MACRO OPS

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THE MARKET BRIEF | **JUNE 14 2023**

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Market Note: Recessionistas Suffering Premature Pontification

Alex here…

In early January I wrote the following in *How To Avoid Stinky Fingers…*

> *In this Market Note, we're going to reiterate why we're at a tradeable bottom, why it's asinine to think that this is a cyclical bottom, why a recession will happen* ***but not until Q4 of this year****, and why stocks will end the year lower (after a strong 1st quarter).*

The note laid out the reasoning for why the market was at an intermediate bottom before going on to discuss why the popular recession narrative was terribly premature, saying:

> *…Unlike past cycles, where consumers' overleveraged balance sheets get squeezed by*

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> *rising rates leading to a pullback in spending. This time around, households are in much better shape due to plenty of fiscal.*
>
> *Real incomes ex-transfer payments have been going up for the last six months, <u>growing at a 2.9% annualized rate</u>. These are not recession levels or even pre-recessionary levels.*
>
> *According to Goldman Sachs, the private sector has been running a surplus of total income to spending that's at a level that <u>"is healthier than on the eve of any U.S. recession since the 1950s."</u>*

The report then talked about the high level of household excess savings ($1.7trn at the time)... along with the fact that most businesses had taken advantage of the generational low in interest rates securing favorable rates, with only 8% of junk bonds set to mature before 2025… and then concluded with the following:

> *At some point, financial conditions will reach a level where the labor market begins to unwind, and that's when we get the positive feedback loop of negative consequences (ie, a recession).*
>
> *Again, **that's a late 2023 discussion**. Not a next six months discussion. There's still some juice left on the balance sheets of consumers.*

Alright, first off predictions are meaningless to us. It's not what this game is about. They're just probability-weighted base cases. Base cases which we <u>continuously</u> and <u>unceremoniously</u> update as new information comes in.

But I want to revisit the above so we have a *starting point* from which to update/change/adjust our larger macro outlook, say looking out for the next 6 months or so and review our calls at the start of this year.

Our non-recession call, which was quite a contrarian take at the time, has been proven right. As well as our call for an intermediate bottom in the market due to excessively bearish positioning/sentiment which wasn't matched up with how we believed reality would unfold.

What **I've found to be most surprising though is the incredible stubbornness of the bears.**

I expected the Narrative Pendulum would've swung firmly back to the bull side by early second quarter. But the initial tepidness of this rally off the October lows helped cement the pessimism. And this stubbornness is the main reason we've stayed constructively bullish year-to-date.

Our Q4 23' recession call is yet to be seen. Looking at the data I *still* think this is likely, though admittedly the probabilities I'd assign to it now are lower than where they were at the start of this year (what was a 70% call is now more like 55%).

It's not that I don't expect the economy to continue to slowly roll over. I do and that's what the data suggests (more on that in a bit).

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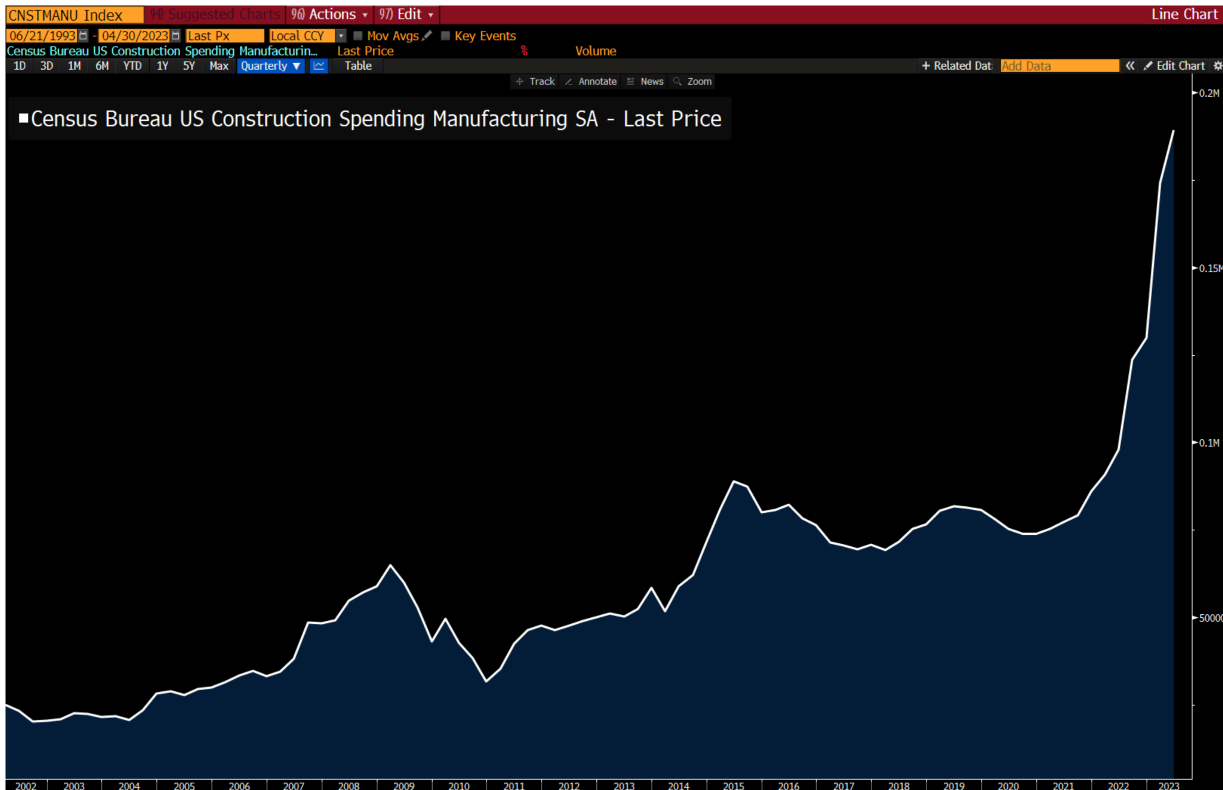
Where the uncertainty comes in for me is in how self-reinforcing the current economic momentum is and at what speed the excess consumer cash gets drawn down — this has been slower to date than expected.

Throw in the increasingly positive tailwinds from the IRA, IIJA, and CHIPs Acts, which are driving a boom in construction spending centered on manufacturing and infrastructure, and we're left with more uncertainty on how this unusual cycle will play out.



In an effort to cut through some of this uncertainty and share with you how I'm thinking about the current macro cycle, let's walk through the foundation of my process for building a probabilistic view of the world.

So let's start with my recession dashboard (note: this table and corresponding indicators will be hung up on the HUD shortly).

This is the table I used to call BS on the recessionistas in 2018/19' and again during all of 22' as well as at the start of this year (red means a recession signal has triggered, yellow means it's close to triggering, and green means it's far from triggering).

Early U.S. Recession Indicators				
Indicator	Median Lead Time	Current Cycle	Key Recession Level	Current Level
Conference Board LEI Peak	10-months	11-months	Negative YoY%	-7.7%
Yield Curve Inverts (2s10s)	19-months	11-months	Below 0	-80
Initial Claims (4wk avg) Trough	8-months	9-months	24-month MA crossover	Slightly below
Temporary Help Labor YoY%	9-months	7-months	Negative YoY%	-2.8%
SPX Peak	7-months	18-months	Below 50-week MA	Above
New Housing Starts Peak	28-months	13-months	Negative YoY%	-21%
Heavy Truck Sales	15-months	New Cycle High	Negative YoY%	+21%
US Recession Probit Model 24m	20-months	11-months	100%	100%
US Recession Probit Model 12m	11-months	9-months	100%	100%

Coincident U.S. Recession Indicators		
Indicator	Key Recession Level	Current Level
Consumer Confidence Index	36-month MA crossover	Above
Philly Fed State Indexes	Below 50	98
ISM Manufacturing Index	Below 44	47
ISM Non-Manufacturing Index	Below 50	50.4
Unemployment Rate	12-month MA crossover	Above
Real Retail Sales YoY%	Negative YoY%	-3.3%
Adjusted National Financial Conditions Index	Above 0	-0.27
Kansas Fed Financial Stress Index	Above 0	+0.46
Cleveland Fed Yield Curve Probability of Recession	Above 30%	+79%

Everything we do in our approach at MO is to make things as simple as possible and no simpler, to quote der Depperte.

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We’re constantly striving to codify and quantify our process as much as possible so to lessen the iinfluence of confirmation bias since **we do this work to make money and not serve our egos.**

To do this we have to have a comprehensive and holistic set of data points that look at the economy from all angles. We then need to rigorously study each indicator to understand what it is, how it's put together, and what it means.

The table at the top shows early/leading indicators of recession. The second table shows slightly leading to coincident indicators.

<u>Out of the nine leading indicators, there are only three that aren’t giving a hard recession signal</u>.

Initial claims and SPX peak are neutral. The 4-week moving average of initial claims remains just *slightly* below its trigger point which is the 24-month moving average. And while the SPX remains below its Dec 22’ peak it’s climbed back above its 50-week moving average for now.

The single positive data point out of the group is Heavy Truck Sales, which recently hit a new cycle high and is running at +20% on a YoY% basis (nominal and YoY charts below).

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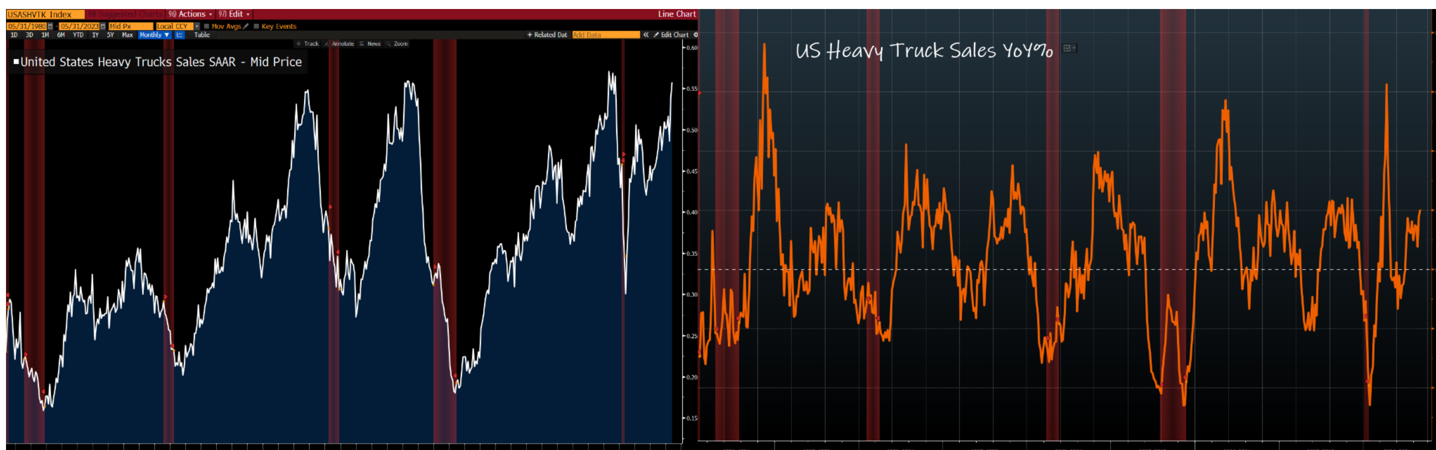

Typically, heavy truck sales as strong as these would be unusual if we thought a recession was likely to begin in the next six months. But this cycle isn't a normal cycle by any means… and this data is almost entirely driven by the recent boost in fiscal (see construction spending on manufacturing chart shown on prior page).

This isn't to dismiss this indicator at all. We have entered a new era of fiscal largess. And government spending is set to play a greater and greater role in the workings of the business cycle, in a way it hasn't over the past 50+ years.

So this bullish data point needs to be respected but also understood in the broader context of everything else that is driving underlying economic demand.

This brings us to our table of coincident recession indicators. Here we have nine indicators with five currently signaling recession. We have three that are neutral and one that is in the green.

This is about what I'd expect from these indicators if we're working off the assumption that a recession will start around Q4 of this year.

Coincident U.S. Recession Indicators		
Indicator	Key Recession Level	Current Level
Consumer Confidence Index	36-month MA crossover	Below
Philly Fed State Indexes	Below 50	98
ISM Manufacturing Index	Below 45	47
ISM Non-Manufacturing Index	Below 50	50.4
Unemployment Rate	12-month MA crossover	Above
Real Retail Sales YoY%	Negative YoY%	-3.3%

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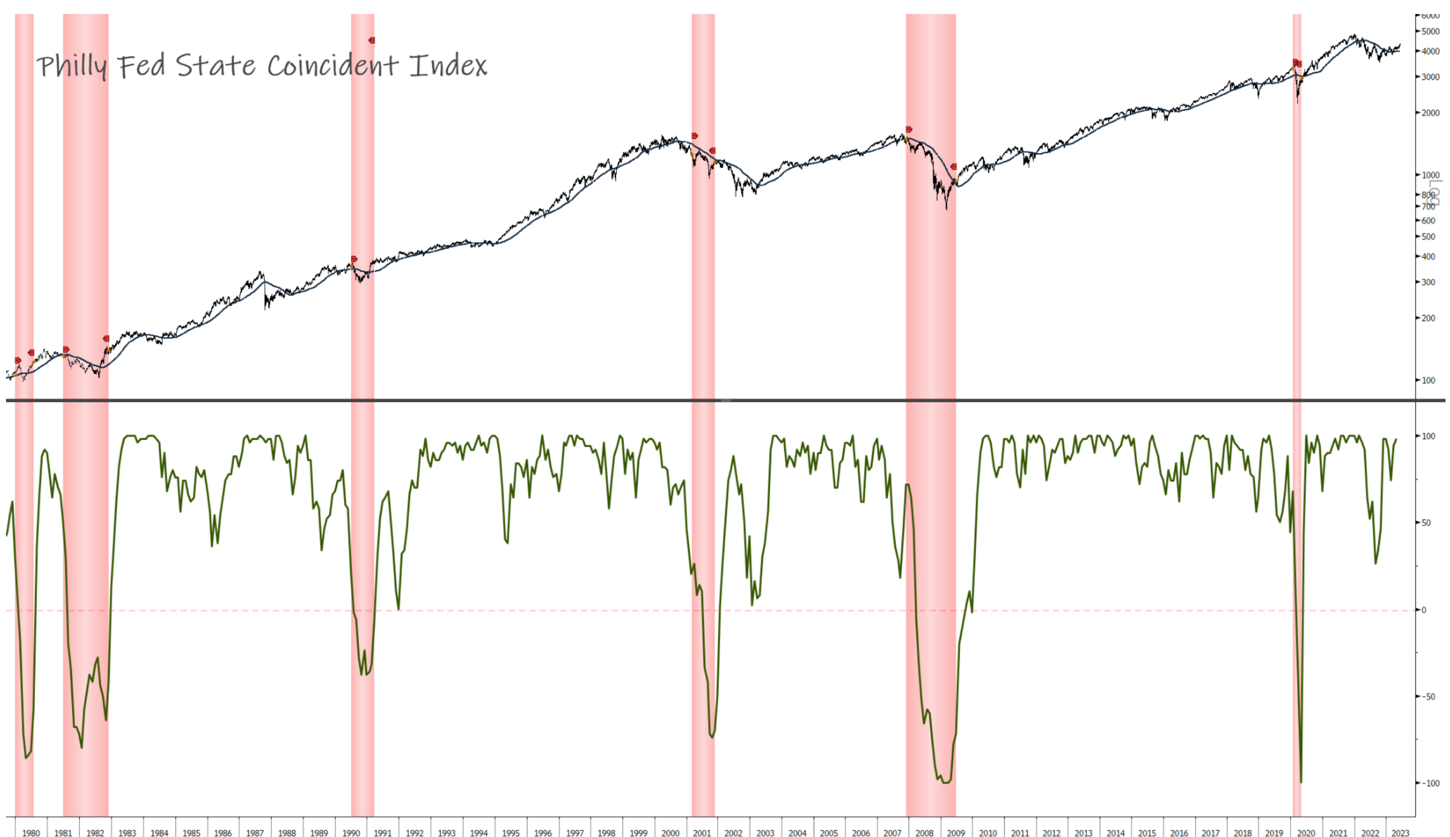
Adjusted National Financial Conditions Index	Above 0	-0.27
Kansas Fed Financial Stress Index	Above 0	+0.46
Cleveland Fed Yield Curve Probability of Recession	Above 30%	+79%

The single green data point is the Philly Fed State Index (pictured below). This one dipped below 50 last summer but has since rebounded back to 98 (100 is its highest reading).

This is a labor market indicator. It's an aggregation of four state-level variables (1) nonfarm payrolls (2) average hours worked in manufacturing by production workers (3) unemployment rate and (4) wage and salary disbursements deflated by CPI.

Labor is the most lagging of all of the economic data points, so it only makes sense that this would be the strongest of the group.



So that's about it… It's not heart surgery. We're not trying to reinvent the wheel here. The above is just a grouping of time-tested leading and coincident indicators. A group that shows weaknesses and strengths of the economy from various angles, providing us with a more full and true picture of what's going on. It's a simple weight-of-the-evidence approach.

And the picture that these indicators paint for us is that we're likely to enter into a recession sometime in the next six months.

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Due to current liquidity tailwinds and the prevailing tightness in the labor market, a recession is unlikely to come before Q4 and may be pushed out to Q1 of next year. This is clearly what the weight of the evidence says currently.

Things could change. The data could meaningfully flip, and though that would be anomalous it doesn't mean it's impossible.

One of the areas of the market that we'll need to continue tracking closely is liquidity, as this should give us a good read on where the trends in the economy and market are headed.

We've written a number of times since early last year about how the large excess consumer savings would keep the economy humming until it was depleted in the second half of this year.

The San Francisco Fed updated their research around these excess savings last month and concluded with the following (highlights by me).

> *U.S. households accumulated excess savings at an unprecedented speed following the onset of the pandemic recession, relative to other post-1970 recessions.* ***Despite recent rapid drawdowns of those savings, a large amount—around $500 billion—remains in the overall economy.***
>
> *A great deal of uncertainty surrounds precisely how the savings are distributed across household income levels and in what kind of assets they are being kept. Nonetheless, data on household assets and checking account balances support the view that* ***households across the income distribution generally have considerably more liquid funds at their disposal compared with the pre-pandemic period.***
>
> *Overall,* ***we expect the aggregate stock of excess savings will continue to support consumer spending at least into the fourth quarter of 2023****.*

Originally the belief was that the vast majority of these savings would be run down by August/September timeframe. But that has proven to be too pessimistic. And because of the amount of guesswork involved in modeling the spend-down rate for this gargantuan cash pile, we need to very humbly carry our assumptions from this work.

This is one of the primary reasons we've been bullish for the past 18 months and it's one of the primary reasons we think a recession will start in Q4 23' or Q1 of next year. We carry these opinions weakly though and will continue to just watch how liquidity unfolds going from here, and adjust fire when necessary.

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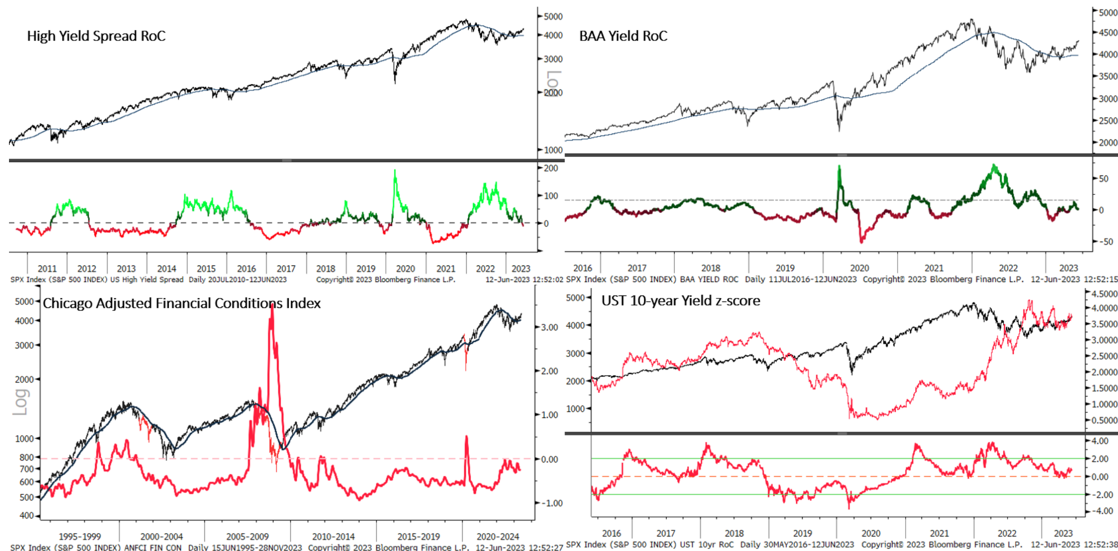
Liquidity



I'll end this section on recession analysis with this chart and text from Simon White of BBG. He writes (emphasis by me):

> ***One of the most comprehensive and reliable leading indicators of a recession is the Recession Gauge****. It is made up of 14 recession sub-indicators that capture a wide array of market and economic-based conditions.* ***The gauge triggers when at least six of them activate, signaling a recession in the next 3.-9 months****.*
>
> *As the chart below shows, the gauge triggered in September, with the number of sub-indicators continuing to rise. The latest activated last week after Friday's employment data showed a further decline in temporary help services, one of the most leading parts of the job market.* ***This took the number of sub-indicators consistent with a recession to nine out of 14, the highest since 2008.***

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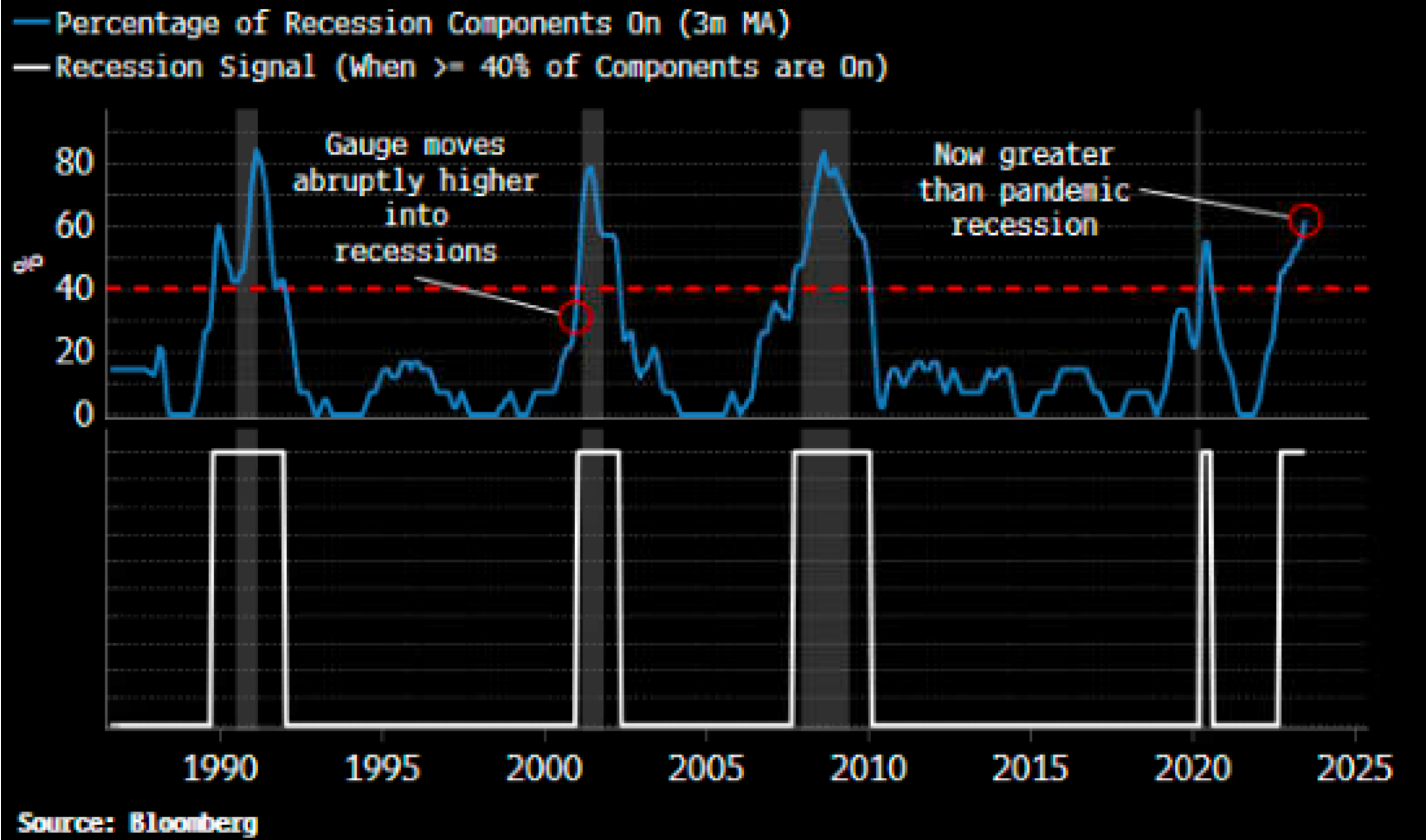

Practically speaking… so what?

Okay, so what does one do with this information?

What one does with this info really depends on where one sits. If I were a whale of an allocator who is limited in the speed they're able to get in and out of the market, then I'd start gingerly lightening up on my risk levels here. I say gingerly because the market remains above its 200-day, it's in a bullish impulse, and though the narrative pendulum is quickly shifting, bearish positioning and sentiment still favor some more upside — though shorter-term signs of positioning/sentiment such as Put/Calls 10mda and AAII are near levels that typically mark pullback/consolidation points.

If you're not a whale and you get to enjoy the market superpower of agility that's afforded to those not swinging massive lines, then a possible recession later this year isn't vitally important to you. In this case, it only matters in that it's helpful context in forming longer-term views and analyzing broader market action.

Example: why has oil been unable to catch a durable bid in the face of three consecutive OPEC cuts and Uncle Sam beginning to refill its SPR coffers? Or why has Dr. Copper been trading so heavy despite the well-known long-term and growing supply/demand imbalance?

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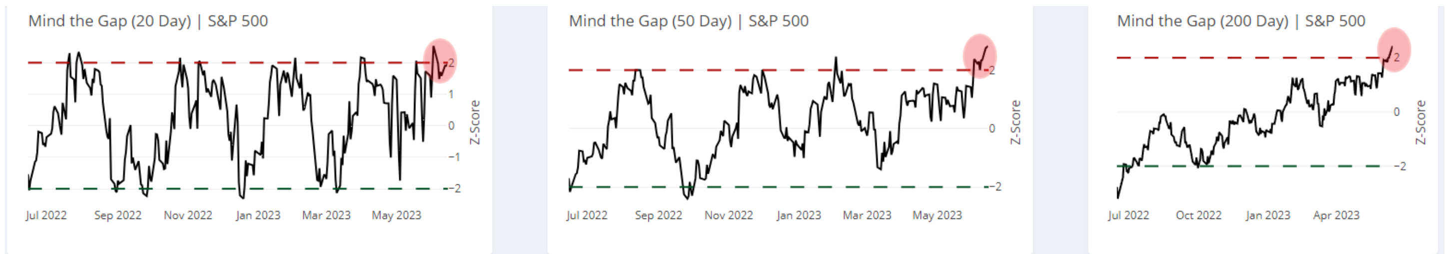
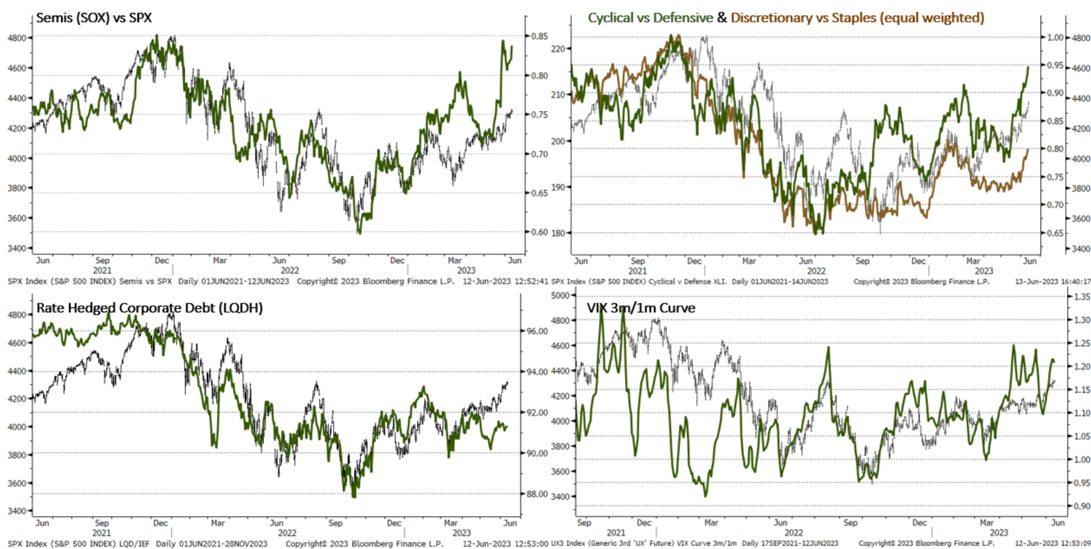
Speaking of market action, the SPX continues to move into extreme overextension (charts below show the price to moving average spread of the 20, 50, and 200 day). This raises the odds of a consolidation/pullback period in US large caps soon if not risk assets more broadly.



We continue to remain broadly constructive on this rally though since market internals are still supportive of the uptrend (note: these charts are currently being added to the HUD).



So we should expect a pullback or consolidation period here soon. But we shouldn't too aggressively cut risk unless we start to see a broader deterioration in the internals shown above and/or our liquidity indicators.

Where's the action?

I continue to like long USD trades against DM pairs, as well as our USDCNH long which has more than 6x'd since our entry in early May.

This pair is stretched over the short term so we should expect some profit-taking soon. We'll likely put on a trailing stop for half profits and wait to add on another pullback reversal, as I think the macro-dynamics are shaping up in a way to give this trade some legs.

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DXY is in a neutral SQN regime. It's retraced back to its lower Bollinger where it reversed and put in a bull bar.

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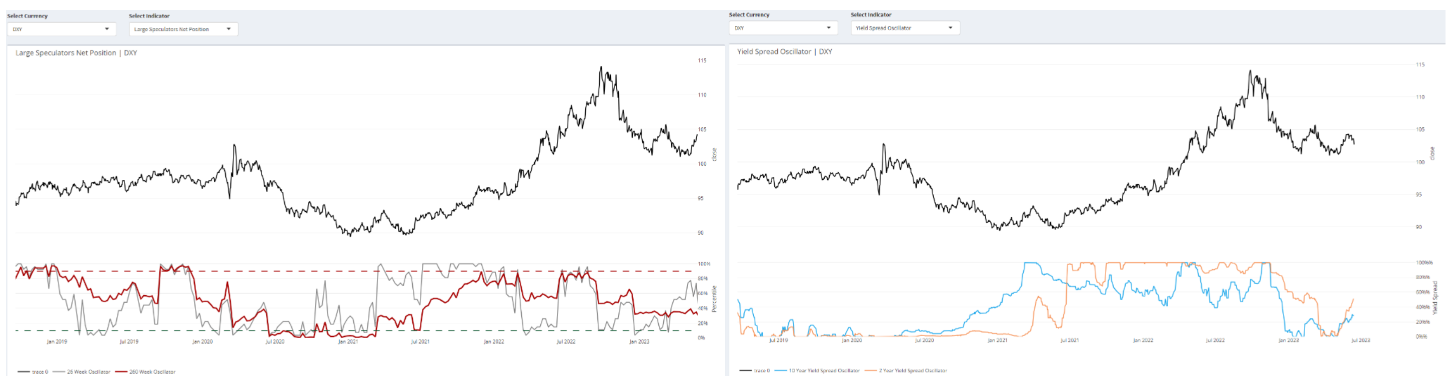
U.S. Dollar Index, 1D, TVC O102.964 H103.245 L102.918 C103.219 +0.217 (+0.21%)
BB (20, close, 2) 103.723 104.524 102.921

SQN (100) 0.333

TradingView

Large spec positioning remains low. And aggregate DXY yield differentials have turned up showing momentum is returning to DXY yield spreads (chart on the right).



Gold and silver look vulnerable to more selling here. This isn't a convicted setup as positioning remains neutral in both. But bonds still look under pressure and as long as yields are rising, we should expect PMs to trade heavily. Though I do think the next major bottom will be in on PMs sometime this quarter.

That's all we've got for trades right now. Brandon and I are working on a Uranium update this week that we're excited about. That's one of the few areas of the market that we believe has incredible upside potential over the next 5-years but which is also actionable right now.

A hawkish pause…

I'll end with some quick thoughts on today's FOMC. As expected, Powell and team paused their rate hiking this month. But… they surprised on the hawkish side by raising their guidance for rates by the end of the year.

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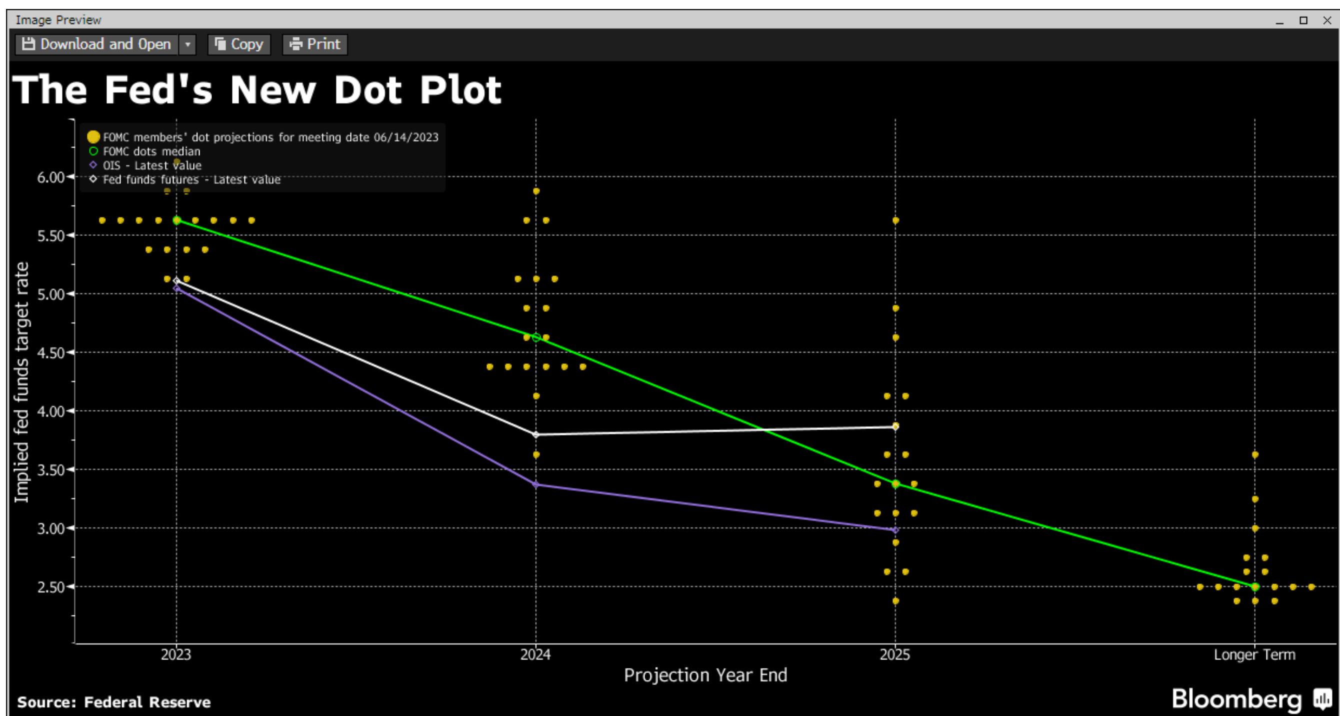


I don't think there's much to read into this. We remain in a Fed hiking cycle. The Fed is going to keep hiking until they lower demand by raising unemployment. Yes, inflation is falling. But the hurdle rates are going to make CPI much stickier going forward.

The next meeting is a live one and we should expect the Fed to jawbone until CPI is firmly below its target of 2%. And that's not going to happen this year.

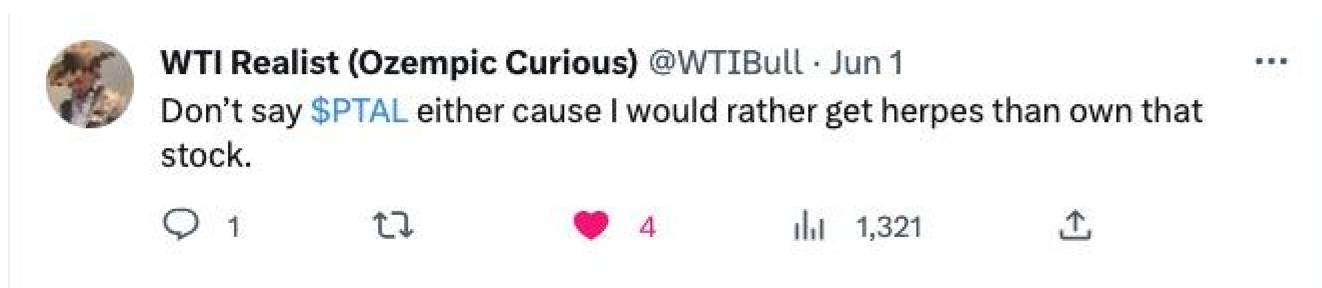
I'll be out with more in the coming days. Here's Brandon with a dive into a hairy Peruvian E&P.

Your Macro Operator,

Alex

Market Note: PetroTal (PTAL)

I like stocks with an "Ick!" factor. This is partly due to my obsession with Michael Burry. But also because it's fun finding value where others see dumpster fires.



PetroTal (PTAL) has a laundry list of Ick Factors:

- ➢ Social unrest
- ➢ Geographic challenges
- ➢ Transportation issues
- ➢ Political risk
- ➢ Oil price pressures

The good news is that **all these issues are currently baked into the stock price.**

The company is an ick oil stock that makes its entire market cap in cash flow in <2 years at $85 oil, <3 years at $70 oil, and <5 years at $60 oil.

PTAL is a Peruvian oil/gas producer generating ~15,000/bopd production this year. Despite the above hair, there's a lot to like about PTAL.

The company has fourteen active wells that are producing above its 2023 FY guidance (currently averaging 20,000/bopd as of May 6, 2023), 97M barrels in 2P reserves at a $1.5B valuation (NPV10), and no debt.

There are a four main reasons why I love this setup.

First, the stock is cheap. PTAL generated 67% of its market cap in EBITDA over the last four quarters at ~$85 Brent oil.

Second, the company used its cash flow to eliminate all long-term debt and has ~$18M in net cash on the balance sheet.

Third, PTAL is profitable at $70/bbl oil and generates ~$3/bbl EBITDA netbacks (which deducts G&A).

Finally, the company announced it will return capital to shareholders via dividends and share buybacks (up to 10% of the float).

PTAL's recent cash flow figures came at $85 oil. We're nowhere near $85 today. In fact, $65 looks more likely as the global economy dips into a recession towards the back half of this year.

Like any stock, but especially with high-risk commodity stocks, it's important to underwrite for pessimism. How much will PTAL make at $65 or $70 oil?

As I mentioned earlier, the company is producing around 20,000/bopd this year, well above its 14-15,000 guidance. But let's use 15,000/bopd for our valuation.

At 15,000/bopd, PTAL spends ~$7/bbl on lifting, diluent, and barging costs. And another $30/bbl in differential, transportation, and royalties/social trust expenses.

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Finally, we'll add another $5.5/bbl in SG&A costs.

That gets us ~$43/bbl in total costs. We'll also assume a 95% production utilization rate (~346 days).

So if PTAL sells its oil at $70, they receive ~$27.5/bbl in profit, or **$143M in annual cash flow.** We're paying 2.5x $70 oil production at the current market cap or a **40% cash yield**.

Even at $60 oil, PTAL generates $17/bbl in profit for ~$88M in cash flow (24% yield).

The company still needs to pay capex for development and reserve replacements. However, PTAL can defer up to $40M in capex should oil stay around $70/bbl or lower. This would free up *even more* cash to pay shareholders in dividends or buybacks (which they started end of May).

A lot can change. This is still a Peruvian O&G producer battling Indigenous protests, transportation blockages, South American political regime changes, and a slowing global economy. PTAL should trade in-line with oil prices. Which sucks in the short-term, but allows long-term investors a more attractive entry price.

Here's how I'm structuring the trade.

PTAL trades in a range between GBX 35 and GBX 56. I want to buy at the bottom of the range and sell if it closes below that GBX 35 support line on the weekly time frame.

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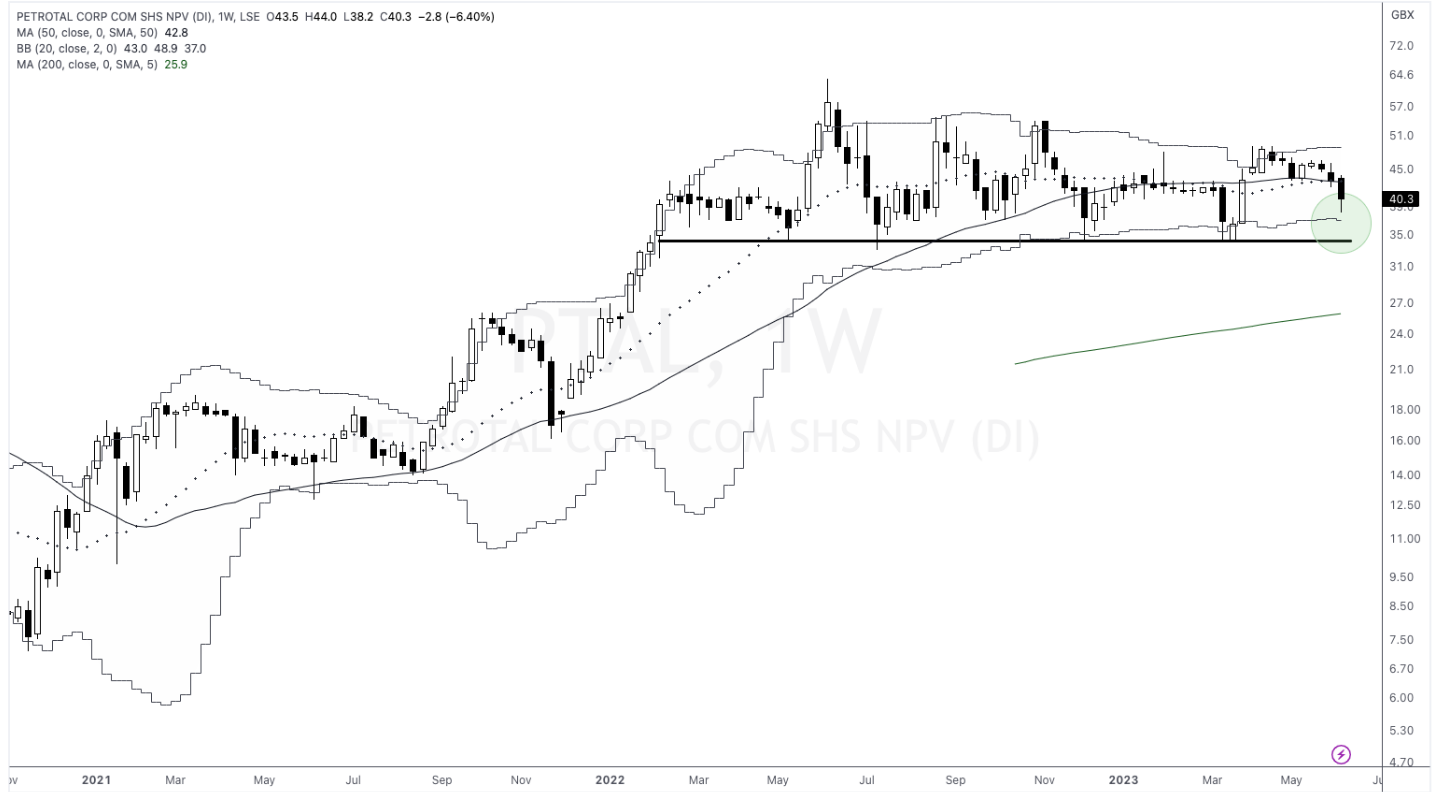
BrandonBeylo published on TradingView.com, Jun 10, 2023 11:44 UTC-4
PETROTAL CORP COM SHS NPV (DI), 1W, LSE O43.5 H44.0 L38.2 C40.3 −2.8 (−6.40%)
MA (50, close, 0, SMA, 50) 42.8
BB (20, close, 2, 0) 43.0 48.9 37.0
MA (200, close, 0, SMA, 5) 25.9
GBX
72.0
64.6
57.0
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TradingView

MO Portfolio Snapshot

The Macro Ops Portfolio

PDF: https://tinyurl.com/mo-portfolio

2023 YTD Return	4.98%
Total Notional Exposure	202.64%
Current Cash Value (%)	69.69%
2022 Final Return	10.21%
2021 Final Return	6.39%
2020 Final Return	66.40%

Futures, Bonds & FX	Ticker	Contracts	Capital	Notional	At-Risk	Cost Basis	Current Price	Stop-Loss	P&L
Dollar/Chinese Yuan	USDCNH	365,650	$2,612,278.03	152.12%	-3.64%	$6.95	$7.14	$7.12	2.77%
Russell 2000 Futures	RTYU2023	4	$376,560.00	21.93%	0.73%	$1,882.80	$1,882.80	$1,819.90	0.00%

Equities	Ticker	Shares	Capital	Notional	At-Risk	Cost Basis	Current Price	Stop-Loss	P&L
Strategic									
Sprott Uranium	U.UN	6,431	$83,217.71	4.85%	0.48%	$11.73	$12.94	$10.44	10.32%
Foran Mining	FOM.TSXV	27,333	$65,599.14	3.82%	0.24%	$2.11	$2.40	$1.96	13.74%
Foran Mining (Second Leg)	FOM.TSXV	16,994	$40,785.45	2.38%	0.51%	$2.48	$2.40	$1.96	-3.23%
Vista Energy	VIST	6,727	$157,208.78	9.15%	-0.27%	$14.11	$23.37	$14.80	65.63%
Triple Flag Precious Metals	TFPM	2,013	$28,598.44	1.67%	0.50%	$16.65	$14.21	$12.35	-14.65%
Tidewater (Second Leg)	TDW	1,249	$59,575.62	3.47%	0.49%	$49.35	$47.70	$42.57	-3.34%
Tidewater	TDW	1,174	$55,982.47	3.26%	-0.13%	$34.15	$47.70	$36.00	39.68%

Tactical	Ticker	Shares	Capital	Notional	At-Risk	Cost Basis	Current Price	Stop-Loss	P&L

Options	Ticker	Contracts	Capital	Notional	At-Risk	Cost Basis	Current (Mid) Price	Stop-Loss	P&L
AG JAN 19 2024 $20 CALLS	AG	237	$4,259.70	0.25%	0.96%	$70.00	$18.00	$0.00	-74.29%
PAAS JAN 19 2024 $45 CALLS	PAAS	660	$23,087.13	1.34%	0.96%	$25.00	$35.00	$0.00	40.00%
HAL JAN 19 2024 $60 CALLS	HAL	67	$2,226.55	0.13%	0.52%	$132.00	$33.00	$0.00	-75.00%

*[*Learn how to interpret our portfolio here.]*
*[*Learn how we size positions and issue trade alerts here.]*
*[*Set up trade alerts here.]*

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What I Learned This Week: Chile's Mining Tax Hike

Whenever you injure yourself in sports or life, what does the doctor usually say? "Take it easy, rest, and whatever you do, **do not do more of what makes it hurt.**"

Easy enough to understand.

The copper industry can't comprehend the above concept. Chile's mining tax hike is the latest example in a series of doing more of what makes it hurt.

Here's an excerpt from the Mining.com article (emphasis mine):

> *Lawmakers in Chile gave final approval in May for a long-awaited mining tax reform, hiking taxes and royalties that large copper and lithium producers must pay the government.*
>
> *"Higher tax won't lead to withdrawal from existing mines, but it may have an impact on new development projects," Akira Nozaki, the chairman of the Japan Mining Industry Association, told Reuters in an interview.*
>
> *"Obviously, profitability will decline due to higher tax, making new mining development increasingly difficult," he said.*

Higher taxes mean less profit for miners, which means lower investmentsand a growing supply and production problem.

Add this to the growing list of reasons to be incredibly bullish copper over the next 5-7 years.

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Community Highlights

Three things you may have missed this week in the Comms Center!

1) Q1 2023 Private Funding Drying Up (#private-investments)

Our resident VC industry expert, Christopher, shared Pitchbook's latest Q1 2023 funding deck. The TL;DR is that nobody's funding anything. The entire PDF is worth a read (link above).

2) Correcting Bad Habits w/ Joel C.A. (#loss-talk)

Do yourself a favor and read this excerpt from Joel C.A.'s latest post in #loss-talk. It's great.

> *"Sometimes I notice that I have no positions on, and no stop orders either. I might blame it on not spending enough time reviewing charts, then go review charts and find valid trades to enter stop orders on.*
>
> *No breaking my rules here – just very subtly trying harder.*
>
> *Then what happens is those multiple stop orders get triggered, often within the same 1-2 days and I find myself with 5 positions on. That's fine. That's my plan. But, chances are these are correlated because they were all put on at the same time. So they all end up failing at the same time and I'm down -5R (usually a bit less due to trailing stops).*
>
> *There's no real rule breaking in this habit, except for the subtlety of extra effort to find the trades. That might mean I'm not waiting for the best setups.*
>
> *I often do this after a winning trade (say, +2R) builds confidence in my strategy. The net result is a loss."*

3) Energy Market Structure Book Recommendation (#ideas-commodities)

AZarro shared a book recommendation on Energy Markets with a specific oil/gas bent. The book, "Understanding Oil Prices: A Guide to What Drives the Price of Oil in Today's Markets", is in the link above.

**Join our Comm Center here.*

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The Vault: How To Make A Trade Log w/ Mike Gyulai

Mike Gyulai is our resident Classical Charting expert. His webinar on creating a trade log **is a must watch.**

A trading log turns your trading data into real-time insights and guideposts toward consistent profitability.

If you don't have a trade log, watch this video. You'll never trade blind again.

Trade Log Post-Analysis & Ideation

Spreadsheet Layouts & Formulas for
Unlocking New Insights About Your Trading

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HUD Focus: Potential Bull Reversal in Corn

We're sticking with ags this week. Check out the bullish setup in Corn below.

Like Soybean Oil (which closed bullish this week), corn is deeply oversold on the 20D, 50D and 200D timeframes.

Large, Small, and Commercial Positioning are all bullish.

The last time Money Manager's Sentiment was this low (~40%) was in August 2020. Right before Corn's face-ripping rally.

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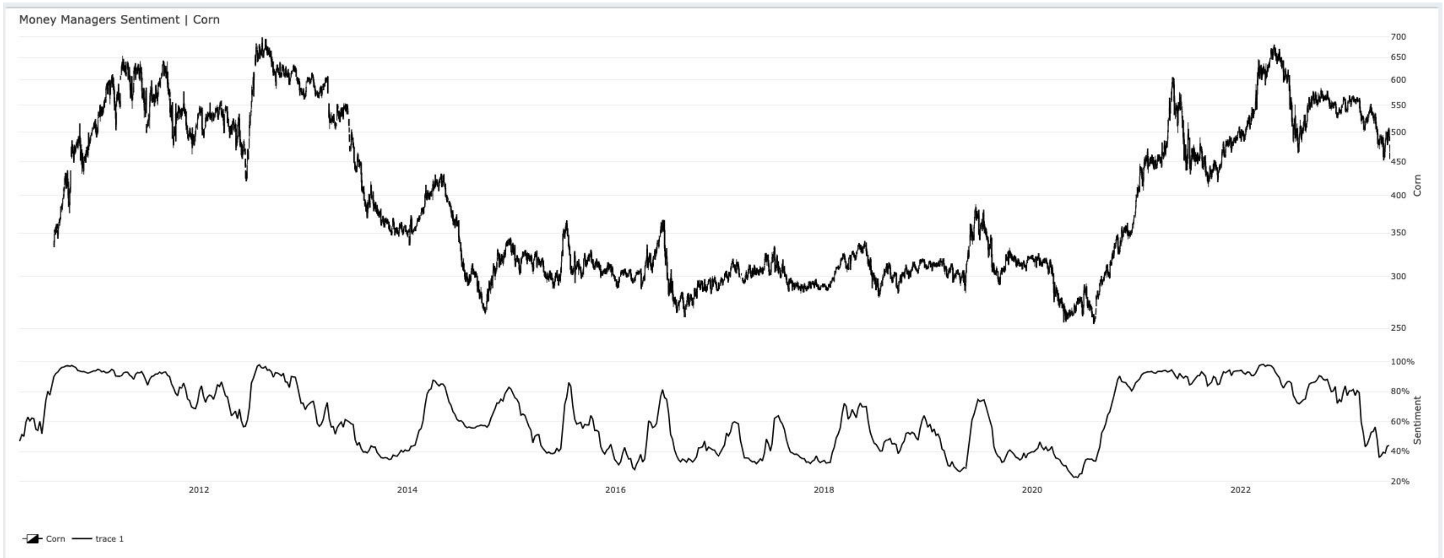

We also have bullish reversal confirmation in the technicals. Let's examine the December contract (XCZ2023).

There are two ways to play this trade. First, you could put a buy stop above Thursday's midline reversal bar, with a sell stop below Thursday's low.

You could also wait for the inverse H&S breakout.

[Access the HUD here.]

The MO Trading Process Explained

Macro Ops Trifecta

- The MO Trifecta Strategy Explained
- Expected Value (EV) & Bayesian Analysis
- Trade Alerts + Position Sizing
- The MO Portfolio Guide

Sentiment

- How To Be A Contrarian
- How To Play The Player
- The Hierarchy Of Markets
- Trend Fragility Indicator

Technicals

- Multidimensional Forecasting
- How to Manage to Uncertainty
- How to Read Price Action
- How to Spot Market Trends
- Momentum, Mean Reversion And Volatility
- Classical Charting, Price Patterns & Entries
- Which Time Frame To Focus and Why
- How To Exit A Trade
- How To Size Your Positions
- Position Sizing Calculator
- Key Options Spreads
- Trading Volatility
- Delta Hedging
- Advanced Options Mechanics
- When To Avoid Options
- Tactical Options Strategies
- The DOTM Options Strategy
- How To Use The SQN To Identify Market Regimes
- How To Execute BVO & FBVO Trades
- The FOMC Trade

Fundamentals

- Finding Compounders
- Investing In An Inflationary Environment
- Finding Inflation-Proof Companies

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