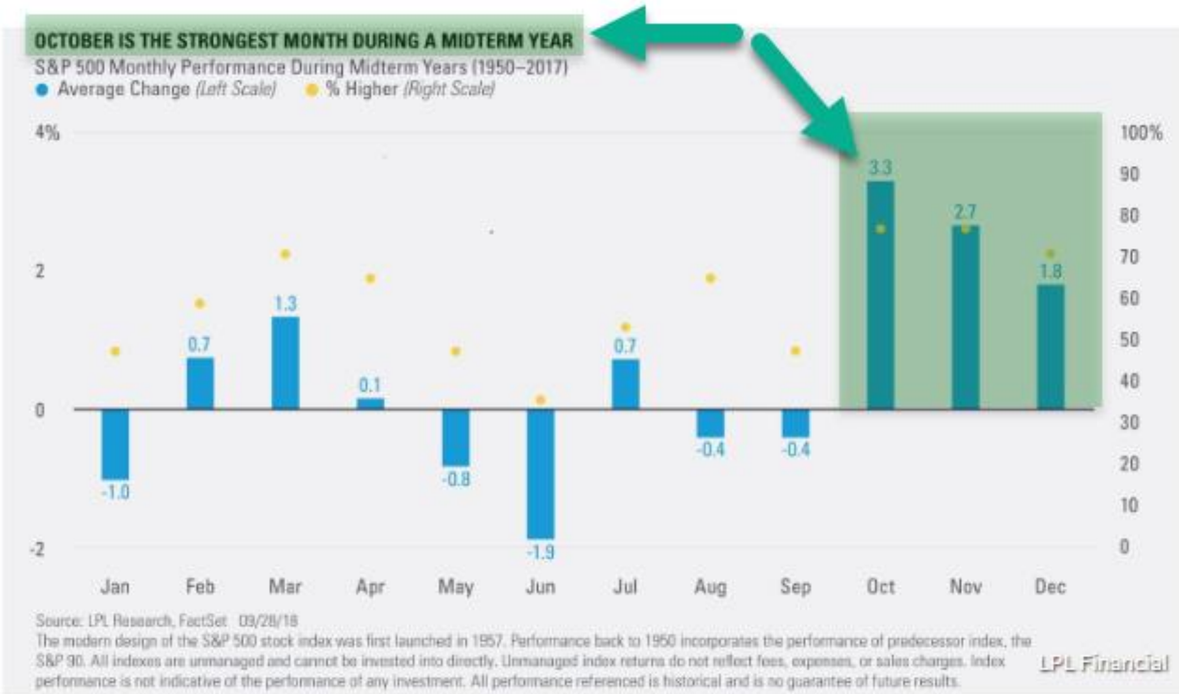
And yet that's precisely what everyone is doing.

And finally, here's why, despite our concerns, we're still willing to go with the flow even if that means up, up and away:

https://www.marketwatch.com/story/a-6-month-win-streak-for-the-stock-market-may-mean-that-the-rally-is-just-getting-started-2018-10-01

A solid April-to-September performance also has been a positive signpost for market performance in the fourth quarter, with stocks notching an average rise of 9.2% in the final three months of the year.

On top of the strong seasonal trend, investors may get a lift from politics.



Read: Should investors fear October, a historic 'jinx month' for stocks?

During midterm years, October has been the best month for stocks going back to 1950 with the S&P 500 rising an average 3.3% in the month, according to Ryan Detrick, senior market strategist at LPL Financial.

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The 6-month run we've just had portends we end the year with 9% plus performance in the final quarter. Midterm election years deliver a big October and superlative 4th quarter. It could still happen despite…everything.

And despite that, we will Bank and Roll when possible!

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Options Academy

We're taking a break, which may be brief, but a break it will be, from covering all the nooks and crannies of the **Diagonal Spread** strategy.

This week we decided to re-point out the obvious and what should be ***obvious*** but becomes far ***less obvious*** once new-to-options investors wrap their heads around the option pricing model and option principles.

As longtime readers likely recall, the Option Pricing Model has 6 inputs, 5 of which are known with the exception being the Volatility Input/Volatility Estimate*. They are as follows and they are the "***obvious***" as is the output they help produce:

1. Stock Price
2. Strike Price
3. Expiration Date
4. Interest Rate
5. Dividend Stream
6. Volatility Input*

In short, we can easily ascertain 1 through 5 with simple observations but the most difficult one, the Volatility Input will always elude us and the only thing we can do is estimate what we believe that should be. This estimate is an attempt to predict the future volatility of the stock price so that the option is priced fairly in accordance with that future volatility. This a process that professional market-makers and traders must engage in, so they have a sense of if they're getting good value to purchase said option (buying it "cheap") or when selling the option (selling "fat vol" as it is described).

Naturally, the idea is simple: Buy low, sell high.

That should sound familiar and although it's quite elementary it can be harder to do than it would seem despite it making nothing but sense.

Once a fair value for an option is arrived at by way of the option pricing model output, we can then derive other values from the output of the model and they are known as the Greeks. So far, so good. But…Here's the problem and what spurred this week's **OA** subject onward:

Once folks get deeper into option pricing they start to believe more in the model, the fair value estimation it provides and the Greeks that are derived from those outputs. After all, they provided the inputs, and its "math" and now their ego is involved! "That's MY estimate man!"

"So, what? What's the big deal? Where's the problem? Isn't that exactly what we should do? Isn't that what the entire industry does?"

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Simmer down, simmer down! We only need a little more of your time to cover the "***not so obvious***" once you get too deep in the option pricing model weeds…

<u>REMEMBER</u> that not only is the option's value heavily dependent on the volatility input (estimate of future stock price movement over the lifespan of the option) but all the Greeks are as well. What that distills down to is that **OUR** "future volatility guess" largely dictates the Greeks that so many are "banking on" and thus… talk about a feedback loop!

So, think about this next time someone tells you that their iron condor strategy has an 87% probability of working out in their favor:

The key part of what produces that 87% figure essentially amounts to a guess about the future and we all know how hard it is to predict how much stock movement there will be over a longer time span let alone a shorter one.

Thus, if you think about it, folks that gain high confidence levels as per delta are using data that's being crunched by an options trading platform that's using the marketplace's volatility estimate to perform the calculations that eventually lead to the Greek delta.

Ask yourself these questions:

How bankable is the future volatility estimate of others?

Is that something you're willing to be the ranch on?

Could you do better?

Are the world and options prices and Greeks more complicated than 6 inputs? Should they be?

Keep those in mind as you move forward in the options markets.

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