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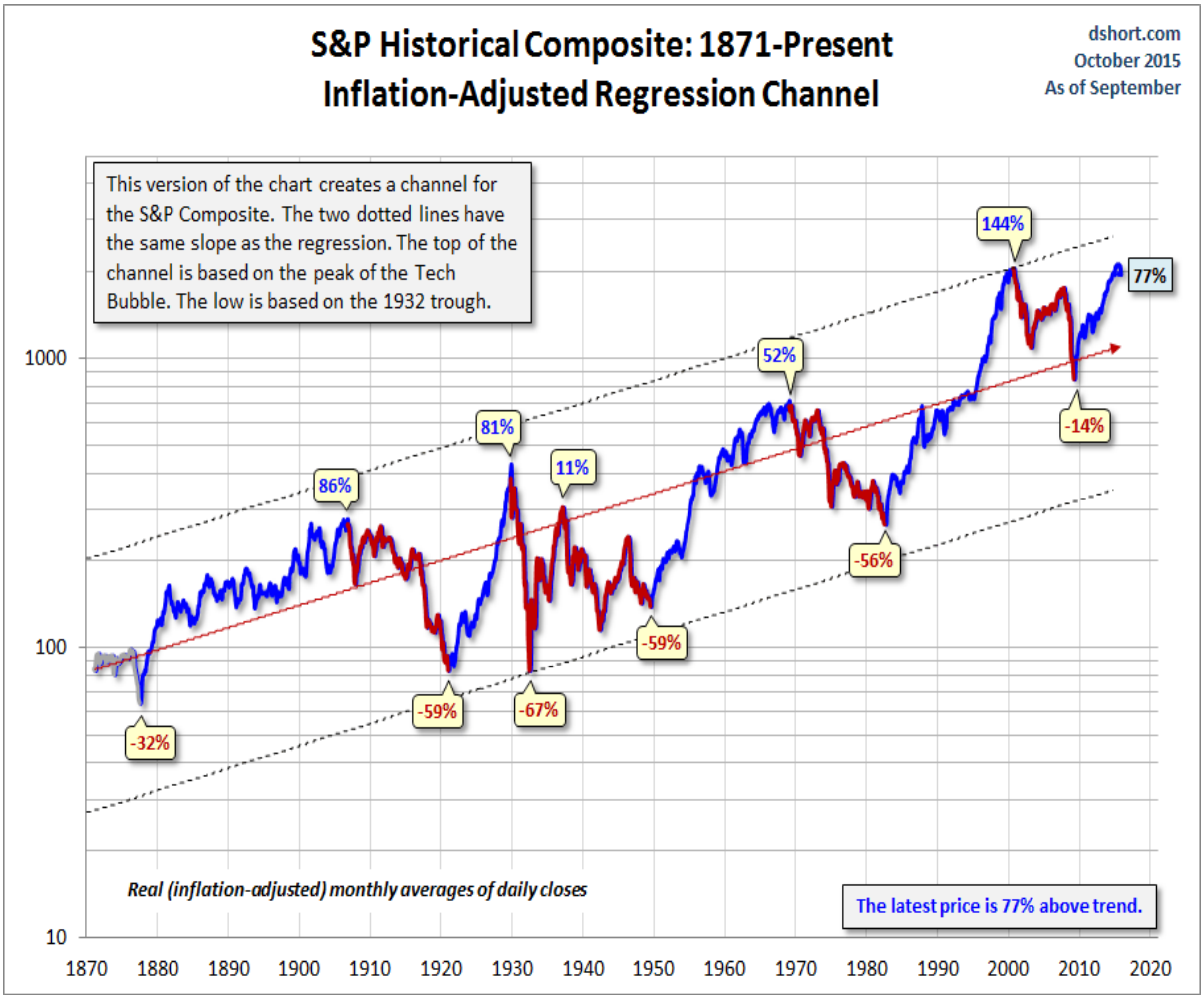
Starboard Weekly Report Ending October 9, 2015

Chart of the Week



The chart above creates a channel for the S&P Composite. The two dotted lines have the same slope as the regression, as calculated in Excel, with the top of the channel based on the peak of the Tech Bubble and the low based on the 1932 trough. This chart was provided by dshort.com Advisor Perspective.

TECHNICAL
Please note that this week's very long-term chart is beginning to turn down. When the decline starts to build momentum, it will nullify any hope that we are in a secular (i.e. longer-term) bull market. Those arguing that we are in a long-term up market do not recognize the fact that the 2008/09 drop was very slight compared to other extended bear market periods. From a technical analysis prospective, this meager 14% descent is crucial. In order for markets to rise over the long term they have to be washed out. However, 14% historically does not compare to the serious downward markets of the 1920's to 1950's or the early 1980 periods. After each of those negative periods we had a strong up secular bull market, most recently from the early 1980's to 2000. Unless this time history proves to be completely different, we will not have a continued bull trend. If a real long-term bear market develops, then we will have tremendous downside risk if we revisit the 50 and 60% reversion to the mean lows depicted on this week's chart.

FUNDAMENTAL
A normal course for supply and demand is that excesses in one direction will beget equal extremes in the opposite movement. Today's economic reason for this is that the modern economy and stock markets are juiced by credit. The more debt imbedded in an economy then the greater likelihood that much of it will be poorly invested. This leads to bankruptcy and the restructuring of bad loans. That often occurs during excessive equity price levels like we have now and causes markets to rollover from bull to bear. Conversely, when equity market prices decline to cheap enough factors below their book value, then they create market bottoms. As the chart above illustrates, the big problem with today's market is that this bottoming process never took place in the 2008 crisis. A 14% decline did not make stocks cheap enough to create a sustained secular bull market. Since 2000, the world credit has grown from 824 Billion to 3.2 Trillion. From 2008 until present, the US has grown its credit from 4.4 Trillion to 7.4 Trillion. Even if a small part of this has to be restructured, it would create a real crisis situation. Reorganization, along with down cycle deleveraging, will prolong a recovery to the extent that we could be in for a long drawn out bear environment. As we have mentioned in recent Weekly Reports, credit markets have started to turn down, so fasten your seat belts as it will be a bumpy ride.

ASIDE
"*History doesn't repeat itself, but it does rhyme*." Mark Twain
No Alice, it will not be different this time. Trust me…