ChartsandMarkets.com

Timely technical analysis
Insightful market commentary

PIVOTAL EVENTS

THURSDAY, MARCH 6, 2020

BOB HOYE

Signs of The Times

"China's Vulnerable Markets Face Deluge of New Shares, Bonds"

– *Bloomberg*, March 1.

"Deepening Rout in Commodities Stokes Fears About World Economy"

– *Wall Street Journal*, March 1.

"Global Property Deals Stall As Virus Keeps China Money Home"

– *Bloomberg*, March 2.

"Private Equity Titans Cheer Outlook Despite Virus Threat"

– *Financial Times*, March 2.

"Shadow Banks in India Face Their Biggest Funding Test Yet"

– *Bloomberg*, March 3.

"Americans Continue to Vote With Their Feet Towards Low-Tax States"

– *The Hill*, March 3.

"China Car Sales Plummet 80 Percent Amid Coronavirus Crisis"

– *ABC*, March 4.

"Fragile Safety Net Leaves U.S. Economy Vulnerable to Coronavirus Hit"

– *Reuters*, March 4.

"Out-of-Funds Chinese Property Developer Tries to Shed its Mega-Money-Pits"

– *Wolf Street*, March 4.

Perspective

It is next to impossible to find a financial headline that does not include the "Virus". But as we have reviewed for decades that whenever an important "natural" disaster occurs it may not materially change the course of financial markets. Stocks and industrial commodities had reached excesses in January, which was our target. And then they got hit and as we noted natural disasters can exaggerate the declines.

Using the S&P it was the fastest 10 percent drop on a history back to 1946.

Examples we have used occurred with the 1873 Bubble when in 1871 America suffered its worst wild fire season on record. With thousands of deaths and then there were the property and insurance losses with the Great Chicago Fire of 1871. Moreover, Europe was devastated by two important countries at war with the Franco-Prussian War that ended in January 1871. Paris was besieged and bombarded by large-caliber cannon, meant to terrorize citizens.

That Great Bubble was scheduled to complete in 1873 and it did. Europe and London in May-June and New York in September. A typically long post-bubble contraction followed. Within this the big-cap tech stock, Western Union, was an outstanding performer, when it was performing. In that fateful fall crash it gave up something like 40 percent in 8 trading days.

The Wolf Street story is about a Chinese property developer with huge projects in SF, LA and NYC that can't be completed. They could become very tall incomplete monuments to folly.

* * * * *

Stock Markets

Our January 9th *Pivot* asked the key questions:

"Is the stock market up when it should be?" The answer was *"Yes"* because in early October Ross had called for a rally into the *"January Window"*, which had ended so many phenomenal bull markets. Such as with Gold in 1980, the Nikkei on the last day of 1989 as well as the S&P in January 1973.

The next question was *"Are there signs of speculation?"* The answer was that the senior indexes were registering "Upside Exhaustions" which is momentum-based. Also the action was generating "Sequential Sells" which is based upon patterns. When both occur within our time window for a top the message is clear.

The January 9th edition also noted that industrial commodities had become overbought and could correct *"into the First Quarter"*. And based upon this it *"would be a depressant to overall stock markets"*. The specific comment on crude oil was that the action was outstanding enough that it could be *"blowing out"*.

Also included was *"over in the yield curve, the inversion of last summer says 'Recession'."*

The high on the broad market (NYSE Comp) was 14,183 on January 17th, the "test" high was 14,148 on February 12th. The high on the S&P was 3393 on February 19th. The World's compulsion to buy US big caps was astonishing to this writer, but created a false breakout and a rapid Outside Reversal to the Downside. On the Monthly basis. Which was part of exceptionally fast 10 percent plunge from a record high. A chart of some key indexes follows.

Not included are the Banks. And today the BKX has dropped taking out the mini-panic low of last Friday. The Transports also plunged more than 5% today – taking out last week's low.

And as the *ChartWorks* noted, the plunge got oversold to a level from which a bounce would be likely. This has worked out showing once again that the more violent the swings the better technical analysis works.

Our January 23rd *Pivot* noted that break in momentum for stocks and industrial commodities and concluded that the *"Everything Correction"* was underway and the decline could be of an *"intermediate"* nature.

Also, through January our bigger-picture concern was that the Yield Curve had reversed in the summer. And that in every case back to 1857 it was followed by a recession. Then the Curve (3M to 10Y) inverted again and we noted that the *"double inversion"* had occurred in 2007, 1929 and with the conclusion of the 1873 Bubble.

A dire warning indeed.

On January 25th the CCC Credit Spread accomplished its First Breakout, with the Second on February 26th.

So far, this has been a clinical approach to a severe reversal in the financial markets. And it has been clearly made more dramatic by Communists in China using the virus threat to extend control. It is bizarre to have such a robust prosperity governed by mindless authoritarians. Thus the massive setback to an already weakening global economy. Quite likely irretrievable.

However, our piece of February 24th argued that this nonsensical intrusion could be the futile gesture that brings down the Communists in Beijing.

Credit Markets

While panics are not a standard item, within this one the behaviour has been standard. Conservative money went to the most liquid items which are mainly Gold and US Treasury Bills. Gold rallied to its highest since 2012 and the 3-Month Bill plunged from 1.59% on February 12 to 1.15% on February 29. And as we enjoy noting, in order to look "in charge" the Fed had to lower the administered rate. Which it did with the Bill Rate declining to 0.67% today. Quite possibly on the way to zero.

This has been so fast that Wall Street economists did not have enough time to "worry" about the economy and then tout that the Fed would lower its rates thereby extending the boom. This was widely pitched in August-September 2007 and that cyclical bear began in the middle of October. The recession was later deemed to have started in that fateful

December when Harvard's Greg Mankiw declared that nothing could go wrong. The Fed had a "dream team" of economists.

We had thought that with troubles the Bond Future would rally on the "Flight" story. And it did with our target a very modest 162. But it jumped to the 172 level, becoming somewhat overbought. However, we have been noting that eventually there could be a problem in servicing the immense debt burden, including Treasuries.

One of the marvels of the year has been the action in Emerging Debt. The EMB rallied to technical excesses at 115.60 in late August and sold off to 111.18 in December. And with the party it soared to 117.20 on February 21st. It plunged to 112.98 on February 28th and the bounce has been to 117.08 yesterday. Not sure how much of the bid would be short covering but the astonishing part has been the compulsion to buy all of the risk products.

So many investment grade buyers have been forced to position risk. All because the state has chosen a bogus theory of economic intrusion. One theory has been that Fed expansion of credit forces a business expansion. Not so. This has been confusing correlation with causation. So the force-feeding has not been driving the economy and the public, as always, choses what will be speculated in. And when the choice is financial assets, as it has been since 2009, there are outstanding distortions.

One of which is the tragedy of forcing investors to buy JNK and EMB, which will not end well.

And it could be like a highly-promoted stock. So long as it is going up, the public will believe even the most preposterous of stories. And then when it goes down the belief vanishes in an instant.

This great financial bubble which has been funding another great experiment in authoritarian government seems to be failing. In which case, except for die-hard communists and liberals, the belief in government intrusion can collapse rather quickly.

Commodities

As noted above, Base Metals and Crude Oil became overbought in January and have sold off. Quite severely, such that last week we concluded that the rallies into 2018 could have been a cyclical peak.

The CRB Commodity Index set its high at 207 in May 2018. The recent low at 158 takes out lows back to the low of 155 in early 2016.

Base Metals (GYX) reached 423 in April 2018 and the recent low was 292. This compares to the low in early 2016 at 236, which is now our long-term target.

Crude Oil (WTI) set its peak in 2018 at 76.90 and the recent plunge was to 43.32. This compares to the low in early 2016 at 42.36.

Oil Stocks (XLE) set a dynamic high at 72.73 in 2018. The recent low has been 42.51, which compares to the low of 42.86 set in early 2016.

Some of these are so bad that one wonders if the bad is over? Don't think so. The reversal to adversity in the credit markets has again only just resumed.

Currencies

As one would expect the US dollar rallied with the mini-panic in stock and commodity markets. On the rush to 92 a few weeks ago it became rather overbought on the Daily RSI. The decline to 96.88 level is almost oversold.

We will stay with our old observation that the senior currency becomes chronically strong in a post-bubble contraction. And after building a base for a few weeks at this level there could be another rally.

To better understand this it should be understood that with most prices deflating in a post-bubble contraction the senior central bank will not able to depreciate its currency. The senior currency is still the US dollar. Another way of looking at it is that service debt due in US dollars represents a massive short position in US dollars.

And a central bank that can’t depreciate its own currency is like a pub with no beer.

Appropriately the Canadian dollar has sold off with the hits to stocks and commodities. The rally was to 77.21 at year-end and the decline has been to 74.29 last week. The bounce was to 75.08 and now it is at 74.08.

Zealots in the overly-populated provinces of Ontario and Quebec have convinced too many people that carbon dioxide is evil. And there will be no expansion of Canada’s outstanding resource industry. Recently Teck Resources announced that their $20 billion oils sands project in Alberta will not go ahead.

With tax revenues from resources diminishing one wonders how Ottawa will pay for the free things that are so popular with the electorate.

Precious Metals

We like to review the basic features of a great financial bubble and the transition to the inevitable post-bubble contraction.

One is that real long-dated interest rates decline through a bubble. As deflated by the CPI, this has been the case. On some bubbles such as in 1772, the real rate got as low as -5%. With the boom and then they head up as most debt becomes unserviceable.

Another stalwart of the mania is that the real price of copper goes up with the boom and down with the bust. And this has worked out with the real price advancing into early 2018 and declining since. The same holds for base metals. And for crude oil. Our charts for these against the CPI need the next update, but there is another way of looking at the change.

And that is against the old CRB Commodities Index. This declined from 788 in early 2016 to 596 in 2018. Now at 1061, gold has been flying relative to commodities, which is the way it should be.

Indeed, in looking at crude oil as a proxy for energy costs, Gold/WTI declined to 16 in October 2018. With a couple of worthwhile corrections it is now at 38. An outstanding move.

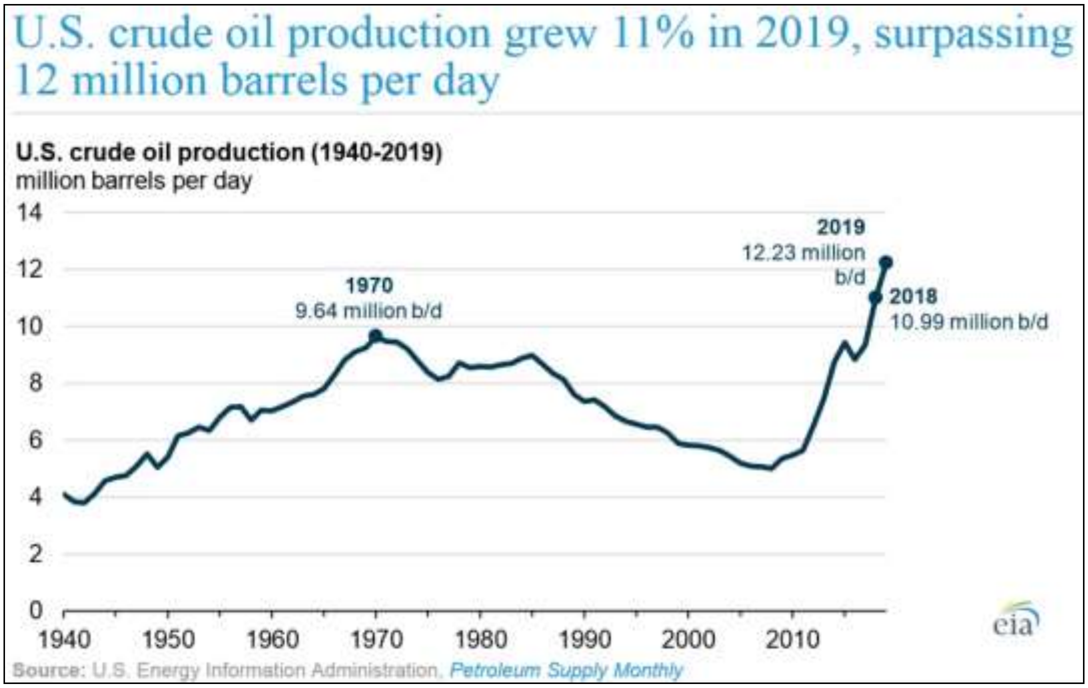
As with the rise (when updated) in gold's price relative to the CPI it is associated with improving profit margins for gold miners. And property valuations for exploration companies.

This is the setup for the lengthy bull market for Gold Stocks which is typical of a post-bubble contraction.

However, the force that drives the bull market for Golds is the financial contraction. And the sector could trade down with the general stock market.

BOB HOYE, INSTITUTIONAL ADVISORS
E-MAIL bhoye.institutionaladvisors@telus.net
WEBSITE: www.chartsandmarkets.com

Listen to the Bob Hoye Podcast every Friday afternoon at
https://www.howestreet.com/author/bob-hoye/


U.S. crude oil production grew 11% in 2019, surpassing 12 million barrels per day
U.S. crude oil production (1940-2019)
million barrels per day
14
12
10
8
6
4
2
0
1940
1950
1960
1970
1980
1990
2000
2010
1970
9.64 million b/d
2019
12.23 million b/d
2018
10.99 million b/d
eia
Source: U.S. Energy Information Administration, Petroleum Supply Monthly

Failed Up - Thrusts and Failures

Sectors –
Monthly Charts show Transports, Materials and Energy as the weakest.