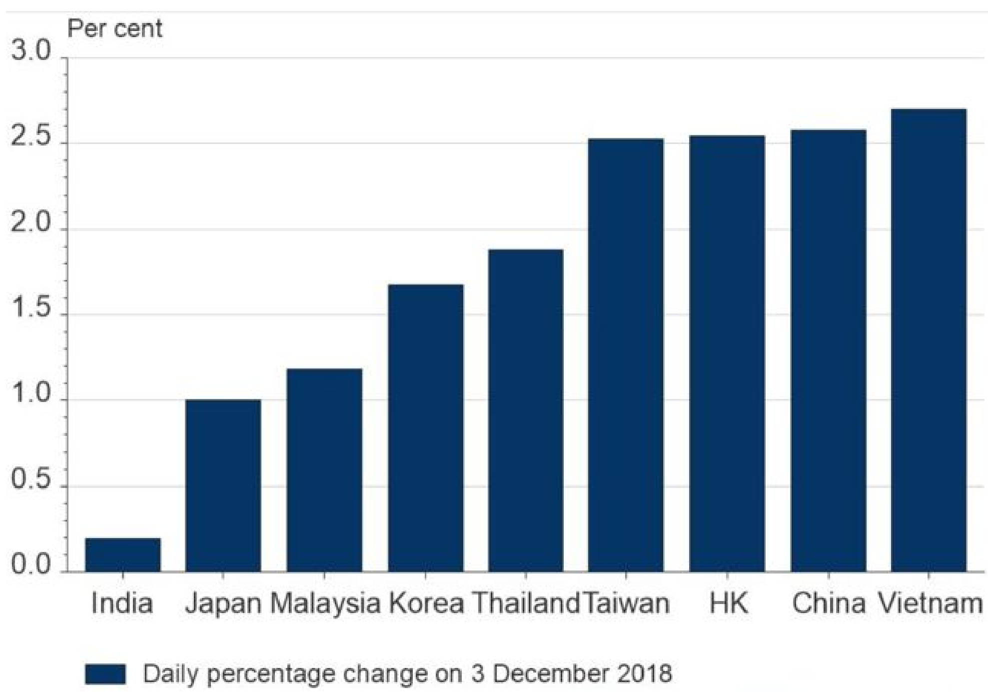
Smoke and Mirrors

Here's a summary of the trade "deal" reached between Trump and Xi this weekend:

- A 90-day pause in the increase of tariffs from the current 10% to 25% (which was originally supposed to go into effect at the start of the new year)
- In return, China has promised to buy more US agricultural products and oil
- There's confusion over whether this 90-day period begins now or Jan 1st
- Also, Trump said that China has agreed to reduce and/or remove tariffs on US car imports

Both sides are playing up the deal and emerging markets are rallying in response.



But it seems there's plenty of ambiguity in the agreement which we can see in the differences in the press releases from both sides, below.

Table 1. Statements from both the US and China after the G20 dinner

	China (media release link)	US (official statement link)
Tariffs	Both sides agree to stop imposing new tariffs, ie tariffs on USD200bn of Chinese goods will not be raised from 10% to 25% on 1 January 2019	Trump agrees to leave the 10% tariffs on the USD200bn Chinese goods unchanged and will not raise it to 25% on 1 January 2019. But if the endeavour to negotiate **within the next 90 days fails**, the 10% tariffs will be raised to 25%.
Imports	China is willing to import more goods from the US based on the needs of the Chinese people and to gradually address the trade imbalance issue.	China will agree to purchase a not yet finalised but very **substantial amount** of **agricultural, energy, industrial and other product** from the US to reduce the trade imbalance.
Others	Both countries agree to open up their domestic markets. They will accelerate negotiations with the aim of withdrawing all tariffs that have been imposed. Both countries may conduct mutual visits in due course.	President Xi and Trump have agreed to immediately begin negotiations on **structural changes** with respect to **forced technology transfer, intellectual property protection, non-tariff barriers, cyber intrusions and cyber theft, services and agriculture,** which will be targeted to be completed with the next 90 days.
Timeline	No mention.	Within the next 90 days.

Source: CNTV, Xinhua, White House, ANZ Research

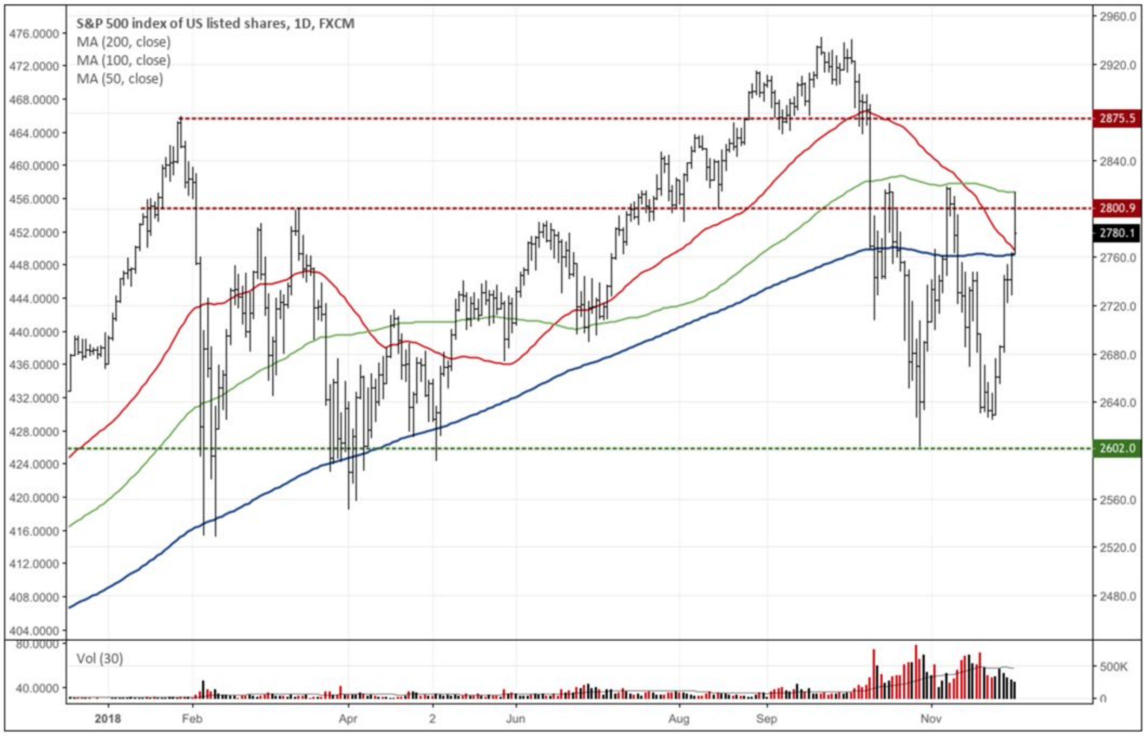
This "deal" is high on fluff and low on substance. It doesn't change the trajectory of the trade war nor narrow the gulf between what both sides want and expect of one another for a full ceasetariff to happen, which remains as wide as ever.

China has promised to reduce/eliminate tariffs on auto imports countless times in the past. Yet, tariffs remain. This agreement is more to give both sides some breathing room, as each leader has been feeling the heat lately; Xi with China's slowing economy and Trump with the volatile stock market that he watches so closely.

But, granted, this isn't negative news either. And since the market is wont to be bullish right now, so everybody can get their end of year Santa rally. Well, this combined with a Fed seen as turning dovish is all the excuse it needs for a pop.

However, this is all just smoke and mirrors. The US-China trade war and the 10% tariffs we've slapped on Chinese goods is NOT the reason why the global economy has slowed, nor why markets have been rocky — more on that below.

First, here's what I see in the US markets. The SPX gapped up on the open today and was then rejected by its 100-day MA (green line). The market is going to have to churn through a lot of overhang (supply) between 2,800 and 2,875 (marked by the red horizontal lines below).



The path of least resistance looks to be up. Sentiment, breadth, and liquidity are still supportive of higher US stock prices. And a very bullish development — if it holds — are interest rates coming down despite the jump in stocks. See the chart below which shows the yield on the 10yr is dipping below 3% for the first time since September.

The emerging market ETF (EEM) has touched its long-term support and bounced. I'm skeptical whether this bounce holds for long, but seeing as how oversold Chinese tech stocks are (EEM is heavily weighted to China/Asian tech stocks) it's not going to take much to drive a temporary bounce into the end of the year.

Technically, I can see the case for a China-led rally here but the macro is just as bad as ever and getting worse.

The latest numbers showing bank asset growth for the major Chinese banks (one of the more important leading indicators to track for broader economic health) show that lending growth just hit a new all-time low. Here's the following from Trivium China:

The details:

- Total assets in the banking system grew by 6.6% y/y in the month.
- That's down from 7% y/y in September and represents a fresh all-time low.
- China's five big SOE banks are expanding assets at 6.7% y/y — down from 7.2% in September.

- China's five big SOE banks are expanding assets at 6.78% y/y — down from 7.2% in September.
- Assets at the 12 medium-sized joint-stock banks are growing at a measly 3.9% y/y — up a touch from 3.6% in September.

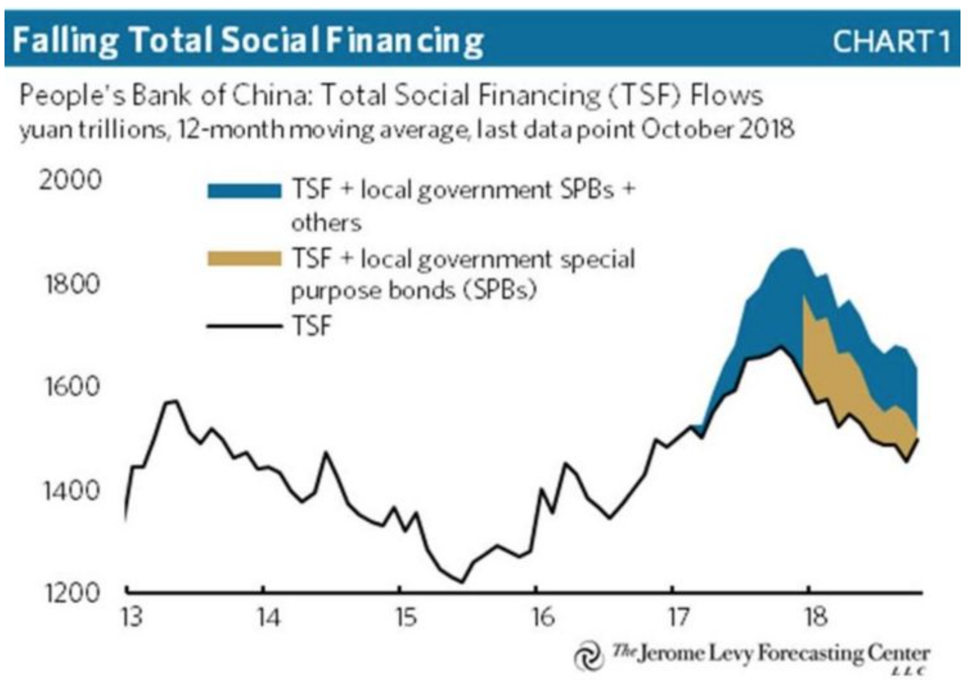
Some context: Those 17 banks combined accounts for **53.3% of the banking system.**

But here's where the real action is:

- The roughly 133 city-level banks are growing assets at 7.9% y/y — down from 8.4% in September and a recent high of 12% back in January.

Get Smart: those city-level banks are the ones that regulators are pushing to support the private sector. But they are only becoming more risk-averse, along with the rest of the system.

We can see in this chart (h/t @teasri) that total credit growth (social financing + bond issuance) continues to decelerate from the highs reached late last year.



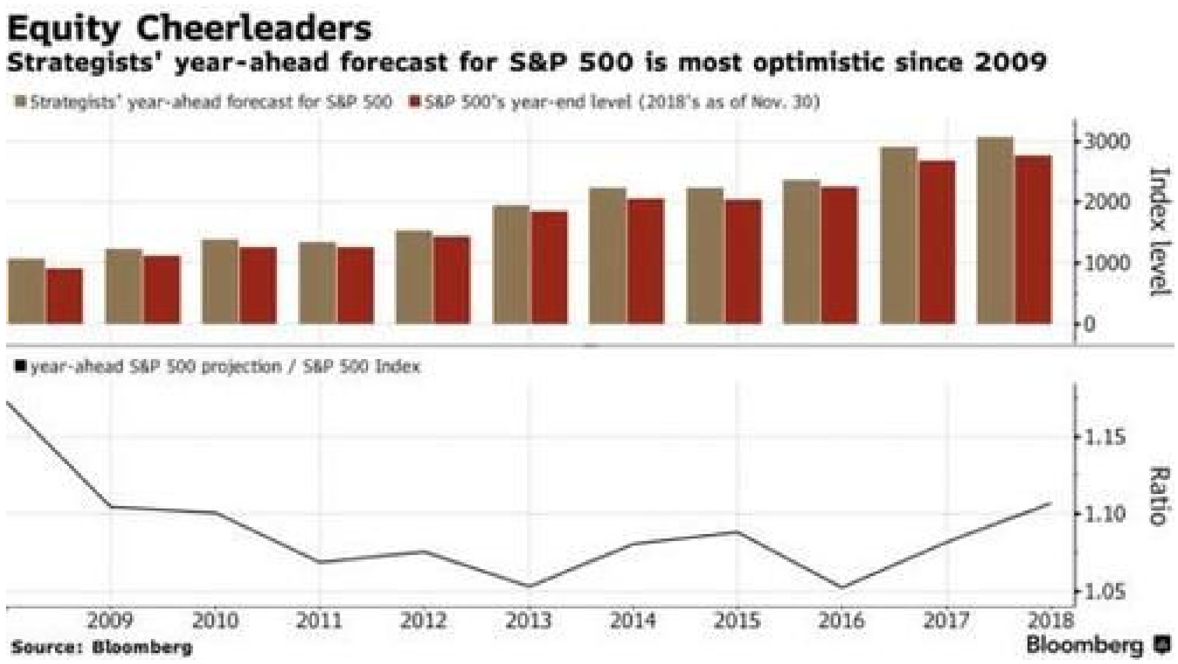
The FT's China Home Price Index just self-immolated; turning negative for the first time since 2014. Remember, China's property market is THE MOST IMPORTANT ASSET IN THE WORLD due to its size, the embedded leverage, and the amount of commodity demand that's dependent on its well-being.

Global M3 money supply trends, which lead equities by 6-months, are racing towards the ground and look to turn negative for the first time since 11'.

According to Reuters, Chinese financial regulators just announced that they're "further relaxing index futures trading rules, reducing margin requirements, cutting trading fees and allowing more trading activities." This is a reversal of their policy from just a few years ago when they sought to clamp down on rampant speculation.

It's starting to look to me like the Party is grasping for straws. And since there's typically a 6-month lag between the change in credit growth and its full impact on the actual economy, I imagine we'll see Xi and team pull out plenty more stops in the months ahead to try and prop things up. But like Fund Manager Jim Chanos recently put it, China is on a "treadmill to hell" and I doubt any of these gimmicks are going to be enough to stay the reckoning from two-decades of mind-boggling credit abuse.

In light of all this, I find it interesting that Investment Bank Strategist' year-ahead forecast for the SPX is the most optimistic since 2009.



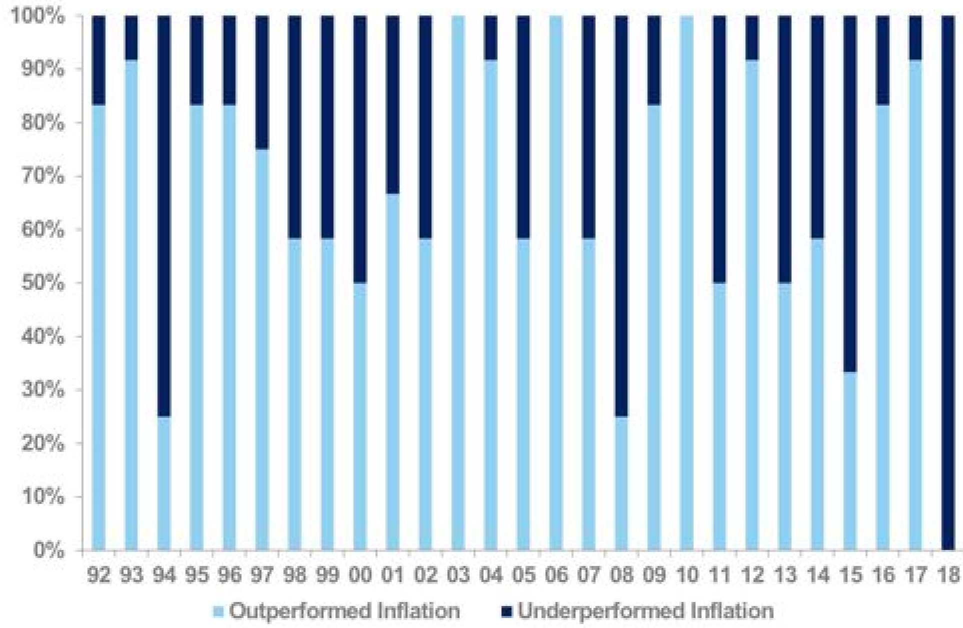
Firm	Strategist	2019 Close	2019 EPS
Bank of America	Savita Subramanian	2,900	$170.00
Bank of Montreal	Brian Belski	3,150	$174.00
Barclays	Maneesh Deshpande	3,000	$176.00
Bernstein	Noah Weisberger	3,150	$170.00
Citigroup	Tobias Levkovich	3,100	$172.50
Credit Suisse	Jonathan Golub	3,350	$174.00
Deutsche Bank	Binky Chadha	3,250	$175.00
Goldman Sachs	David Kostin	3,000	$173.00
HSBC	Ben Laidler	3,150	$179.00
Morgan Stanley	Mike Wilson	2,750	$171.00
RBC	Lori Calvasina	2,900	$171.00
Stifel Nicolaus	Barry Bannister	2,800	$168.00
UBS	Keith Parker	3,200	$175.00
Wells Fargo	Chris Harvey	3,079	$173.37
	Mean	3,056	$172.99
	Median	3,090	$173.19
	High	3,350	$179.00
	Low	2,750	$168.00

I'm not saying we don't hit the median target of 3,090. Maybe we will, maybe we won't. I'm just suspicious as to how sanguine everyone is right now. It seems to me that since markets have shrugged off every worry for so long that we've just become numb to the possibility of potential shocks. Looking around the world right now, we have:

- A decelerating China from the largest credit bubble in the history of the world and who has been the largest source for commodity demand of any one country, ever. And who's acting increasingly authoritarian.
- A budding trade war between two superpowers with little chance of ending soon.
- Paris is literally burning as the city experiences its most violent protests in over 40-years.
- Qatar just left OPEC
- There's the real possibility of a No-deal Brexit and nobody knows what that would mean
- Italy and EU budget disagreements and European banks trading at or near all-time lows and moving lower nearly every day. And hardly anybody is talking about it!

Also, all major 17 asset classes have underperformed inflation in the US so far this year. That's a record.

Exhibit 3: YTD none of the major 17 asset classes has outperformed US inflation - a record!



Source: S&P, BLS, Global Financial Data, Robert Shiller, Morgan Stanley Research;
Note: 2018 data as of November 22, 2018

And yet, Strategist' are the most bullish they've been since 09'? There seems to me to be a huge disconnect between some of the standard sentiment data I track and then what I see and hear people doing. I don't know what to make of it, but it makes me uneasy.

I think back to Dan Loeb's most recent letter when he wrote, "We have delevered our portfolio, reduced our tech exposure meaningfully, and grown our short book. **We expect to be net sellers over the next few months if markets rally** but, while we recognize that we are far along in the cycle, late-cycle and end-cycle are not the same."

Loeb is the smart money. And I get the sense that he and much of the other whales will be using this rally into the end of the year to sell into. So maybe we get a pop, and maybe it's a sizable one. But I think it's to be tactically traded and not aggressively bought, as these fickle winds could soon reverse, and fast.

Some Stocks…

We're going to put on a small tactical trade in Fiat (FCAU) this week, along with Spotify (SPOT) and another Argentinian bank stock (SUPV).

Starting with FCAU, which looks to be breaking out of a declining wedge pattern and is now back above its 100wma (green line).

A number of sharp value guys have made Fiat their largest position. Monhish Pabrai has nearly his entire fund in the stock. Scott Miller, of Greenhaven Road Capital, wrapped up his update on Fiat with this in his last letter.

> *There are all indications that the company would like to restore their dividend. It would be interesting to see how FCAU was valued based on a dividend yield. They could easily cover a €1/$1.14 per year dividend – apply a 5% yield to that and you have a $22+ stock. It would not surprise me at all if Elkann initiates a combination of a tender offer and/or buyback to take advantage of the stock's price as I believe he is inclined in the very short term to try and walk the valuation up to be in a stronger position to effect a merger with another OEM to realize the enormous potential synergies. These options have never been available to him, now they are and I think they will be utilized in 2018, hopefully to dramatic effect. As a result, I have layered a small short-dated out-of the-money option position and an in-the-money option position to allow the fund to profit disproportionately should this scenario occur. I do not purchase options as a regular practice and 90% of options expire worthless, so this cherry on top may disappear, but the opportunity well outweighs the cost. Given the company's current valuation, known catalysts, and orientation of the Chairman, I continue to like the set-up.*

Grupo Supervielle (SUPV) is essentially the same trade as our long GGAL position. I'm just starting to like the chart on this one a tad better. And since our GGAL position is small we can just buy SUPV and treat them as one trade. This trade is dependent on a stronger peso against the dollar, which so far seems to be holding up (more on the dollar below).

And finally, Spotify (SPOT).

We've written about this stock some and now that it's down 30% off its highs with a decent looking bottom in place, it looks worth putting on a small starter position. SPOT is growing revenues upwards of 25% a year and is now trading for just 4x sales. Being solely a music-focused tech company it should also be insulated from the growing backlash we're seeing against tech companies in general. I also use the app and give it the Alex Barrow three fist pumps of approval (that's a stellar review).

I'm going to size these small. I'm not that interested in stocks right now. The market is currently too news driven and I don't see the odds tipping the scale in one direction or the other that much. Hopefully, that'll change in the coming weeks but we'll see…

FX and Commodities

Currencies and commodities, on the other hand, do look interesting.

Take copper for example (weekly chart).

Copper popped up to the upper-bounds of its trading range on news of the trade deal. If it breaks above this level and its 100wma (green line) then there's good chances it'll negate its H&S top.

My bias is that it's going lower from here and I'm considering putting on a small starter position to which I can add if/when it breaks the lower line. But, since we're entering the thinly traded holiday season there's a chance this gets pushed higher, we'll see.

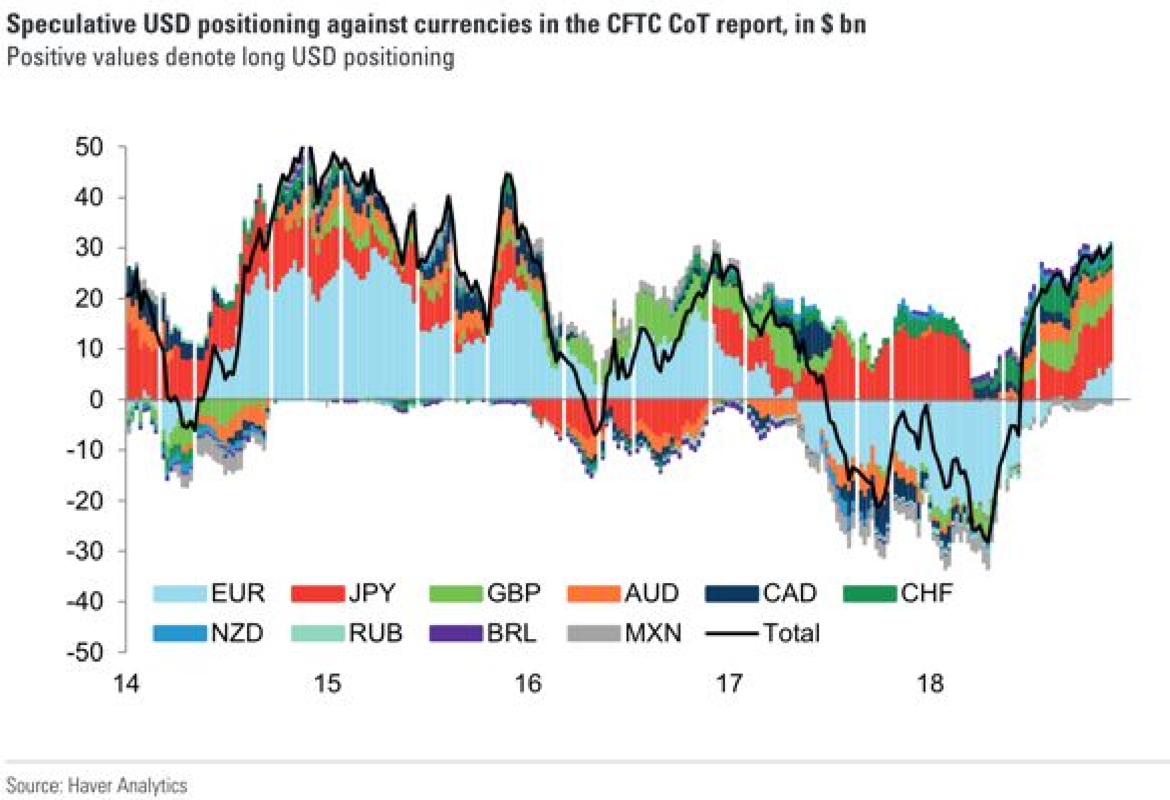
Platinum (PL_F) broke below the bear wedge we pointed out last week. We might see it rally and touch the bottom trend-line again but it looks like it's going lower. And this is interesting because of what this likely means for the precious metals.

Platinum often leads gold and silver at major turning points and that's probably what we're seeing here with the bearish divergence between the two metals. I'm considering putting on another short gold position with it near the top of its range. But again, I'm slightly hesitant to do this now since the holiday markets can often drive sharp false moves.

I'm waiting to see if it can close and hold above its 200wma (Blue line) or not. Once it closes below it, I'll probably go short.

The dollar (DXY) is still battling the 97 level which it's having a tough time closing above and holding.

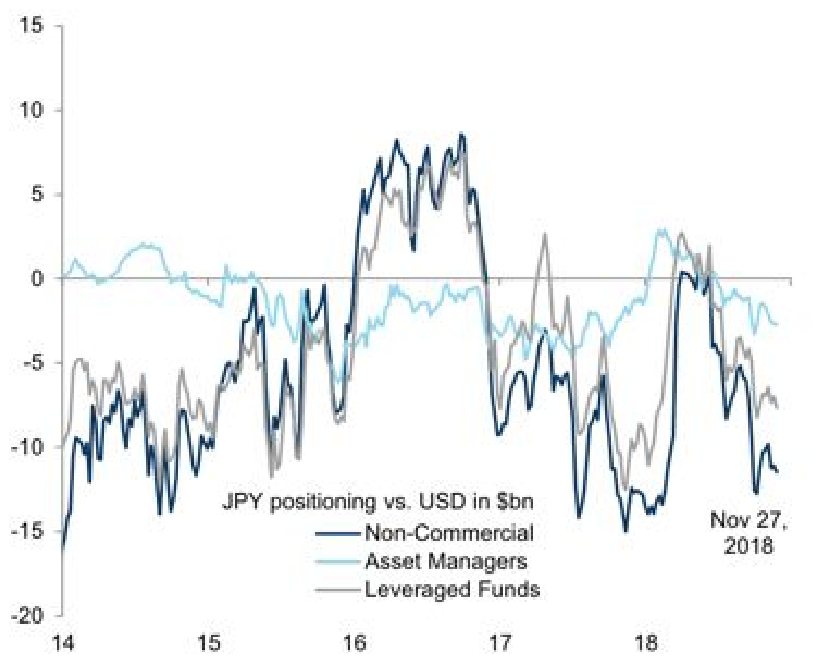
Positioning is still a little “too long”. That doesn’t mean the dollar can’t go higher from here it just means that positioning is a sizable headwind.



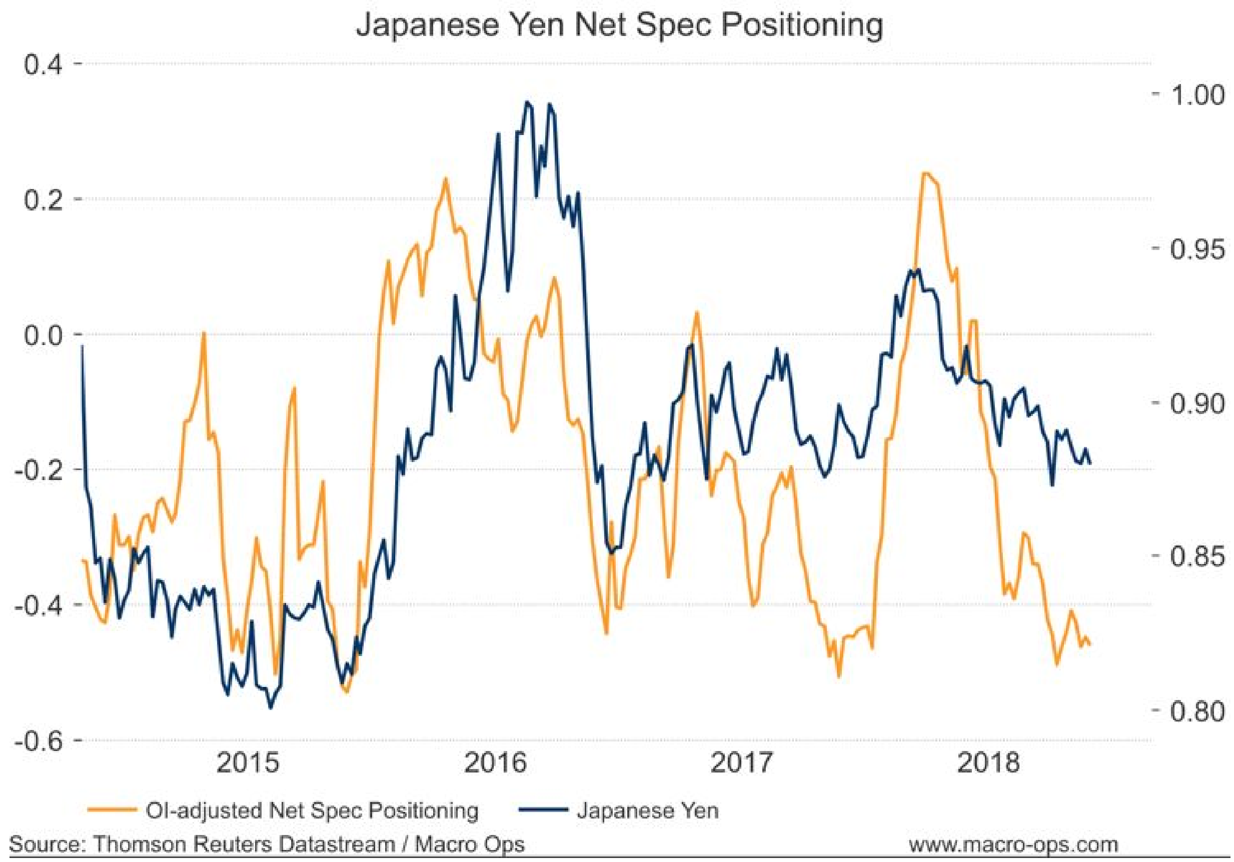
A positive for the dollar is that it seems IB Strategist have reached a near consensus that it has, or is about to, put in a major top. I find their arguments wholly unconvincing. I have strong confidence that the dollar will end this cycle much higher from here. But, I’m still looking for a positioning washout which a risk-on EM led rally into the end of the year may be the thing that does it.

If we want to play a quick short dollar selloff then I like the current setup in the yen cross (USDJPY).

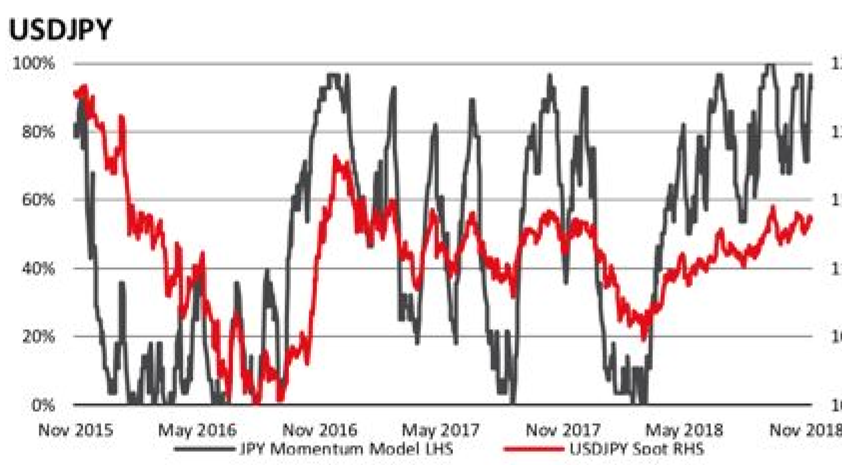
The pair is coiling tight and positioning and sentiment are crowded short.



The last few times specs were this short the yen rallied hard against the dollar.



UBS's momentum indicator also looks stretched for USDJPY, meaning some mean reversion might be around the corner. Here's the latest [Macro Trader]report from UBS.



All in all, I'm not looking to be too active at the moment. I'm sizing small and playing tight into the end of the year; focusing much more on preserving my money than making it. I think next year will bring some new renewed trends but until then I'll follow these words from Chess Grandmaster Gary Kasparov:

> *In life, there is no such obligation to move [as there is in chess]. If you can't find a useful plan, you can watch television, stick with business as usual, and believe that no news is good news. Human beings are brilliantly creative at finding ways to pass time in unconstructive ways. At these times, a true strategist shines by finding the means to make progress, to strengthen his position and prepare for the inevitable conflict. And conflict, we cannot forget, is inevitable.*

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

Your Macro Operator,

Alex