MARKET BRIEF

Pyrrhonian Speculator

I thought this was interesting from a NYT interview I read this week with investor Peter Thiel:

> *Over a four-hour dinner of duck and chocolate dessert — a surprisingly sybaritic meal for a man who admits he is prone to weird diets — Mr. Thiel shows, again and again, how he likes to "flip around" issues to see if conventional wisdom is wrong, a technique he calls Pyrrhonian skepticism.*
>
> *"Maybe I do always have this background program running where I'm trying to think of, 'O.K., what's the opposite of what you're saying?' and then I'll try that," he says. "It works surprisingly often." He has even wondered if his most famous investment, Facebook, contributes to herd mentality.*
>
> *When I remark that President Obama had eight years without any ethical shadiness, Mr. Thiel flips it, noting: "But there's a point where no corruption can be a bad thing. It can mean that things are too boring."*
>
> *When I ask if he is concerned about conflicts of interest, either for himself or the Trump children, who sat in on the tech meeting, he flips that one, too: "I don't want to dismiss ethical concerns here, but I worry that 'conflict of interest' gets overly weaponized in our politics. I think in many cases, when there's a conflict of interest, it's an indication that someone understands something way better than if there's no conflict of interest. If there's no conflict of interest, it's often because you're just not interested."*

> *When I ask if Mr. Trump is "casting" cabinet members based on looks, Mr. Thiel challenges me: "You're assuming that Trump thinks they matter too much. And maybe everyone else thinks they matter too little. Do you want America's leading diplomat to look like a diplomat? Do you want the secretary of defense to look like a tough general, so maybe we don't have to go on offense and we can stay on defense? I don't know."*
>
> *When I ask about the incestuous amplification of the Facebook news feed, he muses: "There's nobody you know who knows anybody. There's nobody you know who knows anybody who knows anybody, ad infinitum."*

I imagine it wouldn't be much fun to debate Peter.

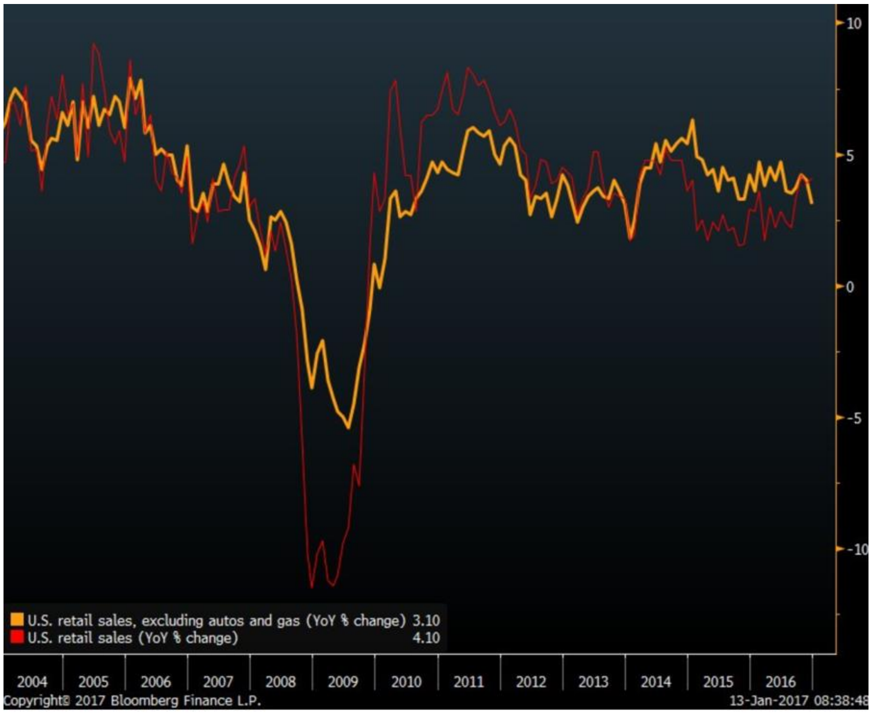
Nevertheless, his practice of Pyrrhonian skepticism and constantly flipping conventional wisdom on its head has worked out pretty well for the billionaire.

We've talked about the importance of inverting our thinking and the origins of Pyrrhonian skepticism in past Briefs. It's an invaluable practice for us traders. Like Thiel, we should always have a background program running where we're thinking, "O.K., what's the opposite of market consensus" and then explore that narrative.

Of course, it's easier said than done.

Consensus is a tough thing to quantify, especially when it's not at extreme levels. And the last thing we want to be are lame knee-jerk contrarians who smugly oppose dominant narratives while standing firmly pat in front of the market steamroller.

This has been a boring wash week in the markets. I won't be surprised if the trades I put on today (Friday) in Strat come back to nip me in the arse. If you didn't manage to follow me in on Friday, don't worry, you'll probably get a better price next week.



Nothing much to note. Retail sales came in mixed, depending on how you cut the numbers. No surprises, there.

The talk of the Russian "Kompromat" dossier on PEOTUS Trump is something we'll probably be discussing more of down the line. But the Bureau will be looking into that for a while before we hear much more.

Markets look like they'll close scratch for the week. Indices closing unchanged. Dollar down a tad, gold up a bit, and bonds near even to slightly up.

Volume was low and action was slow. Good week to not do any trading.

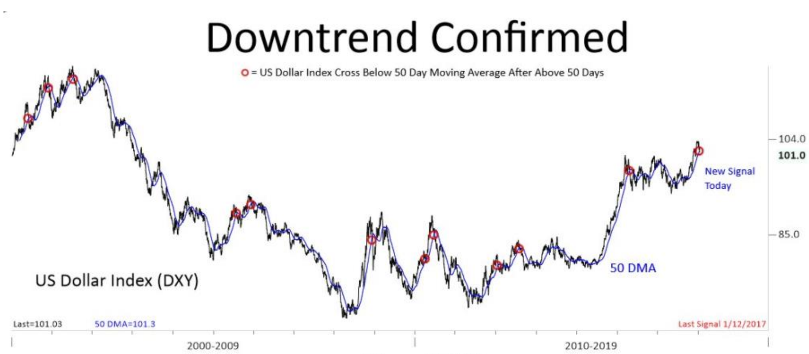
I spent the majority of the last few days continuing to try and wrap my head around the dollar. Are we nearing a cyclical top? Or do we have another leg in the bull left to go?

On this front I only became more unsure.
There are too many variables, most of which depend on the incoming administration's actions on trade, taxes, and regulation. That's a black box at the moment and I think making too many assumptions and assigning probabilities is mostly a sucker's game at this point.

I find both arguments nearly equally compelling. So I'm stuck with following price and seeing where the cards fall.

Either way, I am expecting a short-term selloff in the dollar that could run weeks to a few months without signaling any major trend change.

Here's a chart that was shared by Nautilus showing the short-term returns of the dollar following a crossover of its 50-day moving average, after being above it for over 50-days.



Since 2000

forward returns after 12 events 1/3/2000 - 1/12/2017

		DXY			GOLDS			SPX		
Event Dates	Days Above	1Wk	1Mo	3Mo	1Wk	1Mo	3Mo	1Wk	1Mo	3Mo
06/02/2000	107	-1.05%	-0.95%	3.72%	0.96%	2.56%	-2.47%	-1.37%	-0.52%	2.74%
11/30/2000	90	-1.56%	-5.75%	-3.44%	1.26%	0.67%	-0.81%	2.17%	-2.41%	-5.59%
07/18/2001	110	-0.63%	-3.66%	-2.49%	-1.11%	1.70%	3.95%	-1.43%	-2.16%	-9.75%
08/02/2005	95	-0.98%	-1.33%	0.94%	0.58%	0.67%	9.53%	-1.02%	-1.91%	-2.98%
12/12/2005	57	-0.50%	-0.97%	0.24%	-4.58%	2.75%	3.42%	-0.04%	2.03%	3.38%
12/11/2008	97	-5.21%	0.51%	4.56%	3.84%	4.00%	9.35%	1.34%	-0.21%	-13.70%
04/12/2010	89	0.54%	4.85%	4.05%	-1.77%	6.63%	3.62%	0.09%	-3.40%	-9.84%
07/01/2010	54	-1.05%	-3.75%	-6.73%	-0.07%	-1.50%	9.18%	4.92%	9.59%	11.08%
01/25/2012	52	-0.83%	-0.96%	-0.20%	1.92%	4.10%	-4.19%	-0.15%	2.99%	4.87%
08/03/2012	65	0.22%	-1.42%	-2.98%	1.04%	5.55%	7.31%	1.07%	1.00%	1.89%
04/24/2015	203	-1.68%	-0.94%	0.70%	-0.07%	1.98%	-7.22%	-0.44%	-0.64%	-1.80%
01/12/2017	73									
Avg after Signals		-1.16%	-1.31%	-0.15%	0.18%	2.65%	2.88%	0.47%	0.40%	-1.79%
Average All Periods		0.01%	0.03%	0.04%	0.19%	0.79%	2.35%	0.09%	0.34%	0.98%
T-Statistic		-2.57	-1.64	-0.18	-0.02	2.62	0.30	0.68	0.05	-1.23
# Events Up/Down		2 / 9	2 / 9	6 / 5	6 / 5	10 / 1	7 / 4	5 / 6	4 / 7	5 / 6
Significance		-99%	-94%	-57%	-51%	99%	61%	74%	52%	-88%

Since 1970

forward returns after 36 events 12/31/1970 - 1/12/2017

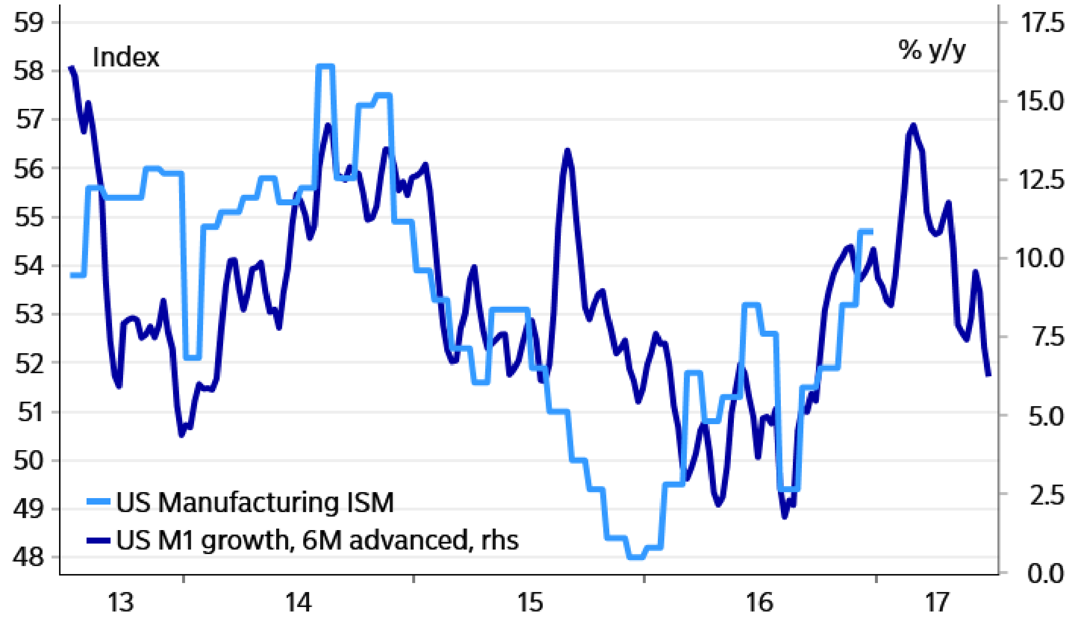
	DXY			GOLDS			SPX		
Stats	1Wk	1Mo	3Mo	1Wk	1Mo	3Mo	1Wk	1Mo	3Mo
Avg after Signals	-0.38%	-0.81%	-0.07%	0.03%	-0.32%	-1.20%	0.58%	0.17%	1.08%
Average All Periods	0.00%	0.00%	0.01%	0.13%	0.53%	1.59%	0.17%	0.68%	2.02%
T-Statistic	-1.35	-1.40	-0.10	-0.20	-0.88	-2.17	0.82	-0.64	-0.81
# Events Up/Down	13 / 22	12 / 23	19 / 16	15 / 17	20 / 12	10 / 22	21 / 14	15 / 20	20 / 15
Significance	-91%	-92%	-54%	-58%	-81%	-98%	79%	-74%	-79%

NAUTILUS INVESTMENT RESEARCH Daily 1/3/2000 - 1/12/2017 Data Source: Bloomberg 1/12/2017 8:13

I'm going to spend a lot of time going through charts over the weekend, but I think there's a decent chance we execute some swing trades in select miners and emerging market stocks next week. I'll keep ya'll posted via email and Comm Center.

Since this was a boring week and I don't feel like beating a dead horse talking about the dollar, how about we go through some chart porn before we jump into tactical and portfolio review.

Here we go.

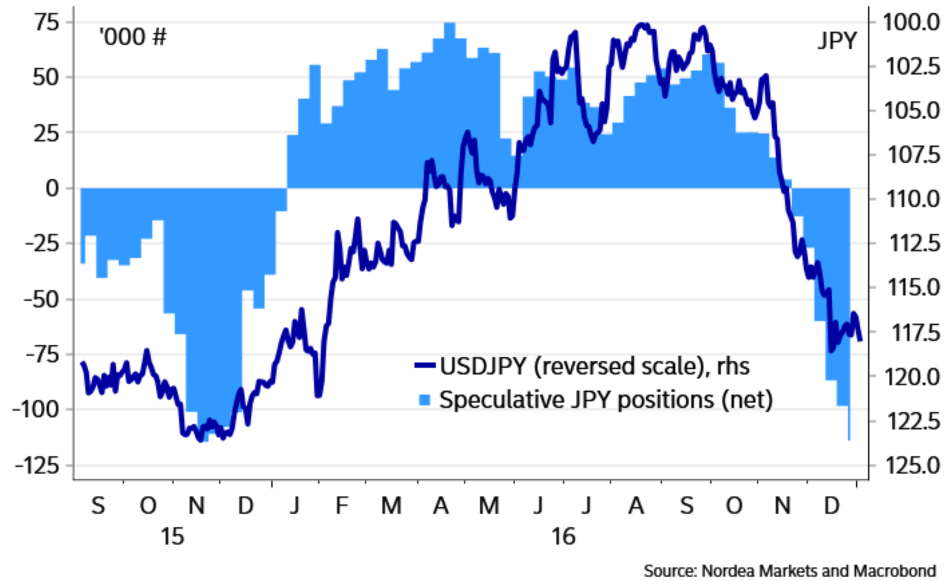


Source: Nordea Markets and Macrobond

The above chart shows US Manufacturing ISM over US M1 growth advanced 6-months forward. M1 is a metric of the money supply that accounts for the most liquid of a country's money stock i.e. paper cash, coin, demand deposits etc…

There tends to be a loose relationship with money supply and certain economic indicators. When M1 expands it means more liquid money is circulating in an economy which should indicate growth and vice-versa. So it makes sense that ISM has a lagging correlation to M1 but this relationship comes and goes and I don't think it necessarily means anything by itself. Just food for thought.

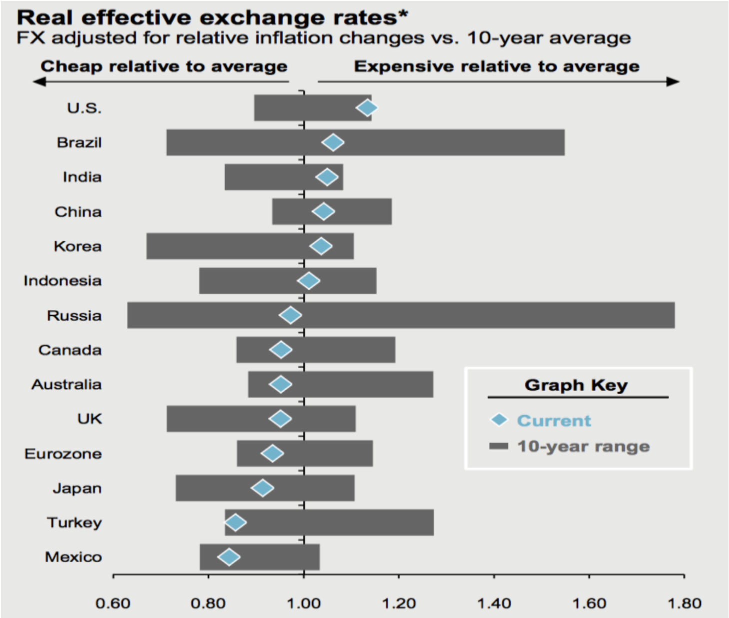
Here's another chart showing USDJPY (reversed scale) over net speculative short yen positions.



Most of the time COT isn't of much use as an indicator or input. That is, except for when it's at the extremes like it is now.

I'm bearish long-term on the yen but think the USDJPY could see a sizable correction over the next few weeks.

Here's a chart from JP Morgan showing the real adjusted exchange rates vs. their 10-year averages.



The dollar is currently the most expensive currency relative to its 10-year average, while the Mexican Peso is the cheapest.

This doesn't necessarily mean much. The dollar spent most of the last decade in a tight range and was trading cheap. So it makes sense that a strong trending currency would be expensive relative to its last decade where it traded in a low range.

This chart from Deutsche surprised me.

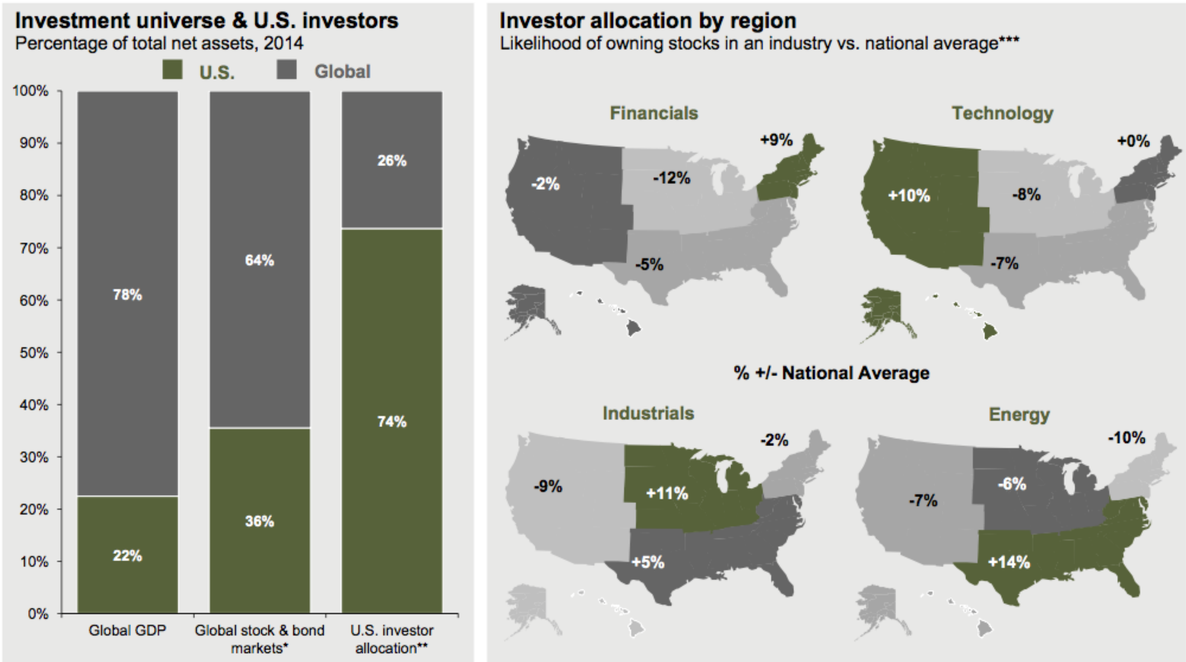
It shows foreign inflows into US equities versus US buying of foreign stock. Essentially, since 2011 there's been a net outflow in foreign holding of US equities. Whether this trend accelerates or reverses could have a big impact on the US market going forward.

And here's basic balance as % of GDP over the trade weighted dollar, again from Deutsche.

Basic balance (BB) is the sum of the current account (exports/imports of goods, services, and unilateral transfers) and capital account (change in physical/financial asset ownership). Basic balance measures structural changes in a country's balance of payments i.e. a summary of a country's transactions with the rest of the world.

So it makes sense that the US dollar tends to track BB as a percentage of GDP. The chart shows how much BB/GDP could rise (and as an extension the dollar) if PEOTUS and the Republicans are successful in executing their planned corporate tax reform.

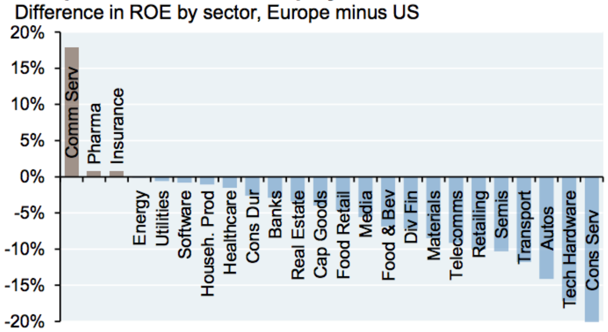
Here's some interesting charts from JP Morgan showing US investor's "home bias" as well as US equity performance relative to the rest of the world.



Source: Openfolio, IMF, ICI, J.P. Morgan Asset Management.
*Global stock and bond markets data are as of 2013. **U.S. investor allocation is the total value of investments in global or domestic equity mutual funds and ETFs. ***Investor allocation by region is based on data collected by Openfolio. Average sector allocations at the national level are determined by looking at the sector allocations of over 20,000 brokerage accounts, and taking a simple average. Portfolio allocations are then evaluated on a regional basis, and the regional averages are compared to the national average to highlight any investor biases. Further details can be found on openfolio.com.

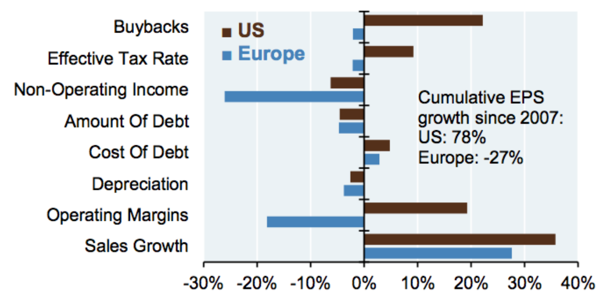
J.P.Morgan

Europe vs. US: return on equity
Difference in ROE by sector, Europe minus US



Source: MSCI, Bloomberg, JPMAM. November 2016.

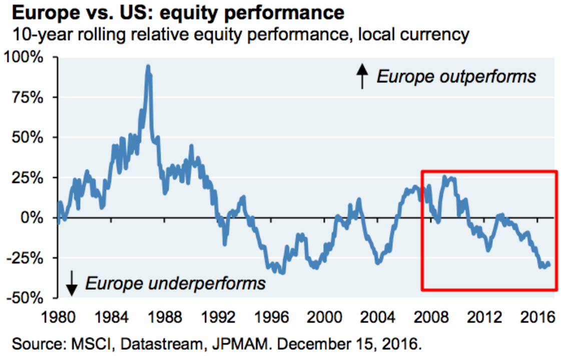
Europe vs. US: profitability components
Contribution to earnings per share growth since 2007

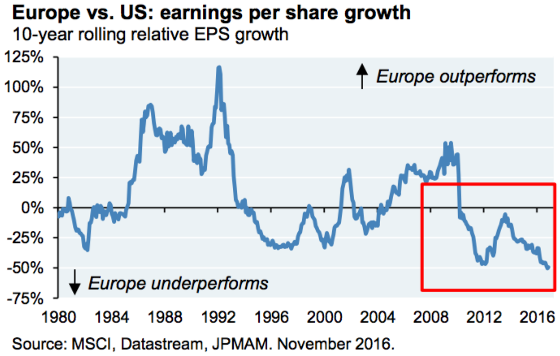


Source: MSCI, Bloomberg, Morgan Stanley Research. June 2016. Excluding commodities and financials.

Cumulative EPS growth since 2007 has been 78% for the US and **-27%** in Europe. US has benefited a lot from share buybacks while Europe issued more shares on net. But the US has also outpaced Europe by a wide margin in sales growth.

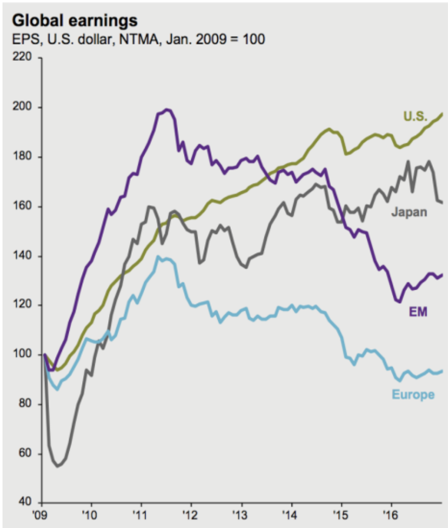
Below is Europe vs US in equity outperformance and EPS. US has dominated Europe on both since the financial crisis. I expect this ratio to improve in Europe's favor over the coming months but I'm not sold on the idea that we'll see strong long-term outperformance from them. Europe's got big structural issues on various levels (ie, politics, business, immigration etc). I see some trades there but no long-term investments, yet.

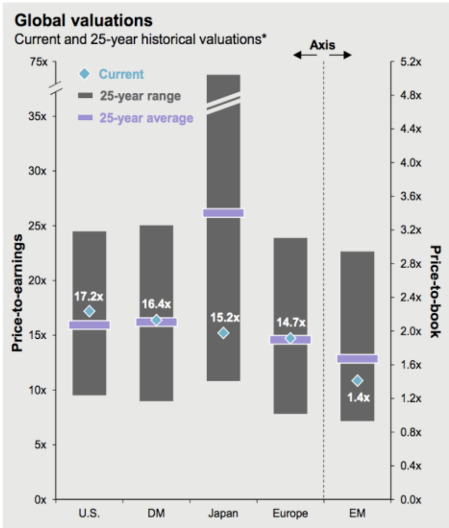


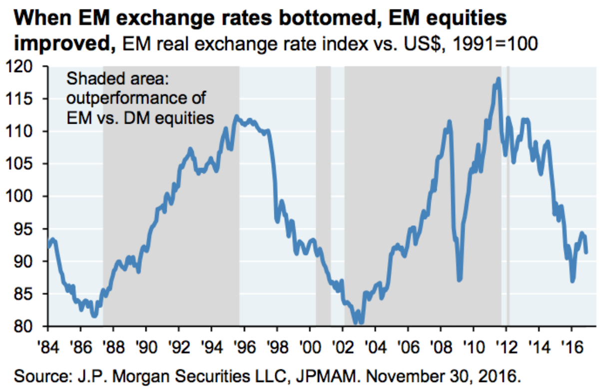


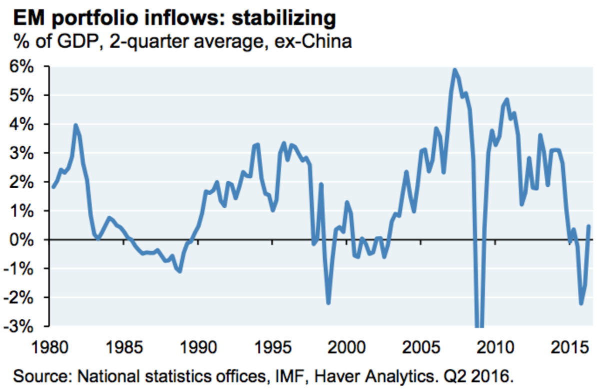
And here's two other charts that graph EPS and compare current and historical valuations for different markets.

The one valuation that really stands out is Japan which is significantly below its 25yr average and at the bottom of its 25yr range. Some Japanese stocks have been looking interesting lately and we'll be digging into a few in the coming weeks.







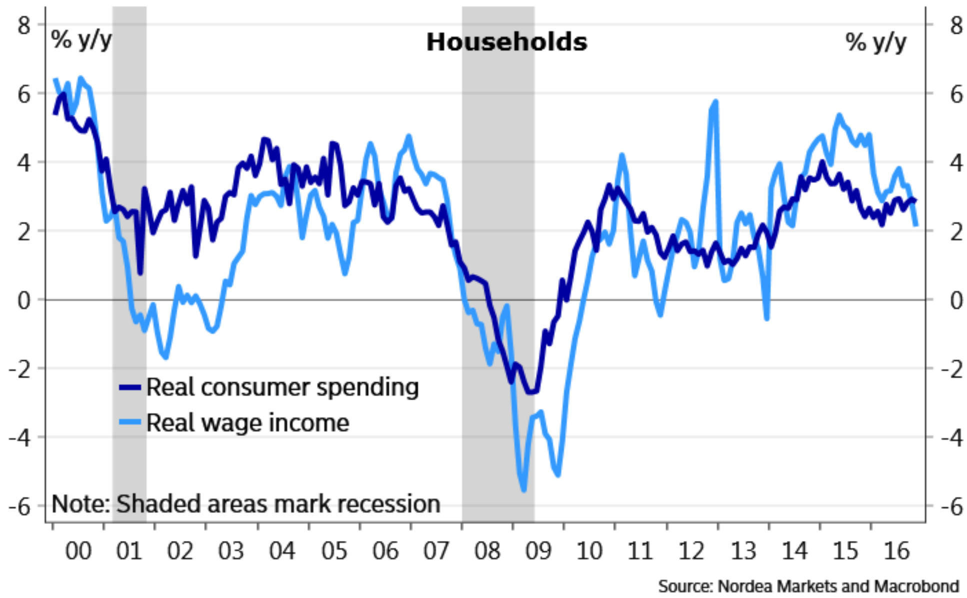


The chart on the left shows the performance of emerging markets vs developed markets (marked by the shaded areas) over emerging market exchange rates against developed market exchange rates (marked by the blue line). When emerging market exchange rates bottom, their stocks begin to outperform developed market stocks. Makes sense.

Many EM currencies look like the could be about to appreciate some more against the dollar, as Jamie pointed out in one of his Daily Dopes this week. The question is if this is a temporary trend, like in 98'-99' or if it's the start of a cyclical outperformance by EM over DM stocks.

My guess is still that it's more of a pause and developed market stock outperformance still has a ways to go. We'll likely reach the lower range similar to the 87' and 03' bottoms on the chart.

And last but not least, household income and spending.



There's been a lot of talk about US wage growth picking up and how this is indicative of a quickly improving economy. But when you back out inflation, you can see that wage growth has actually been slowing over the last two years. Nominal wage growth has been completely due to rising inflation.

And as the chart shows, spending growth tends to follow wage growth, for obvious reasons. So unless there's a pickup soon in real wages, we should see consumer spending (the largest component of GDP) begin to slow down as well.

Conclusion:

Nothing has changed since last week's MIR. The market looks confused and it should be.

There's large macro tectonic shifts going on in the market. The tough thing is that we can't tell where they're moving too, yet.

We should have greater clarity on the environment once stocks break out of their current range and the dollar moves. Everything is still keying off the dollar.

In the meantime, I'm going to trade the Strat portfolio very lightly until I feel I have a firmer grasp on where things are going.

I know it's atypical for someone who's in the "newsletter" business to say he doesn't know exactly what's going on at the moment. But…. I don't know what's going on at the moment.

The fact is that as traders we move in and out of pockets of clarity with the markets. Sometimes I'll go months or a year where I feel completely dialed in and trading is as easy as picking up money off the ground. But occasionally the reverse is true, as well. Right now I'd say I'm somewhere in between.

The key to making money over the long term is by being able to differentiate between the two environments and not overtrade when you're in the latter. It's why infinite patience is a key character trait of all the greats.

I'm hoping things settle after the inauguration and we get some decisive moves. Until then, expect a lot of chart porn, market research and trade theory.

Oh yeah, almost forgot!

We're trialing both a Macrobond and Thompson Reuters terminal over the next month. I can't tell you how excited I am about this. It's been too long since I've had access to a real data set.

I told my girlfriend to not expect to see me much over the coming weeks. I'm going to be living in Reuters datastream doing a bunch of research and studies and sharing it with you guys. Next week's Brief is going to be a lot of fun to put together.

Now let's look at some quick price action.

Tactical Review

Shippers are looking really good to me. I've covered this sector a lot over the last few months so I'll keep this brief since you're probably sick of hearing me talk about them.

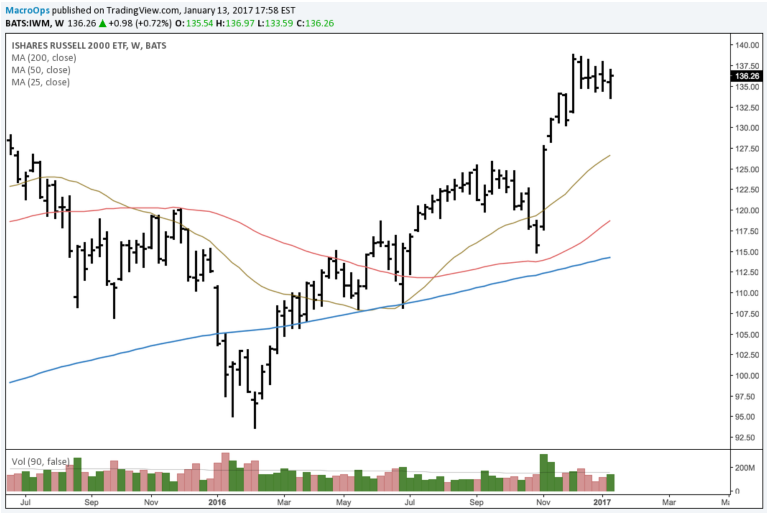
But the case is simple. They've been kneecapped due to slowing global growth and a supply glut of tonnage on the seas. Global PMIs have turned up over the last two quarters and we should see a shift in sentiment on shipping stocks as a result.

From a purely price action perspective, I love the setup. Looks similar to Uranium right before its breakout this week. We put on positions in NMM and NM today simply because those are the best looking charts to me at the moment but we should see the entire industry run.

Current price action in the shippers offers an excellent inflection point allowing us to create strong return asymmetry. If price reverses from here and moves back below its moving averages then we cut for a tiny loss. If it continues to look good into next week then we'll add. This tight R/R point allows us to size up and get outsized returns if the trade moves in our favor.

From a breadth perspective the market looks neither hot nor cold.

IWM (small caps etf) finished the week slightly up but still in the range it's finished in for the last 5-weeks.



The chart below shows the 25-day moving average of NYSE new highs over new lows (in gold) along with the SPX500 (black).

It shows a little bit of weakness but hardly enough to matter. Like everything else this week, it's a scratch.

I can same the same for other breadth indicators like % over 200 and 50-day moving averages. No signs of trouble nor indication of strength.

And the high-yield bond etf (JNK) has also been doing a whole lot of nothing. So there's little to gleam there.

There's been a lot of compression in price volatility for various asset classes over the last few weeks. This type of compression generally precedes large moves.

But the market is giving little indication which direction this move will take. So we wait. Eventually breadth and/or credit will tip us off.

The gold chart does not look particularly constructive to me.

The lack of high selling volume and a wide ranging reversal bar makes me think that this recent turn in price is not a significant intermediate bottom. For that, you need fear selling and capitulation. I'm not seeing that anywhere here.

The same can be said for TLT (UST 20yr+ etf). It doesn't look like this intermediate bottom is done playing out.

It could very well move higher from here over the next week or so but I have little confidence in its ability to sustain a reversal at this point.

I think it's much more likely we see it form this intermediate bottom for a while longer.

The USDJPY chart had a bad close on the week that makes it look like there'll be more follow through next week.

I sold out my probing positions for a small profit. I just don't have conviction in the length of the potential move lower so it doesn't make sense to me from a risk/reward standpoint. I'll just watch from the sidelines.

Portfolio Review

Our book has been mostly flat since the start of the year. We carried over small positions in GV, IPI, SKY and WLL. I'm probably going to take profits on SKY next week and add to GV if it continues to look strong.

I entered a handful of trades (NM, NMM, CCJ, CENX, GGAL) today with small size. I missed the initial entries on URA and CCJ that we pointed out last week in the MIR (hopefully some of you were more vigilant and put the trade on). And then to compound my first mistake, I waited, hoping for a retest of the breakout to enter. Both continued to run so I chased in what hopefully won't be my third mistake on the trade.

That's why I sized small; risking only 45bps in CCJ. CCJ is a straight uranium/nuclear macro play. I've become fairly bullish on uranium over the last two months and think this could be the beginnings of a much larger move.

I also put on a 60bps position into CENX, an American based aluminum producer.

Aluminum should continue higher over the coming months due to the improving global PMI that I mentioned. In addition, the Obama administration this week, sent a complaint to the WTO regarding China's aluminum subsidies. It's likely that the incoming administration will carry on in this direction as well.

This is a plus obviously for aluminum prices and investor sentiment on US producers. I really like the price action on this stock and will add to the position if there's follow through next week.

And then finally we entered into a 50bps position on GGAL which is an Argentinian bank that has enjoyed explosive top and bottom line growth over the last five years (tear sheet here). Technicals on ARGT, the Argentina etf, also look bullish.

This is a go/no go trade for me. If it has a strong daily reversal next week then I'm going to cut quick.

These are small trades. I'm just testing the waters and I'll be quick to cut all positions if the market starts looking weak.

I generally never take the full risk of one of my initial positions. I like to be profitable early on in my trades and I'm quick to cut if they don't move how I expect them to. This is especially true when we're in a low conviction market like we are now, where I don't have a good feel on what's next.

So on a trade like GGAL where I risk 50bps, my actual loss on the trade if price moves toward my stop will be around 15bps. I'll take a small amount off on the way down.

The reverse is true for when price moves in my favor. I'll add in increments and build up a larger position.

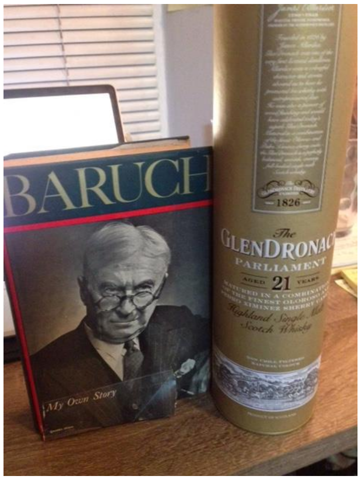
Doing this type of pyramiding and trading around positions is not for everyone. I've just found it works for me. I don't like to lose money, not even 50bps of it.

This trading around positions will be updated in the Comm Center from now on.

GV had a strong weekly close, breaking out of a wedge pattern. This continues to be my highest conviction trade in the portfolio. It's up nearly 90% from our entry and continues to look strong. If the market looks healthy next week I'll add to it.

By the way we also dogfooded the tear sheet process this week. You can check these 1.0 versions out by clicking the links below:

GGAL
PERI
CENX



That's all I've got.

I'll be spending my weekend on the T.R. Eikon Terminal and enjoying the two items on the right which just arrived today (one from Amazon and the other from Scotland).

Have an excellent weekend and see you guys in the Hub.

-Alex

P.S. Here's the following on the absurdity of Australia's housing bubble, in case you've forgotten (via Crescat Capital):

- Australia has a historically high level of household debt to income, 186%. This ratio is even higher than in the US in 2007 after our housing bubble peaked where the ratio reached only 132%.

- At the peak of the US housing bubble, publicly traded US banks had close to $8.4 Trillion in total assets, or about 60% of nominal GDP at the time. Today, Australian banks own close to AUD3.6 trillion in assets, or about 225% the size of the Australian economy. The majority of these assets are domestic real estate loans.

- Australian banks have a high average loan-to-deposit ratio of 120%, higher than Asian banks prior to the 1997 Asian Financial Crisis and higher than US banks prior to the 2008 Global Financial Crisis.
- The number of permits that have been issued for new construction, including pre-existing structures or major renovations, in the private sector declined the most last quarter in 26 years.

- Australia monthly housing starts recently dropped by the most since 1990.

Portfolio Snapshot

Strategic Ops

NAV		$1,150,392					
Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target	Notional
Equity	Goldfield GV	4,000	$3.89	$2.52	$5,480.00	$4.50	$22,750
Equity	Intrepid IPI	6,000	$2.08	$1.09	$5,940.00	$3.50	$32,700
Equity	Whiting Petroleum WLL	2,000	$10.41	$8.10	$4,620.00	$16.42	$26,300
Equity	Skyline SKY	1,000	$13.08	$12.20	$880.00	$22.00	$15,100
Equity	Grupo Financiero GGAL	1,700	$31.60	$28.62	$5,066.00	$41.65	$53,635
Equity	Cameco CCJ	2,500	$13.13	$11.28	$4,625.00	$19.15	$33,375
Equity	Century Aluminum CENX	1,700	$11.11	$7.55	$6,052.00	$16.55	$19,550
Equity	Navios Partners NMM	28,000	$1.65	$1.49	$4,480.00	$4.00	$44,800
Equity	Navios Holdings NM	30,000	$1.75	$1.55	$6,000.00	$4.10	$51,300

Metrics

Exposure Breakdown	
Equity	$16,920.00
Commodity	$0.00
Fixed Income	$0.00
Forex	

Total Open Risk
$43,143.00
3.75%

**Updated 1/13

Volatility Ops

NAV		$1,149,283		
Asset Class	Position	Size	Cost Basis	Max Profit

Scenario Analysis/Stress Tests

Worst Case	Worst Drawdown

**Updated on 1/13