Global Report –July 2010

UK

Europe

US

Japan

Emerging Markets

Bonds

Commodities

Currencies

July 2010

World Investment Strategy

IRC INVESTMENT RESEARCH OF CAMBRIDGE

Introduction

Investment Research of Cambridge was established in 1945 to specialise in technically-based research of the financial and commodity markets. The company has built up an international reputation for its expertise in predicting the trend in global markets and individual stocks.

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- Source of data for charts: Investment Research of Cambridge, Q-Data, Alpha Terminal, Thomson Reuters

World Investment Strategy

The main trend line on any chart is the 200-day moving average. When a price is above this line, which should itself be rising, most analysts would describe it as a bull market. The reverse would be called a bear.

The majority of stock market indices in the mature and developed world are currently below their falling 200-day lines. The primary trend is negative.

Furthermore, in many cases the short term moving averages, such as the 25- and 50-day, have cut below the long term line, forming what are called dead crosses. These can normally be used as selling signals.

However, there is a strong seasonal rally phase that usually lasts through the month of July and sometimes continues to early August. We are now in that phase. This can set up a good selling opportunity.

Chart theory dictates that there will be a special shape to a rally which is a counter-trend move. A surge in the direction of the prime trend will be a five-legged animal, but a counter-trend rally will be a three-legged one. It will have a rise, followed by a setback, then the rest of the rise.

The month of June ended with a period of profound weakness, such that, when the seasonal strength started, the best that the first surge could achieve was to retrace only about a half of what had been lost in June. That surge clearly then stopped and recently a setback has been underway.

There are now two possible outcomes: either the mid-summer rally is already over or, more likely, it has one more surge to go. This surge could last until the end of July, and it is possible that it will overshoot and continue into early August.

We will not buy into this rise. On the contrary, we will use it to sell because, once it is over, the primary downtrend will resume.

The prediction is that in the month of August markets will be distinctly wobbly and in September they will fall.

The final low is likely to come in October. The indices are due to be about 10% to 15% lower at that time compared to current levels.

During the rally phase, the overall trading volume has been small, in fact almost non-existent. This is a bad sign. What has been happening is that short positions have been closed rather than new ones being opened. This just confirms the overall bear market patterns.

Most investors have been moving out of shares and into Treasury bonds. They are simply fed up with losing money and are trying now to take as little risk as possible. They will even sell the good stocks and profitable positions, rather than capitulate fully and cut the losers. That last phase will probably come in October.

There has been a long debate on the risks of inflation or deflation. Are we to expect one, or both, and in which order?

Our work has always been clear that the imminent risk is of deflation and possibly a double dip. In order to get out of this, the Fed will print too many dollars and that will later lead to inflation.

The good news is that the newly-emerged Asian economies are large enough to stop this becoming a global depression. However, the worst parts of the western world are already in Kondratieff winter – the cyclical equivalent of the depression of the 1930s.

On balance, the strongest western economies, such as the US, will bump along with very slow progress of 1% to 2% growth of GNP for many years. The weakest ones will have an actual contraction of between 20% and 30%.

We live in an era of pain and austerity. It calls for caution and prudence. Avoiding risk will be more rewarding than seeking growth. Without it, survival cannot be assured.

Summary: world market overview

The month of June ended really badly for world stock markets. Many indices broke below their 200-day moving averages.

In many cases the short moving averages have cut downwards through the long term one in a so-called dead cross. The prime trend is negative, it is a bear market.

However, this is the season of the mid-summer rally. This started on time in July. It might end in late July, or it might carry though into early August.

Chart theory indicates that a pattern of a rise, followed by a setback, then the rest of the rise is likely. On this basis, the rally is almost, but not quite over. There is still the chance of a rally back up to levels seen in early June.

Either way, the prediction is that from August the market will start to fall. Statistically, September is the weakest month and the final low is made during October.

The fall to the October low is likely to be between 10% and 15% on most indices. Our broad strategy is to be liquid now waiting to buy into that dip. We have no interest in buying any part of the summer rally.

The best relative strength is still with the emerging markets. India, our favourite, is at the high for the year, but it has still not made any actual progress. Similar things are happening in Brazil.

Those markets that are showing good relative strength are still, technically, in a bull pattern. They are above their 200-day moving averages. But even they will not be immune to a setback.

It is clear from the flow of funds charts that money has been leaving equities and going into the lowest risk assets such as US Treasuries. This cautious stance has actually earned investors a good profit. If yields on Treasuries go much lower, they will be discounting a depression.

Latest figures all point to a setback. The earlier recovery has faded already in spite of the huge stimulus packages.

China, as a lead market, is slowing and trying to make a landing – it is likely to be a hard one. This is bringing most commodities down with it, even though they are in secular uptrend.

Gold is well off its top and is now likely to have a meaningful setback. Our target is $1060 and we would regard that as a good buying level. From the low we anticipate a strong rally that could even take the price to $2000 in a year's time.

In the commodity complex, the food stocks are rising rapidly. We can see this on the charts but they are difficult markets to trade successfully.

The dollar has given up some of its recent rise but the downside would seem to be limited. If stock markets have a setback from August onwards, the dollar is likely to enjoy another rally.

The euro meanwhile has rallied and probably has a bit further to go, but remains in a long term downtrend.

The yen has been bought aggressively as a haven of value. We did not anticipate such a strong move.

Sterling has rallied in recognition that the new Government is doing the right things.

The top priority is to be liquid, ready to buy in October. Aggressive traders might well be looking to go short for the setback that will precede that low. We had thought the day to short was the 26th July, but now think it could be early August.

Be careful out there. There is a bear about.

The World at a glance

Major markets

US relative to world: currency adjusted

The US market is now in the weakest category on our ranking table. The S&P index did rally in July but is still well below the 200-day moving average and a dead cross is in place. Even a further rally in August is unlikely to improve on this position. The relative chart here shows that at the start of the year this market had the best performance of the western markets, but is now giving up that position. The reverse has occurred in the European markets which are dominated by Germany, a major beneficiary of the weak euro.

UK relative to world: currency adjusted

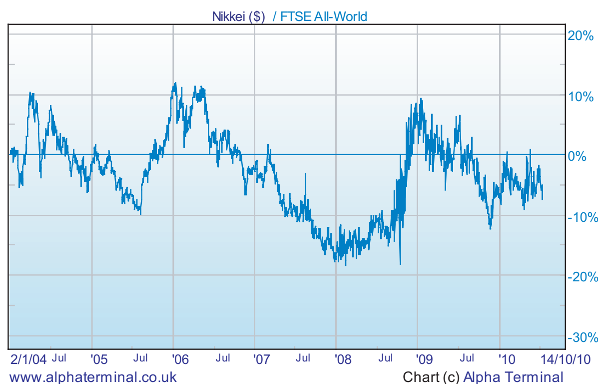
The UK market is in the second weakest category. The story is similar to the US. The reason that it is above the US is that the stocks that dominate this index are so international that only 20% of their earnings come from the UK. The outlook for the index is, therefore, better than that for the country. It may well be that, if BP's problems are solved, a rebound could have an extra bounce to it. But this is far from certain. In the global context, we would still be underweight and risk averse.

Europe relative to world: currency adjusted

The Scandinavian markets, Germany and Spain are all in the strong category on our ranking table. Only Austria is now in the very weakest group. What has happened is the bear-closing rebound has been relatively strong. It has not, however, improved the overall long term picture. It is true that German exports, which are always competitive, are getting an easy ride on the weak euro. This is likely to continue. However, our work still indicates that there will be a better buying chance in October.

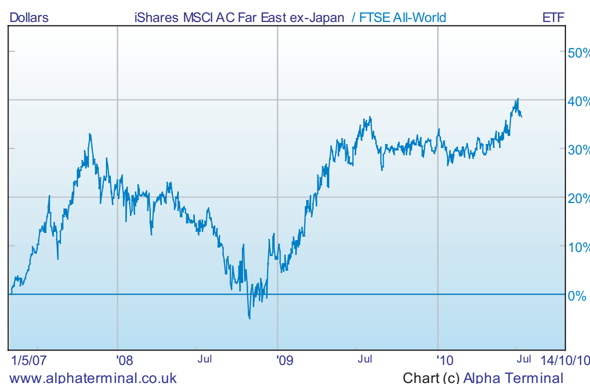
The world at a glance

Japan relative to world: currency adjusted



- The Japanese market has rallied recently on a relative basis. It has done this by dint of not performing as badly as many other markets. The overall prime trend is, however, still negative. The Nikkei index is well below its falling 200-day moving average and a dead cross is in place. We expect it to fall back in our ranking table over the next few months and to fluctuate within the weakest categories of the table. It has been unable to give any clear buying signal.

Pacific ex Japan relative to world: currency adjusted



- The Pacific and Latin regions are both super-strong. They seem to alternate as to which one looks best at any particular time. At present, both China and Korea have slipped down the table and so the Pacific region is in second position. We do not think that China has found a base yet so this feature is likely to continue.
- The strongest markets here at present are Thailand, Indonesia, Singapore, the Philippines and Malaysia. All are likely to see profit taking between August and October.

Latin America relative to world: currency adjusted

- This is currently the top performing group, led by Chile and Colombia. At the moment Peru is the only weak market. Brazil and Mexico are both in the strong group and are likely to maintain this position. From a long term perspective, we are bulls but these are volatile high-beta markets and it is worth trading the minor setbacks. We are currently out of the market but have every intention of buying back into Brazil by late October.

Global stock markets ranked by quintiles in dollars

Country	Quintile	Above Moving Average 25D	Above Moving Average 200D	Upward Sloping 25D SMA?	Percentage Change (US $) % 1 MONTH	AVG	3 MONTH	AVG	12 MONTH	AVG
Chile	++	✓	✓	✓	5.0		4.4		33.0	
Colombia	++	✓	✓	✓	6.9		5.6		45.4	
Thailand	++	✓	✓	✓	4.8		7.3		49.2	
Sweden	++	✓	✓	✓	8.0		-3.1		42.1	
Indonesia	++	✓	✓	✓	6.1		2.2		62.0	
Singapore	++	✓	✓	✓	5.2		-3.1		34.5	
Turkey	++	✓	✓	✓	6.0		-6.4		58.3	
Malaysia	++	✓	✓	✓	4.3	5.8	-0.4	0.8	38.2	45.3
Philippines	+	✓	✓	✓	6.8		0.9		44.8	
Denmark	+	✓	✓	✓	2.9		-5.9		29.0	
India	+	✓	✓	✓	3.2		-4.0		36.0	
Switzerland	+	✓	×	✓	4.9		-9.0		21.2	
Spain	+	✓	×	✓	10.8		-16.9		-3.6	
Mexico	+	✓	✓	✓	-1.3		-9.7		43.0	
Germany	+	✓	×	✓	4.3		-8.3		17.6	
Brazil	+	✓	×	✓	3.1	4.3	-10.8	-8.0	46.9	29.4
South Africa	o	✓	×	✓	1.3		-9.4		31.2	
Argentina	o	✓	×	✓	0.7		-7.6		45.2	
Italy	o	✓	×	✓	6.6		-17.4		2.7	
Taiwan	o	✓	×	✓	4.7		-6.9		19.5	
Hong Kong	o	✓	×	✓	2.1		-7.8		13.9	
China	o	✓	×	✓	1.9		-15.2		11.5	
France	o	✓	×	✓	3.5		-16.6		7.2	
Hungary	o	✓	×	✓	9.7	3.8	-20.6	-12.7	33.0	20.5
Czech Republic	-	✓	×	✓	5.6		-16.8		17.0	
South Korea	-	✓	×	✓	3.5		-8.3		33.6	
United Kingdom	-	✓	×	✓	4.0		-10.8		16.0	
Belgium	-	✓	×	✓	3.9		-13.9		12.9	
Venezuela	-	✓	×	✓	1.4		7.4		-27.7	
Canada	-	✓	✓	✓	-0.7		-7.5		29.2	
Netherlands	-	✓	×	✓	3.9		-13.0		20.4	
Poland	-	✓	×	✓	3.8	3.2	-17.8	-10.1	27.9	16.1
Japan	--	✓	×	✓	1.1		-7.0		9.5	
Russian Federation	--	✓	×	✓	3.9		-15.8		62.7	
Austria	--	✓	×	✓	2.3		-20.7		6.1	
Israel	--	✓	×	✓	-0.5		-14.0		33.3	
United States	--	✓	×	✓	0.5		-9.5		20.9	
Australia	--	✓	×	✓	0.6		-16.2		29.3	
Peru	--	✓	×	✓	-0.6		-10.6		17.2	
Egypt	--	×	×	×	-2.8	0.6	-21.3	-14.4	9.5	23.5

Ranking and data in US Dollars

United Kingdom

Schools out

It is the holiday season, and it is hot. The football is over and so is Wimbledon. All best forgotten and now the family holiday has to be arranged and enjoyed or endured. The stock market is just not the top priority.

The FTSE-100 index is doing what has been expected of it. June ended with a plunge that produced a dead cross of the moving averages underlining that the prime trend is negative.

The mid-summer rally started right on cue in July and has, so far, had a good rebound followed by a setback.

Either the rally is already over, or it may just have a bit more to go. Chart theories favour the second alternative.

It is quite normal for the summer rally to last until early August. As this is a counter-trend move, it is likely to have three legs. In this case a rally, followed by a setback, then the rest of the rally.

To put some numbers on it, we can say that the setback is probably underwritten at 5000. The next rally may go to just above 5300.

Throughout the rally phase, the volume of turnover has been low. This is technically not good. It means that the buying is most likely the result of bears closing short positions. There is no new buying interest. This means that, when we reach the weak part of the season, the market will drop like a stone.

The next leg down should be similar to the fall from the April highs. At that time the index lost 15% in less than a month. Even that was not the end of the fall. On this basis, our targets for the FTSE-100 index by late October are between 4300 and 4500.

We think that the Con-Lib coalition basically has the correct agenda and furthermore the electorate realises this. They know there is some pain to come and they are prepared for it. Let’s get it over with. Ultimately, this will reflect well for sterling and the stock market, but we do have to discount the tough times first.

The type of stock we would hold has a franchise better than many countries, and pays out dividends better than money in the bank. The biggest stocks in the FTSE-100 tend to be in this group. We are just waiting to buy them at a bargain price.

FTSE 100 index

FTSE 100 index relative to world

Europe ex UK

Good in parts

A young curate was having breakfast with his bishop and found that his hard boiled egg was off. Not wishing to offend, he informed the bishop that it was good in parts. Much the same could be said of the state of the European economic union.

Probably the most formidable export machine in the world is not China but Germany. It can sell high quality and expensive products at any time. Give German exporters a cheap currency and they are unbeatable.

The German Dax index has held up, relatively, very well. It is above a still-rising 200-day moving average. There has been no dead cross through this line and the major lows are still on a rising trend. Not surprisingly, this market is in the strong category on our ranking table.

It will not, however, be immune to a setback in the autumn but it should still maintain its relative strength. The downside risk may be no more than 10%.

The Scandinavian markets are also showing relative strength. This, too, will probably continue.

The market that has surprised is Spain. This index has jumped up the ranking table from the weakest position. The IBEX index rally from the lows of June has been 20%. This is partly because its previous performance had been one of the worst. Even now, after the rally, it is still well below its falling 200-day line and a dead cross has occurred. For these reasons we cannot put it in the same category as Germany.

The euro has been doing what we expected. It has rallied strongly against the US dollar. This is a counter-trend move. It could go as far as $1.34 but after that it would be vulnerable to selling pressure again. Major support has been established in the $1.17-$1.20 band.

Depending on future developments within the region, there is still a risk that the euro could go lower than $1.17 and might even test the psychologically important $1.00 barrier. But we see this as a worst-case scenario. In the medium term, trading is likely to be confined within the $1.34-$1.17 range. With the currency anywhere in this range, the German export stocks are on a batsman's wicket. They are a class act likely to beat all competition.

European equities

European equities relative to world

Europe ex UK

France

Germany

Switzerland

Netherlands

Scandinavia

Spain

United States

A growing consensus

There has been a fierce debate about whether the US faces runaway inflation as a result of "Helicopter Ben's" printing press or whether the major threat is deflation. Our work has always favoured the view that the first problem is deflation and, indeed, there is a risk of a double dip. There now seems to be a growing consensus that we have got it right.

The famous economists, Nouriel Roubini, Gary Shilling and David Rosenberg, have each in their own way elaborated on the deflation risks. Theirs is no longer seen as an extreme deviant view. Almost all the leading economic indicators are now clearly turning down.

As we wrote in "Mapping the Markets", the west has been in secular downtrend since the year 2000. We are in the Kondratieff winter phase, which last time occurred in the 1930s.

It is quite clear that the massive Keynesian stimulus has had a minimal effect, and might even have made the problems worse in that the debt burden is now larger than ever. Most other countries have abandoned this policy and are taking the pain of slowly trying to get out of debt. The Obama White House still continues with the failed Keynesian policy. In our opinion, if he does not see the light soon, he will be on course to becoming a lame-duck-one-term loser. The risk is that he will authorise one more huge stimulus move before this is recognised. We think this will be doomed to failure as well.

The S&P 500 index might rally until early August but resistance at 1150 will remain unbroken. It will then drop back to 940 in October.

We would then expect a rally through to March 2011. In a normal year that rally would last until late May. There is little chance of that this time. The double dip will follow and the index will re-test the lows of March 2009.

Although we are now in the phase that is equivalent to the depression years, it may be that the economy this time just bumps along with low growth in the 1%-2% range. This would be our best-case scenario.

America must learn once more to be prudent, frugal and hard working. It must start exporting again and be competitive. It must stop living on borrowed money and hand outs. It has shown before that when the going gets tough, the tough get going.

S&P 500

Dow Jones Industrial Average

Canada

Still a bit early

The TSE index is below the 200-day moving average, which has lost the upwards slope that it had previously enjoyed.

A dead cross with the 50-day moving average is in place but the 100-day line is still above the 200.

Good support for the index has been tested at 11000 and it held strong. This level is only down 10% from the high for the year.

The bottom line is that the market is behaving very well. It is in secular uptrend, but in a cyclical correction. It is not immune to the setbacks elsewhere but is cushioned on the downside.

If there is a setback in late autumn that brings the index below 11000, then this will set up a good buying opportunity.

The long term growth in Asia will resume and even in the US the economy should bump along just in positive territory. The minerals that Canada can supply will find a ready market.

For the past few months the US dollar has given up ground against the euro and the Canadian dollar has moved from 1.0 to 1.07. No imminent break from that range is expected. But longer term we are bulls of the Canadian currency. Investors from Europe will gain both by buying Canadian stocks and from the currency.

Commodities are currently having a cyclical correction but oil, gas, metals (including gold) can all be found in Canada. In an era of fiat money troubles these will be good real assets.

We expect to be buyers in October. If the index drops below 11000 the next support level is 10500 and the buying low will probably be found somewhere in this range.

Canada

Canada relative to world

South Africa

Range bound

As expected, the weakness in May, June and July has found that the support at 26000 on the JSE index is very strong. The pattern is now one of falling highs but static lows. The index does not seem to want to go lower. If it were to break this support, the selling pressure would need to be driven by an event not currently discounted.

Markets are still in their mid-summer rally phase and it could last a little longer. If the rally were to break above the strong resistance at 28000, then an overshoot to 30000 is possible.

Even so, in August the pressure is likely to be negative again and the probability is that 26000 will be re-tested.

If this support level fails, a quick move down to 24000 is likely which would present a good buying opportunity.

We expect most commodity prices, apart from the foods complex, to fall over the next three months. Falls in the price of gold will trigger profit taking in the South African stock market.

The currency has been range bound against the US dollar for over a year in the 7.2-8.0 range. There is no sign of this range breaking any time soon. All moving averages are going sideways at 7.5 which has been the mean level.

This market is technically similar to Canada and to Australia. The latter recently had a setback, taking it into the lowest group on our ranking table. The Australians do now have a new Prime Minister so the worst may be over there.

The prime difference between the two markets is the currency – the Aussie dollar still looks too high and is in a corrective downtrend.

In order to move on to the more positive long term story for these markets, we need to get through the Chinese economy's hard landing. Then the growth story can resume and supplying mineral resources will once again be a profitable activity. Until then we are stuck in the mud – full of potential – but not going anywhere.

JSE All-Share

JSE All-Share relative to world

Japan

Money problems

The Japanese yen has moved from Y94 to the Y86.3 – almost as strong as it has ever been since it hit Y80 in 1995. This is not good for the stock market.

Most people have money problems when their currency is too weak. In Japan the problem is that it is way too strong.

We are clearly living in a period when investors are in panic mode and they are moving back into what they perceive as a low risk position. For some that is US Treasuries but for many it is the yen. This strength undermines the prospects for the export blue chips, which are the backbone of the market.

There are other unique problems for Japan in that it has the longest living, slowest breeding population. The demographic outlook is for a dramatically shrinking population. This will be reflected in the GDP.

Japan is also the role model for what a secular downtrend looks like in the stock market. They have already endured 20 years of a bear market. At least they started the process as wealthy savers, and have a culture that has been able to suffer the hard times without riots

Those western economies now going into a down wave do not have such a culture and they did not have savings in the first place. We are already seeing resistance in Greece and elsewhere to swallowing the necessary medicine. If Japan is the role model then these other countries have 10 more tough years to go.

The Nikkei Index is making a pattern of falling highs and lows below a falling 200-day moving average. There is also a dead cross signal in place.

Strong support over the past year has been found at 9000. This level held last November and more recently. But it looks as if will come under attack again and this time it is may fail to contain the selling pressure. The next support level is the low at 6994, made in 2008.

It is possible that the secular trend is in base building mode. It could be that a giant base has been set up with the 2003 and 2008 lows as the floor level, but the jury is still out on this. Technically it is still a market to avoid.

Nikkei 225

TOPIX

India

Just give us a chance

Given half a chance we will buy back into the Indian market as it is by far our preferred long term investment. We do not expect to get in at the bargain basement, just at a lower price than today's.

The Sensex index is almost back up to its high for the year. Mind you, it first got to this level last October. But at least it has been going sideways at a high level, whilst other less well starred markets have been falling. It has shown remarkable relative strength.

The levels to remember are 21000 (the old all time high), 18000 (the high for this year) and 16000 (the support level that has held repeatedly when tested in the past nine months). There is even back-stop support at 15000.

Finally if the index made a Fibonacci retracement of 38.2% of the last bull surge, it could come back to 14500 but it would still be in an unbroken prime uptrend.

If we are correct that most markets will drop between now and October, the Sensex should fall to at least 16000 again.

We think there are reasonable odds that we will be able to get back into this market at one of the lower levels mentioned. On balance, it is worth waiting to see if this buying opportunity occurs. But at some point we are going to buy back into it again anyway.

The monsoon is on and it is almost bound to be better than last year's disaster, which was the worst for 37 years.

Sixty-five per cent of all Indians are poor and live in rural villages. They are suffering high food price inflation. This is a very real problem but the government is dealing with it by raising interest rates.

The biggest part of the economy is what we invest in and is all about building infrastructure. It looks good and is worth a premium rating. We are just looking for a relative value entry point.

India

India relative to world

Pacific ex Japan

Hot air balloon

I rode in a hot air balloon once and was taught that anything you could walk away from was called a landing. The Chinese stock market is giving its passengers just such an experience.

We believe that the Chinese economy will overtake the US to become the number one in about 17 years from now. But we also think that getting there will be a very bumpy journey.

The Shanghai Composite Index topped out in 2008 at 6124. It fell 73% to the lows in 2008 and has now fallen back 32% again.

In a bear market we always look for a special shape on the charts of a fall, followed by the rally, then the rest of the fall. We are clearly into the last leg of this pattern. Watch out below. Once on the ground again we will be able to concentrate on getting the next flight together.

While this hard landing is going on in China, it is the other markets in the region that are scoring well in our table.

Thailand, Indonesia, Singapore, Malaysia and the Philippines are all in the strongest part of the ranking order.

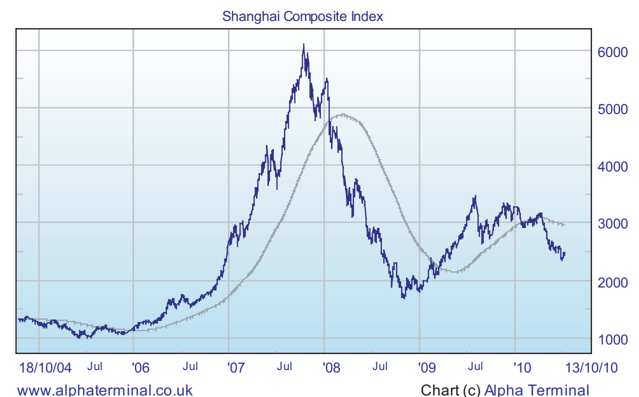
The top part of the table is likely to continue to be dominated by either the Pacific or Latin American regions and usually these markets move in a homogenous way. But the odd one out has been China. It got completely separated from the pack by the Olympic games. The valuation at that time was so excessive that a fall had to take place.

There is a good chance that the excuse for a meltdown into the October lows will be the hard landing in China. Also, the reason for a subsequent rally will probably be the next massive stimulus package from the US. It is important to remember that the market is going to do what it has to do anyway. All these explanations are just so that the media has something to talk about.

Right now the priority is the need to survive a hard landing. Do not break a leg. All other plans are on hold.

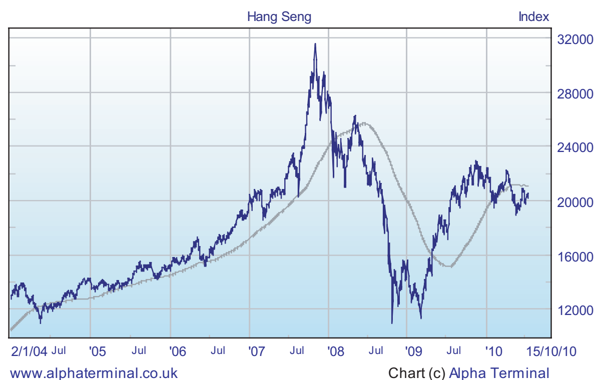
Australia

China



Pacific ex Japan

Hong Kong



India

South Korea

Malaysia

Taiwan

Thailand

Emerging markets

Relative supremacy

With China headed for a landing of sorts, it is the other emerging markets that come out at the top of the ranking table. Currently Chile and Colombia are at the top.

Looking at the larger markets – India, Mexico and Brazil are all in the strong group and are unlikely to slip very far.

Even in the best of these, the indices have cut below their 200-day moving averages, but the slope of these lines remains positive.

In some cases there has been a dead cross with the 50- day average but not with the 100-day one.

The best markets are having a range bound consolidation at high levels and show little need to fall much. Others are falling but at a slower rate than the global index. All are, therefore, showing relative strength.

The fact is that the global tide is going out. The good boats cannot show their true form until the tide comes back again. That should happen in October.

Turkey is included in this group and looks very strong. At no time has its index broken its still rising 200-day moving average. There is no dead cross. The index is almost at its high for the year. Major support is less that 10% below current levels.

If you hold this market there is no technical reason to sell it. A fall of 5% would be a buying chance. This is typical of a market in secular uptrend.

Brazil

Russia

Emerging markets

Emerging markets index

Mexico

Chile

Turkey

Eastern Europe index

Poland

Bonds

What you should have done

Most people prefer to hold equities as these can give prospects of growth. But what they should have done recently is buy bonds.

The move into the lowest risk asset class, even though the yield was tiny, has actually led to a capital profit. Ironically, those who abandoned hope of growth and just wanted not to lose any money have ended up making a profit.

Capital flows show a huge number of investors have been abandoning equities and switching into US Treasuries and sovereign bonds. They have made a profit as interest rates have been driven lower.

The Fed intends to keep rates as low as possible for as long as they can. They will only stop if their money printing leads to runaway inflation. However, at present, most of the data available point to a double-dip.

Our work has always indicated that the greatest risk is deflation. We are in the Kondratieff winter or negative secular trend in mature western markets. This is the cyclical equivalent of the thirties which was the last time we had a depression.

The only reason why the global economy might escape a depression this time is because the newly- emerged economies are large enough and growing fast enough to make the difference.

In the west, a good outcome will be a period of up to ten years of very modest progress in the 1-2% growth area. During this period, Government and private sector borrowings will be paid back, or written off.

Any more stimulus packages will simply delay the day when the economy can get back on a more positive footing. In the US one more stimulus package will increase the odds on Obama being a one-term President.

Whatever happens, there are tough times ahead. It is important to get out of debt. It may well be that what has been happening in Japan is a role model for the US.

If the Fed keeps printing dollars, which they will do while the threat of a double-dip looms, they will ensure a further erosion of the dollar's value. We are already moving into a world that will not use the dollar as its dominant currency, or unit of account.

US Treasury bond 10 year yield

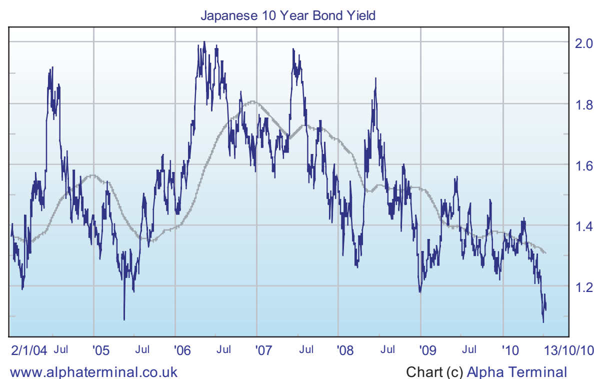
Bonds

US benchmark bond 30 year yield

UK benchmark bond 10 year yield

German benchmark bond 10 year yield

Japan benchmark bond 10 year yield



Commodities

We are out and happy

We never like being long and wrong. The CRB index is in a bear phase, even though it is in a secular uptrend.

The secular trend in commodities is predicated on the continuing growth of China in particular and Asia in general. Overall, we support this view but not in the short term.

China and commodities will make their landing at roughly the same time. If something falls from the sky near you with a loud thud, it is advisable to stand back as it might explode. Only after the all-clear is given will we be prepared come out of our shelter and pick up some of the pieces.

In bear phases investors ought to sell their losing positions, but this is painful so instead they sell the few that running a profit. At the moment this includes gold.

We anticipated this and have already sold our gold position. However, we will be looking to buy it back again – but not yet.

If you plot gold in euro terms, it is already well off its high and the correction does not look complete.

Priced in US dollars, we expect the gold price to retreat back to approximately $1060. It may not start zooming up again until early next year, but we will probably start buying again in October. We think that in its next upsurge the price could possibly double. So targets of $2000 do not seem unreasonable to us.

The only part of the commodity complex that looks like a bull move is the softs or agricultural commodities. Looking at the charts, they have broken smartly into uptrends, however these are specialist markets.

We know enough to know that we do not know enough to trade them. So we are going to stick to gold, where we are out of the market at present. Only after the gold price has made a low and then pushed back above $1265, are the gold mining stocks likely to start outperforming.

The other commodity we like at the moment is Uranium. We use the Canadian stock Cameco as the bell-wether stock and it has suddenly sprung to life. This warrants close attention.

Commodity price index

Gold

Commodities

Platinum

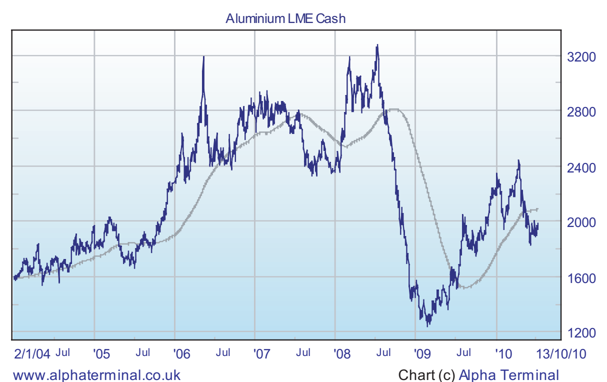
Oil

Silver

Palladium

Copper

Aluminium



Currencies

Counter-trend corrections

The recent trends in currency markets are all counter to the longer term trends in place.

The long term trends never go in a straight line but rather in moves of two steps down, one step up.

The secular trend for the dollar has been downwards, but it got too low too soon in November. Since then there has been a dollar rebound, but this, again, got overextended in June.

The DXY, or dollar-trade weighted, is now 82. Major support is at 80. This was established in February to April and is reinforced by the 200-day line. It seems unlikely to fail. Our view will alter radically if it does. Once the low is in place, a new rally is expected which will take the dollar back towards 88, the June high. It is possible, and indeed quite probable, that this run could extend to 90 or even 93. Only after that is the Fed printing press likely to undermine the dollar and the secular downtrend will resume.

What that means for the euro is that the present rally could go up to $1.34, but then would be likely to re- test the lows at $1.18. Only if the support in the $1.17-$.120 range fails, is there a risk of the rate testing $1.00. There are however credible forecasts of $0.82.

The charts indicate that the euro will not break up. The last time it went to $0.82 it survived. In fact current levels are almost the mean price of the past 20 years .

Sterling looks likely to stay in a range of $1.55- $1.45. Mr Market seems to like the Con-Lib coalition and thinks it is doing the right sort of thing.

Where we have been wrong is on the yen. It had looked to us as though the yen was set to fall. In fact it has been super strong, rallying to levels not seen since 1999 and close to its all-time high. It has clearly been used as a safe haven.

This may not be a sustainable level or trend. As long as the yen is in the $80-88 range it is “irrationally” strong. We need to see it back in the $90-92 range for it to make sense to us (and Japanese exporters).

Gold, in its role as a proxy currency, has become weak in both dollar and euro terms while plotted in yen it is a disaster. We expect the next buying chance for gold to be around October but would not be surprised to have to wait until January before a clear base has developed.

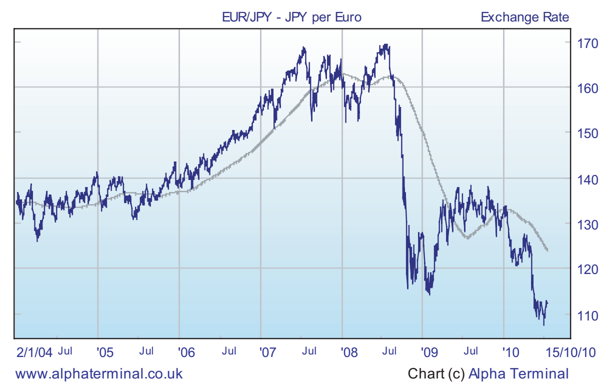
US dollar: trade weighted

US dollar/euro

Currencies

US dollar/Japanese yen

Euro/Japanese yen



Sterling/US dollar

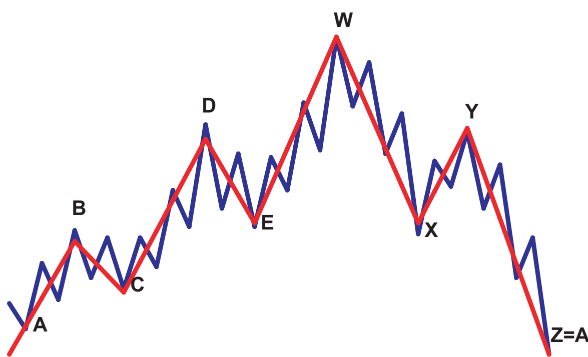
Sterling/euro

US dollar/Canadian dollar

Australian dollar/US dollar

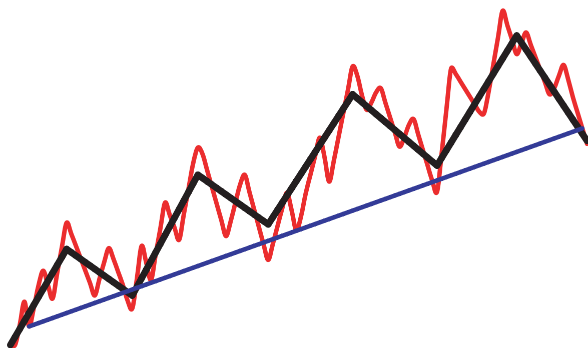
Road maps

Standard road map



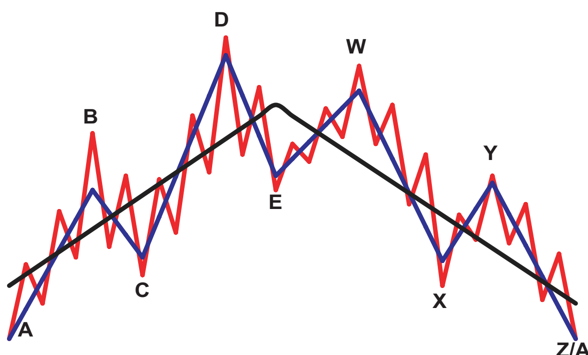
- These road maps are the basic shape of a so called Elliott Wave. We deliberately letter our maps differently from Elliott aficionados. The normal time scale for a complete cycle is four years driven by the Kitchin wave. The bull phase has three surges getting progressively more powerful. The bear phase is a fall, followed by a rally, followed by the rest of the fall. Big waves are composed of smaller waves of exactly the same basic shape. In practice, the waves we wish to trade can be traced out as the Index moves away from and back towards the 200-day moving average. If it is below that average, then it is a bear market.

Standard road map skewed by secular uptrend



- The standard model can be distorted positively by a strong secular uptrend. The small waves tend to take the same amount of time, but there is always an upwards bias. Even in the bear part of the cycle, a new high might be made and the next drop back is the end of the correction. The rule on this road map is always buy the dips as long as it is clear that the underlying secular trend is still valid.

Standard road map skewed by secular downtrend



- The basic map can also be distorted negatively. This, in practice, makes the bull part of the cycle very short and stunted. It also has the effect of lengthening the down part of the cycle. The rule here is always to sell the rallies. The secular trends that perform these distortions last for multiples of the four year cycle. Trends of 16 to 20 years are quite normal. On rare occasions they can be longer.

Source: Robin Griffiths based on Schumpeter

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