PIVOTAL EVENTS

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Signs Of The Times:

Last Year:

"Investors are turning to riskier investments as the turmoil that has racked stock and bond markets now shows signs of fading."

--Wall Street Journal, April 28, 2008.

"Junk-bond market is closing out its best month in years."

--Wall Street Journal, April 30, 2008.

"For the first time in months, analysts and executives sound upbeat Many see a broad, sustained recovery in both the economy and the financial markets in the second half of the year. It is a remarkable revival in attitudes from just a few months ago."

--International Herald Tribune, May 2, 2008.

The article also included the classic: "The optimists believe it is different this time."

The key failure was likely to occur in the third week of May, and it did.

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This Year:

"President Chavez is relying upon private banks to feed Venezuela's increasingly anemic recovery, underscoring a baffling affiliation between the country's banking chiefs and a socialist government that threatens them with nationalization."

--Dow Jones. April 15, 2009. Comparisons between Obama and Chavez are interesting.

"Bank Lending Keeps Dropping"

"Lending at the biggest banks has fallen more sharply than previously realized, despite government efforts to pump billions of dollars into the financial system."

--Wall Street Journal, April 20, 2009.

"More upbeat signs in US market"

"Homes--Bottom is at hand and sales will turn up in the second half of this year."

--Financial Post, April 25, 2009.

Obviously, and thankfully, uplifting spirits have been blossoming like wild flowers on sunlit mountain slopes. We have been expecting a lot, even too much confidence to be expressed in the April-May window.

Last summer, we observed that central bank attempts to make the right rate cut with perfect timing in order to keep a mania going have been impossible. Quite like the certain wisdom that if you pitch your voice just right as you call "Kitty, Kitty, Kitty"--the cat would always come.

The establishment was certain that "stimulus" would keep the boom going, and then that more of it would surely prevent something bad from happening.

Then the financial collapse replicated the 1929 crash with remarkable fidelity. In even greater desperation even more "stimulus" was applied and now that orthodox investments are up "stimulus" is working as it should have all along. After all--Keynes was right--wasn't he?

No way! The "master" was flying on some personal revelations about how interest rates and currencies could be manipulated to create one steady throb of happy motoring. The problem is that Keynes was ignorant of economics, and of greater importance-- ignorant of market history. He and his disciples since have never known that someone else also thought that throwing credit at a credit contraction would make it go away.

In the 1618 to 1623 bust an intellectual by the name of Misselden proposed the idea, as did John Law in 1716. Well, the one thing you can say about ignorance is that you can never be accused of plagiarism. It is worth adding that Misselden mentioned a problem with pirates off of Tunis.

As to all the relief out there that carelessly contrived theories are at last working--just think of it as the cat's return as coinciding with your supplications.

We have been using the post-bubble rebounds to April 1930 and to May 1874 as perhaps the best guidance for this year, and so far, so good. Good--the move is becoming sensational in turning from extreme despair to euphoria, with only a brief stop at complacency.

As outlined below, this is providing an outstanding opportunity that has been likely to displace the 1937-1938 model.

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STOCK MARKETS

We used the following quote in our November 27, 2008 edition as a guide for the high possible for around May:

"It is apparent that the public preference for stock is not only as marked as ever, but also the will to speculate is still a speculative factor not to be overlooked. The prompt return of huge speculation and the liberal manner in which current earnings are again being discounted indicate that it will be difficult to quench the fires of stock market enthusiasm."

That was from The Trader column in Barron's a few weeks before the rebound high in the spring of 1930. Due to the Obama plunge in February the development of post-crash euphoria was interrupted by 4 or 5 weeks but is now well underway and could carry into May.

Current overall readings of sentiment and dynamics are not yet at levels associated with important highs.

In the meantime, a reliable leading sector--base metal mining--accomplished outstanding gains on the expected seasonal move to around now. We have advised aggressive selling.

Going into the low for the BKX at 20 in February and 18 in early March we advised buying because the banks were so devastated. The rally was a double to 38 earlier in the month, when we advised getting out. The index has slumped to around 32 and a test of the high seems likely.

In the dismay of February it was difficult to keep focused on the probability of the post-crash rebound working out--particularly with the zest as recorded in 1930. It--including the fury-- is working out and we should now focus on the next big event, which could be the resumption of credit adversity after mid year.

INTEREST RATES

Last week we reviewed our concerns that once the fit of buying all grades of corporates ran its course the re-discovery of illiquidity would turn all bond prices down. This would likely be underway from around mid-year.

In the meantime, we noted that the long bond seemed vulnerable and this would be confirmed if the price declined below 124. The low has been 122.4 this morning. Next "support" is at 120 and after that the decline has been expected to be huge. Not due to inflation of consumer or producer prices, but due to the usual post-bubble lengthy collapse of liquidity.

This phenomenon is best measured by real interest rates, which adjusts nominal interest rates by CPI inflation. All six great financial bubbles since the first in 1720 have recorded a significant decline in real rates and then a grinding increase during each post-bubble contraction.

Often reaching minus rates of interest during the mania, the typical increase has been 12 percentage points. This time around, the low was -1.5 percent in January from which it jumped to 3.3%. After hanging around this level for a couple of months it has reached 4%, which is a new high for the move.

Our guess on how the twelve-percentage points could be accomplished would have the CPI declining to -4% as the bond yield increases to around 8%. Historically this shocker has taken some three years to accomplish. For treasuries this began in January of this year.

For corporate bonds it began in late 2007 when in the rapture of a credit mania, junk, for example, traded as low as 10%, or 7% real. The initial disaster drove the yield to 42% in early March, or around 41% real. Typically, the increase in lower-grade stuff has been huge, as the action been so far. This strongly suggests that treasuries will increase by their usual twelve percentage points. The chart is attached.

Now, the curious might ask, where does this place the putative skills of central bankers? Somewhere between a crock and a hard place.

This sorry condition for policymakers and their acolytes has been on for some time. For example, on April 25 a widely-read commentator asked a revealing question: "When did this problem start? July of 2007, when we introduced mark-to-market accounting."

Notwithstanding this hindsight, reliable market forces rather than arbitrary action forced the collapse.

Typically, a credit boom will run some 12 to 16 months against an inverted yield curve, and when the curve reverses to steepening it signals the beginning of the contraction. Inversion began in February 2006 and June 2007 would be the sixteenth month. This was discussed in the months leading to May when credit markets can seasonally turn to adversity. Last May we recalled that we made a similar call in May 1998 when such a natural turn in credit markets took out LTCM.

There was enough change by that fateful July to conclude that the biggest train wreck in the history of credit had started. Important and tradable relief has been possible from when the classic fall crash ended in November until around now. The returns from corporate bonds has been outstanding, and in the last few weeks we have been lightening up on junk as the action has become reckless.

For example, the yield for BBB was 10.25% in December at 725 bps, over treasuries. Now the numbers are 8.72% and 472 bps. Of the 250 bps of narrowing, a 100 beeps has been accomplished in just the last three weeks, which is rather fast action. It could continue for a week or so and lightening up could continue.

Spreads have come in when they should have and it is likely that widening will soon resume. Often such a change has been accompanied by an increase in the gold/silver ratio, which had been expected to decline from the crash until the April-May window. This it did and has been trendless over the past few weeks.

Another other warning on a reversal in credit conditions would be curve steepening, particularly if accomplished with short rates declining as long rates increase. Since the first of April this has been the case, as the 30s to 2s have gone from 268 bps to 305 bps, as the bill rate has been declining. In the last seven trading days this has gone from 277 bps to the 305, which seems to quickening a concerning trend.

Three reliable indicators are providing a "heads-up".

CURRENCIES

The Dollar Index has been expected to weaken as orthodox investments such as commodities, stocks and corporate bonds rallied out to around May. This has worked out as the DX, while volatile, has declined as the action has soared. This could continue, and technically, around 82 is possible.

On the longer term, we stay with the pattern that the senior currency becomes chronically strong relative to most currencies, and most commodities, for most of the time.

Independent of these fundamentals, the ChartWorks has a long-term bullish outlook based upon two models. The chart is attached. The ups and downs have been working out and traveling the pattern towards the next significant up leg.

The Canadian has been expected to rally as all of the "good stuff" runs into around May. This has been on track as the latest rally has run from 76.6 to today's 84.2. This could continue for a week or so.

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COMMENTS FOR ENERGY AND METAL PRODUCERS

Energy: We had a forecast that crude could make it to 60, but noted a couple of weeks ago that it was running out of momentum. The RSI had soared from the exceptionally low 20 to 68, which was a huge move. The high was 54.8, from where it has struggled. When it rolls over it could take the stock market with it. The notion that soaring commodities is bad for the stock market should have been buried in last year's crash of modern portfolio theories.

Our Downside Capitulation on natural gas resulted in a bounce to 4.45 from which an intermediate rally did not follow. This was the only commodity that did not enjoy such a rally. However gas stocks did better than the product and two weeks ago we advised positioning for an intermediate decline in both oil and gas stocks.

Base Metals: The action in base metal prices and mining stocks has been a big winner. Copper registered an Upside Exhaustion not seen since the spectacular zoom of a couple of years ago. Copper was likely to get hit and then test the highs before rolling over. Comex high was 225 and the low has been 190 on Tuesday, which is a distinctive break. The rebound has made it to 205 this morning and has further to rise.

On Goldman's metal index (GYX) we had a target of 71 on the RSI and hot action drove it to an exceptional level at 71.9 on April 22. Our April 23 Pivot noted that this was the biggest surge since 2006 and advised selling base metals. The crash low for the index at 190 was also the seasonal low and we positioned for the seasonal rally out to spring. The index made it to 258 in mid-April when we advised getting out. GYX slipped to 228 from which it setting up to test the high. Once accomplished, the cyclical bear should resume.

Similar action in base metal mining stocks carried the SPTMN from 178 on the seasonal-crash low to 460 two weeks ago. The hit was quick to 385, and the rebound has resumed the uptrend. We advised aggressive selling and the overall rising tide in the stock markets is carrying one of our favorite sectors to new highs at 500.

This is providing and outstanding conclusion for our usual seasonal play. The extra leg is a bonus for those who are still riding the action. Traders could begin to short the next break.

Gold Sector: We continue to consider that there are two aspects to gold. One is for traders to position against a currency of their choice. This will continue until the barbarous relic of central-bank "managed" currencies, which has been a disaster for the public and a rip off for big government, ends. The whole point of a "managed " currency has been to fund, through deliberate depreciation, an experiment in unlimited government. Under the current Democrat power blitz this is heading to an ugly climax.

On the big gold stocks--a couple of weeks ago we noted that the HUI was up a 128% from the crash low when we went long and that it was time to lighten up. The high was 343 and it corrected to 274 and the recovery made it to 312 from which it seems to be faltering.

Senior golds will be vulnerable to the pending roll over in the NYSE. The other advice was to begin to short the big silver stocks to hedge our policy to accumulate smaller-cap gold stocks on weakness. For investors, we have emphasized the impressive gains to be made in the gold sector as the real price makes a significant increase in a severe post-bubble contraction.

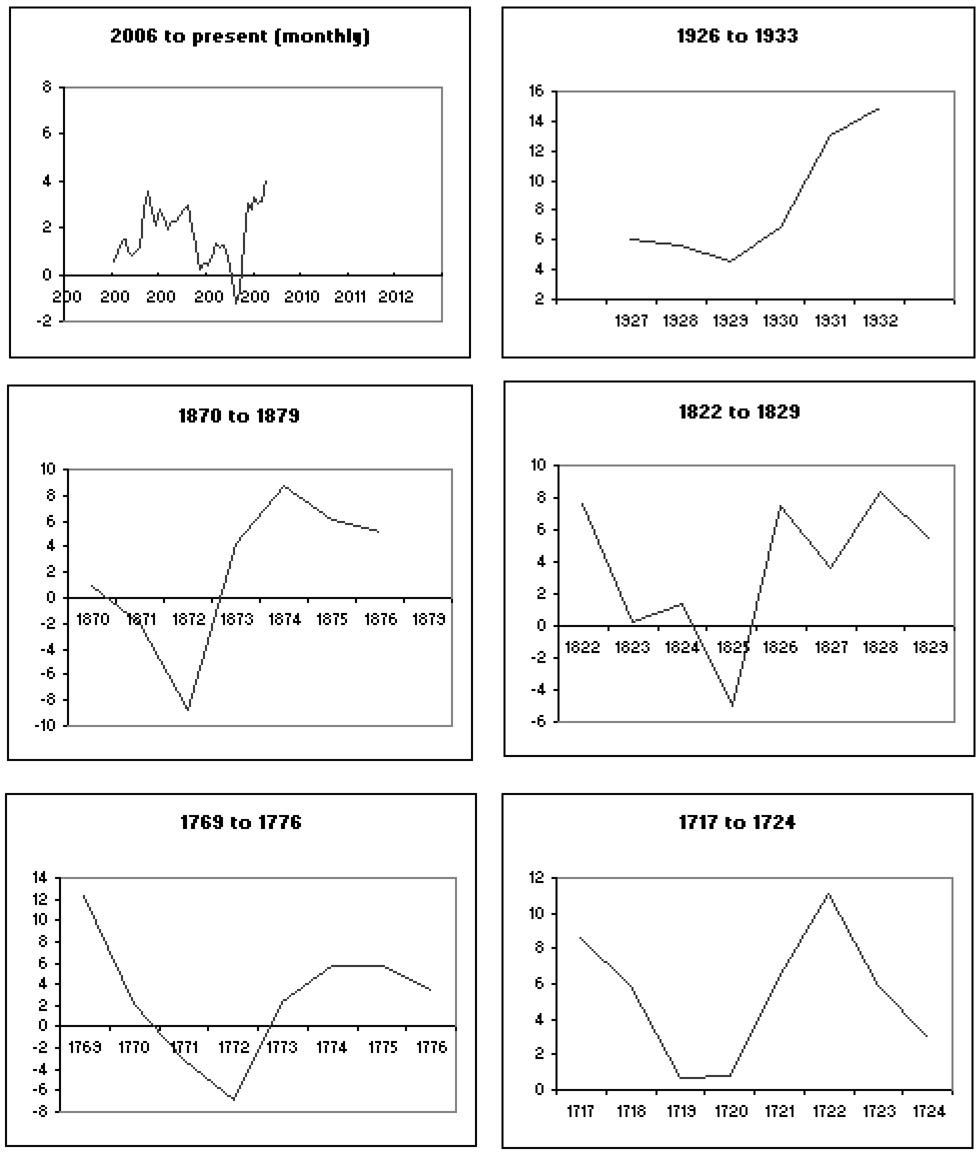
Reflecting the real price, our Gold/Commodities Index declined with the credit mania to 143 in May 2007 and turned up as credit began its collapse. The high was 519 reached with the troubles in February, when we noted that a correction was possible out to April-May. So far the low has been 363 on April 17 and it reached 399 on Monday.

The accumulated gain represents a significant increase in profitability for the sector and it will continue. Our case is that this has yet to be fully discounted by the industry and at some time this will hook up and the party will be outstanding. Particularly in the smaller caps--we are thinking something equivalent to small-cap tech stocks in 1994. So the program is to continue accumulating small caps on weakness, hedging it with some trades in the big caps as well as some nimble shorts in the big silver stocks.

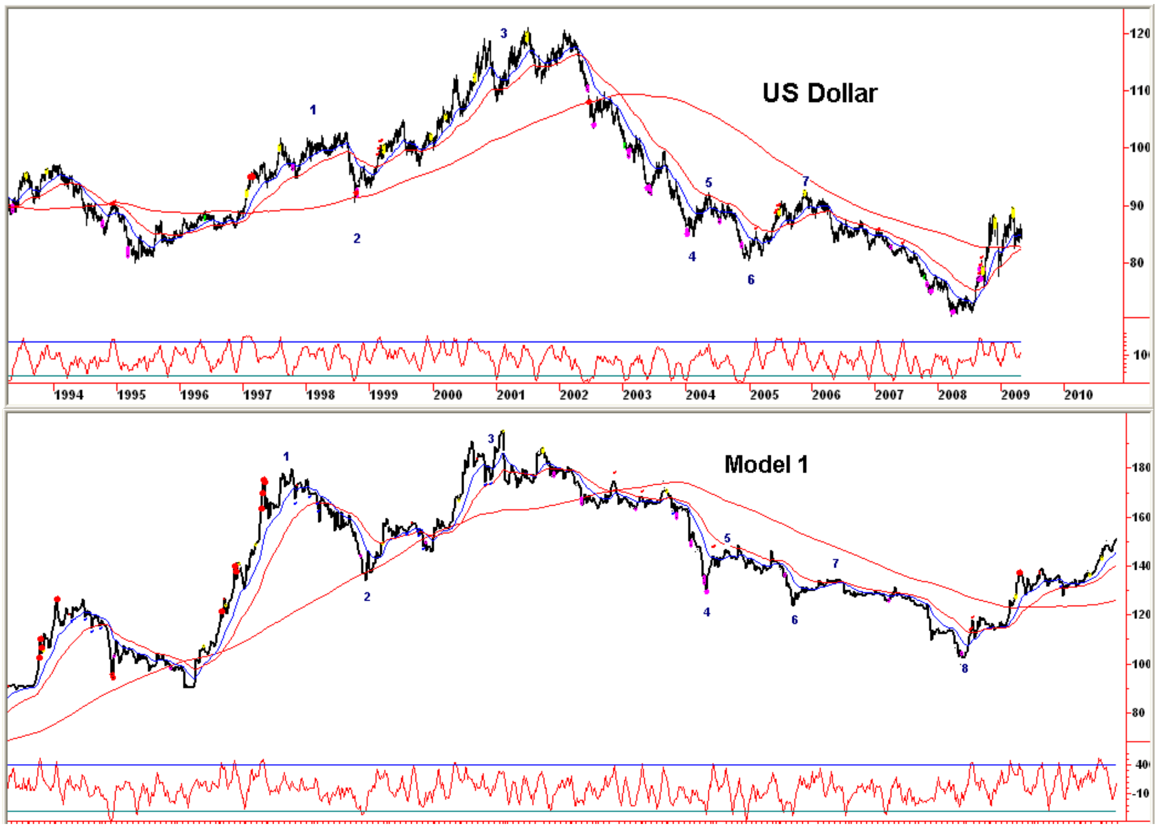
Real Long Interest Rates
Through Each Great Bubble

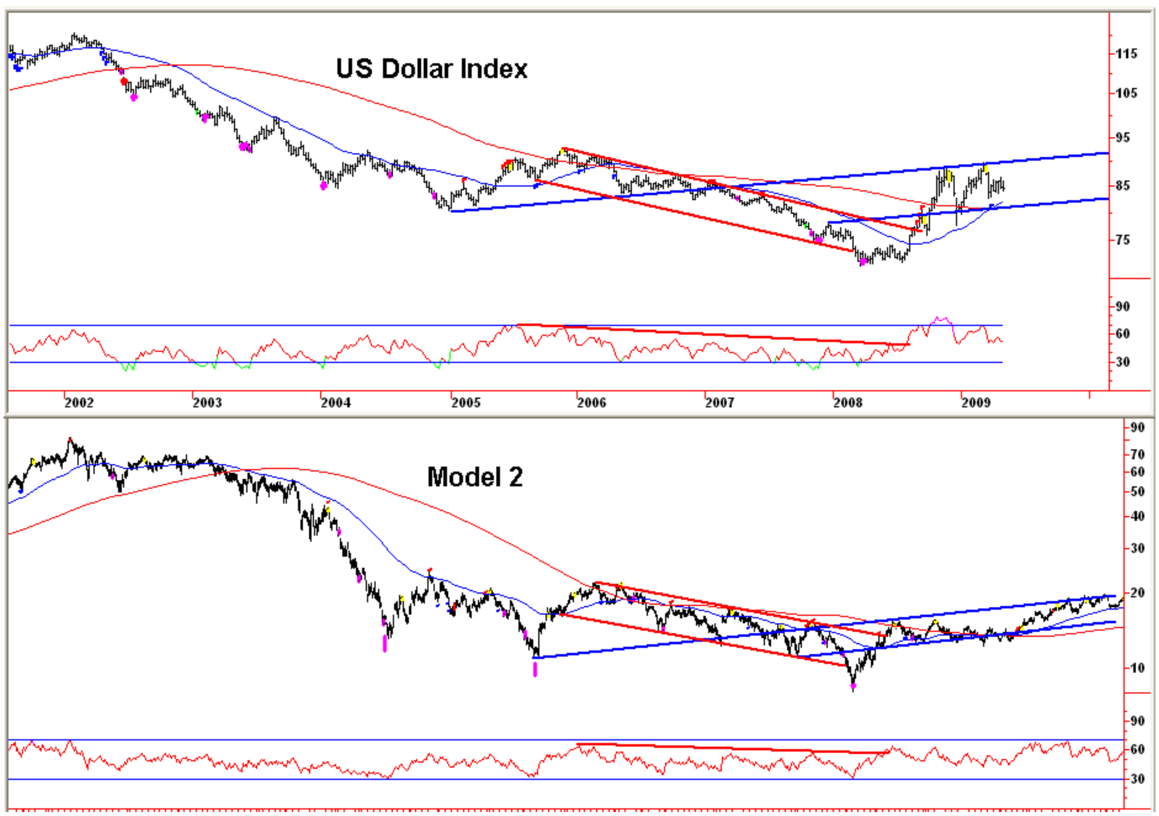
Annual Average Long Term Government Minus Annual Rate of Inflation
<u>% Interest</u>

2007, 1929, 1873, 1825, 1772 & 1720



The typical increase has been 12 percentage points.





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