

# TIMELY ANALYSIS

## AUGUST 25, 2000

### The Critical Call

**Good News From California?** As reported by the WSJ, this trend-setting region may be on to something. "In California, we're very cutting-edge. Savvy people are done with foo foo things like cranberry mustard." The article noted that ordinary hot-dog mustard was regaining popularity and that fancy labels have slumped sharply.

And not a moment too soon as those with a regard for the stability of fine traditions would also welcome the end of "foo foo" martinis as well as "foo foo" currencies.

**The August-September Transition:** Since the 1932 low, the typical pattern for the move from Month 8 to 9 has the DJIA recovering from around mid-August to the first week in September. Within this, if the August rally came out of a consolidation from a significant top earlier in the year, *the probability of an important failure after early September increased.*

Notable autumnal financial events have included the end of the global bubbles as they occurred in the U.S. in 1929 and 1873. In both examples, the hot action in the favoured techs concluded in the first week of September. Bubbles, as they occurred in London, peaked in May or June. That's for the five examples from 1720 to 1929.

*It is worthwhile noting that this has been the biggest and most flamboyant one in financial history. Those in prominent positions in central banking or Wall Street who claim this has not been a bubble obviously have been unfamiliar with the phenomenon. Well, if you can't recognize one as it occurs, it's impossible to forecast the end of one before it occurs.*

Considering current conditions, it is appropriate to have some knowledge of the transition to deflation. Most Economics dictionaries define deflation as some exogenous event beyond the power of policymakers. Actually, they only occur following the dramatic conclusion of every New Era. (Naturally, benign disinflation is the result of brilliant policy measures but actually only occurs during a New Era.)

**The Set-Up:** By way of summary, the current condition of the speculative sectors from equities to bonds was anticipated by our work in January. The model on credit spreads and the curve expected a reversal (ultimately to distressed conditions) in January. A broader measure of financial forces mounting against ambitious speculation has been provided by our list of Bubble Indicators. The dramatic reversal by early February provided a warning on speculative abilities some 6 weeks before the Nasdaq top in March.

**Rebounds:** The critical part of great blowoffs in stock, commodity, or currency markets is the plunge and rebound. It's a maxim that if the rebound fails, a bear market follows. For the past three weeks, we have run a table of the key items.

	High		Rebound		Diagnosis		
<b>Base Metals</b>	Jan 21	240	Aug 23	228	Could be firm through September		
<b>Nickel</b>	May 18	4.79	Jun 2	4.34	Aug 23	3.89	Bear
<b>Crude Oil</b>	Mar 7	34.13	Jun 20	33.05	Aug 23	32	Seasonal Rally
<b>Biotech</b>	Mar 7	806	Jul 12	760	Aug 24	741	Testing
<b>SOX</b>	Mar 10	1332	Jun 21	1269	Aug 24	1065	Bear
<b>NASDAQ</b>	Mar 10	5049	Jul 17	4275	Aug 24	4053	Weak
<b>TOPIX</b>	May 29	1733	Jul 11	1611	Aug 17	1476	Sayonara
<b>Dollar Index</b>	May 17	112	Aug 22	111.8	Aug 24	111.3	Timely?
<b>Obverse Relations</b>							
	High		Low		Diagnosis		
<b>Junk Spreads</b>	May 31	650bp	Jun 23	610	Aug 24	642	Worrying
<b>Corp Yield Curve</b>	May 31	.9124	Jun 23	.8883	Aug 24	.9201	Oops!

**U.S. Dollar:** For this year, our model on the dollar index expected a primary high in May (the high was 112 on May 17), a plunge (the low was 106), and a rebound to August. So far, the rebound high has been 111.8 on August 22. On Tuesday, Tom Peterson noted that the euro was poised for a "spring" and this seems to be part of the setback. We have attached the "big picture" charts we last ran in June.

**The Nasdaq:** In the ChartWorks Department last week, Ross Clark compared the action in the Nasdaq this year with that in Dow in 1929, gold in 1980, the Nikkei in 1990, and Dow in 1987. That the first four have had major similarities and that 1987 was distinctive is critical.

Some rebounds, such as for the semis and biotechs, have become rather vigorous. However, this seems within our expected favourable period from mid-August to early September. There are two ways of looking at the table. One is to watch for a majority of items to roll over from the rebound. The other is to focus on the dollar and the Nasdaq as the two most important, *particularly as the latter is solidly within the "post-great euphoria" pattern.* [Emphasis added]

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