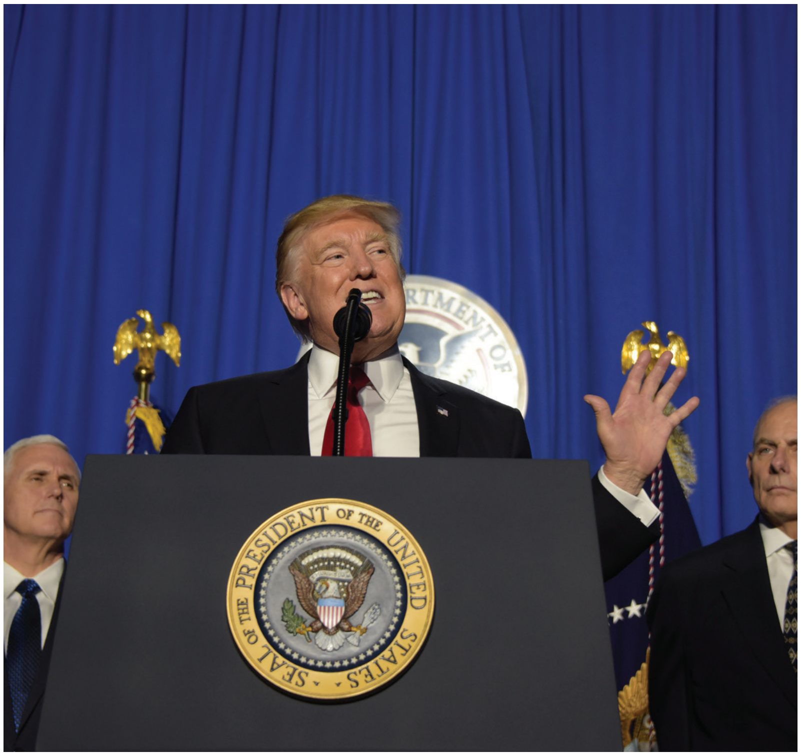
The Kobeissi Letter

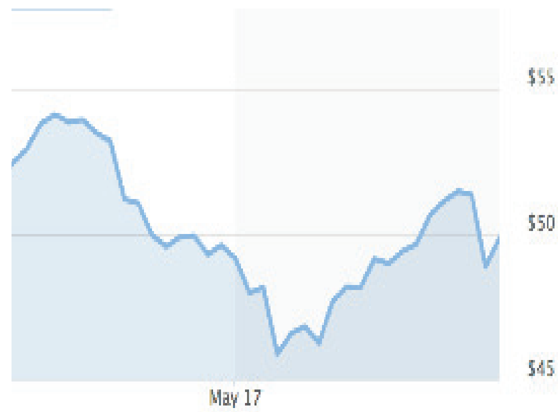
Week of May 29th, 2017



from the DHS

Stocks climb back to new record highs

The S&P 500 closed the week up 1.43%, at 2416, after falling to nearly 2350 last week. We saw aggressive buying in the market leading up to the three day weekend for Memorial Day. This has been a great week for us at TKL as our target of 2415 on the S&P 500 was achieved and held. We Tweeted (@KobeissiLetter) earlier in the week that climbing above 2415 was essential for our 2500 price target as it was a key technical level. Now we need to see this level hold and markets continue to push higher. Many subscribers were asking why the market reacted this way following news that could potentially jeopardize president Trump's presidency. Our answer to that is, the market maintains the mentality that has been present for the last three years, buy all the dips. Investors who have bought the dips in the S&P 500 for the last five years are up 83% and it continues to work. We also saw strength in the markets as president Trump embarked on his journey to several different nations and his approval rating rising to 48%. Furthermore, we received some upbeat economic data with Q2 GDP posting a reading of 1.2%, beating expectations of 0.8%. This has raised market expectations of a June interest rate hike to roughly 85% from low 60s. However, we still expect one interest rate hike for the remainder of 2017. On the other hand, a piece of economic data that caught our eye this week was the housing data. New home sales for the month of April came in at 569,000 which marks an 11.4% decline. Existing home sales also missed expectations of 5.65 million with a reading of 5.57 million. The housing data will be closely watched at TKL as these numbers were very concerning. However, looking forward, we have seen the technical picture in the markets improve tremendously since last week. The key 2350 level on the S&P 500 was held and we claimed the 2415 target. We now look to break above 2430 and establish a support level at that point. An important indicator to watch is the USD/JPY ratio that has been moving almost exactly in sync with the markets. We would like to see that ratio rise to 113 and carry the broader markets along. Our 2017 S&P 500 target remains at 2500 and last week serves as a phenomenal set up from the technical perspective.



WTI Crude Three Month Graph
graph provided by Marketwatch.com

OPEC extends production cuts, oil falls

WTI crude marked a 1.91% loss for the week as OPEC's meeting came to an end and the production cut deal was finalized. OPEC nations and some non-OPEC nations agreed to cut production by 1.8 million barrels per day until the end of quarter one of 2018. WTI crude closed at $49.80 on Friday after hitting $52 days before. U.S. crude oil inventories marked a draw of 4.2 million barrels while a 2.4 million barrel draw was expected. Gasoline inventories fell by 787,000 barrels with expectations of a 1.2 million barrel draw. However, these numbers were taken with a grain of salt as we saw rig count rise by 2 to 722 total operating rigs in the United States which is 28th rise over the last 29 weeks. The CFTC also reported that long positions in WTI crude rose by 44,000 to 373,000 which shows that more fundamental buying has been occurring rather than just short covering. We continue to assert the fact that the recent rally, other than last week, has been almost 100% short covering and that can be deadly to bulls in this market. We have not seen enough buying of long contracts to support this climb crude oil will certainly not hold these levels unless more long contracts are purchased. At TKL, 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. Furthermore, we are not convinced that all OPEC nations will follow the deal as oligopolistic cartels have a tendency to cheat on these types of deals. The inventory numbers will remain a key focus here at TKL. We do expect the commodity to fail here and fall to $44/barrel. Last week we stated that we do not see the commodity rising above its 200 day moving average at $51.96 and that is almost exactly where it failed. The next level we look to break below is the 21 day moving average at $48.87. From there it will be a sharp dive to $45.

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The Editorial Staff's Trading Recommendations

1 Long S&P 500: Last week has served as a tremendous technical set up for our 2500 target on the S&P 500.

2 Short WTI Crude: Crude could be in the low 40's two weeks from now, terrible fundamental and technical set up.

3 Neutral of gold in U.S. Dollar Terms: We expect a pullback to $1,230, but then a bounce $1,300.

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

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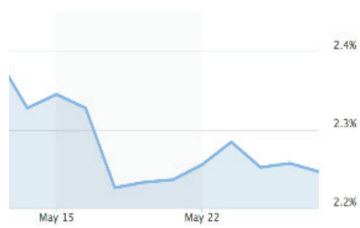
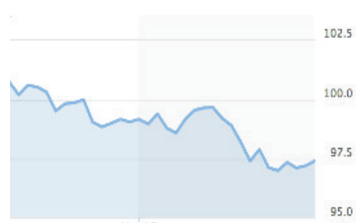
Gold hits multi week highs

Gold prices closed the week at 1,266/oz as the run off recent lows continued. We saw the commodity soar after a large dip in major stock market indices and a rapid rise in volatility two weeks ago and this continued last week. A key report that we like to watch for gold is the CFTC gold long speculative contracts. We saw long contracts rise to 159,800 which marks a 33,000 rise from last week and compensates from the strange dip in long contracts two weeks ago. Despite the large rise in long contracts, we still do believe a pullback is overdue. This pullback will not be severe but a mere few percent. We first anticipate to break below the 50 day moving average at $1,253 and from that point it will be a quick drop. At TKL, we expect a pullback of 30-35 dollars from our current point which will put as at around $1,230/oz. We then expect to see a bounce from there up to $1,300/oz considering the tremendous amount of technical resistance at the $1,230 level. 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. 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 stuck below 2.30%,



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 2.25 percent. We saw the 2.30% level break after safety trade buying picked up earlier last week. Treasurys have been held up by the anticipations of a hawkish Fed and after this week's economic data that is questionable. We see the 10 year note yield dropping to nearly 1.75% by the end of 2017. We see the Fed becoming more dovish and that will take yields lower and bonds higher. If the 10 year note yield rises above 2.50% significantly, we shall close our short positions and reevaluate the situation, but we do not see this being likely. We also saw the ten year note yield approach 2.30% this week and failed instantly to break above. This is a very bearish signal We continue to remain short of U.S. Treasury Yields and long of bonds despite the recent movement.

Keep Your OPTIONS Open:

"The recent rise in crude oil is definitely going to be short lived. That being said, we have seen crude oil related stocks sell off slightly since the recent high, however I think they still have much more room to fall. I am looking to buy puts on the XLE ETF at a $65 strike price with a July 21st expiration date for $1.12 each. The S&P 500 energy sector has been outperforming crude oil in general which is partially because it is being held up by the other sectors in the market. However, this is concerning and these types of scenarios often lead to quick and sharp selloffs. By buying these puts, I think XLE could fall around 10% by the expiration date and this would easily cause your options to double or triple. 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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