MACRO OPS

TRADE - LEARN - EVOLVE

THE MARKET BRIEF | **JULY 23 2023**

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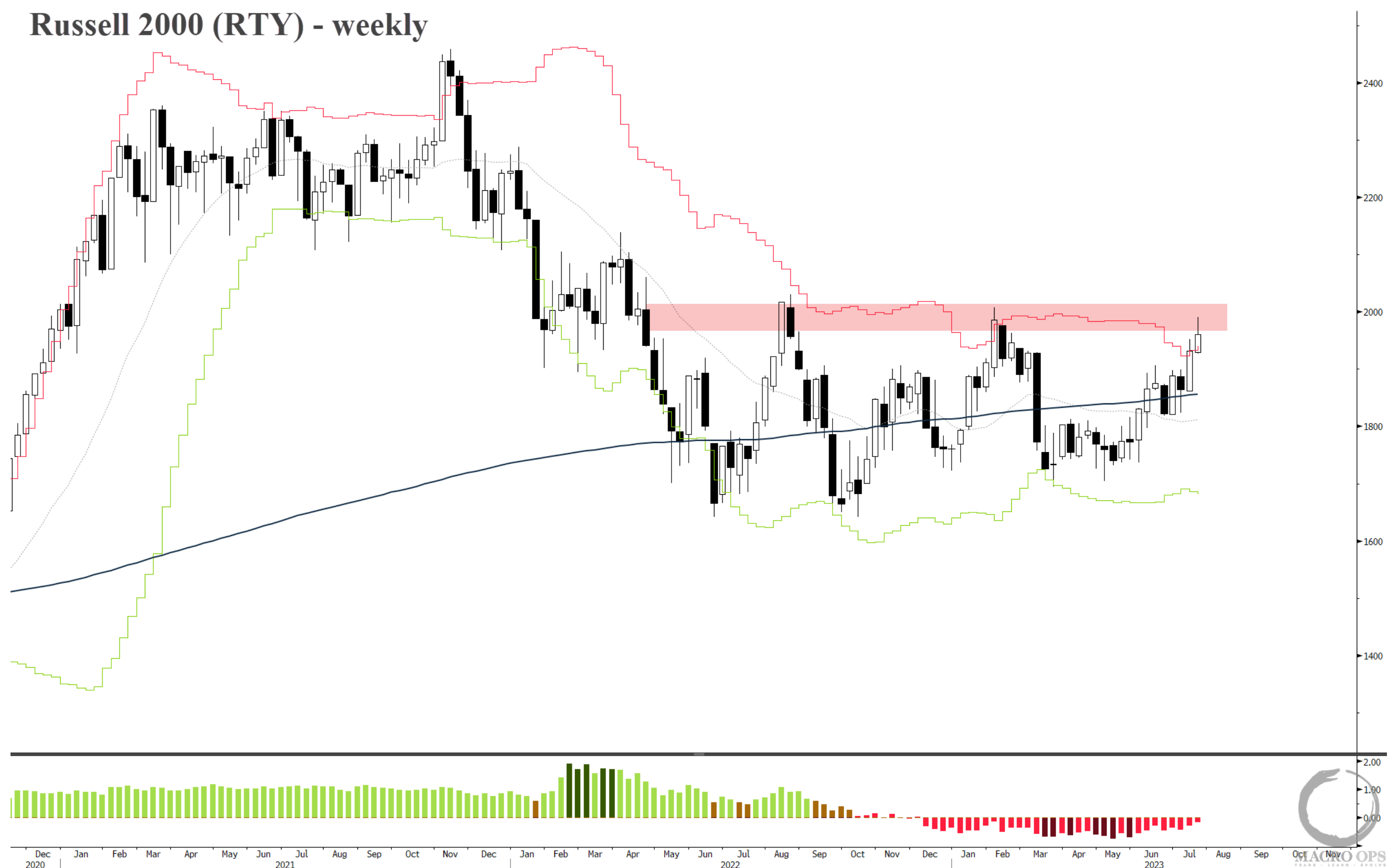
Market Note: It's About The Skew…

Some quick thoughts on equities and then I want to get to more interesting developments.

The Russell (RTY), which we're long, hit the top of its 14-month sideways range and was pushed back, closing the week with a *slightly* bearish bar (the upper wick is larger than the candle's body).

It's also in a neutral SQN regime on a daily basis. And since 80% of breakouts fail in neutral regimes, we should expect some mean reversion in the near term.



We're going to be tight with moving up our stops on this one so there's a good chance we take profits this week, depending on market action.

Our Trend Fragility Indicator (TF) is now in its 80th percentile. This is not an official sell signal but it is the range at which we want to start moving up stops, taking partial profits, and looking to begin slowly adding shorts/hedges.

We'll know we're at the end of this move when we see one or more of the following (1) the TF score rise above 90% (2) two or more of our Market Internals (on the HUD)

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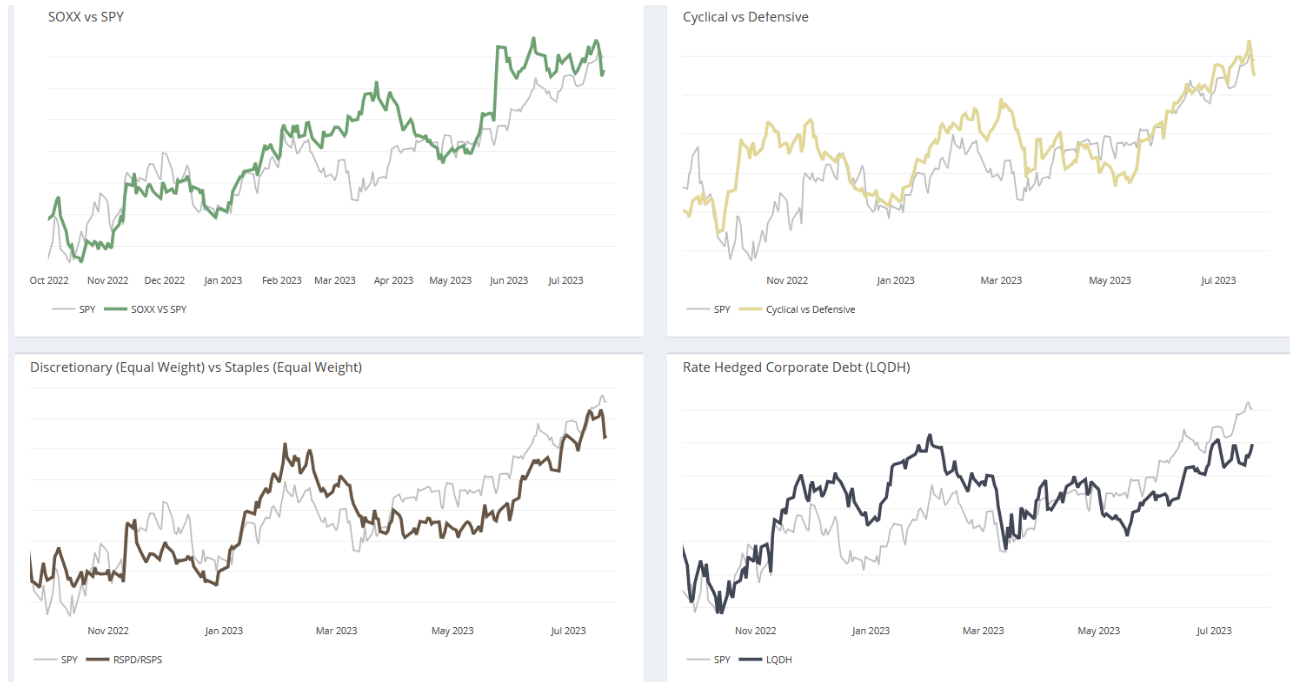
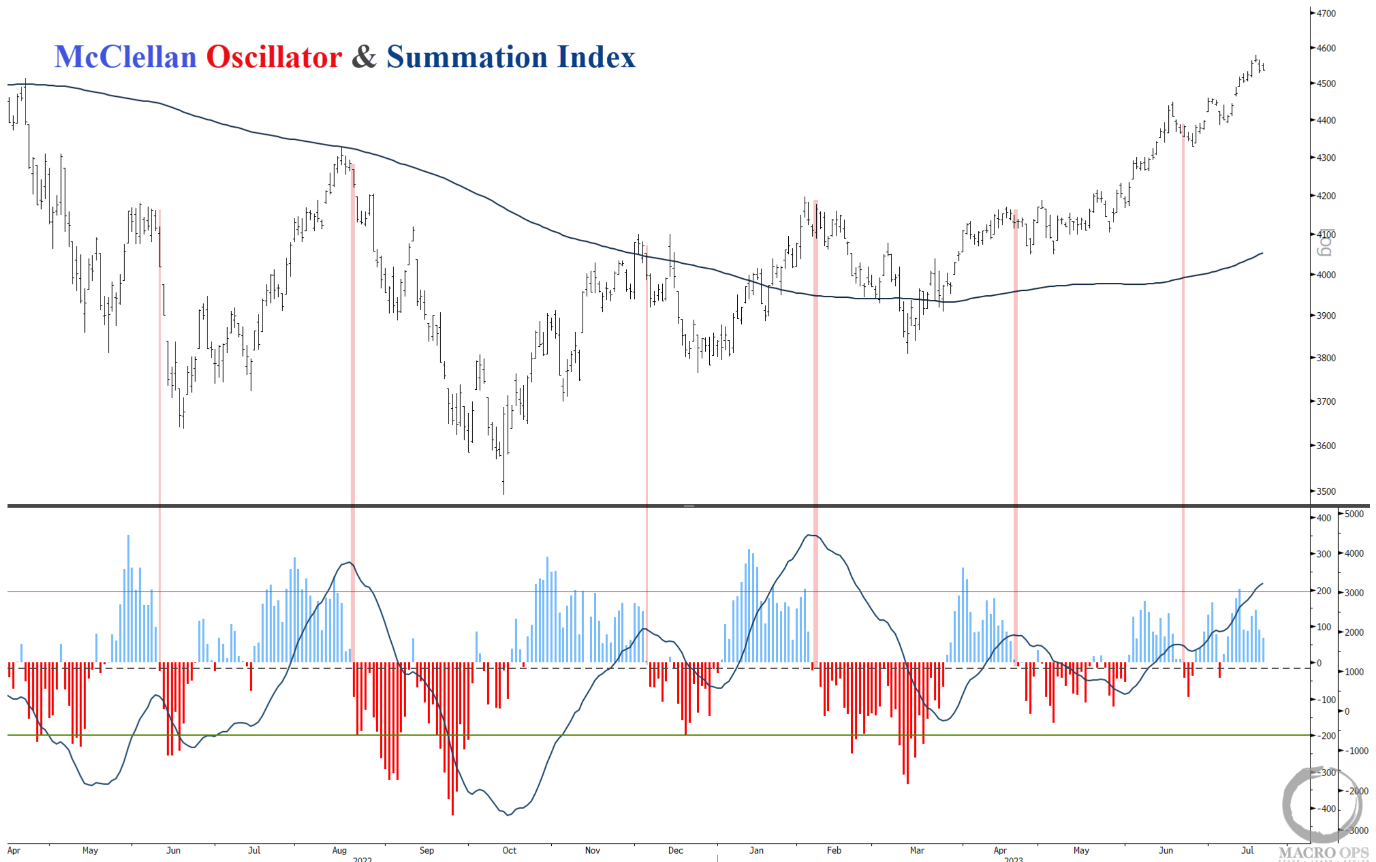
diverge lower and (3) breadth significantly breaks down.



As of now, market internals are still in line with the price (chart above). And breadth, as marked by our favorite breadth indicator, the [NYSE McClellan Oscillator and Summation Index,](#) remains supportive of the trend (see chart below).



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The red and blue histogram is the Oscillator. The blue line is the Summation index. Both look at the same data but in different ways and together provide incredibly useful context for evaluating the health of a trend.

When we see the oscillator flip from blue to red in an uptrend, it's a good indication that the trend is weakening and about to take a pause. When we first see it flip red and the Summation Index (blue line) is elevated, it usually means that we're in for a larger retrace in the market.

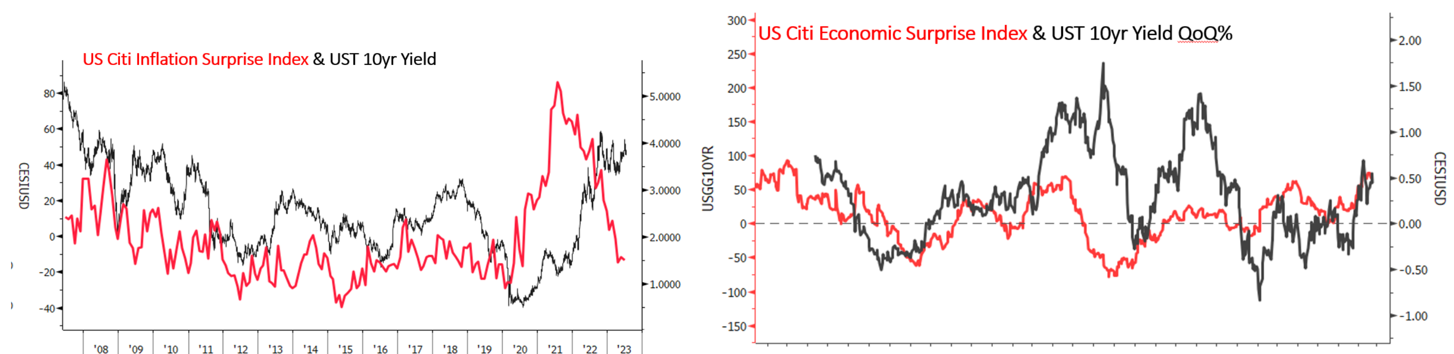
Currently, the Summation line is a bit stretched but not terribly so. And the Oscillator is weakening though still positive. All in all, neither great nor terrible.

So basically, we don't have concurrent sell signals on the SPX or NDX yet, though the RTY being at resistance and lagging all year, probably trades sideways to down. The risk-on trend is getting long in the tooth, sure, but we're still likely a few weeks away from a top. And the thing that will eventually kill this move, is a rise in yields…

The yield pinch…

US bonds are *the* market to watch.

US economic data continues to surprise strongly to the upside while inflation is surprising on the downside. And while we expect both to significantly reverse soon (inflation beating expectations and growth disappointing), we're likely in the clear until September. This gives us roughly a month or so of continued headwinds for bonds.



10yr Notes are trading at the lower end of their 11-month sideways range, after having failed to break above their 200-day moving average over the past two months. This is an increasingly heavy-looking tape.

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Positioning is, as I've been pointing out, very crowded on the short side. But positioning and sentiment alone are not timing tools. They are skew tools. They tell you the potential run of a trade should it work out, which is important information.

So though I may think bonds trade lower over the next month, I don't want to short them. The cone of probable paths forward is skewed too heavily to the upside. I'd rather patiently wait for a setup to get long, as I think buying bonds is going to be a BIG trade going into the end of the year.

The latest data from Sentix support this view.

The green line on this chart shows Sentix's "Strategic Bias" indicator. Orange is CoT speculators and blue is bonds.

Unlike positioning data, which should be looked at from a contrarian perspective, Strategic bias is an indication of where the big money is thinking about allocating to over a longer time horizon.

When you see very bearish speculative positioning (specs tend to be much more short-term in thinking/positioning) contrasting sharply with Strategic Bias, you typically

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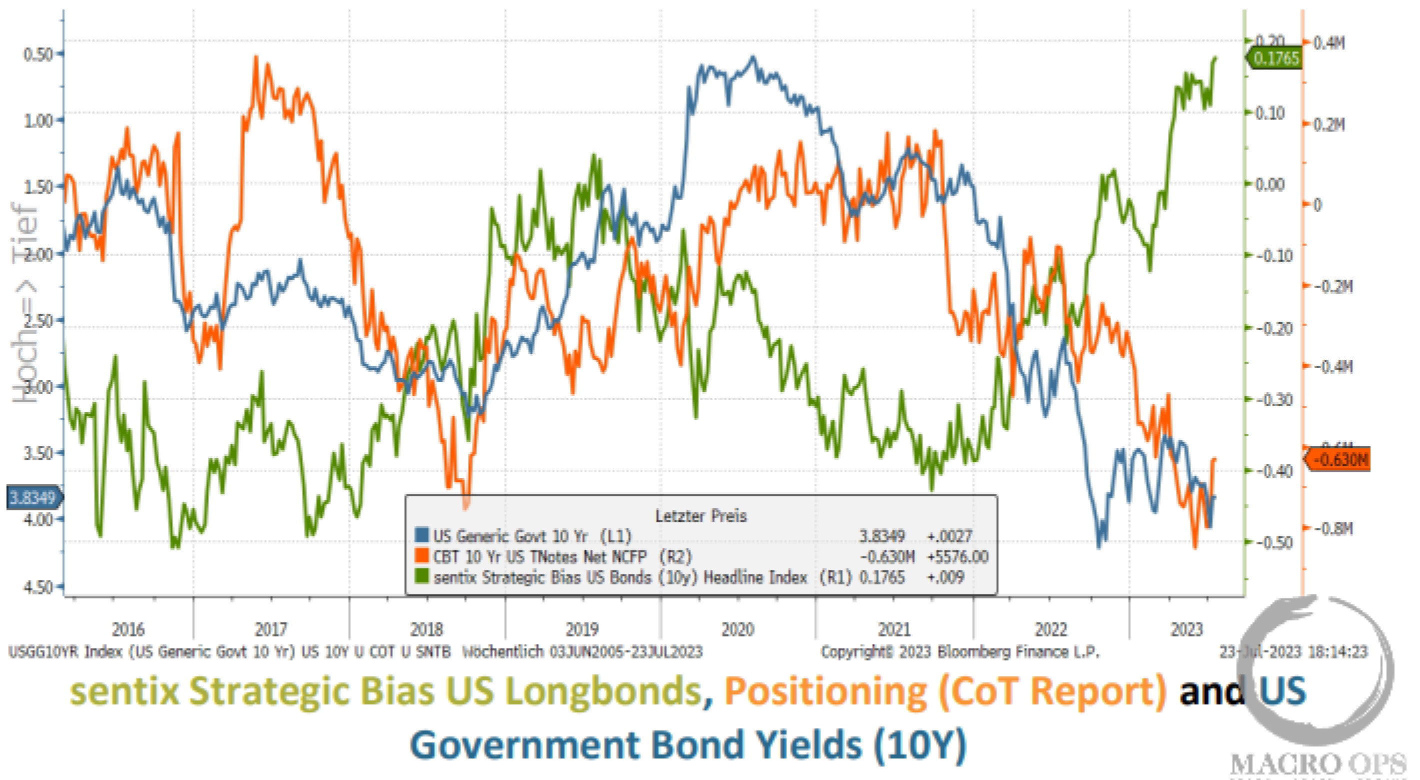
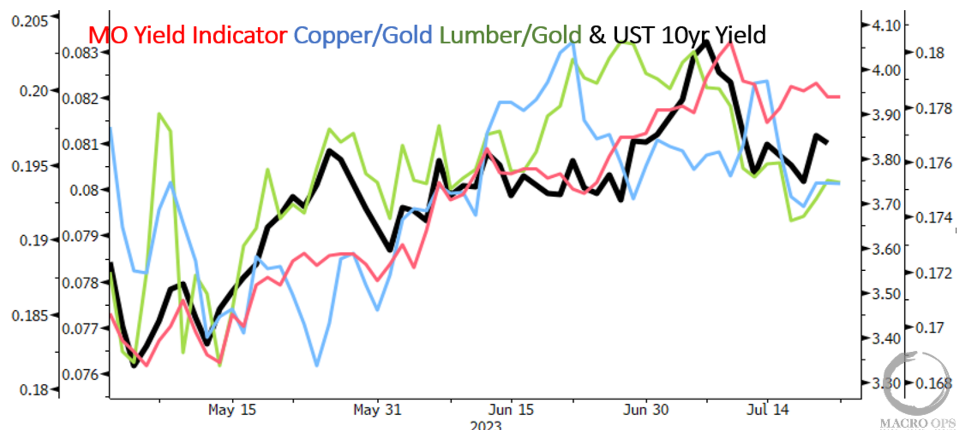
have an extremely powerful trade setting up. And this is exactly what we're seeing develop right now in bonds.



sentix Strategic Bias US Longbonds, Positioning (CoT Report) and US Government Bond Yields (10Y)

I'm thinking we see bonds break below their sideways range and put in a multi-week bear trap.

We'll wait for our leading yield indicators to diverge lower and for price action to signal a bottom is in (news failure event or weekly reversal) before probing bonds to the long side.



Another connected market is crude. Like bonds, specs are also *extremely* bearish. But where bonds are trading heavy, crude is looking more constructive coiling up against its 200dma.

A breakout above this moving average should lead to a bit of a run higher as bears look to get repositioned. And then higher oil prices will start to impact the inflation data

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in 1-2 months' time, bringing an additional headwind for bonds over the near term.

There are some big setups in the works (long bonds, long gold, short equities). But these are going to take some time to develop, so we need to be patient. Right now the play is to stay long equities, short bonds, and short precious metals. Even though the skew on these trades is dramatically shifting counter to their current trends…

Your Macro Operator,

Alex

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Equity Note: Updates On NORAM Drilling (NORAM) and Journey Energy (JOY.TSX)

Brandon here.

Energy is perking up, and it's time to revisit two names we're considering adding to our book: NORAM Drilling (NORAM) and Journey Energy (JOY).

NORAM Drilling (NORAM)

As a quick recap, NORAM is a drill rig operator in Texas's Permian Basin. The company operates 14 super-spec rigs and makes money off a spread between the total operating cost of the rig and whatever day rate they can contract the rig to a customer.

NORAM IPO'd this past year and used the proceeds to eliminate its long-term debt. Along with its clean balance sheet, the company has already spent the money to upgrade its 14 rigs to "super spec" status. This leaves all remaining cash flow available to shareholders via dividends, which it pays monthly at ~$0.09 - $0.11/share (25% yield at the current price).

Where are we today? The stock sold off with crude oil and hovered around NOK 48/share. Yet despite the share price weakness, NORAM's fundamentals are improving. As we mentioned above, the company makes a spread between its operating costs and day rate contract prices.

Operating costs are around $15K/day. As of last quarter, NORAM's average day rate sat around $31K. That means that NORAM makes ~$16K/day per rig at the current day rates.

NORAM only owns 14 rigs, which is small in Permian-speak. Still, it allows them to maintain 99% utilization rates across the entire fleet. Which leads to more substantial cash flows.

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There are only three parts to the NORAM long thesis: high (or higher) day rates, 95%+ utilization rates, and steady-state rig operating costs.

That's it. If day rates stay high and operating costs don't balloon, NORAM makes a ton of money. That money then gets paid to shareholders via monthly dividends at a current 25% yield.

Really it's a bet on continued activity in the Permian Basin. You're betting that oil companies will still demand rigs to drill for oil despite the shiny object that is offshore energy.

If you follow the energy/oil trade, you've seen recent reports and graphs on "Peak Permian." Rozenswacj and Gohering dedicated an entire section in their Q1 letter to the Permian's demise. But is it true?

Yes and no. I think offshore energy is today what shale was in 2014-2016. Over time, most of our world's oil supply will come from offshore wells in Guyana, Suriname, and Latin America. But these are long-cycle plays that take decades of upfront investment.

One of the reasons why offshore is so attractive is because the long-term economics of the wells crush onshore shale plays. Take Guyana, for example. In a recent investor presentation, HESS explained how one of Guyana's potential wells could have a breakeven of ~$35-$40 oil.

That said, shale is still profitable above $55/bbl. This is why crude holding support at $65 is a big deal despite recession fears, paper barrels, and a strong USD. Crude oil held above the breakeven point for most shale operators.

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And as long as crude oil stays above shale breakevens, oil companies will keep drilling in the Permian.

If we examine the NORAM thesis from 30,000ft, we're making two macro bets:

1. The world will still need shale/Permian production until offshore ramps
2. Oil prices will remain at or above onshore shale breakeven rates

The caveat here is that every oil-related company hinges on the same underlying macro thesis. Which is why it's hard to find a direct, company-specific bear case.

NORAM doesn't have debt. It doesn't need to spend money upgrading its rigs. It doesn't require tons of working capital to operate. It only owns fourteen rigs.

Such a simple thesis with a fat dividend makes you wonder what you're missing and why the stock is down so much. I think there are a few reasons for that. First, the company is a micro-cap stock (<$100M). Second, it only trades on the Oslo Exchange and the German Exchange. Finally, the company's parent is a Danish-domiciled business, but NORAM's HQ is in TX.

Despite these structural ownership headwinds, there are two ways to make money here. The first way is to just hold for the dividend, which the company pays monthly. You'll get ~25% of your cost basis back within the first year and your entire cost basis within four years.

Or, you hope/pray/manifest the company uplists to a larger exchange like the NYSE or even the TSX, and investors underwrite the dividend closer to 10-15% versus the current 25%.

Alright, onto JOY.

Journey Energy (JOY): Coiling Like A Spring

JOY is a Canadian oil and gas (~60% liquids) producer run by Alex Verge. The company uses a buy-and-exploit strategy to expand barrels-of-oil-per-day (or boepd)

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production at cheap prices. JOY trades around 5.50 but has a reasonable path towards CAD 15/share over the next 12-18 months.

And with oil breaking out, it's time to revisit the business.

JOY has a simple thesis. Buy low-decline oil-producing assets at low prices during crude oil troughs. Usually, you're paying <5x cash flow for these assets. In some cases, even less. Alex Verge had run this playbook at a company that returned 1,000% for shareholders. And he's doing the same thing for JOY.

The other important thing about this strategy is you're buying the land. Purchasing the land is essential because you control when and how you drill. O&G producers that lease land often have drill covenants that go with their lease agreement (i.e., producers must drill X number of wells per year, etc.). Buying the land allows JOY to drill whenever it is most economical for them to do so.

Most important, however, is the decline rate of the oil-producing assets. As mentioned above, JOY wants low decline rate assets (anything <10-20%). Low-decline assets are highly valuable in a rising-cost environment. Oil production has two primary costs:

- ➢ Fuel to run the rigs
- ➢ Labor

Fuel costs are up, and since nobody wants to work as a roughneck, so are labor costs. Unfortunately for energy producers, it will only get worse. The world's growing need for energy and materials will drive fuel demand. And we've spent the past two decades crucifying anyone interested in petroleum engineering or oil rig work.

Buying low-decline assets at cheap prices sounds like such a simple idea that it makes you wonder why more companies aren't pursuing it. I asked Alex Verge that question during our podcast interview. One reason he gave me was that most O&G management companies are pressured to pay dividends and buy back stock. This makes sense when you’re a small-cap producer trading for <2x cash flow (they’re out there).

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Another reason is that shareholders don't want producers reinvesting in the business, let alone taking on debt to finance new acquisitions (like JOY does). So it's either pay us a dividend, buy back our stock, or do nothing because the last time you did something you fucked it up.

I agree with Alex's bet that buying low-decline assets at cheap prices is the best use of capital. But part of that belief is that management knows how to structure deals to maximize shareholder value and reduce balance sheet risk. Which is what Alex did in his last deal. Here's how Alex structured the deal.

The company bought its most recent producer for ~$140M. Alex paid for that asset with a Choose-Your-Own-Adventure financing arrangement.

He issued $14.16M in JOY stock, paid $50M cash, used $30M from the acquisition's cash flows from May 1 to close, *and then* convinced the seller to use a vendor takeback (read: seller financing) for the remaining $45M.

Attractive Acquisition Financing

- **$140,000,000 purchase price (May 1 Effective)**
- **$30,000,000 cash flow (May 1 – Close)**
- **$45,000,000 vendor take back (VTB) financing (10% interest rate) with scaled monthly repayments:**

Monthly Payment	WTI Price
$4,000,000/month	>US$100/Bbl
$3,000,000/month	US$85 – US$100/Bbl
$2,000,000/month	US$70 – US$85/Bbl
$1,000,000/month	<US$70/Bbl

Price dependent Payment structure

- **$14,160,000 vendor takes back equity; 3.0 million shares @ $4.72/share**
- **$50,840,000 Journey cash on hand**

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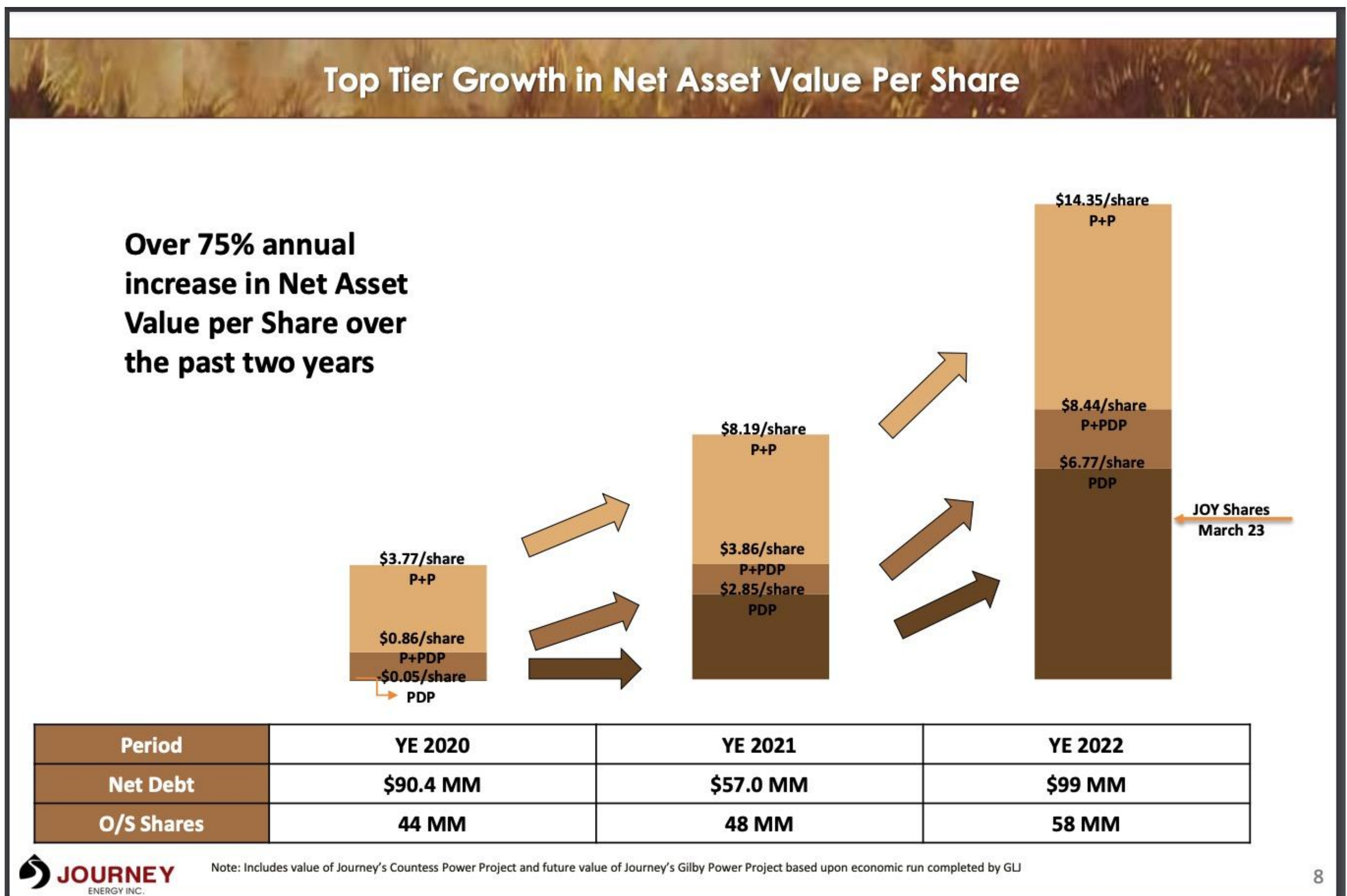
Alex then tied the interest payments on the vendor takeback to the oil price. For example, if oil costs $65, JOY only pays a lower annual interest. If oil is at $90, it pays more interest, etc.

It's creative and reduces JOY's debt burden while enabling balance sheet flexibility as oil prices move.

Like crude oil, JOY's stock has traded sideways over the past year. But we're near the end of its consolidation. Volatility has tightened, and the chart looks like it wants to break. I just don't know if it's up or down yet.

The stock currently trades at ~CAD 5.80, a discount to the value of its production assets alone.

JOY also recently bought a powerplant at fractions of the replacement value.



Period	YE 2020	YE 2021	YE 2022
Net Debt	$90.4 MM	$57.0 MM	$99 MM
O/S Shares	44 MM	48 MM	58 MM

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So not only are you paying less than PDP value for JOY's expanding low-decline production asset portfolio. You're also getting a powerplant at fractions of replacement cost thrown in for free.

JOY is a classic Trifecta Setup. The stock trades at a significant discount to PDP with a profitable powerplant at fractions of replacement cost for free. The company's run by an industry veteran who ran the same playbook in his last company with wild success. And the chart is telling you that something's about to happen.

We'll look to add to our position on a breakout with a stop below the symmetrical triangle low.

Your Value Operator,

Brandon

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MO Portfolio Snapshot

The Macro Ops Portfolio

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

2023 YTD Return	9.89%
Total Notional Exposure	59.88%
Current Cash Value (%)	60.91%
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
Russell 2000 Futures	RTYU2023	4	$400,000.00	22.21%	0.70%	$1,882.80	$2,000.00	$1,819.90	6.22%

Equities – Strategic	Ticker	Shares	Capital	Notional	At-Risk	Cost Basis	Current Price	Stop-Loss	P&L
Sprott Uranium	U.UN	6,431	$79,359.08	4.41%	0.46%	$11.73	$12.34	$10.44	5.20%
Sprott Uranium (Second Leg)	U.UN	10,058	$124,112.02	6.89%	0.48%	$13.41	$12.34	$12.55	-7.98%
Alphamin Resources	AFM.TSX	69,421	$56,925.22	3.16%	0.50%	$0.78	$0.82	$0.65	5.13%
Foran Mining	FOM.TSXV	27,333	$76,532.33	4.25%	0.23%	$2.11	$2.80	$1.96	32.70%
Foran Mining (Second Leg)	FOM.TSXV	16,994	$47,583.02	2.64%	0.49%	$2.48	$2.80	$1.96	12.90%
Vista Energy	VIST	6,727	$176,111.50	9.78%	-0.26%	$14.11	$26.18	$14.80	85.54%
Tidewater (Second Leg)	TDW	1,249	$73,014.48	4.05%	0.47%	$49.35	$58.46	$42.57	18.46%
Tidewater	TDW	1,174	$68,610.80	3.81%	-0.12%	$34.15	$58.46	$36.00	71.19%

Tactical	Ticker	Shares	Capital	Notional	At-Risk	Cost Basis	Current Price	Stop-Loss	P&L
Bitcoin	BTCUSD	4	$116,665.43	6.48%	0.47%	$28,820.00	$29,799.10	$26,635.00	3.40%

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%	0.92%	$70.00	$18.00	$0.00	-74.29%
PAAS JAN 19 2024 $45 CALLS	PAAS	660	$23,087.13	1.28%	0.92%	$25.00	$35.00	$0.00	40.00%
HAL JAN 19 2024 $60 CALLS	HAL	67	$2,226.55	0.12%	0.49%	$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: Time Alpha

Last week I listened to Patrick O'Shaghnessy's interview with Kieran Goodwin. Kieran is a renowned private credit investor. He was the former Head Partner and Trader at King Street Capital, where he grew from $4B to $20B in AUM.

In fact, my good friend and podcast guest Judd Arnold worked for Kieran at King Street Capital. Small world.

From listening to this conversation, it's evident that Kieran is extraordinarily bright and one of the best credit investors in the game from listening to this conversation. Kieran discussed his background at King Street, lessons he learned from trading prop and credit derivatives, and what it feels like to become a "ten-year overnight success."

Kieran's thoughts on alpha generation were the most striking part of the conversation. He explained that initially, credit guys could generate alpha by understanding the Chapter 11 process and recognizing patterns in restructurings better/faster than anyone else.

But now he thinks that's mostly gone.

What's lasted, however, is **time alpha**. Here's a quote from the podcast (emphasis added):

> *I do believe there's alpha in time. And I believe* ***there's alpha in the permanence of your capital****. Going back to Buffet, his big advantages,* ***he had time and permanence of capital.*** *I definitely think there's alpha there.*

The idea of **time alpha** goes beyond the permanence of capital, though. In fact, **time alpha** isn't about the absolute patience of capital but the degree of tolerance for that capital.

Take Druckenmiller, for example. If you remove the name on the front of the door, Druck's strategy is completely unmarketable. It goes something like this. You have a guy that makes broad macro calls (of which he's often wrong), buys stocks that have gone up recently, irrespective of traditional "value" metrics, and constantly flips between futures, forex, and equity markets.

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It's an unsellable strategy. That is unless you're Druckenmiller. Druck's made so much money that he doesn't need outside capital. He runs his own book, accountable to no one.

*That's **time alpha**.*

In other words, there's alpha all around us in financial markets. It's just a matter of knowing the tolerance level of your least tolerant investment dollar.

Community Highlights

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

1) MOHO Webinar #8 w/ @Brent (#general)

ICYMI check out our latest MOHO Webinar #8 announcement with Collective Member, Brent.

Brent specializes in net-net investing, and we'll explore everything about his process. From trade identification, portfolio management, position sizing, and lessons from the biggest winners and losers.

2) J.P. Morgan Energy, Power, and Renewables Conference Slide Deck (#ideas-commodities)

Collective member Phil Deane posted an excellent slide deck from JP Morgan's Energy, Power, and Renewables Conference. There's some great offshore energy/services content in the deck, which helps illuminate our bullish TDW thesis.

It makes for a great weekend read.

3) Deutsche Bank Investor Positioning & Flows (#research)

Mark Neuberger is the hero we need, not the one we deserve. He posts tons of high-quality research content weekly and has done so forever.

This week, Mark shared the Deutsche Bank Investor Positioning & Flows Report. The report highlights how and where investors are positioned in markets, allowing us to spot potential fades or oversold sectors/industries.

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Give it a read this weekend.

[Join our Comm Center here](#)

The Vault: FBO/FVBO Trading Template

For any underlying, price action can be sorted into two major "moods".

The first mood can be referenced as a "trending market". This behavior is observed to occur roughly 20% of the time:

- ➢ Higher average wins and lower average losses are commonly observed here
- ➢ The phrase "let your winners run and cut your losers short" rings true, especially in a trending
- ➢ market.
- ➢ Adding to a position in a trending market is recommended if the underlying price action is
- ➢ strong.

The second mood is known as a mean reverting market. This behavior is observed to occur roughly 80% of the time:

- ➢ There is a clearly identifiable range that the price has been bouncing between, built out of a
- ➢ plethora of failed breakouts and breakdowns.
- ➢ The mean price acts as an attractor (think of a powerful magnet attracting unsuspecting
- ➢ operators back towards the mean price over time).
- ➢ It is advised to cut both winners and losers rapidly, as mean reversion could occur at any time.

This week's Vault has everything you need to learn to trade FBO and FVBO setups.

Read it 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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