

AT FRIDAY'S CLOSE:

Dow Jones	12,777	0.0%
S&P 500	1,357	0.2%
NASDAQ	2,908	-1.0%
NYSE	7,759	0.0%
Russell	801	-0.8%
Oil	87.08	3.5%
Gold	1,588	0.3%

STOCKWORLDWEEKLY

THE EXECUTIVE'S SUMMARY | OF THE GLOBAL MARKETS

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In last week's SWW we had flipped bearish with an SQQQ hedge, the July \$47s at \$1.40 and they hit \$5 on Friday but, unfortunately, we had already gotten out. Still, a very nice gain any time during the week! Two other short positions were mentioned by Phil and featured on page one last week – the AMZN Oct \$185 puts at \$3.80 which finished the week up 35% at \$5.15 and EDZ at \$13.85, which finished at \$15.31 (up 14%) but that was after dropping \$1 on Friday.

Other trade ideas from last week's report are still playable, like the BA 2014 spread, F (even cheaper at \$9.27) and Pharmboy's selection of WAG is "only" up 4% on the stock, at \$30.81 and the 2014 \$30 puts and calls are still \$7.90 for the pair so you can end up paying \$1.19 more per share but now your trade is in the money to start.

Overall, it was a riotous week in the markets (see Dave Fry's SPY chart on the right) ended about flat and right at resistance. Bad news from China (weakest Q2 GDP since Q1 '09, imports 1/2 of expectations in June), Australia (job losses), Japan (machinery orders off 15%) and at home in America (small business optimism becomes an oxymoron, consumer confidence at 7-month lows, refinances hit 6-month low) have all been taken as signs that QE3 MUST be just around the corner because, after all – how much worse could things get?

The PPI, however, remains red-hot at 2.6% year over year – 30% over what many consider the Fed's inflation target of 2%. Our own trade deficit fell \$2Bn as exports from the US hit their second higher level EVER and mortgage rates fell to new record lows of 3.3% while the notes we sold (\$120Bn last week) had record demand and sold at record low rates.

What is it that we expect the Fed to want to accomplish with more QE? In effect, they have done everything they have set out to do and, in fact, have made the US economy "too hot" and spurred some inflation.

The Fed has upped their balance sheet north of \$3.5 TRILLION Dollars after their first two rounds of Quantitative Easing by creating money to purchase distressed assets from their troubled Member Banks (pretty much all of them) in what will one day be revealed as the World's largest Ponzi scheme when it finally unravels (see David Wessel's In Fed We Trust). Operation Twist has been a sort of QE 2.5 and have driven down long-term rates but have done nothing to spur demand as broke people can't afford the same home at 4% that they couldn't afford at 6% and, while it may be tempting to throw another \$1Tn into an experiment, they are not likely to begin buying at 3% either.



Bernanke is BEGGING Congress to do something and will do so again next week and the anticipation of Bernanke's "Humphrey Hawkins" testimony next week has been giving the bulls something to hang their hats on. Unfortunately, the odds of Congress actually doing anything before the next election are extremely close to zero so we take the last day bounce in the markets with a Lot's wife-sized grain of salt and we remain "Cashy and Cautious" in our short-term trading.

Monday Market Movement—Stop Downward Slide?

China's trade growth decelerated sharply during June, presenting a new sign of a continued slowdown in the country's economy. Customs data showed that import growth fell by half from May's level to 6.3%, which reflects weaker consumer and industrial demand. Export growth decline to 11.3% from May's 15.3% amid concerns of weaknesses in the U.S. and European economies. A [slowing demand for Chinese imports](#) is concerning to other economies that have seen relatively strong Chinese growth driving the demand for their exports.

Apprehension regarding China's economic growth contributed to the largest percentage loss in over a month in the Hong Kong stock market. The HIS fell 1.88%. [Market volume was down](#) from HK\$48.96 billion shares on Friday to HK\$42.42 billion. The Shanghai Composite ended down 2.37%.

Major global indices also slipped as traders reacted to the disappointing economic data in Asia, especially a weaker-than-expected Chinese inflation data and a [record fall in Japan's machinery goods orders](#). As EU finance ministers met again to discuss the eurozone's debt crisis, doubts resurfaced regarding future progress; yields on benchmark Spanish and Italian bonds rose to levels considered unsustainable.

In Australia, business confidence fell to a 10-month low in June. The National Australia Bank Ltd. (NAB) surveyed more than 300 companies between June 19 and 29 of this year and found that the measure of hiring, sales and profits--the business conditions gauge--improved to minus 1 from minus 4. "Business confidence fell heavily in mining in June -- down 18 to -14 points -- likely reflecting the recent downgrade to the Chinese growth outlook and concerns about the stability of the euro, with both of these factors influencing the outlook for global commodity demand," [NAB Chief Economist Alan Oster said](#).

The Foundation for Economic and Industrial Research (IOBE) announced that Greece's already crippled economy will fall by 6.9% this year, a figure underlined by data showing that the construction sector is still in a deep slump. This

report could help the country's government persuade its euro-zone partners and the IMF to ease up on the austerity measures that are deepening the recession. Greece's statistics service, ELSTAT, [provided fresh data showing a slump in construction](#) and a 27.3% fall in building volume year-on-year (y/y) for April. It also raised the forecast for unemployment to 23.6% from 20%.

German exports grew more than economists had forecast in May, providing a boost to Europe's largest economy in weathering the sovereign debt crisis. Exports jumped 3.9% from April, according to the Federal Statistics Office in Wiesbaden. [Economists had originally forecast only a 0.2% increase](#).

Indonesia received praise from IMF chief Christine Lagarde, who called the country's economy "solid and encouraging." She continued, however, to say that dark clouds might lie ahead due to global uncertainties. [Lagarde views Indonesia's trajectory was generally positive](#).



Market recap: Stocks closed marginally lower as another late-day pop allowed them to finish well off their worst levels. Concerns of a worsening slowdown in China got everything off on the wrong foot after the country reported a sharp fall in inflation. Oil moved higher as labor issues threaten to shut down all of Norway's production. The fracking revolution may have claimed its first coal company as Patriot Coal could file for bankruptcy protection imminently.

Inside Phil Stock World Member Chat

Real estate – I think it's bottomed in terms of volume but maybe not in price as the consumers have no buying power and loans can't go lower so what else can change except prices if there is a desire to move more than this anemic amount of homes?

Member—What is your opinion on JNPR (\$14.50)? It is trading at ridiculous levels comparable to CSCO (\$16.31) last year.

JNPR – I'm not sure what you mean by compared to CSCO, who have a p/e of 12 compared to JNPR at 26. There's nothing wrong with JNPR if you have faith they can get their costs back under control cut CSCO is still tops in the sector, which is facing tough times and, if push comes to shove – I'd rather be "stuck" with 2x or 4x of CSCO than JNPR and I certainly don't like the sector enough to buy both...

CHKR – They have a sweet deal from CHK on about 200 wells and they have, so far, activated about half. With a 12% dividend and good growth prospects (it doesn't cost them anything if 90% of the remaining wells fail) I certainly like either taking the stock at \$21.20 for the 12% dividend or, better yet, selling the CHK 2013 \$20 puts for \$3 as that's a net \$17 entry and, if CHK holds \$20, you make \$3, which is more than the \$2.64 dividend on less cash up front in less than 8 months. TOS says net margin on short puts is \$3.25 so return on margin close to 100% in 8 months and you have built-in 20% protection on the stock.

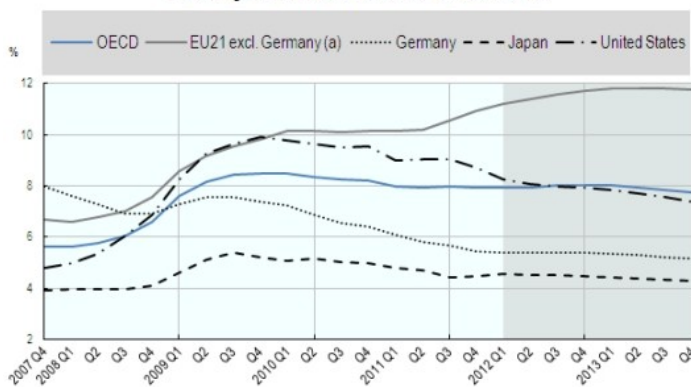
Testy Tuesday – Facing Fiscal Failure G20 Resorts to Tricks

The British government is attempting to support its economy, which BoE Governor Mervyn King says is showing few signs of recovery. Pressure is mounting for the government to fund infrastructure projects directly, despite it contradicting its plan to reduce the budget deficit. The think-tank, the National Institute of Economic and Social Research, announced that Britain's economy shrank 0.2% this past quarter. [Early this year, Britain began its second recession in four years.](#)

According to the IMF, Italy does not have an efficient firewall to shield it from fallout of the region's debt crisis, despite the efforts of Prime Minister Mario Monti. The organization suggested strengthening the eurozone by establishing a fiscal union with more integrated monetary policy. Monti, however, [has been praised by the IMF](#) in reducing the budget deficit and increasing the country's growth potential.

Unemployment rate is projected to remain high in OECD countries

Percentage of total labour force, 2007 Q4 and 2013 Q4



Note: Grey shaded area refers to the OECD projections.

a) Aggregates are weighted averages.

Source: OECD calculations based on OECD Economic Outlook No.

In France, overall industrial production fell 1.9% in May compared to April, according to the national statistics agency INSEE. Released data also showed that manufacturing output declined by 1% in all segments from electronics to transports. This information, plus recent data regarding unemployment and the PMI, [has increased the sentiment that France's econ-](#)

[omy is slowing down.](#)

The Organisation for Economic Co-operation and Development (OECD) announced that it expects unemployment to remain high in advanced countries through the end of 2013. The organization released its 2012 Employment Outlook, which stated that the jobless rate in the 34-country area will be stuck at 7.7% at the end of next year, leaving 48 million people out of work. [According to the report](#), young people and the low-skilled will bear the brunt of this weak recovery, with youth employment having decline by almost 7 percentage points relative to overall employment since the start of the crisis. Low-skilled employment dropped almost 5 percent.

The past few weeks have been turbulent for Chinese firms as the country's slowing economy is taking its toll on corporate profits. At least half a dozen companies warned that earnings would be softer than expected. Several prominent firms have unexpectedly lost top executives recently. *"We are seeing a lot of companies start to come under greater financial stress, and we are going to find out how robust their business models really are,"* [said Patrick Chovanec](#), associate professor at Tsinghua University's School of Economics and Management.

A draft of Japan's growth strategy revealed its goal to create a \$628 billion green energy market by 2020. It will attempt to do so through deregulation and subsidies promoting development of renewable energy and low-emission cars. The growth strategy also states that Japan will seek to create 1.4 million jobs by 2020. [The Bank of Japan will play a part](#) as the government plans to achieve stable price growth and exit deflation.

Market recap: Already lower following more slowing news out of China and earnings warnings from the tech sector, stocks took a mid-afternoon hit when Cummins cut its 2012 outlook. The 10-year Treasury yield fell below 1.50% again, and oil took a beating. The airline sector is the subject of merger speculation and troubles continue at J.C. Penney.

Inside Phil Stock World Member Chat

AAPL (\$604.97) – I think the main reason AAPL is undervalued is simply that it's gotten so big (\$600Bn), that there simply isn't enough capital flowing in this low-volume market to flow into AAPL and bring it up to \$1Tn. Where would the \$400Bn come from? Total market inflows have been negative so money has to flow out of other stocks (\$40Tn) and into AAPL so the whole market would have to drop 1% to bring AAPL up to \$1Tn and, since AAPL is tied up in various indexes with the rest of the market – that's not going to happen. So AAPL can only really rise with the Nas and the rest of the indexes now as the stock is too big to succeed essentially. That's not to say they can't pop 10% on earnings – but sustaining it is another matter entirely.

TLT (\$129.17) – I like starting to short them here but \$132 is

our target top. At the moment, I'd go for the Sept \$124 puts at \$1.85, they are the first strike that can't be rolled up for .35 or less. Then the plan is to keep rolling up for .35 whenever you can (better if you wait for \$1.05 for 3 strikes so you don't kill yourself with fees) and hopefully you end up in the \$129s for net \$3.60 or less (now \$4.20) with TLT at \$132 (now \$128.50).

JRCC (\$2.00) is getting interesting as PCX's bankruptcy is whacking this much-better coal company for no good reason. At \$2.56, I like selling the 2014 \$2.50 puts for \$1.60. TOS, by the way, says I need \$1,050 in net margin to collect \$3,200 on 20 contracts – that's a pretty efficient use of margin!

Which Way Wednesday – 50 DMAs Face Tough Tests

The markets were awaiting the Federal Reserve Minute release in the early afternoon. Further austerity measures in Spain were being considered, including a raise in the VAT from 18% to 21% and additional spending cuts. On Tuesday, the Eurozone finance ministers [had agreed on the blueprint for the Spanish bailout](#) with the first €30bn expected to be disbursed by the end of July. The decision came as yields on Spain's bonds were hitting 7% again.

The Sino-Forest debacle brought on by the Muddy Waters investigation was having an impact on Chinese companies listed in US markets. State-owned China Development Bank Corp. is now [providing more than \\$1 billion to help smaller companies](#) buy back their shares and leave the markets. In addition, new Chinese stock listings in US markets has now almost come to a stop with only one new listing so far in 2012. On his blog, Paul Gillis [wondered](#) if the US would start delisting Chinese companies:

"I think there is a 20% chance that it all falls apart. The PCAOB and the SEC make no progress. The issue becomes political and widely known. Deregistration becomes the only option and it is the PCAOB that pulls the plug. That then forces the exchanges to decide how to enforce their rules that require companies to have auditors and audited financial statements in order to be listed. I expect in this scenario that the exchanges are forced to delist the companies, and the scramble to Hong Kong begins."

Further studies on ["The Pre-FOMC Announcement Drift"](#) [seemed to confirm](#) out of the ordinary stock market returns in the 24 hours preceding the FOMC minutes release which happen eight times a year:

"We show that since 1994, more than 80 percent of the equity premium on U.S. stocks has been earned over the twenty-four hours preceding scheduled Federal Open Market Committee (FOMC) announcements..."

This theory was not supported this time as the market followed through on Tuesday's losses, although there was a sav-

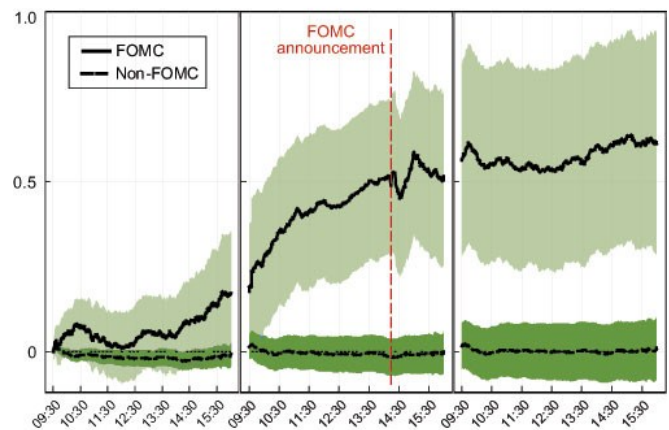
ing "stick" in the last hour. The Dow and Nasdaq closed with losses of around 0.5%. The S&P 500 finished the session flat.

Market action reflected the loss of appetite for risk assets as investors flocked in record numbers to US treasuries, the [10 year note auction](#) drawing an A++++. Dealers were only able to grab 14% of the offering, the lowest percentage in recent years.

Barry Ritholz [pointed out some signs](#) to look for in deciding how much the global economy is slowing (e.g., transportation, oil companies and earning quarterly growth). He concluded:

"These earnings are where the rubber meets the road, and I expect them to be telling."

Average Cumulative Returns on S&P 500 Index on Days before, of, and after FOMC Announcements



Sources: Thomson Reuters Tick History; Tickdata.com.

Note: The sample period is 1994 to 2011.

Market recap: Another late session rally helped stocks close off their worst levels. Nevertheless, it's a 5th straight losing session for the Dow, now off about 3% since July 4. Everyone will read what they want into the FOMC minutes, but the cut in inflation forecasts certainly opens the door for more Fed ease should things deteriorate further. The Treasury auctioned \$21B in 10-year notes at the record-low yield of 1.459%.

Inside Phil Stock World Member Chat

Member— I am sitting on a VNR July 30 call. Any ideas how I could salvage this position?

VNR Calls – They are .05, what is there to salvage? What you can do is make an 8x10 glossy blow-up of this trade and put it up near your computer where you can see it every day – circle the worthless expiration value and write in big, red letters – DON'T BUY PREMIUM – SELL IT!!! Then at least you can salvage some educational value from it.

It's not that we never buy premium but, when we do, we maintain very itchy trigger fingers looking to get out of the position. When you are the sucker burning premium on out of position options, then every tick of the clock is costing you money and if you are not right in short order – waiting and seeing is not likely to be much help.

Cars – The trend in the US is for families to have less cars, not more. Like anything else, when it's cheap and plentiful, everyone wants them but as gas plus repairs plus insurance plus parking prices go crazy – owning a car simply isn't fun anymore. I know so many people in NYC who think it's so great not to have a car anymore (coming from suburbs). Even a cheap car is \$500 a month to keep up and that's a whole closet in NYC!

SVU (\$2.32) already fell from \$8 to \$5 and then back to \$6.50 and then to \$4 and back to \$5.37 – maybe this is the end for them and maybe the .14 per share they made last Q (4x \$0.14 = \$0.56 for a p/e of 6 at \$3.36) was the last \$0.14 they'll ever make because people have just lost interest in buying groceries from anywhere but WFM. I don't think so.

Thursday Failure For the Euro – \$1.22 or Bust!

Futures indicated a much lower open on the back of lowered expectations for growth around the word. The Bank of Korea [lowered its rate unexpectedly](#) to counter a slowing economy. In view of weaker exports, economists at the BoK were now predicting growth of only 3.3% for 2012 below previous predictions of 3.7%.

“The central bank said that some economic indicators in the U.S. have shown signs of deterioration and that the sluggishness of economic activities in the euro zone has deepened. Economic growth in South Korea will be weaker than previously expected as exports and domestic demand, two key growth engines, both remain at low levels.”

This was followed later by [a 50 bps rate cut in Brazil](#). After eight cuts, interest rates in Brazil are at 8%, the lowest on record. Predictions for growth are now at 2% for the year, even with unemployment at a low of 5.8%.

“The slower-than-expected recovery should allow policy makers to maintain the pace of interest rate reductions at half-point intervals, a government official familiar with the bank’s deliberations said last week on the condition of anonymity.”

A closer examination of the FOMC minutes [showed divisions among members](#), with some pushing for additional stimulus. While the Fed agreed to extend the bond-buying program known as Operation Twist, it is likely to stay on the sidelines, unless the economy deteriorates. The markets will be looking for more information from Ben Bernanke when he testifies in front of Congress next week.

The market shrugged off good news such as lower than expected weekly unemployment claims (350K against an expected 372K, the lowest reading since March 2008). Inflation also seemed to be under control as [Import Prices plunged by 2.7%](#) in June, validating the Federal Reserve’s view that inflation is under control despite the low interest rates. The Dow finished down 0.4%, the Nasdaq lost 0.8% and the S&P 0.5%.

The LIBOR scandal was in the news. The FT published a [risk estimate from Morgan Stanley](#) detailing the possible costs to various entities. Included in the analysis were fines, possible litigation, and the impact on earnings. On his blog, Josh Brown [posted two reasons why the LIBOR scandal mattered](#):

1. *This is perhaps the biggest case of market manipulation in world history.*

2. *The culture of unmitigated greed and deceitfulness is alive and well.*

Authorities [took a closer look](#) at the role played by all entities in the PFGBest accounting scandal, dragging institutions such as US Bank into the limelight. Reuters [reported](#)

[that red flags should have been raised](#) by the size of PFGBest auditor – a small home based accounting firm in the Chicago suburbs.

Market recap: The DJIA and S&P extended their losing streak to 6 sessions (Nasdaq 5), unable to recover from the bad tone set by European losses. Jobless claims fell sharply, but look to have been skewed by seasonal adjustment factors. The Treasury sold 30-year bonds at the record-low yield of 2.58%. The grains resumed moving higher as the Midwestern drought worsens.



Inside Phil Stock World Member Chat

Member—Can you help me plan ahead if I sell TLT Jan 13 130/140 call spreads? Approximate credit of \$2.85. It's funny that the verticals which are seen as a "safer" play make me more nervous than naked sales.

Phil— I hate that plan. I hate risking \$7.15 to make \$2.85. You're giving 2:1 odds so you need to be at least 66% sure just to break even, right? Why not BUY the Oct \$135 puts for \$8.35 and sell the Aug \$130 puts for \$3 for \$5.35 on the \$5 spread? If you are right about \$130, then you should retain most of your Aug value and stand to pick up maybe \$2.50 on the net \$5 there but, if you are wrong – you have many ways to roll the position over time.

Short Spreads Adjustments – Best way to adjust spreads is not to get into stupid short verticals in the first place. When you sell the TLT Jan \$130 calls for \$4.80 and you buy the \$140 calls for \$1.90 –

who is the sucker? Your caller is \$1 out of the money so call it \$5.80 of premium that expires over 6 months, so about \$1 a month of decay. You own the \$140 calls but you paid \$11.90 in premium for the same period so you have a decay rate of \$2 per month. While it looks attractive since your caller has more absolute cash to lose – from a position standpoint, he will be ahead of you all the time until decay is enough to really begin to matter – maybe 3 months. That means, if anything goes wrong over the next 3 months – you will be trapped in a position where you are at a huge disadvantage to your caller with very few options to get away since you were the idiot that paid 2x the premium to be in the trade that only pays you 1:2 if everything goes perfectly. The only reason short strangles work is because you are playing both sides and that evens out the odds a bit but single, straight, short verticals are a sucker's bet.

Friday the 13th – Will the Market Make a Lucky Escape?

Stocks began Friday with low expectations after a seven day slide. Overnight economic news was not helpful with Moody's cutting Italy two notches, downgrading its sovereign debt from A3 to Baa2, citing "signs of an eroding non-domestic investor base" for Italy's bonds (FT). Also Chinese GDP came in below estimates at a three year low, with property markets in a downturn and signs of slowing exports (Bloomberg). Oil was helped by the announcement that the US was further tightening its Iranian oil sanctions. Crude oil rose above \$100 again (WSJ). Consumer sentiment came in below expectations. The weakest area of the report was the expectations component-- down 3 points to 64.8, the weakest reading of the year. (Econoday)

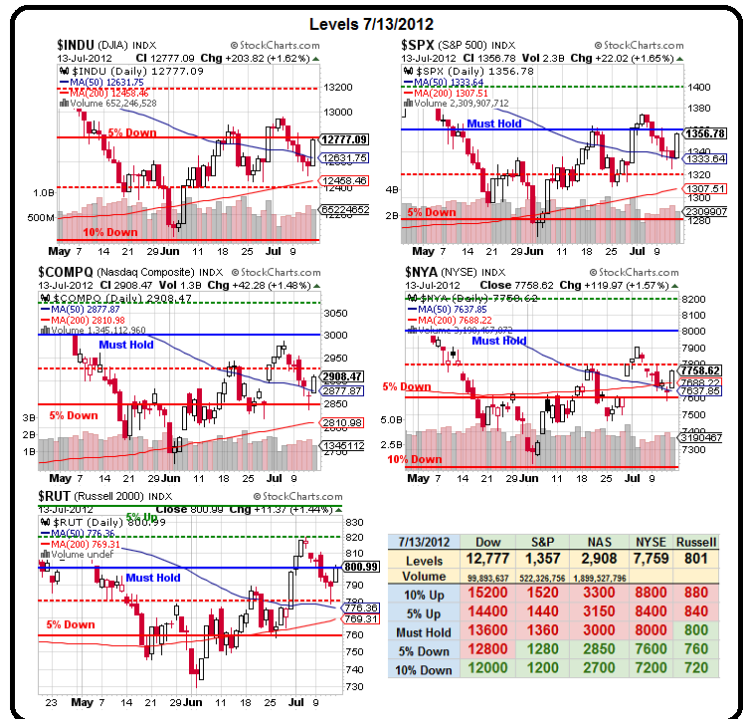
Friday was also dominated by banking news with continued scandals, speculation on the ramifications of the Liborgate, and earnings anticipated from JP Morgan and Wells Fargo. PFGBest CEO Russell Wasendorf was arrested in Iowa, having confessed to 20 years of falsifying data. On the Liborgate front, Morgan Stanley provided a detailed analysis of fines expected from Libor fixing. It concluded that the banks may be on the hook for as much as \$22B in fines and damages (FT).

JP Morgan reported "Net income fell to \$4.96 billion, or \$1.21 a share, from \$5.43 billion, or \$1.27, in the same period a year earlier" and "the company also restated first-quarter earnings, reducing net income by \$459 million, and used securities gains and an \$800 million accounting benefit to help boost profit." (Bloomberg) Losses from the much publicized "Whale Trade" have ballooned to \$5.8B so far according to the Wall Street Journal, and criminal investigations into the traders involved have begun (Reuters).

Fortunately for the markets, remarks by Atlanta Fed President Dennis Lockhart indicated a softening of his position on easing. He said in prepared remarks "My colleagues and I on the FOMC may confront a decision on whether or not to respond more aggressively to the economy's apparent weakness" and "some further use of the balance sheet to promote continued recovery and/or financial stability brings with it manageable risks". The market took this as a potential indication that more stimulus from the Fed was possible, and this, combined with seven days of losses, provided fuel for a market rally, with all major indexes rising early and continuing strong throughout the day.

In other company news, Procter & Gamble rose on the news of Activist Investor Bill Ackman's stake. Wells Fargo rose on its small

earnings beat. Techs continued under pressure after a Lexmark's Q2 warning and a 50% cut in Acer's shipment growth forecast. Lexmark, Hewlett Packard, Sonus and Adtran fell to 52 week lows. Ford forecast European sales at their lowest since 1994. Homebuilders enjoyed a good day with DHI reaching a 52 week high, and HOV jumping 7% after announcing a financing agreement with BX. Seattle Genetics closed down 1.5% after its CEO said it's not the right time to sell the company with its pipeline and growth trajectory looking strong. Stocks closed higher, with the S&P 500, the Dow Jones and the Nasdaq climbing between 1.5-1.6% each, and all finishing above their 50-day moving averages. Crude was up 1.16%, Gold up 1.66%, and the Euro +0.31%.



Market recap: Stocks broke out of a week-long slump after China's GDP print and Q2 reports from JPMorgan and Wells Fargo proved better than some feared. The drama surrounding JPMorgan's CIO trading losses didn't stop the party, nor did a higher-than-expected PPI. Crude rallied above \$87, and many other commodities also posted healthy gains.

Inside Phil Stock World Member Chat

Hedging – See the way we play the \$25KPs or this year's \$5KP or last year's \$10KP, you can't really hedge \$10,000 as you chew up your own gains other than, of course, sensibly mixing in short plays (like AMZN) on over-priced stocks against your longs and, hopefully, you can win both.

Getting what they deserve – People in this country are thoroughly brain-washed. Granted most people do deserve what they make but, in my opinion – no one "deserves" a Billion Dollars, simply because it's too much. The problem is money is abstract and, when you ask questions like that, people don't see the accumulation of wealth as harmful but let's say there is going to be one Rolling Stones reunion tour and tickets are \$20,000 each at a 50,000 seat stadium (\$1Bn). If Bill Gates wants to, he can take about 20% of his disposable in-

come (he has \$56Bn so figure he makes \$5Bn a year and it's all disposable after toothpaste and toilet paper expenses) and buy every single seat and sit there by himself and watch the Stones. How does this benefit society? The only reason the Stones have the balls to charge \$20,000 a seat is because there are people like Gates (people with \$20,000 disposable dollars, not billionaires) who can afford it and there are enough of them (less than 50,000 needed) to sell out a show so they simply price out the bottom 99%. That's what happens with houses, cars, good sushi, art, education – all goes to the highest bidder and crap for everyone else. No single person "deserves" to use the resources of 1,000 other people – it's detrimental to society and this society is in deep trouble if it doesn't wake up to that fact.

Much like Newton was inspired to understand gravity as the Apple fell on his head (or maybe not according to this article!) so too Phil was inspired by nature in his profound work which I affectionately label "Phil's Market Wave Theory". With this week's move in the markets, it seems a particularly appropriate time to recall what Phil said:

At the beach, many people stake out spots near the water but, as the day goes on, the tide gets higher and the people move to higher ground. Some people go much higher and some people move just a little but there's a certain point where the water crests up onto the beach and sends everyone scurrying for higher ground in a mad dash.

Then it goes the other way!

Just when it seems that the water is going to go higher than it ever went before (and, thanks to global warming it does!) and just when you start to think the next wave will wash over the top and soak everyone, it suddenly stops and an hour later you can't believe you ever thought the water would get that high as it seems so impossible as you watch it pull away from the beach, exposing sand that hadn't been seen since the morning.

The markets are like that. Frothy highs and "impossible" lows and lots of investors scurrying back and forth trying to guess where the next wave will stop (day traders) while others stake out medium-term positions (deck chair people) and still others make substantial long-term plays (beach house owners) and are willing to ride out even the harshest storms. While I have fun playing in the waves I guess I have to think of myself as a shell collector, looking for the opportunities that are uncovered once all the excitement dies down. Let the other people get soaked trying to guess the waves – we can do very well renting deck chairs in any market!

Rolling Options to Ride the Waves

In the stock market, renting deck chairs is akin to selling options (in this case call options). Always a buyer is on the prowl for the next great deal (the long call purchaser) and we can happily settle on terms (strike price and timeframe), content in knowing that nobody can take the premium we receive away from us (upon assignment or at expiration, we realize our gains). Only if we buy back the options at a loss do we lose money. But as we will see there is no reason to do that since we can modify the position instead.

When holding the underlying stock and short calls, our cost basis is below the short call strike price and, even if the stock gaps up and we are assigned, we make money. However, when we hold long term long call options, rather than stock, as a hedge against those short calls, assignment is generally not what we want at all!

In Phil's Wave Theory, we can see the movement of the waves often surprises the beach-goers. The waves tend to move much further than expected. So too can the markets move much further than expected. This leaves the short call seller in a predicament!

If short calls are hedged by longer term long call options as part of a calendar trade, assignment is certainly not desirable. The trader is buying the right to buy the stock at a certain price while simultaneously is getting paid to enter a contract that obliges him/her to sell stock at the same price upon assignment. Since it costs more to buy the right than is received selling the same right for a shorter time period to somebody else, it seems like a really bad idea to take

assignment of the short call and offset it with an exercise of the long call. And it is! You never want to end up buying and selling a stock at a certain price and have it cost you money (100% of the risk!) for the privilege!

Instead it is often much more prudent to remain with your big picture thesis – long term bullish (since the long call was applied long-term) – while modifying your short-term outlook. Certainly your initial expectation was for the stock to remain below the short call strike price or at worst not rise much above it by expiration. In the event that it does rise unexpectedly above the short call strike price, it's much more prudent to modify the existing positions than simply to take a loss.

In fact, as stocks gap up we are generally left with one of three choices:

1. *Take assignment of short call*
2. *Roll the short call*
3. *Add a long call*

As previously mentioned, Choice #1 is fine when we have a stock hedging the short call but it is not the preferred choice when holding long calls against those short call options.

That leaves us with choice #2 or choice #3. In fact, choice #2 can really be divided into two categories:

2(a) – Roll the short call up in strike price and out in time for a credit

2(b) – Roll the short call up in strike price and out in time for a debit

Rolling for a credit just means buying back the original short call option and selling a new short call for more premium in order to produce a net credit overall into your account. This is almost always the preferred choice because it means two things are occurring:

Profit Potential Increases – since the short call is at a higher strike price, your profit potential is not limited until the stock reaches those higher levels and you profit in the interim.

Cost Basis Lowered – when you take in a net credit from the rolling operation you reduce the overall cost and risk of the trade. A question often arises then "Which strike price and what time-frame should the option be rolled to?". And the simple answer is "whichever one produces a credit!". Of course if you were more bullish you would tend to roll to higher strike prices if possible or if bearish to lower strike prices but in general sticking to the rule of receiving a credit should serve you well. As much as possible make sure to keep the cost basis below the short call strike. It won't always be possible – particularly when rolling the option down in strike price – but it's generally preferable to mitigate against surprising reversals.

Rolling the options for a debit (2(b)) achieves one of the aims; profit potential increases. Unfortunately so too does cost basis though! And remember our goal is to maximize profits and minimize risk simultaneously when we modify positions.

The final possibility is simply to turn the trade into a ratio call backspread through the addition of another long call option so that even if the original trade has limited profit potential the new trade still has a degree of hedging and unlimited profit potential.

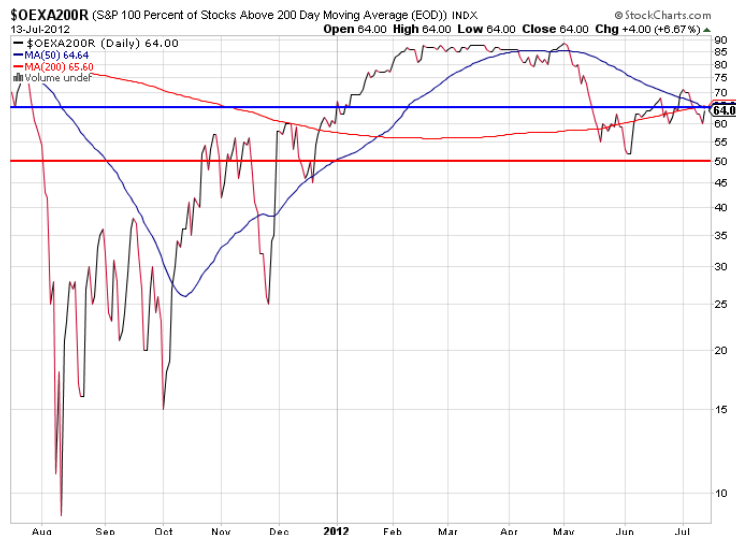
The Week Ahead

Last week we published in this section what Doug Short calls “[The Best Stock Market Indicator Ever](#)” and his conclusion was that the current market is untradeable. His past studies of this indicator has shown that one line is highly predictive of a correction:

“I have found that the 65% point (illustrated by the blue line) is the main predictive value to watch. If the chart drops below the 65% line I take that as my sell signal for all long positions in anticipation of a possible severe correction. It's also the key signal for re-entering long positions after a correction, either brief or prolonged.”

Last week the indicator was barely hanging over the 65% line, but we dipped all the way to 60% this week and even with the big rally on Friday the indicator is on 64%. If last week's conditions were untradeable, this week's indication seems to point toward some danger ahead historically.

Traders will be waiting with anticipation Bernanke's address to the Senate on Tuesday and Wednesday looking for any indication of additional QE. In addition, the Fed will also release its Beige Book on Wednesday.



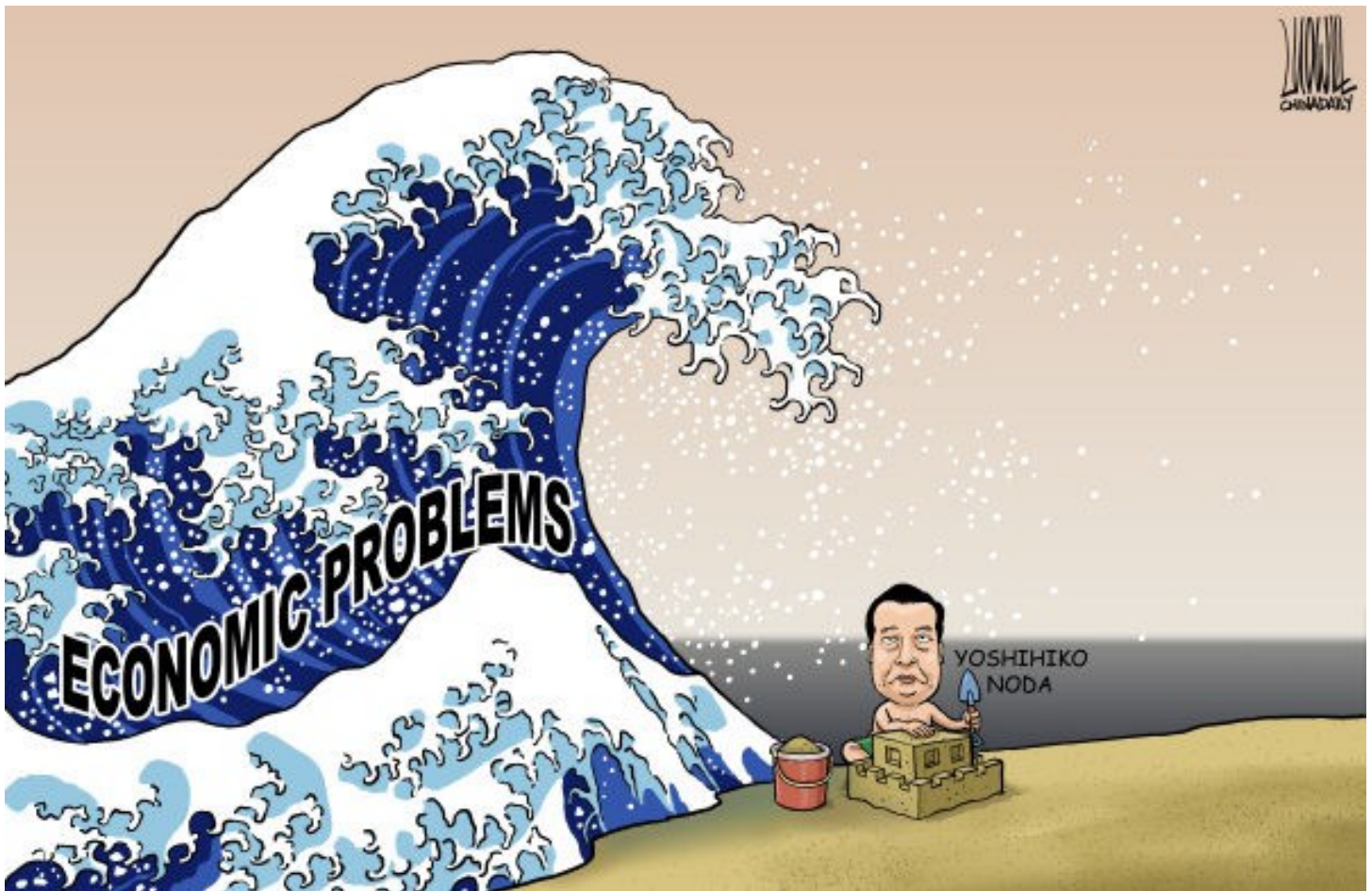
Mon, July 16	Tue, Jul 17	Wed, Jul 18	Thu, Jul 19	Fri, Jul 20
China Foreign Direct Investment (YoY) Sunday / -2.0%	Great Britain CPI (YoY) 4:30 AM / 2.8%	Japan Machine Tools Orders (YoY) 2:00 AM	Japan All Industry Activity Index 12:30 AM / -0.3%	Germany PPI (MoM) 2:00 AM / -0.2%
Switzerland Industrial Production (YoY) 3:15 AM / 0.0%	Great Britain CPI Core (YoY) 4:30 AM / 2.5%	Great Britain Bank of England Minutes 4:30 AM	Japan Leading Index 1:00 AM	Germany PPI (YoY) 2:00 AM / 1.8%
Switzerland Industrial Production (QoQ) 3:15 AM / -8.1%	Euro-zone ZEW Survey (Econ. Sentiment) 5:00 AM	Great Britain Jobless Claims 4:30 AM / 5.0K	Great Britain Retail Sales (YoY) 4:30 AM / 2.6%	Canada CPI (YoY) 8:30 AM / 1.8%
Euro-Zone CPI (YoY) 5:00 AM / 2.4%	Germany ZEW Survey (Econ. Sentiment) 5:00 AM / -20	US Building Permits 8:30 AM / 765K	US Initial Jobless Claims 8:30 AM / 263K	Canada CPI Core (YoY) 8:30 AM / 2.3%
Euro-Zone CPI (MoM) 5:00 AM / 0.0%	US CPI (YoY) 8:30 AM / 1.6%	US Housing Starts 8:30 AM / 740K	US Philadelphia Fed Report 10:00 AM / -8.0	
US Advance Retail Sales 8:30 AM / 0.2%	US CPI Ex Food and Energy (YoY) 8:30 AM / 2.2%	US Bernanke Report to Senate 10:00 AM	US Existing Homes Sales 10:00 AM / 4.62M	
US Advance Retail Sales less Auto 8:30 AM / 0.0%	Canada BoC Rate Decision 9:00 AM / 1.00%	Canada BoC Monetary Report 10:30 AM / 1.00%	US Leading Indicators 10:00 AM / -0.1%	
US Business Inventories 10:00 AM / 0.3%	US Industrial Production 9:15 AM / 0.3%	EIA Petroleum Status Report 10:30 AM	EIA Natural Gas Report 10:30 AM	
3-Month Bill Auction 11:30 AM	US Bernanke Report to Senate 10:00 AM	US Fed Releases Beige Book 2:00 PM		
6-Month Bill Auction 11:30 AM	4-Week Bill Auction 11:30 AM	10-Year Note Auction 1:00 PM		
	China June Property Prices 9:30 PM			

Legend

Credit Market
Equities Market
Energy
International
Fed Speak

Courtesy of Pharmboy

Immunogen (IMGN—\$16.02) announced a stock offering to 6.25M shares @ \$16. The stock fell 7.8%, and I think it offers an opportunity to sell a few puts and see if we can do better than those that picked them up for \$16. I like selling the October \$16 puts for \$1.50 or better. IMGN has been a huge winner for our portfolio, and I see it continuing to be good to us.



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