Sand Spring Advisors LLC

Too Prudent To Be Rich

by,

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May 6, 2006

I have looked myself in the mirror, and I have a clear problem. Beyond the slightly thinning hairline, together with a mild middle-aged look of added jowliness and an expanded waistline, I have concluded that I am too conservative, sane, and honest to ever become really rich. To become really rich, and to prosper in regularly irrational markets, it seems to me that one needs some combination of stupidity and/or luck.

Luck is required to either start with assets, or to be in the right place at the right time in terms of career; and stupidity is required to ride a wave (blithely being unaware of all the risks of doing so) and to overstay a market's move after any rational person would exit. While some people surely then burn and crash when the markets finally turn rational again, a few get lucky and just happen to end up with huge realized profits. It's those types that we tend to read about in the papers – people who took outsized and unreasonable personal risks, but just happened to win. Pick up a copy sometime of Nassim Taleb's book *Fooled by Randomness* and read more if you wish.

After spending the better part of 13 years between 1980-1993 in the metals business – some of which were downright dull and boring (bad timing, bad luck) – in recent months I have basically missed "getting with the program" and participating in the last $150 rally in the gold market. Worse yet, I recently posted a few charts on the Sandspring.com website suggesting a top in Comex Copper near $2.87 and Comex Silver near $13.03. These levels were then promptly run over by the current speculative fervor of the metals markets.

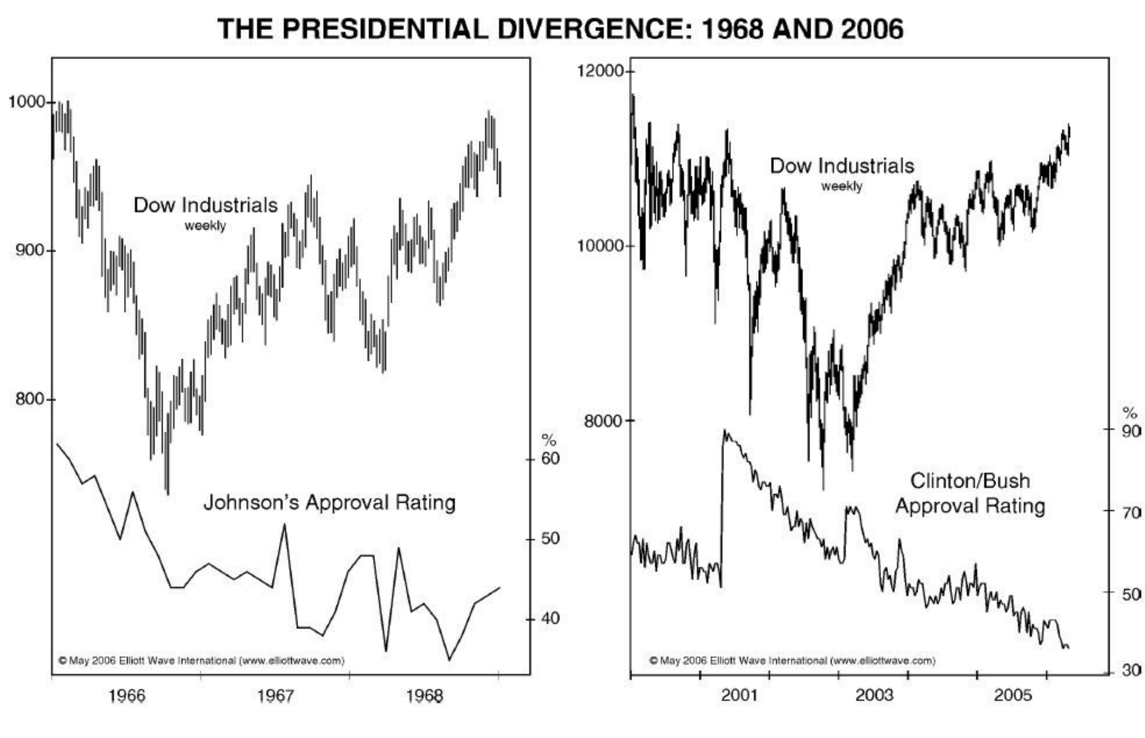
And of course, I am also prone to "cry wolf" from time to time about the potential arrival of a swan dive lower in the U.S. equity markets. In April, we took a refreshing month off from doing so, but more recently have become suspect of equity strength yet again – mostly for sentiment reasons.

The life of a natural contrarian is not a great deal of fun, and while I guess natural contrarians can relish feeling "academically superior" to their peers, we certainly don't tend to end up with the "golden ring" at the end of the day. Instead that goes to some neophyte investor who buys into a story and then simply hangs on.

When stocks rally (as they did last Friday) because fewer-than-expected jobs were created in the economy, and this was interpreted by the market as bullish since "the Fed will soon stop raising rates," I personally don't get excited about chasing upside equity nirvana. Instead, I mull: "Mmmm, the world is getting worse, not better – not only do we have commodity-push inflation, but we also have less than robust labor market growth. The little guys (particularly those unlucky enough to start off without significant assets such as stocks, property, etc.) are clearly getting squeezed." I end up thinking: "Maybe the recent demonstrations in the streets about proposed new U.S. immigration policies are just the tip of the iceberg in America's growing discontent."

The divergence between a frothy equity markets and declining presidential popularity also has served to confuse me. Equity strength and presidential popularity have tended to go hand-in-hand over recent years. So what is happening now? To have the Dow rallying while Bush stumbles in the polls just does not seem like a logical thing to happen.

As a first glimmer of understanding of recent parabolic action in copper, strength in equities, and yet declining presidential popularity, let's start this month with a borrowed chart from the folks at Elliott Wave International. This chart shows that the last time stocks were on a march higher while Presidential popularity took a nosedive was all the way back in 1968 as President Lyndon Johnson was getting America more and more embroiled in Vietnam, while demonstrations started to fill American streets.

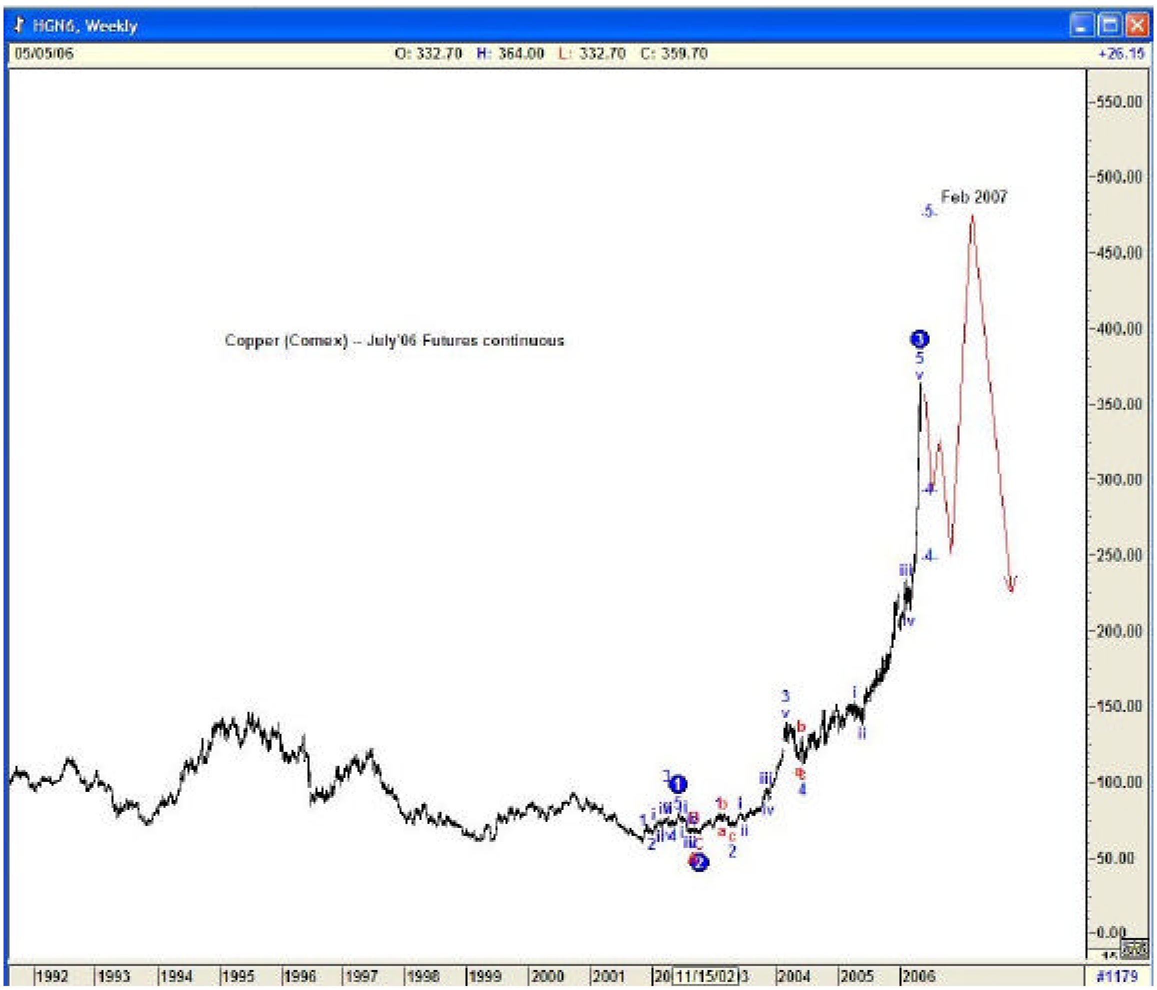


Courtesy of Elliott Wave International (www.elliottwave.com)

In that prior instance, equities of course continued to be frothy all the way into early 1969 before leaving an important top, and in a similar vein, I currently believe that overall equity markets will not finish to the upside until the important PEI cycle date on February 24, 2007 (3,141 [pi] days after the July 20, 1998 pre-Russian ruble crisis/LTCM collapse).

But that does not mean that the path getting to February 2007 will be a straight-up benign affair from here. The story of synchronized global growth – with the global equity, metals, and energy markets all advancing together -- just seems too "pat" and overbought at this stage to really trust much longer.

Indeed, by the mere fact that Copper recently touched 95% bullish on Market Vane sentiment indicators while Silver reached an unheard of 98% Bullish Consensus reading, these markets simply *must* experience a significant downside correction soon. The fact that open interest in the precious and base metals has already been declining for multiple months reinforces my belief that the recent cascade of ongoing metals strength has in part been driven by short-covering, and once the shorts are finally finished getting pasted, there will be a vacuum decline with few others left to buy. A possible path for copper may end up looking something like this:



The Elliott Wave International folks similarly point out that it took 13 Fibonacci-years from Silver's 1980 high to reach an early 1993 low. Add another 13 years to the 1993 low and one gets, of course, early to mid-2006 as a logical time window to expect a metals market high.

Here at Sand Spring, back in May 2000, with gold at $275 on a path still headed lower, I wrote a piece entitled *Cyclical Commodity Turns* where it was suggested that gold was due to form an 8.5-year cycle low in August 2001. The exact chart below was posted:

In December 2000, I subsequently wrote a Sandspring.com article entitled *Time to Start Accumulating the Golds* wherein several different constructive-looking gold stock chart patterns were presented. These were: Harmony Gold at 4 3/8 (16.25 today); Homestake Mining at 4.25 (taken over by American Barrick in 2001 for approximately $8.71 a share); Anglogold at 14 (55 today); and TVX Gold at $2 (taken over by Kinross Gold in early 2003, with converted shares worth over $25 today).

Gold subsequently left a triple test of its $255 low across Feb 2001, April 2001, and August 2001, and finally started to take off in mid-September 2001. So the proposed timing and bullishness on gold from Sand Spring Advisors back in late 2000 ended up working pretty well.

But if the 8.5-year low-to-low cycle discussed back in those articles continues to hold, gold should be due for a trough period somewhere toward the end of 2009 to early 2010. And to get to such a low at that latter time, it means of course that gold should be peaking somewhere in 2006-2007 – maybe with a 3rd wave high about now, and a final 5th wave high into early next year.

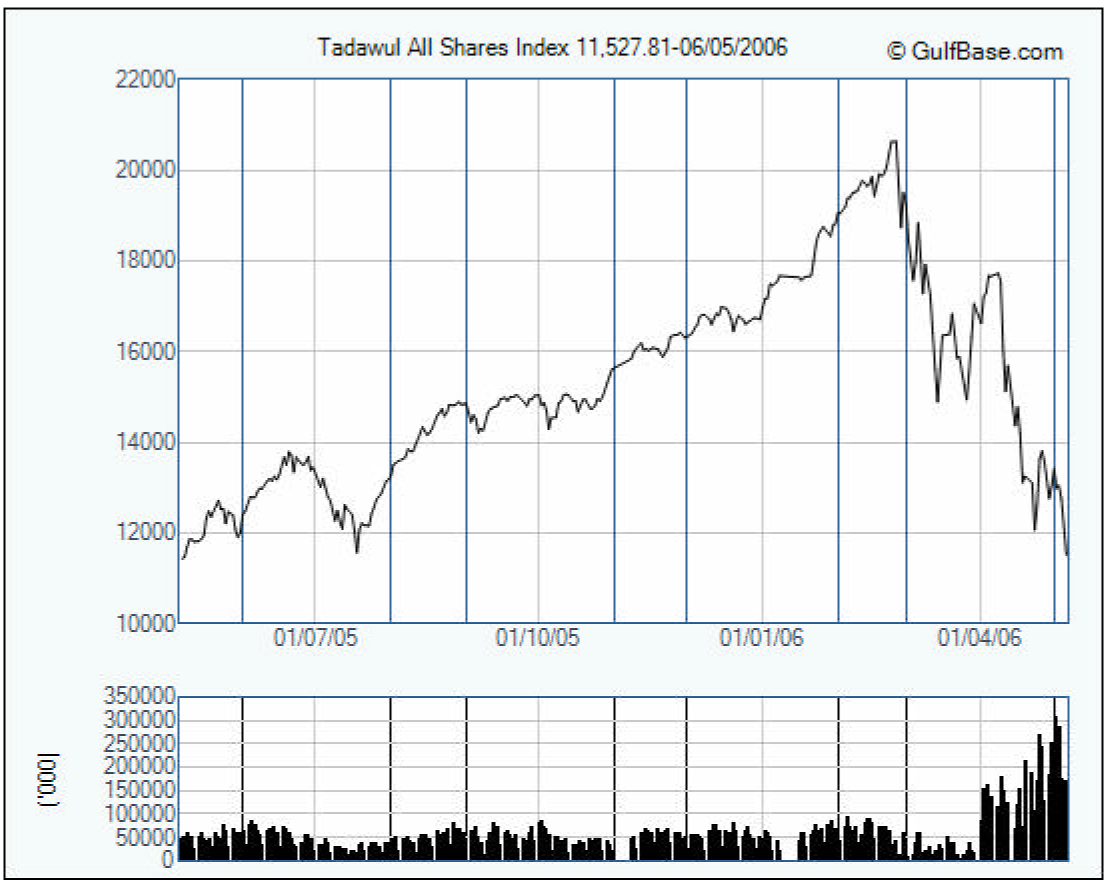
So it's not time to be piggish on the metals. It is time instead to increasingly walk away from the metals, and if overall strength continues all the way into February 2007 (as it may after a sloppy 4th wave down this summer), Sand Spring may even be looking to go short the complex at that latter time.

But to get a meaningful immediate 4th wave correction in the metals sooner rather than later (and thereby satisfy the immediate Market Vane sentiment readings with a reversal), it might of course help to have a fundamental catalyst. The logical sign to look for would be some sort of sudden reversal of global economic confidence to break the mantra of the "insatiable commodity demand." And one of the few things that could cause global economic confidence to wane would indeed be a stock market downswing of some magnitude.

Overall, we continue to expect a sloppy summertime followed by a late October 2006 to early February 2007 dash higher in both commodities and equities. But first we need to deal with the May-October period of anticipated corrective slop and chop.

In terms of important dates to watch, the Full Moon of May 13th followed by the May 18th Bradley Cycle would be one window of time to expect an equity market/metal market turn. Ditto the next minor PEI 4.3 month cycle date which falls June 6-7, 2006. Note that this PEI window sits right atop "06-06-06." Would Osama Bin Laden be so cutesy as to launch an attack on the U.S. on a date that could be associated with the sign of the devil?

Cracks in the façade of bullish times have of course already started to appear – seemingly traveling westward. The first crack may be seen as the extremely messy Feb-March correction in Japanese equity markets. Then came the plunge in Saudi equity markets that has shaved some 40% off of equity values in that country (doing so at the oddest of times with a strong oil price).



Source: www.Gulfbase.com

Turkey turned sloppy next, and while other global markets recently vaulted to new highs, The Turkish ISI National 100 is currently trading well below its peak value 8 weeks ago.

The Turkish ISI National 100 Index

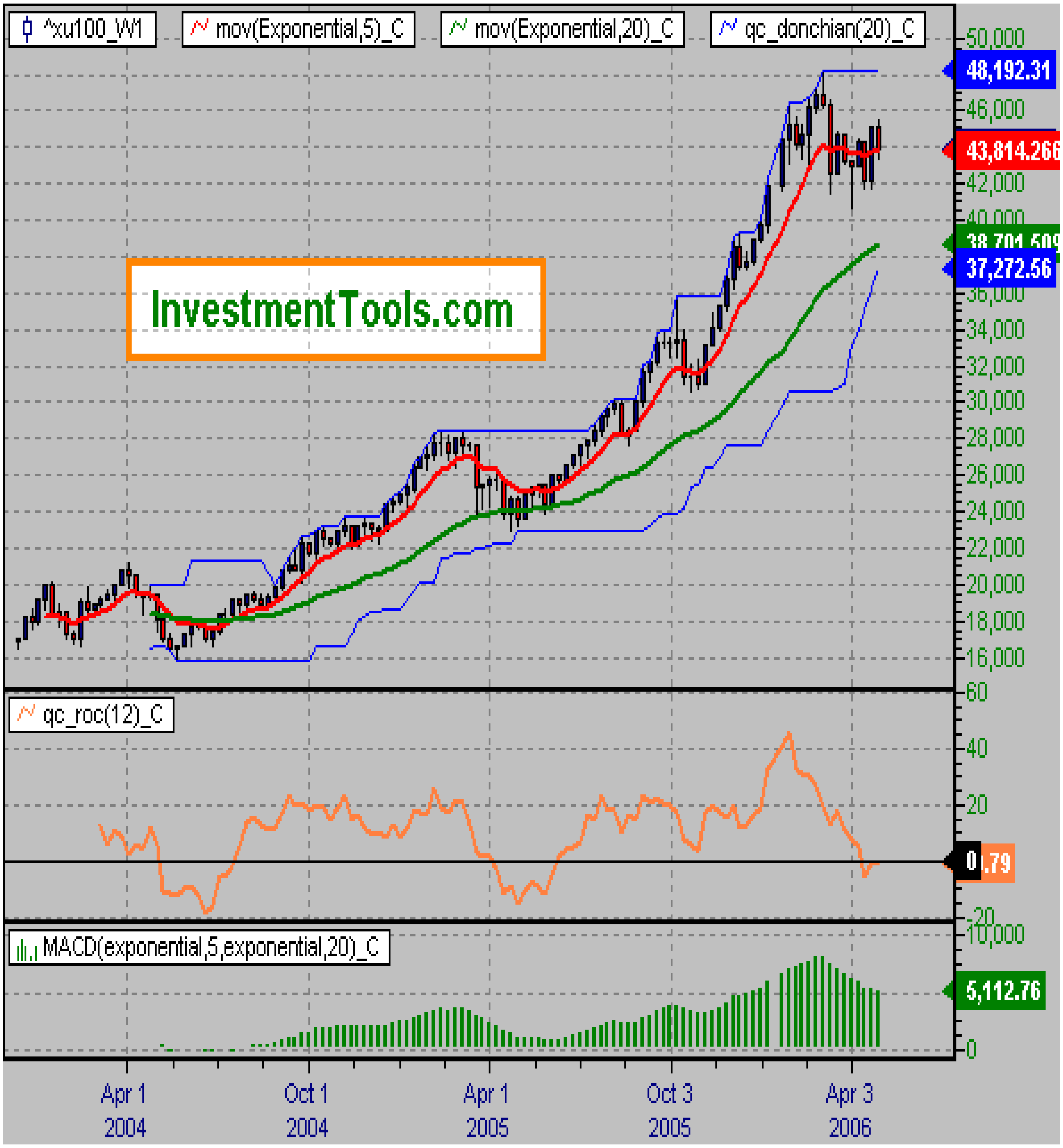
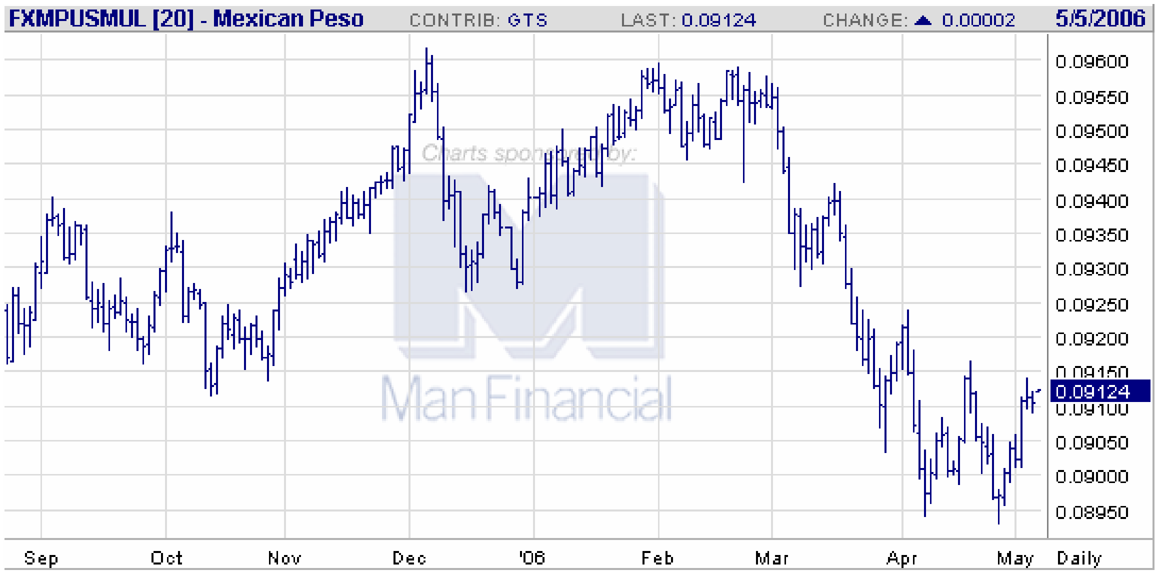
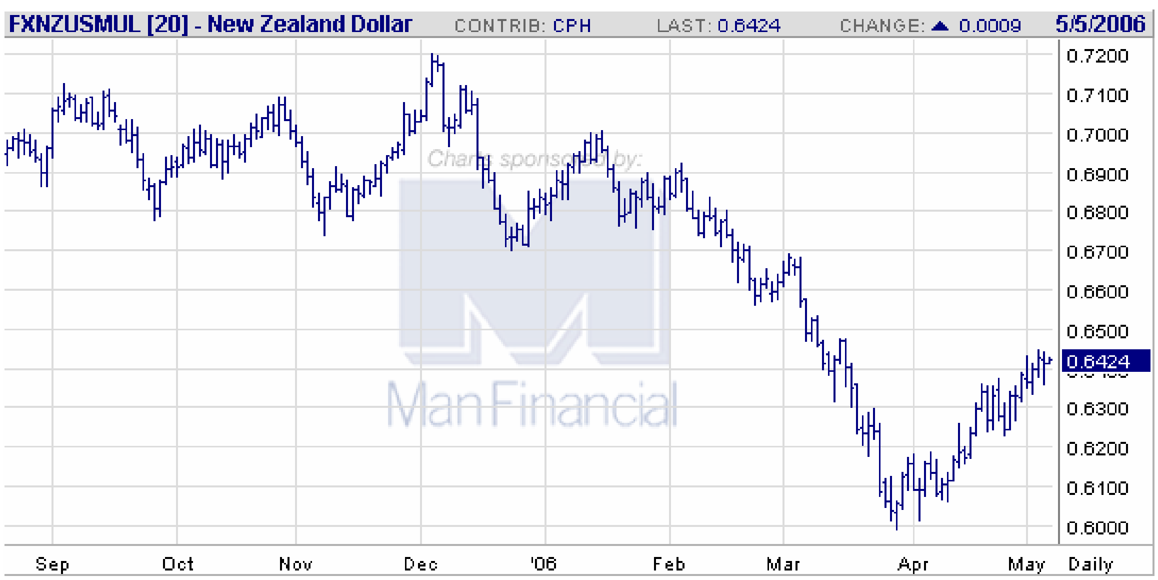


Chart created with NeoTicker EOD © TickQuest, Inc. 1998-2004

Elsewhere, Icelandic debt was downgraded in late February causing that country's currency to plummet. And a flight out of the Mexican peso and New Zealand dollar – two historically popular "carry currencies" -- started at about the same time.

Mexican Peso & New Zealand Dollar – Appeal Suddenly Withdrawn





Then last week, Bolivia moved to nationalize its oil industry – a move that made the lead story on BBC, but was hardly mentioned across the U.S. television media. *The Washington Post* wrote last week how this felt like a throwback to another year: 1937.

Bolivian Gas Takeover Sets a Familiar Scene

By Steven Mufson
Washington Post Staff Writer
Thursday, May 4, 2006; Page D01

A new government in Bolivia, anxious to win public support, charges the big foreign oil companies with fraud and confiscates their local properties. The move generates applause among Bolivian citizens and attracts attention throughout Latin America.

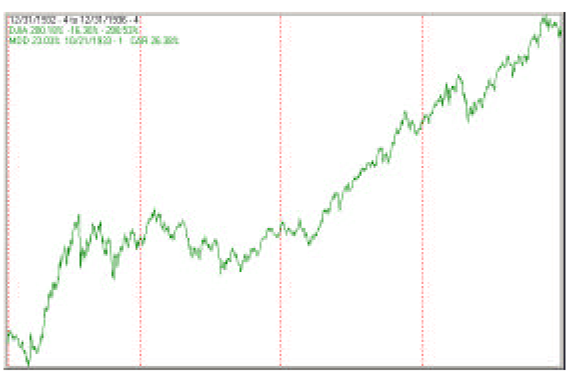
The year: 1937.

Seven decades later, Latin America is experiencing another wave of nationalist fervor, fueled by old resentments and rising energy prices. Inspired in part by the economic nationalism of

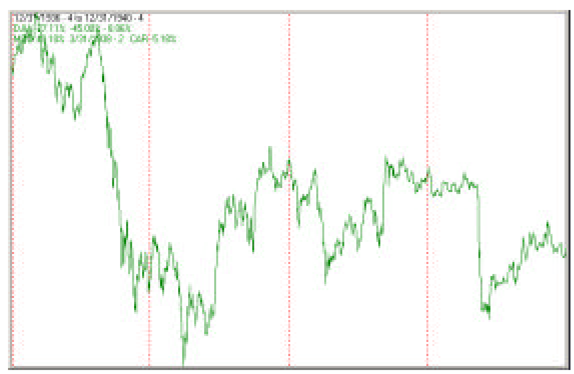
Venezuelan leader Hugo Chavez, new Bolivian President Evo Morales celebrated his 100th day in office Monday with a reprise of 1937: charging foreign oil firms with corruption and sending troops to seize control of the oil and gas fields.

And if Bolivia is acting like it did in 1937, pity for the U.S. perma-bulls if the DJIA starts to do the same. Just look at the price action of the Dow across 1936-1937 shown in the two charts below.

1932-1936 DJIA



1937-1940 DJIA



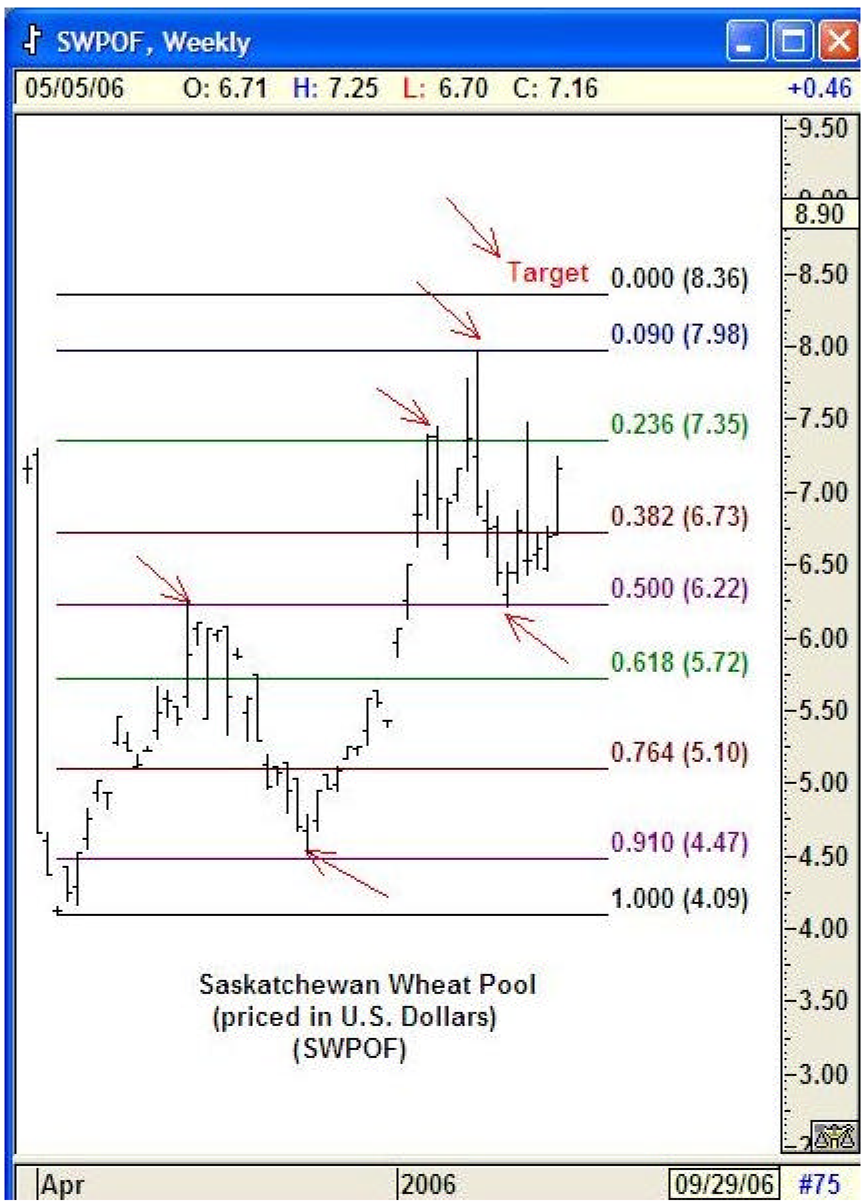
Taken together, all of these different warning shots of one-off volatility across different global capital markets also feel a bit like early 1997 when the Thai baht first came under pressure, but nothing truly horrific made its way to the U.S. until after the July 20, 1998 PEI cycle date. Maybe Sand Spring should simply be bullish and happy awaiting next February 24, 2007 PEI cycle date to turn dour. Maybe we should just "ride the wave" to the upside. But alas, when all the early warning shots of volatility appear, why be imprudent and risk playing a game of "greater fools?" I personally am simply too rational for that – even if such prudence can feel frustrating and irritating and not lead to great riches in the short-term.

This prudence further emanates from the fact that a number of technical breadth divergences have already started to show up within the U.S. itself. For example, despite multi-year highs in the DJIA last week, the percentage of Dow stocks above their 30-day moving average actually peaked toward the end of March, and the Advance-Decline Line of the S&P 500 also peaked in early 2006.

All of this should end badly. And while admittedly I do believe that the S&P might still move a bit higher to touch 1335-1336 region in the short-term, as well as likely reaching 1374 by next February, what happens in between the current topping period and the eventual touch of 1374 could be most surprising and nasty.

But there I go again "crying wolf" once again.

Not to sound like a complete curmudgeon, there *are* individual stocks that I still like and hold long. Saskatchewan Wheat Pool is one, and Lindsay Manufacturing is another. Both are plays on an improving agricultural market. So let us simply close our monthly diatribe with their more bullishly poised pictures.



As always, please do your own analysis and homework. Sand Spring is not a broker-dealer, nor a Registered Investment Advisor. We can express our own opinions, but these should not be construed as specific investment advice.

Send us your comments at information@Sandspring.com.

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