

Technical Scoop E-Commentary August 12 2019

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Currency wars, plunging markets, soaring gold, inverting curve, negative yields

Currency wars! Stock markets plunge, gold soars, bond yields fall and the yield curve inverts more. History is littered with trade wars, currency wars. But negative yield bonds? \$15 trillion and counting. In our Chart of the Week (page 7) we highlight that gold is making new all-time highs in at last count 72 currencies. But is it gold rising or currencies falling? It's the latter. We look at all of these things in this weekend's report. We live in either fascinating times or dangerous times. It leans towards the latter. The Canadian Dividend Strategy is designed to allocate to cash in the event of a sustained market decline.

Best to own a bit of gold.

Have a great week!

DC

"It's not like I'm anti-China. I just think it's ridiculous that we allow them to do what they're doing to this country, with the manipulation of the currency, that you write about and understand, and all of the other things that they do."

—Donald Trump, 45th U.S. president, businessman, television personality; b. 1946

"When the dollar was separated entirely from gold in 1971, it ceased being the official IMF world currency and finally had to compete with other currencies... From that point forward, its value increasingly became discounted."

—G. Edward Griffin, American author, filmmaker, conspiracy theorist; b. 1931

"When monetary policy destroys the currency, it always destroys the middle class."

—Ron Paul, American author, physician, retired politician, congressman from Texas; b. 1935

"China dropped the price of their currency to an almost a historic low. It's called "currency manipulation." Are you listening Federal Reserve? This is a major violation which will greatly weaken China over time!" — Donald Trump, 45th U.S. president, tweet, August 5, 2019

And so it goes. The "tweeter in chief" followed up that tweet with even more bashing of China—how they steal hundreds of billions from the U.S. through unfair trade practices, and how they steal U.S. business and factories, hurt jobs, depress worker's wages, and harm farmer's prices. Trump then continued to bash the Federal Reserve, once again telling them they have to drop interest rates right away and take action to lower the value of the U.S. dollar.

Trump should also tell his economic adviser Larry Kudlow and his Treasury Secretary Steve Mnuchin that as well. Kudlow has said the administration would not undertake currency intervention. Mnuchin has refrained from calling China a currency manipulator. Someone should also remind Trump that it is the U.S. consumer that is paying for his tariffs. China's retaliation has hit the U.S.'s breadbasket hard as China found its soybeans elsewhere. In its place, the U.S. has had to provide upwards of \$16 billion in subsidies to keep America's farmers quiet. Trump has tied Huawei to China's purchase of U.S. agricultural goods. It's a never-ending game with negative consequences all around.

It is not as if this is the first time that China has adjusted their currency. They did it in August 2015 and December 2015. Each time the Dow Jones Industrials (DJI) fell 10% or more. So, what happened this time? The DJI promptly fell over 800 points. But is China really a currency manipulator? Or is it simply adjusting its currency? Only around 1% of global trade is carried out in yuan even though China accounts for 15% of global trade. As well, China's trade with the U.S. represents only about 18% of its total exports. China trades almost as much with Hong Kong as they do with the U.S.

But what if China were to just float its currency? If that happened, the yuan is likely to fall further, not rise. Trade matters but capital flows matter even more. China always had a quid pro quo relationship with the U.S: the U.S. buys China's exports, China buys the U.S. debt. As of May 2019, China held \$1.1 trillion of U.S.

treasuries. Okay, that's down from almost \$1.2 trillion in May 2018. But China is still number 1 in holdings of U.S. Treasuries. Overall, foreign holdings of U.S. treasuries are up over \$300 billion in the past year. The U.K. and others have picked up the slack, given that China is largely absent from U.S. Treasury auctions these days.

Chinese Yuan (US\$/Chinese Yuan)



SOURCE: TRADINGECONOMICS.COM | OTC INTERBANK

Source: www.tradingeconomics.com, www.theice.com/market-data

As if on cue, the stock market fell from what appears as the top of a large broadening top pattern. The S&P 500 also appears to be breaking down from a large ascending wedge pattern. The NASDAQ and DJI are also breaking down, although the breaks are not as yet conclusive. The S&P 500 found support just above the 200-day MA and rebounded. Key would be a break of the June 3 low of 2,728 S&P 500, 24,680 DJI, and 7,298 NASDAQ. The S&P 500 seems destined to fall to the bottom of a broadening channel near 2,200. That's a further 25% decline from current levels.

It has been a volatile week as U.S. treasury yields plunged, stocks fell and then rebounded, and gold shot to new highs above \$1,500. Silver finally joined the party and soared over \$17. While the U.S. dollar was down, it was not falling rapidly as many would think. So far, its key supports have held. The pound sterling remains weak as does the euro but both the Swiss franc and Japanese yen moved higher. Both gold and silver saw their daily sentiment indicators (DSI) soar well past 90%. That is usually the sign of a potential top, not the start of a major move.

What is going on? Is it a race to the bottom? U.S. treasury bond yields plunged and spreads are becoming more negative even as there appears to be no imminent recession in the U.S. Then three Asia Pacific central banks surprised everyone by slashing their key bank rates. New Zealand led the way with a half-point cut to

There are now 12 countries with negative yield bonds – Germany, Switzerland, Denmark, Netherlands, Sweden, Austria, France, Finland, Belgium, Japan, Slovakia and Slovenia.

Why so many with negative yield bonds? This is not how a global economy is supposed to function. But at the bottom of it all lies the faults with the central banks, the China-U.S. trade war, deflationary technology and shifting global demographics. Governments (and even corporations) are being paid to borrow money. We'd hate to think what would happen if interest rates started to rise, but mega bond collapse comes to mind.

The insanity of it all has seen the number of global junk bonds grow because of the low cost of borrowing. There is an estimated \$1.2 trillion of junk bonds outstanding in the developed countries. And that is not even counting economic sovereign basket cases like Argentina, Turkey, Ukraine, Zambia, and others.

Market Cap Negative Yield Bonds



Source: www.bloomberg.com, www.schiffgold.com

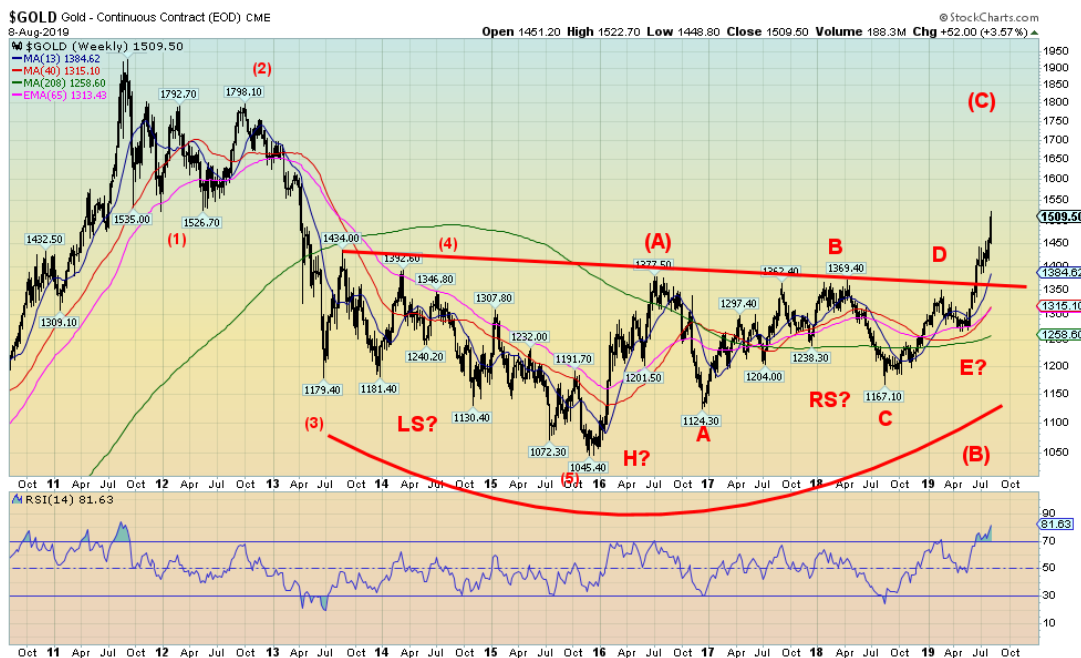
“As global yields continue to fall, and in some cases turn negative, there appears to be a direct correlation between global net negative yielding debt and the price increase in gold, highlighting that as yields decrease, the opportunity cost of holding gold decreases making it more attractive.”

—World Gold Council

With stock markets wavering, bond yields plunging, and negative yield bonds growing, no wonder gold is looking the best since 2009–2011 when prices soared from \$680 in October 2008 to over \$1,900 by September 2011. Grant you, the gold crash was a shock to the gold bugs as the price collapsed to \$1,045 by December 2015. Gold crossed \$1,500 this past week hitting a high of \$1,523.

But gold crossing \$1,500 in U.S. dollars is only a part of the story. The real story is gold hitting new all-time highs in, at last count, 72 currencies. Included are the Canadian dollar, Australian dollar, pound sterling, Japanese yen, Russian ruble, and possibly significantly, the Indian rupee. Global-backed gold ETFs are also seeing record flows. Gold is rising in all currencies, not because gold is rising, but because fiat currencies are falling vs. gold and silver. Central bank buying continues as a record 651 metric tonnes was purchased in 2018 and buying continues into 2019. The central banks of both Russia and China continue to add to their reserves. Both Russia and China continue their quest to diversify away from the U.S. dollar.

Gold – The Big Breakout

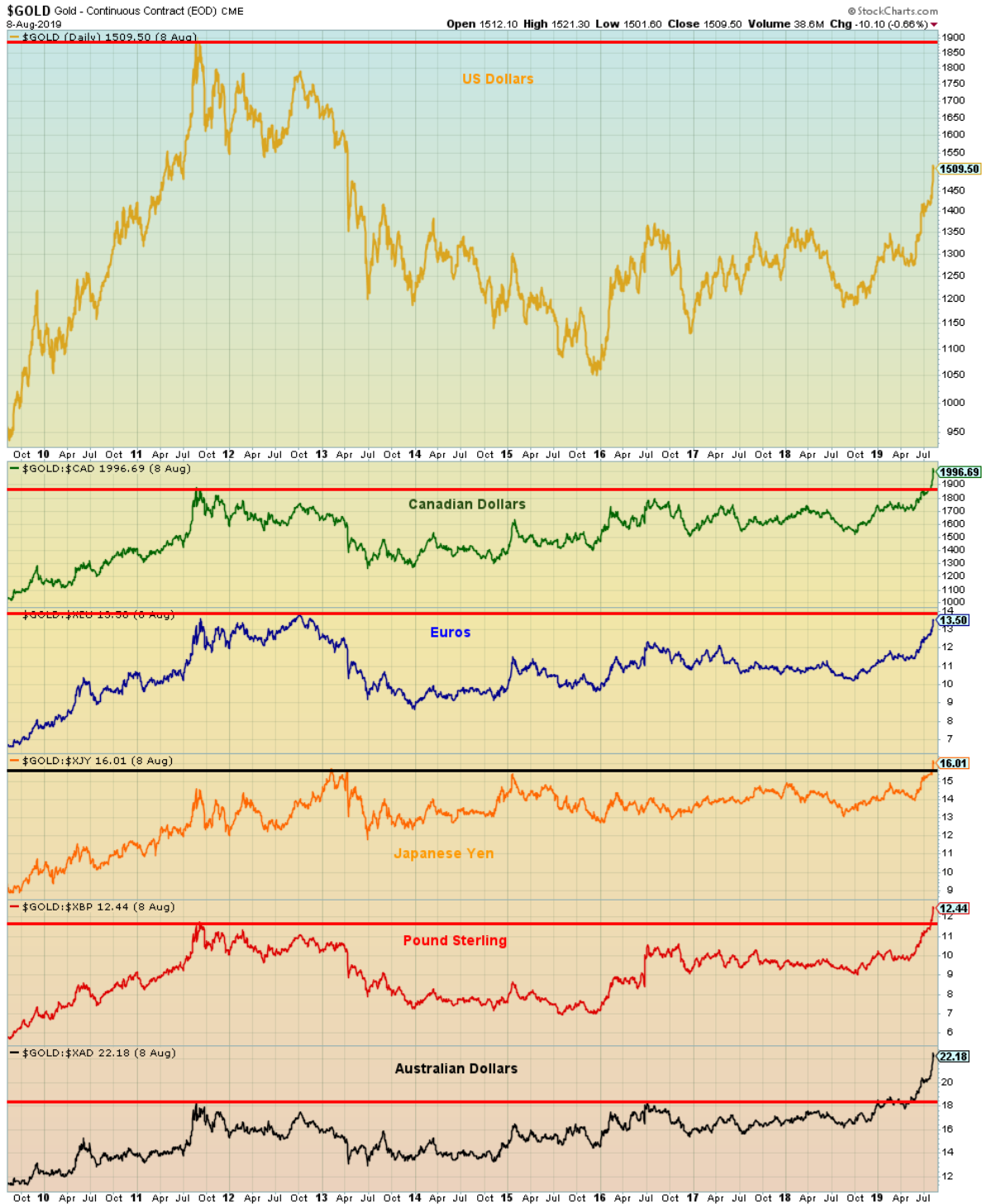


Source: www.stockcharts.com

Gold has broken out of a multi-year basing pattern. It formed what appears as a huge multi-year head and shoulders bottom pattern. The pattern has a projection to \$1,725. Gold fell for four years from 2011–2015, then based for another four years from 2015–2019. It is highly unlikely that this rally is three months and done. Gold's 23–25-year cycle low is not due until 2023–2025 based on the last major double low of 1999 and 2001. That cycle breaks down into three 7.6–7.8-year cycles. Again, based on the 1999–2001 double bottom low, the first low was seen in October 2008 and the second one in December 2015. That puts the current cycle on target for mid- to late-2023. In the interim, our targets could be seen as could sharply higher prices.

Gold is reacting to a breakdown in confidence of governments, central banks, and fiat currencies. The monthly RSI is over 70; however, that doesn't imply an imminent breakdown. For this current up-move, targets could be higher—closer to \$1,600 before a correction sets in. For gold stocks, the targets could also be sharply higher. Junior exploration stocks that primarily trade on the TSX Venture Exchange are just beginning to come to life.

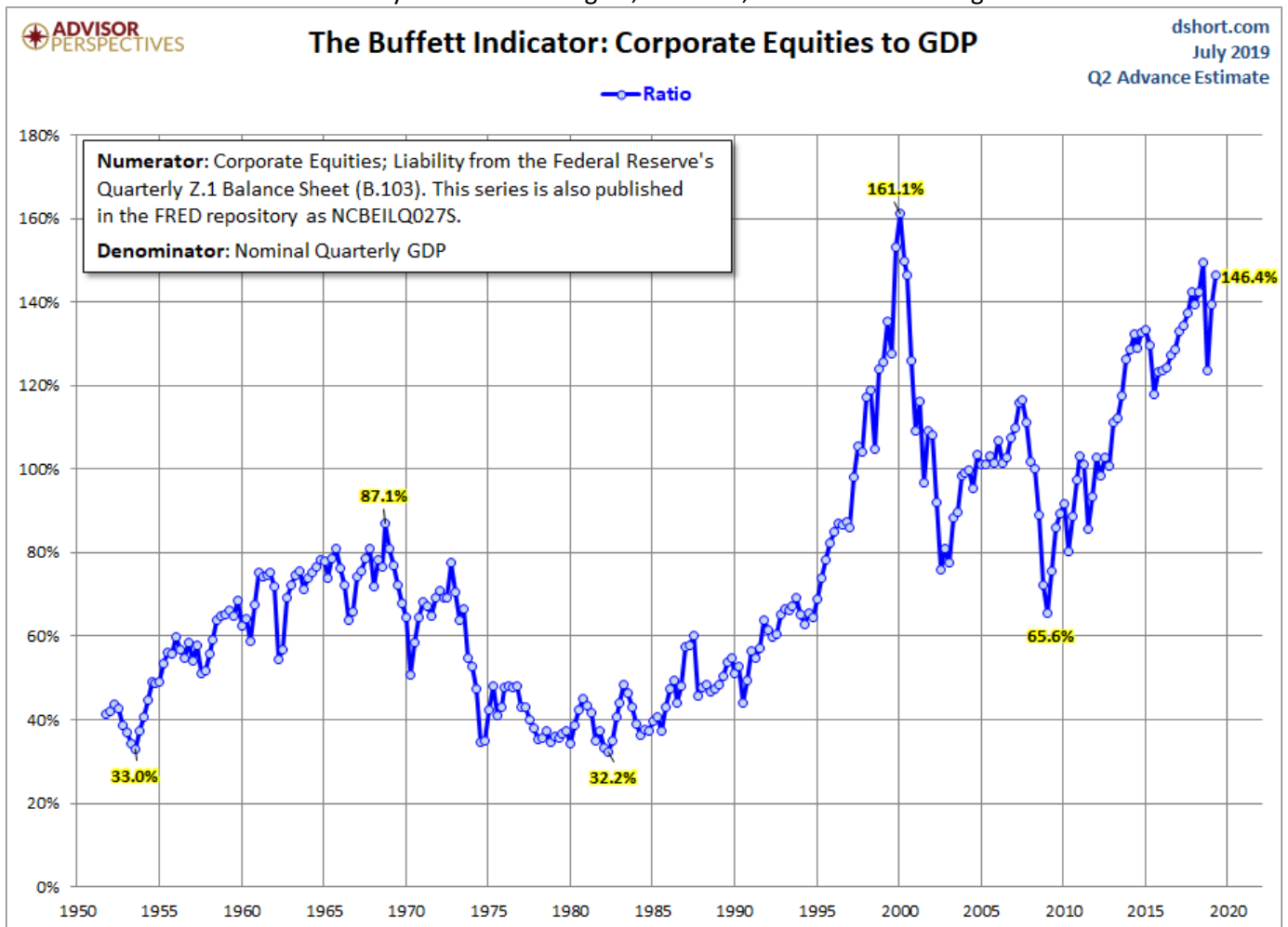
Chart of the Week: Gold in Currencies



Source: www.stockcharts.com

Could we see another 50% plus collapse in the stock market? The thought cannot be treated lightly. Since the world came off the gold standard, such as it was, in August 1971 we have come through five major recessions: 1973–1975, 1980–1982, 1990–1991, 2000–2002, and, 2007–2009. On three of those occasions the stock market fell 45% or more. A reminder that the past ten years have witnessed the most prolific growth in debt ever seen and the easiest monetary policy ever recorded. Yes, the stock market has done well, but is that because of fundamentals or is it because of massive liquidity (debt), capital inflows, and speculative bubbles?

The Buffett Indicator suggests that stocks have rarely been so overvalued. The Buffett Indicator measures the market cap of corporate equities to GDP (U.S.). At a current level of 146.4%, it is not far from the peak seen in 2000 at the height of the dot.com/high-tech bubble. The indicator was lower at the top of the housing bubble in 2007, yet the stock markets still fell over 50%. It took massive amounts of liquidity injections (quantitative easing) and massive amounts of debt to prevent what might have turned into another Great Depression. Keep in mind that this is an indicator only. It is not a sell signal; however, it would seem to urge caution.



Source: www.dshort.com

If one adds in inverting yield curves, negative yields on bonds, massive debt, rising gold prices (falling currencies), trade wars, sanctions, military maneuvering along the Russian border and the South and East China Seas, along with the negative effects of global warming, the potential for an accident is rising. It takes many years for a speculative bubble to build. It can be wiped out in a very short time. Bull markets can last for years. Bear markets can wipe you out in a couple of years. Since 1900, the average bull market has lasted 772 days but the average bear market is over in 422 days (Stock Trader's Almanac – 2019), with many bear markets being short, swift, and devastating.

The warning signs are there. But are they being heeded?

Quickie Market Update

It was a whipsaw week that saw stock markets fall sharply following the Chinese yuan devaluation, then come right back. The bounce-back has the look of corrective rebound. Stock markets, including the DJI, S&P 500, and NASDAQ ended the week testing the 50-day MA. Some indicators such as the VIX volatility indicator spiked, but are nowhere near levels that would indicate a low. The put/call ratio spiked to more puts than calls but before a low is seen it typically spends several weeks with an imbalance of puts to calls. The McClellan Summation Index (ratio-adjusted) (RSI) fell under 500 for the first time since June. The NYSE advance/decline line is turning down. Sentiment is no where near levels that would suggest a low. It is far too early to call a low and our suspicion is the snap-back seen this week is a “suckers” play to bring people back in. The TSX Composite outperformed this past week thanks to a strong up week for gold and mining stocks. The market doesn't get extremely dangerous until the June lows are taken out. For the S&P 500, that level is seen at 2,728. So far, the 200-day MA (2,792) has acted as support with the 50-day MA acting now as resistance (2,936). Short-term trends have turned down and the intermediate weekly trend is weakening.

Gold, silver, and the gold stocks as represented by the Gold Bugs Index (HUI) and the TSX Gold Index (TGD) all made new 52-week highs this past week. But a cautious note is the very high sentiment indicators that were well over 90% for both gold and silver and an 87.50 reading for the Gold Miners Bullish Percent Index. No, that is not at 100 that was seen at the top in July 2016, but it is in cautious territory, suggesting no new buying and selective profit-taking. The commercial COT for gold fell to 23%, the lowest level seen in months—striking another note of caution. We still have potential targets of up near \$1,580–\$1,600 for gold and up towards \$18 for silver before this market tops. Seasonals are also working against gold and silver, but once this period is over both tend to be strong from December to March when another leg up could get underway.

MARKETS AND TRENDS

% Gains (Losses)

Trends

	Close Dec 31/18	Close Aug 9/19	Week	YTD	Daily (Short Term)	Weekly (Intermediate)	Monthly (Long Term)
Stock Market Indices							
S&P 500	2,506.85	2,918.65	(0.5)%	16.4%	down	up	up (topping)
Dow Jones Industrials	23,327.46	26,287.44	(0.8)%	12.7%	down	up (weak)	up (topping)
Dow Jones Transports	9,170.40	10,207.21	(1.6)%	11.3%	down	neutral	up (topping)
NASDAQ	6,635.28	7,959.41	(0.6)%	20.0%	down	up	up (topping)
S&P/TSX Composite	14,322.86	16,341.34	0.4%	14.1%	down	up (weak)	up
S&P/TSX Venture (CDNX)	557.20	592.82	(0.5)%	6.4%	up	neutral	down
Russell 2000	1,348.56	1,513.04	(1.3)%	12.2%	down	neutral	up (weak, topping)
MSCI World Index	1,710.88	1,845.49	(1.1)%	7.9%	down	neutral	neutral
NYSE Bitcoin Index	3,769.99	11,722.50	10.3%	210.9%	up	up	up
Gold Mining Stock Indices							
Gold Bugs Index (HUI)	160.58	219.59 (new highs)	5.2%	36.8%	up	up	up
TSX Gold Index (TGD)	186.74	252.20 (new highs)	6.4%	35.1%	up	up	up
Fixed Income Yields/Spreads							
U.S. 10-Year Treasury yield	2.69	1.74 (new lows)	(6.5)%	(35.3)%			
Cdn. 10-Year Bond yield	1.96	1.26 (new lows)	(8.9)%	(35.7)%			
Recession Watch Spreads							
U.S. 2-year 10-year Treasury spread	0.21	0.11 (new lows)	(21.4)%	(47.6)%			
Cdn 2-year 10-year CGB spread	0.10	-0.11 (new lows)	(37.5)%	(210.0)%			
Currencies							
US\$ Index	95.73	97.32	(0.5)%	1.7%	up	up	up (weak)
Canadian \$	0.7350	0.7576	flat	3.1%	down	up (weak)	down (weak)
Euro	114.58	112.03	0.9%	(2.2)%	down (weak)	down	down (weak)
Swiss Franc	101.88	102.81	1.0%	0.9%	up	up	neutral
British Pound	127.50	120.35 (new lows)	(1.0)%	(5.6)%	down	down	down
Japanese Yen	91.24	94.69 (new highs)	0.9%	3.8%	up	up	up
Precious Metals							
Gold	1,281.30	1,508.50 (new highs)	3.5%	17.7%	up	up	up
Silver	15.54	16.93 (new highs)	4.1%	8.9%	up	up	neutral
Platinum	795.90	863.80	1.3%	8.5%	up	up	down
Base Metals							
Palladium	1,197.20	1,419.30	1.1%	18.6%	up	up	up
Copper	2.63	2.60.8	1.4%	(0.8)%	down	down	down (weak)
Energy							
WTI Oil	45.41	52.54	(5.6)%	15.7%	down	down (weak)	neutral
Natural Gas	2.94	2.12 (new lows)	flat	(27.9)%	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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