Fake News...

Summary:

- How to read the news
- SPX technicals
- Real estate stocks ready to rip
    - XLRE, ITB, SHW
- Portfolio Update

> *The best way I know to learn discipline and patience is to think through a trade thoroughly before putting it on. You need to develop a plan of your strategies for various contingencies. That way, you won't get swayed by every news item that hits the market and causes prices to move up or down.* ~ Gary Bielfeldt

We have a lot to cover in this note but I want to first start with this…

Top stories

Dow Drops Over 450 Points on Coronavirus Fears
The Wall Street Journal · 18 hours ago

Stocks slump as coronavirus fears spook investors in U.S. and overseas
CBS News · 22 hours ago

Top stories

Stocks Shake Off Virus Dread; Treasuries Slump: Markets Wrap
Yahoo Finance · 1 hour ago

U.S. Stocks Rebound, Shaking Off China Virus Dread: Markets Wrap
Swissinfo · 6 hours ago

These are the top "Market" news stories on google less than 24hrs apart.

Yesterday’s news was all about the market selling off due to Coronavirus Fears. Today, the market rebounded because stocks had “shaked off China virus dread”.

Ridiculous, I know…

Long-time Collective members already know the drill… Financial news is all nonsense. The job of a financial journalist is not to educate its readership but to entertain.

They’re focused on clicks, not helping you generate profits. Their job is to select an intelligent-plausible-sounding *and* entertaining narrative to explain moves in the market ex-post. The more fear-inducing the better. You know, the whole “if it bleeds, it leads” deal…

The market is an aggregation of literally millions of humans, computers, governments, banks, retail Joe Schmoes, and professionals from around the world making buy and sell decisions based on a nearly infinite myriad of reasons.

It’s literally impossible to correctly explain the day to day moves of the market; other than *there were more buyers than sellers* if the market went up or *more sellers than buyers today* if the market went down.

Jesse Livermore, one of the greatest traders to have ever played the game, once told this great story — I think it was in the book he authored and not *Reminiscences*… — about one of the best investors he knew.

This investor lived as far away from Wall St. as remotely possible while still having a working phone connection (I think it was in the Sierras somewhere). His only source of market information was the bi-weekly paper he’d receive. And the only thing he looked at in that paper was the stock prices in the back. He’d keep tabs on how these prices were trending and based his investment decisions solely off that information. Nothing else.

This was his edge.

And apparently, it was a very effective one since he made a fortune many times over. In the early 20th century, canceling out the noise and narrative machine that everybody else was plugged into was a profitable strategy. In the 21st century, it still is… perhaps even more so now since we’re constantly inundated with news alerts and drowning under the 24/7 hysteria hose that is financial twitter.

Should you ignore the news altogether?

Sure, you’d almost certainly do better as a trader/investor if you didn’t have the collective voice coloring your bias.

But, if you're like me and you enjoy being plugged into the news (to a limit, of course). Then you just need to learn a new way of digesting it all and taking it in.

You need to understand that its usefulness isn't in its *supposed* "facts" that are transmitted but rather in how it serves as a mirror into what the collective consciousness of the market is thinking. It's a powerful tool for a contrarian once you learn that information you're seeing all over the news has long been discounted in the prices of assets.

When the news is zigging, we want to be zagging.

When the news is all pumping repo-rate hysteria… knowing better, we want to be buying the dip.

Which brings me to the latest fixation of the news cycle. The Coronavirus.

Now, I'm no epidemiologist. Nor do I play one on T.V.

I also don't have any inside information on the actual severity of things on the ground in China. I know we have some Collective members who are locals there or nearby and if any of you have some color to add shoot me an email or post it to the Slack.

With that said, here's how I think about these things.

First, what's the base rate. Meaning, what historical examples (if any) can we compare the current outbreak to and how have those instances impacted markets.

Doing this exercise, we get the following.

Epidemic	Month end	6-month % change of S&P	12-month % change of S&P
HIV/AIDS	June 1981	-0.20	-10.73
Pneumonic plague	September 1994	8.22	26.31
SARS	April 2003	14.59	20.76
Avian flu	June 2006	11.66	18.36
Dengue Fever	September 2006	6.36	14.29
Swine flu	April 2009	18.72	35.96
Cholera	November 2010	13.95	5.63
MERS	May 2013	10.74	17.96
Ebola	March 2014	5.34	10.44
Measles/Rubeola	December 2014	0.20	-0.73
Zika	January 2016	12.03	17.45
Measles/Rubeola	June 2019	9.82%	N/A
			—Source: Dow Jones Market Data

The vast majority of subsequent returns following similar historical instances have been positive. That's not surprising because the market tends to go up more than it goes down over the long-haul.

Of course, there's always a chance, however slim, that the Coronavirus will be the one that creates a major pandemic and lead to a left-tail event in the market.

If that ends up being the case, we'll begin seeing these concerns reflected in asset prices well before they become generally accepted knowledge in the news.

Markets are smart like that.

Barton Biggs wrote in his book *Wealth, War, and Wisdom* about this, saying:

> *The British stock market bottomed for all time in the summer of 1940 just before the Battle of Britain; that the U.S. market turned forever in late May 1942 around the epic Battle of Midway; and that the German market peaked at the high-water mark of the German attack on Russia just before the advance German patrols actually saw the spires of Moscow in early December of 1941. Those were the three great momentum changes of World War II — although at the time, no one except the stock markets recognized them as such. This, to me, confirmed the extraordinary (and unrecognizable wisdom of market crowds).*

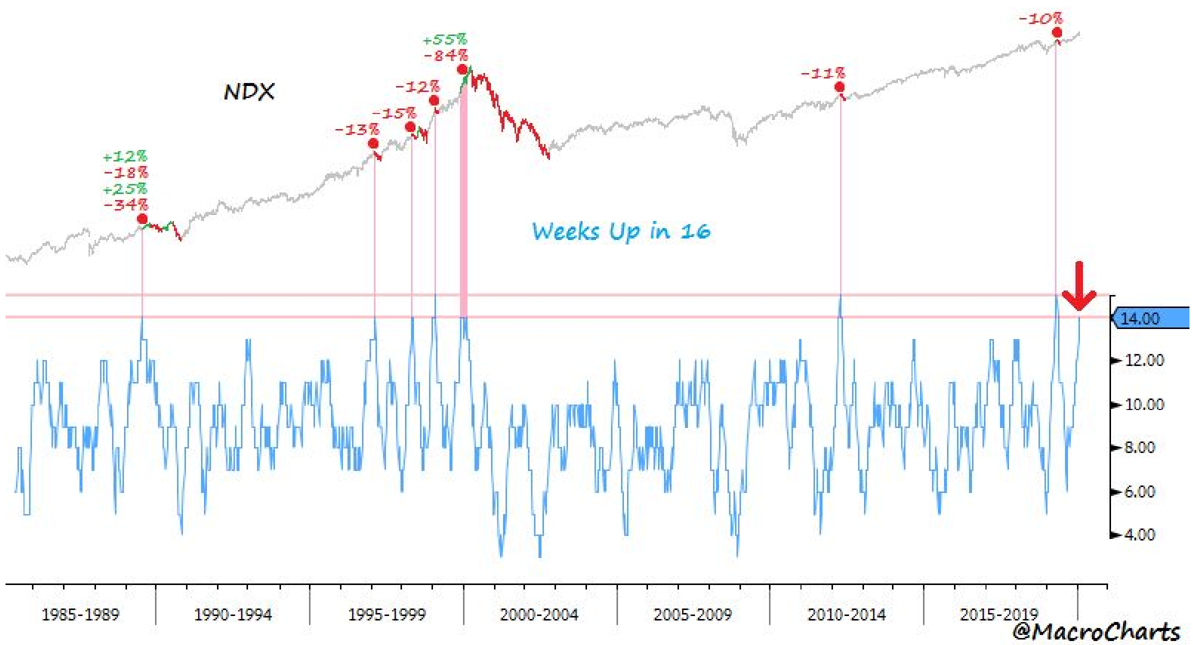
Now on to markets

The SPX continued its selloff on Monday and then rebounded today. There are two magnets working on the market at the moment. The big round number above the current price at 3,300 and below at 3,200. Currently, my base case is that we see the market make one more move lower to around the 3,200 level.

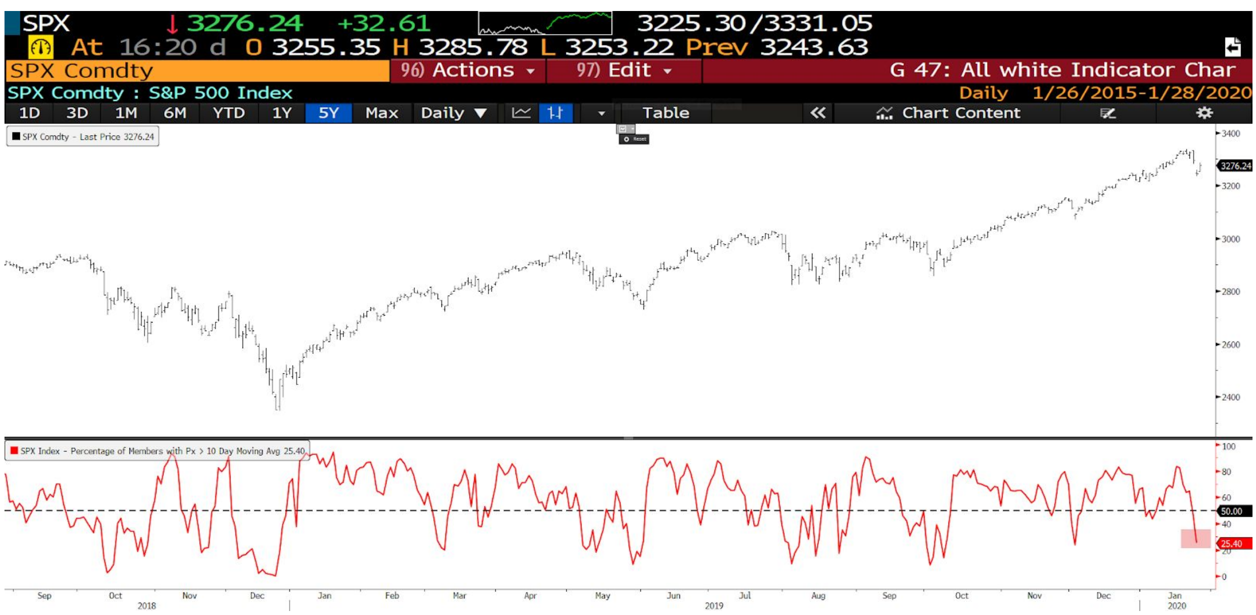
Retracements often consist of two-legs. A kind of zig-zag pattern with one leg down, a short one back up, followed by another move down to a new low. I think we're in the middle of that two-leg move right now. I'd change my views if SPX were to close above the 3,320 level on a daily bar.

There is also a decent chance we see an overshoot to the downside in the form of a larger retrace. This would not be unusual after such a run like the one we've seen where the market went 74 days without a 1% drop, tieing it for the 4th longest streak in over 20-years.

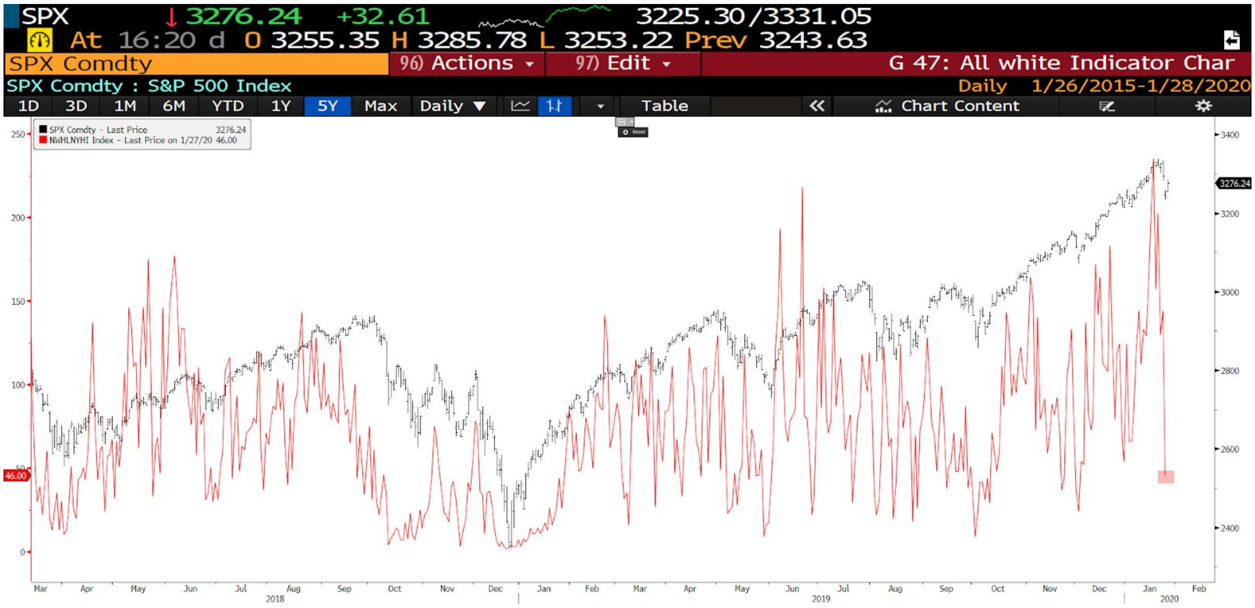
This chart from @MacroCharts shows forward returns following similar streaks.



Market breadth is also deteriorating, seen here by the percentage of stocks trading above their 10-day moving averages.



As well as NYSE new highs over new lows. We'd want to see both turn back up before we believe a bottom is in.



I view this action as a healthy retrace that will wash out the weak hands and overzealous sentiment that we talked about on [Monday.](#)

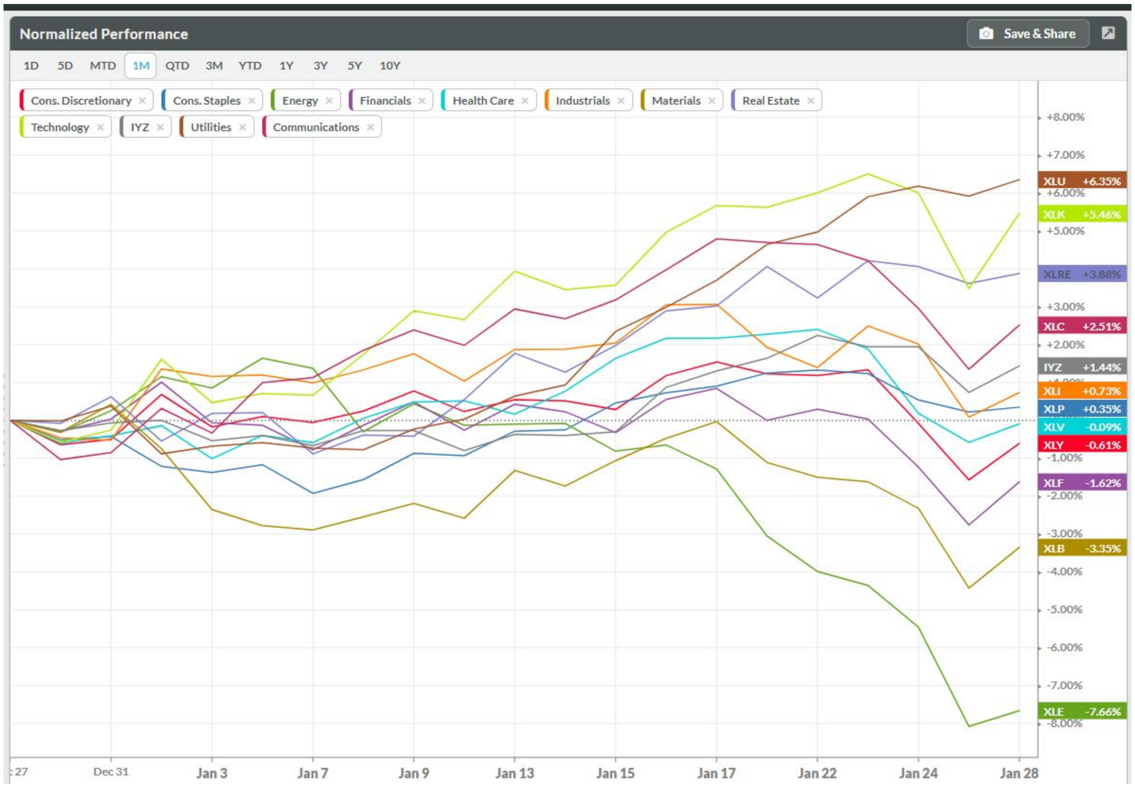
That's why we're staying long our well-performing stocks while hedging out our downside with our position in bonds (ZB_F or TLT).

The play here is to have a list of stocks that you've been watching and wanting to buy. And then start building a position at a discount as the selloff progresses.

A good indicator of which stocks will outperform in the follow-on leg higher is to see which ones hold up the best during a market selloff. A stock that stays buoyed in sinking waters is a stock that's being held by strong hands.

Buy Strength, Sell Weakness

The three best performing sectors over the last month have been Utes (XLU), Technology (XLK), and Real Estate (XLRE). Graph below is from Koyfin.



Utes are insanely overvalued and overbought here. Tech is crowded but should continue to perform well since it has so much momentum behind it. And Real Estate, in particular, looks like a strong play here.

The Real Estate sector (XLRE) has the best underlying breadth out of all the sectors.

Sector	% Mover		% New 20D		% Above MAs		% RSI	
	Adv	Dec	High	Low	5D	30D	> 70	< 30
Communication Services	52.2%	39.1%	21.7%	8.7%	52.2%	43.5%	0.0%	4.3%
Consumer Discretionary	46.7%	37.8%	27.8%	6.7%	64.4%	55.6%	7.8%	3.3%
Consumer Staples	45.0%	35.0%	20.0%	15.0%	45.0%	55.0%	5.0%	0.0%
Energy	8.3%	83.3%	0.0%	16.7%	16.7%	25.0%	0.0%	8.3%
Financials	44.1%	42.4%	25.4%	3.4%	78.0%	47.5%	3.4%	1.7%
Health Care	48.5%	45.5%	27.3%	0.0%	75.8%	51.5%	3.0%	0.0%
Industrials	35.3%	50.0%	23.5%	4.4%	55.9%	60.3%	4.4%	0.0%
Information Technology	27.3%	60.6%	24.2%	18.2%	45.5%	42.4%	3.0%	3.0%
Materials	25.0%	68.8%	3.1%	25.0%	34.4%	28.1%	0.0%	3.1%
Real Estate	77.5%	10.0%	53.8%	3.8%	85.0%	73.8%	11.3%	0.0%
Utilities	38.2%	50.0%	8.8%	5.9%	52.9%	41.2%	5.9%	2.9%
All	45.9%	41.5%	26.7%	7.6%	62.4%	52.9%	5.4%	1.9%

XLRE is close to making new all-time highs.

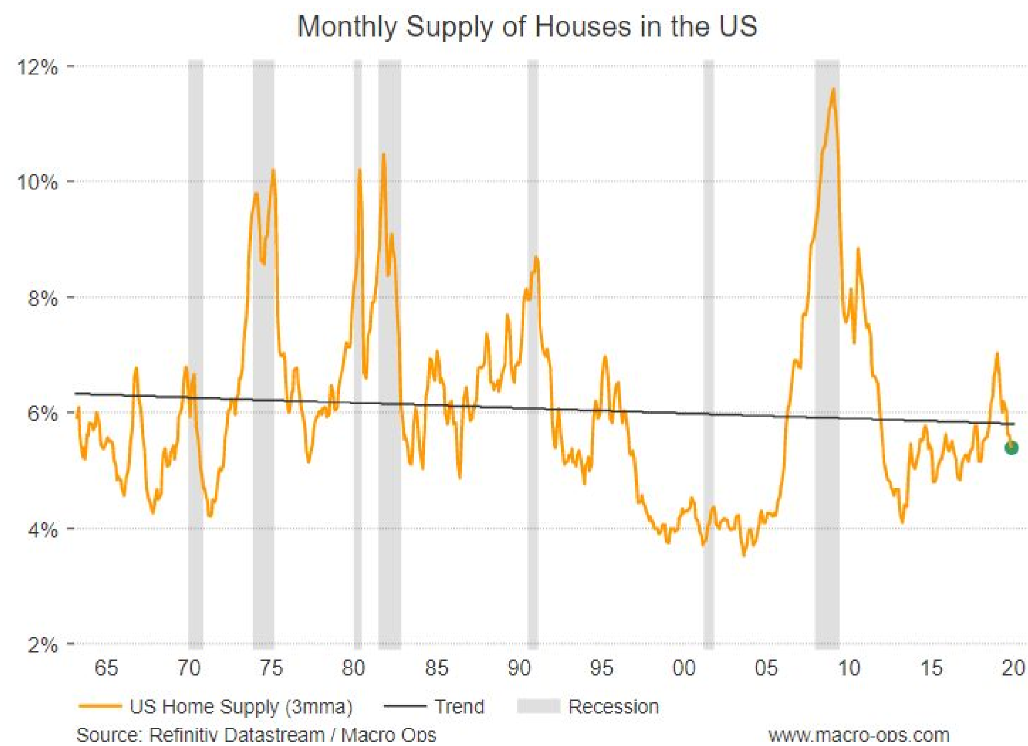
It's consistently been one of the top sectors in beating revenue estimates over the last year.

S&P 500 INDEX		
Surprise / Growth		
Sector (GICS)	Reported	Sales Surprise
11) All Securities	186 / 499	
12) > Energy	5 / 28	
13) > Materials	6 / 27	
14) > Industrials	30 / 70	
15) > Consumer Discretionary	18 / 63	
16) > Consumer Staples	17 / 33	
17) > Health Care	22 / 60	
18) > Financials	34 / 66	
19) > Information Technology	42 / 71	
20) > Communication Services	7 / 22	
21) > Utilities	2 / 28	
22) > Real Estate	3 / 31	

And with yields pinned down, keeping mortgage rates low, there's a large tailwind for the market. But that's not even half of it.

I recently tweeted some charts (link here) about the strength in the US housing market. It's chugging along at a very healthy pace.

Starts are at cycle highs and the monthly supply of homes is well below trend.

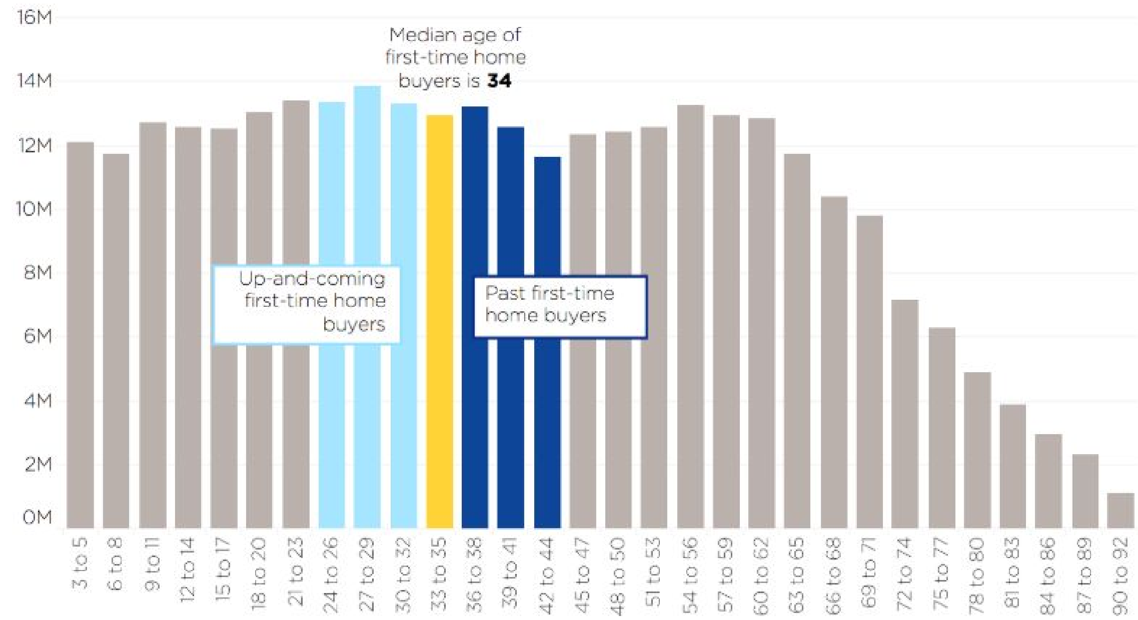


The really bullish driver here though is demographics. Zillow shared the following in a post a few months back ([link here]()), bolding is mine.

> *If you thought there were a lot of first-time homebuyers over the past 10 years, check out what's coming: An extra 3.11 million people at prime first-time home-buying age.* ***From 2019 through 2028, 44.9 million people will turn 34, the median age of current first-time home buyers. That's an increase of 7.4% from the past 10 years, when 41.8 million people passed that threshold.*** *And while we can't say for sure whether the younger group will buy homes as readily when they hit their mid-thirties, by the sheer heft of their numbers, they will have an impact on the market.*
>
> *Millennials hold such fascination partly because they are a massive generation, and that generational heft has yet to fully hit the home-buying market. The largest 3-year cohort in the U.S. is only 24 to 26 years old, yet the median age of the first-time homebuyer is 34.*
>
> *To imagine the scale of the millennial generation's impact on housing, let's look at the size of the U.S. population ages 35 to 44 relative to the cohort aged 24 to 33. We'll call the older set "past first-time homebuyers" and the younger set "up-and-coming" first- time buyers. There are 3.11 million more up-and-coming than past first-time home buyers.*

Coming soon: An even bigger wave of potential buyers

Age distribution of the United States



Zillow Economic Research | Source: Population counts by age and metro was pulled from one-year 2017-ACS data made available by IPUMS - USA. Ages of individuals were bumped up one year to coincide with our source for median age of first time buyer, the 2018 Zillow Group housing trends report. That survey was boosted in five metro areas, allowing for metro level median first-time home buyer ages in Phoenix (34.5 years), San Francisco (37 years), Atlanta (37 years), Chicago (34 years) and Washington, D.C. (34 years).

An extra 3.11 million potential home buyers coming onto the market is a huge tailwind for the real estate sector and all parallel industries. Not to mention a large boon to consumption which makes just one more reason why this cycle is likely to last much longer than anybody thinks.

There's a number of ways to play this trend. You can buy the sector/industry ETF's outright (XLRE, ITB). Or, what I prefer to do, is to find the strongest names with the best fundamentals and technical setups within the space.

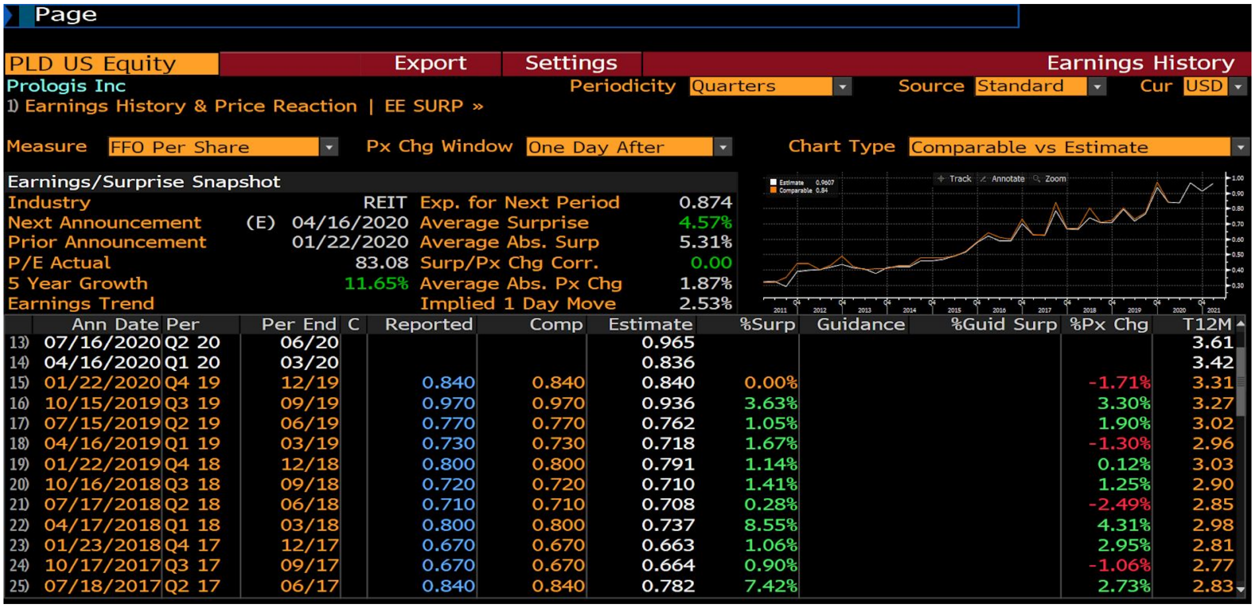
I've got some more looking to do but here's some names I'm liking so far.

Sherwin Williams (SHW). It's been beating earnings estimates over the last few quarters and just completed one of my favorite bullish patterns which is a large bear trap from a basing pattern followed by a rip higher.

Big money creates patterns like these. They run the price down to knock out stops and trap the shorts so they can load up on the stock at cheaper prices before it rips higher.

Then we have Prologis Inc (PLD), a REIT. It's coiling near all-time highs and in a strong uptrend.

The company has beat earnings estimates every quarter going back to the summer of 2013. That's some impressive consistency.



	Ann Date	Per	Per End	C	Reported	Comp	Estimate	%Surp	Guidance	%Guid Surp	%Px Chg	T12M
13)	07/16/2020	Q2 20	06/20				0.965					3.61
14)	04/16/2020	Q1 20	03/20				0.836					3.42
15)	01/22/2020	Q4 19	12/19		0.840	0.840	0.840	0.00%			-1.71%	3.31
16)	10/15/2019	Q3 19	09/19		0.970	0.970	0.936	3.63%			3.30%	3.27
17)	07/15/2019	Q2 19	06/19		0.770	0.770	0.762	1.05%			1.90%	3.02
18)	04/16/2019	Q1 19	03/19		0.730	0.730	0.718	1.67%			-1.30%	2.96
19)	01/22/2019	Q4 18	12/18		0.800	0.800	0.791	1.14%			0.12%	3.03
20)	10/16/2018	Q3 18	09/18		0.720	0.720	0.710	1.41%			1.25%	2.90
21)	07/17/2018	Q2 18	06/18		0.710	0.710	0.708	0.28%			-2.49%	2.85
22)	04/17/2018	Q1 18	03/18		0.800	0.800	0.737	8.55%			4.31%	2.98
23)	01/23/2018	Q4 17	12/17		0.670	0.670	0.663	1.06%			2.95%	2.81
24)	10/17/2017	Q3 17	09/17		0.670	0.670	0.664	0.90%			-1.06%	2.77
25)	07/18/2017	Q2 17	06/17		0.840	0.840	0.782	7.42%			2.73%	2.83

Another notable one is St. Joe (JOE). It's more of a hidden deep value play. I dug into it a while back and need to revisit it over the weekend. But it's breaking out to new all-time highs and I know some smart value guys who are heavy in the name.

I'll be putting out my notes once I'm done digging more into these names in the coming days.

Portfolio Update

Here's our current portfolio.

Over the last week we've trimmed a number of names. These included the remaining of our positions in shipping stocks STNG, DHT, and EURN. I'm putting out a note on shipping tomorrow where I'll update the macro thesis and talk more about why we cut these positions. I also cut GRWG today because I liked the company less and less the more I dug into it.

This leaves us with what I think is a strong stable of holdings. And I'm hoping we can add some more to these positions as well as a few names in the coming weeks.

The Four Pillars Portfolio	2019	YTD
	27.04%	1.12%

The Core	Fixed Allocation	Market-Timing	Net Position
Large Cap Equities (/ES_Z or VOO)	25%	0%	25%
Short-term Bills (/ZT_Z or VGSH)	25%	0%	25%
Long-term Bonds (/ZB_Z or TLT)	25%	150%	175%
Gold (/GC_Z or GLD)	25%	0%	25%

Big Bets	Thematic	Cost Basis	At Risk	Notional %	Risk Point	Last Price
Disney (DIS)	Value	$129.37	Above B/E	22%	$136.00	$145.00
Albemarle (ALB)	Renewable/value	$69.71	Above B/E	13%	$69.71	$76.90
Luckin Coffee (LK)	Growth/Asia Recovery	$33.18	Above B/E	7%	$33.51	$47.36
Centrus Energy (LEU)	Uranium Bull Cycle	$6.69	100bps	7%	$4.81	$6.26
Deutsche Bank (DB)	Europe rebound/value	$8.45	100bps	11%	$7.55	$8.50
Square (SQ)	Growth play	$70.21	100bps	11%	$65.00	$69.73
CADUSD (6C Mar' Futures)	FX relative value	0.7565	100bps	70%	0.7467	0.7702
MXNUSD (6M Mar' Futures)	FX relative value	0.0519	100 bps	70%%	0.0510	0.0524

Our Core futures positioning is currently long 25% of our NAV in stock futures, 200% in bond futures, and 25% in gold. Since our bond position is so large I'm going to be quick to reduce it should the market not cooperate with my current thinking.

Disney (DIS) has been trading lower over past weeks as we wait out the lead up to earnings. This is to be expected. The stock had become a bit too loved from retail so this retracement should wash out those weak hands.

The stock is still well above our initial entry point in early 18' and above our add last Fall.

Lithium producer Albermarle Corp (ALB) is holding strong. It's up roughly 15+% since we entered last month and is trading above its 3-year downward trendline. The company comes out with earnings in late Feb and I expect some chop between now and then.

One of the names I'm most excited about is Chinese discount coffee retailer, Luckin Coffee (LK). The stock quickly ran up 40%+ in just a few weeks after we bought in a month ago and has traded down 20% since we took partial profits on Jan 15.

We'll probably see another leg down but we're at levels where I think it'd be a good place to start slowly building a position or adding to your current one. I'll probably add back the half we took off in the coming week or so. You can find my working notes on the stock here.

As long as the CoronaVirus doesn't go all scorched earth in China then LK has a long growth runway ahead of it.

Deutsche Bank (DB) continues to consolidate nicely above its breakout zone. Between a turn in European sentiment and my general macro view that we'll see greater rate convergence between developed markets and the US, I believe DB has real potential to put in some quick gains over the coming months.

Our newest position, Square (SQ), broked out of its 2-year coiling wedge today. If you're not already in, now would be a good time to put on a position.

Lastly, we have our short dollar positions through long CAD and MXN.

My views on the dollar have shifted over the last few weeks. DXY has failed to breakdown and my base case now is that we see it chop in a continued range. I'm considering getting out of our CAD trade.

We’re currently at breakeven on the position. CAD mostly moves off the price of oil. Oil, along with copper, has been slaughtered over the last two weeks. I’m guessing this is just price range action and we’ll see both bounce soon but if CAD doesn’t find a floor here then we’ll cut.

As for the peso, I like the price action as well as the macro drivers a lot more. But I’m moving up my stops to breakeven on the trade. If we get knocked out then we can always get back in on another day with a better tape.

That’s it for now. Look for my note on shipping to hit your inbox tomorrow.

If you’ve got any questions, just hit me up in the Comm Center.

Your Macro Operator,

Alex