Arbitrage

Stop Watching | Start Living

Our Mission

To provide educational and affordable tools that are easy to use and reduce the barriers to enter into any market so that every individual has the opportunity to pursue their personal and financial aspirations.

The last edition of *State of the Bands* examined the world of Cryptocurrency and Blockchain Technology. In this edition we revisit our December 10, 2018 declaration of the beginning of a Bear Market on December 3, 2018, compare the current market to those of 2001, 2007/08 and 2015, and discuss some key economic factors.

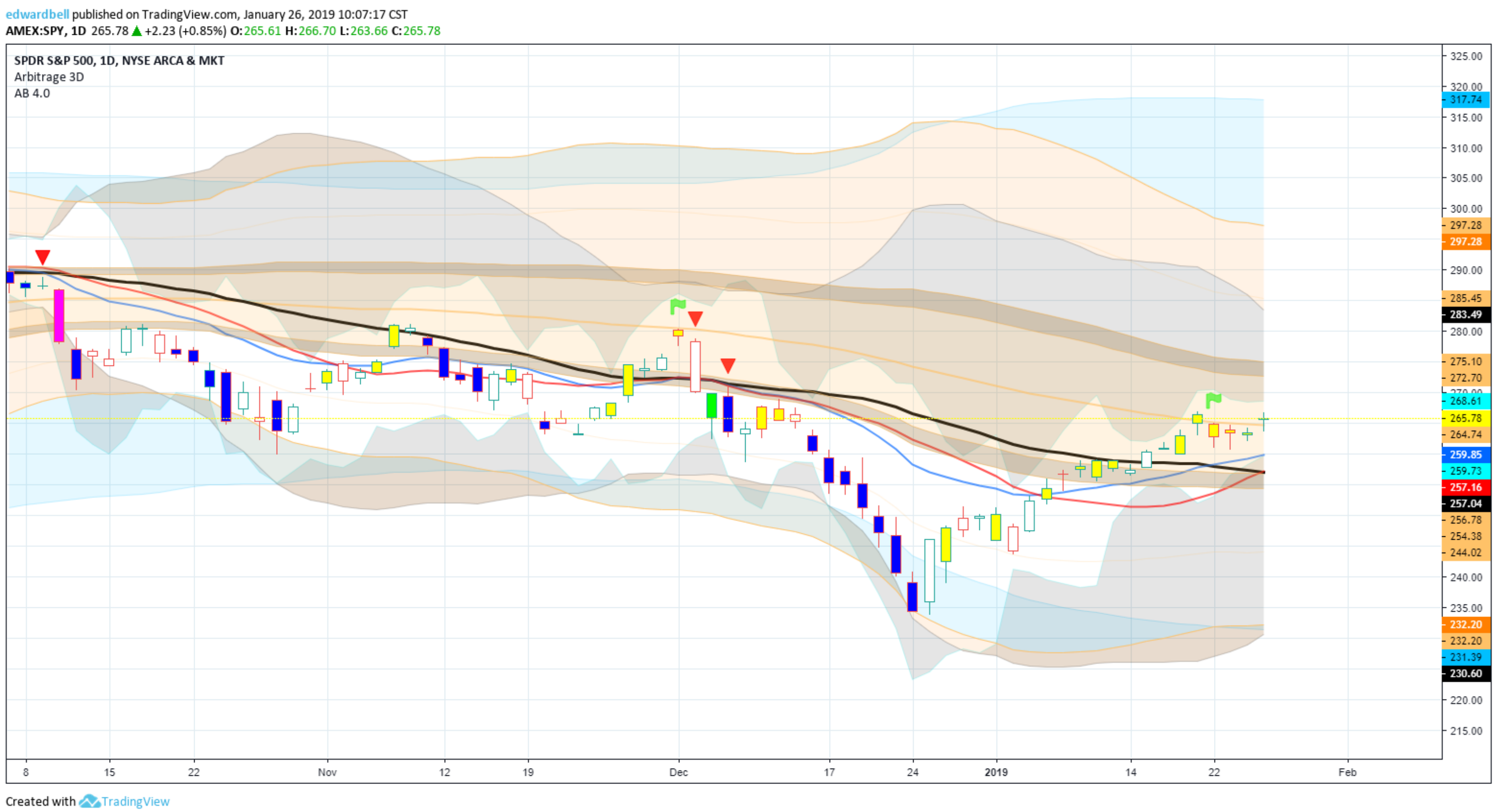
Arbitrage Bands™ identified the beginning of a Bear Market effective December 3, 2018. The chart below is reproduced from the December 10, 2018 issue of *State of the Bands*.

Since December 26, 2018 we have experienced a relief rally...

Arbitrage Bands™ 3D indicator did, in fact, identify the relief rally that started on December 26, 2018.

> *When you have eliminated all which is impossible, then whatever remains, however improbable, must be the truth.* - Sir Arthur Conan Doyle

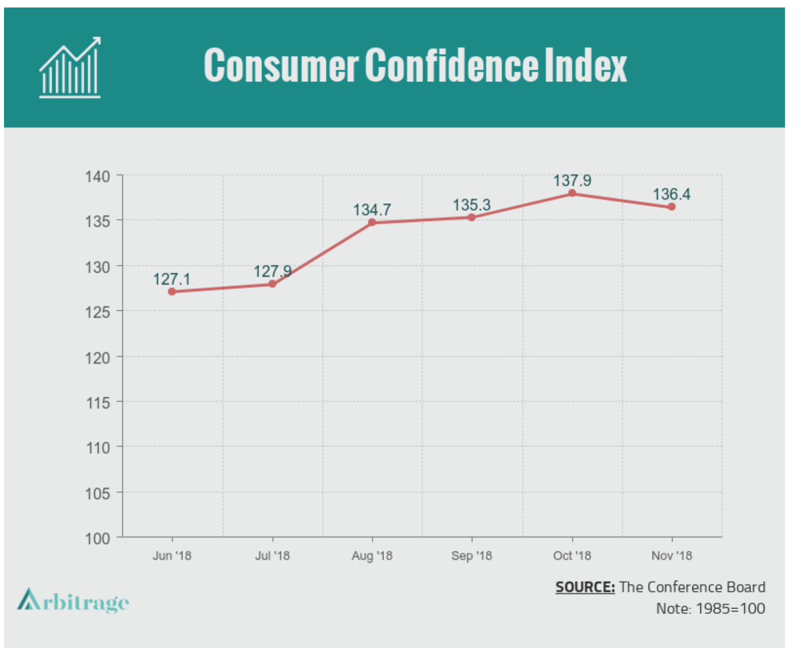
Arbitrage 3D™ indicator uses four Arbitrage Bands™ to eliminate impossible prices and indicate probable price action. In the chart below the Arbitrage Band™ marks the beginning of a new downtrend with the illustrated red triangle. Overlaying the Arbitrage 3D™ indicator paints a clear picture of the probability remaining within the system. In the Arbitrage Bands™ system the candles must stay within the Arbitrage 3D™ indicator.

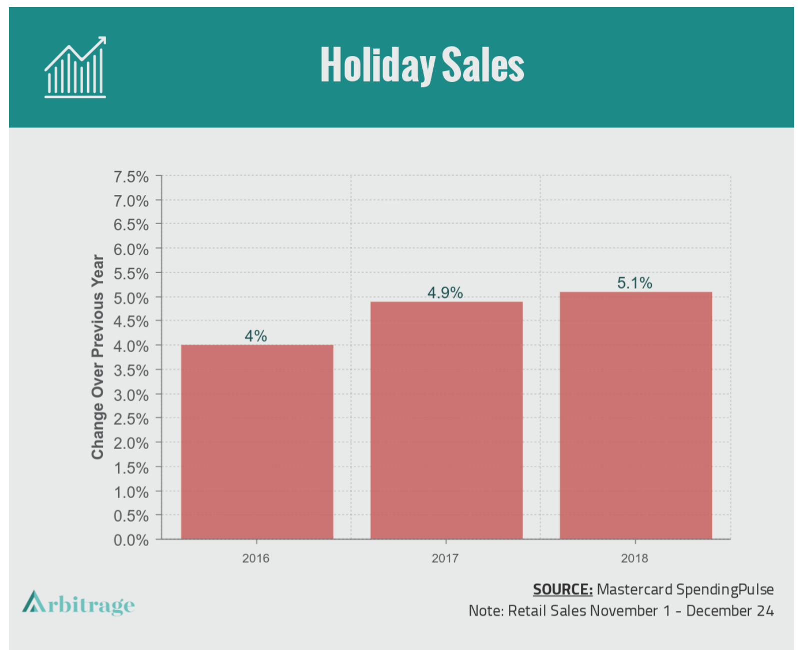


Strong economic indicators and positive developments in trade talks fueled the December 26, 2018 rally. Though slightly down from an 18-year high in October, Consumer Confidence remained at historically strong numbers in November and very strong retail sales were reported through Christmas. In an effort to deescalate trade tensions, the United States and China announced a 90-day truce on December 3 with additional tariffs to be implemented if the two sides cannot reach an agreement by March 1.

Now, 25+ trading days into the relief rally we see a 3-week hiatus in the partial government shutdown and the Chairman of the Federal Reserve becoming more dovish regarding rate hikes in 2019.

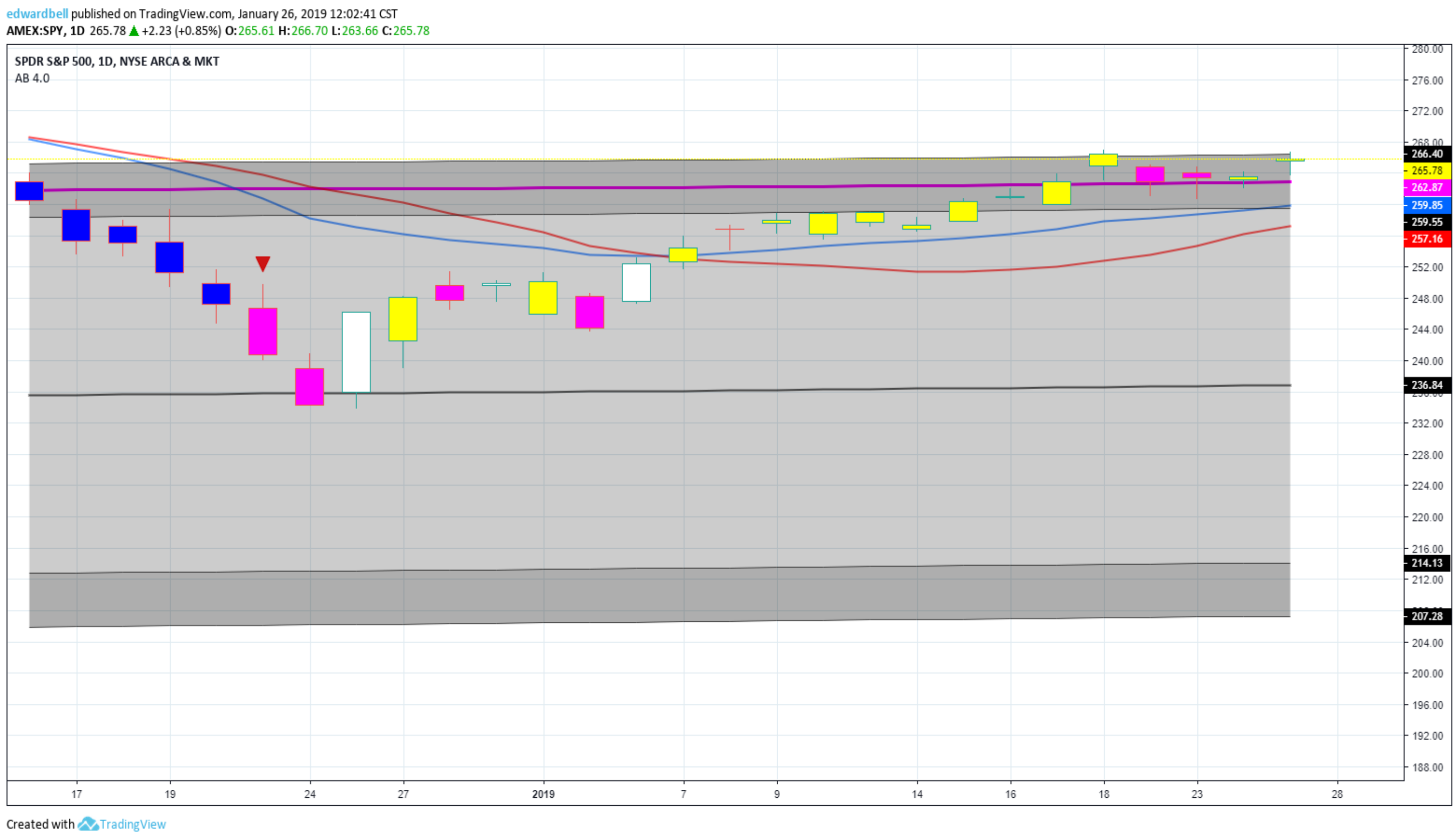
On the surface, this all seems positive...





...a closer look using the Arbitrage Bands™ system will reveal more information about the long-term market trend.

The Apocalypse Band™ indicates that the Pulse Line (the fuchsia line), the heart of Arbitrage Bands™, is pinned to the top of the band on the daily chart.



Introducing the Arbitrage Loop™ indicator (*a different take on the Law Of One Price*)

The Arbitrage Loop™ indicator identifies when a bullish trend or bearish trend is ending. When the lines cross all of the energy within the previous trend has been expended. If the red line is on top a negative trend is in progress; if the green line is on top a positive trend is in progress. The histogram shows what fuel type is in the current trend.

2000 Correction

Due to the gravity of the Y2K bug many software developers were specifically hired/contracted to discover, test, resolve, and replace vulnerable software in the global marketplace. The resolution of the Y2K bug in early 2000 contributed to high unemployment numbers and increased the number of tech-savvy entrepreneurs that were suddenly out of work in the global marketplace. The lower barriers to entry into the emerging software development marketplace for these entrepreneurs resulted in an oversupply of internet service provider start-ups. However, the lack of demand and new ideas resulted in many ISPs and entrepreneurs defaulting on their newly issued bank loans.

Looking at past market corrections with the Arbitrage Loop™ indicator, the duration and magnitude of each correction becomes quantifiable.

The Arbitrage Loop™ indicator in the chart illustrates the compound negative impact seen in the market between late 2000 and 2001.

2008 Correction

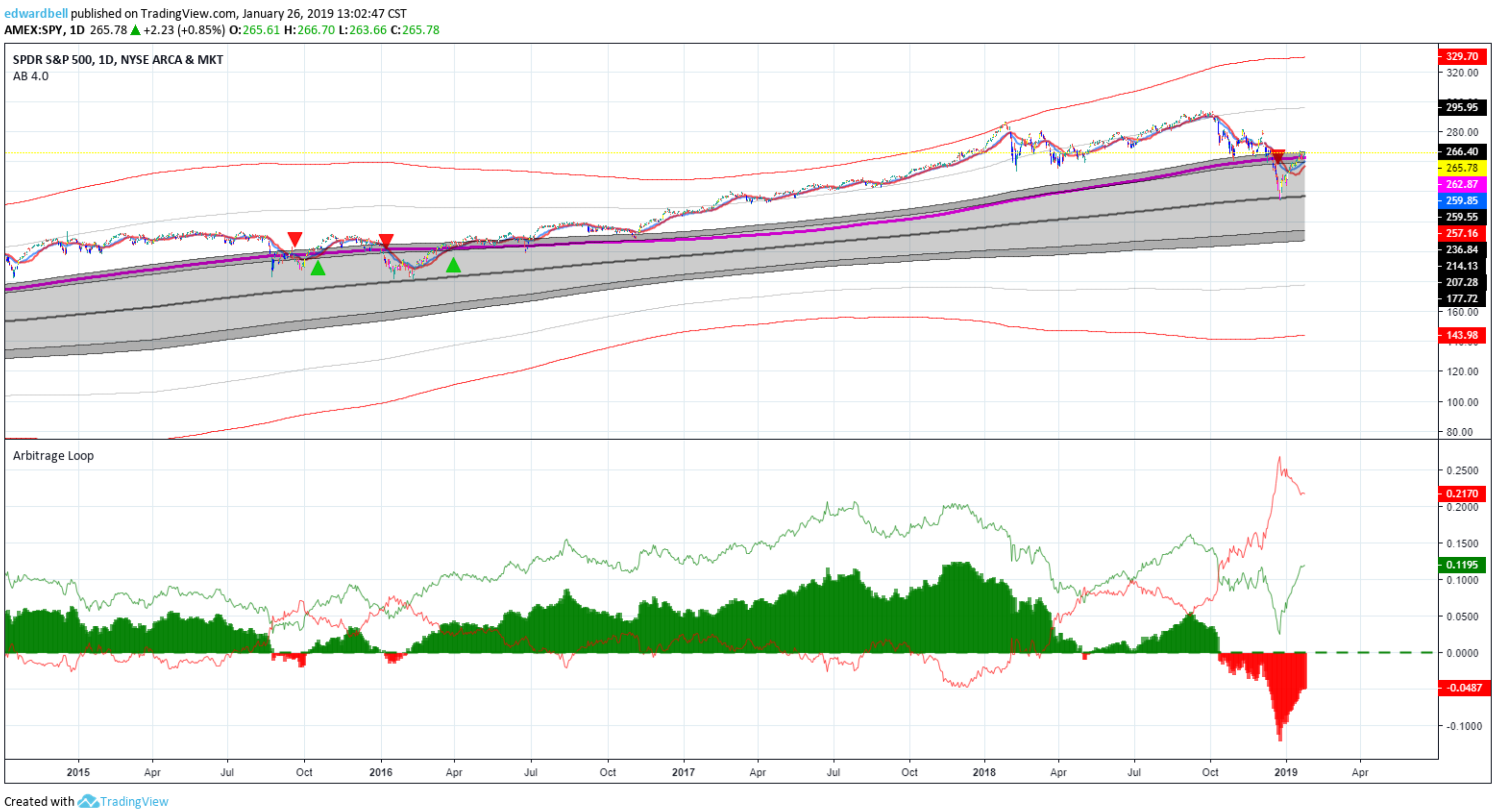
Financial industry deregulation contributed to the correction of 2008. Banks were allowed to engage in hedge fund trading with mortgage-backed securities and other derivatives which led to an increase in the number of mortgages to support the profitable sale of the derivative securities.

The Arbitrage Loop™ indicator in the chart below illustrates the compound negative impact present in the market between late 2007 and 2009.

2015 Market

The negative market influencers of late 2015 and early 2016 were not strong enough to adversely affect equity prices long term. The chart below shows only brief periods of negative fuel in the system until Q4 of 2018.

In comparison to the 2000/01 and 2007/08 corrections, the negative impact reflected in the Arbitrage Loop™ indicator appears negligible.



POTENTIAL MARKET INFLUENCES

CHINA

- Refusal of plastic recyclables effective 2018
- Drastic slowdown in economic growth
- Significant correction in China's stock market in 2018
- Ongoing trade war with the United States
- China's Dagong Global Credit Rating Co downgraded the US credit rating in January 2018

EU/UK

- Brexit negotiations
- Retaliatory tariffs

CANADA/MEXICO

- NAFTA
- Retaliatory Tariffs

DOMESTIC

- Partial Government shutdown
- Delay of Key Economic Indicators

POTENTIAL MARKET INFLUENCE - CHINA

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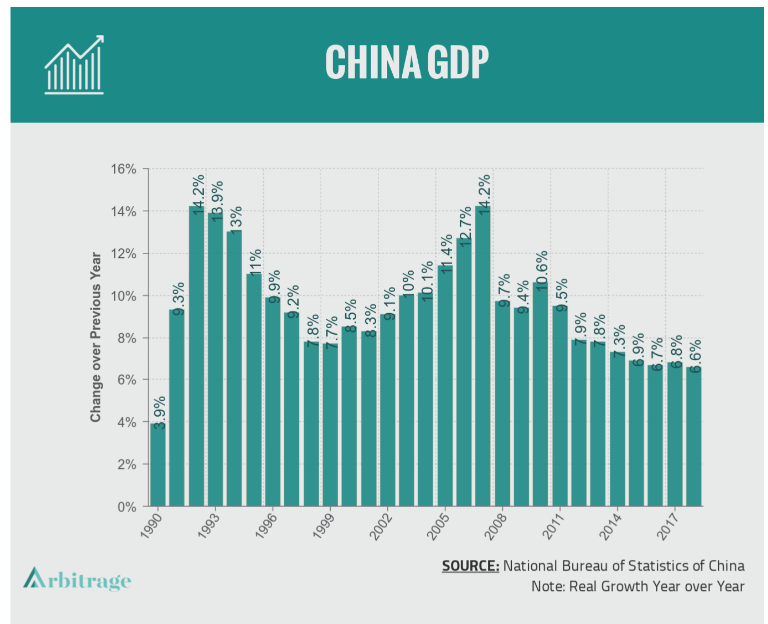
China lacks a fully developed waste management system. Accordingly, China announced they would no longer accept plastic recyclables as of January 1, 2018. Long the world leader in the import of plastic waste, it is estimated that China imported a total of over 100 million metric tons of waste between 1988 and 2016.

China's GDP growth rate has been steadily declining since experienced a drastic slowdown in economic growth in 2018. Their annual GDP growth rate of 6.6% was the lowest level since 1990's 3.9% growth rate.



POTENTIAL MARKET INFLUENCE - CHINA

The Chinese stock market as measured by the Shanghai Composite Index lost 14.5% of its equity value in 2018.

In January 2019 there was a 4.1% increase.

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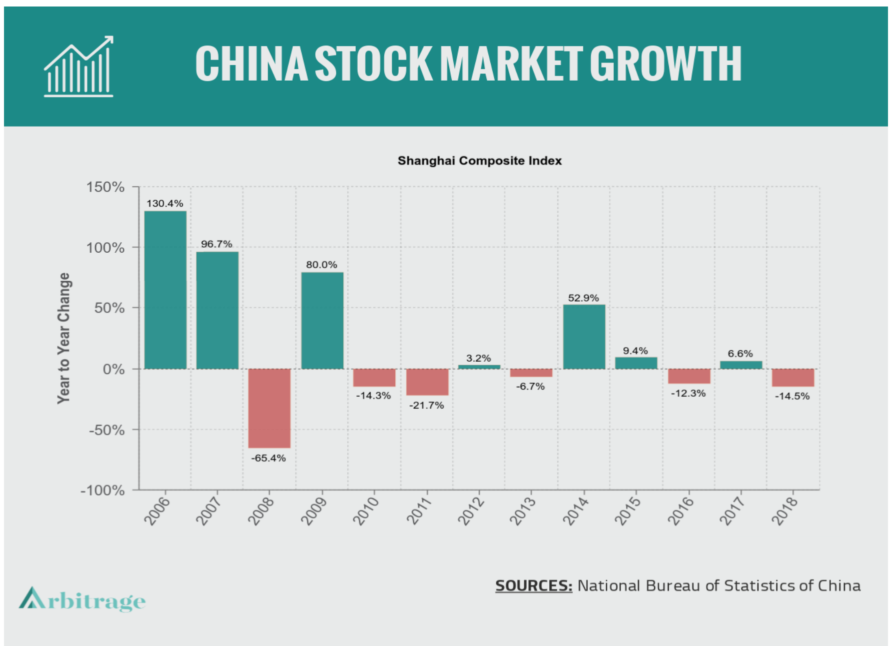

The US government imposed tariffs on steel, aluminum, washing machines, and solar panels in March 2018.

China imposed retaliatory tariffs in July and September 2018.

Since July the US has imposed tariffs on $250 billion of Chinese products and China has taxed over $110 billion of US products. President Trump is looking for China to open markets to a wider range of manufacturing, agricultural and financial products.

China and the US agreed to a 90-day negotiation window during which no new tariffs would be announced and the US agreed to not increase existing tariffs from 10 to 25 percent on January 1, 2019.

Grade	Moody's	S&P	Fitch
Prime	Aaa	AAA	AAA
High grade	Aa1	AA+	AA+
	Aa2	AA	AA
	Aa3	AA-	AA-
Upper medium grade	A1	A+	A+
	A2	A	A
	A3	A-	A-
Lower medium grade	Baa1	BBB+	BBB+
	Baa2	BBB	BBB
	Baa3	BBB-	BBB-
Non-investment grade speculative	Ba1	BB+	BB+
	Ba2	BB	BB
	Ba3	BB-	BB-
Highly speculative	B1	B+	B+
	B2	B	B
	B3	B-	B-
Substantial risks	Caa1	CCC+	CCC+
	Caa2	CCC	CCC
	Caa3	CCC-	CCC-
Extremely speculative	Ca	CC	CC
			C
In default with little prospect for recovery		SD	RD
In default	C	D	D
			DD
			DDD
Not rated	WR	NR	

On January 15, 2018, China's Dagong Global Credit Rating Co. downgraded the US credit rating from A– to BBB+ and placed them in a negative outlook status. This is equivalent to a US personal credit score near 620 which is barely enough to qualify for an FHA loan.

A hard line on tariffs could affect trade, not only with China, but with the EU, Canada, and Mexico as well. And with the US's inability to secure more credit worthiness with its existing trading partners this could easily escalate quickly.

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POTENTIAL MARKET INFLUENCE - BREXIT NEGOTIATIONS

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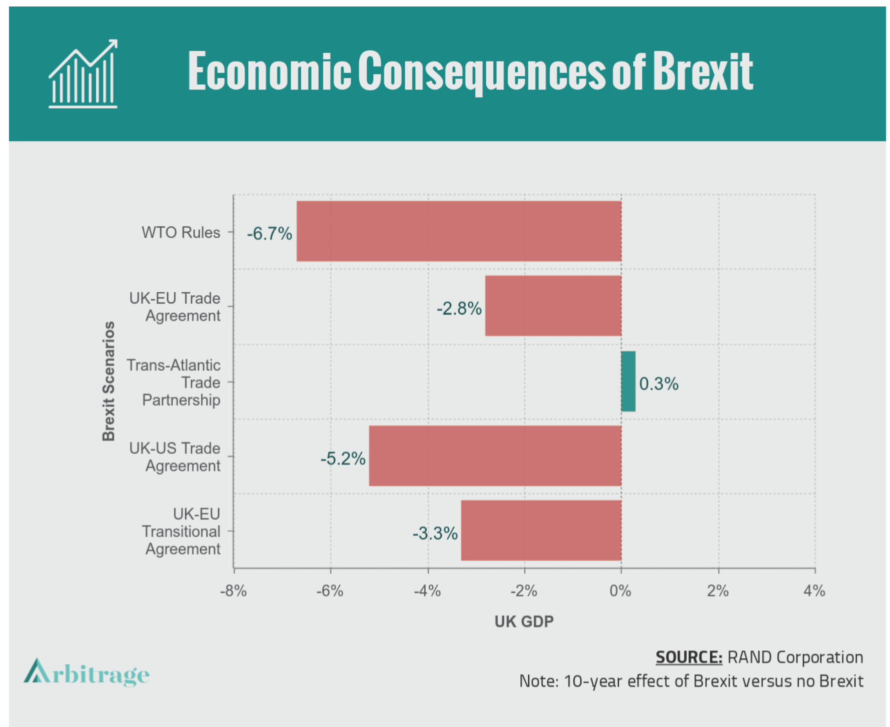
With the two recent votes (January 15, and January 29, 2019) of Parliament soundly rejecting Prime Minister Theresa May's withdrawal agreement with the EU, the March 29, 2019 exit date looms large. Obstacles to the approval of the agreement by Parliament include the buyout amount that the UK would have to pay the EU to exit; the effect the exit will have on expatriates of both the UK and EU; and the avoidance of the return of a physical border between EU member the Republic of Ireland, and Northern Ireland, a country which is part of the United Kingdom.

If the exit date arrives without an extension or an approved agreement, the UK would leave with no trade agreements in place between the UK and the EU and trade between the parties would fall under WTO rules.

While the economic and market effect of the various Brexit scenarios remain uncertain, the 10-year difference in the UK GDP could reach -6.7%. Significant changes would undoubtedly affect the US economy and markets as well.



POTENTIAL MARKET INFLUENCES - DOMESTIC

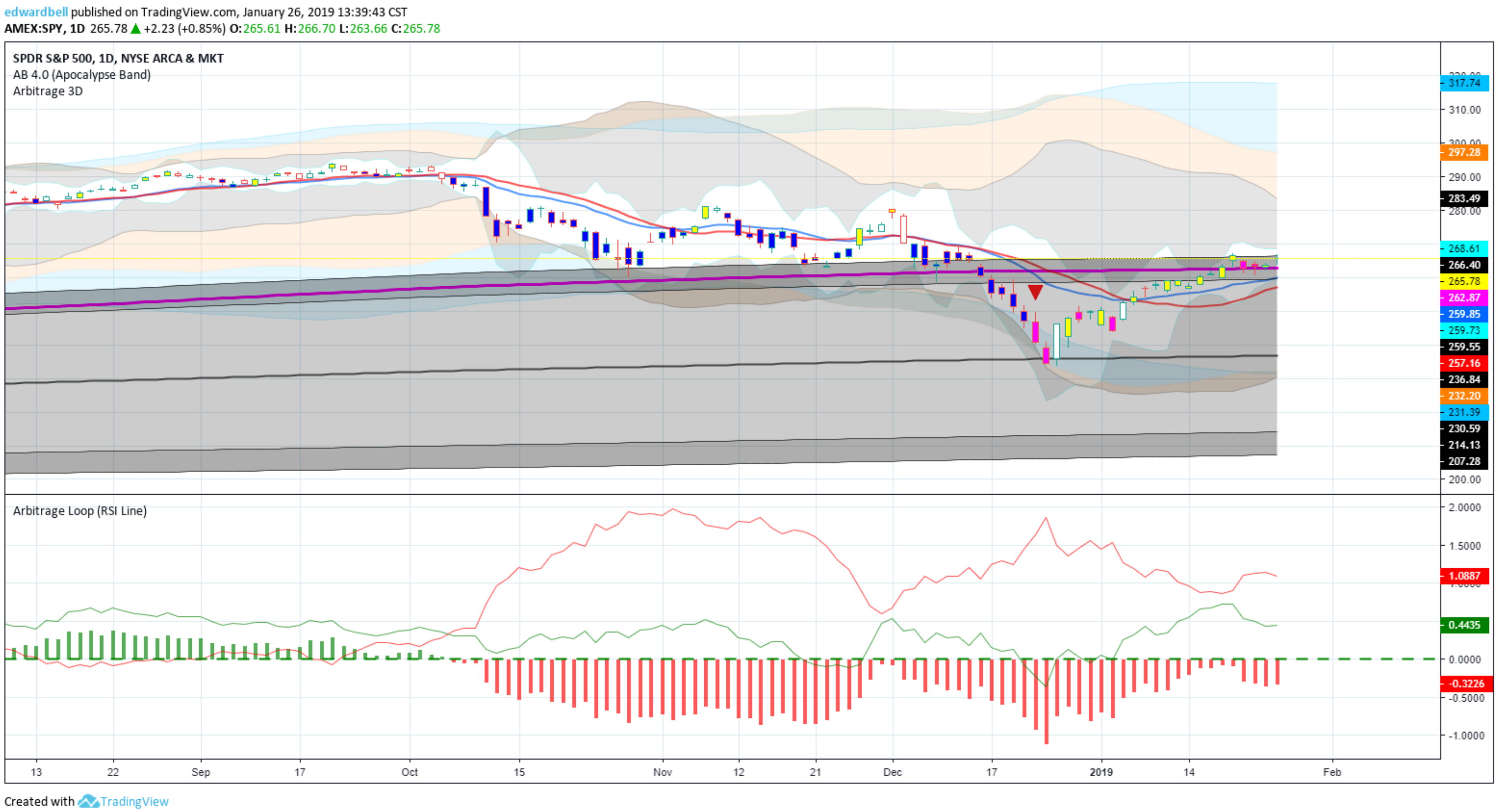
The 2018-2019 partial government shutdown began on December 22, 2018 and lasted 35 days.

The Congressional Budget Office estimates that the shutdown delayed $18 billion in federal spending and lowered the projected level of real GDP in the first quarter of 2019 by 0.2 percent.

If a funding bill is not approved the three week reprieve will end on February 15, 2019, and the government will potentially face another shut down.

Image: ID 136489924 © Stuart Miles | Dreamstime.com

Objectively viewing the state of the world economy the amount of risk currently present is astoundingly high. This is reflected in the significant amount of negative fuel produced by the Arbitrage Loop™ indicator. Also, since the relief rally began on December 26, 2019 the Arbitrage 3D™ indicator is expanding, allowing for more downward probability.



In the weekly chart below, the candles are bouncing off the compass line. The long term trend cannot point up until the candles cross over the compass line. We are now testing the compass line for the first time since the inception of the rally that began on December 26, 2018. The Apocalypse Band's™ Pulse Line cannot break 205.27.

Based on that the candles must close below this level at some point in the very near future...

The Arbitrage Breaker™ indicator shows the length of the current Bull Market at 99 months.

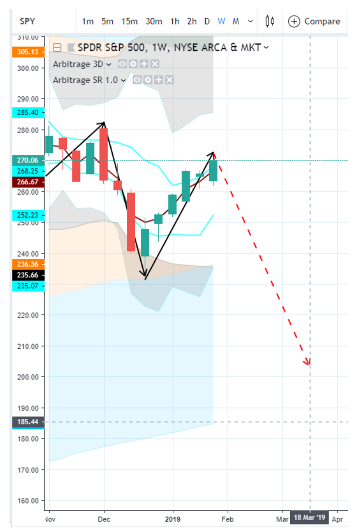
The Arbitrage Loop™ indicator on the monthly chart shows how precariously close the market was to entering a long-term down trend in January 2016 and December 2018.

According to the charts of the Arbitrage Bands™ system the market is making more room for a significant downward movement:

- The pulse line is pinned to the top of the band on the daily chart (p. 5)
- The Arbitrage Loop™ indicator is showing consistent negative fuel even well into the relief rally which started on December 26, 2018 (p. 6)
- The Arbitrage 3D™ indicator is expanding to allow more short-term downward movement (p. 16)
- The candles on the weekly chart remain below the compass line indicating a high probability of an accelerated downward trend (p. 17)
- The Arbitrage 3D™ indicator is illustrating a dangerously low chance of continued upward trend in the coming months (p. 18)

What to expect

- Institutional investors will use this opportunity to take cover and profits
- Less sophisticated investors will invest more in the currently perceived (relief) rally
- The M pattern on weekly chart (traditionally means 'murder') creating a double top



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Effective as of February 4, 2019