Larry Cheung, CFA: Patreon Investment Community Research Updates
July 1st Half (7.1.22 - 7.15.22)

Title & Thesis: The next economic data point that drives the narrative will be released CPI headline inflation on July 13th. The Fed will adjust their guidance based on June headline CPI Inflation. I reiterate my stance that we must be proactive in buying big craters (8-10%) and then using bear market rallies (7-10%) to lighten up. I see the potential for a revisit to 3550-3650 in July. I view the first visit to 3550-3600 (+/- 1.5% discretion) as another ST trading/buying opportunity. I view 3900-4000 (+/- 1.5% discretion) as a range where I once again plan for risk-reduction. Volatility may get amplified as earnings season kicks in.

For context, please make sure to read my previous updates leading up to this one so that you understand my thought process.

Important Note: Given the heightened volatility in the market, I will make this Bi-Weekly report relatively briefer, and include more commentary in our News Feed channel inside Discord as I believe this is a market environment that requires more frequent updates. If you enjoy my research, please share your experience with friends/family who could benefit from my work. TY as always.

Also, I am watching the market every day from 930am-430pm EST.

Dear Patreon Investment Community,

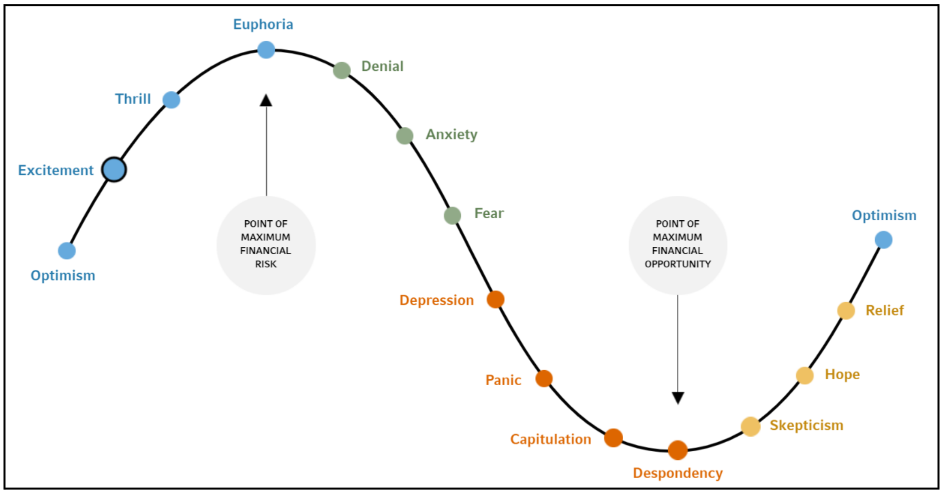
We had a wild ride in June, and this market has shaken out even some of the most veteran retail investors with this volatility. If you are reading this note, understand that we have finished Stage 1 of the Bear Market. Stage 2 of the bear market is now in motion. I believe that in the market cycle image below, we are currently at "fear." However, we have not yet reached the more insidious stages just yet.

The 2H of 2022 is going to determine the real winners and losers of the market. Survive this 2nd half of the year, and you are well on your way to experiencing the benefits of the eventual bull market that will return. There will be intense bear market rallies that come our way followed by large drawdowns. Put on your long-term hat, because this market will only reward those with patience. I expect big buying opportunities later this year.

We have three simple missions for the 2H of this year:

1.) Identify strategic buying opportunities with layered purchases (NEVER all at once)
2.) Developing the mental/emotional strength to HOLD through volatility if you bought at good prices
3.) Identifying bear market rallies where we should sell into strength

Bear markets have historically lasted 12-18 months. We are at the 6 month mark. This will be a marathon. I need you to be strong. At the end of all this, for survivors in this market, you will see prices that will represent lifetime opportunities.



No matter how difficult your emotions may become as volatility enters its next stage, remember that research and planning will stack the edge in your favor even if the near-term looks/feels/seems exceptionally challenging.

I will be with you every step of the way. Lengthen your timeline. Use every day this year to learn. You won't go through many of these events with this magnitude in your lifetime, so do not waste this opportunity to transform your skills.

With that said, let's discuss where I believe markets take us with my conclusions first, and then my commentary second.

Keep in mind that everything provided here is considered my personal journal of opinions, and not financial advice.

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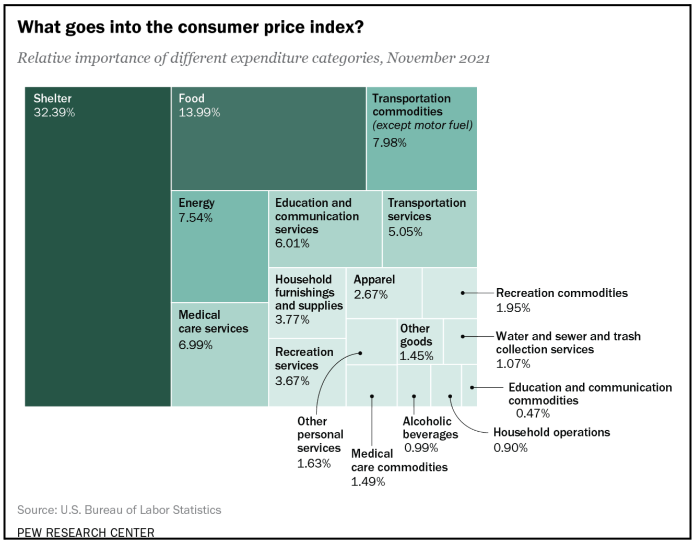
Summary and Conclusions:

Now I know that some of our Members want to get straight to the conclusion first, and then read my research after. Here are my views on the market, which have stayed the same since my previous report. The only thing that has changed is the market's pricing.

- On Inflation: So long as Crude Oil and Fertilizer prices stay high, you will have the energy and food components of the CPI stay elevated. You can see that Food and Energy make up 20-22% of CPI.



- On Consumers: I view the US Consumers as in a relatively vulnerable position. Oil and Food prices are far too high for US Consumers. Oil takes up about 3-5% of disposable income, and Food takes up another 10-15%. For many Americans, rent is about 25-35% of wages. I'm using rent as the proxy because most millennials rent rather than own their homes. Add this up, and you have roughly 45-60% of disposable income going to necessities. This does not leave much for consumption if this type of consumer is fearful about their job prospects. **I am in the camp that we will see <u>at least</u> a soft recession (if we aren't in one already).**
- On the Fed: The Fed believes inflation is far too high, and I do not buy into the argument that the Fed will slow down its tightening (at least for the July & Sept several meetings).
- On China: China continues to prioritize growth as Xi Jinping enters the 20th Party Congress meeting this Fall where he is expected to get re-elected for a lifelong term. Chinese officials need to show the economic strength of its citizens in order to gain their continued support of their political strategy.
- On the S&P 500: With this backdrop, here is my thinking:
  - The S&P has appropriately priced in the Fed's verbal communication that they will raise the target Federal Funds rate to 3-3.5%. Assuming no earnings recession in the SPX, I do believe bear market rallies can bring the SPX up to a P/E ratio of 16-18x, equivalent to a 3900-4200 on the upside. 4200 is an overshoot IMO given current macro conditions.
  - The S&P 500, in my opinion, has not priced in earnings deterioration. The biggest risks from earnings deterioration comes from the following companies

        - Apple on the Consumer
        - Microsoft on Enterprise Spending
        - Google on Advertising
        - AMD/NVDA/MU on Chips' Outlook
    - Some of these names (see below) are still trading at valuations that aren't yet considered bargains. As a result, disappointment from AAPL/MSFT/GOOG will confirm that we are in a 1.) high inflation 2.) weak corporate earnings 3.) rising interest rate and 4.) geopolitical turmoil environment
    - Up until now, it has been corporate earnings that have prevented the SPX from falling as severely as the Nasdaq.
    - In the intermediate term (looking out until end of August), in a continued drawdown, I view S&P 500 defending a 13-14X P/E multiple, which is in-line with previous recessions that we have experienced in the U.S (see chart below). This would translate to a 3400-3550 level.
    - At the troughs of the Financial Crisis, the SPX forward P/E was 9-10X. That would represent 30% downside in the SPX from here, meaning we see a ~3000 level on the index. **This would be a catastrophic level for all investors, and I will monitor the risks of this potential on a daily basis - do not worry at this very moment.** I will do my best to guide you to lighten exposure far before we reach those levels.
    - The Fed will raise interest rates but with the federal deficit as high as it is, they too have limits in how high they can raise rates to combat inflation. That is the modestly good news - that the Fed cannot raise rates past certain thresholds without putting enormous stress on the federal deficit.

To put it simply, I view 3900-4200 SPX as a bear market rally target range to reduce risk. Obviously the higher the index goes, the better pricing you get to reduce exposure.

On the downside, I believe the SPX may revisit that 3550-3650 range as previously mentioned, with a potential overshoot to 3400-3550 if fear grips the market.

If we get to 3550-3650 due to fearful sentiment and not because of fundamental deterioration, I will be a buyer in that range. If we get to 3550-3650 because of weak Apple earnings or a major macro shift, I will wait until 3400-3550.

If we get to 3400-3550 due to simply fear and not fundamental deterioration, I will be a strong buyer in this range. If we get to 3400-3550 because of fundamental deterioration, I will purchase in the manner of a regular DCA rather than aggressive purchases.

I will help you identify if the selloff is fear-driven or fundamental/macro driven.
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Now let's move onto to see the state of the market

<u>A quick summary of market conditions that I am monitoring</u>

- With the SPX at 3750, the market is still no longer oversold. Its RSI is near ~40, which means that risk/reward in the current environment is neutral. Whenever the RSI is around ~40-50, I typically do not guide our community for additional purchases unless the macro environment is very attractive or fundamental developments are very favorable.
- Nasdaq is now down as much as 30% from highs.
- **VIX has collapsed from 34, down to 27 on the latest SPX 7% rally. And now back to 30.**
- 10Y at one point fell to 2.8% before rebounding to 3.2%. Now at ~2.9-3%.
- Dollar Index at one point felt to 103, and now is back above 105.
- BTC is range bound between 19 and 21K
- Gold is stable in the 1820-1870 range. This implies precious metals investors are currently unsure of the Fed's intentions
- ARKK remains under pressure, and high-inflation is the kryptonite of Cathie Wood's ARKK Fund
- Semiconductors have underperformed QQQ, which is in my opinion a greater problem in the big picture
- China's easing has boosted Chinese Internet, but their technical levels are near the upper end of the range
- Commodity stocks CF Industries & Mosaic, along with XLE ETF and oil stocks are starting to falter (which hints to me that we have entered the next stage of the bear market)

(Keep reading below)

SOXX and the Nasdaq-100 Relationship (SOXX/QQQ on TradingView):

My opinion is that there is no sustainable bounce in the Nasdaq until Semis demonstrate strength. Any strength in AMAT/LRCX/AMD/NVDA are leading indicators to markets firming up. Or vice-versa.

Regular readers of my research know that I am a believer that the Chips industry (Semiconductors) are a powerful leading indicator of market strength. If Semis are demonstrating relative strength to the Nasdaq, it is only a matter of time before the Nasdaq recovers. Vice-versa is also true: if Semis is weak while the rest of Nasdaq is strong, my view is that the Nasdaq will eventually falter.

Semiconductors are a way to express a view on global growth, the pace of innovation, and consumer strength all at the same time. When semiconductor valuations and outlooks are weakening, that means the R&D budgets of tech companies are being pulled back.

To help you connect the dots, the R&D expense line in the tech industry is the Revenue line for Semiconductors. If R&D is slowing, you can expect revenues to slow for Semis.

My sentiment on what drives Semis continues to be consistent from my previous reports. I believe that the longer the Russia-Ukraine war drags on, the more disruptive the semiconductor supply chain will be.

Today's semiconductor valuation implies that there are not only issues on the supply side due to the Russia-Ukraine war but also issues on the demand side in the form of a weaker consumer.

We can see this clearly through the share price of AMD, which has a large B2C business where AMD fuels the graphic chips for PC and gaming. AMD's data center and B2B business is likely to stay robust, but they cannot completely overshadow the issues in a weak consumer market.

The latest development that has casted pessimism into Semis is that Finland and Sweden joining NATO is likely to extend the timeline of the Russia-Ukraine war. This development lengthens the Russia-Ukraine war because Russia is now geographically surrounded by more NATO countries, and this additional level of agitation is going to push out the timeline for any serious negotiation for peace.

This means that the Semis industry is being squeezed on both sides - the demand side due to a weaker consumer outlook caused by the Fed AND the supply side due to uncertainty in chip production due to the Russia-Ukraine crisis.

Now this analysis tells you why Semis have borne the brunt of the pressure, but I know all my readers want me to answer the question: when is the expected timeline of the bottom, and where is the opportunity? And how to play the opportunity.

To answer this question, I must first remind you that Semis is the highest-beta segment within the Nasdaq. You will not find a sector in the Nasdaq that can produce stardom like returns or pain-induced losses like you will in Semis. For that reason, if you cannot handle volatility, do not even think about investing in this sector.

If you believe that you can handle volatility and you have done an honest self-assessment of your risk-tolerance, then here is my opinion.

<u>My Opinion on Semis:</u>

- I personally believe Semis as a sector with SOXX being a proxy has the following attributes based on my researched scenario analysis
    - Hard Recession: Semis have another 15-25% to fall from here
    - Soft Recession (Soft Landing): Semis have about 10% drawdown from here
    - <u>Temporary</u> Growth Scare: Semis will choppily range from 5-7% drawdown to 5-7% rally
    - Sustained Economic Rebound due to Inflation Peak /Russia-Ukraine Resolution: Semis rally 20%-30%+ from these levels over a 6-9 month period once the rally begins

Now to tell you how I base my conclusions, I look at a combination of fundamental and technical levels together with my macro analysis.

In this table below, we have important metrics that I tend to focus on to help me stay focused on the objective data. Most investors focus only on price.

I don't do that.

I focus on these other columns here, and I make an investment decision based on OTHER columns and not just the share price. In other words, for beginner investors who want to get more advanced as an example, I would encourage you to start thinking in line with "I'm buying/selling XYZ stock at a PE ratio of XYZ and at an RSI of XYZ" after considering the macro environment. **Never think in terms of "XYZ stock fell 10% last week, so I'm buying it now on the bounce."**

We can see that on a fundamental level, Semis forward P/E ratios and P/S ratios are well below their 3Y and 5Y medians. Now while this tells you that the market has discounted their valuation relative to their history, we also have to use technical indicators to identify the proper entries. If you are a **true** long-term investor, I view the Semis industry as having priced in a lot of pessimism and risk/reward for long-term investors to be very strong.

However, if you are looking to minimize risk in Semis, then wait for confirmation that inflation CPI has peaked, consumer confidence has bottomed, and Russia-Ukraine make peace. That said, confirmation means you will have to buy at higher prices.

Personally, I will be doing a bi-weekly averaging down plan in AMD/AMAT/LRCX/NVDA as I believe any bounce will be sudden and fast. I will do slow DCAs at first, but increase my DCAs if the selloff intensifies (see scenario above). I'm also willing to lock up any NVDA positions accumulated between 120-140, AMD between 50-65, or AMAT 70-85 and simply not touch it for 12 months.

Semis right now is the trade that China was in February/March. The trade that no one wanted to be in, and the trade that everyone hated. The trade that results in intense short-term pain for considerable long-term gain. Once again, do not touch this sector if you are risk-averse. Start small as well. We haven't fully bottomed.

Symbol		Name	Price	14-Day Relativ. Strengt. Index	50-Day Simple Moving Average	200-Day Simple Moving Average	PE Ratio (Forwar.	PE Ratio (3y Median)	PE Ratio (5y Median)	PS Ratio (Forwar.	PS Ratio (3y Median)	PS Ratio (5y Median)
AMAT	+	Applied Materials Inc	90.55	36.56	107.87	131.54	12.07	19.79	17.96	3.096	4.117	3.703
AMD	+	Advanced Micro Devices Inc	75.80	34.63	92.32	115.43	17.26	99.13		4.661	8.664	6.437
AVGO	+	Broadcom Inc	482.84	34.83	554.53	568.02	13.09	43.76	39.30	5.923	7.257	6.131
LRCX	+	Lam Research Corp	421.40	39.63	473.79	565.41	13.28	21.39	18.92	3.474	4.992	4.167
MU	+	Micron Technology Inc	54.59	34.06	67.00	76.96	5.812	19.05	10.19	1.828	2.896	2.529
NVDA	+	NVIDIA Corp	149.20	39.75	178.92	237.60	27.40	70.98	54.05	11.01	21.29	15.21

By YCharts (Our Channel Sponsor & Data Provider)

Chinese Internet Equity Strategy:

The best time to accumulate was obviously back in March-April 2022 as we discussed. Chinese ADRs have quickly priced in the positive developments. Bloomberg media headlines are now positive on China. Institutional investors bought around the same time I guided back in Feb-April. Retail investors are chasing now.

<u>Before reading this update for Chinese Internet Equities, make sure to read my previous report. My macro opinions on China continue to be LT constructive since last update. View previous report to view.</u>

In hindsight, it now appears obvious that with China's lockdowns easing and the U.S. entering QT, that Chinese equities would outperform the U.S markets.

This opinion that I've shared with the public on Youtube has been met with extreme skepticism, but in the end, even the people who disagree with my views cannot disagree with the chart below where it displays that we as a Community have been correct relative to the skeptics.

Alibaba's recovery is a powerful reminder that it takes TIME for my ideas (like any other good idea) to work out. Most of my highest conviction views will take place at a time when there is extreme disorder in the market. If investors think in terms of days or weeks rather than months, they will unfortunately be unable to capitalize on the long-term benefits of my research.

Sometimes a good trade could take a long time to play out. As long as you size your position in a way that doesn't disturb your emotional well-being, you should always give your ideas lots of time to play out.

Chart of BABA vs. QQQ

Since my last report, China's macro picture continues to stabilize with the COVID lockdowns being scaled back as China achieves its zero covid policy. The latest development is that China is also easing travel restrictions by cutting the number of days of quarantine, which should facilitate consumption and the travel sector.

I continue to believe the Party is interested in shoring up economic growth to have political clout ahead of President Xi's coming re-election term this coming Fall.

But at the same time, I do not believe that regulations are going away, and the [latest guidance provided on Chna's livestreamers]is an example. This is why I am cautious on companies that rely heavily on live streaming for their future prospects, like Bilibili. The opportunity in live streaming driven sales is enormous in China, and I view New Oriental as soon to be an opportunity to add back onto my coverage universe if they can keep their live streaming momentum going. I've added a very light addition to EDU on top of my existing position in conjunction with the video that I recently published on Youtube.

This means that while economic growth is likely to resume in China, there are valuation ranges where investors should start paying attention to risk-reduction. As you can see in the chart below, Alibaba now has a forward P/E ratio of 16x at the time of this writing. When I advocated for $BABA, it had a P/E ratio of 12X, which is a slam dunk valuation for investors who had the proper patience.

At 16X, Alibaba now has a similar forward multiple with the S&P 500. And while Alibaba continues to have growth prospects in front of it, we have to be cognizant of investors' capital allocation of resources. Because Alibaba's valuation is no longer at its nadir (low point), investors have other stocks to potentially choose from.

In order for investors to keep expanding the multiple for $BABA, they need to surprise with a strong outlook in the next quarter. A rising share price must be accompanied by verified strong fundamentals. So long as $BABA reports good numbers, the recovery is intact.

As of this Bi-Weekly report, I view that if $BABA gets to 18X P/E or ~130/share, that is the beginning of an area for risk-reduction. Any overshoot that approaches $BABA $150 in a short period of time should be faded IMO if the macro environment is the same. If the macro environment greatly improves, I will let you know my opinion.

On the other hand, if $BABA gets back to 14X forward P/E, which is around that ~95-100/shr region, that is once again an area of value for long-accumulation. If for some reason, we see 12X P/E again on BABA which is that 80-85 region, assuming China's policy is still pro-growth, this will be an excellent area of value for purchases.

I view the market as being hyper selective in what stocks they are selecting. Valuation now very much matters.

In an era of tighter money, investors are doing more due diligence to ensure every dollar allocated is being allocated in a proper way.

We paid 12-13X for the BABA P/E earlier this year. Now it's 16X.

Not expensive, but no longer dirt cheap. I'll continue providing guidance inside Discord when anything updates my opinion.

See Chart below of Alibaba and its Forward Multiple


Alibaba Group Holding Ltd Price
200.00
150.00
117.68
100.00
50.00
Jul '21
Sep '21
Nov '21
Jan '22
Mar '22
May '22
Alibaba Group Holding Ltd PE Ratio (Forward)
30.00
24.00
18.00
16.00
12.00
Jul '21
Sep '21
Nov '21
Jan '22
Mar '22
May '22
LarryCheung.
Jun 28 2022, 12:59PM EDT. Powered by YCHARTS

Appendix of charts mentioned

Chart 1: S&P 500 Forward Multiple: 16X

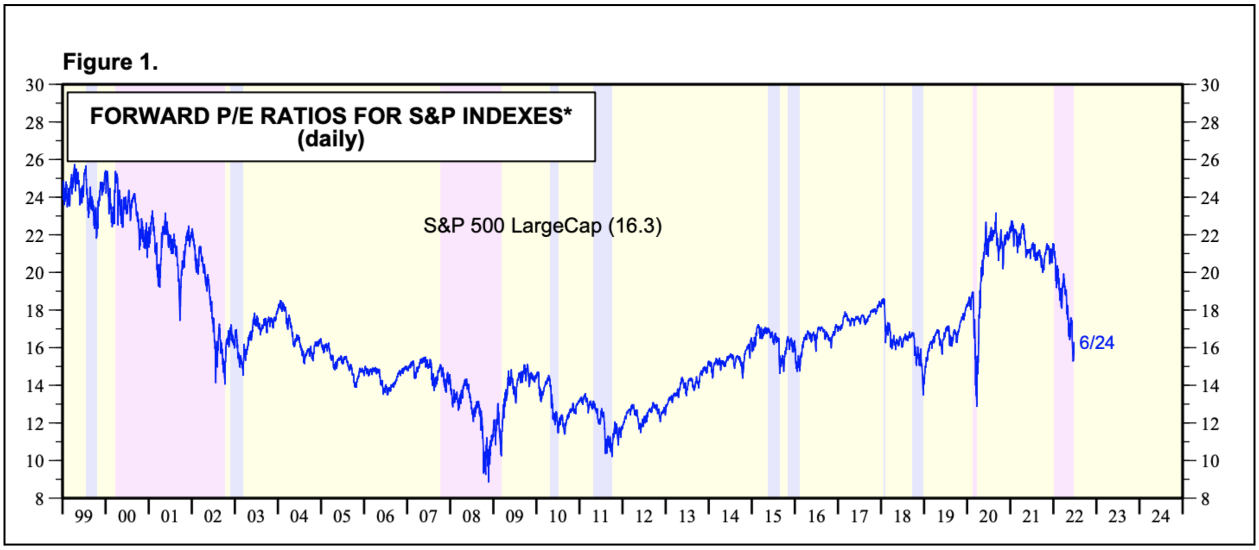

Chart 2: Chart prices of Fertilizer Index