Inter-Market Relationships Analysis

A Daily Review of Global Capital Market Trends

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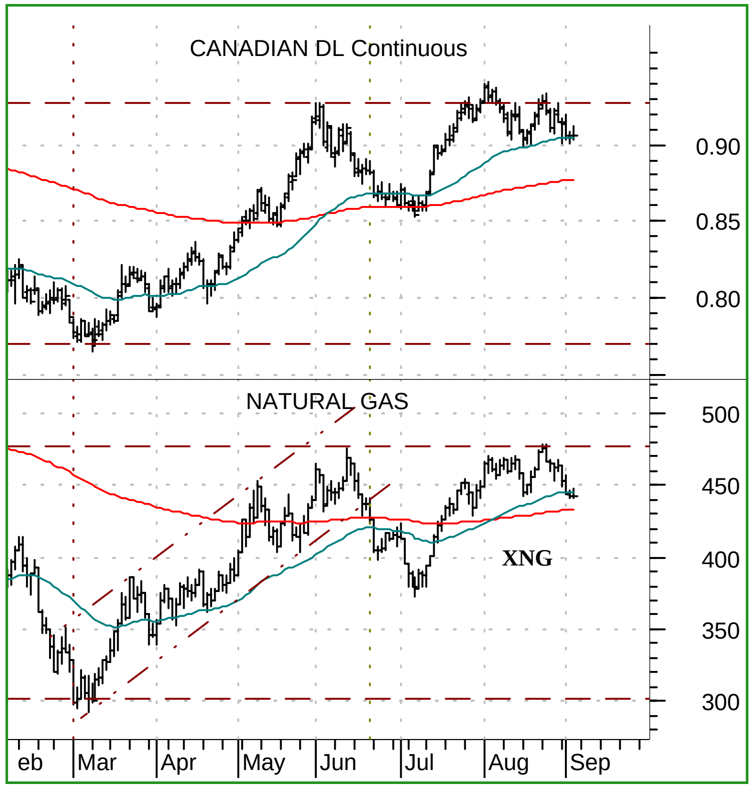
Chart Presentation: Natural Gas

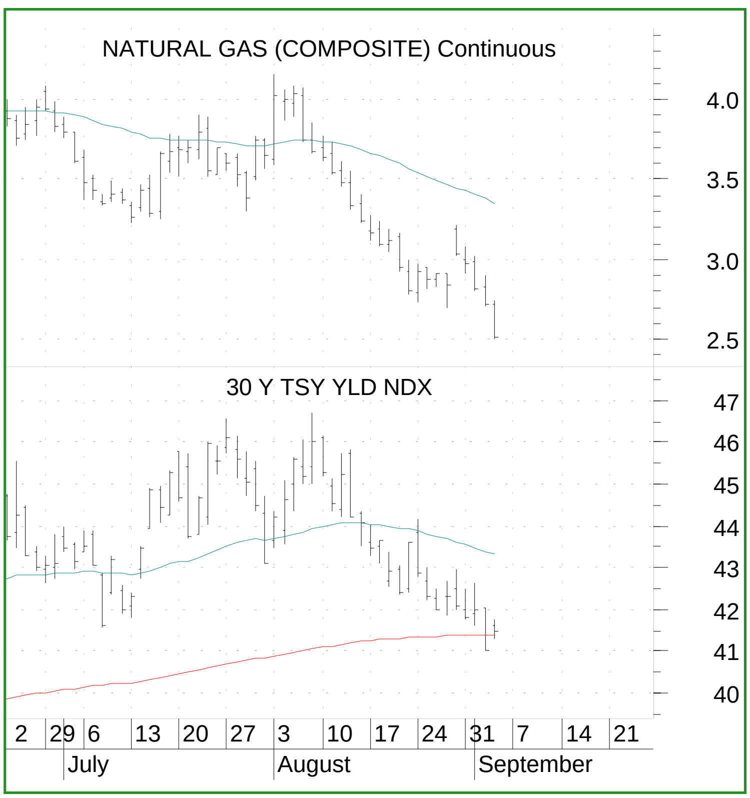
The equities of natural gas producers (XNG) are trading with the Canadian dollar. A rising trend for the gas producers translates into a rising Canadian dollar and downward pressure on the U.S. dollar.

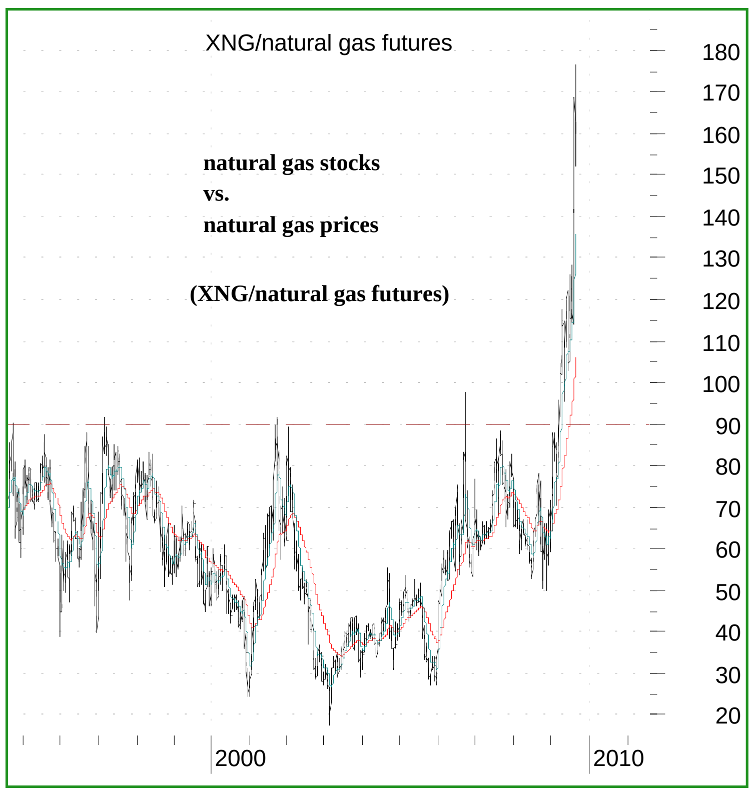
Near-term or front month natural gas futures prices (below) are trending with long-term Treasury yields. A falling trend for natural gas futures prices is going with declining long-term U.S. interest rates.

Meanwhile... as natural gas prices decline and the stock prices of the natural gas producers rise... we end up with the chart at bottom right. The ratio between the Natural Gas Index (XNG) and front month natural gas prices is literally 'through the roof'. If we pick something like 70:1 as a fairly normal ratio between the XNG and natural gas prices the equity markets- and hence the Canadian dollar- apparently are happily discounting a return to something in excess of $6 for gas prices.

Our point? The current level for the Canadian dollar is based, at least in part, on the expectation that supply excesses are temporary. Our thought is... what if they aren't?







Equity/Bond Markets

In yesterday's issue we showed a potential relationship between the gold miners and the share price of Coca Cola. The argument was that in the late 1980's and again in the mid-1990's the XAU and KO had moved through a very similar sequence. The XAU had made a first peak that coincided with the start of a rising trend for KO and then pushed up to a second peak just over two years later that marked the cycle highs for the CRB Index. Following the second peak for the Philadelphia Gold and Silver Index the commodity markets declined for three or four years while the gold miners remained negative on balance for two to three years as the share price of KO pushed upwards to its cycle top. We have included the chart comparisons on page 6 today.

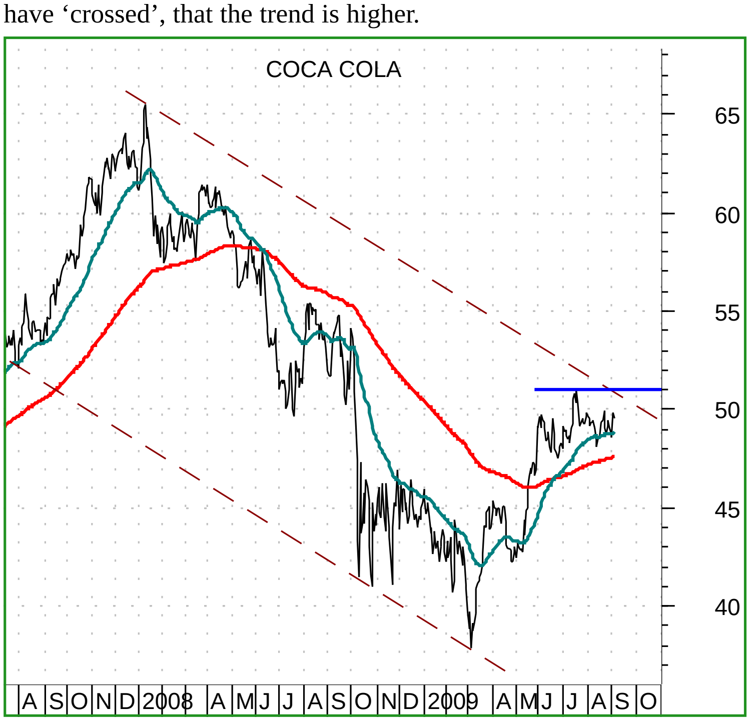
To the extent that the gold miners reached a top in early 2006 concurrent with the start of a rising trend for KO and then pushed to a second top in mid-2008 right at the peak for the commodity markets... we can argue that the sequence may be repeating itself.

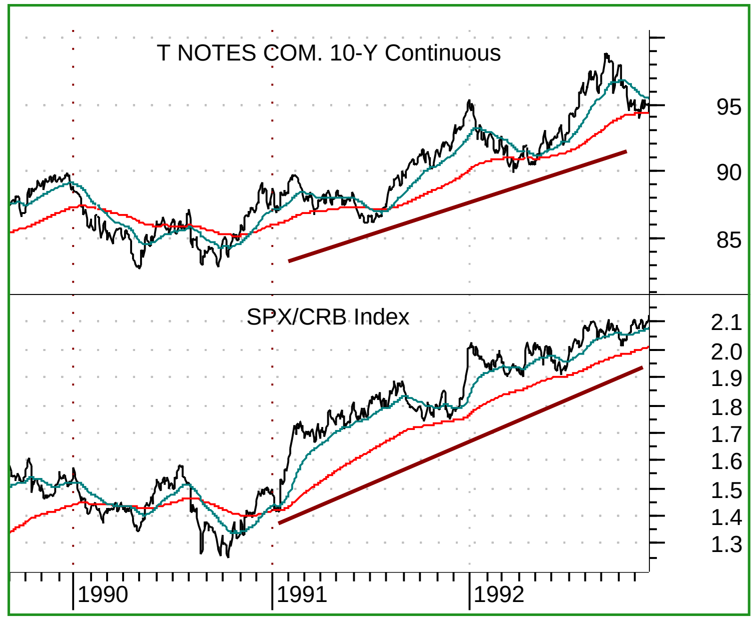
To expand slightly on the idea we have included three chart comparisons at right of the U.S. 10-year T-Note futures and the ratio between equities (S&P 500 Index) and commodities (CRB Index).

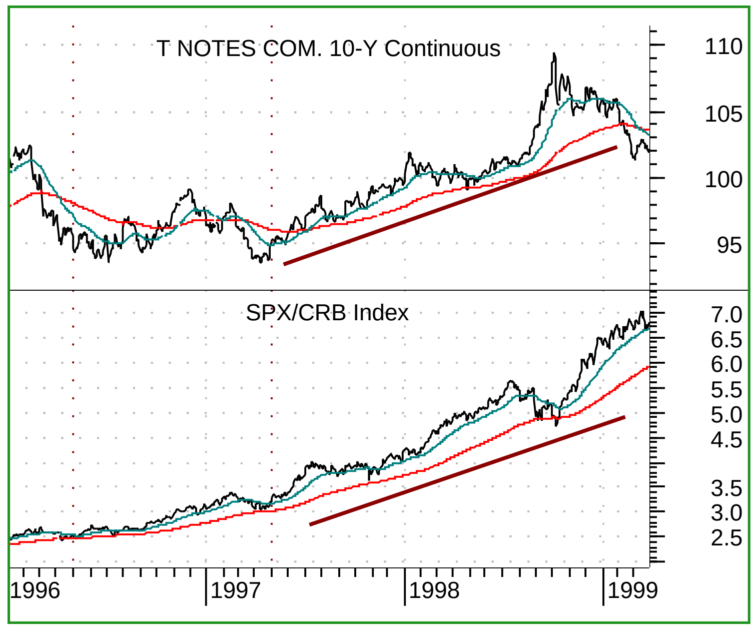
The XAU made a peak in 1987 and a second top right at the start of 1990. It made a top in 1994 and a second top in the spring of 1996. The focus now is on what happened AFTER the second top.

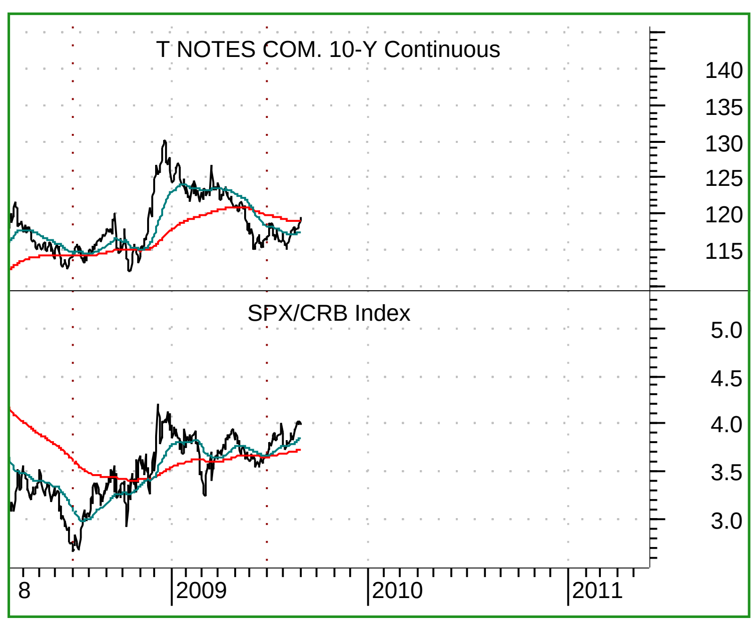
In both prior instances when the XAU made its second top along with the highs for the CRB Index... the bond market was basically lower in price through the next year. A return to rising bond prices and the start of a positive trend for the equity/commodity ratio helped drive the share price of KO upwards. The current situation- shown below right- is actually quite similar.

To get from here to there, however, a number of things have to happen. The bond market has to continue to lift, the SPX/CRB Index ratio has to move to new highs, gold prices have to stop rampaging to the upside, and the share price for KO has to swing upwards out of the downward sloping channel shown below. A nice close above 51 would break the channel top while helping to confirm, now that moving average lines have 'crossed', that the trend is higher.





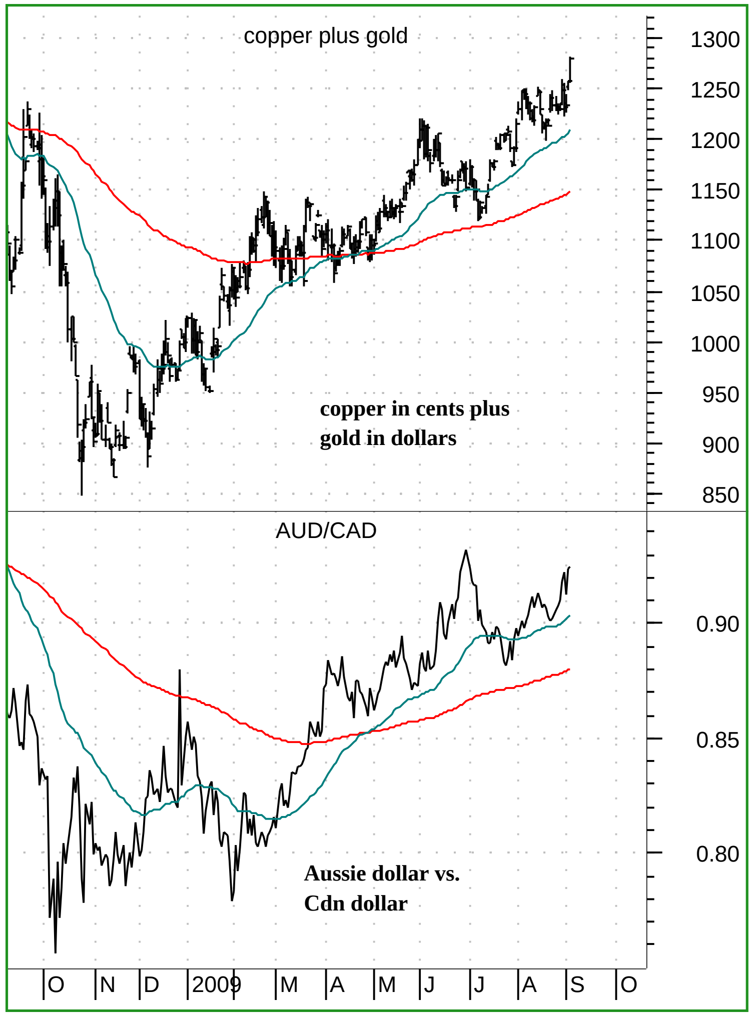




Currency/Commodity Markets

Most currencies are measured against the U.S. dollar so when we write about dollar strength or weakness we can either do it using the U.S. Dollar Index (dollar against the euro, Swiss franc, sterling, Cdn dollar, yen, and Swedish krone) or we can simply use individual exchange rates. In other words if we show that the Canadian or Australian dollars are 'toppy' then we are, in effect, making a positive case for the U.S. dollar.

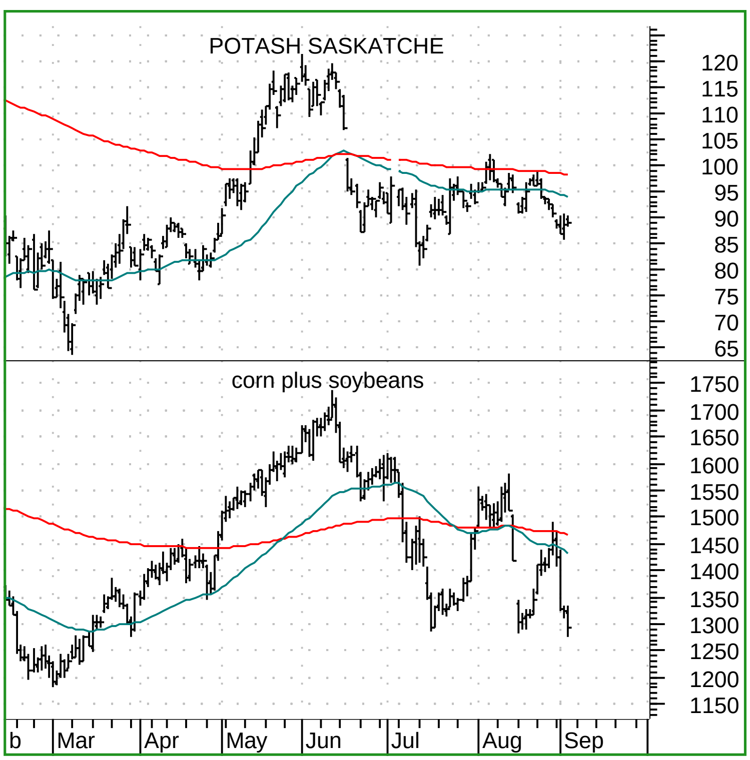
In any event... our initial point has to do with the relative strength between the Australian dollar (AUD) and Canadian dollar (CAD). The chart at right shows that when the Aussie dollar is rising against the Cdn dollar the trend for metals prices tends to be stronger. To check the rising trend for copper and gold prices the Aussie dollar has to start to weaken against both the U.S. dollar and the Cdn dollar. If one were to use the forex markets to either confirm the strong trend for metals prices or look for a potential trend change... the Aussie dollar represents a good place to start.

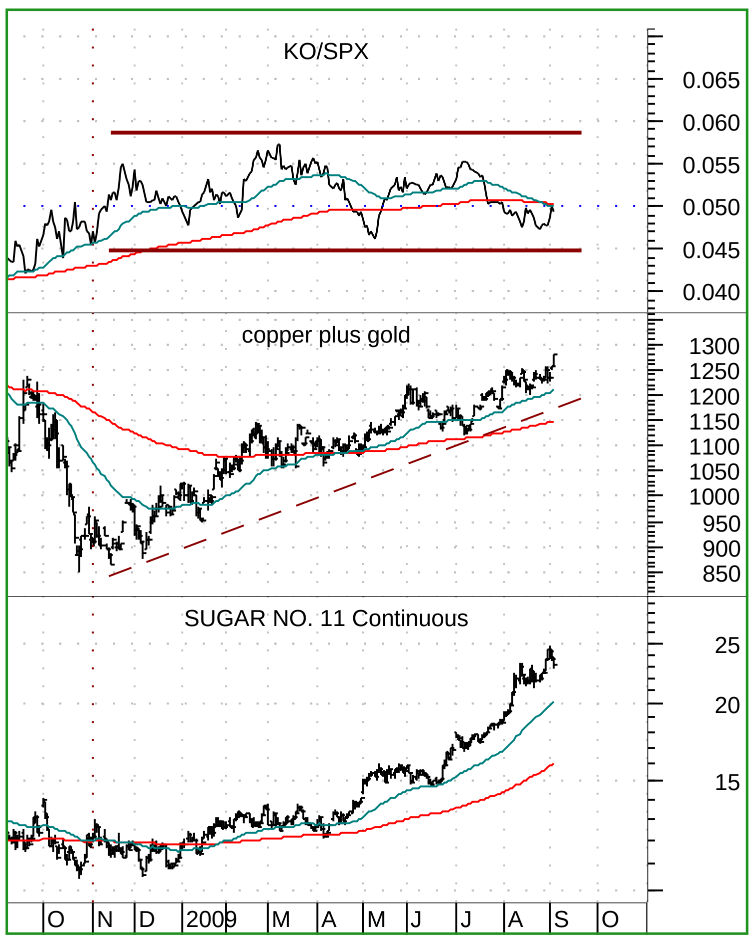


Below right we compare sugar futures, copper plus gold futures, and the ratio between the share price of Coca Cola (KO) and the S&P 500 Index.

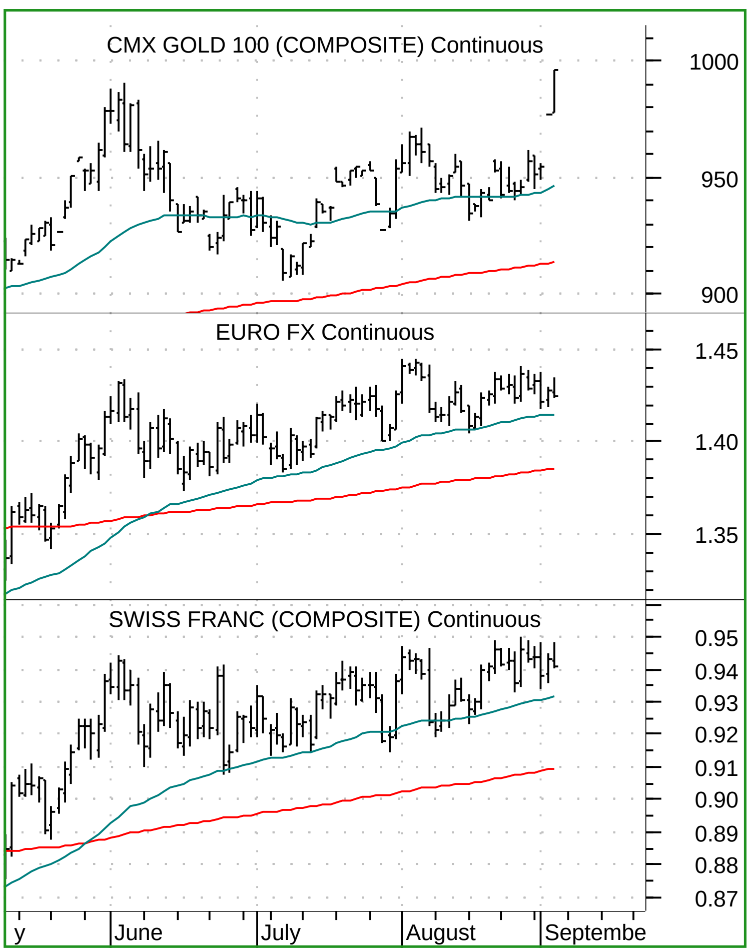
To make a bullish case for KO the commodity markets have to stop pushing Why? Because on a relative basis all the share price of KO has done since last autumn is hover around 5% of the level of the SPX. Now that grains prices have turned lower the two markets that have been doing the work in the commodity sector are metals (gold, silver, copper, and platinum) and sugar. When these rising trends begin to tire look for confirmation through strength in the KO/SPX ratio.

Below we compare the share price of Potash Corp. (POT) with the sum of corn futures and soybean futures. Notice that grains futures prices have given back almost all of the gains made between March and June and falling prices tend to put downward pressure on Potash. The near-term trend will become progressively more bearish if corn and soybean futures prices fall all the way back to the March lows.





Recommendations and Inter-Market Summaries From Previous Issues- September 4, 2009 Page 4



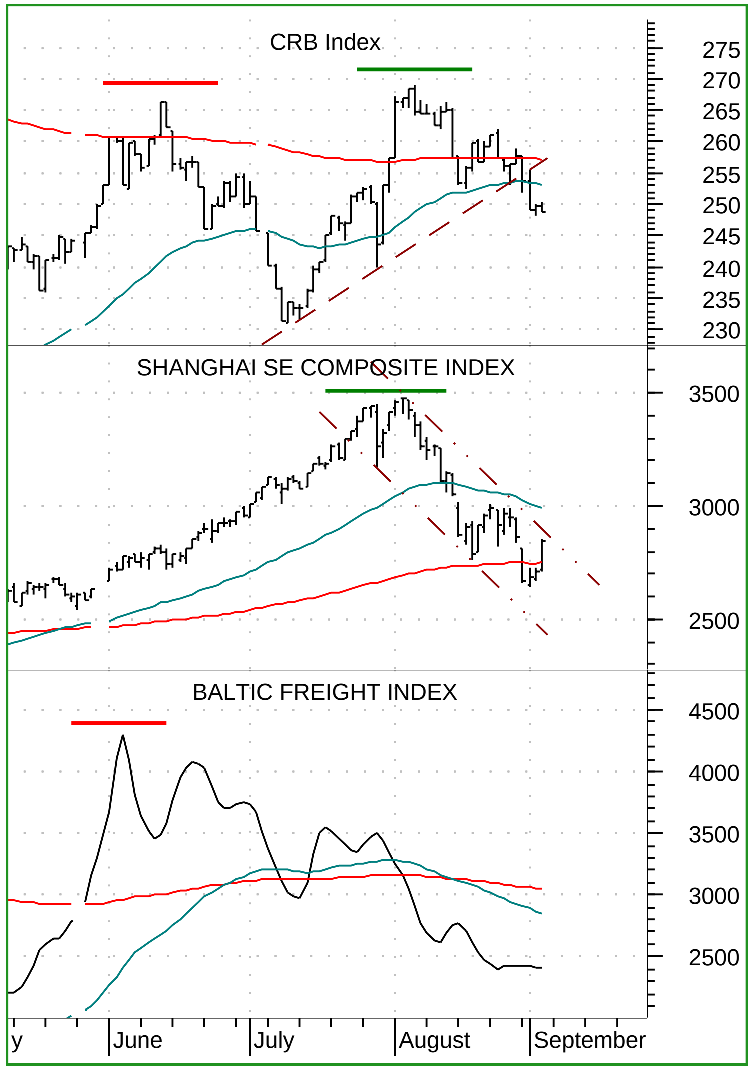
At right we show a comparison between the CRB Index, the Shanghai Composite Index, and the Baltic Dry Index.

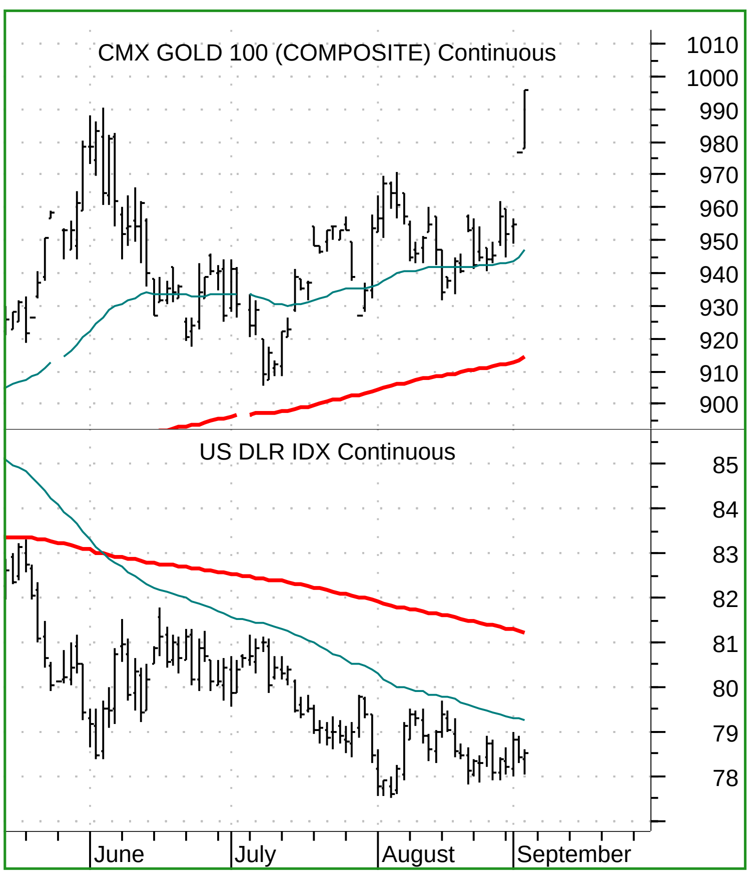
The argument was that the CRB Index peaked with ocean freight rates in June and then made a second top at the highs for China's equity market. As long as both 'drivers' were pointed lower the trend for commodity prices would also be bearish. Fair enough.

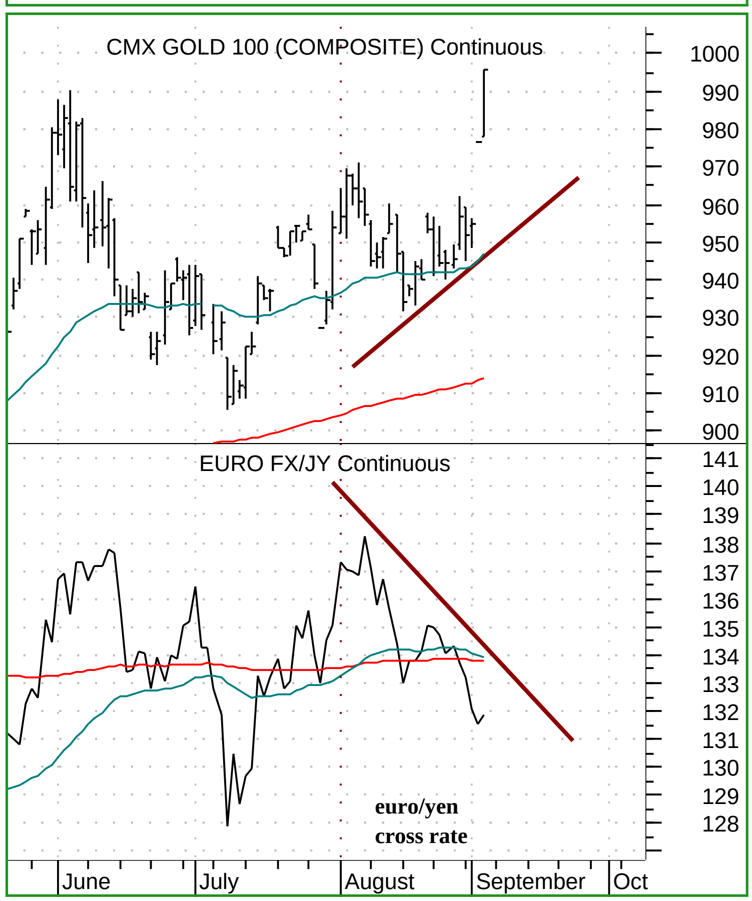
While we have had late cycle strength in the metals and sugar (page 3) the charts still suggest that commodity prices in general remain under pressure. The Shanghai Comp. rallied smartly yesterday evening but only within the confines of a fairly steep downward sloping trading channel. Obviously the channel top could be broken as early as today but with ocean freight rates holding near the lows along with long-term Treasury yields the commodity trend still looks weak to us.

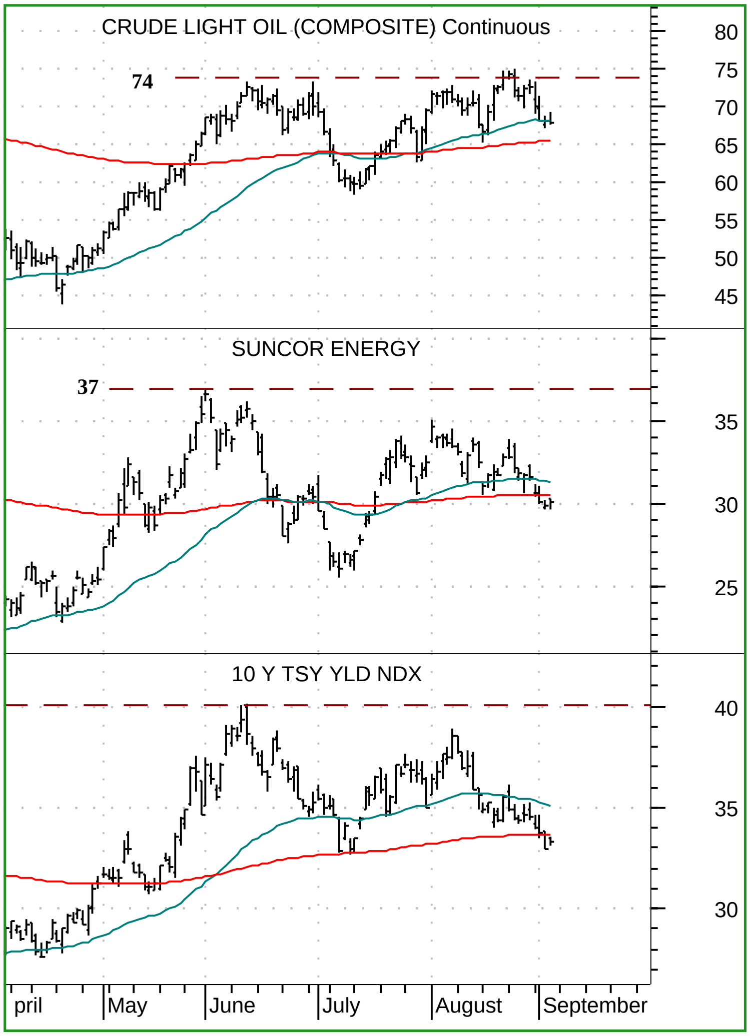
Now... what to do about gold? Our sense is that it is a 'sell' anywhere close to 1000. Our thought is (chart on page 7) that the TBonds/gold ratio has found excellent support just below the .12 level which means that as long as the TBonds hold 120 we would not expect gold futures prices to close much above 1015.

Aside from that the trend for gold requires U.S. dollar weakness and through trading yesterday the dollar was trending sideways. The dollar tends to follow the cross rate between the yen and the euro or, when viewed through the reciprocal, trend inversely to the euro/yen cross rate. The point is that the euro/yen cross rate has actually been lower over the past month so unless gold price strength is an early warning of a massive break to the upside by the euro... against both the dollar and yen... the 'intermarkets' suggest that gold would be better around 930 instead of racing up towards 1000.





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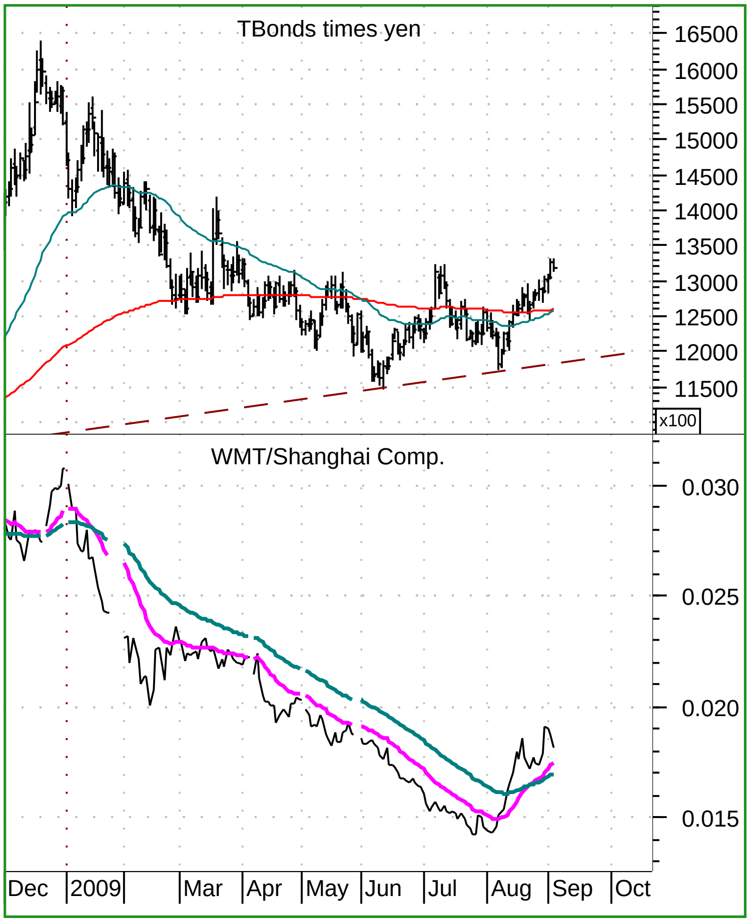
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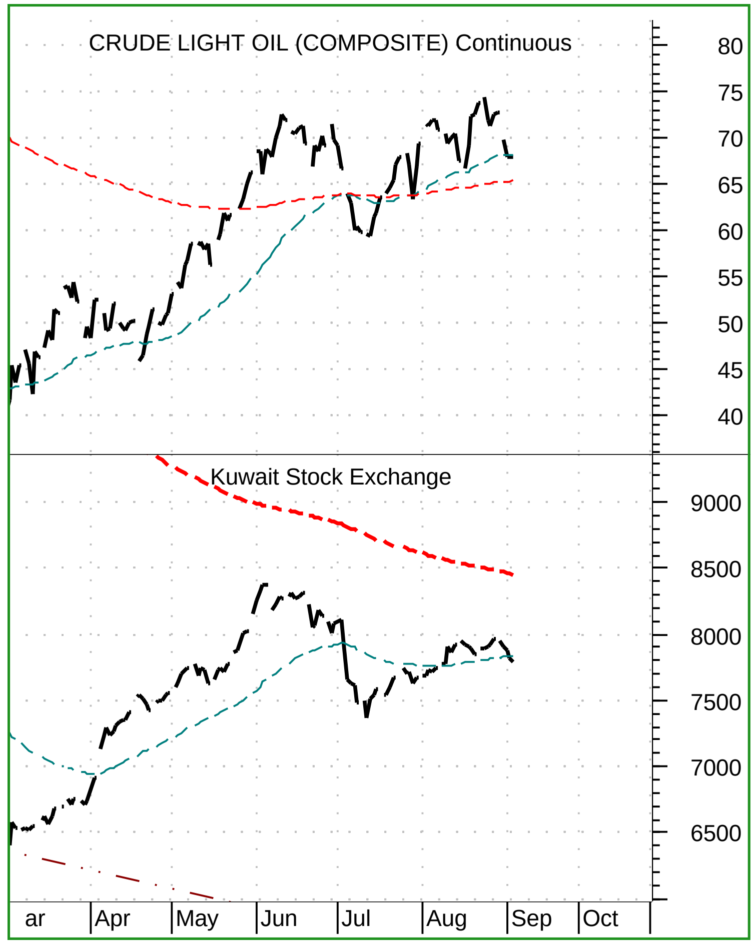
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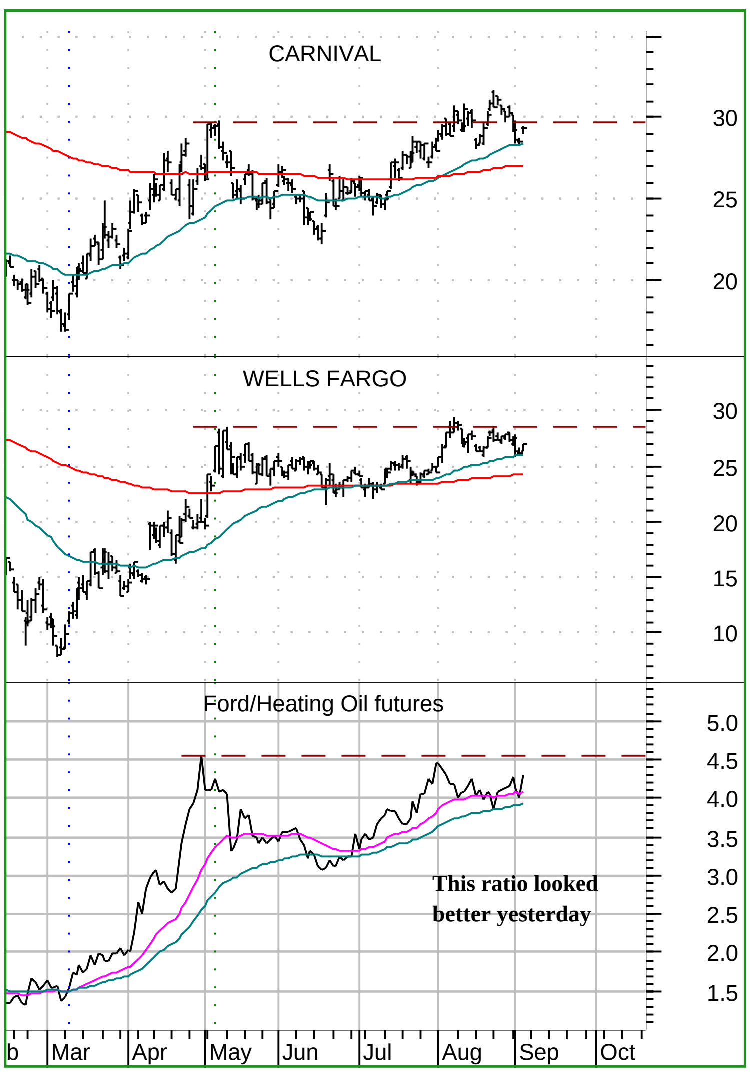
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SWISS FRANC (COMPOSITE) Continuous
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