

# PIVOTAL EVENTS

THURSDAY, OCTOBER 21, 2004

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PUBLISHED BY INSTITUTIONAL ADVISORS

## Signs Of The Times:

" Gushing analysts Greedy bankers, Tiny startups Fast deals.

Calgary's energy sector bears a striking resemblance to the dotcom era."

- **Financial Post**, October 7/2004

" Emerging Markets Capitalize On Low Rates; A record wave of issuance."

- **WSJ**, October 7/2004

## Observation:

- Crude did an outside-reversal to the downside on Tuesday. That's from a record high on the same day.
- High-yield spreads, including those for emerging debt, have widened a little.

**Big Action:** Since early August, our theme has been that the action was building towards a big test of the speculative spikes set earlier in the year. We have been illustrating this in a table and this is how this week's update looks:

### TEST OF THE SPIKES

	NICKEL	COPPER	GOLD/ COMM.	SILVER	NASDAQ	GRAINS
1 QTR. HIGH	8.05	1.42	183	8.50	2054	1763
SUMMER LOW	5.46	1.16	220	5.66	1753	1112
SEPTEMBER	7.52	1.49	199	7.30	1971	1230
RECENT LOW	6.00	1.29	215	6.87	1916	993

The two most critical items for timing the conclusion of the "testing" set of speculative spikes would likely be crude oil and silver. Typically, crude sets an important high in early October and, so far, the high has been 55.33 on Monday. The important thing was to have the hot speculations in the various games culminate with crude oil. Note that gold's real price should be moving in the opposite direction.

The other timing item was that silver was likely to set a high on October 8, which was the case.

The above table compares the two big spikes and the subsequent slump. The following one provides some detail on the most recent spike:

	CRUDE OIL	BASE METALS	SILVER	GRAINS	S&P
HIGH PRICE	55.33	1081	7.30	1230	1142
DATE	OCT. 18	OCT .8	OCT. 8	AUG. 23	OCT .6
RECENT LOW	52.64	900	6.87	993	1103
CHANGE	- 4.9%	- 16.7%	- 5.9%	- 19.2%	- 3.4%

Quite likely, this is the initial break that chills the speculation but, with markets being what they are, it will take a few hits to turn euphoria to discouragement. The key item in the equation has been the course of the dollar index. Obviously, in the last few days key support at 87.2 has been taken out.

On September 30, we noted that if the dollar index did not rebound vigorously to the high 88s, then the "*next level down is 83*". It was possible that, had 87.2 held, it would signal a harsher initial break in commodities than we have had.

On the big scheme, and we have been a little reluctant to make the call, if the hot games were expected to make the big "test", then it fits that the dollar index would "test" its low of 84.5 made last January.

As it represents the massively bearish opinion of last January, the level, around 84, should hold. The slump could be associated with a brief rebound in the formerly hot games.

**Sequence:** Earlier in the year, the speculative spikes started with nickel reaching 8.05 in early January and then plunging. This action was followed by the Baltic Freight Rate in February, grains in March, and silver in early April.

The big "tests" of those spikes seems to be setting a sequence of failures as well. Both lumber and grains set highs on August 23, with base metals spiking on October 8.

The consequent slumps have been significant and, as in the first quarter, we are fascinated with "*What's next?*". The pending list, in alphabetical order, includes the Baltic, credit spreads, and silver.

**Stock Market:** One of the key groups this year has been the housing index (HGX). The first spike blew out in March and, after a severe plunge to May, it accomplished another spike to October 4 when a weekly downside reversal killed the play.

Worth mentioning is that, on this failure, there has been relatively little change in market rates of interest.

Base metal prices continued weak, with our index declining to a new low for the move. A representative mining index made it to 256 on October 7, from which it has slipped 9% to yesterday's 232. This sector needs a test and failure to set the downtrend.

Why would we be looking for a failure?

*"The exchange is now caught up in mining companies, and mining, as my experience teaches, is the last act of the drama."*

- Ludwig Bamberger, Banker  
At the height of the 1873 bubble

Beyond this, it would confirm that the expected spike in this group is over. The ChartWorks special study pointed out that the typical cyclical recovery in copper runs for 13 to 16 months after the breakout above the old cyclical downtrend. (October is *Month 16*.) Failure would confirm that the cyclical peak is in for base metal stocks.

Our Bank Trading Guide rallied to 173 on October 6, from which it declined to 167 on October 13. Today it's at 171 and we, as usual, are alert to a reversal in the reliable indicator.

In the meantime, the BKX continues to decline, ostensibly on adverse news, but underneath it is the so far modest widening of credit spreads. Showing how fast conditions can change, the spread for Marsh & McLennan bonds, over treasuries, has violently widened from 85 bps to 275 bps.

## INTEREST RATES

**The Bond Future** has been likely to rally into the 114s and so far it has made it to 114 ¼. On the ten-year, Levente has been looking for something lower than a 4% yield and so far it has made 3.98%.

Levente is spending a couple of weeks in Australia, but his usual edition of BondWorks should still be available on Monday. On the travel theme, Bob will be attending the CMRE (Committee For Monetary Research & Education) meeting on October 28 and will be traveling until November 2 so no edition of Pivotal Events will be published next week.

**Credit Spreads:** Along with some other changes towards adversity grouped around October 8, the spread for the high-yield, over treasuries, has widened from 232 bps on October 7 to 247 bps yesterday. No big deal yet, but it's interesting especially when it has been accompanied by, for example, Argentineans widening from a low of 3929 bps on October 5 to 4162 bps yesterday. For Brazil, it has been from 473 bps on October 8 to 531 bps yesterday.

## COMMENTS FOR METAL AND ENERGY PRODUCERS

**Commodities:** The CRB commodity index is heavily weighted in agriculturals and the Goldman index is overweighted in energy prices.

Because of this, we created the IA Commodity Index which, in relatively unweighted form, includes crude oil, copper, lead, zinc, aluminum, nickel, corn, soybeans, and wheat. As these are the most likely items of intense and broad-based speculation, we think it is a good representation.

As shown on the attached chart, the index set a high of 221.44 at the end of 1988 and at 220.96 on March 22, 2004. Note that there have been 3 big speculative zooms that are of equal height and, given that it is a log scale, these are the same percentage moves. In so many words, the moves that concluded in 1974, 1988, and March, 2000 became fully exhausted at the same accomplished gain.

Significant bear markets followed.

Supporting the notion that our index is a good proxy for commodities, lumber has joined the general decline. From a multi-year high of 450 on August 23, two x fours have plunged 36% to 290. As Ross points out, over the past 15 years 450 has set the peak 3 times and, in each case, support was found at 260 but, on the longer term, 210 is possible.

With the possibility of the dollar index slipping to 84, commodities could recover for a few weeks. The recent high for commodities was 212 on October 11 and the low has been 195 on Tuesday. Yesterday it was 197.

**Energy Prices:** Crude oil was expected to set a seasonal high in early October and the extraordinary loss of production with the hurricanes has complicated the topping process. There has been a lot of chat this week about low heating oil inventories.

Nevertheless, we will watch crude's price for topping action followed by an intermediate decline into January.

Supporting this is that often share prices lead the turn in crude and Monday's ChartWorks noted that the key stock indexes in Canada and the U.S. are technically poised for an intermediate decline.

Natural gas supplies were also dislocated and the price has rallied from 4.72 to 7.20. Naturally, with this our forecast for 4.10 by late in the year is off. However, the price is likely to weaken to a low in December, which would set up a long recovery in price.

**Base Metal Prices:** The final phase of the rally in metal prices drove our index from a low of 832 on September 9 to 1081 on October 8 (that date again). That's up 30% in only 4 weeks but, as orthodoxy claims, you can't call it a mania until it's over. The 17% plunge in only 7 days may assist some in that decision.

Since the dismal low of 467 in October, 2002, our metal index (including nickel) has gained 131% and a representative index of mining stocks has soared from 104 on October 9, 2002 to 257 on October 7, 2004. that's 147% in 3 years, which seems like a full cyclical bull market. The model on copper called for a cyclical peak some 13 to 16 months from the breakout. As it turned out, October was *Month 16* and it looks like a top is developing.

This model was updated on October 14 (see ChartWorks of that date) and, in recalling that Ross has been using it for a while, the response was "*since 1978*".

Metals now seem eligible for a bounce and this would fit with the dollar index extending its decline to around 84.

**Gold:** On the dollar's decline, gold could advance to around 441. Considering the high of 432 on April 1, perhaps the game of accomplishing tests of the highs made in the first part of the year is being extended to gold.

Of course, silver is not going to be left behind on the party and will likely test the spike high of 8.50 set earlier in the year.

How this fits into history could be described as an indiscretion for, once it's over, the usual post-bubble forces of contraction will re-engage. With this, gold can resume its uptrend in real terms and silver can return to underperforming gold. Also, it is worth keeping in mind that sudden losses of general market liquidity have been signaled by rapid plunges in silver relative to gold.

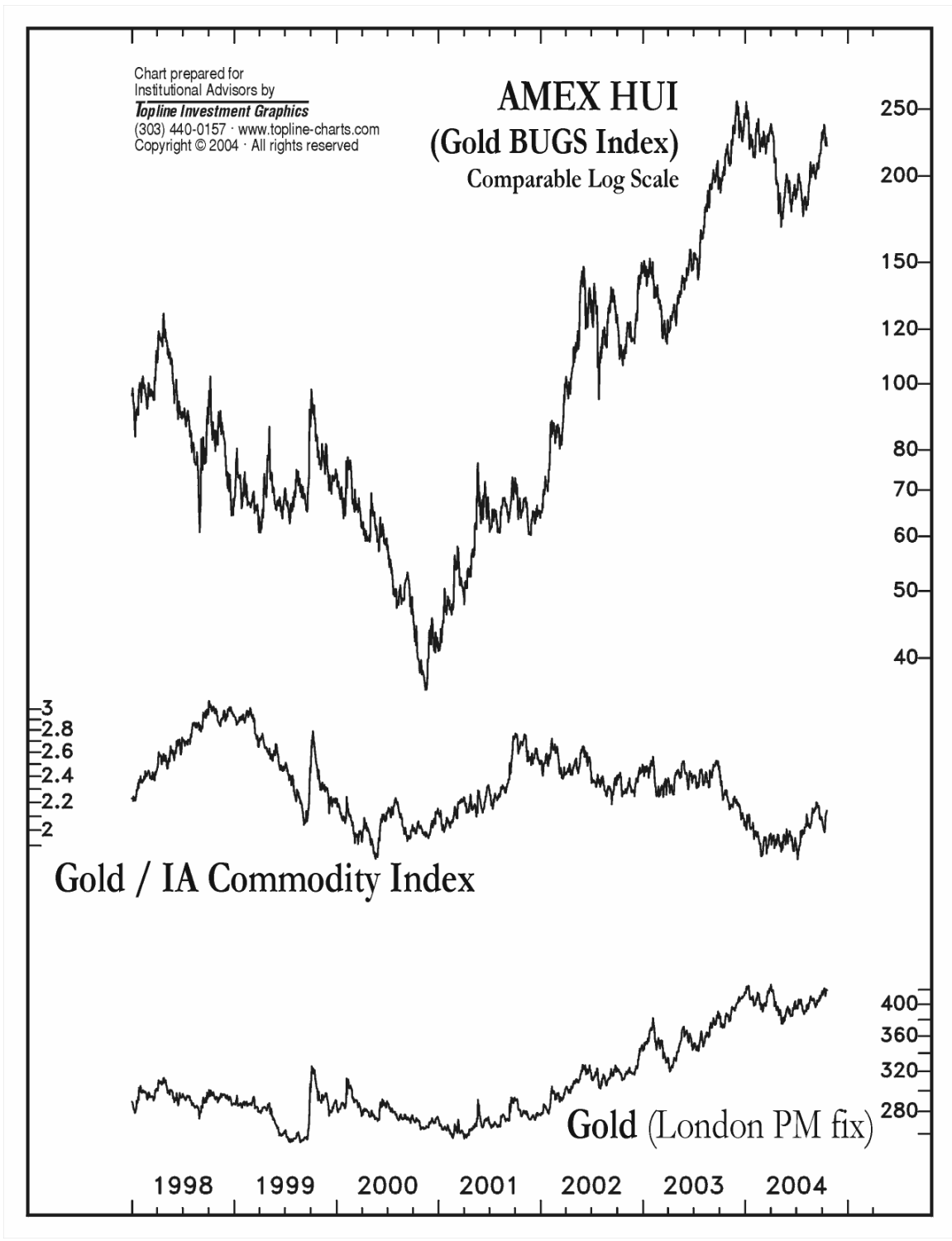
Any setbacks in gold shares should be bought.

	FRI	MON	TUES	WED	THUR NOON
<b>OCTOBER</b>	<b>15</b>	<b>18</b>	<b>19</b>	<b>20</b>	<b>21</b>
Swap Spread	43.50	43	43	42.75	42.25
High-Yield Spread	235	238	242	247	-
Treasury Curve	311	308	300	296	294
Base Metal Prices	924	913	900	900	923
Gold	418.7	416.2	420.3	423.5	423.2
S&P	1108	1114	1103	1104	1106

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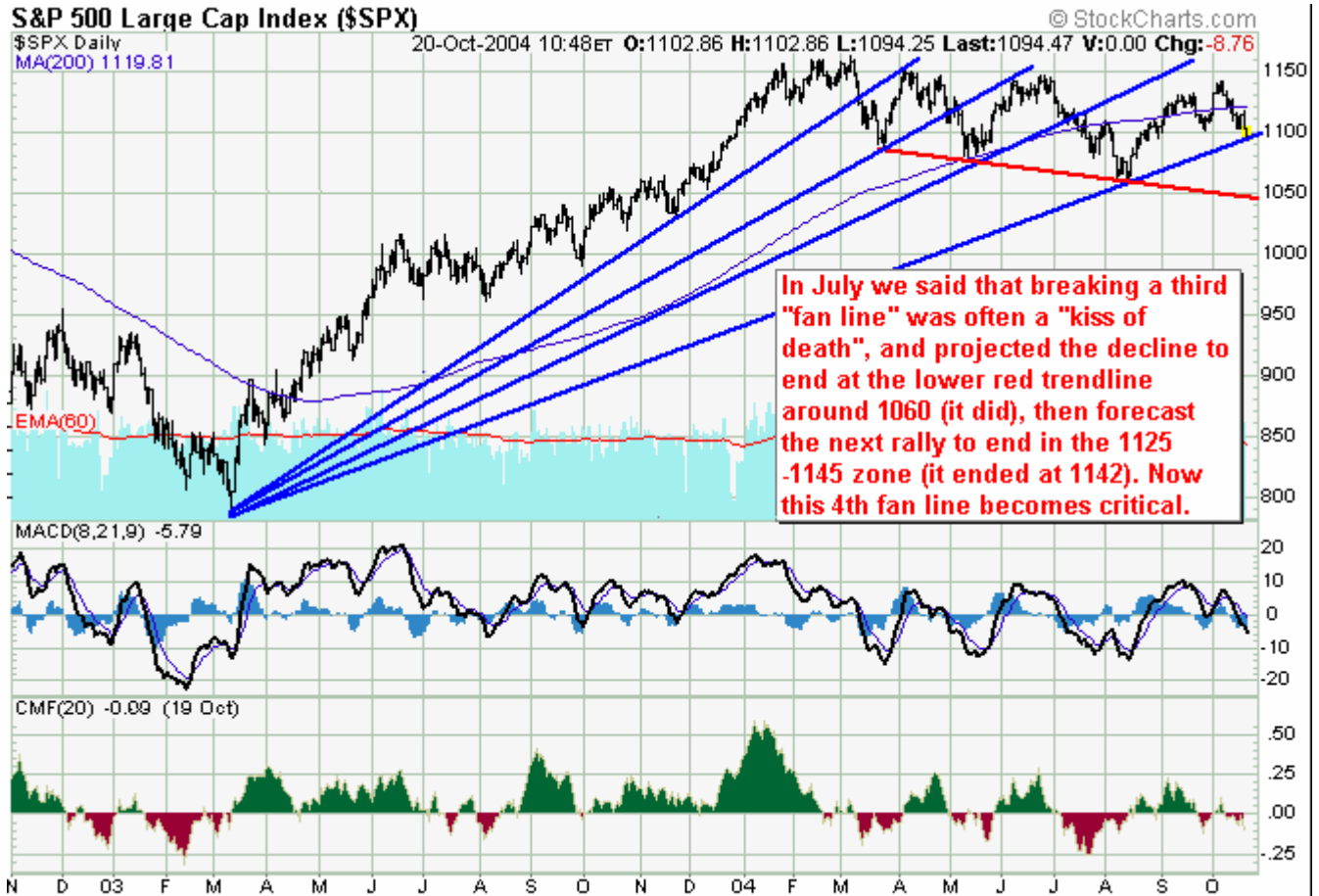
- There have been three speculative "zooms" of equal measure in commodities since the Fed became super-ambitious in the late 1960s.
- These completed in 1974, 1988, and March, 2004.
- The two previous spikes were followed by long bear markets.
- Note the double tops at 221.44 in 1988 and 220.96 this year.
- A long but choppy bear market for commodities seems irresistible.



- The cyclical correction in gold's real price occurred against the cyclical boom in business and the stock market.
- As in 2000, the recovery in gold's real price is anticipating a global contraction.

# SPX ANALYSIS

By Tom Peterson (www.bullseyeresearch.com)



**How far down could the S&P theoretically go in coming weeks? If history is a guide -**

- from 03/04 to 03/24 - there was a drop of 76.17 S&P points
- from 04/05 to 05/11 - there was a drop of 74.25 S&P points
- from 06/24 to 08/13 - there was a drop of 85.72 S&P points

**You can see the "symmetry" there - the drops were fairly similar in size. So projecting that type of drop from the recent highs at SPX 1142:**

- 1142 - 76.17 = 1065.83
- 1142 - 74.25 = 1067.75
- 1142 - 85.72 = 1056.28