Sand Spring Advisors LLC

No Endgame except for Sand Spring

by,

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After a twelve-year run of publishing monthly articles under the Sand Spring umbrella, this will be my last letter. ☹

I have never made huge sums from Sand Spring's subscription revenue base, but kept Sandspring.com going more out of a passion to formally document and explain the hidden mathematical rhythms in both the amplitude and duration of market moves.

I cease publication at the request of the global long-short equity fund, Glenrock Inc., for whom I also act as their Head Trader. In an overly bureaucratic world, there is a need to avoid even the whiff of a potential conflict of interest by being involved with two separate businesses at the same time.

This is a sad moment for me. At its height in late 2006, Sand Spring Advisors LLC managed close to $100 million in its fund of funds offering, provided in-depth consulting services in the hedge fund due diligence area to a number of different clients, and was producing financial articles not only for Sandspring.com, but also for publications such as *Plan Sponsor*, *Derivatives Strategy*, *Financial Executive*, and Hedgeworld.com. It was truly joyous to run one's own business, and to be busy with a variety of different projects.

While my fund of funds portfolio survived better than most in 2008, that year was still a difficult affair. It's when I saw the real underbelly of fund of funds investing. As of 2007, I had made a specific attempt to find managers who I believed would thrive in a high volatility environment. I specifically allocated 20% of my fund to four volatility-oriented hedge funds. I wanted nimble traders with a positive vega and gamma profile (sorry for the options lingo for those who don't understand such). My belief was basically that all hell was going to break lose in 2008, and in actuality, it did.

Sadly, this is when I learned that managers don't always do what they are supposed to do. One volatility manager performed adequately with a +15% year, but three others all screwed up. One of these other managers decided mid-year that volatility had become too extreme, and started buying illiquid European convertible bonds that made his fund synthetically short volatility. As soon as I heard this, I put in my redemption notice, but before this notice period was up, that manager was down approximately -20% on the year. A second volatility manager had gotten inspired for some reason by a bio-tech "special situation" that sized at 15% of his fund, ended up going to zero, and wiped out all of his other long volatility gains. That manager ended down about -5% in 2008. A third manager maintained a long volatility bias, but also a slightly long beta bias, and broke even for the year.

There were no disasters – no outright frauds – no Bernie Madoffs. But altogether, I was disappointed not to have been able to perform better in my portfolio construction, despite having had the right overall macro view. Despite the Sand Spring Fund LP having easily outperformed the major FOF indices by over 600 basis points in 2008, my largest investor was also somewhat nonplussed by the general negative publicity swirling around hedge funds at that time, and with his own liquidity need to pay some hefty tax bills (while most of his other investments were even further in the sewer and more illiquid than my fund), he used the Sand Spring Fund as his source of cash via a series of redemptions.

That was the beginning of the end for Sand Spring Advisors' fund of funds offering. And without that core business, maintaining Sandspring.com as another portion of my activities became more difficult. The folks at Glenrock Inc were most gracious to allow me to do so as I initially consulted to them on their portfolio management, but as they now register with the SEC as a Registered Investment Advisor, I understand their angst to tie up loose ends that might potentially irritate some overly nudgy SEC auditor someday.

But enough with past history and explanations as to Sandspring.com's current sad ending. At least on one good note, in my 2011 personal trading, I caught the equity decline in Europe; I caught portions of the copper and gold market declines during the year; and I was generally nimble enough to deliver a +33% overall gain for the year. I think that there are few other money managers who matched that type of return in 2011. It was certainly a far stronger performance than I delivered in 2010.

But before I leave you, let's look to the future of the markets. What are the next big trends?

In somewhat similar fashion to Byron Wien who puts out his ten prognostications each year at about this time, I will start with a general overview, and drill down to more specifics as I go along. I will most assuredly get some of these prognostications wrong, but hopefully will get more right than otherwise.

Prognostication #1: There will be no successful endgame on the part of the Fed and ECB given their current path. While these authorities – with their monetary stimulus, loan shuffling, and quantitative easing actions -- may ultimately succeed to keep "the game going" so to speak by eventually rekindling economic activity and job growth – this is unlikely to transpire before another period of crisis. In the end, authorities **will risk destroying even more wealth in global bond markets than the wealth that they create in job markets or equity markets.**

Along the way, everything is likely to continue to be a slow "start-stop slog" – a "jump diffusion" world with moments of sheer fear and apoplexy followed by slow grindy market ranges and retracements. **Q1 2012 should be particularly dangerous, but without significant follow-through to the downside thereafter.** Overall, there will be few truly explosive moves until we get to the 2017 period when the current overall market malaise that started in 2000 is scheduled to come to an end.

In your trading, it will be important to <u>not</u> try to hit home runs, but to just try to hit singles and doubles. **This will likely still be a world where you will do well by rotational short-selling different assets. But remember to book out profits before they evaporate. The push-pull between bull and bear paths will be at best a range trading affair on an overall basis, and not an environment where buy and hold (or alternatively sell and hold) investment styles will do well.**

When the authorities seem to be winning in their battle, look for equities to grind higher, gold to firm up, the Australian dollar to be popular (1.15 remains a "missing high" fractal target that I still see at some point here), China growth to appear stable, and U.S. Treasuries to soften. These periods will create swing moves that will last between 10 days to a few months at most. As 2011 comes to an end, we would currently appear to be in at least a mini swing move higher along these lines.

But when the authorities seem to be losing the battle, equities will be soft (likely led lower by European and BRIC countries), copper will be leading gold to the downside, the euro will be declining, China will be declining, and U.S. Treasuries will be temporarily popular.

In the end, when all is said and done, equities are likely to end up trending sideways to lower until 2014, bonds will trend lower, and gold will also likely end up lower as well as the U.S. dollar firms. **This remains a debt deleveraging world, and as such, it will not be a great deal of fun to trade, but instead more a "bad dream" repeat of 2011. Rotational short-selling of a variety of asset classes remains the correct overall mindset to maintain.**

Prognostication #2: As markets meander along, potential 2012 turning point dates to be attentive of will be:

March 1, 2012 (low after early 2012 swan dive lower?)

July 10, 2012 (intermediate rebound high?)
and
November 17, 2012 (expected more major low).

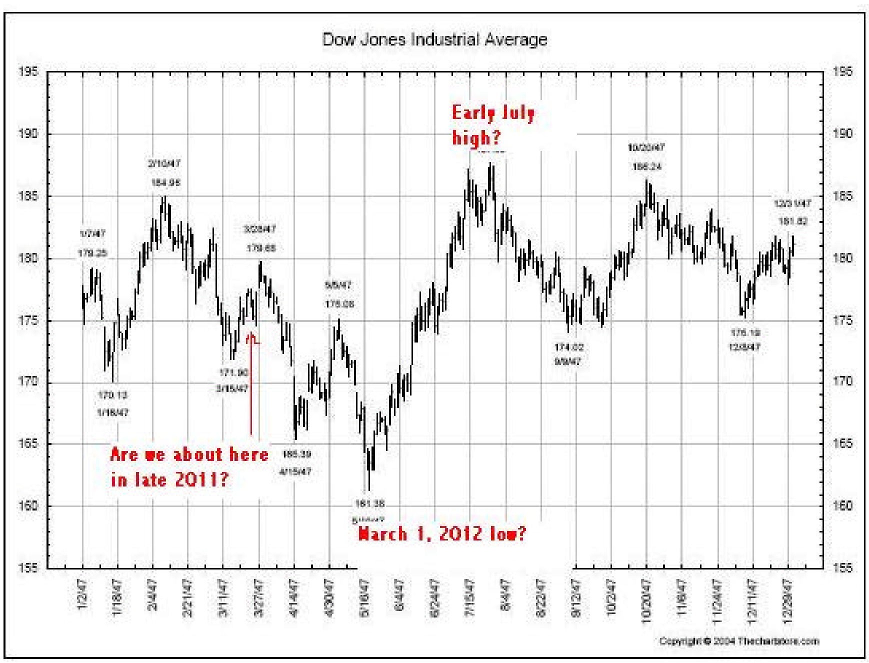
These dates are all related to the historic pi cycle turn dates of July 20, 1998 (equity high in front of the LTCM Crisis) and the February 24, 2007 pi cycle turn date (historic tights in mortgage credit spreads).

In my humble opinion, **November 17, 2012 is likely to be an equity market low, but it could come above the more panic-oriented low due around March 1, 2012.** If a mid-November low comes just after Barack Obama is reelected, and people are disappointed to still have a liberal democrat in the White House, then Obama's second term will turn out surprisingly more successful than his first. If instead, another candidate is elected, this latter candidate will be viewed as the savior and have a somewhat easier time of things than Obama did across 2008-2012. There will be no overall "clear sledding" until the 2017 window of time, but pi cycles suggest that November 2012 to September 30, 2015 should be a somewhat easier time politically – particularly between mid-2014 and late 2015.

Prognostication #3: If there is one historical analog pattern that may match our view of U.S. equities the best, it is the period between early 1947 to mid-1949. This was a slow slog to new lows in post-War America, but with some sharp intermediate rallies along the way. In 2012-2014, it should be a similar slog to new lows as revolts and protests continue to materialize globally against perceived economic wealth inequalities. There will be a change of sentiment for the better after March 1, 2012 and then again after November 17, 2012, but similar to the three years below of 1947 to 1949, 2012-2014 should represent overall a slow step-and-stumble lower. Only look for a victory celebration of some sort by the market between the latter half of 2014 to September 2015.

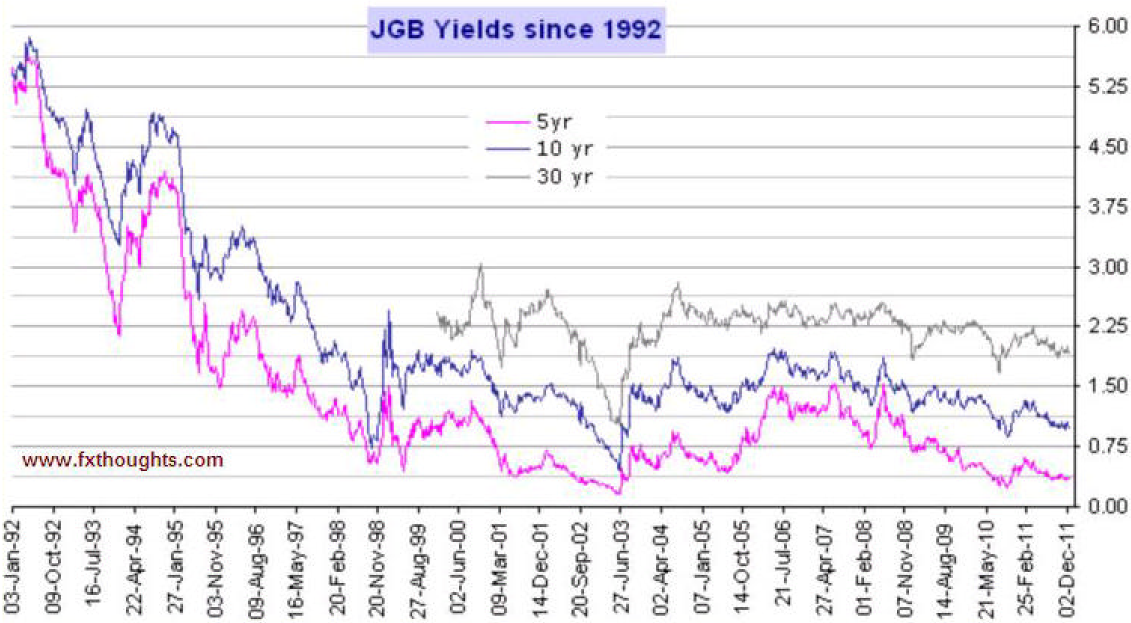
1947 to 1949

Zoomed-in view of 1947 alone as possible 2012 roadmap

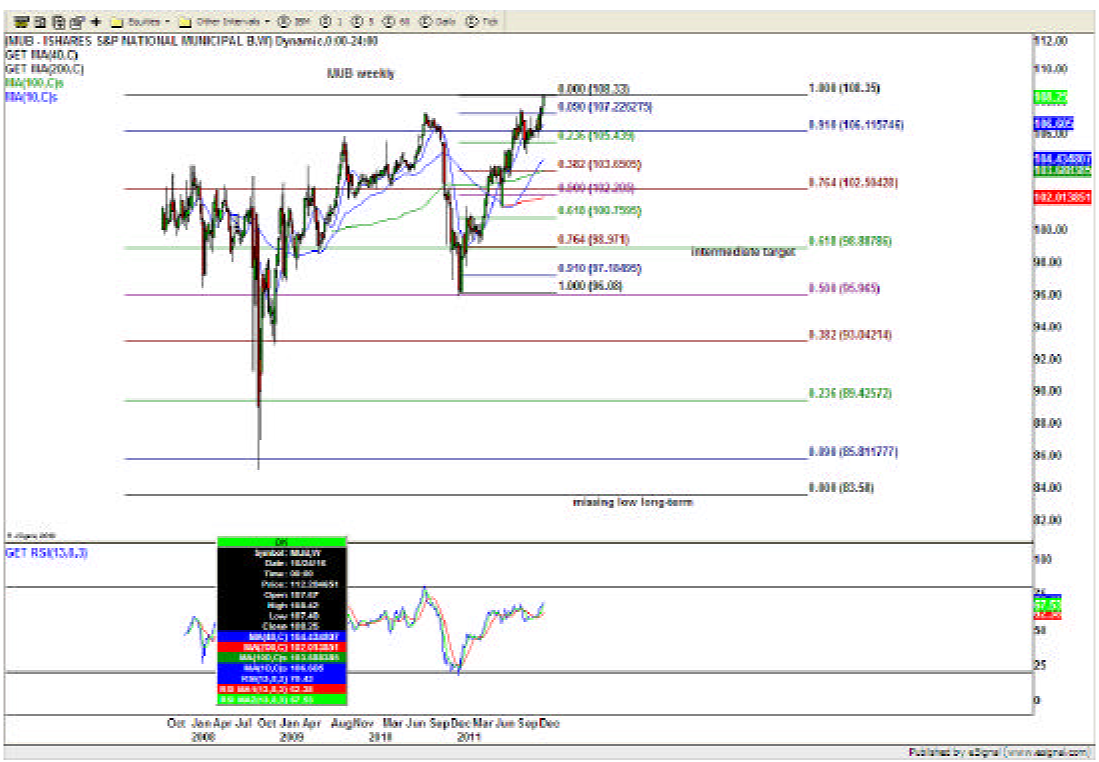


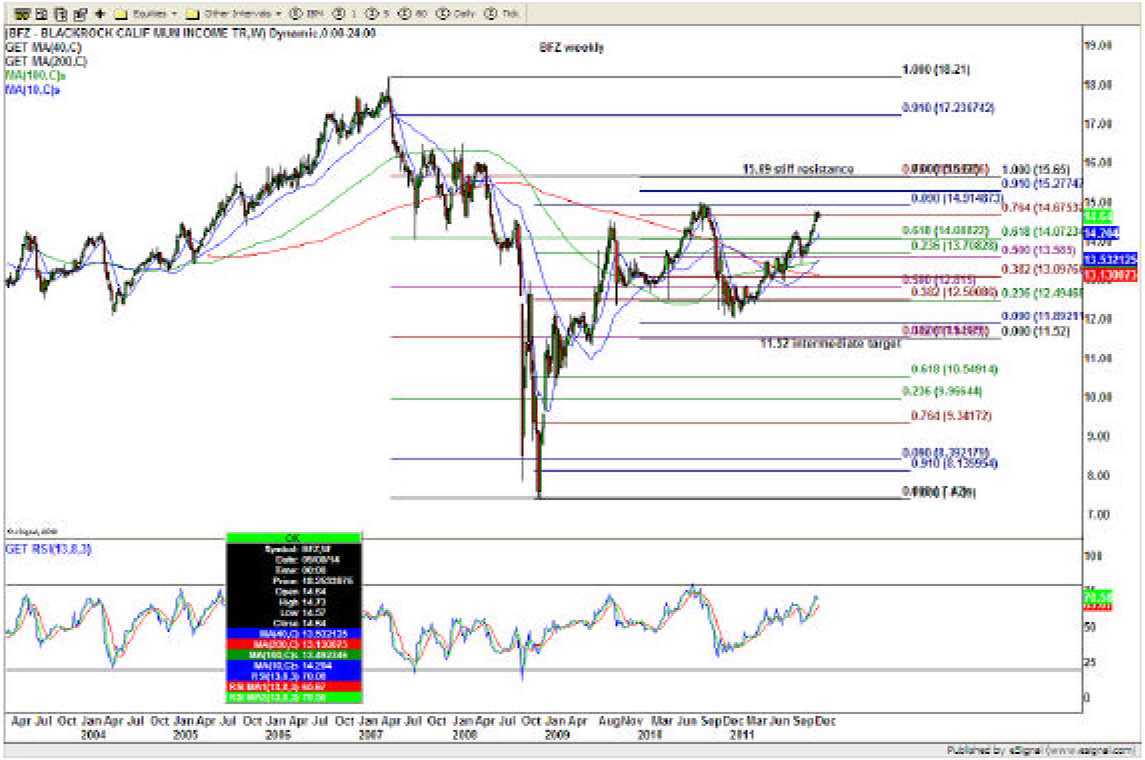
Prognostication #4: In the grope for yield and returns, money has migrated in recent years to venues and instruments that are ripe for disappointment. Russia and BRIC countries should specifically fall from grace in early 2012 as compared to the all-in currency adjusted return of U.S. investments. Thailand is another market that should spike lower sooner rather than later – likely in early 2012. I have previously pointed to Thailand's chart pattern resembling that of Japan in mid-2008. I update that chart comparison below together with the EEB BRIC country etf path that seems likely from a Fibonacci fractal point of view.

Prognostication #5: At long last JGBs will fall from grace – likely in Q2 & Q3 2012. This is one of our favorite trades for mid-2012. Hedge fund manager Kyle Bass has it right that Japan faces a demographic debt funding imbalance that represents a ticking time bomb. And unlike the U.S. -- where we owe much of our indebtedness to foreigners (foreigners who can potentially be screwed by rule changes, inflation, etc.) --Japan owes its debt to itself (somebody domestically is going to get hurt). And when JGBs start to fall, the yen will likely go with it. A declining yen could actually buoy Japanese equities a bit (at long last), but for bad overall macro reasons, not good reasons.



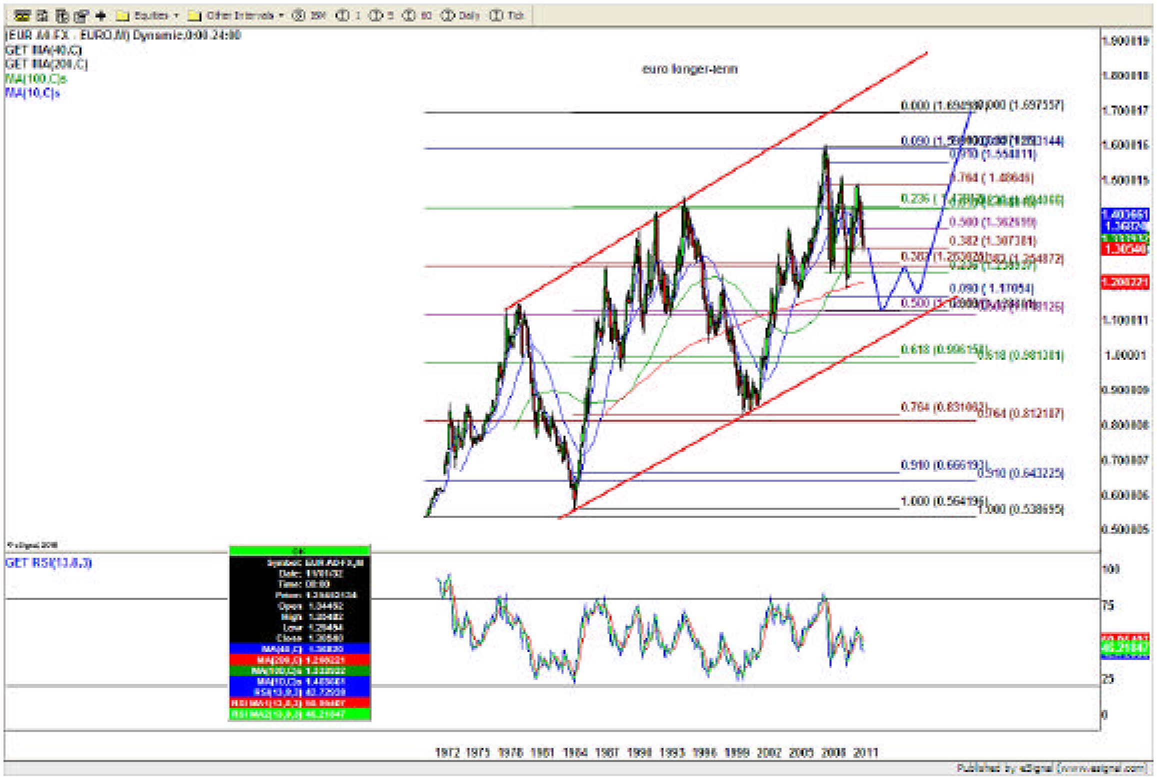
Prognostication #6: U.S. muni-bonds will also fall from grace. Stocks represent some modicum of intrinsic value and inflation protection; bonds do not, and bonds issued by increasingly stressed local municipalities represent little value at all. We remain short MUB and BFZ etfs even though our bearish call here has yet to offer much satisfaction and may be premature.





Prognostication #7: While gold could poke its way back towards $1850 an ounce in the short-term, this will be at most a short-term trade, and gold will make a poor overall investment between 2012 and 2017. $1490 and $1230 are two support levels destined to be revisited with time. A stronger dollar will be one problem here across 2012.

Prognostication #8: The euro longer-term may be destined to someday reach 1.70, but before doing so, will likely poke down to 1.13-1.19 first. There is a clear missing low formation here.



Prognostication #9: China is a short-term house of cards that will fall even further from grace in 2012 before rebounding longer term. On the FXI etf we will try to buy as $24 is approached. Longer-term, there is a missing high up near $78 still to be seen. September 2015 might be a likely time for such.

Prognostication #10: Over the next decade, academic theory will slowly come to embrace the fact that the herding behavior of people as expressed in markets creates non-random fractal chart rhythms based around mathematical constants such as pi and phi. I have not always interpreted these rhythms perfectly, but I have a deep respect for their existence.

I only hope that these pages have helped others appreciate this view as well.

While Sandspring.com is formally ending, please stay in touch in any way comfortable to you. I have certainly appreciated and enjoyed all the feedback from my readers over the years.

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Sand Spring Advisors provides information and analysis from sources and using methods it believes reliable, but cannot accept responsibility for any trading losses that may be incurred as a result of our analysis. Our advice should be deemed our personal opinion and not a recommendation to invest. Individuals should consult with their broker and personal financial advisors before engaging in any trading activities, and should always trade at a position size level well within their financial condition. Principals of Sand Spring Advisors may carry positions in securities or futures discussed, but as a matter of policy we will endeavor not to trade such securities on or near commentary release. The Principal of Sand Spring also offers technical trading advice to an outside hedge fund manager who may at their own behest be involved trading some of the securities mentioned.