MSA 360° Weekend Report

March 10, 2019

Central banks, the stock market, and gold

When the pillars of the asset category that “must” be defended—the stock market—begin to crumble, the central banks always come in with policy guns a blazin’. And again, continuing with policies never imagined before—QEs, ZIRPS, and NIRPS. Game’s on. If you, as an investor or manager, thought CBs had plateaued in their policies of the recent decade, think again. Despite their academic nose-in-the air press conferences, the reality is that their stock markets must always remain inflated. Although couched in such language as “data sensitive” or Draghi’s “the persistence of uncertainties related to geopolitical factors, the threat of protectionism and vulnerabilities in emerging markets,” the CBs’ message is clear. Rattle their stock markets and they’ll intervene in asset pricing as best they can. And given the success of that artificial pricing over the past decade, they’re no doubt confident they’ll continue to succeed. And so do many investors.

On the financial channels, investors and talking heads consider a likely renewal of easy central bank policy “good for the stock market.” No doubt President Trump is also pleased by Powell’s sharp reversal.

The CBs know they must push the pedal to the metal again. But the problem is that investors aren’t likely to direct the flow into the inflated bubble that the CBs so desperately want to keep inflated—namely, the developed market stock indices. The Fed, ECB, and BOJ know what will happen if those plaster and plywood skyscrapers crumble and give back their false pricing gains (especially from late 2011 to 2018). Such a downturn in that category will generate on-the-ground desperation and fracturing beyond anything seen in 2008. And they know that, though don’t mention it in their press conferences. That’s why the Fed raised its white flag so rapidly and with such little encouragement in December, thus rejoining the “print into infinity” policy.

Nice. We know where they stand now.

But for those who do their homework, we know such periods of central bank panic don’t always turn out like the prior cycle. Remember—or go back and study— the mid-1970s to early 1980s. Recall the 2001/2002 and 2008 collapses—which occurred despite desperate the CBs’ monetary defense mechanisms being deployed. Their favored markets failed and investors went elsewhere. This time we argue it will be a similar investor preference shift, one that’s already underway.

We argue that the investor class will move in phases into value categories, into categories that are more down to earth (quite literally), and into gold and related. And, for the time being, into a few government debt markets that offer some yield, such as U.S. government Notes and Bonds—though don’t count on

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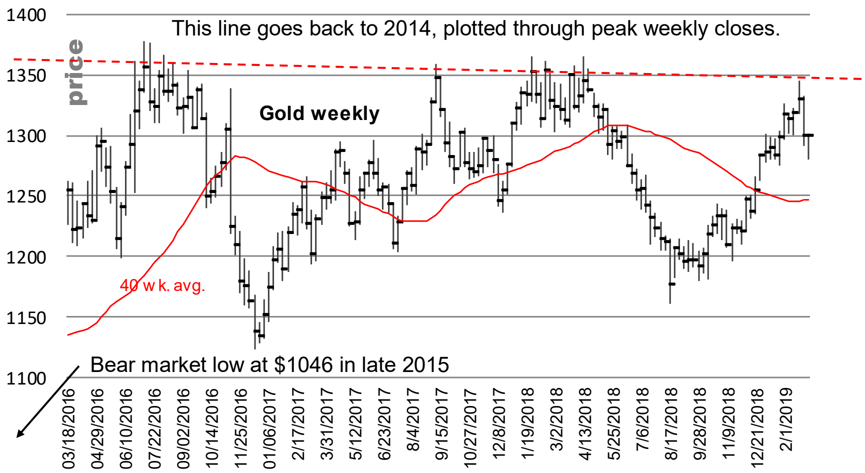
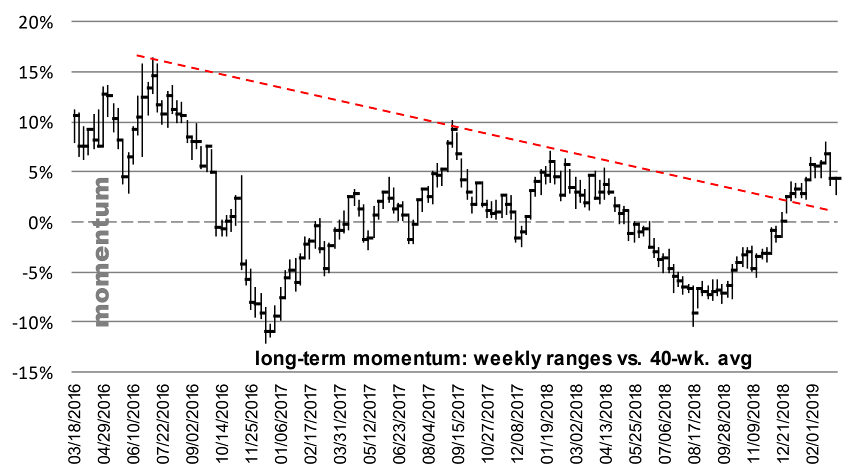
that category sustaining through the next bubble burst.

We begin with gold.





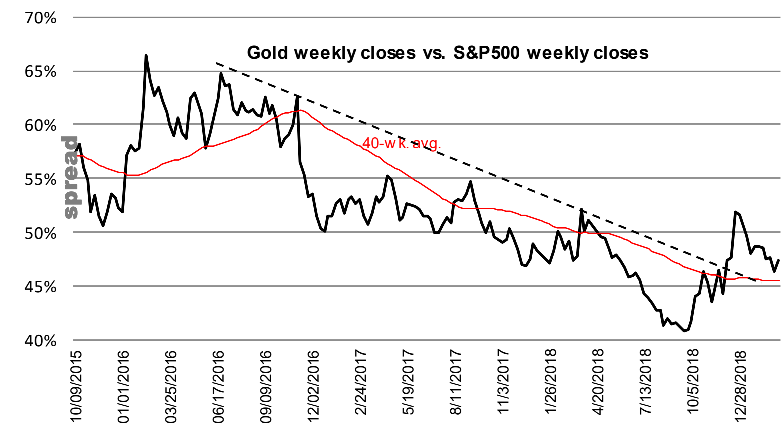
Our momentum metrics turned majorly positive in February 2016 just above $1140. But that's rehashing an old story—a buy signal based on annual momentum (charts not shown here).

Gold then went into a massive three-year-wide range, never threatening the bear lows at $1046, but undulating up and down from 2016 until now. Then, after last summer's selloff, MSA said to buy in the $1200s three times (the average of those three layered entry levels was just above $1240). The run-up that came from the summer 2018 low drove north almost without a wobble into the mid-$1300s, once again visiting a price chart trend line that traces back five years. Those who sold that line three weeks ago no doubt thought they'd enjoy another major drop as occurred in late 2016 or last summer. MSA thinks that game is old and about to be rudely overturned.

Last week's close was marginally up from the prior week, and frankly gold looks poised to soon make another push to the mid-$1300s.

We argue that the major bullish technical that you should consider is that long-term momentum is out above resistance, having earned its way in layers. Expect price to soon overcome its resistance line, echoing its own long-term momentum.

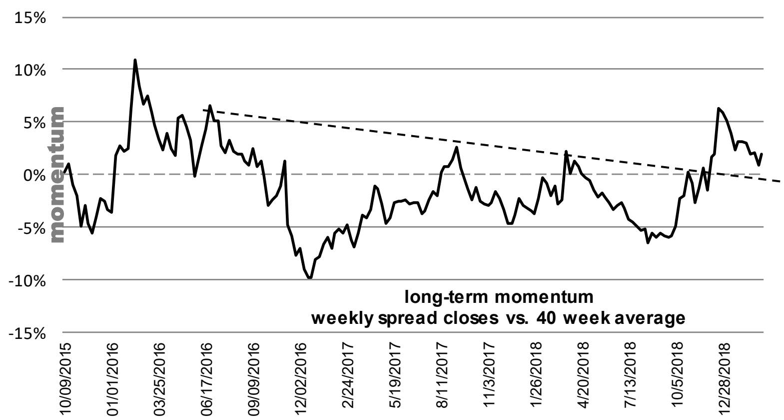
Short-term: Expect the next few days to exhibit congestion—price action up and down without trend. After that, perhaps by later in this week or next, we'll expect further gains, but not early in the week.



Gold versus S&P500 relative performance

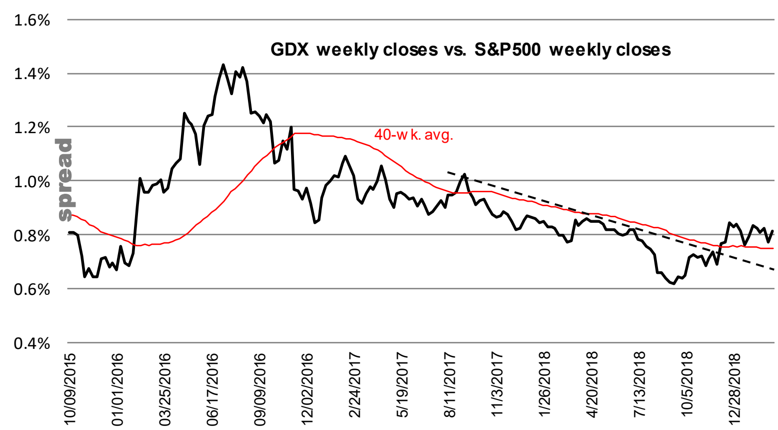
The backbone of gold's underperformance over the past few years was snapped on both charts with action late in 2018. Not only was the S&P500 selling off then, but gold's net price was rising. Meaning the spread was working on both sides, favoring gold.

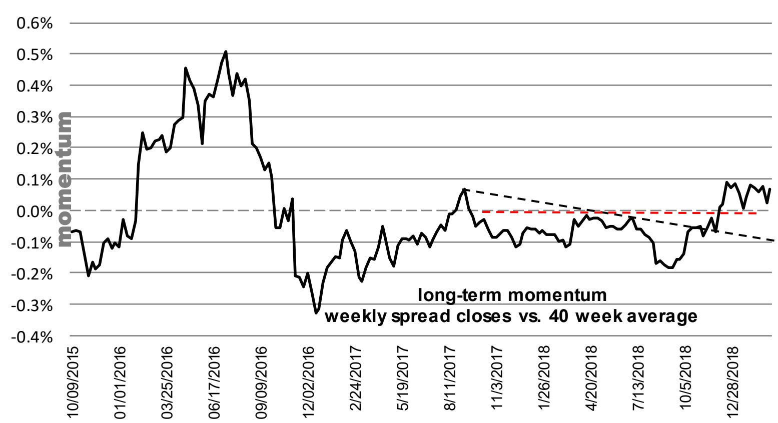
The recent pullback is largely due to the S&P500 rally, not so much to gold's decline. But the pullback (and treat these charts as you would a price chart) is to support.

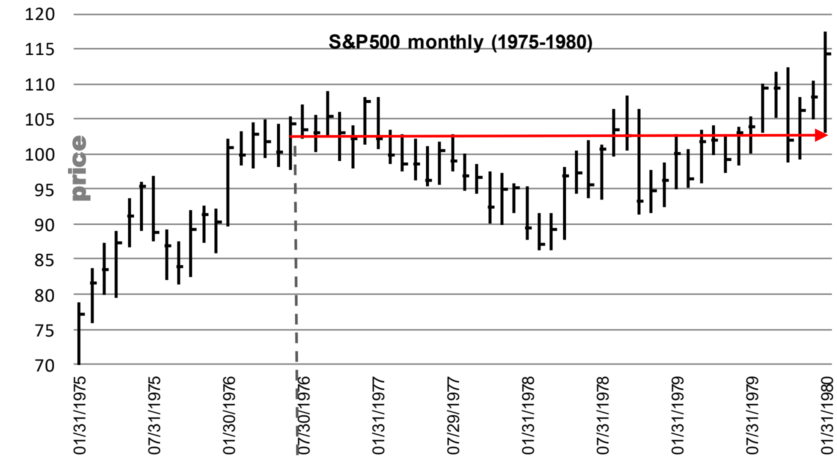


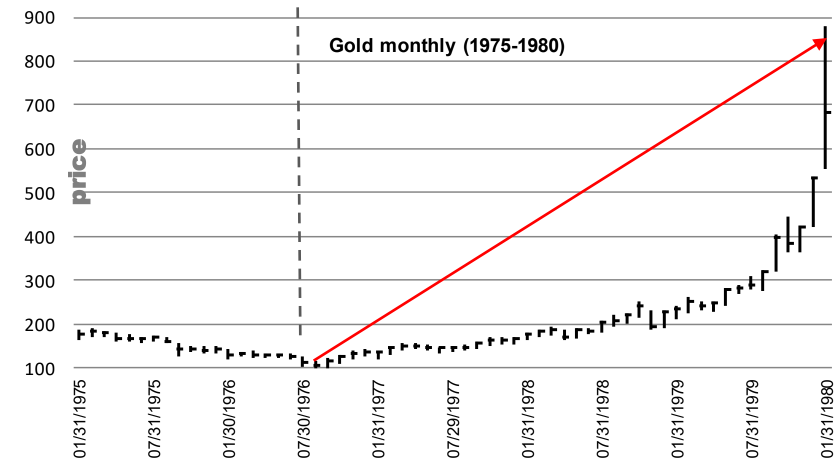
Gold miners relative performance

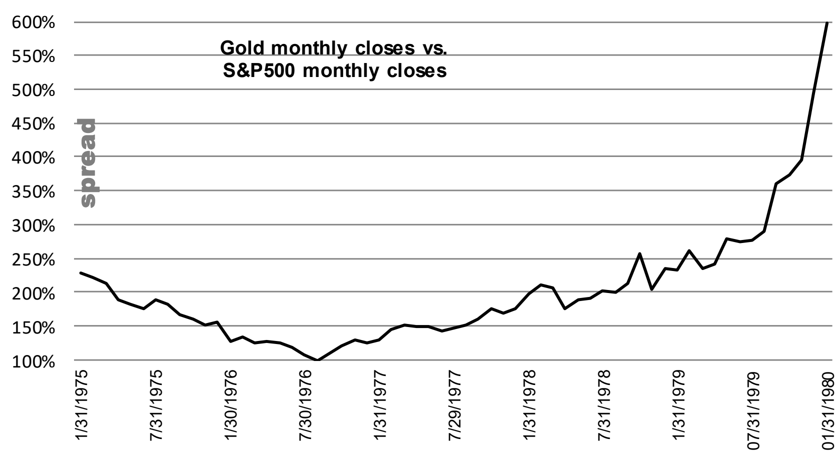
The situation echoes gold's: an emergent shift in long-term relative performance (the 40-wk. avg. as is equivalent to the 3-qtr. avg.) favoring gold miners.











From the archive: Central bank, stocks and gold

The Fed fought the 1974/1975 recession with massive rate cuts (from 13% Fed funds in July 1974 to 4.75% by November 1976).

Also, M2 rose 65% in just five years from January 1975 to January 1980.

Meanwhile, the S&P500 went into an investor wasteland until 1982 (not shown).

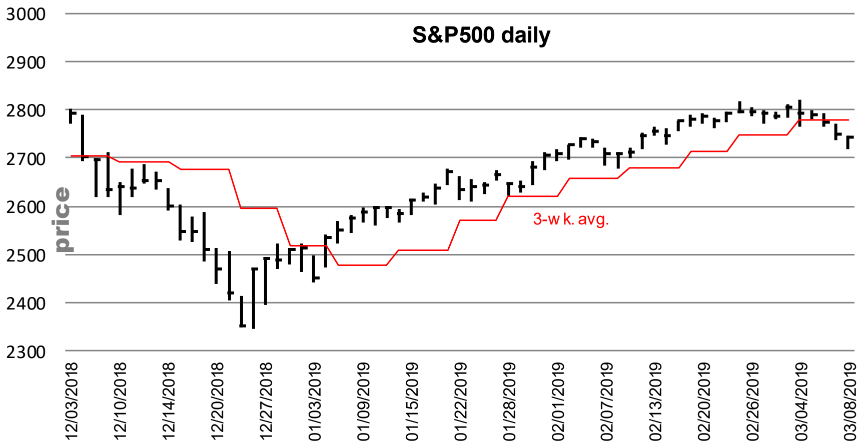
Fed policy created a river of easy money, but investors put it into gold and later commodities. (After all, stocks had enjoyed a massive upside from the 1960s until the mid-1970s, and that was probably also a factor in the investor preference shift.)

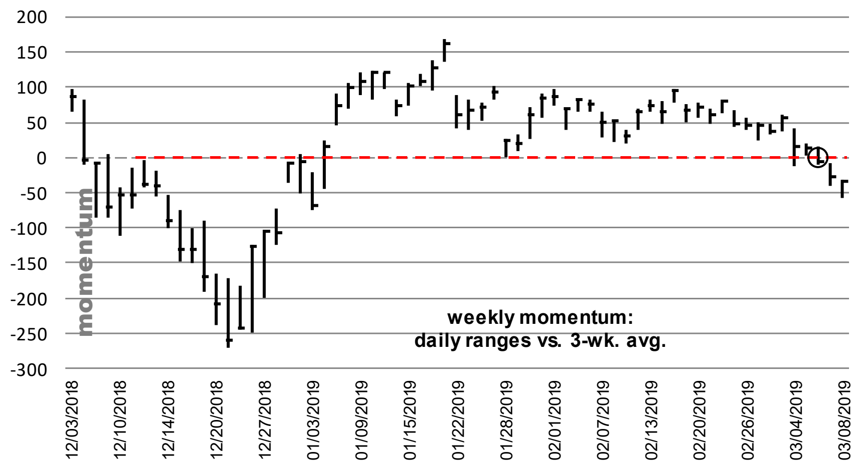
Also, from 2000 to 2011, gold vastly outperformed the S&P500.

This outperformance occurred despite the Fed's efforts to defend the stock market from summer 2007 through the 2009 bear low. And remember the beginning of QEs in late 2008 onward (forever?). At that point, after a 57% collapse, the S&P500 did finally respond to central bank policies. But even then—through late 2011—gold continued to widely outperform the S&P500. It wasn't until gold's bull trend had matured and no doubt "priced" itself, that gold began to give back performance gains.

In sum, don't believe the popular wisdom that easy central bank policy is "good for the market." It often has no noticeable impact, especially if the stock market has only just crested—following years of upside. And even when stocks suffer major decline and are then technically ripe for upside, gold has still shown the ability to gain more from the river of easy money.

We're on the cusp of another such period of market history. Renewed central bank low rate/easy money policy is "**Good for the gold market!**"





S&P500 short-term

MSA had been watching 10-day avg. and 3-wk. avg. momentum for a daily/short-term downturn in the market.

Our trigger numbers on both were pulled at Wednesday's close at 2771.45.

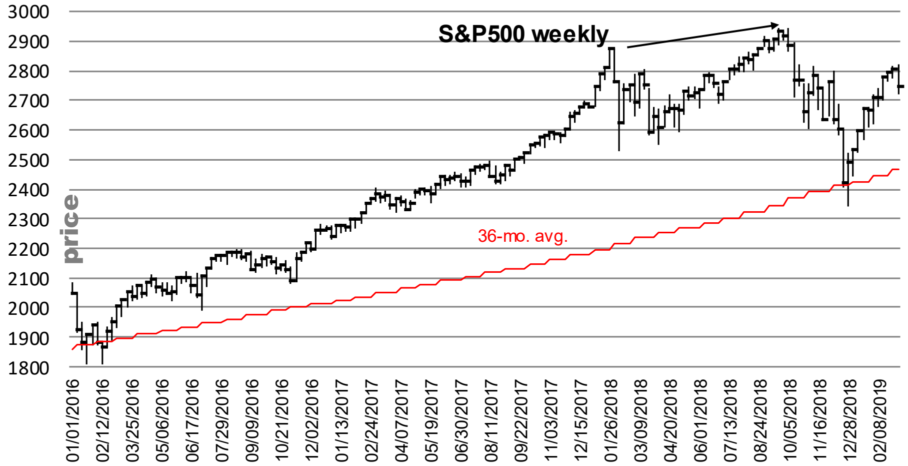
Again, that's a short-term negative indicator.

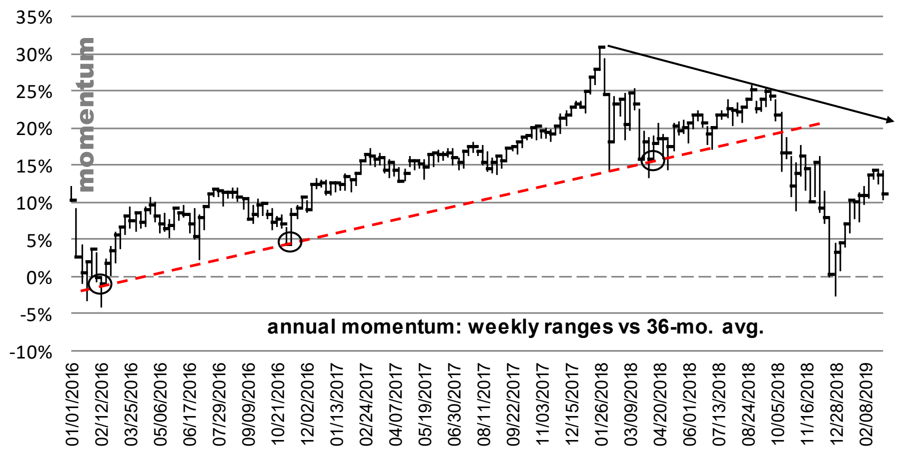
We suspect that at least for this week resistance is probably up around the 2770 area and support just above 2700 (let's say around 2710).

So if you're trading short-term, consider that.

Whether this decline will morph into something larger, we're not sure.

For a longer-term view, see the next page.





S&P500 annual momentum: close up

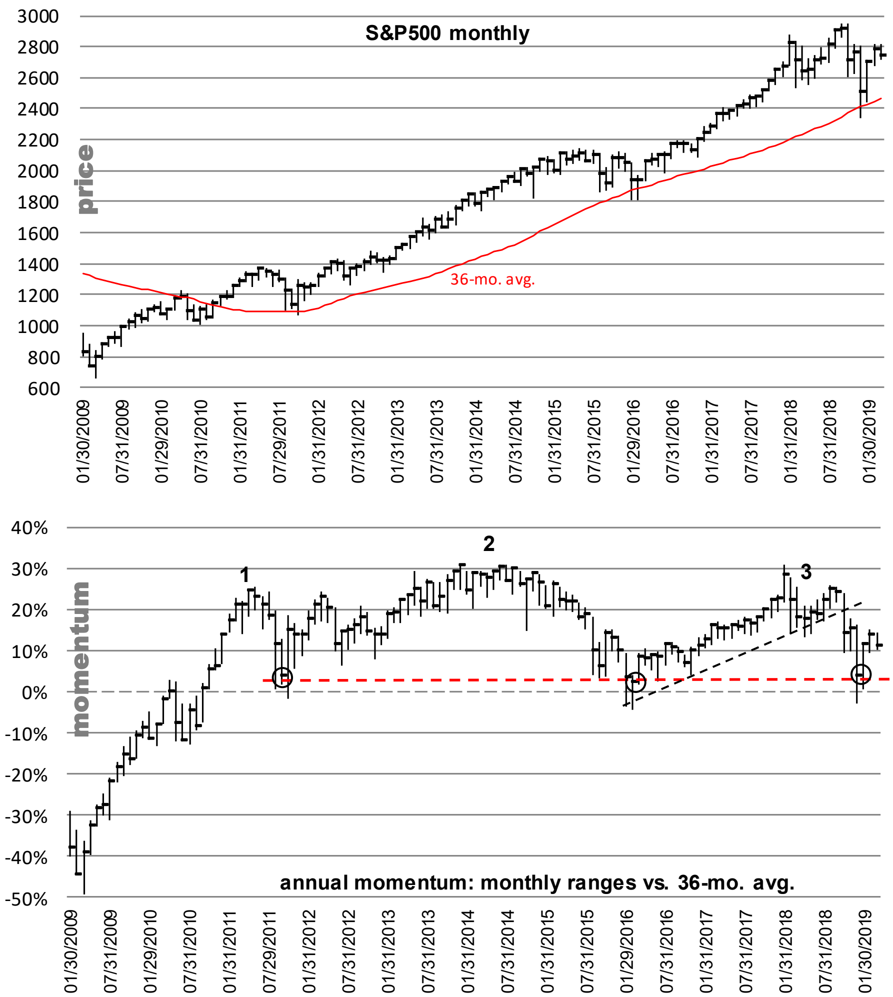
Here we look at long-term momentum but only over the past three years.

The uptrend that began at the 2016 lows was violated in October 2018. The consequent drop held at the 2016 oscillator lows (see the next page as well), and by avoiding touching our final trigger of 2311 in December, the market enabled this rally. And quite a rally it is.

But it's under violated structure, and despite its stretch, it doesn't even approach the downtrend (immature, we should note) that's plotted through the January 2018 and the September 2018 highs.

Note the negative divergence between price and momentum at those two highs.

In any case, a negative situation despite the rally.



S&P500 annual momentum: large vista

Three major up waves in annual momentum is usually all you get. In this case, those waves are very clear. The number of years involved is what most observers note; we note the "maturity" in terms of the number of distinct momentum waves.

Breakage of the third wave to the downside has occurred, implying the last wave is finished.

The only technical point of breakage left is defined by the horizontal floor of readings going back to 2011.

We consider any monthly close below the perfectly horizontal trio of oscillator closes of 2011, 2016, and last December to be our final sell signal.

We should note that the DAX Index and the Eurostoxx 50 Index (European blue chips) have already violated their versions of that red line structure.

For the S&P500, our numbers are: Monthly close for March at or below **2517**; monthly close for April at or below **2538**; May at or below **2558** takes out the last slat of support, adjusting up by about 1% per month. MSA is monitoring and will adjust these numbers as needed (from April onward the numbers are estimated and thus subject to minor adjustment).

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