

Technical Scoop June 18 2018

From David Chapman, Chief Strategist

dchapman@enrichedinvesting.com

For Technical Scoop enquiries: 416-523-5454

For Enriched Investing™ strategy enquiries: 416-203-3028

No Recession yet, Tariffs and Counter-Tariffs Portend Depressions or Wars and Gold still Glitters

It was a fascinating week. It started with the President of the United States leaving the G7 meeting in Charlevoix, Quebec early then on the way out of the door he slagged the Canadian Prime Minister. The President was then off to Singapore to meet with the dictator of North Korea where he heaped effusive praise on him. The communique that was released allegedly to denuclearize the Korean peninsula was long on flowery words and short on specifics.

It was also a week that escalated the potential for trade wars. Tariffs placed on U.S. allies were met with counter tariffs. Tariffs were announced against China as well. The result was the same. China announced counter tariffs. Trade wars do nobody any good and the effects and the fear that this could escalate is already causing slowdowns in global trade. A reminder that the world has been through global trade wars in the past and the result was depressions and eventually real wars.

Our look this week is at trade between the U.S. and Canada and how tariffs could impact Canada. We trace briefly some history of Canada/U.S. trade relations, a relationship that goes back into the 19th century. We also look at the latest Fed rate hike. The Fed then noted that they could be planning on two more rate hikes in 2018 followed by more in 2019. The Fed's hawkish stand was in contrast to dovish words out of the ECB. The contrast caused the US\$ to spike followed by gold and the precious metals getting hit, hard. With short rates rising but long rates remaining unchanged the key 2-10 spread (the "Recession Watch Spread" page 17) narrowed further this week. We believe that at the current rate the U.S. could be into recessionary conditions sometime in the latter part of 2019. The Canadian Dividend Strategy is designed to allocate to cash in a sustained downtrend. Finally we note that Bitcoin has now broken below key support levels and is threatening to break down even further. Nonetheless the bulls continue to hold out hope.

We have our usual array of charts. This week's "Chart of the Week" (page 28) focuses on the Dow/Gold ratio. We note a potentially interesting pattern that could be suggesting soon a shift in favour of gold over stocks. Although given the sharp drop for gold on Friday one might be skeptical that this could happen.

Have a great week!

DC

“The acquisition of Canada this year, as far as the neighborhood of Quebec, will be a mere matter of marching; & will give us experience for the attack of Halifax the next, & the final expulsion of England from the American continent.”

—Thomas Jefferson, August 4, 1812

“No truck or trade with the Yankees!”

—Campaign Slogan for the Conservatives 1911 election

The biggest trading partner of the United States is not West Germany or Japan, it's right here.

—Brian Mulroney, 1988

We know that trade, NAFTA, the free and open trade between Canada and the U.S. creates millions of good jobs on both sides of the border.

—Justin Trudeau, 2018

PM Justin Trudeau of Canada acted so meek and mild during our @G7 meetings only to give a news conference after I left saying that, “US Tariffs were kind of insulting” and he “will not be pushed around.” Very dishonest & weak. Our Tariffs are in response to his of 270% on dairy!

—Donald Trump, 2018

“A special place in hell.” So said Peter Navarro, the U.S. senior trade advisor, directed at Canada’s Prime Minister Justin Trudeau. His statement was directed at Trudeau for engaging in bad-faith diplomacy with U.S. President Donald Trump. He later apologized, but the damage was done. Trudeau was also accused of “betrayal” and that the U.S. was “stabbed in the back” according the U.S.’s chief economic advisor Larry Kudlow. President Donald Trump later followed all of that by saying he’d punish “the people of Canada” because of PM’s Justin Trudeau’s news conference.

We can only hope that Mr. Trump’s punishment does not include invasion, reducing us to rubble like Iraq, Libya, and others. There was absolutely nothing friendly about the unprecedented attacks on Canada, the people of Canada, and our Prime Minister from the President and his minions. The comments are also impossible to ignore and go beyond the tit-for-tat trade tariffs that now appear to be taking hold. We want to talk about economics but become embroiled in politics. The two are often intertwined as much as many would love to separate them. Today economics is politics and vice-versa.

Nonetheless, it makes former President Richard Nixon’s calling former PM Pierre Elliott Trudeau an asshole seem rather quaint. Former President Lyndon Johnson was also alleged to have grabbed former PM Lester Pearson by the lapels and told him “don’t piss on my parade.” That was a result of

Canada's decision to stay out of the Vietnam War and not join the U.S. Former President George W. Bush cancelled a scheduled trip to Ottawa because of former PM Jean Chretien's decision to not join the U.S. in their invasion of Iraq in 2003. Yes, we were with the U.S. during two world wars but, as a reminder, Canada was there first. The U.S. joined later, only when its interests were threatened.

The trouble with the U.S-Canada relation is, economically, Canada is a mouse to the U.S.'s elephant. Still, Canada is no slouch and while Canada has a population that is just over 10% of the U.S., Canada's GDP is only about 7.5% of the GDP of the U.S. Our government debt to GDP ratio is, however, lower than the U.S. who have one of the highest government debt to GDP ratios of any of the major industrialized countries, surpassed only by Japan.

Because of the sheer size difference between the two countries, the health of Canada's economy is somewhat reliant on the U.S. U.S. relations with Canada can have a potentially large impact, but Canadian actions have little impact on the U.S. And that often raises tensions between the two countries. U.S. capital is important to Canada which has resulted in high corporate ownership of important sectors of the Canadian economy by U.S. corporations. At times, this has resulted in the U.S. trying to impose its laws on U.S. subsidiaries and by extension on Canada itself.

Canada/U.S. trade is estimated at over \$600 billion. Canada's exports to the U.S. represent 75% of all of Canada's exports. 49% of Ontario's GDP depends on exports to the U.S. U.S. exports to Canada, while large, are small in relation to their overall exports, representing about 16%. Canada, is however, the number one destination for exports from at least 35 states. Overall, Canada and the U.S. share a \$1.5 trillion bilateral trade and investment relationship. Canada is the largest foreign supplier of oil and natural gas exports to the U.S. and represents nearly 40% all U.S. foreign imports of oil. Canadian travel to the U.S. is estimated at over 25 million trips with \$28 billion in spending. On the other hand, Canada receives roughly 12 million Americans who spend only about \$8 billion. Canada enjoys a \$17.5 billion trade surplus in goods with the U.S. in 2017, but, combined with services, Canada has an \$8.4 billion deficit. President Trump falsely claims that the deficit is \$100 billion. According to the U.S. Department of Commerce exports of goods and services to Canada support some 1.6 million jobs.

The Canada/U.S. relation goes beyond just exports and imports. We also have a huge shared infrastructure in the St. Lawrence Seaway, ports in the Great Lakes, and, the Columbia River Treaty whereby we jointly built dams to supply electricity and allow flood control. We jointly have hook-ups in pipelines, highways, railways, electricity grids, and telecommunications networks. We are jointly in NATO and NORAD covers North America.

Our interrelationship goes back to pre-Confederation times. Indeed, the U.S. tearing up of what was known as the 1854 Elgin-Marcy Treaty, along with subsequent actions, helped lead to Confederation in 1867. The treaty related to free trade in agriculture products and natural resources, particularly timber. Britain's support for the Confederate States helped lead to the abrogation of the treaty. The result of all this at the time triggered a steep recession in Canada. After Confederation, the government of Prime Minister Alexander Mackenzie drafted a reciprocity treaty that was similar to the 1854 treaty only it covered a lot more goods. Failure to implement the treaty led Canada to put high tariff walls to help encourage growth in Canada and east-west nation building.

That actually led to more direct investment in Canada from the U.S. and the start of the U.S. branch plant economy. Nonetheless, high tariffs dominated in both countries. This paved the way for the reciprocity treaty that got underway in 1893, leading to a nasty election in 1911. With considerable opposition to the reciprocity treaty by the Conservatives, the Liberals under Wilfred Laurier were defeated. This was despite the fact that the U.S. had approved the treaty. Despite various efforts going forward things got even worse, and by the 1930s the U.S. was passing Smoot-Hawley that took tariffs to very high levels and was a major contributor to the Great Depression.

Following the election of Franklin Roosevelt things did start to improve as it became clear high tariffs were not working. By 1965 things had shifted to such an extent that the Auto Pact was signed, helping establish a single continental market for the industry. With the election of the Brian Mulroney Conservatives in 1984 things shifted even further, leading to the Free Trade Agreement in 1988 and eventually NAFTA in 1994. Since then there have been disputes, most notably the Softwood lumber agreement, but for the most part until now free trade brought considerable benefits to both countries. Naturally, there were winners and losers, and the losers eventually formed a considerable bloc that led to the election of Donald Trump and today's disputes.

The biggest risk going forward is if the U.S. slaps tariffs on Canadian-made vehicles and auto parts. First, it would blow apart the tightly integrated North American business model built by the auto companies. Second it would be a devastating blow to potentially thousands of jobs here in Canada, particularly in Ontario. An auto tariff of 25% would just about blow up the entire Canadian auto industry. It could cause auto prices to soar, 130,000 jobs directly employed in auto-assembly could be at risk, and hundreds of dealerships could also be at risk. Two-way trade in autos is estimated at over \$140 billion.

But from Trump's viewpoint it makes sense as auto production could shift back to the U.S., thus giving rise to thousands of new jobs in auto assembly plus ancillary services. It is probably no surprise that currently, given Canada's considerably smaller market, 85% of vehicles currently made in Canada

are destined for the U.S. It is estimated that tariffs on the auto industry could hike the price of a car by at least \$6,200. Both Canadian and U.S. consumers would be hit with the bill, especially if Canada is forced to retaliate by placing a tariff on U.S. imports of autos, primarily trucks.

Plants that could be impacted are situated in Alliston, Oshawa, Oakville, Woodstock, and, Cambridge. All, of course, are in Ontario. While the Canadian-based auto companies would be negatively impacted it would also negatively impact parts manufacturers like Linamar (LNR-TSX) and Magna (MG-TSX).

As we have said before, in trade wars nobody wins. And, in this case especially, if the auto industry were hit Canada would be a major loser. We can only guess that is what he means when he says he will “punish the people of Canada.” However, it goes beyond Canada. As a story in *The New York Times* postulates, [“Just the Fear of a Trade War is Straining the Global Economy.”](#)

Given that Trump has decided to extend tariffs against China the world has to be prepared for a major trade war. A reminder once again that the last time the world engaged in major trade wars it helped plunge the world into an economic depression and ended in a war that killed 60 million people. One can only hope that history is not about to repeat itself.

Finally, there was another historic summit this past week. Unlike the unleashing of trade wars this one allegedly was to bring peace to the Korean peninsula 65 years after hostilities ended in a cease fire. This one was between a supposed brutal dictator and a supposed wannabe dictator. They spent their few days together gushing about each other, except in the end their statement said very little. Many believed the supposed brutal dictator won the first round, although it is all hard to say. Nonetheless, the Kim Jong Un/Donald Trump summit was historic even if it accomplished very little and may in the end amount to nothing, unlike the trade wars that appear to soon be headed for even more clashes.

Yet Another Interest Rate Hike

As was widely expected the Fed Funds rate was hiked on June 13, 2018 by another quarter point to 2% with a range from 1.75%–2.00%. It is the seventh-rate hike since December 2015 and the second under current Fed Chair Jerome Powell. Seven times isn’t too many so far. From 2004 to 2006, the Fed hiked the Fed Funds rate 17 times before they finally had to lower it in September 2007. The recession lasted effectively from 2007 to 2009. The Fed is expected to hike the key Fed Funds rate twice more in 2018, bringing it to 2.25%–2.50% by year end.

The current rate hike is against the backdrop of a 3.8% (U3) unemployment rate, GDP growth rate of 2.8% (latest Q1), and an inflation rate of 2.8% (core inflation rate – 2.2%). The Fed describes the current U.S. economy as being “not too hot, not too cold.” In other words, the “Goldilocks” economy. They expect GDP growth to continue between 2% and 3%, inflation to remain benign, and unemployment to stay low. But are things really what they seem?

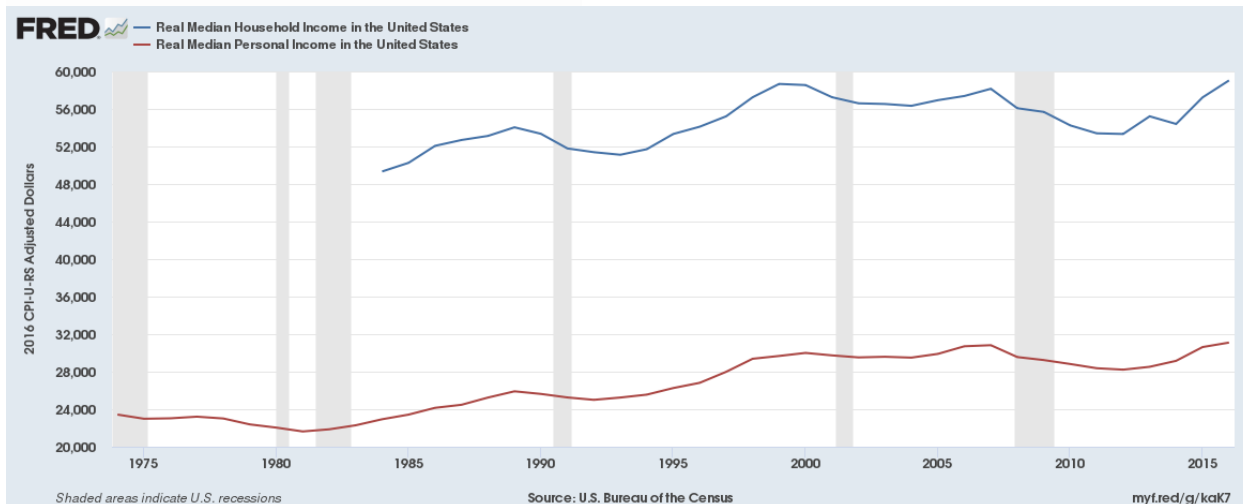
If one follows respected economist John Williams of [Shadow Stats](#), he says the real situation is much worse. The unemployment rate is 21.4%, the inflation rate is 10.6%, and the GDP growth is negative 1.34%. Of these statistics the Fed, or rather the Bureau of Labour Statistics (BLS), does release what is known as U6 unemployment. This number represents the U3 unemployment plus marginally attached workers, short-term discouraged workers, and those forced to work part-time because they cannot find full-time employment. The U6 unemployment rate is currently 7.6%.

The Shadow Stats unemployment takes the BLS’s U6 and adds in long-term displaced workers for more than one year and who were defined out of existence in 1994. Those workers show up in what is known as “Not in Labour Force.” That category holds 95,947,585 people. Not all are retirees (52,259,534), full-time students not working, people on long-term disability, and stay-at-home homemakers.

The same is done with inflation. The number Williams shows is calculated the way inflation was in 1990. Effectively, today’s methods used to calculate inflation reflect more what is needed to maintain a constant standard of living rather than actually measuring the cost of living. If prices go up then a substitute is provided at a lower price. Housing prices are an excellent example of prices rising faster than the stated rate of inflation.

The Fed also uses the core inflation rate that does not contain food and energy as if people don’t eat or need energy to fuel their cars and their homes. The core inflation rate tends to be lower than the reported CPI. If the computing power of computers goes up, that is the same as a price cut. We could go on, but that is basically the picture. The same was done with GDP that helps reflect a better GDP. For the inflation numbers, reporting inflation as substantially lower allows the government and corporations to keep a lid on pension payments indexed to inflation as an example.

As for the GDP numbers, well, according to John Williams, the U.S. has been in a constant recession since 2000 except for three quarters in 2004. It is noteworthy that during this period inequality grew as roughly 20% of the population did well while the remaining 80% saw their wages stagnate. Some of these factors played a role in the election of Donald Trump in 2016.



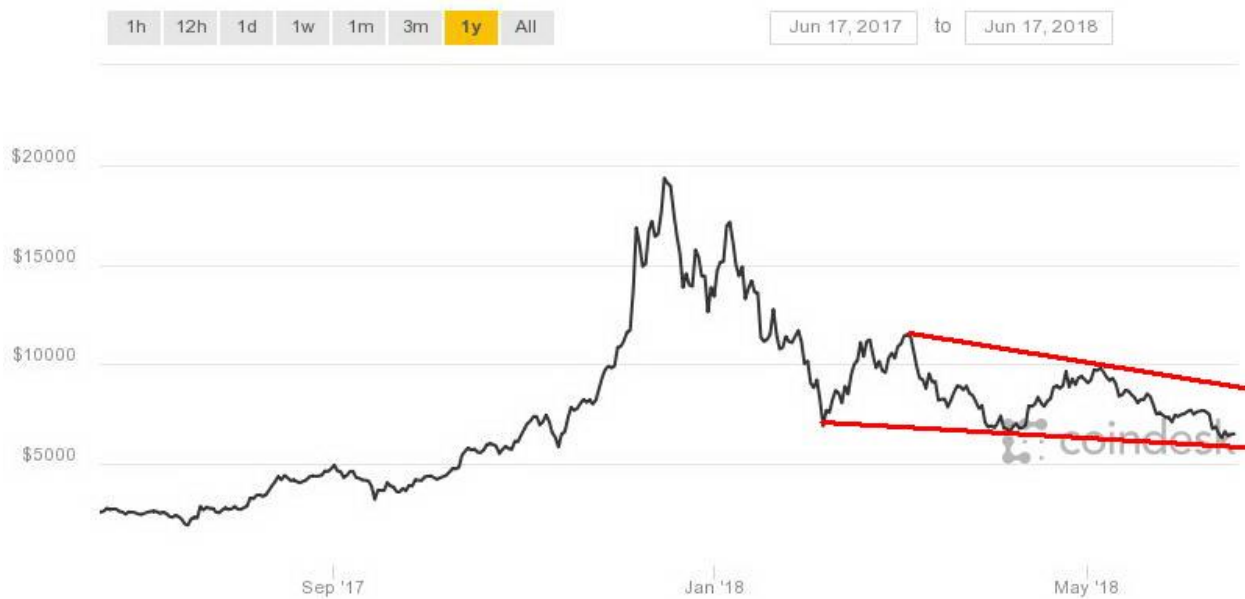
Source: www.stlouisfed.org

Above is a chart of real median household income and real median personal income. Real median household income peaked at \$58,665 back in 1999. It only recently surpassed that level. The same with real median personal income that peaked in 2007 at \$30,821. But that in turn was not much above the 2000 level of \$29,998. Today it is also just above the previous peak level. All of it reflects two decades of stagnating wages adjusted for inflation. And that is using the official inflation numbers, not the higher inflation levels reflected by Shadow Stats. If that was used the median income would be even lower.

After keeping the official Fed Funds rate suppressed at or near zero for a period of seven years from December 2008 to December 2015, the Fed has now been hiking rates in an attempt to normalize interest rates. A quarter-point hike in interest rates adds about \$500 million to the annual interest bill for the Federal government.

Nonetheless, the current rate is still below even the official rate of inflation and well below the inflation rate reported by Shadow Stats. That means, despite the recent rise in interest rates, savers still do not make a return after inflation and wages for the most part are not keeping up or barely keeping up with the rate of inflation. And if one used the Shadow Stats rate of inflation both are way behind. No wonder growth, according to Shadow Stats, remains negative and for many it feels like a permanent recession. It is not feels—it is. And we haven't even hit the point of a turndown in the economy that inevitably will happen given we are now nine years from the end of the last official recession.

Bitcoin Watch!



Source: www.coindesk.com

Bitcoin finally cracked \$6,800 and traded as low as \$6,133 before stabilizing and bouncing back. \$6,800 should now act as resistance. Below is support at \$6,000 and support from the February 2018 low, but a firm break under that level could take Bitcoin to the next good area of support near \$5,000. The bulls, however, will want to view \$6,000 as a key support zone to launch the next up move.

The decline is having an immediate effect. Last week there were 22 cryptos with a market cap over \$1 billion. This week there are only 18. Four fell off. The market cap of all cryptos listed at [Coin Market Cap](#) has fallen to \$280 billion from \$321 billion the previous week. A \$40 billion drop is serious money even if some of it is only paper money. Five cryptos have also disappeared as there are now 1,629 listed at Coin Market Cap vs. 1,634 the previous week.

The drop for Bitcoin has taken many indicators into oversold territory on the daily charts. The weekly charts do, however, have room to move lower. Monthly charts are now mostly neutral and have considerable room to move lower. Oversold conditions such as an RSI under 30 can remain with us for some time. We have seen RSIs go under 30, and then go even lower under 20. So it shouldn't be

taken as a sign that a low is in. But it might be a sign that the market could consolidate to work off some of the oversold conditions. Only a move back above \$6,800 might indicate a low is in. A move over \$7,200 would be a confirmation that a low is in.

We have been consistent in our bearishness towards cryptos. There are too many of them, there is still a lack of clear regulation, regulators continue to circle, there have been far too many scams and outright frauds, and there have been exchanges that have failed. We suspect that prices won't stabilize until there is some order to the market and regulations in place to protect the consumer just as there are regulatory bodies for investment dealers, mutual fund dealers, and more. Cryptos are still only used by a small segment of society and uses for cryptos remain few.

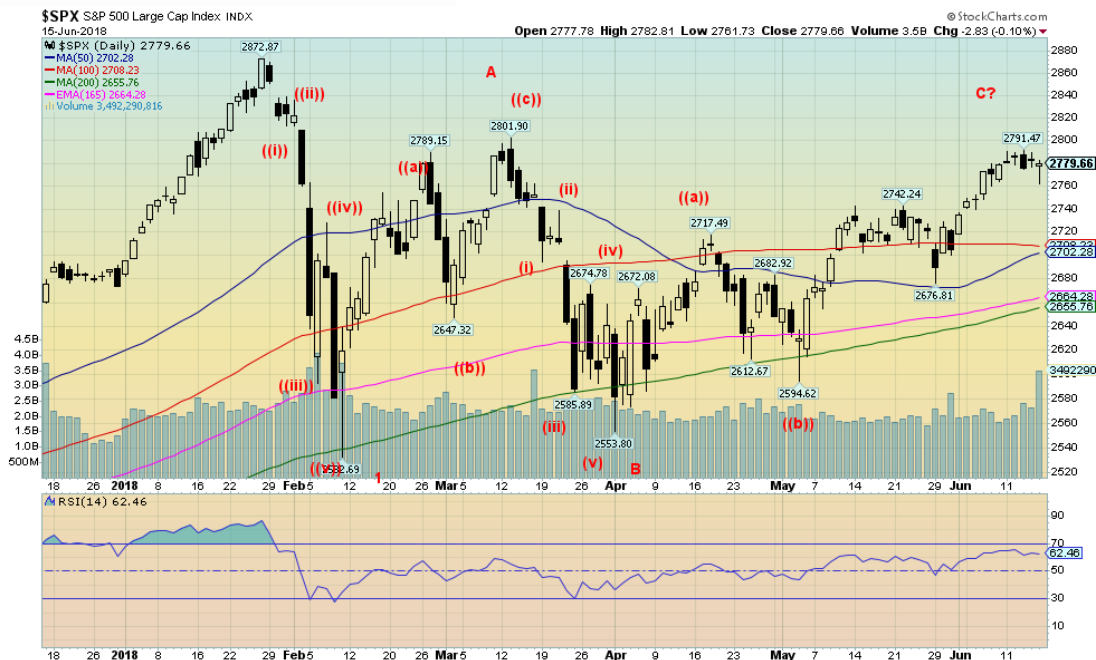
Our near-term expectations are that Bitcoin will consolidate between \$6,200 and \$6,800 before moving lower once again. Potentially longer-term targets remain down to \$3,700 to \$4,000. Bitcoin appears to be forming a descending triangle. A descending triangle is bearish and is characterized by a series of lower highs and relatively flat lows. If the triangle breaks down, Bitcoin could in theory fall to under \$1,000.

MARKETS AND TRENDS

			% Gains (Losses)		Trends		
	Close Dec 31/17	Close Jun 15/18	Week	YTD	Daily (Short Term)	Weekly (Intermediate)	Monthly (Long Term)
Stock Market Indices							
S&P 500	2,673.63	2,779.42	0.1%	4.0%	up	up	up (topping)
Dow Jones Industrials	24,719.22	25,090.48	(0.9)%	1.5%	up	up	up (topping)
Dow Jones Transports	10,612.29	11,073.99	1.2%	4.4%	up	up	up (topping)
NASDAQ	6,903.39	7,746.38 (new highs)	1.3%	12.2%	up	up	up (topping)
S&P/TSX Composite	16,209.13	16,314.42	0.7%	0.7%	up	up	up
S&P/TSX Venture (CDNX)	850.72	754.40	(2.7)%	(11.3)%	down	down	up (weak)
Russell 2000	1,535.51	1,683.91 (new highs)	0.7%	9.7%	up	up	up (topping)
MSCI World Index	2,046.47	1,992.68	(0.6)%	(2.6)%	down	down (weak)	up
NYSE Bitcoin Index	14,492.18	6,545.40	(13.9)%	(54.8)%	down	down	neutral
Gold Mining Stock Indices							
Gold Bugs Index (HUI)	192.31	177.88	(0.5)%	(7.5)%	down	down	neutral
TSX Gold Index (TGD)	195.71	191.62	1.4%	(2.1)%	up	neutral	neutral
Fixed Income Yields/Spreads							
U.S. 10-Year Treasury yield	2.40	2.93	flat	22.1%			
Cdn. 10-Year Bond yield	2.04	2.22	(4.3)%	8.8%			
Recession Watch Spreads							
U.S. 2-year 10-year Treasury spread	0.51	0.38	(11.6)%	(25.5)%			
Cdn 2-year 10-year CGB spread	0.36	0.29	(29.3)%	(19.4)%			
Currencies							
US\$ Index	91.99	94.79	1.3%	3.0%	up	up	down
Canadian \$	0.7990	0.7600	(1.7)%	(4.9)%	down	down	neutral
Euro	120.03	116.10	(1.3)%	(3.3)%	down	down	up
British Pound	135.04	132.81	(0.9)%	(1.7)%	down	down	down (weak)
Japanese Yen	88.76	90.40	(1.0)%	1.9%	down	neutral	up (weak)
Precious Metals							
Gold	1,309.30	1,278.50	(1.9)%	(2.4)%	down	down	up
Silver	17.15	16.48	(1.6)%	(3.9)%	up	neutral	neutral
Platinum	938.30	887.80	(2.0)%	(5.4)%	down	down	down
Base Metals							
Palladium	1,061.00	981.80	(2.4)	(7.5)%	up (weak)	neutral	up
Copper	3.30	3.14	(4.9)%	(4.9)%	up	up	up
Energy							
WTI Oil	60.42	65.06	(1.0)%	7.7%	down	up	up
Natural Gas	2.95	3.02	4.5%	2.4%	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.



Source: www.stockcharts.com

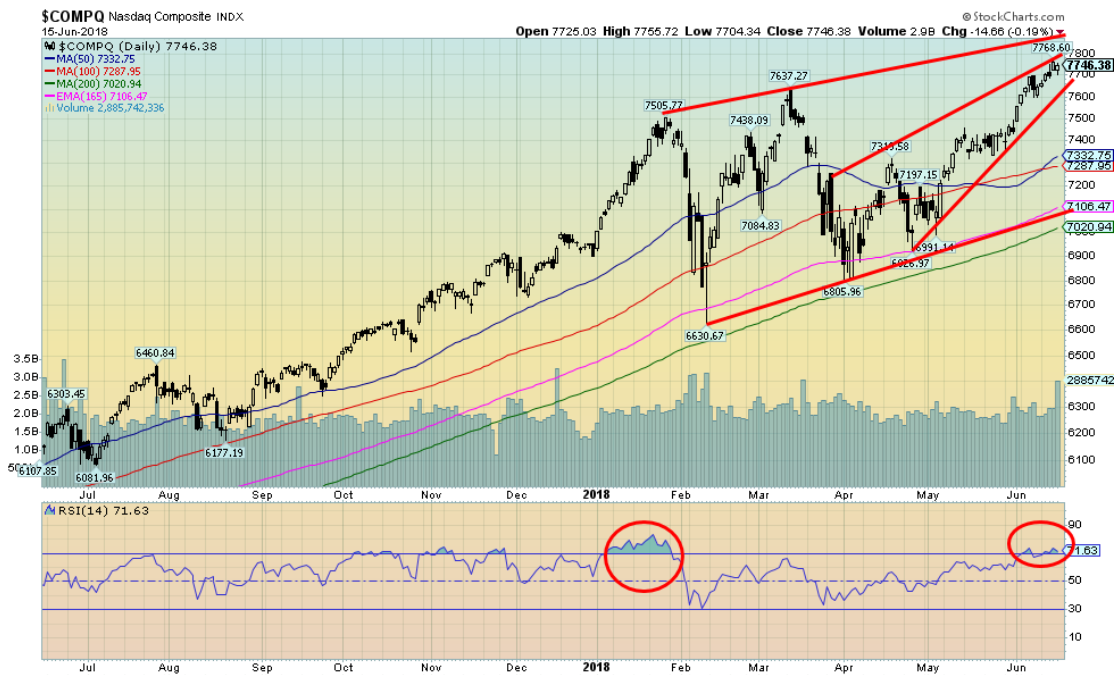
With all the excitement during the week centered on Trump's behaviour at the G7, the Kim-Trump summit, and the Fed rate hike the stock markets were not garnering a lot of attention. The S&P 500 ended the week effectively unchanged. The Dow Jones Industrials (DJI) did not fare well at all, falling 0.9%. But the Dow Jones Transportations (DJT) was up 1.2% and the NASDAQ jumped 1.3%. Small cap indices represented by the Russell 2000 also saw gains up 0.7%.

It was an odd week. Markets are diverging. The NASDAQ made new all-time highs and so did the Russell 2000 and the S&P 600. Small cap stock indices made new all-time highs, while large cap stock indices such as the S&P 500 and the DJI did not make new all-time highs. Others were similarly lacklustre, including the S&P 100 (OEX), the NYSE Composite, and, surprisingly, the Wilshire 5000, the broadest index possible. Overseas, the MSCI World Index was down 0.6%, the Chinese Shanghai Index (SSEC) fell 1.5%, the Paris CAC 40 was up 1.0%, the German DAX also gained 1.9%, and the Tokyo Nikkei Dow (TKN) gained 0.7%. The London FTSE 100 dropped 0.8%. None of these indices are anywhere near all-time highs.

It is still difficult to say what type of pattern is forming here. We continue to think we'll see an ABCDE-type pattern. So far, we can see an ABC pattern as we appear to be working on the C wave. That is presuming that wave 1 was the decline following the January high. That wave bottomed in February. One reason we believe we will see an ABCDE-type pattern is that the B wave appears to

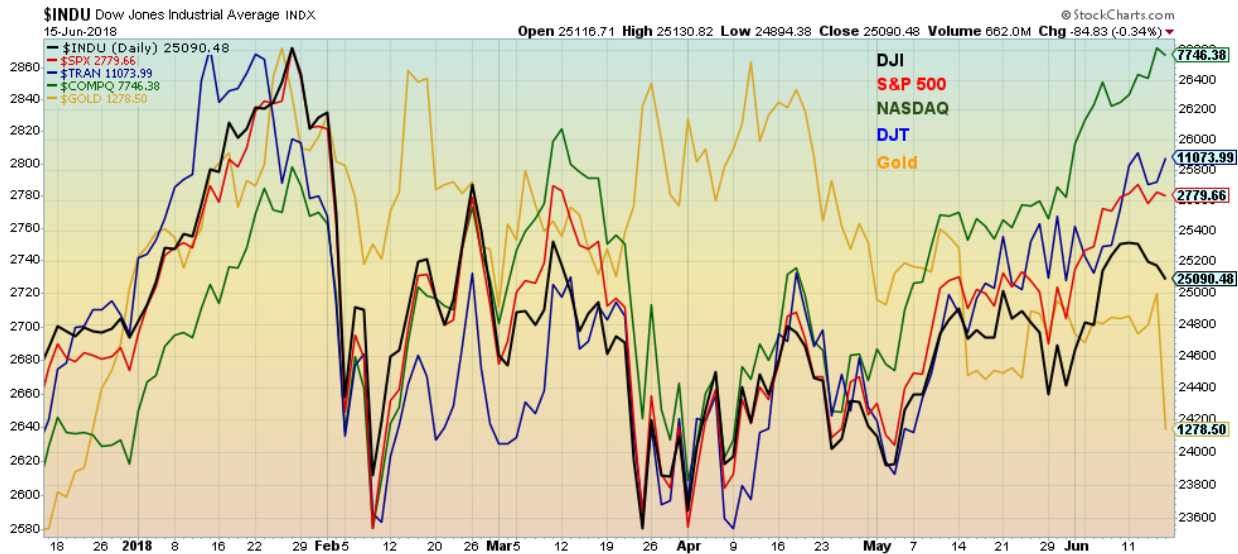
have fallen in five waves. Usually it is the C wave that rises (or falls) in five waves not the middle wave. So that still puts our final high potentially out until later this summer or even into the fall. Nonetheless, the rally since February still appears as a bear market rally following that first break.

The S&P 500 appears to be rolling over and could fall swiftly back to 2,700. Only new highs above 2,791 and especially above 2,802 the March 2018 high could change this scenario. Above 2,802, new highs above the January high of 2,872 are possible. Friday's low was at 2,761 so another break of that level should send the index lower.



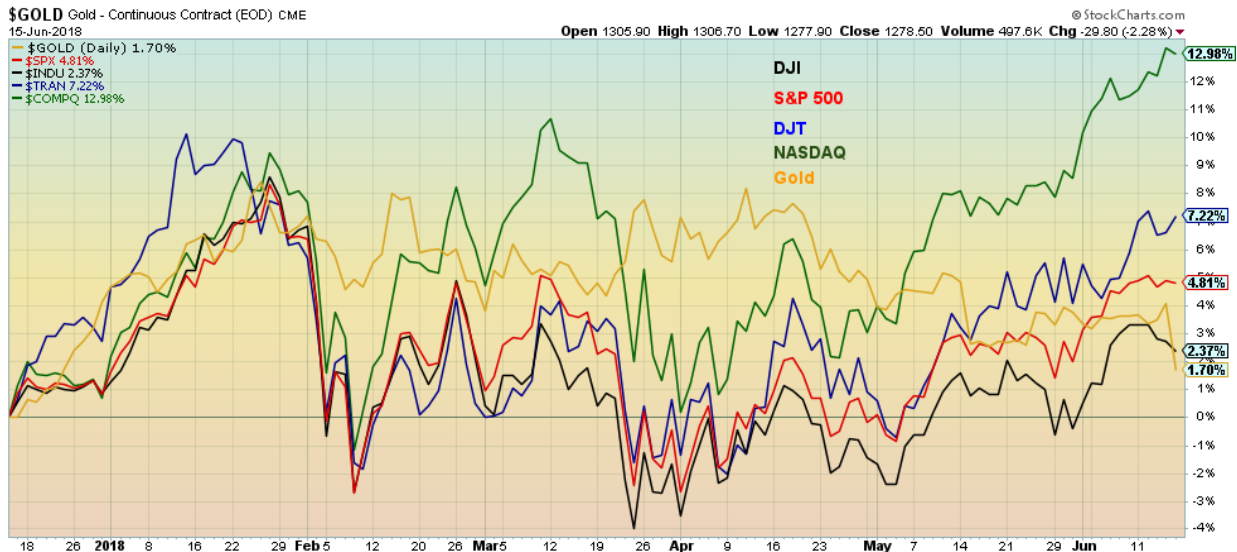
Source: www.stockcharts.com

Thanks to the FAANGs (Facebook, Apple, Amazon, Netflix, Google), the NASDAQ is making new all-time highs. The other indices, as we note below, are not and that is a significant divergence. It is lonely at the top and the rise to new highs is narrow given the dependence on just five stocks when there are dozens, hundreds to choose from. This is not a healthy market in our opinion. Indicators such as new highs-new lows, and the % of stocks trading above the 200 day MA are lagging. The RSI on the dailies are now over 70, an area that often sees tops. A breakdown under 7,700 could suggest that a top is in. As well, we appear to be forming a bearish ascending wedge triangle. A breakdown could take the NASDAQ back to the 200-day MA near 7,000.



Source: www.stockcharts.com

This is how the indices (and gold) look over the past six months. Note how the NASDAQ has made new all-time highs, but the other major indices including the DJI, the DJT, and the S&P 500 remain short of their all-time highs set back in January. The weakest performer has been the DJI and even the DJT is starting to diverge with the DJI. At significant tops and bottoms we often see major divergences between the indices. As Dow Theory states, the indices must confirm each other. They are not. That could change going forward but time is running out.



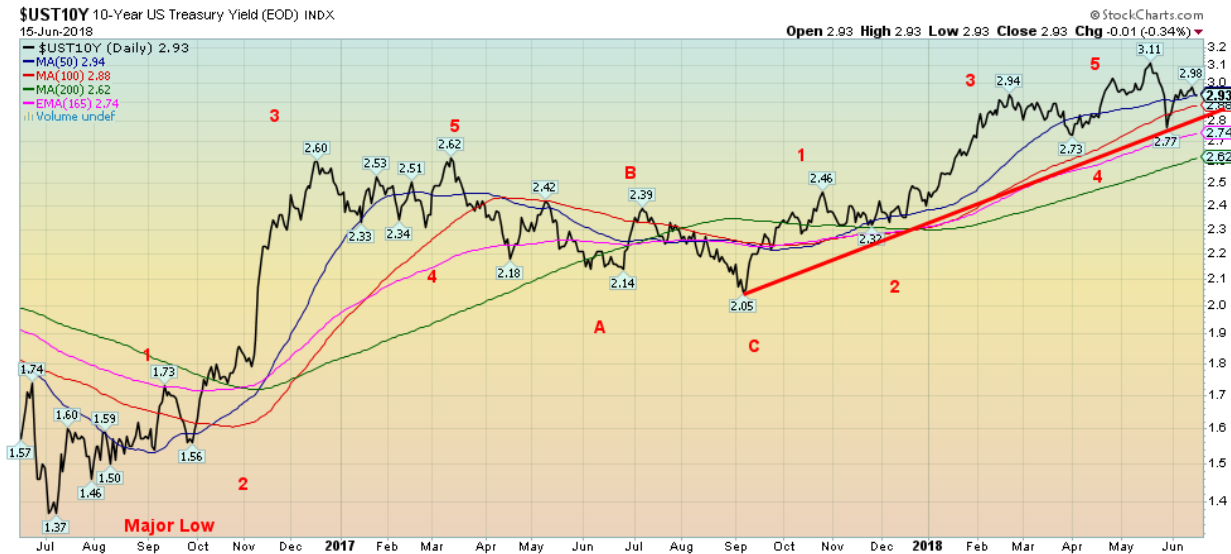
Source: www.stockcharts.com

Here are the same indices (and gold) only by performance over the past six months. Leading the way is the NASDAQ, up 13%. Next up is the DJT, up 7.2%, the S&P 500 has gained 4.8% while the DJI lags up only 2.4%. Gold, especially after this week trails the pack, up 1.7%.



Source: www.stockcharts.com

The TSX Composite continues its upward march, hitting a new high at 16,351 but still short of the all-time high at 16,421 set in January. We could make the argument that the TSX is forming an ascending wedge triangle. Ascending wedges are bearish. The breakdown is around 16,200 and the wedge triangle suggests a return to the bottom near 15,000. The TSX floundered this week with the TSX Energy Index, down on the week thanks to a sharp drop in WTI oil prices. The top of the wedge appears to be up around 16,400 so it is possible that the TSX does eke out a new all-time high.



Source: www.stockcharts.com

Despite the Fed hiking the Fed rate this past week the impact on the 10-year U.S. Treasury note was negligible. The 10-year was unchanged on the week at 2.93%. Once again, it is possible the 10-year has topped (yield – prices bottom as prices move inversely to yields). Our target had long been about 3.20% The high so far is 3.11%. A strong US\$ has helped keep a lid on the 10-year of late. There is considerable support below down to 2.88% and then down to 2.60%. Only below 2.60% could rates fall faster. A move back above 3% might suggest that an attempt will be made on the high at 3.11%.

Recession Watch Spread



Source: www.stockcharts.com

Given the Fed rate hike this past week it is no surprise that the 2–10 spread narrowed this past week from 0.43% to 0.38%. At one point the spread fell to 0.35%. The downward direction is firmly in place. If past events are any guide the rate could be negative in about eight months. We emphasize, however, that reaching negative spreads is not a given. The time to get there could be longer or shorter than eight months. However, negative interest rate spreads are a characteristic that has been seen time and time again before recessions. The average time for spreads to remain negative before the onset of a recession is about six months. By those calculations a recession could be hitting sometime in the latter part of 2019. It is no surprise that once a downward spiral gets underway with the spread that it can fall quite rapidly.



Source: www.stockcharts.com

With the Fed rate hike this past week the US\$ soared, leaping 180 points on Thursday from the low to the high. It was not just the Fed rate hike that helped the US\$. It was dovish statements out of the ECB as Mario Draghi pledged to keep rates unchanged through to the summer of 2019 and not start bond phase-outs until year-end. It was diverging central banks that helped the US\$ soar and the Euro to plummet. It doesn't help that the Euro makes up 57.6% of the US\$ Index. The Euro is now plunging towards 115 and many think it could fall to 110. Other currencies were hit as well as the British Pound fell 0.9%, the Japanese Yen was off just over 1%, and the Cdn\$ was down 1.7%. The Euro fell 1.3%. The US\$ Index is now challenging the earlier high seen at 94.97. We had long thought a run to 95 was possible and the US\$ Index could rise to 95.50. A firm move through 95 could even suggest a run towards 98 but we doubt it. The trade wars might play a role in taking the US\$ down but right now the focus is on the diverging central banks—one a hawk and the other a dove.



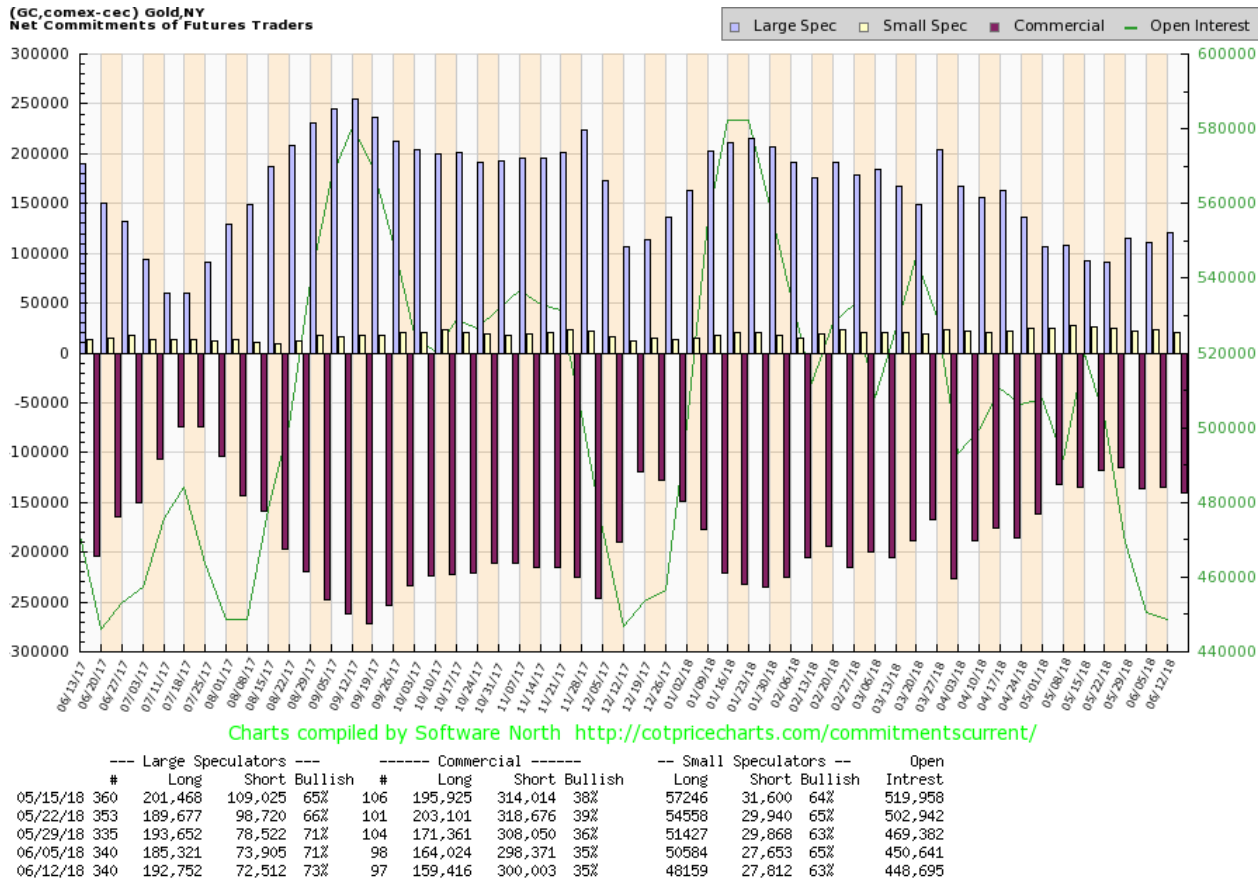
Source: www.stockcharts.com

Trade wars are not friendly to Canada. The Cdn\$ plunged this week against the US\$, falling to new lows at 76. The 52-week low is currently at 75.04 so it won't take much more of a decline to set new 52-week lows. The only hope is that there appears to be trendline support nearby at 75.50. So, it is possible that will hold. But a break of 75.50 should set the course for new lows. Still, since peaking at 82.91 way back in September 2017, the Cdn\$ has been in a decline and could be tracing out an ABCDE-type corrective decline. By our count this is the E wave. We could argue that potential targets are down to 72.75. But, oddly, the minimum target is 75.50.



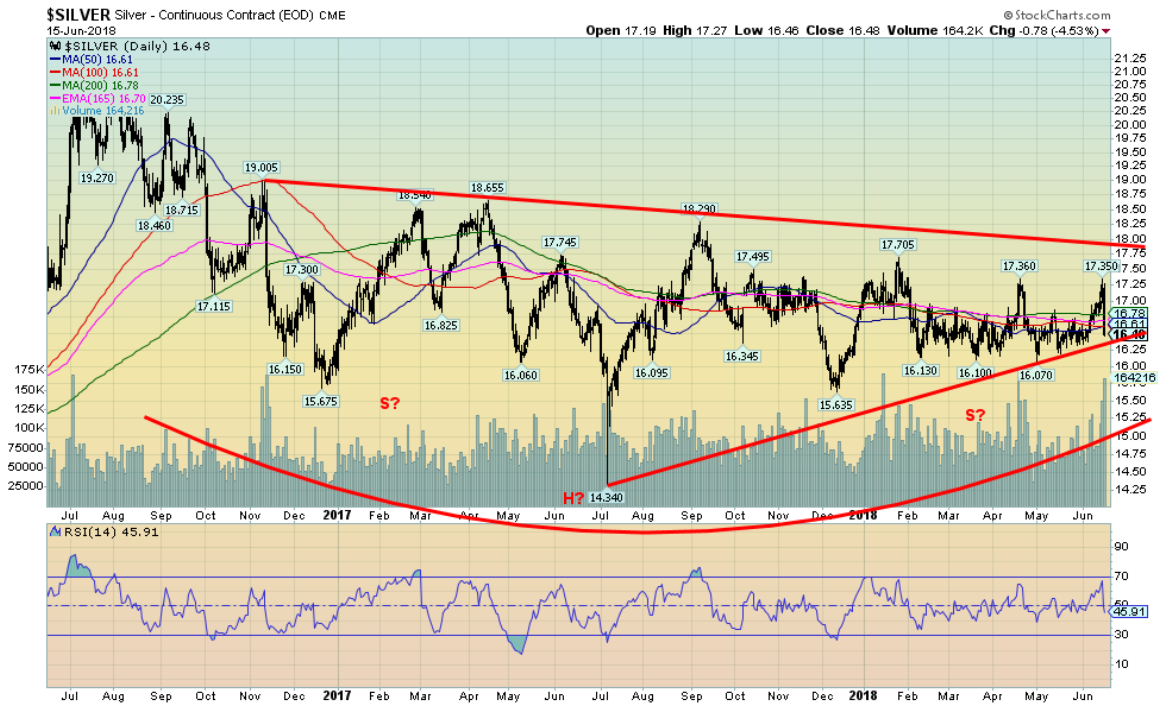
Source: www.stockcharts.com

Gold prices were “whacked” on Friday, falling a sharp \$30 or 2.3%. Overall, the week was better as gold was off only 1.9%. Gold once again hit into a level of resistance up to \$1,310 before turning tail sharply on Friday. The previous day now feels like a set-up as gold rallied despite a sharp 100-bp jump in the US\$ Index. Often, following a Fed rate hike gold has rallied. We saw that in December 2017 following the rate hike and gold also followed a rise upward following the March rate hike before topping in April. Gold broke its previous low of \$1,281, but we are reminded that silver has not broken its previous low of \$16.07. So far this is a divergence that shouldn’t be ignored. The two often diverge at major tops and bottoms. Gold sentiment remains low and we note the daily RSI is now in the low 30s. A move below 30 would signal oversold conditions, which can, of course, remain in place for some time. Gold is holding its uptrend from July 2017 but now barely. Further declines this coming week put the December 2017 low and the July 2017 low in jeopardy. Gold has some support at \$1,270, but below that next good support is at \$1,240. A decline that far cannot be ruled out. While seasonals are poised to turn positive the good seasonals really don’t kick in until July. In the interim there is nothing here to suggest that we first couldn’t go lower. For the bigger picture the patterns remain positive and a solid breakout over \$1,370 and especially over \$1,400 could spark a rally to \$1,500 and higher. Right now, it doesn’t look so good but given poor sentiment, divergences and oversold indicators we could be approaching a final low.



Source: www.cotpricecharts.com

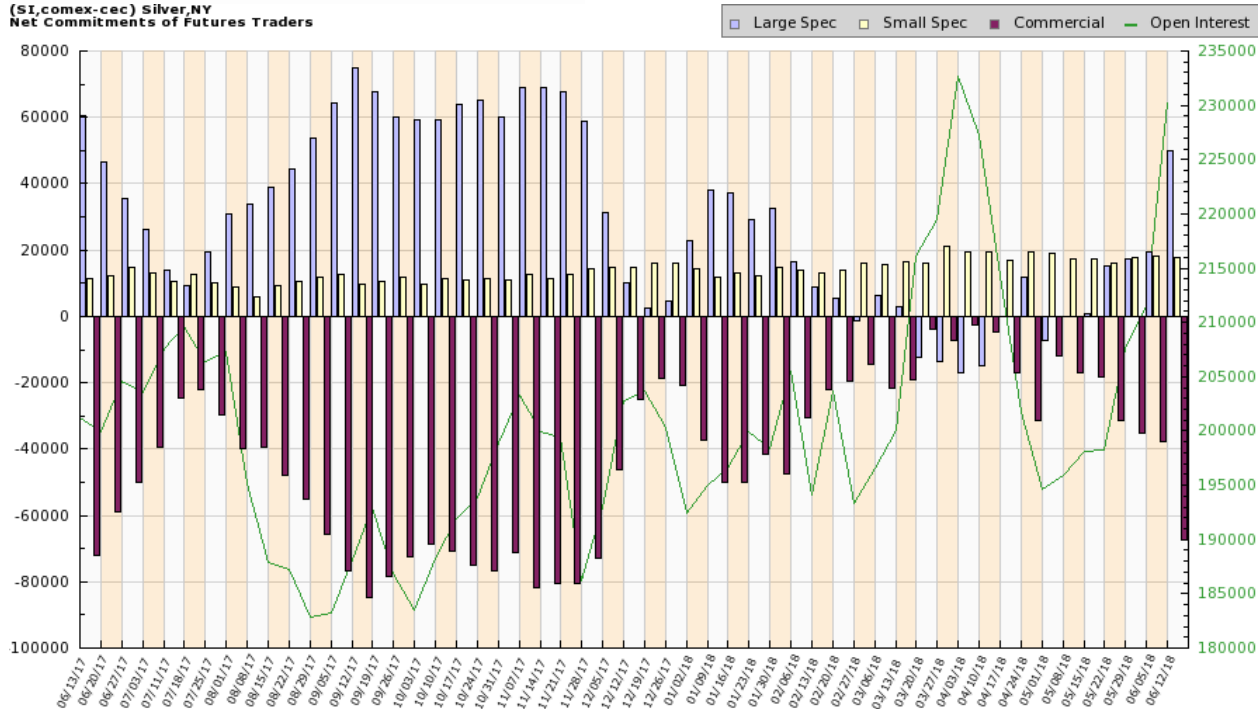
The gold commercial COT was unchanged this past week at 35%. This was in sharp contrast to the silver commercial COT that fell sharply this past week. There was little change in the make-up as long open interest did fall just under 5,000 contracts while short open interest rose just under 2,000 contracts. Naturally, following Friday's debacle, we are now curious to see next week's COT. This one cuts off on Tuesday. The large speculators COT (hedge funds, managed futures, etc.) rose marginally to 73% from 71%. The result is, there is little clue here as to what the next move should be. The COT is not overly bearish nor is it overly bullish, making Friday's collapse a head-scratcher.



Source: www.stockcharts.com

Silver was dumped on Friday taking a nasty hit of 4.5%, falling some 78 points. The week wasn't as bad as silver only lost 1.6%. Other metals were also hit as platinum dropped 2% and palladium fell 2.4%. Silver did trade up into a potential resistance zone between \$17.25 and \$17.50, but Friday's hit was a nasty surprise as there was little to suggest this was about to befall silver prices. Silver is now looking like the previous two times it spiked since the beginning of the year. The first was in January/February 2018 when silver fell swiftly from \$17.70 to \$16.13. The second spike came in April when silver jumped to \$17.36, then swiftly fell to \$16.07 by the end of the month. Now this one. Given perceived silver shortages the drop-in price makes little sense and raises the possibility of price manipulation. Still, as technical analysts we focus on support/resistance, price momentum, and trend. Support at \$17 cracked and support is now just below at \$16.30. A break of that level could lead to new lows below \$16. It remains noteworthy that silver prices have not taken out their earlier lows but gold has, a divergence. If this relationship holds then this current drop could be temporary. Silver needs to regain back above \$17 to suggest higher prices. Sentiment remains low but low sentiment can remain in place for some time just as overbought and oversold conditions can prevail as well. Odds are that we could well see lower prices and a break of \$16.30. Failure to break \$16.30 would be positive.

(SI,comex-ccc) Silver, NY
Net Commitments of Futures Traders



Charts compiled by Software North <http://cotpricecharts.com/commitmentscurrent/>

--- Large Speculators ---				----- Commercial -----				-- Small Speculators --				Open
#	Long	Short	Bullish	#	Long	Short	Bullish	Long	Short	Bullish	Intrest	
05/15/18	212	72,663	72,005	50%	75	78,406	96,472	45%	30546	13,138	70%	198,065
05/22/18	215	78,007	62,782	55%	71	76,516	107,939	41%	29116	12,918	69%	198,248
05/29/18	215	83,066	65,613	56%	72	77,447	112,744	41%	30750	12,906	70%	207,610
06/05/18	224	85,070	65,636	56%	73	75,763	113,310	40%	30637	12,524	71%	211,605
06/12/18	212	101,133	51,403	66%	70	70,970	138,352	34%	30828	13,176	70%	230,163

Source: www.cotpricecharts.com

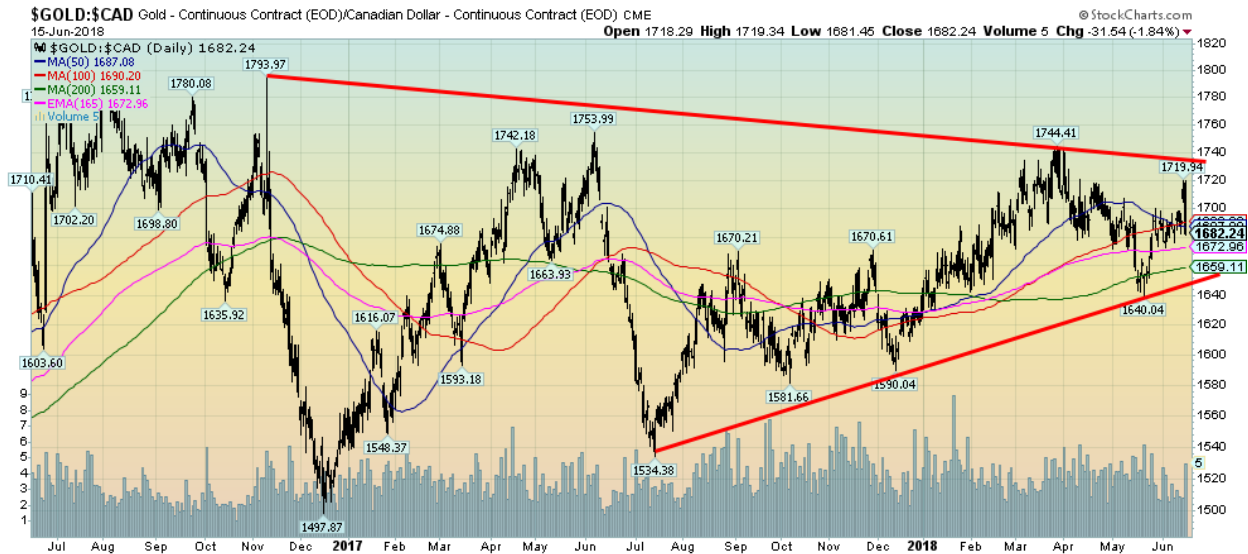
Is the silver rally over? The commercial COT this past week surprised to the downside when it was reported it fell to 34% from 40%. Long open interest fell about 5,000 contracts but short open interest soared by roughly 25,000 contracts. The commercial COT is now down at levels seen from September to December 2017, a period when silver prices were falling from over \$18 to under \$16. Friday's fall was a nasty 78 points or 4.5%, leaving silver down 1.6% on the week following an earlier rally. Naturally, the large speculators COT jumped from 56% to 66% as they loaded up, increasing their long open position by roughly 16,000 contracts while shedding roughly 14,000 contracts from short open interest. Maybe all this signifies that the large speculators loaded up too fast and the commercials spotted it and unloaded on them.



Source: www.stockcharts.com

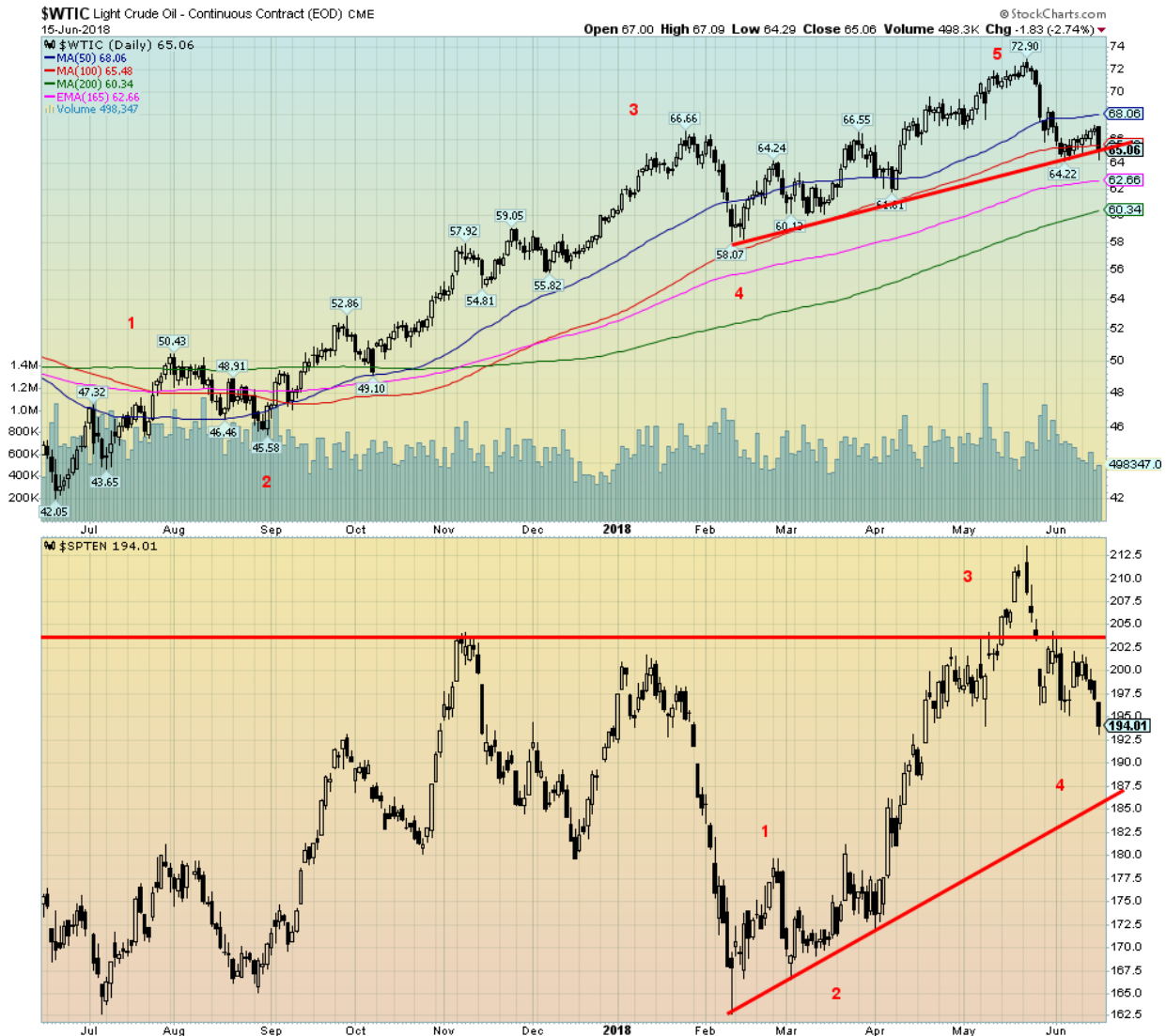
Just as the TSX Gold Index (TGD) appeared to be finally breaking out over 193, Friday's debacle came along and whacked the gold index right back down again below 193. So, is the breakout legitimate? It is difficult to say now because of the failure to follow through and hold above that level. There is good support down to 188, but a break under that level could send the TGD down to test 185 and lower. The TGD at least gained on the week bucking the trend from Friday's debacle in the precious metals.

The TGD was up 1.4% on the week. Far better than its U.S. cousin the Gold Bugs Index (HUI) that fell 0.5%. Still, the gold stocks fared better than the metals so we view that as continuing the positive divergence we are seeing between the gold stocks and the metals themselves. We continue to believe this will eventually lead to a strong rally for the precious metals and the gold stocks as represented by the TGD and the HUI. The huge triangle pattern forming still suggests a potential breakout above 198 that could lead to targets up to 230 and possibly up to 265.



Source: www.stockcharts.com

While gold prices have fallen to new lows for the current move down this past week, gold in Cdn\$ has not. Gold in Cdn\$ was down under 0.2% this past week ending what had been a four-week rebound. Even at that, gold in Cdn\$, currently at \$1,682, is down only 12.4% from its 2011 top compared to gold in US\$ which is down 33% from its September 2011 top. The Cdn\$ has fallen 28% against the US\$ since topping in 2011. It demonstrates the power of gold to protect against currency collapse. Gold in Cdn\$ appears to have good support down to \$1,660. A solid uptrend appears to be in place but acknowledged that a breakdown under \$1,650 could jeopardize that rally. Gold in Cdn\$ breaks out around \$1,740 and from there could project up to over \$2,000. Below \$1,650 gold has further support down to \$1,580/\$1,600.



Source: www.stockcharts.com

Can Trump tweeting about oil take down oil prices? It is possible as the correlation is too much to ignore. In the early part of the week President Trump, in between his “trash talking” at the G7 and his “effusive praise” for North Korean dictator Kim Jong Un at their historical summit, tweeted that “oil prices are too high. OPEC is at it again. Not good!” Oil prices have jumped roughly 40% in the past year, leaping recently over \$70. But since then they are down 10%, including a 2.7% drop on Friday. Gasoline prices in the U.S. had soared to \$2.90/gallon (roughly \$5.22/gallon here in Toronto) and complaints were rising. While drivers may be welcoming the recent drop, it may be short-lived.

Why? A number of factors. OPEC, led by Saudi Arabia and along with Russia had been capping production to try and get prices higher. The two are highly dependent on high oil prices to fuel their economy. Second sanctions against Venezuela are biting and Venezuela's oil production has been sliced from 2.2 million BPD to 1.6 million BPD. Third sanctions against Iran could slice oil production even further. The last time the U.S. applied sanctions against Iran, Iranian oil production fell 1.2 million BPD. Finally, U.S. oil producers have shown little desire to pump up oil production because of higher prices. A fall in prices might discourage them further.

Interestingly, Trump had tweeted about high oil prices before earlier in the year and WTI oil fell from almost \$67 to \$58 before rising again. Trump also tweeted in April and it set oil back from almost \$67 to under \$62. Trump also believes that prices could be forced down to \$25 if the U.S. were allowed to drill more, especially in environmentally sensitive areas. Finally, Trump also said the U.S. should seize Iraqi oil, ignoring, of course, that the U.S. has been there since 2003 and the country is still not stable. No word on how many troops it would take to occupy the country. Trump's tweets also helped push down the TSX Energy Index (TEN). It fell 2.7% this past week and it is putting the recent rally in doubt. The TEN is down 9.1% from its recent top.

Nonetheless, Trump tweeting about oil appears now to be a signal to sell oil. Market manipulation?

Chart of the Week

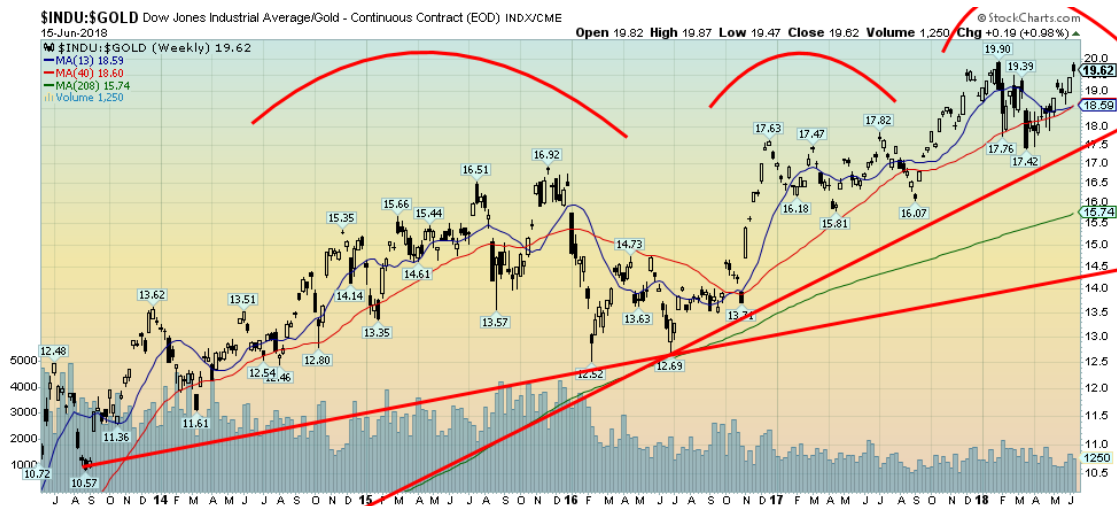


Source: www.goldchartsrus.com

Here is an historical long-term view of the Dow/Gold ratio, dating all the way back to 1800. When the chart is rising, the DJI is outperforming gold and when the chart is falling, gold is outperforming the DJI. Given gold's historical fixed price throughout the 19th century and in the 20th century up until 1970 it is probably not surprising that the DJI (or its proxy) was rising for most of the 19th century. Two periods stand out in those years. The first was the depression of 1840s (1837–1844) stemming from what was known as the Panic of 1837. The second one came through the American Civil War and the early part of the period known as the “Long Depression.” The depression started in 1873 and lasted into the 1890s with a huge railway boom in between.

The next period of a low Dow/Gold ratio came in the period of the “Great Depression” of the 1930s. Note that following the formation of the Federal Reserve the ratio became far more volatile with considerable swings between the DJI and gold. The 1950s and 1960s were a boom for the DJI, but that ended with the stock market top of 1966 and the end of the gold standard and the end of Bretton Woods in August 1970. The 1970s could be termed the “Long Recession” as the DJI stagnated and gold soared from \$35 to \$878 in January 1980. What followed was another long period of the DJI favoured over gold from the early 1980s to the peak in 2000. Many have compared the current rally

for the Dow/Gold ratio to the rally of the ratio from 1974–1976 when stocks rebounded out of the 1973–1974 recession and gold fell from almost \$200 to \$100. The current rebound got underway with gold's top over \$1,900 in 2011 and is now in its seventh year. Gold bugs continue to hope that the next move will be in favour of gold. Our next chart of the Dow/Gold ratio indicates that it just might be possible. If the ratio follows the broadening pattern, the next move could take the Dow/Gold ratio under 1:1.



Source: www.stockcharts.com

In looking at charts over the years we have often noted an overlooked pattern that we have seen on numerous occasions. We call it three thrusts to a top. Here is a closer look at the Dow/Gold ratio over the past five years. The gentler trend line is one that appears to be forming over the past five years. The steeper trend line is the one coming up from the 2008 bottom for the Dow/Gold ratio. What we appear to be noting is that we may now be completing three thrusts to a top. Naturally, it is not as yet confirmed and we freely admit we could go higher. The trendline is currently at 17.5 so a breakdown under that level could send the Dow/Gold ratio down to the gentle trendline near 14.5. That would also break the 4-year MA and potentially signal a new era for gold to outperform the DJI.

We note a couple of other things. The corrective period from roughly October 2015 to October 2016 resulted in a double bottom at 12.52 and 12.69. The subsequent top made what appeared to be a triple top, but as is the case with most triple tops it failed and in October 2017 the Dow/Gold ratio burst through to new highs. We could also be making a double top with the high in January at 19.90 and the current high 19.87. That, of course, remains to be seen.

Copyright David Chapman, 2018

Disclaimer

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.

David Chapman is not a registered advisory service and is not an exempt market dealer (EMD). He does not and cannot give individualised market advice. The information in this newsletter is intended only for informational and educational purposes. It should not be construed as an offer, a solicitation of an offer or sale of any security. The reader assumes all risk when trading in securities and David Chapman advises consulting a licensed professional financial advisor or portfolio manager such as Enriched Investing Incorporated before proceeding with any trade or idea presented in this newsletter. Before making an investment, prospective investors should review each security's offering documents which summarize the objectives, fees, expenses and associated risks. David Chapman shares his ideas and opinions for informational and educational purposes only and expects the reader to perform due diligence before considering a position in any security. That includes consulting with your own licensed professional financial advisor such as Enriched Investing Incorporated. Performance is not guaranteed, values change frequently, and past performance may not be repeated.