THE National Investor

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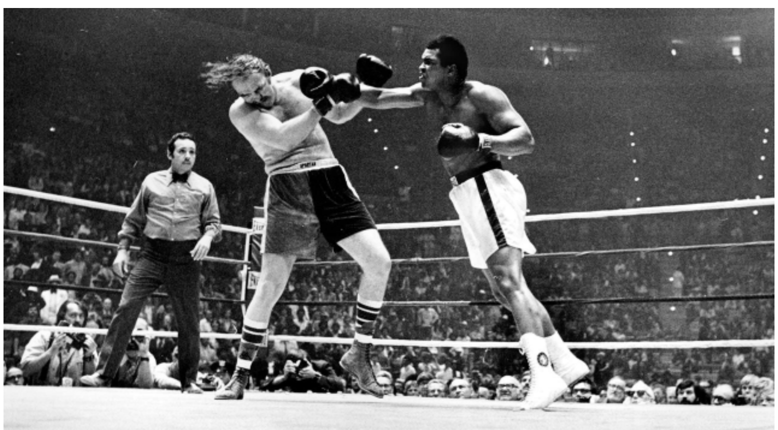
PORTFOLIO COMMENTS & "GAME PLAN"



As Thanksgiving week here in the U.S. unfolds and we head into the final month of the year, the "Wepner rally" is still alive and well, despite numerous blows that have done *some* accumulated damage. And this is despite, as well, NEW *market* worries regarding China specifically that have materialized over the weekend; *more about that shortly*.

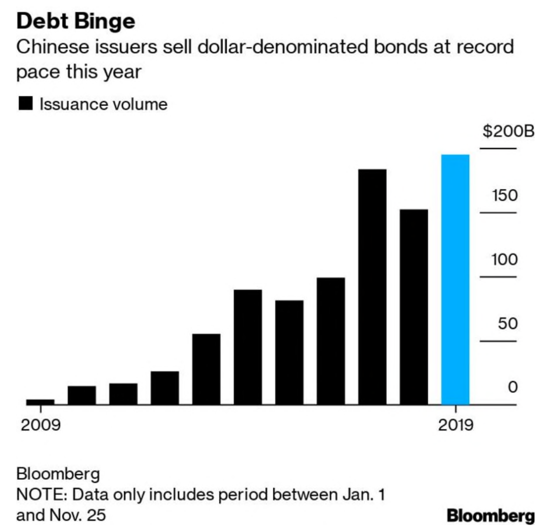
Defying reality, gravity and the accumulation of "punches" stocks don't want to give up quite yet. **Some thematic help came out over the weekend in the form of the *overwhelming* win in Hong Kong of its pro-democracy electoral slate.** Always wanting to look on the sunny side of things these days in order to rationalize the present lofty levels, bulls are pretty much automatically assuming that the Hong Kong electoral results will translate into a more chagrined and softer Chinese "foe" for President Trump to deal with.

Further—and angering an uncharacteristically (these days) overwhelming unified front on Capitol Hill—Trump is holding off on signing Congress' recently-passed "Hong Kong Human Rights and Democracy Act of 2019." Trying to keep dim hopes of some "Phase One" deal alive, he's playing good cop to Congress' bad one, hoping that this concession to a China bristling against numerous brickbats over its *lack* of democracy and horrid human rights record will lead to a deal. We'll see. As I (and others) have been explaining, any deal that does come will actually settle fairly little and not move the needle very much when it comes to the bigger picture of a slowing global economy choking on monstrous debt loads.

As I explained in my two lengthy dissertations on (mostly) China last week, (check out both Tuesday's and Friday's recordings at http://www.kereport.com/) President Xi is arguably under even more pressure than Trump to produce *something* on the trade deal front. Indeed, this—Monday—morning, the *Global Times*, a tabloid run by the ruling Communist Party's official *People's Daily,* is channeling Trump in claiming that a deal is "very close." Again—*we'll see*.

EVEN MORE *MARKET* WORRIES EMERGE

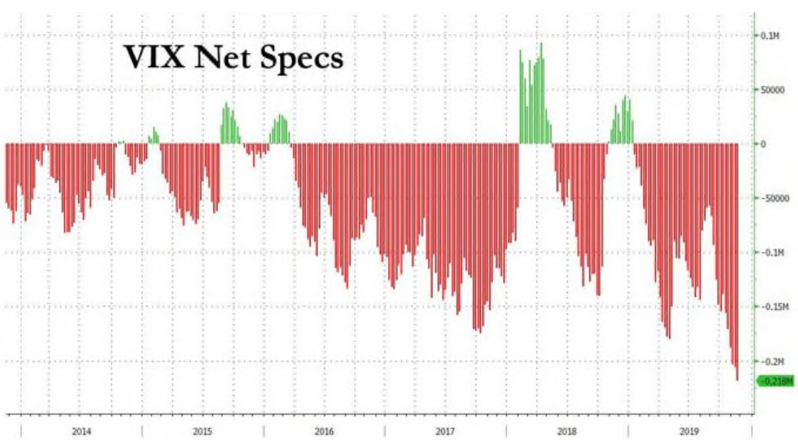
When I got considerably more bearish back around August 1 than I have been in quite some time, it was—as I explained then and have many other times along the way—due to **my concern that *markets/financial structures* were cracking; *not* so much that *the economy* (at least, the U.S. economy) was weakening.** Along the way the repo market mess was discovered by the Federal Reserve in mid-September. That the Fed decided to aggressively get out in front of this by getting back into the Q.E. business and more—all else being equal—mitigates *some* of these market risks and has unquestionably kept the U.S. stock market and some other risk assets levitated.



But things continue going the other way for China. As I've discussed more than once (and flying in the face of the many still-prevalent screeds out there describing the imminent demise of the U.S. dollar as the globe's reserve currency) Chinese companies are coveting greenbacks *more than ever*. Notably, as the Chinese economy has been bogging down *and its credit markets beginning to deleverage more notably*, some companies are able to raise money ONLY in dollars, as opposed to in yuan that have become more suspect.

Nevertheless—on top of growing troubles for "shadow banks" especially—this morning brings news of **the first Chinese SOE (state-owned enterprise) in 20 years to warn that it's in danger of outright default**. As *Bloomberg* is reporting (see https://www.bloomberg.com/news/articles/2019-11-25/china-s-tewoo-seeks-debt-haircut-of-up-to-64-on-dollar-bonds) commodities trading house Tewoo Group Corp. is asking holders of some U.S. dollar-denominated debt to either 1. Take a principal haircut now of as much as (Uggh!) 64% of the debt's face value or 2. Agree to extensions of maturity of the paper (coming up in three years or less) AND at lower coupons than present.

Clearly, my Wepner analogy might be *even more* appropriate in discussing China's debt colossus, which could well give way first depending on how things work out (or not.) That Chinese leaders have seemingly decided to allow more "controlled implosions" such as in the past from time to time is more noteworthy *now*, I.M.O. in the context of its overall trade/New Cold War strategy. *I'll discuss that further in a follow-up issue*.

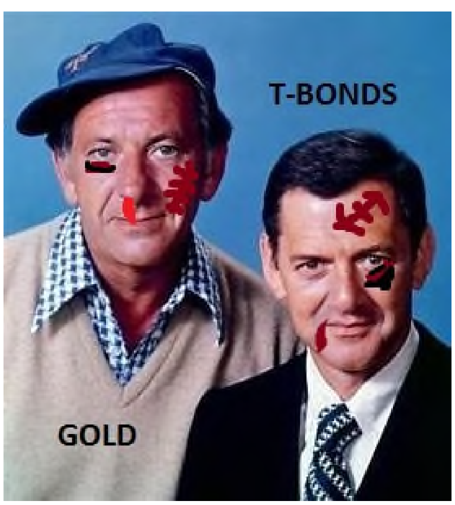


While the Fed seems to have at least some of the liquidity dangers *here* mitigated, **the most glaring market risk in the U.S. now is the growing new record short positions in the S&P Volatility Index.** As you'll remember, this was especially a headache in early 2018, leading to the nasty correction in stocks for a while back then. In short—and especially again *now*, as traders feel as bullet-proof as ever thanks to that renewed "Fed put"—directional traders and others will "short" volatility itself; buying put options, for instance, on VIX contracts in the belief that the complacency, etc. on Wall Street will *keep* volatility measures declining. As a corollary, they will go long on stock index futures and the like; doubling down on the idea that 1. Stocks will keep rising and 2. Volatility/"the fear trade" will keep dissipating.

How/when that reverses is the question; not "if" it does again. *At best*, I.M.O.—barring anything particularly nasty in the coming few weeks—the path of least resistance for stocks may remain modestly higher into year-end. All else being equal, fund managers don't want to have to reveal after December 31 that they were light (not to mention short) on equities *provided nothing of sufficient magnitude spoils the party before then*. In that event, I'd expect a pull back right after the beginning of the year again.

This is pretty much my "base case" right now. Even without the growing cracks *in markets and credit institutions* that could make things much worse, slowing economic activity as well as, simply, gravity will lead to a correction of some magnitude soon. The exact timing/severity is yet to be determined by 1. Whether anything really does come in a "Phase One" deal, 2. Whether the Fed's growing "Drano injections" have really unclogged money markets sufficiently and 3. Whether a credit event in China (or Hong Kong) materializes that markets *can't* ignore.

A FEW MORE ALLOCATION/STRATEGY THOUGHTS



Beyond the *near-term* considerations of 1. The timing/severity of any pull back for equities and 2. The extent to which we may be *even more aggressive* before long in trading into it, **I am continually mulling over what the bigger picture might look like.** You'll be hearing MUCH more about that over the coming weeks, via both a couple regular issues where I preview what lies ahead for 2020, as well as updates to a few Special Reports.

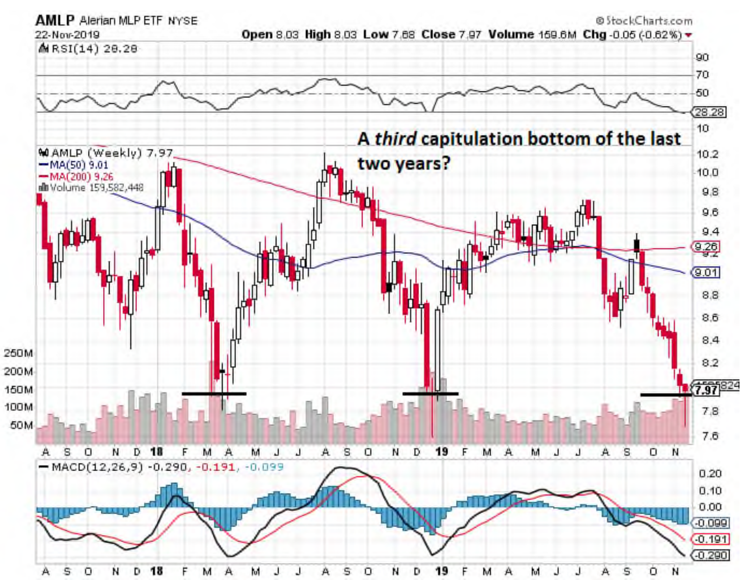
Here are a few thoughts/themes for now, all of which I'll be expounding on in the near term:

* **"The Odd Couple"** – As I've remarked several times lately, neither the rally in Treasuries nor the resumption of gold's secular bull market is over with. **Their pauses/consolidations of late being fairly tame even as stocks have moved to new all-time highs, in fact, *underscores* the underlying strength for them, I.M.O.** Eventually, the music will stop for the stock market, even if we need to wait until January. That's when we'll see the recently-wounded Odd Couple rebound; perhaps dramatically so.

We already have a fairly healthy exposure to Treasury ETF's and the like, so I'm not sure we're going to add much more there. I might add a bit to our yield-oriented companies, although—as you know from my e-mail of last Wednesday—I'm going to err on the side of caution for now. *Ideally*, after stocks get whacked across the board soon and then maybe show some signs of less *systemic* risk (favoring my "Slow, dull ache" scenario) I can be more aggressive in adding some names in this area.

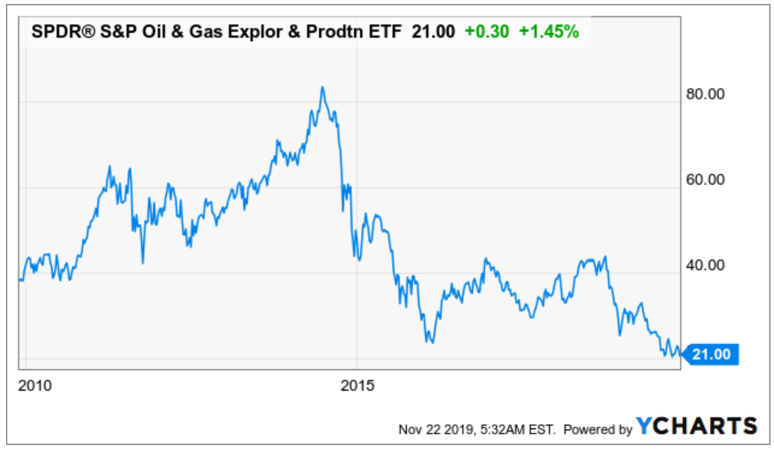
As for **the gold area**, I expect to be adding to our roster of *individual companies* I like the best—especially with tax selling season having provided even greater long-term bargains—on top of the two new companies I've added most recently. At present, my view is that the odds are considerably greater than not that gold's pull back has run its course. Technicians I follow are looking to the most recent intraday low around $1,446/ounce as a first line of defense for support near-term. If that *doesn't* hold for some reason (most likely, a real scorcher of a panic-buying rally for stocks going into the end of the year) the worst case should be that we go back to the consolidation area between, roughly, $1,400 - $1,425/ounce circled above.

It will remain a fact of life in today's environment for gold generally *and mining stocks specifically* that **the rising tide, when it resumes, will NOT lift all boats any time soon.** Indeed—as I'll be explaining among a LOT of other things in my upcoming update to a gold sector-specific Special Issue—it's no accident that a GREAT many "juniors" have lower share prices *today* than at the bottom of the gold price a few years ago!



Two charts that tell but a part of the story of an UGLY energy sector in 2019

* **Energy stocks: YES, some opportunities, but…*DAMN*!** – With interest rates falling, the Fed back in easing mode, hopes (whether legitimate or not is another matter) of a trade war truce and all the rest, you'd think 2019 would have been a year in which long-underperforming energy shares would finally get some love again. *You'd be wrong*. Indeed (and astonishingly, in some sense) even one of the "safer" and relatively stronger areas—MLP's, and other midstream/infrastructure companies—have been DISMAL performers for a while, as evidenced by the above chart on the Alerian MLP. Even one of the true "Cadillacs" in this space—**Energy Products Partners, L.P.**, which we got out of near its recent high—is about flat for 2019.



Even with the oil price having managed to hold its own, the broader sector of E&P stocks has continued on the back foot; *still lower now* than even when oil had crashed back in 2015-2016. *The pattern* is the same as with gold stocks mentioned above: equity valuations even worse now than they were when the underlying commodity was weaker.

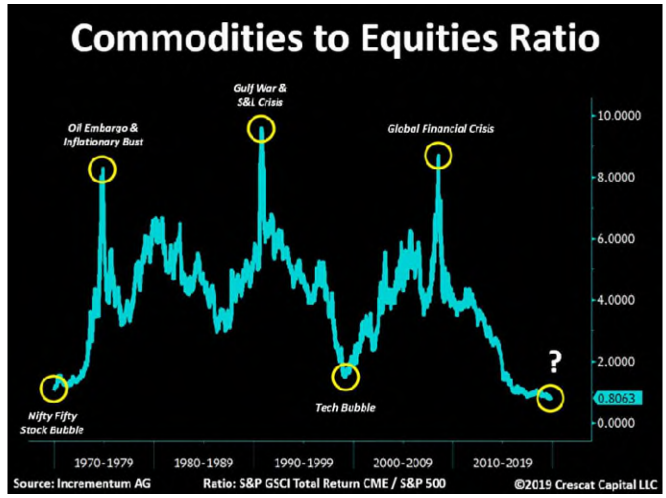
But the causes are different: chiefly, where conventional energy (crude oil and natural gas) are concerned, it's not—as with gold-related equities—too many companies (and their paper) chasing a dwindling number of aging "gold bugs." **With energy stocks, the sector is top-heavy with debt and overcapacity**. A shakeout and wave of bankruptcies is needed to "right" things again. And that wave which started about four years ago but was interrupted already seems to be underway anew.

While that means potential opportunity to invest in what will be the survivors—especially at today's *very* subdued valuations for even the most deserving companies—**the near-term dangers remain great**. Those chiefly include 1. An overall stock market correction, which is overdue, 2. No progress on U.S.-China talks 3. More of a slowdown for the U.S. economy and the "Black Swan" of 4. A *major* bankruptcy or negative credit event in the shaky industry that causes a cascading effect and REALLY hammers the whole sector (not to mention the broader economy and markets!) One or more of those will render beaten-up energy equities *even cheaper*.

But—as I will be explaining in more detail before long—a scenario is growing which *may* still lead to a more bullish environment for energy. **Signs are growing that *supply* destruction is going to be accelerating at a faster pace than demand destruction**. That comes from a few fronts: 1. The peaking production levels in the U.S., 2. The likelihood that "O.P.E.C.-Plus" will further act to curtail supply and 3. Looming outright shortages in some parts of the world (non-U.S.) where capital spending and growing production capacity have been too little in recent years.

Presently, I lean toward the bearish side of things, at least for the foreseeable future; thus, this sector doesn't animate me as much as other themes. But you *still* might see a pick or two here. AND—

again, as I'll be explaining more soon—I can't completely dismiss a more bullish scenario; *though a lot will need to go right.*



* **Other commodities** – Aside from a relative handful of individual company recommendations that have copper and other industrial metals as *a part of* the overall mix, I have for a while been pretty stand-offish on commodities *generally*. **I still am.** Yes, I have seen the well-worn chart at right that has circulated in several similar manifestations; *heck, I've circulated it myself*. But as I said above where energy specifically is concerned, there is, *near-term*, more that can go wrong than right with base metals and most other commodities.

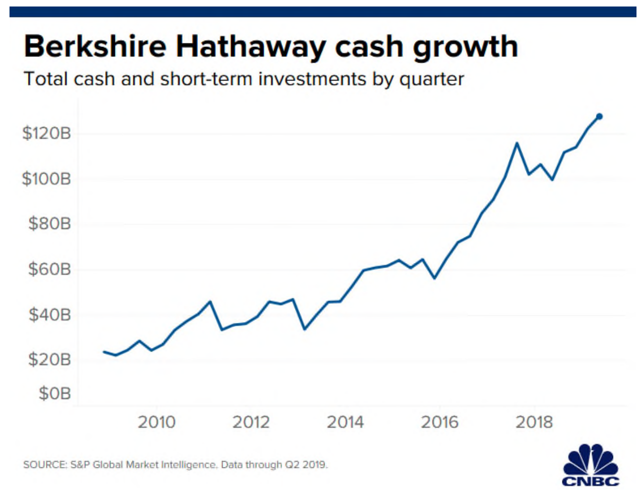
***Gold*, of course, must be divorced from this discussion**. Presently—and for pretty much its whole run from the bottom of its own price in the $1,050/ounce area back in the late 2015 time frame—gold's move had little to do with the factors that traditionally drive commodities generally. And that (as I will describe further in that upcoming Special Issue) is due to gold's being the "Un-Currency," among other things.

Otherwise—except for some one-off stories of *supply* shortages/disruption, such as with nickel and palladium—metals/industrial commodities *generally* have been hostage to trade fears, a slowing global economy and acute worries that China's secular growth spurt is over with, at least for a while. **Notably, economic bellwether copper hasn't been able to get out of its own way**; and this is despite *astounding* long-term bullish fundamentals and even recent supply issues that *should have* had more of an impact.

Even *agricultural commodity* prices by and large have been weak for a while now. The more recent *excuse* for this has been the trade kerfuffle, which has hit some crop prices like soybeans hard for a while now. But here, too—as with industrial commodities—many have underestimated secular, global trends that have squeezed prices even in the context of a burgeoning global population and other factors many thought *had* to lead to a bull market at least in these areas. *More so than with base metals, I think there are actionable opportunities here; stay tuned for more*.

Some think that this long winter for commodities will finally be ending. For one, Goldman Sachs has just issued a report that said raw commodity prices will rise in 2020 *and for the next decade* due, they say, to a worldwide move to "decarbonize" the planet, including less investment in carbon-based industries. That scenario would lead to supply shortages of some key commodities, the report said, as—like copper in particular—present apparent supply and what is known to be coming on in the coming years won't be sufficient to supply the vast amounts needed for the "green economy." (Indeed—and some of this is tongue-in cheek, I think—I've read more than one commentary of how **those pushing for the so-called "Green New Deal" will be the heroes of the mining industry**, as the price to pay for using less fossil fuels in coming years will be using MORE uranium, nickel, copper, cobalt, lithium, etc. needed for the future Green Economy.)

I'll be speaking as well in the next few issues on my lingering views—for now—that forecasts such as Goldman's are premature and overly optimistic; *and why*. None the less, on top of my newest recommendation in this area (a broader update follows in a few pages, in the wake of my visits with the company this month AND its news out *just* as I am finishing this issue) I am looking at adding a couple more names in the base metals space. As with that new energy metal recommendation last month, these are of companies whose *individual* stories/valuations are SO compelling as to overcome what I think will remain near-term weak commodity markets generally. *So be on the lookout here, too*!



*__Values elsewhere?__ – A combination of tax loss selling winding down and—in some instances—added short squeeze candidates emerging have my "shopping list" fairly active right now. *But we'll be treading slowly*. Whether right before or right after January 1, odds are high that good-looking bargains may become more so.

Further, with the recent extension of Wall Street's rally again becoming entirely liquidity/momentum-driven**, value stocks have been getting short shrift for the most part again**. Even here, though, it's hard to get excited about very much. Though he is being ridiculed for it again (as usual) there's a reason why Warren Buffett has amassed the record cash pile he has in his monster Berkshire Hathaway. I am confident he—and we—will have the last laugh.

Finally, I am looking at adding some names in **the recently-hot biotech space** as well (very shortly below, I have some words on **Sarepta Therapeutics**, which has already had a nice surge since I added it back.)

-- The above is excerpted from the November 27, 2019 regular issue of *The National Investor*.