

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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They Said It

“If only we hadn’t had those [Bush] tax cuts, we would be in better shape for dealing with the crisis now. But the trouble with tax cuts, just forgetting about value judgments is that a dollar of tax cuts may translate into quite a lot less than a dollar of additional spending. We have an economy that’s suffering from insufficient demand, ah, tax cuts are not... they don’t give good bang for the buck in dealing with this kind of crisis whereas if the government goes out there and hires people to repair a bridge that’s about to fall down, that not only fixes the bridge but it also contributes directly to the economy.” – Paul Krugman (per Bloomberg video: <http://tinyurl.com/dxfben>)

Paul Krugman and Robert Reich are getting a lot of air time as the public looks to these economic experts for their views from on high in its time of need. The public is looking to the learned opinions of people whose entire economic orientation (fiat money creation and associated spending) has resulted in total failure. It is the perfect illustration of the metaphor of trying to save an overdosed junkie with a mainline of pure heroin.

Government is getting bigger, the money supply is increasing and while intentions are somewhat benevolent right now, projecting a few years down the road, we can see very dark possibilities; we can see individual saving (and prudence) having been discouraged in the interest of spending our way out of this mess (at the cost of our children’s future), people dependant on big government and one grand, and global, inflation problem.

“The jobs the American people care about most -- their own -- will be dramatically safer the day that President Obama signs this plan into law” – Nancy Pelosi

From Bloomberg: *“The stimulus plan provides a half-trillion dollars for jobless benefits, renewable energy projects, highway construction, food stamps, broadband, Pell college tuition grants, high-speed rail projects and scores of other programs. It raises the nation’s debt limit to about \$12 trillion.”*

This is a new New Deal gone steroidal and it is designed to save some jobs in the short term, not to mention enrich those highly connected with government. Raising the already unpayable debt limit is no doubt an inside joke, and it seems we are doing everything that hubris choked, late stage societies would be expected to do in their moment of maximum denial. The result is going to be a delay in reckoning with the final meltdown as a bankrupt system lurches forward killing itself with ever more of its own failed policy.

“I think everyone in this chamber on both sides of the aisle understands we need to act,” said House Minority Leader [John Boehner](#), an Ohio Republican. “But a bill that’s supposed to be about jobs, jobs, jobs has turned into a bill that’s all about spending, spending and spending.” – Bloomberg

Where were these kind of Republicans when we needed them to stand up to the Bush administration? If not for Republican failure to act *Republican* at crucial times, we would not have Democrats in control and simply doing what Democrats do.

Meanwhile, the G7 weighs in: *“We reaffirm our commitment to act together using the full range of policy tools to support growth and employment and strengthen the financial sector,” said the draft statement, which was obtained by Bloomberg News. “The stabilization of the global economy and financial markets remains our highest priority.”*

And Goldman sums it up: *“More is better,” said [Jim O’Neill](#), chief economist at Goldman Sachs Group Inc. “People have had their confidence shattered.”*

Well Jim, perhaps in the long run shattered confidence is exactly what ‘people’ need. Do they really need to be compelled to have confidence in your company, your industry and what has been proved to be an illegitimate way of redistributing wealth? Eh, Jim? More is not better. More is gluttonous. Saving is better. Cleansing is better. But of course it is too late for that.

Honestly dear subscribers, I feel as though we have been stuck in the same cartoon for far too long as we watch these people try to rebuild a failed construct. It is like watching the Coyote suspended in air, holding a heavy hunk of iron and a deeply embedded philosophy "Fail again, only next time, fail better." <http://tinyurl.com/bq2j7b>

Stock Market



The Nasdaq 100 continues to lead the major US markets as it holds above the symmetrical triangle (bearish continuation) that bears have been fantasizing about. The SPX holds by a whisker above a triangle of its own while the Dow is the weakest looking of the three indices. It should be noted as well that the Transports have recently made fresh lows and currently reside just above those lows. There is no room for further downside. If the big feel good is going to happen, it needs to happen next week.

Enfeebled as it has been, the Hong Kong Heng Seng continues to sport a series of higher highs and an uptrend channel while the Japanese Nikkei looks more like the Dow and SPX with its triangle structure and residence below important moving averages. Major European markets are all in some version of the status of the German DAX, struggling with the same moving averages and trying to establish short term uptrends.

Global markets remain very much unresolved and downside risk is quite high, as is that of upside. Hence, the stance should be to let markets state their intentions before risking precious capital. Any rally that does occur is a bear market variety. Enough said.

\$HSI (Hong Kong Hang Seng (EOD)) INDX

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13-Feb-2009

Open 13314.81 High 13576.32 Low 13314.02 Close 13554.67 Chg +326.37 (+2.47%) ▲



\$NIKK (Tokyo Nikkei Average (EOD)) INDX

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13-Feb-2009

Open 7789.35 High 7887.74 Low 7730.27 Close 7779.40 Chg +74.04 (+0.96%) ▲



\$DAX (German DAX Composite (EOD)) INDX

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13-Feb-2009

Open 4458.74 High 4508.72 Low 4397.60 Close 4413.39 Chg +5.83 (+0.13%) ▲



Gold Miners, Gold & Silver



What we want to pay attention to here is the supportive nature of the **EMA 20** and the **SMA 50**, not to mention the resistive nature of the **SMA 200**. HUI is finding normal resistance at the 200 after tentatively breaking above lateral resistance at around 310. With global markets stuck in the mud, the gold stocks appear to be in a holding pattern before a would-be move higher.

We have been trading this sector long enough to know that a neat looking breakout (horizontal green line) that *should* now provide support, may not do so. In that event, the EMA 20, which has supported the short term of the last few weeks and the SMA 50 that supported what I believe may turn out to have been a mid-life crisis for the rally, should be watched closely. The short term upside target remains around 350 in the absence of evidence that there is anything abnormal about the ongoing rally.



Gold maintains its bullish stance and if it can hold the break above resistance (horizontal green line), it will target the highs from July and perhaps the all time highs from March. A bearish development beyond the immediate term is that according to a subscriber, Larry Kudlow had four guests on last night, all picking gold as their “favorite investment”. **Juxtapose this with the fact that the CoT data are becoming more bearish each week.** For the short term, gold targets the resistance as shown on the chart, defined as the range between the March and July '08 highs.

The gold-silver ratio is running out of room to the downside and this, combined with the bearish EMA 20 on the CBOE Put/Call Ratio and the VIX, in a large falling wedge (see chart later in the report in 'Wrap Up) says the shelf life of any broad market rally and potentially the current rally in gold miners, is limited. It also implies that if gold is going to get hit in the next round of deflationary liquidation, silver is going to get blown up.

Again, the rough draft holds that gold may top out in the coming weeks amid much gold bug euphoria, long term treasuries will turn back up (rates down), the VIX will break the wedge to the upside, stock markets will make new, and significant, lows and gold miners will make a significantly higher low, perhaps in the 250-275 range on HUI.

In the meantime, the short term targets remain intact for the HUI, silver, and the HUI-Gold ratio. If these targets are reached (HUI 350, silver 14 and HUI-Gold .41) the plan is to do some selling and/or protect with the ZSL 200% short silver fund. Also note that the next deflation impulse could be the last one on the way to a highly inflationary future. Be prepared.

Commodities

Commodities are in the same boat (ship of fools) as the broad, positively correlated (to the economy) market, at least for the near to intermediate term. If there is a short term 'next leg down', commodities will accompany it. In a positive sign for the markets however, the daily charts of many commodities, copper in particular, look constructive.

Wrap Up

Here is the chart of the VIX showing that historic volatility from Armageddon '08 is still being worked off. The bulls have a chance to keep hope alive to the bottom line of the wedge. I would expect that VIX in the 30-35 range would help signal the next leg lower in human spirits (and markets) right along with a once again rising gold-silver ratio.



Gold should again outperform everything in any coming deflation impulse. There may be a lot of noise about the coming inflation caused by global government policies, with the US being front and center (30 year treasury rates are rising), especially if the dollar does as is expected and tops out near term. At the moment, I believe it will be wise to fade this noise.

The real 'lock and load' buying opportunity may be yet to come in gold, silver, their miners and many vital commodities. Also, productive economies may be worth looking at as we project forward a working picture of what the new global normalcy may look like. But first, the risk is getting higher for another liquidation and this risk should be tracked. But in the big picture, NFTRH is firmly on the stance of INflation.

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

The capital preservation portfolio holds 79% cash and safest equivalents, along with gold miners X, X, X and X. Profits were taken on X and cycled into X, post financing news. Several exploration companies headed by X remain and X was bought back while flashing a *relative* bargain sign at .70. Beyond that, only the sensible XXXXX remains on board.

The speculation portfolio remains moderately in the game with a cash position of 49% and a heavy weighting in gold miners X, X, X, X and X. Exploration is headed up by X and X and for positively correlated stuff, X and X (as long as copper, and X's chart, remain constructive, short term).

Final Thought

The above portfolios represent things that are denominated in increasingly worth *less* paper and in some cases there may be equities listed going forward that depend on counterparties that may not even exist one day, given the depth of the problems facing the credit system.

I have written this several times previously, but it can never be repeated often enough; gold, despite any fluctuations in *price* that may be anticipated, is not about the price casino. It is about enduring, long term value and an anchor to financial sanity. Please continue to consider that concept very carefully.

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