

# Market Timing

## Investment strategies for performance in the next “new paradigm”

Anyone who has been following markets for a few years will notice a common thread. Every so often, you will hear people talking about the next “new paradigm” or “new era.” What this really means is that market and economic trends move in cycles, repeated again and again. Each generation tends to discover their set of trends as a “new era” since memory is as short as one’s own investing experience. When you are a student of these cycles however, you can anticipate what trends should be coming back around next.

As we mentioned in our last newsletter, since the late 1990’s Central Bankers in much of the world have been flooding the monetary system with money by cutting interest rates to 50-year lows. This has increased money supply to levels not seen since the free-lov’in 60’s. It is also noteworthy that the free money ‘60’s were followed by the inflationary 70’s. In fact in a recent Royal Bank study on over a 100 years of historical data, researchers concluded: “inflation usually accelerates when money supply growth exceeds the growth rate in the economy for an extended period of time.” Researchers also noted that there is very often a considerable lag time between the period of low rates and the inflationary period that follows it. Money supply growth has now exceeded the growth rate of the economy since 1997, so there is a good probability that the next several years will bring a period of accelerated inflation. This generally spells higher interest rates.

What does this historical trend tell us? We should be ready to succeed in a ‘70’s like climate. We have studied the ‘70’s: high oil prices (OPEC crises); on-going US led war (Vietnam), and staggering government deficits. In the 90’s we came to view this period in history as tragic and remote. Nowadays it sounds similar to current conditions. A study of this period also alerts us to strategies that are more likely to work in this next “new paradigm”. Value-based stock selection strategies (like ours) should outperform growth-based selection strategies. There will come an end to the secular bond bull market that has pushed up prices on income investments to dizzying heights in the past few years.

Prices for these assets, are much more likely to come down to reasonable prices and higher yields. This would present better yields and less price risk for income-orientated investors. Hard assets such as gold and some commodities may outperform, while financials and retail stocks under-perform. Wall-Mart (which represents 10% of the US retail sector) announced this morning that it missed its Q1 revenue targets and warned that its Q2 numbers are also looking lower than they had previously projected. This news seems in line given our current economic cycle.)



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**The bottom line:** our method is a good one for helping us to find the winning markets of this next “new paradigm”.

### **Market Update:**

Although we have had buy alerts on several sectors in the past few weeks, so far attempted rallies have failed to break through confirmation levels and our buy alerts remain on hold. Many seasoned traders have been commenting of late about the lack of commitment in the market at this time. “Listless” is an adjective in frequent use.

At this time, all of the stock indices are below the value at which we sold them back in February. We continue to monitor money flow for signs of any true commitment into the various sectors and markets, and in the meantime we continue to hold gold, short bonds and cash.

Interest rate futures are pricing in a three quarter point hike in Fed interest rates over the next few months. To put this in perspective, this overnight rate was at 1% in June 2004, and has moved up to its current level of 3% in the past 12 months. Although this amounts to a 200% increase in rates year over year, markets are still expecting a further 1% (or 33%) increase in rates before the end of 2005, with more increases likely in 2006. All other consumer rates flow from the Fed funds rate as a base, so a higher fed funds rate will equate to higher borrowing costs for consumers across the board.

Thank you to all of you who returned our client report cards with your feedback. We appreciate your input, and remain committed to doing the best possible job for our valued clients. If you have any questions, please be sure to let us know.

*“A person all wrapped up in themselves, makes a very small package.”—Benjamin Franklin*

*“The key to immortality is first living a life worth remembering.” --- Bruce Lee*

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