PIVOTAL EVENTS

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Signs Of The Times:

" ***The number of* [residential] *foreclosures jumped 18% in the last half of 2006 – with as many as 100 homes going on the block each week in both Brooklyn and Queens.*"
The New York Daily News, Feb. 12

This compares with a surge of 45% for the same period, nationwide over 2005.

If this seems ugly, it is – tragic for the individual families as well. On the credit side, this distress shows up in the spread index for sub-prime mortgage bonds.

In late October, this was at 100 and at the end of November was at 98.20 when a significant widening started. Last week's announcement by HSBC noted that their exposure in this sector had turned from looking o.k. to bad in only two months, which would likely be November and December. Deterioration since has been greater than recorded on the first two months of the decline.

The spread index, which had slumped to 90.34 in late January is now 80.35 [***no typo***].

While this source does not provide the actual spread, over treasuries, the widening has been substantial.

Sometimes just anecdotal evidence can be startling as well:

" ***Economists Hottest Property on the Street*** **"**

" ***One of the hottest job markets in years for economists as pension funds and other new investment vehicles step up the competition for talent.*****"**
Financial Post, Feb. 8

Last year, they were aggressively buying hot commodities.

Stock Market: Our view since early November was that the long bull market could conclude with a manic zoom into January.

As noted a couple of weeks ago, the power has been sufficient to register "Upside Exhaustion" readings on a number of stock exchanges from Europe to Asia. On the monthly reading, the ChartWorks advice is about opposite to the "Downside Capitulations" registered in late September, 2002 just before that cyclical bottom for investment fortune.

It is worth emphasizing that the model methodically identifies these extremes and what is required now to aggressively sell the global stock market is a distinctive loss of momentum.

Of interest is that the Shanghai index has not registered, but a couple of important North American leaders have – Goldman Sachs (GS) and Brookfield Properties (BPO), which are key representatives of the financial sector and real estate.

Other important considerations include the duration of the bull market. During the secular bull that prevailed from 1940 to the late 1960s, the average cyclical advance ran for 185 weeks and, through the 1980s and 1990s, the typical run was 201 weeks.

This one is now out to some 225 weeks and accompanied by some of the credit conditions symptomatic of a mature stock market and business cycle, the salient one being the yield curve.

This typically prevails for 12 to 16 months and it is worth stressing that it is speculative demand for funds that raises short rates above long-dated interest rates – not senior central bankers.

February is ***Month 12*** on this pattern.

We now look for the senior indexes to establish a top and to lose momentum.

Sector Comment: Our Bank Trading Guide has been likely to extend the latest increase into February.

The status of this is that the quick rise to 220 in December, while favourable to uptrending bank stocks, the rapid rise was an "alert".

The "sell" would be signaled as the high was tested and headed down. The initial decline was to 200 and the rebound has made it to 210 on February 7.

As noted last week, this test can run for a week or so and then reverse, which would give us the "sell" signal on this bastion of complacency.

In the meantime, spreads for sub-prime mortgage bonds continue to widen and so far, and as reported a week ago, bank giant HSBC (HBC) is taking a hit on this exposure. Given the nature of reckless banking during a boom, this setback is unlikely to remain isolated.

The base metal mining sector began to improve on Tuesday along with metal prices and a story about Rio Tinto and BHP taking a run at Alcoa. The key is that this sector has been expected to improve into March and seems to be underway.

INTEREST RATES

The Long Bond: Last week, we thought this could rally a little further when, at some time, we were looking for a bounce in depressed base metals.

That this paradox was not noticed can be attributed to either complacency or a momentary loss of wit. At any rate, bonds can be choppy-to-down with poor seasonals in the face of a pop in commodities.

We had not recommended any trading positions.

The Yield Curve continues to hang around the – 12 to – 13 bps of inversion. That's taking the curve from the 10s to the 2s.

When the change comes in, initially it could be as T-Bill rates begin their decline – perhaps after March.

Credit Spreads continue their negative divergence as the more popular stuff – junk – continues to narrow as the formerly popular sector, sub-prime mortgage bonds, continued to widen. The latter could be panicked enough to enjoy a few weeks of relief.

The Dollar Index: With the mini-panic in base metal prices, the DX firmed to the high-side of our expected trading range. Then with seasonal firming of base metals and crude into March, the dollar could trade to the low-side of the range at 83.5.

The Canadian Dollar became oversold due to political uncertainties and weaker key commodities.

The low was 84.38 last week and last week we thought that the 84.40 level would hold and the rebound looks good. Building a base in the 85s would lead to a longer advance.

Miscellaneous: Along with the recovery in commodities, the Baltic Freight index is recovering as well.

This will give the January high a good test and then it should roll over with industrial commodities after March.

On the grains, the GKX got overbought, set a high against negative divergence, and is working on a top.

The point in monitoring this is that there have been no disappointments in the latest of the pension fund asset classes to rally.

Completing the rollover would remove another rising asset that central bankers need to continue their portion of credit inflation.

COMMENTS FOR METAL AND ENERGY PRODUCERS

Energy Prices: Our point has been that if the bulls could temper their impetuosity, the rally could make it through March.

Last week's rush to 60.80 was worrisome, but the correction seems appropriate. There is considerable congestion in the low 60s and, for a healthy market, it should spend some time working through it.

This seasonal move could be limited at 65.

Into Spring, the XNG can push up to a new high.

Natgas is working its way out of the usual seasonal low in January, and the advance could run into May.

The XOI (oil stocks) has recovered from 1144 in mid-February to resistance in the 1180s. The November high of 1242 seems attainable.

Base Metal Prices: On the mini-panic, our index (less nickel) fell to 570 last Thursday and the rebound is an impressive 11% to 633.

Constructive action would spend a little time working at this level before advancing further. Around 675 seems possible.

In the meantime, the deliberate ramp up in tin continues to new highs and could be inspirational in assisting the battered examples in obtaining a March high.

As discussed in our two previous editions, tin was forced too high by the tin producing countries in 1985 and the fallout did considerable damage to LME merchants.

Being fans of financial violence, our view now is that the tin crowd could take it to the moon and eclipse their foolishness of the 1980s.

While we have been looking for the sun to shine on our base metals index in March, we should review the forces that could limit this move.

One, of course, is the yield curve, which has been inverted for 12 months and it usually takes 12 to 16 months of this to initiate a cyclical contraction.

The other is the ongoing disaster in sub-prime mortgage bonds and the U.S. housing market. This is unlikely to remain as isolated.

Golds: Today's ChartWorks reviewed the nominal price of gold and the underperformance of the gold stocks relative to bullion.

A correction in gold stock prices seems possible.

In the meantime, as determined by our gold/commodities index, the real price firmed from 170 in late January to 181 last Friday.

This week, it has backed off to 177 as commodities have been bid up more aggressively than gold.

Rising through 181 gets the market beyond minor resistance and above 188 extends the trend.

Other than a possible mild correction for gold stocks, the outlook is very bullish.

The Gold/Silver Ratio has declined a little lately. Typically, it rises during a contraction and declines during a boom.

The key decline was to 44.7 on December 12, from which it bounced to 50 in mid-January.

With the revival in industrial commodities, the ratio has declined to 47.7. And it is worth noting that, while the gold/silver ratio does not have big seasonal tendencies, it can have an important low in mid-February, or around now.

An important feature is that when a boom is at full blast, like now, a sharp break in silver relative to gold can signal the advent of liquidity concerns that inevitably follow a party.

	FRI	**MON**	**TUES**	**WED**	**THUR** NOON
FEBRUARY	**9**	**12**	**13**	**14**	**15**
Junk Spread	465	463	460	464	—
Treasury Curve	- 12	- 13	- 14	- 14	- 13
Base Metal Prices	588	591	603	612	633
Dollar Index	84.4	85	84.7	84.2	84.1
Gold	667.5	662.6	663.9	667.4	663
Gold/Commodities	181	180	179	177	—

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