Kabuki Theatre

Summary:

- US/Mexico Trade War on again, off again
- Market Trifecta is strong but tape bomb risks are high
    - Momentum in semis
    - RoC in bonds
    - Strong Breadth
    - Market near upper daily BB
- Dollar Update
- On Watch: Bond short
- Starter positions in energy names (upcoming MIR topic)

The trade war with Mexico ended before it even began. The two sides reached a temporary truce allowing our neighbor to the South to buy some time. The deal hinges on Mexico's ability to stem the flow of migrants traveling to the US across our shared border.

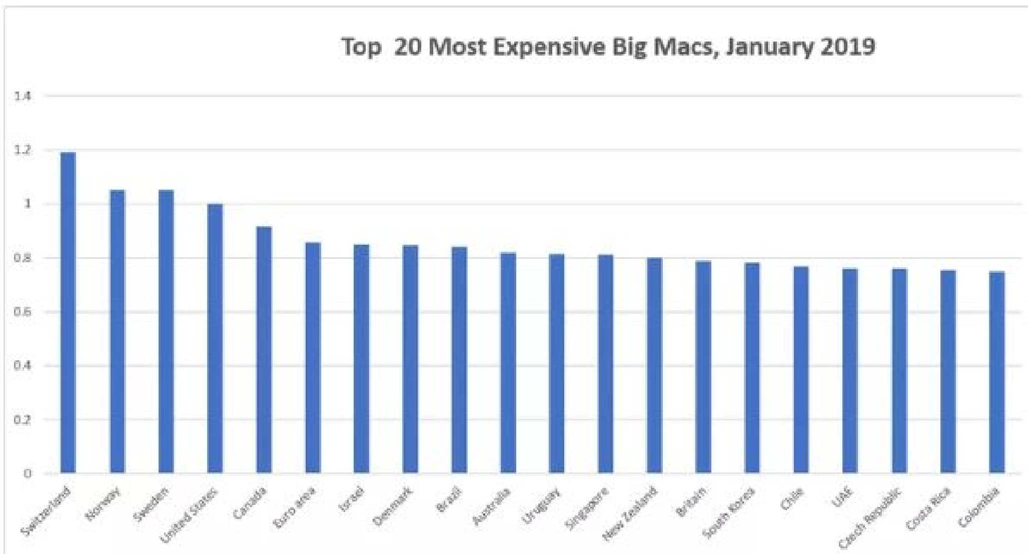
The peso reversed nearly all of its selloff following the initiation of the trade spat (chart is a weekly).

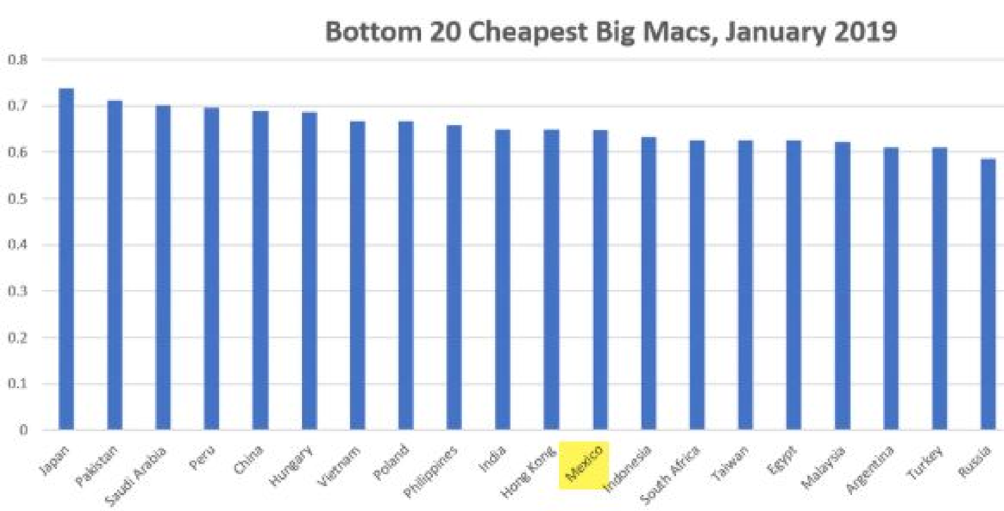
I was discussing with another member in the Comm Center last week a theory that we both share. And that is that Trump is intentionally playing economic chicken, shooting from the hip with tariff threats, not just to rile up his base but also to push the Fed into cutting interest rates.

Once he gets his cuts he'll reverse course on the trade front, make amends, and lay the foundation for an equity runup into next year's election.

Maybe it's giving him too much credit, I don't know.

What I do know is that the peso is cheap… You can get a Big Mac in Mexico City for about 35% less than what you'd pay in the states (chart via *The Emerging Market Investor*).

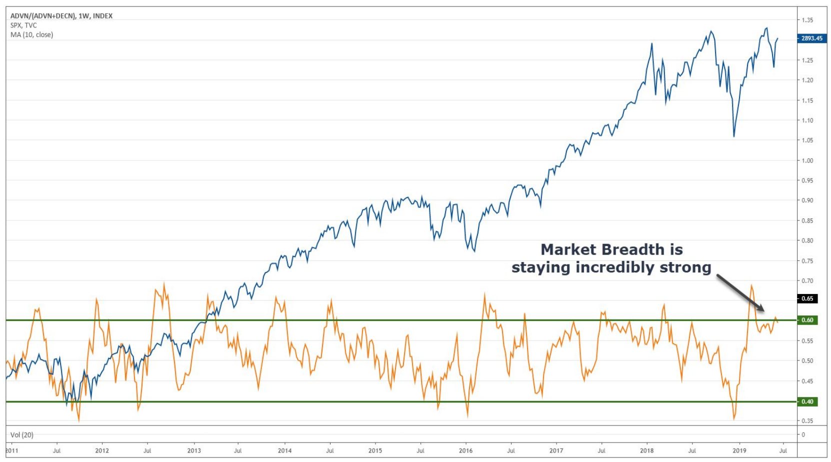




I was looking to get long the peso (short USDMXN) before this trade war threat. I'd still like to though there are obvious tape bomb risks to the trade (i.e., another market moving tweetstorm). I'm just watching the chart, for now, to see how price shapes up. There's significant support around its trendline and 200-week moving average (blue line in the chart above). If it looks like it's going to break through, we'll put on a starter position.

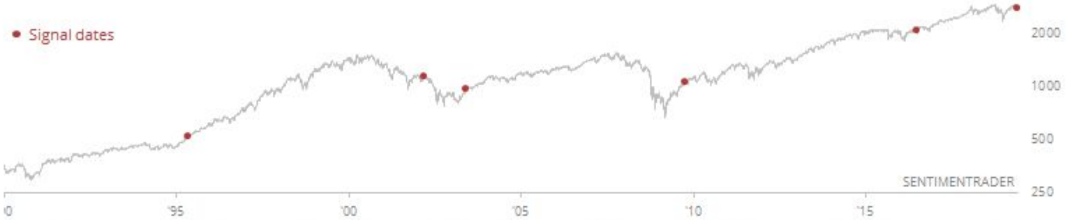
The stock market's Trifecta is strong at the moment. Sentiment continues to become more pessimistic despite the recent rally in stocks. Our leading equity indicators such as semis (SMH), high-yield (JNK), and credit spreads (LQD/IEF) are all moving up and to the right.

Our take on the late Marty Zweig's "Breadth Thrust Indicator" continues to hang near highs (orange line below). This means that there are more stocks rising than falling. A sustainable rally needs broad-based participation like this.



Sentiment Trader shared in a recent note that more than 15% of S&P 500 stocks hit new 52-week highs last week for the first time in a year and a half. According to their study, there have only "been 5 other times since 1990 when it took a year or more to achieve this many new highs within the index." And despite a "fakeout in 2002… the others were all fantastic winners, with very little risk over any time frame." Here's the table showing the median follow on returns.

S&P 500 after > 15% of members at new high, 1st time in 1 year (1990-2019)



Signals	1 Week	2 Weeks	1 Month	2 Months	3 Months	6 Months	1 Year
1995-05-04	0.7	-0.2	2.9	5.1	7.3	12.2	23.6
2002-03-04	1.2	1.0	-2.5	-6.0	-9.8	-20.6	-28.8
2003-06-02	0.9	4.5	1.6	2.4	4.2	9.4	15.9
2009-10-08	2.9	2.6	0.4	2.5	7.5	12.3	9.4
2016-06-30	1.5	3.0	3.4	3.7	2.5	7.2	15.5
2019-06-06							
Median	**1.2**	**2.6**	**1.6**	**2.5**	**4.2**	**9.4**	**15.5**
% Positive	**100%**	**80%**	**80%**	**80%**	**80%**	**80%**	**80%**
Risk	-0.1	-0.2	-0.5	-0.5	-0.5	-0.7	-0.7
Reward	1.5	3.0	3.0	4.3	4.6	9.5	16.9
Z-Score	2.8	2.8	0.8	0.5	0.7	0.8	0.7

© SENTIMENTRADER Numbers are % return after signal; Risk = avg max loss; Reward = avg max gain; Z-Score +/- 2 suggests significance.

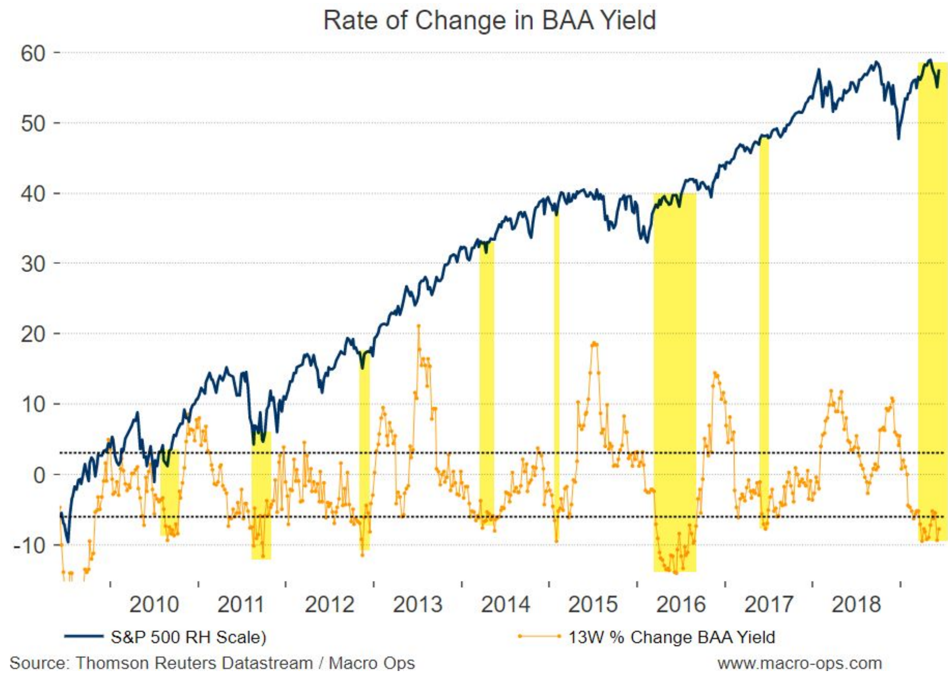
One of the biggest tailwinds to this rally — that we've been continuously pointing out — is the huge drop in interest rates.

Stocks and bonds compete with each other for capital flows. When bonds get bid up, their yields fall. This lowers the discount rate on stock valuation models and widens the risk premia for stocks, making them more attractive. Money then flows out of bonds and into stocks until yields rise to the point where the flows reverse and so on in a endless back and forth of the pendulum.

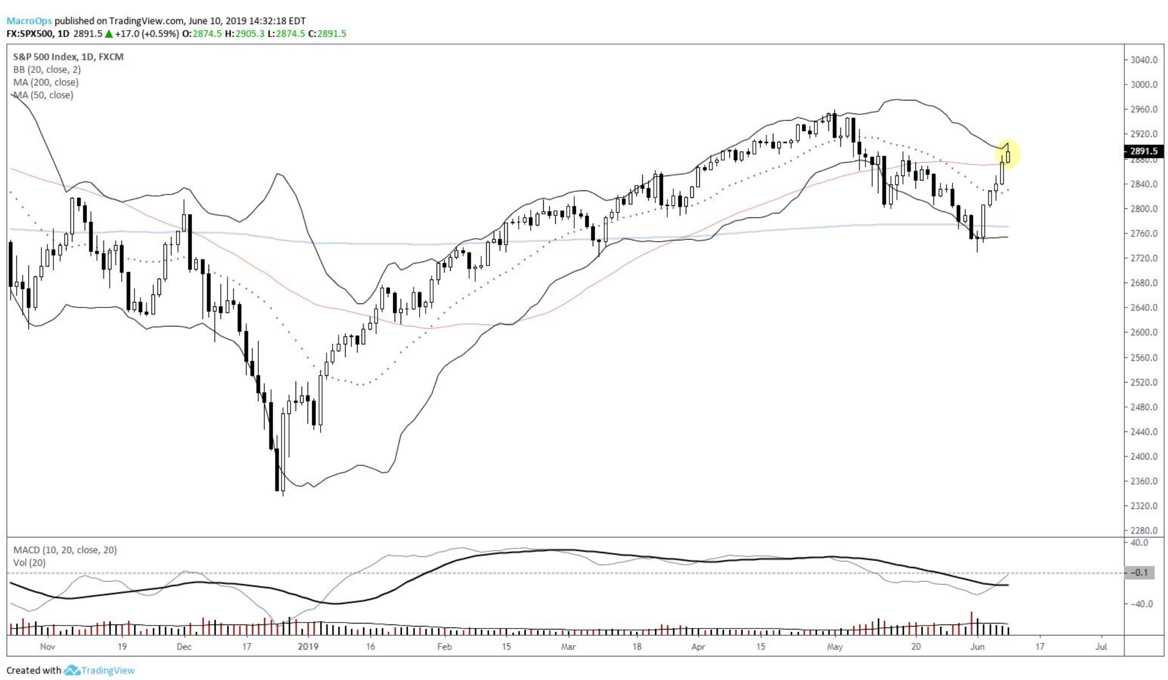
One of the few macro blogs I read regularly is [Macro Charts](). He commented on this stock/bond flow relationship in a recent post titled “The Most Important Force in Stocks” where he wrote:

> *Once again nothing works perfectly, but Stocks generally do well after Yields fall sharply. So let’s go back to the start: is the recent Bond rally telling us something bad is coming?*
>
> *Maybe.*
>
> *Or maybe despite the loud chorus of sideline crisis-callers, the Bond rally may have just* ***saved*** *the economy (and the Stock market) yet again.*
>
> ***For this entire Bull market, yield declines of this magnitude have created huge runways for Stock prices to recover.***
>
> *Bull trends die from inflation scares, not disinflation scares. Some of the biggest Stock corrections in recent years came after Yields rose sharply.*
>
> ***Equities love low-inflation/disinflationary growth.*** *If there’s one “truth” in investing, this could be it. Disinflationary growth has kept this Stock Bull market plodding along for longer than anyone thought possible.*

I agree wholeheartedly. This is why the rate of change in BAA yield (chart below) is one of my favorite stock market indicators. The indicator has only been this low a few other times this cycle and more often than not, it has marked major bottoms.



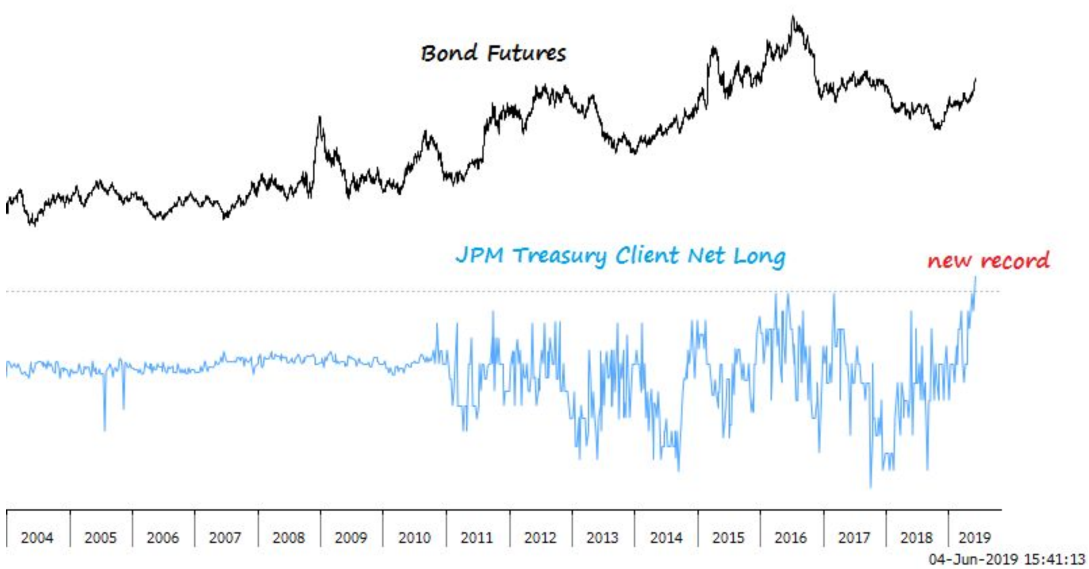
The S&P is knocking up against its upper daily Bollinger Band at the moment. We should expect a pause in the action over the next few days. Perhaps a slight pullback or some sideways chop until we get the Fed meeting next week. We're going to be putting on some positions between now and then but don't want to get too aggressive ahead of the FOMC.



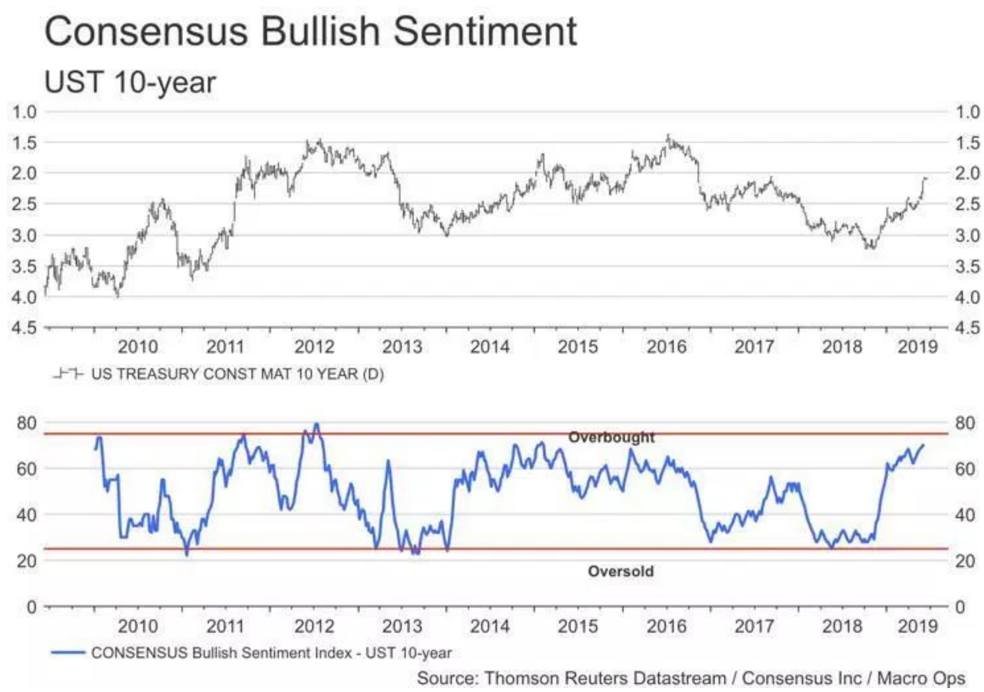
To turn back to our stock/bond circular flow model. If stocks do significantly rise from here then capital should flow out of bonds and chase into stocks somewhat. I've been patiently waiting for momentum to wane in bonds before trying to put on a short. I think we're getting close.

They are overextended now on every time frame (monthly, weekly, daily). The chart below shows 10-year USTs are trading above their monthly Bollinger Bands.

Positioning is at record long levels.

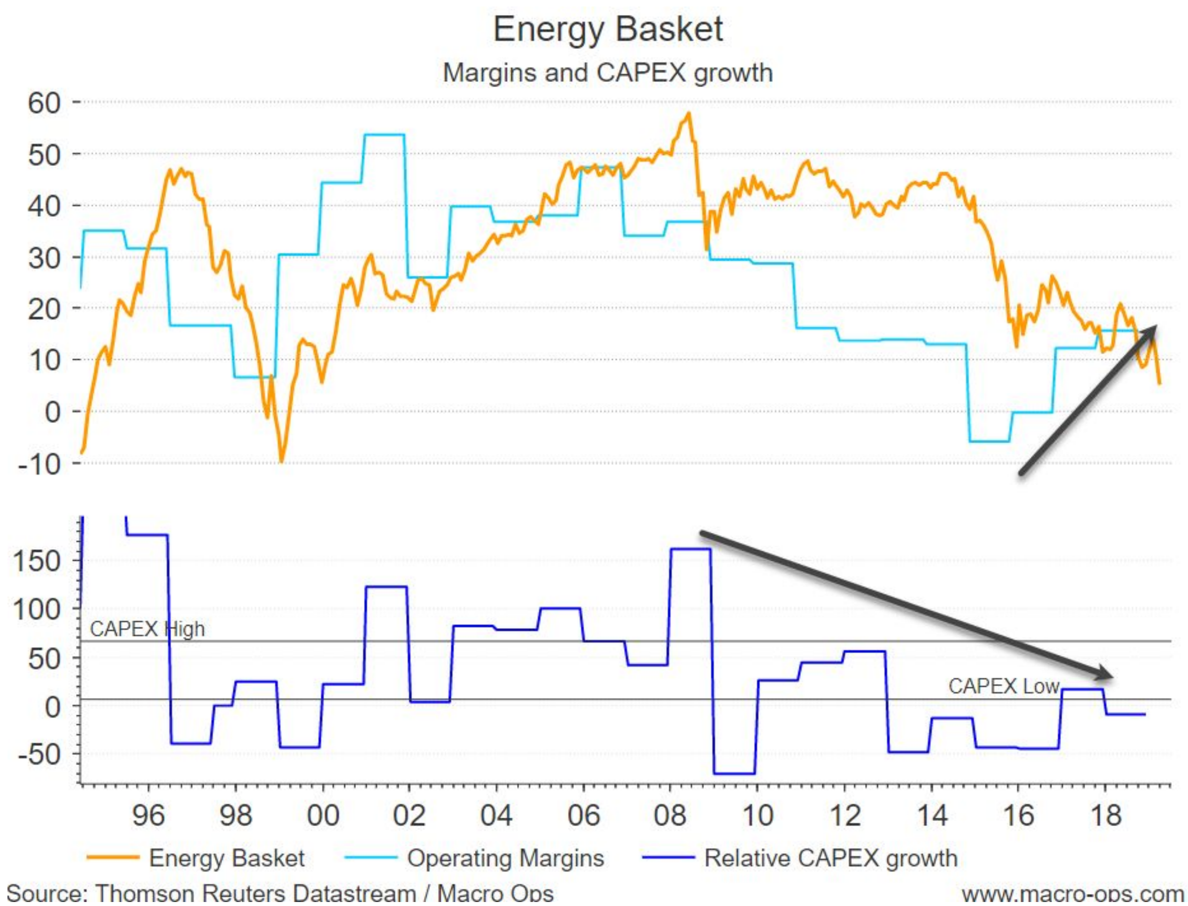


And bullish bonds has now become a “consensus” take.



We put on the first layer of our dollar (DXY) short position last week. It’s teetering on its trend line and is looking like it’s on the ropes. If it breaks below we’ll look to increase our position through either adding to our DX_F (futures) trade or opening additional short USD trades through long CAD, MXN, EUR. All of have very strong looking charts. This is a clear go or no-go zone. If the dollar reverses higher we’ll quickly cut the trade and limit our losses.

The area of the market that I'm most interested in right now is energy. It's gone way past the stage of being hated to where it's now just totally ignored by investors. It's seen its deepest cuts to capex in history over the last 6-years. The capital cycle framework explains what this means: lower capex = future supply and lower supply = higher future prices.



Operating margins are steadily improving in the space (light blue line above). And there are some incredible values to be found, such as E&Ps selling for just 1x normalized FCF. It's nuts.

A dollar selloff would reignite the oil market and perhaps finally send some money flowing back into the energy sector. I'll be writing more about this in the upcoming MIR which I hope to get out to you guys within the next week.

That's all I've got!

Oh, I'd also like to welcome the new members who just joined the Collective. It's great to have you onboard! When you get a chance, hop on into the Comm Center and introduce yourself to the rest of the group.

If you've got any questions for us in the meantime, let us know in the Comm Center. Have a great week!

Your Macro Operator,

Alex

Macro Ops Portfolio			YTD					
			12.78%					
Big Bet Macro								
Asset Class	Position	Position Size	Cost Basis	Notional %	Risk Point	Target	Last Price	P&L
Equity	Construction Partners (ROAD)	8,438	$12.25	9.84%	$10.80	$17.00	$13.15	7.35%
Equity	Fiat (FCAU)	2,666	$15.20	3.18%	$13.70	$28.00	$13.46	-11.45%
Equity	Garrett Motion (GTX)	5,630	$15.11	8.01%	$13.80	$25.00	$16.04	6.15%
Equity	Discovery DISCA	1,300	$28.09	3.26%	$26.70	$60.00	$28.30	0.75%
Equity	Disney DIS	2,146	$102.34	26.13%	$108.50	$150.00	$137.35	34.21%
Equity	Yatra Online YTRA	13,877	$7.24	4.85%	Investment	$15.00	$3.94	-45.58%
Equity	Graftech (EAF)	2,205	$13.59	2.05%	$10.00	$25.00	$10.49	-22.81%
Equity	Frontdoor (FTDR)	1,240	$34.10	4.56%	$28.00	$55.00	$41.50	21.70%
Equity	Anglogold (AU)	5,500	$11.79	7.02%	$10.75	$18.00	$14.39	22.05%
Equity	TSLA Sep '19 175 Put	11	$13.81	1.48%	$0.00	$85.00	$15.15	9.70%
Equity	TSLA Jun '20 100 Put	14	$10.70	1.43%	$0.00	$85.00	$11.55	7.94%
Equity	TSLA Jan '20 150 Put	5	$15.01	0.74%	$0.00	$60.00	$16.70	11.26%
Equity	DIS Jan '20 165 Call	205	$1.11	3.36%	$0.00	$10.50	$1.85	66.67%
FX	Sep Dollar Futures	-7	$96.51	-59.78%	$97.55	$102.00	$96.31	0.21%
							**Updated 6/10	