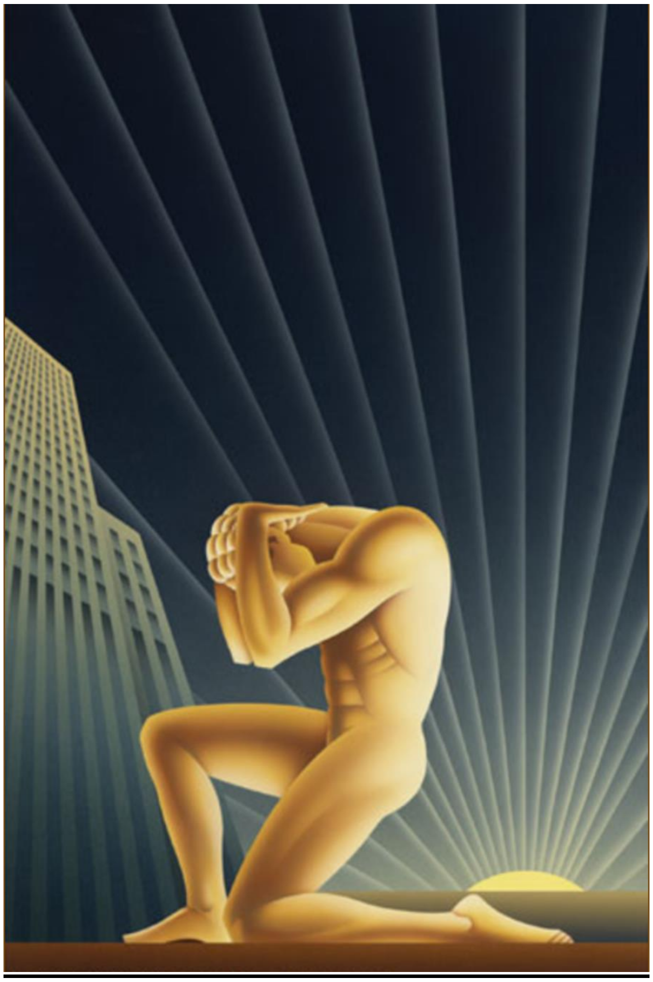
MARKET BRIEF

"Who Is John Galt?"



If you saw Atlas, the giant who holds the world on his shoulders, if you saw that he stood, blood running down his chest, his knees buckling, his arms trembling but still trying to hold the world aloft with the last of his strength, and the greater his effort the heavier the world bore down upon his shoulders - What would you tell him?

I…don't know. What…could he do? What would you tell him?

To shrug.

~ Ayn Rand, *Atlas Shrugged*

No author has had a more profound impact on my life than Ayn Rand.

When I was 14, my grandmother (a big fan of Rand herself) gave me *The Fountainhead*. I devoured all 753 pages in a week, staying up nights completely spellbound by the philosophy Rand preached that spoke dearly to my rebellious adolescent heart.

I quickly read all her other books and essays. And afterwards, I was a changed person.

Rand's philosophy, called *ethical egoism,* is the ethical doctrine that it's everyone's moral obligation to act to promote his or her own interests exclusively. In Rand's own words, the "philosophy, in essence, is the concept of man as a heroic being, with his own happiness as the moral purpose of his life, with productive achievement as his noblest activity, and reason as his only absolute."

I'm still a fan of Rand's ideas but it was heady stuff for a young teenager to digest and I naively took it to its logical (or at least what I thought was logical) extreme at the time.

I had always been bored with school and never enjoyed the mechanical nature in which subjects were taught. I loved learning though and believed I could teach myself a lot more efficiently by reading books. After reading Rand, I began skipping school, and declared to my *very* pissed off parents that it was "in my selfish interest to do so!". I should mention that I was a bit of a stubborn idiot in my early years.

After enough truancies I was asked (told) by my high school to kindly not step foot on their campus anymore.

I thought this was great news. My parents, not so much. And at fear of having their son remain a high school dropout they pushed me to compromise. I agreed to attend a special school where I could test out of subjects at my own speed.

I ended up completing high school in two years and started college on my 17th birthday. I did a year of college and then dropped out after 9/11 to sign up for the Marine Corps so I could "kill terrorists" as I told my all too happy recruiter. I attended boot camp while most of my friends were still in their senior year of high school.

So for better or worse (I like to think it was for the better), reading Ayn Rand changed my course in life and I can only imagine where I'd be had my grandma never given me that book.

I bring up Ayn Rand because Ray Dalio mentioned her in a note recently published on Linkedin (link here). Dalio is also a big fan of Rand's work and her philosophy permeates much of Ray's views and Principles for success.

Talking about the new administration that Trump has assembled, Dalio writes, "Regarding economics, if you haven't read Ayn Rand lately, I suggest that you do as her books pretty well capture the mindset. This new administration hates weak, unproductive, socialist people and policies, and it admires strong, can-do, profit makers."

I think that's a fair assessment.

Dalio's thinking about the market seems to be in alignment with our own, in that we're in the second half of a market cycle and are possibly entering a sentiment driven period not unlike that of the late 90's.

He wrote that "it is increasingly obvious that we are about to experience a profound, president-led ideological shift that will have a big impact on both the US and the world." Noting that, "The shift from the past administration to this administration will probably be even more significant than the 1979-82 shift from the socialists to the capitalists in the UK, US, and Germany when Margaret Thatcher, Ronald Reagan, and Helmut Kohl came to power."

To say that the incoming administration is more pro-business than the last is to state the obvious. And that is the reason given by most for the current vertical bound stock market.

Trump's economic policies (the tax cuts and deregulation) are likely to add a few points to GDP over the next few years. But what's even more important, from the standpoint of markets, is the psychological/sentiment shift we're going to see as a result of this new administration.

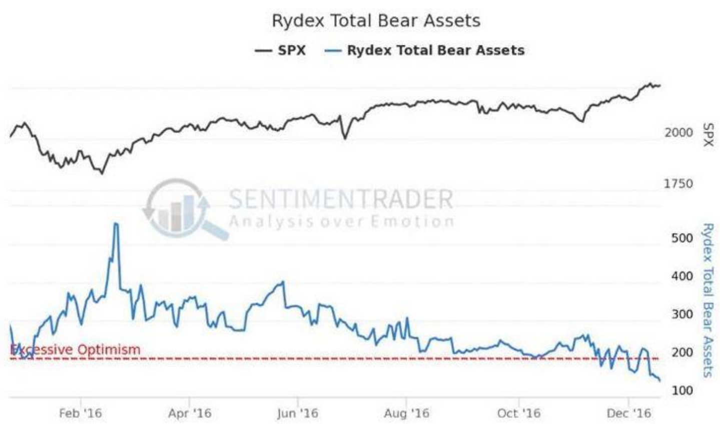
Here's Dalio on the subject:

> *This particular shift by the Trump administration could have a much bigger impact on the US economy than one would calculate on the basis of changes in tax and spending policies alone because it could ignite animal spirits and attract productive capital. Regarding igniting animal spirits, if this administration can spark a virtuous cycle in which people can make money, the move out of cash (that pays them virtually nothing) to risk-on investments could be huge. Regarding attracting capital, Trump's policies can also have a big impact because businessmen and investors move very quickly away from inhospitable environments to hospitable environments.*

I think we're seeing only the very beginnings of these animal spirits in markets. Going back to the late 90's comparison, I would say we're probably mid-98' and sentiment won't really heat up until the end of next quarter.

I think we're going to see a large increase in retail investor participation in markets over the next year. There's been a lot of money that hasn't been in play since the GFC in 09'. And this new Trump narrative is going to change that.

Even the most bearish of perma-bears have flipped their script. Guys like Marc Faber and Harvey Dent, who make their living predicting constant impending economic doom, have come out recently as constructively bullish on US stocks.



This bullish Trump sentiment is also being magnified by the durability and longevity of this bull market. This is a part of the whole self-reinforcing narrative-to-action function of markets. The longer a trend lasts and the longer a strategy (like buying the dip or selling vol spikes) works, the more participants believe in it and the more aggressively they push that strategy. This is why markets generally end in blow off tops. Eventually sentiment exhausts itself.

Dalio ended his note saying, “The question is whether this administration will be a) aggressive and thoughtful or b) aggressive and reckless.... We are pretty sure that it won’t take long to find out.” And “By and large, deal-maker business men will be running the government. Their boldness will almost certainly make the next four years incredibly interesting and will keep us all on our toes.”

I definitely agree with Ray on that last point. The next four years will indeed be interesting and I believe lucrative for macro traders who remain nimble with their ears firmly to the ground.

A more hawkish Fed

Here’s an excerpt from a commencement speech Yellen gave this past week.

> *First, after years of a slow economic recovery, you are entering the strongest job market in nearly a decade. The unemployment rate, at 4.6 percent, is near what it was before the recession. This is a level that has been associated with good job opportunities. Job creation is continuing at a steady pace; the layoff rate is low; and job openings are up over the past couple years, which is another sign of a healthy job market. There are also indications that wage growth is picking up, and weekly earnings for younger workers have made strong gains over the past couple of years. That is probably one reason why younger workers reported feeling significantly more optimistic about the job market compared with 2013, according to a survey published just today by the Federal Reserve.*

And then here’s what she said following the Fed meeting:

> “I see the market moves as implicit forecasts about what the impact these policies are likely to have on the economy”.
>
> “I do want to make clear that I have not recommended running a hot economy as some sort of experiment.”
>
> “I never said that I favor running a high-pressure economy.”
>
> “I would say at this point that fiscal policy is not obviously needed to provide stimulus to get us back to full employment.”

Uber dove Yellen has grown some talons since elections. And what’s more surprising is that the Fed has seemed to dropped its dovish playbook following the FOMC meeting (especially one where they hiked rates).

In past meetings, if they took a more hawkish tone, they would have a number of Fed presidents give dovish press conferences over the following week to balance it out. That act is now clearly gone.

So what does this all mean?

I think moving forward into this new regime there will be two opposing forces dominating the macro space.

(1) Is the improving sentiment igniting animal spirits thus driving up risk assets and (2) is an increasingly hawkish Fed that will become more aggressive in hiking rates to cool speculation and counteract any fiscally expansionary policy from the Trump administration.

Sentiment will win in the short run (a la’ 98’-99’), but tightening liquidity via the Fed will win in the end (it always does) and we’ll see the beginning of a bear market.

When this happens is dependent on Trump’s policies and how Yellen reacts to them. My guess is that things don’t turn until the 10-yr is yielding between 3.5-4%.

I’ll end this section with the following “expert” SPX 500 forecasts for 2017. Not a <u>single one</u> is bearish.

2017 yr end SPX Target	Firm	Analyst
2299*	Finance Twitter	StockCats
2300	Bank of America Merrill Lynch	Savita Subramanian
2300	Morgan Stanley	Adam Parker
2300	Credit Suisse	Andrew Garthwaite
2300	UBS	Julian Emanuel
2300	Goldman	David Kostin
2325	Citi	Tobias Levkovich
2325	Jeffries	Sean Darby
2340	Canaccord	Tony Dwyer
2350	BMO	Brian Belski
2350	Deutsche Bank	David Bianco
2350	Federated Investors	Stephen Auth
2400	JPMorgan	Dubravko Lakos-Bujas
2400	Societe Generale	Roland Kaloyan
2400	Barclays	Jonathon Glionna
2400	Blackrock	Heidi Richardson
2500	RBC	Jonathan Golub
2575	Prudential	John Praveen

*subect to revision

WALL STREET FORECASTS: 2017

Investment strategists expect stocks to keep climbing next year, even as bond yields rise and economic growth improves. Their mean S&P 500 forecast: 2380.

Stephen AUTH
Federated Investors
S&P 500 2017 Year-End Target: 2350
S&P 500 EPS 2017: $130
GDP Growth 2017: 3.0%
10-Year Treasury Yield 2017: 3.0%
Favorite Sectors: Health Care, Telecom, Information Technology
Avoid: Consumer Staples, Consumer Discretionary, REITs

Jonathan GLIONNA
Barclays Capital
S&P 500 2017 Year-End Target: 2400
S&P 500 EPS 2017: $127
GDP Growth 2017: 2.2%
10-Year Treasury Yield 2017: 2.40%
Favorite Sectors: Financials, Health Care, Consumer Discretionary.
Avoid: Consumer Staples

Jeffrey KNIGHT
Columbia Threadneedle
S&P 500 2017 Year-End Target: 2450
S&P 500 EPS 2017: $135
GDP Growth 2017: 3.0%
10-Year Treasury Yield 2017: 2.90%
Favorite Sectors: Financials, Industrials
Avoid: Telecom, Utilities, REITs

David KOSTIN
Goldman Sachs
S&P 500 2017 Year-End Target: 2300
S&P 500 EPS 2017: $116
GDP Growth 2017: 2.2%
10-Year Treasury Yield 2017: 2.75%
Favorite Sectors: Financials, Information Technology, Health Care
Avoid: Consumer Staples, Telecom, Utilities, REITs

Dubravko LAKOS-BUJAS
JPMorgan
S&P 500 2017 Year-End Target: 2400
S&P 500 EPS 2017: $128
GDP Growth 2017: 2.1%
10-Year Treasury Yield 2017: 2.55%
Favorite Sectors: Financials, Energy, Materials, Health Care
Avoid: Consumer Staples, Consumer Discretionary

Tobias LEVKOVICH
Citi Research
S&P 500 2017 Year-End Target: 2325
S&P 500 EPS 2017: $129
GDP Growth 2017: 1.8%
10-Year Treasury Yield 2017: 2.60%
Favorite Sectors: Financials, Information Technology, Energy
Avoid: Health Care, Consumer Staples, Telecom

Adam PARKER
Morgan Stanley
S&P 500 2017 Year-End Target: 2300
S&P 500 EPS 2017: $128.70
GDP Growth 2017: 2.0%
10-Year Treasury Yield 2017: 2.50%
Favorite Sectors: Industrials, Utilities, Health Care
Avoid: Consumer Staples, Materials, Information Technology, Consumer Discretionary

John PRAVEEN
Prudential Int'l Investment Advisors
S&P 500 2017 Year-End Target: 2575
S&P 500 EPS 2017: $122.20
GDP Growth 2017: 3.0%
10-Year Treasury Yield 2017: 2.75%
Favorite Sectors: Financials, Industrials
Avoid: Utilities, Consumer Staples

Heidi RICHARDSON
BlackRock
S&P 500 2017 Year-End Target: 2400
S&P 500 EPS 2017: $127
GDP Growth 2017: 2.4%
10-Year Treasury Yield 2017: 2.5-3.0%
Favorite Sectors: Financials
Avoid: Consumer Staples

Savita SUBRAMANIAN
Bank of America Merrill Lynch
S&P 500 2017 Year-End Target: 2300
S&P 500 EPS 2017: $129
GDP Growth 2017: 2.0%
10-Year Treasury Yield 2017: 2.65%
Favorite Sectors: Health Care, Financials, Telecom, Consumer Discretionary
Avoid: Consumer Staples, Utilities, Materials

Note: Some GDP and yield estimates are from firm's economists, bond strategists.

Tactical: Strong Breadth and Rising Rates

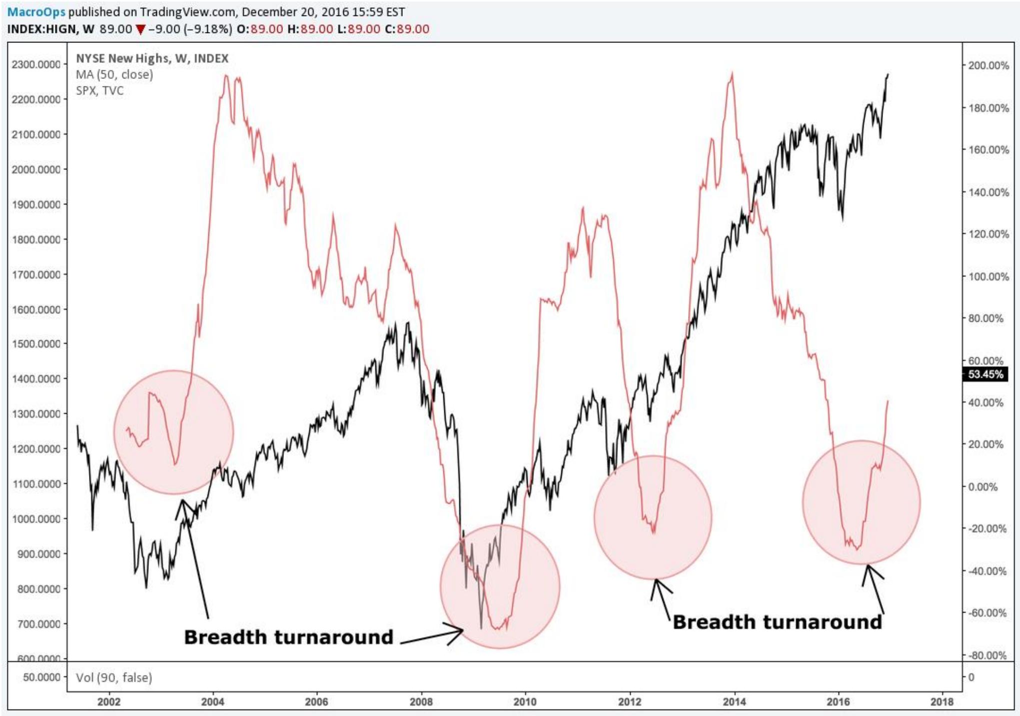
I constantly track market breadth with a number of indicators. Market breadth is the strength, the numbers, behind a prevailing trend.

I think of market breadth as an advancing army. The strength of the breadth is dependent on how many soldiers are moving lockstep with one another in the same direction.

When the front is unified and plentiful, that means the trend is strong and durable. When it starts collapsing and soldiers start running the other direction, it means the tides of war may be changing.

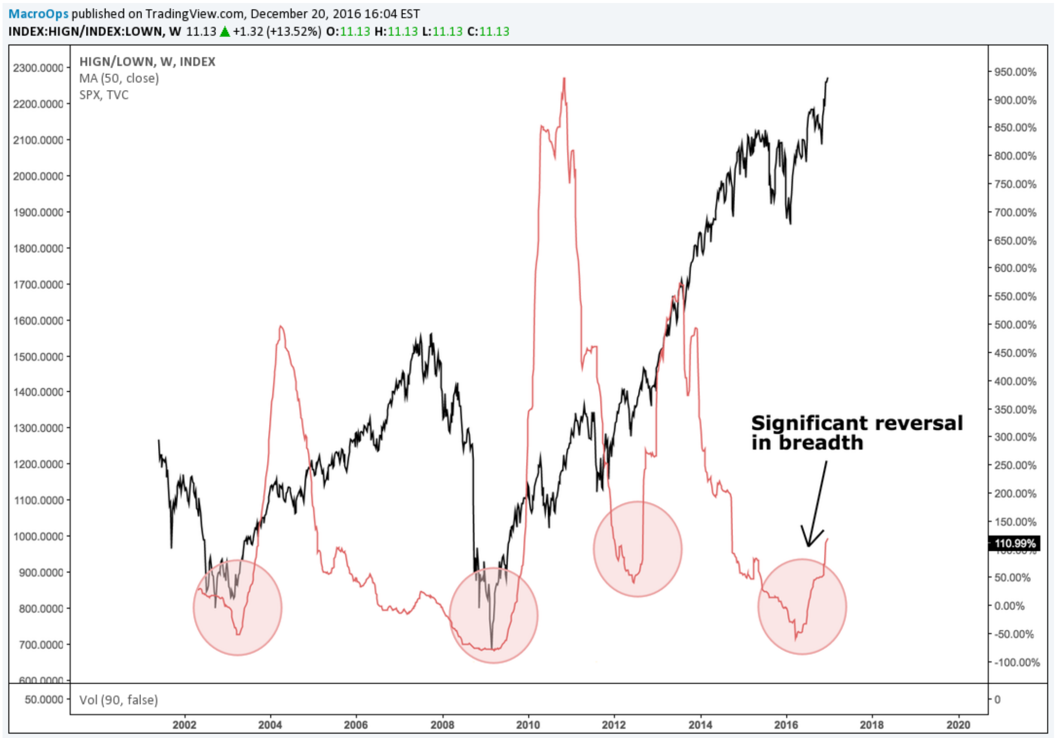
With that said, look at the following three charts showing various indicators of NYSE breadth.

The first one shows the 50-week moving average of NYSE new highs (this is the number of stocks on the NYSE making 52-week highs) in relation to the S&P. You can see that major reversals, like the one we just experienced, are followed by major moves in the index.



The same can be seen on this chart showing the 50-week moving average of new lows on the NYSE.

And then finally this one which just combines the two showing new highs over new lows.



This turnaround in market breadth needs to be respected. The army has regrouped and is forming a strong unified line. This fits right in with our 98' narrative and shows a lot of potential for the continuation of this trend.

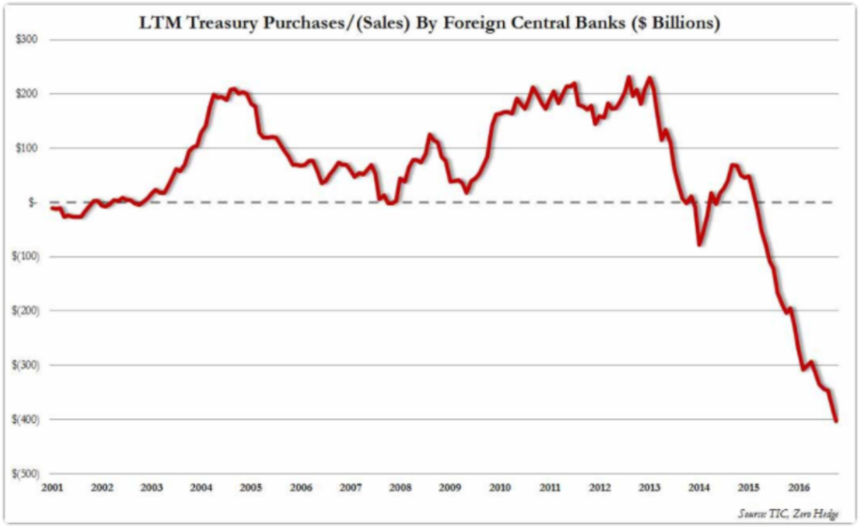
US Treasuries have been dumped like a red headed step child over the last few months. It's been the largest bond rout since 94'.

Aggressively flipping our view on sovereign bonds back in September has been one of our better calls this year (self-congratulatory, I know).

Much of this selling is due to China. The Chinese have been selling their USD holdings to try and maintain the crawling yuan peg to the dollar.

There has never been such aggressive selling of US Treasuries over a 12-month period in history. Bond losses are now over 25%.

I've been nibbling on the long side of bonds this last week, but more so just to feed my trading addiction than due to any level of conviction.



If you look at a chart of TLT or its equivalent, you'll notice that rates tend to consolidate for a few weeks after a large move before they retrace.

I think we're seeing that now. Bonds may even sell off a bit more here but I think we're nearing a short-term bottom.

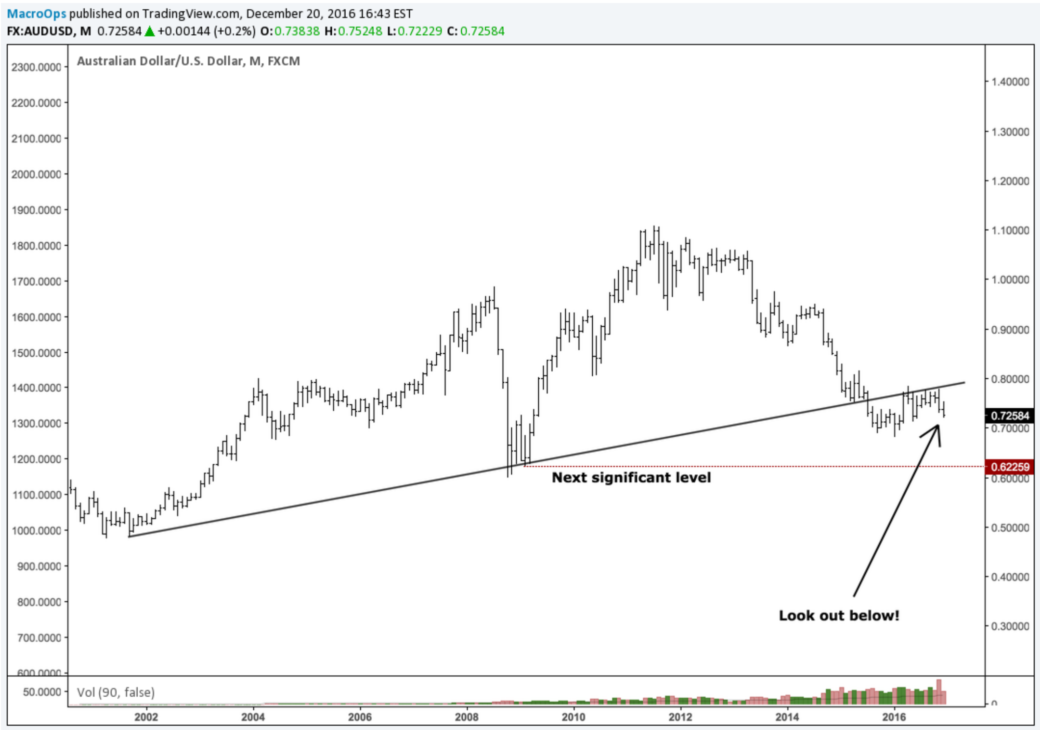
We've seen little selling in the equity markets lately because large holders are waiting till the start of next year to take profits and lock in gains due to expectations of lower taxes in 2017.

Because of this, I think next month we'll see a bit of a selloff and repositioning in equities as well as a retrace in bonds and possibly gold as the dollar is overextended in the short-term.

The next retrace will be a great opportunity to add to and enter new long positions.

Speaking of the dollar, we entered short AUD and JPY positions last week in the Strat account. I may get knocked out of these positions because I was a little slow to hop on this first move but my conviction on the trade has only grown due to the Fed's new hawkish bent. I will gladly take another crack at it if I do get knocked out or add to my positions when the opportunity arises.

Just look at the chart of AUDUSD below.



Next stop is in the 0.60 range against the dollar but ultimately I think it goes to 0.50. And the big reason why is because what's going on in China.

Now I know I’ve talked about China imploding a lot over the last year. I bet you roll your eyes every time I go on another rant about China finally coming to a head.

Here’s the thing, I have a theory about financial news. I think our response to news is a lot like how we respond to price action in the market. The first time we hear a bearish (or bullish) narrative in the media, everybody overreacts and quickly repositions. As a result, the narrative doesn’t play out. It’s like the first retrace at the start of a new bearish trend. People panic, reposition, and things turn out fine.

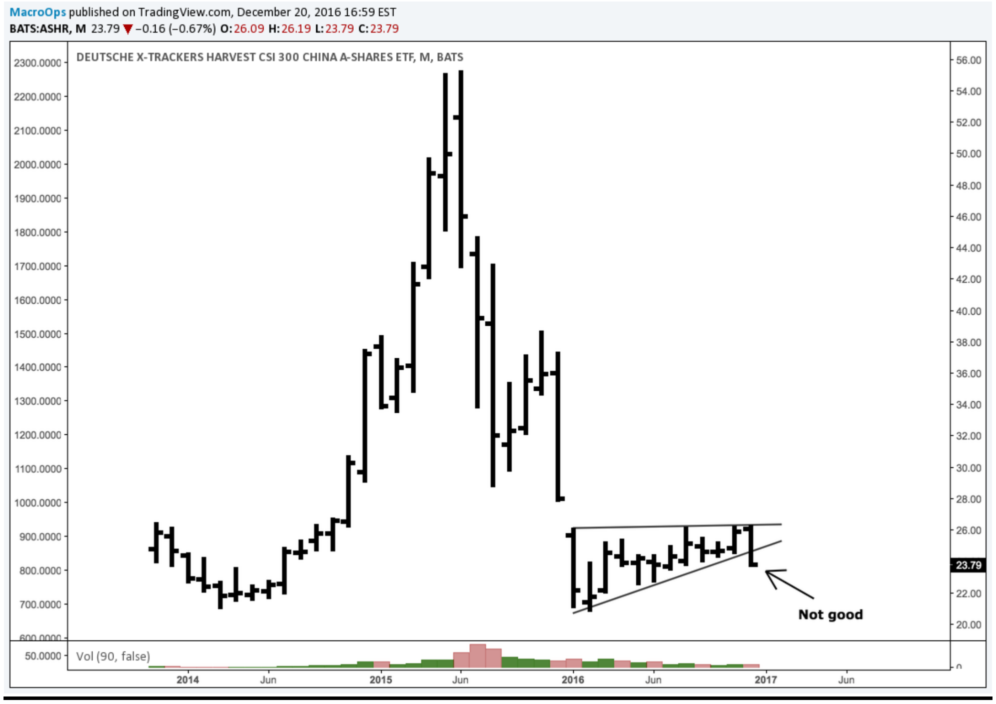
After some time passes, the bearish narrative reemerges and people again react. But this time a little less so. A kind of “news” potential double bottom forms. The narrative moves to the background, time passes, and things seem okay.

Finally, the narrative reemerges but this time everybody has been inoculated to the story and nobody buys into it. If anything, they double down on the bad news because that’s been the play the last few times. But like all good technicians know, a triple bottom hardly ever pays and now the market is positioned in a way where the bearish narrative playing out will hurt the most people possible.

Sorry that was a bit long winded but it’s what I think we’re seeing now in China. I’m not saying China will crap the bed next week. I’m just saying I think the bearish China story is going to come back to the fore over the next few months and this time it may not be smart to fade that move.

China has been feeling the pain of a more hawkish Fed and rising dollar. Here’s the following from the *WSJ* this last week.

> *China’s central bank extended hundreds of billions of yuan in emergency loans to financial firms on Friday and ordered some of the country’s biggest lenders to extend credit as well, as it moved to ease a liquidity crunch and continuing debt selloff.*
>
> *The moves marked a second day in which the People’s Bank of China pumped money into the financial system and markets, after the U.S. Federal Reserve signaled it might quicken the pace of its rate increases. That in turn spooked Chinese investors who were already worried about government attempts to let the air out of a highly leveraged and overheated bond market by tightening credit.*
>
> *The PBOC also ordered a few large banks to extend longer-term loans to nonbank financial institutions, while China’s securities regulator asked brokers tasked with making a market in bonds to continue trading and not shut any companies out of the market, according to Mr. Zheng of Dongxing Securities.*
>
> *The central bank also injected a net 45 billion yuan into the money market on Friday, following a net 145 billion yuan cash infusion on Thursday.*
>
> *“The whole market is scrambling for liquidity and the PBOC is ready to do more to calm the market,” said Arthur Lau, head of Asia ex-Japan fixed income at PineBridge Investments in Hong Kong.*



A rolling loan can gather no loss for only so long. As the dollar continues to rise, global liquidity will be sucked out of China, Europe and emerging markets. Eventually — and I think soon — things outside of the US are going to start to unravel and central authorities will be either out of bullets or just reluctant to stop it. We're hitting that triple bottom on the China narrative and triple bottoms don't pay.

Positioning and Asset Outlook

I likely won't be adding any new positions in the Strat portfolio until January (preferably after a shakeout). There's a number of companies I'm digging into at the moment that I think could be huge trades in 2017. I'll be sending out the Tear Sheets on these to you guys throughout this week and next.

Going forward it's going to pay to focus on US centric companies. Companies that aren't affected by a rising dollar or talk of trade wars. Value investing hasn't paid much the last few years but I think beaten down value stocks will be the winners going forward under the new narrative. I don't like large tech stocks that may be vulnerable to rising angst over their automation of jobs. I think Trump could be vocal about this and this space is already exposed to the dollar and trade war risks. Focus on small caps and value.

Right now I'm diggin into nuclear energy and uranium stocks. And stocks that will benefit from expansionary fiscal policy (defense and infrastructure related stocks). I don't like bonds, though I will be playing them to the long side on swing trades to occasionally hedge out my portfolio. The top of the bond market is in but the trend won't continue straight down. I think rates bounce around for the next six months at least, before decidedly starting a new trend.

I'll leave you with some words of wisdom from Ayn Rand. If you have any questions or comments, just shoot me an email or hit me up in the Hub. I hope you all enjoy your week stay safe over the holidays.

> *Productiveness is your acceptance of morality, your recognition of the fact that you choose to live--that productive work is the process by which man's consciousness controls his existence, a constant process of acquiring knowledge and shaping matter to fit one's purpose, of translating an idea into physical form, of remaking the earth in the image of one's values--that all work is creative work if done by a thinking mind, and no work is creative if done by a blank who repeats in uncritical stupor a routine he has learned from others--that your work is yours to choose, and the choice is as wide as your mind, that nothing more is possible to you and nothing less is human--that to cheat your way into a job bigger than your mind can handle is to become a fear-corroded ape on borrowed motions and borrowed time, and to settle down into a job that requires less than your mind's full capacity is to cut your motor and sentence yourself to another kind of motion: decay--that your work is the process of achieving your values, and to lose your ambition for values is to lose your ambition to live--that your body is a machine, but your mind is its driver, and you must drive as far as your mind will take you, with achievement as the goal of your road--that the man who has no purpose is a machine that coasts downhill at the mercy of any boulder to crash in the first chance ditch, that the man who stifles his mind is a stalled machine slowly going to rust, that the man who lets a leader prescribe his course is a wreck being towed to the scrap heap, and the man who makes another man his goal is a hitchhiker no driver should ever pick up--that your work is the purpose of your life, and you must speed past any killer who assumes the right to stop you, that any value you might find outside your work, any other loyalty or love, can be only travelers you choose to share your journey and must be travelers going on their own power in the same direction.* ~ Ayn Rand, *Atlas Shrugged*

Portfolio Snapshot

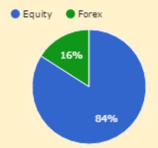
Macro Ops Strategic Portfolio

NAV $1,181,421

Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target 1	Beta (1yr)	Notional
Equity	Goldfield GV	5,000	$3.89	$2.52	$6,850.00	$4.50	1.81	$22,750
Equity	Intrepid IPI	30,000	$2.08	$1.09	$29,700.00	$3.50	-0.37	$72,300
Equity	Whiting Petroleum WLL	5,000	$10.41	$8.10	$11,550.00	$16.42	2.94	$59,550
Equity	Kingstone KINS	2,000	$12.50	$11.61	$1,780.00	$16.20	0.58	$27,300
Equity	Skyline SKY	1,000	$13.08	$12.20	$880.00	$22.00	2.63	$15,100
Equity	Foster FSTR	6,000	$14.30	$11.17	$18,780.00	$20.84	0.44	$87,900
Equity	Neonode NEON	15,000	$1.98	$1.70	$4,060.00	$5.50	2.01	$29,550
Forex	Yen	-2	$0.84800	$0.87950	$7,875.00	$0.7500	-0.27	$106,750
Forex	Aussie	-3	$0.7316	$0.7520	$6,120.00	$0.6500	0.07	$218,520

Metrics

Exposure Breakdown	
Equity	$73,600.00
Commodity	$0.00
Fixed Income	$0.00
Forex	$13,995.00



Total Open Risk	Portfolio Beta
$87,595.00	0.27
7.41%	

**Updated 12/20

Macro Ops Income Portfolio

NAV $1,149,283

Asset Class	Position	Size	Cost Basis	Max Profit

Scenario Analysis/Stress Tests

Worst Case	Worst Drawdown

**Updated on 12/20

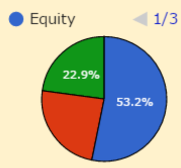
Macro Ops Tactical Portfolio

NAV $951,243.00

Asset Class	Position	Size	Cost Basis	Risk Point	Market Price	Open Risk	Target 1	Notional
Equity	NASDAQ Future (NQH7)	6	$4,947.35	$4,879.00	$4,957.00	$9,360.00	$5,157.50	$590,520
Equity	Eurostoxx50 Future	11	€3,198.20	€3,073.00	€3,265.00	€21,120.00	€3,517.00	€372,462
Equity	Cliffs CLF	3,967	$9.90	$8.04	$9.41	$5,434.79	$15.84	$35,862
Commodity	Soybean Oil ZLF7	6	$36.93	$34.90	$36.09	$4,284.00	$44.48	$132,569
Commodity	Heating Oil (HOG7)	4	$1.6657	$1.6253	$1.6960	$11,877.60	$1.9759	$275,164
Forex	Euro Futures (6EH7)	-7	$1.0463	$1.0614	$1.0438	$15,443.75	$0.9436	$919,012

Metrics

Exposure Breakdown	
Equity	$35,914.79
Commodity	$16,161.60
Fixed Income	$0.00
Forex	$15,443.75



Total Open Risk
$67,520.14
7.10%

**Updated 12/20

Asset Allocation Weightings

Asset Allocation Weightings	Underweight	Neutral	Overweight
Large Cap Growth		X	
Large Cap Value			X
Small/Mid Cap			X
International Equity		X	
Emerging Market Equity		X	
Real Estate, Domestic			X
Real Estate, Global	X		
Consumer Discretionary			X
Biotech		X	
Industrials			X
Materials			X
Financials			X
Tech		X	
Telecom		X	
Healthcare		X	
Consumer Staples	X		
Utilities	X		
Long Bonds	X		
Intermediate Bonds	X		
Short Bonds	X		
High Yield	X		
TIPS		X	
Emerging Market Credit		X	
Gold	X		