MACRO INTELLIGENCE REPORT

November 2, 2016

Market Overview: Never Say Never

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Look again at that dot. That's here. That's home. That's us. On it everyone you love, everyone you know, everyone you ever heard of, every human being who ever was, lived out their lives. The aggregate of our joy and suffering, thousands of confident religions, ideologies, and economic doctrines, every hunter and forager, every hero and coward, every creator and destroyer of civilization, every king and peasant, every young couple in love, every mother and father, hopeful child, inventor and explorer, every teacher of morals, every corrupt politician, every "superstar," every "supreme leader," every saint and sinner in the history of our species lived there-on a mote of dust suspended in a sunbeam.

The Earth is a very small stage in a vast cosmic arena. Think of the endless cruelties visited by the inhabitants of one corner of this pixel on the scarcely distinguishable inhabitants of some other corner, how frequent their misunderstandings, how eager they are to kill one another, how fervent their hatreds. Think of the rivers of blood spilled by all those generals and emperors so that, in glory and triumph, they could become the momentary masters of a fraction of a dot.

Our posturings, our imagined self-importance, the delusion that we have some privileged position in the Universe, are challenged by this point of pale light. Our planet is a lonely speck in the great enveloping cosmic dark. In our obscurity, in all this vastness, there is no hint that help will come from elsewhere to save us from ourselves. ~ Carl Sagan

It seems we could use some saving from ourselves. Maybe if we spent a bit more time gazing up at the infinite night sky, pondering the beautiful meaningless of it all, things would be a bit more chipper. But alas… I suppose most are too busy angrily trolling message boards and battling Charmanders on Pokemon Go to waste time with such drivel…

Anyways… Here we are. And if you're not sure where that is, let me fill you in real quick.

The world is in debt. The most debt it's ever been in. International cooperation is breaking down. War and terrorism are on the rise. We have the worst refugee crisis in decades. Oh… and countries are increasingly electing leaders whom are… how do you say… a bit lacking (understatement).

Let's do a quick review for fun.

Philippines: President Duterte compared himself to Hitler in a self-complementary way. Duterte stated that like Hitler, who tried to exterminate the Jews, he's "happy to slaughter" millions of citizens who suffer from addiction. He has called both Obama and the Pope "sons of whores". And commenting on a female Australian missionary who was gang raped and murdered, he quipped that she was hot and it's a shame he couldn't have had the first turn. He recently threatened to sever US-Philippine relations and boot the US military off his soil while also working to ingratiate himself more with China and Russia.

Turkey: President Recep Erdogan has repeatedly accused the US of carrying out secret plots to depose him. He's muzzled the press. He's been on a tear jailing journalists, lawyers, academics, political opponents and the like. He's recently claimed that Turkey has sovereignty over Greece's Aegean islands. His party has begun issuing weapon permits to party loyalists, primarily those most zealous from the Ottoman Youth Authority. He's extended the timeframe for which turks can be imprisoned without access to an attorney and has consolidated complete control over the country's law enforcement. Oh… and Turkey is a NATO member.

Russia: Putin is perhaps the torch bearer for the rise in populist strongman leaders. He's been invading countries and seizing territories in what looks like an attempt to rebuild the old USSR. Meddling in US Presidential elections. Rewriting history and popularizing Joseph Stalin despite the fact the communist leader is responsible for the deaths of millions of his own countrymen. Russian media (which Putin controls) has been broadcasting news specials, alerting citizens to

prepare for possible nuclear war with the US. He recently unveiled the RS-28 (nicknamed Satan), the world's most powerful nuclear warhead capable of wiping out a country the size of France in mere seconds.

China: President Xi Jinping was recently declared the "Core Leader" by the Chinese Communist Party — a term that did not previously exist but carries definite Maoist overtones. He is likely to break with party precedent and delay the selection of his successor; allowing him to further consolidate power and perhaps remain as the permanent leader. He's been fostering the revival of the "neo-Maoists" in China — a militant leftist group reminiscent of past Maoists. He's led China in more aggressively asserting its military might in the South China Sea. And he's looking to expand China's influence through its ambitious one belt one road (OBOR) policy.

Troubling? Sure. We didn't even mention the leaders of Syria, Iran, Egypt, North Korea and Pakistan and I can go on and on… But the *really* concerning part here is not so much the reign of dangerous leaders in these areas that have a history of the type… but more so the increasing failure of leadership in the west to act as a counterbalance.

It's the rise of populism in Europe and the US that is most troublesome; the fracturing of long standing political unions that, although flawed, were predicated on the highest of ideals.

Just look at the US. The "shining city upon a hill", the leader of democracy in the free world, is left choosing between two of the most undesirable presidential candidates in US political history.

Of the two major candidates running for president, one, a former reality TV star, has been accused of collaborating with the Russian president and his intelligence service. Has openly praised the character and leadership of Putin. Has broken from over 30 years of election tradition by not releasing his tax records (only God knows why). Has taunted the parents of a gold star family, mocked a disabled reporter, and threatened the very foundations of our democracy by not committing to honoring the election results should he lose.

On the other side, we have a candidate who is part of one of the most powerful and opaque political dynasties in the US. Whom, for reasons only her and her inner-clique may ever know, used a private server to send and receive classified messages. Speaking as someone who spent over a decade handling classified information I can say that this is not okay. It's not something you just do on a whim without much thought. It's a complicated and risky endeavor and you only do it if you really don't want the public to see what you said. Then of course, there's the foundation she ran with her husband that facilitated what looks like a lucrative pay-to-play scheme. And finally, the most recent Clinton emails were found on the computer of a man who

goes by the nickname “Carlos Danger”, and who was being investigated for sexting a 15yr old girl all while he was the husband of the candidate’s top aid!

It’s doesn’t matter who wins because America has already lost. Both candidates are one and the same; empty megalomaniac suits who will say and do anything to sit in the throne. They’re basically Gollum from The Lord Of The Rings or Stannis Baratheon from Game of Thrones.

And all this leads me to think… with the rise of dangerous populist and authoritarian leaders around the world, should government bonds — the asset that these “leaders” directly or indirectly control the supply of — be priced, as they are now, for perfection?

The Global Bond Bubble

Asset prices are set by the market’s imperfect efforts at discounting the future.

This discounting is driven by a mix of the market’s interpretation of underlying fundamentals and the momentum behind the asset price itself.

The discounting of fundamentals remains fairly steady. Assumptions swing from overly optimistic to overly pessimistic around a point that is close to fair value.

Momentum is the more interesting factor. It’s when the trend, rate of change, and duration of the asset’s price action drives the discounting assumptions embedded within it. This forms a self-fulfilling cycle. Think Newton’s 1st law: prices in motion stay in motion and prices at rest stay at rest unless acted upon by an unbalanced force.

Fascinating things happen when momentum becomes so powerful that it dominates the discounting of fundamentals. Market participants start adjusting their fundamental analysis based off the trend, rate of change, and duration of recent price action. Current prices begin to set future prices. Recency bias; the extrapolation of the past into the future, drives market imbalances. The stronger the momentum, the larger the imbalance.

Think of momentum as using your rear view mirror while driving. It’s smart to occasionally glance at what’s behind you, but if you’re only looking backwards while speeding on the highway... you’re going to run into problems.

Hedge fund manager Howard Mark’s put it this way.

> *Everyone knows that if you reach into a bag containing both black and white balls and pull out ten white ones in a row, the probability has increased that the next one will be black. But in the investment world, events like that serve to convince people that there are only white balls - favorable outcomes - in the bag. That's part of the illogical, emotional thinking that makes for bull markets and bubbles.*

To tell whether the market is driving while looking backwards or is convinced that only white balls exist, we need to look for areas of consensus.

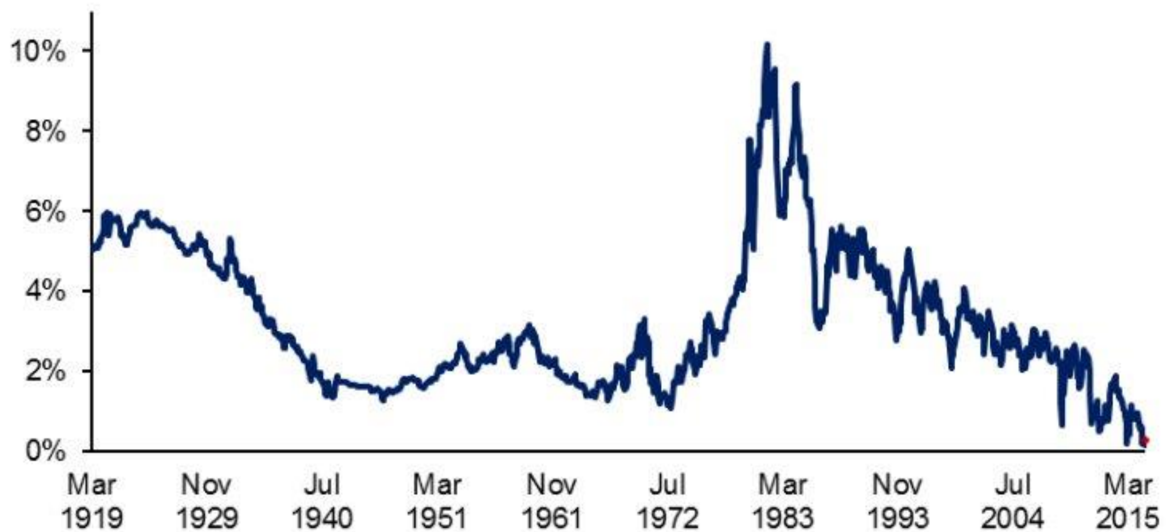
When the market is in agreement on something it's more often than not wrong. So... as Mark Twain said, "whenever you find yourself on the side of the majority, it is time to pause and reflect." Twain — a natural contrarian — would have made a good trader.

We want to identify a consensus that the market is no longer confirming, instances where if the consensus proves wrong, a *LOT* of people will lose money.

Looking around the world, there's one very obvious consensus point. It's the whole lower for longer theme. The belief that we're in a "new normal"; rates will *NEVER* rise and high inflation will *NEVER* appear; we're in an environment of permanently low rates that will stay the same for years or even decades.

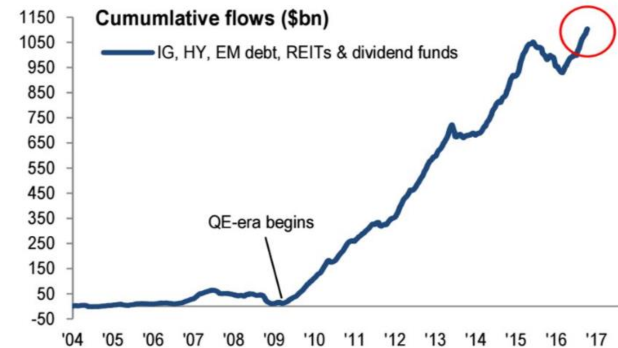
We've been hearing this from practically everybody. Where did this "new normal" consensus come from?

The chart below shows where:



Momentum.

Over 30 years of momentum and 7 years of hanging around zero have combined to create our current narrative. The momentum is driving the fundamental analysis. Price is setting price. Since we haven't had inflation in so long, we're unlikely to have it again. All balls are white.



Everybody has been focused on trying to figure out whether there's a bubble in stocks. But the real mispricing is in bonds. The reach for yield (or dash for trash) this cycle has been nothing short of extraordinary.

Government bonds typically serve as a safe haven. A place for investors to scurry to in the event of a financial storm. But when yields are so low (near zero to negative), bonds take on a risk profile closer to that of selling far out-of-the-money naked options.

An investor selling these options is taking a position that has a high probability of paying out a small sum, but also a small possibility of kicking his teeth in with a huge loss.

Since there is a limit to how negative bond yields can go, buying low yielding government bonds is a small return/ high risk investment. This is why famed investor Ray Dalio recently said "rarely do we investors get a market that we know is overvalued and that approaches such clearly defined limits as the bond market now."

This risk increases with duration. Duration is the measure of a bond's sensitivity to changes in interest rates. The longer the maturity of the bond, the more it's affected by small movements in rates. Buying ultra-long duration bonds, like many of the 50, 70, and even 100-year durations that have been issued as of late, offer investors a laughably high-risk/low-return profile. Investors think what they're buying is safe and prudent… because government bonds have been safe and prudent their entire lives. But the folly of this logic is starting to become apparent to some.

Belgium issued a centennial (100-year) bond this last April. An investor with a $1 million stake in these bonds, Bloomberg reported, would lose more than $6,000 for each basis point (0.01 percentage point) increase in rates. For this "opportunity", investors accepted a nominal rate of just 2.3% a year until the year 2116. That's called an "eat like a bird, poop like an elephant" trade.

And governments have been more than happy to feed the birds. The number of government bonds with duration risk greater than a decade has risen by the *most on record* so far this year.

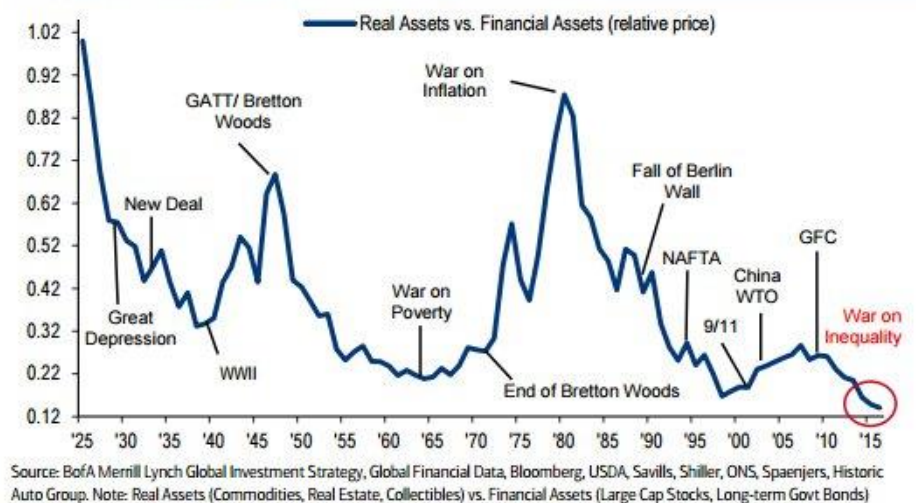
Government debt due in over a decade has more than doubled since 09'. It now stands at $6 trillion. That's a lot of money with a lot of duration risk.

The consensus around the "lower for longer" narrative is obviously a strong one. This means that a return to an inflationary environment and a rise in rates would inflict painful losses on a whole swath of investors.

Looking at the world it's not difficult for your author to imagine the return of inflation… even run-away inflation. As the long-term debt cycle continues to turn, populist sentiment will increase. This sentiment will put more and more populist leaders into office who will then enact populist measures.

We're entering a period where the "Have-Nots" will finally have their way. Historically this results in a marked rise in government spending, transferring of wealth, and the printing of money.

In the near future it's going to be wise to diversify your wealth into harder assets. Real assets relative to financial assets are at all-time lows.



It's likely that we'll experience a deflationary shock before inflationary policies are ramped up in full. But this thesis is subject to the outcome of the elections here in the US and abroad. There are simply too many variables, with the odds too close, to make a worthwhile guess of where the dice will land. We'll have to play things as they unfold.

It's key to remember that market tops — like the one we believe we're experiencing in the global government bond market — are processes and not events. The process will play out over the coming year with a lot of movement in both directions.

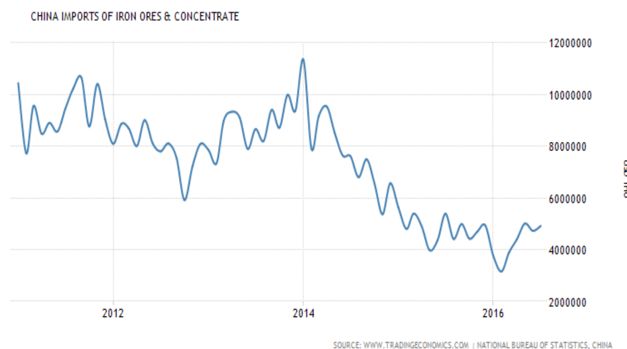
Those who've been saying "never" to rate increases are in for a ride. There's going to be a lot of elephant dung.

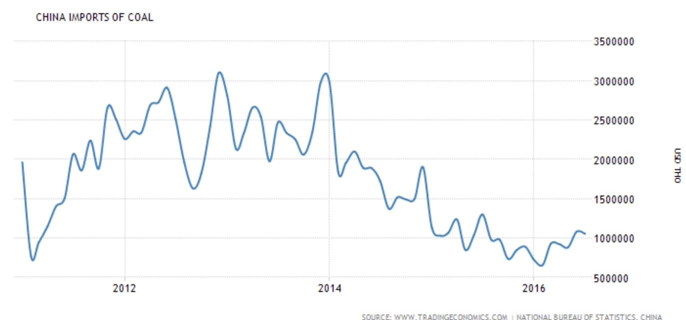
Around The World

Australia: Temporary Relief

In last month's MIR we discussed how the slowdown in imports around the world has been a large burden on major exporters like Germany.

Another country affected by this slowdown is Australia, which is highly dependent on the export of a few key commodities. Iron ore and coal in particular are their biggest money makers, with iron ore making up 20% of all exports in 2015 and coal 15%. The main consumer of these commodities is China. But with China's slowdown, the country's consumption of both iron ore and coal has dropped.



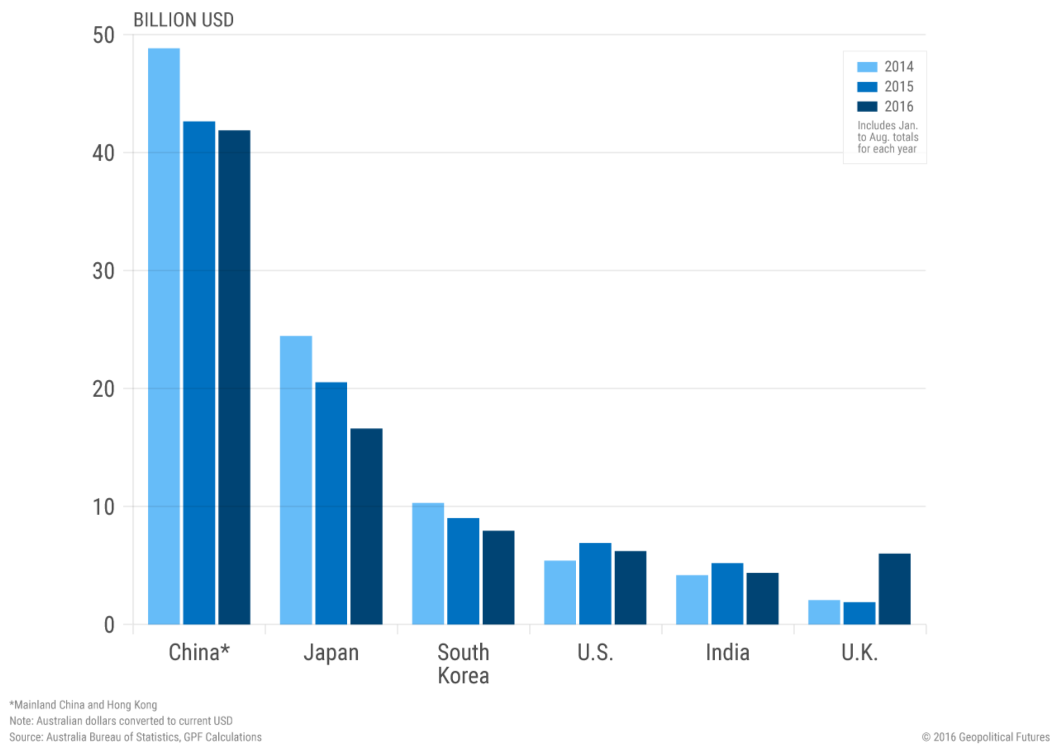


This slowdown *should* spell trouble for Australia's economy, but in 2016, it looks like the country has been able to remain strong.

Moody's recently issued a report ranking Australia as the fastest growing AAA commodity exporter, also stating that the country's GDP should grow between 2.5 and 3 percent over the next two years.

There's a few reasons for Australia's current strength; both are temporary. The long-term trajectory remains lower for the country.

First, like other global exporters, Australia has begun to rely on the western world to make up for the slowdown in China.



From the chart above you can see that exports to the eastern world (China, Japan, South Korea) have steadily decreased while demand from the US has steadied and the UK has vastly increased. Australia offset a large amount of its losses this year by increasing exports to the UK by an impressive 217%. In 2015, the UK was the 11th largest importer of Australian products… now it's the 5th, right behind the US.

But this is temporary. Australia can't expect UK demand growth to continue supporting shortfalls elsewhere. The same can be said of Australia's reliance on the steadiness of the US which has a high probability of slipping into recession over the next year. The western stop gap will eventually run its course and force Australia to deal with the consequences from the Chinese slowdown.

The second reason for Australia's temporary strength is the current resource binge in China. As we explained in a recent Market Brief:

> *China's been hitting the gas on its resource binge. It's buying up and storing astronomical amounts of commodities. There are some reports of large coal shipments coming in, only to be bulldozed right into the harbor; presumably because storage everywhere else is full.*
>
> *The artificial demand they've created has reversed Chinese pricing for commodities, [with steel] leading the charge. This Chinese buying could also be one of the reasons for recent strength in emerging markets and oil.*
>
> *The Chinese may be doing this as a way to diversify their holdings into hard assets. It could also be a strategic move. The Chinese might be concerned about future international conflict and want to store up essential resources in case their Pacific supply line gets cut. There's no way to know for sure, but it's interesting to postulate nonetheless.*

Chinese coal imports have risen 7.5% in May and another 13.1% in June because of this massive spending initiative.

And while they've been beefing up their coal imports, China has also been working to fix overcapacity in its domestic market. The goal is to cut production by 500 million metric tons in the next 3 to 5 years, along with shuttering over a 1000 coal mines this year.

You can see the temporary recovery of Australian equities (EWA) in 2016 below. We can expect prices to turn lower once again and rejoin their long-term downward trend as soon as the Chinese resource binge runs its course. A break of the current trendline at $19.90 should provide a good shorting opportunity.

We're also looking to go short the Australian dollar against the US dollar. We expect the currency to keep depreciating against the USD over the long-term; though depending on election outcomes, we could see a short-term reversal.

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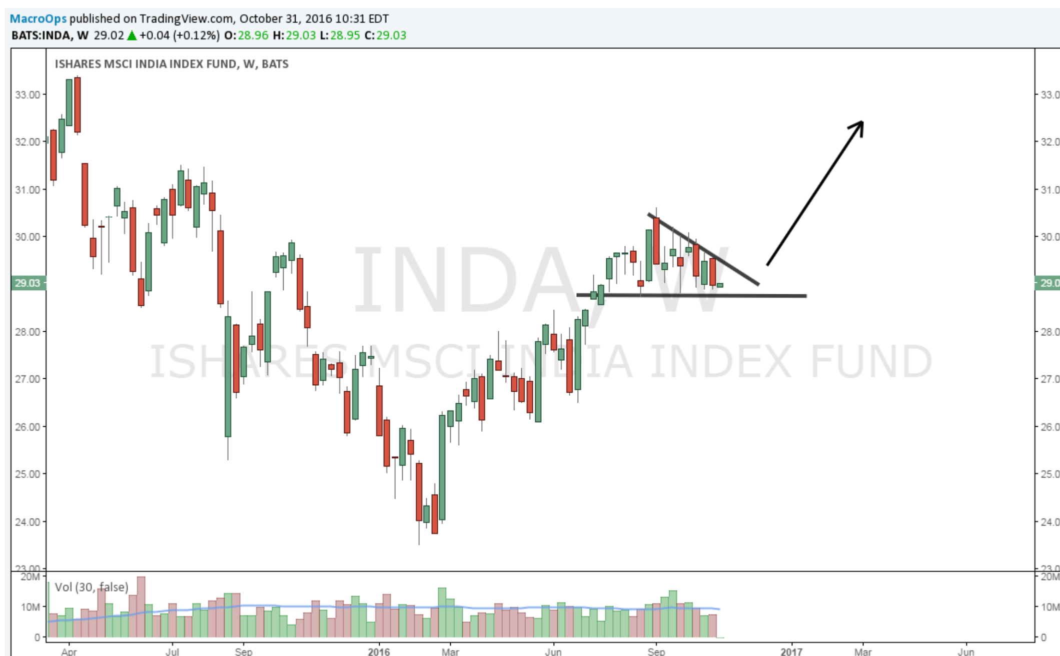
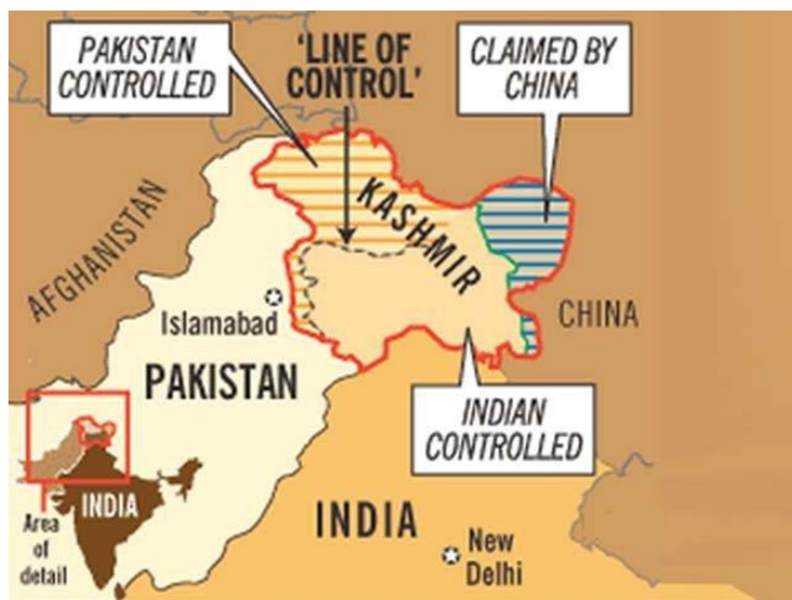
India: Kashmir Conflict Heating Up

We're bullish on India over the long-term. Strong demographics and GDP growth along with solid leadership from Prime Minister Narendra Modi make it a great a place for investment over the next decade. We're currently looking for an entry into Indian equities (INDA) to the longside. A break of the $29.20 level may provide a buying opportunity.



But even though we're long-term bullish, we still need to track developments that may affect this thesis in the short-term. One of those developments is the escalation of the conflict in Kashmir.

Kashmir has been a contested region between India and Pakistan since the creation of their two countries in 1947. Since then, four wars over the territory have taken place between the two states.



The latest flare up in the conflict was over the death of 22-year-old Burhan Wani, a commander of one of Pakistan's sponsored militant proxy groups in Kashmir. Wani was extremely popular and the local outrage over his death at the hands of Indian security forces

resulted in multiple retaliatory attacks by Pakistan-backed groups. India has responded in kind, carrying out surgical strikes across the LoC (Pakistan's Line of Control in Kashmir which you can see in the map above). This is a significant escalation in force for India, which has not countered a militant attack for over a decade.

Neither country wants a war with the other.

Pakistan is much weaker in terms of size, economy, and military strength. And its solution to this power-differential has been to use militant proxy groups to stir unrest in Kashmir. But an actual war with India would result in a devastating loss and a huge embarrassment for the country. They can't afford that, but at the same time don't want to appear weak.

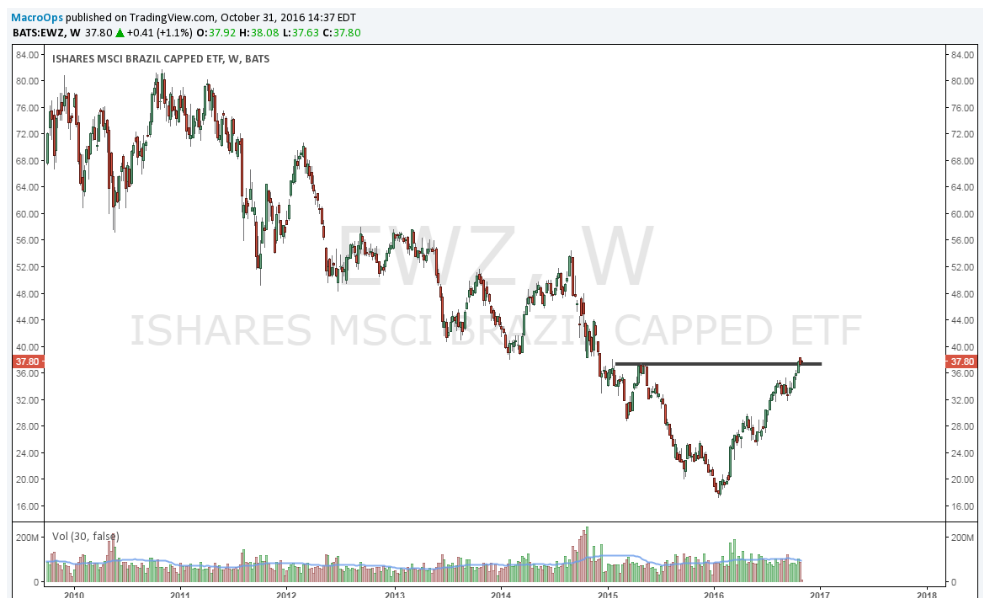
Recently these proxy groups have become difficult to control. This has been especially true after the death of Burhan Wani and has left Pakistan on a difficult geopolitical tightrope; not wanting war, but needing to appease the extremist flames it long ago sparked.

India is conflicted as well. On the one hand, Pakistan's attacks have been too serious to ignore. And Modi's strong response has earned him huge political points domestically. But he is also afraid of escalating a tit-for-tat exchange that spirals out of control (both are nuclear powers). Not to mention the effect it would have on his economic initiatives including the potential to curb foreign investment.

What happens next, if anything, is anyone's guess. One thing that's for sure though is that India is becoming a more assertive power on the global stage.

Brazil: Long-Term Recovery In The Works

If you take a look at the price chart of Brazilian equities (EWZ) you can clearly see that a bottom is in place. We're currently looking for an entry into the index now that price has broken the $37.30 level.



There's a lot of evidence from Brazilian-based businesses that the country's outlook is turning around.

Bemis Manufacturing, for example, is a private global plastic products maker that recently announced it would double its Brazilian investments in 2017 to update machinery and expand capacity. And India's United Phosphorus Limited revealed it would invest 1 billion reais to construct a new plant, which is a much larger investment than the 200 million reais they were considering a year ago. Both these anecdotes show signs of increased confidence in the Brazilian economy.

Brazilian IPO's have also picked up. The country's last IPO was in June 2015, but since July 2016 three new Brazilian companies have filed for IPO's including software company Linx, utility company Energiza, and travel operator CVC. So far investor demand for those IPO shares have far exceeded the quantity offered — a good sign. There are also reports that numerous other companies are planning to go public in the first half of 2017. IPO's only occur when business owners see return potential over the horizon. A recovering economy is key for that to happen.

M&A activity has increased too, with the 3rd quarter showing a total of $98.9 billion raised for mergers, acquisitions, venture capital, and private equity. This is a 109% increase from the same quarter last year. $49.2 billion of this amount also came straight from foreign companies.

A big reason for this increase in business confidence and the recovery in the equity market is due to new Brazilian President Michel Temer's economic reforms. Though these reforms will take a while to have a real effect on the economy, the fact that they're progressing is enough for investors.

One of Temer's major reforms is a much needed limit on government expenditures. His party is currently in the process of promoting a constitutional amendment that will cap government spending for 20 years. The annual increase in the budget would be determined by the previous year's inflation rate. This would control the country's debt levels and keep inflation in check which is welcome change from what past administrations have allowed.

The next set of reforms have to do with Brazil's giant oil industry. There's a few things Temer is pushing for here including:

- Changing the requirement that Petrobras (Brazil's largest partially state-owned oil company) must hold a 30% stake in every oil block in Brazil
- Loosening local content laws (rules specifying that machinery and tools in the oil industry must contain a certain amount of domestically produced material)
- Equalizing domestic fuel prices with the international market

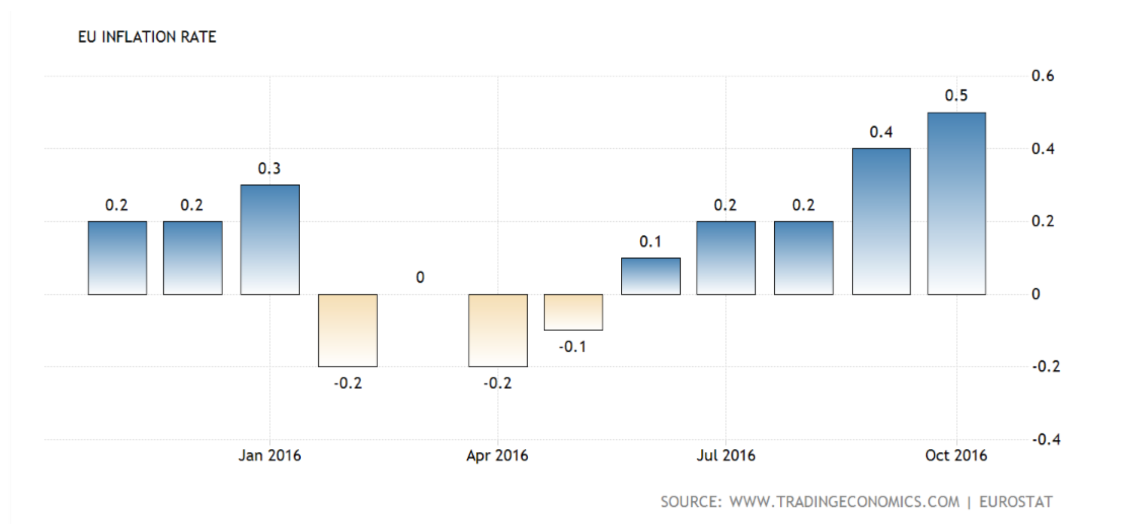
All these reforms are aimed at liberalizing the Brazilian oil market and attracting more foreign direct investment.

Temer's other key reform involves restructuring government infrastructure concessions (contracts). This involves cutting red tape and clearing the system of inefficiencies. This will result in greater market competition and reduced public costs — both big pluses for foreign investors.

Eurozone: Not As Bad As You Think

The macro data coming out of the Eurozone has been better than expected. GDP in the 3rd quarter grew 0.3%, the same rate of growth as the 2nd quarter, which came as a relief to Eurozone leaders who were pulling their hair out trying to understand what a Brexit meant for the economy. There were also concerns over the pound's devaluation and the negative effect it could have on Eurozone exports going to the UK. Considering these factors, a 0.3% growth rate was a blessing.

Inflation in the Eurozone also jumped to its highest levels since June 2014. The consumer price index rose 0.5% in October, an increase from 0.4% in September, in a continued trend higher from the beginning of the year.



The Economic Sentiment Indicator produced by the European Commision also increased to 106.3, the highest level since December 2015. The survey is made up of data from sectors including manufacturing, services, retail and construction, as well as consumer feedback.

And finally October's PMI rose to 53.7, up from 52.6 in September, signaling further economic expansion.

On top of all the positive economic data, Mario Draghi has been mum on further easing. Draghi, as we all know, is usually very vocal in an effort to provide support for the markets. This is why his recent activity, or lack thereof, has drummed up rumours that the ECB has turned neutral on liquidity or may be even plan on tightening in the near future.

Long-term we remain bearish on the Eurozone. There are severe structural problems that will ensure this Frankenstein-esque bloc eventually craters. But in the meantime, we can expect short-term reprieves. Investors have a chance to go long here to profit off a shorter-term bull run when overly bearish sentiment turns around.

The vehicle we're considering getting long is Deutsche Bank (DB), possibly on a break above the $15.23 level. This is a short-term play that can provide some real profits considering the overly-negative sentiment backing it.

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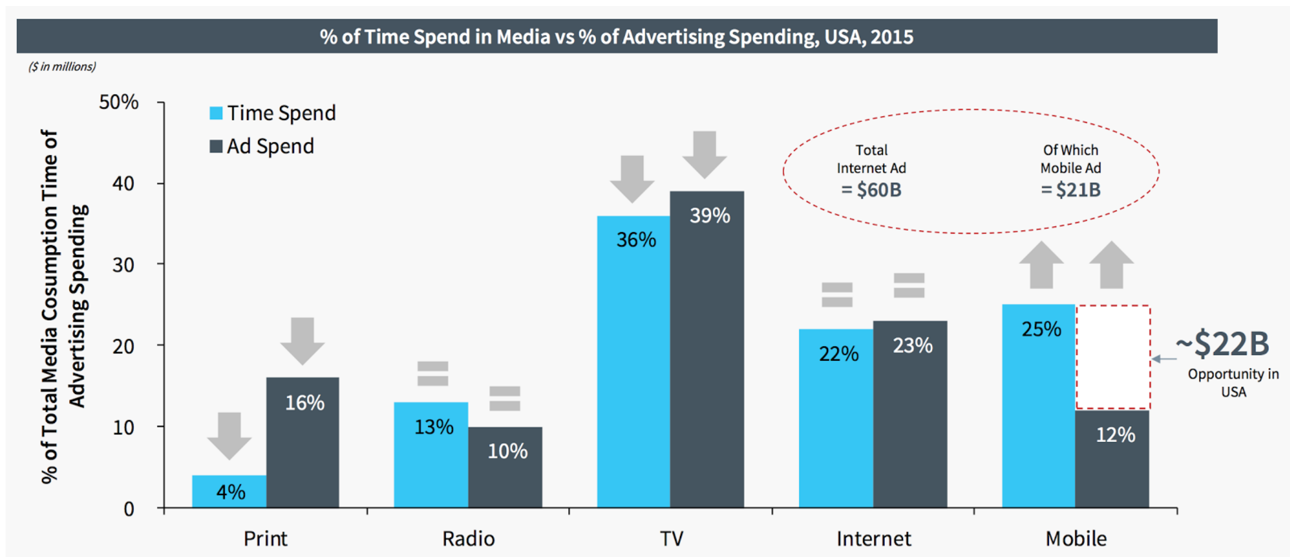
Deep Dive: SITO

Over half-a-trillion is spent annually on global advertising. That's a big number and it's growing every year.

Internet advertising is the primary driver. Spending on digital advertising is growing 3 times faster than total ad spending and is expected to grow in the double digits each year into the foreseeable future. In fact, digital advertising is expected to overtake television (the dominant advert media) next year.

A large majority of the growth in digital advertising is concentrated in mobile. ZenthOptimedia forecasts that mobile advertising expenditure will grow by 128%, an increase of $64 billion, over the next three years. That accounts for 92% of total new global advertising dollars spent over this time period.



To drill down even further and Russian doll this exciting growth opportunity… according to a recent IAB UK study, 66% of marketers believe that location-based advertising is the 'most exciting' opportunity in the space.

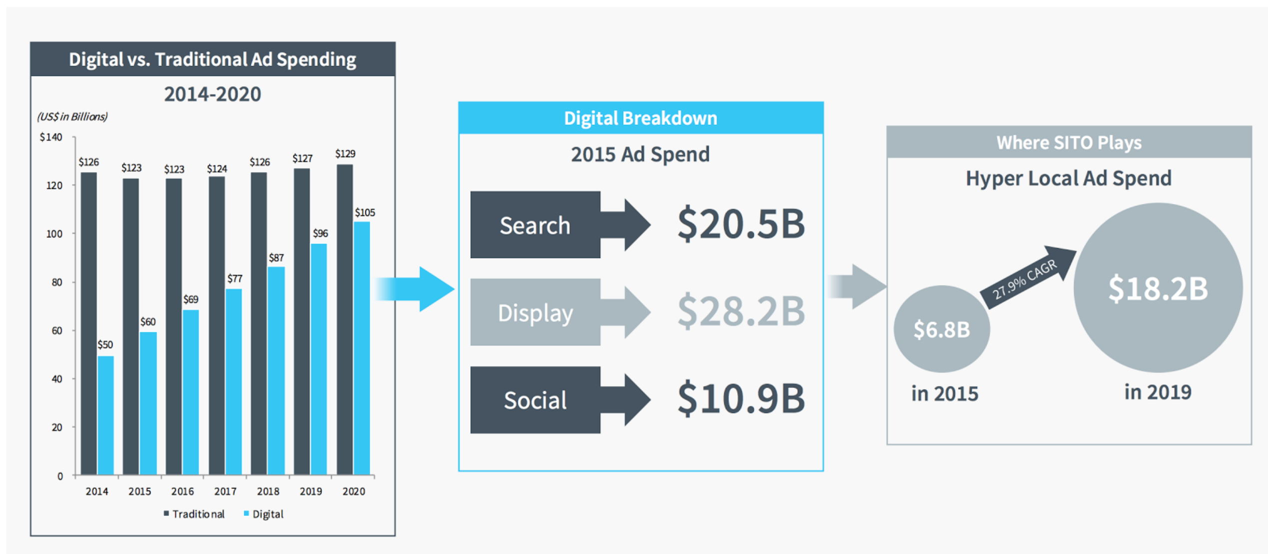
Location-based advertising is a fairly new technology that allows advertises to personalize and target their messages based on consumers' online data and location… all in real-time.

This new segment has emerged because most of us carry around a mobile device wherever we go. And we happily share our location and personal data with the various apps we use — a trend that will only increase as wearable tech matures and becomes commonplace.

Currently this location tech is being pushed by just a small handful of upstarts; the majority of them private companies.

But luckily for us, one of them is publicly traded on the Nasdaq exchange, and it happens to be the most promising leader of the bunch.

Enter stage right… Sito Mobile (SITO).



SITO is a company that has undergone quite the transition over the last two years — a complete rebirth if you will.

Originally it was listed as an OTC going by the name Hosting Site Network in 2002. The company then changed its name to Single Touch Systems in 2008. Prior to the middle of last year, it received over 90% of its revenues from a single advertising client, Walmart. Its sole product was a text messaging/notification mobile service that alerted customers to current Walmart deals and offerings. The company was unprofitable and burned through over $100 million since inception — not exactly a stock worth writing home about.

But in 2015 things began to change after the new CEO Jerry Hug took over.

The company began acquiring a patent portfolio centered around video streaming, changed its name to its current moniker, and through strategic acquisitions, pivoted its business to the new and exciting space of location-based advertising.

SITO now describes itself as a "mobile location-based platform that is focused on connecting advertisers with the 'heads down consumer' at the optimal time and place, driving them to take action."

It accomplishes this specific targeting through a number of methods:

- Geo-fencing: Sends targeted ads, coupons and promotions through 3rd party apps when the customer is within a designated GPS location (geo-fence), generally an area close to the advertisers' store front.
- Targeted Behavioral Analysis: Its platform tracks and analyzes individual consumer's recent behavior and then adjusts advertising campaigns based off its insights.
- Real-time Verified Walk-in: Tracks foot traffic into stores that were the result of a direct targeted ad… all in real-time.
- Data and Analytics: The company is constantly bringing in and analysing new consumer information — over 4.5 trillion unique data points a month. It's partnered with Cardalytics, a credit card data company which allows SITO to track consumers from advertising engagement, to store walk-in, and then to actual transaction; all in real-time. With this it builds detailed consumer profiles that evolve over time, allowing for an increasing network effect that results in more profitable advertising.

The company's pivot is paying off big so far.

YoY revenue is up an impressive 168%. Sales rose to $9.9 million last quarter compared to $3.7 million the year prior. The company still runs its legacy messaging service but it now accounts for under 10% of total sales. It's primary business (location-based advertising) grew 285% over the year prior.

Adjusted EBITDA came in at $1.8 million with an EPS of $0.04; making it the first profitable quarter for the company in six years.

80% of SITO's revenues come from ad agencies, with the rest coming directly from advertisers. Currently some of their biggest customers are Microsoft, Fox, Whole Foods, Amazon, Coca-Cola, Mercedes Benz, the NBA, Volkswagen, U.S. Army, McDonald's, American Express and Disney.

Feedback from customers is extremely positive so far. The average campaign spend has steadily increased and is now over $30k. Last year there were 35 customers running 100 campaigns. So far this year there's over 100 customers running approximately 400 campaigns. The product is proving to be quite sticky with a high renewal rate.

The downside here is that SITO's balance sheet isn't great. Total debt, including capitalized leases, are a bit over $7 million. And because of the company's small size and recent pivot into a new industry, the cost of its debt is high. Last quarter the interest expense amounted to $445,000 — no small sum for such a tiny company.

But here's the interesting thing… the SITO's creditor is Fortress Group, a fund that specializes in lending against valuable IP.

SITO currently has a robust patent portfolio of 29 issued patents and 14 others currently pending. The majority of these have to do with something called over-the-top video streaming. I'm not going to pretend like I know what that is, but Fortress Group must have seen something they liked to have provided $10 million in credit to such a small company.

Another interesting aspect is that SITO has sent letters of infringement to some big players in video like Hulu and Google. The law firms SITO used are also considered part of the top-tier in IP litigation, meaning they don't waste their time harassing big fish over patents they think are worthless.

Management has said that it's looking to monetize its patent portfolio but when pressed for further details on the last earnings call, they were mum, saying they couldn't discuss details due to some of the discussions they're currently in.

The company recently filed for an additional public offering of just over 2.5 million shares for gross proceeds of $10 million. Generally I won't touch a stock that has a history of dilution but in this case it makes sense. The company can use those proceeds to retire some or all of its high cost debt and use any additional funds for further strategic acquisitions. SITO can boost its EPS by 4-8 cents alone by extinguishing these interest payments.

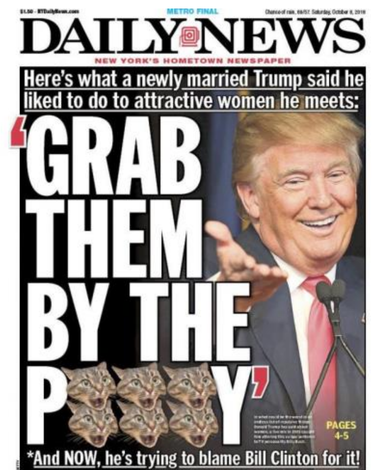
The company currently only does business in North America but is working on expanding internationally; beginning a push into the UK this quarter.

The CEO said he expects revenues to more than double again next year. Assuming they maintain their targeted long-term gross margin rate of 54% and cut their interest expense by at least half, the company should earn roughly $0.45 a share next year. If we give it a PE ratio of 25, the stock would be worth north of $11; it's currently trading below $5.

This is a *very* conservative estimate. If the company can maintain a high growth rate then it'll easily be worth multiples of that.

Even better, with this kind of growth, SITO is a top takeover target. Management has a long record of building up and selling off companies. It's not far fetched to think that's what they'll do here. In that case we could assign a multiple of 5-6x next year sales (ballpark of $70 million) when the buyout would likely occur and we get a stock price in the $25-35 range.

US Elections


DAILY NEWS
NEW YORK'S HOMETOWN NEWSPAPER
Here's what a newly married Trump said he liked to do to attractive women he meets:
'GRAB THEM BY THE P****Y'
PAGES 4-5
*And NOW, he's trying to blame Bill Clinton for it!

NEW YORK POST
Page Six
METRO EDITION
DICKILEAKS: FBI REOPENS E-MAIL CASE
STROKING GUN
Weiner sext probe found dirt on Hill
PAGES 4-5

Ever since Trump's "Grab 'em by the pussy" leak, financial markets had largely ruled out a victory for The Donald. The S&P quietly drifted sideways waiting to confirm the news that Hillary would become the next President of The United States.

As the circus began to simmer down, the election became an afterthought for investors. But boy did things quickly change after last Friday. It all started with FBI director James Comey informing Congress that he was reopening the investigation into Clinton's emails. This came in light of 650,000 newly discovered messages on Anthony Weiner's laptop during the FBI's investigation into his sexting scandal.

The reinvestigation wasn't a one-off either. Hillary has been continually pounded by the Wikileaks monkey hammer. Journalists are working overtime to dig through more and more emails exposing the corruption of Hillary and her staff. The latest accusations include leaked debate questions and even outright instructions from Podesta to dump some emails.

Of course Trump is having a field day with the new developments pressing his #rigged and #draintheswamp themes on twitter.

Donald J. Trump @realDonaldTrump Follow

WikiLeaks emails reveal Podesta urging Clinton camp to 'dump' emails. Time to #DrainTheSwamp!

WikiLeaks emails reveal John Podesta urging Hillary Clinto...
A new round of WikiLeaks documents released Tuesday reveal a March 2015 exchange between Hillary Clinton's campaign chairman and confidant Cheryl Mills on the need to "dump" emails.
washingtontimes.com

RETWEETS 12,413 LIKES 21,929

2:57 PM - 1 Nov 2016

Donald J. Trump @realDonaldTrump Follow

Crooked Hillary Clinton deleted 33,000 e-mails AFTER they were subpoenaed by the United States Congress. Guilty - cannot run. Rigged system!

RETWEETS 5,258 LIKES 12,466

5:47 AM - 2 Nov 2016

5.3K 12K

The leaks are entertaining to read. But rather than speculate on how corrupt Hillary may be, we want to focus on what's fun for us. And that's finding a way to make some money off one of the most bizarre elections in history.

Volatility

We're interested in a play on volatility rather than direction. We know volatility will continue to rise going into the election. And we also know that after the event, we'll likely see a huge drop after some of the uncertainty is taken out of the equation.

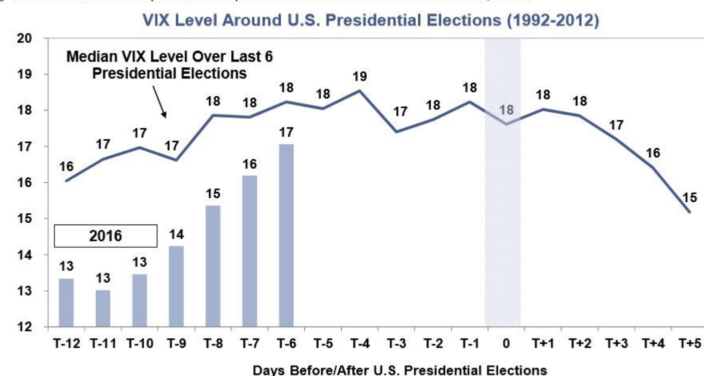
The graph below courtesy of Goldman shows how the VIX has previously acted going into election day.

As expected, volatility gets bid up until about a week before the election. And then there's a subsequent vol "crush" after the votes are counted.

Pre-Election Wagers

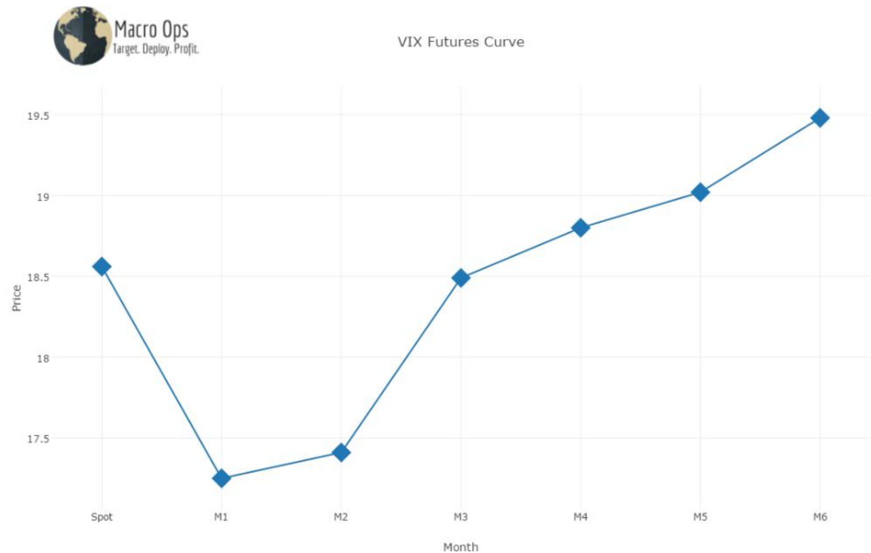
The Macro Ops playbook into the election will consist of buying volatility. The data from Goldman above shows that we don't have to worry about a sell-off in the VIX until post-election.

Exhibit 1: The median VIX level on election day has been 17.6. The VIX landed at 17.1 on October 31.
Closing VIX levels around the past six U.S. presidential elections. As of October 31, 2016.



	VIX Level Around U.S. Presidential Elections																	
	Election	Business Days Prior to Election												Election Day	Business Days After Election				
	Year	T-12	T-11	T-10	T-9	T-8	T-7	T-6	T-5	T-4	T-3	T-2	T-1	VIX Level	T+1	T+2	T+3	T+4	T+5
1	1992	17.0	17.3	16.9	16.6	15.8	16.5	16.3	16.2	16.0	15.5	16.2	16.7	**17.3**	16.3	15.4	14.7	14.0	14.9
2	1996	15.1	16.0	16.4	16.5	16.9	17.3	18.3	18.3	18.5	18.1	17.9	18.0	**17.7**	17.0	17.2	15.8	14.9	15.1
3	2000	24.2	24.7	24.3	26.7	28.6	26.5	25.5	23.6	24.3	23.9	23.7	24.5	**24.9**	25.7	27.2	28.5	26.2	27.4
4	2004	15.0	14.7	15.1	14.9	14.5	15.3	16.6	16.4	15.7	15.4	16.3	16.3	**16.2**	14.0	14.0	13.8	13.1	13.4
5	2008	70.3	53.0	53.1	69.7	67.8	79.1	80.1	67.0	70.0	62.9	59.9	53.7	**47.7**	54.6	63.7	56.1	66.5	69.2
6	2012	15.1	15.0	17.1	16.6	18.8	18.3	18.1	17.8	18.6	16.7	17.6	18.4	**17.6**	19.1	18.5	18.6	17.9	15.2
	2016	**13.3**	**13.0**	**13.5**	**14.2**	**15.4**	**16.2**	**17.1**											
	Min	15.0	14.7	15.1	14.9	14.5	15.3	16.3	16.2	15.7	15.4	16.2	16.3	**16.2**	14.0	14.0	13.8	13.1	13.4
	Avg	26.1	23.4	23.8	26.8	27.1	28.8	29.1	26.6	27.2	25.4	25.2	24.6	**23.6**	24.4	26.0	24.6	25.4	25.9
	Median	16.0	16.6	17.0	16.6	17.9	17.8	18.2	18.0	18.5	17.4	17.7	18.2	**17.6**	18.0	17.9	17.2	16.4	15.2
	Max	70.3	53.0	53.1	69.7	67.8	79.1	80.1	67.0	70.0	62.9	59.9	53.7	**47.7**	54.6	63.7	56.1	66.5	69.2

Source: CBOE, Goldman Sachs Global Investment Research.



Our Hub volatility indicators are also confirming the long vol trade. The vix futures curve is starting to backwardate (spot market is above futures markets). You can see to the right how spot VIX is above M1 and M2 futures. That's a signal to get long vol because the cost to carry a long volatility futures contract is non-existent. As long as spot VIX stays higher than the futures, the futures will slowly appreciate into their respective expiration dates. The same is true for buyers of VXX and UVXY. They won't experience any significant decay in price as long as the futures curve stays backwardated.

Long VIX futures/options, long UVXY, and long VXX are all valid for a pure play on volatility. But our top choice into the election is actually an at-the-money straddle on SPX. Why? We get the benefit of long gamma as well as long vega.

(Vega is an option's sensitivity to increases and decreases in implied vol. Gamma refers to the non-linear nature of options. Long gamma traders get the benefit of increased directional exposure to winning trades and decreased directional exposure to losing trades.)

Normally a straddle slowly loses money as theta (time) decay eats away at option premiums. Think of a melting ice cube. But the picture changes a bit with the election in play. Implied volatility levels are going to stay elevated and continue to increase until the election event passes. This increase in IV will offset the theta decay in the straddle, essentially giving us a free shot at either an upside or downside breakout in SPX. Our ice cube is in a proverbial freezer until Americans cast their final votes on Nov. 8th.

You can see in the chart below that SPX is already showing signs of breaking its consolidation and making a decent move to the downside.

This trade has a great risk/reward profile. If SPX starts to trend back down to Brexit levels, the straddle's gamma will kick in and pay out big time. And if this is a false break and SPX continues to troll around sideways, the straddle will not lose much value due to climbing IV levels into the election.

We are going long the 2115 straddle in the SPX expiring Nov. 18th. Smaller accounts have the option of using the SPY straddle struck at 211.5. The SPY options are 1/10 the size of the SPX.

For trade management we plan on removing this trade at a 100% gain on the price of the straddle or before U.S. election results, whichever comes first. We don't want to hold the straddle through the election event as there'll be a huge vol crush after the event, greatly reducing the value of the straddle.

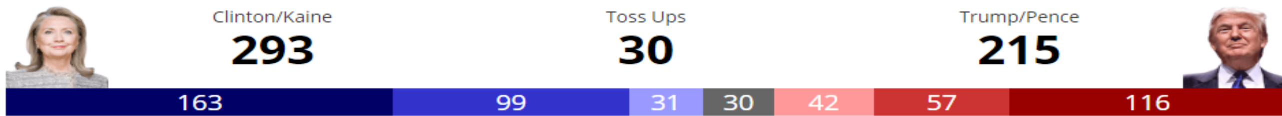
Trade Idea: Buy the Nov. 18th 2115 Straddle in SPX, Sell before the election

Election Bets

Prediction markets are still pricing Hillary as a favorite. For Trump to win he needs to take Florida and then some of Hillary's weaker states including Nevada, Wisconsin, and North Carolina.

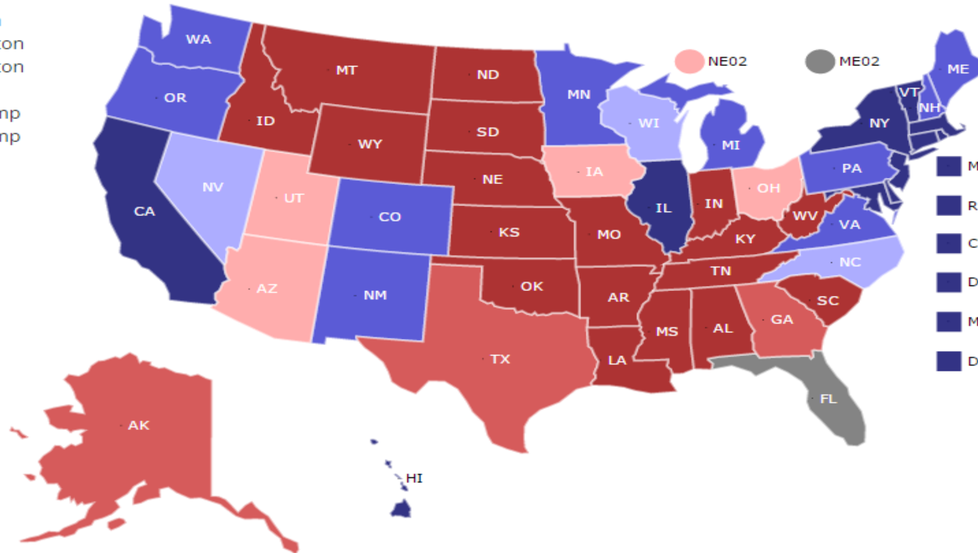
Election 2016

Electoral College Projections



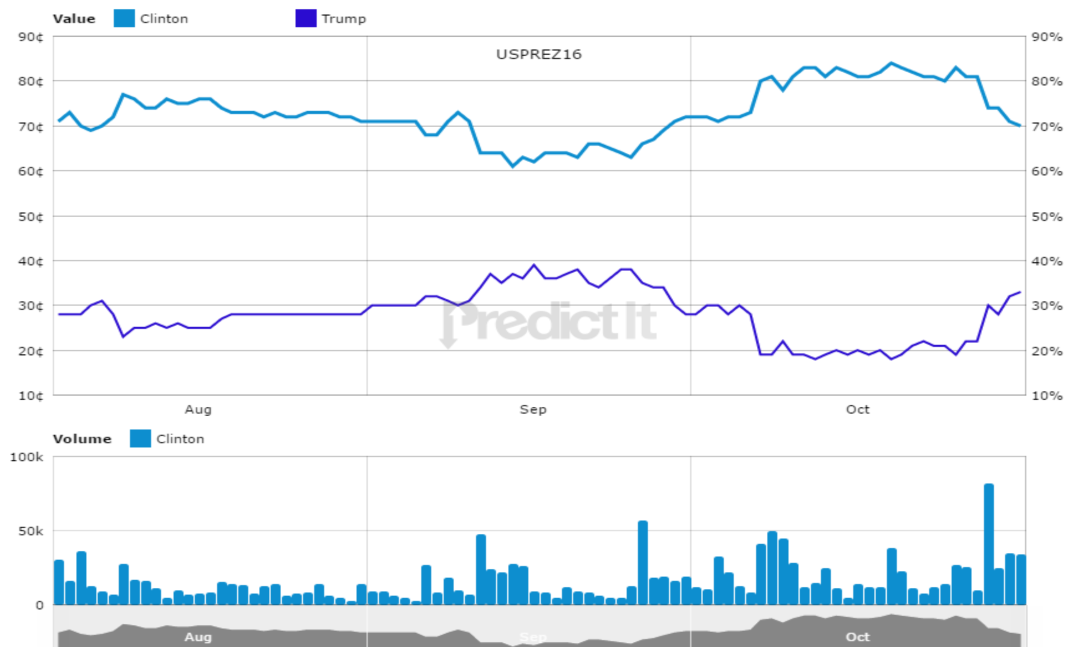
Share Price

- > 90¢ Clinton
- 75¢-89¢ Clinton
- 60¢-74¢ Clinton
- Toss up
- 60¢-74¢ Trump
- 75¢-89¢ Trump
- > 90¢ Trump



This map reflects current prices on PredictIt's Electoral College markets in each jurisdiction. Prices are updated every minute.

The chances of Trump taking these hotly contested states seemed hopeless a few weeks ago. But the fresh FBI probe into Clinton's emails coupled with a relentless Wikileak barrage has narrowed the gap. PredictIt has HRC as a 70% favorite and Trump as a 30% dog. But you can see from the chart below that the momentum is on Trump's side. The latest scandal is always the one that's remembered. And unfortunately for Hillary, it looks like voter's will be going to the ballot box



thinking about her emails instead of Trump's "locker room" talk. It's probable that this gap narrows further as election day approaches.

We have two more plays for the election outcome depending on who you think will win. (And for a deeper explanation of how volatility and options work in these trades, check our options report here.)

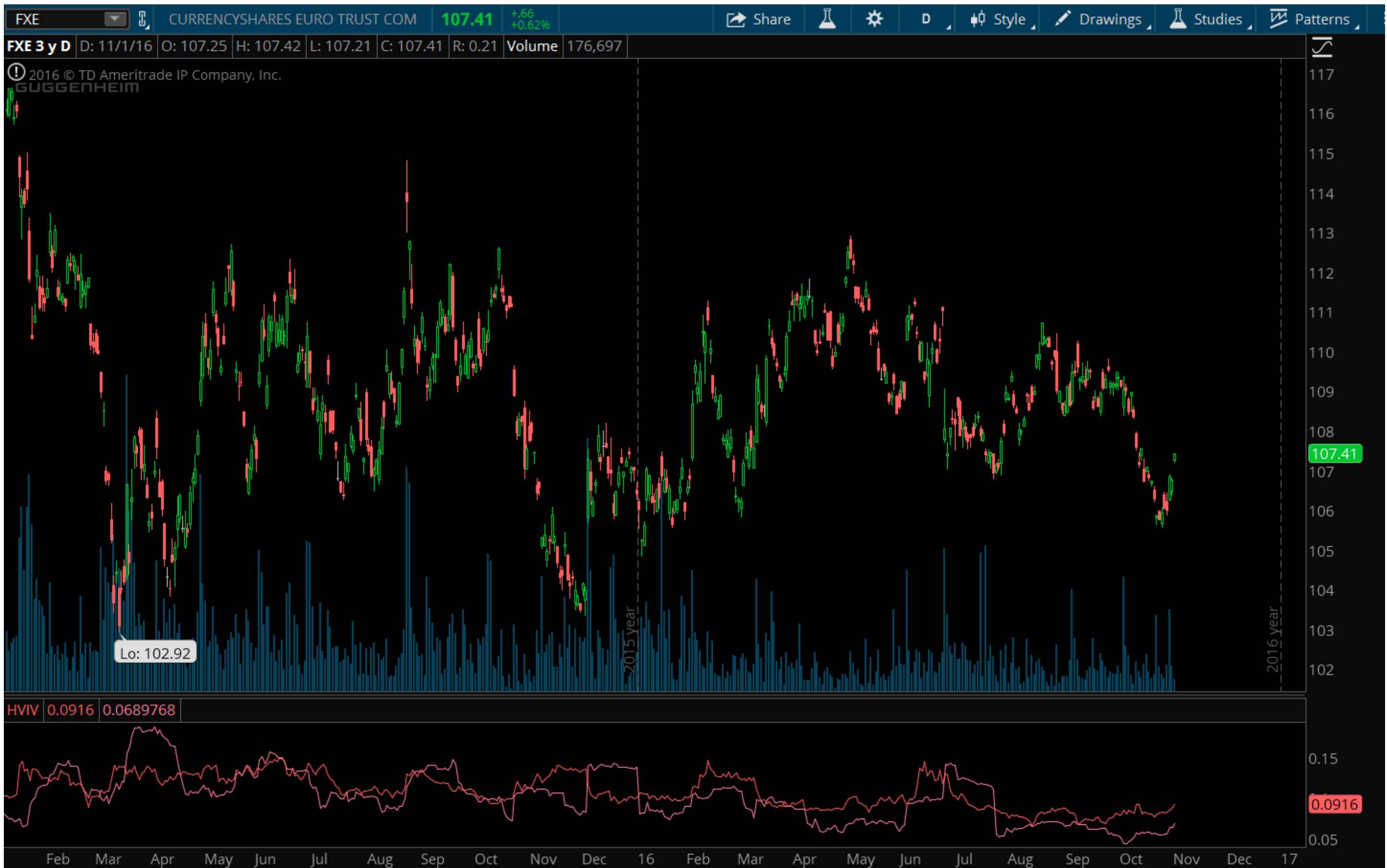
Our first thought for a Trump victory was to buy some puts on the Mexican peso. But it looks like the volatility is already priced into that market. 30-day implied volatility has been spiking into the election making the options far too expensive.

A better bet for a Trump victory will be to buy calls on the Euro. We don't think the market is properly pricing in how much of a negative it will be for the greenback (USD) if Trump takes the White House.

Ever since the beginning of the election, we've heard Trump talk about getting tougher with other nations. He wants to renegotiate and even undo trade deals, in some instances closing off trade altogether. We've seen this protectionist movie before as investors massacred the pound after the Brexit vote. Trump in the oval office could spark a similar knee jerk reaction in the USD.

On top of his trade war rhetoric, he's also publicly suggested the US renege on its debt. Throw in his proposed tax cuts and large ($1 trillion) infrastructure spending plan, and you get a scenario where optics on the USD reverse from bullish to very bearish.

So if you think Trump will win the race, we recommend buying calls on FXE. You can see in the graph below that implied volatility in red is near the bottom of it's range. This is the opposite setup of the peso where IV is in the high end of its range. This makes Euro calls cheap and a good proxy play on a Trump win.

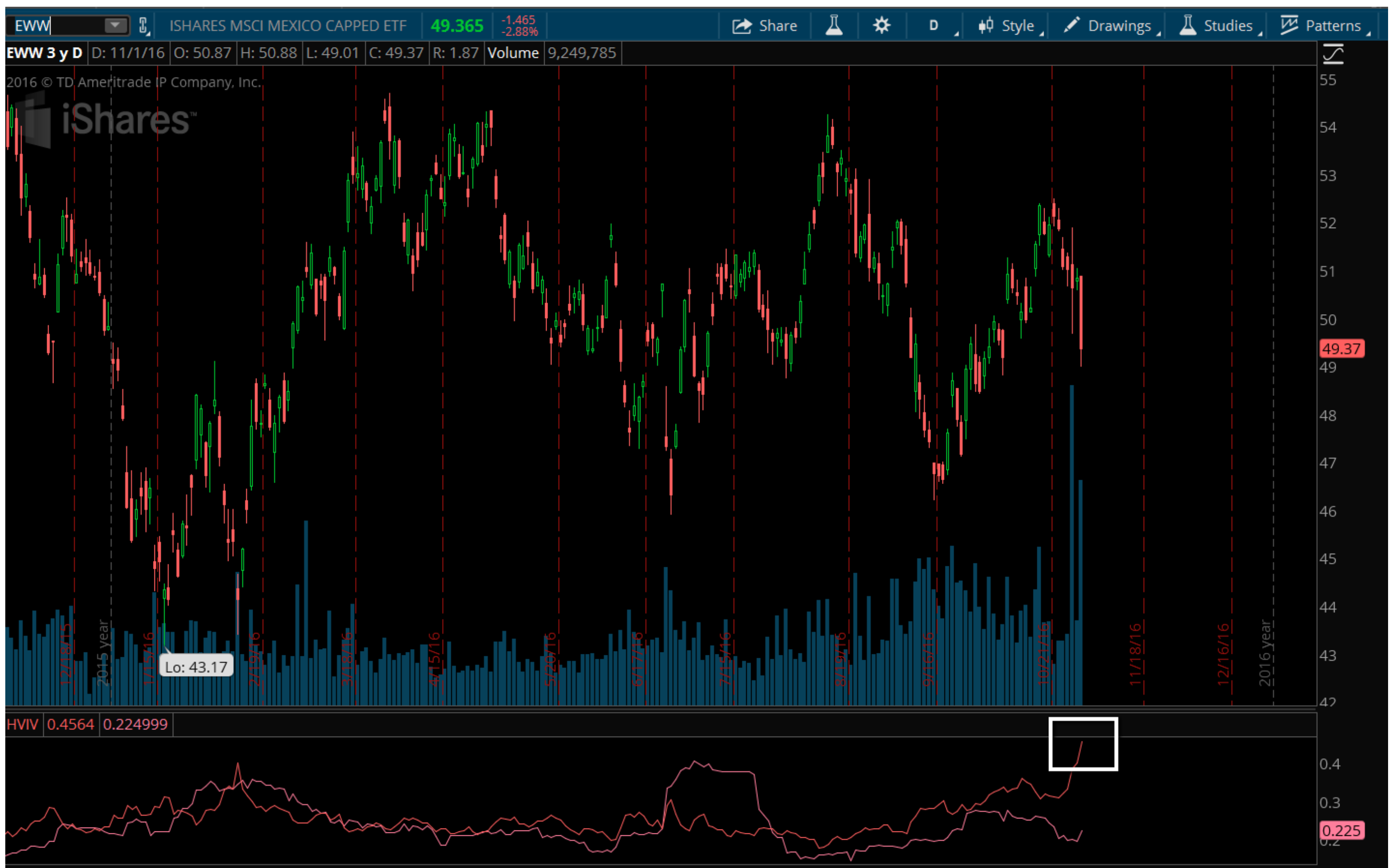


The December 16th 108 calls on FXE have good liquidity and should profit nicely if Trump takes the oval office and the Euro spikes to the top end of its range.

Trade Idea: Buy FXE Dec 16 2016 108 calls

Our Hillary idea is actually a play on the Mexican equity market. Look at the white box in the chart below and you can see that just like in the Peso, implied volatility levels are extremely high in their range. And IV is much higher than the 30-day historical volatility in pink.

Macro Ops
Target. Deploy. Profit.



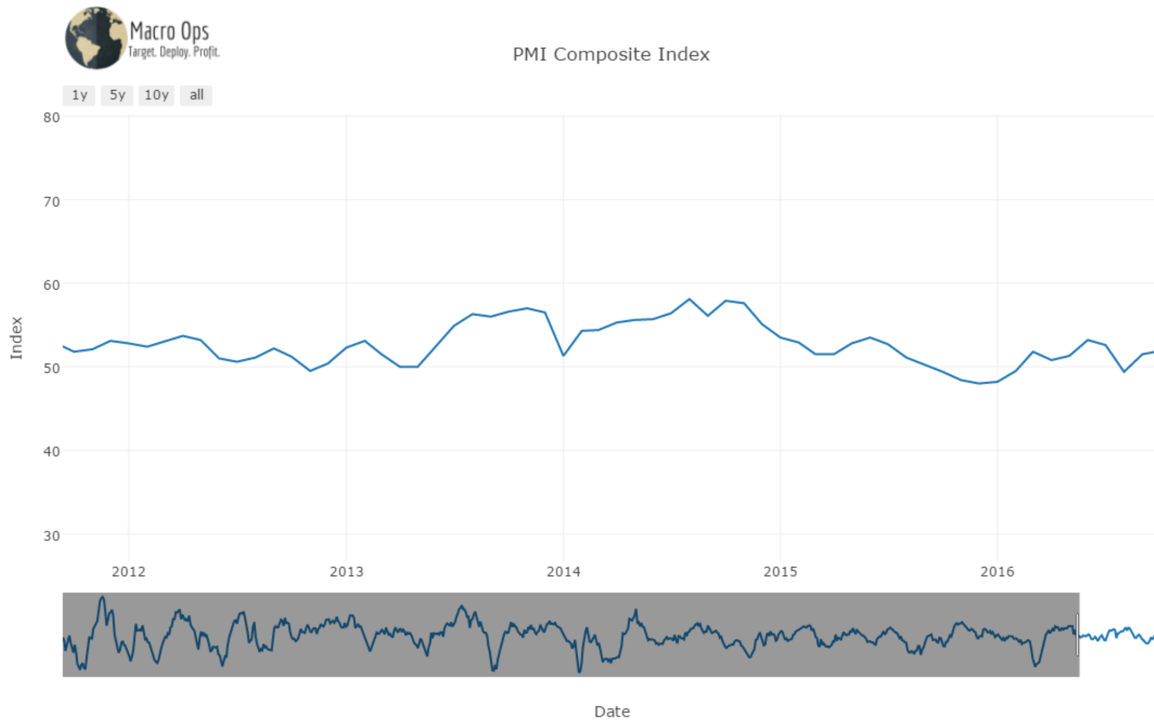
Investor's buying options here on EWW into the election won't make much money even *with* a Trump victory. If you think HRC has this election in the bag, then this is a great fade opportunity for you. We can take advantage of the richness in price by selling the at-the-money straddle in EWW expiring on November 11th. On a Clinton victory, the volatility built up in these options will sell off hard and the short straddle will profit. And if the naked nature of the short straddle is too high risk, you can always spread it off by buying some out of the money options on both sides, turning the trade into a butterfly.

Trade Idea: Short EWW Nov. 11 49 Straddle, purchase 42 put and 56 call against to turn the trade into a butterfly

Post-Election Strategy

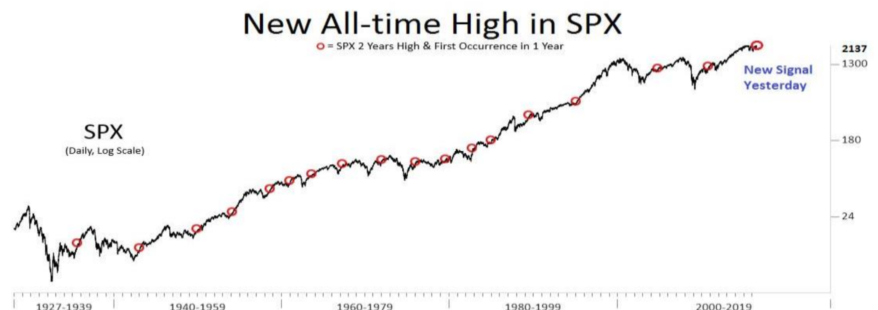
Our plan post elections is to sell the VIX and benefit from the impending volatility crush. Both candidates should have a positive effect on the equity market into year end. A Trump win sends the dollar lower and inflation rate higher which is positive for equity markets. Hillary is more of the same in regards to the last 8 years of Obama, a non-event for equities. After the election investors will quickly turn their focus back to the FED and macro data, which hasn't been

clocking in any significantly bearish numbers. The latest PMI manufacturing release came in at 51.9, signaling an expansion in activity.



We also got our multi-year breakout statistic in play that we wrote about in last month's MIR. To refresh your memory, this stat looks at SPX performance following a new 2-year high. You can see in the table to the right that every time this signal fires we have a higher market one year later.

The breakout signal fired on July 11th and so far the 3-month return from that point has been zilch. According to the statistic, this means we still have good amount of room to go to the upside.



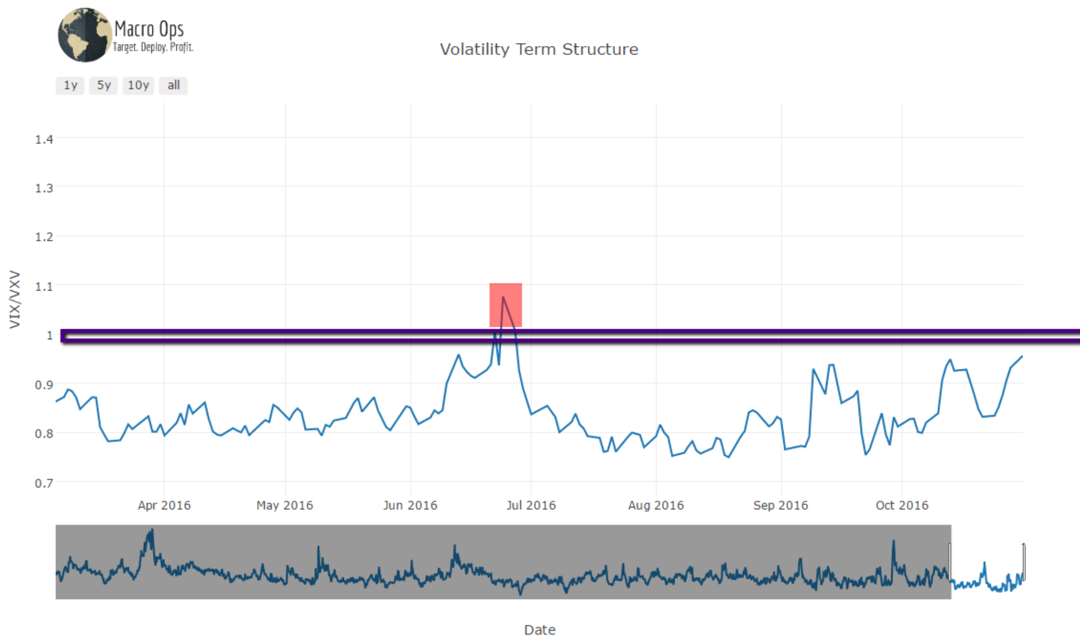
SPX forward returns after 17 events 12/30/1927 - 7/11/2016

Event Dates	1Mo	3Mo	6Mo	1Yr
09/10/1935	-2.95%	10.79%	21.92%	37.35%
02/01/1943	4.56%	12.74%	11.41%	12.17%
01/09/1950	0.88%	3.92%	1.41%	24.06%
03/11/1954	3.33%	6.18%	15.14%	36.57%
09/16/1958	2.49%	8.55%	14.16%	14.93%
01/27/1961	3.59%	6.65%	9.01%	11.32%
09/03/1963	-0.50%	1.57%	7.43%	13.28%
05/04/1967	-6.24%	1.42%	-1.71%	4.86%
02/04/1972	3.82%	1.69%	5.31%	8.39%
01/29/1976	-0.09%	2.02%	2.82%	1.68%
08/13/1979	0.37%	-5.50%	9.03%	16.16%
11/03/1982	-2.93%	0.25%	14.31%	14.54%
01/21/1985	3.40%	3.12%	10.91%	18.43%
07/26/1989	3.98%	1.67%	-2.30%	5.63%
02/14/1995	2.67%	9.46%	15.75%	36.88%
11/04/2004	2.46%	3.56%	0.83%	5.02%
11/04/2010	0.17%	7.36%	9.76%	3.28%
07/11/2016				
Avg after Signals	1.12%	4.44%	8.54%	15.56%
Average All Periods	0.61%	1.84%	3.64%	7.54%
T-Statistic	0.71	2.37	2.98	2.81
# Events Up/Down	12 / 5	16 / 1	15 / 2	17 / 0
Significance	76%	99%	100%	99%

NAUTILUS INVESTMENT RESEARCH   Daily   12/30/1927 - 7/11/2016   Data Source: Bloomberg   7/11/2016 8:24

We think the current dip will fuel the next leg higher in the SPX. Hedges coming off after election results will add a wall of buying pressure to the market. And managers will have to chase the rally higher to avoid redemptions into year end. The money management industry is in the midst of an intense washout. Funds will get allocations pulled if they don't match the performance of the SPX.

To play it we'll be watching our new volatility term structure indicator recently added to the Hub. A picture of it is pasted below.



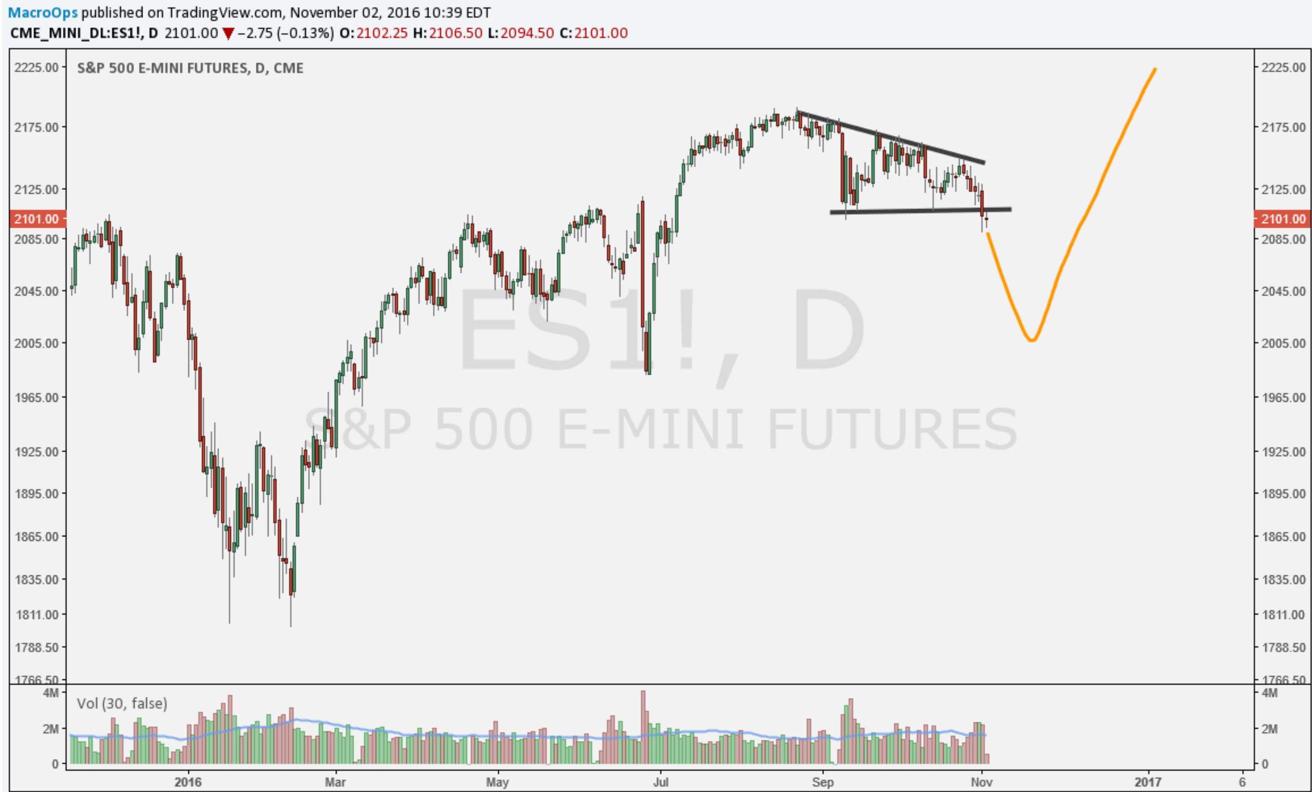
The spread crossing above 1 (notated here by the purple rectangle) is our signal that a potential bottom is in place for the SPX. After the spread crosses below the purple box from above, we almost always get a large sell off in the VIX and a rally in the SPX. You can see the last signal, colored in red, occurred after the Brexit announcement.

Traders that sold volatility products were handsomely rewarded as the market ripped to fresh new highs. We're expecting a similar outcome to occur after the U.S. vote.

You can make this trade by shorting VXX, UVXY, or VIX futures, but our preferred method is to buy puts on VIX. That protects us from the scenario of a super spike in volatility if we're wrong and the market decides to sell off significantly into December.

Remember, this a post-election trade, and the signal still needs to trigger. We'll be updating Hub members in real time whether we decide to take a shot at it.

The yellow path pictured in the chart below is how we think price action will play out into the end of the year. But of course we'll adjust our view as new information becomes available.



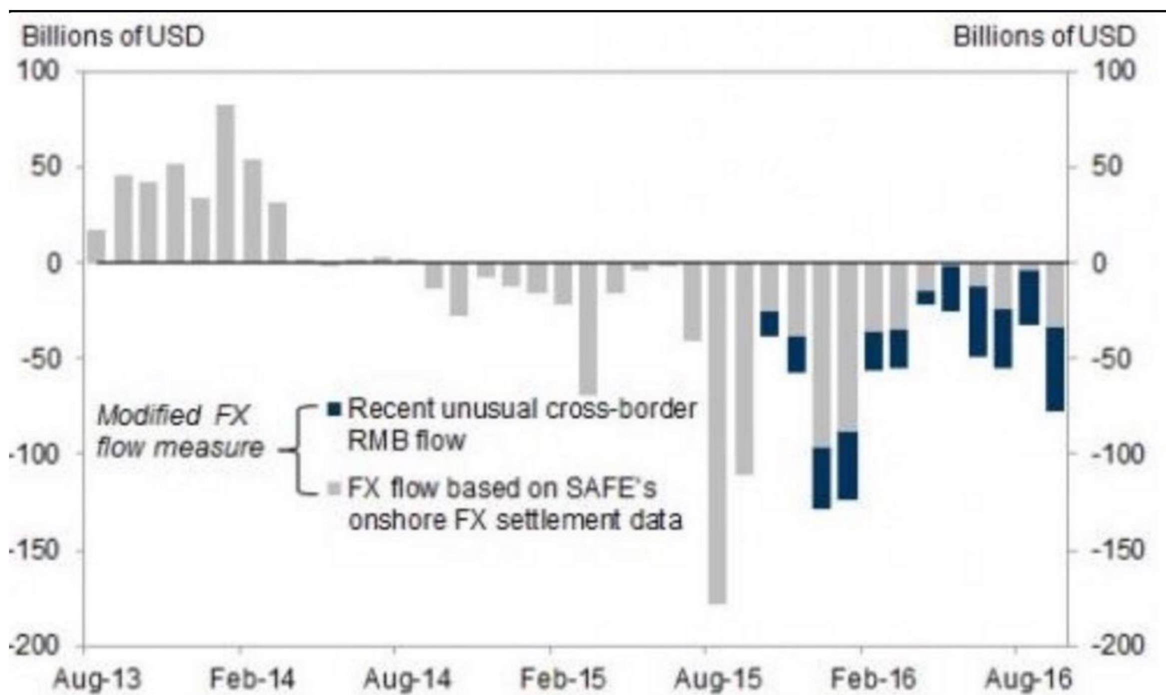
Best of luck with your election bets! We'll be sitting with the popcorn ready next Tuesday to watch the shit show unravel in real time.

Systemic Risks

Yuan Devaluation

The yuan has been on a relentless march lower against the dollar over the last month (when yuan falls the USDCNY pair rises). It's been hitting new six year lows almost daily and has shown no signs of abating until recently, due to current dollar weakness. The yuan has fallen even further against other countries, over 30% just this year against currencies it competes with for exports.

Capital flows out of China have been picking up steam, but much of it is being disguised under other cross-border flows in an attempt by the Chinese Communist Party to hide the severity of the situation.



It's no surprise the Chinese "smart money", the wealthy and politically connected, are transferring their savings out of the country by going on an unprecedented acquisition spree of foreign companies.

Former Chinese government officials have even come out and said that China will not be able to defend the yuan at these levels. Guan Tao, a former departmental head of the State Administration of Foreign Exchange, recently stated in an interview that "*If there is conflict between growth and exchange rates, China's monetary policy should give priority to growth*". He also explained that it was impossible for Beijing to stabilize the yuan exchange rate while also maintaining the size of their FX reserves.

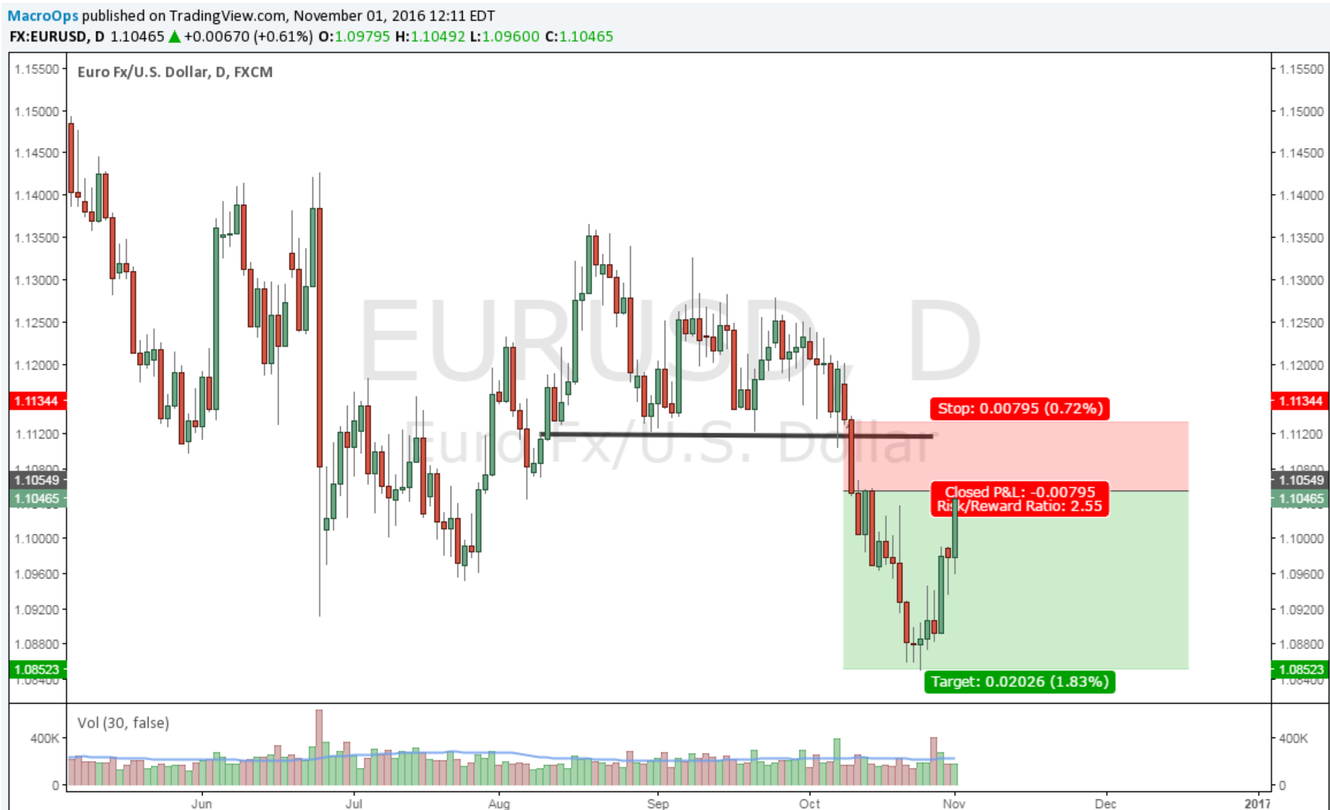
We don't expect the yuan trend to reverse anytime soon.

Tracking

The following are a few trades we've mentioned in past MIR's. We'll continue to monitor the situation in these areas to look for new entry points on winning themes.

Short Euro

Our plan to short EUR/USD at a break of the 1.112 level produced over a 2.5 return over risk. We took a position in our Tactical Portfolio and have now exited due to the short-term pullback in the dollar and recent positive economic data out of the Eurozone.

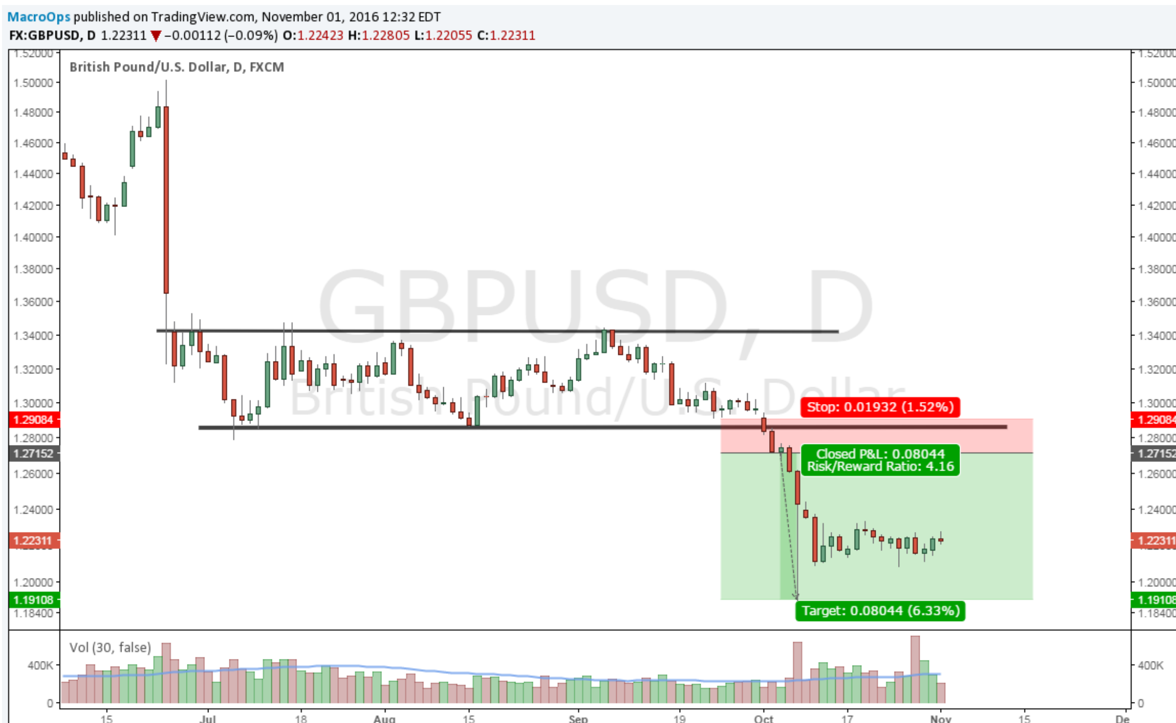


Long MTL

The Russian miner (MTL) we mentioned in the last MIR broke the $2.92 level and shot up 80% over this last month. It's currently consolidating, but may provide another entry point on a close above the $5.19 level. The temporary Russian rally is still intact and MTL has the potential to keep moving higher from here — especially if we see a Trump victory.

Short Pound

The short pound trade was fantastic. The trend was clearly down, but we got an extra boost by the "flash crash" on October 7th. Investors would have made around 4R on the play if they sold at lows. We have since covered our position into the election as the dollar's near-term outlook has changed in light of a possible Trump victory.



Macro Ops
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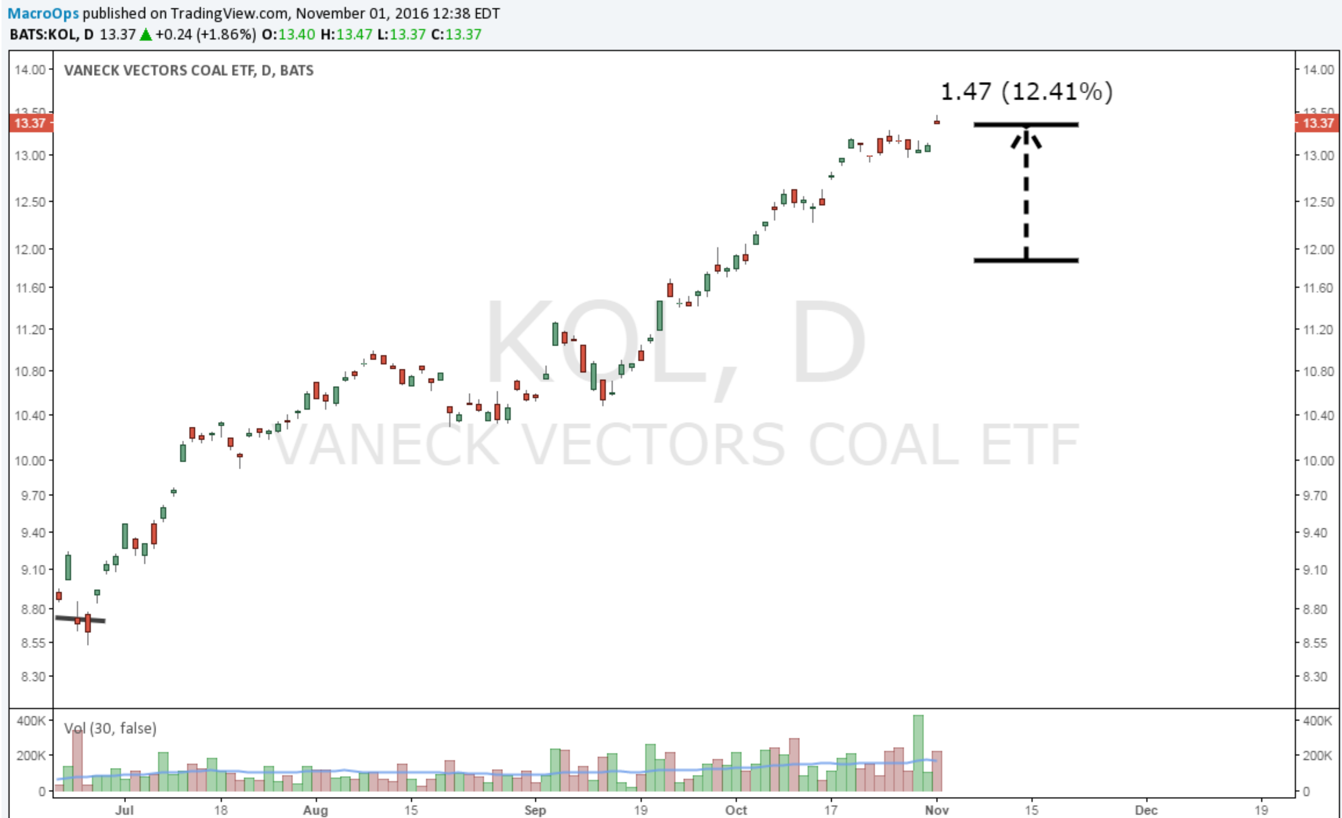
Long Coal

Since our deep dive on coal last month, the coal ETF KOL climbed another 12.5%. The thesis here is still intact and we should see KOL trend higher from here.



Long CLD

Cloud Peak Energy (CLD) is up 20% since we covered it in the last MIR. We still like the idea of adding to this trade on pullbacks, though the thesis won't be as strong should Clinton win.

Macro Ops
Target. Deploy. Profit.

Targets

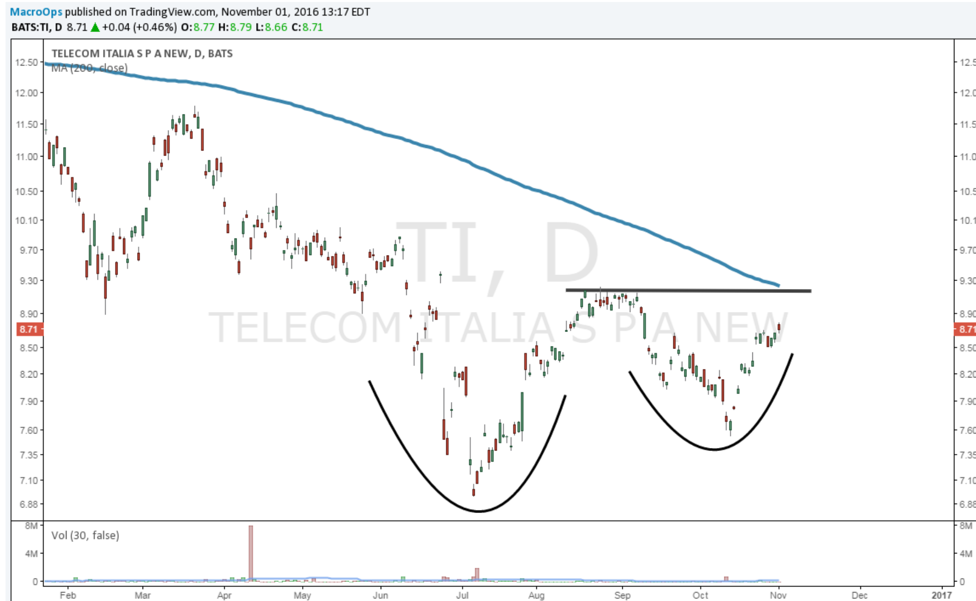
Below are potential targets we're looking to execute on based off broader macro themes we're tracking.

Long CS

Credit Suisse (CS) has formed a nice cup with handle bottom. Price has broken above the $13.90 level and is providing a good entry to the longside. A position in CS is a play on the recovering Eurozone theme. It's very similar to the long DB trade we discussed above.

Long TI

Telecom Italia (TI) is another play on the recovering Eurozone theme, this time with a specific focus on Italy. A nice double bottom base has formed. We'll consider going long on a close above the $9.20 level.



Long PYPL

After strong earnings a few weeks ago PayPal broke out of its 16-month ascending triangle. Price has now retraced back to the original breakout line and is providing an entry point. Depending on how US elections play out, and if the broader indices move higher from here, we'll look to establish a long position in the stock. For a more in-depth look into PayPal, check out our Tactical Targets that Hub members receive weekly as part of their membership.

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Target. Deploy. Profit.

Short PRGO

Perrigo is a pharmaceutical company we're looking to short on a close below the $82.50 level. Over the last month we've seen the healthcare sector hit hard. Part of the reason for the drop is the potential for Clinton to come into office. She's been vocal about attacking high drug prices and investors have taken this as a negative for healthcare stocks. PRGO falls right into the crossfire as a pharmaceutical company that sells over-the-counter drugs. If Clinton does come into office, that could be the catalyst to push this stock lower in its already confirmed long-term downtrend.

Short FSLR

The solar industry has been under fire due to stiff competition from cheap fossil fuels. FSLR has broken a long-term consolidation and is one of our potential short candidates. FSLR was another company covered in [Tactical Targets](#).

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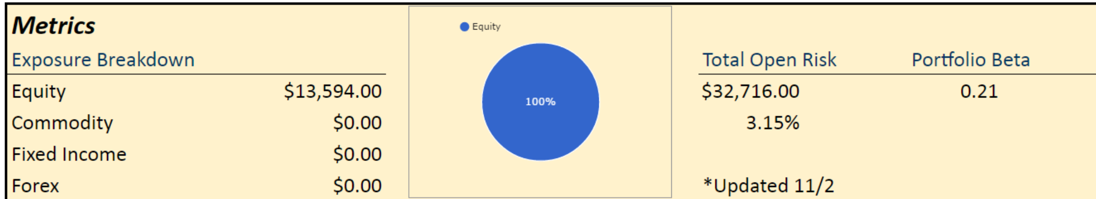
Portfolio Snapshot

Macro Ops Strategic Portfolio

NAV $1,039,017

Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target 1	Beta (1yr)	Notional
Equity	Novatel (MIFI)	11,000	2.10	1.75	$3,850.00	3.00	1.84	$31,240
Equity	PayPal (PYPL)	2,900	43.81	40.45	$9,744.00	50.00	1.26	$124,932
Option	SPX Nov 17 2125 Straddle	3	63.74	~	$19,122.00	~	~	~



Metrics

Exposure Breakdown	
Equity	$13,594.00
Commodity	$0.00
Fixed Income	$0.00
Forex	$0.00

Total Open Risk	Portfolio Beta
$32,716.00	0.21
3.15%	

*Updated 11/2

Macro Ops Income Portfolio

NAV $1,080,203

Asset Class	Position	Size	Cost Basis	Max Profit
Option	SPX Dec 15 2045 Put	-10	$15.38	$15,380.00
Option	SPX Dec 15 2215 Call	-10	$8.08	$8,080.00
Option	SPX Dec 15 1600 Put	10	$1.06	Hedge
Option	SPX Nov 17 2125 Straddle	3	$64.00	~

Scenario Analysis/Stress Tests

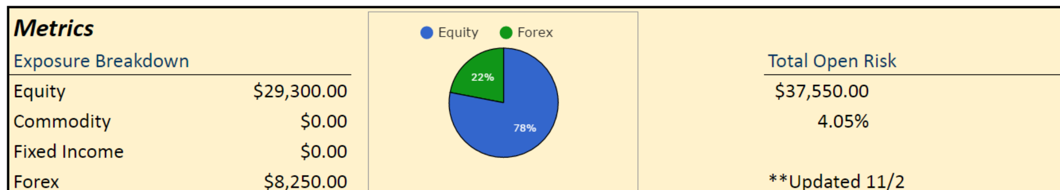
Worst Case	Worst Drawdown
SPX-10%	-$88,800
SPX-20%	-$300,000

**Updated on 11/2

Macro Ops Tactical Portfolio

NAV $927,293.00

Asset Class	Position	Size	Cost Basis	Risk Point	Market Price	Open Risk	Target 1	Notional
Forex	CAD (6CZ6)	-11	0.75007	0.7565	0.74900	$8,250.00	0.70870	$824,868
Equity	S&P 500	-4	2096.50	2129.50	2089	$8,100.00	2023.50	$417,750
Equity	Russell 2000	-4	1187.50	1208	1155	$21,200.00	1131.90	$462,120



Metrics

Exposure Breakdown	
Equity	$29,300.00
Commodity	$0.00
Fixed Income	$0.00
Forex	$8,250.00

Total Open Risk
$37,550.00
4.05%

**Updated 11/2

For more information about real time portfolio updates please email alex@macro-ops.com