GLOBAL INVESTOR
A market view of the world

BLACKSWAN

CONTENTS

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Global Investor: *A monthly global macro view of the world; analysis of key market drivers; and intermediate- to long-term investment ideas using exchange-traded funds (ETFs).*

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Executive Summary
January 2012

2012 Outlook: The Case for US Recession

- First and foremost, it should represent a year of deleveraging…that is deflation.

- Key Rationales why we believe US growth disappoints:
  - Debt overhang—approaching 100% debt/gdp
  - Export headwind
  - Fiscal stimulus deceleration
  - Falling Consumer Real Wealth
  - Limits of monetary policy

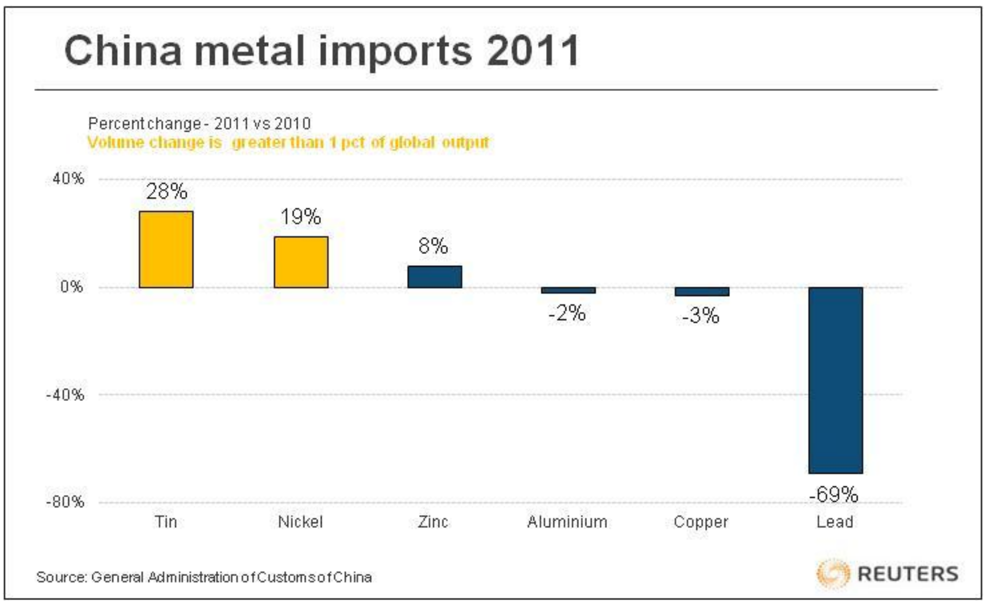
- Thinking linkages it doesn't look pretty
  - Flat US demand pressures China model
  - Slowing Chinese growth hurts German exports (ditto US growth)
  - Eurozone recession pressures Chinese exports
  - Eurozone banking crisis hurts Asian trade finance
  - Slower European and emerging market demand hurt US exports

Trade Idea.

- No trade idea at the moment. We are looking for an end in this run higher in risk assets and believe we are getting very close, i.e. we still expect a big market break. **Be prepared for a Flash Trading Alert soon!**

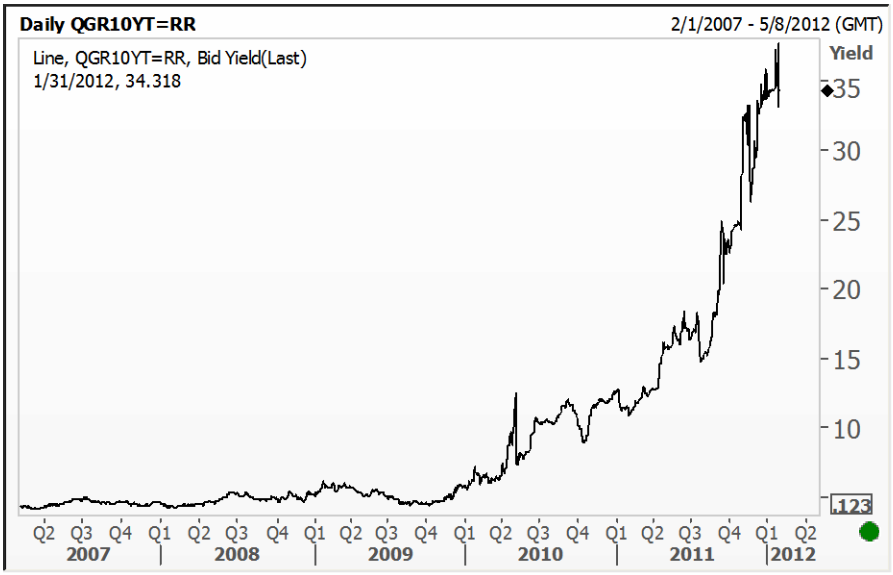
Of Interest

China Import Calculations Murky at Best. [REUTERS] Based on the simple formula that apparent consumption equals domestic production plus or minus any changes in stocks plus net imports, China's nickel demand was up by 39 percent year-on-year in December, its copper demand up 32 percent and its tin demand down by 19 percent. Quite evidently something is not quite right with those figures. China may be the fastest-growing user of copper, but was consumption really up 32 percent in December? When manufacturing growth was slowing? And what on earth has happened to the nation's electronics sector if apparent tin consumption was down 19 percent? The clue of course is in the word "apparent". In the case of copper, the answer is: not necessarily, as the market found out last year.



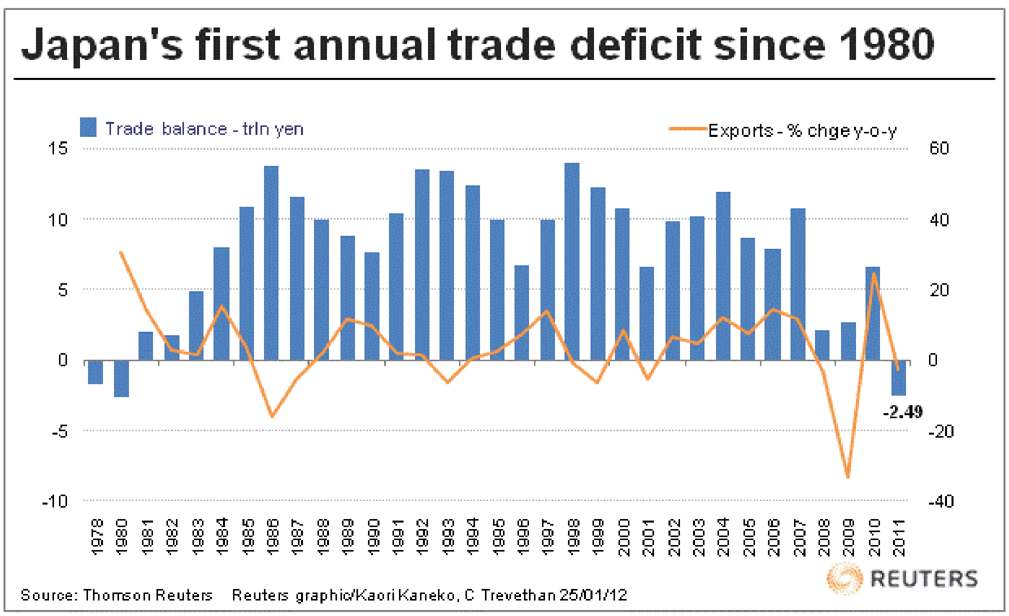
…What passes through customs and is counted as an import may travel through to a mainland buyer. But it may travel only as far as a bonded warehouse in Shanghai, acting as collateral for loans in a trade that has become a minimarket in its own right. When mainland China's appetite for copper increases, positive spot arbitrage and higher physical premiums will lure this metal out of Shanghai "limbo", at which stage the 17 percent VAT is paid. In the absence of that appetite, "imports" will back up to the point that metal starts to flow in reverse into London Metal Exchange warehouses in South Korea. This is what happened early in 2011 when bonded warehouse stocks totalled over 700,000 tonnes and re-exports mushroomed to 145,000 tonnes. As such, anecdotal reports that bonded warehouse inventory is once again rising are starting to ring faint alarm bells in the market. And it's not just copper.

Does a Greek creditor "debt deal" matter? When you add up the numbers, it appears Greek is heading for default either sooner or later. **"An involuntary haircut within the Euro interest payments would be stabilized at a level higher than during the outbreak of the crisis and only a shade below their all-time high, at around 7% of Greek 2011 GDP.** By spending €90 billion in a post-haircut settlement of the Greek debt within the Eurozone – regardless of how generous the haircut may be – the Eurozone cannot achieve debt sustainability. In other words, the official Eurozone creditors such as the German government cannot hope to recover their loans to Greece.



"But there is a far more important reason why Greece's debt is unsustainable beyond the obvious fact that a post-haircut €14.5-€15.5 annual interest bill makes it so**:** The Greek economy and the Greek political system have both disintegrated. Greece will not be an investible country for at least a generation," says Citron Zoakos, at Leto Research.

Oh Japan! A trade deficit, finally!
Ultimately, the dynamics for money flow may be changing as Japan is morphing to a capital importer from a long-time capital exporter.



Leader: The US is On the Road to Recession…Again!

Which road do I take?" (Alice)

"Where do you want to go?" (Cheshire Cat)

"I don't know," Alice answered.

"Then, said the cat, it doesn't matter."

"If you don't know where you are going, any road will get you there."

Alice in Wonderland

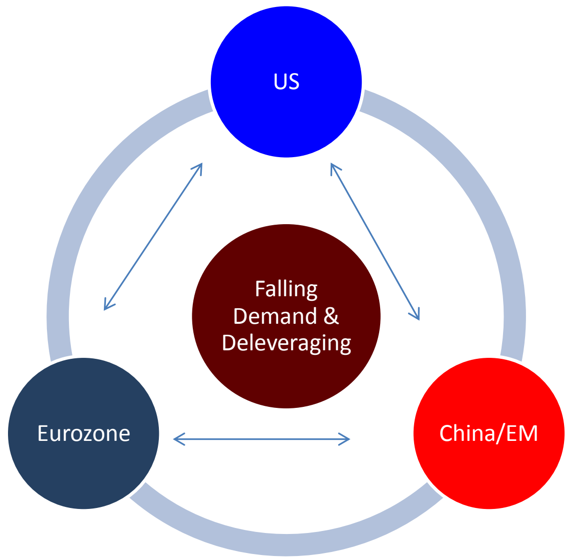
It's not for lack of trying, or knowing where they want to go, but the policy paths taken by global policymakers in an attempt to stave off global deflation and depression may have run their course. The aftermath of massive amounts of government debt and unprecedented monetary stimulus, coupled with a desire to continue down that path – a road that isn't getting us where we need to go – sets the stage for another recession in the US economy. The implications for financial assets are profound as a US recession significantly increases the chance two major systemic risk-events pile together to reinforce the downside — a deep Eurozone crisis and significant undershoot in the Chinese economy.

The most important player in fostering global demand is the US. We believe the US is heading back into, or very near, recession in 2012 and this will add to the already significant systemic risk potential flowing from the Eurozone and China. Plus, exports have added a big boost to US GDP, but the recession in the Eurozone and slowdown in China will bite into export growth; that is just one example of the feedback to the US from its trading partners who are in turn hit by falling US demand.

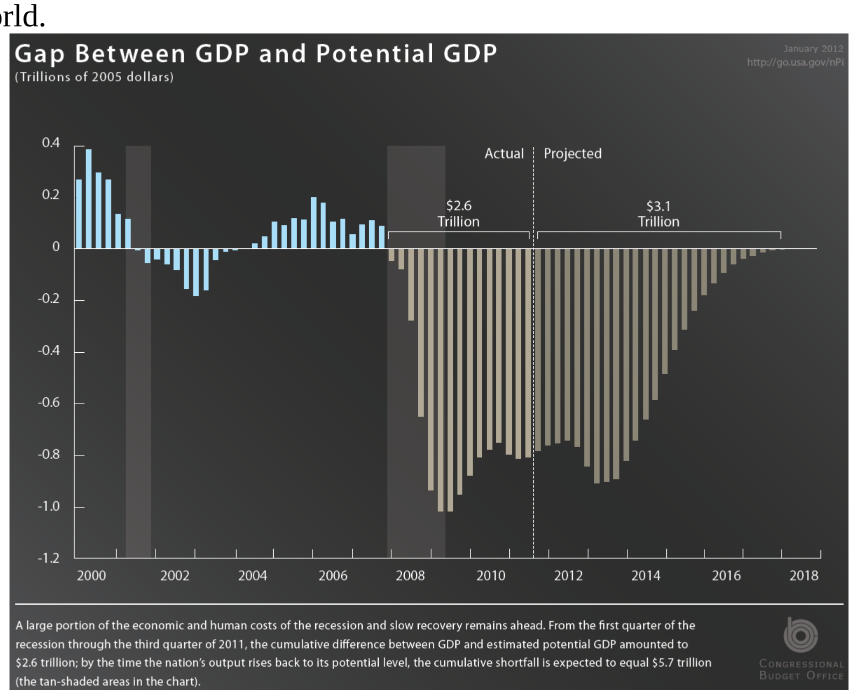
The global macro game is about linkages and money flow based on those linkages. Those cross-border flows can at times be benign, beneficial, or vicious (self-reinforcing to the downside). Because of our belief in some natural limits of both fiscal and monetary policy, we expect global liquidity to soon turn vicious, i.e. become self-reinforcing to the downside, i.e. a break in financial assets will further damage collateral values in the real economy. Policymakers have few tools left in their box of stimulus.

Major Thematic

- Falling Global Demand and Deleveraging



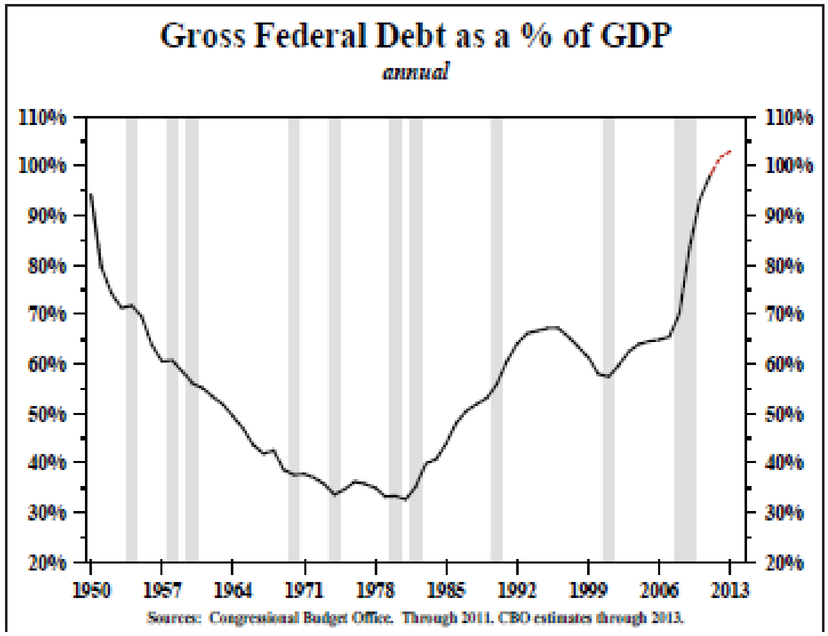
Thus, our major premise for 2012: It will be the year of deleveraging. Debt levels are too high and cutting deeply into the budding recovery and potential future growth capacity throughout the industrialized world.



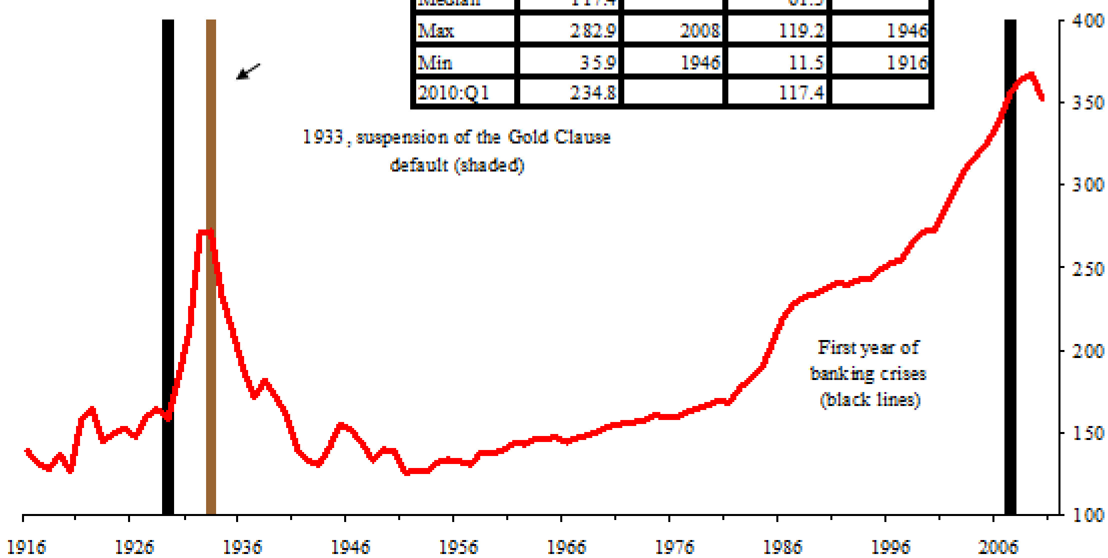
The threshold for debt cutting in to growth among the industrialized world is 90%. Here are some excerpts from the definitive study on this topic "Growth in Time of Debt," by Kenneth Rogoff and Carmen Reinhart [our emphasis]:

> Economics has been under fire since the recent crisis for enshrining abstract models that offer little connection to the real world. In "Growth in a Time of Debt," **our data-intensive approach aims at providing stylised facts, well beyond selective anecdotal evidence, on the contemporaneous link between debt, growth, and inflation at a time in which the world wealthiest economies are confronting a peacetime surge in public debt not seen since the Great Depression of 1930s and indeed virtually never in peacetime.** As Paul Krugman (2009) observed, "they'll (the economists) have to do their best to incorporate the realities of finance into macroeconomics." One might add as a corollary, however, that such discipline is especially needed when those realities are inconvenient to strongly held opinions.
>
> Our analysis was based on newly compiled data on forty-four countries spanning about two hundred years. This amounts to 3,700 annual observations and covers a wide range of political systems, institutions, exchange rate arrangements, and historic circumstances.
>
> The main findings of that study are:
>
> > •First, the relationship between government debt and real GDP growth is weak for debt/GDP ratios below 90% of GDP.1 **Above the threshold of 90%, median growth rates fall by 1%, and average growth falls considerably more.** The threshold for public debt is similar in advanced and emerging economies and applies for both the post World War II period and as far back as the data permit (often well into the 1800s).
> >
> > •Second, **emerging markets face lower thresholds for total external debt** (public and private) – which is usually denominated in a foreign currency. **When total external debt reaches 60% of GDP, annual growth declines about 2%;** for higher levels, growth rates are roughly cut in half.
> >
> > •Third, **there is no apparent contemporaneous link between inflation and public debt levels for the advanced countries** as a group (some countries, such as the US, have experienced higher inflation when debt/GDP is high). The story is entirely different for emerging markets, where inflation rises sharply as debt increases.

Take a look at where the US is now, when considering only Federal Debt to GDP. It is around the 100% level and projected to rise from here:



Adding in private sector debt, the US% jumps to around 350%:



	Debt/GDP			
	Private		Public	
Median	117.4		61.5	
Max	282.9	2008	119.2	1946
Min	35.9	1946	11.5	1916
2010:Q1	234.8		117.4	

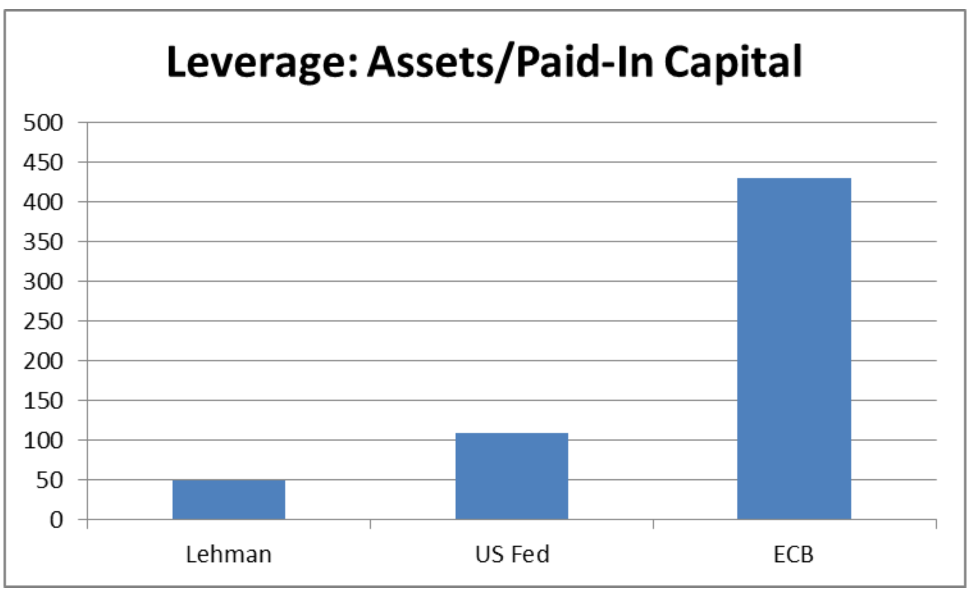
Sources: Historical Statistics of the US, Flow of Funds, Board of Governors of the Federal Reserve International Monetary Fund, World Economic Outlook

Other Industrialized Countries Debt/GDP % adding private indebtedness to the equation:

US	350%
Japan	490%
Euro currency countries	443%
United Kingdom	459%

Interestingly, Rogoff and Reinhart noted the outsized impact on the emerging markets, saying "when external debt reaches over 60% of GDP, annual growth declines about 2%. This is another reason we are quite bearish on China. According to research firm Dragonomics, **China debt/gdp % is close to 90%**, despite official estimates suggesting it is much lower. Off-balance sheet vehicles, many created for local governments, coupled with the massive investment in capacity to replace lost export demand, tells us debt levels in China could dramatically surprise once the warts start coming to the surface.

The two institutions tyring to keep hope alive that are also massively overextended are the US Fed and the European Central Bank. (Granted, they can print till the cows come home and Lehman couldn't, but there has to be some logical limit here, right?) The leverage ratio for the ECB is around 430 now, as measured by Assets divided by Paid-In Capital. Remember, Lehman Brothers went belly up when its ratio was *only* around 50. The US Fed's ratio is a whopping 109; that looks almost tame compared to the ECB largesse.



The ECB continues to expand its operations and is considered the last hope for keeping the Eurozone intact. As Greece inches closer to bankruptcy, Portugal seems to be following closely in its footsteps. Yields are soaring on **Portugal 10-year debt**:

Greece default risk, Portugal default risk, ECB balance sheet risk, and the Eurozone heading for the schools of recession do not suggest this situation is stabilized; nor will the Eurozone provide much demand support for the global economy.

From Leto Research on the incredible debt dependence we now face:

> To discern economic developments going forward, it is essential to decode what happened from 2009 onward. The year 2009 was the first and only time that global GDP declined since the 1945-46 demobilization in the aftermath of World War II, and also the first and only time that global GDP declined since the world abandoned the gold exchange standard in 1971 and the entire world economy began operating on fiat currencies.
>
> Declines in *global* GDP have always been extremely rare. From the beginning of the second industrial revolution to date, there have only been three occasions apart from 2009 when global GDP dropped: World War I, the Great Depression, and post-World War II. In each of these previous occasions, recovery followed the reduction of debt burdens, either via wartime-wipeouts or via deflationary bankruptcy, or – as in the case of inter-war Germany – hyperinflation.
>
> - But the post-2009 recovery of global GDP is the sole instance in which the cause of the recovery was a massive expansion of central bank balance sheets (made possible by the

1971 abandonment of the gold exchange standard) and the even more massive expansion of debt.

- Between 2008 and now, global GDP increased by $2.9 trillion (4.7%) and global debt increased by $25.7 trillion (14%);

The balance sheets of the Federal Reserve and the European Central Bank increased by 140% and 90%, respectively. China's central bank, with its idiosyncratic system, increased lending by about 100%.

In its first-ever encounter with negative GDP growth, the post-1971 global fiat-money system responded with monetary and fiscal expansions on a scale that had been hitherto unimagined.

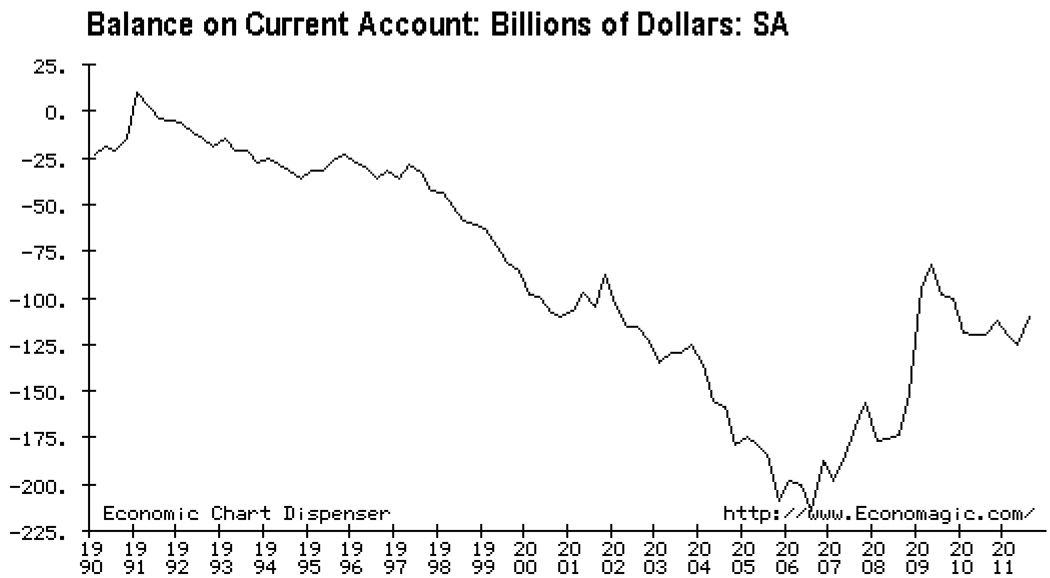
In order to grow in its present configuration, the global economy has depended absolutely on continuing monetary and fiscal expansion. Without further such expansion it will fall into depression – unless a different source of growth emerges apart from the fiscal stimulus spending and the central bank balance sheet expansion that have rolled back the 2009 global contraction.

Thus, we expect the year of deleveraging will be deflationary for real goods and services, in addition to financial assets, as corporate earnings will disappoint current expectations tailored to continued recovery in the US economy and elsewhere. Our major thematic has not changed. Here is some meat on the bones with key points:

1. **United States demand is falling**: Falling demand from US consumers is still the biggest global macro consideration. That is because of existing global imbalances, much to do with the dollar as reserve currency (see Triffin's dilemma, *Currency Investor* October 2009), especially because the US is the largest current account deficit country. That is: the US takes in more goods than it produces and balances that with positive capital flows, and that will negatively impact the largest current account surplus countries: China and Germany.

   You can see this fall in US demand from the improving US Current Account Deficit chart; think of this also as US dollar credit receding from the global economy despite the Fed working overtime with implicit dollar devaluation attempts and currency swaps with the European Central Bank. Mr. Market is telling you something, Mr. Bernanke!

   As we predicted around the time of the Credit Crunch, sooner or later the US Current Account would move back into positive territory as the market does the hard job of rebalancing the global economy. Public debt being thrown into the market is attempting to overpower this trend, despite the fact that economists were telling us for years about the dangers of an imbalanced world. Well, now we are getting the rebalancing these economists wanted and they too are working overtime it seems on stimulus ideas to stop it. "Be careful what you wish for" is the moral of that story.



2. **ZIRP (Zero Interest Rate Policy) is counterproductive.** Zero and negative interest rates are not forcing people to consume because there are so many opportunities to pay down still high debts on their own balance sheets. The idea lower yields will spur spending – a Keynesian theory – is proving to be a total claptrap. There is fear in the air, evidenced by falling velocity of money as people and institutions hoard more cash, just as Irving Fischer predicted in 1933 when an economy is highly over-indebted. The following excerpt is from an article by Frank Shostak on Fisher:

> Fisher maintained that all kinds of shocks can set in motion the liquidation of debt, which in turn triggers a fall in the money stock and in prices of goods. These events in turn lead to a depression. According to Fisher over-indebtedness gives rise to the following nine stages that are instrumental in causing deflation and depression.
>
> 1. Debt liquidation in response to a random shock such as the bursting of a bubble in stock prices. To liquidate debt people are forced into a distressed selling of assets.
>
> 2. The liquidation of debts leads to the shrinking of money and to a slow down in the velocity of circulation.
>
> 3. This causes declines in the price level
>
> 4. The fall in the asset value while the value of liabilities remains constant leads to a fall in businesses net worth, precipitating bankruptcies.
>
> 5. Profits are curtailed and losses emerge.
>
> 6. Production, trade and employment are curtailed.

7. These losses, bankruptcies and unemployment lead to pessimism and loss of confidence.

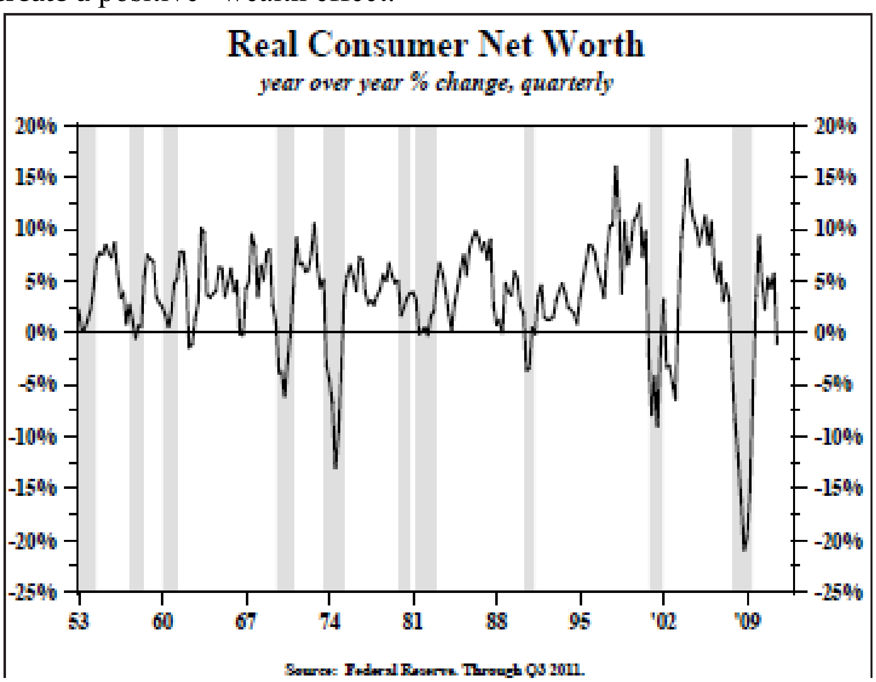
8. **Which in turn leads to hoarding and a further slowing in the money velocity**.

9. A fall in nominal interest rates and a rise in real interest rates.

In addition, retiring baby boomers rely on their investment income for a large share of their spending power; lower rates seem to be having a self-reinforcing negative impact to the downside.

3. **No real "wealth effect."** Boosting liquidity to the financial economy is not having a "wealth effect" thanks to the fact consumers' largest asset – his home – is deeply underwater.

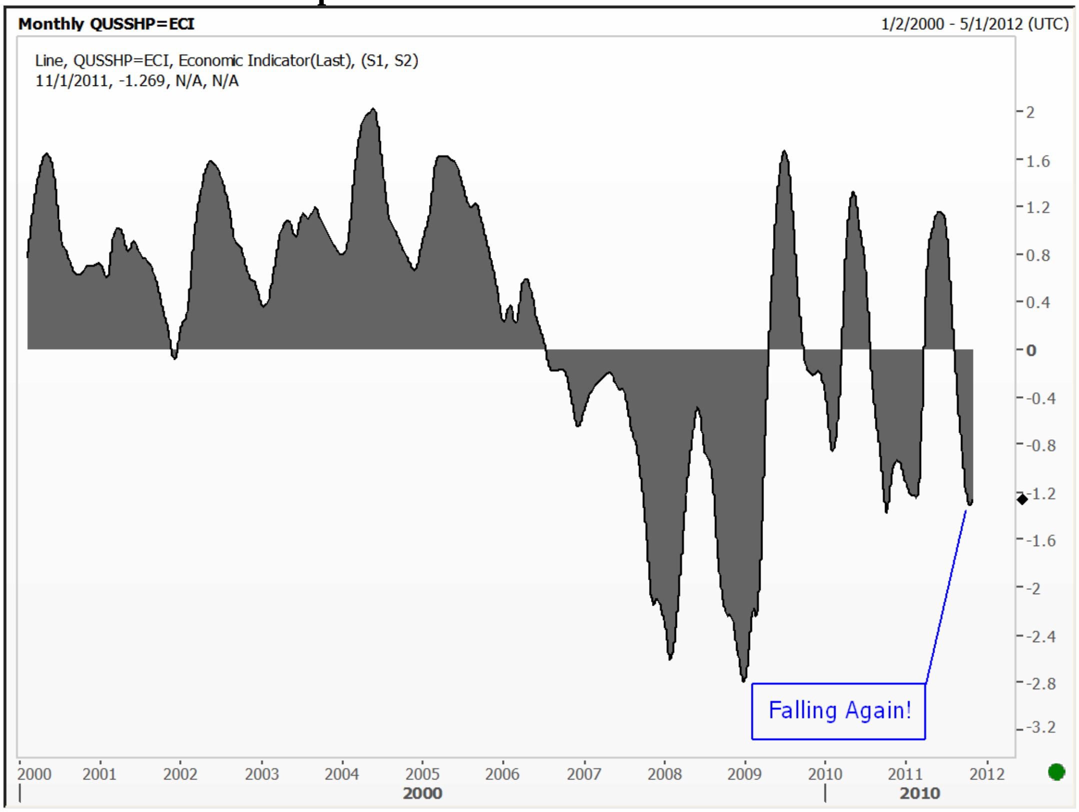
Real Consumer Wealth Year-Over-Year moving back into negative territory; this is hardly a ringing endorsement of the Fed's explicit policy of targeting financial assets in order to create a positive "wealth effect."



Houses are a consumer's biggest asset. And most of consumer debt is related to housing, through mortgages. Thus, falling housing prices are a powerful psychological negative for consumers and will impact real spending decisions.

The impact of falling real wealth and effective rising debt to income burden for the consumer helps explain the "you can lead a horse to water but you can't make him drink" analogy explaining why lower interest rates aren't stimulative in this environment. In fact, they are counterproductive as discussed in the first point above. Nothing new here really; nothing that Japan hasn't experienced in the last 20-years, despite the constant refrain from economists that the US is "nothing" like Japan. Oh really?

S&P/Case-Shiller Composite Home Price Index



Some believe this is setting the stage for a housing recovery. But it might just as well be setting the stage for more mortgage defaults.

- Driving liquidity into banking reserves is not leading to real economy lending thanks to huge debt overhang and a non-functioning interbank market when rates are so low. The interbank lending market is a powerful conduit to get money into the real economy. Banks are not taking on the risk of lending to the risky borrowers (demand from other banks who have lending opportunities in the real world) when they can park their money in government paper and make as much. But there is leakage here, and that leakage seems to be a big part of why the financial economy is doing well – big investment funds can borrow at low rates while small businesses can't. [This bad movie is now playing in theatres across the Eurozone too.]

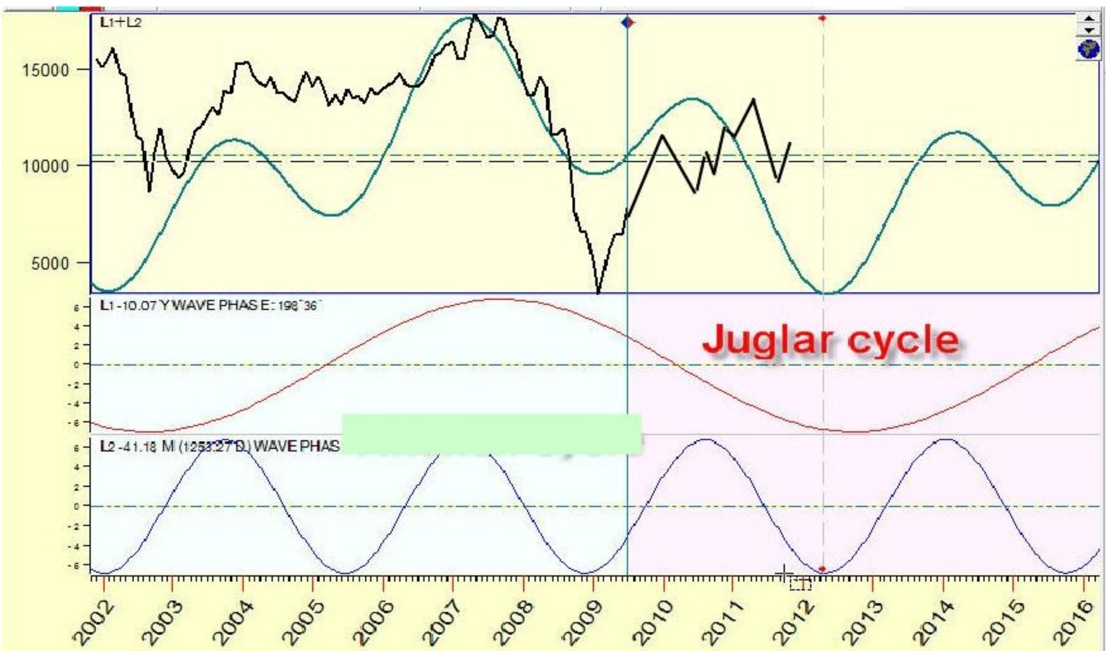
  If we are right about deflation, and stocks begin reflecting that deflation as they did the last time we had a major deflationary bout (Great Depression as discussed in December issue of *Global Investor*), then watch out below:
  Dow Jones Industrial Average comparison – 1929-1933 (blue line right scale) versus 2007-2011 (red line left scale):

Source: UBS

- **Fiscal stimulus and incentives have left the building.** According to Hoisington Investment Research, here are some key reasons why 2012, though an election year and usually good from a stimulus perspective, could be different:
  - Real federal government purchases of goods and services, which comprise 8% of real GDP, will decline by about 1% if the impartial projection of the Congressional Budget Office (CBO) for a fiscal 2012 deficit of about $1.3 trillion is in the ballpark. …In spite of record deficits since the spring quarter of 2009, <u>real federal government purchases of goods and services have risen at an anemic 1.5% annual rate</u>, confirmation that only a small amount of exploding expenditures went for infrastructure projects. The scant growth rate in the economy suggests a negative outlay multiplier.
  - Federal spending is increasingly become politically unpalatable among US voters; austerity is the new norm for many.
  - State and local purchases of goods and services (10.9% of real GDP) has fallen at a 2.1% annual rate since mid 2009, and is poised to decline further in 2012.

- ○ Adding to the recessionary woes of 2012 will be a retrenchment in capital spending. Accelerated depreciation of 100% was permitted for all capital expenditures provided the items purchased were installed by 12/31/11. This year the accelerated depreciation drops to 50%, resulting in a dramatic increase in the after-tax cost of such outlays. If the past is any guide to the present, businesses have worked this one-year tax gimmick to their advantage, just as they did previously. Firms looked into 2012, and in some cases even further, and pulled those outlays into 2011. This creates an artificial boom/bust cycle which will be evident in 2012.

- **Cycle View.** The Juglar cycle will bottom out in 2012.



Source: UBS

According to UBS analyst Michael Riesner:

- In 2012 both the Kitchen and Juglar cycle are pointing down, which suggests that risk of a negative surprise in risk assets in at least the first half of 2012!!
- However, both cycles are running into a major low!!

Summary

The case for a US recession in an over-indebted economy:

- Monetary policy is counter productive
- Fiscal stimulus to decline

- State and local governments a drag
- US export growth set to fall
- Real consumer wealth negative and trending lower
- Lower business capital investment
- Cycle lows

We couldn't say it any better than Hoisington's recent summary on its call for a 2012 recession:

> The actualization of a recession in 2012 will be especially difficult for the average American in that we have not really recovered from the previous recession ending in 2009. This obviously is not a typical business cycle; rather, we may be in the midst of what Harvard historian Niall Ferguson titled a "slight depression." The reason for this analysis is that real personal income less transfer payments, one of the four coincident indicators the NBER uses to determine recessions, has recovered off its recessionary low in 2009, but is still about a half trillion dollars below where it was in 2008. Industrial production is still off 5% from its peak and no higher than in 2005. Full time employment is at the same level as in May 2000, despite a 28 million person increase in population and an 11.4 million rise in the labor force. Real median income stood at $51,800 in 2007, but for the first time ever has declined in this recovery and now stands at an estimated $49,400, a 6.4% drop from the previous peak. These statistics painfully point out the adjustment process in an overleveraged economy.

Other Views: Crude Oil, Boom or Bust?

It is being asked how geopolitics will impact crude oil. I think it's easy to see the Iran fiasco has influenced crude oil prices, considering the potential threat to global crude supplies, 20% of which make their way through the Strait of Hormuz daily. Is the geopolitical risk premium may already be in the price?

Crude oil exports make up substantial portion of Iran's economy. It has already been noted that Iranians are feeling inflation pressures, in part due to their declining currency. If they can't bring in enough revenue from their major economic lifeblood, they'll be facing quite a lot of pressure.
Note that China is already the largest buyer or Iranian oil. If Iran defies the sanctions, it will mean they need to sell more oil to Asia. But does China, in particular, want to increase their dependence on Iranian oil as their domestic consumption decelerates. If they want to be a major world player, they may look at this a bit more diplomatically and think twice about increased business with Iran in the face of new, tougher sanctions. Here are some other views on the topic ...

Reuters *Inside Oil*, John Kemp
Long-term narratives have ... changed. Until recently, most analysts and investors were confident the only long-term direction for oil and other commodity prices was up as supply struggled to match demand from emerging economies. The dominant narrative was that commodities were in the early stages of a decades-long super-cycle.

But signs of an aggressive supply-side response in oil, gas and grains markets have tempered expectations and are forcing a reassessment of where commodities are in the super-cycle. The cycle may be more mature than previously expected.

Few analysts or institutional advisers are now prepared to recommend unambiguous directional exposure to rising prices. Price increases are no longer outstripping the long-term carrying cost of positions.

The result is that **the oil market has been left without a dominant narrative for the moment. Malthusian stories about burgeoning demand in Asia and the rest of the developing world, and peaking supplies, geopolitical risk, or money supply growth and inflation have lost their resonance with investors.**

So far nothing has come along to replace them, leaving the market drifting listlessly, still looking for the next big idea.

Financial Times
In an interview in London, [Opec secretary-general] Mr El Badri said it would take time for European Union countries to find a replacement for the 500,000 barrels of oil a day it normally imported from Iran. “During this period, there will be volatility ... and price swings,” he said.

But **he insisted that markets were well-supplied. “There is no shortage of oil anywhere in the world,”** he said. The Organisation of the Petroleum Exporting Countries was producing 30.6m barrels a day – 600,000 bpd more than the target it agreed at its last meeting in December, he said.

The price of crude has been relatively stable since last spring. But it jumped $4-$5 a barrel in the new year as the EU prepared its ban on Iranian oil and Tehran threatened to close the Strait of Hormuz, a crucial conduit for oil exports from the Gulf. The EU imposed the sanctions last Monday, though delayed its implementation till July 1 to give countries that were heavily dependent on Iranian crude, such as Greece, time to adjust. Iran has since threatened to impose its own, immediate ban on exports to Europe.

Analysts believe Iran’s European customers should be able to find alternative suppliers relatively easily. Libyan production has recovered quickly and now stands at 1.3m barrels a day – not far off the 1.6m b/d it was producing before last year’s civil war. Also, **Saudi Arabia has insisted that it will make up for any Iran-related supply disruptions.**

Platts

China's apparent oil demand in December rose 0.7% year on year to 41.02 million metric ton (mt), or an average 9.69 million barrels per day (b/d), a Platts analysis of recent statistics released by the Chinese government showed.

“But even with that relatively slow rate of growth at the end of the year, the actual demand for December was the highest daily rate the country's oil demand has ever reached,” said Calvin Lee, Platts Senior Writer for China.

Yet, the oil demand growth in December of 0.7% was the second time last year that the rate of increase was below 1%. On a quarterly basis, oil demand growth of 1.6% in the fourth quarter was the lowest among all four quarters in 2011.

The drop-off in oil demand growth in the second half of the year pulled the annual growth rate down to 6.1% in 2011, from 11.3% in 2010.

December's apparent oil demand was a tad more than the previous all-time high of 40.73 million mt, or 9.62 million b/d, recorded in the same month a year ago, when the country was besieged by a diesel shortage.

For the whole year, China's apparent oil demand was at 460.65 million mt, or an average 9.25 million b/d, 6.1% more than the previous year.

The 2011 figure was the highest-ever by the world's second largest oil consumer and was the first time that oil demand has breached 9 million b/d for a full year. The rate of increase in 2011, however, was lower than the 11.3% growth recorded in 2010.

As far as December, Lee said, "High crude throughput and strong net refined product imports continue to lift the apparent oil demand, outweighing the slower growth rates and the recent drop-offs in gasoline and diesel consumption."

Economist
China’s stance over Iran, however, is far from clear-cut. It finds itself in a pivotal but acutely uncomfortable position. The simplistic old platitudes in which its foreign policy is couched cannot do justice to the complexity of the calculations it has to make. Most of its foreign-policy principles, says Minxin Pei of Claremont McKenna College in California, are “either obsolete or under pressure”, and Iran is an example of their irrelevance.

A ... reason for resisting sanctions might be a genuine fear of their effect on Iran. If the Iranians were to carry out their threat to blockade the Strait of Hormuz, China would suffer directly, through a likely surge in the oil price. A blockade would also bring closer the prospect of a potentially disastrous conflict.

However, this calculation of Iran’s possible actions could just as well be one of many reasons why China might eventually soften its objections to sanctions. **If Iran is emboldened by the support it believes it has from China and others to resist Western pressure over its nuclear programme,**

then that, too, could lead to conflict. Israel, for instance, might take matters into its own hands, with a pre-emptive strike against Iranian nuclear facilities.

ChartView

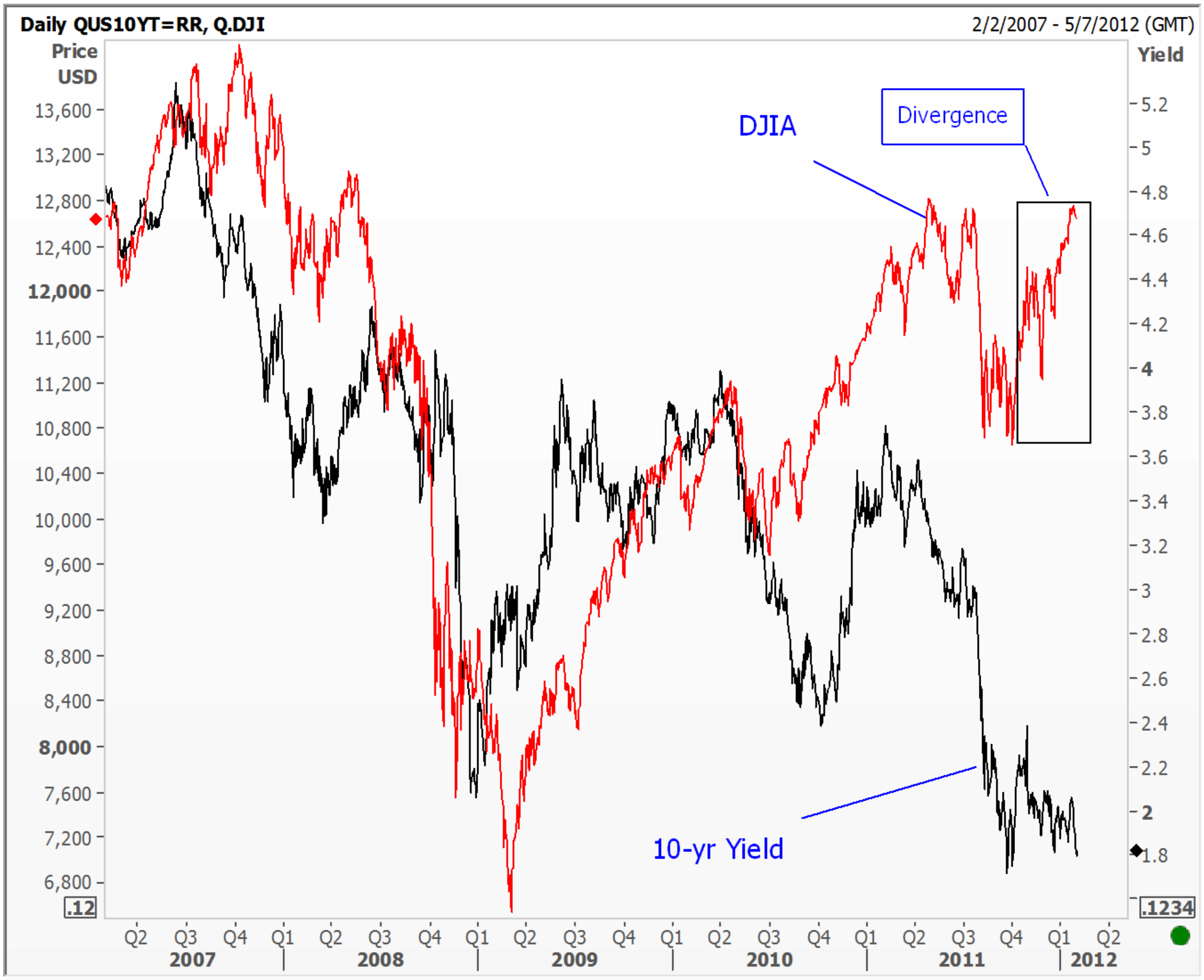
Dow Jones Industrials Daily: We still think this market will break, despite being wrong about this recent rally. The Wiley Coyote moment discussed in a recent Currency Currents seems an apt description should we be right about the US and global economy. We think the reward is clearly skewed to the short side of this market. Divergence into a test of the May highs and we have been seeing lower volume on this rally…

MSCI World Index versus DJIA Daily: The US has clearly outperformed other markets. Part of this is likely haven flow and part is likely the fact that US relative growth has been better. But in general, stocks globally reflect concern the world is not right. A US recession would likely hit US stocks relatively harder as a result.

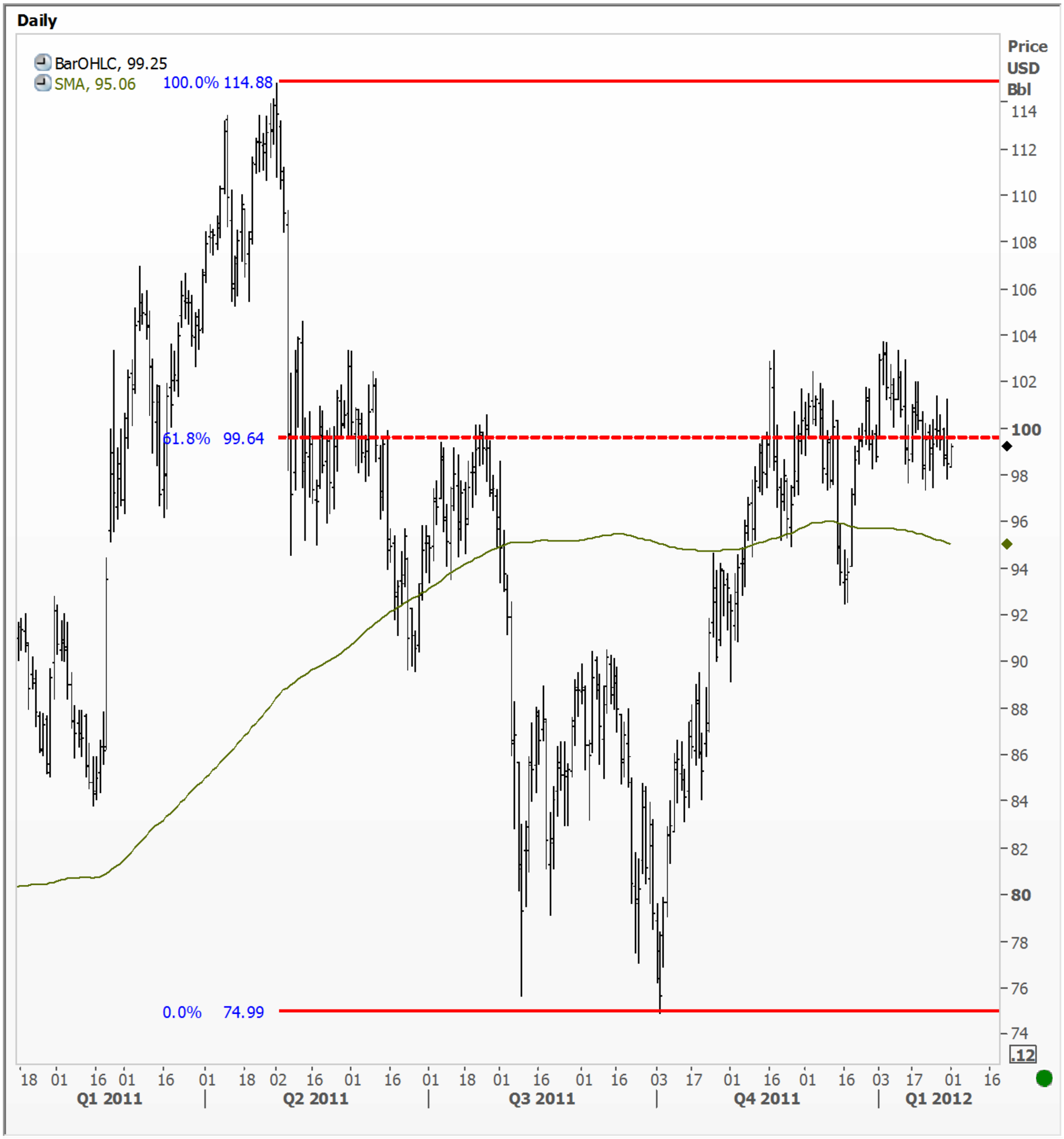
Emerging Market Index Daily: Hitting resistance at the 200-day moving average!

10-year T-Note Futures Daily: Deleveraging and deflation likely means bonds remain supported in 2012! A recent test of the highs…

US Ten Year Note Yield versus Dow Jones Industrial Average: Yields are testing lows, as stocks attempt an intermediate high. Interestingly, these two were joined at the hip i.e. lower rates and lower stocks (fear and risk aversion), of late, and especially in the box highlighted in the chart, we've seen a big divergence. Why? The belief the Fed can save the world? Possibly of late, it is the ECB extended bank loan program (announced on December 8th) which represents quantitative easing in its own right.



Oil Daily: Congestion at the 61.8% retracement level, and still trading above the 200-day moving average that looks to be turning down. We think sooner or later this market goes lower on our macro view despite the geopolitics weighing.

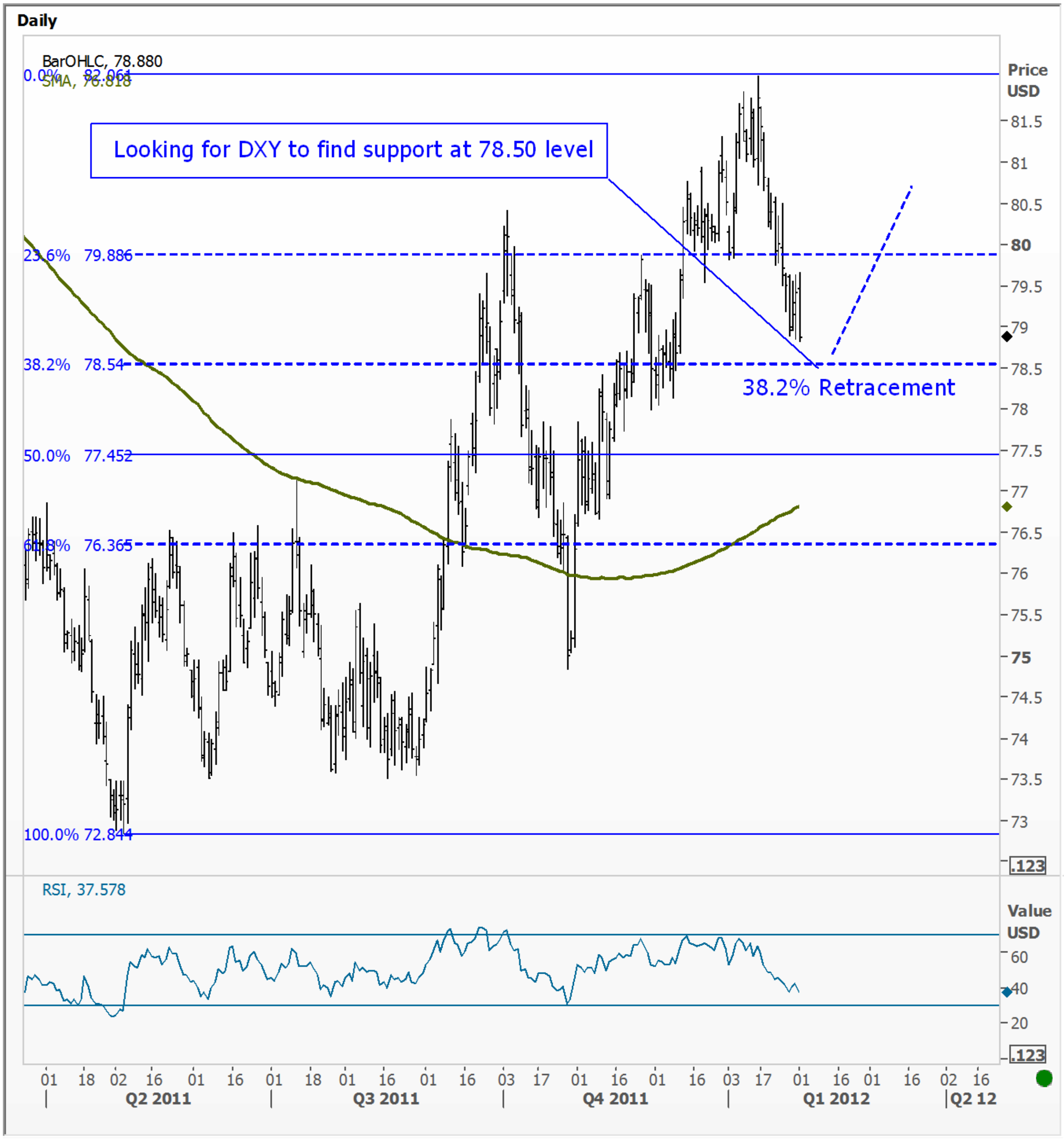


Gold Daily: Liquidity-driven asset or safe haven? At times we have seen both aspects. We have to admit technically we have minimal confidence as a strong case can be made for a blow-off high on systemic risk or the top is in on deleveraging and falling liquidity that could support the US dollar as mirror image (see US dollar versus gold next page). Blue Elliott Wave count and Red Elliott Wave count as alternative are listed on the chart below.

Gold versus Dollar Index Daily: Mirror image of late, suggesting liquidity play, but they have been moving together before that. The Fed likely gave the gold a nice boost of late suggesting there would be little interest rate competition for gold until 2014. Hmmm….

Copper Daily: Perplexed we are this market continues to hold up. Shows the amount of positive sentiment still in this market we would guess…but again, if we are correct on our macro call, we expect copper to test its Credit Crunch lows.

US Dollar Index Daily: The respite on the Eurozone crisis a la the European Central Bank announcement of lending and the Fed's announcement of low rates through 2014 has been bad news for the US dollar. However, we believe the dollar soon finds support near 78.50, a key retracement area.



Open Positions:

As of 1/31/2012:

Entry Date	ETF	Symbol	Direction	Entry Price	Stop Loss	Last Price	Profit Target	% Profit
Currencies								
1/19/2010	US $ Bullish	UUP	Long	22.86	19.89	22.12	29.00	-3.2%
5/6/2011	UltraShort euro	EUO	Long	17.22	12.50	19.84	TBD	15.2%
Equities								
11/4/2011	iShares MSCI Australia	EWA	Short	23.51	27.17	23.42	TBD	0.4%
12/21/2011	iShares MSCI HongKong	EWH	Short	15.07	TBD	16.90	6	-12.1%
Commodities								
8/1/2011	iPath DJ UBS Copper	JJC	Short	58	TBD	48.84	TBD	15.8%

Taking some major heat on our most recent trading idea—Short the **Hong Kong Stock Index (EWH).** However, we think it makes sense to hold this for now. Once this market breaks, it could be a very swift move. In the chart of EWH below, you can see it is bumping against key resistance at 17.20 area—a key retracement level (61.8%) and its 200-day moving average converging there.