

The Nuclear Option

Summary:

- More color on the Trade War
 - US adds Huawei to trade blacklist (that's a big deal)
- A significant reversal in sentiment
- Fed Minutes and Fed speeches this week
- Target Watchlist
 - CCJ
 - Shippers: STNG, DSSI, DSX, LPG,
- Portfolio Update/Commentary
 - TSLA getting taken out to the woodshed
 - Frontdoor (FTDR) on the run
 - Graftech (EAF)

Not surprisingly, there's been a lot of conflicting reporting on what exactly led to the total breakdown in the US-China trade talks and who's to blame for it.

The most compelling explanation I've read so far is that put forth by both the Nikkei Asian Review ([link here](#)), as well as the NYT ([link here](#)).

Both of these articles suggest that the two sides were close to signing a deal but President Xi was forced to renege by his fellow party members. Many people think that Xi is all-powerful in China and his word is law. While he is certainly the most powerful Chinese leader since Mao, it looks as though even he is vulnerable to getting hamstrung by his fellow CCP brethren.

It looks like the seven-member Politburo Standing Committee had serious qualms about the enforcement mechanisms that Xi's trade negotiator, Liu He, had agreed to in the original trade draft. They believed it encroached on China's sovereignty and was reminiscent of past unfavorable deals which China was forced into, such as the Treaty of Shimonoseki following the Sino-Japanese war. The Nikkei Asian Review noted that:

Despite being positioned as the "core" of the party leadership, even Xi cannot overturn a collective decision without securing the consent of the party leaders.

The Xi-Liu duo, which has been leading the trade negotiations, was, in effect, shackled.

This is a sign that, seven years into his rule, Xi's political momentum is slowing. While garnering unrivaled power through an anti-corruption campaign that eliminated his rivals, the president has little to show the public in terms of economic achievement.

Seeing as how including an enforcement mechanism is an obvious must for the US side, it looks like the prospects for a deal are kaput for now.

The US has wasted no time in responding and has already gone ahead and triggered the nuclear option by blacklisting China's tech giant Huawei, the worlds' largest provider of networking gear and the second-largest maker of smartphones.

The move threatens to cut off the company from critical components, both hardware and software, it needs to operate as a business. Bloomberg reports that "Chipmakers including Intel Corp., Qualcomm Inc., Xilinx Inc. and Broadcom Inc. have told their employees they will not supply Huawei until further notice, according to people familiar with their actions." And "If fully implemented, the Trump administration action could have ripple effects across the global semiconductor industry."

This is a very big deal. The Trump admin is pulling out all the guns to try and force the recalcitrant Chinese to the table. It's like a big geopolitical game of Chicken but where global supply chains and US semiconductor stocks are the stakes.

Another significant thing to note is that Huawei had been preparing for this eventuality as far back as two years ago by stockpiling mountains of US hardware (read semiconductors). That's quite a bit of demand that was pulled forward which means that recent past revenues for the big chip suppliers to Huawei, Intel and Micron, were artificially inflated.

I don't know about you but I wouldn't want to be long any of these companies when so much of their immediate future is dependent on the bombastic tweeter in chief and some faceless seven-member Politburo Standing Committee.

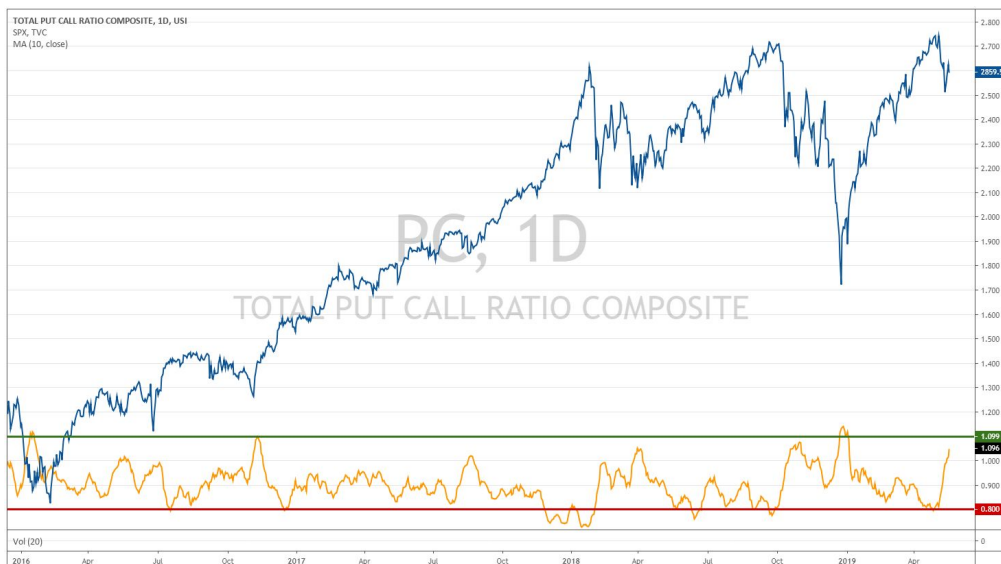
Moving on.

We have a busy week on the economic news front. FOMC minutes are released on Wednesday and a handful of Fed members are giving speeches, including Fed Chair Jerome Powell this evening at 7pm EST.

Whipsaw and chop should be expected.

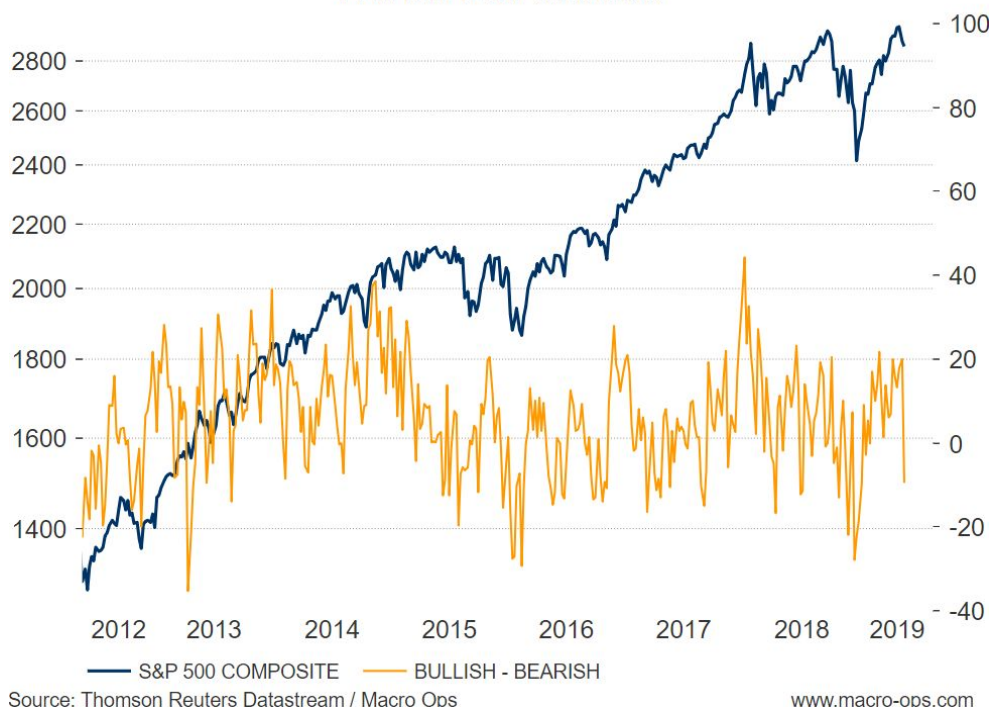
A positive development though has been a surprisingly large reversal in some of our shorter-term sentiment indicators.

Take our 10dma Total Put/Call indicator for example, which gave us a timely sell signal at the start of May. The indicator has now flipped to nearly the other extreme of showing pervasive fear (near the green horizontal line). This indicator is more useful as a sell signal than a buy but this type of reversal is a bullish development, especially if it moves higher and crosses the green line.



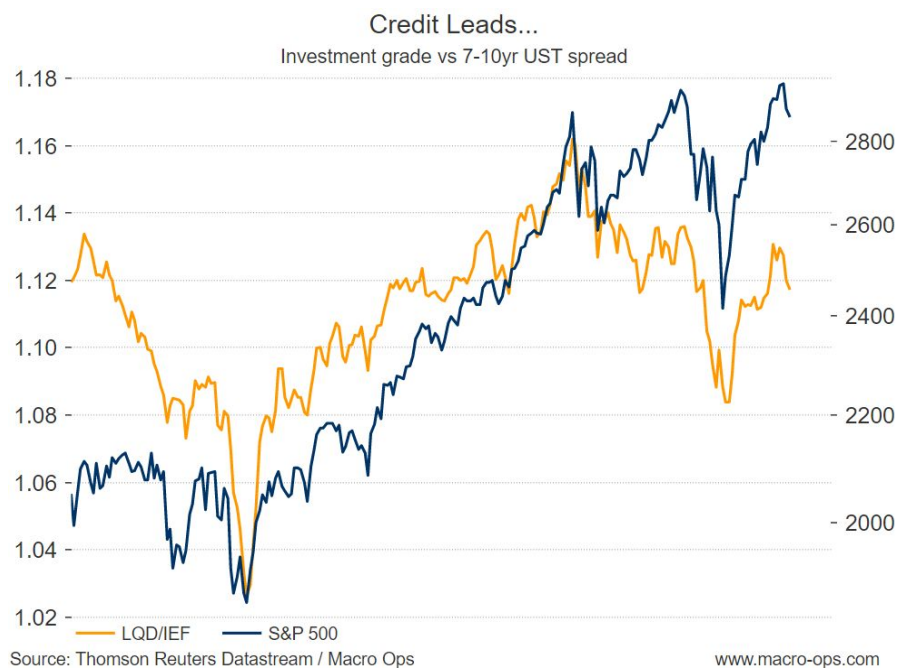
Then we have the AAll Bull-Bear Net Sentiment which I'd been noting the last few weeks that it was stretched bullish and therefore meant more downside likely ahead. Well, it has completely reversed and is now near levels that have marked intermediate bottoms in the past.

AAll Bull-Bear Sentiment



The near-term technical and sentiment/positioning picture is now as muddled as ever, in my opinion. The fundamentals are clearly deteriorating but there are a number of developments that can reverse things, at least for a short while, such as more Chinese stimulus or a major change in Fed policy. Of course, there's an equal, if not greater, number of plausible developments that could really torch things now (more trade war stuff, US bombs Iran etc...)

I'm still keeping an eye on credit and spreads. JNK is holding up surprisingly well, for now at least. And the investment grade to Treasury performance spread is not doing much. If stocks are going to go on a sustainable run higher from here then we'll need to see that orange line make a new recent high. If not, then, derisking will be the move.

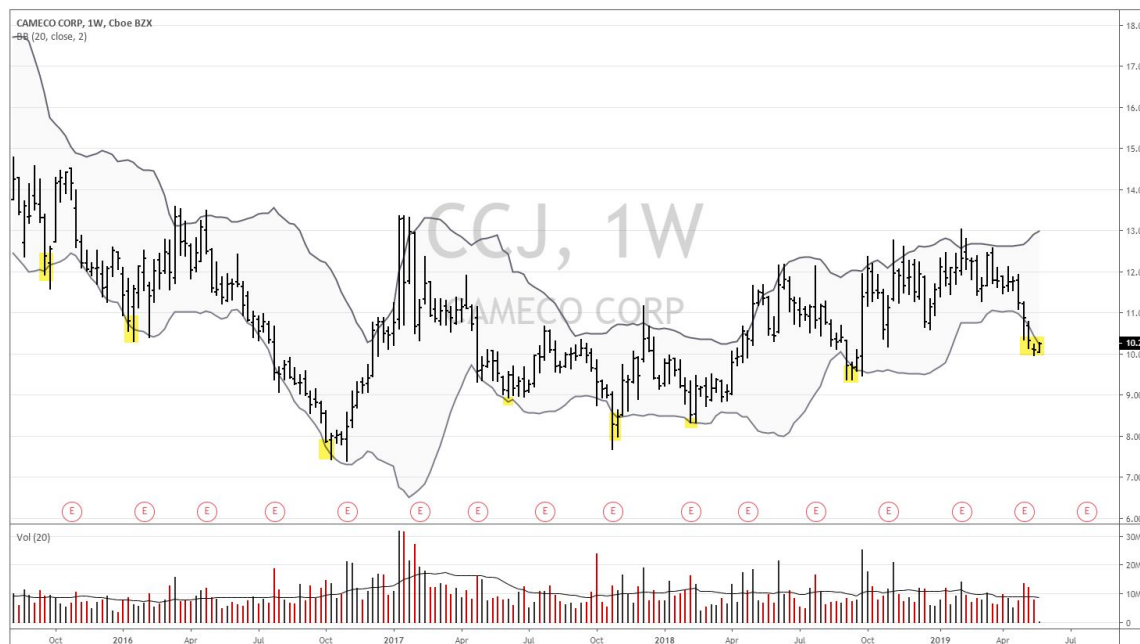


Target Watchlist

Since we're operating under the current macro assumption that we're in the early stages of a massive capital rotation out of high multiple growth stocks into beaten down value names (see our most recent MIR), we're going to be putting on a position in Uranium Miner Cameco (CCJ).

I've written quite a bit about the uranium space over the last two years but if you're not caught up on the bullish thesis, then give Biren's recent writeups on the subject [here](#) and [here](#). He's done as good of a job as anyone laying out the bull case.

The company has a strong balance sheet, positive free cashflow, and is selling on the cheap. The stock just sold off below its lower weekly Bollinger Band, an event that has marked a good buying opportunity in the past. Expect a trade alert on this one soon.



And then we're finally going to be putting a position on in shippers. I missed the initial entry on these after Mr. Bean and I laid out the bull case for this space. But I'm tired of waiting on the sidelines, pinching pennies while dollars are on offer, and waiting for a pullback. So we're going to establish a position in a basket of names (I'm thinking STNG, DSSI, and LPG). Will I toptick shipping stocks with these entries? Likely... The market Gods can be cruel. Here's our original writeups on the [shipping space](#) and some [select names](#).

Portfolio Update

We're seeing a complete and total narrative destruction take place with TSLA. See this monthly chart of the stock. It's fugly. Our June 19' 220 puts are now in the money and in short-time I think the rest of our puts will be as well.

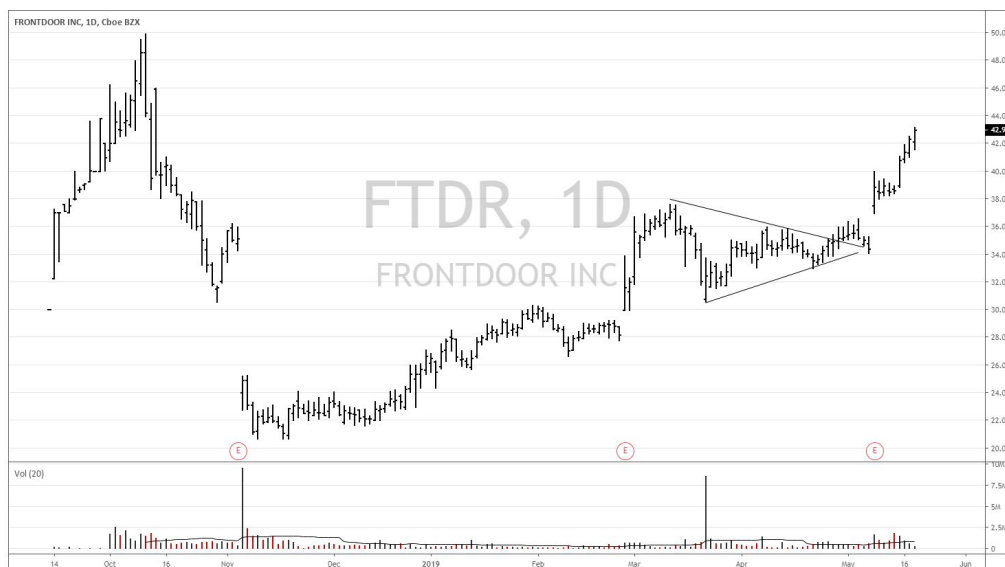


Institutional holders have been dumping the stock as fast as the market will let them while young retail bagholders — sorry, I mean investors — are rushing in to take the stock off their hands so they can hodl it in their Robinhood accounts. Chart below is from [RobinTrack.net](https://robintrack.net) and tracks the trade flows of Robinhood accounts.



Meanwhile, Street analysts are in a rush to downgrade their previously ridiculous price targets so to save face.

Our long position in home warranty and services company, Frontdoor (FTDR), is off to a good start. The stock is up roughly 26% since we initiated the position last month.



Our small position in Graftech (EAF) on the other hand, hasn't gone anywhere — yet...

The market continues to horribly misprice this stock but mispricings like these don't last forever, they just require patience as long as the thesis stays valid. The stock is bouncing off its lower weekly Bollinger Band and I'm considering buying a little more at these levels. Oh, and if you haven't already, go and give this video a watch ([link here](#)). Mr. Bean posted it to the CC. It's a recent investor pitch on Graftech from last month's Valuespana conference. There's also a good one in there on another holding of ours, Garrett Motion (GTX).

