

PIVOTAL EVENTS

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Signs Of The Times:

It is worth noting that at this time last year markets were in a liquidity panic.

"Canadian banks not lending to hedge funds that are shorting bank stocks."

– Business News Network, March 3, 2009

It seems that understanding of markets was trumped by spite.

"White House Knocks Jim Cramer for Calling Obama Budget the 'Greatest Wealth Destruction by any President.'"

– TV Newser, March 3, 2009

"Toyota has leased a cargo ship to store 2500 unsold cars."

– Financial Post, March 4, 2009

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This Year:

"Our work is far from over, but we have rescued this economy from the worst of the crisis."

– President Obama, February 16, 2010

Other reports included *"On anniversary, Obama vigorously defends economic stimulus"*.

Perhaps enraptured by the brilliance of Obama's advice that all the US needs is more Obama, Senator Chris Dodd exclaimed that Obama will win *"overwhelmingly"* in 2012.

"China's demand for import soybeans will remain 'huge and irreversible'".

This was proclaimed by the director of the Development Research Center of the State Council in China.

– Bloomberg, February 24, 2010

"A 'wall' of junk debt maturing in the next four years will increase the risk of corporate defaults."

– Bloomberg, February 24, 2010

This was from a report by Bank of America that included a chilling turn of phrase. *"Almost 90% of such bonds is due to be REPAID between 2012 and 2014."* [emphasis added]

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STOCK MARKETS

Stock markets have coped with the sovereign debt problem rather well. In part, this could be due to the size of the hit down to early February which was enough to prompt a good rebound. The other aspect is the duration and we had originally thought that the good times could run well into March.

This would be assisted by an intermediate rally for crude oil and base metal prices, which seems to be working out. However, last week there were some reports that are disquieting to many pension fund managers. Some of the establishment's economic numbers came in way below consensus expectations and then there is the sovereign debt problem.

If the big participants back off from being optimistic to just complacent it sidelines a lot of buying. Thus, our reading last week that progress over the remainder of this rally could be "choppy".

The overall action remains within the "rounded top" pattern that we thought would end the big rebound out of the crash. This, along with the change in the corporate bond market would likely occur within the "turn-of-the-year" window. Last week the ChartWorks reviewed the combination of the unusually low mutual fund cash position and the signal from the gold/silver ratio (GSR).

The chart is attached and is worth reviewing, with the note that the ratio is plotted as the silver/gold ratio to show sympathy with the direction of the stock market. The ratio tends to lead corresponding changes in the stock market. Moreover, changes in the ratio have anticipated some big events. The huge blow-off high in gold and silver in January 1980 was anticipated by the reversal in the ratio by a couple of weeks.

The combination of exceptionally low mutual-fund cash and the pattern in the GSR confirms that an important top is completing.

INTEREST RATES

As the saying goes *"Credit is suspicion asleep"*, and it seems that one of the main exercises of the Fed is to keep investors complacent. This has been done through the garbage notion that only one bank can get in to trouble at one time. Then brilliant central bankers will bail out that one offending bank and all will be well.

The basic problem has been to assume that all banks won't willingly engage in reckless lending at the same time. This requires a studied ignorance of financial history and a brainwashing by theoreticians who have never reviewed market history. Actually in too many cases the gullible only require a "light rinse".

For some time, these pages have suggested that the establishment's precocious theories would work if enough of the public had taken, at least, Economics 101. Perhaps such an

educated consumer would follow policymaker dictates with more conviction. Reluctantly, we have examined this concept and have decided that this has been wrong. The main financial problem is that too many central bankers have taken, and passed, Economics 101.

It has been decades since a central banker was an actual banker, and commercial banks haven't been run by bankers in a couple of generations.

Back in the good old days when the Fed and New York banks were run by real bankers there was much less recklessness with disasters limited to, say, the extent of the 1929 example.

Today, Canada's federal government has revealed a "budget". This is an annual event and this writer has been fully employed in the investment business for 47 of them. Each as tedious as the one before. It was in the mid 1960s when the big investment dealers began hiring economists and the game of "crunching" the numbers began. There was the notion that part of the budget was "policy" that would improve the course of the economy. Economists would, with great sincerity, change GDP projections from 3% to 3.25%, or the other way around.

This required dedication to the belief that an economy was national. It also required no knowledge of the magnificent speculative bubbles and their consequent contractions that have been global events--since the first one in 1720. There is no such thing as a national economy.

After ignoring so many budgets, our main conclusion is that all they do is artfully obscure the agreed-upon rate of state theft.

"The art of taxation consists in so plucking the goose as to get the most feathers with the least hissing."

– Jean-Baptiste Colbert, Finance minister, 1665-1685, to Louis XIV

Back to the credit markets and if the sovereign problem was limited to just one country no doubt the theory about the bailout of last resort would work. But, as we have been reviewing, all, repeat all, countries become profligate at the same time. It has much to do with a mania in credit.

We don't recall reading that the senior central bank would be called upon to be the lender of last resort to only one country failing, let alone a cluster of them.

In 2007 the sub-prime mortgage disaster began and the establishment boasted that it was "isolated" and could be "contained". In following the post-bubble path (almost typed bath) this was not the case as in 2008 liquidity from Libor at the short-end to junk disappeared.

The panic continued to a year ago when in late February a couple of indicators reversed trend. One was the gold/silver ratio turning down and our Gold/Commodities Index turning down. Then on February 27, Ross made the call on an important change in the currency markets with the dollar heading down.

The carry in corporate bonds, particularly for junk, has been outstanding and prices reached an Upside Exhaustion in January. We took this as culminating action and it was

likely to occur in the "turn-of-the-year" window. The low yield was set in the week of January 12 and the chart has been working on an important bottom for interest rates.

For the high-yield the low was 8.53% on January 14 and the high has been 9.42% on February 12. As part of the rallies into March the yield has slipped to 8.87% yesterday and the move is a test of the low. The unheralded return of risk to sovereign bonds will likely inhibit the return of carefree buying to the corporate sector.

Most corporate bonds are working on an important reversal that could be completed by June.

As with the constructive turn a year ago, our indicators should assist in advising the turn down. Gold's real price and the silver/gold ratio are still sympathetic to the advance in the positive stuff that could run into late March.

Currencies: As the saying goes *"It is hard to keep a good thing down"*. The Dollar Index rallied to our target of 80 and became overbought enough to prompt a worthwhile correction. Instead, the overbought condition is being eased by a narrow trading range. This along with the seismic temblors on orthodox economic numbers and sovereign debt is providing some caution on conventional investment vehicles.

However, we hope that there is enough of a drop in the dollar to provide a technical exit for stocks, corporate bonds and commodities.

COMMENTS FOR ENERGY AND METAL PRODUCERS

Energy Prices: Crude has been on a nice rebound from 71 in early February to 81 yesterday. There is considerable resistance at the early January high of 83. If this is reached over the next 4 weeks, or so, it would be vulnerable to seasonal weakness into May.

Oil stocks (XOI) have recovered from 890 to yesterday's 1042. There is overhead resistance just above this level. The last high was 1130 in early January, which compares to the 1133 reached in October.

The record high for the oil patch was 1663 in May 2008, the subsequent low was 760 in March a year ago.

Natural gas suffered an unusual squeeze due to an unusually cool winter. Gas prices have been deflating ever since the high of 6.08 in early January. There is considerable support at 4.45 and the action is approaching an RSI that could end the move.

Often natural gas follows crude oil and a rally seems likely.

Gas stocks have been acting better than the product with the XNG rebounding from 510 to 550. This could continue for some weeks.

Base Metal Prices have been expected to rebound out to March. The low on the GYX was 335 in early February and after a good correction it has reached 400. Metal prices could rise for a few more weeks.

Base metal mining companies (SPTMN) have rallied from 920 to 1070. We would begin to look for topping action in a few weeks.

We should keep in mind the pattern that led to copper's 21 percent plunge. It only happens at important highs.

Gold Sector: Senior golds were likely to rally with the financial markets into March and this has been working out. The low for the HUI was 320 and it has made it to 433 yesterday. This can run for a few more weeks.

Gold itself has also been expected to rally and it has been doing well without much of a decline in the dollar.

With a rebound in orthodox investments, gold's real price would likely decline. From the last high of 370 in early February, our Gold/Commodities Index has slipped to 341 and could get a little lower before turning up. This along with the gold/silver ratio turning up would signal an end to the current financial rebound.

The ratio has declined from 71 on February 8 to 66 today. It is worth noting that the RSI is at 40. Around 32 to 30 could end the move.

When it turns up it will indicate that the relief rally in stocks, corporate bonds and commodities is tiring. Rising through 71 would indicate the return of troubles.

Investors and traders should begin to think about lightening up in the seniors and await the correction to accumulate smaller caps.

We expect the investment demand for gold to continue to grow as jewellery demand diminishes in your basic post-bubble contraction. The real price will continue to increase prompting substantial increases in production.

This will continue to inspire the big companies to take over exploration ventures.

	FRI	MON	TUES	WED	THUR NOON
FEB./MARCH	26	1	2	3	4
BBB Spread	440	444	435	429	----
Treasury Curve	373	375	378	377	371
Base Metal Prices	609	628	631	638	639
Dollar Index	80.3	80.7	80.5	80	80.6
Gold	1117.6	1118.7	1134.6	1139.6	1130.6
Gold/Commodities	349	344	347	341	----

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Stocks and the Gold/Silver Ratio



- The pattern in the ratio (plotted inversely) signals noteworthy tops in the stock market.
- It is working on one now.