
The Big Rock?

Trading Wisdom

The “Bond King” Jeffrey Gundlach shared a useful analogy for thinking markets in a recent Barron’s interview. Here’s the section below.

Gundlach: As I think more about cycles that end in mania and then turn deeply negative, I have been using the analogy of the big rock.

Interviewer: The big rock?

Gundlach: Let’s say you’re driving to someone’s house in the country and you’ve been told to turn at the big rock—so big, you can’t miss it—and drive a mile down the side road. You’re driving on the main road and come to a big rock but it doesn’t reach the can’t-miss level, so you keep driving. Then you see another, even bigger rock and make the turn, but there’s no house down the road. So you double back and keep driving down the main road until you see a really huge rock. It’s enormous, and that’s the rock. We risk managers sometimes get fooled by the big rock and get negative too early.

We’ve got something now that qualifies as the big rock. It’s these derivatives blow-ups. It’s the triple-B tranche of the ABX cracking and sinking in value. It’s CryptoKitties—a cartoon drawing of a digital cat that someone bought for the equivalent of \$100,000. The hip bone is connected to the thigh bone. These events are all tied to manic speculation, whether it’s betting on something with the word crypto or shorting the VIX at historically low levels. It’s people telling you you’re insane for not seeing that this time is totally, fundamentally different.

That’s why my favorite book on investing is Reminiscences of a Stock Operator. It was first published in 1923, and is filled with the jargon of the day, so you have to learn the language. But once you do, it is a fascinating book about trading and speculation. You realize that nothing has changed. Everything is the same. Even though the markets are global today, and there is so much more regulation, it is still just speculation and human nature.

One of the toughest things to do in a late cycle bull market is to not mistake the ‘big rock’ for the “BIG ROCK”. The rock we’re talking about is a change in the primary market trend. Calling for a cyclical a market top.

As a trend ages we naturally become more and more skeptical of it continuing. But it's a costly mistake to give into this skepticism and think every sell-off is the BIG ROCK. We're all familiar with the perma-bears on fintwit who've been seeing big rock after big rock for the last three years. I'm guessing their portfolio's performance reflects this trend paranoia.

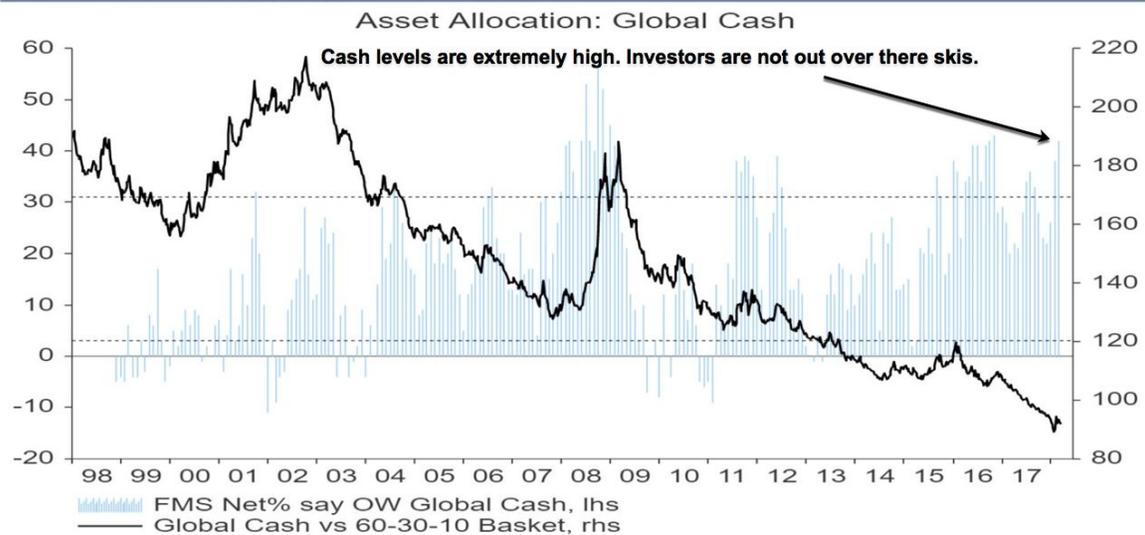
So have seen the BIG ROCK as Gundlach suggests?

The derivatives blow up in the volatility space and the crypto-kitties going for top dollars certainly look like a pretty big rock. But I'm not convinced it's *the* big rock.

We're still not seeing the type of investor leveraging that typifies a big rock moment and leads to a cyclical trend reversal.

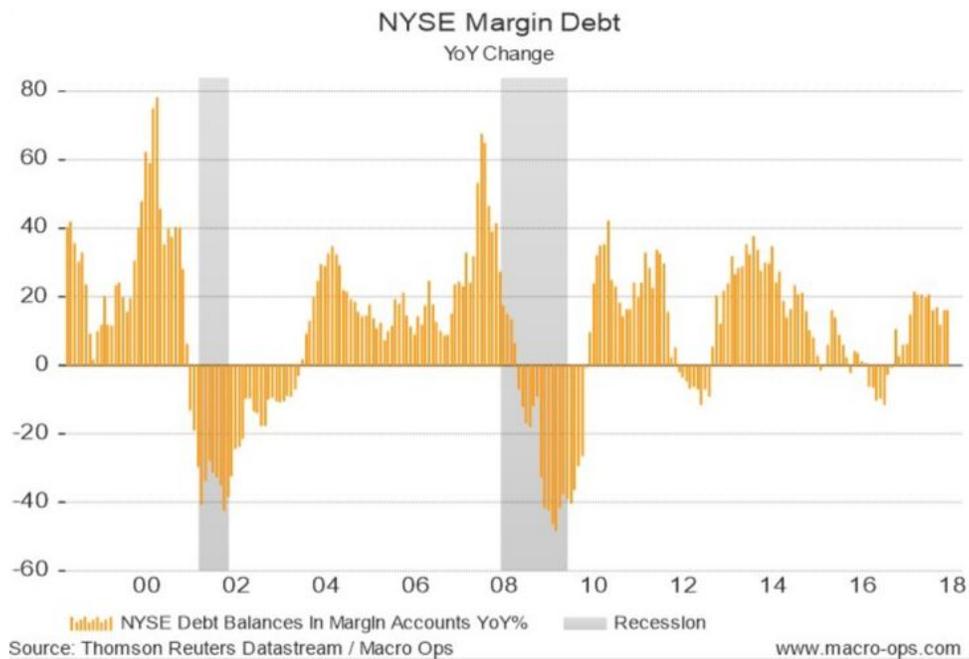
Allocation to cash is still very high.

Exhibit 24: Net % AA Say they are overweight Cash

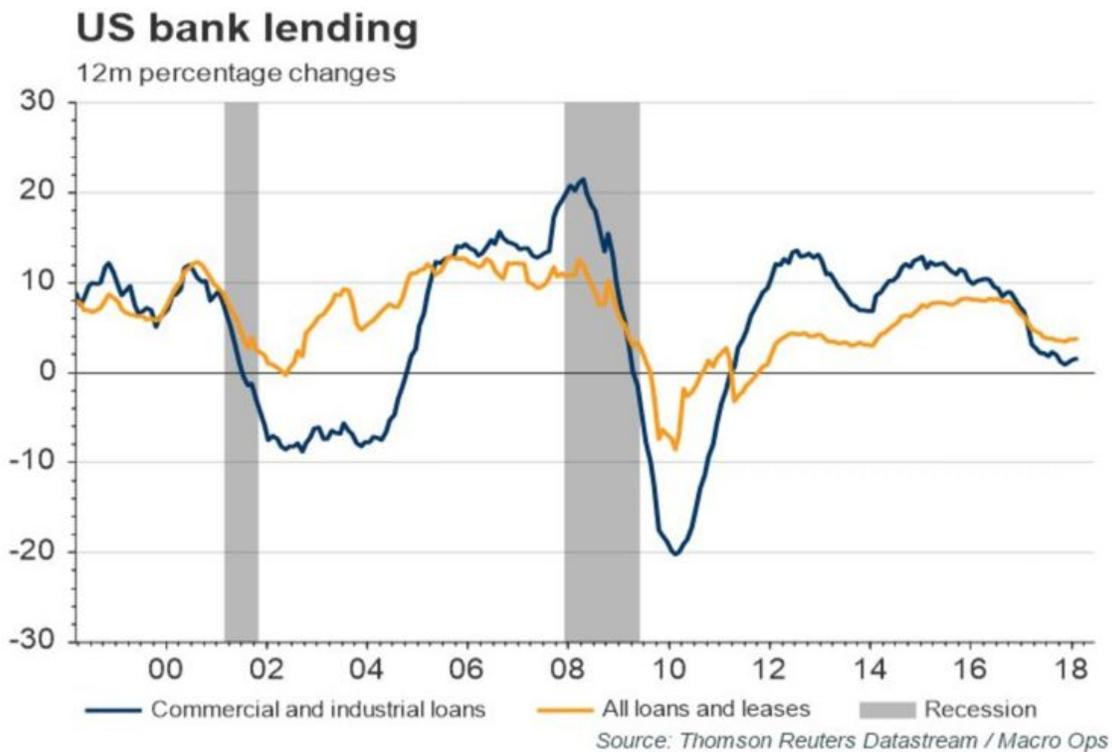


Source: BofA Merrill Lynch Global Fund Manager Survey

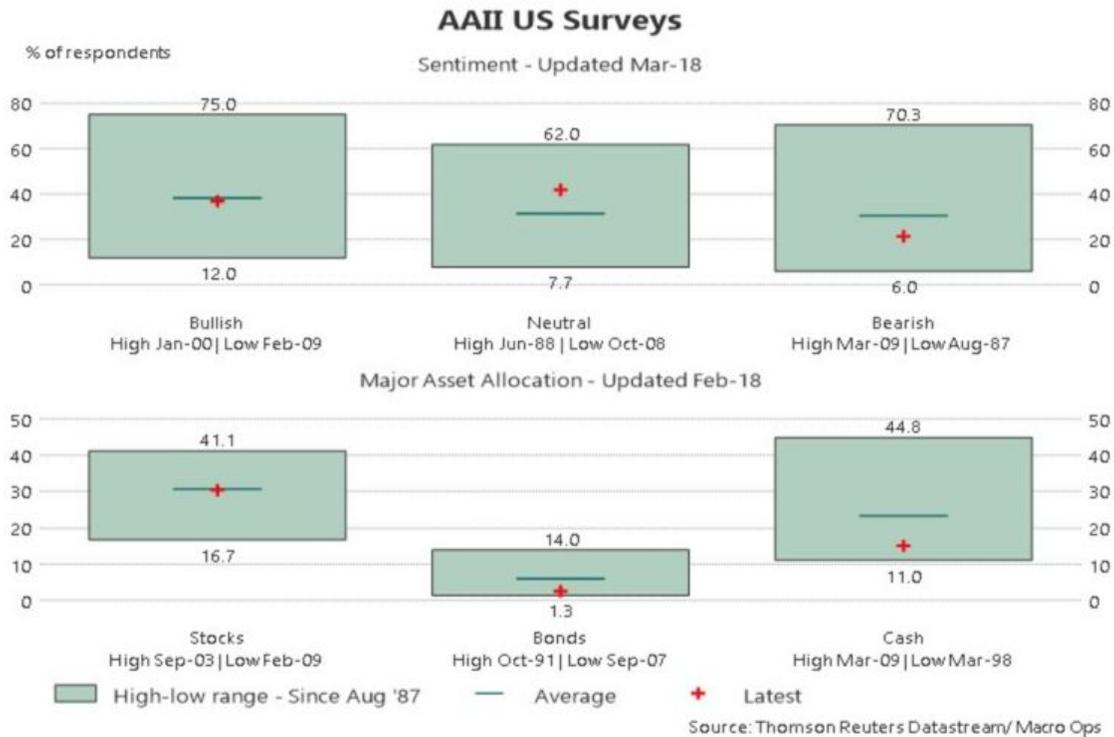
We've yet to see the FOMO margin buying that's common of market tops.



Lending by banks is still really muted. We usually see banks aggressively lending towards the end of the risk cycle. And their aggressive lending partly drives the risk cycle as it adds unproductive leveraging in the system that needs to eventually unwind.



And sentiment was high but following the February market volatility it has come down considerably which shows just how skeptical investors remain.



I could be wrong and we could be hitting a major cyclical inflection point right now. But the market never tops and immediately enters a bear market. There's usually a considerable topping process of long volatile sideways action before a dominant trend change.

And from a portfolio management perspective, it pays to stick with the dominant trend until the market clearly tells you that you've reached the big rock. Thinking every common market correction is the start of a bear market just because the trend is old, is a costly strategy in a late cycle market.

The trend is your friend until the end when it bends, as the saying goes...

The Way of The Dollar

The dollar is increasingly looking like it's put in a bottom and gearing up for another move higher. It's bouncing off of critical trendlines in a number of major pairs. Here's the trade weighted USD index (DXY) below.



EURUSD is in the range of its 9-year downward sloping trendline. Long positioning in the euro is extremely stretched and very vulnerable to a forced unwind selloff here.



AUDUSD shown here on the monthly is at risk of following through on the breakdown below its 16-year upward trendline. The slowdown in Chinese credit growth should start to put added pressure on the aussie as the CCP steps up their efforts to deleverage.



The dollar has increasingly favorable yield differentials versus other majors. Relative equity momentum in the US is picking up versus the rest of the world. Capital flows chase performance and this drives currency trends. Positioning and sentiment have become quite crowded in the USD bearish camp. Everybody is focused on the growing US deficit. But US deficits have a weak correlation to subsequent moves in the dollar.

So I think we may be on the cusp of seeing another major dollar rally. And the technical setups suggests this could be a big move.

We're already long the dollar against the euro and pound. If there's follow through on this move then we'll look to add a long position against the aussie as well.

The Fed meets tomorrow. They're expected to raise interest rates another 25bps. That's already being priced into the market. What's more important is the guidance they give over future rate expectations. If they surprise with a more aggressive tone than what's currently being priced in, we could see the dollar kick off its next leg.

Micron (MU) reports on Thursday after the close. We'll send out an update after the report. Outside of a potential dollar revival there's not a whole lot to do in this market other than to stick with the dominant trends. We're continuing to dig into some equities in the search for value wherever we can find it. We'll be sharing some updates on a few of our digs later this week.

That's all I've got for this week. Hope you had a good weekend and I'll see you in the CC!

- Alex

Macro Ops Portfolio		YTD	Inception (16')				
NAV	\$2,780,805	3.00%	38.42%				
Big Bet Macro							
Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target	Last Price
Equity	Limbach LMB	2,750	\$13.66	\$11.00	\$2,667.50	\$18.00	\$11.97
Equity	JD	5,867	\$44.74	\$36.00	\$45,234.57	\$72.00	\$43.71
Equity	Interactive Brokers IBKR	1,800	\$41.71	\$64.60	\$10,188.00	\$55.50	\$70.26
Equity	W&T Offshore WTI	16,000	\$2.18	\$3.30	\$10,400.00	\$4.50	\$3.95
Equity	Yatra Online YTRA	39,286	\$7.40	\$6.45	\$11,000.08	\$14.00	\$6.73
Equity	United Insurance UIHC	13,000	\$16.98	\$18.00	\$24,180.00	\$20.00	\$19.86
Equity	Trip Advisor TRIP	7,754	\$36.46	\$35.50	\$56,294.04	\$50.00	\$42.76
Equity	MU Jan '19 70 Call	118	\$2.12	\$0.00	\$51,448.00	\$10.50	\$4.36
Equity	BCS Jan '19 15 Call	574	\$0.35	\$0.00	\$25,830.00	\$3.50	\$0.45
Equity	DB Jan '19 30 Call	670	\$0.30	\$0.00	\$9,380.00	\$3.00	\$0.14
Equity	CCJ Jan '19 17 Call	236	\$0.41	\$0.00	\$3,540.00	\$5.00	\$0.15
Equity	FCAU Jan '19 25 Call	108	\$0.90	\$0.00	\$17,820.00	\$5.00	\$1.65
Equity	JD Jan '19 70 Call	108	\$0.92	\$0.00	\$7,560.00	\$7.00	\$0.70
Equity	TRIP Jan '19 75 Call	108	\$0.89	\$0.00	\$7,560.00	\$7.00	\$0.70
Equity	CHK Jan '19 10 Call	750	\$0.14	\$0.00	\$3,000.00	\$1.00	\$0.04
Equity	MS June '18 65 Call	126	\$0.46	\$0.00	\$5,040.00	\$3.00	\$0.40
Equity	WMT June '18 120 Call	126	\$0.51	\$0.00	\$1,008.00	\$3.00	\$0.08
Fixed Income	ZBM8 Bond Futures	14	\$144.47	\$142.375	\$15,750.00	\$150.5	\$143.50
Forex	6BM8 Pound Futures	-3	\$1.4095	\$1.4197	\$1,912.50	\$1.2457	\$1.3852
Forex	6EM8 Euro Futures	-2	\$1.2417	\$1.2575	\$3,950.00	\$1.0972	\$1.2320
Volatility							
Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target	Last Price
Commodity	SLV June 2018 17 Straddle	130	\$2.84	\$0.00	\$22,880.00	\$5.00	\$1.76
Commodity	GLD Sep 2018 128 Straddle	24	\$15.10	\$0.00	\$20,640.00	\$30.00	\$8.60

Risk Budget				
	Total Allowed (In Bps)	Total Used	Total Available	Percentage Used
Master	2500	1,285	1215	51.39%
Big Bet Macro	1750	1128	622	64.48%
Volatility	750	157	593	20.87%

**Updated 3/20