

## 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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### **Just a Rally**

Today's stock market segment is so named so that we can get that distinction out of the way right off the bat. It is just a rally and the only real question is, what will be its nature? The media, led by the wonderful Jon Stewart, are perp walking Cramer and CNBC as the authorities perp mega crook Bernie Madoff. This is good as general public sentiment is one of anger and disgust. It can't get any worse than this in the short term can it? It can, but there is a strong possibility that it won't in the near term. If that is the case, the markets have a chance to continue upward, using all that ill will as fuel.

But as I say, it is likely just a rally for three main reasons. 1) In a bear market, the benefit of the doubt is not on the side of the stock market. There is a lot of work to do for a real bottom and the only thing that can undo the damage since last summer is time, and lots of it. 2) I have noted absolutely no change in the standard financial advisor party line; the old joke that goes 'you haven't lost your money until you sell... the market always comes back' is still prevalent. Until there is genuine doubt about this and until people repudiate the conventional financial advice herd, the bear is in force. That is because this is no normal bear, now is it? Something has ended and something new is beginning after all, in a macro sense. 3) Policy. Lots of really bad policy is being panicked into the system in the form of new debt linked to markers created out of thin air, and I would argue that even if one accepts that inflation policy is the only viable option (I believe it may be in the age of ever expanding, already exponential moral hazard), a lot of the areas on the

receiving end of the new money do not look like the most productive ends for such policy. Either the deflation will continue swallowing this new debt or policy will achieve its goals and a new round of intense inflation – inflation that would erode real stock market performance over time just as it did in the most recent inflation episode (stocks have of course have been crashing in ‘real’ terms when viewed through the Dow-Gold ratio since secular changes burst onto the scene in 2000).

So, all that said on to the status of the current rally.



As noted on the chart, I believe that stock market success will go hand in hand with policy makers’ ability (or lack thereof) to devalue the dollar on a world stage where most of the actors have the same idea. It is no coincidence that the USD’s decline below important support is mirroring the stock market’s impressive rise of the last few days. The 60 minute chart shows the SPX bullishly diverged as the dollar was topping, and has risen strongly above the formerly resistive EMA 60. The distance above this moving average and the toppy MACD argue that the market can consolidate at any moment. A decline to and hold of the EMA 60 would be a healthy starting point to thoughts of another leg higher. This is a 60 minute chart remember, this could happen quickly.

The next chart is the SPX daily. Here we see more significant resistance residing just above 800 in the area of the SMA 50. The daily is not over bought so I would not expect any short term pullback to be overly vicious. Unless of course this is not even a

legitimate short to intermediate term rally, in which case we prepare for the next leg down. Odds favor continued rally however, because odds favor a dollar correction and commodity rally. In short, odds favor a rise of the 'hope' trade or 'infrastructure' trade or 'make-work' trade... whatever you want to call it.



The VIX speaks for itself. The breakout from the wedge and the short term uptrend line have aborted. A breakdown of the VIX would be near term bullish. Note the support.



Following is a chart of the BKX-SPX ratio. Given that the banks and financials – first abusers of the American trust – have led the entire mess downward since October, and given that the most higher powered welfare dollars have been pumped into their coffers, the banks would do well to break the downtrend in terms of the broad market.

The ratio has been in an agonizing and volatile down-sloped trading range for most of 2009, but MACD shows bullish divergence every step of the way. This will need to resolve into some form of market leadership for the broad rally to be taken seriously.



## Commodities

I wrote a lot about oil over the last week and am tapped (pardon the pun) out on that one. WTIC maintains its bottoming stance. Copper maintains a constructive bottoming stance as well and is in a modest uptrend and holding the breakout above important resistance. Even if it loses the breakout line, it will still be considered bottoming as long as the channel is intact. But it would feel a whole lot better to us hopers\* if the breakout holds.

The general industrial metals complex (GYX) is shown as well. This, while not overly inspiring can certainly catch an infrastructure (US *and* China) bid anywhere in here. NFTRH took some bullish positions in commodities last week, which will be noted in the Portfolios section below.

\* I guess you could say that NFTRH is now part of the ‘hope’ trade, and I do *hope* this works out, but that word is the last thing that will be governing my trading going forward.



## Precious Metals & USD

Well, in the gold and silver miners and the precious metal ETFs GLD and SLV, the volume is certainly not anything to get excited over. In fact, it stinks. It could be the calm before the upward storm, but usually this condition indicates a waning of momentum, and in dynamic markets like this one, you know what that means.

The 60 minute chart of miner ETF GDX shows this lack of conviction. Again, we will not beat a dead horse here but keep in mind our unfulfilled potential on HUI to 250 (and a slightly higher low than the January low). I look at any significant downside activity from this point as a buying opportunity, and in my opinion, 220 would be a gift.



The gold miners remain solid fundamentally as the only companies to benefit from an environment where gold outperforms (economic contraction), pending the current adjustment in these ratios (to oil, to base metals, etc.) and because of this, they remain NFTRH favorites to buy on extreme weakness, whereas buying most anything else on extreme weakness could be catching the old falling knife.

Meanwhile, the Gold-Silver ratio, more a macro market and economic indicator than anything particularly relevant to the precious metals stocks, remains in a modest short term uptrend, but is also establishing a pretty distinct intermediate downtrend channel with its recent failure to continue strongly upward off of the bounce from support at the SMA 200. Again, a declining GSR would be the best thing for any market-bullish hopes and is usually the best platform for the precious metals stocks as well, although there were notable exceptions in the previous bull phase for the gold miners early in the decade.



Finally, I want to take a look at gold and the dollar. So let's just dial them up in one chart.



While spending most of 2009 in respective up trends, Mr. Yin and Mr. Yang have diverged in the last few days, as gold attempts to get out of the fear business (as did the Japanese Yen some time over the last month) leaving the dollar against the world. But gold and silver have been panicked into, worthy as they (especially gold) may be, and we cannot be sure that the panic trade – likely now filled with Cramer following automatons is completely unwound in gold, which is at resistance. I remain unimpressed with the rise of the last three days. But then again, here at NFTRH we do not fret or micro-manage the price of gold. The CoT data for gold, incidentally, has inched back from its bearish direction over the last couple weeks. Keep an eye there.

As a side note, how is it that simple, historical, enduring and honest money has gotten so caught up with all sorts of shady characters like economic fear, war, geopolitical angst and worthless currencies and bonds the world over? Why the bad rap and association with negative events? That is another factor telling us that secular changes remain in force from 2000; again, the public still generally believes the myths spun by the

conventional financial advice herd. Gold is not an inflation hedge so much as it is simply the last store of monetary value – at least easily transportable monetary value (true value can be found in many things). It is not a war hedge nor a safe haven in a deflationary depression. It simply *is*. Old Lumpy, sitting there doing nothing while everything else is in motion. So, you know my thoughts on a ‘declining price of gold’; it is actually an adjustment upward – temporary though it may be – in human spirit.

The dollar is a different story. The next decline, which may be beginning, is likely to spur all kinds of valid doubts about this currency. What the dollar has going for it however, is the herd’s ability to suspend disbelief in regard to FOREX being anything other than an epic confidence game. The illusion can last a long time, as these currencies play off of each other and vie for peoples’ favor. Technically, the dollar may have a date with the SMA 200, which will probably be at around 82 by the time Uncle Buck gets there.

## Wrap Up

The stage appears set for a fairly sharp decline in the dollar as its mirror image, as shown on several charts recently, the US stock market, rises amid would-be dollar devaluation disguised as hope. Ironically, the precious metals and their miners may be underperformers here for a while as these adjustments take place. No worry there. Not in my book, anyway.

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

The capital preservation account sits at a hair under 77% cash and safest equivalents. Gold stocks are [REDACTED] having been dumped on this little bump up, loss booked. This reflects my so-so view of the goldies in the short term and the desire to add to smaller, value oriented miners on opportunity. [REDACTED] came back aboard this week in another stab at the confidence trade, and [REDACTED] and [REDACTED] remain, leading the exploration contingent. [REDACTED] is still held.

The speculation portfolio is a wild man risk taker at 26% cash. I don’t believe cash has been this low since NFTRH’s spec portfolio went close to ‘all in’ on the gold stocks in October/November. It *is* a speculative portfolio however, and while I am not the bravest of speculators, sometimes you gotta step up. But I will step down quickly if need be. Gold stocks are [REDACTED] with [REDACTED] and [REDACTED] leading a host of explorers. [REDACTED] was dumped for basically the same reason as above as were the remaining shares of [REDACTED] as it got a little bid the other day. That money was cycled into some economically positively correlated stuff. I may revisit [REDACTED] one day soon, but that will only be if the stock gets hit hard in any sector decline. This will mitigate the risk of idiot management. As for the positively correlated stuff, speculation now sports [REDACTED] (a China fund managed by Mobius), [REDACTED] (agriculture

ETF), █████ (oil/gas trust), █████ (commodity royalty), █████ (copper) and █████ (uranium, to go along with █████'s significant exposure there).

I would also note that I hold a rank speculation in both accounts. Since it is dependant on a court ruling, it shall not be mentioned here. But I thought I would note it anyway.

### **Final Note**

You will hear a lot about gold going forward. If the 'worst is over' story emerges in here, gold will be ghettoized once again by the financial herd. This is called noise. You note above that NFTRH has stepped toward the hope story for a trade. But it is important to always keep a 'big picture' view in mind along with whatever noise-driven events we may be following at any given time.

Old Lumpy has got centuries upon centuries of these shenanigans under its belt and its value has endured. We ride the waves in the short term but always understand our big picture. At some point I expect policy to 'work', although not necessarily in any lasting manner at *this* point. But with this policy simply being the next level of moral hazard, there will be severe implications one day even when the time comes for policy makers to declare success.

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