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## **The Key Word For 2009: *UNSUSTAINABLE***

There are processes at work in the markets that are simply not sustainable. Let's start with interest rates and bonds. The long Treasury has been on a tear since October (as we showed you in the last letter), but this move is faltering. The bloom seems to be off this flower.

Our bond trading model has been long the 30-year Treasury and the associated Rydex Bond Fund – see Page 2 of the online updates. However, the model has just raised the sell point to 132-1/32 basis March. Thus, if the March contract trades at 132-1/32 or lower, we will have an official sell. We will then exchange to the Rydex short bond fund, as detailed in those updates. This may be a very important signal with implications beyond our bond trading program.

China and India will continue to modernize, regardless of the recession in the U.S. and regardless of the related slowdown in their economies. China will not be running their domestic account to a multi-trillion dollar deficit to do it, though. They will use a good chunk of their foreign reserves to fund their economic agenda. By spending their savings, they will not be buying as many of our Treasuries. The change will be easy for them after almost being burned holding Freddie and Fannie agency bonds (the Chinese held 40% of them), especially considering the paltry yields being offered on our Treasuries.

Watch the TIC (Treasury International Capital) flows - <http://www.ustreas.gov/tic>. We need over \$50 billion a month in net positive TIC flows to maintain our Treasury auctions. I expect net TIC flows will go negative this year due to all those friendly lenders using their money for other purposes. If no one shows up at the auctions, the Fed may step in and take up the slack in order to keep interest rates from zooming off the charts overnight, but the effect of their efforts will be temporary at best. Monetizing the debt can have a short term positive effect, but it will only magnify the inevitable adjustment. All in all, the strong bond market we have seen since fall is unsustainable, and that means you should not expect interest rates to fall all that much further.

The biggest fear I have is that a phone call will cost \$1,000. You may suddenly wake up to find that inflation has exploded uncontrollably due to too much “stimulus” and that your paper wealth, your buying power, has been destroyed.

**Buy gold.** Gold continues to improve in my technical work. The picture still looks positive. Bullion has corrected back to minor support at \$800; and in the event that it breaks below \$800, we could see prices dip to \$775. That would be an excellent buy. Regardless, gold should be moving higher again soon.

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The next key level is \$900, where there has been overhead resistance. Once through the \$900 level, prices should move smartly to \$1,050 where the highs were established last July. Essentially, any bullion gold bought under \$900 will prove to be an astute investment in the longer run.

I have the downside buy price on the **Spyder Gold Trust ETF** (GLD-NYSE-\$82.71) at \$75.00. I am leaving it there; and for those adding to positions, that is where I suggest you have your open orders. Gold is volatile; but for those without any position in bullion gold, scaling down under \$80.00 makes sense.

The mining shares are another matter. Their respective downside buy prices are listed in the online updates and monthly letters. Heed those prices for now, and stick with the majors. If I were to pick two, they would be **Kinross** (KGC-NYSE-\$17.89) and **Goldcorp** (GG-NYSE-\$26.36). They are buys at \$12.50 and \$22.50, respectively.

The gold sector is developing an immunity to the bad times. On October 11, 2007, the popular averages topped out. The Dow hit 14,279 and the S&P 500 hit 1,576. To date, those averages are off 42% and 46%, respectively. Even after suffering through the insane and mindless panic for cash, gold has appreciated by over 10% during the same time frame.

I think if deflation were a credible threat to our future, gold would be selling for \$500 rather than \$850, and milk would be \$1 a gallon. Gold is the time-tested, go-to investment during uncertain times.

The gold/XAU ratio is still over 7.00; and, in general, mining shares continue to be cheap in relation to gold. The shares will remain very volatile and could come under selling pressure during future panic liquidation days. I don't think the deleveraging is anywhere close to over, although the worst is behind us. The secret is to use weakness for accumulation.

The profitability of gold since the top of the stock market indicates in its own right that the deflation argument is moot and that the best bets are for a resurgence in commodities. Our work in the energy sector is improving, and so is the technical picture in the overall commodity market. Keep your eye on **ING Managed Resource Fund** (IRR-NYSE-\$13.38) that I wrote up in the last letter. It is a buy at \$12.20 with a stop at \$11.33.

The decline in crude oil prices in the face of depleting production from major fields as well as the future supply destruction being wrought by cheap energy prices - coupled with the lack of financing for continued exploration and development - all but guarantees shortages and higher prices for crude and its derivative products in the future. To me, it is as plain as the face on a goat - crude oil prices will rise. Crude prices at current levels are not sustainable.

At the root of much of this is the U.S. dollar which, in a basket of currencies, has been sinking slower than the rest. That gives it the illusion of strength. It is only in relation to other currencies that you see this strength. Compared to gold money, the dollar is worth less than it was in October 2007 when the averages peaked out. The dollar is close to changing places in the currency mix, which will be reflected in a lower value of the U.S. Dollar Index. The new "strong" currencies will most likely be those from commodity countries like Canada. Obviously, gold will be a beneficiary, as well as other commodities priced in dollars.

Another unsustainable trend I see is in the stock market averages. There will be a more complex payout here, and this could help you immensely. My cyclical work is pointing to a retest of the November lows during the next four weeks. I expect the November 2008 lows will be broken. That is going to bring on a lot of renewed pessimism. However, once the February lows 2009 are in, the market looks like it will be better into summer. The headwinds that have been buffeting prices since November will abate, and we could see the Dow move to 11,000 and the S&P to 1,200.

This will be the most important bear market rally you will see for some time. I expect to see all equity asset classes participate. It will be an opportunity to clean out the weak sisters and paper-based assets. That will not be easy because by then, the new "Obama bull market" will have been proclaimed, and the pundits will all be forecasting the bottom in the recession. The bottom will not come, and the rally will be a massive bull trap. Forewarned is to be forearmed.