

# PIVOTAL EVENTS

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## Signs Of The Times:

Last Year:

*"If a stock I own goes down 50% I'd look forward to it. In fact, I would offer a significant sum of money if you could give me the opportunity for all of my stocks to go down 50% over the next month."*

– Warren Buffett, Wall Street Journal, late May, 2008

Well, fortunately it was not that quick of crash.

*"Credit Storm Back With a Vengeance"*

*"GM back to December 1974 levels"*

– Wall Street Journal, June 23, 2008

*"Bargain farmland sought"*

*"Lured by skyrocketing grain prices, hedge funds and institutional investors...have poured billions of dollars into acreage.. In an effort to get in on the ground floor of what many economists are calling a transformation in the agricultural industry."*

– Financial Post, July 7, 2008

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## This Year:

*"U.S. College grads shun Wall Street for Washington"*

– Thomson-Reuters, June 11, 2009

As the saying goes; *"The route to power in Washington is to go to Harvard and turn left."*

*"Set aside the rule of law, let's strip secured creditors and bondholders of their rights. Take them outside of the bankruptcy process and give them to Democrat allies. It's almost like looking at Putin's Russia. You reward your political friends at the expense of law."*

– Republican House Whip, Breitbart, June 11, 2009

***"The cap-and-trade legislation passed by an House committee is Smoot-Hawley in drag."***

– George Will, June 7, 2009

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## **STOCK MARKETS**

With the "full faith and credit" of the US resting upon the ability of policymakers to continue to depreciate the dollar, we are living in very interesting times.

This is bizarre and would have been a fitting *reduction ad absurdum* if used in 1913 to describe the inevitable excess of undisciplined central banking. Problem is that most would have instantly dismissed the critique, as being too far-fetched – back then. The problem now is that most think that the Fed's truly reckless behaviour can be maintained – at will – and are relying upon the absurdity.

This was also the case last summer, when it was ardently believed that "stimulus" would prevent something bad from happening. But market forces in the form of falling prices and deteriorating credit conditions created an almost perfect fall crash. Our view has been that the Fed would never willingly become prudent and accountable to anything other than arbitrary response.

And, as noted last week the establishment really believes that "stimulus" ended the crash and prompted the 'green shoots' of recovery that a majority of economists think will blossom in the third quarter. Monday's World Bank announcement of a drop in their GDP estimate from minus 1.7% to minus 2.9% was reported to be the hit to stock markets. It is a mark of distinction that they got the direction right, markets ran out of momentum a couple of weeks ago.

Our view has been that after euphoria in May liquidity concerns would resume around mid-year. Monday's "90 percent down day" in the stock markets is as good a start as any, and a nice follow up to the jump in short rates two weeks ago, as well as to last week's slight widening of long-dated corporate spreads.

Other warnings include the upside excesses in commodities that the ChartWorks registered. The CRB index jumped from 200 in late February to 266 on June 11, and the decline to 246 is part of the array of warnings.

However, the markets have had a surprise with the exhaustion of speculation, and a realistic GDP outlook from a high place. Beyond specifics, important tops are as much as a process as an event and this one will take some work to set the next downtrend.

Some key sectors, such as banks, slumped from 37.5 on Friday to 34.5 on Tuesday morning. The concluding rally carried to almost 44 in early May when we advised lightening up, with more aggressive positioning when our Bank Trading Guide registered the "sell".

That came on June 15, accompanied by the initial jump in shorter-dated treasuries. Slight widening of credit spreads since is suggesting that the resumption of troubles expected around mid-year is on track. An illustrative chart is attached.

The hit to most popular games is timely and has become somewhat oversold, and our advice is to sell the rallies. As conditions get worse, as in last fall, relief rallies may only be "day-and-a-half wonders".

## INTEREST RATES

The main thing is that credit conditions were likely to change trend from benign to ugly around now and there has been a modest step in the right direction.

**The Yield Curve** is trying to end the steepening trend that started in May 2007. This is one of the features of the initial stage of a post-bubble collapse of speculation, but, as we have been noting, at some twenty months after the top in the stock market problems resume. It seems that the street runs the 24-month steepening trend to the limit and the turn is not just expensive to those improperly positioned, but is also one of the indicators of the next phase of contraction. The sharp rise in shorter-dated rates on June 8 was the alert, as the two-year increased from .92% to 1.44%. It has since drifted down to 1.12%, which is likely the test.

Once turned, flattening could run into late in the year.

**Credit Spreads:** The great junk-selling panic ended on March 10 at a 42% yield, and the reversal to a weakening DX rejuvenated all of the "good stuff". This ended with what is likely the greatest junk-buying panic in history at less than a 22% yield on June 15, which was a couple of days after the low in the dollar.

The yield has increased a little as spreads have widened a little. Not much so far, but timely. This could deteriorate through the summer and in September head to another disaster. This would include most classes of bonds.

**The Long Bond** was likely to find support at 112 and rebound in price as the uptrend in commodities ended. The low was just under that on – June 10 – and the rebound was associated with other reversals that week. The five-point rally made it to 118(+) and corrected. Positive, but choppy action could run into July.

**The Dollar Index:** The Bible says that "*[T]he love of money is the root of all evil*". We would agree and add that sometimes even moderate affection can get one into trouble.

However, in Biblical times scribes could not have imagined paper and electronic money, let alone a central bank. The latter suggests a new proverb: Central bank hatred of money is the root of financial evil.

Lately, this has generated a monstrous, but official, bear raid upon the US dollar. While this is driving goldbugs and Miseans to distraction, it is not driving the DX to new lows. There is a reason, and that is the whole world has been long hot stories and through the alchemy of leverage – short the dollar.

This was maximized in credit markets in May 2007 when the yield curve reversed to steepening and the usual post-speculation transition of power from central bankers to margin clerks started. The next step in restoring financial power back to conservative hands began as stock markets rolled over in October 2007. The killer step in the series was the classic fall crash, when the dollar soared.

Typically in post-bubble contractions, the senior currency becomes chronically strong against most currencies and commodities for most of the time. Ditto for most stocks and bonds. It's the way deflation works.

The moment the crash began in the fall it was written in stone that there would be a vigorous rebound out to around May, and this would do a couple of things: make some money for traders and it would prompt the establishment to conclude that the ancient recipes of intrusion were valid – at last.

The most recent hit to all the rebounds was associated with a firming dollar. The hit has been a good one, but some relief is possible and the DX could decline a little, perhaps a test of the 78 level.

**The Canadian Dollar** was expected to decline with weakness in the hot games and so far the low has been 86.3. There is support at 85 and the C\$ could firm for a few weeks.

There are some concepts left over from from the 1930s that still defy reason. Interventionist central bankers and rear-engined Porsches.

### COMMENTS FOR ENERGY AND METAL PRODUCERS

**Energy Prices:** On June 2 the ChartWorks registered an Upside Exhaustion on crude oil, and we noted that the high could be set within a couple of weeks. The last such signal occurred in late June last year at much higher prices. At the end of that fateful month, the monthly reading clicked in and we moved the conclusion from cyclical bear to secular bear.

That celebrated high was 147.9 and in achieving a similar Upside reading but in only reaching 73.9 suggests a rally within a long bear market. Perhaps even secular.

However, this decline has been likely to be intermediate, maybe into August, which is not the end of the world. From the high on June 12 the decline has been to yesterday's 68, and gold's rally is lifting the price.

The oil patch, including gas stocks has been a good seasonal play to May for us and we got out. We intend to get long again on weakness late in the year.

Oil stocks (XOI) made it to 1027 at the first of the month, declined to 886 on Monday. This is on a possible decline into around August, but could find some relief for a week or so. Natural gas stocks could see similar action.

**Base Metal Prices:** This sector provided another seasonal as well as pattern gain, and we generally exited positions in May.

Our metals index rallied from 706 in early December to 1176 on June 12, from which it slipped to 1097 on Tuesday. A test seems possible from which an intermediate decline could follow. A severe seasonal low late in the year is possible.

Within the play, copper registered an Upside Exhaustion at 2.25, and the test took it a way up to 2.45 on June 12. The initial slide was to 2.12 on Tuesday and some relief is likely.

Over in mining stocks, the SPTMN set its record high at 958 in October 2008 and in getting over some seasonal excitement in May last year (894) plunged to 178 with the crash. We got aboard on both the crash and seasonal low for a rally out to around May. We exited at around 609 in May and the high was 674 on June 12, and the decline has been to 555.

We were content with the 240% gain, and missed a few points on the rally into the "silly" season.

**Gold Sector:** Ross has been looking for a tradable low in gold and that came in on Tuesday at 913, which was at the Bollinger band.

Wednesday's ChartWorks provided the update and the rebound target is around 990. Last Thursday's Pivot noted that gold in dollar terms could rise even in the face of a steady dollar, which seems to be working out. Perhaps investment demand is increasing.

Another possible indicator on demand has been gold outperforming silver, which within a speculative surge is often the alarm on pending financial distress. In this regard, silver has been expected to outperform gold, along with other commodities until around May. This was the case as the ratio came in to 61.7 (close) on June 4. This was close enough and it has reversed to an uptrend, which is signaling a return of the "bad stuff". A resumption of credit problems has been likely to become visible after mid-year, or next week.

In the meantime, the probable recovery in gold's price is being accompanied by a recovery in commodities with the CRB increasing from the recent low of 246 on Monday. It dropped from 266 to support and a test of the high would be in order.

The rally in gold and commodities may only run for a week or so.

In the meantime, gold's real price was expected to decline into May. The high with the crash was 519 and the low with the revival of good times was 316 on June 12, which week recorded a number of reversals. The increase to 333 on Monday needs a test to establish the reversal and this could be accomplished next week.

On the last surge in golds our advice was to sell the seniors, and then when some of the juniors sprang to life we advised taking some money off that table.

Our strategy remains to sell the big ones on rallies and to buy the smaller ones on weakness. As the financial markets could seriously sell off after the summer it could force weakness in most gold stocks. The other advice was to sell and get short senior silver stocks and this has been onside.

The cyclical recession has further to run and gold's cyclical bull market in the real price is starting another leg up. This represents a significant increase in profitability that could launch the gold sector in early 2010.

	<b>FRI</b>	<b>MON</b>	<b>TUES</b>	<b>WED</b>	<b>THUR</b> NOON
<b>JUNE</b>	<b>19</b>	<b>22</b>	<b>23</b>	<b>24</b>	<b>25</b>
<b>BBB Spread</b>	265	264	269	270	----
<b>Treasury Curve</b>	330	331	326	323	323
<b>Base Metal Prices</b>	450	431	431	438	450
<b>Dollar Index</b>	80.3	80.8	79.8	80.6	80.8
<b>Gold</b>	934.5	922.9	925.4	931.6	937.8
<b>Gold/Commodities</b>	326	333	330	328	----

## JUNK SPREADS AND THE STOCK MARKET



- Spreads had been expected to narrow with the “good times” likely to conclude in May.
- Note the reversal in May last year and again this year.

## BALTIC FREIGHT INDEX



- The BDI represents global trade and last year's failure in April was a warning on last fall's disaster.
- DRYS anticipated the high in 2008, and seems to be doing something similar this year.

## THINKING OF DAVID BROWN

The Institutional Advisors Team has lost a good friend. Freelance artist, David Brown, has drawn some inspired, critical and timely cartoons for our's and other publications.

He suffered a severe fall in late April and passed away on June 12 where he lived for recent years in Orillia, Ontario. Aged 77, David worked many decades in Hollywood and had returned to Ontario where he was constantly illustrating and crafting ideas. We have enjoyed using his work since 2002, and miss him as a friend.

The cartoon we enjoyed the most was published during the worst of last fall's crash. When asked who he used as "models" for the "Upper Alagash Falls Quilting Bee", he responded that they were his "girlfriends" – with a laugh.



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