Sand Spring Advisors LLC

Larger Topping Pattern, but No Straight Line

by,

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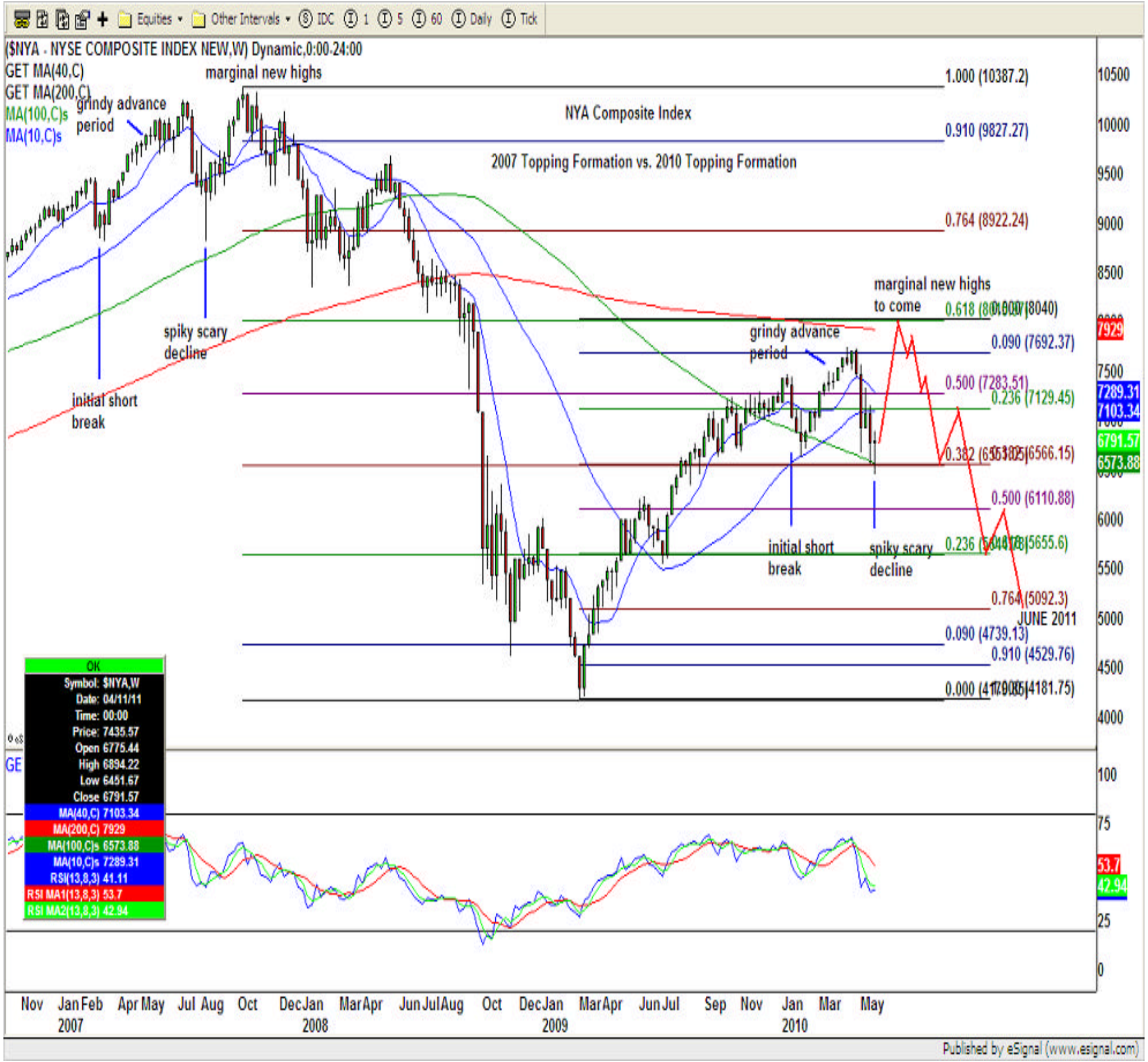
Some may think it odd that Sand Spring -- which was so fundamentally bearish across most of March and April – has recently sent several short-term bullish e-mails. But that is exactly where we find ourselves: short-term bullish.

Perhaps at a younger age we would have expected markets to go straight down and down and down, and one must of course be attentive to the slight possibility of a further “trap-door” type of decline. Our past analog of the 1989-2000 Nikkei pattern compared to the 1999-2010 NASDAQ pattern might even support such a view.

But after actively monitoring markets for over 30 years, we have come to realize that in most instances, bigger moves may tend to take longer to fully manifest themselves than one initially expects. While equity markets likely have entered a larger topping period, extreme “trap door” declines of greater than -10% tend to be somewhat abnormal and rare events. Bullish market juices just don’t tend to move from overt ebullience (mid-April) to extreme fear (late May) without some period where the bulls try to reassert their original view.

What would be more likely is that we have now made the initial “left shoulder” of a larger “broadening top” formation -- something akin to the spring 2007 market high that still awaited marginal new highs into the fall of 2007.

In the chart below of the NYA Index, just look at the similarity of the topping pattern of 2007 to what has been transpiring so far in 2010:



We use the NYA Index above rather than the S&P 500 because the S&P has a few spikes in it (let that read: "flash crash" day related noise) that make the technical picture more jumbled looking and less perfect from a Fibonacci fractal perspective. But in terms of the NYA, the picture is clear. Both fractal and 100-day moving average support for the NYA reside around 6540 while a missing fractal high at around 8040 appears to still beckon.

Some people who I presented this to this past Friday accused me of "burying the headline" in the way I discuss this view – that I should be shouting from the rooftops: "20% advance directly ahead!" But the truth of the matter is that this is likely to be yet another short-term trading advance within an overall topping pattern – and thus hard to really believe in or get excited about. The more important point is to avoid stepping in front of another potential bull move too soon. The really fun trade will be when this move completes, and we can genuinely play for a more sustainable bear market decline from our projected 8040 high down to around 5000 on the NYA.

We still expect such a bear opportunity to present itself soon, but if the February-April advance period taught us anything, it is that bull spirits can be hard to squash, and are likely lurking around the corner to re-emerge in the coming few days.

In defense of the bulls, it is certainly true that by creating a near zero interest rate world, global governments have also created every incentive not to leave one's money sitting safely in a bank earning next to nothing, while slowly being whittled away in purchasing power by inflation.

In comparison, equities do represent something of a "store of value" – albeit a very volatile and imperfect store of value.

But it is also a very "faux" overall environment. If you believe that governments can get away with their reflationary gambit, you buy all risky assets. Conversely, if you think that governments somehow get caught by a group of market vigilantes, then you sell all risky assets.

Europe recently had a taste of the market turning against government assurances and promises. It has been an ugly affair. But even in Europe, we see the possibility of a substantive bounce from current levels. Given that we have reached a line of fractal support for the euro around 1.2150, and many European companies sport high dividend rates (between 5-10%), our guess is the recent minor pi-cycle date of May 18, 2010 represented a shift where the pressure on Europe may abate for awhile.

Don't get us wrong: the Euro-zone could easily still fly apart in the longer-term, but for my mind, June 2011- December 2012 (as the sunspot maxima builds to a peak, together with associated war-like emotions) would be a better window for this to occur than right now.

From an astro perspective, late July-early August remains a time of peak stress, but does this mean that early June to mid-July can't be one where there is yet another faux period of relief? Governments keep sweeping major problems under the rug, and market patience with such actions is admittedly getting briefer and briefer. But this is like a pendulum of reaction and counter-reaction that does not go in a straight line.

Consider the following big picture assertion of ours: Throughout the 1990's and early 2000's, the U.S. government kept interest rates in the U.S. artificially too low and credit too easily available. Because of this, the dollar also perpetually traded at an artificially low price vis a vis its true purchasing-power-parity value, and because the dollar was cheap, U.S. equity markets traded artificially too high as a counter-balance.

To get back to a more properly balanced U.S. and global economy, all of this should eventually be allowed to reverse. U.S. rates should shoot up, easy credit should be cut off, U.S. consumers should stop spending, U.S. import demand for foreign goods should fall, the dollar should rise, and U.S. equities should decline (as corporate profitability is impacted by the toxic combination of a higher dollar, higher financing costs, and a weaker consumer).

But the government has once again stepped in to stop economic Mother Nature from following its logical course. Slowly, one by one, all of the above should happen – *but not necessarily in the order that would seem natural.* The crisis of 2008 would under normal circumstances have struck at the heart of easy credit first, but our government shot back a countervailing blow by moving a great deal of private-sector debt onto public balance sheets. They have continued to keep rates artificially low. In the short term, this has given equities a "free pass" as the asset of choice within an increasingly yield-less world.

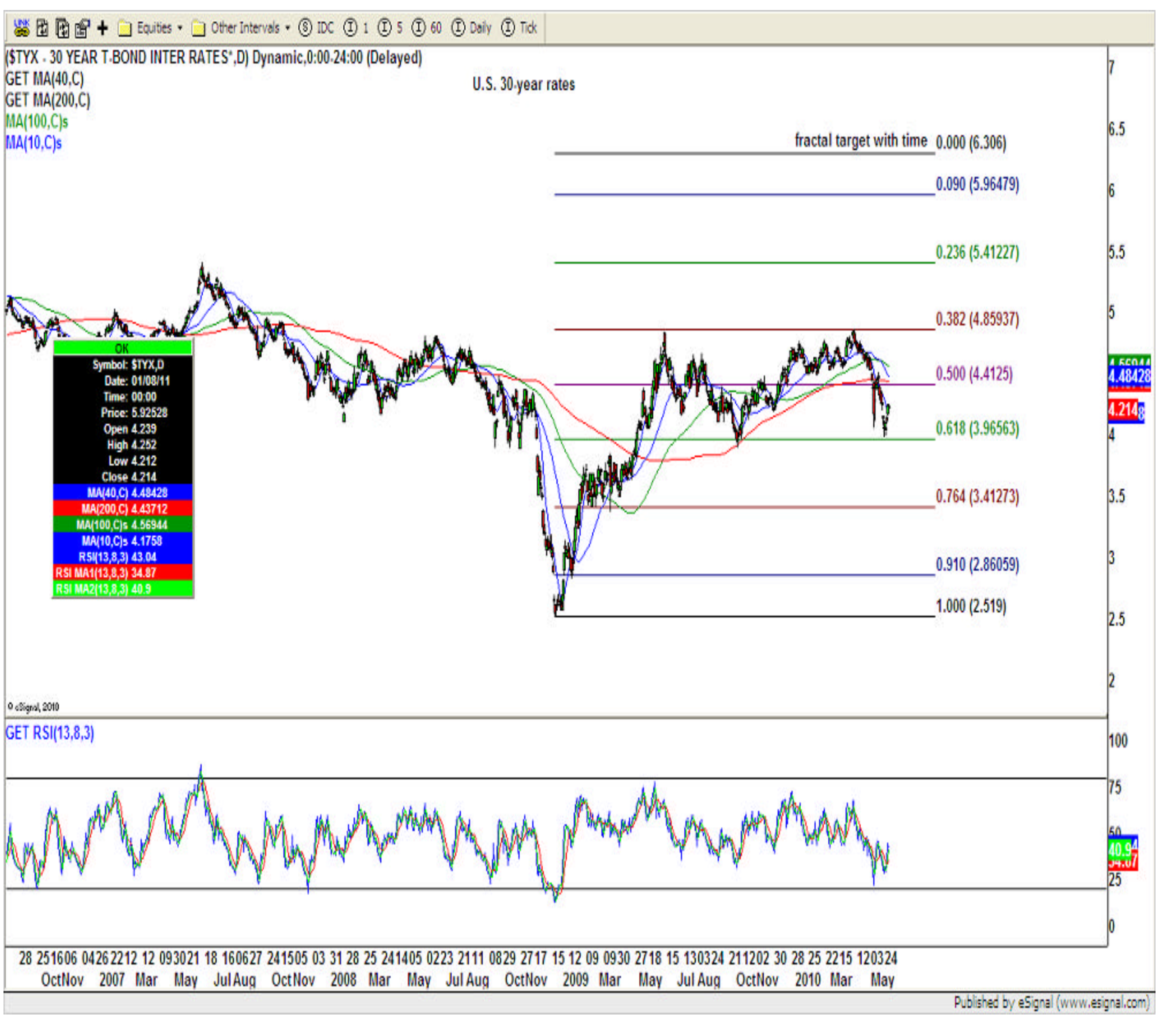
But the imbalances have still popped out in another fashion: European sovereign debt started to come under attack almost like a weak hernia in the side of a U.S. patient who has much more serious fundamental problems. Now Europe is in the process of pushing this hernia temporarily back into place. But next something else will pop out. The level of global debt is like a fundamental sickness, and no government globally has yet to genuinely address the core disease.

If global equities do indeed make another vault higher with renewed speculative juices, the next logical candidate to misbehave would be longer-dated U.S. Treasury Bonds. Now this is a super tough trade because it strikes at the heart of what the government is trying to prevent from happening: U.S. interest rates moving higher.

But understand that Fed hawk Thomas Hoenig has recently been joined by at least two other board members of the Federal Reserve in questioning whether the Fed should maintain its super-accommodative "extended period" policy language much longer. Imagine as well a new financial reform bill (now in the Senate-House Congressional reconciliation process) that as it pushes new requirements on U.S. financial institutions -- both in terms of capital adequacy and general business area regulation -- might just have the unintended consequences of also pushing tighter credit availability on the U.S. economy.

When the Congress of 1930 passed the Smoot-Hawley Tariff, Congress did not intend, of course, to worsen the Great Depression, but as an unintended consequence, it did so. In a similar fashion, when the Congress of 2010 passes financial reform measures, it does not intend to do harm to the American economy. But as it rushes in last-minute amendments and changes, the Congress may just as easily create some unintended consequences as ugly as those of Smoot-Hawley some 80 years ago.

So it is that we believe that a bearish focus may be deserved in the short-term on the TLT ETF (U.S. 20-year bonds). As the chart below shows, we believe that a fair fractal target for 30-year Treasury rates with time will be a 6.30% yield. If equities punch higher in the short-term, while Fed language changes, and Congress reconciles a financial reform bill that imposes more restrictive rules on banks, now is the time to start betting on higher rates – at least for a trade.



Once rates start to get a head of steam going to the upside, they should of course eventually undermine equity strength. But that is a future reactionary trade, not an immediate one. Economic Mother Nature will eventually win out over government intervention: rates will end up higher, the dollar will normalize, and equities will be lower. The only thing that the government has recently done is made the path getting there far trickier and more extended. Instead of having had rates go up first, the dollar went up first (as Europe came undone); but bond weakness will likely be second to adjust, while renewed equity weakness will be last.

In terms of tricky paths, readers have seen us in the past (particularly back in 2008) use various analog chart patterns to the 1907 panic, the 1929-1932 period, as well as the 1937-1942 period.

It was recently pointed out to us however that from an astro point of view, the 1872-1874 period was reasonably similar to current astro alignments. More specifically, Ray Merriman has written:

> Mid-1872 was "the only time in stock market history when Jupiter and Uranus were in conjunction to one another and both in opposition to Saturn. This happens June 2010 through the first quarter of 2011. It also happened around the middle of 1872, just before that 6-year Great Depression. Curiously, the stock market was making new all-time highs then, and continued to make slightly higher all-time highs even into early 1874, even as the longest Depression in U.S history was unfolding. Does this sound familiar? The stock market was soaring, but the economy was falling, and about to fall real hard for the next several years. The stock market finally succumbed and fell hard too, from a double top all-time high in 1873-1874, to a…cycle trough bottom…in 1877, right in the central time band of a Uranus-Pluto waxing square [which will next occur, in our current instance] …between June 24, 2012 and March 17, 2015.

While stock data for the 1860's and 1870's is very limited, and we might easily contest Merriman's reference to this period as making "all-time highs" into 1874 (the 1874 high likely being nowhere close to the twin highs of rail stocks into 1864 and 1869), we are nonetheless intrigued by Merriman's analog. We are currently studying the entire period from the Gold Panic of 1869 through the first Great Depression 1877 low.

We find within this period many initial similarities to current times:

As with our current burgeoning governmental deficit problems – induced in part by the costly military activities in Iraq and Afghanistan – the U.S. government across the early 1870's was trying to deal with the prior excessive issuance of both Treasury debt and greenbacks (not directly backed by gold) that were required to finance the Civil War. The gold market was on fire (particularly into the Panic of 1869) as few trusted paper money.

The 1865-1875 period was full of astute (if somewhat notorious) speculators such as Jim Fiske and Jay Gould who perhaps were somewhat akin to modern day hedge fund manager John Paulson. In both instances, these gentlemen first benefited from bear raids on the market and then later became enamored with gold. (As a side-note, if you have read Michael Lewis's recent book *The Big Short* about the current period, you may easily enjoy Kenneth Ackerman's earlier fine book *The Gold Ring: Wall Street's Swindle of the Century and its Most Scandalous Crash – Black Friday, 1869.* The nature of speculation doesn't seem to change that much over the centuries. The rules of speculation simply get tweaked, and the products traded just become more complicated and sophisticated.)

The speculative fervor of the late 1860's to mid 1870's revolved around the westward expansion of railroads on easy credit. This was perhaps somewhat similar to today's world which first revolved around home building and home ownership on easy credit, and currently revolves around the supposed China growth/expansion story on easy credit.

The trigger point for the 1872-1877 Depression turning ugly was the September 18, 1873 failure of Jay Cooke & Co related to problems financing the Northern Pacific railroad. In the days and weeks thereafter, 37 additional banks and brokers then failed in domino fashion. Maybe Jay Cooke & Co. is somehow an equivalent to our own modern-day 2008 Lehman Brothers failure, or perhaps some other finance company yet to fail due to the eventual unwinding of China's property bubble.

We do not have all the answers here, but the astro alignment pointed out by Merriman is intriguing, and there are enough similarities in "content" that 1867-1877 may easily be a better analog roadmap for 2007-2017 than anything from later periods. Stay tuned as we give this more thought and investigation.

Along these lines, please view our current recommendation to short T-Bonds as a trade, not an investment. Being short bonds across 1874-1877 would certainly not have been very astute. In the current instance, we are looking for a bond market "scare" more than a lasting trend – even if our Fibs point to ever higher yields with time.

Send us your comments at information@Sandspring.com.

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