The 7 Rules of the Game

Trading Wisdom

Julian Robertson's "7 Rules of the Game" via John Train's *Money Masters of our Time.*

1. ***Wonderful management.*** Any company he invests in must be outstandingly well run. Management must be wedded to the bottom line, as against building sales. It must have both a long-term plan and the means to implement it. He is also alert to new managements about to clean house.
2. ***Monopoly or oligopoly.*** Robertson seeks companies enjoying competitive advantages by virtue of their market position. For example, the route structure of American Airlines and United Airlines made it almost impossible for competitors to break into their territories. Wal-Mart's sheer size meant that other companies would have to go through a long process of growth and consolidation before they could hope to compete by cutting their margins. Sainsbury and Tesco in Britain had dominance through their brand ownership.
3. ***Great value, based on careful examination of the company books.*** Robertson keenly scrutinizes foreign company accounts. In Japan, for example, he established the bank's true liabilities, and how much cash flow was available to retailers he was interested in. The price/earnings multiples of a stock is only somewhat less important. Citicorp was a good example; he was highly enthusiastic about when it was at just over eleven times earnings, while being an outstanding enterprise. But one must worry about what could go wrong to push earnings down and the P/E up.
4. ***Regulation**.* A company can benefit when the government is tying the hands of its competitors. He becomes extremely wary when a company faces liability for environmental or regulatory infringements.
5. ***Upstream needs.*** Once a growing industry has been identified, rather than seek out its leading companies, look for the companies that will supply the whole industry. In 1998, for example, Robertson invested heavily in palladium, used in cell phones and auto-emission-control devices. He is convinced that the Russian and South African mines will no be able to meet the world's demand for metal.
6. ***Growth***. It will bail you out of a bad market.
7. ***Big core positions.*** Robertson's portfolio is heavy in tried-and-true companies with solid track records, usually dominated by a dozen or so giants, recently including Intel and Citigroup.

All the great stock pickers share similar rules in selecting stocks. A focus on management, competitive advantage, and growth being the big common threads among them. Plus, the habit of taking big core positions when the stars align and a trade checks all the boxes.

Markets and Macro

The S&P this week confirmed its breakout from a 2-year ascending wedge. Chart below is a weekly.

I have to say, I'm leaning more and more towards Jeremy Grantham's camp in thinking we're likely entering the "stupefying melt-up" phase of this cycle.

Grantham concluded the following in his latest note titled *Brace Yourself For a Possible Near-term Melt-up*:

- A melt-up or end-phase of a bubble within the next 6 months to 2 years is likely, i.e., over 50%.
- If there is a melt-up, then the odds of a subsequent bubble break or melt-down are very, very high, i.e., over 90%.

- If there is a market decline following a melt-up, it is quite likely to be a decline of some 50%.

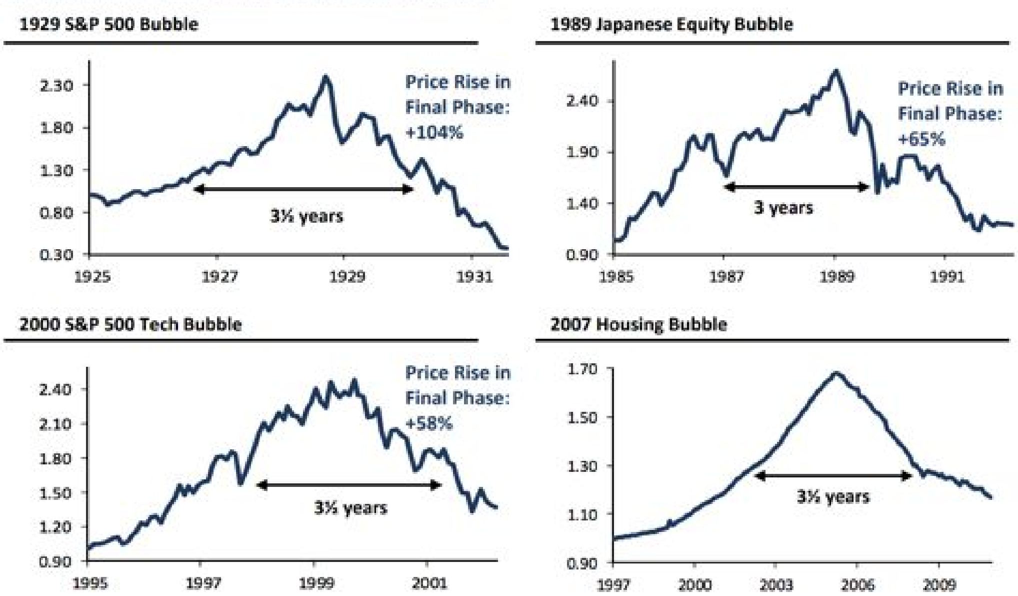
In the paper, Grantham rightly notes the most important component necessary for a bubble to occur, and that's "price acceleration".

Nothing makes "investors" more bullish than seeing prices prices rise… fast. The faster they go up, the more bullish their outlooks become. The crypto market is a perfect study in this.

Grantham's also shared a study of past bubbles, writing:

> *The average time of the final bubble phase of the great equity bubbles shown in Exhibit 1 is just under 3.5 years, with the average upcycle of real acceleration just 21 months. And the two smaller equity bubbles had gains of 65% and 58%. They also show an interesting symmetry don't you think?*

Exhibit 1: Modern Classics of the Bubble World



Source: Robert Shiller, Compustat, Worldscope, S&P, National Association of Realtors, GMO
See "Bubbles for Fama," Greenwood, Shleifer, and Yu, to understand why acceleration is important. The equity bubbles depicted are only looking at price action over the period of interest; the housing bubble is looking at price-to-income ratios.

He then laid out his expectations for what this final throw over top could look like in terms of price rise and time, saying " A range of 9 to 18 months from today and a price rise to around 3,400 to 3,700 on the S&P 500 would show the same 60% gain over 21 months as the least of the other classic bubble events."

Which would mean the S&P would do this....

Exhibit 4: What it Would Take to Make the S&P 500 a Classic Bubble

Source: S&P Dow Jones Indices LLC, GMO

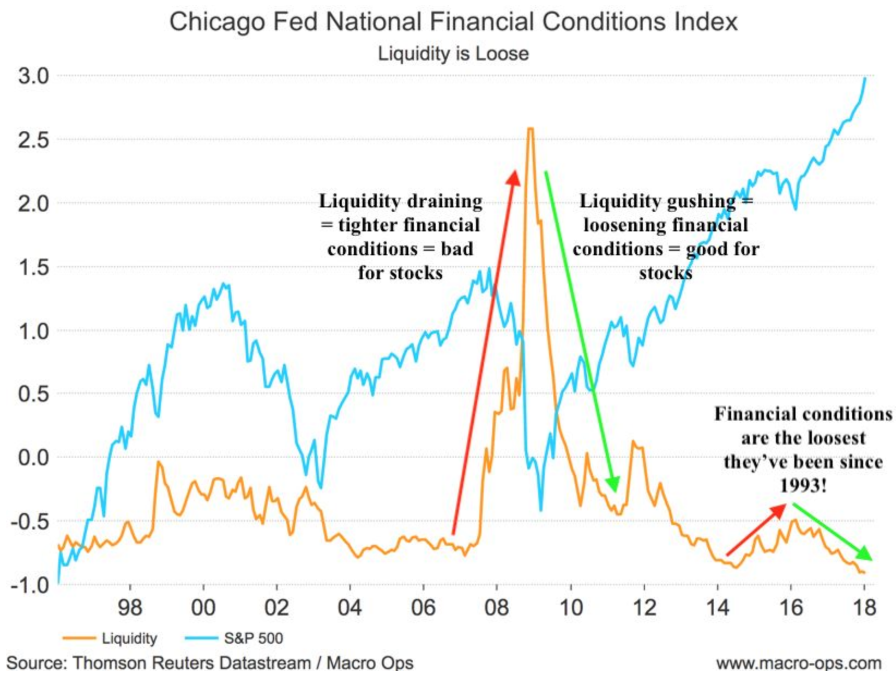
Of course, Grantham doesn't have a crystal ball and neither do we. We just need to keep an open mind to this possibility. Especially because current price action is looking… well… melt-up(ish)?

The biggest risk to markets right now are:

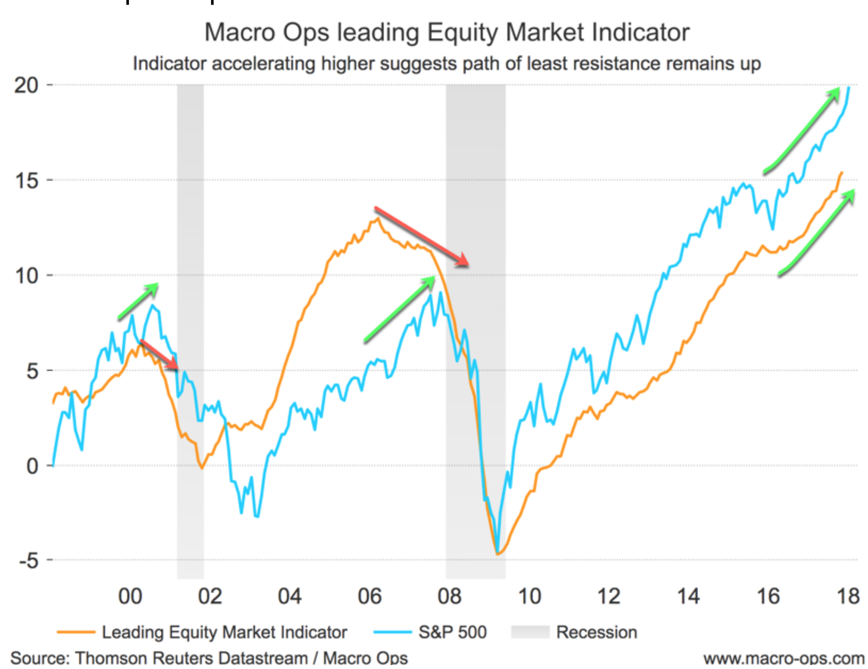
- **Hawkish Fed.** A more aggressive Fed due to a rising inflation and/or concerns over market stability. In addition, there's uncertainty regarding how the incoming Fed Chair, Powell, will choose steer the ship.
- **Tech Crackdown.** Growing concerns over the big tech companies leads to government intervention/regulation/trust busting.
- **War with North Korea.** This is something that is not being talked about in the mainstream news much right now but this will change in the coming months. Having formerly worked in the national security sector, I can tell you with high confidence that the probability of the US engaging in a large scale conventional war with North Korea is not insignificant.
- **Rates Up.** A more hawkish fed or not, greater speculation and increasing inflation could lead to rates going much higher. Fast rising rates eventually leads to instability as bonds begin to attract the capital flows that were once going to equities.

The game is still to stay long and strong and keep an eye on the following indicators which will forewarn us to a large market sell-off.

The Chicago Fed Financial Conditions Index (orange line) is at its **lowest level since 1993.** This means, financial conditions haven't been easier in the last 25 years. And the index is still trending lower. This indicator will turn up well before a market top is completed, as it did in the last two cycles.



Our equity market leading indicator (orange line) is still trending up strongly, and is in fact accelerating in its angle of attack. This indicator will turn over and diverge from the market (blue line) before a market top is in place.



Target List & Portfolio Review

Interactive Brokers (IBKR) reports earnings on Tuesday after the market close. IBKR has been a great trade for us, up 55+%, since we entered in September. The chart continues to look fantastic and we'll have to see how numbers look following the release. As of right now, we have no plans to sell out of our position until given a reason to by the market.

TripAdvisor (TRIP), is a stock we've covered quite a bit over the last six months. We tried taking a swing at it in the Fall, but got stopped out. We also have a small DOTM call position on the stock. Similar to JD.com (JD) this is a company that I really like and believe its assets are being horribly misvalued by the market. There's also a high probability to a buyout sometime this year. You can find our hedge fund notes on the company, along with some commentary from me, here.

I want to build a large core position in this stock and I think we've recently been given the technical opportunity to do so.

The stock (chart below on weekly) sold off hard on weak earnings last quarter. The selloff was accompanied by extremely high selling volume which typically marks a capitulation bottom. And you can see that it bounced off a long-term support at the $30 level and quickly recovered.

The stock recently broke out of a tight consolidation channel. This gives us a good risk/reward entry point. I plan to open a position Monday. We'll put the risk point below this channel, which will allow us to get in on some size.

Gold continues to look constructive. Here it is on a monthly basis, showing price forming a potential 2+ year inverted H&S bottoming pattern.

If the war narrative comes back to the fore, and we think it will, gold should continue to catch a bid. It tends to perform well when international conflict heats up.

I'm considering buying some DOTM calls that are at least a year out on a big miner like Barrick Gold (ABX) shown on the chart below. Gold vol is selling for cheap and many of these calls are inexpensive.

I love the price action out of Japan. Here's the Nikkei on a monthly basis.

Japan is one of the cheapest developed markets in the world right now. They're also home to the central bank that's most likely to keep the QE party going the longest. This, amongst many other reasons, will continue to attract capital flows and drive Japanese markets higher.

If you haven't entered a position yet, we might see another good entry point this week. Price action is currently forming a small wedge pattern. A thrust higher would trigger a potential entry.

I think Japan might end up being one of top performing markets in 18'.

Our DOTM calls in Fiat Chrysler (FCAU) which we bought in November have 3x'd. And they still have a year till expiry. Our fundamental conviction on the trade is as strong as ever. There's still see plenty of upside left in the stock.

Our more recent position in United Insurance (UIHC) is off to a good start. It's currently up 12+% since our entry a few weeks ago. This stock has a decent runway. I wouldn't be surprised to see it take out its previous 15' high before the end of the year.

This week I'm going to be digging into some shippers. The charts for shipping stocks are beginning to look constructive. Check out the Guggenheim Shipping ETF (SEA).

I'm also considering adding another layer to our DOTM position in CHK. Price just broke out of a nice consolidation area. And I want to start adding to our long energy positions, which have been doing well for us.

That's all I've got for now. Expect some trade alerts and research to come your way this week.

Have a great week in the markets and see you in the CC!

Your Macro Operator,

Alex

Macro Ops Portfolio			YTD	Inception (16')			
NAV	$2,775,114		2.89%	38.13%			
Big Bet Macro							
Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target	Last Price
Equity	Limbach LMB	2,750	$13.66	$12.50	$3,190.00	$18.00	$13.59
Equity	JD	5,867	$44.74	$36.00	$59,843.40	$72.00	$46.20
Equity	Interactive Brokers IBKR	1,800	$41.71	$54.00	$14,796.00	$55.50	$62.22
Equity	W&T Offshore WTI	16,000	$2.18	$3.30	$24,000.00	$4.50	$4.80
Equity	Ensco ESV	3,700	$5.15	$5.75	$4,736.00	$6.50	$7.03
Equity	Transocean RIG	2,900	$9.32	$10.30	$4,292.00	$15.00	$11.78
Equity	Cabot COG	1,350	$26.28	$24.00	$6,763.50	$34.00	$29.01
Equity	Tuesday Morning TUES	7,500	$2.60	$2.40	$4,500.00	$5.00	$3.00
Equity	United Insurance UIHC	13,000	$16.98	$16.30	$25,610.00	$20.00	$18.27
Equity	Nikkei Mar 18 Future	6	$23,300	$22,803	$30,810.00	$26,000	$23,830
Equity	CCJ Jan '19 17 Call	236	$0.41	$0.00	$7,080.00	$5.00	$0.30
Equity	FCAU Jan '19 25 Call	108	$0.90	$0.00	$25,920.00	$5.00	$2.40
Equity	JD Jan '19 70 Call	108	$0.92	$0.00	$14,688.00	$7.00	$1.36
Equity	TRIP Jan '19 75 Call	108	$0.89	$0.00	$2,700.00	$7.00	$0.25
Equity	CHK Jan'19 10 Call	750	$0.14	$0.00	$9,750.00	$1.00	$0.13
Equity	Tesla Mar '18 240 Put	28	$8.80	$0.00	$4,564.00	$24.00	$1.63
Equity	MS June '18 65 Call	126	$0.46	$0.00	$3,528.00	$3.00	$0.28
Equity	WMT June '18 120 Call	126	$0.51	$0.00	$8,694.00	$3.00	$0.69
Volatility							
Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target	Last Price
Forex	FXE Jan 2018 104 Put	80	$3.45	$0.00	$0.00	$7.00	$0.00
Rates	IEF March 2018 104/109 St	80	$3.45	$0.00	$2,640.00	$7.00	$0.33
Commodity	SLV June 2018 17 Straddle	130	$2.84	$0.00	$23,920.00	$5.00	$1.84
Commodity	GLD Sep 2018 128 Straddle	24	$15.10	$0.00	$23,520.00	$30.00	$9.80

Risk Budget				
	Total Allowed (In Bps)	Total Used	Total Available	Percentage Used
Master	2500	1,101	1399	44.04%
Big Bet Macro	1250	921	329	73.64%
Volatility	1250	180	1070	14.44%

**Updated 1/11