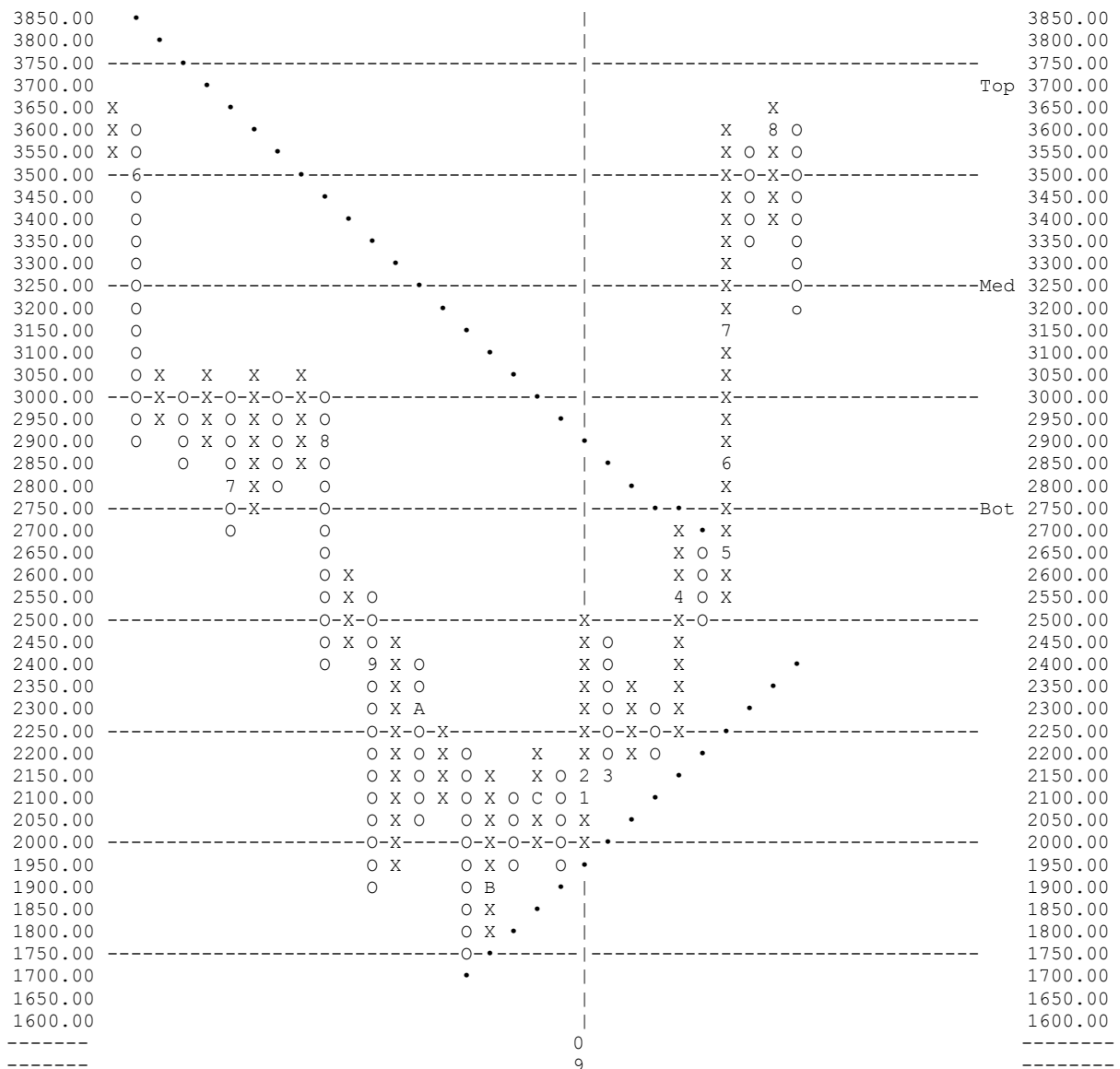


The Starboard Side Report

The week ending August 14, 2009

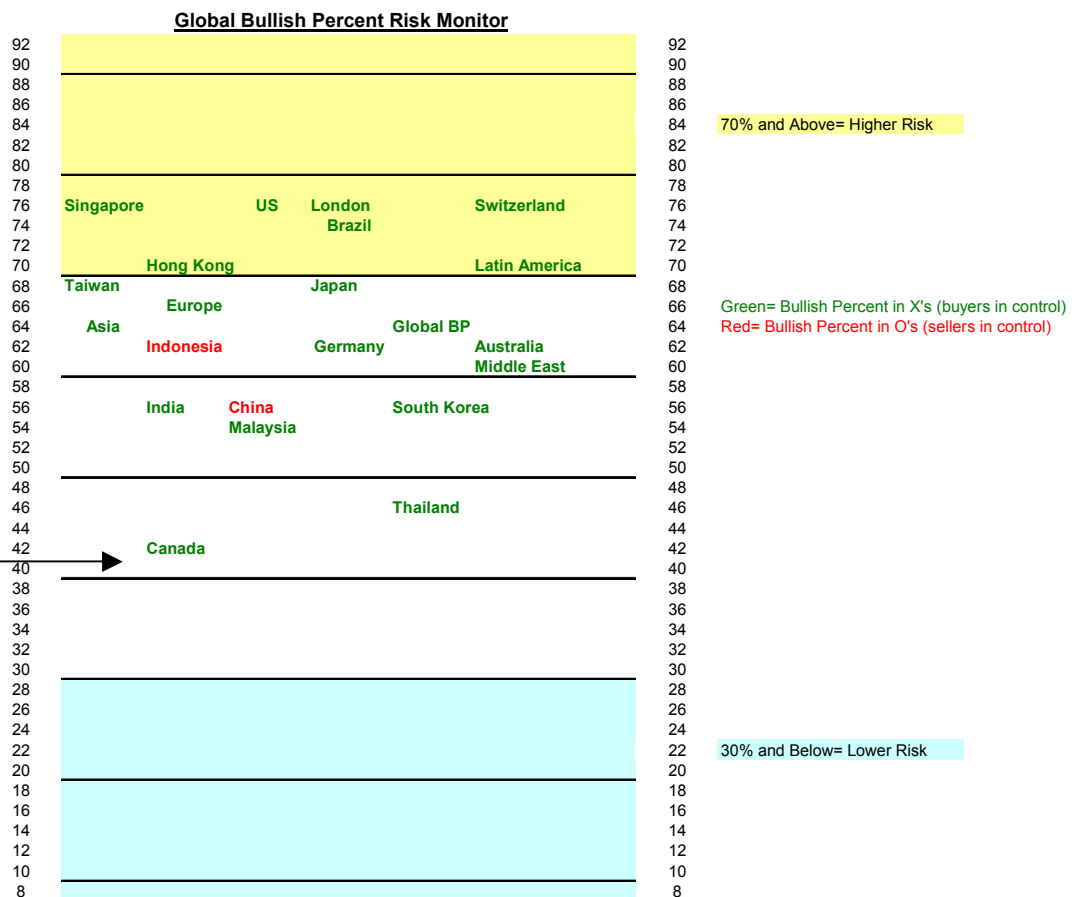
The market continues to move sideways and digest the explosive gains that occurred over the last three weeks of July. Corrections can occur as a function of both price and time. This means that stocks can work off an overbought condition by having a sharp move lower or through a sideways correction that takes time to work off excess supply. So far, we appear to be in the midst of the later scenario in the US, while the Chinese A Share Index is undergoing a more traditional short-sharp price correction.

Shanghai A Share Index
 Updated Through- 08/14/2009 (3198.105 Down 98.214)
 Trend Chart Broke a Double Bottom on 08/12/2009
 Bearish Price Obj: 2700.



As we see above, the Chinese market has undergone a 12% decline since the start of August. This compares to the US S&P 500 which is still trading at the same level where it began the month. The nature of these two corrections is not all that surprising given Chinese stocks have doubled off their post crash lows versus a smaller 52% move by the US benchmark index. Since China bottomed before everyone else last November and led the global economy out of recession, it will be important to monitor the situation to make sure that this is nothing more than a healthy pullback. Signs that it is turning into something worse would be a red flag and a reason to reign in our bullish posture. We believe that the odds are against a major new down leg in Asia right now because our analysis points to an economic recovery cycle that still building momentum. A look at the chart above points to perhaps another 5-10% further downside for China A Shares in the weeks ahead. Technical support first exists at 3000 and then down at the 2700 level. Other Asian stock markets will likely continue to trade down in sympathy. Once the correction runs its course, we expect strong Asian relative strength to return.

One of the best ways to play booming growth in China is not through the Chinese stock market, but rather through those global markets that have more attractive valuations and are leveraged to growth in Chinese infrastructure and consumption. We have discussed emerging Asia and Latin America as good ways to play this theme. However, there are a few developed nations that are also big beneficiaries of Chinese economic expansion without the political risk found in emerging markets. Canada and Australia are the two most prominent due to their abundance of natural resources. Of the two, we currently favor Canada because it has the most attractive bullish percent field position of the 22 countries and regions we track.



Canada with a bullish percent of 42% has the most attractive risk-reward profile of the 22 we monitor.

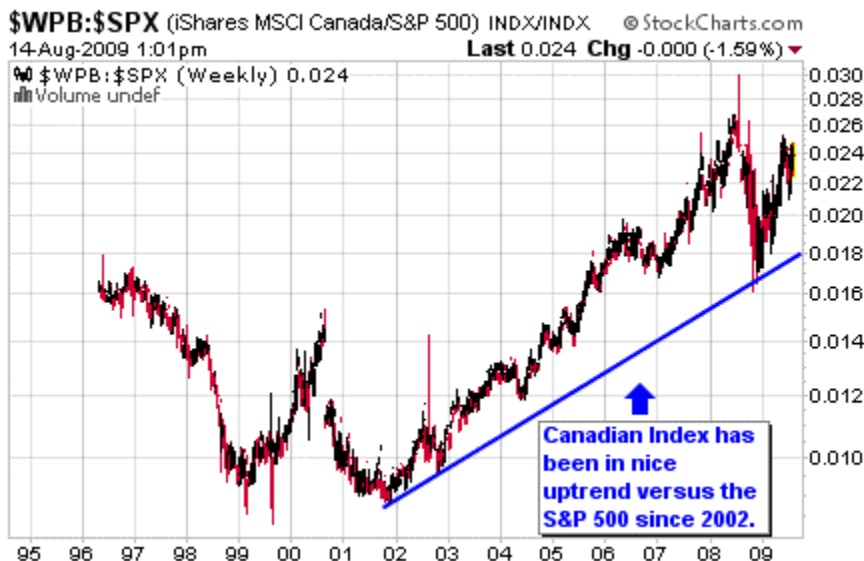
Source: Dorsey Wright & Associates

One of the reasons that the Canadian market has such impressive relative strength is the fact that the energy and materials sectors account for 44% of the MSCI Canada Index. This can be observed in the chart below that shows Canada never getting close to its 2002 lows in the most recent bear market. By comparison, the S&P 500 fell 15% below its 2002 level this March.



Another plus for the Canadian economy besides the vast resource base is the fact that the large banks in Canada did not become overexposed to derivatives and toxic US subprime mortgage loans. In fact, last year the World Economic Forum in Geneva Switzerland ranked the Canadian banking system as the soundest in the world (the US was way down at number 40). That is why we do not have a huge problem with financial stocks being 35% of the MSCI Canada Index. We would rather get our financial exposure here than through US banks.

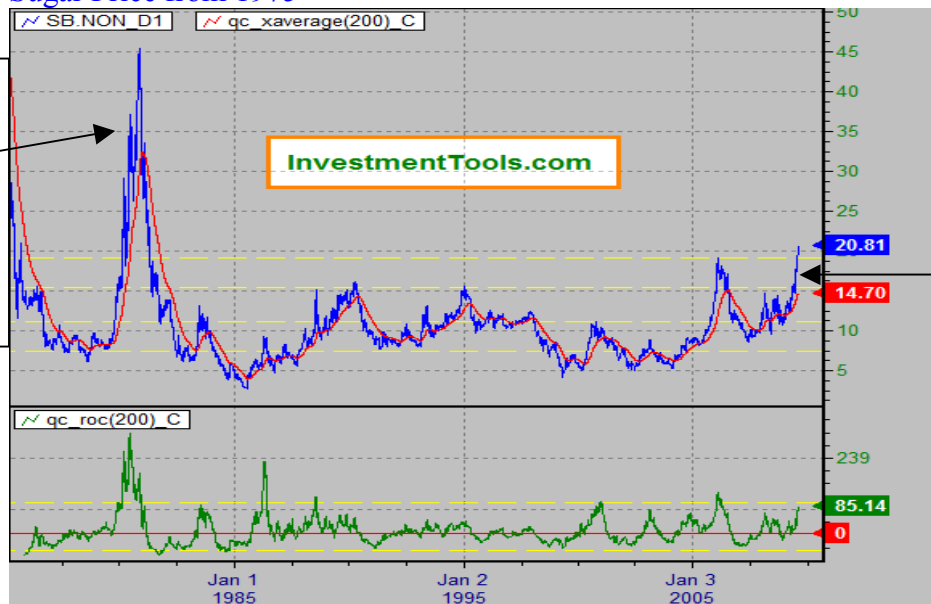
The next picture we will show is a relative strength chart of the US versus Canada since 1996.



For most of the 1990's, stocks in the US were outperforming those in Canada. However, that trend changed in 2002 when Canadian stocks took the baton thanks in large part to China's insatiable appetite for their natural resources. Given our solid long-term outlook on commodities, we see the trend of Canadian relative strength accelerating in the decade ahead. As we discussed in our report from 6-26-09, the S&P 500 is only 15% materials and energy at present. In our opinion, the 43% exposure to these groups in Canada is a distinct advantage.

This week we wanted to take a closer look at sugar prices because they are starting to make national headlines. As you can see in the chart below, sugar prices have just broken out to the upside this month.

Sugar Price from 1975



Expect food inflation to accelerate rapidly if the recent breakout in sugar prices leads to a spike like we had in the early 1980's.

Sugar prices just broke out to a twenty-eight year high on supply shortages in India.

The main culprit for this recent price spike is dry weather wrecking havoc with Indian output. India's production will be down 45% this year and turn them from the third largest exporter to the fourth largest importer of sugar. World food stocks are at generational lows due to overpopulation, global warming and competing usage from ethanol producers. Therefore, negative supply shocks will understandably have adverse consequences for prices. We saw this in 2007 with rice and wheat price spikes. The scary thing with sugar, and all agricultural commodities for that matter, is that although the price gains look dramatic in nominal terms, there is still a enormous room to run on the upside in real terms (inflation adjusted). The final chart below shows the price of sugar adjusted for inflation. As you can see, the price is still 82% below the 1981 high. That means sugar would have to rally 450% just to get back to that level (assuming no inflation). While we don't see this happening overnight, commodity price spikes are a real threat to the global economy in the years ahead. Most bull markets (like the one in commodities) don't end until the inflation adjusted prices of the prior bull cycle are eclipsed. These type of price gains would create big problems for a world that has grown reliant on cheap food and goods sourced from every corner of the earth and transported by inexpensive fuel.

Sugar since 1975 Adjusted by Consumer Price Inflation



Chart created with NeoTicker EOD © 1998-2007 TickQuest Inc.