Larry Cheung, CFA: Patreon Investment Community Research Updates
June 1st Half (6.1.22-6.15.22)

Title: Wall St is pushing the narrative for a bounce. If you got in early at the Snapchat moment as we discussed inside Discord, feel free to continue holding. However, risk/reward for bulls is no longer asymmetrical at SPX 4150+. I see potential bullish exhaustion at ~4250-4400.

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,

The second half of May has been packed with so many events that I believe a quick rebrief is in order so that you can refresh yourself with the current environment we are in with objectivity.

In my previous report, I discussed that my short-term forecast was most likely going to be met with extreme volatility with erratic sharp bounces and drawdowns. That description was very accurate up until Snapchat, and then markets have found their footing since that SPX 3880 retest. Most of Wall Street and Seeking Alpha have suddenly flipped bullish and are calling this past week a potential ultimate bottom. In my mind, bears have dealt bulls 7 weeks of pain. Based on historical bear markets, I wouldn't be surprised if bulls returned the favor for 1-4 weeks to deliver bears with sharp pain/frustration.

We have the US Dollar falling to its 50-Day Moving-Avg and the 10Y stabilizing, so these factors are constructive for U.S. equities. However, as I will discuss below, I believe if we see SPX 4250-4400 levels, that would be a potential area to execute risk-reduction of partial positions. Or for the more aggressively-inclined, consider light index shorts as hedges. I will let you know what I am doing at that point should we get there.

While prices are on the rebound, the structural issues remain in place. Out of all the issues out in the market, I am most focused on the Russia-Ukraine war. This crisis provides upside risk in inflation and also is a catalyst for higher global food prices. Emerging Market countries are facing pressure on food prices, and the longer the Russia-Ukraine crisis continues, the more likely that even higher food prices will make their way into developed economies. Citizens can put up with higher prices for non-essential items. High food prices are a very different story.

From here on out, I want to make it clear that we need to approach this market very differently from markets we've been used to during the 2020-late 2021 era. Make no mistake, we are in a bear market, and we need to adjust our investing style in this market based on this acknowledgement. Bear markets and the turnaround narratives that come with them can be exceptionally potent/persuasive.

Quantitative tightening (QT) of balance sheet runoff officially starts on Wednesday June 1st. Do I believe that the bear market has ended at the very beginning of QT? I'm not sure I can objectively make a strong case for this. I can make a case for a counter-trend rally as I've discussed in previous weeks, which has materialized. But I'm not sure I can make a case to officially call the SPX bear market over. Of course, more than anything else, I am more than happy to be wrong in this opinion. I want the markets to go higher for obvious reasons.

There will be plenty of opportunities to make money in this market, but the first principle is account survival. All of my guidance will first prioritize survival before discussing more aggressive strategies. You can't take advantage of my research opinions if you don't have a clean emotional state.

There is a direct correlation to the percent of your net worth invested in markets and your emotional stress/stake in your decision making. If the percent is too high/uncomfortable, you will be unable to take advantage of my research & insights during the most fearful moments.

While my investment community primarily focuses on strategy, I want to make it clear that investing is about strategy AND execution. This is why I also place a heavy emphasis on investor psychology, which I believe almost no other investment communities provide.

There were a good number of members telling me that they caught the names I mentioned inside Discord when SNAP took SPX to 3880 (I'm happy for you). There were also a good number of members who were unable to take advantage of this moment of opportunity because of the high level of fear gripping the market (I'll help you get the next one).

So I urge you to research what is a proper asset allocation for your situation. Choose an asset allocation that allows you breathing room, and will not damage your emotional well-being should markets take a nasty turn against your positioning. Every other analyst will just provide you the analysis, but me providing psychological management is what distinctly separates my strategy from others.

The most challenging part of falling markets (and rapidly rising ones) is NOT analysis, but managing emotions & psychology.

Along the way, I will share scenario analysis to do so along with probabilistic thinking.

Ready? Let's do a recap along with my commentary.

Major Events in the last 2 weeks

While most analysts and media outlets are heavily focused on where the S&P 500 is going on an index level, I am going to dig beneath the hood to help you understand how I am assessing the context of this latest bounce.

To make sense of the market, it is imperative that we understand what the largest corporations are seeing in their end markets. Combining my bottom-up (fundamental) and top-down analysis (macro) helps to provide a more complete picture of the environment, so that we act with objectivity and not based on headlines and what other influencers are saying.

Catalyst (in chronological order)	**Larry's Research Notes**
Walmart / Target	-Strength in high-ticket items and low-end items. Middle-priced items very affected -High inventory levels that will require discounting to clear -Switching from "brands to private brands" -Witnessing consumers spend more income on food rather than general merchandise
Snapchat Earnings	-Flattish average revenue per user (ARPU) growth -Significant pullback in brand marketing ad budgets
May FOMC Minutes	-Potential for moving rates up to "restrictive" territory -The Fed is paying attention to markets and saying that "conditions have tightened" -Still targeting to bring inflation back to 2% -The Fed is watching Dollar strength relative to Yen and RMB closely. The Fed is watching wage growth as a very important indicator for inflation. -Sees economic growth risk tilted to downside and inflation upside risk
Dollar Tree / Alibaba	Dollar Tree indicated that they are gaining a "new" type of customer. The type of customer that didn't previously shop at DLTR is now shopping there. What does this tell you? Alibaba reported stronger than expected outcomes, but is highlighting that consumers are adjusting their purchase mix to essentials and shying away from non-essential items. Once again, a similar theme to Dollar Tree, except in China.

Nvidia Earnings	NVDA earnings continue to demonstrate its leadership in its end markets. No serious issues in its organic business, outside of external impacts. It is important to continue following China Zero Covid because NVDA is a supplier of technology to Chinese EV companies. When EV production slows, so does the backlog in NVDA's subsequent revenue opportunities. That said, NVDA rides the secular trend in AI development, and their market leading position in their key verticals continue to be very healthy.
Costco Earnings	Costco publicly stated that it is not the right time to raise its membership fees. The company typically raises membership fees every 5-6 years, and the last raise was in 2017. On a macro improvement, Costco said they will revisit this stance. With a 90%+ retention rate and a strong gross margin profile, this reasonable price hike will be a powerful lever to grow their gross margins and profitability in the future. On Costco Stores: -Traffic continues to be very healthy -Different types of purchases - last year was home goods and this year is restaurants, travel, gas, tires. -Most of the inflation in Costco stores has happened in food items -Seeing a bit of fresh inflation level off from previous quarter Net Conclusion: -Costco continues to remain firm in their value proposition. -Says supply chain is improving across the board. 40-50 ships at LA port rather than 100-120.

My read of the situation:

- Walmart's earnings indicate that portions of their consumers are trading down on items.
- Costco's latest earnings commentary on fewer LA ship backlogs abating is a positive sign for the inflation outlook.
- Dollar Tree's earnings indicate that broadly speaking, many Americans are starting to feel the wealth effect of a growth scare as evidenced by their additions of new types of customers.
- Alibaba's earnings indicate that consumers are waiting for the employment picture to clear up and real estate prices to rebound before consuming more non-essential items.

Conclusions from this bottom-up analysis:

- The current high-inflation environment, even if it has peaked, is causing significant issues for both consumers and businesses.
- I don't see the Fed backing down 50BP hikes in June and July, which could continue to weaken consumer spending and housing demand.
- Many analysts are saying the Fed minutes were a lot more dovish than expected. I'm not sure I fully agree with this assessment as the Fed minutes clearly stated they would take rates to restrictive territory if they had to (see image below). The Fed indicated that they want to frontload the rate hikes and see if they need to continue to be as hawkish later this year. The media calls this "flexibility." I don't interpret this as particularly dovish. But again, this is my interpretation, and I could very well misread the intention.

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

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

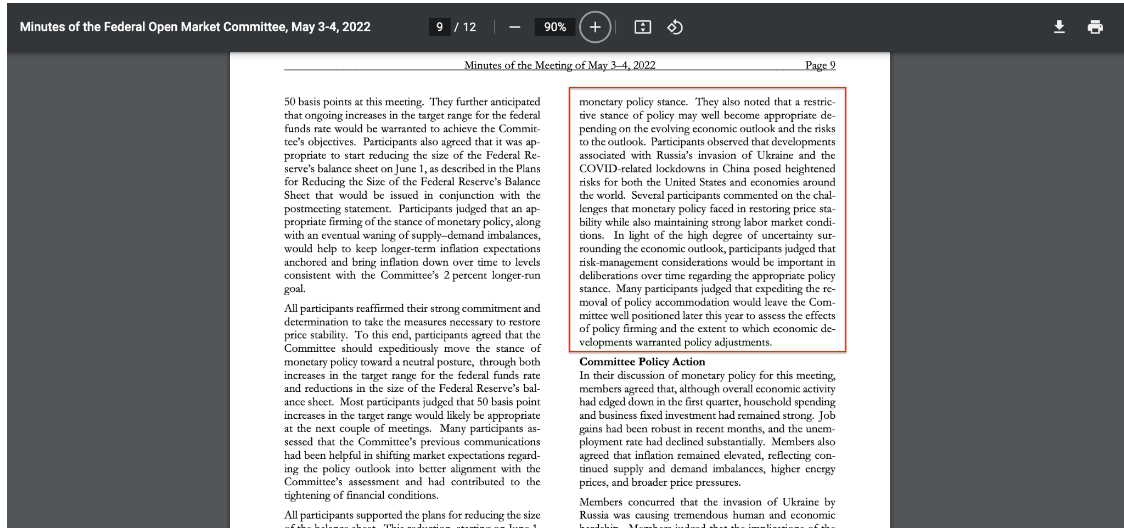
- Quick summary of relative strength in FAAMG (observations for last 2 weeks exclusively) which is 30% of the SPX
  - The AAPL/SPY and AAPL/QQQ ratio continues to look rather weak, indicating that it is not Apple that is supporting the market but rather the other constituents.
  - The GOOG/SPY and GOOG/QQQ ratio is parallel with Apple's ratios. They also look weak in comparison to the market.
  - The MSFT/SPY looks weak but the MSFT/QQQ ratio looks relatively solid. This implies that investors favor MSFT out of all the FAAMG stocks in this current environment.
  - AMZN/SPY and AMZN/QQQ do not look healthy as the consumer continues to bear the brunt of recessionary winds.
- SPX has begun a counter-trend rally from 3880 to 4150 (now 7%). Bear market bounces have historically been 10-12%. So we are approaching that potential range. Caution.
- Nasdaq was down as much as 30% from highs.
- VIX collapsed from 35 now to 25.7.
- 10Y now at 50-Day moving average at 2.74
- Dollar Index now at 50-day moving average at 101.7
- Digital Assets, particularly altcoins significant weakness relative to BTC.
- The ARKK/SPY and ARKK/QQQ ratios continue to support a structural downtrend.
- On the positive side, SOXX/QQQ is demonstrating continued strength

(Keep reading below)

The May FOMC Fed Minutes: What the Fed is actually thinking about

Link to Fed Minutes: May FOMC

Key word here: "Restrictive territory"


Minutes of the Federal Open Market Committee, May 3-4, 2022

Minutes of the Meeting of May 3–4, 2022 Page 9

50 basis points at this meeting. They further anticipated that ongoing increases in the target range for the federal funds rate would be warranted to achieve the Committee's objectives. Participants also agreed that it was appropriate to start reducing the size of the Federal Reserve's balance sheet on June 1, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that would be issued in conjunction with the postmeeting statement. Participants judged that an appropriate firming of the stance of monetary policy, along with an eventual waning of supply–demand imbalances, would help to keep longer-term inflation expectations anchored and bring inflation down over time to levels consistent with the Committee's 2 percent longer-run goal.

All participants reaffirmed their strong commitment and determination to take the measures necessary to restore price stability. To this end, participants agreed that the Committee should expeditiously move the stance of monetary policy toward a neutral posture, through both increases in the target range for the federal funds rate and reductions in the size of the Federal Reserve's balance sheet. Most participants judged that 50 basis point increases in the target range would likely be appropriate at the next couple of meetings. Many participants assessed that the Committee's previous communications had been helpful in shifting market expectations regarding the policy outlook into better alignment with the Committee's assessment and had contributed to the tightening of financial conditions.

All participants supported the plans for reducing the size of the balance sheet. This reduction, starting on June 1

monetary policy stance. They also noted that a restrictive stance of policy may well become appropriate depending on the evolving economic outlook and the risks to the outlook. Participants observed that developments associated with Russia's invasion of Ukraine and the COVID-related lockdowns in China posed heightened risks for both the United States and economies around the world. Several participants commented on the challenges that monetary policy faced in restoring price stability while also maintaining strong labor market conditions. In light of the high degree of uncertainty surrounding the economic outlook, participants judged that risk-management considerations would be important in deliberations over time regarding the appropriate policy stance. Many participants judged that expediting the removal of policy accommodation would leave the Committee well positioned later this year to assess the effects of policy firming and the extent to which economic developments warranted policy adjustments.

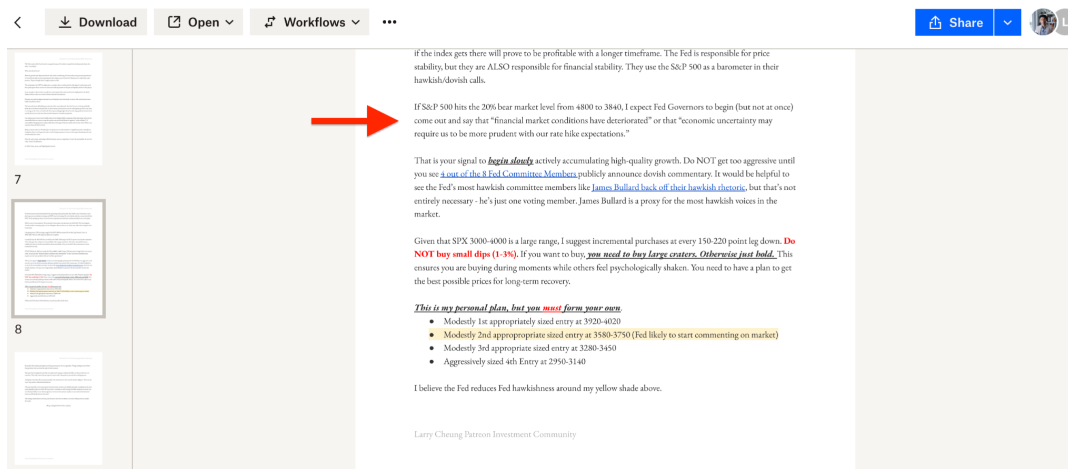
Committee Policy Action

In their discussion of monetary policy for this meeting, members agreed that, although overall economic activity had edged down in the first quarter, household spending and business fixed investment had remained strong. Job gains had been robust in recent months, and the unemployment rate had declined substantially. Members also agreed that inflation remained elevated, reflecting continued supply and demand imbalances, higher energy prices, and broader price pressures.

Members concurred that the invasion of Ukraine by Russia was causing tremendous human and economic hardship. Members judged that the implications of the

It appears that major media outlets such as Bloomberg are pushing the narrative that the Fed is walking back from its hawkish rhetoric. While my reading of the May FOMC minutes didn't leave me with any big surprises, I am not sure I agree with the narrative that the Fed is about to completely walk back their hawkish rhetoric.

I was one of the first Strategists to discuss that as the SPX would reach the 3750-3850 range (see previous Bi-Weekly Reports), some Fed Governors would come out to discuss whether further rate hikes are needed. That indeed came to fruition as Fed's Bostic now has come out to say perhaps the Fed takes a break in September.



if the index gets there will prove to be profitable with a longer timeframe. The Fed is responsible for price stability, but they are ALSO responsible for financial stability. They use the S&P 500 as a barometer in their hawkish/dovish calls.

If S&P 500 hits the 20% bear market level from 4800 to 3840, I expect Fed Governors to begin (but not at once) come out and say that "financial market conditions have deteriorated" or that "economic uncertainty may require us to be more prudent with our rate hike expectations."

That is your signal to ***begin slowly*** actively accumulating high-quality growth. Do NOT get too aggressive until you see 4 out of the 8 Fed Committee Members publicly announce dovish commentary. It would be helpful to see the Fed's most hawkish committee members like James Bullard back off their hawkish rhetoric, but that's not entirely necessary - he's just one voting member. James Bullard is a proxy for the most hawkish voices in the market.

Given that SPX 3000-4000 is a large range, I suggest incremental purchases at every 150-220 point leg down. **Do NOT buy small dips (1-3%).** If you want to buy, ***you need to buy large craters. Otherwise just hold.*** This ensures you are buying during moments while others feel psychologically shaken. You need to have a plan to get the best possible prices for long-term recovery.

This is my personal plan, but you must form your own.

- Modestly 1st appropriately sized entry at 3920-4020
- Modestly 2nd approppropriate sized entry at 3580-3750 (Fed likely to start commenting on market)
- Modestly 3rd appropriate sized entry at 3280-3450
- Aggressively sized 4th Entry at 2950-3140

I believe the Fed reduces Fed hawkishness around my yellow shade above.

Larry Cheung Patreon Investment Community

First Half May Investment Bi-Weekly

Not only did I say that a certain range would play out, I also talked about how the Fed would "communicate this with the market" if that range came true.

And while I will definitely not be right all the time (that's impossible), I want to bring something to your attention. In the latest FOMC minutes, there's a paragraph (see above) where the committee says that they may bring rates into "restrictive" territory. **There was no such mention of "restrictive" territory in the March FOMC Minutes (which was ALREADY perceived as hawkish).**

I leave it to you to determine whether the Fed is actually going to walk away from their hawkish stance.

In my mind, the Fed needs to see 3-4 months of clear falling CPI and a confirmation that the trend is clearly down before they stop hiking rates.

So far we have seen 1 month of moderating CPI in April. Approximately 3 more to go: May, June, and July.

Any stumbling in the CPI or continued strength in economic data points in the coming months will keep 50BPs coming in the FOMC meetings this Fall.

The recent counter-trend rally of markets means the buyside investors are starting to reduce the probability of pricing in 50BPs in the Fall.

From all this, I believe markets have a bit further to run, but once the SPX is back at the 4300-4400 level, the Fed will have a lot more ammunition to get hawkish again in a manner that could once again change the tone of media headlines.

ARKK and the Nasdaq-100 Relationship

Continuing on my last update on ARKK in this market environment.

ARKK has since made higher-lows since my previous update, which is a positive technical signal. However, I continue to shy away from starting a position in this thematic strategy until we see concrete evidence that the Fed will stop raising interest rates.

The top components inside ARKK are very sensitive to a high-inflation and rising interest rate environment. The only name inside ARKK that is somewhat less sensitive to high rates is TSLA. The moment the Fed gets back into easy-money mode (which we don't know when that will be as of this report), I expect the names inside ARKK to make a stunning recovery. ROKU being one of my favorite names that I plan to add further when the context is right.

Of course, there is a case to be buying early rather than waiting for confirmation of monetary policy. However, I believe there are other opportunities that can continue to do well in a moderately rising rate environment, so I don't personally see any reason to take this type of risk in this environment.

As mentioned in previous reports, I believe that Semis, China, and high quality Software can work in this environment. Cathie Wood seems to agree, and recently picked up NVDA again.

One observation I want to share. It appears that in the last 6 months, almost every name that Cathie Wood has purchased (by virtue of her sharing her transactions publicly) seems to have been discarded by the market. Almost as if fund managers are specifically targeting her fund to drive fund outflows from her strategy.

If you are new to the market, understand that fund managers view each other as competitors. There is no such thing as friendship in institutional asset management. As examples: Fidelity has no interest in seeing Blackrock succeed. And Point 72 has no interest in seeing Tiger Global Management succeed. Or vice versa. One fund's loss is usually another fund's gain.

Trading and investing is indeed a battlefield. And the high-inflation environment is a perfect opportunity for fund managers to try to take ARKK out via short-selling strategies.

The current environment continues to be dangerous for ARKK's theme IMO.

Now we can say that ARKK is a 5Y thematic strategy. If you bought in at 35/share, then a 5Y timeline should work out well for you.

Not for investors who bought it at 140/share. You'll just get back to breakeven in that case (if you're lucky).

My goal in my investment community is to present you ideas that will 1.) protect your capital in the near term and 2.) provide you opportunities for alpha in the intermediate term.

When ARKK has potential again, I'll let you know ASAP. In order for ARKK to work, we need to see evidence of deflation.

Chinese Internet Equity Strategy: U-Shape Recovery taking hold
(Must continue to be long-term)

China's Internet ETF KWEB: At the 50-Day Moving Avg

Before reading this update for Chinese Internet Equities, make sure to read my previous report. My macro opinions on China remain unchanged since last update. View previous report to view.

Since my last update on China, the macro newsflow has continued to underpin my existing thesis on the sector that a stronger macro backdrop will eventually be constructive for Chinese Internet stocks. Although short-term hiccups can and will occur, my confidence is becoming firmer that the next 12 months for Chinese Internet will be better than the last 12-months.

What we've witnessed (as I have been projecting for in the past several months)

- PBOC rate cuts in the 5Y loan prime rate
- Greater stimulus to support the economy post-Shanghai COVID episode
- Relaxation of some of real estate dynamics: expedited mortgage approval process, less strict loan requirements, home ownership rules, etc.

Combined with a stronger macro setup, we have seen Alibaba and Baidu demonstrate strong performance after their earnings report. Meanwhile, we are witnessing Tencent (largest component inside KWEB ETF) stay relatively stagnant.

I want to offer my opinion on why this might be the case. Tencent's CEO Pony Ma wrote a widely circulated piece on China's economy and its consumers. The piece can be considered to be critical of government oversight and heavy-handed oversight. It also laments at consumers who take the internet provider's services for granted.

Part of the reason that Tencent outperformed Alibaba since mid 2021 (see below TCTZF/BABA) was that Tencent's relationship with the Chinese government was far more conciliatory.

Pony Ma's widely circulated letter threatens to undo that relationship. While analysts can attribute the recent underperformance of Tencent vs. Alibaba to Tecent's weaker earnings performance, I personally do not believe that is the real reason.

Markets are exceptionally intelligent mechanisms, and the buy side's algorithmic models absolutely weight politics in China as a greater share of their decision models when it comes to buy/sell decisions across the Chinese Internet sector.

I believe that Chinese Mutual Fund Managers are taking a more cautious approach with Tencent or any company for that matter that has decided to speak out against the Chinese government.

Case in point, Baidu and Tencent both have advertising businesses, yet why did Baidu outperform Tencent by such a large margin in the past week when Chinese Internet rallied. Is it because Baidu's advertising platform is superior to Tencent's?

I don't think so.

It's because as of this moment, BIDU is not on the radar of gov. watchdogs like Tencent is. Therefore Baidu's growth/strategy in its markets is likely to not be as heavily scrutinized.

Eventually political relationships in China will lead to business outcomes/consequences (like ANT IPO getting scraped, or M&A deals getting approved/blocked).

I am surprised Tencent's Pony Ma decided to make this move to publicly share his frustration.

Upon any significant rally on Tencent, I plan to trim my holdings by roughly 20-25% and re-allocate into BABA/KWEB/BIDU in this order unless Tencent does a public apology for their latest voicing out of government policies. I'll continue holding my Tencent position post-reduction, but it is now my opinion that BIDU and Alibaba at this very moment are less likely to have problems from the Chinese central government.

Be sure to read my previous reports for my thinking on macro and fundamentals.

Charts & Figures below.

Baidu/Tencent relative strength (BAIDU outperforming TCTZF)

TCTZF/BABA (TCTZF clearly underperforming in latest rally)

Tencent stagnant during broad Chinese Internet rally? On earnings, or something more political?