Sand Spring Advisors LLC

Thoughts into the New Year: A Rock on a Cloud

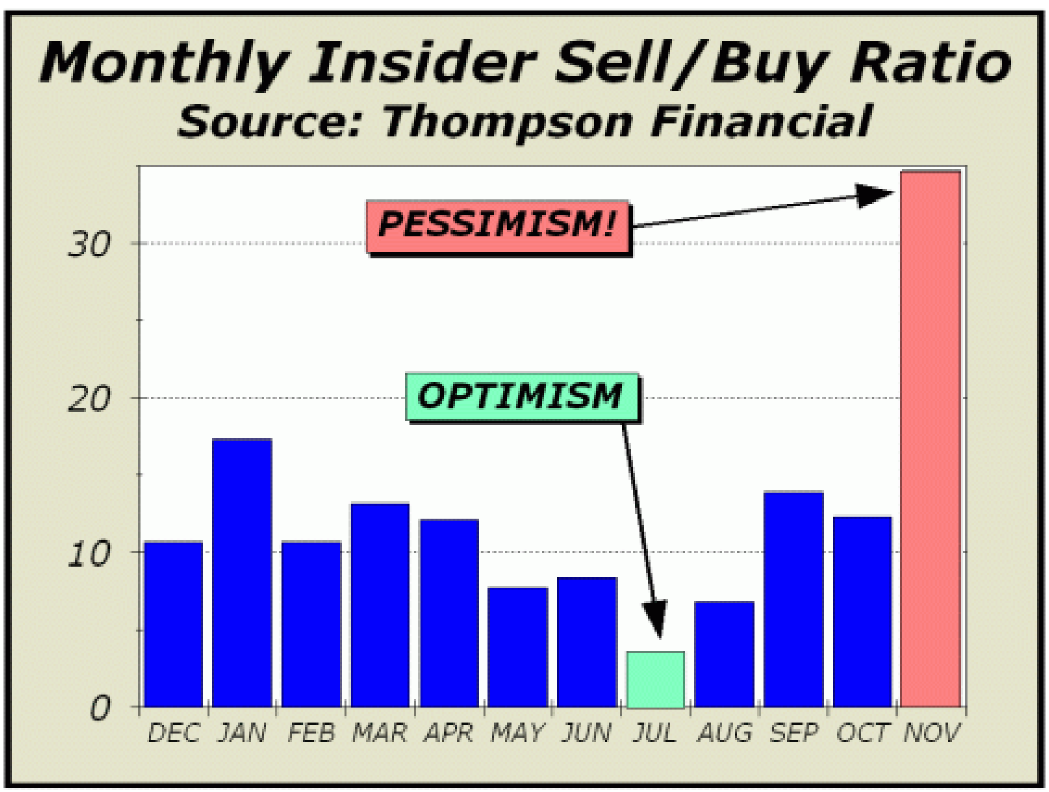
by,

Barclay T. Leib

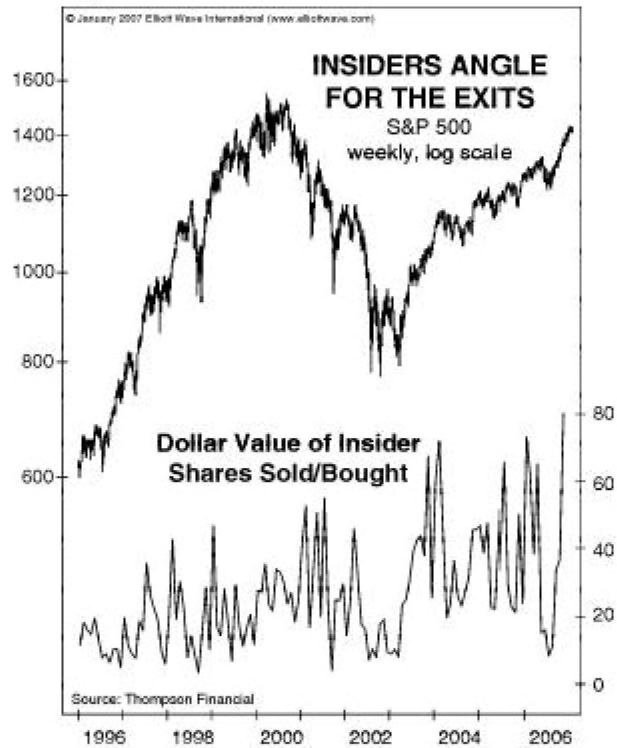
January 7, 2007

There are many anecdotal and technical signals that a major equity market top is near. Primary among these signals:

- Insider selling has recently been extremely high. See the charts below, courtesy of DecisionPoint.com and Elliott Wave International, which show approx. 34.7 times as much insider selling in November as there was insider buying, with a very high absolute dollar value on shares sold:

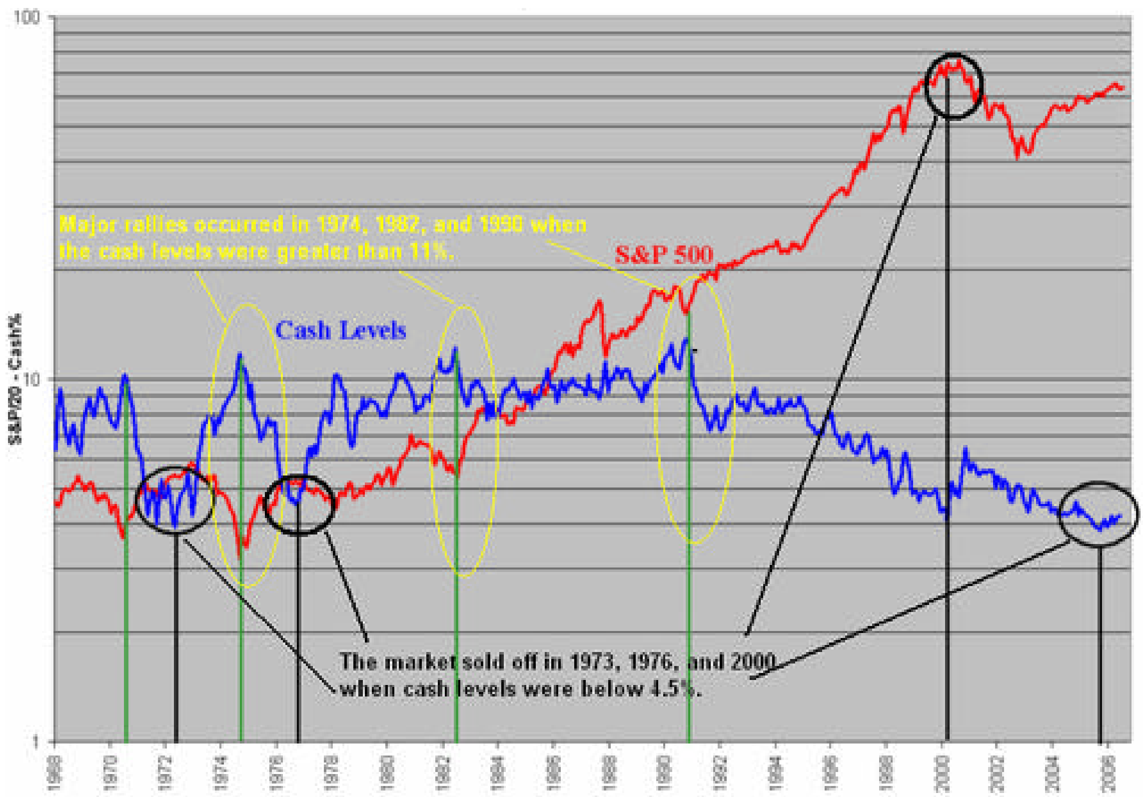


Source: DecisionPoint.com



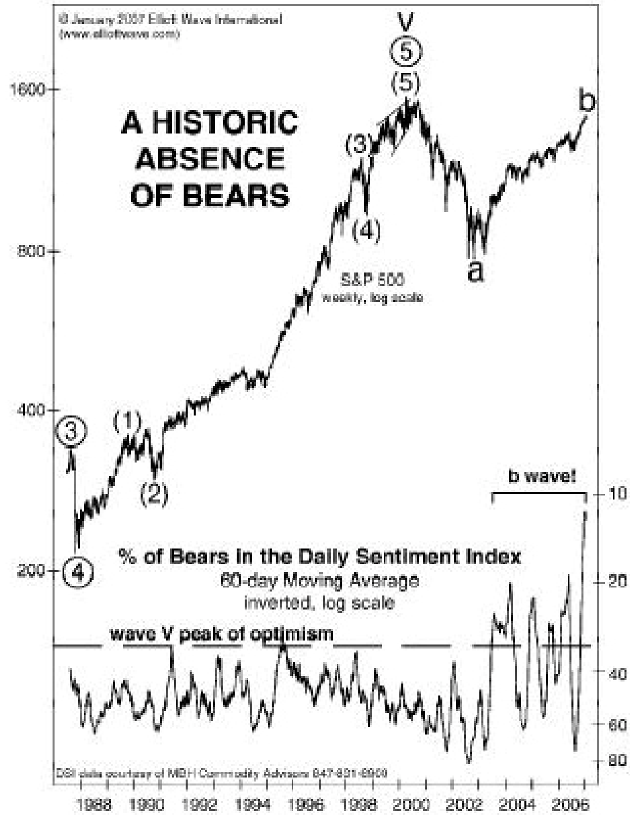
Source: Elliott Wave International

- Mutual fund cash levels are once again extremely low. See the chart below courtesy of Roy Ashworth:

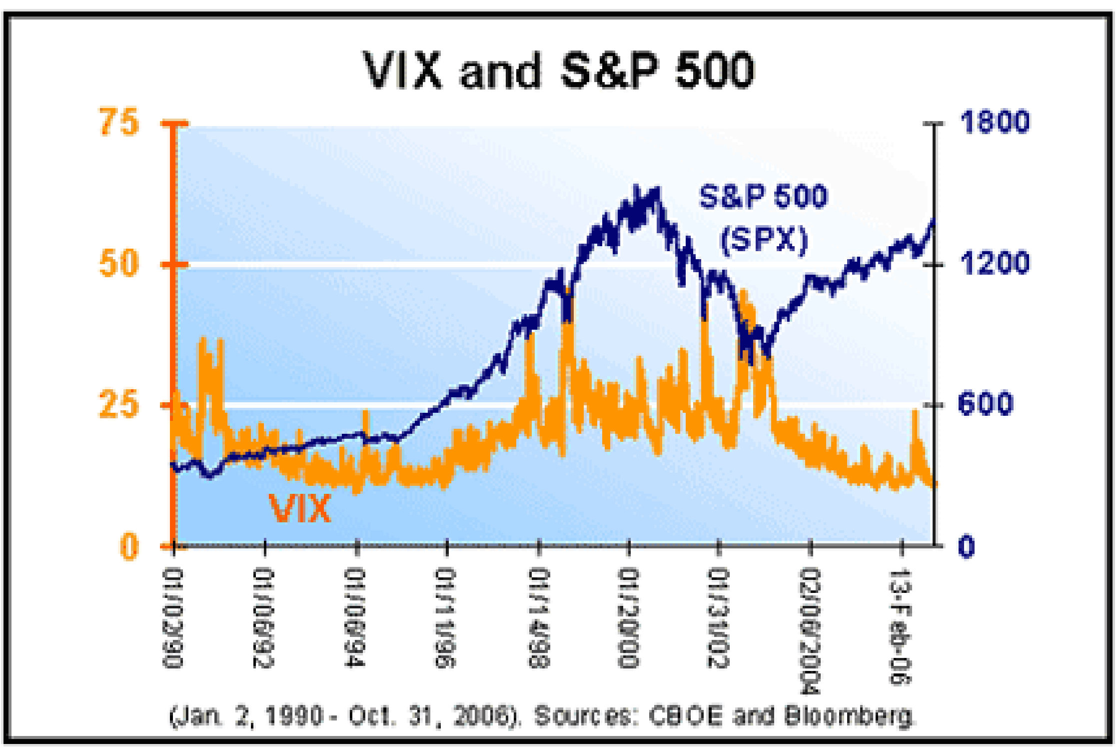


Source: Roy Ashworth

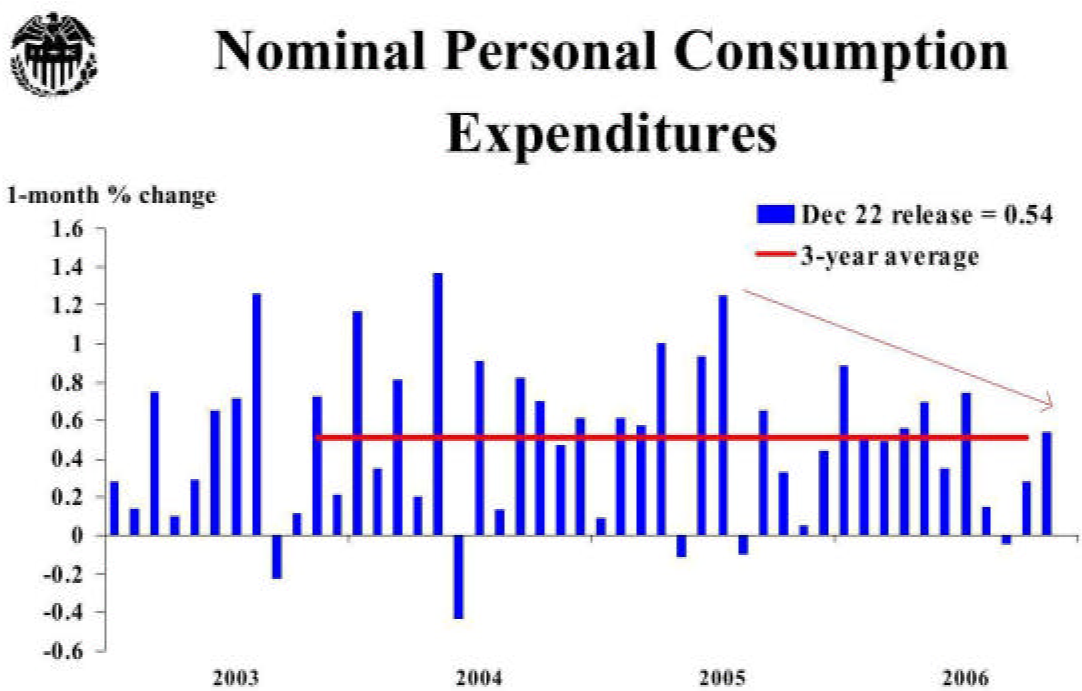
- Investor sentiment levels have been running extremely high, while the VIX Volatility Index stumbles along near its 10-year lows.



Source: Elliott Wave International



- Earnings growth has seemed suspect at many companies – particularly across mid-2006 as consumer spending slowly started to roll over. Motorola just started 2007 with a real earnings fizzle.



Source: Dallas Fed

Motorola warning suggests tough times ahead for industry

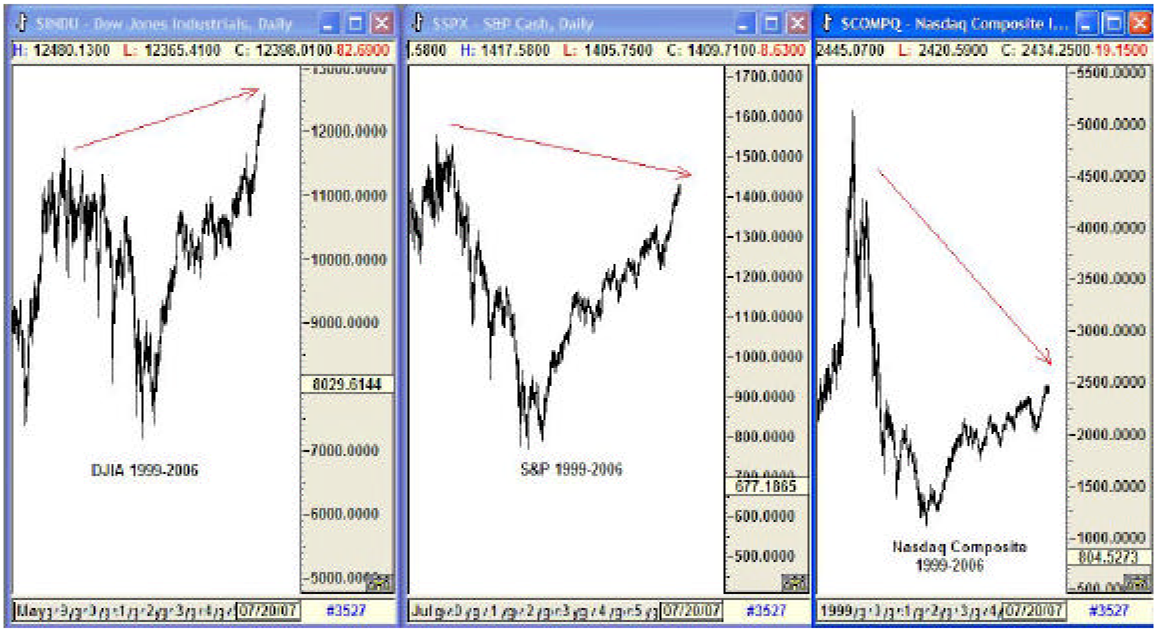
By Roger Cheng
Last Update: 5:01 PM ET Jan 5, 2007

NEW YORK (MarketWatch) -- Motorola Inc.'s (MOT) warning that it will not meet its earnings and revenue goals for the fourth quarter portends continued struggles for wireless handset makers.

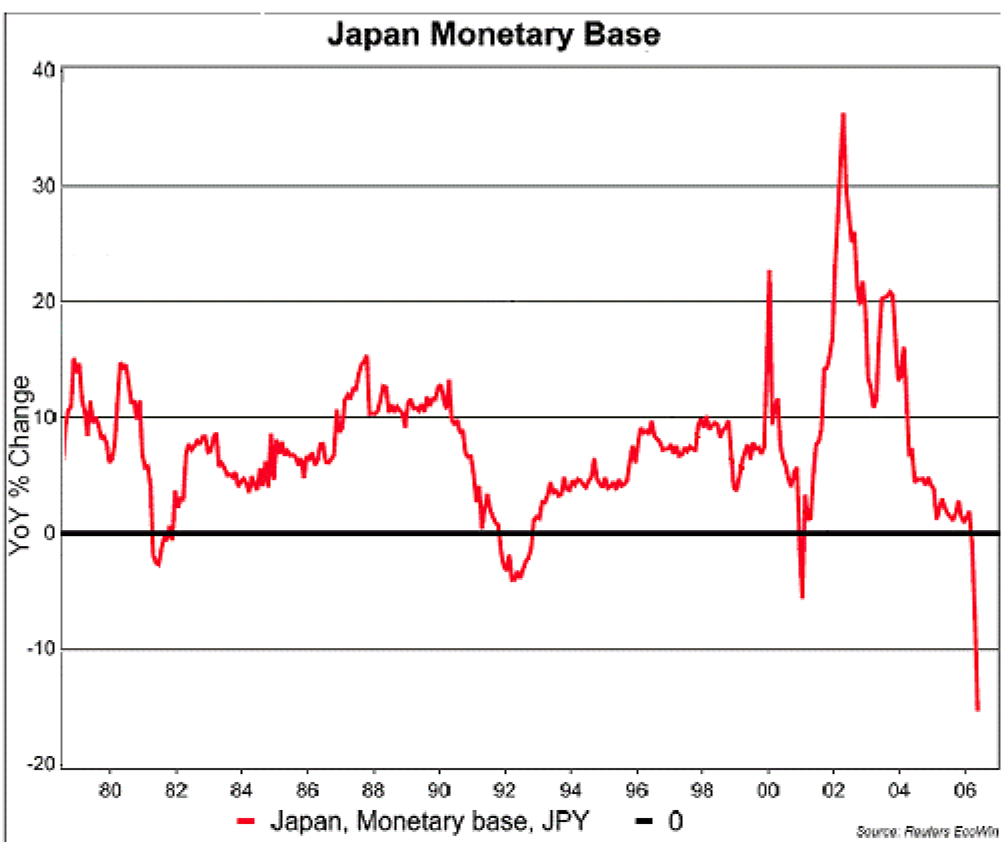
This marks the second quarter in a row that the Schaumburg, Ill., company will report disappointing earnings and revenue. While Motorola blamed the weak third-quarter results on a slowdown in sales of a key product, the most recent warning illustrates the issues affecting the industry.

In November, market leader Nokia Corp. (NOK) warned that its increased presence in the emerging markets area, in which it must sell phones at a much lower price, will negatively hit industry average selling prices. It also cited general competitive factors.

- The breadth of the market has been poor with a few stocks in the DJIA vastly outperforming the broader S&P 500 and Nasdaq Composite indices.

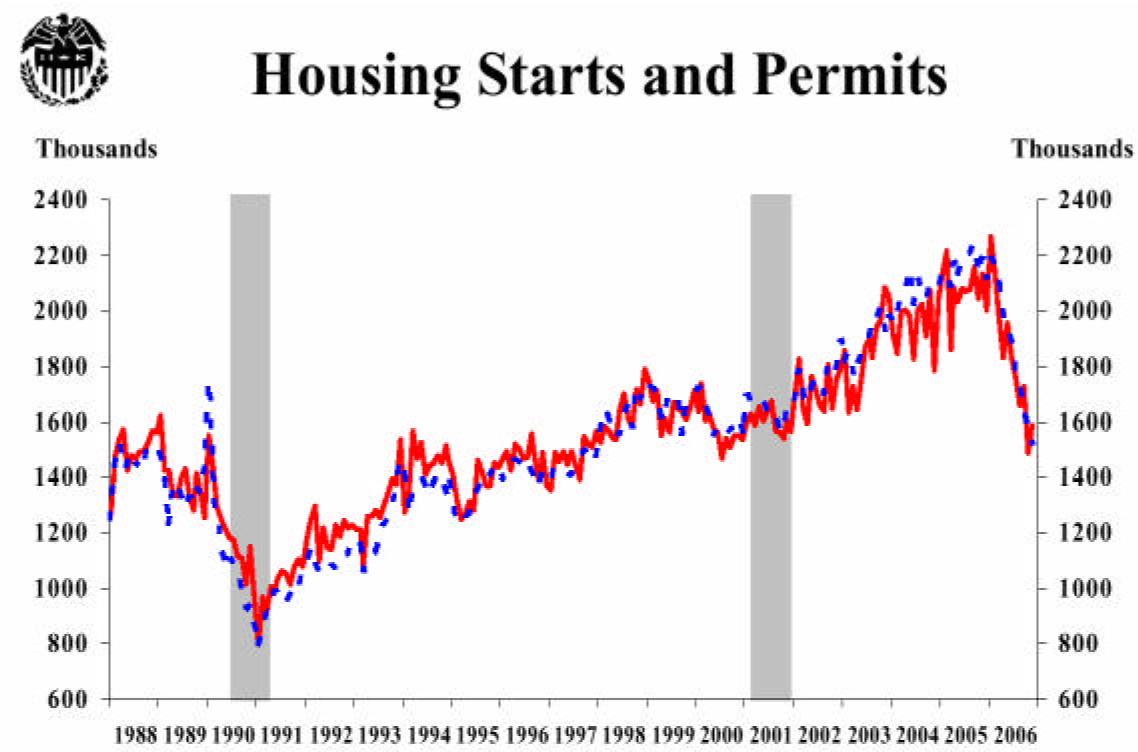


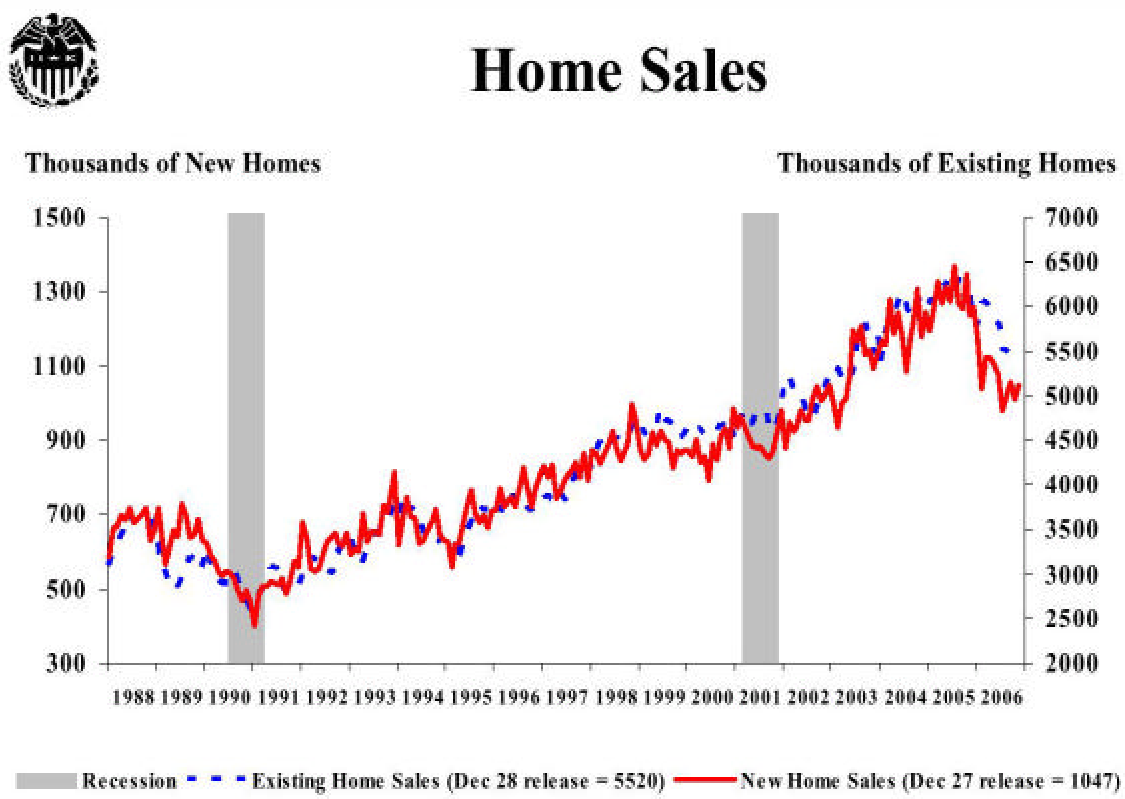
- The Japanese monetary base fell precipitously from late April 2006 onward – an early harbinger of the era of easy money coming to an end.



Source: GaveKal

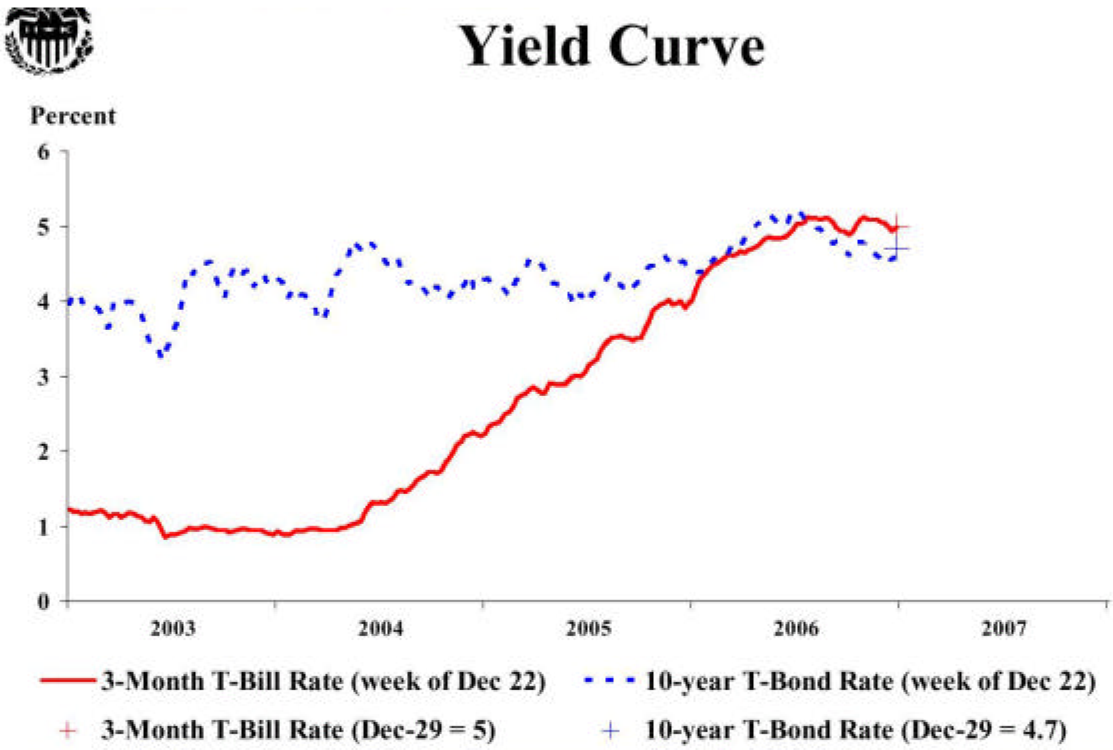
- U.S. housing starts, housing permits, and housing sales have been in freefall over the past 11 months – an early harbinger that the wealth effect of cash equity extraction from housing also being in the process of change within the U.S. economy.





Source: The Dallas Fed

- And is the currently inverted U.S. yield curve making anyone in the financial industry particularly happy? How many small banking institutions and consumers are struggling with their mortgage exposures given the chart below?



Source: Dallas Fed

Back in October, we also wrote to expect an equity market top at about the time when Crude fell to around $56.31 – and we have now reached such a downside target.

But alas – we are not yet ready to pull the trigger and get aggressively short. More specifically, we have yet to reach our time window of the PEI 8.6-year cycle top due February 24, 2007, and thus despite the plethora of fundamental and technical indicators suggesting an overbought and potentially vulnerable U.S. equity market, we are loathe to get short too early.

Indeed, from a Fibonacci rhythm point of view, we recently published on the website a Nasdaq 100 chart suggesting yet one more new high in that index near an extrapolated upside target of 1859.

Similarly, we are unhappy with the current S&P 500 chart as a "complete" rhythm. Might the S&P currently be in a minor iv wave correction of a final 5th wave advance, with a final 5-wave hurrah still in the offing up to the 1470-1496 region by February 24, 2007?

This is our preferred view for now, albeit should such transpire, this will be a difficult move to understand rationally. It will be an even more difficult move in which to participate on a risk-reward basis. Yet basis the DJIA, 12,769 and 13,161 are two Fibonacci target levels that we see as possible during a final blow-off. The key in our mind is simply being patient not to sell into this market too soon. The next big trade will eventually be to the downside, but to be short right here today does not quite seem "fully baked" yet.

Beyond February 24, 2007, everything will be a different story. February 24, 2007 is a major 8.6-year PEI cycle related back to the cycle highs of July 1998, December 1989, May 1981, and October 1972. Once February 24th has been reached, we believe that a hard-landing recession looms for the U.S. economy. Within this recession period, we believe that governmental and corporate entities will come under increasing criticism as "reality bites" about the true weakening state of the U.S. consumer. Naively constructed forward earnings estimates will need to be slashed by Wall Street.

Interestingly, from an astrological perspective, several influences dominate over this late February period that line up reasonably well with our anticipated PEI cycle turn. These astro influences are:

Feb. 13, 2007-March 7, 2007: Mercury Retrograde – a window of time that typically brings increasing chaos and accidents.

February 28, 2007: Saturn opposition Neptune (exact, lasting until June 2007): As described by Astrodynamics.com, "In the opposition (180 degree aspect) there is a tension between these two planets that result in an experience that is disorienting and destabilizing. The effects of the Saturn/Neptune opposition bring our fantasies and illusions (Neptune) into collision with the cold facts of reality (Saturn). From a global perspective, Saturn/Neptune cycles often witness the dissolution (Neptune) of governments (Saturn) and erosion of power structures. Saturn/Neptune events are never enjoyable, but always leave us with a little more wisdom and a little less gullible than before." As described by astrologer Henry Weingarten, "This is a period of a rock on a cloud – it is tension filled where new realities are finally understood." As per Astropro.com: "Think of the infamous Mississippi Bubble, which coincided with the 1719-1720 Saturn-Neptune opposition, the same alignment that beams down from the heavens for [early] 2007. The difference, I believe, is that this will be more like a soufflé settling than a bubble bursting. It doesn't go pop all at once, but in fits and starts over a period of years."

March 3, 2007: Full Moon & Total Lunar Eclipse in Virgo – rational thought reasserts itself.

March 18, 2007: New Moon and Partial Solar Eclipse

After this period of tension in late February to early March 2007, we must skip to the period between mid-June and mid-July before another set of astro and cycle dates hit. What begins in late February could easily lead to a temporary low in this latter window. The summertime may easily bring the typical 4-year cycle trough.

June 14, 2007: Minor Bradley Turn

June 15, 2007-July 9, 2007: Mercury Retrograde – period of increasing chaos and accidents.

July 5, 2007…4.3- month minor PEI cycle window – possible low?

July 18, 2007 and Oct 26, 2007 (exact): Pluto conjunct the Galactic Center, an alignment that occurs every 248 years, and should bring a questioning of old beliefs, and new beginnings.

Other dates later in 2007 leading into early 2008 (and beyond) that then bear watching (but are currently too far away to forecast with any precision as to significance or direction) include:

August 26, 2007: Bradley Turn, near Aug. 28, 2007 Full Moon and Lunar Eclipse in Pisces – beginning of healing?

Sep 11, 2007: New Moon and Partial Solar Eclipse in Virgo

October 11, 2007 to Nov. 1, 2007: Mercury Retrograde – typically a period of increasing chaos and accidents.

October 17, 2007: Major Bradley Turn

Nov. 13, 2007…4.3-month minor PEI cycle window – typically should be a high.

Dec. 22, 2007: Major Bradley Turn next to Dec 23, 2007 Full Moon

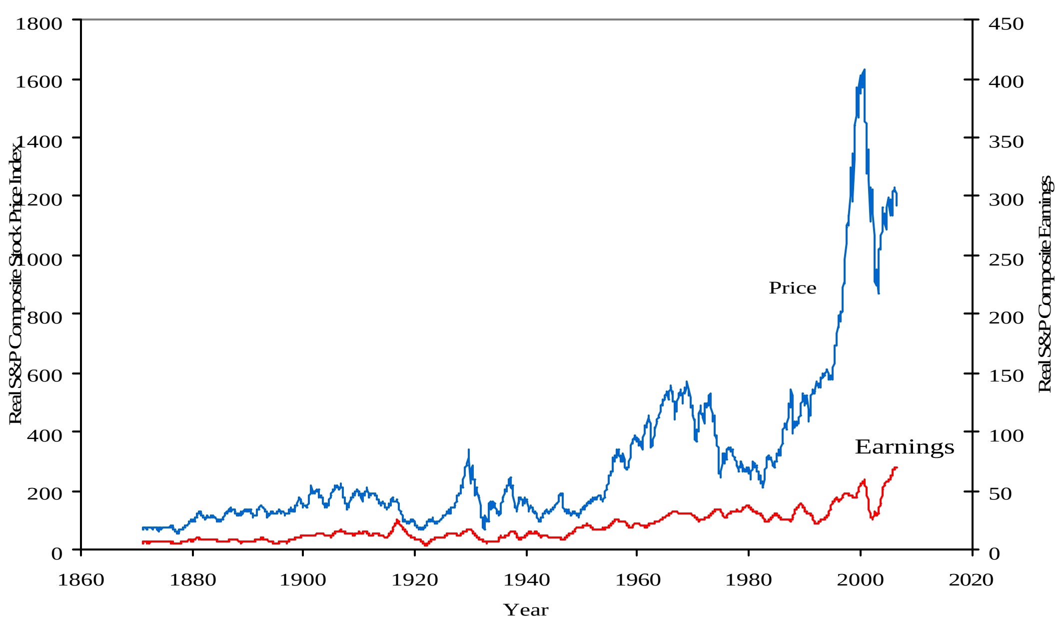
Mar. 23, 2008…4.3-month minor PEI cycle window – typically should be a low.

Aug. 1, 2008…4.3-month minor PEI cycle window – typically should be a high.

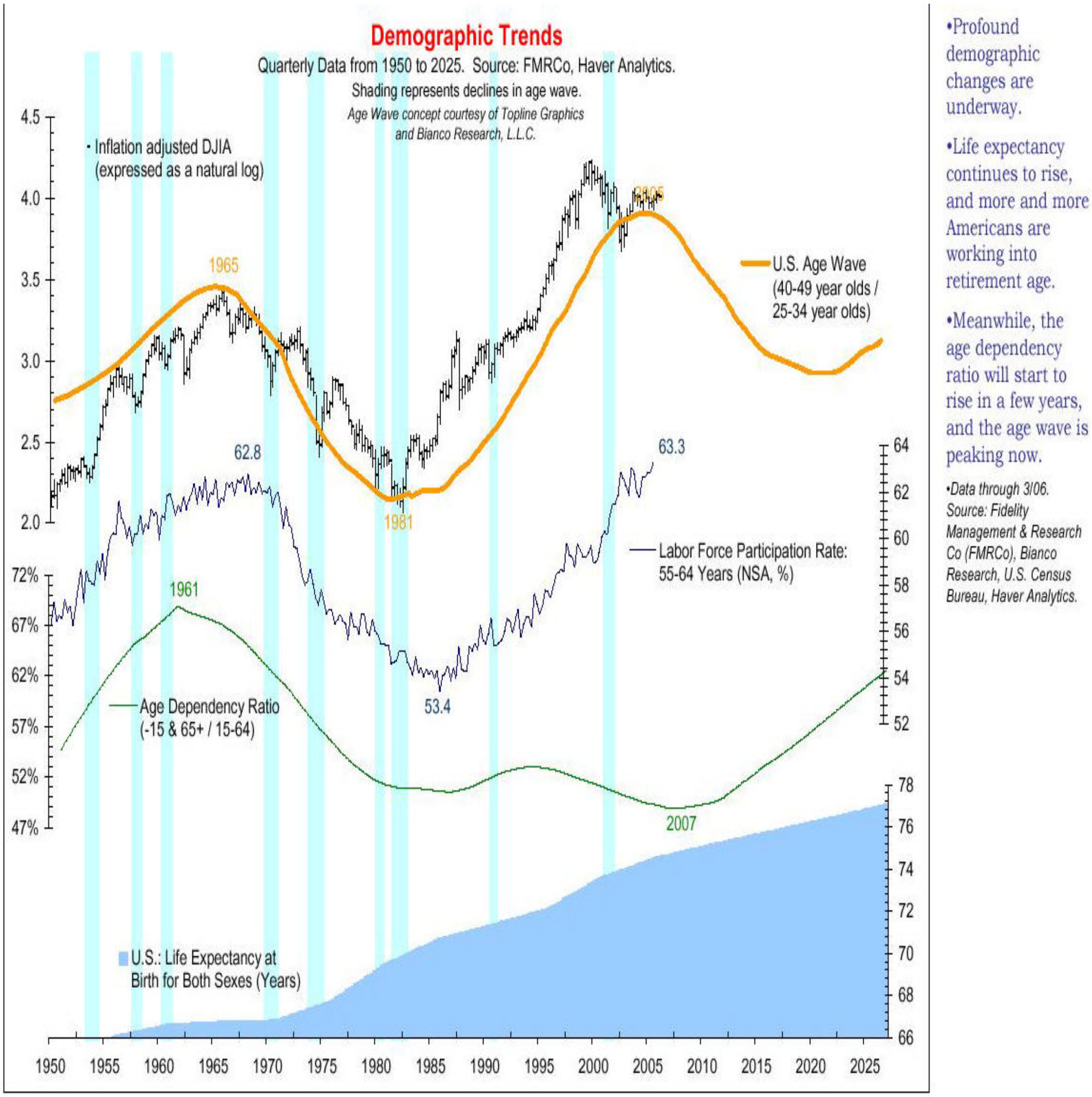
Jun. 14, 2011...4.3-year PEI cycle that typically should line up as a major low (8.6 years from 2002 low)

Overall in 2006, deflationary pressures from strong international labor productivity bumped up against increasing inflationary pressures from financial sector liquidity and strong commodity prices – and these two countervailing forces largely canceled each other out. With global central bankers still willing to buy U.S. dollars and Treasuries, an overall benign low volatility environment emerged. The growing weakness in the U.S. housing sector, the tightening monetary conditions in Japan, and the inability of the U.S. consumer to continue past spending habits – none of these trends truly hit the markets yet in full force. But we can hardly believe that the global economy's natural imbalances will withstand the PEI cycle date turn without some volatility fireworks.

Indeed, the U.S. equity markets in foreign currency and "real asset" terms are of course nowhere near their early 2000 high. In real inflation-adjusted terms, stocks have been in decline since 2000. Real earnings of the S&P 500 have also barely surpassed their bubble high. The chart below by Yale economist Robert Shiller clearly shows this.



This is very similar to the 1972 period when the DJIA poked to new all-time highs, but in inflation adjusted terms, had actually been falling since 1965. Interestingly, the demographic curve of the United States is also currently very similarly positioned to this prior period.



Source: Senate Finance Committee Hearings, April 2006

And what of course happened after the DJIA poked to new all-time highs in late 1972? A PEI cycle window hit in October 1972, and by 1973-1974, we saw a hard-landing recession, together with the first Arab oil shock. Interest rates in the U.S. spiked higher as the Fed had to fight both a weakening dollar and growing inflationary pressures at the same time.

To this end, we remain positively inclined in 2007 toward the energy markets from current levels, even while being forced to allow that Crude may still touch yet one more new low near $54.30 in the short-term. Gold will likely poke up to one more new high near $779 at some point in 2007. Ditto new highs as well in silver. Copper is less clear.

We also see the following potential path emerging for U.S. treasury markets – even though this latter market is very technically jumbled and the most difficult to call.

Overall, 2007 will be anything but a quiet year. Sadly by the end of 2007, the world is unlikely to be a richer and better place to live.

Send us your comments at information@Sandspring.com.

AN IMPORTANT DISCLOSURE

Sand Spring Advisors provides information and analysis from sources and using methods it believes reliable, but cannot accept responsibility for any trading losses that may be incurred as a result of our analysis. Our advice should be deemed our personal opinion and not a recommendation to invest. Individuals should consult with their broker and personal financial advisors before engaging in any trading activities, and should always trade at a position size level well within their financial condition. Principals of Sand Spring Advisors may carry positions in securities or futures discussed, but as a matter of policy we will always so disclose this fact if it is indeed the case. We will also specifically not trade in any described security or futures for a period 5 business days prior to or subsequent to a commentary being released on a given security or futures contract.