

Good morning,

Interesting day yesterday... It's true, most assets traded within range and that in itself is boring. But what is interesting is precisely to understand the reason for this range trading. As I said on April 13th "...Yields on Treasuries are already NOT falling and the Fed will engage in a spiraling process (i.e. upsizing the \$300bn debt purchase program) against those who repudiate the US Treasury debt..." I think the market is only recently (during this week) timidly starting to share this view. From reading different analysts, I get the impression that the market still believes that existing long-term (30-yr) yields can be maintained in the short-term, in spite of the impressive future financing needs of the US Treasury. This would explain why we have not yet seen a more directional trading path in Treasuries. At the same time, this continues to corroborate our thesis No. 1: "When the Fed injects liquidity, asset prices rise. When the Fed does not inject liquidity, asset prices fall". Please, note the immediate conclusion this thesis drives us to: "Sell that which the US Govt. is buying and buy that which the US Govt. will buy (Tincho's letter, April 6th 2009)".

Thus, the question the market is asking lately is: "What (**How much more**) will the US Govt. buy? **As long as the market ignores how much more/what the US Govt. will buy, the market will not sell that which the US Govt. is buying. That is also called range trading.** That is what I think happened this week so far. Yesterday, the Fed bought \$7Bn of \$15.99bn in Treasury submitted offers (from May/12 to May/13). Perhaps the other significant transaction yesterday was the new Freddie Mac \$4.5bn 5-yr issue, at T+65bps (which tightened to 62.25bps at close). The mentioned uncertainty over what/how much will be purchased will be clouding the next two weeks, when there will be no announcements on Treasuries supply.

As you can see in the chart below (right) the 30-yr Treasury did not show any defined intraday trend. Neither did the S&P500, which finished +0.99% at 851.92 pts, on the back of Financials.

April 23rd, 2009: Thesis No. 2 is tested at 10:30am



S&P500 (orange) and 30-yr Treasury in well defined range



What traded even higher was the TSX Index: +1.40%, closing at 9,409.50 pts. The TSX increased driven by Materials. Of course, the most relevant news in Canada came at 10:30 am from the Bank of Canada, which in a press release on the Bank's Monetary Policy Report stated that it already has: "...the appropriate policy stance to move the economy back to full production capacity and to achieve the 2% inflation target...". The Bank explained that such stance is possible thanks to its policy rate 25 bps lower (on Tuesday), and "conditionally" committing (☺) to leaving the overnight target rate (for reference, see yesterday's letter on this rate) to the current level until the end of the second quarter of 2010.

I must confess I was happy on this news, for it meant that Canada continues to seek non-monetary options to address its non-monetary problems. And the Canadian dollar strengthened 1.011% on the news, from 1.2380 to 1.2240 CAD/USD.

Now, the news surprised the market, which was certainly expecting some sort of (at least in a shy way) declaration by the Bank of Canada, that quantitative easing is coming. The Bank merely said that it would consider using it, if required. **The Bank's new guidance does not follow the global inflationary approach of other big Central Banks.** According to our thesis No. 2, under this circumstance, the price of gold should rise. Our thesis no. 2 (refer letters of April 16th and 21st) says that: "When there is global coordination of inflationary monetary policies, gold cannot be a safe and lucrative asset. When inflationary monetary policies are not globally coordinated, gold is a safe and lucrative asset". We tested this thesis yesterday at 10:30am again, and it was corroborated: Gold immediately shot up from \$897/oz to \$907/oz (see chart above right). This also made me happy, because **there's never anything more practical than a good theory!**