OBSERVATIONS

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Is Deflation the Fed's Self Created Stay Puff Monster?

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ICAP Technical Analysis

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Central Bank Created Deflation

Central Bankers cannot inject trillions of free funds into the financial markets, get everyone terrified that the aim is the destruction of the currency through the ignition of inflation, and then expect that the result will ***not*** feature a series of asset bubbles.

If money is free and pays no interest then it stands to reason that it has no lasting value. One off-shoot of this market distortion is the consensus that only the things that money can buy have any chance of holding any value. Hence investors first fled to the Dot-Com bubble, and then to the Credit Drunk Real Estate Bubble, and then to a stock market bubble, and then to a commodity bubble. A bond market bubble is now in line to burst, with another stock market bubble still inflating behind it.

Central bankers well known the risk of free money are asset bubbles. But these bankers fear deflation much more than they fear asset bubbles.

Looking But Not Seeing

What central bankers have yet to figure out is that asset bubbles always burst well before any real inflation can be ignited. And these bankers have yet to figure out that, once a bubble bursts, prices always fall below levels that existed prior to inflation of the bubble. And these bankers have yet to figure out that there is nothing with more deflationary power than a series of burst bubbles across the major asset classes - equities, real estate, and commodities.

How can such really smart people be so obstinately dum? How can they not be aware of the self defeating nature of their tactics? There are usually deep metaphysical causes behind otherwise smart people doing really stupid things. This is clearly the case in economics, as I detail in the following pages. And it is definitely the case in what passes for both religion and politics these days, as current events attest. So let us explore the metaphysical basis of smart people doing dum things.

The Metaphysics of Personality Types

Some experts in the field claim there are four basic personality types. Others make a case for nine types. Still other claim sixteen personality types. My experience suggests that at a deep, metaphysical level there are only three personality types. There are those that fear change, there are those that embrace change, and there are those that are neutral to the whole issue of change versus stability. I would further contend that all classifications of four or more personality types are merely elaborations of how individuals attempt to function with their relationship with change.

A healthy society requires a population that is roughly composed of equal parts of these three basic personality types. A society composed exclusively of those who embrace change risks continuous instability. A society composed exclusively of those who fear change risks implosion through stagnation. In a society composed of all three types, those indifferent to the change versus stability issue are needed to prevent those who fear change from killing off those who embrace change.

Those who fear change fear the unknown. Their fear forces contentment with the status quo, however deeply flawed that statur quo might be. Those who embrace change relish new discoveries and allure of the unknown. Those who are neutral to this whole issue are likely to be thrust into the role of diplomats, mediators, and peace keepers.

Change versus Control: a case study from economic history

Nikolai Kondratiev (1892 to 1938) was a Russian economist who favored free market based solutions to economic progress. He is best known for popularizing a 50 to 60 year economic cycle that now bears his name - the Kondratieff wave. His study of economic cycles convinced him that capitalism was cyclical in nature, and that those cycles were essential to the durability of capitalism. In his view the cyclical down trends weeded out the inefficiencies and excesses of the cyclical up trends. The capitalist system emerged renewed and strengthened from each down trend. This put him at odds with the Marxist notion that the collapse of capitalism was inevitable and indeed imminent.

Kondratieff did well with Lenin in power. By 1923 Kondratiev headed a widely respected think tank in Moscow with 51 researchers. However Lenin died and Stalin seized power. Kondratieff's influence fell off a cliff from that point. Kondratieff was arrested by Stalin's order on trumped up charges in 1930. At the end of his eight year prison term he was re-arrested and re-tried. He was sentenced to another ten years, during which time he was forbidden to communicate with the outside world. He was executed by firing squad the same day he was re-sentenced.

Kondratieff versus Stalin can be seen as a parable of the age old metaphysically rooted conflict between proponents of change and advocates of control. And with Stalin in power there was no mediation.

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The Metaphysics of Central Bank Intervention

The aim of central bank intervention as it has been practiced since the 1990's is the repeal of economic cycles and their replacement with centralized, top down control of the economy. So there is clearly a 'fear of change' personality type at work here. Of course it goes without saying that those who embrace change do not end up in government service. Governments are all about preserving the status quo - at any price. And it can easily be argued that no aspect of governments are more keen to maintain the status quo than the central banks. This is a reality that transcends the nature of the government.

However there is more going on here than the application of control to manage the fear of change. There is the intellectual arrogance that 'my mind can organize the world better than the market can.' And this of course flies directly in the face of the justification for free markets. Even a Russian economist working in 1930 figured that one out. The central bankers, led by the Fed, are confident that they can do better than the market. Kondratieff, ever the student of history, saw how cycle after cycle capitalism emerged stronger from each economic down trend. Kondratieff saw these down trends as the strong winds that take down the dead wood from the trees of the economy. He feared central control because it meant there was no way to periodically weed out the excesses in the system. There is likely no central banker in the world today that sees thing this way. And we are all the worse for it.

Fear Creates the Feared

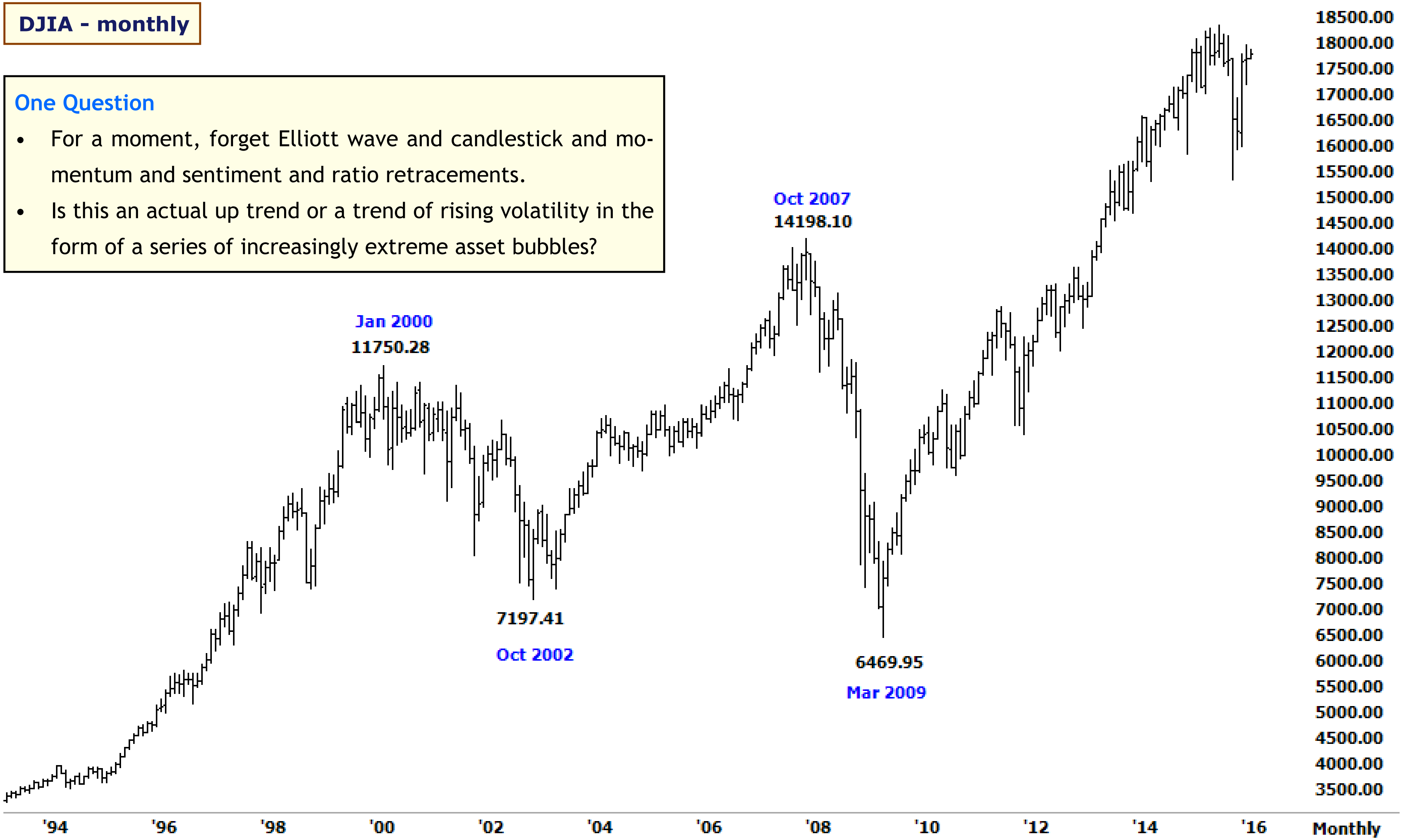
There is a parable from ancient India about a yogi who goes into the forest to spend the remainder of his life in deep meditation. However he is deathly afraid of being eaten by a tiger. His thought force is so powerful that his fear creates the tiger that kills him. The Oedipus trilogy of Sophocles is all about how fear inadvertently creates the feared. A recent iteration of this metaphysical truth is the creation of the giant Stay Puff monster in the 'Ghost Busters' movie. And then there is the fact that fear actually can kill you in the form of a panic attack.

Today we have central bankers around the world desperately afraid of deflation. Their unrelentingly aggressive and unprecedented intervention in the markets arises from their deep seated, metaphysically based fear of losing control. Yet their measures have resulted in a series of asset bubbles. And asset bubbles always burst well before real inflation can be ignited. And there is nothing with more deflationary impact than a burst asset bubble. But good luck trying to explain any of this to a central banker. They are control freaks by nature - control freaks that cannot see beyond their fear of change, their fear of the unknown. They try to hide their fear behind broken economic models, quantitative analysis, and complicated mathematical formulas. This is why they are unable to lose their flawed models and take on a fresh perspective. They are prisoners of their fear of change, of their fear of free markets. And we are all trapped in their prison.

DJIA - monthly

One Question

- For a moment, forget Elliott wave and candlestick and momentum and sentiment and ratio retracements.
- Is this an actual up trend or a trend of rising volatility in the form of a series of increasingly extreme asset bubbles?




Thomson Reuters Continuous Commodity Index - monthly
381.00 vs. 264.00
The 381.00 target has just been hit. The 264.00 target is still a further 31% loss from here.
Each of 17 Commodities at 5.88%
Cocoa
Coffee
Copper
Corn
Cotton
Crude Oil
Gold
Live Cattle
Lean Hogs
Natural Gas
Platinum
Silver
Soybeans
Soy Oil
Sugar
ULSD
Wheat
691.09
615.04
322.53
-A-
598.65
502.28
<A>
27.3% loss
499.99
-B-
-C- of <B>
569.70
379.92
<A> = <C> = 380.89
1.618 x <A> = <C> = 264.20
'09
'10
'11
'12
'13
'14
'15
'16
Monthly

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Bull versus Bear

- At this point the bull case is that 74.65 is hit and holds.
- The bear case is that 74.65 is decisively breached.
- If 74.65 is breached we are talking about a 46.00 to 39.00 downside risk.

Components

- Energy 31.78%
- Grains 22.95%
- Indus. Metals 16.60%
- Prec. Metals 15.67%
- Softs 7.85%
- Livestock 5.14%

74.65 vs. 39.00

- The 74.65 is only a 9% loss in commodity prices from here (81.75).
- The 39.00 is an impressive 52% loss in commodity prices from here.

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AUD tettering on the brink

- The Australian Dollar. is one of the top three global commodity currencies.
- For the last three months the Aussie has been teetering on the brink of another flush lower.
- Suspect the bearish sentiment extreme into .6900 has had much to do with the failure to follow through on the downside.
- Bulls need a decisive break out above ***.7900*** to have any case.

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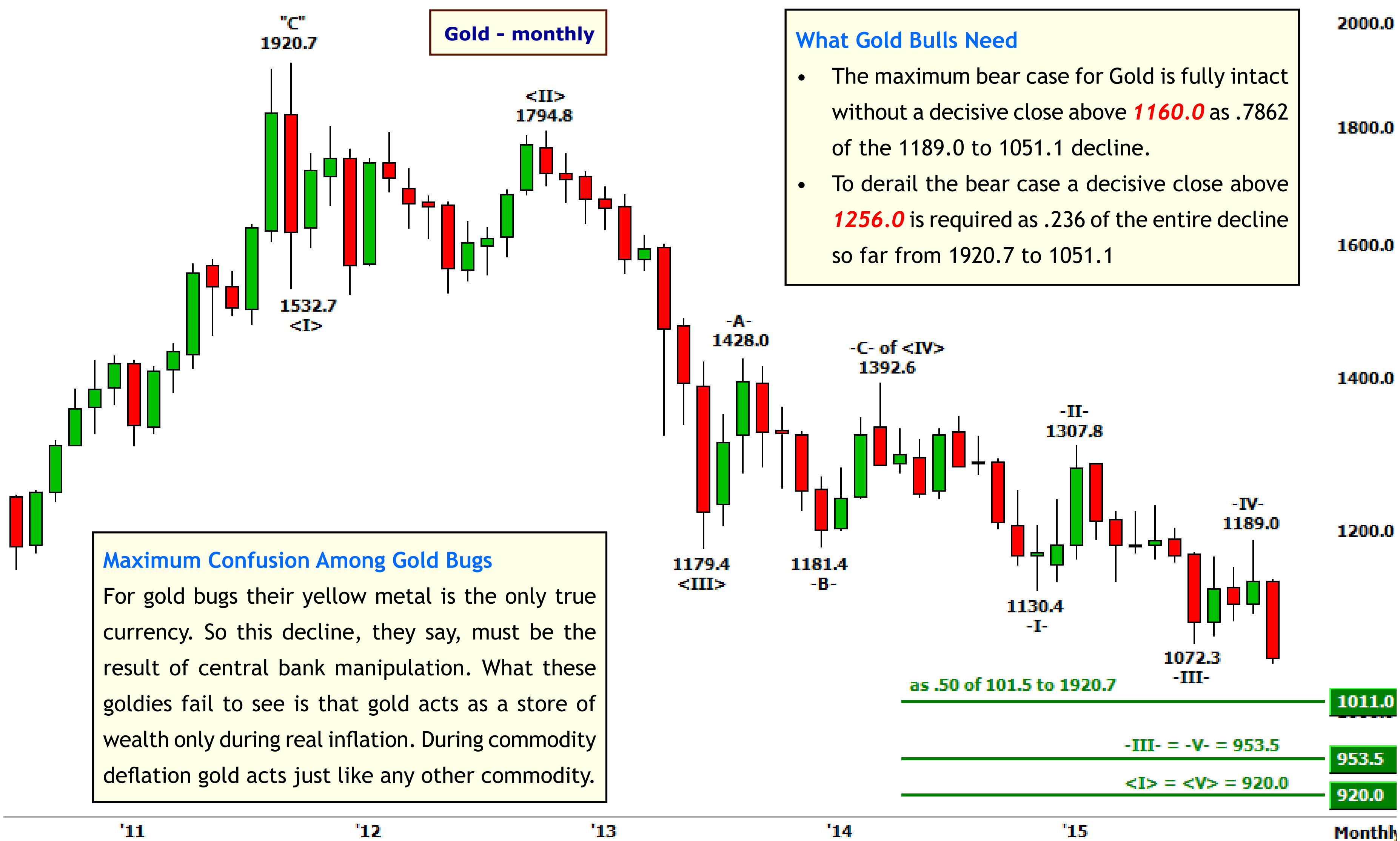

What Gold Bulls Need

- The maximum bear case for Gold is fully intact without a decisive close above ***1160.0*** as .7862 of the 1189.0 to 1051.1 decline.
- To derail the bear case a decisive close above ***1256.0*** is required as .236 of the entire decline so far from 1920.7 to 1051.1

Maximum Confusion Among Gold Bugs

For gold bugs their yellow metal is the only true currency. So this decline, they say, must be the result of central bank manipulation. What these goldies fail to see is that gold acts as a store of wealth only during real inflation. During commodity deflation gold acts just like any other commodity.

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Trend Still Down

From the viewpoint of Elliott wave there are only two candidates for major support between here and the 1.2275 level.

- *1.9700* as .7862 of the advance from the 1.2475 low.
- *1.4645* as .7862 of the larger advance from the .6040 low

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What Does the Price Action Say?

- Since the 9.95 low there has been a consistent pattern to multi-year lows.
- The bottoming pattern has been three months of congestion followed by a decisive push higher starting from the fourth month.
- This was the case from 9.95 and 16.67 and 34.30
- November was the fourth month after 39.99
- Instead of a push higher November gave a dump to a new monthly low close.
- Bulls need a decisive close above ***59.00*** from here as .236 of the 120.69 to 39.99 decline.
- Otherwise I must assume the trend is still down.