The Starboard Side Report

The week ending September 13, 2013

September is a month that can often mark a big turning point. Five years ago Lehman Brothers blew up and forever changed the financial world. Two years ago the gold sector was the hottest asset class on the planet, but it peaked in September and embarked on a two-year bear market.

Market Vectors Gold Miners Index (September 2011 Peak)

At this point last year, Apple's stock was all the rage and seemingly on a highway to $1,000 per share. Yet, it too made a major peak and has been very weak ever since.

Apple, Inc (September 2012 Peak)

What will this September have in store? Right now, the Nasdaq Composite and specifically Biotech stocks are the hottest area of the market.

iShares Biotech Index October (2008 – Present)

US retail sector investors are also feeling pretty invincible right now. Will one of these hot areas of the market peak and mark a key September top this year as gold stocks and Apple have done over the past two years?

S&P Retail Index (October 2008 - Present)

Gold stocks had a rough week, but the trend off of the June bottom is still higher. As we show below, the prior two major bottoms in the gold stocks in 2000 and 2008 had equally volatile uptrends to start their respective new bull legs.

NYSE Gold Bugs index (2000-2001 bottom)

The 2000 bottom episode was 60% higher five months from the main low as shown by the green uptrend line. However, during that five-month advance there were three corrections that averaged 14.2% over an average of 17 trading sessions. These can be seen in the pink boxes on the above chart.

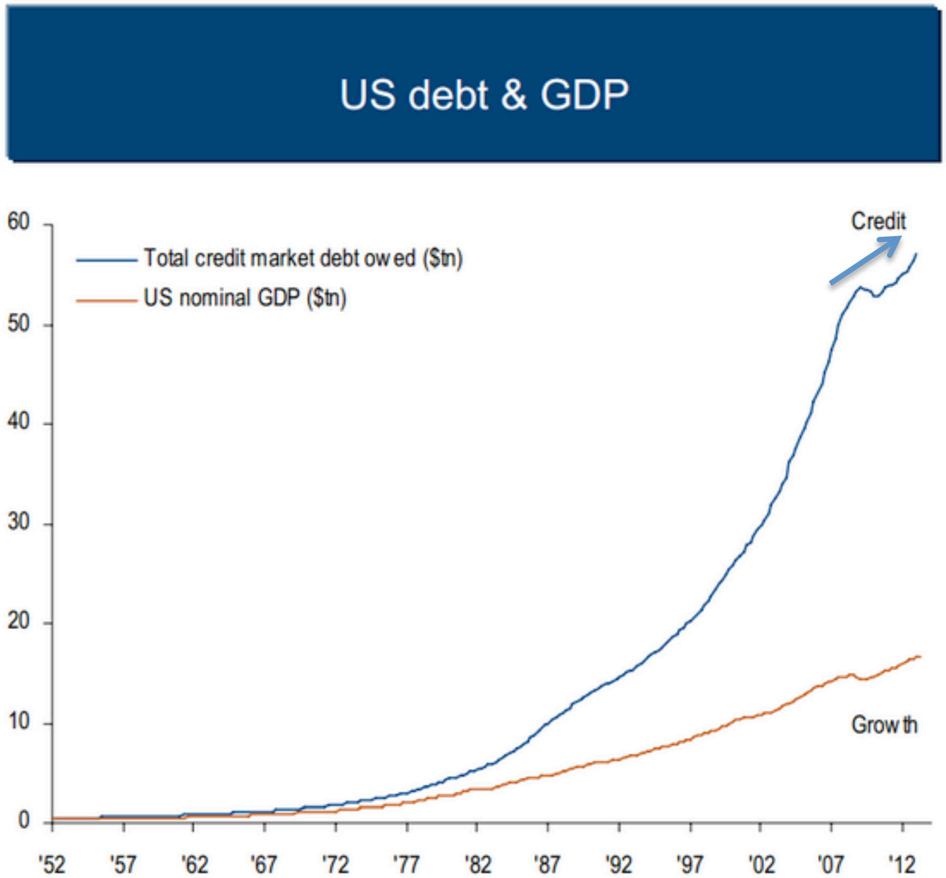
NYSE Gold Bugs index (2008-2009 bottom)

The 2008 bottom episode was 127% higher five months from the main low as shown by the green uptrend line. However, during that five-month advance, there were four sharp corrections that averaged 24% over 11 trading sessions. These can also be seen in the pink boxes on the above chart.

The most recent uptrend off of the June 28th bottom is pictured below. As you can see, we appear to be in the midst of the second significant correction since the low was established. This second corrective episode is still holding the uptrend line and most importantly is above the low established by the first correction in early August. The first pullback shown in pink below was 17.5% over 12 sessions, whereas the current decline has shaved 19.4% off of the index over the past thirteen trading days.

The important take away is that despite the 19.4% pullback, gold stocks are still in a young uptrend from the June 28th low. We will start to get worried if the prior low from the August correction (at the 220 level on the chart) is taken out and the uptrend is broken. That important level is marked on the chart above with a blue arrow. Until then, this still appears to be a normal correction within a burgeoning uptrend and we see no need to panic yet.

We present the following chart as a reminder to those who remain perplexed why we remain so stubbornly bullish on the gold sector and bearish on long-term prospects of the US market.

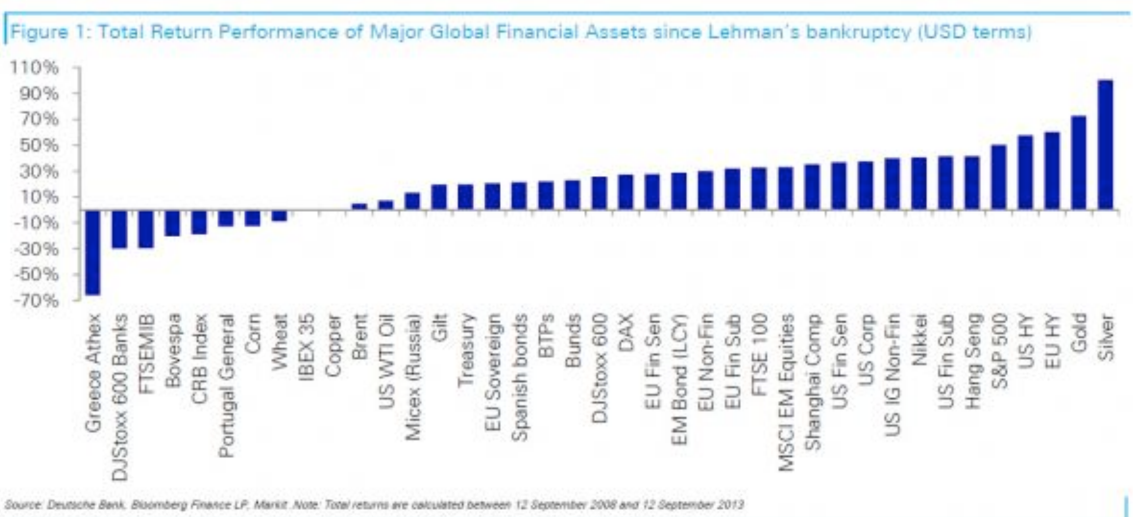


Source: BofA Merrill Lynch Global Investment Strategy, Haver

Furthermore, the amount of debt still in the system makes it all the more perplexing to us how so many people can come out and say the worst of the financial crisis is behind us. The economy was at least growing faster in the years before the crisis hit. Now all we have left over is a mountain of debt and a much slower growth rate. This is a toxic combination that will lead to another financial crisis as bad as the 2008 episode or a huge surge in inflation over the next decade. As we see it, a financial crisis or uncomfortably high inflation are the only two ways out of this mess. We believe the majority of financial market participants are ill prepared for either outcome. That became abundantly clear with the CEO of Morgan Stanley's comments this week. When asked to comment on the chances of another financial crisis, like the one in 2008, CEO James Gorman stated "the probability of it happening again in our lifetime is as close to zero as I could imagine." This is a pretty obtuse statement when you consider the "Too Big to Fail" commercial banks are even bigger and more concentrated than they were in 2008 and there is actually more total credit in the system now than in 2007 thanks to the Federal Reserve. Maybe this Gorman quote will go down in the Wall Street Hall of Shame like the quote of former Citigroup CEO Chuck Price from July 2007; "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing". The music stopped two weeks later for Citi and within fifteen months Prince was out of a job after Citigroup's stock lost 98% of its value.

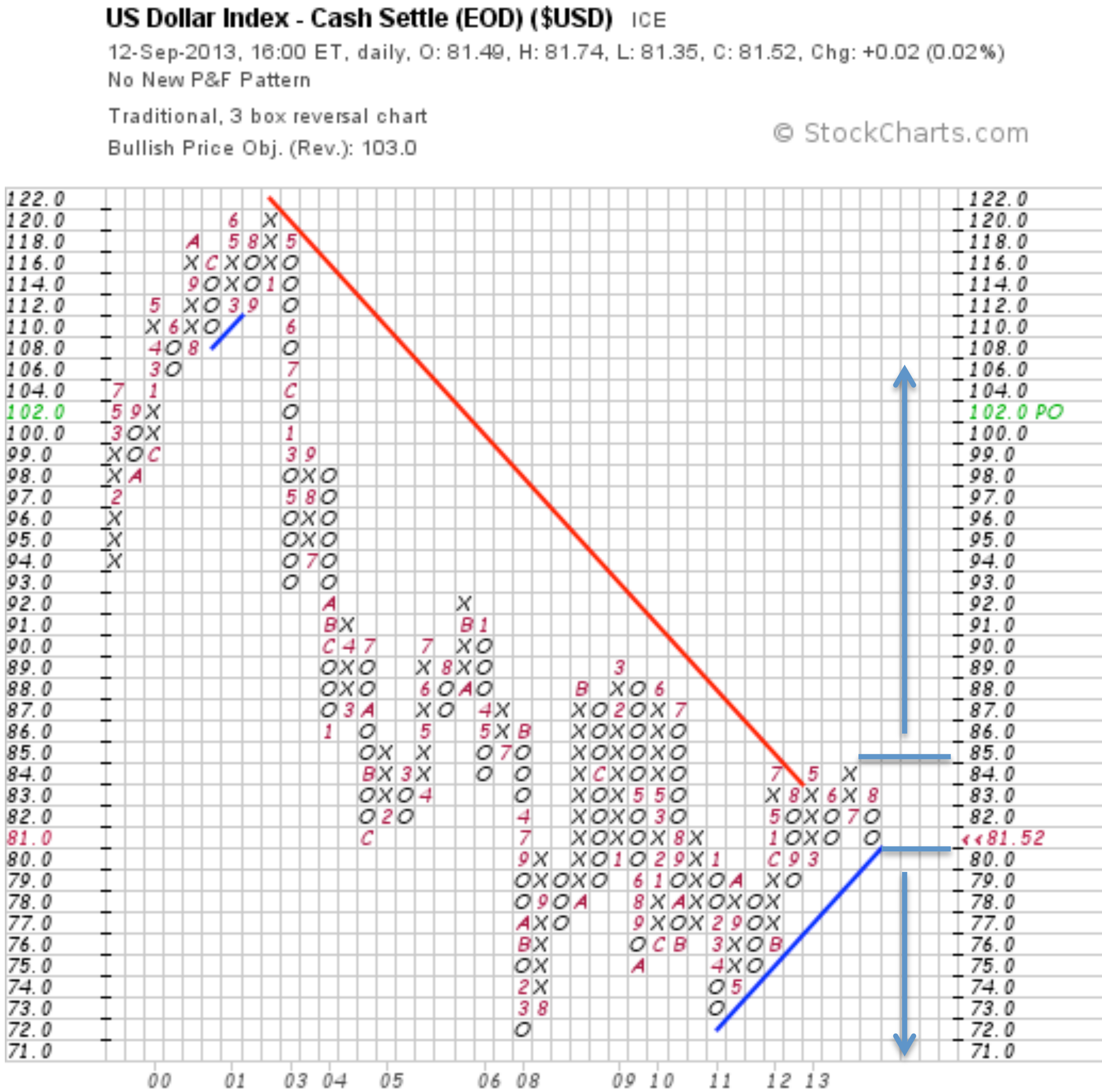
The world changed after Lehman Brothers exposed the shoddy foundation that propped up our financial system. After five years of the same (if not more radical) polices that almost blew up the world, that system still remains immensely fragile. The chart below shows that despite their recent troubles, silver and gold (blue bars on the far right) are still the best performing assets since the Lehman bankruptcy.

Total Return Performance of Major Global Financial Assets since Lehman Bankruptcy



Source: Deutsche Bank

The last chart that we will show this week is of the US Dollar Index. It is a repeat from our August 9th report that discussed the dollar and its importance in detail. At this point, we think it just may be the "most important chart in the world." Whichever way this one-year consolidation breaks will have big implications for investors going forward. A breakdown in the dollar below $80 should see commodities, precious metals and foreign equities come back into favor after a two-year struggle. A break above $85 would likely coincide with more money seeking shelter in the US asset markets. We are remaining conservative with capital until this chart makes up its mind as to which way it wants to break.



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