Sand Spring Advisors LLC

The Next Important Cycle Dates

by,

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August 8, 2010

A seemingly endless choppy range continues in the equity world with rushed moves lower (Apr-May-June) followed by equally rushed moves higher (July). This type of behavior is endemic of a truly *faux* market environment where our government is increasingly targeting to rig markets, but is having a harder and harder time doing so. As one microcosm of this recently: The market swooned lower when Fed Chairman Bernanke's congressional testimony lacked any punch regarding overt support of new quantitative easing policies. But the next day Bernanke was out with clarifying comments to the effect that: "Of course, if the economy weakened significantly again, the Fed would be there with quantitative easing guns afire." The stock market exploded northward on this latter clarification.

We are dealing with an entire society hooked on debt like a junky hooked on crack. When a whiff of deflationary debt withdrawal starts, the U.S. government pulls out all the verbiage (and occasionally new actions) to perpetuate the addiction.

This is perhaps the most bifurcated and truly flaky market environment that I can ever remember having to trade over my past 30-years. It is also the most unfair. People who were conservative and saved their money without over-spending are now being penalized by super-low interest rates on their money. The elderly who thought that they could live off of their interest income on savings are being penalized as well. But those who drank the Kool Aide so to speak of U.S. Government induced over-borrowing (via Fannie & Freddie credit availability, etc) and general over-spending are now effectively being subsidized. The excuse for this inherently unfair and unfortunate situation is the general defense of the U.S. economy as a whole.

Someday soon, there may easily be a more significant resolution of the debt deflation/debt-inflation battle, but for now we have to deal with what the market hands us. And what the market is serving up at present is a classic case of George Soros's concept of *reflexivity.*

I read George Soros's *Alchemy of Finance* book on reflexivity many years ago, and in a similar vein to Victor Neiderhoffer's later book *The Art of Speculation* on pattern recognition, I found Soros's treatise to be overly self-aggrandizing, quite repetitive, and somewhat boring. As with so many books, Soros's concept of reflexivity would have been more cogently covered in a short magazine article, but instead it was stretched with undue verbosity into book-length form.

That said, it does apply to the current game of *chicken* being played by our government very well.

If over the coming few weeks, the economy continues to roll over and act sluggishly, the stock market will initially fall, but then the governmental canons are likely to come out shooting – be it with new incentives, bond purchases, and/or added talk of Bush tax cut extensions. In a reflexive manner, initial undue weakness could easily beget a reflexive wush of sudden undue market strength.

Alternatively, if equities continue to be buoyant, gold goes to new highs, soft commodities continue to rally, then the reflexive response will be for the bond market to weaken as fears of out-of-control "cost-push" inflation mount. What the government wants to create of course is "demand pull" inflation, but this latter goal is ever elusive. What the government gets instead is something else. Stocks pop until bonds drop. When bonds eventually drop, then all hell is likely to break loose across all asset markets simultaneously.

Here at Sand Spring, while we regularly take a stab (using our Fibonacci bands and other technical and cycle tools) at calling various short-term reflexive turns, we do not of course have every answer as to each reflexive move to come. We simply have certain cycle clues, and a general proclivity to believe (per Austrian School theories of Ludwig von Mises) that the building debt bubble will end very badly in the end – for the debt markets at least. The debt junky society will eventually have to somehow pay the piper or otherwise change the rules of the game in a dramatic fashion. And yet, within the current upside-down economic world where we reside, it is actually *into* fixed income that people rush every time there is a mild sign that the economy is weakening. We find this a bit crazy.

At present, with the S&P 500 Index hovering near 1100, we are far more ambivalent and neutral on the equity market than we have been at various points earlier in the year. As a matter of record, we were previously bearish on our Jan 7, 2010 PEI minor pi cycle date (subsequently correct); bullish for a bounce in early February (subsequently correct); prematurely bearish in March and continued bearish and frustrated in April (early and wrong for too long); eventually more satisfied with our bearish call across May and June (but this downswing coming too late for our tastes); and bullish again in early July (subsequently correct). We know that there is fairly major resistance on the S&P up at 1230 and fairly major support down at 840-880, but we are more or less in the middle of this range at present, and which extreme will be seen first? A temporary but uneasy equilibrium seems to have been found by the market for now, but instead of a clean resolution in either direction, we actually expect the market to continue flailing around – potentially in an even faster fashion -- as the summertime yields to the fall months.

Clues as to potential turning dates may initially be found amidst the following list of minor pi cycle dates below. Please note that these dates come from different markets and pi cycle starting points, but interestingly, we have at least two clear clusters of output within them: **August 27-28, 2010** and **September 24-25, 2010.**

Pi cycle dates from important past turns in different markets

Aug 14, 2010 – along the continuum of 131 day (4.3 month) intervals from March 24, 2000 NASDAQ & S&P high.

First major cluster:

Aug 27, 2010 – along the continuum of 131 day (4.3 month) intervals from the events of 9-11-01.

Aug 28, 2010 – along the continuum of 131 day (4.3-month) intervals from the NASDAQ 2002 low.

Aug 28, 2010 – along the continuum of 131 day (4.3-month) intervals from the July 20, 1999 gold market low.

Aug 28, 2010 – along the continuum of 131 day (4.3-month) intervals from the October 16, 2007 Shanghai A Shares high.

Second major cluster:

Sep 24, 2010 – along the continuum of 131 day (4.3-month) intervals from the exact date of the October 19, 1987 Crash.

Sep 25, 2010 – along the continuum of 131 day (4.3-month) intervals from PEI high-to-high pi interval. A high in this latter region should ideally lead to a significant low in June 2011.

As a general rule, 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.

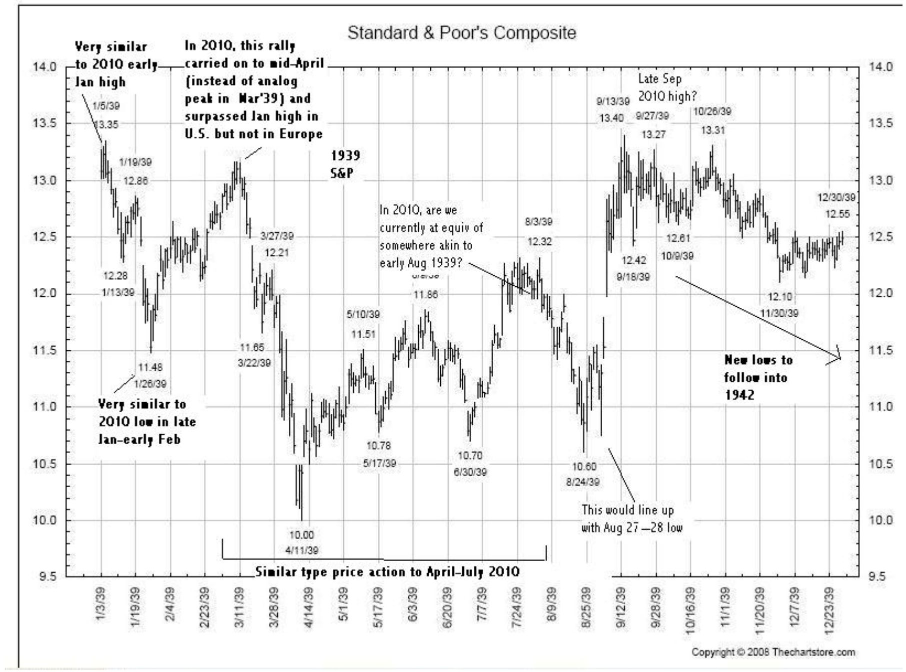
If, for example, markets leave a minor high August 14, 2010, and then start what initially might appear to be a significant decline into August 27-28, 2010, one should expect yet another significant reflexive reaction (likely driven by some sort of governmental policy response) into September 24-25, 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.

Conversely, if markets were to grind higher into August 27-28, 2010 – let's say for argument sake with the commodity markets (gold, silver, ag market, etc.) rallying as well, then this spurt of inflationary pressures would likely yield to a bout of deflationary pressures shortly thereafter. With this latter path, we might expect talk of new Fed/governmental policies to build up, and then ultimately prove inadequate or disappointing to the markets.

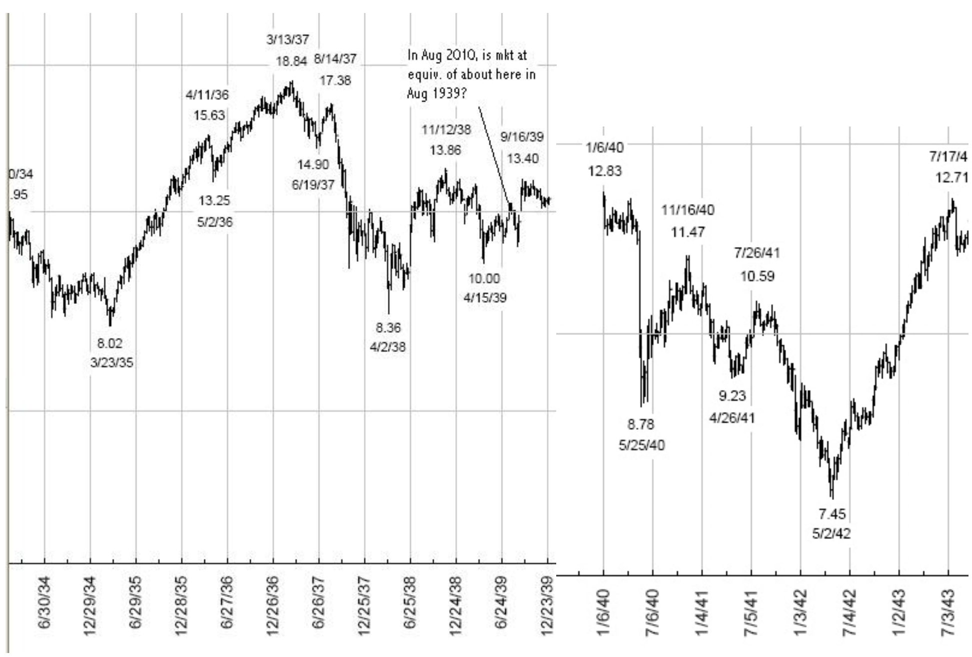
The only real constant is that after a bout of intense short-term volatility, markets ultimately should trade lower into June 2011. In this vein, the former path above with a low in late August and a high in late September likely fits our June 2011 call for a cycle low a bit better than the latter path. <u>The former path is thus more of our preferred view,</u> but we remain open to quickly change our mind as market action may demand.

None of this anticipated continued chop and volatility will be easy for average money managers to navigate. The moves will be too short and swift for them to adeptly turn their huge AUM battleships. As a general rule, the best managers will only have sufficient liquidity to countertrade moves on a limited portion of their total portfolio. Most of their exposures will simply have to slosh through the short-term waves like a ship pointed into the wind during a huge squall.

Should the former path transpire, and on an analog basis, one might continue to expect something akin to the late 1939 period. As discussed in the past when we have looked at the 1939 analog, and as shown below, stocks in 1939 had a very similar pattern to what has transpired so far in 2010 – with just minor differences. After an initial January equity market dump, both periods delivered an early-spring rally, followed by a late-spring early-summer swan dive lower. Stocks then rebounded into early August 1939, started to break lower again across August, before vaulting back up into late September 1939. But ultimately, of course, stocks still faced some very tough sledding into the 1942 war-time lows (with major equity indices breaking below both the 1935 and 1938 lows (let that read perhaps both the 2002 and 2009 lows in the current instance).



Big picture 1934-1944 View



Source: TheChartStore.com

We just finished writing all of the above, when two pieces arrived in our inbox. The first from the Foundation for the Study of Cycles included an extrapolated chart (first published by them back on 7/16/10) basically forecasting a double top of market strength into mid-August followed by a secondary high in late September.

We also received a letter from market analyst Peter Eliades where using a completely different set of long-term cycles, he comes up with the August 27-30th window as an important cyclical turning point. He also has September 30, 2010 noted in one of his charts as important as well.

We also then re-read our own *Market Expectations* letter of January 2010 and spy the fact that a fairly major Bradley turn date is due this Tuesday, August 10, 2010 followed by a secondary turn date on September 30, 2010. *There we have it: this late September window of time popping up yet again.*

We like it when other completely independent methodologies point to similar clusters of time as our own pi cycle work. It is weird, potentially coincidental perhaps, but exciting at the same time. It generally reinforces our belief that there is some sort of natural harmonic out there that may be touched/reached in different ways but is ultimately very powerful and uniform.

As one fundamental note, late August also brings a time when European central bankers will examine Greece to see if they have complied with certain minimum requirements before the European central banks will release further funds to them. Non-compliance on any portion of their previously espoused austerity plan will only cause more headline risk around this period. It would be logical that fears of further problems in Greece could build again across August, and then maybe suddenly (and undoubtedly temporarily) abate again in September.

To this end, we believe that the euro is currently entering an interesting price window where it could easily be a great short again. Two months ago, everyone and their brother was hot to dump the Euro at 1.21. We were buyers down there. Now seems a much better time from a risk-reward perspective to start shorting the euro. It might still squeeze north to more major 1.3575 major resistance, but it also could stop cold right here at 1.3275. We think it is worth starting a half-of-full-exposure at 1.3275 and then scale into additional short exposure if the euro goes higher in the short term. Our longer-term view of the euro is as below. A missing low down near 1.1540-1.1600 still beckons before the euro should eventually recover.

Lastly, we want to mention one other fact. The world was just bombarded in early August by a huge coronal mass ejection (CME) from the Sun. Television news was recently filled with stories of the aurora borealis ("northern lights") that it created. As we have discussed in past years, medical studies done in England have pointed to increased cases of depression and suicide occurring shortly after such CME events. There is also a statistical proclivity for equity markets to decline in the days following a CME bombardment. Maybe that period has now come and gone, or maybe the Sun will flare up again and offer further CME bombardments later in August. We are now clearly entering a period of increased general sunspot activity that will steadily build into 2011-2012. As we have written in the past (see October 2001 *Cycle of War* article), increased sunspots have historically correlated to an increased chance of war on Earth -- "*As above, so below"* – as the ancient Sumerian saying goes. Astro-analyst Arch Crawford is looking for increased war within the current period. A huge Japanese oil tanker just was attacked (somewhat unsuccessfully given its double hull construction) in the Straits of Hormuz by an off-shoot group of Al Qaida. The war in Afghanistan is suddenly producing more and more casualties daily. Hezbollah, the Lebanese military, and the Israelis seem to be at each others' throats. Iran lurks in the background with their various nuclear issues, as does North Korea.

Watch the news carefully. Acts of violence could easily first be construed as negative and then any move toward responsive military action could be reinterpreted as bullish (i.e. stimulative to the economy). On September 1, 1939 this is exactly what happened when Germany invaded Poland.

Also watch out for possible blackouts. As Eric Hadik of the *Insiide Track* newsletter points out, August 2010 fits the bill for a seven-year cycle of blackout activity.

A 'Week'ly Power Outage:
7-Year Cycle of Major Blackouts

1982 - Blackout hits 4 Western US states, impacting 5 million people; 2nd Blackout in Quebec, Canada

March 13, 1989 - Quebec Blackout (see page 7)

July 2, 1996 Blackout impacts 2 million on West Coast; August 11, 1996 2nd Blackout impacts 4 million in 8 West Coast states.

August 14, 2003 Blackout impacts 50 million as power grids go down in domino-like fashion.

2010 - and August 2010 - are next in series of *7-Year Major Blackout Events*

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Source: Insiide Track, Jul/Aug 2010

To be honest, we will not be surprised by anything the market delivers over the coming two months – except if it were to be extremely quiet conditions. We generally expect the opposite: increased volatility, albeit still irritating volatility without a clear lasting trend. We are trying to keep a completely open mind as we watch daily price activity, and will react and comment accordingly by e-mail or further web updates when the price action offers further clues about the forthcoming very interesting period.

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