29 July 2014

The Global Financial Markets

Putin: Villain or Scapegoat?

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United-ICAP

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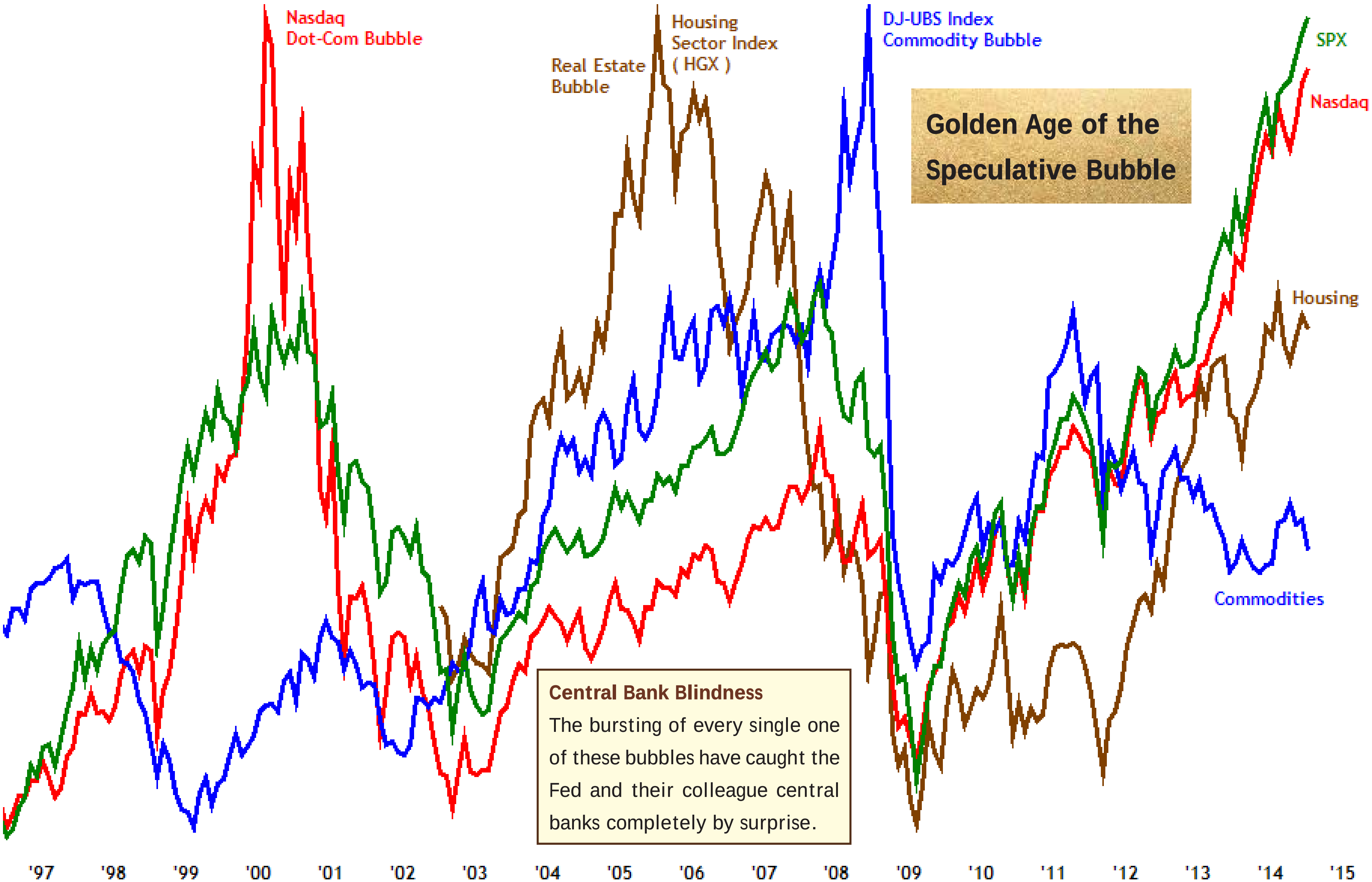
Equity Indices World Tour
24 July 2014



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DJIA - monthly

- If the recovery is for real then what the heck is this big, bearish rising wedge doing here?
- And why did the DJIA quickly drop 235 points from a precise failure into my critical long term resistance?
- The rising wedge support line cuts at 16,090.00 this month and at 16,242.00 for the month of August.
- Big relief for the bulls if 17150.25 is exceeded.
- Big disaster for the bulls if 16242.00 is broken during the next month of trading.

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Euro-fx - monthly

Why does the Euro-fx look like it just fell off a very big cliff? Because it just did.

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Copper - monthly

- Why does Copper look like it has spent the past few years preparing to break down from a very bearish descending right triangle pattern?
- If the recovery if for real, why does this look like a major top is at hand?

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Ten Year Treasury Note Interest Rate - monthly

- Why has this benchmark interest rate been in a down trend channel all year, despite repeated assurances that the Fed will be tightening.
- And why do rates look about to accelerate lower?
- Could a ‘flight to safety’ out of equities and into Treasuries be on tap?

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Dow Jones - UBS Commodity Index - monthly

- Should not a real recovery lift commodity prices?
- Why has this broad based commodity index look like a dead cat bounce?

The implied minimum wave count objective as outlined targets price levels not seen since 1998 - 1999.

- Could a powerful deflation still be ahead?

Components by Sector

- Energy 31.8%
- Indus. Metals 16.6%
- Prec. Metals 15.7%
- Grains 11.8%
- Beans 11.2%
- Softs 7.9%
- Livestock 5.1%

Baltic Dry Index - monthly

- Why does this chart look so awful?
- And why does the bullish case target lows last seen in August 1986?
- Is this a mere glut of ships?
- Or is world trade about to sink?

Market Price Action: Endogenous or Exogenous?

Endogenous means having an internal cause, origin, or dynamic. When it is said that market price action is endogenous it means that the price action arises from the innate dynamics of the market itself, and there are no external causes involved.

Exogenous means having an external cause or origin. When it is said that market price action is exogenous it means that the price action arises from external causes outside of the market itself. and there are no internal market dynamics responsible for the price action.

Analysts, investors, traders, politicians, and economists all very much prefer the view that market price action is exogenous in nature. With this view analysts can spend their time spinning brilliant sounding reasons to stay long, investors can feel confident that everything can be explained, traders can justify enormous positions to their risk managers, politicians always have something or someone to blame. And economists can always claim that, if it were not for this or that unforeseen event over which they had absolutely no control, the economy would be doing much better - as they had originally predicted.

However, the more time you spend closely watching the relationship between the actual price action of a market and the 'external causes' that are cited, the more flimsy the exogenous model appears.

The News Follows the Trend

The old Wall Street proverb cited above is equally hated by investors, analysts, and the media. Especially by the media. What is so despised about this proverb it that is reveals the fact that he so-called news is created after the fact to explain what has already happened. After the fact explanations do not cause previous price action. The proof of this can be seen when the same so called 'cause' is cited to explain both the higher prices after an up day and the lower prices after a down day. This occurs all the time.

The problem is that we are so eager to be comforted by the news that we dare not question its relevance. The news is comforting whether it is 'bad' news or 'good' news because it means that everything can be explained. And with an unquestioning audience it also means that the news narrative can be controlled. When the price action spins out of control there is always another handy external cause to be cited.

As detailed in previous reports, the central banks have created the golden age of the speculative bubble. Because bubbles always burst this makes up trends sharp but brittle, and down trends unrelenting. The bigger the bubble the greater the need for an external cause. I think we can see what is likely to happen here. Putin will be blamed for everything, we will have learned nothing, and the central banks will get off scot-free, again. After further stimulus of course.

Why 'bad things' happen in bear markets

One of the central themes that emerges from any study of longer term cyclical behavior is that the excesses from the down phase of the cycle contain the seeds for the next up phase of the cycle. And more relevant to this discussion, the excesses from the up phase of the cycle contain the seeds for the down phase of the cycle.

For examples, as the cycle high of a multi-year advance approaches you will find a tidal surge of CEOs busy spending their cash buying back their own stock, instead of making investments for the future. The dollar volume of S&P 500 stock buy backs during Q1 of 2014 were only exceeded by those in Q3 of 2007. And if these CEOs are not buying back stock their own stock they are likely buying the stock of some other over-valued company in a take-over attempt. As expressions of bullish sentiment extremes the largest take-over attempts precede the biggest peaks in the market. Like Time Warner, again.

And as the cycle high of a multi-year advance approaches you will find investors reciting "you can't lose" and over-extending themselves accordingly into questionable sectors at even more questionable prices. Like the record volumes of sales of junk bonds today, at record low yields. Or the record highs in many stock markets. Or the fact that the VIX just retested its lows from 2007. Risk is always under appreciated at major peaks and over emphasized at major lows.

"Would you please elaborate on 'then something bad happended'?"

And as the cycle high of a multi-year advance approaches you will find a growing collective sense of inclusiveness and toleration, and a view that the world has finally learned from the mistakes of the past. Hence the great collective shock when Russian trained thugs shot down MH17 and, on the same day, Israel went off to war with Hamas. Were these dual shocks, hitting a bullish sentiment extreme, sufficient to burst the bubble? The answer will be "yes" if the DJIA can now break below the pivotal 16.090.00 level cited on page 3.

Putin: Villain or Scapegoat?

Now that we have finally laid down the necessary foundation, we can intelligently discuss the sub-title of this report.

The first point to make is that by suggesting that Putin will be made a scapegoat for the reckless and dangerous policies of the major central banks, my intension is not to let Putin off the hook for his thuggish and murderous behavior. As I detailed in my observations report dated 3rd May 2014, the history of Vladimir Putin in positions of power can be summarized as 'once a thug, always a thug.' All the evidence suggests that he began his career by blowing up low rent Russian apartment buildings to justify invading an already semi-autonomous Chechnya. Alexander Litvinenko, the ex Russian FSB agent claimed he had proof of this. So he was injected with Polonium 210 by, in all likelihood, Andrey Lugovoy, a member of Russia's FSO. But I digress.

As stated in his own words Putin views the collapse of Soviet Russia as the greatest disaster of this century. And he has appointed himself in charge of fixing that. Putin sees three main obstacles to reviving lost Soviet glories - the United States, NATO, and the Euro-zone. If there is anything that he can do to weaken any or all of these three entities, he will do it. Especially if it is covert enough to be deniable. Remember that he began his career in counter-intelligence in the KGB. So he will prefer covert destabilizing efforts to outright invasions.

The next bursting bubble: endogenous or exogenous causes?

Now we circle back to the page 9 discussion on endogenous versus exogenous causes for market price action and market trends. But now we need to bring this discussion into the subject of market bubbles.

Do speculative financial market bubbles burst because of their own endogenous excesses, or are they punctured by exogenous events like Putin's tactics? I would like to suggest that an up trend born of slow, steady, and sustainable organic growth rather than external, forced, stimulus will be much less likely to result in a speculative bubble. Such an economy is likely to be much more resilient and therefore much more capable of shrugging off the occasional external shocks. However a market where the central banks have forced millions of investors to leave financial safe havens for more speculative investments will be much more vulnerable to external shocks.

In other words I would like to suggest that, while a true bull market will suffer the occasional but healthy bull market correction, it is much more difficult for a bubble market to correct without bursting. And every time a speculative bubble bursts there is the risk of a deflationary meltdown. That is never a risk in a bull market correction. So does Putin have unwitting allies in the Federal Reserve, the Bank of Japan, and People's Bank of China? That would be an irony for the ages. And we may not need to wait long to find out.