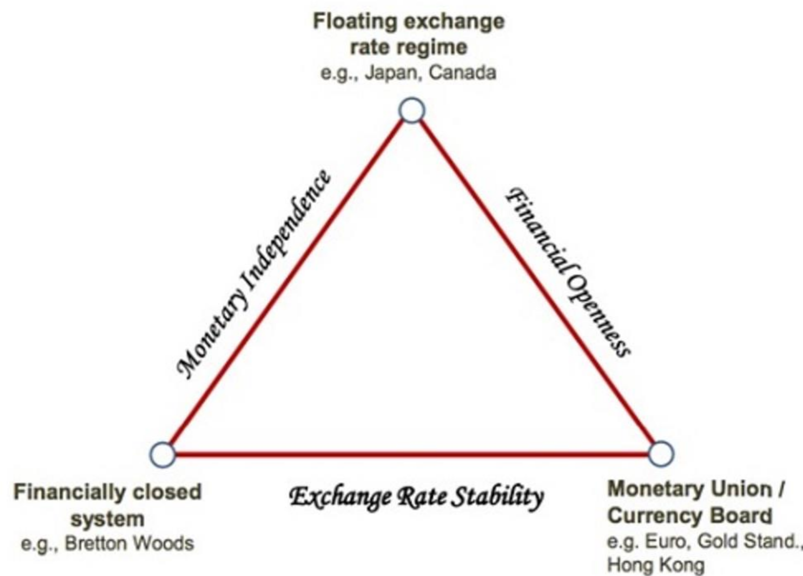
# The Mundell-Fleming Trilemma




Most of you are probably familiar with the story of how Soros and Druckenmiller "broke the Bank of England" in 92'.

The two bet against the pound believing that it couldn't maintain its peg to the Deutsche Mark in the European Exchange Rate Mechanism (ERM). They were right. The Bank of England was forced to stop defending the peg and the pound plummeted. The Quantum Fund (Soros and Druckenmiller) netted over a billion dollars over the course of a few days. The rest is history.

It was an amazing trade. It had all the markings of a "perfect setup"; the kind that only come around once every decade or so. It was extremely asymmetric in that the risk was clearly defined by the upper-band of the ERM peg. And if the lower bound broke, like they expected, they knew the pound would collapse due to all the investors on the wrong side forced to liquidate.

It was also a fundamentally compelling trade. The thesis was based on an economic law derived from the Mundell-Fleming model. It states that in a world of high capital mobility, a central bank can target the exchange rate or the interest rate but not both. This economic reality is also known as the policy trilemma (depicted in the pyramid above). Here's the following explanation from *The Economist*.

> *The policy trilemma, also known as the impossible or inconsistent trinity, says a country must choose between free capital mobility, exchange-rate management and*

*monetary autonomy. Only two of the three are possible. A country that wants to fix the value of its currency and have an interest-rate policy that is free from outside influence cannot allow capital to flow freely across its borders. If the exchange rate is fixed but the country is open to cross-border capital flows, it cannot have an independent monetary policy. And if a country chooses free capital mobility and wants monetary autonomy, it has to allow its currency to float .*

*To understand the trilemma, imagine a country that fixes its exchange rate against the US dollar and is also open to foreign capital. If its central bank sets interest rates above those set by the Federal Reserve, foreign capital in search of higher returns would flood in. These inflows would raise demand for the local currency; eventually the peg with the dollar would break. If interest rates are kept below those in America, capital would leave the country and the currency would fall.*

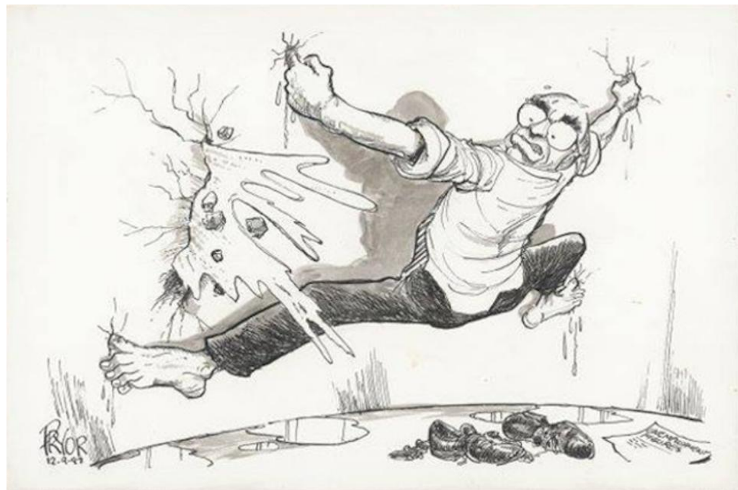
*Where barriers to capital flow are undesirable or futile, the trilemma boils down to a choice: between a floating exchange rate and control of monetary policy; or a fixed exchange rate and monetary bondage.*

In the Bank of England's case in 92', England was in a recession, but the BOE was forced to run constrictive monetary policy (high interest rates) in alignment with Germany in order to maintain the peg. This exacerbated the recession which led to more downward pressure on the pound (which was overvalued when the peg was set).

The BOE was confronted with the choice of (1) try to maintain the peg and as a result, deepen the recession or (2) stop defending the pound, move to more accommodative monetary policy, and benefit from a more competitively priced pound.

The BOE went with the latter and Britain's economy ended up better off for it.

Had the BOE not made that decision, it's likely that the market would have made it for them. Since England did not have capital controls and allowed money to flow freely across its borders, the BOE had to actively engage in the currency market to counteract the downward pressure from pounds being converted into other currencies. They had limited FX reserves and eventually would have run out of their ability to defend the peg anyway.



The policy trilemma is one of those things in economics that's so logical it's self-evident. Yet it's still somehow forgotten or ignored by the very people who pull the financial and monetary levers of our world.

China is a prime example. The People's Bank of China (PBoC) is fighting tooth and nail to maintain its crawling peg to the dollar. Their goal is to carry out a slow coordinated devaluation.

China has chosen exchange rate management and monetary autonomy. This means they can't have capital mobility.

This is why the CCP has been strengthening its capital controls and cracking down on money fleeing the country. The problem is… when your country is the number one trading partner with over 100 other countries, there's a lot of capital holes to try and plug. It's nearly an impossible task.

Simply put, if money wants to leave China, it''ll find a way.

And if fighting the economic laws of the policy trilemma weren't enough, China is facing another unsolvable problem that'll eventually drag down its currency like a 100-ton anvil.

I saw a Bloomberg interview this week with Hedge Fund manager Kyle Bass (can watch here). Bass is a smart dude and one of the few managers I have a lot of respect for.

One of his higher conviction themes over the last year has been the implosion of the Chinese banking system and the subsequent devaluation of the yuan — a theme I agree with and have written extensively about.

The premise is simple; Chinese banks are sitting on trillions of bad debt. Exactly *how much* bad debt nobody quite knows. The data coming out of the country is iffy but we at least we know it's in the trillions… which is a lot.

These banks have been rolling over bad loans by adding new debt. They're playing the old game of "a rolling loan gathers no loss". But we all know that game can only go on for so long.

China has been forced to go to greater and greater lengths to paper over this problem and keep the dam from breaking.

Over the last 18 months alone, credit in China has grown by $6.5 trillion while deposits have increased by less than half that. As Bass notes in the interview, "China has to fund enormous moves in credit growth just to keep in roughly the same place. We call it running to stand still."

All it'll take is a catalyst and these banks will go bust and will need to be recapitalized. This means printing a lot more money which will result in a much depreciated yuan.

And speaking of a catalyst, enter President Trump.

Having Trump in the White House will change many things both geopolitically and economically, the exact details and extent of which are still impossible to know. It's too early and the man is anything but predictable.

However, one of the few things that's become clear in recent days is his willingness to follow through on his protectionist trade agenda through either a Border-adjusted Tax (BAT) or straight tariffs. (Not to mention a lot of twitter threats and posturing on the side.)

The US is China's second largest trading partner after the Eurozone. An increasingly fragile China will have a tough time dealing with 20-30% tariffs on their exports on top of policies that incentivize companies to bring their manufacturing back to the US.

This does not bode well at all for the Chinese. Again, to turn back to Bass, who hits the nail on the head when he says (emphasis mine) that China has "recklessly built a system that's going to need to restructure and that just so happens to be metastasizing right when Trump becomes elected. This is a fire that's been smoldering and it's now starting to burn, and Trump is just more gasoline… **in lifecycles, what Trump is going to do, he is going to speed everything up**."

I think China will remain in the background for the first half of the year, especially if we see a temporary reversal in the dollar. It's the second half of the year that I think China comes back in a big way.

But as these things go, the situation is increasingly unstable and things can unravel in a heartbeat. We'll have to keep a close eye on developments in Beijing.

**Macro: Trump Accelerant and a Sea Shift**

In last week's Brief we talked about the GDP gap and the role that economic capacity plays in the credit cycle through its effect on inflation and as a result, interest rates.
So let's ponder the following real quick:

- The unemployment rate is at multi-decade lows
- Capacity, as measured by the output gap and capacity utilization, are nearing their maximum output levels
- And valuations on US equity markets are near their highest levels in history

It's under this backdrop that we're about to see a whole host of stimulative and inflationary policies introduced:

- Corporate tax rates changed from some of the highest in the developed world to potentially the lowest
- A massive increase in fiscal expenditures on infrastructure and defense
- Either a BAT or tariffs that will raise consumer prices and spur inflation

"In lifecycles, what Trump is going to do, he is going to speed everything up." Yep.

I don't think the impact of this can be overstated. If Trump is successful in doing half the things he says he'll do, it'll will have a massive impact on markets and the US economy.

The 98'- 99' reflexive sentiment driven rally is becoming a more likely scenario. Not to mention the sitting US President is an active cheerleader for the stock market. Here he is lamenting on the Dow crossing the 20K mark this past week (emphasis mine).

> *The Dow on top of it just hit 20,000. First time in history. I'm very proud of it.* ***And now we have to go up up up. We don't want it to just stay there.*** *That's gonna be the*

> *challenge, but it's gone up a lot since I won. Don't forget when I won people thought maybe it will go down, but the business world doesn't think that. The business world knows me, they don't think that. And it was a steady climb and now we just hit a record and a number that's never been hit before, so I was very honored.*

So what does all this mean for markets?

Growth and inflationary policies will drive the Fed to raise rates faster than what the market is currently pricing in. Rates will go higher and bond prices will go lower lower over the next 12-months.

With that said, we have the Fed meeting coming up next week and I expect them to tone down the hawkish tone they've adopted over the last two months.

The recent policy measures (both trade and immigration) enacted by Trump should make the Fed concerned about economic uncertainty.

They aren't expected to hike this meeting and the way the dollar looks, I would not be surprised if Mr. Market *wants* to interpret the Fed as more dovish this time around despite what Yellen and crew may say.

Remember, this has as much to do with the market lens as it does with what they actually say. And so barring any talk of aggressive adjustments to the rate hiking path, I believe the market will read the Fed's actions as more dovish and conducive to higher stock prices and a lower dollar… but we shall see.

The US has been leading the developed world in this tightening cycle. But now it looks as if the US may take a breather for a few months while Europe and the UK play catch up.

Here's the following from Nordea Markets:

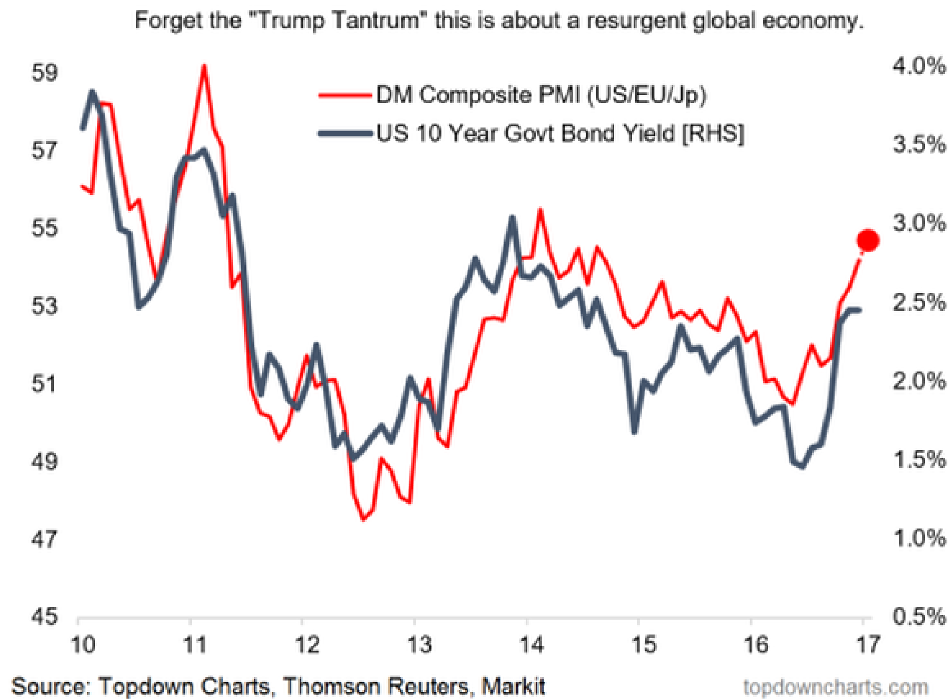
> *Inflation will rise further in the euro area, with the German headline hitting the symbolic 2% y/y for the first time in 5 years. The money/credit supply data released last week suggest a recovery in economic momentum, which ECB should be happy about. So, especially if the Markets continue to be joyful about the US and Fed, the ECB taper talk is imminent. Remember, only 1 month to go before they actually reduce the amount of monthly purchases…call it what you want. But it helps the EUR.*

And

> *Inflation is a big deal in the UK too, and with the BoE policy decision most likely dull this week, the Inflation Report will bring about some changes: growth and inflation near term projections likely revised up. It will make the BoE more uneasy to maintain the easy policies. Consumer is a key worry for markets now, after the recent retail sales miss. And while the household savings rate is back to negative, the consumer credit is booming as we speak. So, back to the "old normal" of 2003-2008… when the GBP/USD rose from 1.60 to 2.*

Check out the developed market composite PMI below. It's gone vertical since the beginning of last year. Of course some of this is due to China's large injections of credit flowing to the rest of

the world. And some of it is also due to base effects; it's easy for things to look good now when they were so bad before.




Either way, this bodes well for my two favorite trades at the moment. We already have one on. The other we'll put on next week. More on that in a moment.

We are currently hitting extreme valuations in the market. Long-term equity returns do not look promising here. The chart below via *Pension Partners* shows the average forward max drawdown per valuation percentile. The US is currently in the top decile of valuation.

| | | S&P 500 Average Forward Maximum Loss (1928 - 2016) | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Valuation Percentile | CAPE Ratio | 1-Yr | 2-Yr | 3-Yr | 4-Year | 5-Year | 6-Year | 7-Year | 8-Year | 9-Year | 10-Year |
| 0-10% | 5.57 to 9.68 | -4.1% | -4.5% | -4.5% | -4.5% | -4.5% | -4.5% | -4.5% | -4.5% | -4.5% | -4.5% |
| 10-20% | 9.69 to 11.22 | -3.6% | -3.6% | -3.7% | -3.7% | -3.7% | -3.7% | -3.7% | -3.7% | -3.7% | -3.7% |
| 20-30% | 11.23 to 12.67 | -3.7% | -4.6% | -4.7% | -4.8% | -4.8% | -4.8% | -4.8% | -4.8% | -4.8% | -4.8% |
| 30-40% | 12.68 to 14.98 | -6.5% | -8.3% | -9.1% | -9.5% | -9.7% | -9.7% | -9.7% | -9.9% | -9.9% | -9.9% |
| 40-50% | 14.99 to 17.03 | -12.7% | -15.5% | -17.4% | -18.9% | -18.9% | -18.9% | -18.9% | -19.9% | -19.7% | -19.7% |
| 50-60% | 17.04 to 18.84 | -6.0% | -11.1% | -13.7% | -15.0% | -15.2% | -15.2% | -15.2% | -15.6% | -15.6% | -15.6% |
| 60-70% | 18.85 to 21.03 | -4.8% | -7.3% | -8.2% | -9.4% | -10.2% | -10.7% | -11.2% | -11.6% | -10.9% | -10.9% |
| 70-80% | 21.03 to 22.21 | -8.1% | -13.0% | -16.0% | -19.0% | -20.8% | -21.9% | -23.0% | -23.0% | -22.2% | -22.2% |
| 80-90% | 22.22 to 26.40 | -5.4% | -9.2% | -15.6% | -22.3% | -24.4% | -26.1% | -26.3% | -26.3% | -25.9% | -23.9% |
| 90-100% | 26.41 to 44.20 | -9.0% | -18.9% | -26.8% | -30.3% | -32.8% | -33.3% | -33.3% | -33.3% | -33.3% | -32.4% |

If I was a long-term asset allocator I would be building up my cash position right now. I would also be putting more money into lower CAPE valuation foreign equities, though I still think the US outperforms in the near term versus other developed markets.

Here's a chart via Meb Faber ranking each country by its CAPE. Russia and Brazil look particularly interesting to me.

| MSCI IMI Country | CAPE (12/2015) | USD Perf. 2016 | TOP 10 LOW 10 | TOP 15 LOW 15 | TOP 20 LOW 20 |
|---|---|---|---|---|---|
| Russia | 4,6 | 58% | | | |
| Brazil | 7,4 | 67% | | | |
| Poland | 9,1 | 3% | | | |
| Hungary | 9,1 | 35% | | | |
| Turkey | 9,4 | -8% | 17% | | |
| Czech | 9,4 | -2% | | | |
| Portugal | 10,9 | -4% | | | |
| Spain | 11,3 | 0% | | 11% | |
| Singapore | 11,5 | 2% | | | |
| Norway | 11,7 | 18% | | | 10% |
| Korea (South) | 12,6 | 5% | | | |
| Austria | 12,7 | 8% | | | |
| United Kingdom | 12,7 | -2% | | | |
| Italy | 12,7 | -10% | | | |
| Greece | 13,7 | -9% | | | |
| China | 13,9 | 0% | | | |
| Thailand | 14,5 | 27% | | | |
| Hong Kong | 14,9 | 1% | | | |
| Australia | 15,5 | 12% | | | |
| Malaysia | 16,4 | -4% | | | |
| France | 16,6 | 6% | | | |
| Israel | 16,9 | -17% | | | |
| Canada | 17,1 | 26% | | | |
| Indonesia | 17,3 | 18% | | | |
| Taiwan | 17,7 | 17% | | | |
| Finland | 17,7 | 1% | | | |
| India | 18,1 | -1% | | | |
| South Africa | 18,2 | 21% | | | |
| Germany | 18,2 | 3% | | | |
| Netherlands | 18,3 | 5% | | | 4% |
| New Zealand | 19,0 | 12% | | | |
| Sweden | 19,8 | 2% | | | |
| Mexico | 20,5 | -9% | | 1% | |
| Belgium | 21,0 | -5% | | | |
| Philippines | 21,3 | -4% | -1% | | |
| Switzerland | 22,5 | -3% | | | |
| **United States** | **24,6** | **13%** | | | |
| Japan | 26,2 | 4% | | | |
| Ireland | 28,8 | -5% | | | |
| Denmark | 40,1 | -13% | | | |

Tyler, Anish and I have joked over the last few months that we don't need to worry about a US bear market until the perma-bears like Jesse Felder, Raoul Paul and John Hussman all turn

bullish. I'm not sure if those three will ever turn bullish on this cycle but it seems that higher stock prices are finally forcing other long-term bears to capitulate.

The chart below shows that short sellers have collapsed to a three year low. And the fall doesn't look like it'll abate anytime soon. Bull markets don't die until the bears have all been picked clean and/or have converted over.

This is the type of sentiment shift that market tops are made of. But I still think we're very early in the process of this one.

Check out this chart via *Bloomberg.* It shows the ratio of puts vs. calls hitting a new cyclical low.

This means less investors are hedging their risk or betting on a downward move in stock prices in relation to those betting on a move higher.

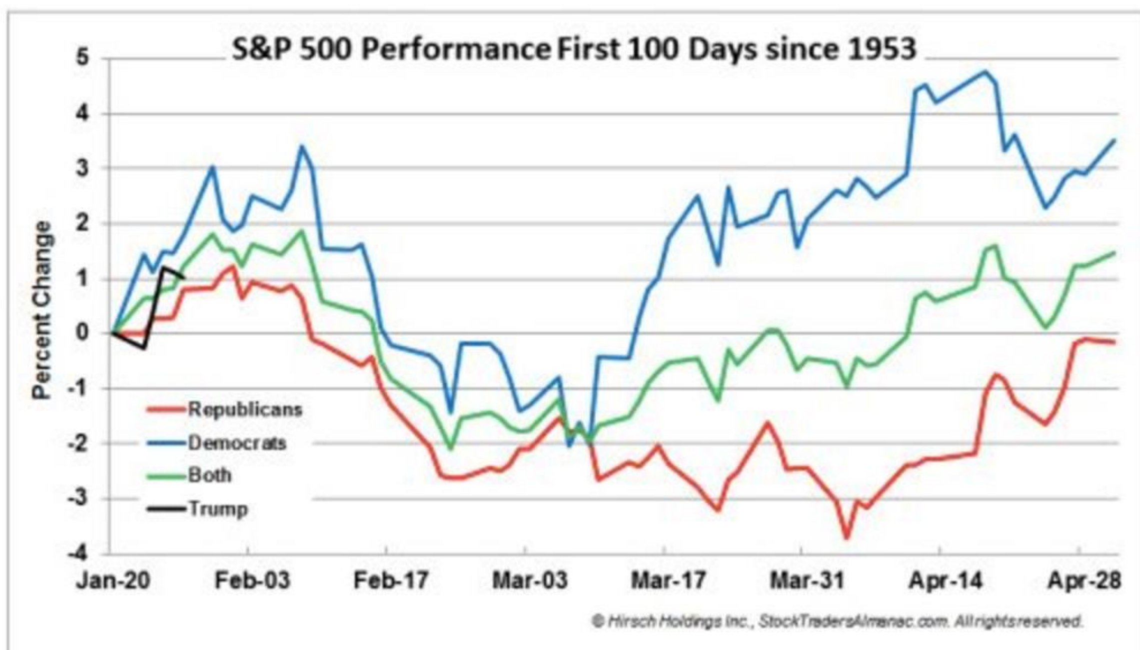
The last two times the put/call ratio hit these levels were at the market bottom in 02' and again in 09'. It came close in 13' as well. Each time, markets ran higher… a lot higher.

This doesn't mean it'll happen this time of course. But it's an interesting chart and pretty telling of the sentiment and positioning in markets right now.

And then there's the VIX which is also at a new cyclical low. In fact, over the last few weeks, COT positioning has reached record short levels in both bonds and volatility and record longs in oil and copper.

This extreme positioning makes the contrarian in me want to jump in and take the other side. Though I think we'll get some wild swings in all of these assets over the coming months, going long is mostly the right bet for the time being, so I'll stay with the crowd on this one.

Here's an interesting chart showing the average SPX return over the first 100-days of a new President.




Looks like it's typical for stocks to rally into the inauguration and peak in early February before rolling over and experiencing a short selloff.

Seeing how technically extended stocks are right here, and the extreme levels of positioning, there's a high likelihood that we see the US market follow a similar path.

In contrast to all the bullish positioning by investors, those on the inside have been cashing out at record rates over the last two months.

Ratio of Insiders Sales to Buys. Readings under 12:1 are Bullish. Those over 20:1 are Bearish.
The total top 20 sales and buys are 264,580,746 and 4,512,419 respectively; Source: Thomson Reuters

A lot of this is due to a small number of insiders at some of Wall Street's biggest banks unloading large blocks of equity after the recent parabolic run in financial stocks. But still…

**Technical: Commodity Currency Cycle (CCC)**

Commodity currencies tend to fluctuate cyclically against the dollar in alignment with the commodity cycle.

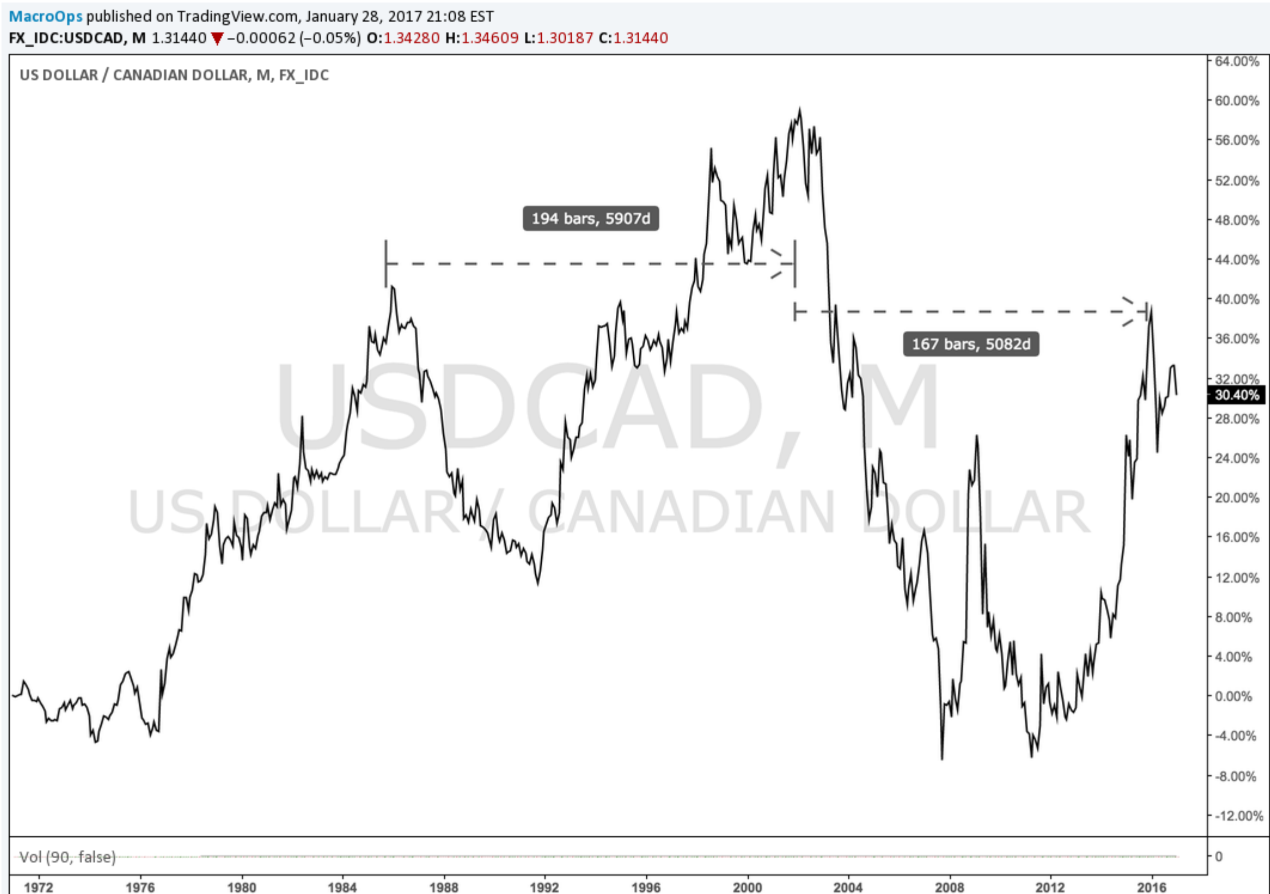
This makes sense. The value of the dollar drives the commodity cycle which in turn drives commodity currencies.

I've been looking at a number of commodity currency pairs and it seems like they've put in a cyclical bottom against the dollar. From a purely technical perspective, they look like they've hit a low and are about to turn.

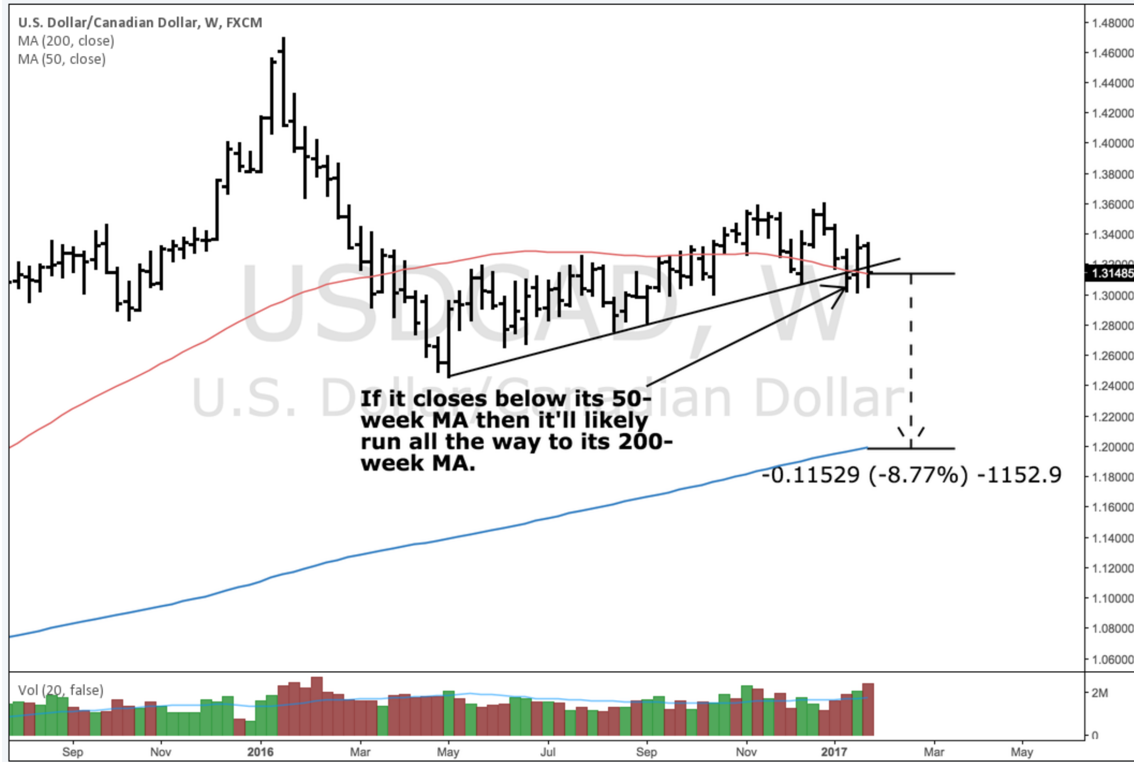
Just look at the following:

This is a monthly chart of the Canadian loonie. USDCAD goes up when the loonie depreciates against the dollar.

Notice how each cyclical top occurs at approximately 16-year intervals.

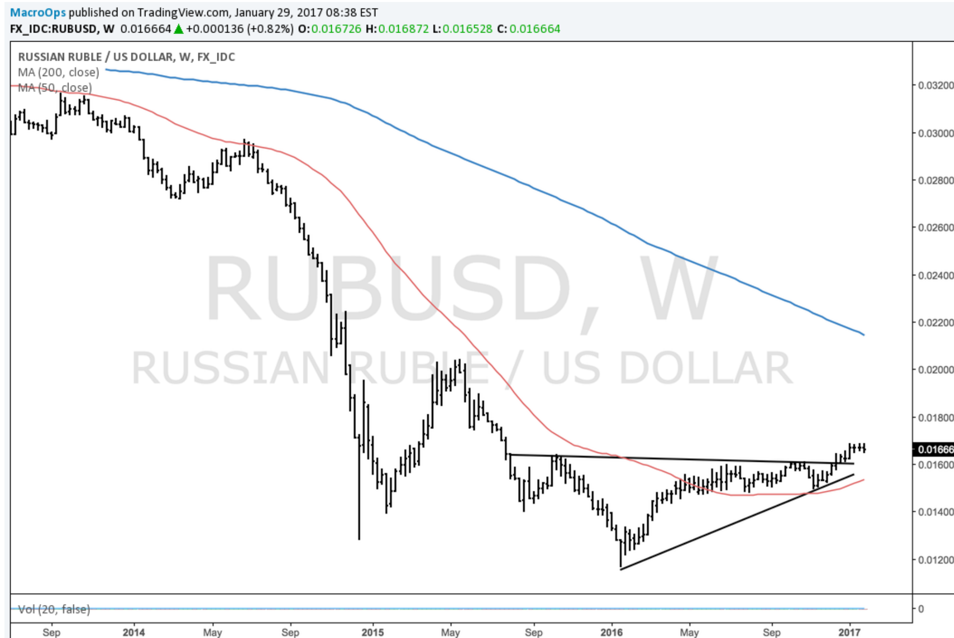



USDCAD looks extremely vulnerable right here. It just closed below its 10-month support trend line and is balancing on its 50-week MA. A move below the 50 WMA offers a high R entry point to the short side (long CAD).




Here's USDNOK (Norwegian Krone) which also follows the 16-yr intervals between tops. The data set is small but the price action looks like it favors a major reversal here.

And then here's the Russian Ruble against the dollar (RUBUSD). That looks like a perfect bottom setup and reversal.




If you recall from the chart earlier, Russia is also the country with the lowest CAPE ratio. With the Trump administration seemingly dead set on lifting sanctions against Russia (which for the life of me I can't understand why) going long the Ruble offers an attractive proposition.

Lastly, here's the Brazilian Real (USDBRL). It's current price action is following a similar pattern to it's last cyclical top in 03'.

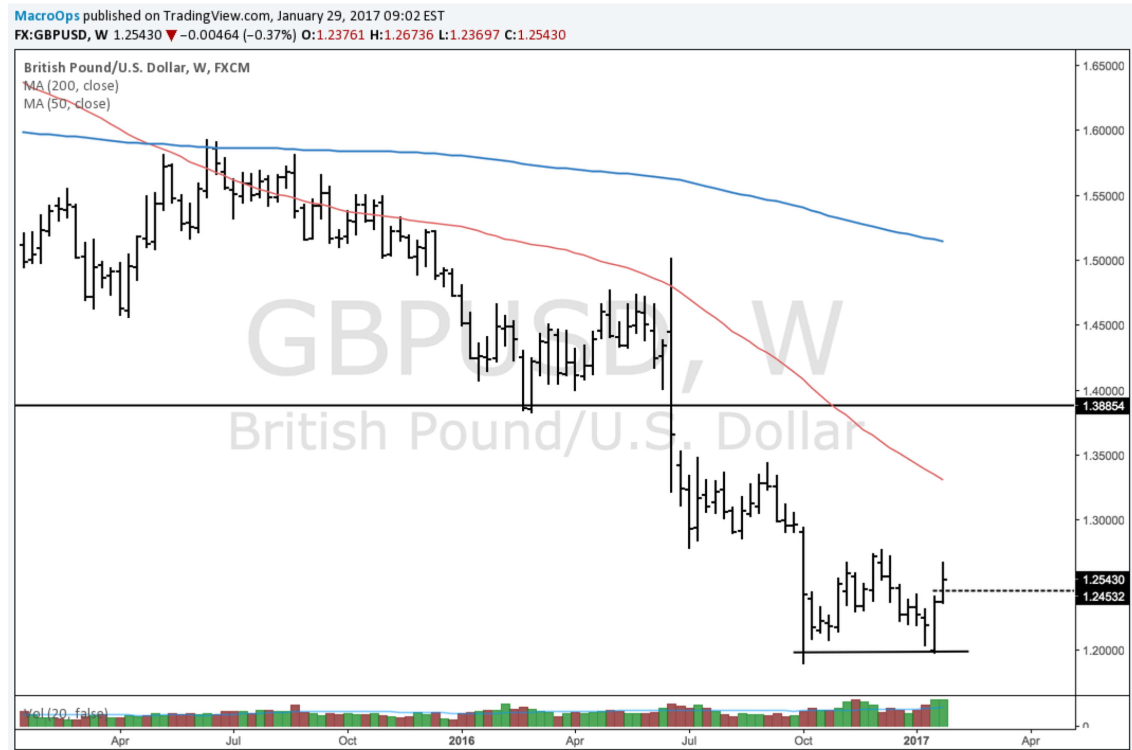
Brazil has the second lowest CAPE valuation in the world. Here's the USDBRL overlaid with the Brazilian ETF (EWZ). The vertical red line marks the last time the currency broke its neckline support marking a cyclical shift. You can see how Brazilian stocks reacted.

If that's what we're seeing now at the current vertical red line, then we could see Brazilian stocks outperform in the near future.

**Portfolio Review**

The holdings in the Strategic portfolio can be boiled down to the following.

CENX (currently up 36% from our entry two weeks ago) is my only moderately high conviction trade but GBPUSD is becoming a close second.




IPI, NMM, NM, and URRE I view as out-of-the-money option plays. They have a small probability of playing out but if they do the payoff is potentially huge.

WLL is somewhere in the middle. It's a simple macro play on oil and natural gas prices. If oil fails to move higher from here we'll cut it.

GV was my highest conviction position. But when a stock runs 150% from your entry price in just over two months, you have to expect a sizable pullback and potentially long consolidation period. We have closed out 90% of our position on the trade, booking some nice profits.

I actually hope it has a sizable retrace soon so that we can build a position back up at lower prices. It's a great company and I think the stock will continue to do very well over the long-term.

And here's something we'll probably enter a position in next week if price action looks favorable: short Euro-Bund Futures.

Euro-Bund futures trade on the Eurex. It's the exchange's most popular contract. The contract is based on German bunds with a duration between 8.5 to 10.5 years. It's considered the long-term benchmark rate for euro-denominated government debt.

The chart below is of the Euro-Bund continuous contract on a monthly timeframe. Price looks to be completing a 12-month long H&S top.

The German 10-year is currently yielding 46bps, having turned positive just this last October. Now look at the chart below showing the difference between the US and Eurozone 10yr rate. The spread is at a historical all-time high.

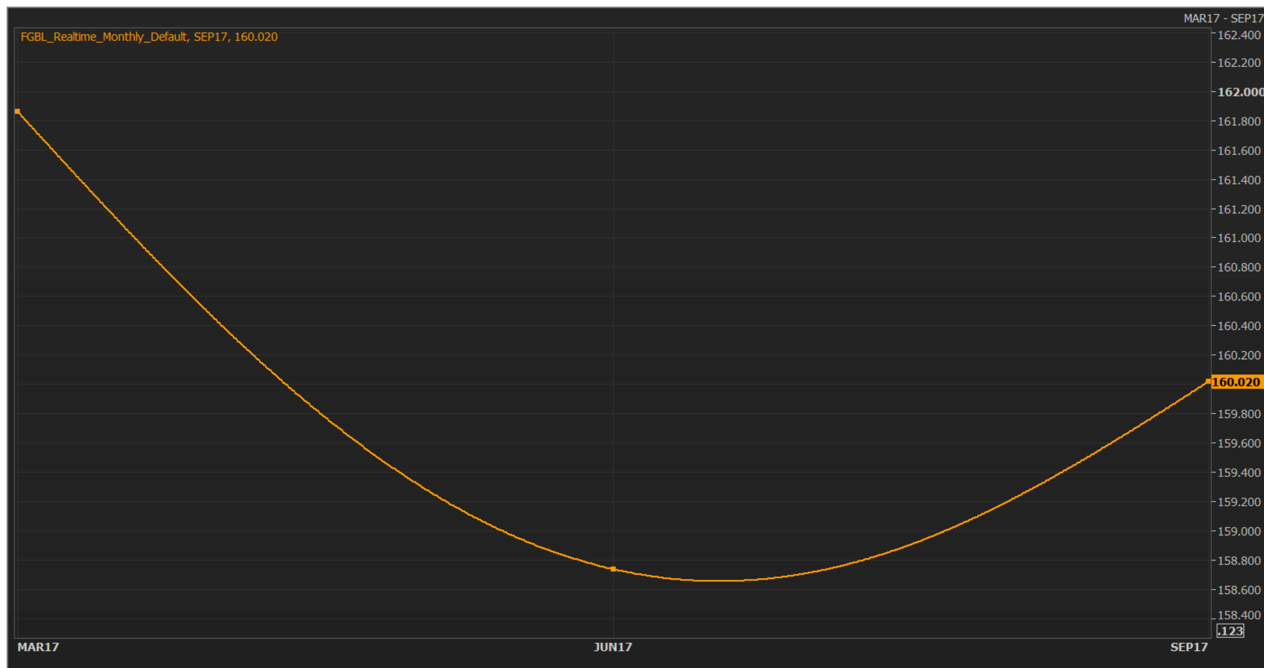
Going back to our discussion earlier, Europe is trailing the US in its hiking cycle. But considering recent inflation and PMI numbers, it looks like Europe will be playing catch up over the next few months. If near term growth and inflation continue to surprise to the upside then rates have just one direction to go… and that's up, up, up.

This is likely the trade Kyle Bass was referring to in his last quarterly investor letter when he said, "One opportunity in particular has the greatest risk-reward profile we have ever encountered in our decade of being a fiduciary." And here's what Bass said about the trade in the Bloomberg interview.

> *Real rates in Germany are at the lowest level ever right now. Inflation in Germany is spiking. It's not even moving in a linear fashion. You have even seen members of the ECB and the Bundesbank speak today about the fact that I think we are going to see inflation running much hotter than any of the central banks thought it would. Therefore I think the move in bonds is just beginning.*

My enthusiasm for the trade doesn't quite match his, but I do look like it. I think the growth and inflation we'll see in Europe over the next few months is transient at best. But regardless, this trade offers a nice asymmetric profile. We'll see a large payout if European rates are able to close just half that spread.

One thing to keep in mind when shorting fixed income is the negative carry you have to pay to hold the position. This makes timing the trade even more important. The longer you hold, the more you pay. In Bund futures the negative carry comes about when rolling contracts from month to month. Take a look at the term structure below:




You can see that the front month bond future expiring in March is trading around 161.8. But the next contract expiring in June is trading at 158.74. So if rates don't move at all, and it comes time to roll the trade, you have to close out the existing position and short at a lower price. This worsens the cost basis of the short. These roll charges can add up over time and significantly impact the final P&L of the short trade.

This trade has a 3-6 month trade horizon for us so we won't have to worry about more than a few roll charges. Hopefully we get paid in the next month to avoid all roll charges.

Anyway, whenever you're thinking about shorting fixed income or dividend stocks, don't overlook the negative carry costs. You'll find yourself severely disappointed if you managed to call the move correctly but realized you didn't make much due to paying out carry month to month.

I mentioned Cemtex (CETX) in last week's Brief. I've dug deeper into the company and it has a lot of potential to be a great growth stock. It's a strong business in an interesting market niche. It manufactures instruments and industrial filtration systems to help companies manage their pollution output.

I'm just going to keep it on my watchlist for now because I'm not yet sure how Trump's administration will impact the business, if at all.

Another stock I'm looking into is Tallgrass Energy Partners (TEP).

TEP owns, operates, and develops midstream energy assets in North America. It has three segments: crude oil transportation and logistics (ownership and operation of a crude oil pipeline system); natural gas transportation and pipeline logistics; and processing and logistics, which include the ownership and operation of natural gas processing and treating and fractionation facilities.

Below are the fundamentals and metrics.

BALANCE SHEET

| | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Total Current Assets | 34,768,000 | 28,068,000 | 55,696,000 | 132,281,000 | 77,223,000 |
| Property/Plant/Equipment, Total - Net | 719,009,000 | 669,476,000 | 1,116,806,000 | 1,853,081,000 | 2,025,018,000 |
| Total Assets | 772,896,000 | 1,035,814,000 | 1,631,413,000 | 2,457,197,000 | 2,562,074,000 |
| Total Current Liabilities | 35,056,000 | 71,854,000 | 182,740,000 | 96,568,000 | 88,929,000 |
| Total Long-Term Debt | 0 | 390,491,000 | 135,000,000 | 559,000,000 | 753,000,000 |
| Total Liabilities | 36,088,000 | 463,980,000 | 640,251,000 | 1,418,474,000 | 1,292,149,000 |

FUNDAMENTAL

| | Dec-2015 FY | Dec-2016 FY | Dec-2017 FY | Dec-2018 FY |
|---|---|---|---|---|
| EPS | 1.910 | 2.342 | 2.715 | 3.347 |
| DPS | 2.340 | 3.045 | 3.620 | 4.158 |
| CPS | 4.860 | 4.810 | 5.411 | 6.064 |
| EBITDA | 252,339,000 | 419,512,800 | 568,030,714 | 718,958,667 |

INCOME STATEMENT

| | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Revenue | 307,043,000 | 255,580,000 | 290,526,000 | 371,556,000 | 536,197,000 |
| Total Operating Expense | 231,544,000 | 204,156,000 | 274,053,000 | 318,143,000 | 338,508,000 |
| Operating Income | 75,499,000 | 51,424,000 | 16,473,000 | 53,413,000 | 197,689,000 |
| Net Income Before Taxes | 77,803,000 | 50,367,000 | 7,624,000 | 59,329,000 | 184,814,000 |
| Net Income After Taxes | 77,507,000 | 50,367,000 | 7,624,000 | 59,329,000 | 184,814,000 |
| Net Income Before Extra. Items | 77,507,000 | 50,367,000 | 9,747,000 | 70,681,000 | 160,546,000 |

PROFITABLITY ANALYSIS

| | 2011 | 2012 | 2013 | 2014 | 2015 | Latest |
|---|---|---|---|---|---|---|
| ROE Tot Equity, % | 10.52 | 7.70 | 1.25 | 6.96 | 13.91 | 17.40 * |
| ROA Tot Assets, % | 9.96 | 5.57 | 0.57 | 2.90 | 7.36 | 9.40 * |
| Income Aft Tax Margin, % | 25.24 | 19.71 | 2.62 | 15.97 | 34.47 | 43.56 * |
| Revenue/Tot Assets | 0.39 | 0.28 | 0.22 | 0.18 | 0.21 | 0.22 * |
| Long Term Debt/Equity, % | 0.00 | 68.29 | 13.62 | 53.82 | 59.29 | 95.96 ** |
| Total Debt/Equity, % | 0.00 | 68.99 | 13.62 | 53.82 | 59.29 | 95.96 ** |

**Legend:**
* = TTM (Trailing Twelve Months)** = LFI (Latest Fiscal Interim)

The company has seen strong top and bottom line growth despite the lower energy prices for the last two years. With the new administration cutting environmental regulation, which is a big cost for these mid-stream operators, combined with Trump's calls to make America energy independent, companies like TEP are poised to benefit.

The chart shows the stock is close to breaking out of a two-year long triangle. I'd like to see more volume and follow through on the breakout before entering, but in general this looks like a lucrative trade to the longside.

To conclude, US stock indices continue to maintain strong breadth and look technically constructive. This is in spite of the fact they're overextended on a technical and valuation basis in addition to positioning and sentiment being at extremes.

A sector I wouldn't touch with a 10-foot pole is retail. Something like over 90% of the clothing and shoes sold here are made overseas. So a BAT or tariff would especially hurt this sector. If you look at a chart of XRT (retail ETF) it looks like it's dangling over a cliff.

We'll have to keep a close eye on the dollar over the coming weeks to see if the retrace continues to develop.

If so, we'll be adding to our GBPUSD trade (which has the potential to be a bottom liner for the year) and possibly entering a long Canadian dollar or Ruble trade. And if it looks like a cyclical bottom in commodity currencies is in place, we'll want to really start digging into some emerging market stocks.

Hope you all are having a great weekend and I'll see you in the Hub!

-Alex

**Portfolio Snapshot**

***Strategic Ops***

*NAV* $1,144,947

| Asset Class | Position | Size | Cost Basis | Risk Point | Open Risk | Target | Notional |
|---|---|---|---|---|---|---|---|
| Equity | Goldfield GV | 1,000 | $3.89 | $2.52 | $1,370.00 | $4.50 | $6,450 |
| Equity | Whiting Petroleum WLL | 1,000 | $10.41 | $8.10 | $2,310.00 | $16.42 | $11,910 |
| Equity | Century Aluminum CENX | 1,700 | $11.11 | $7.55 | $6,052.00 | $16.55 | $25,625 |
| Equity | Navios Partners NMM | 5,000 | $1.65 | $1.49 | $800.00 | $4.00 | $8,000 |
| Equity | Navios Holdings NM | 15,000 | $1.75 | $1.55 | $3,000.00 | $4.10 | $30,750 |
| Equity | Intrepid Potash IPI | 5,000 | $2.34 | $1.74 | $3,000.00 | $4.20 | $10,800 |
| Equity | AV Homes AVHI | 3,200 | $17.92 | $16.12 | $5,760.00 | $29.35 | $60,480 |
| Equity | Uranium Res URRE | 6,000 | $2.56 | $1.58 | $5,880.00 | $9.00 | $14,280 |
| Forex | Pound (GBPH7) | 6 | $1.2531 | $1.21 | $14,662.50 | $1.38 | $470,925 |

***Metrics***

| Exposure Breakdown | |
|---|---|
| Equity | $28,172.00 |
| Commodity | $0.00 |
| Fixed Income | $0.00 |
| Forex | $14,662.50 |



Total Open Risk

$42,834.50

3.74%

**Updated 1/29

***Volatility Ops***

*NAV* $1,149,465

| Asset Class | Position | Size | Cost Basis | Max Profit |
|---|---|---|---|---|

***Scenario Analysis/Stress Tests***

| Worst Case | Worst Drawdown |
|---|---|

**Updated on 1/29