Timing is Everything

In this week's *Brief* we're going to talk EM, China, Gold, some tech stocks, and then give some updates on our portfolio. But first, a quick rant on the importance of timing in the game of speculation.

> There is timing in the whole life of the warrior, in his thriving and declining, in his harmony and discord. Similarly, there is timing in the Way of the merchant, in the rise and fall of capital. All things entail rising and falling timing. You must be able to discern this. In strategy there are various timing considerations. From the outset you must know the applicable timing and the inapplicable timing, and from among the large and small things and the fast and slow timings find the relevant timing, first seeing the distance timing and the background timing. This is the main thing in strategy. It is especially important to know the background timing, otherwise your strategy will become uncertain.
> ~ Miyamoto Musahi

> The flying eagle is able to destroy its prey due to its precise coordination of distance and time. The skillful warrior, during battle, avoids the enemy's high-spirited moments and attacks when the enemy is anxious.
> …
> When the gushing torrential water tosses stones pushing boulders, it is because of the force of its momentum. When the ferocious strike of an eagle, breaks the body of its prey, it is because of the timing of the strike. Thus the forces and momentum of the adept in warfare are so overwhelming and ferocious and his timing of engagement is precise and swift. ~ Sun Tzu, "The Art of War"

Timing is a critical aspect of the game we speculators play. **It's one thing to have the correct theory but if you're out of alignment in your timing and application of that theory, then you're no better off than if you were wrong.** Jesse Livermore put it like this:

> *The way to make money is to make it. The way to make big money is to be right at exactly the right time. In this business a man has to think of both theory and practice. A speculator must not be merely a student, he must be both a student and a speculator.*

Expectations need to match up with timeframes. **In markets, there are cycles within cycles within cycles, and the correct action for any speculator depends on one's temporal perspective.**

The timeframes we choose to act in should be in accordance with our analytical framework and edge. For example, a significant edge for many long-term value investors is their ability to think and operate on a longer time horizon than the majority of the market. Here's Joel Greenblatt on the topic:

> *Legg Mason's Bill Miller calls it time arbitrage.* ***That means looking further out than anybody else does.*** *All of these companies have short-term problems, and potentially some of them have long-term problems. But everyone knows what the problems are.*

At MO, we operate within two primary timeframes. These are:

1. **Strategic:** This is the primary trend that's driven by long-term factors and from an operational perspective, is at least a 12m+ timeframe.
2. **Tactical:** These are countertrend moves to the broader cyclical direction and these typically last anywhere from 1 month to a year.

What does this mean from a practical standpoint?

It means that these are the two primary timeframes that we focus are trading and research on. Like I said, there are cycles within cycles, and there are actionable trades at much shorter periods, such as intraday and 1-2 weeks. But, our analytical and execution edges are diminished at these shorter intervals.

The majority of our money will be made at the strategic level. The simple reason for this is because these are the longer more powerful directional trends. To again quote Livermore:

> ***I began to realize that the big money must necessarily be in the big swing.*** *Whatever might seem to give a big swing its initial impulse, the fact is that its continuance is not the result of manipulation by pools or artifice by financiers, but depends on underlying conditions. And no matter who opposes it, the swing must inevitably run as far and as fast and as long as the impelling forces determine.*

The Marcus trifecta of macro (fundamentals), technicals, and sentiment (positioning) drive price action at all the various timeframes. But, the further out in time you go the more the underlying fundamentals matter and the shorter in time you go, the more important things like technicals, sentiment, and positioning become.

You may ask the question: why even operate at the tactical level at all? Why not focus entirely on the strategic level since those are the more powerful trends?

There are two reasons for this **(1)** is that tactical countertrends can last a long time, up to 12m. An example of this is the outperformance by emerging markets vs the US last year. It not only hurts our performance to sit that out but it is also extremely psychologically taxing and **(2)** playing high conviction countertrend moves at the tactical level is a good hedge against our own fallibility (ie, the chance that our opinions on the strategic trend direction are wrong). This keeps us from being too exposed to the wrong side of the market at major turning points.

These are of course personal choices, but this is the best mode of operation that we've come up with which aligns with our framework and approach to markets.

The difference in how we execute trading between the strategic and tactical levels come down to position sizing and risk/trade management.

Naturally, since tactical trades tend to be less convex than strategic ones, we'll size smaller and hold fewer positions. We'll also be be tighter with our risk points and quicker to take profits.

I'm writing about timing and the differences between strategic and tactical **because I think we may be seeing a tactical countertrend setup forming.**

To refresh, our current appraisal of the strategic conditions are:

- We're in the mid-to-late part of the cycle, with the bull market to likely run for another 2+ years.
- The primary trend will continue to be the US market outperforming the rest-of-the-world (RoW).
- This is due to:
  - A slowing and deleveraging China which will have ripple effects throughout the world.
  - A tightening Fed which the market continues to underprice.
  - A strengthening dollar combined with large amounts of global dollar denominated debt will continue to act in a positive feedback loop on tightening global liquidity.
  - Emerging markets have already maxed out their share of global exports and are BoP constrained.

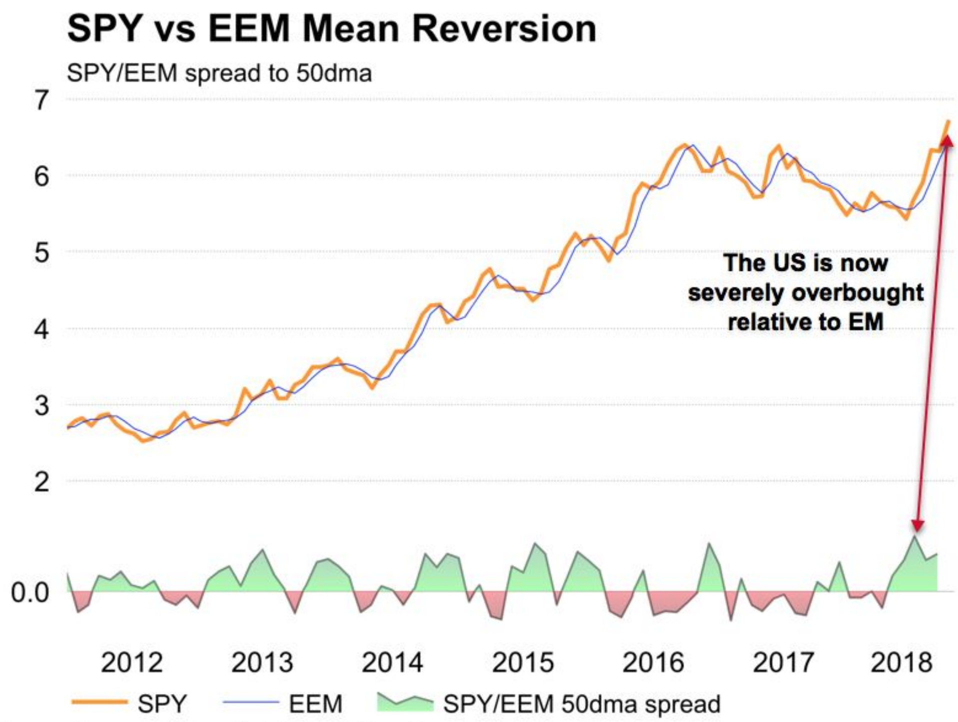
These macro fundamentals are unlikely to change anytime soon which is why this will remain our strategic positioning until a number of the above variables clearly shift.

Tactically speaking though, the market is beginning to look very different. Remember, **at the tactical level markets are driven more so by technicals, sentiment, and positioning than fundamentals,** and so these are the things we need to focus on when looking to place a tactical trade.

And here's what I'm seeing at the moment.

Technicals: The chart below of the MSCI Emerging Market etf (EEM) shows that price action has bounced off a significant 11-year line of support (the chart below is a monthly).

US stocks are now severely overbought relative to EM. The chart below shows SPY vs EEM and its subsequent spread against its 50dma. When US stocks outperform EEM by a lot over a short period, this spread widens and like a rubber band it wants to snap back and revert to its mean (the 50dma).



Source: Thomson Reuters Datastream / Macro Ops

EEM is heavily weighted to Chinese/Asian stocks (particularly Chinese tech stocks), with Tencent being its largest holding at 4.6% (it's 7% if you include Naspers which is mostly Tencent) of the index. So when looking at EEM you need to look at the technical picture for TCEHY, TSM, Samsung, BABA, BIDU etc…

And the technical picture for many Asian stocks, and in particular Tencent (TCEHY), looks strong.

The chart below shows that Tencent's RSI is now at its most oversold level ever. And price recently pierced its lower bollinger band, signalling extreme oversold conditions. In the past, when Tencent's price hit its lower BB the stock saw a significant rally (highlighted in yellow on the chart below).

China’s A-share market (ASHR) is down over 30% since its most recent high in the fall of last year and is now deeply oversold.

Asia focused market research shop, CLSA, shared in a recent note that according to their PB-model, that "**if history repeats the MSCI China A index now offers a 100% hit rate of at least a positive return over the next year with the historical average upside being 69%.**"

And Deutsche Bank also [recently reported] that China's so-called "National Team" may be stepping in to put a floor under Chinese stocks. They write:

> *We estimate total holdings of the National Team, a group of state-backed institutional investors set up during the sharp stock market correction in mid-2015, amounted to Rmb 1.24trn, c.5.5% of the A-share free float market cap, as of end-June 2018. If the National Team were to resume its strong support for A shares, there could be positive spillover effects on offshore markets.* ***Several signs from recent weeks suggest the National Team is on the cusp of lending support to the current fragile stock market,*** *especially given the latest US tariffs on USD 200bn of Chinese goods.*

Sentiment/Positioning: Measures of short-term sentiment and positioning have clearly shifted on EM which suggests that odds now lie in favor of a period of short-term EM outperformance.

The latest BofA Fund Manager Survey, which is one of our favorite reports on sentiment and positioning, shows how much both have shifted since the beginning of the year when EM was a crowded long consensus trade.

Here's Urban Carmel's, of the Fat Pitch Blog, summarizing the latest report (emphasis mine):

> *Fund managers came into 2018 very bullish, with cash levels at 4-year lows and allocations to global equities at 3-year highs.*
>
> *9 months later,* ***global equity allocations are nearly the lowest since November 2016. Moreover, cash balances are high. Globally, investors are relatively bearish.*** *How can this be?*
>
> *The reason is mostly outside of the US. While US equities are at all-time highs, both European and emerging markets are down in 2018. That has impacted investors' regional allocations in an important way.*
>
> *After being out of favor for 17 months,* ***fund managers are now overweight US equities by the most since January 2015.*** *It's at an extreme, and the US should underperform.*

Fund managers are now underweight emerging market equities by the most in 2-1/2 years; the region is now a contrarian long. *Europe is neutral, as are global bonds.*

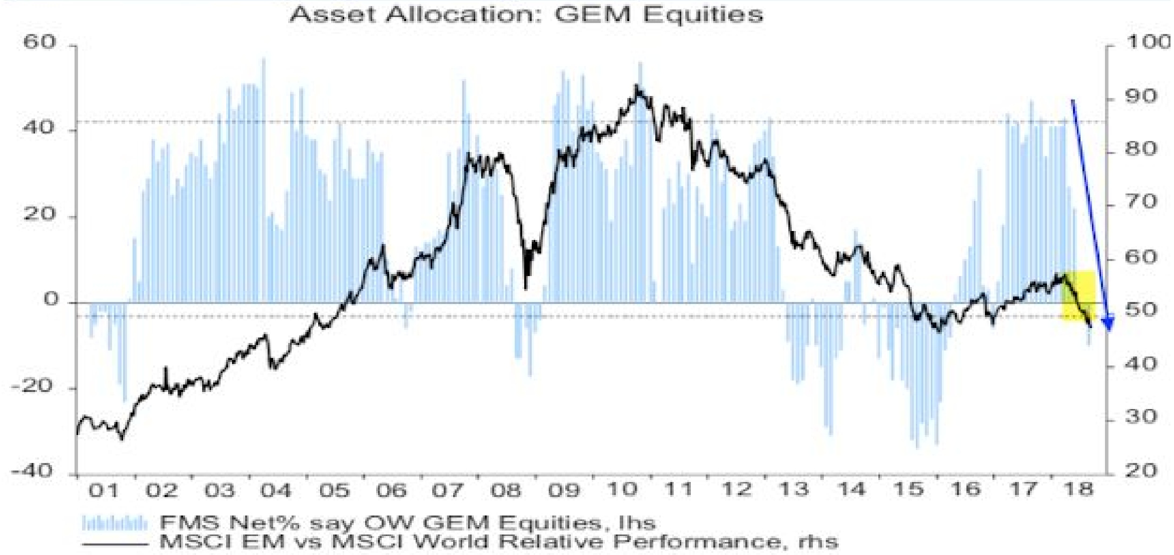
Here are the relevant charts from the report.

Fund managers are now very long US stocks, cash, and REITs and very short EM, UK, and materials and energy stocks.

The percentage of respondents who say they are overweight US equities is now at levels that have corresponded to temporary peaks in US vs RoW outperformance.

And investors are the most underweight EM stocks since the start of 2016.

Exhibit 29: Net % AA Say they are overweight GEM Equities



Source: BofA Merrill Lynch Global Fund Manager Survey

BofAML's latest "Flow Show" report contains the following evidence in support of a tactical EM bounce.

> **Bad EM breadth**: combo of price capitulation (80% of EM indices <50- & 200-day averages) & flow capitulation (EM outflows >1% of AUM) have past 8 occasions since 2009 (Chart 6) led to big EM rallies; 19 of 23 EM indexes now big oversold but we need $11bn EM equity outflows ($1.2bn this week; $1.6bn out of EM debt).
>
> **Bear price action**: global stocks ex US tech -15.5% from Jan highs; CRB industrial metals -18.2% from April highs; global IG bonds annualizing -5.5% loss, worst since '08.
>
> **Bear positioning**: BofAML Bull & Bear Indicator high 8.6 on Jan 31st, low 2.3 Jul 19th, now 3.6; watch Oct FMS cash levels Tuesday…rise to 5.2% from 5.0% = contrarian risk positive.
>
> **Market long cash, US stocks, IG bonds, crude**: BofAML private client allocation to T-bills highest since Sept '08, BofAML FMS US equity OW >1Sd above norm, IG bond inflows $56bn YTD, WTI crude futures net long +1.8sd versus history (Chart 7)
>
> **Market short gold, Treasuries, EU equities, HY**: GWIM private client gold ETF asset allocation 0.9%, new low; Treasury futures net short -2.6sd versus history; $57bn EU equity redemptions past 6 months; $48bn HY bond outflows YTD.
>
> **Pain trades**: bearish price action & positions say September pain trade up via EU & EM stocks; inflation & China say Treasury bears to be disappointed.
>
> **Since Lehman**: biggest flow trends since GFC are Passive>Active ($2.5tn into passive vs. $2.0tn out of active - Chart 3) & Bonds>Equities ($2.2tn into bonds vs. $0.7tn into equities since '09 - Chart 4). Flow winners since 2008 illustrate investor desire for safe haven (cash, gold), yield (EM debt, MLPs), growth (tech) & QE (banks & Japan) themes.

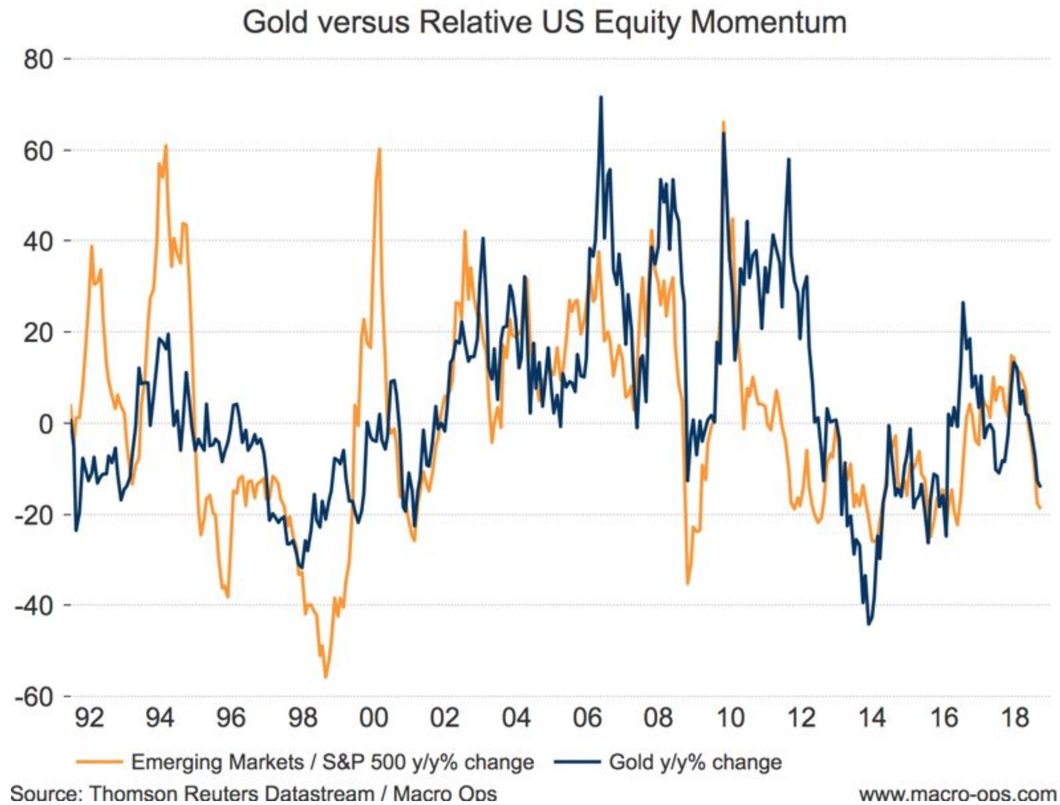
In light of the above, I think we should expect a short period of EM relative outperformance; likely lasting 1-2 months.

There's a number of ways we can position ourselves to profit from this move.

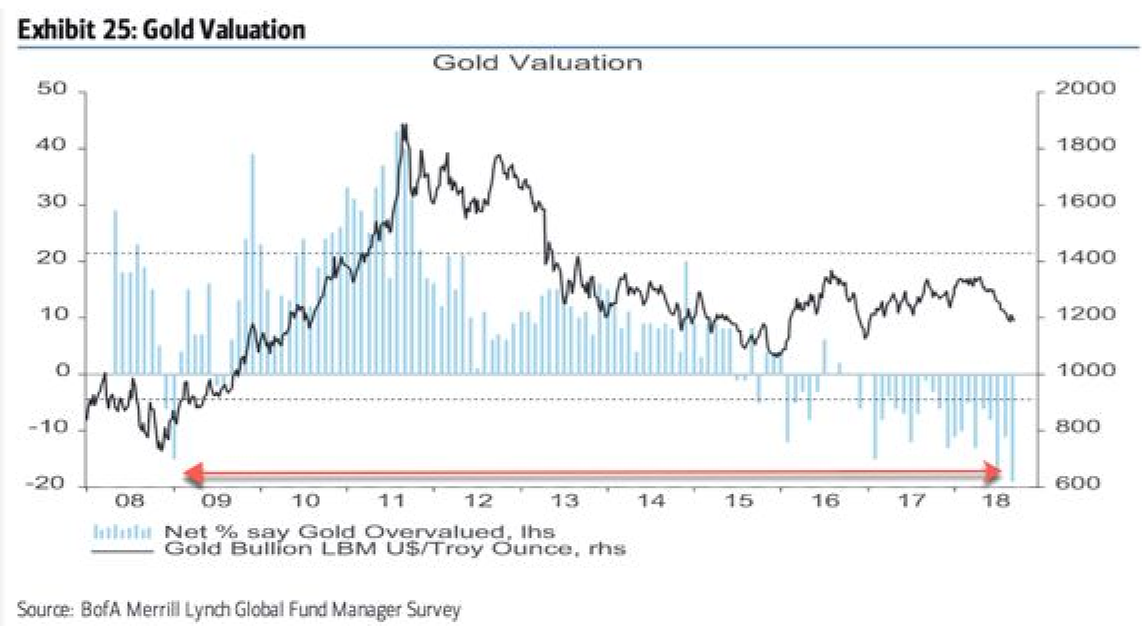
My preference is to go long a number of Chinese stocks that have strong technicals and fundamentals. My current favorites are TCEHY, WB, and JD (a company we've covered extensively and which is now trading at a ridiculously low valuation of 0.59x revenues).

There's also some interesting corollary trades in the metals space. Our long Platinum trade should continue to work well if EM does in fact outperform. And going long gold on a tactical basis seems like it offers a good risk/reward at these levels.

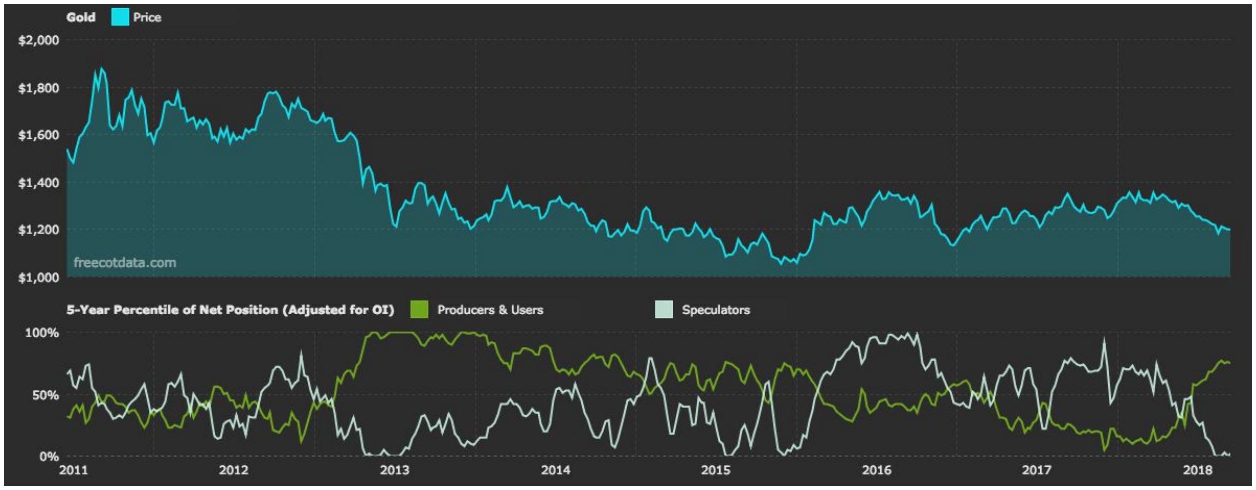
Gold reflects the world's marginal relative demand for 1 USD of liquidity. This is why the price of gold closely tracks the relative performance of EM stocks to US stocks, shown on the chart below.



Respondents to the BofAML survey also think gold is the most undervalued it's been in 17-years.

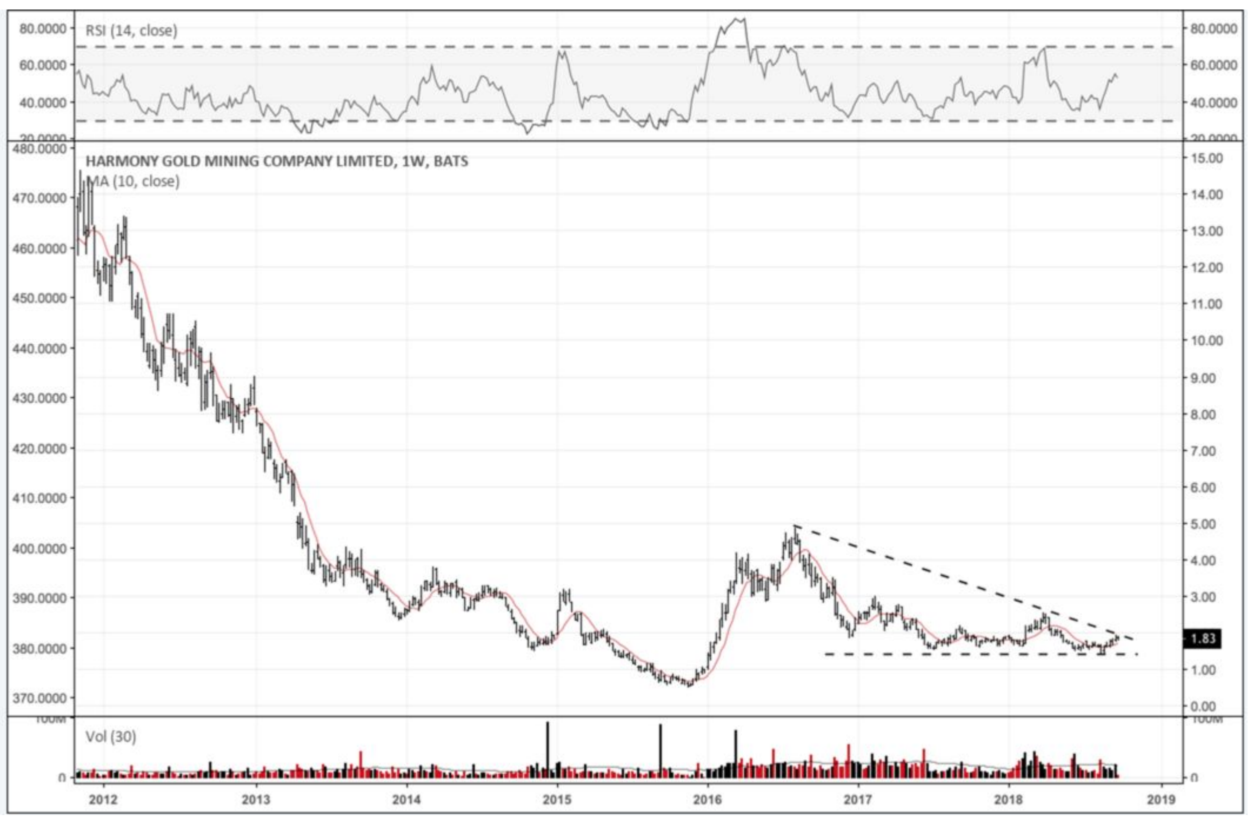


And speculators are extremely net short the yellow metal (chart via Free CoT Data).



We can play the long gold trade directly in the futures or by going long a miner. My favorite on a purely technical basis is Harmony Gold (HMY).

This is a good looking chart.



Portfolio update: Our largest position, which is Disney (DIS), finally looks to be taking off. We're looking at potentially adding some DOTM calls soon. You can get Jan 2020 calls struck at $160 for pretty cheap. This may be a nice way to add more leverage to our favorite trade.

Yelp (YELP) continues to move nicely. We're going to add to this position, either through more naked stock or some DOTM calls, or a combination of the two. Look for a trade alert soon.

Our position in Homebuilder (NVR) looks like it's going to hit its risk point. This trade is getting pinched by the rise in long-term rates, which is shifting sentiment on the housing market. I'm becoming increasingly bullish DM rates (I'll be writing about this more in the upcoming MIR) and so I don't mind cutting this trade. Though, I still love the company and will keep it on my watchlist for an entry at another date.

Finally, Spotify (SPOT), which we've been following for a while looks to be setting up. We're also looking at some DOTM calls on this one.

That's all I've got.

If you've got any questions for us in the meantime, let us know in the Comm Center.

Your Macro Operator,

Alex

Macro Ops Portfolio			YTD	Inception (16')			
NAV	$3,098,535		14.61%	54.23%			
Big Bet Macro							
Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target	Last Price
Equity	NVR Inc (NVR)	104	$2,765.58	$2,545.00	$4,048	$4,000.00	$2,583.92
Equity	Yelp (YELP)	6,667	$45.10	$40.65	$59,870	$80.00	$49.63
Equity	Stratasys (SSYS)	12,396	$24.76	$20.50	$31,610	$50.00	$23.05
Equity	Discovery DISCA	3,450	$28.09	$26.70	$17,526	$60.00	$31.78
Equity	Stitch Fix SFIX	1,750	$32.96	$27.00	$22,960	$60.00	$40.12
Equity	Advanced Micro AMD	3,718	$14.84	$19.00	$45,211	$25.00	$31.16
Equity	United Insurance UIHC	13,000	$16.98	$19.20	$28,470	$20.00	$21.39
Equity	Google GOOGL	332	$1,073.37	$1,100.00	$23,409	$1,400.00	$1,170.51
Equity	Disney DIS	5,694	$102.34	$108.50	$11,217	$150.00	$110.47
Equity	Yatra Online YTRA	36,819	$7.24	Investment	~	$15.00	$5.48
Equity	DAX December Futures	-2	€11,960.0	€12,420.0	€1,700.00	€10,600.0	€12,386.00
Equity	BABA Jan '20 110 Puts	150	$4.10	$0.00	$53,250	$20.00	$3.55
Equity	SPX Mar '19 3150 Call	19	$8.10	$0.00	$27,360	$80.00	$14.40
Equity	MU Jan '19 70 Call	118	$2.12	$0.00	$3,186	$10.50	$0.27
Equity	FB Jan '19 260 Call	35	$2.59	$0.00	$1,085	$20.00	$0.31
Equity	AMD Jan '19 28 Call	96	$0.40	$0.00	$59,808	$3.90	$6.23
Equity	BCS Jan '19 15 Call	574	$0.35	$0.00	$8,610	$3.50	$0.15
Equity	DB Jan '19 30 Call	670	$0.30	$0.00	$1,340	$3.00	$0.02
Equity	CCJ Jan '19 17 Call	236	$0.41	$0.00	$2,360	$5.00	$0.10
Equity	FCAU Mar '19 24 Call	360	$0.25	$0.00	$16,200	$2.50	$0.45
Equity	FCAU Jan '19 25 Call	108	$0.90	$0.00	$1,620	$5.00	$0.15
Equity	JD Jan '19 70 Call	108	$0.92	$0.00	$1,512	$7.00	$0.14
Equity	TRIP Jan '19 75 Call	108	$0.89	$0.00	$1,620	$7.00	$0.15
Equity	CHK Jan'19 10 Call	750	$0.14	$0.00	$14,250	$1.00	$0.19
FX	UUP Jan'19 27 Call	1,230	$0.13	$0.00	$6,150	$1.20	$0.05
Metals	Platinum Jan Futures	13	$817.9	$794.00	$24,440	$920	$831.60
Volatility							
Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target	Last Price

Risk Budget

	Total Allowed (In Bps)	Total Used	Total Available	Percentage Used
Master	2500	1,513	987	60.52%
Big Bet Macro	2250	1513	737	67.24%
Volatility	250	0	250	0.00%

**Updated 9/23