

## Jubak Picks

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*The cure for the common portfolio*

January 17, 2019

## Jubak Picks Daily Newsletter

Daily Newsletter Access: <http://www.jubakpicks.com>

### Bear Market Worries

BW: This is a two-part article.

#### **Why I Can't Put Away My Bear Market Worries: #1 Hong Kong Overnight**

Did you see what happened in Hong Kong overnight?

The major Hong Kong Index, the Hang Seng, was down slightly, dropping 0.54% on the session. However, a smaller group of stocks in the Hong Kong market got slaughtered. Jiayuan International Group, Sunshine 100 China Holdings and Rentian Technology Holdings fell over 75% in a matter of minutes, and at least 10 stocks were 20% lower or more by the close. The plunge in those shares wiped out HK\$37.4 billion (\$4.8 billion) in market value. The biggest loser was Jianyuan International, which dropped HK\$26.3 billion on record volume.

If you are like me, you have never heard of these companies and you don't own shares, so why should you care?

Because the downdraft came as a result of structural weakness in the Hong Kong market—and one thing that keeps me worried about a resurgence of the bear market in U.S. equities is structural weakness in the domestic market.

One likely explanation for the drop in Hong Kong is a high degree of cross-shareholding where companies own each other's shares and use those shares as pledges against liabilities. Once selling starts in one of those cross-holdings, all the connected parties look to sell too.

In addition, rules on the Hong Kong exchange say a controlling shareholder can borrow against shares and not disclose the loan as long as it is for personal finance reasons rather than for corporate purposes: loans, guarantees, or other forms of support for the company.

Something like the overnight plunge took place in 2017 when a network of 50 inter-connected stocks triggered a cash run that wiped out \$1.4 billion in market value from five small-cap stocks in November.

The Hong Kong market is not alone in having this “inter-connectedness” problem. It is true of mainland Chinese markets as well (and in Japan.) The Chinese problem and danger may be even bigger since it involves bank lending on inter-connected collateral and loans from local governments.



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So, one thing that worries me is that the economic stresses in the Chinese economy and banking system could result in a larger version of this overnight sell-off, and be large enough so that volatility in China's financial markets would unsettle emerging markets in general.

The other thing that worries me is that while the United States' financial markets do not have this kind of "inter-connectedness" problem, there are reasons to be concerned with the huge financial concentration in a handful of stocks, such as Amazon, that are owned by, seemingly, every ETF in the financial universe. There is also the problem of the huge increase in corporate debt with disclosure and covenants much weaker than, say, five years ago.

The global financial crisis may look explicable in retrospect but, at the time, it seemed unthinkable that a problem in the sub-prime mortgage market could send the global financial system into crisis.

In the next crisis, whenever it may be, we are not likely to see the source of the problem until it bites us.

So, despite the losses I have taken on my Put Options in Amazon, Netflix, and other short hedges (including my Call Options on the VIX volatility index), I am not putting these tools away quite yet.

### **Why I Can't Put Away My Bear Market Worries #2: Financials To Tech Earnings Transition**

The big banks have delivered to start off earnings season, and the financial sector has been a key source of strength for the uptrend in stocks since January 3. Over the last month, the Financial Select Sector SPDR ETF (XLF) is up 5.4% as of the close on January 17.

However, now the going gets rougher as earnings season transitions to the tech sector, and the earnings picture here does not look nearly as positive. (Technology and financials, I would argue, are the two essential sectors for a continued market advance. By weight, they occupy the No. 1 and No. 2 positions in the S&P 500, with the top-ranking switching back and forth as one sector or the other rallies.)

We have already had a big warning from Apple (AAPL) that hit hard its shares, and those of suppliers such as Broadcom (AVGO) and Skyworks Solutions (SKWS). In the last month, shares of Apple are off 5.81% and shares of Broadcom and Skyworks have tacked on meagre gains of 0.20% and 0.49%, respectively.

Yesterday, Taiwan Semiconductor Manufacturing (TSM), the company that makes the chips for just about every chip company except Intel and Samsung, warned on revenue for the first quarter of 2019. The shares are down -0.66% over the last month. Today, January 17, Netflix (NFLX), the momentum star for 2019, announced a miss on fourth quarter revenue and warned on revenue for the first quarter. The shares fell 2.89% in after-hours trading.

That is why the Technology Select Sector SPDR ETF (XLK) is off 0.02% for the last month.

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Other technology bellwethers still to report include Texas Instruments (TXN) and Intel (INTC) on January 23 and 24, respectively, Facebook (FB) and Microsoft (MSFT) on January 30, Amazon on January 31, and Alphabet (GOOG) on February 4.

As a reminder, the markets are closed Monday for the Martin Luther King holiday.

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**BW: See “About the Author” on the next page.**



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## About the Author



Editor and Founder of JubakPicks.com; and Senior Markets Editor, MoneyShow.com

**Web sites:** [www.jubakpicks.com](http://www.jubakpicks.com); <http://jubakfund.com/>; <http://jubakam.com/>

### **BW: here is an excerpt from Jim's WELCOME message on his website**

After twelve years with MSN Money, I am excited at being on my own. The move gives me a chance to bring you, my readers, more and better ideas for profitable investing. Each week the folks at the MoneyShow.com and MSN Money will publish seven of my posts from this blog on their sites. That is already an increase in your weekly dose of Jubak from the days when I wrote Jubak's Journal twice a week. But you will also find another 18 or so posts a week on my JubakPicks.com blog that do not appear on either of those two sites. (Although they have appeared as much as three days ago and as little as a few minutes ago, if they are really important) on my new subscription site at <http://jubakam.com/>)

Here I am aiming for five posts a day five days a week. I won't always get to those numbers. Some posts just take longer to research and write and sometimes, like everyone else, I run out of gas and need to take a break. But my goal isn't some arbitrary number of posts, anyway. The goal is to bring you the best market intelligence that I can on a schedule that keeps you at least one step ahead of the market.

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