A Bad Moon Rising...

Summary:

- Why the market is heading for a rough patch
  - Stretched sentiment
  - Slowing Growth
  - High Valuations
- Portfolio Changes: drastically reducing our equity exposure
  - Taking ⅔ profits on Disney (DIS)
  - Reduce Target Hospitality (TH) position by half
  - Take ½ profits on Construction Partners (ROAD)
  - Reduce Sandridge (SD) position by half
  - Close entire Yatra (YTRA) position
- Target List
  - Precious metals confirming breakout and start of a new cyclical bull
    - Silver should lead
  - USD still headed lower
    - Entering MXNUSD on breakout

Markets are about to hit some rough seas in the month(s) ahead. I'm not calling for a bear market or major crash but more expecting some choppy sideways/slightly lower action. We're going to button up the hatches a bit (ie, reduce equity exposure).

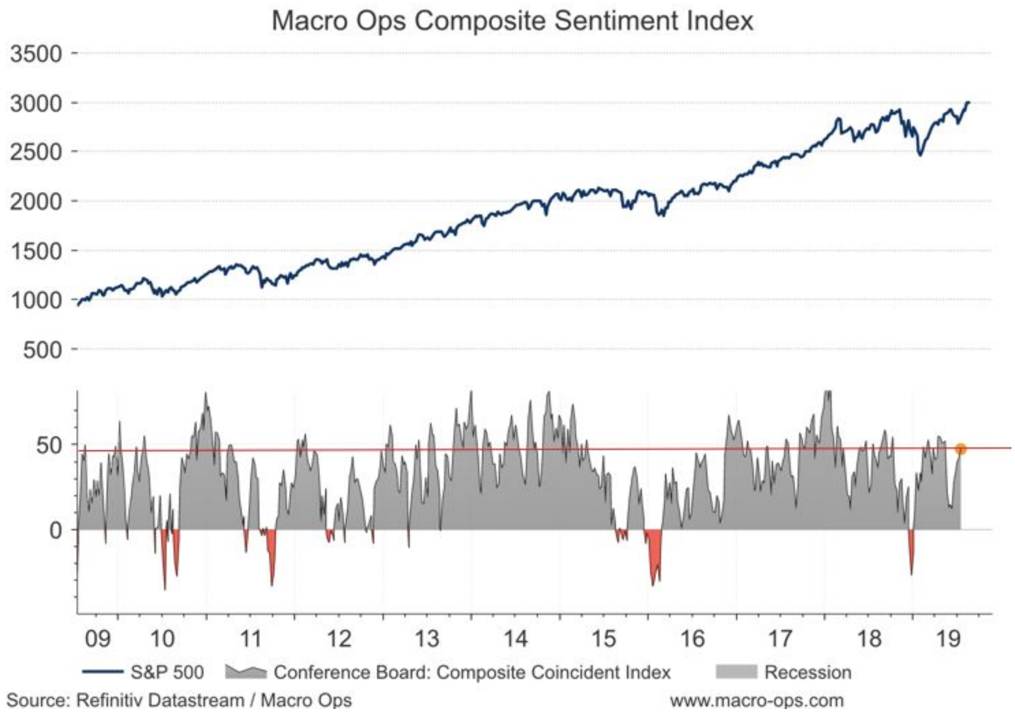
Here's what I don't like:

- Numerous measures of sentiment/positioning are now showing excessive bullishness and complacency
- Our indicators suggest US GDP is about to roll over hard and that means lower earnings
- Consensus earnings estimates for Q4 on are way too high considering
- Market valuations are at levels that have acted as a brake on further gains in the past
- I'm expecting earnings beats but bearish guidance this quarter

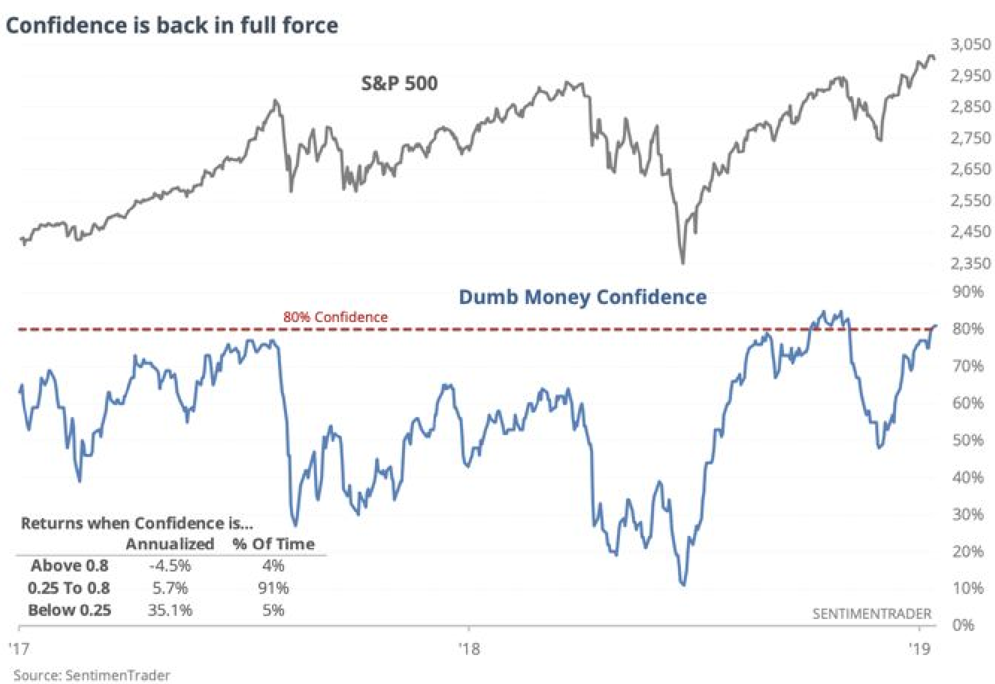
I'll walk you through each one, then we'll discuss changes we're making to our book, and I'll finish with how/when I think this period of volatility will end.

Starting with sentiment and positioning.

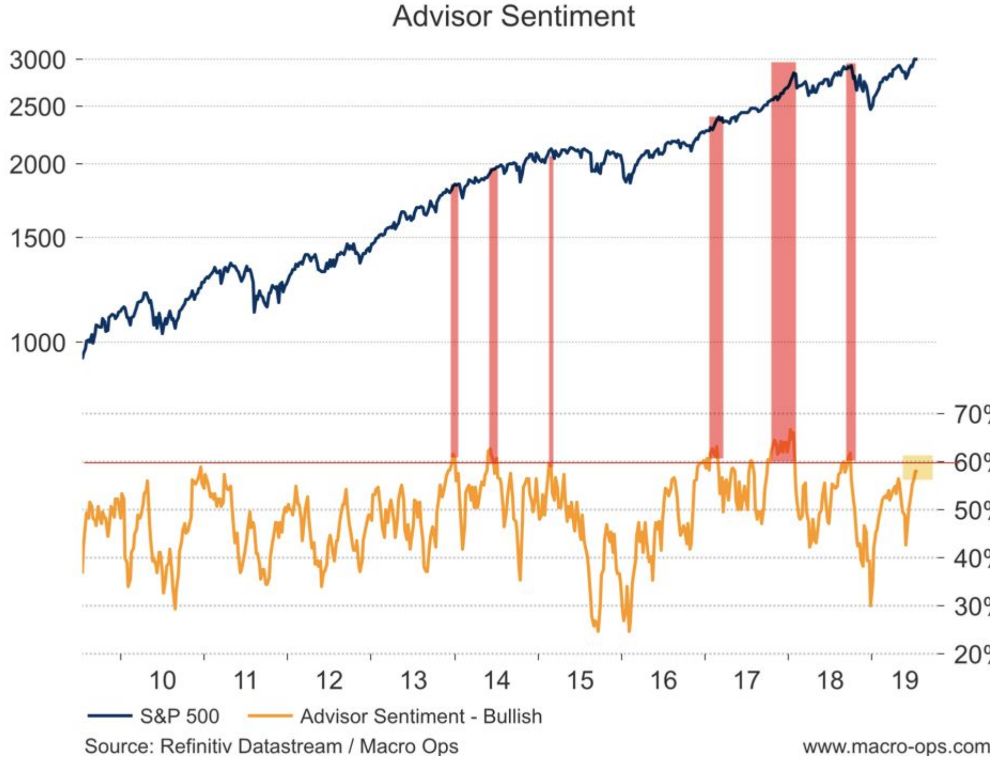
Our Composite Sentiment/Positioning Index is back above the 50 level (red line) which marks excessive bullishness and complacency.



Sentiment Trader's "Dumb Money Confidence" indicator is near cycle highs. Forward returns for stocks have been weak following similar readings in the past.



Investors Intelligence Advisor Bullishness is near 60%. The market has dipped or traded sideways over the following month each time this indicator has crossed the 60% mark.



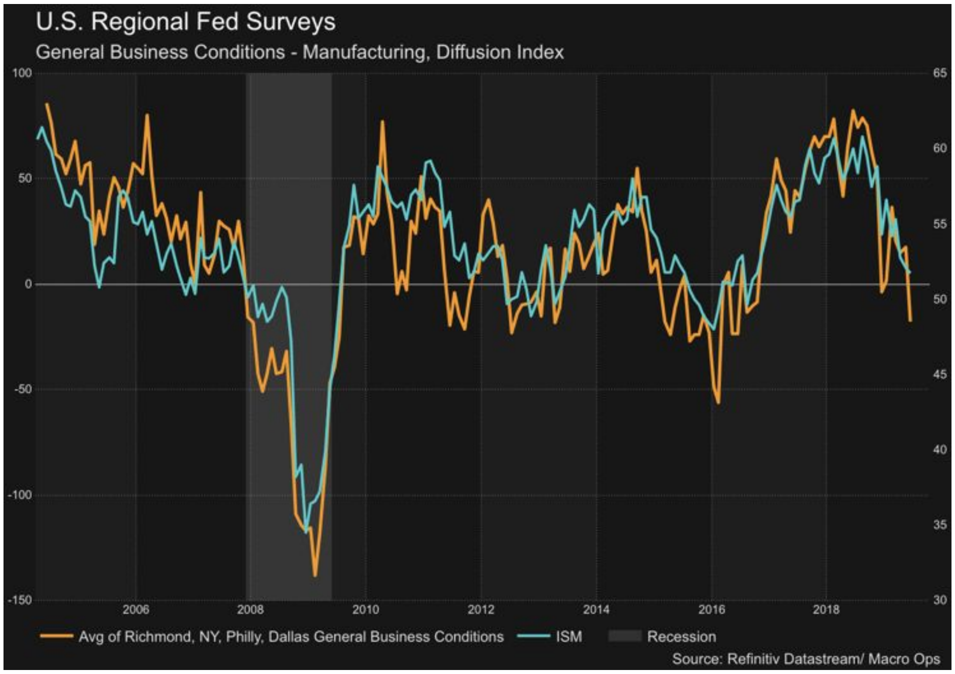
And then our Total Put/Call 10-day moving average indicator shows that investors are complacent and are not hedging their downside relative to their bullish bets.

Now let's look at economic growth.

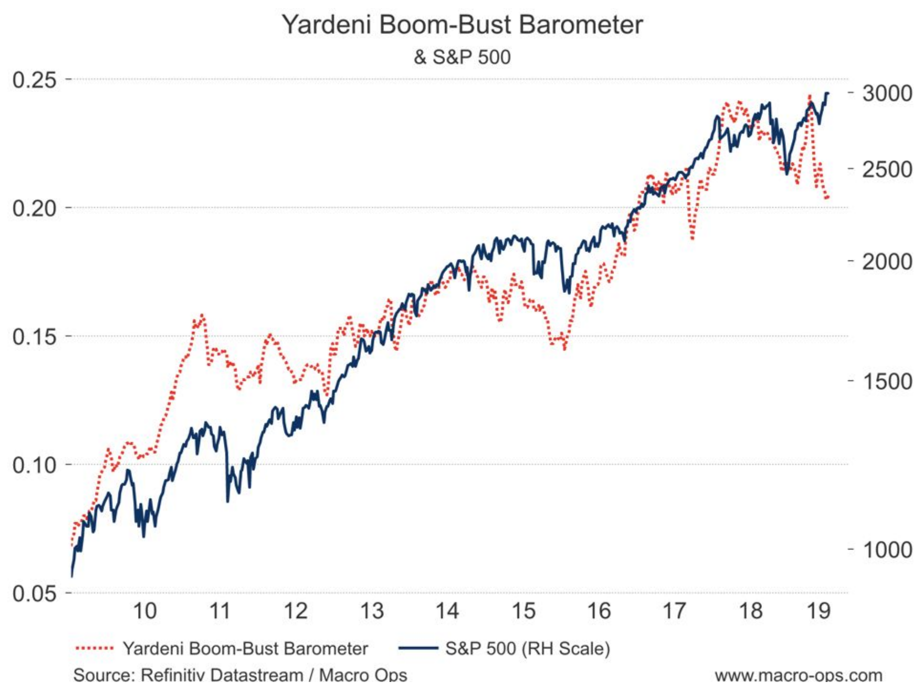
I've been talking about this one a lot, but our Philly Fed indicator suggests US GDP growth is headed for sub 2%.

The Atlanta Fed's GDP Now Forecast is tracking just 1.6% growth.

Our Business Conditions Diffusion Index points to the ISM entering contraction territory in the coming months.



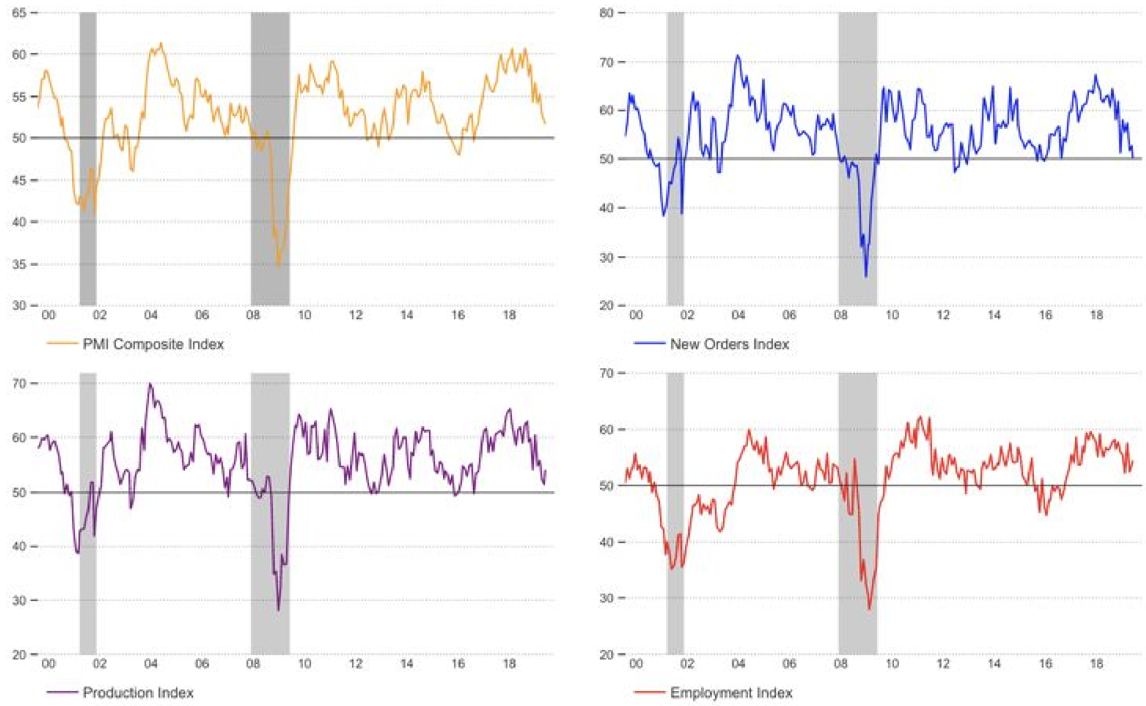
The Yardeni Boom-Bust Barometer, which is a composite fundamental indicator, is diverging from the uptrend in stocks.



Service's growth looks like it's about to follow manufacturing's lead and trend lower.

ISM Manufacturing Indices

Above 50 signals expansion

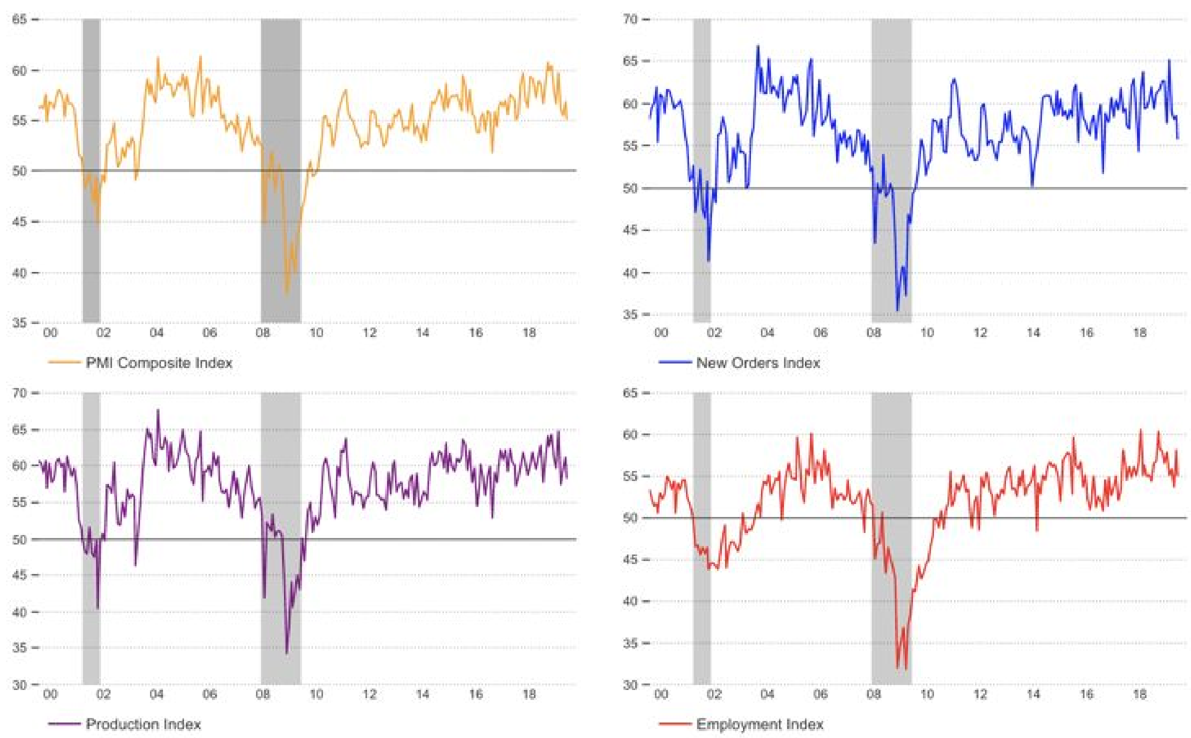


Source: Refinitiv Datastream / Macro Ops

www.macro-ops.com

ISM Non-Manufacturing Indices

Above 50 signals expansion



Source: Refinitiv Datastream / Macro Ops

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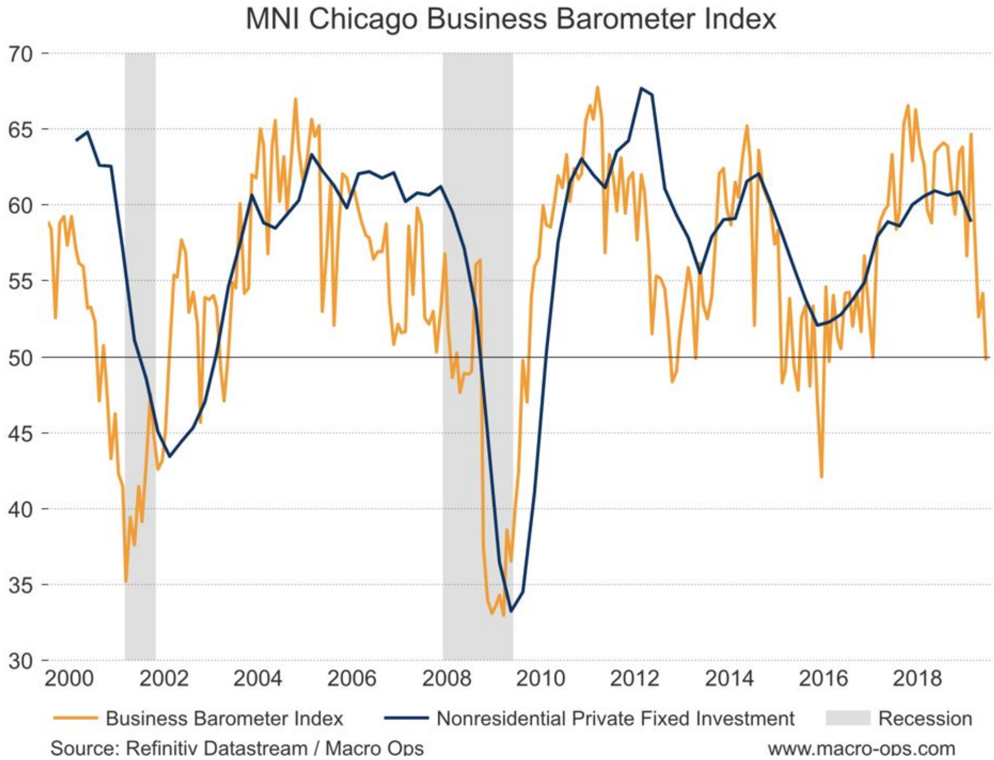
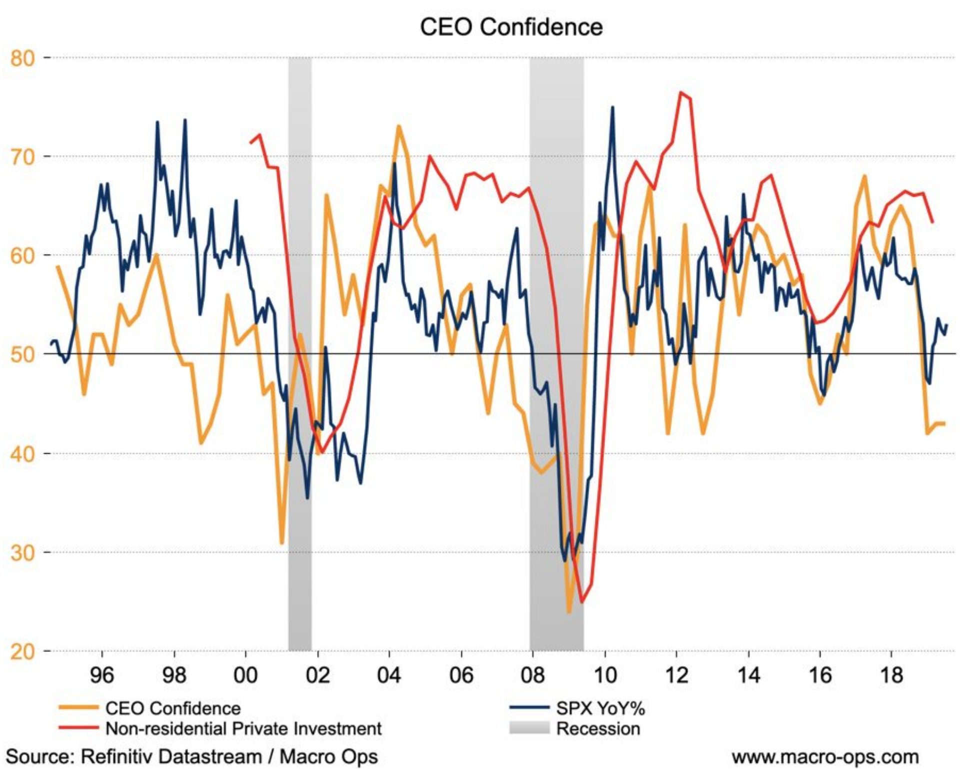
Remember the Levy/Kalecki Profits Equation? Net investment is what drives profits in an economy, which is why capex or non-residential private fixed investment is so important to both economic and earnings growth. This is why the following is no bueno.

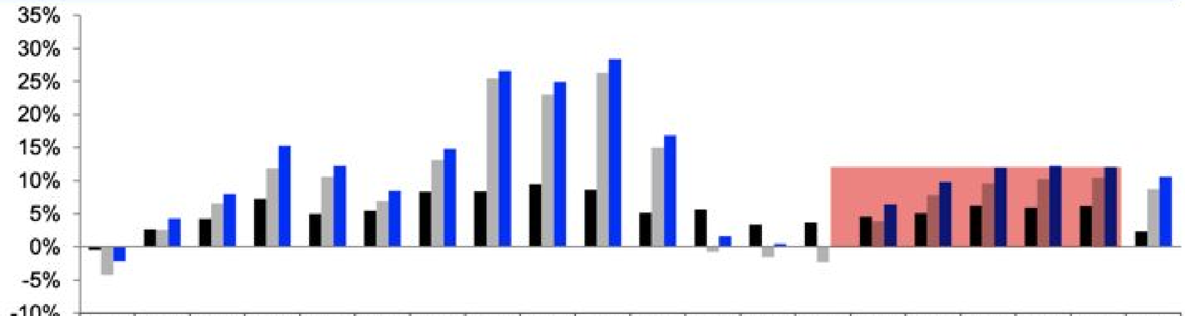




The fiscal stimulus in the US is rolling off. What was once a tailwind is becoming a headwind. Growth in the US is now “catching down” with the rest of the world. This is bearish US equities, bullish bonds, bullish precious metals, and bearish the US dollar.

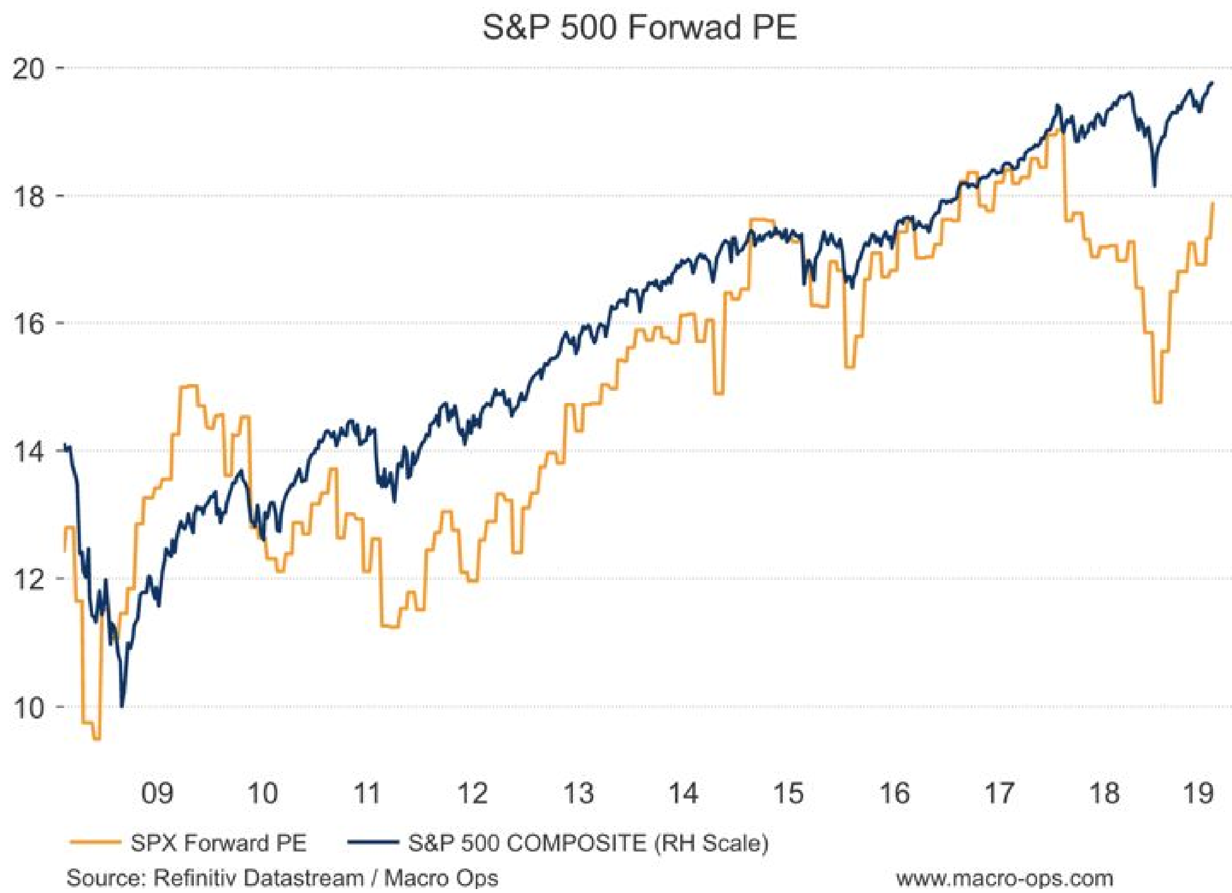
Considering this backdrop, earnings estimates following Q3 onwards are way too optimistic and the current Forward PE for the S&P 500 is too high at just under 18x next year’s earnings.

Exhibit 5. S&P 500 YoY Growth Rates



	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	21Q1
Revenue	-0.4%	2.6%	4.2%	7.3%	5.0%	5.5%	8.3%	8.4%	9.5%	8.6%	5.1%	5.7%	3.4%	3.6%	4.6%	5.1%	6.2%	5.9%	6.2%	2.3%
Net Income	-4.2%	2.6%	6.6%	11.9%	10.6%	6.9%	13.1%	25.4%	23.0%	26.3%	15.0%	-0.8%	-1.6%	-2.3%	3.9%	7.9%	9.6%	10.2%	10.4%	8.8%
Earnings	-2.1%	4.3%	8.0%	15.3%	12.3%	8.5%	14.8%	26.6%	24.9%	28.4%	16.9%	1.6%	0.4%	0.0%	6.4%	9.8%	11.9%	12.2%	12.1%	10.6%

Source: I/B/E/S data from Refinitiv



Consensus earnings estimates for this quarter are low so I'm expecting some easy beats. But we're likely going to get decent beats coupled with bearish forward guidance and management commentary this quarter, commentary like the following from CSX Corp's recent earnings release (excerpt via CNBC):

> "Both global and U.S. economic conditions have been unusual this year, to say the least, and have impacted our volumes. You see it every week in our reported carloads," Chief Executive James Foote said on a conference call Tuesday after the earnings report. **"The present economic backdrop is one of the most puzzling I have experienced in my career"**
>
> Mark Kenneth Wallace, executive vice president of CSX, said on the earnings call. "On the merchandise ... **there are signs of slowing economic conditions in both IDP and GDP for Q3 and Q4, pointing to a less robust economy in the second half.**"
>
> "We've obviously seen evidence of this in our own business, and now see a softer industrial environment, with signs in our automotive, chemicals and metals segment," Wallace said.

In light of all this, we're going to make the following changes to our portfolio:

- Take ⅔ profits on our long Disney position; both stock and call options
- Cut our position in Target Hospitality (TH) by half and widen the existing stop
- Take ½ profits on our long Construction Partners (ROAD) position
- Reduce our long Sandridge (SD) position by half
- Close entire Yatra (YTRA) position following confirmation of EBIX buyout

We'll look to add back to these names once the market washes out the excess sentiment and positioning.

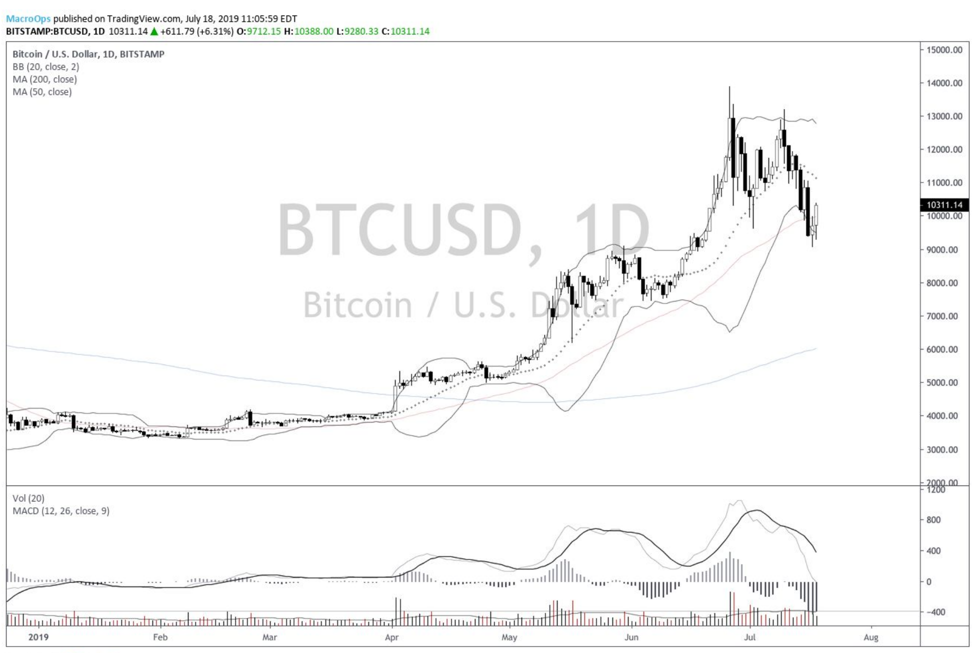
Bonds should do well in this environment and we may buy some in the week ahead. Though I am concerned with the debt ceiling debate coming to a head, that bonds may not perform as well as a hedge as they usually do. If this ends up being the case then stocks will be in for a much bumpier ride.

Precious metals are breaking out and I believe that they're now in the early stages of a cyclical bull market. Silver confirmed the bottom that I pointed out last week. Silver should outperform gold in the coming months. We're going to be entering a long position in futures or adding one of the miners (CDE, PAAS, FSM) to our book, as well as adding more to our long Anglogold position.

The dollar is still in a range but it should head lower in the coming months as US growth slows and catches down to the rest of the world; closing the wide US/DM rate spread.

One of the best looking charts — outside of our current short DXY positions in long CAD and CHF — is the peso (chart below is a monthly). I'm looking to add this to our book on a confirmed breakout.

We're also going to enter a long position in bitcoin. Bitcoin has been trading inline with gold and seems to be moving off the same drivers (ie, an alternative to the growing number of assets with negative real yields). BTC is bouncing off its lower Bollinger Band, giving us a nice inflection point to enter.



Trade alerts will be coming out shortly.

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 14.76%

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	10.23%	$10.80	$17.00	$13.92	13.63%
Equity	Disney DIS	2,146	$102.34	26.43%	$108.50	$150.00	$141.34	38.11%
Equity	Yatra Online YTRA	13,877	$7.24	5.18%	Investment	$15.00	$4.28	-40.88%
Equity	Graftech (EAF)	2,205	$13.59	2.07%	$10.00	$25.00	$10.78	-20.68%
Equity	Frontdoor (FTDR)	1,240	$34.10	4.92%	$28.00	$55.00	$45.54	33.55%
Equity	Anglogold (AU)	2,750	$11.79	4.46%	$10.75	$18.00	$18.60	57.76%
Equity	W&T Offshore (WTI)	4,710	$4.81	1.99%	$3.60	$8.00	$4.84	0.62%
Equity	Ecopetrol (EC)	1,686	$18.78	2.78%	$15.40	$25.00	$18.91	0.69%
Equity	Sandridge Energy (SD)	9,661	$6.41	5.36%	$5.80	$12.00	$6.37	-0.62%
Equity	Target Hospitality (TH)	10,000	$9.90	7.76%	$9.30	$15.00	$8.90	-10.10%
Equity	Scorpio Tankers (STNG)	1,700	$27.10	4.27%	$21.00	$40.00	$28.81	6.31%
Equity	TSLA Sep '19 175 Put	11	$13.81	0.30%	$0.00	$85.00	$3.17	-77.05%
Equity	TSLA Jun '20 100 Put	14	$10.70	0.78%	$0.00	$85.00	$6.37	-40.47%
Equity	TSLA Jan '20 150 Put	5	$15.01	0.30%	$0.00	$60.00	$7.00	-53.36%
Equity	DIS Jan '20 165 Call	205	$1.11	5.72%	$0.00	$10.50	$3.20	188.29%
FX	Sep CAD Futures	5	$0.7587	33.47%	$0.7467	$0.8096	$0.7682	1.25%
FX	Sep CHF Futures	7	$1.0301	78.07%	$1.0067	$1.0887	$1.0240	-0.59%

**Updated 7/15