MARKET TRACTION

The Good News? This “Scary” October will Soon Be Over!

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

Bullish Ideas: (View Webinar)

GIS > General Mills Inc. > $45.50 Last. Buy the Nov. 16th 45 Calls for $1.35 or less with a close or anticipated close above $45.60 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.

HRB, VIRT, JNJ, ORCL, ETFC.

Bearish Ideas: (View Webinar)

Plan to re-scan if indices become heavy again.

None at this time due to so many names being deeply oversold.

<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.

None at this time due to so many names being deeply oversold.

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:

We didn't buy last week's early rally: *"It could be, but our gut still isn't buying that it's over."*
We're not buying this one fully, but, with so many stocks at extremely oversold levels, we are much more open minded with respect to a rally. However, without having seen a final wipeout phase, we can't say this is over yet.

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:

Another simple week to recap. It started badly last Tuesday and stayed that way (mostly) until this Tuesday when stocks finally found a lasting bid. For that reason, no bullish names could have even been part of the mix without a VERY GOOD reason!

As for the bears, **NRG** was the official bear and it dropped small, about 2% of its price. Not that great but that's what happens when you go for safety. And now, onto the bearish mentions of which there were several, but many were faced with looming earnings reports:

NLSN* (Earnings 10/25) – At one point, it was down over 10% since spotted last Tuesday.
UAL – Dropped over $4.00 almost initially but has rallied back from that low.
DISCA* (Earnings 10/31) – A $3.00 drop was to be had potentially.
MTDR* (Earnings 11/1) – Fell by over 8% at one juncture.
VEEV – Fell off by about $6.00 but rallied back somewhat today.
GDDY* (Earnings 11/6) – Had a very nice drop of over $8.00.

Last week our bears all delivered to one degree or another, but we wanted more and hoped to see it with a final round of cascade selling but that's yet to come. All you can do is play the game the smart and safe way and hope. That's what we'll continue to try to do.

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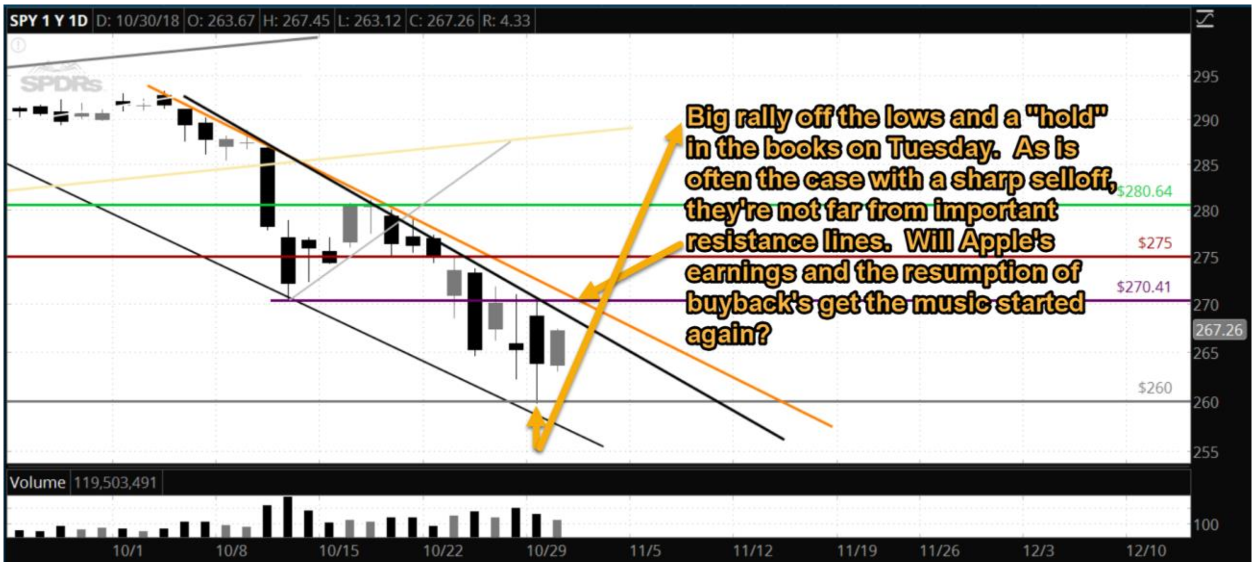
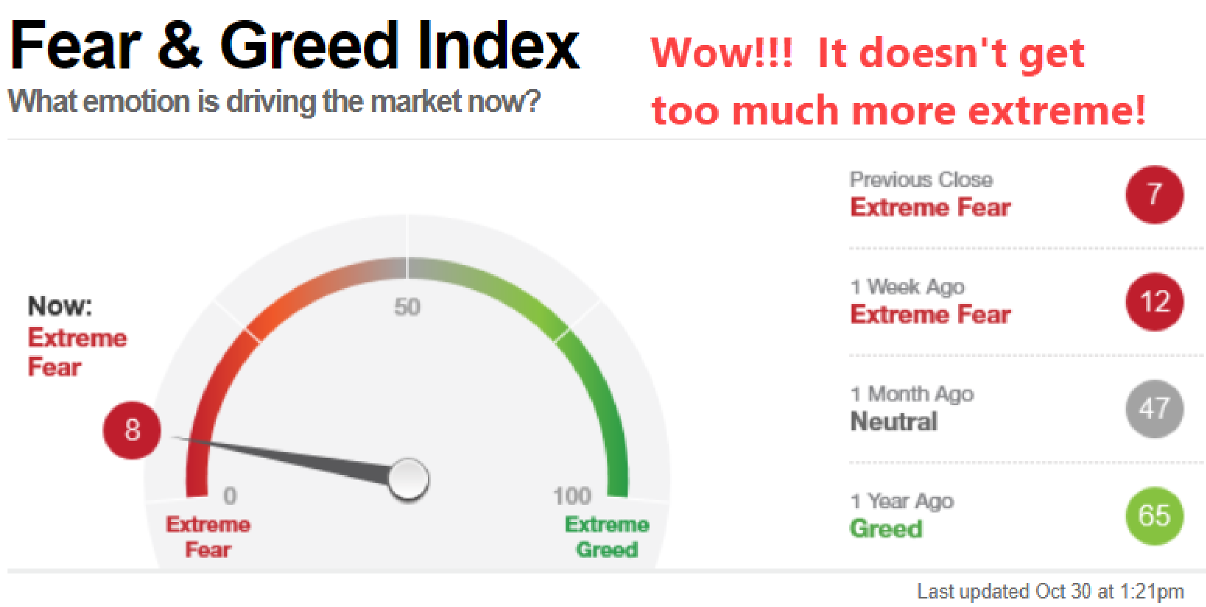
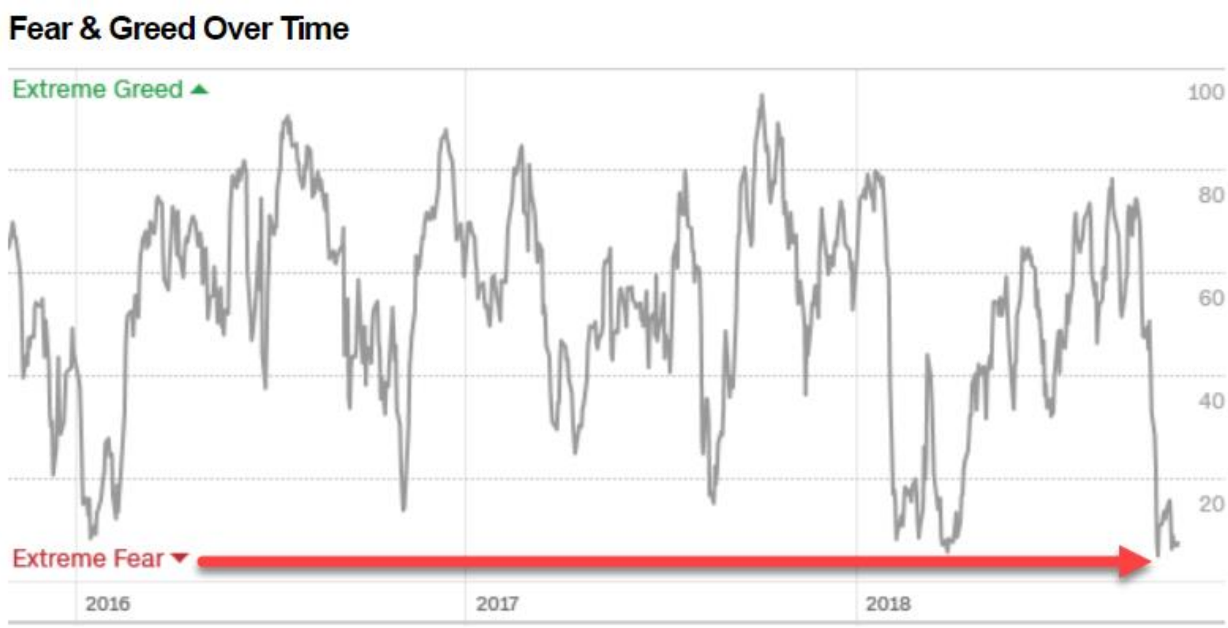
Market Overview

The SPYs will serve us *just fine* again this week because everything has become and remains so correlated, as we've previously discussed. We remain flexible but since it isn't over yet, we must treat it as if it isn't over yet! We have a sense that more "bounce" will be attempted and that the excitement over Apple's earning's announcement, and a resumption of corporate buybacks, not to forget to mention the end of an abysmal October, and the midterms soon to be behind us, and the need for stock market makers to "offload", will all be part of the combustible mix used to propel us back up somewhat. We're not forecasting it yet, but we can see things shaping up. In volatile periods, news that we can't foresee normally dictates the next move, which makes these periods harder to predict, and why we simply embrace the results of a big move and roll aggressively. Once the dust settles, and we see something definitive, then we react with greater directional confidence.



Aside from across the board oversoldness:





… the VIX, looks VULNERABLE:

This week brings a fairly-heavy economic calendar with a significant release, or more, slated for each day. As we often note, it gets even heavier from mid-week on into the weekend. The news will be there for "them" to use if they care to do so and we know that late-week selloffs can accelerate so that market players avoiding holding positions over the weekend. We've yet to witness that final "whoosh" lower where we see cascade selling for a few days in a row that's punctuated with that final capitulation. It doesn't have to happen, but it normally does. We'll see what lies ahead…

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This Week's Economic Calendar

TIME (ET)	REPORT	PERIOD	ACTUAL	MEDIAN FORECAST	PREVIOUS
MONDAY, OCT. 29					
8:30 am	Personal income	Sept.	0.2%	0.4%	0.4%
8:30 am	Consumer spending	Sept.	0.4%	0.4%	0.5%
8:30 am	Core inflation	Sept.	0.2%	0.1%	0.0%
TUESDAY, OCT. 30					
9 am	Case-Shiller home price index	Aug.	5.8%	--	6.0%
10 am	Consumer confidence index	Oct.	137.9	136.4	135.3
10 am	Home ownership	Q3	64.4%	--	64.3%
WEDNESDAY, OCT. 31					
8:15 am	ADP employment	Oct.		--	230,000
8:30 am	Employment cost index	Q3		0.7%	0.6%
8:30 am	Treasury quarterly refunding				
9:45 am	Chicago PMI	Oct.		--	60.4
THURSDAY, NOV. 1					
8:30 am	Weekly jobless claims	10/27		212,000	215,000
8:30 am	Productivity	Q3		2.3%	2.9%
8:30 am	Unit labor costs	Q3		1.1%	-1.0%
9:45 am	Markit manufacturing PMI	Oct. final		--	55.9
10 am	ISM manufacturing index	Oct.		58.7%	59.8%
10 am	Construction spending	Sept.		0.2%	0.1%
Varies	Motor vehicle sales	Oct.		17.2 mln	17.4 mln
FRIDAY, NOV. 2					
8:30 am	Nonfarm payrolls	Oct.		202,000	134,000
8:30 am	Unemployment rate	Oct.		3.7%	3.7%
8:30 am	Average hourly earnings	Oct.		0.1%	0.3%
8:30 am	Trade deficit	Sept.		-$53.6bln	-$53.2bln
10 am	Factory orders	Sept.		0.5%	2.3%

Below the Radar

This week, we're going to go for a little balance in celebration of *this* October coming to an end! It's been the nastiest October in about 10 years and even the leadership stocks have lost their way:

We're going to return to the market at-large, but we'd first like to visit *Housing Market USA*. At times, we've focused on the housing market but not so much recently. We're changing it up this week because it seems appropriate after noting how challenging things have been for bank stocks last week. In other words, yet another important part of the economy/market is not faring well, not in the least. Additionally, let's keep in mind that bank stocks aren't suffering because *too many* loans are being taken at this time. For an economy that's too credit-dependent, these developments simply aren't good…

Housing is important because the consumer is so important. The consumer is said to account for about 2/3rds of GDP, and there's no more important asset for most consumers than their homes and home values. This is often the source of their optimistic or pessimistic spending plans. If they feel good about their home value and where it is heading to, they'll spend, and, naturally, the converse is true. That's why, many of the graphics we recently came across, left us concerned. Like many, we've been concerned about rising interest rates affecting mortgage rates which would naturally affect housing purchases, well…:

*Amid the collapse on US home sales, as **mortgage rates surge above 5.00%, August's Case-Shiller home price data plunged to its weakest annual growth since Dec 2016**, dramatically missing expectations).*

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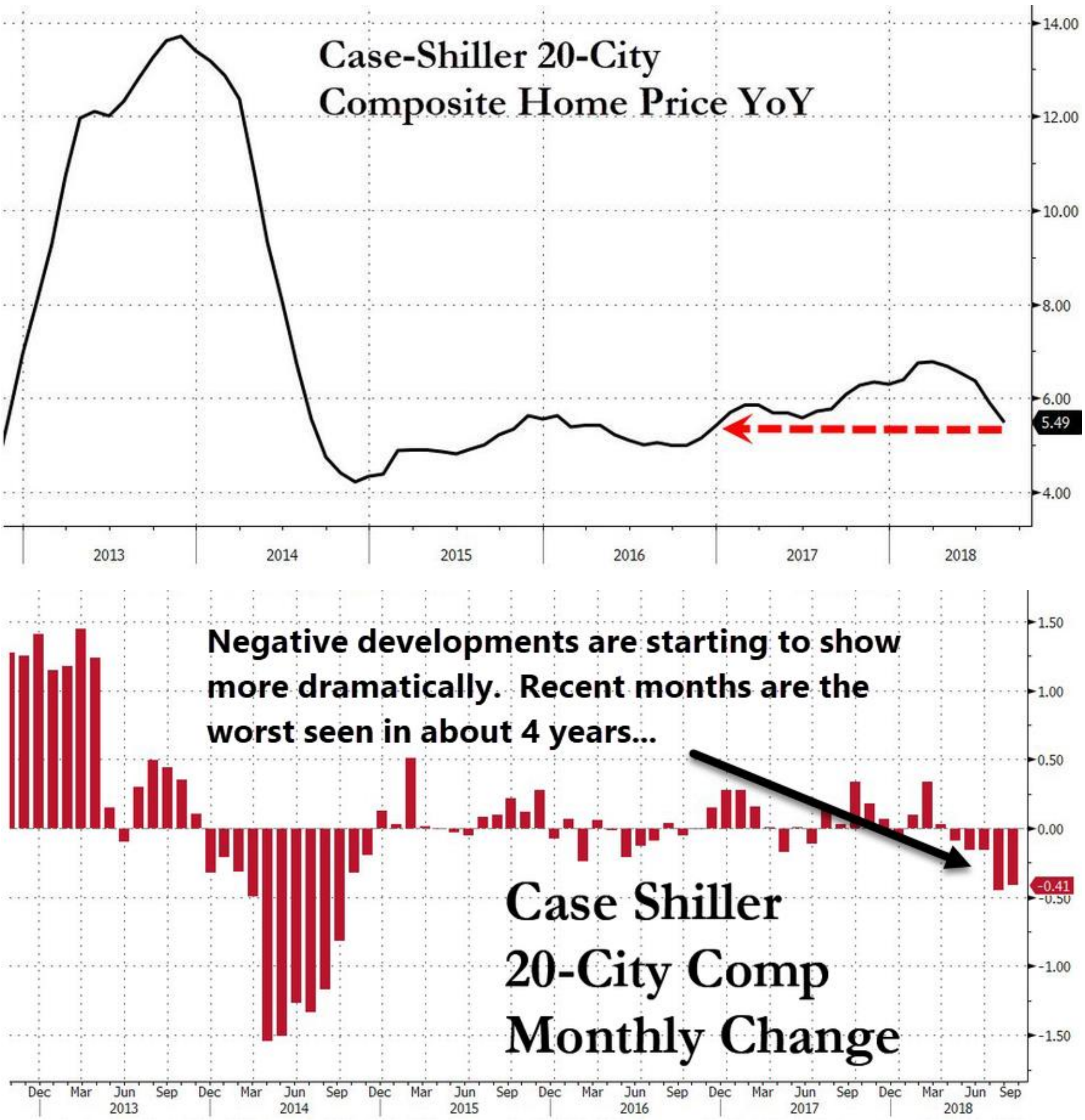

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And now, the graphic that would seem to seal the deal on conditions in this important area becoming worse before they get better!

Politics aside, Trump may have a point that the FED is raising rates too quickly. We already know that, from considering a counter-trend (short squeeze expected that never happened!) trade a few months ago, that home builder stocks have been smoked lower. We know banks stocks have been smoked lower too. This has come as rates have risen, risen, risen. One has to think that this will eventually spill over further and that would seem to be at least part of what the markets have flipped over hard in October.

(If you care to consume even more bearish porridge on the housing front, check out this piece that argues that the next decade will not have much curb appeal: https://econimica.blogspot.com/2018/10/what-is-future-of-new-housing-and-more.html)

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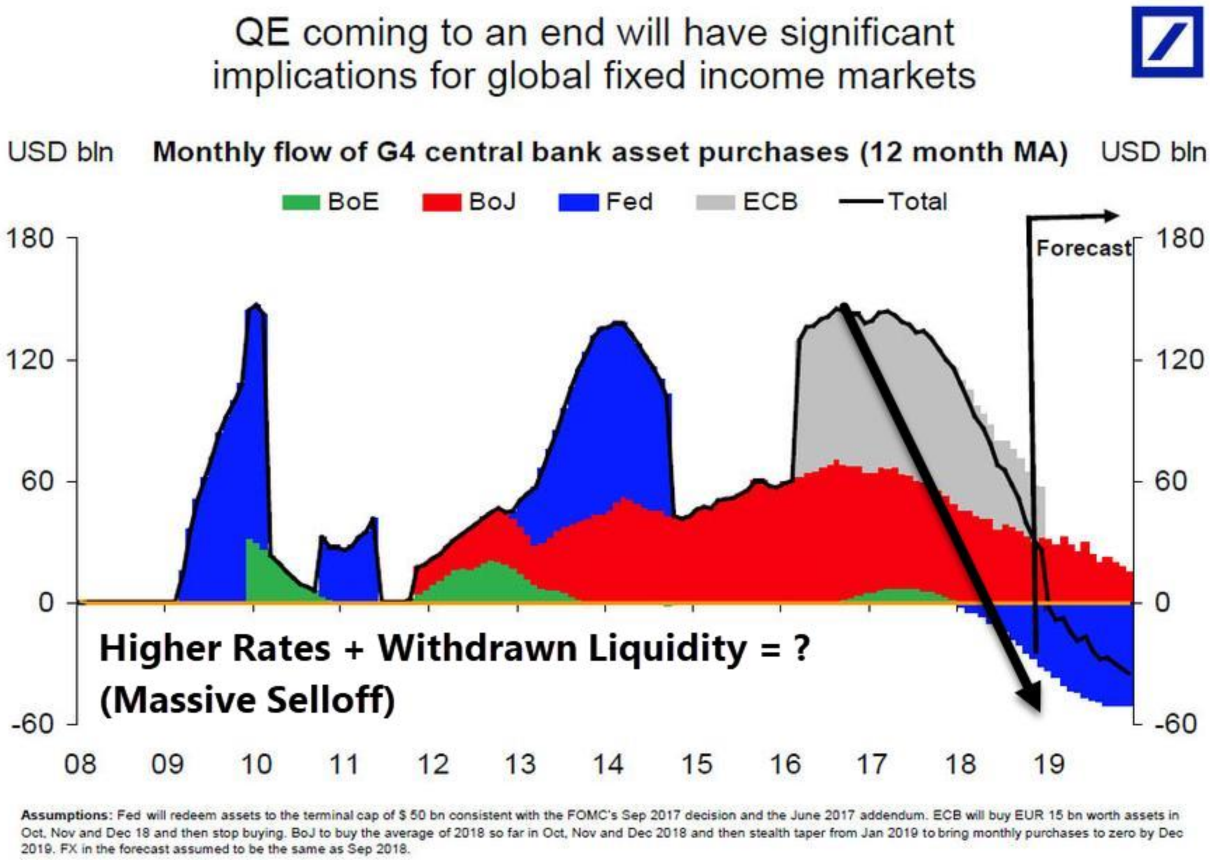
Another question we must ask: Are rising rates coupled with withdrawn central bank liquidity, now and in the future, an even larger issue than we've previously believed? Perhaps… Here's what's going on now and what's in store for 2019, and it's not encouraging when we consider how important central bank manipulation was to this record-long bull market:



As far as equity market bearishness goes, this is the best piece we could dial up over the prior week and the gnashing of teeth comes courtesy of Morgan Stanley via a synopsis from ZH:

https://www.zerohedge.com/news/2018-10-29/extreme-portfolio-pain-ahead-morgan-stanley-expects-cyclical-bear-market-slamming

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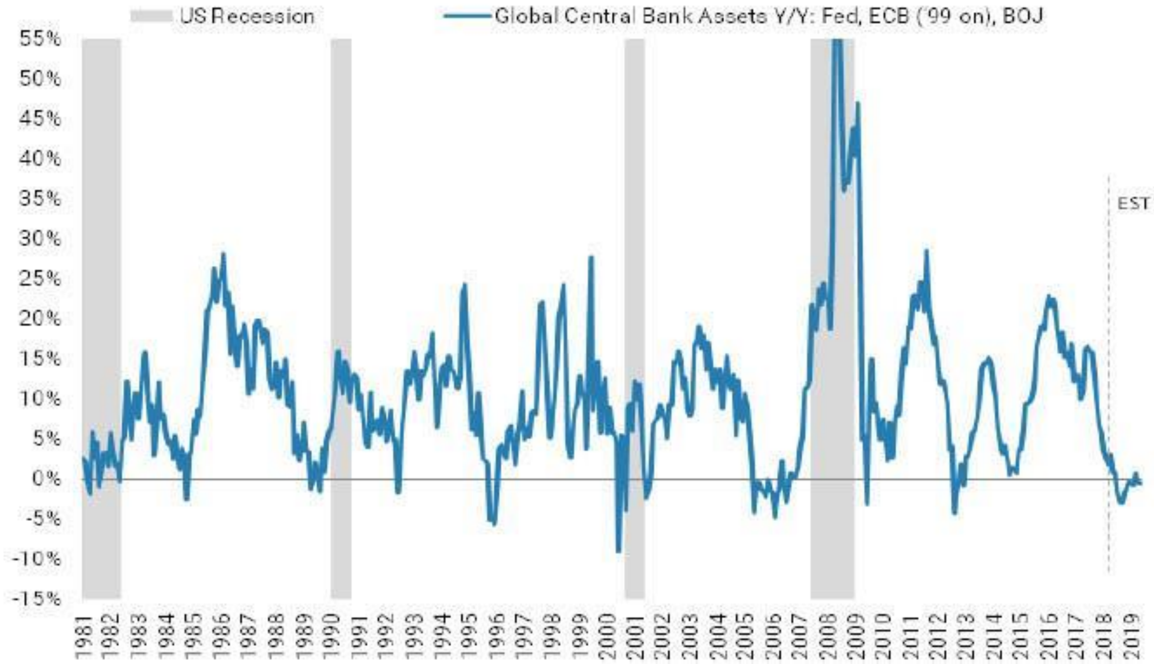
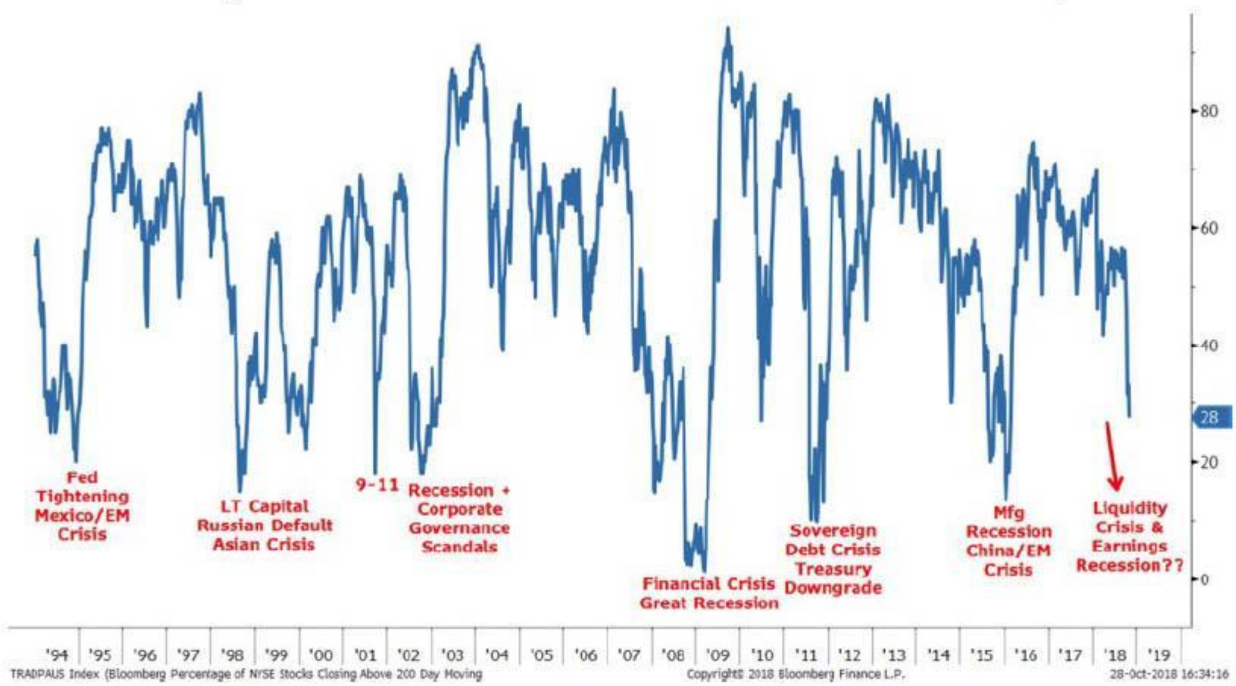
They don’t care for the central banks fleeing the scene:

Exhibit 5: BIG 3 Global Central Bank Balance Sheet Growth is Falling Fast and Should be Negative by January



Or the technicals at all:

Exhibit 4: The Negative Breadth of the Market Confirms the S&P 500's Break of the Uptrend



Source: Bloomberg, Morgan Stanley Research

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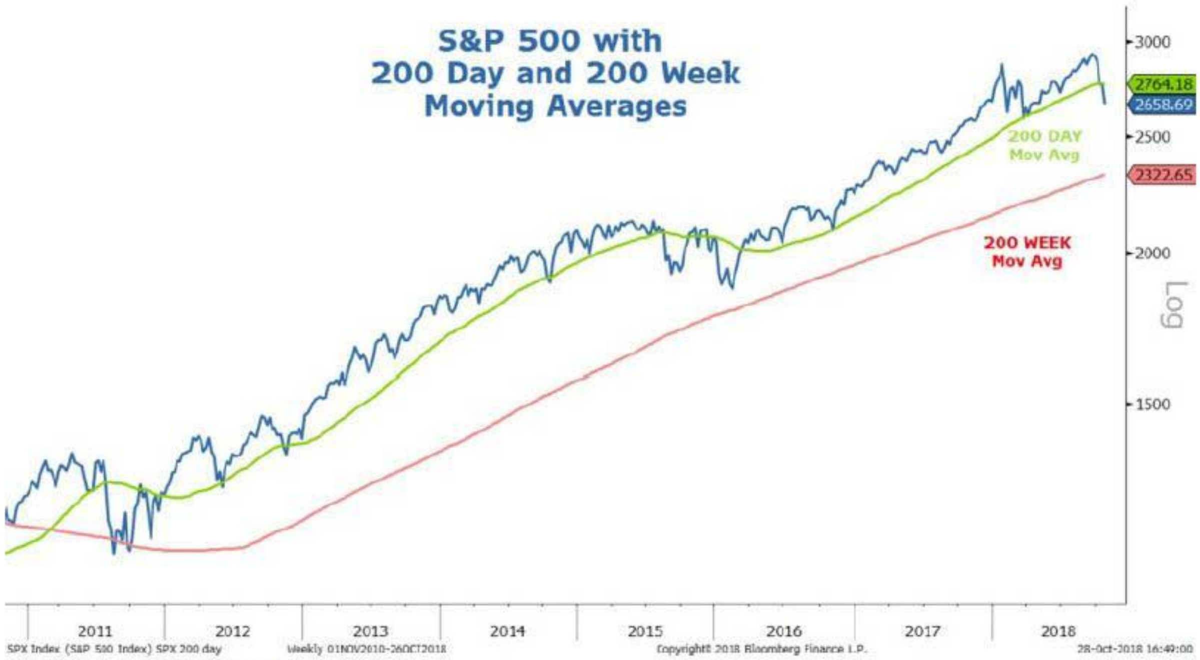
Exhibit 3: S&P 500 Has Definitively Broken It's 200 Day Moving Average-Confirming Our Concerns



Source: Bloomberg, Morgan Stanley Research

As far as the scary stuff goes, here's the last of it for this week. October is on its way out, and maybe so are the bad vibes, well, for at least a little while. (Wouldn't that be nice?) If you care to contemplate October on a deeper level, allow us to suggest this dismal piece from Charles Hugh Smith. He seems to think that the damage isn't nearly complete: http://charleshughsmith.blogspot.com/2018/10/whats-real-meaning-of-stock-market-swoon.html

And now, as promised, here's a little good news in the form of a few graphics that inform us that the "Buyback Game" is about to ramp back up soon and Wow! What timing!

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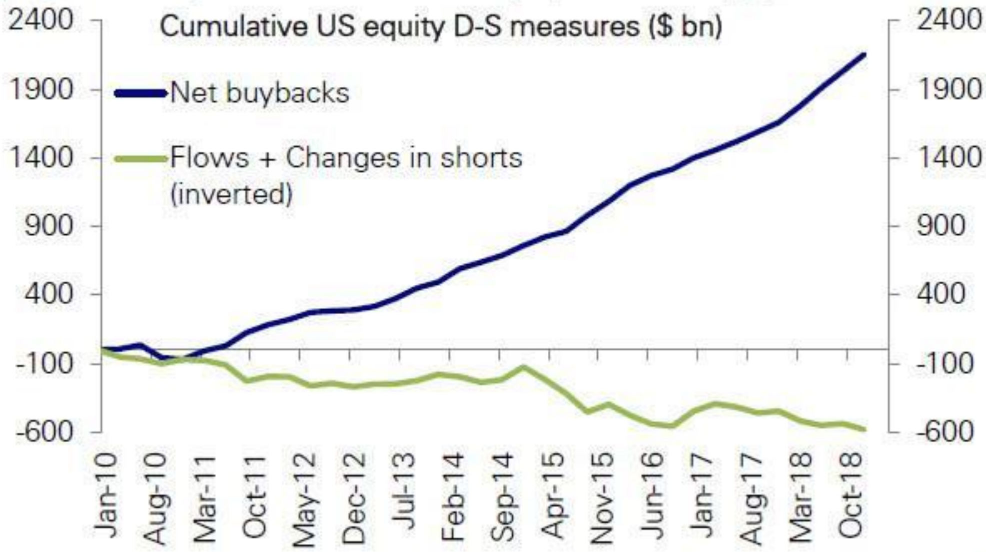
First up, let's recall how important this has been to the bull market sustaining itself. Corporations through stock buybacks have been, by far, the biggest acquirer of shares late cycle:

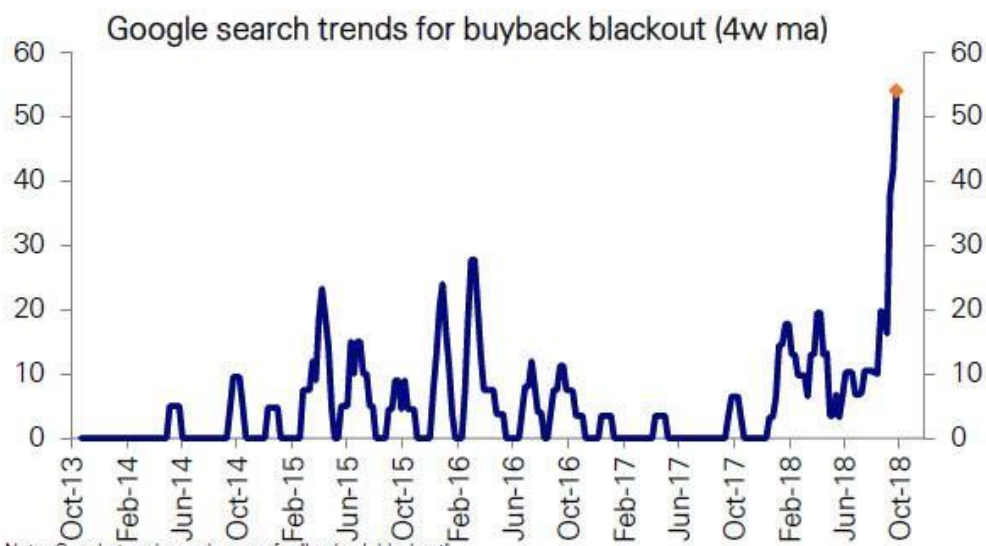
Figure 12: Buybacks main driver of equity demand-supply



Source: EPFR, Haver, Compustat, Deutsche Bank

Many companies were in the so-called "blackout period" in October, and well, we all saw how well that went! So, how important have they become to the fortunes of stocks and those that play them? Players appear to be more concerned about them than ever!:

Figure 10: Google searches for "buyback blackout" surged in October



Note: Google trend search score for "buyback blackout"

Source: Deutsche Bank

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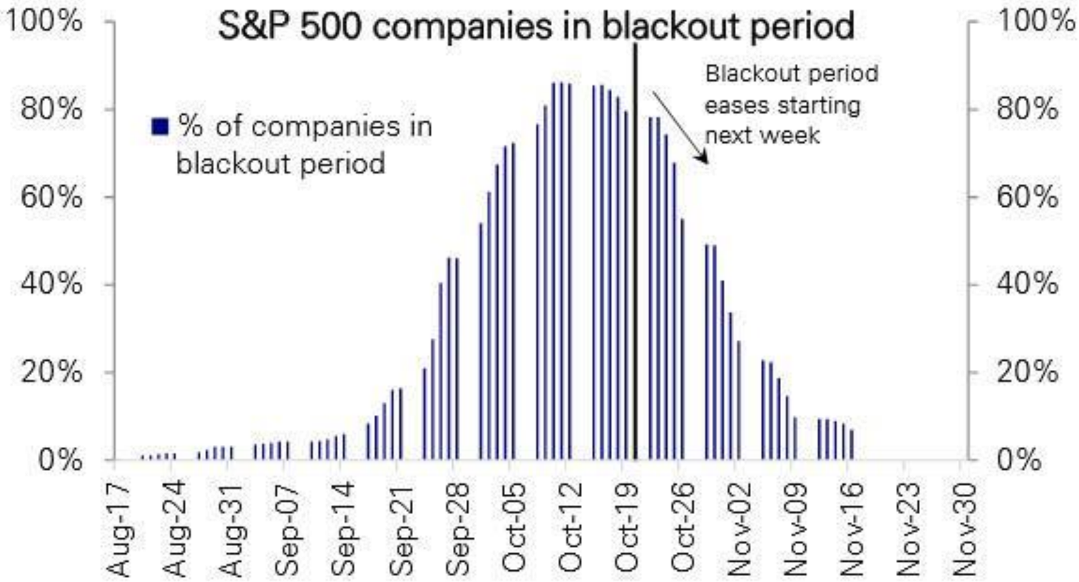
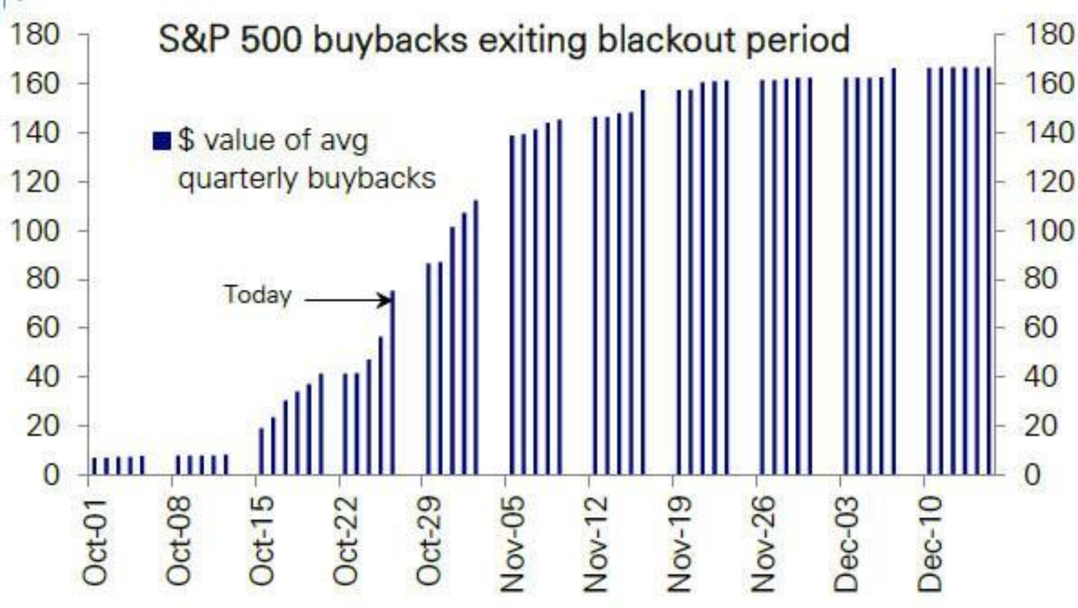
Happily, they are on the verge of roaring back!:

Figure 7:Blackout period starts to ease next week



Source: Deutsche Bank Asset Allocation & Delta-1 Strategy, Factset, Data as of 18-Oct-18

Figure 11: Companies with large buybacks rolling off the blackout period



Source: Factset, Deutsche Bank

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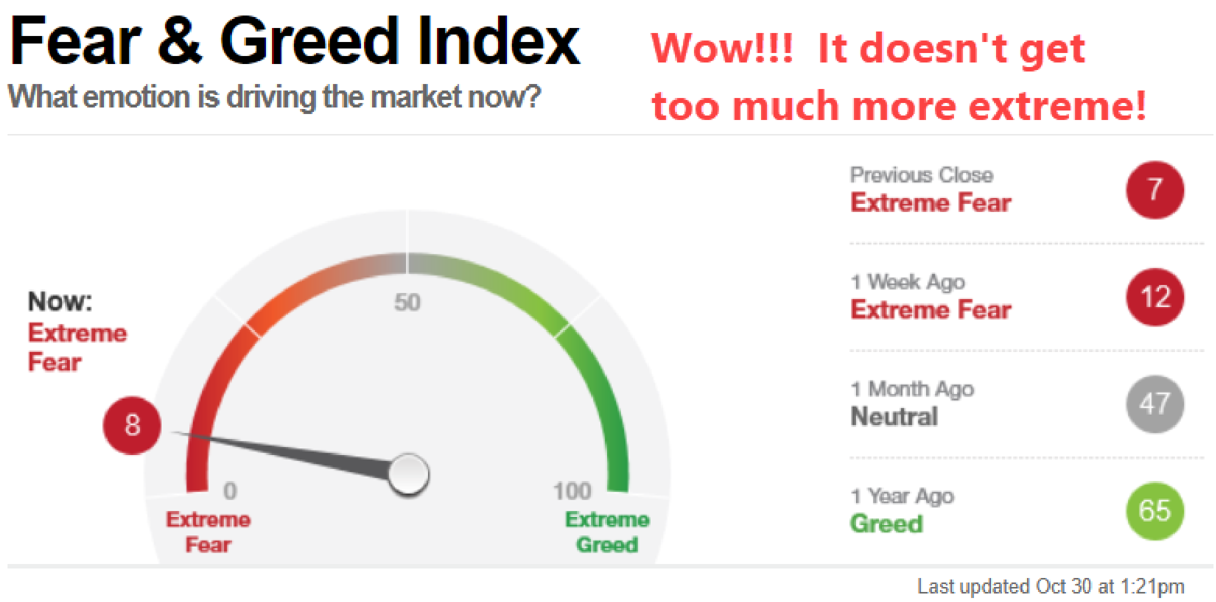
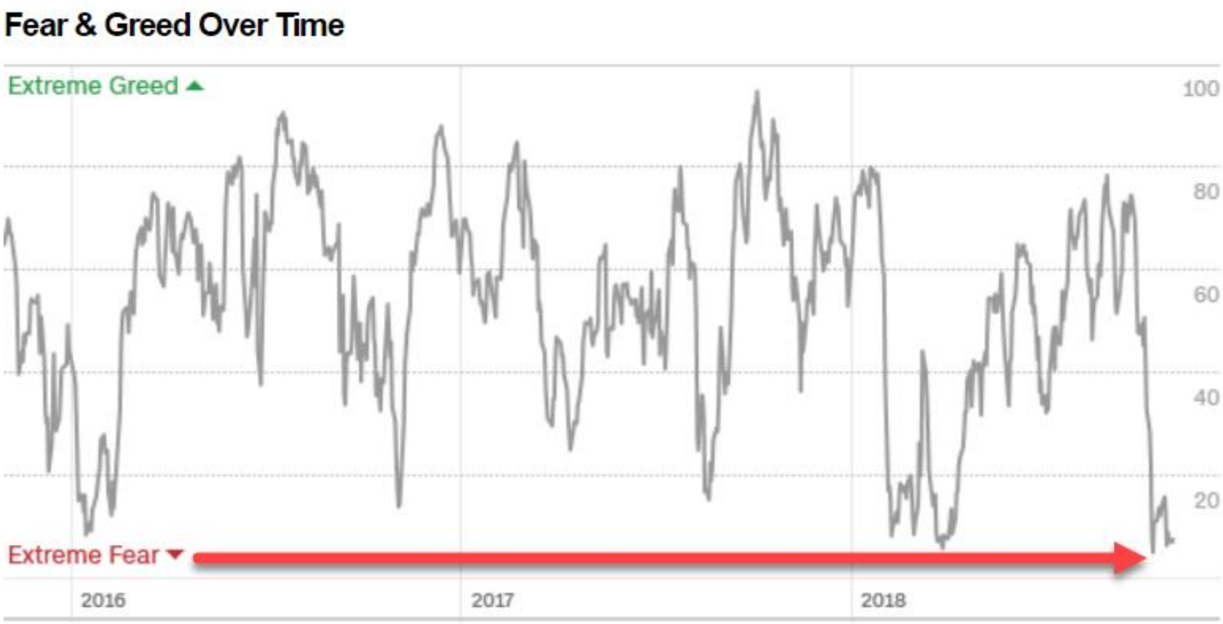
Which is incredibly timely for bulls and for companies that are bullish on their own stocks! They're about to buy with both hands at a great time in terms of oversoldness:





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This is just an aside as we close out this week's **BTR.** We were only recently speculating that even just *wind* of a US-China trade war truce would produce a short squeeze (or more) the likes of which only GOD has ever seen. That didn't happen but it *almost, sorta* did (in China mainly) at the same time. Maybe it was just a prelude:

https://www.zerohedge.com/news/2018-10-30/futures-rally-fizzles-after-trump-china-great-deal-headline-sparks-algo-confusion

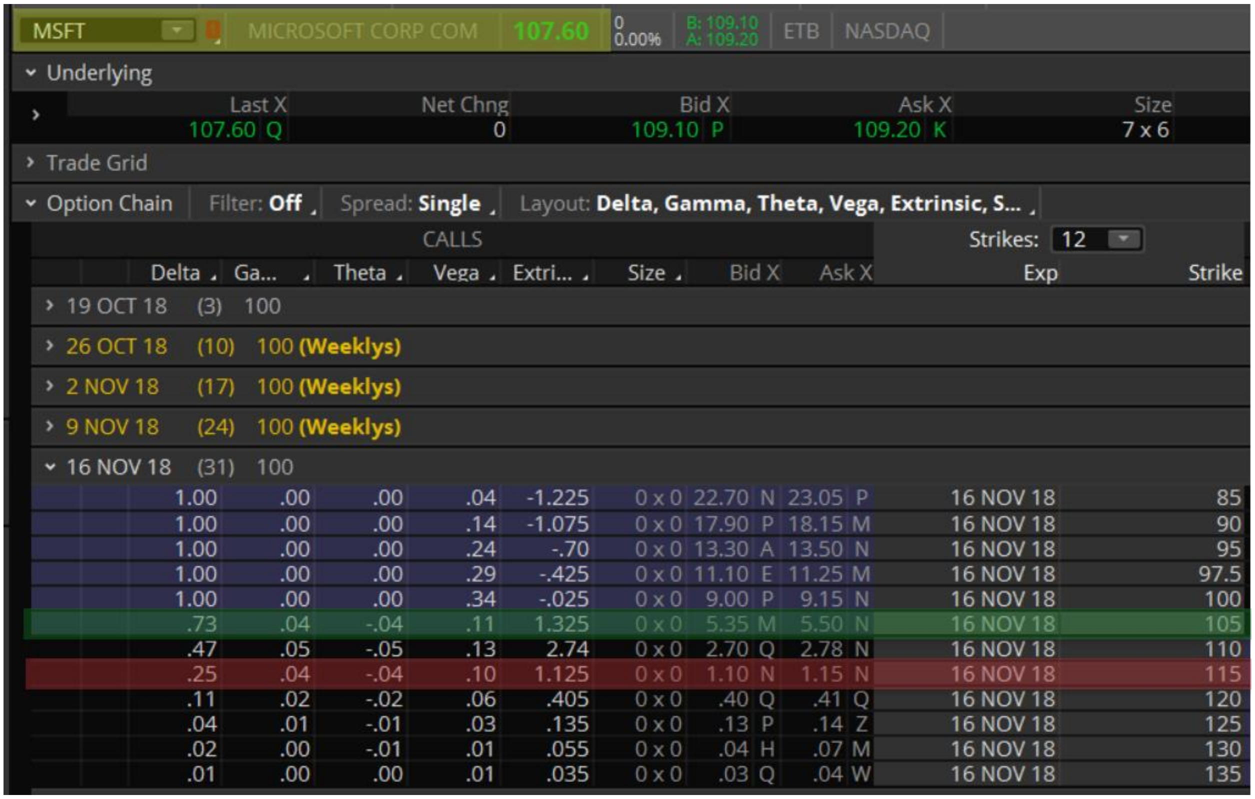
Which serves as a fitting end for us and reminder that, regardless of our directional bias, we must…

Bank and Roll!

Options Academy

We left off last week by noting that the “net Greeks” that we learned how to calculate, were NOT set in stone. We’re picking up right there this week.

Once again, we’ll use the same MSFT options quote page along with the same spread we used last week:



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

And, if you’ll kindly recall, we hypothetically went long the MSFT 105-115 vertical call, for a debit of course, with the stock trading at $107.60.

That left us with these NET GREEKS after having purchased the spread:

.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.

We know that, with the exception of Delta, the other Greeks are the highest when the stock price is at the strike price in focus. We can logically extend from there that if MSFT was at $105.00 currently, the 105 call would have the higher Greeks of the two options in question. We can logically run with this too: If MSFT were at $115.00, the Greeks (with the exception of Delta) would be higher in the 115 call. So, can we generally assume that if the stock price were $110.00, right in the middle of the strike prices in our hypothetical spread, that the Greeks (aside from Delta) would be about the same. Well, we can, sort of…

The “sort of” is due to the components missing from our discussion to this point:

Market Prices and TIME

Once brief run through will crystalize this for us quickly.

Let’s assume that with MSFT “right in the middle at $110.00”, the marketplace shows that the 105 call has $1.00 of extrinsic value left while the 115 call has $1.50 of extrinsic value left, for whatever real-world reasons.

We know that each strike is the same dollar distance away from the current stock price: $5.00

We also know that the same number of days to expiration apply to each option.

We know too that the 115 has $0.50 more extrinsic value than the 105 call.

So, what does that mean to us? It means, if we think about it, that the 115 call is trading at a higher implied volatility than the 105 call because the extrinsic value is clearly higher (IV or Vol. Input is the main determinant in calculating the time value portion of an option’s value.) That means that the 115 call has a higher Vega number meaning that it is more susceptible to changes in implied volatility (supply and demand.) It also means that with both expiring on the same date, the 115 call will have a higher Theta number than the 105 because the 115 must lose more value in the same amount of time as the 105 call.

Time is clearly a significant factor when it comes to option values, but it also significantly influences the Greeks that are derived from option pricing model outputs. It’s for that reason that we have to keep our eyes on our positions as the Greeks are dynamic just as stock prices are dynamic.

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