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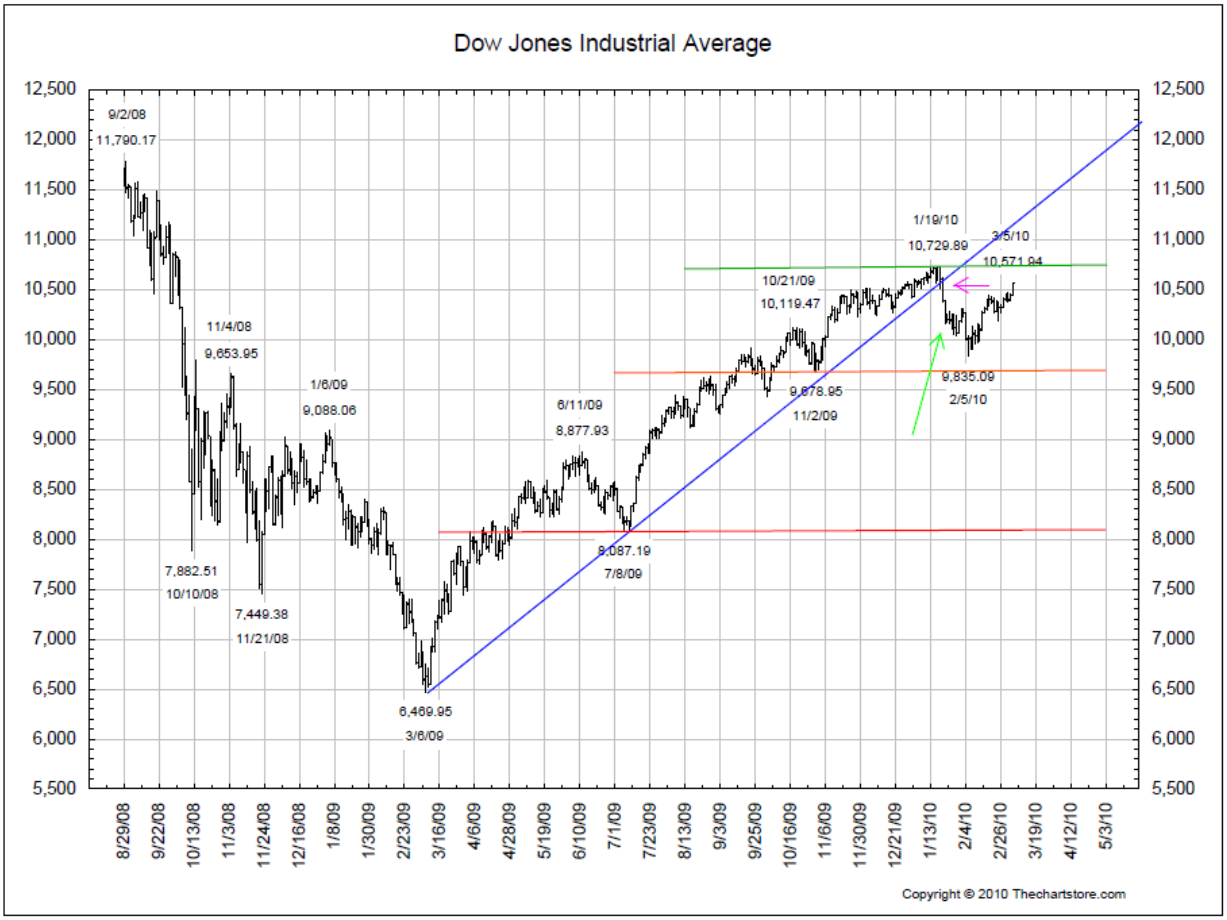
Tech Spotlight

Last month, the stock and commodity markets sold off on increasing trading volume. The sell-off resulted in the stock averages breaking down below a trend line which has been in place since the stock markets bottomed in March of 2008. Technically speaking, this is a negative sign. The question now is what the follow-through will be on the change in trend.

Following are a number of charts looking at different assets that we are now tracking for you (some monthly and some quarterly) in order to try and give you an idea of what they may be telling us about the stock, bond, commodity and currency markets. We hope you find these efforts helpful in interpreting what is happening with the U.S. economy and the various asset markets.

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 within a tide will move. Our intent is to keep clients apprised of changes in the various markets' movements in the months and years ahead.

Data as of March 5, 2010

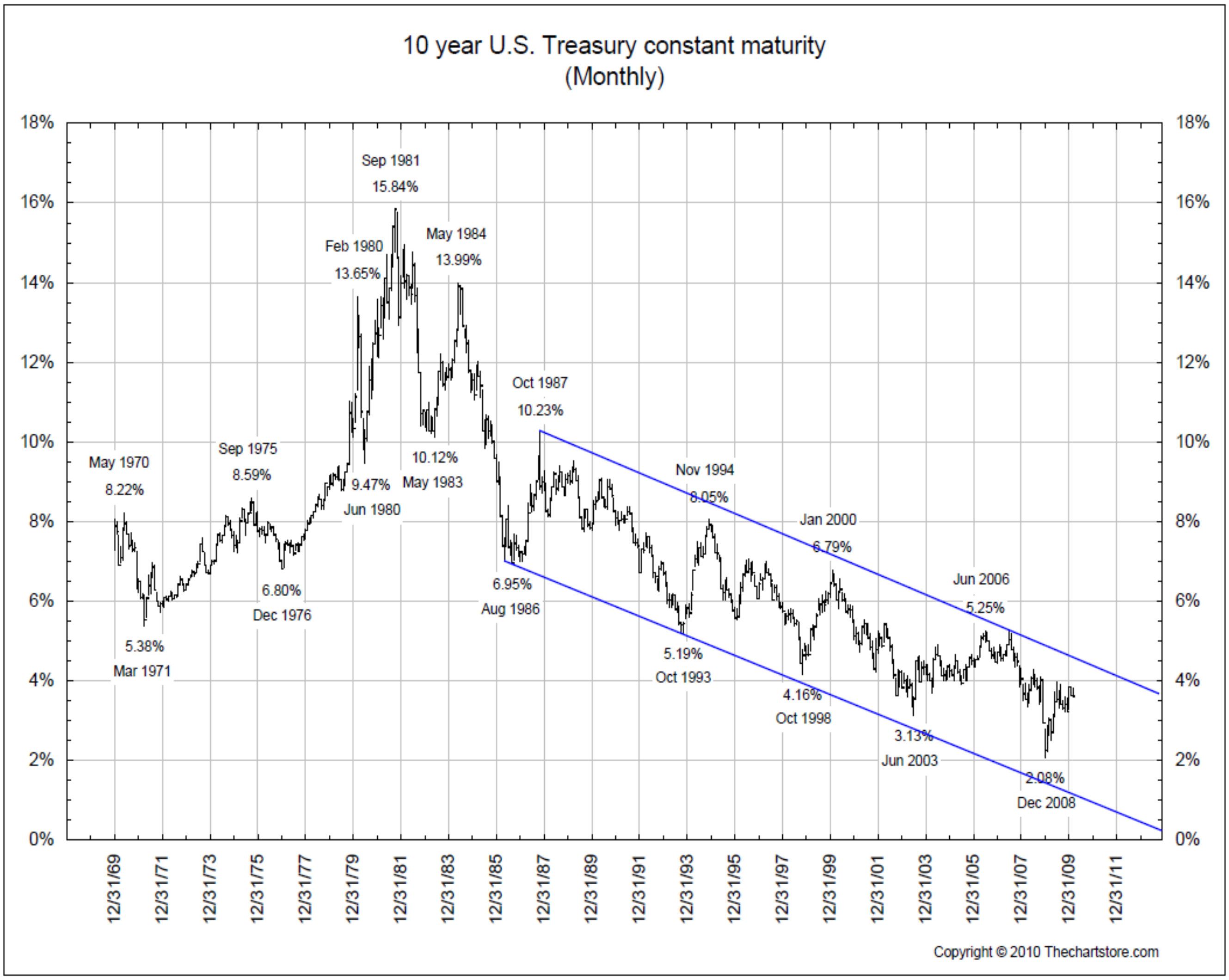


DJIA – Intermediate-Term Chart

The negative action in the stock markets in January caused some technical damage to the intermediate-term chart of the DJIA by breaking an uptrend line (pink arrow) that has been in place since the intermediate-term bottom made in the markets last March. Such a break in a trend line usually indicates (but not always) that a change in trend is taking place. In this case, that would mean that the DJIA would begin correcting down to 9,700 in the near-term with stronger support down around 8,100 in the intermediate-term.

Since last month's Tech Spotlight (green arrow) the DJIA made a minor move to test the 9,700 level (orange line) and has since rallied (more like floated) up to almost 10,600, just 130 points away from its January high. This rally has, unfortunately, taken place on very low trading volume. We would like to see trading volume pick up as the market continues floating up to give the rally some technical validity. If the chart can break above 10,730 on increasing volume then this would indicate the market is in a sustainable rally that could easily carry the DJIA to 11,200 or higher. Otherwise, without increased volume, we would expect the rally to run out of "steam" and roll over and once again test the 9,700 level and then perhaps more.

Data as of February 2010

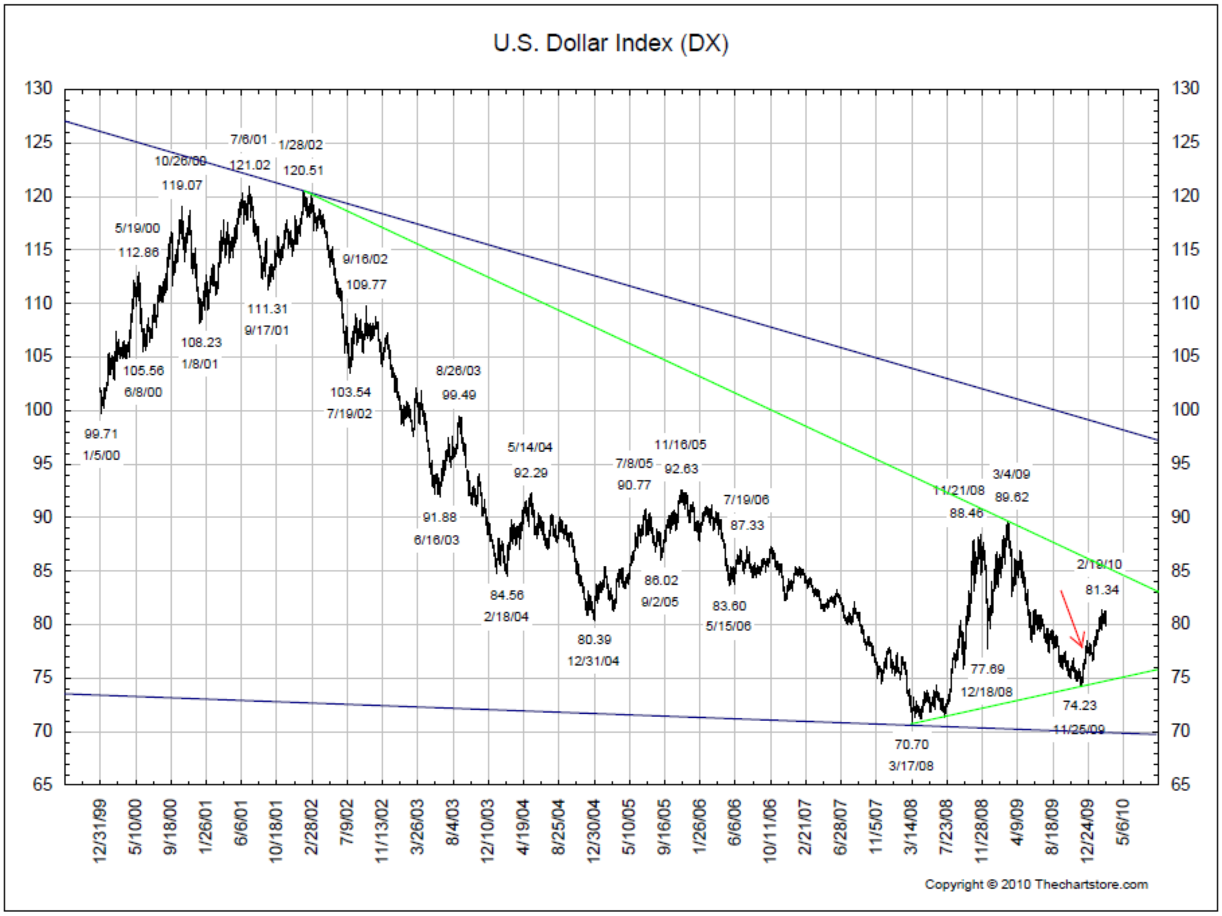


10-Year US Treasury Bond Yield – Inflation and Mortgage Rates

Though there has been a lot of talk about higher interest rates and inflation being "right around the corner", the yield on the 10-Yr T-Bond has been trending down since 1981, and has been ranging in a well-defined channel since 1985. That channel would seem to indicate that the interest rate yield on the 10-Yr T-Bond could rise up to as high as 4.25% in the near-term before resuming its 29-year downtrend and heading down to possibly as low as 1-2%. Until we see interest rates break out of this "channel" to the upside we won't be seeing any significant inflation anytime soon nor should we see 30-year fixed mortgage rates move up significantly in the near future.

Since the beginning of the year (2010), the yield on the 10-Yr T-Bond has ranged between 3.92% and 3.54%. The yield closed at 3.84% in December, 3.61% in January and 3.59% in February.

Data as of March 5, 2010

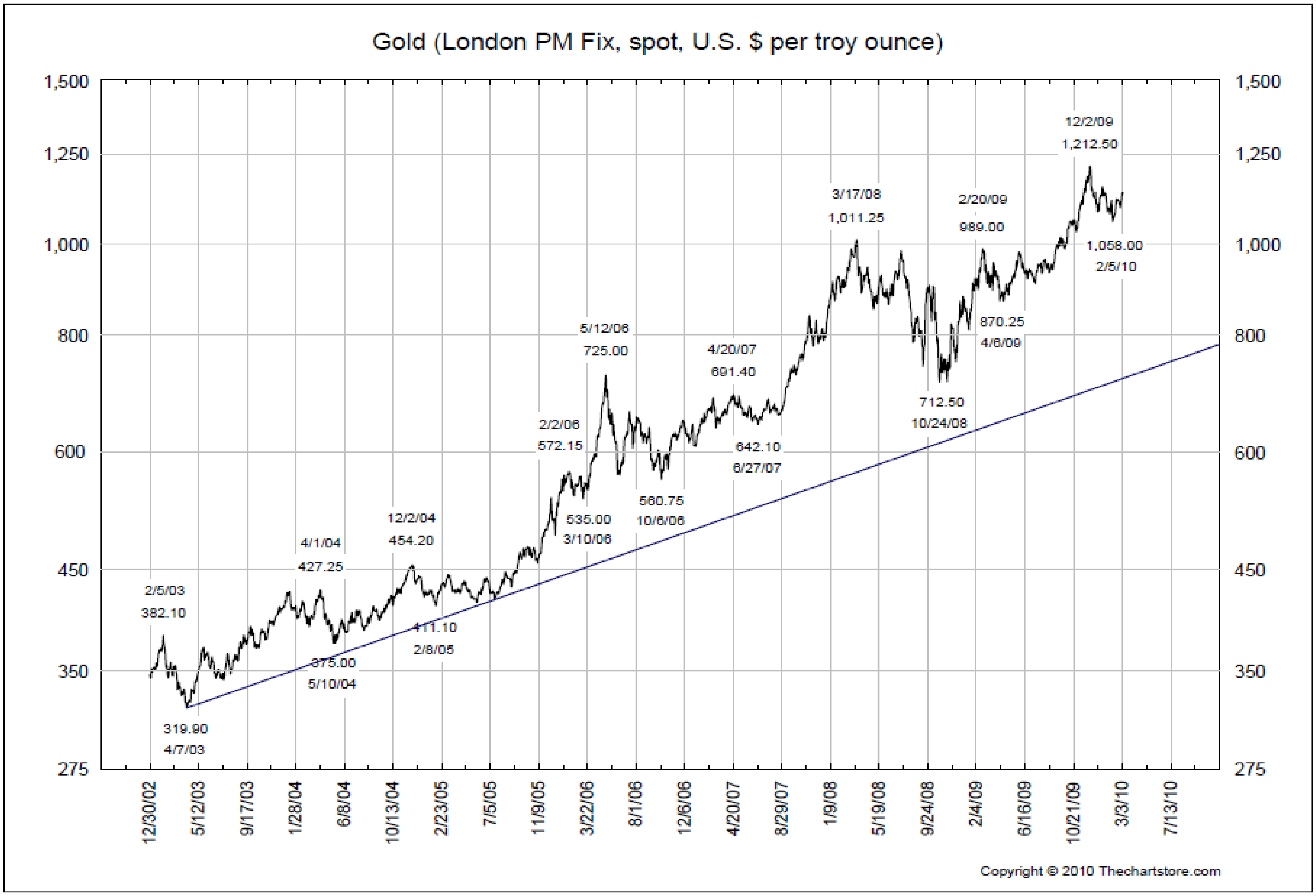


U.S. Dollar Index (DXY)

Chart movement over the past month (since red arrow) has been slightly up, but the assessment for the long-term has not changed … the US Dollar, in terms of the DXY, has been in a long-term downtrend since 1985 (the upper dark blue line) similar to the 10-Yr T-Bond and trading within a somewhat shallow triangle pattern that appears to be some years away from its apex. In the short-term, though, the US$ has begun to trend upward and could rally to as high as 85-95 over the next 3 to 12 months. At that point we will see if the US$ then falls getting back in line with the downtrend of the past 25 years or whether it breaks out to the upside in a major way. The movement in the US$ can have a serious effect on other asset classes (for example, interest rates and the prices of gold and oil) which is one reason why we keep an eye on its movements.

(The US Dollar Index is just a measure of the relative value of the US Dollar (US$) versus a basket of six foreign currencies (including the British Pound, Euro, Japanese Yen, Canadian Dollar, Swedish Krona and Swiss Franc). As the US$ (DXY) rises in value it means that it is gaining strength versus the basket of six currencies. And, as your intuition suggests, as the DXY falls, the US$ is weakening versus that same basket of currencies.)

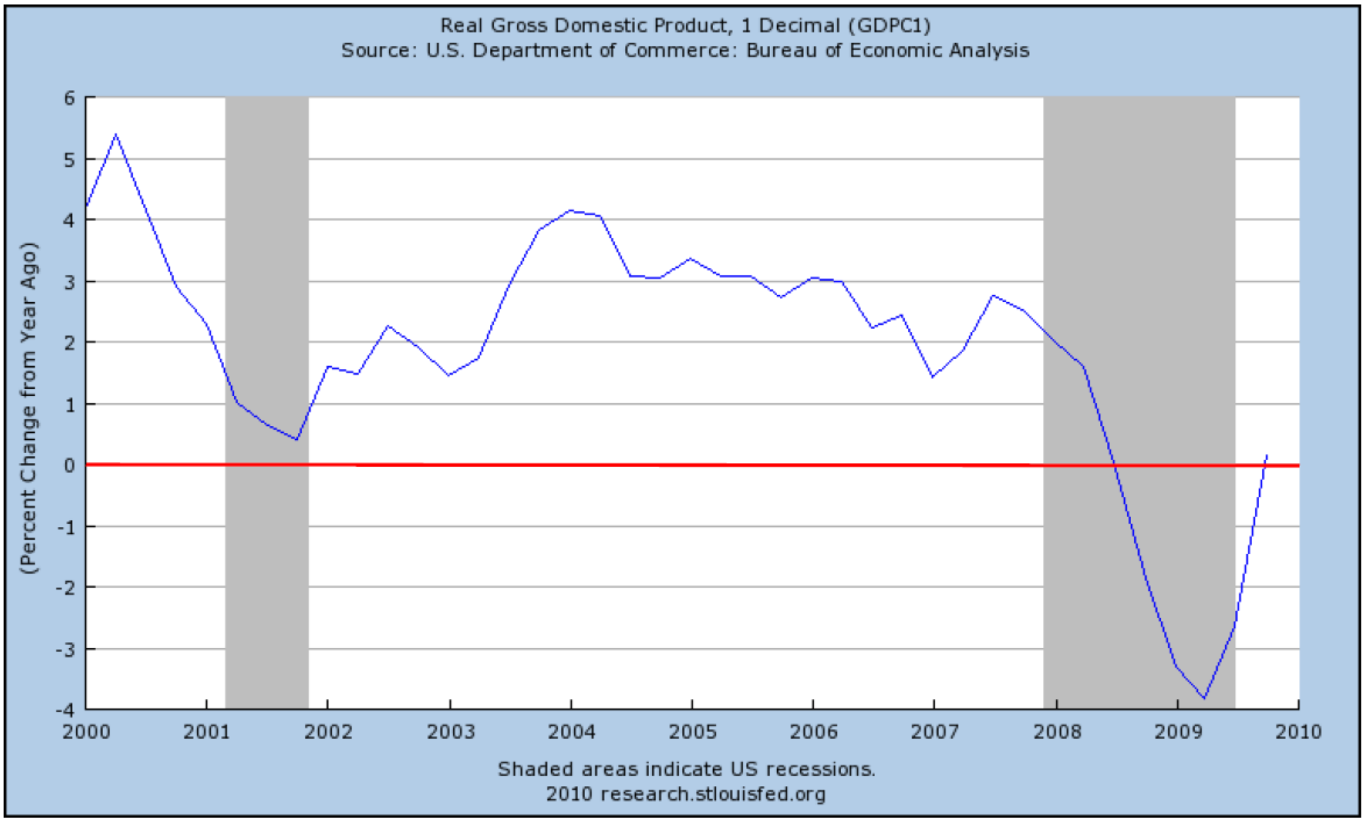
Data as of March 5, 2010



Gold

After a long move down from Gold's peak of $850 in 1980 (see the Gold chart in last month's Spotlight), Gold finally bottomed in 1999 at $252 and then broke out of its downtrend in early 2002 at $300 and took off as you can see in the above chart. With the US$ now on the rise, it is very possible that Gold will correct significantly (again, depending on the rally in the US$ and inflation expectations). The purpose of charting is to try to determine the trend in the price of a particular asset class and to determine targets on its short-, intermediate- and long-term trends.

The above chart is a logarithmic chart of the price of Gold since late 2002. As you can see, the intermediate-term trend for Gold is up and the price has plenty of room to move down from its current level in the 1100's and still maintain being in an uptrend. The arithmetic chart shown last month gave room down to the high 600's while still maintaining an uptrend. The above logarithmic chart shows room down to about 750. The price of Gold has been moving inversely to the level of the US Dollar index (DXY) for the past year. If this relationship continues, then the expectation would be for Gold to continue correcting down while the US Dollar continues to rally vs. foreign currencies.



A little over a week ago, it was announced that the US Gross Domestic Product (GDP) grew at the rate of 5.9% during the fourth quarter of 2009. Taken by itself at face value, this would appear to indicate that the US economy may be firing on all cylinders and on its way back to "normal" again. But, let's drill down a bit … the US economy actually grew 1.45% in the 4th quarter of 2009 compared to the 3rd quarter of 2009. 5.9% is 1.45% annualized. The above chart, put together by the Saint Louis Federal Reserve Bank, shows the annualized percentage change in the US GDP compared to the year ago quarter. As you can see, all the values below the red line represent negative growth (or decreases) in US GDP from one quarter to the prior year's quarter.

The actual percentage change in GDP from the 2008 1st qtr. to the 2009 1st qtr. is -3.30%.

The actual percentage change in GDP from the 2008 2nd qtr. to the 2009 2nd qtr. is -3.83%.

The actual percentage change in GDP from the 2008 3rd qtr. to the 2009 3rd qtr. is -2.64%.

The actual percentage change in GDP from the 2008 4th qtr. to the 2009 4th qtr. is +0.15%.

So, while negative growth in US GDP appears to have abated, we need to see the Real US GDP get significantly back into positive growth territory. As you can see, even during the recession in 2001 and 2002, growth remained positive.

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.

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.