



## **Main Financial Markets in 2012 Long-Term Technical Forecast**

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*This analysis is prepared to discuss the long-term prospects of the main financial markets: U.S. stock market, EUR/USD market and GOLD market. In our regular updates on our web site, we mostly concentrate on shorter-term time frames: Medium-Term (lasting several months) and Short-Term (lasting several weeks). The long-term view on the markets is posted at beginning of each year and is supposed to act like a map of what is about to occur during the year.*



## U.S. STOCKS MARKET

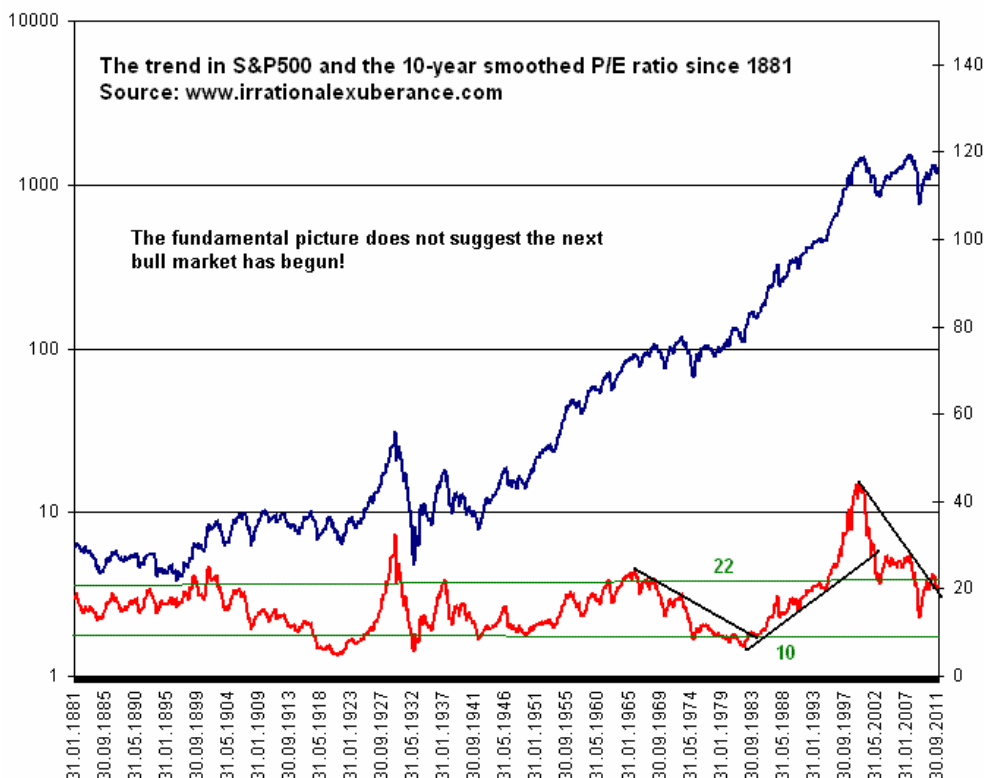
### The Long-Term trend in S&P500 and the evolution of the P/E ratio:

On the chart below you can find the long-term trend in the U.S stock market and the trend in the 10-yr smoothed P/E ratio (the latter is derived by dividing the current stock price to the companies' average profit for the past 10 years) going back as far as 1861. You can deduct many conclusions from the chart below regarding the long-term relationship between the stock prices and the P/E ratio, but one of them is that the stock market can be considered overvalued when the P/E ratio climbs above 20.0/22.0 and can be considered undervalued when the P/E ratio declines below 10 (and you can see from the chart that the market can stay undervalued for years before the next bull market begins). You can also see from the chart how the change in the trend of the P/E ratio signals the change in the trend of the stock market.

Trading in 2011 was quite volatile as the S&P500 moved back and forth on the positive or negative territory. As result, there is no significant change in its dynamic with the smoothed P/E ratio. This ratio still cannot climb above 22 and therefore, we still do not have a confirmation that the next bull market has begun. So, our previous call remains valid:

*„the current strong rise from the Mar 2009 low is likely a part of a broad sideways consolidation that began in 2000 and it is not the start of a Long-Term bull market. We can argue that a sustained LT bull market (as the one from the 1950s and 60s and the one from 1980s and 90s) will likely begin only after 5-10 more years of sideways trading during which period, the P/E ratio will be a one-digit number for at least a year or two.”*

**The relationship between S&P500 and the 10-yr P/E ratio suggests the sideways consolidation from the year 2000 top will likely last for several more years:**



Source: [www.irrationalexuberance.com](http://www.irrationalexuberance.com)



The downtrend line from the 2001 top in the P/E ratio was quickly penetrated in 211 but overall it remains intact and thus there is no reason now to assume that the Medium-Term rise from the Mar 2009 low is a beginning of a new secular bull market. Most likely, the bull market from Mar 2009 low is simply a MT bull market similar to the one of 2003-2007 within the broad sideways consolidation that began in early 2000.

### The Long-Term prospects of the U.S. stocks market:

The sideways trading in 2011 does not change in any way the Long-Term prospects before the S&P500: We still think that the current decade will be one in which the market will trade in a broad sideways consolidation: between 900/850 and 1400/1500. And we cannot rule out the possibility for a brief decline below the 2009 low yet, though this possibility is considered less likely.

### **The Long-Term Trend in S&P500**



### Medium-Term prospects for 2012

In the first half of 2011 the stock market was strong, but then we witnessed a furious decline between July and October. The year-end rally however was a positive signal that the Medium-Term rise from the Mar 2009 low was still under way. That means that most likely the market will rally in the next few months toward 1400/1450 zone, before this uptrend ends. Most of the global markets are already in confirmed bear markets and therefore, the expected rise in U.S. stock market (if it occurs) will likely be very selective and will not spread out to many international markets.



### The most likely scenario for S&P500 in 2012:

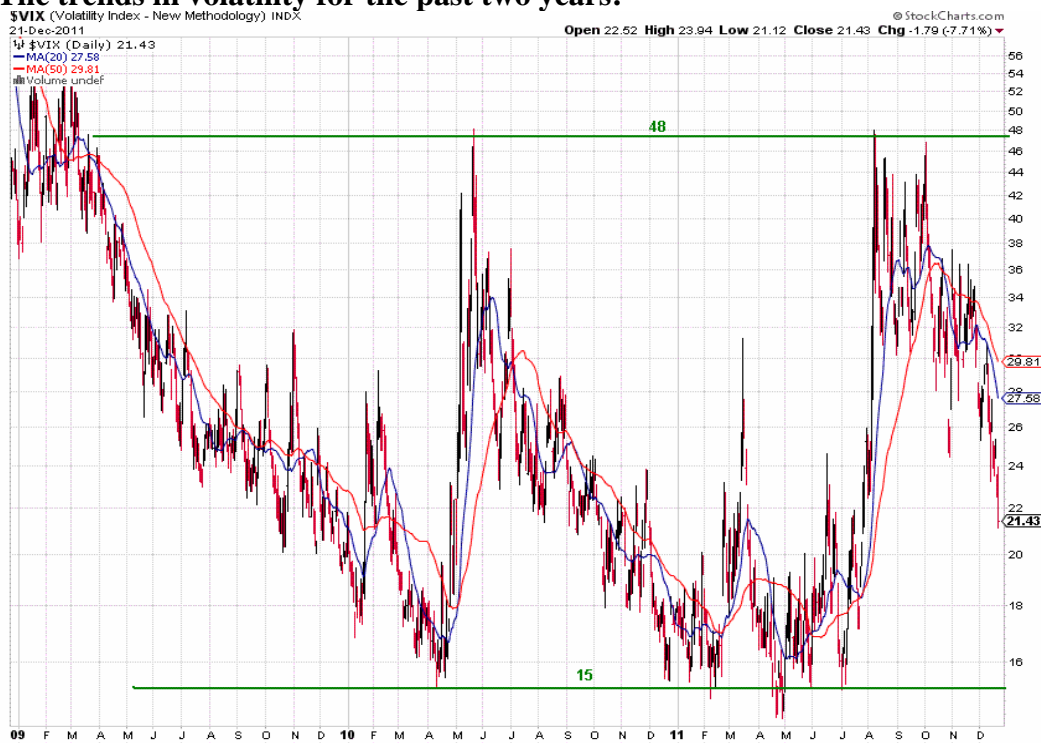


Source: MetaTrader

### The Volatility of the U.S stock market:

Our forecast a year ago for a lower volatility in 2011 was not very accurate. For most of the year the volatility was relatively low with VIX staying below 25. However, in the August-November time frame, the volatility remained higher.

### The trends in volatility for the past two years:



Source: [www.stockcharts.com](http://www.stockcharts.com)

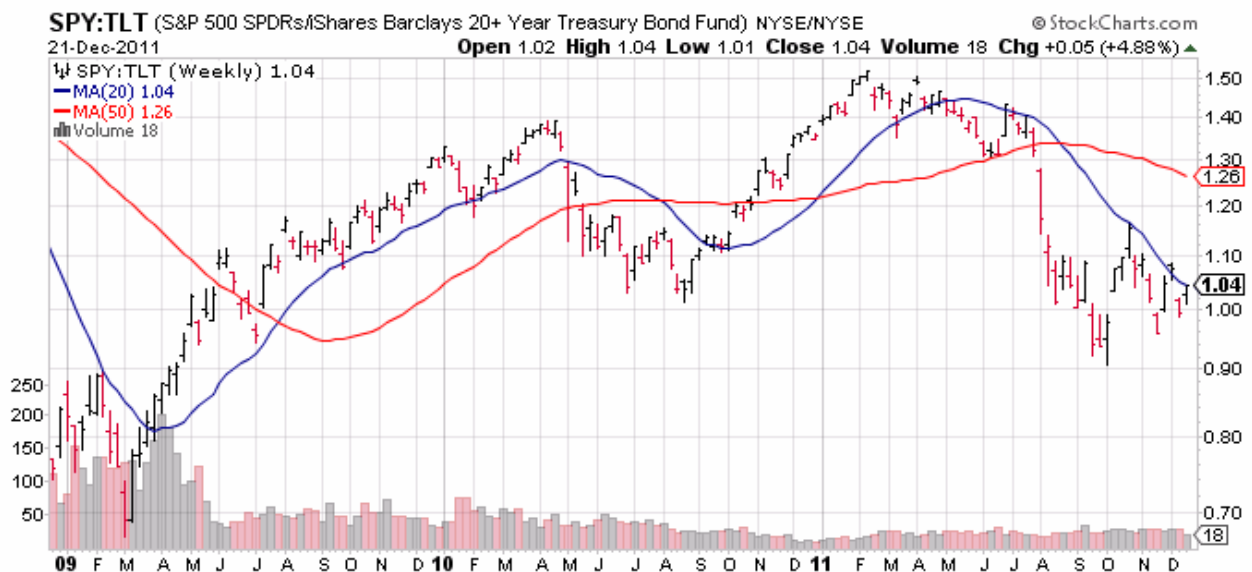


What can we expect for volatility in 2012? Considering the current low interest rates, we do not have reasons to expect a sustained rise in volatility. The intermediate-term trend in VIX is actually down and most likely VIX will decline to levels near 15 in the first few months of 2012. In the second half of the year however, we expect the VIX to rise back again and to re-visit its 2010 and 2011 highs near 48.

### **SPY/TLT ratio:**

One good indicator of the investors' preferences between bonds and stocks is the SPY/TLT ratio (U.S. stock market divided to the U.S Treasury bonds). When this ratio trends up, that is a clear indication that the investors prefer stocks over bonds and that almost assures a bull market for the U.S. stocks (it however does not tell us what the trend of the bonds is in this case). When this ratio trends lower, the investors prefer bonds over equities and it almost guarantees a downtrend for the S&P500 index (again, it is unclear by this indicator what the trend of TLT in this situation is, it only shows that bonds are performing better than stocks).

### **The current dynamics in SPY/TLT ratio:**



Source: [www.stockcharts.com](http://www.stockcharts.com)

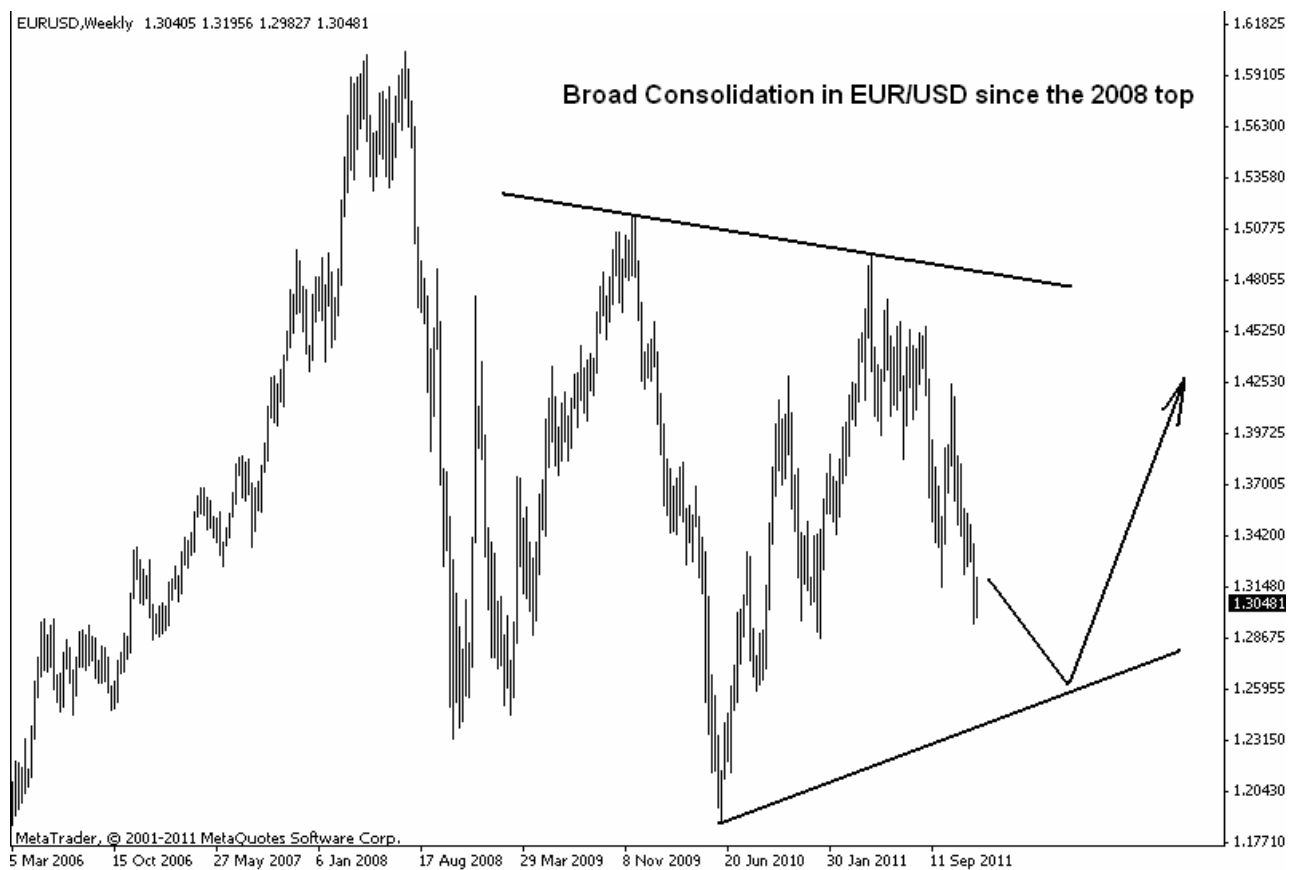
The current trend in SPY/TLT ratio is down. Right now that fact does not support our expectations for a rally on the stock market in the 1<sup>st</sup> few months of the year. But of course, the things can change and either the expected stocks rally will be slower and weaker than expected or the SPY/TLT ratio will turn up again. Considering this chart though, we further believe that in the second half of 2012 the investors will prefer bonds over equities and the equity market will be under pressure. The economic and financial problems in many regions are likely to persist for some time!



## EUR/USD

A year ago we wrote that we expected 2011 to be a good year for the U.S. dollar as we forecasted a move toward 1.19 in EUR/USD market. Initially however, the dollar was under pressure and the single European currency rose to 1.45/1.49 area. Later in the year though, as the problems before the euro increased, the expected appreciation of the U.S. dollar occurred but the move was not too strong – to about 1.29/1.30 level. That development does not mean the previously expected decline to 1.19 is impossible, but it makes it unlikely at this stage. More likely, we will see a several months of sideways consolidation between 1.25 and 1.35 followed by a rise of the European currency. That forecast seems a bit odd considering the debt crisis in Europe and all comments that suggest the collapse of the euro. But this is what the market is telling us right now. And the market message is that all negative consequences are more or less priced in already and the single currency is unlikely to collapse.

### Weekly chart of EUR/USD for the past 6 years:

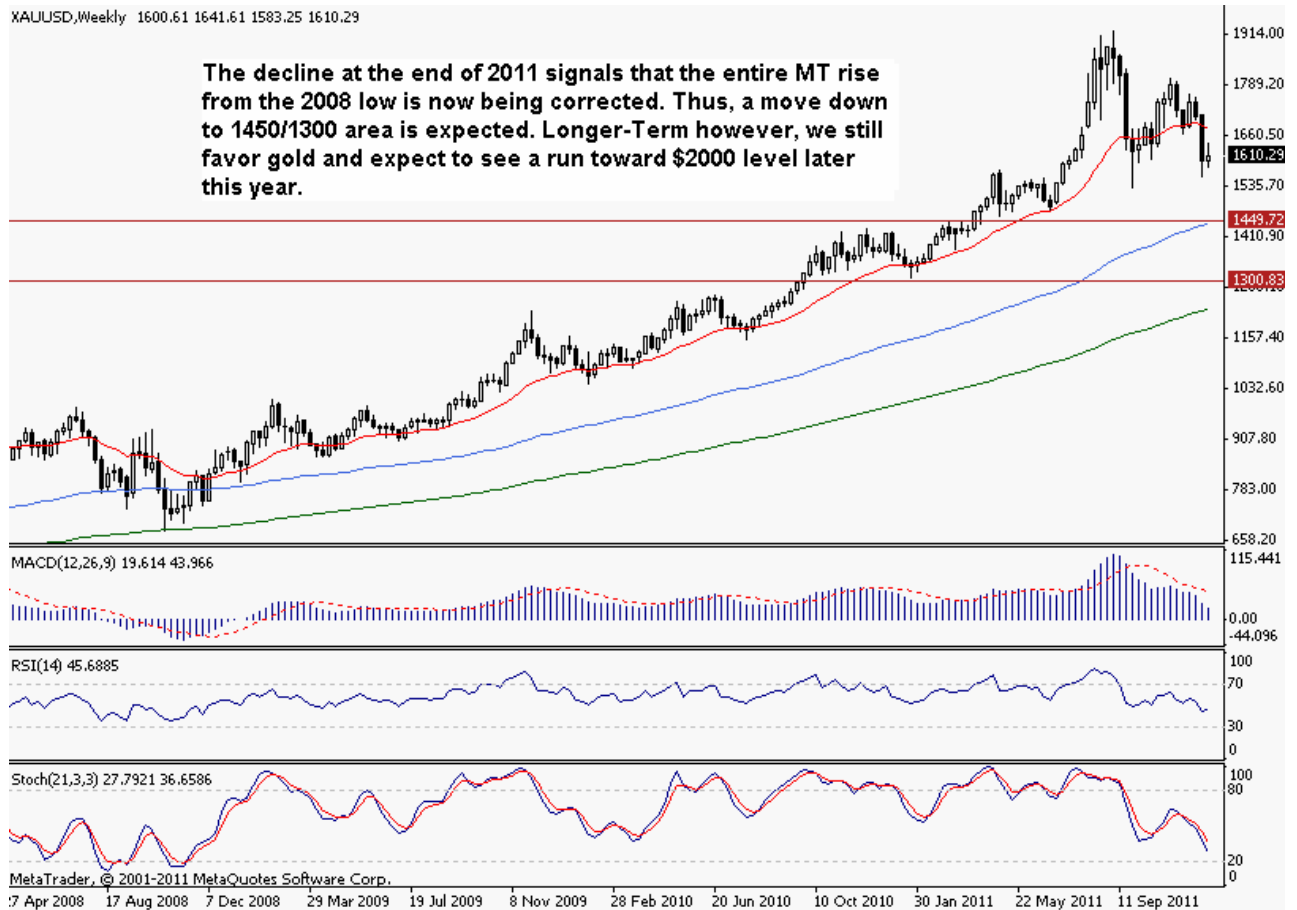


Source: MetaTrader



## GOLD

### Weekly chart of gold (XAUUSD) for the past 4 years:



Source: MetaTrader

The decline from the \$1900 top is a signal that a more significant downside correction or sideways consolidation has begun in this market. Right now the decline does not look impulsive which means that most likely it will be limited to 1450/1300 zone and is more likely a pullback only of the move up from the 2008 low. Most likely, this correction/consolidation will take 3-5 more months to complete. If the market does not decline stronger than that, we think the gold can still rally above \$2000 later in the year as the Long-Term trend remains intact for now.



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