Inflection Points & a MAJOR Buying Opportunity

Merriam Webster defines an inflection point as “a point on a curve that separates an arc concave upward from one concave downward and vice versa.”

In market terms, it should be thought of as a tipping point where if a price range is crossed it’s likely to spur a cascade of buy or sell orders (essentially, the asymmetry of probable outcomes goes up significantly).

There are a number of markets, both in equities and currencies, that are near or at critical inflection points. This means there’s outsized opportunity for those of us paying attention and jump on the wave once the market tips its hand.

We’re going to go through the charts showing these inflection points, but first, let’s cover the upcoming news/events of the week that may act as the catalyst that drives the break one direction or the other.

- FOMC meeting on Wednesday where a rate hike is on the table
- China kicks off its Central Economic Work Conference on Tuesday and there’s chatter that there may be a big announcement

First, the FOMC meeting.

There’s not much new to say about this one. The Fed may or may not hike. President Trump and the market is certainly hoping for a no-hike announcement and a lowering of rate guidance going forward.

Stanley Druckenmiller and Kevin Warsh wrote an Op-ed in the *WSJ* this weekend calling for the Fed to halt its double-barrelled tightening (rate hikes + QT). Here’s the link.

The market is pricing in a significantly more dovish Fed in the year ahead. You can see on the chart below the much shallower path of rate hikes the market is now predicting, well below the FOMC’s last median dot plots (red line is avg FOMC predicted path and yellow is market’s recent pricing).

The market is now only pricing in one more rate hike in 2019.

This may or may not be the right call depending on if/when China hits the stimulus button. But… it seems a bit overdone to me; at least at the moment. The economy in the US is slowing but still running strong and I get the sense that the event echo from the GFC is driving this overreaction.

My base case is that the Fed hikes on Wednesday but lowers guidance significantly. But, we can't read minds so we'll just have to see.

Secondly, China's Central Economic Work Conference (link to a Bloomberg article about it).

President Xi is kicking off the conference, which marks the 40-years of reform and opening that was started by Deng Xiaoping, with a big speech on Tuesday.

The focus of the speech and conference is rumored to be on accelerating SOE reform, market opening, and supporting private business. But according to *Trivium China*, there's also growing speculation that Xi might announce significant fiscal spending.

This could be a big deal or just wishful thinking. We'll find out later in the week.

If/when China stimulates is the most important factor to markets right now. Even much more than the Fed, because Powell and team will key off the data and the biggest wild card which could affect it, is Chinese stimulus.

The more China's economy slows the greater the odds are that the CCP eases. And incoming data continues to support our China slowing thesis. Data from last week shows that:

- Industrial production growth slowed to just 5.4% YoY, down from 5.9% in October
- Retail sales growth decelerated to 8.1% YoY — the lowest growth rate on record

This is a wait and see macro variable. Xi and the CCP — like most of China — are a black box. Xi's speech tomorrow may give us some insight but with all things China, we have to see action and not just words. Like we've been saying, keep watching the M1 numbers for signs of stimulus.

This brings us to our first of the major critical inflection points. And that's the MSCI emerging markets index (EEM).

EEM is sitting on a 10-year trendline following a major breakout.

Here's a closer look.

The index is heavily weighted to Chinese/Asian tech names (Tencent and Alibaba being the two largest holdings).

I outlined back in September the many large structural problems facing emerging markets and where I thought the index is headed (lower). You can find the write-up here in the Brief titled *BoP Constrained*.

But, of course, another reckless injection of credit by the Chinese, similar to the one we saw in 16', would change this.

My base case is that China continues to announce market reform and stimulus measures but does not partake in the gargantuan sized stimulus needed to right the ship, at least until later in 19'. Of course, this is just my best guess and the actual data is all that matters.

Either way, EM is at a major inflection point. Whatever direction it breaks over the coming month will dictate the direction of its longer-term trend (next 6-12 months). EM stocks have been holding up much better than DM ones. Whether that's an indication of a bottom or just a pause before the real selling begins is to be seen.

Another point that has me thinking this period of EM outperformance may soon end is positioning data. The popular narrative right now is that the market is overly bearish EM stocks and that the worst is over. Especially, when late-cycle conditions are taken into account, along with high valuations, then buying EM here is a no-brainer.

But, the charts below via JPM show that investors are more heavily exposed to EM/Asia than the US relative to history.

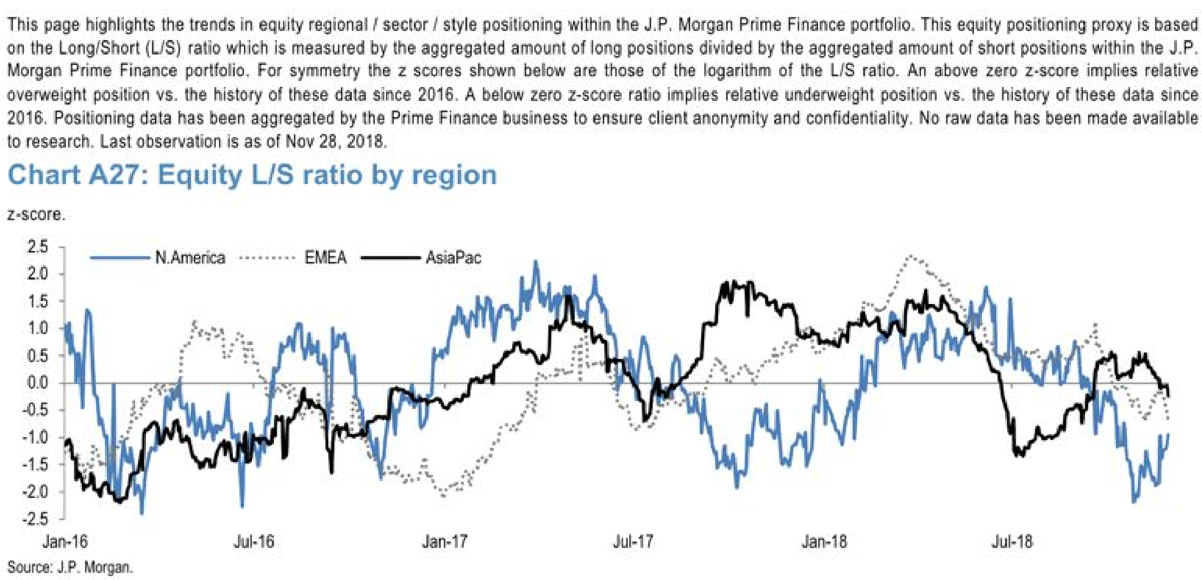


Chart A28: L/S ratio by sector in NA

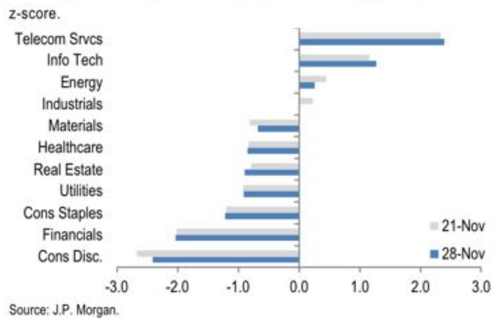


Chart A29: L/S ratio by style in NA

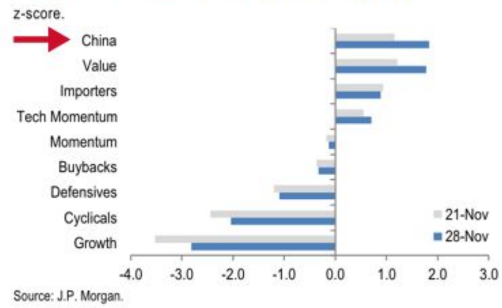


Chart A30: L/S ratio by style in EMEA

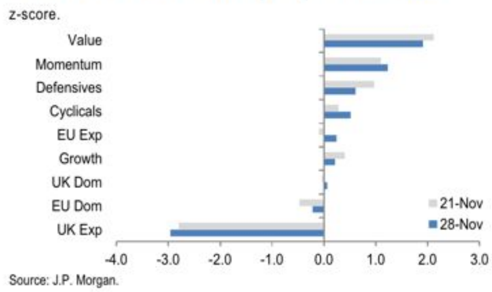
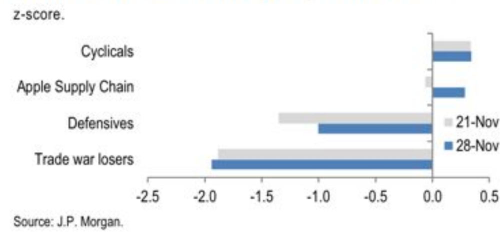


Chart A31: L/S ratio by style in APAC



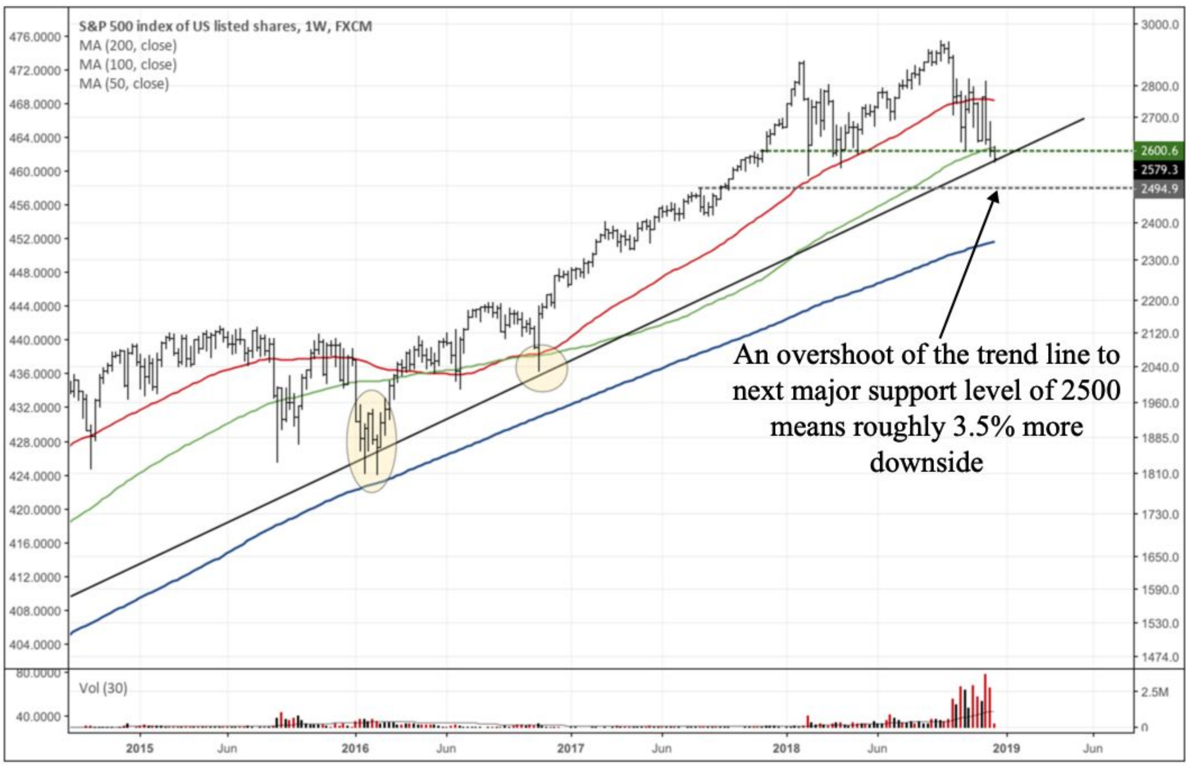
So maybe there's room for sentiment and positioning in EM to fall further…

I don't know. I still really like our BABA puts.

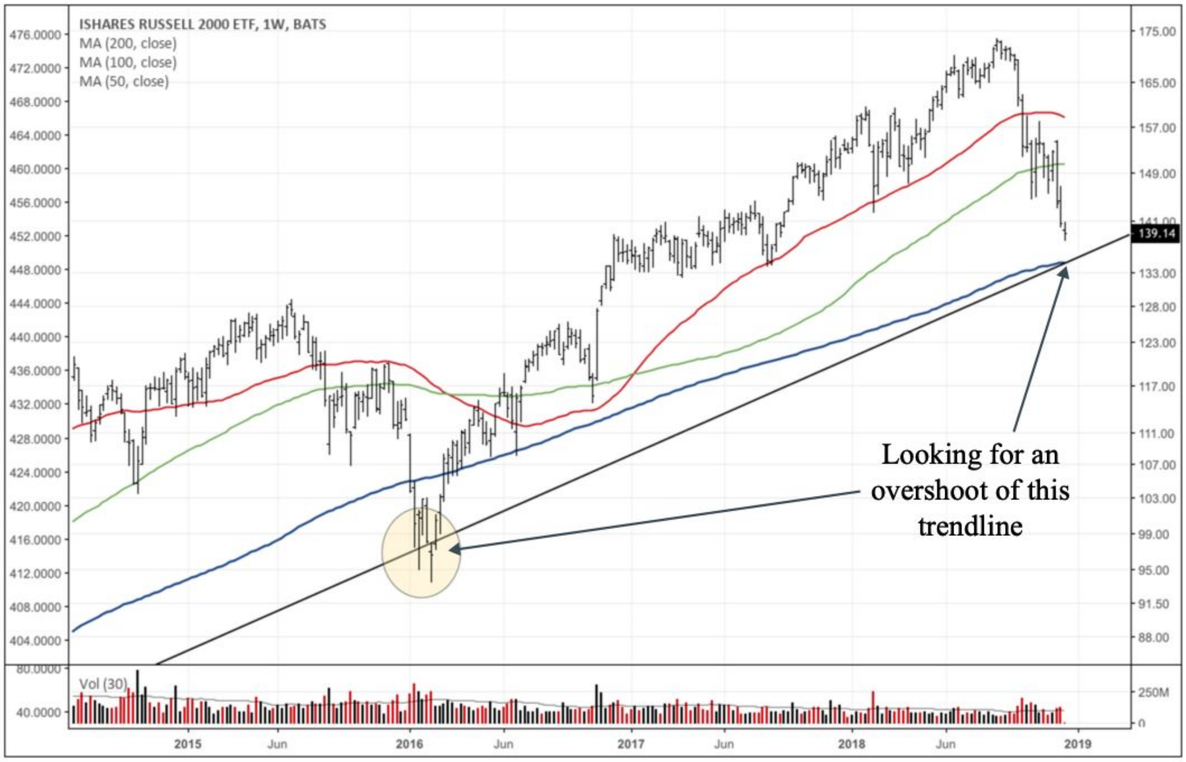
The US markets on the other hand, look a lot more constructive. I'm getting excited for the buying opportunity that's setting up.

Take the S&P for example.

It's now below the important 2,600 level and is right at its long-term trendline. As I write this, the market is selling off and VIX is bid. It looks like we're getting that capitulation selloff. I'm looking for the SPX to dump below the trendline in the coming day and perhaps sell off to the 2,500 level before reversing. Odds are that this is setting up to be a major bear trap, more on why that is, below.



Same thing with small-caps (IWM). They're getting close to the 200wma and long-term trendline. We should see a dump below followed by a quick reversal to regain the trendline.



The VIX is close to breaking out. We'll need to be quick to take profits if/when it does, as spikes tend to reverse fast. We'll send out an alert when we do.

We'll also likely take full or partial profits on our NVDA puts soon.

Micron (MU), another semiconductor company, reports earnings tomorrow. The semi index (SMH) is also sitting at a critical inflection point. MU's numbers will likely decide the direction of the next leg for the index.

Sentiment, positioning, and technicals ALL say that we're getting close to the bottom of this move. And the market is setting up for a monster rally (at least in US stocks).

Let's start with sentiment.

We're still waiting for the capitulation spike in bearish sentiment via the Investors Intelligence report, but we should get that this week.

Other indicators and signs of sentiment suggest that bearish sentiment is finally becoming near consensus.

BofAML's Bull & Bear Indicator is near "Extreme Bearishness" levels and should give a buy signal in the week(s) ahead.

BofAML Bull & Bear Indicator (B&B)

Our BofAML Bull & Bear Indicator ticks down to 2.6 (still close to a "buy" signal).

Chart 13: BofAML B&B Indicator (scale from 0 to 10)

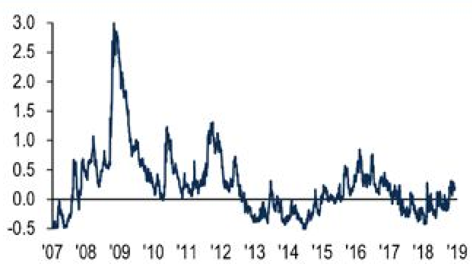
Source: BofA Merrill Lynch Global Investment Strategy

Table 4: Components of BofAML Bull/Bear Indicator

Components	Percentile	Sentiment
HF positioning	79%	V Bullish
Credit market technicals	55%	Bullish
Equity market breadth	9%	V Bearish
Equity flows	66%	Bullish
Bond flows	7%	V Bearish
LO positioning	30%	Bearish

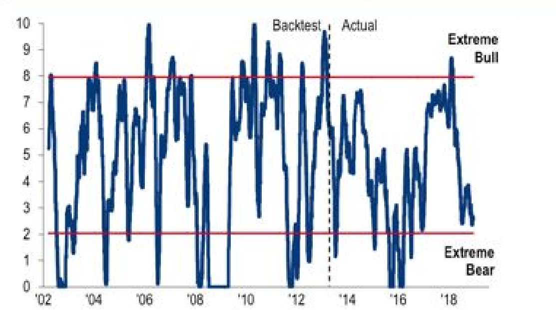
Source: BofA Merrill Lynch Global Investment Strategy, Bloomberg, EPFR Global, Lipper FMI, Global FMS, CFTC, MSCI

Chart 14: BofAML Global Financial Stress Indicator



Source: BofA Merrill Lynch Global Research

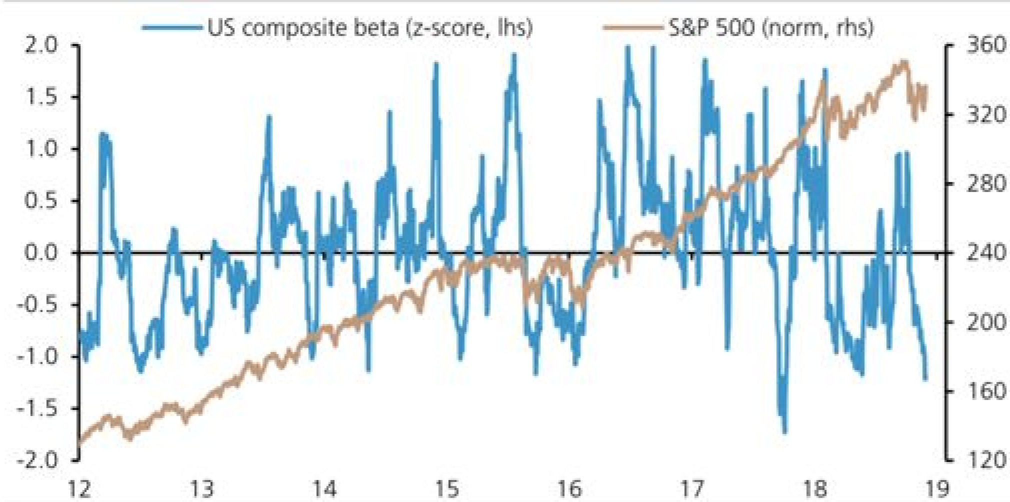
Chart 15: BofAML Bull & Bear Indicator history



Source: BofA Merrill Lynch Global Investment Strategy, EPFR Global, FMS, CFTC, MSCI

UBS's composite positioning amongst fund managers in US stocks show that fund manager holdings of US equities are near extremely oversold levels relative to history.

Figure 12: US composite positioning



Source: Bloomberg, UBS

The mainstream non-financial news is now predicting a market crash in 2019. The above is from the NYT's Lifestyle section of all places. This is NOT what you see at market tops.

Michael Santoli @michaelsantoli · 6h

"Lifestyle. Relationships. Society." And market timing?

Happy Sunday morning...

Ron Paul is back to making headlines pitching doom and gloom.

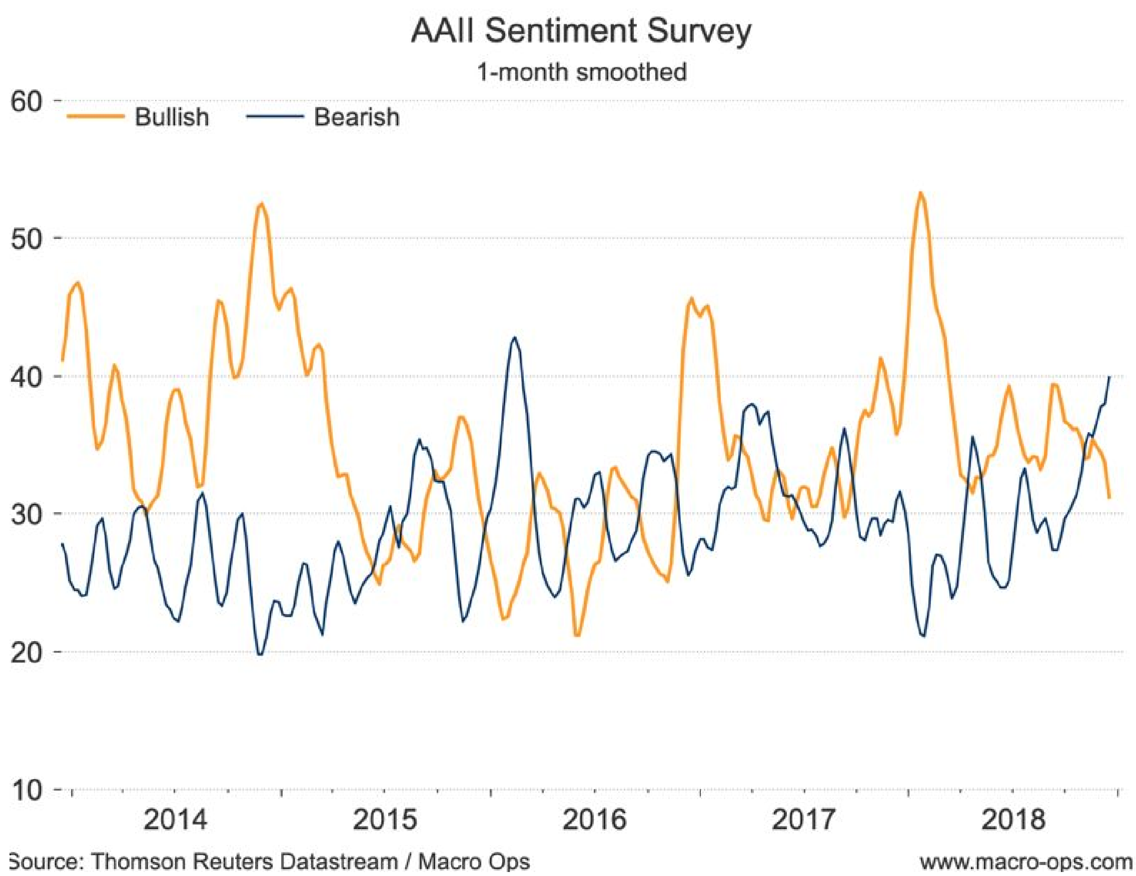
Ron Paul: A 50% correction will spark depression-like conditions that may be 'worse than 1929'

Stephanie Landsman | @stephlandsman

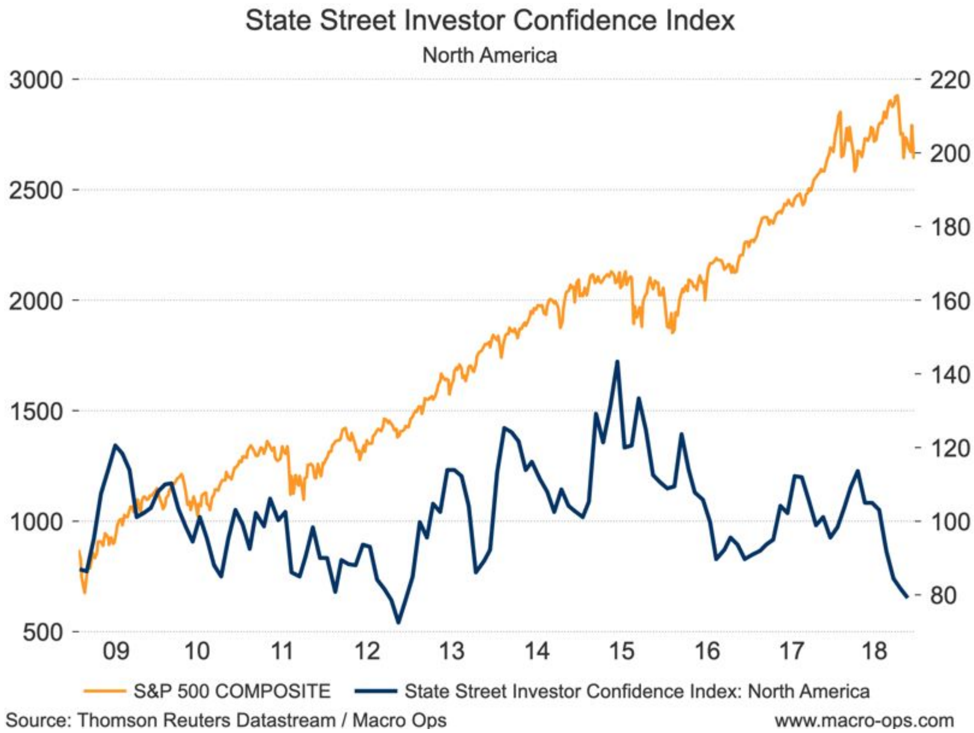
Published 5 Hours Ago

CNBC

AAII bearishness is at its highest levels since February 2016.

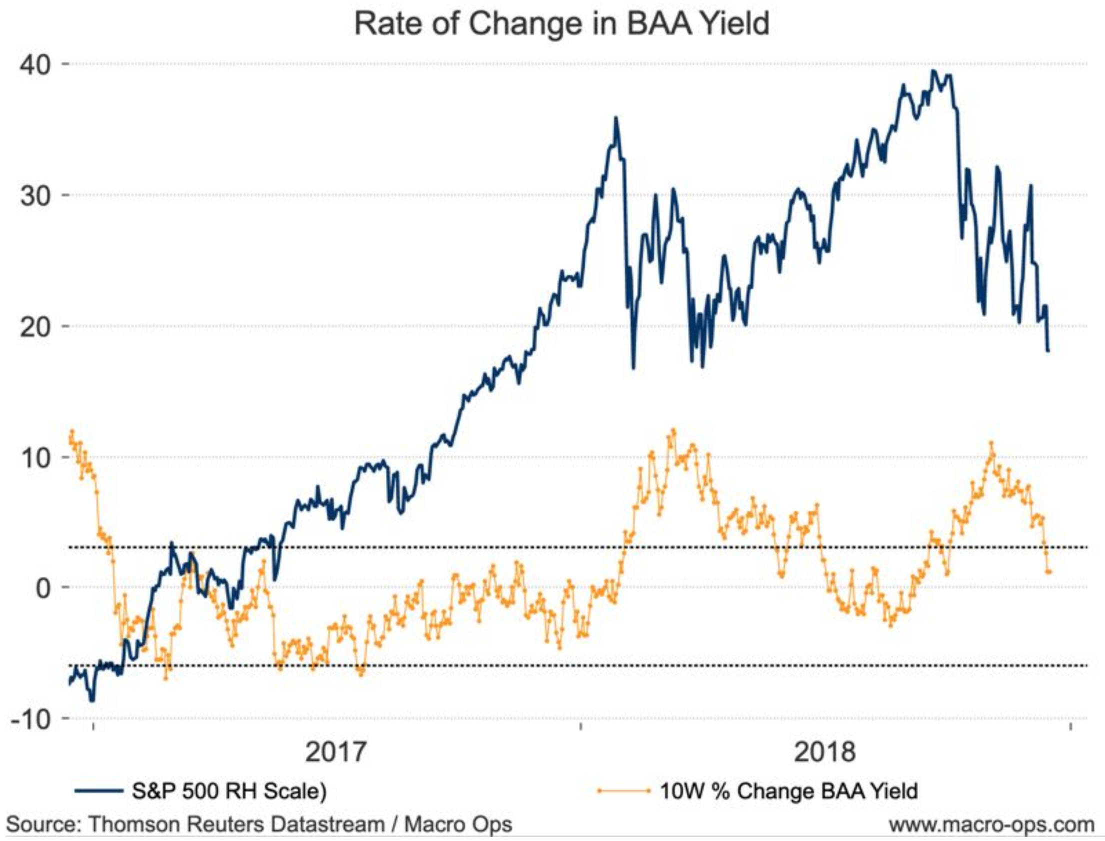


The State Street Investor Confidence Index for North America is at its most bearish level since 2012.

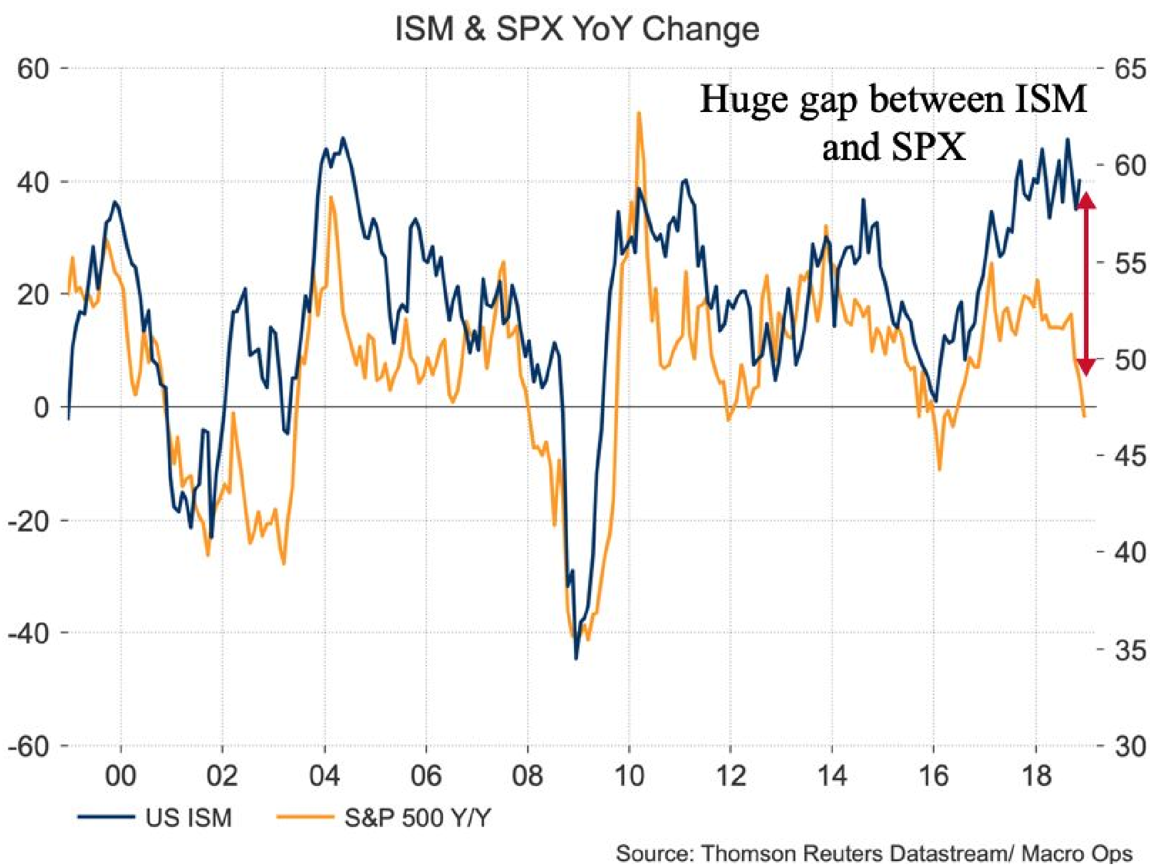


The percent of stocks trading above their 200-day moving averages is now at 19%. **This is DEEPLY oversold territory.** The last three times the indicator was this low, it marked major bottoms in the market.

The RoC in rates has reversed and is now back in neutral territory and is no longer a headwind for stocks. We should see this come down even further on dovish guidance from the Fed.



Now look at the giant gap between the ISM in the US and YoY change in the SPX. They typically track each other as the ISM is an indicator of economic growth in the US and therefore company earnings. This type of divergence is extremely rare and should be closed by the SPX doing most of the work by moving higher.



I believe US stocks are setting up for an extraordinary buying opportunity. I see a LOT of amazing deals in stocks. I'll be putting out our shopping list later this week. **I think we see a major bottom in the next 1-3 weeks.**

Moving onto currencies, the major dollar pairs continue to wind up and are now at significant inflection points.

A major move is coming in the next few weeks.

See EURUSD and USDJPY charts below.


Euro Fx/U.S. Dollar, 1W, FXCM
MA (200, close)
MA (50, close)
Vol (30)
1.13472


U.S. Dollar/Japanese Yen, 1W, FXCM
MA (200, close)
MA (50, close)
Vol (30)
112.764

The long-term fundamentals support a much stronger dollar. But as we've discussed, the positioning is still slightly crowded long USD. This doesn't mean it can't or won't rally it just means it's a bit of a hurdle and that we should be on the lookout for potential bear traps before the real move begins.

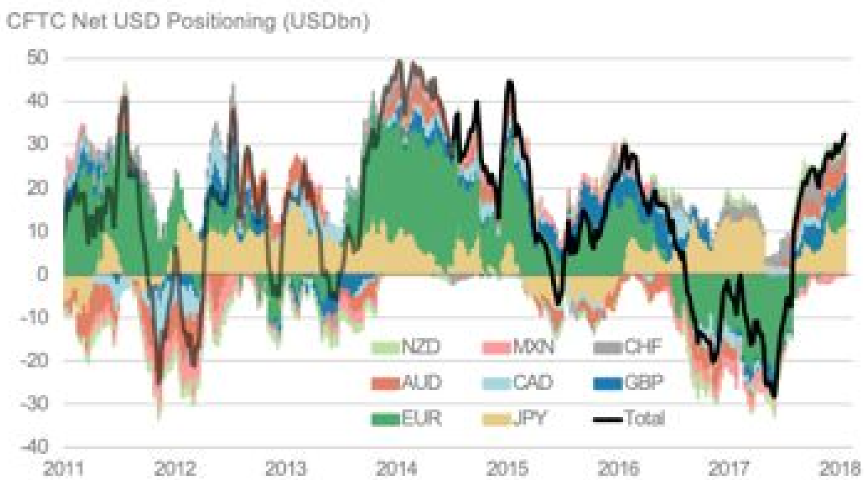
DSI is finally turning over from excessively bullish levels.

Exhibit 6: Daily Sentiment Index (DSI)

Source: Daily Sentiment Index provided by: www.trade-futures.com, Morgan Stanley Research

CoT positioning is stretched long but can get more stretched on a move higher.

Exhibit 2: IMM CFTC USD Positioning



Source: Bloomberg, Morgan Stanley Research

Morgan Stanley's Positioning Matrix show traders are long USD but not extremely long.

Morgan Stanley Matrix

	This Week	Last Week	IMM	Toshin	TFX	Beta	ETF	Sentiment	
USD	4	4	10		-8	8	5	3	USD
EUR	-3	-4	-9		8	-9	-1	-3	EUR
JPY	0	0	-6	2	-2	10	-1	-5	JPY
GBP	1	0	-1		7	8	-3	-6	GBP
CHF	-3	-4	-3				-1	-4	CHF
CAD	-3	-3	-1				-3	-5	CAD
AUD	-3	-4	-7		4		-4	-3	AUD
NZD	-3	-3	-6		-1		-6	0	NZD

Gold continues to flag. It's direction will largely be decided on if/when China stimulates. Until we see a spike in China's M1, my bias will stay bearish gold. We'll enter another short position on a close below its 200wma (blue line).

Similar to copper, gold continues to consolidate in a tight wedge. We should see a break soon and my bias is to the downside. We'll enter a start position as soon as it breaks the pattern and add to it once it closes below the 200wma.

Our short German DAX trade is playing out well. The next major technical support level isn't until 10,000, which is over 6% lower. We'll likely take profits there.

That’s all I’ve got for now. We’ll be putting out our shopping list later this week and update you with news on Xi’s speech.

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	$2,584,089		-4.42%	28.62%			
Big Bet Macro							
Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target	Last Price
Equity	Grupo Financiero (GGAL)	4,076	$26.13	$21.00	$26,616	$44.00	$27.53
Equity	Stratasys (SSYS)	6,196	$24.76	$20.50	-$5,886	$50.00	$19.55
Equity	Discovery DISCA	3,450	$28.09	$26.70	$4,382	$60.00	$27.97
Equity	Google GOOGL	519	$1,129.78	$1,100.00	-$25,950	$1,400.00	$1,050.00
Equity	Disney DIS	5,694	$102.34	$108.50	$21,068	$150.00	$112.20
Equity	Yatra Online YTRA	36,819	$7.24	Investment	~	$15.00	$4.16
Equity	DAX December Futures	-2	€11,333.0	€12,120.0	€64,500.00	€10,600.0	€10,830.00
Equity	TSLA Jan '20 150 Put	13	$15.01	$0.00	$16,575	$60.00	$12.75
Equity	TSLA Jun '19 220 Put	11	$18.01	$0.00	$14,630	$60.00	$13.30
Equity	NVDA Mar '19 150 Puts	43	$6.60	$0.00	$71,079	$22.00	$16.53
Equity	BABA Jan '20 110 Puts	111	$5.17	$0.00	$54,723	$20.00	$4.93
Equity	SPX Mar '19 3150 Call	19	$8.10	$0.00	$665	$80.00	$0.35
Equity	DIS Jan '20 165 Call	545	$1.11	$0.00	$33,245	$10.50	$0.61
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	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	$1,800	$2.50	$0.05
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	$5,400	$7.00	$0.50
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
Fixed Income	ZB March Futures	6	$139.81	$136.31	$38,460	$145.00	$142.720
Volatility							
Asset Class	Position	Size	Cost Basis	Risk Point	Open Risk	Target	Last Price
Volatility	Long VIX Feb Futures	13	$20.75	~	~	~	~

Risk Budget				
	Total Allowed (In Bps)	Total Used	Total Available	Percentage Used
Master	2500	1399	1101	55.95%
Big Bet Macro	2250	1399	851	62.16%
Volatility	250	0	250	0.00%

**Updated 12/16