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Technical Scoop E-Commentary July 29 2019
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Weakening economic environment, note-fund spread, central bank assets, market top, gold temporary top

We continue with a somewhat shortened commentary. Our focus this week is on the weakening economic environment, an interesting look at the spread between the 2-year U.S. Treasury note and Fed Funds, a look at central bank balance sheets, and the deterioration of the world economic order. We do provide a synopsis of the S&P 500 and gold. The S&P 500 continues to trace out what we believe could be an important top while gold may have made a temporary top. The Canadian Dividend Strategy is designed to allocate to cash in the event of a sustained market decline.

We hope to return with a full report next weekend.

Have a great week!

DC

"The Mexican debt crisis, Latin American debt crisis, the crises of the 1990s, the Wall Street stock market crash, and other events should have reminded us, and did remind us, that financial instability remains a concern, remains a problem."
—Ben Bernanke, economist, Chair Federal Reserve 2006–2014, b. 1953

"My father was a very successful businessman, but he was ruined in the stock market crash. A big stockbroker jumped out the window and fell on his pushcart."
—Jackie Mason, American stand-up comedian, film and television actor, b. 1931

"From early Colonial days, sex life in America had been based on the custom of men supporting women. That situation reached its heyday in the Twenties when it was easy for any dabbler in stocks to flaunt his manhood by lavishing an unearned income on girls. But with the stock-market crash, men were hard put even to keep their wives, let alone spend money on sex outside the home. The adjustment was much easier on women than on men, who jumped out of windows in droves, whereas I can't recall a single headline that read: KEPT GIRL LEAPS FROM LOVE NEST."
—Anita Loos, American screenwriter, playwright, and author, 1889–1981

It was Mueller time this past week. Except the markets didn't care. However, the markets would care if the House Democrats decided to launch impeachment hearings against President Trump. Impeachment hearings could still begin even though they will fail in the Senate. President Trump could launch court action to prevent impeachment proceedings. But it is the entire spectacle that would be on display, eating up air time while the economy continues to slide despite the seemingly strong job market.

U.S. GDP growth for the 2nd quarter slid to 2.1% after a 3.1% gain in the 1st quarter. Final year-over-year GDP growth is expected to be 2.3%, the lowest growth rate since early 2017. However, the reported 2nd quarter GDP was better than expected because of stronger than expected consumer spending as personal consumption expenditures jumped 4.3%, the best since Q4 2017. Government spending rose 5%. But let's not look at the rapidly growing debt, now $22.5 trillion up $1.2 trillion in the past year. U.S. earnings are beginning to soften while trade concerns and a slowing global economy are weighing on business confidence and delaying investment decisions. To no one's surprise, business investment tumbled 5.5%, the worst since Q4 2015. That shaved 1% off the GDP report. Still, this is below the Trump administration's desire for 3% growth and ought to get the "tweets" a-flapping.

The problems are in the EU, China, and Japan. If Japan is lucky, growth for 2019 will be 1%. For the EU they live in the Japanese debt trap—meaning, they have, over the years, thrown billions of dollars at the economy through quantitative easing (QE) and lowered interest below zero and still the economy is sluggish and rolling over again. This past week the ECB did not lower interest rates as many expected; however, ECB head Mario Draghi was quite dovish in his statements and more QE could be on the table. EU growth is expected to be around 1.2% for 2019. Draghi was confident the EU would not slide into recession. The reality is the ECB has little room to maneuver.

China has been buffeted by the trade wars, with the U.S. and their corporations—particularly real estate—are laden with far too much debt. A decline in GDP growth to 6.2% sounds great when compared to everyone else.

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The reality is China's growth has been declining steadily since 2010. The most recent Manufacturing PMI fell under 50 (actual 49.4 in June 2019 vs. 50.2 in May 2019). A reading below 50 signals a potential recession.

China GDP Annual Growth Rate

Source: www.tradingeconomics.com, www.stats.gov.cn

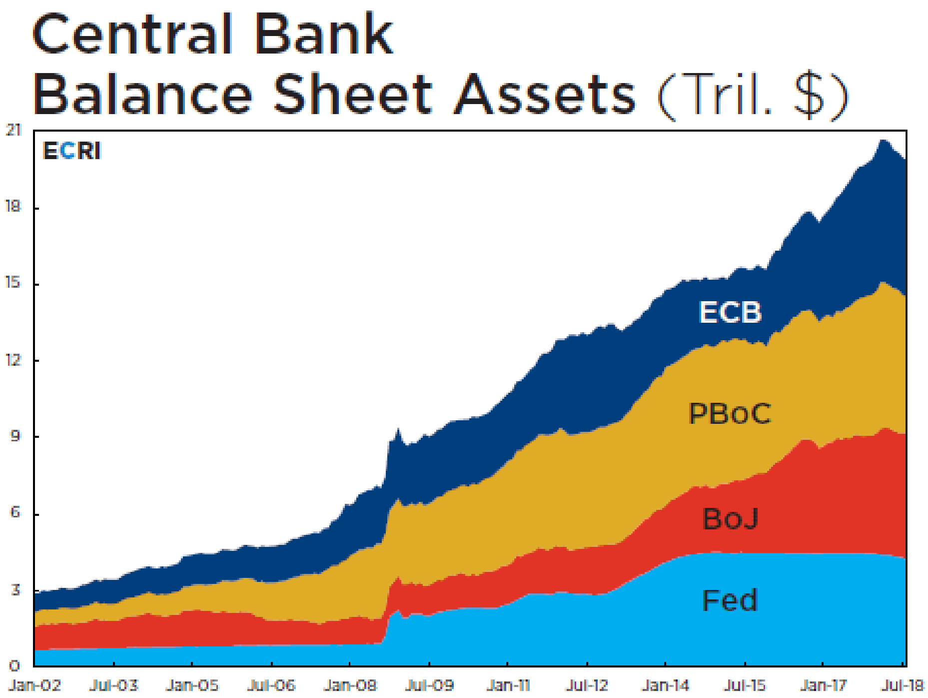
Nonetheless, there is widespread speculation that the Fed will cut its key rate by at least one-quarter percent at the FOMC meeting on July 30–31. Naturally, failure to cut will disappoint the market but it will help continue to steady the U.S. dollar. Gold would be a victim to a no-cut and sell-off.

Source: www.stockcharts.com , www.mcoscillator.com

Maybe the Fed should be following the 2-year U.S. Treasury note a little closer. For years during the tech bubble of the late 1990s, the housing bubble of 2002–2007, and the current bubble (appropriately called the "everything" bubble) the 2-year note traded above Fed Funds. Thanks to Tom McClellan of MC Oscillator for pointing out this anomaly (www.mcoscillator.com). During the bubbles, the 2-year consistently traded above the Fed Funds rate. However, in May 2000, again in October 2005, and now again in November 2018 the 2-year began to trade below the Fed Funds rate.

In the 2000 and 2005 case it was heralding the coming recession and stock market crash. While the 2000 signal was right on, the 2005 signal started a good two years ahead of the 2007-2009 financial crisis. So, what is this one saying? It does appear to suggest, given the 56 bp differential between the Fed Funds and the 2-year, that the Fed should be cutting rates ½% now. And, like the previous two signals, it could be heralding a coming recession and stock market drop. Another recession watch spread?

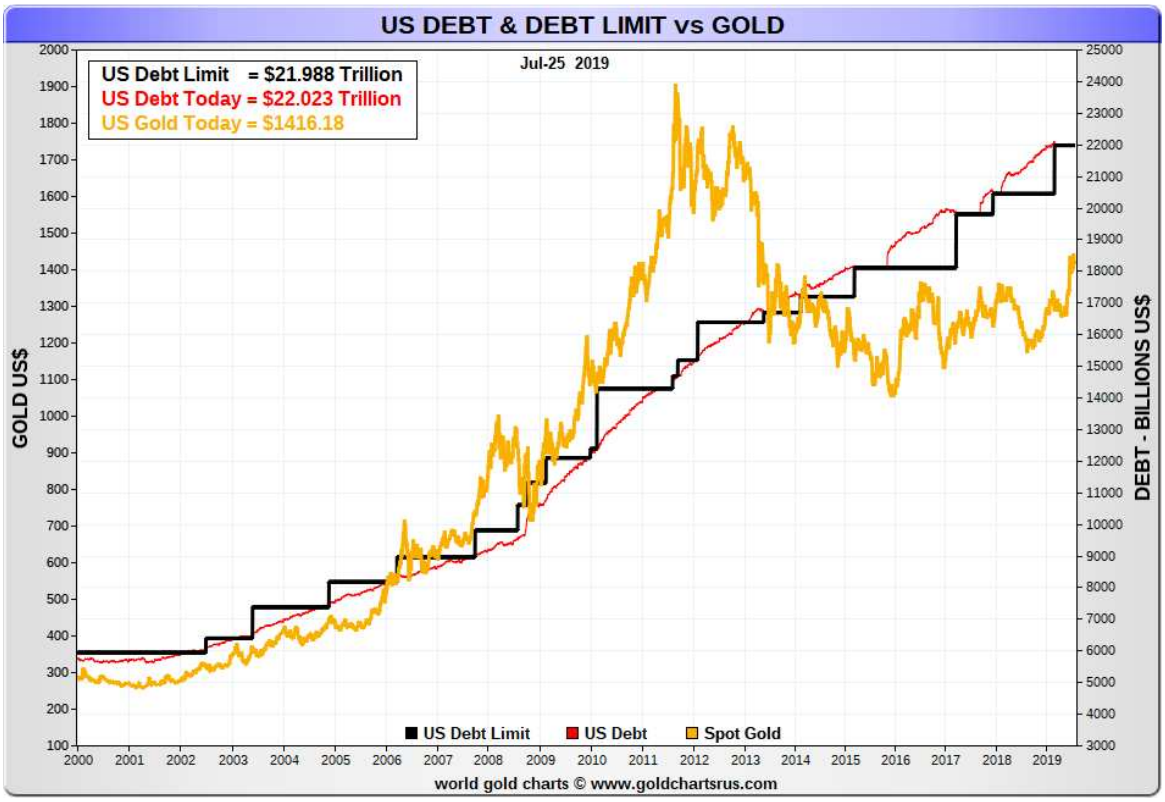
The trouble with the world's major central banks—the Fed, ECB, BOJ, PBOC, and the BOE—is that they can no longer be the saviours for the market. Bluntly, their ability to deal with another crisis on the scale of 2008 is at best limited and at worst non-existant. How do you cut rates when they are already at or near zero, or even below zero in the case of the ECB and the BOJ? Rates are low by historical standards. Central banks have expanded their balance sheets by some $17 trillion since 2008. The Fed's balance sheet has dropped over the past year, thanks to its running off maturities and slowly selling off some product. The chart below is about one year behind but, overall, the picture has not changed much.



Source: www.businesscycle.com

At one point there might have been a chance that the world's central banks could have pushed an expansion. But the start of trade wars in January 2018 by the Trump administration, the threat of a U.K. withdrawal from the EU, and a slowdown in China have all conspired to heighten the risks. While the EU insists there is room to buy bonds the reality is different. China has room and would take action. However, Japan is trapped and the BOE will have their hands full with Brexit. Even the Fed is compromised although they do have room to lower rates and would probably pump up their balance sheet further.

The reality is, the central banks need help on the fiscal side and in most cases that is mired in politics. The U.S. Congress recently agreed to expand its debt limit, expanding discretionary spending to $1.37 trillion in 2020 and suspending the U.S. borrowing limit for another two years. It still has to pass the Senate and, interestingly enough, it was Republicans that voted against it which was against Trump's wishes. The tax cut effect on the economy is most likely over and now comes the pain with rapidly rising budget deficits.



Source: www.goldchartsrus.com

But if the world's central banks are in a bind over any economic crisis on the scale of 2008, one has to wonder whether the world order is coming apart. It may be the 75th anniversary of Bretton Woods (July 1–22, 1944), but the rule-based order that was created is now severely strained. (For a more in-depth report see David Parkinson's article, *The Globe and Mail*, *Report on Business*, July 24, 2019 (https://www.theglobeandmail.com/business/commentary/article-on-the-75th-anniversary-of-bretton-woods-remembering-why-the/). Bretton Woods realized that global economic cooperation was the only route out of the mire of two world wars and a devastating depression. There needed to be an end to the previous disasters of economic warfare, and "beggar-thy-neighbour" policies.

Out of the dust of WW2 emerged the International Monetary Fund (IMF), the World Bank, and the General Agreement on Tariffs (GATT), the predecessor to the World Trade Organization (WTO). The U.S. dollar was set as the world's reserve currency, pegged to gold at $35/ounce. The wheels started to come off the bus in August 1971 when President Nixon took the world off of the gold standard. The period from 1971 to the present has been one of increased prosperity, taking much of the world out of extreme poverty but it was also built on a mountain of debt that today totals over $250 trillion and climbing. It is the elephant in the room.

So, what do we have now? Economic warfare through sanctions, trade wars, and currency manipulation have become dominant. Ironically, two of the strongest opponents to the world order and its institutions that emerged from Bretton Woods are its chief architects: the U.S. and the U.K. The world is threatening to divide into three major trading blocks—North America, the EU, and Asia, dominated by China. Each would most likely have their own reserve currency. All are a major threat to U.S. domination and hegemony and a threat to the U.S. dollar.

The EU has even been threatened with break-up, thanks to Brexit and a host of governments dominated by right-wing parliaments that want to pull their country out of the EU. Many of these countries are also heavily debt laden. The European continent has a history of distrust and wars, and the last thing that the EU—and by extension Europe and the world—needs is a return to that era of non-co-operation and potential war. Bretton Woods was about economic co-operation and it was also about peace. One could add the United Nations (UN) to the global institutions that emerged following WW2. The isolation of Russia through sanctions is not helpful either, as like it or not, Russia is and has been historically a key player in the European theatre.

Nonetheless, the current global tensions are such that they lead to economic decline, a potential steep recession or worse, and eventually to war. We also have the negative effects of "global warming" or whatever one wishes to refer to it as, and its potentially destabilizing effects and displacement of millions of people due to flooding, and increased severity of hurricanes, tornadoes, and heat waves. Parts of the world could become uninhabitable and that alone could trigger war and displacement. We have already seen the negative effects in a host of countries in the Mid-East, Africa, and Central America as battles emerge over energy, water, and food supplies as crop failures mount, and in places like Africa the deserts expand. Add it all up and we have a potential disaster in the making. The negative effects of global warming globally are not in the billions but in the trillions. The cost of doing nothing far exceeds the cost of doing something.

The U.S. has just come through the longest expansion in history—ten years and counting. But the threats are quite visible with trade wars, sanctions, and natural disasters. Economic disasters and potentially war would follow the demise of the global institutions that have helped maintain peace and prosperity. The increase in natural disasters due to global warming threatens life itself.

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Source: www.stockcharts.com

The S&P 500 continues to climb, touching up against what still appears as a huge broadening pattern. The S&P 500 is also rising in what appears as a huge ascending wedge. Both patterns are ultimately bearish.

No break has taken place; however, we are about to enter the August/September period, generally acknowledged as the two weakest months of the year. Since 1950, August ranks 11th for the S&P 500 and September ranks 12th in terms of performance. August tends to do marginally better in pre-election years, while September is a very poor performer in pre-election years.

The first signs of trouble would be a drop under 2,950 and the S&P 500 starting to break down under 2,900. The market has been rising against a backdrop of negative news. But earnings surprises on the downside (see Amazon) could begin to weigh on the market. We also note that the NASDAQ hit 93% bulls this past week, a level often associated with a top in the market. It is the third time this year that sentiment has hit over 90%. The first two were followed by a market decline, especially the second one that took us into the June 2019 low.

The S&P 500 made another new all-time high this past week. The NASDAQ followed, also making a new all-time high. There were others: NASDAQ 100, Russell 1000, Russell 3000, S&P 100 (OEX), and Wilshire 5000. However, some key indices did not make new all-time highs, including the Dow Jones Industrials (DJI). Others important indices failing to make new all-time highs were the Dow Jones Utilities (DJU) and the Dow Jones Composite (DJC). Major international indices followed North American markets to the upside. Some made new all-time highs including: Dow Jones World (DJW), Euro Next 100, Sydney All Ordinaries (Australia), Paris CAC 40, and AEX (Netherlands). Canada's TSX Composite remains well short of new all-time highs. However, some TSX sub-indices made new 52-week highs, including Gold, Global Mining, Industrials, TSX Small Cap, and Information Technology.

The divergence between the S&P 500 and the Dow Jones Industrials (DJI) is interesting, but it is non-confirmation divergence. The divergence is not confirmed until both break down. There remain other non-confirmation divergences: the Dow Jones Industrials (DJI) made new highs but the Dow Jones Transportations

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(DJT) did not, and the S&P 500 (large cap) has soared to new highs but the S&P 400 (mid-Cap) and the S&P 600 (small cap) have not. Divergences are to be noted, but they are not a guarantee of a drop in the market. We only know that in hindsight when it becomes a confirmed divergence.

Next week's FOMC could decide the next direction.

Source: www.stockcharts.com

Has gold made a top? On the chart above we note that gold appears to have made 5 waves to the top on July 19, 2019 at $1,454. We would have preferred a move to at least $1,490/$1,500, but we can't knock the move that has occurred with gold up 12% since May. Silver has finally performed better, rising about 15% from its May low of $14.27. The gold stocks fared even better as the TSX Gold Index (TGD) is up 32% and the Gold Bugs Index (HUI) gained almost 42%. But gold closed lower this week, the second week in a row. Silver made new 52-week highs and closed up on the week, while gold did neither, showing a divergence. The TGD made new 52-week highs but the HUI did not—another divergence. Following new 52-week highs, the TGD closed lower on the week. Silver hit 91% bulls this past week, the most extreme in three years. The Gold Bullish Miners Percent Index hit 75 this past week. While not extremely high (it hit 100 in July 2016), it is at a level that might suggest a pullback.

Other signs that we might have made at least a temporary top are the weekly COT reports. Gold's commercial COT fell to 27% this past week from 28% as short open interest rose by over 10,000 contracts. Silver's commercial COT fell to 33% from 36%. Long open interest fell by roughly 4,000 contracts and short open interest rose by about 13,000 contracts. Another sign is it would appear that the Japanese yen has topped. Gold tends to follow Japanese yen and it too fell this past week and has turned bearish.

The U.S. dollar rose this week as both the euro and the pound sterling hit new 52-week lows. A rising U.S. dollar is anathema to gold. Trump wants a lower U.S. dollar. Aggressive rate cuts and a resumption of QE would do the trick. Despite Trump's attacks on the Fed they are not likely to cave into his tweets and insults. However, they could use the Exchange Stabilization Fund in an attempt to lower the dollar as that is controlled through the U.S. Treasury department under Steve Mnuchin. An outright attempt by Trump to fire Fed chair Jerome Powell would also do the trick but that is actually unlikely.

Seasonals tend to support a pullback into August, September, and October followed by a rebound and another decline into December. If gold has made a top it should be a correction only to the wave up from the May 2019 low. A normal correction would take gold back to around $1,380/$1,385. A shallow correction (not favoured) would be down to around $1,410. A break of $1,400/$1,410 would target next $1380/$1,385. A break of that zone would suggest a target down to around $1,335/$1,360. Under $1,335 and especially under $1,310 would suggest that gold has topped for good and we are headed back to the May lows at minimum. We do not support that thesis. If the wave count is correct, then gold has made the first minor wave up in what should be a five-wave up pattern. A correction now would be wave 2 down. Wave 3 up would be strong and long. Recall we do have targets up to $1,725 based on the long base formed from 2013 to 2019.

There is a small minority who believe the Fed will do nothing next week. That would be surprise to the market which widely believes a quarter-point Fed cut would be in order. But even a quarter-point cut might disappoint those expecting or wanting a half-point cut. That would likely send stocks lower and gold and gold stocks lower as well. That would set thoughts of a Fed cut to focus on the September FOMC due for September 17–18, 2019.

View a correction as the pause that refreshes. Not the end of the world as some gold bugs are sure to profess as they spend mounds of ink attacking the gold manipulators.

MARKETS AND TRENDS

	% Gains (Losses)				Trends		
	Close Dec 31/18	Close Jul 26/19	Week	YTD	Daily (Short Term)	Weekly (Intermediate)	Monthly (Long Term)
Stock Market Indices							
S&P 500	2,506.85	**3,025.86 (new highs)**	1.7%	20.7%	up	up	up (topping)
Dow Jones Industrials	23,327.46	27,192.45	0.1%	16.6%	up	up	up (topping)
Dow Jones Transports	9,170.40	10,776.67	1.6%	17.5%	up	up	up (topping)
NASDAQ	6,635.28	**8,330.21 (new highs)**	2.3%	25.5%	up	up	up (topping)
S&P/TSX Composite	14,322.86	16,531.04	0.3%	15.4%	up	up	up
S&P/TSX Venture (CDNX)	557.20	592.89	0.2%	6.4%	down	down	down
Russell 2000	1,348.56	1,578.97	2.0%	17.1%	up	up	up
MSCI World Index	1,710.88	1916.39	(0.3)%	12.0%	up (weak)	up	up
NYSE Bitcoin Index	3,769.99	9,791.26	(5.8)%	159.7%	neutral	up	up
Gold Mining Stock Indices							
Gold Bugs Index (HUI)	160.58	206.90	(1.9)%	28.9%	up	up	up
TSX Gold Index (TGD)	186.74	**234.07 (new highs)**	(1.4)%	25.4%	up	up	up
Fixed Income Yields/Spreads							
U.S. 10-Year Treasury yield	2.69	2.07	1.0%	(23.1)%			
Cdn. 10-Year Bond yield	1.96	1.47	(2.0)%	(25.0)%			
Recession Watch Spreads							
U.S. 2-year 10-year Treasury spread	0.21	0.21	(16.0)%	flat			
Cdn 2-year 10-year CGB spread	0.10	0	(100.0)%	(100.0)%			
Currencies							
US$ Index	95.73	97.75	1.0%	2.1%	up	up	up (weak)
Canadian $	0.7350	0.7605	(0.8)%	3.5%	neutral	up	neutral
Euro	114.58	**111.26 (new lows)**	(0.8)%	(2.9)%	down	down	down (weak)
Swiss Franc	101.88	100.63	(1.2)%	(1.2)%	up	up	neutral
British Pound	127.50	**123.88 (new lows)**	(0.9)%	(2.8)%	down	down	down
Japanese Yen	91.24	92.00	(0.9)%	0.8%	down	up	up (weak)
Precious Metals							
Gold	1,281.30	1,414.70	(0.8)%	10.4%	up	up	up
Silver	15.54	**16.41 (new highs)**	1.4%	5.6%	up	up	down (weak)
Platinum	795.90	874.00	2.6%	9.8%	up	up	down
Base Metals							
Palladium	1,197.20	1533.90	1.7%	28.9%	up	up	up
Copper	2.63	2.685	(2.5)%	2.1%	neutral	down (weak)	neutral
Energy							
WTI Oil	45.41	56.05	0.5%	23.3%	neutral	neutral	neutral
Natural Gas	2.94	2.15	(4.4)%	(26.9)%	down	down	down

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.

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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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