

## INTERMARKET VIEW: Remembering 1994

Everything is super-duper great. What could make things not so great? Consider the year 1994. Back in 1994, everything was also great. Inflation was low. Markets looked invincible. The bulls saw no clouds on the horizon. Hedge funds were making a mint. Then the Federal Reserve started to “nudge” interest rates higher, to prudently get ahead of potential inflation pressures. Instead of reacting calmly, bond markets violently cratered, causing more than \$1 trillion in losses. The markets were completely blindsided. The event is referred to historically as “the great bond massacre” by *Fortune*. Here is a series of excerpts from *Fortune*’s article of that same title, *The Great Bond Massacre*, written way back in 1994:

*In a year of low inflation, bondholders have suffered more than \$1 trillion in losses. Here’s why it happened, and could happen again...*

*Since the Federal Reserve began nudging short-term interest rates higher in early February, the bond market has inflicted heavy damage on financial companies, hedge funds, and bond mutual funds.*

*...Part of the reason for such staggering losses is the sheer size of today’s bond market. As corporations and financial institutions “securitize” an increasingly larger share of the American financial pie, everything from home mortgages to credit card receivables and aircraft leases winds up as bondlike securities available to investors and speculators alike...*

*The bond business isn’t just bigger. It has also become mystifyingly complex as Wall Street’s financial wizards use high-powered technology, even an occasional Cray supercomputer, to devise new ways to hedge risks or speculate on minute changes in interest rates. The growth of financial derivatives, which basically are side bets on the future course of interest rates, exchange rates, and commodities prices, has not only magnified the financial consequences of a market move but also thwarted traditional analysis of interest rate movements, which tends to focus more on economics than on internal market dynamics.*

*Combine these recent developments with the new technological capability to hurl billions of investment dollars across oceans electronically, and you suddenly have a global bazaar where events in Chiapas, Mexico, can lead to huge gains or losses in New York, London, and Frankfurt. Not only do these markets react to one another, but they react faster than ever before. Says one veteran trader: “A move in the long bond that used to take six weeks now happens in six days.”*

Remember, everything written above was from 1994, nearly a quarter century ago. Bond markets are now a full order of magnitude more leveraged, interconnected and complex.

Crashes tend to happen over and over (and will continue to happen over and over) because the game of taking money from greedy, gullible investors, including many institutional investors, is just too profitable. You can see this with some simple rules of thumb. Are highly complex products and opaque ways of doing business necessary to extract profit from greedy, gullible investors? Yes. Do such products make large amounts of money during the uptrend and the boom? Yes. Are the profits accrued during the boom sufficiently big enough to warrant the pain of the crash, especially if the pain of the crash is paid for by someone else, e.g. taxpayers? Yes. Are the gullible, greedy investors set enough in their ways to keep going back to the same well, blowing themselves up yet again and again? Yes. All of these conditions are met, and so crashes will keep happening, not as a feature of the system, but as a necessary and acceptable side effect of the racket.

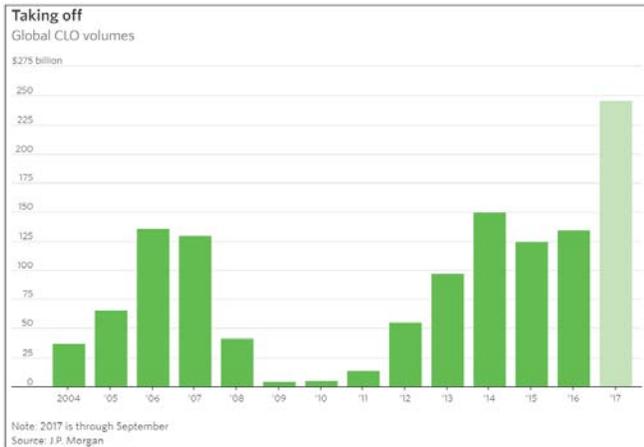
This is why the system will never be engineered to take the crashes out, in the same manner that, say, skyscrapers are designed to never fall down. The complexity and the opacity enable the profit extraction, always taken to extreme levels, which in turn means there is always, at some point, a nasty ending, because how else can a mini Ponzi scheme end? At the end of the last one, you just move on to the next one.

Here is more from the 1994 *Fortune* article, and remember these are still 1990s numbers they are using:

*Among the hardest hit in the bond debacle have been the big hedge funds that gambled on a continuing decline in European bond rates. Steinhardt Partners, one of those buying on whisper-thin margin, reportedly had amassed a \$30 billion position in Eurobonds before the market turned. Its holdings were so large and so leveraged that Steinhardt was losing \$4 million for each basis-point rise in European rates. By May the fund’s losses amounted to about a third of the \$4.6 billion it had under management. Steinhardt, which had blessed its investors with gains of better than 60% in each of the past three years, was still down more than 30% at the beginning of September.*

It’s funny they mention European bond rates, because yields on European junk bonds, as of this writing in late 2017, are now at some of the stupidest levels in the history of man. As investors chase the price of junk bonds higher, the yield, aka the percentage payout on the bond itself, goes lower. It has recently been reported that European junk bond yields, on average, had fallen lower than ten-year US treasury yields. It is like hearing that chocolate purple pants went wojimbo. If you read that last sentence twice because it didn’t make any sense, then you get the point: *It makes no sense*. Except in the context of investors losing their damn minds. One way this “perfect environment” could end is like 1994. But worse.

We say “but worse” because the use of debt-based ETFs has created concentrated forms of sell-off risk like the world has never seen. The ETF, or exchange-traded fund, has been used extensively not just by small and medium-sized investors but by large institutional investors. Even Bridgewater, the largest hedge fund in the world, which runs more than \$150 billion in assets, makes heavy use of ETFs due to their simplicity and low transaction costs upon entry and exit. This means that, if a whole bunch of investors decide to, say, sell a chunk of their holdings in popular corporate bond ETFs, all at the same time, nobody knows what will happen. But, one asks, what could cause a bunch of investors to want to sell at the same time, out of the blue? Ask the guys who got whacked in 1994.



Then too, the old tricks of the global financial crisis are back and bigger than ever, as the WSJ reports:

*Volumes of CLOs, or collateralized loan obligations, hit a record \$247 billion in the first nine months of the year, according to data from J.P. Morgan Chase & Co. Fueled by a wave of refinancings and nearly \$100 billion in new deals, that far outpaces their recent full-year high of \$151 billion in 2014 and the precrisis peak of \$136 billion in 2006.*

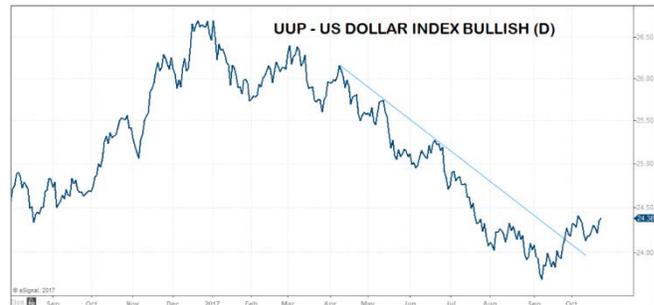
*The CLO boom is the latest sign of the ferocious hunt for yield permeating markets. Stellar performance over the past year has made CLOs increasingly hard to ignore for investors like insurance companies and pension funds.*

*CLOs are one of the largest demand sources for the leveraged loan market, which has also been booming this year. Volumes of leveraged loans, often used by private-equity firms to fund buyouts, are on track to surpass their 2007 record, according to LCD, a unit of S&P Global Market Intelligence. At the same time, investors have voiced concerns about companies' rising leverage level, and weaker creditor protections...*

It will continue to be the case that none of this matters... until the day when it really starts to matter. Like, a lot. As in, holy crap what the hell just happened. Like 1994 redux but worse. Investors seem to have a cartoon-like urge to repeat history.



The unexpected trigger in 1994 was interest rates tightening up, in turn brought about by the Federal Reserve hiking rates, to try and get ahead of inflation. Check out the 10-year yield above. Notice that, while that yield had been falling for most of 2017, it is now rising. Also notice that, as in 1994, the Fed is now talking about tightening up interest rates to get ahead of inflation. But why would the Fed make the dumb mistake of tightening up too early? It's not like we have the lowest jobless claims since 1973. Oh wait, we DO have the lowest jobless claims since '73. (March of 1973, a 44-year-low.) The data the Fed looks at to decide whether or not to raise rates is like that Shia LaBeouf motivational video saying “DO IT.”



Here and now the fear quotient in markets remains minimal. The Dow is trading at one the most overbought levels of all time (a top ten reading), emerging market indices and China indices and European indices are all at multi-year highs, and various debt instruments are showing no sign of visible stress in price movements. But at the same time, trading volumes are drying up, which both calls into question the validity of recent moves and increases the likelihood of dislocation if a turn in sentiment occurs, and various liquidity warning signs are flashing. If the US economy continues to show signs of strength – like the lowest jobless claims in 44 years – the Fed will be set in its determination to raise interest rates to get ahead of inflation, and the question will be what happens if markets adjust to that reality. The potential rising US dollar is also a threat, as shown via UUP above, in that the extra liquidity boost from a profoundly weak dollar is part of what extended this boom in the first place. In 1994, the aggressive yield-reachers went from invincible to down +30 percent in a manner of weeks. The Federal Reserve was the unexpected trigger. Yields, the dollar and the Fed are all on close watch.

## MACRO VIEW: Sovereigns and the Psychosphere

“Psychosphere” is a strange and obscure concept, originating with science fiction authors like HP Lovecraft. It had a small burst of popularity via the HBO show *True Detective* a few years ago. But the concept has been in use since at least the year 1999 by another powerful group – Russian operatives.

The following excerpt comes from *Information-Psychological War Operations: A Short Encyclopedia and Reference Guide*, a 495-page encyclopedic text, published in Moscow, which can be purchased online for a few hundred Russian rubles:

*“The population doesn’t even feel it is being acted upon. So the state doesn’t switch on its self-defense mechanisms... information war is supple, you can never predict the angle or instruments of an attack. Victory is a case of yes or no; in information war it can be partial. Several rivals can fight over themes within a person’s consciousness.”*

The psychosphere is not supernatural or science fiction. It is “the sphere of collective consciousness,” which is an invisible but real thing. Think of how group opinions emerge. It is the emotional energy and instinctive consensus for a given group of humans. As such the psychosphere operates at varying orders of magnitude, just like variations of scale in groups of humans who identify with one another. One can speak of the national mood, or geographic regions of the country, or the summed attitude of allies in the post-WWII Western alliance. On a smaller scale, one can measure the prevailing mood, or sphere of collective consciousness, within a single culture or a single industry, or even at a one-off event like a company gathering or a birthday party. These are all manifestations of the psychosphere at different scales. The common element is an emergent property of consensus mood and feeling that is born of humans coming together, interacting as a group.

The psychosphere is also a place to do battle. Just as a family or a company can be weakened, or even destroyed, by the escalation of conflict and emotional strife, a national mood can be turned on itself. Age-old phrases like “a house divided cannot stand” imply the dangers of ignoring fault lines in the psychosphere. Plotlines dating back to Shakespeare, Homer and Sun Tzu make clear reference to psychosphere attacks, though not using the term, in reference to poisoning a mood or sowing divisions of mistrust within the enemy’s ranks.

We have some very good and very old friends in Russia, and do not point this analysis at Russian citizens. But it is known that the Russian government made a decision, not recently but nearly two decades ago, to deliberately and aggressively focus on doing battle in the psychosphere, as a trade-off for lacking more traditional forms of military hard power. As far back as 1999, Marshal Igor Sergeev, the Minister of Defense, sought “revolutionary paths” and “asymmetrical directions” to compete with the West. This led to a psychosphere focus.

During the Cold War the USSR viewed the United States, and the post-WWII Western alliance, as an existential threat. The feeling was mutual. Each side made calculations as to the risk of being destroyed by the other. That paranoia did not fade after the Cold War ended. In some ways it intensified, with a weakened Russia obsessed with shoring up its long-term strategic interests in the world, and countering the West. As such, from the turn of the millennium onward, Russia put a great deal of investment into psychosphere operations. The idea was that, if you can’t dominate in physical warfare, find other ways to fight. This attitude was further justified by the argument that Russia was already under “attack” by way of Western media operations, Western border encroachments and so on. By the year 2013, Russia had more than a decade of theory and tactics under its belt. Valery Gerasimov, Chief of the General Staff of the Armed Forces of Russia, had then declared it was possible to defeat enemies – to win wars in other words – through a “combination of political, economic, information, technological, and ecological campaigns.” As *Information-Psychological War Operations* concludes in its final pages: “Information war... is in many places replacing standard war.” Russian manipulation of the 2016 election, in other words, did not happen in a vacuum. Nor was it just a spontaneous opportunity scooped up on the fly. There was a focus, gearing up to wage war in the psychosphere, for nearly seventeen years prior, with a further foundation of military tactics that were older still. The Russian doctrine known as *Maskirovka*, or military deception, is referenced in the *Soviet Military Encyclopedia* of 1944. Russian operatives, not least the ex-KGB agent running the country, are lifelong students of the invisible chessboard: Battle within hearts and minds.

Russia aggressively embraced psychosphere tactics around the turn of the millennium as a kind of consolation prize. If you can’t compete respectably in the main arena, then seek out another vector of attack. It’s a geopolitical version of the Innovator’s Dilemma, a famous theory which describes how innovators beat powerful incumbents. At first the innovator focuses on an offbeat niche, too obscure for the big players to worry about. Then a sizable shift in the landscape occurs, and the scale of the niche expands by 100-fold or 1,000-fold. Think of Airbnb, a company with an initial idea so strange the founders got laughed at in the early days of fundraising. Now every hotel CEO on the planet has to worry about Airbnb. In similar fashion, Russia did not first hit the innovation jackpot with the 2016 presidential campaign. That happened roughly a full decade earlier, with the dawn of global social media. The psychosphere of the West, in some ways, is comparable to a massive computer operating system, programmed for optimal function in a world without hackers. Social media exploits thus expanded the hacking opportunities 1,000-fold.

Nor is it just the West that's been hacked, or Russians alone orchestrating the hacking. Facebook, for example, now helps enemies of decency actively manipulate psychospheres, for purposes of violent partisan gain, throughout the developing world. As the editorial board of *Bloomberg* recently wrote:

*In rapidly changing countries such as Myanmar, Facebook has become a platform for hate speech and incendiary rumors targeted at vulnerable minority groups. Elsewhere, shadowy political actors and authoritarian regimes have used the site to smear opponents and tighten their grip on power.*

*...In India, Facebook's second-biggest market, fake stories spread on its WhatsApp messaging service have led to lynchings; in Myanmar, Facebook posts and fake images have contributed to the toxic hatred of Rohingya Muslims, more than 500,000 of whom have been driven from their homes since late August. Religious tensions in Indonesia are running higher than they have in years, in part due to a fake-news campaign cynically used to demonize and oust Jakarta's Christian governor...*

Ignorance, gullibility and stupidity on the part of a "neutral" citizenry can be just as corrosive as evil intent, because those with evil intent can weaponize public opinion at scale. The worst instincts of humanity have been emboldened by data engineers in Silicon Valley, who can no more claim innocence than the mathematicians who helped create nuclear bombs.

In prosperous or relatively prosperous countries, inequality within the economic system is a top cause of psychosphere faultlines. The "haves" get pitted against the "have nots" in a battle of whether or not to share resources, or over how much sharing should occur. You see this over and over, in country after country. In the Catalonia crisis now playing out, many middle-class Catalans reportedly support a separatist movement because they think the poorer regions of Spain are taking from their prosperity. In Italy, there has long been a movement for the more prosperous North to break away from the far less prosperous South. These views are dumb beyond belief in practical terms in that, were Catalonia or the northern region of Italy to actually secede, there would be a violent collapse of wealth almost instantly, due to near-total lack of preparation, in terms of no trade agreements with the rest of the EU. But this isn't surprising, as movements born of populism almost always put emotion before rationality or common sense, thus embracing ignorant self-destruction.

In Brexit, the "haves versus have nots" polarity was reversed: angry people in Britain's weaker economic regions chose to punish wealthy London and blame immigrants. In the United States a related story unfolded, a critical mass of Americans (though less than half the popular vote) deciding to throw a temper tantrum, or to otherwise "blow up the system."

And in all the situations described, Russia has participated via means that intelligence analysts call "active measures," using whatever tools it can to wage war in the psychosphere. If correct that "a house divided cannot stand," what Russia seeks is for the West's house to be as divided as possible, and thus ripe for falling apart. In this battle of the psychosphere there are no permanent winners or losers. The game will just keep going, until or unless the crucial Russian players are removed. There is a scoreboard of sorts however, roughly gauged by the degree to which Western countries start to look and function more like Russia under Vladimir Putin.

Russia in 2017 could essentially be dubbed a quasi-capitalist kleptocrat mafia state, presenting the illusion of democratic elections coupled with the reality of almost everything being reduced to hidden power plays and transactional politics, focused not on the national interest but efficiently extracting large sums of money from the system. Also in 2017, this is the direction the United States is heading in. Propaganda and mass confusion, coupled with voter suppression techniques, enable crony capitalism without protest, resulting in a semi-paralysis of free markets favoring deep-pocket incumbents (who possess the means to pay off the kleptocrats running the state). International foreign policy is also moving away from national interests and the multi-country alliances that stand in the national interest, in the direction of flexible arrangements again oriented to crony capitalism and bribes.

At one end of the health spectrum, a nation with a resilient psychosphere has a government that legitimately seeks to defend and promote the nation's best interests; at the other end of the spectrum the country is a smashed storefront, its assets to be looted. A broken psychosphere enables looting in that it keeps everyone distracted, and confused as to real information versus fake, disillusioned and hating each other.

And then you have China, where the Communist Party now enjoys a shining moment and the demons of financial crisis appear to be vanquished. China's leader, Xi Jinping, appears to have amassed the most leadership power since Mao. And China's psychosphere, the coherence of the national mood and the emergent property of China's public consciousness, is seen as confident and stable (at least from the outside).

For decades China has offered a blunt alternative to Western democracy. It can roughly be defined as "neo-conservatism," which itself evolved from "neo-authoritarianism." The basic idea behind neo-authoritarianism is that democracy can be a good thing, but only in the long run. In the short run (which can mean decades), the masses are not responsible enough to handle democracy: Their bad choices could screw up the growth path. A central authority is thus needed, some kind of wise benevolent hand, to build strong institutions and fully set the stage before democracy can truly be implemented.

China takes the events of 2016, and specifically the election of President Trump, as justification of its skepticism towards the Western traditions of democracy and free speech. As a Communist Party colleague recently told the *Financial Times*: “The American people elected a 70-year-old celebrity with no relevant experience. Our system forces men like Xi to prove themselves for decades in a series of increasingly difficult posts.” Brexit is another folly noted by democracy’s critics.

China’s top down authoritarian management style includes total management and containment of the psychosphere, which means putting outside forces on lockdown. If the rise of social media enabled the psychosphere of the West to be ruthlessly hacked, China’s psychosphere is like an operating system with triple-tight firewalls and anti-virus controls. The problem of Facebook isn’t a problem in China, for example, because Facebook is banned in China, and the home grown versions of social media are tightly controlled. Censors tend to monitor everything. Freedom of speech as understood by the West does not exist. The drawbacks of this system are obvious, and we are not at all praising a totalitarian system which, on balance, grows more totalitarian by the day. (One of China’s tech projects now in the works is a face-scanning system which has the goal of identifying any Chinese citizen, with 90% accuracy, in the space of seconds.) The point here is to compare and contrast psychosphere faultline weakness. Because the West is, by design, an open system oriented to tolerance and freedom of expression, the psychosphere of the West is hackable; China’s closed, top down system is not.

If China does finally experience a major financial crisis — and make no mistake, the country is sitting on multiple trillions in leveraged derivative accidents, and it would be surprising if China avoided this — then the lockdown management of the psychosphere may prove to be a kind of mass civil unrest containment advantage. Disruptive protests? Not when the authorities can disappear you off the street. The long running assumption was that, eventually, the rise of democracy in a partnership with free markets would completely overwhelm the one-party system. Given how China has been able to co-opt its capitalist tech giants (Alibaba, Tencent, Baidu etc) and keep the system running, that assumption may be wrong. For those who run China’s neo-authoritarian system, and who continue to strengthen it with ever more intrusive rules and technological controls, anticipating the need for full control in any future episodes of civil unrest may be part of the point.

In 1989, the political scientist Francis Fukuyama wrote a now famous essay titled “*The End of History?*” which more or less argued that, with the fall of the Berlin Wall, the prosperity underwritten by Western democracy had become a source of permanent triumph, thus implying no more wars (i.e. no more “history” in the painful sense). Nearly three decades later this view has, in some ways, been turned upside down.

One could imagine, in 2029, a forty-year anniversary essay titled “*The End of Democracy?*,” which comes to an opposite conclusion from Fukuyama’s original. This conclusion might be that the model of China, also shown in long-run success stories like Singapore and Hong Kong, was the real successor to democracy, which had fallen apart in the West by way of rapidly accelerating inequality, vicious infighting, and cracks in the psychosphere leading to irreparable damage and the downfall of liberal democracies (replaced by kleptocracies).

There is no happy ending here. While President Trump, his presidency the result of interference from a hostile foreign power (not in total but pushing him over the finish line) is still likely to be impeached or forced to resign (and members of the Trump family to see jail time), the dangerously vicious occupant of the White House is but a lone man, a surfer who caught a giant wave. The fault lines in the psychosphere that produced Brexit, and then enabled Trump, run deeper than just Brexit as an event or a one-off Trump presidency. While Putin’s Russia was a motivated and hostile actor, it did not create the psychosphere’s fault lines. Russia merely figured out how to dynamite the fissures created by technology.

We have written of the recent dawn of the Information Age, the seeds of which were planted in the late 1990s, with the rise of e-commerce and mass installation of fiberoptic cables. It has taken nearly twenty years for the big, slow flywheel of Information Age technology to create large transformations relative to the Industrial Age. Many existing business models and organizational systems won’t survive the full transition from Industrial Age to Information Age. One of those models may be the current configuration of the United States itself.

For more than a century, the American “Sea to Shining Sea” combination of democracy, free speech, economic and geographic dispersion, and commitment to lightly regulated capitalism was seen as the winningest hand in the world. But now that same combination threatens fatal weaknesses in the USA’s psychosphere, by way of rising regional tensions of economic disparity and cultural gaps leading to soft civil war, the possible result America becoming a permanent “house divided,” and thus a house that falls down. Sometimes the business model, or the nation state model, simply fails, riven asunder by a hidden flaw, exposed by a changed landscape.

This is more a probability than prediction, but the odds are non-trivial. Say the odds are just thirty-three percent that the Western psychosphere continues to unravel, devolving into a collapse of functioning democracy and the rise of feudal city-states scattered among economic wastelands, overseen by a dysfunctional federal kleptocracy, news streams turned to noise, the din of misinformation overwhelming. With a risk factor as high as one in three, or potentially higher, one should be prepared. The battle of the psychosphere is raging. The West barely acknowledges it is fighting, let alone losing.

## TACTICAL VIEW: Populism and Profits

We don't naturally favor currencies over ETFs (or stocks or commodities), but in this environment we're again struck by how much currency opportunities stand out. There are other backdrops, where action is elsewhere and currency markets can be dull as a doornail. But for now, with liquidity factors pressing valuations against the ceiling, currencies are tops.

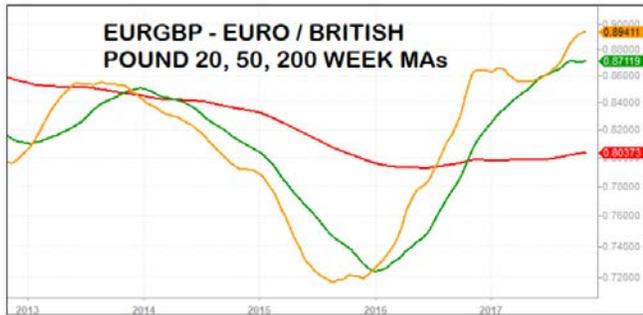


Our trades against the New Zealand dollar are starting off on the right foot. AUDNZD and CADNZD rise as the NZD weakens against the Australian and Canadian dollars respectively. The surge higher in both positions last week was the result of an election outcome – New Zealand choosing its prime minister after a delay. Winston Peters, the leader of NZ First, became kingmaker in terms of deciding who his minority party would coalition with, and thus who would get the top job. NZ First chose a coalition with the opposition Labour Party, returning them to power for the first time in nearly a decade, in turn giving the prime minister job to 37-year-old Jacinda Ardern, New Zealand's youngest prime minister in over 150 years.

The New Zealand dollar weakened on the news because the Labour party is expected to be more pro-populist and less of an inflation hawk, possibly changing the mandate of the NZ central bank to focus more on employment versus solely on inflation. New Zealand also faces the prospect of a downturn, immigration cuts, and rising debt levels. All of this creates the possibility of the NZ dollar's continued weakening, possibly by a large amount, versus the Aussie and Canadian dollars. As we've noted in past SIRs and analysis pieces, the weekly charts for AUDNZD and CADNZD show potential breakout moves with multi-year consolidation power behind them.



Our new long position in dollar-yen (USDJPY) also triggered. USDJPY goes higher as the dollar strengthens versus the yen. We post the monthly chart above to demonstrate how clear and powerful the long-term pattern is. USDJPY is working off a very, very large bullish flag. The good news for USDJPY was a landslide victory for Prime Minister Shinzo Abe in Japan's snap election, which in turn serves as a supporting mandate for "Abenomics," the aggressive platform for reviving Japan's economy. The landslide win for the Abenomics party means that the Bank of Japan will continue with its highly aggressive stimulus measures, with the yen likely to weaken further as Japanese inflation stays stuck near the zero level. There are also breakout levels of bullishness surrounding Japan's stock market, which just broke an all-time record by way of rising fifteen straight days in a row. (The last record was 14 days in a row in the early 1960s.) Bullishness on Japanese equities is also good for USDJPY because this encourages takeup of the "carry trade," in which cheap yen is borrowed (shorted) and the funds used to buy Japanese stocks. As a darker side point, for all of the bullishness surrounding Japanese markets and the noted success of the Abenomics platform, we can't help but wonder what Japan is signing up for if it actually succeeds in its goals. That is to say, if and when Japan truly manages to bring back inflation, the country will then have to face the immediate problem of a multi-trillion debt pile priced at zero inflation levels. If Japanese Government Bonds (JGBs) start to get dumped over the side en masse because their pricing makes no sense in a newly inflationary environment, the BOJ might be forced to buy the JGBs to halt debilitating interest rate spikes – which in turn would vaporize the currency. The biggest macro problems are interesting because the costs of a decision can delay for years, or decades, and then, boom. Long dollar-yen is one of those trades that, at some point, could become a "trade of the decade," with the foundations of a monster trend move decades in the making. But as with other slow-moving macro ideas, you can't predict the nature of the timing so much as keep watch on events as they play out. The bigger the potential movement, it seems, the more hidden factors that have to unite to finally ignite for lift-off.



The euro versus the British pound (EURGBP) is another forex trade we would like to get back into, with size, although the move hasn't yet triggered. It came close, but turned away at the 50 day MA (see green line at top). It is easier to see the bullish nature of EURGBP by looking at the weekly averages, shown in the second chart from above. The 2017 highs seen earlier for EURGBP were violently reversed on talk of a rate hike from the Bank of England, but the prospects for Brexit are now so ugly that the British economy is likely to weaken much further regardless. Brexit was such a violently bad idea, with such utter lack of preparation, that Britain now faces a prospect of either having to agree to extremely unfavorable terms for new trade agreements, or alternatively to risk a "no deal" and have current agreements torn up completely. This is a disaster competent economists saw coming, simply by looking at the mechanics of the thing. But they were wholly ignored in favor of pot-stirring populism, geared to benefit the pot-stirrers (this is generally how dumb populism works). In the poker hand that is Britain versus Europe with regard to negotiating Britain's exit terms, Theresa May's hole cards are so bad she has resorted to trying to make weakness into a strength, as in: *"Please be nice, because if you are too mean the nutters in my party (whom I can't control) will blow up all hopes of a deal and make things a nightmare for everyone."* This is akin to one party threatening to blow itself up, causing harm to the other party via shrapnel wounds. But it is all that the UK side has got left. The reality of Brexit hasn't hit home yet, as there is still plenty of scope for UK rationalization and denial. But it is starting to sink in, partly via the weakest UK retail sales in four years and a cratering London real estate market. The British pound likely has great weakness ahead.



We are closing out of NEM completely after this small breach of the 50 day MA, and also souring on gold stocks (again), as they show sign of (again) breaking out in the wrong direction. All year we have felt ambivalence towards gold stocks, open to the possibility of a breakout but not seeing followthrough. Now gold stocks are again showing sign of breaking out in the wrong direction (bearishly), subjected more to the weight of monetary policy tightening and rate hikes than the lightness of inflation optimism. It may be that gold stocks have seen a vital part of their life force sapped by the neighboring nutso bull market in cryptocurrencies; it may be the market still just doesn't believe in the inflationary narrative. Either way there just isn't enough price confirmation to keep hope alive here.



We are also clearing out of our energy positions XLE and OIH, as it has become clear the mania-level mood won't transfer over to relatively cheap energy stocks. The shale industry is having a decidedly non-mania moment, as investors demand a more sober outlook from shale companies and drillers like Schlumberger and Baker Hughes report weak outlooks tied to North American production slowdowns. As the old saying goes, in a windstorm even turkeys will fly, so these turkeys must be lame indeed. And speaking of turkeys, we got taken out of our (thankfully still small) short position in IBM, which had stunk up the joint with declining revenues 22 quarters in a row, but got investors super-excited by the possibility of a turnaround. We are wary of shorting individual stocks unless there is strong conviction behind the idea: In the case of IBM conviction was present, as the company is both a financial engineering Frankenstein and a cloud also-ran. But in high liquidity market environments, hope always springs eternal.

## PENDING POSITIONS

Bull / Bear	Ticker(s)	Vehicle / Area / Industry Group	Description / Strategy	Analysis PDF Links
BULL	EURGPB	euro currency / British pound	The British pound likely has much further weakness ahead as the reality of Brexit penalties hits home.	<b>SIR 156 (CURRENT)</b> <a href="#">10-19-17</a>

## CURRENT POSITIONS

Long/ Short	Ticker(s)	Vehicle / Area / Industry Group	Description / Strategy	Analysis PDF Links
LONG	USDJPY	US dollar / Japanese yen	The USD could gain a rate hike edge on the yen, or rocket higher against all comers on a short squeeze.	<b>SIR 156 (CURRENT)</b> <a href="#">10-12-17</a>
LONG	AUDNZD CADNZD	Australian, Canadian v. NZD	Long-term breakout potential vs the New Zealand dollar on weekly charts, NZ populism issues, concerns over the new Labour government.	<a href="#">09-26-17</a>
SHORT	XLP	Consumer Staples ETF	Moderate short position as consumer staples face threats on at least three different fronts.	<a href="#">09-01-17</a>
LONG	TAN	Guggenheim solar ETF	Moderate long position from breakout with add-on. Boom-bust solar industry capturing imaginations as solar shows potential for waterfall expansion uptake.	<b>SIR 150</b> <a href="#">06-23-17</a> <a href="#">06-14-17</a>
LONG	EURJPY	Euro currency / Japanese yen forex pair	Sizable position, moderate starter plus multiple add-ons as Europe sees investor capital flows and yen is treated as a funding currency in a bullish backdrop.	<a href="#">09-12-17</a> <a href="#">08-24-17</a> <a href="#">06-16-17</a> <a href="#">06-09-17</a> <a href="#">06-02-17</a>

## RECENTLY CLOSED POSITIONS

Bull / Bear	Ticker(s)	Vehicle / Area / Industry Group	Description / Strategy	Analysis PDF Links
LONG	NEM	Blue chip gold stocks	Add-on to NEM position on strong weekly pattern, long-term potential for blue chip gold stocks.	<b>SIR 156 (CURRENT)</b> <a href="#">09-25-17</a> <a href="#">08-14-17</a>
LONG	XLE, OIH	Energy and oil service ETFs	Energy stocks have potential for bullish rotation as bulls show strength and crude oil rises above \$50.	<b>SIR 156 (CURRENT)</b> <a href="#">09-28-17</a>
SHORT	IBM	Int'l Business Machines	Starter short position on break of current sideways congestion resuming downtrend, IBM getting beaten in aggressive cloud battles.	<b>SIR 156 (CURRENT)</b> <a href="#">07-20-17</a> <a href="#">06-21-17</a>