QUICK PIVOT

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Surreal Policymakers Are Blowing Serial Bubbles

The above is more a sarcastic observation than a title for this edition. A play on words that is not inaccurate. Also it is descriptive of a mania in policymaking whereby central bankers in their desperation to prove their theories have exaggerated speculation in the All-One-Market (AOM).

In November we noted the ability of a methodical rise to soar to compelling conditions, become unstable and then fail. If it becomes big enough the buying frenzy drives our proprietary Momentum Peak Forecaster (PMF) to a critical high. Anything above 1.21 has been followed by a major high and slump.

It does not matter what the focus of speculation is. Examples since 1970 include credit spreads in 1998 that led to the LTCM disaster and housing in 2006 that led to the 2008 financial collapse.

In early December the "Forecaster" reached 1.25, which prompted our first alert. The implications were reviewed two weeks later when it had reached 1.27, which compares to 1.31 before the 1987 Crash.

This is plotted weekly and the number is now at 1.284 and is running out of momentum. Let's call it 1.28 and conclude that the formal signal has been accomplished. In which case the speculative frenzy in markets and policymaking is about to fail.

Typically, the lead from alert to failure has been within one to two months, which is a rather wide time window. There are some indicators that are confirming that both private and central bank speculators can no longer continue to bull the markets.

STOCK MARKETS

"Get set for a great bull market. The stock market leads the economy."

This was reported in December and it is worth noting that "great bull markets" are different because the culmination does not lead the recession but is virtually instantaneous. Using NBER determinations, the peak in the business cycle and financial mania occurred with a month of each other in the 1929 and 1873 examples. In the 2007 example stocks peaked in October and the recession started in that fateful December.

Lately our view has been that recovery in markets and the economy is the first business cycle out of a fairly typical post-bubble crash. If the AOM (including stock markets) is peaking now we would expect that the business recovery is peaking as well.

Our "Forecaster" has something to add to this. In examples that included big action in commodities the signal occurred close to the start of the recession using the NBER determination.

In 1973 speculation encompassed all commodities and our Forecaster registered on November 23 and the recession started that November. The next sensation in commodities was the 1979 precious metals mania. The Forecaster registered on November 9, the high for gold and silver was on January 21, 1980. That recession started in January 1980.

Over the past six weeks the stock market has reached bullish sentiment numbers associated with previous important highs. One, the Trin, has the most exceptional reading since the 1960s.

Risk on the downside is becoming more obvious and our Forecaster suggests there is only a little time left for the favourable stock market and business cycle.

COMMODITIES

This time around, the AOM phenomenon definitely includes "big action" in commodities. In which case our Forecaster includes a warning, not just on the stock market, but upon the economy as well. The cycles for business activity, commodities and stock certificates are going to turn down together.

The CRB commodity index has registered the highest weekly RSI since the cyclical high in 2008. That one recorded a momentum divergence as the index made the final high. Recent action is similar but the RSI is not as high as in 2008. At 335 the index is not as high as the 473 reached at the cyclical high.

Within this, agricultural prices (DBA) have gained 45%, as base metals have soared 145%.

Our work on commodities, particularly base metals in 2008 mainly rested upon the developing "train wreck" in credit markets and the firming dollar.

These are currently part of the equation and now our Forecaster has clicked in. A cyclical peak in commodities is developing.

CURRENCIES

The Fed has blown another in a series of bubbles. It reminds of the rock star, Janis Joplin, who it is said could never blow under .08 on the breathalyzer. The Fed has been blowing above .08 since it opened the doors in January 1913.

Despite recent massive efforts to depreciate the dollar, the DX has set rising lows. The major low was 70.7 in March 2008, the next was 74.2 in late 2009 and the latest was 75.6 in early November.

Each law, including November's, was anticipated by our Downside Capitulation model and the Sequential Buy pattern.

Another technical point is that negative sentiment at the 2008 and 2009 lows was at 7 Percent Bulls. At only 3 Percent in November bearish sentiment was extreme.

The DX is likely in an intermediate uptrend.

It could be significant. On the huge speculative reversal in January 1980 the decline in the DX completed a Sequential Buy pattern and set the low at 85 on January 18 and the high for precious metals was on January 21.

The dollar soared 12 percent to 95 in the next three months.

PRECIOUS METALS SECTOR

Too many analysts have been drinking the silver Kool-Aid.

In any bull market for precious metals, silver will outperform gold. Our benchmark for a correction in a bull market is when the RSI on the silver/gold ratio gets to the low 70s. That happened in early October and a moderate correction set up the "Springboard".

The next jump took the RSI to 86 in November, which usually is followed by more lengthy setbacks for gold and silver. We've been calling it the "Correction Zone".

And now our dispassionate Forecaster has registered a rare excess in the overall speculation.

Of interest, is that the last time this registered when precious metals were the focus occurred with the Hunt Brothers' fabulous attempt to drive the gold/silver ratio to 15. It briefly hit that in January 1980. We have seen no forecasts from a major firm that the ratio would decline to that level until Sprott Asset Management outlined a target of 16 (The Globe and Mail, November 29, 2010).

Following the attempted corner by the Hunts, the lengthy banking distress took the gold/silver ratio to 100 in 1990. Nothing startling about that – it was part of a long-term pattern.

That disaster extended the ratio's history of setting higher highs on every great financial disaster since the 1825 example.

On that bubble the annual average for the ratio was 15.8 and at the end of that Great Depression the number was 17.2. With the bubbles of 1720 and 1772 the ratio stayed in a tight range from 14.7 to 15.4.

On the 1873 bubble the ratio was 17.3 and at the conclusion of that Great Depression in 1895 it was at 34.1.

In the Roaring Twenties, the gold/silver ratio was 22.1 in 1920, the year commodities blew out. In 1929 it averaged 42.1 and with that Great Depression it reached 91.

With the subsequent expansion and era of tangible asset inflation the ratio declined (briefly) to 15 in January 1980.

Within today's excitement, silver has been outstanding. Outstanding enough to complete a weekly Sequential Sell pattern. The following chart notes that the typical sell off can run up to two months and declines have been in the order of 35 percent.

Traders and investors should be prepared for Mother Nature's disregard for fundamental analysis of silver's supply and demand numbers. On the next liquidity crisis the

gold/silver ratio could get to 100. In time of crisis it acts like a credit spread. In the 2008 panic it reached 84.

Gold and gold shares have also been in the Correction Zone, but the decline may not be as severe as for the silver sector.

In looking to the brighter side, gold's real price is close to starting an important advance. Typically, one of the features of a post-bubble contraction is that gold's purchasing power increases for a couple of decades and this enhances gold mining profitability.

We remain bullish on the long term for the gold sector.

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"If the gold standard could be reintroduced in all of Europe, we all believe that the reform would promote trade and production like nothing else, and would stimulate international credit and transfer of capital to the places where they are most useful. One of the greatest elements of uncertainty would be suppressed."

– John Maynard Keynes
Commercial Manchester Guardian, April 20, 1922

- Keynes was reasonably lucid until he took a bath in the 1929 crash and sought solace in the "liquidity preference".

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SILVER
Sequential Sell Setups

- A tradable correction is possible.
- It could run for up to two months.
- Following similar setups declines have been as high as 35%.