

Models & Methodology

Performance 1998 to 2001

Methodology:

Our models are based upon a thorough review of the highly volatile conclusions of 5 previous new financial eras. This provides forecasts of significant trend changes with enough lead time to formulate strategy. At each expected change, the ChartWorks, using uniquely successful technical models, confirms the probability of change.

This approach has been reliable since assembled in 1998 such that our subscribers have suffered very little surprise, either up or down, showing a conservative and successful integration of different disciplines.

SERVICES

Pension Fund Portfolio Balance:

We maintained a maximum 60% weighting in equities until February, 2000 when our Boom Indicators reversed to a warning.

A 60% fixed income weighting was recommended by selling maturing equity sectors.

For 2001, our model expected the rebound to set the high for the year in April-May.

As this was reached (on May 22), we advised reducing equity exposure to 35%, which is as low as we will recommend.

A detailed review of our Boom Indicators will gladly be provided upon request.

EQUITIES

Dominant Trends and Sector Rotation:

Most of the significant changes in the stock market trend have included equally significant sector rotations.

We get most of them ahead of the change.

The accompanying pages in Appendix 1 provide the track record.

Extreme Volatility:

The overall model expected the great financial boom to conclude in the 10th year following the top of the last business expansion of the old era of inflation (July, 1990). Our work on short-dated market rates of interest (not the discount rate) in January, 2000 concluded that the speculation would blow out around March, 2000 (✓).

By June, 2000 The ChartWorks had developed the "[Exhaustion-Capitulation](#)" model, which has been very reliable in determining the conclusion of extreme upside moves as well as those to the downside. This has proven successful on indexes or individual stocks.

Following the "Upside Exhaustions" of 2000, many of the widely held stocks suffered profound declines which, for far too long, standard analysis continued to recommend as purchases.

The downside or Capitulation Model avoided this by providing a methodical discipline for re-entry. We have also called this the "Falling Knives Model"

FIXED INCOME HIGHLIGHTS

Major Calls:

- The remarkable bond rally in 1998 was expected to conclude in late September. Using the bond future, the high was 134 on October 5 when our initial target became 117 and the projected was 110. The latter was accomplished in January, 2000.
- Our Boom Indicators began to improve in October, 1998 and were positive until December, 1999. These reversed dramatically by January 28, 2000 when we shifted portfolio balance from 60% equities to 40%.
- The only increase in the weighting was recommended in late September, 2002. Our November 1 advice was that spreads would narrow until March - April.

Bond Future:

In 1998, the model expected the outstanding rally to conclude in late September. Our October 1 edition noted this, as well as the possibility of a significant rise in both long and short rates. With this, The ChartWorks reckoned the high for the future at 136 (actual 135 on October 5), the reversal imminent with the initial target at 117, and a projected one at 110.

The eventual low in January, 2000 was within a point of our target and anticipated in the December 1 edition.

For 2001, the high price was expected in October (high November 2), from which a long bear market has been possible.

Yield Curve:

The year 2000 would most likely conclude the most speculative side of the great financial boom. This would be confirmed by the curve making two thrusts towards inversion (✓). The onset of a significant financial contraction would be confirmed by the curve reversing to steepening in November, 2000 and retracing all of the inversion in 1Q2001 (✓).

Our regular publications provide the interim moves, usually with enough time to implement policy change.

Credit Spreads:

Generally, as part of a new financial era, spreads narrow inordinately and then widen to eventually dislocating conditions.

One example of the power of the model was for 1998 when spreads were likely to narrow until April-May and then widen. Our May 1 edition reviewed this and noted that "dislocating conditions could be reached in August-September".

This pushed off the LTCM failure. Some think it was the other way around.

The most recent phase of narrowing was expected to run from around November, 2001 until around March, 2002.

Discount Rates:

Our December 15, 2000 edition noted that the Fed would soon follow the downtrend in treasury bill rates with a series of discount rate cuts. This stressed that this would continue until a typical post-boom contraction was eventually exhausted.

THE ECONOMY

May 5, 2000:

"In all five previous New Eras, the recession started virtually as the bull market ended. The wealth effect quickly turned to the dearth effect"

April, 2000:

"The irony is that the New York establishment in 1989 competently described the action in Tokyo as a "bubble", but seems unable to make the same diagnosis now. As with previous examples, participants find them too prosperous for circumspection. As Lord Acton might have said, bull markets tend to corrupt and great bull markets corrupt absolutely."

June 23, 2000:

"Recession Watch: If our Boom Indicators continue at this negative level [plunged from +12 on January 4 to -1] for a few more months, a recession would be inevitable."

By September, the Indicators had deteriorated to -3 and the Industrial Production index, which is the longest running such determinant of the business cycle, began an unusually relentless decline.

Deterioration continued to a -11 reading in December, 2001. With favourable action in the yield curve, credit spreads, and industrial commodities, it has improved to -10.

EQUITIES

"Institutional Advisors' research has been very critical in establishing a correct macro view on key developments in the financial markets."

- Equity fund manager with a 28% annual return over 10 years and up 43.8% in 2001. Their hedge fund (long or short stocks only) won the top-ranking in North America with an 80.95% yr./yr. gain to March, 2002.

U.S. BOND FUTURE

- October, 1998 - December, 1999:
23 1/2 Points in 2 Trades; 29.5% Total Return

- 2000: 23 Points in 4 Trades; 29% Total Return
- 2001: 27 Points in 8 Trades; 31% Total Return

CURVE AND SPREADS

Most major trend changes have been anticipated with enough time for investors to determine policy changes. Our models are based upon the fundamentals of previous New Eras.

ALLOCATION

After being very positive, our Boom Indicators reversed to a warning in February, 2000 when the advice was to lower equity exposure from 60% to 40% by selling into strength. Investment and trading positions in fixed income have been appropriately advised.

THE ECONOMY

In May, 2000, we noted that if the Boom Indicators remained at a warning for 4 months (✓), a business contraction would be inevitable. Also that month, our study of Base Metal Prices called for a cyclical decline. Our September, 2000 study on Gold expected its real price to reverse to a 3-year recovery (reversed in October, 2000).

GOLD

- In early 1982, the basic model expected gold's real price, as deflated by the CPI or a commodity index, to decline until the new financial era climaxed in a bubble.
- By June, 2000 we observed that the bubble had completed, in which case the cyclical low for real gold and gold shares would be around November, 2000. It was accomplished in October, 2000.
- Then the first speculative high would probably be in May/02 (✓).
- Our September, 2000 study outlined that the real price could more than double by 2004.
- Our emphasis that gold's real price would be a proxy for the change in investment demand as the bubble failed is still controversial.

BASE METAL PRICES

- The model expected base metals to rise with the last business expansion with the new financial era (✓).
- Our May, 2000 study concluded that base metal prices had entered a multi-year bear market (✓) with a flattening consumption growth curve (✓).

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