

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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We're Only Making Plans...

My investment and trading style involves always having a plan that is subject to revision and evolution at all times, and generally serves as a road map for navigating financial markets that can be complicated on a good day and downright violent and irrational on a bad day (or in the case of recent events, many bad days clustered together).

In 2008 I had done my homework and decided who and what I was and despite the traumatic moves in markets that went wildly against my bullish gold miner stance, I held strong and took good advantage of HUI 150, which you will recall was merely the latest (and ultimately last) downside target after 250, 220 and 175 were snapped like dried kindling during Armageddon '08. But a target it was, and it held.

The original plan, before the acute phase of panic began, was to hold gold miners and cash in the face of an on-coming deflation impulse. Bearish oil, bearish copper, bearish human hopes for prosperity, bearish the Ponzi scheme known as the United States – and by extension, global – financial system, I held what my research told me to hold; cash (along with t-bills and short term treasuries) and gold miners. Once again, here I will interject my belief that gold miners are to be 'played' only after one has seriously considered ownership of the actual precious metals, especially gold.

As noted many times, the reason to hold gold miners is that they should perform well in an economic contraction environment as these companies' cost drivers decline relative to their product. Well, as the market crisis grew more violent and human hopes crashed along with cost inputs like oil and base metals while gold held its own, I grew more bullish the gold miners as they came on sale at crazy prices.

The plan morphed and I began to have visions of an epic opportunity in the making; something we would look back at years from now and thank the trading gods we had the focus and courage to capitalize on while most people were panicking. Even as I was suffering financially in the short term and being negatively reinforced by everything around me, I was able to get outside the October/November bubble in fear, look at it objectively, tweak the plan and remain on course and on message.

The message was updated weekly here at [NFTRH](#) and regardless of how things were to turn out for the investment stance – and I believe it is well on its way to being validated – I wanted to have it documented during historic times. The letter's entire 'Q1' will remain posted on the website as a sales tool, yes. But it is in reality a once in a lifetime opportunity for me to have shown exactly how the service operates in the most difficult of circumstances; *historically* difficult circumstances. After all, everybody is a genius in good times and I am glad I waited until the world began falling apart to see if [Notes From the Rabbit Hole](#) could pass muster.

Both portfolios are now back above 'baseline' (their levels at NFTRH launch in late September), the panic phase is over and a plan is in place. This one involves a broad global market recovery from unsustainably morose sentiment levels with the gold miners – relative strength leaders already having doubled off the bottom – leading. This makes sense because not only did the same forces that drove the world's reserve debt note impulsively higher also drive gold mining fundamentals higher, they put a serious exclamation point on the proceedings in the form of gold-oil, gold-industrial metals and now gold-thirty year rate ratios.

It is advisable to tune out hyperbole (bullish *and* bearish), look at convention with distrust (and really, has conventional thought not been the undoing of the vast herds of followers, including most financial professionals?) and to have your own plan, subject to ongoing revision through rational thought.

At this point, my personal plan holds that a *bear market* rally is beginning as the markets grind out a bottom. The rough target for the S&P500 is in the 1200 area. The plan holds that the gold miners have begun a new bull market; one that may eventually make heads spin. But be aware, the plan also holds a contingency that if our broad market 'next leg down' is as severe as I suspect it could be, some serious profit taking may come into play in the gold miners as well. After the recent panic, we know all too well what can happen in emotionally charged markets despite fundamentals.

Markets are now functioning 'normally' and the major media, always a day late and a dollar short, continue to beat the dead economic horse. The new US administration will

continue a rich history of inflationary policy that has been the product of the most myopic academic minds on the planet; a Keynesian nirvana, which is actually the worst nightmare of honest economists, the likes of whom come from the Austrian school of [von Mises](#) and Rothbard.

The world turns, a global depression (in many assets and industries) is likely to get worse before it gets better, misperceptions will run rampant and within the confusion, there will be opportunity. I am not here to save the world. [Biiwii.com](#) was started as a free resource to try to do its small part in that regard. Most of the world yawned. It is time to make money, preserve wealth or do whatever else is necessary to navigate a world in financial and social disarray.

Thank you dear subscribers for being aboard [NFTRH](#) during its first quarter in existence. 2009 stands to be an interesting and potentially profitable year. We will remain outside whatever box gets constructed post Armageddon '08 and attempt not to predict the future, but to interpret events along the way in service to an ongoing and revisable plan.

US Dollar

Again, we track the Dollar not because it has any particular relevance beyond the misperceptions of the global gamblers who got us into this mess in the first place, but because it is still acting as a polar opposite to most other assets, gold miners included.

Even as the gold miner fundamental ratio charts have continued to explode higher, the correlated USD has not only experienced its first major damage on the daily charts, but as the following weekly chart shows, the MACD has down triggered from over bought levels and that is not a good sign for the intermediate term. The ADX and Wm%R lower panels are hinting that the intermediate trend may be about to turn down (AROON is still positive, but it lags these other indicators).

On the bullish side – and whether they know it or not, people holding 100% cash are bullish the Dollar – this epic debt note has already retraced 62% of its impulsive rise and come down to visible support.

But the fundamentals for the Dollar stink and I will say that the MACD along with the break of the EMA 20 (notice how this moving average contained any bear rallies into 2008 and supported the first leg of the post-July advance) trumps any bullish indicators and it is now up to the USD to prove the breakdown as false. It may one day rise again in any 'next leg down' in human hope for prosperity (and markets), but first the MACD signal will need to be negated.

In short, the Dollar remains bearish until it climbs above the EMA 20 *and* the MACD triggers back up. It could be a long wait.

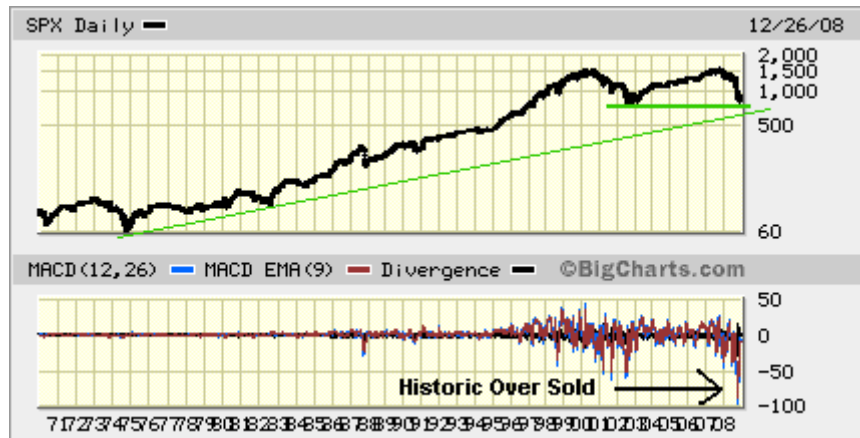


Stock Markets

We now dial out to the big picture for the stock market. At this point all I am willing to speculate on is that we are attempting to form *some* kind of a bottom. This is based on patterns shown previously on daily charts and also the idea of the 2002 low acting as lateral support. The 850 level remains critical on the daily SPX chart.

While I do not have enough focus in my game plan at this early juncture to proclaim such, some analysts see the ultimate lows in this bear market as being not much lower than current levels. I would imagine the trend line noted below might factor in to this analysis. But if we want to get really big picture, we can draw Dow trend lines from the 1930's that target much lower levels, as shown previously. Best to let events unfold.

But we do know that markets are tentatively holding daily support levels and 2002 lateral support and sentiment-wise, markets could be ripe for a rally. If and when said rally becomes acknowledged more universally, it would be time to begin thinking about the 'next leg down' and what its nature may be.



In the here and now however, recall the potential for a series of higher highs and higher lows on the Hong Kong \$HSI index noted in NFTRH11. The index did indeed go on to break the SMA 50 and make a higher high before correcting back down to test the SMA 50 in search of support and the formation of a third, and higher, low. What this chart tells us is that this important global market remains in tune with the near to intermediate term bullish scenario.



Gold Miners

Today I am using the GDX chart instead of HUI. This is because the GDX shows the gaps that have been left in the sector as well as volumes and money flows. Now, maybe I have been doing charts for too long, but gaps tend to really bug me. Understand that they do not necessarily need to fill in the short term, but they are usually filled sooner or later. The rise off the bottom has been very gappy as opportunistic money poured in.



The filling of some or all of these gaps meshes with the very rough sketch of a potential 2009 game plan, where the markets rally on hope for a few months and then decline to fresh bear market lows while the gold miners make a higher low in an exhibition of relative strength in a prelude to the next leg of an ongoing bull market. But bull market or not, I do not want to be aboard any retest of the lows scenario in a big way. So I watch the gaps and this potential scenario going forward.

HUI 250 has been the target for this mini correction of the initial upward thrust off the bottom. The corresponding level on GDX is around 26. Will it get there? People looking to get aboard the sector are running out of time to find out and this is the reason I do not try to nickel and dime bottoms, but rather buy 'all in and around' them.

The EMA 20 is rising rapidly and now the SMA 50 is beginning to rise. This is supportive. All panel indicators are a-okay and supportive. Best of all, gold miner fundamentals as represented by the ratio charts (gold-oil shown below) are just wildly bullish, but way over bought. This sets the scene for gold stocks to rise as their fundamental indicators potentially decline from over bought levels. When everyone is a gold stock aficionado it will be time to brace for a hard correction. But first things first, the sector is bullish and I remain bullish just as I have since before it bottomed.



Wrap Up

LIBOR1 at .47, **LIBOR3** at 1.47, **TED** at 1.48. Can we say ‘enough said’ about these credit crunch indicators and move on now? They are supportive and are likely to remain so until such time as any Armageddon ’09 festivities kick in.

MZM and **M2** are being fashioned into hockey sticks, taking the lead from that **Monetary Base** graph you see all over the internet compliments of the hyper-inflationistas. The government is institutionalizing a bailout mentality and it is becoming apparent that this is how a system ends; by becoming more of what it is and always had been. Namely, an experiment in mediums of exchange by fiat. The system will end and it will end at the hands of the system’s fundamental ideology, that money can be created out of thin air at will to solve economic down cycles. It is timing that is the issue.

The sick joke that is our **long term treasury market** continues to be the main ‘fundamental’ underpinning to a dying economy. Again, this is financial incest of the worst kind and cannot succeed beyond appearances. Read the views of John Hussman and Bill Buckler for rational analysis:

<http://www.hussman.net/wmc/wmc081222.htm>

<http://www.321gold.com/editorials/buckler/buckler122208.html>

The future will likely include inflation *effects* of the worst kind because inflation *policy* of the worst kind is currently being engaged.

THE Obama

Unfortunately, the current system is saturated and our leaders’ credibility is bankrupt just like the system they promote. We will call any rally in hope over the short term ‘the Obama rally’ because THE Obama should inspire hope. Heck, I am hopeful that he will prove a better, more open (to rational delegation) leader than GW. But with inflation policy set to go on steroids, Mr. Obama is not going to solve the mess he inherited. He is very likely to make it worse. But then, dead 20 times over is no worse than dead 10 times over now is it?

Why ‘THE’ Obama? Because during a very nice Christmas get together with extended family, I was brought under siege by a rabid and possibly delusional relative after questioning Obama’s economic knowledge. I will spare you the details but it drove home the power that this man, or more accurately the *idea* of this man carries among a very many Americans and global citizens.

Again, in some ways I am hopeful as well, but NFTRH is a financial and economic letter and in that regard, hope remains a four letter word. Don’t fall for the big feel good financially. It could break many hearts later in 2009.

Portfolio Notes *(Portfolio notes edited for NFTRH sample editions)*

The **capital preservation portfolio** is as fully invested as it is likely to get and still sports a hefty 70% cash and equivalents level and holds what I consider to be a stable fund, the Permanent Portfolio Fund (PRPFX). The XXX position was increased on manic downside that mirrors last summer's upside hysterics and is still considered a hedge on home heating and nothing more at this time. XX, XXX, XXX, XXX, XXX, XXX and XXX anchor the gold stock segment of the portfolio with XXX, he of the sound business model, anchoring the much smaller exploration contingent. XXX is also still held as a favored silver stock and XXX April '09 \$10 calls remain on board as well. The portfolio also includes a small position in XXX (commodity royalty) and XXX, an ultra short play on the over extended long term treasury market and can hedge short term treasury funds that the portfolio still holds.

The **speculation portfolio** is locked and loaded for a gold miner – and to a much lesser extent – stock market rise. All of the above mentioned gold stocks are held along with a higher concentration of explorers like XXX and XXX along with additional silver stock XXX and the silver bullet, XXX. XXXX was added in a nod to the idea that world is not ending and XXXX, my pet favorite trading stock is back in again after several profitable round trips off the 6 area. In energy, XXX remains on board for dividends and hopefully a nice price rally and XXX was just added this week near what should prove irrational lows as things get ironed out in the herd's sentiment. Cash level is now 18%.

To give you an idea of why I needed freedom from documentation of every detail of the portfolios in NFTRH, yesterday included a little wiggle. XXX has more than doubled off of the bottom and I felt the urge to take partial profits. Concurrently, I have been trying to be patient in reestablishing a XXX position in the spec account (it has been held all along in preservation). I ran a XXX/XXX ratio chart and saw that XXX had exploded in XXX terms as well as in nominal terms. So selling some XXX and cycling the proceeds into XXX made sense. It is all about balancing, and sometimes I do this as second nature. It would create a lot of extra work if I tried to run portfolios the way I need to run them and document every detail weekly. Again, I am at heart a trader. I can't help it. ;-)

2009

I want to wish you all a continued excellent holiday season and happy new year and thank you once again for your support, encouragement and most of all for your readership! I am very pleased to have been able to start the letter into the teeth of something historic that has changed the world. Going forward we will continue to do the work necessary to have a good chance of being on the right side of those changes.

Thus ends NFTRH's Q1. NFTRH13 (lucky 13) will be the last issue to be posted for free (time delayed) on the website. I think prospective subscribers have by now gotten an idea of what it is all about.