

THE MIKE ALKIN SHOW

TALKING STOCKS OVER A BEER



Announcer: Free and clear from the chatter from Wall Street you are listening to Talking Stocks Over Beer, hosted by hedge fund veteran and newsletter writer, Mike Alkin, who helps ordinary investors level the playing field against the pros by bringing you market insights and interviews with corporate executives and institutional investors. Mike sifts through all the noise of mainstream financial media and Wall Street to help you focus on what really matters in the markets, and now here is your host, Mike Alkin.

Mike Alkin: Welcome to the podcast, it is Monday, October 15th, 2018. I hope you had a good weekend. I am first going to give you a caveat on the sound quality, it is not our fabulous engineer Garret down in Baltimore. It is because I am doing the podcast from my home recording studio and office today. I decided I am going to do it from here. Of course, because I decide that the village is doing jack hammering in front of my house. Decided there was some sewer truck there so I apologize if you hear all this background noise, it actually might have just stopped, I am not sure.

But about 15 minutes ago it started and I thought you've got to be kidding me and it looked like they were just settling in. So it's interesting, so I can record from here, I have an office 20 minutes from here, but I like to work from home when I can and sometimes I just feel like doing it right, I am the boss, I write the newsletter that Frank publishes and I have my investment firm so I work where I want to work.

I find working from home, I actually get a lot done, so sometimes, even though it's 20 minutes away, it's nice to work from home. One of the things I've noticed though is over the summer it drives me absolutely crazy, because the entire day all you hear is landscapers, that's it. You the weed whackers, you hear the blowers and its constant. It can go right through you sometimes. When you are working you are not really paying attention, I am on conference calls, I am doing whatever I am doing, but then all of a sudden you get that moment when you hear it and once I hear something, once it's ... it's like with my kids if they do something I notice it and it will stick in my craw and that will happen.

But I figured okay it's safe here now, right, because it's the end of summer the landscapers are gone from all over the neighborhood and all the fall clean-up has been done and it's jack hammering, so I apologize, I will try to cut the background noise as much as I can, or Garrett can, but it's tricky.

Anyway, great weekend, I am pretty fired up, my New York Jets, J-E-T-S, Jets, Jets, Jets. I think you know I have a very very roller coaster sports life, an emotional sports life, because I am a New York fan, and the New York teams can't suck enough, right? Whether it's the Mets, whether it's the Islanders, I pick all of the ... it's a train wreck as you guys know, those who listen to me on a regular basis. But I see a glimmer of hope, the Jets are, they will disappoint don't get me wrong, I am not delusional, Patriots fans I get it, don't worry about it.

But they are on a two game winning streak, I can't remember the last time that happened, but we have got the young quarterback Sam Darnold, who is a rookie he makes his mistakes but he has talent, he has poise and the last two games, they beat Denver two weeks ago really handily. And they beat Indianapolis as well yesterday pretty handily, the score was a little closer than the game really was, but for the first time in years I am like, okay I can watch a Jets game without getting a little nauseous.

I will admit it, yesterday afternoon my son was at lacrosse practice and the Jets had just won and I had to go pick him up, but he also, he also plays football and in October, like the NFL, the local schools they wear pink socks, and of course we can't find his pink socks, I don't know what happened since last week so I had to go out to DICK'S Sporting Goods, and I am in DICK'S and I am buying him a new pair of pink socks before I picked up from lacrosse practice and there was a Jet hat staring me right in my face. I think about three ago I threw mine out, because I said I can't do this anymore. I was in search of a new team after close to 50 years of a sports fan, I was searching, I hit bottom.

But I did it, I feel as though they might be back. You can't say I'm a front runner because I went and bought a Jet hat, because they suck, but they are getting better. Actually they might not suck this year, but they are a little better. Anyway, Sunday, and last night the Patriots Chiefs game was just, it was great. Pats won 43-40 on the last second field goal. I wasn't happy to see the Pats win, but it was great game, young Pat Mahomes young quarterback for the Chiefs has a canon, so it was a pleasure watching him.

And of course who people will say is the goat, greatest of all time, Tom Brady, I actually disagree with that, I think Drew Brees is, but we will go with it. But great performance, so it really was great, it was great to watch.

The other thing I did over the weekend which is, my lights, my lights in the front of the house, and the back of the house, for some reason a week ago just decided at night the timer wasn't going to work, why I have no idea. So here I am trying to ... I took a couple of hours, an hour this weekend and an hour during the week, it's a little thing on the wall, right, a little programming pad. I can't figure it out, no matter what, YouTube videos, nothing. So no matter how I have tried 20 times, I have tried 20 different ways I have tried everything, can't get it to work. So last night right before the game I am doing it, it doesn't work, I come downstairs they are on, a mind of its own.

But it's the story of my life with stuff around the house, no matter what it is it just doesn't matter, it can be basic, it could be simple. Anything whether it's the sound system, anything electrical, anything that requires technology, it just drives me bananas. I try and I try and I try and ultimately I have got to bring the guy in, right? And if you tell him, listen hey I have been trying ... because I don't want to look like I'm that guy who just says call in somebody for everything. So of course it's hey, I tried, I tried, I tried, so I like to look a little macho and I tried it, and then he is like, okay now I am going to bang you for the price, because why not, because you can't fix it. So, anyway that was my weekend, great time with family and I hope you had a good time as well.

So last week was an ugly week, it's been quite a while since you've seen stocks sell off so sharply, the S&P was down 4%, you had all these fears over potentially weakening economic earnings growth that kind of fueled the selling and stocks, I think end of the week they hit really three month low, right, which is right as we are going into the third quarter earning season. The Dow was down about 4%, NASDAQ was down 3 7, 3 8 something like that.

During a week where you are seeing that, the fear, the IMF comes out and they cut their global growth outlook for 2018 and 2019 to 3.7%, 3.9%. Still not bad growth but you just had a lot of uncertainties, uncertainties around the tariffs between the US and China, you have this pending Predix deal, and then you've got the trilateral agreement between the US, Canada and Mexico that is supposed to replace NAFTA. We will see, on the trade front right, right, Trump and President Xi is supposed to meet next month

before G20 Summit. I am going to talk in a few minutes though about some of the things I am thinking about that go beyond just what we are going to see from the earning stand point. But really earning season kicked off, you saw specialty chemicals maker, PPG Industries they had a tough quarter, that kind of weighed on [inaudible 00:09:26] a little bit.

The big banks, you saw JP Morgan, Citi Group, Wells Fargo they kicked off earning season as they always do. Results were kind of mixed, no real take away from it, initially the stocks moved higher, but then they rolled over and closed the week down, in the mid-single digits. So nothing really to take from there, mixed results, not sure. You saw that the yield on the tenure treasury, the benchmarks back to a seven year high. It had gotten as high as 3.2%. Trump was out blaming the Fed, it's their fault, he said they have gone crazy with rate hikes. So the Fed's raised rates three times this year, and the last one was in September.

And it looks like they are on track to raise rates again in December, so that's caused some fear in the market. But there has been telegraphs so I am not really sure why it is such a big deal. Then you also saw last week the VIX, which is the CBOE Volatility Index, right, it's people call it the investors' fear gauge, it was its highest level since March. It backed off a little bit on Friday, but for the week it was 40% higher.

And then starting this week you have got the [inaudible 00:10:48], there is 55 or 60 companies reporting earnings so as I mentioned and I will mention again, I do much of the macro stuff, but I just wanted to ... I am not going to have a guest this week I am going to talk a little bit about some of the things, where we are in the market with ... and you will hear me talk about a piece that Ray Dalio of Bridgewater Associates did. And we'll talk about the risk on, risk off, and it's been a heck of a nine year run and there's a lot of geo-political stuff going on, there is a lot of individual stuff going on.

If you look at earnings, earnings have been great this year. But they are supposed, in 2019 they are supposed to go from like 20% growth in 18 down to 10% in 2019, so you can make the argument that hey stocks go in the direction of where earnings are going. So there is a lot to just think about, digest, but not just the obvious stuff and I am going to talk about that in a minute. But it's portfolio positioning, right? You want to think about your realtor investment, you're investing your own money, you had a nice run. Start to think about how you can protect some of those gains, because-

Mike Alkin:

How you can protect some of those gains because those sell offs we saw the last few days could become more commonplace. I'm not calling it a crash, I'm not going to get into that whole big argument but prudence would dictate to start to reduce exposure a little bit to your equities. To what degree? That's up to you. But I want to jog some thoughts for you, that's what we're going to talk about today as we go into earning season.

I get asked a lot of questions. I get a lot of emails, I get a lot of direct messages on Twitter. What do you think, what's your view on the market? I think, for those who are regular listeners, you know that I don't talk a lot about the market. When I was trying to figure out the podcast when I started eight, nine months ago, I used to open with a market update and I thought ... really, what the hell do I know. I'm not going to sit here and be a talking head or a prognosticator about the market because at the end of the day, nobody knows where it's going and I think you know my view is rather than ... I use the market gauge and I'm going to walk you through now how I kind of think about it, but I use my gauge as to what's going on in the world, what's going on with interest rates, what's going on with policy and I have a more bearish or more bullish stance depending on the time but to sit there and call, "this is where the market's going", I don't know, but I use it from a positioning standpoint. You know, how do you want to be positioned.

There's obviously the front and center stuff that you see every day and that the market people are talking about and the more they talk about, the less they know which way it's going. But the more it's talked about, the more things get priced in. That's because it's a lot of people talking about it. You have opposing views and those opposing views get expressed in the form of capital flowing in or out of certain markets. I like to think about what's second order type stuff, what's next, what's around the corner. And I've talked to you a lot about ... I think a lot about geopolitics and the role that they play. And I read a lot of different stuff and I was reading something this weekend that was written by Ray Dalio and he's the founder of Bridgewater Associates. He's probably worth \$20 billion dollars, they run several hundred billion dollars and he's a global thinker. And I was reading something and he wrote it ... I forget where I read it, it might have been on one of his articles on Linked In or something and it was called The War with China is Spreading and it was interesting.

He went on to say in his article that geopolitics has played a greater role in driving economies and the market and any time

during his 50 years of investing, which he went on to say it makes him think a lot about it, and I find it interesting, I think you know ... or if you don't, if you're new to listening to me ... a lot of stuff in investing is repeatable. You can have a repeatable process but history repeats itself. And he, Ray, believes that the most important things happen over and over again and basically in the same way because the most fundamental cost and effect relationships are timeless and universal. And that seems logical, and right now the conflicts within countries and between countries are increasing, Ray claims, because of the increased wealth opportunity gaps and you've got these diverging values and you've got rising powers which obviously is China, which are coming out to challenge the existing power, which is the US.

He talks about these, in the past the conditions leading to this rise of populous in which you're seeing, which leads to really important policy shifts which also can influence economic outcomes. You've got tariffs, you've got economic sanctions, capital controls. You've got massive corporate tax cuts, and these things have big market implications. And he goes on to talk about the conflicts that are increasing within countries as you're seeing ... Really, you think of Trump, you've got these confrontational populous from both the right and the left and you're seeing them gain a lot of traction and their outnumbering the moderates who ... The moderates are kind of looking for a compromise, they're looking for ways to bring unity so not only do you have internal strife, but you're seeing these conflicts that are increasing between countries. He goes on to say these populous leaders, they're more nationalistic and they're more willing to fight than globalists who are obviously more inclined to cooperate.

You marry that with countries like China, challenging the US, challenging their dominance, and he marries that and his next order of thinking, his next level of thinking he said okay, we know that's what's happening but what's the landscape that's happening in and he points out it's happening in the later stage of a short-term debt cycle which we're nine years into. There's not a lot of slack in the system and central banks are shifting from being simulative to being restrictive. And he goes on to add that in the later stage of the long-term debt cycle when debt and non-debt obligations, think pensions, think healthcare obligations, are high, interest rates are near zero and we've seen all this printing of money to buy financial assets and that's kind of coming to a slow down, that's slowing down. So that reduces the simulative effect.

And when you put all that in the hopper, he goes on to say that

the risky configuration of circumstances has occurred numerous past times, most recently in the late 1930s. Bridgewater did a study about 18 months ago on populism because they were really looking to better understand and help them focus on how conflicts are being handled, what the implications are for the market. And obviously they concluded that the most important international conflict is going on between the US and China and it's something that they pay a lot of attention to but they take it then to a next level. What we read about right now is everything is the trade war, the trade war and Ray's view is the conflict is spreading way beyond trade. And he points to the military, brings up a lot of interesting points.

Talks about on September 20th how the US sanctioned the branch of the China military that's responsible for weapons procurement and the guy who's actually responsible for it, General [Yu Zhongfu 00:19:34], he was sanctioned and the US did this because there was a 2017 law which created the Economic Sanctions Weapon Act, it's called the Countering America's Adversaries Through Sanctions Act and that was originally put in place to punish Russia for aggression in the Ukraine and was used to punish Russia for meddling in the US elections and all that stuff but the US used that for China and it's using that to hit China with sanctions and that was like a new non-trade related act and that led to a verbal spat. It was pretty strong words. China issued a statement on September 22nd from the Defense Ministry that said the US has no right to interfere, it's a basic violation of basic norms of international relations.

On the 24th of September the US said it would sell 330 million worth of military and aircraft parts to Taiwan and that kind of pissed China off. China came out and said we strongly disagree with this and we are very dissatisfied and that it violates international law and it could cause severe damage to US/China relations. He points out on the 25th of September, China denied a request for a US carrier strike route to visit Hong Kong. September 26th Trump came out and charged China with trying to influence midterm elections raising the possibility of further sanctions. Oct 1st, a visit to Beijing by Secretary Mattis, US Defense Secretary Mattis to discuss security issues was canceled right before the trip. They couldn't come to an agreement.

Mike Pence spoke on October 4th, he gave a speech describing the great power competition and in that speech he said the Chinese security agencies have masterminded the wholesale theft of American technology and that "China has initiated an unprecedented effort to influence American public opinion,

the 2018 elections and the environment leading into the 2020 presidential elections". And Pence went on to say in that speech that Beijing is also using its power like never before. They now spend as much on military as the rest of Asia combined and is prioritizing capabilities to erode US military advantage on land, at sea, air and in space. Now he didn't bring up US military activities, which is also doing the same stuff.

And then on October 10th, US Treasury came out and said it's going to be using new powers that Congress gave it earlier this year when it passed the Foreign Investment Risk Review Modernization Act which more strictly reviews Chinese investment in the US technology area. And then on October 10th the Justice Department officials announced that a Chinese intelligence official had been extradited to the US to face espionage charges. So when you think about all these things, it really is more than just a trade war. There's a lot going on.

A lot of what I just mentioned is in the news but it's not front and center, especially if you're an investor. The trade war is front and center but all of these things are happening behind the scenes. Where it lands, the broader issues and results of it, nobody really knows, including the guys who are setting the policy but Dalio points out a few things. What are the possible scenarios? Well, they're pretty wide ranging, could be just your tariffs, which raises inflation, that lowers growth a bit. You could have a more serious conflict that disrupts supply lines in a way that have big negative impacts on companies, on their profits and that's kind of what the market is focused on right now if you think about it.

What if it leads to an all-out capital war in which China boycotts or sells Treasuries? They are the largest holder of US debt. That's a possibility. So, they are going to see ebbs and flows in relationships, that's obvious but, and this is where I love the essence of his thinking, he says as far as the asymmetry of the surprise goes it seems to me that they are more asymmetrical on the down side relative to what the market is.

Mike Alkin:

Mean they are more asymmetrical on the downside relative to what the market is discounting. Business is happening in the later stages of both the short term and long term debt cycles. While central banks were tightening with the duration of assets long because rates are so low. It's an environment which we prefer to have a risk off posture. Risk off posture. If you are a listener to this podcast, you've heard me say countless times I think about the world in risk on or risk off.

Risk on is when people are feeling giddy, right? Risk on, we're gonna take more chances. We feel as though environment is ripe. You've seen a big risk on appetite the last nine years. Risk off is okay, let's reduce our exposure. Let's reduce our risk. We don't like the asymmetry of the risk reward. There's more downside risk than upside risk.

So I get asked, like I started this ramble, I get asked a lot, "What's your view on the market? Where's it going?" I have no idea where it's going. But if one were to be more, at times, be more aggressive versus more conservative, and I've stated this now for the last eight months. I think now is a time to be more cautious. And I've said it again and again, yeah the market keeps going up. Is it a blow off rally towards the end? Maybe. But I think prudence dictates that a risk off posture is right.

So I think it's something to keep in mind when you're thinking about it. That's just my view. Another thing I get asked a lot is, "What do you look at? How do you look at stuff right? What are you thinking about? What's your day like?" I have a Bluebird terminal, some of you may, most probably don't. And I'm looking at different, during the year, right now we're going into an earning season.

Some of the things I like to look at is I like to watch how the commodity companies are trading. You get really a rich amount of information that comes out during earning season about what's going on. A lot of it impacts the global economy. So [Alcoa 00:26:29] is reporting, [Vale 00:26:31] is reporting. You've got Schlumberger in oil fields business. So that gives you a good indication of what's taking place. This year, I mean this week. For Alcoa it updates outlook on the aluminum market. That's a pretty big market. So it kind of gives me a sense of what's going on when Vale reports, they're the world's top producer of iron ore.

So I get to get a sense of what's going on there. And BHP and Rio Australian rivals, they're also reporting. So you get a look into what's going on in the global economy there. So you'll see ship tracking data coming out from Iran on Monday. Which gives you a preliminary sense of the oil flows from the Persian Gulf country in the final month before the sanctions resume on November 4. So that gives you a good sense of what's going on.

So I like to take a look at those big companies and I like to listen to a lot of earnings calls during earning season. But there's big commodity companies, they cover the earth. No pun intended. But they really are pretty interesting.

Another risk I think you need to be thinking about is what's going on in Saudi Arabia right now. Obviously if you've been paying attention to the news in the last week or so, Washington Post report Jamal Khashoggi entered the consulate in Turkey. He's a Saudi who was exiled about a year ago. And there's video of him entering the consulate, the Saudi consulate, but there's no video of him leaving. His fiancée was waiting outside, he never came out. And it's believed by many that he was killed by the Saudis in the embassy. That has caused quite an uproar.

The Saudis are going through under MBS Mohammed bin Salman that this complete revamp they're trying to show the world that they are a modern, thriving economy with massive investment. He came, MBS came to the US last year, I think it was. And he went on his introductory tour and he wooed a lot of politicians. He wooed a lot of big business. So people are thinking well, Mohammed bin Salman, he's really turning it around. The crown prince, he's young, he's got this economy going. They're going to reduce a little bit of dependency on oil and it's going to be a thriving, thriving economy.

Well, they came out over the weekend, they've been saying all week, "We didn't do it." And people said, "Well something happened." Because really at the end of the day, Khashoggi was a really fierce critic of MBS and the kingdom. There's been a lot going on. I think several months ago, part of the royal family, they were rounded up in Saudi and brought to the Ritz Carlton hotel and imprisoned. Some for upwards of a month. They had to pay billions and billions of dollars, in supposedly money back to the kingdom for ill-gotten gains. But who knows what that was. Maybe it was MBS exerting his power.

This has really drawn the ire of people around the world. Richard Branson was supposed to do a big development project and also take a big investment from Saudi Arabia, and he canceled that. And other leaders have come out and said, "This is not okay." But here we are. We're getting into so what does Saudi have? What are they? 13% of world oil production. You've heard me talk a lot in the past about energy as a weapon. And obviously we see that with the Russians and natural gas. If you think about Saudi Arabia, it last used its petroleum resources as a political weapon when it led an Arab oil embargo in '73 and '74 during a war between Israel and the coalition of the Arab states.

But since then, Riyadh has put oil above politics and they always promise a stable supply under any scenario. The rhetoric over the weekend might suggest that that's changing because Trump has

come out and said, "Listen. We need to understand what happened to Khashoggi. And if what is being said happened, there will be severe punishments to Saudi Arabia."

Saudi came out and said over the weekend, "You don't want to do that. Because if you do that, we have a huge influence over the economy. The global economy. And that would be a big mistake." So you're seeing this big rising tension, this war of words. Now with Brent in the '80s, Brent Crude, WTI, West Texas in the 70s. Oil's spiked up quite a bit here. If they start to squeeze the market from it, you could see oil I don't know where? 100? 125? 150? If they use it as a weapon, that could cripple economies.

So again, back to the risk on, risk off stuff. That stuff you need to think about and put that into your calculus when you're thinking about how you want to be positioned.

Hope you took something out of that. I just thought it was time not to have a guest, not to talk about different stuff. I just wanted to give you my thoughts and hopefully that shed some light on a few things. I just wanted to let you know I am the co-founder and chief investment officer at Sachem Cove Partners LLC. Due to industry regulations I don't discuss any of Sachem Cove's funds on this podcast. And all the opinions expressed by the podcast participants are solely their own opinions and do not necessarily reflect the opinion of Sachem Cove or its affiliates. This podcast is for informational purposes only and it should not be relied upon as the basis for investment decisions. Clients and or affiliates of Sachem Cove Partners may maintain positions and securities discussed on this podcast.

I'll have a guest next week. In the interim I hope you have a great week and we'll talk next week, thanks.

Announcer:

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