The Starboard Side Report

The week ending April 04, 2014

Euro (2000 – 2014)

The chart above is very important to the global investment picture. July will be the two year anniversary of European Central Bank (ECB) head Mario Draghi's famous speech in which he pledged that the ECB would do "whatever it takes" to save the Euro. Since that time, European stocks and government bonds have been some of the best performers in the world and the Euro one of the best performing currencies.

Spanish Government 10-year Bond Yield (2006 – Present)

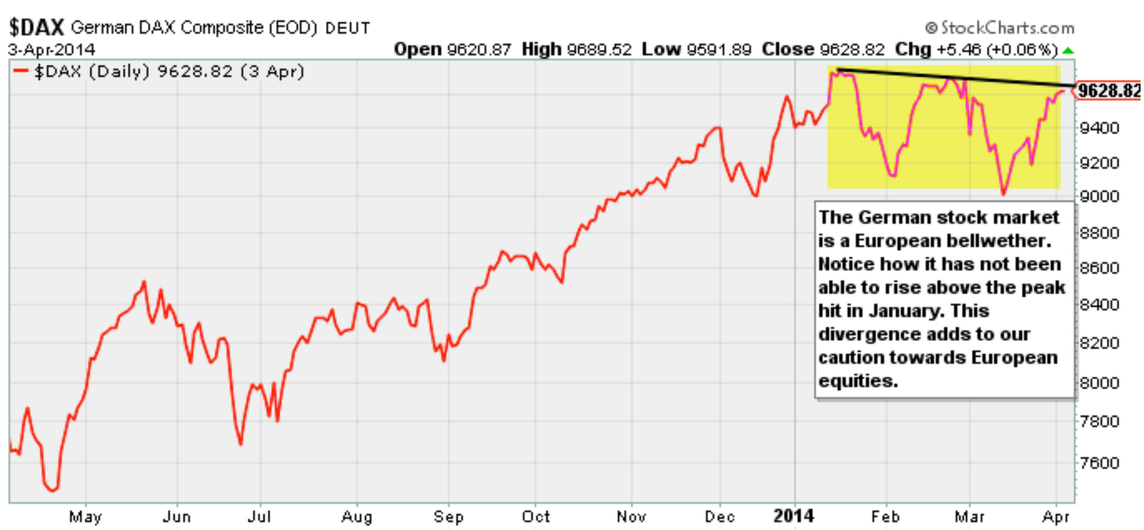
Spain was one of the poster children for profligate spending and debt. Yet, since Draghi's call to action in July 2012, the bond yield on the Spanish 10-year yield has collapsed from 7.5% to just over 3.0% at present. This has brought yields back to the level last seen before the financial crisis in 2006 and within spitting distance of US 10-year Government Bond yields. Additionally, the Spanish stock market has rallied 75% from its July 2012 trough as pictured below.

Spain IBEX 35 Index (2004 – Present)

We are generally more bullish on European shares than the US stock market for long-term investment dollars, but we feel that the recent euphoric rise of the European market has gotten ahead of itself and prices are now due for a major correction before heading any higher. A good comparison to the current European situation might be the US market in 2011. There was still upside to the US bull market, but there needed to be a big shakeout before the rally could resume. The Euro's tenuous position makes us think that a similar shakeout could be rapidly approaching. As such, it could be a rough summer for Euro bulls.

One final note about Europe comes from looking at the below chart of the German DAX Index. Notice how this European bellwether has not been able to rise above the peak hit in January. This divergence adds to our caution towards European equities.

German DAX Composite Index (1 year Chart)

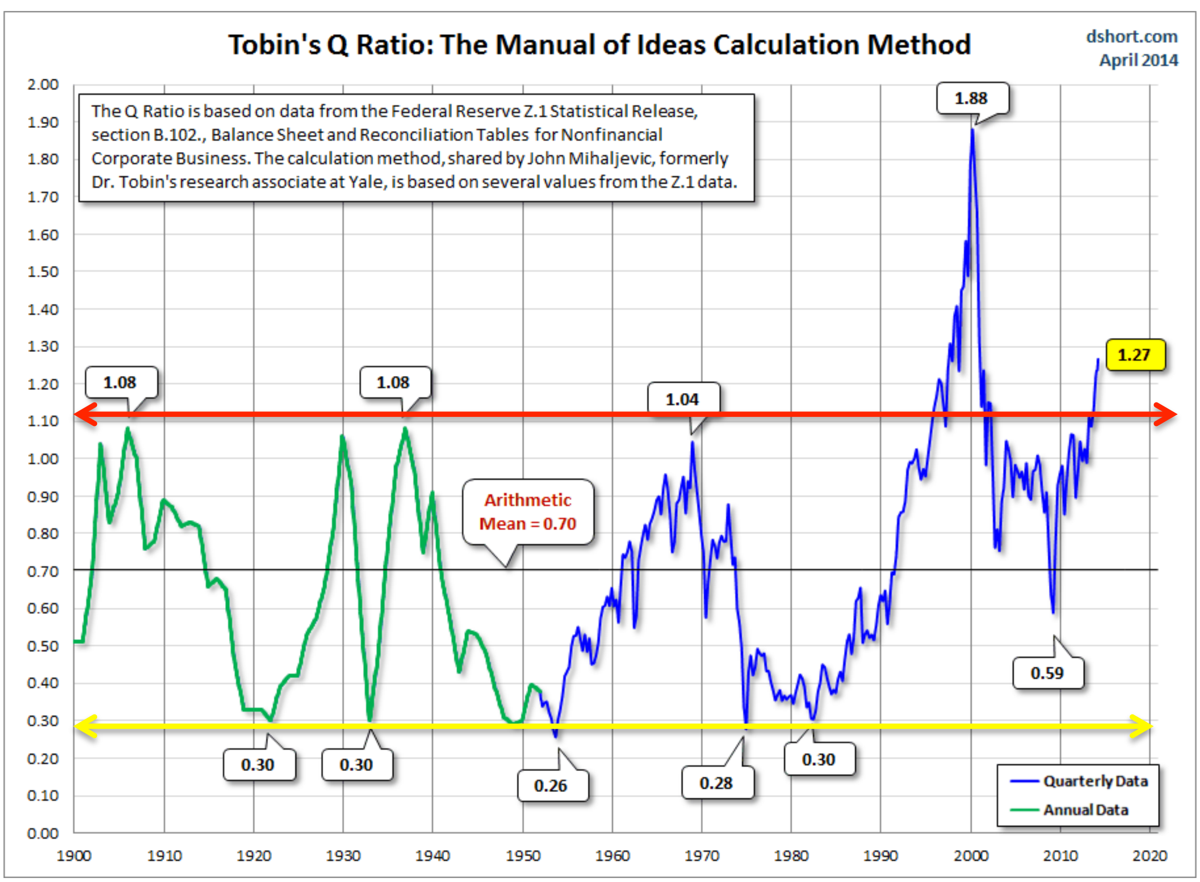


The Euro makes up over 60% of the US Dollar Index currency basket. Therefore, a renewed decline in the Euro would likely mean an extended positive monthly momentum cycle for the US Dollar Index. As we pointed out in our report dated 2/7/14, bad things have happened over the past five years when the US dollar rallies during its positive momentum cycles.

US Dollar Positive Monthly Momentum Cycles since 2008

Start	End	Months	Crisis
Jun-08	Feb-09	9	Lehman Blow-up/US Financial Crisis
Jan-10	Aug-10	8	Flash Crash, Greek Debt Blow-up
Aug-11	Aug-12	13	Debt ceiling crash, Escalation of Euro Debt Crisis
Feb-13	Jul-13	6	Gold Crash, Global Bond Market Panic
Mar-14	?	?	???

We can't claim to know the crisis that would accompany this dollar rally phase. The main candidates are an emerging market crisis centered on China's massive property debt overhang, a Japanese currency/debt problem, a flare-up of the Euro debt crisis or perhaps even a market dislocation in the highly inflated US stock market. One thing is for certain; risk levels have rarely been this elevated in US market history. We will leave you this week with Doug Short's monthly update of the Tobin's Q Ratio. We have shown this many times before in this report. As a refresher, the Q Ratio is basically a snap shot of how cheap or expensive the US market is versus the underlying assets of the economy (a holistic price-to book ratio of the US economy).



Only during the last year of the technology bubble has the Q Ratio ever been above its current 1.27 level in over 100 years of recorded market history! Please see the red line on the chart for other major peaks in history and the yellow line at the bottom of the chart for the level associated with great long-term buying opportunities. The complacency of the market at such extreme levels only 14 years removed from a similar boom-bust episode is really astonishing.