

NOVEMBER 4, 2021

MONTHLY



Global Investment Letter



Notable Inside This Issue:

- *The Importance of Price Action*
- *Our Equity Positions Continue to Post Strong Gains*
- *Long VIX Position is Closed*
- *US 10-Year Treasuries Look Likely to Decline Further*
- *US Dollar Still Our Favoured Major Currency*
- *We Turn Bullish on Canadian Dollar*
- *Now Bullish on Oil*
- *New XLE ETF Position Shows Profit*
- *We Maintain Our Long Position in Gold*

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THE IMPORTANCE OF PRICE ACTION

The S&P 500 rose strongly in October despite the negative seasonal tendencies of the month and a preponderance of evidence presented in these pages in support of our contention, held for most of 2021, that equity markets represent a poor risk/reward proposition for investors.

The essence of successful investing is the constant calculation of the probability of outcomes because investors do not possess the luxury of dealing in certainties. Our calculation of probabilities strongly suggested that we would experience a sharp market correction at some point in 2021 as the aggregate of our measures (both public and proprietary) of valuation and investor sentiment suggested that the probability of a market pullback was very high.

That the market correction has yet to occur, and that the Global Investment Letter maintained and profited from its positions despite our very bearish macro view, offers a valuable lesson.

That equity markets have yet to correct from levels that can objectively be called extreme is surprising to us but not shocking. Markets are a function of human psychology, which means that they can rise and fall farther and longer than objective analysis would suggest. This aspect of human psychology has produced many market bubbles and crashes through the centuries.

Our own experience during the internet bubble of the late 1990s remains vivid. Many of our most astute and competent colleagues lost money buying put options in anticipation of a market decline that didn't occur. Until it did. It is in the nature of crowd psychology that shifts can happen very quickly and with little warning. A favourite example we use is to think of crowd psychology being represented by a pile of sand. At first, a small amount of sand can be seen trickling down the pile, then suddenly a whole side collapses. It is these swift wholesale changes of investor sentiment that produce sharp market declines as well as the beginnings of great bull markets.

The current environment is much like that of the late 1990s. That we will experience a sharp correction/bear market is inevitable, but the timing remains uncertain.

How do we reconcile our analysis that risk levels are elevated but still participate in rising markets given that our goal as investors is to earn a return on our capital and efforts?

Hard-earned experience has taught that however elegant (and ultimately correct) our market analysis may be, it must be confirmed by price action. Markets should provide clear evidence of a change of trend before we exit or enter positions. This pragmatic approach has yielded positive results over time and has certainly proven its worth in 2021.

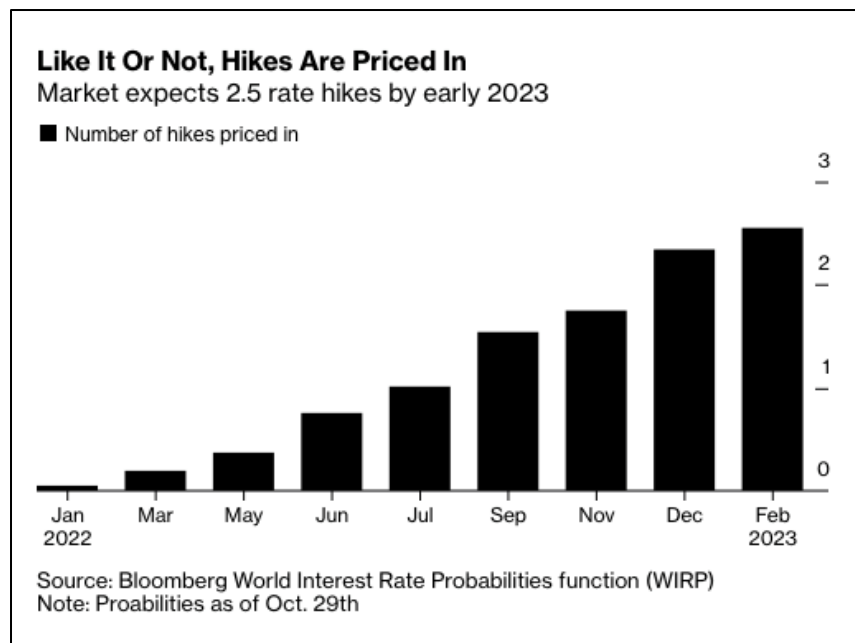
We have maintained our long investments through 2021, and added profitable positions in the Indian, German, and French markets during the year, because global stock markets have not triggered a sell signal based on our analysis.

A key aspect of our risk control discipline is the use of protective sell prices on our long positions, which are detailed in each issue. We place these sell targets at levels that, if penetrated, would suggest that a change of trend is probable.

Thus, when the inevitable correction/bull market does occur, these protective sell prices will preserve the bulk of accrued profits. We advocate that all investors incorporate the setting of protective sell prices as part of their risk control strategy.

We wanted to devote a portion of this issue to this important concept because it seems apropos given current market behaviour.

While markets continue to push upward, reasons to be wary continue to accumulate.



Markets have been pricing in the probability of more interest rate hikes, at a more rapid rate, in recent months as inflationary pressures produced by supply chain disruptions prove more persistent than originally expected.

Bond markets have begun pricing in the prospect of rising interest rates, which has been a factor in their recent weakness. However, the continued strength of stock markets suggests that equity investors have yet to factor the potentially negative implication of rising interest rates into their investment calculations.

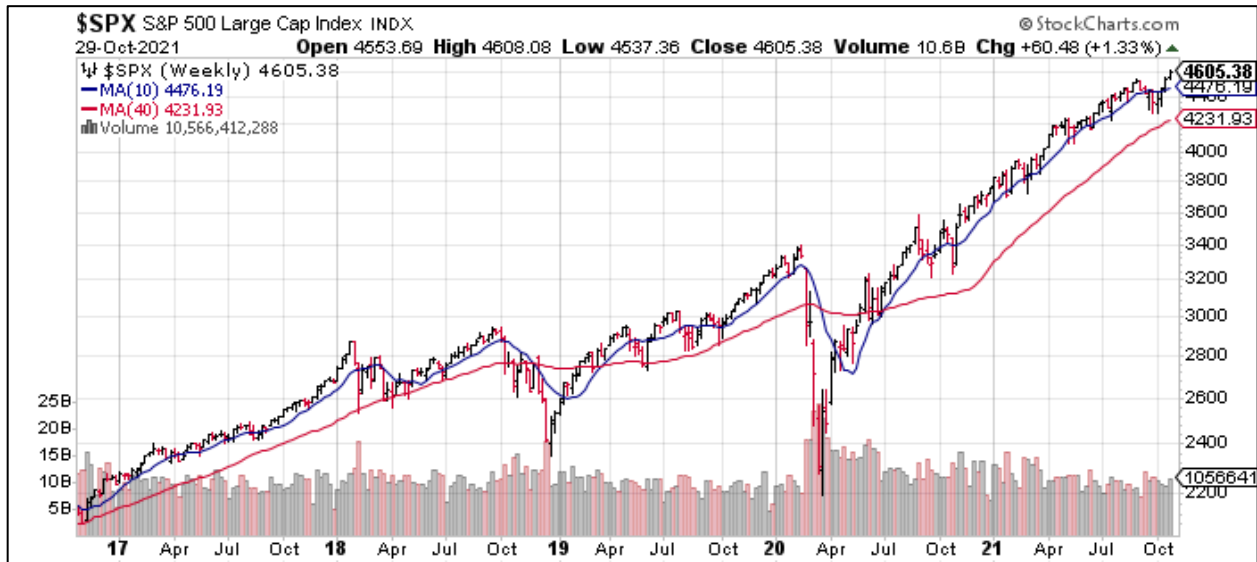
Our original expectation that the supply disruptions that have fueled inflation would be quickly resolved has proven too optimistic. Inflationary pressures will be more persistent than first imagined. However, we remain of the view that the bulk of the inflationary pressures is a product of these COVID-induced disruptions, so our expectation remains that inflation will cool when the global supply chain returns to a semblance of normality. Growing evidence of a slowing global economy contributes to our view that inflation will eventually recede.

That being said, we acknowledge that we may be proven wrong. We will, as with stock markets, ultimately depend on price action to inform our opinions. If inflation proves persistent even as supply chain issues are corrected, we will adjust our views accordingly. However, the weight of evidence is not yet sufficient for us to believe that inflation will grow to resemble the 1970s phenomenon. Time will tell, and we are prepared to change our mind if required.

The COVID pandemic generated few major headlines in October as cases in many countries are well below their peak levels. The onset of winter in the Northern Hemisphere is expected to produce an increase in cases, particularly among the unvaccinated. On a positive note, however, a COVID variant that could replace the currently dominant Delta Plus strain has yet to appear. While Delta Plus is highly virulent, vaccines remain largely effective against it.

EQUITIES COMMENT

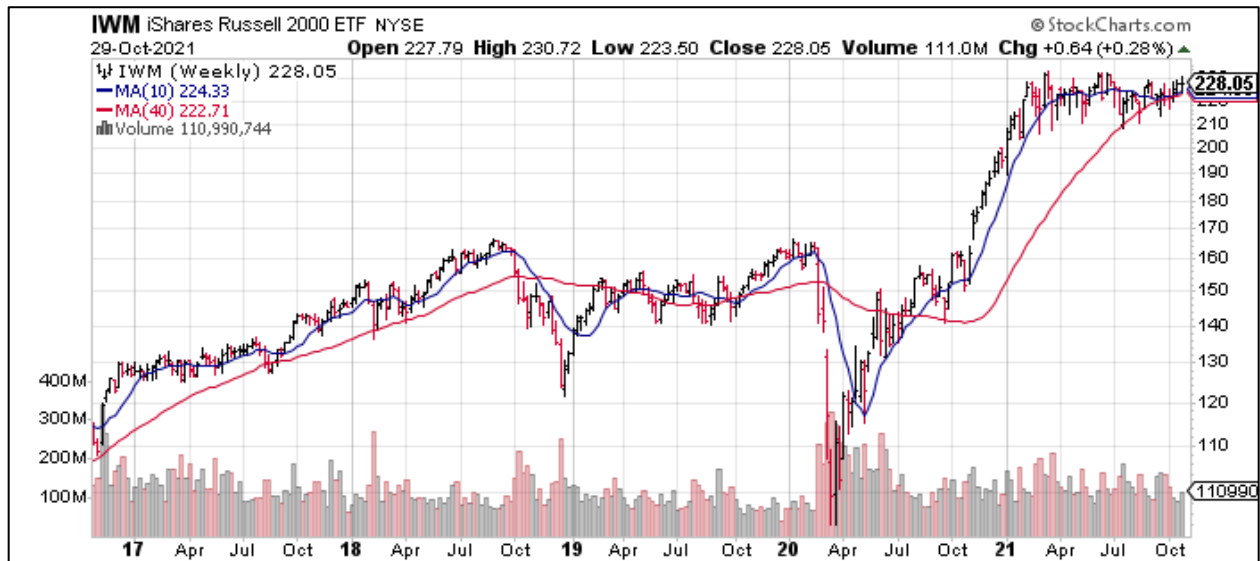
S&P 500 (WEEKLY)



The S&P 500 rose to a new high in October, which is very bullish price action.

While our risk/reward concerns remain intact, we cannot deny the bullish tone of the market and remain long the S&P 500. Our position has produced a greater than 30% return since its purchase last November.

In response to the strong price move in October, we are raising our protective sell price to 4400 from 4300.



Our position in the Russell 2000 initiated last November at circa 170 continues to trade in the relatively narrow price channel it has occupied for most of 2021.

A move higher to set a new 2021 high would be bullish and prompt us to add to our position.

We will maintain our protective sell price at 210.

VOLATILITY TRADE

S&P 500 VOLATILITY INDEX (VIX) (DAILY)



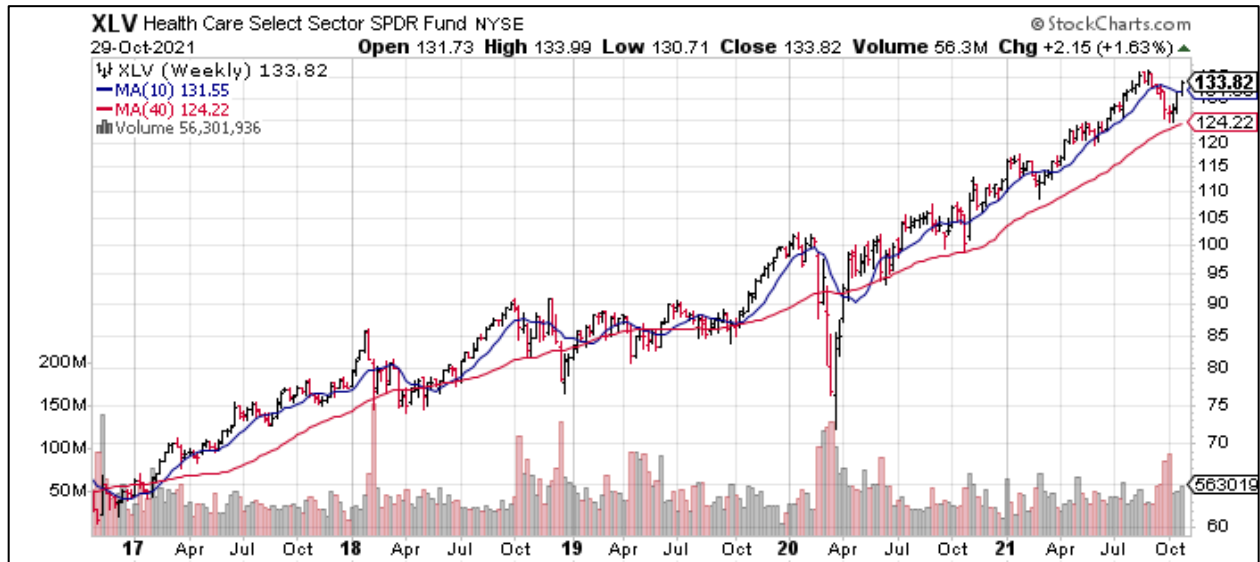
Our position in the VIX has been our only disappointing position in 2021. Our positions in the VIX have historically been our most profitable, but 2021 has produced a loss for this strategy, with markets failing to exhibit the volatility expected when we established the position earlier this year.

Given the bullish tone of the S&P 500, and the beginning of the seasonally strong November to April period, we will take our loss and close this position.

We may reinstate the position upon evidence of a trend change by markets.

HEALTH CARE TRADE

HEALTH CARE SPDR ETF (XLV) (WEEKLY)



Our position in the XLV Health Care ETF rebounded smartly in October, rising to 133.82 from 127.30 the previous month (a gain of 5.1%). This position has thus far produced a gain of 25% since its purchase about a year ago.

Our protective sell price remains at 125. The 2021 price high bears attention. A move through that level would suggest significant further upside. Alternately, if XLV attempts and fails to surmount the 2021 high, that would raise the risk of a trend change. We'll have to await events.

As we do in most issues, we remind readers that healthcare is one of our core investment themes given the rapidly ageing demographics of Western societies and the rapid pace of new treatment methods. We will monitor the sector closely though we may not have exposure to it from time to time if we view the risk/reward as unattractive.

FTSE 100 (DAILY)



The FTSE 100 continues to trade in the relatively narrow trading range it has inhabited for much of the year. The proximity of the FTSE to major chart resistance at circa 7500 (such resistance often serves as reversal points for rallies) makes the risk/reward prospects of establishing a position at current levels unattractive.

Our long-standing reservations about the prospects for the FTSE and the British economy stem from our anticipation of negative economic consequences from COVID. One of the more conspicuous unintended consequences of Brexit has been a shortage of drivers to deliver petrol, which has forced the closure of petrol stations, hoarding and the occasional fistfight at pumps.

The delivery of petrol is not the only economic challenge that has been produced by Brexit.

That being said, a move by the FTSE through circa 7500 would be technically very bullish and prompt us to establish a long position. However, we consider such an eventuality unlikely at this time.

DAX INDEX (WEEKLY)

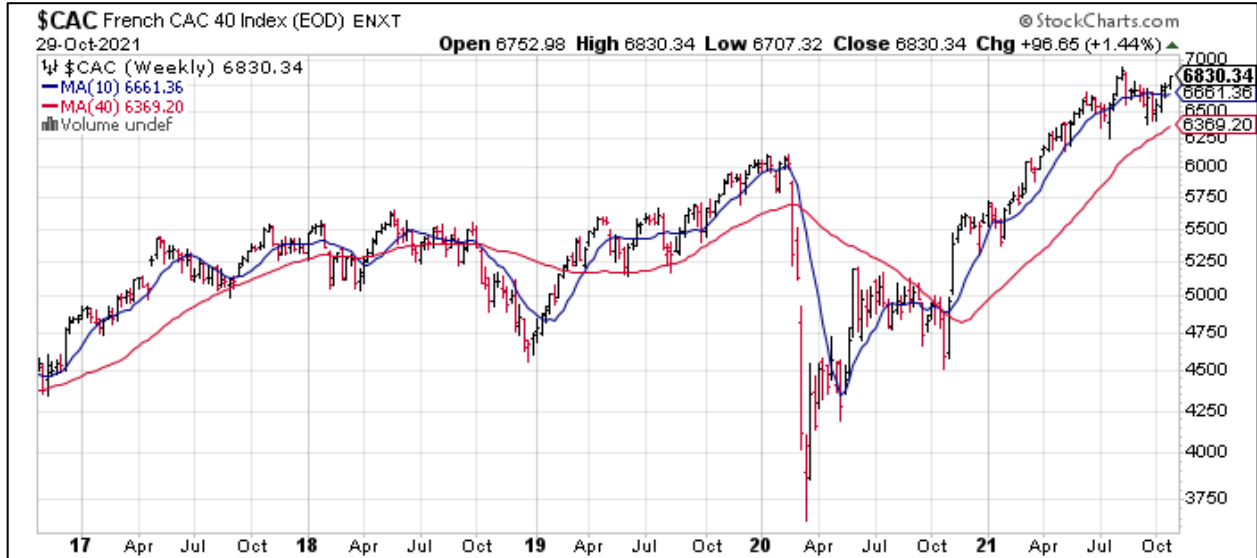


The DAX rose 2.8% in October and has produced a gain of 10% since our purchase at 14250 this past spring. We maintain our protective sell price at 14900.

The 2021 price high at circa 16000 is a key chart level. A solid move through 16000 would be very bullish. However, the 2021 high could also constitute a significant level of price resistance. A failed attempt by the DAX to breach 16000 raises the risks of a change of trend.

We remain bullish on the DAX, for it has yet to provide evidence to be otherwise. However, given our general wariness of the risk/reward offered by markets, we remain alert to indications of a trend change.

CAC 40 (WEEKLY)

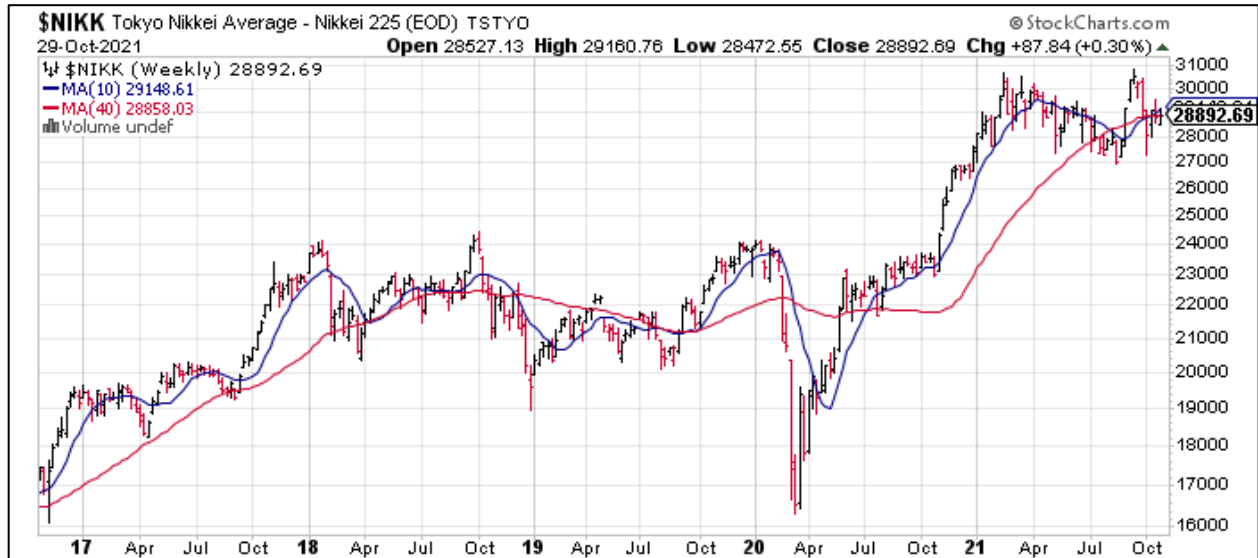


The Paris CAC 40 Index rose 4.7% in October, which has produced a profit of 10.6% since our purchase at 6175 this past spring. We maintain our protective sell price at 6240.

As with the DAX, the 2021 high is an important price point. The establishment of new 2021 highs would be bullish, while a failed attempt to breach the existing price high would raise the risk of a change of trend.

We remain bullish on the CAC 40 until evidence suggests otherwise.

NIKKEI INDEX (WEEKLY)

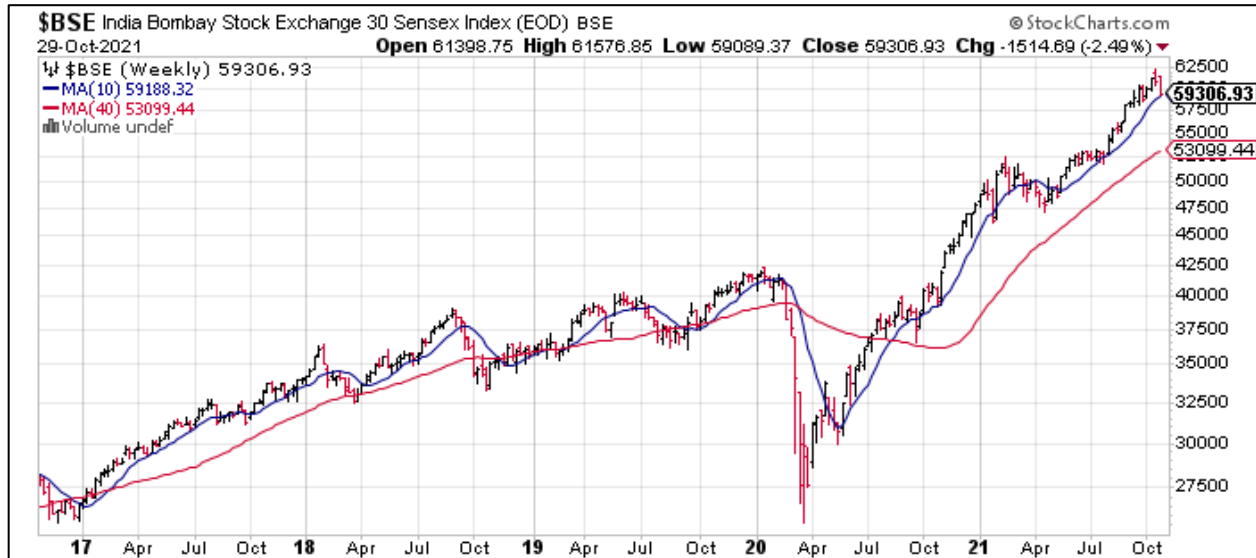


Our comment in the last issue that, “the failure of the Nikkei to establish a new 2021 high in September should be viewed as a potentially negative harbinger” bore fruit as the index declined sharply in early October before rallying later in the month. All told, the Nikkei declined just under 2% in October to lower our profit to 20% on the position we initiated at 24000 last fall.

The performance of the Nikkei is growing more concerning. The failure to sustain a move through the 2021 price high established earlier this year, despite the benefit of a weakening yen (the yen and Nikkei typically trade inversely), can only be construed as bearish behaviour, though not sufficiently so to compel us to sell the Nikkei.

We continue to hold our long position in the Nikkei and will keep our protective sell price at 27000.

SENSEX (WEEKLY)

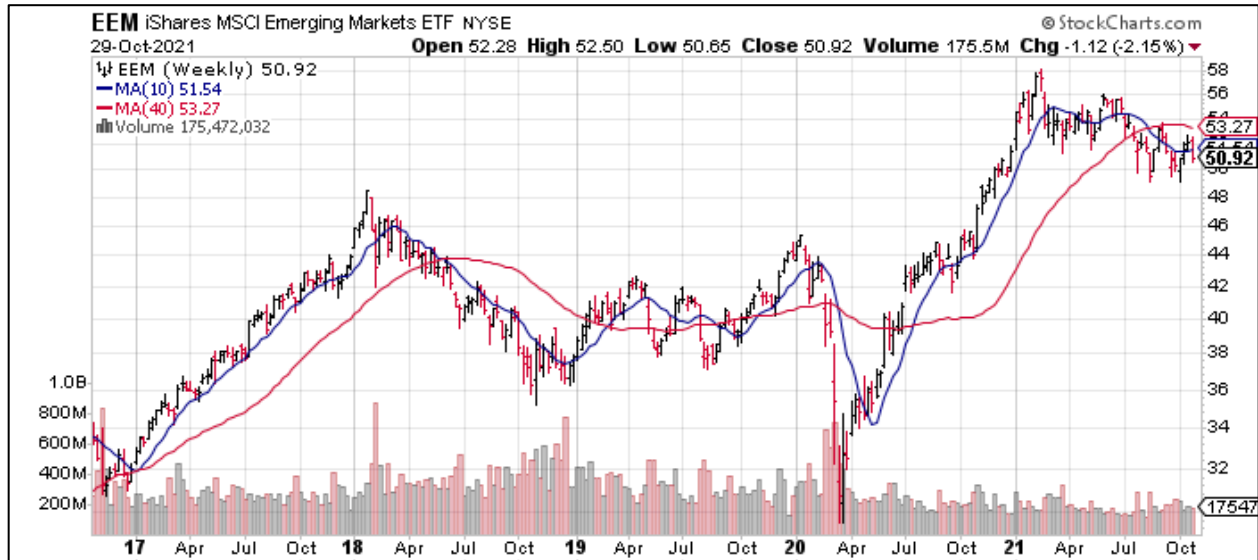


The Indian SENSEX Index was essentially flat in October, which has left the gain on the position purchased at 52600 in June (described in July issue) at 12.4%.

The establishment of a new high in October and the subsequent month-end close below the previous high is negative technical price action. As a result, we’re moving our protective sell price up to 57400 from 56000.

The SENSEX position has been a gratifying example of the value of buying a market performing bullishly when it presumably should be behaving bearishly (for that is very bullish indeed). However, the index’s rapid ascent in recent months and poor end-of-month performance suggest that a larger pullback is possible. We have, therefore, raised our protective sell price to capture the bulk of our gains in that event.

EMERGING MARKETS ETF (EEM) (WEEKLY)



We wrote in last month’s letter that the circa 50 level was important for EEM, and that level again provided support in October.

The EEM chart continues to exhibit a bearish bias by trading below its long-term 40-week moving average.

The large weighting of Chinese equities (about 35%) within EEM is a major potential obstacle to higher prices until more clarity is available on the state of the troubled property developer Evergrande and its peers.

The risk/reward for EEM remains underwhelming, in our opinion, so we will continue to stand aside from this market and await an attractive buying opportunity.

FIXED INCOME COMMENT

10-YEAR US TREASURY NOTE (WEEKLY)



We commented in the October issue that, “ lower prices (higher interest rates) are probable.” A further decline did occur in October, with the 10-year Treasury declining to 129.9 from 130.87 the month previous.

The close below 130, which provided support during the previous pullback earlier this year, is a bearish development and suggests that further weakness is likely.

The ongoing global supply disruptions continue to provide impetus to inflationary pressures. This is being reflected by capital markets as they begin to price in a series of interest rate increases over the next two years. The attitudes of central banks do seem to be shifting toward a less accommodative stance, which would put upward pressure on interest rates. Announcements about “tapering” bond purchases and a more hawkish tone in discussing interest rate policies are becoming more likely. Both would put continued pressure on bonds.

Offsetting the effect of the uptrend of inflation on interest rates is mounting evidence that the global economy is slowing rather quickly. The two largest economies, the United States and China, are certainly cooling, with U.S. economic growth slowing to a 2% annual rate in the third quarter.

In conclusion, we expect further pressure on interest rates (lower bond prices). We suspect that a resolution to the inflationary pressures produced by the supply disruptions and/or a decision by central banks to arrest the acceleration of weakness in the global economy will ultimately act as a brake to rising interest rates.

CURRENCY COMMENT

US DOLLAR INDEX (DXY)(WEEKLY)

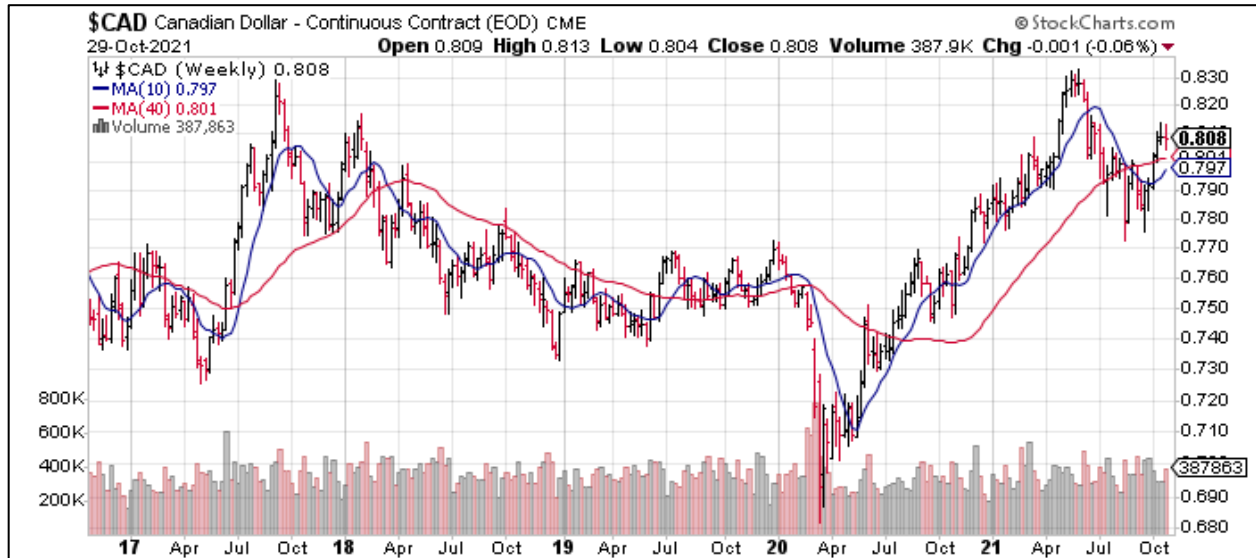


The US Dollar Index ended its rather conspicuous strength of recent months by declining in October. We would not be surprised to see some additional weakness given its recent sharp rise.

However, we still find it difficult not to be bullish on the dollar long term given the lack of apparent alternatives. In our opinion, the size and strength of the American economy, the dollar’s continued role as the world’s reserve currency and its positive interest rate differential vis-a-vis major competitors create a potent argument for ongoing dollar strength.

Despite the possibility of continued short-term weakness, the dollar remains our favoured currency.

CAD/USD (WEEKLY)



The Canadian dollar rose very sharply against its American counterpart in October. The major reason for the currency’s strength was the rise in the price of oil. Oil prices have historically been the major driver (both up and down) of the Canadian dollar. Studies have demonstrated a greater than 60% correlation between the two.

Our currently bullish view on the prospects for oil, therefore, suggests that further strength by the Canadian dollar is likely. Major price resistance exists at the circa .83 level, as that represents both the 2017 high and the failed breakout attempt earlier this year. It is a very important price level that, if crossed, suggests that materially higher prices for the Canadian dollar are likely.

The future path of the dollar will be largely a product of oil prices.

EUR/USD (WEEKLY)



The euro versus UD dollar rate was essentially unchanged in October. The strength exhibited by the euro earlier in October was largely reversed by weakness late in the month.

The prospects for the euro continue to look decidedly bearish from a technical perspective. The month-end weakness and the fact that the euro is trading below both its 10 and 40-week moving averages are bearish indications.

On a fundamental basis, the European Union continues to face a host of economic and geopolitical challenges.

We remain bearish on the euro and expect continued weakness.

POUND/USD (WEEKLY)



The British pound rose by almost two full cents against the US dollar in October. The rise by the pound would seem to owe more to dollar weakness than its own merits. Part of the rise could also be attributable to an oversold condition produced by the weakness of the prior month.

The pound ended October trading just under its 40-week moving average, which may prove to be a barrier to higher prices.

We remain bearish on the prospects for the pound given our expectations that the negative economic implications of Brexit will become increasingly apparent over time.

Thus, we maintain our short position initiated at 1.393 and maintain our protective buy price at 1.39 as this will prevent this position from registering a loss through an unexpected change of trend.

YEN/USD (WEEKLY)



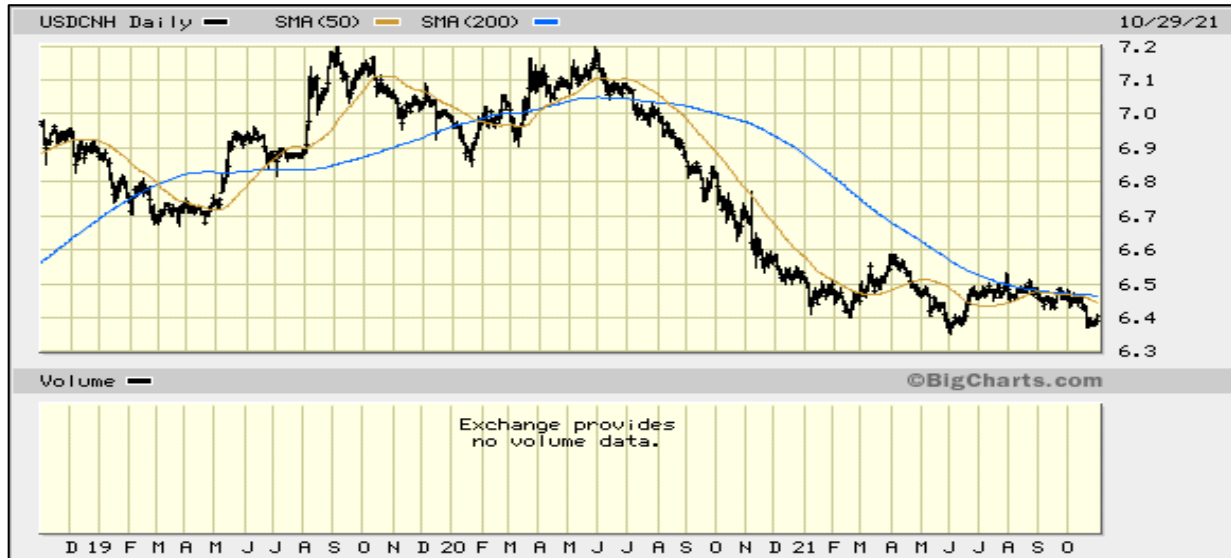
We stated in the October issue that, “ It has been our opinion that the long-term trading range of the currency would be resolved by yen weakness. That process may be beginning.”

The yen weakened further in October and appears intent on testing the upper boundary of its long-term trading range at circa 115.

If the yen ultimately trades through the price support at circa 115, more significant yen weakness against the dollar becomes more probable.

We will continue to stand aside from this market until evidence is provided that the yen has broken out of its long-term trading range.

YUAN/USD (DAILY)



The yuan strengthened against the US dollar in October and now trades at a major resistance level. We don't expect further strength from the yuan, but a move below circa 6.4 level would be a noteworthy bullish development.

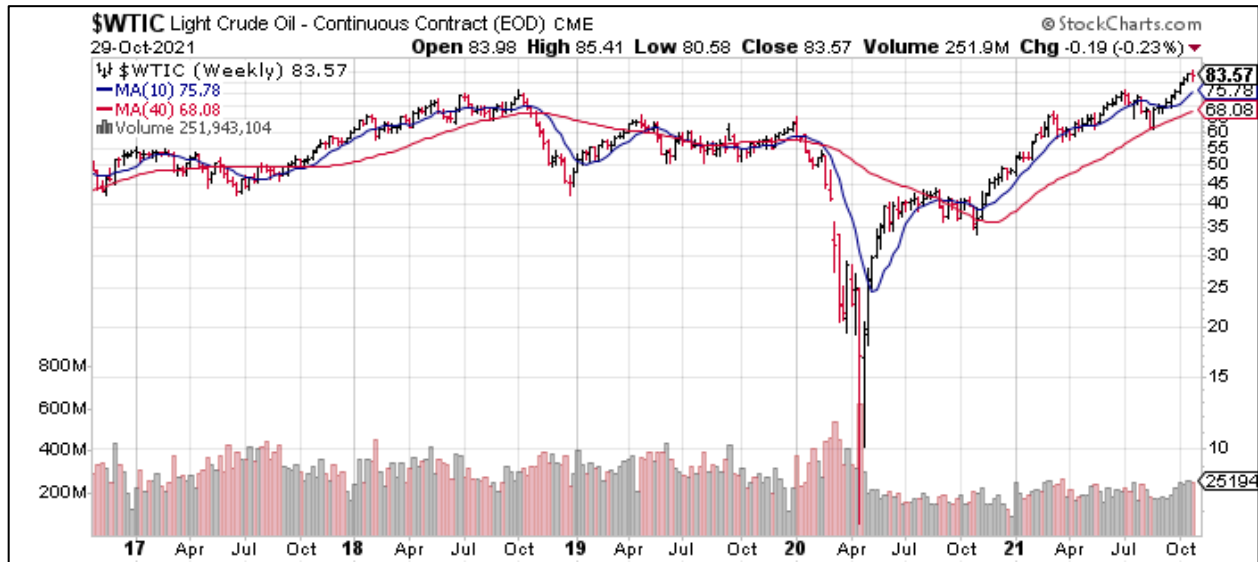
Our long-term expectation remains that the yuan will ultimately weaken against the dollar, for we believe that would be in China's interest. However, the yuan is an instrument of the Chinese Communist Party, and its behaviour depends on the Party's perception of its self-interest, which may differ from our opinion (especially in the short term).

The slowing Chinese economy, which could be exacerbated by the substantial credit problems within the Chinese property development sector, suggests a weaker rather than stronger yuan going forward.

We believe it wise to hedge yuan exposure.

OIL COMMENT

CRUDE OIL (WTI) (WEEKLY)



The price of oil posted a dramatic increase in October, rising 11.2%.

As we noted in the October issue, a move through the 2018 high would be a very bullish development for oil and prompt us to change our stance from bearish to bullish. The price did trade through the 2018 high and we changed our stance accordingly.

A confluence of events has served to create a bullish environment for oil. Saudi Arabia, along with the rest of OPEC+, has stated that it will not accelerate oil production despite the rising prices. Surging prices for alternative fuels, i.e., coal and natural gas, has also served as an impetus for rising oil prices.

The replenishment of oil inventories has been challenging during the COVID pandemic because of supply chain disruptions. China, the world’s largest importer of oil, has seen its oil inventory fall to a four-year low. The combination of the approach of winter and current electricity shortages suggests that the Chinese may be forced to aggressively purchase oil even at these elevated prices.

The oil futures market is currently in backwardation (near-term prices are higher than longer-term prices), which is an indication that oil is currently in short supply. Futures markets in backwardation are typically an indication of higher prices until the market returns to its normal state of contango (near-term prices lower than longer-term prices).

The volatility characteristics of markets are an important input into our market analysis. We have long noted the strong tendency of volatility to mean reversion, i.e., periods of unusually low volatility are typically followed by a period of above-average volatility as markets return to equilibrium.

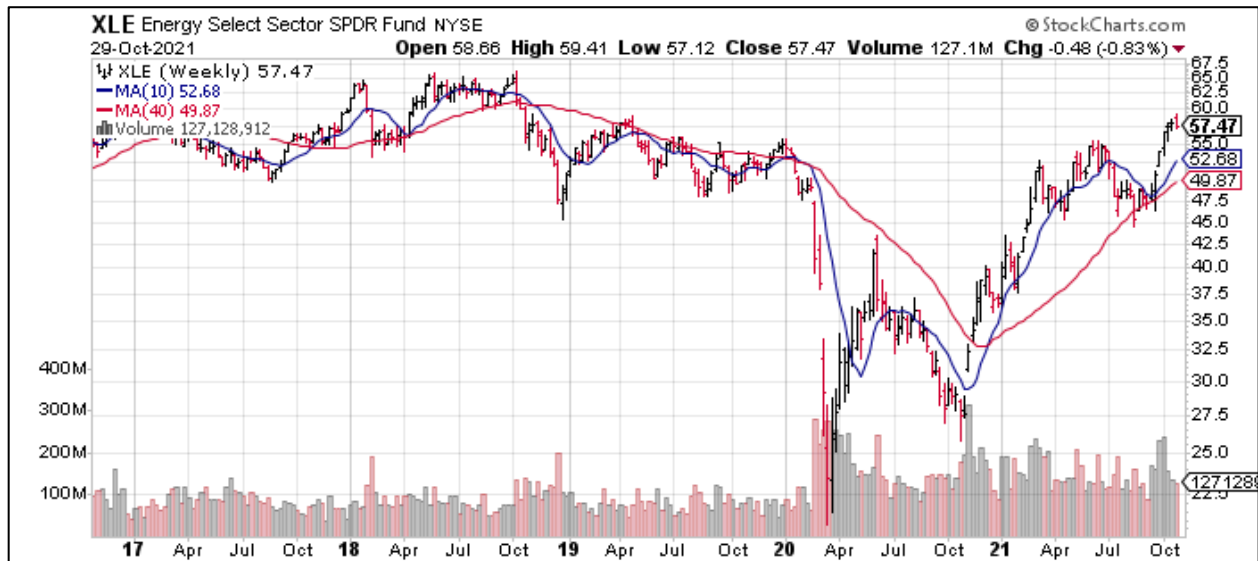
The oil market presents an interesting case. Before the crash in the price of oil in March 2020 (when oil briefly traded at negative prices), the weekly level of volatility during the previous few years had been very low. The huge volatility produced by the March 2020 price crash proved to be the resolution of the previously extended period of muted volatility by oil.

Since the dramatic events of March 2020, the price volatility of oil has returned to trading in a constricted fashion. Thus, the probability of a sharp move in the price of oil is once again rising. A characteristic of the mean-reverting nature of volatility is that the timing and direction of the market move that will produce a spike in volatility are uncertain.

We must attempt to calculate the likelihood of an increase in volatility from a combination of factors.

As we are currently bullish on oil, we tend to anticipate an eventual sharp upward move in its price. However, we must be prepared for the opposite result, for the price of oil is unusually difficult to forecast given its unusual sensitivity to geopolitical events, the actions of OPEC+ et al.

Therefore, we will remain bullish with an expectation of higher prices. However, a decline by the oil price back below the 2018 price high would be a very bearish development and prompt us to return to our previously bearish stance.



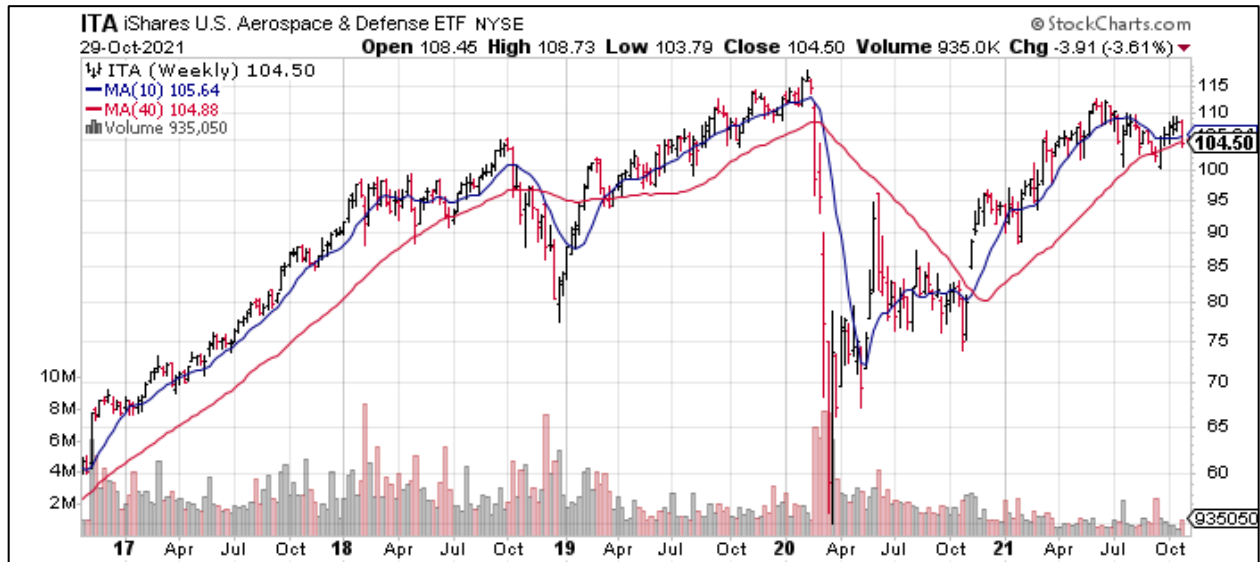
As noted last month, we intended to establish a long position in the XLE Energy Select ETF on a move by oil through its 2018 high. Thus, we established a position in XLE at \$55.10 on oil's breakout.

XLE ended the month at \$57.47, which has produced a small gain on our position. Our initial protective sell price will be placed at \$54.50.

The next major price hurdle for XLE will be its own 2018 price high at circa \$65. Such long-standing price levels can provide significant price resistance. We will be monitoring the behaviour of XLE as it nears \$65 for signs of a price reversal. A clear move through the 2018 price high would be very bullish.

DEFENCE SECTOR COMMENT

US AEROSPACE & DEFENCE ETF (ITA)(WEEKLY)



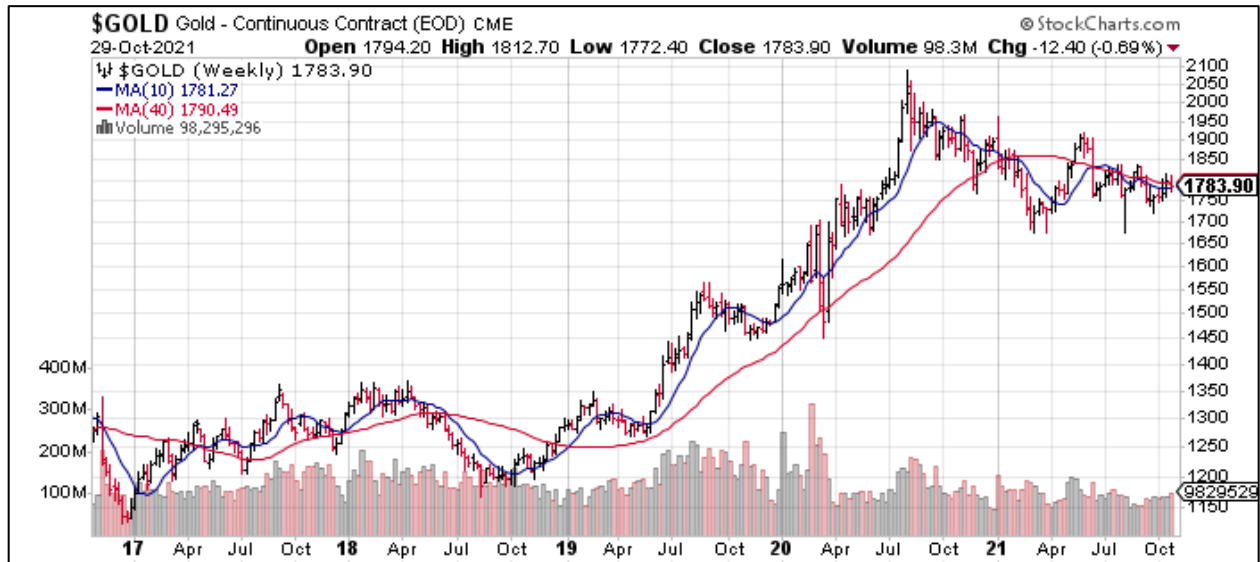
The defence sector, through our proxy, the ITA ETF, is a core investment theme that has previously yielded handsome returns.

However, we have yet to identify a compelling opportunity to re-establish a position in ITA following our sale prior to the March 2020 market crash. The lack of relative price strength exhibited by the ITA versus the S&P 500 has been a concern.

A price rise by ITA through its 2020 price high would be a bullish signal and prompt us to initiate a new long position.

GOLD & SILVER COMMENTARY

GOLD (WEEKLY)



Our latest long position in gold, established in August at \$1700, remains profitable. However, the less than dynamic trading activity by gold during the abundance of discussion of inflation and money supply growth remains a concern.

We continue to be bullish and will leave our protective sell price at \$1680.



We exited our hypothetical (we restrict our activity in gold to bullion) long position at 129 in September, which prevented our sustaining a “hypothetical” loss on XAU’s decline to circa 119.

The gold index bounced back in October to trade near its 40-week moving average. XAU looks less than compelling, and we stand aside from this market even on a hypothetical basis.



We continue to have no position in silver and await a move through the circa \$30 price level, which could be a precursor to much high prices.

ABOUT THE EDITOR

The Editor and Publisher of the Global Investment Letter is Jonathan Baird CFA. Prior to founding the Global Investment Letter, Jonathan spent more than 25 years as an award winning money manager in Canada, most recently winning a Lipper Award in 2010 for managing the #1 Global Equity Fund in Canada. Jonathan managed several #1 ranked funds over the course of his career as a money manager, investing in all major industries, asset classes and markets. Along with his interest in the world of investment, Jonathan has been a lifelong student of history and uses the lessons of history to help interpret and provide context to current events. Jonathan no longer invests money for others, managing only his own account. The Global Investment Letter represents his personal thoughts and opinions.

Jonathan well understands the difficulty of the investment process, and the essential role that quality information and opinion play in successful investing. Each monthly issue will contain comments on major markets, economics, geopolitics as well as investment ideas. There may also be discussion of investment philosophy or practices and reviews of books deemed of potential interest to readers.

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