233% Potential

JR here ...

This week subscribers to my *Commodities Essential* newsletter had the opportunity to score gains of 35% or more on a leveraged ETF position we held for less than a week.

To be sure, that’s a monster move for an ETF over such a short amount of time.

But it made me curious: what if my subscribers had used options to play for the same move we targeted with that ETF?

Here’s the answer ...

Quotable

“What if everything is an illusion and nothing exists? In that case, I definitely overpaid for my carpet.”

Woody Allen

Commentary & Analysis

Running for the exits of ephemeral fundamental expectations!

Earlier in the year when JR and I did our “Best Guess” Issue for 2011, aka our “Forecast” Issue, we talked about the key linkages in the global economy; I shared these again during my most recent webinar sponsored by Mirus Futures and CME. I think it still works well as a framework ...
Simply put, US demand is still the driver. Chinese demand is critical, but Mr. US Consumer still controls about 50% of the world demand pie. But most important to Germany (and the eurozone by default) is Chinese demand—it has been a huge source of growth for Germany of late (but as I said before, once China is done reverse engineering all those advanced machine tools, Germany may be hurting). Of course China demand is also key to everyone’s most loved asset—commodities. I note with interest and surprise even Jeremy Grantham, the Bostonian Barron of All-Seeing and All-Knowing (proven “for real” in many market cycles past) has been caught up in the Malthusian madness expecting an inevitable march higher in commodities prices.

Three deep bows in respect to the Northeast I do right now to Mr. Grantham, but wholeheartedly disagree with his premise: “We now live in a different, more constrained, world in which prices of raw materials will rise and shortages will be common.”

It’s different this time? It is a Malthusian moment? Oh really Mr. Grantham? No more inventions or material substitutes or new forms of energy or et al? I think you have been spending too much time rubbing elbows with the libs in Cambridge, a crowd that always thinks the sky is falling as they wring their hands in compassion.

Okay...sorry...back to the point...now it seems the US is slowing again; the numbers flowing from China suggest a slight slowdown and it could be a decent slowdown should China really get serious about credit-driven inflation (thanks to our most dangerous
export—Ben Machiavelli Bernanke). Plus a host of numbers shows a “surprising” slowdown in Germany, as reported by Reuters.

Now to link these linkages back to the Fed:

1) We know the Fed is targeting financial assets—it has never been so explicit. And they wonder why their reputation is in the proverbial toilet; oh let us count the ways.

2) We know every analyst worth his CNBC public relations firm fees loves commodities and the stock market thanks to the cute little dictum—“don’t fight the Fed.”

The big problem with all these beliefs is they were predicated on the belief that yes—growth in risk assets can have a significant feedback loop to enrich holders of those assets and spur consumer demand. Well, as I pointed out in these august pages recently (if Grantham can do it so can I), thanks to a great piece of analysis by Hoisington Investment Management, that dog won’t hunt!

Mr. Consumer ain’t jumping for joy in a world where his feedback loop is rising cost of living everyday instead of a rising portfolio of risk assets. Note to Ben: I realize you don’t get out much so let me bring you in on a little secret: those happy-haves who show up on TV to tout your and their brilliance in identifying and riding this “new” bull market aren’t the ones who drive the bulk of spending in the US economy. No, those guys are the unhappy have-nots and they can’t for the life of them figure out what those boys on the Street are smoking or why your driver and delivery boys don’t tell you how much it costs now to buy a pound of tomatoes.

The game our boy Ben has played has done one thing VERY WELL in my most humble opinion:

It has created a massive spec premium in many, if not all, risk assets.

You name the risk asset: stocks, commodities, high-yield bonds et al

And of course what is the flip side of the ledger that is funding all this risk asset euphoria? Tick...tick...tick....tick....tick....tick....Shazam! The US dollar! That is right boys and girls!

So, in my most humble opinion, despite the fact markets can remain seemingly irrational for much longer than expected (or very rational to some much longer than expected), it seems at some point there has to be a connection with financial and real assets. To date, continued steady growth in the US and elsewhere was the expectation being dragged along by financial assets ... but if we have one of those “switch on the light” sentiment swings, i.e. a Wiley Coyote moment—bada bing bada boom ... the house of cards Ben just built a la QE1 + QE2 all comes crashing down.
**US Treasury bonds** aren’t playing nice with the other expectations in the market and haven’t been despite the Bond King’s machinations to the contrary ... heck, they seem to be foreshadowing, and dare I say it, a RISK BID!!!!!!

![Chart](chart.png)

Notice the relationship between **10-yr Note Futures and the US weekly index** in the chart below—if someone yells RISK BID in this crowded theater of risk asset dream-ology, all those Johnny Come Lately dollar bears and commodity bulls will be running for the exits labeled “ephemeral fundamental expectations” as fast as they can.
Impressive vs. Sensational

JR here again ...

No doubt the move my subscribers caught this week was impressive. But had we used options, *impressive* would have instead been *sensational!* That’s because had we used call options on the leveraged ETF in question, and entered and exited at the exact same points, it would yield roughly a 233% return.

Yes, 233% ... from Thursday, April 28th to Wednesday, May 4th!

Are returns like this possible? Yes.

Are returns like this probable? Yes.

Are returns like this typical? No. Jack would kill me if I tried to play this off like returns of 233% were commonplace. The point I want to make is that options put you in a place that...
investing in stocks and ETFs simply cannot. [And if you assume the power of options is a double-edged sword, much like the leverage in futures and FX markets, you’d be assuming wrong.]

This is why Jack is unveiling a new BLACKSWAN offering next week.

It is called Options Predator.

And it is not restricted to any one asset class or any one direction. It is a comprehensive options trading solution for those who seek speculative returns, in any market environment, without taking on undue risk. Currencies, commodities, stocks, indices, fixed income, carbon credits – it’s all in play. (Ok, maybe not carbon credits.)

We plan to release the first issue of Options Predator next Wednesday. If this is something you know you want in on, then you can sign up now at a very attractive introductory offer. Also keep in mind there is a 30-day, risk-free, money back guarantee slapped on to this offer.

If you’re interested, but want to learn more first, stay tuned to Currency Currents over the next several days.

Thanks.