A Macro Inflection Point…Cont'd

Trading Wisdom

Joel Tillinghast writing on how to be an effective contrarian, from his terrific book *Big Money, Thinks Small*.

> *Almost by definition, the biggest mispricing will involve a glaring, hideous defect that popular opinion thinks cannot be overcome. That's when you're lonely, preferably well-researched conclusion that it either can be resolved, or isn't so bad, will be rewarded. In principle, we would always buy understandable, well-run, durable franchises at bargain prices, but in practice the market must think that some element is missing. On average, you are paid for being a nerd and sorting out the true situation. Even more, you are rewarded for the courage to act on an unpopular opinion that made you look like an idiot, provided it turns out to be correct. Before then, there's endless pain and worry that, indeed, the crowd is right.*
>
> *Are you willing to do the digging and endure the pain, loneliness, and worry that go with superior returns? Economic man is willing, but many are not. Personally, I tolerate boredom well but am not eager to take pain. If it all seems too much for you, your best options are to invest in an index fund or a low-cost fund in a well-resourced fund complex whose managers take a long-term horizon. Even then, your impatient trading may destroy the benefit of your manager's patience.*
>
> *About economists: Their goofy, surreal psychological assumptions are coded advice. Invest where you have an edge through superior information. Consider the popular interpretation, but also variant perspectives. Estimate the value of stocks; don't trade for other reasons. Try to look out as far into the future as possible. Be (calculatingly) bold. Minimize taxes, fees, and transaction costs; this is done most easily by trading infrequently. Above all, don't underestimate your rivals. If you are average, don't count on superior results. The perfect-competition assumption — that in competitive markets firms earn only a fair profit — means go where competition isn't.*
>
> *Psychologists advise that you broaden your horizons beyond the easily available information to include social context, historical statistics, and some notion of baseline and normal. Be skeptical if you think you've fallen for the narrative fallacy. To correct a misplaced data anchor, use the outside view. Focus on what a stock is worth today. Counteract confirmation bias by seeking refuting evidence and asking whether the*

opposite thesis is also true. Frame trade-offs as trade-offs, not as losses or gains. Think for yourself.

The aim of mindful decisions is to ensure that things that matter are never slaves to the trivial. By widening your perspective and reflecting, you can avoid unforced errors and being backed into tough choices. Separate the idea from the person, and let ideas fight, not people.

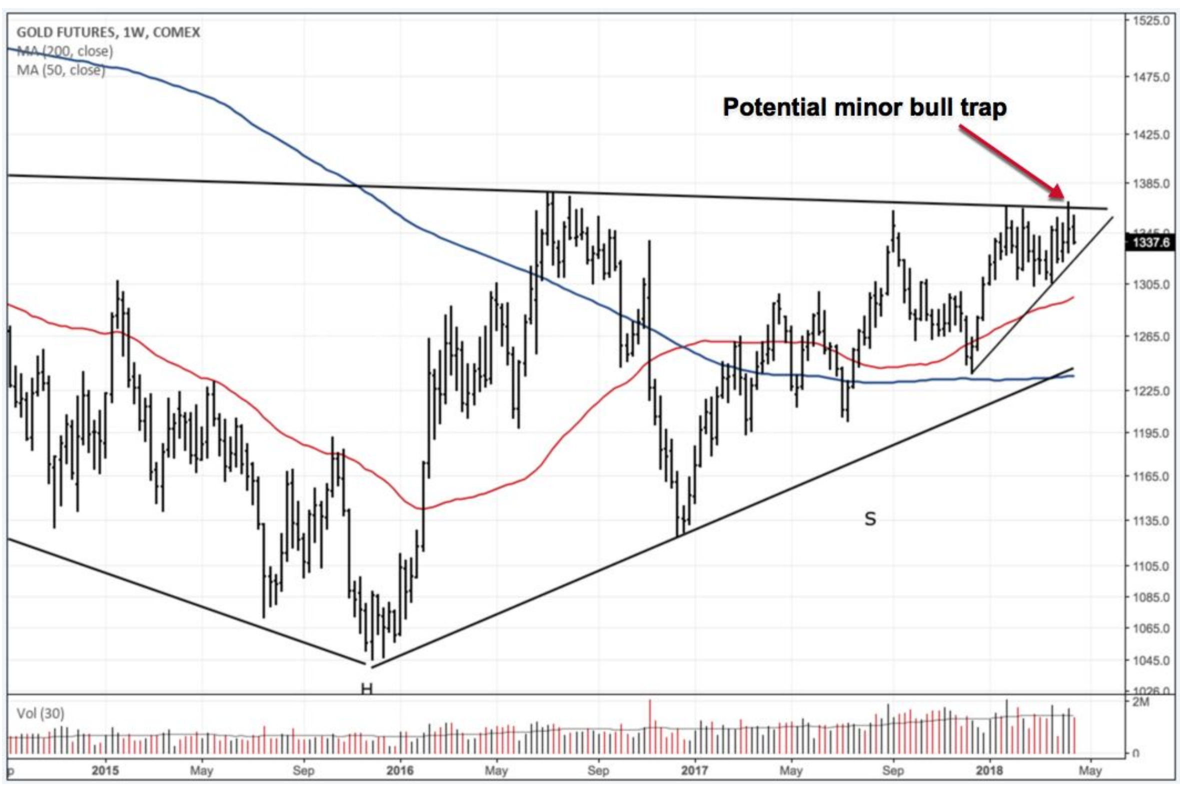
Macro: A Potential Major Reversal of Trend

Macro is about to get interesting again.

The inflection points we've been tracking in the major instruments (precious metals, USD pairs, and rates) continue to coil. It looks like we're going to see a major breakout in the next week or two.

Let's go through the charts real quick (all charts are on a weekly basis unless otherwise stated).

Gold, after spiking above its H&S neckline last week in a minor bull trap, reversed and finished this week on its lows.

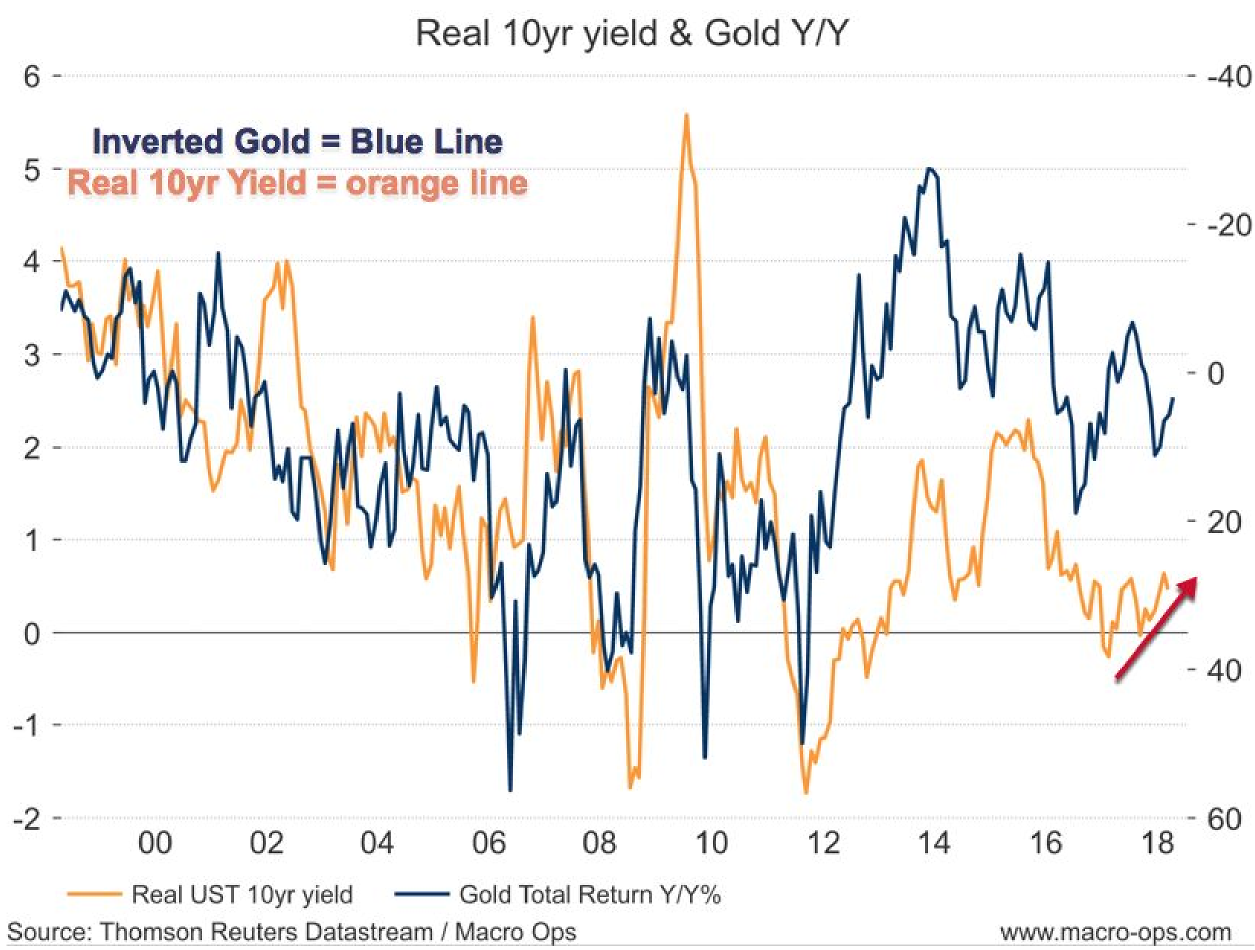


And a confluence of factors are lining up to make gold a potentially lucrative short at these levels.

Gold is largely driven by international demand for dollar assets and expectations over the real yield of these USD assets.

We can see this relationship in the chart below where the orange line is the real (inflation-adjusted) yield on 10-year Treasuries and the blue line is the inverted year-over-year change in the price of gold. When the real return on treasuries rises, gold falls, and vice-versa.

The orange line is delayed by one month but the next print should be significantly higher due to the recent move in bonds.



The nominal 10-year yield closed the week at 2.95%. Its highest level in nearly 5-years.

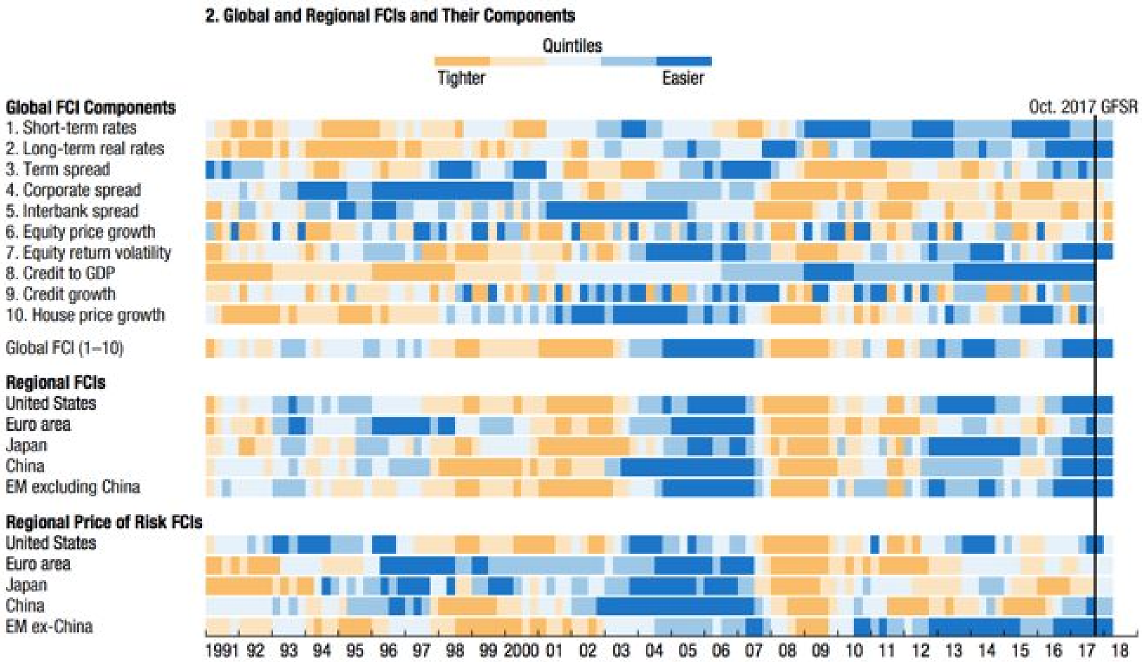
This makes gold vulnerable…. Especially when we consider the conditions its had over the last year to rally but yet has still failed to breakout of its range.

The setup has been perfect for a gold bull; the dollar puked nearly 15%, we've had a domestic political drama at home that'd make cast members of the Jersey Shore blush. We've seen rising geopolitical tensions in the form of threats of trade war and even nuclear strikes. We've even seen the US military bomb Syria. AND... the "rise of inflation" narrative has come back front and center.

But yet, all gold managed to do was a measly little bull trap spike above its 3-year neckline.

And now it seems we're moving from a perfect environment for a gold rally to a… well, the opposite of that.

Not only are rates going up but it looks like we're beginning to see the end of the global synchronized growth that we've enjoyed over the last 18-months.

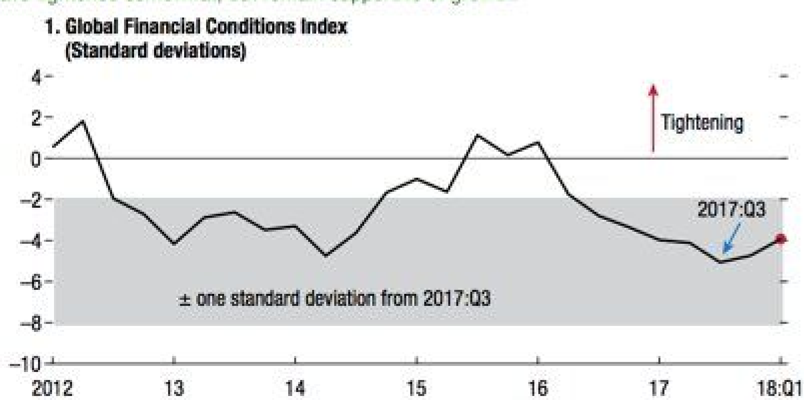


The above is the global and regional financial conditions tracker from the IMF. The blue indicates easy liquidity, which is bullish for risk assets and bearish the dollar — which in turn is bullish gold.

But this second chart, also from the IMF, suggest that we've already seen peak global liquidity and should expect tighter conditions going forward (ie, less blue and more orange in future prints on the chart above).

Figure 1.1. Global Financial Conditions

Global financial conditions have tightened somewhat, but remain supportive of growth.



The price of risk is low, markets are buoyant, and leverage is high across both advanced and emerging market economies.

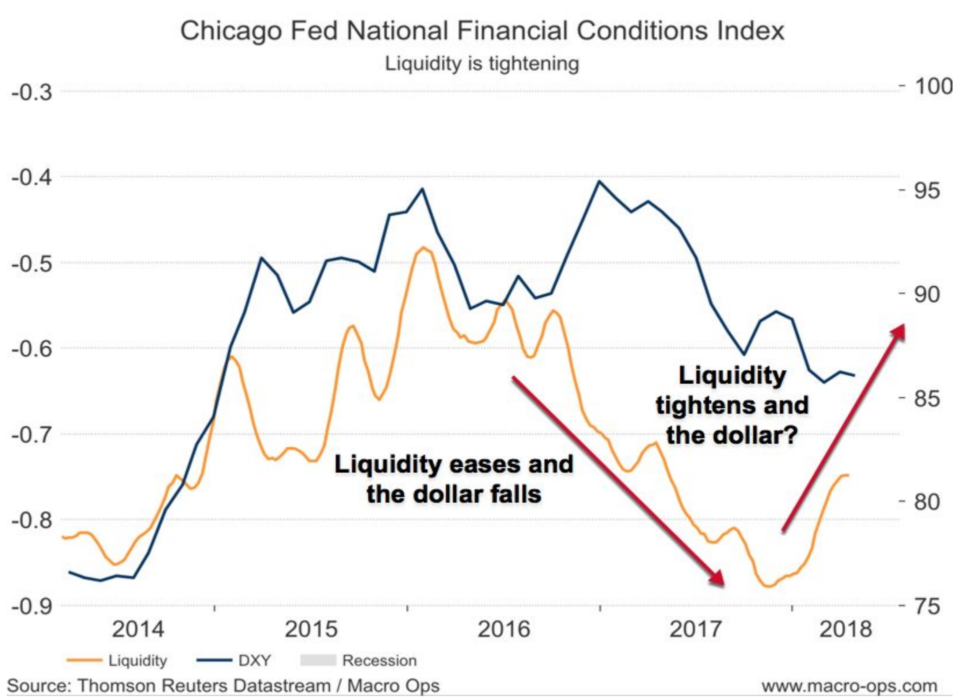
And we’re seeing the start of this global tightening in indicators across the board. Below is the Global FMS Macro Indicator from BofAML. It’s moved from bullish to neutral territory.

Exhibit 16: BofAML Global FMS Macro Indicator

* based on YoY chg in inflation exp, capex, risk appetite, cyclicals vs defensive sector positioning and equity vs bond positioning
Source: BofA Merrill Lynch Global Investment Strategy, FMS, Bloomberg. Backtesting is hypothetical in nature and reflects application of the screen prior to its introduction. Past performance should not and cannot be viewed as an indicator of future performance. Disclaimer: The indicator identified above as BofAML Global FMS Macro Indicator is intended to be an indicative metric only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise relied upon by third parties for any other purpose, without the prior written consent of BofA Merrill Lynch Global Research. This indicator was not created to act as a benchmark.

Tightening global liquidity leads to rising perceptions of risk. Higher risk perceptions typically leads to a stronger dollar as the dollar catches the flight to safety bid.

This relationship between the dollar and liquidity can be seen on the chart below.

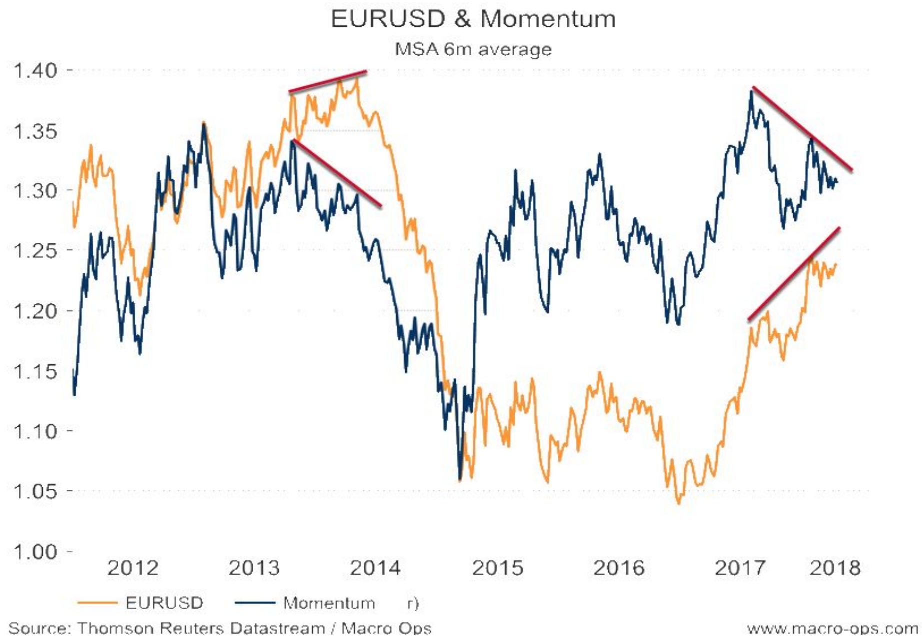


The interesting thing about this relationship is that it’s inherently reflexive. Looser liquidity leads to a lower dollar and a lower dollar leads to looser liquidity. Until a limit is reached and the process kicks into reverse. Then, tightening liquidity leads to a stronger dollar which leads to tightening liquidity and so on.

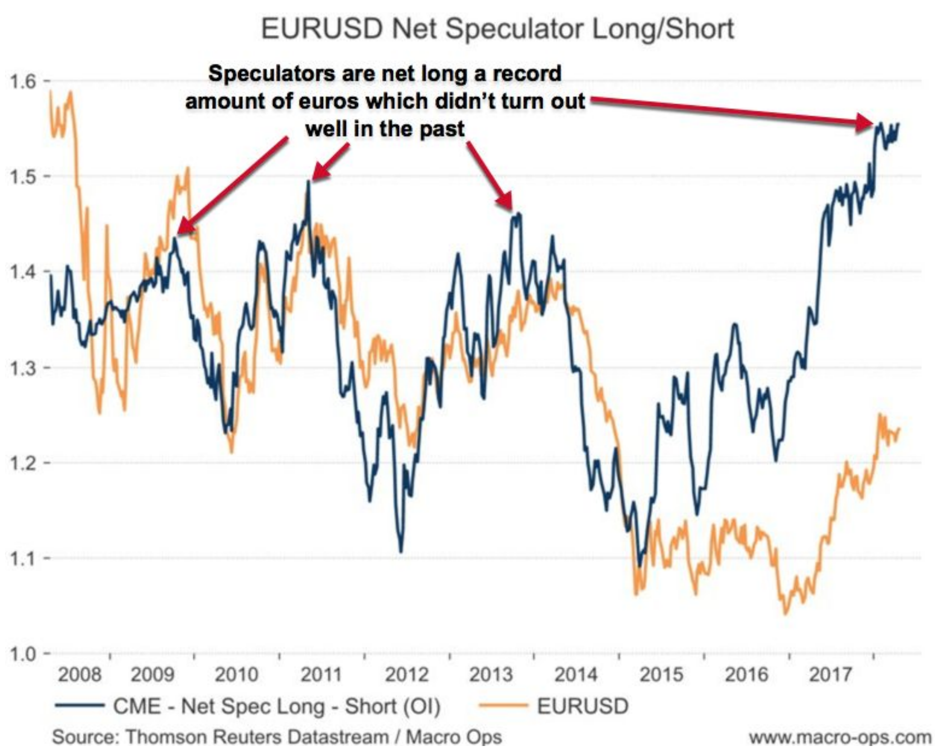
With this in mind, let's look at some dollar charts which are setting up for what looks like could be monster breakouts.

Here is EURUSD which is the most important pair to look at when analyzing the dollar since it makes up roughly 60% of the dollar trade-weighted basket (DXY).

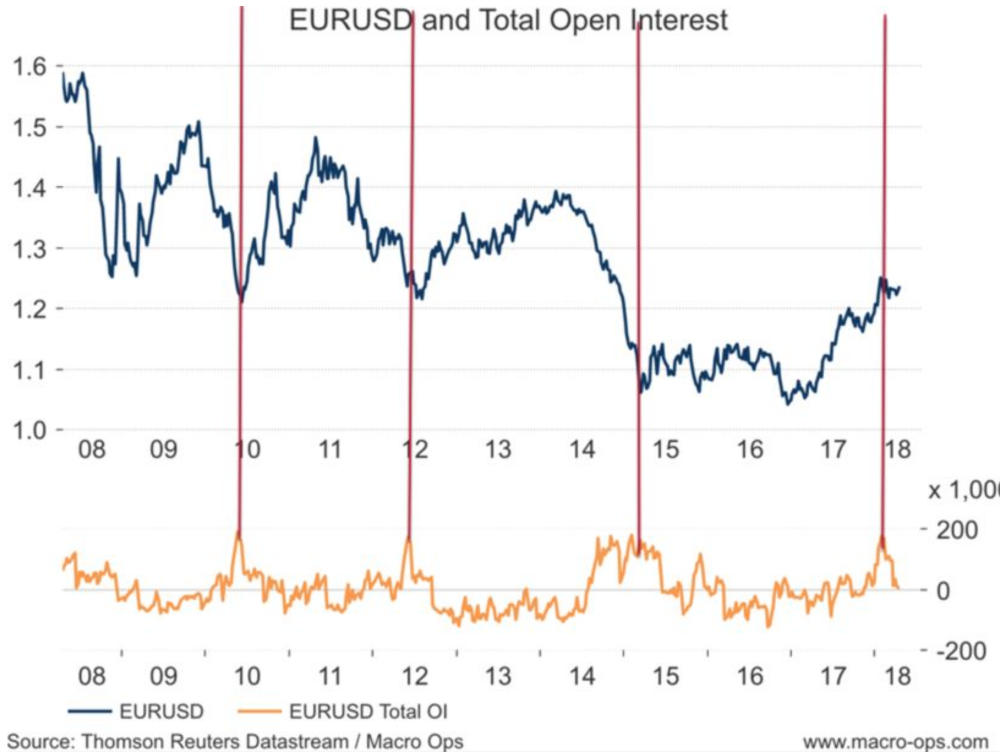
It has bumped up against its 10-year downward trendline; a major level of resistance. And momentum has diverged from recent price action, which often marks a turn in trend.



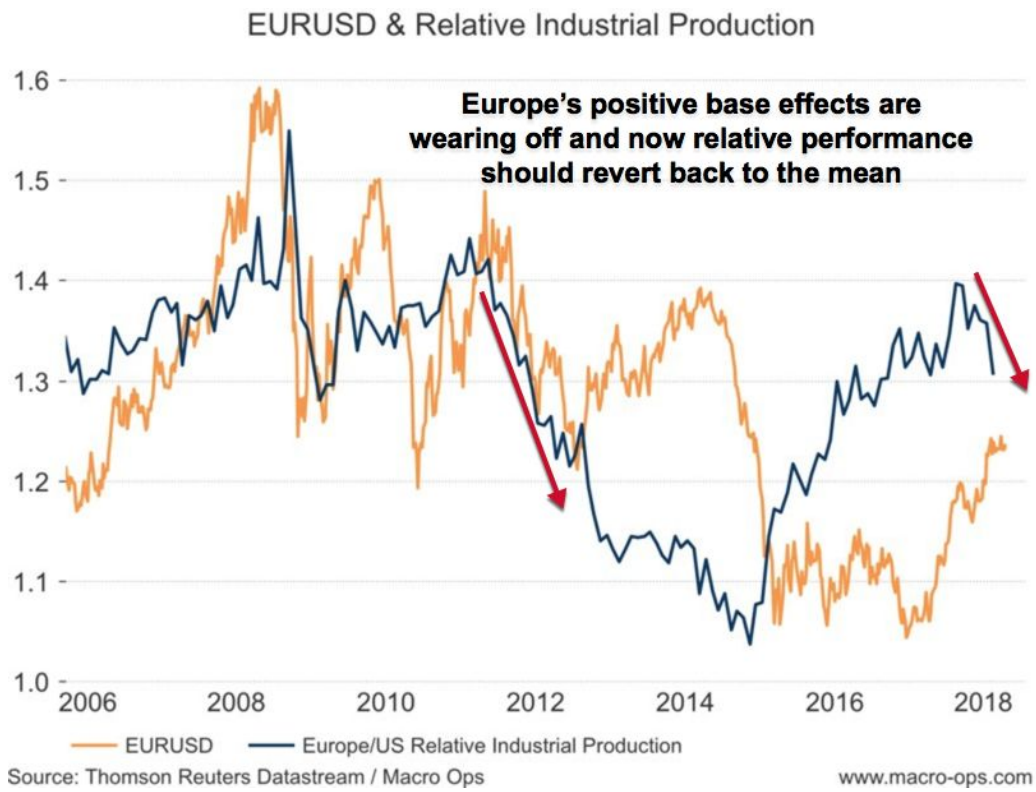
Speculators are net long a record amount of euros. Making positioning a major headwind for continuation of the current trend.



Spikes in total open interest show a fever in speculative activity which tend to mark major turning points.



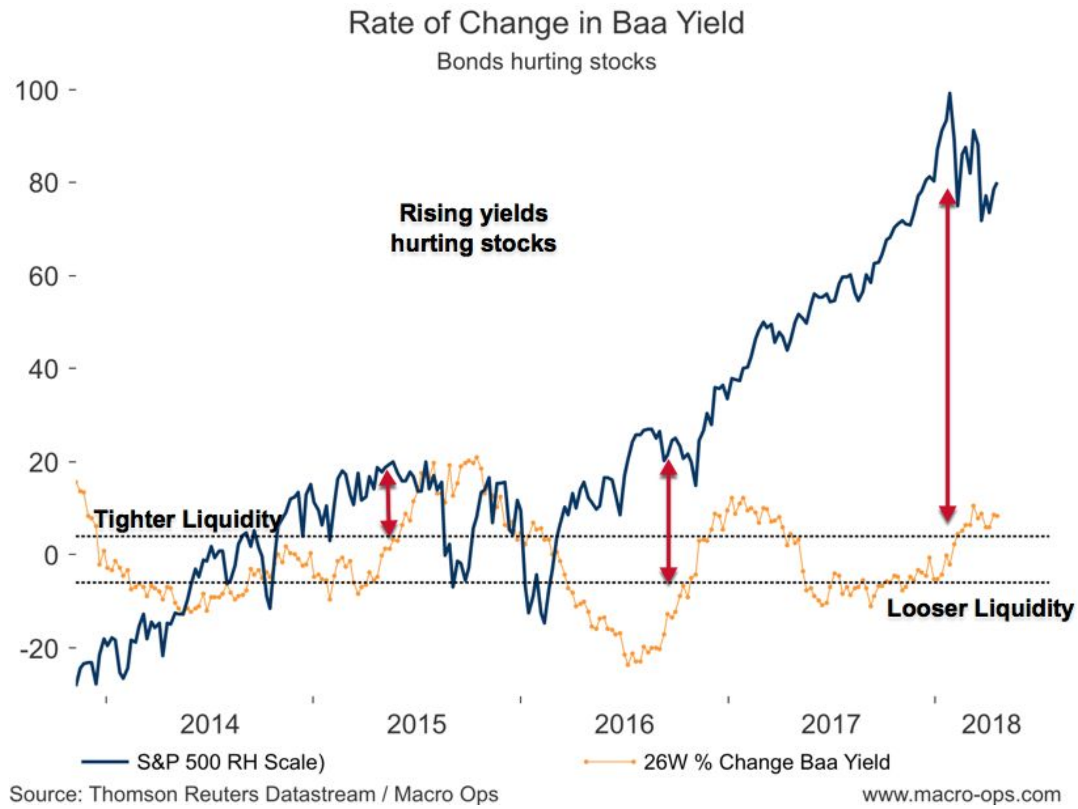
Plus we're seeing a change in trend in relative growth between the US and Europe. Shown below by the relative performance in industrial production. Not only are Europe's base effects beginning to wear off but a stronger euro is hitting their exports which is slowing growth.



The euro looks like it's setting up for a major reversal which means the dollar is setting up for a major reversal. And it's not just this pair. AUDUSD, USDJPY, and GBPUSD all look like they're ready for a big move.

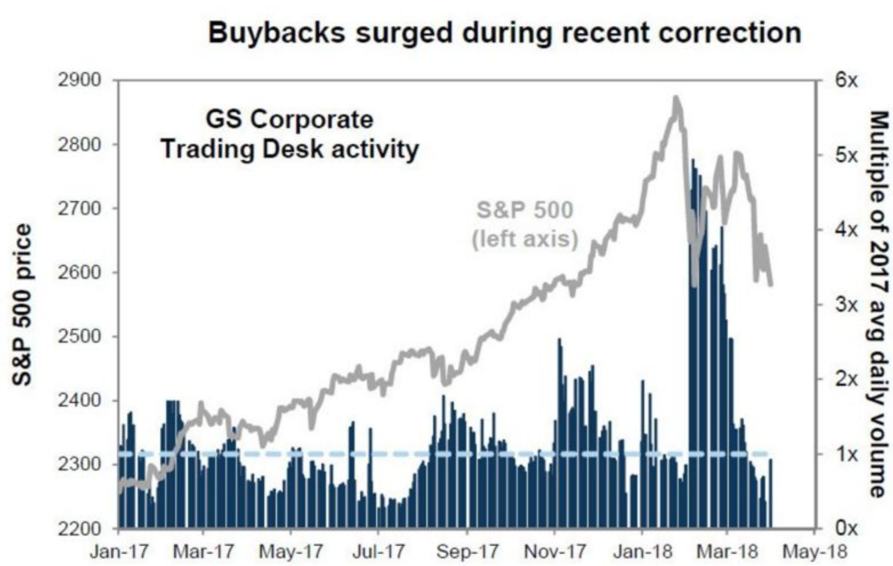
In the week(s) ahead we'll be keeping a close eye on these charts. If there's a breakout we'll want to move aggressively. Long dollar and short gold could end up being THE big trades for the year.

As for the broader stock market we should expect continued chop and vol. I think we could stay in this range for a few more weeks, or even months. The recent selloff in bonds (rise in yields) is a short-term headwind for risk assets and I'd like to see the rise in rates settle somewhat before adding to our long equity book.



The good news is it's likely that most of the recent selloff in bonds is due to US companies converting some of their treasury holdings into cash so they can continue to ramp up their buybacks.

We can see in the chart below that companies have been using this selloff to buy back their shares. And buybacks are expected to continue to rise to record levels this year.



This bull market is unlikely to end for at least another 18-24 months. But as we progress into the latter innings of this cycle we should expect to see a greater dispersion between stock returns and a narrowing market — an increasing number of losers.

Because of this, I think it's time that we begin slowly building up our short book in order to hedge out our longs. We want to look for companies with leveraged balance sheets and deteriorating fundamentals that make them more vulnerable to rising rates.

I'm considering taking another swing at TSLA which technically looks like it's ready to self-immolate. And IBM also looks like a potentially interesting short here. We'll be looking at these and plenty of others over the next few weeks. If you have any intriguing short ideas, please shoot them our way.

Portfolio Update continued...

We quickly reviewed a number of our holdings last week and today we'll go over the remaining positions.

Limbach Holdings (LMB), an under the radar HVAC construction and service company that we've been involved with since last September continues to do a whole lotta nothing.

The long thesis for this company was simple. It's an overlooked company that trades at very low relative multiples to peers. It has a growing backlog and an increasing revenue share from its higher margined service business. And a number of very smart small cap value HF managers are large holders of the stock.

But there's also some potential red flags. The way they account for adjusted earnings appears to be somewhat aggressive and makes their numbers appear to be better than they *may* actually be. This could be a result of the company being a recent SPAC and so has a lot of one-time expenses from going public. I personally don't have a lot of experience in SPAC specific accounting norms, so this could just be something I'm misreading — or not.

Either way, we only have a very small probing position on and we'll cut if the stock trades below our $11 risk point.

Yatra Online (YTRA) remains one of my favorite trades. Its numbers last quarter were strong and the chart continues to base. There appears to be a large liquidity ceiling around the $7.75 range (marked by the red line below). Each time price hits this range, large offers flood the market and push the stock back down. Once the stock finishes digesting this large offer we should see it begin to advance.

The rest of our book consists of DOTM trades. As we explain in our DOTM Guide, these trades are meant to have a high loss rate but big payout. That means we should expect the majority of them to go to zero — which is why we size small — and we only need to win big on one or two to pay for the rest.

And because the prices of these positions fluctuate so much, there's little benefit in paying attention to their weekly/monthly value. We have a year + on these positions and so should set them and forget them.

But out of the current positions, I think Cameco (CCJ), Fiat Chrysler (FCAU), and JD.com (JD), and Micron (MU) have the best chances of ending up in the money.

The uranium market finally looks to be heating up again. There's been some interesting developments with Russia, the largest miner and refiner of uranium, threatening to cut off supplies to the US in response to Western sanctions. In addition to this increasing geopolitical risk we're also just seeing old fashioned supply and demand come back into balance.

CCJ just broke out of a 1yr+ long symmetrical triangle. Uranium will be an interesting market to watch over the next few years.

FCAU is now up roughly 120% since we first recommended it in our April 17' MIR and CEO Sergio Marchionne continues to do a great job of creating shareholder value by selling off non-core assets and growing the main business. The value thesis for this company still stands even after its impressive run. I think FCAU can be a $30+ stock by the end of this year. Our DOTM calls are currently up 292%.

Both MU and JD are in the middle of corrections. JD's chart will begin to worry me — solely from a technical standpoint — if it trades much lower from here. But currently, I view these ranges to be good buying opportunities for both.

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

- Alex

Macro Ops Portfolio			YTD	Inception (16')			
NAV	$2,642,745		-2.01%	31.54%			
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	$2,860.00	$18.00	$12.04
Equity	JD	5,867	$44.74	$36.00	$8,448.48	$72.00	$37.44
Equity	Interactive Brokers IBKR	1,800	$41.71	$64.60	$16,560.00	$55.50	$73.80
Equity	W&T Offshore WTI	16,000	$2.18	$3.30	$36,480.00	$4.50	$5.58
Equity	United Insurance UIHC	13,000	$16.98	$17.45	$22,880.00	$20.00	$19.21
Equity	Trip Advisor TRIP	7,754	$36.46	$35.50	$47,454.48	$50.00	$41.62
Equity	Yatra Online YTRA	36,819	$7.24	Investment	~	$15.00	$7.34
Equity	MU Jan '19 70 Call	118	$2.12	$0.00	$32,450.00	$10.50	$2.75
Equity	BCS Jan '19 15 Call	574	$0.35	$0.00	$20,090.00	$3.50	$0.35
Equity	DB Jan '19 30 Call	670	$0.30	$0.00	$1,340.00	$3.00	$0.02
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	$28,404.00	$5.00	$2.63
Equity	JD Jan '19 70 Call	108	$0.92	$0.00	$2,160.00	$7.00	$0.20
Equity	TRIP Jan '19 75 Call	108	$0.89	$0.00	$2,376.00	$7.00	$0.22
Equity	CHK Jan'19 10 Call	750	$0.14	$0.00	$1,500.00	$1.00	$0.02
Equity	MS June '18 65 Call	126	$0.46	$0.00	$1,134.00	$3.00	$0.09
Equity	WMT June '18 120 Call	126	$0.51	$0.00	$504.00	$3.00	$0.04
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	1,028	1472	41.12%
Big Bet Macro	1750	863	887	49.34%
Volatility	750	165	585	21.96%

**Updated 4/22