The Kobeissi Letter

Week of November 11th, 2019

By Wikipedia commons user Cezary p

Stocks mark three consecutive weeks of record highs

The S&P 500 closed the week 0.85% higher, at 3,093, as Q3 earnings season neared its end and trade optimism continued to fuel gains in major market indices. We have now received third quarter earnings from 89% of S&P 500 companies, according to FactSet, and 75% of those companies have exceeded expectations on an EPS basis. Furthermore, the blended earnings growth rate for the quarter rose from -2.8% two weeks ago to -2.4% last week. At the beginning of this earnings season, we saw the blended earnings growth rate at -4.6% and this has nearly halved, significantly beating expectations of -4.1%. Immense negativity surrounding the prospect of declining earnings was holding the S&P 500 back, however over the last month the outperformance of S&P 500 earnings has provided a strong bullish catalyst for the index. While we are seeing a decline in earnings on a year-over-year basis, perhaps this is simply a weak period which is being supported by Fed policy to avoid a full recession. This is the mindset that we are seeing prevail in the markets and will likely continue to trigger new all time highs. On the trade war front, A spokesperson for the Chinese Commerce Ministry said that China and the U.S. had agreed to roll back tariffs, but President Trump denied this statement on Friday morning. Interestingly, the pullback that came after President Trump's statement was short lived and the S&P 500 actually ended the session positive, at new all time highs. We continue to see further upside potential as this trade deal rolls out and President Trump's denial of tariff rollbacks last week has priced some negativity into the markets which will lead to further upside on the next bullish trade development. From a technical perspective, pullbacks are becoming even more brief, especially on a daily basis, and higher lows continue to form. A move above 3,100 this week is highly likely as momentum continues to drive equities higher, however a pullback in the near future must not be ruled out. The S&P 500 is trading above its top Bollinger Band on a daily and weekly basis with a daily RSI above 70. However, the weekly RSI remains below 70 and this rally certainly has more room to into the end of this year. As far as a pullback goes, 3,025 would be the first target to watch and 2,940 would be the worst case scenario. To the upside, momentum could easily drive the S&P to 3,150 and the overall trend continues to point higher. We maintain our reduced long positions and look to add to them in the case of a pullback.

Crude oil higher after bullish Chinese data

WTI crude closed the week 2.26% higher, at $57.44, after Chinese crude oil imports rose 11.5% to a record high. Furthermore, bullish comments from OPEC Secretary-General, Mohammad Barkindo, combined with trade war stability between the United States and China paved the path in last week's rally. In the weekly reports, crude oil inventories marked a 7.9 million barrel build while a 1.5 million barrel build was expected. Gasoline inventories fell by 2.8 million barrels while a 1.8 million barrel draw was expected. We also saw rig count fall by 7 to 684 total operating oil rigs in the United States. Active rig count in the United States has now fallen by 100 in just four months and sits at its lowest point since March 2017. The continued decline in rig count is incredibly bullish for crude oil prices and markets are finally beginning to price this in. The decline in rig count alone is enough to push WTI crude above $60.00 by the end of this month. The fundamental picture for the crude oil markets is remarkably strong right now with Fed intervention to avoid a recession, progression in a trade deal agreement, OPEC's production cut compliance, and a steady decline in active United States rig count as many shale producers are being forced out of production. From a technical perspective, we saw the commodity extend its rebound off uptrend support at $54.10 and this has established a range bound bottom at $54.10-55.00. We are seeing multiple points of technical support in that range which will serve as a barrier against downside and a great point to add to long positions if tested. Furthermore, the top Bollinger Band shifted from $56.90 on Monday to $58.10 on Friday which is exactly what we wanted to see and this will allow for an extension of last week's rally. As WTI crude continues to push towards $60.00, we expect the top Bollinger Band to gradually shift higher to prevent a pullback. This week, we look for an extension above $58.50 and for the RSI to break above resistance at 60 which is the level we saw fail multiple times this week. From there, we expect a quick gap to $60.00 where we will reassess our position objectively as we always do when reaching our price targets. As for natural gas, we saw the commodity rally 3.33% last week, closing at $2.79, in another incredibly volatile week as cold temperatures hit the United States but forecast uncertainty overshadowed price action. We saw a hard rejection at $2.90 last week high is concerning as this is the level we have seen fail multiple times in the past. This is a particularly important week for the commodity because we expect a high likelihood of a breakout in either direction. To the downside, a move below $2.70 support could jeopardize the most recent rally and will lead back to $2.58 if it holds on a daily basis. To the upside, a gap above $2.90 will open the door for massive upside potential, immediately to $3.00 and possibly $3.50 by year end. We are seeing a massive spread of roughly $0.90 between the top and bottom daily Bollinger Bands and a fairly neutral RSI. These are all signals that volatility will certainly continue here. Finally, net speculative long positions increased by 49,500 contracts to -136,100, which is further evidence that widespread short covering is happening. With that in mind, we will be taking profits on 50% of our long positions to minimize risk exposure and placing stops at $2.65 to limit our downside in the wake of a gap lower.

The Editorial Staff's Trading Recommendations

1 Long S&P 500: As earnings have proven to be stronger than expected and further potential upside exists on the trade deal front, we are seeing momentum drive the S&P 500 higher and 3,100 will be broken this week. From there, 3,150 by year end is highly probable, but a healthy technical pullback to 3,025 is also becoming more likely. We maintain our long positions and look to add to them if 3,025 is tested. This rally is incredibly strong and should not be fought.

2 Long WTI Crude: Our long positions in WTI crude are looking very strong after the extension of last week's rally off $54.10 uptrend support. We now look for a move above $58.50 this week and for the daily RSI to break above 60. To the downside, the most important level to hold is uptrend support at $54.40 and we are shifting our stop-loss positions up to $54.00.

3 (Reduced Position) Long Natural Gas: Despite the rally last week, natural gas prices are at a fairly neutral point (although we are still bullish) and we are taking profits on 50% of our position. Short covering has continued, according to the CFTC report on Friday, and volatility is likely to continue. We watch $2.70 to the downside and $2.90 to the upside with a stop at $2.65 to minimize risk in a week will set the tone for the commodity's price action into December.

4 Short Gold and Gold Mining Stocks (GDX): Gold and GDX have taken serious fundamental hits with Fed dovishness well priced into the safe haven asset while equities and trade deal optimism dominate the markets. We look for gold to break below $1,450 by the end of this month but also note that a relief bounce to $1,480 is possible as the decline will not be a straight line lower.

5 Long U.S. Treasury Yields or Short of Bonds (ETF Ticker: TBT): Last week's extension to the upside and failure to reclaim downtrend resistance at $24.80 has opened the door for much more upside. We look for the ten year note yield to move to 2.00% and TBT to $27.00 before a brief healthy pullback to lead to a rally into year end.

From the Editor:

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

Gold collapses to three month low

Gold prices closed the week 3.62% lower, at $1,463/oz, closing the biggest weekly drop in three years for the commodity. The reasoning behind the drop is simple; investor risk appetite continues to grow and safe haven assets are paying the price. The U.S. Dollar Index (DXY) rallied 120 points, closing the week at 98.35 and reclaimed uptrend support which stands at 98.00. As S&P 500 earnings, trade deal optimism, and bullish momentum prevails in the markets, gold's safe haven attributes, which caused the entire rally this year, are fading rather quickly. Interestingly enough, we saw an increase in net speculative long positions in gold last week from 276,500 to 279,800 contracts. We have seen this happen in various other commodities this year and it seems to be a final period of buying before long positions are wiped out. The bottom Bollinger Band has begun to shift lower, down from $1,481 on Monday to $1,462 on Friday, and this is a strong technical sign that recent range bound trade is coming to an end. With that said, we do not expect the commodity to fall in a straight line lower. Brief relief bounces are likely and healthy for our short positions which is why we will utilize them to add to shorts. To the downside, the next checkpoint is at $1,450, and to the upside $1,480 is a strong resistance level to hold. Our price target on this trade is currently at $1,380 and we will continue to update that target as the trade progresses.

Yields breakout in remarkable weekly rally

The yield on the ten year note closed the week 22 basis points higher, at 1.94%, as safe haven investor appetite in the bond markets reached new lows. Our positions in TBT marked an 8.50% weekly gain and closed well above downtrend resistance which now stands at $24.80. Treasury yields continue to reward the simple stability of markets which we have not seen for the vast majority of this year. While the recent runup in the ten year note yield is a breakout, we expect some sort of a pullback once 2.00% resistance is tested on the ten year note. This will likely be a 10-15 basis point pullback before extending the rally to 2.15% into the beginning of next year assuming that the fundamental picture remains relatively stable. We have also seen the vast majority of Fed dovishness priced into bond markets and we expect this to be another catalyst for our TBT positions going forward. As the Fed becomes less dovish when the economy displays signs of improvement, the second leg higher for treasury yields will begin. As for TBT, the breakout last week was strongly bullish, but also displays some signs of a brief pullback ahead. This week, we look for a test of the September 13th high, at $27.00, which will put the ETF above its top Bollinger Band, at $26.86, and likely cause a pullback to $26.00 before the next move higher. Overall, the medium term timeframe for TBT and treasury yields remains very bullish and we maintain our positions in both assets.

Keep your OPTIONS open:

"For this week's options market trade, we look at the Coca-Cola Company (KO) which dropped after its earnings report on October 18th where EPS came in at $0.56, in line with expectations. Q3 revenue increased by 5.0% year-over-year due to an increase in pricing, but adjusted net income fell by two percent year-over-year and this worried investors and has led the stock 4.7% lower since the earnings release. Overall, this earnings report was solid aside from the decrease in net income and the vast majority of negativity has been priced into the stock. Furthermore, on a technical basis, KO is trading below its bottom Bollinger Band with an identical setup to the September 2nd bottom when looking at RSI and Bollinger Bands. We are expecting a move back to $54.70 as bargain investing enters this stock and this creates a potential upside of 4.8%. The options market is displaying a particularly attractive play to this trade by buying the December 13th, $52.00 calls for $0.90 per contract, a 1.72% premium. This is an incredibly cheap price for 32 days of bullish exposure as implied volatility on these options sits at just 16.2%. The in the money puts are the best way to play this trade because we expect a rapid rebound with little further downside ahead. By purchasing in the money calls, we can immediately capitalize on this rally by paying a slightly higher premium. " Adam Kobeissi