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Market Update: 5-20-15

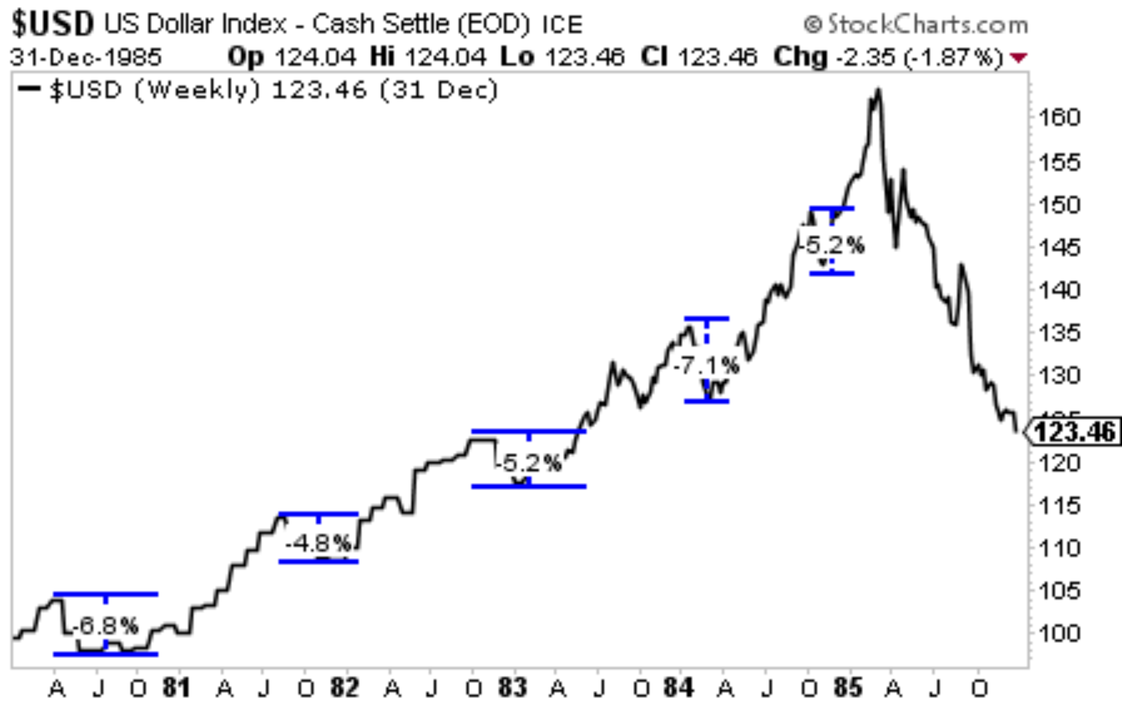
The larger story for the investment world remains the US Dollar.

The US Dollar rally took a breather starting in late February 2015. Since that time, it has corrected a total of 7.2%. Technically this isn't even a correction (it would need to fall 10%) and it's far from entering a bear market (it would need to fall 20%).

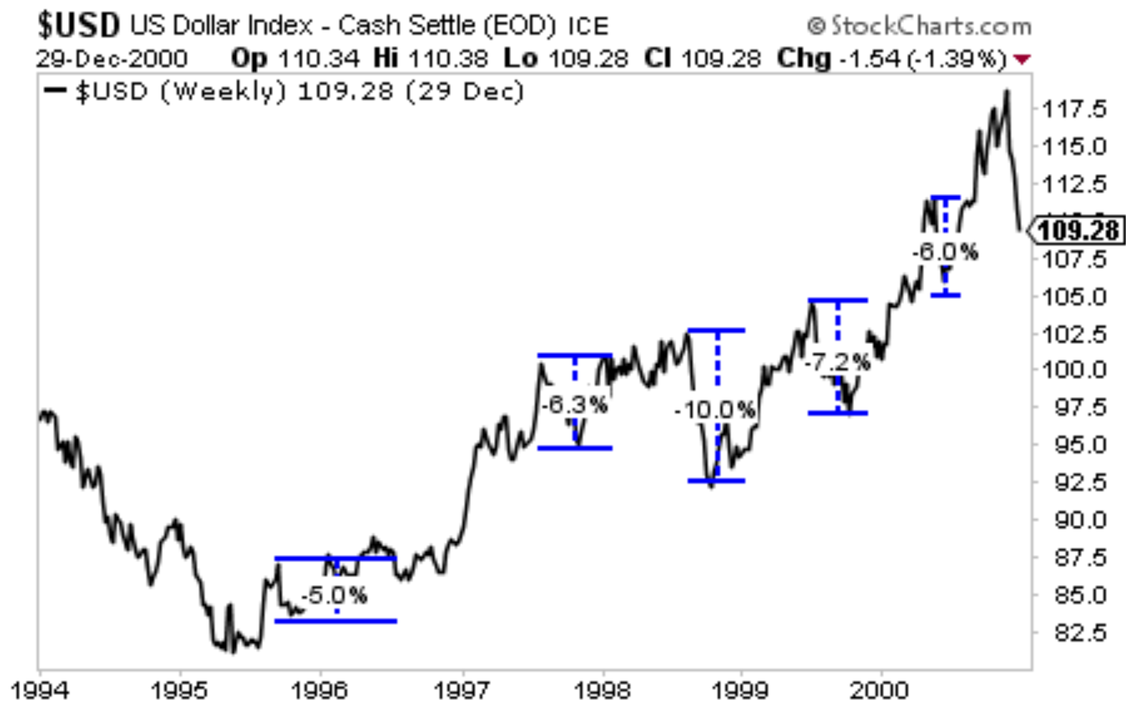
In spite of this… the financial media is trumpeting that the bull market in the US Dollar is over. I think they are grossly underestimating what is happening in the US Dollar.

First of all, during the last two US Dollar bull markets (the early '80s and the late '90s) the Dollar had no shortage of 5%+ corrections.

Here's the Dollar bull market of the early '80s.



Here's the US Dollar bull market of the late '90s. Again there are five corrections of 5% or more.



My point is that 5%+ corrections are normal during US Dollar bull markets. Remember, the greenback rallied over 25% before starting this cool down period. So it was due for a pull back.

Moreover, in the BIG PICTURE, this correction has not violated the larger technical pattern we've been following in the US Dollar in any way:

This is the single most important chart in the investment world. It is the largest bullish falling wedge pattern **in fiat money history**. And we've broken out of it to the upside.

If you want to think of this in terms of macro-economics… think of it this way: since the US abandoned the Gold standard via Breton Woods, it has been in an ongoing process of devaluing the US Dollar while issuing paper debt/ credit.

When you borrow in US Dollars, you are effectively shorting US Dollars. So the entire Credit Super Cycle of the last forty years has seen the financial system become increasingly leveraged at the expense of the US Dollar.

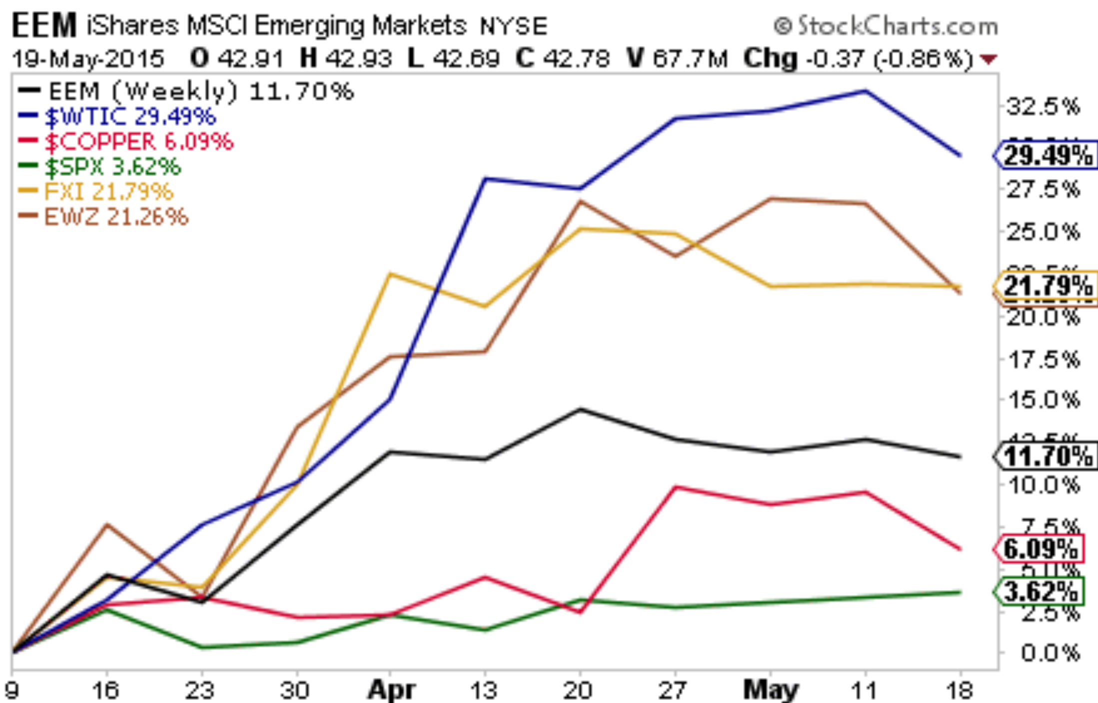
I believe that the above chart is telling us that this Super Cycle of leveraging is ending. **This means that we are entering a period of DE-leveraging.**

This period will be marked by defaults and debt restructurings. **Both of those processes reduce the number of US Dollars in circulation**. This is especially true when you consider that there are over $9 trillion in the US Dollar carry trade currently (this doesn't include US Dollar denominated bonds or credit instruments…

simply US Dollars that have been borrowed and invested in other financial securities).

With that in mind, the hype surrounding the US Dollar's recent correction is overblown. Being long the US Dollar was the most crowded trade in the world at the beginning of this correction… so it's not surprising that the correction has been sharp.

The US Dollar rally peaked on March 13 2015. Since that time, risk assets have exploded higher with Oil and the Emerging Markets (particularly Brazil and China) rallying over 20%. Emerging markets as a whole are up 11% over the time period. Copper is up 6%. Indeed, the only real laggard has been US stocks that are up a measly 3.6%.



The size of these moves tells us that the majority of investors still don't understand the risks that the US Dollar bull market poses to the financial system. A 29% rally in Oil over the course of two months is not normal by any stretch of the imagination.

As soon as the US Dollar begins to rally again, these trends will reverse… **violently**. At that point I expect we'll see an absolute collapse in the commodity space.

By the look of things, this has already begun. The US Dollar has *just* reclaimed former support:

Oil's already due for a sharp correction based on this recent US Dollar strength. Below is a chart showing Oil against an inverted chart of the US Dollar chart (so if the US Dollar strengthens, the blue line falls).

You'll note the US Dollar has lead Oil (meaning if the Dollar strengthens… Oil collapses).

Based on this, Oil is due to break below the mid-40s per barrel. I think we could easily go even lower than this.

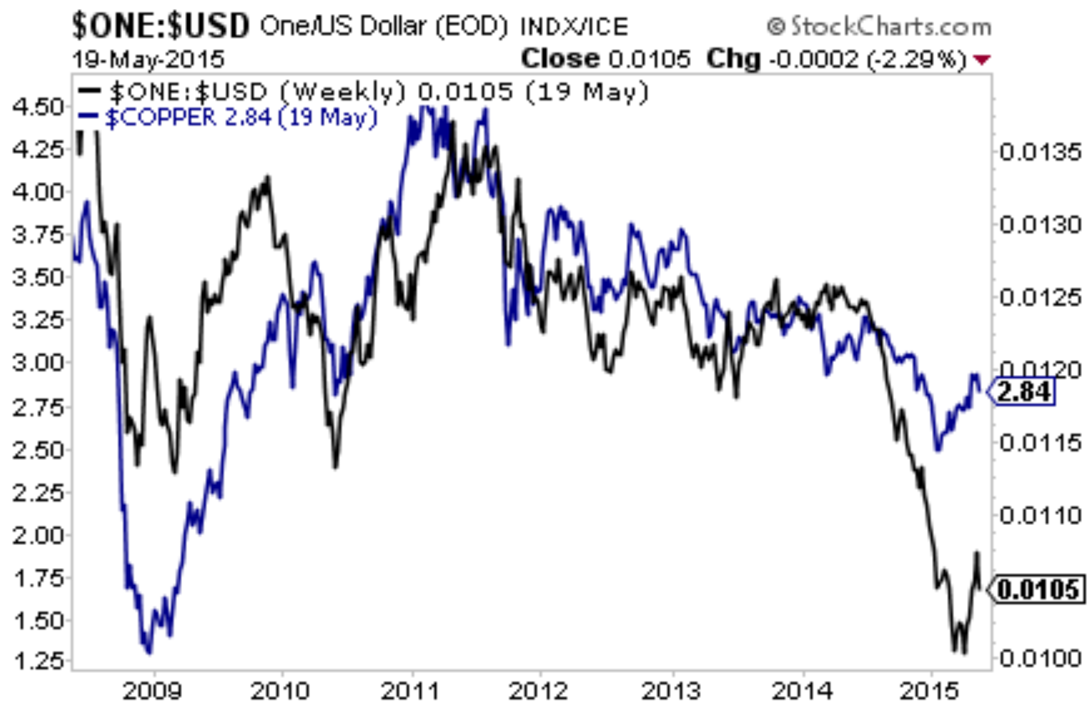
With that in mind, we're closing out several of our Oil/Energy Plays.

Action to Take: Sell the BP Prudhoe Bay Royalty Trust (BPT).

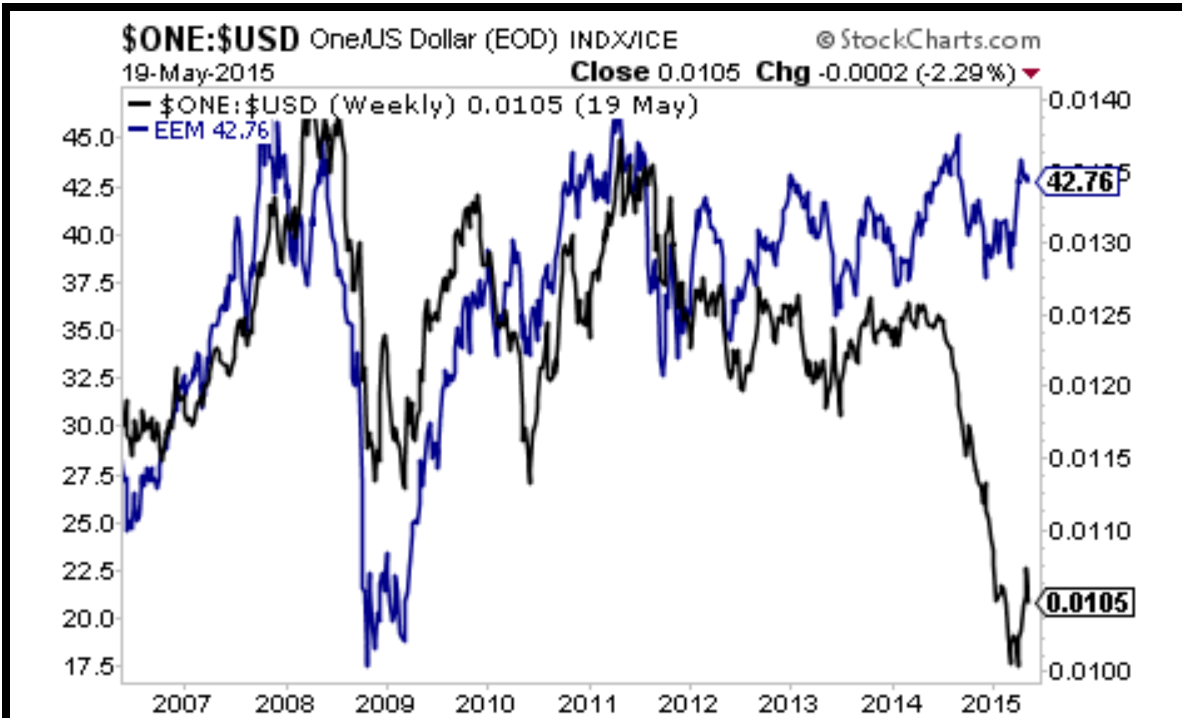
Action to Take: Sell the Conoco-Phillips (COP).

Action to Take: Sell the Russia ETF (TRF).

Oil is not the only asset class at risk of a sharp correction due to the US Dollar's strength. Copper has a LONG ways to go to close the gap:



The same goes for Emerging Markets:



US stocks will not be immune either. During the last two US Dollar bull markets stocks fell over 20%. This time will be no different.

Indeed, I believe this current breakout is the "last hurrah" for stocks.

While the S&P 500 as a whole hit a new high, the market technical are showing serious deterioration:

1) This most recent new high occurred when less than 60% of stocks were above their 50-DMAs. This is the narrowest run to new highs since 2007.

2) Some 18% of S&P 1500 stocks are down over 20% (H/T Walter Murphy).

3) Tobin's Q is at its third highest reading in history (more on this in a moment).

Moreover, the economy is worsening again… at a time when the Fed is tightening or preparing to tighten (any rate hike will kick the economy off a cliff).

1) The Retail Sector (ex-Drug stores) just posted the first decline in Same Store Sales since 2009.

2) Wal-Mart (the largest retailer in the US and a close proxy for the economy) just posted its first drop in Same Store Sales since 2009.

3) US Corporates just posted their drop in Annual Sales since 2009.

None of these are stock positive. If anything it looks like we are putting in a final top before the inevitable correction begins. By the look of things, we could see more than a correction (10%) we could see a full-scale collapse of 60%+.

Tobin's Q measures the value of stocks against the replacement value of their assets (replacement value is how much it would cost to make the same asset). Today stocks are priced 10% above their replacement costs.

Stocks have only been this overvalued twice in history: 1929 and 1999. Both times they were in massive bubbles that saw them lose 60%+ of their value in the next two years. This time will be no different… it's just a matter of waiting for the top to complete.

In conclusion: this move in risk assets that started mid-March was a response to the US Dollar correcting. With the US Dollar now beginning to show strength again, this trend will reverse.

With that in mind I believe we'll see Commodities and the Emerging Market space plunge in the coming weeks.

We're exiting most of our Energy Plays in anticipation of this.

And if we do find that Emerging Markets roll over, we'll be adding to the following positions to average in better entry points:

1) **China Real Estate ETF (TAO)**

2) **UltraShort Nikkei (EWV)**

3) **UltraShort Emerging Markets ETF (EEV)**

4) **UltraShort China ETF (FXP)**

DO NOT add to these positions yet. I'll send out an alert when it's time to do so.

This concludes this week's market update.

I'm watching the markets closely and will issue updates as needed. Barring any new developments you'll hear from me next week in our longer monthly issue of ***Private Wealth Advisory***.

Until then…
Best Regards

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