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> *"Gambling: The sure way of getting nothing for something."*
>
> *Wilson Mizner*

Event Horizon

Tax selling in December turned into mutual fund funding in January. A reversal of money flows – not the reason to be bullish. However, we're still on the bullish theme because the Fed is still supplying money to the Primary Bankers. As Lee contends, the Primary Bankers are the "house," the stock market is the casino, and we are counting cards and staying with the house. (The Fed's role in all this? God.)

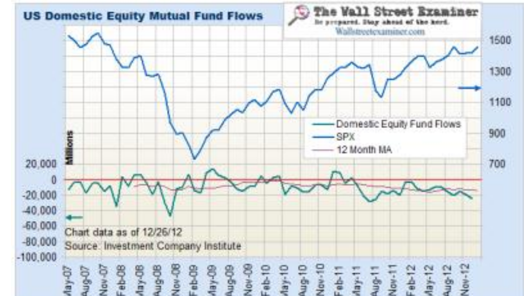
Bet with the House

Courtesy of Lee Adler of the Wall Street Examiner

Wall Street Journal

Surge into stock mutual funds is most in 11 years
USA TODAY
BOSTON (AP) — The flow of cash into stock mutual funds the first week of 2013 was the largest weekly inflow in more than 11 years. Mutual funds investing in U.S. stocks attracted $4 billion in net deposits during the weeklong period that ended Wednesday, ...
That Big Inflow To Stocks Ain't All It's Cracked Up To Be Wall Street Journal (blog)
US stock mutual funds gain $7.5 billion, most since 2001: LipperReuters
Fiscal cliff deal fuels surge into stock funds Bismarck Tribune
The Associated Press -CNBC.com -Barron's (blog)
all 192 news articles »

This story got wide play yesterday afternoon, as the 192 news articles lined above suggest. Some pundits have glommed on to this as being a contrarian sell signal. The truth is that **it's just a reversal of the "beat the cliff" tax selling that reached a crescendo in December** as the chart below, based on data from the ICI, shows. Their data is a week behind the Lipper data. What Lipper and none of the hysteria stories mentioned was that **selling reached a 4 year record high in December**, and at $8.2 billion in net outflows for the week ended January 2, was even at a higher rate than the December average of around $6 billion per week. So I don't put much "stock" in these stories.



Equity Mutual Fund Flows

In fact, the only "sentiment" that matters is Primary Dealer sentiment, and the Fed is stuffing their accounts with $120 billion in cash per month. This is as great as the liquefaction of the Primary Dealers that took place under QE 1 beginning in March 2009, and we know what happened then. So I'm not too worried about this ridiculous story about the surge in mutual fund flows.

Using that information as a signal for market direction is like looking at the gamblers' betting patterns in the casino for a clue as to who will win and who will lose. Obviously, we already know the answer. **The House always wins. In this case the**

FOMC Meetings

By law, the FOMC must meet at least four times each year in Washington, D.C. Since 1981, eight regularly scheduled meetings have been held each year at intervals of five to eight weeks. If circumstances require consultation or consideration of an action between these regular meetings, members may be called on to participate in a special meeting or a telephone conference, or to vote on a proposed action by proxy. At each regularly scheduled meeting, the Committee votes on the policy to be carried out during the interval between meetings, requiring members to think ahead.

Attendance at meetings is restricted because of the confidential nature of the information discussed and is limited to Committee members, nonmember Reserve Bank presidents, staff officers, the Manager of the System Open Market Account, and a small number of Board and Reserve Bank staff.

Source: Wikipedia.com

(Click on charts to enlarge)

Primary Dealers are the House. They own the casino. They are flush with a tidal wave of cash, and will continue to be flush for months to come. I'll place my bets accordingly. (our emphasis)

Liquidity Indicators

The indicators all still point up, thanks to Fed printing— not just printing, but **mammoth, monumental printing** that's likely to go on for a while and **pulverize, obliterate, every little bear thought** that tries to stand in its way. *I'll stand by this analysis until something changes, something that I can't see yet.*

Last month's Fed meeting minutes contained a veiled threat that maybe QE might end this year, even at mid year, but I think that that was a bluff and a threat in an attempt to keep speculators off the inflation train. It may work for a little while, but so what. And so what if the Fed does stop the insanity at mid year. At the current rate, it would add over $700 billion to the accounts of Primary Dealers by then. Money talks, and talk, even Fed talk, walks.

I would not be surprised to see the Fed forced to end QE in June or July by a surge of inflation. I also wouldn't be surprised to see them continue to print through most of the year. **I do think that QE will end, probably this year, but that until it does, the leveraged speculating crowd, both the Primary Dealers and their biggest hedge fund customers, will do what speculators do. They will buy crap.**

They will buy whatever crap makes the most sense to them, and they will mark up their inventories until the Fed stops providing them with the wherewithal to do so.

The composite liquidity indicator rose sharply at the end of December/beginning of January as the Fed bought Treasuries on balance, and bank inflows surged. The uptrend in market liquidity is not only firmly in place but it is getting steeper and will continue to do so as a result of the Fed pumping cash into the financial markets. Most of the lesser weighted components have had and should continue to have sympathetic upmoves as Fed cash flows through the system. Stocks should continue to oscillate along and around this wave.

Key bullet points in this week's Wall Street Examiner's Professional Edition:

- Treasury supply has been and will continue to be relatively light. There will be enough cash coming from the Fed's Treasury purchases and huge settlement of MBS purchases this week to absorb all new supply and then some.
- Settlement of the fiscal cliff removed a temporary psychological blockage to deployment of that cash, lifting stocks. The debt ceiling may play a similar role as we get closer to the deadline.
- With sentiment possibly shifting away from bonds, the freed up liquidity could flow toward equities.

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Value Exploration

We are still bullish due to the liquidity factors that Lee Adler mentioned at the beginning of the newsletter. While we are almost fully invested in our Virtual Value Portfolio, we decided to illustrate the techniques and thought processes behind selling puts by starting a Put-Writing (Selling) Virtual Portfolio. Selling puts is taking a decisively bullish position. We are still operating under our initial premise that the market will trade generally flat-to-higher over the next few months. If we thought had reasons to be bearish, these are not the kinds of positions we'd be initiating!

Selling Puts on Value Companies - A New Market Shadows Virtual Portfolio

By Ilene (with Paul Price)

Options are not just for speculation. One excellent use of options involves selling puts on stocks you'd like to own, but at prices cheaper than the stocks are currently selling for. (If you are not familiar with "puts," see the note at the end.)

Our Virtual Value Portfolio is almost fully invested, so we've decided to add a separate, virtual account to illustrate opportunities we find using the Put-Selling technique.

Selling a put (aka "writing" or "shorting") is taking a bullish position. The results will be best if the underlying shares go up or remain flat compared to the stock price at the trade's inception. Once we sell a put, there are only two potential outcomes at expiration.

- If the stock remains **above the option's strike price**, the puts will expire worthless. (We keep the money for selling the put.)
- If the stock is **below the strike price**, we will be forced to buy 100 shares per put or "contract" (one put = one contract).

When puts expire worthless, the seller of those options keeps all premiums received and has no further obligations. We make a maximum profit of 100% of the money received upon settlement of the sale ~ i.e., the price of the put we sold.

Exercises of puts typically occur at or near expiration dates, but they can occur sooner. Timing is at the discretion of the option buyer/owner – not the seller.

Selling puts is similar to placing below-market limit orders to buy. In either case we might, or might not, end up owning shares. If we acquire shares, our entry price will always be lower than had we simply purchased right away.

To begin our "Selling Puts Virtual Portfolio," Paul likes selling puts on two stocks in our Virtual Value Portfolio. The shares are now below their prices when we first added them to the Virtual Portfolio. These are Express Scripts (ESRX, $54.86) and Kohl's (KSS, $41.87). Here's how these looked on Wednesday (1/9) around midday.

Last Trade as of 12 Noon Jan. 9, 2013

					Bid	Ask
ESRX	54.67	0.69	1.28%	300	54.67	54.68
ESRX 140118P60	9.50	0.00	0.00%	570	8.65	8.95
KSS	41.87	0.06	0.14%	400	41.86	41.87
KSS 140118P45	6.90	0.00	-0.00%	181	6.90	7.10

Source: TradeStation

Puts are often less actively traded than stocks. When we sell a put, we always try to get a price in the middle of the bid -ask spread. Mid-range orders almost always get filled and provide better prices than if we simply submitted a market sell order.

We're going to use January 18, 2014 expiration dates to allow plenty of time for the stocks to hit their strike prices. The raw material we're selling is 'time'. Selling a full year costs us nothing except the opportunity to move quickly to the next trade.

Having a one-year time horizon brings in larger initial premiums and lower break-even points than writing shorter expiration puts.

Here is the math on the ESRX and KSS positions:

Express Scripts (ESRX)

ESRX @ $54.67	Premium /sh.	'If Put' Price*	Margin of Safety**
Sell to Open 1 ESRX Jan. 2014 $60 put	$8.70	$51.30	6.16%
* Net cost per share if Put is exercised		** Maximum % drop without loss	

If ESRX rises by 9.8% or better and closes above $60 on Jan. 17, 2014:

- The put will expire worthless
- You will keep $870 per contract as pure profit

If ESRX closes below $60 on Jan. 17, 2018:

- The put will be exercised
- You will be forced to buy 100 shares / contract
- You will need to lay out $6,000 /contract in cash
- Your net cost will be $51.30 /share or 6.16% below the trade inception price

Options

In finance, an option is a contract which gives the owner the right, but not the obligation, to buy or sell an underlying asset or instrument at a specified strike price on or before a specified date. The seller incurs a corresponding obligation to fulfill the transaction, that is to sell or buy, if the long holder elects to "exercise" the option prior to expiration. The buyer pays a premium to the seller for this right. An option which conveys the right to buy something at a specific price is called a call; an option which conveys the right to sell something at a specific price is called a put. Both are commonly traded, though in basic finance for clarity the call option is more frequently discussed, as it moves in the same direction as the underlying asset, rather than opposite, as does the put.

Options valuation is a topic of ongoing research in academic and practical finance. For simplicity of discussion, the value of an option is commonly decomposed into two parts: The first of these is the "intrinsic value," which is defined as the difference between the market value of the underlying and the strike price of the given option. The second part depends on a set of other factors which, through a multi-variable, non-linear interrelationship, reflect the discounted expected value of that difference at expiration. Although options valuation has been studied at least since the nineteenth century, the contemporary approach to is based on the Black–Scholes model which was first published in 1973.

Options contracts have been known for many centuries, however both trading activity and academic interest increased when, starting in 1973, options were issued with standardized terms and traded through a guaranteed clearinghouse at the Chicago Board Options Exchange. Today many options are created in a standardized form and traded through clearinghouses on regulated options exchanges, while other over-the-counter options are written as bilateral, customized contracts between a single buyer and seller, one or both of which may be a dealer or market-maker. Options are part of a larger class of financial instruments known as derivative products, or simply, derivatives.

Source: Wikipedia.com

(Click on charts to enlarge)

Disclosure: *MarketShadow* writers may own stocks discusses in this section and may buy or sell these stocks at will, with no notice, in the future. Click on this link for the Market Shadow's Virtual Portfolio.

Kohl's (KSS)

KSS @ $41.87	Premium /sh.	'If Put' Price*	Margin of Safety**
Sell to Open 1 KSS Jan. 2014 $45 put	$7.00	$38.00	9.24%
* Net cost per share if Put is exercised		** Maximum % drop without loss	

If KSS rises by 7.5% or better and closes above $45 on Jan. 17, 2014:

- The put will expire worthless
- You will keep $700 per contract as pure profit

If KSS closes below $45 on Jan. 17, 2018:

- The put will be exercised
- You will be forced to buy 100 shares / contract
- You will need to lay out $4,500 /contract in cash
- Your net cost will be $38.00 /share or 9.24% below the trade inception price

We'll initiate our new Selling Puts Virtual Portfolio by selling one of each of the two put options detailed above. In the worst case scenario, we'll end up owning 100 shares of each stock at lower prices. Best case – both put options will expire worthless, and we'll keep the $1,570 (total) in premiums received without having to buy anything.

Here is the math on two more short put positions that make sense to me right now.

Jan. 9, 2013	MOS @ $59.36	LH @ $87.26			Bid	Ask
MOS	59.36	0.89	1.52%	500	59.35	59.45
MOS 140118P60	7.45	-0.45	-5.70%	9	7.45	7.60
LH	87.26	0.49	0.57%	100	85.72	90.74
LH 130518P87.5	4.80	0.00	-0.00%	114	3.80	4.20

Source: TradeStation

Mosaic (MOS) @ $59.36	Premium /sh.	'If Put' Price*	Margin of Safety**
Sell to Open 1 MOS Jan. 2014 $60 put	$7.50	$52.50	11.5%
* Net cost per share if Put is exercised		** Maximum % drop without loss	

If MOS rises by 1.1% or better and closes above $60 on Jan. 17, 2014:

- The put will expire worthless
- You will keep $750 per contract as pure profit
- If MOS closes below $60 on Jan. 17, 2018:
- The put will be exercised
- You will be forced to buy 100 shares / contract
- You will need to lay out $6,000 / contract in cash
- Your net cost will be $52.50 /share or 11.5% below the trade inception price

Lab Corp (LH) @ $87.26	Premium /sh.	'If Put' Price*	Margin of Safety**
Sell to Open 1 LH May 2013 $87.50 put	$4.00	$83.50	4.3%
* Net cost per share if Put is exercised		** Maximum % drop without loss	

If LH rises by 0.3% or better and closes above $87.50 on May 17, 2013:

- The put will expire worthless
- You will keep $400 per contract as pure profit
- If LH closes below $87.50 on May 17, 2013:
- The put will be exercised
- You will be forced to buy 100 shares / contract
- You will need to lay out $8,750 / contract in cash
- Your net cost will be $83.50 /share or 4.3% below the trade inception price

In a worst case you will end up owing 100 shares of each stock at what I'd deem a bargain price. In the best case scenario both options will expire and we'll keep the $1,150 (total) in premiums received without having to buy anything.

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Note about Puts

Selling (or "shorting") a put is a bullish position because we are selling someone the right to make us BUY a stock at a certain price (strike price) on a certain date (expiration). The put buyer will only "put" the stock to us (make us buy the stock at the strike price) if it is trading lower than the strike price.

Put options are the opposite of "calls." When we buy a put, we're buying protection against the stock going down – paying someone for the right to sell our stock to them for a higher price. When we sell a put, we are selling someone the right to make us buy the stock. If the stock is above the strike price at expiration, the put will be worthless. The price of a put increases as the underlying stock drops in price.

SELLING a put lets us either buy a stock at a discount to where it is trading when we initiate the trade OR it lets us keep the money from selling the put. We risk being forced to buy the stock for MORE than it is trading for at expiration. A drop in the shares greater than the amount collected selling the put becomes a loss.

(Click on charts to enlarge)

[Silver Lining Play on Tiffany's Plunge](#)

Courtesy of [Paul Price](#)

High-end retailer Tiffany (TIF, $60.28) has posted excellent long-term results. Tiffany's took a hit last Thursday after lowering guidance to $3.20 per share for the fiscal year ending Jan. 31, 2013. This will be just its third negative year-over-year comparison of the past decade.

Tiffany's High-End Results over the Past Ten years

	FY 2002	FY 2012	% Increase
Earnings	$1.23	$3.20*	160.2%
Closing Quotes Jan. 10th, 2003 & 2013	$26.05	$60.40	131.9%
Data: Value Line, Yahoo Finance		* Includes FY Q4 estimate	

Traders who bought when negative sentiment was running wild in 2004 and 2009 ended up doing very well. Good news during peak profit periods like 2005, 2007 and 2011 chased TIF shares to price pinnacles at P/Es of 23x – 25x. Those who bought when 'all clear' signs were flashing are the ones who eventually suffered buyers' remorse.

Tiffany offers a well-covered and growing 2.15% current yield. Its balance sheet is solid. The shares are a buy.

I would consider either buying a small position in the stock or simply selling a one-year put at a $60 strike price (one Jan 2014 $60 put). Here is last Friday's (1/11/13) morning quote (note that TIF stock is up slightly since Friday morning, and the put price is down from $7.95 to $7.85):

TIF $59.58

					Bid	Ask
TIF	[illegible]	[illegible]	[illegible]	800	59.56	59.58
TIF 140118C60	6.80	0.00	-0.00%	24	6.50	6.70
TIF 140118P55	5.49	0.00	0.00%	63	5.50	5.65
TIF 140118P60	7.80	0.14	1.83%	39	7.95	8.10

If we sold one of these, here are the result possibilities:

If TIF closes above $60 at expiration on Jan 17, 2014:

- $60 strike put would expire worthless
- We'd keep $7.80 per contract (put option) sold as 100% profit
- We would not be obligated to buy any TIF shares
- This best-case scenario results in a net profit = $785/contract on a $1,200 margin requirement.

If TIF closes below $60 at expiration on Jan 17, 2014:

- The $60 put would be exercised
- We'd be forced to buy 100 TIF shares/ contract (one put = one contract)
- We'd need to lay out $6,000 in cash/ contract
- Our final position will be long 100 TIF shares /contract (at a net price of $60 – $7.85 or $52.15 per share)

This worst-case scenario would compute to a net outlay of $6,000 – $785 = $5,215 per contract (put).

Our break-even price of $52.15 per share means any decline of less than 7% would not result in a net loss. Tiffany's absolute bottoms in 2011 and 2012 were $54.60 and $49.72, respectively, and I think the risk is low.

We are going to add selling [one TIF Jan 2014 $60](#) put to our new [Virtual Selling Puts Portfolio](#).

Disclosure: Long TIF shares

New Put Writing Virtual Portfolio:

Virtual Value Put Writing Portfolio (pricing as of Jan 11, 2013 @4 pm)

Underlying Stock (Price @ Inception)	Trade Date	Expiration Date	Strike Price	Premium Received	BreakEven* @ Exp.	Jan. 11 Stock Price
Express Scripts (ESRX) $54.67	1/9/13	Jan 2014	$60.00	$8.70	$51.30	$55.60
Kohl's (KSS) $41.87	1/9/13	Jan 2014	$45.00	$7.00	$38.00	$42.02
Lab Corp (LH) $87.26	1/9/13	May 2013	$87.50	$4.00	$83.50	$86.33
Mosaic (MOS) $59.36	1/9/13	Jan 2014	$60.00	$7.50	$52.50	$59.88
Tiffany (TIF) $59.58	1/11/13	Jan 2014	$60.00	$7.85	$52.15	$60.25
* Lowest price @ expiration to avoid loss						

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