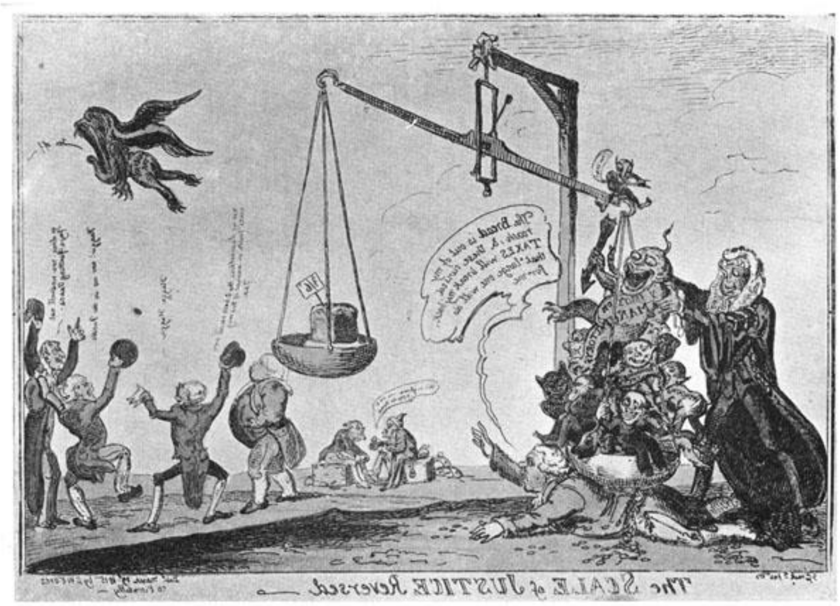
MACRO INTELLIGENCE REPORT

June 2nd, 2017

A Market Salmon



In this Issue:

- How To Be Contrarian
- Macro: The Death of Retail
- Micro: PGAL, BBRY, HDSN
- Quant: Brazilian Fear
- Portfolios
- Asset Allocation Update

On being a contrarian from Michael Lewis' Liar's Poker:

> *Everyone wants to be, but no one is, for the sad reason that most investors are scared of looking foolish. Investors do not fear losing money as much as they fear solitude, by which I mean taking risks that others avoid. When they are caught losing money alone, they have no excuse for their mistake, and most investors, like most people, need excuses. They are, strangely enough, happy to stand on the edge of a precipice as long as they are joined by a few thousand others…*

Contrarianism is the most abused platitude in trading. Everybody thinks they're a contrarian, but few actually are.

And that, by its very nature, *has* to be the case. Because to be a contrarian is to go against the herd (the majority).

As traders, we make our money on price movement. But for price to move, the *current* price must be wrong. If you're betting on a trend, you're betting that the market is currently wrong. And by disagreeing with the market, you're disagreeing with the consensus. You're being a contrarian.

This is very important to grasp.

Hedge fund legend Ray Dalio puts it like this, "You can't make money agreeing with the consensus view, which is already embedded in the price."

Exactly.

To be successful in this game over the long haul, you have to be a market salmon of sorts. You have to be willing to swim (trade) against popular opinion.

This is no easy feat. The vast majority of market participants don't have an inkling of what true contrarianism means.

But their loss is our gain because in this month's report we'll lay out exactly how to be a smart contrarian. We'll then apply that framework to the current market and identify the most contrarian trade we can find.

First off, market prices aren't set according to independent facts. They're the result of an aggregation of various individuals' beliefs. The average of these beliefs sets the market price.

Sometimes beliefs are widely dispersed and the market is relatively balanced. Trends develop as market participants abandon one belief and adopt another. Occasionally a trend develops a reflexive feedback loop where the price trend spurs greater belief adoption spurring a stronger trend. This sometimes lead to a market consensus and extreme price trends.

Understanding the market's belief structure and putting it to your advantage goes back to Keynes' famous Beauty Contest analogy. Keynes likened profitable investing to a common newspaper game of the time:

> *… in which the competitors have to pick out the six prettiest faces from 100 photographs, the prize being awarded to the competitor whose choice most nearly corresponds to the average preferences of the competitors as a whole: so that each competitor has to pick, not those faces that he himself finds prettiest, but those the he thinks likeliest to catch the fancy of the other competitors, all of whom are looking at the problem from the same point of view… We have reached the third degree where we devote our intelligences to anticipating what average opinion expects the average opinion to be. And there are some, I believe, who practise the fourth, fifth, and higher degrees.*

Our goal isn't to identify "correct" asset pricing. There's no such thing as "correct" prices. It's all based on investors' opinions and beliefs.

What *we're* concerned with is understanding how future market outcomes affect these beliefs, which in turn determines how securities will be valued.

First we need to identify the beliefs driving the market. Now we can't possibly do this for *every* belief affecting pricing, but we don't need to. We just need to identify the dominant beliefs.

There's always one or two dominant beliefs driving prices because investors find safety in numbers. Most, whether they realize it or not, do not like to think for themselves. To go back to the quote from *Liar's Poker*:

> *Investors do not fear losing money as much as they fear solitude, by which I mean taking risks that others avoid...They are, strangely enough, happy to stand on the edge of a precipice as long as they are joined by a few thousand others.*

Man's tendency towards herding ensures that large sections of the market will always interpret information through similar belief structures.

As smart contrarians, our job is to sniff out consensus views and exploit them.

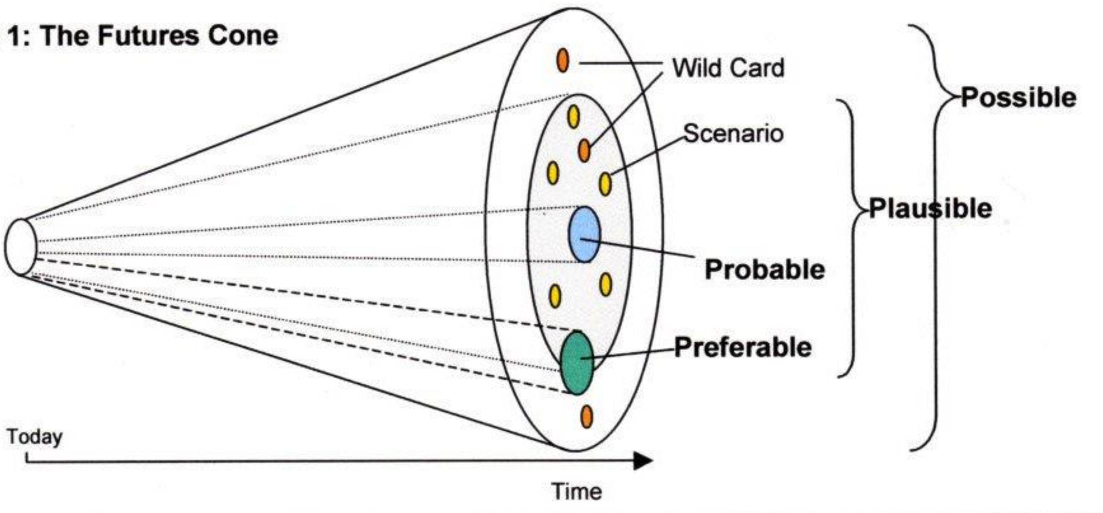
For an explanation on how to put this into practice, let's turn to Drobny's interview with *The Philosopher* from his book The Invisible Hands (emphasis mine).

> *It is important to note that a key element to this exercise is the fact that what other people believe will happen is just as important as the eventual outcome.* ***A market is not a truth mechanism, but rather an interaction of human beings whereby their expectations, beliefs, hopes, and fears shape overall market prices.*** *People in the private equity business can decide if something is a good idea or not if held to maturity. My horizon is much shorter term.*
>
> *A good example of this psychological element can be seen in inflation.* ***At the end of 2008, U.S. government fixed income was pricing in deflation forever. At that point, the only thing of interest to me was the question of whether people might think that there could be inflation at some point in the future.*** *Quantitative easing made it easy to answer this question affirmatively, because there are many monetarists in the world who believe that quantity of money is the driver of inflation.* ***Whether they are right or not is a problem for the future — what is important to me is that such people exist today.*** *Their existence makes the market pricing for U.S. long bonds completely lopsided. Such pricing only makes sense if you are a died-in-the-wool output gapper who believes that when unemployment goes up, inflation goes down, end of story.* ***Market prices reflect the probability of potential future outcomes at that moment, not the outcomes themselves.***

Some people do not believe in the output gap theory of inflation, and these people believe that pricing for U.S. bonds should be somewhere else. Because these two divergent schools of thought exist, it is possible that market sentiment can shift from deflation to inflation and that pricing will follow.

One way to think about my process is to view markets in terms of the ***range of reasonable opinions.*** *The opinion that we are going to have declining and low inflation for the next decade is entirely reasonable. The opinion that we are going to have inflation because central banks have printed trillions of dollars if also reasonable.* ***While most pundits and many market participants try to decide which potential outcome will be the right one, I am much more interested in finding out where the market is mispricing the skew of probabilities. If the market is pricing that inflation will go to the moon, then I will start talking about unemployment rates, wages going down, and how we are going to have disinflation. If you tell me the markets are pricing in deflation forever, I will start talking about the quantity theory of money, explaining how this skews outcomes the other way****…. People tell stories to rationalize historical price action more frequently than they use potential future hypotheses to work out where prices could be.*

Figure 1: The Futures Cone



Here's how to put theory into practice.

1. Identify the dominant beliefs driving markets
2. Imagine alternative future scenarios that would impacts these beliefs and their subsequent pricing
3. Wait for indications to see which scenario is playing out (price action helps here)

Financial news is a great place to begin your search for dominant beliefs. But remember, you're not reading the news for facts, you're reading it to get a sense of how other players are thinking.

You need to read the news as a contrarian.

Journalist get their tips and leads from traders, investors, researchers, etc… They report on where the large moves in the market have *already* happened. Key word being "already". The news is backward looking. As traders, we care about the future, not the past. By the time reports start hitting the papers, especially the front page, they've long been priced in.

This is key to remember. If you're reading about a trend or market development on the front page of the newspaper, or in a big story in Barron's, chances are it's **already priced into the market.**

When you see this happen, your job is to start asking "What if?"

For example, last October the dominant financial news story was about the inevitable blowup of Deutsche Bank. You couldn't read the WSJ, FT, or any investment blog without hearing pundits cite every reason DB would soon fail.

This extreme scenario became increasingly priced into DB's stock price. The stock fell 70% from where it was just over a year prior.

When you saw this broad market consensus develop, all you had to ask was "what if?"

What if the market is overpricing the likelihood of this event. Maybe DB is a bad bank but *what if* it manages to continue being a bad bank for a very long time and never actually blows up. *What if* the market regulators (ie, central bankers and government officials) who are reading the same doomsday news as you, become compelled to act? *What if* they promise to backstop and recapitalize the bank?

Clearly there were many alternate and equally probable future outcomes for DB other than its inevitable blow up. And many of these alternate scenarios were actually quite bullish for the stock. But the market was only pricing in one of these at the time; the doomsday scenario.

All a good contrarian had to do was ask these *what if* questions and then wait to see how the price action and fundamentals unfolded.

When there's consensus it means there's a singular belief driving market pricing. That belief can quickly become overly discounted. And when something becomes overly discounted, it means it wouldn't take much contrary evidence to flip people's belief and drastically move prices.

Deutsche Bank is now 60% off its lows and the dominant belief has transitioned. It's gone from one of doom and gloom to more dispersed beliefs that tilt bullish, but are far from a broad consensus.

Another prime example is oil in 2014.

In early 2013, I remember going to a "peak oil" lecture given by a very respected academic. You probably know the one. For a number of years it became somewhat of a consensus view that we were nearing peak oil supplies and that the earth's reserves would inevitably decline.

I remember the lecturer making a very compelling case that in just a decade's time skyscrapers would no longer be in use. Energy would be so expensive that we wouldn't have the means to power common things like elevators or air conditioning.

Laughable right? But at the time this was a serious belief that was being debated by many "experts". Triple digit prices as a floor for oil were all but given. The real question at the time was, how long until oil goes over $1,000bbl?

Of course we all know how that played out. Right around that time fracking was developed. All of a sudden we were able to pull vast amounts of new energy from the ground, even as the "peak oil" belief dominated markets. This belief was completely baked into the price at around $100bbl. It didn't take a genius to ask the right *what ifs* to uncover this HUGE mispricing and asymmetric opportunity.

2014 still remains my most profitable year. The highly contrarian trades of short oil and long dollar paid out the easiest and most consistent double digit monthly gains I've ever had.

At the same time, the majority got crushed.

This is how the market works. To quote market wizard Bruce Kovner, "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."

The stock market works to transfer money from the many to the few.

Those few are the ones who identify and exploit market prices dominated by narrow singular beliefs and consensus views.

As George Soros said, "The prevailing wisdom is that markets are always right. I take the opposite position. I assume that markets are always wrong. Even if my assumption is occasionally incorrect, I use it as a working hypothesis.

That's how to operate as a smart contrarian.

It's not easy holding an independent opinion. But that's why it works.

Now, where is the most consensus driven trade in the market?

Or to put it another way, what is the most contrarian trade at the moment?

Macro: The Death Of Retail

You haven't been able to open a newspaper or hop on Twitter over the last six months without reading about the inevitable "Death of Retail".

Just Google the term and you'll see countless hyperbolic titles and taglines like the ones to your right.

Like all consensus beliefs, the death of retail narrative is built upon a lot of truth.

The consumer trend of ditching brick and mortars for shopping online has been swift and dramatic.

We are without a doubt seeing a major technology driven secular shift in the way consumers shop and buy goods.

Warren Buffett just confirmed the death of retail as we know it

Hayley Peterson
May 8, 2017, 11:14 AM 187,181

FEATURE

The Amazoning of American Retail

Retail Apocalypse – Sears Death Spiral?

Profit from the Death of 40 Retail Stocks

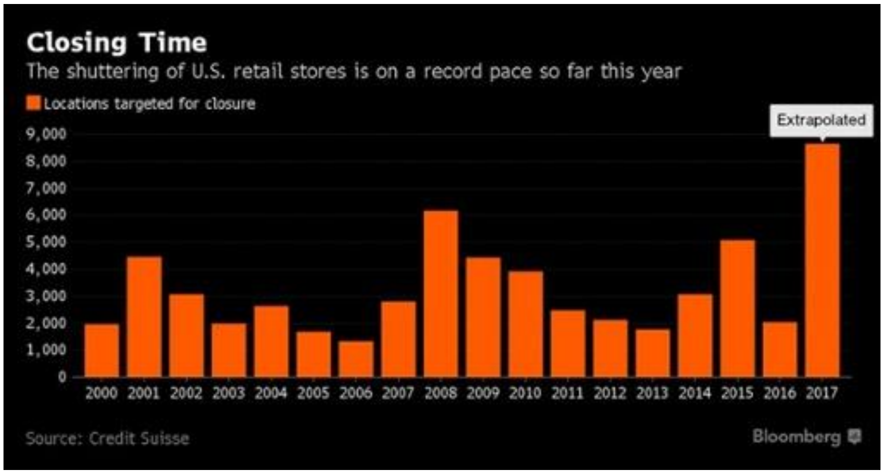
Will this be the death of shopping centres as we know it?

The tidal wave of store closures is far from over

By Business Insider | May 13, 2017 11:30AM

Companies like Amazon are eating the lunch of traditional retail. And the stocks of brick and mortar retailers have been decimated because of it.

Traditional retail stocks such as Macys, Sears, JC Penny, Nordstrom, GNC etc… are all down 70, 80, and 90+% from their highs.



And if you peek at the chart to the right, you'll see that US retail stores are closing at a record rate.

In this case, it's very easy to identify the dominant belief that's driving market prices in the retail sector:

"Traditional retail is dying and it's being killed off by e-commerce giants like Amazon."

This is already strongly reflected in prices.

Our job *now* is to ask the contrarian "what ifs".

What if this "death to retail" belief is already mostly priced in?

What if many more brick and mortar retailers die, yet many still survive?

What if the death of the dinosaur retailers becomes a large opportunity for surviving retailers because of less competition?

What if the executives of these traditional retailers have been reading these same doomsday news headlines and as a result have had a fire lit under their arses, driving them to adapt and evolve to the new market environment?

And finally, *what if* a number of these "traditional" retail stocks have made the necessary positive changes but are going unnoticed because investors are hook line and sinker bought into the "Death of Retail" narrative?

We don't and can't know the future of retail with certainty. Maybe all brick and mortar stores *will* die out. In that case, many of these stocks are still overvalued.

But that seems extreme doesn't it?

By asking "what ifs" and developing alternate scenarios, we have a working basis to gauge the asymmetry of potential long retail trades. We can compare these alternate scenarios to the current dominant belief and see if there's a large enough disparity to trade.

With this quick exercise we can easily surmise that if some retail companies *do* survive, and end up doing just *okay*, then there's a potentially huge mispricing in some of these names.

And large mispricings equal large profit opportunities.

We can take this *"what if"* knowledge and use it to identify the companies likely to survive and thrive should the alternate scenario play out.

An easy way to do this, without having to be a retail expert, is to follow the insiders.

We can screen for instances where corporate insiders have been purchasing sizable blocks of their own stock after the large selloffs. When you see hand over fist insider buying in a cratering stock, it signals that management sees a brighter future for its company than what the current prices imply.

To play it safe, we can filter further for only companies with strong balance sheets, low debt to equity, high current ratios, and minimum daily traded volume.

Doing so gives us the following list.

No.	▲ Ticker	Company	Sector	Industry
1	GNC	GNC Holdings, Inc.	Services	Drug Stores
2	SIG	Signet Jewelers Limited	Services	Jewelry Stores
3	SQBG	Sequential Brands Group, Inc.	Consumer Goods	Textile - Apparel Clothing
4	TUES	Tuesday Morning Corporation	Services	Discount, Variety Stores

A quick look through these company's last few quarterly calls and earnings reports shows that each one is working furiously to make the necessary changes and to adapt to the new environment. Management of each appears extremely confident they will be successful, which is why they're loading up on shares.

Now we don't just go in and start buying these stocks. There's a thin line between being a smart contrarian and being road kill for a stampeding herd of investors.

Remember that quote from Ray Dalio, "You can't make money agreeing with the consensus view, which is already embedded in the price." Well, there's a second part to that quote where Dalio says, "Yet whenever you're betting against the consensus, there's a significant probability you're going to be wrong, so you have to be humble."

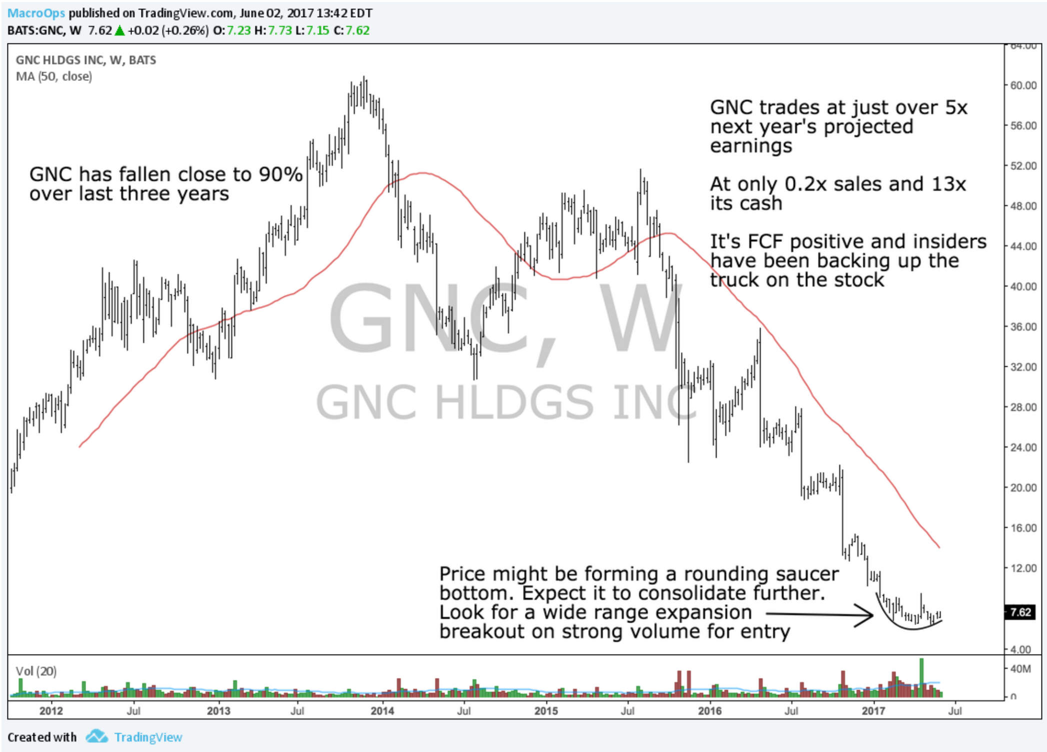
We don't know the future and aren't trying to predict it. We're just trying to identify alternative scenarios that the market isn't pricing in. We can always end up being wrong, and when you're a contrarian thinker, oftentimes, you're wrong.

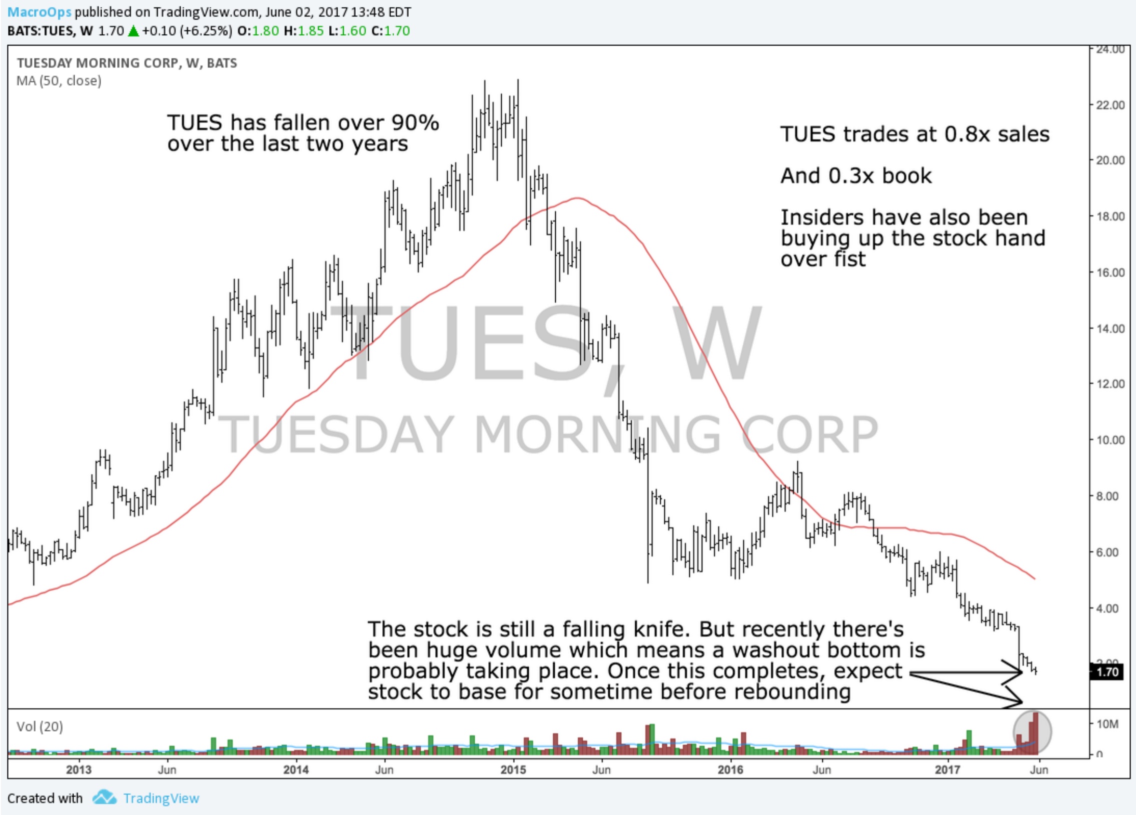
Trading legend Michael Steinhardt put it well when he said the following.

> *There is a very important difference between being a theoretical contrarian and dealing with it in practical terms. In order to win as a contrarian, you need the right timing and you have to put on a position in the appropriate size. If you do it too small, it's not meaningful; if you do it too big, you can get wiped out if your timing is slightly off. The process requires courage, commitment, and an understanding of your own psychology.*

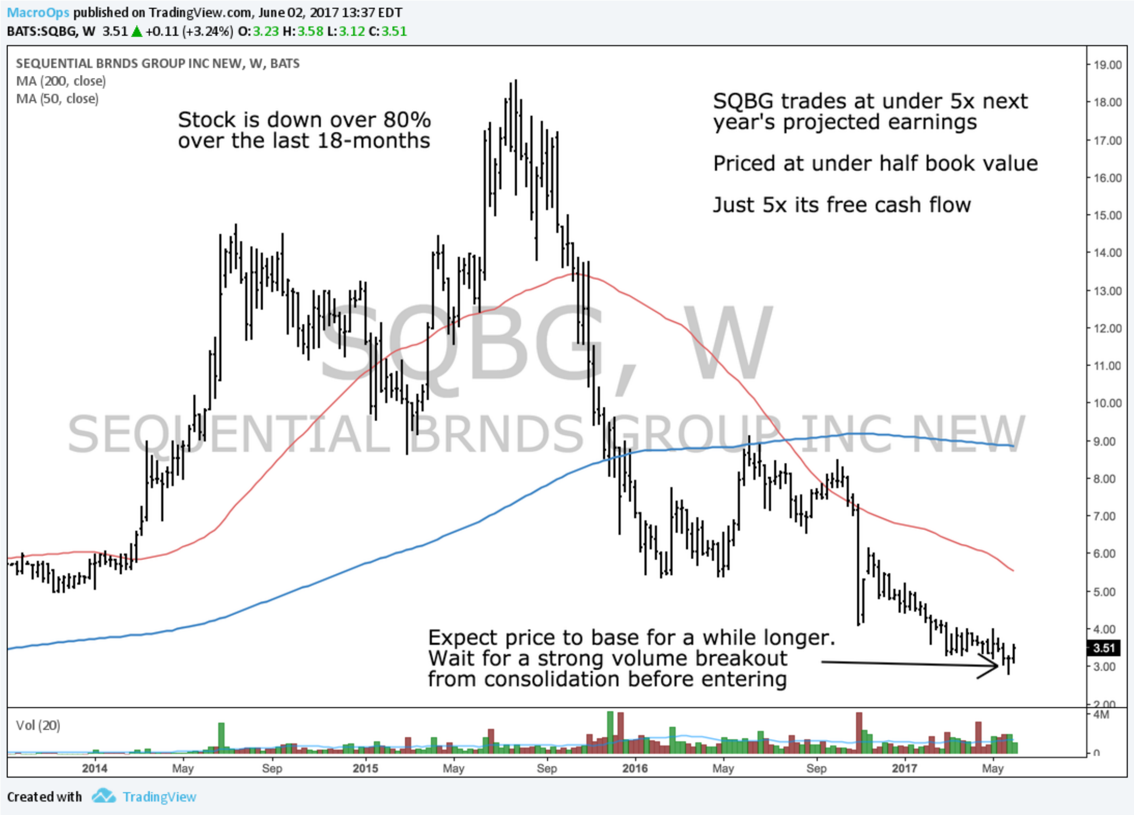
We need to exercise patience. We need to follow the price action of these stocks and wait for the market to tell us that it's waking up to the possibility of our alternate scenario.

Here's what we'll be watching closely and waiting for before entering a position.




MacroOps published on TradingView.com, June 02, 2017 13:48 EDT
BATS:TUES, W 1.70 ▲ +0.10 (+6.25%) O:1.80 H:1.85 L:1.60 C:1.70
TUESDAY MORNING CORP, W, BATS
MA (50, close)
TUES has fallen over 90% over the last two years
TUES trades at 0.8x sales
And 0.3x book
Insiders have also been buying up the stock hand over fist
TUES, W
TUESDAY MORNING CORP
The stock is still a falling knife. But recently there's been huge volume which means a washout bottom is probably taking place. Once this completes, expect stock to base for sometime before rebounding
Vol (20)
Created with TradingView


MacroOps published on TradingView.com, June 02, 2017 13:31 EDT
BATS:SIG, W 53.13 ▲ +0.72 (+1.37%) O:49.17 H:53.20 L:46.09 C:53.13
SIGNET JEWELERS LIMITED, W, BATS
MA (200, close)
MA (50, close)
Stock is down 70% over the last 18 months.
Sig trades at a TTM P/E of 7
0.5 of sales and 14x FCF
Annual dividend of 2.4%
SIG, W
SIGNET JEWELERS LIMITED
Potential bottom. High volume wide ranging reversal bar on a weekly timeframe. We'll have to track follow on price action closely to see if it holds up.
Vol (20)
Created with TradingView



Understanding how to read the tape and use classical charting to set your stops and manage your risk is key to being a profitable contrarian.

Thus, we will have to follow these names closely over the coming months. Look for evidence that the dominant belief structure of the market is shifting. And patiently wait for price action to confirm this transition and offer positive expected value entries.

If and when that happens, there's potential for a massive repricing of these stocks.

Now let's pass it off to AK and we'll take a look at three of our most recent high conviction additions to our equity portfolio.

Micro: PGAL, BBRY, HDSN

PGAL

"Sure… when PIGS fly."

That's the response you used to get when asking portfolio managers about investing in Portugal.

And for good reason too.

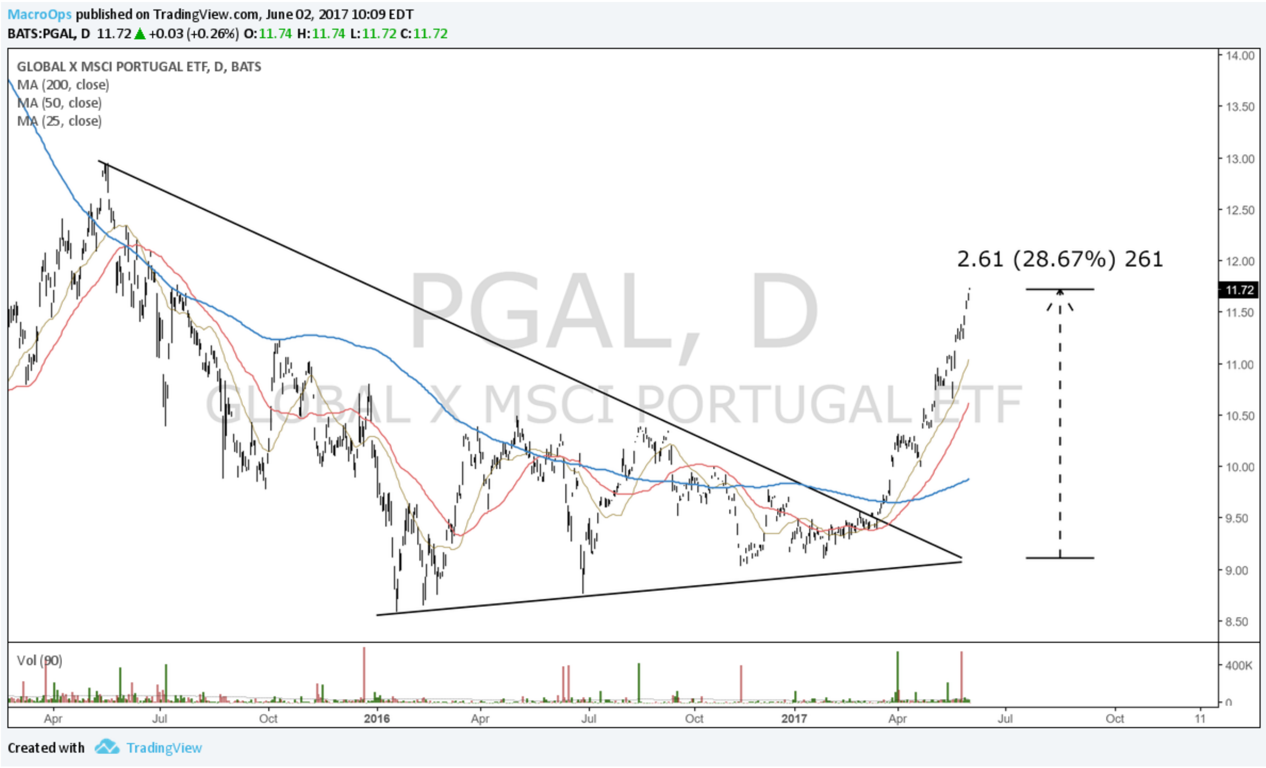
Portugal was at the heart of the 2011 European Sovereign Debt Crisis along with Italy, Greece, and Spain. *(Hence the endearing acronym PIGS.)* Gross mismanagement of their finances led to unserviceable debt levels and the near collapse of their banking systems. Just short of default, "the powers that be" (ECB/IMF) were forced to bail them out at the last minute.

Portugal in particular spent the better part of four decades inflating their state-managed public works projects. They gave management (aka themselves) huge bonuses and hired with the goal of paying two people to do *one person's* job. This short-sighted strategy lead to massive levels of debt fueled by risky credit. The whole thing cumulated into a €78 billion bailout sponsored by the IMF and ECB in April of 2011.

The crisis roiled investors, especially those invested in Portuguese bank debt. One of Portugal's major banks, Banco Espírito Santo, collapsed. Novo Banco was created with Espírito's best assets while a "bad bank" was created to house everything else. But then, at the end of 2015, almost €2bn worth of Novo Banco bonds were moved to the "bad bank", effectively wiping out their value and screwing the investors involved. Blackrock, Pimco, and 12 other institutional investors are now locked in a legal battle with the Bank of Portugal who approved that bond transfer.

Investors don't like getting burned. And given this tumultuous past, shunning Portugal is understandable.

But since the beginning of this year, the Portugal ETF (PGAL) has risen nearly 30%. So what gives?



In past [MIR's](), we've thoroughly covered the improving economics and sentiment in Europe.

Portugal is no different.

The country's economic conditions continue to improve and attract more investors back to its markets.

Just last week the EU announced that Portugal was no longer in breach of the bloc's budget rules. The country's budget deficit fell to 2% of GDP in 2016, well below the limit of 3%. The EU expects this deficit to maintain itself into 2018.

GDP growth in the first quarter of 2017 also came in 1% higher than the previous quarter. This raised expectations that the country will exceed the government's forecast of 1.8% growth in 2017— the best in seven years.

This data comes as a pleasant surprise to investors who were concerned about Portugal's economic management after a Socialist government took office in late 2015. Prime Minister António Costa's anti-austerity program was backed in parliament by the communist left and did not bode well for the economy. But surprisingly, Costa stuck to the fiscal targets he agreed to with international lenders. Now Portugal's budget deficit is running at a 40-year low, the economy has grown for 13 straight quarters, and unemployment is at an 8-year low.

Fanny Jacquemont, a portfolio manager at CPR Asset Management, explains:

> *The main risks are behind us. The macroeconomic dynamic is improving, the government is very keen to reduce the deficit, the banking system is being sorted out.*

We agree with this, but only partially.

Portugal's debt is expected to stay elevated at 125% of GDP into 2020, with its growth slipping back to 1.4% next year. Portuguese banks' non-performing loans are also up 2.5% to 19.5% over the last two years. There are good reasons rating agencies like Moody's still haven't bumped Portuguese debt to investment grade. Moody's explains:

> *The [banking] sector remains burdened by high non-performing loan levels, low levels of profitability and weak capital buffers which continues to hinder the provision of credit to productive investment opportunities.*

Our view of Portugal fits with our view of the rest of Europe: clear to run in the short to intermediate-term, but still troublesome over the longer-term.

Like our other European plays, we're not looking to buy and hold here. We'll let price action be the guide as we ride sentiment higher, but will keep an eye on the exits should the tides turn.

We entered PGAL around $10.56 with a risk point of $9.98.

BBRY

BlackBerry (BBRY) is known for two things: cellphones and security.

Its cell phones are what caused the company's share price to collapse over 95%.

But its security is what investors are betting will help BlackBerry rise from the ashes.

We all remember how popular BlackBerry phones used to be. If you were an exec in a suit, then you sure as hell had your "CrackBerry" on you at all times. It was THE vital tool of the modern businessman. It kept you connected by providing the first real opportunity to work around the clock, constantly checking emails and sending BBMs (Blackberry messages). Oh joy! The go-getters of the world were so excited that they developed a little something called "BlackBerry Thumb". But hey… no pain no gain right?

The phones were a cultural phenomenon and the company seemed unstoppable. That is… until the iPhone showed up to play. The iPhone, a much *bigger* cultural phenomenon, completely revolutionized the smartphone market and left slow-to-adapt BlackBerry in its dust. BlackBerry's market share fell from 20% in 2009 to 0% today. Its stock price followed suit, plummeting from a high of $148.13 to as low as $5.44.

Everyone expected the company to go bankrupt.

But then… BlackBerry pivoted.

The first step was to throw in the towel on its cellphone business. Management had to face the fact that they lost the smartphone race. There was nothing left for them there. And so, just last year *(better late than never)*, BBRY decided to cease production of their phones. They then began to outsource their brand and software to other developers who would release products under the BlackBerry name. In return, BBRY would collect licensing fees.

So far this strategy has worked.

The brand-new BlackBerry KEYone smartphone was released this year to far more favorable reviews than the company is used to. The KEYone was made by a Chinese company called TCL and runs Google's Android operating system (OS) with Blackberry back-end software for security. It comes with the standard touchscreen along with a not-so-standard physical keyboard — an ode to the BlackBerry's of the past. The physical keyboard has managed to appeal to a niche group of users that still miss their old-school smartphones. The KEYone is already the #1 unlocked phone on Amazon and Techradar.com called it "the latest smartphone comeback story of 2017".

The strategy looks to be paying off in India as well, a market we believe is poised to be one of the biggest growth stories over the next decade. Optiemus Infracom, India's largest original design and contract manufacturer of mobile headsets, recently announced plans to generate $350 million in revenue off BlackBerry-branded handsets this year. These launches should bring in some high-margin licensing dollars for BBRY.

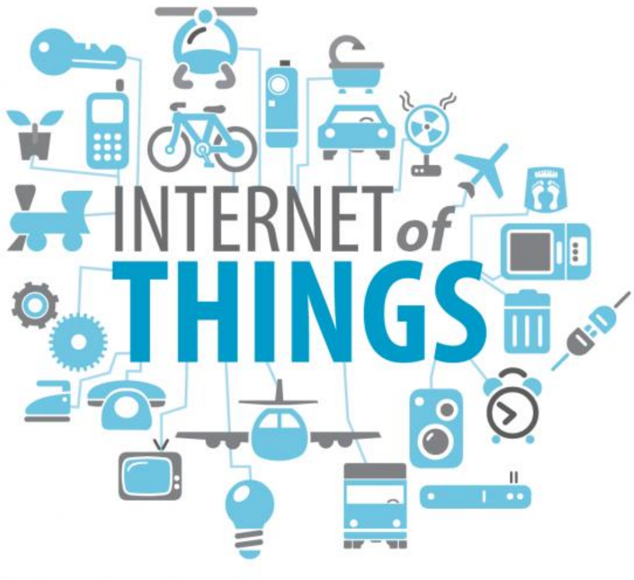
The company's hands-off licensing strategy will continue to provide decent cash going forward. And there's even a possibility the market for BlackBerrys re-establishes itself to some extent. But the likelihood is low. Like we said, BlackBerry screwed up. And if they wanted any chance of surviving, they needed to pivot.

Pivoting required looking deep into their business to see where *(if anywhere)* they still had an edge.

Now one of the reasons BlackBerry phones were so popular was because they were SECURE. The brand was synonymous with security and corporations trusted them enough to issue the phones to their workforce. This relationship was slow to change, even as iPhones took over. Many corporations clung to the security BlackBerry provided until the last minute, when they were forced to switch as BlackBerry cratered, even with its security still intact.

That same security is even more highly valued in today's treacherous online environment. From Yahoo losing over 500 million user accounts, to the Russians hacking left and right, to ransomware that makes its users "WannaCry", security is the utmost priority of businesses today.

This is especially true with the trend towards the "Internet of Things" (IoT). IoT is the term used to describe the rapidly increasing machine-to-machine interconnectivity in our everyday lives.



Nowadays everything has sensors and cameras that feed information to outside sources. Your fridge can tell your smartphone when you're low on milk. Medical devices can feed biometric data straight to doctors in real-time. Even your toilet can analyze your morning business. Of course all this data is sensitive *(especially your morning business)* and needs to be protected and made secure.

This is exactly where BlackBerry shines.

Back in 2010, BlackBerry bought a company called QNX with the goal of using its software as the OS for the new BlackBerry 10. The phone predictably flopped, but the QNX software took off and spread outside the phone industry.

QNX, with its ultra-reliability and strong security, became the go-to choice of various life-critical IoT systems including air traffic control, surgical equipment, and nuclear power plants. These are all systems that cannot be hacked and fail, or else lives would be lost.

Along those same lines, QNX also became a key component in another huge industry — autos. This is what's got investors excited now.

QNX's software is used as the basis of car infotainment systems. Infotainment systems are the touch screens you see in your dashboard. From making hands-free calls through your cell phone, to controlling your seat warmers and navigating you to your destination, QNX's software does it all.

QNX is currently in more than **60 million** vehicles, controlling **over 50%** of the car infotainment market. It's in all the major automakers worldwide including BMW, Mercedes-Benz, Ford, General Motors, Audi, Toyota, Hyundai, and Honda.

Taking it a step further, QNX recently partnered with Ford on their autonomous car program. If you've been following the historic carmaker, then you'll recall the recent management shakeup where CEO Mark Fields was fired and replaced with Jim Hackett, the former head of the company's autonomous vehicle division. This was a huge move proving Ford's commitment to autonomous vehicles. Self-driving cars are all the fuss in the auto-industry and QNX is right in the middle of it. As Raj Nair, president of Ford's North American operations explains:

*Growing our expertise, experience and use of the BlackBerry QNX embedded software platforms will help ensure we deliver the **high-quality, highly secure** experience that our customers expect.*

That's the reputation of BlackBerry and QNX in the auto market: high-quality and highly secure.

Investors are hoping this trend continues with BlackBerry supporting the Internet of Things, while playing a huge role in the rise of autonomous vehicles.

BlackBerry is already developing new security software to complement QNX in the auto market. The new software will work as a virus scanner for cars, warning drivers when their vehicle may be compromised, as well as automatically installing software patches over the air to keep its security up to date. This anti-virus program will use the software-as-a-service (SaaS) model, generating about $10 per vehicle per month.

This is just the beginning of what investors see as a very lucrative future for BBRY as it continues to introduce new SaaS subscriptions through its QNX platform.

The increasingly successful transition from phones to SaaS security services is the reason BBRY's share price shot up *over 50% in the last two months*. But the real kicker here is it its role in autonomous vehicle development. Self-driving cars are THE hot theme right now. We've talked about how overblown the hype is in our coverage of Fiat Chrysler (FCAU). And have you seen Tesla's (TSLA) share price lately? Ridiculous…

We've seen this same phenomenon play out with Nvidia already. Wall Street stopped valuing it as a graphic chip maker and instead shifted its attention to the company's future in autonomous vehicles, artificial intelligence, and data center tech. This caused NVDA's enterprise value to shoot from $5 billion to $85 billion in just 2 years, while its revenues *only* doubled. This meteoric rise was possible because the market began looking at the growth of the various segments NVDA was involved in, instead of the company's growth by itself. The same valuation standard could apply to BBRY as well.

But while BBRY is benefiting from this hype, we still need to be realistic here. And the reality is that QNX won't be the only big player in the car market for long. Google and Apple are right on their ass, both developing their own automobile-specific OS's. Google has been working on Android Automotive, which both Audi and Volvo announced they would use in their future models.

The problem with QNX is that even though it may be secure, its usability is still garbage compared to anything Google or Apple makes. I've been leasing brand new Ford vehicles for the last decade, and not once have I been pleased with their infotainment system. I'm always left staring at the dashboard, frustrated, wondering why the hell it doesn't work like my smartphone. It drives me crazy.

I was overjoyed to hear Google was making its own OS. I'll finally get something that'll work like it's supposed to! I'm sure the rest of the market feels the same. And that's not good. *(I didn't even mention how much better Google Maps is compared to the navigation system in these damn cars. But that's a rant for another day…)*

Both Google and Apple also have much larger developer ecosystems compared to QNX. The evolution of these infotainment systems depends on apps. And who develops apps for QNX? Nobody. Most developers are focused on either Google or Apple. So if either of these two enter the market, they'll bring a whole suite of apps from their pre-existing app stores along with the developer community to make even more car-specific apps. Imagine hollering at your Google Home to start your car from your living room while also throwing a reminder on your phone to get gas. QNX won't be able to compete.

That being said, QNX does have a huge first-mover's advantage and a significant moat. They already have their software in over half the market, along with deals with large companies like Ford, and a great reputation of being secure and dependable. And this isn't even mentioning their 40k+ patents, or their IoT RADAR technology that's taking the transportation industry by storm, or their rumored potential deal with Walmart…

There's also the possibility BBRY gets acquired by a larger company to take advantage of their market lead and QNX sfotware. A similar situation presented itself in Mobileye, another auto-focused software company, who was acquired for $15 billion by Intel to leverage Mobileye's 16 million installed units in the autonomous driving space. At over 60 million installs, BBRY is much more appealing acquisition target.

Veteran BlackBerry analyst Gus Papageorgiou recently gave a price target of $45 for the stock by 2020. This is the best-case scenario. We fall more in line with Citron Research who established a target of $20 over the next 24 months. If BBRY becomes valued like NVDA, we can expect its current forward EV/Revenue of 5.3 to catch up to NVDA's at 9.9. Assuming this is achieved purely through multiple expansion and investor momentum, a price target of $20-$21 seems reasonable.

We entered a position around $9.70 and would be interested in adding on another prime technical setup.

HDSN

Summer's here.

And that means it's time to crank up the A/C.

But to get that cold air you love so much, you're gonna need freon. That's the stuff your A/C unit uses to cool the air before blowing it out.

There's a problem though. The EPA banned the stuff.

Freon, or as it's known by its fancy name, R-22, has been subjected to a rapid phase down schedule by the EPA.

EPA Final Rule (10/16/14) Production Phase Down Schedule:						
2014	2015	2016	2017	2018	2019	2020
43.5M pounds	22M pounds	18M pounds	13M pounds	9M pounds	4M pounds	0 pounds

By 2020, no new R-22 can legally be produced. The gas was too harmful to our ozone layer.

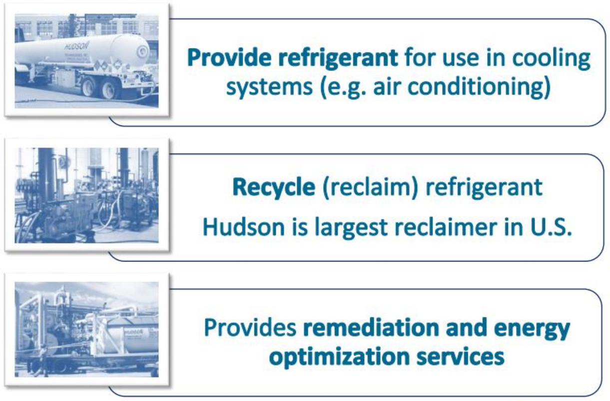
But then how do you stay cool? *(Apart from being in the super-cool Operator community I mean…)*

Fortunately, even though production of R-22 will be illegal after 2020, the reclamation and reuse of it will not be.

Refrigerant reclamation and reuse involves taking *used* refrigerant, like R-22, and processing it to remove its contaminants so it can be utilized as new refrigerant once again.

Because of this EPA law, reclamation companies set to profit heavily from the R-22 phase down.

And that's where Hudson Technologies (HDSN) comes in.

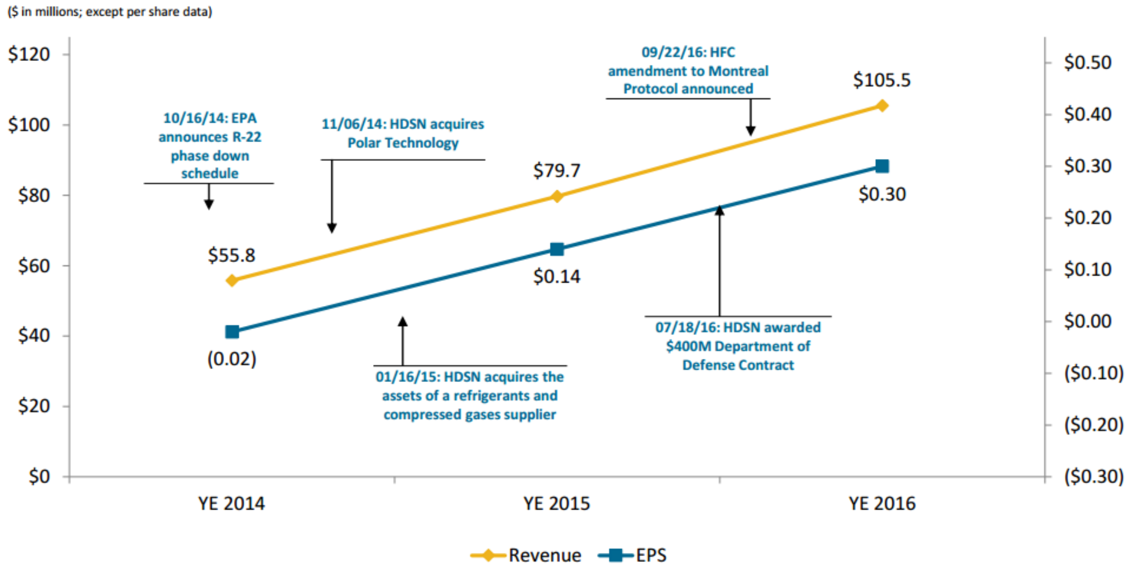


HDSN handles refrigerants across their entire life cycle, from their initial sale and recovery, to their reclamation and reuse, and even with their final disposal. But the most important segment of their business, and the one that makes the most cash, is the reclamation and reuse.

Hudson is the industry leader in refrigerant reclamation with **25%** of market share. This is a huge advantage for the company. As it currently stands, the aftermarket demand for R-22 (demand for the reclaimed version of it) should continue for 20 years after new R-22 production ceases in 2020. By that year, demand should reach 50M pounds, which Hudson will service most of.

What's even sweeter is the massive price squeeze occurring across R-22 products. Because the max amount of R-22 allowed in production keeps dropping each year, prices continue to shoot higher. In 2014, the price of R-22 was $7/lb. Today it's **$22/lb**. <u>That's a 214% increase in *just* 3 years.</u> The last refrigerant that was banned by the EPA, CFC, saw its prices rise as high as $30/lb by the time it was completely phased out. R-22's price should increase similarly, meaning it could jump another 36% from current levels.

This directly influences Hudson's bottom line by enabling them to charge a higher price for reclaimed R-22. And with their costs staying pretty much the same, their margins explode. They currently sport a nearly 19% 5-year revenue compounded annual growth rate along with a long-term gross margin above 30%.



Their margins and revenue will continue to grow as R-22 prices get squeezed. In their most recent quarter, revenues increased 38%. And gross margin increased to 32% compared to 27% last year.

While R-22 will eventually cease to be a lucrative profit source as coolant equipment adapts to more eco-friendly compounds, a whole new market will present itself in the coming phase out of other popular refrigerants such as HFC.

Refrigerant Aftermarket Landscape

CFCs	• Virgin production phased out in 1995
HCFCs (R-22)	• Virgin production phase out underway; vast majority of virgin HCFC production will cease in 2020
HFCs	• High global warming gases scheduled for phase out beginning 2019
HFOs	• Producers focusing on next generation offerings of HFOs • Potential for large market opportunity as HFC refrigerants are increasingly replaced by HFOs

HVAC Aftermarket is Growing at High Single Digit Rate
With Phase Out of Virgin Production, HDSN Becomes the Producer

Management believes the HFC phase out beginning in 2019 will be even more lucrative than the current R-22 opportunity. Hudson is perfectly positioned to take advantage of it with the reclamation capabilities they already developed with R-22.

Now the risk here is that Hudson's fortunes are somewhat tied to the EPA. If their rulings change, prices in R-22 could reverse, along with any future HFC phase out. Investors are rightfully worried about the EPA with Trump in office. There's no way to predict what he'll do with the organization, but he's frequently tweeted his views against climate change. And his latest move to pull out of the Paris Climate Agreement — the worldwide accord meant to slow global warming — proves that he's a risk.

But in reality, the EPA has already made their final decision regarding R-22 from 2015 through 2019. If they wanted to change the remaining two years of the phase out, they would have to go to Congress and amend existing legislation. The EPA doesn't have the authority to change the ruling themselves. The likelihood of this actually happening is very low.

Plus, Trump is all about business and jobs. Changing this law would wreck the capital plans of many businesses converting their equipment away from R-22. This phase out also has the effect of creating new jobs through forced capital expenditure, which Trump would not fight against.

HDSN should be a solid play over the next few years even with the volatility we may see as Trump putzes around climate change. HDSN currently has $40 million in cash on its balance sheet with $105 million worth of working capital. This makes the company extremely liquid considering its entire market cap is only around $330 million… And did I mention it has 0 debt? It's a solid company with a bright future ahead of it.

If we assume continued 35% quarterly revenue growth, along with gross margins holding near 32%, EPS should come in around $0.65 this year. Keeping a conservative PE multiple of 20, the stock should trade above $13 a share by year's end which would equate to a 50+% rise. This is a conservative estimate too. Both revenue and margins are likely to be higher than our assumptions as R-22 prices continue to rise.

We entered a position around $8.13 and will add the position when given favorable technical setups.

And finally we'll hand it over to Tyler. He's found an interesting short-term contrarian play in the EWZ option market.

Quant: Brazilian Fear

Part of becoming a great contrarian is learning how to notice extreme emotion. Investor emotion is the primary fuel that drives consensus views. And when consensus views get too extreme, we can fade them for a nice profit.

The two classic investing emotions are fear and greed.

But fading investors' fear is far more consistent and lucrative than fading their greed.

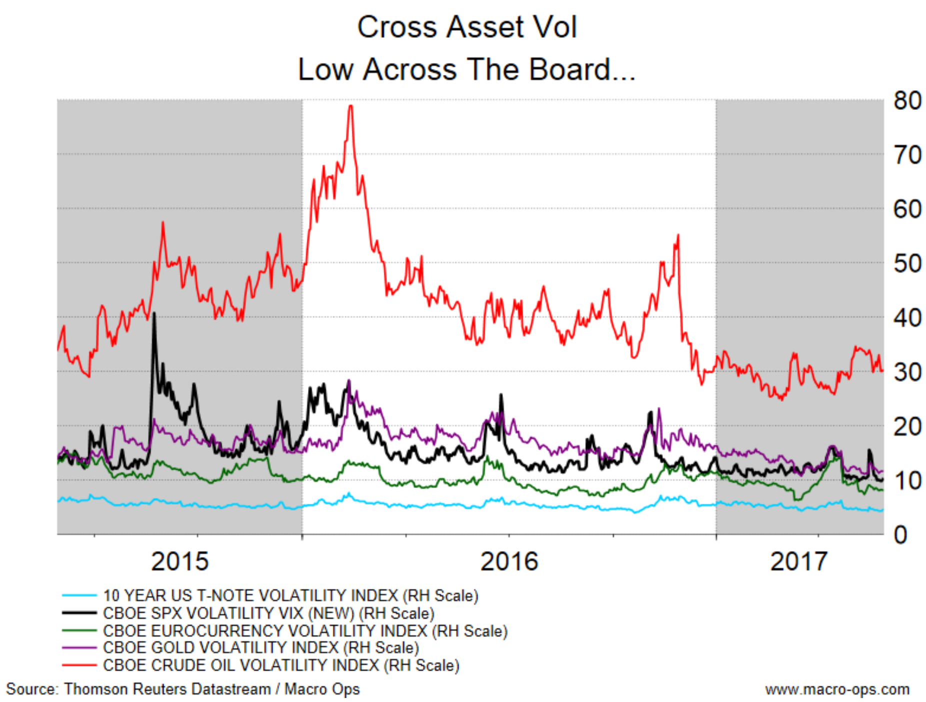
Greed bubbles tend to go on and on, frustrating every bear to death before finally crashing into the abyss.

Fear based moves on the other hand resolve much more quickly. Timing is easier and you don't have to wait around to get paid.

In financial markets, you find investor fear by watching volatility. A spike in vol means there's blood in the water — and tremendous opportunity.

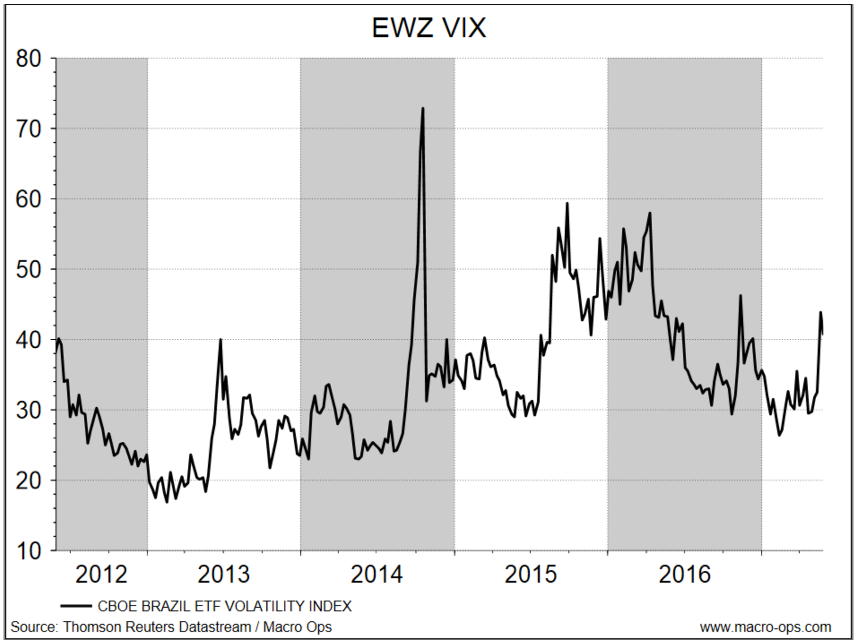
Unfortunately, for most of 2017 it's been slim pickings for market sharks.

Vol in every asset class from stocks to gold has been flirting with multi-year lows….



That finally changed a few weeks ago when our scanners picked up on some fear over in Latin America.

Option premiums on EWZ, the Brazilian ETF, spiked hard. You can see this in the EWZ VIX chart below which tracks the implied volatility of the option market. The higher the value the greater the fear.



It was accompanied by an overnight 18% kneecap in the ETF.

Investors sold big time on allegations Brazil's president Michel Temer authorized hush money payments to a jailed ally.

It's not surprising investors had an extreme emotional reaction. They still have a bad taste in their mouth from the last political scandal. Temer's predecessor, Dilma Rousseff, ran the country into the ground before finally being impeached on corruption charges in mid-2016.

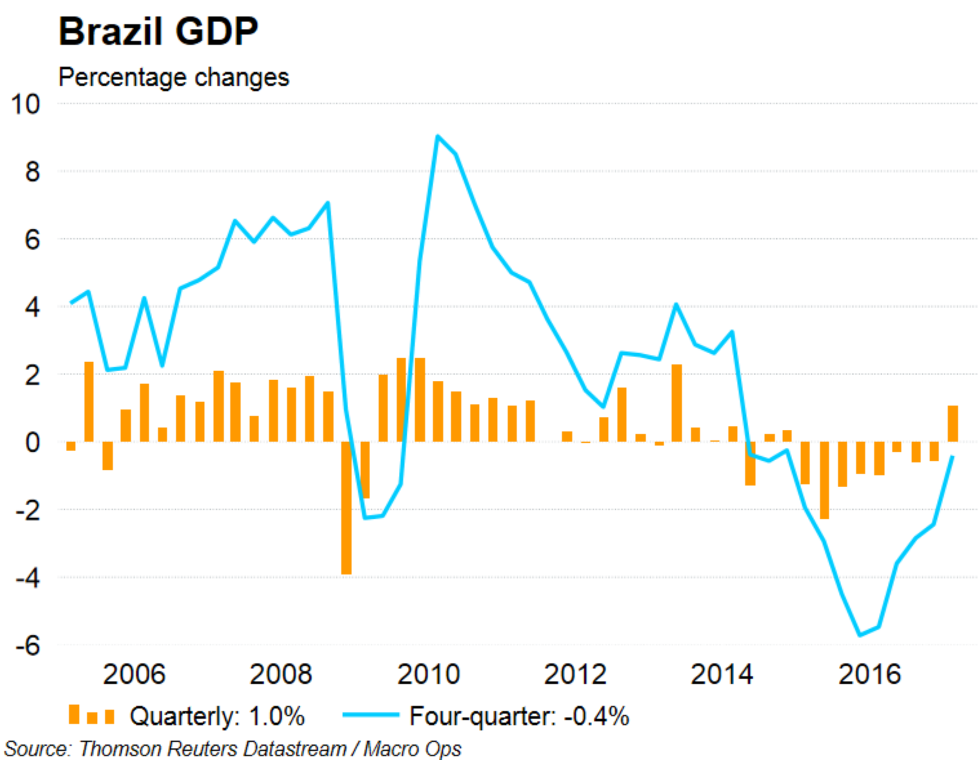
The market's logic makes sense on the surface. A corrupt administration under Rousseff led to major equity losses, so another corruption scandal probably means more equity losses. Investors sold as fast as humanly possible.

But when you evaluate the guts of the Brazilian economy, the surface level logic starts to break down. It becomes clear investors are acting out of fear rather than rationality.

Macro fundamental and liquidity conditions are remarkably different today than under Rousseff's leadership.

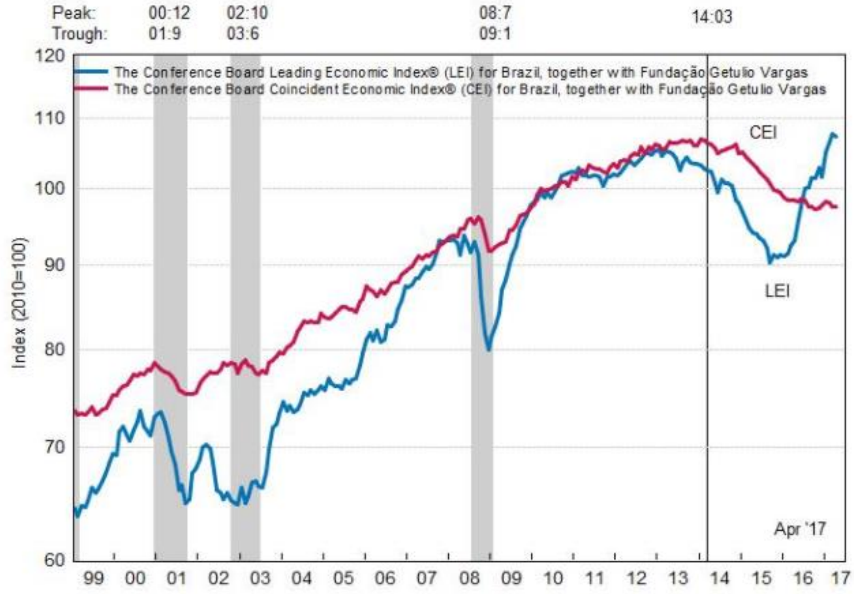
The most recent data out of Brazil was great.

QoQ GDP expanded for the first time in 2-years, officially ending a brutal recession.



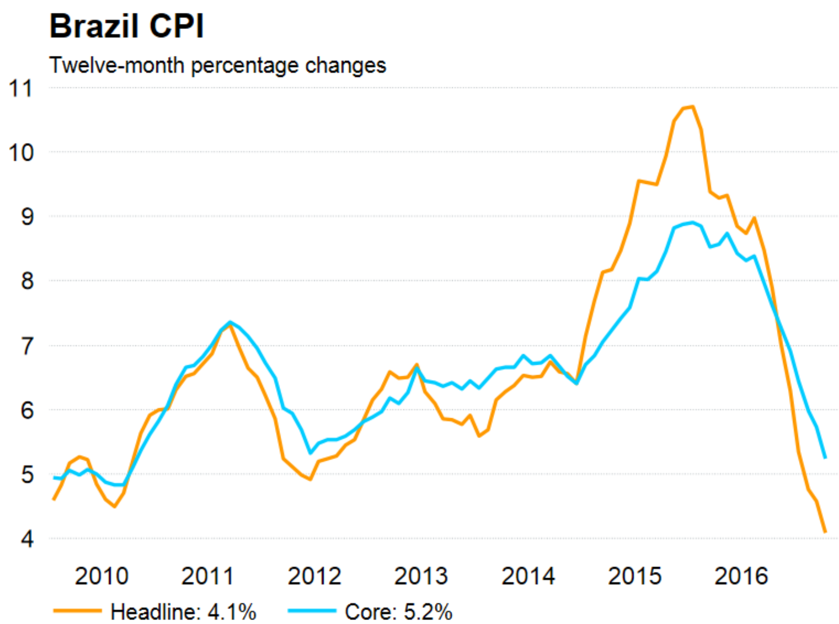
A number of leading economic indicators show that the strength is here to stay too.

Brazil's Leading Economic Index (LEI), put together by the Conference Board, continues to rip higher.



The shaded areas represent business cycle recessions. The peaks and troughs are determined by CODACE.
Source: The Conference Board

And inflation has fallen to a 10-year low.

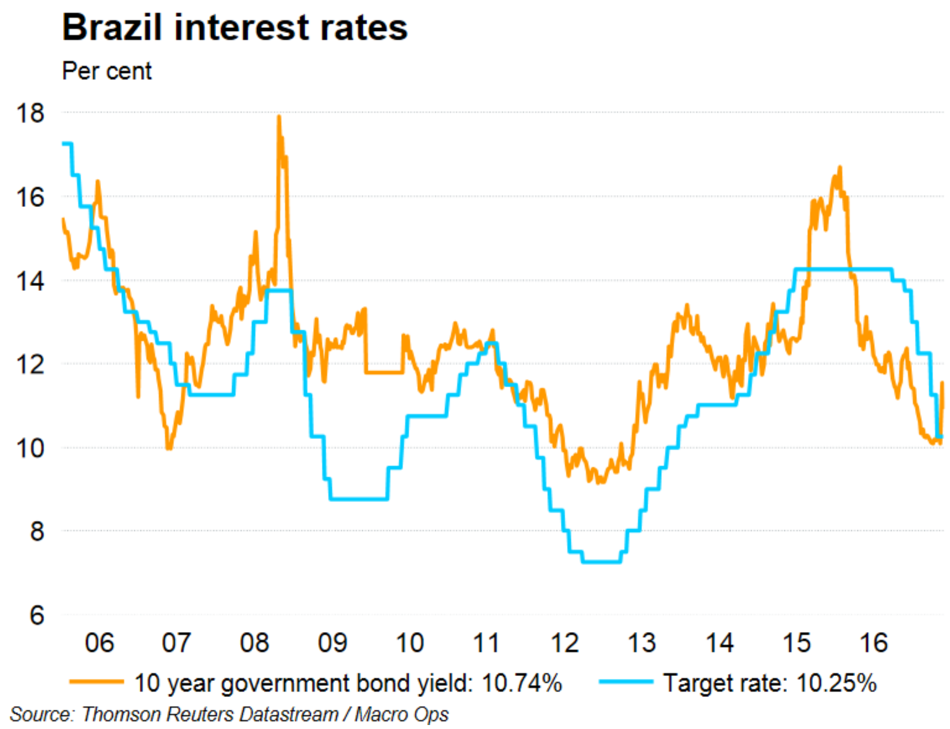


Source: Thomson Reuters Datastream / Macro Ops

Low inflation is a huge deal for emerging markets because it allows central banks to properly stimulate their economies.

Back in 2014-15, high inflation forced Brazil's central bankers to tighten into economic weakness. They had no choice. In order to save the integrity of the currency, they were forced to raise rates and put additional stress on the real economy.

Now that inflation has come down dramatically, Brazil's central bankers have the green light to ease and lower rates. You can see below that their easing cycle is well under way.



As long as inflation remains around their target of 4.5%, the Central Bank will continue to ease and create favorable liquidity conditions. The most recent meeting minutes (excerpt below) even mentioned frontloading this easing cycle.

The Committee members reaffirmed the understanding that, with anchored inflation expectations, with inflation forecasts at the target for 2018 and a little below target for 2017, and with the high level of economic slack, the Copom's baseline scenario ***prescribes frontloading the monetary easing cycle.***

That means they're looking to get even more aggressive on rate cuts as inflation stays reined in.

In reality, comparing Temer's economy to Rousseff's makes no sense at all.

Here's the picture under Rousseff.

- GDP contracting and at an increasing rate
- Downtrending LEI
- Inflation skyrocketing
- Tightening liquidity conditions

Whereas today we have the opposite macro landscape under Temer.

- GDP printing its first positive QoQ increase in 2 years
- Uptrending LEI (hitting new highs)
- Steady inflation
- A Central Bank in full-out ease mode

When EWZ sells off 18% in one day, spiking implied volatility like it's the start of another crisis, you have to ask yourself… is this move made out of fear or rationality?

To us it's clear that investors are acting out of fear.

They're trading the Temer corruption news as if it exists in a Rousseff macro environment.

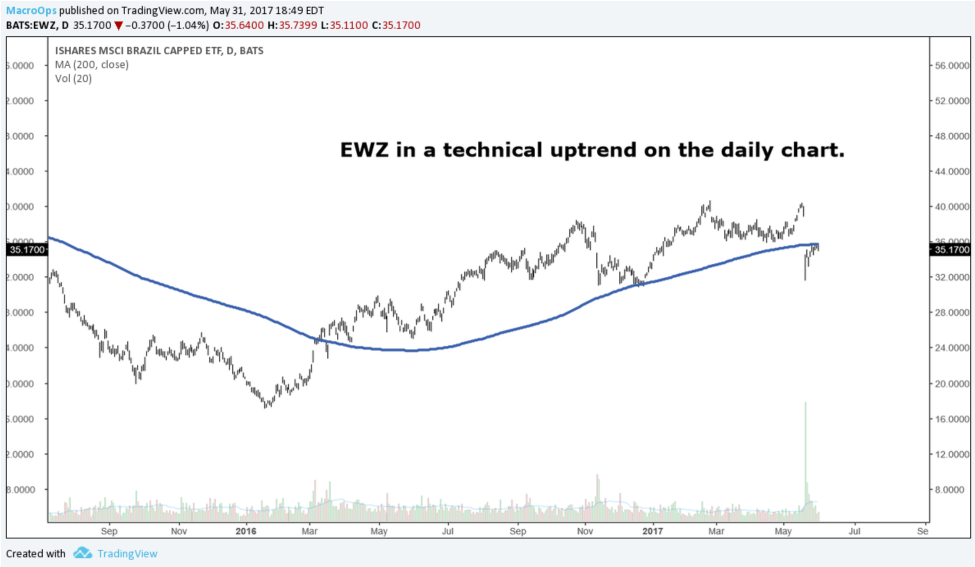
This error creates opportunity for us.

The recent sell off isn't the start of a new downtrend. It's a one-time write-down that'll recover on the back of a strengthening macro environment.

On top of the bullish macro case, the technicals look strong too.

The 200-day moving average has been trending upward for the last year or so.

And whenever price falls into an uptrending MA, it's usually a good opportunity to buy the dip and play for upside.



EWZ is also heavily influenced by the USD/BRL exchange rate because the fund isn't currency hedged.

That means when the U.S. dollar strengthens relative to the Real, EWZ falls. And when the Real rallies relative to the dollar, EWZ rallies.

Recently the trade weighted dollar index broke down from a descending triangle.

This is good news for the Real and strengthens the bullish case for EWZ.

To take maximum advantage of the overblown fear, we're looking at selling puts. Puts will benefit from both higher prices and a contraction in implied volatility.

We already dipped our toes into EWZ a few weeks ago right after the initial drop. In the Macro Ops Hub we sold a bunch of weekly straddles which will expire at the end of this week for a nice profit.

Since this initial test went well, it makes sense to double down on the "fade the fear" trade in Brazil.

Right now we're stalking the EWZ July 21st puts struck at $33.00. As of this writing, they're trading for around $1.15. A small dip in EWZ will create an optimal entry, but we're okay opening positions at these levels too.

If this trade's a winner, and investor fear persists, we'll revisit this theme again in July and sell another tranche.

To Contrarianism!

Trade Idea: Sell EWZ July 21st $33.00 Puts For $1.15 in credit.

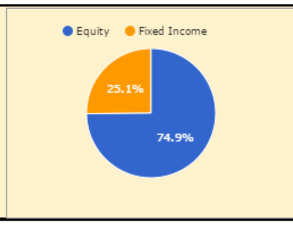
Portfolio Snapshot

Strategic Ops

NAV	$1,175,410							
Asset Class	**Position**	**Size**	**Cost Basis**	**Risk Point**	**Open Risk**	**Target**	**Notional**	**Beta**
Equity	Goldfield GV	1,000	$3.89	$2.52	$1,370.00	$4.50	$5,250	1.0694
Equity	GAIA	7,600	$9.88	$8.50	$10,488.00	$13.75	$79,040	0.4497
Equity	Videocon VDTH	2,900	$11.27	$9.26	$5,829.00	$17.45	$32,335	0.7855
Equity	Portugal ETF PGAL	8,000	$10.57	$9.98	$4,720.00	$11.75	$85,040	1.0467
Equity	BlackBerry BBRY	2,600	$9.70	$7.50	$5,720.00	$18.00	$25,038	1.084
Equity	Colombia GXG	10,350	$10.17	$9.62	$5,692.50	$12.75	$105,104	0.6661
Equity	Hudson Tech HDSN	5,300	$8.08	$6.98	$5,830.00	$11.50	$43,142	0.8107
Equity	Trivago TRVG	1,750	$21.16	$17.70	$6,055.00	$30.00	$35,245	-4.961
Equity	SSYS	1,546	$24.45	$21.44	$4,653.46	$31.50	$40,528	1.4414
Fixed Income	30 Yr Bond Futures	9	$153.44	$151.56	$16,920.00	$161.62	$1,381,716	-0.582

Metrics

Exposure Breakdown	
Equity	$50,357.96
Commodity	$0.00
Fixed Income	$16,920.00
Forex	$0.00



Total Open Risk
$67,277.96
5.72%

**Updated 6/2

Volatility Ops

NAV	$1,351,134			
Asset Class	**Position**	**Size**	**Cost Basis**	**Notional**
Volatility	Aug 16th VIX Future	-38	$14.71	-$530,100
Forex	FXE Jan 2018 104 Straddle	80	$7.20	~

Scenario Analysis/Stress Tests

Max Loss	-$350,000

**Updated 6/2

Asset Allocation Weightings

Update

The path of least resistance for global equities is still clearly higher. We expect that both US and foreign equities will continue on their dominant trend higher over the coming months. But with that said, we are entering a period of weak seasonality through the summer months and US markets especially are due for a short-term pullback. The FOMC meeting in two weeks could be the catalyst for this selloff. The chart below via Urban Carmel shows the follow on performance of both the SPX and 10yr yield following the last three rate hikes by the Fed. Stocks sold off and bonds rallied.

We have a large position in long bond futures and think this is a great addition to the Strat Ops portfolio. Bonds are rallying along with stocks on signs of weaker econ data now that we're rolling off the backend of the base effects. And they're also a very effective hedge for our equity exposure. So at the moment being long bonds is a win-win trade.

Another important macro development that we expect to play out over the following month is the continuing selloff in the US dollar. The dollar recently broke out of the lower bound of a key technical range. And the dollar remains a very crowded long trade. We expect its move lower to pick up steam over the coming weeks as these long positions are forced to unwind.

This move will positively impact emerging market equities along with many commodity stocks. Many precious metal miners in particular look appealing at these levels. We plan on buying some gold miners next week for a swing trade with a 1-2 month timeframe.

Asset Allocation Weightings	Underweight	Neutral	Overweight
EQUITIES			
Large Cap Growth		x	
Large Cap Value			x
Small Cap			x
Mid-Cap		x	
International Equity			x
Emerging Market Equity			x
Cyclical			
Materials		x	
Gold			x
Commodities			x
Consumer Discretionary			x
Financial Services	x		
Real Estate, Domestic		x	
Real Estate, Global		x	
Sensitive			
Energy		x	
Industrials			x
Technology			x
Telecom		x	
Defensive			x
Consumer Staples		x	
Healthcare			x
Biotech			x
Utilities			x
FIXED INCOME			
Preferreds		x	
Government Bonds		x	
Corporates		x	
Munis		x	
Long Duration			x
Intermediate Duration		x	
Short Duration	x		
High Yield	x		
TIPS		x	
Emerging Credit	x		