MARKET TRACTION

Tweets, Trade Wars and Controversies. All Paths Leading to More Volatility?

<u>This Week's Trade Ideas:</u>

***Be careful folks! News is falling fast and frequently!

Bullish Ideas:

(View Webinar) KHC > Kraft Heinz Co. > $62.14 Last. Buy the July 20th 60 Calls for $3.30 or less with a close or anticipated close above $62.65 in an up market with expectations for continued strength in the major indices.

AND/OR:

(View Webinar) OC > Owens Corning. > $67.04 Last. Buy the July 20th 65 Calls for $3.85 or less with a close or anticipated close above $67.84 in an up market with expectations for continued strength in the major indices.

AND/OR:

(View Webinar) HAIN > HAIN Celestial Group > $29.46 Last. Buy the Jun 20th 29 Calls for $1.65 or less with a close or anticipated close above $29.67 in an up market with expectations for continued strength in the major indices.

<u>Bullish Mentions</u>:

(View Webinar)

CVS Trigger = > $71.33, USB Trigger = > $52.23, MNK Trigger = > $20.25, CBOE Trigger = > $106.08.

Bearish Ideas:

(View Webinar) LVS > Las Vegas Sands > $79.34 Last. Buy the Jun 20th 81 Puts for $3.20 or less with a close or anticipated close below $79.05 in an up market with expectations for continued strength in the major indices.

<u>Bearish Mentions:</u>
(View Webinar) V* Trigger = < $133.05 (Counter-trend), UTX Trigger = < $124.17, ABBV Trigger = < $96.93, CVX Trigger = < $123.84.

We're noting this AGAIN!

… if you decide to become or remain involved, you must remain nimble!!!

The recent tweets and trade war developments have made this abundantly clear!

We strongly suggest viewing this week's **Morning Call** webinar for full details with respect to these idea(s), last week's and options education.

MARKET TRACTION

Week 21 of our Special Note:

Swing trading in an environment like this one can be very challenging and clearly the news, that we can't foresee and time, is driving stock movement, mostly downward! We've tried to make remaining nimble a focus here in the newsletter and in our **Morning Call** webinar. In fact, we left this here last week:

The markets have become increasingly driven by news and tweets that we can't know of in advance. *Not losing a great deal of money is a very important part of the process of making money over time in the markets!*

It couldn't be any clearer than that and that's exactly what we've witnessed. Be smart!

Outlook:

From last week's Outlook:

"All this means that gaining bankable visibility may be very challenging for swing traders this week."

The BIG and KNOWN events from last week came and passed and all they really did was to remove the short-term overboughtness from the markets. By Thursday's close, we had NOKO, the FED and the ECB out of the way and the SPX was barely off the recent highs. However, once the trade wars reemerged on Friday and since, the indices have been slammed lower. All are try8ing to hold some level of support. We'll see if they can soon enough. The recent run higher barely took a breath over two weeks of trading. We need to see if this a basic and overdue pullback or something more. Once again, we'll be called on as traders to be ready to react and react quickly at times. Banking and rolling even more aggressively when significant profits have materialized is something we do when the market experiences a pick-up in volatility. Why? Because we never know what news will hit the tape next. When in doubt, we take the money and run and hope for more but knowing we can't give it all back.

Technicals:

Will be discussed in-depth in the **Point Morning Call** webinar.

Fundamentals:

These trade idea(s) and mentions are technically-driven.

(Editor's note: These trade ideas may be updated periodically, in keeping with market conditions. It is intended solely for educational purposes.)

MARKET TRACTION

Recap of Last Week:

Last week was another less than ideal one. We didn't make anything official due to the oozing out of news from every crack in the markets. We decided to have names at the ready on both sides, bull and bear, thus allowing traders to select from those that were working in whatever environment held sway in the markets. After remarking that we were short-term overbought, we had no idea how many would agree and begin selling! The bull side simply couldn't have been considered at all last week. The S&P 500 topped out last Monday and has remained heavy ever since. As we can't be sure as to whom does what, we put out a comprehensive update just in case some made highly personalized selections. However, all names that were selected from Thursday onward had to be from our bearish mentions.

Our bullish mentions, **MGM, WMB, SJM, SCI,** and **NFX,** have largely held their own during a strong market selloff. That's fine we suppose, but we're not much interested in them when the bears are in control. Overall, if you decided to play the bull in them, you didn't get smoked but you should be happy with NOT losing because you've been fighting the dominant trend of the past week!

On the bear side, we had these: **(V, MA, AMTD, ETFC – financially related/***Counter trend/reversal ETFC trades), OLN, ECL, VIRT, NOV.**

V and **MA** have been stubborn and barely fallen which is often the case with counter-trend ideas. **AMTD** and **ETFC** though, have, and quite nicely at least in **AMTD's** case. ECL, VIRT and NOV also fell, but the gang seems hell bent on marching them back up when they do. So, those are somewhat disappointing. **OLN** however, was the best of that remaining lot. **OLN** fell as we'd hoped and that's really about it.

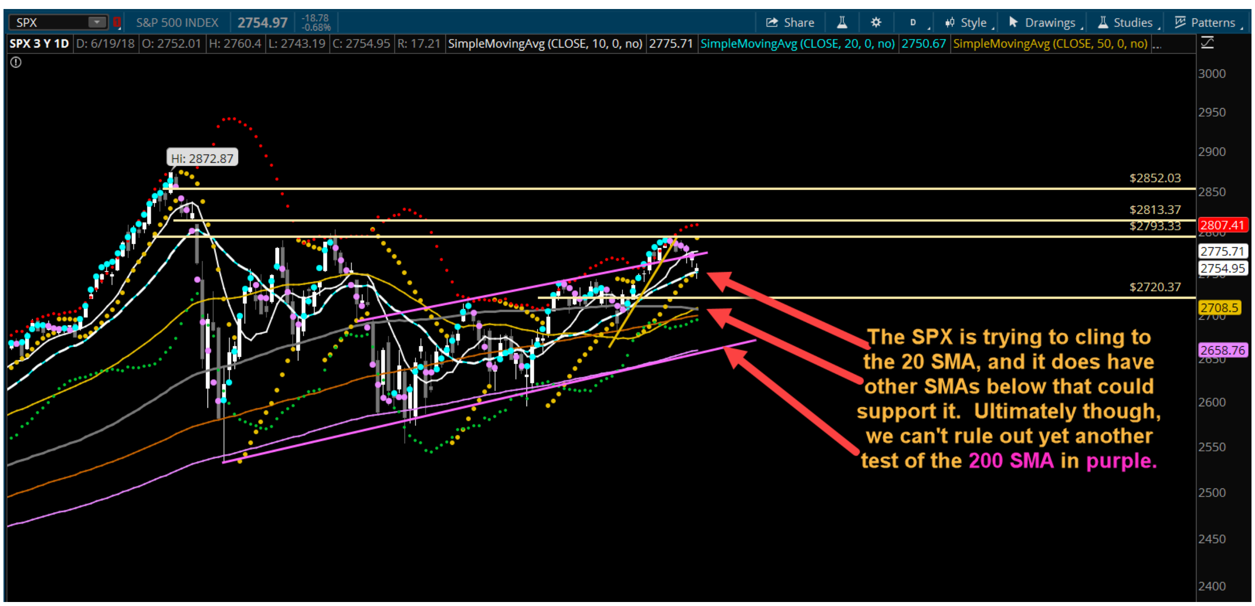
So, the wrap is: bullish mentions were a "no go", bearish financial mentions were "nothing special" with one standout, and the rest were boring and forgettable save for **OLN**. If you picked the best ones you did fine but if you liked all the bears, several left you frustrated. We can live with last week because it amounted to a guessing game and we didn't lose. We're not happy when not trading just like all other traders, but we know that sometimes we must sit on our hands for better long-term results. Last week reminded us of that fact yet again. There wasn't a lot to be had unless you guess that Trump would erupt with tweets as the week drew to a close.

Market Overview

Last week we arrived at a juncture where we concluded that the indices were somewhat short-term overbought but that the “bigger picture” was still improving. However, we also included this blurb:

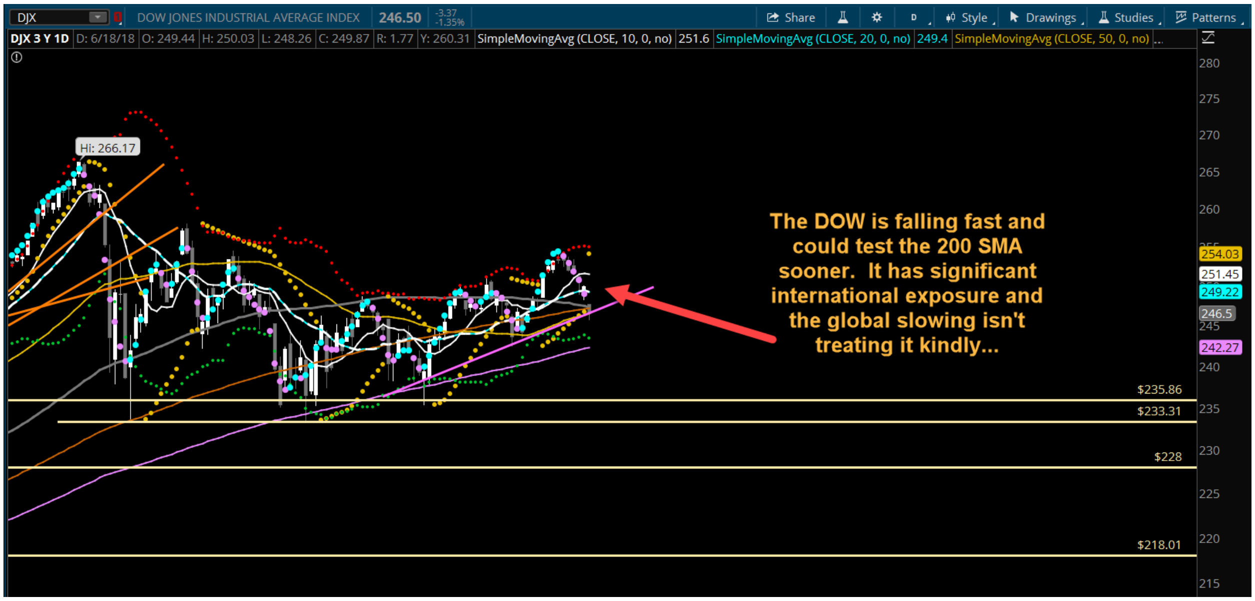
As a final reminder for now, because we do realize we’re beating this drum too loudly and too frequently, ***anything we formulate now can be reduced to smithereens in no time by news that we cannot know until after markets have already popped or dropped in a big way.*** *Certainly, news can drive markets at any time, but if it should this week, we can’t say we had no chance to see the steamroller before…*

The markets have been nothing but heavy since last Tuesday’s publication. The obvious news came and passed, and it didn’t help equities, but it didn’t crush them either. The short-term overboughtness was removed from the market with Thursday’s close. However, ever since, that’s when things really picked up on the sell side. Stocks have been pounded for the last 3 days but as we write on Tuesday, we wait to see if the DOW can hold its 50 SMA and the SPX can hold its 20 SMA. What brought about the reduction to smithereens? Why Tweets and Trade Wars of course! Both are items we’ve noted, often jokingly, that can wreak havoc on the markets, especially in the short-run. And, that’s exactly what’s happening. Each time the markets awake, there’s another shoe dropping in Trade War Land. We were uncomfortable last week when it came to time propose official ideas for this reason. We had the obvious “on the calendar” news drivers to be concerned with but we also sensed that something like we’ve witnessed for the past few trading sessions was also lurking. With Trump, the risk of sudden news hitting the tape is greater than we can remember, ever. So, if you pass right by our “**Special Note**” with respect to trading in this marketplace, that’s somewhat understandable but knowing that unforeseen news can upset the apple cart more than ever, we’ll keep those warnings in their places. It’s time for a look at the S&P 500:



We’ll let our caption do the talking. We think it’s all right there. Short-term overbought last week but on our way to short-term oversold? We shall see. The picture varies depending on what we look at. For example, the DOW is almost in free fall:

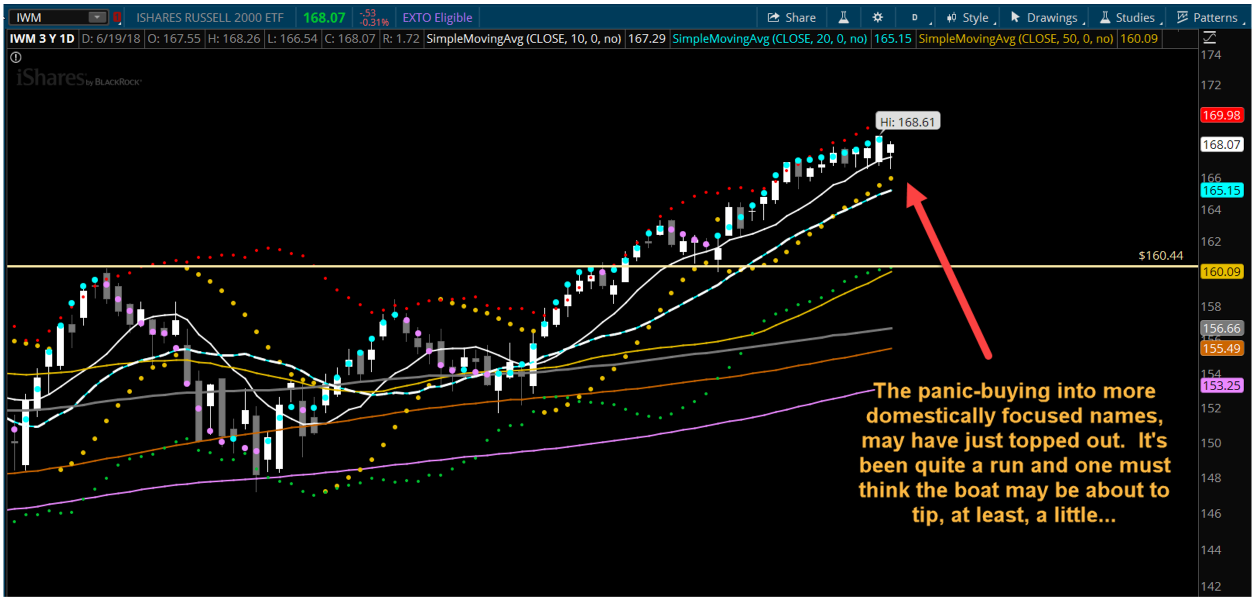
MARKET TRACTION



Yet, the NASDAQ aka "Tech Land", is still in the stratosphere:

So, we can see that the gang has positioned themselves in NDX stocks and driven them to ATH's, but they've done the same in the domestically weighted Russell 2000 (IWM) as well:

MARKET TRACTION

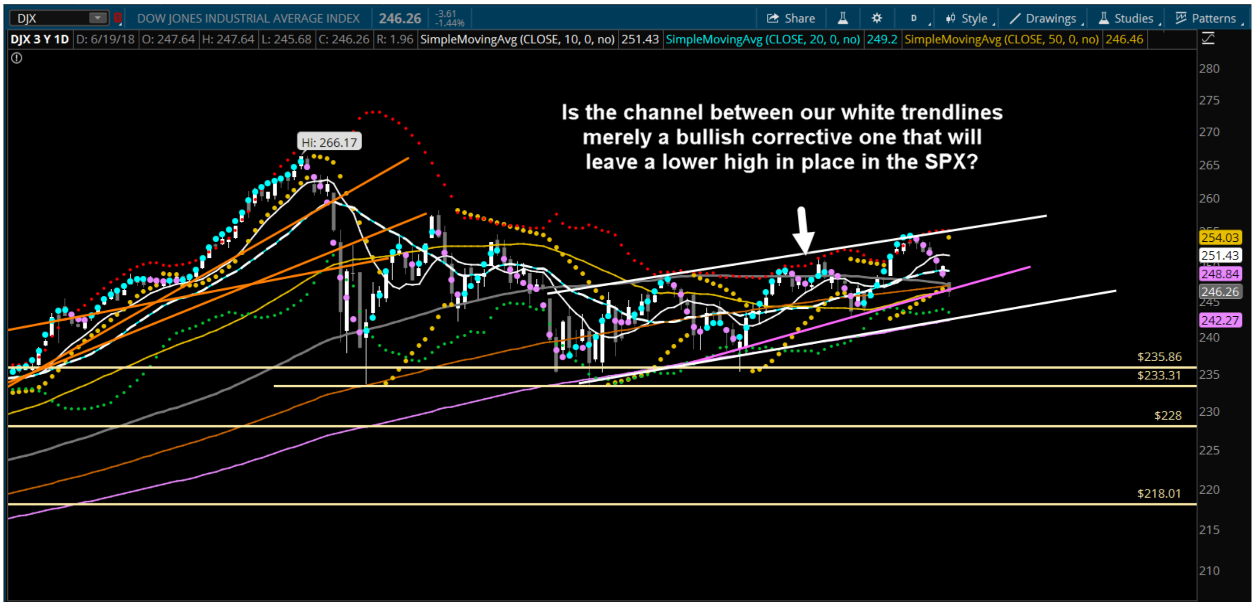


We must note, that thus far, it's the typical: *What? Me worry? Not a chance…*

So…who's right? Those nonplussed by the selling or those that are early bulls in the VIX. The trade wars and tweets haven't ebbed yet but the VIX is acting as if they will…so far…

We don't believe it is over yet. However, we do believe that it is in all major parties' best interest to get it sorted out and quickly. In the major market, the SPX, we can't yet know if we've merely been in a bullish but corrective channel. If so, more waves of selling are due to hit.

MARKET TRACTION



We have to keep monitoring and going with the flow, it's that simple. Since the move downward has been in place for a while, we'd normally expect at least a bounce. However, that will depend on what news hits the markets next in all likelihood.

The calendar is fairly-consistent throughout the week and it could contain reports that will be used to move markets but the trade wars and the US bond selling but big international players (CHINA) could continue to spook the bond markets which could continue to spook the equity markets. This summer isn't a lazy one it would appear, at least here at the start of it. After a few fairly-boring weeks in a row, last week seems to have pushed the markets become more alive. We shall see if they remain so…

This Week's Economic Calendar

TIME (ET)	REPORT	PERIOD	ACTUAL	MEDIAN FORECAST	PREVIOUS
MONDAY, JUNE 18					
10 am	NAHB home builders' index	June	68	--	70
1 pm	Raphael Bostic speech				
TUESDAY, JUNE 19					
7 am	James Bullard speech				
8:30 am	Housing starts	May		1.300 mln	1.287mln
8:30 am	Building permits	May		--	1.352mln
WEDNESDAY, JUNE 20					
8:30 am	Current account	Q1		--	-$128bln
9:30 am	Jerome Powell panel discussion				
10 am	Existing home sales	May		5.52 mln	5.46 mln
THURSDAY, JUNE 21					
8:30 am	Weekly jobless claims	6/16		220,000	218,000
8:30 am	Philly Fed	June		29.0	34.4
9 am	Neel Kashkari speech				
10 am	Leading indicators	May		--	0.4%
FRIDAY, JUNE 22					
9:45 am	Markit manufacturing PMI (flash)	June		--	56.4
9:45 am	Markit services PMI (flash)	June		--	56.8

Below the Radar

Much of the *good vibes* that we focused on in last week's abbreviated **BTR**, are still there, but they've receded into the background thanks to trade and tweets. Risks we've mentioned many times. The markets care about them temporarily, then digest them, then ignore them, until the next tweet storm. Such is trading life in 2018!

Last week, we thought about things and noted that we could still see a run to challenge the all-time highs. We have witnessed a new ATH in the NDX, but the DOW and the S&P 500 haven't been able to muster one. Is it over? Have the lower highs that registered in the two latter indices shown us the best we'll see? It's too soon to tell. We can't yet say if we're experiencing just a pullback here or that we're about to see cascade selling that will take the S&P 500 down to the 200 SMA, which, would be much more troubling.

This week will be a little bit of a mainly-Chinese smorgasbord of news in **BTR,** as once again, the "here and now" news is pushing markets and commentators are covering those developments more than speculating about future issues.

This isn't breaking news today, but we didn't want to skip by this on our way to Asia:

REAL ESTATE

REAL ESTATE | HOUSING | MORTGAGES | CONSTRUCTION | COMMERCIAL REAL ESTATE |

US house prices are going to rise at twice the speed of inflation and pay: Reuters poll

- An acute shortage of affordable homes in the U.S. will continue over the coming year, according to a majority of property market analysts polled by Reuters.
- The shortage is driving prices up faster than inflation and wage growth.
- Annual average earnings growth has remained below 3 percent even as house price rises have averaged more than 5 percent over the last few years.

https://www.cnbc.com/2018/06/06/us-house-prices-are-going-to-rise-at-twice-the-speed-of-inflation-and-pay-reuters-poll.html

The same type of insanity that drove the housing bubble is driving it again. The actual drivers may be different, but the absurd pricing is much the same. Markets don't behave like this absent bubble conditions. Now that we have that out of our system…

Meanwhile, China is all over the news. Most know about the headline stuff they're doing:

https://www.zerohedge.com/news/2018-06-15/china-strikes-back-retaliates-50-billion-tariffs-us-goods

Naturally, Trump fires at them and they fire back. Where does it end? Unknown. But, while it continues to flare, the US equity markets get hit and hit hard on breaking news. Folks have now begun to speculate as to what China's next move will be:

https://www.zerohedge.com/news/2018-06-19/here-are-six-ways-china-could-retaliate-trade-war-us

None are "good" but number 6 has many experiencing insomnia, like never before:

There are 6 possible things that China can do at this time, in order of escalating severity:

1. **China could de-escalate tensions by presenting a list of actions it will follow to reduce its significant trade deficits *in services* with the US.** This could affect education service institutions, the local tourist industry, and entertainment. However, as the CFR's Brad Setser writes, it increasingly looks like the Administration is putting China in a position where China cannot make concessions without appearing to cave - which most think China won't do. Setser, not alone, has trouble seeing a de-escalation option if Trump goes through with the $200b
2. **China will likely launch an economic subsidy for its economy in the form of further easing in financial conditions to offset any potential trade-drag.** Some, such as Deutsche Bank have proposed that in order to offset the negative hit to its consumers, China will loosen policy such as tolerating the property and land market boom in tier 3 cities and cutting the RRR twice over the rest of this year to partly offset the potential drags. This would also involve a modest devaluation of the Yuan.
3. **China could unleash differential treatment of local enterprises**: as some have suggested, Beijing could simply opt not apply its "market access liberalization" policy recently announced. This could greatly disadvantage US firms greatly. Beijing could also engage in an aggressive crackdown on US firms operating in China (Apple), hinder border passage of US products (automotive), or pursue antitrust and monopoly allegations against US tech names (Micron).
4. **China could also choose a diplomatic retaliation,** and order Kim Jong Un to scuttle the recent agreement North Korea signed with the US, humiliating Trump by showing that it was Beijing all along who made the US-N. Korea summit possible and successful.
5. **China could pick an aggressive route, and instead of a mild depreciation, it could aggressively pursue a weaker Yuan to boost trade competitiveness**: which, ironically, is the catalyst behind much of the Trump administration's animosity toward China. To achieve this, China would relaxing some of the capital control measures that have helped strengthen the renminbi in the past 2 years. That said, such a move would unleash sizable outflow demand, while boosting precious metals and cryptos. The US would also brand China a currency manipulator.
6. **China, finally, could pick the nuclear option, and gradually or suddenly liquidate its Treasury holdings.** This is a long-running worry by markets given China's $1.2 trillion in Treasury holdings. In January, Bloomberg reported this was a possibility which was at the time denied by China State Administration of Foreign Exchange; however the recent liquidation of half of Russia's Treasurys was seen by some as a rehearsal for what would happen if Beijing decides to pursue this approach.

Supposedly, the Russians dumping US treasuries in April caused bond prices to fall and yields to rise. The yield curve has been watched much more closely over the past 9 months than the prior 9 years so the yield curve flattening continues to worry some. Russia is "small potatoes" when it comes to US Treasury holding whereas China is the "Big Kahuna". The thought is, if the Russians tested the damage they could inflict on US markets on behalf of the Chinese, then… YES, then. That's scary stuff to contemplate given how dependent the US economy is on debt funding. Naturally, this has many worried and beyond. But the Chinese aren't without their own domestic economy issues:

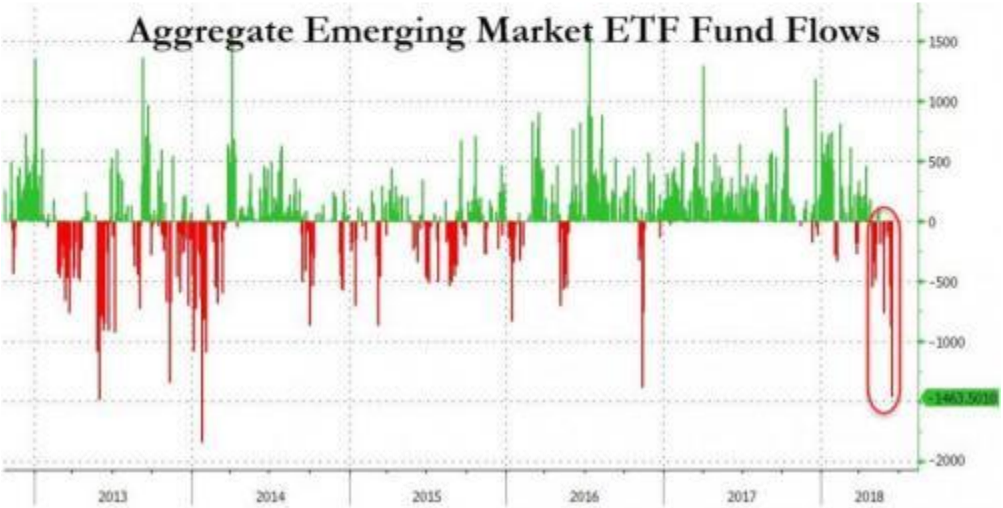
http://www.chinadaily.com.cn/a/201806/19/WS5b28aa8da310010f8f59da49.html

Once the planners begin "tweaking" things, it seems like it never ends…because it doesn't. And, with the turmoil only ratcheting up as the global growth cycle seems to be slowing down, things are getting uglier beyond the borders of the USA:

https://www.zerohedge.com/news/2018-06-19/emerging-market-contagion-goes-global-fund-outflows-spike-most-over-4-years

Panic selling is becoming the order of the day in Emerging Markets. We've discussed EM charts as having had weakness in them over the past 4 months, but now, it's really accelerating to the downside:

MARKET TRACTION



And that may be just the start of things:

YES, they've fallen, but, if they re-couple, there's a very long way that Emerging Markets stocks can fall! And that, could really start to trigger selling in other "healthy" places!

Other "things" are being ditched too, like the US Dollar. This is small stuff, but it certainly doesn't help debt-dependent USA:

https://www.zerohedge.com/news/2018-06-19/russia-and-india-ditch-dollar-military-deals

We've noted that the financials haven't looked as good as other areas and their struggle has left us concerned in at least some ways. Well, others are feeling that too and they're thinking that if financials don't right the ship soon, other equities will need to readjust lower to *sync-up* with financials. The corporate yield curve is inverting and that's potentially *big stuff*. You can read all about it here:

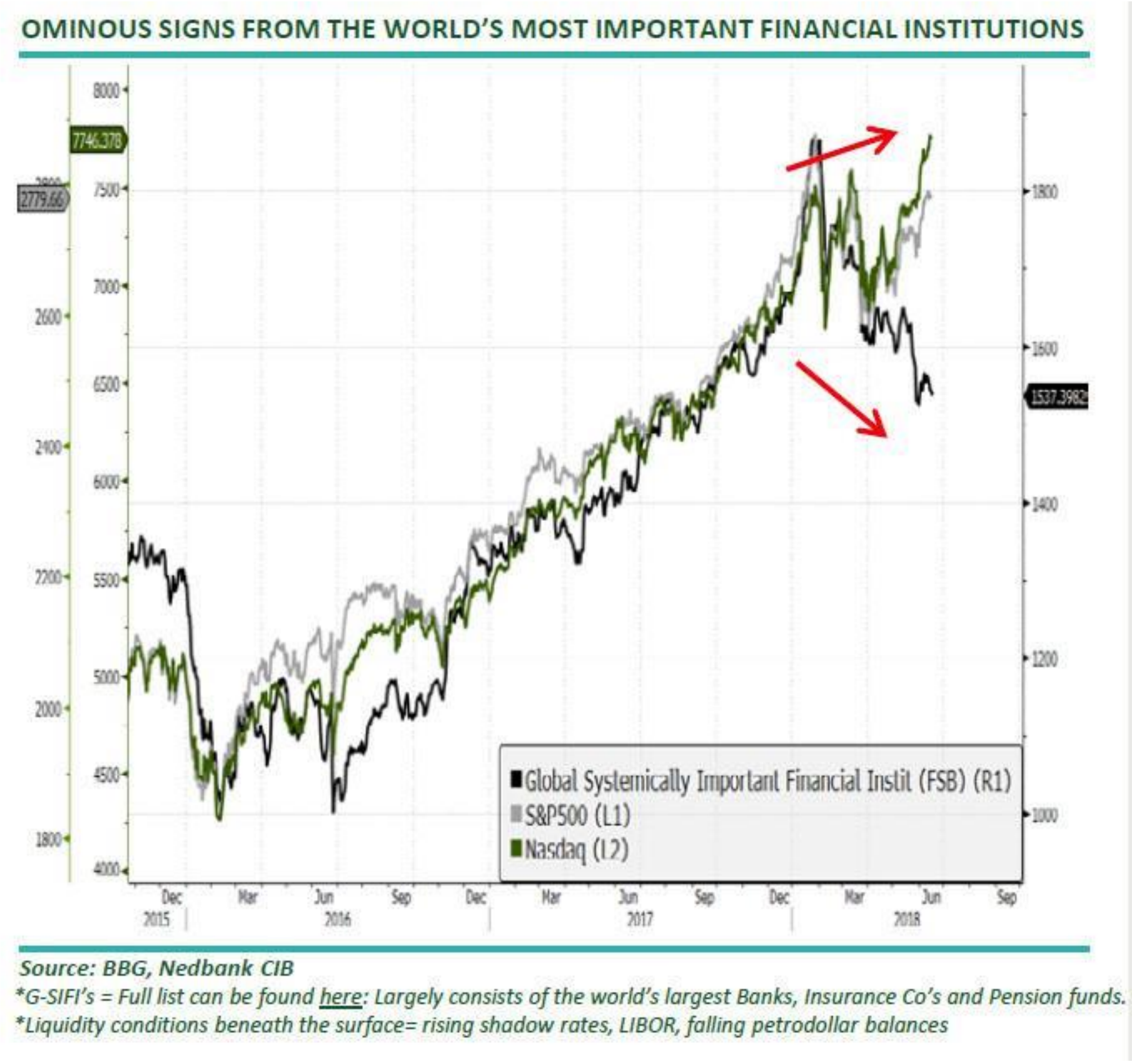
MARKET TRACTION

https://www.zerohedge.com/news/2018-06-19/corporate-yield-curve-has-just-inverted

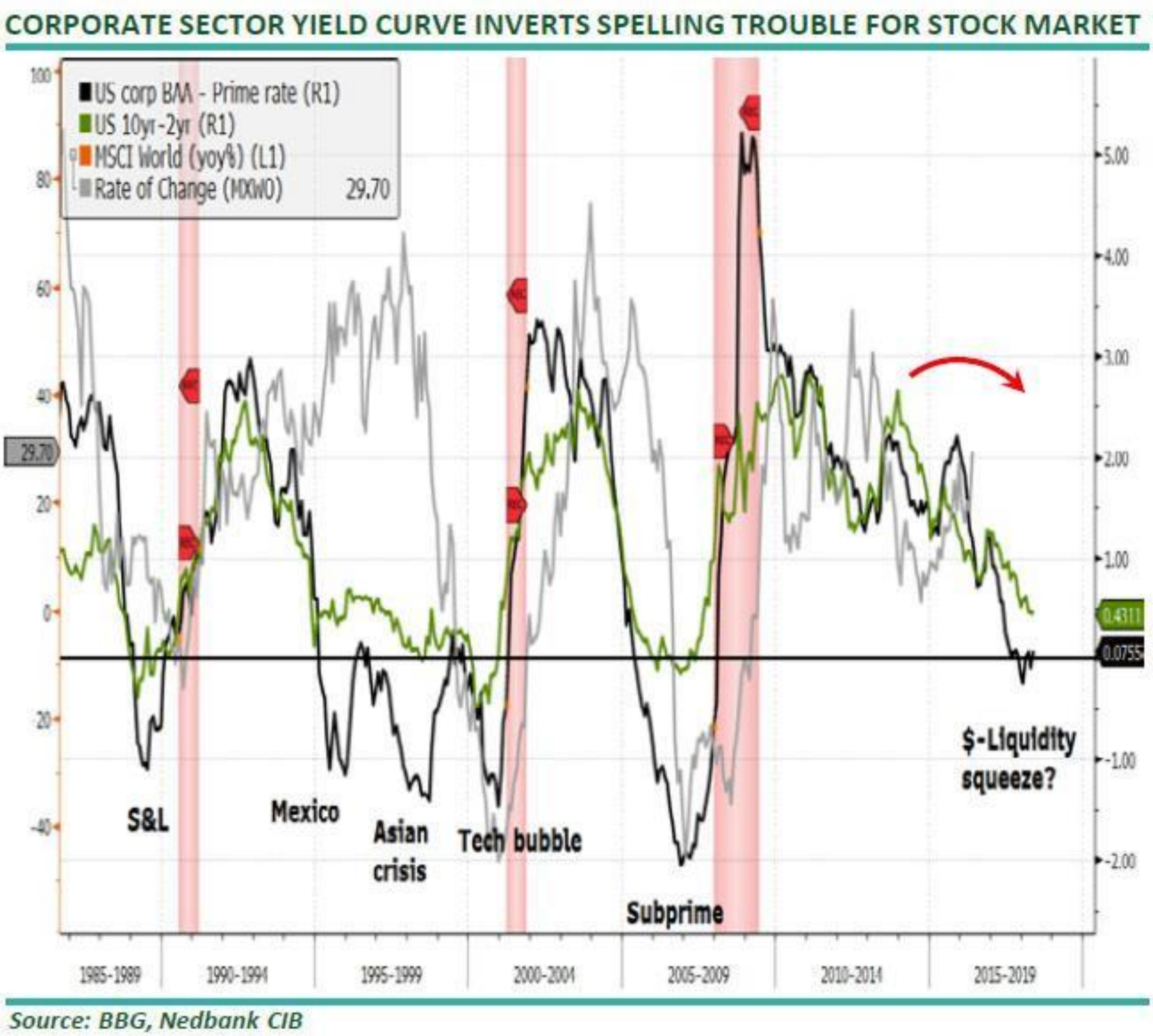
However, we've decided to include a few morsels from the piece because this is the stuff that major selloffs are made of:

... Nedbank analysts Neels Heyneke and Mehul Dahya picked up on this topic, and in the latest note write that with the market-weighted cap index of the FSB's G-SIFI's starkly decoupling from the S&P 500 and the Nasdaq since the beginning of 2018, and nearly entering a bear market, or down 18%, they warn that **"this decoupling will be sustainable. Either the rest of the equities must come under pressure or the financial sector must rally."**

And while we noted much of this last week, a more interesting observation by the Nedbank analysts is that **the corporate sector curve (*Baa-rated Corporates less the Prime rate*) has now inverted.** The implication of this is just as profound as a sovereign yield curve inversion as it means that **"the cost of capital for corporates is now higher than the return on capital."**



MARKET TRACTION



Their conclusion: "**Corporates are highly geared and we are concerned the next phase of a contraction in global $-Liquidity and rising real rate (term premium) <u>will infiltrate the stock markets.</u>**"

Well, the dollar just hit a fresh 2018 high, and stocks are tumbling, so **<u>once again the shape of the yield curve may very well be all we needed to know what happens next.</u>**

It just keeps getting more and more challenging out there!

Be Smart & Stay on it!

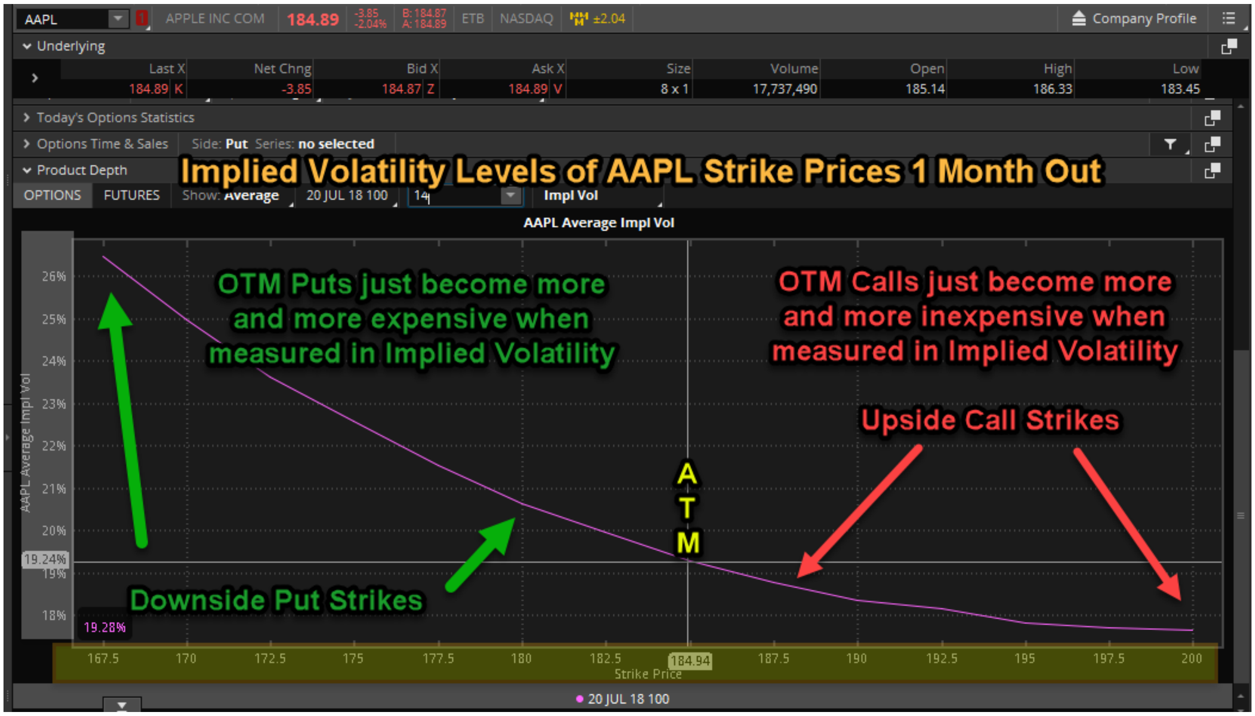
Bank and Roll!

MARKET TRACTION

Options Academy

Last week we discussed options *skew* and the *Upside Call vs. the Downside Put*. We finished up by noting we may pursue things a little further this week, and, we shall!

Last week we wrote up quite a bit of prose on the subject and had to cap things out. This week, we decided that a graphic may go a long way in helping us to SEE the skew we discussed so thoroughly.



We captured a graphic of Apple options with a July 20th expiration, thus, about 1 month out in time. Please note that the strike prices are on the horizontal axis and the implied volatility levels of each strike price resides on the vertical axis. Naturally, we labeled the **ATM** strike for reference.

Right away we can see how dramatic the difference in *price* (measured in IV terms) there is when **UPSIDE** calls are compared to **DOWNSIDE** puts. With Apple's stock price very close to $185.00, the $190.00 strike is about $5.00 away to the upside and the $180.00 strike is $5.00 below the ATM. Notice that the 190 strike is trading close to an 18% IV level while the 180 strike is close to a 21% IV level. That may seem like only 3% in implied volatility terms, and it is, but in mathematical percentage terms when comparing the 190s to the 180s, we can state that: The 180s are trading at about 16% premium to the 190s. That's quite a bit of difference.

If we go further upside and then compare to further downside, we can see that the $195.00 strike is trading below an 18% IV level while the $175.00 strike is trading above a 22% IV level. If we round off the difference and compare them, the 175s are trading 4% higher then the 195s in IV terms. That works out to the 175s trading at about a 22% premium to the 195s. If we continued this exercise, the premium percentage would continue to grow thus reflecting what we discussed last week. In a nutshell, last week's discussion focused on the natural inclinations of investors to sell upside calls and to buy downside puts as insurance. We see that almost perfectly reflected here in the prices of AAPL options. The upside strikes are much cheap in IV terms than the downside strikes. Next week perhaps, maybe we'll delve into *no skew* and possibly beyond.

If you have questions, ask away in this week's **Advantage Point Morning Cal**l webinar. 😉

Here's a reprint of last week for reference:

In keeping with our recent riffing on "moneyness", we decided that it couldn't hurt to pick up on it one more time to highlight a little more of an option trader's lexicon and tools within his/her toolbox. To wit, we're going to touch on something that pro traders discuss often, that's not normally a focus of the individual traders. And, that would be "the upside call and the downside put". Let's proceed…

The Upside Call and the Downside Put are important in the minds of pro traders because they can inform them as to what direction and risks market participants may be focused on. How these have to do with moneyness is as follows:

The Upside Call, depending on with whom you're speaking, refers to an out-of-the-money call that is upside from where the stock price is currently trading and carries a certain delta. For some, it's the 30 delta call but for others it can be a little more or a little less in terms of delta.

The Downside Put, again, depending on with whom you're speaking, refers to an out-of-the-money put that is downside from where the stock price is currently trading and carries a certain delta. For some, it's the 30 delta put but for others it can be a little more or a little less in terms of delta.

Upside calls and downside puts can be referred to in group form as well, as in, "the upside calls", which would describe calls within a certain OTM delta range. The same is true and holds for downside puts.

Why this is important has to do with the concept of skew, which, is something valuable to become informed by. Skew, in options parlance, refers to how expensive or cheap some options are with respect to others. That is, all options are not treated the same with respect to their pricing. But, in getting back to the Upside Call/Downside Put issue, the larger point is that these options are OTM (100% extrinsic/time value) but they're not too far OTM that they're worth very little. There's still a decent amount of time-value meat on the bones of most 30 delta options with any reasonable amount of time remaining to expiration. For this reason, this delta-range, on the call side, can be a favorite of call writers (sellers) that like to consistently sell premium against their stock holdings to generate an income-based return with regularity. For now, let's establish that these are favorites of premium collectors that regularly bang on their bids to increase their returns. In a nutshell, these are the happy hunting grounds for covered-call players, of which, there are VERY many. As this is the case, the market-makers, knowing the proclivities of the masses, will often discount these calls relative to other options on the board because they know they're most likely going to have these calls sold to them and they don't want to buy OTM ("longshot") options that are 100% time-value because that's stacking some serious odds against the market maker's chances of profiting! So, quite simply and literally, these types of calls trade cheap. When we analyze the implied volatility levels that 30 delta calls trade at relative to ITM calls, we'll typically find that they have significantly lower IV levels vs. their ITM counterparts. The markets anticipate the intentions of market participants and thus they discount the prices accordingly. Let's not forget the very basics: More supply = lower prices! And that's really it. 30 delta calls are often in great *supply due to the natural tendencies of so many who desire to sell them. Now, let's move over to the flip side, in this case, puts…*

As usual, it's a different story with puts than calls. The 30 delta put is normally held in higher regard than the 30 delta call because most investors are long/own shares of stock and when they become concerned with respect to stock market risks, their first instinct is to reach for insurance that's not too far away (in terms of strike price) and not too expensive (in terms of dollars). Of course, that's essentially what a 30 delta put looks like when evaluated against other options. Thus, a 30 delta put is naturally and regularly bought by a large number of investors to protect their stock holdings for a period of time. Market makers are aware of this behavioral tendency and thus they naturally raise the price of the OTM puts because they know they're much more likely to be called upon to sell those puts to Nervous-Nelly market players. Moreover, this will result in those types of puts trading on a much higher implied volatility level than other puts respectively and certainly a much higher IV level relative to the upside call. Hence, we have Upside Call / Downside Put implied volatility skew.

So, to summarize to this point and weave more skew into the mix, the IV level the Upside Call trades at vs. the IV level the downside put trades at, should show a skew in pricing that reveals "cheap calls" and "expensive puts" on a relative basis. That's the normal skew we'd expect to see during normal times.

With this in mind, the next time you're looking to sell calls to profit from premium collection and you notice that you can't sell them for as much as you hoped to, realize that you're in line with many other call writers and the marketplace isn't going to let sellers of calls clean their clocks without defending themselves! Nor are they going to allow insurance-seeking put buyers to swoop in and transfer big-time downside risk to them without a fight either! You will be paying a premium (in relative pricing terms) if you're in the queue with all the other opportunistic and timely insurance buyers!

Perhaps next time, we'll expand on skew in some ways and discuss what we should be thinking if there's no skew at all!