The Kobeissi Letter

Week of June 5th, 2017

By Terry from uk - Clear up day uefa 15 May 2008 manchester, CC BY 2.0, https://commons.wikimedia.org/w/index.php?curid=4073587

Stocks remain in record territory

The S&P 500 closed the week up 2.46%, at 2,439, as a variety of economic data was reported. We saw the labor department report that 138,000 jobs were created last month which missed expectations of 185,000. Wages were reported to have grown at a 2.5% annualized rate which also missed expectations. However, this was offset by a drop in the unemployment rate from 4.4% to 4.3%. Another interesting fact that we received from our colleagues at CNBC is that "the U.S. economy has added jobs for 80 straight months now, the longest positive streak dating back to the 1930s." Clearly, the United States economy is doing well even though expectations on some of these numbers were missed. As with any economic data, the focus has now been shifted to what this means to the Federal Reserve board and their monetary policy. Although the numbers were weaker than expected, they still indicate that the economy is healthy enough for a June interest rate hike. In economics, a 5.0% unemployment rate is considered "full employment" and we have beat that expectation significantly. As we have been saying for a couple months now, we do expect a June interest rate hike but that will be the last one of 2017. Looking forward, we are optimistic as ever on the broader markets and our 2017 S&P 500 target now sits roughly 60 points away. The 2417 level is now a point of strong resistance and on any pullback we do want to see that level be held. If a more severe pullback occurs, 2400 is the next strong level of support that should be held. To be clear, we do not expect a pullback of this magnitude any time soon, but these are just important levels to keep in mind. Markets may experience volatility Monday as investors around the world respond to the horrible attacks in London. That being said, we still encourage our subscribers to buy the dips in the market as that has proven to be the best strategy since the election of president Trump. We will keep an eye on economic data and global political tensions going forward as these are the two biggest drivers in the market that we trade today.

WTI Crude Three Month Graph
graph provided by Marketwatch.com

Oil tumbles as OPEC production RISES

WTI crude marked a 5.93% loss for the week as Libya and Nigeria, who are not a part of the OPEC deal, reported rising production levels. This excess supply is detrimental to the oil markets as we now have rising OPEC and non-OPEC production levels. In addition to this, the Trump Administration decided to withdraw from the Paris Climate Deal which caused speculation about even further ramping of U.S. crude oil production. The inventories this week were surprisingly bullish. U.S. crude oil inventories marked a draw of 6.4 million barrels while a 2.5 million barrel draw was expected. Gasoline inventories fell by 2.9 million barrels with expectations of a 1.1 million barrel draw. These numbers were, like last week, taken with a grain of salt as U.S. rig count rose by 11 to 733 total operating rigs in the United States. This is the 29th rise over the last 30 weeks. The CFTC also reported that long positions in WTI crude rose by 800 to 373,800 and this number indicates that once WTI crude falls further, there will be a much more fundamental selling and liquidation. The main level that investors are watching globally is the $45 level and that is the point where we will see large liquidation of long contacts. Furthermore, we still do not see how the most recent OPEC deal presents a bullish picture for the supply and demand market as United States and other non-OPEC nations' oil production is rising quickly to compensate for these OPEC cuts. We do expect the commodity to fail here and fall to $44/barrel and we will assess the situation at that point. From a technical perspective, we do not expect any bounce in the commodity to rise about the 50 day moving average at $49.02. To the downside, once we break below the $47 range it will be a straight shot to $45. We maintain our short positions and plan to add to them if any bounce occurs on Monday.

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The Editorial Staff's Trading Recommendations

1 Long S&P 500: The S&P 500 now sits only 60 points away from our 2017 target. We continue to buy all dips in the market.

2 Short WTI Crude: The technical and fundamental pictures are incredibly bearish.

3 Neutral of gold in U.S. Dollar Terms: We expect a pullback to $1,250, but then a bounce $1,300. We watch the gold miners closely.

4 Short U.S. Treasury Yields or Long of Bonds: We believe the rally in treasury yields has been overdone and shall reverse. If bonds rise, treasury yields shall fall which is why we have provided two potential investment recommendations.

From the Editor:

Farewell and Trade Well,
Adam Kobeissi, Founder and Editor-in-Chief

Gold continues higher, miners signal weakness

Gold prices closed the week at 1,280/oz as the dollar continued its slump. Gold rose 1.2% on Friday as the jobs number came in weaker than expected. As many subscribers know, we have been calling for a pullback in gold prices since $1,265/oz to the $1,228 level. That being said, we still do expect this to happen, but we now raise our target to the $1,250 level. A major indicator that a pullback is overdue in the markets was the price movement ratio of GLD to GDX. We saw GDX rise a mere 0.71% which significantly underperformed the commodity itself. We generally expect to see triple the percentage movement in GDX as we do in the physical commodity. This weakness that we saw on Friday is a strong indication that a pullback will occur. The CFTC reported that long contracts rise to 167,100 which marks a significant rise from last week. At TKL, we expect a pullback of 30-35 dollars from our current point which will put as at around $1,250/oz. We then expect to see a bounce from there up to $1,300/oz and potentially even $1,400/oz by the end of 2017. It is important for investors to remember that nothing rises in a straight line upwards and retracement is health in a stock, commodity or index. To be clear, our long term picture of gold remains very bullish, but in the very near term we do expect the commodity to take a breather. At TKL, we also see the Fed becoming more dovish as the year proceeds, which will ultimately lead gold higher. There is a very high chance that the June interest rate hike, that we expect to occur, will mark a bottom in gold prices. Gold in 2017 remains a dollar and Fed driven story and the new "Trump trade" seems to be gold and gold companies. The pullback that we expect is purely a technical driven hypothesis. The long term fundamental outlook on gold remains bullish in our view.

10 year note yield falls below 2.20%

U.S. 10 Year Note One Month Performance provided by Marketwatch.com

U.S. Dollar Index Three Month Performance provided by Marketwatch.com

As the market soars to new all time highs multiple times per week, treasury yields follow. The fact is that investors stopped looking for safety and decided bonds were not the investment to make in this market. The yield on the 10 year note was at 2.16 percent. We saw a break below 2.20% last week on the 10 year note yield and this is what we have been waiting for. Treasurys have been held up by the anticipations of a hawkish Fed and after this week's economic data that is questionable. Now that we saw this 2.20% level break, we see the 10 year note yield dropping to nearly 1.75% by the end of 2017. We see the Fed acting more dovish than markets expect and that will take yields lower and bonds higher. This week serves as a very bearish signal. We remain short of U.S. Treasury Yields and long of bonds.

Keep Your OPTIONS Open:

"Our options trade last week was a great way to cash in on the beginning of a large decline in WTI crude and it rose by over 100% last week alone. We would like to build onto that trade by recommending buying puts on the USO ETF which is the largest single leverage oil ETF. We like this play a lot because it does not have exposure to equities in the broader markets that may be carried higher by the tremendous strength of the stock market. I am looking to buy puts on the USO ETF at a $10 strike price with a July 21st expiration date for $0.49 each. I picked a strike price that is in the money because it allows you to make a greater percentage on an immediate fall rather than looking much further out at a strike price that is out of the money. These puts will be worth much more if oil continues its current route and this is a great way to leverage gains from a large decline. I also see implied volatility on this ETF to rise which will contribute to the value of your put contracts. I think it is a relatively cheap and smart play." - Adam Kobeissi

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