Sand Spring Advisors LLC

2006 Overview

by,

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We have never been set to a rigid schedule at Sand Spring Advisors in publishing our letters. Instead, we like to write only when we have something compelling and adroit to say. At the moment, we are thinking both back to 2005 and forward to 2006, and attempting to cull our best past and ongoing perspectives. We have many thoughts swirling around still being pieced together. Thus, this letter will be on the short side, but will be expanded upon as market evidence either supports our current views, or forces us to change them.

Back on February 20, 2005 we penned a letter entitled "Lost in Space: Varied 2005 Macro Views & More Definitive Astro Path." Almost a year later, this letter still makes for interesting reading as not that much has fundamentally changed over the past year. If anything, many of the same global imbalances cited by various hedge fund managers in that letter continue to exist today, and have simply gotten bigger and more dangerous. Notably, most of the macro managers that we quoted last February didn't do a bad job in forecasting 2005. There was an overall consensus by the group for a muddled year in U.S. equity and fixed income markets, with greater strength in foreign markets, precious metals markets, and oil. But there was no immediate Armageddon last year as some feared, and almost all got something wrong.

Manager 1 got the gold market strength the most correct, but his other "doom and gloom prognostications" fell short – at least so far.

Manager 2 got the fact that M&A activity would be strong, while total employment would remain mildly anemic due to consolidations, foreign outsourcing, and layoffs, and that the consumer would slowly get squeezed by higher inflation. But his forecast that large cap stocks would outpace small cap stocks didn't quite pan out.

Manager 3 basically went through the year as a somewhat frustrated bond market bear, but in real-time, this manager actually staggered to a reasonably good year through nimble trading of various short-term swing moves.

Manager 4 got some moments of 2005 equity strength to celebrate, and was correct in recognizing that there remains a tremendous amount of global liquidity sloshing around the world, but at the end of the day, was likely equally frustrated in his equity bullishness as Manager 3 was with his bond market bearishness.

Manager 5 recommendations were the furthest off-base. Neither the spread trade of selling TIPS vs. buying Treasuries, nor buying Asian currencies led to great 2005 riches. (Thankfully under the fund of funds umbrella of Sand Spring's business, we had no dollars allocated here, although this manager also ended up positive for the year on other views developed as the year progressed.)

Manager 6 was correct that housing refi-activity was petering out and that the consumer had little pent-up spending demand, but was wrong (to date) that the Fed would slow its tightening pace because of this.

Manager 7 got some wonderful moments of equity market volatility to celebrate in the spring and early fall, but an overall "muddle-through" investor psychology still prevailed, and frustrated any sustainable volatility advance. Indeed, 2005 ended up as the tightest annual percentage trading range the DJIA since that index's inception in May, 1891. Ditto – the NASDAQ Composite made its tightest annual trading range since its inception in 1971.

We feel empathy for this last manager the most. For anyone looking at the news of 2005 – namely, an ongoing and increasingly unpopular War in Iraq, a U.S. trade deficit spiraling ever higher, $60 crude oil, increased global inflationary pressures together with higher short-term U.S. interest rates, and a major American city wiped out by Hurricane Katrina, the news flow would have hardly suggested such a benign market outcome.

But the major U.S. equity indices were also somewhat deceiving in 2005. This is because the energy and utility sub-indices advanced respectively by over 40% and 20%, while almost all other areas of the S&P 500 (excepting small single digit advances in Health Care and Consumer Staples) ended the year in negative territory. In other words, most major U.S. stocks were actually on the weak side if it hadn't been for the huge bull market in energy. Yes, several small-cap and mid-cap indices did poke to new all-time highs, but if you missed the few hot sectors of metals, energies, and utilities, and weren't invested abroad, 2005 was likely a losing year for your portfolio.

Following the opinions of Sand Spring and some of the astro-prognostications that we listed in the second portion of the February 2005 letter might have helped this cause – at least until October. We correctly predicted equity weakness into the spring, and using our PEI pi cycle rhythms, concurred with astro-technician Arch Crawford when he predicted that post May 15th the equity cycle would be up for the summer before more sloppiness starting on or about August 30th. Toward the end of the spring, in our April 30th letter "Time for a Rabbit Out of the Hat," we specifically wrote:

> "Our gut and technical view of the world tells us that it is time for world political and economic leaders to pull some sort of "rabbit out of their hat" to create yet another "false glow" over the summer months – a postponement of sorts from any immediate financial market meltdown."

Then in late August we were looking for both a significant energy market and equity market top within the first two weeks of September, and we got both – the former top being more significant and persevering than the latter.

But our February 2005 letter had other interesting views that subsequently proved correct.

First, we wrote of Henry Weingarten's view that "within one month of the April 8th Solar Eclipse, there was likely to be a Chinese revaluation of the yuan." On April 29th, the Chinese did allow a trial balloon move of its currency through its previous peg, before formally revaluing the yuan on July 21, 2005. But this reval itself was small, and ended up being interpreted as a token political gesture to the Bush administration.

Elsewhere, Weingarten got gold's overall 2005 market strength correct, and adroitly stated: "The astro-alignment is also supportive of Japan this year, especially in the 4th Quarter on a relative basis to other global markets." Nice call Henry. The Nikkei advanced by over 40% last year, with a large portion of that gain transpiring in the 4th Quarter. Unfortunately, our own cautious investing nature caught the first half of this move, but then sat out the second half when we thought the market had become overbought in September.

In our Feb. 2005 letter we also spoke about the first of three Jupiter-Saturn squares (the first such alignment since 1945-1946) setting up another Cold War type of situation – a real "clash of civilizations." Mr. Bush versus Iraq/Iran seems to increasingly be fitting that bill.

And almost creepily, our Feb letter stated that per the AstroProfile.com website, "the mid-March to April 2005 alignments would be consistent with important religious leaders retiring or dieing." Pope John Paul of course passed away on April 2, 2005 – a close enough prognostication to set the hair aloft on the back of our proverbial neck.

But we also spoke of Venus – representative of prosperity – still being near to the Earth in 2005, albeit so too was Mars – planet of war. All that this alignment brought to mind -- both last February and still now -- was Nostradamus's famous Centrury 10 Quatrain 72 about war "reigning happily" for a considerable number of years starting around July 1999. Unfortunately, Venus is now moving away from the earth, while Mars will linger relatively close for awhile longer -- dangerously entering the sign Leo in June-July 2006.

Lastly and interestingly, looking back at 2005, the two Lunar Eclipses of 2005 – the first on April 24th and then the second on October 17th -- came pretty close to nailing the two significant equity market lows for the year. Mmm…we'll have to watch Lunar Eclipses more carefully in the future.

So overall, while our macro managers of 2005 had generally the right ideas, each view was frustrated to some extent by something, while we actually achieved somewhat more precision in "swing timing" by looking toward the heavens and our pi cycles.

This was of course until Sand Spring overstayed the bearish equity downswing into mid-October 2005, and was subsequently hurt by the November 2005-January 2006 equity market rebound. Call this our own false step of irritation and confusion. We are contrite in having made this misstep, and honestly still a bit puzzled at having apparently misinterpreted this 4.3-month swing cycle. But of course January still has three more weeks to run, so a late shock to the markets certainly remains possible.

2006

So where does this all leave us on a forward-looking basis**?**

Fundamentally, we continue to consider the U.S. consumer as key. From a secular big-picture perspective, household savings rates and debt levels in the U.S. are currently as absurd in early 2006 as equity P/E levels were in early 2000. Household savings is now negative and household debt as a percentage of Quarterly GDP is fast approaching 90% -- an all-time high. Insatiable consumer spending to date has led to a 6% Merchandise Trade deficit (measured as a % of GDP) and the numbing statistic that 57% of tradable U.S. treasuries are now owned by foreign investors. Not that long ago, many considered 30% foreign ownership of U.S treasuries as dangerously high. Mark our words: Someone somewhere someday soon is going to get really screwed by these imbalances. In our humble opinion, this is not a matter of "if," but simply "when" and "to whom" such transpires.

From a cyclical perspective, our major 8.6-year high-to-high rhythm of the past 30-years started between late 1972 and early 1973 with a DJIA high at 1067.20 that lasted for years. 8.6 years later, spring 1981 saw another equity high near this level before Volcker started to tighten monetary policy aggressively and the DJIA plunged some 20%. Another 8.6 years later we saw the all-time high in Japan during the last week of December 1989. 8.6-years later, we saw a July 20, 1998 significant high in American and European markets just before the Russian ruble/LTCM crisis. The next 8.6 year "high" cycle is due February 24, 2007 – and we continue to see that date as a likely high, maybe in Asian markets this time around.

The harder question is: what will be the path followed in reaching that February 2007 high, and how volatile will this path be? If we had to bet, it will be a *very* volatile path because this is exactly what markets are not currently expecting or discounting.

From a sub-PEI 8.6-month and 4.3-month cycle basis, we originally believed that a late January 2006 low would yield an early June 2006 high; then a mid-October 2006 low; before the final vault higher into late February 2007. This path is still possible, but as we type on January 8th, the markets better hurry up and turn lower to meet the January 28/29th low expectation. Perhaps we are wrong.

So we thought that it might be interesting to look toward the heavens once again, and to see if we could find any dates of importance that might line up with our PEI cycle approach.

Per Manfred Zimmel of www.Amanita.com, bond prices should make their annual high in the first quarter, and fall in price until a low in the third quarter. He sees the entire 2006 year of Saturn in Leo having elements of hyper-inflation with some similarity to the Saturn in Leo year of 1919 (German hyper-inflation).

For the first half of the year in terms of the equity markets, he sees something similar to 2005 – "nothing really world-shaking." He sees a peak for equities in the second quarter on or about May 17th, with a third quarter break lower into a late October 2006 low. He sees bulls "being cut off at the knees" after June 19, 2006, but many businesses improving again after Jupiter enters Scorpio on October 26th, 2006. Interestingly, this is relatively consistent timing to our PEI pi cycles that point lower from early June until mid-October – albeit derived in a very different way. We like it when two very different analytical techniques line up in such a manner.

Zimmel specifically sees the chance of a September 2006 collapse of -10-15% magnitude (or far worse if associated with some sort of natural disaster). He suggests some possibility of an earthquake during the year in or near Japan causing giant 50-80 meter tsunami waves on the U.S. west cost. He quotes from cycle analyst Eric Hadik:

> "2006 is 190 years – 10 times the lunar-related 19-year cycle time – from 1816, when Mt. Tambora created "the year without a summer" (2005 being 190 years from the actual eruption in 1815). This event was exactly 190 years from May 1626 when 'the worst frost in 500 years' froze lakes and rivers and destroyed crops in Europe."

Zimmel is generally bullish on gold and oil, as well as soft commodities – particularly after late spring into the end of the 3rd quarter and early 4th quarter. He also states that Uranus in Pisces will continue to be bullish for everything related to water (a previous theme of Sand Spring Advisors) through 2010. But we've shared enough of his insights here. For Zimmel's longer-term views into 2008-2012, his recently released annual letter, priced at $73, is well worth the cost. Even if the lay-person will not understand all of the content, Zimmel has done a tremendous amount of work within this letter.

Arch Crawford (www.CrawfordPerspectives.com) meanwhile, points to a Mars-Uranus "crash alignment" that begins in August 2006 and extends through March 2007 – covering a portion of the June-Oct PEI cycle and Zimmel's astro analysis period of expected market weakness, as well as the February 24th, 2007 major PEI 8.6-year cycle turn date. All past U.S. stock market crashes occurred during this alignment, albeit Crawford always points out that (similar to periods of an inverted yield curve that often lead to equity weakness, but don't always) these alignments sometimes pass in benign fashion.

But in this instance, Crawford is not pulling too many punches. He also talks of a Jupiter-Neptune series of squares from late January 2006 into Sep. 2006 that he expects will touch off a "serious round of inflation" -- consistent with Zimmel's view.

Forthcoming 2006 Saturn/Neptune opposition at the same time that Uranus passes through Pisces are also nasty concomitant alignments in Crawford's analysis. To him, they suggest blockage in the flow of oil and possible epidemics. Like Zimmel, Crawford points back to a similar alignment of the heavens during the pandemic and hyperinflation of 1918-1919. Like Zimmel, Crawford uses Bradley Sidereal Cycle analysis which points to a mid-May 2006 equity high, with equity markets then expected to move down into the 4th quarter. Interestingly, a partial lunar eclipse on October 17, 2006 also lines up with calls by Zimmel and Crawford for equity weakness into the fall.

More short-term, Crawford expects a "damaging decline" between January 13th, 2006 (a minor Bradley peak) and January 26-27th when he suggests "Sunspots go nuts, weird weather – Quakes?" So maybe our earlier forecast for a 4.3-month PEI low into January 29th is still possible (although it will hardly have been worth anticipating at this stage given the late 4th quarter 2005 advance).

Elsewhere, Henry Weingarten worries about the Mercury Retrograde period in late March when we also will see a total solar eclipse on March 29th, followed by another Mercury Retrograde period in July. Mercury Retrograde periods – which occur 2-3 times each year – generally involve missteps, detours, and confusions. Weingarten predicts sever equity market weakness within 90 days of the March 29th solar eclipse (which implies Mar 29th might be a high), with the Jupiter-Saturn-Neptune T-Square of June 22nd leading to a very hostile and difficult July 2006 in terms of war.

Another forecaster with a more "Nostradamus bent," John Hogue expects that after America tries to reduce its troops from Iraq this spring, Iraq will dissolve into true civil war such that US forces will be called upon to "reinvade" Iraq between the summer and late 2006. With Saturn in Leo, Hogue expects that Saddam Hussein – someone in Hogue's mind who is likely to be executed sometime in 2006 -- will "exploit his final act on history's stage to the fullest unto his end," and the Iraq situation will then only get worse after his death. Meanwhile Hogue expects that Mr. Bush will become more obstinate in his position on Iraq even while the nation turns increasingly critical of his actions.

Century 6, Quatrain 13 Quatrain from Nostradamus starts with the French words "Un dubieux viendra loing du reigne." If one considers that "dubieux" matches Mr. Bush's nickname "Dubiya" fairly closely, the rest of that Quatrain translates as follows:

Dubiya will not come far from the realm,
The greater part will initially want to support him;
A Capitol will not want him to rule at all,
In the end, his great burden he will not be able to maintain.

Hogue thus suggests some chance of an eventual Bush impeachment, but only after 2006 ends when the Democrats will presumably have taken back the majority in both the House and the Senate, and an eventual Third Party starts to appear on the American scene.

So overall, everyone on the astro front, as well as PEI cycle work, pretty much lines up as follows:

- Equities trade down from current levels into late January 2006 – (perhaps from some sort of sudden unexpected weather/seismic-related shock?).
- Bonds top early in the year, but then start to fall as inflationary pressures build between the spring and 3rd Quarter, while stocks may initially rally back from late January lows during February and March. Keep an eye on soft-commodity markets such as wheat, soybeans, and corn for potential "catch-up" bull markets.
- Watch for something to start going wrong during the Mercury Retrograde period just prior to the March 29th solar eclipse. Things then start turning nasty again around mid-May, and get particularly bad in the July-October period.
- But from late October 2006, equities rally yet again -- possibly to new highs on certain indices (Asian?) -- into February 2007.

Overall, this sounds like a more volatile year than 2005 – particularly in the second half of the year.

Taking this a step further, then watch out for 2007-2008 -- the period in our mind when the real equity ugliness begins, with general oil market strength continuing into 2008-2009. This latter period is when the tallest building in the world (pictured below) is scheduled for completion in Dubai. How fitting we think it would be to see an oil peak in 2008-2009 just when this building is scheduled for completion. Of course, the bigger question concerns the potential level of the oil price at this extreme. Will it be $100 per barrel or $500 per barrel? Either way, don't expect equity markets to enjoy the process of getting there.

The Burj Dubai building will be nearly
half a mile high when completed in 2008/2009

A Final Word

The longer-term broad-brush forecasts made above are of course just our current personal opinions. In your investing, please use your own judgment and watch the Sandspring.com website for short-term updates that may adjust these views.

But in espousing our longer-term views, at least we have a theory of how to approach markets – a model so the speak that attempts to combine as many different fundamental, cycle, astro, and technical indicators together, looking for commonality -- so as to reach some sort of high-probability "timing roadmap."

As a culture, most Americans are completely ignorant as to the real vulnerabilities of the U.S. economy, while those who are somewhat cognizant of the current imbalances, are mostly short-term "statistic happy." They want to see and react to each and every statistical number without having any real economic model or overall approach to help define which of these numbers are important, and which numbers represent just random noise. To this point, we recently loved the words of Austrian-school economist Dr. Kurt Richebacher when he wrote:

> "The [average] American is not trained to think about things. In America basically, theory is non-existent. The Americans say: 'We don't need theory, we have statistics.' …They think: 'Greenspan will come into action again and we'll continue, as always'….A perception [currently exists] that the U.S. economy is in splendid shape. Interest rates make nothing and yet consider the bullishness of the stock market.
>
> "[Conversely,] I think that the American economy is at its most critical situation point in the whole post-war period *because of all the excesses that have accumulated*. How can

you just obtain statistics if you don't have an overall theory that gives you the ability to distinguish between important and unimportant numbers?"

Richebacher attributes this tendency by Americans to love statistics, but not really put them into their proper context, to early U.S. economist Wesley Mitchell who once told Friedrich von Hayek: "We know too little in order to develop a theory. All we can do is we must develop statistics. We must have as many statistics as possible and then we can judge what is happening."

The big problem with the American mindset is that most statistics tend to be concomitant or lagging. The average American is not forward-looking, but instead just listens to CNBC, and extrapolates the future from the past. The average American thus ends up "shocked" when statistics suddenly degrade and the future takes an abrupt turn.

Hopefully, such is not a fault that Sand Spring Advisors should ever be held guilty of – even as we inevitably make our own market forecasting mistakes from time to time. We believe that it is more important to see the forest, not just the trees – to think prospectively and not retrospectively.

More specific chart analysis will follow toward our January 29th cycle date.

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Send us your comments at information@Sandspring.com.

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