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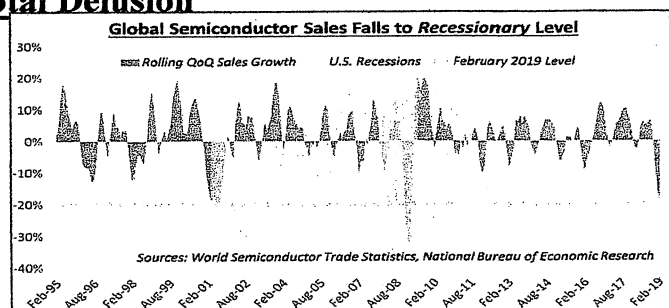
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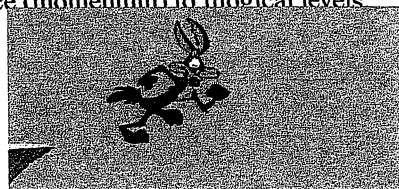
Complete & Total Delusion

“Stocks Are Off to Their Best Four-Month Start in Decades.” That’s the *Wall Street Journal* headline from a couple of days ago. The WSJ story continues: “The Dow, up 14% this year, is enjoying its best four-month start since 1999, while the S&P 500’s 18% gain this year ranks as the broad index’s strongest run since 1987.” Tech stocks have led the way in 2019, with a 27% year-to-date gain, “more than any other sector in the S&P 500,” the Journal story stated. Not mentioned was the fact that within the tech sector, semiconductor stocks were the best performers of all, with the Philadelphia Semiconductor Index (SOX) up a whopping 35% in the first four months of the year. See the chart below of the terrific run up to record highs in the SOX index this year (the sharp spike up on the right side of the chart).



a year-to-year basis across all major regional markets and semiconductor product categories, consistent with the cyclical trend the global market has experienced recently,” Neuffer stated. Global semiconductor sales in the first quarter dropped 15.5% from Q4 and 13% from the first quarter of 2018. Regionally, sales in the Americas market were hardest hit, down 26.6% year-over-year.

These numbers are consistent with the mostly terrible results issued over the past couple of weeks by the world’s largest semiconductor companies. What is not consistent (almost inexplicable) is the action of semiconductor stocks during the worst industry downturn in a decade and the third worst (so far) in twenty-five years. For comparison purposes, consider what happened to semiconductor stocks during those prior two downturns. In mid-2007 to November 2008 the SOX index plummeted from 550 to 168 (a decline of 70%). From its top in 2000 (1362) the SOX index collapsed 85% (to 209) by October 2002. But the SOX index today just tacked on 35% over the past four months on top of the longest bull market in U.S. history. The SOX index in November 2008 was 168. Now it’s 1556 – up 9.3x. Investors don’t seem to know it (yet) but they’re in the same position as the Looney Tunes cartoon character Wile-E-Coyote who’s gone over the cliff after trying to catch the Road Runner (see below) and there’s a long way down to fall. Instead of chasing the Road Runner, today’s investors have been chasing performance (momentum) to illogical levels.



The SOX index’s recent performance is nonsensical on all sorts of levels. Semiconductors are the key components that go into products such as smartphones, PCs, communications and networking equipment, automobiles, industrial equipment and data center equipment. These are the major end markets for semiconductors, accounting for the vast majority (almost all) of

Now it’s not unusual for semiconductor stocks to lead the stock market – both up and down. What is very unusual – in fact is unprecedented – is that semiconductor stocks have done this during one of the sharpest industry downturns in decades. The chart at the top of the next column titled: Global Semiconductor Sales Falls to *Recessionary Level* (put together by Meritocracy Capital Partners) overlays global semiconductor sales sourced from the World Semiconductor Trade Statistics (WSTS) organization against recessionary periods (shaded areas) as determined by the National Bureau of Economic Research.

As you can see from the chart, which covers the past 25 years, there have been two recessions – in 2001-2002 (following the tech bubble crash) and in 2008-2009 (following the Global Financial Crisis). In both instances, semiconductor sales on a quarter-to-quarter basis (three-month-moving average) fell at least 20% (over 30% in 2009). This chart uses WSTS data through February 2019, but just this week the Semiconductor Industry Association (SIA) reported updated WSTS semiconductor sales data through the end of the first quarter (March).

“Global semiconductor sales slowed during the first quarter of 2019, falling short of the previous quarter and Q1 of last year by double-digit percentages,” said John Neuffer, SIA president. The downturn has been broad-based as “Sales in March decreased on

semiconductors consumed each year. All these key end markets have deteriorated considerably.

The largest U.S. smartphone maker, Apple, tonight reported iPhone revenues fell 17% year-over-year, driving an overall company sales decline of 5% to \$58 billion – the exact same level of sales it reported in the first quarter of 2015 (four years ago). At the time, Apple's stock was just a little over \$100 compared to today when Apple's stock is over \$200 – meaning that Apple's price-to-sales ratio has almost doubled even as Apple's growth rate has evaporated and now gone negative.

Earlier today Samsung, the global smartphone leader (23% market share in Q1) reported a 13.5% year-over-year drop in revenues with an estimated (by research house IDC) 8% decline in smartphone unit volumes. IDC tonight reported total smartphone industry shipments fell 6.6% year-over-year to 310.8 million units from 333 million units a year earlier – “the sixth consecutive quarter of decline.” IDC: “This quarter's results are a clear sign that 2019 will be another down year for worldwide smartphone shipments.” “From a geographic standpoint, while the China market will likely be challenged for the remainder of 2019, it was the U.S. market that felt the worst of the downturn in 1Q19. Smartphones declined 15% year over year during the quarter as replacement rates continue to slow in one of the world's largest markets,” IDC said.

Note that smartphones are the largest end market for semiconductors and IDC doesn't expect any “second half rebound” in 2019 for smartphone sales. Anthony Scarsella, IDC research manager for IDC's Worldwide Quarterly Mobile Phone Tracker: “Consumers continue to hold onto their phones longer than before as newer higher priced models offer little incentive to shell out top dollar to upgrade. Moreover, the pending arrival of 5G handsets could have consumers waiting until both the networks and devices are ready for prime time in 2020.” In Apple's case, their first 5G capable phones won't be available until late in 2020 (never mind ones “ready for prime time” – those might not come until 2021) and that's a long time away.

Though Apple's Q1 revenues announced tonight (Tuesday) were lousy, Apple was able to report a top and bottom line earnings “beat” that was celebrated by investors (stock up 10 point in after-hours trading). Remember that Apple had slashed their Q1 guidance three months earlier, so they “beat” low-balled, truly awful sales and earnings estimates. Apple's sales fell year-over-year for the second quarter in a row and their vaunted “Services” business growth slowed too. Though Apple recently stopped providing iPhone unit sales numbers (surely to avoid embarrassment), after doing so since the iPhone was first released in 2007, IDC estimated that Apple's (flagship) iPhone unit shipments in Q1 fell a “staggering” (IDC's term) 30.2% year-over-year to 36.4 million units (from 52.2 million a year earlier).

IDC explained Apple's predicament: “The iPhone struggled to win over consumers in most markets as competitors continue to eat away at Apple's market share. Price cuts in China throughout the quarter along with favorable trade-in deals in many markets were still not enough to encourage consumers to upgrade.”

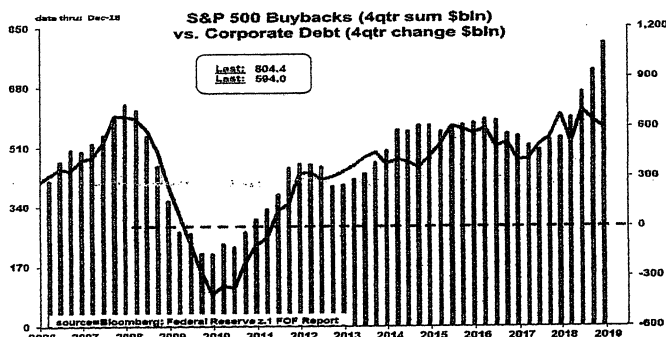
Though Apple CEO Tim Cook claimed Apple's business in China had recently improved (Apple's revenues in China fell 22% year-over-year), the reality is that Apple's losing gobbs of market share to lower-priced, high-quality domestic Chinese suppliers such as Huawei (a 50.3% leap in smartphone unit shipments globally to 59.1 million units – 62% more than Apple shipped in Q1) and vivo (smartphone unit shipments up 24% year-over-year). Apple's global market share for smartphones fell to just 11.7% in Q1 from 15.7% a year earlier, per IDC. Four years ago, Apple's smartphone global market share was around 23%, so it's been nearly cut in half as investors have nearly doubled Apple's stock price. As this letter's title says: “Complete & Total Delusion.”

The Games Bubble Blowers Play

You may remember my new moniker for Apple: International Consumer Machines (ICM). As its close cousin IBM has often done (for years), Apple “beat” the low-balled earnings estimate with lots of financial engineering (including massive stock buybacks) to reduce the denominator in the

earnings per share (EPS) calculation. Apple's Operating Income fell 16% year-over-year in the first quarter.

This is the game that's being played across America. Inflate bottom line EPS results using any means possible. Continually write off costs as “one time” in nature so they can be excluded from the phony “non-GAAP” earnings per share numbers. GAAP is **generally accepted accounting principles** put forth by the accounting stewards that are now regularly ignored by companies, Wall Street and happily deluded investors. Heavily weight employee pay with stock and stock options and then ignore the costs as non-GAAP in EPS calculations. Most tech companies now do this even though labor costs in the tech world are the companies' largest component of overall costs. Buy back shares to reduce the share count. In 2018 U.S. corporations announced a record \$1 trillion of stock buybacks. The buybacks were often funded by taking on more debt (corporate debt also is at a record high – in total and as a percent of GDP).



In my first two decades as an investor (before the Fed got into the stock bubble blowing business) interest rates were much higher (short-term U.S. Treasuries yielded 6% in 1999) and corporate borrowing rates were even higher – so there was a relatively high *COST* to borrowing (thus limiting buyback activity). Prior to 1982 (and throughout most of the 20th century in the US), share buybacks were illegal as it was feared corporate executives would use them to manipulate share prices (exactly what they're doing today – and it's made worse by all the executive pay coming in the form of stock options). In 1982 the SEC passed Rule 10b-18 creating a legal avenue for stock buybacks – and thus opening the stock buyback floodgates. See chart above sourced from Meridian Macro Research (info@meridianmacro.com) and notice the close correlation to stock buybacks and changes in corporate debt. Also in my first two decades as an investor and many decades before that, reporting non-GAAP EPS numbers was nonexistent – GAAP EPS ruled.

The end result of all these shenanigans is that while non-GAAP P/E ratios are elevated, they're not at near-record levels as are other valuation measurements such as the price-to-sales ratios and market valuations compared to book values. These metrics are today in the same league as the 2000 and 1929 bubble markets – just before they crashed. The median stock's price-to-sales ratio was recently reported to be nearly TWO times that of the 2000 stock bubble top.

Can Only Fool People For So Long

As I've said before, the future for Apple, like IBM, is not bright. I expect a long, slow, painful deterioration for ICM that may last for decades. However, if Apple continues to lose market share and sees unit sales declines at the pace they saw in Q1, ICM may implode faster than I thought. Staggering 30% drops in unit sales means a much smaller customer base to sell those “services” to. Meanwhile, back in the world of Complete & Total Delusion (the U.S. stock market), Apple's stock is currently up 33.5% year-to-date on the back of those terrible Q1 results. Apple's stock is far from “cheap” as its backers proclaim (at 18 times stock buyback inflated earnings and negative revenue growth). I can't figure out which is more delusional – the \$1 trillion valuation for the shrinking Apple or the 35% year-to-date gain for the SOX index, as end markets such as smartphones decline and semiconductor industry sales plummet.

Like many tech companies that have generated a lot of cash flow over the years, Apple used to have no debt on its balance

sheet. Now it has over \$100 billion of debt. Eventually (like IBM) Apple will be forced to cut back on its share buyback game. For now, to keep investors happy after reporting miserable results, Apple announced a \$75 billion addition to its buyback program (buying stock at nosebleed levels with a \$1+ trillion market cap). Earlier in April, IBM announced it would suspend its share repurchases in 2020 and 2021 in order to PAY DOWN DEBT. IBM has finally hit the wall and eventually ICM will too. Over a six-year period IBM wasted over \$40 billion buying back stock, often near peak price levels. I say wasted because IBM's stock price (inflated as it is at today's price of 141) is over 30% lower than it was six years ago (end of April 2013).

More Dreadful End Market Data

IDC estimated global PC industry shipments in Q1 fell 3% year-over-year to 58.5 million units. However, sales to end users may have been worse, especially in China – the largest end market for PCs in the world. PC unit shipments in China “came in above expectations as vendors pushed more inventory into the channels despite macroeconomic woes and trade tensions with the U.S.” IDC said.

Intel, the largest semiconductor maker in the world and the dominant supplier of microprocessors to the PC market, guided its Q2 and full-year estimates (both sales and earnings) significantly lower last Thursday. Thankfully, (because it was my second largest put options position) Intel's stock was knocked sharply lower on the news (down 8 points to 51, a 14% drop over the past few days). There was no sugar-coating their forecast (no second-half rebound here either). Amazingly (to me at least, as the problems that felled Intel's stock I had written about in last month's letter), the lunatics (“investors”) had run up Intel's stock to an 18-year high in the days leading up to its shockingly disappointing quarterly report. Intel had become a new favorite of the momentum monkeys. Now it's “broken.”

Intel's PC business was a relatively bright spot in Q1, offsetting much weaker than expected results from its Data Center business (DCG revenues down 19% sequentially and 6.3% year-over-year, with units down 8% year-over-year). Data center equipment is another major end market for semiconductors. The still-plummeting NAND flash memory business (the second largest segment within the semiconductor market, with DRAM the largest), also hurt Intel's results and will continue to do so going forward.

Intel's microprocessor shortages over the past few quarters that caused PC (HP and Dell) and cloud players (such as Amazon and Microsoft) to double order and hoard inventory is now almost over. HP, Dell and Microsoft have all come out recently and said they now have plenty of microprocessor inventory (likely too much). This led Intel to forecast that “The PC-centric segment is expected to decline in the high single digits on declining PC ASPs (average selling prices) on a relative mix of more small core units.” Intel forecast Q2 revenue to be down 8% year-over-year and earnings per share to drop 14% to 89 cents per share.

On the conference call, Intel CEO Robert Swan indicated the excess inventories among the data center cloud players in China were worse than in the U.S. Swan: “Look, what we're highlighting today as it relates to cloud is two things: that we expect the (inventory) digestion to continue into Q2; that demand is going to be soft in Q2. And it's even exacerbated in China, where, if you'll remember, through the third quarter of last year, our demand from cloud players in China was close to triple digits,” (meaning Intel's results last year were inflated by the double ordering from China). “So overall, they're still in a digestion period – the cloud guys. And in China, it's even – it's been even more dramatic in the first quarter **and the first couple of weeks in the second quarter.**” Swan acknowledged. So while many investors expect a pickup in demand from the major U.S. cloud data center players in the second half – they're missing the fact that China's major cloud players are still glutted with excess parts.

Intel also saw weakness from its enterprise (big business) and government customers (E&G). Swan: “I just think that the ordering ahead or the digestion of last year's strong growth, we expect now to just continue in enterprise and in government

through the first half **and even a little more into the second half** as it relates to E&G.”

Intel's NAND flash memory business plunge caught Intel by surprise. “The not planned in the quarter was just the ASP declined much greater than we had anticipated for NSG. We were expecting kind of mid-20s to 30% ASP declines – the reality is it was closer to the mid-40s,” Swan explained. The plunge in pricing for NAND memory also caught Western Digital (WDC) by surprise, as it reported on Monday just 17 cents per share in earnings (non-GAAP, on a GAAP basis, including inventory write-downs that WDC excluded, WDC lost a jaw-dropping \$1.99 per share in the first quarter). Nevertheless, the 17 cent non-GAAP EPS number was still a 63% shortfall versus analysts' average estimate of 46 cents and was down a whopping 95.3% from Q1 2018's \$3.63 EPS number.

I was happy that WDC's stock fell 8% immediately following Monday's report (I had put options), but unhappy that's all it fell (it should have been down a LOT more). Once again, WDC's management held out hope for a “second half rebound,” helping to keep the stock afloat. Investors want to believe (more delusion) that this time WDC's rosy forecast will be accurate (unlike their most recent forecasts which have been woefully off-the-mark). WDC cut its capex spending in 2019 to the “low end” of its \$1.5 billion to \$1.9 billion range and slashed its 2020 capex estimate even further to \$1 billion – because of the big rebound that WDC is forecasting starting in the second half? It's pure nonsense.

Even more nonsensical was the non-reaction in the stocks of the biggest semiconductor capital equipment suppliers to these big WDC capex cutbacks – particularly the non-reaction in Lam Research's stock (LRCX) – which I (unfortunately) have put options against. LRCX is the most exposed equipment maker to the memory end markets (79% of their sales in Q4, 61% in Q1) and WDC is a major customer. Nevertheless, as long as LRCX's stock chart holds up (strong momentum), the wildlings on Wall Street don't give a hoot about the (collapsing) industry fundamentals. Just give them an EPS “beat” (in LRCX's case in Q1 an unexpected single-digit tax rate and a big one-time gain) and tell them another bedtime story about that second-half rebound that might be coming (some year). As I've written before, LRCX's management started calling for the bottom in the semiconductor industry way back in July of last year (but these days there's no memory on Wall St. after a few days have passed).

Though LRCX has been calling for the bottom to occur, their management has actually pulled back on their recent forecasts a bit. From last week's conference call: “In DRAM, we continue to believe the spending correction will extend through this calendar year as customers continue to rationalize long-term profitability with near-term focus on reducing channel inventories and bringing supply and demand dynamics back into balance for our business.” In NAND, LRCX CEO Tim Archer thought “that market conditions are setting up well for **future** recovery as demand and supply balance improves through the year.”

Samsung, the world's leading memory maker (both DRAM and NAND) had a less optimistic outlook than LRCX or Micron execs. (Micron Tech's CEO has been comforting investors with the second-half rebound story). On Samsung's conference call this week: “Regarding price outlook, fundamentally price, of course, is determined by the demand and supply situation of the market. **But more recently, I think the visibility has even become lower.** So it's very difficult to predict where the price will go.” a Samsung executive explained. Samsung also admitted its inventories were still climbing. “To answer your question, even though we can't share with you the details of our inventory levels, we can say that our inventory has definitely increased quarter-on-quarter, mainly due to the fact that we're in the weak season of the year and also the fact that we went through the expansion of the capacity in the second half of last year.”

Micron Tech's inventories were at twenty-five year highs (on a days of inventory basis) and are expected to soar even further (above 150 days!) when they report results in late-June. There have been NO reductions in total industry inventories yet – making the second-half rebound story nearly impossible. Samsung reported its operating profit for Q1 dropped more than 60% year-over-year and predicted that the margin-suppressing

price declines for memory chips would continue in the second quarter.

Archer (and investors in LRCX) are missing a couple of key points. The first is there's still an epic glut of memory supply versus demand as the continuing ASP train wreck shows (because NAND manufacturers believe/hope that demand will pick up soon – typical of the industry over-optimism) – so they don't cut back enough. They also don't understand that this supply/demand imbalance occurred BEFORE the global economy sinks into recession for the first time in 10 years – and it's heading that way (more on that later). The other part to the story they're missing is that in reaction to the severe shortage of memory parts they found themselves in over a year ago, the U.S. cloud players have PERMANENTLY changed the configurations of servers to use much less NAND and DRAM in their datacenters, I'm told. I'm also told that this glut could go on for years.

Another major end market for semiconductors (\$54 billion or 12% of all semiconductor sales in 2018 per WSTS) is autos. Here again, the largest end market is in China. Auto sales in China in the first quarter fell 13.7% year-over-year per data reported by the China Association of Automobile Manufacturers and have now declined for nine consecutive months. European new passenger vehicle registrations (essentially car sales) dropped 3.2% year-over-year in Q1 to 4.15 million vehicles. It was the second consecutive weaker quarter of car sales in Europe. The decline of 136,000 cars was especially disappointing due to a later Easter weekend in 2019 versus last year. This will likely hurt car sales in April.

In the U.S., sales were estimated to be down 3.2% year-over-year in Q1, and *Automotive News* reported this week that automakers and dealers have a near-record 4.2 million unsold vehicles as of April 1 – just 114,300 vehicles less than the all-time, modern-day record set in May 2004 and more than half a million more than the heavy inventory level in the spring of 2007, prior to the start of the “Great Recession.”

The *Automotive News* story explains the predicament: “Pushed each month by factory reps to load their lots with more and more of the latest and greatest, many dealers now find themselves stuffed to the gills, paying extra for off-site storage while the interest clock ticks and each vehicle's floorplan allowance melts away.” The conclusion is that the major domestic automakers will have to cut back production during the remainder of 2019. Fiat-Chrysler has a 90-day supply of vehicles on hand, Ford, an 84-day supply and GM with 83 days of inventory – all far above what's considered normal. That's not a recipe for a “second-half rebound” in semiconductors.

Harder to Find – But There Are Still Honest Tech Cos.

Over the years, I've mentioned on several occasions that one of my all-time favorite tech companies is factory automation and machine vision expert Cognex (CGNX). I like to own the stock when the stock is cheap (not now). I bought put options against it last month before its report on Monday because I know they have one of the most honest tech managements there is and I knew they were exposed to the weakness in China, automobiles and other industrial end markets. Cognex guided Q2 estimates lower and the stock immediately fell 16% when the stock market opened the next morning. I sold my puts and actually went briefly long the stock, as I anticipated a bounce (which happened).

CGNX CEO Robert Willett on this week's quarterly conference call: “The American automotive market is noticeably slower than it was. Manufacturers are scaling back large automation projects as they focus on reducing production rates.” “I would add that in terms of automotive, I spent substantial time last month in the southern states of America visiting automotive companies and their suppliers (in other words, in the heart of industrial America). I did see a lot of uncertainty and stagnation there. I saw big automotive plants reducing their shifts from 3 to 2 shifts in some cases, and I saw a slowing down of investments going on among tier-one suppliers, notably Japanese suppliers as an example.” Willett was bullish on the future of his industry (as he should be) and believes the situation he described is temporary, but I suggest you re-read what Willett said in the last paragraph.

It mightily conflicts with the economic “boom” comments coming out of the White House over the GDP report of 3.2% growth for Q1 (the election is coming!) which was inflated by one-time factors. Stripping out those factors such as the third consecutive quarter of huge inventory builds (to be reversed later this year) and the calculation of Q1 GDP falls to the sub-par 1% range. One of the best economists there is, David Rosenberg of Gluskin Sheff – and one of the very few economists to accurately call the 2002 and 2009 recessions in advance – had this to say about Q1 GDP: “Just remember that consumer spending disappointed, housing contracted, business capex growth stagnated and non-residential construction activity dropped in Q1.”

Back to Monday's Cognex conference call. CEO Willett on a question about China: “So China has been a great growth market for many years, and we believe it will continue to be in the long-term. But near-term, as you rightly pointed out, it's broadly soft – more so than anywhere else. And what we see is a lack of confidence, among other issues, is causing capital expenditures to be delayed.” On the Americas and Europe: “I think as I look across our Americas business, I would say in general, it's not the sort of buoyant investment in automation right now that we did see, say back a year ago or in 2017. So I would say that's the case. I think it's also Europe. You see and read a lot about a lot of hesitancy in that market too.” Willett specifically cited Southern Europe “where financing may be more difficult to come by.”

Willett added, “And then I think another thing to appreciate about the automation market, which maybe many of us do, is it's quite global and there are certainly big machine builders in Southern Germany or in Italy or in Japan or Taiwan or Korea that are very dependent on global customers, particularly in China. So, if those customers are paring back their investments or waiting, it can hurt the order books of companies in those very distant geographies.”

Let me throw out some data to back up Willett's points. Last month German and French surveys of purchasing managers in the manufacturing sector showed activity in April continued to contract. Germany's manufacturing sector PMI index in April was 44.5 – well below the 50 mark separating growth from contraction. A similar reading of Japanese manufacturing activity showed new export orders fell at the fastest pace in almost three years. Inventories in Japan rose in March at the fastest pace in a year, led by higher levels of metals, plastics and heavy equipment. Italy cut its 2019 economic forecast last month to 0.2%, compared with an earlier forecast of 1%. This week Mexico (third largest trading partner of the U.S. in 2018) reported that its economy contracted in the first quarter, led by a drop in industrial production which had been the main engine of growth in recent years.

In Taiwan, the Ministry of Economic Affairs reported last month that industrial production in March fell 10% from a year earlier, led by electronic components (includes semiconductors) which plunged 15% year-over-year – the steepest decline since May 2009 (during the global recession). South Korean semiconductor exports plummeted 24.7% year-over-year in the first twenty days of April, while overall exports dropped 9% year-over-year, led by a 12% decline in exports to China. Singapore's electronics exports fell 26.7% in March. All these numbers fit with the terrible WSTS report of recession-like semiconductor sales in Q1 and contrast with the euphoria in semiconductor stocks, which have led the U.S. stock market higher this year.

The bulls have claimed that China is again aggressively stimulating – just as they did in 2009 when they led the world to economic recovery – but China is now massively loaded down with record, off-the-charts amounts of debt, excess inventories and malinvestment. Meanwhile, China's Politburo a week ago threw cold water on the super-stimulus fairy tale by indicating that it will PARE BACK support for the economy, sending Chinese stocks last week down 5.6% (a \$2.3 trillion drop in market value). In contrast, U.S. stocks barely skipped a beat on the news. Per a *South China Morning Post* story titled “Chinese Leaders Vow to Reform, Not to Stimulate,” the Politburo comments following recent meetings “suggested that China's

emergency economic management focus on growth is largely over.” The story quoted Liang Zhonghua, chief macro analyst at the Research Institute of Zhongtai Securities: “The stimulus will be weak and the reform will be strong.”

As for the much-flogged China/U.S. trade deal (incessantly by Trump’s people touting the “great progress” that’s been made), it might help a bit but it isn’t going to solve the long-term trade tensions between the two countries. It looks like some, but not all of the recently instituted tariffs may be lifted and “Tariff Man” (as President Trump has called himself) has other trade battles with Europe (autos) and Canada that are again escalating. The announcement of a trade deal with China could/should be a “sell the news” moment.

Another of the more honest tech companies to recently report quarterly results was Texas Instruments (TXN), the second largest U.S. semiconductor maker. TXN stated, “Revenue decreased 5% from the same quarter a year ago **as demand continued to slow across most markets**. TXN saw weakness in its industrial, auto, smartphone, PC, and enterprise systems. The only area of strength was in communications “due to shipments of products that support 5G.” TXN’s guidance for Q2 calls for accelerating year-over-year declines in sales (-10% year-over-year). The last time TXN reported a Q1 to Q2 sequential revenue decline was all the way back in 2001 (during that recession) – and that’s what TXN’s 2019 forecast calls for. A TXN VP on the call noted that (down) “cycles can last four to five quarters” and “we’re two quarters into that.” That doesn’t sound like a “second-half rebound” to me. Despite the honesty, TXN’s stock inexplicably soared 8% in after-hours trading (very disappointing to me as I owned puts against TXN). However, that seemed to be the peak of semiconductor lunacy last month. Back-to-back disappointments from high-flying Xilinx and Intel late last week (both acknowledging weakness in the Data Center market) seemed to squelch the rabid buying frenzy.

When Will This Crazyness End?

The inexplicable run-up in semiconductor stocks this year to lead the U.S. stock market to new highs is an example of the 2000-like craziness (total & complete delusion then too) we’re unfortunately experiencing. Thoughtful investors are at a great disadvantage when Bubblevision (CNBC) runs the following headline this week: “Central Banks Have Almost Eliminated Recessions” and when Bloomberg has this headline last week: “What If the Bull Market Just Never Ends? The April 20 *Bloomberg Businessweek* cover has a picture of a dead red dinosaur laying prone with the caption over it: “Is Inflation Dead?” and *Barron’s* April 8 cover has a gigantic picture of a bull’s head with the caption: “IS THE BULL UNSTOPPABLE?” with a sub-headline: “The Decadelong Rally Could Continue For Years, The Optimists Say.”

Thanks to the Fed, I’m an experienced asset bubble fighter. My comments in my December 1999 newsletter (#145) in a section titled “Anatomy of a Mania,” are as applicable today as they were back then, just a few months before the tech bubble cracked in early March, 2000.

“What I’ve tried to describe is an out-of-control frenzy, a speculative bubble, a mania. When I hear market strategists on CNBC explain how the market is “fairly valued” or just “slightly overvalued” with “few signs of speculation,” (they’re saying the same in 2019) I want to scream! The market is certifiably bonkers even though the participants are completely oblivious to this fact. There’s no question about what this is, the only question is when it will end. The answer is that no one knows for sure. Manias always end in exhaustion, when the valuations get so high there just isn’t enough money to propel them any longer.”

There were signs of exhaustion in 1999. “Every day the stock market’s breadth gets narrower and narrower. With each new record high in the Nasdaq, the advance/decline line sets a new low.” It’s a similar situation today – poor market breadth and a narrowing list of winning stocks and a lower number of new highs. Today over 80% of IPOs are coming public sporting bottom line losses. The last time that happened was in 1999-2000. The difference is, the “unicorns” coming public – Lyft, Uber, WeWork etc. are so much bigger and lose orders of magnitude more money than the dotcoms of twenty years ago. For example, WeWork lost \$1.9 billion last year on revenues of

\$1.8 billion. WeWork also burned \$2.3 billion of cash. Its business model is doomed: borrow long-term (lease commitments) and watch your short-term renters vanish in the coming recession. Bring on all the Unicorn IPOs, bring on the \$2B Tesla fund raise (including 2.7 million shares of stock) – they’ll get us to the exhaustion point that much faster.

The Fed hiked rates six times (175 basis points) between November 1998 to May 2000. Typically, (over 80% of the time) Fed rate hike campaigns lead to recessions (and bear markets). The Fed has hiked rates nine times between December 2015 to December 2018 (225 basis points). Additionally, the Fed has let nearly \$600 billion of bonds on its balance sheet mature (more tightening) and that tightening is still ongoing. The economy is weakening and earnings are no longer growing – so far coming in down 2% year-over-year in the first quarter versus double-digit growth last year.

The beloved “FANG” favorites are showing signs of distress. In addition to AAPL’s deteriorating results, GOOGL shocked investors earlier this week (stock fell over 100 points) on a sharp slowdown in revenue growth (slowest in four years at 17% growth versus 28% a year earlier, with ad sales growth at 15% versus 24% a year ago) and though AMZN smashed EPS estimates due to lower-than-expected spending, it also reported a significant revenue slowdown, especially from its core online retail business. I don’t think AMZN and GOOGL are losing a lot of market share. Their top line sogginess is another indication of a weakening economy. NFLX reported significantly slower subscriber count gains in Q1 and forecast that trend to continue in the current quarter, both in the U.S. and abroad.

Crazily valued tech stocks today are another similarity to 2000. Take the much favored “cloud” stocks. Here’s a list of popular cloud stocks with price-to-sales ratios as big as price/earnings ratios in a normal market. ADBE 14x, CRM 10x, CYBR 14x, Hubs 14x, MDB 29x, NEWR 13x, NOW 17x, PAYC 21x, TEAM 23x, TWLO 26x, VEEV 24x, and WDAY 16x. Some of these stocks report non-GAAP earnings but under GAAP rules, they’re losing money (infinite P/E’s). Take NOW for instance. NOW (a \$270 stock) reported \$2.61 in earnings (non-GAAP) over the past four quarters for a P/E ratio (trailing) of 103. That’s awfully high for a company growing its top line 30% annually.

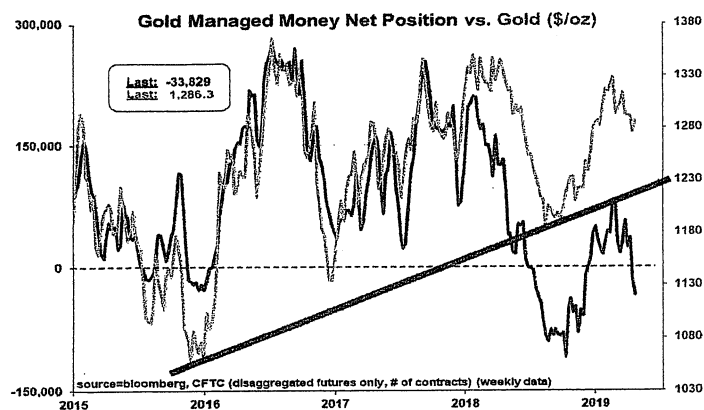
However, NOW’s GAAP earnings are virtually nil when including stock-based compensation costs. For example, in Q1 (just reported) NOW reported 67 cents in earning per share (non-GAAP) on \$789 million of revenues. However, the GAAP numbers include \$158 million in stock-based compensation (20% of sales). Add back those costs and a couple of smaller items stripped out and NOW reported a 1 cent per share GAAP LOSS. NOW pays every category of employee with these stock options: 39% went to sales and marketing employees, 28% went to research and development employees (software engineers) and 16% to G&A (corporate administration). How are they allowed to strip these costs out? By doing so, the stock’s valuation appears more reasonable (“only” a 103 P/E!). NOW’s stock is up 100 points (52%) year-to-date (in just four months). Momentum investors keep pushing the stock higher and higher – 1999-2000-style. What could go wrong?

One thing today that’s different than in 2000: trading volumes in 2019 are shriveling up to the point where relatively small trade orders are having an unusually strong impact on bid and ask quotes. When there is a rush to sell, it will cause panic and price plunges – likely worse than what we experienced in October and December of last year (how soon they forget!). The record number of levered, “short-vol” derivative positions will only make matters worse.

When This Crazyness Ends –It’ll be Good for Gold

Another similarity to 2000 is the distain among U.S. investors for precious metals and mining stocks. When the tech bubble broke, gold then soared 650% to record heights (twelve consecutive years of gains in the 2000s decade). With the cloud, semiconductor and FANG stocks roaring higher at the start of this year, U.S. investors have been dumping metals positions (no fear, so no need for gold). During the steep stock market selloff in Q4 of last year, investors added over 80 tons of gold to the

giant GLD ETF (from October through January). Over the past three months they've disgorged all of those additions.



Similarly, the heavily levered large spec futures traders have been dumping their gold futures contracts and adding a huge number of shorts this year. It's a fact that their buying and selling has a huge impact (short-term) on precious metals prices. See the chart of the Gold Managed Money (mostly hedge funds) net futures position versus gold above sourced from Meridian Macro Research (info@meridianmacro.com). These speculators now have a bigger net short position than they did at gold's \$1050oz bottom in December 2015 and are approaching the record level net short of last summer, when gold bottomed at \$1160 an ounce, yet gold has only fallen to around \$1275oz currently. Given the continued dumping that appears to have occurred over the past week+, when this chart is updated over the next two weeks, the Managed Money net short position may be nearing that of last summer - but with gold over \$100 higher.

The chart shows the close correlation between the rising and falling Managed Money positioning and the direction of gold. However, the red line on the chart shows a pattern of higher lows for gold following the major speculative attacks on it. The speculators appear to be losing influence over gold's price. That's likely due to the huge physical gold buying that's continuing to build from overseas investors. The IMF reported that central banks purchased 651 tons of gold in 2018, the highest amount in over 50 years and that buying continued (Russia, China, India, Kazakhstan, Argentina, Columbia) in the first two months of 2019 (up 61% year-over-year). And all of the US-based GLD ETF selling this year has been more than offset by additions to other international gold ETFs, especially in Europe. The Germans, Italians, British and Swiss have been big buyers of gold ETFs in their own countries in 2019. Chinese and Indians are currently paying unusually high premiums over the global spot price for gold when buying physical.

People around the world are apparently not seeing the global economic situation as brightly as U.S. investors (who have their beer goggles on). All this means is that when the U.S. investors go to rebuild their gold positions and cover their substantial shorts (likely coinciding with a stock market selloff), it's highly likely that if the starting point for gold is in the mid-\$1200s price range, then the all-important 'resistance' level near \$1365 will finally be surmounted. After that, it's anyone's guess how high gold could fly. The chart above is very, very exciting.

Strategy/Positioning

Last month I noted that I'd sold some metals positions and established a relatively large cash balance in order to be able to take advantage of a seasonal selloff for precious metals (especially miners) into early summer. I stated, "I'll be happy to buy the opportunity, and if gold rallies from here...then I'll be even happier." Gold has sold off and I'm happy to have the cash pile. So far, I'm just monitoring and not putting the cash to work. The speculators' net short positions could go higher, sentiment for gold could get weaker than it is today and I'd like to move closer to summer before I begin committing funds. However, as the speculators' net short positioning has increased, I'm more inclined to start buying. Stay tuned.

I currently have put options positions on Micron Technology (MU), Texas Instruments (TXN), Tesla (TSLA), Nvidia

(NVDA), Intel (INTC), Vishay Intertechnology (VSH), Lam Research (LRCX), KLA-Tencor (KLAC), Salesforce.com (CRM), and Microsoft (MSFT). With the exception of KLAC, VSH and NVDA (all of which report results within the next two weeks), the others have expiration dates of July or later. These put options total to a very small percentage of my total portfolio (less than 1%). I'm still short a very small amount of Nvidia (NVDA) stock.

NVDA is expected to report results on May 15. NVDA had to slash guidance last quarter and their current guidance for the remainder of the year is still far too high. NVDA has high exposure to China and the data center end markets. They were both trouble areas for Intel. Additionally, there's still excessive inventory in the graphics chip channels. Last month I bought put options against semiconductor maker Amphenol (APH) just before it reported results and it worked out very well when Amphenol stock immediately dove 10% on a guide-down. VSH is in the same business and hopefully, I'll get a similar result when it reports on May 9. KLAC reports on May 6.

My precious metals positions are my largest positions, by far. My largest miner positions are Agnico-Eagle Mines (AEM), Newmont Goldcorp (NEM), Alamos Gold (AGI), Kirkland Lake (KL), Barrick (GOLD), and Pretium Resources (PVG). This list is not ordered by size. The Newmont/Goldcorp acquisition closed last month and the stock has been under pressure since. Part of the decline may be a rebalancing issue and part has been caused by troubles at a couple of mines. Some of the locals at Penasquito are trying to extort the new management through a partial blockage of the road leading into the mine and Musselwhite is shut down due to a conveyor belt fire. No one was injured and the origin of the fire is being investigated. These should both be short-term problems, but could hurt results in the current quarter. As I typically do, I'll devote much more space to the miners in the next two letters. There's just too much in tech going on (quarterly reports) in the first month of each quarter.

I also own physical gold. I established a significant call option position in the iShares Silver ETV (SLV) last month with expirations in January 2021. I have smaller-sized positions in New Gold (NGD), Franco Nevada (FNV), Pan American Silver (PAAS), Hecla Mining (HL), Wesdome (WDO, WDOFF) and NovaGold Resources (NG).

I don't want to make too much of it - but they won't ring a bell when this grossly inflated stock bubble begins to implode and the nearly 400 points lost in the Dow Jones Industrial Average over the last 24 hours on no particular bad news ("Sell in May and Go Away?") could be the start of something...or at least another indication we're getting closer to the stock market's exhaustion point.

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