The Gallery of Crowd Behavior Returns May 2, 2011

Doug Wakefield

" [From an intensive two-year study], I found that market price movements are like people – they have statistically significant life expectancy profiles that can be used to measure risk exposure...Consider life insurance, which deals with the life expectancy of people instead of price moves. If you're writing life insurance policies, it's going to make a great deal of difference whether the applicant is twenty years old or eighty years old.... Similarly, in a market that is in a stage of old age; it is particularly important to be attuned to symptoms of a potential end to the current trend. To use the life insurance analogy, most people who become involved in the stock market don't know the difference between a twenty-year old and an eighty-year-old."
Hedge Fund trader Victor Sperandeo in **The New Market Wizards: Conversations With America's Top Traders** (1992) Jack Schwager, p 256

On November 2, 2007, I released a short article titled A Gallery of Crowd Behavior. The objective was simple. Display a set of charts across a variety of markets, in an attempt to point out that major turns in markets, when they come, are not a total surprise to those who are looking for them, and charts are the picture that are worth more than a thousand words at key historical points. It is my belief, that the odds are extremely high, that May 2011, like January 2000 and October 2007, should be one of those times. Since my opinion is of no value in and of itself in the sea of human opinions, I only ask that you examine these charts, and consider their relation to previous tops, and the concept of age as explained by Mr. Sperandeo in the opening quote.

Three Tops

Last Thursday, I decided to study the previous tops, and compare them to the Dow's jet propulsion movements since its March 16th at 11,555. What I found was quite interesting.


$INDU (Dow Jones Industrial Average) INDX
© StockCharts.com
18-Jan-2000
Close 11560.70 Volume 225.4M Chg -162.20 (-1.38%)
$INDU (Daily) 11560.70
2000 top - last 31 days- gain 891 pts.
1- 709, 2 - (630), 3 - 812
1
3
2
11750.20
11663.10
11568.70
11505.10
11383.70
11341.20
11282.20
11098.00
11054.60
10938.60
10859.60
Best Minds Inc.
11800
11700
11600
11500
11400
11300
11200
11100
11000
10900
29
Dec
6
13
20
27
2000
10
18


$INDU (Dow Jones Industrial Average) INDX
© StockCharts.com
15-Oct-2007
Close 13984.80 Volume 542.5M Chg -108.28 (-0.77%)
$INDU (Daily) 13984.80
2007 top - last 31 days - gain - 1164 pts.
1 - 460, 2 -(473) - 3- 1177
14,198
3
1
2
14166.97
14115.51
13947.73
13950.25
13877.17
13741.01
13494.06
13469.27
13387.33
13248.24
13034.78
13021.93
Best Minds Inc.
14200
14100
14000
13900
13800
13700
13600
13500
13400
13300
13200
13100
13000
27
Sep
10
17
24
Oct
8
15

If one looks at the trading days leading up to the January 14, 2000 top, they can see a bottom 31 days prior to that top. We can see a bottom 31 days prior to the October 11, 2007 top. And, if we start at the bottom on March 16th, on can see that Friday, April 29th, marks 31 days from that trading bottom.

The last 31 days leading up to the January 14, 2000 top pushed the Dow up 891 points. The last 31 days to the October 11, 2007 top pushed the Dow up 1164. In the 31 days of trading between March 16 and April 29th, the Dow has moved up faster than both of these previous tops, leaping 1277 points.

Now one mighty say, “Yes, but Monday, May 2nd, the Dow moved even higher”. While this is most certainly correct, why would someone ignore the parallels between the 2000 and 2007 top, especially if the speed of ascent today (AFTER the fastest bull market in US history) was even faster. Shouldn’t any investor or trader perceive our current juncture with extreme caution, rather than EXPECTING a very old trend to continue climbing into the stratosphere?

Two Aircraft Carriers

Anyone seeking to understand developments and data in the global currency and derivatives market would read the [Triennial Central Bank Survey on Foreign Exchange and Derivatives Market Activity]() (April 2010). The most recent survey was released in September 2010. The following helps us understand the enormous size of the global currency market, the largest market in the world:

> "Global foreign exchange market turnover was 20% higher in April 2010 than in April 2007, with average daily turnover of $4.0 trillion compared to $3.3 trillion. The increase was driven by the 48% growth in turnover of spot transactions, which represent 37% of foreign exchange market turnover. Spot turnover rose to $1.5 trillion in April 2010 from $1.0 trillion in April 2007."

I don't know about you, but the numbers in the BIS report are almost incomprehensible. While the currency markets are experiencing a turnover of $4 trillion a DAY, the April 2011 release on the World Development Indicators by the World Bank, reveals a global GDP of $59 trillion (Atlas method), and the US GDP of $14.1 trillion ANNUALLY, and the US deficit stands at $829 billion ($0.8 trillion) at the midpoint in its fiscal year.

Let's compare these three massive numbers once again.

- Annual turnover in global foreign exchange market – (assumes 260 trading days) - $1,040 trillion.
- Global GDP - $59 trillion; U.S. GDP - $14.1 trillion
- U.S. Deficit, largest in its history – on pace for $1.6 trillion.

When one looks at these numbers, it is like talking about the distance to the nearest star or the speed of light.

The next chart makes it very clear, that the largest currency trade in the Forex market is the US/Euro trade.

Table 4

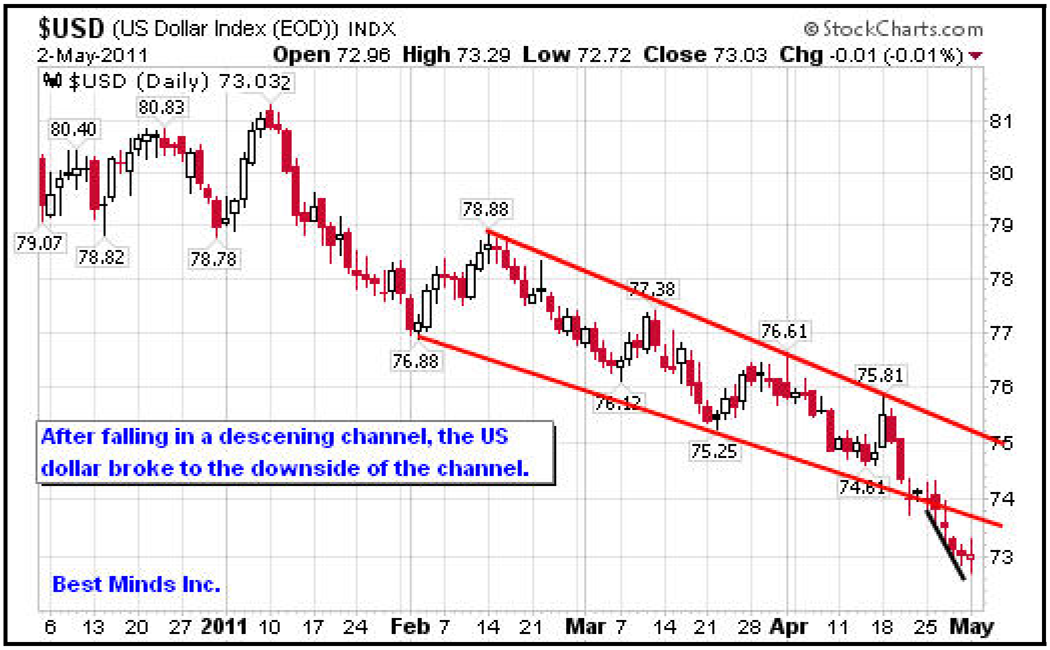
Global foreign exchange market turnover by currency pair[1]

Daily averages in April, in billions of US dollars and percentages

Currency pair	1998		2001		2004		2007		2010	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
USD/EUR	.	.	372	30	541	28	892	27	1,101	28
USD/DEM	309	20	.	.	.	.	.	.	.	.
USD/FRF	60	4	.	.	.	.	.	.	.	.
USD/XEU	17	1	.	.	.	.	.	.	.	.
USD/OthEMS	178	12	.	.	.	.	.	.	.	.
USD/JPY	292	19	250	20	328	17	438	13	568	14
USD/Oth	140	9	152	12	251	13	498	15	445	11
USD/GBP	122	8	129	10	259	13	384	12	360	9
USD/AUD	44	3	51	4	107	6	185	6	249	6
USD/CAD	52	3	54	4	77	4	126	4	182	5
USD/CHF	82	5	59	5	83	4	151	5	168	4
EUR/JPY	.	.	36	3	61	3	86	3	111	3
EUR/GBP	.	.	27	2	47	2	69	2	109	3
EUR/Oth	.	.	17	1	35	2	83	2	102	3
USD/HKD[2]	14	1	19	2	19	1	51	2	85	2

[BIS Triennial Survey: FX and Derivatives Activity in Apr10, rel. Sep10 – pg 10]

Based on this information, it would seem extremely important for anyone depending on our global capital markets to pay attention to trends in the US dollar and Euro. From looking the charts below, and once again considering the comments of Mr. Sperandeo earlier, it would appear that a massive change in direction should be expected for these two aircraft carriers.



With the Euro sporting one of its highest bullish sentiment readings since its bottom in June 2010, and the US dollar providing one of is lowest bullish sentiment readings from the same period, it would seem to behoove us to think as contrarians, and look for the end of these trends and the start of new ones. This is not an argument for the long-term sustainability of either of these currencies, as they exist today, only a reminder that trends change along the way in this historical journey.

When one compares the patterns in US equities since last June, with that of the US dollar, it seems to beg the question, “Could these two powerful markets change trends together?; How could these changes impact other capital markets?”

These words, written by Nassim Nicholas Taleb and Mark Blyth in the May/June Issue of Foreign Affairs, should make us all think hard about the current level of risks in global markets:

> “Complex Systems that have artificially suppressed volatility tend to become extremely fragile, while at the same time exhibiting no visible risks. In fact, they tend to be too calm and exhibit minimal variability as

> silent risks and accumulate beneath the surface. Although the stated intention of political leaders and economic policymakers is to stabilize the system by inhibiting fluctuations, the result tends to be the opposite."

As I continue to remind my subscribers, expect the unexpected.

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