Larry Cheung, CFA: Patreon Investment Community Research Updates
June 2nd Half (6.15.22-6.30.22) - Initial Thinking on June FOMC

Title: An insidious bull trap was laid during the multi-day consolidation in early June as big money most likely knew about CPI 8.6% before it was released. While the LT trend is lower, we may soon witness another bear market rally that could bring us back to the 3850-4000 level before sellers double down on their efforts. Any drawdown to SPX ~3550-3650 is a moment of opportunity for ST traders to buy this crater in their best ideas in the short-term.

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.

Dear Patreon Investment Community,

This Bi-Weekly report is being sent out during FOMC day. Therefore, it will be relatively briefer compared to past notes, and given market volatility, I will focus more timely commentary inside Discord.

For that reason, for our members who are very focused on my directional opinions/guidance, please read this report purely for research purposes and focus on my Discord in terms of levels I'm watching for adding/reducing risk.

When I will flesh out a more detailed opinion, I will have my opinion reflected in my levels & guidance inside Discord after I re-read the Fed Q&A transcript.

For now, here are my preliminary thoughts.

- I believe the bond market (2Y yield and 10Y yield) have done a LOT of the tightening for the Fed.
- The Dollar index is supporting the thesis that investors are rushing to take advantage of higher yields here by buying US debt (you can only own US treasuries by purchasing via USD)
- The Fed has limits in terms of how high it can raise the Fed Funds Rates before true havoc enters the financial market.

In short, for those of you short on time and want a quick conclusion, my current thinking is the following based on scenario analysis:

- We may soon (anytime from now to next 2 wks) see another 3-6% bear market rally that could bring the S&P 500 into the 3850-4000 range again. However, I believe most of that run will be due to short covering and not organic investor demand. Any overshoot north of 4000, without the 2Y or Dollar index retracing, is probably not sustainable. **My bias will change IF the 2Y and Dollar come back down (will alert you in Discord)**. Otherwise, I believe any 3-6% rally from new positions started at SPX 3750 is an opportunity to once again reduce risk and NOT to bet on a continued recovery (yet - until further notice).
- Ultimately, if the Fed guides to raise 75BPs later this year in all the meetings of July, or Sept, or Nov, or Dec, **then it truly time to take any bear market rally to strategically fade long exposure and increase cash positioning (I will provide guidance in Discord)**.
- If the Fed guides to raise even 50BPs later this year in the rest of the meetings (July, Sept, Nov, Dec), I see the S&P 500 having a very tough time getting the "blow-off" top that several Seeking Alpha and Youtube analysts are calling for.
    - Look, I want that scenario to happen as much as you do, but if consumers are 70% of US economy, and all their money is going to credit card debt payments, food, gas, and other items that are now more expensive, I just struggle to see how corporate earnings can guide optimistically into 2023.

My sentiment in this Bi-Weekly report is very similar to the previous one. I'm not any more bearish or bullish than I was 2 weeks ago (even though prices have dropped a lot).

Now why is that? It's because we've been expecting the markets to chop very severely in a range. And a range is exactly what we've gotten.

I even discussed 3700 SPX inside Discord as a potential level that the index could reach, and we indeed reached it this week. This was all discussed when SPX was still at the 3950-4000 range.

As a result, so far, no material surprises. But my thinking is always updated when data comes out, and I will keep you updated with my opinion.

Now before I walk through a summary of the market, I want to provide scenario analysis on the June FOMC. At the moment, I do not believe a 100BP hike is in play for June, and my scenarios will reflect this.

- Scenario 1: Fed hikes 75 BPs, and guides for future meetings to hike 50 BPs.
  - My opinion: Markets will CHOP, and bulls and bears will fight viciously with each other from 2pm-3pm with no side having an edge *until final hour of trading or the next trading day*
  - Unlikely scenario: If Fed guides for future 75BP hikes at all future meetings, I personally might be inclined to sell some of my existing positions at losses to raise cash. I almost never like to guide to sell when markets decline, but this will be one of those situations. The LT outlook will objectively darken, and it does not make sense to be in a market where it's clear companies will get fundamentally weakened. I will let members know what I do inside Discord. **The good news is that this is not my base case scenario.**
- Scenario 2: Fed hikes 50BPs, and guides for future meetings to be more hawkish
  - My opinion: Markets will rally strongly briefly, but the sustainability of the rally will be in question after 1-3 trading days. For me personally, if I'm on margin, I will 100% use this opportunity to continue to reduce margin on a mkt bounce. If I'm on cash, then you have a bit more flexibility to hold and wait. Remember, margin gets more expensive as Fed raises rates.
- Scenario 3: Fed hikes 50 BPs, and guides for future meetings to be 50BPs.
  - My opinion: The 2Y yield will reverse lower south of 3.4%, Dollar will weaken, and the SPX could rally back to 3850-4000 within ~2-4 trading sessions. At that point, I will provide additional guidance on my thinking.

Keep in mind, that this is my personal opinion and my thinking is a reflection of my journaling of my thought process.

Should the Fed produce any scenario outside what I listed, my biases will be completely void and I will update you in Discord in a timely fashion.

Once again, my goal is to provide you with my thinking process and do my best in terms of my research. But outcomes may be very different from my thinking.

(See next page)

Now let's move onto to see the state of the market

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

- SPX's multi-day consolidation phase in early June ended with a dramatic 10% drawdown in 3 trading days. Traditional TA methods such as RSI show that the market is near oversold territory, but my macro indicators (2Y, Oil, Dollar) tell me that it may not be time yet to buy the index.
- Certain names are attractive to me such as FB, AMD, GOOG, MSFT for a swing trade opportunity (not yet buy & hold).
- Nasdaq is now down as much as 33% from highs. **You can assume that US 401K accounts for people aged 25-40 have gotten decimated and that investor confidence is very fragile.**
- VIX soared from 25 now back to 34.
- 10Y bounced off the 50-Day moving average to local highs- now 3.4%
- Dollar Index bounced off 50-day moving average to local highs- now 105
- Digital assets have gotten trounced. Many Youtubers are telling their viewers that BTC will create generational wealth at these levels. If many hard-working Americans cannot afford gas & food, and QE being over, I struggle to see how BTC at 20K is "remarkable value", but that's just my view.
- The ARKK/SPY and ARKK/QQQ ratios continue to support a structural downtrend.
- SOXX/QQQ have retraced off upper range bound levels, leading to a more severe selloff in technology

(Keep reading below)

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

In the past, I've voiced my opinion that it is the Semiconductors industry that leads the QQQ technology index. I continue to believe that is the case.

We saw strong relative strength throughout May in SOXX compared to QQQ (see SOXX/QQQ ratio chart above). However, that relative strength has started to be unwound. I have several opinions on why this may be the case.

Russia-Ukraine

- Zelensky is showing no signs of wanting to end the war or make concessions. The longer the Russia-Ukraine war drags on, the more disruptive the semiconductor supply chain will be.
- AMAT/LRCX's latest earnings report demonstrated that the backlog that was very strong in early 2022 may start to run its course in 2023. While I still believe AMAT/LRCX has upside, these names continue to be hypersensitive to Russia-Ukraine.

China-Taiwan

- Taiwan's TSMC takes up about 52% of the global semiconductor foundry market, and the country accounts for 92% of the world's most advanced semiconductor manufacturing.
- This means that any US-China escalation rhetoric on Taiwan (even if an imminent invasion isn't on the table) is going to put a lid on investor enthusiasm on Semis.
- The semiconductor chip backlog driven by demand is starting to fade in 2023 due to a weakening end market.

One of our Patreon members asked me about TSM's stock. I want to make it clear that TSM is a clear leader in the semiconductor industry.

However, I believe that Semis already is a macro trade, and TSM is not only a macro trade but one that has to balance Taiwan's relationship improving significantly with China. I've often expressed publicly that I would like to see all countries get along, as it is better for everyone.

But real-life politics make this desire difficult, and sadly, unless Taiwan's political party shifts from the DPP to the Kuomintang (KMT) in the 2024 election, I view the China-Taiwan relationship continuing to be tense. This simply does not bode well for TSM for investors who wish to buy & hold this name. Given that it is a Taiwanese company that has great political risk due to military conflict from the U.S. AND China, this name simply isn't for me.

I hope shareholders do well with TSM, but I'm not in it.

On Youtube, I will discuss the political structures of Taiwan of DPP and Kuomintang (KMT) if you are unfamiliar.

Chinese Internet Equity Strategy: Divergence from U.S. is a welcome sign, but signs of overextension are objectively surfacing (Must continue to be long-term)

KWEB/QQQ ratio indicates positive divergence, but divergence may need consolidation before continuation.

<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>

If we look at the KWEB/QQQ ratio above (which measures whether China is outperforming/underperforming U.S. Tech), we can see that China is clearly showing a positive divergence compared to U.S. Tech since the end of March.

This was reflected in the many macro updates that I've discussed in previous Bi-Weekly reports ranging from public commentary/speeches at China's Vice Premier level, at the regulatory level, and at the monetary policy level (via cutting rates).

Investors are starting to understand the environment we are in: that the U.S. is in QT mode and that China is in easing mode.

Now, whether the policies that China is enacting will work are still to be determined - what we do know is that the policy is pro-growth. The policies are designed to stabilize housing prices, stimulate consumer demand, and make economic growth strong enough to achieve the 5.5% GDP that China has set out to achieve.

Meanwhile in the U.S., we are witnessing clear intention at the Fed to weaken demand to control inflation (because they cannot control supply). Home prices are halting their advances, and are about to decline. Consumers are in a lot weaker shape than they were 1 year ago. Oil and gas prices are taking a serious toll on consumer psychology. We see inventory buildup at the largest U.S. retailers like Walmart and Target.

Meanwhile, we see phenomenal strength at low-ticket item stores like Dollar Tree, and to a lesser extent bulk-shopping leader Costco.

What does this tell you?

Tells me that if the Fed continues its QT path, the consumers' situation may get worse before it gets better.

The U.S. stock market will experience bear market rallies that will allow investors to lighten up exposure, and tactically take short-term opportunities to profit. It will not go down in a straight line without opportunities to mitigate losses.

I intend to help you capture as many of these scarce opportunities available as they come.

While the risk is to the downside, I cannot recommend the typical member in my Patreon to short-sell the market. If you get the timing wrong (aka market goes up & your short position goes down), the opportunity cost is enormous. Your purchasing power would become weaker when the market went up. That is not an ideal situation to be in.

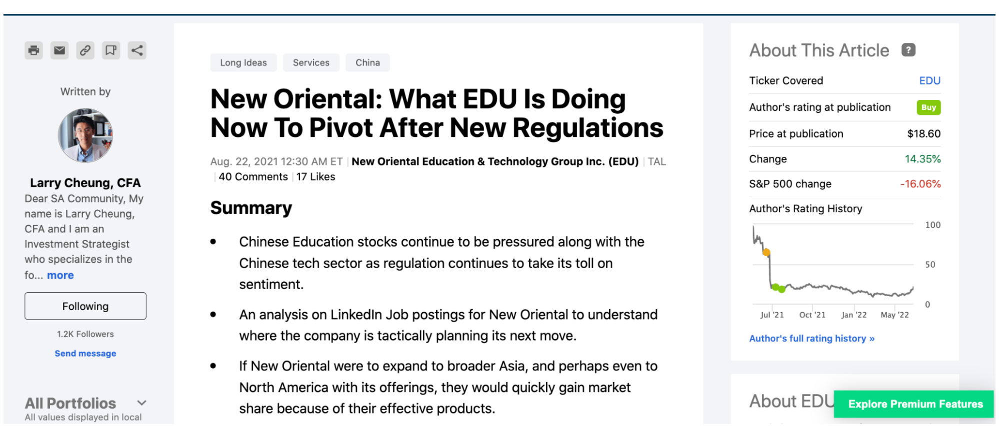
China Education: A brief note on New Oriental (EDU)

I know many members are interested in hearing my opinion on what's happening with China Education and why EDU has gone up so much in the past several weeks.

I'm going to keep the suspense high, and make a Youtube video on this in the near future. Stay tuned.

<u>*Quick preview:*</u> I still hold EDU, but less than I have before, and I've marked it off almost like a venture capital play. The future of their business (and stock) is going to be driven by live-streaming.

In a stunning reversal of EDU's stock (after-adjusting for its stock reverse-split) in the past several months as China macro improves, EDU is now trouncing the S&P 500 since Summer 2021.



<u>**This is a reminder to all of us that investing in China is a *long-term* play.**</u> All of the alpha can literally come in the span of several months within the time horizon that you're in China.

I will link my Seeking Alpha article on New Oriental (EDU) in the Special Youtube Bonus folder if you want to read it.

It goes without saying that after a 100% rise off the lows in just 6 weeks that I cannot recommend this name at this moment in time.