Bill Gary's

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Selective Recovery Ahead?

In the November 1 issue of *Price Perceptions*, I wrote about a discussion with my old friend, Cy Fox. The point of discussion was how quickly the "real" economy collapsed following the 1929 market crash. The article also pointed out while most people think the 1929 low occurred in October, it actually occurred during the second week of November. From there, it advanced 52% into mid-April before beginning the final phase of the bear market. Following the rally into April 1930, it fell another 86% to a final low in July 1932.

Equity markets have followed a similar path to 1929 this year. However, the Treasury and Federal Reserve have many more tools at their disposal today to fight deflation than during that time period. Regardless of today's dissimilarities, there are reasons to believe markets could follow a similar pathway into 2009…

The US is the world's largest debtor nation. We are dependent on foreign capital to fund the current massive bailout programs. However, England and many other European nations are also dependent on foreign capital for their bailout programs. Therefore, there is a high probability that long-term interest rates will rise and the value of the dollar will fall as these programs are funded in months ahead. The first inkling of higher interest rates came with this week's announcement by American Express and Citigroup to increase interest rates on credit card holders. A move away from the dollar was also signaled by this week's Chinese announcement they would begin diversifying their foreign exchange reserves by buying gold.

As the dollar falls in value, it could once again ignite a recovery in commodities as well as stocks. In the next move to safety of capital, investors are likely to favor stocks and commodities over dollars invested in treasury notes and bonds. After all, what are the prospects the US will ever pay back its debts with a strong currency? This line of thinking could produce a recovery into 2009 similar to the one experienced in 1930.

Conventional wisdom tells us stock market bottoms occur about six months before the economy turns around. If this general belief holds true, stocks and commodity markets could recovery in months ahead even though the "real" economy continues to sink. Following several months of market recovery, it will then become a function of the marketplace to determine whether or not the "real" economy is beginning to improve. If improvement is not apparent, then markets could begin the second phase of deflation, similar to the 1930-33 pattern.

If markets are to follow a similar pathway in the next few months, subscribers should consider selling short the dollar index and US bonds. Gold, grains and petroleum products could recovery during this time period. However, commodities closest to the consumer, such as cattle, hogs, sugar and lumber may falter as the "real"economy struggles.

These have been difficult times for some traders as deflationary economic forces have overridden fundamentals. However, we believe volatility may subside in weeks and months ahead with some markets moving into a recovery mode. We are moving away from a short only trading posture in selected markets.

Bill Gary