MARKET BRIEF

A Swing And A Miss…

The Affordable Healthcare Act (AHCA) failed to make it to a vote on Friday, dealing a major blow to the White House and a divided Republican party.

Here's the following assessment of the damage from *Axios*:

> *It's hard to overstate the magnitude of the Day 64 defeat. President Trump, who made repeal-and-replace a central theme of his campaign, and House Republicans, who made it the central theme of every campaign since 2010, lost in a publicly humiliating way despite controlling every branch of government and enjoying margins in the House rarely seen in the past century.*
>
> *This virtually guarantees no substantive legislative achievements in the first 100 days. And it creates rifts and suspicions and second-guessing that make governing much harder.*

Here's the *WSJ* Editorial Board on the difficulty faced by Trump in forming a governing coalition:

> *Much of the current conservative establishment profits from fanning resentments, not governing. Legislative compromises don't help Heritage Action raise money for its perpetual outrage machine. An earlier generation of leaders at Heritage understood that*

the goal of winning elections was to achieve something. The current leaders seem happy with failure.

And just to drive the point home here's this from *Politico*:

"The Republican Party is still operating as an opposition party," said Josh Holmes, a former chief of staff to Senate Majority Leader Mitch McConnell, who added, "If they can't break the fever… it says an enormous amount about the prospects of tax reform, infrastructure and some sort of immigration proposal."

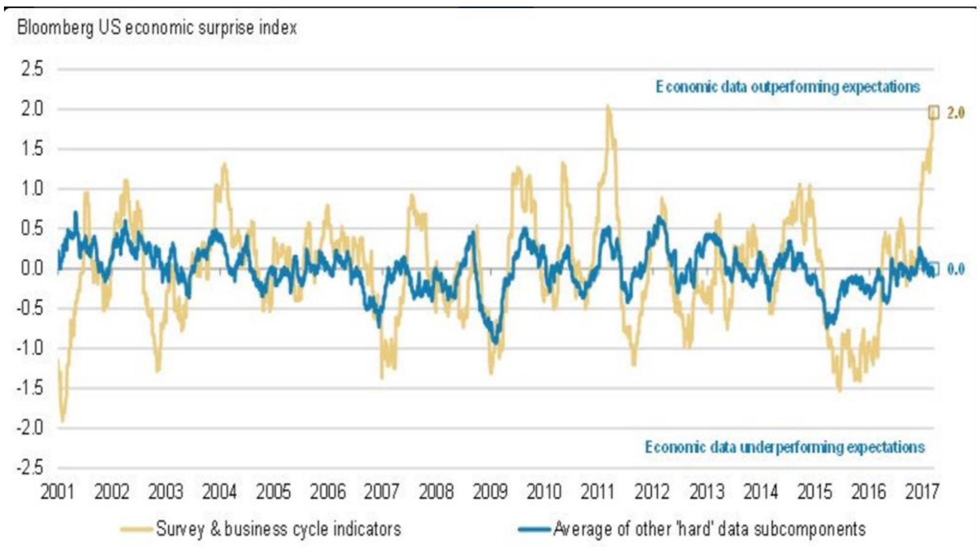
I think this administration screwed the pooch by leading with health care reform. Healthcare is always a contentious and emotionally charged issue. Why you'd start with it out the gate is beyond me… they should have gone straight to tax reform. Everybody loves lower taxes.

This loss will cost Trump political points. It also puts some of the first cracks in the "Dealmaker in Chief" belief that's driving the Trumpflation narrative.

I wrote last week that:

One of the more important tests to this narrative is Trump's ability to pass healthcare reform. His "deal making" abilities are central to the narrative and passing his healthcare bill is the first real test of this. It's also the first major hurdle he has to clear before moving on to tax reform. If successful, the narrative will be reinforced. If not, it'll be weakened.

Because expectations have far outpaced reality, the market's dependence on the strength of this narrative is ever more crucial. The precariousness of the current expectations/reality gap can be seen on the chart to the right. Expectations of the data greatly exceed the actual data released.



The Whitehouse understands this situation and will pivot its focus hard to tax reform. I expect a lot of aggrandizement on how GREAT their reform will be over the coming weeks.

The *Soros Cycle* would put the market narrative into the "Narrative Drift" stage. This is where "information starts to challenge accepted fact, which leads to data cherry picking and growing cognitive dissonance."

Similar to major trends in the market, narratives never just turn 180 degrees on a dime. That's because they develop a momentum of their own.

The *Soros Cycle* plays out like this:

> An **established regime** exists and is comprised of a few dominant narratives —>
>
> **Narrative drift** begins as information starts to challenge accepted fact, which leads to data cherry picking and growing cognitive dissonance —>
>
> **Narrative crisis** hits because reality has diverged too far from the dominant narrative for the regime to be sustained (narratives always lag shifts in reality) —>
>
> **Narrative revolution** finally happens when reality forces the majority of people who were reluctant to admit they were wrong to adopt a new narrative —>
>
> **Regime change** occurs when a new narrative becomes dominant and accepted by the majority of market participants. It's reinforced by reality which eventually brings us full circle back to the established regime.

This is how narratives can drive such large divergences between expectations and reasonable outcomes. Financial actors fully adopt narrative assumptions and blind themselves to incoming data that challenges those beliefs.

We already see the market narrative spinning the failed healthcare reform into something positive for the stock market. The belief is that with healthcare out of the way, the government can now focus on tax reform which is the "real" reason to be bullish stocks.

This belief is obviously illogical. The government's failure to reform healthcare will directly impact what they can do on tax reform. Here's the following from *CNBC*:

> *The Congressional Budget Office estimates that government revenue will total $41.3 trillion over the next decade under current law. The latest version of the Republican plan to repeal and replace the Affordable Care Act would have reduced that income by nearly $1 trillion, because it would have gotten rid of taxes connected to Obamacare.*
>
> *Right now, there are no calls to offset that lost money by finding other revenue sources — a task that is always politically charged. Instead, the now-dead GOP plan offset the reduction in revenue by cutting spending elsewhere.*
>
> *Therefore, passing the GOP health care scheme would have reduced the amount of revenue the government needed from $41.3 trillion to $40.3 trillion — which is a much lower bar for Washington to clear.*
>
> *The key thing to know is that the rhetoric around tax reform is very different from health care. House Speaker Paul Ryan and Ways and Means Chairman Kevin Brady have both said they are* ***committed to maintaining "revenue neutrality" — that is, they don't want changes in the tax code to result in a change in government revenue. That would have been a lot easier to do if they were trying to hit a revenue goal of $40 trillion instead of $41 trillion.***

A large flock of the Republican party are budget hawks. They don't want to raise government spending or tax revenues.

But it's safe to say that the Trump administration is less concerned about a balanced budget. They *did* create a $1T infrastructure spending plan after all…

These two competing ideologies will come to a head in the tax reform debate. The outcome is anything but certain.

Expectations over tax reform are likely to shift dramatically over the coming months as the debate develops. This shift could impact certain markets in interesting ways. Here's the following again from Axios (emphasis mine):

> *White House officials plan to plunge ahead with ambitious tax reform, but they know it'll be harder now. As one of the lessons learned, look for the White House to drive the truck on tax reform – to set the policy and work the members from the beginning, undercutting Ryan.* ***So the border adjustment tax, a favorite of Ryan but viewed skeptically at best by the White House, is less likely to be part of Trump's tax reform bid.***

The border adjustment tax has become a central pillar to the popular dollar bullish narrative. It's believed that the dollar would rise to offset any border tax on imports by an equal amount. Pull the possibility of BAT, and you're left with a shaky long dollar narrative in an extremely crowded trade, which we'll discuss more below.

Macro: *Hurt the most traders...*

A couple of my favorite quotes from legendary trader Bruce Kovner are:

> *What I am really looking for is a consensus the market is not confirming. I like to know that there are a lot of people who are going to be wrong.*
>
> *As an alternative approach, one of the traders I know does very well in the stock index markets by trying to figure out how the stock market can hurt the most traders. It seems to work for him.*

If you can figure out how the majority of the market is positioned and where the most consensus trades are, you can do very well by opportunistically fading the herd. This is playing the player and trading at the second level… a skill that's vital to long term market survival.

Fading crowded trades is a great strategy, especially recently.

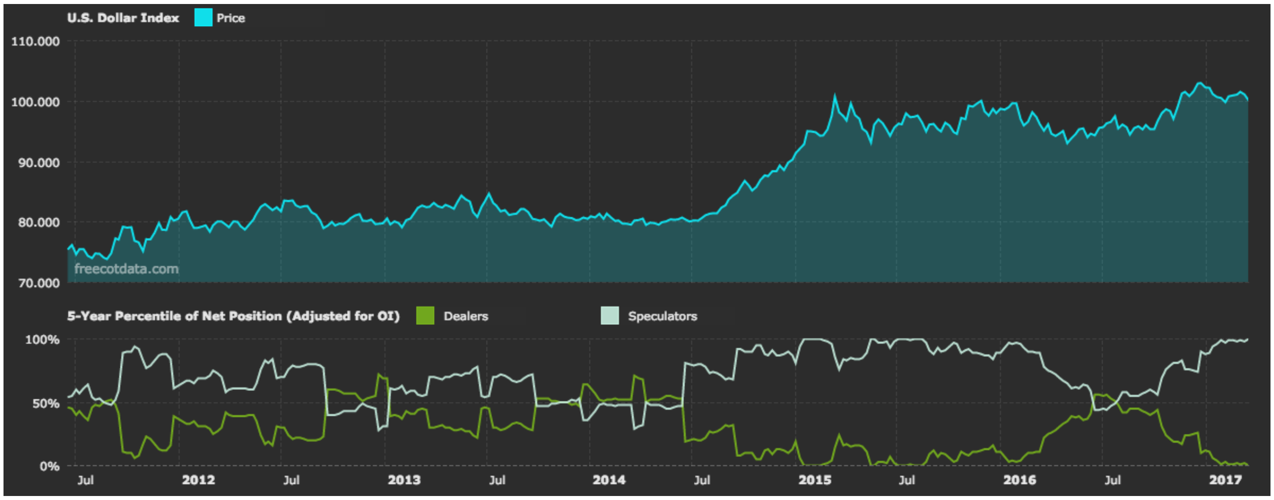
For example, our oil short went against near record long speculative positioning as noted in the COT report. Our long bonds trade went against speculative positioning as well and has been very profitable for us.

Since markets have lacked volatility and benchmark indices have gone vertical over the last few months, money managers have been desperately chasing and recklessly crowding into trades. This is resulting in a lot of one sided positioning that traders like us can continue to take advantage of.

Looking around global markets there's one obvious trade that would make a lot of people wrong and hurt the most traders. That trade is the ole' greenback.

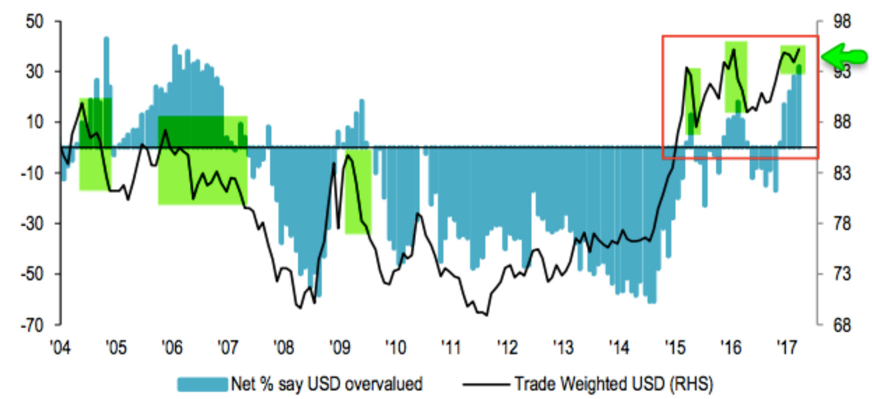
Let's look at the evidence.

This chart shows speculators are max long the dollar against broker dealers. This is an extreme reading. When you see COT positioning at these levels of divergence, it's almost always the dealers who win out. The market doesn't pay a bunch of speculators so easily.



BofA's monthly Global Fund Manager Survey was released this week. The chart to the right shows that a large net % of respondents are saying the dollar is overvalued. This survey has a pretty good track record of noting short-term reversal points in the dollar.

Exhibit 3: US$ Valuation and Trade weighted index



Source: BofA Merrill Lynch Global Fund Manager Survey

It's been a long time since there was a large and violent forced selloff in the dollar. That means dollar longs have grown complacent and many of them are probably leveraged. When there's been mostly one way moves in an asset for a few years, it creates a situation where positioning, leverage, and complacent beliefs are like piles of dried, kerosene-soaked kindling. They're just waiting for a spark.

Take away talk of the border adjusted tax and combine it with other global central banks like the BOE and ECB looking to end their easing cycles, and you have the potential for a ripe and violent reversal… or a dollar bonfire if you will.

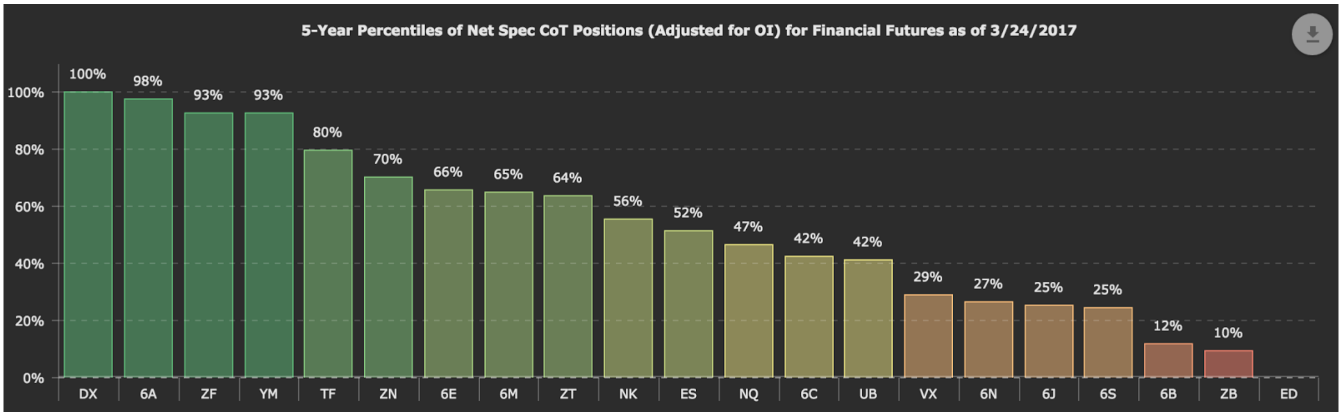
USD price action is setting up in what looks like a textbook head and shoulders pattern. We could see a break below the neckline this week.

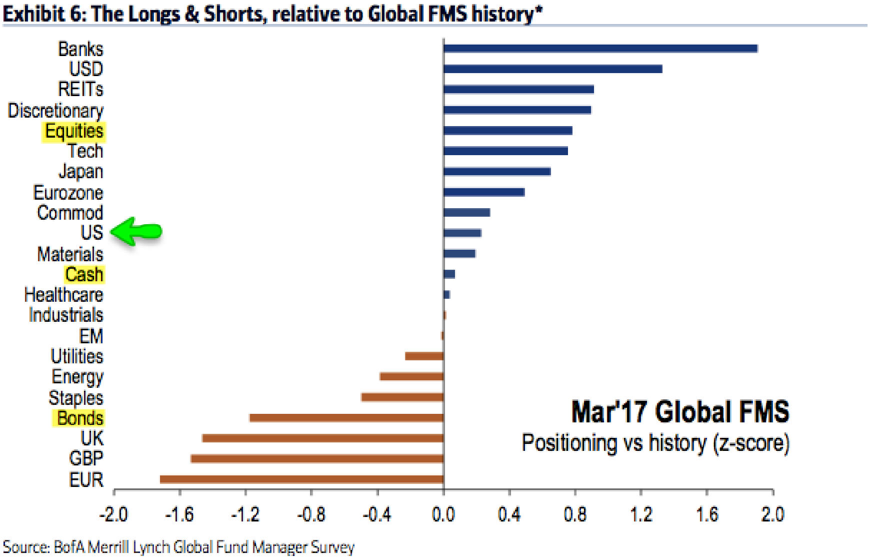
Now we don’t think this is a major reversal in the dollar here, it’s only short-term. But it’s still very playable.

There are a number of ways to get short the dollar since the it directly and indirectly affects the pricing of many other assets (ie, emerging markets, oil, gold etc).

But in order to find the optimal dollar short trade, let’s again look at market positioning — using COT data and the BofA Fund Manager Survey — to see how other players are long dollars directly or synthetically.

The chart below via www.freecotdata.com shows the 5-year percentiles for Net Speculator positioning. The instruments in red on the right are those that speculators are net short and vice versa for those in green on the left.





ZB, which is the bond futures contract we are currently long, is essentially a synthetic dollar short position.

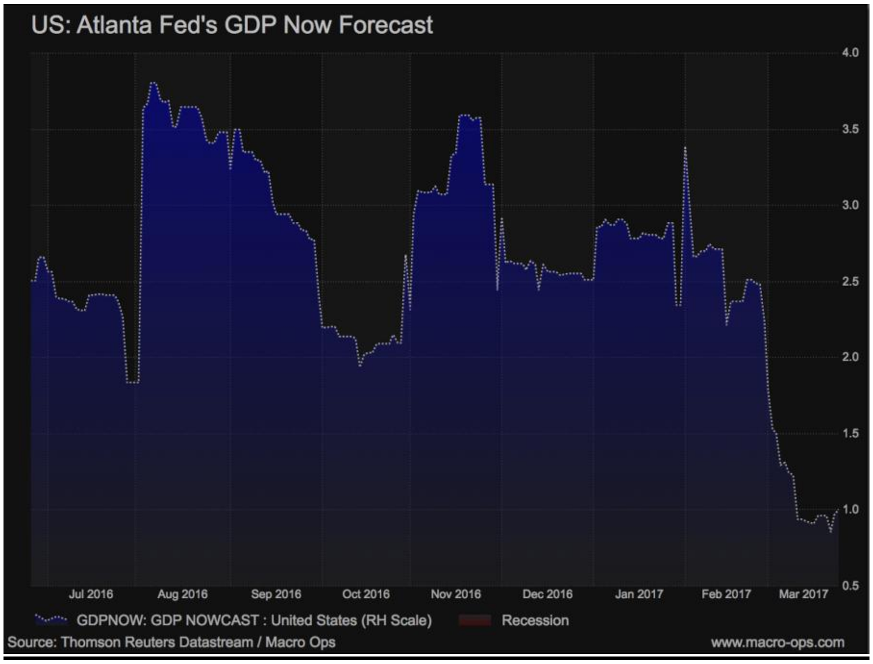
The 10-year yield and USD have moved in lockstep fashion over the last two years. This means that the potential for a dollar selloff looks good for our long bond positioning.

The next instrument — 6B — is the British Pound futures contract. Looking at the graph on the right from the Fund Manager Survey, you can see that respondents are historically net short the euro, pound, and bonds.

Like the dollar, both the euro and the pound have been forming inverse head and shoulders and are close to closing above their necklines.

We took a crack at going long the pound (FXB is the ETF alternative for the pound and FXE is the euro ETF alternative) a few months ago but closed our position for a scratch as it failed to carry through. I'm willing to take another stab at it and perhaps the euro as well should we see price break those necklines.

GDP comes out on Thursday and if the Atlanta Fed's GDP NOW forecast is anywhere close to the actual number — it's sitting at GDP growth of 1 percent currently — then the Fed will have a lot to think about regarding their rate hike expectations. They're currently factoring in two more hikes this year. A poor GDP number would also support a dollar sell off…



Strat Ops Portfolio Review

We added two new positions to our Strat book this week with GAIA and VDTH.

We're keeping our initial positions small with relatively wide stops, giving them room to work. These microcap plays are part of our strategy of moving away from the overvalued broader market. We want to gain equity exposure in instruments that have little to no correlation to the broader stock market. VDTH and GAIA check all those boxes and there's a number of other similar trades that we're currently looking into.

GAIA

GAIA, the yoga/wellness company run by the impressive Jirka Rysavy, is a textbook example of the type of price action we like to see in our equity plays.

The 17+ week triangle consolidation formed on very low volume. This was a key signal that investors were holding their shares, increasing the probability that price would continue higher.

As price approached the lower bound of the triangle formation, which coincided with the 30 WMA (a significant support level), it bounced higher with above average volume. This was another strong signal.

Volume increased in the weeks following until price broke out of its formation with the heaviest volume since the start of the consolidation. This week was the perfect time to enter. In case you missed it, you can find our entry parameters here.

We're currently monitoring the position to see what it does at this large resistance. We're already seeing a slight pullback, which makes sense after this week's move.

<u>VDTH</u>

India's premier satellite TV provider VDTH has shown solid price action since its huge volume breakout earlier this month. You can review our entry/exit parameters from this week [here](#).

In our introduction to VDTH, we discussed a few of our concerns with our thesis regarding the general trend towards cord cutting and the rampant piracy that plagues India's media industry. Operator Prabhat, who lives in India, had some great insight into our concerns that strengthens our thesis:

> ***1)*** *I don't think piracy is necessarily such a huge issue in the demographic we're talking about. Many of the most important channels require set-top boxes and piracy can't really fulfill the demand entirely because this involves things like live sports, which can't be meaningfully pirated without broadband.*
>
> *I don't think I am a full-fledged expert on Indian TV watching habits, but most of the demand comes from a) Saas-Bahu serials (a type of family drama soap opera particular to India and Pakistan), watched mainly by an astonishing number of women who are not in the financial elite, b) Live sports, mainly cricket, which is so insanely popular in India that the cricket captain Virat Kohli is on track to enter the Forbes Top 10 highest earning sportsmen list despite salaries that are quite low compared to EPL, NFL or NBA salaries and c) a whole range of regional news and the like which isn't really conducive to piracy.*
>
> ***2)*** *While it's true that Indian customers are notoriously price-conscious and will by and large pirate anything they can, much of the range of offerings on DTH can't be effectively pirated. Moreover, like cars, a proper fully functioning TV set is often a point of pride and ego in the middle and lower middle classes of India. HD television sets were advertised during the last cricket World Cup, by then captain M.S. Dhoni informing a gentleman in an ad that if a TV isn't HD, it isn't a TV at all and that people will laugh at him. Crude as that may be, it captures the mentality of it's target audience very well.*
>
> *Indian culture is often obsessed with keeping up appearances and while consumers are very cost-conscious, a fixed price subscription for TV isn't the sort of thing at which people will cut their costs.*
>
> ***3)*** *The internet: This is a distant dream. If you have a lot of experience with the net, are rich and have a great net connection you can find workable alternatives to your TV set, and the kind of people who can do that are also the kind of people who wouldn't bother to go to all that trouble to avoid paying $10 a month.*
>
> *I wouldn't be too worried about these negatives.*

CENX

We still have 20% of our original position in CENX, having taken the majority of our profits at around $14.

This stock is intricately tied to the Trumpflation narrative and can be used as a barometer of the narrative's strength/weakness.

We'll continue to sit on this and see if it's got any more steam left in the engine. If it falls below our entry point we'll cut the rest.

Bonds

Like we talked about, our bond trade is off to a good start. The dynamics behind the trade suggest that it's possible we see bonds run all the way to our second target.


MacroOps published on TradingView.com, March 25, 2017 15:00 EDT
CBOT_DL:ZB1!, D 150'26 +0'10 (+0.21%) O:150'16 H:151'06 L:150'06 C:150'26
T-BOND FUTURES - ECBT, D, CBOT
MA (200, close)
MA (50, close)
MA (100, close)
2nd Target
157'22
1st Target
153'01
150'26
146.22 Entry
146'21
Vol (20, false)
Created with TradingView

NEWM


MacroOps published on TradingView.com, March 24, 2017 11:51 EDT
BATS:NEWM, W 14.48 +0.19 (+1.33%) O:14.82 H:14.83 L:14.10 C:14.48
NEW MEDIA INVT GROUP INC, W, BATS
MA (30, close)
MA (15, close)
14.48
Vol (10, false)
Created with TradingView

Our print media pick NEWM is currently finding support at the bottom of its large triangular consolidation. We're looking for price to bounce here. So far we've seen some positive action, but on very little volume. Friday's negative price reversal was also not reassuring.

If price breaks below the significant level near $14.20, we'll cease coverage on this stock until sentiment becomes more positive.

GV

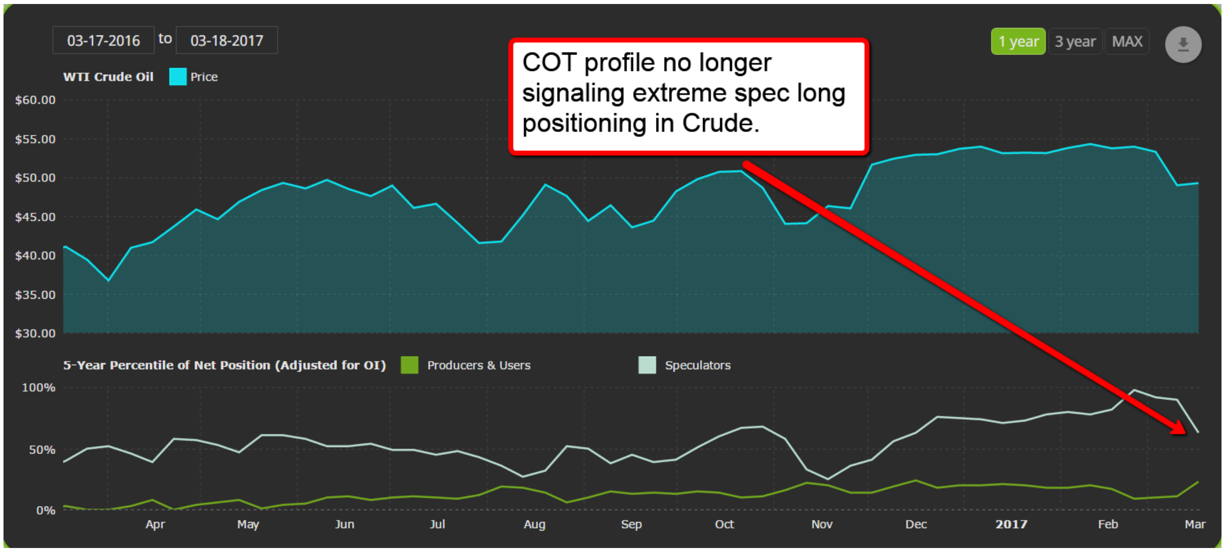
I've written up a short analysis on GV, one of our other equity holdings in Strat. I've used the opportunity to discuss some important trade management rules. We'll be pushing that out to you guys this coming week.

Vol Ops Portfolio Review

Oil

Our crude oil puts in Vol Ops are up about .67R as of this writing. Oil had a nice continuation down right after we executed, but has since stalled right on the 200-day MA.

This trade has become a little less attractive since we put it on the book. The COT profile has cooled off substantially. We no longer have extreme spec long positioning.

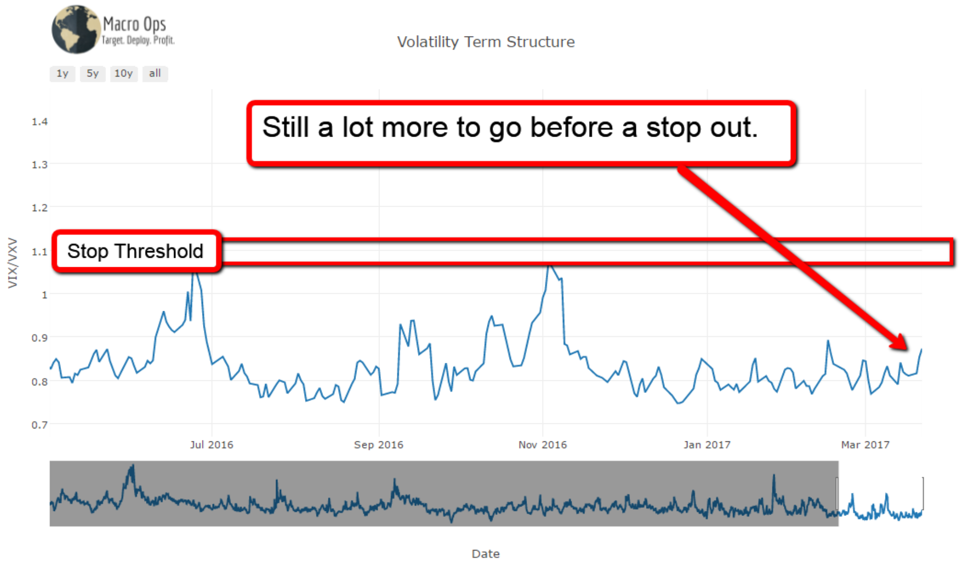


Ideally we'll get one more flush down near $44 so we can take profits. The options only have 24 days left in them so the sooner the better. If oil continues to congest or retrace, we'll cut the position and keep the loss small.

VIX Futures

On Monday we rolled our VIX futures position from April to June. We booked a nice 3.7% gain on April. But our June futures are a bit underwater because of the recent rally in vol. VIX finally closed above 13 for the first time in 2017! Crazy.

In the grand scheme of things this is only a small drawdown. We don't exit our short VIX futures position until the term structure indicator reaches a value of around 1.1. It's not even above 0.9 yet.



The key to this trade is making sure the position sizing is correct so you can last through the times you're underwater. Our current sizing methodology for the VIX futures saw a max drawdown of 25% during the flash crash in 2010. We're prepared to take that kind of heat on this account. Keep in mind that since we employ a multi-strat approach with two accounts, the max drawdown from Vol Ops on our combined portfolio is only half the total (12.5%).

— — — — —

Keep playing the player and think about which market moves would hurt the most traders.

Let me know if you come up with any good ideas.

Enjoy your weekend and have an excellent week.

Your Macro Operator,

Alex

Portfolio Snapshot

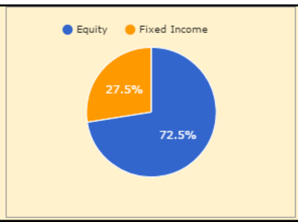
Strategic Ops

NAV $1,129,434

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	$7,000
Equity	Century Aluminum CENX	400	$11.11	$7.55	$1,424.00	$16.55	$26,860
Equity	GAIA	5,000	$9.74	$8.50	$6,200.00	$13.75	$48,500
Equity	Videocon VDTH	2,900	$11.27	$9.26	$5,829.00	$17.45	$32,625
Fixed Income	30 Yr-Bond Futures (ZBM7)	6	$146.69	$145.75	$5,625.00	$153.00	$890,952

Metrics

Exposure Breakdown	
Equity	$14,823.00
Commodity	$0.00
Fixed Income	$5,625.00
Forex	$0.00



Total Open Risk

$20,448.00

1.81%

**Updated 3/25

Volatility Ops

NAV $1,210,191

Asset Class	Position	Size	Cost Basis	Notional
Volatility	June 21st VIX Future	-36	$15.00	-$543,600
Commodity	Crude Oil May 2017 48.5 P	11	$1.06	~

Scenario Analysis/Stress Tests

Max Loss -$350,000

**Updated on 3/25