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Market Update: This Latest Rally

Dear Subscribers

I wanted to post an update to you as you no doubt are worried about the market especially given the speed and strength of this latest rally at a time when we are largely short the markets.

First and foremost, you should know that nothing has changed in Europe. This market move was kicked off by Mario Draghi, Prsident of the European Central Bank, claiming that he has some secret up his sleeve that will save the EU.

Draghi is lying. The EU simply does not have the funds to do anything major at this point. THE EFSF bailout fund has €65 billion in funding left. Spain alone will need €500 billion in the next six months if not sooner. Italy will likely need that much if not more.

The ESM, which is the other bailout mechanism is supposed to be up to €700 billion in size. However, 30% of this €700 billion is supposed to come from Spain and Italy. Does anyone see a problem with that?

Also, Germany has not even ratified the ESM yet. Instead, the German constitutional courts will decide on September 12 whether or not the ESM is constitutional. If they do not, then the EU will implode.

But, for the sake of argument, let's assume that the German courts vote in favor of the ESM. The issue still remains that Germany will not permit the ESM to get a banking license (we know this as it's been repeated time and again by German officials) which means the ESM *cannot* buy banking bonds (which is what Spain and Italy desperately need).

Why would Germany not go for this? Because Germany will be the largest contributor to the ESM. If it decides to give the ESM a banking license, then Germany is putting itself in a position where it would have to potentially backstop EU banking deposits.

The EU's banking deposits are north of €17 trillion. The banking deposits at the PIIGS alone are over €5 trillion. Germany's economy is only €3 trillion.

It's simple math. Germany does not have the firepower to backstop the EU. The country has already committed nearly €1 trillion in backdoor bailouts. As a result of this, its Debt to GDP ratio is closing in on 90%... calling its own solvency into question.

German political leaders are many things. Stupid is not one of them. Instead of Merkel and her team taking the fall for what will ultimately be Germany's decision NOT to support the EU (how could they? Germany doesn't have the money and the German people don't want to support more bailouts), they've decided to make the issue a matter of public referendum.

Given that the vast majority of Germans are sick and tired of bailing out Europe, what do you think the likelihood of the German people voting to support the PIIGS are? We already know that most Germans want Greece kicked out of the Euro if it fails to meet its debt repayments. So it's pretty obvious that if it comes down to it, the German people *won't* vote in favor of supporting the EU for much longer.

This leaves the ECB as the sole backstop of the EU. The ECB cannot simply monetize everything under the sun. If it did, the EU bond market would blow up and it's game over. Moreover, if the ECB did this, Germany would pull out of the Euro (69% of Germans are already worried about inflation). So again, that's a checkmate position.

My point with all of this, is that we've just witnessed Mario Draghi's "bazooka" moment. Remember back in 2008, when Hank Paulson claimed that it he made a big enough monetary intervention threat that the markets would somehow correct themselves? Well, we know how that turned out (the markets called his bluff and the Crash happened).

Mario Draghi has just done the same. And he's produced the same sharp short covering rally. But it's going to end in the same way.

Let me show you.

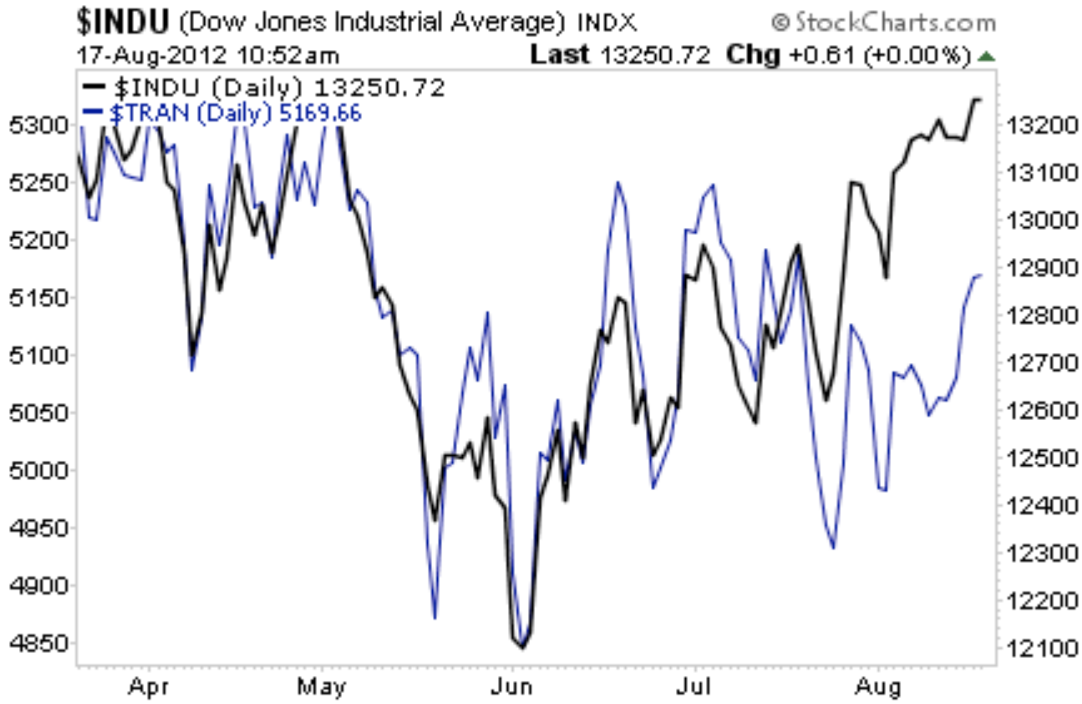
European financials which have lead this short covering rally are up against MAJOR resistance and are overbought. Remember, this is based on a Central Banker claiming that he's got what it takes to save the world… at a time when Angela Merkel was on vacation.

In terms of individual markets, the Spanish Ibex is the pack leader for this move. Again, we're sharply overbought and coming up against major resistance:

Interestingly the German Dax, which should be benefitting in a big way from capital fleeing the PIIGS into Germany, is also coming up against major resistance and has seen its RSI put into a lower high… a sign that this move will not be long-lived and that we're likely to see a top soon:

What about the US?

We have massive divergence between the Dow Industrials and the Dow Transports (not a good sign for more market strength)

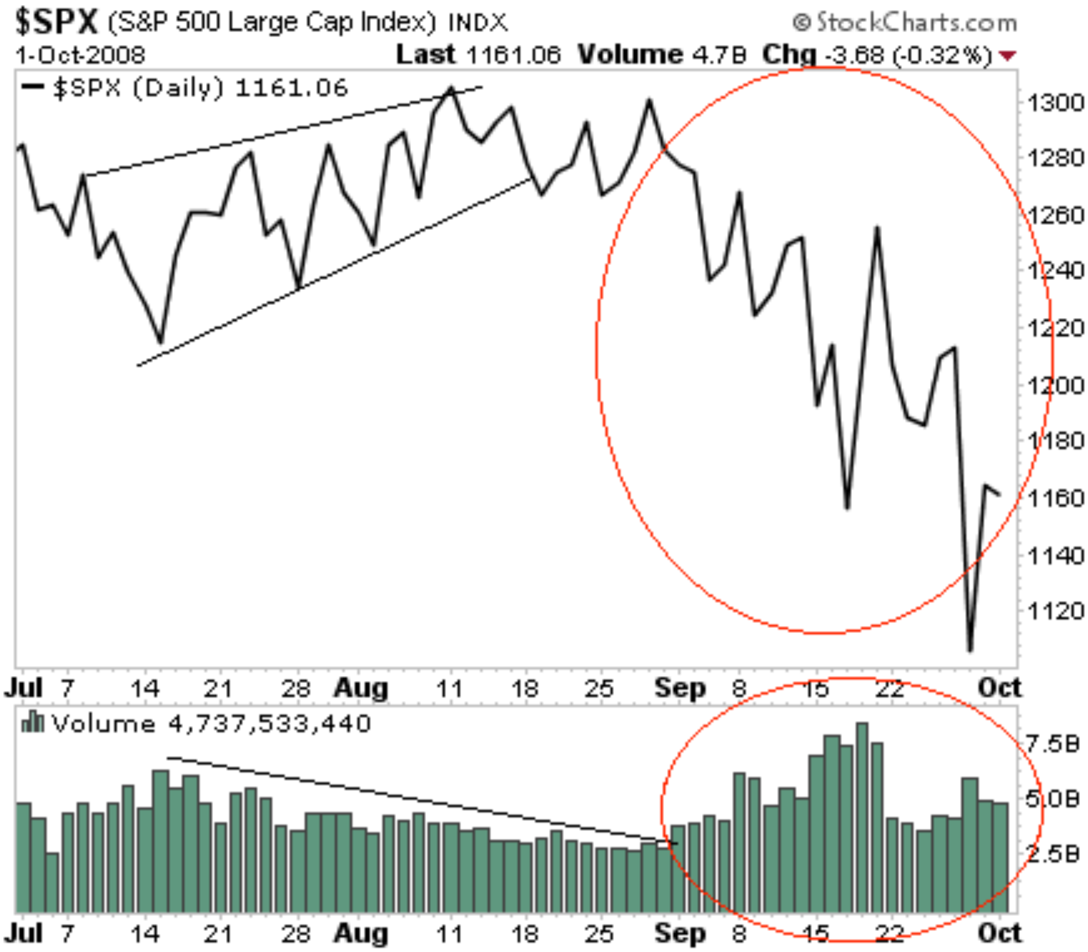


The S&P 500 has formed a bearish rising wedge on horrendous volume (some of the last few days have been the lowest volume non-holiday sessions in a year). It is now at major resistance.

Here's a close up of that rising wedge.

Finally, the emerging markets: volume has all but disappeared and we're in a very ugly triangle formation that suggest we're going down in a big way within a week or two:

None of these technical signals indicate that we're at the start of some major new bull run. Indeed, the whole thing is reminiscent of Hank Paulson's "bazooka" rally in 2008: a bearish rising formation on increasingly lower volume:



On a final note, we *must* bear in mind that this week is options expiration week: THE week in which Wall Street guns the market higher to shred options traders so their trades expire worthless.

This has happened like clockwork for years now. The fact it's happening this week should be no surprise at all.

In light of this, as well as the clear technical signals from the above charts, and the fact that nothing has fundamentally changed in Europe, I suggest we all stay calm and maintain our discipline.

I know this is very difficult to do as the markets have moved strongly against us. But the underlying realities that nearly took down Europe in June remain firmly in place. And the markets are sending us clear signals that this rally is not to be trusted.

So try to stay calm. My feeling is that in one to two weeks, we're going to see some *real* fireworks. At that time our patience will be more than handsomely rewarded.

Graham Summers