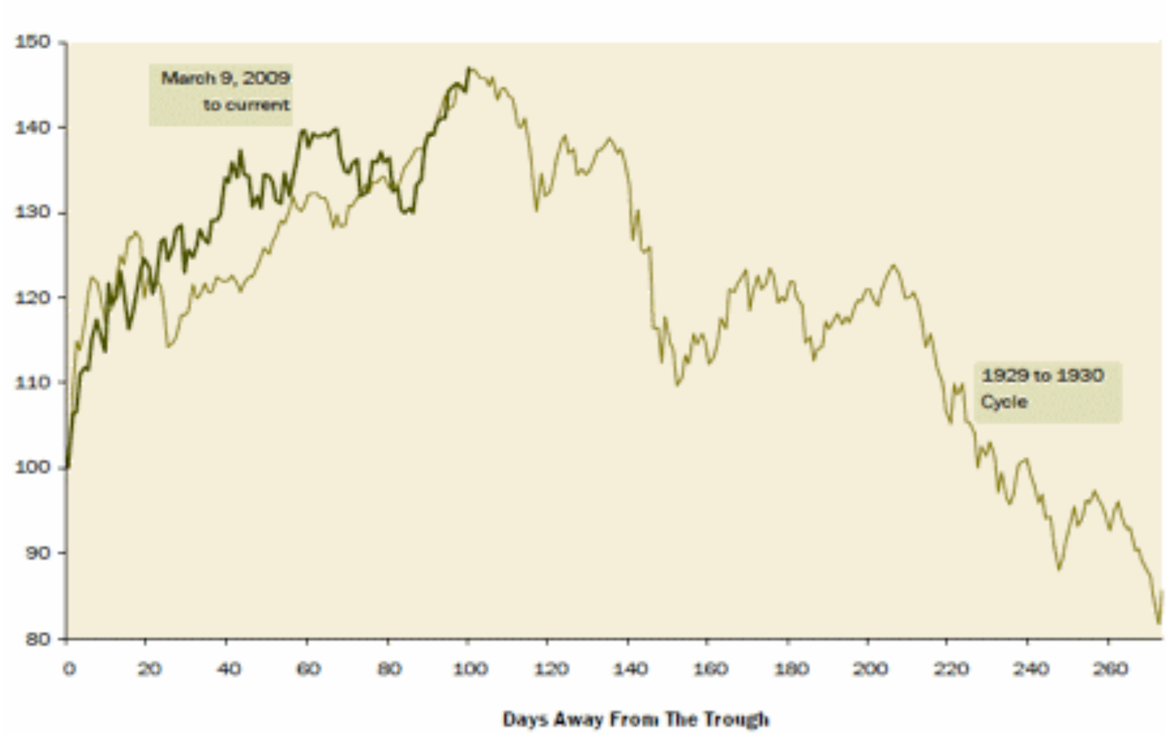
PRIVATE WEALTH ADVISORY

AN OMNISANS RESEARCH PUBLICATION AUGUST 12, 2009

The Correction Has Begun

As I've noted in previous issues, this stock market rally has come much too far, much too fast. All told the S&P 500 is up over 48% since the March lows. This is unprecedented in the post-WWII era. As I've pointed out earlier, this rally is mirroring the post-'29 Crash rally to perfection. In fact, we just hit the "peak" in terms of both gains and days. This does not bode well for stocks.



At current levels, the S&P 500 is pricing in a 40-50% growth in earnings for 2010 AND GDP growth of 4.5% for the 3Q09. I put the likelihood of both of these items at less than 1 in 100. Earnings may have beaten Wall Street estimates, but they did so by laying off workers en masse and cutting back on inventory.

REAL earnings (including credit write-downs), in contrast, have fallen off a cliff. And they're not coming back any time soon. The reasoning is simple: the CONSUMER IS DEAD. Despite incredible stimulus efforts, consumer spending fell at a -1.2% annualized rate in June.

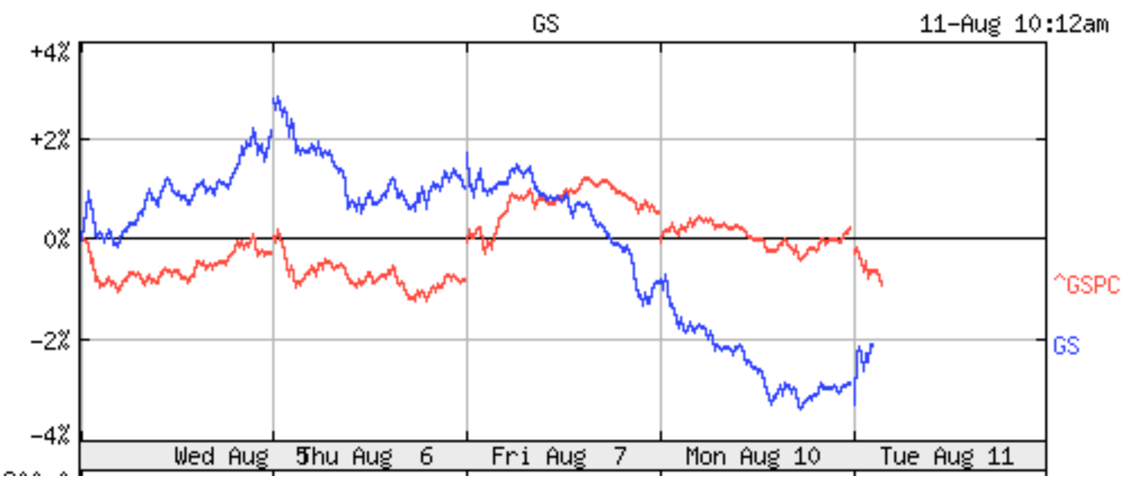
In simple terms, the government is finding it harder and harder to get growth out of debt: it now takes a record $5 and change in debt to stimulate $1 in GDP growth. Failing another Stimulus Plan (I'm not in favor of this), 3Q09 earnings will be a disaster. And even WITH another Stimulus, there is NO CHANCE of earnings rebounding 50% in the next six months.

Historically, as famed economist David Rosenberg notes, by the time the stock market rallies 48%, the following have occurred:

- Real GDP had expanded on average by 4.5%
- Employment had rebounded an average of 850k jobs
- Corporate profits had recovered 12%
- Bank lending had risen an average of 5%

This time around, NONE of those has occurred. This market has risen largely based on momentum NOT fundamentals. And it's beginning to show serious signs of weakness.

First and foremost, the financial bell-weather, Goldman Sachs, which has been leading stocks on the upside, has suddenly started breaking down.



As you can see, GS (blue) peaked in the middle of last week and has since posted a significant decline of nearly 5%. Meanwhile the S&P 500 (red) has only just started to come unraveled.

Besides this, the Baltic Dry Index has failed to confirm the July rally in stocks. If you're unfamiliar with the Baltic, it measures shipping rates around the world. When people are moving a lot of goods and ships are in high demand, the Baltic rises. In contrast, when things slow down and ships needed less, the Baltic drops.

And as you can see, the Baltic (dotted line) has been dropping steadily against stocks (solid line) since June, which indicates that claims of economic recovery and growth are just that: **claims, NOT facts.**

I believe the market is set for a serious correction. And I've got several picks lined up to profit from it:

Going Short Tech

The NASDAQ has lead this rally to the upside. It will lead it to the downside as well. Indeed, tech stocks (as measured by the Relative Strength Index) haven't been as overbought as they are now since October 2007: the all-time high for stocks.

The relative strength index (RSI) is a metric used to measure the velocity and momentum of a given investment by comparing its upward and downward moves from close-to-close. If an investment is moving up strongly, its RSI is higher. Similarly, if an RSI is low, it means the investment is performing weakly.

Historically, RSI's of 70 or higher mean an investment is overbought while an RSI of 30 means an investment is oversold. In these situations the market is primed for a "revert to the mean" trade, meaning you could see a quick correction or turnaround rally as the market snaps back to a more reasonably RSI.

Which is what is happening today…

As you can see, the NASDAQ recently posted a new lower high and new lower low: both serious signs that its rally is losing steam. The first support line is the 21-day moving average (blue line: 1949). After that, the next line of support is the 55-day moving average (red line: 1863).

The risk to reward ratio of going short the NASDAQ at these levels is fantastic. Using 2008 (the recent high) as a stop-loss and the 55-day moving average (1861) as a profit goal, you've got a 2% risk with a 7% gain.

And when you add a little leverage, the trade is even more promising. The **UltraShort Nasdaq Proshares ETF (QID)** returns 2X the inverse of the NASDAQ ETF (QQQ). So it QQQ falls 10%, QID returns 20%, and so on.

QID has tested its lows 26.06 twice recently. It then staged a NEW higher low of $26.19. This is a great bullish sign of hitting bottom. With the NASDAQ rolling over and primed for a major fall, QID is not in a great position for a VERY serious rally.

The first point of upside resistance is the 21-day moving average (blue line: 27.80). After that it's the 55-day moving average (31.13) and then 33 (where QID peaked in early July.

Given how overbought the NASDAQ is, I think we could easily see a re-test of 33 here. Using $26.06 as our stop loss (the price we'll sell if the trade goes against us) and 33 as our profit objective this gives us a 4% risk and a 21% reward. I'll take that trade any day of the week.

Action to take: Buy the UltraShort Nasdaq Proshares ETF (QID).

We'll use $26.06 as our stop loss to limit our losses should the trade goes against us. But I expect we'll see QID hit 33 within a week or two.

Speaking of overbought…

China's House of Cards is Ready to Collapse

The Shanghai Stock Index is THE most overbought market in the ENTIRE overbought financial universe. All told, the index is up over 100% for the year. The reason?

China's stimulus.

As the US Federal Reserve has learned, giving money to a US bank doesn't result in that bank lending the money out. In China it's a different story completely: what the government SAYS, the banks DO, no questions asked.

And China has pumped $1.1 trillion into its economy (roughly 1/3 of GDP). To put that figure in perspective, imagine if the US Stimulus Bill had been $4.5 TRILLION instead of $787 billion. Do you think people would have gone out and invested that money like crazy?

You bet they would have.

And that is precisely what happened in China. And it's fueled a speculative bubble of epic proportions. The number of brokerage accounts opened per week just hit an 18-month high at the end of July. Everyone and their mother are buying stocks in China: I recently read an article stating that many Chinese are no longer looking for jobs but are instead living off their trades.

Sounds like the US Tech Bubble, doesn't it?

Indeed, China's funny money has pushed the Shanghai Stock Index to levels no rational person would ever consider. And recently Chinese stocks are showing SERIOUS signs of exhaustion:

As you can see, the Shanghai Stock Index recently staged a new lower low and broke below its 21-day moving average (blue line 3303). This does not bode well for the China bulls. But it does present the bears (me included) with an opportunity to cash in.

China's economy is an export-driven economy. As I mentioned earlier the US consumer is dead. And it shows in China's data: Year over Year, China's July exports fell 23%!

I think we've got a short-term correction in China due. Using the recent high (3,471) as a stop loss we've only got a 6% risk by going short here.

The first real line of resistance for a collapse is the 55-day moving average (red line: 3031). After that it's 2,800 and then the 126-day moving average (green line: 2663). I think there's a good possibility we could see the Shanghai Stock Index fall to test that level in the next month. Going short now has a down side risk of 6% and an upside profit potential of 18%. That's a classic 3 to 1, reward to risk ration: the ideal for any trade.

So we're shorting China with the **UltraShort China ProShares (FXP).**

FXP returns 2X the inverse of the 25 largest stocks in China. So if Chinese stocks fall 10%, FXP returns 20%, and so on.

I really like the look of FXP's chart:

As you can see, FXP recent staged a brief period of consolidation after bouncing strongly off of 9. It's now on the verge of breaking above its 21-day moving average (blue line 10.22). After that, the first point of resistance is the 55-day moving average (11.90). Then it's 13.

I think it's highly likely we'll see FXP hit 13 within the next few weeks. With 13 as a profit objective and 9 as our stop loss, we've got 10% at risk to make 28%. That's a solid risk to reward ratio.

Action to take: Buy the UltraShort China ProShares ETF (FXP).

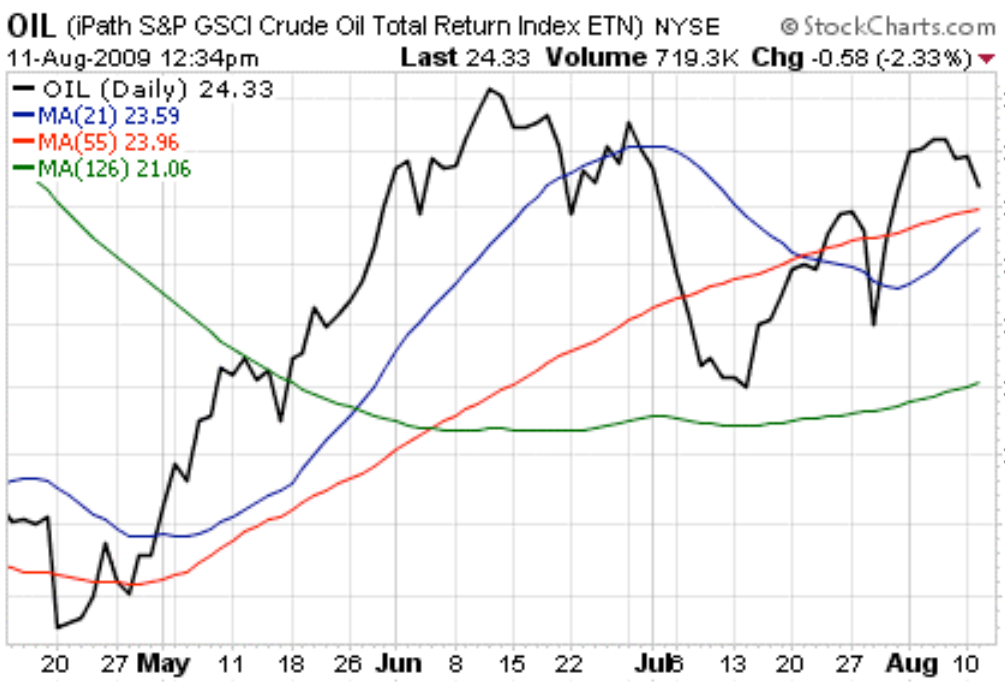
Use $9 as your stop loss.

Other Future Trades Lining Up

I've also got a few other trades on my radar, though I'm not quite ready to make them. In particular, I'm interested in shorting oil, Russia, and homebuilders.

We got in a few weeks too early shorting oil last time. I'm not going to repeat that mistake again. Oil has the perfect storm for a collapse: relative calm in the mid-east, a global economic contraction, and mild weather (no hurricanes so far).

I think it's highly likely we'll see it trading at $50 a barrel by October, but it's still too early to go short. If the Crude Oil Total Return Index falls below its 55-day moving average (red line) and its 21-day moving average (blue line), it'll be time to go short: at that point it's a nice drop down to $21 (a 20% potential return). However, right now, it's too early, so don't short oil just yet.



Russia is looking equally primed for a drop. After all, the Russian economy is largely hinged on oil. In this regard, the Russian stock market can be looked upon as oil with leverage.

If and when the Templeton Russia Fund (TRF) falls below its 126-day moving average $14.64, TRF is primed for a collapse down to $9 and change… or possibly even $8. Hold off going short just yet, however, it's too early: TRF is perfectly mid-way between its 21-DMA and 126-DMA.

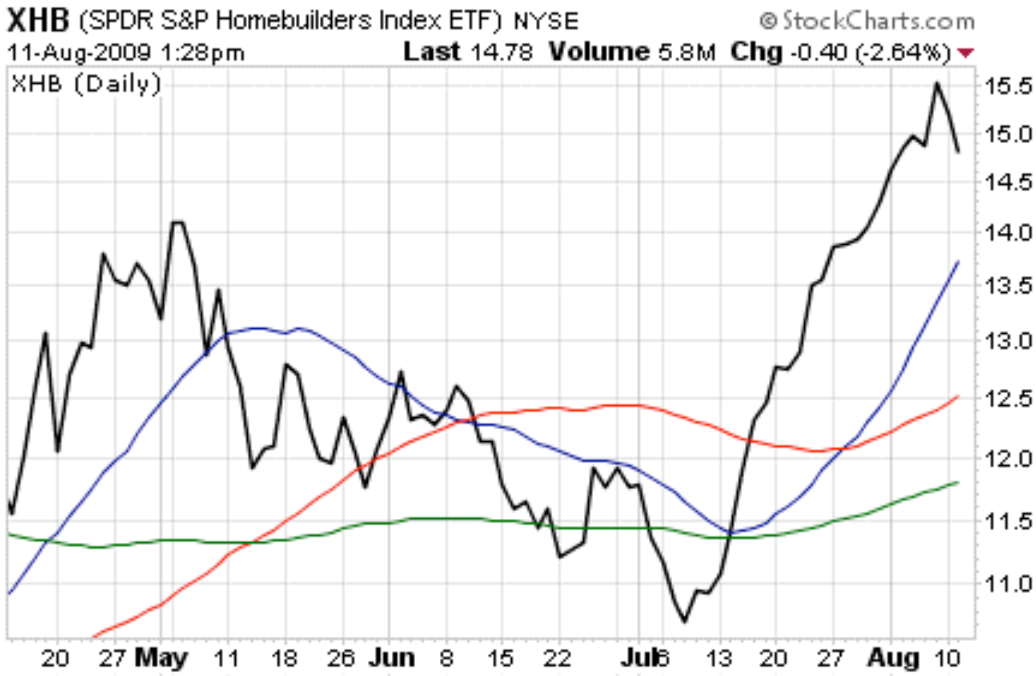
Finally, homebuilders are ripe for a fall.

While stocks in general have rallied hard, homebuilders have gone absolutely parabolic. **The homebuilder ETF (XHB) rose 50% in the last month alone!**

This is absolutely ridiculous. A house is not like a cup of coffee: you can't just run out and buy it. You have to get a loan. And banks are NOT lending: commercial bank lending fell $64 billion in July. That's an annualized contraction of 12%.

On top of this, bank lending standards are going up, requiring a larger down payment. And who has 10-20% to put down on a house right now, when everyone is trying to pay off credit debt?

In spite of these bad fundamentals, homebuilders have exploded higher like it's 2005 all over again. If you want to see what a vertical or parabolic chart looks like, look no further:



I would love to short these guys… but the rapid drop makes me wonder if we'll see a quick bounce followed by a "double top": when an investment peaks two times at the same price within a short time period. Momentum of the kind homebuilders have shown in the last month does not end quickly. So there is great potential for another brief bounce.

At that point I'd got short big-time.

Put this guy on your radar. The potential for a drop to $12 or even $11 is high.

That wraps up this week's *Private Wealth Advisory*. I believe the next 2-3 months will prove exceedingly difficult for stocks. I also think commodities and emerging markets are highly susceptible to some intense pain. We'll profit handsomely from both.

To re-iterate the update I sent out this morning: because the market correction looked to already be underway, I moved this week's issue up one day to Tuesday. Barring emergency circumstances, this will be a one-time deal: we'll continue publishing *Private Wealth Advisory* on Wednesdays after the market's close.

I'll be watching all of our open positions closely in the next week. Barring any developments you'll hear from me next Wednesday in the next edition of *Private Wealth Advisory*. Until then…

Good Investing!

Graham Summers

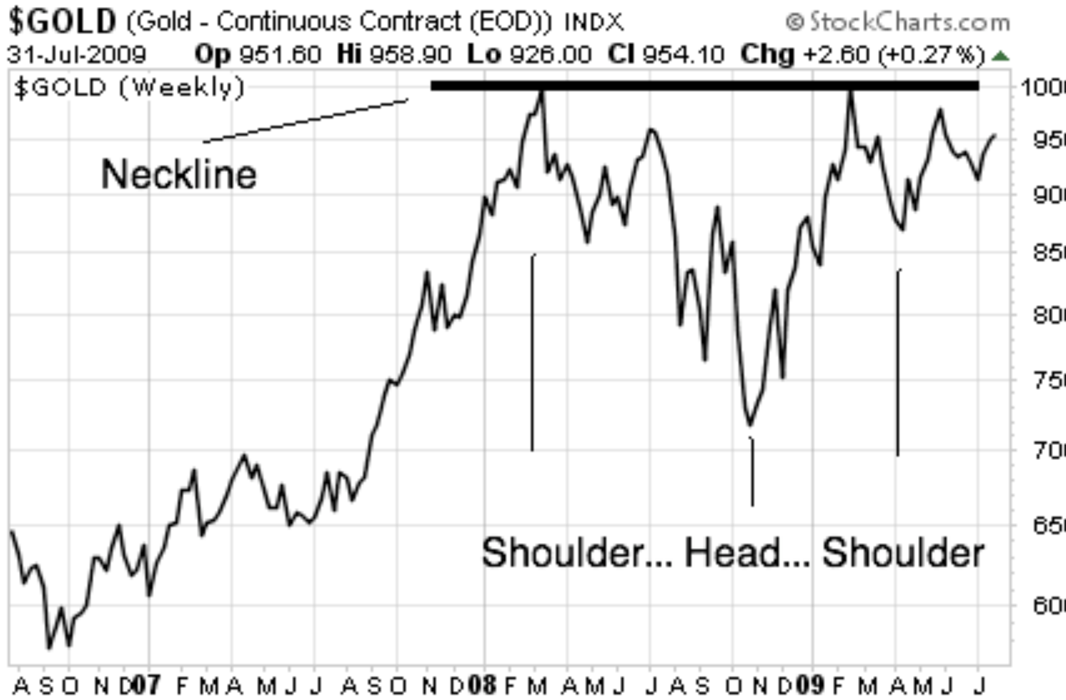
Portfolio Review

Gold (GLD): GLD came under pressure in the last week when the dollar bounced. However, the gold chart looks great, having made a series of higher lows in the last month. If GLD holds up at current levels ($92.5), then we're definitely in a strong uptrend since $92.5 was previously a point of upward resistance.

From a bird's eye perspective, is close to completing a large inverse head and shoulders pattern. The famous head and shoulders pattern is when you have one low peak, one higher peak, and one lower peak in succession. Typically this precedes a large decline for an investment.

When you patter plays out in reverse, you get a small break down followed by a larger breakdown, followed by a smaller breakdown. This can set the stage for an enormous breakout to the upside, especially when the investment finally breaks above the "neckline" made by the previous tops.

Gold has formed one of the clearest inverse head and shoulders I've seen in years:



If this current rally holds up and gold manages to break above $1,000, the stage is set for a blast to $1,325.

Hold tight for now, big gains are on the way.

Gold Miner's ETF (GDX): similar to GLD, GDX has had a bumpy time due to the dollar's rally. However, gold miners are primed for an explosive rally in the coming months as gold clear $1,000 on its way to $1,300.

As you can see, GDX has staged a series of new higher lows I the last month. This latest correction should prove short-lived as the uptrend continues.

OPEN POSITIONS					
Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Gold ETF	GLD	8/25/09	$94.75	$92.79	-2%
Gold Miner's ETF	GDX	8/5/09	$40.93	$38.43	-6%
UltraShort Nasdaq	QID	8/11/09	$27.06	**NEW**	**BUY!**
UltraShort China	FXP	8/11/09	$9.98	**NEW**	**BUY!**