

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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NFTRH8

Fast Forward

Oz

Every week brings new financial and economic chaos and further cementing of perceptions (that should have been adopted years ago) that all is not right in Oz. The wizard is simply human and he is *not* an evil overseer. He is worse than that. The wizard is incompetent and that is what scares the hell out of people, or at least it should.

There is no master plan coldly implemented by secret illuminati, bankers or any other global fascist alliances. The truth is worse; the people in control do not know what they are doing. They are simply the latest generation of bureaucrats unquestioningly operating the controls of a doomed system. At the moment they are being presented a canvas (deflation) on which to paint their policy (*inflation* policy, same as it has been throughout the history of the current system).

If policy works yet again, it will manifest itself in rising prices, *again*. But prices will not rise equally. They are likely to rise based on the real value they provide to real human beings. Yes, food, water, energy and materials in the practical world and precious metals in the monetary world. If policy makers are *successful* yet again, it will come at the

expense of societies' faith in paper money created out of thin air and backed by confidence in the wizard, or the government he represents.

Think of modern day Oz as a bunch of stage props from the original production sitting out on an old abandoned Hollywood lot that is now used by junkies as a place to shoot up and nod. Yes, I suppose there is some value left here, but it is seriously diminished from the heyday when the original production premiered and enchanted millions. The current boom-bust-boom system is fated to continue delivering ever diminishing real returns until the day comes when it just rusts up and ceases to function, gets cast out to the back lot and is inhabited by said users on the nod.

Is that day here? Deflation proponents claim it is. The system of inflate... bust... inflate... ends here and now with this final bust. Inflation proponents say there is another round left in the chamber and this is the round the system will use to blow its head off (hyperinflation). Given policy makers' gargantuan efforts to fight the current deflation impulse and with nearly a century of history under its belt, I am inclined to think the current system will grind on to – as most trends do – a final blow off. This blow off would take the form of the most intense inflation problem to date and could ultimately break the system.

Recent Past

As my wife and a few friends and acquaintances know, I had a bee under my bonnet for several years (the bee has always been there but it was aggravated by my then-'guru'), looking forward in dread at what I knew was coming. I am personally relieved that it is here because the manufacture of ill-conceived and unsustainable credit systems is and has been real, which means it would eventually be dealt with. The reckoning has been and will continue to be severe, but I am glad to simply not have this thing hanging over my head any longer. I review the recent past because when I write about the present and potential future, this provides perspective.

Present

Deflation is everywhere. Confidence is lost. People have been scared back into the 'safe' paper issued by those in whom confidence has been lost. Think about that. In the short term, in the *present*, safety means liquidity and refuge from price destruction. This is a necessary refuge. But the same crowd that could not wait to get aboard the commodity mania now lusts after worthless paper. Are they suddenly right in the big picture? I know I am like a broken record with this theme, but you have simply got to consider a way to establish a contrary focus if you want to survive financially in the future.

Fast Forward

How many people were worried about inflation in late 2001 and 2002? Relatively few, that's how many. Die-hard gold bugs, the Austrians <http://mises.org> (who understand the

dynamics of money creation) and a thoughtful few others. Fast forward from 2002 to 2007 and you have manic hysteria and the 'resources' trade going full steam. This trade seemed more valid than the previous mania in revenue-free dot coms. In fact, many commodity companies appeared to be undervalued even at the height of the boom. But were they? No, they were not considering that the entire commodity bull train was steaming down a track that ended at a cliff. But investors did not see a cliff out on the horizon. They saw a China growth story. They saw an ascending India and developing world. They saw what they thought was an unstoppable global apparatus being constructed. But it was an illusion. The illusion was built upon a foundation that really was never there to begin with; this foundation was the idea that America could keep borrowing its way to prosperity and fueling the global system. Sober, forward-looking people knew this had to end.

But what are we here for at [NFTRH](#)? We are here to do what we have always done; look ahead once again. My personal belief is that the new unsustainable story is that people can hide, en masse, in various global paper, the only value of which is the value that respective governments say it holds. Therefore, I am an 'inflationist' as some people have described me because when I look forward I see a realization out on the horizon – perhaps as faint as today's deflationary crash episode looked to most in early 2007 – that the current rush to cash will have been only a knee jerk race for short term liquidity even as global authorities did all they could to destroy the units in which this cash was denominated.

So, with the same hazy timing (it took longer than most of we doomsayers expected for the current crisis to arrive) I look forward and [NFTRH](#) assumes the stance of balancing short term needs for 'safety' with long term needs for a very different kind of safety; protecting oneself from the devaluation of global currencies. Understand that the stance is monetary first and foremost and while I can see a new commodity boom well out on the long term horizon, I remain focused on the producers of the monetary metals first. The great commodity boom, part II will have to wait until still declining economies experience their next upturn due to today's policy now being carpet bombed globally, 24/7. As for the economies themselves and associated stock markets, the returns are likely to be diminishing indeed. But there could be select opportunities there as well.

Only a few are watching for this today. It is as it always has been and tomorrow's counterparty remains secure in its conventional wisdom.

Global Markets Bottoming?

The acute phase of the panic is over. Despite yesterday's decline, which was aggravated by a late bounce in the Dollar (propelled by a large de-leverager?), the scenario remains viable for a post-panic bottoming process and rally in most things not USD.



The Dollar continues to sport a potential ascending triangle targeting the low 90's, but it is important to keep in mind the bearish divergence by indicators like MACD and now, the slower TRIX. The erosion in these indicators shows the rally in this panic paper getting long in the tooth.

Likewise, while US markets cling to a bottoming stance with some bullish indicator divergence, many global markets look bullish. The Japanese Nikkei (see chart below) and German DAX for example, have distinct bottoming patterns in the making.

As the G20 meets and pretends to have a useful plan, as the results of the US election settle in, as one crazy bailout scheme blends into the next, and as the aftershocks of the worst market debacle of the modern era work their way through, the stage looks set for relief. But that is all it is likely to be if it does indeed come to pass. Some relief perhaps borne of watching markets rise simply on technicals and sentiment. Maybe a little story can even get going here about the worst being over.

But given the damage to the global economy and the Ponzi dynamics contained therein exposed for all to see, the problems will not be undone soon and if and when the damage is mitigated, it will be done with inflation policy which would beget inflation effects later on, which would compromise any global economic recovery.

But for the near term the \$NIKK chart sports a potential inverted head and shoulders bottoming pattern and a target that would come into play if the neckline breaks and global markets get the expected strong relief rally. Note the bullish divergence that is also present in most markets.

Again, the cautious note is that it is wise to let any rally prove itself before participating in a sincere way. Markets could be bottoming but a bottom is not a bottom until it is confirmed. Upon daily confirmations, which were compromised yesterday, it will be wise to shift to weekly charts which will provide the least risky confirmations. Some upside would be sacrificed, but if the rally is what we might 'hope', the extra insurance will be well worth it.

More details to follow as events unfold, or fail to do so. ;-)

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

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14-Nov-2008

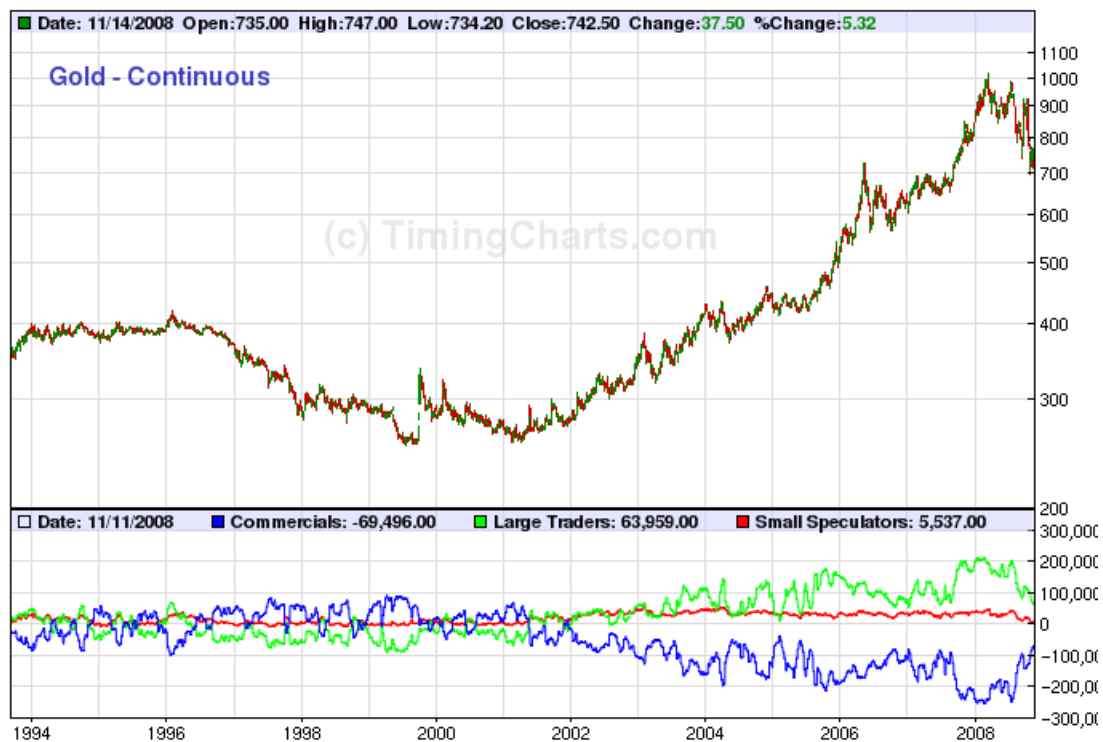
Open 8378.13 High 8689.84 Low 8378.13 Close 8462.38 Chg +223.75 (+2.72%) ▲



Gold Sector

The situation remains the same. In my view gold miner fundamentals continue to move from improving to compelling (gold to cost input ratios). Technically, the HUI is doing nothing abnormal with regard to a successful bottom. The lack of follow through yesterday in the Huey, along with most other markets, is a bit of a concern however. But being fundamentally engaged, I take this in stride.

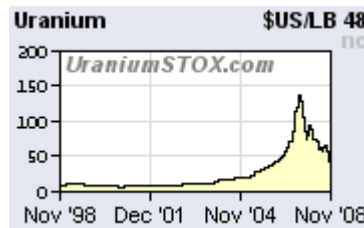
As for the metal itself, the fundamentals continue to improve but in the short term and in the face of global asset liquidation, the potential still exists for a drop to my technical target of 600-650. The following chart however shows just one of the much improved fundamentals, the latest CoT data. The commercial interests have come to levels that have preceded large rallies, the specs have panicked out and the little guys have not been this flat gold futures since the bull market began. This is obviously bullish.



Uranium

I have not looked at this sector in a while and that is because the pricking of the uranium bubble preceded the destruction of the entire commodity complex. But I do see the value in this commodity in the big picture and perhaps the original uranium bug can keep himself contained long enough for us to squeeze out a nice rally in this absolutely bludgeoned sector.

Positives for producers in the sector include Uranium One's closure of the South African Dominion mine (they say it is unlikely to affect the spot price, but that is debatable) and the well publicized and ongoing water problems at Cameco's Cigar Lake. Then of course there is this chart, which simply shows that the price of a precious commodity now contains a heck of a lot less downside risk than it did at the height of its parabola.



I personally dipped back into the sector yesterday as Dennison Mines (DNN, DML.to) <http://www.denisonmines.com/SiteResources/ViewContent.asp?DocID=31&v1ID=&RevID=337&lang=1> pulled back with the markets. Why Dennison? Given the problems at Cameco and Uranium One, I felt that a uranium producer that was selling for over \$14/share a little over a year ago and \$9 just last summer is worth a kick at the can at around a buck. This is no small speculative 'look at our resources that will never be mined' type of play of course. It is uranium producer. In fact, in the Q3 report Dennison made note of cuts to exploration initiatives as part of cost-cutting measures. A pdf file of Dennison's Q3 release is available for your review:

http://www.denisonmines.com/SiteResources/data/MediaArchive/pdfs/annual_quarterly_reports/q308-pres.pdf.

This is not a fundamental recommendation of DNN. I am simply highlighting a trade based on technicals in a sector that I think is ready for a bounce. Note that Dennison is not overly secure financially with significant debt to cash. Please read the attached Q3 report if you have any interest whatsoever, even if just for a trade.

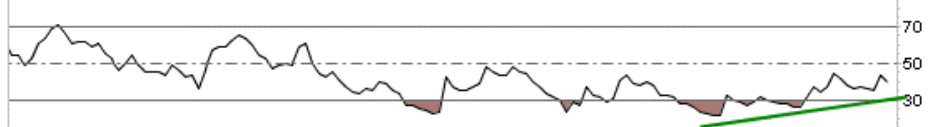
That said, even a temporary rebound in uranium along with the rest of the beat downs could produce a nice little rally here. One positive is that insiders have been buying, albeit not in overwhelming volumes, at prices double and quadruple the current price.

As for the technical picture, DNN is typical of the commodity complex as it has been hammered down to levels that raging commodity bulls could not have conceived of just four months ago. Entry at around a buck could provide a 60% gain even if the trade 'fails' at the resistance at around 1.60, which is how absurd some of these charts are currently. Risk is straightforward and can be controlled with a break below the previous low at .92. I have once again delineated the next two resistance areas, the first of which resides 150% higher. This is simply a trade idea and it is entirely predicated on a would-be rally for the entire anti-USD trade, uranium included. In other words, on relief for a beaten down world of assets.

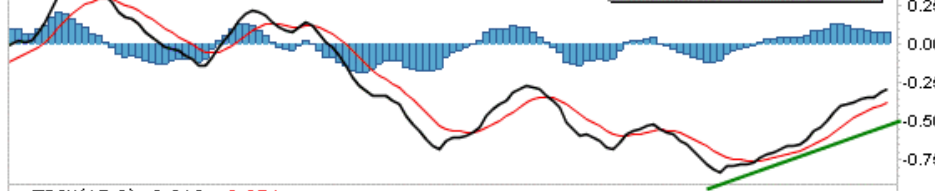
DNN (Denison Mines Corp.) AMEX © StockCharts.com
 14-Nov-2008 Open 1.30 High 1.30 Low 1.11 Close 1.18 Volume 567.4K Chg -0.16 (-11.94%)



RSI(14) 39.58 B-bands contracting



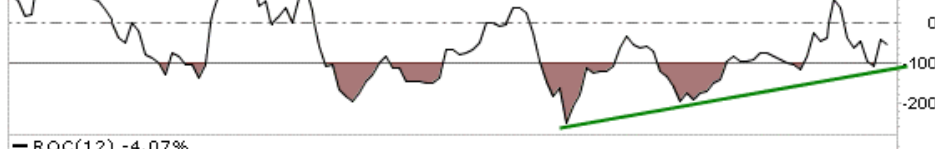
MACD(12,26,9) -0.293, -0.373, 0.079 Bullish divergence by RSI, MACD, CCI & Rate of Change



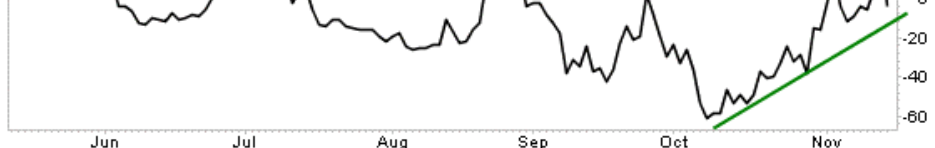
TRIX(15,9) -2.810, -3.074 Slower TRIX is back in our toolbox as many stocks and markets attempt to make meaningful bottoms



CCI(20) -51.96



ROC(12) -4.07%



Wrap Up

The post-panic grind continues. Will it churn upward or fail? Watch the various gold ratios, sentiment indicators and the US Dollar for the answers.

Portfolio Composition

Portfolios are not comprehensive. They represent investments in 'paper' assets. Also, these are not meant as recommendations. They merely reflect current NFTRH positions at the time of writing.

Portfolios omitted for NFTRH sample editions

Portfolio 1: Capital Preservation & Investment

Portfolio 2: Speculation & Investment

* As part of the current NFTRH stance, which is to potentially capture a major bottom in gold stocks, trading is being kept to a minimum. Hence performance during this process bounces up and down with the bottoming process. Short-term traders are, or should be operating in an entirely different manner.