Sand Spring Advisors LLC

Unsatisfying 4-10 Week Swing Moves

by,

Barclay T. Leib

July 5, 2010

Wall Street money managers have hit mid-year, and at best, most are flat or negative in their year-to-date performance. If there had been a steady trend up or a steady trend down over the first six months, some hedge fund managers would undoubtedly have done better. But short four- to ten-week "swing moves" that quickly peter out seem oh-so difficult for lumbering large portfolios to adjust to.

If there is one thing that I have learned over the past four years, it is that liquidity in a vast number of equities is just not what one would hope it to be. You may see an opportunity long or short in a given stock, but getting a substantive position in that stock for a $500mm+ money manager is not always easy. It may take multiple days or even weeks nursing computer algorithms to establish a position. Then, just when you get to where you think you wanted to be, the tone of the market may suddenly change. Pulling the rip cord to exit or somehow re-alter a position -- once finally established -- then becomes even more difficult.

2010 began with a sobering four-week dose of the deflationary bear, copper notably starting a substantive decline directly in line with our January 7, 2010 minor pi cycle turn date. But then we got ten weeks of more or less straight-up equities into mid-April, with many consumer and retail stocks oddly leading the market in terms of sector performance. This was truly a mid-bending period that made little sense. The April 19, 2010 pi anniversary of 9-11-01 (3141 days removed) then changed all this once again, and in a hot-and-cold fashion, consumer/retail stocks have since been among the worst performing equities for the last six weeks. April 19/20 did of course also represent the exact moment when the BP oil rig exploded in the Gulf of Mexico, changing the overall psyche of America in the process. We had expected something really bad to happen in that pi window of time, and while it was hard to predict exactly what that event would be, the Gulf disaster certainly qualified.

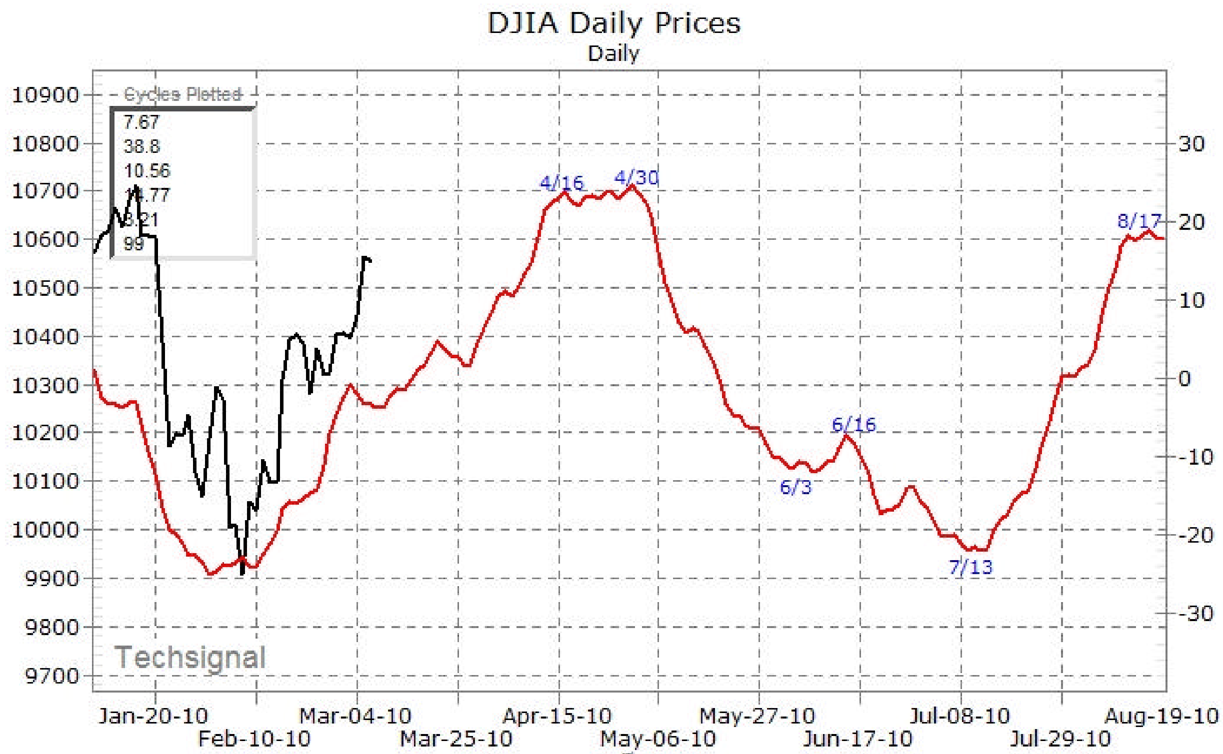
At the end of the day, across the first half of 2010, everyone has been groping for the next big trend – a move that will extend into a substantive enough magnitude and duration that positioning for such will be worthwhile. What they have gotten instead is lot of fits and starts that hardly last long enough to get their hands around.

At present, there is increased fear in the air. European markets in particular have shown a singularly weak underbelly -- as their past debt excesses have slowly moved to become front-page headlines.

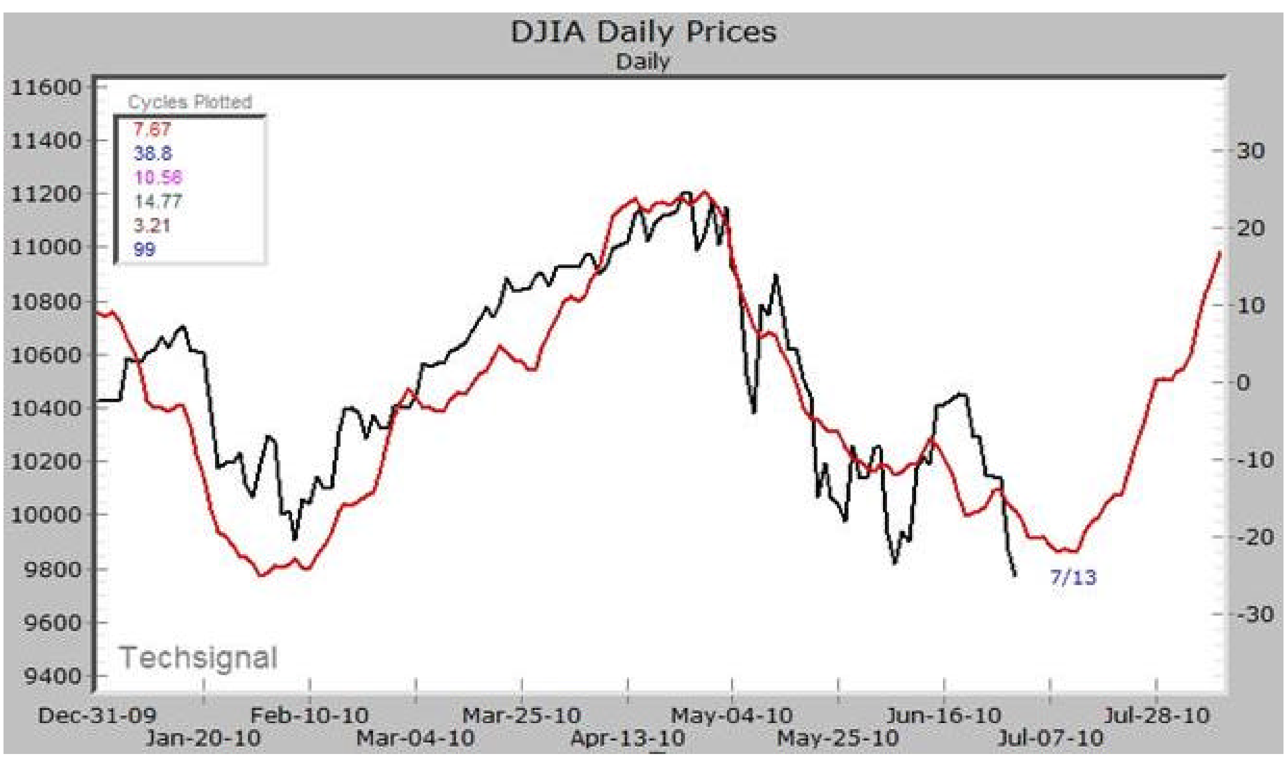
But as we look across a variety of chart patterns, we find a variety of "missing high" patterns – particularly in the Hong Kong market. Thus, notwithstanding our longer-term view that June 2011 likely will represent an important equity market low still beckoning in our future, <u>we have to wonder whether the markets are not ready for another 4-6 week swing move higher in the very short-term.</u>

This anticipated swing move higher could be considered just another irritant to drive fund managers nuts. Now that most people have adjusted their portfolios into a defensive/negative stance, something should come along to temporarily buoy market spirits, and make people feel stupid and naked at having become under-invested.

The Center for the Study of Cycles – using a composite of different cycles -- sent out the chart prognostication below back in early March:



Price performance since then has led to the following updated picture:



Per the Center for the Study of Cycles, the week of July 12th would appear the most likely time for the beginning of a swing move higher into the week of August 17th. This general pattern also just happens to be what our fractal techniques also suggest.

As we have written previously, if the recent crisis environment were instead set to get worse (as folks such as Bob Prechter are currently calling for), we would <u>not</u> expect to see a fear gauge such as Euro-Swiss already at the extreme price pictured below:

If we were headed to a real crisis straight away, we would not expect to see JGBs already sporting a complete looking fractal rhythm to their high last week:

We also would not expect to see everyone flocking to sell Euros and buy yen into clear long-term fractal support for that cross:

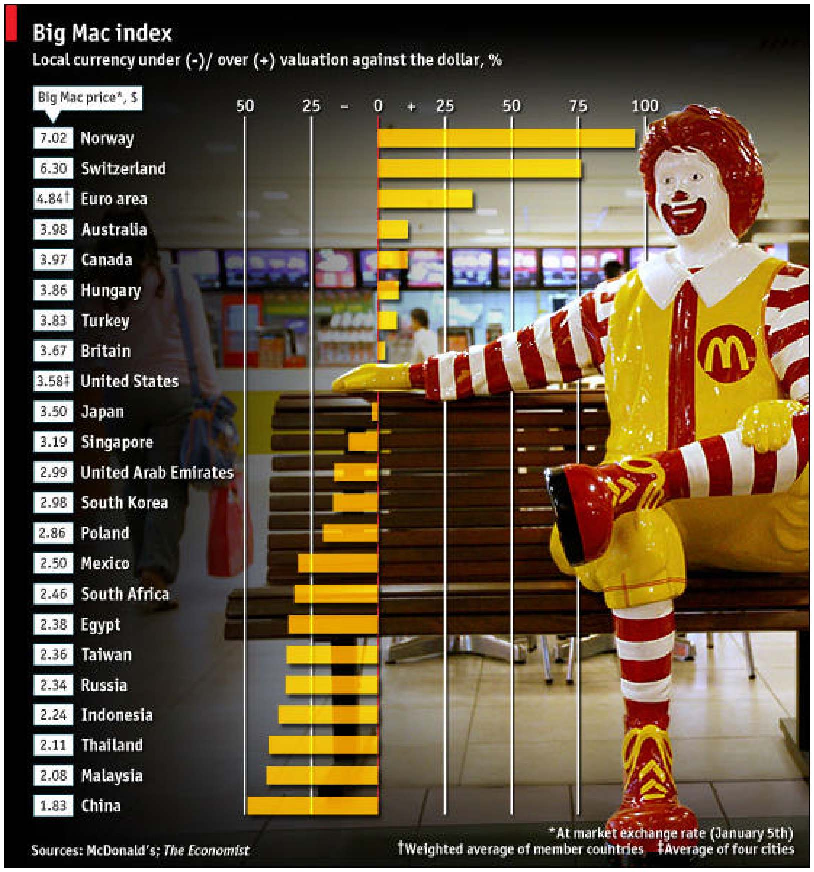
We would not expect to see 30-year Treasury yields already sub-4%.

No -- The current “bubble” (if there is one) is not in equities, but in the things people are flocking into *in lieu of equities*. Let that read JGBs, the yen, and T-Bonds. These latter three assets should generally be avoided like the plague.

In the meantime, where *should* one be hiding?

In our mind, a portfolio mix of approximately as follows makes sense:

20% long the Chinese yuan ETF…the recent trickle of noise about revaluation should with time turn into more of a torrent. The Big Mac Index tells us this.



The Chinese know that they need to let their currency appreciate. Now it is just a matter of it actually happening – and the pace. We have an initial target for the yuan near 6.35. The yuan is an adequate store of value in an otherwise difficult world to find such.

20% long the Hong Hong market as represented by the EWH ETF…If Hong Kong companies have major holdings in China, then the rising yuan over time will only produce knock-on added profits in Hong Kong. We see a missing high in this ETF still to be reached up near 18.35.

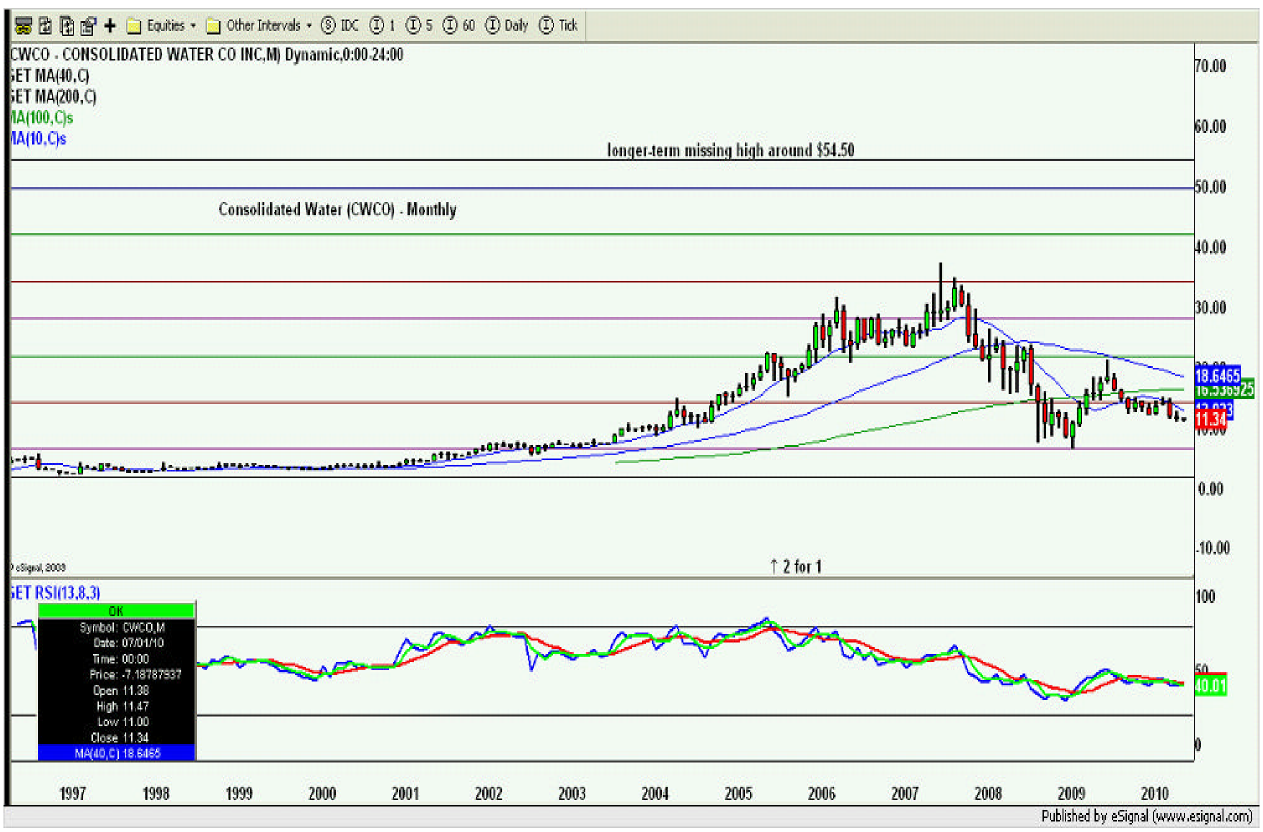
20% long Uranium-oriented assets such as U-CN, UUU-CN, and CCJ…Nuclear power plants are on the drawing boards almost everywhere globally, and the Chinese and Russians are already trying to lock in their future supply chains. Now is the time to buy into this space. Not later.

20% long the agricultural/meats sector as represented by the DBA and COW ETFs. If there is one constant, it is that there are more people in the world who generally want to eat more and better – particularly in China. If there is a second constant, it is that global weather patterns are increasingly fickle and strange these days, and water table levels in China are dropping.

Anything ag-related should hold some deep value longer-term, and anything protein-related should do well as more people in China can afford to eat meat.

We specifically see SFD (currently around $14.20) as a takeout candidate closer to $25. ADY is another closely-held company that sells American milk powder and baby formula into China. I can think of few better businesses to be in at present. While this latter stock has recently been in a soggy retracement mode, longer-term we see a clear missing high in its fractal rhythm up above $48.

Then we'd add too our portfolio mix about 15% to water-related equities such as AWK and CWCO – in part for their stability and yield, and in part for their growth aspects. AWK appears to our eye to have a missing high up above $24. CWCO, which provides fresh water to a variety of Caribbean islands, should eventually be a $50+ stock someday.



A few stable large caps on the long side totaling 5% of one's portfolio are also likely fine. XOM might be one good choice -- now trading under its 2008 low, and sporting a fractal rhythm that implies a "missing high" up at around 102.84. CL, KO, or CCE (not pictured) might be other reasonable large cap companies to consider.

As a volatility-muting counterbalance to the above longs, and with a stand-alone chance to fall from grace of their own accord, we would then suggest a combined 20-30% short position in certain high-flying cult stocks such as BIDU and CMG, and certain over-priced consumer-sensitive stocks such as HFL and LTM.

CMG - CHIPOTLE MEXICAN GRILL INC,W) Dynamic,0:00-24:00
CMG - weekly
0.000 (155.15)
0.090 (144.730836)
0.236 (127.85896)
0.382 (110.97552)
possible target
0.500 (97.33)
0.618 (83.68448)
0.764 (66.80104)
0.910 (49.929164)
1.000 (39.51)
Apr Jul Oct Jan Apr Jul Oct Jan Apr Jul Oct Jan Apr Aug Nov Mar Jun
2007 2008 2009 2010
Published by eSignal (www.esignal.com)

HLF - HERBALIFE LTD,W) Dynamic,0:00-24:00
HLF - weekly
0.000 (53.11)
0.090 (49.416801)
0.236 (43.43636)
0.382 (37.45182)
possible target zone
0.500 (32.615)
0.618 (27.77818)
0.764 (21.79364)
0.910 (15.813199)
1.000 (12.12)
Jan Apr Jul Oct Jan Apr Jul Oct Jan Apr Jul Oct Jan Apr Jul Oct Jan Apr Aug Nov Mar Jun
2005 2006 2007 2008 2009 2010
Published by eSignal (www.esignal.com)

As a very last step, maybe sprinkle in a few JGB shorts (chart pictured earlier above) or T-Bond (TLT ETF) shorts, and overall, you likely will end up with a portfolio filled with steady profits over time.

There will, of course, always be some noise and angst on a day-to-day basis with such a portfolio. Could the market still stumble a bit lower in the short-term (i.e. between today and the week of July 12th)? Certainly. Will one need to remember to build other shorts on any substantive rally later on? Most certainly again. Might we be playing for short-term pops that end up smaller in magnitude than some of the fractal pictures above? Yes again.

This market is not one to get married to. Positions are to be rented and then harvested when their risk-reward profiles eventually become less compelling.

Right now, we see the bulk of the risk-reward pointing to being more long than short equities – but selectively – and only really for a trade.

As examples of sectors where we do not see opportunity at the moment, we have no ambition to be either long or short of the precious metals sector. While gold might easily still pop to $1300 or so in the short-term, there is no "easy trade" in that sector. Regardless of whether gold makes one more advance or not, someday soon, gold should eventually flush out a bunch of speculators like John Paulson, and when that trap door opens, you don't want to be anywhere nearby. The precious metals are currently a very crowded trade.

We also see few compelling trades in the financial sector. While technically we see bullish opportunities in a few financial names and the IYF ETF, fundamentally we are wary that the past problems of Fannie Mae and Freddie Mac are still lurking in the background – effectively unresolved. We are wary that bank yield curve bets (induced and encouraged by the Fed to get banks healthier) could eventually hit problems. Regulatory realities also remain murky. So with a mixed picture of cross-currents between technicals and fundamentals, why feel compelled to play in that space? Why not just leave financials alone?

The above are our views at present. We are not naturally good equity bulls, and we acknowledge that some of our earlier cycle work does not support getting overly bullish before mid-June 2011. But we have to deal with what the market gives us, and for now, yet another 4-6 week swing move higher would appear to be in the short-term cards.

Send us your comments at information@Sandspring.com.

AN IMPORTANT DISCLOSURE