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Loonie uncouples from oil price

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It's a fact that our Canadian dollar is influenced by the price of oil. Despite a favourable move by West Texas intermediate (WTI) crude oil recently - and potential for another dollar or two more upside for oil - the loonie remains in a downtrend. This is unusual.

Meanwhile, I wonder how much there is left in the move for oil. Note that WTI is currently hitting its top Bollinger Band. For the uninitiated, a Bollinger Band (a "BB") is plotted two standard deviations away from a simple moving average and was developed by famous technical trader John Bollinger.

Typically, the price of a stock is banded by an upper and lower band. For those familiar with statistics, two standard deviations from a price movement should encompass about 95 per cent of all action on a security.

Thus, when WTI hit its upper BB recently, it suggested we've seen the majority of upside movement for the short term (note that BBs do NOT predict longer-term movements). Meanwhile, crude oil also displays near-overbought levels on the various momentum indicators I watch. All in, this suggests that oil has moved aggressively of late.

Technical resistance for WTI comes in somewhere near US$55, although I'm not sure it will make it there. Nonetheless, rising oil should be good for a rising loonie. And yet, despite a couple of positive days in mid-May, we really haven't seen our currency follow the rising path of oil over the past month.

A weakening U.S. dollar compared to worldwide currencies should also be helping the loonie on a relative basis. But it's not. Note the six per cent decline in the USD versus the world basket of currencies - which has not helped stabilize our dollar.

I offered some insight into Canada's plight - and why this might be happening- in a couple of blogs over the past two years (www.valuetrend.ca). My blog on the plight of Canada, written in 2015, suggested our market is destined to be an underperformer on world markets due to: low commodity prices for the foreseeable future, record high personal per capita debt, and a new socialist government with a tax 'n' spend philosophy as well as arguably the least qualified leader in our history.

As our young and rather inexperienced leader follows his father's footsteps, TD Bank has forecast that Ottawa is headed for $150 billion in deficits over the next five years.

Ironically, when asked after leaving office if he had any regrets, Pierre Trudeau said yes – he wished he had paid more attention to the economy…sigh!

I noted on that 2015 blog that you might see the TSX rise to its old highs (technical resistance) at around the mid-15,000s and presented that as my ultimate target. I was right. I also noted that the bigger picture from there was bleak for the TSX, the commodity cycle and the Canadian economy.

Gosh, it sucks to be right. The TSX, as noted above, has rallied to its old highs per my target of two years ago. And the index appears to be struggling right on schedule.

Meanwhile, as suggested on the blog, the picture is growing bleaker for the economy. For greater insight, please refer to my blog post entitled "It sucks to be right", which quotes further research on the Canadian markets from well-regarded analyst and trader Larry McDonald of The Beartraps Report.

At ValueTrend, we attempt to achieve low-volatility, consistent returns in our equity platform. As such, we pay attention to currencies and how their movements will affect our portfolios in real terms for our clients.

While a falling USD and temporarily rising barrel of oil may temporarily push the loonie up a penny or two in the near term, I'm hesitant to reduce our USD portfolio positions any time soon.

At least, not until the trend channel noted on the chart below has broken to the upside. Given the concerns surrounding Canada's economy that I've outlined in the past, I'm skeptical of any meaningful breakout for our currency.

I continue to target less than US$0.70 to the Canadian dollar before we see any meaningful bottom on the loonie.

Not to be the bearer of bad news, but I am also a bit concerned about the current potential for a pullback on U.S. markets. I'm not a fan of Elliott wave projections. Not that there's anything wrong with Elliott wave theory when used in the right context.

I really don't see any logic in using this theory to tell you at what level, and when, you should buy or sell. However, as I wrote in my book Sideways, I do believe that markets have a tendency to behave differently during different phases of bull and bear markets. Elliott wave theory gives us an idea of what inning, so to speak, the stock market is in.

For example, the first wave (or inning of the game) is one of disbelief after a bear market, the second wave is corrective action ("I knew that was a head fake!"), the third wave is where the crowd joins in – which tends to make it the longest wave. This brings us to a final correction (wave four) before a shorter, sharper wave of speculation (wave five) ends the game.

Elliott wave analysis will not tell us when a given wave is over. Sorry, Fibonacci lovers. Still, it's an excellent tool for giving us a feel as to where we are in the cycle. And that's what I'd like to look at here.

For that final fifth wave, the tendency is for some new development to add a new paradigm to the expectations of stock market participants.

For example, in the past – wave-five final market moves have been characterized by such new paradigms as "the Nifty 50" – which ended the bull market of 1950-64. It was the new paradigm of the "Tech Bubble" that finished the greatest bull market in history, from 1982-2000. And it was the new paradigm of "Peak oil theory and Sub-Prime debt" that ended the 2002-2008 market.

Each one of these new paradigms ended. In other words, they really weren't new paradigms. They were just events or developments that are part of human growth and market reflection of that growth.

Right now, I believe that the "new paradigm" has been "TINA" –There is No Alternative. Super-low interest rates have driven investors into the stock market and out of safe investments. That, along with the low rates inspiring easy leverage to overinflated real estate—in turn creates a "wealth affect".

People buy a better car and better stuff when they have a valuable house and a good stock portfolio. This pushes earnings higher, justifying higher valuations. It keeps going until it can't keep going anymore.

Like the other new paradigms that we thought would never end – this one will end too.

We're in wave five of the current bull market. It could run for another month, another quarter, another year, or even longer. But make no mistake about it. We're in that final inning.

Stay aware, and be prepared. For my part, we are holding about one-third of our ValueTrend Equity Platform in cash at this juncture, with the remainder being held in market leaders with good fundamentals and solid technical profiles. Perhaps you should consider ensuring your portfolio is positioned conservatively as well.

Keith on BNN

Keith will be on BNN's popular call-in show MarketCall on Monday, June 12 for the 1 p.m. show. Phone in with your questions on technical analysis for Keith during the show. Call toll-free at 1-855-326-6266. or email your questions ahead of time (specify they are for Keith) to marketcall@bnn.ca.

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