CLEARVIEW INVESTMENT PARTNERS

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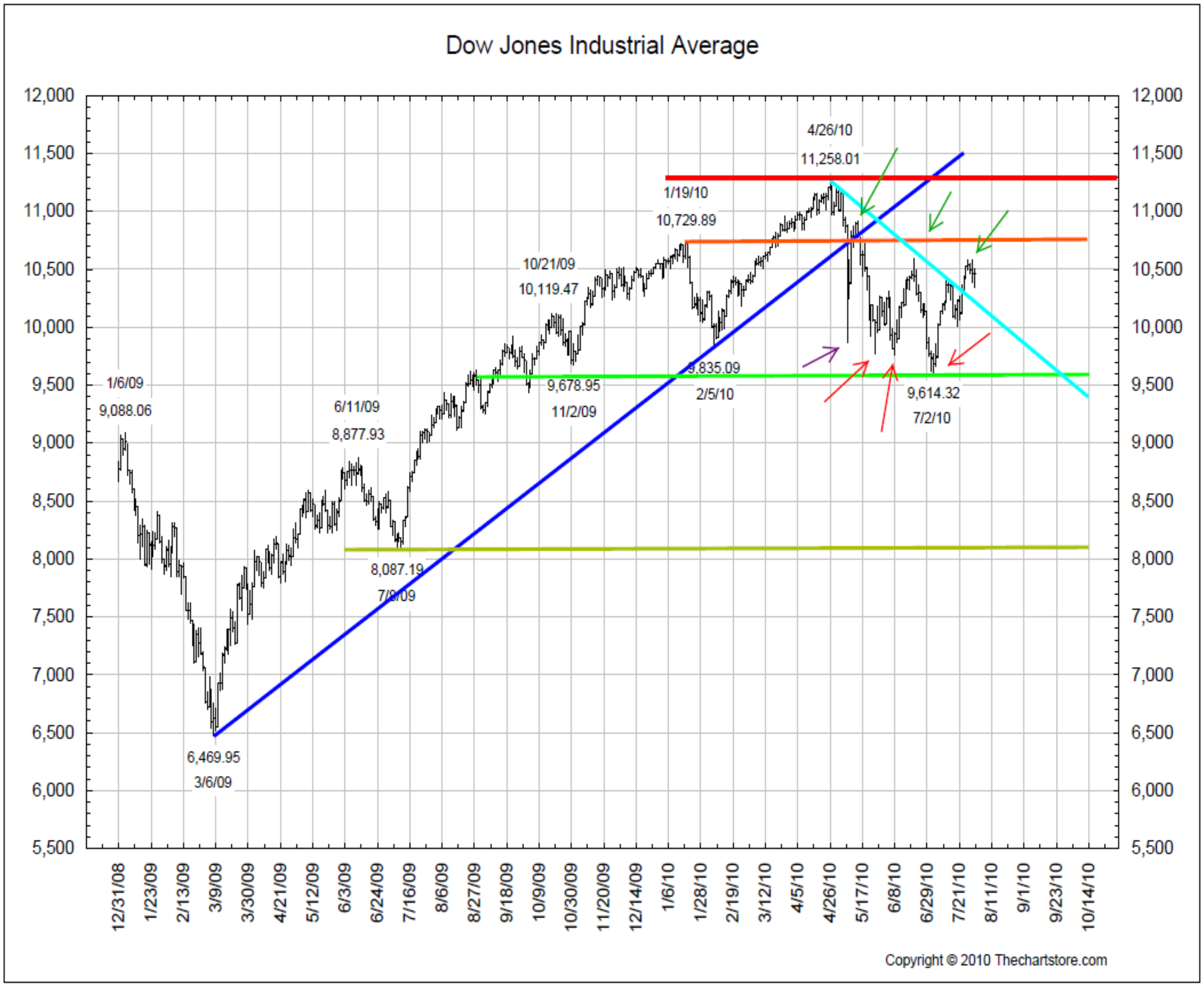
Tech Spotlight

Sometimes technical analysis can seem repetitive and so very, very slow to unfold (the following adjectives may also apply – boring, frustrating, exciting as watching paint dry, feel free to add to the list …). And so it is the case at the current time. Here is where it can seem repetitive - in January, the stock and commodity markets sold off (about 10%) on increasing trading volume. After bottoming in February, the markets began to slowly grind upward on low volume trading for about two and one-half months. In early May, the markets returned to higher volume and volatility as the markets sold off very quickly, again, this time in the neighborhood of 15%, depending on the index you are looking at. After bottoming on July 1st or 2nd, the markets have begun to rally once more and this time on even lower volume than in March and April. Sell-offs on higher volume and rallies on low volume are a classic bearish sign. The May sell-off resulted in the stock averages breaking down below the trend line drawn from the March 2009 market bottom (discussed in the June issue) and, despite the market rally since July 1st, we are still below the point where we, technically speaking, would be more comfortable and confident in a rising market. As mentioned in June as well as February, the question repeatedly remains, "what will the follow-through be on the change in trend?"

Given the break in trend line and the "classic bearish sign" mentioned above, one might be inclined to see that the markets are rolling over and are at the beginning of a much more significant correction. I fall into this camp. But, please remember, as I remind myself, Technical Analysis is not a black box that spits out answers of what is definitively going to happen in the future. It is a tool best used at providing signposts along the way that can give indications of whether a trend is staying in place or whether it may be changing. Combined with Fundamental Analysis, we can have more confidence in the trends that we see or the changes in trend that we may come to see and whether they are either shorter-term or longer-term in nature than they may initially, and sometimes frustratingly, appear.

After looking at a chart of the Dow Jones 30, we'll look at some charts of commodities, including gold, oil and commodities in general.

Data as of July 30, 2010



DJIA – Intermediate-Term Chart

The plunge in the various market indices on May 6 (see purple arrow in the above chart) caused some technical damage to the intermediate-term chart of the DJIA by breaking an uptrend line that had been in place since the market bottom in March of 2009. The plunge was initially explained as a “fat finger” sell mistake on one individual trader’s order entry computer. With the immediate market rally, this initial assessment appeared plausible to many people. However, since that quick and short rally, the market has three times broken down through the level reached on May 6 (red arrows), indicating more fundamental concerns with the economy than the “temporary after effects” of an accidental large sell order by one trader. Instead, we now see a short-term picture of lower highs (green arrows) and lower lows (purple and red arrows) – another bearish sign. We need to see the DJIA first rally through the light-blue short-term downtrend line (which happened last week) and then get significantly through the June 21 high of 10,594 and the January 19th high of 10,730 before we can say the short-term downtrend has changed back upwards.

If the DJIA falls below the most recent "lower low" of 9,614, then we expect the markets to continue correcting down more significantly to eventually probe the 8,100 level on the DJIA.

Data as of July 2010

Above is a chart of Gold that we originally printed back in January of this year. To repeat, after a long move down from Gold's peak of $850 in 1980, Gold bottomed around $252 in 1999 and then broke out of a sideways trading range in early 2002 (red arrow) at $300 per ounce and took off in an assault on the old 1980 high. So, it is obvious that the longer-term trend for Gold is still up. But remember, assets never move straight up or straight down, they appear to surge up or down like the tides. So while Gold has had a big move from approximately $700 (in October of 2008) to over $1260 earlier this month, it may be getting ready to rest a little before continuing its upward trend. Based on the above chart, it is possible for Gold to "correct" all the way down to $650 (purple arrow) while still maintaining its longer-term uptrend.

But first, we must see if Gold is, indeed, getting ready for a short-term correction. One way to tell is to look at a shorter-term chart of the price of Gold. Please consider the chart shown below where I use a chart of the Gold ETF (GLD) as a proxy for Gold (the GLD ETF approximates roughly one tenth of the price of Gold). As you can see, Gold has been trading in an upwardly trending channel for almost two years since its last price "correction" between March and October of 2008 when Gold "rested" after running up to a little over a $1,000 in March and correcting down to almost $700 in October. If the GLD (and by decree, Gold) were to break down below the channel shown below (around $1150, red arrow) and stay below the lower solid blue trend line we would expect Gold to begin a more serious correction downward before resuming its longer-term uptrend. I would expect to see Gold trade down to somewhere between $650 and $900 if the channel is significantly broken. Breaking below $650 would be an indication that the longer-term trend for Gold was changing. This does not currently appear likely, but it is a "signpost" to be watched.

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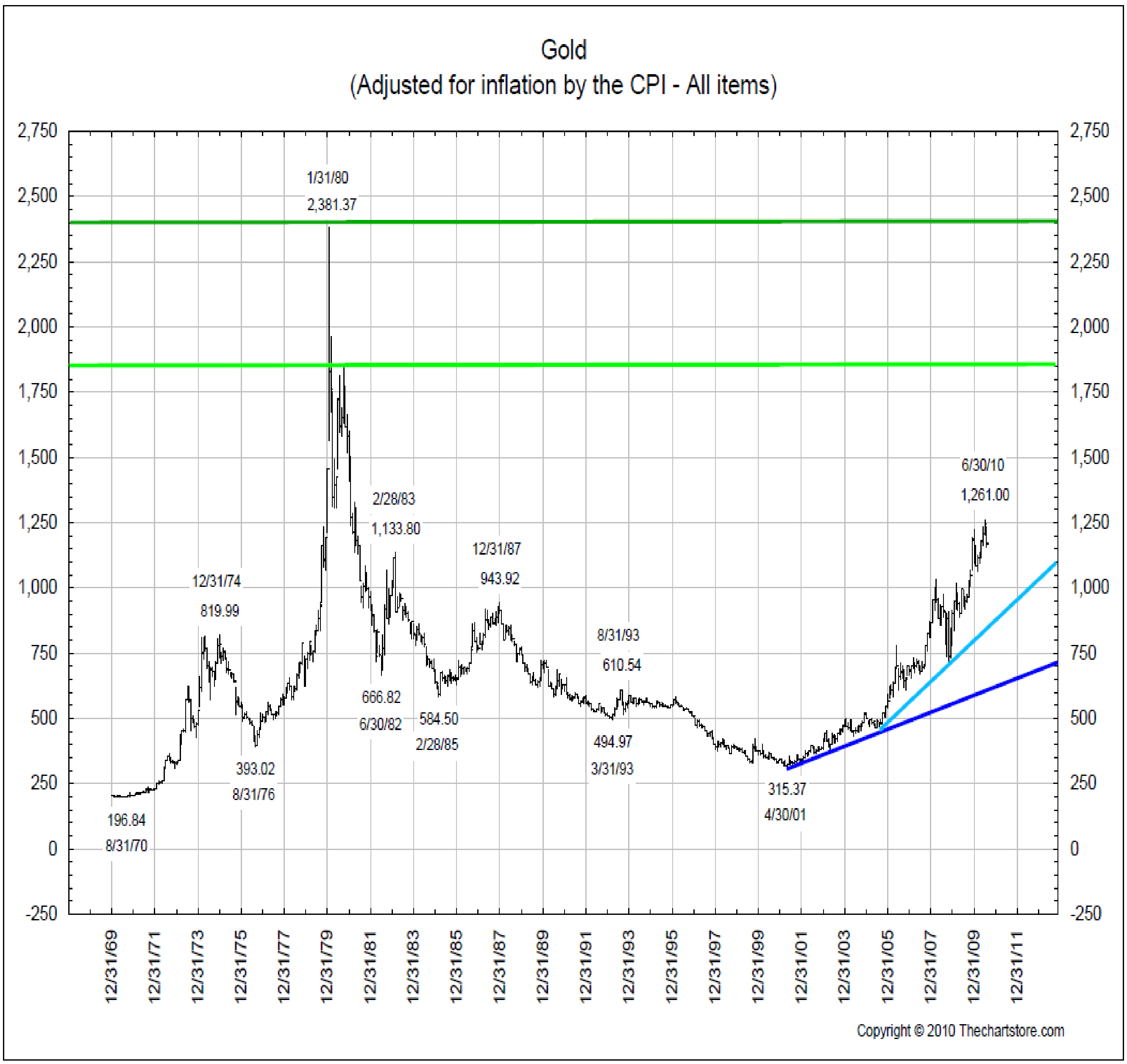
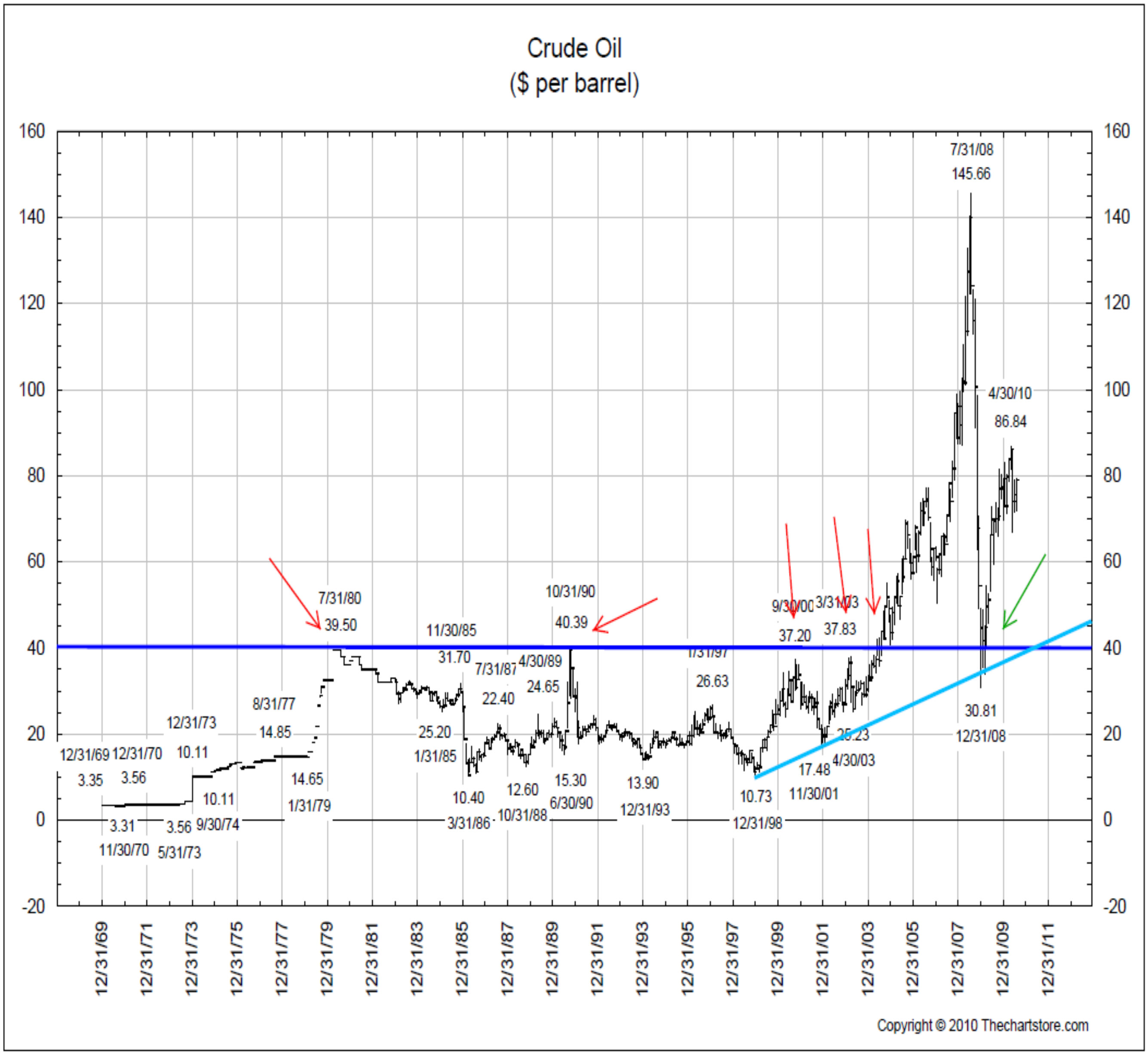
Assuming the longer-term trend line is not broken and that Gold were to continue upward after whatever rest may come, just where might the price of Gold eventually rise to? Well, one way to consider this is to look back at the price of Gold after it is adjusted for inflation. Shown below is the price of Gold adjusted for inflation going back to 1970. As you can see, when adjusted for inflation, Gold has not even come close to the value it reached back in 1980. Consequently, it is possible that we could see Gold approach $2,500 and even higher if it were to rise parabolically like it did in 1980. At the least, we should see Gold eventually head up to $1,850 at some point in the years ahead, again, assuming its longer-term uptrend stays intact.

Data as of July 2010



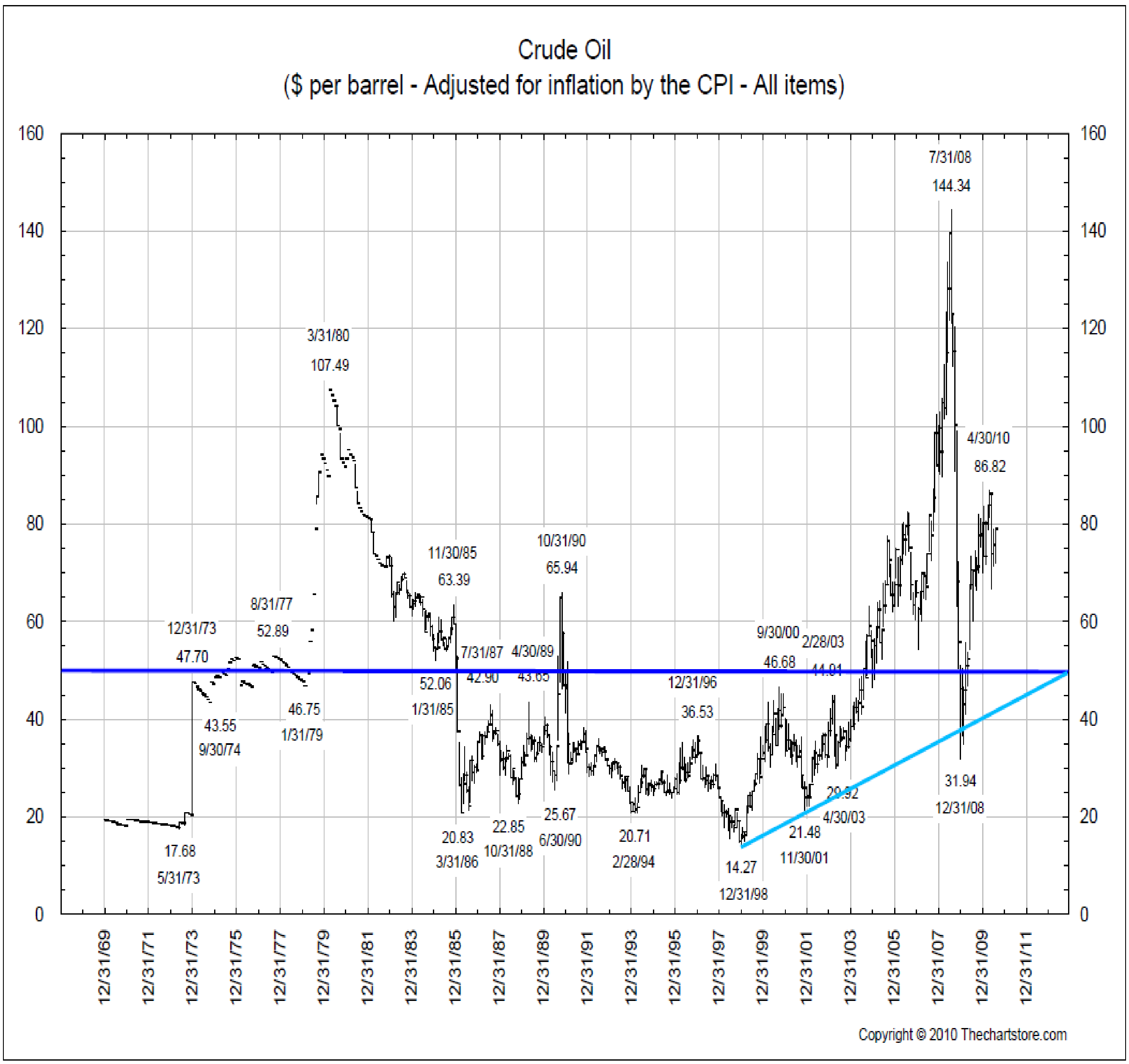
Data as of July 2010



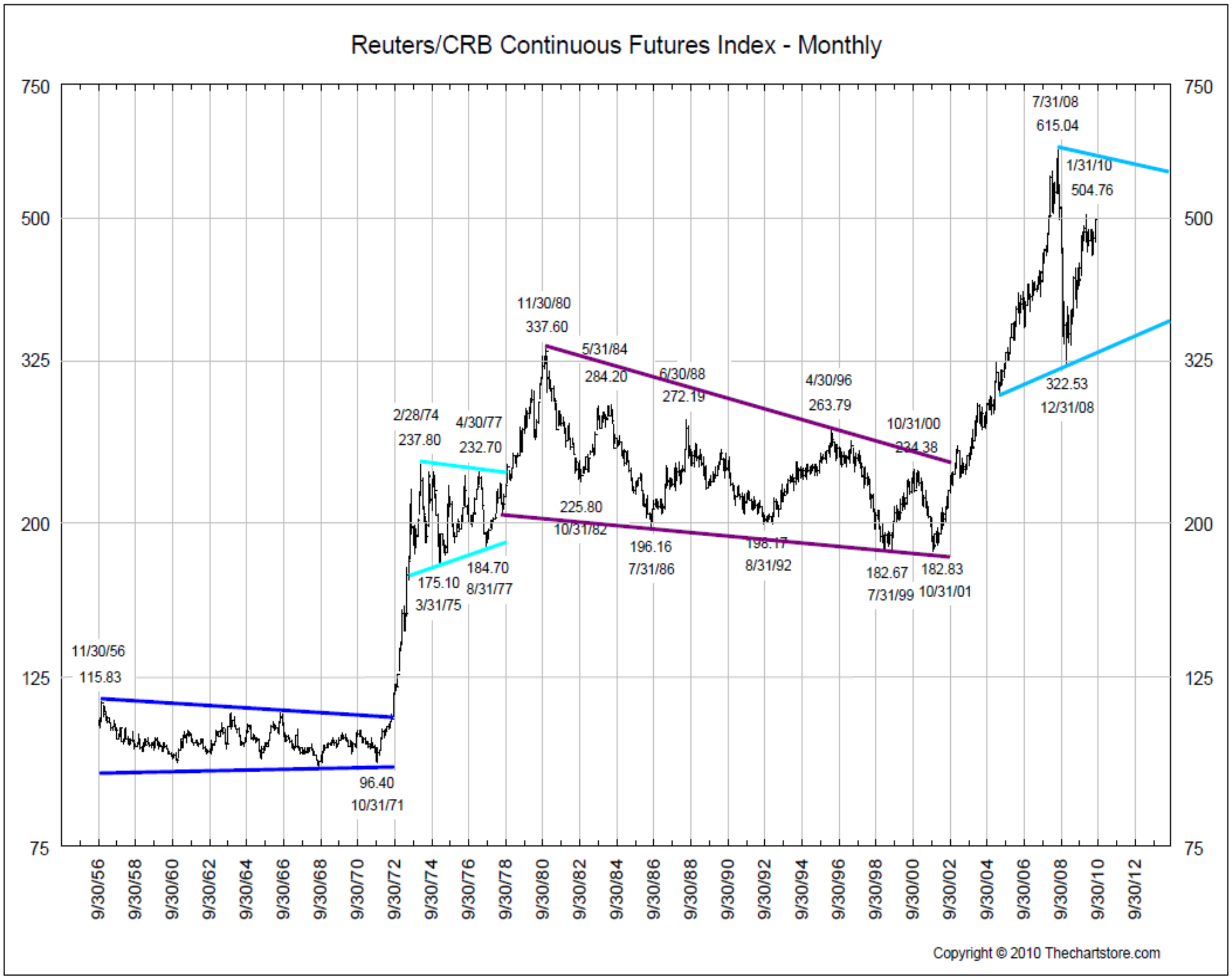
After peaking at just under $40 a barrel in 1980 at about the same time Gold was peaking at $850 an ounce, Oil also entered into a 20+ year sideways trading range between $10 and $40 per barrel. After bumping up against the $35-$40 range five times (all five red arrows) Oil finally broke out in late 2003. Whereas $35-$40 was acting as an invisible "ceiling" through the 1980's and 90's, it now appears it may be acting as a "floor" price for Oil (green arrow). While the longer-term trend for Oil is still up, it, too, may be in for a short-term trend of "rest" just like Gold. If it ends up being an extended nap, Oil could end up back down around $40 per barrel and still be considered within its long-term uptrend. Oil's "rest" could last for a couple of years, which would be part of a nearer-term deflationary picture.

Just for the heck of it, I am including a long-term chart for Oil where the price of Oil is adjusted for inflation as we showed above for Gold. Unlike Gold, which has not yet reached its equivalent 1980 value, Oil has gotten well by its equivalent 1980 value of $107 per barrel. As you can also see, the longer-term price of Oil is still easily in an uptrend and would have to break below $45 to be in threat of reversing its upward trend. Can "Green Technology" improve so much as to effectively change the trend of Oil in the next 3-5 years? Or can the global economy slow so much that the price of Oil can return to its 1980's and 90's level?

Data as of July 2010



Data as of July 2010



Lastly, we are including the above chart on commodities in general going back to the mid 1950's. The Reuters/CRB Index is designed to provide an accurate representation of broad commodity price trends. It is currently made up of 19 commodities (all quoted on various U.S. and Canadian exchanges) and include agricultural products, industrial metals and petroleum based products (Please note that this commodity index does *not* include precious metals prices).

As you can see, the index shows a picture of consolidating prices, then relatively short-duration price explosions followed by consolidations before another big rise in prices. As you can also see, the consolidation time can be either short (4-5 years as in the 1970's) or long (20 years as in the 1950's, 60's and 70's and then again in the 1980's and 90's). Now, with the breakout in commodity prices between 2001 and 2008, are we in a similar position as in the past where we will see commodity prices rest for a bit? And, if so, for how long will they consolidate and rest, 4 years? 12 years? 20 years? I am inclined to think that the “consolidation/rest”, if we are indeed in such a time period now, will be on the lower side of this range. Time will tell.

In the meantime, talk of “Deflation” is in the air. I do not mean to get into a thorough discussion of Deflation here in this technical piece, but I would like to point out the difference between price declines and deflation. Deflation results from a significant decline in demand which can lead to lower prices. Lower prices, by themselves, do not mean that Deflation is in the air. Lower prices that lead to an increase in demand are *not* deflationary. Lower demand that leads to lower prices *is* deflationary.

In looking at the above chart, it appears that commodity prices may already be in the process of resting and consolidating. The question the Fed is trying to figure out is whether the trend in prices is deflationary (because of decreasing demand) or signs of a recovery (do lower prices lead to increased demand). It is an important difference that will determine how they choose to “help” the economy sustain and consequently improve itself.

Next month we’ll tackle some charts on employment and credit in further attempts to figuring out whether deflation or inflation is on the near-term horizon.

Kenneth G. Hobbs III, Managing Partner

TECHNICAL ANALYSIS

Seeks to define the trend of various markets, be it short-term, intermediate-term or long-term.

Remember, markets never move straight up or straight down, they move more like the ocean tides, surging (trending) up or surging (trending) down until the tide changes direction. We use various chart time horizons to give us an idea of how far a wave will move within a tide. Our intent is to keep clients apprised of changes in the various markets' movements in the months and years ahead.

Technical Analysis operates under three Basic Premises:

1. Market Action discounts everything. Or …

   Supply Versus Demand governs market action.

2. Prices move in trends. And …

   Trends stay intact until broken.

3. History often (but not always) repeats itself. Or …

   At the very least, it sure seems to rhyme.

The study of charts is based on the evaluation of past events to determine future probability. We seek a stock, or other asset or financial instrument, forming a particular pattern. We note that this pattern resembles that which typically precedes an asset's upward or downward move. In this way we are able to use our knowledge of the way a particular asset has acted in the past to estimate this particular asset's most probable future move. There will be a rational, logical and fundamental explanation for a particular chart formation usually following a given move in price.