

PIVOTAL EVENTS

WEDNESDAY, MAY 27, 2015

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Signs of The Times

"Hong Kong's best performing stocks this year are tumbling, even faster than they rallied."

– Bloomberg, May 20.

"Investment banks are on a hiring spree in Hong Kong and Shanghai for research analysts."

– Wall Street Journal, May 18.

Traditionally, brokers add to staff as a bull market peaks. Gerald Loeb's *Battle for Investment Survival* was published in 1936 and is outstanding on the markets. In it he has the classic observation: *"You don't need analysts in a bull market, and you don't want them in a bear market."*

"U.S. Government to Review mystery of Slow 1st Quarter"

– Associated Press, May 22.

"We are still focused on this business expansion, given we think it could last for several more years."

– Morgan Stanley, May 25.

"Shiller: You can't tell a bubble until it is over."

– Business News Network, May 26.

He must have missed the following headline:

"As spring [art] auction sales wrapped up in New York at a record \$2.7 billion last week, a slew of art fairs shared in the frenzied buying."

– Bloomberg, May 20.

The following is equally profound:

"Talk to almost any banker, investor or hedge-fund manager today and one topic is likely to dominate the conversation. It isn't Greece, or the U.S."

Economy or China, let alone the U.K.'s referendum on European membership. It is the lack of liquidity in the markets."

– Wall Street Journal, May 21.

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Perspective

Decades ago, we used some quips attributed to the "trading floor cynic." After more than fifty years in the markets and after reading so much of financial history one might become jaded about the markets. Not in these pages. There are very few stock market trading floors anymore and there never were any for the interest rate markets.

But we used to like the trading floor cynic and it might have been an invention of Ed Hart who was on FNN a business channel in Southern California. Sometime in the 1980s, Bob was in LA and while there interviewed with Ed.

The NYSE still has a trading floor, but the "back office" no longer handles paper transactions. The process has become remarkably efficient. As a boom culminated frantic traders would execute orders faster than the tape could record. The tape running late was exciting and worthy of comment. And as speculation went vertical the back office would seize up, which was one of the signs that the boom was over.

And then there were the days of very quiet trade and on one of those days, Ed said that ***"Trade was so slow that the tape was running fast"***.

His other classic was that on the sudden reversal to a major plunge, ***"The confirmations go out with the margin calls"***.

Ed may have passed away and FNN was taken over by CNBC.

Stock Markets

The structure of the overall stock market is still within a big Rounding Top. The NYA has been a good monitor and this Topping has run from last June to recent. Within the structure, sentiment and momentum numbers reached levels seem only at cyclical peaks. Margin employed accomplished a peak last year. And after a natural correction, set a higher high on the latest number which is for March. The second peak is unusual. Complacency builds.

As we have been noting, the NYA pattern is looking like the peak in 2000. In which case, the first step to change will be taking out the 50-Day ma. The defining step will be taking out the 40-Week ema. It is at 10903 and the index is at 11143.

Now why are we so interested in this turndown?

Private stock market participants are more than capable of driving a market to the speculative climax of a bull market. This has been happening and it is accompanied by the greatest speculation by policymakers in history. Not only have central bankers been buying stocks and bonds, they have been buying all the way up.

In the US, this is becoming concerning as Fed officials could be in violation of the "Prudent Man Rule", which in various iterations dates back to 1830. This essentially instructs that those with fiduciary responsibility ¹ should not be buying anything that they would not buy themselves.

That a committee can manage an economy depends upon the concept of a national economy, which does not exist. The other key concept has been that a forced credit expansion by the Fed will force a business expansion. This is a primitive syllogism.

As exemplified by the Fed, interventionist central banking is a speculative concept. As exemplified by the ECB, policy implementation of policy has become fanatical.

This financial bubble has both the private and policy sectors in a highly speculative mode.

On our dedication to archaic, since February we have been monitoring the Dow Theory. It has been in the heads-up mode since March and in an alert mode since the Trannies took out the 50-Day in late March. Taking out the 200-Day on May 11 was a warning. Last week it rose to the 200-Day and has failed. Not good.

A chart follows that takes the warning from the change in credit spreads to a peak in the stock market. It is complicated with a 12-month shift in the indicator, which reversed in late February. We take it as a warning.

In the meantime, we have considered that this stock rally would make it into May and then become vulnerable to the pending reversal in credit spreads.

Are we close to a cyclical peak for the stock market?

This one requires a comment on the economy. In a world of financial engineering and financial manias business activity and the stock market turn down, virtually, together. Examples include 2007, 1929 and 1873. All using NBER determinations of recessions.

We have considered that weakening "Macro" numbers since January could be indicating a recession. This would be cyclical but the stock market is on a seasonal rally. At some time they will get together.

Some items have been changing and are no longer supportive. The Treasury yield curve reversed in April. After reaching a targeted high, commodities have turned down. Credit spreads have stopped narrowing.

A positive for the big cap stocks is the firming dollar.

¹ The 1946 review include archaic words and meanings from a long lost world.

"which men of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard for speculation but in regard to the permanent disposition of their funds."

Commodities

Iron ore appears to be a late bloomer on our "rotation" move for this year. Last week we asked the question about a possible rotation. The posting for April was 51.15. Within this, the May contract set a low of 49 and is now trading at 59. Cheers and perhaps the relief rally could run for a number of weeks.

Some commodities have met our objectives and have weakened.

Base metals (GYX) rallied from 299 in January to 346 in early May. As noted a couple of weeks ago, the swing from oversold to overbought was huge. As it was for the miners (SPTMN), which rallied from 513 to 832. This has slipped to 731 where it is holding at the 50-Day and 200-Day moving averages.

Metals have taken out the 200-Day at 338 and the 50-Day at 320. Today's trade is at 313.

Crude and oil stocks also accomplished the big swing from very oversold to overbought. Our May 14th Pivot advised taking the money off the gaming table.

By stages, cotton is declining from its overbought at 68 at the first of May to 63. This is below the 50-Day and holding at the 200-Day moving averages.

Grains (GKX) did not join the "rotation". The last rally worth mentioning was from the low of 290 in September to 342 in December. That was turned back by the 40-Week ma. Each rally since has been ended by the declining 50-Day.

At 281 now, it is at a new low for the bear market that started at 570 in 2011.

We monitor commodities for opportunities as well as a guide to the global economy. Also most are relatively free-trading and generate strong trading signals that have generally been reliable. However, the main instruction from chronic weakness in commodities in the face of remarkably belligerent central banking is that their intuitive theories and bureaucratic rituals have not been obtaining the expected robust economy.

When will they admit that there is a problem with the theory?

Currencies

Our May 14th Pivot noted that on the decline in the DX the action had gone from extremely overbought in March to oversold two weeks ago. We thought the momentum swing was "impressive" and that there was support at the 94 to 93 level. The low was 93.15 on the 15th.

With two steps the DX has made it to the 97 level, which is above the 50-Day ma. This is constructive and getting above resistance at 98 would be even more constructive. That Pivot concluded that a firming dollar could attract foreign funds into the big NYSE stocks. Commodities would be repressed.

On the same review, the Canadian dollar, which had recorded the big momentum swings would decline. The key high was 83.87 on May 16th and in a couple of steps declined to 80. The 50-Day is at 81.18 and has been taken out. Weakness can continue.

Precious Metals

The sector started with a robust rally out of Christmas. GDX rallied from a low of 17 to 22. This was on our "rotation" theme and it was too much, too soon. It ended at the 200-Day ma. The next low was 17 and the next high was 21.90 in the middle of May. This also ended at the 200-Day.

Our November "Special" on the sector reviewed that for a bottoming process, gold stocks would have to outperform the bullion price. This has replicated the action in gold stocks, but with five attempts to get through the 200-Day. After a good beginning, the inability to break out has been a negative.

Last week's conclusion was that if it declined below the 50-Day it would indicate the direction of the trend. It did and this is negative.

Also noted last week was that the Daily RSI on the silver/gold ratio had reached 74. Anything towards 80 indicates dangerous speculation and we used this to advise that the play had become "somewhat overdone".

The 50-Day was taken out and it is again time to lighten up on precious metals stocks.

One of the more important items in the gold story is the real price.

We keep track of it through gold's performance relative to commodities. The rally into January as crude crashed was outstanding. From very overbought Gold/CRB slumped to oversold at the first of May. This has recovered from 5.10 on May 12 to 5.45. This is at the 50-Day and rising through it would be constructive. Above resistance at 5.62 would be significant.

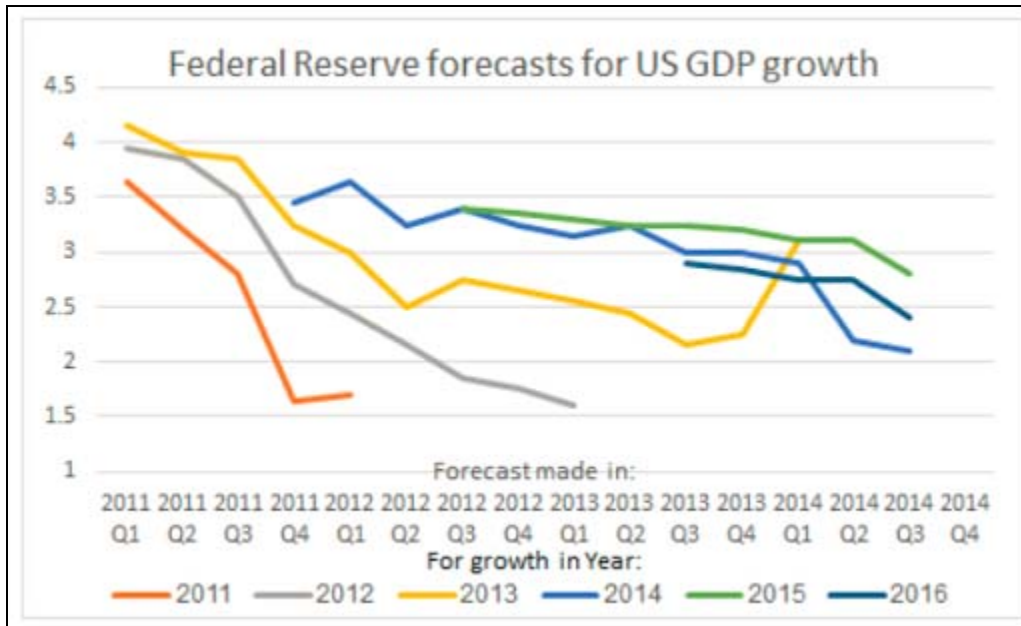
Rising real prices for gold and improving gold mining operating margins have been the long-term feature of post-bubble deflations. It will eventually pull up most gold stocks.

We use the gold/silver ratio to anticipate booms and contractions. With the financial boom so far this year, the ratio declined to 69.4 in the middle of the month. This was somewhat oversold on the Daily. The action has been volatile which suggests pending change. The ratio rising above 73 would turn the trend up. Above resistance at 76 to 77 would be a warning to deterioration in credit markets.

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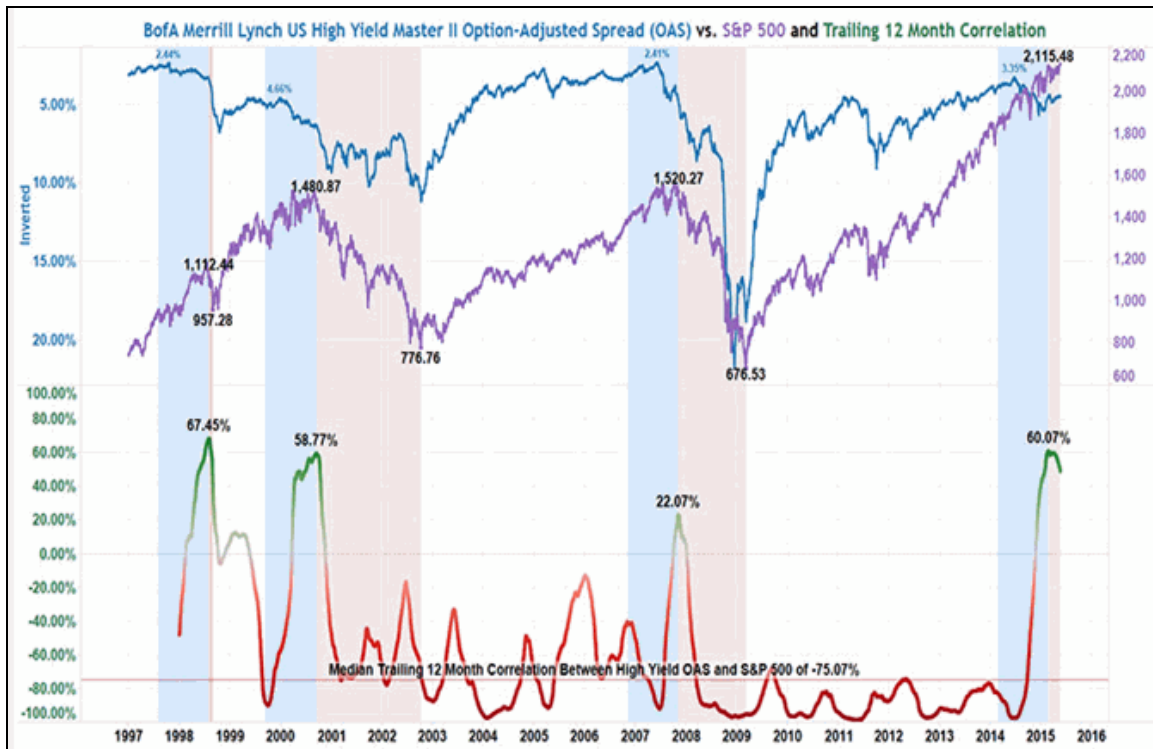
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Fed GDP Forecasts



- How wrong can you get?
- How often?
- No self-criticism.
- When do they change their concepts to fit reality?

Interesting Indicator



- This is based upon the US corporate credit spread.
- The key is the change in the correlation chart at the bottom.
- This is shifted by 12 months.
- The alert is given when the correlation spikes up and then turns down.
- That occurred on February 25th and the turn down is becoming acute.