Global Report –Aug/Sept 2010

UK

Europe

US

Japan

Emerging Markets

Bonds

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Currencies

Aug/Sept 2010

World Investment Strategy

IRC INVESTMENT RESEARCH OF CAMBRIDGE

Introduction

Investment Research of Cambridge was established in 1945 to specialise in technically-based research of the financial and commodity markets. The company has built up an international reputation for its expertise in predicting the trend in global markets and individual stocks.

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- Source of data for charts: Investment Research of Cambridge, Q-Data, Alpha Terminal, Thomson Reuters

World Investment Strategy

Summer is over. Stock markets had their customary seasonal rally and that is very nearly over. They are now entering the period which, in a normal year, is the weakest six weeks of the year. They should go straight down without touching the sides.

Let us just clarify what would have to happen for us to be wrong. It is worth pointing this out because so far this year the twists and turns on our road map have been working very well indeed. If we are wrong now then equity indices will immediately go up and break above the highs made on April 19th. That is they will make new highs for the year. We do not think that will happen but, if it does, we will have to change our entire scenario.

On our road map, the rally that started in March 2009 ended this April. It was a fantastically good rally but not out of the norm for such rallies in a secular bear market. It was comparable to the one that followed the crash of 1929 – just as the fall in 2008 had itself been comparable to the crash of 1929. We are running to a script here.

Since April the trend has been downwards but not in a straight line. It is a pattern of falling highs and lows. Obviously, if the high is taken out, that pattern is negated. But, at present, the pattern is still in place.

Markets had a fall of about 15% to a low on 1st July. The normal mid-summer rally then took place and carried through until 6th August. The indices then fell again and became extremely oversold. As is normal, they have rallied to correct the overextended situation and so entered September with a strong move. They are now approaching the traditionally weakest period and we expect the rally to end soon and a violent fall to new lows to occur. The final low should be in October.

The first of October is a Friday, then there is a weekend, so the first time a low could form is about 6th or 7th of the month. It is normal for a dead cat bounce to take place and then be followed by a later retest of the low. This looks likely to be around 20th October. Our advice is to stand back and allow markets to fall. Our target for the FTSE-100 index is 4,400 and for the S&P 500 index it is 940. At these levels we would be ready to buy for a rally through to the year end.

In an average year the rally would go through to late May. But, just as this year the move became exhausted by April, it looks as though in 2011 it will run out of steam even earlier in March.

At the low in October, the US market will have discounted the result of the upcoming mid-term elections. It looks as though this will be a catastrophe for the Democrats. It may not be Mr Obama's fault but he will probably be a quacking lame duck one term loser. He will still be President for another two years but he will not be able to do anything. A state of gridlock will exist.

One in six people in the US are getting food stamps to eat. Next year the rate of interest on a huge number of mortgages will be reset. They are already under water. Housing, high and rising unemployment, will make a double dip in the economy inevitable. Much of the economy never came out of the first dip. All that happened was the government spent so much money that it created the impression that something was recovering. This was a delusion.

The bond market is far bigger than the equity market and it has been screaming, almost hysterically, that the economy is in bad shape. Bonds got overbought and had to give up some of the rise. On current yields they are not a long term lock-up buy, but they are still the safest haven for now and rates will be going lower for longer.

In the new norm that we are now enduring, the return of our capital is worth a lot more than the hoped for return on the capital. Be risk averse. If you think you should hurry to buy something, then go take a walk in the fresh air until you feel better.

Summary: world market overview

We never write in August as there is no one there to read it. The kids go back to school now and the work starts again.

The seasonal deviations have been working pretty well so far this year. If they continue to follow form, we need to take note that we are now entering the weakest six weeks of the year.

Many markets entered secular downtrends in the year 2000. They are ten years into the downturn with possibly another ten years to go. Even if we have a cyclical bull phase in these markets, we will only dip into them for brief rallies, they are not investments.

Other markets are in secular uptrends and will stay in them for another ten years. We do not like to be out of these markets for long, but the short term volatility they can display is brutal.

The problem is that when major markets have a meltdown, all investments – even the ones that are not supposed to be correlated together – are going to move down at the same time. This is one of those times.

We may not call the timing exactly, and so might have to tolerate a small rally against us for a time, but we do expect all markets to be lower at the end of September than at the start.

September is normally the weakest month of the year. The final lows come in October and that month usually ends with the start of a rally. The present rally is not it.

Our work has always indicated that the US economy is in the equivalent phase of the cycle that last time around was the great depression.

In these circumstances expecting a V-shaped recovery any time soon is a delusion. We do not believe in it, and think that the true data, as opposed to the spun data, is already massively negative.

Even in the parts of the world that are still enjoying strong growth, such as China and India, value is not great and there are problems. We need a setback here before we can become excited about buying again.

We think that bargains will be offered later in the year – probably by 20th October.

We do not think that bonds are a bubble, or at least not yet. At times like this, the least-risk investment does well. The 30 year US Treasury bond has risen 30% since April. If it offers a 4% yield again, buy it as when it goes to 2% – you will have doubled your money. A bubble never bursts when commentators are telling you it is a bubble. They only end when investors have capitulated. At present, bonds are a much better investment than equities for most investors.

When we get bullish of equities again, our preferred markets will still be India, Brazil and the resource-based markets.

The US dollar is being printed into oblivion and the only way to hedge that risk is with gold and silver. We still expect a pull-back in gold which will give another buying opportunity. At which point we will be buyers. The ratio of gold to silver seems to imply that there will be a much bigger bang for the buck in silver. So we would now start to build a position in silver. If we wait any longer, we might miss it. This stance enables us to be a bit more relaxed with respect to timing the gold trade.

In the short term, or next few weeks, we anticipate the dollar will rally.

The World at a glance

Major markets

US relative to world: currency adjusted

The US economy is in a depression and the stock market in a bear phase. It had a strong rally from March 2009 for no other reason than that the government was spending 2 trillion dollars. But unemployment was rising and the private economy crashing. The market is now in the weak part of our ranking table and falling back on a relative basis. On the relative chart, it has just cut below the 200-day moving average. For the next six weeks it is a sell.

UK relative to world: currency adjusted

The UK market is in the neutral part of our table and currently rising on a relative basis. There is a golden cross of the moving average on the relative chart, which is above its 200-day moving average. We still expect the FTSE-100 index to actually fall between now and late October, but it is showing some relative strength. The market is acknowledging that the coalition government is trying to do the right thing and get out of debt. We may have to endure a winter of discontent when the trade unions start to protest.

Europe relative to world: currency adjusted

With the exception of Switzerland, all European markets are in the lower part of our table. On average, they are weaker than both the UK and the US. But this disguises the fact that the giant export companies of Germany are in rather good shape. In spite of this, the German market overall is in the weakest category. The developed western world really makes up the entirety of the lower half of the table. By being currently neutral, the UK is as good as it gets. There are likely to be lower buying levels for these markets in October.

The world at a glance

Japan relative to world: currency adjusted

- Japan is still in the weak group of the rankings. The relative trend is downwards and is just now cutting below its falling 200-day moving average. This indicates that it is likely to be lower again next month. The political situation is still very uncertain. The economy is certainly in a mess. The yen is being bought as a safe haven which, unfortunately, does not help the export companies. All in all it is to be avoided for now.

Pacific ex Japan relative to world: currency adjusted

- This is obviously by far and away the top performing area. All the top part of our table is taken up by Asian markets. Thailand has just made a run to the very top, with the Philippines and Malaysia close behind. We doubt that even this region will be totally immune to a global setback, but it almost certainly will maintain the relative uptrend. These markets are basically in secular uptrend and should stay on this track for a decade. China may well trigger a bit of a sell off soon, after which it could go back to being the leader of the pack.

Latin America relative to world: currency adjusted

- This is the second best region on an actual and relative basis. Rotation does, however, take place and Brazil has recently dropped down the table. We do not own it at present. Chile, Colombia and Peru are all at the top. From October onwards, we expect Brazil to move back up the rankings again and become a core holding using an ETF. Only Venezuela is in the weakest category, but this has always been a slightly special case and this month's election adds to the uncertainty.

Global stock markets ranked by quintiles in dollars

Country	Quintile	Above Moving Average 25D	Above Moving Average 200D	Upward Sloping 25D SMA?	Percentage Change (US $) % 1 MONTH	AVG	3 MONTH	AVG	12 MONTH	AVG
Thailand	++	✓	✓	✓	8.4		27.2		47.7	
Chile	++	✓	✓	✓	7.9		31.8		58.5	
Colombia	++	✓	✓	✓	6.8		26.6		52.0	
Philippines	++	✓	✓	✓	8.5		21.8		45.9	
Peru	++	✓	✓	✓	7.3		19.0		16.8	
Malaysia	++	✓	✓	✓	6.2		19.0		35.6	
China	++	✓	✓	✓	6.9		24.2		32.3	
Turkey	++	✓	✓	✓	0.2	6.5	18.6	23.5	31.9	40.1
Indonesia	+	✓	✓	✓	4.6		20.5		54.0	
Singapore	+	✓	✓	✓	1.3		16.0		21.9	
Israel	+	✓	✓	✓	0.9		10.4		20.0	
Switzerland	+	✓	✓	✓	4.0		17.2		8.8	
Poland	+	✓	✓	×	-4.0		20.9		6.3	
Sweden	+	✓	✓	×	-4.3		19.1		13.4	
South Korea	+	✓	✓	✓	-1.1		14.6		16.5	
Argentina	+	✓	✓	✓	0.2	0.2	11.9	16.3	31.5	21.6
Canada	o	✓	✓	✓	1.2		7.0		13.6	
Australia	o	✓	✓	✓	0.4		18.9		10.4	
India	o	✓	✓	✓	1.3		11.7		20.9	
Brazil	o	✓	✓	✓	-0.2		18.1		25.8	
South Africa	o	✓	✓	×	-2.6		13.6		15.6	
United Kingdom	o	✓	✓	×	-2.8		12.6		2.5	
Egypt	o	✓	×	✓	-0.2		3.1		-7.2	
Hungary	o	×	×	×	-6.7	-1.2	14.2	12.4	-0.2	10.2
Taiwan	-	✓	✓	×	-1.7		11.7		12.2	
Russian Federation	-	×	×	×	-3.7		8.4		33.0	
Czech Republic	-	×	×	×	-8.1		15.6		-9.3	
Spain	-	×	×	×	-6.1		27.2		-19.5	
Belgium	-	✓	×	×	-4.7		12.3		-6.0	
United States	-	✓	×	×	-1.5		5.1		8.7	
Japan	-	✓	×	×	-1.6		5.4		0.9	
Austria	-	×	×	×	-5.6	-4.1	17.6	12.9	-13.5	0.8
Hong Kong	--	✓	✓	×	-1.4		11.0		3.5	
Denmark	--	×	✓	×	-6.9		9.6		6.7	
Mexico	--	×	×	×	-3.6		5.5		17.2	
France	--	×	×	×	-6.1		13.9		-11.5	
Venezuela	--	✓	×	✓	0.5		2.8		-37.4	
Germany	--	×	×	×	-5.9		11.2		0.0	
Italy	--	×	×	×	-7.4		16.8		-19.8	
Netherlands	--	×	×	×	-5.3	-4.5	10.1	10.1	-2.5	-5.5

Ranking and data in US Dollars

United Kingdom

Back to work

The holidays are over. Kids are back to school and parents back to work. Fund managers get their portfolios out to see how things are and frequently succumb to an overwhelming "get-me-out-of-here" urge.

The road map has been working well. We have arrived at the place where the road bends sharply. Actually it seems to go straight over a cliff edge. This is a dangerous, scary part of the trip.

In an average year, the seasonal deviation makes the next six weeks the worst of the entire year. The month of September is the worst month and the final lows usually come in October.

To recap on the big picture, a secular bear trend started in 2000. The FTSE-100 index was then at 7000. The trend has been negative since then and remains so, with a high probability of being so for at least another ten years. There have been, and will again be, cyclical bull moves which we can invest in, but they are most unlikely to break out above the highs of 2000.

The last cyclical bull run started in March 2009 and clearly ended in April this year. Any rally that does not break out above 5,833 on the FTSE-100 simply confirms the pattern of falling highs and lows and, therefore, the downtrend. But our work suggests that this is not the trend that will take the market down to the lows of March 2009.

We expect a fall roughly equal to that which occurred from this April to July, which was 17%. A fall of this size would take the FTSE-100 down to 4,500.

We should then enter the strongest period of the year with a good run up into the New Year. We wish to have money available to buy in anticipation of this rally. The best way to do this is to hold cash now.

Active traders may want to sell short and be ready to reverse later. Even good stocks will fall in the setback.

UK gilts have been so overbought recently that they are also likely to experience a dip. But you can only pick up a bargain if you have something to buy it with. Our current strategy is to preserve wealth and cash balances for a few more weeks.

FTSE 100 index

FTSE 100 index relative to world

Europe ex UK

Only the lonely

Of all the markets in the wider European area, only Switzerland is in the strong category on our ranking table. This in itself gives an insight into investor sentiment as Switzerland is where the funk money goes to. These investors have already made a profit and now just do not want to lose anything. So their funds are left to sit in a lonely sterile bank vault. This is the world we live in now.

The euro is a weak currency and will get weaker as the so called PIIG markets drag it down. It is almost bound to go back to $1.20 and probably even test the recent low of $1.17. If this level fails to hold, the next target is $1.0 with $0.82 the last stand. (These lower numbers are not a firm forecast. They will only be tested if the levels above them fail, which is not our central forecast.)

The bottom line is that, as global markets come under pressure between now and October, we are likely to see a strong dollar and a weak euro. This will make German exports almost ridiculously competitive.

In spite of this, the overall German index is still in the weak part of our ranking list.

All of Europe is below the UK in the table and most of it below the US as well. Only Switzerland and Sweden are above the UK.

We think that the setback in markets will be triggered by some event or development and it is likely to come from the banking sector. Greece or Spain may come up with news that is the last straw on the camel's back.

On balance, we think the euro will hold together in some form or other. It might be necessary for Greece to devalue their currency and even possibly leave the EMU for a while and re-apply for entry at a later date.

If we draw a 40 year chart of the euro against the dollar (using the Deutsche mark as a proxy for the euro pre-1999), the mid-point of the range for the entire period is $1.20. Critical break points are nowhere near to hand.

If we get our setback between now and late October, the order in which to buy into the western markets is first the UK, then the US and, finally, the eurozone. If we were to hold any stocks during the immediate vulnerable period, they would be the top German exporters, which seem to be on a batsman's wicket.

European equities

European equities relative to world

Europe ex UK

France

Germany

Switzerland

Netherlands

Scandinavia

Spain

United States

The Buck stops here

It may not be the President's fault that the US is in a mess, but it is the fault of his party. They may have inherited a tough situation from the Republicans but they have made it a whole lot worse. The voters are going to express their extreme displeasure in November in the mid-term elections. It looks as though these will be a disaster for the Democrats. Spin doctors being what they are, anything less than total destruction will be construed as a success for President Obama. But he is almost certainly going to be a lame duck for the next two years.

The uptrend in the S&P index from March 2009 topped out in April this year at 1,220. On our map that is point D on a market that is in a secular downtrend (see page 25). We are now in the downward leg which takes us to point E and the shape of the move is likely to be a fall, followed by a rally then the rest of the fall.

On the S&P500 index, the first fall ended on 1st July at 1010 after a 17% decline. The rally phase then continued until 6th August. A new fall now should take us down to about 940. Attempts to bolster the market are likely to fail.

Most of the Keynesian style stimulus to date has been wasted. All government expenditure is notoriously inefficient. Spending another $50 billion now will be no more effective and only makes the problem worse. You cannot borrow your way out of debt.

One in six people are receiving food stamps in order to eat. Many mortgages are under water. Even the official unemployment rate is at 9.6%, the real rate is probably nearer 20% (see www.shadowstats.com). The economy is in that part of the cycle that is equivalent to the great depression of the 1930s. It will not end quickly or without pain.

The long end of the Treasury market became incredibly overbought. It had to have a pull-back, which is now underway. Even so, this is the market that is sending out the true message about the economy. And it will become a safe haven again, pushing rates lower. Each day seems to bring us closer to the Japanese experience of the last 20 years.

The US does still have some great companies that are world class leaders. Caterpillar is one of the best. These companies supply what the parts of the world that are still growing want. They can compete and win. We just need more of them. We can buy into these companies on the dip.

S&P 500

Dow Jones Industrial Average

Canada

False start

The Canadian TSE index has just jumped to life from above a rising 200-day moving average but this looks to us like a false start. Top athletes do this from time to time, they are so eager to get going but they have to wait for the gun.

This market is in a secular uptrend and has been for years. But it still has to have the cyclical corrections in step with other markets, especially the US, even though the latter is in a secular downtrend. The short term move now should be down and this will set up the next proper start to a resumption of the secular uptrend.

Even though it is in a secular uptrend, the TSE index still had a 50% decline in 2008 and then from March 2009 it rallied, retracing 61.8% of the fall. That rally ended months ago and the index has since been range bound and the support and resistance levels of the range are respectively the 50% and 61.8% Fibonacci levels of the previous rally.

It may look as though it is about to make a new high for the year, but the TSE index is more likely to go lower, thereby setting up a buying chance in October.

If we are wrong and it goes higher now, it will still not give a clear buy signal because there is massive overhead resistance between 13,000 and 15,000. But there does not seem to be sufficient buying momentum to break through this resistance at the moment. Waiting – even though there is a risk of missing out – is the best policy.

There is a lot to like about this market in the long term. We are bulls of uranium and Canada has some good stocks in this sector. It looks as though a three to four year bear phase in this metal has ended and the sector looks well placed to move higher.

We also expect a low for natural gas by the year end and, again, Canada is big in this clean fuel. We will also be looking to buy the metals, including gold, on a dip.

Finally, we like the currency. We always thought that the Canadian dollar, or Loony, would sell at a premium to the US dollar. It may be a bit too high in the short term. But, as the US prints its helicopter money into oblivion, the Loony backed by real resources will look attractive. Diversifying out of sterling is no great hardship either.

It would be advisable to wait a few more weeks to get a proper recall signal for this market.

Canada

Canada relative to world

South Africa

Temporarily vulnerable

The long term trend for this market is positive. It has been on the road map of a secular uptrend for a long time. Nevertheless, it will still have cyclical setbacks. Just now it is stuck in a sideways trading range but global influences are liable to cause it to break out of the lower end of this range before the secular uptrend can resume.

In spite of being in a secular uptrend, the JSE index fell 50% from its high in 2008 to the low in 2009. Since March 2009, it has been in a rebound phase and has done relatively well. It retraced 76.4% of the fall. This is the strongest Fibonacci level for a bounce – it is more usual to retrace 38.2% or 50% – so from here the buying momentum is likely to peter out.

The support, mid-point and resistance levels of the current trading range are all respectively the 50%, 61.8% and 76.4% Fibonacci levels of the previous fall. As global markets enter this vulnerable period, the likelihood is that it will come down to test the support level. Once it has done that and made a base pattern, we could buy again.

The Chinese economy is cooling down. It is official policy that it should slow down and this process is likely to be a bit bumpy. In the short term, orders of metals from South Africa and elsewhere are likely to fall.

It is also more than likely that the Chinese have themselves been stock piling some of the most useful metals. They usually do. At times of need some of these stocks could find their way back onto the open market. This would give an added downward push to the South African market.

All in all, we like this market in the long term and want to buy into it – but just not yet. If the JSE Index fell to 24,000, where it was a year ago, we would deal then.

JSE All-Share

JSE All-Share relative to world

Japan

Shogun

In Japanese culture there is often a figure behind the scenes who rules with power, but who is not the Emperor. The Shogun normally has this role. Even today it is the same in political circles and for many years Mr Ozawa has been seen in this light. He has spent most of his adult life trying to get to be prime minister. He is making a now or never move. This fact alone tells us that the economy and the policies to deal with it are in a mess. The Japanese stock market continues in a bear phase.

The secular downtrend in the Nikkei 225 index started in 1989 at 38,957. It tried to bottom in 2003 at 7,600 but has subsequently gone lower. In 2008 it was at 6,994. The present trend seems to be heading back there again. There is no end in sight to the pattern of falling highs and lows below falling moving averages.

The present political climate has done nothing to help and, even if we get a new, seventh prime minister in three years it may still not end there. Unfortunately, the economy may be a role model for the US if it is not careful.

The greatest saver on the planet was the legendary Mrs Watanabe. In search of yield, she sent her savings overseas. Now she is older she needs them back again. This is making the yen super-strong, even though this strength does not appear to be justified by the economy. The top for the yen against the dollar was in 1995 at Y79.5. The present trend seems on course to beat that level.

Our prediction is that the rate will go below Y80 before reversing. If we can get the timing right, we will then sell the yen and buy the export blue chips of Japan, which are great companies and now cheap.

On the Nikkei 225 index there is overhead resistance at 9,500 and the latest low of 8,796 does not look as though it will hold. A move back to the lows of 2008 and 2009 – under 8000 and near to 7000 – seem inevitable.

For the moment, at least, this market is still an avoid situation. Let us hope that the new Shogun has more power than the last one and some new policies as well.

Nikkei 225

TOPIX

India

A new high for the year

From a long term point of view, this has long been our favourite market. It is now at a new high for the year. It is the best of the newly emerged markets and stands on a premium rating. It is worth a premium but may not hold it all the way along. Currently the P/E ratio is 18.2 and the dividend yield is 1.3%.

We must not forget that this index was at 21,206 in 2008 and then fell to 8,000 in 2009. The volatility is brutal. For this reason, there are times when we choose not to own it.

It is entirely possible that the Sensex index goes above 21,000. Our road map indeed predicts this. This would be point Y on the map in secular uptrend. However, it then predicts that it will drop back again to close to current levels, and probably a bit lower, before getting to the start of the next up cycle.

If investing for a pension plan, there is nothing to do but grit your teeth and hold on. But more active traders will want to be careful now. It is unlikely that this index will race away higher whilst western markets move lower. India is not immune to global events.

As a broad strategy, we believe it is a good idea to up the weighting in India and similar markets and reduce exposure to western markets. And, as this market cannot absorb a huge inflow of funds, much of its premium will stay. We just need to keep in perspective the fact that our long term story about India becoming the largest market on the planet is a 25 year saga, not a one week soap opera. Getting there will be a journey. There will be many problems along the way.

The present problem is local inflation, which is mainly in food prices. This is running at about 15%. For the 65% of all Indians who live in the villages this is a huge worry. Food is an enormous part of the family budget. So far the government has not been effective in curing this.

On balance we are underweight what would normally be a full holding in this market. There is a good chance of a setback to around 16,000 for the Sensex if not a bit lower. If ultimately we are wrong, we will just have to buy at higher levels but, by then, there will be good reasons to do so.

India

India relative to world

Pacific ex Japan

Plus ça change

Everything is changing, but the answer is the same. The western world, and especially the US, is in a depressionary environment. There was no V-shaped recovery, only a government frittering away 2 trillion dollars of other people's money. Most of the real economy is still in the same old single scoop depression. It is getting worse not better.

Along with the BRIC markets, the markets where all the growth is going to take place are in Asia.

There is a problem in that China got out of step with the real world. The hype surrounding the Olympics was so great that the Shanghai Composite index had to decline. It has lost 70% since then but has not yet bottomed out. It is currently at 2,690 but needs to drop to below 2,000, and probably 1,700. There are bubbles in place, especially in property and we expect these to be cooled down.

The top markets in this region at the moment are Thailand, the Philippines, Malaysia, Indonesia and Singapore. These all look good technically. They are in secular uptrend and a cyclical bull phase. A new high break out, as seen in Thailand, is always bullish.

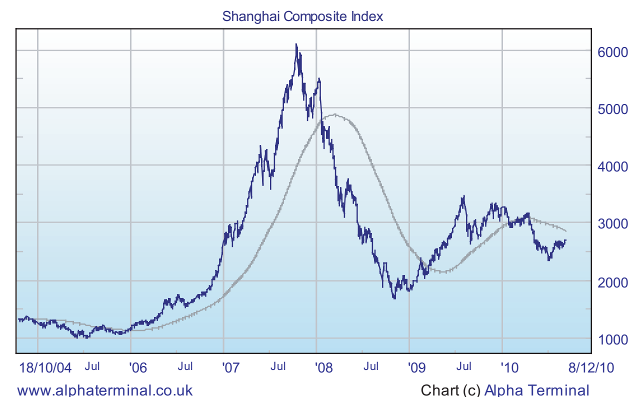
The only question to resolve is how resilient these markets are to what is happening elsewhere. Can they continue to rise, even if the larger markets of the western world have a setback? We would like to believe that they could but in practice this is unlikely.

All asset classes are correlated in a bear phase. When people need money they will sell whatever has held up. These markets may well still show relative strength but they are still vulnerable to selling pressure. It may even be that China gives the signal that triggers the sell off.

We wish to own these markets in the long term as they are in secular uptrend, but prefer to wait for a setback on which to buy. As the beta is huge in this region, the percentage decline may well be a lot larger than most people expect.

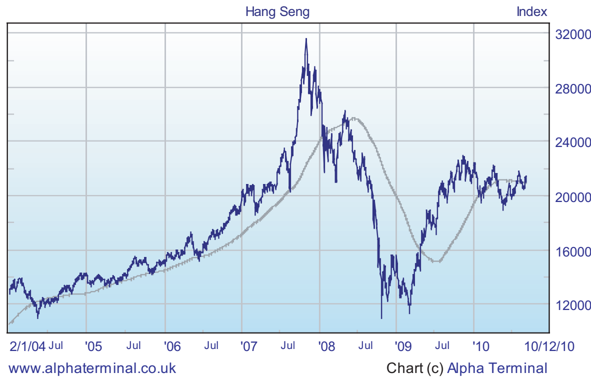
Australia

China



Pacific ex Japan

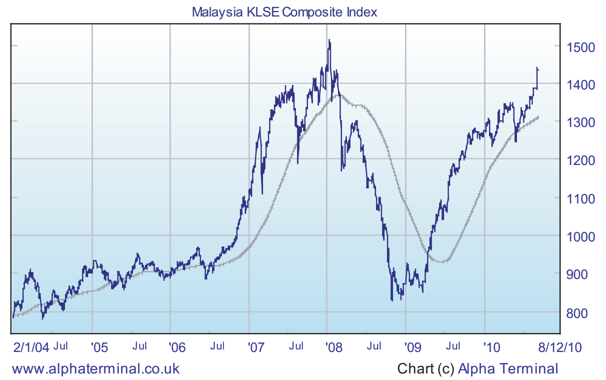
Hong Kong



India

South Korea

Malaysia



Taiwan

Thailand

Emerging markets

If in doubt, stay out

In this section the top-performing markets are currently the smaller Latin American ones, Israel and Turkey.

The only relatively weak market is Russia, and even that is not in the weakest category.

It is quite clear that investors are being pushed out into the highways and byways to try to find something to be bullish about, because all the obvious big markets look so dire. Herein lies a message. Maybe we should not play this game at all. Better to stand back and let the next shoe fall.

The secular uptrend in these markets has been in place a long while and shows no signs of ending yet. But we should not forget that they are emerging markets. They have always been, and will continue to be, extremely volatile.

We prefer to sit on the sidelines and wait until either we have had a good setback or, alternatively, it becomes clear that we are not going to get one.

When the buying signals are given, it is very likely that we will want to own Brazil and India, rather than some of the more esoteric markets here. It is always important to take account of geopolitical risk.

The message here is, if in doubt stay out. The risk: reward ratio is such that we do not mind missing out if we are wrong.

We will be buyers into these markets. We just do not want to buy at the moment.

Brazil

Russia

Emerging markets

Emerging markets index

Mexico

Chile

Turkey

Eastern Europe index

Poland

Bonds

The fat lady shouts

The market capitalisation of the bond markets is ten times larger than that of equities. Ben Graham's Mr Market may give out his forecasts in measured tones, but the bond market's equivalent – the Fat Lady – has a much louder voice. Recently, she has not been singing some pretty aria, she has been shouting loudly. In fact she has been screaming hysterically. She has not liked what she sees in the future.

The simple message is that some people in the equity markets think they see a recovery, but the fat lady does not. She says we are in a depression. We do not even need a double dip as most of the economy never came out of the first hole. All that really happened was that the government spent two trillion dollars of other people's money, and whilst they did that it created a picture of growth. This was pure illusion. The hole we are in is now that much deeper than it was before.

History lessons teach us that Keynesian stimulus packages do not work. They have never worked, and certainly are not working now. Also, history teaches that when a credit bubble bursts, and we have just had the largest one in the entire history of the universe, the borrowed money has to be written off or paid back. The average citizen "gets it". The savings ratio is rising. They are trying to get out of debt. They will, but it will take them a long time. Until they have done so, consumption, which is a large part of the economy, is not going to pick up. Interest rates are going to go down and stay down for a long time yet.

Some people will tell you bond markets are a bubble, and they are right. You do not lock up long term money on low single figure yields. However, equally certainly, bubbles never burst when a large number of pundits are telling you it is a bubble. The bubble only bursts when those same pundits tell you "this time it is different" and you must now allocate huge sums to this asset class.

If the yield on the 30 year note had gone through 4.8% in April, then a sell on bonds would have been given. In fact yields fell, giving bond holders a 30% profit. They were overbought at this point and had to unwind. If they give a 4% yield again, they will be a new buy. In a double dip, or depressionary environment like the current 'Kondratieff winter', that is a good return. If we keep following the Japanese example, yields will go to 2% which means you would double your money.

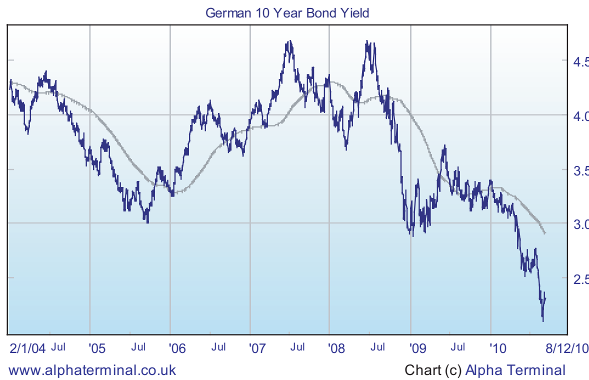
US Treasury bond 10 year yield

Bonds

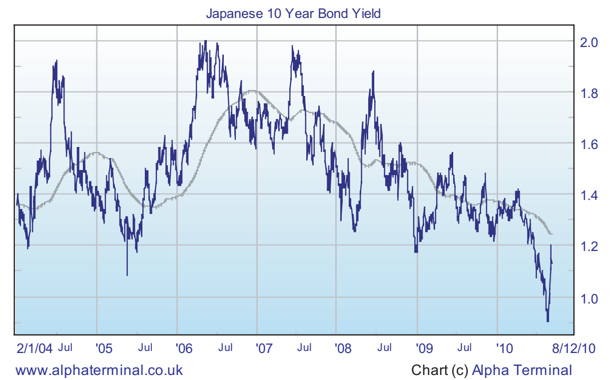
US benchmark bond 30 year yield

UK benchmark bond 10 year yield

German benchmark bond 10 year yield



Japan benchmark bond 10 year yield



Commodities

Glowing In the dark

The Reuters/Jefferies CRY commodities index is testing the downtrend that has been in place since January.

We are currently out of commodities and prepared, but in no hurry, to buy back again. If we get our equity setback between now and October all asset classes will drop together and our cash will buy a lot more then.

There are hard, soft and glow-in-the-dark commodities. The one we like right now is uranium. It has had a three to four year bear phase which seems to be ending. The nuclear lobby has a lot to do to sell its case but China, in particular, will be building a huge number of reactors. In order to use fewer hydrocarbons, the west will also have to go down this route.

Food is expensive and getting more so .This is going to be a long secular uptrend. BHP Billiton's potash deal is all a part of this view. We can follow the charts but do not trade these markets ourselves. We have noticed that you can read a commodity chart correctly for direction, but still lose money because of the contango. This is an activity best left to specialists.

Gold is near its high. If it breaks above $1,265, it could run on to $1,320 on the back of an equity shake out. But it may not perform really strongly again until January. So, looking further ahead, it should be a core holding. Eventually the price could go to at least $2,500 – and possibly even higher on a worst case scenario for the US dollar.

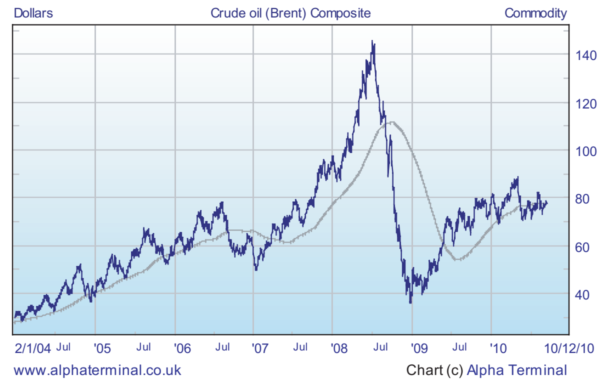
Commodity price index

Gold

Commodities

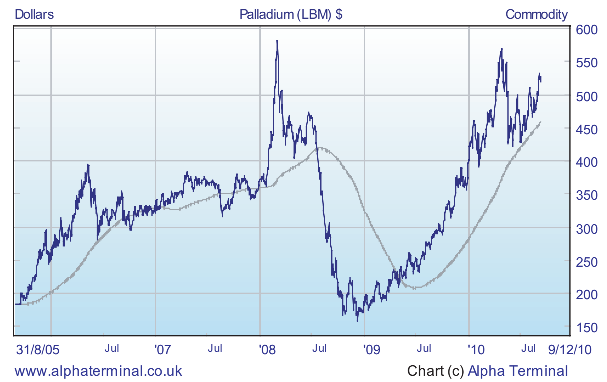
Platinum

Oil



Silver

Palladium



Copper

Aluminium

Currencies

Risk off means dollar long

On our market calls we should be out of equities for a six week period. It is all about taking risk off the table and preserving capital. When global investors do this, it triggers a rally in the dollar. We may eventually go into a renminbi-based world but we are not there yet.

The trade-weighted dollar DXY index based out last December at 74 and rallied to 89 by June. It was way overbought at that stage. It had to fall back which it did as investors put risk on by moving back into stock markets. The index found support at 80 on the rising 200-day moving average line.

In resuming the uptrend, the first surge went to 83.5. It then fell back to just under 82, retesting the rising 200-day line. If we are right in our forecast, the next surge should start now and go up to 87. The move could extend to 90 or even 93.

Against this background, most other currencies will be weak. Sterling is already falling back to support at $1.50. It had bottomed out at $1.42 in May before rallying strongly up to $1.60. At the time of the rise it seemed that the markets were giving the thumbs up sign to the coalition government and its plans to get out of debt. But the move overshot. There is good support between $1.47 and $1.50.

The euro is in the process of falling back towards $1.20 and is unlikely to go back above $1.30 before hitting this lower level. If support at $1.20 fails, the June low of $1.17 will almost certainly be retested. There is an outside chance that it could fall to parity and possibly even $0.82. The people who believe in those lower levels think the euro will break up but there is nothing on the charts to support this view at the moment. It is a political issue and the bottom line is, if Germany wishes to keep the euro going, it can easily afford to do so. For as long as the euro is weak, German exporters make out like bandits. They choose not to advertise this fact.

The yen is very strong and will be for as long as Mrs Watanabe is repatriating her money. The target is for the dollar to under Y80.

The Aussie dollar has recently reached a four-month high against the US dollar and an all-time high against the euro. But we do not feel as positive about the long term prospects of this currency as we do about the Canadian dollar.

US dollar: trade weighted

US dollar/euro

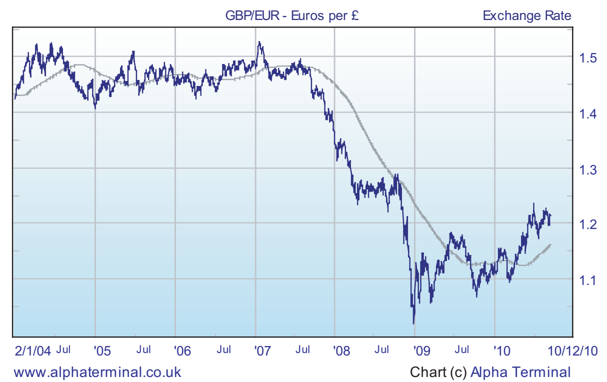
Currencies

US dollar/Japanese yen

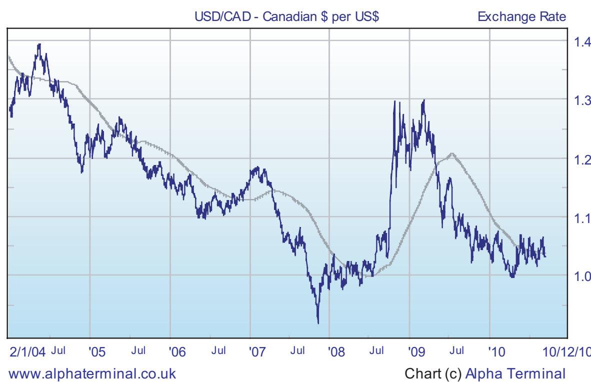
Euro/Japanese yen

Sterling/US dollar

Sterling/euro



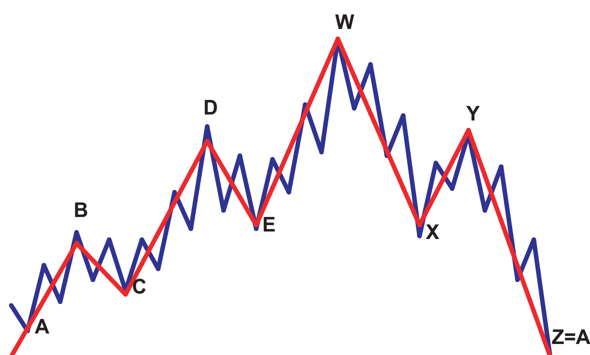
US dollar/Canadian dollar



Australian dollar/US dollar

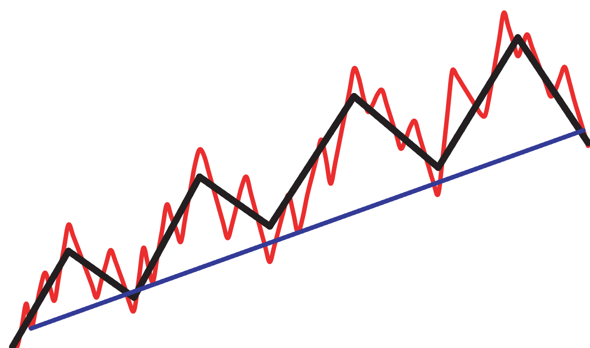
Road maps

Standard road map



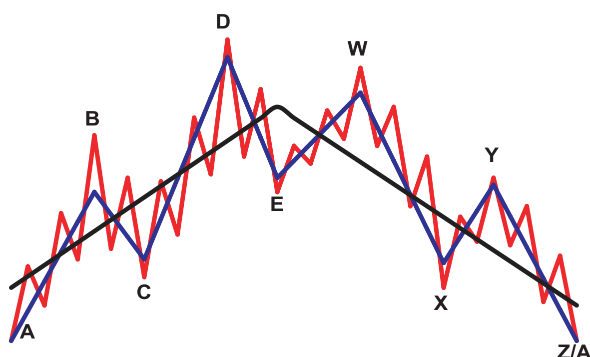
These road maps are the basic shape of a so called Elliott Wave. We deliberately letter our maps differently from Elliott aficionados. The normal time scale for a complete cycle is four years driven by the Kitchin wave. The bull phase has three surges getting progressively more powerful. The bear phase is a fall, followed by a rally, followed by the rest of the fall. Big waves are composed of smaller waves of exactly the same basic shape. In practice, the waves we wish to trade can be traced out as the Index moves away from and back towards the 200-day moving average. If it is below that average, then it is a bear market.

Standard road map skewed by secular uptrend



The standard model can be distorted positively by a strong secular uptrend. The small waves tend to take the same amount of time, but there is always an upwards bias. Even in the bear part of the cycle, a new high might be made and the next drop back is the end of the correction. The rule on this road map is always buy the dips as long as it is clear that the underlying secular trend is still valid.

Standard road map skewed by secular downtrend



The basic map can also be distorted negatively. This, in practice, makes the bull part of the cycle very short and stunted. It also has the effect of lengthening the down part of the cycle. The rule here is always to sell the rallies. The secular trends that perform these distortions last for multiples of the four year cycle. Trends of 16 to 20 years are quite normal. On rare occasions they can be longer.

Source: Robin Griffiths based on Schumpeter

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