Rohr Report
Capital Markets Observer
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Overview

Today is a US National Day of Mourning for ex-President Gerald Ford. While not the most dynamic president of the twentieth century, the pundits have it right when they express the nation's appreciation for a man who returned a degree of respectability to the Office, and helped calm the extreme partisan emotion developed during Richard Nixon's scandal ridden second term. (More below.)

In deference to his passing US equity Markets are closed, and the fixed income and foreign exchange markets are on a short day ending at 12:00 CST (13:00 EST; 18:00 GMT.) A few of the most important US economic information releases have been rescheduled as well. These include the shift from today into tomorrow for the ISM Manufacturing Index, and (more critically) the release of the December 12th FOMC Meeting minutes. The latter will prove especially interesting in light of recent inconsistency between the FOMC rate decision statement and the content of the minutes at times. As the last, rather dovish adjustments to the statement did little to assist a fixed income market which has been dominated by the weakness in Europe, with the combined expectation of higher rates in Europe and a weaker US economy also part of the problem for the US dollar, it will be very interesting to see both the actual deliberation minutes, as well as the market reaction.

Last Wednesday's Lex column (coy reference to those who explain the meaning of words) in the Financial Times had a very interesting comment about the ability of the US to continue to lead the world economies with continued technological innovation. While the full context of that analysis was quite interesting, the preamble may be the most relevant portion heading into this year. Lex noted, "In ancient Rome, the flight paths of birds were scrutinised to avoid flawed decisions. Economic augurs of the present day are no less fascinated by fleeting patterns - and no more reliable in their assessments." As we continue to believe there are some rather extensive dislocations possible this year in markets that have such striking anomalies that are being blithely explained away by many analysts and fund managers, the potential for some of the current 'received wisdom' to look fleeting in retrospect surely exists.

We commence this market year in the wake of an end to last year that was dominated by what seemed at times to be 'momentum misdirection' in thin holiday markets. This included the fixed income markets' total lack of ability to respond constructively to any weak news, as the equities were conversely able to remain at extended up trend levels in spite of the higher interest rates that the fixed income activity seemed to imply. Ultimately this means that ECB President Trichet has won the debate about whether interest rates remain accommodative. Whether this will still appear to be the case in the wake of any significant negative reaction by German consumers to the current major VAT increase is yet to be seen. The potential for an equity market surprise if German retail sees a major decline in turnover is certainly there, yet (as noted previous) it will likely need to combine with other factors to have a major impact.

Can the low interest rate, very tight corporate credit spreads, yet aggressively bullish stock market seemingly contradictory trends continue? And what does that mean for the foreign exchange market; especially the return to what appears to be a sustained down trend in the US dollar? We have expressed our doubts about the sustainability of the current equity market trend to continue apace in light of the potential problems with either consumers (both US and German) and/or the lack of any return to strength in the US housing market. Even if the latter does no worse than stagnate at current price levels, sustained and rapid expansion of the US consumer piggy bank of the last couple of years is over for now, and the radical alternative is for housing to experience further slippage. While disruptions to the foreign exchange market may include some weakening of the mighty Euro in the first instance, any real slowdown is likely that much worse for a deficit ridden US dollar that already has a somewhat weaker economy.

Yet, all of this has been extensively reviewed by us (among many others), and we refer you back to previous issues of ***Capital Markets Observers*** (II-48 & II-49), now available on our website **Sample Reports** page for more of the extended background. It seems to be a more volatile situation than many observers and more than a few of the market indices would seem to predict. At some point some substantial portion of the various trends will likely be impacted by the consumer and geopolitical cross currents from the draconian German VAT hike beginning this month, the US housing situation remaining stagnant at best in spite of more optimistic sentiment, and the degree to which those impact the assumptions behind some of the more exuberant expectations for corporate earnings.

On the geopolitical front, the various hotspots and ingrained instability in the Middle East also hold the potential to disrupt what is a very upbeat economic and equity market view for next year. While the stock markets are said to like "climbing the wall of worry," the actual event of significant exacerbation of various problems is sometimes less constructive. This year beginning with several situations in energy and commodity sensitive locales that can only rightfully be describes as near- civil wars or the actual event is not necessarily what equity markets and economies which are "priced for perfection" (or well near it) need to continue the impressive extended gains of the past several years recoveries throughout 2007.

The real question from a tactical point of view is whether any combination of them will hit early enough in the year to more than offset the classical early year equity market investment. In any event, due to this early year impact being based upon indications from retail turnover, we suspect it will take a couple of weeks for the markets to assess this influence. Only then will it become more apparent if this is indeed a potential problem for the equity market, with the attendant fallout elsewhere.

MARKETS

The early year technical bottom line for the markets is whether the fixed income can hang on to foment some sort of recovery after the abysmal activity of late last year. Whether this is a return to a bull market, or just a bounce in a bear trend is moot. To recover at all is to stem a very weak trend from last year that is on the verge of turning the previous firmer long end trend signals back DOWN in a major way with European short money (and the Gilt for that matter) already at new lows. This needs to be predicated on the March **T-note** holding for weekly Closes no worse than the major UP Break and other support in the mid 107-00s, albeit below which next support is as early as the 107-00/106-19 range.

While some may take some comfort from that, the failure below the mid 107-00s would mean that it was joining the Bund failure below the 117.00 area by violating the only remaining major long term chart UP Break from the summer rally. That would be reinforced by long end weekly MACDs turning DOWN, which has not occurred in a convincing manner quite yet in spite of the recent miserable price action in the **Bund** and **Gilt**. The equivalent supports in the Bund and Gilt are 116.00-115.80 and the 107.50 area, respectively.

Yet, it seems no matter which way the interest rates go in the near term, the US dollar does not get much support. While co-weak sisters **Japanese yen** and **Canadian dollar** are still suffering against the buck, the rest of the world seems to continue to strengthen, with the **Australian dollar** putting in a new high for the rally from the top of the week above the previous .7900-30 resistance (now support.) After holding repeated tests (with only minor slippage) back at the 1.3120-00 support (i.e. violated resistance), **EUR/USD** reinvigorates its climb above the 1.3200 congestion, with next targets at the 1.3350 early December weekly DOWN CPR, and the congestion in the 1.3450-1.3550 range.

However, as noted previous those are just near term resistances in a market with a renewed UP trend out of a sustained trading range. As such, in spite of the recent rally EUR/USD is not overbought to any significant degree, and that leaves the potential to move through the old “official” 1.3666 high from December 2004 to extended congestion area resistances at the pre-official Euro launch equivalent 'basket' congestion at 1.4250 (from mid 1995) and back at the approximate ‘synthetic’ all-time EUR/USD March 1995 high (i.e. US dollar low) at 1.4535. That was all part of the major secular US dollar selloff against other currencies at that time as well, and will be a good guide to extended targets for any but the weakest other currencies against the US dollar.

While the equities were still struggling against oscillator resistances around recent highs, über-market **DAX** has now pushed through its next interim oscillator resistance in the low 6,600 area, with next resistance not until the upper 6,700-6,800 area. While this in contrast to the **FTSE**, even that weaker sister is now above its lower oscillator resistance in the 6,250 area, with more major resistance in the 6,450-6,500 area. While US markets have stalled into **S&P** 1,450 and **DJIA** 12,500, the opening of the year in Europe is propitious, and we expect those areas to be challenged again soon. While we will not know anything further until the post holiday trading on Thursday, the other market exhibiting extended strength is the **NIKKEI**, with the previous weak sister pushing through its 16,800-17,000 resistance (now support), with the next not until the congestion area into the previous 17,600 area April high.

Energy markets remain moderately weak in spite of the potential for geopolitical tensions to impact them at any time. However, the limited regional impact of any of the US winter storms notwithstanding, generally warmer than expected seasonal temperatures have kept these markets on the defensive, which has been a contributing factor for equity market strength and fixed income weakness. More on that in our next full technical projections update.

Contact

During the first week of January we will be on the road, yet analyzing markets and providing email updates. Yet, if you need to contact us, that will be possible on our cellular telephone number (USA 1) 847.254.0099. Please leave a return telephone number as part of your message, and designate the message as 'urgent' to facilitate its timely delivery. We also suggest using the web server email address at ar.rohr.intl@Gmail.com. While we will also only be checking this sporadically, we will respond either by email or with a direct call by the following morning if we do not see the message timely on the day you send it.

Reports & Events

While we usually like to know the specific release date for any report, there are always the usual culprits each month that crop up ad hoc during a particular time frame. This week these include German Retail Sales (NOV), and UK HBOS House Price (both the monthly and rolling quarterly annualized figures for (DEC.) As Monday was the national New Year holiday everywhere (which the Japanese sensibly extend through Wednesday), the first data of the week was this morning's Australian AiG Performance of Manufacturing Index (DEC.) It was weak, which was a rightful precursor to the mixed-to-weak European PMI Manufacturing Surveys where only Germany (not surprisingly at this point) outperformed the already expected increases. While they were supposed to be released this morning, we have not been able to access the figures for UK Hometrak House Prices (DEC.)

As we have already noted, the US reporting calendar has been adjusted to accommodate the observance of a national Day of Mourning to honor ex-President Gerald Ford. This will cause the delay of two key releases into tomorrow, after which the calendar will get back on schedule for the week.

Wednesday sees German ILO Unemployment Rate as well as their Retail Sales (both NOV), as well as the more recent German Unemployment Change and Unemployment Rate (DEC), along with the UK CIPS PMI Construction Index (DEC.) After that the focus shifts to the us, with the ADP Employment Change (DEC) that some view as at least a passing guide to what will come in Friday's more important numbers, Construction Spending (NOV) and the delayed ISM Manufacturing (DEC) and its important Prices Paid component, followed in the early afternoon by the also deferred minutes of the December 12th FOMC meeting.

Thursday brings the Australian Performance of Service Index as another precursor of similar European and US numbers (DEC), with UK lending data that includes Net Consumer Credit, Net Lending Secured on Dwellings and Mortgage Approvals (all NOV.) That is followed by what could be an important Euro-Zone CPI Estimate (DEC) along with the likely less critical Italian CPI (DEC preliminary), and UK GfK Consumer Confidence Survey (DEC. Then it's a plethora of data out of the US that includes the Monster Employment Index and Challenger Layoffs (both DEC), Initial Weekly Jobless Claims, Factory Orders (NOV), the as scheduled ISM Non-Manufacturing (DEC), also including its important Prices Paid component, Pending Home Sales (NOV) and EIA Crude Oil Stocks for the week ending 12/29.

Then it's on to more critical data Friday, with French and Euro-Zone Consumer Confidence, and Euro-Zone Industrial Confidence, Services Confidence, Business Climate Indicator, and Economic Confidence (all DEC), followed by the Euro-Zone PPI, Unemployment Rate and Retail Sales (all NOV), with the grand finale being the US Employment data (DEC) and the lone talking head of the week: Chairman Bernanke speaking to economists at lunchtime in Chicago adding a bit of additional uncertainty to the end of a very important week.

Equities and the Economy

That Mr. Bernanke should have the last word on the week is interesting, as what he has to say might be either the ultimate confirmation or once again bring into doubt the indications from what are sure to be a very interesting set of FOMC minutes on Wednesday. What is critical for the equity markets from both of these important early year inputs from the Fed is that the continued rally is predicated substantially on the idea that regardless of what they may say about inflation the FOMC is done raising rates and will likely even ease sometime not to far down the road. All of which makes most equity fund managers very cheery folk, even if it is based upon some slackening of the US economy into below trend growth for a good portion of the year.

Yet, can so many upbeat forecasts and investment strategies all be right at the same time? The degree to which the bullish consensus pervades the equity markets only reinforces our previous focus on risk factors, even if we allow several of them still need to combine to create a significant equity market and economic setback from early this year. And just how extensive is that bullish consensus? Funny you should ask. Just before the end of the year CNBC financial news network (among others) had Mr. Randy Lert from Russell Investment Group on as a guest to preview their current Investment Manager Outlook. What the attached study does not say explicitly that Mr. Lert highlighted in his interview was that while over 80% of the funds managers polled believe the US equity market will rise next year, an impressive 31% believe it will improve by more than 10%. This extends to increased bullishness for non-US equities as well.

While it does not necessarily hold that markets need to break just because an overwhelming majority of the participants are bullish, contrarian psychology tells us that historically the market does not let 80% of the people all anticipating movement in the same direction make money for very long before a correction, sometimes substantial, is necessary to relieve the overblown psychology. The Russell Investment Group study and a key graphic from the program are attached. The link to the video of Mr. Lert's interview on CNBC.com (if they have maintained it) is: http://www.cnbc.com/id/15840232?video=157357028&play=1.

Miscellany

UK Politics: Catching the American Disease

It's called the Strange Bedfellows Syndrome. The US public is generally so apolitical that they get exactly the level of government excellence that they richly deserve. For many years the UK has one way or another had a more informed and ardent voter base. The average London cabbie has traditionally been more politically aware and fluent than most US corporate execs or even university professors outside of the specifically political disciplines.

Now a real acid test of continued electorate political awareness is afoot in the UK, as Tory party leader David Cameron has asserted his is the "party of the working people" and not that of "rich and powerful vested interests." All fine and good, except for that more than modest shift begging the question of just what changes in the party platform will evidence this, and who will fund their return to power? Unless the TUC is going to buy this assertion hook, line, sinker and member dues redirection, we wonder how motivated the Tories' traditional backers are going to feel about footing the bill for a much more Bolshie Conservative Party?

Rohr for President
Continuing on the subject of electoral politics, it is with great humility born of having made what maturity and perspective demonstrate was a classic mistake that I relate my feelings about the recently departed esteemed ex-President Ford. The 1976 US election was a very contentious affair, with emotions running high against the Republicans in retribution for the predations of the Nixon administration against the civil liberties and sensibilities of even the middle class, much less the liberated Left.

In truth, most younger conservatives of that time had no use for Richard Nixon. While he may have achieved great things internationally with the assistance of Dr. Kissinger, and even did a couple of clever things at home like instituting price controls to temporarily cool inflation in the wake of the Bretton Woods (currency) Agreement breakdown and attendant demise of the gold standard for US currency, they saw him for what he really was: one of those folks so common throughout the developed world political establishment of that time who played on conservative themes to further a megalomaniacal (and in his case paranoiac) pursuit of power for its own sake.

As such, when Gerry Ford was picked as his Vice President (after Spiro Agnew's bribery scandal drove him from the office) it was a return to a more steady and low key individual who everyone rightfully believed cared more about the country than his own power or legacy. However, Mr. Ford was prone to both physical and verbal gaffes that left him looking less competent than he actually was. This is a shame, as it allowed for one of the first outside the "Beltway" (as Washington D.C. is known due to its prominent ring road) challengers to surface in the person of one James Carter. As I could not see myself voting for a bland technocrat like Mr. Ford after the excitement of the Kennedy years and intrigue of the Johnson and Nixon administrations, and truly believed even then that Mr. Carter was the sanctimonious dilettante that he has repeatedly proven to be, I did the unthinkable…

…I wrote myself in for President of the United States. No kidding. I did this in deference to the idea that I felt I could do a much better job than either one of the major party candidates. Based upon the ensuing for years, I now know that I was indeed at least half right. Yet, that does not excuse the frivolous sentiment toward a great institution.

As I noted at the beginning, this was a classic mistake, and I now wonder how many folks who did not vote in that or subsequent elections rue the opportunity lost through throwing away their chance to express their democratic right in a meaningful way. Maybe my vote alone would not have made the difference, but the collective force of all of those who either didn't bother or also wrote themselves in (I cant believe I was the only one) might have left the USA and the world with a much different situation in the challenging late 1970's.

We look forward to providing further comments as the situation warrants, and hope you have found these perspectives helpful.

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