

TECHNICAL SCOOP CHART OF THE WEEK

Charts and commentary by David Chapman

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Trouble is a Brewing!



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There appears to be trouble brewing along a number of fronts of which Greece might only be one of them. Above is the sinking ship known as Greece as represented by the Global FTSE Greece 20 ETF (GREK-AMEX). Greece is just one of a number of growing global problems. The problems are both economic and geopolitical. All or anyone of them could have a profound negative impact on global stock markets, gold and oil.

As the first quarter of 2015 winds down, there are a number of ill-winds that threaten the global economy. One would think that seven years after the financial meltdown of 2008 and seven years of unprecedented amounts of QE coupled with historically and abnormally low interest rates that the global economy might be humming. Instead, it has been plagued by low growth in North America, and, anaemic growth and

recessionary conditions in the Euro zone and Japan. China, the other BRICS and emerging markets are also slowing. Parts of the Euro zone have spent most of the period not just in a recession but also in what one can only be described as an economic depression with high unemployment and social unrest (Spain, Greece and to a lesser extent Italy and Portugal).

World trade is beginning to contract not grow after growing for the first few years following the financial collapse of 2008. Debt has grown at an unprecedented rate but the debt growth has not been accompanied with comparable economic growth. Most tellingly global debt to GDP has grown from 269% in 2007 to 286% in 2014. A sharply rising US\$ is showing signs of causing financial instability particularly in emerging markets.

The Greek situation continues to deteriorate. As the Economist points out (*Dangerous Liaisons – The Economist, March 21, 2015*) the Greek crisis has become not just an economic crisis it is also becoming a geopolitical crisis. But the economic crisis continues to deteriorate as Greece could run out of cash as early as April. The spectre of a Greek default could hang over the heads of the Euro zone. Greece is also pulling the levers by demanding war reparations from Germany (Germany is Greece's largest creditor) and as well as cozying up to Russian Premier Vlad Putin. As the Economist notes – is this a whiff of blackmail?

Since the election of the Syriza Party in January, the Greeks have upped the ante in the Euro zone. Many wonder why they would in particular alienate their biggest creditor and to a lesser extent France and Italy two countries that one would think Greece might wish to please. As to Russia, both Greece and Russia are Orthodox countries so there has always been a natural affinity. The biggest thing hanging over Greece has been the austerity programs pushed on Greece in order to receive loans from the Troika – the ECB, the IMF and the EU. Nonetheless Germany has pushed back hard against easing austerity or altering loan provisions largely because if they give into Greece then others such as Spain and Italy might come demanding a similar deal. Austerity in particular has considerable social unrest in Greece as it has elsewhere.

Germany can't be seen to give in because at the end of the day Merkel has to please Germans not the Greeks. This in turn is another possible failure of the EU experiment and why the zone still might fall apart led by Greece if they were to exit (the "Grexit"). But all of the commotion is having some negative and positive effects. Below are two interesting but opposite charts. Money has been pouring out of Greek banks at a supposed rate of €2 million per week. The National Bank of Greece (NBG-NYSE) has fallen roughly 26% in 2015 but it has fallen an astounding 99.8% since it peaked in July 2007. Greece and Greek banks are heavily exposed to Euro zone banks particularly German banks so a complete Greek collapse could have a further negative impact on the German and Euro zone banking system, which in turn could require its own bail out. Except today, the laws have been changed to bail-ins rather than bailouts. Depositors and bondholders would be most impacted under that scenario.

While NBG has what looks like an enticing falling wedge triangle forming the bank might also be a candidate for bankruptcy. Meanwhile the chart of GREK appears as one that is in a longer term meltdown and it could soon fall under \$10 making new lows. Has there been anything positive about the Greek crisis? While money has been fleeing the Euro zone largely being exchanged for US Dollars money has also been flowing into Germany as the Euro zones strongest economy. The result has seen German bunds move to negative yields and the German DAX soar to record highs. Germany has become the magnet for funds in the Euro zone.



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While many in the Euro zone are suffering from the effects of austerity and the high price of imports, Germany has been able to largely weather the storm primarily because exports have grown due to the sharply lower Euro. If for whatever reason the Euro zone were to start to break up or just Greece leave Germany could benefit further. Not surprisingly, however, with stock markets off this week the DAX has also fallen.

The DAX's bull channel is currently up over 14,000. Given that the DAX has broken away from a more gentle bull channel could the DAX rise to those heights. The DAX breaks down under 10,000 although a move back under 11,000 would be a warning sign that a further decline could occur. The downside of a breakup of the Euro zone is that Germany could see its currency soar if they were to go back to the Deutsche Mark.

Both sides are essentially playing a game of "chicken" to see who blinks first. Trouble is Germany believes the Euro zone is protected and can withstand a "Grexit" without adverse consequences. As to the Greeks they believe they can default and stay in the Euro zone. The trouble is both sides could be wrong and a "Grexit" might become quite destabilizing for global financial markets. As well there are potentially dangerous geopolitical consequences of Greece's ongoing overtures to Russia. Further Greece is not the only Euro zone country making overtures to Russia.

But a potentially more destabilizing event could be slowly looming. The rapid rise of the US\$ over the past year (up roughly 22%) has been causing numerous dislocations. The rapid rise of the US\$ has helped the Euro zone and Japanese exports but it is squeezing US exporters and slowing the profits of the US multinationals whose operations are predominantly in foreign countries. The sharply rising US\$ also means the US is importing everyone else's deflation. This is causing a problem for the Fed who may want to raise interest rates but its hands are tied due growing signs of deflation.

Exports may be the least of the problem. The big problem is that over the past several years the world went on a debt binge denominated in US\$. US\$ loans and bonds offered a cheaper alternative then local currency primarily because US interest rates were lower. The result was the world now has according the Bank for International Settlements (BIS) some \$9 trillion of debt issued by sovereigns and foreign corporations. China has over \$1 trillion of US\$ denominated debt primarily backed against its shaky real estate market. Emerging markets are estimated to have issued over half of the \$9 trillion.

Given the rise in the US\$ the debt has become quite expensive to service. Many have earnings in their local currency but owe in US\$. Much of the debt is held by Euro zone and US banks as well as pension funds and large funds. Large countries such as Russia and Brazil are heading into very deep recessions and China's real estate market is sitting on "quicksand". Could there be a blow-up of foreign issued US\$ debt such as a sovereign default or a real estate collapse in China? The Fed potentially hiking interest rates does not help as that would most likely strengthen the US\$ further. A wrong move could trigger a Lehman Brothers type of collapse. In a crisis money would most likely flee to the safety zone of the US\$ and Germany and possibly gold. None of that suggests that stock markets would benefit.

Apparently, Ukraine is on the verge of financial collapse. Moody's has downgraded Ukraine's debt to Ca, which apparently signals that default could be imminent. Ukraine owes its money primarily to Euro Zone and Russian banks. Sanctions have hurt Russia and if further sanctions were placed on Russia it might trigger a Russian default deliberate or otherwise. Russian banks and corporations are primarily exposed to the Euro Zone and even US banks. It is estimated that Russia has upwards of \$600 billion or more in debt denominated in US\$. The debt was primarily issued by Russian corporations and it is not sovereign debt although it is implied that Russia would back the debt.

The crisis in Ukraine could now be taking a different twist with the recent ouster of the governor of Dnipropetrovsk, the oligarch Kolomoisky by the President Poroshenko. Oligarchs and corruption run Ukraine. Despite being President, Poroshenko does not control all of the military. The country is divided between the Ukraine military as well as militias loyal to their own leader. The militias have their own agendas that do not necessarily align with Poroshenko and the Ukraine military. Kolomoisky controls militias that were instrumental with the fighting in Eastern Ukraine. The Ukraine military is trying to disband these militias with little success.

The border along Russia with the Baltics and elsewhere along the Russian border has become an armed camp with both NATO and Russian troops and armaments lined on both sides of the border facing each other. Russia has moved nuclear tipped missiles into the region. Both sides have been conducting ongoing dangerous reconnaissance along the borders along with ongoing military exercises. There continues to be talk of arming the Ukraine in the dispute over the breakaway Russian Eastern provinces. NATO warships prowl the Black Sea dangerously close to Russia. Many are worried that an accident or an inadvertent spark could trigger WW3 with nuclear weapons.



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Now into the fray comes the crisis in Yemen. Yemen may be inconsequential as an oil producer (ranked 37th in the world) but Yemen is on the entrance to the Red Sea at the Bab-el-Mandeb Strait. The Gulf of Aden is also the entrance to the Red Sea while the Red Sea leads to the Suez Canal and the Mediterranean Sea. It is the world's 4th largest oil delivery route delivering primarily to Europe.

The crisis in Yemen had started as a civil war between the former President Saleh and the al-Houthi tribes who dominate what is North Yemen and the current President Hadi and his forces largely in the South of Yemen. Saleh was ousted in 2011 during the initial Arab "Spring" uprisings. Saleh was originally backed by the US, as he was an ally in the US's fight against Al Qaeda. Hadi was brought to power in 2012 in a

dubious election where he was the only candidate. He was backed by the US as well. The population of Yemen is roughly 60% Sunni and 40% Shiite. The Houthi's are Shiite sect and have aligned themselves with Saleh to oust Hadi. Hadi has fled Yemen for Saudi Arabia.

But into the fray has come Saudi Arabia and an Arab coalition of 10 to oust the Houthis. Saudi Arabia is Sunni Muslim. Shiite Iran, Saudi Arabia's enemy, backs the Houthis. Also in the mix in the country is Al-Qaeda in Yemen and possibly even ISIS forces. It is now believed that Saudi Arabia has amassed an army of 150 thousand that may be prepared to invade Yemen to take out the Houthis.

Oil prices have leaped roughly 6% since the crisis broke. Gold has also jumped. Saudi Arabia is the world's largest producer and exporter of oil. The Saudi fields are far from Yemen and it is unlikely that Houthi missiles could hit the Saudi fields. But anything involving Saudi Arabia and an important oil chokepoint spikes the price of oil. As well apparently, the US is providing logistical support to Saudi Arabia. The wild card that could change the entire situation is what if Iran or even Russia got involved to help the Houthis. Both Iran and Russia have demanded a halt to the Saudi intervention. Irrespective, many analysts believe that neither Iran or Russia would become militarily involved.

Oil prices have managed to reverse higher over the past couple of weeks. Short-term the weekly WTI oil chart now looks bullish. A firm breakout above \$54 could see oil prices move to at least \$60 with an outside possibility to \$65. While I am not showing a chart of gold, gold prices are also looking positive. A break above \$1,240 would confirm the potential for a move to at least \$1,350. Trouble in the mid-east may be the perfect panacea for both gold and oil.

The final item worth mentioning is the US attempts to throw roadblocks against the Asian Infrastructure Bank (AIIB). The AIIB is a new financial institution in Asia meant to provide finance and support for infrastructure projects in Asia. The bank is regarded as a rival for the IMF, the World Bank (WB) and the Asian Development Bank (ADB). Unlike the latter three institutions that are generally regarded to be dominated by the US, the AIIB would be dominated by China. The AIIB would be Yuan based as opposed to the IMF, the WB and the ADB which are US\$ based.

Where the conflict comes in is that the US has gone out of its way to try to persuade other western countries to stay out of the AIIB. Many are not listening fearing that if they don't join they will have no say and it might cost them major business in Asia. As a result, Australia, Great Britain, Germany, France and Italy are considering either joining or have already joined. South Korea is also considering joining. Left out thus far besides the US are Japan and Canada. There is also a new BRICS bank coming that is expected to be a direct challenge to the IMF.

China has upwards of \$4 trillion of reserves that needs to be recycled. What the Chinese are doing is not much different than what Great Britain did in the 19th century and the US did following WW2. As noted the US effectively runs the WB and while Europeans are generally at the top of the IMF the US maintains a veto. China and many others want to get out from under the hegemony of the US and the US\$. The AIIB is a start but it is also a direct challenge to US and US\$ global hegemony.

Greece and the potential for the "Grexit"; \$9 trillion in US\$ denominated debt as the rising US\$ puts the squeeze on; the great powers (NATO and Russia) facing each other along the border with Russia; the potential for a Ukraine default; a new crisis in the Mid-East; and, the US and China facing each other in a quest to change the financial direction of the world are all brewing trouble spots. Any one of them alone might not be a huge problem but put them all together and there could be trouble brewing.

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