A Market Note: The FUMO Rally…

The other week Brandon and I were on a zoom call with a long-time honorary Collective member. An OG trader who has influenced the way we approach markets, probably more than any other person.

I can't give his name, but you'd know him. He's been featured in Schwager's Market Wizards books and has worked alongside many other GOATs. Anyways, near the end of the call, I asked him who the best pound-for-pound trader he's ever worked with and why?

Without hesitating, he answered Bruce Kovner. The reason he gave… **Discipline.**

He said Kovner was by far the *most* disciplined trader he'd ever worked with. He said Bruce was a cold, calculating machine who knew his edges and applied them ruthlessly.

I appreciated his answer for a few reasons (1) Kovner has long been one of my favorite traders to study, and (2) discipline is one of five essential traits that all master traders and investors share. The other four being: self-awareness, cognitive flexibility, independent thinking, and an unquenchable passion/curiosity for the game.

Discipline, however, is the most important of the five. It's the foundation on which everything else stands.

You can be the most self-aware, open-minded, passionate independent thinker alive… Yet, if you're not disciplined in your approach, your actions, your process, then it's worth bunk all.

It's also a topic that's grossly underexplored and under-discussed in trading and investing. Which I get. Discipline isn't nearly as sexy at talking about potential fat pitches, and hot macro takes. Even though the former is infinitely more valuable.

Our OG trader is a perfect example of how valuable this trait is, especially in difficult and choppy markets like the one we now find ourselves in.

He told us that he was in the midst of one of his worst losing streaks in over a decade. He said something to the effect that his last 14 trades had been losers.

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Fourteen duds in a row is a tough pill. Hard to swallow that. But bad streaks are inevitable in this game. They're a cost of doing business. And it's in how we manage the difficult times, that largely determines how we perform over the long pull.

Our OG Trader is the most disciplined and skilled risk manager I know. So despite his rough patch, he was still only a few winning trades away from new NAV highs, which is an incredible testament to his process and the discipline at which he executes it.

I'm going to hash out my thoughts on this subject some more in upcoming piece. But I just wanted to share the above to plant the seed and maybe get a discussion going in the slack.

If you've come across any good books, articles, podcasts, etc.. on the topic, please post them in the slack and tag me.

FOMU: Fear of materially underperforming…

In mid-October, I wrote in my market note titled "A Toxic Mix" that:

> *…The setup is there for a considerably counter-trend rally… Net speculative (3yr adjusted OI) long positioning is in the 9th percentile (dotted orange line). But speculators are starting to buy again, which we can see on the solid lines (orange, red, blue) which adjusts for positioning changes across a shorter timeframe.*
>
> *These have started turning up, and this is exactly what you want to see if you're looking for a rally. Positioning aggressively turning up from off the floor. Next, there's seasonality which turned hugely positive this week. This seasonality tailwind is even more impressive when adjusted for midterm years. And lastly… the SPX is at or near 2std below its 20, 50, and 200-day moving averages.*

That report was published on October 13th, which happened to mark the bottom of SPX's downtrend to date.

But saying the conditions are set for a bottom is just a statement of facts. Not a market call. The market could have kept moving lower while the conditions remained for a rally.

Market bottoms, can only be called in hindsight, after the tape and the weight of the evidence paint you enough of a picture to do so.

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So while I've been writing that the conditions were set for a market bottom for nearly a month now. And the Oct 13th SPX low has held just as long, we had to wait for the tape and the internals to play out before we could say "yep, this is a tradeable bottom" with any level of probable certainty.

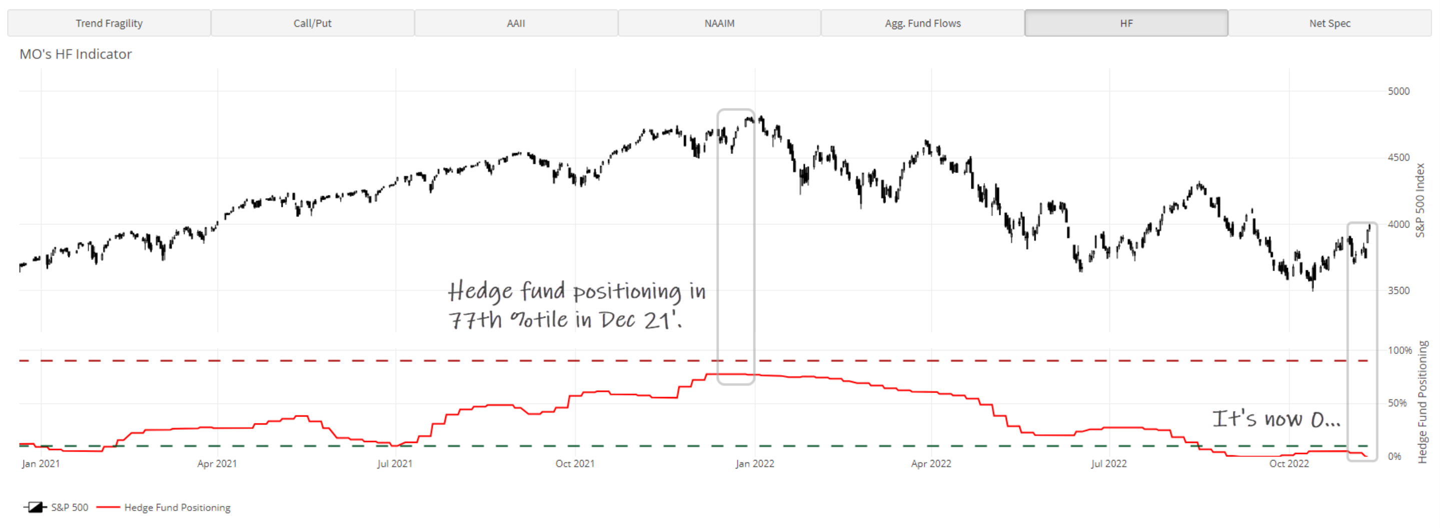
Now, we've seen enough of the evidence to say just that. This is a tradeable bottom. See slides 5 and 6 in this week's *Trifecta Chartpack*. Market internals, credit, yields, and short-term breadth all confirming the move up in stocks. So far, this is textbook. And while markets are always full of surprises. **The probabilities greatly favor continued upside in risk assets.**

But, we still haven't seen any confirming breadth thrusts that mark a larger more enduring one. And I don't expect we will.

We're in a bear market. We're almost certainly going to enter a recession sometime in the latter half of next year. When looked at relative to rates, the market is more expensive now than it was at the end of last year.

Monetary policy works with a 12-18 month lag. The impact of these rate hikes won't truly begin to be felt until after the turn of the year. And liquidity is set to significantly deteriorate from there on.

However, over the short-term, there a LOT of underinvested managers… many who've been grossly underperforming on the year. And it's one thing to underperform in a down market. But to underperform when the market goes up… well, that will get you fired.



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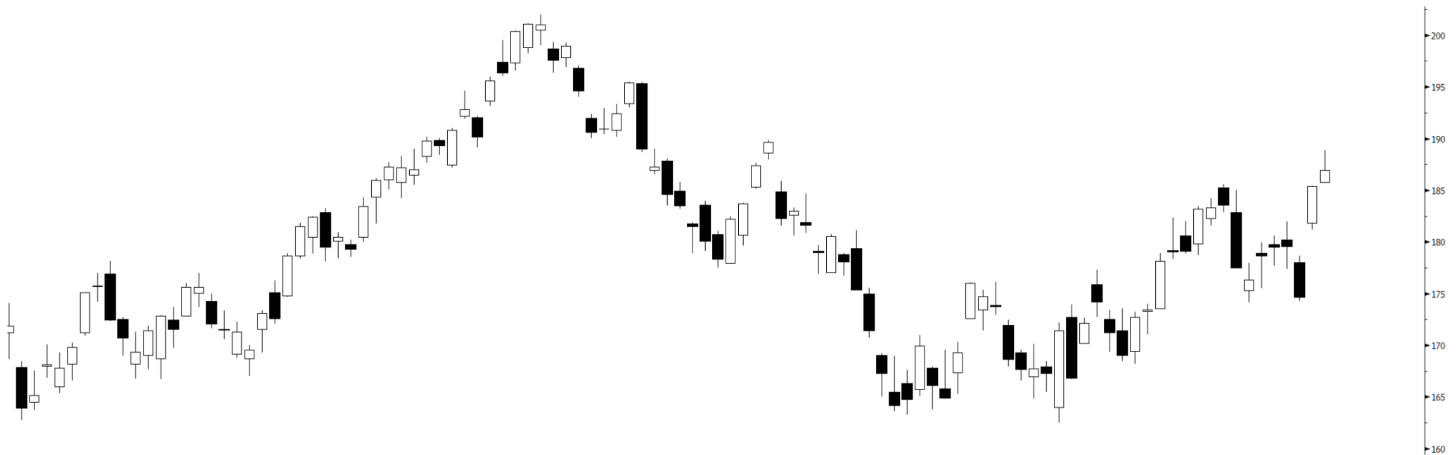
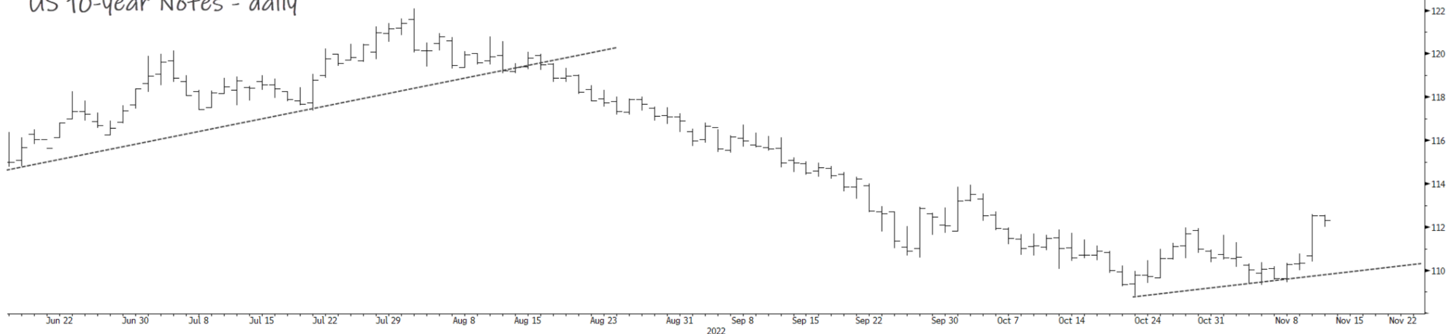
This means there's a likelihood we see some FOMU flows back into risk assets, sending stocks higher into the holidays.

The bulls have some cover with developing narratives of (1) peak inflation, with the recent below expectations CPI print. Nevermind the fact, that Octobers CPI was greatly flattered by one-time adjustments made to the way medical care is measured, which led to the biggest monthly drop in those prices in nearly 50-years (2) Ukraine military retaking Kherson, which greatly raises the possibility of this war ending much sooner than anybody expected

I'm less concerned with the narratives at the moment, than I am with the actual drivers of the tape. Which, is still yields. It's really one of the very few things we need to be tracking here to give us a sense of how long this rally will last.

So we need to keep watching 10s and make sure they hold their recent base. The action so far looks good.





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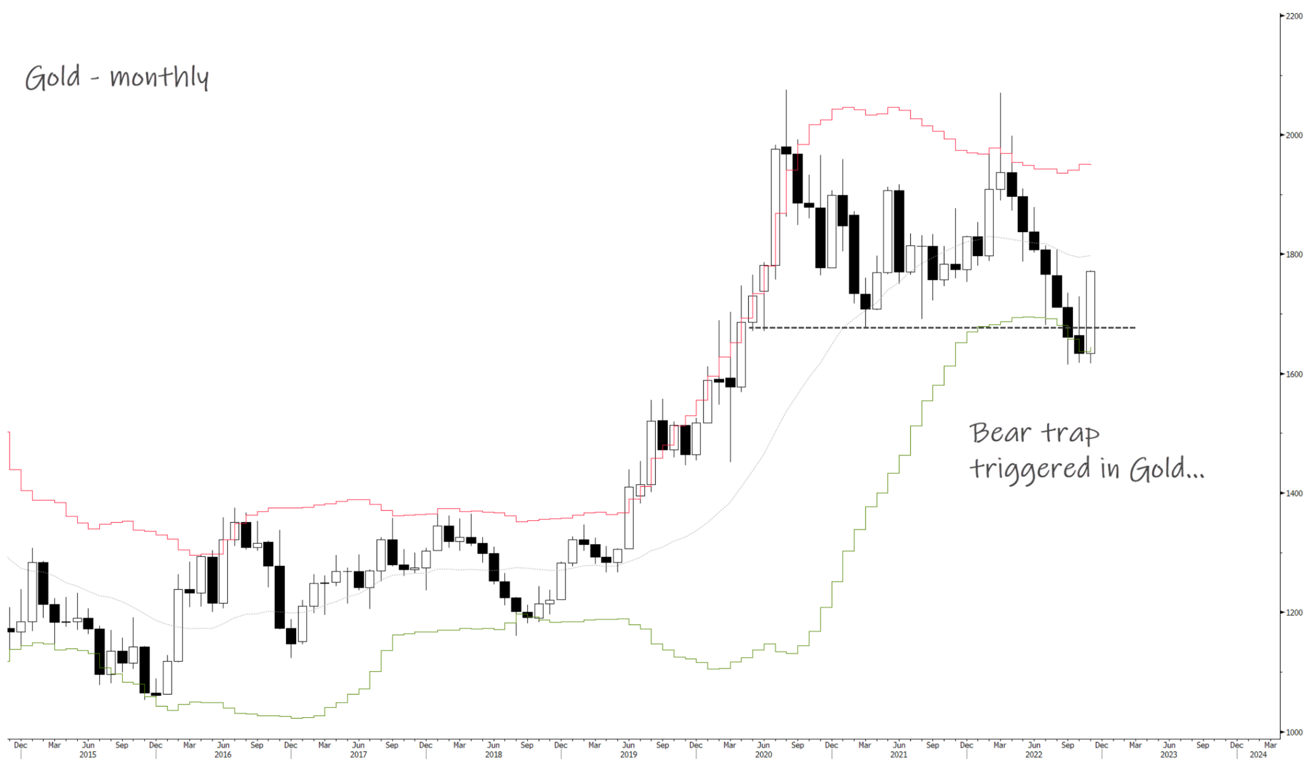
We'll likely get long NQ or RTY futures at the start of this week to get more exposure on for the FOMU rally.

The most important move over the past week was in precious metals.

Gold completed a major bear trap on the back of this softening in yields. I wrote about the likelihood of this happening back at the start of October in "A Golden Trap…"



It's putting in a strong bullish impulse, which is typically what you see at the start of larger trends.

We're already long some miners (equity in EGO and DOTM calls in AG). And we plan to add to our DOTM position soon. The charts are overextended on the short-term but we'll look to get a futures position on once we get a pullback/consolidation.

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We're going to be a bit more aggressive with sizing on the PM trades as bullish gold and silver is one of my higher conviction trades over the next few years. And there's good reason to think that trend is kicking off now, as PMs often bottom in the middle of an equity bear market.

That's it for now. I've got a larger note going out in a few days where I outline my thoughts on inflation and why I expect it to stay sticky and elevated at around 4-5% over the next decade, along with what that will mean for markets.

Sidenote, I've been battling my worst case of COVID yet this past week. A number of us caught it at the recent reunion. I've been high dosing Vit-C, Vit-D, and zinc. If you've got any recs to help with recovery, please shoot them my way!

Your Macro Operator,

Alex

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