CHINA DEAL IS ON...KIND OF

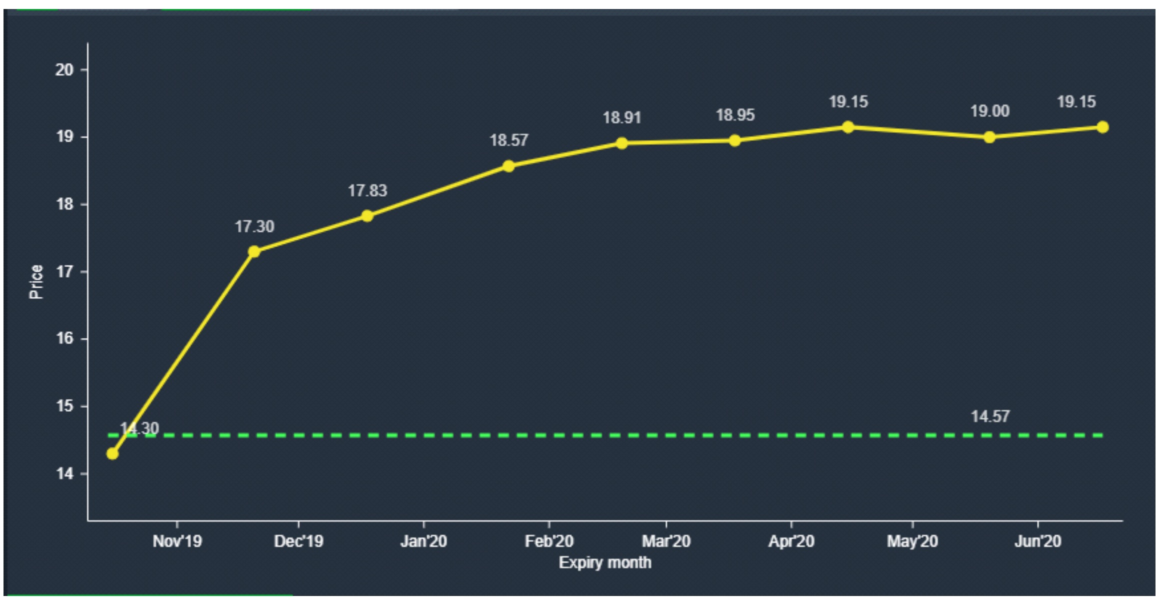
The US and China have reached 'Phase 1' of trade negotiations. If you asked me, Phase 1 is agreeing to stay at trade escalation number 4 instead of moving on to 5 or 6. I am not sure I would call it a victory, but sometimes agreeing to stop escalating a fight is good enough. It's not like this is a real fight, anyway. It's more like a fight where everyone knows it's eventually going to end and no one is actually going to get hurt or change in the long run. Kind of like the knife fight scene in 'Beat iIt.'

With that in mind, maybe that is why the selloffs from China trade stories are becoming limper, as are the rallies. The real question many ask is whether all the fake blustering can create a recession out of our own fears of a recession forming. This would be about the only scenario where the yield curve inversion in August could lead to a real recession (seriously everything else related to that seems like bunk).

So where does this put us? If Monday is any indication, we are heading for some slowness in the markets, at least until earnings season really heats up, toward the end of the month. China's main newspaper says, "Let's Keep the Champagne on Ice" and the S&P 500 gives away less than 5 points. The S&P 500 looks like it is range bound for a while.

Seriously the index has been below the 50 DMA a few times since June, never touching the 200 DMA; it's basically bouncing between 3000 and the 50 day.

Even more telling, the VIX got crushed the and the curve completely normalized:



The one concern in the VIX curve is that the spread between the VIX and the Nov future may be TOO wide. When a future and the cash have a really wide spread, the cash index has tended to be wrong and the VIX future to be right. November futures are looking for more fireworks. There is a TON of opportunity in the VIX product. We might look at a Nov VIX play in the Volatility Newsletter later this week.

Option Pit Traffic Light:

SPX Direction: Green

SPX IV: Red

V: Yellow

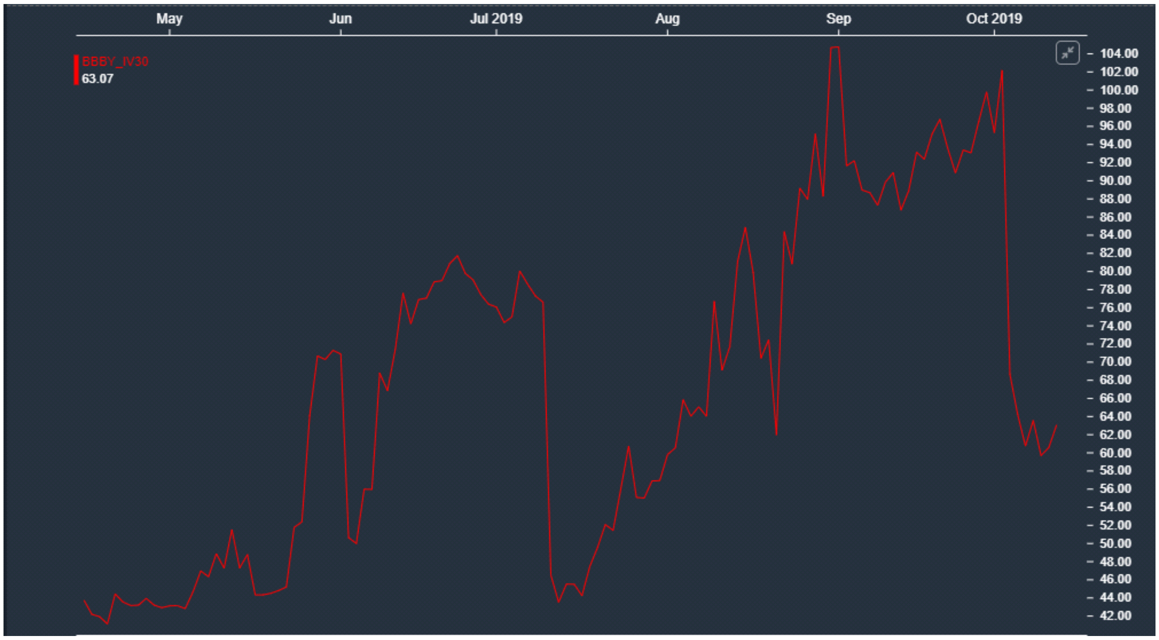
VIX Direction: Yellow

VIX IV: **Blood Bath and Beyond**

During the decline of a company, there are always gasps of air as the company fights for its life. It's like your college team scoring two back to back touchdowns to get the game within two scores (with two point conversions) before eventually losing 58 to 14. Bed Bath and Beyond just scored at least one touchdown on their last earnings report. The stock absolutely rocked higher on the news:

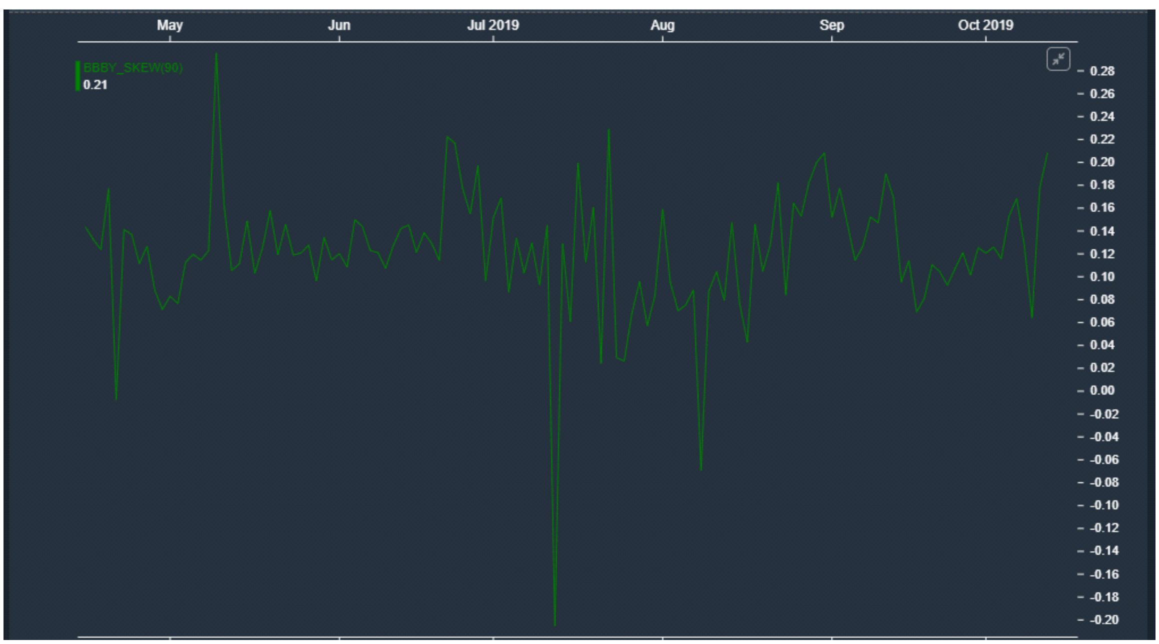
BBBY had a nice earnings report, and jumped from $10 to over $13, before finally backing off back toward $12.5, on Monday. Why such a strong move: short interest. There is a LOT of short float in BBBY. The stock has currently seen its borrow come in about $.20 since that earnings pop. A sign that a chunk of the dollars 'buying' BBBY are actually short covers and may not be investors piling in to a great investment. SHLD and JCP each had gasps before ending up the where they are now. It may not happen in 2019, but there is going to be a funeral for this company.

Looking at the options, the IV is not particularly expensive. I like buying options that are somewhat near the money.



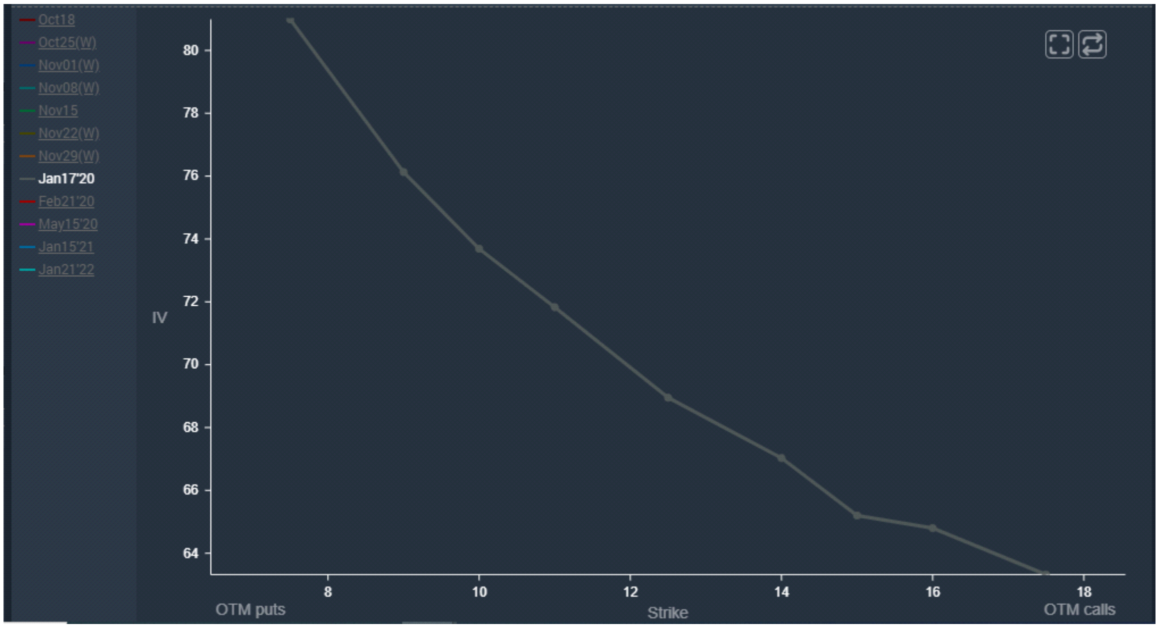
Yes, the IV might head a touch lower, but with the stock popping higher and short interest coming out, I think we probably have a higher floor in IV. This is also related to simply having a higher ATM strike price: the higher the strike price, the lower IV.

Moving on to skew, I would point out, puts have popped and are particularly expensive . It appears that the short covering of stock has been joined by out of the money put buying. Puts relative to calls are about as expensive as it gets in this name.

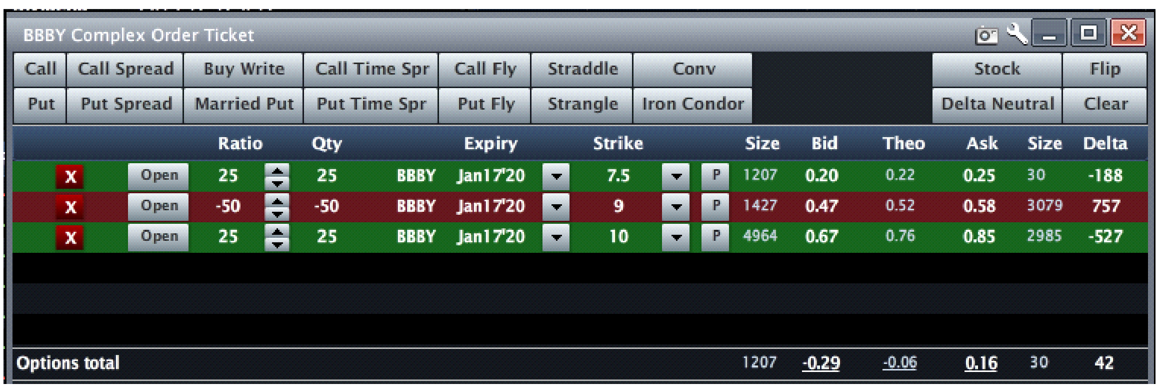


Low IV and high skew in a stock that I think is going to drop makes me want to set up a bearish butterfly. I also like bear put flies because I think the drop in the underlying is more likely to be slower than faster. It's going to take a weak Christmas season to push this back below $10 a share, something I think will happen. Thus, I like setting up my trade in January.

Let’s look at the skew structure of January:



The 10s are the cheapest out of the money option on the board. The 9s, in relative terms, are expensive. The 7.5s read higher but are a $.25 option. Thus, I know it sounds like a 'tight fly', but I like buying the 10s, selling 2 of the 9s, and buying the 7.5s against it to create a small broken wing butterfly. While one point wide might seem tight, remember, we are dealing with a $10 stock, it’s kind of like a 10 point wide fly on a $100 stock.



Trading 25 by 50 by 25 creates about $1100 of risk. The fly likely takes in a credit of more than .05, meaning if the stock rallies on continued short covering the trade wins. The only real downside in the trade is if I am 'too right’ and the stock drops quickly. This could happen as we approach the

Here is a risk chart view of the trade:

RISK Management:

If BBBY runs much higher, we will take this trade off up $100.00, or buy back the shorts. If the stock drops slowly, I will take the trade off at around $9 a share, hopefully around late December. In the event of a quick drop, I will close this trade and set something up that is more aggressive.

We buy 25 BBBY Jan 10 puts for $.80, we sell 50 BBBY Jan 9 puts at $.50, we buy 25 BBBY Jan 7.5 puts for $.23.