WIZARD OF OPS
FUNDAMENTAL TRADER
VOL. 6 NO. 6 JUNE 2023

June's monthly expiration had a lot of hedging from the bank crisis, so it was not surprising to see an advance. However, to see SPX rise 5.7% was very surprising. I had projected a bit of a rally for this month, which I thought would get to as high as 4325, but it exceeded that target by 100 points.

An extreme move in SPX, and in particular the tech sector, dominated headlines this month. There was a lot of put vanna underneath the market to support such a move, but the underlying economy is not supportive of it. Bank lending is contracting, ISM indices are showing contraction, and earnings reports are declining. In fact, the S&P500 stocks combined for a -6.5% contraction in 2023Q1. That is not consistent with 5.7% SPX rallies. We do know that flow is a main component and the hedge unwind was strong, but for it to go this far was remarkable. At some point, the fact that these are pieces of ownership of contracting companies will play a part. With vanna taking a hit over the next several weeks on the put side, this rally should be coming to an end.

The fundamental trader had mixed results, basically reflecting the market. The bullish trades did well, while the bearish UPS trade did poorly. None of the theses have changed, so if you are delayed in entering these positions, now is as good a time as any. Since I believe there will be a slow bleed to the downside with maybe only one sharp downside spike, you can sell puts to pick up bargains if these battered stocks continue their slide.

Although rare for this newsletter, sometimes there need to be adjustments. For immediate adjustments, join my Discord and message me to be added to the private #woo-subscribers server. These adjustments HAVE been included in the calculation for the portfolio in this newsletter.

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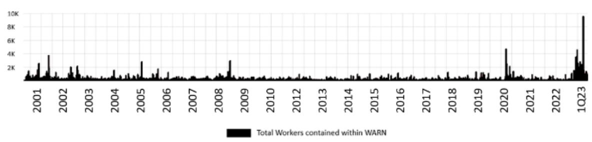
FUNDAMENTAL SITUATION

I still believe a recession is coming, despite a lot of chatter that it will not. There are plenty of signals that a recession has already begun, and we will discuss my three favorites:

1. Unemployment leading indicator

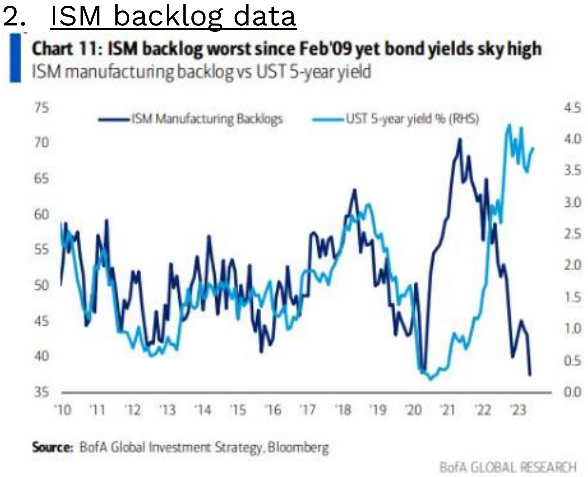
When large companies (more than 50 employees) are about to lay off workers, they must send a warning notice to their state unemployment office with varying lead times. Here's a chart of how many workers have been put on notice that they will be laid off. You can see that the past several months is the highest since data has been available:



Source: State unemployment offices.

You can see that it has spiked even higher than the dot com bubble in 2000 and the 2008 GFC.

2. ISM backlog data



The ISM backlog typically runs concurrent with the 5y bond yield, but now that the backlog orders have dropped to recessionary lows, the bond yields need to fall too. This means now is the time to buy bonds.

Up until now, as SPX forward P/E Ratios have declined (and SPX has been on the rise for a while now to that ratio is clearly on earnings decline). Price is overdue for a correction.

Further, bank lending has been restrictive as well. There is way too much data pointing to recession with a sudden spike in unemployment and sudden drop in inflation.

In past pre-recessionary periods, there was always debate whether a recession is about to occur if you look at past Wall Street Journals. In 2008 there were banking concerns. In 2000, there were concerns about the overvaluation of tech stocks, but in both cases, there were debates about their impact on the overall economy, and many did not think there would be crises. In the end, there was something to worry about. There are also times where worries went unfulfilled, including during QE and a time of 0% interest rates in America. IN this case however the Main St. recession looks like it will hit the market last, but the bears that notice are creating flows that support the market through put buying. When they say that equity markets climb the "wall of worry", this is what they mean. However, in this case there seems to be a real reason for worry to exist. The question is whether the flows from vanna and charm on all those bought puts will allow the market to realize those economic worries. Eventually liquidity will dissipate, and there could still be a final "vol event" drop from data dislocations as they become more apparent.

Right now, we have a solid mix of stocks positioned for the time at hand. I am not going to propose a new trade since the proposed portfolio is already full, but if you wish to diversify even further, consider large cap stocks in consumer staples or healthcare.

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(Fundamental Situation continued)

Media – Old News

Paramount fell briefly below our short strike, but recovered with the market, even though it was not as sharp as the tech sector. That leaves another opportunity to sell puts on the name at a similar valuation.

The New Trade: Sell 7 21Jul23 PARA $15 puts @$.36 credit. ***This uses $10,500 in capital.***

The Plan: Keep this on through expiration. If PARA closes above $15, you make 2.76%.

Logistics – Old News

Over the past few days, UPS rallied a little bit after news came out that they had come to an agreement with the Teamsters about air conditioning on new trucks. This was not a total surprise to me, as UPS refusing that would have been a public relations nightmare for them. The real sticking points in the labor negotiations surround compensation, more full-time workers, and sick leave policies. UPS had doubled their revenue since the pandemic, and the Teamsters have not received a pay increase commensurate with that. UPS sees a period of falling revenues upcoming, so there is an impasse of vision. The Teamsters are looking at what UPS had already made, while UPS is looking at looming economic turmoil in the future. The new leadership at the Teamsters Union won election on a platform of taking a hardline stance against UPS, and unionizing Amazon delivery. So, the bearish thesis remains, and this is likely an opportunity to increase your bearish position if you have not already done so.

The Trade: Hold 30 18Aug23 UPS $155 puts. ***This uses $9,900 in capital.***

The Plan: Keep this on through expiration. Buy back these puts if the union and UPS settle on terms.

Metals – Old News

NEM did rally upon resolution of the debt ceiling fiasco, but it had fallen quite a bit before that. It closed the month even, so we will keep this stock, but sell a call a little lower than 52.5 to collect some premium in the possible decline event.

The New Trade: We own 300 NEM shares. Sell 3 NEM 21Jul23 $47.5 calls @$.44 credit. ***This uses $15,000 in capital.***

The Plan: Keep on through expiration. If NEM rallies past $47.5, we gain $132 in premium plus capital gains.

Utilities – Old News

ED dropped alongside bonds, which is a typical correlation. Now that we own the shares, we can sell calls. I believe bonds (and as a result, utilities) are due for a rally as recessionary forces start to manifest, so I will sell calls that allow for more capital gains.

The New Trade: We own 100 ED shares. Sell 1 ED 21Jul23 $97.5 call @$.40 credit. ***This uses $10,000 in capital.***

The Plan: Keep this on through expiration. If ED rallies past $97.5, we gain $40 in premium plus capital gains.

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FUNDAMENTAL BIOTECH

Image Source: Chimera Research Group.

Analyst: David "Dave" Sobek is a disciplined value investor. Using models, research, and fundamental data, Dave devises a value for biotech stocks, buys when significantly undervalued, and sells when significantly overvalued.

New Trade Idea

Replimune (REPL)

Dave Commentary: As a new one I like REPL. They had good data at ASCO [American Society of Clinical Oncology Annual Meeting] and have a lot of catalysts coming the next year including phase III.

Wizard of Ops Commentary: More than any other sector, biotech has random companies pop up out of nowhere. You need a guide to help navigate all these new companies and cash burn. This stock is another oncology company, one of Dave's specialties. It had a big bump last month because of a JPM analyst upgrade, so now is a good time to sell puts on it when the IV is particularly high.

The New Trade: Sell 5 21Jul23 REPL $20 puts @$.70 credit. ***This uses $10,000 in capital.***

The Plan: Keep this on through expiration. If REPL closes above $20, you make 3.63%.

Old News

Amylyx (AMLX)

Dave Commentary: AMLX noted that they are expecting a negative opinion on the approval in the EU. Was this the overhang that was impacting the stock? Perhaps, but there was only a modest move down. One could argue this was essentially priced into the stock. If you ask me, I think the negative EU opinion and negative phase III data are priced into the stock. I do not think negative phase III with removal from the US market is priced into the stock, but I also think that outcome is less likely than the market believes. The uptake of the drug and clean safety profile makes me think the phase III would have to show a clear negative effect for it to be pulled, but that is a debate for next year.

It seems like the EU is going negative because of a lack of evidence of efficacy, which seems odd as the data are better than the currently approved ALS drugs in the EU. AMLX plans to appeal the decision and this will lead to new reviewers. According to some sell-side analysis about 25% to 39% of appeals are successful, which is higher than I would have thought. The appeal process will take around 4 additional months and if the appeal fails, then it will require the phase III data to achieve EU approval.

Obviously negative news impacts the stock, which is particularly the case when the sentiment in the sector is trending poorly. This is one of the stocks, where I think the market is really mispricing the stock. Mizuho, for instance, noted that completely removing the EU from their model decreases the DCF by $10 but that would only lower their price target from $50 to $40. In other words, even if you zero out the EU, there is still almost 100% upside to their price target. I understand that sellside can be too optimistic on their price targets but an amazingly strong launch with cash flow positive and no real competition should lead to a strong stock not one that is this weak.

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(Fundamental Biotech continued)

Wizard of Ops Commentary: At this point, I will keep the stock since Dave seems to think it is still undervalued, but I'm not so sure about its prospects at this point. I will sell a call, and hope to be exercised. With no near-term catalyst, it is probably going to fade to the downside if anything.

The New Trade: Hold 300 shares of AMLX. Sell 3 $25 21Jul23 calls @$1.15 credit. ***This uses $9,807 in capital.***

The Plan: Keep this on through expiration. If AMLX rallies past $25, we gain $345 in premium plus the capital gains.

Coherus Biosciences (CHRS)

Dave Commentary: CHRS cannot give us a break. I thought it was going to be able to get nice traction with a potential bottom in and a nice setup the rest of the year with the eventual approval of topi and growing revenues with the biosimilar launches. Instead, we get another IO deal with CHRS buying SURF. Whether the deal will ultimately be good or bad will be discussed but it is another complication of the story and will not help near term valuations. That is a definitive negative for the deal outside of the natural dilution given that they are buying it with stock.
To be fair (and attempting to be objective), the deal is small. It is $40M plus the cash on hand at closing (which will be around $20M to $25M). So even if we take the discounted valuation of CHRS as of trading, it is around a 15% dilution but it is lower as the share price used in the deal is $5.2831 (which I think is a $500M valuation of CHRS). The transaction then is likely closer to 13% dilution and they get $20M-$25M in cash. So when all is said and done it is a small deal and probably could have been done with cash on hand but the equity gives SURF shareholders a greater potential to continue and share in the upside of the deal.

The deal still provides a lot of upside, as SURF shareholders get a CVR that provides cash on from existing partnerships (75%) as well as cash on any new partnerships (25% or 50% depending on the asset). It seems from the PR that CHRS is certainly looking to license ex-US rights of these new assets, which would be good for both at it lowers the costs of the deal for CHRS and provides more cash for the SURF shareholders. It would not take a big upfront payment for CHRS to more or less pay for the deal, although you do have continuing R&D.

When all is said and done, it is a small deal with decent upside for both companies. That being said, it swamps the good news. They guided to a nice revenue this quarter and re-affirmed full year guidance (and R&D guidance is maintained even with this deal). In addition, the ABBV potential litigation is already resolved (although I do not think ABBV really had a chance to stop the launch of the CHRS biosimilar given others have already launched). So, there is actual good news for CHRS today but it gets overwhelmed with new questions associated with this deal.

Of course, if either of these molecules gets approved and is a decent commercial success, then we all will be eating proverbial crow in the future. That is a long time before we know and perhaps the data later this year and next might provide some confidence in the deal but even then, we are 6+ months before even having a little bit of confidence that the deal is good and the assets have potential. In some ways, I am keeping an eye on SURF shares and perhaps there will be a way to get CHRS shares even cheaper through buying SURF (although the price is set but you do get the CVRs, so it would really be more of a play on those CVRs).

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(Fundamental Biotech continued)

Wizard of Ops Commentary: CHRS had good news in the beginning of the month, but then bought a small company with an all-stock deal, diluting the stock. Now is a buying opportunity, but we shall see if this was a good deal or not soon enough.

The New Trade: Hold 1000 shares of CHRS. ***This uses $4,504 in capital.***

The Plan: Keep this on through expiration. We will sell a $15 call for July if they rally enough.

DIVIDEND PORTFOLIO

Images Sources: Red Barn Financial and Wizard of Ops.

Analyst: An internal trade strategy in conjunction with Red Barn Financial, the dividend portfolio is a safer type of investment strategy, where high dividend stocks are purchased with an option collar to prevent massive drawdowns. The dividend is guaranteed while the option collar prevents excessive capital losses while sacrificing excessive capital gains.

New Trade Idea

No new trade idea.

Old News

Verizon Communications (VZ)

Wizard of Ops Commentary: Verizon has not had much movement at all. There is no indication that they will cut their dividend, so hold onto this name.

The New Trade: Hold 1000 shares of VZ. Hold 10 20Jan24 VZ $40 synthetic short @ $1.72 debit. ***This trade uses $38,550 in capital.***

The Plan: Keep this on through expiration. At expiration, decide whether to apply a collar for next quarter or sell the position.

Devon Energy Corp (DVN)

Wizard of Ops Commentary: DVN has such a low dividend priced into its options, but the stock has remained consistent. With a drop in oil prices even further (another sign of an impending recession), there is a chance that dividends will be lowered again, even if they guided too low last quarter. Be aware of that.

The New Trade: Hold 200 shares of DVN. Hold 2 19Jan24 DVN $65 synthetic short @ $1.80 debit. ***This trade uses $13,702 in capital.***

The Plan: Keep this on through expiration. At expiration, decide whether to apply a synthetic for next year or sell the position.

PAST PERFORMANCE

This chart details past performance over a one-year timeframe. For a comprehensive trade list, please send us an email at info@addeumfunds.com. Open trades are not included in this chart.

Fundamental History (Assuming $50K in each strategy)				
	Open Capital ($)	**1-Yr Gains ($)**	**Portfolio Gains ($)**	**Percent Gain (%)**
Multi-Market (Value Line)	44,500	8,192	28,307	70.8
Biotech (Dave Sobek)	23,000	(9,766)	10,044	25.1
Dividend Portfolio	50,246	767	767	0.0
Total	117,746	(1,574)	38,351	47.9