
PIVOTAL EVENTS

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Politics:

"These are the times that try men's souls. The summer soldier and the sunshine patriot will, in this crisis, shrink from the service of their country; but he that stands it *now*, deserves the love and thanks of men and women."
- Tom Paine, December, 1976

Of course, Tom Paine was a revolutionary in favour of common sense over authoritarianism. President Bush's struggle is not limited to the authoritarian movement in Iraq but to where it occurs in varying degrees in so many countries, including the U.S.

Well, George Bush stayed with his vow as commander in chief to defend U.S. citizens and the popular understanding and appreciation of this is spreading.

Going the other way, the leadership of the Democratic Party and their mainstream media have been opposing this and continuing to move to the left (this is an inflammatory term for authoritarianism).

As we last discussed in September, on booms the left becomes vigorous and the political consensus tends towards those who like big government. And those who are concerned about intrusion into private life are scorned as "morons"¹

It was no accident that communist governments failed at the end of tangible asset inflation in 1989. A similar political change away from the left after the inflation high of 1920 was touted in 1929 as a reason to ride that "new era" forever.

Should Howard Dean, as representing the "tantrum generation", win the Democratic nomination and not change his platform he will be severely trashed in the November, 2004 election. On the other hand, Bush can now move away from his big government expedients and increase his and his party's majority in Congress.

¹ By definition, a "moron" is anyone who doesn't think like a liberal. The problem is that liberals don't think, they feel, and can often articulate it well.

Also, as we wrote in September, on the next phase of the post-bubble contraction, the political consensus will resume its trend towards greater individual freedom.

To place this in financial terms, being aggressively left now is the equivalent of being aggressively long in stocks and commodities. Some margin calls in the markets and politics could be painfully evident later in 2004.

As with rounding tops in real time, the process seems to take a long time. However, in retrospect, they seem to have occurred so quickly. Just recall how quickly things happened after January 14, 2000, which was the record high for the Dow at 11723. With this, and essentially driven by nickel, our base metal price index topped at 704 on March 10, 2000. This also set the record high of 5049 for the Nasdaq.

Majority convictions in politics and in the markets may be vastly changed by November, 2004. As the Romans would say, "*tempori parendum*", which translates as "*yield to (or move with) the times*".

Stock Market: Some of the divergences are becoming more noticeable. On the "investment" side, and using the S&P, a pop through resistance (which the "techies" call an upthrust) has been likely to be followed by a failure. As it is turning out, the S&P has become heavy, but the Dow continues its rise and is fitting the model somewhat better.

In which case, the resistance is at 10050 and the upthrust has been to 10290. Falling through 10000 would mark the failure, from which an intermediate decline could follow.

It is worth emphasizing that bullish sentiment is at record measures, upside dynamics are similar to those seen at previous cyclical tops, and insider selling relative to buying is at record levels. On the apparent shortage of equities, new offerings are growing with some very hot IPOs.

Key divergences include the slump in the SOX (semi-conductors) and, as led by Wal-Mart – the retail group.

Timing: A few weeks ago, we briefly reviewed our study that outlined that often powerful bull markets for base metal prices blew out at the turn-of-the-year window. More of this will be published soon.

In the meantime, the turn-of-the-year statistics for the stock market should be reviewed as well. There has been a tendency for stock markets to make speculative highs in the mid-December to late January window.

On Tokyo's mania in 1989, their broad index (Topix) peaked at 2885 on December 18, 1989 and the Nikkei topped at 39300 on December 31, 1989. (This week the numbers are 996 and 10104.)

Going further back, from 1893 to 1982, of the 13 significant bear markets, 7 started from bullish excesses accomplished in the "window". Using the Dow, the worst bear markets since the 1930s started on January 3, 1973 and on January 14, 2000.

On the optimistic side, 3 out of 4 modest bear markets started in the "window".

Showing that the seasonally inspired crowd doesn't so much care about what it speculates in, silver ran from 1.27 in 1972 to 50 on January 18, 1980. The history of recurring patterns and the speculative fury suggests – beware the Ides of January.

It's a maxim – in order to accomplish a significant top in the "window", there has to be extremely bullish consensus and powerful upside dynamics.

This we have in the stock market and base metal prices. Within the latter, nickel has soared 29% in four weeks, with just 3 trading days from Friday to Wednesday clocking 14%.²

INTEREST RATES

The Bond Future continues its quiet recovery (this week to new high prices) and is likely looking beyond commodity speculation. When the latter fails, bonds could enjoy a nice pop.

Credit Spreads: As part of the halcyon times, US corporate spreads continue to narrow. Representative emerging debt spreads, after shrugging off some concerns, are no longer narrowing.

Stocks, spreads, and commodities are enjoying speculative attention, which seems to be approaching a climax sometime between now and late January.

Discount Rate: One of the most reliable post-bubble trends is the magnificent and lengthy plunge in treasury bill rates. In order to appear to be "in charge", the Fed has been lowering administered rates. As a matter of fact, this type of a plunge in short rates has only followed a financial bubble.

This time the "disaster" of plunging rates has been leveraged against aggressive car buying, the housing refi game, and all manner of derivatives in the credit spread markets.

Although it may be difficult to record the total exposure, the "carry trade" is likely as fully exposed as in the calamity years of 1998 and 2000. This could be fully pressed now and at some moment the various speculators may lose the

² In the face of the huge 6.5% jump on Wednesday, this veteran researcher got so excited that he attempted to punch in the calculation on the phone dialing pad.

ability to keep prices rising. Any drop could force a liquidity crisis that could briefly increase short rates.

Money Supply: The M_3 definition of credit has been enjoying outstanding absolute growth for decades. However, since August it has shown the sharpest turndown since November, 1943. This is covered in the shorter term chart (from 1990 to recent).

Those few out there with a regard for the longer term will appreciate the chart for real M_3 money supply. The upper clip covers from 1910 and the lower is based upon 200-month moving average so it starts in 1922.

As plotted and tabled, there are some significant points. First of all, the huge gain in the 1940s was associated with funding WW II so we will ignore it. However, note the growth with the "New Financial Eras" that ended in 1929 and 2000 as well as with the bull markets that ended in January, 1966 and January, 1973.

The next feature is that whenever the ratio gets above 40%, it is in dangerous territory and trouble is anticipated when the ratio rolls over. This has now happened. This is graphically shown in the third chart, which ranks all the plunges.

In practical terms, what has happened is that huge leverage has been built upon all the assets showing rising price trends and, as mentioned above, these have ranged from SUVs to metal prices. Some pundits mistake this as excess "liquidity" – hell, it's all IOUs and the moment enough asset prices are heading down, central bankers' power to inflate could be overwhelmed by margin clerks, who have a dramatically different job description.

The illusion of liquidity is about to turn into an absence of liquidity.

The Dollar Index slipped a little more than we expected, but stabilization now with a rally up to 92 seems likely. The Canadian dollar is vulnerable to a failure in commodities and widening spreads, which should not be noticeable in January.

COMMENTS FOR METAL AND ENERGY PRODUCERS

Base Metal Prices have become very exciting which, hopefully, makes the action eligible for analysis. A top within the next 4 weeks is outlined above and this section will deal with anticipation.

Whether at tops or bottoms, often share prices lead the reversal in metals. This was the case with the developing correction in gold bullion. As change for the base metals is revealed, we will advise.

Investors should be taking cash off the table and producers could begin to sell forward.

Energy Prices, helped by some cool weather and a powerful rally in base metal prices, crude oil, and natural gas, are making new highs for the move. That's since the seasonal low last June.

These are vulnerable to a break in the mania for metals possible over the next 4 weeks.

Gold: The pop to 412 on Friday was mainly prompted by dollar weakness, which is perhaps oversold enough to stabilize. On top of this, speculation in industrial commodities has become sensational and is expected to spike within the next 4 weeks.

This, along with the weaker dollar, has excited the goldbugs, who could quickly depart when base metal prices fail.

For investors, this would provide another opportunity for aggressive buying as the next rally has been expected to be better than the last one. Indicating outstanding valuations for gold, our gold/commodities index continues to set new lows. At 210, it is down from 252 in September. It's the lowest since early 2001.

Gold shares can get a little cheaper; relative to commodities, gold is very cheap.

	MON	TUES	WED	THUR	FRI NOON
DECEMBER	15	16	17	18	19
Swap Spread	37	36.5	36.5	37	37
Junk Spread	245	246	245	255	-
Treasury Curve	421	419	417	406	411
Base Metal Prices	852	889	930	919	930
Gold	409.2	409.7	412	410.4	408.9
S&P	1068	1075	1076	1089	1088

All the best for a Merry Christmas and a Prosperous New Year!

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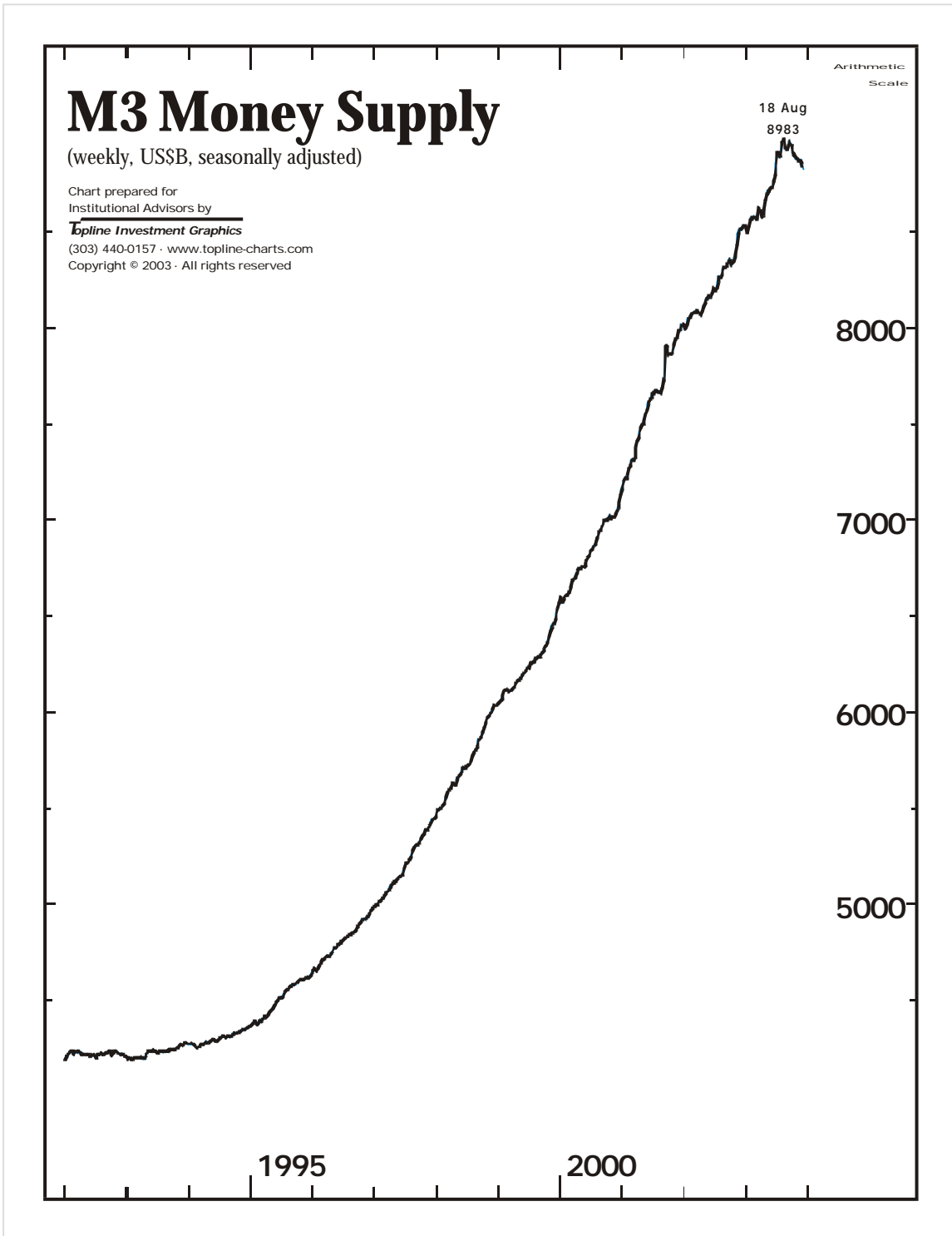
DJIA

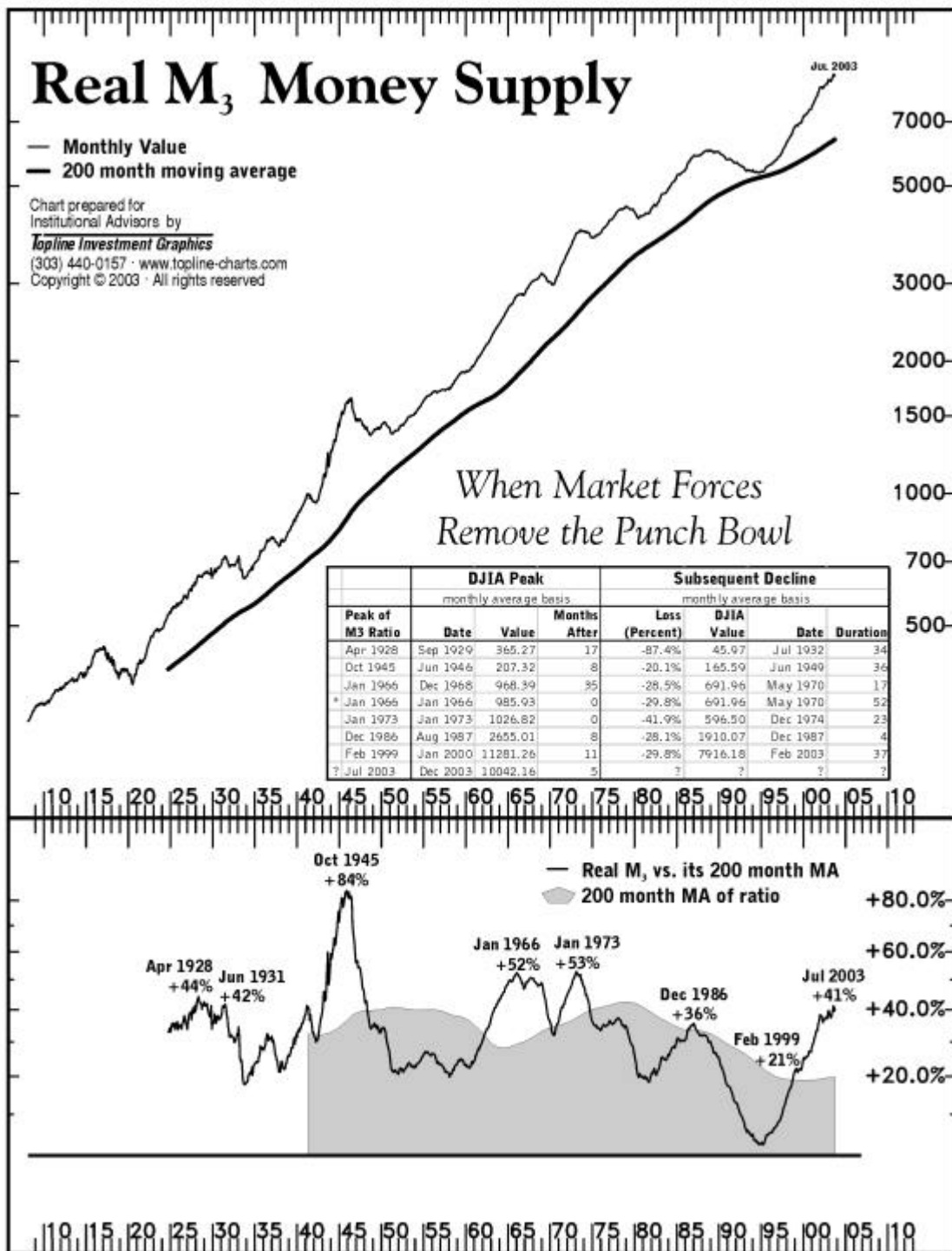
Rising Channel and "Upthrust"



- This model has guided well since introduced in July.
- Note the similarity on the ADX lines.
- Once failed, selling the stock market would be the equivalent of buying gold once it turned off the 104 low in 1976.

Oops!





- The key to the subsequent contraction is the rate of change rolling over. This is the case now.
- Note the impressive "reflation" in 1931.

