

Short setups in JNK, HYG, adjusting EMHY (12-19-17)

The gist: Looking to add potential shorts in JNK and HYG, also adjusting entry point on potential short EMHY as high yield ETFs look bearish in the presence of tightening central banks.

Actions: Will short JNK, HYG and EMHY, each in moderate size, on a $\frac{1}{2}$ ATR break below the Dec 14th lows. (This is an adjustment for the EMHY pending short which has not yet triggered.)

US equity markets are looking bulletproof as the Republican tax cuts appear set to pass. Hopes for a boost to corporate earnings through the tax cuts, plus expectations of more buybacks, are powering extreme optimism.

Morgan Stanley's chief equity strategist says that "Our call for investor euphoria to appear in 2017 has finally arrived."

Investor cash levels in Charles Schwab accounts are at their lowest levels since 1995, meaning that small investors are now more "all in" on stocks than at any point in the past 22 years.

Hedge funds are heavily leveraged too. The Morgan Stanley analyst adds: "**Never** have we witnessed such high gross leverage by long/short equity funds on a delta/beta adjusted basis."

This is what it looks like when everything but the kitchen sink is priced in. (And maybe the kitchen sink is thrown in at this point too.)

Credit markets are another story. High yield bond ETFs are looking bearish, responding to the fact the Fed has raised interest rates five times now and may raise multiple times more in 2018.

Our initial entry point for EMHY was not triggered. We are adjusting that entry point and adding moderate short positions in JNK and HYG, all with a trigger of $\frac{1}{2}$ ATR (half the average daily trading range) below the December 14th lows.

It may be that equities party on and credit markets feel the pain first. If we see enough of a drop in credit markets, that could then introduce enough volatility to blow up some heavily overextended vol sellers... who would then take stocks down in their wake.

Price is a key factor here, in terms of the possible signal given by these high yield bond ETFs. If credit markets didn't care, we wouldn't see the current patterns in JNK, HYG and EMHY – dead cat bounces that appear poised to fail and could establish new downtrends.

