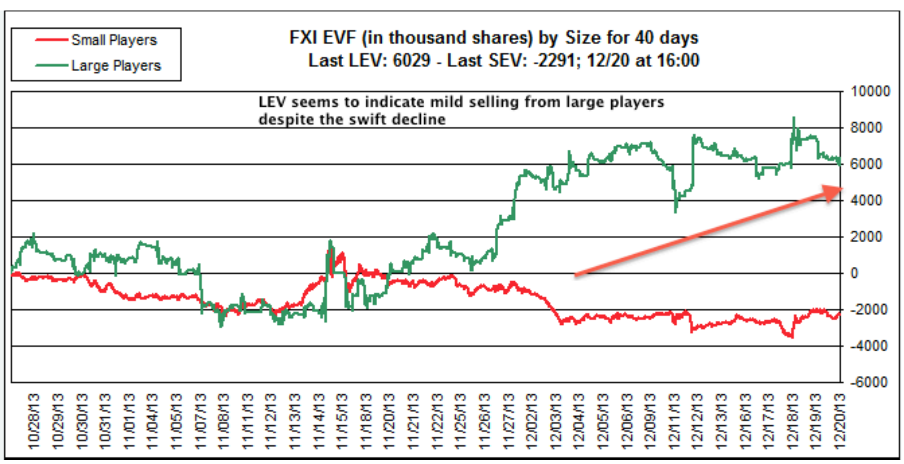
Market Notes: 12/21/13
By Eric Coleman

First, some updated thoughts from my previous post.

China:

FXI exhibited weakness in price during the past two weeks, which coincided with renewed fears of a credit crunch.[1] From a technical perspective FXI remains above a neutral 200 day moving average. LEV does not show an immediate rush to the exits from large players. Year-to-date, FXI is down about 4% and may also be subject to some tax loss selling and end of year portfolio adjustments. I do not own this fund, but do believe the Chinese market and economy are important to monitor. Chinese problems are well publicized, and the relatively poor performance during the past 5 years reflects such observations; nonetheless, China is a growing economy with many transitions underway and will continue playing an important role in worldwide trade and investment.



This is not necessarily a short-term trade but a developing theme to track. On a similar note, other funds possess different portfolio allocations, which might offer better performance or additional insight to the Chinese market. These include GXC, ASHR, and FCA (limited liquidity).

Steel:

A more bullish tilt permeated some of the steel stocks during the past two weeks, exceeding my expectations. This is most strongly demonstrated by the surprise announcement from AK Steel on Thursday of an expected profit versus analyst expectations of a loss. Consequently, AKS rose 15% capping a very impressive run that began during the late summer. Industry peer US Steel (X) rallied to a new 52-week high, too. These aren't particularly great companies, but due to their cyclical nature,

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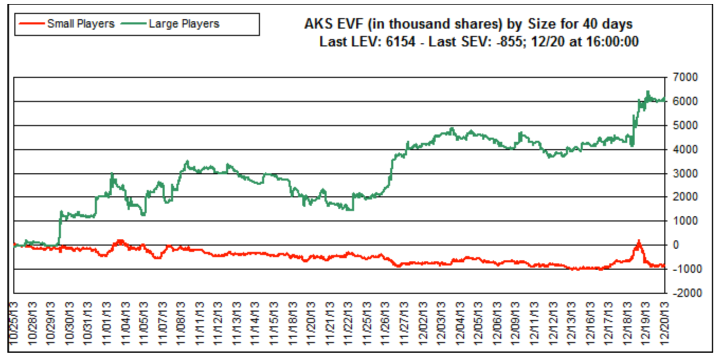
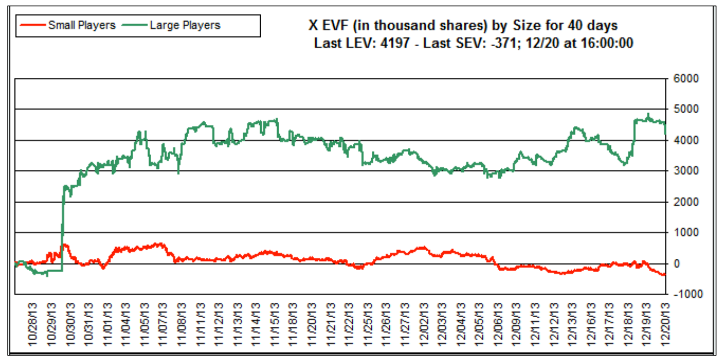
[1] http://www.zacks.com/stock/news/117411/the-peoples-bank-of-china-just-announced-another-emergency-injection-into-its-banking-system

they can move quite powerfully, especially when short interest remains elevated and a cycle may be turning. I suspect that increased bullishness may result in some choppy trade or consolidation in the near-term. The SLX fund still remains below its 52-week high. Longer-term weekly charts appear to suggest that a significant bottom occurred in the summer of 2013, though this is a speculative conjecture.



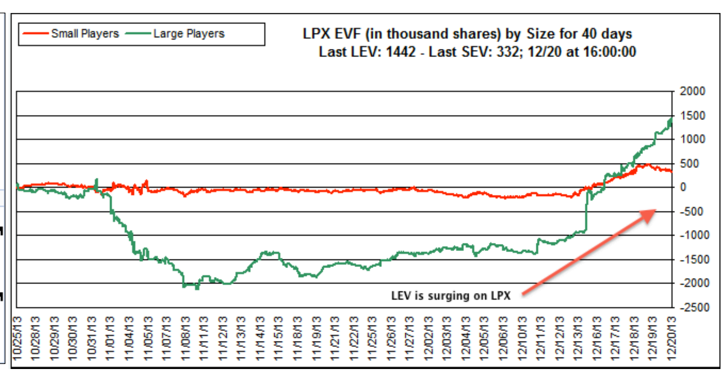


A low risk entry does not presently appear for AKS. After reviewing previous multi-month rallies in AKS, the first pullback to the 50-day moving average usually presented an opportunity while the second generally coincided with a choppy topping event. One risk that remains is the potential for a secondary offering that causes a negative reaction in price. Given the deep bear market these stocks experienced, though, the *possibility* exists for additional upside in 2014.

Housing-Related:

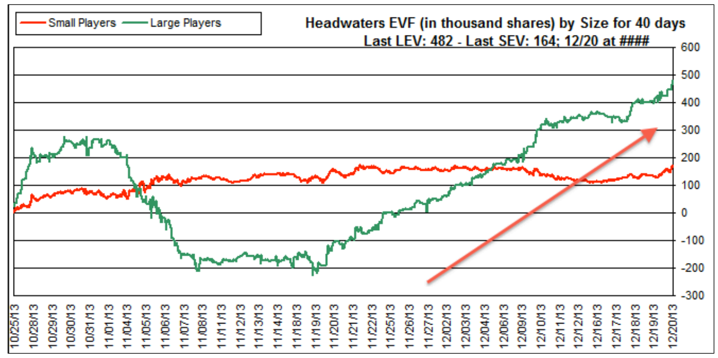
Housing stocks and their related counterparts were abuzz in 2012, as the XHB posted a 57% return. Those price gains were digested through consolidation and range-bound trading this year, and some opportunities may now be emerging. Several stocks within this group have undergone corrections and may be preparing for a leg higher, especially as fundamentals improve.[2] My thoughts are that if a sector goes up, then many of the stocks will do so, too. Consequently, these are ideas for further research, and some may be more compelling than others. Below are some charts to consider.

Louisiana-Pacific (LPX) underwent a spectacular run from about $5 in 2011 to a high of $22.55 in 2013. Over the course of the year, LPX corrected about 35% and now trades just shy of $18. The company made plans to acquire Canadian company Ainsworth Lumber during September.

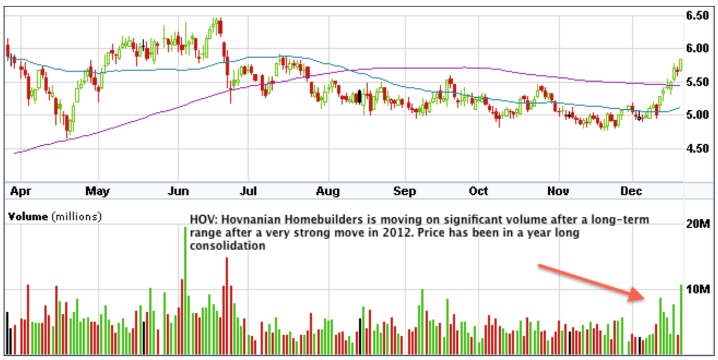


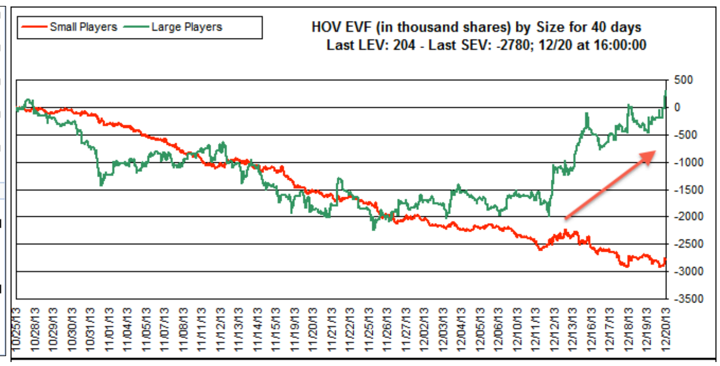
2 http://www.cnbc.com/id/101281934

Like LPX, Headwaters (HW) surged out of a multi-year bottom in 2011. Headwaters is much more levered, and one should research the fundamentals of the companies in which they consider investing. LEV shows strong accumulation by large players. Earnings are due at the end of January.



Lastly, another levered homebuilder Hovnanian Enterprises (HOV)



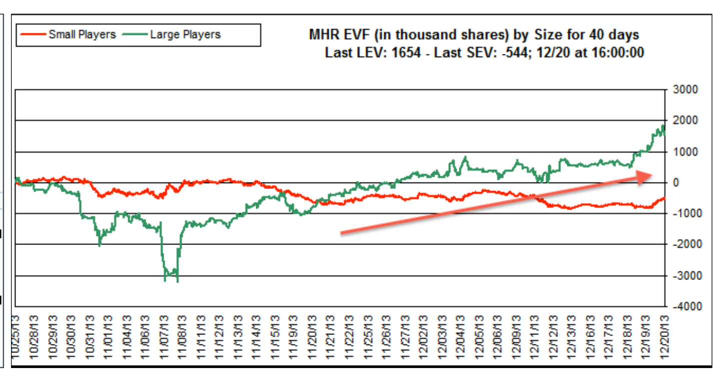


I reiterate that these ideas are speculations. This sort of year-end action may indicate early positioning for 2014. This is a sector that might offer short-term opportunities, but also multi-month movers.

Energy:

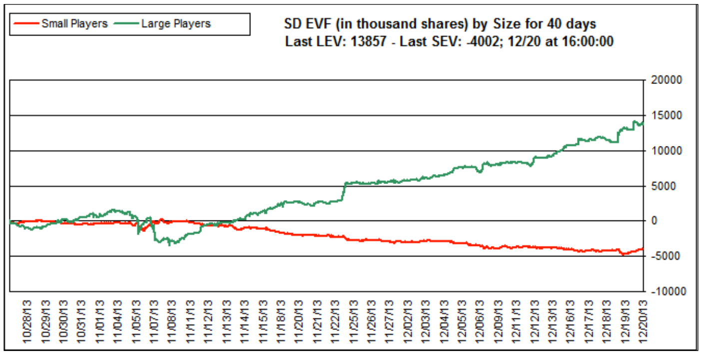
Some energy related stocks might be putting in tradable bottoms, or even multi-year bottoms. A few that I found of interest are MHR SD and MDR. Equities levered to the price of natural gas, which has had a serious rally, might be worth monitoring in 2014, too. MHR is highlighted below.

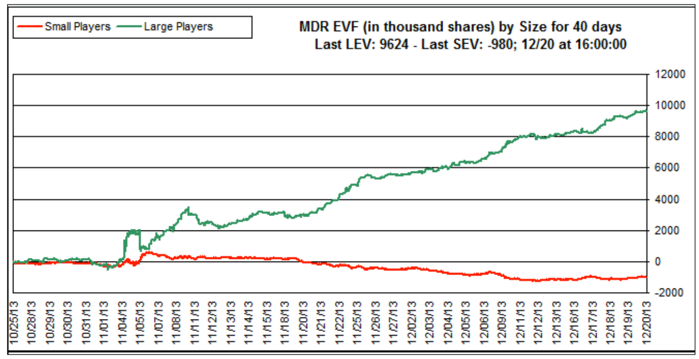
Pascal mentioned Magnum Hunter Resources (MHR) in a recent Daily comment, which is most interesting. MHR shows an uptick in LEV over the past few days. Additionally, the CFO engaged in two open market purchases during the 2nd week of December.



From a brief overview of MHR, this company seems to warrant additional research.

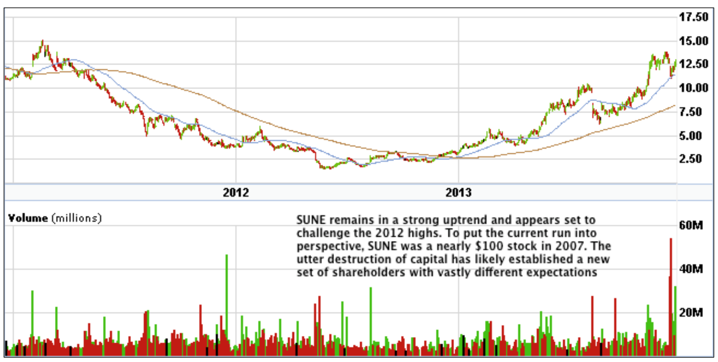
Sandridge (SD) and McDermott (MDR) fall into a category of value/deep value/activist type of situation. Both have interesting LEV patterns, though. Noted investors Leon Cooperman and Prem Watsa hold SD. There is plenty of information and debate about this stock

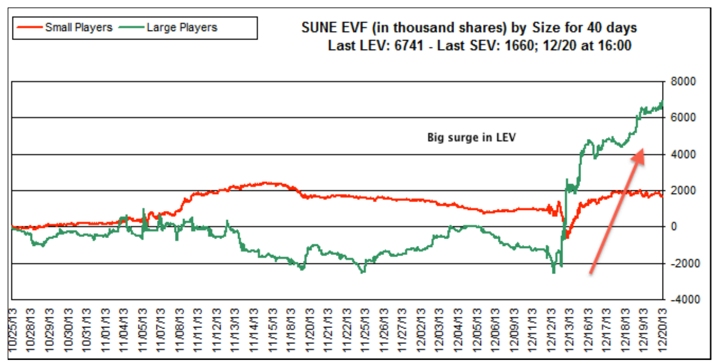




Solar:

One of the standouts from an LEV perspective is Sunedison (SUNE). Given the leadership of the Solar group during 2013, the possibility of mean reversion or range-bound trade certainly exists, but this may be worth monitoring.



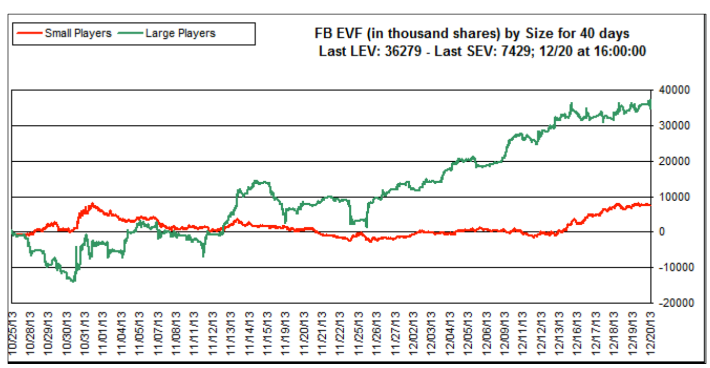


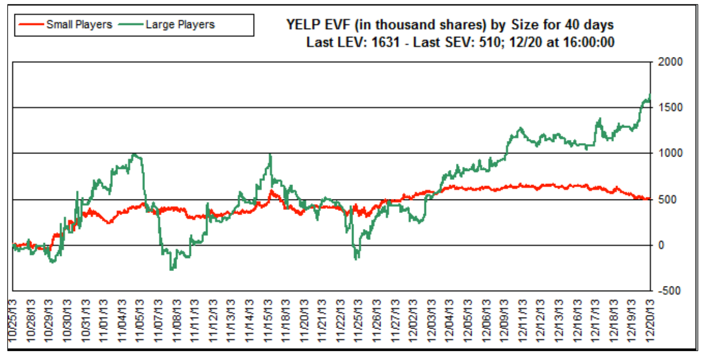
Market Leaders and Tech:

Valuations on tech stocks are always subject to emotion and debate. Facebook (FB) garners an extremely high composite rating from IBD while Yelp (YELP) does not. An important question to ask is whether the market is in the mood to reward such companies through appreciation in the share price. I do not have an answer. LEV on both FB and YELP remains noteworthy. Facebook announces earnings at the end of January and Yelp the following week.

Google continues as a market leader while displaying active large player participation. My suspicion is that when these trends start cracking, the overall market will likely be heading for a more meaningful correction. That is something to which I will pay close attention.

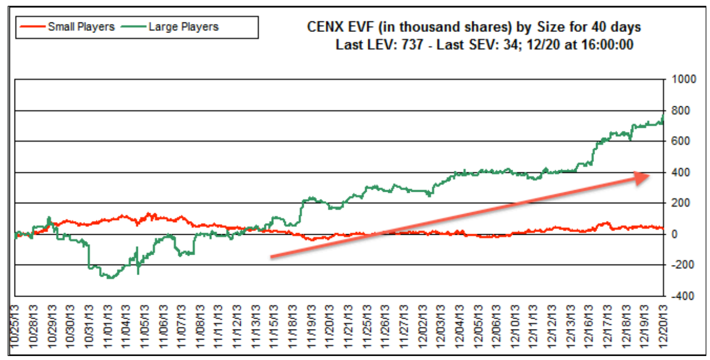
FB recently made a new 52-week high. It is possible that these stocks rally into their respective earnings announcements.





Aluminum:

Alcoa experienced a massive breakout in late October. At this stage, a smaller company like Century Aluminum (CENX) looks more interesting. I provide a long-term weekly chart for perspective; however, the stock is not particularly extended above the 50 and 200 day moving averages on a shorter-term view.



Conclusions:

The above ideas highlight some of the stocks I track and their corresponding EV patterns. How one invests or trades is very individualistic so the above are just observational starting points. Some of the action, especially in housing-related stocks, steel, and aluminum, seems noteworthy. Glamour stocks like FB and YELP have potential to engage in large moves that surprise many, though no guarantees exist.

My conjecture is that 2014 will encounter some periods of serious volatility. I am avoiding stocks that have been in long uptrends and are in multi-month topping patterns. An example of a stock that I would avoid is FOSL; such a stock seems vulnerable to a broad market correction and long-term underperformance. Alternatively, cyclical sectors that benefit from an improving economy like steel, housing, and energy may warrant further research and opportunities. Additionally, I continue to focus on select small caps that do not possess enough liquidity for EV to properly evaluate and are therefore excluded from these notes. These stocks usually have a catalyst and are emerging from or have emerged from a long base.

I speculate that when inflation expectations increase that a large move in oil could take place. This may not be "the" move that results in oil prices doubling, but a move that dampens confidence and causes a selloff in the averages. In this case, oil may be a good trade at some point in the coming months. EV seems to catch these moves when they are emerging.

I think gold and silver equities will eventually have a massive short-covering rally. The sustainability of such a rally seems doubtful. A review of the XAU gold miner index from 1986 to the present displays short periods of extreme strength punctuated by long period of choppiness. For example, gold stocks had a massive rally during the first half of 1987 despite gold being well off its prior highs. One possibility is that a swift and steep decline in the equity market causes short covering and fear buying in gold and gold mining equities. That is pure speculation but a scenario that I can envision.

A major difference between now and 2011 is that prices for soft commodities such as wheat, corn, soybeans, sugar, cotton, and coffee are extremely depressed. All of these surged in 2011, which coincided with the weakening of the broader equity markets. Big price increases in food are not politically palatable and can cause serious instability. A major reversal in these trends would be an important development. Due diligence is always upon the individual.

Disclosure: Long AKS