04/19/2021: Very Dangerous...

> *One telephone conversation with Gates in 1993 sticks in Ellison's mind. "It was the most interesting conversation I've ever had with Bill, and the most revealing. It was around eleven o'clock in the morning, and we were on the phone discussing some technical issue, I don't remember what it was. Anyway, I didn't agree with him on some point, and I explained my reasoning. Bill says, 'I'll have to think about that, I'll call you back.' Then I get this call at four in the afternoon and it's Bill continuing the conversation with 'Yeah, I think you're right about that, but what about A and B and C?' I said, 'Bill, have you been thinking about this for the last five hours?' He said, yes, he had, it was an important issue and he wanted to get it right. Now Bill wanted to continue the discussion and analyze the implications of it all. I was just stunned. He had taken the time and effort to think it all through and had decided I was right and he was wrong. Now,* ***most people hate to admit they're wrong, but it didn't bother Bill one bit. All he cared about was what was right, not who was right. That's what makes Bill very, very dangerous.*** ~ "Softwar: An Intimate Portrait of Larry Ellison and Oracle"

Malcolm Gladwell once retold the following story about George Soros.

> *An old trading partner of Taleb's, a man named Jean-Manuel Rozan, once spent an entire afternoon arguing about the stock market with Soros. Soros was vehemently bearish, and he had an elaborate theory to explain why, which turned out to be entirely wrong. The stock market boomed. Two years later, Rozan ran into Soros at a tennis tournament. "Do you remember our conversation?" Rozan asked. "I recall it very well," Soros replied. "****I changed my mind, and made an absolute fortune.****" He changed his mind!*

Two important takeaways here.

1. Cognitive flexibility or being able to hold strong opinions weakly is an incredibly rare talent as well as an extremely profitable one
2. You need to know your sh*t… you *have* to have a framework from which to index against in order to know <u>when</u> it makes sense to change your mind

My buddy Tom Morgan wrote the following in a note this past week. It's a critical point and should be etched into our trading desks.

> *Philip Tetlock found that rapid belief-updating is as much as 3x more important for successful forecasting than intelligence. It's less a question of beating the markets, but more of a deep sense of attunement that enables you to update your beliefs faster than those that are still trying to justify their actions.*

I frequently write about how discretionary trading is not about making predictions but assessing the odds. This helps with the cognitive flexibility part. It's much easier on the ego to update the odds than it is to admit one was wrong and 180 on a market call. And that's important because we never want to get caught trying to *justify* our actions… we can leave the senseless pontificating to the Twitterati with large followings and eight-digit TDAmeritrade paper trading accounts.

But… and *this* is important…. In order to effectively assess the odds, we have to have some sort of reference points to benchmark against. Signposts along the way to gauge whether or not we're walking the right path or if we need to turn around.

It's not *enough* to have strong opinions weakly held. We can't just randomly flip-flop from bullish one day to bearish the next, because of daily swings in the tape. We need to *respect* the wisdom of markets while *acknowledging* they'll move in ways to hurt the most people, most of the time (translation: *a lotta* surprising counterintuitive moves).

To effectively and rapidly update our beliefs, then, we need to have high-fidelity signposts. Tested markers that give us a confirming or disconfirming signal for our various scenarios, which when taken holistically provide us with a statistically significant trail map to walk upon.

Our Trifecta Lens Score and the data we cover each week in the Trifecta Chart Pack are such signposts. Some mix of our Hierarchy of Technicals; price action levels, sentiment/positioning, breadth, and liquidity typically works best.

Nothing gives us anything remotely close to certainty though. It's a weight of the evidence approach. One that's continuously updated… helping us develop that *deep sense of attunement* and giving us conditional statements so that if enough of our signposts are there, then yes. If not, then no.

If things are noisy and none of our scenarios stand out as particularly supported by the evidence. We lighten our loads, hedge our risks some, go back to the drawing board, and/or wait for the dust to settle.

There's some interesting signposts popping up right now so let's walk through a few of these to give you a practical sense of what I'm talking about.

Back in March, I began pointing out the signposts I was seeing suggesting a Buy Climax was on the way. We had a Bull Quiet Regime, strong underlying breadth, and credit pointing the way higher (here's a piece "Inflection Points Abound…" from the 31st where I go into more detail).

Currently… the tape, a Bull Quiet Regime in the Qs, and strong breadth suggest this move isn't yet over and new highs still lie in our future.

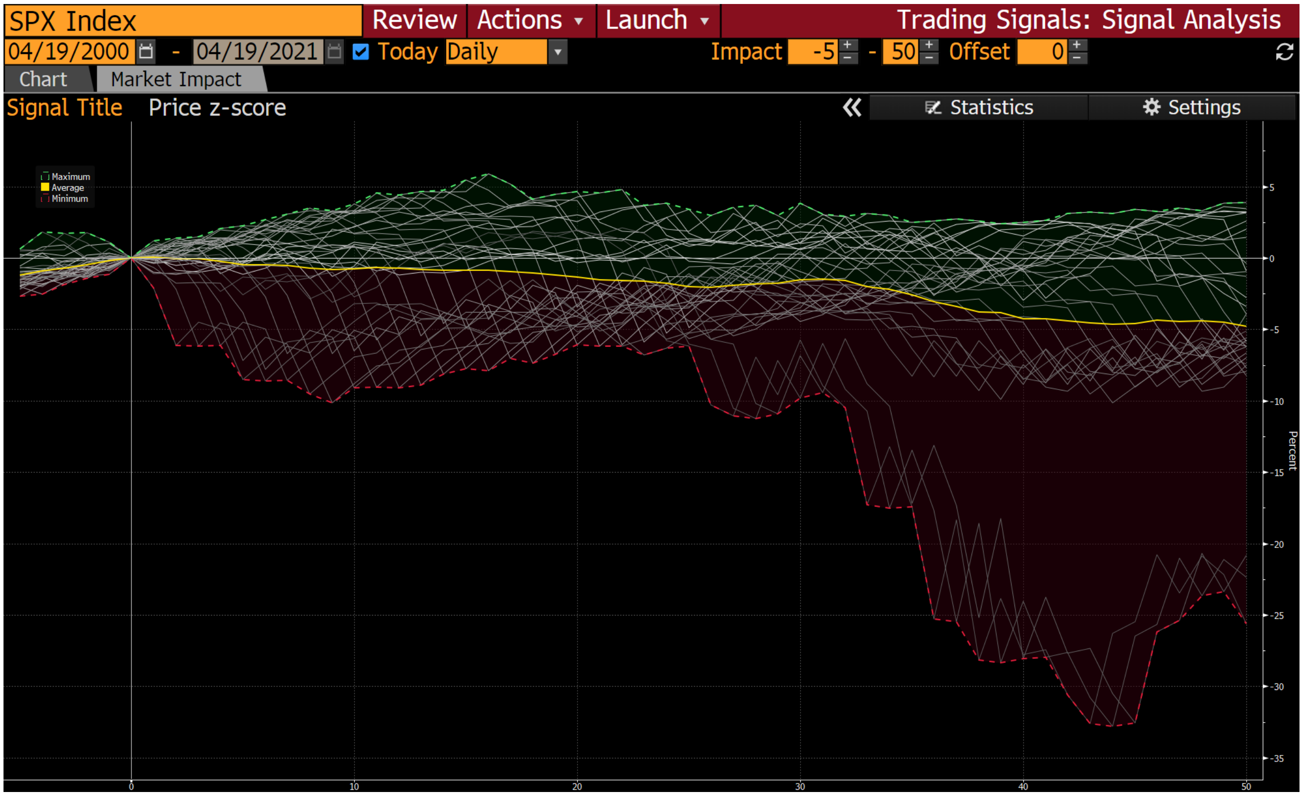
However, like all major Buy Climaxes, the gloss starts coming off the paint *well* before the turn. These are the signposts we need to track while we wait for the tape to confirm we're heading on a new trail.

Let's go through each of these starting with technical overextension.

There's a number of ways we can look at this but here's the standard data points I use for the broader market.

I use two factors (1) the annual z-score of price itself and (2) the SQN level. The below screen combines the two. We use a z-score above 2stdev and a Bull Volatile reading above 2.5. The yellow dots on the chart mark instances over the past 20-years where both signposts have triggered simultaneously.

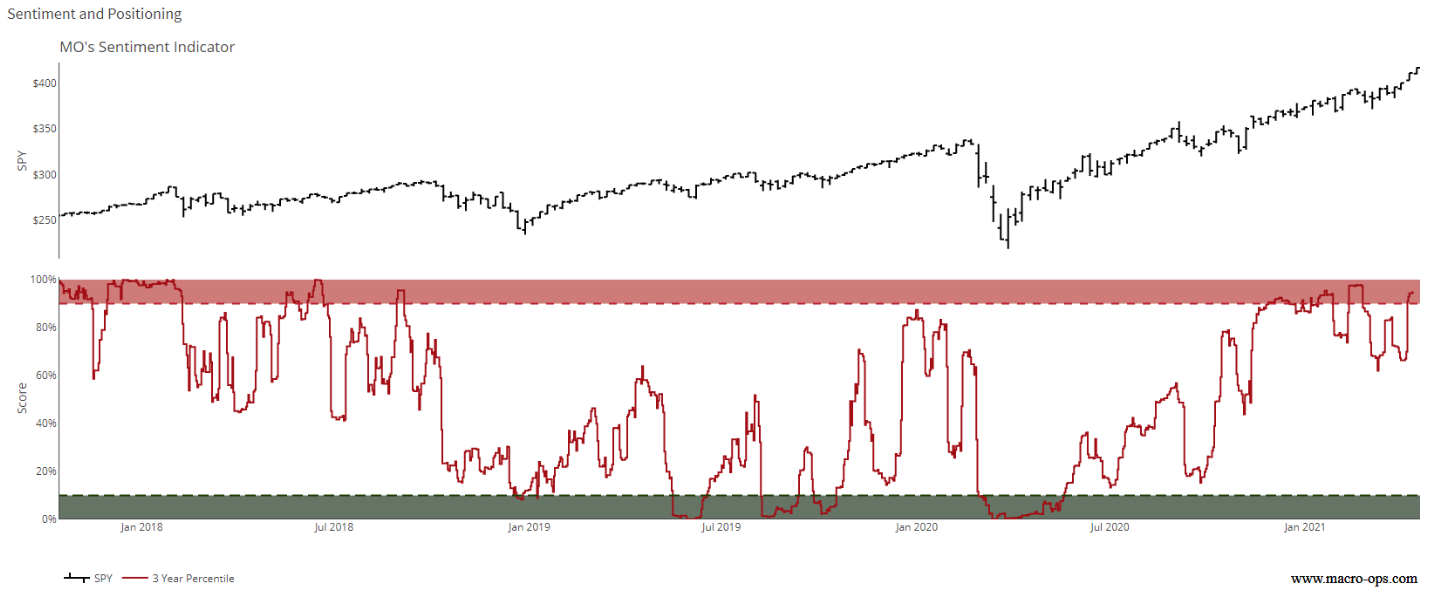
There have been 34 instances, with only 8 leading to higher prices over the following on 2-months with an average return of -4.79% (average shown by the yellow line below).



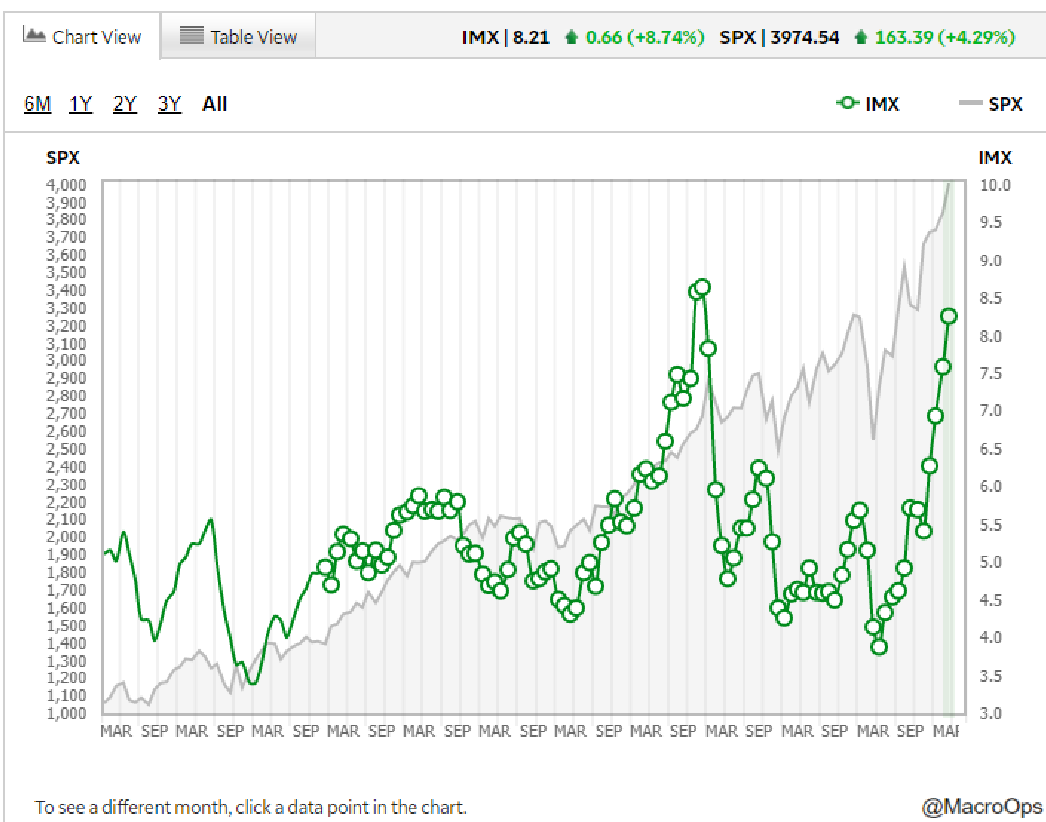
Currently, only the z-score has triggered. The SQN is in Bull Volatile but chopping around 2. It will likely get above 2.5 before this Buy Climax ends.

Next, we have credit where LQD/IEF has rolled over. This could quickly turn back up but if it fails to do so and keeps diverging, it'll be another signpost that we're getting nearer the end of the trail.

No matter how you slice it, sentiment and positioning is stretched and at near-record highs. The MO Sentiment Indicator is in the 93rd percentile. BofAML's FMS shows money managers have record-high allocations to stocks, are reportedly taking their highest ever level of risk, and expectations for inflation, profits, and growth are at their highest levels ever.



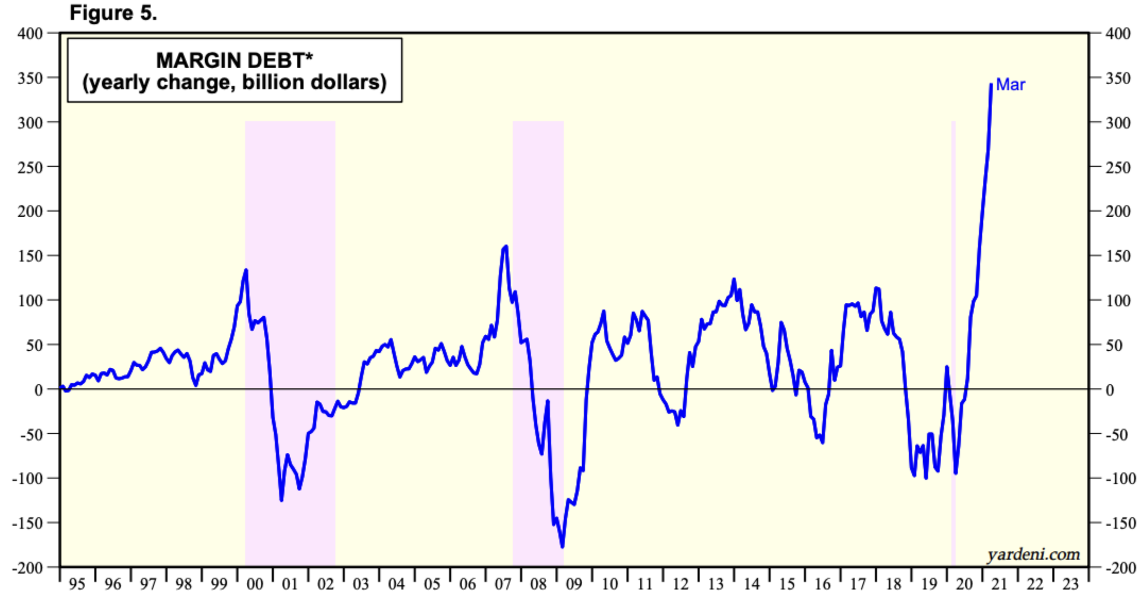
Retail traders are just a scratch and a hair below their all-time record high positioning in stocks.



And finally, Margin Debt indicates participants are all in and borrowing to do so.

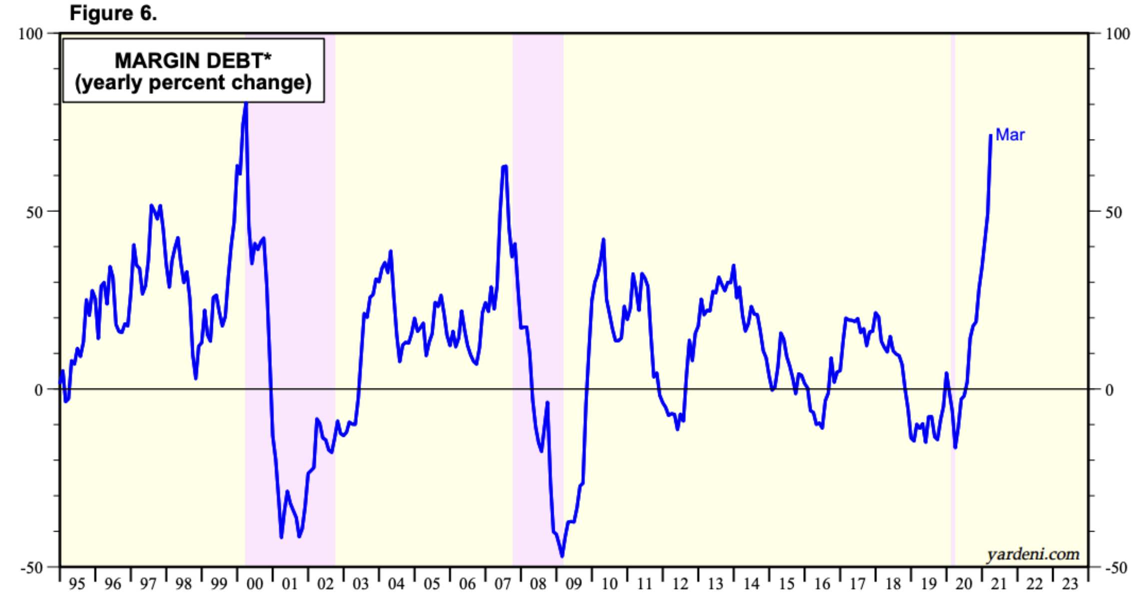
Margin Debt

Figure 5.



* Debit balances in margin accounts at broker/dealers.
Note: Shaded red areas are S&P 500 bear market declines of 20% or more. Yellow areas show bull markets.
Source: New York Stock Exchange through December 1996, FINRA thereafter, and Haver Analytics.

Figure 6.



* Debit balances in margin accounts at broker/dealers.
Note: Shaded red areas are S&P 500 bear market declines of 20% or more. Yellow areas show bull markets.
Source: New York Stock Exchange through December 1996, FINRA thereafter, and Haver Analytics.

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This is a classic Minskian risk cycle at work. The underlying macro fundamentals improve, this converts the faithless into believers, the believers start drinking a little too much of the punch, and we end up with a Jonestown incident.

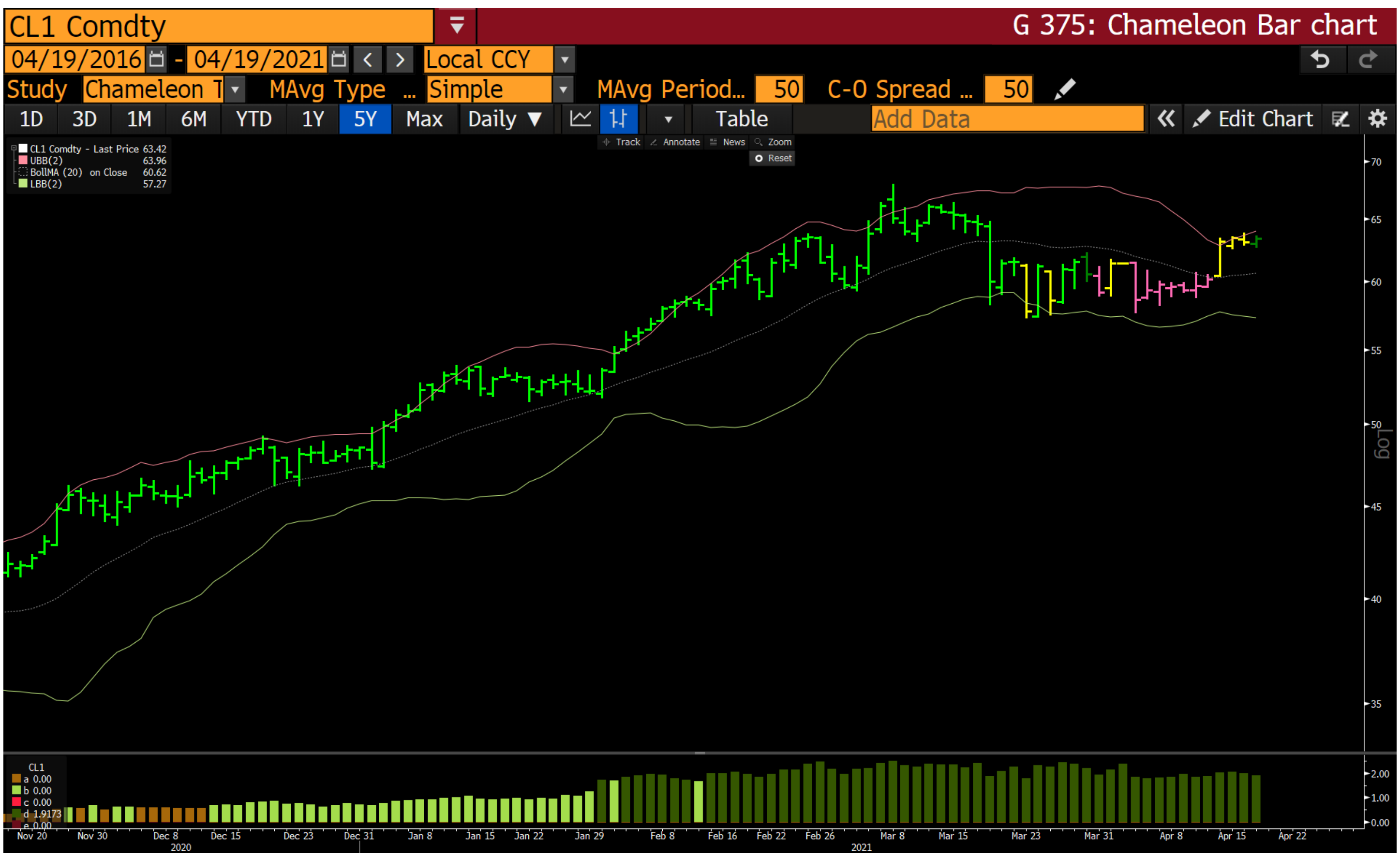
This is just speculation… We're looking at some new signposts and forming a hypothesis. The current weight of the evidence still supports higher prices. We could easily run up for another week, month, or quarter… Though if I had to guess, I'd say we're likely a month out from the turn.

I'll caveat all this with an emphatic: ***I'M NOT BEARISH OR TOP CALLING HERE***… The new fiscal and monpol regimes have put a floor under this market. My base case calls for volatile sideways chop, especially in crowded and expensive US names. This vol will in turn accelerate the flows out of the Core (US) and into the Periphery (EU/EEM).

We'll have to keep reading the signposts as they materialize, adjust fire when needed, and try to stay in a *deep sense of attunement* as best we can.

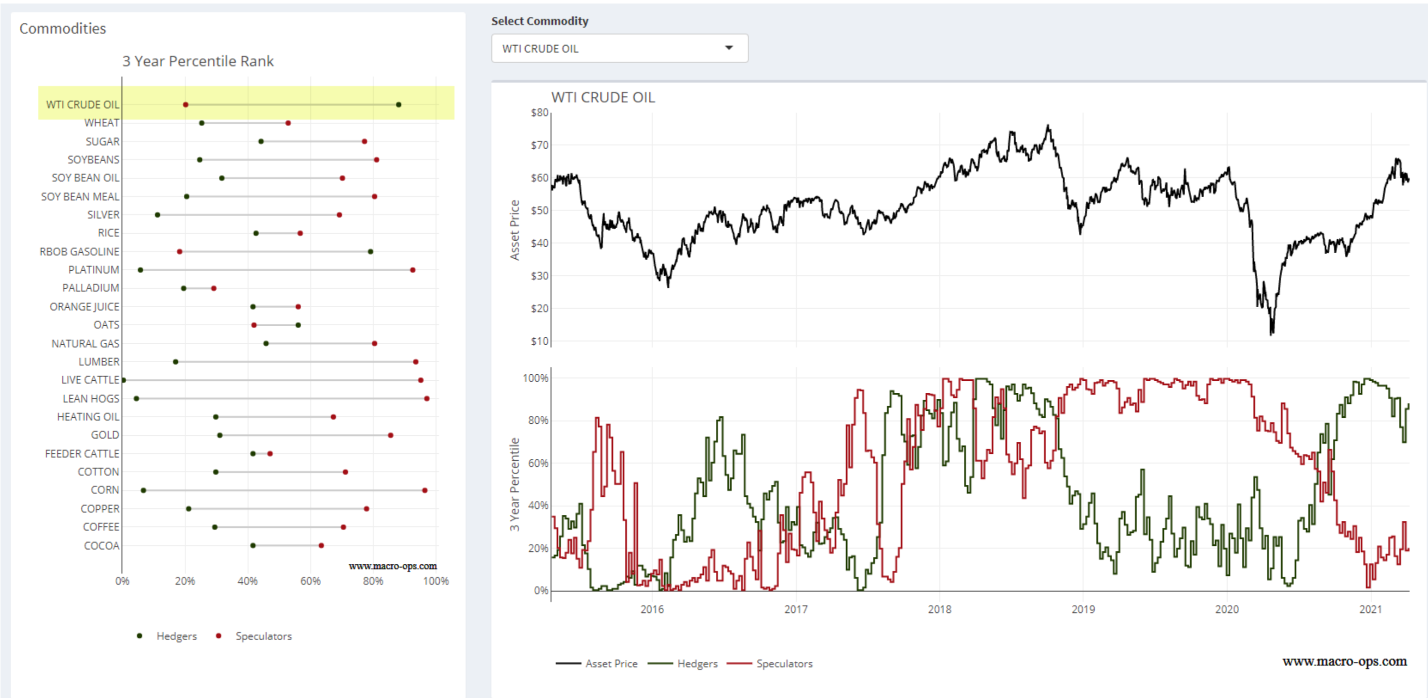
Oil at an inflection point

CL_F failed to break down last month after being given many opportunities to do so. It's now consolidating up along its upper Bollinger Band (chart below is a daily).



I shared in this morning's Monday Dozen the JPM chart showing OECD inventory down big YoY, which often leads to surges in the price.

Despite crude's fairly steady rise since the COVID March 20' lows, Speculators have stayed away (red line). Positioning remains near multi-year lows which provides plenty of fuel for a move higher.



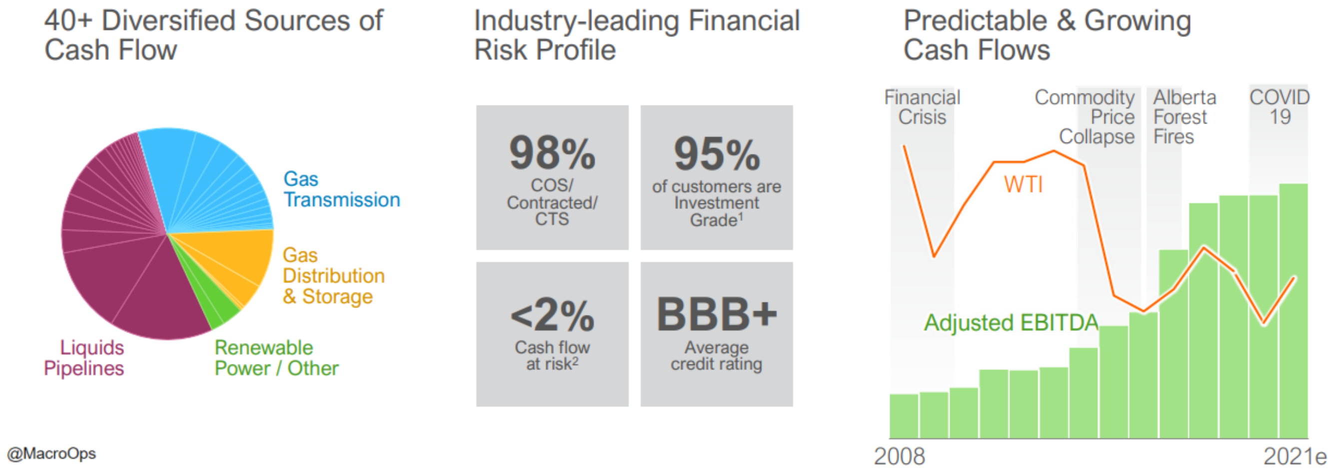
We're going to take a shot at this trade and we'll do so in two parts.

First, we'll buy the underlying. We're going to put in a buy stop order right above its upper BB and multi-day consolidation, at the $64.15 level on the June contract. If the market gets to that level then it should keep going (I'll include all the details for the following trades at the end).

Next, we're going to buy some DOTM calls on Canadian energy infrastructure company, Enbridge Inc (ENB).

ENB operates through five segments: Liquids Pipelines, Gas Transmission and Midstream, Gas Distribution and Storage, and Renewable Power Generation, and Energy Services.

I like this play for a host of reasons. One, it gives us exposure to natural gas, oil, and renewables, as well as *infrastructure* which I assume will become an increasingly popular buzzword as we move closer to September.



The chart is one of my favorite setups. It's been trading in a tight sideways/slightly down-channel for the last six years. It's just now bumping up against its upper channel line and my guess is it soon punches through and starts running.

Another thing to like about this play is that the DOTMs are cheap (because of the extended low vol range it's been in). We're going to start with a small leg now and add more once the move has gotten underway (details below).

I pointed out this morning the DXY chart breaking down. Which is a good signpost that the cyclical USD bear trend is resuming.

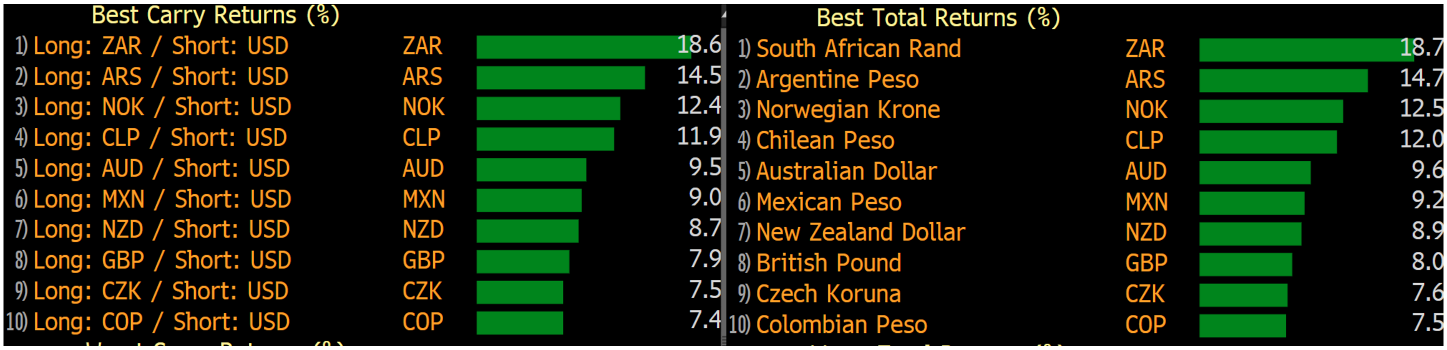
We're going to continue to build out our international (synthetic USD short) exposure in our equity book as well as take some direct shots.

The other week I presented the bull case for Mexico and the peso in "Slowbalization and Near-Sourcing".

We've now got decent exposure to the country through HCITY, Q, and BWMX.

Recently though I've been eyeing the South African Rand. Below is a daily chart of the ZARUSD cross.

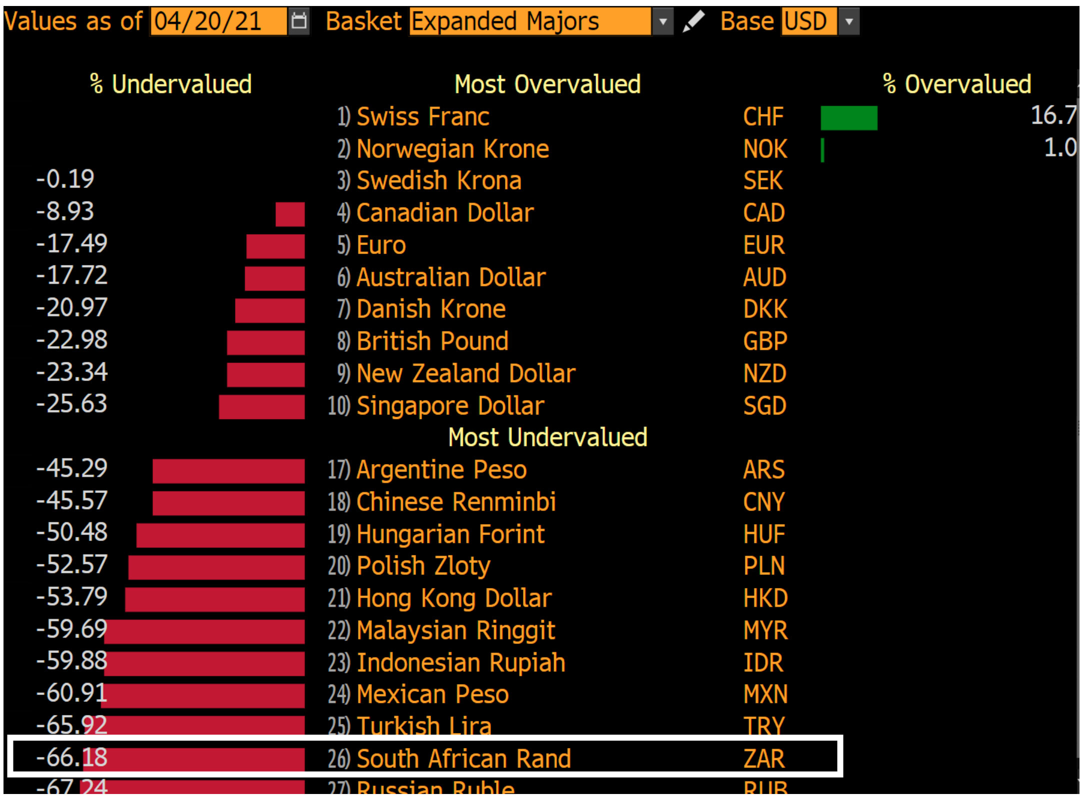
The rand is the best-performing currency on a 12m, 6m, and 3m basis. It has the best carry and total return profile over the last 6m.



Best Carry Returns (%)			
1) Long: ZAR / Short: USD	ZAR		18.6
2) Long: ARS / Short: USD	ARS		14.5
3) Long: NOK / Short: USD	NOK		12.4
4) Long: CLP / Short: USD	CLP		11.9
5) Long: AUD / Short: USD	AUD		9.5
6) Long: MXN / Short: USD	MXN		9.0
7) Long: NZD / Short: USD	NZD		8.7
8) Long: GBP / Short: USD	GBP		7.9
9) Long: CZK / Short: USD	CZK		7.5
10) Long: COP / Short: USD	COP		7.4

Best Total Returns (%)			
1) South African Rand	ZAR		18.7
2) Argentine Peso	ARS		14.7
3) Norwegian Krone	NOK		12.5
4) Chilean Peso	CLP		12.0
5) Australian Dollar	AUD		9.6
6) Mexican Peso	MXN		9.2
7) New Zealand Dollar	NZD		8.9
8) British Pound	GBP		8.0
9) Czech Koruna	CZK		7.6
10) Colombian Peso	COP		7.5

And it's the second most undervalued currency against the US dollar.



Values as of 04/20/21 | Basket Expanded Majors | Base USD

% Undervalued	Most Overvalued		% Overvalued
	1) Swiss Franc	CHF	16.7
	2) Norwegian Krone	NOK	1.0
-0.19	3) Swedish Krona	SEK	
-8.93	4) Canadian Dollar	CAD	
-17.49	5) Euro	EUR	
-17.72	6) Australian Dollar	AUD	
-20.97	7) Danish Krone	DKK	
-22.98	8) British Pound	GBP	
-23.34	9) New Zealand Dollar	NZD	
-25.63	10) Singapore Dollar	SGD	
	Most Undervalued		
-45.29	17) Argentine Peso	ARS	
-45.57	18) Chinese Renminbi	CNY	
-50.48	19) Hungarian Forint	HUF	
-52.57	20) Polish Zloty	PLN	
-53.79	21) Hong Kong Dollar	HKD	
-59.69	22) Malaysian Ringgit	MYR	
-59.88	23) Indonesian Rupiah	IDR	
-60.91	24) Mexican Peso	MXN	
-65.92	25) Turkish Lira	TRY	
-66.18	26) South African Rand	ZAR	
-67.24	27) Russian Ruble	RUB	

Brandon and I are currently looking into some South African names, to see if there's anything we like. In the meantime, the rand has broken out of a 5-month sideways consolidation. This gives us a good entry point to take a stab at getting long.

South Africa is a politically volatile country but there are some promising signs that things may be changing for the better (I'll be writing more on this topic in the future). Plus, the country is a big exporter of many of the things we want to be long. Below are their top 10 exports.

1. Gems, precious metals: US$20 billion (23.3% of total exports)
2. Ores, slag, ash: $12.8 billion (14.9%)
3. Vehicles: $8.5 billion (9.8%)
4. Mineral fuels including oil: $6.9 billion (8%)
5. Machinery including computers: $5 billion (5.8%)
6. Iron, steel: $4 billion (4.6%)
7. Fruits, nuts: $3.8 billion (4.4%)
8. Aluminum: $1.6 billion (1.9%)
9. Electrical machinery, equipment: $1.5 billion (1.8%)
10. Other chemical goods: $1.5 billion (1.8%)

Trade Details below.

Buy Stop on CLM21 (trade only triggers if entry price is hit)

- **Entry**: $64.15
- **Exit:** $62.61
- **At-Risk:** 50bps

Long Enbridge Inc (ENB) Jan 2023 $50 Strike DOTM Calls (To avoid running up the price on each other, we can ladder our orders between the $40, $45, and $50 strikes.)

- **Cost:** $0.50
- **At-Risk:** 100bps

Sell short USDZAR

- **Entry**: $14.21698
- **Exit:** $14.75000
- **At-Risk:** 100bps

Your Macro Operator,

Alex