Sugar, Texas Tea, and Gold

Trading Wisdom:

> *You can't build in a feedback or reactive model, because you don't know what to model. And if you do know — by the time you know — the odds are the market has changed. That is the whole point of what makes a trader successful — he can see things in ways most others do not, anticipate in ways others cannot, and then change his behavior when he starts to see others catching on.* ~ Richard Bookstaber

One of the most misunderstood market mechanisms is the common knowledge / embedded expectations function. This is simply, that which is "known" or believed by the crowd, is already reflected in the price. This is why as traders, we're not just trying to figure out what is true, but really what level of that truth is believed by the market and reflected in prices. This is a difficult task and why we have to remain humble, embrace our fallibility, and stay nimble in our thinking — the whole "strong opinions weakly held" adage.

Data and Events in the week ahead:

We have some important data releases this week with a few PMI releases, inflation data, and unemployment numbers. Monday is a holiday and the stock market will be closed but the futures and forex markets will be open on both Sunday (today) and Monday. There's a tendency for large price moves to kick off the beginning and end of long-term trends in the first trading week of the year as the big players reposition their books. So we'll have to remain alert for these moves and try and catch them early.

MONDAY:

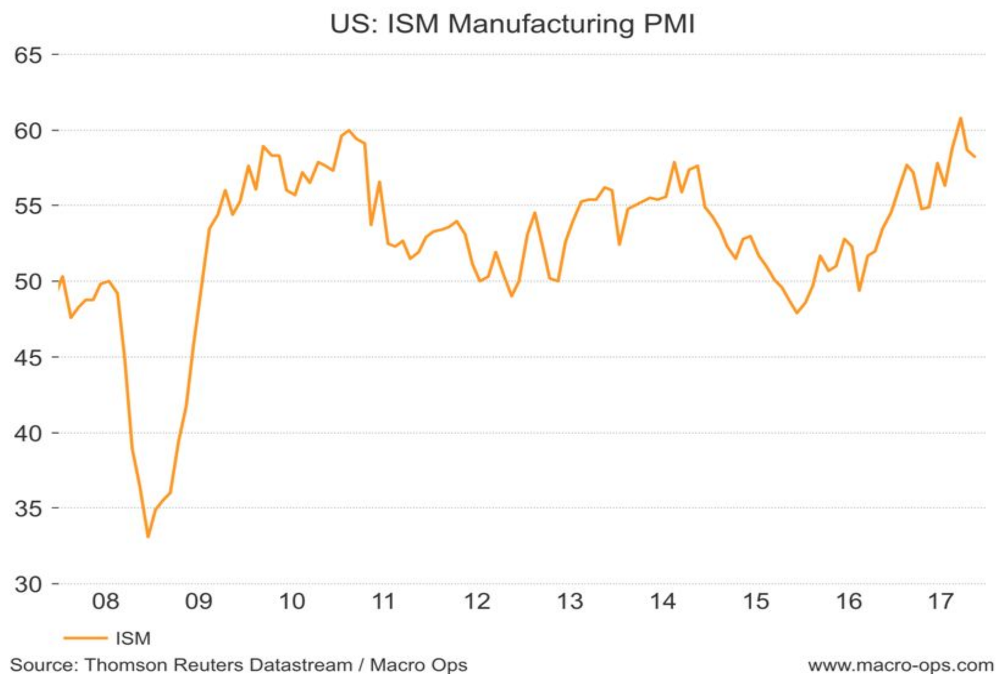
Monday is New Year's Day, and all markets (even Japan) are closed.

TUESDAY:

China's Caixin Manufacturing Purchasing Managers Index (PMI) prints. This index measures the performance of China's manufacturing sector through a survey of 430 private industrial companies.

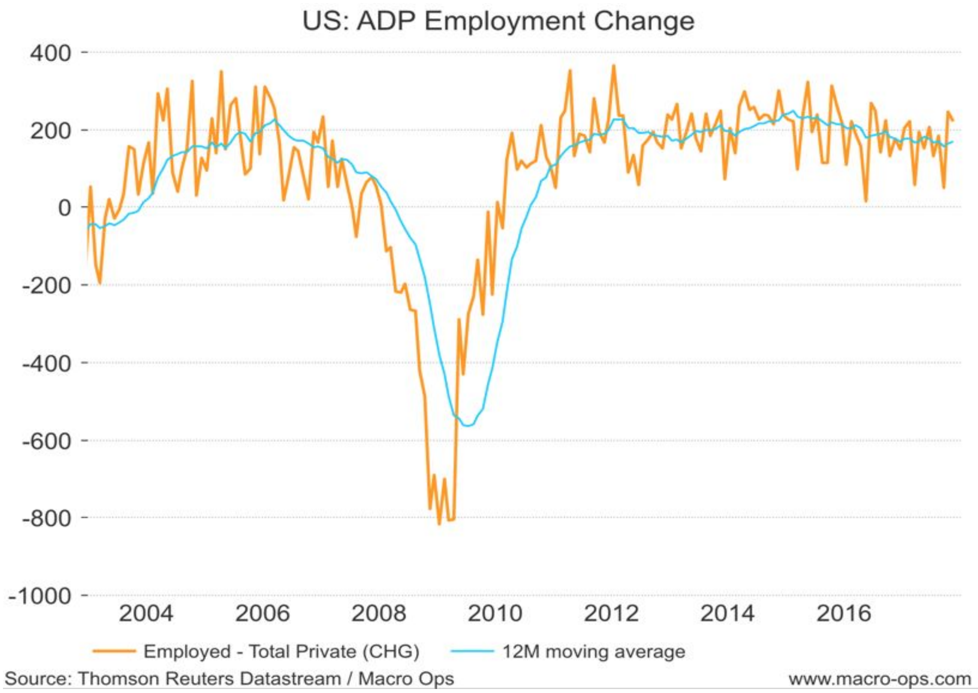
The index has been in a strong uptrend since the start of 16' when the Chinese government began a massive stimulus program. The strength of the Chinese economy will be a major factor for markets in 18', so it will pay to keep a close finger on the red dragons pulse going forward.

WEDNESDAY:
ISM numbers come out for the US. Similar to China, the US PMI number have been in a strong uptrend since the start of 16'. The ISM has a strong correlation to not only the returns in the S&P but also inflation so it's always an important number to track. Also, the minutes from last months FOMC meeting will be released.



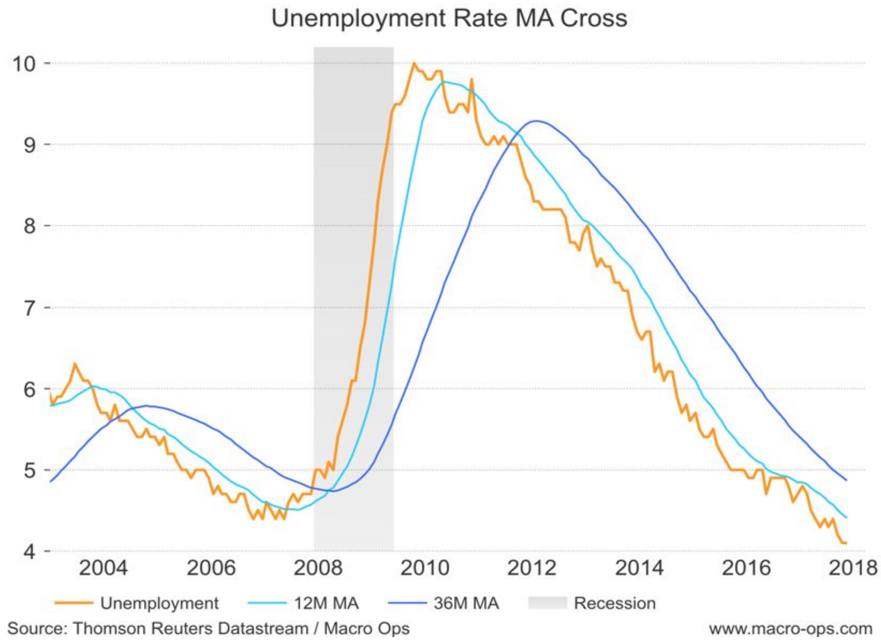
THURSDAY:
ADP change in total employment numbers for the US print on Thursday. The consensus is for a slight dip to 190K. A large miss could trigger a selloff in US markets.

The ADP is a good data series to track for the health of the labor market. What's important to watch is the larger trend (marked by the 12-month moving average in blue). This line will turn over and trend downward prior to a recession. It is currently trending sideways which is a good sign for the broader market.



FRIDAY:
This is the biggest day of the week for data releases. Eurozone inflation comes out. The ECB made some noise last time about inflation picking up, signalling a slightly more hawkish tone. If inflation comes in weak we could see a selloff in the euro.

We have unemployment numbers come out for the US. Consensus is for the number to hold steady at 4.1%. The unemployment moving average crossover indicator (chart below) is one of our favorite big picture indicators. The unemployment rate has crossed over both the 12 and 36 month moving averages prior to every recession. The rate remains well below those averages which suggest this business cycle still has plenty of room to run.



Balance of trade numbers for the US come out and we also have three Fed speakers (Bullard, Harker, and Mester) giving speeches.

Earnings Releases:

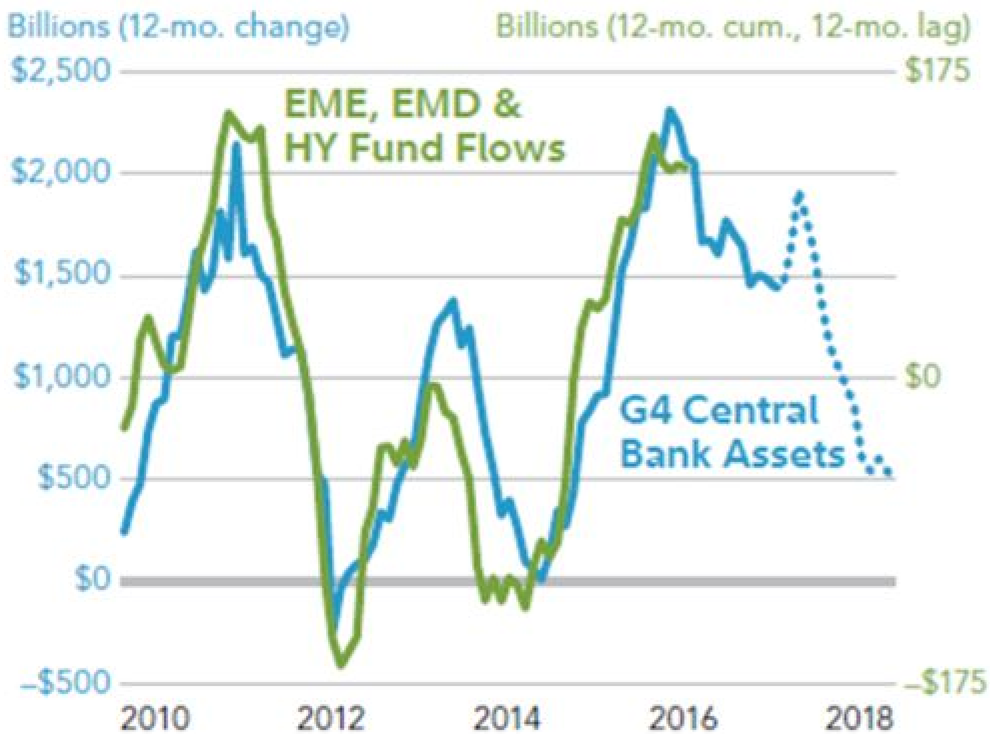
It's a slow earnings week. Earnings season will pick up again after this week with the start of the new quarter. Companies will have tougher comparables this year, meaning that the earnings in 18' have a higher hurdle to clear than they did last year. This is especially true for the stocks trading on lofty multiples and high growth expectations.

Tesla (TSLA) will report their fourth quarter vehicle deliveries this coming week. TSLA delivered just 220 Model 3 sedans in the 3rd quarter, well below its forecasted 1,500. The company has been in production hell in trying to get its new “mass market” sedan out.

The company said that it hopes to reach a production rate of 5,000 vehicles a week by the end of Q1 2018. We don’t believe these goals will be reached and are short the stock.

Interesting Charts:

Emerging markets went on a tear last year, even outperforming the stellar run in US shares. This was a function of excess global liquidity via the major central banks and a retracement in the US dollar bull market. EMs perform well when liquidity is flush and perceived risk is low. And these conditions defined 2017. But they are likely to be less favorable in 18’ (see chart below).

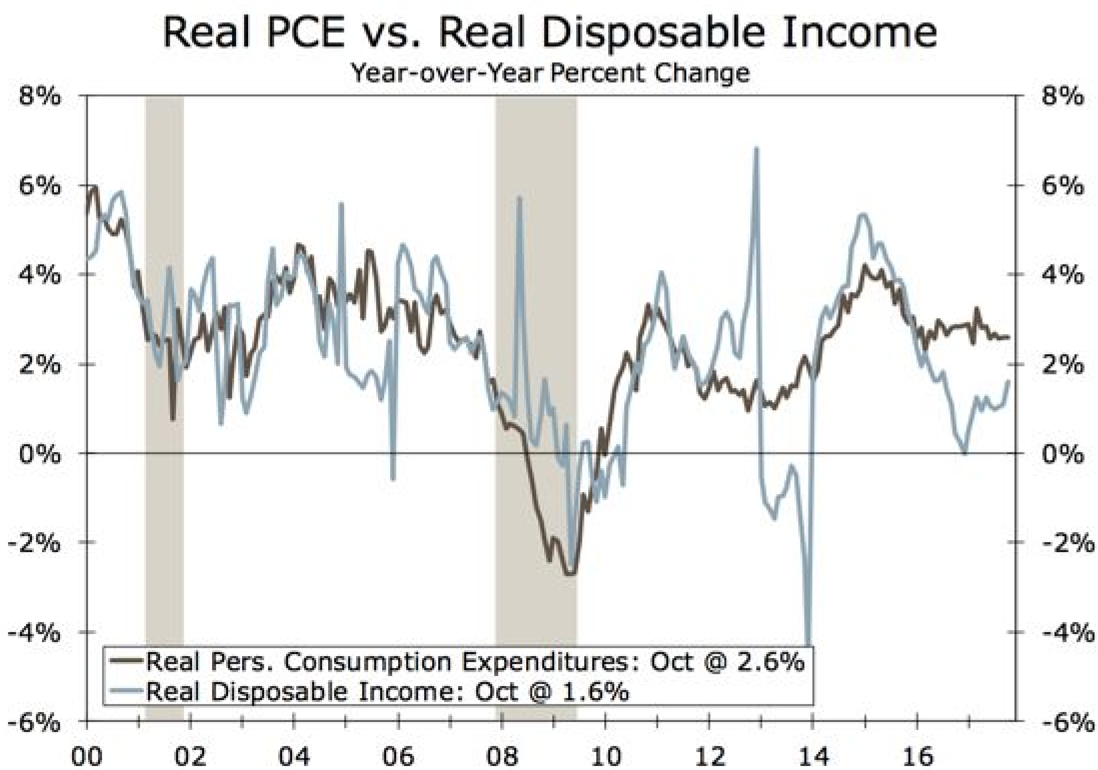


This chart shows the YoY change in G4 central bank assets and fund flows into EM, EM debt, and high yield bonds lagged by 12-months. You can see the strong correlation between the two with a strong increase in central bank assets (global liquidity) over the last couple of years leading fund flows into EM.

Most major central banks are set to begin policy normalization in 18’ as indicated by the forecasted dotted blue line in the chart. This should put a strain on capital flows from the core to the periphery and possibly reverse them completely. This could have a large impact on emerging markets and the US dollar.

We'll be talking more about this in the January MIR which comes out next week.

This is an interesting chart put out by Wells Fargo securities team. It shows the correlation between real PCE vs real disposable income. The connection itself is obvious, higher real wages (income) lead to greater inflation. But the extent in the Y/Y collapse in real disposable income from 15' to 17' is surprising.



Source: U.S. Departments of Commerce and Wells Fargo Securities

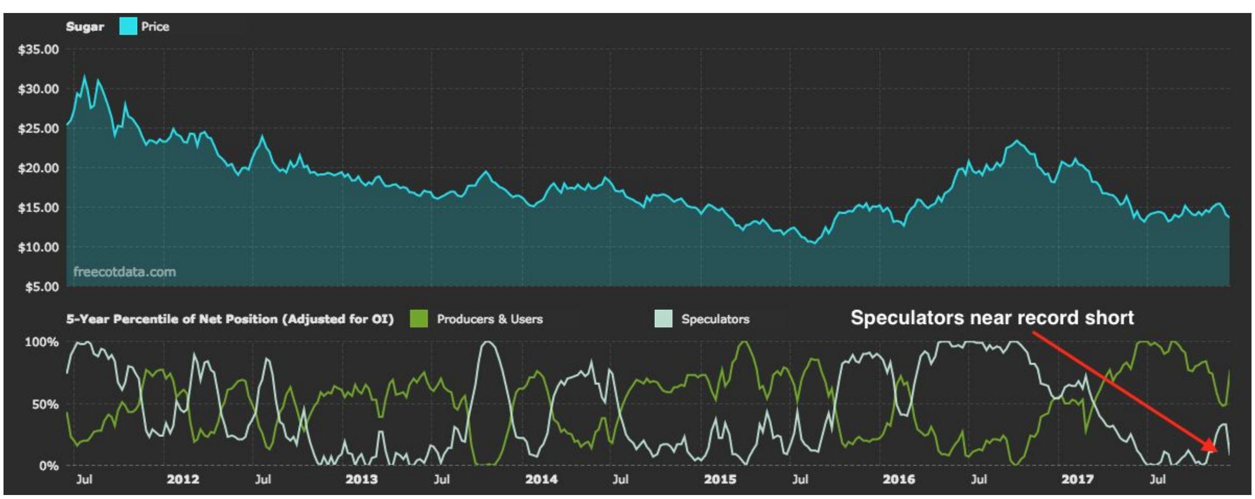
Much of this drop is attributable to the bear market in commodities and the loss of jobs in the mining and energy sector over that period. Now that commodities are recovering we should see real disposable income trend higher, along with the PCE, in 2018.

Target List - Trade setups that might trigger this week:

Sugar did an end-run into a large bear trap (shown on the March contract below) and now looks set to break out of its congestion zone, potentially marking a major bottom.

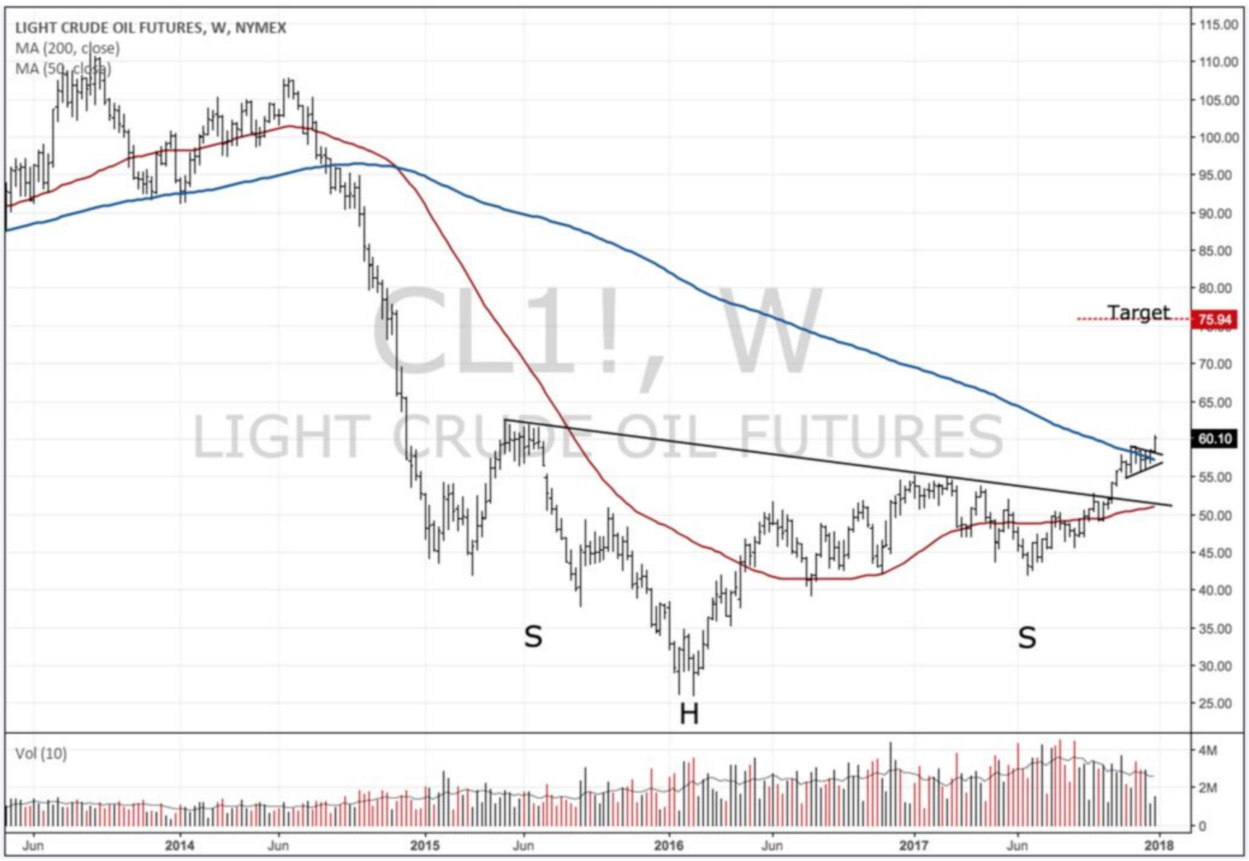
The COT profile is extremely supportive of a move higher in sugar.

Speculators are still holding near record short positions. A lot of bad news is priced into this market and the price action isn't confirming the bearish take. We'll put on a small starter position early in the week and add on a breakout above the upper trend line. This trade can be executed on the futures or the ETF (SGG).

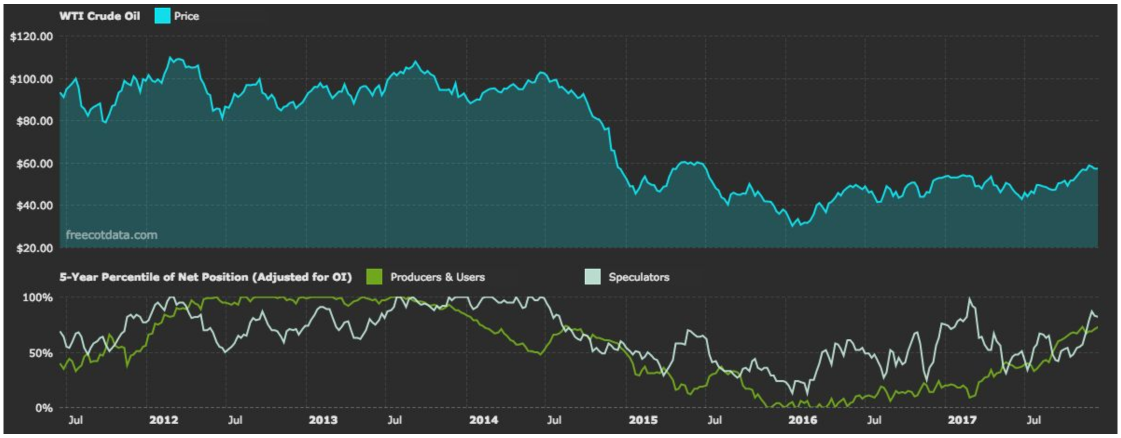


Crude oil (shown below in WTI) has completed a 3-year inverse H&S bottoming pattern and is now above its 200-week moving average.

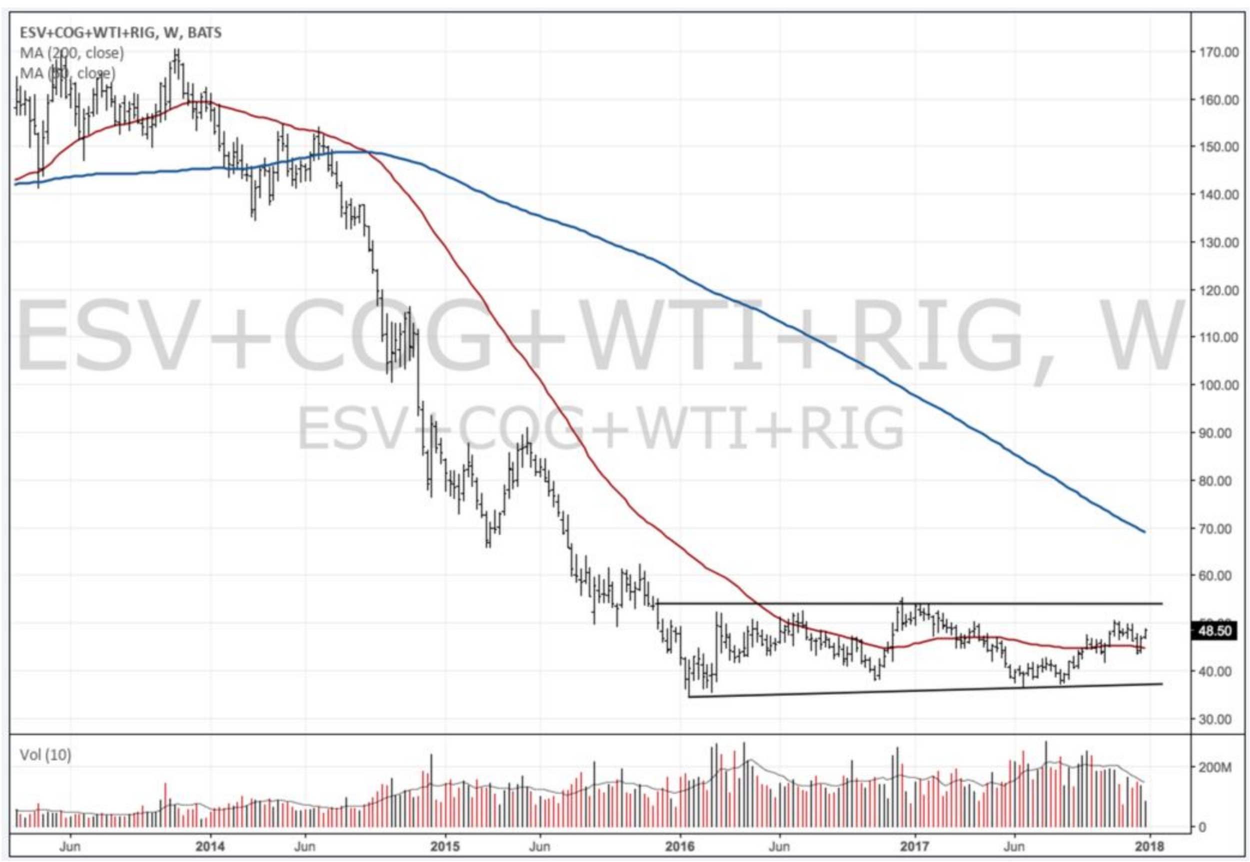
Long energy remains one of our favorite themes going into 2018. Continued global growth and rising tensions in oil producing regions (ie, Venezuela, Iran, Saudi Arabia) will further tighten an increasingly supply constrained market. We expect WTI oil to pass $75bbl before the end of 18'.



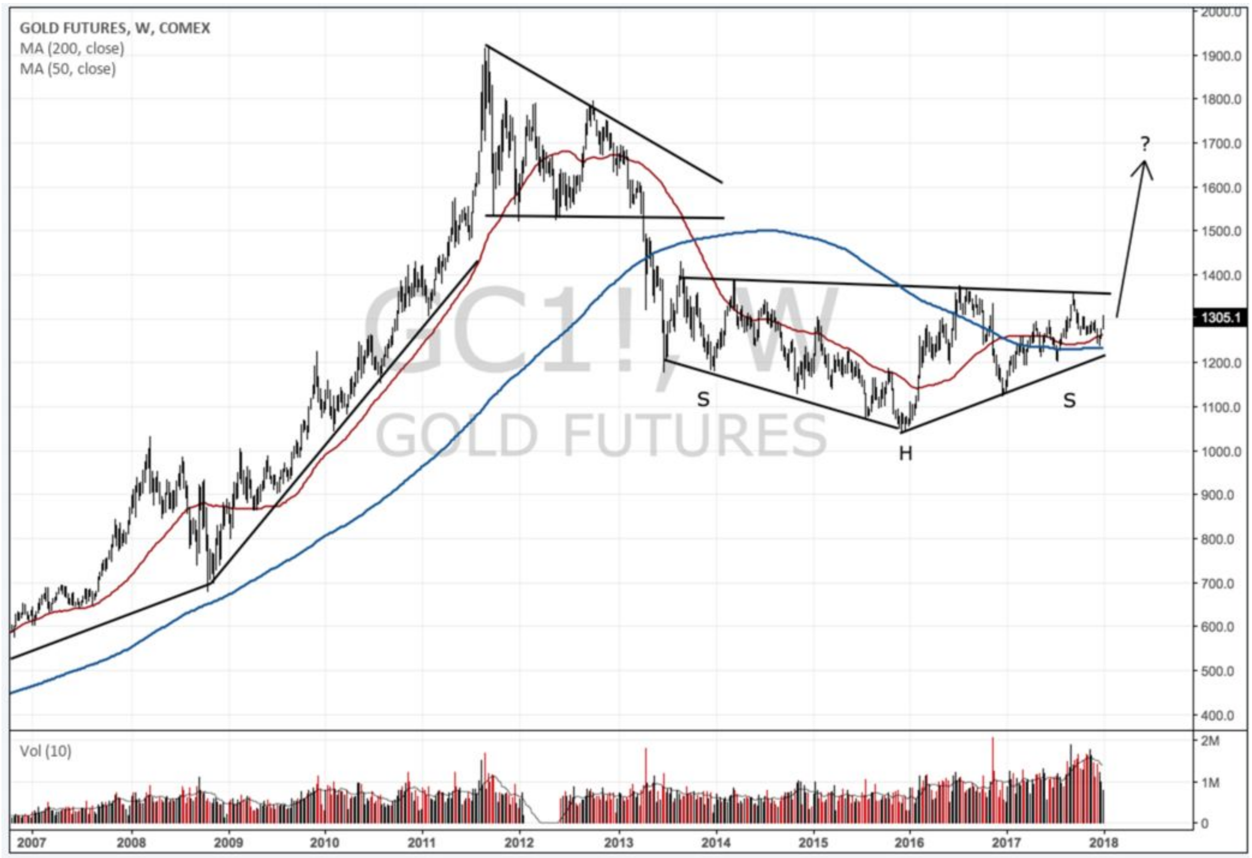
The COT profile shows that spec and producer positioning could serve as a headwind in the short term. The large long positioning by producers is likely due to hedging required by lenders in order for the producers to roll over their financing.



Our long energy basket consisting of ESV, COG, WTI, and RIG, shown below on a weekly basis, continues to setup nicely. It's put in a 2-year rectangle bottom and I expect that it'll breakout to the upside in the coming months. When it does we'll aggressively add to our positioning.



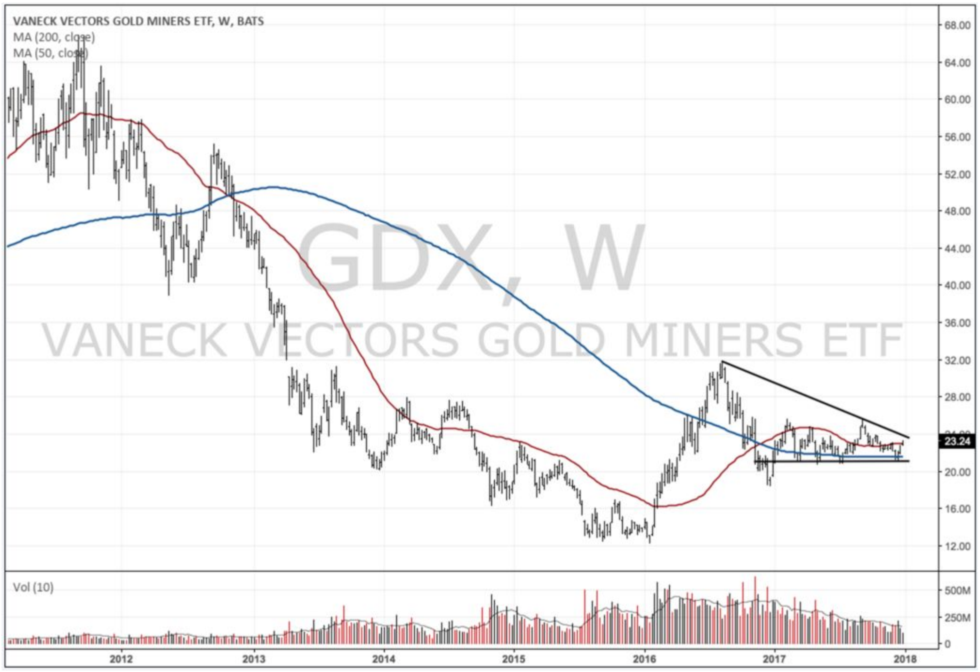
The price action in gold is interesting. The chart below is a weekly and shows gold may be putting in 5-year inverse H&S pattern, potentially setting it up for a massive run in 18'.



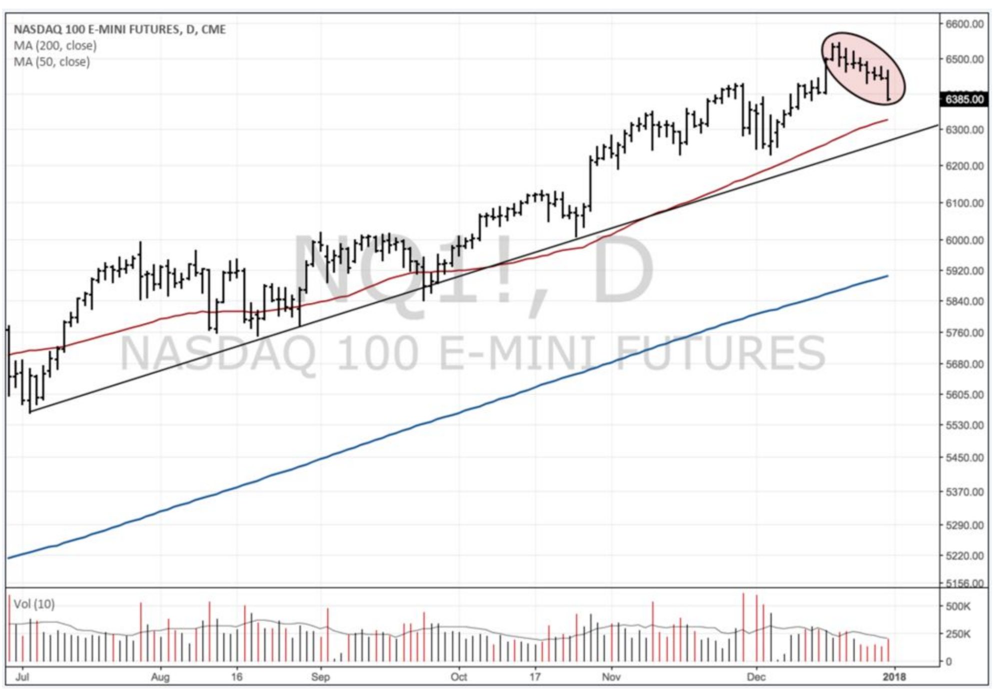
Gold is the internationalized value of $1 USD unit of account. This means that the price of gold tends to reflect the fundamental value of $1 US dollar of liquidity (ie, global liquidity relative to demand for US bonds and shares).

If we see global liquidity tighten somewhat in 2018, which is our current base case, then gold shouldn't perform well. But there's a scenario where the incoming new Fed Chair, Powell, surprises with dovishness and talks down the rate hike path while China doesn't follow through on its stated deleveraging goals where we could see the dollar continue on a bear market and gold perform very well.

I see this as a low probability scenario but something we should remain cognizant of. The technicals in gold miners are certainly setting up well and price always needs to be respected because we could be missing a part of the puzzle.



The Nasdaq has put in a string of lower closes over the last two weeks with some notable weak price action amongst the FAANGs. The majority of our broader market indicators (ie, breadth, credit, momentum) are giving fairly strong readings so this isn't reason to get defensive yet, just something to watch out for as January has a tendency to be a choppy month for stocks.



Our swing trade in SQ was quickly knocked out last week as the Santa Rally failed to materialize going into the end of the year. But our long UIHC trade had a strong close and the tape looks good. Hopefully we see some follow through in the weeks ahead.

Redknee (RKN) is on our target list for this week. If price holds above the 50-week MA then we'll enter a starter position. You can find the fundamental thesis for this trade here in our HF quarterly notes doc.

We will also be taking profits on PGAL and ASHR next week. We've been in these positions for a while and they've done well for us but we'd like to reallocate that cash to some other trades.

That's all we've got for this week. We hope you all have a safe and happy New Years. We're looking forward to attacking the markets with you in 2018.

Your Macro Operator,

Alex

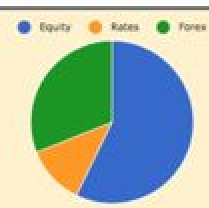
Macro Ops Portfolio

NAV $2,695,675

Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target
Equity	Limbach LMB	2,750	$13.66	$12.50	$3,190.00	$18.00
Equity	Interactive Brokers IBKR	1,800	$41.71	$38.50	$5,778.00	$55.50
Equity	GAIA	7,600	$9.88	$8.50	$10,488.00	$13.75
Equity	Portugal ETF PGAL	4,000	$10.57	$9.98	$2,360.00	$11.75
Equity	China A-Shares ASHR	3,464	$26.69	$25.83	$2,979.04	$31.30
Equity	W&T Offshore WTI	16,000	$2.18	$2.00	$2,880.00	$4.50
Equity	Ensco ESV	3,700	$5.15	$4.30	$3,145.00	$6.50
Equity	Transocean RIG	2,900	$9.32	$8.26	$3,074.00	$15.00
Equity	Cabot COG	1,350	$26.28	$24.00	$3,078.00	$34.00
Equity	Tuesday Morning TUES	7,500	$2.60	$2.00	$4,500.00	$5.00
Equity	United Insurance UIHC	13,000	$16.98	$16.30	$8,840.00	$20.00
Equity	Nikkei Mar 18 Future	3	$22,975	$22,460	$7,725.00	26,000
Equity	CCJ Jan '19 17 Call	236	$0.41	$0.00	$96.76	$5.00
Equity	FCAU Jan '19 25 Call	108	$0.90	$0.00	$9,720.00	$5.00
Equity	JD Jan '19 70 Call	108	$0.92	$0.00	$9,936.00	$7.00
Equity	TRIP Jan '19 75 Call	108	$0.89	$0.00	$9,612.00	$7.00
Equity	CHK Jan'19 10 Call	750	$0.14	$0.00	$10,500.00	$1.00
Equity	Tesla Mar '18 240 Put	28	$8.80	$0.00	$24,640.00	$24.00
Equity	MS June '18 65 Call	126	$0.46	$0.00	$5,796.00	$3.00
Equity	WMT June '18 120 Call	126	$0.51	$0.00	$6,426.00	$3.00
Forex	FXE Jan 2018 104 Put	80	$3.45	$0.00	$27,600.00	$7.00
Rates	IEF March 2018 104/109 Stra	80	$3.45	$0.00	$27,600.00	$7.00
Commodity	SLV June 2018 17 Straddle	130	$2.84	$0.00	$36,920.00	$5.00
Commodity	GLD Sep 2018 128 Straddle	24	$15.10	$0.00	$36,240.00	$30.00

Metrics

Exposure Breakdown	
Equity	$134,763.80
Commodity	$0.00
Rates	$27,600.00
Forex	$73,160.00



Total Open Risk
$263,123.80
9.76%
**Updated 12/24