Global Report – February 2011

UK

Europe

US

Japan

Emerging Markets

Bonds

Commodities

Currencies

February 2011

# 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

There are times when the correct tactical move is different from the strategic policy. In fact sometimes it can appear to be the exact opposite. Now is one of those occasions.

Last year was all about buying the emerging, or even the emerged, markets and ignoring the mature western ones, especially the US. That activity was successful but pushed prices in the emergent world too high, too quickly. And likewise created bargains in America.

The simple long term strategy is to increase the weighting in portfolios to the emerged world, but to avoid paying too high a price for the obvious growth prospects. Secondly, most investors want to get some yield from their portfolio and this is best done from western equities.

There are two significant capital flows going on right now and they are different from those of last year. Money is coming out of emerging equities and out of bonds and going back into western equities. Within this process the US is the preferred home.

This is a momentum play. There is a huge amount of money involved and it must be invested somewhere. In terms of value, the stocks being purchased are probably already above fair value, but not absurdly expensive. The prices can go higher but will fall back later.

We think there is still time to make some money, but this is a tactical trade and not a lock up investment. Our road maps can help us with the levels that might be achieved and the timing on when they will turn down again.

In a standard cycle, the duration from start to finish is 48 months. Normally it is 36 months up and 12 months down again.

We know where the last cycle low was, it was in March 2009. That is 23 months ago. On this road map the next top would be sometime in early 2012 and the next major low would be in March 2013. On this basis there will be plenty of time to make money.

However, most western markets are in secular downtrend. We know this because they are still lower than the high made in 2000. In most cases the next bull high was in 2007 at about the same level as the 2000 top. The correct road map to use is the negatively-skewed one.

On this map, the top of the cycle is usually 26 months after the low, or possibly a little later, but it does not usually extend for as long as 36 months..

Currently we are in the strongest part of the seasonal deviation. This goes on until late May. That is incidentally 26 months from March 2009.

On balance, we think that buying now for a run up is safe until at least late May. Once we get past the middle of the year, and especially from the last quarter onwards, it will be just a case of "when", not "if", we sell out again.

Meanwhile the emerging markets will fall back, driven partly by profit taking, and partly by the fact that they already have inflation and are trying to get rid of it by raising interest rates. This process will set up a great buying chance.

We do not intend to sell out of India and then buy back again. A hedge fund can do that, but even they do not often capture all the profit that seems to be in the trade. We will be looking to increase our holding on the dip, as it will provide a good value entry point to a long term growth situation.

Meanwhile, all commodities are going up together and most bond prices are breaking down.

Real assets are the top pick and paper money is considered toxic.

Think "Asia for growth", but "buy western and indeed US stocks for income". Many of these companies are very international in their outlook.

# Summary: world market overview

The quickest way to find out if a market sector or stock is in a secular trend is to check where the price is with reference to the level made at the highs in the year 2000.

If the price is higher, it is in secular uptrend and, if lower, then it is in secular downtrend.

Typically, the Asian and mineral-related markets and stocks are in uptrends, but are currently experiencing a down phase in the short term cycle.

Mature western markets are in secular downtrends but are in the bull part of the short term cycle.

The short cycle turned positive in March 2009 and should last until late May this year, but by the final quarter of the year they will be on borrowed time.

The 10-year Juglar wave is relatively neutral in the first year of the decade and is unlikely to exert a strong influence. The major low in this cycle is due in the period between 2012 and 2013. The next up cycle should be 2014-2016, with 2017 a down year. The seventh year of any decade is often a problem. Think 1987, 2007.

We are currently in the strong part of the four year cycle.

Although this was originally a cycle relating to the British economy, since 1946 it has morphed into a US Presidential election cycle. The low point for this cycle is the mid-term Congressional election in which it is quite normal for the incumbent President to get a shellacking.

He does not give up of course but comes out fighting back. At the same time, new leaders appear in the opposition party telling voters how good it would be under their guidance. The market tends to believe some of this.

The nine months after the mid-term election is the strongest part of the move.

The annual seasonal deviation is strong from late October until late May. Even though the Fed bent the normal drop in September out of shape by injecting so much money into the economy, we are still in the strong part of the seasonal trend.

All in all, it should pay to put risk on and buy equities now. It would be risky to leave it until the second part of the year.

Last year investors flooded into Asian markets and pushed them too high too quickly. Their premium rating became too stretched. Now, because of the trouble in the Middle East, investors are reminded that these markets can be extremely volatile.

Money is flowing back out of these markets and into good western equities that had, to some extent, been left behind.

The second major flow is out of government bonds. Ironically, this started with the announcement of QE2. As soon as the Fed announced it would buy bonds, Mr Market said, “well then you can have mine.”

The long term downtrend in yields is close to breaking. The great bond bull market of the past 20 years is all over bar the shouting.

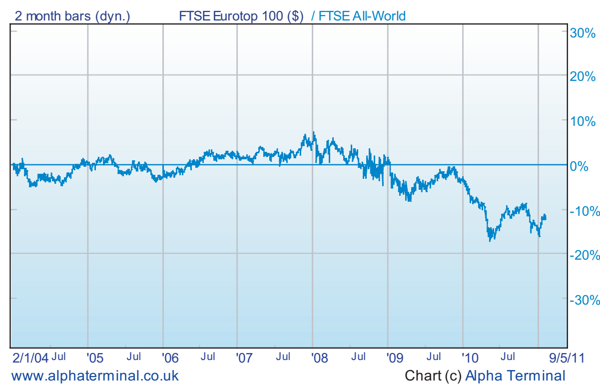
These two flows lead to buying of big blue chip equities.

Inflation pressures everywhere, except where Mr Bernanke is looking, mean that real assets are in risk-on mode. This means the dollar goes down.

# The World at a glance

## Major markets

### US relative to world: currency adjusted




The relative performance chart shows an uptrend that is now resuming after a consolidation phase. Overall the US is in the neutral part of the ranking table, but in the top part of that quintile. In the results season the large cap stocks have tended to surprise to the upside with their figures. Trading analysis indicates that directors of smaller companies are selling. This emphasises the buy big caps story. These are the very stocks that drive the index upwards.

### UK relative to world: currency adjusted

The UK is in a very similar position to the US market. It is actually two places higher in the ranking table, but that is not a significant difference. Again, the results season is underway and the giant mining stocks are declaring fantastic profits. The proportion of their weighting in the index is growing and will probably exceed 30%. These stocks are all so international that they have a much better outlook than the UK economy.

### Europe relative to world: currency adjusted

Europe, overall, has been weaker than either the UK or the US. However, it is now recovering and has always been good in parts. The best performers are Germany and Sweden, which are both in the top category of the ranking table. France, Poland, and the Netherlands come in the quintile just below the top one. Surprisingly, Spain's recent bounce has parachuted it into the top group. Markets are no longer worrying about the euro region breaking up. The PIIG problem is deemed to be under control but this saga has not ended yet.

# The world at a glance

## Japan relative to world: currency adjusted

- Japan is actually doing well. The Nikkei index is up 20% since last September. It has, however, slipped recently in the relative performance league now that other markets have sprung to life. We still cannot convince ourselves that the secular downtrend is over. It might be, but no such signal has been given. We can find great value in individual stocks but, overall, the market is in the weak category. There are other markets where the investment case seems clearer.

## Pacific ex Japan relative to world: currency adjusted

- This region has the strongest long term trends of all. However, in the short term profit-taking has set in. Inflation has meant that interest rates are rising. This setback will eventually produce a great buying chance - but not yet. China has slipped down the ranking table to the neutral category and India into the weakest group. It may take several more months before a buying signal is given. It may well occur just as western markets get to their new highs.

## Latin America relative to world: currency adjusted

- Much the same thing has happened to the large markets in the Latin American region. Brazil has dropped from the top group to the bottom of the table, along with India. Chile has fallen back too. However, for the time being, Peru and Argentina are holding up at the top of the table. This is because the price of copper is at a new all-time high and food prices are trending up steeply. We expect to be buying back into Brazil in a few months time.

# 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 |
|---|---|---|---|---|---|---|---|---|---|---|
| Russian Federation | ++ | ✓ | ✓ | ✓ | 9.3 | | 20.8 | | 37.1 | |
| Peru | ++ | ✓ | ✓ | ✓ | 4.6 | | 17.2 | | 76.7 | |
| Taiwan | ++ | ✓ | ✓ | ✓ | 5.3 | | 12.3 | | 40.0 | |
| Italy | ++ | ✓ | ✓ | ✓ | 15.7 | | 3.8 | | 8.5 | |
| Germany | ++ | ✓ | ✓ | ✓ | 8.3 | | 3.1 | | 31.6 | |
| Sweden | ++ | ✓ | ✓ | ✓ | 4.4 | | 5.5 | | 39.9 | |
| Spain | ++ | ✓ | ✓ | ✓ | 19.8 | | 1.0 | | 5.5 | |
| Austria | ++ | ✓ | ✓ | ✓ | 7.1 | 9.3 | 5.5 | 8.7 | 23.1 | 32.8 |
| South Korea | + | ✓ | ✓ | ✓ | 1.1 | | 7.3 | | 40.3 | |
| Argentina | + | × | ✓ | ✓ | 1.3 | | 6.7 | | 60.4 | |
| Poland | + | ✓ | ✓ | ✓ | 6.7 | | -1.1 | | 33.4 | |
| Czech Republic | + | ✓ | ✓ | ✓ | 6.8 | | 5.5 | | 22.7 | |
| France | + | ✓ | ✓ | ✓ | 9.2 | | -0.3 | | 12.5 | |
| Hungary | + | ✓ | ✓ | ✓ | 13.2 | | -0.3 | | 17.0 | |
| Netherlands | + | ✓ | ✓ | ✓ | 8.2 | | 2.9 | | 16.3 | |
| Canada | + | ✓ | ✓ | ✓ | 4.3 | 6.3 | 8.2 | 3.6 | 33.0 | 29.5 |
| United Kingdom | o | ✓ | ✓ | ✓ | 4.6 | | 2.4 | | 23.1 | |
| Denmark | o | × | ✓ | ✓ | 3.3 | | 2.0 | | 24.2 | |
| United States | o | ✓ | ✓ | ✓ | 3.1 | | 6.9 | | 23.0 | |
| China | o | ✓ | ✓ | ✓ | -0.3 | | -0.8 | | 27.8 | |
| Belgium | o | ✓ | ✓ | ✓ | 7.8 | | -3.3 | | 11.5 | |
| Malaysia | o | × | ✓ | ✓ | -1.3 | | 3.1 | | 39.5 | |
| Mexico | o | × | ✓ | ✓ | -1.1 | | 5.1 | | 34.3 | |
| Singapore | o | × | ✓ | ✓ | -0.7 | 1.9 | -0.6 | 1.9 | 32.6 | 27.0 |
| Colombia | - | × | ✓ | × | -4.1 | | -12.9 | | 38.6 | |
| Hong Kong | - | × | ✓ | ✓ | -0.7 | | -5.7 | | 19.6 | |
| Australia | - | ✓ | ✓ | ✓ | 4.9 | | 2.0 | | 28.6 | |
| Chile | - | × | ✓ | × | -1.4 | | -4.4 | | 44.4 | |
| Japan | - | ✓ | ✓ | ✓ | 1.9 | | 10.6 | | 16.0 | |
| Switzerland | - | ✓ | ✓ | ✓ | 2.0 | | 0.0 | | 17.9 | |
| Thailand | - | × | ✓ | × | -6.0 | | -8.6 | | 54.1 | |
| South Africa | - | × | ✓ | × | -4.1 | -0.9 | -2.3 | -2.7 | 35.3 | 31.8 |
| Israel | -- | × | ✓ | × | -3.5 | | 2.3 | | 17.4 | |
| Venezuela | -- | ✓ | ✓ | ✓ | 1.5 | | -1.4 | | 15.5 | |
| Indonesia | -- | × | ✓ | × | -3.3 | | -5.1 | | 45.1 | |
| Philippines | -- | × | ✓ | × | -6.6 | | -12.7 | | 45.0 | |
| Brazil | -- | × | ✓ | × | -6.6 | | -9.7 | | 16.3 | |
| Turkey | -- | × | × | × | -6.3 | | -18.8 | | 21.5 | |
| India | -- | × | × | × | -8.6 | | -16.5 | | 17.4 | |
| Egypt | -- | × | × | × | -22.0 | -6.9 | -18.4 | -10.0 | -20.5 | 19.7 |

*Ranking and data in US Dollars*

# United Kingdom

## A good result

The results season is underway and the mining companies, in particular, are coming up with spectacular figures. This trend seems likely to continue.

The market is now in the strong part of the year from late October until late May.

As last September was a strong month – usually it is weak - the index entered the new year too high too soon.

Some setback in January was needed to get back on track. It was, in fact, a negative month, but on the FTSE-100 support came in at 5800, which was a significant high in April last year. This major support is at the moment 3.5% below current levels.

The major overhead resistance is the old high of 2007, which was 6754. This is 10% above current levels.

A three to one reward-to-risk ratio is not bad and encourages buying. This is a momentum trade which should be reasonably safe until late May. It might even last past the middle of the year.

We do not expect a new all-time high breakout but neither do we anticipate there being a major sell signal until later in the year. The good news is that the constituent stocks to this index are so international, that they will perform much better than the overall UK economy.

On current form, the UK economy might well be the first to go into the next dip but so much liquidity has been created which must be invested somewhere. This liquidity is seeking income and the best return is from dividends. There is an exodus out of emerging markets and government bonds and the UK stock market is a relatively attractive home for these funds.

### FTSE 100 index

### FTSE 100 index relative to world

# Europe ex UK

## Problem, what problem?

The markets that had been deemed to be in major trouble and at risk of dragging the entire European region into trouble have all rebounded strongly.

Italy, Greece and Spain have all moved up so fast that they are now three of the strongest markets in the region. The rate of rise in a recovery rebound can often be greater than in a proper bull market.

Discussions are ongoing about how to change the rules of the euro club so that it can hold together rather than break apart.

It was never viable on the original rules, but policy makers have always taken a pragmatic approach and assumed that they would be able to revise the rules if necessary. This will be an ongoing process.

When an individual country gets into trouble, it provides the opportunity for the next tweak of the system. We have such a moment now. We do not need to second guess what the new rules will be. Mr Market has assumed that they will work but the structural problems have yet to be resolved.

Russia is included in this region and is by far and away the strongest chart. It is, in fact, the strongest of all the markets we follow on our ranking table. It is clearly in a secular uptrend and is 400% above its high in 2000. Owning an ETF here is a good long term idea. Short term weakness provides a buying chance.

Germany and Scandinavia look strong, as they have done all along. Germany is the prima donna of the export markets, and it sells on quality not price. Any weakness in the euro currency just gives them an added advantage.

The momentum trade, fuelled by excess liquidity, will tend to drive these indices back up to resistance levels stemming from their old all-time highs. The time to put risk on is now and we will be looking to take it off again in the second half of the year.

### European equities

### European equities relative to world

# Europe ex UK

## France

## Germany

## Switzerland

## Netherlands

## Scandinavia

## Spain

# United States

## Super trooper

When playing American football at the Super bowl, it pays to be a big guy. The bigger the better, that way you do not get crushed.

The super troopers of corporate USA are coming out with good results that typically have surprised the markets on the upside.

These stocks are bigger than some countries, have great surviving franchises and will pay a better stream of dividends than many governments bonds will pay.

Sell bonds, buy equities and collect dividends. That is the game to play.

The US stock market is, of course, in a secular downtrend - and has been since 2000.

It was in a cyclical bear phase until March 2003, it then had a run bull until 2007. The next bear phase bottomed in March 2009.

On our road map for cyclical bull moves in secular downtrends, the bull phase lasts for around 26 months but not, usually, for as long as 36 months.

On this basis, the top is unlikely to put in before at least the end of May and could run on a little longer. Putting risk on now is good as a momentum trade. The big guys are the ones to back.

Both IBM and Caterpillar have gone to new all-time highs, always a buy signal. GE is now in a strong recovery phase.

It is probable that the smaller companies will not surprise the market when their figures come out. The mid-cap stocks have had a good run and insiders have been selling more than they have been buying. The message is clear that we should stick with the giants.

Unlike the UK index, the S&P was up over 3% in January. It is now 7% above its major support but the resistance overheard is 16% above present levels. The money coming out of bonds has to go somewhere.

But do not be lulled into thinking the market is cheap. Overall, it yields 1.8% and the P/E ratio is 15.8. This is a momentum trade and you will need to find a greater fool to sell to when the game is over in the second half of the year.

We will not repeat the demographic story in this issue, but the oldest of the 78 million baby boomers are retiring now. This will keep the secular downtrend in place for many years yet.

### S&P 500

### Dow Jones Industrial Average

# Canada

## Bonanza

Relative to the world index, the Canadian market is in a strong uptrend. In price terms, the TSX index is only 8% below the all-time high.

On our ranking table, the market is in the strong half, above South Africa, but below Australia and Russia.

For many years this market has been in secular uptrend and on the appropriate road map. It is now in the leg X to Y phase (see page 25).

The rally started in March 2009 and has a special shape to it of a rise, then a major consolidation, followed by the rest of the rise. Normally, this last move at least revisits the old all-time high and can go higher still before dropping back .

The old high was at 15,154 for the TSX, and so targets above 16,000 are not unreasonable.

Even on the positively-skewed road map, there should be a subsequent fall back later this year or early 2012. This is often captured by the four year moving average, which is currently at 12,200 but rising strongly.

The commodity growth story is linked to Asian growth, but, of course, Asia is slowing down at present. Inflation in both India and China is being addressed through rising interest rates, but things should get back on track next year.

The gold and silver story has got much more upside potential in the long term and this plays well in Canada.

Some of the smaller stocks in the mining sector have been on fire recently and may see profit taking, but the long term potential is still attractive. We expect the major miners to start outperforming shortly. These usually take over smaller exploration companies to increase their reserves underground. This process has started with the Newmont deal. We expect more to follow.

### Canada

### Canada relative to world

# South Africa

## Almost there

The South African market has had a subdued start to the year. January was a negative month and after the recent rally the Johannesburg All Share index is only up 0.5% so far this year.

The reason for the apparent lack of progress is that the index is almost at the old all-time high made in 2008. A consolidation phase was inevitable.

The market is manifestly in a secular uptrend, as indeed it has been for years.

It is at almost the same stage – between leg X and Y – on our road map (see page 25) as the Canadian market.

The shape predicted was a rise to almost the old high, followed by a consolidation phase and then a further rise to new highs at Y. The period since November has been the consolidation phase.

We expect a new high breakout imminently, which could be followed by a rise to around 35,000.

We would anticipate a fall back to Z on the map, with this phase being completed by mid-2012. That will be a good long term entry point for the next cyclical bull phase, which is still in the presence of an underlying positive secular trend. In other words, it is a buying chance we will not want to miss.

On our ranking table, the JSE index has fallen back into the weak half. This is because other markets, which had lagged behind it, have been catching up very quickly.

Australia has not yet fallen back, but it is quite likely to do so soon, so we will be getting some theme rotation within the group of markets driven by mineral resources.

Given a new high breakout, which would be a move over 33,309 for the Johannesburg All share index, we could see a momentum trade that might last for six months. After that we should get a sell signal that would eventually set up a really good buying opportunity.

### JSE All-Share

### JSE All-Share relative to world

# Japan

## Extreme longevity

The Japanese are famous for their longevity, and this long term tendency is also evident in the bear trend of the Nikkei index.

It is possible that the secular downtrend of the past two decades is over, but the technical position is not such that we can confidently make that call just yet.

One of the rules of technical analysis is that, after such a long bear phase, the final low to end it all will at some stage retest the previous low. So even if the low at 6,994 in 2008 was the absolute low, there should at some point be a retracement back towards that level.

If the next swing down can establish a higher low then the 2008 level, that would set up the potential for the subsequent rise to break the long term downtrend line. That line is currently at around 17,000, but it will be down to near 14,000 by the end of the year.

It is entirely possible that this favourable development will take place, but it is by no means a racing certainty. In any event, a better entry point later in the year is probable.

Some of the best companies in this market are cheap by any standards.

The yen has been very strong. Too strong in fact and this strength is hurting the export blue chips. We would need to see the rate go back above ¥86 to ease the pain. If that happened soon, we would be willing to bring forward our buying of Japanese equities.

The demographic picture is dire – a combination of the longest living race with one of the lowest birth rates. This means that the total population will shrink.

In a crowded island that may be no bad thing. But consumption is not going to be a powerful driver of the economy for many years, so it is vital that Japan's export markets hold up well.

Japan is well placed to sell into Asia, but parts of Asia are cooling down now in an effort to quash inflation. This all suggests that we should wait for a better buying opportunity.

### Nikkei 225

### TOPIX

# India

## She stoops to conquer

The Indian stock market is falling fast. This is good news for those looking to buy for the first time or increase their exposure.

For the past decade we have been promoting this market as a long term growth story. The risk was that those who were late in following this advice would end up buying at the all-time high for the market.

There is no doubt that the Asian markets should expect strong long term growth, but the trick is to buy that expectation if not dirt cheap at least at a reasonable price.

The Sensex index has been on the road map in secular uptrend (see page 25). It was in leg X to Y and had already got back up to the old all-time high. The map allows for it to go higher still before dropping back to Z. In December it looked as if that last rise was underway, but it has been cut short.

The reason is that the huge amount of liquidity created in the western world has gone abroad and blown a variety of bubbles.

In Asia it has caused inflation - especially in food prices. In India about 65% of the people still live in villages and food accounts for a large proportion of their family budget. In the poorest regions it can represent as much as 70% even though for the country as a whole the figure is nearer 40%. This is an urgent problem. Interest rates have been raised three times and further increases will follow. The government has had to import food to bring prices - especially that of onions - down. While they are trying to dampen down inflationary pressures, it is better to hold off buying.

We always expected the setback to Z on the road map to bring the Sensex index down to somewhere between 18,000 and 16,000. This move is now underway. The 16,000 level was established in May 2010 and is a Fibonacci retracement within the primary uptrend. A pullback to this level would not invalidate the secular uptrend.

The historic P/E ratio is currently at 15.9 and the yield is 1.9%. If we can buy on a P/E of under 14 with earnings growth expected to be 15% this year we will do so. Our long term positive view is as strong as ever and the present fall will set up a buying window.

### India

### India relative to world

# Pacific ex Japan

## Always wear a seat belt

We have encountered turbulence, the captain has switched on the fasten seat belt sign, please return to your seats until further notice.

The China aeroplane is not going to crash. There is no need to discuss if it will be a hard or soft landing, there is not going to be any landing at all. The long term journey will continue on course. It will, however, be bumpy for a while. Remain seated until the captain has switched off the sign.

Massive liquidity has caused inflationary pressure in many places and particularly in China. This is not welcome. It will be dealt with.

China can be relied on to play a long game. It will do whatever it needs to do to keep the aircraft in the air. In the short term, they can take some quite drastic measures.

Probably the supply of credit will be controlled. Elsewhere it is the price of it that is important. But China can do this in ways not available in other countries.

Property feels like a bubble but it is a real asset. Bought with fiat money it will not drop easily.

At present, the stars of the region are Taiwan and South Korea. China has dropped down our ranking table to the neutral zone.

Thailand and Hong Kong are in the weak category.

The Shanghai Composite index became detached from the real world at the time of the Olympics. It has been falling back ever since towards a more credible level. That downtrend is still underway so we remain in risk-off mode.

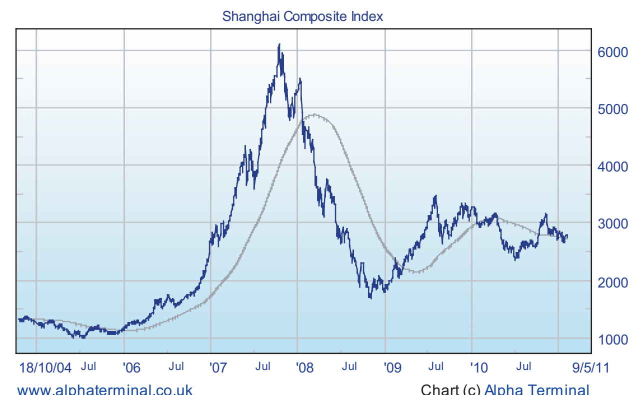
However we expect the buying chance to present itself later this year. In round numbers, the Shanghai index can go to 2400 - and possible a little lower. This was the low made in July 2010.

The current P/E ratio is 17.7. We think it will bottom at about the same level as India.

The world has recently been reminded that emerging markets, even if they are now so big that they have emerged, can be high beta plays. It is important to buy the growth prospects at a good price. If you do not enjoy the flight, there is always the slow train in the west.

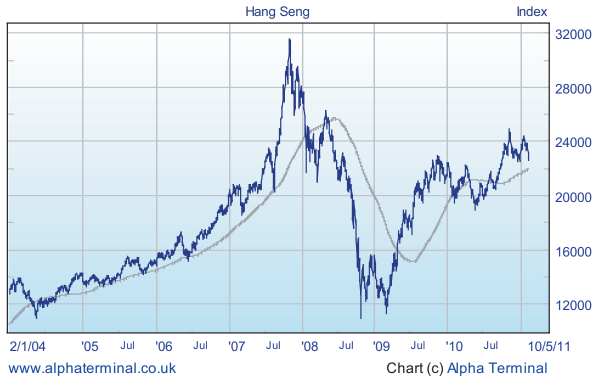
### Australia

### China



# Pacific ex Japan

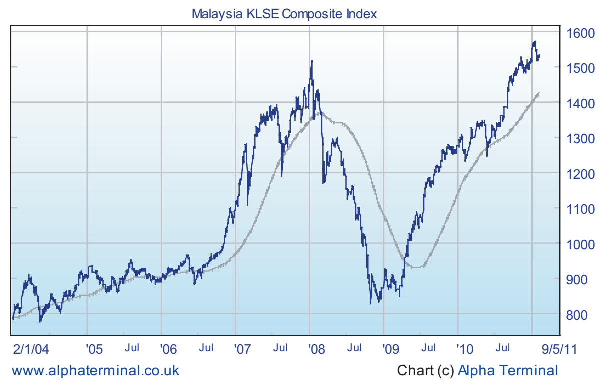
## Hong Kong




## India

## South Korea

## Malaysia




## Taiwan

## Thailand

# Emerging markets

## All creatures great and small

Markets in this section feature in both the top and the bottom categories of our ranking table - and every other group in between as well. It is a real mixed bag.

The action taken by governments to curb inflation in what have in the past been some of the strongest-performing markets together with political unrest in the Middle East have prompted some profit- taking.

Brazil and Turkey have dropped from the top to the bottom of the ranking order. In this respect they are similar to India and China in the pattern of the chart, but the degree of correction has been greater.

All these markets are in secular uptrend, but in a cyclical correction now. This will set up a good long term buying opportunity in due course.

At present we are seeing dead cross signals on the moving averages, but this is a lagging signal. In percentage terms, a half of the probable fall has already occurred. It is too late to sell now.

In Brazil, the P/E ratio is already down to 12.9 and the yield is over 3%. On a further 10% decline, we would be buyers again.

Russia is the strongest market on the entire list as the price of oil is trending higher. We favour owning this market with an ETF.

Peru is holding up on the strength of the copper trend.

Mexico has recently been at a new all-time high so there is no doubt that it is in a secular uptrend.

There are some leaders and laggards in this group but, basically, they have just reached - or soon will - point Y on the positively-skewed road map. The present fall will get down to Z, which is a long term entry point not to be missed.

For the next few months the tactical trade is to move into the mature western markets, buying the big blue chips that pay strong dividends. After that the growth story of the emerging markets will reignite from a level which makes them once again good value.

### Brazil

### Russia

# Emerging markets

## Emerging markets index

## Mexico

## Chile

## Turkey

## Eastern Europe index

## Poland

# Bonds

## It is over now

If this is not the end, it is the beginning of the end. The great bond bull market of the past 20 odd years is over.

If it appears to be still showing signs of life from now on, it is the final death tremor. A chicken with its neck broken can still run round a farmyard for a while.

The yield on the 30-year US Treasury bond has backed up ever since the Fed embarked on QE2.

Mr Bernanke says that this will not cause inflation, but nobody outside the US believes him as they are already seeing it take a hold.

There are two capital flows going on right now that were not seen last year. One is a temporary retreat out of emerging markets and the other is a more permanent exodus out of bonds.

Governments are not trusted. Governments print money and trash the currency. Governments effectively steal money from their hard working and prudent savers and give it away to Wall Street predators. This is no way to win an election.

Unlike the leopard, if the incumbent President wants to stay on, he will have to change his spots. He now has to stand for small government that will cut its spending and get out of the way of the animal spirits that can save the economy. He will have to say he will cut some of the big four spending agencies: medicaid, medicare, social security and defence.

When the yield on the 30-year US Treasury bond backed up to 4.7%, it broke the 10-year moving average or primary downtrend in the bond market. If this move overshoots to 5% the signal will be crystal clear.

The Fed may worry about high unemployment and falling house prices, but everybody else has already got inflation on their radar screens.

In this environment we do not want bonds, we need real assets. That is why so much money is going into equities even though most of them are not that cheap. They are the least bad option. Bonds are worst.

Unless the Fed intervenes aggressively to drive long rates right down again, the bond king is dead and the equity king will be crowned.

### US Treasury bond 10 year yield

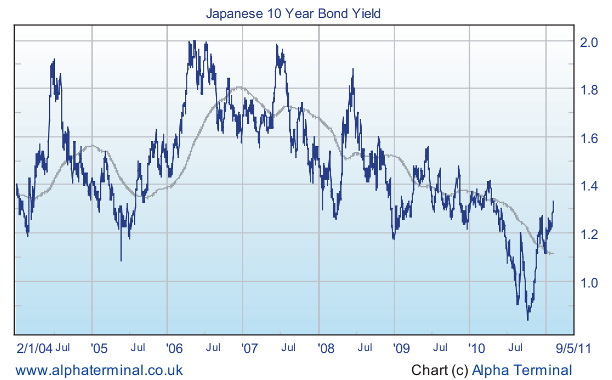
# Bonds

## 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

## All together now, sing

All commodities are going up together. The chorus line for the investment community is - paper assets are toxic; what we need are real assets.

We used to have meaningful conversations about soft and hard commodities, precious and base metals but they are all now considered to be part of the same investment universe. We do not want paper money or government bonds we need a hedge against inflation. Commodities provide this.

Try telling the Chinese or Indians that there is no inflation and that QE2 will not cause a problem, when it quite obviously already has.

The long period of disinflation is over and inflation is picking up. All governments always over-promise and under-deliver. In the process they devalue money.

It is true that in the US unemployment is structurally high and it will be extremely hard to bring it down. Stagflation describes this situation. It is going to become a much over-used word.

In the long run, we see western economies bumping along with very modest, well-below-trend, growth for years to come. Demographic forces lock that in as a given on top of all the other problems.

There will be much better growth in emerged and mineral based economies, but they are always highly volatile. The ride in these markets and commodities will be bumpy. If the emerging markets cool down, there is likely to be a correction in the commodity markets.

It will be important to buy on dips to get a good value entry, and not chase surges.

Gold did make a triple top at $1,400 and started to fall back to the 200-day moving average. However, just as the downside was developing, the Middle East problems blew up and so a low seems to have formed at above $1,300. We have not sold and will buy more if the price dips below $1,300. The same applies to silver. The large mining companies will start to perform, having been subdued for all of last year.

There are many ways to play the rise in food prices, which we think has further to go. John Deer tractors, seeds and fertilizer stocks should all do well.

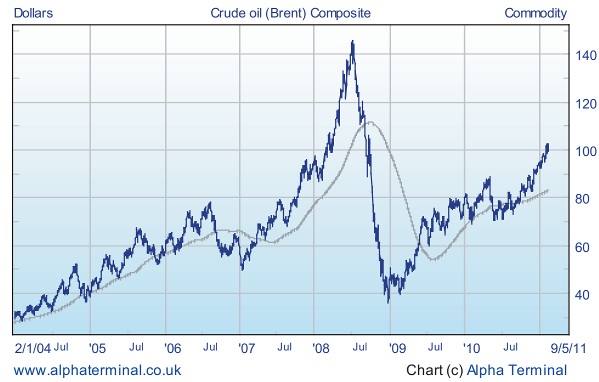
### Commodity price index

### Gold

# Commodities

## Platinum

## Oil




## Silver

## Palladium

## Copper

## Aluminium

# Currencies

## The war of the worlds

If you are a bull of equities, you are a bear of the dollar. Risk-on is dollar negative and risk-off is dollar positive. That's it. Remember the KISS principle (Keep it Simple Stupid).

For all the problems in Greece and Ireland, the euro went up last year against the dollar. The reason is that the printing press at the Fed and Bernanke's helicopter were working overtime. In the dash-to-trash the US is winning.

The European area is a club and the club has rules. From time to time they change the rules. They are doing this now. The club will hang together and get stronger. In the new rules there will be penalties for members that break the rules. Losses will be taken and some defaults are likely. Some members may get black-balled by the markets and have to leave the club for a while but they will be welcomed back once they get their finances in order and are more competitive. However the club itself will continue and get stronger.

On purely technical analysis grounds, there is no reason to be negative about the pound or the euro. Both are essentially range bound but stable.

The currencies with the strongest trends are backed by commodities. The Aussie dollar has not, so far, broken down in spite of the huge floods.

The Canadian dollar and the Russian rouble are, similarly, in prime uptrends.

The South African rand is, at present, the weakest of these currencies, but only because the others are extremely strong.

Even though the UK economy is struggling and seems at risk of dropping into recession again, sterling trade-weighted is still above its rising 200 day-moving average and there is a golden cross of the short moving averages. For the time being, fears about the UK are not strong enough to overcome the Fed's printing press.

The Chinese currency is on a steady trend, rising against the US dollar at a rate of 3.5% every six months. There is no sign at present of this changing.

The yen is strong at ¥82 but has made no further progress since October. In the short term a move up to ¥84 or possibly ¥86 is on the cards but even that would not alter the prime trend. A move above ¥86 or below ¥80 would be very important and signal the direction of the next trend. Japanese exporters would like it to be upwards (i.e. the yen to weaken).

### US dollar: trade weighted

### US dollar/euro

# Currencies

## US dollar/Japanese yen

## Euro/Japanese yen

## Sterling/US dollar

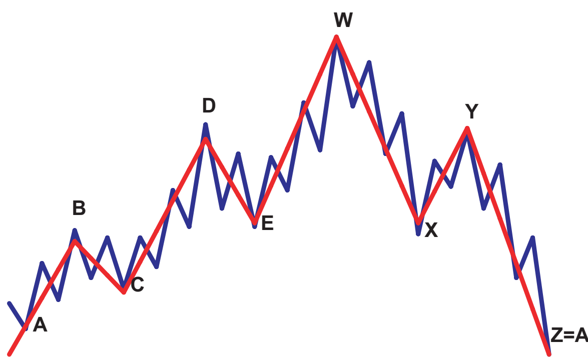
## Sterling/euro

## US dollar/Canadian dollar

## Australian dollar/US dollar

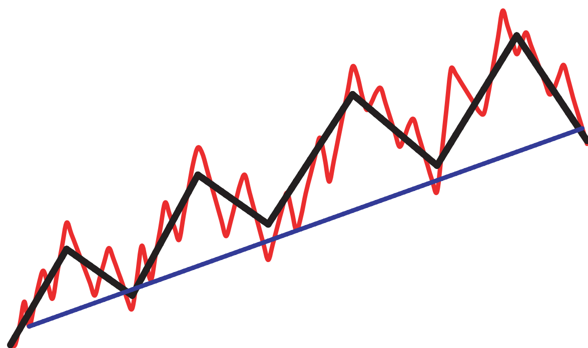
# Road maps

## Standard road map



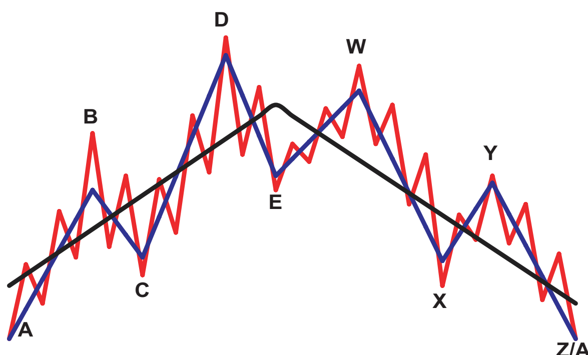

These road maps are the basic shape of a so called Elliott Wave. We deliberately letter our maps differently from Elliott aficionados. The normal time scale for a complete cycle is four years driven by the Kitchin wave. The bull phase has three surges getting progressively more powerful. The bear phase 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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Investment Research of Cambridge, PO Box 37389. London N1 0WE Tel: 0207 278 4605