

Sand Spring Advisors LLC

Marty's Date

by,

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3,141 days ($\pi * 1000$) -- 8.6 years ago -- from this weekend, I sat in Martin Armstrong's offices and watched him carefully sell 1000 S&P futures, 750 DAX futures, 750 CAC futures, and 500 Nasdaq futures. The date was Monday, July 20, 1998 and for many years he had previously forecast this date to become a significant high in European and U.S. financial markets. As things turned out, that Monday July 20, 1998 was indeed the exact high in front of the extremely nasty LTCM and Russian ruble period of default and turmoil. Marty stayed more or less short these same futures positions for about 8 weeks, until one day he walked into my office -- with Monica Lewinsky crying through her deposition on television, as I remember -- and said that he had just covered all of his shorts, and was going to chill at his beach house for awhile.

Shortly thereafter, the CIA called Marty's offices and wanted to know more about his techniques that had allowed him to pull off such an accomplishment. I set up a meeting between Marty and two CIA researchers in the early fall of 1998. Marty had a long discussion with them, but deferred about sharing any of his actual models with them.

Marty was on top of the world, and was nicely growing both his economic/technical consulting and fund management businesses. A seeding group named Magnum Funds had just launched a fund wrapped around Marty's trading, and it vaulted by some +57% in its first month of trading. Marty had asked that the fund's launch be rushed so as to be in place by his cycle date. Magnum's Dion Friedland was ecstatic at having backed such a winner on such a timely basis. Deutsche Bank had another feeder fund wrapped around Marty which had already been up and running in Australia for three years. As custodian and prime broker with full transparency into Armstrong's trading for this Fund, Deutsche had analyzed Marty's trading record and found that "Armstrong had achieved an average annual return of approximately 27% per annum, while being actively invested in the market just 25% of the time." In other words, 75% of the time, Marty was simply not trading. He was sitting on his hands in cash, often at his beach house on the Jersey shore. But during the other 25% of the time, he would pounce and attack the markets in size -- typically around one of his key cycle dates.

Marty was a middle-aged man who, as may be seen in the photo below, mildly resembled Vladimir Lenin, but was a wonderfully friendly and thoughtful student of financial market behavior. I certainly remember him as being a great boss for the 14 months that I worked for him.



However, the one thing Marty did not have was tremendous attention to operational detail. His secretary Tina checked brokerage statements from his prime broker Republic Bank, and she was ill-equipped to solve all of the inevitable position and price break problems that human error created over time. In addition to the separately administered Magnum and Deutsche funds, Marty had some 139 managed accounts at Republic, and yet he traded his futures through one master account, and the accounting and margin management of this set-up was a logistical nightmare.

I sat down with Marty one day and introduced him to a firm called Derivatives Portfolio Management (DPM) – a administrator that I thought could help him better manage all of the back-office snafus, and double check Republic Bank's record keeping better than the secretary. Marty was interested to hire them, but let the decision on signing their contract linger.

Then one day, in October 1998, the dollar-yen rate unexpectedly plunged -- experiencing a massive -18% three-day decline from above 135 to below 110. Huge speculators including Julian Robertson, Wolfgang Flottl, and Marty were all clearly caught off sides. Marty had long maintained exposure to the dollar-yen exchange rate via his main source of funding out of Japanese investors to whom he guaranteed to eventually give back yen. If he did no hedging, he was always naturally short the yen that he would someday have to repay. Because he was generally bullish on the dollar against the yen, he did not mind the exposure, but did make an attempt to manage an overlay long yen hedge when he deemed such appropriate. As the dollar started to collapse, and the yen exploded, Marty was scheduled to fly to London, but at the last moment did not board the plane. Instead, from his car and then beach house, he traded actively, and by the morning of the third day when I spoke with him, he said: "I've been up for 48 hours straight, and am exhausted, But I think that I am OK. I actually got myself net short dollars at one point, and have been scooping back dollars at around 111."

To this day, I do not know this for a fact, but within that conversation, Marty's ego may easily have underplayed the damage that the yen advance had actually caused on his portfolios. Marty certainly became quieter in his trading over the subsequent months, and retreated to his beach house more often than he showed up at the office. He resold the equity markets in size one more time 8.6-months later in the spring of 1999 (April 8, 1999), but then was quickly forced to cover those positions when the market stubbornly refused to go down, and dot-com mania took over. But he did not fight the tape over the remainder of that year. Once the April 1999 8.6-month turn failed to deliver a high, he knew in his own mind that patience was required until the next 8.6-month cycle window that was due in the waning days of December 1999.

But of course, as those who know this sad story already know, his subsequent trading never made it that far. In late August 1999, an audit request from one Japanese client of Republic uncovered the messy operational underpinning of Marty's business. Monies weren't where they were supposed to be, and the FBI was sent in. Marty was being accused of fraud.

But was it really fraud or just a bad combination of a very sloppy back-office, legitimate trading losses from his dollar-yen exposure, and maybe an evil broker dumping losing trades into his account that he never noticed?

I was there at the time, and honestly, it was hard to tell.

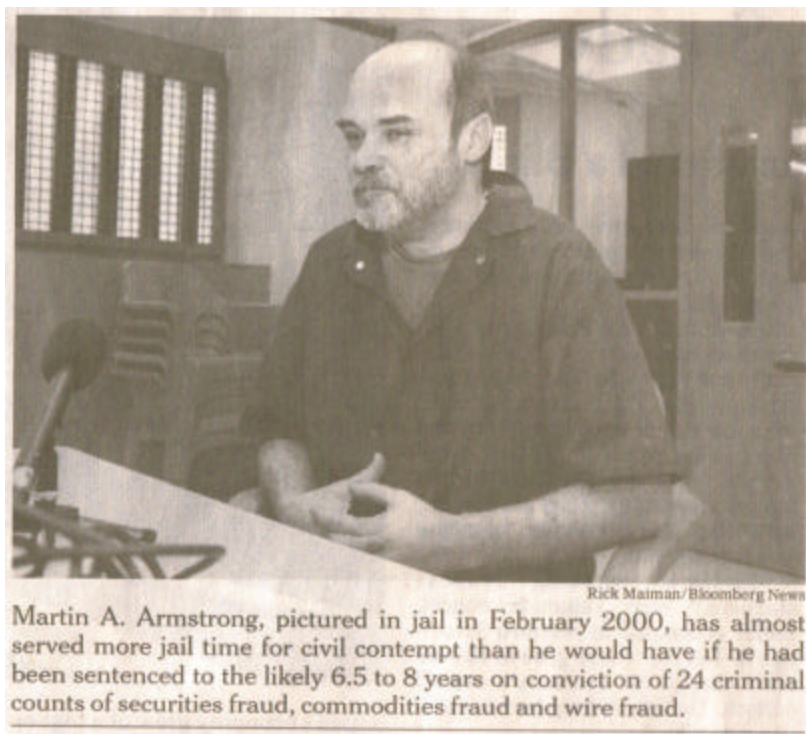
Whatever the case, several hedge funds immediately spoke up asking to buy Marty's cycle models, but the receiver for Marty's business appointed by the Court quickly snuffed out

such an idea of selling this software by telling these hedge funds: "All the code for these models is locked-up in this guy's head, and this guy is going to jail. Now what exactly do you want to buy?"

Then of course came the sad verbal food fight between Justice Richard Cohen appointed to Marty's case and Marty himself. A huge collector of antiquities and occasional purchaser of physical gold bars, Marty was commanded by the Court to turn over a variety of assets that from various records, they knew that he had once purchased. For three days in a rented car, he drove up and down the NJ Turnpike from his home in south Jersey to New York City delivering assets to the court. The only bust of Julius Caesar done when Julius Caesar was alive was among the items tendered, but missing was a bust of Julius Caesar's second wife. Also missing were certain gold bars (that he claimed he had given away to employees as bonuses – and I think he had!), and certain other items.

In the end, the Court wanted more than he surrendered. Among the missing items were two of his computers with the source code of his models. Was the CIA still trying to get their hands on this? Or was Marty trying to protect certain assets that are still hidden away today? I'm not a conspiracy theorist, and do not know the answer to these questions, but either way, the Judge was clearly pissed off, and sent Marty to jail for contempt of court. And there he has stayed for the last seven years – easily shattering the previous 18-month jail stay record for contempt of court charges that was held by Susan McDougal when she refused to testify against President Bill Clinton in the Whitewater Scandal.

This whole denouement for Marty was of course a horrific fall from grace. His business fell apart, and he was even stripped by the court of the ability to pay his own lawyers defending him. When the government wants to be tough on someone, Marty Armstrong is the sad sad example of what government has the power to do to one. He has been left to pine in a jail cell without ever really having had his day in court on the original charges of fraud initially made against him.



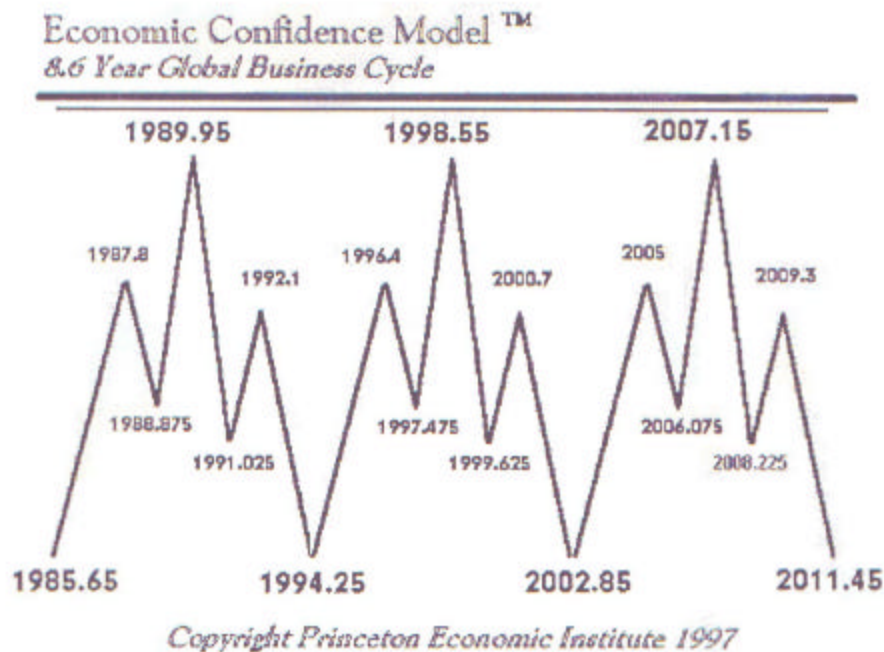
Source: Recent Feb 16, 2007 New York Times article by Gretchen Morgenson

In the meantime, Republic Bank quickly made restitution of the account losses to all of Marty's Japanese investors. They did so as Republic rushed to merge with HSBC and admitted to some culpability in their futures broker's own behavior. The Magnum and Deutsche Funds were wound down with no losses at all. In the end, no one was really hurt – except for the estate of Republic Bank's founder Edmund Safra who forked over the money to make Armstrong's investors whole, and who then happened to die under mysterious circumstances a few months later. In a strange twist, Marty and Edmund – who had been good friends in life -- both fell from grace almost concomitantly. It's all enough to make for a mysterious story-line within a pulp fiction novel.

But alas, 8.6 years has gone by, and if Marty were still in his trading seat, he would certainly be attentive of market action into this weekend when February 24, 2007 marks a perfect 3,141 ($\pi * 1000$ days) from that sparkling July 20, 1998 top that Armstrong forecast and then traded so well.

Let me stress that the 8.6-year cycle that Marty looked at was just one "hard coded" cycle of great importance to him, but he certainly had other momentum and price driven cycles that also were phenomenal. I can remember trading his so-called "panic cycles" which appeared on a daily basis about once every two months, and seemed to catch "outside day reversal patterns" in markets with uncanny regularity. All of these models are now presumably sitting on some dusty hard drive somewhere – but are lost at present to the market.

What remains is the Princeton Economic Cycle chart below – published in 1997 – which stands as a testament to Marty's core PEI cycle being a valuable one. Yes, the 1998 high was surpassed in 1999 during the dot.com era, but per this chart, the markets did then subsequently bottom around his 2002.85 anticipated low. Was this low to the exact day? -- No, But he wasn't that far off, and in general, I have found the high-to-high rhythms of this PEI cycle to have been more precise than the low-to-low rhythms. Per Marty's cycle model, the markets then traded up into 2005, and then had a mild swan dive lower in the first and second quarters of 2006, before vaulting northward again. Marty got it all reasonably right from over a decade ago.



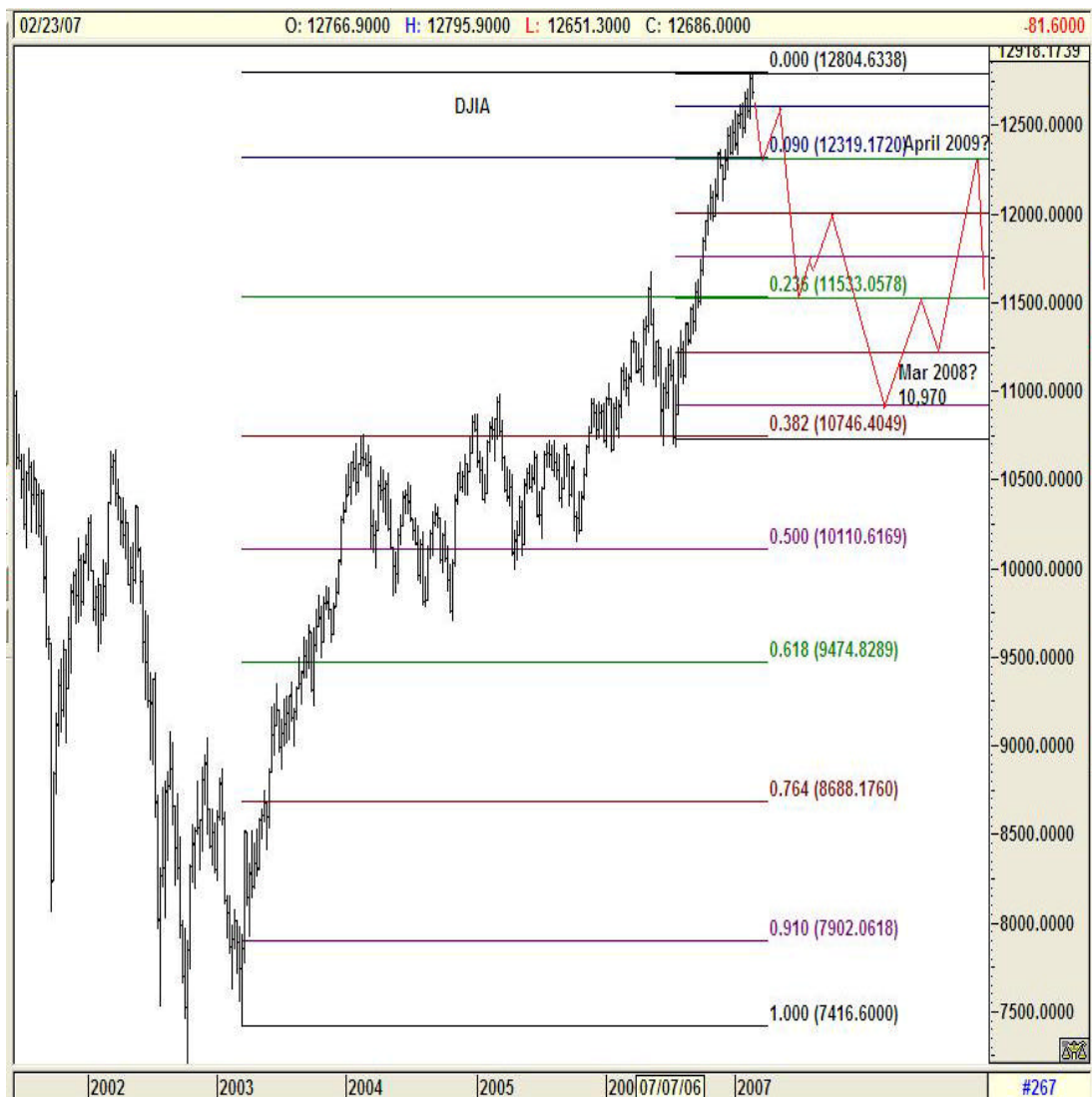
And from here, his PEI Confidence Cycle Model would of course point downward. Marty specifically points in his 1997 schematic to the next interesting potential low being somewhere on or about **March 23, 2008** (five 4.3-month mini-cycles away), followed by a bounce into **April 20,**

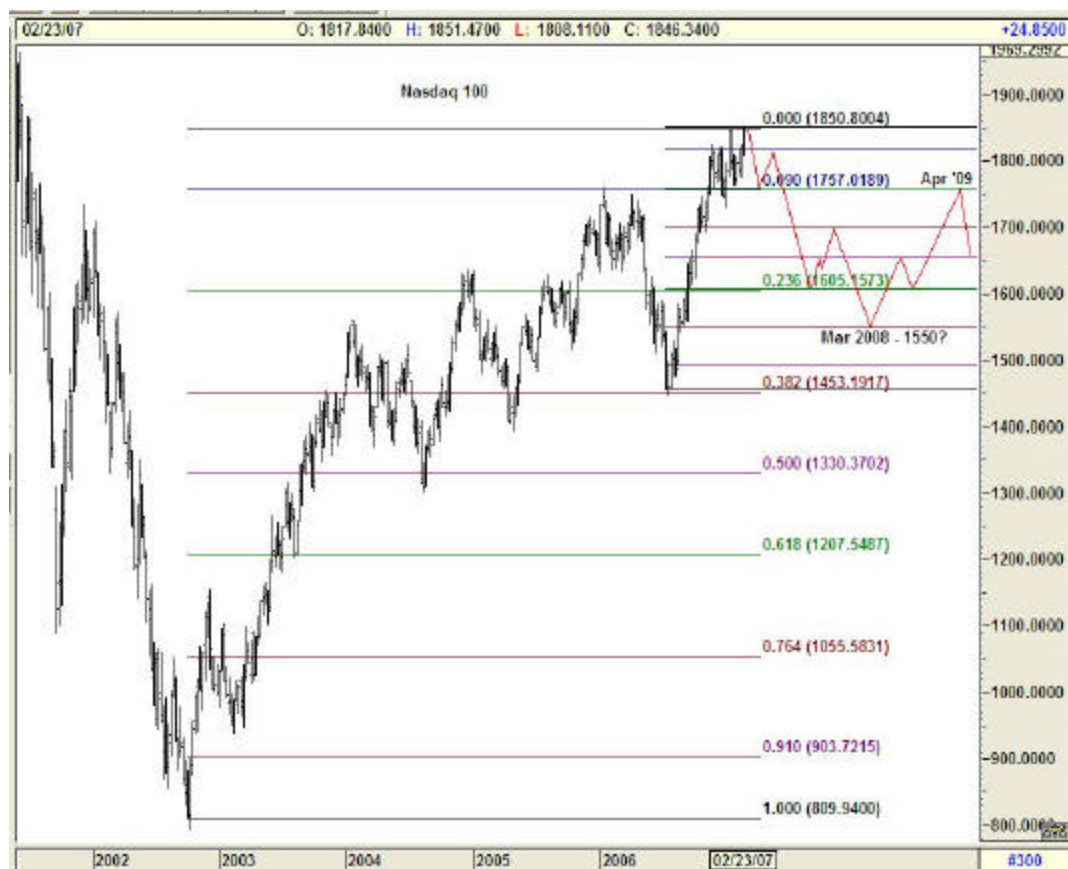
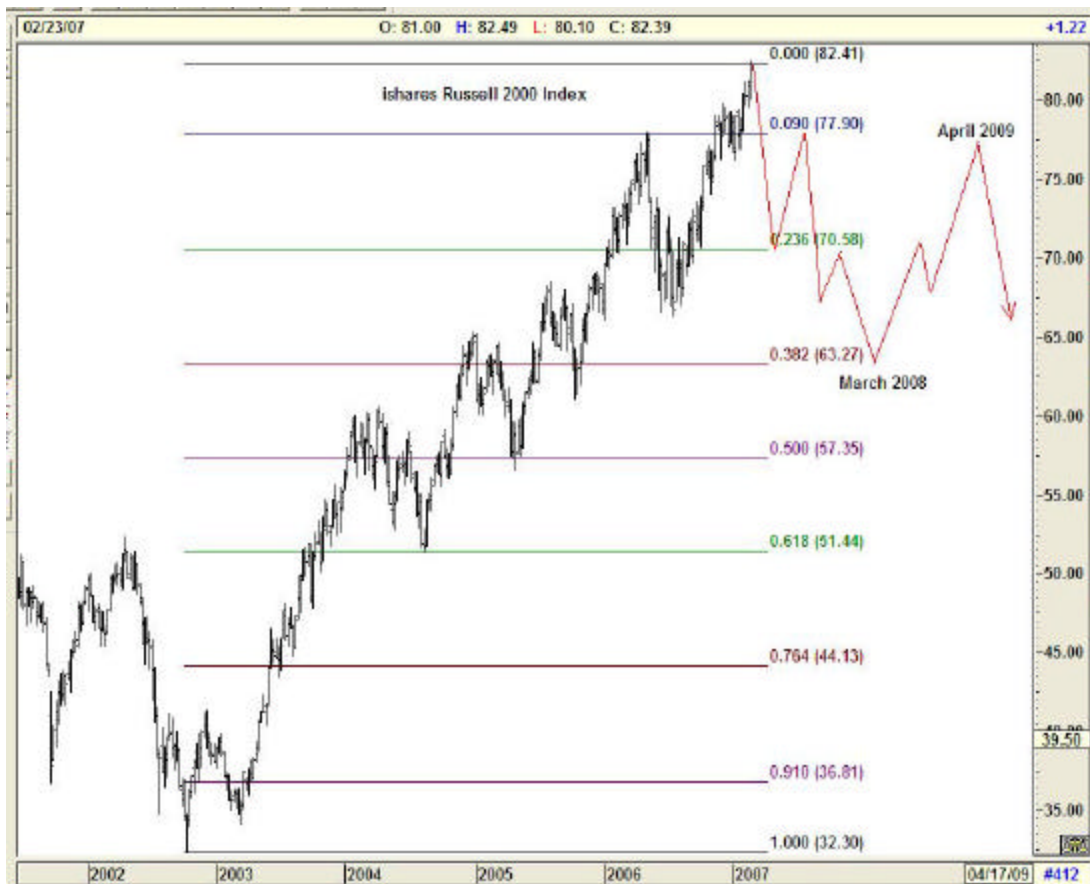
2009 (another three 4.3-month mini-cycles out), followed by the next Armageddon-type environment similar to the summer of 2002 coming 4.3-years out on or near **June 13-14, 2011**.

Now let's move to the real time chart pictures. Wall Street always has the hardest time handling periods where both stocks and bonds go down together, but at least for the next three-to four-months, we currently see the real possibility of exactly this type of environment. To our eye, this looks like a possible stagflation-city environment a la 1973-1974.

The DJIA, Nasdaq 100, and Russell 2000 all sport complete Fibonacci rhythms to their current highs, with only the S&P having – in our humble opinion -- a longer-term potential to someday touch 1500. Meanwhile, the Nasdaq 100 looks the most congested of the patterns, while the Russell 2000 is certainly the most vulnerable.

Our expected paths on each of these markets are something approximating the following pictures:







Marty -- If you are still paying attention after your long trials, and this letter somehow makes its way to you, all of your work is not lost, and your natural genius is certainly sorely missed by many. Hopefully, Sand Spring Advisors has done some humble justice to interpreting your ongoing PEI Economic Confidence Cycle in real time.

God speed to being a free man soon.

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