Sand Spring Advisors LLC

Looking for a Trigger into Sep 24-25th

by,

Barclay T. Leib

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We wrote in bold letters in early August:

> **"Whatever the markets are doing into August 27-28, it will likely be correct for traders to do the opposite from that window of time into September 24-25, 2010.**
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> **If, for example, markets leave a minor high August 14' 2010, and then start what initially might appear to be a significant decline into August 27-28, 2010, one should expect yet another significant reflexive reaction (likely driven by some sort of governmental policy response) into September 24-25, 2010. Any high left in this latter window of time would then likely lead to a grudging decline back down and a more significant low in mid-June 2011."**

In point of fact, equity markets bottomed exactly on August 27th, and have been vaulting higher ever since. Investor sentiment – which in late August was as bearish as it had been since early 2009 – has now popped significantly higher. Hedge fund shorts have been squeezed.

This "on-again off-again" compulsion of investors and traders to chase prices first higher (March-April), then lower (May-June), then higher again (July), then lower yet again (August), only to now chase them higher one more time in September is emblematic of a market full of frustrated investors desperate to get their hands around a trend of some sort, but relatively lost as to what that trend really is. Hedge fund and mutual fund managers keep trying to "get onsides" with the market, but have little fundamental conviction what exactly "onsides" actually is. The result of this behavior is schizophrenic volatility belying faux underlying factors within the markets (mostly government-created, in our humble opinion), and a huge ongoing push-pull as to whether these faux influences will be revealed for what they are (perhaps the ultimate Ponzi scheme), or simply allowed to persist and build.

With regard to the economy as a whole, we are reminded a bit of the housing market circa late 2005 or early 2006. All the imbalances in housing were clear in late 2005-early 2006, but the unwinding of these unbalances initially took longer to come undone than any rational investor might have expected. Then, almost in entropic fashion, everything came apart very quickly. Just as housing suddenly imploded in 2007, so too do we expect all the governmental market manipulation attempts of 2008-2010 to suddenly come undone in a "wush" someday soon.

Our best guess is that this "unwinding" will initially be driven by something **beyond the immediate control of U.S. bureaucrats. It might easily be a major California earthquake, the**

outbreak of a new major war, or a sudden implosion of a foreign economy. In this latter regard, debt pressures on Ireland and Spain have started to build again, but we find ourselves even more transfixed by China than Europe.

China is a country that effectively at present accounts for the large majority of global growth. *As goes China, so goes global commodity and equity markets* – or so it has felt while watching the macro inter-relatedness of markets for awhile.

And yet China has been achieving this growth in a very artificial way: by building skyscrapers and indeed entire cities (see Nov 2009 video: http://www.youtube.com/watch?v=0h7V3Twb-Qk) that no one is actually living in – but instead just investing in. While markets in the U.S. have undoubtedly been rigged by quantitative easing and other tactics, China is the ultimate faux environment of big government trying to create an economic picture which obfuscates reality. As communism has met capitalism, a very strange economic experiment in motion has resulted.

We wrote in early 2010 that watching the behavior of the Chinese markets was likely the key to understanding trends in the U.S. equity, fixed income, and commodity markets. We wrote that U.S. market hours often now feel very much like "night-time hours" waiting until Asia re-opens to thereafter set a more definitive tone for global capital market behavior. China's monthly data releases have certainly started to nudge out our own GDP and Unemployment releases as numbers that fundamental investors most eagerly anticipate.

Across a choppy 2010, we then stopped focusing on China for awhile. As the U.S market flailed around, China seemed content to quietly range trade. But as we approach our September 24-25th pi cycle window of some importance, we find ourselves drawn back to this key market once again.

Of late, the Chinese A and B shares have been wobbling a bit – even as the Hong Kong market has been very firm and the renminbi has started to move a bit more swiftly higher.

Even if one buys into China as a long-term growth story, Chinese A Shares <u>in the short-term</u> seem poised to our eye to visit a downside technical target of 2340 first – about a -14% move down from current levels.

There are a variety of potential downside targets for China B shares, so the path depicted below is very tentative, but a correction of some sort also appears likely in this pattern. Maybe it will only be a C-wave within a corrective A-B-C Elliott wave that began last April, but it should be a trend worth positioning for.

In terms of the FXI China ETF traded in our markets…. 32.20-32.50 would seem like a reasonable downside target range.

Meanwhile, the EWH Hong Kong ETF might ideally spurt to major resistance around 18.30 (maybe by next weekend), and then reverse lower.

It is possible of course that we are wrong in these views. Should the EWH ETF go barreling through 18.30-18.40 resistance, we would likely lose our conviction for a turn lower. We also have five more trading days until our pi cycle window hits. Should the Obama administration suddenly offer up an extension of the Bush tax cuts, markets could celebrate for a few days longer (maybe as high as 1170 on the S&P 500) before <u>only then</u> turning lower. Whatever the immediate price behavior, it would take a sustained move above 1170 on the S&P to make us question our overall bearish cyclical roadmap from September 24th onward.

As one added note, readers may remember that we have been looking at late 1939 as a possible analog for 2010. In that former instance, prices shot higher in early September 1939 and then simply stalled. There was no immediate collapse lower. Instead a quiet “grind lower” period began, with the collapse not coming until the spring of 1940. Such a stultified result is also possible in 2010.

Also keep your eye on other extended markets – maybe even gold – for potential signs of reversal. Pi cycle dates are when previously popular but over-crowded trades have a tendency to come undone, and if we are right on China weakness, then inflation hedges in the short-term could easily do poorly. We will certainly update this brief article in real-time as the behavior of markets into Sep 24-25th may dictate and require.

In addition, please note that while we are calling for some equity weakness in the short-term, we also remain steadfast in our belief that the real excess in the world lies in the fixed income markets, not in equities. A combined sovereign debt and muni-market crisis truly brews. But we do not immediately see a fixed income market implosion. This will take longer to gestate.

As one savvy muni-manager discussed with me in late August: “There is little doubt in my mind that the City of Chicago will default on its debt at some point over the next five years. I just don’t see a way that they can avoid it, and when I privately asked the two major rating agencies to show me a way that Chicago might avoid default, they could not do so either. But in the short-term of course Chicago will do everything it possibly can to avoid that outcome – not to miss a payment. And as long as they don’t miss a payment, people will keep lending to them to pick up the extra interest spread." Let this read in effect: "Just the same way that banks kept lending to sub-prime borrowers for a tad too long, so too will the muni-market one day wake up to a disaster – already fully developed – sitting on its doorstep."

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