MONEY, MARKETS & MILESTONES

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Black Clouds & Silver Linings

"In spite of the cost of living, it's still popular."
-Kathy Norris

"If a central bank is ever created in America, through inflation and deflation the bankers will rob the Americans."
-Thomas Jefferson

"Endless money forms the sinews of war."
-Cicero

INTRODUCTION

According to Bloomberg, "*Global investors give Federal Reserve Chairman Ben S. Bernanke top marks for combating the worst financial crisis since the Great Depression and overwhelmingly favor his reappointment amid optimism that the world economy is on the mend*." Mr. Bernanke is being applauded for cutting the benchmark lending rate to zero and expanded credit to the economy by $1.1 trillion over the past year. Mr. Bernanke has become a hero for many in the financial world.

Yours truly, on the other hand, have certain points to consider before applauding.

First, it seems true, at least for now, that the Fed under Mr. Bernanke and the US Treasury have stabilized the economy and the financial system for the most part. However, what strikes us is how the current "economic dream team", which consists of academics, completely failed to see the current crisis occur. On May 17 2007 Mr. Chairman said: "*We believe the effect of the troubles in the subprime sector on the broader housing market will likely be limited, and we do not expect significant spillovers from the subprime market to the test of the economy or the rest of the system*." Such was their view even when all classical signs of a bubble where in sight. For a number of serious investors, only the timing of the imminent downfall was unclear. Mr. Bernanke and the US Treasury, on the other hand, thought all was well in the world.

The irony, of course, is that the Fed and the US Treasury helped create the crisis with their loose monetary policy and excessive stimuli in the first place. Had they not bailed out LTCM, the Nasdaq bubble might not have gotten so out of hand. If they had not kept interest rates artificially low in the early 2000s, it is likely that the credit boom which lead to the housing bubble and the current crisis, would not have occurred. But these people were not the least bit concerned about the rapid build-up of and excessive leverage. Also, when talking about excessive leverage, we have to remember that it was the Fed that initially provided it. Now we

have the same people, that helped create the crisis, continue to run the US monetary and fiscal policies!

Second, most portfolio managers who applaud Mr. Bernanke's ultra-expansionary monetary policies are basically only interested in stocks going up – so that they may charge higher fees. For them, whoever can create rally in the stock market through monetary measures is the right man for the job. Would they bite the hand that feeds? We don't know whether we should feel sorrier for their clients' portfolios or their stupidity.

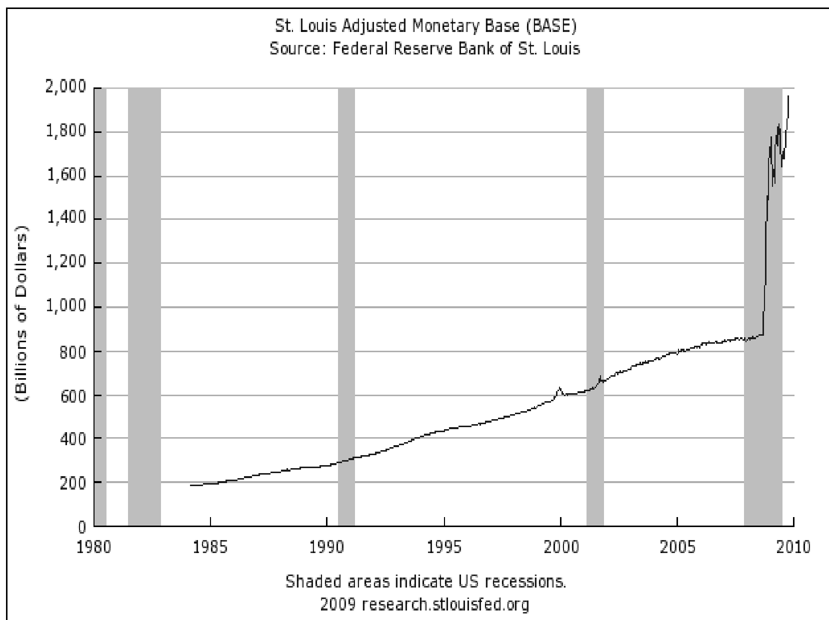

Figure 1: St. Louis Fed Adjusted Monetary Base **Source: The Federal Reserve**

Now, we are well aware that many of our readers will disagree with our ruthless criticism. Even though the Fed did a good job of combating the crisis, we need to look at its longer-term consequences in order to make a proper judgment. Particularly, let's look at the US monetary base.

The monetary base consists of currency in circulation plus bank reserves. It is the Fed's steering wheel to adjust money supply and growth. It seems that the adjusted monetary base of St. Louis Fed has taken steroids lately. Having skyrocketed to a record high of $1.96 trillion, it is up 4.2% from the prior two-week period. Any average person with a pocket calculator can recognize that the monetary base has been growing at an annualized rate of 96.6% (see Figure 1). Mr. Bernanke has definitely pushed the panic button more than once.

The obvious question is where is all that money going?

The money supply did not respond to the surge in liquidity during the past 12 months. This is mainly because the bulk increases in the monetary base were in excess bank reserves, which banks are leaving on deposit with the Fed instead of lending into the normal flow of commerce. The interesting – and horrifying – fact is that M2 (institutional money funds and large time deposits) by and large seems contracting. Liquidity is mounting in the banking system at the same time as money supply is contracting. Generally, contraction in money supply tends to be followed by economic contraction. There is a valid threat of a double-dip recession in the US economy. Under this scenario, money printers are unlikely to get cold any time soon. The avalanches of newly-created liquidity will then flow somewhere.

We cannot be overly optimistic about the future as long as monetary authorities have no better idea than to print more money to create another bubble in the system. Personally, we think that the ultimate crisis still lies ahead. But as always, any economic climate offers spectacular investment opportunities, and this case is unquestionably no exception to the rule!

The most obvious outcome of extremely expansive monetary policy is inflation. The classic inflation hedge is gold. There are a number of people who are considered "gold bugs", who regard gold standard as the only way to go and that all central banks, especially the Fed, should be abolished.

We do not comment on abolishing the Fed, because its ultimate

consequences would also be disastrous. We think it is easier to align our portfolios to any economic climate than to try to fight the windmill. There are powers connected to the Fed that are far out of reach for the average person. If inflation is purposefully created, we think it's best to be prepared to take advantage of it. **The fact is that inflation definitely can be created if the authorities really want it. The problem is that they will undisputedly overdo it**. **Gold prices will react even to the expectations of rising inflation.**

As to gold, it has always had a special role in our monetary history. The interest in precious metals has increased lately. Yet it escapes even some financial people what the rise in gold price actually signals.

Between 1934 and 1970, the market price for gold had been linked to the US gold parity of $35 an ounce. In the early 1970s, the US authorities broke the link between gold and the US dollar. Gold seemingly became "just another commodity" such as oil, coffee and milk. Obviously gold had a very different role in history from these other commodities. We have yet to see a book written about the monetary history of milk. Gold was considered (and in some circles still is) the ultimate cash, which no authority can confiscate.

One of the clichés is that gold is a good inflation hedge. Over the long run, one could buy virtually the same basket of commodities with an ounce of gold. This statement has seemed valid during most of the history. While this belief is attractive, it is healthy to remember that gold too has had its abnormal surges in prices.

On January 1, 1970, the market price for gold was a little less than $40 an ounce. On December 31, 1979, the price was $970 an ounce. In the 1970s, the increase in the market price for gold was many times greater than the increase in consumer prices. The prices of other commodities increased in the 1970s as well, but gold prices increased much more rapidly. At some stage in the late 1970s, the price of gold was increasing simply because the price of gold was increasing. It seemed that the greater fool theory was at work. Hilariously, investors were buying gold on Monday and they would project the price for Friday. They then anticipated that they could sell their gold for a profit on Friday and repeat the cycle on Monday.

Of course, like all manias, the gold mania had to come to an end. At the end of the 1990s the market price for gold was less than $300 an ounce. The price of gold had increased by the factor of 15 since 1900 and the price of a basket of US goods had increased the same amount. The cliché that gold was a good inflation hedge seemed valid again.

The point we are making is that precious metals, gold and silver specifically, are just as prone to mob psychology or hysteria as any other asset class. As the central banks of the world continue to print currency at will, the public becomes more interested in protecting their savings with assets that are perceived as good inflation hedges. To some extent, the fact that gold prices are above $1000 is a reflection of the unconscious collective concern that something is very wrong with the US dollar. If high inflation sets in the economy in the coming decade, as we are convinced that it will, the market price of gold may be driven much higher from today's levels. Optimism in gold prices may become self-fulfilling prophecies until it evolves into a mania.

This is especially likely if a proper outside event, a displacement, triggers a change in the situation and alters expectations. A surge in oil prices is a displacement. 9/11 was a displacement. War is a major displacement.

It is not uncommon to see wars occurring after deep recessions. Remember, the market panic of 1907 was followed by the beginning of World War One in 1914. The crash of 1929 and the subsequent Great Depression were right before World War Two broke out in 1939. Today in 2009 the economy is trying to recover from its deepest recession since WW2. We are not saying that WW3 will follow this crisis, but we do see certain areas in the Middle East and North Korea that do not need very much heating to explode into a large military conflict in the coming decade. Major wars always

impact economies and monetary policy.

For example, from August 1939 to November 1941 wholesale prices rose 23% as raw material demand surged, with economies across the globe, gearing up for war. In April 1942 the equities reached the bottom of bear market. The US military was defeated by forces in the Philippines, which triggered a change in the US financial architecture. As in 1917, the Fed abandoned all other financial goals (including inflation goals) to further the ability of the government to finance the war effort. As in WW1, unlimited monetary fuel was made available by the Fed as needed to finance government bonds sales and support bond prices.

Today America is stuck in two exhaustive wars, one in Iraq and the other in Afghanistan. Taken that these wars provide questionable benefits (except for supporting the business of certain mercenary business) we have to admire the US government's lack of any exit strategy from these fronts. This makes us concerned about the eventual cost of these wars. The US must borrow to hold its war efforts together, just as the British once did. Only, instead of borrowing from friendly allies in the West, the US borrows from future rivals in the East.

One could argue that war is especially useful for certain politicians in shifting the public's attention from hard economic times to outside events. It also allows governments to increase their expenditures, which then drives up the GDP. War is also a good excuse to apply Keynesian stimulus plans combined with expansionary monetary policies. As Mr. Obama put it in his speech about Afghanistan, "*This is fundamental to the defense of our people*."

One has to wonder what kind of magic mushrooms the Nobel Committee has been taking since they thought Mr. Obama was a good receiver for their peace prize. After all, he does not hesitate to meaningfully increase engagement and war expenditure in Afghanistan. As Winston Churchill once said, "*Yes, madam, I am drunk. But in the morning I will be sober and you will still be ugly."* Only future historians can tell in relatively sober eyes, if the Committee judged correctly.

Since new wars have occurred after significant financial crisis, we would be especially wary of the US entering any new military conflict. Military efforts are always expensive and will put additional pressure to the US financial stability and especially the US dollar. This scenario should not be completely ruled out since the US is still struggling with massive problems in its financial sector. Unemployment is also likely to remain high for some time.

Whenever the large masses start to suffer too greatly, they are inclined to turn against their government. This the US does not want and it has means to shift focus. In an extreme situation, a national threat can be invented and war can result. This would not be completely out of question in the context of history. Such incidents are never intended, but very bad economic times usually precede them.

THE BLACK CLOUD

Above we discussed how gold has been viewed the traditional inflation hedge. We then showed how gold has quite recently had its own mania, not reflecting inflation levels in certain times. We then discussed how wars can trigger major shifts in the market and how the US is stuck with two costly wars with no end in sight. In addition, the purchasing power of US dollar is declining, which makes commodities more expensive in the US.

Our ramblings about precious metals and war may seem little to do with the world of finance. Yet a country's fiscal and monetary policies can't be analyzed in isolation. They must be viewed in the context of the nation's external commitments. Monetary, fiscal and military issues are closely entwined.

In addition to its war efforts, we are especially concerned about the way the US is managing its financial sector. The economy is weak and any corrections in asset prices are dealt with aggressive stimuli. **Then there is the baby boom generation that is starting to retire. Their income will drop, which means that their consumption will go down.** This

means that a whole generation is shifting from being an asset to being a liability to the society. Their pensions and healthcare costs will be a huge burden.

To see the irony of the picture, one has to consider who is in charge of the economic and financial management of the US. It is given in the hands of academics, who have never worked in the private sector. They have studied, but we have serious doubts about how useful their studies have been. For them, the causes and consequences of excessive debt levels don't exist. We don't remember the Treasury or the Fed ever expressing concerns about debt growth. Yet credit is one of the most important factors driving business cycles and cycles of speculation.

So, if this is an economic dream team, we have to ask, whose dream they are making come true. It is not certainly the average person's, who sees the price of his necessities go up and does not own very much financial assets. **We think it is fair to suppose that the wealthiest 1% of Americans is not the least bit concerned about rising food and gas prices. Instead, they worried if asset prices start to decline. These are the people who are in favor of excessive stimulus packages, because new liquidity lifts their asset prices**. The average person is not bailed out. He just pays his bills and in his taxes he pays the bills of the elite rich, who received tax-payer's money in order to cover for their mistakes. He watches the prices of his necessities such as insurance, food, and transportation go up as a result of excessive money printing. He then hopes to retire and expects the government to take care of him. Little does he know that no ear-marked pension money readily exist in the US Treasury. It is all blown away a long time ago. Public pension plan is little different from a pyramid scam, where the bottom (the large part) of the pyramid pays to the top. It just so happens that when socialists get to establish pyramid scams, the practice their anomalous thinking again in such a way that they position the pyramid upside down so that there are far less people paying to the top than being paid for! As often with politics (and life in general), big problems start as good ideas.

At the same time, the Fed is doing what they know best: printing massive mountains of money to combat any economical or financial problem. We could envision a future, where the Fed's balance sheet has ballooned from $2 trillion to $4 trillion. Perhaps they think that 20% inflation rate would solve the debt problem! It seems that Mr. Bernanke once had a handle on the dollar, but it broke.

Now, we do not know when the ever distant crash of the dollar will come. We do not know if it is next year or in 20 years. **What seems imminent is that the US is completely unable to pay its debt and will eventually go broke. At the same time, money is printed at will. This is a recipe for a complete disaster, which endangers the whole capitalistic system as we know it. The ultimate crisis is still yet to come**.

This criticism is not aimed at Americans, but the few people in US Treasury and the Fed that are practicing horrible economics and horrible moral. Although we are not Americans, we find it distasteful that certain small interest groups are favored at the expense of the great public of Americans – most of whom did nothing wrong – and subsequently the rest of the world.

In spite of the positive GDP results from last quarter, it is early to celebrate that the worst is over. Mr. Bernanke will of course happily announce that we have certainly seen the worst. He is much like a bar tender announcing that despite the fact that most customers have vomited on the floor, there is somebody who can keep a whisky down for five minutes, so therefore the party's on again! Crashes, after all, are the vomiting reaction of markets. Usually money comes in, but in crashes it comes out. Lowering interest rates to near zero is like offering free booze to anybody who can still drink it.

Now, the GDP results were unarguably positive. The estimate of 3.5% annualized real GDP growth for third quarter included a 1.7% gain from auto sales, 0.9% gain from inventory increases (which were more likely involuntary inventory buildup), and a 0.6% gain from new residential construction. Most reported progress was due to auto sales and housing-boosted (and by now

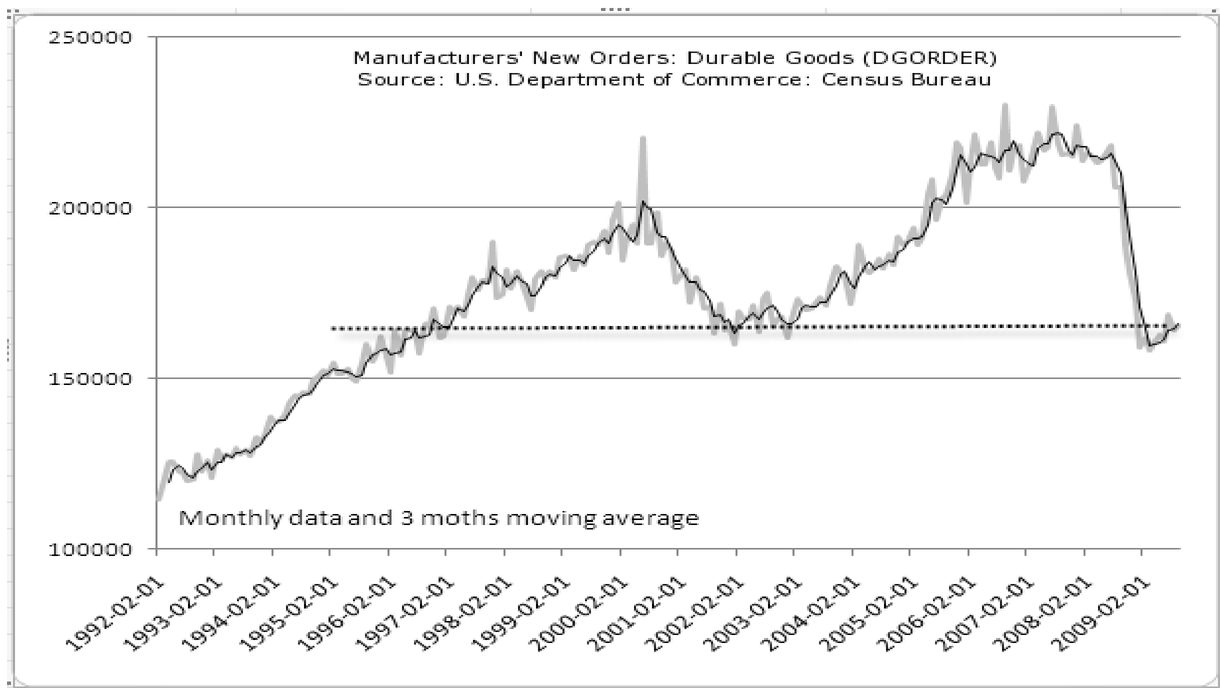

Figure 2: Manufacturer's New Orders: Durable Goods **Source: StockFinder**

expired) government stimulus giveaways.

Year-to-year, September new orders from nondefense capital goods were down by 19.1%, versus a revised August annual decline of 23.5% (previously down by 22.9%). New orders for automobiles fell by 0.1% in September. That makes us hesitant to believe in any real follow through.

Let's observe the three-month moving average of data. Even a quick look at new orders of durable goods shows seven years of lost growth and the bouncing from bottom. The data is in nominal terms and not inflation-adjusted. Based on the data series, the monthly change in durable goods is still within the normal volatility.

Here is the thing. All US recessions in the last four decades have had at least one positive quarter-to-quarter GDP reading, followed by renewed downturn. Business contraction is structural in nature, tied to a lack of real growth in consumer income and liquidity constraints from a contracting consumer credit. The US government's fiscal stimuli have not resolved the real problem. In fact, it would not surprise us to see the fourth quarter GDP turn out to be negative again. We have to confess that it is scary to follow this data and central bankers', notably the Fed's, ultra-expansionary responses to any weakness. We can't avoid the thought that we are in a serious threat of hyperinflationary Great Depression some day in the future. We are 100% sure that an inflation wave is ahead. When exactly that is, we cannot tell. As Jim Rogers so eloquently put it out in his recent email to us: "*I have no idea when the inflation will get worse, but it seems to be every quarter or so to date.*"

As we mentioned above, every problem has a hidden opportunity in it. Even though bashing central bankers has become somewhat of a popular sport, it's time to look at the future in context of massive money printing. While gold is an obvious opportunity on the long run, there is something even more interesting that we think we should share.

THE SILVER LINING

Gold has been perceived a safe haven for investors since ancient times. Even the rise of paper currencies has not killed the idea of gold in people's minds. There have been times when we too thought that gold was unattractive. In fact, when we were participating in the real estate boom at full scale, real estate greatly

outweighed gold in our portfolios. During the past four years, though, we think it is fair to expect that holding gold has become considerably more important than previously. In many ways, the markets have similarities to the 1970s: the weakening dollar, easy monetary policies and geopolitical uncertainty.

As our frequent readers know, we have argued for years that excessive money printing causes not only inflation but also volatility in the market. In the current crisis, the Fed has continuously printed more money, and will continue to print dollars *en masse*. Mr. Bernanke put it neatly in his speech in 2002: "*Like gold, US dollars have value only to the extent that they are strictly limited in supply. But the US government has a technology, called a printing press (or, today, its electronic equivalent), which allows it to produce as many US dollars as it wishes at essentially no cost. We conclude that, under a paper-money system, a determined government can always generate higher spending and hence positive inflation*."

We have to congratulate Mr. Chairman. Although he is doing a terrible job in preserving the purchasing power of the US dollar and hence protecting the American middle class, he is at least walking the talk. He has certainly kept the money printers in speed. The outcome of his printing mania, of course, as he said himself, is inflation. Printing money to solve problems is similar to burning your clothes to get warm in Siberia: you will feel the initial warm, but very soon the situation becomes far worse. Of course, in his mind printing mountains of money will solve any problem. For this reason, holding gold has become attractive again.

Figure 3: 6 month Gold-to-Silver Ratio Source: goldprice.org

Gold has risen in price lately. We hope you've made some money in the process. We expect that a number of our readers have not yet participated in silver investing. In our view, silver is likely to have even more potential than gold in the near future.

In a good year for gold, silver can provide even greater gains driven by the same precious metal trends that push gold higher. It has been our observation that whenever gold jumps, silver almost always follows. As you certainly know, many analysts refer to the gold-to-silver ratio.

Let us consider the reasons to buy silver in addition to gold. In addition to the trends that drive gold prices, silver prices have an additional component that may push it higher. Silver is an industrial metal, which is consumed far more than gold in electronics. The electronics industry uses 44% of silver produced each year. From an industrial standpoint its demand far outweighs that of gold. Silver is in high demand.

On the supply side, we notice that there are only 22 pure silver mines around the world. For the past 15 years, they have fallen short of meeting total silver demand. In total, the world has about five times more gold than silver.

Over the long run, gold has sold for about 13-20 times the price of silver. Presently, the gold-to-silver ratio is around 60. This means that either gold is far too expensive relative to silver or that silver has not yet followed gold in its recent increase in price. **We believe that silver will outperform gold in the coming two years**.

Silver has risen in price lately as well. We hope that our frequent readers were in the silver train and made money in the process! Even if that was the case, and especially if it was not, there are many ways to participate in the precious metal market. For reasons that we have continued to express along the

years, we think that gold and silver should be included in one's portfolio.

It may not be convenient to own large amounts of physical silver. Even $10,000 will get you 35 pounds (16 kg) of silver while it gets far less than one pound of gold. We will express more ways to invest in silver in the next chapter of this report.

INVESTMENT OBSERVATIONS

It seems that for many of our readers it has been challenging to fully accept the fact that a weak economy and strong asset markets can co-exist. In fact, many people completely confuse the economy and asset markets altogether. As we discussed above, any more serious volatility in asset markets has been and will be countered with even more aggressive money printing.

The irony of the past year has been that the worse the economy became, the stronger asset markets became. Of course, the fact that asset markets rebounded had nothing to do with fixing the fundamental weaknesses in the economy – most of what has not been solved at all – and everything to do with excess liquidity, which flew into asset markets.

Now, when there is lack of production capacity, the newly created liquidity typically flows into investment plants and equipment. This way the new liquidity transforms into the employment of more workers. However, this is not the case at the moment. After the boom, which was largely driven by excessive credit, substantial investments in production capacities were made. Presently, there is still an enormous excess of these capacities, which tortures the manufacturing sector.

We should wish to stress that as long as central banks keep their lending rates near zero and viciously print money, it should be obvious that holding cash is not attractive. Also, if capital expenditures and real estate are not desirable, **existing and newly created liquidity in the system flows into asset markets, which keeps equities and the prices of precious metals (such as gold, silver, platinum and palladium) soaring**.

Now, assuming that the economy does not fully recover at record speed and that unemployment remains relatively high, **we continue to expect the Fed and ECB to keep short-term interest rates near zero for some time.** Again, it is highly likely that any considerable downside volatility in equities markets will be combated with additional stimulus packages and further money printing.

Under this scenario, this will unquestionably lead to weakening purchasing power of any paper currencies during the next 5-10 years. The US dollar is likely to lose its purchasing power at an accelerating speed. Eventually all paper currencies are on the path to losing their purchasing power, but all currencies will not lose value at the same rate. Especially, there are some Asian currencies, such as the Singapore dollar, which will easily outperform the US dollar by losing their purchasing power at a much slower rate. For those of our readers that find it interesting to accumulate investments based on Singapore dollar, perhaps we should mention that you might find some solid Singapore REITS offering very attractive dividend yields.

It is our opinion that as long as central bankers are trying to combat any economic problem by printing money and keep interest rates at artificially low levels, it is fair to assume that precious metals will outperform cash. We are well aware that some of our readers have found some pundits argue that precious metals are overbought and are historically expensive and that they should therefore be avoided. We have some sympathy for their views (although not much), but for the reasons we already discussed above, it is fair to expect that precious metals will greatly outperform cash. In an economic climate, where interest rates are near zero and paper money is printed in colossal amounts in a blink of an eye, the supply of metals is still very limited and can't keep in phase of demand. In such climate, we don't see any reason as to one would not own gold and silver rather than US dollars. It would not completely surprise us to see gold hit $1,500 within the

next 12 months. We continue to think that gradual accumulation of precious metals is a sound idea.

Physical gold is easier to own than most other commodities such as copper and oil. Presently, soft commodities offer some very lucrative investment opportunities. As most of you know well know, some of those commodities have heavily outperformed gold from their March lows.

Wheat is one of our special interests in soft commodities. Its inflation adjusted price is near its historical low. Those of our readers that like to play a rebound in wheat prices could find interesting to look at Cresud (**CRESY**) or potash producers such as Potash Corp (**POT**). Then there are of course the wheat futures.

Also, we have found silver to be a very interesting addition to our physical gold position. Investors, who like to join the party for medium to long-term, can consider buying silver mining companies and silver ETFs (**SLV**). We have recently purchased some mining companies on pullbacks and shorted some puts on ETFs to satisfy our appetite for precious metals. At the moment, we hold Hecla Mining (**HL: NYSE**), Silver Wheaton Corp (**SLW: NYSE**) and a very speculative play at NovaGold Resources Inc (**NG**).

As to silver, we continue to buy silver mining stocks. For example, HL offers an interesting opportunity to leverage the play. At the time this report is being written, HL's production cost for a silver troy ounce is around $3. It would not surprise us to see HL trade much higher in the years to come.

The take off in silver is likely to be a bumpy ride, so investors looking to participate in the silver play should expect serious volatility on the way. As always, we highlight that our readers should do their own comprehensive research around their investment topics.

A broad look at the US equity market signals that the indexes could pull back at any date. The economy is flooded with liquidity, which for reasons explained above, is likely to flow to financial markets. Now that the market has experiences a robust 50% recovery from its March bottom, the intermediate term top is likely to be placed in.

Financial and technology stocks have lost their leadership roles and have run out of steam. The SPDR KBW Bank ETF (**KBE**) has moved under its three month trading range, signaling serious weakness. Considerable weakness is also shown in managed-care stocks, steel, clothing, retail, semiconductors, homebuilders, and gaming to name a few. All major areas of the market are drifting lower. This indicates that all engines in the stock market are not running loud and clear.

Those readers of this report that participate in short-term trading have definitely noticed the return of volatility in the markets. The VIX index has jumped over its 200d EMA for the first time since April 7th. This indicates that this stock market decline is different from previous ones during an up-move.

The S&P 500 has pulled back to its 13-week moving average and rests slightly below the weekly trend line, which is drawn from March lows (see figure 4). Once again, this could be a sign of a real correction. However, when a major trend line breaks, it does not always signal an imminent decline. Often big moving averages make markets struggle until the move continues. So, in order to declare a market correction, the market has to show a meaningful correction. The point is that this is now increasingly possible.

We find it considerable that the S&P bounced from the lower channel line on the daily chart (see figure 5). This is the short-term oversold zone. At the same time the daily NHNL has rallied from its recent bottom and risen above the crucial +100 line. NHNL in October points out to the fact that the prices of major indexes are highly likely to retest the October tops. This is a point worth paying attention to, because they could break through it or stumble and reverse.

Generally, the fact that markets sell when bad news arrive is all logical and healthy. It is basically a bullish sign. On the other hand, it's a strong bearish sign when markets cannot rally on good news. Today we see a number of robust earnings, which are much better than estimated. Still they have failed to lift the markets to new highs. Earnings for many

Figure 4: Market Volatility Index Source: StockFinder

companies have considerably beaten estimates. Yet the market never rallied and sustained new highs. This indicates that the probabilities of a further corrective move are increasing. It is therefore increasingly likely that the run from March lows may have hit the ceiling – at least a mid-term top might be forming in the coming weeks.

The S&P 500 index is possibly forming a head and shoulder formation, which is missing its right shoulder at the moment. Should it complete the formation, we should see a bounce back to the 500d EMA (around 1074) and slide back to the neckline. Breaking the neckline should offer juicy shorting opportunities.

If the October top is retested and penetrated successfully, there is a substantial space to continue the run. Should the penetration fail, traders still are still set in the trading range.

The industry group indexes suggest shifting to defensive strategies. We should like to highlight one point, though. Big corrections usually don't happen when everybody is waiting for it. It is therefore equally possible that the markets turn south and that buyers come to buy this up (like last July).

We don't like to be the first ones to arrive in the party. Neither do we want to be the last ones leaving it. However, we are somewhat bear biased at the moment. We would not be surprised to see SP-500 pull back somewhere between 875 and 950 if the correction gives its best shot. However, we don't see the danger of the markets testing its March lows any time soon. Happily, we don't need to forecast the move but live with it and profit from it.

As long-term investors, we need to see the big picture and take advance of the possibilities to accumulate our holdings and protect our portfolios during the rough ride. If you are a short-term trader, keep your stops tight and protect your capital and profits very carefully.

In conclusion we like to point out that the misallocation of capital that has occurred by money printing orgy and unprecedented fiscal stimuli packages will most likely lead us to a fast rotation of

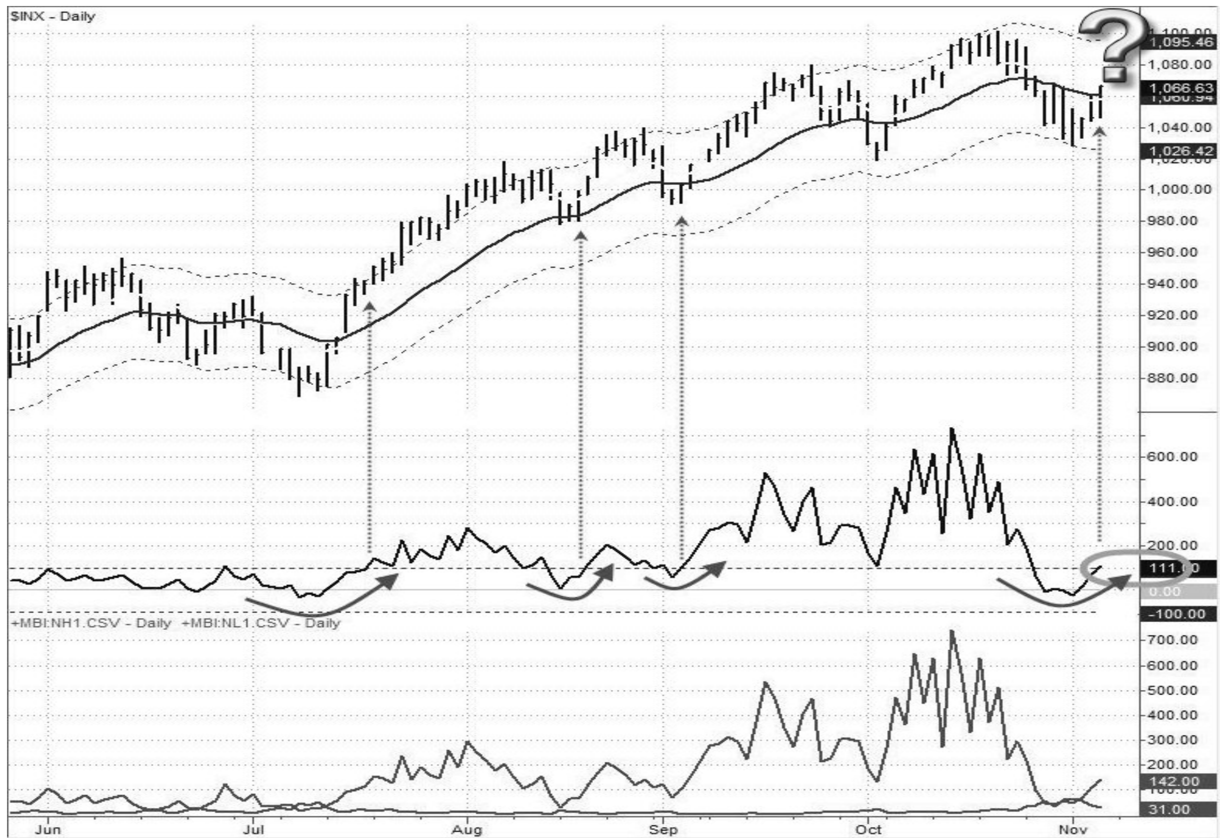

Figure 5: S&P Daily Chart Source: StockFinder

inflating and deflating sectors, making life for investors rather difficult. Passive investment strategies are more likely to lead to substandard results.

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