Sand Spring Advisors LLC

Slouching Towards Great Angst

by,

Barclay T. Leib

March 13, 2011

As a general rule, it is probably an imprudent step to start a monthly letter by citing a prophet who was addressing multiple centuries of time, while we trade by necessity across daily, weekly, and at most monthly intervals.

But hell, I can't resist.

As some readers may know, the prophet Nostradamus wrote about a Third World War emerging out of the Middle East that eventually spills over to Europe. Quatrains such as the one below set the general tone:

> **The Arab Prince Mars, Sun, Venus, Leo,**
> **The rule of the Church will succumb by sea:**
> **Towards Persia very nearly a million men,**
> **The true serpent will invade Byzantium and Egypt.**
> **~ Nostradamus Century V, Quatrain 25**

Within some of his quatrains, Nostradamus makes specific reference to Libya, albeit mostly in a somewhat obtuse manner.

> **From the East of Africa shall come the heart of Carthage**
> **To vex Venice and the heirs of Romulus,**
> **Accompanied by the Libyan tribe,**
> **Malta shall tremble and the neighboring islands shall be empty.**
> **~ Nostradamus Century 1, Quatrain 9**

Some think Quatrain II:5 may make reference to Libya's Colonel Muammar Muhammad Khaddafi potentially using a submarine to arrive in Italy:

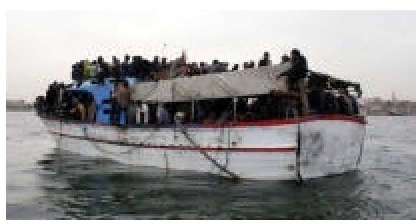
> **When weapons and documents are enclosed in an iron fish,**
> **out of it will come a man who will then make war.**
> **His fleet will have traveled far across the sea**
> **to appear near the Italian shore.**
> **~ Nostradamus Century II, Quatrain 5**

Libya does indeed possess two Foxtrot Class submarines purchased from the Soviet Union in the 1980's.

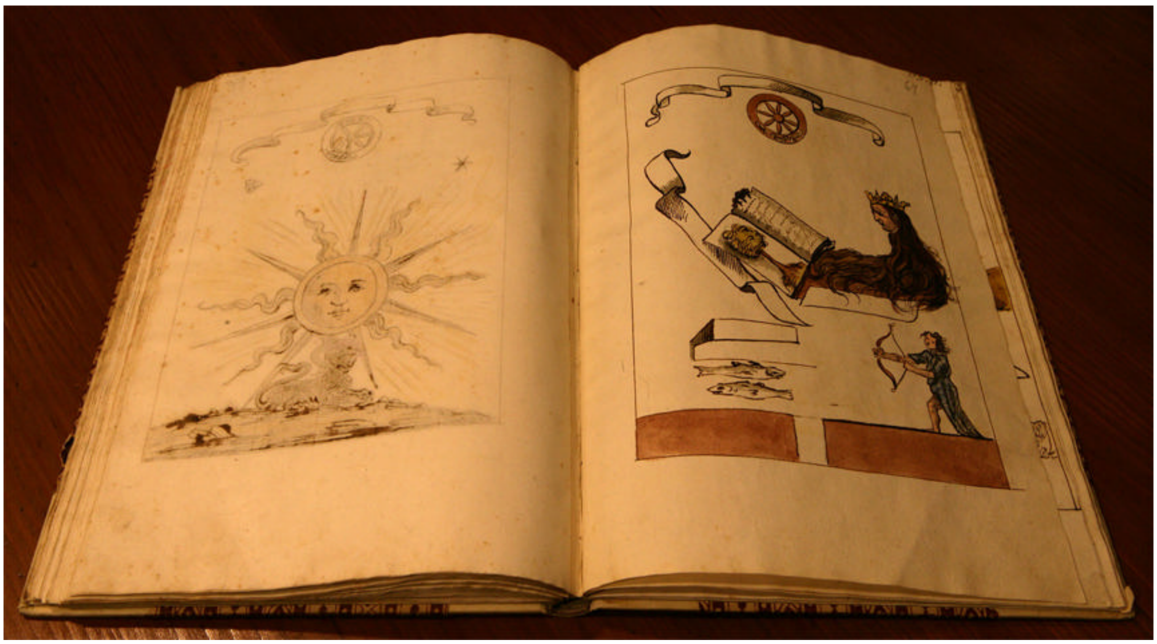
Whether this reference is indeed to Khaddafi or someone else, Nostradamus repeatedly predicts the eventual rise of someone powerful out of Arabia who wreaks havoc in Spain and Italy, somehow arriving by the sea:

Out of the country of greater Arabia,
Shall be born a strong master of Mohammedian law,
Who shall vex Spain and conquer Grenada,
And by sea shall come to the Italian nation.
~ Nostradamus Century V, Quatrain 55

As readers of these pages know, I have long held that early 2011 would bring the outbreak of war that should witness some sort of escalation/accident by mid-June 2011 that then could possibly build across the solar sunspot maxima period expected in late 2012. Will the Arab world possibly just become such a mess that the exodus of people trying to escape the instability creates a stampede for European shores? Is a sea of Arab refugees what Nostradamus saw as he stared into his bowl of water late in the Provencal evening of the mid-16th Century?



In the drawings of the "Lost Book of Nostradamus" discovered in Rome just recently in 1994, a picture shows not only a burning tower (symbolic perhaps of the burning towers of 9-11), but also a burning horned king head attached to a monster. This may easily be symbolic of a powerful Arab leader leading the Islamic world to its own destruction.



As a “recipe for a crash” I have long believed that three key ingredients are needed at the same time:

-some major stress **financially**;
-something going awry **geo-politically**;
-something odd occurring **geo-physically**.

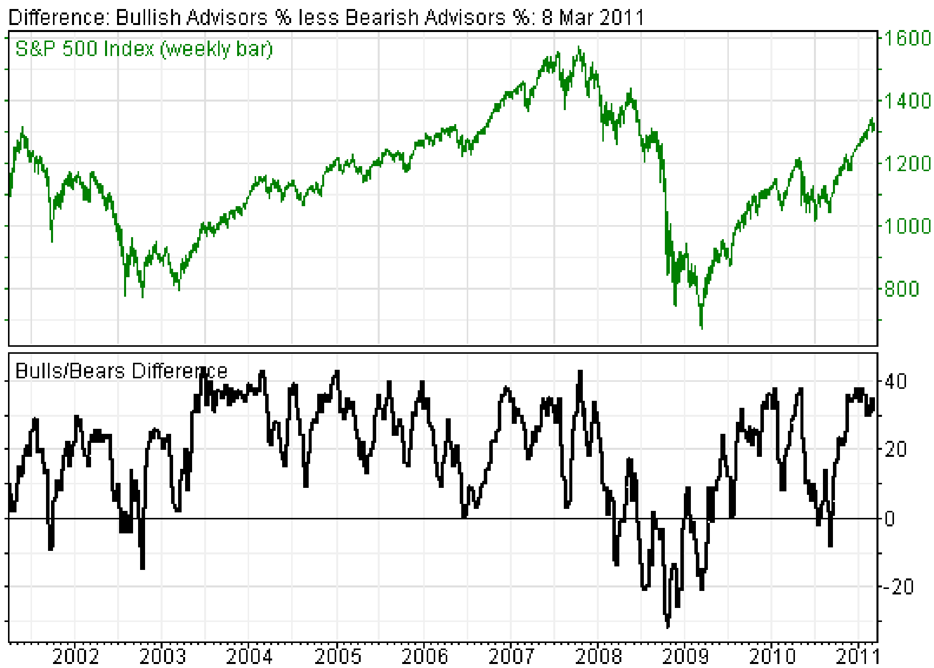
In the Crash of 1987 for example, we witnessed the following confluence of events which all occurred exactly on October 18-19, 1987:

- financially: Treasury Secretary Baker effectively said to Germany: “Tough luck if you don’t like it; let the dollar fall;”
- geo-politically: Reagan called in reprisal air strikes versus Iranian oil platforms;
- **geo-physically:** a freak hurricane hit London preventing most traders from getting to their desks that Monday morning.

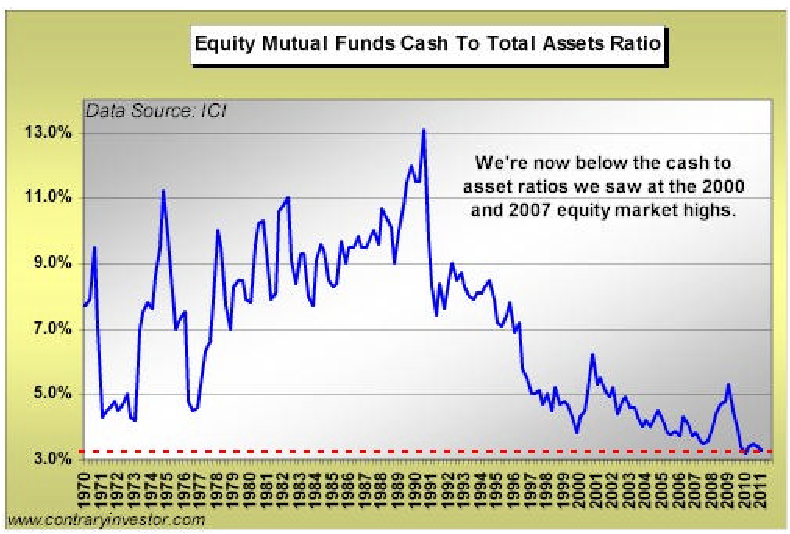
These events seem almost trite in comparison to what is currently brewing in 2011:

- **financially:** European PIIG sovereign debt are experiencing ever-widening spreads and refinancing stress;
- **geo-politically:** the Arab world effectively is on strike;
- **geo-physically:** earthquake activity has now humbled both New Zealand and Japan, and created a nuclear accident that may easily worsen.

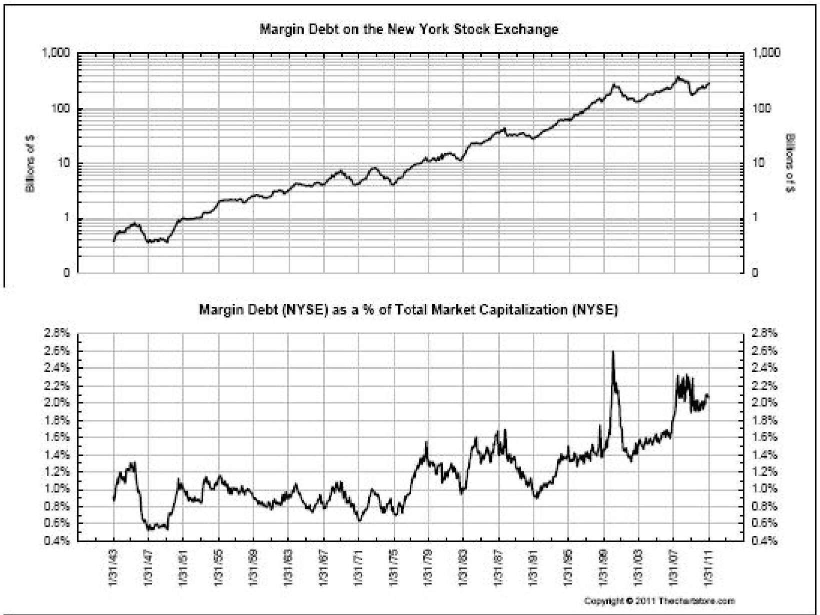
We know as well that market complacency is palpable. Investors' Intelligence Bull-Bear Ratio is near its historic upper extremes, while mutual fund cash levels are historically low, and margin debt levels are quite high.



Source: Investors Intelligence

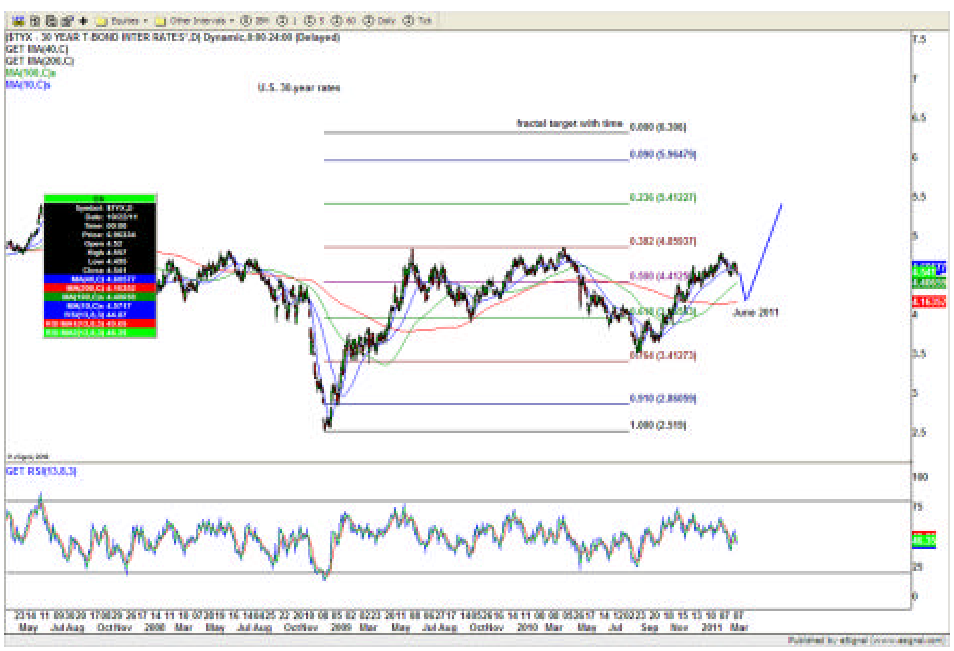


Source: contrayinvestor.com



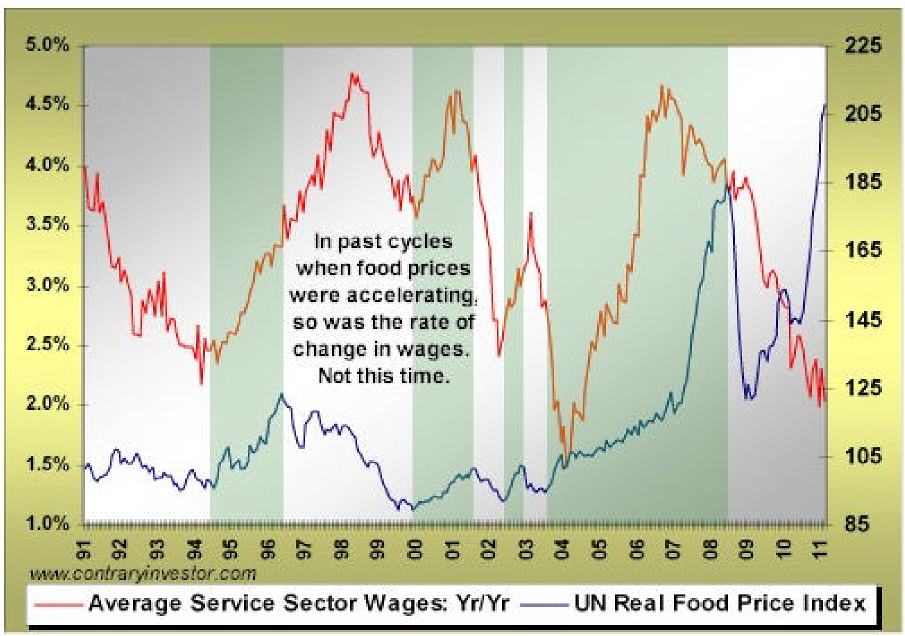
Source: TheChartStore.com

We also know that the Bradley Cycle pointed to a Feb 18th market turn, and the market turned perfectly down on that date. What started on February 18th should now extend at least to our PEI pi cycle crisis period scheduled to arrive by mid-June 2011. While some may argue (and it is of course possible) that this mid-June date could be a high in equities while a crisis in fixed income transpires (inflation finally coming home to roost in the destruction of our bond market), I think that this is unlikely. It would make more sense to my analysis to see mid-June as a time when the equity markets serve up a real whiff of deflationary pressures – a time when long-biased folks like John Paulson will be suffering, and as a result of an over-crowding effect, even gold could be falling. It will be a time when Bernanke will have backed himself into a corner and will find it hard to pull another QE rabbit out of the hat – particularly with the pressures of conservative oversight from the new Republican majority in the House of Representatives. The destruction of the bond market will then begin <u>beyond this period</u> as politicians once again try to react to the deflationary pain with ongoing methods of fiscal and monetary cheating around the edges. It is at this point that the bond market should truly revolt, but first a dip in yields on a "flight to safety" trade is more likely.



From a socio-economic point of view, one might consider ourselves somewhere akin to 1968-1972 when serious labor unrest started to spontaneously erupt across America (together with anti-war unrest). Somewhere about that period, I can remember Hunter College students coming down Lexington Avenue in Manhattan (where I lived at the time) setting cars on fire and breaking store windows. The recent anger of government union workers in the Wisconsin state house may be a whiff of the increasing anger in America now reemerging after a long hiatus.

The core problem fueling this unrest is the chart below: As food costs and general inflation have mounted, wages have not. This is a natural recipe for social angst both domestically and, as already seen in the Arab world, abroad.



Source: Contraryinvestor.com

And if 2010-2011 is somewhat akin to 1968-1972, where were stocks in this former period? Topping, but still quite bid. It took until 1973-74 for the real ugliness of the stagflationary economic situation to really hit home. So too do we now see the markets taking multiple more years before boom times in America will be able to re-emerge.

More specifically, the high-to-low 17.2 year pi cycle between the peak of the DJIA in real terms in 1965 and the August 1982 trough of despondency was followed by a 17.2-year boom period between August 1982 and late 1999. **This now has set up for another 17.2-year high-to-low period whereby the real period of despondency still looms out in early 2017.**

In between, June 2011 should be a panic low, 2012-2013 may see periods of attempted rallies, but ongoing tough sledding – particularly as one may expect bond

market problems during this period. October 2015 should then be an equity high of some sort, followed by a major low – akin to the Aug 12, 1982 low or the March 17, 1948 low -- on or about January 4, 2017. This latter period may easily be when the world's central bankers are forced to completely re-calibrate and re-set the financial world in some manner with a new set of Bretton Woods-like pronouncements.

We are thus at present in the following mode: **<u>sell every rally</u> because the world should get worse over the next three months, not better, and it should remain vulnerable all the way until January 2017 before a new 17.2-year bull will explode. By 2017, America's "Baby Boomer" retirement funding problems will be front and center in the headlines; CNBC may be facing financial stress from general disinterest and disgust; all the warts of U.S. fiscal and monetary excesses will be more widely understood; and long-only non-trading fund managers will be outnumbered by (or at least far less popular than) those espousing more market neutrality and short-term bop-and-weave trading. <u>It will be the perfect contrarian set-up to be a bull. But that will be then, not now.</u>**

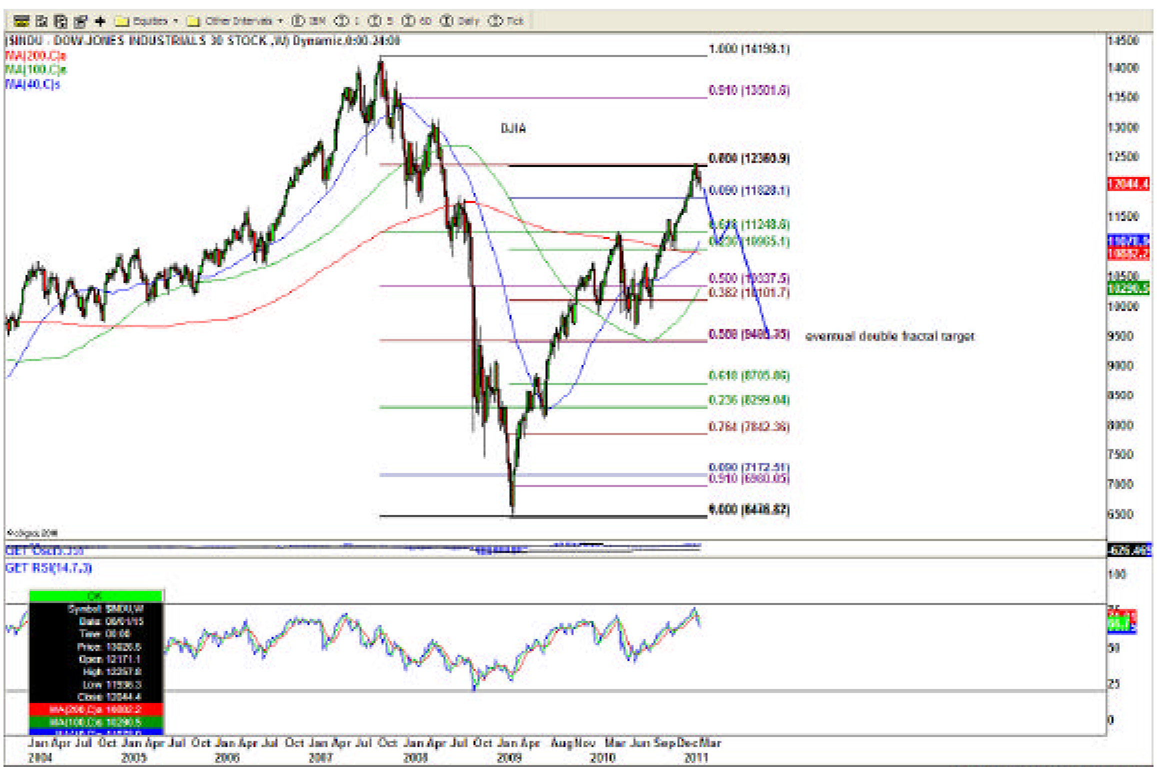
In the shorter term, and in addition to my previously espoused shorts in the XLY and IWM ETFs, here are some of my favorite chart patterns at present:

1) Market volatility is about to increase. Be long the Intermediate-Term VXZ ETF with an initial target near 66.6 and an eventual target closer to 76 – maybe by mid-June.

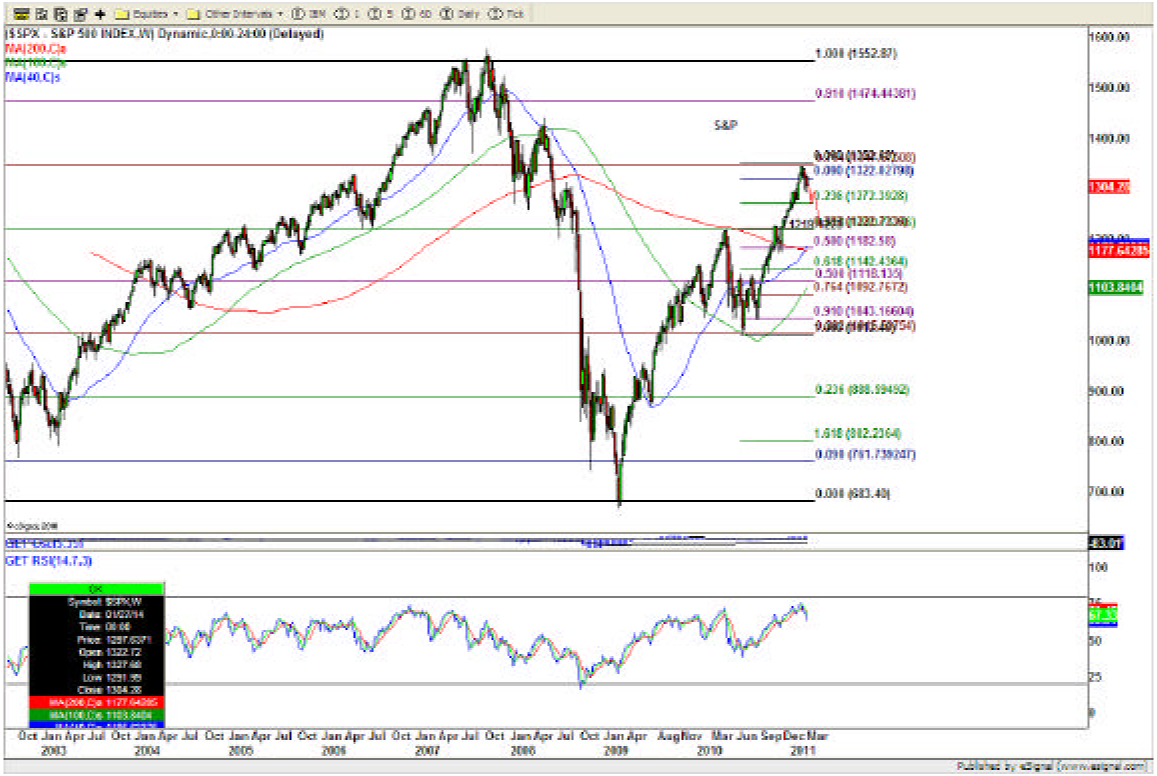
.

2) In a similar fashion as Boston Market fell from grace in the 1990's, look for Chipotle Mexican Grill (CMG) to do the same over the next few years.

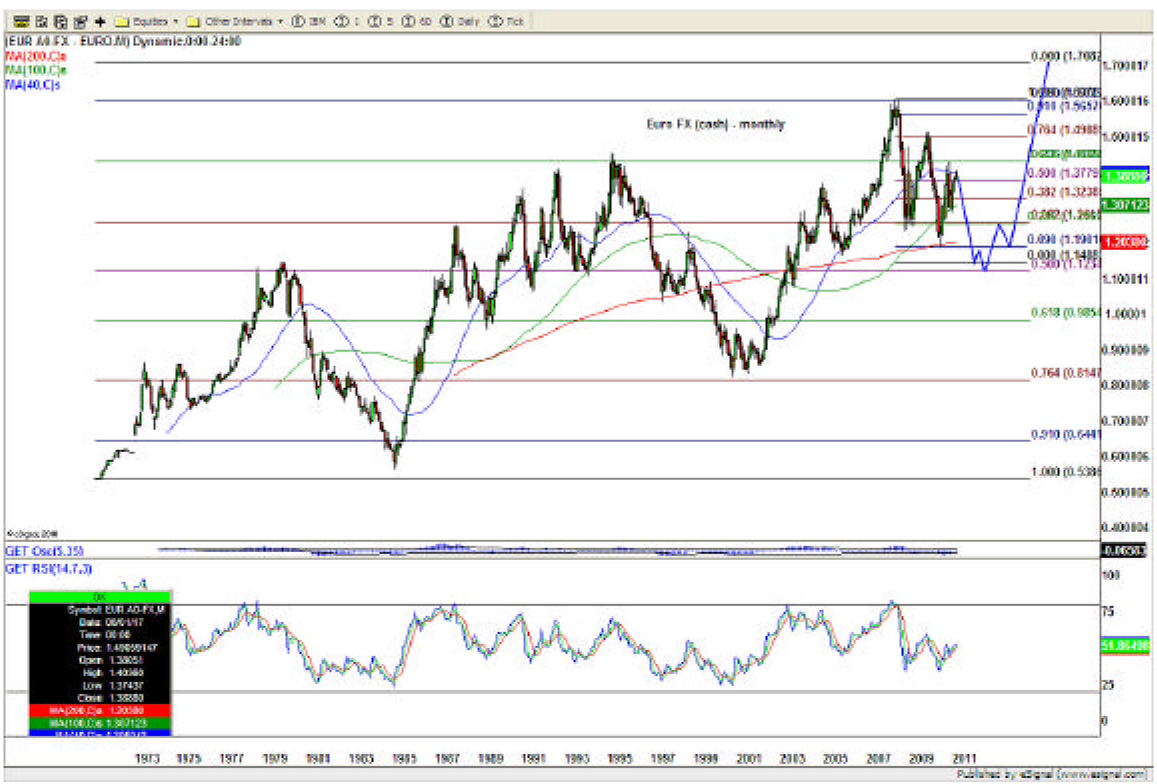
3) Look for DJIA 9400 as an intermediate-term downside target. The fractal rhythm on this chart is particularly clear.



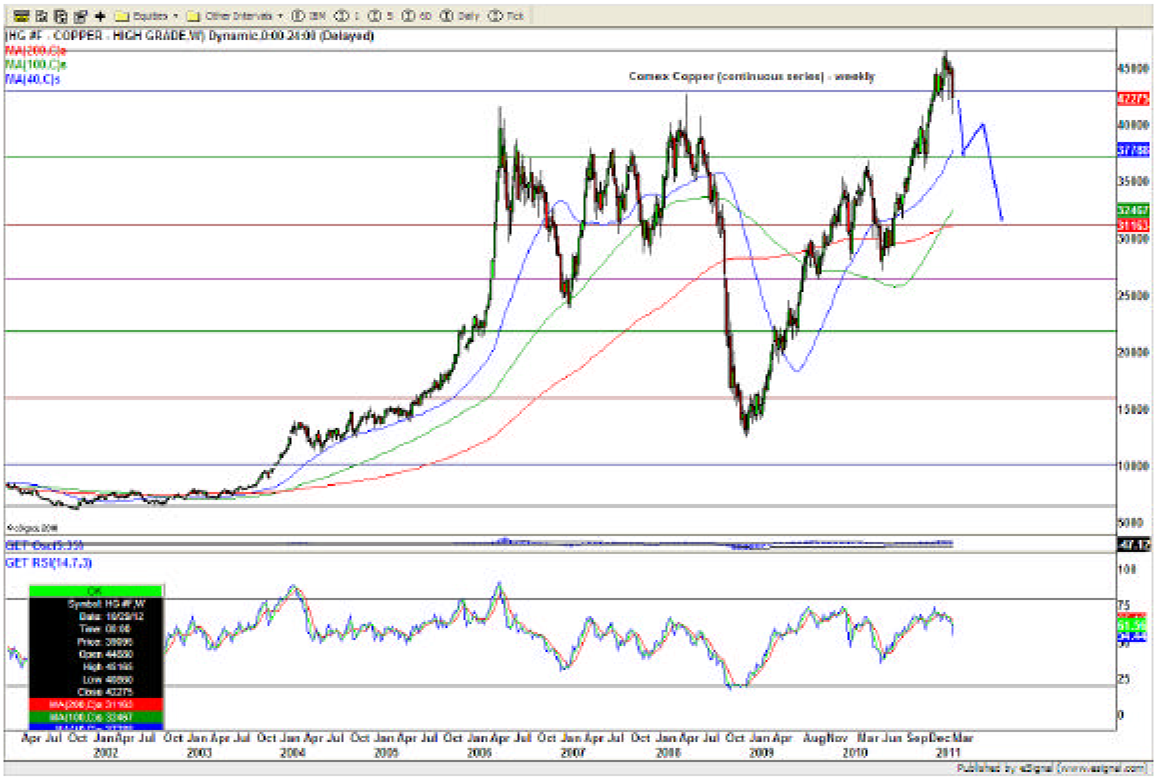
4) On the way to 9400 on the DJIA, and shifting to the S&P 500, 1219-1223 should be a first target zone on the S&P, followed by a bounce period, then down again.



5) As the equity market falls, the dollar is likely to rise – particularly against the euro – at least in the short-term. While a euro high up near 1.70 will likely be seen later in this half century, the 1.12-1.18 region in the euro beckons first.



6) Gold is over-owned and setting itself for a real crap out to the downside at some point. This may result from simple liquidity chasing needs from long-biased investors caught up in other losing trades who under redemption pressure eventually must puke their gold positions as well. Seasonally, the spring to early summer period is often a down period for gold. But calling the exact top is not easy. The $1600 region remains possible before the eventual entropic reversal. It is probably easier to play copper from the short side or iron-ore producers such as VALE (albeit VALE has some short-term support around 30.85).



7) Look for a China railroad company or two to blow up. Chinese property development and construction companies will follow. When this occurs it should be a further trigger to deflationary pressures globally. Stories will only grow in magnitude and importance from the initial one below that appeared March 2nd.

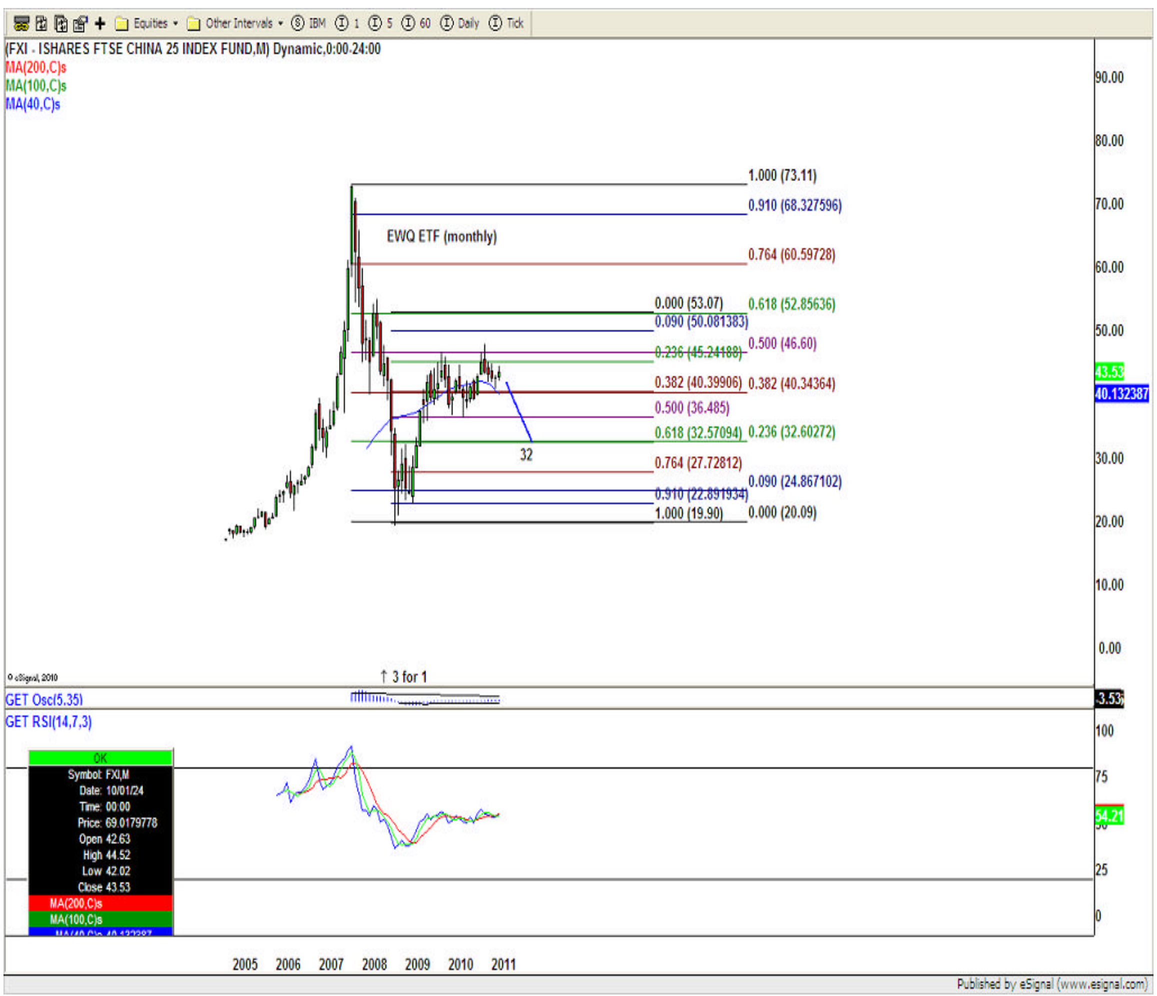
China railways scandal widens, raising criticism
By [Associated Press] on March 2nd, 2011

SHANGHAI (AP) — A widening probe into corruption in China's powerful Railways Ministry is raising questions over the scale and pace of its multibillion-dollar drive to build costly high-speed railways, though it is unlikely to derail the program.

Along with concerns over financing and other issues, at least one proposal for scaling down the showcase program is due to be presented to a top advisory group meeting in Beijing this week during the annual session of China's National People's Congress, a state media report said Wednesday.

Critics of the high-speed railways expansion say ticket costs are too high and the services do not really meet the needs of average travelers in many areas.

8) If the dollar heads higher, and global equity markets come under pressure (inclusive of those in Europe), one may want to consider a core short in a European equity ETF. The French EWQ's appear to be headed to at least 32 in our opinion.



.

In the end, the dollar will revert to some semblance of PPP competitiveness, U.S. and global equities will be far lower than they are today, and U.S. interest rates will eventually normalize higher. This should be a cleansing and somewhat cathartic moment economically – albeit also likely to be a very painful moment politically and socially.

Getting to this point will bring increased anger, riots, and general angst in America. Across this path, Ben Bernanke (if he survives at all in his current position) may even be forced to appreciate (and perhaps more closely study) the wisdom of Austrian economist Ludwig von Mises. He will come to appreciate that the longer you have allowed monetary excesses and interest rate mispricing to persist, the more painful it becomes to reverse this credit mispricing.

Bernanke's December 2010 *60 Minutes* moment of claiming full control of inflation will almost assuredly end up as his entropic moment of true hubris.

Send us your comments at information@Sandspring.com.

AN IMPORTANT DISCLOSURE