



## *Indecision Time*

### From the June 21, 2009 HRA Dispatch

As we move through June, markets look less and less decisive about the medium term trend. Large cap indices have flattened out and look like they are slowly rolling over. All the commentary about how large the bounce has been off the March lows belies the fact that most of the bigger bourses really haven't gone anywhere since early May. The truly impressive aspect of this to us has been the down shift in volume. It has been falling almost constantly for several months, with average daily volume off by almost a third on the US S& P and over half on the Dow over the past three months.

The volume levels in Q1 may not be a good comparable since the markets were still in panic mode and (one sincerely hopes) capitulation. Current low volumes do speak to a definite lack of conviction on the part of traders however, which is mirrored by indices that seem to be meandering almost aimlessly. Larger exchanges contrast with a number of "developing country" indices, like Shanghai (the top chart on the right) which continues to be on a more direct upward trajectory. The chart for the Bombay Sensex looks considerably more bullish than even Shanghai ever since voters handed Prime Minister Singh a stronger mandate. Some will view this simply as a danger sign where the Chinese and Indian stock markets are concerned. Yes, they do look frothy, but we also consider their greater strength another aspect of the new world order that is now evolving. Foreign buying is helping them along, but that may become a caution if these buyers head for cover again.

There has been a lot of comment recently that this is a "retail" rally, but recent figures from Trim Tabs, a firm that monitors fund flows, indicate there has been little retail participation. The "retail only" argument tends to get proposed by those that are fundamentally bearish. The underlying assumption is that funds are smarter than the retail crowd so if the funds aren't all in, it must be a head fake. After the past two years, we're surprised so many still assume superiority on the part of fund managers. Low retail participation and tepid volume can be read either as an indication that there is lots of money on the sidelines waiting to get in (if you're bullish), or that retail investors have thrown in the towel and blocked their broker's phone numbers (if you're bearish). The second answer may be closer to the truth. There was a lot of money pulled out of equity funds in Q1 and moved to money market and bond funds. That doesn't mean these people (and funds) are gone for good. If it turns out this rally is not a giant head fake and the markets just keep rising, those disillusioned traders will be back as things are getting frothy again.



We still think a major correction towards the March lows is the highest probability outcome. We can't help but look back at the aftermath of the Tech Wreck which produced a sizable multi-month rally only to be followed by lower lows. Given the extreme oversold levels in March however, we are still not assuming those levels will be reached and breached this time. It's worth remembering that the most common movement during long bear markets is actually 'sideways' and that they can be flat and boring for long periods. We are also well aware that the market's job is to make as many pundits as possible look stupid and virtually everyone is expecting an imminent collapse. That alone makes the contrarian in us wonder even though the signs do point downward in the major markets.

Increased nervousness in the market has caused **metal prices** to start to flatten, though no more than that, so far. A glance at the one year chart for the GFMS base metal index shows that prices, in aggregate, are still holding up well. It's not, fortunately, the V shaped bounce major equity indices display. Skittishness is more apparent in base metal equities, with producers seeing interim highs along with the broader indices, but then dipping more quickly when they slip. Caution is advised since base metal stocks tend to get punished during pull backs, even if its not deserved based on their individual fundamentals.

**Copper** continues to consolidate and move sideways, but warehouse inventories are still declining. We note with interest the news out of China that high car sales in May were a shock to everyone, including dealers and manufacturers. If May's monthly run rate of 1.1 million units continues, China will be the world's biggest car market this year. Yes, that is largely due to the simultaneous collapse of North American and European car markets.

But, that change in leadership – retail leadership – is after all the point of the stimulus. Chinese car dealers have two month delivery wait times; most of the cars sold haven't been built yet.

We are still seeing good accumulation and in some cases strong buying in the exploration space, especially in **precious metals**. Until we see this dry up, a summer rally for a limited number of summer explorers, and some of their neighbors, is at least still in the cards, and we'll play it. Ω

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