Week of March 9th, 2020

S&P 500 ends higher after another wild week

The S&P 500 closed the week 0.69% lower, at 2,972, as Coronavirus (CV) fears continued to sweep markets and cause immense volatility. The number of CV cases officially rose above 100,000 last week and global growth rates ticked higher over the weekend despite a leveling off of cases reported in China. Last week, we received a historic 50 basis point interest rate reduction from the Federal Reserve to bolster the economy as CV fears continued to worsen. Markets immediately rallied on this news but erased the gains by the end of the same session. On Friday, we received a remarkably strong jobs report, with the United States economy adding 273,000 jobs in February, well above expectations of 175,000. The unemployment rate fell from 3.6% to 3.5% and average hourly earnings grew by 0.3%, in-line with expectations. Putting the CV outbreak aside, we currently see far stronger economic conditions than what was observed throughout the entire 2019. The Fed has reduced interest rates by over 100 basis points, Q4 2019 earnings date posted a 0.9% blended earnings growth rate, and economic data is exceptionally strong. However, none of this matters over the short run as CV fears will continue to drive markets until a foreseeable end to the outbreak emerges. At The Kobeissi Letter, we want to stress our strong belief that the CV outbreak and its resulting price action is a severe overreaction, however it should not be fought until more stability is realized. When looking five months out, we believe that the S&P 500 will be trading above current levels. Given the aforementioned, it is important that we turn to the technical setup to determine short term price action. Last week, the S&P 500 began with an immediate gap fill from 2,950 to 3,100, exactly as expected. From there, we saw an immediate gap up to 3,130 channel resistance which also corresponds to the 125 day moving average. However, that level was quickly rejected and this led to a move to 2,900, which held on Friday. We saw a sudden move from 2,900 to 2,970 in the final trading minutes on Friday, however this has formed another unfilled gap that will be filled early this week. We expect an early drop to 2,850 channel resistance this week to be met by support from the February 28th low and form a short term “W” bottom which leads the index back above 3,000. From there, a retest of 3,130, the most pivotal point in this trade, is possible and will result in one of two outcomes. First, a daily rejection of 3,130 leads back to 2,900 quickly and a shortable pullback to 2,900. The second is a break above 3,130 which opens the door for a gap to 3,200 and new all time highs fairly quickly, but this would have to be supplemented by fundamental relief surrounding CV. Therefore, we believe a short-to-long strategy is best this week with an initial target of 2,800-2,850 before scaling long positions and bracing for a 200 point move higher where we will reassess the technical setup.

S&P 500 CHART

Crude oil mark six year low on OPEC+ tensions

WTI crude closed the week 8.77% lower, at $41.60, after failure to reach an OPEC production cut extension worsened the commodity's freefall on Coronavirus (CV) fears. This quickly executed our tight stop-loss orders from last week. As we write, WTI Crude has fallen by its highest percentage amount since 1991, and trades at $28.10. It is first important to understand the developments at last week's OPEC+ meeting where an agreement to extend production cuts was not reached. OPEC countries proposed an additional 1.5 million barrel cut, on top of the 2.1 million barrels per day of production that was cut in December, and Russia rejected this deal as non-OPEC countries would be responsible for covering 500,000 barrels of this production per day. Failure to reach this agreement brings on an additional 2.1 million barrels per day of production which does not include the increase in production levels that Saudi Arabia pledged over the weekend and resulted in the drop into the futures open on Sunday. While this is incredibly bearish from a fundamental viewpoint, and other countries in addition to Saudi Arabia will now be ramping production, there certainly is a light at the end of the tunnel. Crude oil prices below $40/barrel have proven to be unsustainable, especially after the 2014-2016 drop which exposed the weakness of oil companies globally. Large scale producers, such as Chevron and Exxon, are unprofitable with crude oil prices below $40.00, shale producers break even at $50.00, and producers pumping from oil sands need $65.00 crude oil prices to break even. Therefore, we should begin to see a sudden drop in active rig count, especially in the United States and non-OPEC countries as prices fall. Furthermore, efforts to drive out production through price wars haven proven to be short lived in the past and we believe that an OPEC emergency meeting will occur over the next month in efforts to revive oil prices as Saudi Arabia begins to feel the pain from lower prices. Therefore, from a fundamental viewpoint, we believe ~$30.00 oil has priced in the vast majority of bearishness from this weekend's developments. From a technical perspective, We see the lowest daily and weekly RSI reading since 2015 and the gap lower at Sunday's open led to a bounce exactly at $30.00, which shows the psychological significance of the level. WTI crude broke sharply below the bottom end of its downward trending channel, at $40.50, stemming from the initial drop in January 2020, and we see a high volume washout currently occurring with a $6.10 drop below the daily bottom Bollinger Band. Breaking sharply below a downward trending channel is often seen before a reversal and current technical levels are unsustainable. Over the very short run, it is certainly possible to see a drop to $26.00-28.00 resistance zone from the 2016 bottom. However, we believe that an OPEC emergency meeting will commence soon and technical conditions must correct to a more healthy point which signals a relief bounce to $40.00 is ahead. Furthermore, as CV fears ease over the next few months, the 30%+ discount that oil prices are currently trading at will be erased. We now look to re-establish a small long position with a $40.00 price target over the next two months and add drastically if $30.00 and $26.00 are tested.

WTI CRUDE OIL CHART

When looking at natural gas, the commodity posted a 2.34% weekly gain, closing at $1.73, giving us a strong start to our long positions especially after closing half of this position in the initial spike to $1.82 (as alerted on [Twitter](#)). Natural gas prices have fallen for a variety of fundamentally bearish factors, the most prominent being unfavorable weather conditions. However, CV took control of natural gas over the last month as its risk-on attributes hurt price action. Last week's move off the $1.63 trendline test confirmed a weekly higher close, which is exactly what we were looking for. From there, we saw the quick spike to $1.80 downtrend resistance, as expected, and booked a healthy gain, however that level failed to hold and lead to a technical follow through above $1.90. This was not as concerning as it may seem because the commodity marked a weekly close above its downward trending channel, at $1.72, for the first time since the February 18th headfake breakout. Looking ahead, we see natural gas prices currently trading at $1.65 as CV fears carried over from last week and crude oil prices took a tumble, but we believe downside is capped at $1.60 trendline support especially as the daily bottom Bollinger Band has already been breached. Furthermore, the daily RSI has fallen to 33 which is a healthy level for a higher low before turning to 50 in the next attempt to break above $1.80. This would confirm a third consecutive higher low in the daily RSI and lead to an uptrend formation. We now look to add to the small long positions which remain from last week, and expect $1.60-$1.65 range bound resistance to hold. To the upside, re-breaking above the downward trending channel, at $1.72, on a daily basis is key, however a weekly close above $1.72 is even more important. From there, a gap up to $1.80 is inevitable before a retest of last week's high at ~$1.86. To the downside, we set stop-loss positions below trend line resistance at $1.55.

NATURAL GAS CHART

Gold approaches eleven year high

Gold prices closed the week 6.76% higher, at $1,672/oz, as Coronavirus (CV) fears continued to worsen and the Fed issued a historic rate cut which sent both bonds and gold higher. We saw the first follow through downward in the U.S. Dollar Index (DX) which fell from its peak on February 19th, at 99.90, to 95.60. This was incredibly supportive of gold prices and we expect continued downside in the U.S. Dollar going forward as safe haven asset demand remains at its peak. When looking at spot gold, the interest rate cut of 50 basis points was only half priced into gold prices which explains the sudden gap higher after the announcement on Tuesday last week. Going forward, we see much more room for upside as emotional selling continues and bonds remain in freefall. Furthermore, short term market volatility will worsen this week with crude oil prices' recent tumble, leading more investment to the shiny metal. From a technical perspective, extension above $1,600 and $1,650 was very supportive last week and signals a follow through this week to the top end of the gold's upward trending channel at $1,720. At that point, we should see the daily RSI above 70 and trade well above the top Bollinger Band which will lead to a retracement to the $1,670 support level before bracing for the next move which we shall assess upon completion of the pattern. We maintain long exposure to gold and GDX and look for a follow through to $1,720 this week before scaling back long positions and bracing for a 5-7% technical pullback.

GOLD CHART

Ten year note yield falls below 1.00%

The yield on the ten year note closed the week 36 basis points lower, at 0.76%, marking the first ever close below 1.00% after the Fed issued a surprise 50 point basis point interest rate reduction. After establishing long positions in TLT last week, our thesis was that dovish Fed policy globally would be the catalyst for a new all time low in the ten year note yield. Last week, we saw half of this thesis come to fruition after the Fed's interest rate cut, and the other half is set to come to fruition as other major world backs have no option but to follow this lead. Furthermore, we expect additional pressure from the Trump Administration on the Federal Reserve to reduce interest rates to drive bond markets and ultimately lead to another 50 point interest rate reduction by year end. Last week, our long positions in TLT marked a 7.38% gain, closing at $166.77, and continued into all time high territory. We look for extension above $170.00 this week and for the ten year note yield to continue to tumble as oil prices fall, Coronavirus fears worsen, markets remain in volatility, and the Fed's dovish policy strikes markets. Seeing negative rates is certainly not out of the question here and we continue to see value in shorting treasury yields/buying bonds. We maintain our positions in TLT and look for the ETF to break above $170.00 this week while the ten year note yield approaches 0.50%.

Keep your OPTIONS open:

"For this week's options market trade, we look at GDX (Gold Miners ETF) which is poised for a rapid gap higher this week as markets digest developments from this weekend and crude oil prices fall to their lowest levels since 2016. When looking at the technical picture for GDX, we saw the ETF close above a long term uptrend channel, at $29.35, and follow through above channel resistance at $28.33 after establishing a bottom at $26.00 channel support. This all came with a daily top Bollinger Band which is nearly $2.00 higher and an RSI which stands in neutral territory. This week, we expect gold's rally to extend above $1,700 and take GDX with it. Therefore, we see value in increasing long exposure to GDX which lagged spot gold, on a historical basis of 3x outperformance, last week for the first time since the Coronavirus outbreak began. I am looking at purchasing the April 17th, $30.00 strike calls for $1.51 per contract, a 5.13% premium as of Friday's close. While this is a hefty premium, we expect implied volatility to continue to rise from its current levels at 49.27% creating an environment which is conducive to buying calls rather than selling puts. We look to close this position before expiration if GDX marks $32.00, putting these calls $2.00 in the money." - Adam Kobeissi

GDX CHART

What We're Trading:

Short to Long S&P 500: After booking a modest gain last week, we see a short-to-long strategy paying off in this highly volatility market. We see an initial drop to the 2,800-2,850 region before a "W" bottom forms, allowing us to increase long exposure, and the S&P 500 spikes up to 3,000 rapidly. With a three to five month time horizon, we see value in simply averaging down before CV fears ease and the other factors contributing to an overall strong economy regain focus.

Long WTI Crude: After breaking below our stop-loss positions at $41.00, WTI crude has extended downside to overwhelmingly overextended technical conditions. Such low prices are already driving small producers out of business and we believe OPEC will call for an emergency meeting within the next month. We are establishing small long positions at current levels and will average down if $30.00 and $28.00 are tested. Timing an exact bottom is impossible here, however we are confident that oil prices will be higher over the next five months. Patience pays in this trade.

Long Natural Gas: After booking a gain on half of our long positions in the initial gap above $1.80 last week, natural gas prices managed to close the week above downtrend resistance at $1.72. With prices at $1.65 early Sunday, we see a range bound bottom forming at $1.60-1.65 and a move for a higher weekly close above $1.72 downtrend resistance. To the downside, we set stop-loss orders at $1.55 to limit our losses in the case of a break below trendline support at $1.58.

Long Gold and Gold Mining Stocks (GDX): After re-entering long positions in gold and GDX, we broke above $1,600 and $1,650 preliminary checkpoints almost immediately. The U.S. Dollar continues to drop sharply along with treasury yields aiding the rally in gold. Looking forward, we expect a gap up to $1,720 channel resistance before a technical pullback of 5-6% to brace for the next move in gold prices.

Short U.S. Treasury Yields or Long of Bonds (ETF Ticker: TLT): The ten year note yield broke below our 1.00% target immediately last week and the freefall has no end in sight. As global central banks continue to issue dovish policy surrounding Coronavirus and its impact on the global economy, rates are headed to near zero or perhaps even negative territory. We maintain long positions in TLT and short positions in treasury yields with weekly targets of $170.00 and 0.50%, respectively.

Farewell and Trade Well,

Adam Kobeissi
Founder and Editor-in-Chief