

# PHIL'S STOCK WORLD

HIGH FINANCE FOR REAL PEOPLE | FUN AND PROFITS

**DOW JONES - 13,092 (-1.06%)**

**S&P 5000 - 1,414 (-0.94%)**

**NASDAQ - 2,982 (-1.26%)**

## THIS WEEK'S NEWSLETTER

### Stormy Monday & Post-Traumatic Tuesday

Hurricane Sandy devastates the East Coast and Markets Close.

### Back To Work Wednesday

Markets adjust to the storm's aftermath; burden for insurers and windfall for builders

### Thankless Thursday

Bad economic news from Europe; QE3 revisited

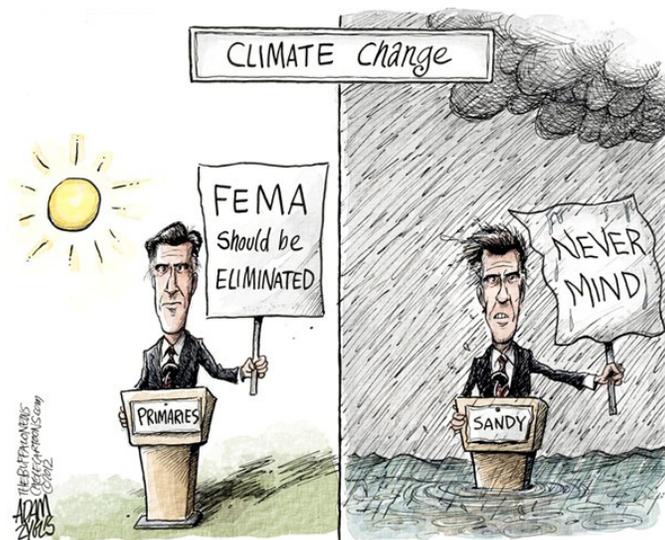
### Thank Jobs It's Friday

Promising US jobs report; pessimism for AAPL release

### The Week Ahead

It was a short week for equities. The New York Stock Exchange and NASDAQ were closed for the first time in 27 years on Monday and Tuesday because of Hurricane Sandy. Our thoughts are with everyone who suffered in the path of the devastating storm.

The extent of the damages is mind-boggling; reports of Sandy's human and economic toll worsened every day. Eqecat, a firm that tracks hurricane damage, estimated on Monday that the total insured losses were between \$5 and 10 billion. It upped the amounts on Thursday, estimating insured losses to be between \$10 and 20 billion. It said total losses (insured and uninsured) could be as high as \$50 billion. That is bad news for the insurance companies as well as the individuals, businesses, and governments that will need to make up the difference.



Over the three trading days this week, the major indices closed lower. The rally on Nov. 1 failed to hold as stocks slid back down on Nov. 2.

On Friday, the Labor Department's October jobs report was released. It is the last employment information that will be available before Tuesday's election. October's unemployment rate was 7.9 percent, .01 percent higher than September's. Pundits saw it as good news for Obama because the rate stayed under the 8 percent level—silencing critics who called September's report a fluke.

AAPL, the stock with the world's highest market cap, fell nearly 5 percent in another down week. The company began selling its new iPad Mini on Friday, but Wall Street was skeptical that sales for the new device could beat previous product launches.

## Stormy Monday & Post-Traumatic Tuesday



The financial world's eyes were on the hurricane, which leveled incalculable damage up and down the East coast. It is impossible to measure exactly how big the loss will be for insurers—or the windfall for companies that will be tasked with rebuilding—but an early estimate from insurance industry consultant EQECAT estimated the total insured loss at \$5-10 billion and total economic damages at \$10-20 billion.

Phil took the opportunity to teach an important investing lesson. “What a great time to point out why we have disaster hedges. Aside from riding out the obvious potential dips in the market, having a few disaster hedges protects us from unexpected and unknowable events like natural and man-made disasters. Just last weekend we got nervous enough about a market drop to put up a special post suggesting [5 Plays that Make 500% if the Market Falls](#) and we're off to a great start on those, with the market giving up 250 Dow points last week. We're down another 90 in the Futures this morning. The DXD Jan \$49/55 bull call spread jumped from net \$0.85 to \$1.40 – up 65% already on just a 2% drop in the Dow.”

Phil continued, “That means, if you had \$100,000 worth of long trades that were well-indexed to the Dow, you'd be down about 2% and all you would need to be totally even would be a \$3,000 hedge – which would have been 35 contracts for \$2,975, now worth \$4,900 and right on the money with DXD at \$48.90. There's still room to pay out in full, up to \$21,000 (up 600%), if DXD hits \$21 and holds it through January expirations.”

Member Stjeanluc brought up an important point to remember when hedging an investment. [“One thing that many people forget when they plan for hedges is the beta of their portfolios. When you say you plan for a 20% dip in the market and your major investment](#)

[is in a market index, then that 20% dip will be closely matched in your portfolio. If your major investments are in high beta stocks – then you need to take that into account in your portfolio. With a beta of 1.5, a 20% dip in the market might mean a 30% dip in your portfolio.”](#)

Monday morning brought news from Spain, as the country reported that its retail sales fell 10.9 percent in September on an annualized basis. The Bank of Spain announced its “bad bank plan” to buy up distressed real estate assets from the banks in hopes of boosting capital levels.

Asian markets dropped a little as Japan announced a stimulus plan that was less expansive than analysts had hoped.

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*If played well, against a position you have also hedged, it can be a powerful combination. For example, lets say you have 500 shares of GE at \$21.10 (\$10,550) and you have sold the Jan \$21 puts and calls for \$1.80 (\$900) – that right these pays for almost 1/3 of the hedge on your whole portfolio and, of course, when we get to January, we have an excellent chance of rolling those short positions out to 2014 and collecting even more money.*

-Phil

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# Back to Work Wednesday

Despite massive damage, the MTA being inoperable, widespread power outages, and a post-apocalyptic ambience in the streets of lower Manhattan—Wall Street resumed trading on Wednesday morning. Pundits, market-watchers, and traders speculated on the dollar value of the damage caused by Hurricane Sandy's damage, but the storm was still too fresh for any consensus on the matter. That insurance companies would be taking a hit, however, was clear.

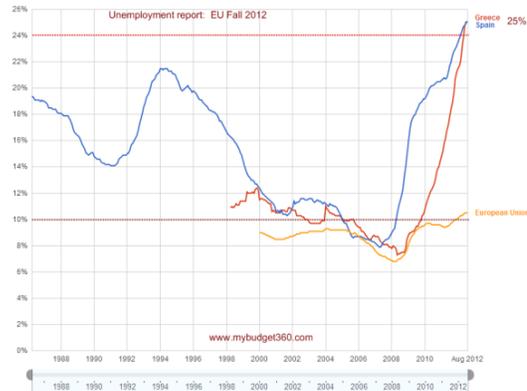
“Yesterday they were saying \$20Bn in damages but the NYC subway system alone may have more than \$20Bn in damage. Who's insuring it, I have no idea, but things like that and the devastation along the Jersey shore, where single homes are worth well over \$1M and 100 miles of home-filled coastline was hit with record flooding means we could, ultimately, be looking at \$50-\$100Bn worth of total (not all insured) damage from Hurricane Sandy.”

- Phil

Phil wrote, “We’re not going to go bargain-hunting for insurance companies – it’s a very hard group to pick winners and losers, but some segments, like title insurers, tend to sell off with the group – even though they don’t even write the kind of insurance that will be paid out. Those can make for some good fishing once the dust settles.”

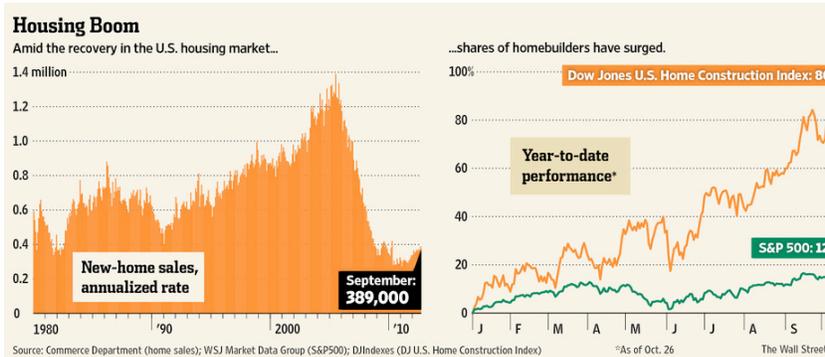
Aside from hurricane Sandy, economic numbers were the talk of the day. In Europe, the unemployment rate ticked up to 11.6 percent from 11.5 percent in August. Both Spain and Greece reported higher than 25 percent unemployment.

Spain’s resistance to the EU’s attempts to impose harsh austerity measures seems to be paying off as the



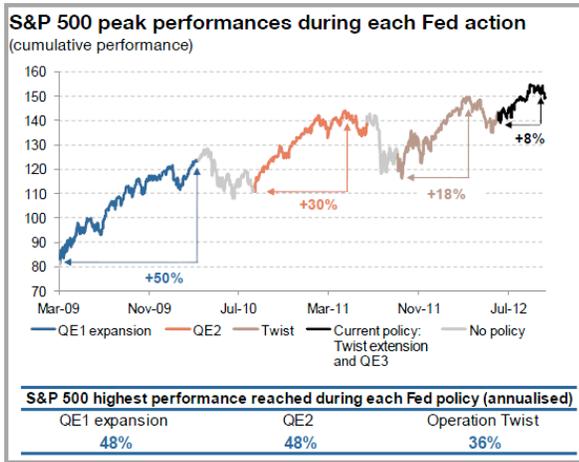
country narrowed its deficits from 4.77 percent of GDP in September to 4.39 percent in October. Phil attributed this sign of life in Spain’s economy to an increase in VAT taxes bringing in higher government revenues: “The 5% drop in the deficit in the first month of a tax increase bodes very well for Spain and gives credibility to the Government’s resistance to the EU bailouts and their draconian terms.”

On the home front, the S&P/ Case-Shiller index of property values in 20 cities brought positive news, as it reported a 2 percent increase between August 2011 and August 2012. It has overall been a good year for the US markets, with the S&P up 12.3 percent and the improving housing market driving the Dow Construction Index up 80.3 percent (gains as of Wednesday). Suggesting that the construction industry still has a lot of room for growth, Phil wrote, “Even back at 20, [the index] is still down 60% from the top and our housing market still has a very long way to go before it’s back on track – at least another 50% to 600,000 annual starts. That only replaces the nation’s 110M residential properties at a rate of once every 183 years so it seems like a pretty good bet that new home construction should continue to trend higher. We’d love to add some ITB on a pullback (\$19.50 is the 50 dma, \$16.50 is the 200 dma but we’re not likely to see that again).”



# Thankless Thursday

On Thursday, markets closed up--the Dow, S&P 500, and NASDAQ all gained more than 1 percent. The markets rose despite ominous news from Europe. The British manufacturing PMI came in at 47.5, below the estimated 48.1 and the prior figure of 48.4. The Irish government also slashed its GDP growth guidance from 2.2 percent to 1.4 percent.



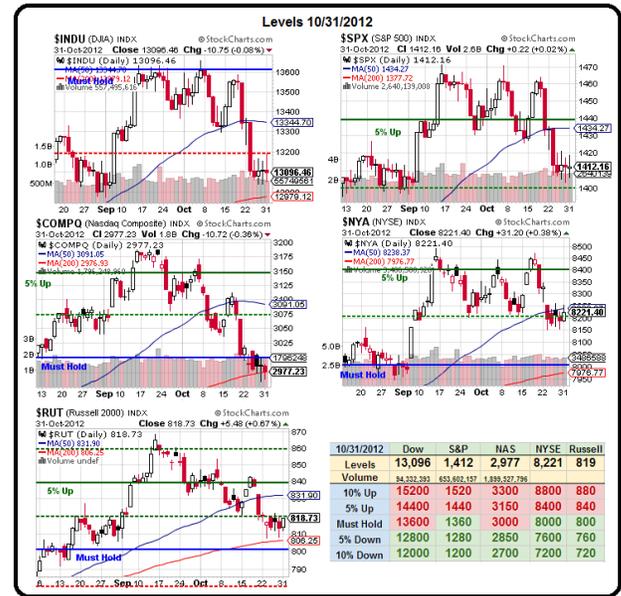
Phil turned his attention towards the latest in the Fed's seemingly endless rounds of quantitative easing, QE3. Or in Phil's words, "QInfinity"

Phil noted that the latest easing has not impacted the market as the previous two did. "Clearly, so far, QInfinity is having much less effect on the market than its predecessors but, measured over the short amount of time it's been in place – this chart shows it's really not that far off track – yet. Also, the Fed naysayers fail to take into account that QE1 (\$1.25Tn) was much bigger than QE2 (\$600Bn) and that Operation Twist (\$400Bn) was barely a stimulus at all but more a move to shift the yield curve." (S&P 500 Peak Performances Chart

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*Now we have QInfinity, where the Fed has committed \$240Bn in Q4 and another \$480Bn in 2013 and another \$480Bn in 2014 and probably another \$480Bn in 2015 so it's a huge amount of QE but it's also stretched over a long period of time so we shouldn't expect the markets to rocket on this type of stimulus. But we can assume there's a floor being put in somewhere.*  
 - Phil

Source: Credit Suisse, viz Barry Ritholtz)

In September, Phil wrote that [he expected to put in a floor](#) around 200 dmas. Even during the market's October rally Phil [warned against unfounded optimism](#). Phil's picks turned out to be prudent. "The TZA Jan \$12/15 bull call spread at \$1.50 I had suggested for overall portfolio coverage in that last post, is now 124% in the money with TZA at \$15.74, so it's in-line for a 100% gain if the Russell can't get back over 830."



"But we have gotten a bit more bullish – even as we take quick profits on bear plays, like yesterday's DIA Nov \$129 puts, which we picked up for \$1.10 in our virtual \$25,000 Portfolio and later sold at \$1.28 (up 16%) at 2:08 pm, when we decided the Dow had bottomed out at 13,050. The Dow finished the day at 13,096. We'll short it again if it struggles but, for now, we're looking to see what kind of bounces we can get off our indices."

"Applying to our 5% rule – we're going to be watching the following lines for strong and weak bounces while, of course, 3 of our 5 "Must Hold" levels MUST HOLD:

- Dow 13,170 (weak), 13,300 (strong)
- S&P 1,418, (weak), 1,431 (strong)
- Nas 3,010 (weak), 3,050 (strong)
- NYSE 8,220 (weak), 8,280 (strong)
- RUT 818 (weak), 826 (strong) "

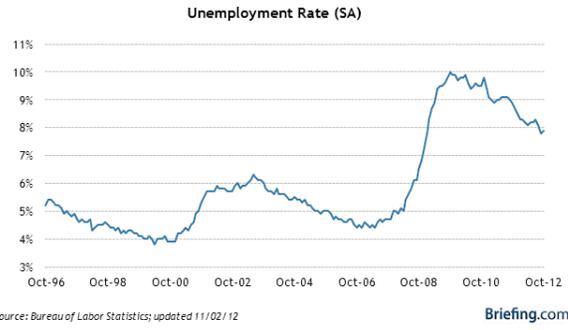
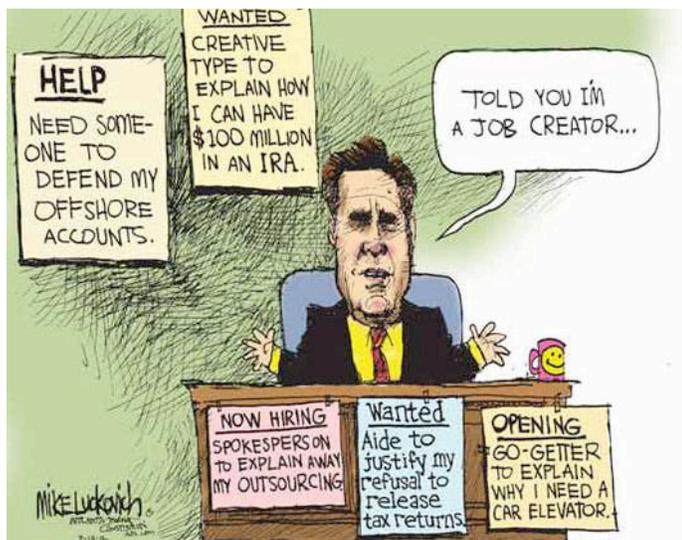
# Thank Jobs It's Friday

Markets closed lower on Friday. The biggest news story was the October unemployment figure, which matched estimates at 7.9 percent, slightly higher than September's surprise report of 7.8 percent.

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*No mater how they try to spin this (and, on CNBC, they are trying REALLY hard), this is a great jobs report. Not only a follow-through to last month's surprising upside report but a clear uptrend showing further improvement. The Futures got a nice pop on the news but not as much as it could have been as the Dollar shot up to 80.74 before settling back down to 80.50. More people working creates demand for more Dollars to pay them and strengthens the Dollar – that's a simple relationship.*  
 -Phil”

Pundits considered the number good news because the rate stayed below 8 percent and confirmed that the September figure was not an aberration or a part of a conspiracy to reelect Obama by manipulating the numbers. This is encouraging for Barack Obama in the days leading up to the election.

In other positive news for the US economy, nonfarm payrolls were reported at 184,000, well above the expected 125,000 and the prior figure of 128,000. Factory orders were also reported and came in at 4.8 percent—



above the expected 4.6 percent and leapfrogging ahead of the previous -5.1 percent figure.

News out of Europe was less optimistic, as PMI releases reflected a drop in Italian and Spanish manufacturing in October.

Phil's Thursday listing of bounce levels proved timely. "So our plan to flip bullish was well-timed," Phil wrote. "But we need to see a third index over that strong bounce line and then we need to see those 50 dmas taken back to confirm a bullish move. The NYSE is leading us there, well above its 50 dma of 8,042. We'll want to see the Russell (832) and S&P (1,434) join it – hopefully on some strong jobs numbers but, with the storm, it's very hard to say how the data will play out."

Friday was another important day for AAPL. The company released its new iPad and iPad Mini. AAPL product releases usually bring widespread fanboy pandemonium. But Benzinga reported uncharacteristically underwhelming crowds at Apple Stores this morning.

Phil wrote, "Will an extra 171,000 pay-checks get AAPL back over \$600? The iPad Mini is out today but it's the wi-fi only version, which no one wants. If AAPL has a 30% market share then 171,000 new workers mean about 55,000 new AAPL customers at about \$500 each for iPhones or iPads, but that's only \$27.5M a month and AAPL already sells \$16.25Bn worth of product per month. So this is not a game-changer and we'll be leaving our short calls in place in the new Apple Money Portfolio as well as in our \$25,000 Portfolio.

It was interesting to see the Nasdaq make a big move up yesterday without AAPL's help – let's hope they can keep it going and let's hope our indexes can make their levels."

# The Week Ahead: Elections & Earnings

With the upcoming elections and earnings announcements, the first full week of November will be a critical one for the markets.

After much speculation and mudslinging, the US Presidential election will occur on Tuesday. Both Mitt Romney and Barack Obama are in full-throttle on the campaign trail fighting for every last voter. Traders will be watching very closely. Wall Street will also keep a close eye on congressional and local elections. Results of these will set the tone for the legislative environment for US business in the coming years. Investors are particularly on edge about the election's impact on the looming fiscal cliff.

In addition to affecting fiscal policy, the Presidential election will impact monetary policy. In a second term, Obama would be likely to keep the Federal Reserve in a "dovish" mode—with the Fed working towards jobs growth more so than curbing inflation. On the other hand, Romney would more likely push the Fed in a direction to limit quantitative easing.

Companies reporting earnings next week include: DIS, JCP, QCOM, TWC, TSLA, HUM, ESRX, WLT, AOL, CVS, CVS, DTV, FOXL, NWSA, RAX, LEAP, THC, CBS, ATVI, SODA, DF, DUK, KSS, GRPN, and NVDA.



# Next Week's Economic Calendar

Mon, November 5	Tue, Nov 6	Wed, Nov 7	Thu, Nov 8	Fri, Nov 9	Legend
China HSBC Services PMI Sunday	US Presidential Elections	Switzerland CPI (YoY) 4:15 AM / -0.2%	Japan Eco Watchers Survey: Current 1:00 AM / 40.5	Japan Consumer Confidence 1:00 AM	Credit Market
Great Britain PMI Services 5:30 AM / 52.0		Japan Leading Index 1:00 AM / 91.8	Euro-Zone Retail Sales (YoY) 6:00 AM	Japan Eco Watchers Survey: Outlook 1:00 AM	China Industrial Production 1:30 AM
Euro-Zone Sentix Investor Confidence 5:30 AM / -21.0	Euro-Zone Italy Services PMI 4:45 AM / 44.5	Euro-Zone Germany Industrial Production (YoY) 7:00 AM	Switzerland Unemployment Rate 2:45 AM / 2.9%	China Retail Sales (YoY) 1:30 AM / 14.3%	Energy
US ISM Non- Manufacturing 10:00 AM / 54.5	Euro-Zone France Services PMI 4:50 AM / 46.2	EIA Petroleum Status Report 10:30 AM	Euro-Zone Germany Trade Balance 3:00 AM / €15.5B	Euro-Zone Germany CPI (YoY) 3:00 AM / 2.0%	International
3-Month Bill Auction 11:30 AM	Euro-Zone Germany Services PMI 4:55 AM / 49.3	10-Year Note Auction 1:00 PM	Great Britain BoE Rate Decision 8:00 AM / 0.50%	US U. of Michigan Confidence 9:55 AM / 82.9	Fed Speak
6-Month Bill Auction 11:30 AM	Euro-Zone Services PMI 5:00 AM / 46.2	China Manufacturing PMI 9:00 PM / 50.3	Euro-Zone ECB Rate Decision 8:45 AM / 0.75%		
Australia BoA Rate Decision 11:30 PM / 3.00%	Euro-Zone Composite PMI 5:00 AM / 45.8	China HSBC Manufacturing PMI 9:45 PM / 49.1	US Initial Jobless Claims 8:30 AM / 365K		
	Great Britain Industrial Production 5:30 AM / -1.6%	Japan Machine Orders (YoY) 7:50 PM / -4.9%	US Trade Balance 8:30 AM / -\$45B		
	Great Britain Manufacturing Production 5:30 AM / 0.4%	Japan Trade Balance 7:50 PM / ¥416.9B	EIA Natural Gas Report 10:30 AM		
	Euro-Zone PPI (YoY) 6:00 AM / 2.6%	Australia Unemployment Rate 8:30 PM / 5.5%	30-Year Bond Auction 1:00 PM		
	Euro-Zone Germany Factory Orders (YoY) 7:00 AM / -1.5%		China CPI (YoY) 9:30 PM / 1.9%		
	Great Britain NIESR GDP Estimate 11:00 AM		China PPI (YoY) 9:30 PM / -2.8%		
	4-Week Bill Auction 11:30 AM				
	3-Year Note Auction 1:00 PM				
	Treasury STRIPS 3:00 PM				

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