MACRO OPS

TRADE - LEARN - EVOLVE

THE MARKET BRIEF | **JULY 9 2023**

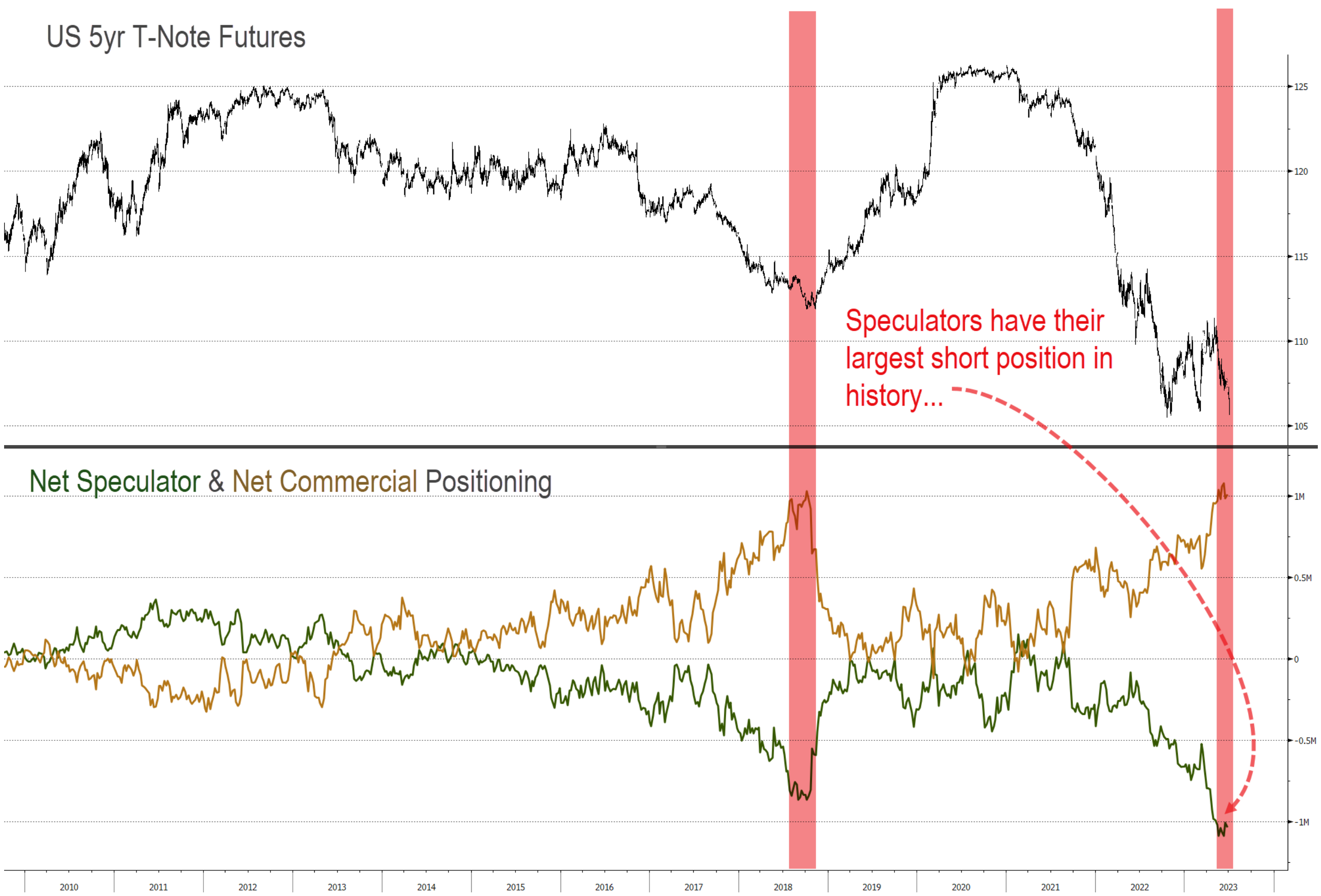
Market Note: Budding Trifecta Trades…

Kovner once quipped that what he's "really looking for is a consensus that the market is not confirming. I like to know that there are a lot of people who are going to be wrong."

The intersection of price and sentiment (with a macro overlay) is our bread and butter. It's where we live. We wait for a consensus to form, then look for a news failure event (the tape to move contrary to expectations on some anticipated news) or general divergence of the tape, and enter on a given technical setup. If our macro analysis aligns with our contrarian take, we size up.

This is the Trifecta approach in a nutshell.

Two markets are in the process of setting up for a Trifecta trade. In bonds, where speculators are crowding to the short side (see CoT chart of 5yr Notes below). And oil where Managed Money positioning has reached levels that historically precede major bottoms (more on this in a sec).



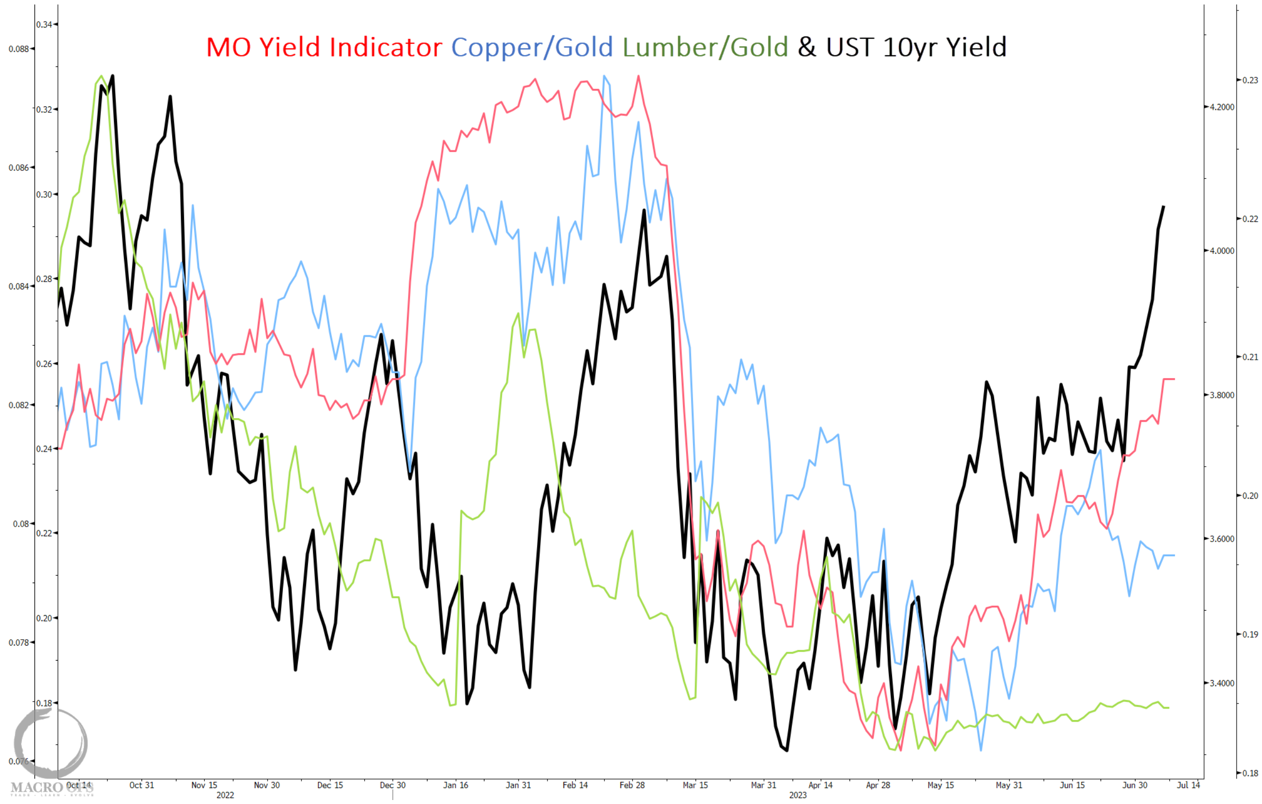
Let's first take a look at bonds.

Despite the crowded positioning on the short side, the bears remain in control of the price action. Below is a daily chart of 10yr Notes.

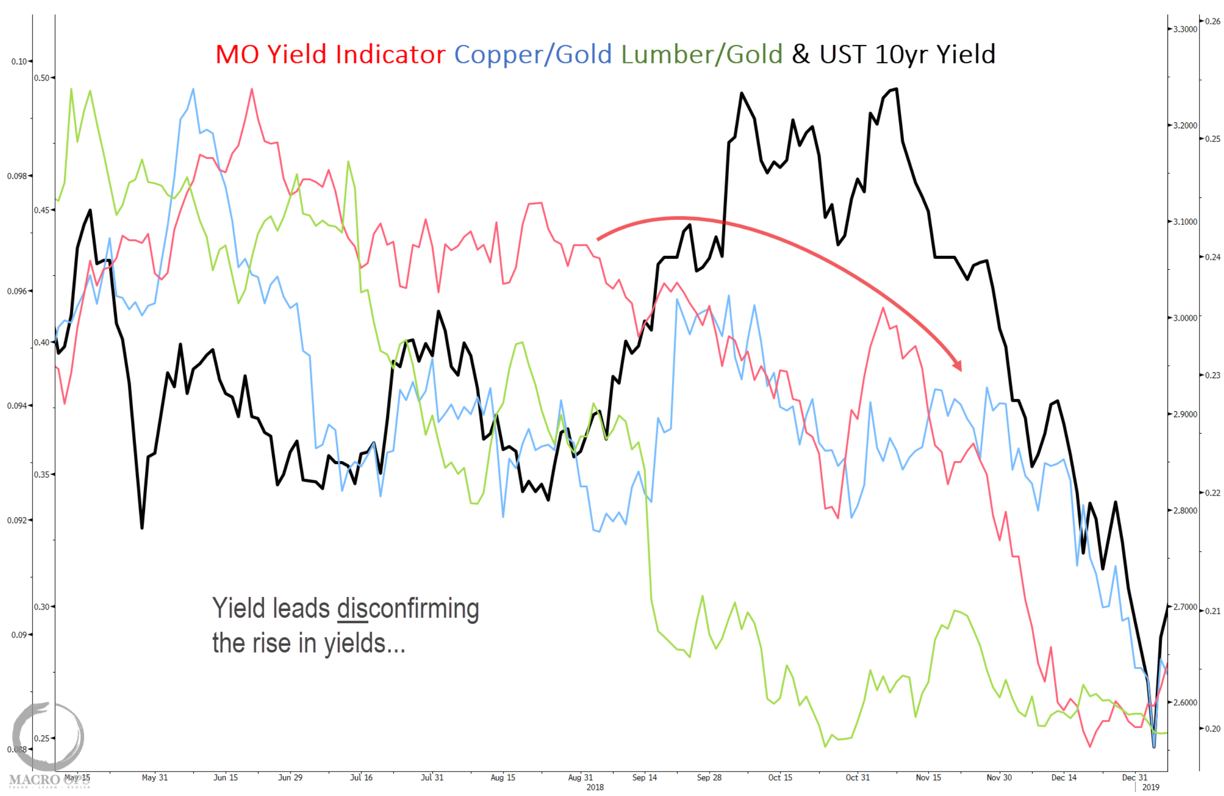
Price closed last week at the bottom of its 10-month sideways rectangle on Friday. It's trading in a bearish/neutral SQN regime. Price is over 2std below both its 20 and 50d moving averages, so we likely get some mean reversion soon.

Nonetheless, this is <u>not</u> a tape we want to start fading *yet.*

Our leads pictured below are only somewhat confirming the move-up in yields, except for lumber/gold (green line) which is trading flat. All in all, the picture given by these leads is fairly neutral. Neither a strong confirmation of the move nor disconfirming.

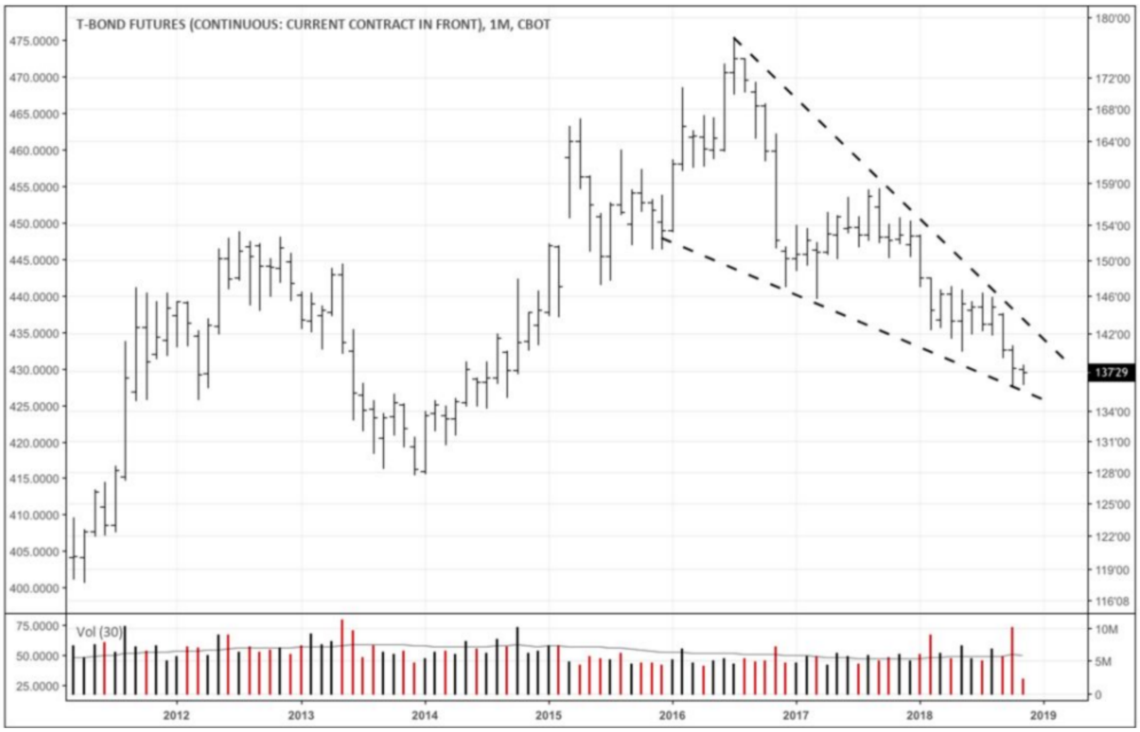


Ideally, we'd like to see these leads diverge lower, similar to what we saw during the Nov 18' top in yields (bottom in bonds). As the chart below shows, all three leads began trending lower 1-2 months before yields peaked.



This divergence was combined with an extreme consensus in bearish speculative positioning at the time (bullish yields). We wrote the following in a report dated Nov 12th, 2018:

> *So to sum up, we have declining global growth — a high probability of recession ex. US — with peak US growth and profits behind us. Inflation indicators turning over and heading lower plus extreme bearish sentiment and positioning in bonds. Combine this with the great technical setup in bonds and you have the makings for a great macro trade.*
>
> *The chart below is a monthly and shows bonds getting squeezed in a 2-year-long descending wedge. Setups like this often lead to explosive upside moves.*



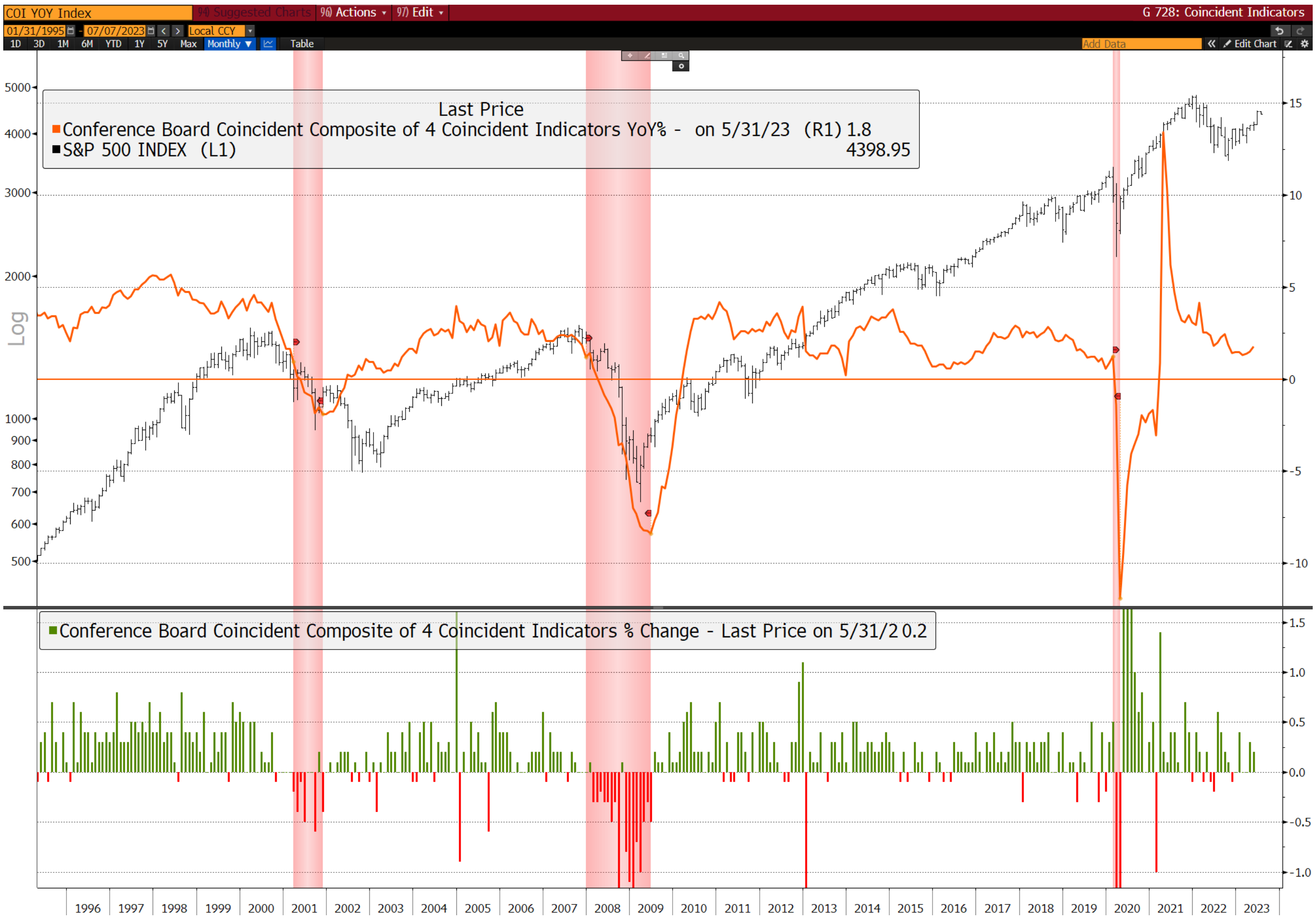
That trade and a number of parallel positions we put on to play the bottom in bonds, ended up being big winners for us. It was a perfect Trifecta setup: technicals, sentiment, and macro…

We're not currently there yet in bonds. But positioning is, and a popular narrative is beginning to gain traction, though I wouldn't call it a consensus quite yet.

I think we'll see it develop into one over the next two months as resilient economic data continues to grind away the remaining few of the *Premature Recession Pontificators*… and Fed cuts get repriced further out in time.

Citi's US Economic Surprise Index is over 0.5, meaning economic data is strongly surprising expectations. This favors higher yields/lower bonds. When the time comes to buy bonds, we'll likely see the CESI chopping around the zero mark or negative.

The Conference Board's Coincident Index is still at high levels and more importantly, continues to see consecutive month-over-month gains. This dispels any notion that we'll see a recession begin in the next quarter.



So it's premature to try fading this move in bonds. The bears are in charge and the weight of the evidence suggests they'll continue to control the trend for the time being.

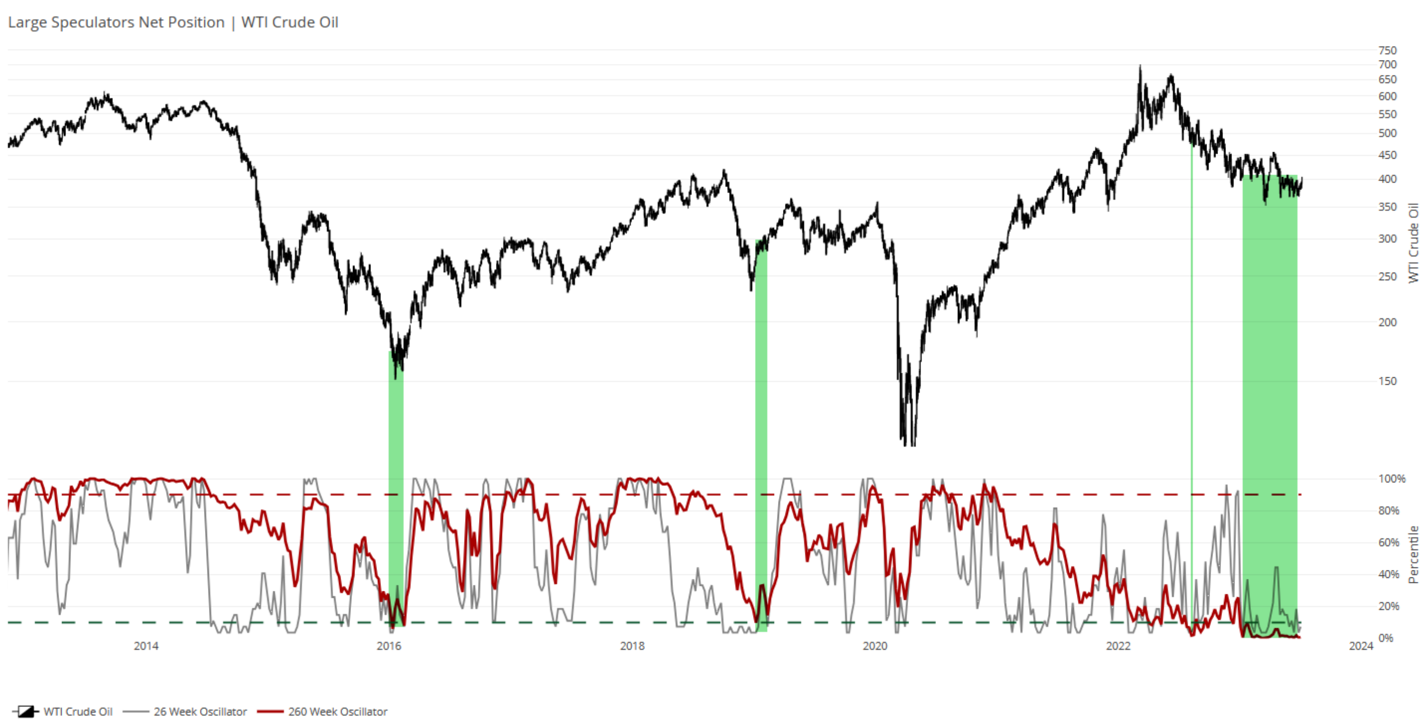
But over these next few months, we should see a consensus narrative of "higher yields / bearish bonds" take hold. While at the same time, the higher yields will tighten liquidity to the point where our leads begin diverging and we see bonds eventually stop going down on anticipated news events (ie, high CPI prints, strong econ data, etc…)

This will give us a proper Trifecta setup. And that will be the time to plunge.

A more timely setup is in oil.

Our Managed Money Sentiment gauge has triggered a buy signal (green dots mark past signals).

Large Net Spec positioning is below the 10th percentile on both a 6m and 5yr OI-adjusted basis.

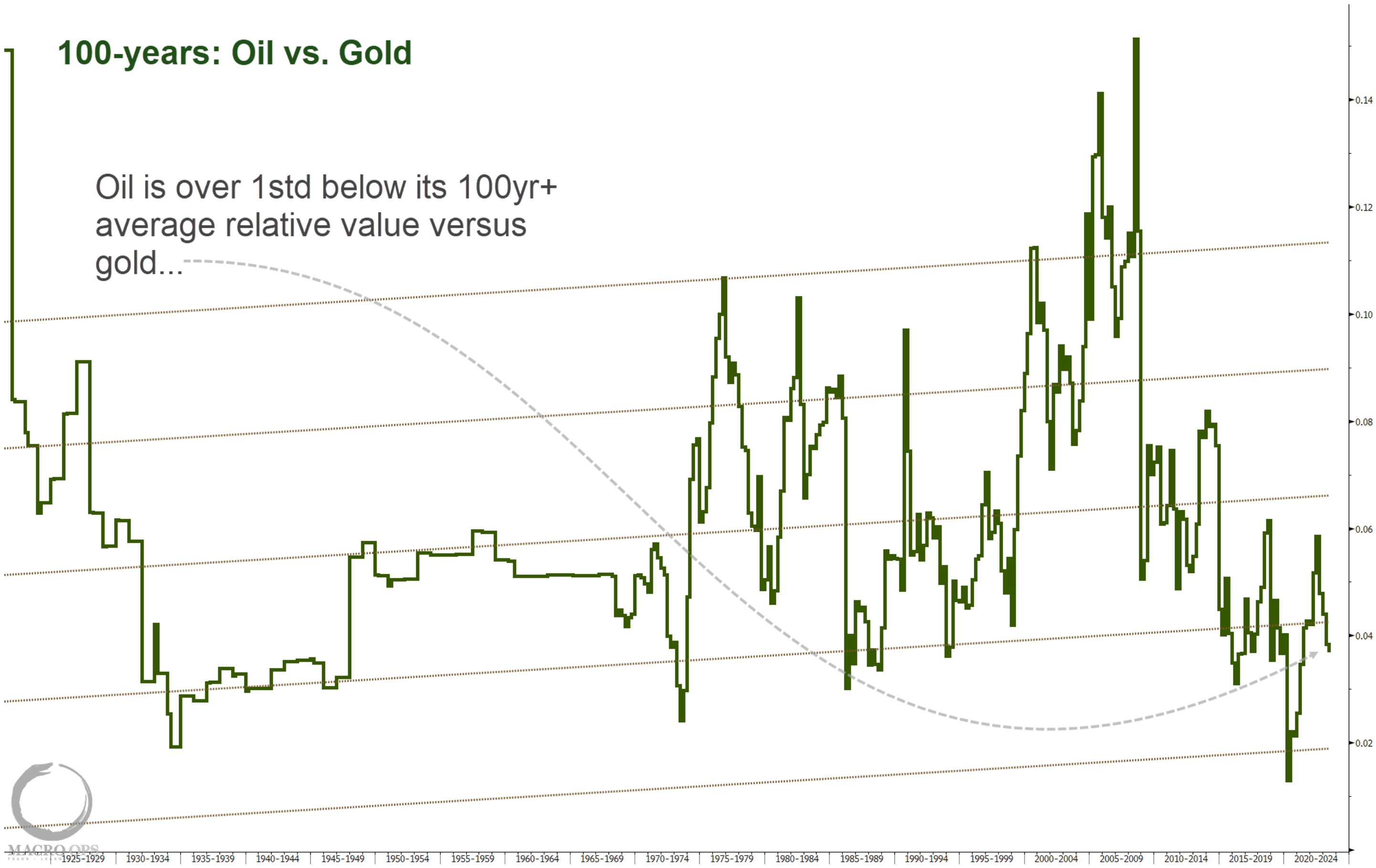


The technicals are shaping up as well.

 Chop wood, carry water…

Crude has been trading in an increasingly tight sideways range since March. And despite all the recession talk through the first part of this year, the bears were never able to get a move below $65 to stick. It's looking increasingly like the previous cycle high of 19' is now acting as a floor.

Oil remains very cheap relative to its historical average versus gold.



Our shorter-term valuation oscillator is at levels that have preceded or marked each of the prior bottoms over the past 8 years.

This gives us an actionable Trifecta trade.

We already have exposure in our equity book to the long oil theme (more on that below from Brandon). And we'll look to add a bit more on either the equity side (NORAM, JOY, adding to TDW maybe) or the futures side, soon.

With that said, there are a few things that make me hesitant to press this trade hard.

One is Chinese stimulus or the lack thereof. We've seen a couple of rate cuts out of the PBoC but China is Japan in the early 90s. What they need is some aggressive fiscal stimulus to steady the economy.

So far, we're only seeing talk of targeted stimulus and further monetary easing. That's not enough to cut it this time. And as long as China languishes, this trade is unlikely to have much in the way of legs.

That could change any day though and if it does we'll be quick to add to our positioning.

Second, it still feels like there are too many macro punters trying to nail this one. So despite the bearish positioning, that makes me a bit hesitant. Not enough to not take the trade but enough to make me size less aggressively and be quick to jam up stops if the tape turns heavy.

We'll see how the trade unfolds and adjust accordingly.

Now here's Brandon with an update on one of our holdings, Tidewater (TDW), along with an interesting microcap play.

Your Macro Operator,

Alex

Equity Note: Tidewater (TDW) & A New Idea (SRX.ASX)

Brandon here.

On Monday, Tidewater (TDW) announced it would tap debt markets for a five-year bond to buy 37 vessels.

Companies constantly issue debt, so why was this such a big deal? Because TDW has declared bankruptcy twice in its history.

Think about it through the lens of a consumer. Say I want to buy a new car, but I've declared personal bankruptcy twice over the past ten years.

I go to the dealership, pick out my favorite color Toyota Tacoma, and nervously wait in the dealership's finance department. They'd run my credit, see the two bankruptcies, laugh all the way back to their desk, and hand me a 60-month 25% interest loan.

The beauty of bankruptcy is that it provides a clean financial slate. The price for that privilege is high-interest rates and frozen credit markets.

Back to TDW. As a two-time bankruptcy company, it wasn't *guaranteed* that they'd have access to the credit markets. And if they did, assuming 20%+ interest rates on debt for a capital-intensive, massively cyclical business is not unreasonable.

So you've got all this negative sentiment baked into the debt issuance. Then Monday comes, and the company raises **$250M in senior secured notes at 10.375%.**

TDW secured credit market funding and did it at roughly half the cost of capital that most equity investors had in their models.

Simple math states that when you reduce your risk premium (i.e., cost of capital), you increase your equity value.

That's why we saw significant buying pressure into this week's close (look at Friday's volume) and a sustained breakout (see below).

If securing debt funding at reasonable prices lifted the ceiling on the stock price, what will sustain this move higher? **Capex cycles.**

TDW is a **long-term capital investment cycle play**, not a daily oil price movement play. Major producers like Petrobras (PBR) and ExxonMobil (XOM) contract TDW's boats for offshore production assets and projects.

These companies don't care about today's oil prices. They're investing with a 15-30 year time horizon. And they'll keep investing as long as oil stays above ~$50/bbl.

My friend Judd Arnold is one of the sharpest offshore energy investors in the game. He describes offshore investments as cruise ships. Once a company decides to invest in offshore (think Guyana), it's almost impossible to stop that inertia.

Capital commitment from the largest energy producers should sustain higher day rates, cash flows, and thus a higher share price.

And with access to credit markets, TDW can execute an LBO model buying vessels from smaller players in a highly fragmented market. Then, you get a twin engine of shareholder return through higher day rates and cash flows, which the company can use to reduce debt and increase equity value.

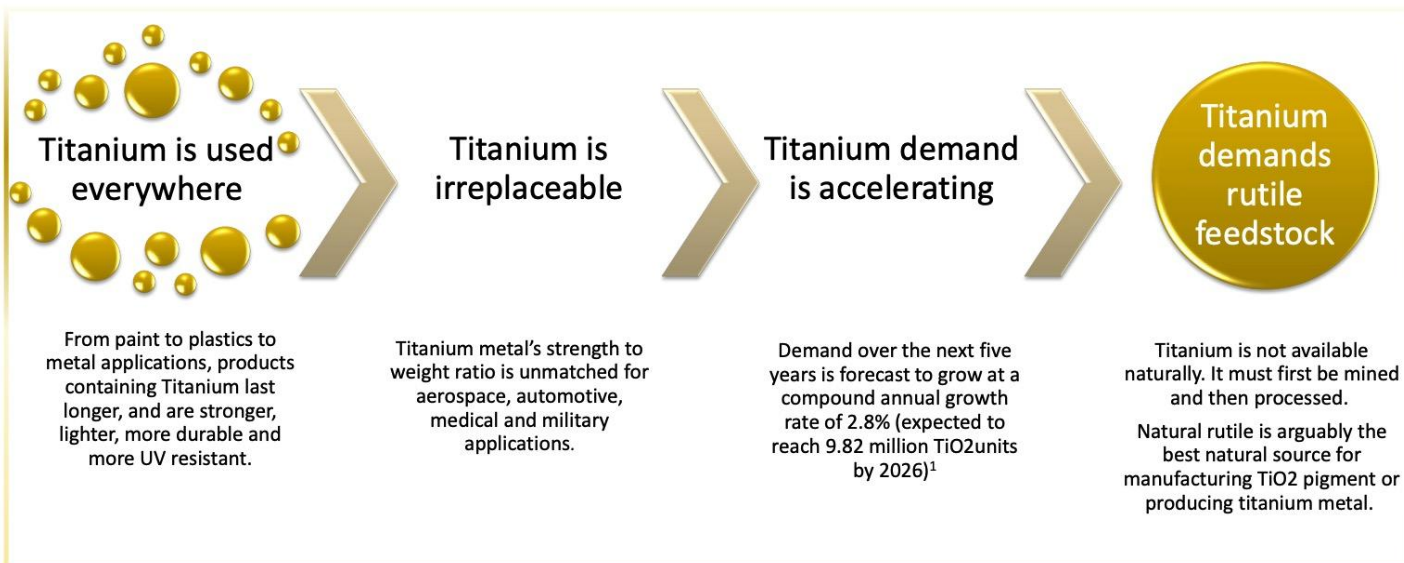
We hold a ~8% notional position in TDW and will let it run with wide stops.

Sierra Rutile (SRX.ASX): A Net-Net Single-Mine Recent Spin-off

Sierra Rutile (SRX) is a single-mine commodity producer. It trades on the Australian Stock Exchange (the ASX), is highly illiquid, and <$50M market cap.

The company is a recent spin-off from its parent Iluka Resources. SRX produces natural rutile. Rutile is a titanium dioxide commodity used to make paint, paper, and plastic pigments.

It's also a raw material in titanium metal for aircraft frames and engines, medical and sporting goods, and other industrial applications. You can also find rutile in welding applications like steel fabrication, shipbuilding, pipes, construction, and transport.



The company's customers include prominent industrial players like Tronox (TRX) and Chemours (CC).

Why Is This Idea Interesting?

SRX is interesting for a few reasons. First, nobody is watching this name. It's a micro-cap spin-off that trades on the ASX. It's a commodity mining business with uncontrollable price and cost inputs. Oh, and it only has one operational mine with a few years of production left.

Second, the spin-off triggered forced selling as large institutions and indices can't hold a micro-cap mining company.

Third, forced selling allows us to buy the business at less-than Net Working Capital (i.e., Cash + Receivables + Inventory - AP).

All these things are interesting, but here's the kicker. **SRX is profitable and a vital cog in global natural rutile production.** The company's current mine, Area 1, throws off ~$30M in annual cash flow.

Buying $30M of Cash Flow For Nothing

SRX trades at a $66M market cap with 424M shares ($0.16/share). They have $0.09/share in net cash, $0.13/share in receivables, $0.08/share in inventory, and -$0.03/share in payables.

- ➢ **$0.09 Cash**
- ➢ **$0.13 Receivables**
- ➢ **$0.08 Inventory**
- ➢ **Less $0.03 Payables**

That gets you $0.27/share in NCAV versus its current $0.16/share market cap.

Remember, this company threw off $57M in EBITDA last year. Even if you assume compressed natural rutile prices, the Area 1 mine will likely generate $25-$35M in FCF annually until the end of the mine's life.

That's another $90M in incremental FCF covering the current market cap.

So not only are you paying sub-NCAV for the mine. But that mine will generate the current market cap in FCF within three years. At this point, the company either uses the cash to expand its mining operations (see below), sells to another player, or returns it all to shareholders.

Before we discuss mine expansion, I want to note that we're also assuming a $0 valuation for the company's Property, Plant, and Equipment (PPE) in our above calculation. If we look at the balance sheet, we see $564M in Gross PPE. The company has subtracted $510M in Accumulated Depreciation for a net PPE of $54M.

Let's assume that SRX's PPE is worth $54M (spoiler: it's worth more). That's another $0.13/share and a near **$0.40/share in NAV,** 150% higher than the current stock price.

Why SRX Will Get A Deal Done To Expand Its Operations

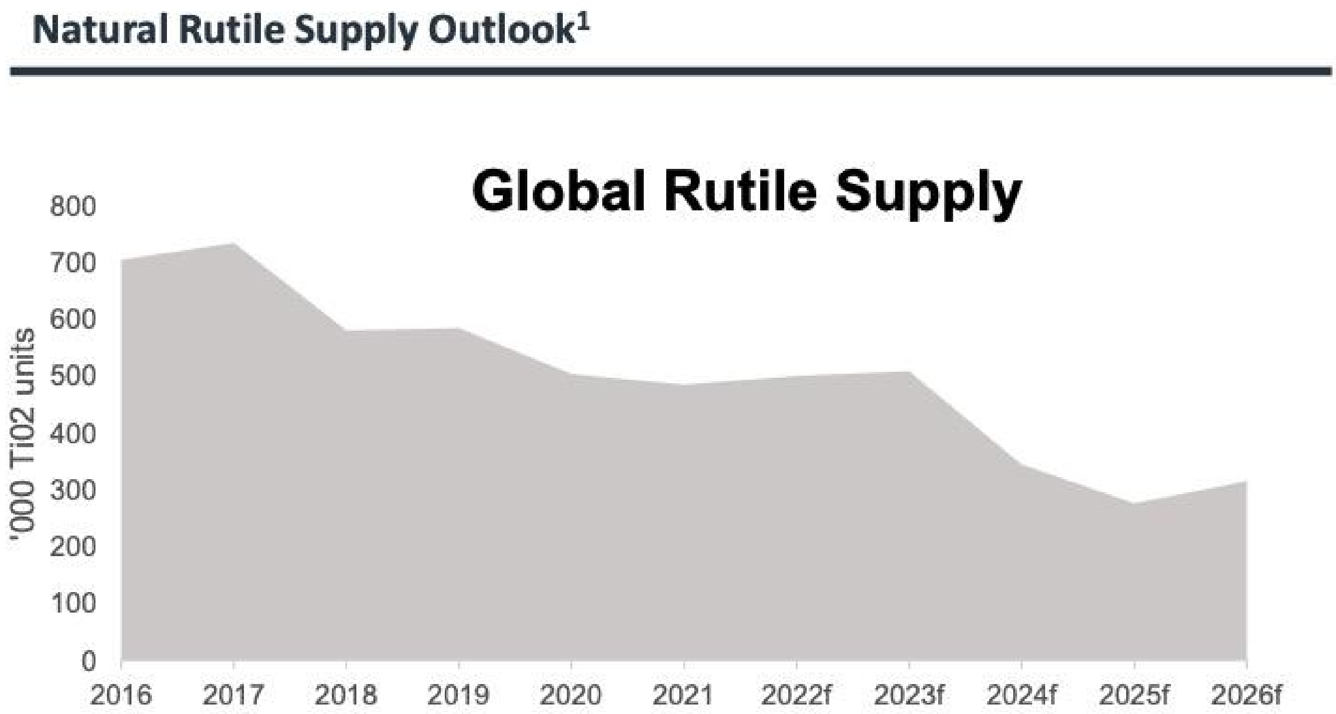
Enter Sembehun. The new mine would add another 13 years of rutile production at the current throughput rate. The only problem is that it costs around $338M to build, and the company trades at a ~$90M market cap.

SRX doesn't have the cash to build it. It would need a JV partner like another rutile mining company or one of its customers up the value chain looking to turn a cost center into a profit center.

There are three main reasons to extend SRX's mining operations.

First, SRX produces some of the world's highest quality rutile. This means it captures the highest price point for its product. And when you're a price-taker in a commodity business, you take all the help you can get.

Second, SRX produces ~20% of the global rutile supply. SRX's downstream partners have a clear incentive to extend the life of SRX's rutile mines. Especially given natural rutile's supply/demand imbalance and high costs (see below).



The final reason is the price. An acquirer could buy the company, and its accompanying Sembehun plans, at a fraction of the cost to build independently. Think about how long it takes to get permits approved. Once (or if) you successfully obtain permits, it still takes 10-15 years from feasibility to production. Also, SRX has excellent relations with South Africa, particularly Sierra Leone, the area where they plan to build the second mine.

Suppose a new entrant wanted to compete or build a new mine in Sierra Leone. In that case, they'd have to endure relationship-building, smooching with local government, and throwing some bribe money across a few tables. These are long-cycle processes.

Of course, long-duration cycles aren't an issue if there's adequate supply and a healthy supply/demand balance. But Rutile doesn't have that. The commodity faces a supply shortage over the next few years. Customers like Tronox and Chemorous need their rutile TODAY. In fact, current supply constraints are restricting the rutile market, forcing end-users to substitute or slow/halt production.

This supply/demand imbalance should buoy higher rutile prices and allow SRX to squeeze as much profit out of its current mine's remaining life.

In a few years, SRX will have another {insert cash amount} on the balance sheet, no debt, and will be in a stronger position to finance the second mine.

What's the advantage of buying today? At today's prices, you're paying less than the company's current working capital and getting the profitable mining operation for free. This is a mining business throwing off millions in cash flow. Yours for less than working capital.

My base case is that SRX gets bought by a competitor or value-added customer for multiples of working capital, leaving shareholders with an outstanding return on capital. TROX, for example, already owns mining assets in Africa.

There are a few risks to this thesis. Rutile prices will collapse over the next three years as SRX drains its current mine. This would reduce (or eliminate) free cash flow generation and put SRX in a financial spot where they might be forced to sell themselves at a lower price.

Two, the company tries to build the mine by levering the fuck out of its balance sheet, issuing a shit ton of shares, and diluting existing shareholders along the way.

Third, nobody buys them, they make more money over the next few years and then close the business and return what's left to shareholders.

I love finding ideas like SRX because it's completely market-agnostic. SRX will work regardless of where the S&P 500 or NASDAQ 100 trade. And who doesn't want a piece of that in their portfolio?

MO Portfolio Snapshot

The Macro Ops Portfolio

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

2023 YTD Return	8.33%
Total Notional Exposure	232.55%
Current Cash Value (%)	60.42%
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	$2,638,546.33	148.82%	-3.65%	$6.95	$7.22	$7.13	3.81%
Dollar/Chinese Yuan (Second Leg)	USDCNH	85,893	$619,809.41	34.96%	0.48%	$7.20	$7.22	$7.10	0.18%
Gold	GCQ2023	-1	-$192,960.00	-10.88%	0.29%	$1,921.50	$1,929.60	$1,973.00	-0.42%
Russell 2000 Futures	RTYU2023	4	$366,920.00	20.69%	0.71%	$1,882.80	$1,834.60	$1,819.90	-2.56%

Equities

Strategic	Ticker	Shares	Capital	Notional	At-Risk	Cost Basis	Current Price	Stop-Loss	P&L
Sprott Uranium	U.UN	6,431	$77,815.63	4.39%	0.47%	$11.73	$12.10	$10.44	3.15%
Sprott Uranium (Second Leg)	U.UN	10,058	$121,698.17	6.86%	0.49%	$13.41	$12.10	$12.55	-9.77%
Alphamin Resources	AFM.TSX	69,421	$56,925.22	3.21%	0.51%	$0.78	$0.82	$0.65	5.13%
Foran Mining	FOM.TSXV	27,333	$71,612.40	4.04%	0.23%	$2.11	$2.62	$1.96	24.17%
Foran Mining (Second Leg)	FOM.TSXV	16,994	$44,524.11	2.51%	0.50%	$2.48	$2.62	$1.96	5.65%
Vista Energy	VIST	6,727	$161,783.10	9.12%	-0.26%	$14.11	$24.05	$14.80	70.45%
Tidewater (Second Leg)	TDW	1,249	$73,201.82	4.13%	0.48%	$49.35	$58.61	$42.57	18.76%
Tidewater	TDW	1,174	$68,786.85	3.88%	-0.12%	$34.15	$58.61	$36.00	71.63%

Tactical	Ticker	Shares	Capital	Notional	At-Risk	Cost Basis	Current Price	Stop-Loss	P&L
Bitcoin	BTCUSD	4	$118,267.87	6.67%	0.48%	$28,820.00	$30,208.40	$26,635.00	4.82%

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	0.24%	0.93%	$70.00	$18.00	$0.00	-74.29%
PAAS JAN 19 2024 $45 CALLS	PAAS	660	$23,087.13	1.30%	0.93%	$25.00	$35.00	$0.00	40.00%
HAL JAN 19 2024 $60 CALLS	HAL	67	$2,226.55	0.13%	0.50%	$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.*

What I Learned This Week: Kevin Kelly Is A National Treasure

Kevin Kelly is the founder of technology magazine *Wired* and renowned writer. You might know him from his “1,000 True Fans” blog post.

Kevin joined *Invest Like The Best* this week to dissect meaning, passion, and the idea of wealth.

My favorite part of the podcast was Kevin’s thoughts on wealth and the definition of success. Traditionally, we view success as having tons of money, a fancy car, or a trophy wife on our side. Those are all good things. But are they *really* what defines success?

Kevin’s thoughts on success are pure gold (emphasis added):

> *I think that the #1 thing is following other people's definition of success is **being swayed by other people's definition of success**. And that's so hard to let go of. **It's so hard to surrender the idea that unless you have $1 million by the time you're 30, whatever it is, that you're not successful.***
>
> *That's a very narrow, well-trodden niche and is likely holding you back from your true greatness and your true benefit and your true authentic self and your best self because it's probably going to look very different.*
>
> *And **I think just trying to let go of and overcome the cliches**, the assumed cultural biases that we have on what it is, that, to me in my opinion, has been what I see is **the largest impediment to people achieving this because a lot of really authentic success may not look like that to us**, to everybody else around you.*
>
> *You don't own a car. You're walking everywhere, whatever it is. And you're saying, I don't think that's successful. And part of it is you're educating people about that, other people so that you have the kind of support that you need or else ignoring it. But **it's a very, very difficult thing to let go of and to surrender the assumptions and the prejudices that we have of what that looks like.***

It’s worth reading a few times. This applies directly to trading, too. What are our assumptions on trading success? What do we *think* trading success should look like? Managing billions of dollars executing orders from a NY corner suite?

Or does trading success look more like this … The freedom to spend time with family and friends. Freedom from being chained to a desk or monitor. Freedom. How much is that worth?

Community Highlights

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

1) [Inverse H&S Setup in Dow Futures]() (#classical-trading)

Collective member *david* posted a potential long trade in Dow Futures on Monday. It's a classic inverse H&S pattern. What's important to note is the symmetry between the left and right shoulders. Our resident Classical Charting Expert, Mike Gyulai, stresses this for these trades.

2) [Platinum Worth Watching]() (#ideas-commodities)

Operator *Phil Deane* alerted members to a potential trade in Platinum. Here are Phil's comments:

> *Being ignored by COTs - neutral to the extreme. Rolling over? Moving into deficit next year? Keep an eye on it.*

3) [Japanese Yen Intervention Coming Soon?]() (#general)

Check out *ChrisM*'s recent post in the #general chat on Japan's potential FX Intervention. It's worth watching for anyone interested in investing in Japanese equities (like we are).

[**Join our Comm Center here*]()

The Vault: Taming Your Ego

The greatest traders who've ever played the game all possess five distinct qualities. These are:

- Self-knowledge
- Competitiveness
- Discipline
- Open-mindedness
- Independent thinking

George Soros was one of the best at taming his ego. Read our guide on Taming Your Ego here.

THE VAULT

Macro Ops Collective

Taming Your Ego

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! The truest thing about Soros seemed to be what his son Robert had once said:

My father will sit down and give you theories to explain why he does this or that. But I remember seeing it as a kid and thinking, Jesus Christ, at least half of this is bullshit. I mean, you know the reason he changes his position on the market or whatever is because his back starts killing him. It has nothing to do with reason. He literally goes into a spasm, and it's this early warning sign. ~ excerpt from Malcolm Gladwell's *Blowing Up*

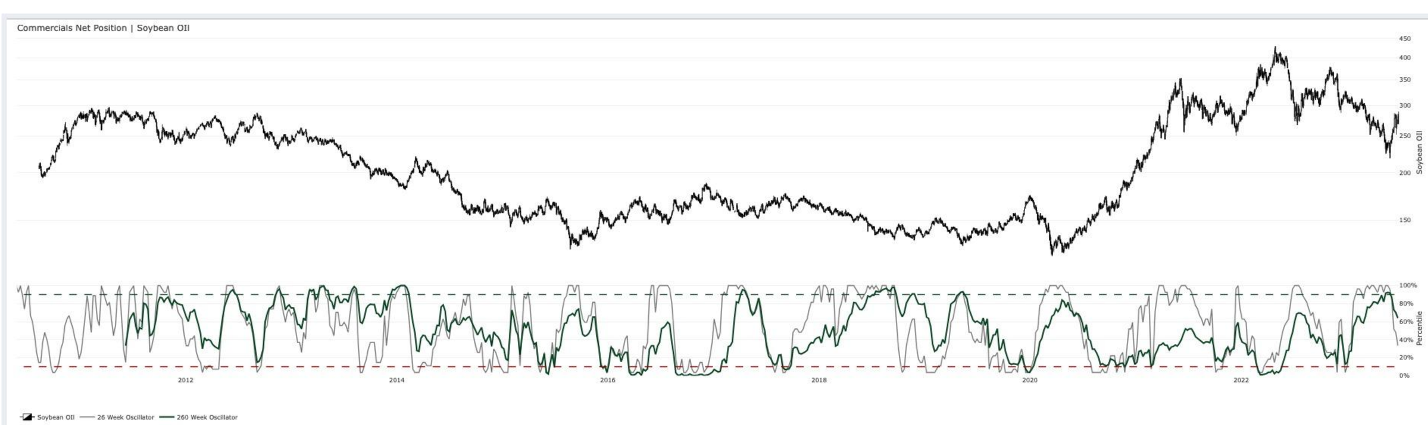
HUD Focus: Soybean Oil Still Has Legs

A few weeks ago, I highlighted a potential reversal long trade in soybean oil. It was a Trifecta Trade with **technicals, fundamentals,** and **sentiment/positioning** all confirming a decent probability of a big move higher.

We got that move, and a few *Collective* members profited from the trade (if that was you, congrats!).

If you missed out, don't worry. The Trifecta Setup still exists, and the technicals allow us another entry. Let's head to the HUD.

Positioning remains bullish across large and small speculators. But I want to focus on Commercials. Check out the chart below. The last time Commercials Positioning was at these levels, it marked a huge run from 129 to 317 (April 2020).



Soybean Oil is overextended on the 20D and 50D time frames but neutral on the 200D. My base case is that we'll pull back here before another leg higher.

Look at the December contract.

You've got a failed H&S breakdown *and* a strong bull bar close above the 200MA. That's a chart you want to be long.

[*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