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Weekly Market Update 3-5-20

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Dear Subscribers

The market looks terrible to me.

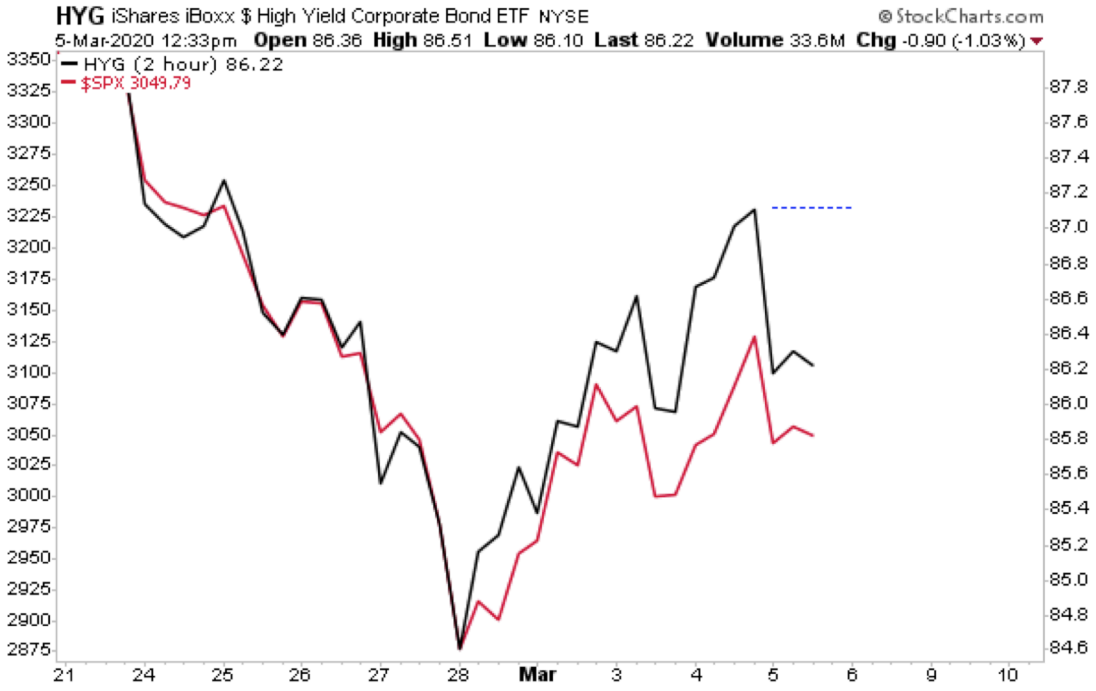
I'd like to say that we have definitively bottomed, but it looks more and more like we might revisit the lows. If I'm wrong about this, that would be great. But the charts look awful.

As I write this Friday around noon, the S&P 500 is barely clinging to support (red line) after starting to breakdown from a bear flag formation.

The bulls had a chance to take control and push the market higher, but they've failed to follow through. After closing the gap (red box) at 3,125 with yesterday's close, the bulls fumbled the ball and the market in danger of breaking down.

Moreover, breadth has already broken down and is on its way to retest the lows.

Junk bonds also look like they're going to roll over.



And the Big Tech stocks look weak as well.

Put simply, the bulls NEED to grab ahold of the market in a big way within the next 24 hours, or BAD things will start to happen.

What is causing this?

There is a liquidity shortage in the financial system again.

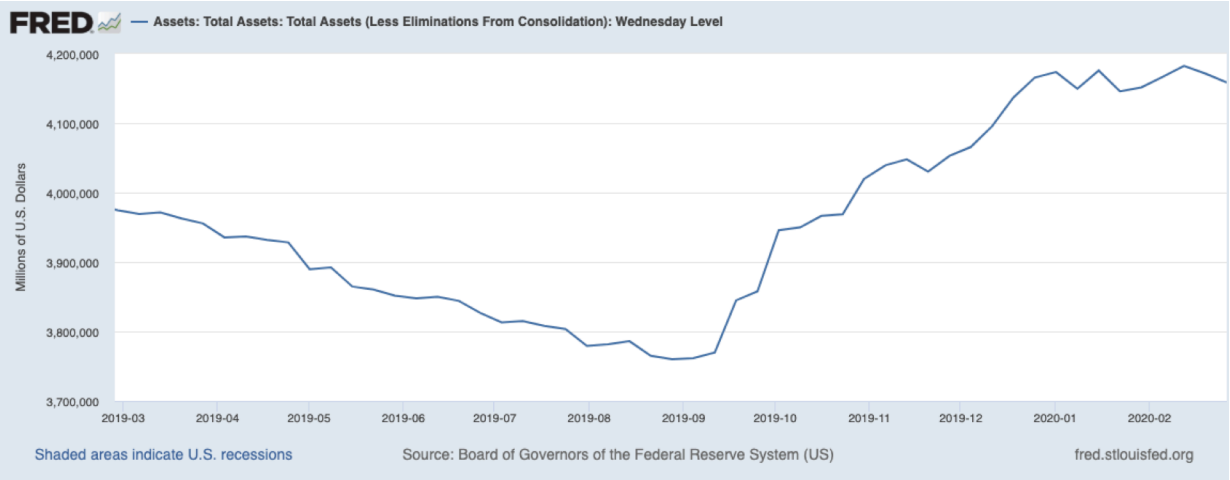
Back in August 2019, the Fed launched a number of "repo programs" through which large hedge funds/ financial institutions/ banks could park some of their assets with the Fed overnight or for one to two weeks in exchange for cash.

By law, hedge funds, financial firms and banks are required to have a certain percentage of their assets in cash or cash like securities. However, many times, these guys are so leveraged (have borrowed so much money) that they don't have the cash.

As a result of this, they go to the Fed for a repo and say, "can I park $200 million worth of assets (bonds, stocks, real estate) with you in exchange for $200 million in cash?" By doing this, they don't have to sell anything, and can meet their cash requirements.

The Fed started multiple repo programs of this nature either for overnight or fixed periods of time (one to two weeks) last year in August/ September. **By doing this, the Fed allowed players that have WAY too much leverage to stay in the game.**

This, along with the Fed's $60 billion per month QE program is why the Fed's balance sheet exploded higher by $100 billion per month from August to December last year (2019).



Fast-forward to December/ January and the Fed started talking about ending its repo programs sometime in April. By the look of things, the Fed actually began withdrawing some

liquidity as early as December. Note that the Fed balance sheet has effectively flat lined since mid-December, **indicating that the Fed was no longer providing as much liquidity via its repo programs and QE.**

This more than coronavirus is what triggered the liquidations we saw last week: funds and other players that were highly leveraged started to blow up, forcing them to SELL EVERYTHING.

This situation has not been resolved. The Fed is currently running a $100 billion overnight repo program. Last night, funds/ financial firms/ banks requested $111.48 billion from the Fed, or **$11.48 billion MORE than the Fed was making available**.

This is a RECORD amount of repo requests. And it suggests that there is a serious funding squeeze going on behind the scenes. Someone needs cash BADLY.

THIS is what could ignite another round of liquidations. If the intraday lows don't hold at 2,850 on the S&P 500, we could easily flush down to 2,730 or so.

I think 2,850 will hold, but given that market internals look so terrible, I'd like us to open some hedges to profit from any potential collapse.

Action to Take: Buy the UltraShort S&P 500 ETF (SDS).

Action to Take: Buy the UltraShort Nasdaq (QID).

Action to Take: Buy the VIX ETF (VXX).

I would keep these positions smaller than usual. With central banks around the world committed to trying to get the markets to rally, we don't want to have too much capital at risk betting on a collapse.

I want to stress that ALL of the above is a short-term market forecast. I don't want to bother with long-term market forecasts right now because what happens in the next two weeks will determine a LOT of how things go forward.

Stocks remain in a bull market. Stocks are a great long-term buy at current levels or lower. But unless you're willing to stomach some significant paper losses over the few weeks, I'd steer clear of putting a long of capital to work on the long-side right now.

I want to keep this update short and sweet because things are moving quickly now. If anything changes I'll have an update to you ASAP regardless of our publishing schedule.

Until then…

Best Regards,

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