

Notes From the Rabbit Hole ©



Peter Newell's illustration of Alice surrounded by the characters of Wonderland. (1890)

In Lewis Carroll's *Alice's Adventures in Wonderland*, Alice follows a mysterious white rabbit into a rabbit hole to enter 'Wonderland', an absurd and improbable world inhabited by many strange characters.

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Bull?

I want to call your attention to a [bit of analysis](#) and a monthly chart of gold I did on the old [Biiwii.com](#) COW (Chart Of The Week) in March. I do so because back then I was getting bearish, which was appropriate given the over bought technicals and the level of impenetrable bullishness in the sector now that gold bugs' long awaited Armageddon had finally visited the financial markets. People were convinced that the yellow metal was going straight to 1500 from severely over bought levels. My thoughts included what I have parroted over and over for years:

"The play in the miners is and has been that if gold declines, it needs to outperform the likes of oil, industrial metals and human hopes for positive economic prospects and the gold miners should be okay, counter-cyclical instruments that they tend to be. But this dynamic is also a factor in our 'buy the corrections only and take some profits on strong runs' mentality."

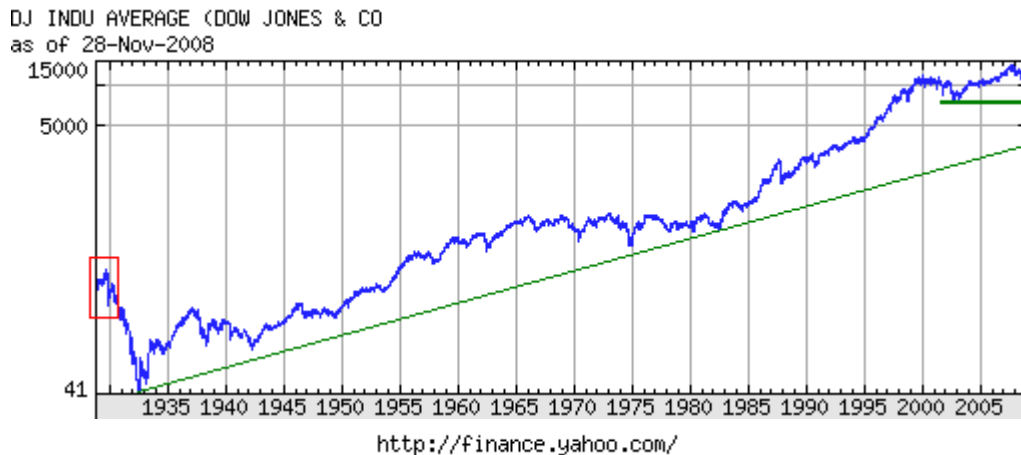
Well, the gold miners were not okay and in the words of Marcellus Wallace in Pulp Fiction, they were 'a long #\$\$%&'n way from okay' as the contraction in credit set off a frenzied race to cover what had been the trade of the cyclical bull market (2002-2007): short the USD (and Yen), long everything else (especially the commodity and resource bubble linked to the popular 'China Trade').



This is now water under the bridge because the acute phase of the panic ended with October's passing and the retest phase appears to be coming along nicely as well. I am now looking for a decline in the extended and bearishly diverged (MACD, TRIX and other indicators) US Dollar. The daily technicals have eroded and the world's number one debt note remains strenuously over bought by weekly charts.

By the same token, bullish divergence has presented itself in most other markets, which stand to benefit from unsustainable bearish sentiment as the major media the world over have done their job once again. The result being that people sit safely in cash which is right where they're supposed to be from the perspective of those who need a counterparty in waiting.

I am bullish nearly everything except the Dollar and Yen, for a technical rally at least.



As this chart (courtesy yahoo! Finance) shows, there was a long way down following the initial panic of 1929. But do you see that little hitch upward in the red box? Well, it may not look like much but for many market participants at the time it felt like *'the worst is over and happy days are here again!'* Be forewarned. Longer term this chart tells me the Dow has potential to 4,000 as all the chickens born of immoral activity on Wall Street dial us back to 1994 levels. I don't necessarily *believe* this will happen but neither did I necessarily *believe* gold would go to 700 after the charts told me of that 'potential'. As shown later in this edition of NFTRH, current portfolios reflect bullish positions in Asia, energy and US stocks. This is for a trade and a trade only.

Is there a true bull out there? Yes, I believe so. This bull lives with the gold miners. Various hockey sticks known as the gold-oil ratio, gold-gyx ratio and gold-human hopes for prosperity ratio provide undeniable evidence of superior fundamentals in the making.

As short term evidence now, post panic, again please review the HUI technicals provided yesterday on the blog: <http://biwii.blogspot.com/2008/11/hui-current-status.html> and note that yesterday's low volume, post-holiday action has brought Huey to resistance as noted at around 250. This means we are ripe for a correction, which would be a buying opportunity per the notes on the chart. But this is a very healthy index overall, having been savaged along with the rest of the market during the October panic and November retest phases despite fundamentals that were made ever more positive by the same forces that drove the USD higher. I expect *relief* in the post-panic broad markets to provide the underpinning for a real *BULL* market in the gold miners to begin to unfold.

As I always say, the market is full of short term noise and misperception, but that eventually gets sorted out. The playbook has always shown the gold miners as superior investments during economic contraction, not as part of the greed-fueled 'inflation trade' (RIP 2003-2007). There is only one sector in which profit margins are set to expand, therefore there is only one sector where the bull is likely to be a cycle as opposed to a hopeful reaction to fear and panic of unsustainable levels.

US Dollar

Uncle Buck is the center of the world's attention after spending years as the dirty little secret of the 'inflation trade' AKA illegitimate stock bull (see dow-gold ratio) and the China and commodity manias. The vampire-like sucking of the Dollar's value (or reputed value) led to incorrect assumptions by 'resource' bulls, speculators, the public and eventually supposedly conservative institutions charged with guarding peoples' retirement accounts and general wealth. The anti-Dollar trade spawned a global casino filled with 'can't lose' patrons. They leveraged, they lost, and what is left of their funds now resides safely in cash.

Here is a daily chart of the Dollar with the usual add-ons. The chart has continued its degradation while the weekly remains over bought, as mentioned earlier. There looks to be a bear flag forming, which will likely coincide with a not too serious pullback in the

gold miners and broad stock markets. As noted on the chart, I expect a decline in USD to the low 80's at least before any thoughts of renewed upside (vs. other degraded currency). The MACD and TRIX are simply damning for the near to intermediate term. Add to this that if October and November did not get you to buy Dollars, nothing will. The counterparty is happily in place.



Gold Miner Fundamentals (again)

I must go over this again because it seems that many people either do not want to see it or cannot see it due to all the static flying around in resource guru land. First off, the lower two panels on the USD chart are conclusive evidence that the gold miners' product has outperformed the gold miners' cost drivers (oil and base metals being two big ones, and human hopes – for which I do not have a ratio chart, but we can safely assume this one – being another).

Ironically, on any coming hope rally in many markets, things like oil, copper and silver are likely to lead gold. I doubt however that gold miners will under perform because by the time the rally is expressed for all to see, we should be seeing actual reported evidence of the bottom line improvements for which the ratios are early indicators. By the time the third indicator, human hope kicks in, it will probably be time to begin selling the market and perhaps taking some well deserved gold miner profits as well. But that is just a general sketch. Let's just take this step by step, and right now the next step is to prepare for some potential consolidation followed by continued upside.

The Macro Indicators

Status of some of our frequently watched indicators:

LIBOR 1 Month: Turned up to 1.90

LIBOR 3 Month: Holding steady at 2.20

M2: Resumes uptrend and back to highs

MZM: Further into blue sky territory (new highs)

TED: Still behaving at 2.10

The picture here remains one that is constructive to the post-panic story. It is the holiday season after all and America has 'hope' for change which, given the previous administration can only be an improvement. But an economic deceleration does not stop on a dime and the new administration has full support in ongoing efforts to fight the deflation impulse.

The combined policies of the current and new administrations are likely to set the groundwork for severe inflation issues in the new decade.

Wrap Up

The general outline, which I look forward to detailing and revising as events unfold, is that the financial world was shocked in October and the spirits of the plucky few who survived emotionally were crushed in November. The situation is bad and there is

