MARKET BRIEF

Macro Ops Collective

Bombs Over Baghdad...

Summary:

- WWWIII?
    - SPX: Larger trend still bullish but odds on of 5%+ correction in coming weeks. Reduced Core Equity position back down to 25%
    - Bonds: Finding a bid. Expect a multi-week bounce
    - Oil: CAPEX cycle and deep value plays in the energy space
    - Gold: Boosting our core gold position back to 25%
- Charts/Trades
- Portfolio Review

> *I first became fascinated with the subject of the wisdom of markets when, by chance, I discovered that the British stock market bottomed for all time in the summer of 1940 just before the Battle of Britain; that the U.S. market turned forever in late May 1942 around the epic Battle of Midway; and that the German market peaked at the high-water mark of the German attack on Russia just before the advance German patrols actually saw the spires of Moscow in early December of 1941. Those were the three great momentum changes of World War 2 — although at the time, no one except the stock markets recognized them as such. This, to me, confirmed the extraordinary (and unrecognized) wisdom of market crowds.* ~ Barton Biggs

There's a lot of charts I want to go through but before we begin I want to share a few thoughts on the Soleimani killing and what this escalation could mean for markets.

Qassem Soleimani was the senior General of Iran's Qud's Force. That arguably made him one of the top three most powerful men in Iran, second only to the Ayatolla. He was the Iranian Rommel. A master at guerilla warfare. We drilled a bomb into this guy's head. That's a big deal.

Now, I personally relish the fact that this guy is no longer breathing. Soleimani was a bad dude. He was behind thousands of deaths in the middle east; everything from orchestrating attacks on US troops/contractors in Iraq to assisting in the mass killing of civilians in Syria and more. The fact that he was killed on Route Irish, a Baghdad road in which his men routinely carried out assaults on US personnel, is sweet sweet justice to my ears.

With that said, I have questions about the strategic decision behind this move.

Why now?

We've had eyes on this guy for a long time. Since Bush, we've had numerous opportunities to take him out. We've also been in a cold/hot proxy war with Iran since the invasion of Iraq — and much earlier if you count the actions of Hezbollah (an Iranian backed militia).

Prior Administrations passed though… Preferring to keep things at the proxy-war level versus the alternative. That was the M.O. of the Trump administration as well, at least until last week. Trump had shown incredible tolerance to the constant poking by Iranians over the last year. I mean, he hardly responded to the pestering by gunboats in the Strait of Hormuz, their puppet mastering behind violent protests in Iraq, the shooting down of a $200m dollar reconnaissance drone, the attack on Saudi's Abqaiq oil facilities and so on.

Maybe the recent assault on the American Embassy — a violent protest organized by Soleimani — was a poke too far?

Or was this a perfect opportunity to divert the news cycle from the constant droning over impeachment to something that Americans can rally behind… a common outside enemy?

The cynic in me leans to the latter but who knows.

Here's the deal though. Neither side wants war. Despite what the media is saying, WWIII is not imminent.

The US populace is burnt out on foreign military escapades. War with Iran won't get politicians votes so it's an unlikely move for now.

And the Iranian regime can't afford one. They know they'd lose.

Their pestering over the last year was just a feeble response to us literally putting their economy into a stranglehold through sanctions. Kind of their way of saving face without really doing much.

Plus, the US is on its way out of the region. Our force profile in the Middle East has dropped over 80% and is on its way towards essentially zero. We've got oil now and so we no longer have any strategic imperatives in the region.

This is great for Iran, who can't wait for us to be fully out of their backyard. They effectively control Iraq now. We gave it to them when we toppled Sadam without any real plans on who to replace him with.

Iran is limited in how they can “retaliate” in a hard sense. They really only have two options: attacking US forces/interests in Iraq or Saudi Arabia.

So we’ll probably see some small scale responses there but they’re likely to refrain from pushing too hard. Knowing that any significant attack by them would bring the direct attention of the US Fifth Fleet operating in the Persian Gulf not to mention it’d risk slowing the troop withdrawal from the region.

Rather than hard retaliation, we should expect soft moves from them such as pulling out of the nuclear deal and/or pressing the Iraqi government on kicking US forces out (remember, the Iraqi government is effectively an Iranian proxy at this point) ***as this goes to press news is breaking that this is exactly what they’re trying to do***.

This way they get to save face without risking an all-out war that they cannot afford.

What does this mean for markets?

Generally, with these types of geopolitical events, it pays to fade the first move. When it comes to stocks, it’s the present technicals, sentiment, and earnings that’ll drive stocks up or down. The Iran skirmish is a non-event, except for perhaps to our shipping and energy names which we’ll cover more of here in a bit.

So don’t expect much further escalation of this for now. But do expect the media to beat this horse to death.

Let’s take a trifecta (fundamentals, technicals, sentiment) look at markets as they stand now.

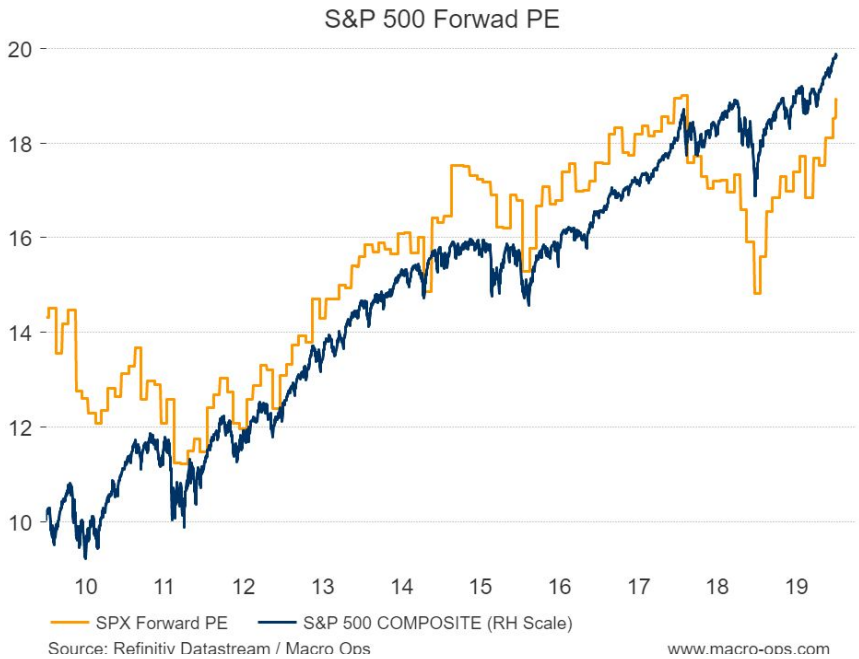
The SPX remains in the tight bull channel it started all the way back in October. During that time, the bulls have been in full control with the most damage the bears have been able to unleash is two slightly bearish Doji candles on a weekly basis (chart below is a daily).

This trend is extended, overbought, and overloved (as I'll show here in a minute). But, trends like this hardly ever turn on a dime. Usually, momentum wanes then flattens out before the other side can wrestle control and drive an extended retracement or change of trend.

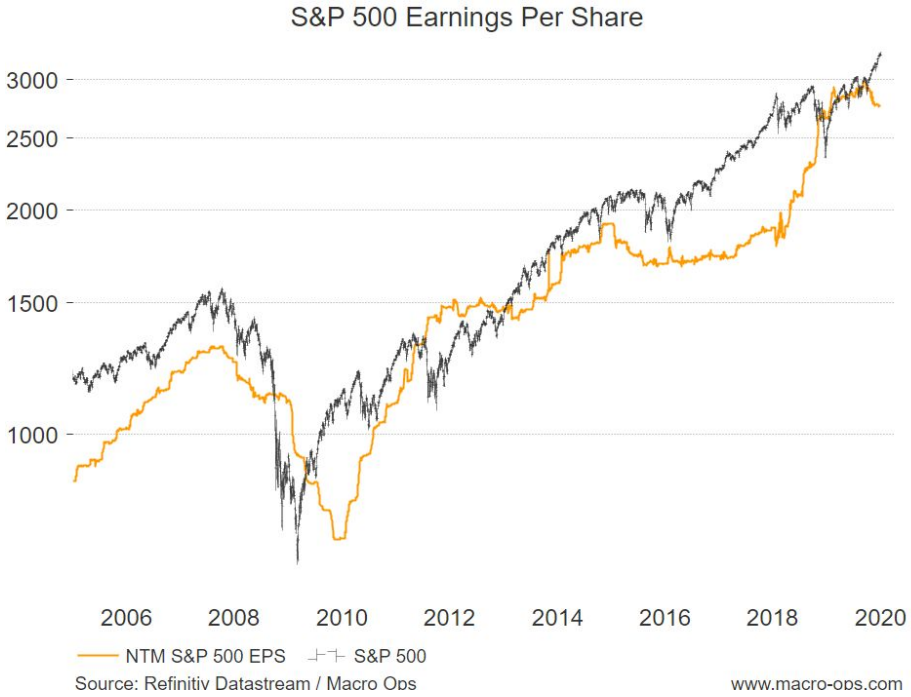
I think that's what we're in the process of seeing right now but we need to see a few more consecutively strong bear bars first. As of right now, the bulls still have control and the onus is on the bears to prove that this trend has run its course. But all the ingredients are in place for a 5%+ retracement.

One of these being the screaming signs of complacency that I've been noting these last few weeks. A number of our indicators have reached extreme levels. Take our Total Put/Call ratio 10&3dma for instance. It's at its lowest levels since August 15'. The two other times it's been at/near these levels it's preceded a long and drawn out correction.

The SPX's forward PE is back to its cycle high of 19 reached during the parabolic run-up in Jan 18'. Equity valuations are now a **firm headwind** for stocks barring any major source of earnings growth.

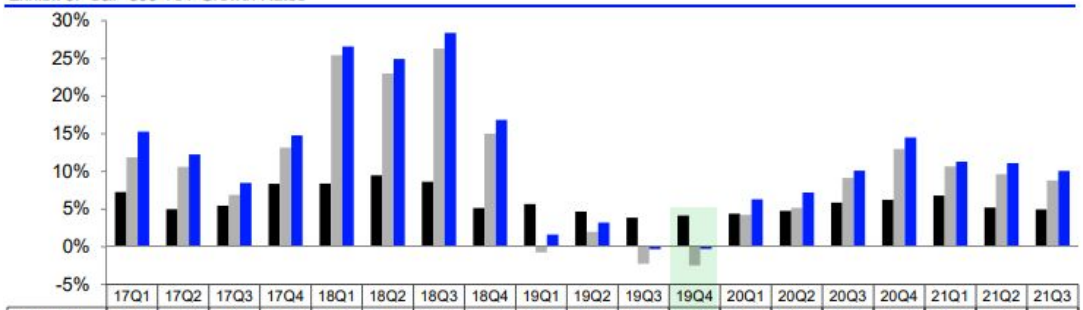


And with earnings expected to decline for a second straight quarter the only boon I see for EPS is further financial engineering through share repurchases.



One positive though is that just like the last three quarters the market continues to set a **low hurdle**. Consensus estimates are for net income to decline this quarter by -2.5%. Like quarters prior, I expect that the majority of companies will find a way to safely clear this bar.

Exhibit 5. S&P 500 YoY Growth Rates



	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	21Q1	21Q2	21Q3
Revenue	7.3%	5.0%	5.5%	8.3%	8.4%	9.5%	8.6%	5.1%	5.7%	4.7%	3.9%	4.1%	4.4%	4.8%	5.9%	6.2%	6.8%	5.2%	5.0%
Net Income	11.9%	10.6%	6.9%	13.1%	25.4%	23.0%	26.3%	15.0%	-0.8%	2.0%	-2.3%	-2.5%	4.2%	5.2%	9.1%	13.0%	10.7%	9.6%	8.8%
Earnings	15.3%	12.3%	8.5%	14.8%	26.6%	24.9%	28.4%	16.9%	1.6%	3.2%	-0.3%	-0.3%	6.3%	7.2%	10.1%	14.5%	11.3%	11.1%	10.1%

Source: I/B/E/S data from Refinitiv

The percent of stocks in the SPX who've triggered MACD sell signals in the prior ten days have reached levels that have preceded market weakness in the past.

Shorter-term indications of market breadth, such as the McClellan Summation Oscillator still remain supportive of higher prices though they're weakening and may turn negative in the coming days. **I've reduced our Core equity position from 100% to its neutral 25%**.

Overall, the longer-term picture for the SPX is still bullish though there's a high probability we'll see a 5-10% pullback in the coming weeks. A selloff would help reset some of the valuation headwinds we're now facing as well as further rerate expectations lower.

Bonds

I talked about bonds this week's *Dirty Dozen*. I've been slightly bearish on them over the last few months which has been the right call but it looks like it might be time to turn bullish. We've kept our core bond position at 50% **but I'm increasing that to 100%** and will leverage it to 200% to help hedge out our long book when it looks like a selloff is firmly getting underway.

Bonds put in a micro double bottom on the weekly and monthly charts and we should now expect them to rise for at least a few weeks. Overall, I've been rather surprised by how well they've held up despite the persistent strength in the equity markets. That's a good sign that there's an underlying bid for bonds in the current environment.

Another interesting thing to note is where analysts are expecting the 10yr to trend to this year. Last year Wall Street analysts were literally tripping over themselves to see who could give the most bullish bonds forecast (lower yields). This year the average forecast has the 10yr pegged at 1.92% by year's end — it's at 1.78% currently.

Enter # <GO> to view analyst forecast, <Back> to Return

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United States
US 10-Year

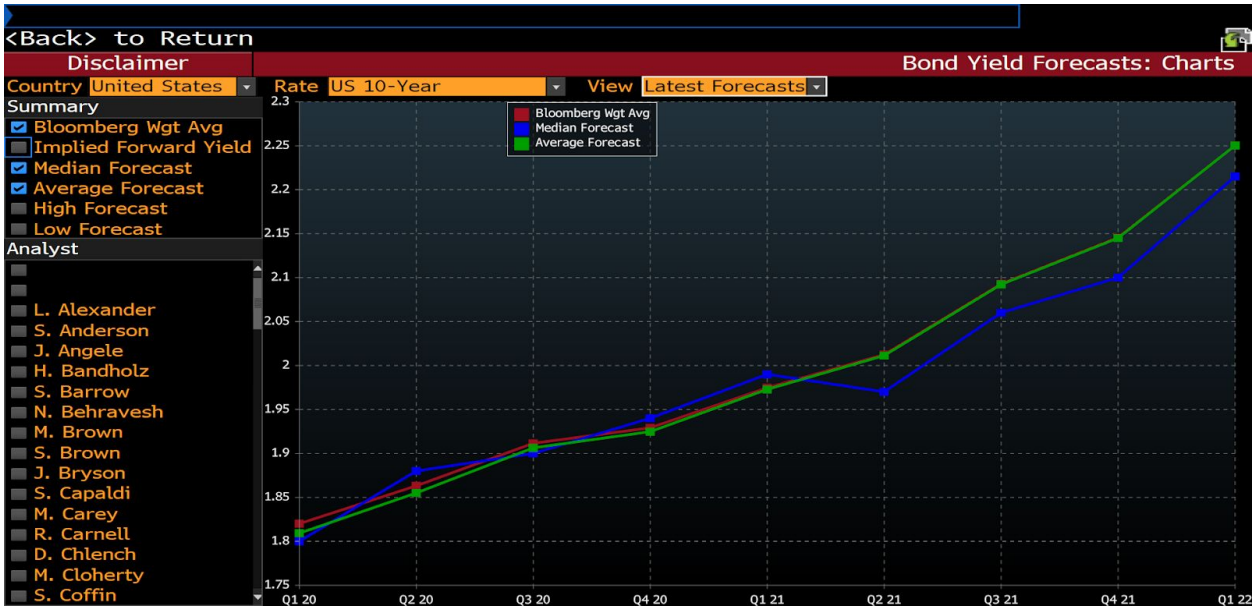
Market Yield 1.79

Recent Updates
N. Mukharriz
Research

	Q1 20	Q2 20	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
Bloomberg Wgt Avg	1.82	1.86	1.91	1.93	1.97	2.01	2.09	2.15	2.25	
Implied Forward Yield	1.81	1.82	1.83	1.85	1.86	1.88	1.89	1.91	1.92	
Median Forecast	1.80	1.88	1.90	1.94	1.99	1.97	2.06	2.10	2.22	
Average Forecast	1.81	1.86	1.91	1.92	1.97	2.01	2.09	2.15	2.25	
High Forecast	2.35	2.75	3.03	2.75	2.95	3.05	3.25	3.48	3.67	
Low Forecast	1.25	1.00	1.05	1.00	1.00	1.00	1.20	1.25	1.30	
Responses	60	60	60	61	50	47	46	48	32	
Dec. Survey Median	1.80	1.88	1.90	1.93	1.98	1.97	2.04	2.10	2.22	
Nov. Survey Median	1.80	1.90	1.93	2.00	2.00	2.05	2.05	2.10	2.00	
Change in Medians	0.01	-0.02	-0.03	-0.07	-0.02	-0.08	-0.01	0.00	0.21	

Firm Name	↑Analyst	As of	Q1 20	Q2 20	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22
1) Action Economics LLC	M. Englund	12/13	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75		
2) Amherst Pierpont Securities LLC	S. Stanley	12/13	2.10	2.30	2.50	2.75	2.95	3.05	3.15	3.25	3.35	
3) BBVA Research SA	N. Karp	12/13	1.63	1.67	1.72	1.78	1.82	1.88	1.94	2.04	2.13	
4) Bank of America Corp	M. Meyer	12/13	1.80	1.80	1.80	1.80						
5) Bank of the West	S. Anderson	12/13	1.66	1.49	1.48	1.53	1.67	1.70	1.85	1.96	2.18	
6) Bayerische Landesbank	N. Wuthe	12/13	1.60	1.70	1.90	2.10						
7) CIMB Investment Bank Bhd	N. Mukharriz	12/16	1.90	2.00	2.10	2.20						
8) Canadian Imperial Bank of Comm...	A. Shenfeld	12/13	1.75	2.00	2.10	2.20	2.20	2.30	2.35	2.50		
9) Chamber of Commerce Inc	B. Higginbotha...	12/13	1.65	1.70	1.75	1.90						
10) Comerica Inc	R. Dye	12/13	1.96	1.93	1.87	1.92	1.98	2.06	2.10	2.14	2.15	
11) Commerzbank AG	Research	12/13	1.90	1.65	1.50	1.40	1.45					
12) Dai-ichi Life Research Institute I...	S. Katsurahata	12/13	1.84	1.86	1.81	1.84	1.88	1.89	1.78	1.68	1.56	
13) Desjardins Securities Inc	F. Dupuis	12/13	1.70	1.75	1.80	1.65	1.50	1.40	1.45	1.50	1.55	

Looking out even further, the average estimate has the 10yr yield continuing to climb well above 2% in 2021.



I think the global economy clearly showed in 18' that it can't handle rising rates and that was with large scale Chinese stimulus as well as a big US fiscal impulse. As of right now, we have neither on the horizon. That, of course, could change. But as of right now the macro winds will keep rates range-bound and/or moving lower.

Gold

This has obvious implications for gold, which moves off the real rate of interest. Gold is attempting to punch through a major level in the $1,550-1,600 range. It's currently overextended and above its upper weekly Bollinger Band so I'd expect at least some sideways action or a slight pullback if it's going to go higher from here.

I don't know if this is the breakout or if we'll make another intermediate top (I'm still very bullish on gold's longer-term prospects). But I'm willing to drop my bearish bias which I may have held onto for too long.

Our Core gold positioning has been flat, **I'm moving that back up to its 25% today**. And I'm going to be watching precious metals closely and will consider putting on a position in some miners or playing silver in the futures market.

US Dollar

The bears are making some progress against the dollar. This monthly chart of EURUSD shows that euro bulls were able to close December near its highs and put in its highest price since August.

It's odds on that we're seeing the beginnings of a turn in the dollar or are at least moving to a new sideways range-bound regime in the major pairs.

There are three big drivers of this trend:

1. Capital concentration in the US relative to the rest of the world is at extreme levels and valuations are stretched, especially on a relative basis. It won't take much of a rebalancing from global investors to kickstart a positive feedback loop that works in the other direction
2. We're going to see a continuation in the trend towards US/DM rate convergence. US rates should continue to move downwards, weighed down by low global growth and inflation while rates in Europe have long since hit bottom and can only go up (take Sweden for example, which just ended its 5-year experiment with negative rates).
3. We're running a deficit of roughly 4% of GDP. When you factor in the size of the deficit, the low growth rate of the economy (sub real 2%), and the maturity of our debt profile. In just a few years, we end up with massive debt roll-overs. I'm talking about gross Treasury issuance in the realm of **25% of GDP or higher**. Every year. The pressure from our rising gross issuance can only be relieved through one of two ways. It can reset through higher interest rates -- unlikely due to the anchoring of low rates globally. Or it comes through on the FX side, in say a lower dollar. A much lower dollar.

Our long CAD position is putting in some work. It just made a new 52w high, clearing a major range. CAD benefits from the rise in oil prices and is undervalued relative to the US dollar. We'll look to add more to this position on pullbacks.

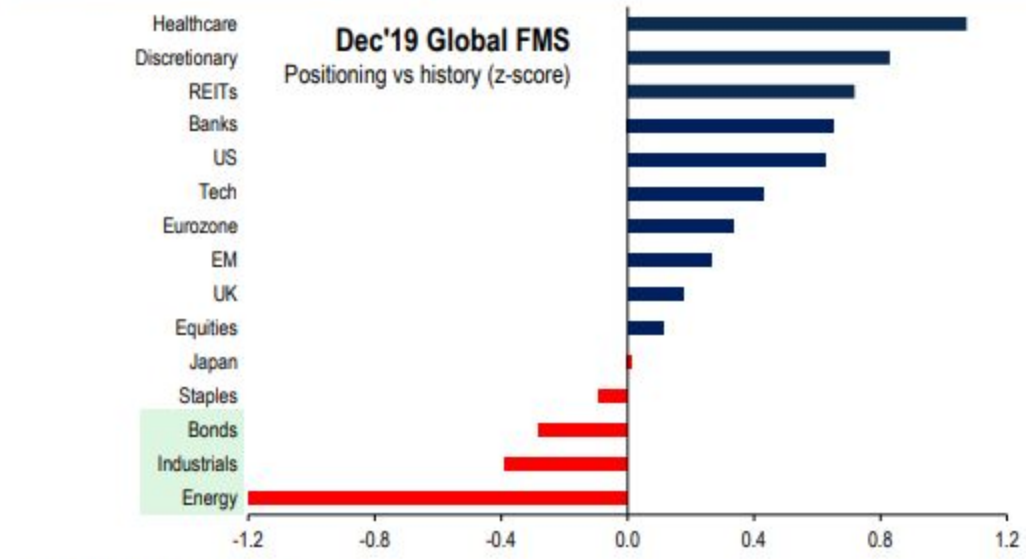
Our long position in the Mexican peso is also shaping up nicely. This is one of my favorite trades for the year. The peso has a number of tailwinds. Mexico is just coming out of a major economic slump. The new NAFTA is expected to be ratified in the near future. The peso is the highest yielding major currency. And Mexico is the biggest beneficiary of the US/China trade war and the long-term dislocation of major supply chains from Asia — we're already seeing a number of big US multi-nationals move their operations to Mexico.

This trade has excellent technicals and large macro tailwinds. We'll look to add to the position on technical setups.

Energy

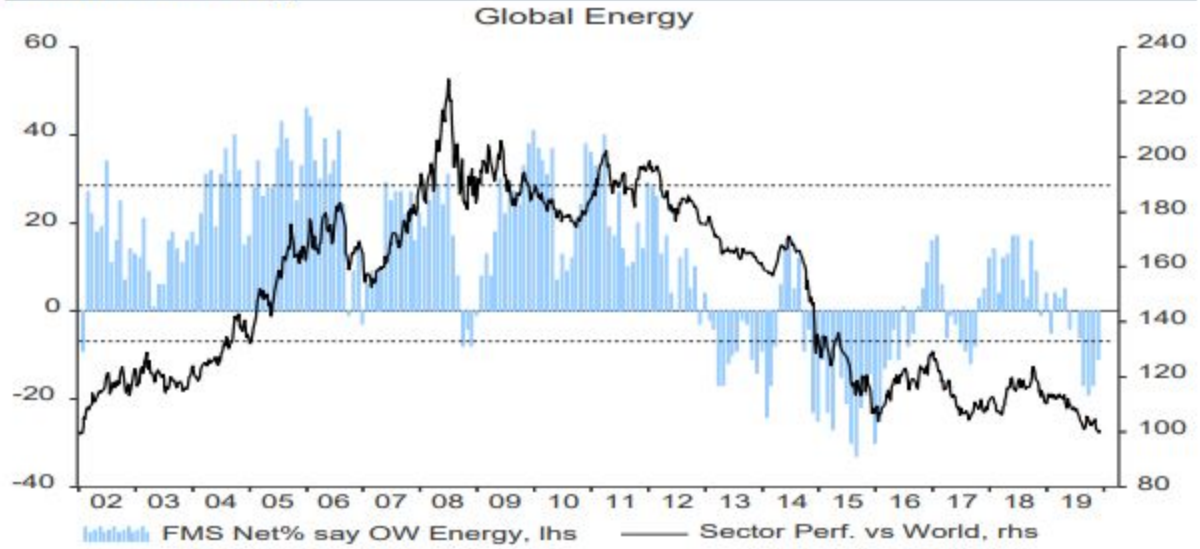
The last BofAML Global Fund Manager Survey showed that managers are way under positioned energy, industrials, and bonds.

Exhibit 9: FMS positioning vs. history



Source: BofA Global Fund Manager Survey

Exhibit 51: Global Energy



Source: BofA Global Fund Manager Survey

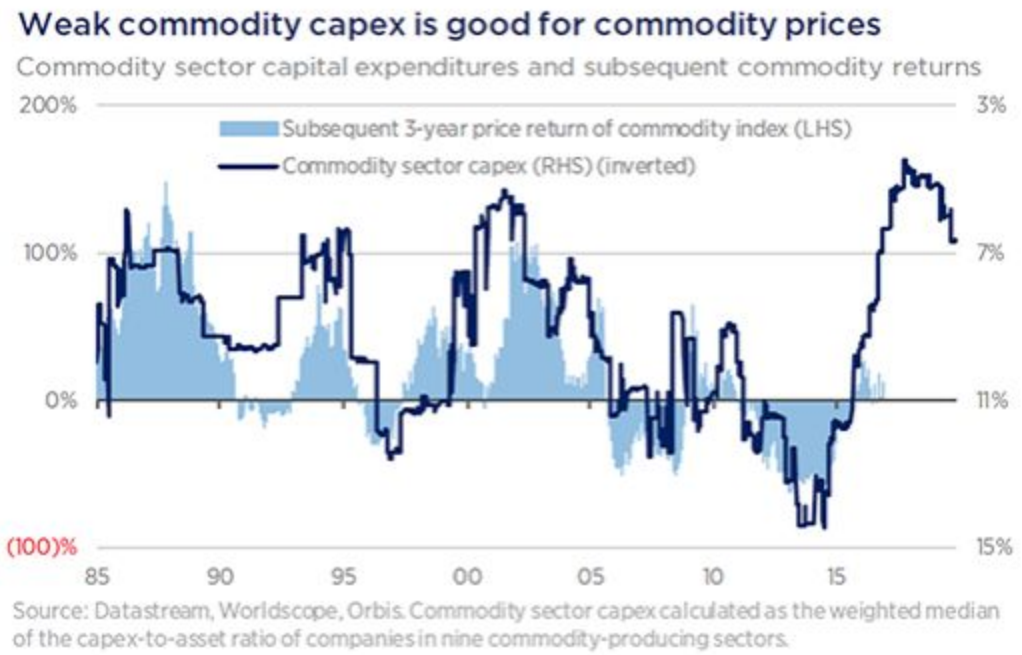
I don't have strong conviction on the near-term direction in the price of oil. It's still range bound and needs to firmly clear the $65 level for the chart to become more constructive to the bullish side (chart below is a monthly). Until then, my base case is for more sideways chop.

But longer-term I think oil prices are likely headed much higher for reasons I've discussed a number of times, here's an example.

The reason is CAPEX. The end of the internal combustion engine narrative and the global focus on renewable "green" tech has pulled capital out of the energy sector en masse. Combine this with investors getting traumatized by years of uneconomic frackers lighting their capital on fire and it's no surprise that E&Ps have been forced to reduce their investments. According to Goldman Sachs, the cost of capital for US E&Ps increased over 50% YoY. The end is nigh for negative ROE shale companies. And that's good for the rest of the industry.

Like all capital cycles, low investment eventually leads to higher prices and the start of the new cycle. I don't know when the next one starts but I know it's coming.

This great chart from Orbis Capital shows total CAPEX for the commodity sector as a whole. Total CAPX hit its lowest level in over 30-years recently. Add this to global wealth s-curve dynamics we'll start seeing in the coming years and you have the foundations for some fireworks in commodities.

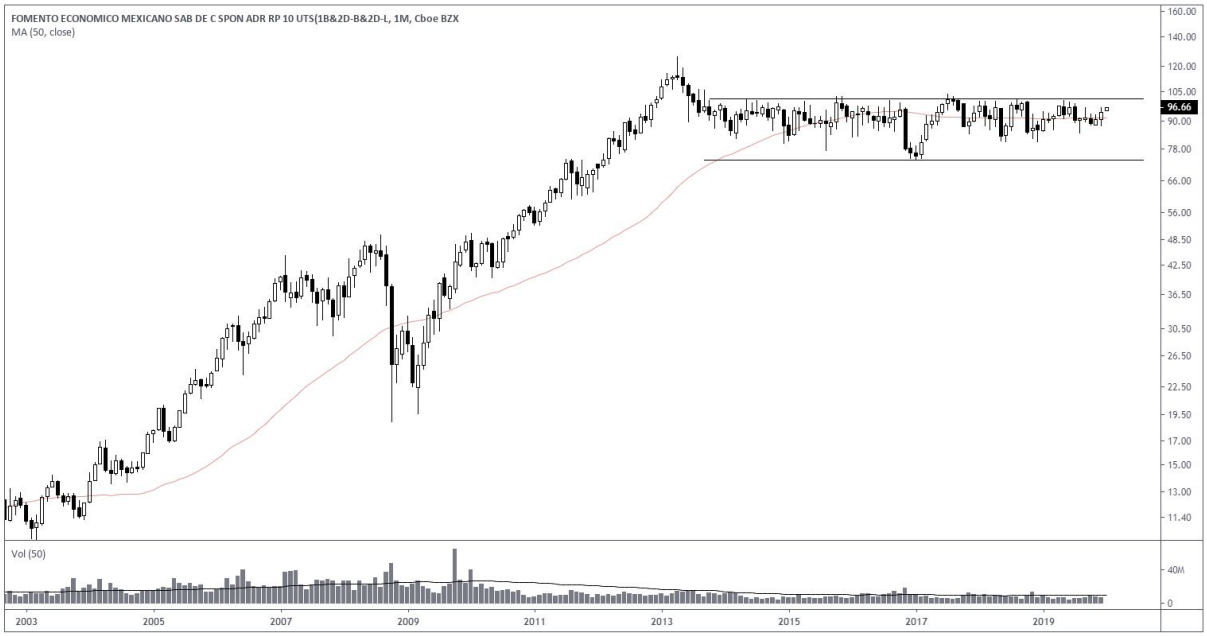


It's a great sign that we're beginning to see some big-name value investors, such as Peter Lynch, begin to return to the E&P space pointing out the deep value on hand. In addition to the E&P stocks that I like (GPRK, WTI, EGY) there are also some great opportunities in the oil services space where service companies are priced at their all-time lowest value relative to that of producers (red line shows relative valuation).

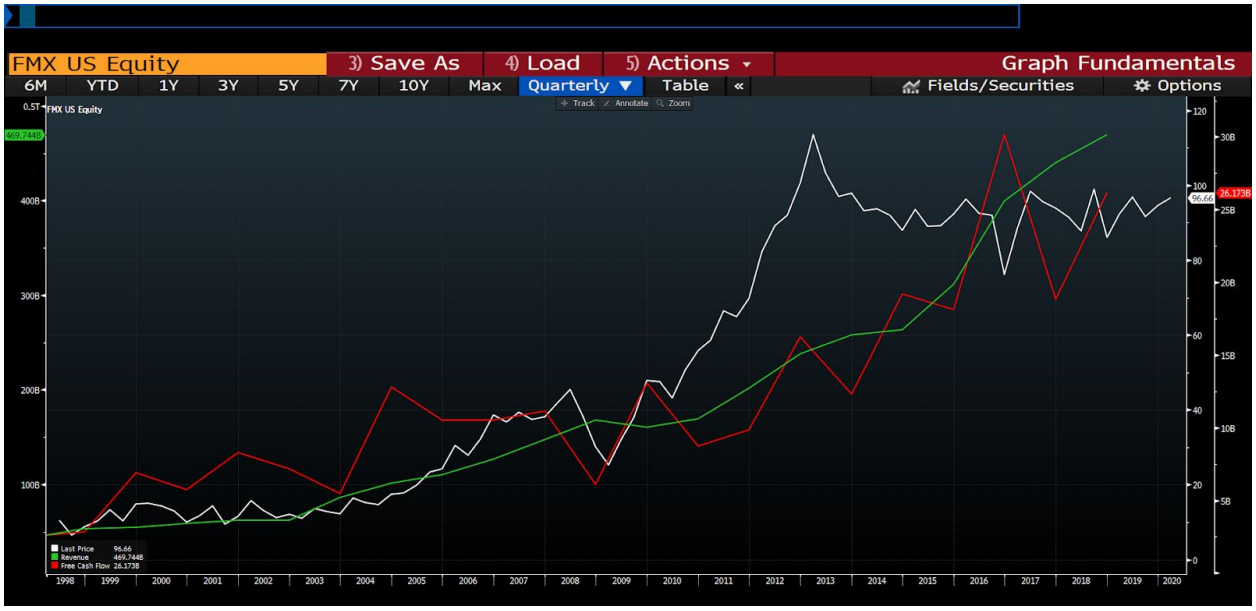
There's a number of great charts in the space but Baker Hughes (BKR) is one of my favorites.

Trades/Chart Review

Here's a number of trades I've been digging into recently. Take a look at this monthly chart of Fomento Economico Mexicano (FMX). It's a Mexico based company that operates as a bottler of Coca-Cola trademark beverages of which it produces, markets, and distributes. Look at the size of the base it's put in. 7-years of tight sideways action.



While the stock has gone nowhere over the 7-years we've seen revenues increase by 37% (green line) and free cash flow more than double over that same period.



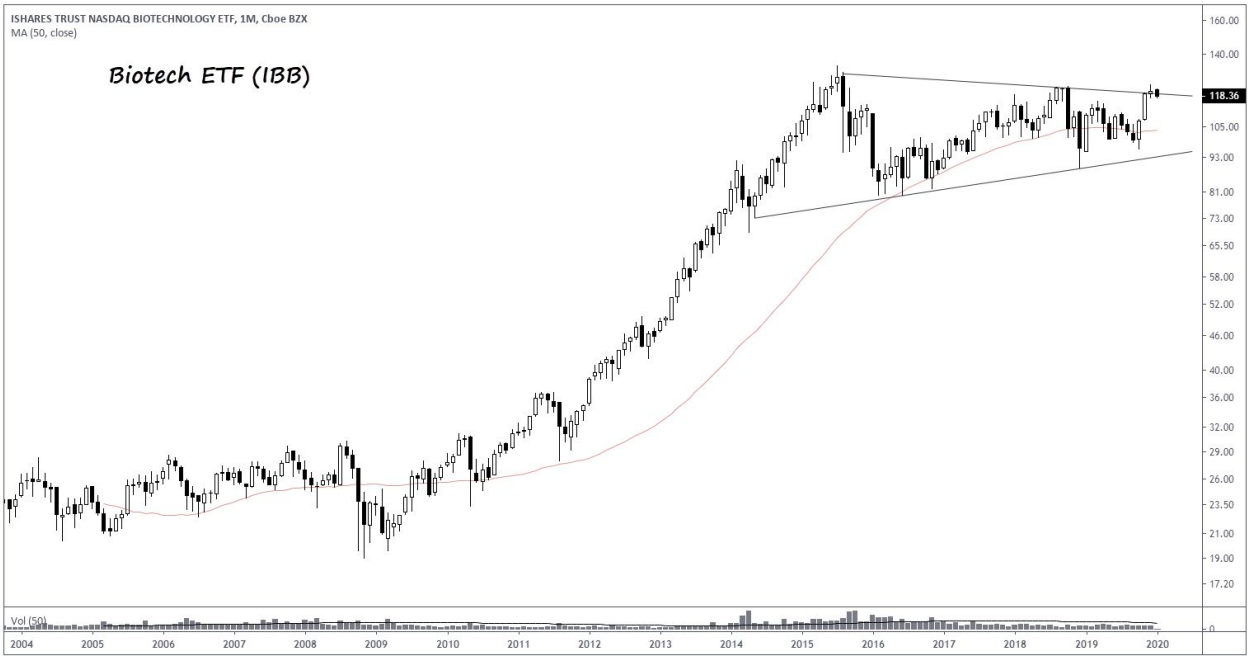
I think Mexico will be one of the better-performing markets this year. Stocks like FMX are worth keeping a close eye on.

Waste Management (WM) is keying off its 200-day moving average (red line) and has just broken out of a tight 6-month bullish wedge.

Baozun (BZUN) is a Chinese tech company that helps foreign brands with their e-commerce initiatives; things like marketing, e-store management, inventory management, and warehousing and logistics.

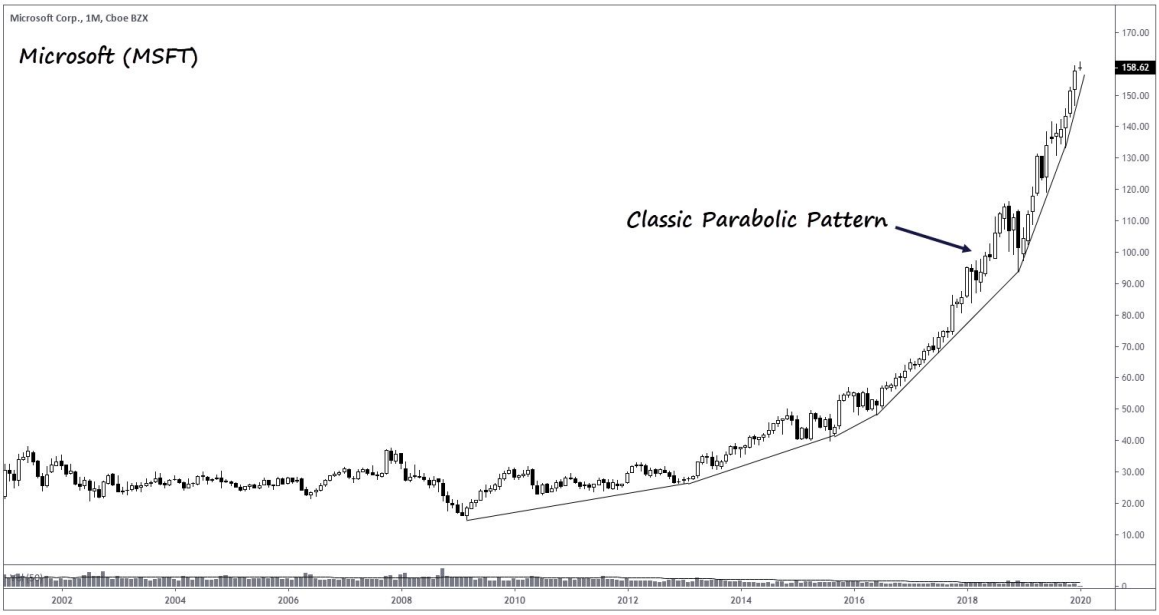
The company is growing revenue at 35% YoY, services revenue at 38% YoY, and adj. net profit at14% YoY.

The biotech (IBB) sector is setting up nicely (chart below is a monthly). IBB has gone sideways for the better part of 5-years. That's a big springboard should the ETF breakout from here.



Remember how fund managers are grossly underweight Industrials (XLI). This monthly chart shows XLI has completed a 2-year long inverted H&S pattern and has clear skies ahead.

Lastly, look at this chart of Microsoft (MSFT). It's formed a classic parabolic blow-off top (chart is a monthly). Parabolic patterns tend to reverse to the downside just as quickly as they climbed on the way up once the line is broken.



Portfolio

Disney (DIS) continues to trend well. It's consolidating in a 7-week bullish wedge (chart is a weekly). We're still sitting on our full position.

Shipper DHT Holdings (DHT), along with STNG, remain in strong uptrends. The Iran situation should further help an already hot shipping market as the regional risk is likely to divert some shipping routes resulting in longer distances traveled which equate to less available supply. Shipping continues to be my highest conviction play for 2020.

We finished 2019 with a return of just over 27%, helped by a run-up over the last few weeks in a number of our holdings. That's a decent return but we still underperformed the index by a few percentage points. This year we're going to do better.

The Four Pillars Portfolio		2019	YTD			
		27.04%	-1%			
The Core	Fixed Allocation	Market-Timing		Net Position		
Large Cap Equities (/ES_Z or VOO)	25%	0%		25%		
Short-term Bills (/ZT_Z or VGSH)	25%	0%		25%		
Long-term Bonds (/ZB_Z or TLT)	25%	50%		75%		
Gold (/GC_Z or GLD)	25%	0%		25%		
Big Bets	Thematic	Cost Basis	At Risk	Notional %	Risk Point	Last Price
Disney (DIS)	Value	$129.37	Above B/E	22%	$130.00	$146.09
Scorpio Tankers (STNG)	Turn in Shipping Cycle	$35.35	Above B/E	22%	$26.50	$39.74
Albemarle (ALB)	Renewable/value	$69.71	100 bps	11%	$63.70	$73.33
DHT Holdings (DHT)	Turn in Shipping Cycle	$7.67	100 bps	11%	$6.90	$8.42
Luckin Coffee (LK)	Growth/Asia Recovery	$33.18	100bps	8%	$28.90	$37.51
CADUSD (6C Mar' Futures)	FX relative value	0.7565	100bps	70%	0.7467	0.7702
MXNUSD (6M Mar' Futures)	FX relative value	0.0519	100 bps	70%%	0.0510	0.0524

If you've got any questions, let us know in the Comm Center. Have a great week!

Your Macro Operator,

Alex