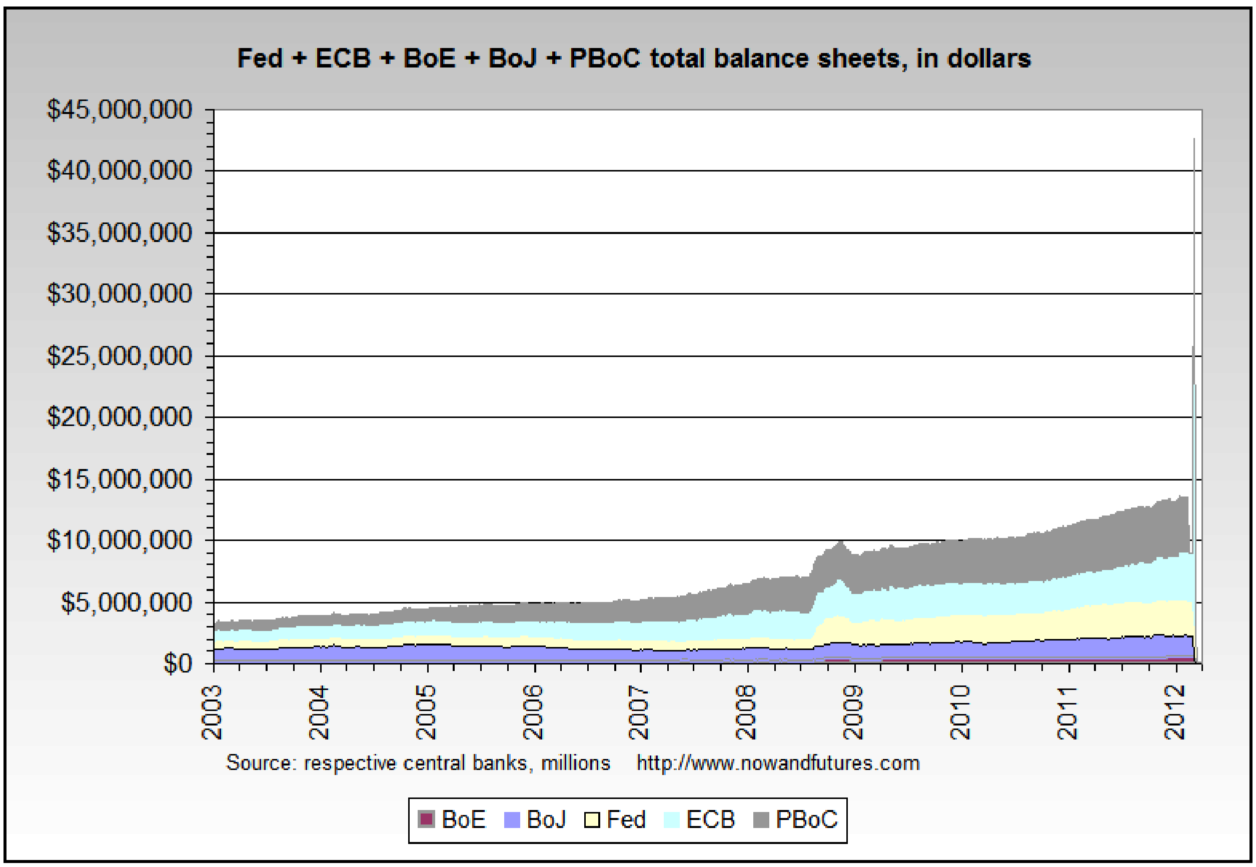
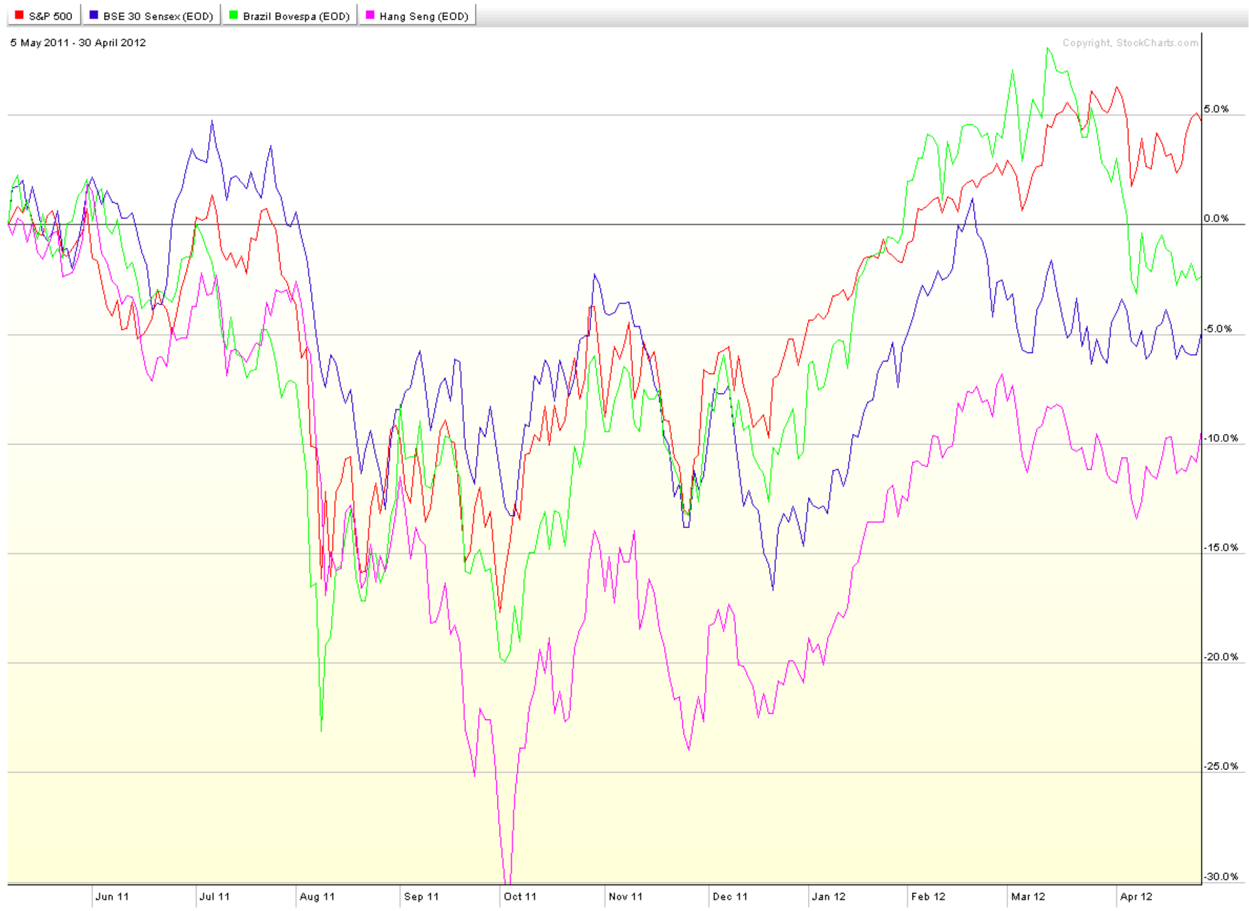
May 2012

Charting the Markets

The last few years have been very trying for investors. 2010 saw the S&P 500 peak at 1220 and crash to 1011 by July 1st. Money printing 2.0 caused an enormous rally and the S&P 500 then peaked again on May 3, 2011 at 1370 for the "Bin Laden Rally." August of 2011 produced a crash that sent us to 1101 on August 9. As I write the S&P 500 has recovered to 1415 after a huge rally since the October 4th lows. As can be seen by the chart below, the central banks have massively expanded their balance sheets since the 2008 crisis. This money printing causes price increases in assets, consumer goods, art, and metals. The difficult job for the investor is determining which asset prices will be inflated by all of the money printing.



Central Bank Balance Sheets, Source: www.nowandfutures.com



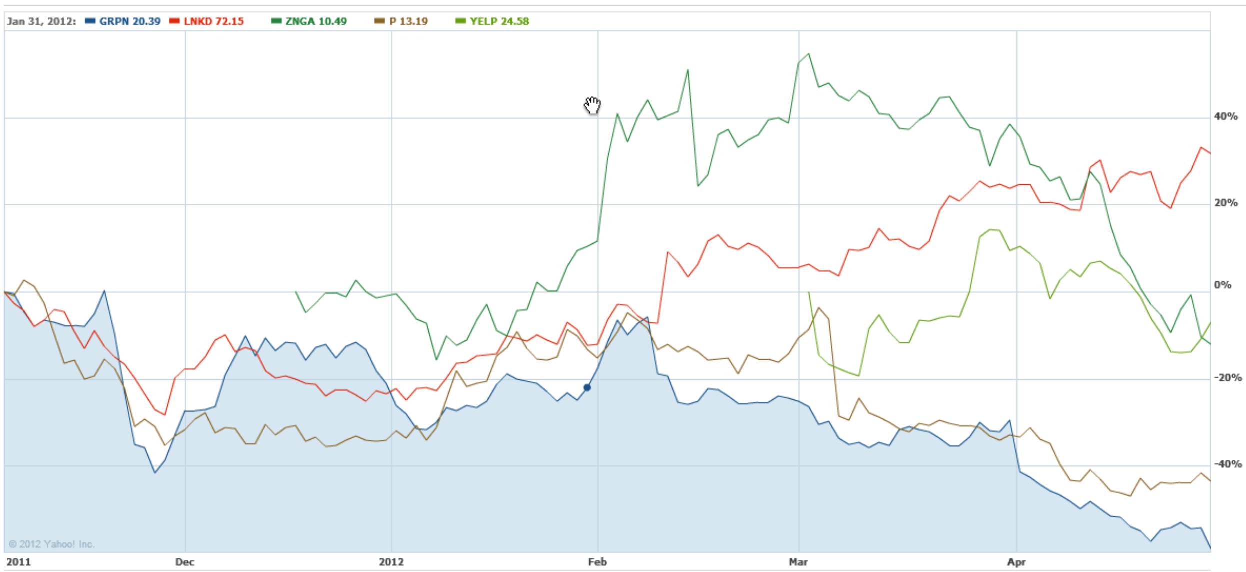
US (red), India (blue), Brazil (green), and China (pink) stock markets since May 5, 2011. Source: www.StockCharts.com

The US has been the best major stock market to own recently. As you can see by the above chart listening to the news about how Asian and Brazil are inevitably going to take over the United States has been hazardous to your wealth over the last year. How many investors were able to weather that 30% drawdown on the Hang Seng to boot?

At 1415, the S&P 500 is less than 10% from its March of 2000 high of 1553, but according to the Leuthold Group if we have averaged 2.5% inflation for the last 12 years, the inflation adjusted high for the S&P 500 is 2009! This means that the stock market still needs to go up 42% for investors to be "back to even" defined by the purchasing power they had back in 2000 when the dollar was actually a strong currency.

In October of 2000 it only cost a US Dollar holder .82 to buy a Euro. Since then, the Euro has soared 61% against the dollar to 1.32 dollars for a Euro. As an aside, I just saw a friend of mine from high school who lives in England. We went out to eat and he said the bill for four people is what it costs for one person in London to eat. Long live the United States Peso!

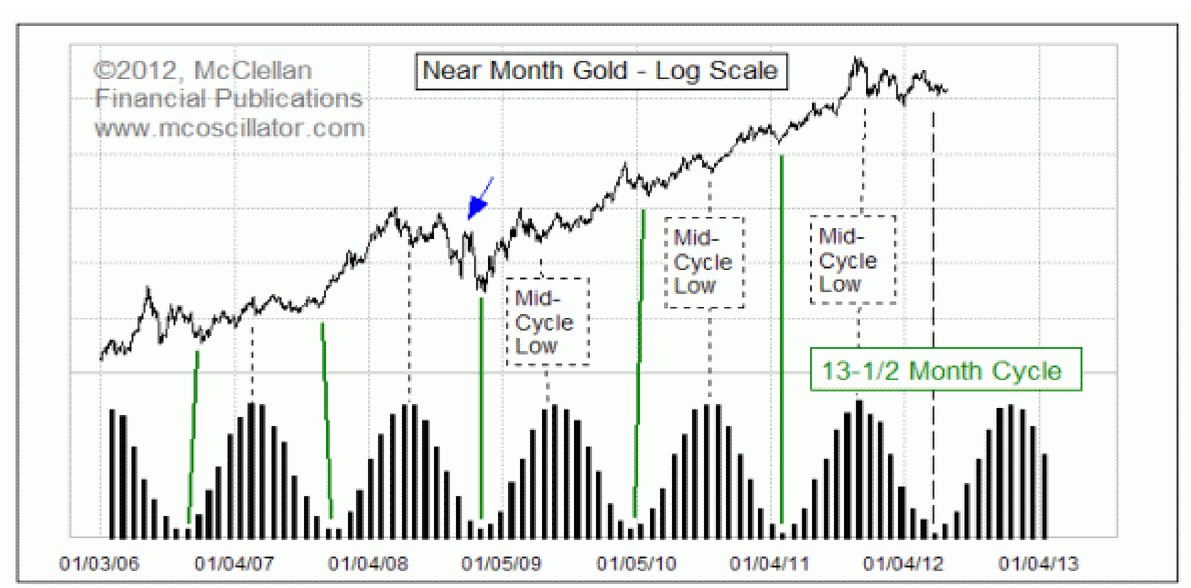
The Web 2.0 has created some great companies that have made the world a more fun place (even though my wife cheats at Words with Friends). Unfortunately for investors the initial public offerings have been a good way for the founders, early investors, and Wall Street firms to unload their shares at the highest prices they could get.



Groupon (blue), LinkedIn Corp (red), Zynga, Inc (green), Pandora (brown), Yelp (light green) over the last 6 months. Source: Yahoo! Finance

Investors have joked that Groupon is having a 60% off Groupon for its own stock that is down 60% since its IPO. LinkedIn is the only one of the five companies that is up over the last six months. Whether or not the facebook IPO can reverse this trend remains to be seen.

When I think money printing, I always think of gold. It is clear that investors got too excited about gold last September and it dropped about $400 into its December 2011 low. Since then it has been consolidating around $1,650 per ounce. According to Tom McClellen, gold tends to put in a major low every 13.5 months (plus or minus a month). April fourth could be a major low in gold and I would not be surprised if we made a new all time high for gold in 2013.



The 13.5 month gold cycle. Source: McClellan Financial Publications

So will "Sell in May and go away" work as well as it did the last two years? I actually doubt it because it appears to me that too many people are tuned into the strategy's recent relevant success. The markets tend to inflict the maximum amount of pain to bulls and bears and a third year seems to easy to me. Many markets have participated in a 2-2.5 month consolidation and are no longer medium term overbought. It also seems to me that Bernanke has learned that when he stops the printing presses there is a large "air pocket" under markets. He may be more careful this time so close to the election.

The counter argument to that is in 2008 everybody said that the Fed/congress would be able to keep the stock market together until the election. Despite the easy monetary policies and stimulus we still saw a major crash in September/October 2008. Markets>policy makers. Have a wonderful month.

Domestique Capital LLC
4601 Old Shepard Place
Ste. 117
Plano, TX 75093
214.556.8904 phone
www.domestiquecap.com