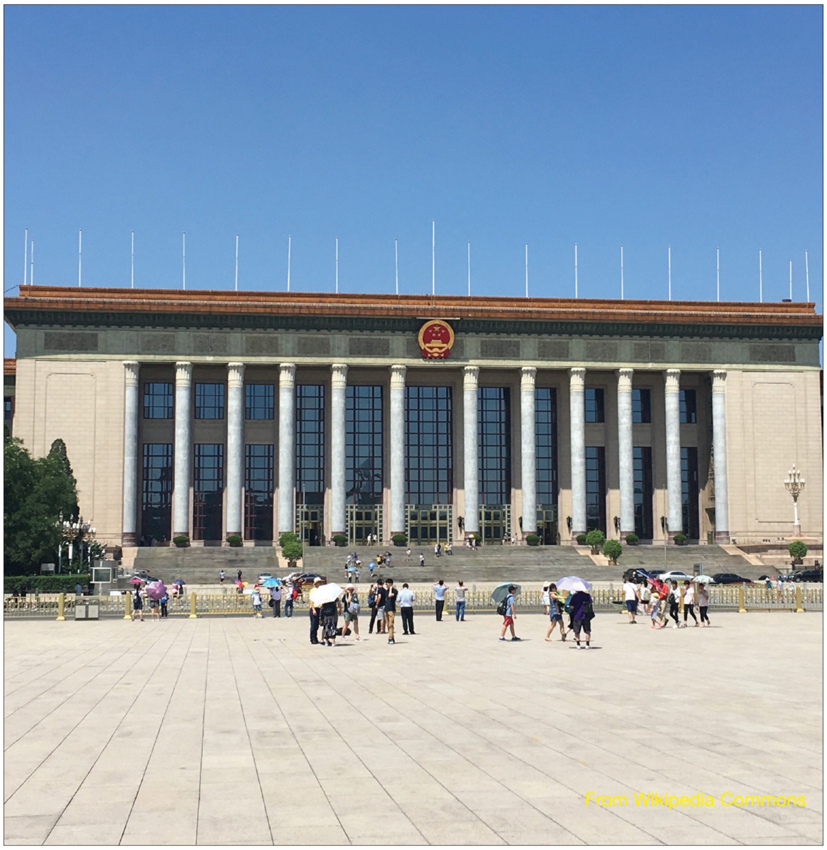
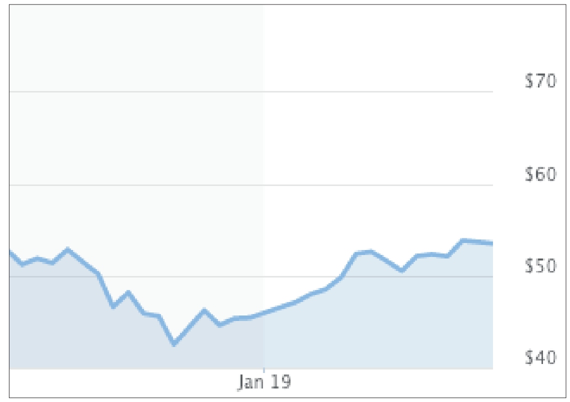
The Kobeissi Letter

Week of January 21st, 2019



Stocks extend rally on trade talks

The S&P 500 closed the week 2.89% higher, at 2,671, after the United States and China continued their trade talks and now appear to be making significant progress. On Friday, U.S. indices hit session highs after news broke that China offered a six-year increase in U.S. imports during recent trade talks and further improved investor sentiment. However, we are now seeing the impact of trade negotiations between the United States and China far more priced into the markets than we did at the beginning of the year. Going forward, trade talks between the United States and China should have less of an effect on equities as a trade deal is now roughly 80% priced into the markets in our opinion. We also saw a variety of earnings reported last week ranging from banks to Netflix and results were all around mixed. Each report contained some bullish statements and some bearish, but not enough to clearly decide if earnings are bullish or bearish overall thus far. We continue to look ahead and watch earnings for a better sign of global economic conditions. From a technical perspective, the S&P 500 rallied through two key technical levels last week: 2,600 and 2,650. This was a strong improvement for the index, however technicals are now suggesting that the recent rally is approaching resistance and some sort of pullback is ahead. The S&P 500 is now just 14 points away from the downtrend line at 2,685 that formed on the October 3rd high and has held since. We expect 2,685 and 2,700 resistance combined with an overbought RSI to pose a significant technical barrier to the index which has led us to closing our long positions. Since December 26th, the S&P 500 has gained 14% without any sort of pullback which is unusual and a pullback is likely ahead. We have now established a small net short position in the S&P 500 and look for a break of 2,650 to the downside as a pullback is now imminent.



Three month WTI Graph provided by Marketwatch.com

WTI crude approaches $55

WTI crude closed the week 3.92% higher, at $53.73, after U.S. and China trade negotiations spread optimistic buying throughout the oil market. Additionally, a report from OPEC on Thursday indicated that daily production in December fell by 751,000 barrels per day and proved that OPEC nations are complying with the recent output cut agreement. In the weekly reports, crude oil inventories marked a 2.7 million barrel draw while a 1.3 million barrel draw was expected. Gasoline inventories rose by 7.5 million barrels while a 2.8 million barrel build was expected. We also saw rig count fall by 21 to 852 total operating oil rigs in the United States. The drop of 21 operating oil rigs was massive and proves that small producers are feeling the pain after the recent nose-dive in oil prices which is exactly what we anticipated. We should see more oil rigs continue to shut down and drive WTI crude to $60. Technicals are also still pointing higher and we now watch $55 as strong resistance that will likely be broken this week. The RSI on WTI crude is now just over 60 and still signals that the indicator has 15-20 points to run to the upside and should get the commodity to our $60 target. To the downside, we will be placing stop orders at $51.50 which is the point that marks uptrend support from the recent rally beginning in the low $40s, and will allow us to limit downside if a pullback occurs. Beyond $55, we watch $57.50 as a checkpoint on the road to $60 and expect the pace of the rally to remain quick. As for natural gas, the commodity reached our $3.50 target level early last week and resulted in us closing our long positions. This marked an 11.1% profit in just under two days and shows the tremendous ability for natural gas to move quickly. After booking profits on last week's rally we now move back to the sidelines on this trade and watch $3.70 as a point that could mark a double top and lead to a correction back to $2.90 support. To the downside we watch $3.25 as a key support level that will lead to $2.90 if broken. We shall continue to monitor natural gas prices and provide an update in next week's Letter if new positions are established.

The Editorial Staff's Trading Recommendations

1 Short S&P 500: Last week, the fundamental picture in the market was vastly unchanged as earnings were mixed and a U.S. and China trade deal now 80% priced into the market. Technicals are suggesting that the S&P 500 has risen too quickly and resistance at 2,685 and 2,700 is strong. We have established a small short position here and look for a 5-10% pullback in the index.

2 Long WTI Crude: We received a variety of bullish fundamental news last week including United States and China trade talks, OPEC production cut compliance, and a weekly drop in U.S. active oil rig count by 21. Technicals are now pointing to a break of $55 and $60 remains our target on this trade. We will lock in profits on the most recent move higher by placing a stop at uptrend support at $51.50.

3 Neutral natural gas: We booked our profits in natural gas early last week after the commodity hit our target at $3.50 marking an 11.1% gain on the trade. The next move for natural gas is unclear as $3.25 and $3.70 are both probable targets. We have re-established a neutral stance and look for more directional clarity before trading the volatile commodity.

4 Short gold and gold mining stocks (GDX): We are now establishing short positions in gold for the first time in over a year at The Kobeissi Letter. The technical failure for gold to break $1,300 for three consecutive weeks combined with a breakout in DXY and a lack of fundamental support suggests that a pullback is ahead.

5 Long U.S. Treasury Yields or Short of Bonds (ETF Ticker: TBT): The ten year note yield has officially broken above downtrend resistance from its 3.25% peak and TBT has made significant progress as it continues higher. We look for the ten year note yield to break 2.80% this week and TBT to break above $36.50.

From the Editor:

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

Gold runs into $1,300 resistance

Gold prices closed the week 0.47% lower, at $1,282/oz, and failed to break above $1,300 for the third consecutive week which has formed a triple top in the commodity. Additionally, we saw the U.S. Dollar Index (DXY) break above the downtrend at 96 which has held ever since the decline from the 97.70 peak. This was a major setback for gold bulls and a pullback in gold prices catalyzed by a rebound in DXY appears to be ahead. We expect DXY to rally back to its highs around 98 after the technical breakout last week which has led us to establishing short positions in gold and gold miners. Additionally, gold prices now factor in zero to one interest rate hikes for 2019 which is an extreme dovish case that will likely be proven incorrect and contribute to the upcoming drop in gold prices. Fundamentally, safe haven buying and trade deal benefits are fully priced into gold and the commodity has run out of bullish catalysts. From a technical view, the failure to break $1,300 last week and the immediate reversal below $1,286 is also adding to the bearish thesis. With our new short positions, we look for gold to break below $1,275 this week and expect a drop below $1,250 in the coming weeks.

Treasury yields rally on China trade talks

The yield on the ten year note closed the week eight basis points higher, at 2.79%, and broke above the downtrend level that has held since peaking at 3.25%. Our TBT positions gained 2.26% and broke above $36 resistance, confirming the January 7th breakout above downtrend resistance. Momentum in the bond markets has clearly started to shift and profit taking on the recent runup in bond prices is taking place. It is also clear that an overly dovish Fed, excess safe haven trade, and geopolitical tensions were all overpriced into the bond markets and this remains the case. We expect the easing of these factors to continue to push treasury yields higher and should lead the ten year note yield to 3.00%. It is important that the ten year note yield obtains a weekly close above 2.80% as that has been a pivotal point in the treasury yield over the last year. We look for TBT to break above $36.55 this week and maintain our target at $40 on this trade. Furthermore, we continue to watch Fed statements and the ongoing trade negotiations with China as they both remain the two fundamental drivers of the bond markets.

Keep your OPTIONS open:

"For this week's options market trade, we look at GDX (Gold Miners ETF) after gold prices experienced a strong technical reversal last week and more downside appears to be ahead. As discussed in the gold section, the fundamental and technical picture for gold has shifted to a fairly bearish state and the options market is presenting an attractive opportunity to cash in an upcoming pullback in gold prices. The implied volatility on GDX is low, at 25%, and options premiums are also low which makes buying puts a great option here. I am looking at buying the March 15th, $20 strike puts for $0.54 per contract which represents a 2.66% premium as of Friday's close. With this premium we are granted short exposure to GDX for 52 days and I expect GDX to be trading around $19 at expiration, resulting in these puts being one Dollar in the money. Overall, the odds of profitability appear high on this trade and this is a relatively cheap way to obtain short exposure on gold." - Adam Kobeissi