PIVOTAL EVENTS

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Signs Of The Times:

" ***Investment advisors hired by Ontario's public guardian to oversee $1 billion in assets for the mentally incompetent lost millions of dollars … the Provincial auditor said yesterday.*" **- Financial Post, Dec. 1**

" **I*nvestors flock to*** [rare] ***coins amid rising metal prices*."** **– WSJ, Dec. 1**

" ***Steel Hunger Feeds Ship Shortage*"**
" ***China Ravenous For Metal*"** **- F.P., Nov. 26**

" ***One thing is sure, the earth is cultivated more than ever before … We have become a burden to our planet. Resources are becoming scarce and soon nature will no longer be able to satisfy our needs.*"**
– Quintus Septimus Tertullian, C.200 BC

" ***Wall Street Aids the Gold Rush*"** **- WSJ, Dec. 2**

Market Characteristics: Our theme since August has been that all, or at least most, of the hot games would take a run at the speculative spikes set earlier in the year.

While we are, by our sober nature, chary of hot speculations they are particularly welcome when they have been anticipated. The other part of this was that the action in the latter part of this year would be a "test" of speculative spikes set earlier in the year.

	BASE METALS	DOLLAR INDEX	DJIA	BALTIC INDEX	HIGH-YIELD SPREAD (bps)
INITIAL SPIKE	1068 (JAN)	84.5 (JAN)	10737 (FEB)	5681 (FEB)	194 (JAN)
TESTING SPIKE	1081 (OCT.7)	81.8 (NOW)	10602 (NOV)	6092 (NOW)	194 (NOW)

Note that for the dollar and credit spreads the action is a spike down. Also worth noting is the upside spikes in stock market sentiment, which reached 86.7% bulls on January 27. This was the day after the Nasdaq high of 2154.

Bullish sentiment evaporated down to 13.3% in August, which was typical for an important bottom. This has soared to 89.3 percent bulls! As Steve Hochberg, at Elliott Wave, points out, this calculation (10-day ma of daily sentiment) is beyond typical highs found at stock market peaks and is at a record high on an indicator with a history since 1987.

In January, the action was in the Naz and now it's in the Dow-type stocks, which makes little difference – speculation is fungible and now it's in the old blue chips.

More On Sentiment: Ned Davis Research (ndr.com) has crafted the "Top & Bottom Spotters Index" that, back-tested, has provided 92% profitability on its signals. It's an amalgam of a number of measures of stock market sentiment and it gave a "sell" signal on November 26. It is designed to assist intermediate to long-term decisions.

In looking at the application to the Value Line Geometric, it was outstanding during the "older" style of stock market from 1966 to the "buy" in late 1990. With base metals and all, this year's action has been "old-style" and this indicator will likely be reliable.

Technical Analysis: The ChartWorks "Presidential Model" served us well through the election and the November 17 edition did the match-up to the culmination of the 1972 bull market (also an election year).

The November 25 update noted the rally possible into the turn-of-the-year window and concluded "***one more marginally higher high***". Final has such a daunting connotation – let's just call this the post-penultimate rally. On the S&P, the target was 1193 and this was tagged earlier today.

Of course, there is the reliable trade whereby the small caps outperform large caps from mid-December to January 8. The details of this trade will be provided.

On the overall stock market, these are the key considerations:

- Essentially, the action is testing the highs of early in the year.
- Sentiment readings are at the moon, which is also a test of early in the year.
- As with older business and credit-cycle peaks, a number of key items have been soaring together.

- These failed sequentially in the first part of the year and highs for lumber in August and crude oil in October seem to be starting the next series of speculative failures.

At such extremes, it is prudent to disregard all the standard bullish touts about earnings, GDP, or the genius of the Fed. It is very important to consider that the stock market is at measurable conditions only found at cyclical peaks.

The ChartWorks conclusion in October, 2002 was that a cyclical bull market was possible, but that it would likely be within a secular bear market.

Until the top has actually concluded, this will be our theme and investors should continue to lighten up and traders should prepare for aggressive selling.

Sector Comment: Our Bank Trading Guide rallied to 172 in early October, from which it traded sideways until 169 was set on the downside on November 23.

The next leg up has been impressive, with the Guide making new highs at 177.

The key is that, after being dull, some spark has appeared at a time when the street is ragingly positive about the general stock market. At important tops for banks and financials, the Guide typically becomes volatile in calling the reversal.

INTEREST RATES

Credit Spreads: The party is definitely long risk and short caution. It is also on the test mode with the spread for high yield, over treasuries, narrowing from 247 bps on October 20 to 194 bps on Monday.

The big picture on this is that during the panic that ended the last bear market in October, 2002, this spread widened excruciatingly to 923 bps. Then, with the good times, it narrowed to 194 bps on January 23, which was two days before stock market percent bulls topped out on the first speculative spike of the year.

This then widened to 269 bps on August 12. Recall the dismal stock market sentiment, then at only 13.3%.

Recently, the WSJ reported that "***Mom and Pop are venturing into junk bonds***". In so many words, the action is attracting new investors who have been piling in since June. This has brought the junk yield down to 7.14%, which is a near record low.

Coming in to only 320 bps, over treasuries, this is the narrowest since the last mania in junk in 1997.

Going against the bliss is that default rates, while still very low, have been creeping up. At 2.9% on the October report, this has increased a little since the cyclical bottom at 2.6% in August. The other fundamental is that so far during this quarter the number of credit downgrades has exceeded upgrades. This has reversed the favourable trend through the second and third quarters.

Both suggest that credit quality could be on the downtrend.

We have been lightening up on the lower quality stuff. Now it's time to begin selling aggressively.

The Bond Future: Last week's quip about nothing happening in the curve and spreads was the sign of boredom. Spreads continued to narrow, but the treasury curve took a little turn to steepening.

This could be important as, since early October, we have mentioned that the reversal from flattening to steepening is one of the signs that a boom is over. So far, this has been accomplished by the long yield increasing faster than the rise in bill yields. This indicator will become more urgent when treasury bill rates start to decline.

In the meantime, at 5.05% the long bond yield is at a new high for the move. We have been looking for a pop in the price sufficient to provide a selling opportunity. Perhaps this leg down in energy prices will provide the lift.

Rallies should be sold. The reason is mainly that the long bond has been part of the speculative party and it is bound to suffer a proportionate hangover. Beyond a loss of abilities by speculators to sustain the action, the longer term fundamentals would include a spreading loss of liquidity as lower grade bonds get progressively trashed next year.

Some have thought that an end to major buying by senior central banks such as China and Japan would then drive U.S. yields up uniquely. The action in the yield curve and credit spreads is a global phenomenon, not nationalistic as far too many generations of interventionist economists have assumed, so the reversal will be universal.

Beyond that, the feature of every post-boom contraction has been a steepening curve and widening credit spreads - globally.

Dollar Index: Obviously, the "oversold" at 83.6 was dissipated by a sideways move rather than a rally.

However, as new lows are recorded this week it has been with a downside dynamics sufficient to register some daily "capitulation" readings. Last week's comment was that the chart was in a "spring" pattern, which is the opposite of the "upthrust" that often ends an intermediate rally.

Still, we are uncertain how low it may go or how many days of capitulation it may take but, between this and the "spring", this is the best dynamic for a rally since last January.

That was the last such capitulation, which suggests that the action, as with the hot games, is testing the lows of early in the year.

Investors and traders can begin positioning for a rally against a couple of technical items that will signal a strong "buy". Capitulation readings have registered on November 24, 26, 29, 30, and December 1.

The Canadian Dollar has had a good run but, while it has mainly been U.S. dollar depreciation, there has been basic support from cyclical firming of industrial commodities and narrowing of U.S. credit spreads.

The latter fundamentals seem eligible for change and investors should begin to position in anticipation of a decline in the C$.

COMMENTS FOR METAL AND ENERGY PRODUCERS

Energy Prices: The initial plunge took crude down 17% to 46.22 in only 3 weeks. The rebound made it to 49.76 on Monday, from which it plunged 6.8% yesterday. The 3-day drop to today's low amounts to 15%.

We have been expecting an intermediate decline from October until January and then a recovery into March. The full decline is impressive in the face of the slip in the dollar index from 85.5 to 81.4.

Base Metal Prices: This week, Teck Cominco reported a new and improved method for refining nickel. We checked with our long-time friend – the ancient miner (actually a metallurgical engineer with an MBA from Harvard in 1961).

He says that this is a variation on the old hydro metallurgical method, which touts are typical of a cyclical peak for base mining stocks and base metal prices.

On the big double spike, the high for our metals index set the first high at 1068 in January and at 1081 on October 8. The initial slide was to 894, from which the rebound is to 978 on Tuesday. Nickel's 3.7% decline since is noteworthy.

The model that Ross has been using for copper projected a cyclical high for as late as October. What seems to be developing since is an extended peak for base metal prices along with the stock market.

This rally for both could be the last of the topping process. We would use any strength to lighten up on mining stocks and other "old" cyclicals. Producers should be selling forward aggressively.

Gold: The upside target has been 440 to 450 and so far the high was 456.5 this morning. (The target was based upon the ChartWorks target of 83.6 on the dollar index.)

Both have exceeded the targets, but technical analysis suggests that a major reversal is pending soon, from which intermediate trends could follow – gold down, dollar up.

The decline in gold could be modest. The main positive could be the increase in financial demand that is possible on the next phase of the post-bubble contraction. This would be signaled by a reversal to steepening of the treasury curve and widening of credit spreads.

As discussed above, the interest rate market is global and the above change could result in an increase in gold's investment demand in any number of important countries. For a real bull market in gold, it should be rising in a number of important currencies – much the same as there are real bull markets for base metals or crude oil.

The other characteristic of a bull market based upon rising demand is the increase in its real price – that's relative to the CPI or against a commodity index. The latter is preferred because the CPI calculation is suspect.

Our gold/commodities index set a multi-year low in March at 183. The tested uptrend has brought it to a high in a narrow trading range of 228 on November 9. The dip was to 222 and yesterday's number, at 233, extends the rally.

Gold Shares: The ChartWorks edition sent earlier today was timed with what seems to be the start of a major reversal in all of the games.

Investors should be prepared to aggressively buy the next important low.

Silver: The "poor man's gold" is catching up to the other hot games in testing its speculative spike of earlier in the year. This morning's 8.19 compares with the 8.50 high on April 2.

It is worth recalling that the earlier cluster of spikes failed sequentially with nickel at 8.05 on January 6, the Baltic in February, and the grains in March.

So far, the sequence has been lumber on August 23, base metals on October 6, and crude oil on October 27.

Silver is next and it is also worth noting that for the remaining hot games the time for reversal could run from around now until early January. At conditions of great excitement, often a sudden plunge in silver relative to gold is the herald of a reversal in fortune. That melancholy event is at hand.

Last Minute Note: The S&P topped at 1194.81 this morning. This satisfies the measured target (1193-1194) from the October 25th bottom.

Look for an initial pullback to 1176. If this does not hold, then the deeper correction to the 50-day ema (1148 and rising) should provide the next good bottom by mid-month. If 1178 holds, then we can look for a marginally higher high (1196-1198), but still followed by a break to the 50-day ema before the end of the year.

With more emotion than logic, the liberal-left, from Marx to Keynes, occasionally goes berserk with policy. The Ayn Rand letter of July 1, 1974 summed it up nicely:

When the curtailment of government spending is imperative, they demand more welfare projects. When the need for men of productive ability is desperate, they demand for equality for the incompetents. When the country needs the accumulation of capital, they demand that we soak the rich. When the country needs more savings, they demand a "redistribution of income".

	FRI	MON	TUES	WED	THUR NOON
NOV./DECEMBER	**26**	**29**	**30**	**1**	**2**
High-Yield Spread	198	194	200	197	-
Treasury Curve	270	278	281	281	282
Base Metal Prices	969	968	978	974	951
Dollar Index	81.78	81.95	81.82	81.40	82
Gold	-	453.7	451.3	454	448
S&P	1183	1179	1174	1191	1193

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