

Technical Scoop E-Commentary October 26, 2020

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Contentious election, aftermath chaos, topmy divergences, rising rates, ravaged revival, small-cap challenge

A shortened version of the Scoop this week as we were away for a part of the week. As we wind down into the most contentious election ever polls seem almost meaningless in a divided America ravaged by the pandemic where despite poll numbers indicating a Biden victory, Trump could still win because of the electoral college and the Supreme Court. Irrespective the growing consensus is that the aftermath of the election could bring some chaos.

The markets continue to trace out what could prove to be an important top. There are no sell signals yet, but there are numerous divergences. We cite the continued divergence between the DJI and the DJT where the averages are not confirming each other. Interest rates are rising and appear to be pointed higher largely due to the huge deficits and signs of a revival in the economy. As the debt, money supply and the Fed's balance sheet rise so too will gold. But is the economic revival sustainable given the continued ravages of the pandemic that is now setting records? While small cap stocks appear to be showing some signs of broadening strength it is still too early to suggest that a strong shift from large cap stocks to small caps is underway. Still there is signs of life in junior technology, renewables and mining (golds) in particular. Copper and natural gas (NG) made fresh 52-week highs this past week. NG stocks in particular are benefitting. Toumaline Oil Corp, for example, is held in the Canadian Conservative Growth Strategy* and has assembled a multi-year drilling inventory and operating control of natural gas processing and transportation infrastructure in three core Alberta long-term growth areas.

Fall is beginning to wind down and stormy November is approaching. But there is still some good weather to enjoy. Have a great week.

DC

* Reference to the Canadian Conservative Growth Strategy and its investments is added by Margaret Samuel, President, CEO and Portfolio Manager of Enriched Investing Incorporated who can be reached at 416-203-3028 or msamuel@enrichedinvesting.com

**"The stock market is filled with individuals who know the price of everything, but the value of nothing."
—Philip A. Fisher, American stock investor, author of *Common Stocks and Uncommon Profits*, a guide to investing; 1907–2004**

**"The difference between playing the stock market and the horses is that one of the horses must win."
—Joey Adams (born Joseph Abramowitz), American comedian, vaudevillian, radio host, night club performer, author; 1911–1999**

**"Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down."
—Warren Buffett, American investor, business tycoon, philanthropist, Chairman & CEO Berkshire Hathaway; b. 1930**

With just over a week to go to what may be the most contentious election in U.S. history, it seems appropriate to look back on what has been a most difficult year. Most difficult year ever? Well, that might be a stretch. We've seen a few articles claiming the year 536 AD may rank as the worst year ever. Why 536? Well, a mini ice-age, triggered by a haze probably brought on by volcanic eruptions that settled over Europe, the Middle East, and parts of Asia (no word on the Americas) resulted in one of the coldest decades on record. Crops failed; famine was rampant. The haze lasted upwards of 18 months.

Then came the plague that became known as the Plague of Justinian, named after the Byzantine emperor at the time who ruled over what was the Eastern Roman Empire. The bubonic plague got underway in 541 AD and killed an estimated 100 million throughout Europe and Asia. And we think we have it bad. The combination of a mini ice-age famine and plague helped push the world at the time into what became known as the Dark Ages. Well again at least the European continent but again no word on what happened in the Americas where empires were forged, rose and collapsed.

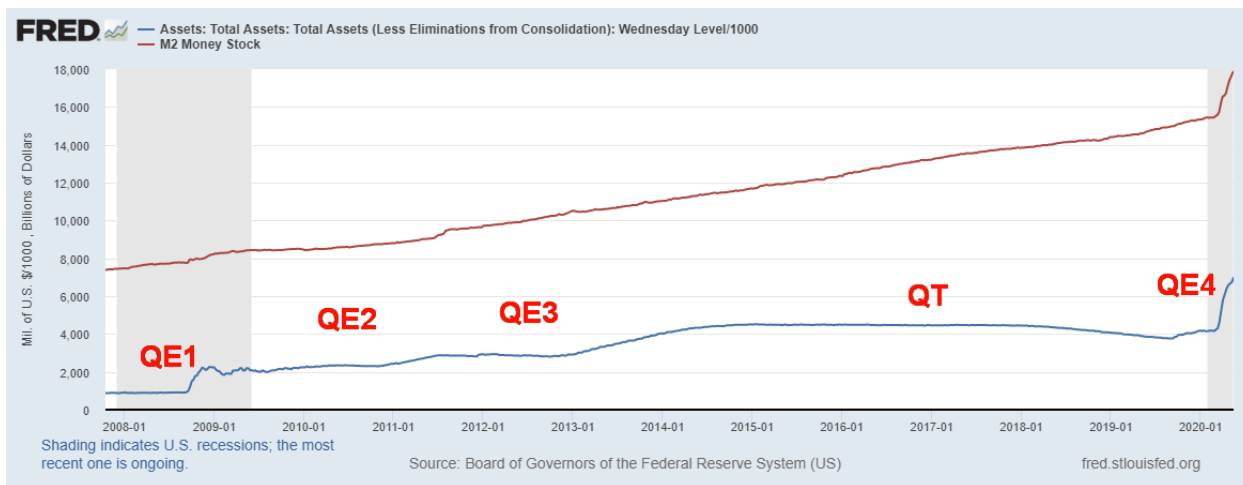
So, what about 2020? Well, fires, floods, extreme temperatures, hurricanes, and, oh yes, a plague. Missing so far are the earthquakes, massive volcanic eruptions, and tornadoes. Yes, we have had them, but not on a massive scale. And dare we mention famines and drought? It would almost seem that we are being hit with the biblical plagues. Okay, no blood, lice, frogs, locusts, boils, and the killing of the firstborn.

These are not natural disasters but, depending on one's view, they could be seen as disasters of another sort: the ubiquinols of surveillance technology including facial recognition technology, and the deep civil-war like divisions in the world's supposed leading democracy. The latter is being shown in the extremely contentious Supreme Court vacancy, the attempt by white supremacist groups to kidnap a sitting governor, riots in cities centered around Black Lives Matter, and accusations that ANTIFA (anti-fascists) is a terrorist organization—and, against this backdrop, an historic inequality of wealth. And we think Halloween is going to be scary?

The president thinks it is going to be a V recovery. The presidential candidate is saying it is a K recovery. Wall Street vs. Main Street. The stock markets are at/near record highs on Wall Street, with near-record unemployment and rising business bankruptcies on Main Street. One arm up, the other arm down. The K recovery.

What has driven the Wall Street arm is sure to continue past the election, no matter who wins. And this could continue to drive stock markets higher. The reason: unprecedented money printing as the money supply (M2) soars and the balance sheet of the Federal Reserve, along with other central banks, also soars; plus, interest rates are to remain negative to the rate of inflation and, in some cases, even below zero. We don't want to "beat a dead horse" with a chart we have shown before, but this one is compelling.

U.S. Fed Balance Sheet and Money Supply (M2) 2008–present



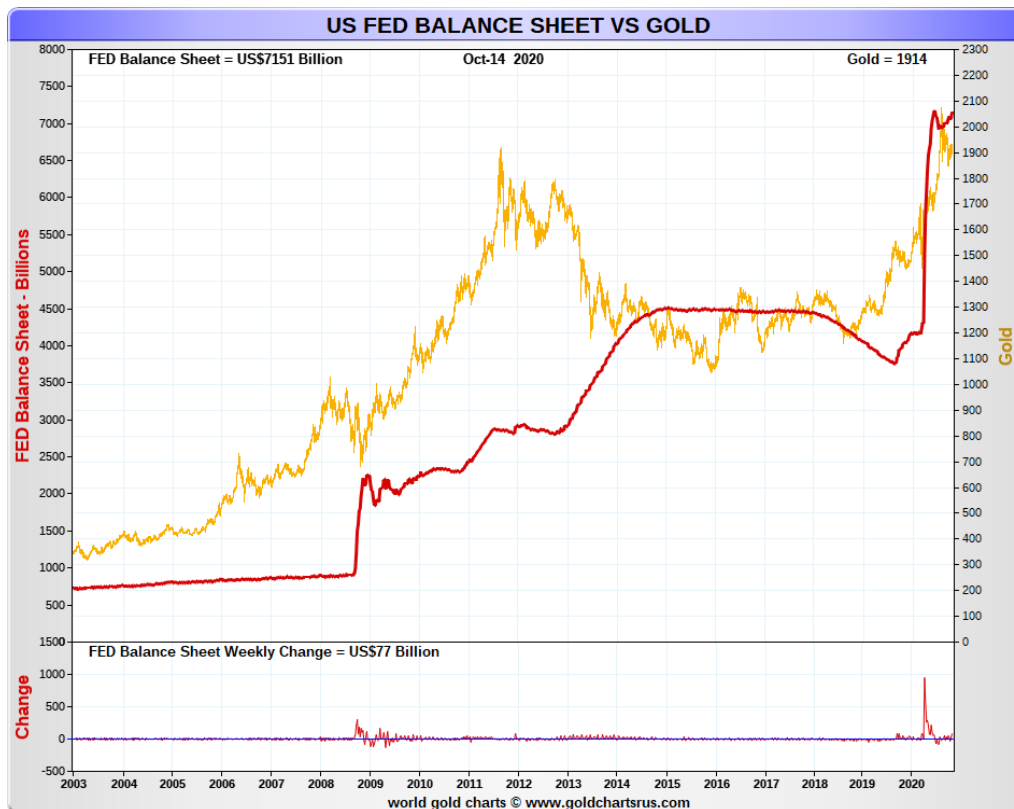
Source: www.stlouisfed.org

Both the money supply (M2) and the Fed's assets are now pointed straight up. This could be what we call the "hockey stick pattern" where, after a period of steady growth, the growth suddenly goes straight up. Inflation shows up not in the form of sharply rising prices—at least, not initially—but instead in inflationary asset growth, whether it be stocks or hard assets such as housing. It also shows up in rising gold prices. As the Fed Balance sheet rises along with M2 and debt, gold also rises. The message is simple—own some gold and silver, and by that we mean physical gold and silver. Gold stocks are also good as they are leveraged to the price of gold and silver, but they are paper, like any stock.

Once again for the record, since 2008 M2 Money Supply is up \$10.7 trillion (132%), the Fed Balance Sheet has exploded up \$5.4 trillion (304%), U.S. Federal Debt is up \$16.3 trillion (151%), while gold is up \$1,248 (183%). The stock market (DJI) is up 18,722 points (200%). But can the stock market maintain that rate of growth?

Since 2008 there have been only four periods where the market corrected downwards to any extent. In 2011 the DJI fell 19.2% (EU/Greek debt crisis), 2015/2016 15.8% (end of QE), 2018 18.4% (trade wars), and 2020 38.4% (pandemic). Since the 2009 financial crisis bottom that's a sharp correction, roughly every two years nine months. We are well aware of the 4-year cycle (range 3–5 years), and the 6.5-year cycle (range 5–8 years). It is possible that the 2011 low, the 2016 low, and the 2020 low were 4-year cycle lows. The 2016 low was most likely a 6.5-year cycle low. The March 2020 low appears to have been too early for the next 6.5-year cycle coming in four years and two months later. So, another cycle low could be due somewhere between 2021 and

2024, most likely occurring in 2022. The 2009 low was also an 18.75-year cycle low (range 13–22 years). That means the next one is due 2022–2031.

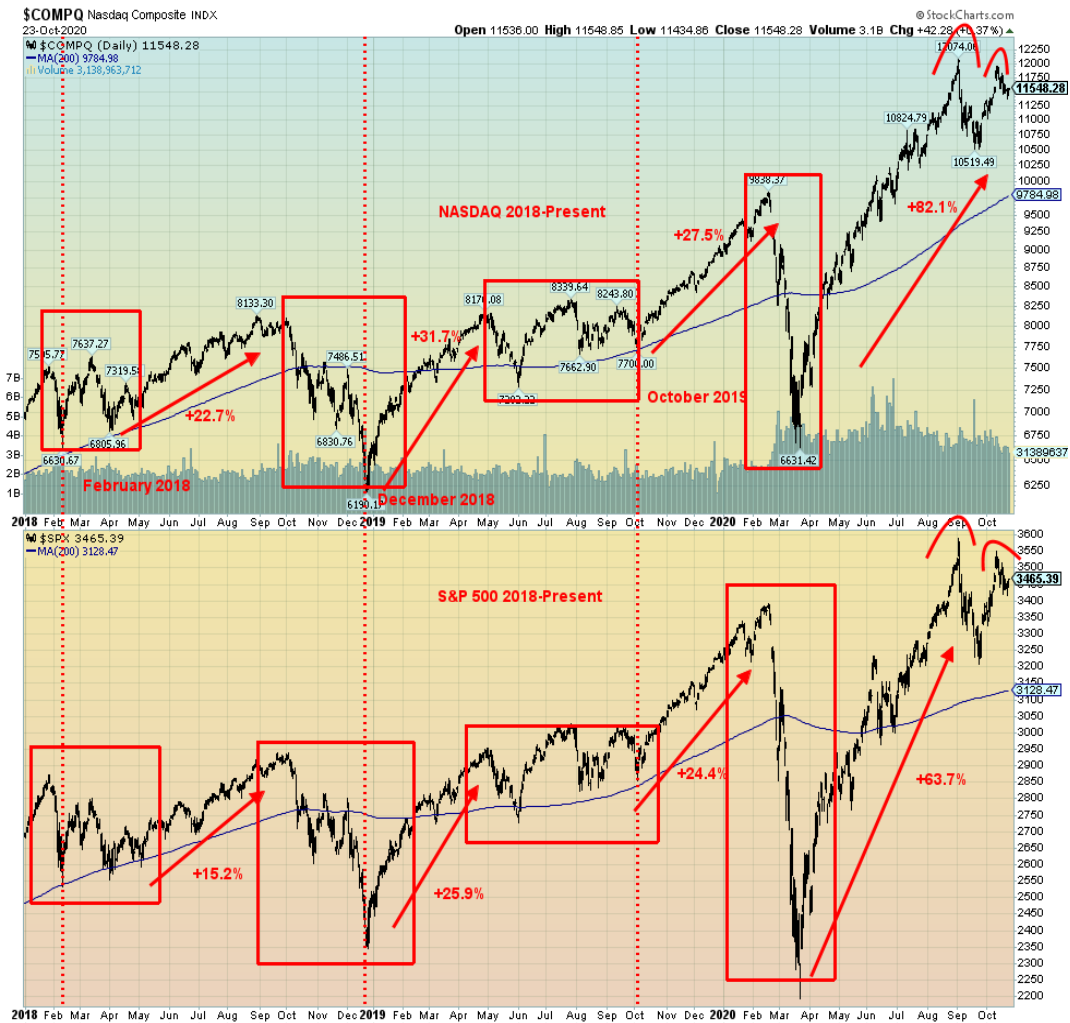


Source: www.goldchartsrus.com

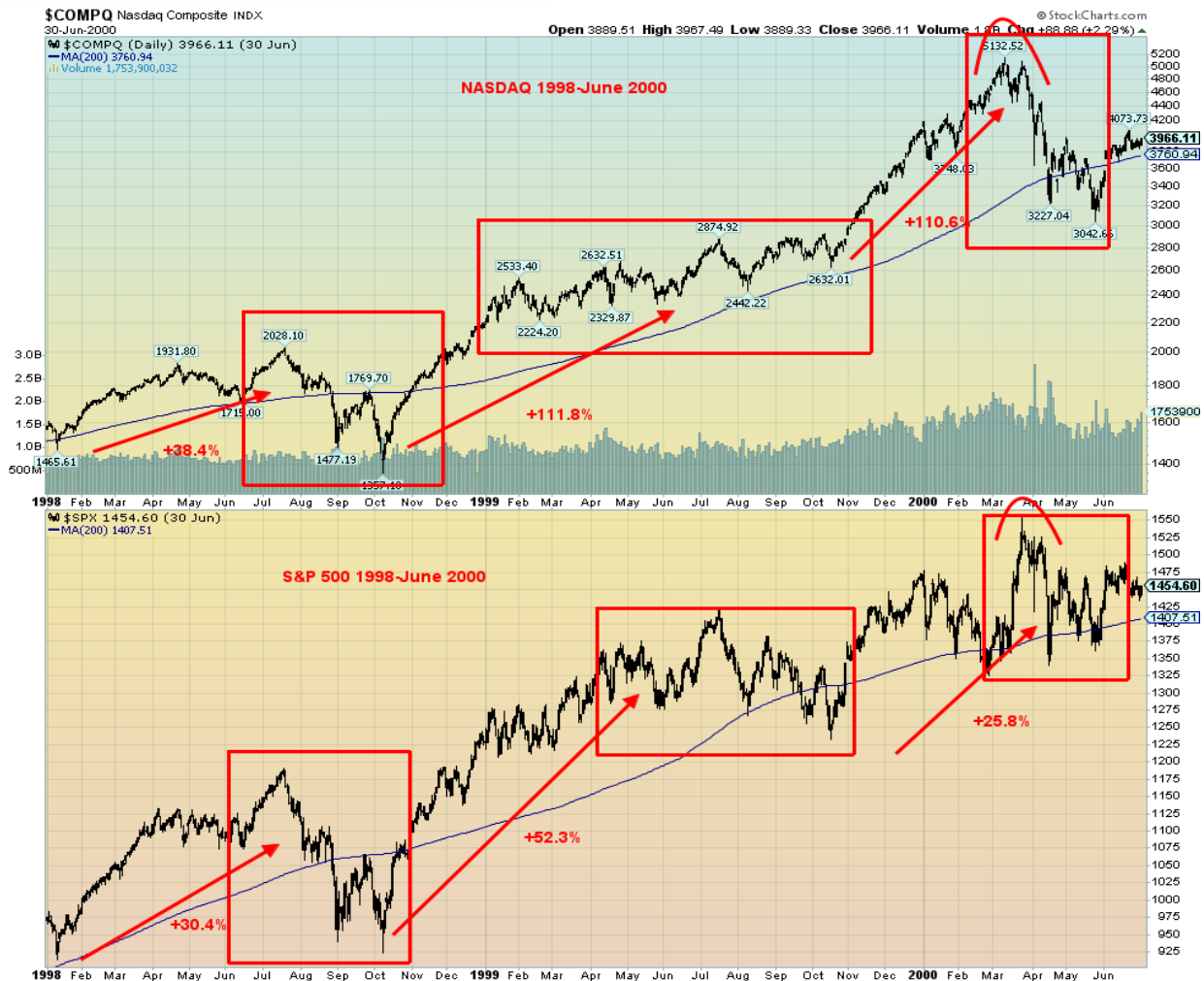
For the record there have been 6 major bear markets since 1950. A major bear market is one where the stock market falls 30% or more. They were 1966, 1973-1974, 1987, 2000-2002, 2007-2009 and the most recent 2020. Two; 1987 and 2020, were relatively short-lived bears of 55 days and 39 days respectively. Being over in such a short period of time makes it difficult to call them major bear markets. But 1987 did not result in a recession, at least not until 1990, while the March 2020 collapse resulted in a recession that continues.

The huge rise in the stock market has been led by the technology sector. The technology-dominated NASDAQ was up 82.1% at its most recent high on September 3, 2020 (ironically, also the high of the DJI on September 3, 1929). The S&P 500 was up 63.7% in the same time period. But, as is so often noted, roughly only a third of the stocks have been rising, dominated as they are by the FAANGs plus some other high technology stocks.

Below, we show an interesting comparison of the NASDAQ and S&P 500 during 2018–present vs. 1998–June 30, 2000. The general shape is the same, even if the periods of consolidation or declines don't quite match up. But we are seeing what appears to be a double top on the charts today and a double top on the charts back in March 2000. Unless we see new highs soon, the word is—look out below. Can the Fed save the day again? They have saved the stock markets, so far, but not the economy.

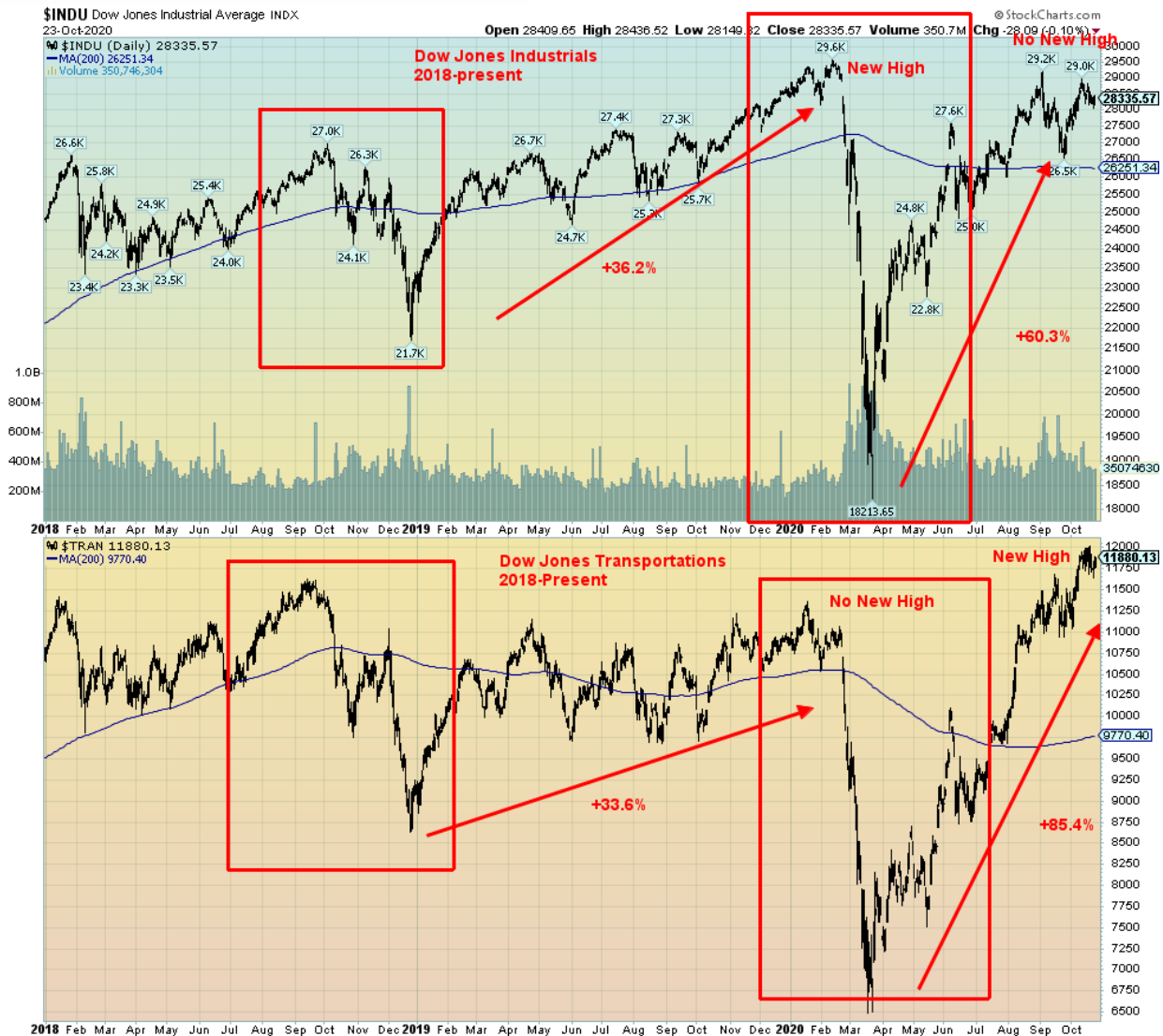


Source: www.stockcharts.com



Source: www.stockcharts.com

Another interesting divergence is between the Dow Jones Industrials (DJI) and the Dow Jones Transportations (DJT). One of the prime tenets of Dow Theory (Charles Dow in the Wall Street Journal) is that the **averages must confirm each other**. Here, we see a non-conformation with the DJI making new all-time highs in February 2020 but not the DJT. That is being repeated again in September 2020, except the roles are reversed—the DJT is making new all-time highs while the DJI is not. We note that we had similar divergences in 2000 and again in 2007–2008. In both instances, the divergence turned out to be right and stock markets fell precipitously in 2000–2002 (DJI down 38.7%, DJT down 49.4%) and again in 2007–2009 (DJI down 54.4%, DJT down 60.3%). Are we being set up once again?

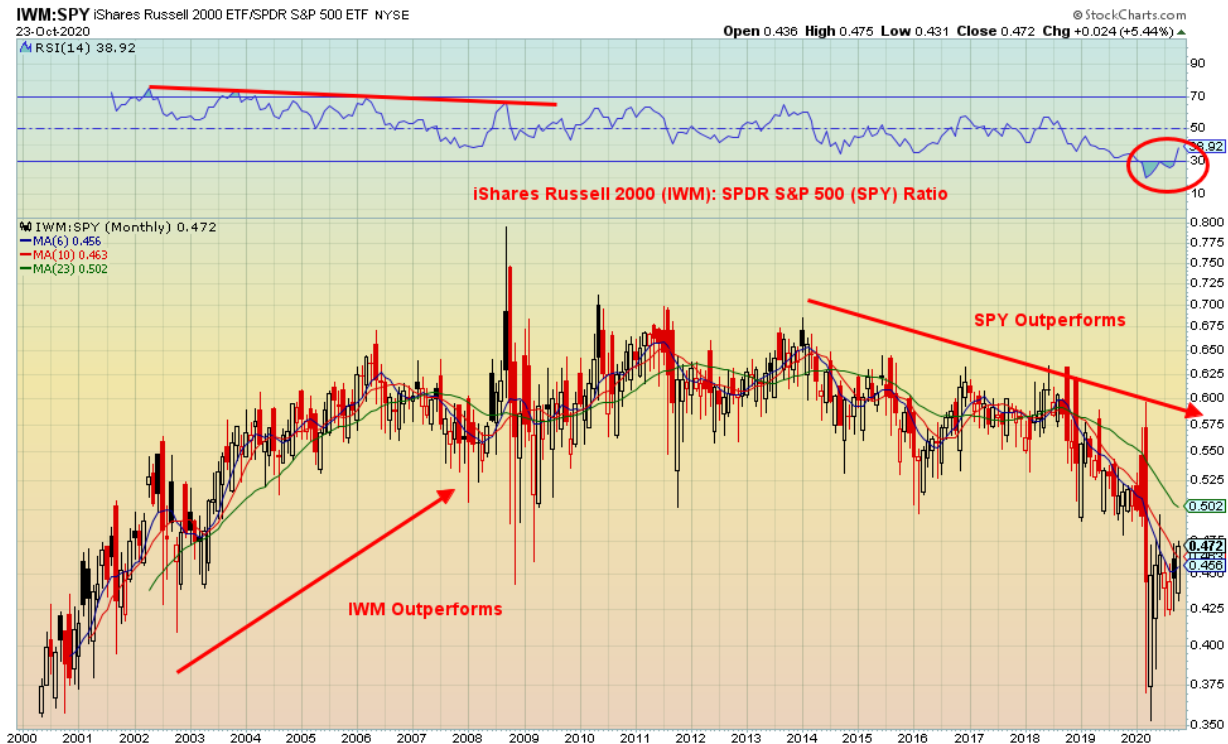


Source: www.stockcharts.com

One last thing to consider is the relationship between large cap and small cap stocks. Here we show the ratio between the iShares Russell 2000 (IWM), representing small cap stocks, and the SPDR S&P 500 ETF (SPY), representing large cap stocks. Between 2000 to 2008 the IWM outperformed the SPY. After the 2008 financial crash, investors preferred large cap stocks to small cap stocks and the SPY outperformed, at least until recently. The chart below is a monthly chart so it represents the long-term. The RSI recently plunged below 30 for a number of months. But it is now starting to rise again.

Does that imply that we are beginning a new era where small cap stocks will outperform? Possibly, but as we saw in 2008 through 2011, it took several months and even years for a top to form. It was only after 2012 that the SPY began to outperform. There are no divergences seen just yet in the ratio. So, it could take several months or more for a proper bottom to form. The last sell signal (the 6- and 10-month MAs crossed over the

23-month MA) on the ratio was seen in November 2018 as the market was plunging into the December 2018 low. No new buy signal has been seen at this time. Note that in 2000–2002, as the market plunged into the 2002 low, the IWM had been outperforming for months before the final plunge of the bear market. It is also interesting that the peak for the ratio came in September 2008 as the market was preparing for the Lehman Brothers crash that followed.



Source: www.stockcharts.com

We are in the midst of a pandemic. The numbers have picked up substantially with almost 500,000 cases on October 23. The U.S. is now recording over 70,000 cases daily. An extremely divisive election is just a week away. Yet the Fed continues its QE program (as do other central banks) and, no matter who wins on November 3, huge stimulus packages are coming. But the signs we are seeing suggest that the stock markets could soon be entering a dangerous phase, no matter who wins. Forewarned is forearmed.

MARKETS AND TRENDS

% Gains (Losses)

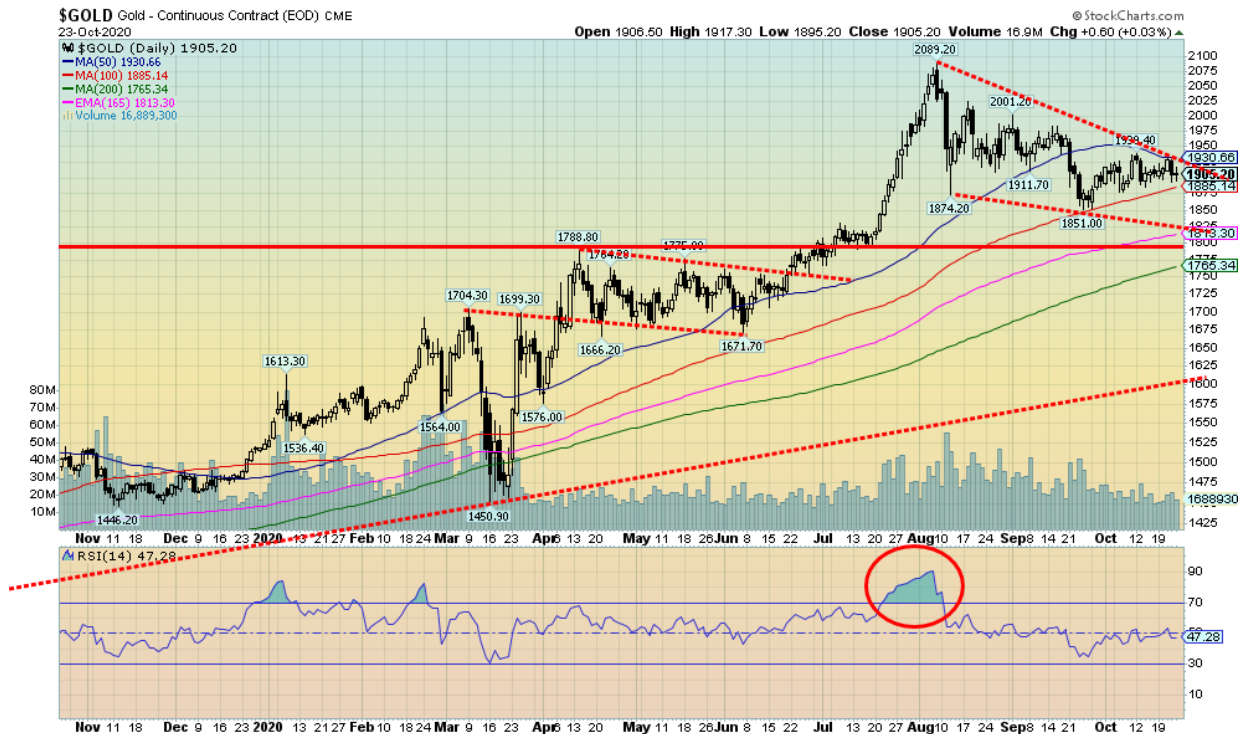
Trends

	Close Dec 31/19	Close Oct 23/20	Week	YTD	Daily (Short Term)	Weekly (Intermediate)	Monthly (Long Term)
Stock Market Indices							
S&P 500	3,230.78	3,465.39	(0.5)%	7.3%	up	up	up
Dow Jones Industrials	28,645.26	28,335.57	(1.0)%	(0.7)%	up (weak)	up	up
Dow Jones Transports	10,936.70	11,880.13 (new highs)	0.4%	9.0%	up	up	up
NASDAQ	9,006.62	11,548.28	(1.1)%	28.7%	up (weak)	up	up
S&P/TSX Composite	17,063.53	16,304.08	(0.8)%	(4.5)%	neutral	up (weak)	up
S&P/TSX Venture (CDNX)	577.54	718.13	(1.0)%	24.3%	down (weak)	up	up
S&P 600	1,021.18	933.72	1.1%	(8.6)%	up	up	down (weak)
MSCI World Index	2,033.60	1,883.46	Flat	(7.4)%	neutral	up (weak)	neutral
NYSE Bitcoin Index	7,255.46	12,943.57 (new highs)	14.2%	78.4%	up	up	up
Gold Mining Stock Indices							
Gold Bugs Index (HUI)	241.94	323.73	(2.9)%	33.8%	down	up	up
TSX Gold Index (TGD)	261.30	352.77	(3.3)%	35.0%	down	up (weak)	up
Fixed Income Yields/Spreads							
U.S. 10-Year Treasury yield	1.92	0.84	13.5%	(56.3)%			
Cdn. 10-Year Bond yield	1.70	0.64	12.3%	(62.4)%			
Recession Watch Spreads							
U.S. 2-year 10-year Treasury spread	0.34	0.68	13.3%	100.0%			
Cdn 2-year 10-year CGB spread	0	0.39	21.9%	3,900.0%			
Currencies							
US\$ Index	96.06	92.76	(1.0)%	(3.4)%	down	down	down
Canadian \$	0.7710	0.7610	0.3%	(1.2)%	up	up	neutral
Euro	112.12	118.61	1.2%	5.7%	up	up	up
Swiss Franc	103.44	110.60	1.2%	6.9%	up	up	up
British Pound	132.59	130.42	0.9%	(1.5)%	up (weak)	up	neutral
Japanese Yen	92.02	95.46	0.6%	3.7%	up	up	up
Precious Metals							
Gold	1,523.10	1,905.20	(0.1)%	25.1%	down (weak)	up	up
Silver	17.92	24.67	1.1%	37.7%	down (weak)	up	up
Platinum	977.80	906.70	4.3%	(7.3)%	neutral	neutral	neutral
Base Metals							
Palladium	1,909.30	2,398.60	2.4%	25.6%	up	up	up
Copper	2.797	3.13 (new highs)	2.0%	11.9%	up	up	up
Energy							
WTI Oil	61.06	39.85	(3.1)%	(34.7)%	neutral	neutral	down
Natural Gas	2.19	3.19 (new highs)	15.2%	45.7%	up	up	up

Source: www.stockcharts.com, David Chapman

Note: For an explanation of the trends, see the glossary at the end of this article.
New highs/lows refer to new 52-week highs/lows.

data is driving risk sentiment and a move to higher yields in expectation of continued better economic performance. Spreads are also widening between the 10-year and the 2-year. That usually happens as the economy improves. The question is—is this sustainable, particularly given the rising COVID-19 numbers and the risk of the economy being put back into the deep freeze once again?



Source: www.stockcharts.com

Not yet ready for prime time. That was gold and silver this past week. Just as both gold and silver seemed to be breaking out of what appears to us as a descending wedge triangle, both were hit back, failing at the 50-day MA. Could instead this be a descending triangle rather than a descending wedge triangle? We can't dismiss these thoughts until the upside breakout is resolved. The appearance is wedge because of lower highs and lower lows as the triangle constricts as we move lower. A descending triangle is usually seen as lower highs and relatively flat lows.

This past week gold fell not even 0.1%, but silver gained 1.1%. Platinum, which has struggled, had a good week gaining 4.3% and palladium was up 2.4%. Copper made new 52-week highs, up almost 2.0%. Oil fell 3.1% but natural gas (NG) also made fresh 52-week highs, up 15.2%. Strong NG prices drove the energy indices higher as the ARCA Oil & Gas Index (XOI) gained 0.8% and the TSX Energy Index (TEN) was up 2.4%. NG stocks did well. But the gold stocks did not fare as well as the Gold Bugs Index (HUI) fell 2.9% and the TSX Gold Index (TGD) was down 3.3%. Are the gold stocks pointing to lower prices for gold and silver? That's to be resolved.

If gold is continuing in a descending wedge triangle, then we should find support at \$1,885 and down to \$1,825. Silver looks a little more vulnerable to a decline breaking under \$24 and could fall to \$21. But it is will

be important that those low levels hold. A breakdown under \$1,825 points to a decline to around \$1,600 and for silver, even scarier, down to \$13. We doubt that, given the strong fundamentals. But we need to warn in case the worst case happens. To the upside, a breakout over \$1,930 is needed for gold with a confirmation on a close over \$1,950. For silver, the breakout needs to come over \$25 and confirmed over \$26.

The commercial COT for gold and silver isn't helping as the gold commercial COT this week was steady at 22%. However, short open interest rose roughly 10,000 contracts while long open interest was up less than 1,000 contracts. The silver commercial COT slipped to 31% from 32% as short open interest rose roughly 2,000 contracts while long open interest fell about 700 contracts. Both commercial COTs remain somewhat bearish.

The US\$ Index has been falling but it has failed to break down to new lows. The lack of a stimulus package is also hurting gold. Election uncertainty should be positive for gold and silver. We are in the vicinity of a potential trough for gold's 31.3-month cycle. It would be the second one counting from the major December 2015 cycle low. The first 31.3 monthly cycle low came in August 2018. The next one is due in April 2021 +/- 5 months or the period November 2020 to September 2021. We are approaching the early part of that potential cycle low. Once that low is established, we should embark on the third and final wave up before the market falls into more significant longer-term cycles of 7.8 years and 23 years.

From our perspective, if the bullish scenario is correct, it will be important that any further pullback here holds the lows we mentioned at \$1,825 for gold and \$21 for silver.

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GLOSSARY

Trends

Daily – Short-term trend (For swing traders)

Weekly – Intermediate-term trend (For long-term trend followers)

Monthly – Long-term secular trend (For long-term trend followers)

Up – The trend is up.

Down – The trend is down

Neutral – Indicators are mostly neutral. A trend change might be in the offing.

Weak – The trend is still up or down but it is weakening. It is also a sign that the trend might change.

Topping – Indicators are suggesting that while the trend remains up there are considerable signs that suggest that the market is topping.

Bottoming – Indicators are suggesting that while the trend is down there are considerable signs that suggest that the market is bottoming.

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