Market Talk

Bell COMMODITIES

The global equities rally caught most by surprise with investors misjudging both its speed and its size. It can continue but not at this pace, it may be time for prices to retrace!

It's hard to believe that global equity markets sentiment could have gone from the depths of despair seven weeks ago, to near total euphoria in recent days. Very few, if indeed anyone, could have envisaged gains of between 16% and 30% in global equity markets over such a short time span.

One only has to rewind the clock back to the 9th of March 2009 to find most investors in a foetal position totally bewildered with the markets performance. Financial advisers were shell shocked, bunkered down trying hard to avoid the financial carnage. Many fund managers had reduced their exposure to equities to their lowest levels in years. The economic outlook was woeful.

Then, suddenly, without warning, equity markets around the globe started to rally. A silver lining seemed to appear out of the blue! Investors were at first sceptical, putting the rally down to the oversold condition of the market. The advance however gathered further upside momentum, buoyed by a spate of comforting stimulus comments from the US Government and a recovery in commodity prices. There were murmurs that the Chinese stimulation package was beginning to take effect as traders noted declining copper inventories out of European warehouses. Copper prices started running hot, prompting some market pundits to declare its proven historical record of signalling the start of an economic upturn. Soon the financial world seemed to be marching to a new creed. Words like "green shoots" and "improved risk appetite" started to echo in financial morning meetings around the globe.

So, what's changed?

In reality, nothing has changed! The current strength in global equity markets has been borne out of a change in perception more than anything else. America has decided to take a giant leap of faith, somehow convincing itself and the rest of the world that the economic glass is half full, rather than half empty.

A classic example of the glass half full phenomena was seen recently when it was leaked that Bank of America needed to raise $35 billion in new capital. The stock initially fell 11% on the rumour before mounting a 27% rally from its lows in the wake of confirmation. Now that's what I call one hell of a giant leap of faith!

Keeping the faith!

Similar positive reactions were seen on Wall Street during the corporate reporting season. Investors were very keen to put a positive spin on what really were some very ordinary results. It's clear that some analysts had profit forecasts at such low levels that "beating the street" was more easily achieved. This resulted often in stocks performing better than they really deserved. The next reporting season will be much more interesting as it will give us a much clearer insight into the real health of corporate America.

Talk about stress

The US Treasury department will no doubt be breathing a sigh of relief, having massaged itself through a self-inflicted torture session in its handling of banking stress tests. I'm not sure what was running through the minds of the US Treasury when they decided that stress testing the banks was a good idea. The general consensus is, however that they caused more harm than good. The stress test projected that 19 of the nations biggest banks could suffer losses of up to $599 billion through the end of next year if the economy does worse than expected.

They ordered 10 of them to raise a combined $74.6 billion in capital in order to create a cushion. The governments much-anticipated stress-test results unleashed a scramble by the weakest banks to find money and a push by the strongest ones to escape the government shadow of taxpayer-funded rescues.

Fed Watch and Economic Outlook

Recent comments by Fed chief Ben Bernanke indicate that he expects economic activity to bottom out in the next few months then to turn up later this year. It worries me that one of the key elements of this forecast is the assessment that the housing market is beginning to stabilise and that the sharp inventory liquidation that has been in progress will slow over the next few quarters. In my opinion there is nothing concrete to suggest the housing market is in any way near bottoming. Indeed that latest data showed that US Median House Sale Prices fell 14% in the March quarter.

Mr Bernanke also pointed out that a sustained recovery in economic activity depends critically on restoring stability to the financial system. In my opinion, the banking system is still very fragile and while conditions in a number of financial markets have improved in recent weeks, there is still a long way to go before banks and financial institutions are back to some semblance of what we used to call normality. It's clear the system remains under considerable stress as cumulative declines in asset prices, tight credit conditions, and high levels of risk aversion continue to weigh on the economy.

The Government is depending heavily on its massive fiscal and monetary stimulus to turn the economy around. The Fed Chief has stated that an "important caveat" in his forecast is the assumption of a gradual repair of the financial system. That's why it's so imperative that the banks start lending. The system will remain grid locked unless loans are made and funds start flowing between banks and other financial institutions. Mr. Bernanke has warned that a relapse in financial conditions would be a significant drag on economic activity and could cause the incipient recovery to stall.

Wall Street needs to take a breather

The Dow Jones Index has rallied from 6547 on the 9th of March 2009 all the way to 8574 on the 8th of May 2009. The move represents a staggering 2027 points or 31% gain in the index over 44 working days. The speed and magnitude of the rise, while very impressive, does not, in my opinion reflect the true economic state of the US economy. The US economy is still clearly in recession and the fundamentals suggest it will be a long road to recovery. The idea that the worst is over is flawed in my estimation. This type of reasoning works on the premise that the US Federal Reserve and US Treasury department are making all the right moves. One only has to look back over the past twelve months to recognise their track record suggests otherwise.

The Dow Jones Index

Technical Comment

Support = 7,800 and 7,429

Last = 8,284

Resistance 8,600 and 9,078

The Dow Jones Index has recently tested the main downtrend line set at 8,500 before easing back from that level. Coincidently the 200-day moving average sits above the market 8,952. The Index has had a strong rally over the past couple of months and now needs to consolidate these gains with some back filling. Support should be encountered at the 7,800 area and fresh buyers would be expected on any pullback towards that level. A close above 8,600 would be required to signal the market's intention to make the next move higher and ultimately test the 9,100 level and above. The next month should be more interesting from a trader's perspective. Bigger picture players will be happy to observe and await developments.

Commodity markets rock and roll!

Commodity prices have risen across the boards since my last comments with both hard and soft commodities racking up gains in excess of 20% in some cases. Copper and crude oil prices have led the advance as sentiment improved on the Chinese economic outlook. China is reported to be stockpiling a large range of commodities as their 4 trillion Yuan (US $585 billion) stimulus package gets into full swing. A sharply lower Greenback has also played a big hand in the overall gain in commodity prices. The CRB Index remains the best gauge to monitor where prices are likely to go for the remainder of 2009.

CRB Index

Technical Comment

Support = 229.36 and 208.00

Last = 240.82

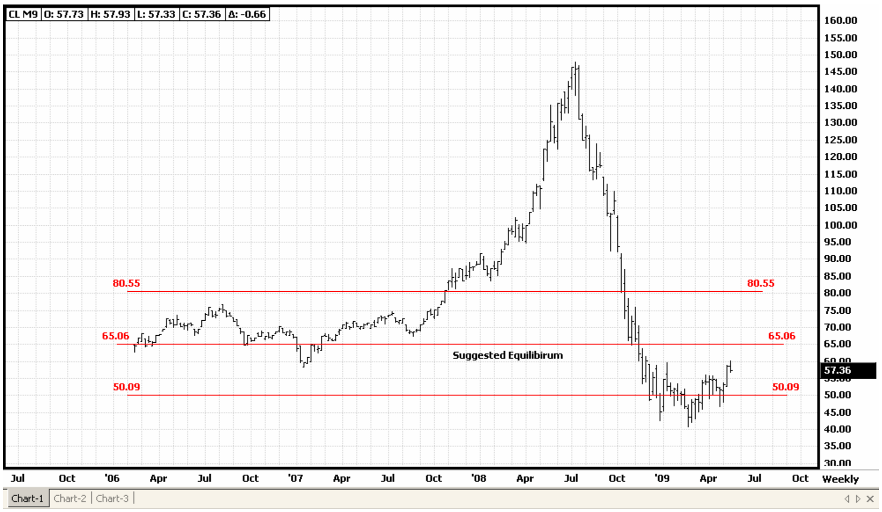
Resistance 244.38 and 280.00

The CRB Index has moved sharply higher over the past month breaking through the 229.36 resistance area and testing the early January 2009 highs of 244.38. The Index really needs to spend a period of time consolidating these good gains. A pullback towards 229.00 would be viewed as healthy and would provide a buying opportunity for those who missed the boat first time around. The technical picture will become much more positive and exciting if the Index can close above the 244.00 level conclusively in the next few months. A weekly close much above 244.00 would convince many investors to be on board all commodities as it will set the stage for much higher levels.

Crude oil moves towards a Goldilocks price!

The crude oil price has had a rollercoaster ride over the past year having hit US$150.00 a barrel in July 2008 only to plummet to US$32.00 a barrel six months later. The crude oil price found a base over the past couple of months and the fundamentals are starting to see supply and demand come together. OPEC have steered a very interesting course recently watching supply curbs for full compliance from members while keeping a low profile. The next few months will be very important for OPEC as they try to find that elusive “fair value” for crude oil. They must be careful not to tighten the supply factor in order to achieve what it considers a higher than fair price. They will be mindful that if they push prices too high it will jeopardize any chance of a global economic recovery. I remain of the view that crude oil prices will find equilibrium somewhere around US$65 a barrel over time.

Crude Oil



Technical comment

Support = $56.00 and $52.00

Last = $57.36

Resistance = $60.00 and $65.00

The crude oil price is currently trying to complete a bottoming out process that started late in December 2008 and has taken nearly five months to come to fruition. The price will find support at $56.00 a barrel on the downside and further technical support set at $52.00 a barrel. Resistance is now likely to be encountered at $65.00 a barrel and above. The overall trend has now reverted to the upside and buying weakness below $56.00 down to $52.00 a barrel is the suggested trading strategy. The price is on target for a test of $65.00 a barrel over the next couple of months.

Gold seems confused but still stacks up

The gold price has gone everywhere yet nowhere since my last comment. The price seems to swing either side of **US$900** an ounce at this point. The yellow metal it seems, is suffering an identity problem with conflicting signals causing the price to mark time. Put simply, the gold price does not know if it's Arthur or Martha.

In the past the price has firmed during periods of uncertainty, with the so-called "fear factor" the driving force. This element has disappeared over the past couple of months as the so-called increase in "risk appetite" has offset this activity. The overall fundamentals are also at odds, with investment demand on the increase while jewellery demand seems to be waning.

Then there are those constant rumours that keep resurfacing that the IMF may need to sell part of its stockpile in gold due to the global monetary crisis. The IMF last year approved the sale of 403 tonnes of gold from its stocks of 3,217 tonnes (103.4 million ounces) as part of a plan to put its finances on a sounder footing and create an endowment with the proceeds. Then there are the offsetting rumours regarding China's central bank buying gold. The picture was clarified lately with Hu Xiaolian, Head of the State Administration of Foreign Exchange (SAFE) saying that the country's gold reserves had risen by 454 tonnes from 600 tonnes since 2003, when China last adjusted its State gold reserves figure. Whether more such purchases are in the offing, only time will tell.

The Inflation clock is ticking

Inflationary fears maybe currently on the back burner as the current harsh economic climate keeps the beast at bay. It's a negative for gold at this point and yet another reason why some investors may be looking elsewhere for returns. I am sticking with my opinion however, that gold has the potential to become explosive to the upside at any time going forward from here. The inflationary risk pressures from the massive global monetary stimulus makes gold a must for every serious investors portfolio.

Gold

Technical comment

Support = $860 and $845

Last = $924.45

Resistance = $933 and $980

The gold price has spent the past month marking time with the key supports set at US$860 and again at US$845 an ounce remaining intact. The price does not seem to spend much time below the US$900 level despite having had a couple of forays below that area. The technical picture will remain positive as long as prices remain above the US$860 level. Only a weekly close below US$845 an ounce would be cause for concern. A close back above the US$933 level would be viewed as constructive and this would set the stage for a second and more powerful assault on the physiological US$1,000 an level and ultimately the all time highs of US$1032 and higher.

Buying Treasury securities sinks the US Dollar

The US Dollar has recently lost a significant amount of the dominance it had gained, post the 16th of July 2009. A review of the Greenback's action shows that the USD strength slowed in late November 2008. The Greenback then entered a choppy trading period thought January and February 2009.

The tide turned suddenly on the 18th of March 2009 when the Federal Reserve surprised everyone, announcing it would buy $300 billion in longer-term Treasury securities over the next six months.

The news sent the Treasury market wild, 10 year notes fell 50bps to 2.52% as policy makers said they would expand asset purchases to include U.S. government debt. The Fed's actions jolted the currency markets and sent the USD into a tailspin. The USD has not been able to recover since, making the Fed's move look more and more like a "game changer".

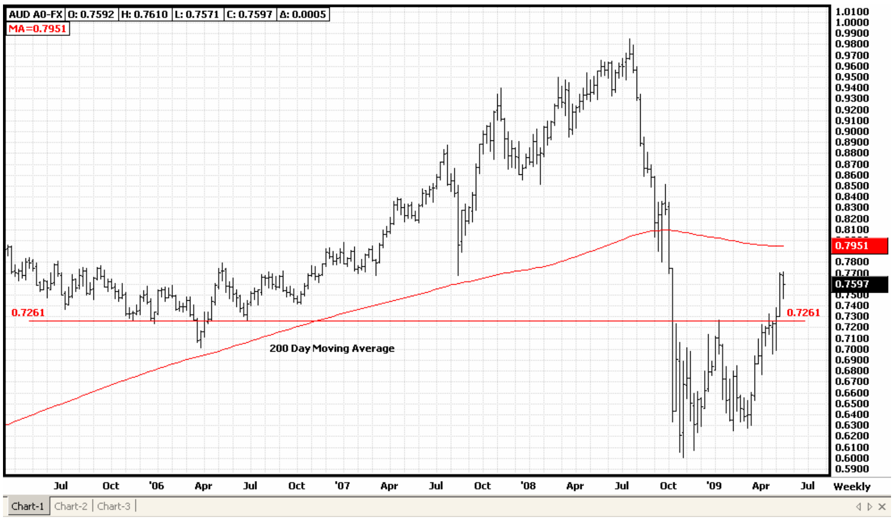
The world must be starting to consider the consequences of the huge deficit spending and money-printing operations that the Obama government administration is using to fund its bailouts of Wall Street and major banks.

Surely these policies raise questions about the value of the US Dollar. Commentators are in particular pondering the desirability and implications of a diminished international role for the American currency.

GO AUSSIE GO!

The AUD has performed brilliantly since my last comments, having started Feb 2009 at 0.6300 and is currently trading around 0.7600. That's a staggering 21% gain in just over three months by the little Aussie battler. The general weakness of the USD has combined with rising commodity prices and has helped the AUD to outperform most other currencies. The AUD is likely to continue to rise in the medium term in my opinion, buoyed in particular by that renewed Chinese demand for Australian hard and soft commodities. I would not be surprised if the AUD was to trade as high as the 0.8200 levels before the end of 2009.

The Australian Dollar

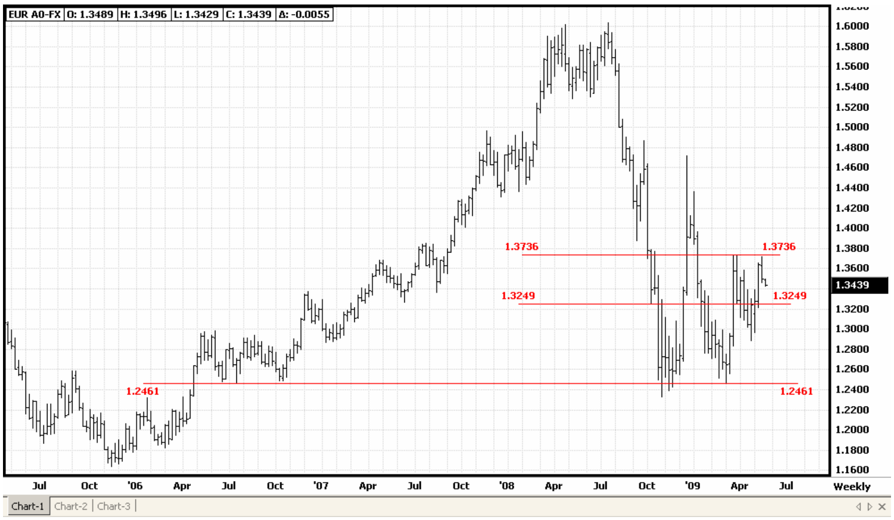


Technical comment

Support = 0.7261 and 0.7000
Last = 0.7597
Resistance = 0.7718 and 0.7803

The AUD finally broke through the key resistance set at 0.7261 turning the technical outlook very positive in the process. The path is now clear for a longer-term assault on the 0.8200 levels, perhaps by the end of 2009.
The AUD will now find support is located at 0.7261 and again at 0.7000.
Only a weekly close below 0.7261 would be viewed as cause for alarm.

The Euro



Technical comment

Support = 1.3249 and 1.2860
Last = 1.3439
Resistance = 1.3736 and 1.4400

The Euro is currently trying to erode the supply set at 1.3700 and above. This area of resistance may prove hard to penetrate in the medium-term. A weekly close above the 1.3800 levels would be viewed as very constructive and signal the start of the next major advance. Support is clearly set at 1.3249 and again at 1.2860. Would expect fresh buying to emerge towards the 1.3249 levels.
The Euro would need to move back below 1.3000 to raise the alarm to lower levels.

Bond yields set to rise

The Federal Reserve realise that rate cuts are no longer an option, so Bernanke & Co. have embarked on a massive plan to buy up mortgage-backed securities, agency debt, and Treasuries to boost the economy

The U.S. Federal Reserves plan is to buy more than $1 trillion in debt to help unfreeze the credit markets. This however will act to effectively cap U.S. Treasury yields and undermined the US dollar in the process. The move has already caused commodities to soar as currency speculators and safe-haven investors head for higher ground.

The 18th of March 2009 decision by the Committee to purchase up to $300 billion of longer-term Treasury securities over the next six months caught everyone by surprise. The Fed's move was clearly a lot more aggressive than usual, suggesting the announcement may have been a desperate attempt to instill confidence in the markets and loosen credit for consumers and businesses. Interestingly, the Fed had previously suggested that there was no need for them to buy Treasuries since there was a strong market for them already.

So! What's the message?

I strongly suspect that investor demand is not as strong as the Fed would have us believe. In fact investors and foreign governments may well be getting out of the U.S. dollar and looking for other assets to put their money into. In essence, the Fed have had to step up to the plate to buy Treasuries.

In order to acquire these bonds, the Fed will print more money to make the purchases. Consequently, the more bonds the Fed buys, the less they are worth. The Fed printing money to purchase Treasury bonds must in my opinion end up being detrimental to the value of the US dollar and ultimately trigger inflation. The Fed may well need to keep rates low for some time yet, however yields will need to rise in the next twelve months as the Fed start to mop up the excess cash associated with its massive stimulus package.

US 10-year Note Yields

Technical comment

Support = 2.50% then 2.00%

Last = 3.12%

Resistance = 3.24% then 3.50%

The 10-year Bond yield has moved up significantly over the past eight weeks. The yield is now working towards a test of the key supply, which is set between 3.25% and 3.50%. A weekly close above 3.50% would be required in order to suggest a trend change is in play. I suspect that the 3.25% and 3.50% levels will prove hard to erode and some time will be required in order to erode that supply. Meanwhile dips towards the 2.50% will attract fresh buyers.

The Bottom Line -----the right strategy!

The recent strong gains on Wall Street and other global equity markets while very impressive, do not in my opinion correlate with the overall state of the global economy. There is not enough factual evidence to indicate the worst is over and an economic recovery is at hand.

The recent robust rally in equities is the equivalent of an athlete having suffered a couple of heart attacks, leaving hospital and suddenly starting the Boston marathon by running the first 500 metres at a sprint. It's clear that this pace cannot possibly be maintained and will surely end in the patient collapsing if he does not slow up. Global equity markets must slow down and consolidate their recent gains. If markets keep going at the current pace they will most assuredly fall over.

The **Dow Jones Index** has bottomed for the time being and the recent rally is now very over extended. I expect the Dow Jones Index to pullback over the next month before embarking on a second wave higher taking it towards **9,600** over time.

The **ASX 200** Index nearly achieved my end of **2009** target of **4,000** several months early. I would like to see the index pullback towards **3,500** over the next couple of months before working higher for a new target of **4,200** before the end of **2009**.

The recent **USD** action suggests the Greenback may be in for a period of pressure. I would recommend building a core long position in the Euro on a scale down basis to **1.3000** looking for a rise to **1.5000** over time.

I'm still very keen on the Australian Dollar. It's had a huge run from my recommend buying level of **0.6500** levels. I would continue to buy the AUD on any weakness towards **0.7300** in the medium term. My longer-term target is **0.8200** possibly by the end of **2009.**

I remain very bullish on gold in the long-term, however the price may well work lower in the short-term. I'm happy to accumulate gold futures on any pullbacks towards **US$845** an ounce. Crude oil has run ahead and is now overbought. I would be happy to recommend buying crude oil on any weakness towards **US$53.00** a barrel. Copper has run well above my target levels and is also overbought. I'm looking for copper to pullback towards **180.00** in the next couple of months.

Regards,

Kevin Mc Kay.

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Sources:

CNBC]

MBCNY Research Bureau

Reuters

Futures Source charts

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