A Macro Inflection Point

Trading Wisdom

> *Theoretical and empirical analysis of price-earnings ratios suggests that they are probably nonstationary. In fact, research shows that there has been no statistically significant relationship between a price-earnings ratio at the beginning of a year and the subsequent twelve and twenty-four month returns over the past 125 years. More bluntly, the historical-average price-earnings ratio provides investors little or no guidance about market returns over the typical investment horizon.* ~ Michael Mauboussin in his book *More Than You Know*

The PE ratio — the most overhyped metric — has probably cost me more money than any other fundamental measure of value. A high PE ratio kept me out of buying Amazon stock 9 years ago, along with many other great companies that I thought were "expensive" because of high price-to-earnings multiples. I was ignoramus...

To discern a business's *true* value, we need to look past the numbers and asses the company's operations so we can give the numbers context. Because metrics like P/E, P/S, and P/B are at best meaningless sans context and at worst, detrimental to one's P&L.

Besides, we live in a world of big data, complex screening algos, and satellites that can track the number of customer vehicles parked outside of a store in real-time. There's no edge in finding value through a PE ratio — the thousands of quant funds out there have arbitraged away the value in valuation metrics, the edge is now in developing context and a deeper understanding of what you're analyzing. Qualitative over quantitative. A low PE company is almost always low for good reasons… it's a melting ice cube or ticking leveraged time bomb etc…

Cash flow metrics provide a much more honest look at the health of a business and price to cash flow / cash flow yield are a much better screening metric for finding value. But even then, we need to look at the business as a whole to build context around the accounting data in order to discern the company's true value.

Macro: An Inflection Point - Bonds, Gold, and Currencies

The big macro instruments (ie, bonds, gold, the dollar) are all winding up tight and near critical inflection points. There's a big move coming… and coming soon.

I have my biases as to which direction they're each going to go but I'm trying to keep an open mind and stay tactical about it since the odds are pretty fairly balanced — especially since the President seems to be turning his focus back to currency manipulation and Federal Reserve policy which could have a big impact in the space.

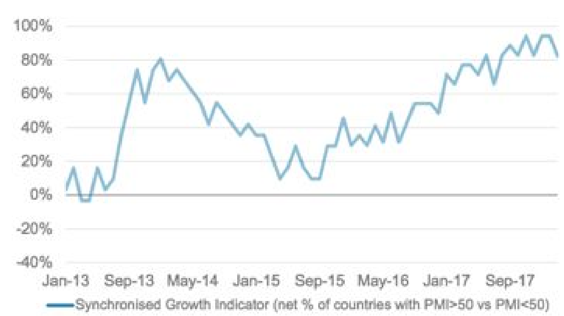
Let's start with the dollar. All of these charts are weeklies unless otherwise noted.

The US dollar (DXY) is in a tight consolidation range right up against its 7-year upward trendline.

Here's another look at the dollar, this time against the euro (EURUSD). EURUSD has been coiling in a wedge pattern since the beginning of the year. Coiling wedges like this tend to precede large moves.

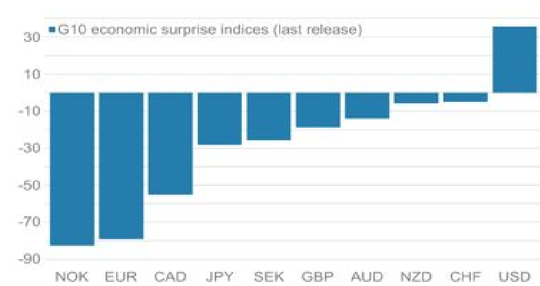
Speculators are holding record net long positions in the euro, according to the CoT data. This means that sentiment/positioning is now a major headwind for the euro. The euro is the largest weighting in the trade weighted dollar basket (DXY), making up roughly 60% of the index. Euro strength/weakness matters a lot for the dollar.

Exhibit 6: Share of countries with contractionary PMIs is increasing



Source: Haver Analytics, Morgan Stanley Research

Exhibit 5: Economic surprise indices positive for US, negative for rest of G10



Source: Bloomberg, Macrobond, Morgan Stanley Research

The share of countries with contractionary PMIs is increasing (charts via Morgan Stanley) and the US is the only G10 country now with a positive economic surprise index. If we're seeing the end of global synchronized growth then that's a positive for the dollar since the greenback tends to get a consistent bid in global "risk-off" scenarios.

I've been working on a post about the dollar which has turned into a bigger "Currency Analysis Framework" piece that I will get out to the group sometime this week. FX has been a dead market the last few years but I think that's about to change. We should see some big trends develop in this space, soon.

Bonds have also been trading in a tight range since the beginning of the year. Below is a chart of Treasury bond futures showing a completed major H&S pattern with a potential bearish pennant forming.

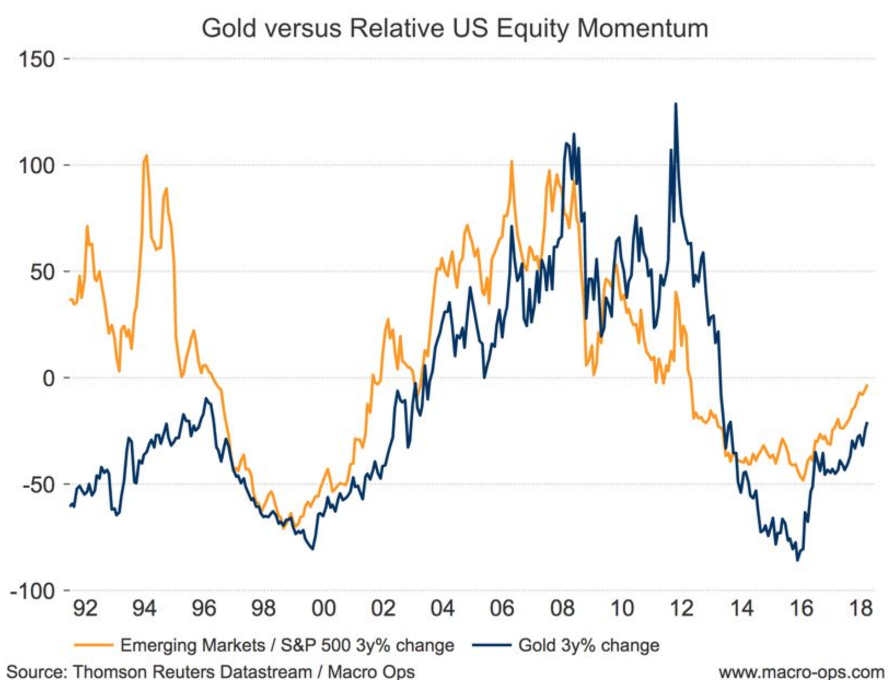
We're currently long bonds as a tactical hedge against our long equity positions. And we think there's a chance that bonds continue to hold up well due to positive seasonality (investors in Asia tend to up their exposure in foreign assets in April which is the start of their fiscal year).

But like currencies, we're trying to keep an open mind. It's possible that inflation surprises to the upside and bonds take off on another leg down.

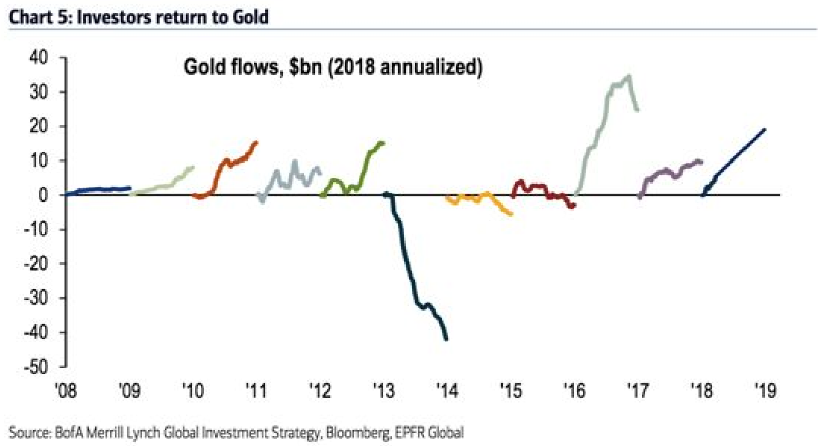
And then gold continues to consolidate along the neckline of its 5-year inverted H&S pattern.

Gold often leads the dollar and bonds at major inflection points so I'm watching this chart very closely. If we see a decisive weekly close above this neckline then that means it's probably time to close out our bond position and short the dollar, as well.

Emerging market equity momentum against the US remains supportive of the bullish gold case.



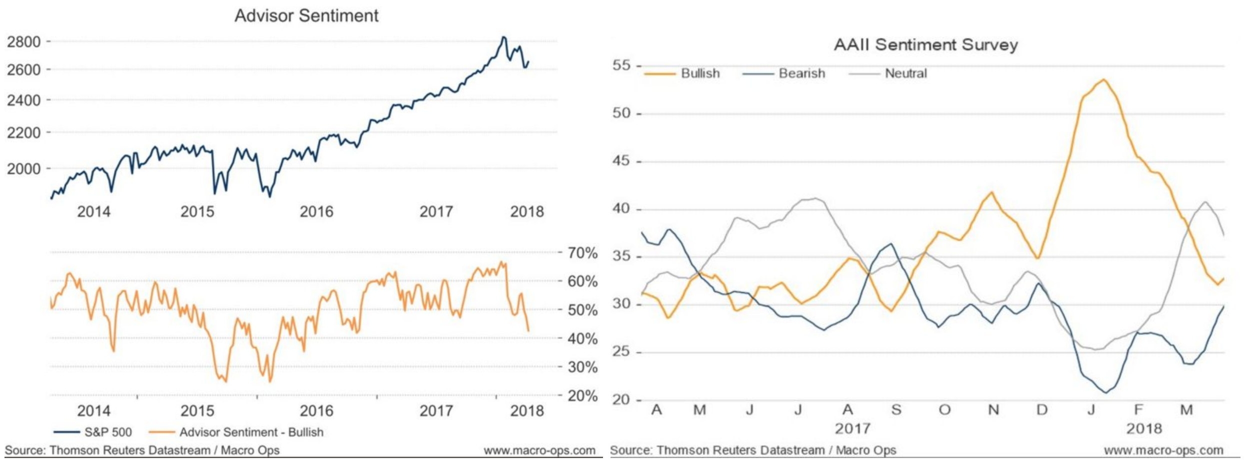
As well as the capital that's flowing into the barbarous relic.



If gold does close above the neckline we'll put on a sizable position in AU and/or NEM using DOTM calls. But until then we'll patiently sit and watch…

The market continues to chop around but breadth indicators have firmed up and, like the advance/decline indicator below, are now showing positive divergences. If this divergence continues we should see the market begin to move towards its March highs and the important 2775 level for the S&P.

Sentiment has also reset back to neutral levels so it's no longer a headwind for stocks.



Credit markets have also been strengthening which is another sign of improving market "risk-on" sentiment. Earnings are set to rise 18.6% y/y this quarter which may be the catalyst that gets the market trending again. But we could see more chop and another shakeout lower before that happens… we'll see!

I'm currently digging into internet/cable provider Charter communications (CHTR). John Malone of *The Outsiders* fame, owns a large chunk of the stock and there could be an interesting value case here as customers cut cable and move to higher margined internet/data packages. Plus, the company is going to benefit from a finished capital cycle, meaning better margins going forward. I'll be put out a report on my findings soon.

Portfolio Update

I want to go through our portfolio real quick and give some updates on our larger holdings. We'll cover half our positions today and the other half later this week.

Interactive Brokers (IBKR) continues its relentless march higher.

The stock is now up roughly 75% since our entry and our August MIR when we first recommended it. CEO, Thomas Peterffy, continues to execute like a boss and though the stock is well past our initial target we'll continue to stay long until it hits our trailing stop (now at $64.60) or if the fundamentals turn south. Earnings come out tomorrow and we'll relay any relevant news from the release.

WTI Offshore (WTI), is up roughly 130% since our entry 6-months ago when we first turned bullish on oil and the energy sector in our [September MIR.](#)

We're still bullish on the energy sector and think there's lots of upside left in this stock as well as a few others that we're looking at like Diamond Offshore (DO), which we're waiting to buy DOTM calls on.

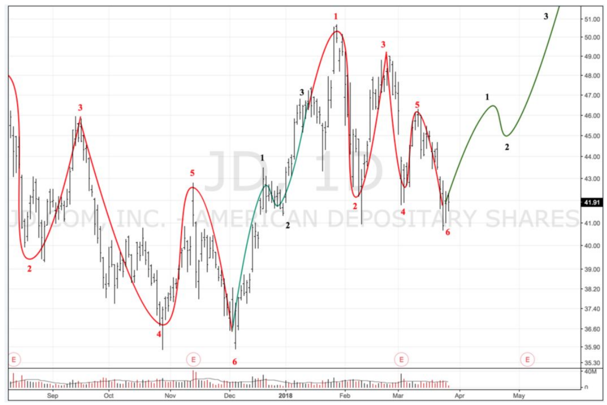
The major headwind in the near-term is the crowded spec positioning to the long side in the oil market. This makes crude, and crude related stocks, susceptible to a shakeout in the coming weeks. I'll be ready to up our positions on this theme once we see this. Until then we'll sit on this name and continue to advance our trailing stop.

JD.com (JD) continues to coil in a descending wedge pattern and is now close to 10% below our original entry point in January.

JD is one of my higher conviction investments. The runway for this company is massive. It operates one of the largest and most advanced supply chains in the world, which happens to be located in one of the fastest growing large economies (China) and run by a Founder/CEO who rivals Jeff Bezos in vision and skill.

This company does more in annual revenue than Facebook and is growing these revenues at roughly 40% y/y but its stock is only selling for 1x sales and 14x free cash flows. That doesn't make any sense…

Chinese stocks have been going through a distribution period since the beginning of the year. But I'm thinking the stock will follow a similar pattern to the charts below, which I talked about in a daily note a few weeks ago. The company reports earnings next month. A good print might be what it takes to get this thing moving again. I'll be aggressively adding to this position once technicals improve.



TripAdvisor (TRIP) is up a little over 10% since we entered in January of this year. While management has disappointed in how they've executed the company's transition to direct booking, we think the bigger picture remains bullish and the stock fundamentally undervalued (you can find our original write up on the company [here](#)).

The stock is currently forming a bullish wedge right above its 200-day moving average. We might consider adding to this position if their earnings next month show continued improvements.

United Insurance Holdings (UIHC) ran up as high as 20+% from our December entry but then settled back down and is now consolidating in a bullish pennant.

We entered this trade because of its strong technicals, fast topline growth, and lots of insider buying. I still think this stock will take out its previous all-time highs of $28.20 before the end of the year. But if it closes below its current range we'll cut it and move on.

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	$2,646,338		-1.88%	31.72%			
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	$6,902.50	$18.00	$13.51
Equity	JD	5,867	$44.74	$36.00	$22,235.93	$72.00	$39.79
Equity	Interactive Brokers IBKR	1,800	$41.71	$64.60	$11,700.00	$55.50	$71.10
Equity	W&T Offshore WTI	16,000	$2.18	$3.30	$26,560.00	$4.50	$4.96
Equity	United Insurance UIHC	13,000	$16.98	$17.45	$12,610.00	$20.00	$18.42
Equity	Trip Advisor TRIP	7,754	$36.46	$35.50	$38,925.08	$50.00	$40.52
Equity	Yatra Online YTRA	36,819	$7.24	Investment	~	$15.00	$7.34
Equity	MU Jan '19 70 Call	118	$2.12	$0.00	$40,946.00	$10.50	$3.47
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	$28,080.00	$5.00	$2.60
Equity	JD Jan '19 70 Call	108	$0.92	$0.00	$3,240.00	$7.00	$0.30
Equity	TRIP Jan '19 75 Call	108	$0.89	$0.00	$3,780.00	$7.00	$0.35
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
Rates	ZBM8 Bond Futures	14	$144.47	$142.375	$29,330.00	$150.5	$144.47
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	1,091	1409	43.65%
Big Bet Macro	1750	927	823	52.96%
Volatility	750	164	586	21.93%

**Updated 4/14