Daily Market Note: September 5th 2023 by Larry Cheung, CFA (This note will be longer than its usual length as setups are discussed)

September is here: What I'm watching, What I'm looking for.

Forward-looking Conclusions of this note:

- Macro: The VIX trades near 2019-2020 lows at 13-13.5 with the Unemployment Rate now making a notable move higher to 3.8% and Jobs Openings (JOLTs) shrinking. This convergence of simultaneously low volatility and weakening macro data cannot last indefinitely, in my view.
- Stock-Specific: Ideas and setups for September discussed below.
- Bonds: As conveyed in a very recent note, our TLT Jan 2024 Sell/Short Puts netted us 30-40% of the option value evaporating during TLT's range bound movement during August. If we see TLT revisit 92 or lower, the probability increases that we see unexpected adverse shocks in Equity & Bond markets.
- China: Hong Kong stocks digest the recent property stimulus rally with a 2-steps forward, 1-step back type of behavior. Fundamentals are improving, but perhaps the greatest opportunity isn't just equities – as will be discussed below.

Daily Market Note & Context

Welcome back from Labor Day weekend – I hope you are all well rested and ready for the seasonal tricky setup that is September and October.

In this note, I will highlight ideas & setups that I'm actively watching for this month and the conditions I have to enter these ideas. So that I can make this note concise and directly to the point, please be sure to catch up with my ongoing macro views by reading the last 3 Daily Market Notes (or 5-7 if you are a new member) as this note will be much more action driven and focused on implementation.

From a big picture standpoint, I keep my view of being tactically constructive on the U.S. market while being very aware that shocks in the system can all at once change the tune within 2-4 trading sessions. With Unemployment rate finally starting to catch up with the lag from monetary policy, JOLTs job openings declining, and Consumer Confidence weak, I do not see much possibility of significant EPS growth in the coming 2-3 quarters for the S&P 500, which is a pre-requisite to sustain a durable advance based on fundamentals. In the absence of EPS growth, there will be what is known as valuation expansion, which is a form of market advances that represent rising stock prices without rising earnings. The S&P 500's rise in 2023 has been primarily due to valuation expansion, where investors bid up the Forward P/E multiple (now 19X) in the hope that EPS will catch up later. That can persist during periods of low rates, but with the 10Y Yield now rechallenging 4.2%, seasonally weaker months like September/October is a window of opportunity for Sellers to cause sporadic shock events, which I hope to prepare our folks for within our Community here. Below I will talk about the setups that I am watching in conjunction with my views for the coming weeks ahead. The setups are organized by Category, Timeframe, and Risk-Tolerance.

So here's the context: with the VIX now at 13 (near multi-year lows) and the S&P 500 at 4515 (17% advance YTD for Passive Fund Managers), I must now share that Selling Puts across my coverage becomes more of a vulnerable strategy at current elevated prices. Earlier in August, Members saw me get very active with Selling Put setups within U.S. technology such as AAPL, AMD, META, MSFT, ORCL, TXN (to name a few) as it was my belief that after a 10% quick drawdown in QQQ, markets were poised to at least stabilize first and possibly recover. This indeed happened and as the indices and broader tech sector recovered, the Put Options on nearly all guided names (with the exception of the U.S. Thrift Shops DLTR/DG/FIVE) all saw evaporation of their premiums (good for Put Sellers, bad for Put Buyers), netting us a handsome win in an otherwise difficult month for most retail traders or passive investors. This month, I think that only a very select number of companies in my coverage has the margin of safety to Sell Puts on, which I will discuss below. I will also talk about other setups and ideas that I'm now watching.

September Equity U.S. & China Watchlist of Direct Shares/Options/Sector Rotation/Other Asset Class Ideas with Conditions I'm watching

Let me first start off by sharing that I am becoming more positive on China's Real Estate sector as an asset class (not necessarily the property equities). One of the reasons I am going to China this Mid-September (with probably more trips planned) as discussed in previous notes is to begin closely evaluating the market for Real Estate. One of the biggest "trades" that I will personally be making from a 5-7 year standpoint is to rotate OUT of the S&P 500 and INTO China Real Estate Tier 1 cities (especially the Greater China Bay Area) during this period of property value stress. I am not so interested in U.S. Real Estate homeownership as the value tradeoff for what you get is typically not ideal in many coastal cities. I am planning to dedicate up to 1/3 or even 40% of my entire asset allocation to China Real Estate, and for this reason, must be more conservative in my equity investing and my positioning will reflect this. Because of my interest in this area, this means my observations and journey in this asset class will provide a lot of information to you that isn't readily accessible online. With this said, let's talk about setups for September.

From Intraday to Tactical

- As discussed yesterday evening in Private Group Chat, I view a light position in January 2024 at-the-money calls on VIX to be appropriate to target 10-20% appreciation of the option. **Once a market shock happens, this position must be closed immediately.** If there is no market shock in Sept/Oct, then I will close the position as I believe Nov/Dec will suppress volatility again.
    - This VIX Call also hedges the rise of Implied Volatility (IV) in markets, so it serves a dual purpose to limit the adverse effects of a rising VIX Implied Vol. on Sell Put Positions.
- If one wishes to not use Options, then one could use Futures. On Interactive Brokers, there are 2 VIX Future Products which trade outside of market hours.
    - VIX Futures (suitable only for large accounts): $10 for every .01 move or $1000 for every $1 move in VIX. For example, VIX goes from 13 to 14, then that's $1000 profit.
    - Mini-VIX Futures (more suitable for most accounts): $1 for every .01 move or $100 for every $1 move in VIX. For example, VIX goes from 13 to 14, then that's $100 profit. Or $100 loss if VIX goes from 14 to 13.
- If one wishes to hedge the market, keep in mind that Long Puts on SPY, Long VIX Calls, Long VIX Futures, or Short Micro E-Mini S&P 500 (/MES) are all very similar trades. They express very similar views.

Intermediate-Term (45-60 Days)

- JNJ: I am Selling Puts for January 2024 at 145 Strike. My timeline for this position is around 30-45 days as I think 20-40% of the premium value will evaporate if JNJ stays stable. This position is threatened if there is a sharp decline in a very short period of time. Slow declines do not threaten this position, in my view.
- If JNJ enters the 153-155 level, I am interested in Direct Shares for a 2-4% return expectation within 45 days. JNJ yields 3% as a Dividend Stock and offers defensive capital appreciation potential at the right level.
- Top ideas within U.S. Technology would be relative outperformance from AMD, META, and MSFT against other tech names.

Long-Term (9-Months+)

- I personally think that Hong Kong (HSI) and many constituents inside are positioned for a highly volatile cyclical upswing after the shakeout now that China is cutting downpayment rates for Tier-1 Cities in China, which will be a direct cause for improved consumer sentiment.
- Beyond day-to-day or week-to-week trading, I see 15-20% upside across China ADRs if given time to play out. Temporary Drawdowns can be significant during this period of time, and this sector is suitable for the risk-tolerant, but I see net/net higher prices for China ADRs and HK-Listed shares if given a 9-month timeframe into 2H 2024.
- On pullbacks, PDD, EDU, TCOM continue to be best ideas within U.S. ADR coverage. In Hong Kong, I see opportunity in Hua Hong (HK-1347) to recapture 23-25HKD (now 20) as China doubles down on chip self-sufficiency, BYD (HK-1211) to recapture 270HKD (now 250) as competition heats up with TSLA, and AIA (HK-1299) to recapture 75 (now 69) as Hong Kong's local economy and loan environment start to normalize.

Speculative Longs (this will only work if SPY/QQQ is stable) - make sure to take profits fast and quickly on these calls as a retracement can significantly move the option. Keep stop losses rather close by.

- Costco January 2024 Strike 550 Calls
    - Note: Longer-term, I see Costco higher than today's level. The only difficulty is the timing.

- Broadcom January 2024 Strike 880 Calls
    - Note: Longer-term, I see Broadcom higher than today’s level. The only difficulty is the timing.