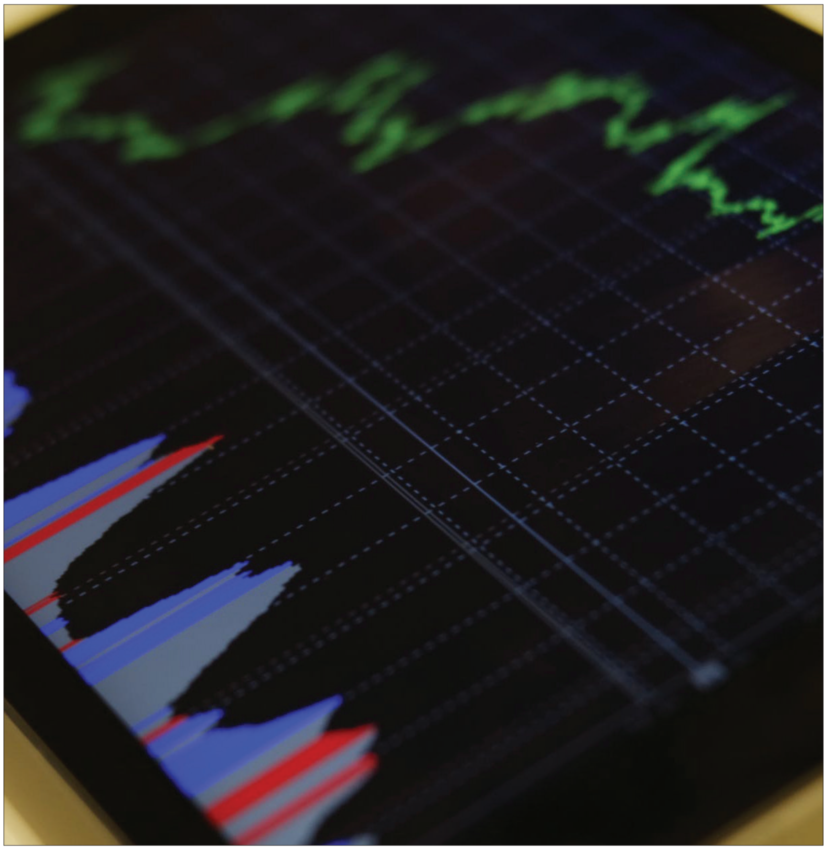
The Kobeissi Letter

Week of April 29th, 2019



Stocks end higher after GDP and earnings

The S&P 500 closed the week 1.20% higher, at 2,940, after the busiest earnings week of the quarter and a strong GDP number on Friday. The GDP number came in at 3.2%, which was well above expectations of 2.0%, and provided more optimism and fuel to the rally despite large misses in other economic data such as Existing Home Sales and Initial Jobless Claims. On the earnings front, 46% of the companies in the S&P 500 have now actual results for the quarter. Of this 46%, 77% have reported a positive EPS surprise and 59% have reported a positive revenue surprise, according to FactSet. However, guidance for Q2 has not been great with 32 S&P 500 companies issuing negative EPS guidance and 6 S&P 500 companies issuing positive EPS guidance thus far. Overall, it appears that the top and bottom line numbers have been stronger than expected, but many companies are warning of slowing revenue and net income ahead which does not clear the market of economic slowdown fears. Fundamentally, it appears that we have seen some improvement and the economy is not as terrible as previously expected. However, this does not mean that the economy has not slowed at all. In fact, the blended Q1 earnings decline for the S&P 500 is -2.3% thus far, and this could be indicating that we are at the beginning of a slowdown that could potentially worsen. From a technical perspective, the S&P 500 reclaimed the bottom end of the rising wedge formation (2,936) which broke to the downside last week and we must watch to see if the bottom end can hold this week. The RSI on the index is back at a 52 week high and the top Bollinger Band is now just six points away from Friday's close. Overall, the S&P 500 remains highly overbought on a technical basis, however momentum in the markets is ignoring this. With that said, we are now looking to reduce short positions by 50%, still remaining net short, until the momentum shifts to the downside. We remain bearish, however this will limit our losses in the unexpected case that momentum drives the index 50-100 points higher over the next couple months.

Three month WTI Graph provided by Marketwatch.com

Crude oil drops on Trump rhetoric

WTI crude closed the week 1.81% lower, at $62.84, after one of the most volatile weeks of the year resulted in a late sell off. Early last week, the administration announced that waivers which exempted several countries from U.S sanctions on Iranian Crude oil would not be renewed. Therefore, the countries were required to stop buying Iranian crude by early May or U.S. sanctions would be placed on them as well. This sent oil prices nearly 4% higher, however on Friday, President Trump Tweeted that Saudi Arabia and other OPEC nations have agreed to ramp oil production to compensate for the drop of Iranian oil on the market and pushed oil prices back down. In the weekly reports, crude oil inventories marked a 5.5 million barrel build while a 1.3 million barrel build was expected. Gasoline inventories fell by 2.1 million barrels while a 1.1 million barrel draw was expected. We also saw rig count fall by 20 to 805 total operating oil rigs in the United States. We expect President Trump to continue his advocacy for lower oil prices and markets will take this seriously especially as production levels begin to rise. From a technical perspective, WTI crude's decline last week began after the top end of the upward trending channel, that has held since the December 24th low, was rejected at $66.50. This led to a test of $65 support which behaved far weaker than expected and resulted in a break below uptrend support at $63.08. This was the first break below uptrend support during the entire rally off the December 24th bottom end should lead to a test of $60. This week, we look for a follow through to the downside to $62.25 support and eventually a move to $60. Additionally, a small healthy relief bounce is certainly likely in the near future (to the ~$63-64 range) and should be used as an opportunity to add to short positions. As for natural gas, we saw an indication of capitulation last week after a gap down to 52 week low at $2.43 led to a rebound back above $2.50 and weekly close at $2.58. However, the commodity is not yet in the clear until downtrend resistance at $2.60 is broken and we will wait until a daily close above $2.60 to establish long positions. A rejection of $2.60 this week will likely lead to a new 52 week low which is why we remain on the sidelines for now.

The Editorial Staff's Trading Recommendations

1 Short S&P 500: We are now reducing short positions by 50%, still remaining net short, as momentum in the markets has led to a "blind rally" which we did not expect. While earnings have declined and economic data continues to give conflicting signals, investors continue to buy. We watch the bottom and top end of the rising wedge in the S&P 500 this week at 2,936 and 2,946 respectively.

2 Short WTI Crude: After last week's roller coaster ride in WTI crude, it has become more clear that fundamentals have worsened and President Trump is advocating strongly for lower prices which will come to fruition. We look for a break below $62.25 and will utilize any relief bounce in the commodity as a buying opportunity.

3 Neutral natural gas: We seemed to receive some signs of capitulation last week after the mid-week gap down to $2.43 in natural gas prices combined with its RSI bottom. We now watch downtrend resistance at $2.60 as a daily close above that level indicates a breakout while a rejection likely leads to new 52 week lows.

4 Short gold and gold mining stocks (GDX): As noted in previous editions of The Kobeissi Letter, a relief bounce in gold prices was highly likely and actually quite healthy for our short positions. This week, as fundamentals and technicals still point lower, we look for DXY to continue higher, pressure gold prices, and a weekly close below $1,285 for gold to confirm that more downside is ahead.

5 Short U.S. Treasury Yields or Long of Bonds (ETF Ticker: TLT): The ten year note yield dropping below uptrend support at 2.54% last week is strong evidence that the recent rally was simply a relief bounce. This week, we look for the yield to fall below 2.50% and $124 as a key resistance point to break on TLT.

From the Editor:

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

Gold rebounds in overdue relief bounce

Gold prices closed the week 0.86% higher, at $1,288/oz, after a multi-week decline lead to an inevitable relief bounce in the commodity. We can be certain that last week's gain was a product of a relief bounce rather than a directional shift in the commodity because of the fact that gold behaved irrationally in accordance to historic price action. The U.S. Dollar Index (DXY) reached its highest level since May 15th, 2017 and displays no signs of a pullback, all while gold's daily RSI approached oversold territory and bottom Bollinger Band was crossed. However, when looking at the three year chart of gold prices (weekly candles) the Bottom Bollinger Band is currently at $1,265 and the RSI is in the middle of its range which are both indications that the longer term picture is not oversold yet. Looking forward, it is important that gold does not reclaim the support level at $1,302 while was broken amid the triangle formation breakout two weeks ago. Additionally, the fundamental picture remains bearish with a soaring U.S. Dollar and DXY likely to break 100 by the end of May. Meanwhile, the CFTC reported that net speculative long positions in gold fell by 18,900 contracts, or 33.6%, last week which is further proof that this bounce is a headfake and not backed by fundamental investment inflow. This week, we would like to see gold's upside limited and ultimately close below $1,285 support which is a key level we have been watching all year. The short gold and GDX trade remains attractive and we maintain our positions.

Treasury yields drop despite GDP beat

The yield on the ten year note closed the week six basis points lower, at 2.50%, and the bond markets seemed to completely sell the news after the strong GDP report on Friday. Our TLT positions rose by 0.74% and the ten year note yield crushed through theuptrend line from recent lows at 2.54% which was a very important development for our short positions in the treasury yield itself through TLT. The drop in treasury yields last week appeared to be mainly a product of imminent fear in the markets and the fact that other important data last week was not as positive. Other noteworthy data included, Existing Home Sales for March which fell by 4.9% and initial jobless claims for the month which came in at 230,000 while expectations were at 199,000. Overall, the widespread uncertainty in the markets should continue to push bond prices higher regardless if the market pulls back immediately or not. We look for TLT to push above resistance at $124 which is the last major technical level before retesting broken uptrend support at $125.90. Overall, last week's reversal in treasury yields was highly constructive and we maintain our positions in TLT.

Keep your OPTIONS open:

"For this week's options market trade, we take a look at Chevron (CVX) which has been underperforming the broader market rally after breaking the December 24th uptrend support line on April 11th. Last week, the decline escalated after Chevron missed earnings on the top and bottom line by a large margin. The oil giant reported Earnings Per Share of 55 cents on revenue of $63.6 billion while expectations were an EPS of 75 cents on a revenue of $67.93 billion. Decreasing margins and maintenance were noted in the earnings release as a reasoning for the large miss and we do not expect margins to improve as President Trump continues to promote lower oil prices and the overall technical and fundamental picture for the commodity has worsened (see crude oil section for more on our oil call). As a result, we expect CVX to continue its route lower, and buying the June 7th, $116 strike puts for $2.90 per contract appears to be a great trade. Momentum should follow through into this week and likely even put these puts in the money by Friday, as the strike price is just 0.94% below Friday's close." - Adam Kobeissi