Upper Bands

Happy Sunday!

Alex here with a shorter than usual Market Brief. I'm out in Puerto Rico for the next few days and I'm about to head out for some deep sea fishing here in a bit. I'll be back in the saddle on Wednesday. Hopefully the market doesn't get too squirrely in the meantime.

The FOMC was the big news this week. The Fed came out and emphasized patience in assessing the need for further rate hikes, which is inline with what we were expecting. There were a few notable signals though, and all-in-all the meeting was *more* dovish than the market was expecting.

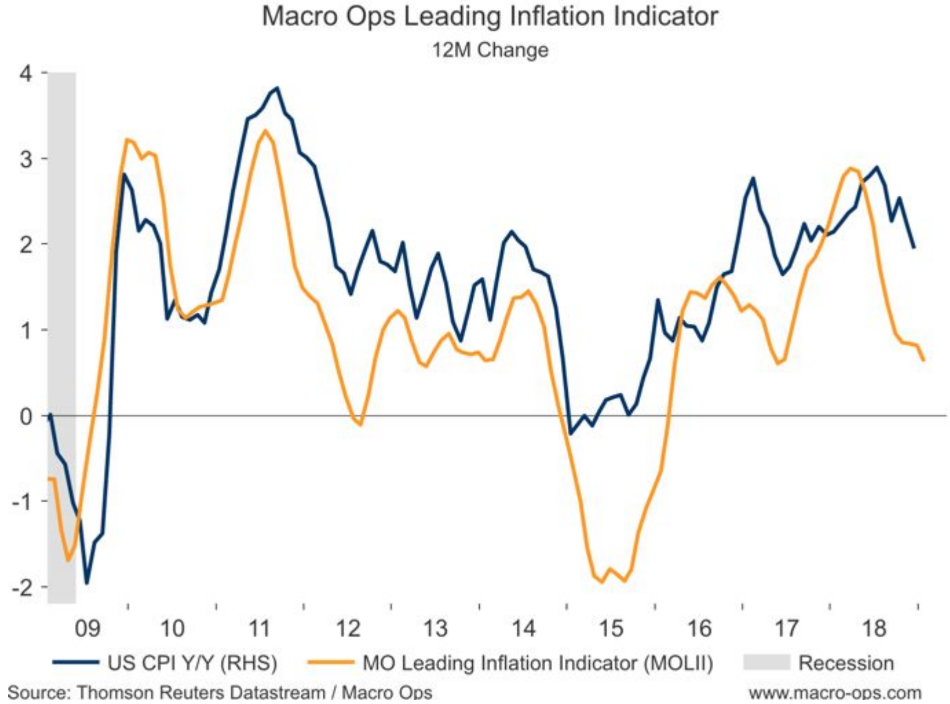
The most important news was the announcement that they'd be winding down their balance sheet runoff sooner than expected. They updated their policy normalization guidance to where they now plan to manage short-term interest rates via a floor system since there are abundant reserves. What this means is that the Fed is expecting to maintain a larger than expected balance sheet (ie, ending QT in the near future). This is a big deal and means the Fed is being responsive to the market, which is bullish.

Fed watcher Tim Duy summarized the FOMC as this:

> *The Fed made a dovish shift, declaring that they are on the sidelines for the time being. Given that they seem to believe the downside risks are more prevalent, it is reasonable to think the bar to easing in the near term is much lower than the bar to hiking. Importantly, it looks to me that the Fed has shifted gears well ahead of any recession; then did not invert the 10-2 spread and then keep hiking as typically occurs ahead of a recession. A flexible Fed and the lack of inflation was always a saving grace for the economy. The Fed may have just pushed back the next recession. If so, expect everyone who expects an imminent recession to "blame the Fed" when that recession fails to emerge.*

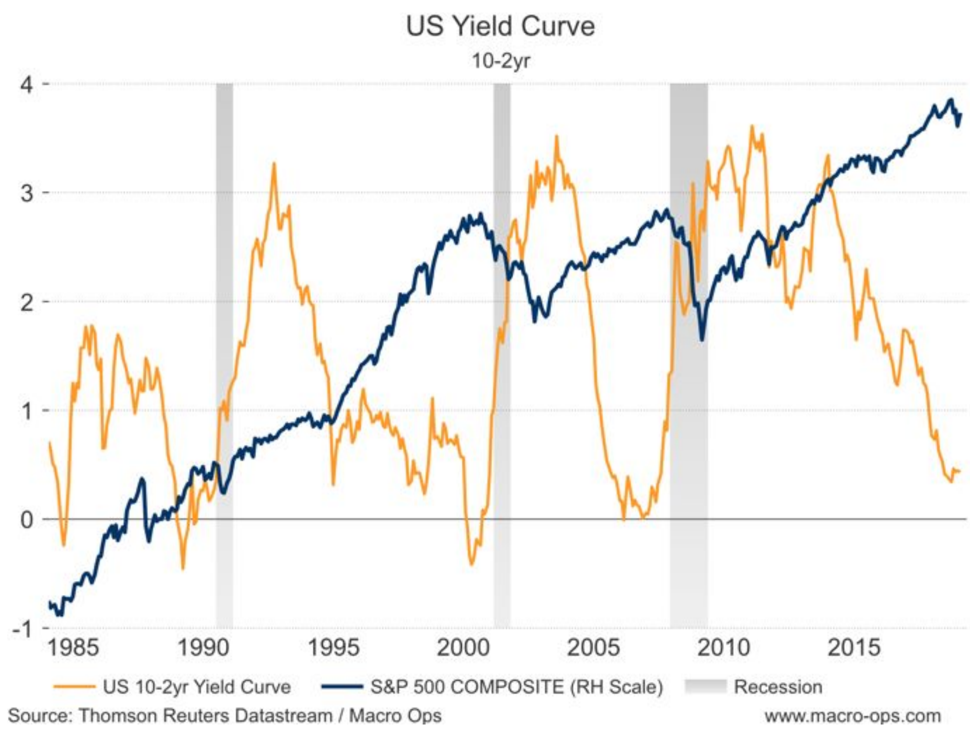
Jerome Powell said, "I would want to see a need for further rate increases, and for me a big part of that would be inflation." This means that the Fed is on standby with rate hikes until either inflation begins to perk up or — and this is just my take and wasn't explicitly stated by the Fed — the market begins to run hot again and the Fed wants to cool risk-taking.

On the first point of inflation, all our indicators suggest it'll be a while before rising prices become a problem. Our leading inflation indicator (MOLII) points to lower inflation in the coming quarters.



A slowing China and lower oil prices should help counteract the late cycle inflationary pressures of a tightening labor market and growing wage pressures (which are still pretty weak at the moment).

On the second point, I think the markets are in the clear over the next couple of months regarding the Fed. The March meeting is certainly off the table and beyond that, we'll have to see how things develop. We should see the curve stabilize somewhat and might even see it steepen a bit if markets stay in risk-on mode.



Another quick side-note with regards to the yield curve. The TBAC, which is the Treasury Board Advisory Committee, issued a report recently with new suggestions on how the Treasury can better meet its growing funding needs (link to Bloomberg article). The report suggested new debt tools including (emphasis by me):

- Inflation-protected debt indexed to the health care and education components of the consumer price index
- Longer-tenor floating-rate notes beyond the 2-year maturity the Treasury now utilizes
- Floating-rate debt linked to the Secured Overnight Financing Rate, or SOFR
- **15- or 20-year Treasuries**
- **Perpetual horizon debt sales**
- **Zero-coupon bonds**

This is a complete reversal from two years ago when Treasury Secretary Mnuchin was discussing the possibility of issuing 50yr+ debt and was rebuffed by the TBAC. This tells me that we're likely to see the Treasury begin to shift a greater amount of its debt issuance from the front end to the back end. This should help stabilize if not steepen the curve somewhat.

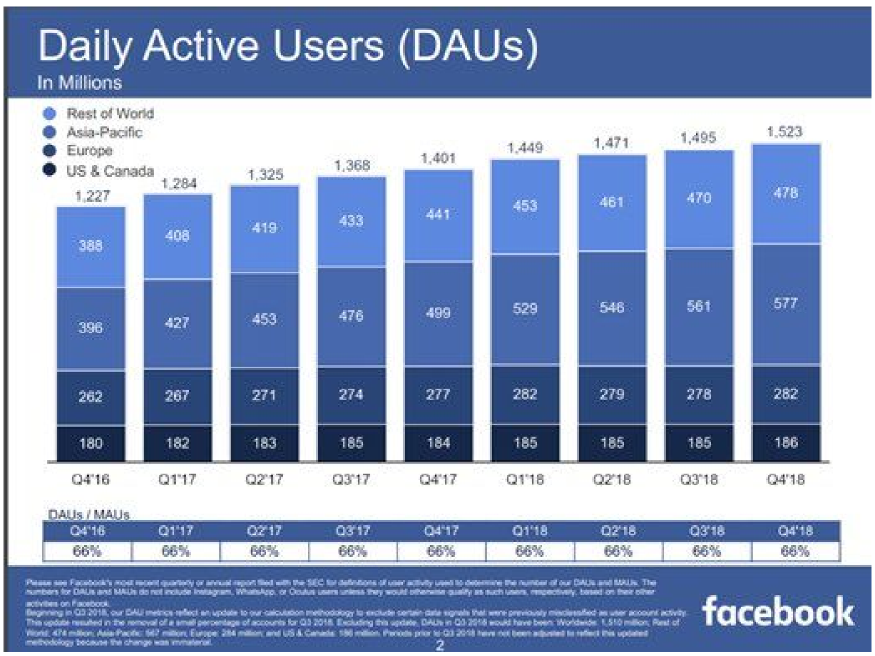
Recommendations by the TBAC typically take a few quarters before they are implemented, but this is a development worth watching. I'd expect to see the market to begin to front run this a bit, by selling off the long end. And this may soon make financials a good play as they tend to do well in a steepening environment.

Moving on…

Let's cover some of our positions that had earnings or other notable mentions this week.

Starting with the company that everybody loves to hate: Facebook (FB).

FB reported very strong numbers. It's still growing revenues at 30%+ and even saw its daily active users (DAU) increase sequentially 1% YoY for the first time since Q1 2018.



The stock jumped more than 10% on the report and is now up roughly 22% since we first bought 4-weeks ago.

The company is coming off a spending binge on security (a much-needed one) and we should see opex level off going forward while the company refocuses on product and monetization; two areas where there are plenty of untapped revenue sources and earnings levers to pull (think Whatsapp and greater Insta monetization).

Here's Zuckerberg commenting on a few of the things they're working on.

> **Mark Zuckerberg**
>
> I'd like to talk about - a bit about commerce. When I think about it, just from the consumer side, increasing commerce on Instagram, Facebook and WhatsApp, I think, is one of the most exciting product opportunities that we have in all of these products and a big business opportunity as well. The big things that I think we want to make sure that we nail, in Instagram especially, are discovery. People are already doing a lot of commerce activity and are really interested in following brands, and I think making sure that, that works is - and does well is a big deal. But I think there's also a very big opportunity in basically enabling the transactions and making it so that the buying experience is good and that when you buy from someone - from a seller that you know that you can trust them, that you're going to have a good experience and in facilitating and making that go well. The work that we're going to do in Instagram also will go across the efforts in Marketplace and Facebook, the work - the rest of work that we're doing in Facebook and all the work that we're going to be doing in WhatsApp as well. So this is a big area that I'm personally very excited about and focused on.

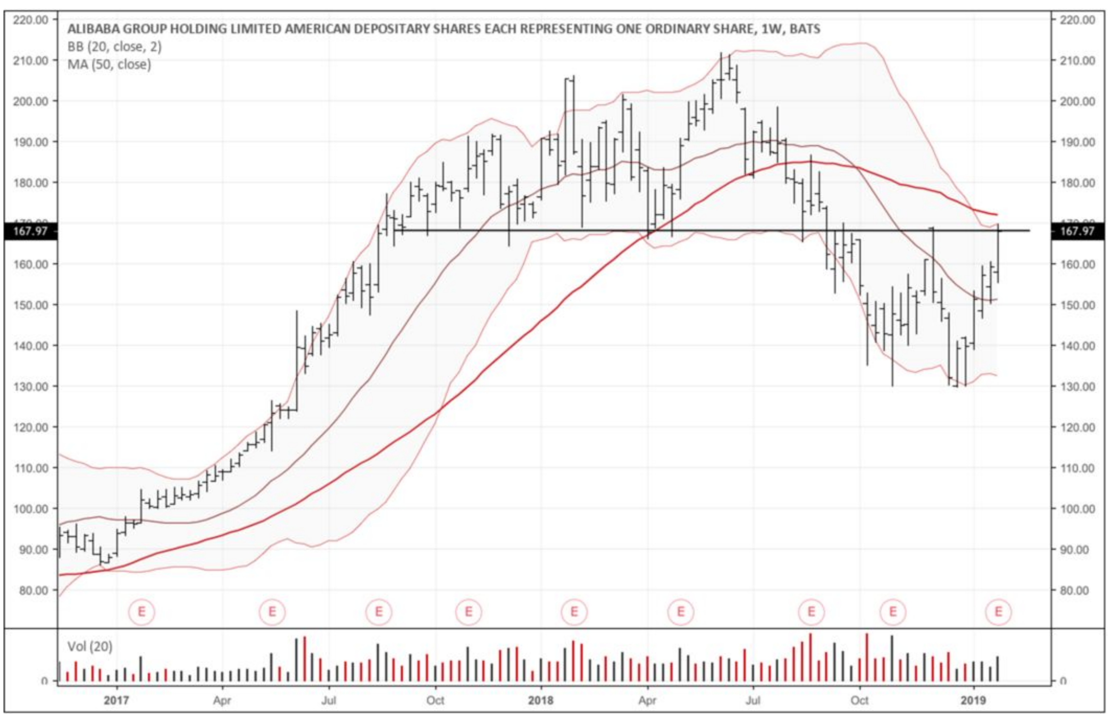
Facebook is looking to further integrate all of their apps, enable cross-platform encryption, and more deeply embed the ability for brands to directly transact with consumers. There is huge potential here and it seems like Zuckerberg and team are moving towards the WeChat model where they create an internet within the internet where users rarely have reason to leave their platform.

Former PM, Gavin Baker, put out a great thread on FB hitting on all these points and what this means for the company. I suggest giving it a read (here’s the link).

We’ll look to add to our position but will be patient. The stock is currently trading at its upper weekly Bollinger Band which means it’s likely we see a pullback soon. That’ll give us a nice area in which to add.

Industrial 3D printing company, Stratasys (SSYS), closed for the week at a new 18-month high, pushing above its 200-week moving average for the first time in 4-years. This is a great looking chart. The stock is breaking out of a tight 3yr+ base on strong volume and on the back of improving fundamentals. We first pitched SSYS in our August 18' MIR, you can find the write up here.

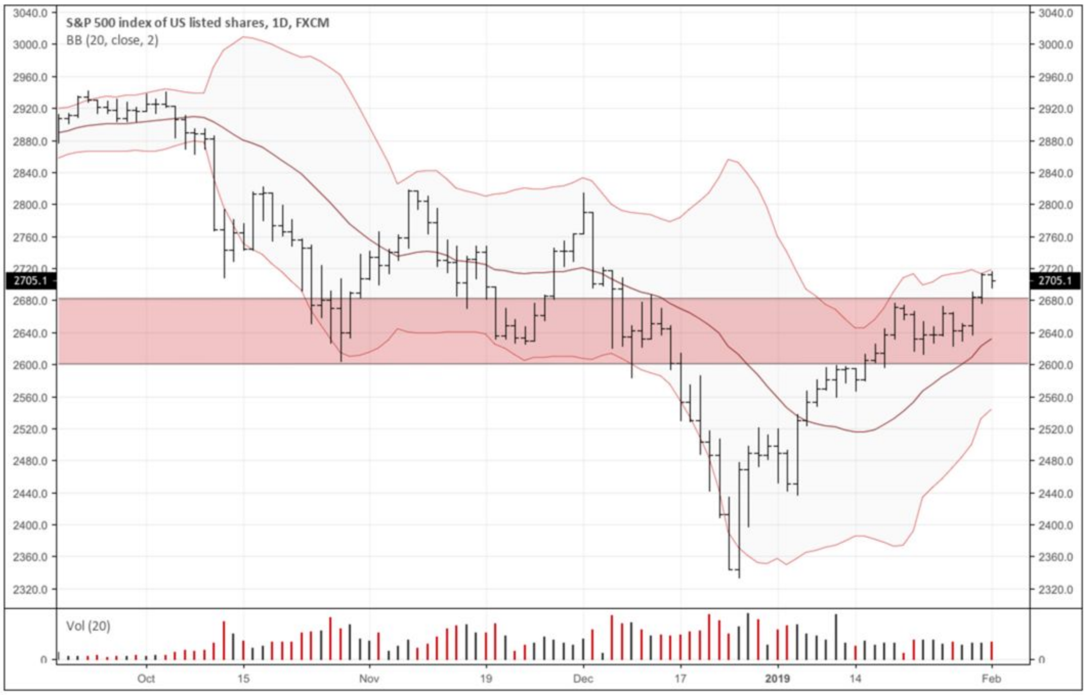
Alibaba Group (BABA) is retesting the bottom of its previous trading range and is at its upper weekly Boillinger Band (BB). This may be a good spot for us to reload on our puts.



There are a number of markets that are now stretched to the upside and banging on their upper weekly BBs. Here's the iShares Global 100 ETF (IOO). You can see the last few times the market traded up to its weekly BB we saw a retrace.

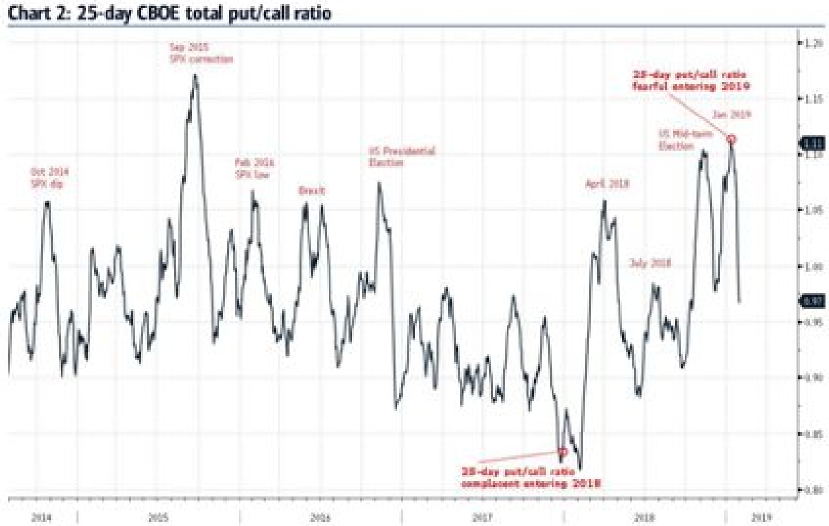
Gold is severely stretched here too and looks setup for at least a breather, if not a full reversal.

The US market is also somewhat stretched (SPX is at its upper daily BB) but all of my indicators are still showing strength, which tells me that if we do see a pullback in US stocks it likely won't be a strong one and the path of least resistance is still to the upside.



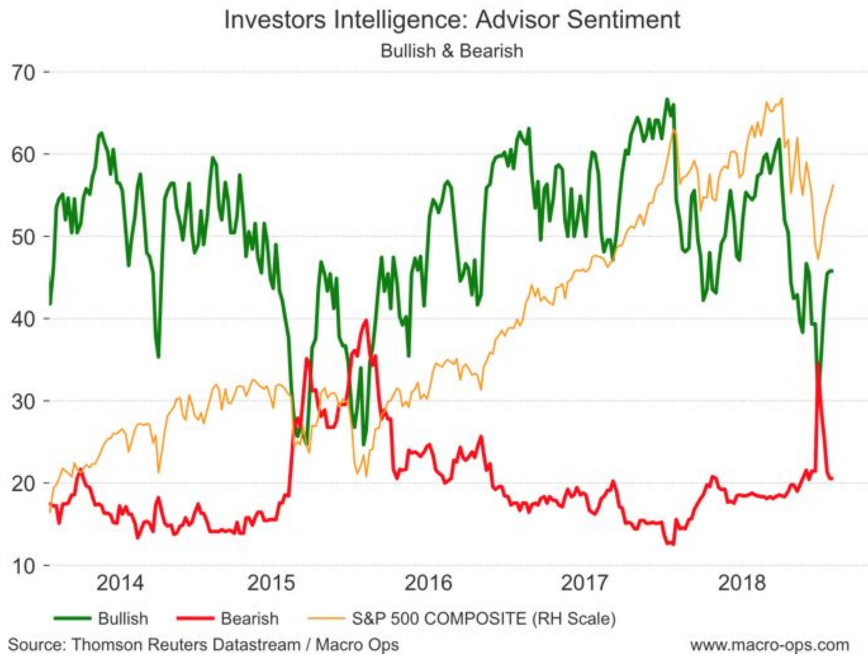
The 25-day CBOE total put/call ratio is still elevated showing investors remain wary of this market.

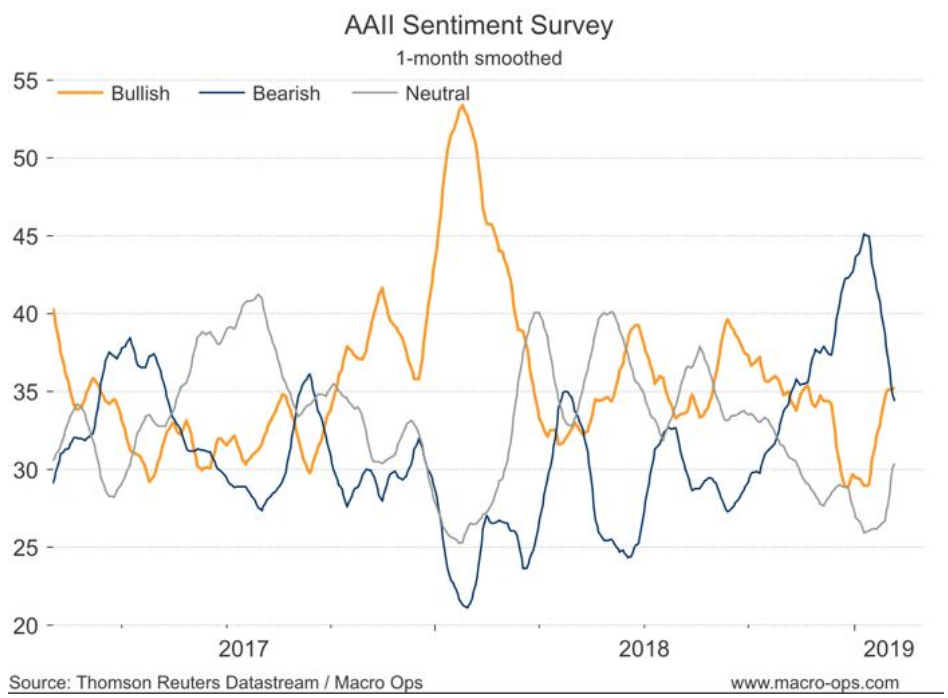
Chart 2: 25-day CBOE total put/call ratio



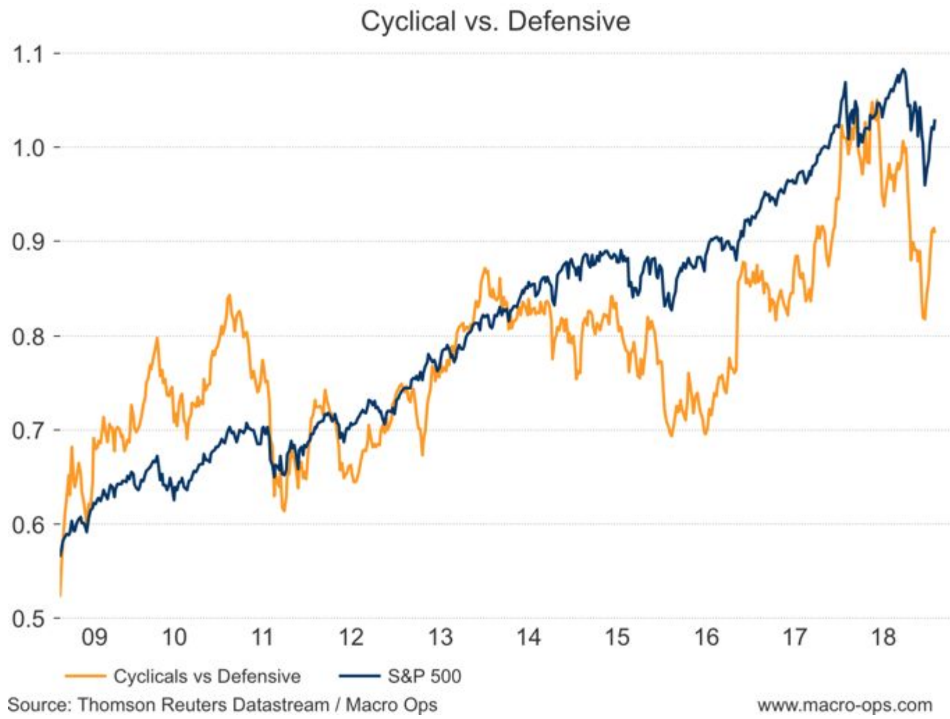
Source: BofA Merrill Lynch Global Research, Bloomberg

And our sentiment indicators are still at neutral/supportive levels for the market.

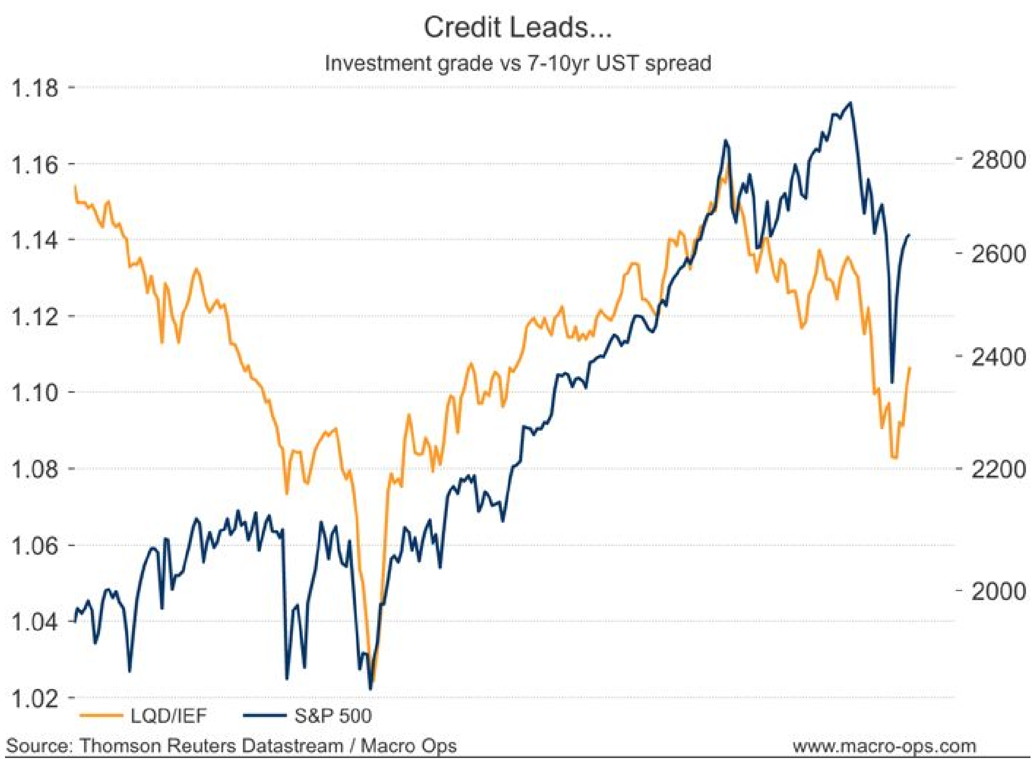




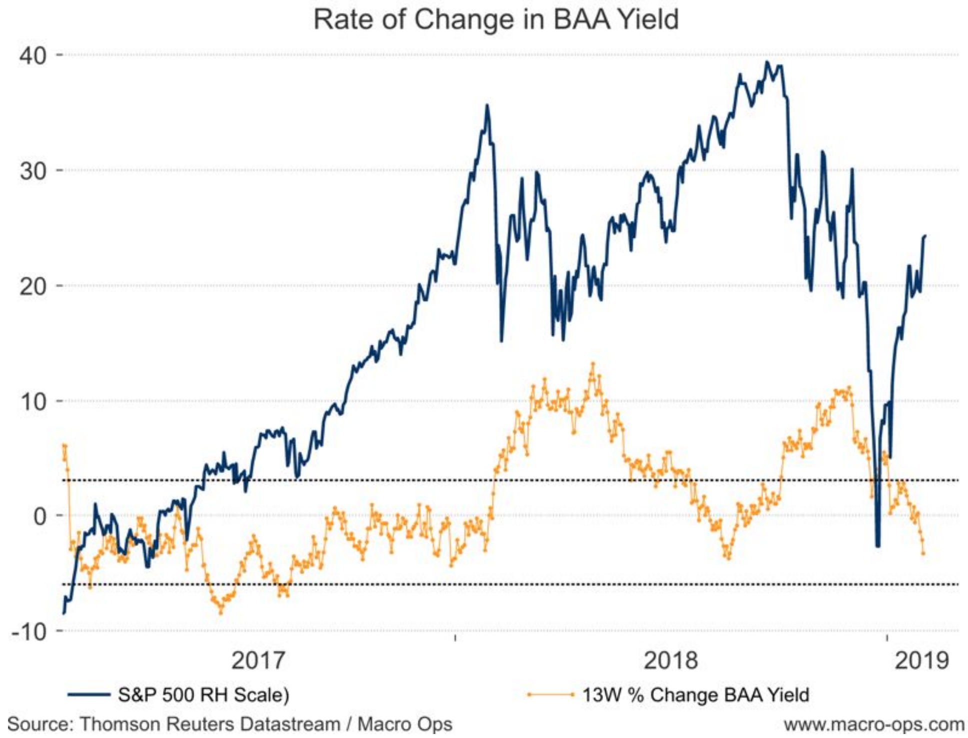
Cyclical vs Defensives are backing the rally higher.



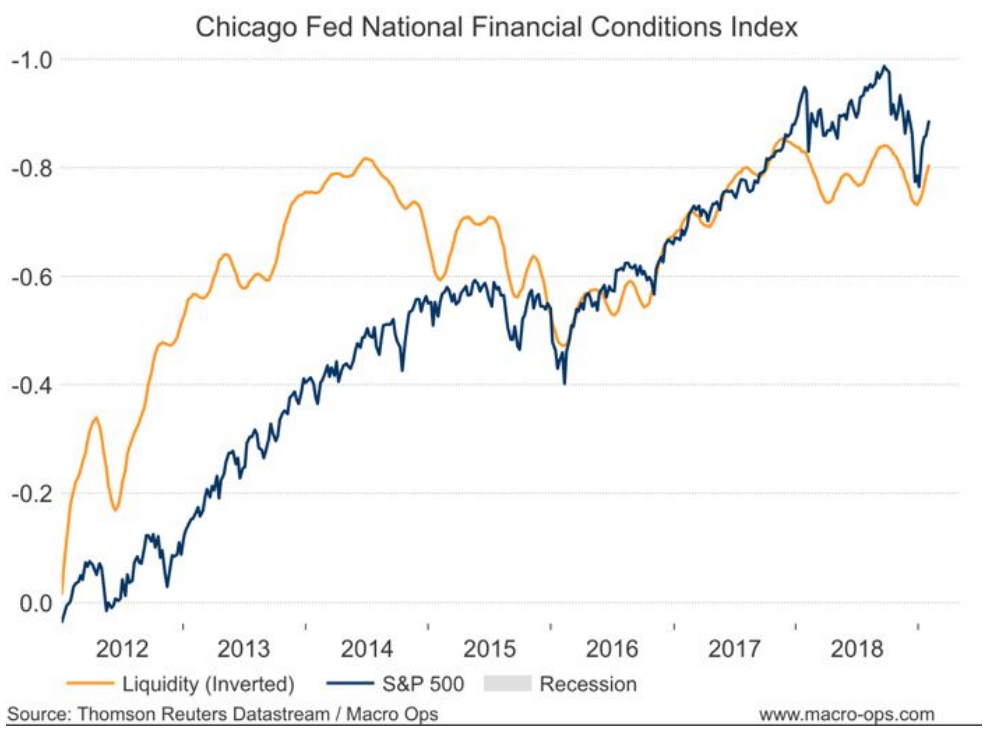
The credit market continues to show persistent strength.



While the rate of change in rates has come down significantly and are supportive of the move higher in stocks.



And financial conditions are loosening.



So for now it seems that the thing to do is to remain bullish and to keep selectively adding to our longs while balancing out our risks with selective shorts.

This week we'll likely add to our positions in Fiat (FCAU) and Box (BOX). And enter a new position in Criteo (CRTO), and add DOTM calls in Starbucks (SBUX).

That's all I've got for now.I'll put out a note and trade alerts later this week. Hit me up in the CC if you've got any questions!

Your Macro Operator,

Alex