

PIVOTAL EVENTS

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Signs Of The Times

"Banks Not Lending? Corporate Borrowing Soars in 2011"

– USA Today, December 23

"The Fed's Mission Impossible"

"The Fed's proposal opens an eloquent ode to the evils of too-big-to-fail and moral hazard. Then it spends 168 pages describing exactly how it's going to stop any large financial institution from ever failing again."

– Wall Street Journal, December 29

This obfuscation came under the heading *"Enhanced Prudential Standards Early Remediation Requirements"*.

"Derivatives that track the risk of owning India's bonds and the rupee are surging the most since 2008."

– Bloomberg, December 30

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Perspective

It has been an interesting quarter. Stories out of Europe about continuing financial and political pressures have been offset by a favorable period for stock markets. This was likely to run from early October into January, and the action was expected to be choppy. Essentially, we are where we expected to be and it is time to take the winnings off the table.

It is worth emphasizing that financial and political pressures will continue and at times be severe. Quite likely markets will turn down and dramatize another acute phase of the ongoing contraction. This could be anticipated by the stock market indicating a top, money market spreads (Libor) continuing to widen and the next rise in the gold/silver ratio.

On the the stock market, Ross has an indicator based upon the VIX that is giving a "heads up". This follows and is independent of a similar alert from the gold/silver ratio.

CREDIT MARKETS

Political pressures are varied but it is worth focusing on the struggle by politicians and their agencies to impose arbitrary theories upon the market place. This has been going on for a long time on yet another demonstration that an experiment in unlimited government requires unlimited funding. The latter has been provided in the usual way – confiscatory taxation, deliberate currency depreciation and massive issuance of debt.

As part of what will eventually be seen as a great political reformation the tax payer is finally stating a strong "No!". Deliberate depreciation will be again constrained by the next slump in asset prices.

This will include stocks, commodities, real estate and all classes of bonds--including long treasuries. The latter is building a huge top. Of course the US dollar will become firm as speculative positions are liquidated. It will be another one of those times when the Fed is denied the dangerous privilege of deliberate depreciation.

At important highs "blue chip" companies may be soundly managed, but their stock prices get bid up by speculators to unsustainable levels.

For generations this also held for the long bond, whereby government finances were run as conservatively as possible. Recently government fiscal practices have become extremely reckless with a political adventurer in the White House and financial adventurers in Treasury and the Fed. This is without precedent and yields have not been providing an appropriate discount. This is because the "stimulus" doesn't go to losers, but to the winners and the asset bid to new highs has been the long bond.

Prof. James Tobin described a bubble as "*Speculations on the speculations of other speculators who are doing the same.*"

The old and continuing "loser" has been housing and it looks like China is joining this melancholy sector. Long-dated treasuries are on the verge of becoming the next big and new loser – with profound consequences.

Municipal bonds participated in the "good stuff" likely to run into January, and the rally has been strong enough to register technical "alerts" similar to those seen at previous highs. The chart follows.

COMMODITIES

Out of the oversold in early October base metals (GYX) accomplished a quick rally of 15% and have been fading over the past 8 weeks.

Agricultural prices (GKX) were late to turn up and then accomplished a 12% gain in only a couple weeks.

We had thought that most commodities could rally into January as an initial target. The action has been weak and that is telling a story about the strength of the global economy. Ross's study on crude oil is expecting an immediate decline, followed by a rebound into March. The latter would generally help commodities.

Our "Forecaster" expected commodities to complete a speculative surge into April 2011 and then set a cyclical bear. The high for the CRB was 370 in April and two lows have

been set. At 292 in early October and 293 in mid-December. The previous cyclical high was 473 set in mid-2008.

CURRENCIES

Dollar down over the next month or so and then up.

PRECIOUS METALS

We have gone back to the heading "Precious Metals" in anticipation of a brighter market.

Our exit was based upon our Forecaster that expected a commodity blow out last April. Within this, silver and gold were outstanding participants. At the top the action the silver/gold ratio had enough momentum to drive the RSI to 92, which was the highest seen since the magnificent mania that concluded in January 1980.

The equivalent in downside momentum and sentiment is now being recorded. The recent low on the daily RSI is about as low as it gets. And sentiment has been bleak with the Sentiment Trader numbers for the end of the year at the lowest since 2008 (repeat 2008).

Gold and silver stocks are poised for a significant rally.

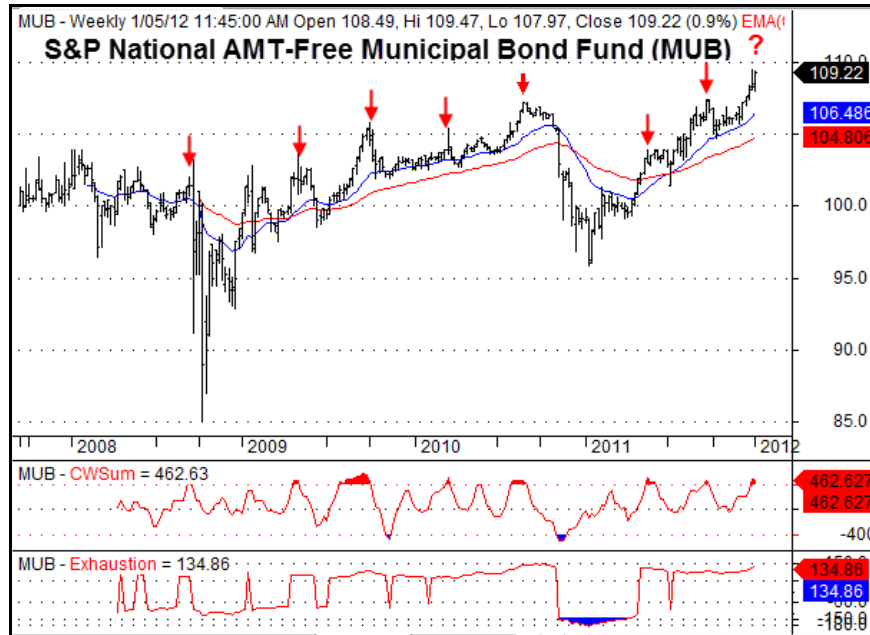
Currently, we monitor the seniors through the HUI index. It is recording a monthly Springboard Buy signal.

Historically, we use the old XAU index and similarly low readings were recorded in January 1995, September 1994, February 1982 and in August 1976. Those are all of the opportunities with this indicator and the latter was set with the low for gold at \$103.

The emotional hangover for the sector was at its worst over Christmas – our heads are clear and it is time to party.

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Municipal Bonds



- The MUB is registering the same overbought alerts that have been seen around interim highs.
- Declining through 106 would set the downtrend.

Italian Bonds



- Rising through 7.25% would be trouble.
- Rising through 7.50% would be part of a panic.