PRIVATE WEALTH ADVISORY

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Portfolio Review

First and foremost, we need to consider the action in the US Dollar.

Like it or not, the greenback remains the single most important asset class in the world. And due to the ongoing collapse in Europe, the Dollar is now *the* primary indicator for deflation in the financial system: if the Euro falls the US Dollar will rally pushing down commodities and stocks.

The first US Dollar chart I'm presenting is the futures chart first because we get a very clear picture of a trend reversal beginning.

As you can see, we've bounced off of support here in a big way. The image is slightly different for the cash (non futures) market, but it's clear that 78 is major support.

I'm using the weekly chart here because it removes the daily volatility that has become so commonplace due the European banking Crisis. The picture here is clear, the US Dollar needs to bounce hard here and reclaim the trendline of the last few years. If it can do this, then we are into another round of serious deflation which should see US Dollar strength, commodity weakness and weakness in stocks, particularly emerging markets.

This is the single most important chart to watch. My gut feeling is that we'll see continued Dollar strength going forward for the following reasons:

1) The January jobs report (we supposedly added 243,000 new jobs that month), while completely fraudulent (without adjustments we actually *LOST* 2.69 MILLION jobs), *does* set the bar for more QE from the Fed much higher as the vast majority of people now believe the US economy is improving and unemployment is dropping. This is US Dollar positive.

2) Europe is most certainly facing a breakdown of epic proportions (see the latest issue of PWA). This is Euro negative and US Dollar positive.

3) The Eurozone's economy is entering a recession. Regardless of the actions taken by individual EU countries (Greece or Germany leaving) this makes it likely the ECB will maintain an accommodative or loose monetary stance. This is Euro negative and US Dollar positive.

For this reason I believe we should remain invested in the **PowerShares DB USD Index Bulls (UUP)** as well as the **Rydex Strengthening 2X Dollar Fund (RYSDX).**

It's also why I believe we should remain shorting the Euro via the **UltraShort Euro ETF (EUO).**

As I explained in Wednesday's PWA, I believe the Euro is heading into a full-scale Crisis and that the EU will breakup between now and May. The Euro chart certainly looks bearish:

As you can see, we have major resistance at 132.5. We also find resistance at this level in the form of a key multi-year trendline:

The technical picture here is bleak. The macro and fundamental picture is even bleaker. For that reason we remain short the Euro via the **UltraShort Euro ETF (EUO).**

Regarding our European Bank Stock Shorts, the fundamental picture for all of them is outright brutal. As an example, Deutsche Bank (DB) is widely considered to be one of the strongest, most solvent German banks on the market. Yet, as I demonstrated in last night's issue of PWA, by its own admission, DB is a just a few steps away from being insolvent:

Country	Deutsche Bank's estimated net exposure in millions of Euros
Greece	1,203 €
Ireland	1,973 €
Italy	18,278 €
Portugal	1,821 €
Spain	12,117 €
Total	35,392 €

DB's entire shareholder equity is 59 billion Euros. With even a 20% writedown on its PIIGS exposure (with Greece they're talking about a 50+% writedown so a 20% writedown is being *extremely* conservative) DB would need to raise capital aggressively or face collapse.

By the way, according to International Financial Reporting Standards, DB is currently leveraged at 43 to 1…

From a technical picture, DB's recent rally looks primed for a reversal as well. We've got major resistance at $47 going back to the 2008 collapse.

Moreover, DB is also bumping up against its multi-year descending trendline going back to its 2009 peak.

Bad technical, horrid fundamentals, overbought and overstretched? This is why we recently added to our short here. I fully expect DB will be back at $35 per share within the next two months.

The story is much the same for two of our other European banking shorts: Santander (STD) and Barclay's (BCS). I've written about European banks' excessive leverage levels before. However, by focusing on leverage, we are in fact ignoring the true level of risk lurking on these banks' balance sheets.

For that reason in this analysis I'm presenting these banks' exposure to PIIGS' debt relative to their shareholder equity. Be warned, the following is not pretty.

Bank	Symbol	Leverage*	Exposure to PIIGS Relative to Equity*
Santander	STD	16 to 1	499%
Barclay's	BCS	24 to 1	110%

*Using latest shareholder equity and total assets data from company filings
**According to European Banking Authority's (EBA) stress test results (likely understating truth of the matter)

Mind you, we're only including PIIGS exposure. If we were to include exposure to the UK (the mother of all debt bombs waiting to explode in Europe), the situation is far worse for these banks.

Indeed, it is not PIIGS exposure, but UK exposure that sets our other European Banking short HSBC (HBC) up for disaster. It also makes the likelihood of Santander and Barclay's staying in business next to zero.

Bank	Symbol	Leverage*	Exposure to PIIGS & UK Relative to Equity**
Santander	STD	16 to 1	864%
Barclay's	BCS	24 to 1	582%
HSBC	HBC	13 to 1	165%

*Using latest shareholder equity and total assets data from company filings
** According to European Banking Authority's (EBA) stress test results (likely understating truth of the matter)

I will be devoting a future issue of ***Private Wealth Advisory*** to the situation in the UK. For now, I simply want to alert you that these banks are massively undercapitalized and are in fact facing potential insolvency by virtue of their PIIGS exposure alone. When you include their UK exposure, it's clear that it's only a matter of time before these banks collapse.

A final note here… the PIIGS exposure data points are from the EBA's stress test results… so it is safe to assume that: their true PIIGS exposure is likely much higher (the EBA stress tests were a farce aimed at making the banks looking as good as possible)

The technical picture for all three banks is equally bearish. For starters, Santander is about to crash into major long-term resistance:

The close-up of the last month's action shows us on the verge of breaking a bearish wedge to the downside:

Long-term chart wise, Barclay's is already crashing into major resistance and primed for a reversal:

Short-term, we've also got an ugly bearish rising wedge pattern about to break to the downside:

The long-term situation for HSBC, is the same as for Barclay's: we've just crashed right into long-term major resistance:

Short-term, we've once again got an ugly bearish rising wedge pattern about to break to the downside:

I remain extremely bearish on all of these positions. It's taken longer than expected for them to collapse again, but the fundamental and technical pictures for all of them are downright awful. Whether it takes another week or another month, all of these banks will be trading much, much lower in the future. We're well positioned for when that happens.

Regarding our Crisis trade in China, I want to share a client note I recently sent to *Rapid Fire Options Alert* subscribers (we had placed a bearish bet on the Chinese stock market) as it summates that situation there extremely well.

Excerpt from client note:

Most of the rally in China's markets over the last few months stemmed from the belief that China was going to begin monetary easing again in order to soften its economic slowdown.

> **Risk Of Hard Landing Rises As China Begins**
> Monetary Easing (From Forbes 11/18/11)
>
> Chinese policymakers have begun to selectively ease macroeconomic policy to support growth, according to Barclays' analysts. While full on easing won't come until 2012, China will face a significant economic slowdown as the export sector feels the impact of a fragile global economy, and residential

investment, which makes up 12% of GDP, falls drastically as the People's Bank of China (PBoC) seeks to control a real estate bubble.

In their attempt to execute a "soft landing," China's leaders have engineered a slowdown by tightening policy over the last several quarters. This was a response to unwanted consequences of prior stimulative policy.

[Read the Rest of the Story]

Note the effect this view had on the Chinese stock market's action:

China cannot risk a severe economic slowdown. There are already over 30 million Chinese who have lost their jobs, left the coastal cities, and are moving back to the countryside.

Moreover, during times of economic turmoil, civil unrest grows. Since 2006, China has averaged 90,000+ "mass incidents" (riots and protests) per year. In 1993, during the boom years, this number was less than 10,000.

Suffice to say, an economic slowdown is a MAJOR problem for China's Government.

This is most recently clear in the village of Wukan, which in September began a series of protests based on the fact that the Government took away the villagers' farmland and fishing rights (thereby removing their primary means of earning a living).

Wukan began a mass sit-in/ protest. The tiny village of 13,000 has since become such a headache (thanks to the international press) that China's Government actually let the villagers vote on who should be their local officials.

This is absolutely unbelievable. China...letting a village vote on its leadership. And it gives us some idea of just how tenuous the Chinese Government's control over the general population is.

However, while unemployment is a big problem for the Chinese Government, inflation is a HUGE problem. Over one third of China's population lives off less than $2 a day. If the price of food rises in China... those "mass incidents" will explode into outright widespread rioting and civil unrest.

Well, thanks to China's aggressive easing since November, inflation is back in a big way (it had been in decline since July 2011 before this).

> **China's inflation rebounds in January,**
> **renewing pressure to control living costs**
> (From Washington Post 2/8/12)
>
> China's inflation rebounded in January as food prices soared, renewing pressure on Beijing to control surging living costs as it tries to boost slowing growth in the world's second-largest economy amid warnings of a global downturn.
>
> Consumer prices rose by an unexpectedly strong 4.5 percent over a year earlier, up from December's 4.1 percent, data showed Thursday. Food prices jumped 10.5 percent, accelerating from the previous month's 9.1 percent.
>
> Read the Rest of the Story

This is a major development. China's Government will ABSOLUTELY have to put the brakes on monetary easing and possibly even tighten if it doesn't want to have the whole country begin to go up in flames.

Investors take note, there is a seismic change taking place in China. As inflation spreads throughout China there will be dramatic social, political, and monetary changes. And these will ripple throughout both the Asian region as well as the global financial system.

With that in mind, I believe China is on the verge of a major break down:

As you can see, we've hit overhead resistance and have just broken out of a bearish rising wedge pattern (as you've no doubt noted, much of the market has formed this pattern). So I expect the Chinese stock market to collapse in a big way, likely to $35 if not $34 shortly. Our UltraShort China ETF (FXP) position will explode higher when it does.

The exact same story is true of the Materials sector, which is essentially a play on commodities, which, aside from emerging markets such as China, are the number one "risk on trade" out there:

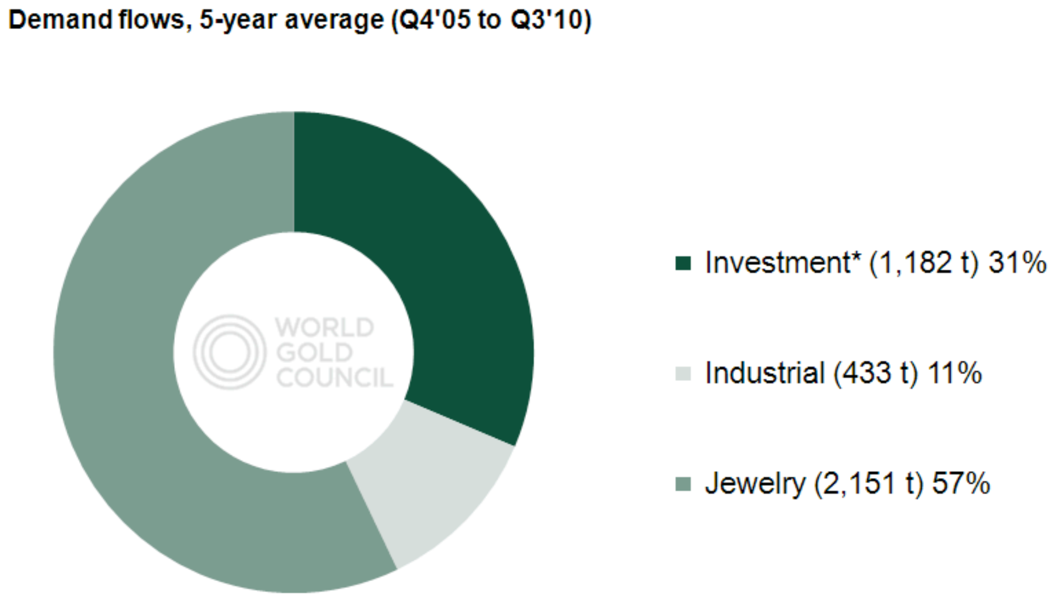
We will be at $65, if not $62 shortly here. When this happens, our UltraShort Materials ETF (SMN) position will profit beautifully.

Finally, we need to address our Gold positions. Gold is a complicated investment. Aside from other things it's:

1) A standalone currency
2) An inflation hedge
3) A bullish play on India's economic strength (Indian weddings traditionally utilize a lot of Gold and Gold is viewed as an indicator of wealth there: India is the single largest consumer of Gold accounting for 20% of global demand)
4) A play on currency and debt defaults (demand in Europe for gold jumped 135% Year over Year for the first nine months of 2011)

I want to take a moment to focus on #3 in the list above. While we investors tend to focus entirely on Gold as an asset class, the vast majority of global Gold demand is in fact for Jewelry: this accounts for 57% of global Gold demand.

With that in mind, it's critical to note that economic downturns can impact the price of Gold as a drop in jewelry demand (not to mention investment demand as economic downturns mean people getting poorer) especially if those downturns hit the critical Gold markets of East Asia, the Indian sub-continent, and the Middle East which account for approximately 70% of world demand.



Source: GFMS, WGC
* Includes identfiable and non-identifiable investment

Fundamentally, most investment themes are bullish for Gold. For this reason we are exposed to Gold Bullion as well as a very promising Gold miner located in Egypt called Centamin Mining (CEE.TO). I'm also currently researching a handful of other Gold miners for us to invest in which I will publish in a future report.

However, Gold, like any asset, can suffer downturns and corrections. Indeed in the last 11 years, Gold bugs have ridden out 13 corrections of roughly 7%, six corrections ranging from 10-16%, and three full-scale Crashes of 22-23%.

My point is that there are times to short or at least hedge one's Gold position. In my view we entered one of those periods when Gold broke the trendline that has supported it throughout 2011 (see chart below).

Regrettably, soon after we opened the UltraShort Gold ETF (GLL),Gold reversed and began moving higher. It has since risen to re-challenge its former upper trendline line. However, by the look of things, we've just had a rejection here , which would confirm my view that Gold is in a corrective mode.

As you can see, Gold appears to have been rejected at resistance at $1750. The next real line of support is $1675. And if we cannot hold *that,* then we are likely heading into a full-scale Crash: we have recently come dangerously close to registering a "Sell" signal on my Gold trigger: when Gold's 13-week exponential moving average breaks below its 34-week exponential moving average.

This has only happened *once* since Gold began its bull market, and that was right before the 2008 Crash.

With that in mind, we need to pay close attention to the below two lines:

If the 13-week EMA (red line) crosses below the 34-week EMA (blue line), then we are heading into a VERY sharp correction.

To conclude my thesis here, I continue to believe in Gold in the long-term. But I am increasingly concerned that we could see a sharp sell off. With that in mind, we continue to hold on to our UltraShort Gold ETF (GLL) position.

I realize this has been one of the more frustrating positions for us in recent times. Hold steady here. We'll know whether my investment thesis is correct very shortly. The technicals certainly suggest that Gold is primed for greater drops in the near future.

This concludes our portfolio review. I have a number of new positions I'm monitoring for us (the various inflationary brands I noted in the issue titled ***Two Markets and How to Play Them Pt 2***) as well as a handful of smaller Gold miners that will give us more exposure to Gold once this (potential) sell-off completes (likely in a month or so).

I will send out alerts when it's time to buy all of these new positions. However, right now the inflationary brands I noted in ***Two Markets and How to Play Them Pt 2*** are all overbought and likely to retrench along with the market in general.

And Gold mining stocks have just entered a very ugly correction (we'll likely use it to double down on our position in Centamin Mining (CEE.TO) if things go as I expect).

Thank you again for your interest. If anything changes I'll issue an update. Otherwise you'll next hear from me in the next issue of PWA on February 22.

Until then…

Best Regards,

Graham Summers