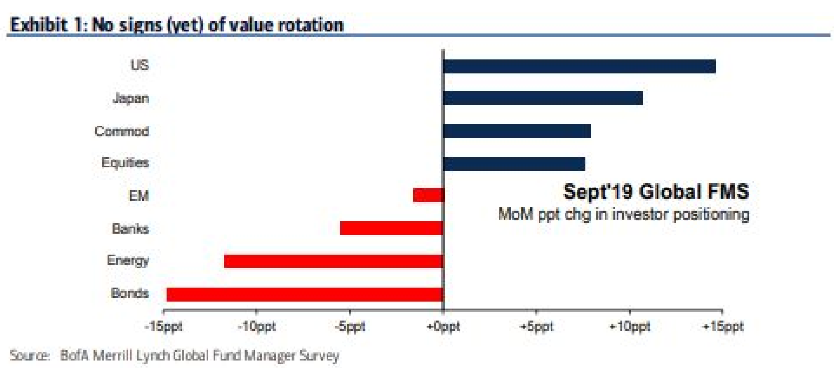
Value in Energy

Summary:

- BofAML Global Fund Manager Survey release
- The setup is sooo ripe for a coming bull run in stocks
    - Positioning offsides
    - Strong breadth thrusts
- FOMC tomorrow - I'm predicting a slightly hawkish cut
- Draghi throwing down the gauntlet
- Is the House of Saud on fire?
- The big trend coming to energy stocks

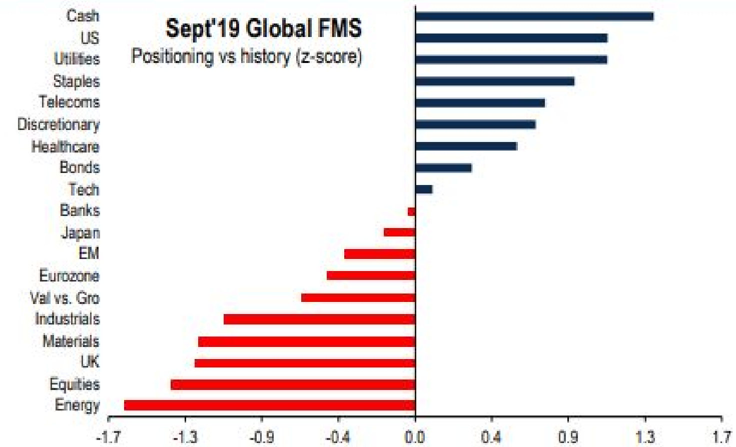
We've got a lot to cover this week but first I'd like to share a few charts with you from the latest BofAML Global Fund Manager Survey which I just posted to the Comm Center (link here).

Funds have been dumping bonds and energy over the last month while buying US and Japanese equities.



Relative to history they remain extremely overweight cash and US assets while running in the other direction from energy and stocks in general.

Exhibit 3: FMS investor asset allocation remains risk-off



Source: BofA Merrill Lynch Global Fund Manager Survey

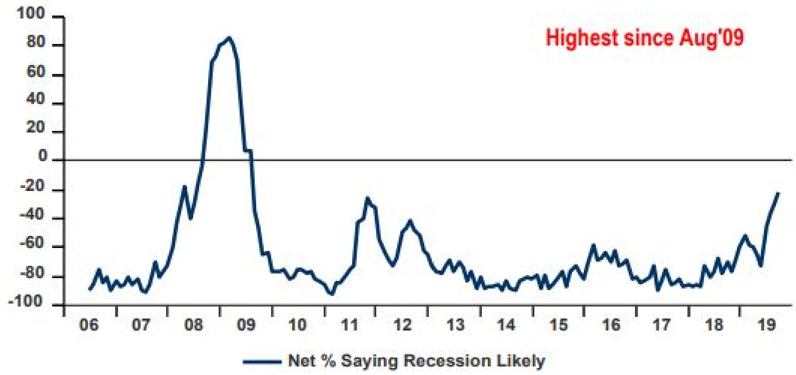
The most “favored region” is the US where current allocations are 1.1 stdev above the long-term average.

Exhibit 39: Net % AA Say they are overweight US Equities

Source: BofA Merrill Lynch Global Fund Manager Survey

The survey has the highest number of respondents expecting a recession since August of 09’.

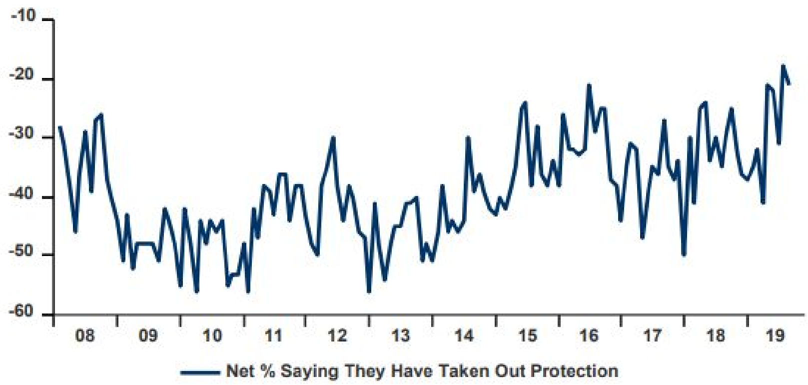
Exhibit 4: How likely do you think it is that the global economy will experience recession (i.e. two quarters of negative real GDP growth) over the next twelve months?



Source: BofA Merrill Lynch Global Fund Manager Survey

And a near-record (last month set the record) number of them have taken out protection against a sharp fall in equity markets over the next 3-months.

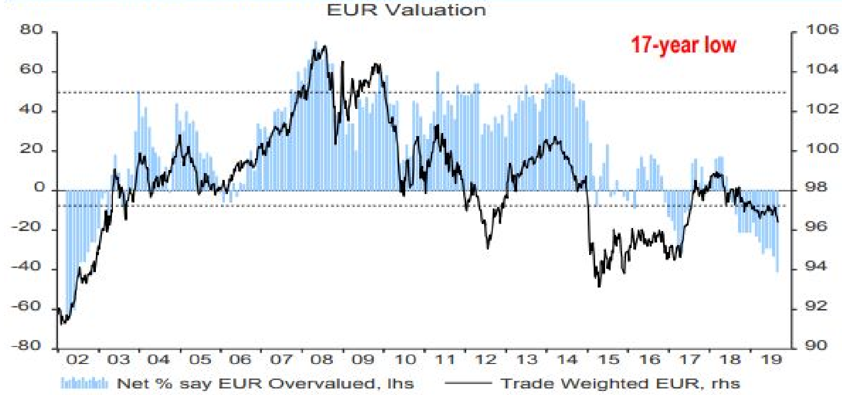
Exhibit 27: Have you taken out any protection against a sharp fall in equity markets in the next three months?



Source: BofA Merrill Lynch Global Fund Manager Survey

The euro's valuation is at a new 17-year low.

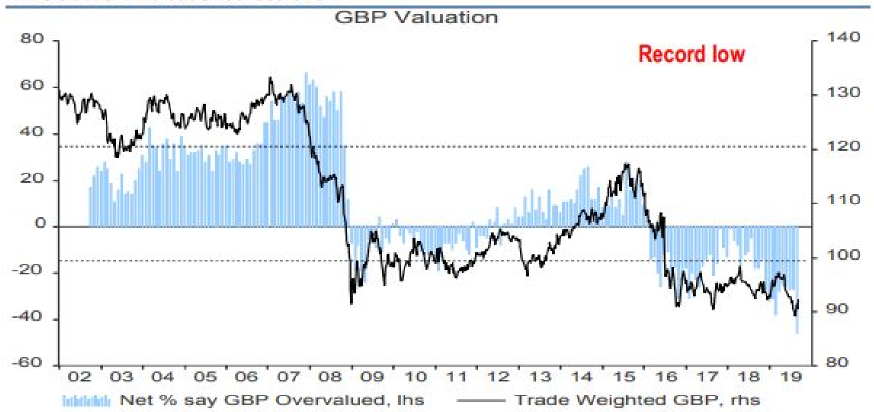
Exhibit 37: EUR valuation at new 17-year low



Source: BofA Merrill Lynch Global Fund Manager Survey

While the pound's valuation is at a record low.

Exhibit 38: GBP valuation at record low



Source: BofA Merrill Lynch Global Fund Manager Survey

Finally, here's another chart showing just how much fund managers hate stocks. There have only been three other times over the past 20-years when their general risk exposure was this low (green highlighted areas).

Exhibit 31: Net % AA Say they are overweight Equities

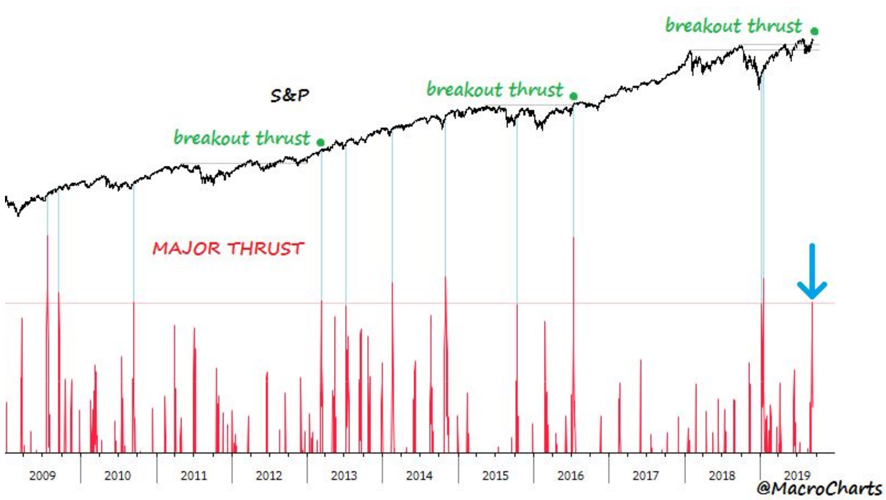
Source: BofA Merrill Lynch Global Fund Manager Survey

Either we're headed into a recession in the near-term — which I don't believe — or the global economy is going to bottom out and return to positive but slow growth and a hoard of fund managers (the survey consists of 230 managing over $650bn and is reflective of the asset management community as a whole) are going to scramble to get more exposure back on, chasing the market higher.

This is the environment I think we're heading into.

I've been commenting on the strong market breadth over the last few weeks, such as the Zweig Breadth Thrust buy signal that was triggered the other week. Well here's another great illustration of the underlying demand-pressure that's starting to come back into the market.

This chart from @macrocharts shows a major "breakout thrust" just occurred.



This indicator was developed by the great technical analyst, Walter Demeer (you can find his public StockCharts chart list here). The indicator actually goes by the name "Breakaway Momentum or BAM" and is similar to the Zweig one we use. Here's Demeer's full breakdown of how its constructed (link here).

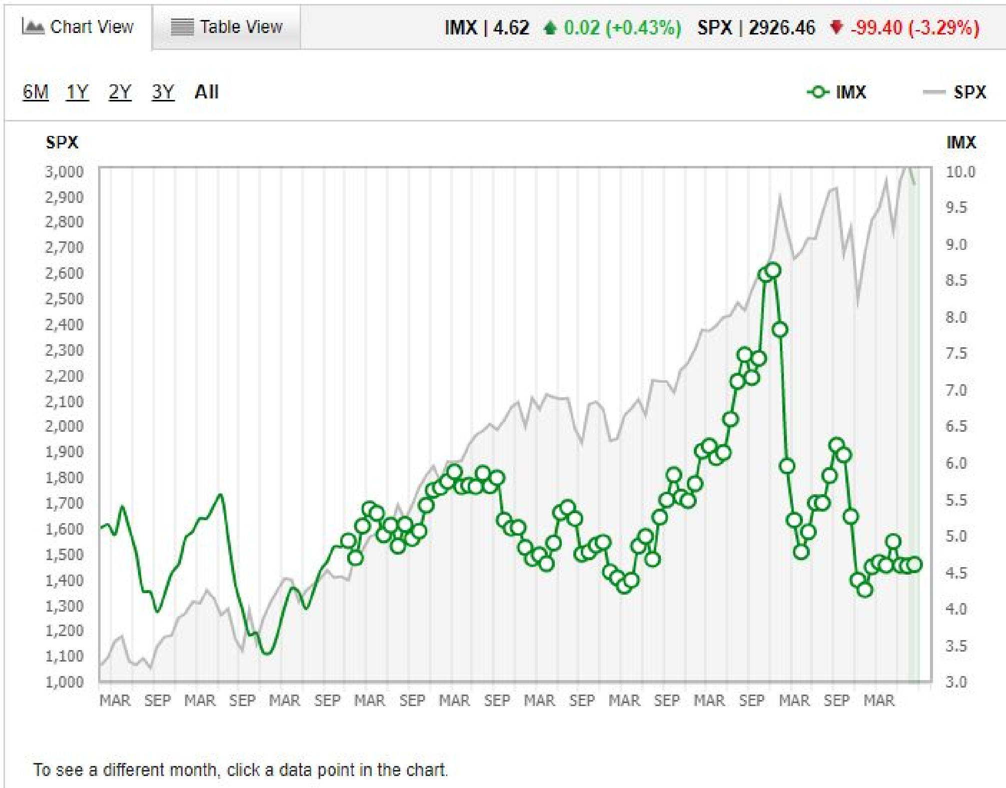
The short summary of it is that it is a ten-day total of NYSE advances minus a 10-day total of NYSE declines. A "breadth thrust" occurs when the total advances are greater than 1.97 times the total declines, which is what's just happened.

Here's a table (it's a bit dated but gets the point across) of the SPX's following returns after a BAM buy signal is triggered. That's a pretty good record.

$SPX Forward Tendency after Breakaway Momentum Signal Since 1949

Signal Date	Close	1 Wk	2 Wk	1 Month	2 Months	3 Months	6 Months	1 Year
7/14/1949	14.79	0.7%	1.7%	3.6%	6.4%	7.0%	12.8%	27.0%
11/20/1950	19.93	1.3%	-2.0%	-3.0%	5.9%	11.0%	10.2%	19.4%
1/25/1954	25.93	0.2%	1.2%	-0.4%	1.9%	7.5%	17.0%	37.0%
1/24/1958	41.71	0.0%	0.0%	-2.5%	1.8%	3.4%	11.8%	33.7%
7/11/1962	57.73	-2.7%	-2.2%	-0.3%	1.2%	-0.9%	12.1%	20.8%
11/9/1962	58.78	2.3%	4.4%	6.0%	10.3%	11.9%	19.9%	22.2%
1/18/1967	85.79	0.1%	0.7%	2.4%	5.1%	7.2%	9.2%	11.4%
12/4/1970	89.46	0.9%	0.8%	3.2%	8.0%	11.1%	13.0%	8.5%
12/8/1971	96.92	1.7%	4.4%	6.8%	7.9%	12.4%	11.1%	21.8%
1/8/1975	70.04	3.0%	2.4%	12.2%	21.3%	18.3%	35.4%	34.1%
1/6/1976	93.53	2.2%	5.7%	9.0%	6.0%	10.7%	10.7%	13.0%
8/23/1982	116.11	1.3%	4.5%	6.8%	19.8%	18.0%	27.5%	41.2%
10/13/1982	136.71	1.8%	-1.0%	3.7%	2.4%	7.3%	14.7%	24.6%
1/23/1985	177.3	1.2%	1.8%	1.2%	0.4%	2.8%	8.1%	15.2%
1/15/1987	265.49	3.2%	3.3%	5.4%	10.2%	7.1%	17.8%	-7.4%
2/5/1991	351.26	4.1%	4.0%	7.0%	7.8%	7.4%	11.2%	17.8%
1/6/1992	417.96	-0.9%	-0.4%	-1.0%	-2.7%	-3.9%	-1.0%	4.2%
3/23/2009	822.92	-4.3%	1.5%	2.5%	7.9%	8.5%	29.4%	42.7%
7/23/2009	976.29	1.1%	2.1%	5.1%	9.8%	10.8%	11.8%	12.9%
9/16/2009	1068.76	-0.7%	-1.1%	2.6%	2.3%	3.7%	9.1%	5.2%
3/11/2016	2022.19	1.4%	0.7%	2.0%	2.1%	3.7%	5.2%	17.4%
7/12/2016	2152.14	0.5%	0.8%	1.1%	-1.1%	0.5%	5.4%	13.5%
	Average	0.8%	1.5%	3.3%	6.1%	7.5%	13.7%	19.8%
	Median	1.1%	1.3%	2.9%	5.9%	7.4%	11.8%	18.6%
	Total	22	22	22	22	22	22	22
	% Positive	77%	77%	77%	91%	91%	95%	95%
Reward: Risk (Average)		2.08	2.38	3.04	4.48	5.32	6.77	7.95
Reward: Risk (Median)		2.11	2.95	4.73	6.04	9.31	12.13	18.12
		Note: R:R > 2.0 desired						

So I'm pretty bullish looking out over the next six months. I think Trump is going to do everything he can to boost the market and economy going into the election, whether that's making trade deals or easing sanctions on Iran. And considering how off-sides everybody is, and it's not just fund managers, look at how under-positioned retail investors are — the IMX is near the 16' low that preceded the 17' bull run — **I think the coming rally is going to be a real face ripper**.



The very short-term picture is mixed, as I noted in this week's *Dirty Dozen*. The market is short-term overbought, bumping up against significant resistance, and put/call ratios are getting close to sell-signal territory.

But things like high-yield debt (JNK) look like they may be breaking out and NASI is still giving a strong buy signal.

The FOMC meeting tomorrow will set the tone for the short-term. I'm expecting a slightly hawkish cut of 25bps. Meaning, I expect them to cut 25bps and not commit to or strongly signal another imminent cut. This gives them flexibility. Personally, I think they should cut 50bps and get in front of the market so they actually get some juice from these rate cuts but alas I have yet to be elected to the FOMC for some reason. Here's Tim Duy's latest on what he's thinking they'll do (link here) which is basically what I just wrote.

These are just guesses. Like everybody else, I have no clue what they're going to do. The only thing I do know is that the market will overreact and the immediate follow-on moves should be largely ignored. I'll be putting out an update following the meeting and I think Chris and I are going to do a short podcast on it as well.

Draghi throwing down the Gauntlet

Speaking of Central Banks, Draghi went and made a splash in his last major policy meeting as ECB head. There's a lot to unpack here, most of it is more wonkish policy debate that's probably not that important to markets, yet. I'll link to a few things on that for those of you who want to nerd out. But first, let's get to what matters for markets.

So Draghi went announced the tiered rate or dual-interest rate policy which money manager Eric Lonergan, writing over at *Philosophy of Money* had been pushing for a long time and which I've shared with you a number of his articles on the topic over the last few months.

The debate on how this will impact Europe's economy and markets is split and quite heated — that's the wonkish bit. But the equally if not more important takeaway — at least in regards to its near-term impact — is that Draghi basically threw down the gauntlet to Europe's core, telling them that if they don't like negative rates then they should go and DO something about it. Meaning, get off your arses and boost your fiscal spending.

The Dutch are already working on setting up a fiscal spending package and the tight pocketed Germans are even talking about setting up a "shadow budget" in order to boost spending while not technically breaking their black budget rules.

It's still early days and the fiscal sums being discussed are small but the important thing is that the paradigm is shifting. The fact that the Germans are openly discussing this at all is a milestone. We'll have to watch this closely and see how things develop.

For those of you who want to read up more on the recent ECB policy change and the subsequent debate, I'd start with Lonergan's post (linked above) and then follow up with this one from The General Theorist and then read this opposing thread from @teasri as well as this from Thomas Hirst. That will get you completely up to speed on where the debate now stands.

Flames in the House of Saud

Some people (the US claims the Iranians, the Saudis just say it was Iranian backed Houthi rebels) apparently used drones to hit Abqaiq which is Saudi Arabia's massive oil processing facility.

This is all over the news so I won't bother going into the details but here's my quick two cents.

Abqaiq has been called the most valuable real estate in the world. That's because it's literally the chokepoint for Saudi's oil; something like half of all the Kingdom's oil flows through there before then getting sent out to global markets.

Oil spiked on the news and then quickly reversed following more news from the Saudis that they're close to restoring 70% of the production capacity lost following the attacks.

I don't trade news like this. It's a total crapshoot where things go in the near-term. I like to step away and see how things settle and listen to what the market is saying.

So far here's what I think and I hope you don't mind putting on your tin-foil hat with me for a second. I think the Saudi's did this to themselves or had some help from allies (Israel). They're looking to IPO Aramco as early as November of this year (they're looking to do a local listing of 1% this year and next before the big international IPO).

They need the money and higher oil prices will help bring in more of it. Framing the attacks on Iran, or at least Iran backed rebels, serves not just to bring geo-pol risk premium back into oil markets but it also hurts the chances of the US lightening up on sanctions — both Israel and SA badly want regime change in Iran which is why they've become such unexpected bedfellows.

What proof do I have of this you might ask?

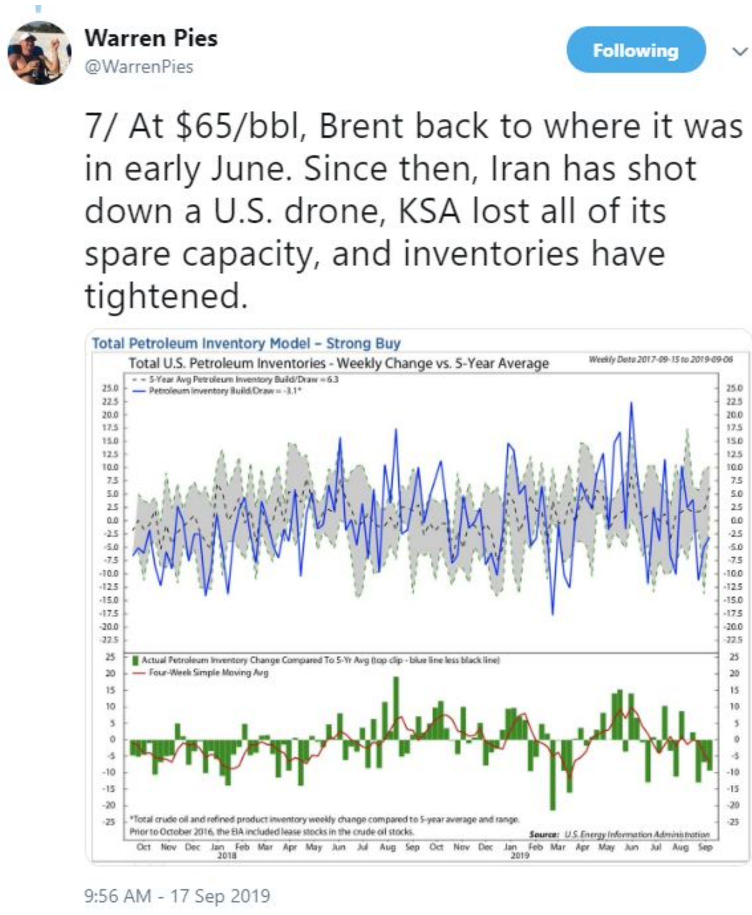
Absolutely none. But I do have over a decade working in the intelligence field where I spent a lot of time focused on this region.

Take my crack-pot theory with a shaker of salt. But don't completely dismiss it either.

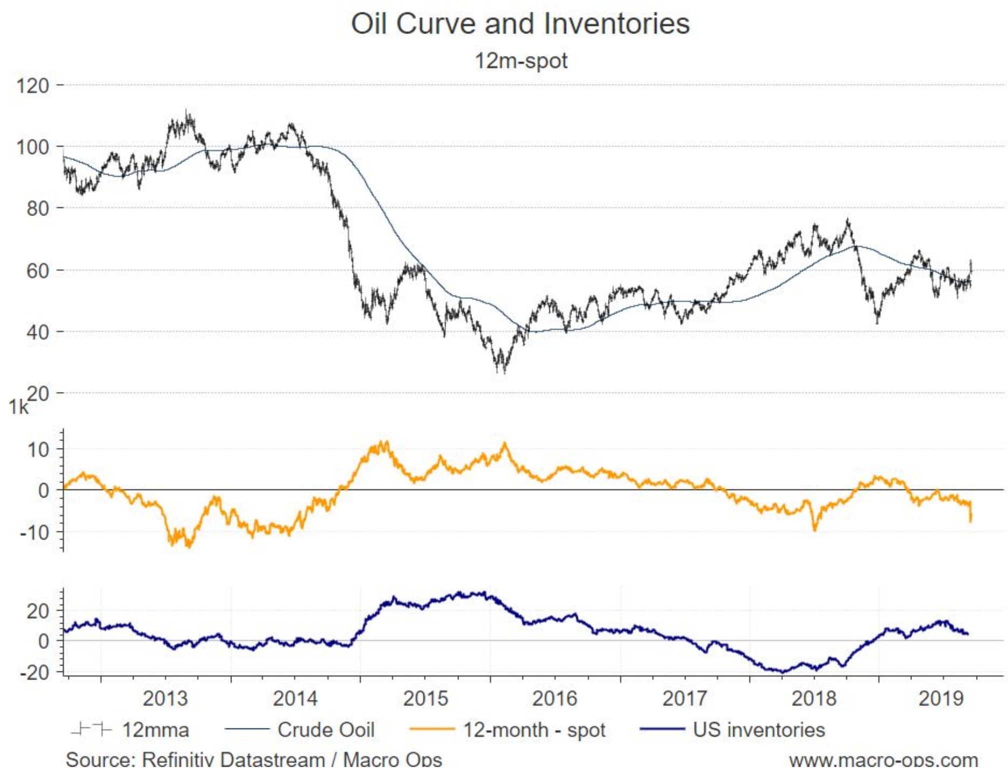
What does this mean for the oil markets and our long energy trades?

Well, it's not a bearish development at all. I was bullish on oil before the "attack" and now I'm just a little more so.

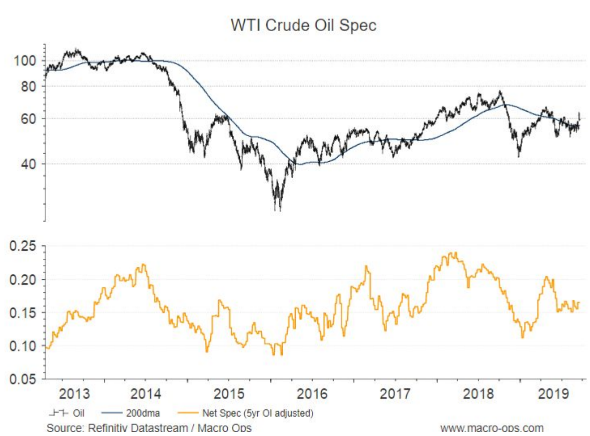
Warren Pies, energy analyst over at NDR, put out a good thread on the twitters this week and the last one sums up the current oil situation quite well.

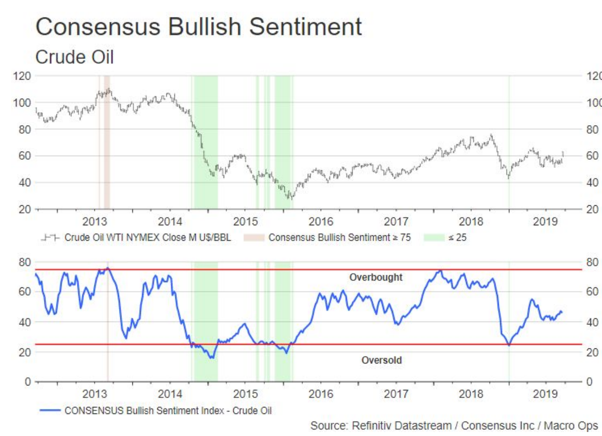


The curve is in backwardation. That typically leads inventories by 6-9 months, meaning we should expect inventories to drawdown in the coming future, which is bullish.



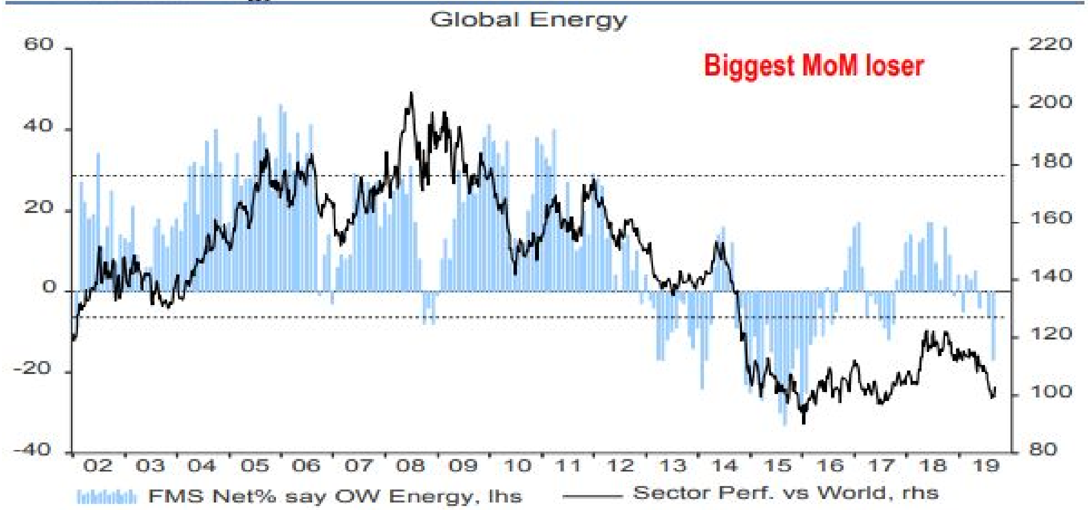
Positioning and sentiment are both neutral.





And just to reiterate, energy was the biggest MoM loser amongst all global sectors in the BofA FMS.

Exhibit 52: Global Energy

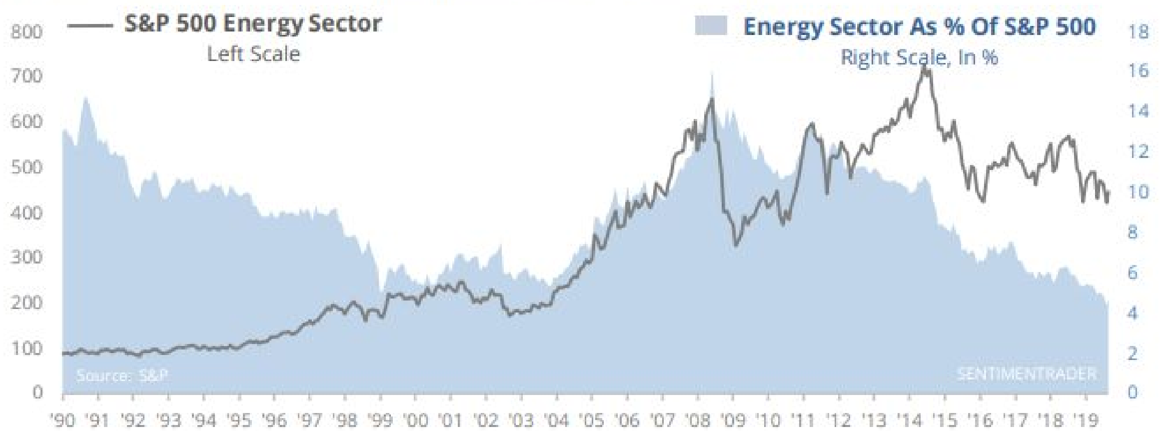


Source: BofA Merrill Lynch Global Fund Manager Survey

This is really interesting to me because energy has the best dividend yield to Treasury spread amongst all the sectors. It's actually at record highs.

Also, the sector's percentage of the S&P 500 now makes up less than 5% of the index for the first time ever, according to Sentiment Trader.

The move comes at a fortuitous time for the sector. As a percentage of the S&P 500, energy stocks now make up less than 5% of the index for the first time ever (at least since 1990).



I'll be writing more about this in the week ahead. But there's some names — some which we already hold and others I plan to buy very soon — that I'm really liking here. It'd be nice to see them sell off a bit more with the broader market over the next week or two so we can get better prices, but we'll see.

That's it for now. I'll be back following tomorrow's FOMC with a followup and then will be covering some new trade setups and talking about a few of our positions later this week.

Until then, stay frosty and try and not get whipsawed by Powell tomorrow.

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
	14.28%

Big Bet Macro

Asset Class	Position	Position Size	Cost Basis	Notional %	Risk Point	Target	Last Price	P&L
Equity	Construction Partners (ROAD)	4,338	$12.25	5.47%	$10.80	$17.00	$14.40	17.55%
Equity	Disney DIS	709	$102.34	8.46%	$108.50	$150.00	$136.31	33.19%
Equity	Graftech (EAF)	9,855	$12.24	11.47%	$10.30	$25.00	$13.30	8.66%
Equity	Frontdoor (FTDR)	1,240	$34.10	5.59%	$28.00	$55.00	$51.56	51.20%
Equity	Anglogold (AU)	896	$11.02	1.55%	$14.00	$40.00	$19.75	79.22%
Equity	W&T Offshore (WTI)	4,710	$4.81	2.16%	$3.60	$8.00	$5.25	9.15%
Equity	Ecopetrol (EC)	1,686	$18.78	2.62%	$15.40	$25.00	$17.77	-5.38%
Equity	Sandridge Energy (SD)	4,911	$6.41	2.49%	$5.80	$12.00	$5.79	-9.67%
Equity	BlueLinx (BXC)	725	$23.75	2.04%	$19.50	$35.00	$32.08	35.07%
Equity	Scorpio Tankers (STNG)	5,765	$25.75	15.41%	$21.00	$40.00	$30.55	18.64%
Equity	GAIA Inc (GAIA)	12,750	$8.16	9.23%	$6.25	$18.00	$8.27	1.35%
Equity	TSLA Sep '19 175 Put	11	$13.81	0.00%	$0.00	$85.00	$0.04	-99.71%
Equity	TSLA Jun '20 100 Put	14	$10.70	0.51%	$0.00	$85.00	$4.20	-60.75%
Equity	TSLA Jan '20 150 Put	5	$15.01	0.14%	$0.00	$60.00	$3.10	-79.35%
Equity	DIS Jan '20 165 Call	68	$1.11	0.33%	$0.00	$10.50	$0.55	-50.45%
Equity	AG Jan'20 15 Call	387	$0.35	0.85%	$0.00	$3.50	$0.25	-28.57%
FX	Sep CAD Futures	5	$0.7587	33.20%	$0.7467	$0.8096	$0.7587	0.00%
FX	Sep CHF Futures	7	$1.0301	78.87%	$1.0067	$1.0887	$1.0301	0.00%

**Updated 9/16