Global Report – April 2011

UK

Europe

US

Japan

Emerging Markets

Bonds

Commodities

Currencies

April 2011

World Investment Strategy

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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

Global equity markets are still in risk-on mode. There is a huge amount of money available and it has to go somewhere. Sitting on cash does not give a worthwhile return so investors are forced to take more risk.

It is also clear that the great bond bull market of the past 20 years, especially in so far as it is represented by the US long dated Treasury stocks, is over. It is dead. It has been destroyed as a matter of deliberate policy by a man with a printing press and a helicopter. Any further apparent signs of life are nothing more than final death spasms.

It is also clear that most commodities are still going up. As the poorer people of the world become more prosperous, they wish to improve the quality of their life – including their diet. The world needs to grow more food.

They also wish to own motor cars and have electricity in their homes. There is a chronic shortage of energy. After the disaster in Japan there will be a marked reluctance to go ahead with nuclear projects, at least for a while. This puts relentless pressure on all other forms of energy.

King Coal still sits on his throne. Oil has broken all overhead resistance and is headed to a new all-time high. Gas has been revealed as a probable saviour of the western world.

Because of modern fractal drilling, the western countries can release endless amounts of gas at cheap prices. They can become self sufficient as long as they put in the infrastructure. This is the cleanest burning hydrocarbon. It is a slam dunk that further investment will be made in gas. This is an investable theme that will have a long shelf life.

Finally, the precious metals are going up not because they are commodities, but because they are real money. They hedge the debauching printing press.

We regard it as essential to hold some gold in all portfolios. It does not matter that Lord Keynes said it was a barbarous relic. We are moving into a world where the thoughts of a dead economist, or indeed most western leaders, are irrelevant. We are moving into an Asian-led universe. In their culture gold is real money. It has been so for thousands of years, and will continue to be so in the future. Paper money just does not cut the mustard.

Silver is now performing at a leveraged rate to gold. In the short term it has become overbought as it has just made a 31-year high. It will probably have a major consolidation phase. It could be a mistake to be wobbled out of long term positions. Trade out if you want, but remember you will want to back in again. Our final targets are way, way higher.

Western equity blue chips are still going up as they were left behind last year. But it is a catch up trade. They can continue to rise, driven by the weight of money. They are, however, already higher than fair value and will need to come back down again later. They are a trade not an investment.

The best of them have better franchises than many countries, and in some cases are actually bigger. Their dividend stream should grow. They are real assets.

As to timing, we think the rally should last until at least late May and could run through June. But once the mid-summer rally is over, we will need to get out and protect capital. The next recession will then be being forecast by more than Mr Nouriel Roubini.

The best markets will simply lose some of what they gained in the rally from March 2009. The worst ones are already lower than that low.

The markets that reach a buyable low first will be those driving the global economy. They will be China, India, Brazil and the commodity-related markets that supply them. They are likely to hit their lows late this year while other markets will bottom between late 2012 and early 2013.

Summary: world market overview

The curse of interesting times

In China there is a saying, “May you live in interesting times”. It is almost a threat. We seem to be cursed to do so. Never in recent experience has so much uncertainty existed on so many fronts simultaneously.

Some things we can explain and make forecasts about while others are completely unpredictable.

The natural disasters affecting the Pacific region in general and Japan in particular are probably triggered by gravity. This is driven by the moon.

The moon goes in an elliptical orbit not a circle. It gets closer and then further away. Gravity is an inverse square law. It gets much stronger if the moon comes a lot closer.

We recently passed the Super moon, when it was as close as it gets and was last there 18 years ago. The gravitational effect was powerful. As a sailor, I live with this and can assure you I have never seen a tide so low at low water and then so high six hours later as at the time of the Super moon.

The weight of the giant tides on the Pacific ring of fire triggers the many rumblings and quakes we have had. They in turn cause the tsunami.

In practice, the moon slowly approaches and then moves away. When it first started to have a big effect, the tipping point, New Zealand had its earthquake. The Japanese event was at the worst moment. The peak is past now, but we are still vulnerable for another three months. After that the strong earthquakes and tsunami should abate.

There has just been another 7.4 richter earthquake and smaller tsunami off the Japanese island of Honshu which shook buildings in Tokyo. Rebuilding will not achieve much for a few more months. After that they should be able to recover.

The area where it is much harder to make predictions is in North Africa and the Middle East.

It seems to us that the US and European countries have no right to be there at all. They have very little idea of what they are doing, how long it will take, or what it will cost. The whole thing is open ended.

We find the idea that you can hand out something called democracy like a lollipop to a child is worthy of ridicule.

From an investment point of view we follow the maxim ”When in doubt stay out.”

The other big issue is inflation. Emerging, or emerged markets are already experiencing uncomfortably large price rises and are trying to cool their economies down by raising interest rates. Bonds are in the death throes of a 20-year bull run. Gold is going up. So are most commodities.

Real assets are more beneficial that paper assets. Equities of multinationals with a strong brand are going up. We have to follow the flow for now but expect a top in the second half of the year. How long we stay for the ride is a game of chicken.

The World at a glance

Major markets

US relative to world: currency adjusted

All the major markets are in the bottom category of our ranking table. They are simply not the stars of the investment universe at present. However, within this group, the US is the strongest performer. The trend of relative strength is above its moving averages, which are themselves rising. This looks as though it can continue for a while longer. Trouble is brewing but it may not actually bubble up until the second half of the year. The stocks to own are the blue chip giants like Caterpillar or John Deere.

UK relative to world: currency adjusted

The UK is just weaker than the US. It had done well because of the miners and oils but the relative trend has now rolled over and is below the moving averages. The short-term average has already lost its positive slope and is trending down. It is clear that the economy is only just growing and it is fair to say it is in stall mode. The government's tough measures and cut backs are not popular. Consumer confidence is beginning to ebb. Long positions should be very stock specific – and even then be ready to take profits.

Europe relative to world: currency adjusted

There is a very disparate performance amongst the European markets. Germany and Scandinavia are in the strong category of our ranking table. Only Switzerland and the UK are in the weakest group. The markets are becoming increasingly inured to bail outs of the peripheral members. The German index still looks as though it can go back up to at least the highs of 2008. The euro currency is trending up against the US dollar and there is no present sign that this will change.

The world at a glance

Japan relative to world: currency adjusted

- Not surprisingly, Japan is in the weakest group on our ranking table. We are sure it will recover and they will rebuild but it is too soon to expect the secular downtrend on the chart to break. The yen has broken down however so buyers of good export blue chips will need to hedge the currency. As long as the next major low for the Nikkei Index is above 7,000, we could at that time make a major buy call. We think it will be worth waiting for that, rather than rush in now.

Pacific ex Japan relative to world: currency adjusted

- Hong Kong and Taiwan are in the weakest group of the ranking table at present while Thailand and Indonesia are in the strongest. This is because theme rotation is occurring within the region. China has rallied back up into the second quintile but we do not wish to chase after it. We think it may still drop back to a better buying chance later in the year. It has just responded to the latest risk-on move in all markets. In the long run, however, this region is still the engine of the world economy and the one in which we wish to be overweight.

Latin America relative to world: currency adjusted

- Brazil and Chile are neutral at present and the other markets of the region come lower down the ranking table. Our view is that the region has moved too high, too quickly. We do not think the value is attractive and so would wait for a setback on which to buy. In the long run, we like Brazil and want to own it as it is in a secular uptrend and the growth is linked to that of China. For now patience is required.

Global stock markets ranked by quintiles in dollars

Country	Quintile	Above 25D	Above 200D	Upward Sloping 25D SMA	Percentage Change (US $) % 1 MONTH	AVG	3 MONTH	AVG	12 MONTH	AVG
		Moving Average								
Russian Federation	++	✓	✓	✓	3.8		18.0		28.4	
Hungary	++	✓	✓	✓	7.4		20.6		-0.5	
Thailand	++	✓	✓	✓	9.0		2.3		42.8	
Indonesia	++	✓	✓	✓	5.6		1.0		33.6	
Poland	++	✓	✓	✓	3.9		10.4		16.1	
Philippines	++	✓	✓	✓	7.1		-0.1		35.8	
South Korea	++	✓	✓	✓	8.7		5.7		27.3	
Austria	++	✓	✓	✓	5.0	6.3	9.7	8.4	15.7	24.9
South Africa	+	✓	✓	✓	3.4		2.0		20.9	
China	+	✓	✓	✓	1.0		4.2		21.4	
Canada	+	✓	✓	✓	0.8		9.9		21.8	
Czech Republic	+	✓	✓	✓	3.5		12.0		12.6	
Netherlands	+	✓	✓	✓	2.9		12.8		11.6	
Sweden	+	✓	✓	✓	3.3		6.7		25.3	
Australia	+	✓	✓	✓	3.1		7.5		14.1	
Germany	+	✓	✓	✓	2.5	2.6	12.9	8.5	22.3	18.7
Israel	o	✓	✓	✓	8.1		-0.1		11.0	
France	o	✓	✓	✓	3.1		13.0		6.5	
India	o	✓	✓	✓	7.8		-1.1		9.8	
Belgium	o	✓	✓	✓	2.5		12.0		7.0	
Turkey	o	✓	✓	✓	16.0		-0.4		14.1	
Venezuela	o	✓	✓	✓	4.1		7.0		20.6	
Chile	o	✓	✓	✓	4.0		-0.2		37.4	
Brazil	o	✓	✓	✓	5.1	6.3	2.1	4.0	7.2	14.2
Mexico	-	✓	✓	✓	3.9		0.8		16.4	
Spain	-	✓	✓	✓	4.0		19.0		1.3	
Italy	-	✓	✓	✓	1.2		16.0		0.0	
Denmark	-	✓	✓	✓	0.6		6.6		22.8	
Argentina	-	✓	✓	✓	0.6		-4.6		37.1	
Peru	-	×	✓	×	-6.7		-8.9		40.2	
Malaysia	-	✓	✓	✓	2.1		0.5		23.5	
Singapore	-	✓	✓	✓	3.3	1.1	-0.8	3.6	17.5	19.8
United States	--	✓	✓	✓	0.9		4.4		12.2	
United Kingdom	--	✓	✓	×	0.4		4.6		11.3	
Hong Kong	--	✓	✓	✓	3.4		1.6		12.0	
Taiwan	--	✓	✓	✓	-0.5		-1.9		17.8	
Switzerland	--	✓	✓	×	-1.3		3.2		7.2	
Colombia	--	✓	✓	×	-2.3		-1.0		24.8	
Japan	--	×	×	×	-11.5		-7.4		-3.0	
Egypt	--	✓	×	×	-1.7	-1.6	-22.6	-2.4	-22.2	7.5

Ranking and data in US Dollars

United Kingdom

Spring is here

Spring is sprung, the grass is ris... but the economy and the stock market are stuck in the mud. The actual UK indices look alright but, in a global context, the relative performance is bumping along and looking vulnerable to further weakness.

When most markets dropped back from mid-February until March they fell into two categories. The best bounced off their still rising 200-day moving averages but also stayed above the highs made last April, which are now important support levels. The weakest ones broke down well below these levels.

The FTSE-100 Index came in a middle position. It did indeed test the rising 200-day line, representing the long term trend, and bounced right off it. That was all well and good. However, it fell considerably below the 5,800 level of last year's April high.

The good news is that it has recovered and is now retesting the resistance at the recent highs of around 6,100 made earlier this year.

If these highs can be overcome, a further rise towards the highs of 2007 at 6,754 could take place.

In practice, it seems unlikely that the move will extend that far, but a move to 6,400 or 6,500 is definitely possible.

As to timing, the market should remain strong until late May, and it might hold up as long as late July but, increasingly, the top priority will become capital preservation and taking risk off the table.

The economic news is not wonderful. The cut-backs are very unpopular. We may not experience the same level of violence as the riots in the Middle East but we are certainly going to get some protracted strikes. The UK economic engine is stuttering and could easily stall.

There is no need to panic as most of the big stocks earn a large part of their revenue from the parts of the world that are still growing. That, however, is a long term benefit and, if China cools down to control its own inflation, theses economies will also have a setback. A Fibonacci retracement of the rise from 2009 indicates that the 4,500 area would eventually be a good buying level.

FTSE 100 index

FTSE 100 index relative to world

Europe ex UK

Running on wheels

The first thing that the people in Asia want as soon as they can afford it is an expensive German car. Germany also produces many of the other capital goods that people look to acquire as they get richer. It is the pre-eminent export machine on the planet.

You might have thought there were problems with the euro – but what problems? The euro has gone to new highs against the dollar. The market appears to have discounted the bail out packages for Greece, Ireland and Portugal.

We all know that according to the existing rules, the euro cannot survive in its present state. The solution is simply to change the rules of the club.

There are huge vested interests in holding it together. Enormous amounts of economic and political capital have been invested in this project. Ultimately, it can be afforded so long as the political will stays firm.

We believe that markets are wiser than us. They are behaving as though the bail outs will work. The rules will change and the euro will continue to be a widely respected and used currency.

It is even in the interests of China and others that this should be so. We go with this flow until such time as there is a clear reversal on the charts. There is no sign of it yet.

As to the stock markets, we think that Europe will remain highly correlated to the UK and the US. If all other things remain equal, the markets should continue to rally until the middle of the year. But, after that, expect a topping out process and the next decline.

At present, the Fed are indicating that QE2 will be completed and there is no need to embark on QE3. However, if the economy starts to falter and the market looks like as if it is about to dive, they may change their mind. A big enough QE3 could bend our road map out of shape again, just as it did last October. Ultimately the market always wins.

The next four year low would be in March 2013 if it was a mechanical process. The real world is, of course, more complex. We go with a forecast that the low will be between late 2012 and early 2013. With or without QE3, the top should be between mid 2012 and late 2012. Trade accordingly.

European equities

European equities relative to world

Europe ex UK

France

Germany

Switzerland

Netherlands

Scandinavia

Spain

United States

There is a recovery of sorts

It is true that a recovery of sorts is occurring. On a relative basis, things are better. That does not mean that things are good, but they are better than they were.

As recoveries go, this one is incredibly modest and it is running late. It has been bought at an amazingly high cost. The idea that it is now self sustaining in our view lacks credibility.

To citizens of the US things might seem OK as you have to own the dollar. The rest of us would prefer not to own dollars as they seems to be turning to dust in our hands.

It is really very difficult for overseas investors to make money in the US stock market as much of the equity gains are cancelled out by the loss on the currency.

To put some numbers on that; on a trade-weighted basis, the dollar is down 15% since last June, it is down 38% in the last 10 years and since 1985 it is down 55%. The S&P index is still 14% lower than it was in the year 2000.

A tsunami in the Pacific, social unrest in the Middle East and North Africa and operation bail out of PIIGs would normally have been enough to send the dollar surging higher. Indeed, any one of those events on its own would normally be enough to send investors scurrying into the dollar and yet collectively they have produced no 'safe haven' reaction. This is very significant. The world is voting with its feet. They do not want the dollar.

There are, however, some excellent US companies, such as Caterpillar, John Deere and others, that can compete with the rest of the world and whose businesses should grow strongly. They are not really cheap but they are good quality. We expect the share price of these companies to keep rising until probably late July – the top of a normal mid-summer rally.

We continue to worry about house prices. The Case-Shiller index seems to be heading down again. The unemployment numbers, although improved, are still far too high.

Once QE2 is finished, the market looks vulnerable. A QE3 could puff it up for a bit longer than our road map indicates, but the price to be paid will be that it trashes the dollar. The only time we expect the dollar to rally is when markets go back into risk-off mode.

S&P 500

Dow Jones Industrial Average

Canada

We have it

If you want it, Canada has it. There is relentless upward pressure on oil, gas, metals to name just a few of the resources with which this country is abundantly supplied.

In terms of oil reserves, Canada is ranked just below Saudi Arabia and, moreover, it shares a border with its largest customer.

As the use of gas for power generation picks up again, Canada can provide huge quantities at a reasonable price.

Gold and silver are at new highs and are likely to trend higher before the final peak is seen. Again, Canada owns these metals.

Eventually, the world will realise that it does not have the luxury of saying it will abandon nuclear fuel. After the Fukushima partial meltdown, nuclear power may adopt a low profile for a while. But, as Asia grows and the demand for cars, air conditioning and the other trappings of an industrialised society rises, it will have to make a come back. Otherwise we will not be able to breathe the air on the planet.

The TSE index is on our road map in secular uptrend. It is up 70% from the highs of 10 years ago. Since March 2009, it has almost retraced all of what was lost in 2008. The high was 15,154. It seems quite likely to exceed that level this year.

If it falls back again with other markets later in the year, it is likely to encounter good support at 12,000.

The Canadian dollar is one of the strongest currencies and this trend seems likely to continue.

We long ago forecast that it would not only achieve parity with the US dollar but go to a premium, and that still seems to be the case. The premium can get a lot wider since the "loony" is underwritten by real assets. In an era of inflation, this quality will be prized by investors.

Canada

Canada relative to world

South Africa

Rising tide

The entire African continent is growing rapidly. Having been trapped in poverty for generations, the tipping point has passed and it is now on a booming secular uptrend.

South Africa has long been the blue chip of the continent. It is on our road map in secular uptrend. The All Share index is up 270% since the highs of 2000.

It did fall back dramatically in 2008, but It has now almost retraced the entire fall. It is up 84% since March 2009.

To a large extent South Africa's growth is driven by the Chinese and Indian economies. Obviously if they slow down, this will have a knock on effect. Some cooling down is expected later in the year but not just yet.

Meanwhile, the world has been through a long period of disinflation which now seems to be coming to an end. We do not need to predict strong inflation to still prefer real assets

Of the markets that come into this category, South Africa comes above both Canada and Australia on our ranking table. South Africa still carries a higher level of political risk than either Canada or Australia but in the past those that have been willing to shoulder this risk have been well rewarded. Many of the feared outcomes have in practice never materialised .

Long term investors should find that this market continues to be a worthwhile holding and the currency should also hold up well.

JSE All-Share

JSE All-Share relative to world

Japan

Struck down

The Japanese have been struck down by terrible disaster, but they will recover. They are down but not out. They will rebuild and do so better than before. They will probably do this quicker than anybody expects, but even so it will take time.

In the immediate aftermath of the earthquake and tsunami, the yen rallied strongly as funds were repatriated. But it has made a clear reversal on the back of the Bank of Japan's massive injection of liquidity and the trend is now for a weaker yen.

The new downtrend for the currency seems likely to continue which will help the export blue chips. These are good companies and are likely to surmount the short term problems quickly.

In spite of this, it is still too early to make the call that the secular downtrend has ended. The low to date for the Nikkei Index is 6,994 made in 2008. We need to establish a higher major low to start the reversal process.

It is possible that, since 2008, a base pattern has been building. The disaster may complete that pattern.

When a shock occurs, the standard pattern is a fall, followed by a rally, followed by the rest of the fall.

The first impulse is to protect capital and ask questions later. The second is that the fall was overdone and a rally is due. The third is the realisation that it will still take a long time to put the problem right.

The first fall took the index from 10,500 to 8,230. The rally has come back up to just touch the 200-day moving average at 9,819. There could be a further fall to below 8,000.

If this second fall bottoms out above 7,000, we will then have the first real buy signal for 20 years. The market will be cheap. It will be assisted by a weak yen stimulating the export sector while the rebuilding program will boost the domestic economy. Although appalling in terms of the loss of life and havoc it has created, the March 11th disaster may be what galvanises the country to do what it has failed to do in the last two decades.

Long term, Japan's growth will be linked to the growth of Asia. But we must wait patiently for this set-up to occur. The value is there and when the signal finally comes we will be looking to go overweight in this market.

Nikkei 225

TOPIX

India

A brilliant innings

India has just shown that it is the world champion at cricket. They produced a brilliant innings. The same could be said of Prime Minister Manmohan Singh. Should he retire now?

He is, after all, 78 and has done well. However, he is in a weak position. He is a good honest man but he is forced to lead a coalition that he does not control. Some of his cabinet appear to be seriously corrupt. The scandal will not just go away and it may bring about his well-earned retirement. The market will not like this uncertainty.

Having fallen back from 21,000 to 17,341 the Sensex index has recently rallied again to 19,800. We had been expecting it to retreat down to 16,000 or so where we would be prepared to buy it. There could still be an opportunity to do so.

The latest rally just followed other markets higher when they switched to risk-on mode again. But there was no specific domestic Indian event to trigger the rally – unless you believe that that cricket is that important.

The inflation rate is at least 12%. Rates have been going up and will go higher. When other markets come down again this one will do so as well. We are still looking for a lower level to buy later in the year.

Using last month's analogy of a train, India is an engine and so will be one of the first to reach the bottom of the hill. It could do so very late this year, whereas the carriages at the back will not get there until late 2012 or early 2013.

We have not lost our belief that India will eventually become both the largest economy and stock market in the world. The demographics are extremely strong.

The latest census revealed that, if India still included what is now Pakistan and Bangladesh as it once did, the population of this amalgamation would have already overtaken China in numbers. India will eventually get there on its own.

We remain confident about the growth story here but we are equally sure that we do not want to pay an unreasonable price for it. To achieve this, we need to wait for a suitable buying opportunity. We are not sufficiently confident of a fall, however, that we would sell existing holdings we have. So hang on and be ready to buy more later.

India

India relative to world

Pacific ex Japan

Emerged or still emerging

The giant markets of this region can no longer be classified as 'emerging'. They have long since achieved a superior status on their way to the top.

However, there are some smaller markets in the region where the label 'emerging' does still apply. They are having there time in the sun now.

In the very top category of our ranking table are Thailand, Indonesia, Philippines and South Korea. They all look good technically.

China has slipped down the table a bit even though the Shanghai Composite Index rallied last month. Like India, we think it participated in the risk-on surge, but the market specific news is not that great.

Our road map still expects one more setback for this index and it is likely to occur between now and the end of the year. The target is 2,600 and it may well go below the July low last year of 2,319.

We could be wrong if global inflation suddenly picks up and all markets surge to offset the fall in the purchasing power of money. But this possibility is not our central case scenario for the short to medium term.

The Hong Kong and Taiwan markets are both in the weakest category on our ranking table. They are lower than both the UK and the US, and only just above Japan.

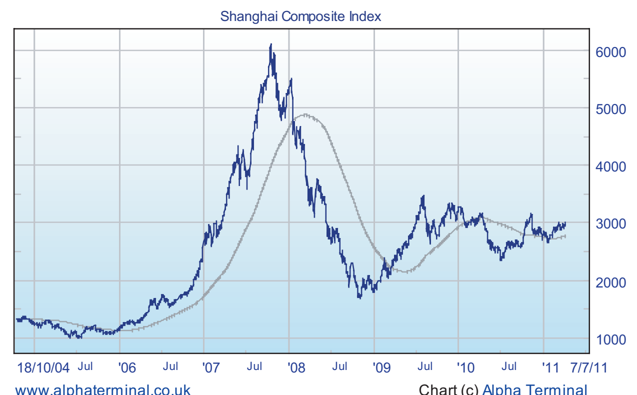
Malaysia and Singapore are in the next group but still weaker than the global average at present.

The overall message is not to chase the major markets yet but to wait for them to fall back and become better value.

Braver souls can still buy the 'emerging' markets but remember they are small and harder to deal in and much more volatile.

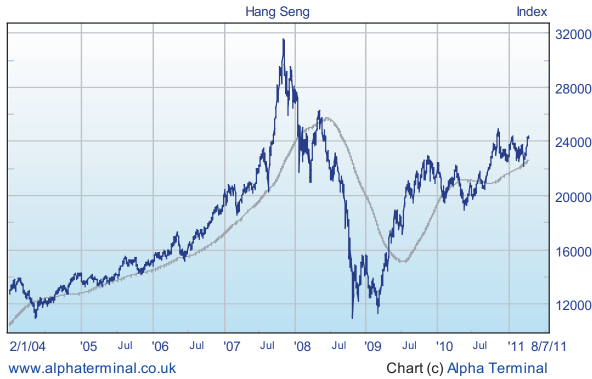
Australia

China



Pacific ex Japan

Hong Kong



India

South Korea

Malaysia

Taiwan

Thailand

Emerging markets

Comrades

It is all about Russia. The Russian market is not only the very top-ranked market on the entire table but it is the only market from this group of markets to be ranked above neutral on the global ranking table

We believe in the KISS principle (Keep it Simple, Stupid). We like it when things are uncomplicated. And the message here could not be clearer. In the markets called emerging – as opposed to Pacific ex-Japan – we either buy Russia or we do not bother at all.

This will not always be the case. Brazil is a long term favourite of ours but at present it is consolidating at a high level. We need it to fall back to complete our road map shape and become better value.

We think that will happen roughly in step with China and India. But not yet.

Russia is in demand for its oil and gas and Germany, with its strongly performing economy, is one of its best customers.

But being a customer is not the same as being a shareholder. It is not clear what the rights of outside shareholders might be when push comes to shove. For as long as there is no pushing, the market can go up.

Those that wish to play the oil and gas theme through exposure to Russia might want to use an exchange traded fund. That spreads risk a little but not a lot.

Of the constituents of the traded RTS index, Gazprom accounts for 19%, Sperbank for 18% and Lukoil for 16%. Rosneft and Norilsk each represent about 9%. The spread of risk is, therefore, only five stocks.

It may only be for the brave but we have to admit that at present it is the strongest market on our list.

Brazil

Russia

Emerging markets

Emerging markets index

Mexico

Chile

Turkey

Eastern Europe index

Poland

Bonds

Dead money

The great bond bull market of the past 20 years is over. It is dead but not quite buried.

When the yield on the 30-year Treasury first rose past 4.7% it broke the falling trend line that had held for two decades.

When the Fed, with its QE2 program, announced that it would be a major bond buyer, China, together with Russia and some of the other sovereign funds, sold aggressively. So yields did not go down, as the Fed hoped, they went up.

The same cheap money that the Fed is churning out is what is pumping up commodity prices. The Fed sees no inflation and yet its own actions are one of the prime causes of the upward pressure on prices.

Mr Market does not believe the Fed, and neither do other central bankers. The trend in rates now is upwards and the only way to abort this signal is for the Fed to push the yield on the 30-year bond down below 3.5%. Any move less that that is ineffective and will amount to little more than the death throes of the old bull.

Only if rates went back below 3.5% would we have to admit that we have got it wrong. The chart strongly supports the view expressed by Bill Gross of PIMCO. Long dated Treasuries are now toxic wealth- destroying waste.

Of course investors must own some bonds in their portfolios. Good risk diversification demands this. But they should now own the bonds of good quality companies.

Many of these companies are bigger than some countries and have a better franchise. Their dividend streams should grow. At the very least, the business should survive. It is a measure of the state we are in that some of the shrewdest bond managers now believe it is safer to lend to a good company, than to trust a government.

All governments over-promise, under-deliver and destroy the value of your currency. They have now been rumbled. The game is up. We need to own real assets not government paper.

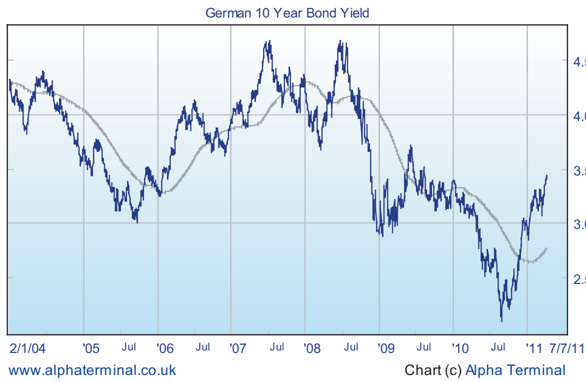
US Treasury bond 10 year yield

Bonds

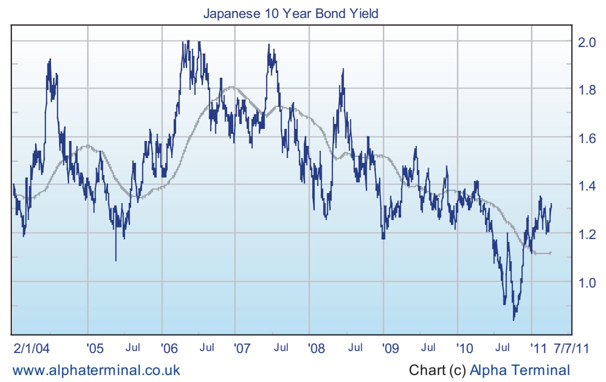
US benchmark bond 30 year yield

UK benchmark bond 10 year yield

German benchmark bond 10 year yield



Japan benchmark bond 10 year yield



Commodities

Going for gold

The riots in the Middle East originally started over rising food prices. It is quite clear that most food prices are in secular uptrends. The increasingly wealthy populations in Asia are looking to improve the quality of their food intake. To grow crops to feed animals and then eat the animals creates a multiplier effect on the demand for cereals. This trend is relentless and now unstoppable.

In terms of energy, most countries – and especially those in Asia – are chronically short of most forms of energy (some do have supplies of environmentally-unfriendly coal). As they follow the example of western nations and acquire cars, the demand for oil will go up exponentially. Oil has made a new high break out from its recent trading range and seems to be heading back up towards the old all-time high. In the west the so-called “driving season” is yet to start.

If China and India take more short term measures to cool their economies, in order to keep them on track for the long term, there will be bouts of profit-taking in the price of copper, steel and some of the other base metals. These, however, should be seen in the context of a secular uptrend.

Precious metals are different in that they are money. In the Asian culture, gold and silver have been regarded as ‘real’ money for thousands of years and are seen as infinitely preferable to paper money – especially the US dollar. Many western governments are printing their own money too liberally and this risk needs to be hedged. The trends for both these metals are likely to be powerfully upwards for a long time to come. But, from time to time, they will get overbought and there will have to be periods of consolidation. Silver is due one of these phases now. The current rise could just hit $50 per oz but then a retracement would be expected. This could well be traded by nimble investors. However, they should be looking to buy again as in three years’ time our target is for the price to more than double from its current level.

In the case of gold, the price is just making another new all-time high breakout. This is technically a very strong buy signal. The trend to date form $250 to $1,450 has been linear. We are expecting an exponential phase before the trend comes to an end. With such a large potential upside, it does not seem worth trying to nuance the short term trades but we could now see a short term consolidation.

Almost all commodities are in secular uptrend. They are also ‘real’ assets and so will eventually hedge inflation as these pressures build up. Short term pull backs will, therefore, create buying opportunities.

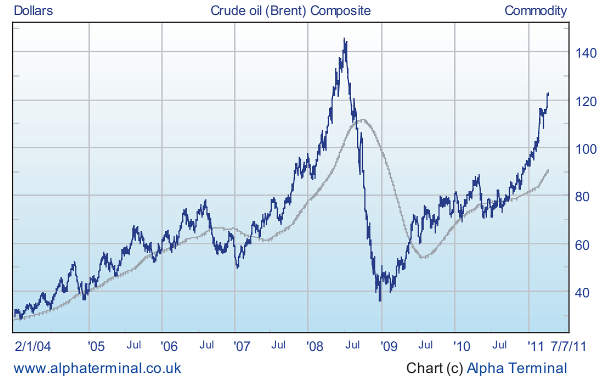
Commodity price index

Gold

Commodities

Platinum

Oil



Silver

Palladium

Copper

Aluminium

Currencies

This much we know

The combination of Euroland needing a bailout, the Middle East on fire, and the Pacific being hit by a tsunami have neither individually, nor collectively, been able to make the dollar rally. The reputation of the dollar has been shattered by a printing press and a helicopter.

It has become clear that when equity markets are in risk-on mode, the dollar goes down. It presumably follows that if and when markets get to a top and switch to risk-off mode then the dollar could rally.

Many nations are now willing and able to price commercial trade with each other in their own currencies and not go through the dollar. This will continue and become a larger business.

In spite of all the trouble with bail outs for Portugal, Ireland and Greece, the trade-weighted dollar index is at a low. The euro has gone to a new high this year and, indeed, for the past 12 months. A further rise to $1.50 is probable.

The resistance levels overhead are $1.50 and $1.60. On the downside, the closest support is at $1.40 and below that some buying should come in at the December/ January lows of $1.30.

Against the dollar, the pound has support at $1.60 and more at $1.55. Only if that lower level fails, would the trend favour the dollar for a bigger move.

However, in the Pacific it is clear that the yen has turned. The dollar is rising against the yen and we expect the Japanese currency to remain weak.

Although it has not attracted much press attention, yet another earthquake has struck Japan and the yen will be provided freely to help the nation rebuild the damage of these disasters.

It is just possible that the dollar is bottoming out in sequence against the other currencies. It has already turned against the yen but it would need to establish a reversal pattern against the others – and gold. So far the markets are rejecting this hypothesis, but we must stay alert to this possibility if the support levels start to break.

US dollar: trade weighted

US dollar/euro

Currencies

US dollar/Japanese yen

Euro/Japanese yen

Sterling/US dollar

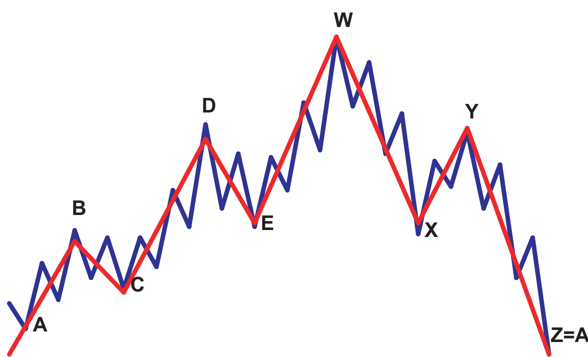
Sterling/euro

US dollar/Canadian dollar

Australian dollar/US dollar

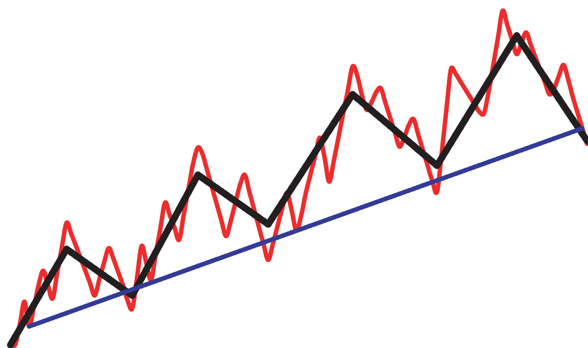
Road maps

Standard road map



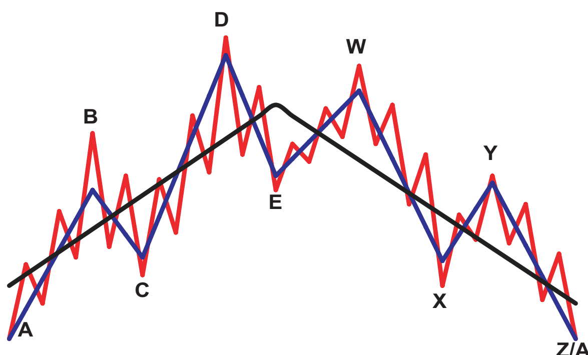
- These road maps are the basic shape of a so called Elliott Wave. We deliberately letter our maps differently from Elliott aficionados. The normal time scale for a complete cycle is four years driven by the Kitchin wave. The bull phase has three surges getting progressively more powerful. The bear phase 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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