Black Swan Option Bets See Rocky 2020 for US Markets

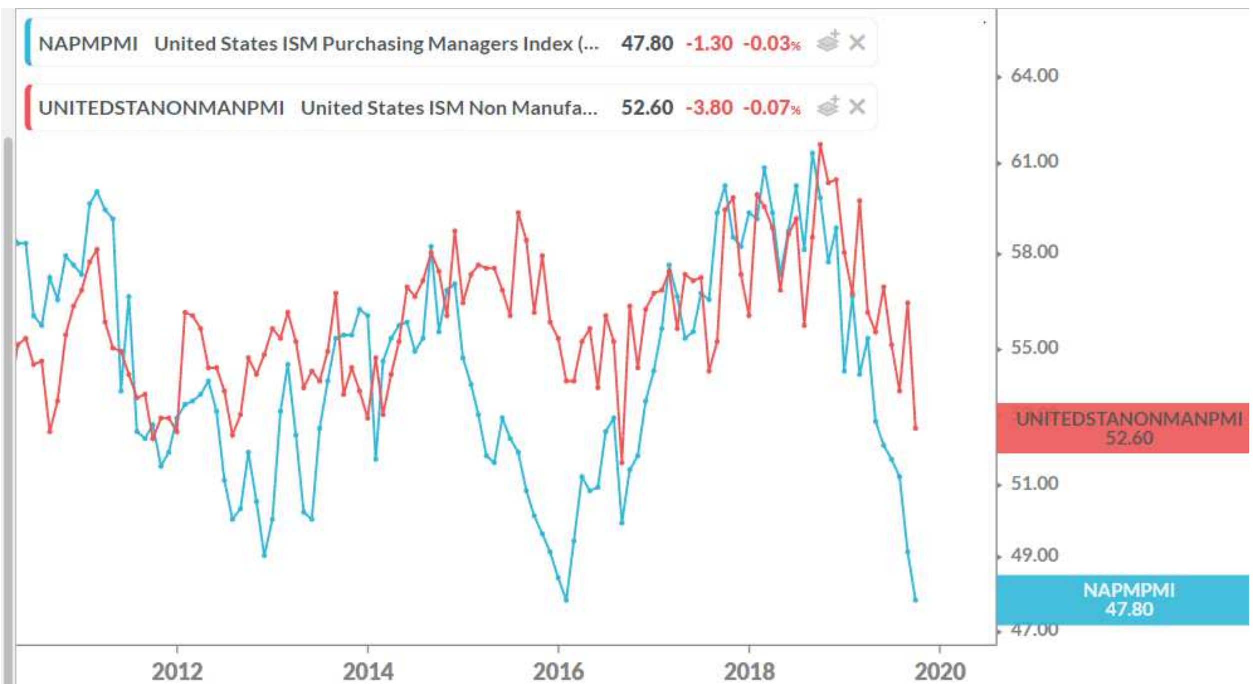
On October 18th in the matter of minutes an interesting set of option trades crossed the tape as roughly $17 million in put options were bought across Sector SPDR ETFs. The details of the trades are below with a clear focus on economic sensitive groups with **Industrials (XLI), Technology (XLK), Consumer Discretionary (XLY), Healthcare (XLV),** and **Oil & Gas (XOP)**. I would also note among the Sector SPDR ETFs there were not put buys in the more defensive groups like Utility (XLU) and Consumer Staples (XLP). I have highlighted the heavily weighted stocks in these ETFs below as well to get a sense of the names targeted. There is always the possibility that put buys can be protective against a long portfolio but these puts bought were between Delta -9 and Delta -13 which offers little in terms of portfolio protection and highly likely it was more of a Black Swan bet on a potential market shock in 2020. I would also note that American options do not need to be held through expiration and these positions could close for profits into a market sell-off at any time and would also benefit additionally from a rise in volatility and steepening skew.

Date	Description	Volume	Premium
10/18/2019	XLV 100 15 JAN 21 70 PUT	17,200	$3,663,600
10/18/2019	XOP 100 15 JAN 21 16 PUT	26,717	$3,606,795
10/18/2019	XLY 100 15 JAN 21 85 PUT	19,700	$3,546,000
10/18/2019	XLI 100 15 JAN 21 55 PUT	25,025	$3,353,350
10/18/2019	XLK 100 15 JAN 21 55 PUT	21,903	$2,891,196

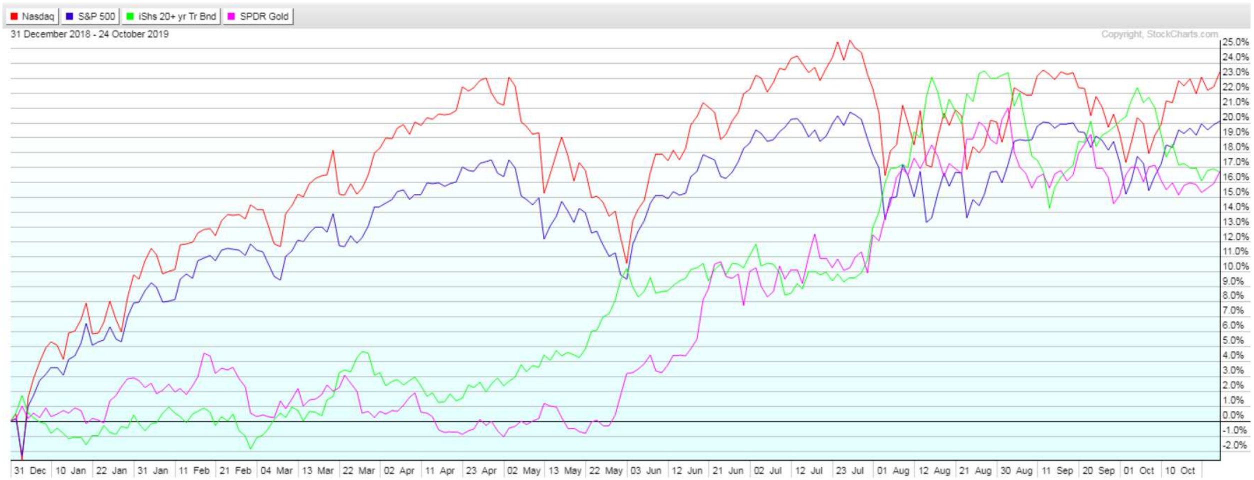
Industrial (XLI)	Tech (XLK)	Discretionary (XLY)
Boeing (BA) 7.94%	Microsoft (MSFT) 19.26%	Amazon (AMZN) 22.33%
Honeywell (HON) 5.32%	Apple (AAPL) 18.98%	Home Depot (HD) 11.12%
Union Pacific (UNP) 5.17%	Visa (V) 5.44%	McDonald's (MCD) 6.46%
United Tech (UTX) 5%	MasterCard (MA) 4.28%	Nike (NKE) 4.97%
Lockheed Martin (LMT) 4%	Intel (INTC) 4.2%	Starbucks (SBUX) 4.32%
3M (MMM) 4%	Cisco (CSCO) 3.67%	Booking (BKNG) 3.77%
Healthcare (XLV)		**Oil & Gas (XOP)**
J&J (JNJ) 9.8%		Marathon (MPC) 3.03%
United Health (UNH) 6.75%		PBF Energy (PBF) 2.93%
Merck (MRK) 6.16%		Valero (VLO) 2.69%
Pfizer (PFE) 5.86%		Holly Frontier (HFC) 2.65%
Abbott (ABT) 4.19%		Phillips 66 (PSX) 2.6%
Medtronic (MDT) 4.11%		Hess (HESS) 2.58%

There are a number of notable overhangs remaining for markets as Brexit and China/US Trade are two that have been in focus for nearly two years and continue to be kicked down the road, but eventually there will be fallout from each of these situations. Macro conditions have been weakening in China for a few years and persisted in the Eurozone but we are finally seeing the

US follow suit. In the US we have seen a number of red flag Macro indications as ISM Manufacturing recently hit its worst level since 2009 and the Services side also weakening to a three year low. The Fed's quick reversal on its rate strategy also shows clear concerns for the economy. The ISM Manufacturing and Services charts are shown below via Koyfin. There are a number of other indicators such as Durable Goods Orders, a slowdown in job growth, Rail Traffic, and others showing similar deteriorating economic conditions in the US. The IMF recently trimmed its global growth outlook to a decade-low of 3%. A few years ago all the talk was about a global coordinated growth acceleration while all the data is currently pointing to a global slowdown, though there remains a coordinated effort of monetary stimulus to attempt to keep economies propped up as long as possible. We are early into the Q3 reporting season but my early takeaway is CEOs are showing a lot less optimism and we are not seeing a lot of raised guidance across all key industries. The yield curve inversion that was much of the talk over the Summer is also seen as a lead recessionary signal and historically would project the start of the recession late in 2020.



We are also in a year where not only are stocks rising but Gold and Bonds are also rising with similar performance which begs the question, which group is lying? Fund Flows are clearly confirming fears of equities and the flight to safer assets like Bonds and Gold has been strong since May. The US Election in 2020 is also a major cause of uncertainty that can persist through the November event, and potentially be a Black Swan event itself. The price action in growth stocks has been poor the last few months and a clear multiple compression period underway with a rotation to value and away from growth, another indicator of economic slowdown concerns.



From a technical analysis view the S&P 500 (SPX) is near a new high though currently struggling to clear trend resistance off July & September highs that could put a potential third lower high in play for October. Momentum is bullish with a 2019 rising channel pattern that held right at support at the October low and a bearish trend break would trigger on a move under 2850. There is a notable bearish monthly RSI divergence that looks eerily similar to the top in 2000 though one would like an 8/13 month EMA bear crossover for confirmation. From a pattern view a large broadening wedge may be forming, higher highs and lower lows, and if plays out would target a move back to the 2000-2200 zone taking out the Q4 2018 low. (Chart below via TradingView)

I've been firmly bullish US markets for many years and continue to be optimistic on a number of thematic and individual growth stories but the number of red flags are mounting. It never pays to be early in calling for a market correction and need to see price confirmation as well as further data signaling this is more than the average downturn in a bull cycle, but everything I am seeing tells me there is a high probability for a steep market correction in 2020. Sentiment in terms of positioning remains quite bearish with high cash levels and allocations to yield/safety and would prefer to see more of an overshoot in equity markets combined with a return of bullish sentiment for a better short set-up, possibly something we could see into the end of 2019.