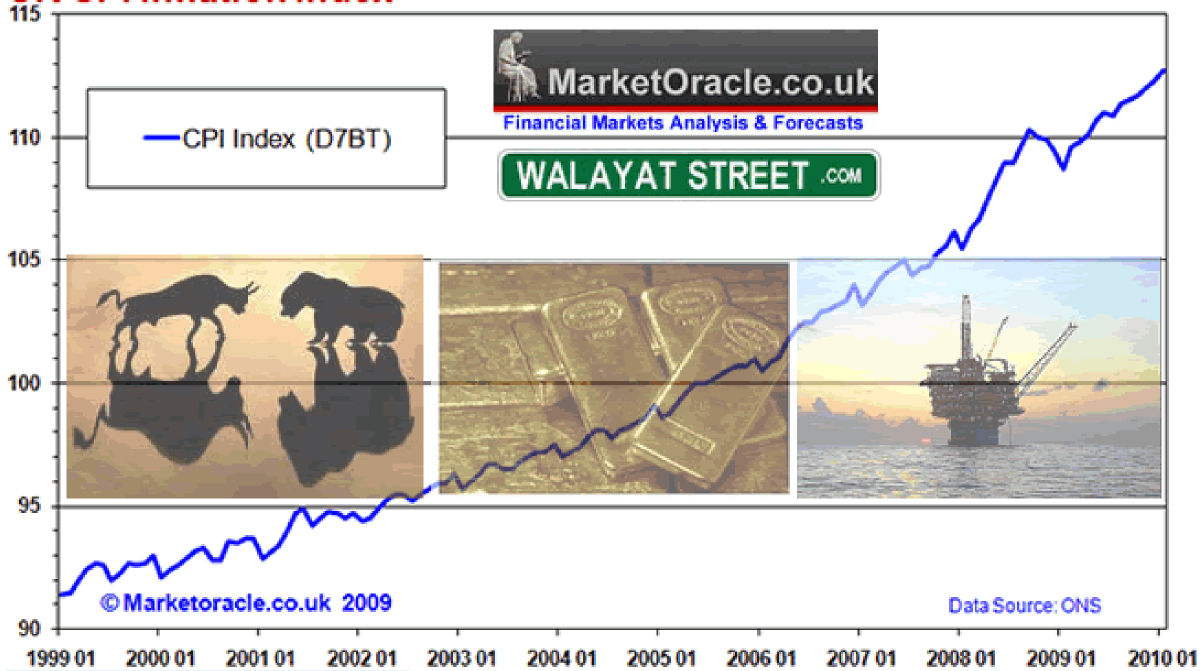
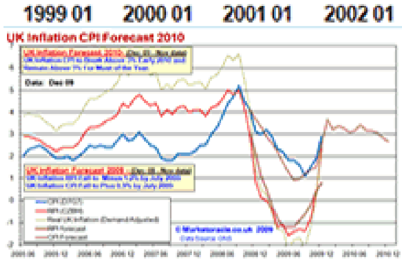
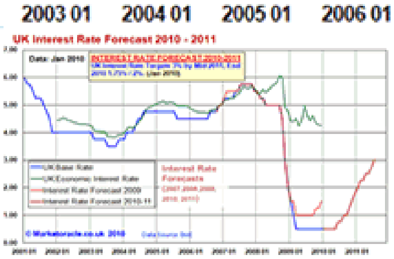
The Inflation Mega-Trend

Analysis and Forecasts for UK Inflation, Economy and Interest Rates,
Financial and Investment Implications

UK CPI Inflation Index







Nadeem Walayat

The Inflation Mega-Trend

Analysis and Forecasts for Inflation, Economy and Interest Rates

Financial and Investment Implications

By Nadeem Walayat

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INTRODUCTION

The worlds economies swim in an ocean of inflation that is punctuated by occasional ripples of deflation which is illustrated by the perpetual upward curve of general prices as measured by the Consumer Price Index (CPI). Inflation in the long-run impacts on virtually all commodities and asset prices. The Inflation Mega-Trend ebook contains in-depth analysis for the aim of generating accurate forecast trends for Inflation, Interest rates and the Economy for 2010 and beyond, the implications of which have been further applied towards generating key financial market and investment trend projections.

The primary purpose for generating the analysis and investment conclusions contained within this ebook is to arrive at as accurate as possible conclusions for the target of enabling me to make definitive and conclusive long-term investment decisions for the management of my own investment portfolio. Analysis which I choose to freely share in an easily accessible and distributable pdf format. Therefore as you read this ebook, please do bear in mind that I am a trader / investor, not a journalist / writer, so yes, I will have made some grammatical errors that I seek your forgiveness for in advance.

The economic analysis in this ebook was completed between 1st Nov 2009 and 13th January 2010. The implications of which has been applied to the financial markets and investment trends which was completed by the 30th of January 2010.

It is important that you are subscribed to my always free newsletter (http://www.marketoracle.info/?p=subscribe&id=1 - only requirement is for a valid email address) to ensure that you get the latest updates, as at the end of the day all forecasts are made on the basis of the probability of an outcome occurring which undoubtedly requires re-appraisal in the light of subsequent price action.

The Inflation Mega-Trend Ebook is broken down into 4 chapters. Chapters 1, 2, and 3 deal with fundamental economic analysis that builds towards the Inflation-Mega-trend conclusions. Whilst the fundamental analysis is primarily focused on the UK Economy, however the conclusions are just as valid for all of the debt ridden western countries and even apply towards the major emerging economies.

Chapter 4 takes the Inflation Mega-Trend conclusions and applies them to the financial and commodity markets where further analysis develops into precise forecasts and investment trends for major markets. I had originally planned for this to be the shortest chapter of the book, however it has grown to encompass half the ebook and thus could have become an ebook in its own right.

My next planned ebook is due to be completed by the end of April 2010, which will be an in-depth analysis of the UK Housing Market that will conclude in a trend forecast into at least 2013, which follows on from the highly accurate UK housing market analysis of August 2007 that called for a 2 year bear market into August 2009 (UK Housing Market Crash of 2007 - 2008 and Steps to Protect Your Wealth).

Your Inflation Mega-Trend investing analyst.

Nadeem Walayat
31st Jan 2010

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CHAPTER 1

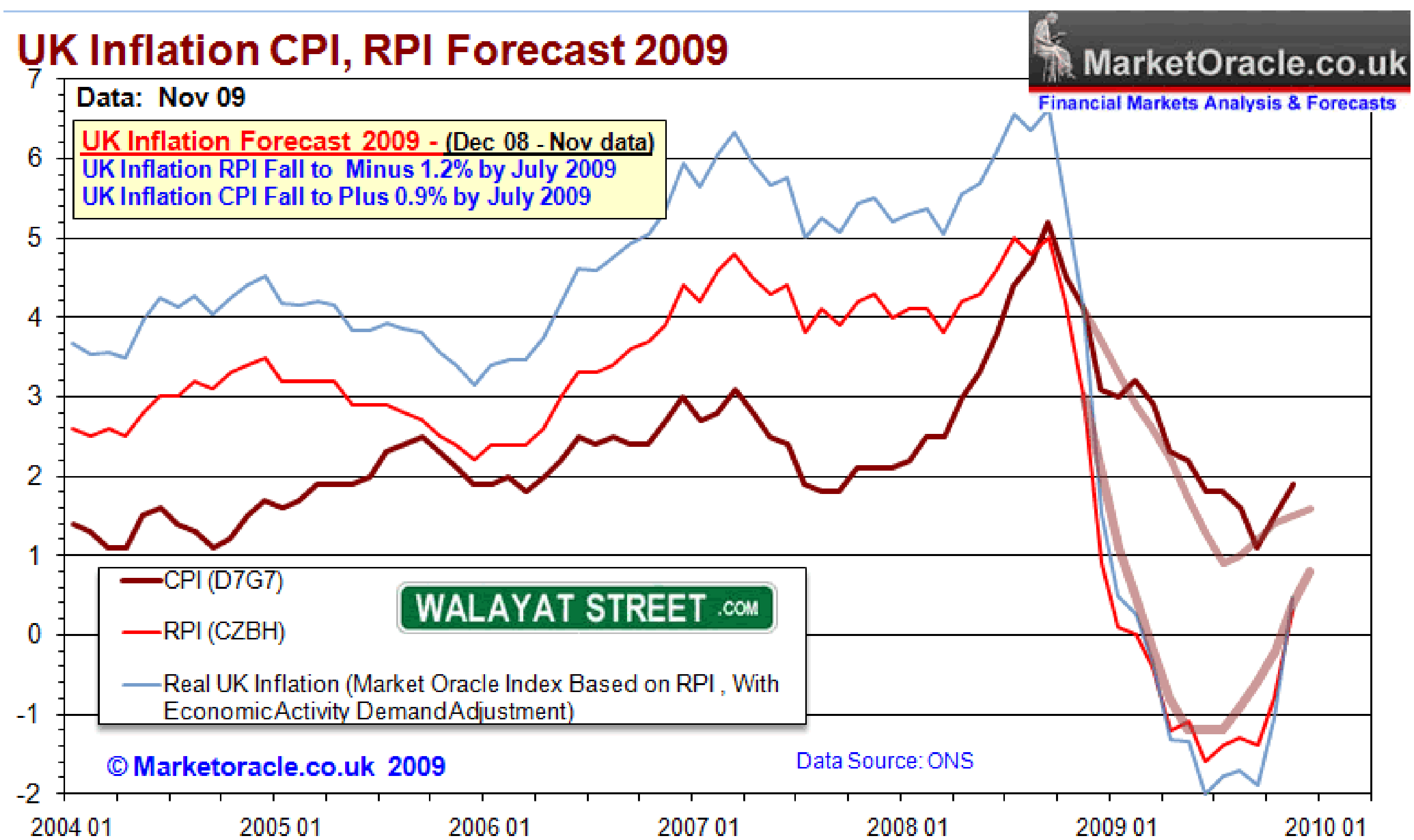
UK INFLATION

The UK inflation analysis and forecast for 2010 and beyond is the first of three parts of in depth analysis that form the basis for the inflation-mega-trend. The UK economy experienced real price deflation during 2009 as a consequence of economic and commodity price collapse as measured by the Retail Prices Index (RPI), however the government's preferred measure, the Consumer Price Index (CPI) managed avoid price deflation, which will be the index that this analysis concentrates upon as the primary measure for UK inflation and similarly for most other economies.

Inflation Forecast 2009

The UK Inflation forecast for 2009 (30 Dec 2008 - UK CPI Inflation, RPI Deflation Forecast 2009) proved remarkably accurate with the road map contributing towards the generation of many accurate projections for subsequent trends throughout 2009 and not least for UK savers that for those that followed my cue of fixing savings at rates of above 5% for 1 - 2 years would not have been burned by the subsequent crash in UK interest rates to pittance of as low as 0.1% on savings accounts across the bailed out banking sector and later for stock market investors that monetized on the stealth bull market that began in March 2009 the genesis for which was in the preceding inflation analysis forecast.

Conclusion - UK Inflation Forecast 2009
The UK is heading for real deflation during 2009 as the below graph illustrates in that the RPI inflation measure is expected to go negative and spike lower around June / July 2009 as the RPI is sensitive to falling mortgage interest rates. The CPI will also continue to fall sharply into May 2009, which is targeting a rate of just below 1%. However the more money the government borrows as the difference between spending and tax revenues then the greater will be the eventual resulting inflation as there is no such thing as a free lunch, that will reverse many of the trends we have observed during the past 6 months and will continue to see during virtually all of 2009. However I am only expecting a mild up tick in inflation late 2009 due to the deflationary nature of economic contraction.



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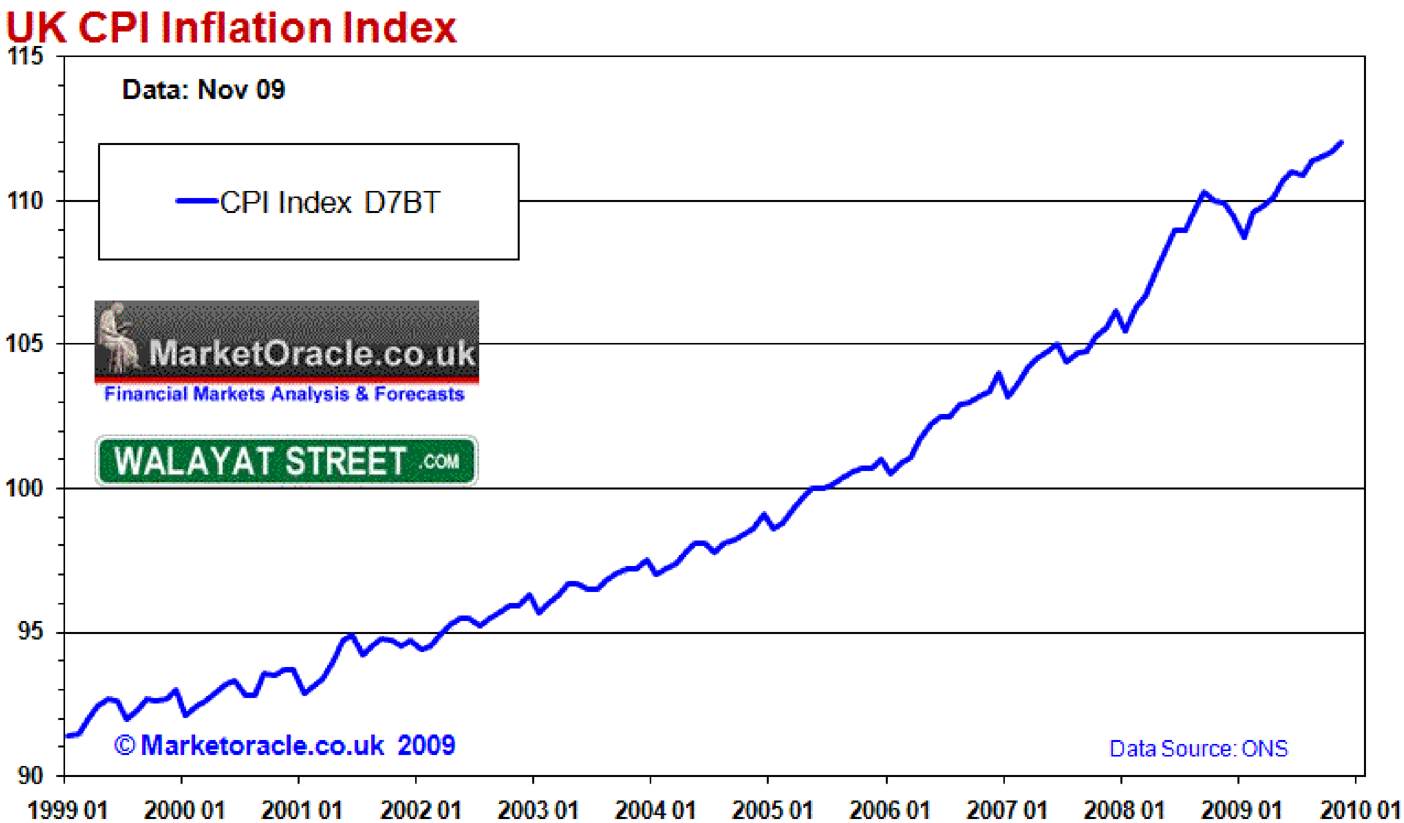
Therefore the conclusion is for UK inflation CPI to bottom at just below 1% by July 2009 and RPI inflation to bottom at -1.2% also by July 2009.

***Risks to the Forecast** - At this point the risks to the forecasts are more to the downside than the upside, meaning that inflation could spike still lower during mid 2009 than forecast above.*

The Inflation Mega-trend



The UK Consumer Price Index (CPI) clearly illustrates that all we saw from mid 2008 and into early 2009 was a minor deflationary corrective wave amidst an ocean of year on year inflation. Subsequent inflation has far surpassed the now in-consequential deflation seen during 2008 and into early 2009. Therefore the facts are completely contrary to the headline grabbing mainstream press and blogosphere scare mongering of price deflation.

There has been NO SIGNIFICANT DEFLATION, despite economic contraction of more than 5% GDP, despite Unemployment soaring to above 2.5 million, despite asset price destruction ranging from between 25% and 50% into the early 2009 lows. In fact the price deflation that we witnessed is probably mostly due to the sharp drop in commodity prices such as Crude Oil's collapse from mid 2008 into early 2009.

The Inflation Mega-trend scenario analysis continues to conclude towards the Government and the Bank of England as with other central banks around the world mistakenly continuing to be fixated with fighting deflation whilst at the same time stoking the fires for a surge in inflation during 2010 and many years beyond.

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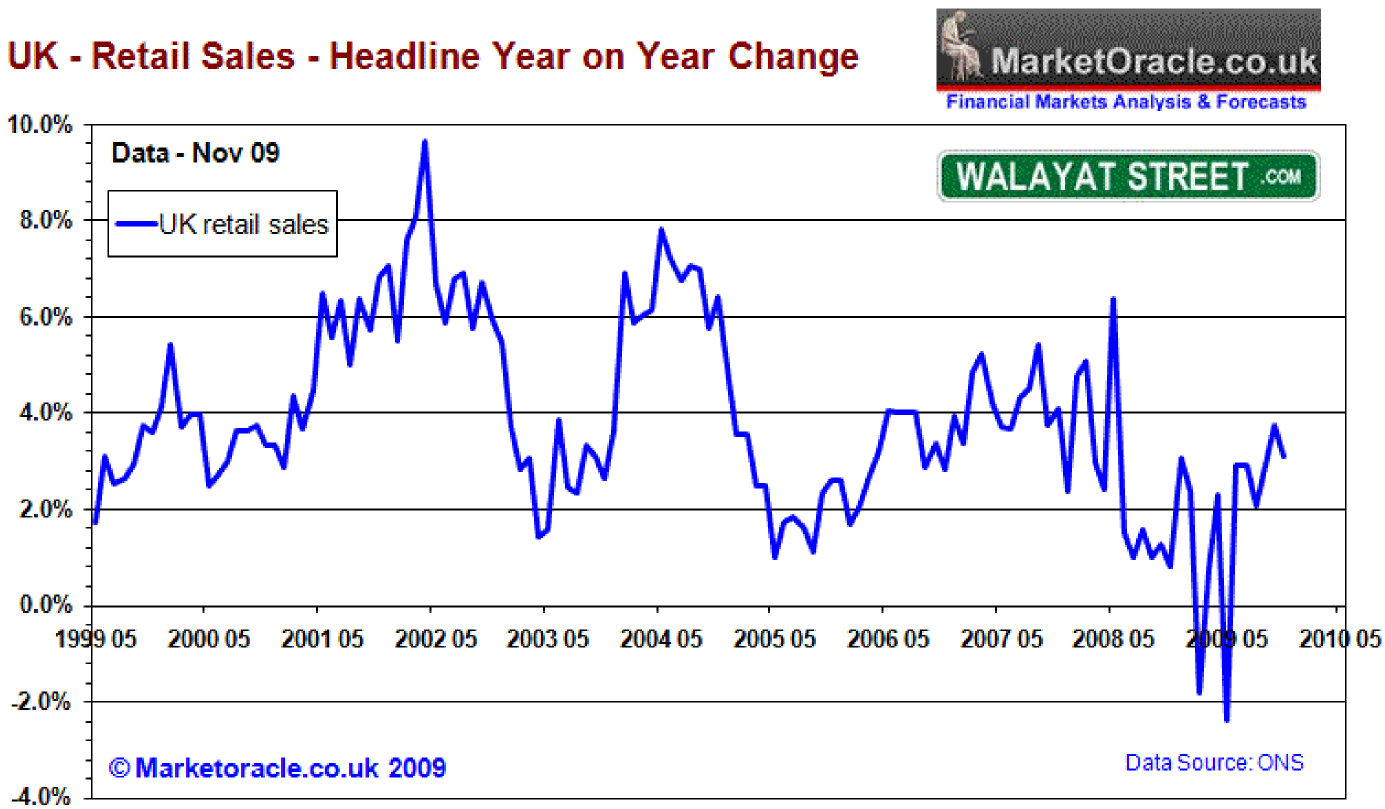
UK Retail Sales Signal Debt Fuelled Election Consumer Boom

The mainstream press and academic economists have been surprised by the most recent headline retail sales data that showed a decline of 0.3% against expectations of rise of 0.4% i.e.

BBC News 17th December - http://news.bbc.co.uk/1/hi/business/8417860.stm

> UK retail sales fell in November, according to official figures, despite analysts' predictions of a rise.

> The figures came as a surprise to many economists, who had hoped for consumer spending to fuel economic recovery.



However I recognised the inaccuracy in the published retail sales data many years ago which prompted me to generate my own retail sales data which more accurately reflects the condition of the high street then the official data which typically results in a highly volatile retail sales series which feeds through into volatile mainstream headlines which are in most cases contrary to what is actually taking place on Britains high streets as the below graph more clearly illustrates.

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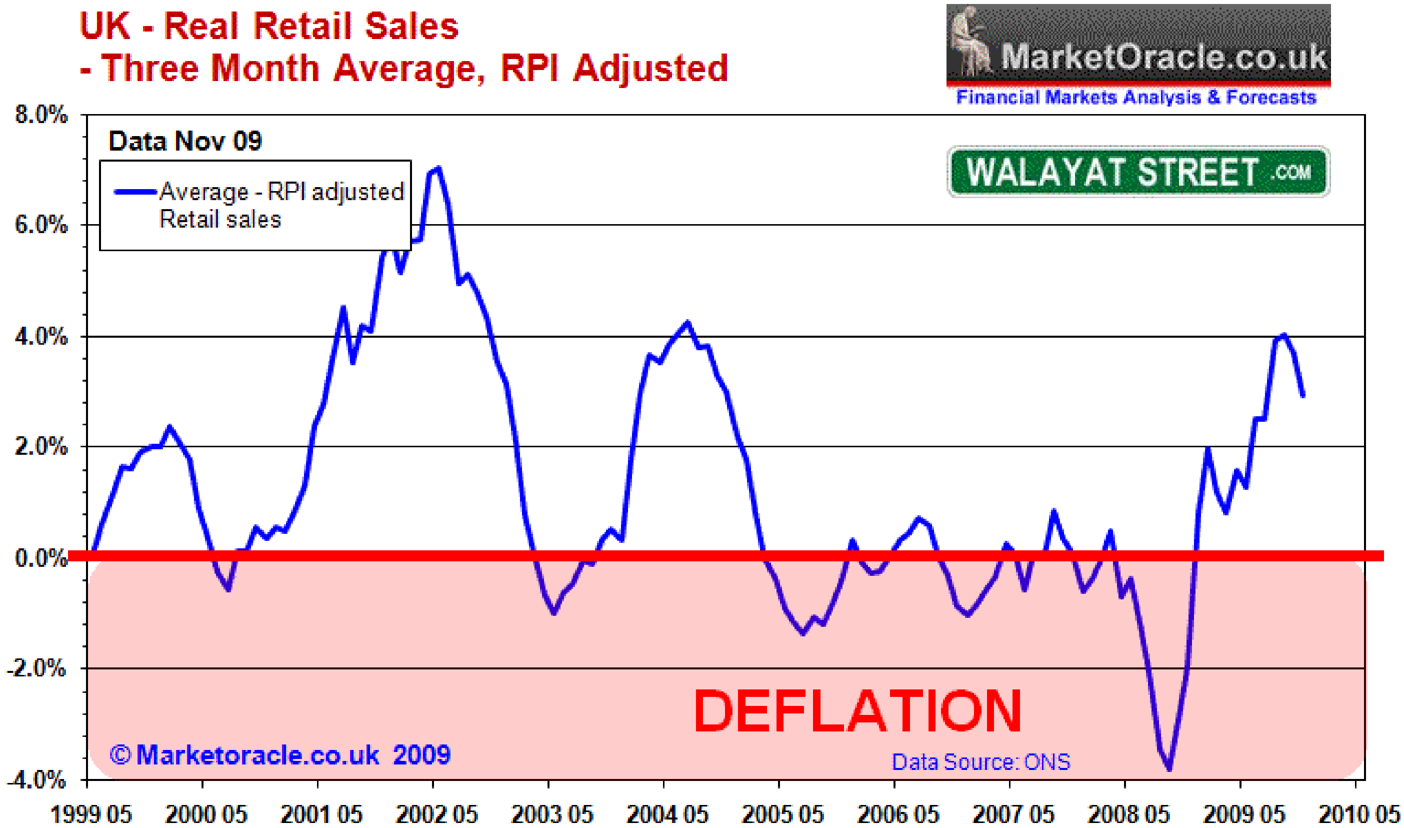

The adjusted retail sales data clearly shows that UK retail sales act as a leading indicator for economic activity and inflationary pressures of as long as 6 months. Retail sales led the price deflation into mid 2009, and now are again acting as a leading indicator for forward inflation and resurgent economic activity during the first half of 2010. The trend is extremely strong and continues to confirm the analysis of June 2009 that stated that Britain had embarked upon a debt fuelled economic recovery into a May 2010 General Election.

Very little of this strong retail sales trend is visible in any of the official or academic economic data that continues to look in the rear view mirror of what is "old news". The actual trend shows that the Labour party has succeeded in igniting a debt fuelled election consumer boom that will increasingly become apparent in mainstream press as we approach the May 2010 election deadline, but it is also indicative of a steep upward curve in UK inflation and we are talking about inflation hitting the upper end of the Bank of England's 1% to 3% CPI Band early during the first half of 2010 which politically suggests the UK General Election may take place earlier than the consensus view for a May 2010 General Election.

M4 Money Supply Adjusted for the Velocity of Money

Whilst the mainstream press have been obsessed by headline M4 data throughout the past 12 months, however as I voiced in last years inflation analysis and forecast that the key to interpreting money supply data is to look at M4 adjusted for the velocity of money that implied imminent extreme deflation that has come to pass -

> UK Money supply M4 (blue) has risen sharply from the 10% targeted low of mid 2008 to the current level of 16.6%, on face value this is highly inflationary and has been taken by many economists and market commentators to suggest much higher forward inflation. However the money supply adjusted for the velocity of money which takes into account the state of the economy as a consequence of the credit freeze tells a completely different story. The UK economy is now in extreme real monetary deflation of approaching -5%. The leading indicator of the implied money supply, is suggesting recent deep interest rate cuts of Novembers 1.5% and Decembers further 1% cut will lift future money supply growth out of extreme deflation, however it will still be far from supporting the levels north of 15% which accurately forecast forward inflation during 2008.

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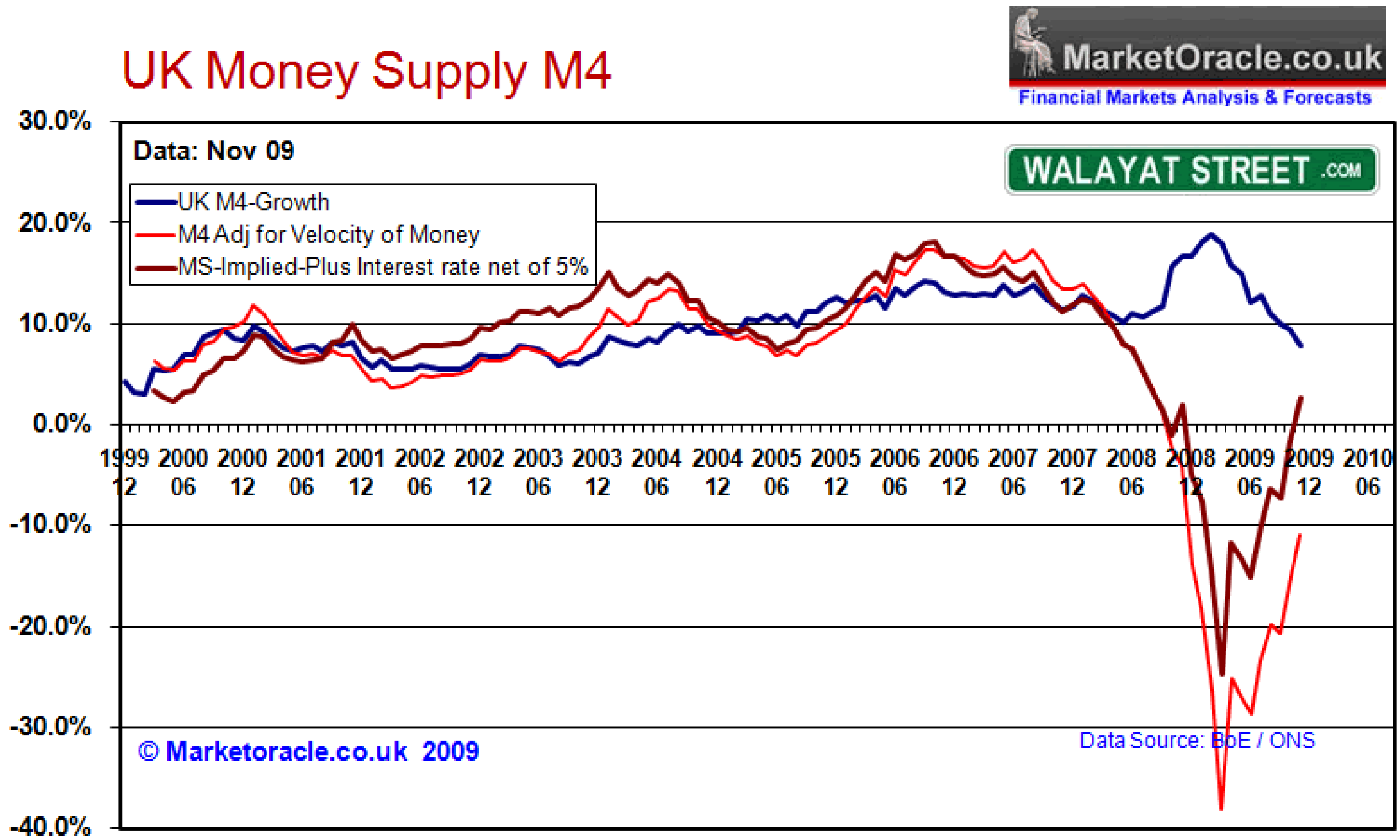

The above graph shows conflicting trends, it shows M4 falling from an extremely high level of near 20% that was jumped on earlier by the press to imply higher inflation, to now nudging below 10% to imply credit contraction deflation. However the real indicator of money supply shows the consequences of Quantitative Easing and near zero interest rates in that Money Supply adjusted for the velocity of money bottomed from a crash into March 2009, and it is only now that the money supply is breaking positive.

This suggests that the Bank of England and majority of economists remain mistakenly fixated on the headline M4 which has nudged below 10% and therefore continue with the policy of Zero Interest Rates and Quantitative Easing. What is remarkable in the most recent inflation data is the surge higher in both RPI and CPI (1.9%) despite weak money supply data, this strongly supports the view that the UK economy has drifted into a period of stagflation where models based on spare output capacity keeping inflation in check will fail ! I.e. we GET Inflation WITH spare capacity i.e. high unemployment, this is because the government is attempting to fill the output gap through increased public spending which is uncompetitive and hence inflationary.

Therefore the expectation is for UK Money Supply adjusted for the velocity of money to continue trending higher and supportive of a strong trend higher in the RPI and CPI inflation indices that will leave the vast majority of the academic economists still mistakenly fixated on deflation scratching their heads. I can easily see MS Implied surging higher to above 10% and M4 Adjusted passing above zero within the first quarter of 2010 on route to pre-credit crash levels during 2010, this also suggests a turnaround to some degree is also imminent in the M4 headline data.

UK Unemployment

The UK unemployment forecast as of October 2008 (July 08 data) forecast UK unemployment to hit 2.6 million by April 2010. The actual data to date of 2.49 million to Sept 2009 is inline with this trend, with unemployment benefit claimant count registering a small fall from 1582 to 1569 for November. The moderating unemployment data has surprised academic economists as it is much milder than their economic models suggest it should be by this point. However the data is strongly indicating to me of a STEALTH Economic Recovery underway which implies headline data is near an imminent peak and therefore should start to fall early 2010.

Academic economists have collectively converged during 2009 into the consensus 2009 that UK unemployment would soar to between 3 and 3.2 million by the time of the next general election (May 2010). Now with the slowdown of the unemployment growth in the face of a strong economic turnaround in the fourth quarter these same institutions will be busy revising forecasts for UK unemployment much lower in the coming months.

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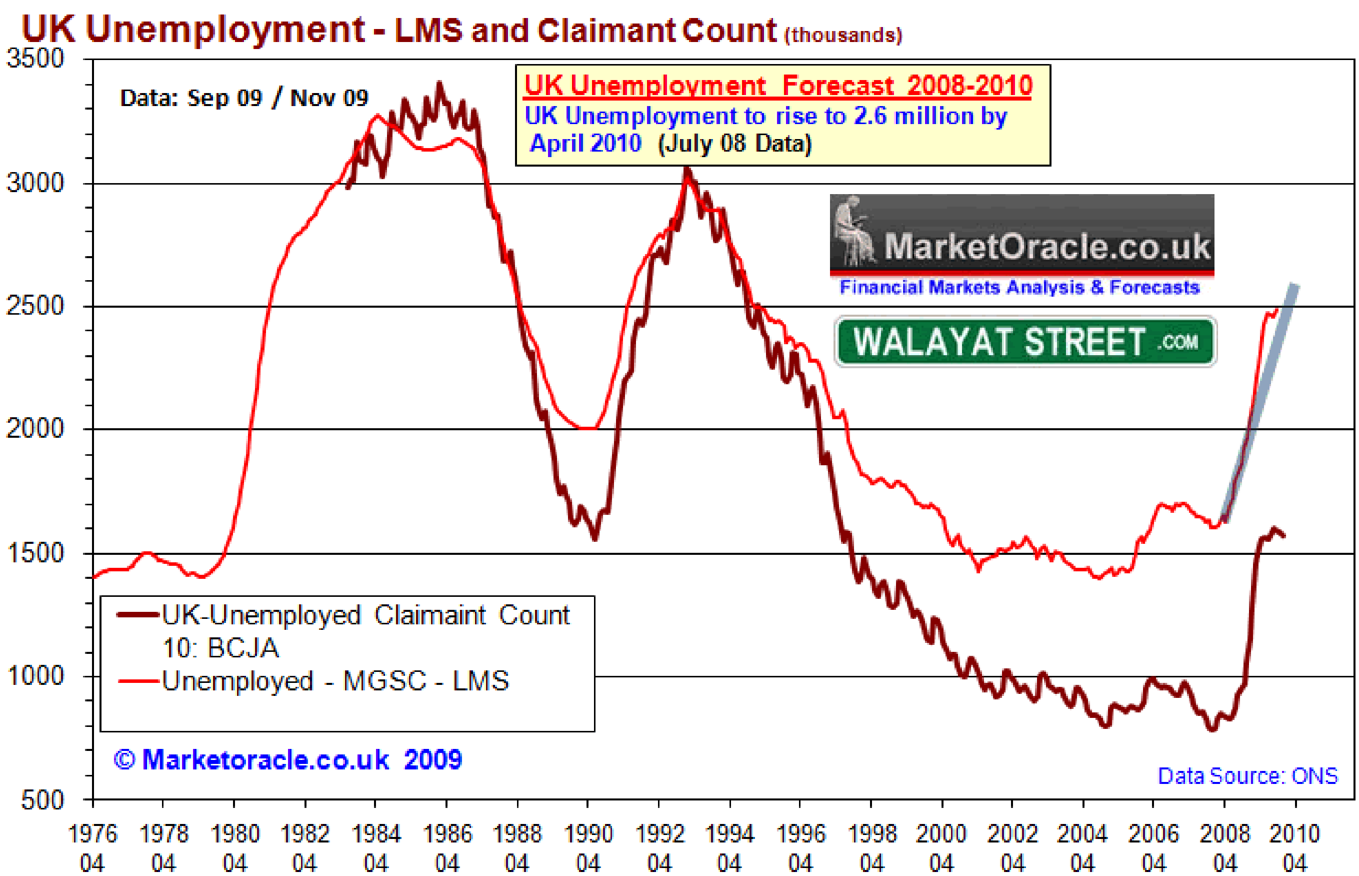
European Commission - May 2009 - It expects UK unemployment to rise to 9.4pc by 2010 leaving 3m workers jobless.

British Chambers of Commerce - April 2009 - Last month, data confirmed that the total number of people out of work surpassed the 2m mark in the three months to January, taking the official unemployment rate to 6.5pc – the highest since 1997. The BCC believes the total could hit 3.2m by the third quarter of next year.

Bank of England - Blanchflower - April 2009 - Warned unemployment was likely to top 3 million by the end of the year and there was a 'good chance it could go much higher still'.

CBI - Feb 2009 - The UK's leading business group predicts the recession, which began in the third quarter of 2008, will last throughout 2009. The economy is expected to contract by 3.3 per cent and unemployment will reach close to 2.9 million by the end of the year.

I have long questioned the accuracy and validity of the official unemployment data which over several decades and much manipulation by successive government's has been tweaked many hundreds of time to under report true unemployment for political purposes. Current official unemployment stands at 2.49 million for September data release against which the total recorded as economically inactive of working age stands at 7.99 million which in my opinion is more accurately reflective of the true rate of unemployment as the below graphs illustrate.



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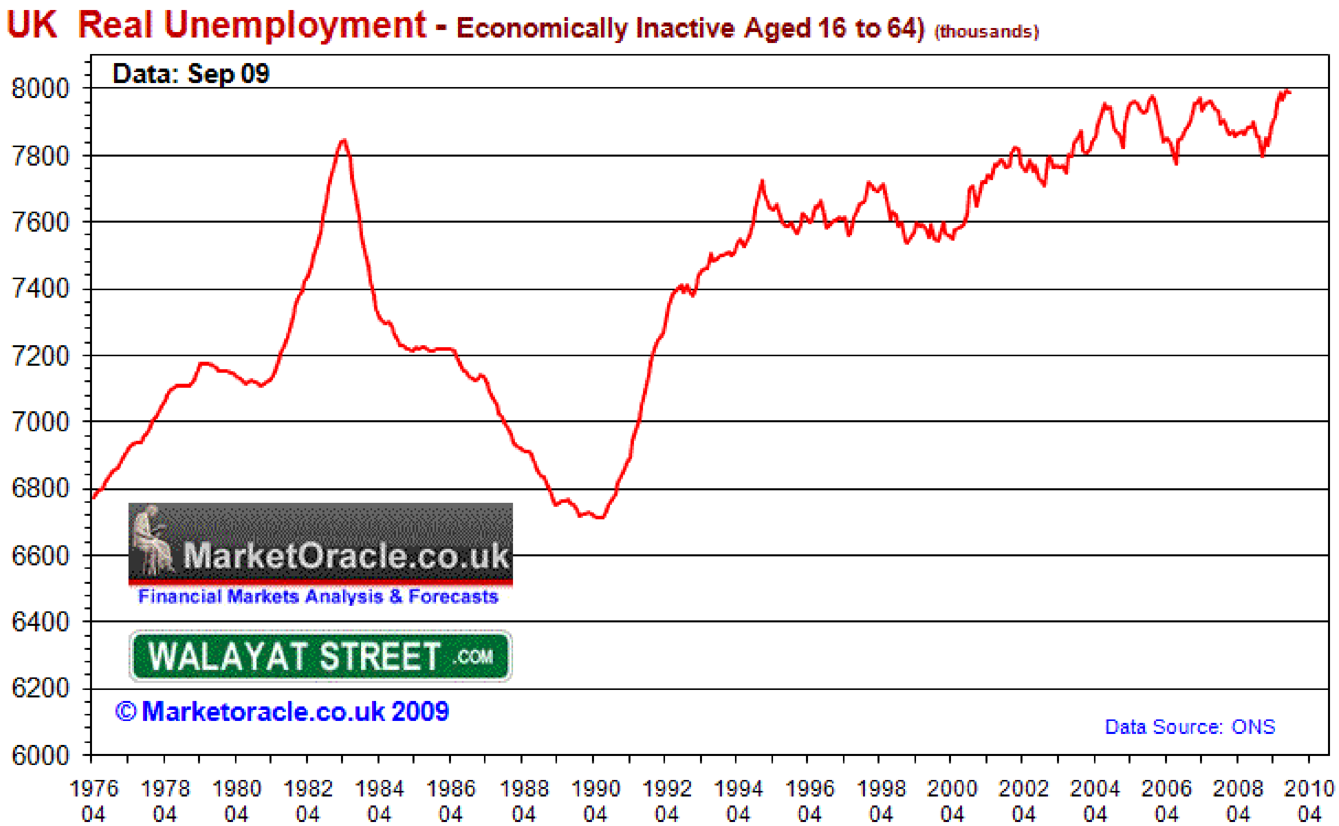
The real unemployment trend clearly shows a sideways trend channel of between 8 million and 7.8 million, Having hit the upper channel it is now strongly suggestive of having peaked and targeting a trend back towards the lower end of the channel i.e. projecting towards a decline of 200,000 during 2010.



In conclusion the headline UK unemployment rate of 2.49 million is just a stone throw away from the 2.6 million target which suggests little upside momentum left in the unemployment data and therefore indicative of an imminent peak and decline in unemployment statistics to be announced during Q1 2010, which therefore confirms my view of a much stronger than expected economic recovery and therefore has much higher inflationary implications as well as political implications of improving Labours election prospects.

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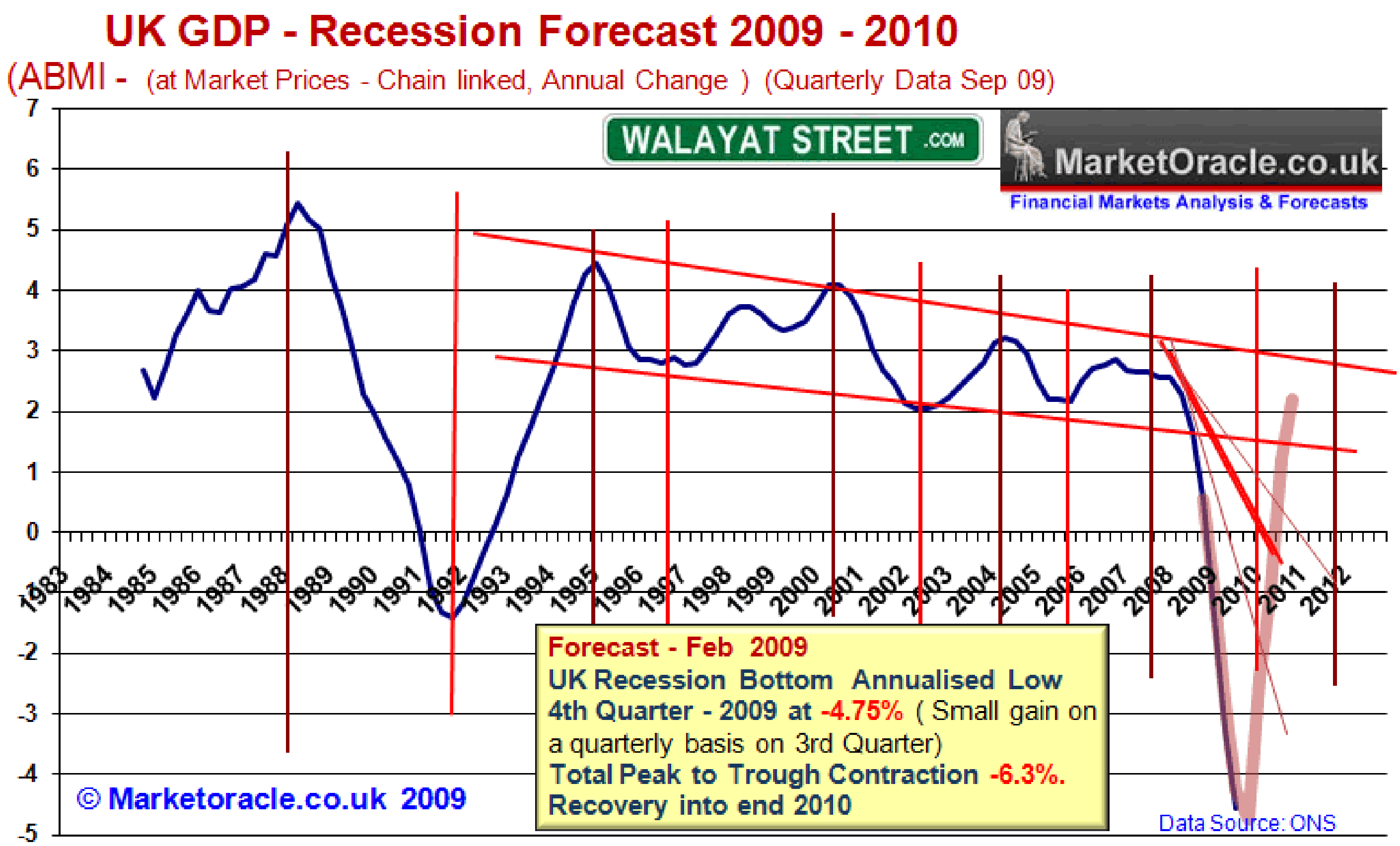
Debt Fuelled Economic Recovery Heading for Double Dip Recession?

UK GDP for the 3rd Quarter was revised marginally higher to minus 0.2% from the earlier ONS estimate of minus 0.3%. The year has witnessed 'think tanks' and academic institutions flailing in all directions as optimistic forecasts of earlier in the year proceeded to be continuously revised lower in terms of economic contraction and then by late summer in advance of third quarter GDP data starting to anticipate an economic recovery in the third quarter with consensus for a 0.3% growth which failed to materialise.



The GDP trend for the UK economy has been accurately mapped out in the in depth analysis and forecast of 17th February 2009 (UK Recession Watch- Britain's Great Depression?), that both called for severe peak to trough economic contraction of -6.3% at a time when the likes of the UK Treasury were forecasting contraction of less than half at -3%. The analysis also concluded in a strong debt fuelled economic recovery during 2010 to coincide with a summer 2010 General Election. As of the revised ONS GDP data (ABMI Chain linked at Market Prices) total peak to trough contraction is now 6.23% virtually exactly inline with the forecast for -6.3%. Annualised contraction for the third quarter is at -4.56% with trend on target for -4.75% for the fourth quarter.

The UK economy remains on track to bounce back strongly during 2010, as indicated by June's in depth analysis, however this economic recovery is based largely on debt as shown by the graph below, as the Labour government's strategy appears to be to deliver the next Conservative government a scorched earth economy.

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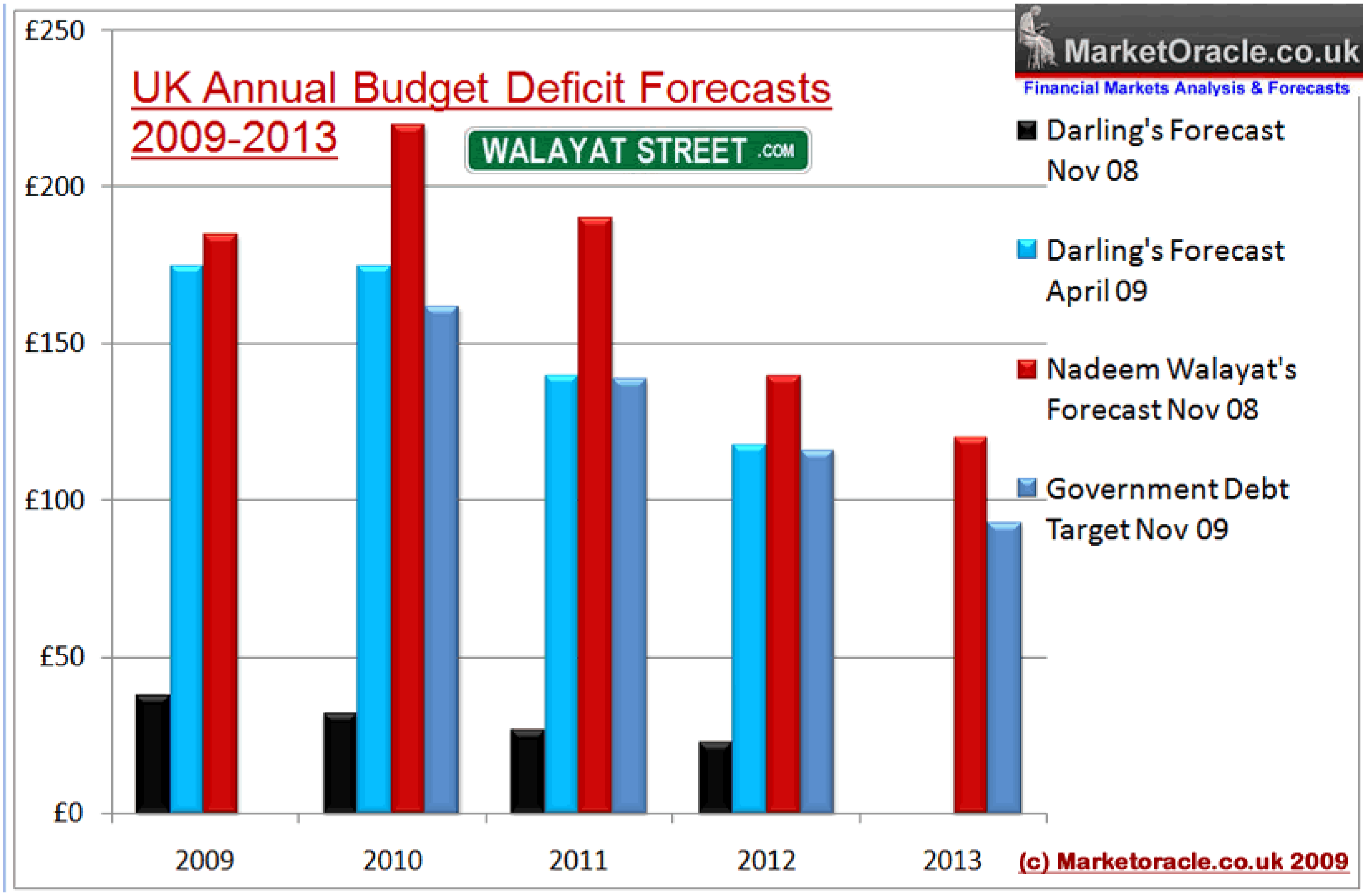

Alistair Darling's forecast for government net borrowing for 2009 and 2010 in November 2008 totaled just £70 billion. However, since the amount of projected borrowing has mushroomed to £350 billion, which is set against my November forecast of £405 billion for 2009 and 2010 alone, with continuing subsequent large budget deficits thereafter of well above £100 billion a year.

Whilst many economists were surprised by Alistair Darling's April forecast that the UK Economy would grow by 1.25% in 2010 and 3.5% in 2011. However we need to consider the following in that 1.25% growth on the annual GDP of £1.2 trillion equates to growth of just £15 billion and for 2011; 3.5% growth equates to just £42 billion. Therefore the government is borrowing a net £175 billion for 2009 and £175 billion for 2010 to generate £15 billion of growth, and then a further £140 billion for 2011 for £42 billion of growth. Thus total net borrowing of £490 billion to grow the economy by just £67 billion, (£595 billion my forecast) which shows the magnitude of the scorched earth economic policy now implemented that literally aims to hand the next Conservative government a bankrupted economy that will be lumbered with the consequences of continuing huge budget deficits and therefore demand deep cuts in public spending.

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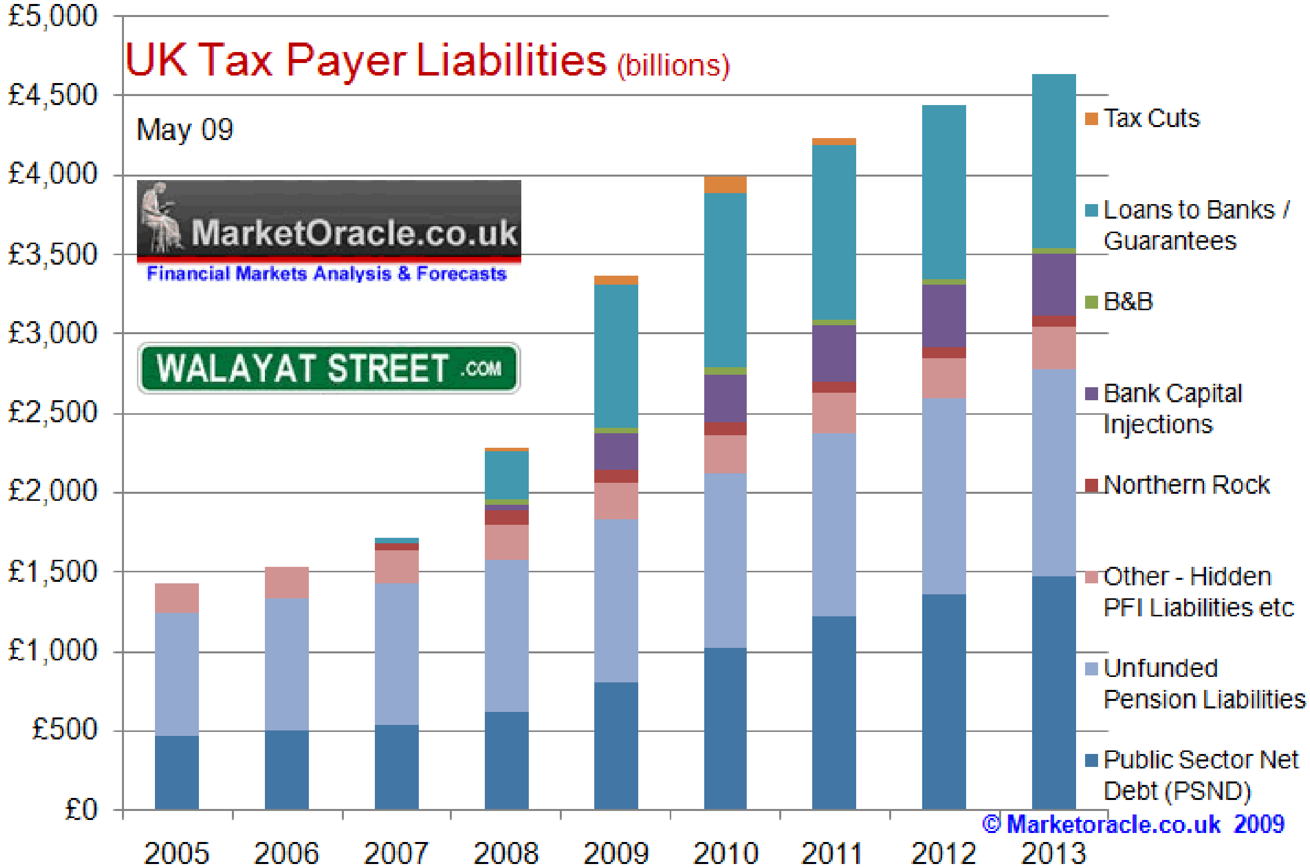
Debt and Liabilities

The total liabilities as a consequence of bailing out the bankrupt banks and debt fuelled economic recovery remains on target of £4.75 trillion by the end of 2013/14, which confirms my view that to cope with the debt burden the Bank of England will have to keep monetizing government debt which puts Britain on the path towards many years of stagflation, which my UK GDP forecast will next cover in greater depth.



Meanwhile the Bank of England remains skeptical of a UK economic recovery during 2010 as the Guardian reported on 23rd December-

> *The Bank of England is leaving the door open to a new year £200bn money expansion programme after revealing that it remains unconvinced about the economy's ability to emerge from the deepest and longest recession on record.*
>
> *"Jonathan Loynes, chief European economist at Capital Economics, said: "We continue to expect interest rates to remain at their current level until the end of 2010, if not considerably longer."*

Whilst I agree that the Bank of England will continue to monetize debt, however my economic analysis is concluding towards a strong bounce back and hence the Bank of England's policy of further QE ensures that the inflation flames are being stoked higher, which suggests above trend inflation and growth rates.

UK Interest Rate Being Kept Artificially Low For Bank Profiteering

The UK interest rate forecast of early December 2008 for 2009 forecast that UK interest rates should decline to 1% (from 3%) by early 2009 and remain there into the second half of 2009. However following the cut to 0.5% in March 2009, the Bank of England has continued to engineer an artificial banking system by keeping interest rates at an extreme historic low of just 0.5% into the end of 2009 so as to flood the bankrupt banks with liquidity to enable them to rebuild their balance sheets by overcharging customers against the base interest rate and manipulated interbank market rate of 0.66% against rising real market interest rates which have been in a steady climb since March 2009, which increasingly means that the base interest rate has become irrelevant to the retail loans market place as explained in the article - Bailed Out Banks Not Lending, Sitting on Tax Payers Cash.

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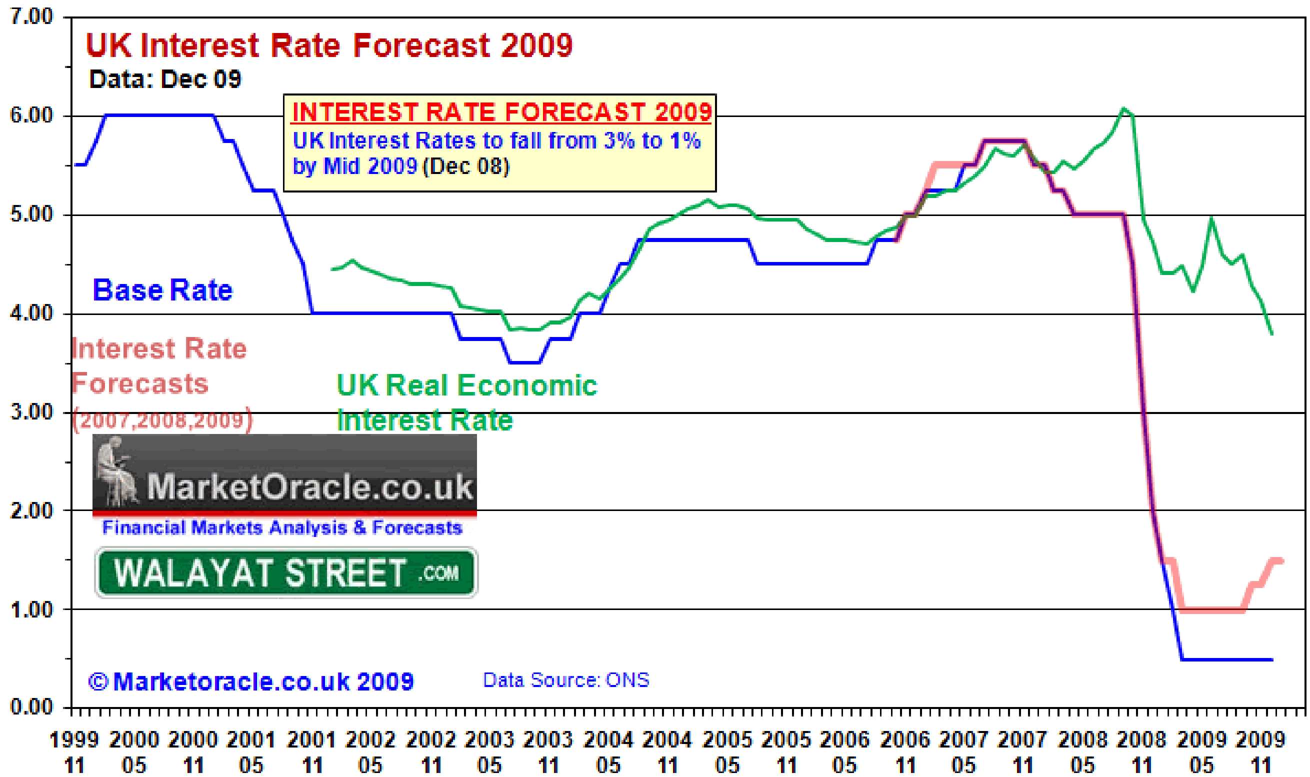
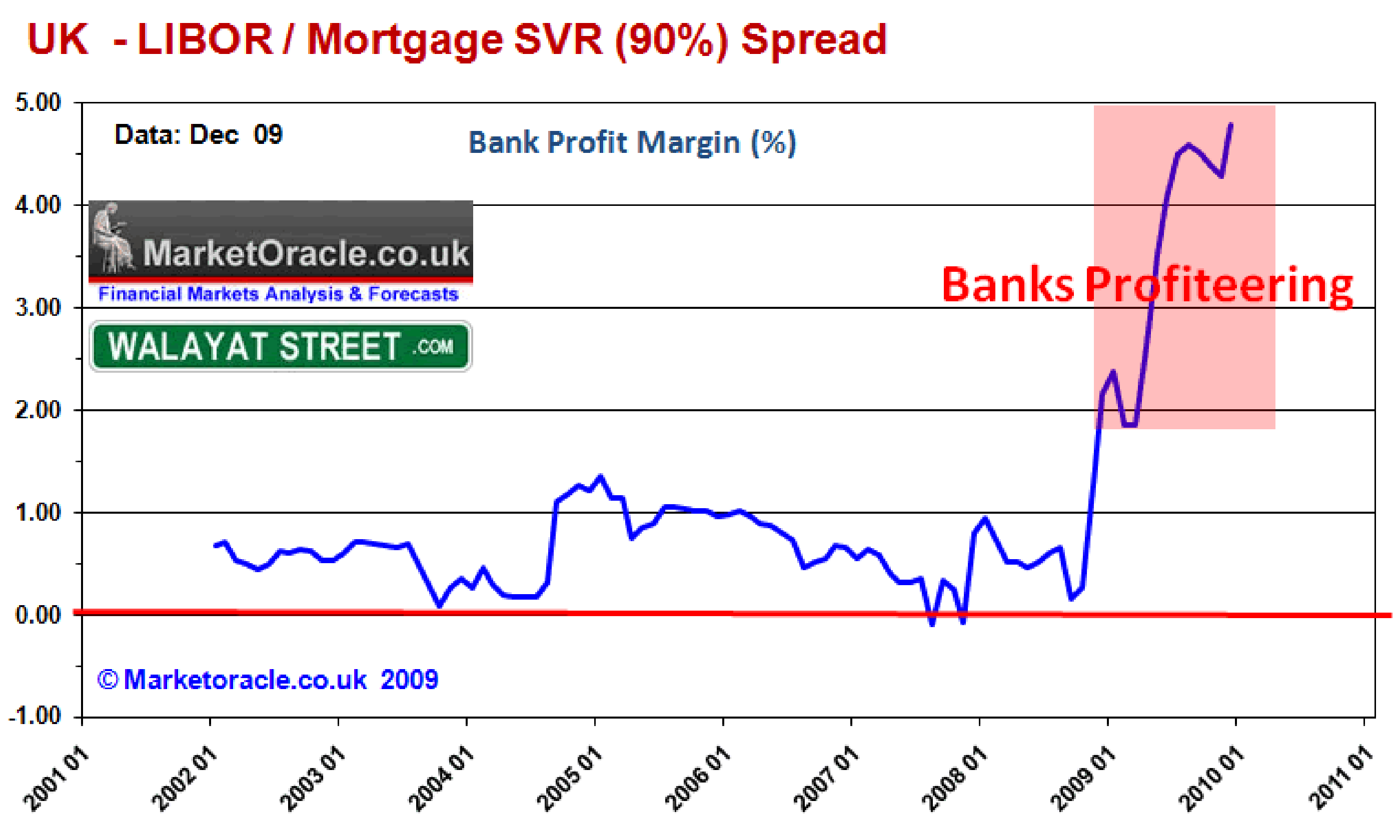


The artificial banking system means that the bill for low interest rates is being paid for by Savers who along with all tax payers are being forced to pay for the bankers crimes as tax payer bailed out banks such as HBOS pay a pittance on instant access savings accounts of as little as 0.1% against a requirement of 2.3% just to cover CPI inflation of 1.9% plus the 20% tax charged on interest earned.



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Money is being sucked out of the pockets of savers and being deposited onto the balance sheet of bailed out banks that have no incentive to pay a decent rate of interest when they can borrow at 0.5% from the Bank of England and marginally higher from other UK banks. The artificial banking system is resulting in unprecedented huge profit margins for the banks as market interest rates charged to retail customers continue to rise regardless of the base rate being held at 0.5% well into 2010 which is inflationary in terms of rising mortgage and other debt interest costs as these rising costs will show up to varying degrees in the RPI and CPI inflation indices.

UK House Prices Continue 2010 Government Debt Fuelled Election Bounce

The UK housing market bottomed in March / April 2009 which was recognised in the May analysis and has since continued the debt fuelled bounce as a consequence of money printing and zero interest rates as the Labour government has succeeded in inflating the UK economy out of recession in time for the 2010 General Election.

As is the case with virtually all market junctures, back in March of this year the Telegraph and other mainstream media ran with a scare story that UK house prices could crash by a FURTHER 55%, this was after UK house prices had already fallen by 22% and whilst house prices had yet to bottom the Telegraph story at the time seemed to be a completely ridiculous scare mongering purely for the purpose of sensational headline grabbing rather than presenting something that their readers could utilise to their advantage.

12th March 2009 - Telegraph Runs with Improbable UK House Price Crash Forecast of Another 55%

> The mainstream press as illustrated by The Telegraph has run with a house price forecast by Numis Securities (NS) that states that UK house prices could fall by a further whopping 55%, that is a rather incredible forecast to make in light of the of 22% fall to date. NS states that a buy to let investor panic will trigger an avalanche of further selling. I am not aware of Numis Securities past forecasts, however analysis of the perma-bear Capital Economics that has consistently been cropping up with bearish house price forecasts since at least 2002 in the mainstream media illustrated the propensity to reprint press releases with-out checking the facts as to whether the forecast is actually probable or not.

The Telegraph wrote: House prices 'could fall by further 55 per cent

> "People who bought buy-to-let flats are expected to “begin panic selling” and the average home value could drop below £100,000."

> “Despite UK house prices already having fallen 21% from the peak, we do not believe that the correction is anywhere near over.

> “Our core headline forecast is that UK property prices remain between 17% and 39% overvalued based on fair valuation. Moreover, history has shown us that when property…which has experienced a price bubble corrects, the price tends to fall below fair value for a period of time, as confidence in that market remains low. Prices could fall a further 40-55% if the over-correction was as bad as the early 1990s in our view.”

Subsequently, UK house prices bottomed in April / May 2009 and have embarked upon a debt fuelled bounce into a May 2010 General Election that has already seen UK house prices RISE by more than 7% from the April / May low rather than to CRASH toward another 55% drop.

Whilst many are focused on the headline unemployment data, however back in August 2009 in the analysis (UK House Prices Tracking Claimant Count Rather than Unemployment Numbers), the conclusion was that the focus should remain on claimant count rather than the headline unemployment rate, in this regard the claimant count is turning positive in the most recent data and is therefore supportive of a continuation of the trend higher in UK house prices.

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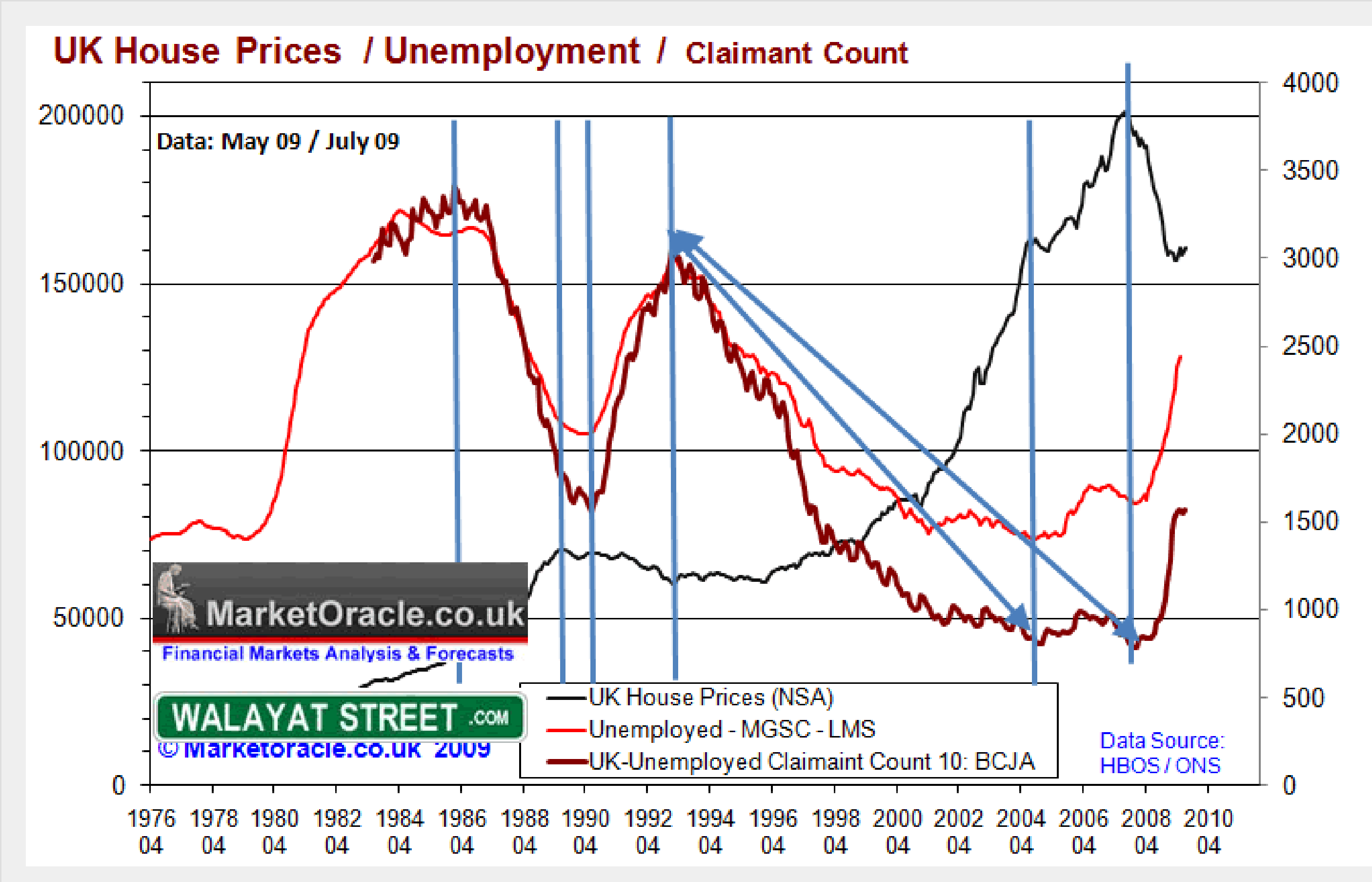

The above chart indicates that there does exist a strong relationship between house price trends and the unemployment benefit claimant count, more so than the unemployment data. The possible reason for this is that those made unemployed that do not claim benefits are not in as financially distressed state than those that have no choice but to claim benefits, therefore house prices can and have risen in the past whilst the official rate of unemployment rose, if at the same time the claimant count did not rise.

*The recent bounce in house prices is tracking quite closely with the stabilisation of the unemployment claimant count numbers, which therefore suggests that as long as those claiming unemployment benefits continues to stabilise at the current level of 1.6 million then the outlook remains positive for UK house prices to continu*e drifting higher, this is despite official unemployment data that looks set to continue to rise towards 3 million from 2.43 million.

My on going research suggests that the debt fuelled economic recovery is expected to continue into mid 2010 that could see house prices up by more than 10% year on year and therefore contrary to the widespread view of flat house prices during 2010, however this warrants in depth analysis to formulate a higher probability forecast which I aim to complete by April 2010.

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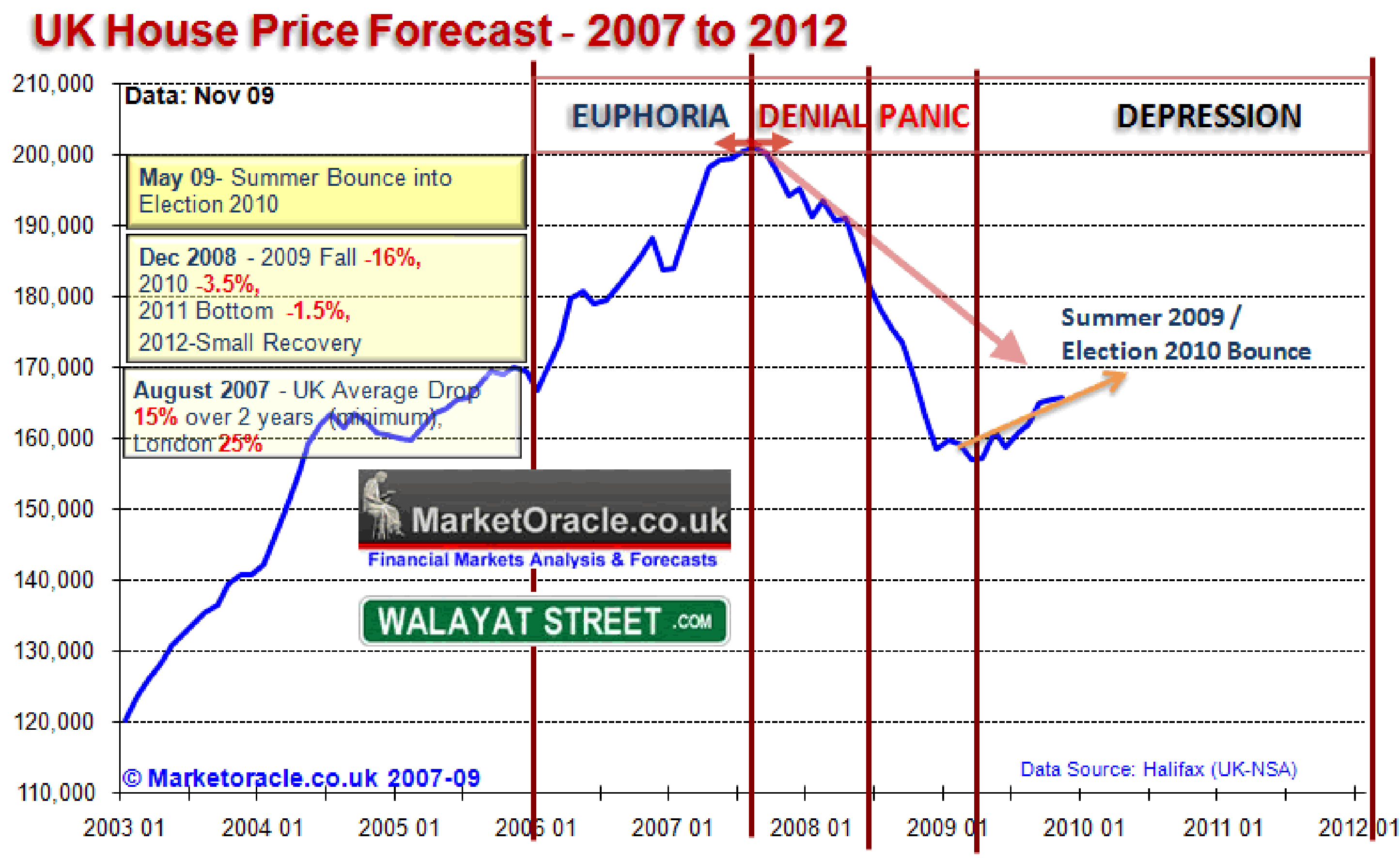

In conclusion the trend of inflating UK house prices into mid 2010 is supportive of the trend of inflating general prices that will play catch up during early 2010 and continue upward into the second half of 2010 due to increased consumer spending as a consequence of some of the return of the feel good factor amongst consumers.

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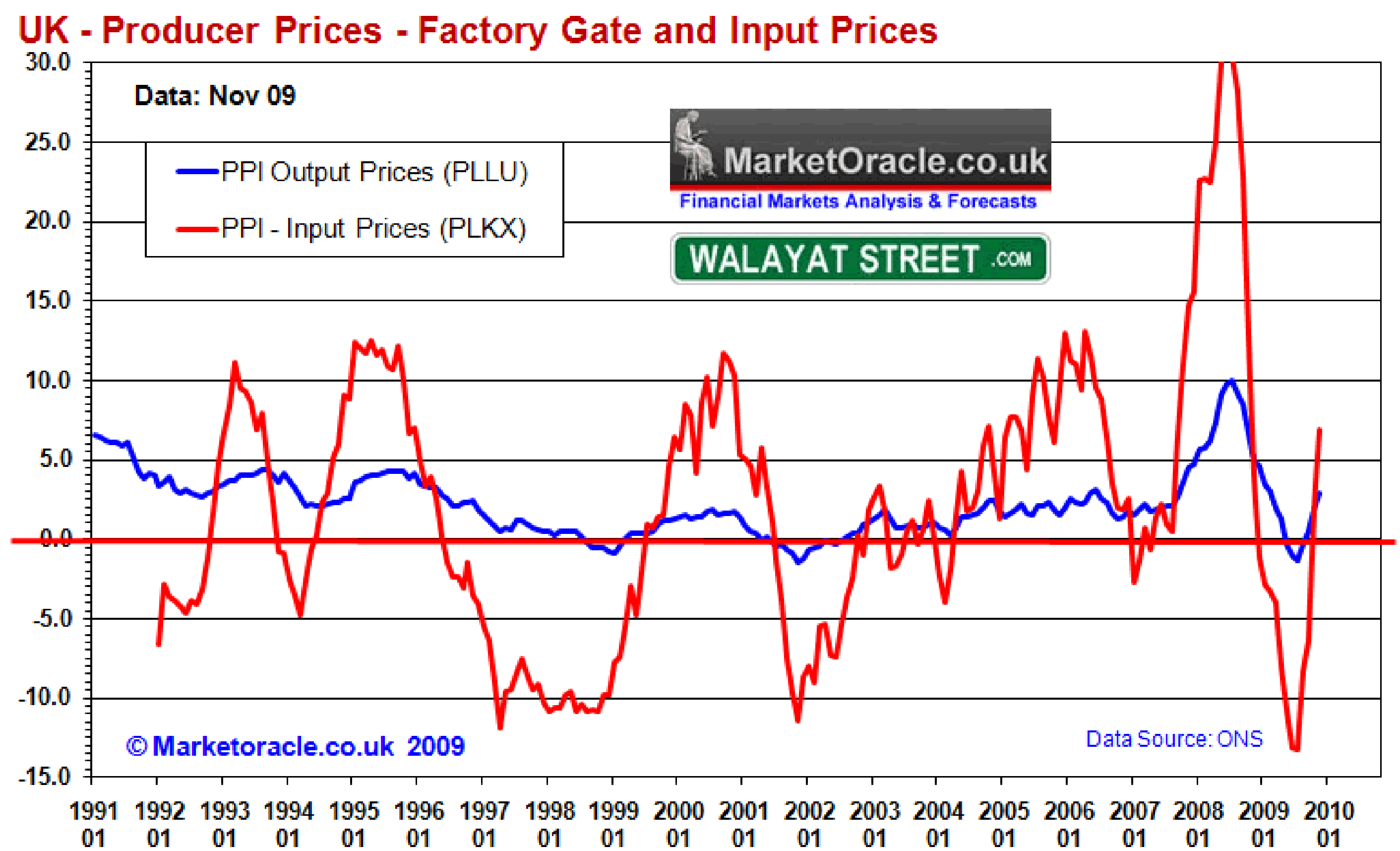
UK Producer Prices



Producer Input and Output prices bottomed in June 2009 and have bounced strongly from deflation back into inflation. The trends again act as a leading indicator for consumer prices that lag by a couple of months or so. The momentum behind the recovery in producer prices is suggestive of a trend towards extremes in the coming months i.e. PPI Output to above 10% and PPI Input to more than 5%, both of which suggest that the imminent spike higher to follow in retail and consumer prices towards the upper bands will be sustained into at least mid 2010.

Stocks Bull Market Signaling Strong Economy

The stocks stealth bull market of 2009 has been one of the greatest bull market rallies in history and for its whole duration has been explained away by academic analysts as an aberration, a bear market rally who's demise was always imminent that illustrates the difference between theory produced in ivory towers than to actually attempt to monetize on trends as the consequences of being wrong for the latter is loss of real money. The fact is simple, the stocks bull market of 2009 is by far the strongest indicator of a economic recovery than anything seen in any economic data that academic economists and even many market analysts / mainstream press commentators pursue with a vigour whilst ignoring the biggest indicator of all that is staring them right in the face. The birth of the bull market right from early March has increasingly indicated to me that we are heading for much stronger economic activity during 2010 and therefore much higher inflation.

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British Pound to Wobble Lower During 2010

The existing U.S. Dollar bull market scenario analysis calls for the Dollar to rally towards a target of 84, with the initial buy trigger of 77.00 achieved during the past few days (24th Dec 09) this now sets the scene for sterling weakness against the Dollar, which has already seen the GBP nose dive from £/$1.68 to below £/$1.60. A U.S. Dollar index rally to 84 would coincide with a drop in sterling to below £/$ 1.50, therefore presents a bearish starting point for chart analysis.

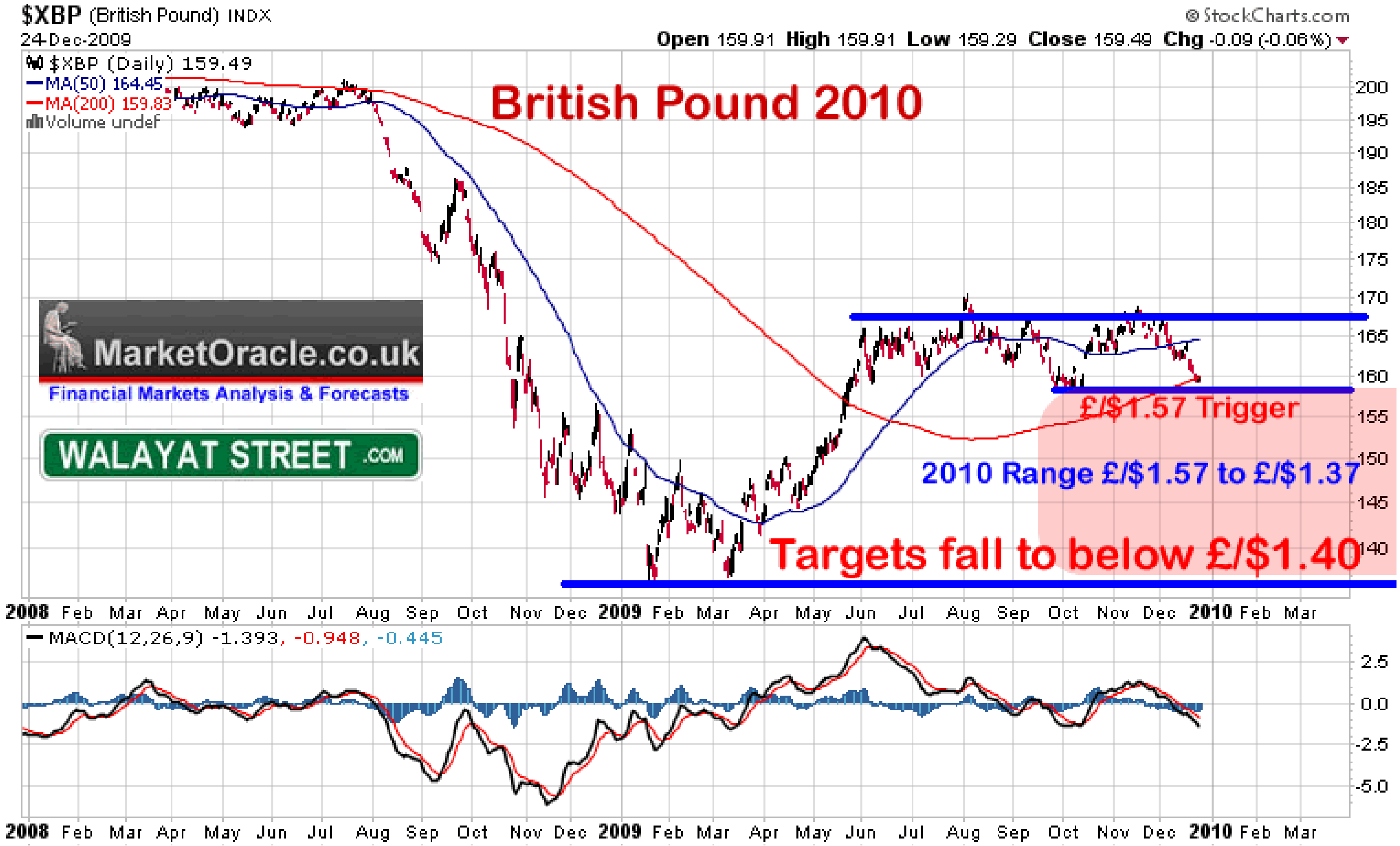

Chart courtesy of StockCharts.com

Two items stand out from the GBP chart:

1. That sterling is targeting immediate support at £/$1.57 which implies it may temporarily bounce from there back through £/$1.60 before the eventual break.

2. That a break below £/$1.57 would target a trend to below £/$1.40.

On a longer term view, the chart is indicative of trading range between £/$1.57 and £/$1.37, on anticipation of the eventual break of £/$1.57. On average this implies a 10% sterling deprecation against the trend of the preceding 6 months or so. I expect sterling to fall against other major currencies.

What could drive sterling lower during 2010 apart from Dollar strength ?

The obvious thing that comes to mind is the Bank of England keeping UK base interest rates artificially low whilst the economy recovers, inflation rises and the trade gap widens, therefore this WILL impact on the currency and result in relative weakness as commodities such as crude oil are priced in dollars and thus will result in an inflationary feed back loop. Neither is the currency helped by open ended money printing to monetize the huge amount of government debt issuance as a consequence of a 12%+ budget deficit.

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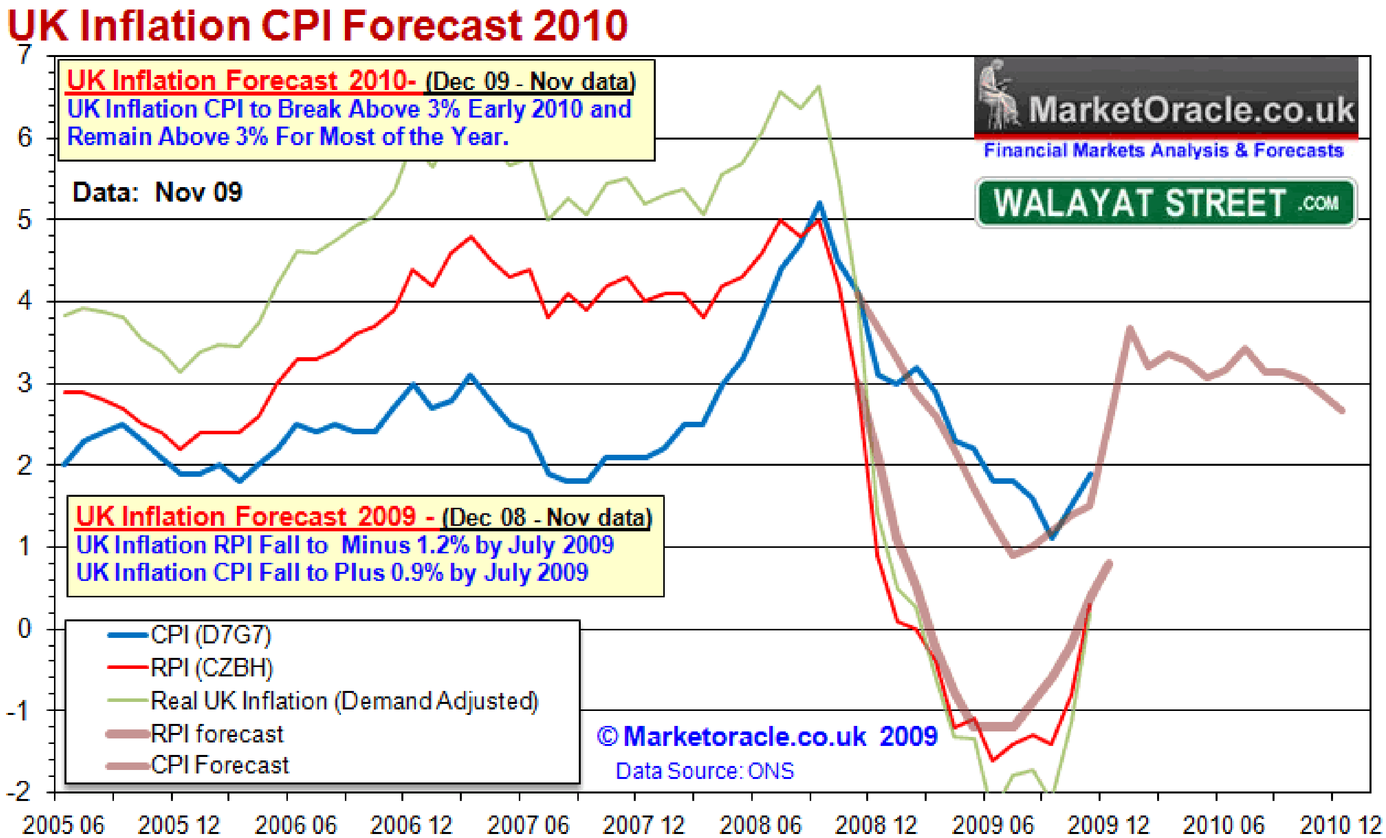
Conclusion and UK CPI Inflation Forecast 2010

The sum of the above analysis is concluding towards UK inflation to spike higher in the coming months during early 2010. This is in-line with my view that the Labour government has succeeded in sparking a strong debt fuelled economic recovery that will become clearly visible during the first quarter of 2010. I expect UK inflation as measured by CPI to break above the Bank of England's upper CPI target of 3% very early in the year, and stay above 3% for most of the year only coming back below 3% late 2010 as a consequence of the next government's attempts to bring the unsustainable budget deficit under control.



Risks to the UK Inflation Forecast

The obvious risk is of the collapse of another major financial institution triggering a deflationary financial armageddon, though the risks of this are now infinitely smaller for 2010 then they were in the lead up to the Lehman Bankruptcy. The real risk is of countries imploding under unsustainable debt burdens, but whilst this would hit the economies however the consequences of imploding countries is inflationary rather than deflationary as panicking government's with citizens rioting in the streets tend to ramp up the printing presses to full steam and similarly to induce a collective panic amongst other central bankers to do likewise, therefore this suggests to me that the actual risk to the forecast is more to the upside then the downside, though yes government debt defaults will not look pretty in the financial markets which like 2008 would induce extreme market volatility.

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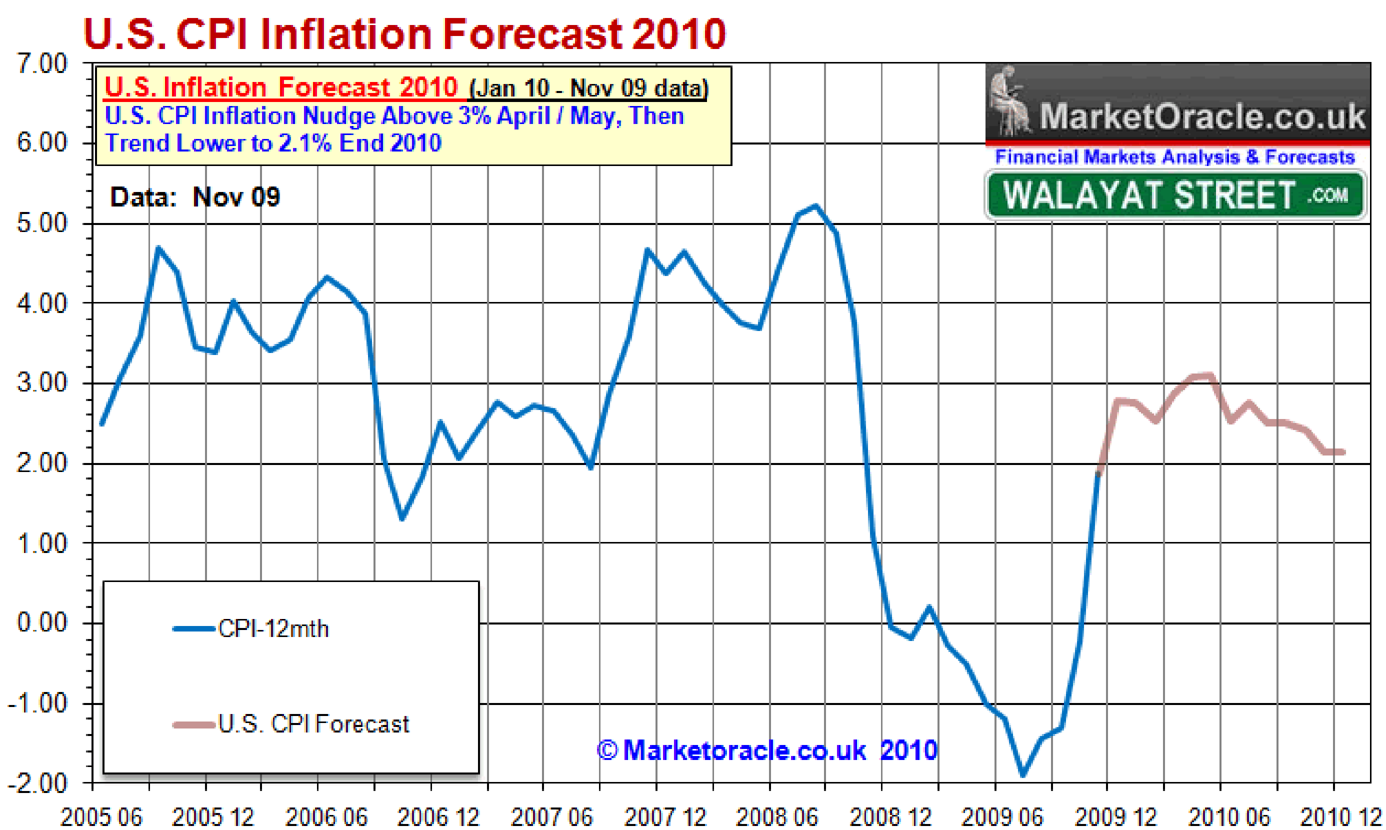
U.S. CPI Inflation Forecast 2010

Whilst the United States has experienced real year on year price deflation during 2009 as illustrated by the comparative CPI indices below, however key elements of the in-depth analysis for UK CPI inflation of 27th December 09 can also be applied to U.S. inflation expectations that converge towards 2010 being a year of inflation for both countries with UK inflation to break above 3% early 2010 and staying above 3% for most of the year which was confirmed by recent UK Inflation data that showed CPI soar by 1% in one month to rise from 1.9% to 2.9%.

U.S. CPI Inflation Analysis and Forecast

Whilst it is not possible to conduct the necessary in depth analysis for the U.S. economy which would require an ebook in its own right. However I can extrapolate a trend for U.S. inflation by taking account of the comparatively less inflationary pressures in the U.S. than for the U.K. as a consequence of LESS Q.E. in the U.S. and a significantly higher U.S. unemployment rate which translates into greater spare capacity and thus generates the following forecast graph for U.S. Inflation, which despite being probably less accurate than for UK inflation, it does however present a road map trend for U.S. Inflation that suggests:

U.S. CPI Inflation 2010 Forecast to just break above 3% in April / May 2010 and then trend lower into the end of the year to target 2.1%.



This projection is amidst an ongoing inflation / deflation debate in the U.S. that clearly is resolving towards INFLATION during 2010 rather than DEFLATION which my earlier analysis suggested would come to transpire over the coming year (16 Dec 2009 - The Inflation Mega-trend and the Illusion of Price Deflation). Which is basically summed up by the fact that virtually all of the worlds economies are swimming in an ocean of inflation washed over by the occasional waves of Deflation as the below graphs for U.S. and UK CPI Inflation indices illustrate.

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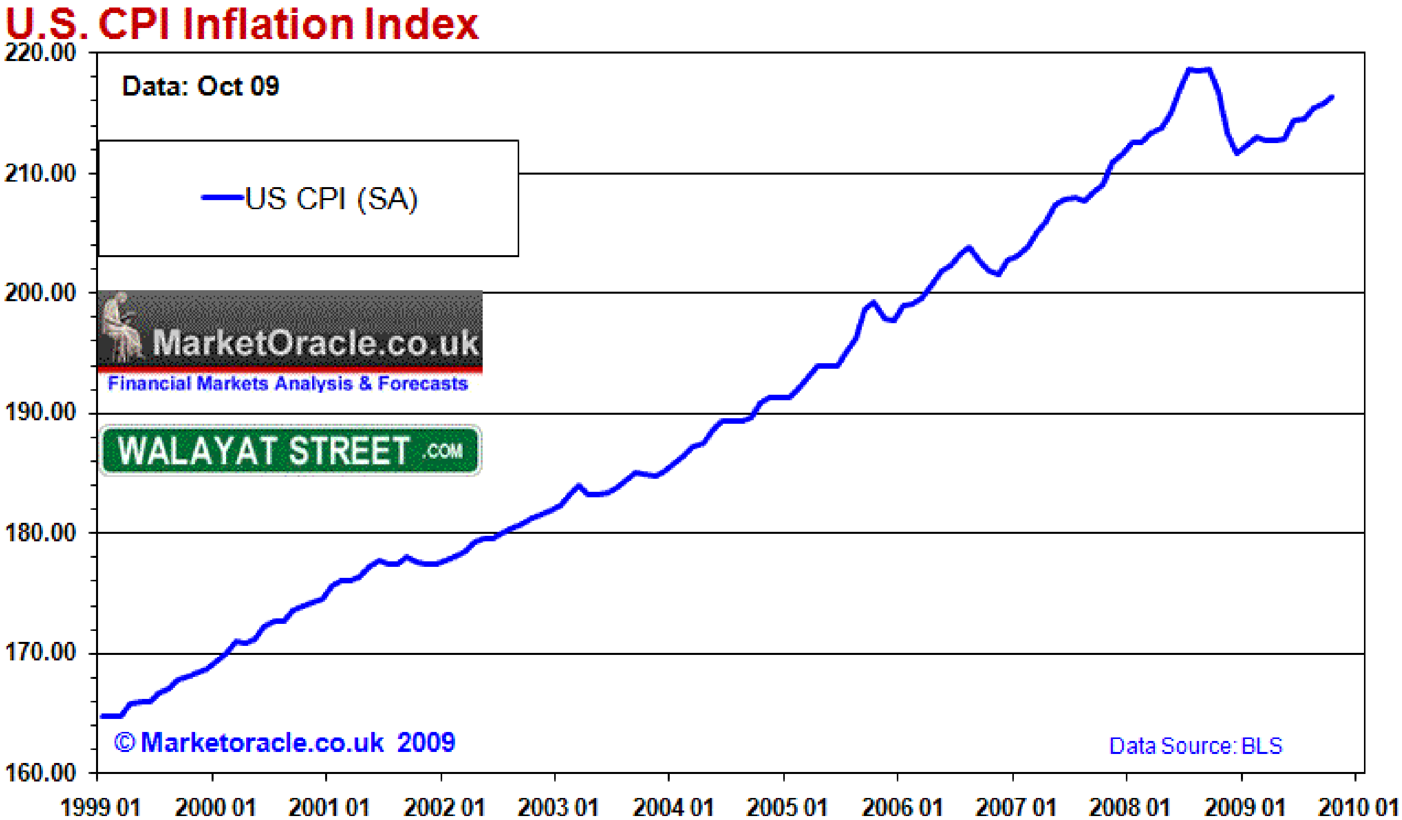

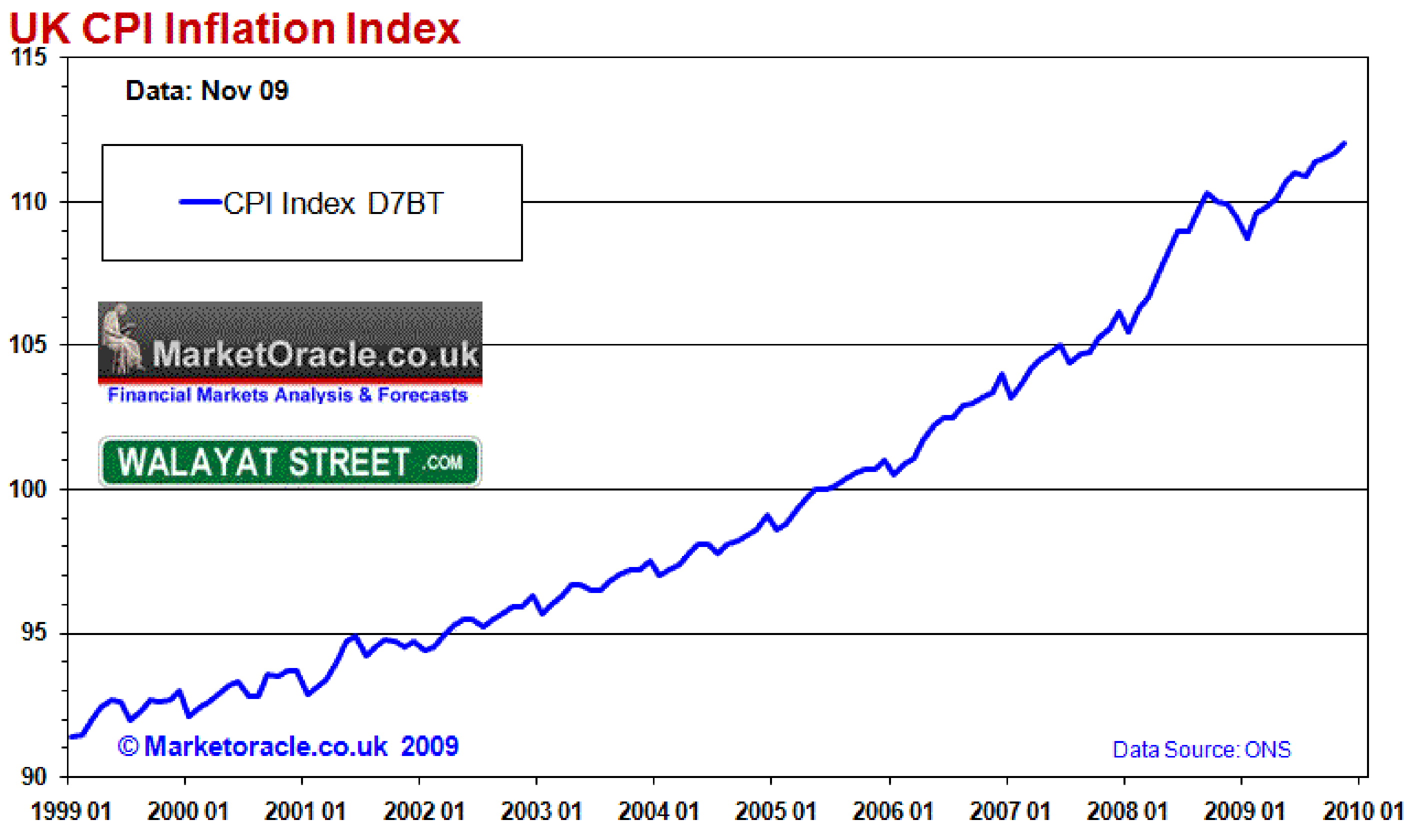

It will be interesting to see how the deflationists explain away real year on year CPI inflation over the coming 12 months.

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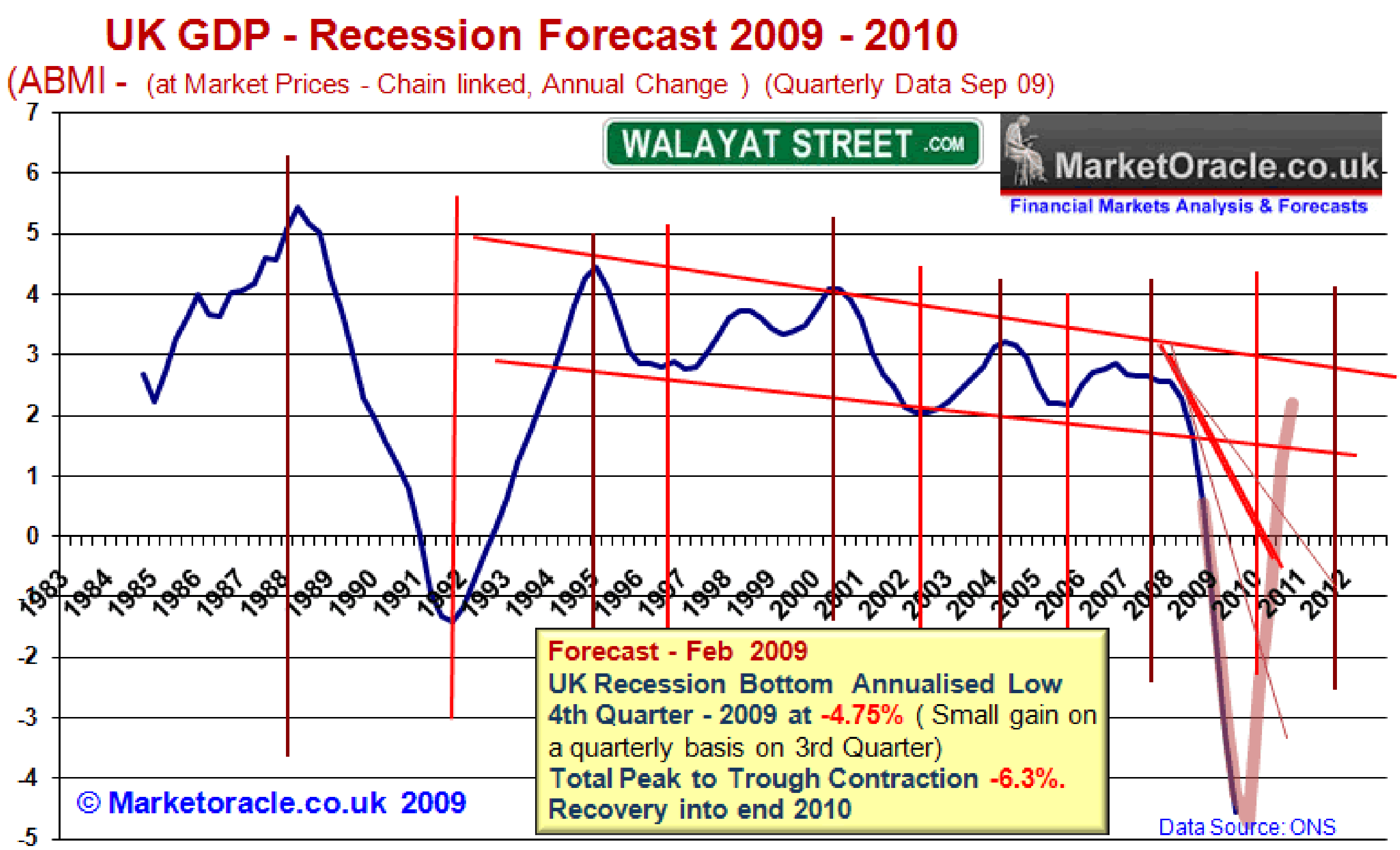
CHAPTER 2

UK ECONOMY

UK GDP Forecast 2009 - Britain's Great Depression

Britains Great Depression is expected to have ended in the third quarter of 2009, the trend for which has been accurately mapped out in the in depth analysis and forecast of 17th February 2009 (UK Recession Watch- Britain's Great Depression), that called for both a severe peak to trough economic contraction of -6.3% for 2009 at a time when the likes of the UK Treasury were forecasting contraction of less than half at -3%. The analysis also concluded in a strong debt fuelled economic recovery for 2010 to coincide with a summer 2010 General Election. As of the revised ONS GDP data (ABMI Chain linked at Market Prices) total peak to trough contraction is now 6.23% virtually exactly inline with the forecast for -6.3%. Annualised contraction for the third quarter is at -4.56% with trend on target for -4.75% for the fourth quarter.



UK Recession Projection / Forecast Conclusion

In the final analysis, the projected course of the recession over the next 2 years is as illustrated by the below graph in that the severe recession is expected to bottom at an annualised rate of -4.75% GDP in the fourth quarter of 2009 (small quarterly gain on the 3rd quarter), which will be followed by a recovery as the rate of annualised GDP contraction improves as government stimulus measures announced to date and deep interest rate cuts as well as future stimulus during 2009 kick into gear. The UK economic recovery is expected to continue into the fourth quarter of 2010 i.e. after the general election. The total recession from peak to trough is expected to see GDP contract by 6.3% and therefore this will be the worst recession since the 1930's Great Depression.

Therefore this analysis seeks to update the prospects for 2010 GDP growth forecast of 2.1%, as well as project the trend out for at least 2011 and possibly further out, which is in the face of over bearing mainstream press commentary that has jumped onto the double dip recession band wagon.

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Labour's 10 Year Economic Boom Evaporated into an Even Bigger Bust

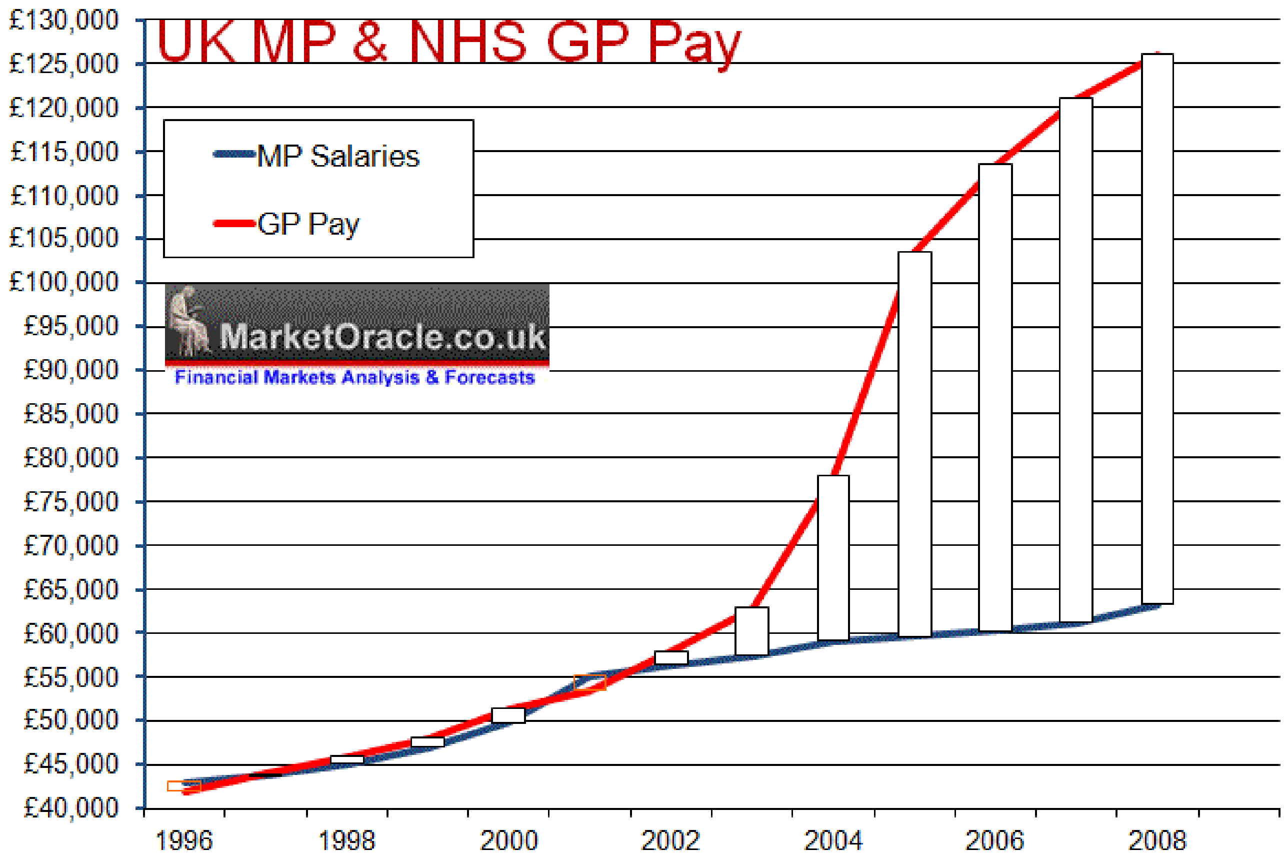
John Majors Conservative government handed the New Labour government a lean mean economic growth machine back in 1997, which during the first 2 years of the new government, the Labour party managed to restrain its traditional tendencies for wasting money by sticking to strict limits on government spending. However, increasingly following the first two years, the Labour party let rip with out of control public sector spending with a vengeance on the back of North Sea Oil revenues and the Casino Banking Sector profits that ensured that Britain skipped the Dot Com / Sept 11th recession of 2001-2002 that hit many other countries including the United States.

Unfortunately both Tony Blair and Gordon Brown took this as a sign that they had acquired the midas touch, thus further escalated spending on the public sector that despite booming revenues from what turned out to be fictitious profits from the mark to market banking sector (for the purpose of paying huge bonuses) the Labour Government repeatedly broke its own Golden rules of balancing the countries finances over an economic cycle. If Labour had stuck to its own rules during the good times as they had repeatedly promised the electorate at each election then Britain would now not be peering over the financial abyss of an hyper-inflationary debt spiral.

NHS Spending Black Hole

Out of control public sector spending is no better illustrated than by the more than tripling of the NHS budget from £37 billion to more than £120 billion, as the NHS and wider public sector sought to not only match the private sector in terms of pay but to beat it when pension entitlements are also taken into account.

GP Pay illustrates the greed is good factor more than anything else that contributed towards the 2009 MP Expenses Scandal. When New Labour came to power in 1997 average MP pay was £43,722 against average NHS GP pay of £44,000, so both were inline with one another at that time. However as the below graph clearly illustrates in 2003 something started to go seriously wrong with GP Pay which took off into the stratosphere as GP's decided to award themselves pay hikes of more than 30% per annum at tax payers expense that has lifted average GP pay to over £126,000 per annum against £64,000 for MP's.



This was as a consequence of the now infamous 2003 GP contracts, where basically GP's managed to hoodwink gullible Labour government health ministers into signing up to contracts which were meant to deliver value for money for the tax payer but were instead designed to do the exact opposite and resulted in GP's pay doubling whilst at the same time cutting back on

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hours worked. This was not only a total fiasco for the nations health and finances but also ignited jealousy amongst MP's that directly led to the adoption of the policy of claiming dubious expenses up to the allowed for limits so as to fill the ever widening gap between MP's and NHS GP's, as MP's could not get away with awarding themselves pay hikes of 30% per annum without voter discontent at elections. Therefore across the board systematic abuse of expenses started to take place which basically means the real average MP pay is currently approx. £98,000 per annum.

This example illustrates why the Labour party appears destined to leave office with the economy left in the worst state since at any time since the Second World War. No British Government since WW2 has ran an annual budget deficit at 15% of GDP and it is this deficit as a consequence of the public sector spending black hole that the next Government will have to come to grips with which implies near immediate and deep spending cuts of as much as 10% of the public sector or £65 billion.

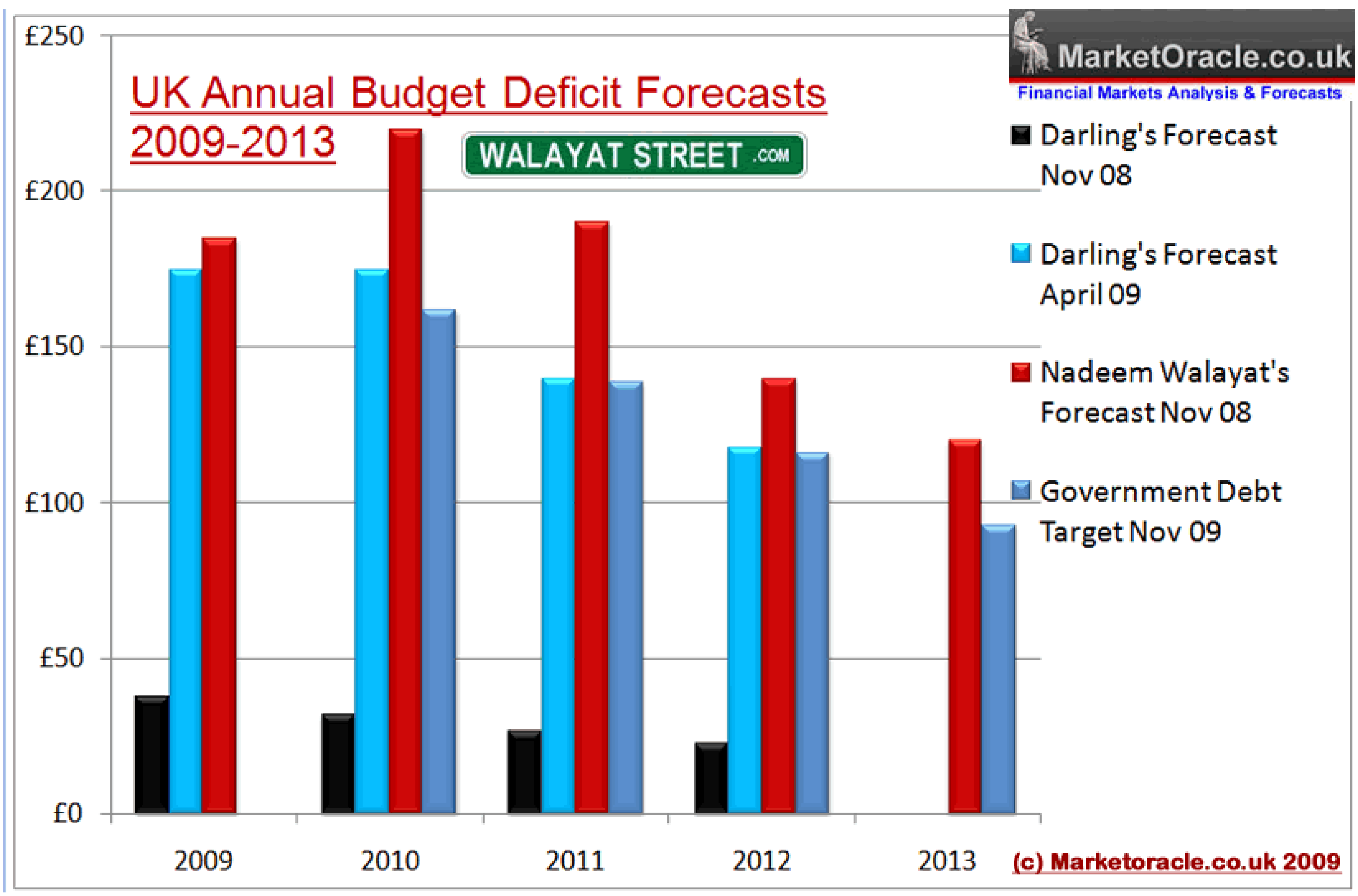
Stock Market the Key Indicator of Economic Strength of 2009

Key conclusion of the inflation analysis projected towards a strong bounce back in the economy which implies higher inflation, all of which was strongly indicated by the stock market that began a stealth stocks bull market back in March, that only now nearly 9 months and 60%+ later are most analysts are starting to drop the bear market rally mantra and recognising the fact that the stock market is THE LEADING ECONOMIC INDICATOR . The article 2009 The Year of the Stocks Stealth Bull Market recaps my analysis that began with the birth of the Stocks Stealth Bull Market in March, all the way into a year end target of 10,500+ on the Dow. My analysis and outlook for the stock market for 2010 follows in Chapter 4.

Budget Deficit Cutting Solutions to Britain's Debt Crisis

The next government's primary objective will be to get an urgent grip with Britain's out of control budget deficit that risks an out of control inflationary debt spiral due to ever escalating interest payments exacerbated by a depreciating currency as a consequence of continuing money printing (QE) to monetize the deficit.

The Labour government's most recent updated projection for the annual Public Sector Net deficit remains unchanged against Alistair Darlings April 09 targets, as well as my original estimate of November 2008 (Bankrupt Britain Trending Towards Hyper-Inflation?).



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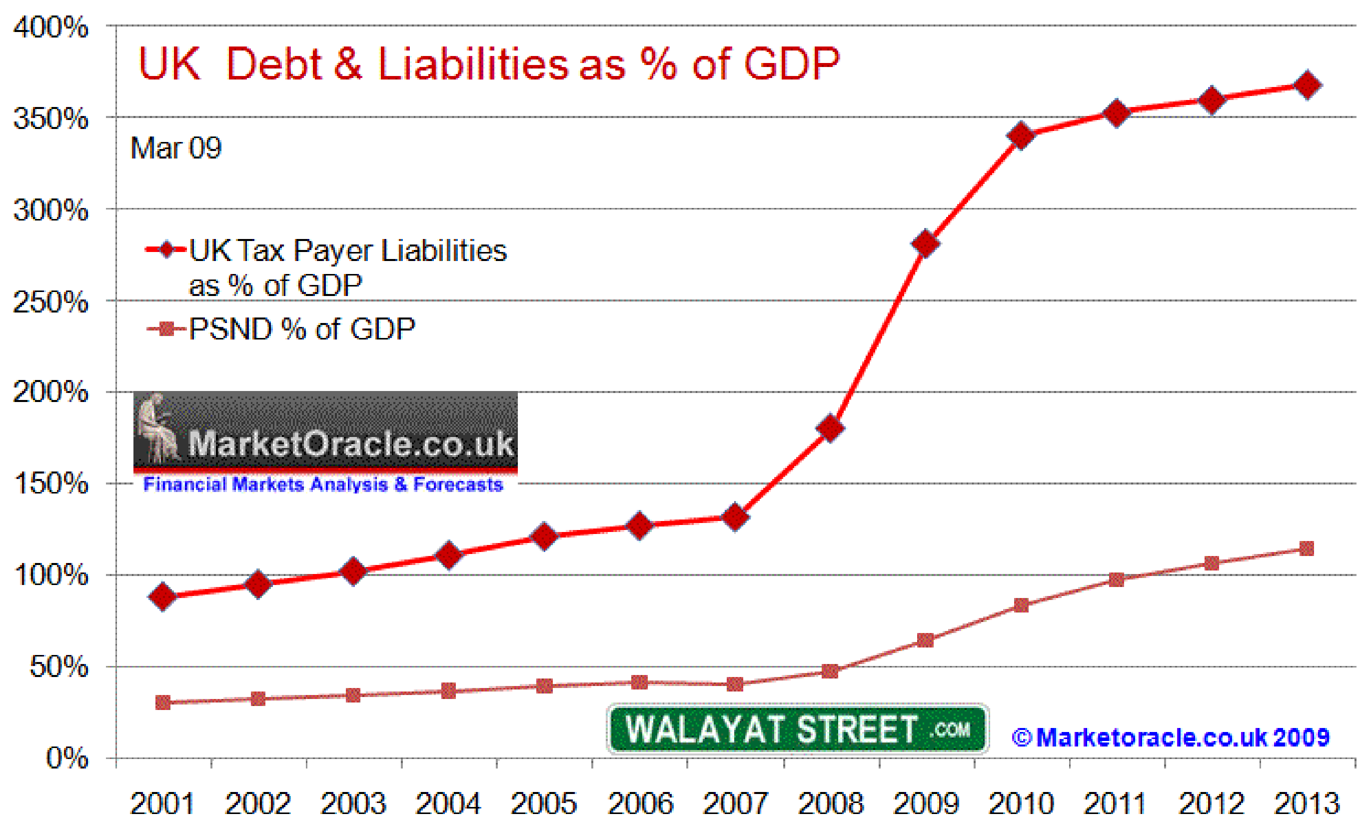
The target PSND of £1,300 trillion would approximately equate to 100% of GDP by 2013/14. This is against my original target as of November 2008 of £1.48 trillion by the end of 2003/14 at a projected 114% of GDP.



The existing government deficit reduction targets as of the November 2009 budget is to reduce the deficit by £23 billion per year for the year 2010-11 onwards. However as I pointed out in the article Britain's Inflationary Debt Spiral as Bank of England Keeps Expanding Quantitative Easing, reducing the deficit by £23 billion per year does nothing to stop the deficit from expanding by a further £510 billion or 42% of GDP, i.e. there is NO DEBT REDUCTION, Instead DEBT Escalates by a further £510 Billion. Therefore the Labour government's deficit reduction targets are NOT sustainable, as the market will NOT allow £510 billion of new debt to be issued on top of the existing debt mountain of over £1 trillion, which is leaving aside for the moment the total liabilities that look set to expand to over £4.75 trillion.

Solution to Britain's Debt Crisis

The only solution to the path Britain is on is for a balanced budget, in that regard the best way to achieve a balanced budget is to grow ones way out of debt i.e. increase tax revenues, failing that the option available is to inflate ones way out of debt which is what the Labour government has enacted through its policies of Quantitative Easing, Zero Interest rates and increased public spending.

So it is going to be a tough balancing act for the next government as it will need to cut spending, increase taxes AND grow the economy so as to bring the deficit under real control, not the nonsense of cutting the deficit of £23 billion per year over the next four years which as I have illustrated means at least an extra £510 billion of debt.

The current financial years deficit is projected to be £185 billion or 15% of GDP, this is not sustainable which therefore requires a cut in the annual deficit to below 5% of GDP or £60 billion within a short period of time but WITHOUT triggering a Double Dip Recession which would just bring Britain back to square one i.e. were we were 6 months ago.

How to Really Cut the Deficit

Spending Cuts

Both Labour and the Conservatives have made loud noises of making severe cuts to public spending but when one looks at the actual figures pumped out they are non existant for the Conservatives and show INCREASED public spending for Labour. This is clearly electioneering therefore without any real concrete figures before me I can only guesstimate that cuts of approx 4% will follow in the post election budget which is significantly less than the 10% that would be necessary, which is not going to happen

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when the mega spending departments of NHS, Education and Welfare have been ring fenced for growth, which would mean a 10% budget cut would be impossible. Public sector spending cut by 4% would equate to about £24 billion.

Economic Growth

My existing forecast for the UK economy is on track for 2%+ growth for 2010, therefore this should like for like imply a 2% cut in the annual deficit or £24 billion by means of increased tax revenues due to economic growth.

Tax Rises

Tax rises have already been scheduled by the Labour party to start kicking in during 2010, with the first on 1st of Jan 2010 when VAT goes back up from 15% to 17.5% and with NI scheduled to follow in April 2010. Add to this the projected post election tax hikes of an increase in the basic rate of income tax to 24p and higher upper band increased from 40p to 45p.Though a further VAT hike to 20% may be overkill and could trigger the feared double dip recession that would be a disaster, so I doubt if 20% VAT will follow, but it is a tough call as it could raise a further £12 billion per year. In conclusion total tax revenues could increase by a sizeable £30 billion a year and contribute to a significant dent in the annual budget deficit.

Cutting the Deficit

Therefore putting all of the probable spending cuts, tax rises and increased revenues from economic growth all together, then by the start of financial year 2011 the budget deficit could be cut by £78 billion to approx £100 billion instead of the Labour government's target of £162 billion. A deficit of £100 billion would still equate to about 8% of GDP, so would still require more money printing to monetize government debt, but the cuts would not be so severe as to trigger a double dip recession and therefore allow the government to both grow and inflate its way out of debt during the subsequent years i.e. the country will experience below trend growth coupled with higher inflation that would target a rate above the Bank of England's 3% limit, which suggests that the next UK Government may set a NEW Inflation band of 2% to 4%, which is inline with the outlook being painted by the inflation forecast.

On this basis the deficit could be cut to about 4% of GDP by the end of the third year of the next government, so hope for saving Britain from the debt spiral is not lost, but it does require urgent action as the longer the country accrues budget deficits of approaching £200 billion per year, the greater will be the price paid in terms of debt interest payments that are already at £44 billion per year and could easily pass £80 billion if the Labour party's current 5 year deficit reduction plan is followed.

Learn the Lessons from the Financial Crisis

I hope the next Government will have learned the primary lesson from last years Financial Crisis, which is that the longer you leave a crisis to fester the greater will be the eventual crash. With regards Britains Debt Spiral, that crash would be for UK Government Bonds and Sterling, which would trigger panic reactive measures. So it is infinitely better to grab the debt bull by the horns BEFORE the inevitable sovereign debt triggered collapse occurs.

The Election Cycle

The next government will have 5 years to prepare for the next general election of 2015. Therefore it has at its disposal the valuable asset of time to engineer an economic boom into 2015. This suggests two harsh years of economic activity i.e. below trend growth, followed by two years of above trend economic recovery into the 2015 election.

Bank of England Quantitative Easing Gilts Market Smoke and Mirrors Dangerous Game

The Bank of England's actions throughout 2008 and 2009 have shown that it's primary objective is to massage the UK Government Bond market. The evidence for this is in the fact that the vast majority of the £200 billion of Q,E, has been utilised for the purpose of monetizing government debt i.e. buying gilts to prevent Gilt auction failures and higher yields.

The original story of Quantitative Easing or Money Printing in statements made by the Governor of the Bank of England during February 2009 was that QE would be utilised primarily for the purchase of corporate bonds to help companies that were unable to sell debt / bonds to the banks. This is NOT what has transpired as most of the QE to date of £200 billion has been utilised for the purchase of Gilts, where even what little corporate bonds that have been bought are expected to be sold in the coming months.

This tells me that those analysts that look to the Bank of England for possible answers for the UK economic growth indicators are following a red herring, as that is NOT the BoE's primary administrative function, the number 1 priority is massaging the Gilt market, yes inflation and economy come 2nd and third but only in so far as they impact the Gilt market. So the Bank of England could be a problem during 2010 as it continues to adopt a blinkered attitude towards the economy much as it did during the Great Recession of 2008-2009, in that the Bank of England sat twiddling its thumbs whilst the economy burned and it was only after the Prime Minister effectively took control of interest rates away from the Bank of England on 8th of October by

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announcing the first of a series of cuts in UK interest rates from the Prime Ministers Despatch box rather than by the Bank of England as I mentioned around the time.

> UK 1% Interest Rate Cut

> The MPC meeting is widely expected by the consensus to cut UK interest rates by 0.5% today, however as my recent articles (Credit Quake Persists Ahead of UK Interest Rate Cut of 1%?) have concluded that effectively Gordon Brown cracked the MPC round table in half when he stood up at the House of Commons despatch box on 8th October to announce the interest rate cut of 0.5%, which was followed by the Bank of England's announcement. This suggests that the Monetary Policy Committee is now no longer totally in the control of setting UK interest rates and therefore in many aspects control has been transferred back into the government's hands.

At the end of the day the Bank of England will first look after fellow bankers and then placate the government by giving lip service to the wider economy for were it the institution that many think it is then it would not have contributed in a big way towards pushing the UK economy over the edge of the cliff during 2008 by sitting on interest rates of 5% for a whole year AFTER the credit crisis broke and the UK housing market peaked. The Bank of England coupled with the FSA contributed to towards the creation of the financial crisis by means of the de-regulation of the banking sector that ensured that bank officers turned their banks into hollow husks for the purpose of maximising bonuses on the basis of fictitious profits, with all of the liabilities at the end of day being dumped onto the tax payers backs. Had the Bankers that run the Bank of England done what the people thought they were there to do, then the banking crisis would not have happened! For we are not talking about a new institution on a learning curve that is just a few years old, but rather a 300 year institution that knows full well the ins and outs of the banking system that it created over the centuries that exists primarily to turn everyone, including the government into debt slaves. The mainstream press instead of holding the Bank of England to account is praising the bank for its actions in preventing an Economic Depression.

The Bank of England whilst talking about halting QE several times throughout 2009 that the mainstream press lapped up in July 2009, which at the time I mentioned was NOT possible, as the BoE will continue with QE to ensure that Gilt Auctions do not fail. The BoE will also put increasing pressure on the government to cut the deficit asap so that the Gilt market is under less pressure, regardless of the impact of a too severe cut in the deficit i.e. triggering a double dip recession.

The Bank of England embarked upon a programme of printing money or Quantitative Easing during March 2009 with an initial print run of £75 billion of a total limit set at £150 billion in an attempt to wave the central bank magic wand to increase the supply of credit. However as I warned at the time (5th March 2009: Bank of England Ignites Quantitative Inflation) that once started the Bank of England would continue printing money right into the May 2010 General Election targeting an print run of as much as £450 billion and therefore igniting Quantitative Inflation during 2010.

Virtually all of the mainstream press swallowed the Bank of England's hints and winks that Quantitative Easing had ended at £125 billion during the summer months, which at the time I stated was not possible (8th July 2009: Irrelevant UK Base Interest Rate on Hold as Real Rates have Already Begun to Rise)

> This confirms my view that the Bank of England will continue printing money into year end to beyond the current arrangement of £150 billion and probably as high as £250 billion.

I projected a Quantitative Easing total towards £250 billion by the end of 2009 with the current tally now standing at £200 billion of money printed as a direct consequence of the Labour Government's objective of both aiming to maximise the number of seats retained at the next General Election as well as to deliver a scorched earth economy to the next Conservative Government. Therefore the Labour Government also wins because it gets to hide this Quantitative Easing debt as theoretically purchases and sales cancel each other out in the fantasy land of central bank accounting and feeble government auditing. I.e. by magic approx £200 billion of new government debt has vanished into thin air, for if had not been hidden under the carpet then UK Gilt interest rates would be much higher due to the increase in supply of approx 33%.

The real damage of this game of smoke and mirrors is that the markets are not stupid and when they eventually do react to the progressive trend of QE it will be Earthquake style and that is to dump UK assets, bonds, stocks, cash and therefore hit sterling hard in a matter of hours let alone days or weeks which would send interest rates sky rocketing i.e. to discount the £200 billion of new hidden Q.E. debt.

In the final analysis money printing as I have repeatedly pointed out over the past year is a scam perpetuated upon existing currency holders, i.e. savers. The Bank of England's actions of the past 12 months amount to alleged theft of the value of savings from savers by means of zero interest rates and the printing of money that seeks to destroy the value of capital /

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savings both gradually through the process of inflation AND at the point of time of a currency crisis triggering a severe devaluation.

What this means for the UK Economy is that a. serious efforts will be implemented by the next Government to cut the deficit, and b. whilst the deficit is above £80 billion per year then Quantitative Easing will remain and continue to expand which suggests several more years of QE rather than several more months as the BoE officially continues to always allude to, which given its actual primary objective is not going to happen.

China Leads the Way for Strong Global Growth 2010 and Beyond

China is leading the way to the return of global growth with expectations for GDP growth for 2010 of as much as 10%, which further confirms expectations for the potential of a global growth story surprise to the upside for 2010. Whilst at the present time many analysts / commentators worry about China market bubbles, much as they worried about the "stocks bear market rally" that was always destined for an imminent demise during 2009 which instead was one of the greatest bull markets in history.

I don't see why China is not going to keep growing strongly for 2010, 2011 and beyond especially as domestic consumption becomes an ever larger part of China's growth story with other emerging markets not far behind. Having originally called the China stock market as a Great Buy at SSEC 2,000, with the index now at 3,200 up 92% from its bear market low just continues to prove how wrong the China doom mongers have been found out to be as they continue harping on about how China has to at some point withdraw the huge economic stimulus of 2009, though without understanding that with growing reserves of over $2 trillion they do not have to as I pointed out back in June 2009. China Mega-trend Stocks Stealth Bull Market Update, SSEC Up 47%. Many of the comments I made at the time of China boosting World trade and commerce is coming to pass and will increasingly do so during 2010.

Chart courtesy of StockCharts.com

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So regardless of volatility during 2010, China will continue to notch up a further gains during 2010 AND 2011, We could see the Chinese stock market end 2010 above SSEC 4,000 which 'should' help elevate all major stock markets higher, just as the Chinese economy helps elevate the major economies higher (See Chapter 4 for more precise analysis on China Stock Market).

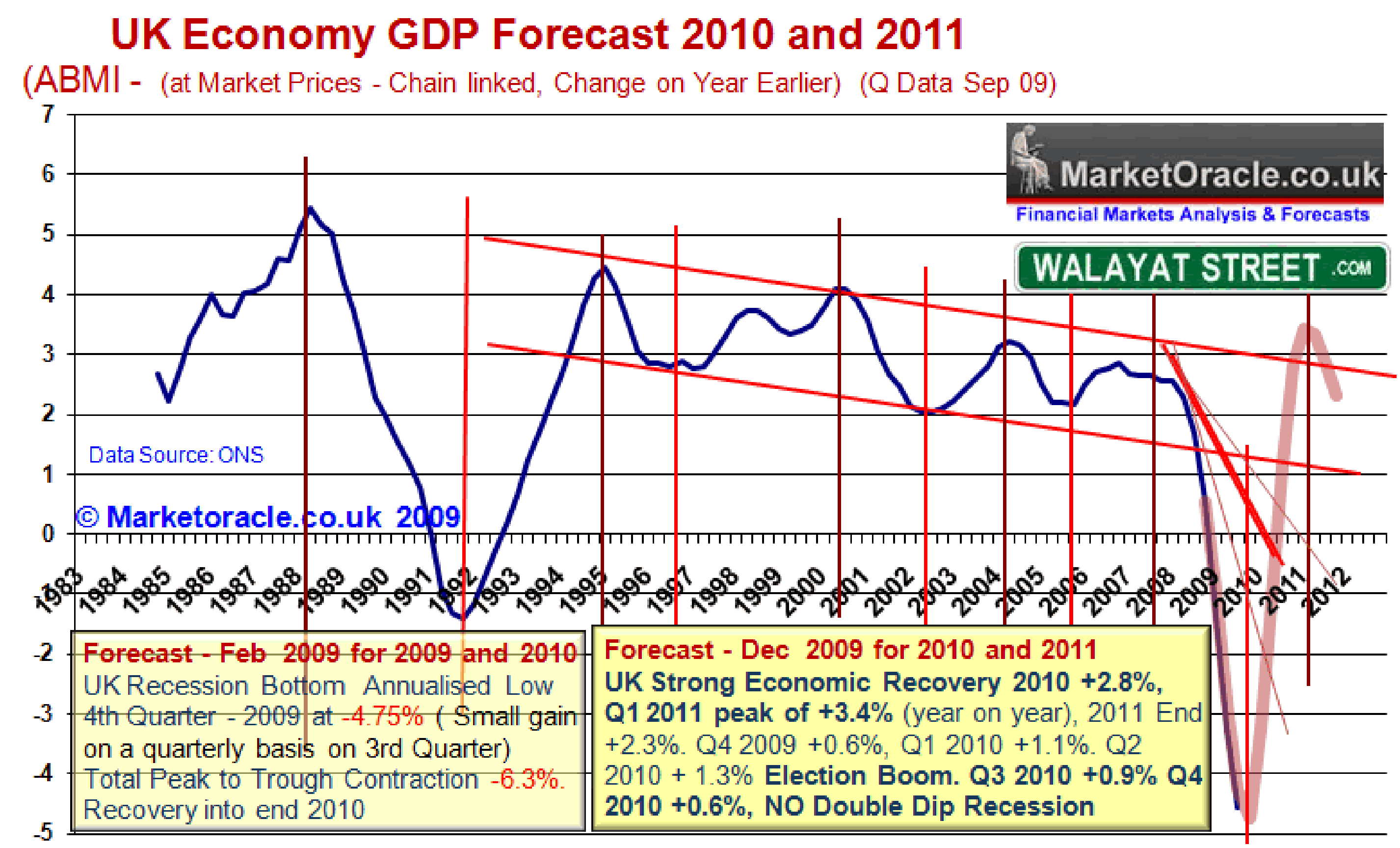
China's thirst for resources and energy also sets the scene for the continuing commodities bull markets right across the board as part of the inflation mega-trend scenario, which ensures mineral producing countries such as Australia and Canada and oil exporting countries will see China lift their economies higher as prices are driven higher.

UK GDP Growth Forecast Conclusion

The sum of the above analysis is for a strong economic recovery into the end of 2010 which given the pessimism today I term as the Stealth Election Boom that followed the Stealth Bull Market of 2009, the economic 'boom' will continue in to a peak in Q1 2011, which will be followed by weakness during 2012 and 2013 and strong recovery for 2014, and into a 2015 summer general election, breaking this trend down into GDP terms for end 2010 +2.8%, 2011 +2.3%, and taking account of the election cycle preliminary GDP projections for 2012 of +1.1%, 2013 +1.4%. 2014 + 3.1% with expectation of strong Q1 growth for 2015.

Therefore I just cannot see this double dip recession that the mainstream press and so called think tanks are obsessing over at this point in time, no year on year economic contraction or even a quarter on quarter dip is visible.

The following graph illustrates my trend forecast for quarterly GDP growth over the next 2 years 2010 and 2011.



UK Strong Economic Recovery 2010 +2.8%, Q1 2011 peak of +3.4% (year on year), 2011 End +2.3%. Q4 2009 +0.6%, Q1 2010 +1.1%. Q2 2010 + 1.3% Election Boom. Q3 2010 +0.9% Q4 2010 +0.6%, NO Double Dip Recession, NO Negative Quarters for 2010 or 2011.

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Mainstream Press and Think Tank Current UK Growth Forecasts for 2010

UK Economic Growth 2010 - LoveMoney - 30th Dec 2009

Forecaster	***Forecast***
European Commission	+0.9%
International Monetary Fund	+0.9%
David Kern, British Chambers of Commerce	+1.1%
Organisation for Economic Co-operation and Development (OECD)	+1.2%
Alistair Darling, Treasury	+1% to +1.5%
Bank of England	+2.1%

> Considering the OECD recently had to double its growth forecast for 2010, it's clear forecasts are unreliable.

CBI Predicts Fragile Economic Recovery - BBC 21st Dec 2009

> The CBI predicts that the UK will exit recession in the fourth quarter of 2009, helped by consumer spending ahead of the VAT rise in January. But the group says the economy is unlikely to have returned to pre-recession levels by the end of 2011.

> It says unemployment will peak at 2.8 million - lower than first forecast. Annual growth of 1.2% in 2010, followed by growth of 2.5% in 2011

What will happen to the economy in 2010? - ThisisMoney 29th Dec 2009

> This growth should prove sustainable well into 2010, and the average prediction from leading UK's economist is for Gross Domestic Product (GDP) to rise at a rate of 1.4% next year.

As you can see there is a wide range from a cluster around 1% to the Bank of England at the upper end of 2.1% which is the most nearest to my own forecast for 2010 of growth of 2.8%.

One thing that stands out to me is that academic economists and "think tanks" apparently do not understand the critical concepts of trend and momentum which has to be at the core for those that seek to successfully trade the financial markets, some food for thought to end on.

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CHAPTER 3

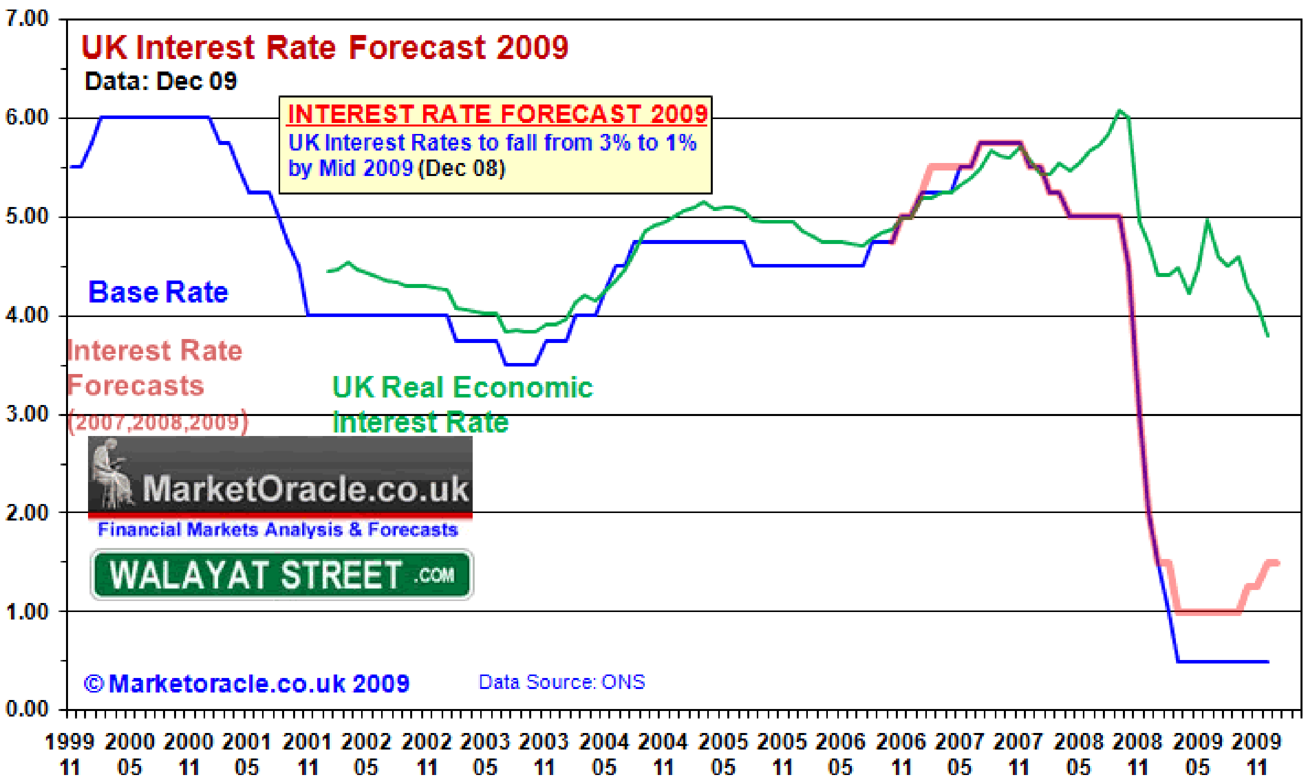
UK INTEREST RATES

The British Economy as with other developed economies entered 2009 in recession and on the brink of depression which triggered a series of panic interest rate cuts all the way to 0.5% by March 2009 and they have stayed there right into the start of 2010.

UK Interest Rates Forecast 2009 Recap

The analysis of December 2008 forecast (UK interest rate forecast of early December 2008) for 2009 that UK interest rates should decline to 1% (from 3%) by early 2009 and remain there into the second half of 2009.

The UK base interest rate was cut to 0.5% in March 2009, following which the Bank of England has continued to pursue an artificial banking system by keeping interest rates at an extreme historic low of just 0.5% into the end of 2009 so as to flood the bankrupting banks with liquidity to enable them to rebuild their balance sheets by overcharging customers against the base interest rate and manipulated interbank market rate of 0.66% against rising real market interest rates which have been in a steady climb since March 2009 which increasingly has meant that during 2009 the base interest rate had become irrelevant to the retail market place.



The forecast for most of 2009 showed a positive bias of 0.5%, rising to 1% by year end against the actual UK base rate.

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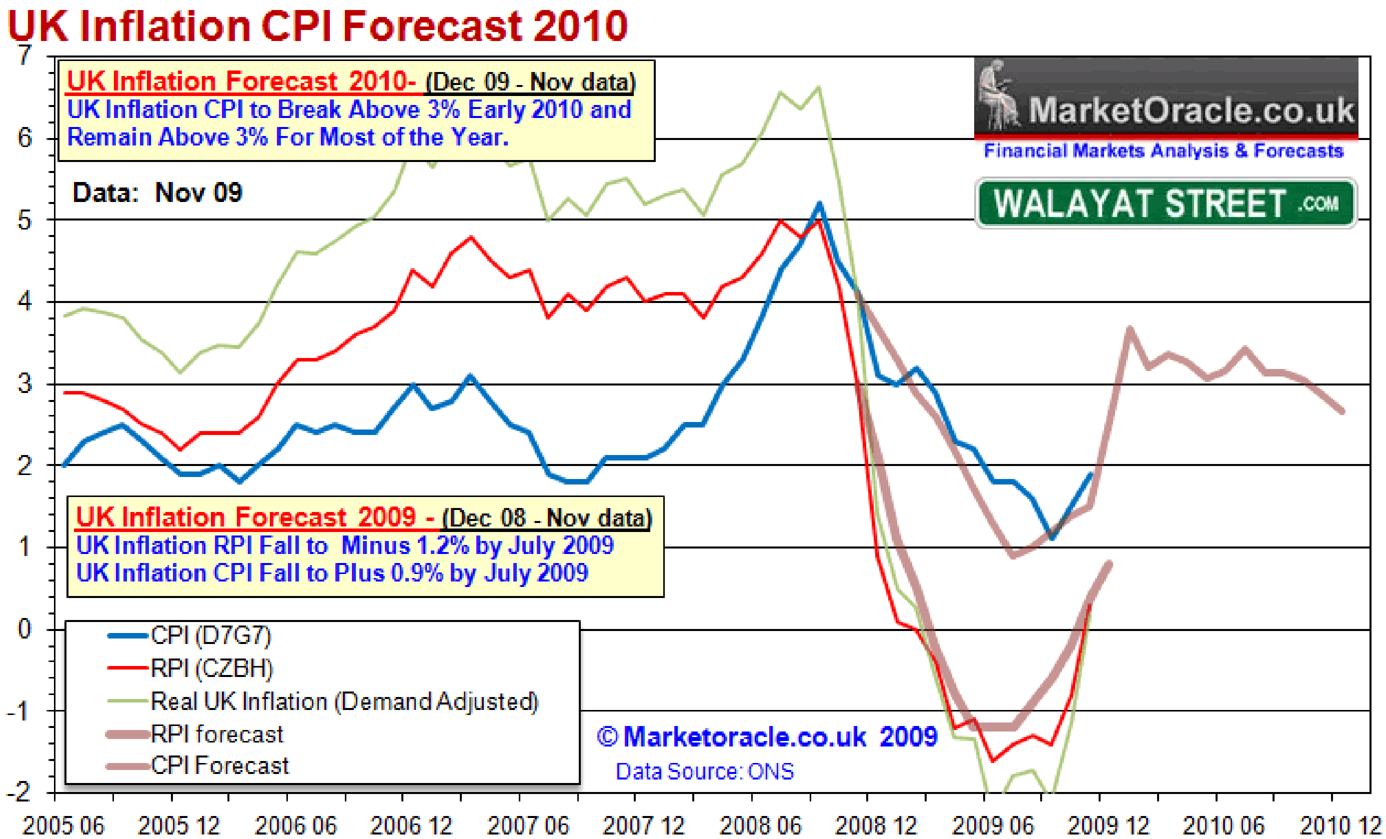
UK CPI Inflation Analysis and Forecast for 2010



Higher inflation implies higher interest rates, especially as the CPI rate is expected to break above 3% early 2010, which means market interest rates will continue to trend higher even if the Bank of England continues to keep the base interest rate fixed at 0.5% at least into the next General Election. However the 0.5% interest rate policy is not sustainable under the weight of persistently high inflation (above the BoE's 3% upper limit) and therefore the pressure for the base interest rate to rise will become intense during 2010.

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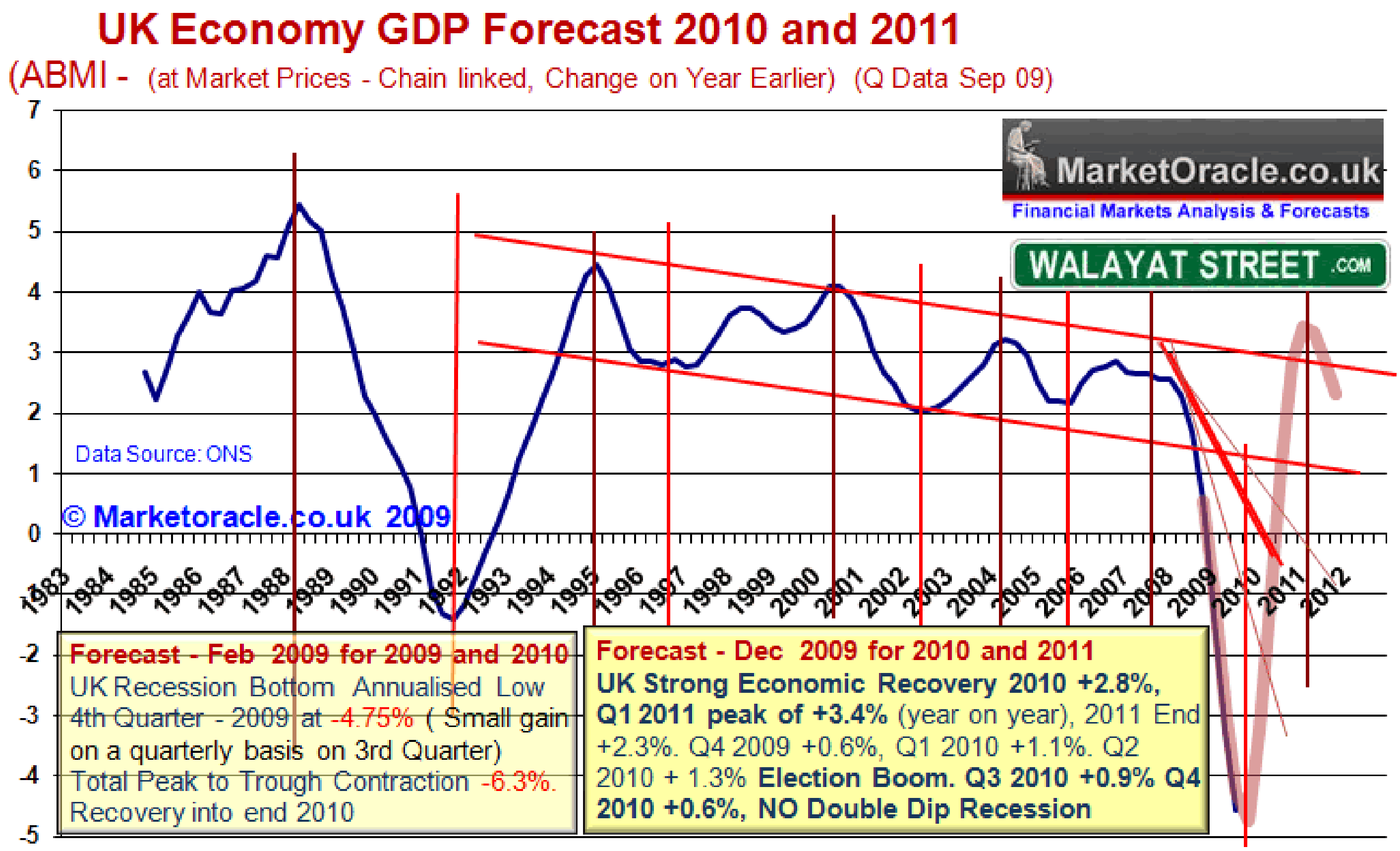
UK Economy GDP Growth Forecast 2010 and 2011, The Stealth Election Boom



If the anticipated strong economic recovery starts to materialise during 2010, then the Bank of England will view its continuing policy of keeping interest rates at 0.5% as erroneous and should start to lift interest rates rapidly to levels far above today's consensus view emanating out of the mainstream press that UK interest rates will be kept at 0.5% for not just 2010 but possible several years beyond. Above trend growth of 2.8% by the end of 2010 does NOT imply an interest rate of 0.5%. This suggests a series of rises during the year, so whilst the first half of 2010 my appear benign in interest terms the second half could prove a rate shocker, which is suggestive of a rate in the region of at least 3%.

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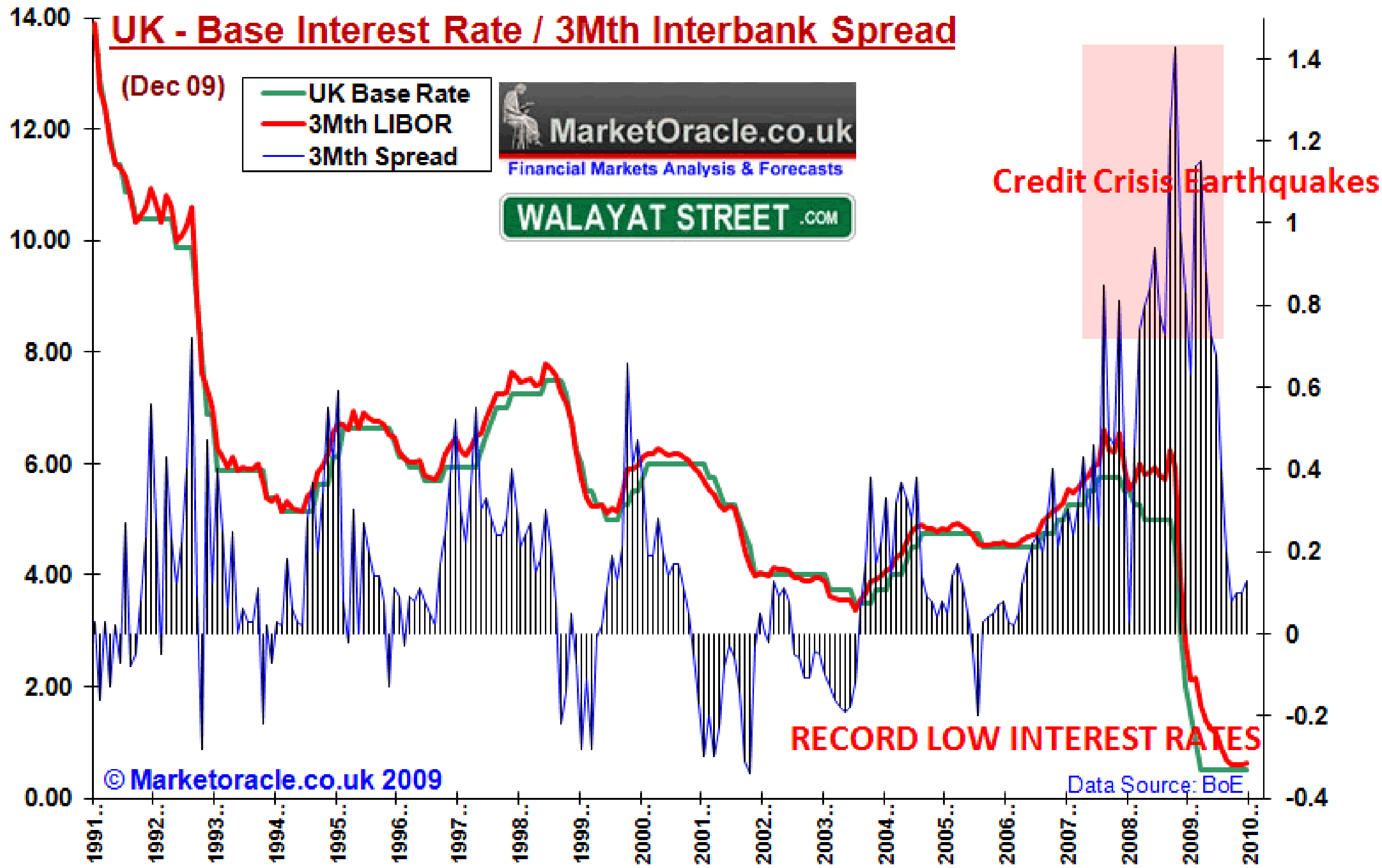
LIBOR / Base Interest Rate Spread Analysis

The below graph shows the spread between 3 Month LIBOR and the UK Base Interest rate.



The above graph illustrates that the credit crisis did not just appear out of the blue in September / October 2008 but began over a year earlier in August 2007 when the interbank money markets froze as a consequence of the fictitious mark to market valuations on sliced and diced collaterised debt obligations that the banks had created and accumulated. Whilst the central banks attempted to unfreeze the credit markets through a number of increasingly desperate actions during the subsequent 12 months however all of these measures failed which resulted in a series of credit crisis earthquakes culminating in the September 08 Lehman's bust which galvanised government's and central banks to literally throw everything they had at the crisis to force the inter bank interest rates down, which in the UK included cutting the base interest rate to virtually zero and pressing the monetary nuclear button of printing money and forcing the tax payers to guarantee more than £1 trillion of bad bank debt which has resulted in bringing the base rate / LIBOR spread down to within historic norms, but at huge cost to bank customers including borrowers and savers as the following illustrates.

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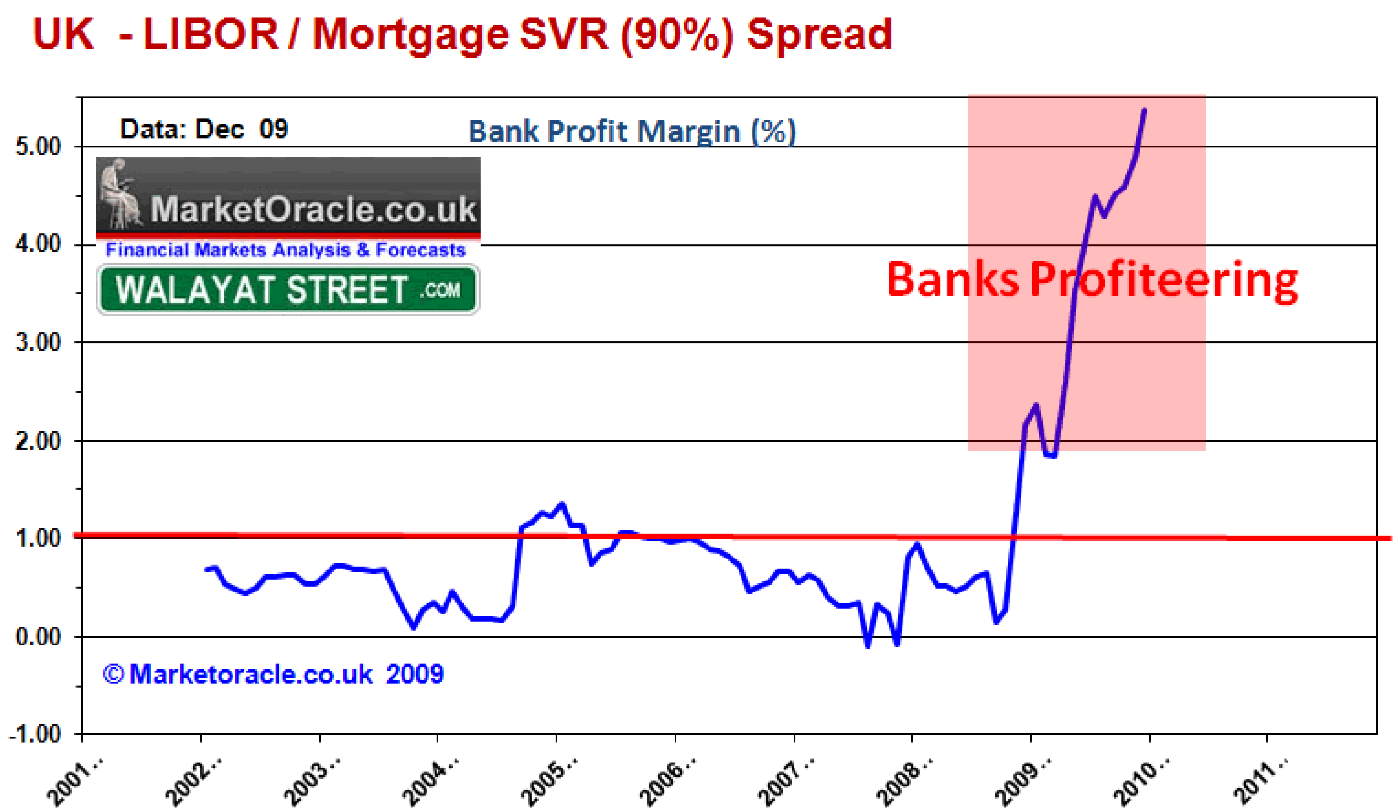
Banks Profiteering From Artificial Banking System

The artificial banking system means that the bill for rebuilding the bank balance sheets (and bonuses) is being paid for by Borrowers and Savers who along with all tax payers are being forced to pay for the bankster's crimes as tax payer bailed out banks such as HBOS pay a pittance on instant access savings accounts of as little as 0.1% against a requirement of 2.3% just to cover CPI inflation of 1.9% plus the 20% tax charged on interest whilst at the same time upping the rate on borrowers far beyond the illusion of low interest rates as presented by a base rate of 0.5% as the following graph illustrates the spread between the mortgage standard variable rate and interbank market rate resulting in a huge profit margin for the banks.



Money is being sucked out of the pockets of borrowers and savers and being deposited onto the balance sheet of bailed out banks that have no incentive to pay a decent rate of interest on savings when they can borrow at 0.5% from the Bank of England and marginally higher from other banks. The artificial banking system is resulting in unprecedented huge profits margins for the banks as market interest rates charged to retail borrowers continues to rise regardless of the base rate being held at 0.5% into 2010.

The big question is when will the Bank of England start to reduce this unprecedented artificial support for the UK banks. The marginal up tick in the LIBOR spread suggests that this is now underway to a small degree. However we are talking about a minute movement. The key indicator for a series of increases in interest rates will be when the spread rises to above 0.3 from the current 0.13, which considering the first graph suggests that this is not on the immediate horizon and therefore implies that we are still many months away from the first rate rise i.e. the trend is suggestive of no rate rise during the first half of 2010.

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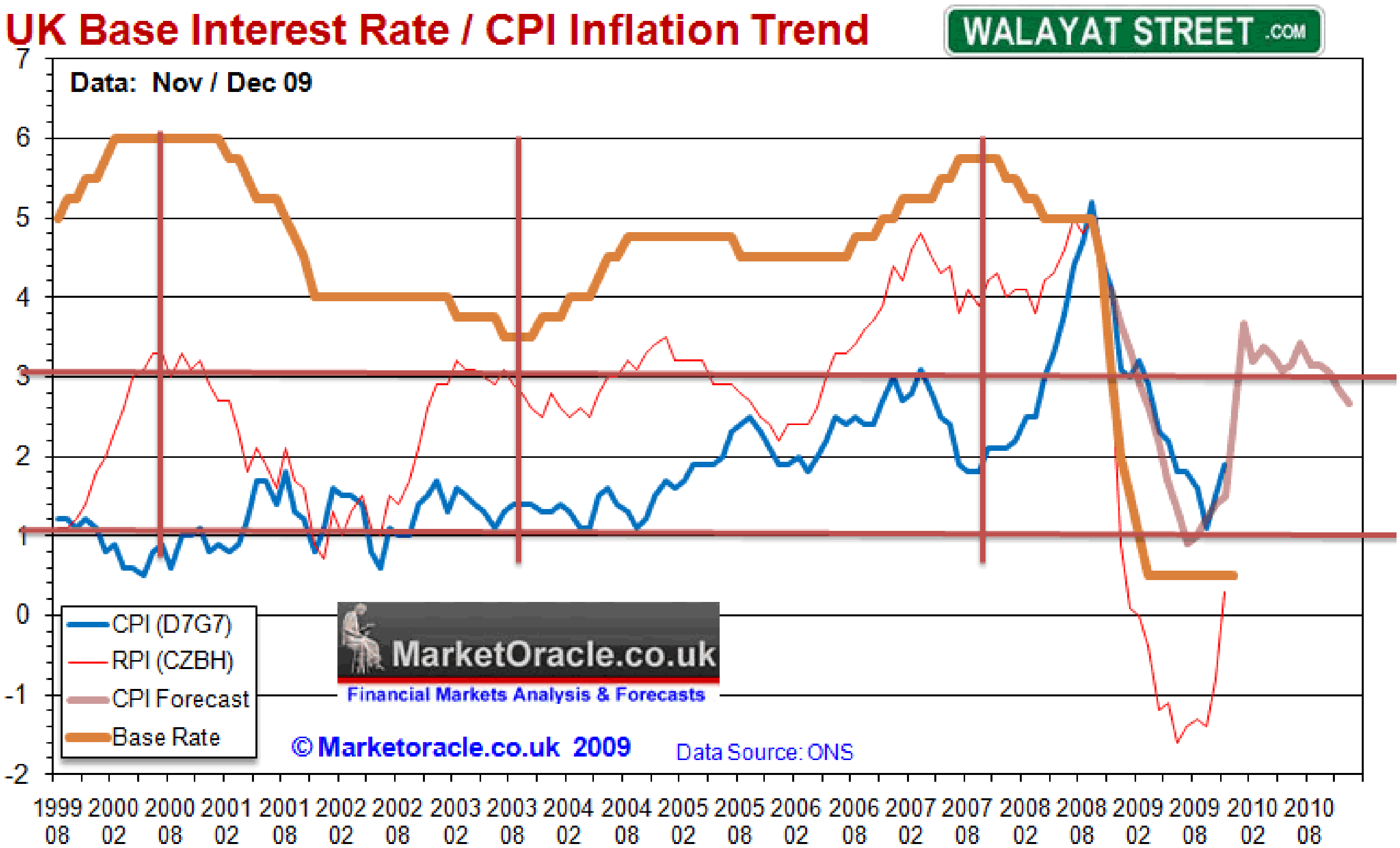
Do UK Interest Rates Lead or Lag CPI Inflation?

One of the Bank of England's primary objectives is to target UK inflation at CPI 2% in 2 years time and stay within a range of 1% to 3% through the use of monetary policy with the primary tool being interest rates. The consensus view is that when inflation is expected to rise then the Bank of England raises interest rates, and when the Bank of England expects inflation to fall towards its lower band then it lowers interest rates so as to boost economic activity and hence inflation. Therefore the purpose of this analysis is to confirm the role inflation plays in determining the Bank of England's primary objective of managing inflation and what it suggests for interest rates during 2010.

The below graph includes the Inflation forecast for 2010 as of December 2009 which projects towards a sustained trend to above 3% which on face value would imply the Bank of England should start raising interest rates.



The above graph implies that the Bank of England tends to react late to changing inflation and then continues the interest rate trend too far in the opposite direction which implies ever increasing volatility in the series. Given the already completed inflation forecast this implies that the Bank of England will respond much later than expected to rising inflation, though when it does respond it will continue raising interest rates even after inflation turns lower, which is suggestive of interest rates rising from mid 2010 and continuing into mid 2011,with smaller initial steps of 0.25%, throughout the proposed 12 month forecast rate rise cycle.

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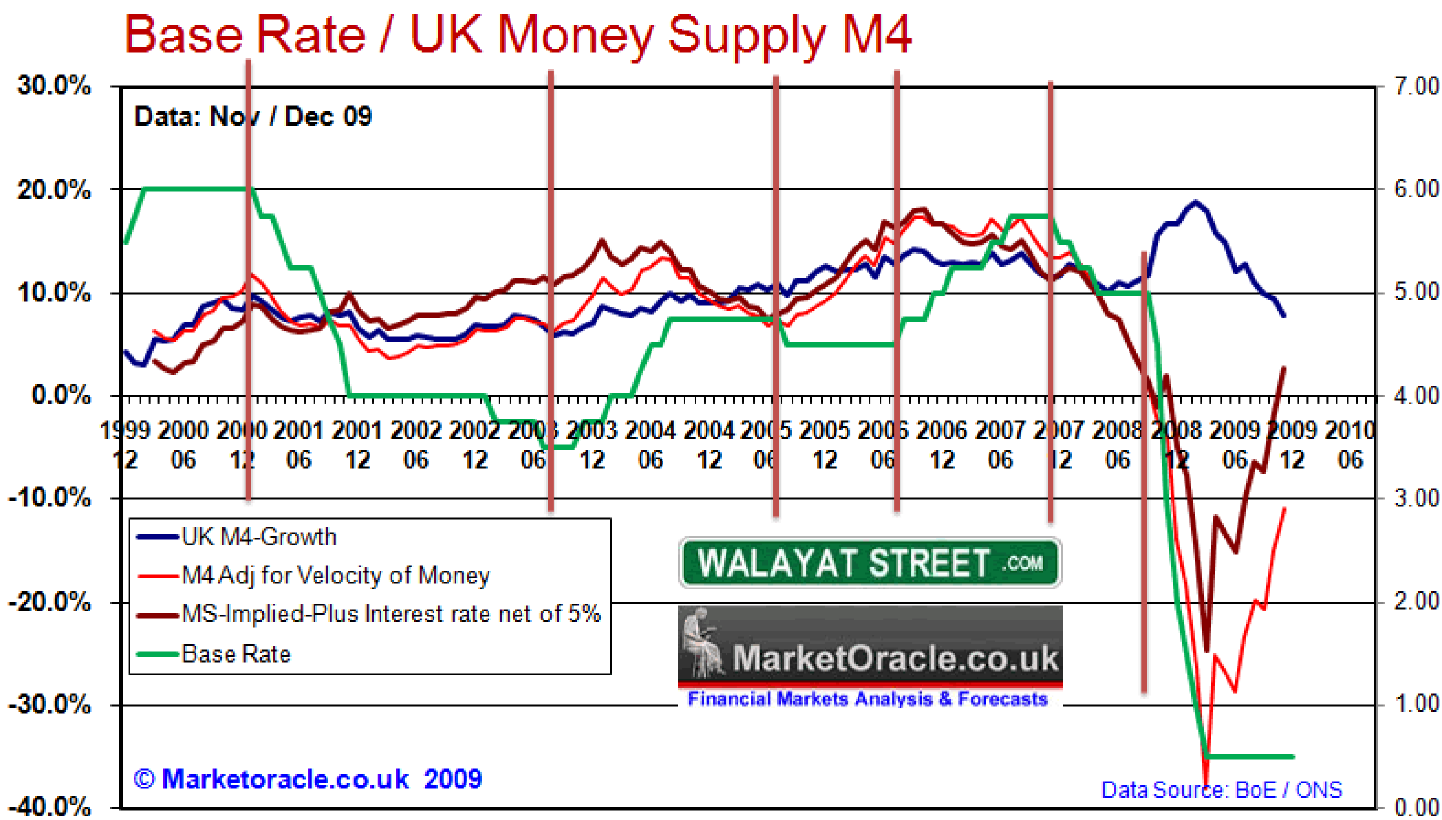
UK interest Rates and M4 Money Supply Relationship

The below graph shows UK M4 Money Supply and Money Supply adjusted for the velocity of money that takes into account the state of the UK economy i.e. an booming economy has a higher velocity of money and hence money supply has a more inflationary impact than an economy in recession where high headline money supply in reality is masking deflation rather than inflation as we saw during 2009.



The above graph shows some relationship between interest rates and the money supply adjusted for the velocity of money (red) in that when the M4 Adjusted is below 10% the Bank of England cuts interest rates and when it is above 10% the Bank of England raises interest rates.

The graph shows the consequences of extreme deflation into early 2009 which was followed by the unprecedented near panic interest rate cuts to 0.5%. The subsequent trend is resulting in a fast M4 recovery though which at this point remains negative, however the projected trend can be seen reaching the 10% level by mid 2010 and therefore implies UK interest rates may be held at 0.5% until mid 2010 before interest rates are gradually raised as long as M4 Adjusted remains above 10%. This also suggests should Adjusted M4 continue to accelerate well above 10% then the pace of rate rises could escalate further i.e. in 0.5% jumps.

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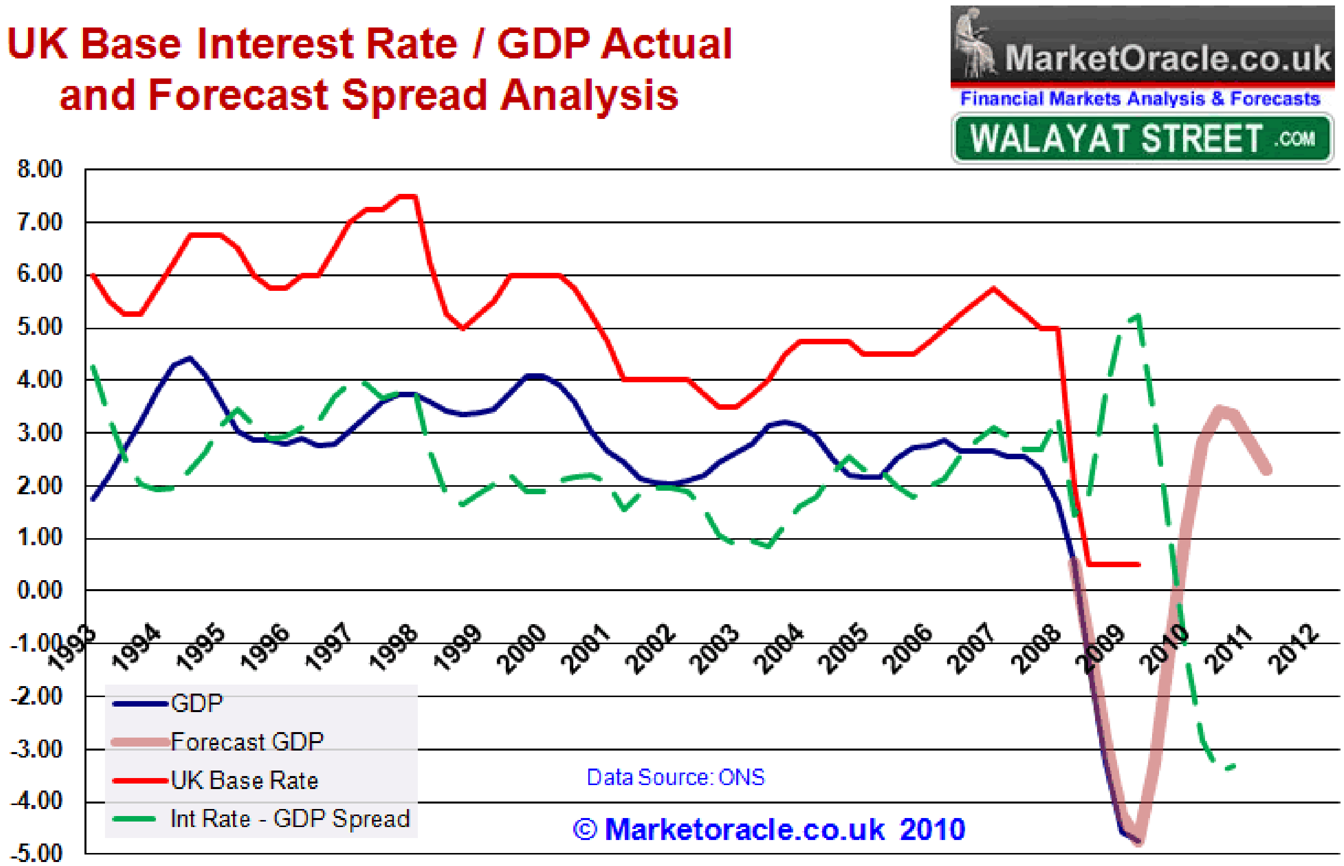
UK Interest Rates and GDP Growth Trend Relationship

The below graph shows UK Interest rates against annual GDP as well as the spread between the two. Also included is the current forecast trend for UK GDP growth for 2010 and 2011.



The above graph shows an average interest rate spread against annual GDP of 2%, with a wider range of 4% to 1% i.e. UK interest rates are normally expected to be 2% above GDP. The current spread as of Q4 estimate of -4.73% is at 5.25% which illustrates why the Bank of England embarked upon Quantitative Easing aka money printing in March 2009 as interest rates of 0.5% had little impact on the actual economy at the time due to the degree of economic contraction under way.

However taking the strong forecast GDP growth into account that projects to +2.8% for 2010 and +2.3% for 2011, then the current base interest rate of 0.5% will result in a swift plunge in the real economic interest rate to far below the trend of 2% and the low of 1%, which therefore suggests that the UK interest rate by the end of 2010 could be targeting 4% to stay within this range and rise to 4.5% by mid 2011. Off course this is dependant upon the strong GDP forecast growth of +2.8% actually materialising, nevertheless this analysis does suggest that even a mild economic recovery of below trend to +1.5% would still target an interest rate of at least 2%, therefore this analysis is suggestive of an end 2010 interest rate range of between 2% and 4%.

UK Quantitative Easing Money Printing to Hit £275 Billion 2010

The Bank of England cut UK interest to a historic low of 0.5% in March 2009 for the objective of boosting the economy so as to enable it to SELL government bonds, however this did not work as bond auctions started to FAIL in March, which therefore triggered the Bank of England to hit the panic button, igniting Quantitative Easing or Quantitative Inflation, having received the green light from the Government a few months earlier.

The initial print run was for £75 billion which has been steadily extended to £200 billion to date. Nine months on the phrase Quantitative Easing is bandied about in the press as though it is normal, however I cannot emphasis enough how big an event Quantitative Easing aka Money Printing is, QE is the biggest monetary event in the Bank of England's 315 year history, as once ignited it is difficult to wean an economy off of QE as government's fail to control the budget deficits that become endemic which demands a continuance of Q.E. and therefore risks igniting Quantitative Inflation and currency / market panics.

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QE Huge Boost to GDP

I have received a few emails critical of my strong UK growth forecast for 2010 of +2.8%, mostly from those that expect / hope for a double dip recession that would allow them a second opportunity to buy into the stocks bull market at near the bear market lows having missed the birth of the stocks stealth bull market last March, in that light the following may enlighten readers on the huge boost to GDP during the past 9 months:

Whilst approx £190 billion of the £200 billion of QE authorised to date has been deployed over the past 9 months. However the true implication of QE on the economy can be better appreciated when setting it against the recession that has seen a contraction of some 6.2%, as QE of £180 to £200 billion is equivalent to GDP of 14% to 16% i.e. far greater than the loss of GDP during the 15 month recession, and not forgetting that QE is just one part of the programme of huge Government deficit spending (14% of GDP) and near ZERO interest rates (Savers subsidised bailouts) and the over £1 trillion of bailed out banks bad debt liabilities, then direct capital injections of over £80 billion (6% of GDP) illustrates the extreme lengths to which the authorities have gone to, to bring the recession to a halt, which sows the seeds for above trend growth during 2010.

The Bank of England's Route towards £200 billion QE

The Bank of England embarked upon a programme of printing money or Quantitative Easing during March 2009 with an initial print run of £75 billion of a total set at £150 billion in an attempt to wave the central bank magic wand to increase the supply of credit. However as I warned at the time (5th March 2009: Bank of England Ignites Quantitative Inflation) that once started the Bank of England would continue printing money right into the May 2010 General Election targeting an print run of as much as £450 billion and therefore igniting Quantitative Inflation during 2010.

Virtually all of the mainstream press swallowed the Bank of England's hints and winks that Quantitative Easing had ended at £125 billion during the summer months, which at the time I stated was not possible (8th July 2009: Irrelevant UK Base Interest Rate on Hold as Real Rates have Already Begun to Rise)

> This confirms my view that the Bank of England will continue printing money into year end to beyond the current arrangement of £150 billion and probably as high as £250 billion.

I projected a Quantitative Easing total towards £250 billion by the end of 2009 with the actual total of £200 billion of money printed as a direct consequence of the Labour Government's objective of both aiming to maximise the number of seats retained at the next General Election as well as to deliver a scorched earth economy to the next Conservative Government. Therefore the Labour Government also wins because it gets to hide this Quantitative Easing debt as theoretically purchases and sales cancel each other out in the fantasy land of central banking accounting and feeble government auditing. I.e. by magic approx £200 billion of new government debt has vanished into thin air, for if had not been hidden under the carpet then UK Gilt interest rates would be much higher due to the increase in supply of approx 33%.

Asset Price Implications of the Potential End of Q.E.

Quantitative Easing being brought to an halt / unwinding of purchases would hit asset prices hard, i.e. we would see the Gilt bond market impacted as instead of purchasing 'most' of the government bonds the Bank of England would become its biggest seller with a lot of supply overhanging the market which would send the bond market into a tailspin and immediately hit the stock market that has soared in good part as a consequence of Q.E., similarly the bounce in UK house prices would soon evaporate.

This suggests whilst the BoE will repeatedly talk about ending Q.E. I just don't see it happening whilst the Government runs a budget deficit anywhere near as large as 15% even half of this would not be enough to end Q.E. So it looks like Q.E. will be here for many years as I originally voiced before Q.E. began. However as the asset markets stabilise at higher levels, the Bank of England rather than printing new money may force / entice banks and financial institutions to purchase more UK government bonds rather than further drive up stocks which is therefore suggestive of a tough year for asset prices.

Bank of England Forcing Banks to Buy Gilts

The official line of QE was to boost bank lending, however Q.E. is apparently having the opposite effect at the commercial banks as the Bank of England's twin objectives of monetizing government debt and for the bailed out banks to improve their balance sheets is in effect forcing the banks to BUY government bonds as Gilts are seen as the safest asset class and therefore boosts the Banking sectors credit worthiness in terms of capital ratios so instead of lending tax payer money loaned to the banks, the banks are using tax payer money to buy UK government bonds and put on short-term deposit at the Bank of England.

Surely this must be by design as the Bank of England's primary purpose is for the orderly management of the Government debt market, hence this is ensuring the maximum demand for a huge amount of debt issuance estimated at £225 billion for the current financial year, which includes new debt and maturing debt rolled over.

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Continuing Budget Deficits for Several Years

Even if the next government manages to implement significant policy measures to cut the annual deficit by £80 billion per year to approx £100 billion by means of tax rises, spending cuts and revenue from growth, against the Labour government's target of £162 billion. A deficit of £100 billion would still equate to about 8% of GDP, so would still require more money printing to monetize government debt of which approx £60-£70 billion would need to be monetized.

Bank of England Blaming Government, Seeking Greater Powers From Conservative Government

Governor of the Bank of England has been ever more vocal during 2009 in his criticism of the government's policy of only cutting the huge deficit over the next 5 years by half as clearly this is not a sustainable policy. However whilst Mervyn King is busy blaming others he needs to take a long hard look in the mirror at his own failure both before the crisis broke and right into the present day. The Bank of England has consistently shown itself to be an incompetent institution that tends to act too late to respond to both inflation and economic concerns which has directly contributed to the depth of the 2009 crisis. The truth of the matter is that the Bank of England had sat twiddling its thumbs during 2008 by keeping interest rates at 5% for far too long whilst the economy burned which pushed the economy over the edge of the cliff.

Also I should remind readers that interest rates were only cut in early October 08 when the Prime Minister effectively seized control of monetary policy by forcing the Bank of England to start cutting rates as illustrated by the first cut of 0.5% which was announced on October 8th 2008 by Gordon Brown himself from the Prime Ministers dispatch box in the House of Commons rather than by the Bank of England.

Mervyn Kings continuing criticism is even more outrageous in the run up to General Election as clearly his party political outbursts electorally favour the Conservatives, and probably helped by George Osbourne's recent comments that he would transfer even more powers to the Bank of England despite the fact that it consistently fails in its primary government set objective of keeping Inflation at 2%, as we will again repeatedly witness during 2010. Though the FSA charged with regulating the banks has been even less competent which despite knowing as a fact that banks such as Northern Rock and HBOS were lending 100% mortgages financed from short-term money market borrowings which resulted in an extremely high risk institutions, but the FSA FAILED to regulate the banks for several years in the run up to the August 2007 credit crisis and beyond.

QE is Just More Bankster Fraud

We were told by the politicians and the Bank of England that printing money was to boost the UK economy, however the primary purpose of printing money was to enable the banks to generate huge profits to rebuild their balance sheets, which they are doing. If the government wanted to boost the economy rather than bank profits then the government should have taken the £200 billion printed and given it to the 29 million or so of tax payers which would have resulted in a huge cash for consumption windfall of nearly £7000 per tax payer ! Now that WOULD have immediately boosted the economy ! Imagine 29 million people receiving a cheque for £7,000 each, imagine the resulting consumption boom that would take place. So the FACTS are that the £200 billion is for the purpose of bankster's to profit from then to boost the economy, which is what one would expect the BANK of England to do ! i.e. to support its brethren bankers then to consider the debt slave tax payers that are being forced to bail the bankster's out.

QE Money Printing 2010 Conclusion

QE will continue during 2010 until the Bank of England is sure that a. their brethren bailed out banks no longer risk financial armageddon, and b. That government debt issuance does not risk a Gilt bond market collapse.

My original estimate was for QE to rise to £450 billion over the next 5 years (from 2009), therefore I expect we will pass the half way point during 2010 as I expect the Bank of England will keep printing money for several more years.

The Bank of England's December 09 announcement that it would now buy and sell corporate paper to me suggests that the Bank is considering selling what little of corporate paper it has bought during the past 9 months in favour of supporting the Gilt bond market. Therefore I expect this coupled with further incentives for banks to buy gilts means much less QE during 2010 than 2009, which suggests a target total for 2010 of £275 billion, whilst at present academic economists and mainstream press suggest that there would be no further Q.E. beyond £200 billion and even that the Bank will seek to unwind QE during 2010 i.e.

> Bank set to close the £200bn printing press - Independant 8th Jan 10
> The Bank of England's £200bn quantitative easing (QE) experiment is set to come to an end next month, with the Monetary Policy Committee (MPC) yesterday voting to leave the scale of the scheme on hold. The remaining money in the programme will be exhausted by the time of the MPC's February meeting and it is then expected – barring shocks – to take the economy off its life support system.

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Though the mainstream press said basically the same thing last July when Q.E. was at £125 billion, as mentioned earlier.

Money Printing Theft of the Value From Holders of Existing Currency

Quantitative Easing is not a free lunch, the price of which is being paid for by savers as the supply of money increases so does it decrease the value of all currency, this is most clearly evident by two indices,

1. Sterling exchange rate against other currencies, though all currencies are engaged in competitive devaluation so probably something like gold is a better indicator, in this case 2009 saw a devaluation of about 20% with more to come during 2010.

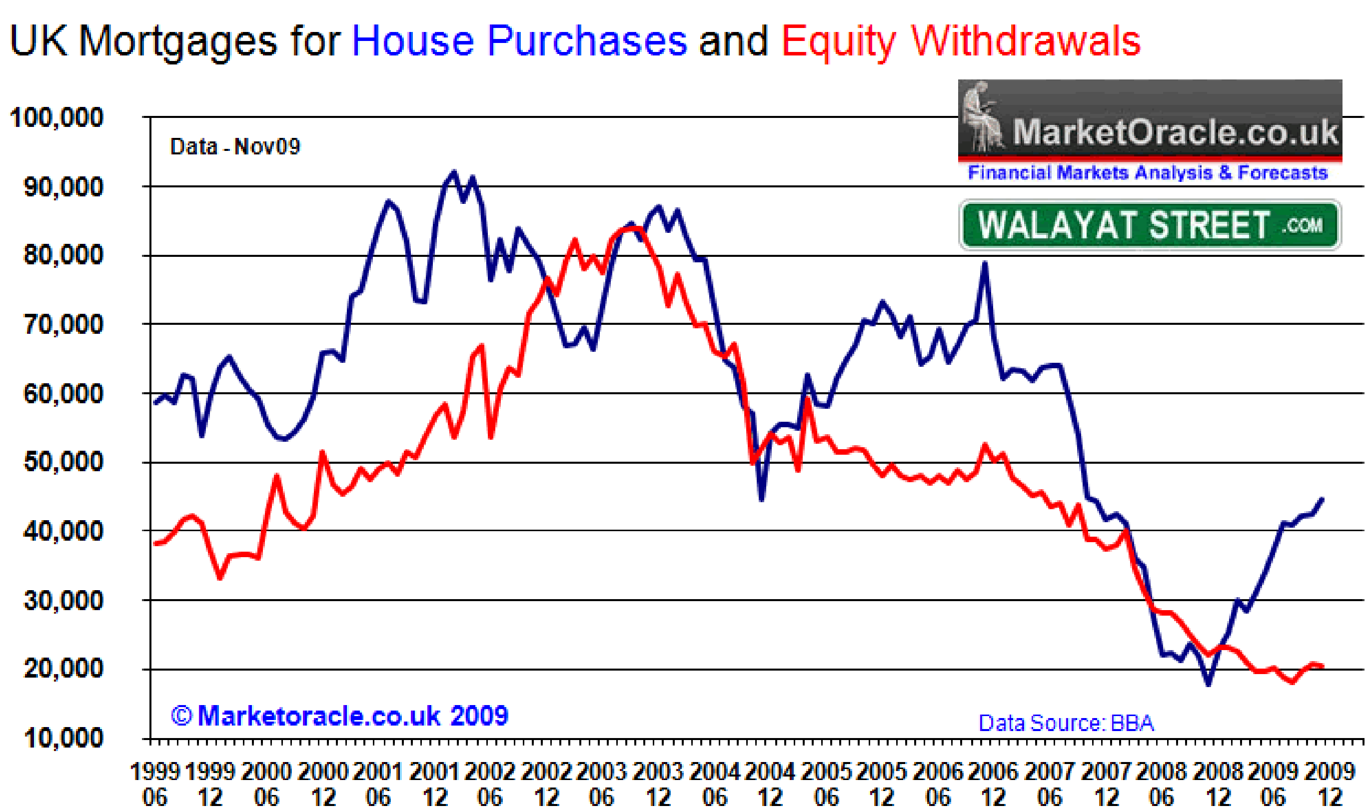
2. The inflation indices of which the Consumer Price Index is the government's preferred measure. Throughout 2009 and into 2010 we have seen the base interest rate BELOW the rate of CPI inflation which means NEGATIVE real interest rates i.e. your rate of interest is below the rate of inflation. This means that the bill for low / negative interest rates is being paid for by Savers who along with all tax payers are being forced to pay for the bankster's crimes as tax payer bailed out banks such as HBOS pay a pittance on instant access savings accounts of as little as 0.1% against a requirement of 2.3% just to cover CPI inflation of 1.9% plus the 20% tax charged on interest.

Implications for Interest Rates

The Bank of England is likely to be reluctant to raise interest rates whilst Q.E. continues. Which therefore suggests rates will only rise when the Bank of England is forced to raise rates by the markets as a consequence of risks of bond purchases. Which suggests 2010 is going to be a difficult year to forecast interest rates.

Improving UK Mortgage Lending Feeding the House Prices Bounce

The below graph shows UK Mortgage lending for House Purchases and Equity Withdrawals



The Government and Bank of England have succeeded in their primary objective of increasing both the supply of mortgages and lowering the interest rate burden on borrowers so as to bring the UK house price crash to a halt, which suggests that in terms of supply, the credit markets are starting to return to a LOW NORMAL state.

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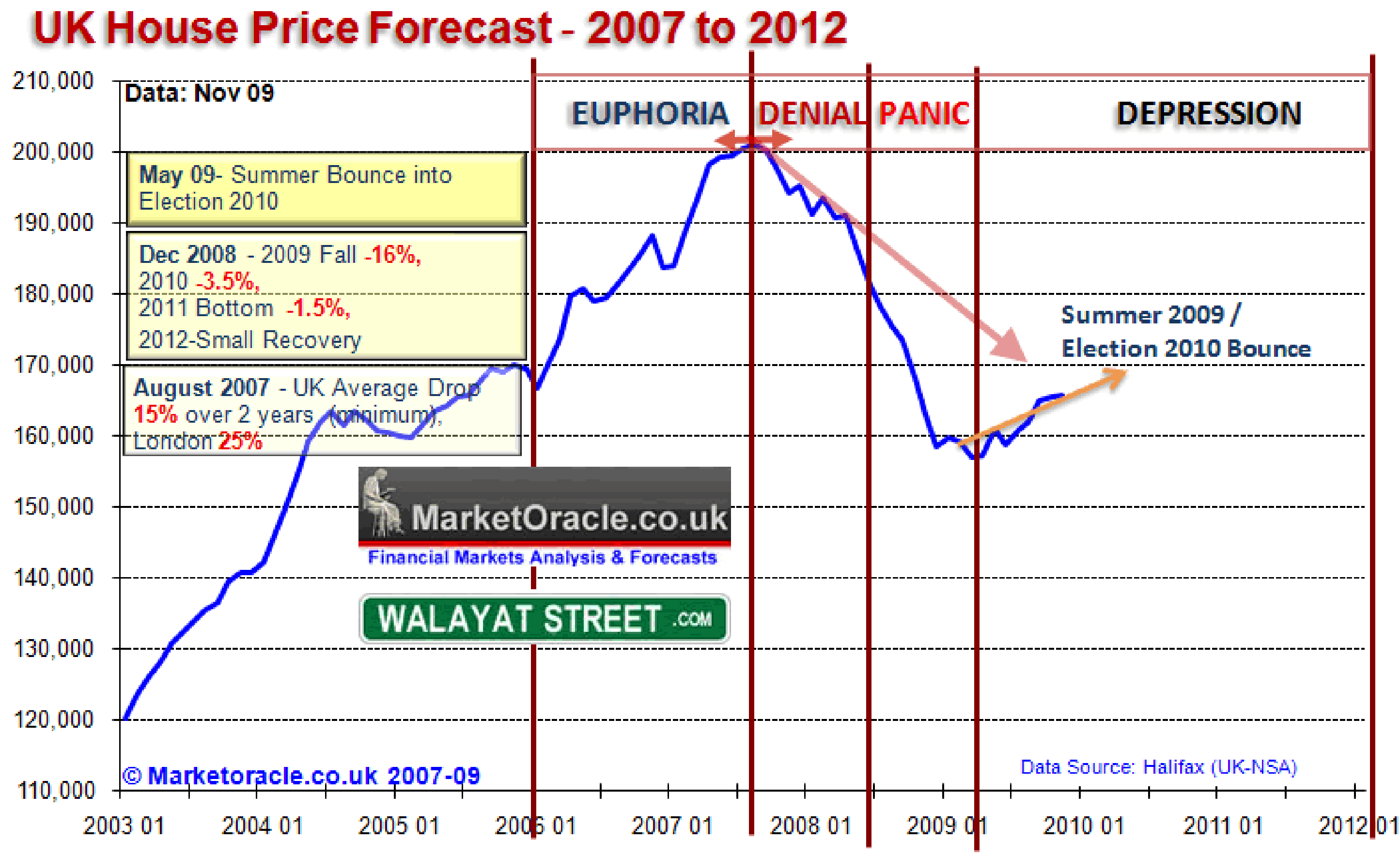

UK house prices have now risen by nearly 10% from the March lows as a consequence of unprecedented measures such as near zero base interest rate, mortgage banks arm twisting to limit repossessions and £200 billion of money printing. All of which leave the government's coffers empty and the Bank of England with little ammo to fire at future crisis which therefore suggests that the Bank of England should start to focus in the near term to tepidly begin to unwind the ultra loose monetary policy by starting to gradually raise interest rates though without wanting to unravel the work done so far in stabilising the banking system which therefore is suggestive of small steps spread out rate increases as the Bank of England adopts a cautious wait and watch attitude for any negative impact before each subsequent rate rise.

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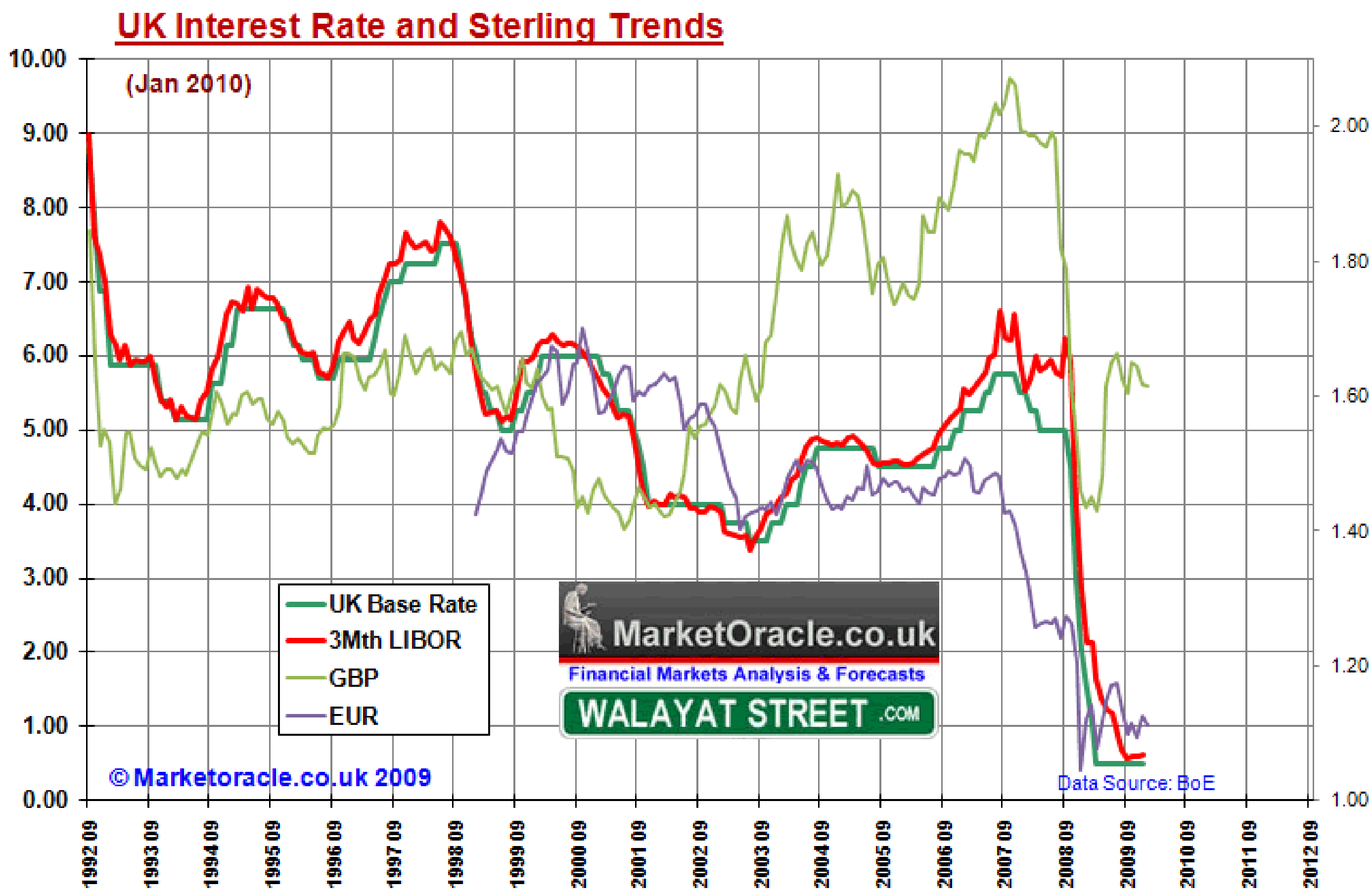
British Pound Trends and Interest Rates

The below graph shows the UK base rate and sterling trends against the U.S. Dollar and Euro to test the widely held hypothesis that Rising UK interest rates results in a rise in the exchange rate and conversely cuts in UK interest rates results in a fall in sterling.



The Pound / Dollar trend suggests that GBP tends to lead UK interest rates i.e. sterling has a tendency to rise against the Dollar ahead of UK interest rate hikes and a tendency to fall against the Dollar ahead of UK interest rate cuts. The most recent price action has seen sterling rally from £/$1.40 in early 2009 to above £/$1.60 as of the present which therefore implies that the currency markets are discounting future interest rate hikes.

The Pound / Euro trend suggests that the objective is aimed towards a stable exchange rate against the Euro i.e. less volatility, hence interest rates are used in an attempt to limit fluctuations as we saw between 1999 and 2007, as when the £/Euro rate was high at 1.60 interest rates were cut, and when the £/Euro was below the floor of about 1.40 then interest rates had been steadily increased so as to maintain the 1.40 floor. This is part of the Bank of England's objective of ensuring price stability by tracking the Euro.

However during 2008 and 2009 we saw a crash in sterling that traded to below 1.10 to near parity with the Euro as the Bank of England abandoned everything in the interests of preventing financial and economic armageddon. However as the banking system gradually stabilises, it is highly likely that Bank of England's focus will again shift towards price stability which means keeping sterling with-in a tight range against the Euro.

The £/Euro has managed to trend higher from near parity 12 months ago to today stand at 1.10. This is suggestive of a higher range then seen over the past 12 months i.e. a probable wide target range of between 1.10 to 1.30 against the Euro, therefore the current rate is at the floor which suggests a rise towards the target mid range of 1.20 which on face value suggests further downside trend is limited and more than likely that the Pound will rise against the Euro towards 1.20, which therefore suggests UK interest rates should be relatively higher than the ECB interest rate to reinforce this trading range.

In summary, the sterling trend is suggestive of the Bank of England targeting a £/Euro trading range of between 1.10 and 1.30, which is therefore suggestive of relatively higher UK interest rates against the Euro-zones which my next analysis will look at.

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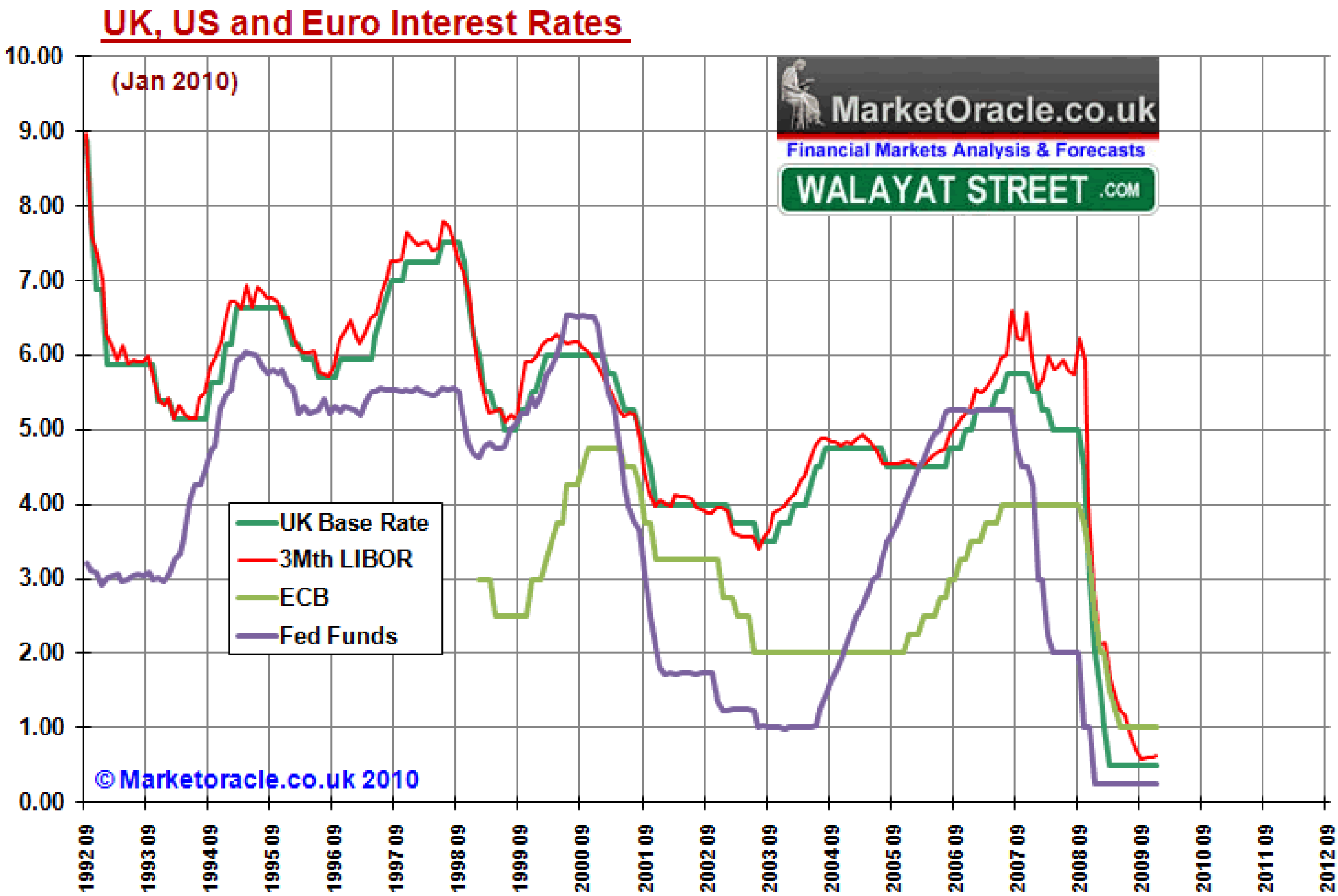
UK, U.S. and Euro Interest Rate Trends Analysis

The below graph shows the key interest rates for the U.K., U.S. and E.U. so as to determine any advance trend change signals for UK base interest rates during 2010.



Fed Funds - The above graph clearly shows that the U.S. Fed Funds rate usually acts as a leading indicator for U.K. interest rates both in terms of timing and in terms of trend. The current trend shows no sign of an imminent increase in the Fed Funds rate and therefore implies a UK base interest rate increase is not imminent either.

ECB - The European key interest rate trend shows a less volatile dataset then either that for the U.K. and U.S. which suggests a more cautious response to economic events, this is borne out by the tendency for European interest rate trend changes to lag both the U.S. and U.K. and therefore not particularly useful in signaling UK interest rate trend changes. However European interest rates are usually significantly below that of the UK interest rate due to less perceived risk, with a normal UK rate usually at least 1% above the European rate therefore at present would indicate a interest rate of 2% as a minimum.

Summary, U.S. Rate changes tend to lead UK rate changes, with UK rates usually at least at a 1% premium to either European or U.S. rates which therefore illustrates the current state of an artificial heavily subsidised banking system with no visible sign that the central banks are willing to return to a normal market at this point in time and therefore implying that the first UK interest rate hike still remains many months away.

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UK Interest Rate Forecast 2010 - 2011 Conclusion

The difficulty in arriving at an interest rate forecast conclusion for 2010 is that we have a heavily supported artificial banking system for the primary purpose of the near unlimited bailout of the banking sector. The problem in arriving at the forecast is that I need to look beyond economic indicators and put myself into the mindset of the scared officials at the helm of the Bank of England, who having tasted financial and economic armageddon are now so terrified by what they saw that they would rather continue to support the bankrupt banking sector for far too long and thereby allowing the bankster's to continue effectively stealing billions of tax payer cash as 'bonuses' and also allow price inflation to let rip as a consequence of printing money.

But against the petrified Bank of England, reluctant to do anything that may risk a return to financial armageddon, we have the market in the wake of a flood of government debt issuance that despite ever increasing quantitative easing demands higher interest rates, otherwise the Bank of England risks Gilt Auction failures which could trigger a sterling crisis during 2010. So it is both a tough balancing act for the Bank of England and a tough call for anyone to attempt to forecast UK interest rates for 2010.

So why forecast if it's so difficult this year ?

Well, because finance and investing IS all about forecasting the future, perhaps if the bankster's had registered this fact then they would not have been caught up in generating short-term fictitious profit reports to bank huge bonuses, when at the end of the day today's decisions should boil down to what one thinks is a probable future outcome so as to allow investment decisions to be made in the present.

The primary message from my accumulative analysis of inflation, economy and interest rates is that the Bank of England WANTS to swim in the warm waters of Inflation after the deep freeze of Deflation, which strongly implies that the Bank of England will IGNORE soaring inflation early 2010 and instead DELAY raising interest rates until it sees actual evidence of a strong economic recovery which my analysis suggests should transpire during the first half of 2010. Therefore the BoE will be focused on the quarterly GDP data, first Q1 to be released at the end of April 2010 and then Q2 to be released late July 2010. Which means that there is a high probability that the first rate rise may not materialise until August 2010. After which rates will be increased not in line with inflation but in line with improving GDP and other indicators of economic activity into the end of 2010.

As a final conclusion, I expect a presently petrified Bank of England to be gradually forced by the market to start raising the UK Base interest rate in small steps of 0.25%, with the first rate rise probably coming just before release of Q2 GDP Data (July) in June 2010 i.e. after the next general election deadline and then followed in August and September 2010 on further indications of improving economic activity. My concluding target is 3% by mid 2011, the difficulty is in saying where rates will be at the end of 2010 as the range is 1.5% to 2%.

UK Interest Rates Forecast 2010-11: UK interest Rates to Start Rising From Mid 2010 and Continue into end of 2010 to Target 1.75% / 2%, Continue Higher into Mid 2011 to Target 3%.

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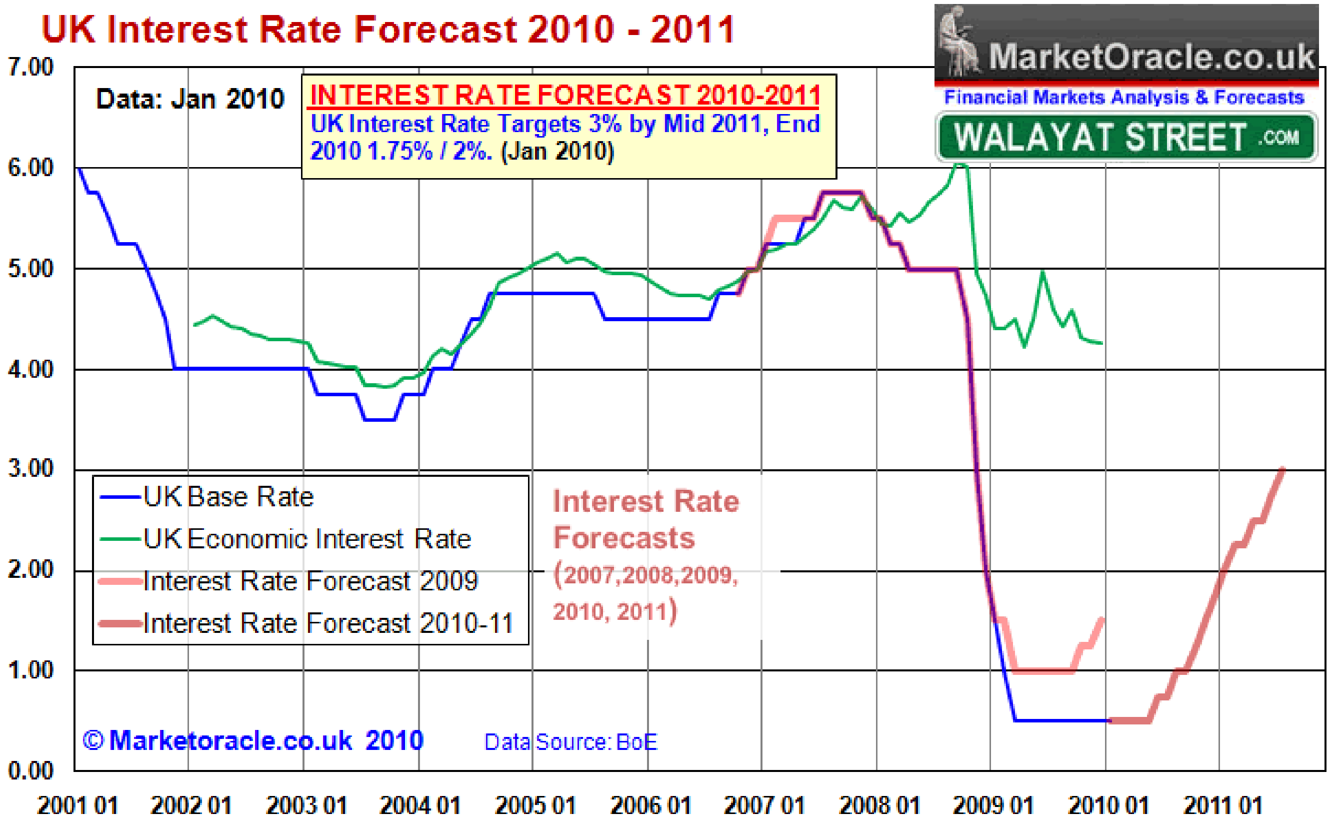

Press and Economic Organisation Interest Rate Expectations

Bank of England interest rates 'will not rise until late 2011' - Houseladder - 12th Jan 2010

> Alan Clarke, UK economist at BNP Paribas, says: "During 2011 GDP (gross domestic product) will be very sluggish, we will be in a soft patch and I think inflation will be very low." He argues that these factors will support the bank maintaining low interest rates for 2010 and much of the following year. According to the economist, the Bank of England will not change its mind and raise rates just because a positive GDP is seen. Roger Bootle, economic adviser to Deloitte, echoes Mr Clarke's comments predicting that interest rates will remain at below one per cent for the next five years.

No UK rate hike seen until Q4 2010, QE capped -Reuters poll - Guardian - 22nd Dec 2009

* Rates to rise to 1.0 percent in Q4 next year
* Quantitative easing programme capped at 200 bln pounds

LONDON, Dec 22 (Reuters) - The Bank of England won't raise interest rates from a record low until the fourth quarter of next year, according to a majority of 62 analysts polled by Reuters,

No hike in sight for interest rates - Interactive Investor - 7th Jan 2010

> "Whilst inflation is certainly rising and there are signs of growth and improvement in the both the services and manufacturing sectors, talk of a recovery is, as yet, far too premature. Until the Bank of England sees consistent evidence that banks are lending more regularly, interest rates will continue to be held at 0.5% until the beginning of 2011 at least."

The above implies a current consensus view that either UK interest rates will remain at 0.5% until early 2011 or a small rise in the fourth quarter 2010 to target 1%, against my target of trend of 2% on route 3% by mid 2011. Therefore watch how the press and academic economists will busily revise interest rate forecasts higher during mid 2010 AFTER the event, i.e. AFTER market interest rates have already risen to discount behind the curve Bank of England rate rises. Much as the press ran with the forecast by CEBR UK Interest Rate Forecasts 0.5% Until 2011, Below 2% until 2014 of October 12th 2008. Which I concluded at the time had a 90% probability of being wrong as a consequence of debt monetization of the 15% budget deficit that implied higher inflation and thus higher interest rates.

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Inflation Mega-Trend Conclusion and Opportunities From Crisis

The inflation mega-trend continues to gather momentum, fed by literally out of control budget deficits that are being monetized by the printing of money (electronically) by ALL developed countries, for example this year the UK government will issue £225 billion of debt or £3,750 per every man women and child in the country, this IS out of control borrowing that risks national bankruptcy that will manifest itself as ever higher inflation that looks set to accelerate over the coming years.

All of the developed countries are running huge budget deficits in the order of 10-15% of annual GDP which is resulting in the loss of value of all fiat currencies against which people MUST seek to protect their wealth. The huge official debt burdens of approaching and passing 100% of GDP (Real debt is many times higher than official debt) are not going to go away, the only way government's can respond to such debt is through competitive currency devaluations i.e. INFLATION.

The government's of the world have been busy writing unlimited cheque's to bailout the bankster's who they primarily serve, the only problem is ALL of the pain will be felt by ordinary tax payers and NOT the politicians, who as we saw in the UK during 2009 have been busy burrowing their snouts in the expenses troughs so as to ensure that virtually every day to day living expense is a freebie at tax payers expense whilst tax payers are about to be hit by huge taxes.

Meanwhile Deflationists continue to look to Japan as the example of what is to transpire, however all Japan has done is to set itself up for an ever bigger inflationary BUST, Japanese public debt is now over 200% of GDP, this debt will resolve into high inflation. The Japanese government's response instead of addressing inflation will be pour more petrol onto the inflationary fires and could spark HYPERINFLATION. That is where Japan is heading and we SHOULD NOT MAKE THE SAME MISTAKE. However that is what academics and journalists that delude themselves that they are economists continuously advocate i.e. Keynesian deficit spending without end.

Furthermore, low interest rates plus rising inflation amounts to THEFT FROM SAVERS and WORKERS and all existing currency holders, including bond investors, therefore the best strategy to protect ones wealth is to diversifying OUT of fiat currencies. This strategy must remain in force as long as government's continue to run budget deficits that results in more accumulated debt resulting in higher debt to GDP ratios and hence more money printing and inflation as part of a perpetual inflationary debt spiral.

People have been conditioned by politicians and the mainstream press to think that inflation is not only normal but it is good, it is NOT GOOD nor NORMAL, Inflation is a stealth tax on your savings and earnings that over time seeks to STEAL the value of all that you have accumulated during a life time of hard work which is why most pensioners in Britain retire with savings that have little real value, whereas if there were NO inflation ALL of your savings would retain the SAME value throughout your life.

Inflation is created by government's and the banking cartel by a number of means but primarily as a consequence of the fractional reserve banking system that effectively allows the banks to continuously conjure new money out of thin air that continues to erode the value of all existing money as manifested by near continuous year on year high growth in the money supply far beyond that which is necessary as a consequence of economic growth.

Furthermore whilst people are forced to link their earnings against the official inflation indices such as the CPI and RPI, the real rate of inflation is usually significantly higher due to the fact that over time successive government's have sought to raise the stealth tax on their citizens by means of manipulating the official inflation indices lower. This has been illustrated earlier in this ebook which shows that the real UK inflation rate usually tends to be between 1.5% and 3.5% above the official CPI rate.

You are reading this at the very beginning of the inflationary mega-trend that will probably culminate in an inflationary super spike many years from now, whilst many commodities have rebounded somewhat from the crash of 2008-2009, however we have yet to see the inflation mega-trend manifest itself in the various manipulated inflation indices of the world, especially as the consensus view amongst academic economists and the mainstream press is still that of DEFLATION. However once inflation manifest itself in these manipulated indices then watch as the wage price spiral kicks in and pushes fixed assets and scarce resource prices such as commodities to unimaginable heights over the coming decade.

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Opportunities From Crisis

The financial crisis that led to the stock and commodity market crash of 2008 - 2009 presented stock and commodity market investors with a golden opportunity to buy at bargain basement prices. Similarly the global sovereign debt crisis of 2010 looks set to generate enormous profit potentials to again buy assets at bargain basement prices, as of writing the headlines are concerned with the risk of a Greece debt default and a break up of the Euro. In my opinion investors should view crisis such as these as new potential opportunities to accumulate at rock bottom prices on any short-term price plunges against the long-term inflation mega-trend sensitive investments.

The current sovereign debt crisis is manifesting itself in those developed countries at greatest risk of default, namely Greece, Spain and Portugal which are showing an extremely wide yield spread against German bonds on the basis of one or more of these countries being ejected out of the Euro which in my opinion is not going to happen because the primary purpose for the creation of the Eurozone and Euro single currency is to avoid World War III by keeping Germany firmly locked into a European Union, therefore economic and financial considerations are of secondary importance which implies the risk of booting out any of the EU members due to economic factors is extremely low, thus the yield spreads present a huge current profit potential, this is but one example of how crisis present great opportunities to accumulate into.

Therefore Investors need to always keep in the back of their minds the potential investment opportunity whenever they see doom and gloom headlines of financial and economic armageddon in the mainstream press.

The next chapter seeks to give clear conclusions and precise forecasts for many key markets impacted by the inflation mega-trend, on how to protect and grow ones wealth for 2010 and many years beyond as a starting point for your own research, starting with the Agricultural commodities as the grains appear to be trading at ideal levels for long-term mega-trend accumulation right now!

To keep updated on the unfolding Inflation Mega-Trend, ensure you are subscribed to my always free newsletter (only requirement is a valid email address). You may also visit my extensive article and regularly updated analysis archive at http://walayatstreet.com

Your Inflation Mega-trend analyst.

Nadeem Walayat
31st Jan 2010

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CHAPTER 4

Financial and Investment Implications

Agricultural Commodities

Stocks and Commodities have boomed following the March 2009 lows, but grains have NOT ! They are STILL trading near the lows and therefore the grains are presenting one of those once in a life time mega-trend buying opportunities right now ! Read on....

Population Growth

The world population now stands at 7 billion, an increase of 50% over the past 50 years and is expected to increase again by another 50% over the next 50 years towards a target of 10.5 billion. However the forces that are expected to drive food and commodity prices ever higher are even more notable when one considers the growing size of the middle classes of emerging market countries such as India and China that will demand a similar standard of living to that enjoyed in the west that will result in the doubling of the worlds middle class within much shorter space of time and therefore resulting in a far greater impact on commodity prices than which is implied by the overall rate of population growth.

Whilst the population growth will continue to drive the price for all scarce commodities inexorably higher (allowing for seasonal variations), however the agri-food's sector in particular is expected manifest the inflationary mega-trend to a greater degree over the coming years, as no matter what happens to the worlds economies during the next decade as recessions come and go, an overall growing and more affluent world population will continue to increasingly favour a more varied and costly food diet. This therefore brings my first focus of the inflation mega-trend to agri-food's. Especially as wages tend to be far more sensitive to food prices than that for other goods and services, therefore world government's are expected to adopt inflationary responses to any future food crisis which will continue to feed the overall long-term wage / food price growth spiral at a higher velocity especially for the developing countries which is a strong contributory factor towards the inflation mega-trend.

Global Warming Mega-trend

The earth is not only warming but it has ALREADY increased by an average temperature of 1 degree ! a near unprecedented rate that continues to accelerate, this mega-trend is being borne out by changing weather patterns and severe impact on agriculture right across the world as deserts expand. Global warming is showing itself in rising foods prices. What this suggests is that the inflationary mega trend can be strongly exhibited in near across the board annual food price rises and therefore agri-food's should form an important part of the inflationary mega trend investing for the next decade.

On top of the global warming impact on commodities, we have the inflationary impact of increasing natural disasters as we witnessed with Hurricane Katrina, as government's respond to $100+ billion disasters by printing money as the world moves into a new generation of super storms more powerful than Cat 5.

Methane Hydrates Ticking Time Bomb

Whilst I in no way claim to be a climate scientist, however the threat posed from the release of methane hydrate deposits (mostly formed from dead plankton) situated around the world that is 20 times more potent a green house gas that co2 does require the world to sit up and take notice of the serious risks that Man made global warming could trigger a release of at least some of these methane deposits that could at the very LEAST DOUBLE the temperature increase upto that point as the gas is only stable at low temperatures.

However I cannot resist the being intrigued by the investment opportunity from a Natural Gas supply point of view, with the methane hydrate deposits situated right across the worlds coastal regions, especially clustering in Siberia, North and Central America, as well as to the North of Britain, which could literally supply Natural Gas for at least another thousand years.

Agricultural Commodity Trends

Therefore the expectations of continual year on year increase in demand against the extreme difficulty of expanding supply supports the view that the food sector will be most likely to experience significant inflation over most other commodity groups. On top of demand for human consumption we are also witnessing existing food production being increasingly utilised towards the production of bio fuels such as ethanol, which further supports my mega-trend view that this is one of the key sectors that will experience serious and sustained price inflation.

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Most of the soft commodities (cocoa, coffee) production occurs within developing countries that are more prone to supply side problems due to weather, and internal stability than Agricultural commodities the production of which is concentrated across the developed world. The implications of which are that soft commodities are more prone to price spikes and greater volatility than agricultural commodities, the supply of which is better able to respond to changes in demand and thus resulting in less volatile price trends. Which therefore suggests investors should concentrate on accumulating positions in agricultural commodities as part of the inflationary mega-trend over soft commodities as whilst soft commodities present opportunities more for traders that are able to take advantage of the greater volatility.

Whilst cyclical bear markets will come and go as speculators jump onto seasonal trends across the agricultural commodities, however the underlying long-term trend for virtually all commodities is for prices to continuously ramp higher towards new all time highs. Therefore a good long-term accumulation strategy is to take the view that the further a commodity falls from its all time high the better the long-term investment accumulation opportunity it presents.

How to Get Exposure to Food Price Inflation

In my opinion, the easiest and safest way for investors to gain exposure to the long-run food price inflationary mega-trend is via ETF's of which the number available is constantly growing. However I would first concentrate on ETF's that give exposure to a wide basket of Agri-food's so as to iron out short-term price volatility in any particular commodity as is often the case especially where the soft commodities are concerned.

One of the largest and most liquid ETF's is the Power Shares DB Agriculture Fund (DBA) which covers a basket of food commodities including Cattle, Cocoa, Coffee, Corn, Cotton, Lean Hogs, Soybeans and Oil, Sugar and Wheat. The commodity price collapse as a consequence of the financial crisis of 2008 has been followed by sharp rises in the metals, and oil commodities, but has yet to be experienced in the majority of the Foods as the following graph of the DBA ETF illustrates.

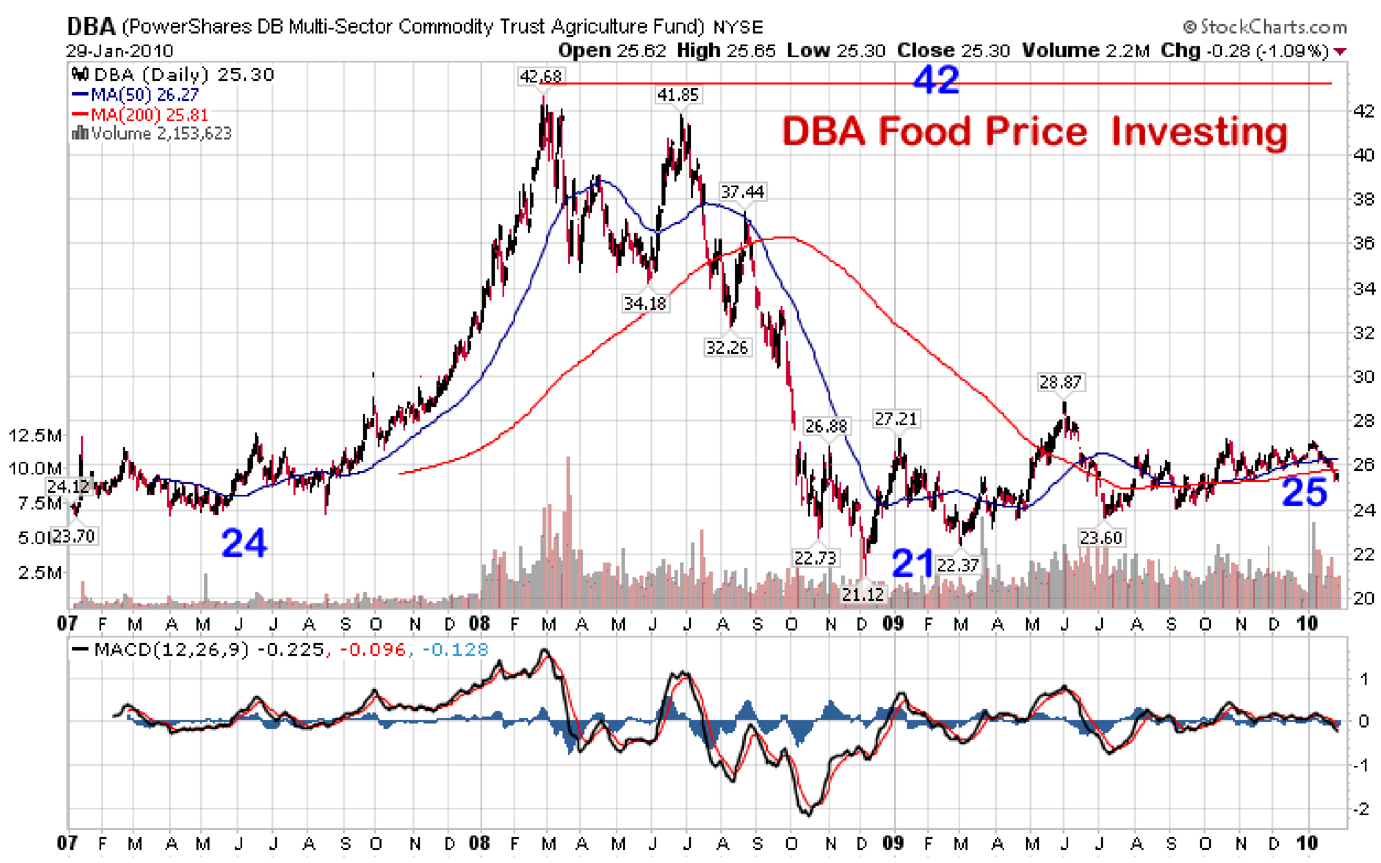

Chart courtesy of StockCharts.com

Whilst DBA is one of many ETF's that you could use as a starting point for their own research. However I should warn readers to ensure they steer clear of leveraged ETF's that are extremely high risk where investors can lose money even if the underlying commodities move in the right direction as I elaborate upon in a later section on Natural Gas. Also to steer clear of small, illiquid ETF's and ETN's.

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For UK Investors who may not be able be to invest in some U.S. ETF's, alternatives are available such as AIGA which tracks the DJ-AIGCI commodities index and has shown a similar performance to the DBA, again when selecting ETF's ensure to check the actual performance of the ETF against the underlying index and ensure that the ETF is liquid.

In conclusion, as mentioned earlier and in the context of a long-term investment, the grains in my opinion are presenting just as good a opportunity to buy now as the metals and stocks were during early 2009. Now I am not saying that they will immediately rocket higher, and may even not respond for the whole of 2010, BUT they will at some point over the next few years PASS their all time highs.

Borrowers and Savers

BORROWERS

Firstly do not forget that the primary purpose of the banking sector is to turn everyone (including government's) into debt slaves. So the first objective is for people to implement a plan to FREE themselves from DEBT SLAVERY. The artificial banking system is currently running on a huge profit margin which means borrowers are paying through the nose despite a 0.5% base interest rate and 0.63% interbank rate i.e. borrowers are paying many multiple of times in excess of the rates banks borrow at, from mortgages with SVR's hovering around 6%, to personal loans of 10% to 15% to credit cards of 20%+, which are generating huge profits for the tax payer bailed out banks supposedly for the purpose for the banks to rebuild their balance sheets but as we are again witnessing is in significant part being pocketed by bankster's as bonuses for profits that ONLY exist because of the tax payer cash.

So given the fact that the banks are already running on huge profit margins, therefore I do not see much change in rates for most borrowers during the year as the interest rates charged are already excessively high which effectively discount a much higher base interest rate north of 4%, which means there is plenty of scope for borrowing rates to actually fall during the year rather than to rise.

Mortgages - Most people can only get on housing ladder with a mortgage, therefore the prime consideration for borrowers is in able to service the loan, in this regard the long standing but often broken rule of not borrowing more than X3.5 salaries should be at the forefront of ones mind. This rule is not to prevent you from buying a bigger house, but to prevent you from LOSING your current home. That, coupled with a minimum deposit of 25% should signal when someone is ready to buy. If someone only has a 5% deposit or not enough income, then to be blunt you should NOT be considering to buy a house. I will cover the UK housing market in depth in my next ebook. I expect mortgage interest rates to be little changed for most borrowers. However those that are the most desirable customers in terms of credit risk are likely to see the rates on the best products rise marginally.

Pay Day Loans - During the great recession many pay day loan outfits have sprung up that offer to fill the gap between each pay cheque with near instant small loans of upto £1000 that borrowers are further enticed to roll over into the next pay day. To be blunt, if you are considering these types of loans then you might as well put a gun to your head for all of the distress they will eventually cause you. Whilst the base rate is at 0.5%, pay day loan outfits are charging over 2,000% APR. These types of loans should be illegal in Britain but they are not, which just illustrates how inept the financial regulator is in allowing ordinary citizens to fall victim to 'legal' loan sharks. If the FSA had the best interests of the general public at heart then it would lobby the government to introduce legislation to CAP ALL interest rates at base rate plus 10%. Yes it would mean that the financially illiterate presently taking on extremely high risk loans would usually be denied loans due to the risk / reward factor, but that is how it should be.

SAVERS

After the wipeout of 2009 when savers subsidised the bailout of the banking sector through ultra low interest rates of as little as 0.1%, 2010 should see some decent recovery in nominal savings rates and hopefully in real rates of interest as well (after inflation and taxes). The best variable rates are usually 1% to 1.5% above the base rate. Fixed rates offer a premium of approx 2 to 3% depending on the term fixed. So by the end of 2010, this is suggestive of a variable interest rate in the region of 2.75% to 3.5% and fixed rates of between 4% to 5%, which should take place BEFORE the first base interest rate hike as market competition will move ahead of the curve to discount future interest rates mid year. This suggests savers are probably better off NOT fixing now in advance of rising market savings rates by the time of the first base rate hike.

Cash ISA's - Whilst NOT an inflation hedge, however they do allow savers to receive interest payments tax free in perpetuity (until death) and provide a hedge against future tax rises which will soon hit all income brackets. Currently, the equivalent taxable return on a 3% cash ISA for standard rate tax payers is 3.6%. For higher rate tax payers it is 4.2%.

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The cash ISA allowance is currently £3,600 per annum which is set to rise to 5,100 from 6th April 2010. Savers need to shop around before depositing as there is a wide spread in interest rates offered between institutions.

Foreign Banks Offering Higher Rates - Remember Iceland ? Stay with British institutions which is both good for Britain as well as depositors, because if a foreign institution goes bust and then the foreign government defaults on its obligation to pay (as Iceland has apparently done) then the British tax payer will be black mailed into stepping in to cover this money as the consequence of not doing so would result in a run on virtually all banks.

Inflation Index Linked Bonds - Whilst traditional government gilts may fall in price, index linked bonds linked do the RPI index may buck the trend to some degree, which depends on how high this measure of inflation actually goes, since the RPI is more volatile than the CPI then I would expect it to spike significantly higher than the CPI and with an overall long-term tendency to trade higher than the CPI. Therefore offer good inflation protection. Though index linked bonds are investments, rather than deposits and thus do require monitoring for entry and exit timing to maximise returns and limit risk, they are not a buy and forget, not unless all you want to do is secure index linking into maturity.

Strong interest in index linked Government bonds is also illustrated by the fact that the Bank of England's own staff pension fund has tripled its holding of Index Linked Gilts to 70% of the total fund.

Inflation Index linked Certificates - These are issued by the Government's National Savings bank. The certificates offer a bonus interest rate on top of the RPI inflation index which is dependent on the term bought, typically paying between 1% and 1.5% interest on top. These are ultra safe government backed savings without any risk to the capital that provides a good hedge against inflation loss as measured by RPI.

These are probably the best suited for those that want to hedge against inflation but do not want to carry any capital loss risks or want any of the responsibility of having to monitor bond price movements for timing of entry and exit. And last but not least there is a tax advantage to investing in Index linked certificates which especially benefits the higher rate tax payers.

UK Gilts / Government Bonds Generally - Rising inflation and large persistent budget deficits are ultimately a killer for government bonds, therefore despite the illusion of being the safest investment in the land i.e. in terms of the virtually zero risk of default, however what you will see increasingly over the coming years is that UK gilt yields will have to rise i.e. falling bond prices. The bond market is not going to continue to put up with either the large budget deficits or the Bank of England's Quantitative Easing smoke and mirror bond purchases. However if you do want invest in government bonds then it should be at the shorter end of the yield curve with the objective of holding the bonds into maturity to ensure you avoid next capital loss (net of interest earned against the market yield).

It is amazing that despite the fact that government bonds are the worst place to be invested in that many trillions have been parked in them. Whilst I understand China and Japan's strategy as a consequence of currency manipulation, what I fail to understand is the behaviour of investors and pension funds having such a large exposure to government bonds, perhaps they have yet to wake up to the inflation mega-trend that will seek to destroy the value of the capital after all over the last 100 years virtually all fiat currencies have lost 97% of their value.

But Government bonds are probably the worst place to be invested, not for 2010 but for many years. So do not be deluded by current government bond market stability for it is an illusion as a consequence of money printing monetization of government debt which IS sowing the seeds for future inflation that erodes the real value of capital invested in low interest bonds over real time and when interest rates rise, as they surely will so will the actual price of longer dated bonds fall significantly (unless held into maturity).

As with all markets, there will be a once in a lifetime investment opportunity to invest in government bonds, that will be when inflation and interest rates are high thus resulting in very high bond yields, i.e. as occurred during the earlier 1990's. But that time is NOT now.

British Pound

The British Pound analysis as part of the Chapter 3 UK Interest Rate Forecast, that built on the analysis of 26th December 2009 expected sterling to weaken against a strong U.S. Dollar, eventually targeting a rate of £/$1.40 on break below of the trigger level of £/$1.57, whilst at the same to strengthen against the Euro to rally from 1.10 towards a mid trading range target of £/Euro 1.20 that could even spike as high as £/Euro 1.30.

U.S. Dollar Bull Market

Many analysts have only recently begun to wake up to the reality of a bullish trend expectations for the U.S. Dollar having missed the boat with relentless and persistent calls of a U.S. Dollar crash for the past 2 years that NEVER materialised, with the "black swan" excuse repeatedly trundled out to explain away the reason for consistently being wrong on the dollar.

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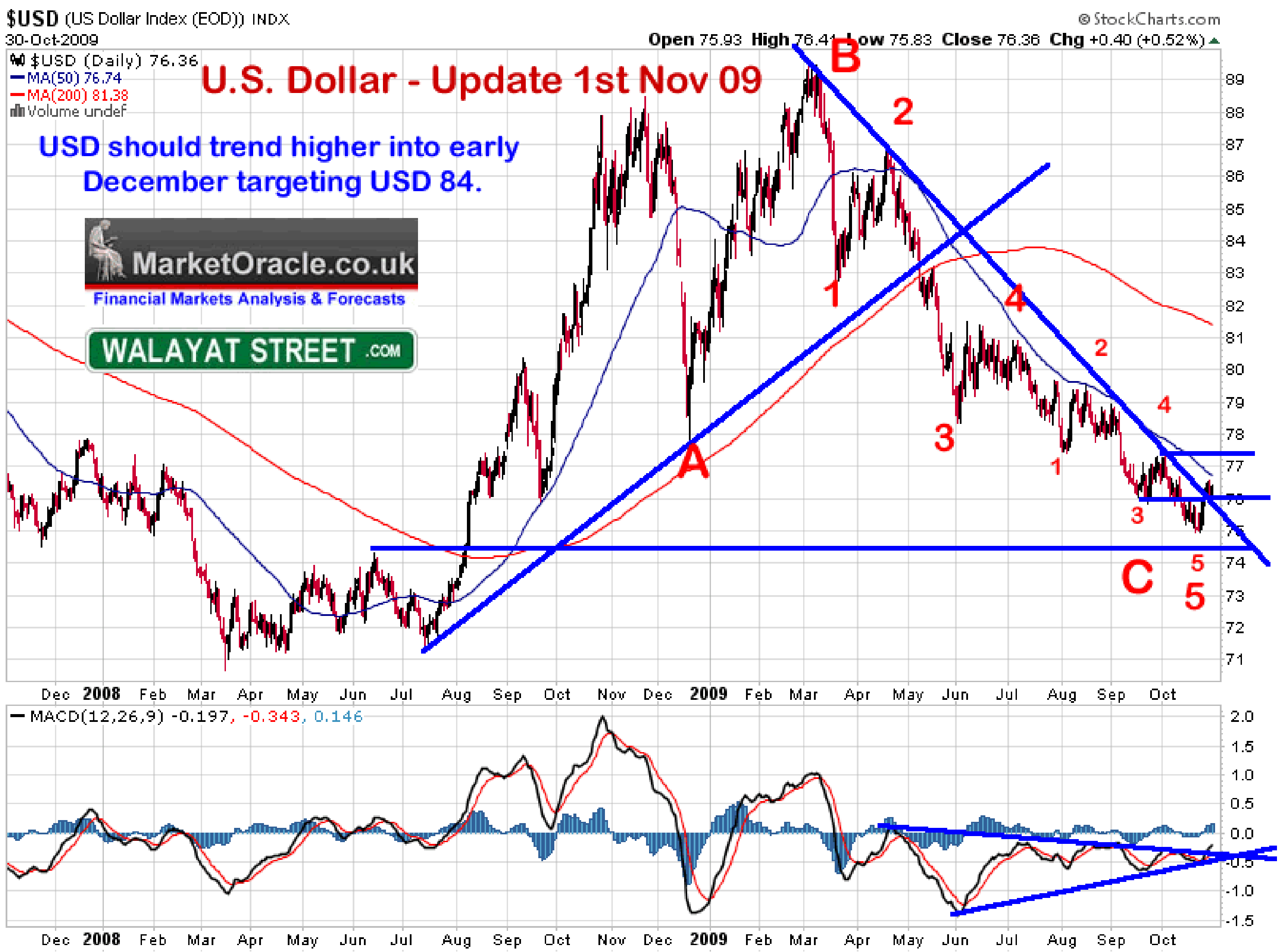
Though off course a dollar rally amidst the inflationary mega-trend which depreciates all currencies is just a function of the fact that the other currencies are depreciating at a faster rate!

However, I did correctly identify the trend for a U.S. Dollar bottom way back in March 2008 which subsequent analysis has continued to confirm and support in the face of continuous calls of a collapse to new lows as the following illustrate -

Summary of Key USD Bull Market Analysis

- Update - 1 March 2008 - Dollar Bear Market Bottom called, initial target of 80. (DELEVERAGING- Gold and Commodities Teetering on the Brink of a Bear Market?)
- Update 2 - August 2008 - Dollar Base building complete - breakout targeting USD 80 (The US Dollar Bull Market)
- Update 3 - October 2008 - Expecting USD to correct after rallying to between 87and 90, targeting support at 80, to be followed by a resumption of the up trend targeting USD 92. (U.S. Dollar Bull Market Update)
- Update 4 - January 2009 - USD Sideways consolidation trend into July / August 2009 (US Dollar Bull Market 2009 Update 4)
- Update 5 - August 2009 - USD Attempting to bottom above 75, for a trend to 90 by year end (U.S. Dollar Bull Market Trend Forecast 2009 Update)
- Update 6 - November 2009 - USD failure to rally to date and weakening trend at 75, concluded in a revised dollar target of 84. (U.S. Dollar Bull Market Scenario Update)



The U.S. Dollar has since rallied off of the lows at just above USD 74 to presently stand at a new high for the move of 79.50, which is a weak rally given the time taken to reach current levels, therefore remains on target to reach 84 within the next few

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months, after which a correction can be expected to bring the USD back towards 80. The 3 month or so bullish dollar trend therefore is suggestive of weakness for stocks and commodities going forward due to the inverse relationship. Though Gold, Stocks and the Dollar have all managed to rally since October 09 which again is a function of the inflation mega-trend i.e. on going depreciation of all currencies against scarce resources and assets.

British Pound Trend Forecast

The implications of a USD trend towards 84, therefore implies that GBP is expected to break below the £/$ 1.57 trigger level over the next few weeks to enter a new trading range if between to £/$1.57 and £/$1.40 for most of 2010, with the initial expectation of a trend to below £/$1.50 towards the £/$1.40 floor as illustrated by the below graph for 2010 :

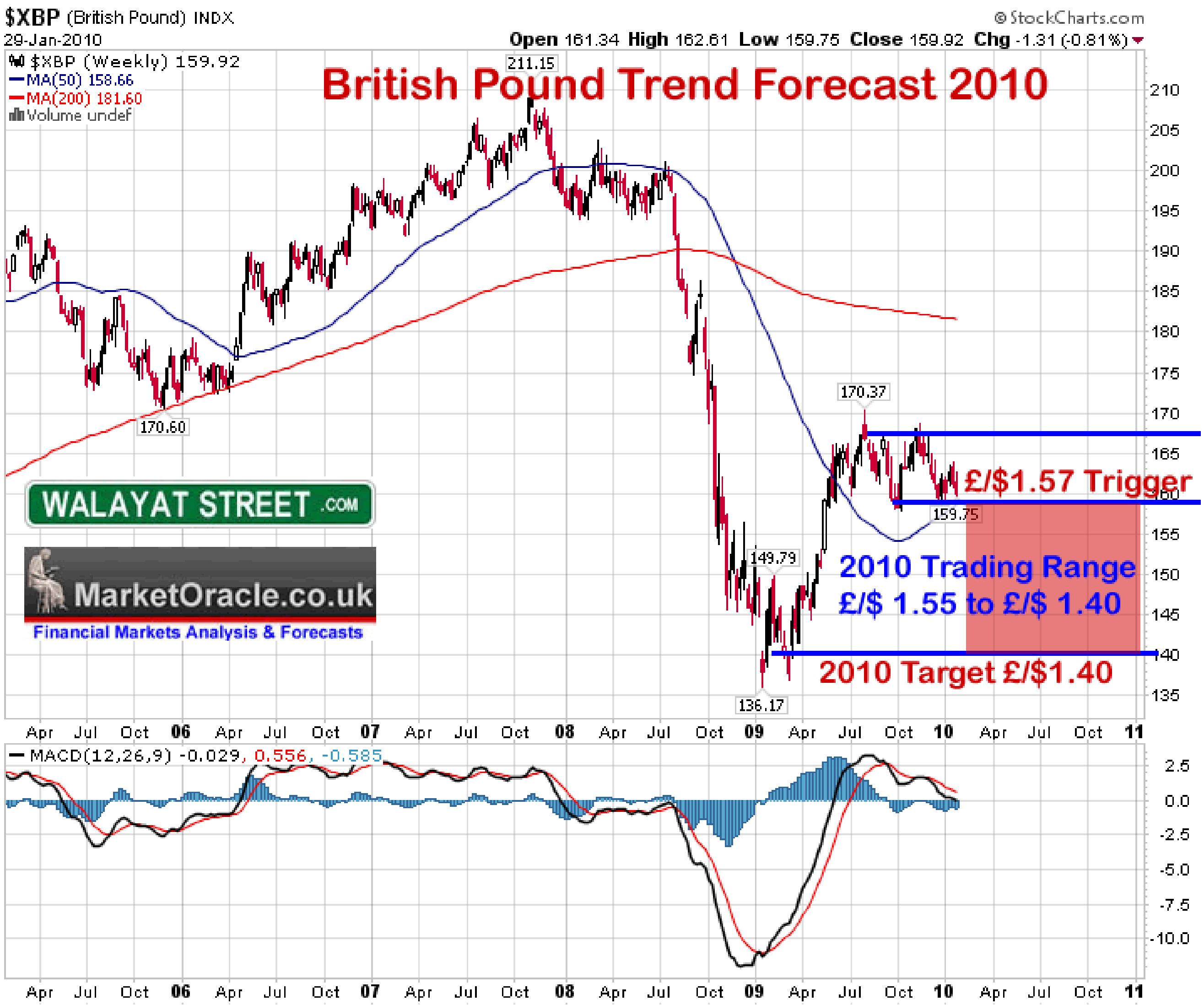

Chart courtesy of [StockCharts.com]

The trend expectation therefore remains little changed from the from the original forecast of [26th December 2009 -British Pound GBP Forecast 2010 Targets Drop to Below £/$1.40]

1. That sterling is targeting immediate support at £/$1.57 which implies it may temporarily bounce from there back through £/$1.60 before the eventual break.

2. That a break below £/$1.57 would target a trend to below £/$1.40.

On a longer term view, the chart is indicative of trading range between £/$1.57 and £/$1.37, on anticipation of the eventual break of £/$1.57. On average this implies a 10% sterling deprecation against the trend of the preceding 6 months or so.

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And the 13th Jan 2010 UK Interest rate analysis that concluded for Sterling strength against the Euro. Therefore sterling weakness against the Dollar but strength against the Euro implies that the Euro-zone may come under serious pressure in its own right during 2010 as a consequence of the developing debt crisis amongst some of its Euro zone members such as Greece.

Emerging Markets Investing Mega-Trend

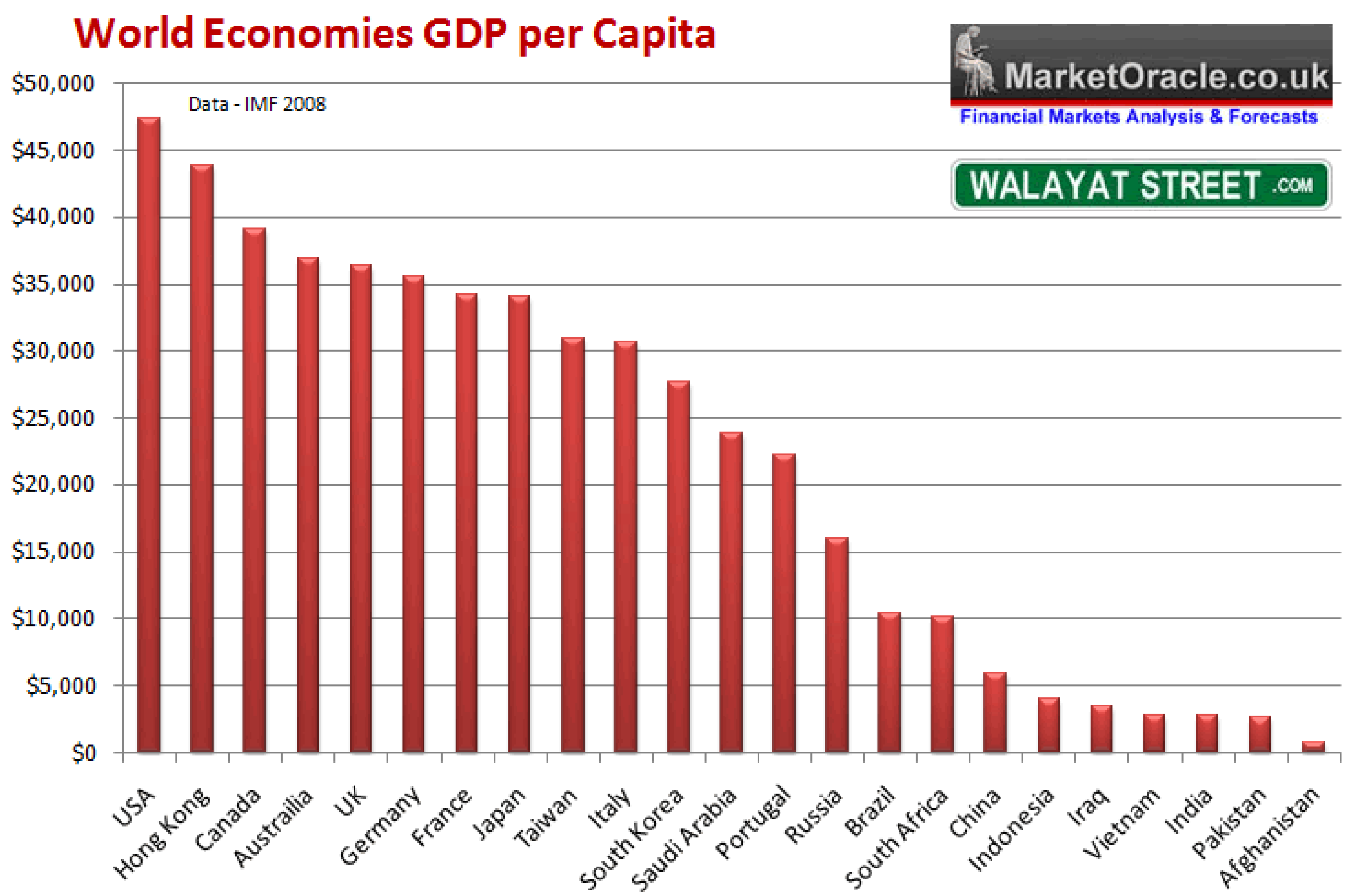
All investors need to have portfolio exposure to emerging markets because that is where most of the new economic growth is going to come from over the next 10 years at least. Whilst the western economies may experience average growth of between 2% to 3%, the emerging markets are expected to experience growth of between 5% to 7%, compound that figure annually and one gets an even better picture of the wide gap in the growth prospects.

Whilst many analysts worry about over heating developing economies and growing bubbles, although forgetting that there is a fundamental shift taking place in terms of risk, as illustrated by the general high indebtedness of western economies over many developing economies, which therefore implies that instead of carrying a risk premium to the west, it is the western markets that should be carrying a risk premium in the pricing of assets.

Furthermore as long as the economies retain the following characteristics then over the long run the risk of losses or underperformance is further reduced. Some of the key characterises that I look for are:

- Political Stability
- Economically liberal in terms of free market economics
- Literate population
- Abundant Natural Resources
- Environmentally stable
- Favourable demographics
- Low debt to GDP ratio

And last but not least is the per capita graph capacity as illustrated by the following graph:



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At the present, the mainstream press is busy worrying about the credit bubble in China, however the economic growth to date has barely bridged the huge gap between the emerging market giants and established western economies which implies a huge potential for the gap to narrow as manifested by strong growth in the emerging markets and below trend growth or even economic stagnation by many of the western economies which means that capital investments made today can be expected to return significant real capital growth over the next 10 years on the basis of real GDP growth that typically targets a growth increase of 100%.

Global Warming Impact on Emerging Markets

The most immediate impact of global warming is on agricultural production due to desert expansion and variability of fresh water supplies. This will most likely impact the 2.5+ billion people across China and India where the share of imported food supplies will continue to increase, thus highly inflationary domestically which will undoubtedly be exported abroad in terms of higher costs of production and supply of services.

With the continuing sea level rise spelling even worse disasters for low lying countries such as Bangladesh which will have increasing inflationary consequences due to millions of people becoming climate change refugees.

Demographics

Many analysts are mistakenly fixated on the so called deflation of Japan being replicated especially in the West whilst completely forgetting the fact that what is driving Japanese stagnation is demographics i.e. the large ageing population that is not as apparent to anywhere near the same extent in either the UK or US, as both have active and favourable policies for IMPORTING young and productive populations from abroad. Though this does put an investment time frame limit on the developing economies such as China which will eventually hit their own demographic time bombs similar to that of Japans, where China's working age population is expected to peak by 2020 and then decline as the burden of the elderly grows. But still offer a good 10 to 15 years of strong growth before economic activity can be expected to taper off as a consequence of demographics.

CHINA

The Chinese fast growing economy with consistent annual growth rates of 10% per annum is on course towards becoming the worlds dominant economy over the next 10 - 15 years, with GDP per capita at just $6,000, China's economy retains the capacity to keep doubling in size several more times before growth rates seriously start to diminish, therefore despite the growth to date the economy still has a long way to go towards even reaching half the per capita income of that of the western economies.

The financial crisis had afforded investors with a great once in a life time buying opportunity to buy into China's growth story at less than SSEC 2000. Maybe we will get some more chances over the coming year though probably nowhere near the depths of what we saw during 2009, therefore the best strategy is to scale into China over a period of time as I mentioned as part of my bear market accumulation strategy way back in October 2008 (Stocks Bear Market Long-term Investing Strategy).

With over $2.4 trillion of reserves and growing by some $400 billion per year, little debt and a very high savings rate of over 30%, China can afford to keep going on highly expansive inflationary stimulus spending sprees so as to buffer its economy from any future economic and financial crisis, whilst in the west each new stimulus will be financed by ever more debt that will have to serviced by means of interest payments in large part PAID to CHINA.

Chinas first growth phase was led by export growth that is gradually feeding into domestic consumption growth which in turn is being followed by the financial growth phase. Which means as long as China does not make the same mistakes as western economies by putting a debt noose around their necks then China remains the investment destination.

The ultimate impact of the Chinese economic super power is that the world will increasingly turn Chinese, as more wealthy Chinese travel abroad so will tens of millions of wealthy Chinese choose to become expats living abroad, especially in the western english speaking world which will likely promote greater economic ties and economic dominance of China across the world as a new economic empire is born, therefore make room for the next big wave of human migration from east to west that will seek to buy up large tracts of the remaining means of production and probably be invited in by desperate government's eager for foreign investment to spark life into stagnating regions.

China Government Competent

Whilst no one in the west would want to live under a totalitarian one party state. However the Chinese government has shown itself to be fairly competent in managing the economy, far better than many western democratic government's which continues to surprise many people that look to the experience of the last communist giant, the Soviet Union which collapsed into hyperinflation. It could be said that being a totalitarian state enables decisions to be implemented far more quickly and similarly any mistakes made can be far more easily brushed under the carpet.

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Whilst the western government's have been engaged in piling debt upon debt for consumption, the Chinese have been busy utilising hundreds of billions of dollars of stimulus spending to build up China's infrastructure by building new cities, roads and railways, all of which generates capacity for future economic growth.

China Blowing Bubbles

Yes strong economic growth and high liquidity i.e. bank lending is leading to bubbles that will burst, but the Chinese fiscal position is such that the government can keep blowing bubbles as long as it continues to import foreign currency reserves that can be utilised to cushion the blows which therefore means that the post bubble crashes remain long-term buying opportunities, as the crash of the Chinese stock market to SSEC 1,600 in October 2008 proved.

China to Export Inflation Abroad

China's fast growing and overheating economy is inevitably going to experience significant price inflation. However at the moment China actively intervenes to keep its currency pegged to the U.S. Dollar, that has contributed to an enormous trade imbalance with the U.S. resulting in huge currency reserves that are a natural boost to the Chinese currency were it not for the high level of currency market intervention.

As the inflation mega-trend unfolds and inflation rises in China, then China can with ease let the Yuan appreciate against the other debt ridden currencies over time which has the effect of exporting inflation abroad as the costs of imports into China falls. This will increasingly become the case as the size of the domestic consumer sector grows over the coming years which will feed higher inflation in western economies.

An appreciating Yuan will have the effect of boosting profits for foreign investors when converted back into their own depreciating currencies.

China to Drive Foreign Stock Markets Higher

China is drowning in a sea of dollars that it cannot sell as that would undermine its dollar currency peg objective. However China can achieve the same thing whilst at the same time reducing its risk to a depreciating dollar by investing in dollar assets such as stocks, ETF's and commodities. Therefore those that continue to seek a bear market in U.S. and other western stock markets fail to recognise the huge potential pool of investment funds that are expected to continue to flow into western and other emerging market stock markets over the coming decade and hence contributing towards driving the stocks stealth bull markets higher.

Though it is not necessary to know which stocks China is buying as it is obvious that a resources hungry China is clearly targeting the resources, and energy sectors, where stock buying would tend to lift the whole sector. China will also be seeking to invest in the large liquid stocks and ETF's with strong cash-flows and profit potentials which the stocks investment section seeks to illustrate.

China Intellectual Growth Problems

One possible fly in the ointment is future political stability, as so far the 'communist' in all but name one party state in China has been able to keep its peoples eyes focused on economic prosperity and not to stray into political activism, whether at some point in time a crunch point comes when a more wealthy educated people demand more openness and freedom of expression.

Another problem that follows on from the authoritarian government structure is that China's access to the information age is very limited, i.e. web searches are usually blocked and user access to the internet closely monitored. This implies that China is unlikely to replicate the global growth in the production of consumer durable goods on to the internet technologies, which will still largely remain something in the hands of the democratic relatively free English speaking world as long as they do not erode their own countries freedoms by means of the states misapplication of technology to prevent free thought.

Chinese 10 Year Stock Market Outlook

A sustained average growth rate for the Chinese economy over the next 10 years of 8% per annum implies a GDP compound advance of 115%. China's Price / Earnings ratio currently stands at approx 30, which whilst still high is down from the eye watering days of the bull market peak that had the P/E as high as 70. Still 30 is NOT cheap and therefore despite the high growth potential of the Chinese economy, this is expected to narrow over the coming decade towards an average of 18.

Therefore taking a P/E of 18, and GDP advance of 115% and applying this to the current SSEC level of 2990, this would therefore suggest a fair value for the Chinese Stock market of approx SSEC 9,200 in 10 years time. Off course the actual trend is expected to function as a consequence of speculative runs to over valuation and subsequent corrections into states of under valuation as we saw with the 2007 peak of 6,250, a stock market boom into a bubble in 10 years time could see the SSEC as high as 17,000 against the current price of 2,990.

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Chinese Stock Market 2010

The Chinese stock market has doubled after the powerful rally off of the October 2008 low of 1664 to a high of 3,478. Subsequent price action clearly indicated a period of consolidation is underway with the last close at 2990, the price pattern being painted is that of an ABC correction of which we have just embarked upon a C wave decline that implies the SSEC is currently targeting a correction towards a range of 2750 to 2600 which in my opinion would present a further good long-term accumulation opportunity. As for the end 2010 target ? I expect the SSEC to target an end 2010 level of 3,750 as illustrated by the below graph.

Chart courtesy of StockCharts.com

In conclusion the more I analyse China the more it comes back to me as a screaming long-term buy, China remains one of my KEY investment destinations with an over-weight rating as by far the single greatest source for future world economic growth will be from China. Not only is the country swimming in cash but foreign investors will be ever eager to plow more of their own money into China. So I am firmly putting my money where my mouth is by remaining fully invested in China. Therefore I will let others worry about the potential black swans and stay scared of investing in China.

China Stocks Crash ?

2008 and 2009 have shown us that the markets are extremely volatile, so yes the speculative Chinese stock market could crash, but as long as the fundamentals remain in place i.e. that the Chinese economy continues to grow strongly as it did throughout the recession then market crashes are excellent long-term buying opportunities. Think of it this way, instead of buying the market at 30X earnings a 33% stocks crash offers you the opportunity to buy the same market at X20 earnings. Just as the crash to below SSEC 2k presented a golden opportunity to buy China in 2008.

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Foreign Investors Currency Advantage

Foreign investors should also take note of the strong currency advantage of investing in China, as the Yuan will eventually appreciate against all fiat currencies. This means that over 10 years investors in say sterling could see their returns increase by as much as a further 50%, as the current trade imbalances are not sustainable, i.e. last year China exported $338 billion to the U.S. whilst importing $69 billion, which should have resulted in a significant Yuan appreciation, but the exchange rate has not budged for the past 18 months which strongly suggests intense currency market intervention to hold the peg to the dollar that will culminate in a series of rapid revaluations, thus driving the value of Chinese investments higher in currencies such as sterling and the dollar. Therefore foreign investors into China are effectively buying an inflation hedge on top of capital growth as a consequence of economic growth.

China ETF's

There are several liquid China ETF's available including iShares China Index Fund (XCH), iShares FTSE/Xinhua China 25 (FXI) and SPDR S&P China ETF (GXC) as a starting point for your own research.

India

Indian Growth

India presents a higher risk than China, but also a higher potential for profit with GDP at less than $3,000 per capita. There exists the potential should the Indian government continue to seek to pull its people out of poverty for even a longer run of consistently high economic growth than for China.

India's economy is presently growing at 7% per annum which could be sustained for the next 10 years resulting in an compound growth of 96% on current GDP, which will undoubtedly be reflected in the stock market indices that could extend to three times the GDP growth rate, therefore despite the 2009 bounce back, the Indian stock market still presents a good opportunity over a 10 year time frame.

India Risks

The primary risk to India is lack of competency in its governance which yields poorly thought out economic decisions that has culminated in the countries persistently high overall budget deficit of 10% of GDP resulting in a high and growing debt burden that is not keeping pace with GDP growth i.e. overtime this will gradually squeeze economic growth lower unless addressed, thus shaving several % points from India's annual growth potential by the end of the decade to instead of a 100% real terms increase in GDP to a more probable 80% increase.

India's inability to control the exploding population which coupled with the impact of climate change that will hit India particularly hard as the inflationary mega-trend will manifest itself more in India than China which sows the seeds of future population driven food price crisis, that even now is already manifesting itself in a high food price inflation of over 15% which generates much discontent amongst India's hundreds of millions of poor that forces the government to maintain the budget deficit rather than to introduce austerity measures.

Therefore investors in India are likely to have bumpier ride and a potentially shorter window of opportunity for profit from investments than from China, as India's greater risk implies perhaps a decade of high growth before population growth, debt and climate change evaporate the high growth potential of the Indian economy towards a period of stagflation especially considering the already eye watering high inflation rate of more than 10% for 2009.

Indian Stock Market 10 Year Growth Prospects

The Indian stock market is priced at about 20 times earnings, which against GDP growth expectations of 80% compounded over the next 10 years implies if stocks remained at current price levels the P/E would be at just 3.7. Whilst in 10 years time a more maturing and environmental sensitive economy may not be able to demand a P/E of 20, it should still be able to muster a PE in the region of 12 to 16 which therefore suggests a stock market advance of between 300% and 450% onto the current level of 16,350 i.e. implying that the BSE could be trading at a level of between 50,000 and 73,000 in 10 years time, if not higher if the budget deficit problems and total debt problems can be addressed.

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Indian Stock Market 2010

Whilst the big picture strongly suggests that the BSE index will multiply several times over the coming decade, however the picture for 2010 is much more difficult and again is related to India's poor budgetary position and high inflation rate, the 10% budget deficit is on par with that which has sent many western economies such as Ireland and Greece crashing over the edge, therefore risk averse investors shying away from countries with large budget deficits and debt burdens implies a great deal of volatility for the Indian stock market during 2010 which implies that Indian stocks are unlikely to show any significant advance during 2010.

The technical picture implies a wide trading range for the Indian stock market between 18k and 13k, which puts the current level of 16,350 towards the upper end of the range therefore suggesting that a better accumulating opportunity may come later in the year.

The BSE chart also indicates a risk that it could break below the lower end of the trading range at 13k, which could trigger a retracement all the way back to 10k. On balance the BSE is presenting 2010 as being more a year for consolidation of the advance off of the 2009 lows, with the resumption of the bull market at this time expected during 2011 rather than 2010 which therefore implies a year for accumulating on weakness.

India ETF's

There are several liquid China ETF's available including iShares S&P India Index Fund (XID), PowerShares India Portfolio ETF (PIN) and iShares S&P Nifty 50 Index (INDY) as a starting point for your own research.

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RUSSIA

Russia is rich in resources but remains politically unstable. The country has all the potential in terms of resources to achieve first world status, the only seriously limiting factor is the tendency of its leaders to seek out conflicts with bordering states and hence squander accumulated wealth. That coupled with GDP per capita of $16,000 does not support the view of strong growth in relative terms over the coming decade, despite the potential that is pending internal reforms to capitalise upon.

The Russian economy has a strong commodities driven cash-flow with a sizeable foreign currency reserves that can and have been utilised to help weather financial crisis. Where investing is concerned the equity market is far more volatile than many other large emerging markets but it is far more cheaply priced than other markets therefore presents a good risk / reward potential. The banking sector as with developed countries banking sectors is saddled with a lot of bad debt hence this will need to be inflated away so higher inflation in Russia is likely to help devalue the bad debts of its banking sector.

Russia may one day follow the other emerging market BIC economies of China, India and Brazil, in terms of industrialisation, but for now it remains mostly a commodities play therefore especially susceptible to the oil price.

Russian Stock Market

The Russian stock market is definitely not for the faint hearted. The RTSI peaked in May 2008 at 2498 and then completely collapsed over the next 6 months to a low of 492, or by 80%, a truly spectacular collapse on par with that of the 1930's Great Depression. But this is not the 1930's and the subsequent bounce back has been equally remarkable with the RTSI rallying to a recent high of 1590, a more than tripling of the index from the low, which illustrates that investing in the Russian market does require close monitoring and thus greater investor experience.

Russian ETF's

A Russian ETF as a starting point for your own research is Market Vector Russia ETF Trust (RSX),

BRAZIL - Rich in Resources

Brazil continues to gather momentum towards becoming a developed state over the next 20 years, of the three major emerging markets it is the most distant from capacity restraints of population demographics, environment and resources. therefore probably presents the highest potential growth prospect of the three for several decades.

Resource wise, Brazil has virtually everything going for it, from oil, gas, minerals and metals to land and water, many of which both India and China are deficient in requiring importing of raw materials.

The strong long-term trends are reflected in the Brazilian stock market indices which whilst not far behind Russia in terms of price volatility, have recently recovered close all time highs prior to the current correction. The Brazilian stock market at 66k is more fully valued trading on a P/E Ratio of 23, when compared against other emerging giants for at least the next 12 months, therefore I would view to accumulate exposure to Brazil on any further corrections to below 56k, and as is the case for China, investors in Brazil are expected to experience the added benefits of a strong Brazilian currency given the high real-term interest rates, low debt and a small current account deficit.

Vietnam - The Next China in GDP per capita terms ?

Vietnam is a country that remains invisible to most investors radar, which appears to be following the path of China i.e. turning itself into an export based economy growing in the order of 6-8% GDP per annum. Today's Vietnam is perhaps where China was some 10-15 years ago therefore for the very long-term investors it could present an ideal opportunity to get into the next mini-china near the ground floor.

As China continues to grow more wealthy then gradually over time the means of production will be exported abroad to cheaper labour countries such as Vietnam, that coupled with very positive demographics for several decades means that Vietnam most definitely does have the potential to follow China's lead.

Investors seeking exposure to Vietnam will need to show patience and tolerance for wild price swings as can be expected from small less liquid markets such as Vietnam so truly would have to be long-term investments aiming at a decade time frame.

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Iraq and Afghanistan - High Risk Gamble Economies

Iraq and Afghanistan present a golden opportunity to get in near the ground floor in broken economies that are pending internal stability and infrastructure development. The potential is for both economies to grow at least three fold over the next decade in GDP terms if peace and stability can be established.

Iraq by far presents the greater opportunity of the two given its large proven oil reserves that rank 3rd in the world. Western countries such as the U.S. and U.K. have also heavily committed themselves towards turning both countries around. Where investments are concerned then for Iraq, clearly the oil sector is the most favoured then construction of Iraqi infrastructure which allows exposure to Iraq to be gained from oil companies holding Iraqi oil contracts such as Shell and BP.

AFRICA

If crisis breeds opportunities than sub-Saharan Africa is awash with huge potential. Starting from a low per capita GDP base, a large % of young population and resource rich countries such as Congo and South Africa present great long-term opportunities. However on the negative side we have the question of political stability, weak corrupt government's and civil unrest / warfare.

It is beyond the scope of this ebook to analyse Africa in depth, therefore probably the best way to participate from future African growth would be to follow China's lead by concentrating on the resources sector such as metals and mining funds and ETF's that spread exposure across several African countries such as Van Eck Market Vectors Africa Index ETF (AFK).

Emerging Markets ETF

Whilst virtually all of the emerging markets represent good long-term risks in terms of growth. However the financial crisis has illustrated that individual markets can come under greater stress due to particular domestic concerns. Therefore one way to reduce the risk of investing in single emerging markets is to invest in an ETF that spreads the risk across several emerging markets. The i-shares MSCI Emerging Markets Index Fund (EEM) does just the that by spreading the risk across 10 emerging markets with the greatest weighting given to Brazil, China, Taiwan, South Korea, South Africa, India and Russia.

Emerging Market Debt Defaults and Market Crashes

Investors in Emerging markets need to ensure they get one thing straight, and that is for the higher return they are taking on higher risk. Whilst we may all enjoy riding the emerging markets boom, however we have to be aware that they can and have gone bust in spectacular style by defaulting on their debts resulting in an hyperinflationary collapse i.e. Brazil defaulted on its debt in 1983 and then again in 2000, not to mention the intervening period of hyperinflation. So investing in emerging markets should NOT be a case of putting all of your eggs in one basket.

So all emerging markets are HIGH risk for this reason, as they have a far higher potential for screwing up their economies in spectacular style than is usually the case for the developed economies and markets. Though looking at the commentary surrounding the Greece that 'may' now be changing.

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Gold Analysis and Forecast

Gold Bull Market Forecast 2010 - (1st Nov 09)

Gold has had a stellar run of late, which recently saw Gold pushing to new all time highs on a near daily basis which has galvanised wider mainstream press attention to the precious metal with many gold bugs revising targets ever higher into loftier goals such as $2000 and even $4000+. Gold is one of the most popular asset classes both sought after by readers and written about by market commentators, and one of the most emailed query as to when will I update my original gold analysis of [22nd January 2009] which concluded during mid 2009, therefore this analysis seeks to project the Gold Price trend well into 2010.

Gold Price Forecast 2009 Evaluation

My original analysis for Gold as of [22nd January] concluded with a gold price trend higher into March 2009 towards a target of $960 to be followed by a subsequent decline into mid 2009 as illustrated by the original forecast graph below.

The Gold price forecast proved to be accurate in terms of the projected impulse waves. This analysis seeks to project Gold forward several months into 2010.

Fundamentals - Inflation Driving Gold?

The problem with this scenario is that the inflation of the 1980's and 1990's did NOT drive Gold higher, so clearly the mantra of Inflation driving gold higher is not correct, especially as we are presently emerged in debt deleveraging deflation, and neither does discounting future inflation expectations hold up, as the Gold bull market is now into its 10th year with a gain of 400% to date.

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Gold Secular Bull Market

From 1980 to 1999 Gold fell for 20 years, eventually it would bottom and embark on a bull market, eventually, the signs for this would be not in fundamental data, but contained within the price chart as Gold breaks the pattern of corrective rallies followed by the downtrend resuming to new bear market lows. Now some 9 years later gold has corrected the preceding secular bear market by 50% in time and 100% in price. Therefore gold is not in a new bull market which has already contained many vicious bear markets within it as we witnessed last October, so just bear in mind that this is not a fresh young bull market, therefore much of the talk of waiting for public participation to join in can be discounted.

U.S. Dollar / Credit Crisis

My [earlier analysis]of a positive trend for the USD clearly implies given the inter market relationship between a two for a weaker trend for Gold. However the risk is that amidst the next phase of the global financial crisis as the bankrupt banks have far from recovered, the next stage of the banking crisis accompanied by recognised inflationary panic measures of money printing which devalues all fiat currencies could give a lift to gold.

Quantitative Easing aka Money Printing Hedging

We are in a new world (for the west anyway) and that is a world of Quantitative Easing, the more the government's of the world print money and monetize debt the easier it is for government's to keep printing and monetizing ever escalating amounts of government debt to cover the government budget deficit gap. What this means is collective currency devaluation where relatively speaking there appears to be little change but in real terms the flood of money has to be seen in rising commodity prices and other scarce resources, after all the supply of resources is mostly known and the population of the world is not decreasing so the demand is known to be on an upward curve. Therefore as long as the central bankers are embarked on the experiment of quantitative easing that should give a lift to gold and other commodities as it increases inflation expectations and therefore inflation hedging using gold and more liquid commodities such as crude oil.

Gold Technical Analysis

ELLIOTT WAVE THEORY - The elliott wave pattern implies we are a strong bull market that has much further to run, i.e. in Wave 4 of a larger Wave 2 advance. This also suggests that the immediate future should see further weakness in gold towards $1,000. However, this is just a correction in the trend that projects to a price of more than $1,100 by the end of this year, with the trend continuing into March 2010 toward $1,200 before a more serious correction takes place.

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TREND ANALYSIS - Gold's breakout to a new all time high is a clear signal of further strong advances. The support trendline is at $1,000 and therefore fits in nicely with the elliott wave correction projection target. After the uptrend resumes this trendline is unlikely to be revisited until the second quarter of 2010.

SUPPORT / RESISTANCE - Resistance lies at the last high of $1071, Immediate support lies across the string of previous highs of $1033 and $1007, therefore there is very heavy support whilst very light resistance overhead, which again is suggestive of a mild correction in the current phase of the trend.

PRICE TARGETS - The measuring move off of the $681 2008 low projects all the way to $1,350, which looks set to be an achievable price during 2010. Nearer term immediate targets extend to $1,100 then $1,200.

MACD - The MACD indicator signaled a Gold breakout at $960, with a firm established uptrend. The current correction is inline with that of a mild correction within a strong uptrend.

SEASONAL TREND - There is a strong seasonal tendency for gold to rally from November through January i.e. for the next 3 months. This is suggestive that the current correction is living on borrowed time and may not last much longer

Gold Conclusion (1st Nov 09)

I started off this analysis skeptical of the prospects for gold given the 10 year bull run to date, but the price that is talking off the charts is pretty bullish! enough for me to consider accumulating a position. In the immediate future Gold appears to be targeting a continuing correction towards $1,000, after which it targets $1,200 by March 2010 and a price of $1,350 later during 2010.

Gold Long-term - Gold has broken out to a new high and it does look as though it is going much higher in the long run, there are multiple measuring moves that one can consider, such as 133%, 150%, 1.618% etc. However given the gap in time between the all time peaks, Gold of $2000 plus would now not surprise me.

Gold Update - 30th Jan 2010

The Gold bull market remains intact which is supported by strong fundamentals of record high investment demand coupled with shrinking mine production. I expect the Gold bull market to run for several more years. and as with all scarce resources / commodities, the price of Gold is bring driven higher by increasingly out of control money printing and huge deficit spending feeding the inflationary mega-trend i.e. ultimately money printing just increases the supply of money which will eventually force prices ever higher as the increased fiat money exchanges hands for what remains a limited commercial and investment resources.

GOLD Elliot Wave ABC Correction - The recent Peak in the Gold price at 1225 can be interpreted as a Wave 3 that suggests gold is under going a relatively minor ABC correction that extends towards a target of $1050 i.e. along the previous resistance area. Gold presently has completed Waves A and B, with the C wave well underway which suggests that the target could be reached by mid February.

GOLD Mega-trend - Those that are looking for a FINAL peak in the gold price will be greatly disappointed because Gold will NEVER peak, yes it will experience cyclical bear markets (buying opportunities), especially after powerful bull runs but as long as the worlds central banks continue to debase their currencies then the upward inflationary spiral in the gold price, as with virtually all commodities is an inevitable mega-trend for the duration of human civilisation, which is based on the premise that a. The worlds population will continue to increase, and b. That technological alchemy that is able to produce new 'cheap' gold will remain out of reach for at least another 50 years.

GOLD - Dollar Relationship - There does exist an important Dollar / Gold inverse relationship which given that my analysis projects towards USD 84 during the first half of 2010 suggests that Gold will find it difficult to break above the $1225 high during this time period.

GOLD Technical Analysis - After the Gold correction bottoms at the target of $1050 or lower, Gold will initially target the former $1225 peak and then 1.618% of the swing from $1225 to $1050 (anticipated low), which projects towards an 2010 target of $1,333, which amazingly is precisely in line with my 1st November 2009 target of $1350.

Furthermore, a trendline extending through the current correction illustrates a probable trend path around which gold can expect to gyrate towards its target of $1333 by late 2010, and continue further on into 2011 as the Gold price continues to look set to trend towards $2,000 which should be easily achievable within the next 3 years.

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GOLD Seasonal Trend - The seasonal tendency is for gold to trend lower from a Jan / Feb peak to a July / August Low, which is then usually followed by a trend higher into Jan / Feb of the following year.

Gold Price Forecast Conclusion

The two key conclusions are:

1. That the current correction is targeting $1050 to be achieved during February 2010

2. That Gold is targeting an Impulse Wave 5 into late 2010 peak of at least $1333 which remains as per the original forecast of 1st November 2009.

Both the Dollar forecast and the seasonal trend are supportive of the view for Gold price relative weakness into July / August 2010, following which the Gold price is expected to break out to a new high. This suggests that Gold may trend sideways for the first half of 2010 into July / August as the following graph concludes:

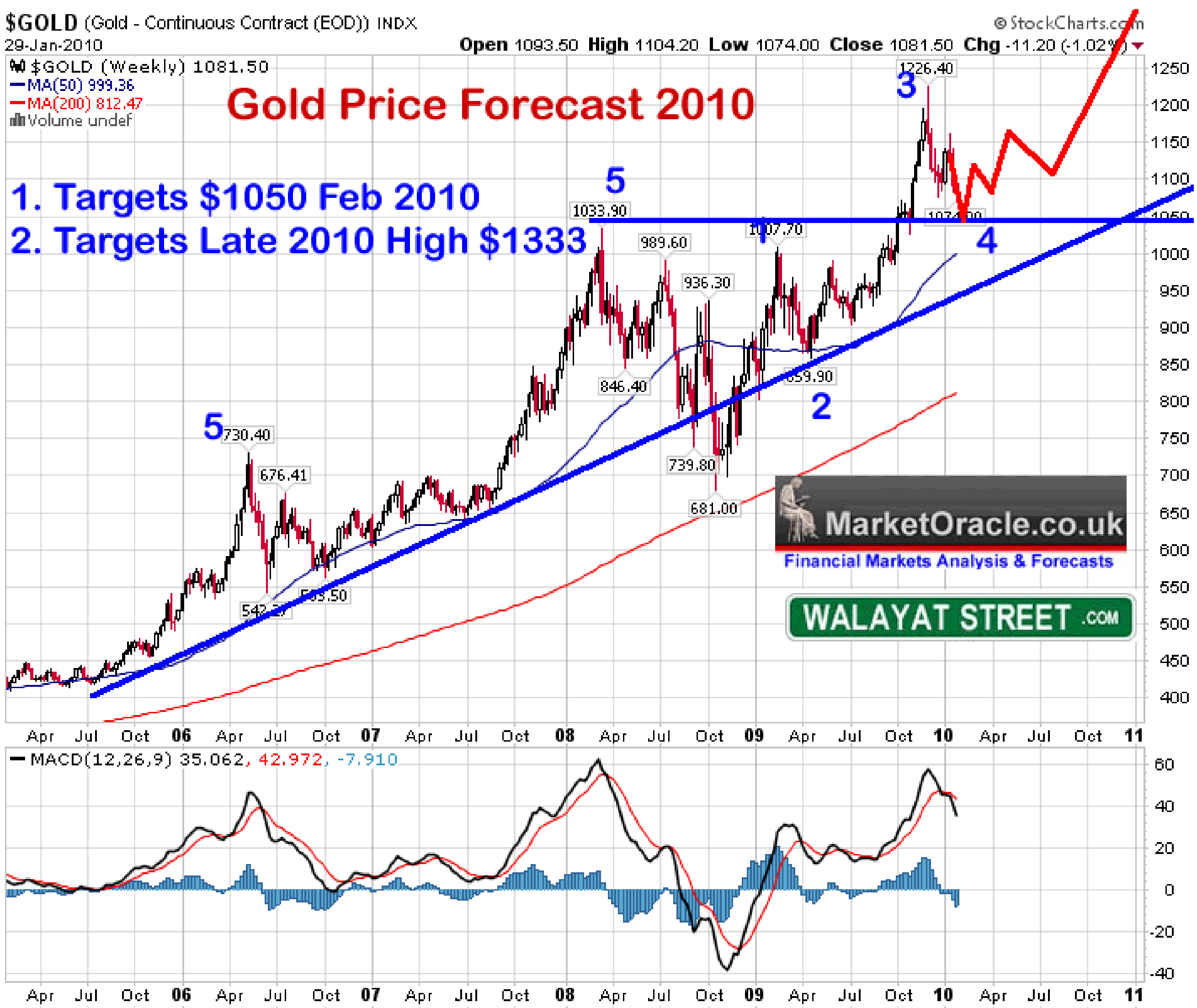

Chart courtesy of StockCharts.com

Gold Beyond $1333

As mentioned earlier, $1333 is just a target for 2010, the Gold price may even reach as high as $1,400 this year, enroute towards my longer-term target of $2,000 which would basically represent a 85% gain on the current price of $1081 and much more so when Gold stocks are brought into the equation though there trends are also subject to that of the general stock market.

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Gold Trend in Sterling

Gold price in Sterling is showing a similar trend pattern and price expectation of the current correction having a little further to run before Gold hits its major support trendlines as indicated on the below graph. Therefore currency movements have only marginal impact on the trend as the Gold price volatility is far greater than the expectations that the British Pound will fall by approx 10% over the next 12 months. Still this 10% will further extend gains for sterling on top of that forecast for the Gold in Dollars.

Chart courtesy of StockCharts.com

Silver Price Trend

On face value a Gold price target to a new high of at least $1333 during 2010 is undoubtedly bullish for Silver also, however the price trend exhibited by silver is not as healthy as that for Gold as Silver during the recent precious metals bull run FAILED to break above its 21.44 2008 high, which is a sign of relative weakness.

Key technical support is at 16, then next way down at 11. Whilst upside resistance lies at 19.45 and then 21.44. The current sharp correction is at support of 16, which if breached could trigger a sharp decline or spike as low as $11, which if it happened would be a great long-term buying opportunity. However on the basis of support holding, the upside looks limited, as silver first needs to overcome $19.45 and then $21.44, whilst of if $16 breaks then that will become the next resistance level to overcome.

On the plus side due to the sideways trend, Silver lacks any speculative froth that may be building in the Gold market which implies that should silver manage to breakout to the upside, i.e. above $21.44 then we may witness a particularly strong spike higher that could carry Silver to $30 in a short period of time.

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The relative weakness between Silver and Gold is attributable to the fact that Gold is clearly seen as an alternative currency against paper fiat money, whereas silver is seen more as an industrial metal which means it is more subject to economic trends than Gold.

Silver Conclusion

Silver is boxed in a very wide trading range of between $21.45 and $11, the bullish Gold outlook should push silver during 2010 towards the upper end of the range which if breached would trigger a powerful rally towards $30. Immediate term Support of $16 looks set to give way for a trend that targets the long-term support zone of $14 to $11 which in my opinion would be both a great long-term and range trading buying opportunity. Where will silver be by late 2010 ? I would say at a price above $20.

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GLD and SLV ETF's

This analysis continues the study of the price trend relationship between Gold : GLD and Silver : SLV as part of the inflationary mega-trend investing as the following graphs illustrate:

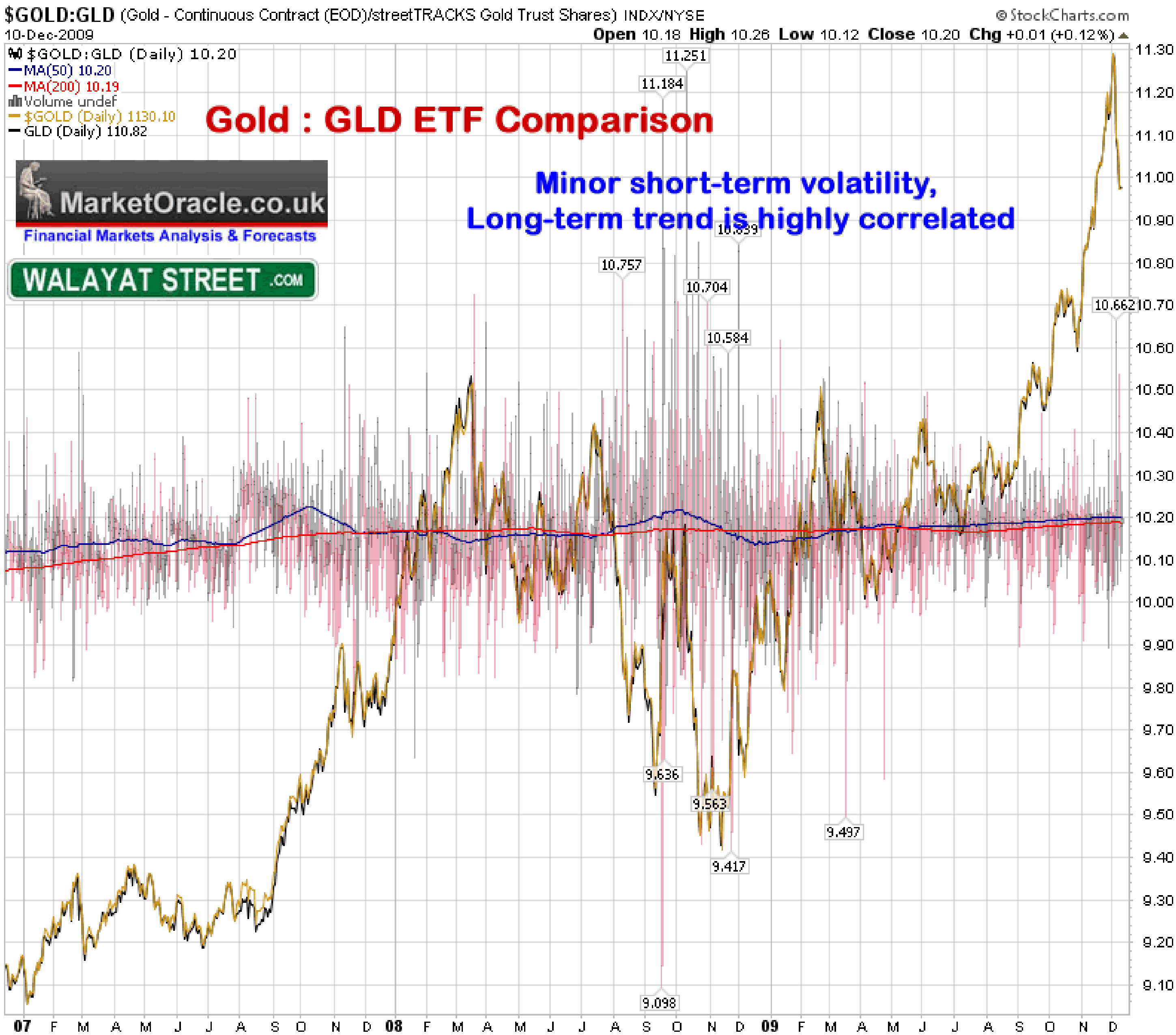

Chart courtesy of [StockCharts.com]

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Both graphs show that during the past 3 years and at the present time, the spot prices of Gold and Silver are highly correlated in terms of trend with their GLD and SLV ETF equivalents for a similar period of time.

ETF Expenses - Investors should note that both GLD and SLV ETF's deduct annual expense ratio's of 0.4% for GLD and 0.5% for SLV which over time will erode the value of the funds and result in a significant discount to the spot price for investments spanning several decades, though it should also be noted that the expense ratios compare favourably to the fees charged for bullion storage that can amount to more than 1% per annum. For instance Gold is up approx 20% over the past 12 months, against the expense ratio of 0.4%, therefore is not of any real significance for medium term investments (upto 5 years).

ETF Risks - I understand that a number of rumours are doing the rounds during the past few weeks of potentially 1.4 million fake tungsten gold bars in existence, of which many form part of the GLD ETF holding. However the GOLD:GLD price trend relationship suggests that there is no substance to these rumour's for if these rumours were true then GLD would be trading at a significant discount to the spot Gold price. Though that it is not to say that some future event may bring about such a large discount.

Leaving aside the risk of fake gold, there is also the risk of that during a currency crisis the U.S. Government seizing the Gold held in New York, maybe if it were disbursed across several vaults in several countries this would ensure greater security. Other risks exist as with all ETF's i.e. that of the risk of theft and fraud. Though as I have pointed out earlier, if in the future a problem with the GLD and SLV did start to occur, we would see it manifest itself in the spread between GLD and Gold, as the smart money would start to exit the fund first.

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Natural Gas Mega-trend

Whist most commodities have soared during the year, however Natural Gas has been one of the few commodities lagging behind and therefore may present an opportunity to scale in at rock bottom prices for the Long-run as have mentioned several times during the divergence between Crude Oil and Natural Gas over the summer months.

Do You Wish You Had Bought Crude Oil at $35 ? Stocks at Dow 6600 ? Gold at $700 ?

Much as past great market opportunities, at the low no one wants to buy for a multitude of reasons. However taking a look at the long-term charts, you do not have to be a genius to arrive at the conclusion that Natural Gas is cheap, the only way a future Natural Gas spike to the upper ranges of many multiples of the current price is not possible is if Natural Gas suddenly became an redundant energy resource, which given that it is a far cleaner form of energy than other fossil fuels seems extremely improbable!

Remember Natural gas is not a stock therefore its not going to go out of business to ZERO, nor is it likely to be displaced from the market place by new technology during the next decade at least.

Natural Gas Fundamentals

High prices bring on stream new supply, low prices bring about reduction in supply and investment, the longer Natural Gas trades at higher prices the greater will be the eventual new supply and subsequent crash in prices. The longer Natural gas trades at ultra low prices the less the forward supply investment and thus the greater will be the eventual spike higher in Natural Gas prices. What this suggests is the best type of price action for commodities is that of highly volatile highs and lows where sustained trends tend to resolve to extraordinary spikes in the opposite direction. The current Natural Gas price trend has been that of a sustained downtrend, which is primed to resolve to much higher prices to eventually more than the normal range. Off course this would also require Natural Gas position holders to ensure they are ready to distribute INTO such a spike else like many novice investors they may end up giving back most of the gains on the way down!

Natural Gas is CLEAN ENERGY

Natural gas is the dream fossil fuel of global warming proponents, as it is by far the cleanest of the three major fossil fuels of gas, oil and coal. Developed countries could cut their electricity generation green house gasses by at least 33%by making the switch to natural gas, whilst at the same time saving money.

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Natural Gas in Dollars

Chart courtesy of StockCharts.com

Natural Gas price range is typically between $9 and $6. Last close was at $4.66. Natural Gas is in short-term downtrend therefore suggesting lower immediate term natural gas prices. The price collapse form $13.7 to a low of $2.62 in September resulted in a powerful bounce to 5.83 that now brings Natural gas to its present day downtrend at a much shallower velocity than the preceding uptrend, Natural Gas.

However Natural Gas HAS given a Buy Signal and therefore now targets a higher low (than the Sept low). Once the higher low is in then that will mark a strong stepping board for a sharp rally higher to significantly above the September peak taking Natural Gas into the Normal range, in the meantime my opinion is that of a great long-term accumulation opportunity with Natural Gas trading below the normal range.

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Natural Gas in Sterling

Sterling (GBP) Natural Gas is exhibiting a similar trend suggesting that sterling's trend is not an important factor given the magnitude of natural gas price movements i.e. the near doubling of price from 0.016 to 0.035 during September and the fallback now to 0.028.

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Natural Gas - Crude Oil Relationship

The Natural price collapse is most evident when compared against crude oil which saw the relationship drop to levels not seen in over 10 years, even after the recent September bounce the Natural Gas is still trading at near 10 year lows. Natural Gas has the potential to play catch-up to Crude Oil in the order of 300%. I.e. even if Crude oil does rally any further, Natural Gas could triple in price.

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UNG ETF Performance Relative to the Natural Gas Price

Now we come to the crunch point, having identified Natural Gas as being at an opportune level to accumulate into are the Natural Gas ETF's of which UNG is the most widely followed actually going to make us any money or not ? After all many an investor has dived blindly into ETF's on the suggestion of mainstream media hacks that rarely invest their own money on their commentaries to only find that they have lost money rather than made money which is especially true with regards Leveraged ETF's that should be ALWAYS AVOIDED AT ALL COSTS !

Back to UNG - The following charts UNG and the UNG / Natural GAS relationship.

I have highlighted two areas that are suggestive of caution on the first chart. One in mid 2007 and second following the September spike. What we are witnessing is serious divergence between the Natural gas price and UNG, that is NOT subsequently resolved. Natural Gas gave a solid buy trigger in September, there was NO SUCH buy trigger on UNG, Natural Gas is making a significantly higher low, UNG is trading at fresh lows ! Those that bought Natural Gas Futures in early September would be sitting on a profit of 76%. Those that bought UNG are sitting on a LOSS!

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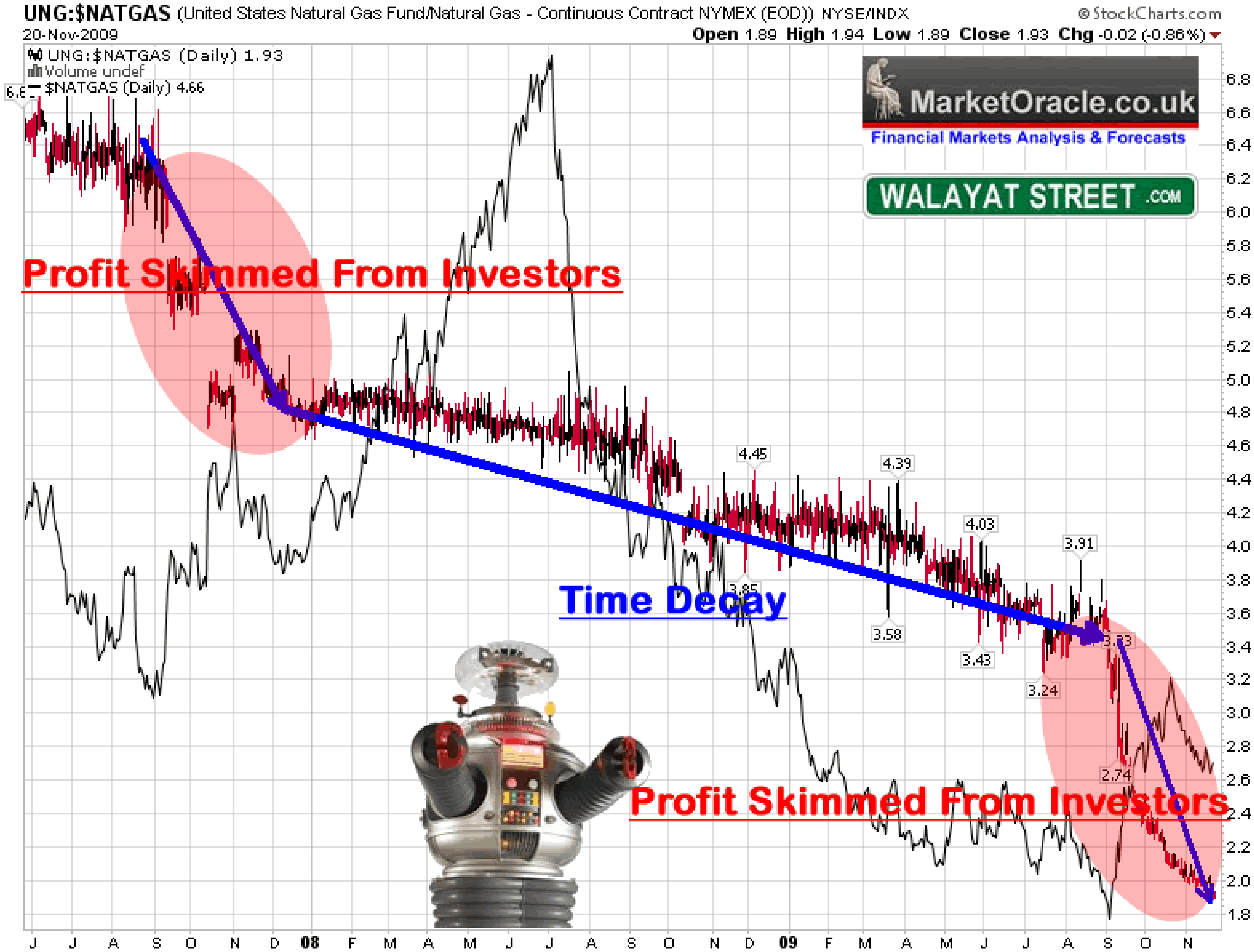

The second chart illustrates that there exists a perpetual tendency for the ETF to underperform the futures over time, which is impacted by the same issues as the Leveraged ETF's in utilising % of daily movements. What this means is that UNG IS NOT A GOOD LONG-TERM INVESTMENT !

The UNG website states -

> The investment objective of UNG is for the changes in percentage terms of the units' net asset value to reflect the changes in percentage terms of the price of natural gas delivered at the Henry Hub, Louisiana, as measured by the changes in the price of the futures contract on natural gas traded on the New York Mercantile Exchange that is the near month contract to expire, except when the near month contract is within two weeks of expiration, in which case it will be measured by the futures contract that is the next month contract to expire, less UNG's expenses.

Okay don't get disheartened after having been built up towards a Natural Gas position. What this means is that you can expect between 40% and 70% of any Gain in the Natural Gas by utilising UNG. Would Natural Gas rising to $13 result in UNG trading anywhere near 63.89 ? I doubt it. More likely Natural Gas of $13 would equate to UNG price level of anywhere between 25 and 47. Though more probably in the region of 37 i.e. the expectation is to receive just 50% of the gain that of Natural Gas futures.

Therefore whilst investing in ETF's can yield a profit, however unlike much of the hype surrounding them they are NOT always the one stop shop for investors, so there is no excuse for not doing your own home work in identifying individual stocks and alternative funds that could benefit hugely from a rise in the Natural Gas price, and again DO NOT EVEN THINK ABOUT Investing in LEVERAGED ETF's.

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INVESTING LESSON - Before you invest a single penny in any ETF, make sure you check its performance against the underlying market, better to find out the truth now then wake up one morning to find that you have not made any money whilst the underlying security soared in price! Unfortunately many analysts FAIL to perform this exercise after having performed analysis of the underlying market then jump straight into recommend an ETF. I don't want excuses or explanations of why the expected return never materialised. There is no point in investing in an fund that only generates profits only for fund managers!

Natural Gas Conclusion

Yes you missed the September low, but the recent correction gives you another bite at the cherry AFTER the initial trend change buy trigger has already occurred. I.e. the risk of a loss is far lower now than accumulating before the September buy trigger occurred. Now I am NOT saying that Natural Gas is going to rocket higher in the coming days or weeks, or even months but what I am saying is that it is not unreasonable to assume that Natural Gas will spike higher at some point during the next 1-2 years that would lift Natural Gas to at least $13 from the present $4.66. Especially as many commodities are busting OUT of their upper ranges which could conclude in an eventual spike significantly higher than $13.

Natural Gas Exposure

UNG has shown itself to mot be a good short or long-term investment vehicle, however the stocks investment section features a few Natural Gas exposure plays.

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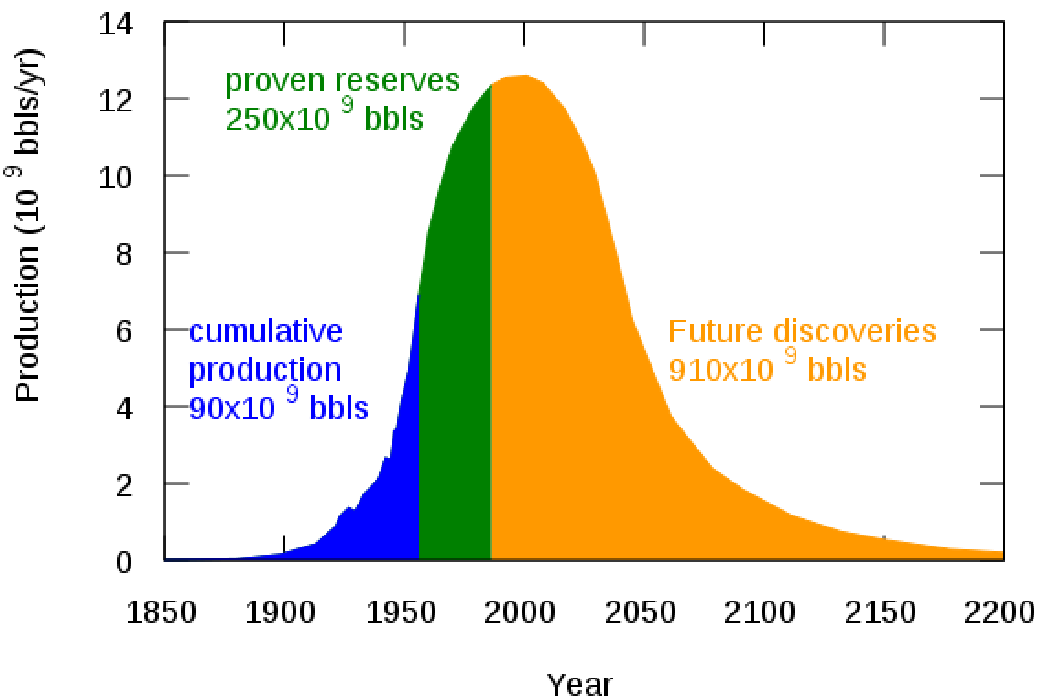
Oil Price Inflationary Mega-trend

Crude oil is both a major driver and beneficiary of the inflation mega-trend because during times of high inflation or expectations of future high inflation the highly liquid crude oil market is utilised to both hedge against and speculate in favour of future inflation, thus one could say illustrates the self full-filling prophesy at work as witnessed during 2008 that saw inflation hedging result in a surge in the crude oil price to $148, which had the effect of dragging inflation higher with it only to crash as a consequence of the financial crisis which continued into the deflation of late 2008 and early 2009. In addition to its inflationary impact, crude oil is also subject to the Peak Oil, which the next section touches upon.

Peak Oil Mega-trend

Firstly, Peak Oil does not mean that the world is running out of oil any time soon, peak oil means that the world is about to pass the point of maximum rate of production after which production is expected to decline as it becomes ever more costly to find and extract new oil fields, thus resulting in diminishing supply. The theory of Peak Oil is based on the principle originally developed by M King Hubbard in the 1950's, who observed the rate of production and depletion of oil output from the United States oil fields over time which culminated in a bell shaped curve. M King Hubbard went on to use his findings to accurate predict that U.S. oil production would peak by 1970 and decline rapidly. The below updated graph illustrates the most recent forecast projection for global Peak Oil which implies that the supply output peak is imminent, where the test will come when supply fails to respond to rising demand as the worlds economies return to trend growth.



http://en.wikipedia.org/wiki/File:Hubbert_peak_oil_plot.svg

Whilst the developed world continues to stabilise and in some cases cut back on total oil consumption due to improvements in technology and switch to renewable's and alternatives such as natural gas. However much of the reduced western oil demand (ignoring the recession) for oil consumption can be attributed to the exporting of industrial production abroad to China and India , which remain several decades away from reaching the level of West in terms of stabilisation of consumption as the collective total of 2.5 billion people of both countries consume on a per capita basis less than 10% of that by the average western person.

Peak Oil is a reality, the major cheap oil fields across the big producing nations have already passed their peak outputs and are declining fast in output and where discoveries of new economically recoverable reserves are not keeping pace with. We got a taste of the consequences of peak oil during 2008 when Crude oil soared to $147, where a small shift in the supply demand balance can cause extreme shifts in price as MARKET SENTIMENT drives prices into ever increasingly volatile price trends.

Therefore, oil and energy commodities despite continuing to exhibit high price volatility over the next 10 years, will still result in an rising trend curve as the oil price repeatedly moves to ever higher trading ranges, therefore I expect we will continue to see extremely high price volatility in the region of 50% I.e. suggesting that current price range is $85 to $45 as speculative funds continue to dominate short-term trends in the highly liquid crude oil markets, which the long-term inflationary mega-trend (as a consequence of emerging markets growth, population growth and fiat money printing) continues to force oil prices ever higher.

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Crude Oil Technical's and Forecast

The crude oil price has trended higher from the March 2009 low of $37 to a recent peak of $84 on the back of world wide economic recovery, especially the return of strong growth amongst the emerging market giants of China and India.

Crude Oil 2009

The in depth analysis of early December 2008 (Crude Oil Forecast 2009- Time to Buy?) concluded in the following trend forecast for 2009

> Crude oil is still in a downtrend, that means investors and traders need to WAIT for a buy trigger which normally means the break of a recent high or a significant resistance area ($50) before scaling into a position, and I mean scaling in because it will take much time for crude oil to formulate a bottom that I expect will form a very volatile double or even triple bottom pattern i.e. protracted bottom formation punctuated with very sharp short-covering rallies that could see crude oil spike higher to $80 and declines back to below $50 over the next 12 months as the below graph illustrates. What this anticipated scenario means is that there is TIME for investors to buy into crude oil positions as the base building confirmation takes place, as any strong rallies will likely be followed by tests and probable breaks of the previous low so as to enable the creation of the overall saucer shaped double bottom pattern.

> However the long-term trend for crude oil remains higher, when I mean long-term I am looking at well beyond the next 12months towards 5 to 10 years, when I would not be surprised given the peak oil fundamentals that we will actually be visiting the $200 crude targets that were loudly pronounced during mid 2008 as being imminent when crude oil was trading at $147. This scenarios should not be surprising given that the US Dollar bull market remains in tact that will continue to bear down on all commodities during 2009, but more on the dollar in my next (fourth) US Dollar bull market update.

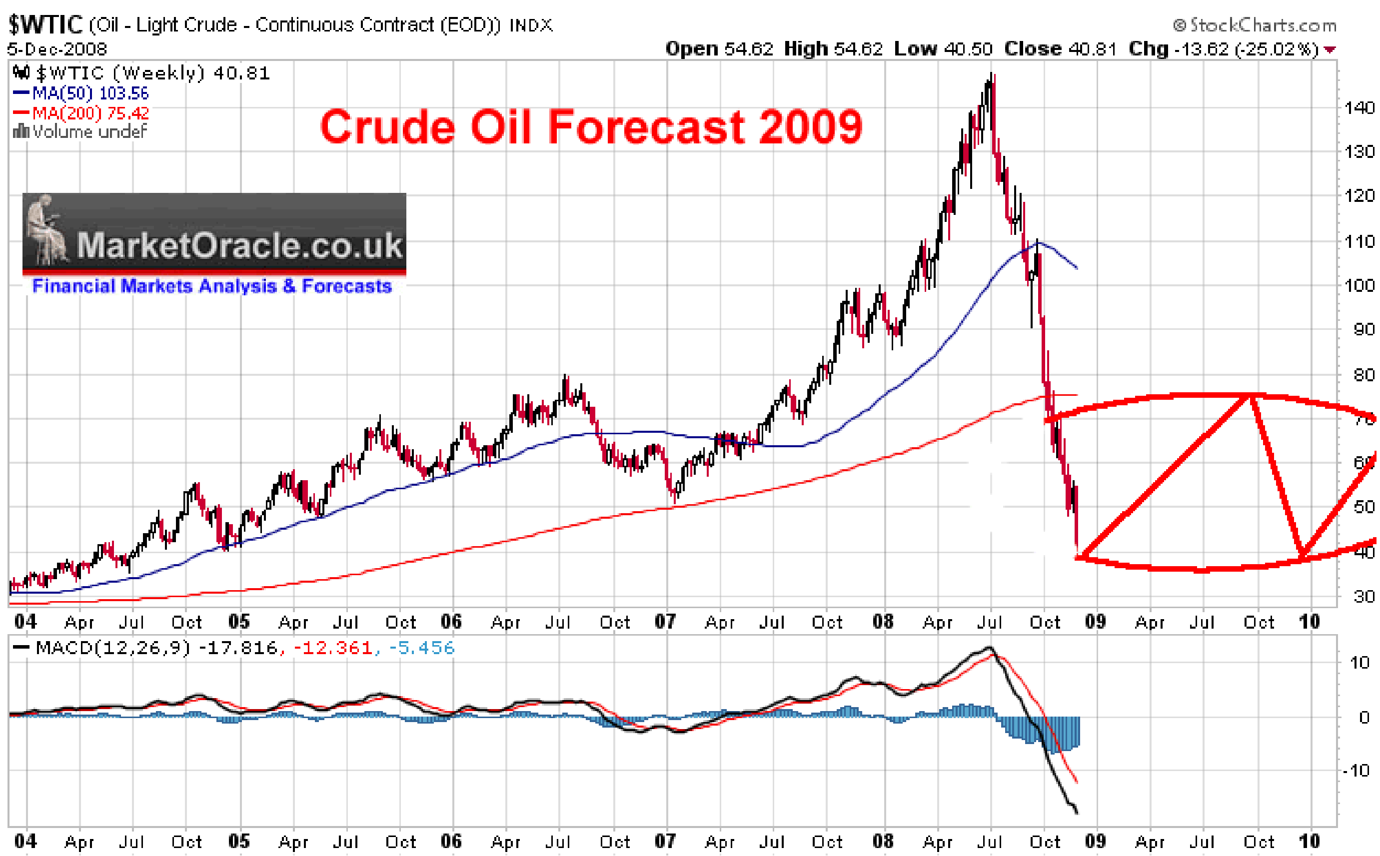

Chart courtesy of StockCharts.com

The forecast trend into an early October peak towards $80 proved remarkably accurate, however the price started to deviate from the forecast for the final 3 months of the year.

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Crude Oil Analysis 2010

Economic Fundamentals - During 2010, all of the major economies of the world are expected to recover to some extent and thus put upward pressure on crude oil demand in advance of which the oil price has already responded by rising to the recent high of 84. Which illustrates that despite the recession and weak recovery to date crude oil is trading near historic highs that were only really significantly beaten during the 2008 speculative oil price spike to $148.

CRUDE OIL FUNDEMENTALS - The current supply demand balance stands at 86 million barrels per day for supply and 86 million for demand which follows the crash in demand to 84 million during 2009 Q2. Demand is expected to rise to 87 mb/d during 2010 which the worlds supply capacity of upto 88 mb/d is able to cope with as OPEC is expected to increase output to cover. This therefore implies that for 2010 at least, oil prices can be expected to trend sideways within a range.

The worlds total known oil reserves are being depleted at the rate of 2 barrels for every 1 new discovery, and each new barrel is estimated to cost an average of $65 to discover, therefore a lower oil price would result in lack of exploration for new fields therefore sowing the seeds for a future oil price spike. These fundamentals are therefore supportive of a $60 - $65 floor and the longer-term peak oil uptrend.

TREND ANALYSIS - Crude oil has trended higher following the December 2008 and February 2009 lows, making higher highs and higher lows along the way with the most recent price action managing to keep the up trendline intact. However having entered the seasonally weakest period of the year implies that this trendline should break which would first target $72 and then $65. The overall trend picture being painted for crude oil during 2010 is that for a period of consolidation between a range of $85 and $60.

SEASONAL TREND - Crude oil's seasonal tendency is by and large linked with that of its largest consumer, the United States, which suggests oil prices are expected to trend higher from a February low into the summer vacation season and continue towards late in the hurricane season i.e. October, before trending lower again into a February low. Last year the seasonal trend only extended to the extent of a rally into October after which the correction failed to materialise until this month, which has seen crude oil correct towards $72.

MACD - The MACD indicator is painting a neutral picture for crude oil which is supportive of the uptrend.

ELLIOTT WAVE THEORY - Elliott Wave is warning that the rally off of the March lows may have been corrective in nature i.e. a B wave rally as the price action at the low was not significant enough to generate an ABC pattern into the low thus implying that it marked the end of a A wave decline. However given the extent of the decline, I cannot see $35 being revisited during 2010, which therefore is suggestive of significantly higher B wave, though that would change the wave pattern from an B-C wave pattern to a 1-2 wave pattern. Therefore at this point in time Elliott Wave theory is generating conflicting wave scenarios. Therefore I am concluding towards a more significant correction for crude oil than experienced during the past 10 months, but not one that would take crude oil to anywhere near the $35 low but probably more in the region of $60.

SUPPORT / RESISTANCE - Resistance for crude oil lies at $80, then $86 which contained the most recent high, then $100. Meanwhile support lies at $60. This suggests an immediate term trading range for crude oil between $80 and $60 and a wider range of $100 to $60.

PRICE TARGETS - Downside targets for the current correction resolve to $70, then $65. Upside shows a target range of $80 to $86 which again supports the view that 2010 could be a year of a trading range which is contrary to what we have experienced during past 5 years, something more akin to the trends experienced during the 1990's.

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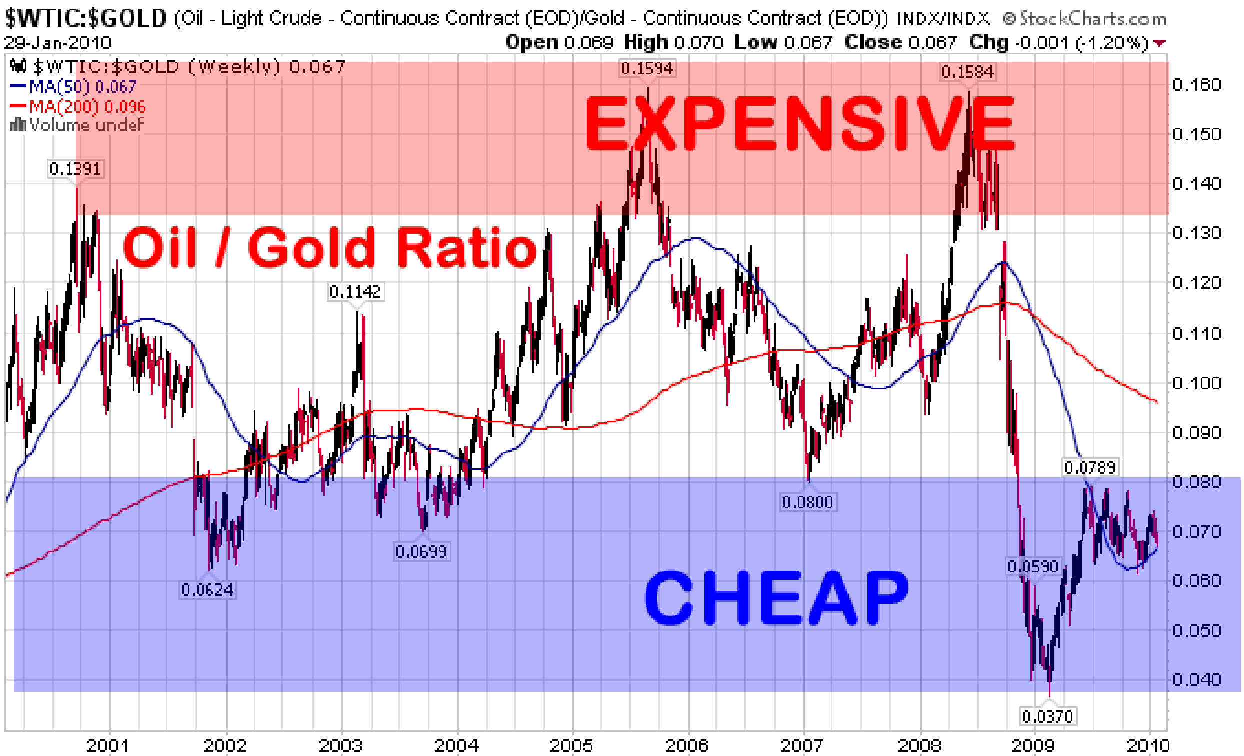
OIL GOLD SPREAD - The spread between Oil and Gold is a good way of gauging whether oil is expensive or cheap when priced in Gold rather than dollars. the below 10 year graph illustrates the wide trading range which despite the doubling of oil prices form the March lows still puts crude oil towards the lower end of the long-term range. This either implies Gold is expensive and heading for a sharp drop, or it implies oil is cheap and well supported at current levels.



Crude Oil at this point in time is nowhere entering a bubble frenzy as experienced going into the Mid 2008 spike to $147. Therefore a return to a high ratio is perhaps more than a year away. However the ratio does strongly suggest that Crude oil is HEAVILY supported at current levels, which paints a more bullish picture than from other analysis.

CRUDE OIL BLACK SWAN - IRAN ATTACK- Speculation is again rife that Iran's nuclear infrastructure will be attacked this year that would spike crude oil to well above $100. However as I pointed out a couple of years ago (04 Jul 2008 - Crude Oil Seeking Black Swan for Spike above $150 in Overbought State), that the probability of such an event was at less than 20% and that much of the commentary suggesting an attack is imminent is more akin to wishful thinking than based on any firm analysis. The fact of the ,matter is that the attack Iran story has been trundled out every year for at least the past 5 years. Still, if enough of the mainstream press are convinced of such an outcome even if it does not happen, then it could help build a speculative bubble in the oil price that would spike the price significantly higher as some 17 mb/d flows through the Gulf of Hormuz or 20% of the oil worlds supply. However an attack against Iran is currently NOT being priced into Crude Oil, as the above analysis on the Oil / Gold ratio illustrates.

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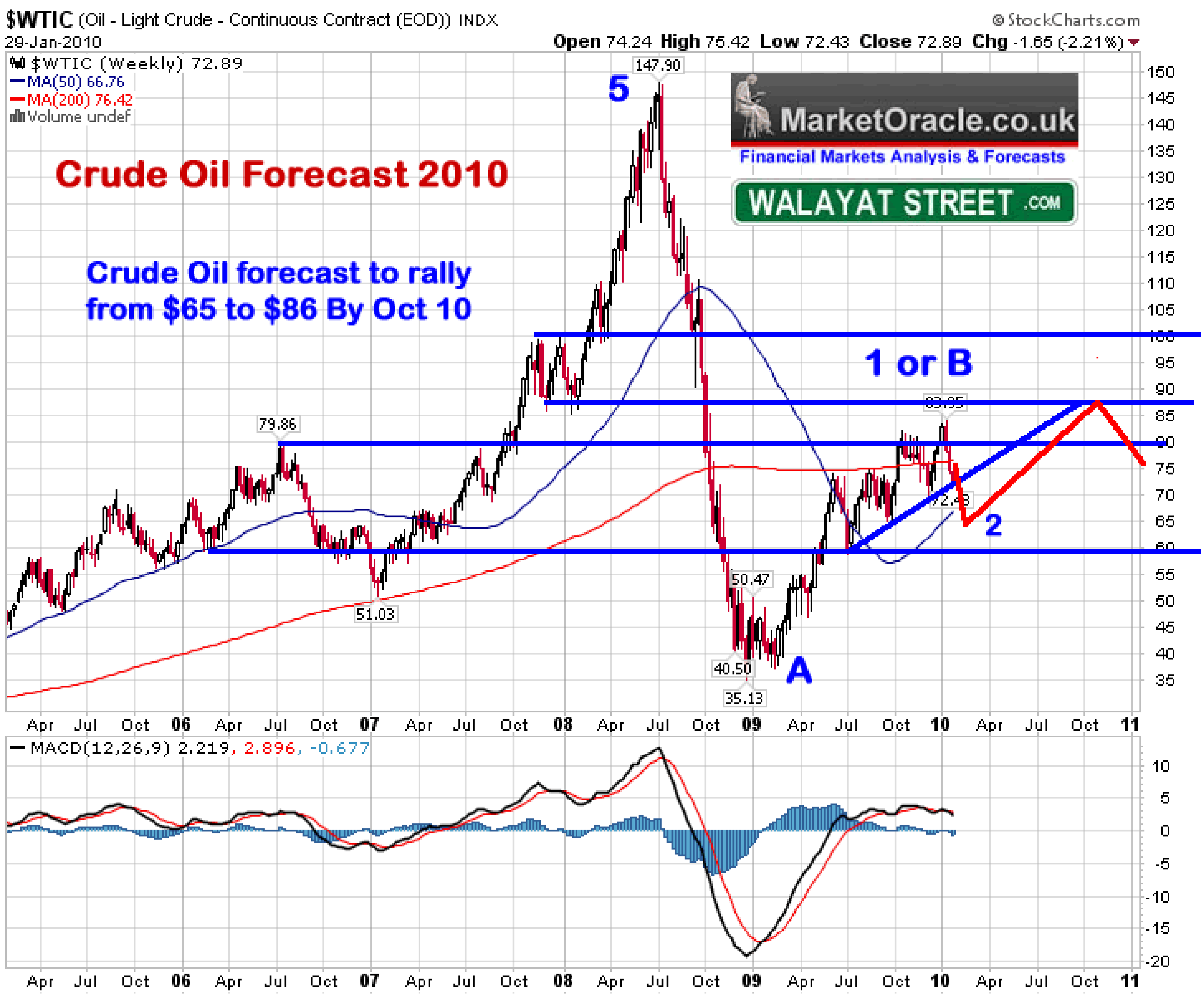
Crude Oil 2010 Forecast Conclusion

Despite Crude Oil being one of my primary inflationary long-term mega-trends, however I am expecting crude oil to trade within a trading range of between $80 and $60 for most of the year, with the immediate trend targeting a correction towards $65 which would mark the low for a rally into the seasonally strong period of the year of Sept / Oct targeting $86 (though it may spike as high as $95) that may be followed by a mild correction back towards $75.

Therefore the forecast presents plenty of opportunity for investors to accumulate for the long-run in inflationary mega-trend which does suggest that that crude oil at some point during the next few years WILL revisit and pass its 2008 peak of $147, just that this is unlikely to do so during 2010, but PEAK OIL is a REALITY that we will probably manifest itself during 2011-2012.



Crude Oil Investing

Considering that the forecast is basically for a trading range of between $86 and $65 for 2010, for investors it would probably be better to accumulate large cap crude oil stocks paying decent dividends on the general stock market correction underway for the long-run than to gain exposure to crude oil that may end 2010 little changed on the current price of $73 (oil stocks are covered in the Stocks and Sectors Investing section).

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Stocks Stealth Bull Market Trend Forecast

The reason why my analysis is focused on the Dow and not the FTSE index is because the Dow has been my primary trading vehicle for some 25 years, as at the start of my trading career back in 1986 the FTSE was the new kid on the block with little price history behind it, whereas the DJIA had relatively easily obtainable data dating back over a hundred years (via bulletins boards, a precursor for the internet).

Whilst this analysis attempts to accurately project a road map trend for the Dow for the whole of 2010, however readers should ensure that they read my regular in depth updates on the Dow trend (approximately every 2 months) which are emailed out and also at walayatstreet.com

2009 The Year of the Stocks Stealth Bull Market

For stock market Investors and traders there were two key events during the year.

1. The Stocks Bear Market Bottom of early March 2009 (Dow 6470).
2. The birth of the Stocks Stealth Bull Market that saw many indices soar by more than 60% over the next 9 months.

The primary purpose of analysis is to generate market scenario's that have a high probability of success for the primary purpose of monetizing on these trends that are usually contrary to the consensus view.

In this regard the stock market bottom of early March fulfills this as the whole subsequent rally has been called by the vast majority of analysts across the board a bear market rally to SELL into, virtually every correction has been followed by calls that the market has topped and the resumption of bear market lows as imminent. The most notable crescendo of the crash is coming calls was during the October correction when widespread commentary spread forth of an imminent crash that AGAIN FAILED to materialise.

Dow Jones Stock Market Forecast 2009 - 20th Jan 2009

Dow Jones Mid 2009 Low 6600 - 70% Confidence; End 2009 at 8,600 (During December 2009) - 65% Confidence

Chart courtesy of StockCharts.com

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Stealth Bull Market Follows Stocks Bear Market Bottom at Dow 6,470 - 14th March 2009

Now watch ! How this STEALTH bull market will consistently be recognised as just a bear market rally to sell into and NOT to accumulate into. All the way from 6,600 to 7,600 to 8,600 and even beyond, the move will be missed by most as consistently bearish rhetoric and data will ensure only the smart money accumulates, for the small investor has now become Conditioned to the Bear Market Rallies of 20% and subsequently plunges to fresh lows. Many, many months from now, with stocks up 30%, investors will then WAIT for THE BIG CORRECTION, THE RE-TEST to buy into the apparent BULL Market , Well these investors will still be waiting as stocks pass the 50% advance mark, AGAIN only those that will have profited are the hedge funds and fund investors (Smart Money) WHO HAVE BEEN ACCUMULATING , as I elaborate upon next.

In Summary - We have in all probability seen THE stocks bear market bottom at 6470, which is evident in the fact that few are taking the current rally seriously instead viewing it as an opportunity to SELL INTO , Which is exactly what the market manipulators and smart money desires. They do not want the small investors carrying heavy losses of the past 18 months to accumulate here, No they want the not so smart money to SELL into the rally so that more can accumulated at near rock bottom prices! Therefore watch for much more continuous commentary of HOW this is BEAR MARKET RALLY THAT IS TO BE SOLD INTO as the Stealth Bull Market gathers steam.

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Stealth Stocks Bull Market, Sell in May and Go Away? - 26th April 2009

Conclusion - Immediate term conflicting analysis, will there be a continuing rally into early May or not ? Clearly early week will be weak and a lot now depends on whether the support of 7,800 holds, the 280 point gap between the last close and support should give the market plenty of swine flu room to breath, it is a tough call but after that early week wobble, I would go with a continuation into early May to set up for the main move which is for the significant correction that targets a decline of about 14% or Dow 7,500 from 8750. If 7800 fails early week that implies Dow 7,100. So just as the herd is starting to pile in the smart money will be positioning for a significant correction and importantly the move will be TRADEABLE, none of these 1 or 2 day falls that have suckered the bears in during the rally, but for a sustained down trend though swine flu may bring this forward to the start of the week. Note this is an interim update, my in depth analysis will attempt to more accurately map out the Dow swings of several months so make sure your subscribed to my always FREE newsletter to get this on the day of publication.

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[Vicious Stocks Stealth Bull Market Eats the Bears Alive!, What's Next?](#) - 23rd July 2009

CONCLUSION - My earlier fears about a bull trap appear to be unfounded, the stock chart is talking that we are in a stocks bull market, and is suggestive of a trend higher towards a 2009 target of between 9750 and 10,000, with a high probability that we may get there before the end of October!. Key danger areas for this scenario are a. for the trend line to contain corrections, and b. that 8080, MUST HOLD.

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The Crumbliest Flakiest Stocks Bull Market Never Tasted Before - 7th Sept 09

Chart courtesy of StockCharts.com

The target for the termination of the current phase of the bull market rally was between 9750 and 10,000. As mentioned above, I am not expecting an easy ride for the fifth wave as clearly it is an obvious pattern to interpret following waves 1,2,3,4. What does this mean ? Well wave 3 is screaming weakness, so that suggests a weak push higher rather than something that resembles wave 1.

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Stocks Bull Market Correction Continues, U.S. Dollar Bears Running Out of Time? - 4th Oct 09

Stocks Bull Market Forecast Update Into Year End - 2nd Nov 09

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> There is nothing to suggest at this point in time that the stocks bull market is over which means that that corrections are for accumulating into, the overall trend is for stocks is to continue climbing a wall of worry whilst investors are scared by the vocal crash is coming crowd that will continue to re-write history to always be right in hindsight to again come out with more crash calls over the next few months as the Dow chart of the 1930's gets it's start / end date manipulated again so as to fit fresh crash calls.

> The stocks bull market that has raged since the March low has fulfilled the original objective for a 50% advance, therefore upside for the next two months looks limited with greater risk of downside in the coming weeks though pending a break of the major support trendline which implies a rally in the immediate future. All in all this is suggestive of a downtrend towards 9,400 into Mid November with a year end rally to back above 10,000 targeting a rally high in the region of 10,350 to 10,500 during December.

Stock Market Santa Rally and Election Weapons of Mass Deception - 13th Dec 09

> My concluding thought, we get the santa rally to a new 2009 high for the Dow into the last few days of December and then the market starts the significant correction.

Economy, Inflation and Interest Rate Forecasts Conclusions Applied to the Stock Market

The in depth economic analysis (inflation, economy, interest rates) has resolved towards the conclusion for a strong above trend economic recovery and rising inflation (UK early spike higher) during 2010 with a relatively mild up tick in interest rates during the second half of the year which will allow government's the opportunity to get a grip with the deficits under the momentum of economic growth and the return of consumer / investor confidence. However, I also do expect both the Bank of England and U.S. Fed to continue quantitative easing aka money printing to monetize the huge budget deficits, without which market interest rates would be significantly higher.

The analysis conclusions are highly supportive for the stock market during 2010 and probably beyond as corporate earnings continue to play catch up to the stock market price trends with institutions and large speculative funds continuing to dump cheap money into the stock market and other speculative assets having been driven out of low yield assets, therefore driving prices higher whilst the small investors are left to follow the perma bear crowd that are perpetually expecting a break of the March 2010 lows as though it is a done deal.

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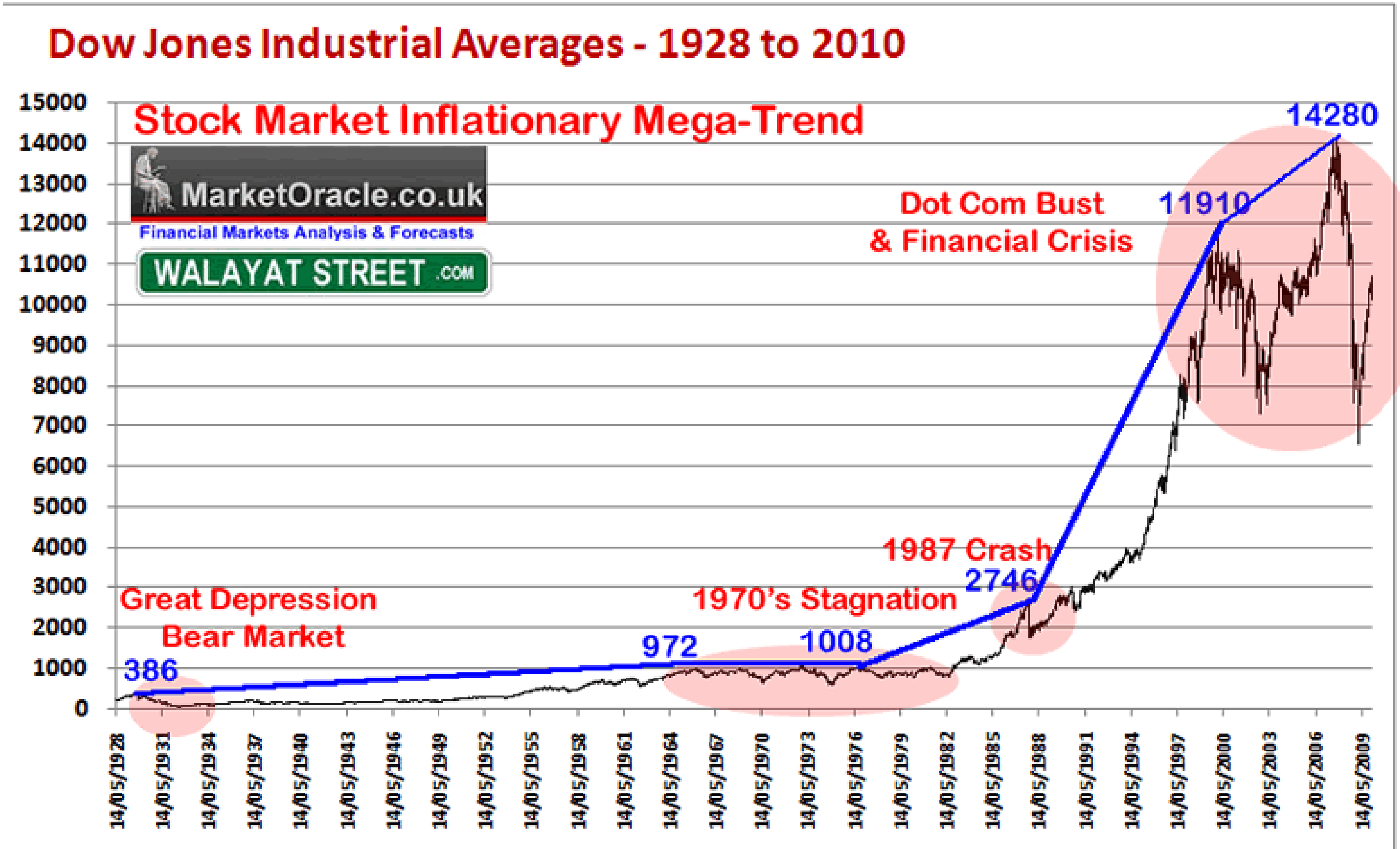
Stock Market Mega-Inflationary Trend



The Above graph illustrates the stock market inflationary mega-trend or growth spiral which basically implies that the further a general stock market index such as the Dow, S&P or FTSE deviates from its peak in terms of price and time, then the greater the long-term potential it presents for investors. Which highlights why the early 2009 stock market plunge into the March lows was literally a once in a life time buying opportunity, as I warned investors to prepare towards in October 2008 - Stocks Bear Market Long-term Investing Strategy

Whilst I don't like to transpose past price action onto the present as it is not reliable, however I do recall at the time of the rally off of the 1991 decline everyone had their eyeballs fixated on the 1987 crash lows as though they would be revisited, when in fact it was another great buying opportunity of a lifetime as the subsequent price action illustrated. All you folks may not realise this now but the period from 1991 to 1996 was ALL followed by perpetual extremely bearish commentary of the end is nigh. Few BOUGHT This rally ! Even Greenspan appeared to play the bearish card at about Dow 6,000 with his famous Irrational exuberance speech at the end of 2006 to frighten and keep weak small investors out of the market that would only return towards the end of the dot com boom. The Dow doubled from 1996 to 2000.

Where do we stand today ? Well we have not even reached the stage that demands another Irrational Exuberance speech. We are in the overwhelming bearish commentary phase that frightens and keeps all but the smartest money out of the market much as the occurred following the 1987 crash rally, much as occurred from 1991 to 2006. Presently this commentary appears as an avalanche of bearishness on EVERY correction, the consequences of which is reflected in the volume data that shows most people are NOT buying the rally but SELLING, which is why I termed this a stealth stocks bull market back in March 2009.

What we are witnessing today is pretty much similar behaviour that I suspect will persist for many years! whilst the bull market rages on!

Yes, for 2010 the best of the gains in terms of price / time are behind us, however the Dow is a long way from reaching an overbought / expensive state, therefore still presents a good long-term accumulating level.

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Market Manipulation

I came to the conclusion a couple some time a couple of decades ago that the markets were manipulated, therefore taking account of market manipulation in terms of what direction will the dark pools of capital deployed by the worlds investment banks and speculative funds take the markets next as part of its psychological make up i.e. Mr Market, is a very important component of the tripartite of analysis in addition to technical & inter-market analysis and the sum of all fundamental analysis. Put all three together and one has a higher probability of profiting from today's investment decisions. Apart from working within a dark pool institution such as Goldman Sachs, the only way to get an insight into their behaviour is to evaluate which trend would the dark pools most profit from at any particular point in time i.e. market psychology which usually means the opposite action to the consensus view.

This is one of the key contributory reasons why I called the birth of the stocks stealth bull market of March 2009 that has since consistently been called a bear market rally despite the fact it has seen a phenomenal 65% gain in 10 months. I mean that is a DREAM return for investors, one cannot hope for or expect anything better, but instead of enjoying a hugely profitable bull run, most small investors have been convinced to WAIT for evidence of economic and corporate earnings recovery by which time as occurs it will be TOO LATE as the market will have already moved, precisely as I warned of in Mid March 2009.

So what does my interpretation of the dark pools or market psychology telling me today ?

It is telling me for the stock market as a whole that the dark pools are still engaged in accumulating into a stock market multi-year mega-trend which at present is in the motion of shaking out the temporary weak longs along. Which means we are STILL in a stealth bull market where the vocal media-sphere view it as a BEAR MARKET RALLY that has ENDED, consistently WRONG market calls by popular perma-bears are a god send for the market manipulating dark pools of capital as they continue to accumulate and profit from the stealth mega-trend.

Stock Market Crash Again?

Forget swine flu, the pandemic that has been doing the rounds for the past 6months is that of another Crash with the 1930's chart dusted down and presented as near fact of what is to transpire on every correction. However the markets response has so far always been to eventually push to a new high for the move.

What happens to the crash calls ? They get amended and rolled out again on the NEXT correction! Don't believe me go check out what I wrote on 2nd November.

However the damage has been done as short stops are hit and losses accrued that no broker will refund for the next crash call.

Stock Market Crash Calls

1. You CANNOT know with any reliability that the stock market is going to crash until AFTER it has actually peaked and entered a downtrend. Anyone that tells you a bull market pushing to new highs is going to crash is going to lose you all your money, as the market rallying significantly from the crash call NEGATES THAT CALL where trading is concerned, because any short positions enacted upon the call are stopped out!

2. You can only enter a Crash TRADE barely a day or hours before the crash event. Crash calls made weeks, months or years in advance are WORTHLESS where trading is concerned, and where investing is concerned, all investors should have stops on their positions based on technical considerations of where they would admit their analysis is wrong on a particular stock.

Crash calls are dangerous in that bring emotions into play which instead of staying focused on reacting to price action, adrenaline gets traders to commit to positions that will soon most probably bust their accounts where EVEN if the market eventually does CRASH, they will have been wiped out by the intervening rally SINCE the crash call! It is this fact that that is always forgotten.

Don't believe me ? Go check ALL of the hyped stock and other market crash calls that in actual fact WERE FOLLOWED by moves that would have wiped out REAL trades had those calls been acted up on.

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During 2009 I have shared some of my trading ideas that may go towards a future ebook-

- Get in Synch with the Market
- Forecasting and Trading
- The Holy Grail of Trading
- How to Learn to Trade
- Don't Think Too Much

Economic Depression, What Depression ? - US GDP soared in the fourth quarter at an annualised 5.7%, yes, the rate of accent is probably NOT sustainable, but the debt fuelled bounce will continue a while before it peter's out into. The key point is as I pointed out in the analysis of October 2008. That we are NOT heading for another 1930's GREAT DEPRESSION, and therefore readers should scrub the notion of following the 1930's chart pattern towards anything like a 90% stocks crash. So far the analysis is proving correct.

Corporate Earnings - Corporate earnings have FOLLOWED the stock market higher, despite continuous doom orientated commentary of the past 10 months that has repeatedly stated that corporate earnings forecasts implied stocks could NOT rally.

ELLIOTT WAVE THEORY - The elliott wave pattern resolves to an easily recognisable wave 4 correction which implies a further 5th impulse wave higher will follow that could take the Dow significantly higher. Clearly the alternative more bearish count is that Wave 3 was a Wave C of an ABC move which would imply that the rally to date corrected the preceding bear market from the 2007 high. My interpretation is that we get something in the middle, i.e. that BOTH interpretations are now FAR TOO EASILY discernable from the price charts which suggests to me we get a volatile 5th wave higher, rather than a strong wave similar to Wave 1 and Wave 3. On a shorter term basis the immediate trend should resemble an ABC correction of which we are presently in the wave A decline that should shortly resolve towards a B wave rally before a C wave decline to end the correction.

TREND ANALYSIS - The Dow is falling towards major support at 10k. Given the strength of the downtrend to date, the probability favours a break of 10k that would target approx 9,600. The bull market trendline has been breached which suggests that the stock market has entered a new character of behaviour that will be significantly different to that which followed the March 2009 low. I.e. greater volatility, which suggests it will take the market some time to break the 10,729 high, which will probably now not occur until the second half of 2010.

SUPPORT / RESISTANCE - There is a series of strong support in the region of 10,000 to 9,800. and then 9,500. Should 9,500 break then the Dow could tumble all the way to 50% of the rally at 8,600. Overhead resistance lies at 10,300, then 10,400. With strong resistance in the region of the 10,600 to the high of 10,726. It will probably take some time for this resistance to be overcome. Next resistance above is at 11,250 that may mark a pause in the uptrend if it breaks higher enroute towards the target for 2010.

PRICE TARGETS - Downside price targets resolve into the 9,500 to 9,800 zone, therefore this should contain the current correction, a failure here would negate this analysis and probably mark the end of the bull market which initially targets a decline to 8,600. Upside projections show difficulty in breaking above the 10,729 high, though once overcome the Dow would target a level north of 12k.

MACD - The MACD confirms both the significant correction currently underway and the expectation of difficulty for the Dow to overcome its recent high for some time i.e. until it has been able to work out the overbought state. This suggests that it may take the Dow several attempts to break above 10,729 during 2010, with the eventual break out higher probably not taking place until the third quarter of 2010.

VOLUME - Volume has been WEAK throughout the rally, which has been one of the main reasons why so much commentary has been bearish during the rally. However it is perfectly inline with that of a stealth bull market and also implies that this rally has NOT been bought into. So all of the talk of hyper bullishness investor sentiment is basically rubbish as there is no sign of such sentiment in the volume, which remains heavier on the declines than the rallies and thus suggestive of SELLING rather than buying into the rally.

SEASONAL TREND - There is a strong seasonal tendency for stocks to rally into Summer then correct in October followed by a sharp rally into December. This is contrary to my growing expectations of a tough first half of 2010. In fact we may see in large part the opposite trend during 2010.

PRESIDENT CYCLE YEAR 2- The impact of the 2nd year of the presidential cycle on the stock market is for a weak trend into September, and a rally in the fourth quarter into the end of the year for a small average gain for the year. This much more closely resembles my growing expectations for 2010 then the seasonal trend.

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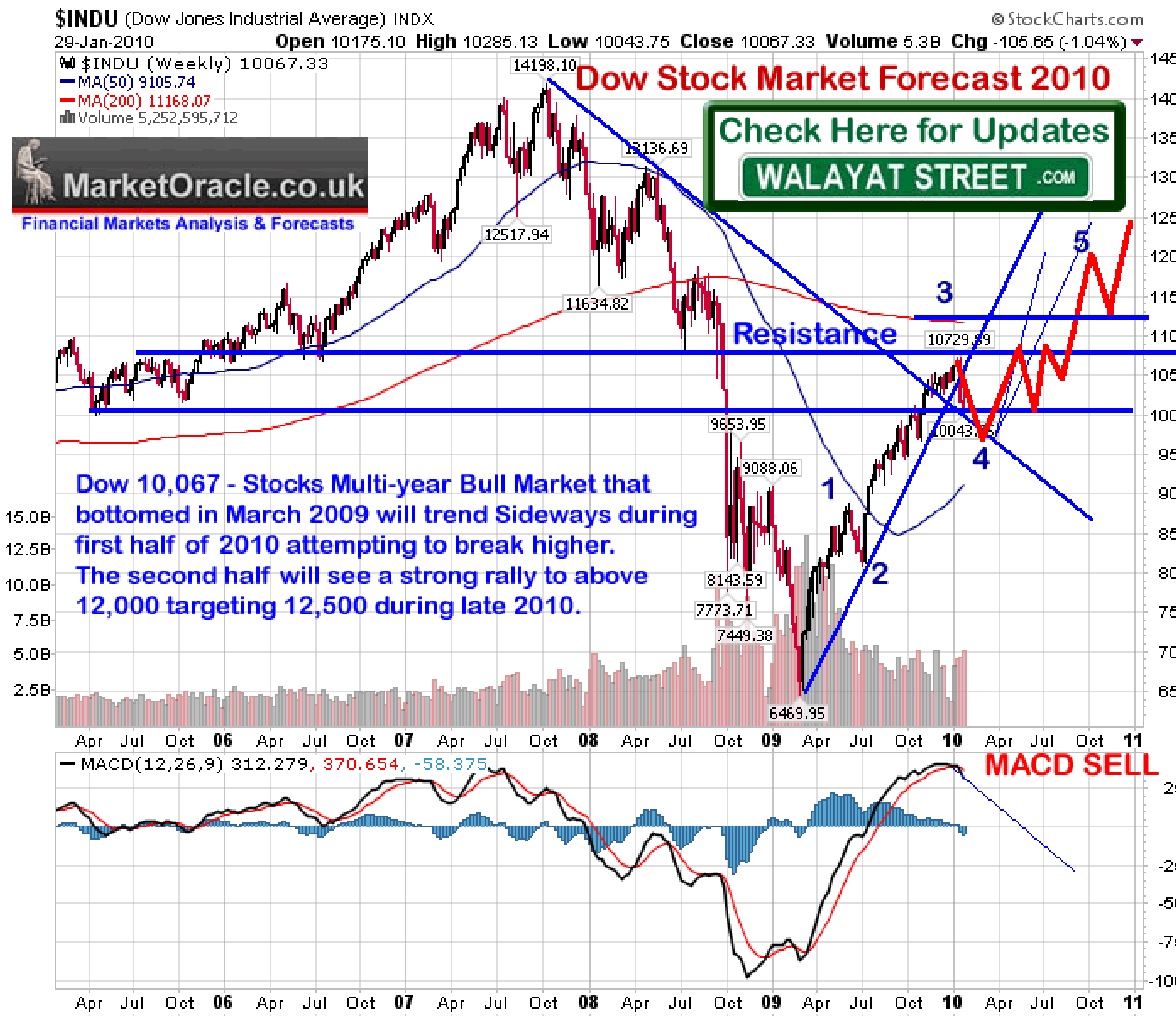
Stock Market Conclusion

Whilst the bull market is undergoing a significant correction that targets 9,500 to 9,800, nothing in this analysis has changed my long-term conclusion as of March 2009 that we are in a strong multi-year stocks bull market. Therefore I will leave it to others to still debate on whether or not to invest or playing around with transposing of charts form the 1930's whilst one of the greatest bull markets in history continues to pass them by as the further the stock market deviates from its bull market peak the greater will be the buying opportunity presented.

Where the forecast is concerned, Ironically I am finding the first half of 2010 much more difficult to conclude towards than the second half, as I do expect a strong rally in the second half of 2010 to a new high for the bull market with the Dow breaking above 12,000 during late 2010 and may hold onto the 12k level into year end. The first half of 2010 will probably resemble a wide sideways trend with an upward bias after the current low is in, the Dow will repeatedly attempt to break above 10,729, how many times ? well there lies the volatility question, however turning towards utilisation of elliott wave theory, I am going to conclude the analysis towards 2 failed attempts before the final break higher, but it could be 1 or 3.

Dow (DJIA) 2010 Stock Market Trend Forecast Conclusion

Dow 10,067 - Stocks Multi-year Bull Market that bottomed in March 2009 will trend Sideways during first half of 2010 attempting to break higher. The second half will see a strong rally to above 12,000 targeting 12,500 during late 2010.



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Risks to the Forecast

Technically we have had a major sell signal on break of the main uptrend line which means the current correction has YET to bottom, my target is eventually a bottom at 9,500 to 9,800 after a corrective B wave rally towards 10,300, the C wave decline should hold at this, however if 9,500 goes then this at least implies a bear market that initially targets 8,600.

The primary risk for the end to the bull market is that the central banks pull the plug on easy money as a consequence of a series of sovereign debt crisis. I.e. forced to push interest rates much higher than forecast to prevent a bond market / monetary collapse. In reality the government's have a window of opportunity to benefit from the strong economic recovery currently underway to CUT the budget deficits and get a grip on debt to GDP ratios. If they waste this opportunity then this forecast could fail as it resolves towards a bear market trend back towards the March 2009 lows.

However I put this risk at this point in time at about 25%, small but significant. It really depends on the economic bounce being as strong as I forecast it to be which will carry the markets AHEAD of it, and inflation and consumer confidence along with it therefore allowing deficits to be cut along side economic growth.

FTSE 100 Forecast 2010

I expect the FTSE to follow a similar trend to the Dow in terms of price pattern which resolves towards a target for FTSE 6,250 to 6,600 by late 2010, with similar downside risks.

Stock Market Sectors and Stocks For the Mega-trend

This section aims to generate a selection of stocks as examples of what could be expected to perform well during the inflationary mega-trend as revenues and profits are inflated ever higher. My focus in the selection process has been towards safety over risk therefore concentrating on elements of value investing, therefore the list contains mainly large cap stocks with strong cash-flows, low debt and paying healthy dividends as well as being geared more towards a UK based investors. Again this should act as a starting point for your own research into which stocks as part of the mega-trend sectors are likely to prosper on the basis of your own risk profile.

Dividends Value Investing Strategy

Investors were hit hard during 2008 by the collapse of the banking sectors high dividend paying stocks such as HBOS and Lloyds TSB in the UK which had consistently paid a dividend in the region of 7% per year. This has left many investors battered and bruised as they seek to rebuild their high dividend yield portfolios. However despite the banking sectors spectacular collapse, my long-term investment strategy is still geared towards a model that aims to accumulate stakes in high dividend paying low risk high probability return stock investments. Therefore where individual stocks are concerned I continue to concentrate on the more boring big cap sector leaders with strong cash flows, low debt ratios and usually paying a good dividend yield.

Yes capital growth is limited but so is price volatility, which is especially illustrated by the past 2 years across virtually all sectors excluding banking. The actual growth comes from the fact that dividends can be expected to be INCREASED year on year, this coupled with the second half of the strategy which is geared towards REINVESTING dividends back into the companies results in growth of ones holding over time, even if the stock price underperforms against the general stock market or sector indices.

The inflation mega-trend implies that the focus of investors should be towards real assets which favours the likes of the commodities and energy sectors that are more likely to grow due to price increases and emerging markets demand for scarce resources.

So putting all things together one has a low risk portfolio diversified across several sectors geared towards inflation proofing long-term growth and dividend income reinvestment strategy.

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In Summary the strategy is -

- Select Medium to Large Caps, Focus on Sector leaders
- High Dividend Yields
- Strong and Consistent Cash flow
- Low Market Cap to Net Asset Values.
- High and consistent Return on Equity
- Sizeable cash reserves, strong balance sheets
- Low Debt Ratios

Investors can further reduce the risk posed by individual stocks by selecting mega-trend sector ETF's

Check Your ETF's and ETC's Before You Invest

Whilst ETF's and ETC's potentially give an excellent opportunity to spread ones risk across a sector rather than investing in 1 or 2 stocks within a sector, however as my earlier analysis of natural gas and UNG pointed out, after having identified a sector, market or commodity to invest in, one needs to check the performance of the various ETF's and ETC's to ensure that you are NOT going to be short changed due to the way they are constructed. I.e. my analysis has shown that GLD and SLV are good ETF's that do closely track the underlying commodities whereas my research indicates that many ETF's and ETC's do NOT track the underlying securities closely (especially commodities) and consistently underperform.

The easiest way to check if you do not have a comparison tool is to eyeball a 5 year chart of the underlying market and the ETF and write down the highs and lows, work out the % movements by dividing the high against the preceding low and then you will see to what degree the market tends to underperform.

Again, CHECK BEFORE YOU INVEST! Also steer clear of ANY leveraged ETF or ETC.

Monitor Your Portfolios

There are two fundamental parts of investing - a. Entry and b Exit. Whilst the majority of investors spend most of the time focused on the process of stock selection and entry, how many actually take the time to monitor their investments or if not monitor enter conditional exit orders.

The key to long-term successful investing IS in having an exit mechanism for a stock, commodity or ETF. Without an exit mechanism then bull market profits will inevitable be wiped out by bear market losses.

The most simplest mechanism for an exit strategy is to seek to update a SELL order with your broker every month at 20% from the high on the price chart. In today's internet trading world such SELL STOP order facilities are routine.

A slightly more intensive mechanism is to eyeball on the price chart a significant support level under which the price should NOT fall for you to be right in your investment decision.

Once SELL STOP orders are placed then you should seek to monitor your portfolio AT LEAST once a month, if a SELL STOP is hit then you need to take the time to re-evaluate your point of view on your decision making process for entering into the position.

Self Select ISA's

Self select ISA's are part of the UK annual tax free ISA allowance of £7,100 which comprises two components, the Cash ISA and the Shares ISA, which for the current tax year for most people is £3,600 in each part, rising to £5,100 each from 6th April 2010 (total £10,200).

Self select ISA's as the name suggests allow investors to select their own stocks and bonds i.e. they are basically ordinary share dealing accounts encased in an ISA wrapper.

All capital and income gains accrued within a self select ISA are tax free (dividends are still taxed at 10% at source).

For those that want to invest more than the component part i.e. £3,600 then if you do not open a cash ISA you can utilise the

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full annual allowance of £7,200 towards a shares self select ISA.

Virtually all self select ISA providers charge a small annual fee, usually a fixed amount in the range of £30 - £50 on top of dealing costs.

Healthcare Sector

Japan is leading the way for the West towards an increasingly elderly population which sows the seeds of below trend growth and ever higher healthcare costs. However it is not all gloom and doom, as many western countries such as the U.S. and UK are easily able to import bright, young labour from abroad from the large population pools of the emerging markets as well as attracting populations from emerging european countries which should offset the demographic consequences that have been hitting Japan's economy for at least a decade.

government's of Both the UK and U.S. have recognised the need for increased healthcare spending demanded by their respective ageing populations as the baby boomers increasingly enter into retirement, demanding greater healthcare provision and have thus embarked on initiatives which ensure that the healthcare sector will continue to expand as a % of the economy. For instance the NHS in the UK as a consequence of the Labour government's tripling of the healthcare budget over the past 10 years now stands at approx 9.5% of GDP which is destined to increase to 12% of GDP over the next 5 years.

Meanwhile the United States is engaged in the process of bringing universal health care coverage to all of its citizens as President Obama attempts to implement the first of many steps along the path that will ultimately drive many more extra trillions of dollars into the U.S. healthcare sector that already stands at 17% of GDP.

Whilst the focus is on the west's ageing populations, however it should not to forgotten that an increasingly prosperous emerging markets middle class will increasingly pay for a developed world quality of health care thus a lot of demand is going to flow from the emerging markets.

Therefore the healthcare sector despite some discounting of future expansion and the strong rally off the bear market lows, still presents an excellent long-term investment mega-trend as healthcare spending can only go up regardless of what happens to the wider economy therefore I expect the healthcare sector to outperform other sectors over the coming decade.

Clearly the safest exposure to the healthcare sector is via the large drug companies such as Pfizer and Merc in the U.S. or Glaxo in the UK.

Furthermore exposure to the related biotech sector is warranted, especially as the big cash rich drug companies seek to take over the smaller bio-tech companies to replace their ageing and expiring existing drug patents. To reduce risk to the bio-tech sector, an ETF or fund is probable the better option such as SPDR Biotech ETF (XBI)

Pfizer- Low Risk- Low Growth
Dividend Yield = 4%
P/E Ratio = 11 / Forward 8
Market Cap = $143bn
Return on Equity = 30

Glaxo - Low Risk- Low Growth
Dividend Yield = 5%
P/E Ratio = 11.5 / Forward
Market Cap = £64bn
Return on Equity = 60

iShares S&P Global Healthcare (IXJ) ETF - Medium Risk - Medium Growth
Dividend Yield = 1.2%
P/E Ratio = -
Market Cap = $550mn

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Metals and Mining Sector

China's thirst for minerals and metals ensures that the big miners that are able to meet China's needs remain the key long-term stocks to be invested in as the inflation mega-trend unfolds. Off all the miners, at the top of the list is BHP Billinton which manages to deliver low risk growth potential with a decent dividend payment.

A number of ETF's are available that spread the risk across several miners such as the SPDR S&P Metals & Mining (XME) that offers a yield of 1.1%.

BHP Billiton - Low Risk - Medium Growth
Dividend Yield = 2.3%
P/E Ratio = 23 / Forward 17
Market Cap = $205 billion
Return on Equity = 21

Vale - Medium Risk - Medium Growth
Dividend Yield = 1.7%
P/E Ratio = 26 / Forward 19
Market Cap = $142 billion
Return on Equity = 8

RIO Tinto - Medium Risk- Medium Growth
Dividend Yield = -
P/E Ratio = 20 / Forward 17
Market Cap = $51 billion
Return on Equity = 16

Oil & Gas Sector

The oil, gas and energy sector are expected to be one of the main beneficiaries of inflation mega-trend as energy prices consistently rise to new highs over the coming years i.e. crude oil will at some point over the next decade pass $200.

The dominant UK global oil players are BP and Shell, which despite the rally off of March lows are trading relatively cheaply in price earnings terms, especially if the crude oil mega-trend continues to manifest itself towards a price north of $150. The big bonuses for big cap oil stock holders is the high consistent dividend growth payments as long as crude oil stays above $60, which ensures a less volatile and slowly growing share price.

The riskier stocks are smaller caps involved in exploration and services such as Tullow Oil and Cairn Energy.

In my view the oil majors present a solid long-term investment i.e. sizeable increasing dividend income plus some capital growth potential, yes their share price won't fly to the moon, but nor are you likely to wake up to a total wipeout.

Where Natural Gas is concerned in the UK, the gas suppliers have near monopoly powers with little competition that is reflected in the high prices charged to domestic customers despite low natural gas market prices, this is reflected in the profits generated by the likes of Centrica operating under the brand name British Gas not to be confused with British Gas Plc which concentrates on exploration and production. My earlier Natural Gas mega-trend analysis concluded that the UNG ETF is not a good investment vehicle, however after hunting high and low for exposure to the Natural Gas price I settled upon The San Juan Royalty Trust, a relatively small cap ETF stock quoted on the NYSE that pays a 8% dividend, which gives plenty of time for an investor to sit tight waiting for the inevitable spike higher whilst collecting an excellent sized dividend.

Renewable's - Another sector to participate in as a consequence of Peak Oil and the looming energy crisis is renewable energy, however many of the companies are far too small and speculative to select between them, therefore a fund or ETF is probably the best way to gain exposure to renewable energy such as the PowerShares Global Wind Energy ETF as one of a possible number.

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Oil Stocks

BP - Low Risk - Low Growth
Dividend Yield = 4.8%
P/E Ratio = 10 / Forward 7
Market Cap = £108 billion
Return on Equity = 17

Royal Dutch Shell A - Low Risk - Low Growth
Dividend Yield = 6.2%
P/E Ratio = 8 / Forward 7.5
Market Cap = £62 billion
Return on Equity = 10

Tullow Oil - High Risk - High Growth
Dividend Yield = 0.5%
P/E Ratio = 40
Market Cap = £11 billion
Return on Equity = 12

CAIRN ENERGY - Very High Risk - High Growth
Dividend Yield = -
P/E Ratio = 26
Market Cap = £5 billion
Return on Equity = -5

Natural Gas

British Gas - Low Risk - Low Growth
Dividend Yield = 1%
P/E Ratio = 18
Market Cap = £40 billion
Return on Equity = 16

Centrica - Low Risk - Low Growth
Dividend Yield = 4.5%
P/E Ratio = 14 / Forward
Market Cap = £14 billion
Return on Equity = -35

The San Juan Royalty Trust - Medium Risk - Low Growth
Dividend Yield = 8%
P/E Ratio = 19
Market Cap = $800mln

Technology Sector

Recessions come and go but technology marches on ever further and at an increasingly accelerating pace. New technologies represent new investment opportunities. The dot com bubble burst some 10 years ago and still the tek stocks as an overall group remain some distance from attaining their former heights, the past 10 years technological developments have enabled many tek stocks to actually deliver what they were promising 10 years ago in terms of revenues and profits, so the sector is many years from attaining a bubble state again and therefore primed for accumulating into.

One things for sure the next decade will see new technologies appear that will be just as world changing as the internet has been,and in that respect the world leader in technological innovation remains the United States. Whilst most write about the shift of power from West to East, which as I have pointed out is as a consequence of the East being so far behind the West in terms of development and GDP per capital, therefore has plenty of room to play catch-up. However new technology such as artificial intelligence could make much of the cheap asian labour obsolete as the new technology allows for the manufacturing base to once more return to within Western countries.

Whilst we wait for the next Google to emerge, we can still reap mega rewards from the existing Google and the other Tek sector leaders.

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There are a number of ETF's available to spread the risk amongst the tek sector giants such as iShares S&P North American Technology Sector Index ETF (IGM)

Google - Low Risk - Medium Growth

Dividend Yield = 0%
P/E Ratio = 26 / Forward 19
Market Cap = $169bn
Return on Equity = 20

Google is operating what amounts to an internet monopoly, therefore if the internet continues to grow rapidly then so will Google's earnings and profits. Neither is Google resting on its laurels with a plethora of new developments seeking to expand Google's reach out of the computer monitors and literally into everyone's hands as illustrated by the Nexus One mobile device which is a direct competitor for Apples i-phone, a development which follows on from Google's Android smart phone operating system.

So Google should rank as a key element of any tek stocks portfolio as the safest play is in the strongest stock in any sector. The only lingering issue is that Google has never paid a dividend and nor is it likely to do for some time. However Google is a money printing machine which suggests investors can expect strong capital gains in the long-run.

Vodafone - Low Risk - Low Growth

Dividend Yield = 6%
P/E Ratio = 26 / Forward 10
Market Cap =£72bn
Return on Equity = 7

A UK telecom rather than a tek stock. Vodafone is the sector leader in the UK and generates a strong cash flow and sits on a cash mountain. The company pays a healthy dividend and unlike other telecom's such as BT is not saddled by crippling debt.

Intel - Low Risk - Low Growth

Dividend Yield = 3%
P/E Ratio = 18 / Forward 12
Market Cap = $112bn
Return on Equity = 10

When the chips are down the big player has to be Intel which dates back more than 40 years and has shown consistently that it is able to retain leadership of the chip sector for the whole of those four decades through innovation, as highlighted by its most recent microprocessor that contains more than 1 billion transistors against the some 2000, of its first microprocessor. I remember in the early 1990's as the chips were passing the 1 million transistor mark there was much commentary that surely there must be a limit, now some 20 years on with 1 billion transistors we can only imagine that in 10 years time, Intel chips will have more than 10 billion transistors with exponentially greater processing power. Therefore another long-term tek stock has to be Intel that is able to ramp up its prices and dividends inline with rising inflation.

Microsoft - Low Risk - Low Growth

Dividend Yield = 1.7%
P/E Ratio = 16 / Forward 13
Market Cap = $248bn
Return on Equity = 40

Microsoft is another monopoly giant in the software and operating system sector which ensures continued ramping up of dividends and earnings and profits and as for Google and Intel, Microsoft will still expected to be the sector leading giant in 10 years time, however I do see less growth as it loses some market share to the internet. Include Microsoft in a portfolio ? Yes.

Microsoft is a great long-term buy, especially on any market plunges as it is remains a monster cash flow generator that allows it pac man style to gobble up the competition.

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Cisco - Low Risk - Low Growth

Dividend Yield = None
P/E Ratio = 23 / Forward 16
Market Cap = $138bn
Return on Equity = 15

Cisco is another company that is sitting on a mountain of cash ($35bn). The company is the back bone of the internet with more than a 50% share of both the network switching and router markets, that looks set to grow with the internet. Though on the negative side, Cisco does not pay a dividend despite its huge cash mountain which is necessary for especially low growth companies.

Water Utilities Sector

Water companies whilst being subject to the whims of the regulator in determining the scope for price rises, they do however operate natural monopolies with little competition that have stable cash-flows which enable then to continue to pay high dividends. Water demand is in a perpetual upward curve whilst the supply of water is becoming more problematic both as a consequence of climate change and as a consequence of under investment which the regulator is attempting to rectify by forcing the companies to upgrade infrastructure.

Virtually all of the water companies pay high consistently high dividend yields, which therefore represent low risk, low growth, income earning opportunities that can be expected to grow their dividends for most years in real terms i.e. after inflation.

Severn Trent - Low Risk - Low Growth
Dividend Yield = 6%
P/E Ratio = 11
Market Cap = £2.5bn
Return on Equity = 18

United Utilities - Medium Risk - Low Growth
Dividend Yield = 6.4%
P/E Ratio = 20
Market Cap = £3.5bn
Return on Equity = 25

Disclaimer of Holdings

Currently as of the 31st of Jan 2010, Nadeem Walayat has holdings in the following stocks and ETF's that have been specifically mentioned within this ebook - BHP Billinton, RDSA, BP, HSBC, British Gas, Google, DBA, FXI, SLV, United Utilities, Vodafone, Centrica, UK Index linked Bonds.

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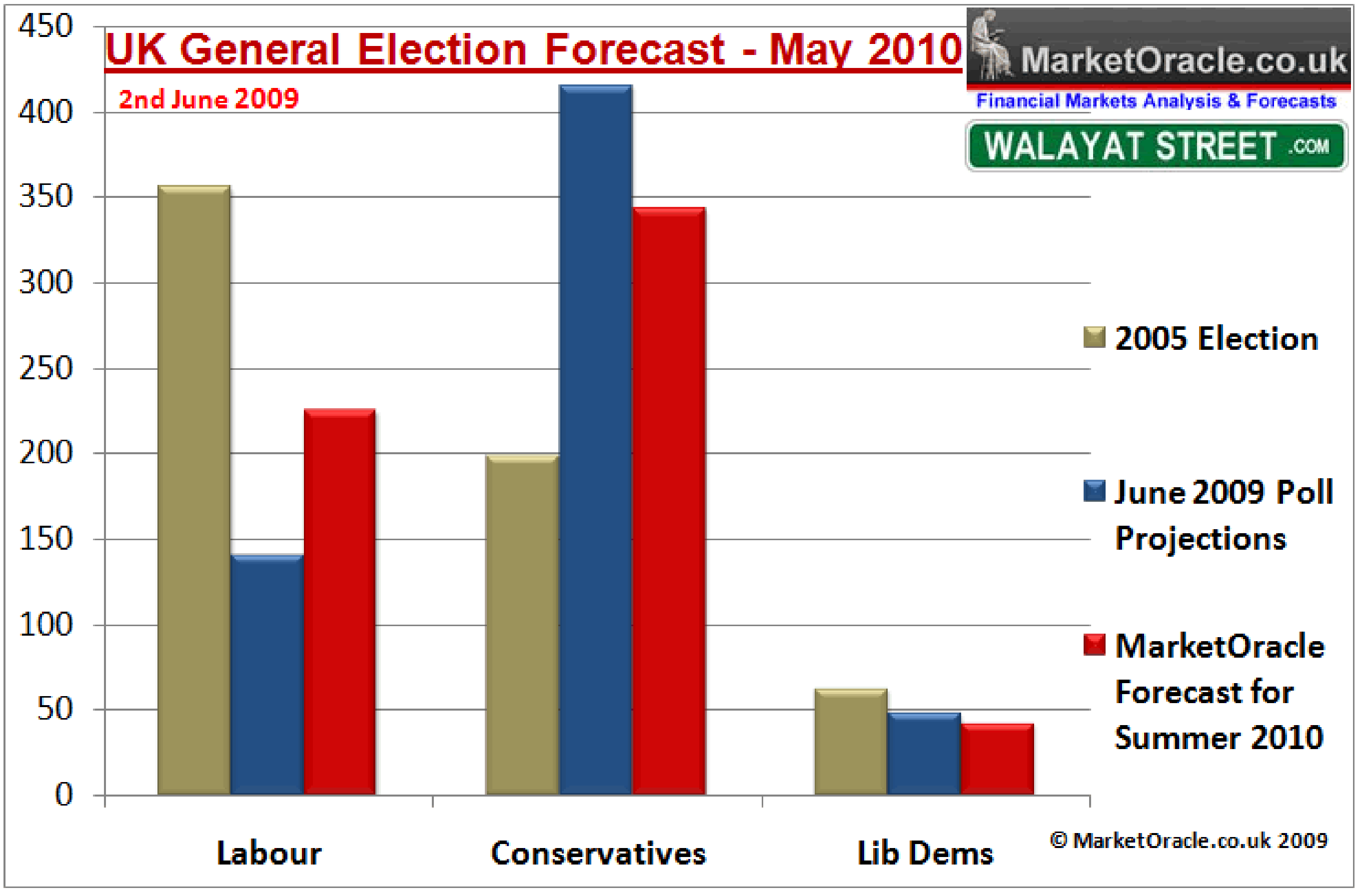
UK General Election 2010

The anticipated date of an early May 2010 General Election remains, my original projection on the number of seats as per the UK election forecast of June 2009 was for the Conservatives on 343 seats, Labour 225 and Lib Dems on 40 as illustrated by the below graph.



The continuing low interest rates and economic recovery by the time of the next general election which is already being reflected in the unemployment data that has surprised many of the academic economists suggests that there could be some narrowing between the two parties.

Apart from the economy, the major significant factor impacting all three major political parties is the MP expenses scandal that broke in May 2009. Which had revealed that more than 50% of MP's to some degree had allegedly submitted fraudulent claims of which a small number face a possible criminal investigation. This has had the effect of giving support to the lunatic fringe far right parties as voters were turned off from the main parties, therefore suggesting that the 2010 General Election will be decided on the basis of which party do the voters least despise.

Another factor is the bailout of the banks, which despite being the actions of a Labour government, actually impacts more negatively on the Conservatives who are seen as the bankster's kindred spirits, therefore the bank bailouts controversy favours the Labour Party over the Conservatives.

A minor but still significant factor remains the Iraq war which will again hurt both major political parties and benefit the Lib Dems due to their stance against the illegal war the case for which was built in totality on a dodgy dossier full of bare faced lies.

The degree to which the election result could narrow between the parties is dependant on the economic data released late April, i.e. primarily GDP Data. That 'SHOULD' show an strong recovery in the order of an annualised rate of more than 5%, which will swing some voters in the direction of Labour. That coupled with the fact that the Labour party has an inbuilt bias of at least 4% for the same number of seats suggests that Labour's position suggests that a large conservative victory is highly unlikely.

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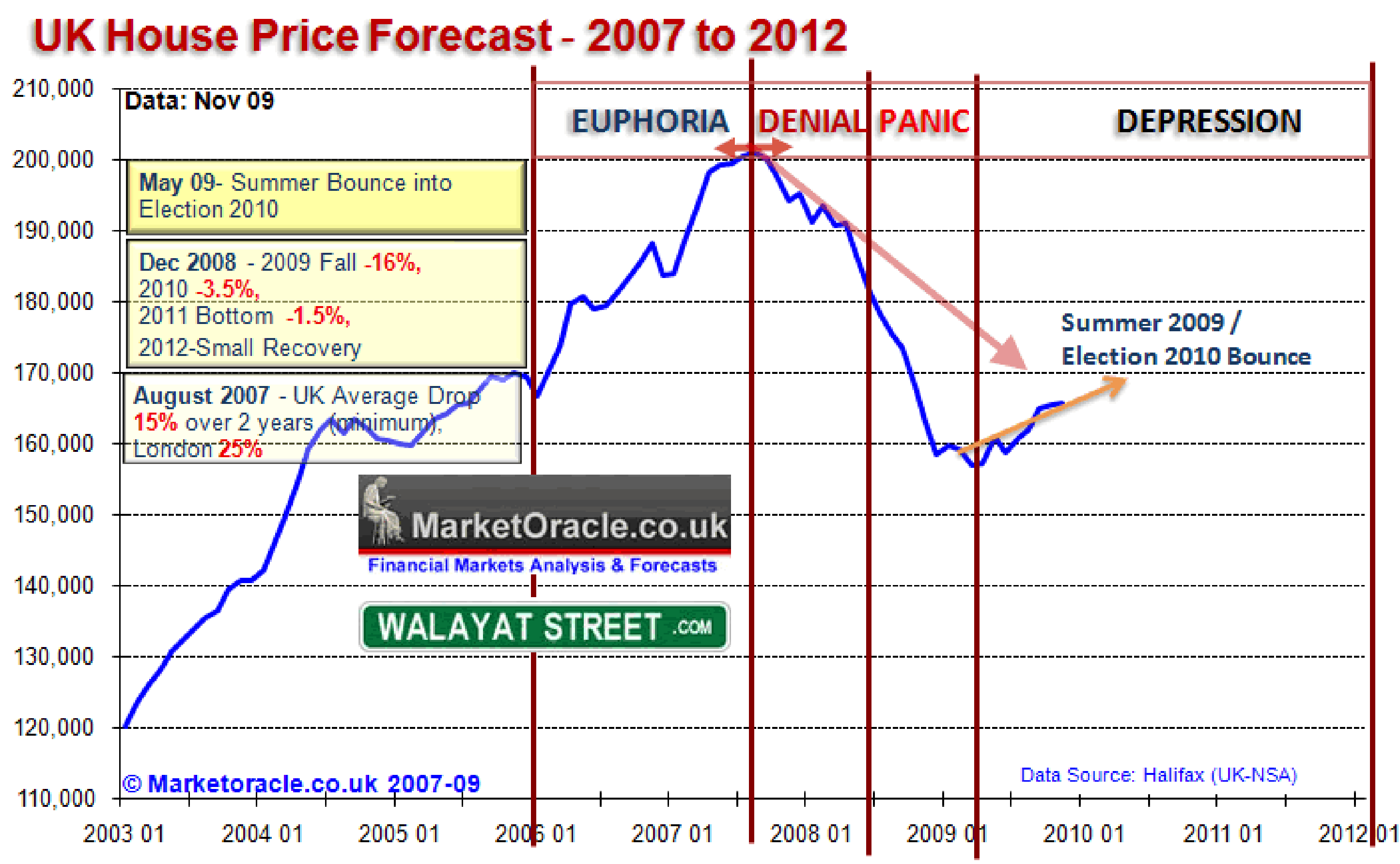
Similarly the growing prevailing expectations for a hung parliament also seem unlikely as historically hung parliaments have been few and far between and the fact is that government's that have been in power for several terms in office are more susceptible to decisive election losses. Labours long string of disasters starting from the Iraq war and ending with worst depression since the World War 2, ensures that at the end of the Day Labour will lose the next election, therefore I see little reason to change my original forecast as of June 2009 that still projects towards a small majority Conservative government in the order of 343 seats against Labour on 225 seats.

UK Housing Bear Market Election Bounce

The UK housing market peaked in August 2007 and entered into a 2 year bear market exactly as forecast at the time (22 Aug 2007 - UK Housing Market Crash of 2007 - 2008 and Steps to Protect Your Wealth), analysis which projected towards a fall in UK house prices from August 2007 to August 2009 of between 15% and 25% that has subsequently came to pass as UK house prices bottomed in March 2009 after having fallen by 23% from the 2007 peak.

The UK housing bear market has experienced a strong bounce off of the March 2009 lows and now stands up approx 10% off of the low as a consequence of unprecedented measures as mentioned in this ebook, the Labour government has succeeded in temporarily bringing UK house price falls to a halt and triggering an Election Bounce.

The impact of the inflation mega-trend on the UK housing market will be for UK house price to be supported in nominal terms, however this it does NOT ignite the feel good factor that triggers housing market booms which only follow when house prices begin to significantly rise in REAL terms i.e. after inflation.



Whilst the current corrective bounce looks set continue into the middle of 2010 (allowing for a potential one month blip as a consequence of the bad January weather), this rally is still seen as a correction within a housing bear market that is expected to remain in a depression for many years, before house prices succumb to the effect of the inflation mega-trend and start to rise.

A full in depth analysis and trend projection for the UK housing market will follow in my next ebook due to be completed by the end of April 2010 that aims to analyse the UK housing market from every angle possible so as to arrive at an accurate trend forecast that seeks to replicate the accurate analysis of August 2007. Ensure you are subscribed to my always free newsletter to keep updated on this and regular ongoing analysis.

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About the Author

Born in 1968 in the city of Rotherham, UK. Nadeem Walayat became one of the original computer geek's of the late 1970's before the term was applied to computer enthusiasts, owning his first computer a ZX80 in 1980 and soon thereafter set up his first software company in 1983 at the age of 15, writing machine code utilities for the Dragon 32 computer under the company name of Pegasus Software Services, which he later changed to Walayat Software and Network Systems (Walsoft).

Nadeem went on to discover the financial markets during 1985 and began trading the stock market in 1986, having discovered the means to trade commodity futures and more importantly stock indices such as the Dow Jones via spread bet trading in late 1986 thus triggering a 25 year trading career which has seen many highs and lows including having beaten the 1987 Stock Market Crash.

Apart from being an active trader, Nadeem continued his professional development and worked as a corporate accountant for 15 years until 2008, as well as remaining an active programmer for more than 30 years, hopping from programming language to programming language as information technologies have evolved.

By 2005, Nadeem's 20 year trading experience and 30 year programming experience afforded him the opportunity to develop the Market Oracle website with the primary objective of freely sharing his analysis, trading ideas and methodologies, which has gone on to become one Britain's most popular totally Free quality resource for economic & financial markets analysis and debate on the internet that continues to constantly evolve towards becoming one of the worlds key quality free financial market analysis hubs.

He currently resides in the city of Sheffield with his wife and three children and remains fully focused on trading and sharing of his analysis as a firmly private person who shuns the media spot light. His most recent analysis can be viewed at walayatstreet.com

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