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INTAGLIO

July 26, 2012

"Out of chaos, find simplicity. From discord, find harmony." Bruce Lee

Intaglio are techniques in art in which an image is created by cutting, carving or engraving into a flat surface and may also refer to objects made using these techniques

The image appears from what has been taken away. By carving, or other technique the flat plane of realty becomes an image.

Sometimes the markets reveal much by what is not happening. The dog that doesn't bark[1]*. You look at the surface of the markets and what is known is known. What might be unknown is estimated, and what isn't known – isn't known.*

Every era is different and every market is different, yet the old truths still apply, as time goes by. [i]

What is known appears obvious.

GLIDE PATH TO OBLIVION

Much of the evidence suggests that the entire world, with a few outliers, is entering an economic recession. Significant international political and military unrest is continuing to spread and escalate. This cannot be conducive to a recovery in foreign economies.

At the National level, the largest tax increases in our history are set to take place January 1, 2013. One can argue over terminology as to why or who – but taxes at all levels of income, on nearly all types of income are set to rise precipitously, as the old tax code vanishes like Cinderella's coach. And the wicked step sister of the health care taxes also appears on the scene. Meanwhile, the countryside is about to be ravaged by the famine of clumsy and dangerous spending cuts.

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[1] One of the most popular Sherlock Holmes short stories, "Silver Blaze" focuses on the disappearance of the titular race horse (a famous winner) on the eve of an important race and on the apparent murder of its trainer. The tale is distinguished by its atmospheric Dartmoor setting and late-Victorian sporting milieu. It also features some of Conan Doyle's most effective plotting, hinging on the "curious incident of the dog in the night-time:"

> Gregory (Scotland Yard detective): "Is there any other point to which you would wish to draw my attention?"
> Holmes: "To the curious incident of the dog in the night-time."
> Gregory: "The dog did nothing in the night-time."
> Holmes: "That was the curious incident."[2]

http://en.wikipedia.org/wiki/Silver_Blaze

There's also the issue of hitting the debt ceiling in January, 2013.

Who says that we can't repeat the mistakes of the past? – Does the name Herbert Hoover, or the Smoot Hawley Tariff haunt the renowned scholar of the Great Depression, Federal Reserve Board Chairman Dr. Bernanke? In my opinion, there will never be enough Mea Culpa for Dr. Bernanke and his predecessor Mr. Greenspan to atone for their monetary policy errors. The rollercoaster ride of bust and boom, bubbles and boondoggles of the last 25 years is properly attributed to their hubris; the conceit that they can somehow control both inflation and employment by providing the precise monetary policy mix for prosperity. The very idea is absurd on the face of it – hubris is a mild term for the conceit of such people.[2]

The rise of this conceit is naturally associated with the rise of a separate "elite" the governing class – those who have seized the reins of power through various schemes, whether lobbyists for big labor, big business, or the most insidious insiders, the lawyers who gain influence to write the rules that keep them in business. Proof positive – a health care reform that did not include tort reform. Are you kidding me?

Hard not to see the Nation is in severe economic trouble. The polling is consistent. Americans know there that too many people have been out of work too long. They know that the Nation's balance sheet has becoming dangerously unbalanced as debt has grown exponentially without improving the economy.

At present we are accruing an enormous financing benefit from confidence that the USA is the largest and safest haven for capital. Hard to imagine, where does this faith arise? Might not call our national finances a Ponzi scheme, but it is a confidence game in the pejorative sense. A confidence game lasts only until it runs out of money. The money can run out if confidence is lost, a Bank Run type collapse. Or if revenues fall sharply because of a failed economy and you cannot pay your bills – your pick of California cities. Or, the economy fails to attract enough capital to grow because of competition from more dynamic regions.

Thus far we have avoided the bank run type of collapse, although we came close in 2009. We are running huge deficits with no clear cut plan to resolve the debt which has yet to trigger an expected rise in interest rates. I believe this is in part due to the interruption of the flow of capital to emerging economic powers. However, the long term reality is that over time, more attractive capital havens and friendlier economies will garner a greater part of the flow of international investment capital currently directed to the United States.

Prosperity is based on the self fulfilling prophecy *that growth attracts investment, which promotes growth, which attracts investment, and so on*. The US didn't lose this understanding all at once, it could not happen overnight, but it seems like it. The last 3 years of the new normal – slight growth at best, rising unemployment and no rational hope for a recovery - remind me of the last days of the Carter Presidency. How quickly we forget the damage inflicted by his stint of incompetence, and barely remember the astounding recovery engineered by the Reagan administration.

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[2] Not solely their fault, there are numerous other actors implicated. The Treasury Secretary has been at the center of all the recent economic blow ups, either at the NY FED or in his current post. And generally the Bush administration does not receive passing grades for their management of the economy in 2007 and 2008.

The 500 year long ascendancy of the American Empire had many severe ups and downs on its way to the apex of power sometime in the mid to late 20th century. I would expect the same developments in emerging economic and military powers. Not a straight line, and there are some nations that might fail – Russia for example, but also high probability success stories, like Brazil and other alliances likely to emerge in the Far East. The Asian and Emerging Nations' economies and markets will eventually stabilize, and having proven their mettle, will be the places to lend and invest again.

Then, "Buddy can you a spare a dime?"[ii] will be our new National anthem - although it will actually be trillions of dollars. Spain is paying 7% interest – despite the fact that their ratio of debt to GDP is considerably lower than ours. At the average interest rates of 4+%, our 16 trillion dollar debt elephant in the room will consume our national wealth and security.

We're on a glide path to financial ruin, a rudderless ship approaching the rocky coast. We can see the peril, it is obvious. The captain is AWOL, running around the deck trying to assure passengers that he has everything under control while selling tickets for his next cruise. Also trying to contain a mutiny. We can hear the roar of the waves and smell the brine.

Requires a strong stomach and conviction to invest in such an environment. Few will. The national economy is becalmed, lost in the Bermuda triangle of the election. There is access to a nearly unlimited capital, natural resources and labor in our Nation, but until someone yanks the rudder in another direction, aimless drifting will result in the economy wrecked on the reef. Until the election outcome becomes obvious – probably a Republican sweep, nothing, or even less than nothing of economic substance will benefit our economy. QE3 would be sheer folly, a concession that there are no new ideas and rightfully viewed as a political move to support the President's reelection. But, why not? If you are going to raise taxes in economy barely treading water – more economic foolishness is in order.

Growth attracts capital which creates growth which attracts capital. A virtuous feedback cycle that needs to be restarted!

INTAGLIO

So what is the image? Is it discernible? Where's Waldo? Some people find him faster than others. Is it possible to discern the design from the surface and the cut outs?

Let's look at our asset class performance again. The US Dollar has been the standout leader, underpinning the performance of US equities and bonds. The standout losers remain emerging markets, Europe, oil and precious metals. On the flip side, the performance reversals have been extraordinary over a relatively short period. Does it reflect a fundamental shift in views of the economic future? Or something less? A fight to stronger currencies in the face of the determined reduction in the value of the Euro at this juncture?

Looks to me like this the selected course, necessary for economic rebalancing of the Eurozone. Germany and the strong countries will gain an export edge and use their strength to fund the rebalancing. Or so the theory goes. A continued round of beggar thy neighbor currency devaluations; reducing living standards around the world. In this environment the rich get poorer and the poor remain poor. Everyone is grabbing for a slice of the smaller pie.

That pie that represents the sum total of society's wealth, its capital, including the economic seed corn of the next generation continues to shrink. The US Government's appetite for a bigger portion this pie has been insatiable. They see the seed corn and pull out the popper.

Much of this appetite is based on a big lie – that the government can and does make wise capital "investments" in the economy. In reality, there are only private pools of capital. There is no such thing a pool of public capital – the government's capital is confiscated private capital, hijacked and devoted to what appears to be a huge slush fund used for the repayment of political favors, and for the further purchase of political support via crony capitalism.

A grim picture. Worse - 2013 is looking very weak because the tax increases coming in 2013 will probably cause tax payers to accelerate income into 2012, and then basically hide it in plain sight from the Federal and State tax collectors. The planning has already begun, why allow the government to seize more of your assets than legally possible? The lessons of the real world are clear; it is not possible to increase tax revenues by imposing punitive, confiscatory rates. The underlying income disappears - from California, New York, or Maryland because the taxpayer and the wealth have migrated to another state.

Similarly, there are certainly loopholes, exemptions and other tax "favors" throughout the tax code that will permit many to legally avoid the impact of higher rates. Or, just as bad for the economy, we will see a continued capital strike, money invested for little or no return.

We've also begun to see the inevitable municipal bankruptcies, a few here and there - and then?

So what are the US equity market doing flirting with the recent highs? It is in sharp contrast to the other world equity markets which seem to be well into primary bear markets.

Why are US interest rates at all time record lows? How can the uniform consensus on interest rates be correct? There's plenty of demand from borrowers with low credit scores – Greece, Spain, Italy, Portugal. Those prices now reflects an "end of the world" mentality; potentially offering significant rewards to risk takers.

And, investor sentiment, what gives? Could it be that complacency rules because of portfolio allocation – heavy weighting to income and cash equivalents? Too many bulls for such a difficult environment, in my opinion.

What happened to the commodity boom? Gold? How about oil?

Is your head spinning yet?

Let's go to the charts, and see if we can gain some insight. There are times however, when our crystal ball is dark, there are simply too many long tail events[iii] possible as the quants like to say.

Pattern recognition fails, there are too many conflicting vectors.

CONCLUSIONS

The US economy is tumbling quickly into recession. Top line growth is nonexistent; bottom line performance is beginning to fall. The ranks of the unemployed continues to swell, the reported statistics undercount the problem, as people leave the workforce, giving up on finding a job and/or substitute "disability" for long term unemployment compensation.

Most of the rest of the world is already in recession. The Chinese miracle is undergoing a Wizard of Oz unmasking.

The world equity markets could, at best, be described as "seeking support" at the lows of 2009.

In a futile gesture, the US FRB is preparing to crank up the printing presses like the Weimar Republic.[iv] The US equity markets, gold and oil are the logical alternatives to this profligacy. Market participants are anticipating the outcome of the flood of cash, and placing their bets.

Can't be in the bond market – the implied 30 year inflation rate has plunged to 2.19 per cent, and each basis point in that series represents a substantial shift in outlook. 2.40% would be a huge change for example. But, even at 2.2%. It quickly consumes the meager earnings on deposits, and for taxable investors the return is even more negative.

Despite the weak interest rate returns, the good news has been the relatively steady appreciation of the dollar versus many asset classes based primarily on what is perceived as a precarious Euro. This situation will not last, although it would appear that the US Dollar could continue to appreciate another 5-7%. This strength should ideally be used to invest in markets the farthest from the mean of 10 year performance, emerging markets and the EAFE foremost. Ike I said it requires a strong stomach.

The most negative charts: US 30 year interest rates – continue to reflect fear of the economic environment and a "capital strike" by choosing the safest and lowest yielding investments.

OIL, IF IT VIOLATES the trend line around $73-75 and heads into the $60s – below the all in cost of production , would be proof positive of recession/depression in my opinion. QE3 and the spike in corn prices, hence ethanol and gasoline could also push oil back to $100.

Gold remains the conundrum. I hate the idea, but it looks to me that Gold might be the asset class that could benefit the most from QE3, followed by dividend paying US equities, if, and when the dividend tax hike is resolved. Oil oriented equities with substantial dividends would be the best merger of the two sub sets, particularly in a market subject to intense merger and acquisition activity. With the caveat of strong balance sheets, excellent reserves, and a good track record of creating wealth.

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[i] Herman Hupfeld wrote "As Time Goes By" for the 1931 Broadway musical *Everybody's Welcome*. In the original show, it was sung by Frances Williams. It was recorded that year by several artists, including Rudy Vallee and Binnie Hale. In addition to the American Film Institute including it as number two in their list of the 100 best songs in film,[4] National Public Radio included it in their *NPR 100*, the 1999 list of the most important American musical works of the 20th century as compiled by their music editors.[5] http://en.wikipedia.org/wiki/As_Time_Goes_By_(song)

[ii] Brother, Can You Spare a Dime?", also sung as "Buddy, Can You Spare a Dime?", is one of the best-known American songs of the Great Depression. Written in 1931 by lyricist E. Y. "Yip" Harburg and composer Jay Gorney, "Brother, Can You Spare a Dime?" became the best-selling record of its period, and came to be viewed as an anthem of the shattered dreams of the era http://en.wikipedia.org/wiki/Brother,_Can_You_Spare_a_Dime%3F

[iii] These patterns suggest that standard economic models based on the notion of equilibrium — markets will fluctuate but then settle down like the surface of a still pond — may not capture the whole story. Freak events may be a normal part of long-term economic behavior. If that's true, then the mathematical methods guiding Wall Street's estimation of risk are seriously flawed, offering a dangerous false sense of security. http://www.sciencenews.org/view/feature/id/335383

[iv] The cause of the immense acceleration of prices that occurred during the German hyperinflation of 1922–23 seemed unclear and unpredictable to those who lived through it, but in retrospect was relatively simple. The Treaty of Versailles imposed a huge debt on Germany that could be paid only in gold or foreign currency. With its gold depleted, the German government attempted to buy foreign currency with German currency, but this caused the German Mark to fall rapidly in value, which greatly increased the number of Marks needed to buy more foreign currency. This caused German prices of goods to rise rapidly which increase the cost of operating the German government which could not be financed by raising taxes. The resulting budget deficit increased rapidly and was financed by the central bank creating more money. When the German people realized that their money was rapidly losing value, they tried to spend it quickly. This increase in monetary velocity caused still more rapid increase in prices which created a vicious cycle.[9] This placed the government and banks between two unacceptable alternatives: if they stopped the inflation this would cause immediate bankruptcies, unemployment, strikes, hunger, violence, collapse of civil order, insurrection, and revolution.[10] If they continued the inflation they would default on their foreign debt. The attempts to avoid both unemployment and insolvency ultimately failed when Germany had both. http://en.wikipedia.org/wiki/Hyperinflation_in_the_Weimar_Republic

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Companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

The price of gold has been subject to dramatic price movements over short periods of time and may be affected by elements such as currency devaluations or revaluations, economic conditions within an individual country, trade imbalances, or trade or currency restrictions between countries. As a result, the market prices of securities of companies mining or processing gold may also be affected.

MLP distributions are not guaranteed. The actual amount of cash distributions may fluctuate and will depend on the future operating performance. Increasing interest rates could have an adverse effect on MLP unit prices as alternative yields become more attractive.

The S&P 500 is an unmanaged index of 500 widely held stocks.

The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities.

The MSCI EAFE (Europe, Australia, Far East) index is an unmanaged index that is generally considered representative of the international stock market. These international securities involve additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability.

The Dow Jones U.S. Select Real Estate Securities Total Return Indexsm (RESI) is comprised of equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the U.S.

The MSCI Emerging Markets Index is designed to measure equity market performance in global emerging markets.

The Bombay Stock Exchange Sensitive Index (Sensex) is a cap-weighted index of 30 constituent stocks and is generally considered representative of the Indian stock market.

The Bovespa Index is a total return index (includes the affect of dividends) and is generally considered the main indicator of the Brazilian stock market's average performance. The index is comprised of the most liquid stocks traded on the Sao Paulo Stock Exchange.

Germany's DAX Index is the most commonly cited benchmark for measuring the returns posted by stocks on the Frankfurt Stock Exchange. The index is comprised of the 30 largest and most liquid issues traded on the exchange.

The Nikkei index is an unmanaged index which is representative of the Japanese stock market.

The Dow-China Broad Market Index, which represents 95% of shares traded on the Shanghai and Shenzhen exchanges, is constructed by combining the Dow-Shanghai and Dow-Shenzhen indexes.

It is not possible to invest directly in an index.

Dividends are not guaranteed and will fluctuate.

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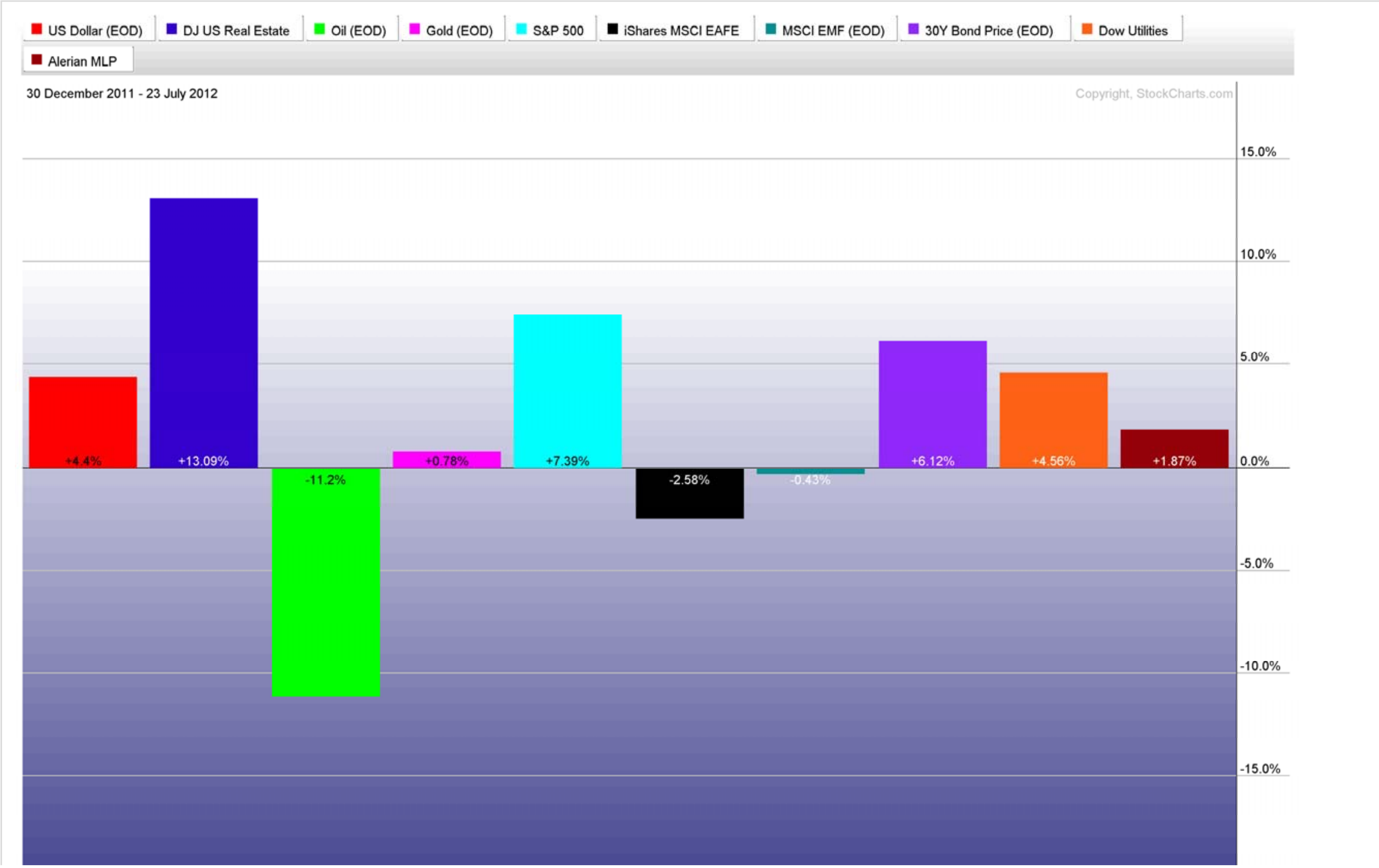
TRAILING 12 Months

PerfChart: $USD,$DJUSRE,$WTIC,$GOLD,$SPX,$IEE,$MSEMF,$USB,$UTIL,$AMZ



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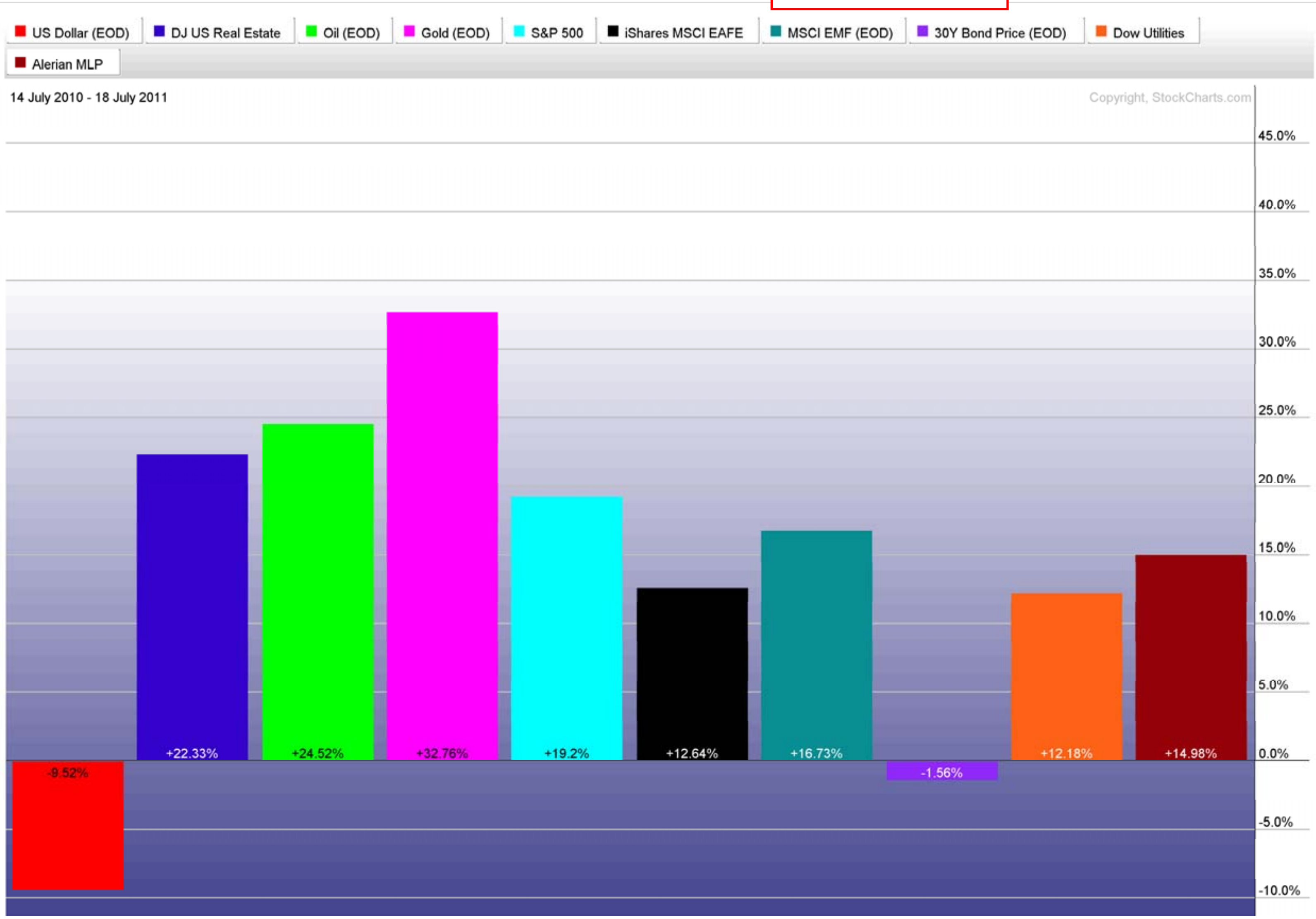
LAST YEAR

PerfChart: $USD,$DJUSRE,$WTIC,$GOLD,$SPX,$IEE,$MSEMF,$USB,$UTIL,$AMZ



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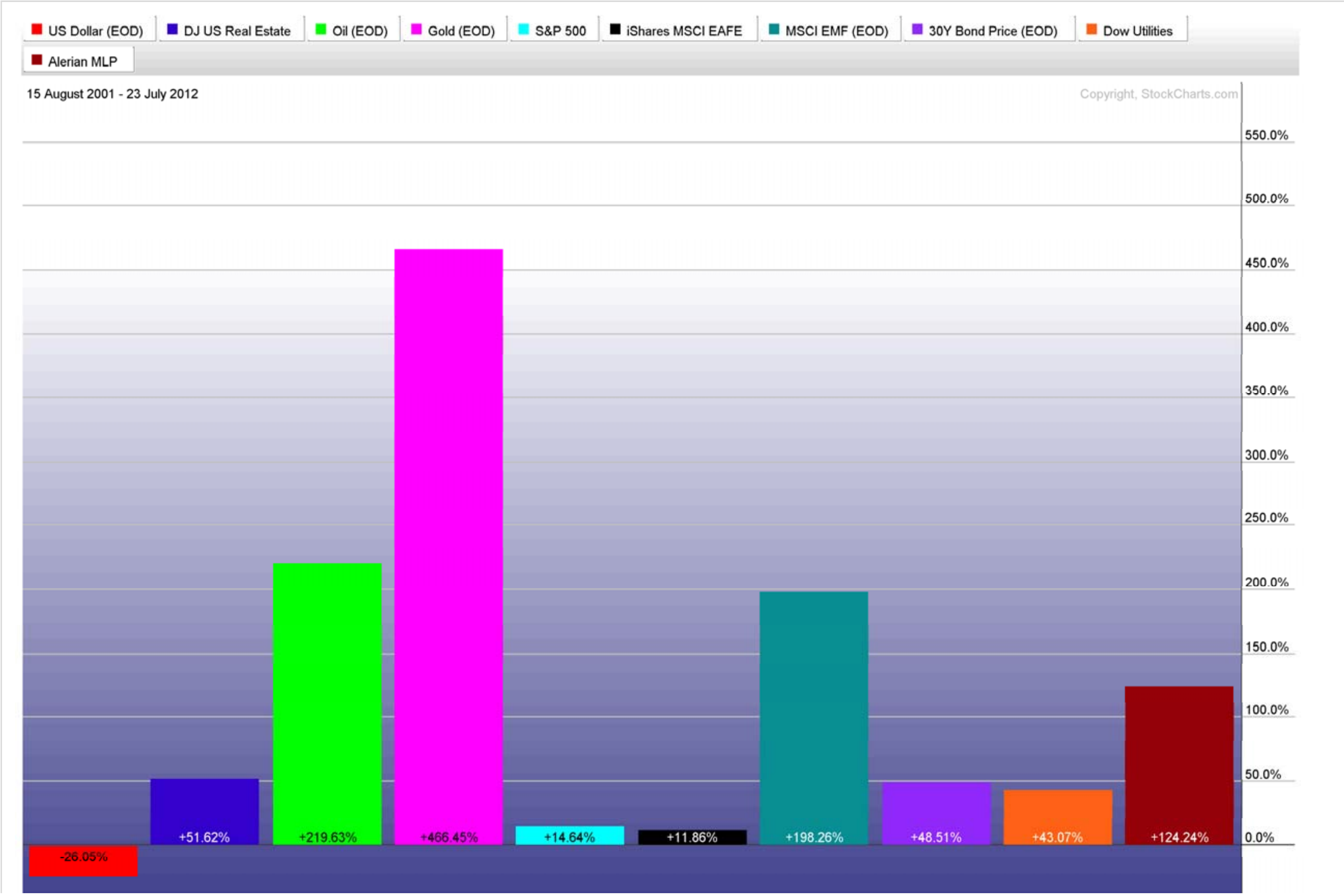
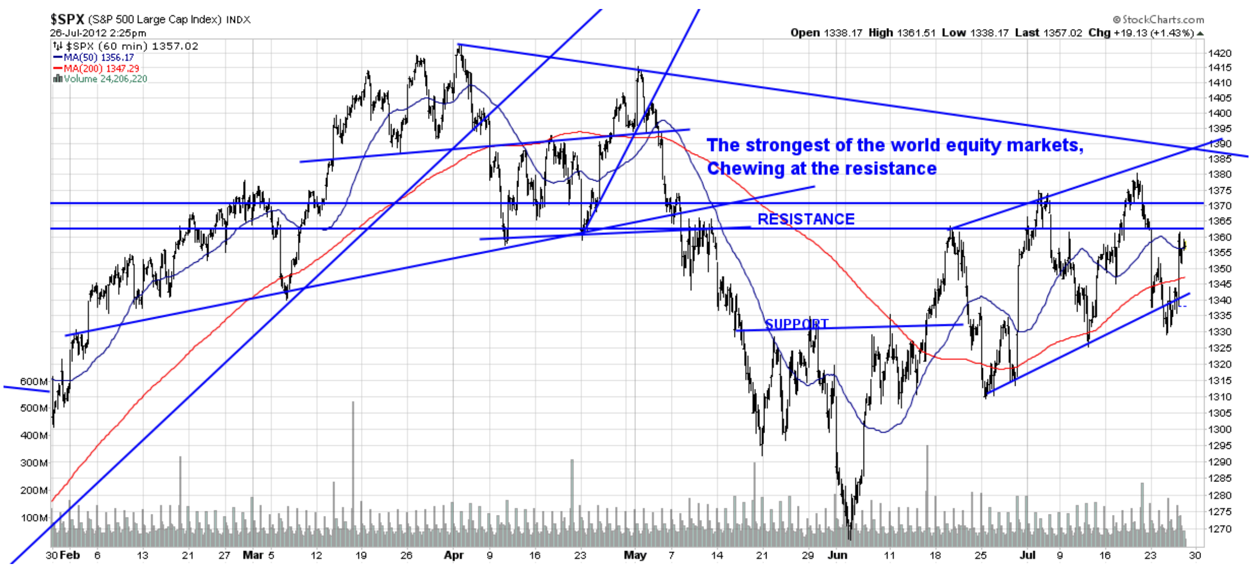
TEN YEARS

PerfChart: $USD,$DJUSRE,$WTIC,$GOLD,$SPX,$IEE,$MSEMF,$USB,$UTIL,$AMZ



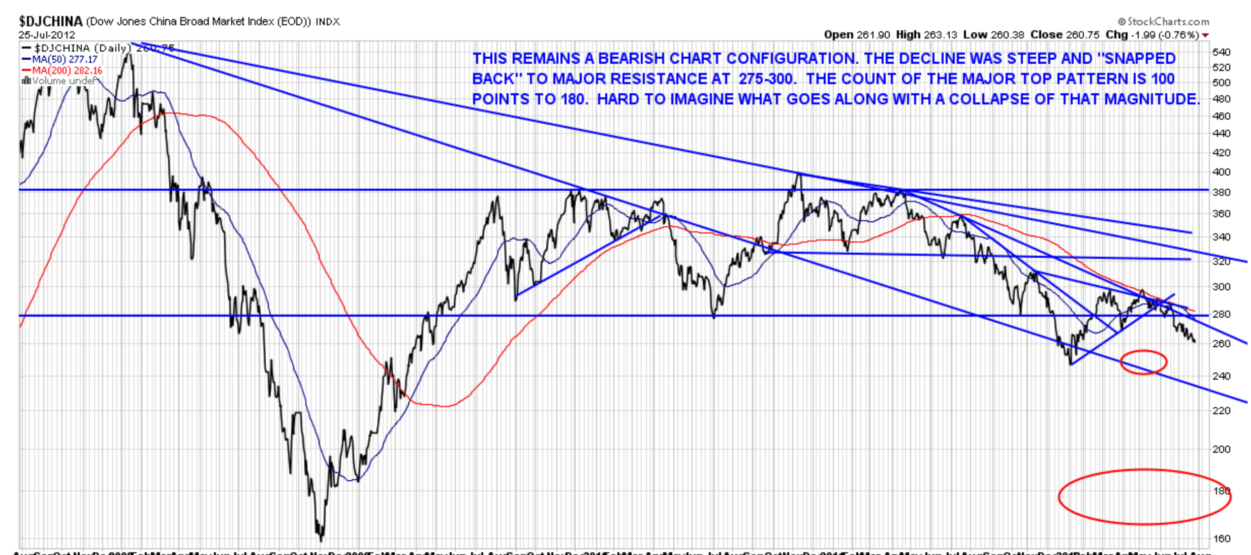

$SPX (S&P 500 Large Cap Index) INDX
26-Jul-2012 2:25pm
Open 1338.17 High 1361.51 Low 1338.17 Last 1357.02
$SPX (Daily) 1357.02
MA(50) 1333.32
MA(200) 1316.95
Volume undef
THE US EQUITY MARKETS HAVE BEEN AMONG THE STRONGEST


$SPX (S&P 500 Large Cap Index) INDX
26-Jul-2012 2:25pm
Open 1338.17 High 1361.51 Low 1338.17 Last 1357.02 Chg +19.13 (+1.43%)
$SPX (60 min) 1357.02
MA(50) 1356.17
MA(200) 1347.29
Volume 24,206,220
The strongest of the world equity markets,
Chewing at the resistance
RESISTANCE
SUPPORT


$BSE (India Bombay Stock Exchange 30 Sensex Index (EOD)) INDX
25-Jul-2012
Open 16899.01 High 16899.01 Low 16736.60 Close 16846.05 Chg -72.03 (-0.43%)
$BSE (Daily) 16846.05
MA(50) 16809.05
MA(200) 16898.53
Volume undef
Stairstep decline
Floor 15000 looks possible


$BVSP (Brazilian Bovespa Stock Index (EOD)) INDX
25-Jul-2012
© StockCharts.com
Open 52658.46 High 53232.62 Low 52345.81 Close 52607.54 Chg -31.09 (-0.06%)
$BVSP (Daily) 52607.54
MA(50) 54603.48
MA(200) 59488.33
Volume undef
Nothing positive about the development of this chart. Playing out according to the texts, look for retest of 48,000 August low. This appears to be a primary BEAR market.

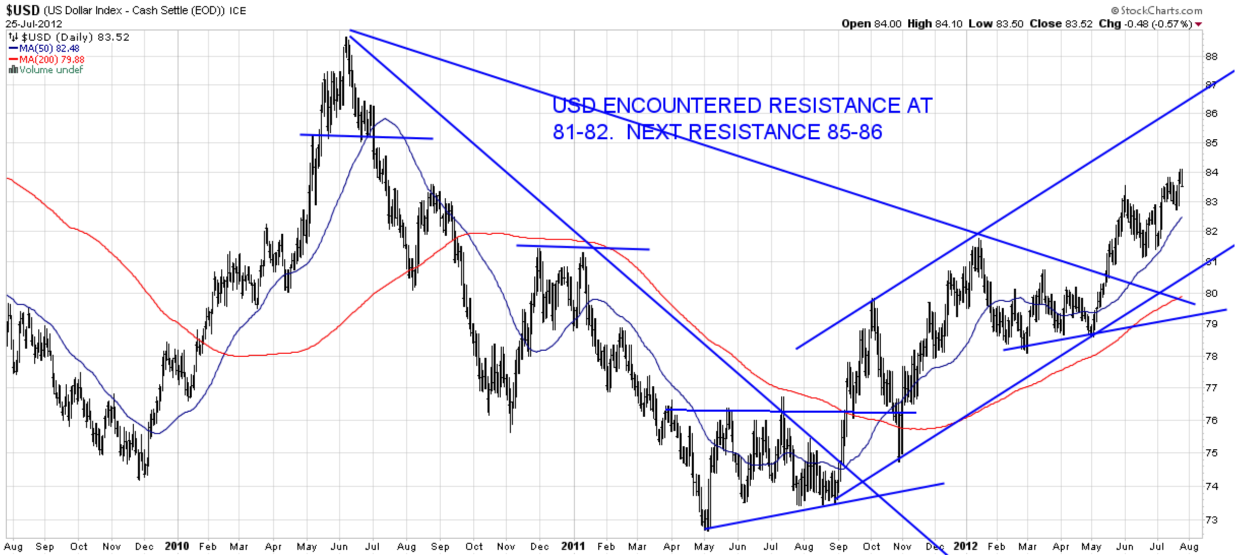

$DAX (German DAX Composite (EOD)) DEUT
25-Jul-2012
© StockCharts.com
Open 6387.84 High 6475.33 Low 6375.15 Close 6406.52 Chg +16.11 (+0.25%)
$DAX (Daily) 6406.52
MA(50) 6333.82
MA(200) 6370.30
Volume undef
Trailing the US - S&P 500 - Long term neutral to negative

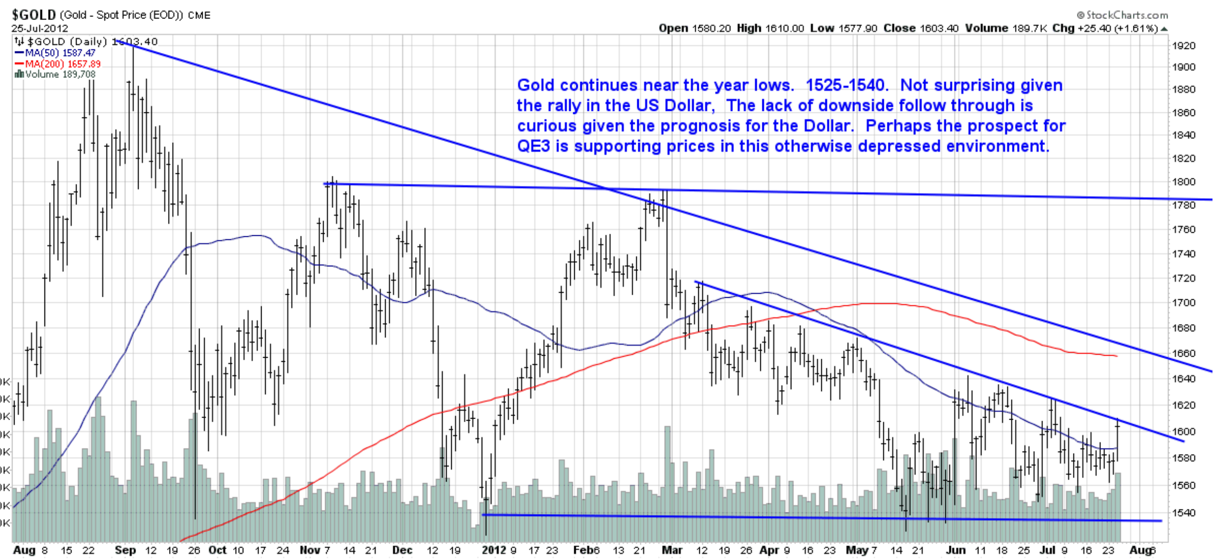

$DJCHINA (Dow Jones China Broad Market Index (EOD)) INDX
25-Jul-2012
© StockCharts.com
Open 261.90 High 263.13 Low 260.38 Close 260.75 Chg -1.99 (-0.76%)
$DJCHINA (Daily) 260.75
MA(50) 277.17
MA(200) 282.16
Volume undef
THIS REMAINS A BEARISH CHART CONFIGURATION. THE DECLINE WAS STEEP AND "SNAPPED BACK" TO MAJOR RESISTANCE AT 275-300. THE COUNT OF THE MAJOR TOP PATTERN IS 100 POINTS TO 180. HARD TO IMAGINE WHAT GOES ALONG WITH A COLLAPSE OF THAT MAGNITUDE.

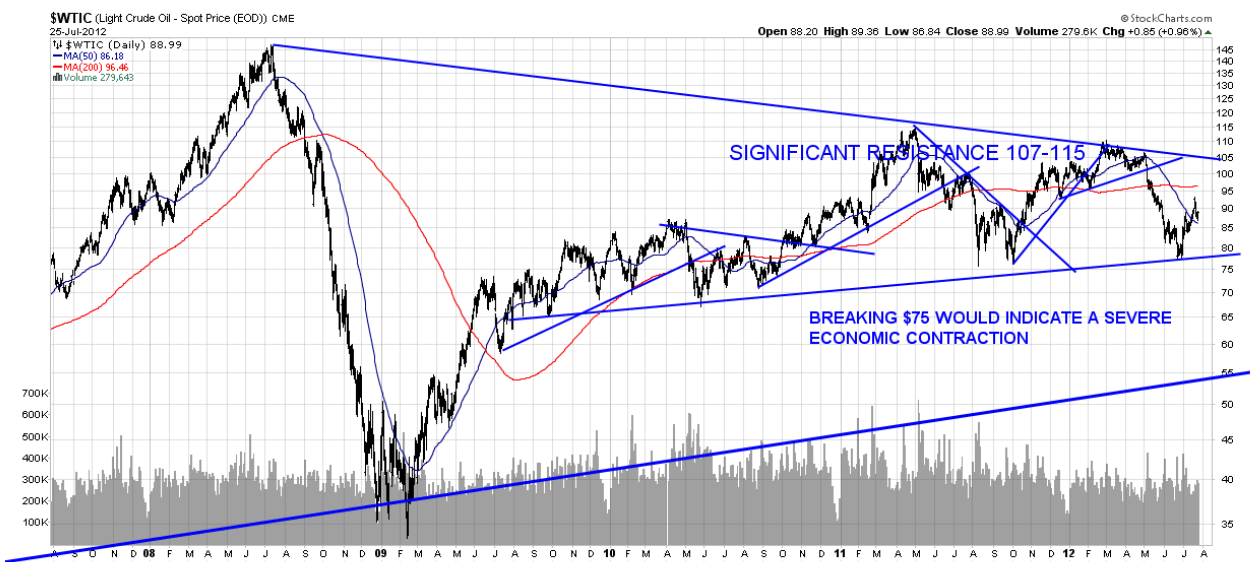

$NIKK (Tokyo Nikkei Average (EOD)) INDX
25-Jul-2012
© StockCharts.com
Open 8410.98 High 8433.58 Low 8328.02 Close 8365.90 Chg -122.19 (-1.44%)
$NIKK (Daily) 8365.90
MA(50) 8696.25
MA(200) 8964.59
Volume undef
IT COULD HAPPEN HERE
A retest of the lows is increasingly likely.

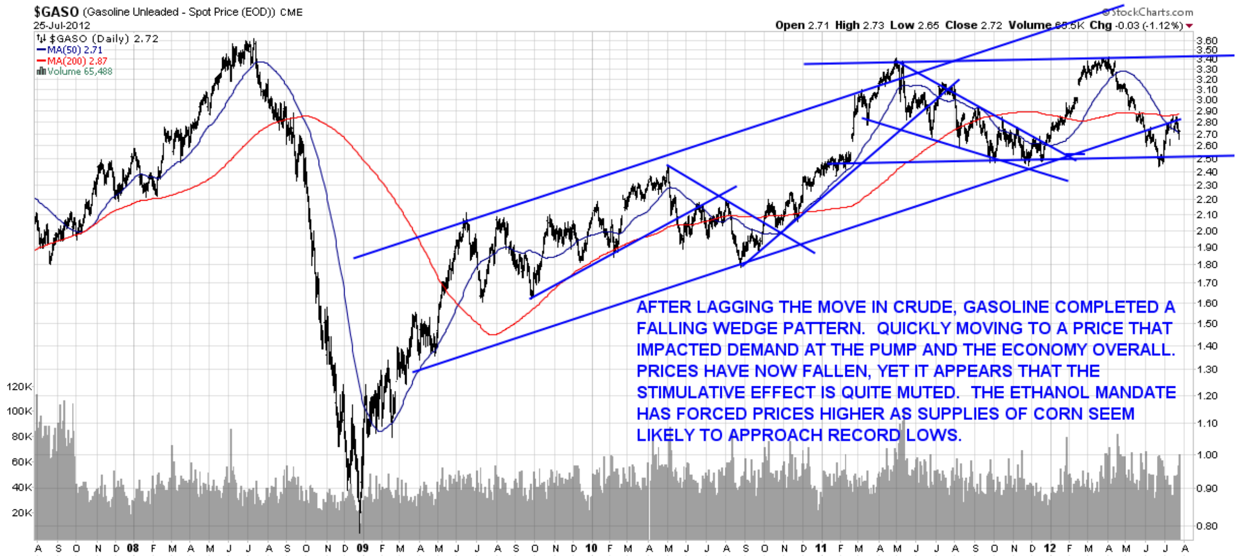

$TYX (30-Year T-Bond Yield) INDX
26-Jul-2012 2:25pm
© StockCharts.com
Open 24.81 High 24.97 Low 24.72 Last 24.97 Chg +0.30 (+1.22%)
$TYX (Daily) 24.97
MA(50) 26.83
MA(200) 30.02
Volume undef
THE FED EXTENDED OPERATION TWIST THROUGH AT LEAST THE END OF 2012. INTEREST RATE LEVELS ARE CONSISTENT WITH A SIGNIFICANT DOWNTURN IN THE US ECONOMY. LOOKS LIKE THE USA IS JOINING THE WORLD ECONOMIC RECESSION


$USD (US Dollar Index - Cash Settle (EOD)) ICE
25-Jul-2012
© StockCharts.com
Open 84.00 High 84.10 Low 83.50 Close 83.52 Chg -0.48 (-0.57%)
$USD (Daily) 83.52
MA(50) 82.48
MA(200) 79.88
Volume undef
THE US DOLLAR REMAINS DOWN 33% OVER THE LAST TEN YEARS
SINCE THE LOW, IN EARLY 2008 THE DOLLAR HAS APPRECIATED A NET 10%
resistance


$USD (US Dollar Index - Cash Settle (EOD)) ICE
25-Jul-2012
© StockCharts.com
Open 84.00 High 84.10 Low 83.50 Close 83.52 Chg -0.48 (-0.57%)
$USD (Daily) 83.52
MA(50) 82.48
MA(200) 79.88
Volume undef
USD ENCOUNTERED RESISTANCE AT 81-82. NEXT RESISTANCE 85-86


$GOLD (Gold - Spot Price (EOD)) CME
25-Jul-2012
© StockCharts.com
Open 1580.20 High 1610.00 Low 1577.90 Close 1603.40 Volume 189.7K Chg +25.40 (+1.61%)
$GOLD (Daily) 1603.40
MA(50) 1587.47
MA(200) 1657.89
Volume 189,708
Gold continues near the year lows. 1525-1540. Not surprising given the rally in the US Dollar, The lack of downside follow through is curious given the prognosis for the Dollar. Perhaps the prospect for QE3 is supporting prices in this otherwise depressed environment.


$WTIC (Light Crude Oil - Spot Price (EOD)) CME
25-Jul-2012
© StockCharts.com
Open 88.20 High 89.36 Low 86.84 Close 88.99 Volume 279.6K Chg +0.85 (+0.96%)
$WTIC (Daily) 88.99
MA(50) 86.18
MA(200) 96.46
Volume 279,643
SIGNIFICANT RESISTANCE 107-115
BREAKING $75 WOULD INDICATE A SEVERE ECONOMIC CONTRACTION



$GASO (Gasoline Unleaded - Spot Price (EOD)) CME
25-Jul-2012
©StockCharts.com
Open 2.71 High 2.73 Low 2.65 Close 2.72 Chg -0.03 (-1.12%)
$GASO (Daily) 2.72
MA(50) 2.71
MA(200) 2.87
Volume 65,488
AFTER LAGGING THE MOVE IN CRUDE, GASOLINE COMPLETED A FALLING WEDGE PATTERN. QUICKLY MOVING TO A PRICE THAT IMPACTED DEMAND AT THE PUMP AND THE ECONOMY OVERALL. PRICES HAVE NOW FALLEN, YET IT APPEARS THAT THE STIMULATIVE EFFECT IS QUITE MUTED. THE ETHANOL MANDATE HAS FORCED PRICES HIGHER AS SUPPLIES OF CORN SEEM LIKELY TO APPROACH RECORD LOWS.