INSTITUTIONAL ADVISORS

FRIDAY, JUNE 13, 2014

BOB HOYE

PUBLISHED BY INSTITUTIONAL ADVISORS

The following is part of *Pivotal Events* that was published for our subscribers June 5, 2014

"Policymaking, itself, is highly speculative."

Signs Of The Times

"Stock-Picking Triumphs Asset Allocation"

– Financial Post, May 27

This observation could be part of the topping process whereby sudden setbacks in hitherto hot growth sectors shift the focus to "value" stocks.

"Freddie Mac: Many of the Nation's Housing Markets are Stalling"

– Washington Post, May 28

"Borrowers Tap Their Homes at a Hot Clip"

– Wall Street Journal, May 30

The home has become an ATM, again.

"US Recovery Hits 5-Year Mark, But Long Way To Go"

– CNN Money, June 1

"A Cringe-Worthy Economic Data Blunder Rocked Wall Street Monday"

– Business Insider, June 2

* * * * *

Stock Markets

We have been writing that some could be thinking that the economy would have surge to top out. The above June 1st quote included ***"Main Street America still doesn't feel recovered. Because, quite frankly, it's not. A full recovery is two or three years away."***

Nowhere is it written in stone that it requires booming GDP to end an economic expansion. In an age of financial asset inflation things could be different. This was the case with the end of the bubbles of 1929 and 1873. The economy headed South with the start of the financial contraction. We expected this in 2007 and the market topped in October and the recession started in that fateful December.

Then in 2009 the economy turned up just two months after the panic ended.

Our thesis has been that when the bull market rolls over, so will the economy. The key has been not the strength of the economy but the degree of speculation in stocks and bonds. Leadership in stocks was provided by the Nasdaq and it reached measurable excesses in March.

With strong action in the senior indexes sentiment is again high.

Investors Intelligence percent bulls number is up to 62.2, which is as high as it gets and the accomplishment is rare. Previous examples were recorded in October 2007, December 2004 and a away back in 1987. On the 2004 example the S&P declined from 1134 to 1060.

Speculation by policymakers is without precedent.

It is worth noting that the theory that a committee can "manage" a national economy has always been, itself, highly speculative. And then there has been the recent practice of buying bonds until employment improves to some arbitrary number.

Both theory and practice have been impractical.

Our outlook has been that business and economic reports will be positive until the credit contraction becomes more visible.

There, we have covered the economy without guessing at Fed aspirations, nuances or wording.

Senior indexes continue positive with the S&P reaching new highs at 1925. The possible "false breakout" proved false.

What's next?

Inevitability springs to mind and it is worth noting that the VIX, a good measure of complacency, was down to 11.32 on Friday. This is the lowest since 11.05 set in March 2013. The lowest before that was 9.70 reached in March 2007.

Technically, the action has registered a "Sequential Buy" that suggests a brief trading opportunity. Of more importance is that it represents a pending reversal in complacency.

On sentiment, there was the big reading of 46.4 with the speculative surge that drove the Nasdaq to its big high in March. This week the Investors Intelligence reading of bulls minus bears is back up to 44.8.

Interesting set up.

Also interesting is the weak action in banks. BKX rallied to 72.90 in March and the decline to 66 in May was worse than that of the Nasdaq.

Prior to this year's dullness the last worthwhile correction was from 56 to 33 in 2011. That was with the plunge in commodities.

Within this we should look at Citigroup (C). With the 2007 Bubble the high was 513 and the low in the Crash was 9.67 (no typo). The initial rally made it to 54 in September 2009. The next low was 21.34 in 2011 and it reached 55.26 at the first of the year. Essentially no net gain in almost five years.

Most banks are overdue for a meaningful correction.

The senior indexes are again overbought with outstanding sentiment.

There is the possibility of risk discovery and stops should be used.

Credit Markets

A children's ditty goes ***"Rain, rain go away, come again some other day"***.

This sums up policymaking in recent decades. Rain is not allowed to happen. Sort of "always rain tomorrow, but never rain today".

At one time the Fed would go along with the rise in market rates of interest natural to a boom. When the Fed, in following rates up, had completed three increases in the administered rate the bear market would soon start. Thus, the old "three steps and then a stumble".

Nowadays, the treasury bill rate remains locked at Depression levels, not giving any signals.

Aggressive, if not belligerent, central bank buying has helped drive long rates down during a stock market boom. It goes without saying that the economy is not booming.

Those accustomed to bond bear markets occurring with stock bull markets may wonder when bonds and stocks have soared together.

Oddly enough, that was the case with the bull market that ran from 1932 to 1937 when AAA bond yields increased to 5.5 percent with the crisis and then declined to 3 percent in early 1937. Then it increased to 3.5 percent as the stock market topped.

This time around, the AAA increased to 5.6% with the 2009 panic and declined to 3.5% at the end of 2012. That was overdone and the yield increased to 4.6% in December. It has since declined to 4.2%.

The main thing is that key yields in Europe and North America have declined with most of the stock market boom.

And as we have been mentioning, those in Europe (Spain and Italy) have been setting Downside Capitulations. Junk has spent five months above 70 on the Weekly RS, which is replicating the condition going into the key reversals at the end of the first half of 2013 and in 2011.

In the past few weeks the surge in emerging debt bonds (EMB) has lifted its Weekly RSI to 76. This is the highest it's been since the price reached 116 in May last year. (For junk the yield increased from 5% to 6%.)

This time around, the price has reached 115.5 which is close to the resistance level.

As to the unprecedented intervention, the velocity of money continues to decline. To the lowest level on record. Mother Nature is not impressed by the theories. The chart follows.

The bond future made it to 139 last Thursday against our target of 136 to 138. That target was made in January.

Last week we noted that the price rise was not overbought. However, in looking at the Daily it became overbought enough for a correction.

What's more, today's announcement of negative interest rates in Europe is a grand testament to absurdity. Best to shorten term.

The decision by the ECB to set negative interest rates is a sign of intellectual and practical nonsense. It shows that the difference between arbitrary ambition and actual market developments continues to increase.

If the "great" step to buy bonds made in September 2012 had worked the absurdity of negative interest rates would not have been needed.

There could be some instruction from that foolhardy event. Gold and silver bugs thought that it would drive the dollar down and precious metals up. This sector became exceptionally overbought on the "news" and headed down.

European and lower-grade bond prices turned up and have, now, accomplished an outstanding rally. For ending action there is momentum, enthusiasm and news at what has been the potential season for a trend reversal.

Opposite to conditions in September 2012, bonds are very expensive and gold is very cheap.

Precious Metals

Just how "expensive" were precious metals in September 2012. Momentum in the silver/gold ratio told the story as the RSI soared to 84, which we took as recording "dangerous" speculation.

This "model" became very oversold a year ago with the ratio at 145 (leaving out the decimal) and the RSI down to only 23. That was on June 7, 2013.

Results have been some good trades but no new bull market for the sector.

Our view has been is that the cyclical bear for golds has been against the cyclical bull market for stocks and low-grade bonds.

The reversal seems more at hand now than at any time over the past year when precious metals have been dismal.

Our call in November had two aspects. One was the "Rotation" into beat-down commodities with the probability that these would bottom in December and rally out to around March. This would help a similar move in precious metals.

The second part of the theme was that it would set up the golds for a more extended move. However, these became very overbought in March and we advised taking money off the table. That was for the hot commodities as well.

Sentiment for gold reached 58 percent and now it is down to 38 percent. It has been lower but considering the timing this could be in the level that ends this decline.

Similar sentiment numbers are not available for stocks, but Rydex figures are very low indicating the public has no interest in the sector. As if we didn't know, but it is interesting to see the measure.

The ECB announcement has immediate effect in moving bonds up and the euro which had declined in anticipation of the news has firmed up.

We take this as desperate policy with only brief turmoil. Most key items are at extremes opposite to conditions at the big announcements in September 2012.

OK, then we will stay with what worked in 2008. And that outlook was based upon what worked at the conclusion of the 1929 and 1873 bubbles.

Fundamental researchers will appreciate this.

Jewelry consumption could decline, but could be more than offset by the increase in investment demand. Conservative funds will flow to gold's unique liquidity.

In which case gold's price relative to most commodities could increase and gold's price in most currencies could also increase. This will not be gold going up as the dollar crashes. In the "new" paradigm, which is what gold has done in previous post-bubble contractions; gold and gold stocks will come into favour as most everything else deflates.

The dollar won't crash, but highly inflated bond prices will. And the best part of it will be that the esteem for central bankers will also crash.

But let's look at the sector without considering the possibility of financial troubles.

The sector is oversold, gold set what could be *the* key low at 1181 in December and this is being tested this week at 1240. A minor decline to this level in February could provide support.

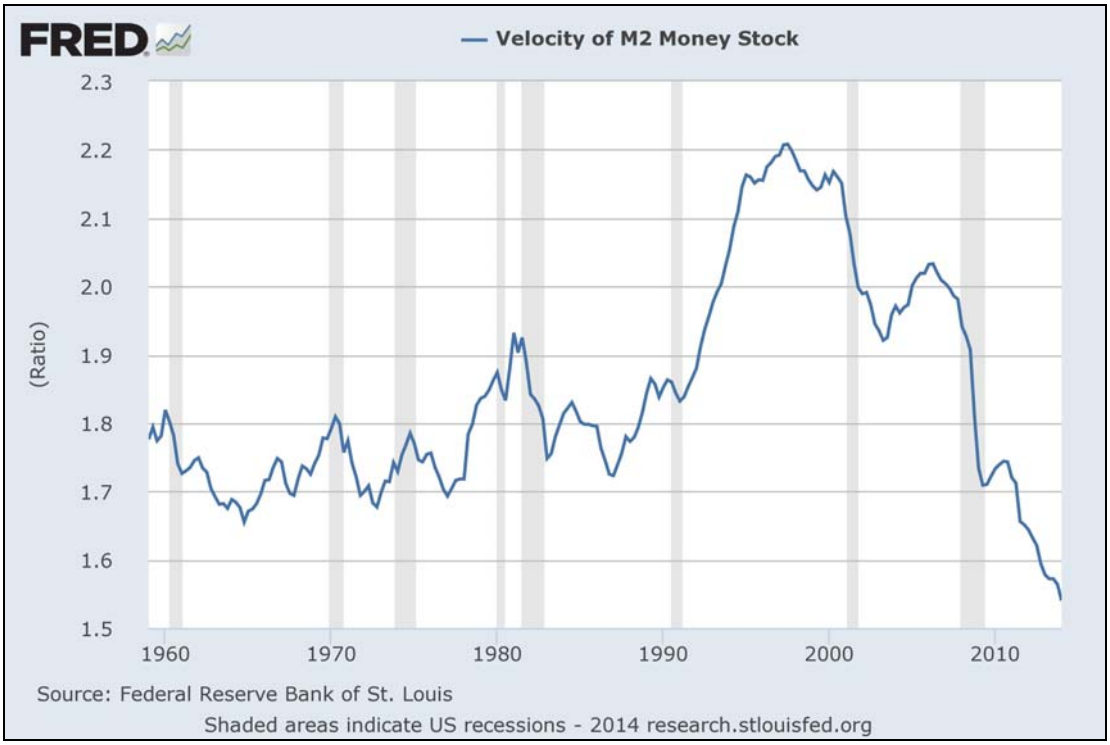
The action in gold stocks relative to bullion (GDX/GLD) has been improving since last week. The washout low was .171 set in December with the Daily RSI down to 30. The high was .211 in March and last week's low was .181, with the RSI down to 28.

Rising above .195 would be very constructive.

Commitments to gold could be increased and some of the money taken off the table in stocks could be reemployed. There could be setbacks in the stocks if credit conditions take a turn for the worse.

BOB HOYE, INSTITUTIONAL ADVISORS
E-MAIL bhoye.institutionaladvisors@telus.net
WEBSITE: www.institutionaladvisors.com

Velocity Of Money?



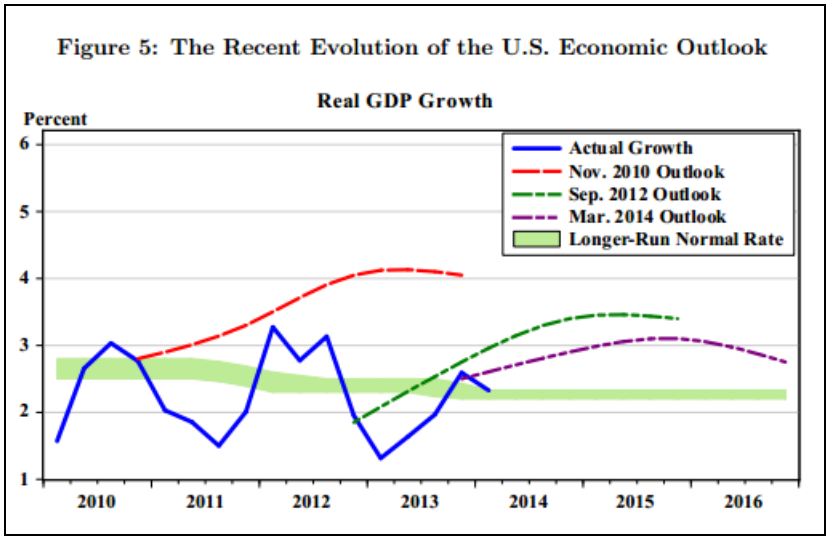
- Ooops, there goes another economic theory down the drain.
- The Fed opened the liquidity taps with the 1994 Mexican financial problem, otherwise known as the "Tequila Crisis". The taps have been open ever since.
- The extra "lolly" went into speculation. In 2000 it was the Tech Bubble. In 2007 it was housing and the stock markets.
- The 1920-1921 Crash in commodities was so shocking that Fed policy was to be very "easy" in order to keep basic prices from falling. The "lolly" went into the stock market.
- Mother Nature runs "Velocity", not central bankers.
- Not just new low for the move, it is a record low.

Greece Ten-Year

- The "great" news about negative interest rates is the story behind a technical test of the low of 5.85% set in April.
- The initial high was 6.86% and at time of writing the yield has declined to 6.21%.
- Rising above 6.50% would set the uptrend.
- Negative interest rates is equivalent to the 1930s policymaker angst about "hoarding" of money.

Gold Stocks Outperforming Gold

Economic Forecasts



- Economic 'modeling' seems as reliable as climate "modeling".