

Technical Scoop July 16 2018

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## Continued Climb up the Wall of Worry

Despite threats of mounting trade wars, rising interest rates, high oil prices, mountains of debt and even major new indictments in the Mueller investigation the markets shrugged it off and rose once again. The NASDAQ and the Russell 2000 led the way to new all-time highs for some small-cap indices. But the major stock market indices are lagging as are major international indices. Well all except one. The TSX Composite made new all-time highs this past week as well. But despite the new highs the markets look fragile and technical patterns that are forming look negative. The markets are becoming complacent again and as our “Chart of the Week” (page 32) notes margin debt in the U.S. continues to hover at or near record levels.

The number one topic for everyone (besides Trump) is the potential for trade wars. Once again the U.S. is threatening to slap tariffs on an additional \$200 billion of Chinese goods. The Chinese reacted negatively and threatened counter measures. Yet the U.S. continues to believe that countries won’t retaliate and will eventually come back to the table to negotiate a deal. We take a look at the trade wars and note that the strength of the U.S. economy might allow it to withstand these disputes. At least for the time being. But pressures are there, there are already dislocations with some plants impacted and job losses. There is also rising inflation as this past week’s PPI noted. That would continue to put upward pressure on the key Fed rate. With rising short term rates and steady to slightly falling long term interest rates due to trade war pressures the “recession watch” spread (page 22) continues to narrow and is now falling at a rapid pace. The US\$ Index bounced back this week threatening to break out over 95 and that in turn put pressure on commodities and gold as they all fell.

This week brings us the Trump/Putin summit following Trump’s NATO meeting and meeting the U.K.’s Prime Minister May and the Queen this past week. As always he remains at the forefront of the news.

The Canadian Dividend Strategy invests in stocks with above average growth, below average valuation (lower is better), low historical risk and above average Return on Equity and above average annual dividend growth, and is also designed to allocate to cash in a sustained market decline. Feel free to call Margaret at 416-203-3028 or email [candiv@enrichedinvesting.com](mailto:candiv@enrichedinvesting.com) if you would like to find out how to benefit from the Canadian Dividend Strategy.

Have a great week!

DC

**We should keep on going along the path of globalization. Globalization is good...when trade stops, war comes.**

—Jack Ma, Executive Chairman, Alibaba Group

**As history has repeatedly proven, one trade tariff begets another, then another—until you've got a full-blown trade war. No one ever wins, and consumers always get screwed.**

—Mark McKinnon, U.S. political advisor, reform advocate, media columnist, television producer

**The Berlin Wall wasn't the only barrier to fall after the collapse of the Soviet Union and the end of the Cold War. Traditional barriers to the flow of money, trade, people and ideas also fell.**

—Fareed Zakaria, CNN anchor, Washington Post columnist, author

**Every decision on trade, on taxes, on immigration, on foreign affairs, will be made to benefit American workers and American families. We must protect our borders from the ravages of other countries making our products, stealing our companies, and destroying our jobs. Protection will lead to great prosperity and strength.**

—Donald Trump, President of the United States

Trade wars are the biggest threat to both the U.S. and global economy. Set aside, at least for now, rising U.S. interest rates and rising oil prices. It is trade wars that are the biggest threat. At least, that is the consensus of most leading economists. The White House begs to differ and has consistently said they can win the trade wars because countries will be fearful of retaliation, or they will capitulate and sign a deal that the U.S. wants. President Trump has said “trade wars are good, and easy to win.” Trump’s White House trade czar Peter Navarro has said “I don’t believe any country will retaliate.”

Except the EU, Canada, Mexico, and China have already retaliated. But will they retaliate if the U.S. ups the ante? Given they have already retaliated the odds would favour another round of tariffs directed at the EU, Canada, Mexico, and China, a round that may now be getting underway with the announcement of an additional \$200 billion in tariffs directed against China. Keep in mind, however, that these tariffs would not take effect for at least another couple of months, and, in the interim negotiations could take place.

Despite this first round of trade wars, the risk of an immediate recession is not likely. The U.S. economy has continued to be stronger than expected and may withstand at least this round of trade wars. Evidence of a strong economy is seen in low unemployment (U3) at 4%, declining unemployment claims that hit a 49-year low, new home sales making a 10-year high even though they remain well off the highs of 2006, and, retail sales continuing to trend higher in record territory. Other indicators such as the ISM manufacturing indices and consumer confidence are also near multi-year highs.

As for the labour market, the monthly job openings and labour turnover survey (JOLTS) indicates the number of workers voluntarily leaving jobs has increased. In the most recent jobs report 600,000 new entrants came into the labour force. This shows confidence in the labour market. JOLTS also reported 6.6 million vacancies at the end of May 2018.

So, you could say things are good? Well, yes, according to many economic numbers, but a reminder that the “good” times have been predicated on years of extremely low interest rates, and endless amounts of quantitative easing (QE) that effectively pumped money into the financial system. One could even add in the tax cuts. But now interest rates are rising and QE has become QT (quantitative tightening). And all those years of QE and now tax cuts have only done marginal things for main street as the main beneficiaries were the banks, Wall Street (the stock market), and the wealthy.

Debt has exploded as we know that \$140 trillion in global debt in 2008 has become \$237 trillion of global debt in 2018. In the U.S., \$50.4 trillion of debt in 2008 has become \$70.6 trillion in 2018. U.S. debt growth has been huge but relatively modest compared to the rest of the world, especially China. While U.S. debt has gone up by \$20.2 trillion, U.S. GDP has increased by only \$13.9 trillion. That’s a lot of debt to purchase a considerably smaller amount of GDP.

Wage growth has not kept pace and it is only recently that wage levels adjusted for inflation have at least returned to 2000 levels. Adjusted for population there are fewer people in the labour force today than in 2000 while a lot more people are considered to be not in the labour force compared to 2000. The official unemployment rate (U3) would be a lot higher today considering the labour force participation rate at 62.9% is considerably lower than the same rate in 2008 at 66.1%. The U.S. (and Canada) have huge infrastructure needs costing billions that have been neglected, and in the U.S. in particular the unfunded liabilities of social security, Medicare and the real federal budget (GAAP) totals almost \$114 trillion. The vast majority of consumers are one paycheck away from food stamps or welfare while the number of people living in poverty has gone up, and despite Obamacare (which is being chipped away at) the number of people in the U.S. without medical insurance is still around 27 million.

Job numbers continue to be poorly reported. The nonfarm payrolls were reported as up 213,000, but when one looks at a separate survey known as the Household Survey the economy lost 89,000 full-time jobs but gained 145,000 part-time jobs in June. Civilian employment, according to numbers supplied by the [St. Louis Fed](#), showed a gain of 102,000 jobs in June 2018. That’s well short of the nonfarm payrolls reported of 213,000. As a percentage of the population there are fewer employed today than there were at the peak in 2000. Today the civilian employment population ratio is at 60.4%, down from the peak in 2000 at 64.7% but up from the depths of the financial crisis recession at 58.3%.

Our chart of the civilian employment population ratio is shown below. It shows the percentage of the civilian population that is actually working. It is now back at levels seen in 1979–1980, a time when

women were just really getting started in the workforce. Still, it peaked back in the late 1990s and hasn't been near it since. Note the great head & shoulders pattern that formed. The target on that pattern was a decline to 58.7%. The low was seen at 58.3% in 2010.



Source: [www.stlouisfed.org](http://www.stlouisfed.org)

Given the enormous increase in debt levels one realizes that the economy is built on a sea of debt. No wonder it led well-known stock market analyst and mutual fund owner John Hussman to declare that the economy is a “Ponzi Scheme.” Hussman says:

“The hallmark of an economic Ponzi scheme is that the operation of the economy relies on the constant creation of low-grade debt in order to finance consumption and income shortfalls among some members of the economy, using the massive surpluses earned by other members of the economy.

The debt burdens, speculation, and skewed valuations most responsible for today's lopsided prosperity are exactly the seeds from which the next crisis will spring.”

Trade as a share of the U.S. economy is lower than for many other countries. According to data from the OECD, exports as a share of the U.S. economy are 12% while imports are at 15%. Canada, on the other hand, has exports at 31% of GDP and imports at 33% of GDP. It's even higher for Mexico, the other NAFTA partner, at 37% and 39% respectively. For the Euro zone it is even higher again at 41% and 46% respectively. For China as a whole trade makes up 38% according to the latest numbers from the World Bank. Trade makes up 56% of global GDP but even that is down from a peak of 60% back in 2012 (all figures quoted are from either [World Bank Open Data](http://World Bank Open Data) or [OECD Data](http://OECD Data)). Trade is important to the world and to individual economies. To disrupt that through trade wars could have considerable negative impact on the global economy, individual economies, and eventually on business and consumers. Trade wars are not to be taken lightly.

One area where business and consumers could be seeing pressure is in prices as the impact of higher tariffs works its way through the economy. Already both the Consumer Price Index and the Producer Price Index are moving higher. The CPI rose 2.9% year over year to June 2018, up from 2.8% in May 2018. The PPI rose 3.4% year over year in June 2018 vs. 3.1% in May 2018.



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com)



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com)

Both core CPI and core PPI are up 2.2% year over year in June 2018. That is now above the Fed's target of 2%. The trade wars are just getting under way and the full impact has not yet hit the economy. There is a potential negative impact on prices even as economic activity drops and GDP falls. Already the U.S. and China have put tariffs on some \$34 billion of goods. China is no longer buying U.S. soybeans causing prices to crash in North America but rise in Brazil as China shifts its buying. A further \$200 billion in Chinese goods is now being threatened by the U.S. China will no doubt retaliate. The U.S. has also threatened to place tariffs on autos from Canada and Mexico which will also be sure to face retaliation, thus pushing up the cost of cars to consumers. It is also noted that China holds \$1.1 trillion of U.S. Treasury securities. This could also be jeopardized.

Markets are also reacting negatively with a sharp decline in some commodity prices such as copper and oil. The Chinese Shanghai stock Exchange Index (SSEC) has hit multi-year lows and is now down 21% from its January 2018 high. Its all-time high was seen back in 2015 and the SSEC is down 45% from that level. These are signs that markets are reacting negatively to the potential for trade wars. The SSEC is a warning sign of what could befall the North American markets. The U.S. administration thinks everyone else will roll over and beg for concessions to keep things going. The reality is they won't because of national pride and a persistent belief that the U.S. won't really carry through with this. The U.S. most likely will, and the U.S. will suffer just as much as everyone else.



Source: [www.stockcharts.com](http://www.stockcharts.com)

The Fed has already hinted there will be two more interest rate hikes in 2018. Rising inflation from the CPI and PPI will put pressure on them to respond. The same could happen in Canada where the BofC will be facing increasing pressure to combat rising inflation due to trade wars. The BofC reacted this past week and hiked Canadian interest rates by 25 bp. There were hints of further rate hikes. Can the U.S. withstand trade wars? It is possible, at least in the early going. But longer-term trade wars are a lose/lose proposition. The Great Depression showed that. Are we doomed to repeat history?

Here's an interesting chart we found that looks at the U.S. history of trade wars over roughly a 200-year period. What it shows is that trade costs have been constantly falling, with the result that international trade has boomed. But there have been blemishes; two in particular. The first was seen before WW1 when trade relations broke down and a period of protectionism broke out. It may have contributed to WW1 but it wasn't a significant cause. But after the war ended the world returned to some sanity, with costs falling and trade growing, until the 1930s. Then the second shoe dropped. The 1930's started with what was known as the Smoot-Hawley Tariff Bill which sparked trade wars and bank failures contributing to the depths of the Great Depression. Following WW2, the world returned to lowering tariffs and the result was international trade boomed again. Oh, there were bumps along the way. But the current round, which admittedly is still in its early stages, could set in

motion something similar to what happened during the Great Depression. Naturally, it remains to be seen. For clarity and due to the length, we cut off the other conflicts but did want to include the comment about Smoot-Hawley. The source for the chart was found at [Visual Capitalists](#). Note number IV the War of the Woods on the chart. It is referring to what remains the ongoing softwood lumber spat between the U.S. and Canada.



Chart of the Week

## THE MODERN HISTORY OF U.S. TRADE WARS

A look at seven historic trade skirmishes, and how they compare to the current trade war



## Red Tape AMERICAN TRADE WARS IN MODERN TIMES



### GOOD GOLLY, SMOOT-HAWLEY

Combatants: vs

Starting year: 1930

Primary items affected:

20,000+ AGRICULTURAL AND INDUSTRIAL GOODS

What happened?

In late 1929, Reed Smoot, chairman of the Senate Finance Committee, began championing a tariff increase. The Smoot-Hawley Tariff Bill passed that same year, increasing tariffs on over 20,000 imported goods. Many U.S. economists and politicians sought to veto the

legislation, and trading partners quickly introduced their own retaliatory tariffs. By the following year, imports and exports dropped by 66% and 61%, respectively. It's thought that this trade war exacerbated the Great Depression.



### CHICKEN EDITION





## Bitcoin Watch!



Source: [www.coindesk.com](http://www.coindesk.com)

Bitcoin continues to struggle to stay above \$6,000. After reaching as high as \$6,750, Bitcoin is now down roughly 8% from that level and down roughly 5% on the week. The battle between the bulls and the bears continues with the bulls convinced Bitcoin will recover and rise above \$7,000 again and even get back above \$10,000. We continue to see ads (stories?) touting how great Bitcoin is and it will soon soar. Meanwhile, the bears still seem to be generally in command and should help ultimately to push it lower, but it needs a firm break under \$6,000 and then under \$5,000 to break the back of the bulls. In the interim, range trading remains possible with obvious resistance up to \$6,700 and a major defense being put up at \$6,000.

With banks and other dealers getting involved in the market their interest is arbitrage. But there is also a high element that will help short the market. The market overall remains relatively thin for most participants and the large financial institutions backed by considerable resources know how to take advantage of that. They could in essence arbitrage a crypto currency to zero, and then move on to the next one given there are so many to choose from.

We didn't see any news over the past week to stir us. As of Friday July 13, 2018, there were 1,633 cryptos listed at [Coin Market Cap](#), up from 1,615 the previous week. Some names of recent ones we saw include Halloween Coin (HALLO), Cheapcoin (CHEAP), BigONE Token (BIG), EggCoin (EGG), and FCoin Token (FT). The mind boggles. The market cap of all coins was noted to be \$249 billion down \$18 billion from what was reported a week ago. There were 862 cryptos listed at [Dead Coins](#), up from 853 the previous week.

\$NYXBT NYSE Bitcoin Index: (EOD) INDX

© StockCharts.com

Open: <b>6254.49</b>	Ask:	P/E:	Options: <b>no</b>	Friday 13-Jul-2018
High: <b>6254.49</b>	Ask Size:	EPS:	Annual Dividend: <b>N/A</b>	▲ +1.33%
Low: <b>6254.49</b>	Bid:	Last Size:	Yield: <b>N/A</b>	Chg: <b>+82.38</b>
Prev Close: <b>6172.11</b>	Bid Size:	VWAP:	SCTR:	Last: <b>6254.49</b>
				Volume: <b>0</b>



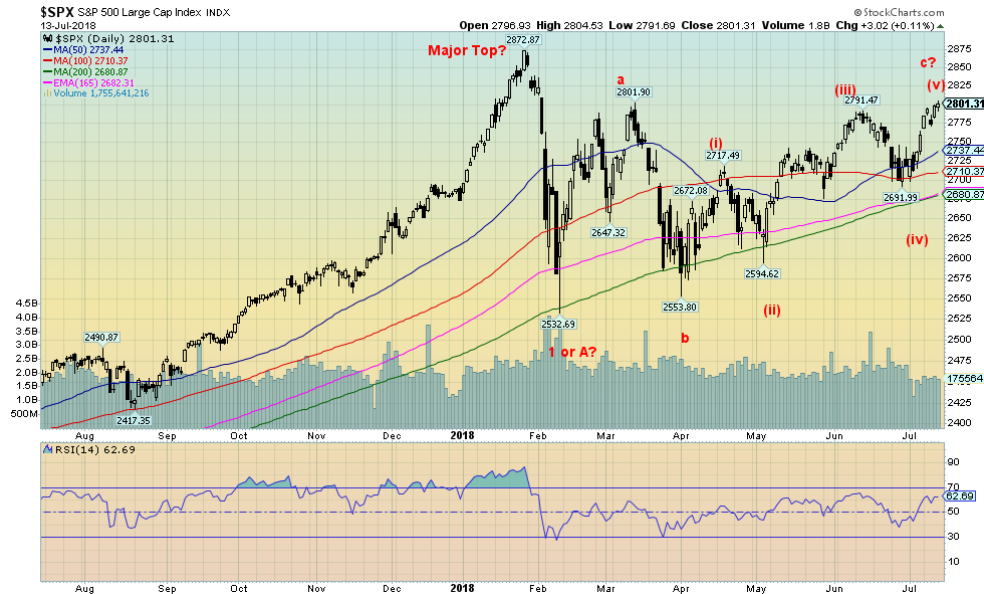
Source: [www.stockcharts.com](http://www.stockcharts.com)

## MARKETS AND TRENDS

	% Gains (Losses)				Trends		
	Close Dec 31/17	Close Jul 13/18	Week	YTD	Daily (Short Term)	Weekly (Intermediate)	Monthly (Long Term)
<b>Stock Market Indices</b>							
S&P 500	2,673.63	2801.31	1.5%	4.8%	up	up	up (topping)
Dow Jones Industrials	24,719.22	25,019.41	2.3%	1.2%	up	neutral	up (topping)
Dow Jones Transports	10,612.29	10,546.41	0.7%	(0.6)%	down	neutral	up (topping)
NASDAQ	6,903.39	7,825.98 (new highs)	1.8%	13.4%	up	up	up (topping)
S&P/TSX Composite	16,209.13	16,561.12 (new highs)	1.2%	2.2%	up	up	up (topping)
S&P/TSX Venture (CDNX)	850.72	725.24	(2.0)%	(14.8)%	down	down	neutral
Russell 2000	1,535.51	1,687.08 (new highs)	(0.4)%	9.9%	up	up	up (topping)
MSCI World Index	2,046.47	1,970.89	0.2%	(3.7)%	down (weak)	down	up (topping)
NYSE Bitcoin Index	14,492.18	6,563.76	11.6%	(54.7)%	down	down	neutral
<b>Gold Mining Stock Indices</b>							
Gold Bugs Index (HUI)	192.31	173.57	(3.2)%	(9.7)%	down	down	neutral
TSX Gold Index (TGD)	195.71	188.88	(2.8)%	(3.5)%	down (weak)	neutral	neutral
<b>Fixed Income Yields/Spreads</b>							
U.S. 10-Year Treasury yield	2.40	2.83	0.2%	17.9%			
Cdn. 10-Year Bond yield	2.04	2.14	0.5%	4.9%			
<b>Recession Watch Spreads</b>							
U.S. 2-year 10-year Treasury spread	0.51	0.24	(17.2)%	(52.9)%			
Cdn 2-year 10-year CGB spread	0.36	0.20	(4.8)%	(44.4)%			
<b>Currencies</b>							
US\$ Index	91.99	94.50	0.8%	2.7%	up	up	down (weak)
Canadian \$	0.7990	0.7610	(0.4)%	(4.8)%	down	down	down (weak)
Euro	120.03	116.84	(0.5)%	(2.7)%	down (weak)	down	up
British Pound	135.04	132.33	(0.4)%	(2.0)%	down	down	down (weak)
Japanese Yen	88.76	89.02	(1.7)%	0.3%	down	down	neutral
<b>Precious Metals</b>							
Gold	1,309.30	1,241.20	(1.2)%	(5.2)%	down	down	neutral
Silver	17.15	15.81	(1.6)%	(7.8)%	down	down	down
Platinum	938.30	830.30	(2.2)%	(11.5)%	down	down	down
<b>Base Metals</b>							
Palladium	1,061.00	932.80	(1.6)%	(12.1)%	down	down	up
Copper	3.30	2.78	(1.6)%	(15.8)%	down	down	up (weak)
<b>Energy</b>							
WTI Oil	60.42	71.01	(3.8)%	17.5%	neutral	up	up
Natural Gas	2.95	2.75	(3.9)%	(6.8)%	down	neutral	neutral

Source: [www.stockcharts.com](http://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](http://www.stockcharts.com)

Set aside concerns about trade wars and rising interest rates. Even set aside concerns about the indictment this week of 12 Russians related to the Mueller investigation. Focus instead on—falling oil prices. This past week the markets once again ignored the negative signs concerning the potential for trade wars and charged higher once again. The S&P 500 gained 1.5% on the week. The Dow Jones Industrials (DJI) did even better, rising 2.3%. The Dow Jones Transportations (DJT) lagged with only a 0.7% gain. The NASDAQ was up 1.8% and made new all-time highs again. Elsewhere, foreign markets were also generally up. The TSX Composite rose 1.2% but the TSX Venture Exchange (CDNX) fell 2%. The MSCI World Index rose a small 0.2% but still looks negative. The London FTSE 100 was up 0.6%, the Chinese Shanghai Index rose 3.1%, the Paris CAC 40 jumped 1% while the German DAX rose a much smaller 0.4%. The Tokyo Nikkei Dow (TKN) jumped a solid 3.7%.

The markets seem to be ignoring the trade wars despite announcements from the Trump administration that tariffs are being proposed on another \$200 billion of Chinese goods. Negative announcement but it will take at least two months before the tariffs would actually be executed as they have to go through at least some process. As well, Treasury Secretary Steve Mnuchin suggested that a deal could be worked out with the Chinese. We wouldn't hold our breath on that happening as usually when dealing with the U.S. it will be U.S. win and China lose. The Chinese would look for more U.S. goods to place tariffs on. The Chinese are already hitting U.S. farmers as they stopped buying their soybeans, causing soybean prices to fall sharply in the U.S. and Canada. Instead, they are getting

their soybeans from Brazil, putting upward pressure on Brazilian soybeans. Ah, the consequences of trade wars.

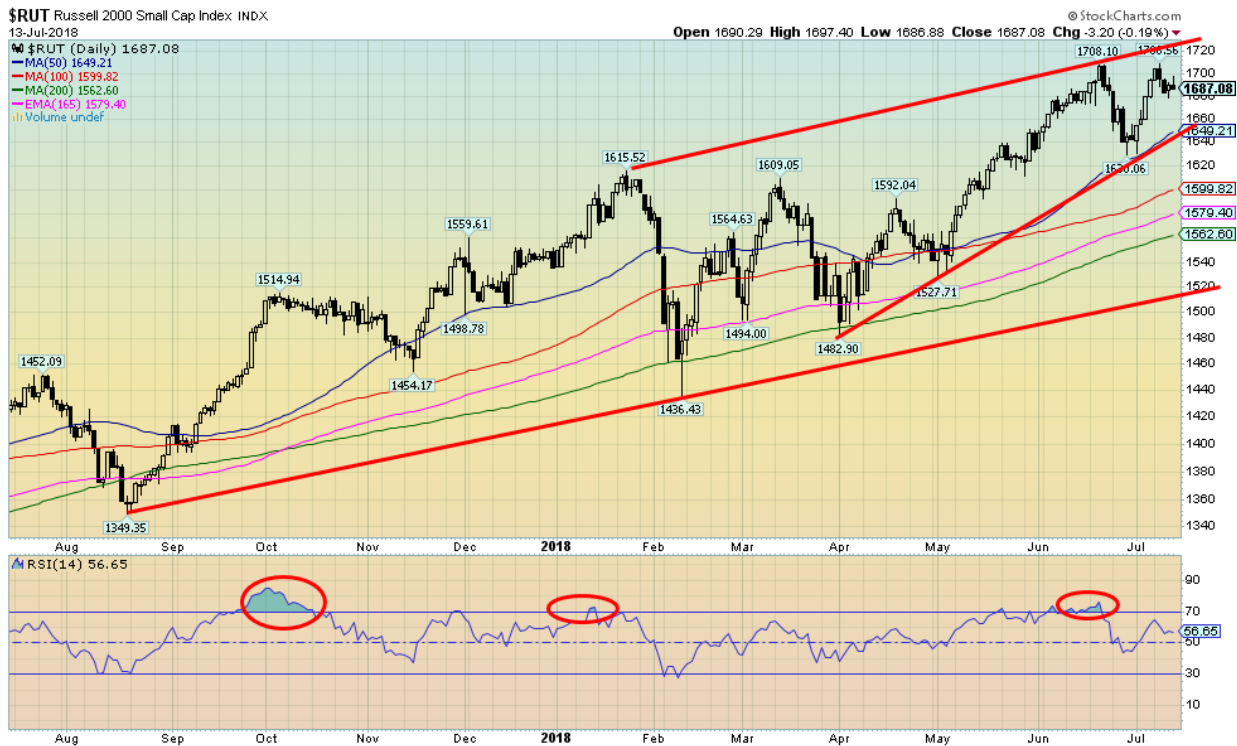
After plunging sharply in February, the S&P 500 has spent the past five months going up and down in an irregular manner. This is typical corrective action. That the S&P 500 is only about 3% off its all-time high is not a surprise either as we expected any return action could take us back to those highs or even slightly higher. So far, we appear to have made an ABC type correction but admit it could still unfold as an ABCDE type correction. A mid-summer high would not be surprising nor would one extending into late summer; i.e., September. Despite the negative background noise, the markets are actually becoming complacent. In particular, they seem to be ignoring the monstrous pile of debt out there, a pile that makes what was outstanding before the 2008 financial collapse look like mini-me compared to today's Dr. Evil. But keep in mind there is an enormous amount of country (sovereign) debt, half of U.S. corporations' debt is rated BBB or lower, pension funds are for the most part grossly underfunded with an aging society, and, there is the growing propensity for trade wars. There is also the potential for bank failures particularly in Italy and mounting concern about the state of Deutsche Bank, Germany's largest bank and one of the largest banks in the world. But for the moment at least, it doesn't matter. The markets are rising.



Source: [www.stockcharts.com](http://www.stockcharts.com)

Once again, the NASDAQ moved to new all-time highs this past week. Few others did. The Russell 2000 made new all-time highs as did the AMEX Composite, the S&P 400, and, the S&P 600. Those

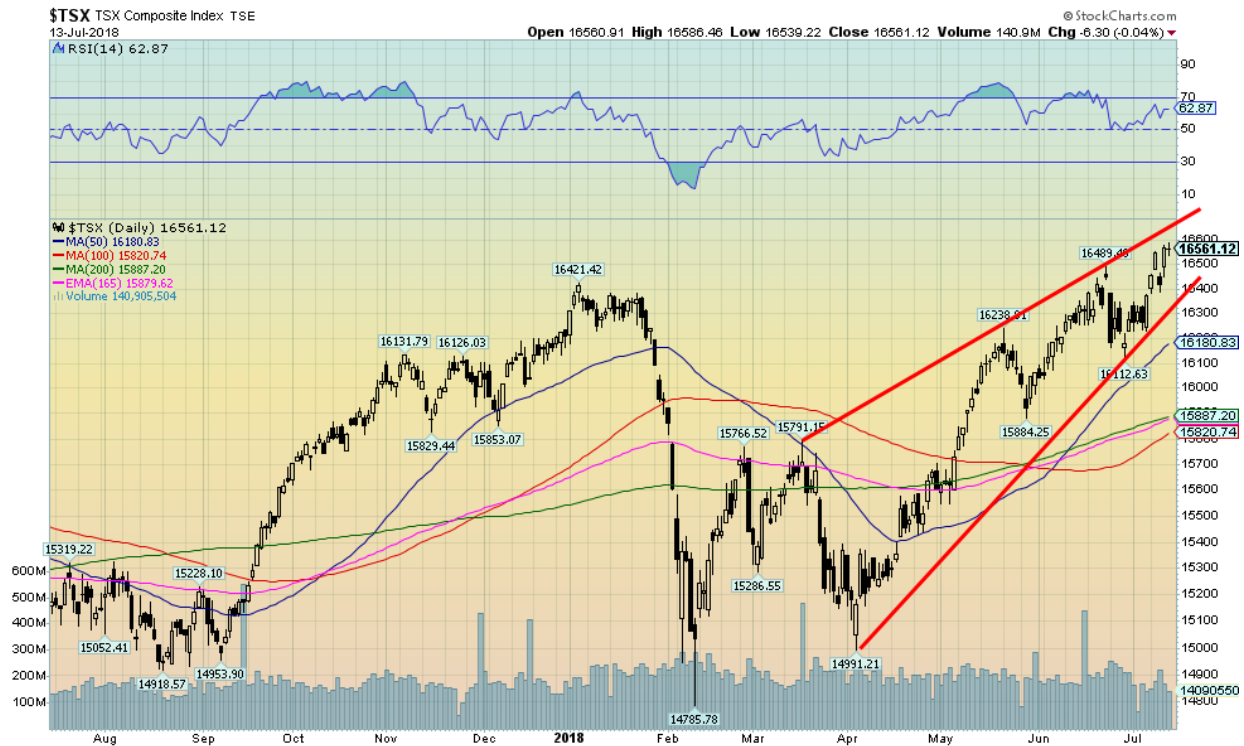
indices are all either mid-cap (S&P 400) or small cap (S&P 600, AMEX and Russell 2000). Oddly, the broad-based Wilshire 5000 did not make new all-time highs. There has been an ongoing divergence between the small cap stocks and the large cap stocks over the past number of months as the small cap indices make new highs and the large cap indices do not. To us this is a negative sign. It should resolve itself over the next few months with a decline in the latter part of the year.



Source: [www.stockcharts.com](http://www.stockcharts.com)

The small cap Russell 2000 managed yet another all-time high this past week, then turned tail and fell, actually closing lower on the week by 0.4%. A reversal of some significance? Well, it is not confirmed yet. If the wedge triangle is correct then the Russell 2000 needs to break under 1,650 to suggest that a sharper decline might get underway. The small cap Russell 2000 has been a surprise, given the underperformance of the large cap of the S&P 500. But then when markets are rising the small cap stocks tend to outperform. If the tide turns it is the opposite. The small cap stocks fall faster.





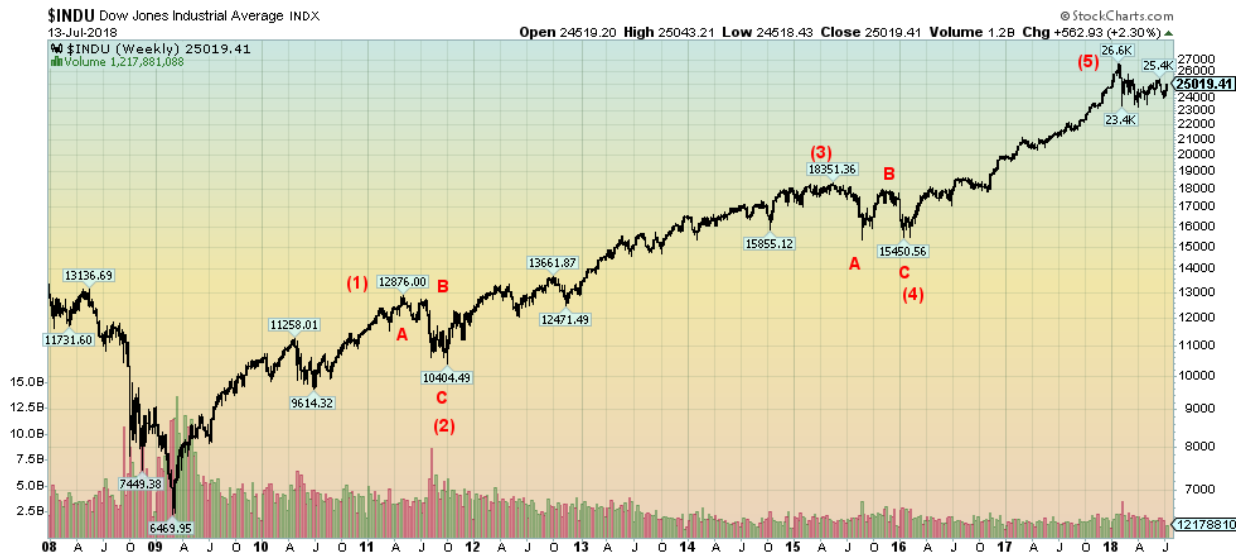
Source: [www.stockcharts.com](http://www.stockcharts.com)

The TSX Composite continues to rise in what appears as an ascending or rising wedge triangle. The TSX Composite gained 1.2% this past week and posted another all-time high. As the wedge moves higher the trading range becomes narrower. The breakdown point is now near 16,400. A solid break under that level and especially under 16,200 could suggest a move right back to where it started near 15,000. Volume has typically remained lethargic on this rise.



Source: [www.stockcharts.com](http://www.stockcharts.com)

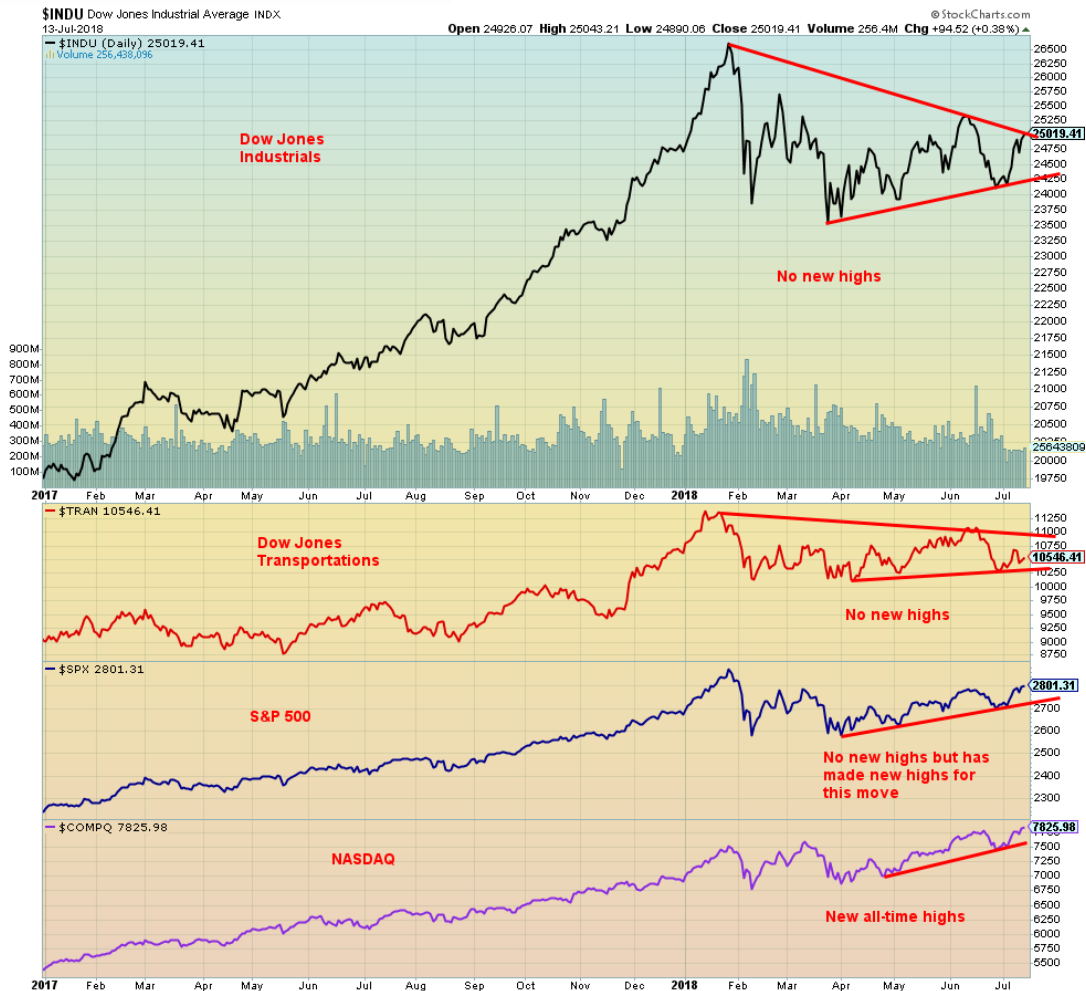
The TSX Venture Exchange (CDNX) has taken on an “ugly” look. After topping out at 940 back in January 2018, the CDNX has now fallen almost 23% and is back to the levels seen in late 2016. Okay, not good. But at least it is not really “ugly” and down at the 466-level seen in early 2016 before a sharp rally got underway. From a high of 2647 way back in 2011 the CDNX was brutally dumped, falling to 466 in early 2016, a decline of 82%. Some CDNX stocks fell more than 90% and some just disappeared. The CDNX is the lifeblood of innovation and exploration. Many CDNX stocks have gone on to bigger and better things. The index is roughly 50% junior mining exploration stocks. They are the lifeblood of the mining industry trying to find new resources for a resource hungry world. When the going is good making 2, 3, 5, or 10 times your investment is not unusual. But when the bad times come, falling 90% is also not unusual. After clearing above the 4-year MA the CDNX has now fallen back to that key level. So, this might just be a corrective to the run-up from 466 to 940. It wouldn’t take much more of a drop to see the weekly RSI fall under 30 a level usually associated with a low. As well, sentiment towards the CDNX is pretty miserable right now. Nobody wants them and that is often a good sign to accumulate them for the next move to the upside. There also appears to be forming a large descending wedge triangle, which if correct, could trigger a huge rally once it breaks above 740. There would, however, be resistance up to at least 800.



Source: [www.stockcharts.com](http://www.stockcharts.com)

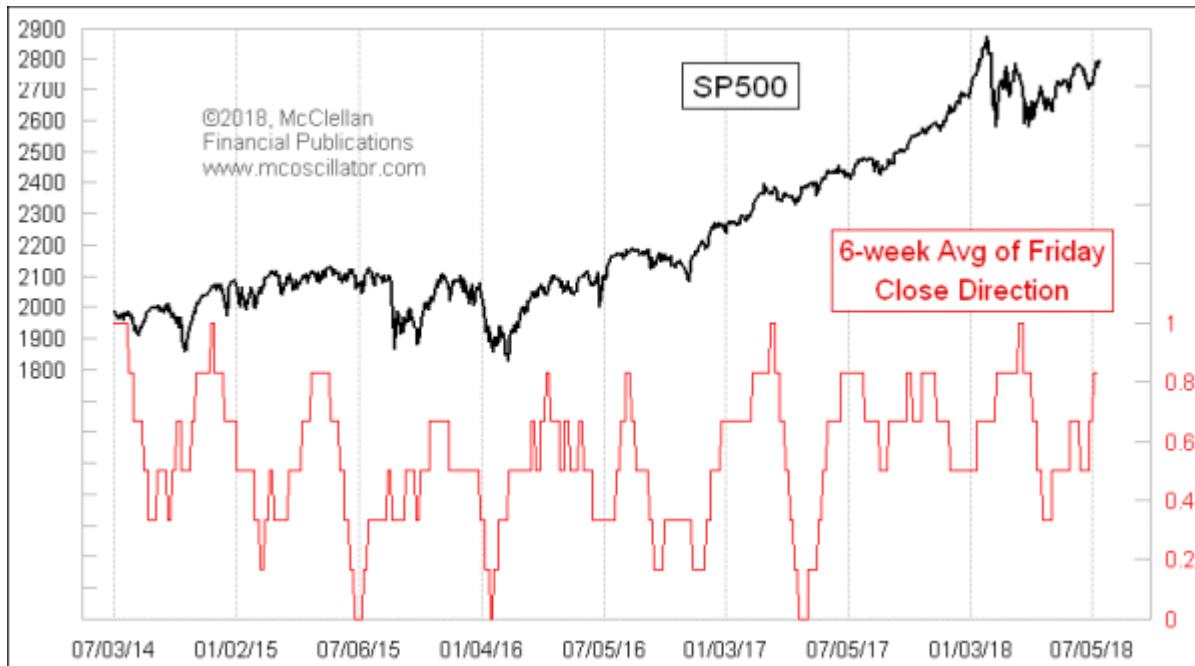
Here is the longer-term chart of the DJI from the major 2009 bottom. It has been an impressive run. It has also made what clearly appears to be a five-wave advance. In Elliott Wave terms that suggests that the major advance is most likely over and a corrective period could set in. So far, the market has topped back in January 2018 and since then the DJI has failed to make new highs for six months now. In some respects, it reminds us of 2000 when the DJI topped in January then spent the next several months going back and forth before finally breaking to the downside in October 2000.

After plunging in February 2018, the DJI has spent the past five months making an irregular advance on low volume and in an up/down manner. It appears to us as a corrective wave to the February plunge. Is it over? Well, we are not sure of that but had often thought that once the market made its first low (February) a return rally could take us into the summer or even late summer for the final high and before the third wave down gets underway. We are now into mid-summer. Late summer takes us into September. It could continue here for awhile, but irrespective of this we could or should be setting up for another decline soon, even if it is not the fatal one.



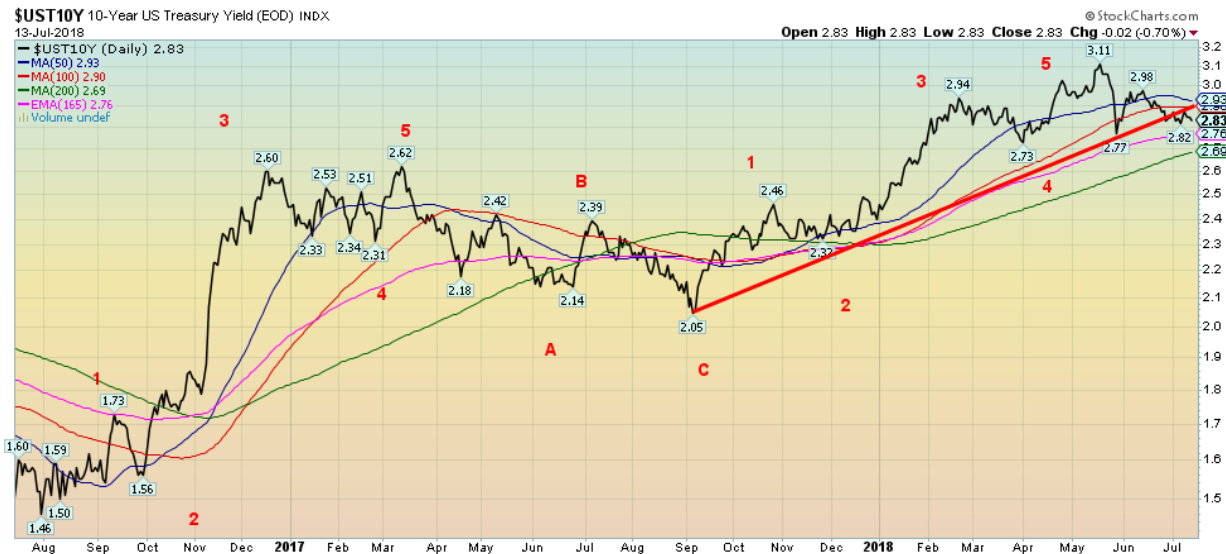
Source: [www.stockcharts.com](http://www.stockcharts.com)

The markets are diverging and that is somewhat worrisome. You want the markets to be acting in sync, but they are not. The NASDAQ and even the Russell 2000 made new all-time highs this past week. Few others did. The Russell 2000 subsequently closed down on the week after making the new high. The S&P 500 made a new high for the current move but remains short of its January all-time high. Both the DJI and the DJT are nowhere near their all-time highs and haven't even made new highs for this up move. Somebody is wrong and, in this case, we usually go with the ones not making new highs. That tells us one should be cautious that the market could be poised for a downward surprise. Dow Theory tells us the markets must confirm each other. Dow Theory was meant that to be between the DJI and the DJT. But they are in sync. It's the others that are not in sync or, to state it the other way, the DJI and the DJT are out of sync with the other markets.



Source: [www.mcoscillator.com](http://www.mcoscillator.com)

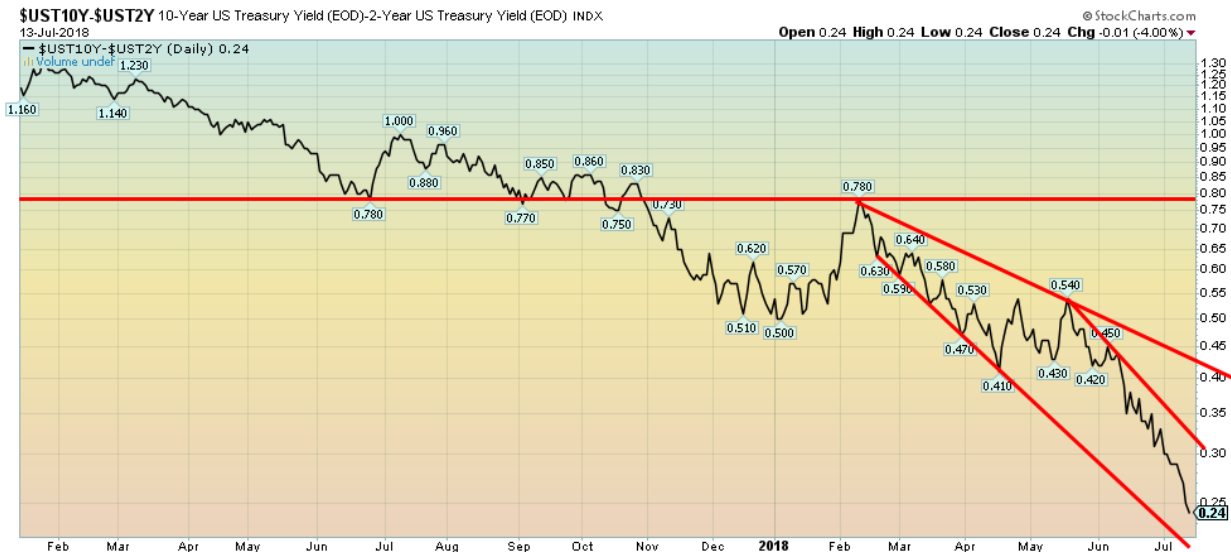
Here is an interesting chart from Tom McLellan [www.mcoscillator.com](http://www.mcoscillator.com). McLellan's theory is that Fridays reveal event risk complacency. If Fridays are continually closing on an up note it means buyers are in charge and they are not too worried of something negative happening over the weekend. On the other hand, if sellers are in charge on Friday and the market continually closes down on Fridays then they are worried about something happening over the weekend. McLellan considers a window of six weeks to be a pretty good indication of what the market is thinking. So apparently six of the past seven weeks has seen the market close up on Friday (as it did again Friday July 13). Even on the down Friday the S&P 500 fell less than 3 points. So, what this is telling McLellan is that the market is not too worried that something negative will happen on the weekend. On the other hand, to a contrarian it suggests complacency and one should be concerned and therefore cautious.



Source: [www.stockcharts.com](http://www.stockcharts.com)

The U.S. 10-year Treasury note was little changed this past week at 2.83%, up marginally from 2.82% the previous week. After topping at 3.11% back in May the 10-year bond has been steadily declining in yield (rising in price as prices move inversely to yield). Our original target for the 10-year was 3.20%, but given the recent decline the high may already be in. A breakdown under 2.70% could set the stage for further declines.

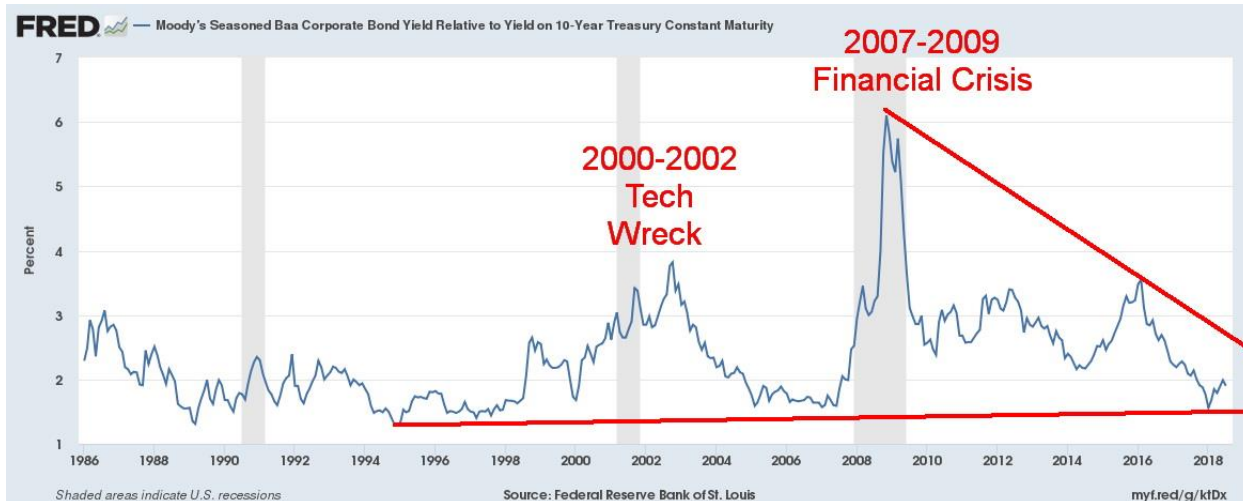
## Recession Watch Spread



Source: [www.stockcharts.com](http://www.stockcharts.com)

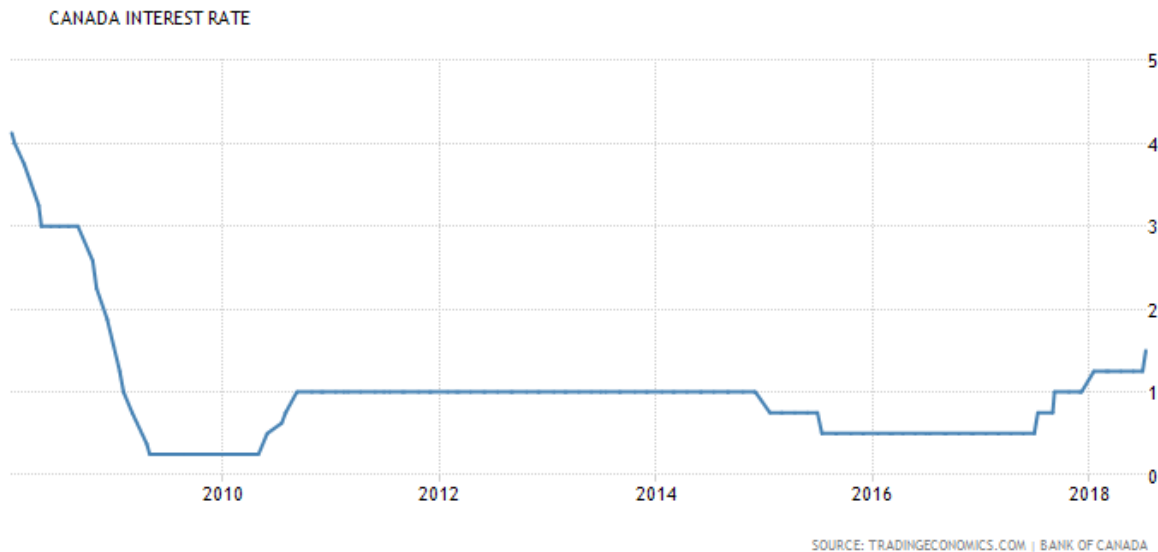
Our recession watch spread just keeps on falling. This past week the spread between the 10-year U.S. Treasury note and the 2-year U.S. Treasury note fell to 24 bp, down from 29 bp the previous week. What is stunning is how rapidly the spread is falling. It was only in June the spread was at 50 bp. In Canada the 2–10 spread is down to 20 bp from 21 bp the previous week. We guess we can say that it is still not in recession warning territory. Negative spreads are usually considered recession warning territory and even then, we usually get upwards of 6 to 10 months of negative spreads before the recession hits. Still, we expect to be in negative territory sometime into 2019. At the current rate of decline it could even happen in 2018.





Source: [www.stlouisfed.org](http://www.stlouisfed.org)

It is worth keeping an eye on credit spreads as the trade wars heat up. Rising credit spreads are a sign that things are deteriorating. Over the past thirty years there have only been two significant rises in credit spreads. The first was during the 2000–2002 tech wreck crash and then again during the 2007–2009 financial crisis. During the latter, credit spreads just spiked rather than rising over time as they did in the former. There was a bit of bounce up during the 2011 EU/Greek crisis but mostly that problem was “over there.” Spreads rose once again as the Fed was ending QE in 2015 but following that the credit spreads narrowed sharply falling back to levels seen in the 1990s and the mid 2000s. They have gone up slightly of late but that is about all one can say. Above is the spread between U.S. 10-year Treasury notes and Moody’s Baa corporate bonds. After hitting a low of 1.56% earlier this year the spread is now up to 1.90%. Baa bonds are one notch above what is known as junk bonds. Junk bonds are usually rated Caa and lower, although bonds with a rating of Ba are considered speculative and not investment grade.



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com)

The Bank of Canada hiked its key interest rate this past week by 25 bp to 1.50% in line with market expectations. It was the second hike in 2018. The bank hinted there could be more as inflation has ticked up and is expected to hit 2.5% in 2018 before moderating. This is above the Bank of Canada's 2% target. The Bank of Canada in its statement expressed concern about the growing propensity for trade wars. But they also noted the stronger than expected U.S. economy and even that Canada's economy wasn't doing too bad either. They noted the upward pressure on the US\$ and the corresponding downward pressure on the Canadian Dollar. The bank actually expressed thoughts that the Canadian economy could grow faster in the second half of 2018. But they noted wage growth is lagging slightly behind economic growth. Yet Canadian unemployment is at the lowest level since prior to the financial crisis of 2008. At the conclusion of its statement they emphasized once again the potential negativity of growing trade actions.



Source: [www.stockcharts.com](http://www.stockcharts.com)

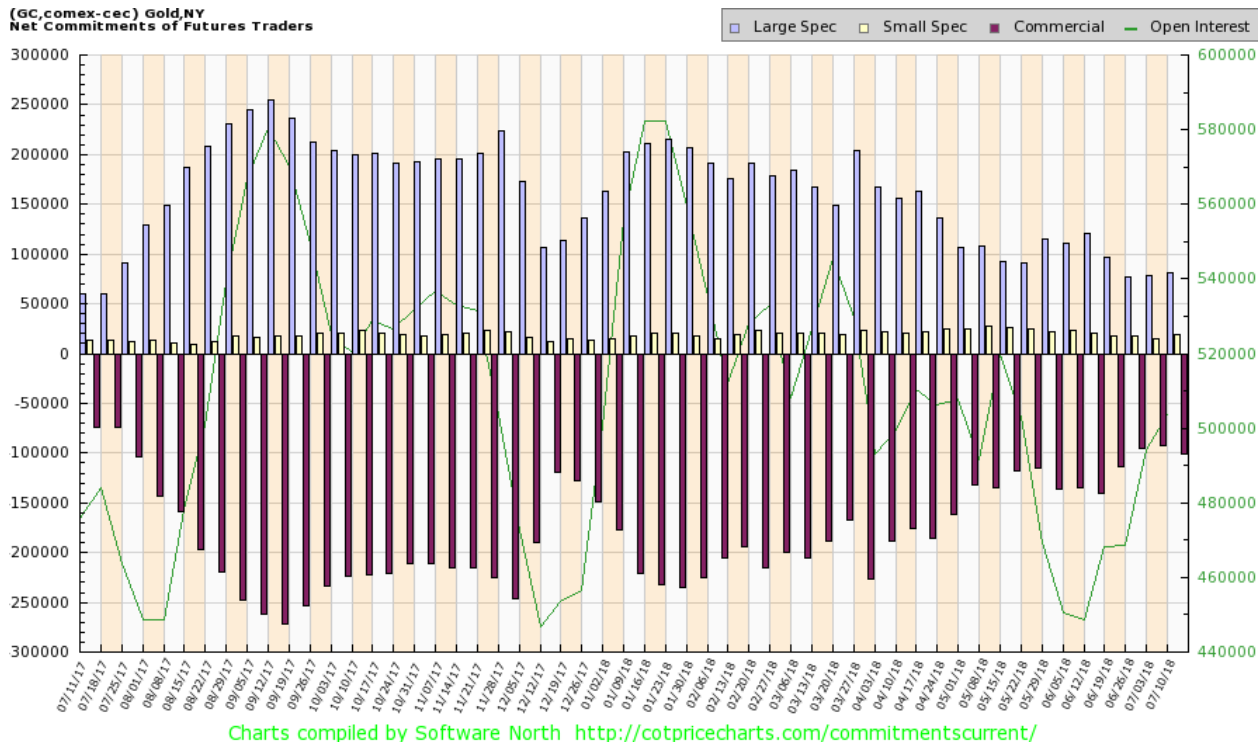
The trade disputes, coupled with the weak EU banking system and continued fears over Italian banks and even Deutsche Bank, helped spur the US\$ Index back up this past week. Despite the trade disputes, suggestions that they might find a way out of the mess always helps ease tensions and sparks stocks and the US\$ higher. Over the past few weeks the US\$ Index has made repeated attempts at firmly taking out 95. It still could, given the persistent testing of the level. Triple tops are rare (tops seen at 94.97, 95.22 and 95.25). This week's high hit 95 on Friday before the market backed off, closing at 94.50 up 0.8% on the week. The Euro fell 0.5% while the British Pound was off 0.4%. The Cdn\$ dropped 0.4% but the Japanese Yen took the hardest hit falling 1.7%. A breakout over 95 could send the US\$ Index up to its next level near 96. A break now of 93.50 could prove negative and a drop down to 92-92.50 could get underway. The stronger US\$ has made life miserable for commodity prices as energy prices, metals prices, and precious metals have all taken a hit.



Source: [www.stockcharts.com](http://www.stockcharts.com)

Just as we thought we might be starting to get “out of the woods,” gold took it on the chin and moved to new lows for the current move down. \$1,240 continues to act as support as the low was \$1,236 but gold managed to close just above \$1,240 at \$1,241. With the new low the RSI did not make a new low so it is a divergence. Gold has now taken out the December 2017 low at \$1,238. That suggests that gold could have further to fall. All of that is occurring despite very low sentiment, and the potential for seasonals to turn positive. Despite the positive seasonal tendencies there is no law that says it must and occasionally that trade has failed. Failure to regain back above \$1,250 could suggest that more losses lie ahead. Next good support is seen at \$1,200 to \$1,220. Firmly under \$1,200 we could be looking at the December 2016 low of \$1,125. We are hard pressed as well trying to find what cycle low we might be attempting to make. The longest cycle is one 23.5-25 years as noted by cycle analyst [Raymond Merriman](#). It subdivides usually into three cycles of roughly 7.8 years. The last major low was the 1999–2001 low and the first 7.8-year cycle low was October 2008. It is possible that the next 7.8-year cycle low was December 2015 and 2016. So, we should be embarking on another up leg at least in theory. And we did, at least until the \$1,365/\$1,370 tops seen earlier this year. The 7.8-year cycle breaks down into three 34-month cycles or two roughly 4-year cycles but usually the former. If the December 2015 low was correct then the first 34-month cycle low could be seen this year 2018 and come in anywhere from October 2018 +/- 6 months. We are now in that time window, but admittedly it stretches out until early 2019. Still, extremely low sentiment and at least a somewhat friendly commercial COT still suggests that a rally could be underway. The

question is, do we go lower first before rebounding. Major support is seen down at \$1,200 with a range from \$1,190 to \$1,220. It is possible that could be tested. Resistance is at \$1,260 then \$1,285. Above \$1,300 we would be starting to confirm the low. We remain positive longer term but the short-term picture is cloudy and remains negative.



Source: [www.cotpricecharts.com](http://www.cotpricecharts.com)

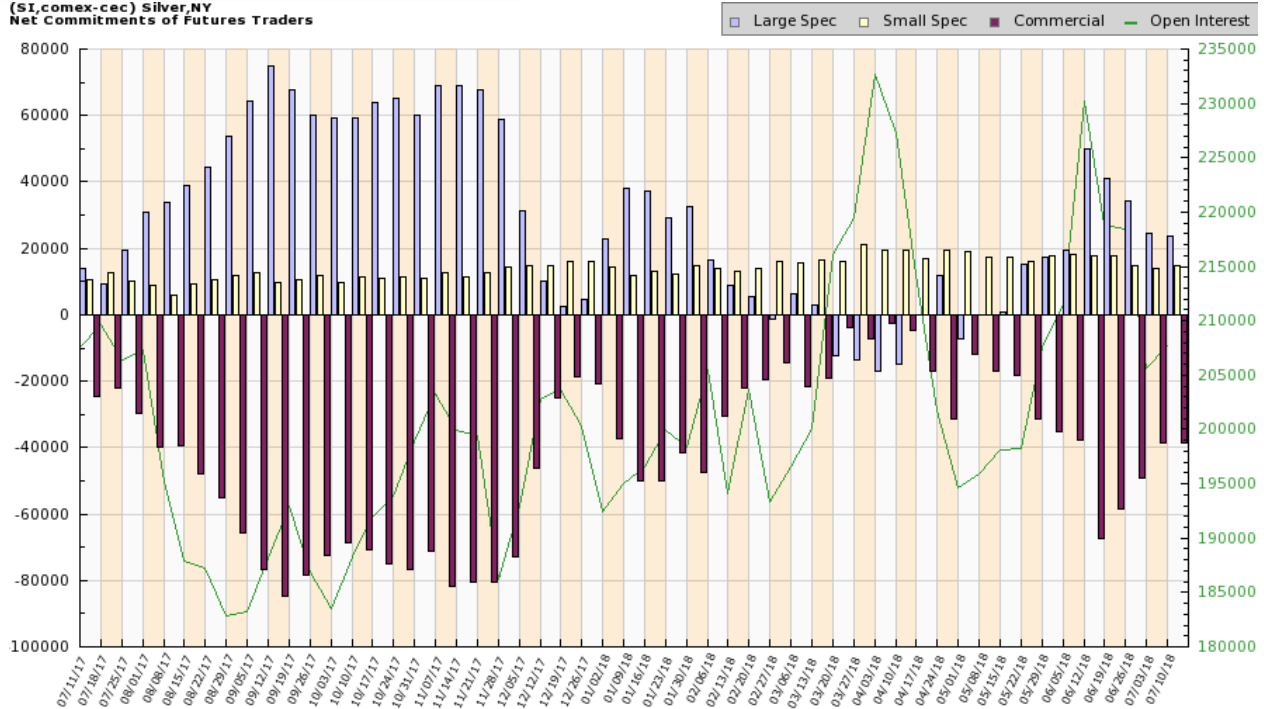
The gold commercial COT slipped to 38% this past from 39% the previous week. Long open interest fell roughly 7,000 contracts while short open interest was off small. The large speculators COT (hedge funds, managed futures, etc.) rose marginally to 62% from 61%. The COT remains somewhat friendly to gold given it is nowhere near levels usually associated with a top. But it also could be better in the mid or high forties. A more bearish stance would be a commercial COT under 30. A higher level would definitely be more encouraging and bullish.



Source: [www.stockcharts.com](http://www.stockcharts.com)

With a stronger US\$ silver joined gold and fell this past week. Silver has now fallen to its lowest level since the December 2017 low of \$15.64. The low this week was at \$15.70, taking out the previous low of \$15.80 seen only a week or so ago. Silver fell 1.6% this past week and is now down 7.8% on the year. Given its industrial uses it is no surprise that other industrial-use precious metals are also taking it on the chin. Platinum fell 2.2% this past week and is now down 11.5% and palladium, which was a big star in 2017 is down 12.1% in 2018 after falling 1.6% this past week. Copper is also taking it on the chin, down 15.8% in 2018 falling 1.6% this past week. The global trade dispute is making people nervous that demand for industrial metals will fall. As a result, they sell off. Platinum and palladium are used in the manufacture of automobiles. Copper is heavily used in housing. Silver has numerous industrial applications, particularly in the computer industry. While volume may have fallen recently it is no panacea for turning this market around as it could fall further. The December 2017 low of \$15.65 is not that far away. The RSI at 39 still has room to move lower. A breakdown under \$15.65 could see silver free-fall in a washout not dissimilar to what happened a year ago in July 2017 when it suddenly collapsed to \$14.34 before also recovering sharply intraday. It then embarked on a sharp rally to \$18.29. The series of falling highs coupled with some line of support down to \$15.65 suggests what we might be looking is a falling or descending triangle. That's bearish. Bizarrely, that could see silver prices fall to around \$12/\$12.50. We don't think so, but could a spike collapse take it there before sharply recovering as it did in July 2017? Considerable resistance is now up to \$16.50. Above \$16.65 things look better. But right now, we are becoming hard-pressed to be at least short-term positive even if it is a sudden down spike followed by a quick recovery. Longer term we remain quite positive. But, as we know, everyone lives in the now. And the right now doesn't look good.

(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
06/12/18	212	101,133	51,403	66%	70	70,970	138,352	34%	30828	13,176	70%	230,163
06/19/18	206	95,323	54,421	64%	80	71,799	130,340	36%	31117	13,478	70%	218,814
06/26/18	211	93,565	59,344	61%	75	73,397	122,428	37%	31131	16,321	66%	218,492
07/03/18	200	92,678	67,996	58%	70	72,877	111,432	40%	30693	16,820	65%	205,622
07/10/18	209	90,598	66,899	58%	73	72,068	110,668	39%	31414	16,513	66%	207,701

Source: [www.cotpricecharts.com](http://www.cotpricecharts.com)

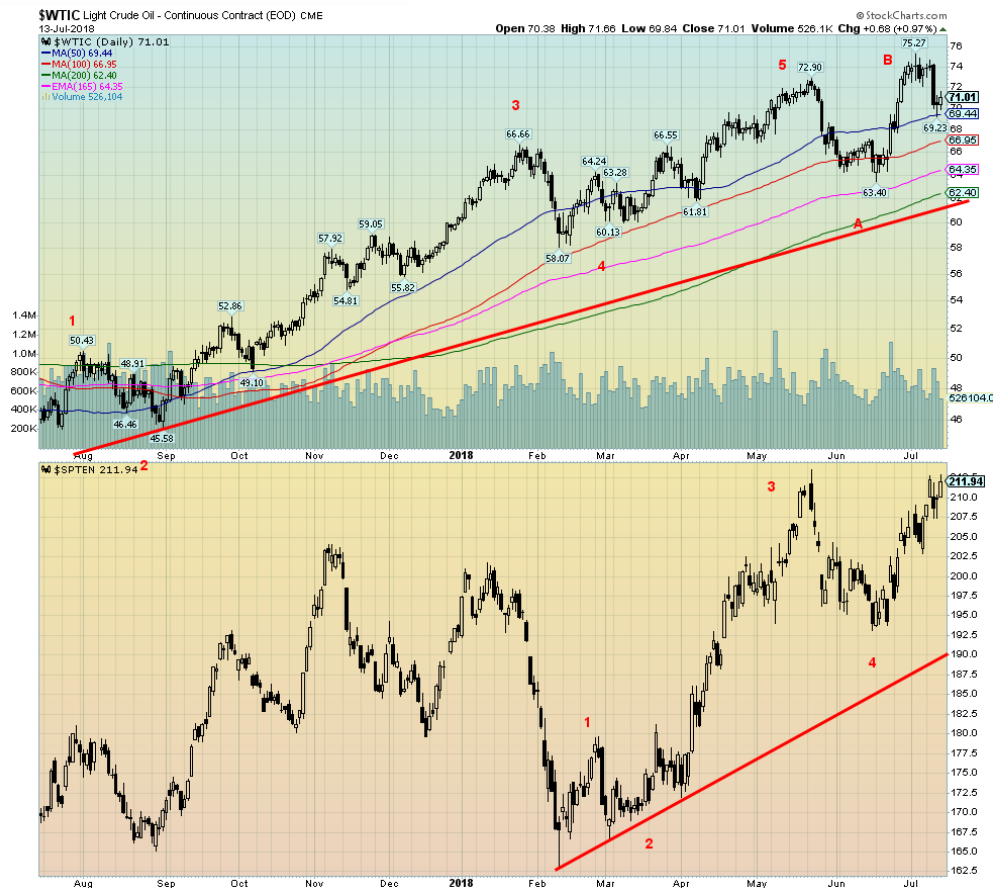
The silver commercial COT slipped slightly this week to 39% from 40% the previous week. Both long and short open interest fell less than 1,000 contracts each. Effectively the commercial COT was unchanged. The silver commercial COT is still friendly towards silver but somewhat more cautious than it was in March/April 2018, just before a rally that took silver from \$16.07 in early May 2018 to \$17.35 by mid-June. Still, it is sufficiently friendly towards silver—just not as much as it was earlier this year. The commercial COT is nowhere near levels seen in 2017 before the December 2017 low at \$15.64. We have to rate the COT as being at least somewhat friendly towards silver. The large speculators COT was unchanged on the week at 58%.





Source: [www.stockcharts.com](http://www.stockcharts.com)

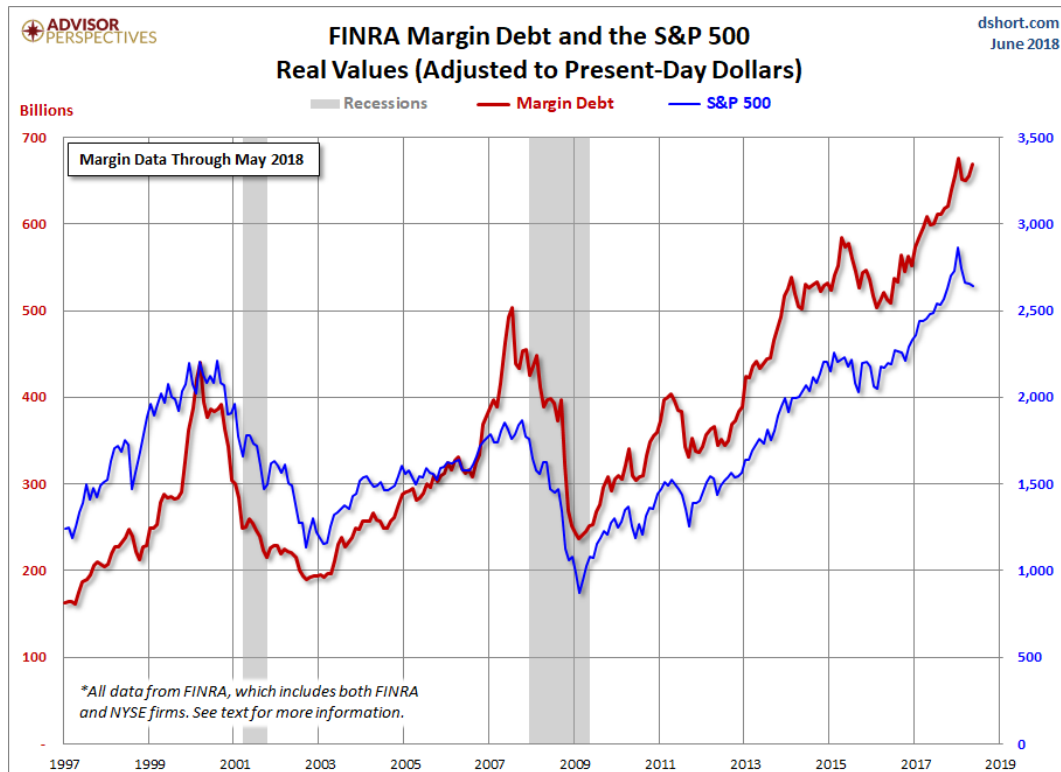
Gold's weakness finally translated into selling for the gold stocks. We can suppose this is not a surprise given the recent persistent weakness for both gold and silver. That the gold stocks held on for so long was, we believed and still do, a sign of resiliency and a significant divergence between the commodity (gold, silver) and the gold stocks. Gold stocks are leveraged to the price of gold and a rise in gold prices can bring an even stronger rise in gold stocks. It also works the other way that when gold prices fall the gold stocks tend to fall even harder. So, when they diverge as they have it is usually a sign that one of them is wrong. Experience and observations have shown that when the commodity (gold, silver) is weak and falling while the underlying stocks are holding and even rising it ultimately suggests that the market will soon embark on a strong rally. Well, we are still waiting and in the interim the gold stocks have now taken a hit falling to new lows for their recent move. The TSX Gold Index (TGD) fell 2.8% this past week and is now down 3.5% on the year. The U.S.-based Gold Bugs Index (HUI) fell even more, losing 3.2% and is now down 9.7% on the year. The gold stocks remain well above lows seen earlier in the year even as gold and silver made new lows for their down move. Gold and gold stocks have been a lousy investment this year. The TGD even fell below what appears to be an up-trend line. The 100-day MA lies just below at 188.30 so it could provide support. Stiff resistance up to 198 remains just that—stiff resistance and seemingly impenetrable. But the low volume and the weak sentiment towards gold and gold stocks is often suggestive of a bottom. Still, it is frustrating and the highs of September 2017 at 213 seem a long way away. Even the January 2018 high of 205 seems distant. As we have noted the seasonals turn positive. Now we need some evidence. Support down to 188 then 185. Below 185 we could be looking at that February 2018 low of 174.57. Resistance is at 191 and up to 197. Above 197/200 a sharp run upwards could get underway.



Source: [www.stockcharts.com](http://www.stockcharts.com)

The U.S-China trade disputes, suggestions by the Saudis that they could unleash 2 million barrels oil/day given their current capacity, and suggestions by Trump that they could release oil from their Strategic Petroleum Reserves (SPR) all conspired to send oil prices down sharply this past week. While WTI oil did bounce off the lows it still ended down the week by about \$2.80 or 3.8%. Prices briefly dipped under \$70, hitting a low of \$69.23. Helping WTI oil (Brent oil) to fall was news that Libya was able to export more than expected. WTI oil prices bounced off of the 50-day MA. But a breakdown to new lows below \$69 could trigger further losses down to the next level of support near \$67. The potential for releasing oil from the SPR was triggered by high gasoline prices at the pump. Bring them down to help keep the U.S. economy humming, particularly through the heavier-use driving season which we are now well into. Despite the drop in WTI oil prices the S&P Energy Index (TEN) held up actually rose 2.2% on the week. The TEN is now just short of its May high of 213.47. New highs are now possible. If WTI oil is not also making a new high then we have a divergence between the stocks and the commodity. Interestingly when WTI oil was making new highs in early July the TEN was not. Now the TEN is threatening to make new highs even as WTI oil has fallen.

## Chart of the Week



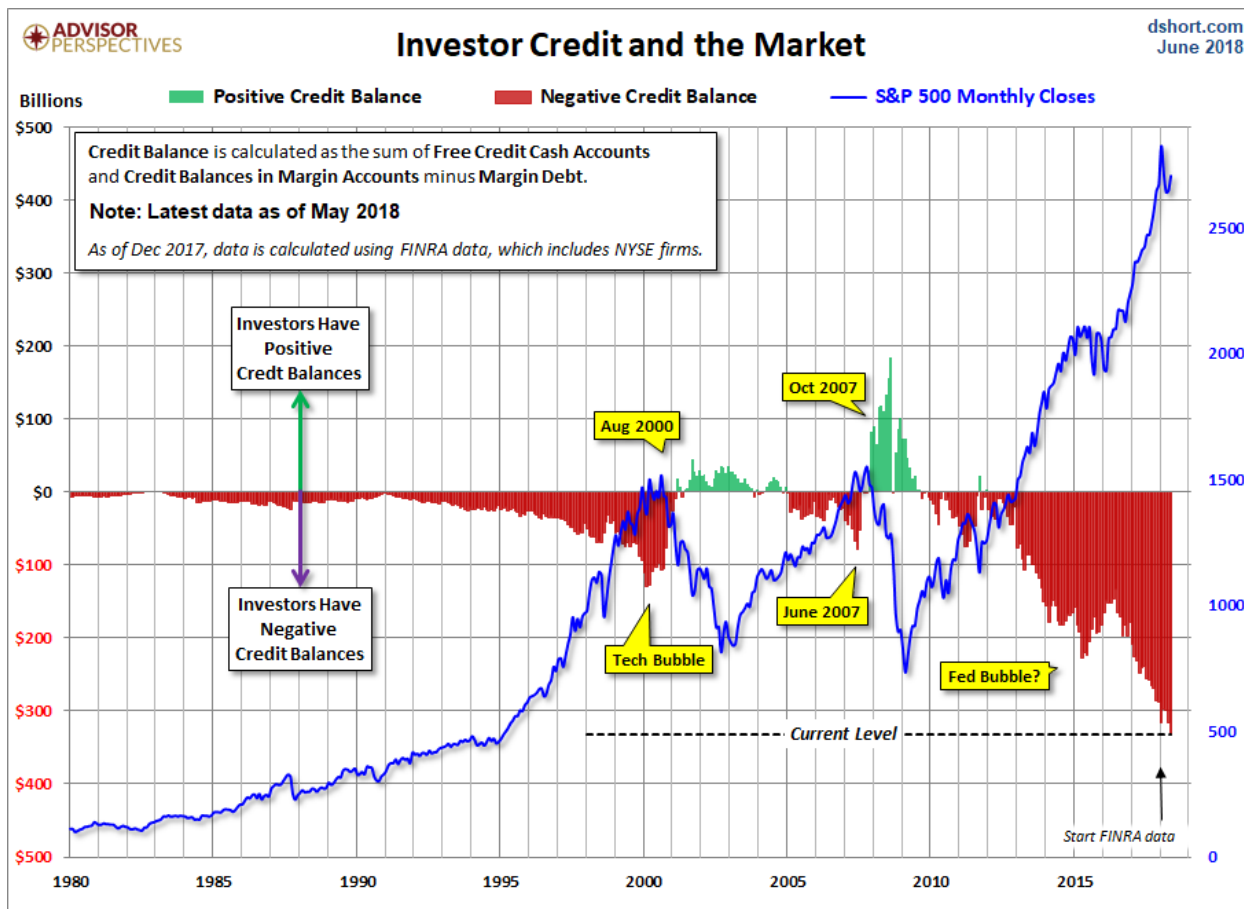
Source: [www.dshort.com](http://www.dshort.com)

Despite a softening in the market since January 2018 margin debt is climbing once again. The chart above shows adjusted for inflation margin vs. the S&P 500 over the past twenty years. The last update was for May and it showed a 2.6% rise from April. The updated data is from FINRA whereas previously until December 2017 the data was provided by the NYSE member firms. FINRA data includes all firms and not just those firms with the NYSE.

It is interesting to note that surges in margin (or leverage) surged just before market peaks in 2000 and again in 2007. The same phenomena has happened again before the January 2018 peak in the markets. Interestingly, the last major trough occurred in February 2009, one month before the actual stock market bottom in March 2009.

A second chart below looks at free cash accounts and credit balances. The calculation includes the sum of free credit cash accounts and credit balances in margin accounts minus margin debt. It is nominal data and not inflation adjusted. But it shows a rather disturbing picture in that over the past twenty years it has never been so high (or in this case so low meaning so much negative credit

balance). Given years of ZIRP and QE maybe it is not surprising that investors were encouraged to leverage up to take advantage of a sharply rising market. Trouble is what happens when it starts to fall. Strange that the negative credit balances were not as huge before the 2008 financial crash as they were before the 2000 tech bubble wreck. Interesting as well that troughs in negative credit balances preceded the actual tops in the markets by up to six months. Anyway, the data series is not long enough to read too much into it. If history were an indicator and it turns out that May 2018 is the trough, then we have until November before the market could seriously crack. We'll attempt to retrieve updates when we see them. This is a great picture as to why the markets seemingly stay up even against the backdrop of negative news. Leverage. Lots of it.



Source: [www.dshort.com](http://www.dshort.com)

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## 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.

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