Global Report – March 2011

UK

Europe

US

Japan

Emerging Markets

Bonds

Commodities

Currencies

March 2011

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 market overview

Every so often a *force majeure* will disrupt the general pattern of life. By any standards a force 8.9 on the Richter scale is such an event. A huge area on both sides of the vast Pacific Ocean will be affected.

This could be a game-changer for many of the trends that had been in place. But it will take time for these changes to occur.

The world was unprepared for the giant tsunami that has hit Japan but we must try to be ready for some rapid changes in direction even though we cannot predict what exactly they will be. We will have to be quick to recognise them when they occur.

This report was prepared before the tsunami occurred and is based on where we are on the cyclical trends. As Joseph Schumpeter, the Austrian economist, noted these cycles can be distorted by external events. The tsunami is an external event and may twist the cycles out of shape for a considerable period but it is too soon to judge this. So, for the time being, we are assuming that the cyclical trends will hold good.

The Asian world is where most of the growth will be coming from in the years ahead. These markets are in secular uptrend but they are now already in the bear part of the short term cycle.

The mature western world markets are in secular downtrend but are still in the strong part of the short term cycle.

As a result, there is currently a flow of funds from the east back to the west. This is a reverse of last year's swing and was looking a little overextended even before last week's disaster. That event may accentuate the pull back that would have occurred in response to the overbought situation Any wobble now may well set up a buying chance for a further positive trade.

The month of March has been a turning point in the last few years but it still only looks like an intermediate type of top. Both the annual seasonal deviation and the four year Presidential cycle should give a favourable tailwind to stock markets until at least late May and this could stretch as far as early August.

So, unless the effects of the quake and tsunami have a major impact on the cycles, we would expect western markets to try and rally one more time back up to the tops made in 2008 and 2000.

The large markets of Asia – China and India – were both deliberately cooling their overheating economies and stock markets. The natural disaster in Japan may, again, give added momentum to this correction process. When good value appears we have every intention of being ready to buy and indeed overweight these markets in our portfolios.

Finally, one important general point, we are living in such uncertain and traumatic times that placing huge gutsy calls is foolish. Taking modest positions, with well diversified risk, is the way to ride these markets. Preservation of capital is more important than always trying to maximise it. Discretion is the better part of valour.

Summary: world investment strategy

Imagine a train being pulled by an engine at the front, and going along a track that has regular hills and valleys. The engine will get to the top of the hill first and start going down again even as the carriages at the back are still going up.

Stock markets of the world are like that now. The ones that are the engine were climbing fast to the top of the hill all last year, but have now passed the brow and are coming down again. They are, nonetheless, the engine of the train.

The back carriages are still rising and therefore seem to be outperforming the engine. This will continue until they, too, get to the top of the hill. There will then be a time when they all go down together.

Lastly, it follows that the engine will get to the bottom first and start going back up again, even as the carriages keep falling.

There is one further complication in that we have so far only explained the short term cyclical movements. In reality the markets that are the engine of the world are following their cycles around a rising secular trend and the carriages are following their cycles around a falling or flat secular trend.

If you are familiar with our three road maps at the back of this document (see page 25), you will find that the carriages, or mature western markets, are on the negatively-skewed road map and are rising to point W.

The engine, or emerging markets of Asia, are on the positively-skewed map and are in leg Y to Z.

The length of the train is from Y back to just before W but, apart from this time lag, they are all moving along the track at the same speed.

We do not think that the back of the train has reached the top of the hill yet.

Using our cycle theories we are in the strong part of the annual seasonal deviation. From late October through to late May is usually the best of times.

Secondly, on the four year cycle the best nine months of the entire wave follow a low after the mid-term Congressional election. This period is, on average, good for a rise of 14%.

The ten year Juglar wave gives an important low probably in late 2012 or early 2013.

On our road maps the phase from W through X and Y to Z sets up a good buying chance. The Asian markets are already in the Y to Z leg and the western markets will get to W probably after late May, but before October this year.

If the time lead/lag is maintained, we will get a great ‘Buy Asia’ moment later in the year but will have to wait until late 2012 or early the next year to reach this point in the western markets.

At present, money is coming out of emerging markets and into the blue chips of the west. This is a momentum play.

Money is also coming out of government bonds and into real assets.

It is interesting that, with all the problems in the PIIG markets in Euroland and the uprisings in North Africa and the Middle East, it is nonetheless the US dollar that has gone down to new lows. The markets are rejecting the dollar as the major global currency, which offers a safe haven of value in uncertain times.

Against this background, It will come as no surprise that gold has gone to a new all-time high. Not owning any gold in these uncertain times might be considered a sign of insanity or, as Mark Twain is attributed to have said, “Denial is not just a river in Egypt.”

The world at a glance

Major markets

US relative to world: currency adjusted

The US stock market is slap in the middle of our ranking table. It was almost unchanged in the past month but up 7% over the three month period. The relative performance is above its moving averages but the slope of those trend lines is static. Last year this market was overlooked as funds flowed into the emerging markets. This year it is being bought, but even in catch-up phase it does not come out at the top of the ranking table. There is also little currency boost for overseas investors as the dollar is not being used as a safe haven in these troubled times

UK relative to world: currency adjusted

The UK is highly correlated to the US. It happens to come out higher in the ranking table at present, indeed it is in the strong category. This is partly an illusion. The difference in the slope of the moving averages is not that great. We must remember that the stocks in the FTSE index are very international. They reflect a very different picture from that of the underlying economy. The largest stock in the index, HSBC, only has 12% of its business in the UK. So, although the US economy is stronger than the UK, this is not being reflected in their respective stock markets.

Europe relative to world: currency adjusted

The euro region is good and bad in parts. Fortunately the largest economy, Germany, is in the strong half. German exports are doing well but the domestic political wrangle over the viability of the euro needs to be sorted out. The rules of engagement for the euro will have to change if it is to hang together. There is renewed pressure on the peripheral markets and during any general wobble in equity markets they will fall further than their stronger counterparts. We are not looking to invest in these peripheral markets.

The world at a glance

Japan relative to world: currency adjusted

- Quakes of 8.9 on the Richter scale are not normal and we do not read them on stock market charts. Until this disaster occurred, the Japanese market was in a rally phase, roughly in step with the US and neutral on our ranking table. It is probable that this will now change for the worse, but we cannot make predictions until more data is available on the extent of the damage.

Pacific ex Japan relative to world: currency adjusted

- China is back in the top category of the ranking table but this is a little artificial. The latest five year plan has been announced and a certain amount of official support has been applied to the market. This may be temporary. We still expect the index to fall back to make an important low later this year. Meanwhile, we are worried about a property bubble developing in Hong Kong. This market, together with Taiwan, is in the weakest group. But the sell off should produce a buying opportunity later in the year.

Latin America relative to world: currency adjusted

- Markets in the Latin American region are all slipping down our ranking table at present. They have been in the strongest group and are now all in the bottom half of the table. The base metal prices, especially copper, have broken down and this will drive these markets lower. The secular uptrend is still in place but we are now in the cyclical bear phase following China and India lower into the next great buying level. We do not expect to hit this for several more months.

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
Russian Federation	++	✓	✓	✓	5.4		18.8		33.5	
Canada	++	✓	✓	✓	2.8		10.8		23.7	
China	++	✓	✓	✓	4.7		7.0		26.1	
Germany	++	×	✓	✓	-0.5		8.0		24.1	
Netherlands	++	✓	✓	✓	0.4		11.2		10.3	
Italy	++	✓	✓	✓	0.0		15.3		1.6	
Denmark	++	✓	✓	✓	2.1		8.9		22.5	
Poland	++	✓	✓	✓	0.5	1.9	9.1	11.1	18.0	20.0
France	+	×	✓	✓	-0.6		10.2		4.7	
Indonesia	+	✓	✓	✓	5.1		-2.5		42.3	
United Kingdom	+	×	✓	✓	-1.5		5.6		14.3	
Thailand	+	✓	✓	✓	4.7		-1.3		52.4	
Belgium	+	✓	✓	✓	0.0		7.8		5.0	
Australia	+	×	✓	✓	-2.4		5.8		12.7	
South Africa	+	✓	✓	✓	0.8		0.8		21.4	
Czech Republic	+	×	✓	✓	-1.6	0.6	13.5	5.0	12.0	20.6
Austria	o	×	✓	×	-4.0		6.3		15.4	
Peru	o	×	✓	×	-4.6		4.2		59.0	
Hungary	o	✓	✓	✓	-1.6		11.5		0.4	
Sweden	o	✓	✓	×	-0.2		6.6		24.8	
Switzerland	o	×	✓	✓	0.8		6.2		9.2	
Spain	o	×	✓	×	-2.1		10.7		-4.3	
United States	o	✓	✓	✓	-0.2		7.6		16.1	
Japan	o	×	✓	✓	-2.0	-1.7	6.1	7.4	11.5	16.5
Venezuela	-	✓	✓	✓	1.6		3.3		18.7	
Malaysia	-	✓	✓	✓	-1.4		4.2		26.3	
Argentina	-	×	✓	×	-3.1		-0.2		44.0	
Brazil	-	✓	✓	✓	4.2		2.0		7.1	
Colombia	-	✓	✓	×	2.9		-2.2		27.3	
South Korea	-	×	✓	×	-4.7		4.6		21.8	
Philippines	-	✓	✓	✓	0.4		-6.9		32.8	
Mexico	-	×	✓	×	-2.6	-0.3	0.9	0.7	18.7	24.6
Hong Kong	--	✓	✓	×	0.9		2.4		11.4	
Taiwan	--	×	✓	×	-5.6		3.2		22.1	
Chile	--	×	✓	×	-1.0		-7.4		29.3	
Singapore	--	✓	✓	×	-2.3		0.6		20.8	
India	--	✓	×	✓	4.2		-6.4		8.9	
Israel	--	×	✓	×	-3.4		-1.2		7.2	
Egypt	--	×	×	×	-0.5		-17.1		-19.3	
Turkey	--	×	×	×	-7.1	-1.8	-14.9	-5.1	10.8	11.4

Ranking and data in US Dollars

United Kingdom

Puffing Billy

Like a steam train going up a steep hill, there has recently been a lot more heavy puffing and groaning than actual progress. It is hard work.

The highest of the Fibonacci ratios is 76.4%. The FTSE index has now retraced more than 76.4% of all that it lost in the 2007-09 bear move. This suggests that, if it manages to go any further, it ought to be able to retrace the entire drop.

The old high, made on 07/13/07, was 6754 which is 11% higher than current levels. That is the upside potential. The immediate downside risk is only back to the resistance levels of last year, about 3% down from here. On balance, a fair risk:reward ratio.

We must not forget, however, that the entire move is in the presence of a secular downtrend. It is all taking place at levels lower than the high of ten years ago. Secular trends do not normally stop after 10 years. On average they last for 18 to 20 years and sometimes it can be longer.

What this means is that the recovery of the past two years has been a rally within a major bear phase. It is inherently unlikely to make new all time highs. The rally is probably not quite over yet, but it is getting near to the top.

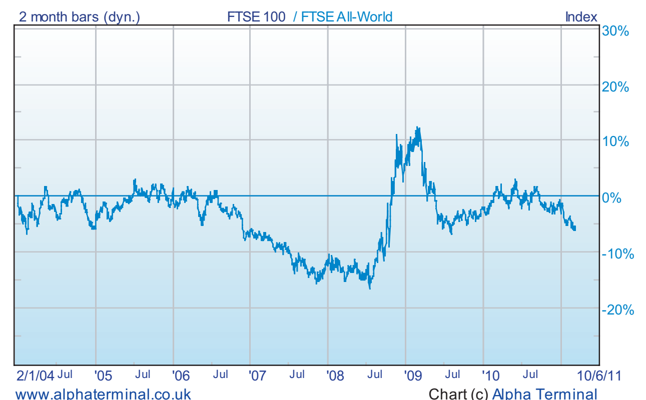
We might experience a small setback now to alleviate the overbought condition of the market. But thereafter the seasonal pattern gives good odds for a small further rise until late May. There is even a chance of a mid-summer rally which could run into August but from then on the protection of capital will become the dominant theme.

The internationally-exposed businesses that dominate the FTSE-100 index are good franchises and will pay good dividends. Many have just released good profit figures and in many cases represent a safer haven that government bonds.

Sterling meanwhile has been strong and still has some upward momentum - at least against the US dollar. When markets finally top, this will reverse. Risk-off trades are dollar positive.

FTSE 100 index

FTSE 100 index relative to world



Europe ex UK

Renegotiating the rules

We are still in the process of renegotiating the rules of the Euroland. It has become increasingly clear to the market that, under the original rules, the club could not survive.

Forging an integrated Europe was always going to be a gradual process. The member countries have a long history of acting as independent states and it will probably take a generation or longer to pull their various laws into a coherent United States of Europe.

Yields on Portuguese, Irish and Greek debt have hit new highs. It is entirely possible that for a while a two tier membership will follow, but that is far from a foregone conclusion. The vested interests are huge. There are fewer uncertainties involved in pulling it together than in allowing it to blow apart.

Martin Wolf recently wrote an article in the FT with which we agree. The eurozone will survive because the political will for it is strong. The advantages over time are huge and the bottom line is they can afford it. As he pointed out, although the individual debt figures for some of the member countries are rather daunting, overall, eurozone public debt is only 84 per cent of GDP and the fiscal deficit is just six per cent. Both these figures are lower than the US equivalents.

The greatest export machine in the world is not yet China - it is Germany. German exporters are doing spectacularly well as a result of the weak euro.

Over the past 100 years, the long run rate of interest has been close to 5.5%. If Greece and Ireland cannot afford bail-out loans at that rate, then they will have to temporarily leave the club. In practice, they should be able to handle it, but they will have to work harder and behave a bit differently in future.

There is no sign of a top on the German stock market yet. The strong brethren in the euro group can all still go higher. The weak ones are already below their lows of 2009.

In a nutshell, we can continue to invest in the strongest and best companies of the eurozone. It is only once these markets top out and a risk-off period starts that the dollar is likely to be stronger than the euro currency.

European equities

European equities relative to world

Europe ex UK

France

Germany

Switzerland

Netherlands

Scandinavia

Spain

United States

Because it is there

When asked why they had made so much effort to climb Mount Everest, Sir Edmond Hillary and Sherpa Tensing said, “because it is there.” All you get at the summit is a brief photo opportunity and then you have to come down again, but humans are like that. Some things just have to be done.

Stock markets are no different. The Nasdaq Composite Index has already climbed back to the highs of 2008. But do not get too excited - the all-time high is still another 2000 points away.

The S&P 500 and Dow Jones indices have still to make their attack on the 2008 summit, but they do look as though they are determined to have a try. There is about 13% more upside potential. Then, of course, they will have to come down again.

The strong season of the year is still upon us. More importantly, the strong part of the Presidential cycle is underway. Although the nine months after the mid-term election are often the toughest period for the incumbent, it is statistically the best part of the entire four year cycle for the stock market.

On average, the market has a gain of 14%, which is more than the entire remainder of the cycle. This seasonal strength should therefore last until later in the year.

We can expect a bit of a pull back now to eliminate the overbought condition that has been created by the strong rise so far. It should then have one more rally phase until possibly August.

We are quite clear that the secular downtrend is still in place. No sustainable new all-time high breakout is expected. This rise is a momentum trade up and is probably best played by investing in the giant franchises that pay good dividends and are globally competitive. The US still has plenty of these and they were left behind last year as the money went into emerging markets so there is catch up potential.

Importantly, with the unrest in the Middle East and the euro region forced into rule-changing mode, it is nevertheless the dollar that has been the weakest currency. It is not at the moment regarded as a safe haven.

A risk-on environment in equities is dollar negative. It follows that when the top for markets is in place, a massive de-leverage move should cause a dollar rally of some considerable size.

S&P 500

Dow Jones Industrial Average

Canada

Golden highway

Dick Whittington thought, wrongly, that the streets of London would be paved with gold. However, the path on our road map that the Canadian stock market is following certainly is.

The strong road map shape is being traced out perfectly. The low last year was at the same level as the high in the year 2000. Now 30% above that high, it is obviously in secular uptrend.

The high in 2008 was point W on the map and the low in 2009 was X. The latest rise is taking the index up to Y. This must be followed by the setback to Z.

The Indian and similar markets are already well into the Y to Z leg, but otherwise the overall chart pattern is similar. The slowdown in Asia will soon knock on to Canada.

There is a 7% upside until the high of 2008 is reached – for the TSE index this was 15,154. It might just exceed that level before profit taking sets in.

Gold has played a big part in the stocks that are on fire here. Once stock markets start topping out, the US dollar is likely to rebound. The price of gold could then be in for a decent setback or consolidation phase lasting six months.

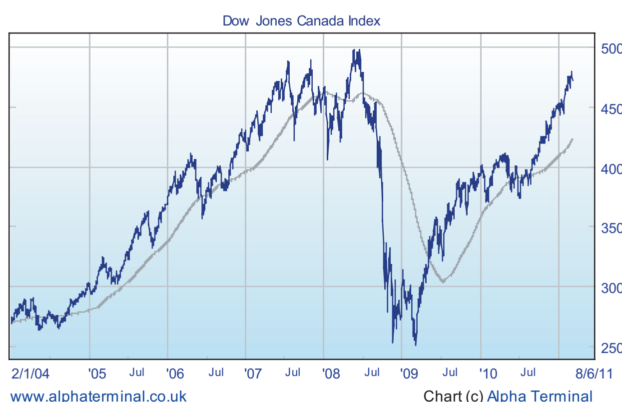
But we are not quite at the top yet. In terms of timing, as with the other western markets, we think it will be in the second half of the year.

Any short term setback now could still be followed by one more big surge. Momentum such as we have been seeing is hard to squash.

The long term tend for the Loony (Canadian dollar) is upwards and it has already achieved a premium rating to the US dollar. This can go higher still until the de-leveraging phase in the markets begins. At that time a return to parity should be expected.

After the setback, the Canadian market will be at a new point A on our road map. This will be the start of a new cyclical uptrend still in the presence of a secular uptrend and backed by a strong currency. This huge buying chance should occur in 2012.

Canada



Canada relative to world

South Africa

On steroids

The overall chart pattern for South Africa is almost identical to that for Canada except the actual moves are more dramatic.

Whereas Canada is currently 30% above the highs made in 2000, the South African market is up 264%

Both are, of course, in secular uptrend but in the negative part of the cycle. The high in 2008 was point W and the low in 2009 was X. The high that is now being approached will be Y.

Using our analogy of the train, these markets are the carriages right close behind the engine. They will make the next top sooner than the western markets but, by the same token, they will get to Z first as well.

The road map for a market in secular uptrend allows for Y to be higher than W. That means that, although the 2008 high has already been achieved, a further run up can still be achieved. It is a momentum trade and will later be reversed.

Last month the JSE index hit a high of 33,334, which is up 87% from the lows of March 2009. This move created an overbought condition and a modest setback would neutralise that.

The theories of W.D. Gann lead us to expect a 100% quantum jump from the low. It is uncanny how frequently markets double or halve.

This means there is possibly a 13% further surge to go for. But we should then sell that rise.

The setback to Z (new point A) on our road map would be quite likely to retrace a half of the most recent big rise. In ball park numbers we could expect a buy signal in the region of 26,000 for the JSE index.

We still believe that the Asian growth story is intact, and remains the engine of the global economy. This is what will ultimately underwrite the future for many African economies. They are, however, all high beta plays and currently in the correction part of the cycle.

JSE All-Share

JSE All-Share relative to world

Japan

Fundamental value

Before the tsunami there were good fundamental reasons to be buying shares in Japan. The best stocks are basically cheap. But even then we could not use technical analysis to enhance the buying story.

The Japanese Nikkei index has been in secular downtrend since 1989. It is not possible to say with confidence that that downtrend has made its final low.

The index has risen 52% since March 2009. That compares with the US market having almost doubled. Some markets are now back to where they were in 2008. For the Nikkei that was 18300. Last week's level of 10,600 was still 40% down from the 2008 high.

It is true that the index is making a pattern of rising highs and lows and is above its 200-day moving average. However the slope of that average is still negative.

The index is still lower than the highs of 2009. The important April high was at 11,408. As an absolute minimum, it needs to push above this level for us to turn bullish and support the fundamental story.

On the downside, a prolonged move back below 10,000 would be a new sell signal and imply a re-test of the old lows of March 2009 at 9,000.

Needless to say, if this support area failed, then it would be straight back to the 6,995 low made in 2008.

Prime minister Naoto Kan has promised that the long term effect of this disaster will be to create a new Japan. This might be what is needed to kick-start the long-awaited bull phase for the Nikkei Index.

Nikkei 225

TOPIX

India

Waiting for a bargain

As one of the markets that we have called the engine of the world economy, the Indian Sensex index is already well into the Y to Z phase on our strong road map.

The index fell 18% from its all-time high and found support at 17,292. In the process of falling, it broke its 200-day moving average and the short term averages have made dead cross signals with the long term line.

Recently, there have been three attempts at a rally but none of them have been able to break back above the 200-day average, currently at 18,866.

The pattern we expect is for short term rally, followed by a further decline during which the index could easily reach 16,000. This would be a good entry point into what remains our favourite long term market. The secular uptrend remains intact.

The economy is likely to grow at about 9% and earnings per share at about 15%. These earnings are currently rated at a 16.5 P/E. We will be looking to buy at a P/E of 14.

Apart from the fact that foreign money flows drove the market too high, too soon last year, there were two important issues to be dealt with.

The price of food items had got to levels that were causing real hardship, and, secondly, there was a political corruption scandal.

The first of these issues is being brought under control through interest rate increases.

The corruption issue has unfortunately revealed Manmohan Singh as a weak prime minister. He is part of a coalition which he does not fully control.

We anticipate the flow back into emerging markets will take place before the next major low in western markets. For now, the east is cooling and the west is catching up. This will reverse again but meanwhile the current market dynamics should create a good window to build up a substantial exposure to the long term growth story of India.

Driven by positive demographics, we believe this market will become the biggest in the world. The next 20 to 25 years should be mainly positive for the stock market and investors should be looking to take advantage of setbacks such as the current one to increase their weighting.

India

India relative to world

Pacific ex Japan

No joke

In the west we have a saying, if you want to make the gods laugh, make plans. But when China announces its new five year plan it is never intended as a joke.

The latest plan has been accompanied by a rise in the index. However, this rally may not last long.

Bubbles have blown up, especially in the property sector, and the steam needs to be let out of these. The indices should get back down to levels where some long term value is available.

While the Chinese market is consolidating lower, most of the other markets in the region will follow it down.

Almost all of them are in secular uptrend but rallied too far, too fast. In order to keep the long term economic outlook positive, it is necessary to have a short term cooling off period. The policies used to achieve this may be quite draconian.

It is not just Japan that will be affected by the giant earthquake and tsunami. A reading of 8.9 on the Richter scale will cause enormous damage and the cost is going to be huge. It will have repercussions throughout the region. An exogenous shock on this scale is potentially a game-changing event.

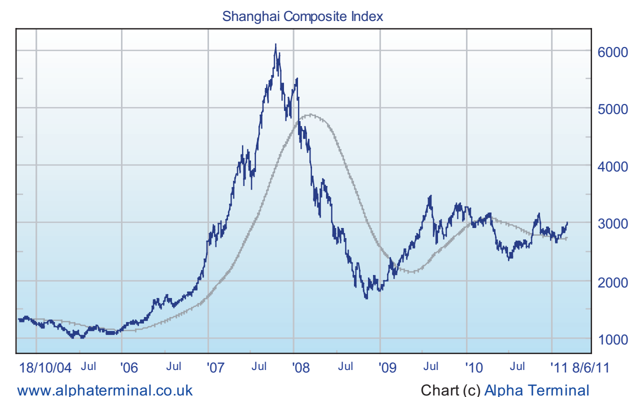
We have only seen the knee-jerk reaction so far. A more considered reaction will be more meaningful.

The tsunami has come at a time when these markets were in any case falling. They are mostly on our secular uptrend road map but at the moment are in the bear part of the cycle.

We do not expect the secular trends to end but in high beta markets the setback before they can resume the uptrend can be a big percentage decline. So we fully expect further selling pressure before the buyers come back into these markets. It is therefore advisable to stay on the sidelines for the time being.

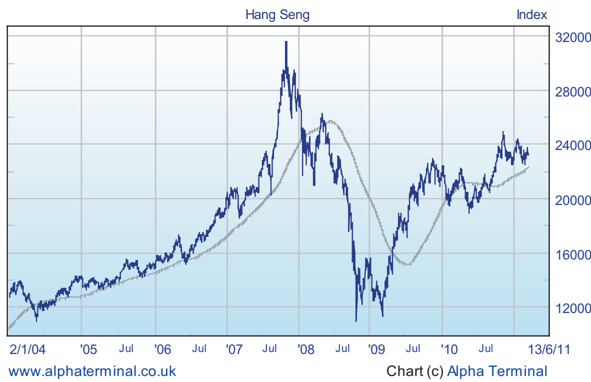
Australia

China



Pacific ex Japan

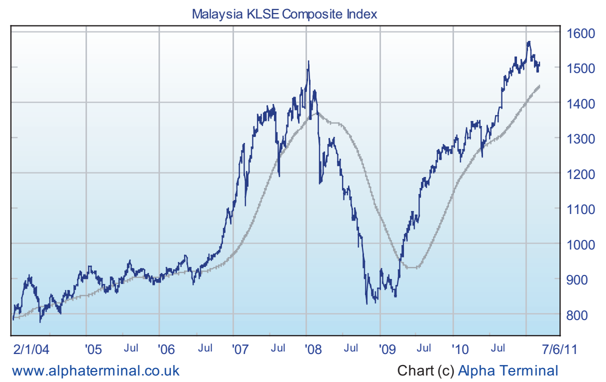
Hong Kong



India

South Korea

Malaysia



Taiwan

Thailand

Emerging markets

From the sublime to the ridiculous

Once again, markets in this group appear in both the very top and the very bottom sections of our ranking table. It is obviously difficult to make generalisations about the emerging markets at the moment.

In Russia, it is not clear what rights a foreign minority shareholder will ultimately have but, for as long as that does not seem to matter, it is a top-performing market. Being able to supply plenty of energy – in the form of either oil or gas – is obviously a colossal advantage. Almost certainly for most clients, an ETF would be the way to best way to establish a position here.

Most of the other emerging markets are in secular uptrends but have just turned over into the bear part of the cyclical move. This could last for at least six more months.

As the markets were all overbought, they can drop back by quite large percentages to neutralise this condition. They are an avoid for now.

Some markets, like Chile, are linked to mining a particular metal, and it is noticeable that copper has now broken its 200-day moving average. This break down cannot be viewed as a bullish development for economies, such as Chile, which are heavily dependent on mining the metal.

In the current state of flux, emerging markets will be inherently more volatile than their western counterparts.

Take profits where possible and hold cash in large measure. There will be a later and lower opportunity to buy back in to the region, when its undoubted long term growth potential can be bought on more reasonable terms.

Brazil

Russia

Emerging markets

Emerging markets index

Mexico

Chile

Turkey

Eastern Europe index

Poland

Bonds

The king is dead

The great bond bull market of the past 25 years is over. As we warned in the last issue, any apparent movement now is simply rigor mortis.

The greatest exponent of the bull was Bill Gross, manager of the largest bond fund in the world. He has now basically sold out of long dated US treasuries.

It was long becoming clear that the market was not willing to take much more new issues. For the past two months both China and Russia have been reducing their holdings of US bonds and Bill Gross has posed the not unreasonable question "who is going to buy once the Fed stops in June?"

Inflation in the everyday goods that people buy such as food and petrol is rising sharply. Although the Fed Chairman is correct to point out that larger items are still in deflation mode.

For most people it is expectations of future inflation that they find worrying, and which drive their investment decisions. With such fears gathering momentum, bonds become increasingly unattractive and do not meet the capital preservation test.

Sovereign debt has ballooned and there are concerns that this bubble will burst. By contrast, many of the big companies appear more stable and better managed. Consequently, they look a more attractive investment proposition and this year there has been a huge cash flow out of bonds and emerging markets, into the shares of giant international equity franchises.

In the bond market we get better rewarded by owning the bonds of great companies.

At present, we would only own short dated government bonds which are almost cash. A modest return on our money is acceptable if we can be sure that we can get it back when we want it.

US Treasury bond 10 year yield

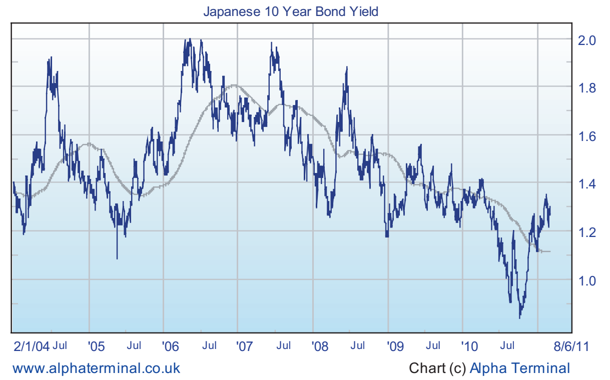
Bonds

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

Blowing off the froth

If a barman pulls a pint of beer badly, it will have too much froth on the top. This needs to be blown off so the glass can be topped up to a full measure. This is what is happening in many commodity markets now.

The long term story of growth in Asia, which will pull a sustained commodity bull market behind it, is still intact.

However, the Chinese and Indian economies are now being deliberately cooled down. They do not need to stockpile commodities at this point - and might even sell some of their inventory.

Thus, a sharp correction phase is upon us. This process was underway even before the tsunami occurred in the Pacific.

Using normal Elliot wave counts on most commodity charts shows a five wave up count has been completed, so a three wave correction should now take place.

The exception is gold, which has made a new all-time high break out. This is because it is money and not really a commodity.

According to the rules of technical analysis, a new high breakout should be followed by a further rise. If the move becomes overbought, we could see gold at $1,600 this year. At some point it will need to have a proper six month consolidation, but this is unlikely to happen until the dollar is ready to rally. This will only take place when investors sell equities and de-leverage their portfolios.

Some of our readers may well have bought Silver Wheaton. Silver has moved up faster than gold and this stock is a geared play on that move.

Of course, it will be highly volatile and there will be many times when you will think you could have sold and bought back again for profit. I have tried this and it is hard to get right.

Gold and silver could eventually double from their current levels. However, it will be a rollercoaster trajectory. If you are prepared to live with the volatility, hold on for much higher levels. But, as the saying goes, “if you can’t take the heat, get out of the kitchen.”

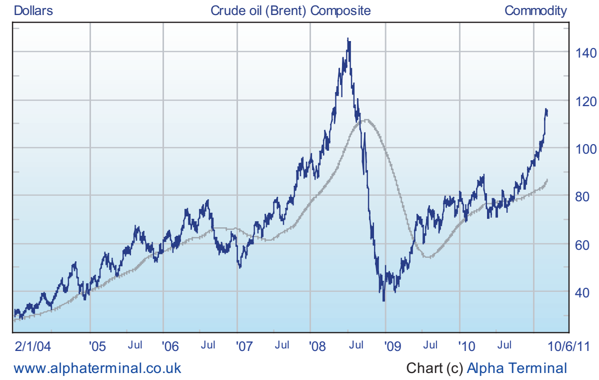
Commodity price index

Gold

Commodities

Platinum

Oil



Silver

Palladium

Copper

Aluminium

Currencies

Nobody loves me

The US dollar is suffering from rejection. It is not being treated as the world's most important currency and it has not been used as a haven of value in uncertain times.

If you had to make a list of conditions and circumstances that at any normal time would have made the dollar rise you would have included the following:

1. Financial problems in Greece, Ireland, Portugal and Spain that threaten the viability of the euro.

2 Regime after regime falling like dominoes in the Middle East, which has sent the price of oil shooting up.

3 An earthquake so large that affects the entire pacific region.

Yet with all these factors having occurred, the dollar drops to a new four month low.

It is clear that the printing press and helicopter have done their work in the US and nations like China feel that they now hold more dollars than they would wish under almost any circumstances. (They do not want any more long dated US Treasury bonds for that matter either.)

What has become clear is that investors, such as hedge funds, have borrowed in dollars to finance investments in other asset classes. So putting risk-on in markets has been a dollar-down experience. It follows that when they take risk back off again, they will pay back the dollar loans, triggering a rally in the currency.

If and when the dollar does start to rally, it is likely to gain ground across all the cross rates simultaneously. To trigger a bullish signal for the dollar, we would need to see the trade-weighted index break back above 82, cable back down below $1.55 and the euro below $1.35. The Canadian dollar would probably come back to parity as well.

A powerful dollar rally would still be seen as a rally within a secular downtrend. Once stability returns to markets and growth gets underway again, we will find that the engine of the world is still in Asia. The renminbi and rupee will be in secular uptrends.

The Japanese yen is hard to read. It has rallied in the aftermath of the tsunami on the expectation that funds will be repatriated but could weaken if there is significant quantitative easing to facilitate reconstruction works.

US dollar: trade weighted

US dollar/euro

Currencies

US dollar/Japanese yen

Euro/Japanese yen

Sterling/US dollar

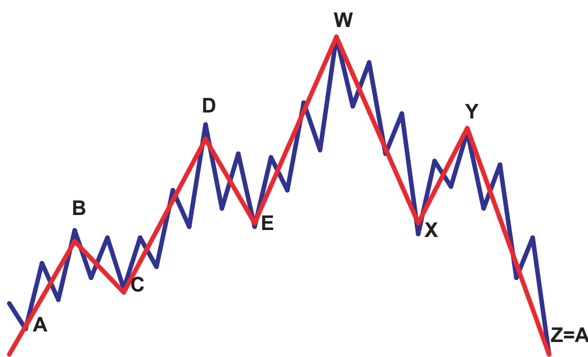
Sterling/euro

US dollar/Canadian dollar

Australian dollar/US dollar

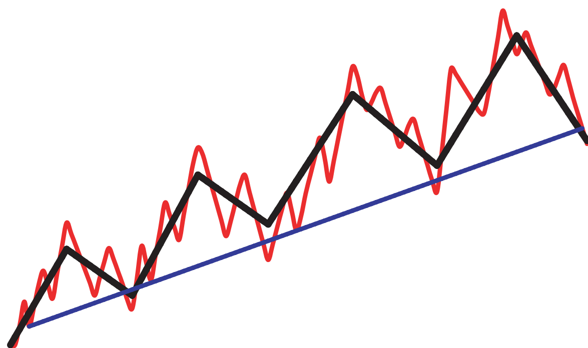
Road maps

Standard road map



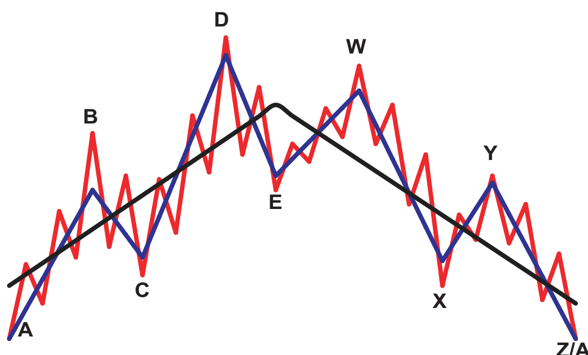
These road maps are the basic shape of a so called Elliott Wave. We deliberately letter our maps differently from Elliott aficionados. The normal time scale for a complete cycle is four years driven by the Kitchin wave. The bull phase has three surges getting progressively more powerful. The bear phase 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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