Patient Capital.... Positioned for Profit

A PEEK AT THE WEEK THAT WAS - October 5, 2013

"This would be a much better world if more married couples were as deeply in love as they are in debt."

- Earl Wilson -

Last week we looked (all too laboriously, as some readers rightfully suggested) at interest rates.

This week we will look at Mr. Market and try to determine where his frame of mind might be right now. In other words, we wonder if his formerly exuberant mood will return and continue or will he swing into one of his all too frequent manic depressive states.

In so doing, we will take a look at Mr. Market's behavior from past decades and try to determine if there is method to his madness...and if not method, then perhaps at least some rhythm. To do so, we will travel back to those halcyon days of rhythm itself...the 60s and 70s...specifically 1967 and 1972.

And for those readers who firmly believe that a picture is worth at least 10,000 of our words, we will try to include plenty of charts and a lot less words. At least we will promise to try...just like our politicians.

Speaking of which, this past week saw the shutdown of the US government and no one noticed, except the media. Over in Euroland, the Italian government didn't shut down...and no one noticed there either, including the media.

So much ho hum. Even Club S&P seems boring, despite Mr. Market's occasional gyrations. Ms. Bond is a bit quieter...for now. Dr. Copper is meandering along, while over at Bill Bullion's Gold Bar, the patrons are once again morose. It seems like even the cheap gold and silver cocktails that Bill is plying are not that appealing.

Maybe things will get a tad more interesting as the US debt ceiling deadline looms.

Does it strike anyone else that the whole concept of simply continuing to raise a debt ceiling that is already pushing $17 trillion is just a least bit silly? And does it seem prudent to run the world's most powerful country year after year without so much as a budget?

Imagine, if Joe and Jane Citizen simply conducted their lives that way? Every time they ran over budget, assuming they had one, they would simply apply for a larger limit on their credit card.

How long until their friendly banker cries..."no mas"?

But that is what our (currently non-operating) government does. Which might be fine, except that our so-called democratic government is really just a collective of Janes and Joes. It does not exist without the good Citizens funding it with taxes (with the inevitable over-spending being funded through the generosity of strangers). How long can we get away with it? Probably longer than most imagine but probably not forever.

On that note, our chart of the week (from our Friendly Fed) shows the recent parabolic rise in one particularly insidious form of debt...one that is likely to cause a lot of grief to its participants for decades to come.

Those who cannot remember the past are condemned to repeat it.

- George Santayana (1863 - 1952) -

The Life of Reason, Volume 1, 1905

With the markets stalling just a bit under the weight of the government shutdown and the diabolical debt ceiling, we think it might be time to take a stroll back in time. One thing we know for sure is that Mr. Market is a moody beast. He goes from euphoric to manic depressive to euphoric...sometimes in a day...but often for much longer periods.

From our "**history doesn't repeat but it often rhymes"** file, let's look back at the last secular bear market, which occurred from the mid 60s till the very early 80s. In this regard, we happen to agree with those who believe that we are currently in the midst of our very own secular bear market, which started with the tech crash of 2000. We all remember how much fun that was.

But hang on, what is a secular market anyway? And how is it different from a cyclical market?

In very simple terms, a secular market runs for an extended period (as in years or even decades), whereas a cyclical market tends to be shorter (from months to a year or two) and is tied to some business cycle or extraneous influence (Bartender Ben?). While you can have a cyclical market within a secular market, you can't have it the other way round. If you prefer visial explanations, you can click here for a very quick You Tube explanation.

Now take a look at the chart below, which maps out the various secular markets since 1929, As you will see, there have been four major secular markets, two bears and two bulls. We suspect that when we look back at this chart in 10 years time, we will be adding a fifth cycle...and it will be a bear.

Stock Market Returns (in percent)

Type of Market	1929-1999 Total Period	1929-1941 Secular Bear	1942-1965 Secular Bull	1966-1981 Secular Bear	1982-1999 Secular Bull
Length in Years	71 years	13 years	24 years	16 years	18 years
Annualized Return of S&P 500	10.6	(2.4)	15.7	6.0	18.5
Inflation Index (CPI)	3.3	(0.8)	3.1	7.0	3.3
S&P 500 Real Return	7.1	(1.6)	12.2	(0.9)	14.7

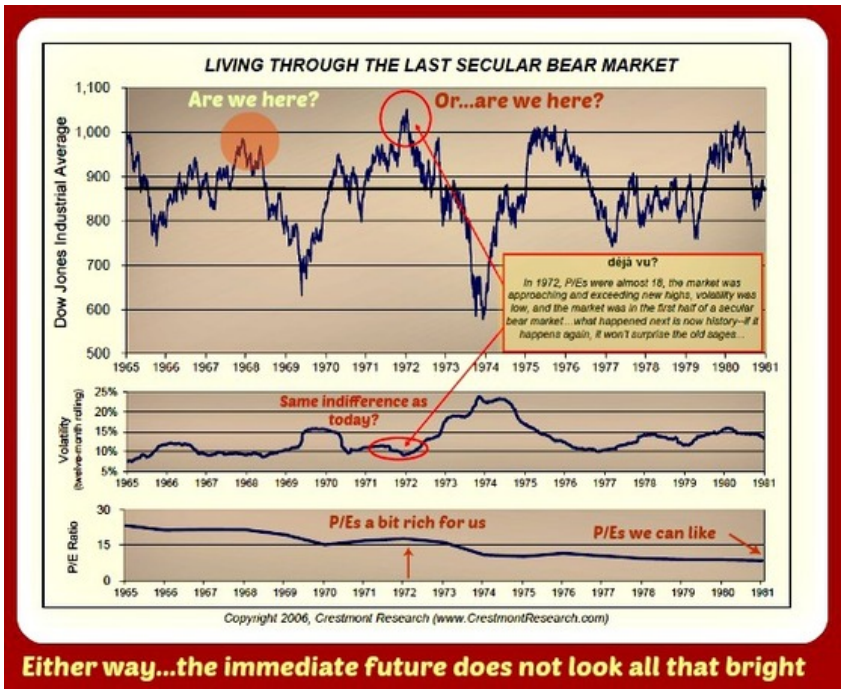
Now, take a look at the following chart which illustrates the last secular bear (highlighted above) in more graphic detail. This chart, along with a couple of others that follow, come courtesy of Ed Easterling and our friends at Crestmont Research.

The underlying chart and prescient "deja vu?" comments belong to Crestmont. The remaining wise cracks are ours.

If we are, in a way, reliving the last secular bear market, right now, are we replicating 1967 or 1972?

That's the problem with history rhyming. You're never sure which line of poetry or prose you are supposed to be on.

Let's try to find out. The crew at Crestmont clearly see us now replicating 1972. We seem to be at a peak. The volatility is virtually non-existent and the P/Es (Price Earnings Ratios) seem a bit rich.



And if you look at the following chart, also courtesy of Crestmont Research, you might be inclined to agree that we are **"deja vu 72"**.

And thinking back, we're reminded of what a year that was.

Roberta Flack's "The First Time I Saw Your Face" was top, followed by Gilbert O'Sullivan's (whatever happened to him) "Alone Again...Naturally" at #2 and Don McLean's classic "American Pie" at #3.

Such sensitive stuff. Just our cup of tea. Click here for the complete list of Billboard's top 100 songs, if you dare!

Those top three songs alone were probably enough to depress Mr. Market. And so, the market descended, dropping almost 50% between 72 and 74. Is that in store for us in our near future?

Certainly the folks at Crestmont believe that we are at the 1972 phase of the current secular bull...in other words, about half way through our travails. And likely due for a fall.

But LPL Financial Chief Strategist, Jeff Kleintop, in his Current Market Commentary (9/30/13) sees the current times akin to 1967, rather than 1972.

Ahh...1967.

Lulu's "To Sir With Love", the theme song to the movie of the same name starring the great Sir Sidney Poiter topped the list. "The Letter" (we like songs about love and determination) by the Box Tops was #2 with Bobbie Gentry's sultry "Ode to Billie Joe" rounding out the top 3. You can see Billboard's top 100 for 1967 by clicking here.

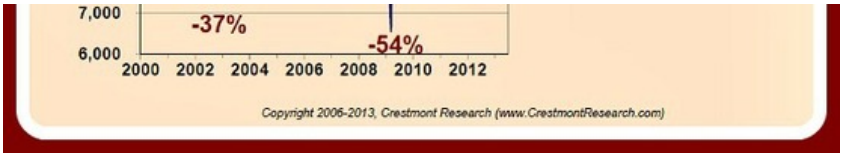
But beyond the music, the clever Mr. Kleintop found some rather startling historical similarities to our current year. For example, during that year...

- **Republican lawmakers voted down a debt ceiling increase (before they later passed it)**
- **Syria was involved in a war**
- **Bond yields rose (most notably from April to August when the 10-year Treasury note rose about one percentage point)**
- **Gross domestic project (GDP) averaged a lackluster 2%in the first half of the year**
- **Earnings per share growth for S&P 500 companies was roughly flat on a year-over-year basis**
- **The United States won the America's Cup with a sweep (over the Aussies, in fact)**

And if you look at the S&P performance between 1967 and 2013, the correlation is uncanny.

So, assuming you agree that we are somewhere within a secular bear market, is it 1967 or 1972? And does it matter anyway? The chart below...again from Crestmont Reseach...shows where we are so far...from 2000 to June 30, 2013.

And what a volatile ride it has been, with potentially more to come. Whether you agree that we are rhyming with 67 or 72, we suspect that the next major step is down.



Part of the reason for our reasoning is illustrated in our final chart on the subject below, which shows a particular technical pattern known affectionately as a **"Megaphone Top".** These charting patterns occur for stocks and markets frequently enough but this is one for the ages. For those interested, you can read more about this chart pattern by clicking here.

Notice in the highlighted circle in the top right hand corner that there is potentially more room for the market to go higher during this cycle. But also notice where the bottom blue line is pointing.

That's a long way down from the heady highs of the current market.

Can it happen? Sure, it's happened plenty of times before. Will it happen? Who knows. As John Maynard Keynes, the favorite father of money printers the world over, once noted...***"the market can remain irrational longer than you can remain solvent".***

With a view to remaining solvent, if not entirely rational, we would suggest keeping a handy amount of cash on hand just in case.

Next week, we'll start looking at some of the things that could send Mr. Market into a downward spiral...starting with that nasty modern phenomenon, **High Frequency Trading**. Will the mechanical tradiing wizardry be enough to set Mr. Market's head spinning...downward? We would have touched on it this week, but we are trying to hold to our promise to limit our words.

Stay tuned.

In these matters the only certainty is that nothing is certain.
- Pliny the Elder -
Roman scholar & scientist (23 AD - 79 AD)

From our **"living in the age of deception"** and **"don't believe everything you read"** files, comes this story out of Spain.

Apparently, some good news for a change. Their national debt is not **99.8%** of GDP after all. It's actually **98.9%** instead. A typo is apparently to blame for the erroneous number, which added approximately 10 billion euros to the Spaniard's bill. You can read the full report from the Pommie press here.

Wow...think about it...correct a typo...save 10 bill or so. Isn't it amazing what you can do with a keyboard these days. Just ask Bartender Ben.

And speaking of our favorite central banker and all the bright lights inside his brilliant cranium, we were reminded of the vulnerability of the US power grid, given that the 10th

anniversary of the last big blackout in August 2003 has just occurred.

From Time Magazine, August 13, 2013

> **10 Years After the Great Blackout, the Grid Is Stronger — but Vulnerable to Extreme Weather**
> *More than 50 million people throughout the Northeast lost power in the great blackout of 2003. Could it happen again to the grid?*
> Read more here and here.

Well, apparently, it costs about $1-5 billion to build a decent power plant these days...anything from natural gas to nuclear. Probably even cheaper for thermal...you know...to keep the environmental types happy.

So....just imagine if, instead of spending $85 billion a month on paper "assets" (treasuries, mortgage backed securities, etc.) Ben directed his magic money into building real stuff. Just one month's spending would buy Jane and Joe Citizen some 20 or more brand spanking new power plants. That's a lot of electricity.

Even a government economist knows that there is a direct correlation between energy availability and increased productivity. And think of the boost to the ecomony in construction employment and related goods and services. Seems like a no brainer to us.

Believe it or not, even Barackus Caesar could be on board (click here for proof).

Sadly of course, the EPA will never approve and Ben prefers paper to power anyway, believing as he does that paper IS power.

So it will never happen...at least until we have another one of those nasty blackouts.

In the meantime, keep those candles handy. There is always a perfectly good reason to light one and at some point, there may be many!



CHART OF THE WEEK

"Debt, n. An ingenious substitute for the chain and whip of the slavedriver."

- Ambrose Bierce -

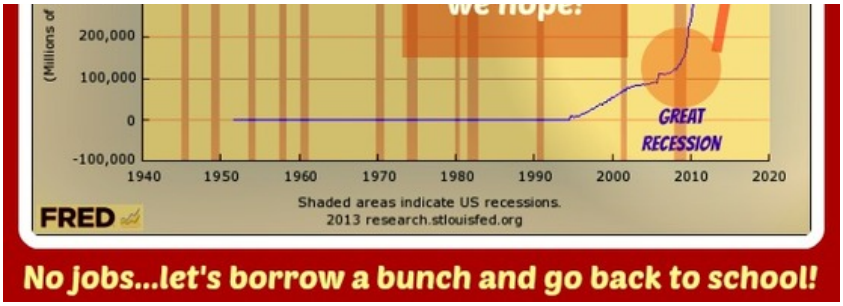
With the doomsday debt ceiling debacle descending devilishly deeper (forgive the unadulterated alliteration...we just couldn't help ourselves), we thought it timely to look once again at that evil son of subprime...student loans...about 1 trillion bucks worth of them.

Talk about shackling oneself to the yoke of debt in the name of "self improvement".

Well, that's what the nation's children and grandchildren have been doing with a passion since the mid-90s and exponentially since the so-called "Great Recession". The chart below illustrates this monumental increase all too clearly. Remember, these student loans are not readily dischargeable in bankruptcy so they will hobble the economic future of the bearers for years to come. Surely not a good thing...for them, or the economy. Heaven forbid, they may not even be able to afford Barry's Obamacare.

But don't worry...if you're bearing a heavy load of student loan liability AND you work for the Federal Government... you can apply for forgiveness of this debt...after 10 years or so. Just click here.

And we thought bonded servitude was a thing of the past.



Til next week...

"Ignorance is the curse of God. Knowledge is the wing wherewith we fly to Heaven."
William Shakespeare

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