

# Weekly Trend Watch

January 29, 2010



Inflation/Deflation Timer - Current Indication:

## Neutral

**The Inflation-Deflation Timer is a trend-following model, and this class of model is incapable of calling tops or bottoms, and therefore its value is in the ability to spot trends. The trends we are looking for are: inflation, deflation and neutral.**

This is an ongoing monitor of the Inflation-Deflation Timer model, for more information on the model, see [http://www.qwestfunds.com/publications/newsletters\\_pdf/newsletter\\_november\\_2009.pdf](http://www.qwestfunds.com/publications/newsletters_pdf/newsletter_november_2009.pdf)

Cam Hui, Board of Advisors, Qwest Investment Management Corp.

## Qwest Commentary

### A neutral reading

The Inflation-Deflation Timer model has turned neutral after showing an "inflation" signal that has been in place since July 2009.

The chart shows the price graph of the Reuters/Jeffries CRB Index. The Inflation-Deflation Timer model turned bullish on inflation and commodities in late July and moved to a neutral stance this week, which represents a profit of about 8.5%.



### We suggest a more defensive position

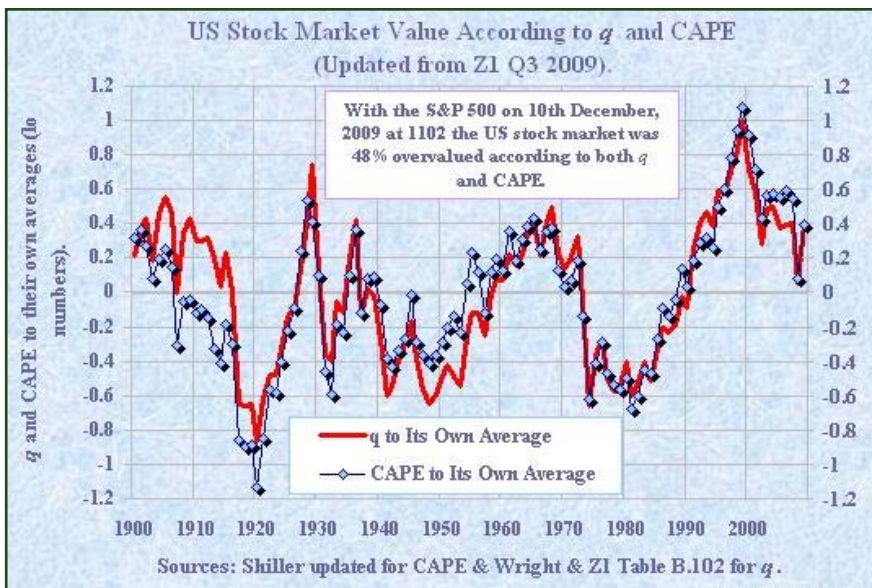
An investor who strictly follows the Inflation-Deflation Timer model would move from a position of holding a Canadian Dollar hedged basket of commodities into a 100% equity allocation. However, we would be inclined to be more cautious than to assume the risk of an all-equity portfolio for a number of reasons.

Firstly, there is substantial valuation risk embedded in the stock market. The chart on the following page shows the Tobin Q ratio, or the market value of a company divided by the replacement value of the firm's assets. (A low Q,

between 0 and 1, implies undervalue while a high Q, over 1, implies overvalue.) Right now, it indicates that the S&P 500 is substantially overvalued. (see [www.smithers.co.uk/page.php?id=34](http://www.smithers.co.uk/page.php?id=34)).

In addition, the loss of price momentum in commodity prices also indicates that investor sentiment may be turning against the investment thesis of economic recovery. Therefore, commodity selection will be as critical as stock selection. We continue to favour oil and gold in our basket of commodity favourites.

The combination of a valuation headwind and neutral or negative price momentum makes us highly nervous about a full all-equity commitment. Under these circumstances, we would suggest adding a greater bond component to a balanced fund portfolio. For example, if our benchmark were a 60% stock/40% bond asset mix, we would be inclined to move a portfolio to a 50% stock/50% bond asset mix.



**DEFINITIONS** (as defined in the American Heritage Dictionary)

**Inflation**

A persistent increase in the level of consumer prices or a persistent decline in the purchasing power of money, caused by an increase in available currency and credit beyond the proportion of available goods and services.

**Deflation**

A persistent decrease in the level of consumer prices or a persistent increase in the purchasing power of money because of a reduction in available currency and credit.

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