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Investment Letter?

April 3, 2014



CUP & HANDLE MACRO

Introduction

My name is Michael Lingenheld, managing editor, and welcome to the first weekly edition of Cup & Handle Macro. I'd like to point out that in addition to my thoughts, the content in this publication will be written in collaboration with [my partners](#), including one who is featured on the [cover of Crain's Magazine](#) this week.

Growing up in rural New England, my interest in finance was piqued in 5th grade by entering a statewide stock-picking contest. After looking up the definition of short-selling, I allocated an irresponsible percentage of my (fictional) portfolio shorting a healthcare company called Vencore. I don't recall whether the courts went against Vencore in a lawsuit or if the company filed for bankruptcy, but the (fictional) trade boosted my (fictional) portfolio by more than 4,000%. I quickly moved to cash and won an all-expenses paid trip to the World Trade Center and New York Stock Exchange.

I continued to pick stocks in my personal account throughout high school and college but my first macro bet had nothing to do with trading. In the fall of 2007 I was finishing my final year of education and felt the economy was headed for a major downturn. With that in mind, I graduated a semester early and locked down an accounting job with a fund administrator. This call proved prescient as the majority of my classmates struggled to land jobs in the spring of 2008. I stayed at that job until 2009 when I moved to Stamford, CT, taking an operations position at a macro hedge fund, and quickly discovered that macro is much more interesting than picking stocks. From there I worked my way up to become a trader, then analyst, and finally portfolio manager in 2012.

Today, I have been running a profitable macro portfolio for three years and have, along with my partners, decided to distribute ideas to a wider audience via this newsletter because we believe there is a significant void in the marketplace. While we deeply respect several macro commentators, my partners and I feel that the vast majority of newsletters offer redundant and unoriginal insight into markets. Even more, most newsletter writers have never actually invested in a professional setting (managing other people's money, looking investors in the eye after losing money, managing risk, etc.) As actual practitioners, Cup & Handle will never be a comprehensive overview of markets but will instead look into aspects of the market that you would never find in the Wall Street Journal or other mainstream outlets. In addition, because we don't work for a bank, we frequently take positions that go against consensus. Finally, over time we plan on introducing several features, including insights into agriculture and precious metals from our partners at US Farm Trust and GBI, respectively.

Most important, I've made a personal decision to educate others and believe that the combination of my own skill set and those of my very successful partners, will create a truly unique place in our reader's minds. We are not media people entering the investment market, we are investors entering the newsletter market. Our team has worked for the most accomplished investors and built large businesses on the back of those insights. We believe Cup & Handle will be a vehicle to provide those insights to others.

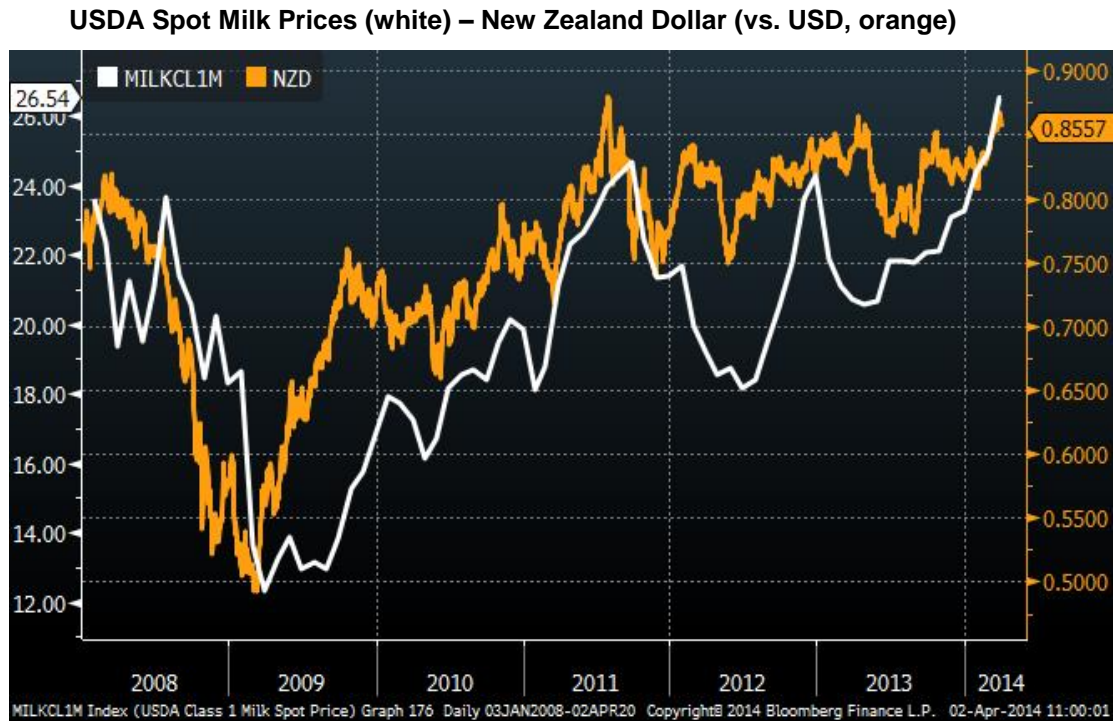
With that, I bring you our first weekly publication. If you have any comments or criticisms of this product, please feel free to contact me directly at mike@cup-handle.com.

I look forward to exchanging ideas with you,

Michael Lingenheld

Milk and Kiwis

New Zealand is perhaps best known as the backdrop for *The Lord of the Rings* but it's also the world's leading milk supplier. Dubbed the "Saudi Arabia of milk" by the Financial Times, the Kiwi economy has been surprisingly resilient due to its dairy industry which accounted for nearly 1/3 of the country's exports in 2013.



The majority of dairy shipments went to China, whose increasingly wealthy population and aging demographics are splurging for milk, cheese and butter. Last month it was reported that New Zealand's trade with China rose 45% Y/Y in 2013. These booming trade figures have attracted inflows from investors looking to capitalize on the burgeoning Chinese consumer, pushing CPI in New Zealand to a two-year high. As a result, the central bank raised interest rates 25bps on March 13, sending the Kiwi (New Zealand Dollar) within 1% of its all-time high against the US dollar.

New Zealand Official Cash Rate (white) – New Zealand Dollar (vs. USD, orange)



The two charts above show New Zealand's strong currency may have more to do with rising milk prices than interest rate differentials. The Reserve Bank of New Zealand was the first G10 central bank to raise interest rates since the ECB's ill-fated hike in 2011, and other prominent central banks will be watching to see how local markets react. If there is clear evidence that higher rates smothered New Zealand's economic recovery, investors could be waiting for higher global rates until the cows come home.

Possible sign of the apocalypse?

If the stock market crashes in the next six months, we'll all look back and say that Facebook's acquisition of Oculus VR, a company that sells virtual-reality goggles, for \$2bn was the sign QE had created a bubble. Following the announcement, fast-money traders and their computers accidentally bought shares of Oculus VisionTech (ticker: OVTZ), a \$2mn company that designs and markets digital watermarking. Oculus VR was a private company that didn't trade on any exchange.

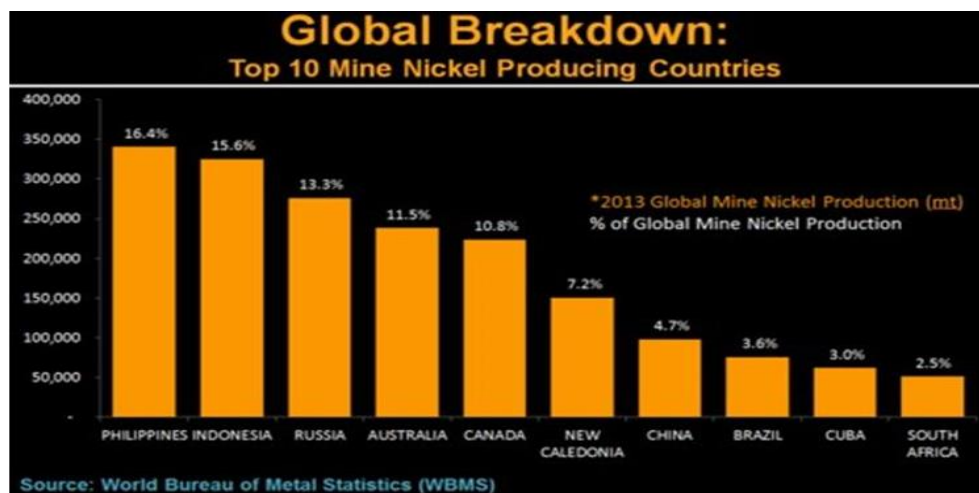
Oculus VisionTech (OTC exchange)



Eventually these quick-triggered traders did their homework and Oculus VisionTech finished lower on the day after jumping 125% high on the open. High-frequency [trading received a lot of negative attention this week](#), but perhaps the bigger problem is the lack of common sense incorporate into trading algorithms.

Nickel's back

The geopolitical tension between Russia-Ukraine has been simmering since late last year before escalating in early March. Many investors sought to capitalize on possible Russian trade sanctions by buying palladium and nickel. While certainly a big player in the palladium market, [as we've already documented](#), Russia is synonymous with nickel mainly because of MMC Norilsk Nickel (ticker: MNOD LI) owned by prominent oligarch Vladimir Potanin. In fact, Norilsk is the world's largest miner of both nickel and palladium. However, as a country Russia is only the world's third largest producer of nickel, behind the Philippines and Indonesia.



It would be wrong to say that the Russian developments haven't been supportive of nickel prices but the far more important development is in Indonesia, the world's second largest producer, [which recently banned nickel exports](#). Indonesia's export ban is a huge development for an industry that has been plagued by oversupply and high inventories for some time. At current prices, it is estimated that 30% of global nickel production is operating at a loss.



Nickel has already rallied more than 20% from the lows, but the chart still looks fantastic with plenty of upside left. Analysts now predict that nickel will move into a shrinking surplus by mid-2014 before entering a sizeable deficit in 2015. As with most commodities, China is the largest consumer and most important player on the demand side. Barring a Chinese economic slowdown, which looks increasingly unlikely, stockpiles should be depleted before too long. Unfortunately nickel isn't a very liquid market, especially in the US, and can be hard to access for smaller investors. There is an ETF based in London managed by ETFS (ticker: NICK LN), but the LME exchange is where the bulk of volume occurs. This is a potential money-making opportunity but perhaps more importantly, it touches on resource nationalization, a theme we will cover frequently in this newsletter.

Swap-ortunity?

Every 5% pullback in the S&P 500 seems to illicit cries from fatalists on CNBC that "the end is near," before the inevitable rally back to new all-time highs. Equities may be overdue for a correction but several indicators show that stock-pickers have nothing to worry about. For example, the VIX, a

measure of equity market volatility, hasn't closed a week above 20 since late 2012. Even more calming is the chart of 2-Year US Swap Spreads:



Swap spreads, which measure the difference in yield earned by lending to the US government (“risk-free”) vs. a bank for a given duration, gauge systemic risk currently being priced by the market. Quantitative easing is still very much alive (despite tapering), US banks are some of the healthiest in the world, and Janet Yellen [seems intent on making Ben Bernanke look hawkish](#). All of which reduces the amount of systemic risk in financial institutions. With that being said, good investors are taught to buy low-sell high, and it doesn't seem like it's possible for swap spreads to go much lower from here.

Reader Question:

****Editor's note: Every week we'll try to answer at least one reader question. If you would like to submit a question, please send us an email at info@cup-handle.com, we'd love to hear from you! This week's question isn't about markets, but we do have an answer. ****

Q: Where did the name Cup & Handle Macro come from? – Dan, New York

A: Good question. A “cup and handle” is a [fairly well-known chart pattern](#) that signals continuation of a trend. We look for high probability investment opportunities with an asymmetric risk profile (little risk / high reward) that can be very profitable if observed and executed correctly. Importantly, this pattern applies to all markets, both liquid and illiquid. It's even helpful for non-financial data that can be charted. As you read more of our research, you'll likely notice that many of our highest conviction trade ideas exhibit at least some characteristics of the cup and handle pattern.

Flagged readings this week:

- [Mark Cuban on the NFL's inevitable decline](#) - ESPN
- [The very entertaining and profitable future of VICE Media](#) - Forbes
- [How a Giant Kazakh Oil Project Went Awry](#) – Wall Street Journal
- [Cabrera's Millions And Baseball's Billions](#) - FiveThirtyEight

Reward for reading this far:



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Cup & Handle Macro partners:



Best of luck this week,

Michael Lingenheld

Managing Editor – Cup & Handle Macro

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