A Trader's Dilemma

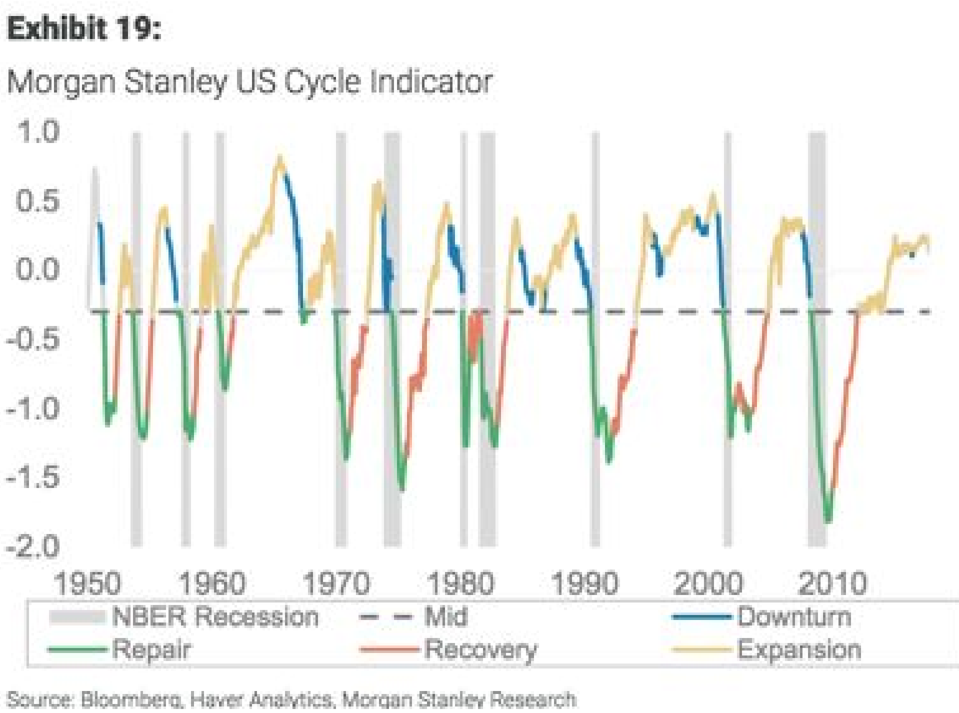
Here's the current dilemma I'm wrestling with. It's one we traders often struggle with.

I'm bullish on a big picture cyclic basis. There are thematic long trades I like and that I want to add to my book (i.e., Ags, asset management stocks, shippers). But… In the short-term, the market is so damn stretched, sentiment indicators so high, and cash levels so low. I'm hesitant to add additional risk to a full book because I keep expecting a pullback that has yet to materialize.

Let's quickly look at some of the evidence.

Here's Morgan Stanley's US cycle indicator which shows the current cycle is in "expansion" mode which is similar to our "overheat" phase of the investment clock.

This means it's late cycle but the party isn't close to ending yet. Our big picture indicators are saying the same and I don't see any data that says this bull can't continue on for another six months, at least.



A common characteristic of late cycle bull runs is that they often have low volatility. Small dips are quickly bought. And those who think themselves prudent, by waiting for a larger pullback, tend to end up watching jealously from the sidelines as the market melts up and up.

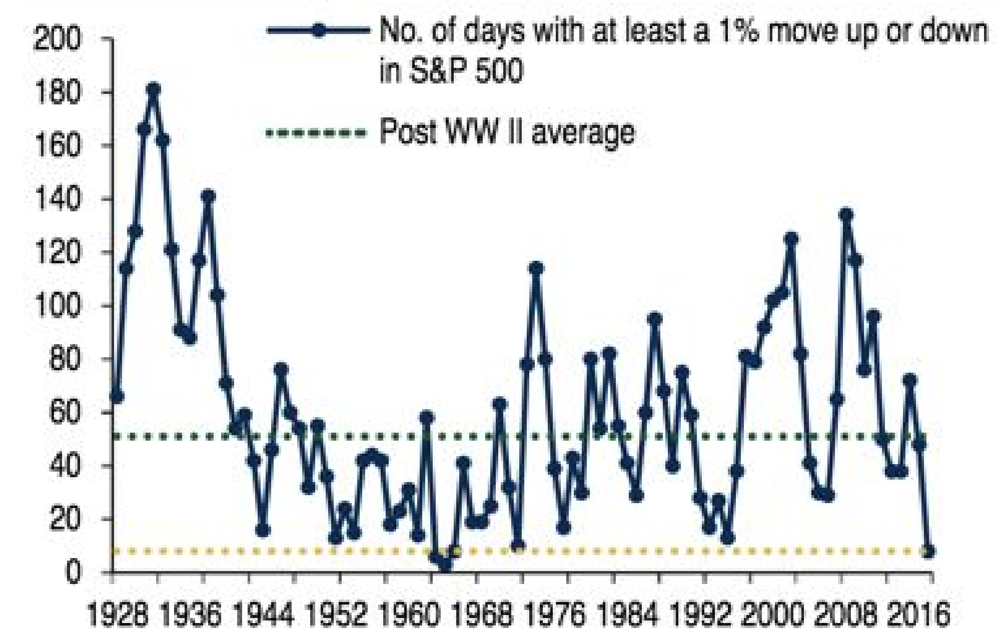
In old bull cycles, the market rewards those who throw caution to the wind and punishes those who play conservatively… at least for awhile.

The problem is, is that that “while” can be a really long time. Often a year or more.

This late cycle run is shaping up to be no easier. Check out the following three charts.

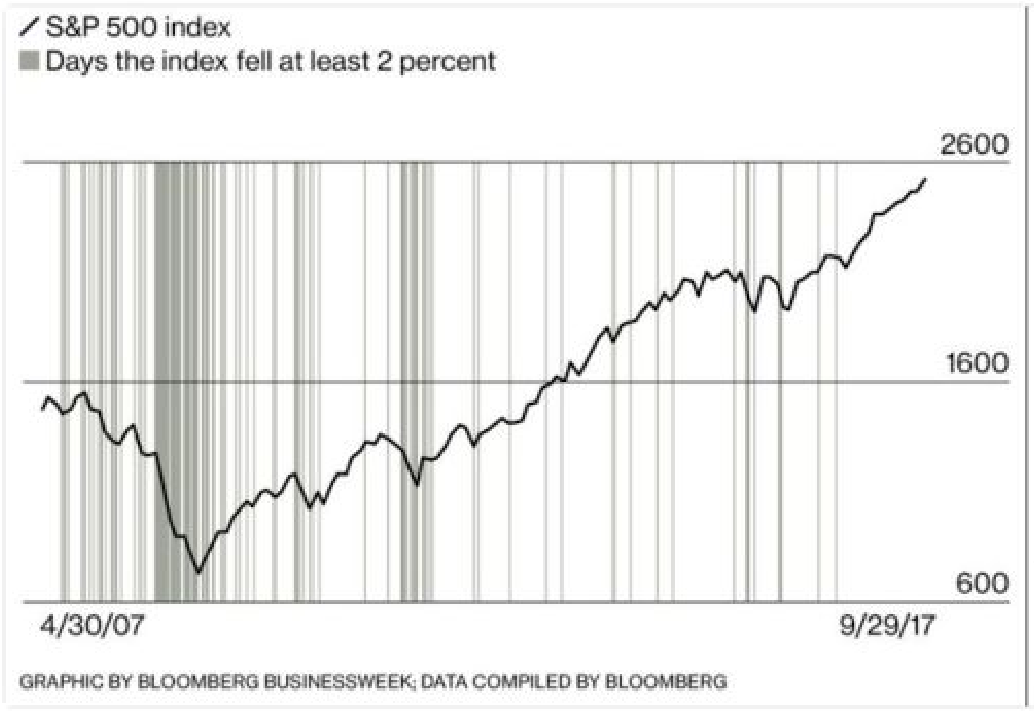
We’re near 100 year lows in the number of days that the market has had at least a 1% up or down move. The last and only other time we saw such a sleepy market was in 1963

Chart 3: Number of days with large equity moves

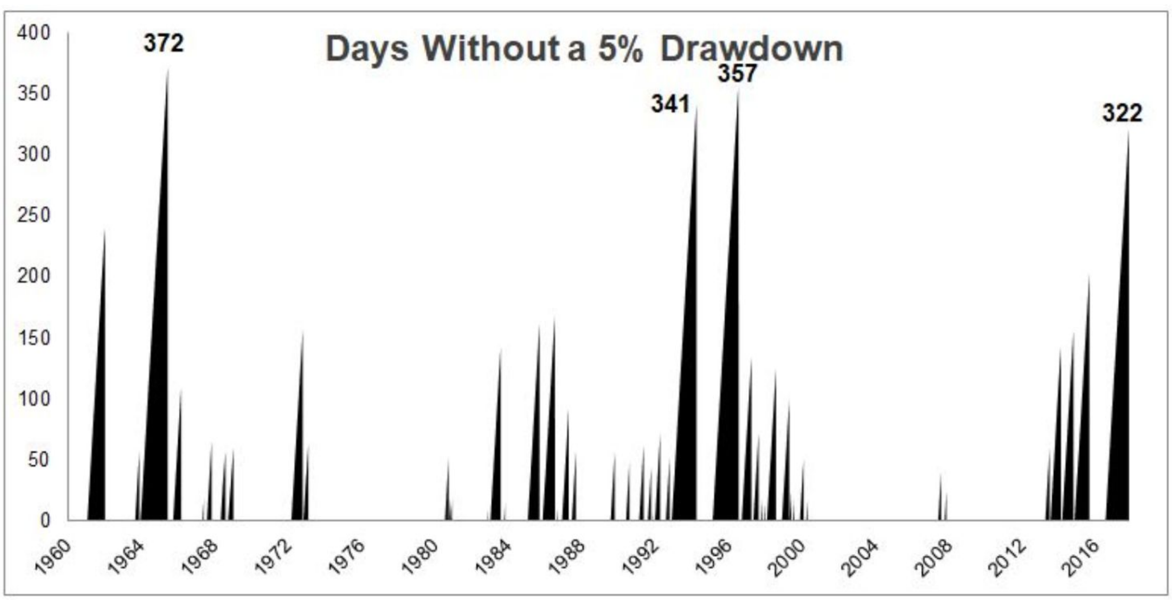


Source: BofA Merrill Lynch Global Research, Bloomberg

This is a great chart. The shaded vertical lines mark days the S&P fell at least 2%. This year it’s been nothing but white.

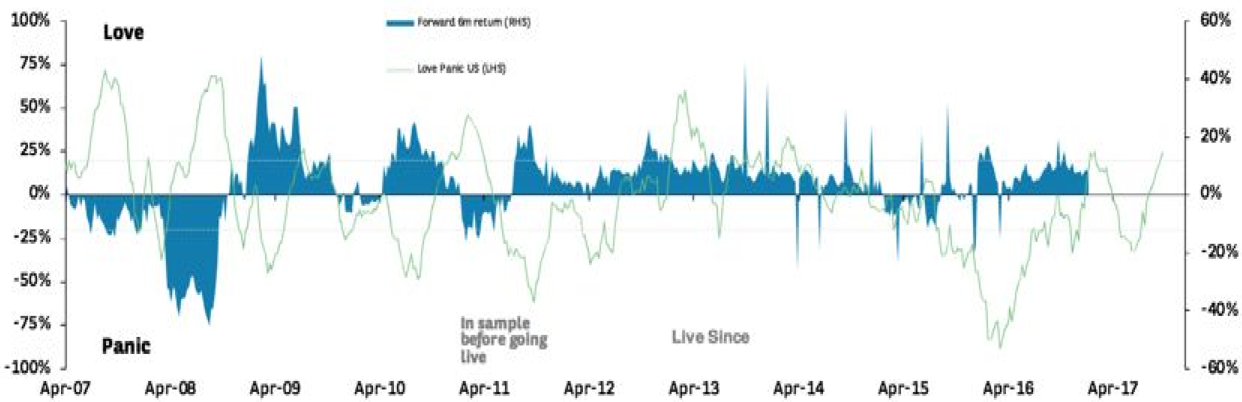


And this chart from Michael Batnick shows that the market is now less than 50 days away from breaking a record streak of days without a 5+% drawdown.



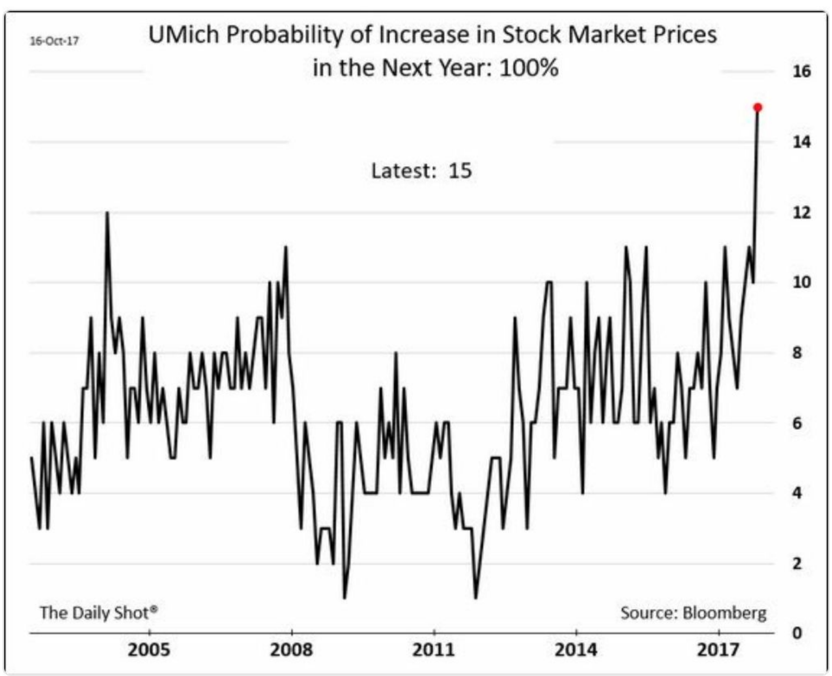
And then there's sentiment and complacency. Both are extremely high at the moment.

The below sentiment (Love/Panic) model from BNP Paribas, which is a composite of 20+ sentiment/positioning indicators, shows that investor sentiment is hitting its highest point in over 3 years (green line).

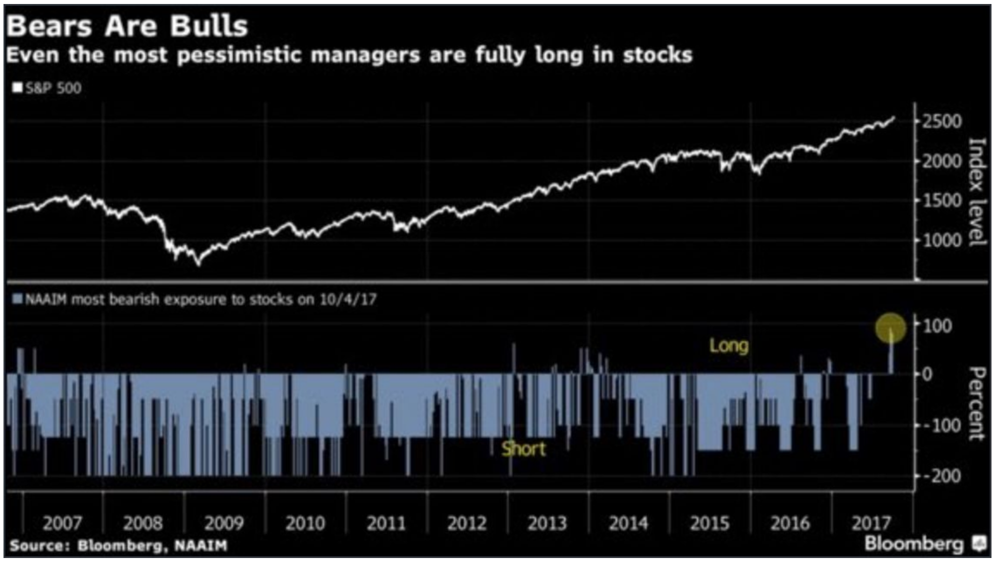


According to BofA's fund manager survey, fund managers around the world hold the lowest levels of cash, as a percentage of AUM, in over two years.

And for the UMich survey, respondents when asked to rate the likelihood of the stock market being higher in a years time, they gave it the highest probability in the survey's history.



Even the bears, as noted by the NAAIM survey, have the most long exposure to equities that they've had in over 10 years!



This is why I haven't added any of the trades like Ags or active asset management stocks that I've written about over the last few weeks.

I'd love to put these on after a market selloff. But I wonder if everybody else is thinking the same thing and because of that the market will just keep doing what it's been doing; and that's punishing those who are waiting for a large dip to buy into.

I don't know the answer here. I suspect the best route is to walk the middle road between being overly cautious and overly aggressive which is what we've been doing.

Since our long book is full we'll benefit from further upside, if the market keeps doing its thing. But we'll leave some chips on the table by not jumping on these other opportunities.

And if we do see a selloff, then we'll get a great buying opportunity to load up on these trades we've been digging into.

The market is down a little this morning. Not by much, but after months of nothing it seems like a lot. There's a little weakness in our generals (i.e., AMZN, TSLA, FB etc.). Credit looks like it could be turning over and breadth is weakening slightly.

No red alarms yet, not even close. And the last 20 or so times, this weakness has quickly been bought and reversed. Something to keep an eye on though.

In the meantime, let's continue to dig into trades so if/when a mythical selloff ever happens we'll have our pick of great trades to add.

I recently shared the following charts on twitter.

The top one (SEA) is the Guggenheim Shipping ETF and the bottom one is the Baltic Dry Index (BADI) over the last 17 years.

We've been following shippers for a long time now. Shippers have been dead money since the GFC in 09' following a secular bull run along with commodities where a lot of excess supply was added. And in typical capital cycle fashion: High prices attracted investment, investment led to oversupply, and oversupply led to lower prices.

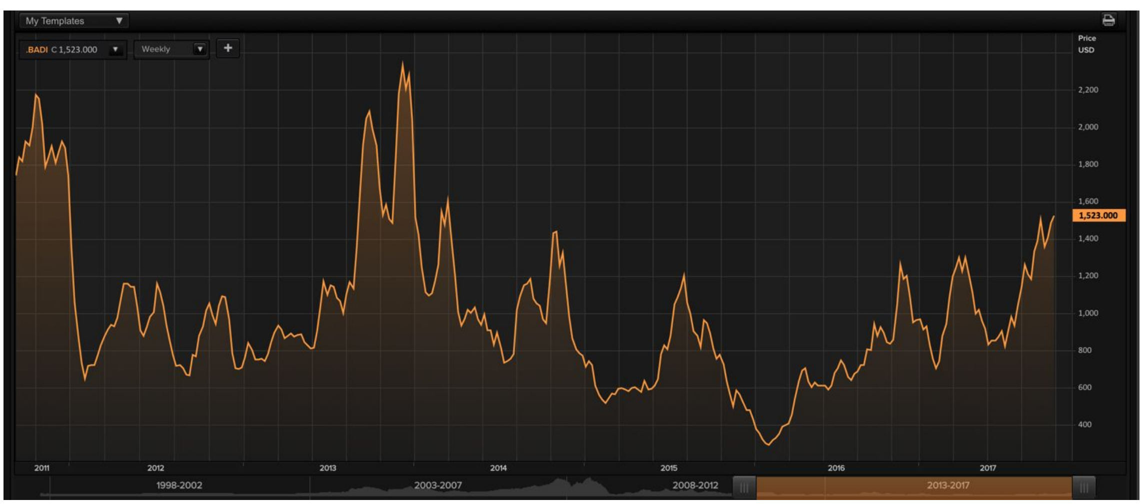
And that's where the shipping industry has been sitting the last 8 years with a whole lotta nothing happening.

Low interest rates and easy financing extended the bear market in the industry as it allowed unprofitable shippers to stay alive and delay bankruptcy through rolling their loans with new credit injections.

We took a stab at some shippers last November. We bought a basket, and some like Dorian (LPG), performed well, shooting up roughly 80% over the following months. But all in all the trade was a scrap and we were too early.

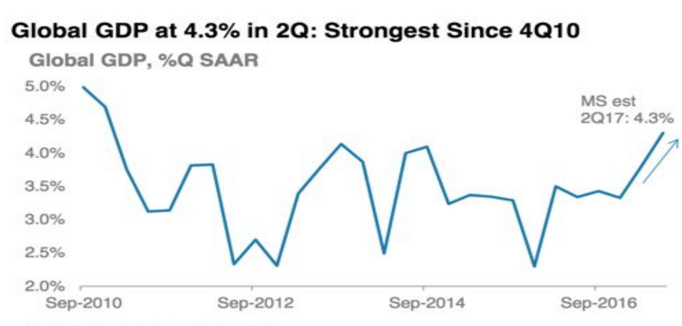
But I've kept shippers on my watchlist knowing it's just a matter of time before they have their day in the sun again.

Now a confluence of factors suggest that day could be coming soon. Take a look at the baltic dry index on a closer timeframe. It's trending upwards and hitting new four year highs. And just as interestingly, hardly anyone seems to be noticing.



The macro picture looks very positive for the shipping industry, which is why BADI has been doing so well.

Shippers benefit when the global economy is doing well. Higher growth means more people are buying



things and more trade is being done, hence more goods need to be shipped.

The chart to the right shows that global GDP is hockey sticking upwards and is now at its highest point in 7 years.

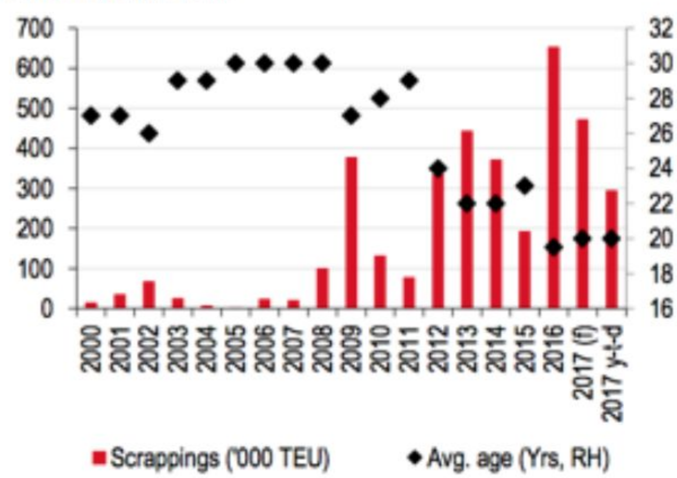
This fits in with our Investment Clock and Wealth S-curve thematic. Both are macro drivers that should benefit stocks, like shippers, that transport global goods.

Also, shippers are about to receive some formidable tailwinds in the form of environmental regulations that are being put into place. These are:

- Big changes to international fuel regulations aimed at curbing emissions. They will require the sulphur content in marine fuel to be cut from 3.5% to less than 0.5%. This is expected to increase overall fuel costs by roughly 50% over the coming years. In response, shippers will need to reduce their speed of travel by over 20% to still turn a profit. And this reduction in speed is effective to cutting the global fleet by about the same amount, 20% or so. This means tighter capacity.
- Both China and India are moving aggressively to curb pollution. One way they're going about this is to require their metal industries to use cleaner fuels for their forges. This cleaner fuel will need to be imported from the likes of Australia and the US. This will result in a boost for global transport.

The data coming in supports this improving backdrop. The charts below show that ship scrapings remain high which is supportive of a tightening capacity.

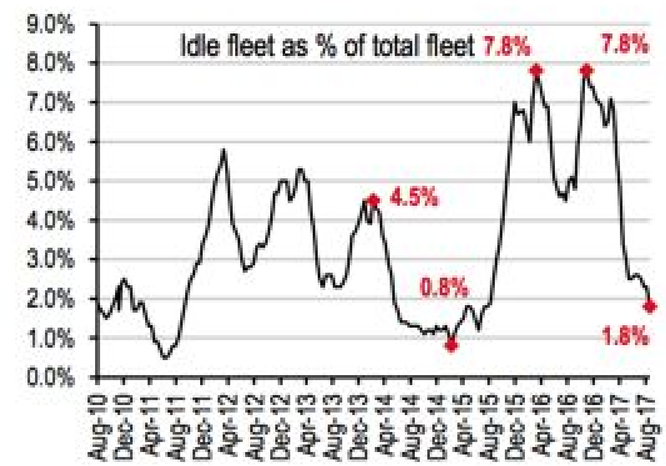
15. Clarksons expects scrapping to remain elevated in 2017



Note: 2017 forecast is as per Clarksons Research Services. 2017 y-t-d data is as of July 2017
Source: Clarksons Research Services

Idle capacity is nearing two year lows which means that available ships are being put to work and supply no longer outstrips demand by a wide margin.

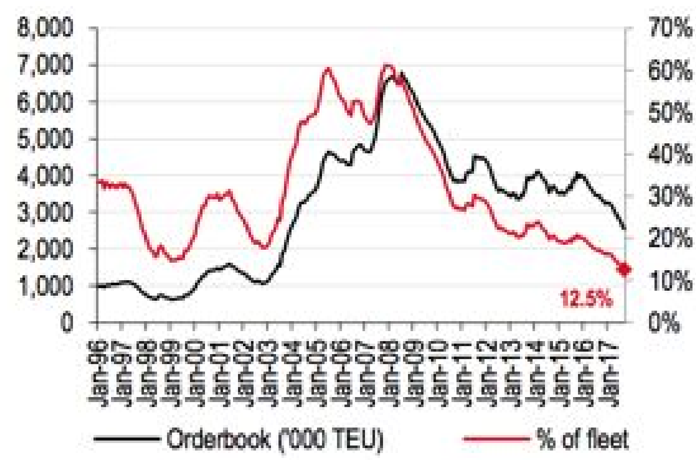
13. Idle capacity dropped to two-year low



Source: Alphaliner

And most importantly, the order book (new ships being built) as a percentage of the existing fleet is at an all-time low. This is very important. It takes a few years to build a ship and get it onto the water. So a low orderbook relative to fleet size means that supply should stay tight or even tighten going forward.

17. Order book as a percentage of fleet is at an all-time low



Source: Clarksons Research Services

Here's a list of some of the shippers I'm currently looking at (link here). Since this is a macro/cyclical play we'll look to buy a basket of our favorite 2-3 stocks to express the theme.

The technicals of many of these names look like they're setting up nicely.

But we'll be patient and see where the market goes. If it looks like it's going to run away from us then maybe we just start with a small position.

Strat Portfolio Review

IBKR, one of our larger holdings, came out with great earnings on Tuesday and the stock popped on the news.

The trade is up nearly 20% since we entered two months ago. CEO Thomas Peterffy continues to do a killer job by taking advantage of the new brokerage environment and is quickly building out a sizable competitive advantage. We'll continue to sit on this trade for a while.

Quick note: We almost bought deep out of the money long-term calls (LEAPs) on IBKR instead of buying the underlying.

There's an interesting thing we've noticed in more liquid issues, that their deep OTM calls often don't efficiently price in drift/trend.

This creates some highly asymmetric trade structures. The calls that we didn't buy have 20x'd since. So this anomaly is something we're very interested in and we'll likely be making this a key part of our strategy, when available, going forward.

Only other thing to note on the Strat portfolio is that CRR, one of the holdings in our energy basket looks like it'll close below our risk point today so we'll be cutting it if that's the case. The rest of our energy basket is doing pretty well. But we'll continue to cut the laggard positions and add to those that are moving strong. I think it's still very early days in the energy recovery theme.

Also, earnings season is starting up again and we'll be tracking developments with our holdings closely and sharing relevant info with the group.

That's all for this week.

Shoot me an email and hit me up in the CC if you've got any questions!

Your Macro Operator,
Alex

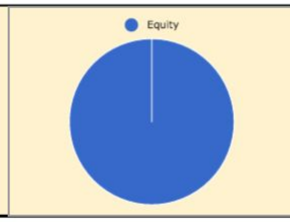
Strategic Ops

NAV $1,272,790

Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target	Notional	Beta
Equity	Limbach LMB	7,750	$13.66	$12.50	$8,990.00	$18.00	$104,703	-0.1902
Equity	Interactive Brokers IBKR	1,800	$41.71	$38.50	$5,778.00	$55.50	$74,628	0.9292
Equity	GAIA	7,600	$9.88	$8.50	$10,488.00	$13.75	$79,040	0.4497
Equity	Portugal ETF PGAL	8,000	$10.57	$9.98	$4,720.00	$11.75	$85,040	1.0467
Equity	China A-Shares ASHR	6,764	$26.69	$25.83	$5,817.04	$31.30	$199,876	1.475
Equity	Intrepid Potash IPI	28,769	$3.70	$3.64	$1,726.14	$6.00	$117,403	1.053
Equity	Trip Advisors TRIP	873	$42.83	$38.52	$3,762.63	$64.00	$37,164	2.368
Equity	Daseke DSKE	6,400	$13.49	$13.10	$2,496.00	$19.00	$89,920	0.7348
Equity	W&T Offshore WTI	16,000	$2.18	$2.00	$2,880.00	$4.50	$40,800	2.415
Equity	Ensco ESV	3,700	$5.15	$4.30	$3,145.00	$6.50	$18,574	1.667
Equity	Transocean RIG	2,900	$9.32	$8.26	$3,074.00	$15.00	$26,796	1.683
Equity	Carbo Ceramics CRR	2,600	$7.91	$6.65	$3,276.00	$12.00	$19,578	1.654
Equity	Cabot COG	1,350	$26.28	$24.00	$3,078.00	$34.00	$36,288	0.4829
Equity	Tuesday Morning TUES	7,500	$2.60	$2.00	$4,500.00	$5.00	$18,000	2.041
Option	Tesla Mar '18 240 Put	28	$8.80	$0.00	$24,640.00	$24.00	~	1.048

Metrics

Exposure Breakdown	
Equity	$63,730.81
Commodity	$0.00
Fixed Income	$0.00
Forex	$0.00



Total Open Risk

$88,370.81

6.94%

**Updated 10/17