Private Wealth Advisory

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And Down We Go

Watch the last 30 minutes…

Through this year and the last, the last 30 minutes of trading has been a critical point for manipulation. Countless times the market has shown signs of breaking below critical resistance points, only to have stocks rally sharply in the final 30 minutes of trading. Indeed, there were even several days in which stocks actually reversed losses to close at a gain all in the final 10 minutes.

This is not coincidence.

As I've noted countless times on these pages, this market is being manipulated… HEAVILY. And these last minute rallies have come at the hands of JP Morgan, Goldman Sachs, and other large Wall Street firms. I know personally of at least two instances in the last two weeks in which JP Morgan stepped in and bought 1,000 S&P 500 futures at critical points, pushing the market higher *just* when it looked about to break-down.

You can see this in the below chart of the S&P 500. Stocks staged late day rallies on August 6th, 10th, 11th, 13th, 14th, and 17th (that's only the last two weeks!) The most critical rallies came on the 10th and 11th. Without those, the S&P 500 clearly was heading for 980 in a very rapid fashion.

It's important to note that this late day manipulation can only last as long as there are equity bulls who believe in it. That is, buying a ton of futures only kicks off a rally in stocks if there are enough stock bulls who believe that someone in the futures market knows something they don't. Much like in poker, you can only run the table when you've got a patsy or two to pony up the cash.

And the stock market ran out of patsies this week.

The above chart shows the S&P 500's daily action in one-minute increments. As you can see, traders shot for late day rallies on both the 17th and the 18th (yesterday). Both days, they failed to get enough bulls to buy into the manipulation (stocks rolled over in the final minutes). They did manage to stage a major rally today (the 19th: this was largely due to options expiration which I'll address later) but even that one rolled over towards the close.

You can take these recent late day rally failures one of two ways:

1) The bulls are out of steam.
2) Reality is taking hold.

I'm inclined to go with the latter. I have always believed that the efficient market theory (the idea that the market is always pricing what's to come in an efficient manner) is a complete and utter load of nonsense. Few things illustrate this like the US indexes.

The China Growth Myth Debunked

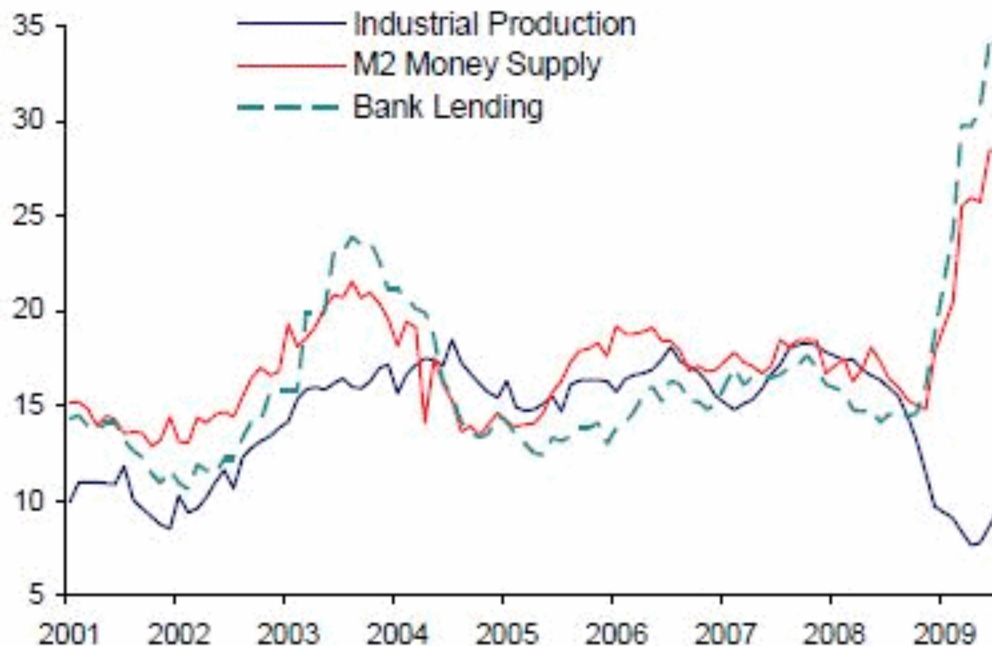
Virtually 95% of all the evidence of economic recovery has stemmed from China in one way or another. Whether it's the rise in price of commodities (China stockpiling), the global economy (the "China" growth miracle will lead us into a recovery), or even retail numbers (China producers lowering prices in an effort to move inventory), China is linked in one way or another to the "green shoots" nonsense.

Unfortunately for those of us living in reality, the view that China will bring about a new era of growth is a total fraud through and through. The Chinese government, unlike its US counterpart can FORCE China's financial industry to do anything it says. And China's government has been screaming "lend, lend, lend!!!"

Indeed, Chinese banks have lent out $1.1 trillion in the first half of 2009: an amount equal to one third of the country's GDP. Over the same time period, loan-deposit ratios at Chinese banks have only increased from 65% to 66%. Put another way, only the tiniest fraction of the money being lent out has actually gone into deposits.

So where has it gone?

Well, China's exports (about 40% of its economy) in July were down 23% Year-over-Year. China's industrial production is up, but only back to 2001-2002 levels: hardly a sign of major investment.



Meanwhile China property values are EXPLODING. According to Andy Xie formerly of Morgan Stanley, property in China now costs roughly the same per square meter as in the US. The only difference is that your average Chinese worker makes 1/7th as much money as your average US worker.

And then of course, there is the Chinese stock market which exploded higher starting with the Stimulus plan in November.

What I'm trying to say is that China's "boom" has almost entirely been the result of financial speculation. China's economy is not growing anywhere near what its "official" numbers claim. Instead, the boom in commodities and the Shanghai Stock Exchange have come from Chinese investors taking out loans and piling into the markets. There are stories of Chinese college graduates taking up day trading instead of looking for jobs.

Will China become the next economic super-power?

Probably in a decade or so.

Is China's economy stronger than the US's now?

They're certainly throwing a LOT more money around relative to GDP.

Can China transition from an export-focused economy to a standalone entity within a year by pumping hundreds of billions of dollars into its system?

ABSOLUTELY NO CHANCE WHAT-SO-EVER.

So what happens when China's credit bubble pops?

US stocks finally catch on two weeks later.

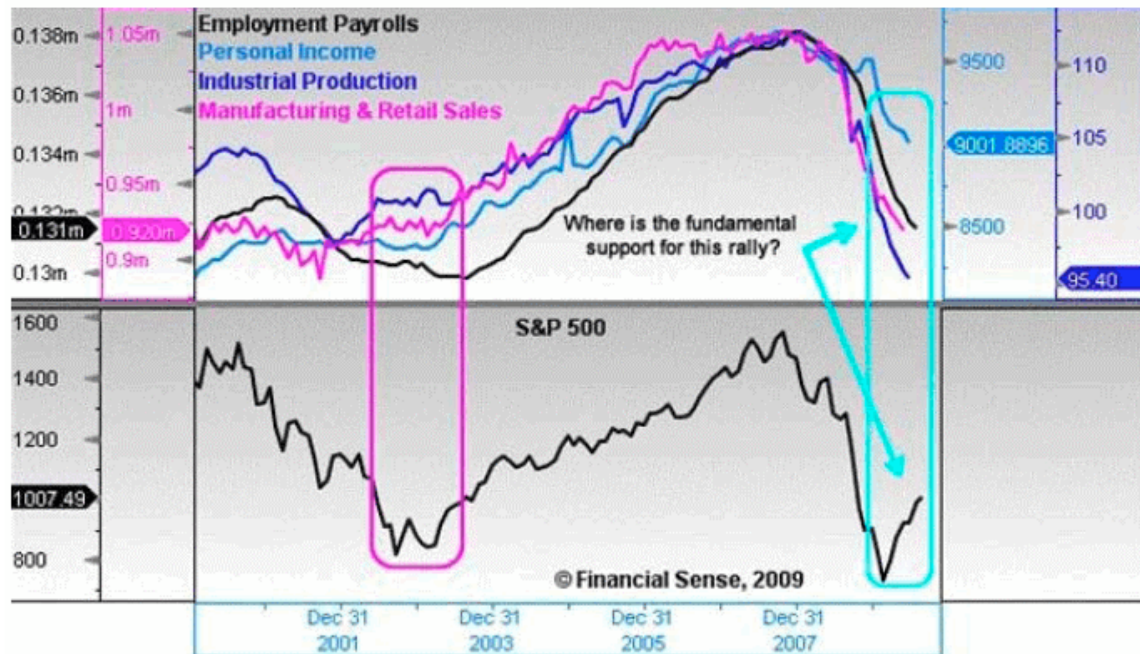
As you can see, the Shanghai Index (dotted line) rolled over in earnest at the beginning of August. US stocks only just started to figure this out two weeks later. Indeed, looking at the world financial markets as a whole, you could easily argue that the US market is the last to "catch on" to any major change in the world economy.

Well, that might be too harsh. But US stocks certainly haven't discounted the future OR economic realities in any way shape or form during this latest rally.

Indeed, the below chart shows just how disconnected stocks have become from the underlying economic realities. Employment payrolls, personal income, industrial production, and manufacturing/ retail sales are all largely in a freefall with no uptick from their 2007 peaks.

The US economy, for all intensive purposes, is back to where it was in 2002 after the post-9/11 mini-recession.

And yet US stocks staged a massive 50% rally from the March lows.



I've addressed this issue before, suggesting that we may be retracing the 1929-1930 major bear market rally we saw during the Great Crash/ Depression. The below chart (which I've shown before) from David Rosenberg certainly provides evidence for this idea. If this is the case, then the current correction underway could very well be the beginning of a MAJOR leg down in US markets.

Indeed, even options expiration is failing to produce the usual explosive rallies.

Today's Rally in Stocks Was ALL About Options

As I've noted in previous issues (and essays in my free e-letter, *Gains, Pains, & Capital*), options expiration usually results in major 1-2 day rallies as traders push the market higher to close their options positions in the black.

Typically, the largest pre-expiration moves occur the day before expiration (Thursday). August's options expire Friday of this week. **However, I believe the rally on Tuesday and the today are ALL we're going to see from performance gaming.**

An entire slew of significant economic data (jobless claims, leading economic indicators, and the Philly Fed's statement) comes out tomorrow (Thursday: the usual day for pre-expiration rallies). Because of this, it's highly IMPROBABLE traders will be able to push the market higher in the face of what will likely be BAD announcements.

So today's rally is likely to be all we see from options expiration gaming, which leads me to believe the market will roll over either on Thursday or Friday and begin their descent down again.

We've already prepared for this by going short China (whose credit bubble is beginning to implode) and the NASDAQ (the most overbought index in the US markets). However, a few more trades have caught my eye.

Shorting Oil and Emerging Markets at the Same Time

With supplies rising, demand falling, a lack of hurricanes, and relative peace in the Middle East, I am DYING to short oil. However, the oil market has become such a den of speculation and manipulation that I am hesitant to make a direct short on the commodity (seriously, how is oil at $71+ a barrel during a global economic contraction?).

So instead of shorting oil, I am suggesting shorting Russia's stock market: which is essentially a combo play on oil and a bunch of bankrupt Russian companies.

As I noted previously, Russia's economy has some serious problems. For one thing it contracted 11% Year-over-Year from in 2Q09. Industrial production collapsed 10% Year over Year in July. Unemployment is soaring, retail sales are diving, the list goes on and on.

The reason for this is simple. The Russia economy (and stock market) are largely hinged on oil. Heck, even the Russian President admitted this earlier this week when he said that Russia needs to diversify its economy because relying on commodity exports is a "dead end."

Russian stocks certainly seems to know this:

As you can see, the Templeton Russia ETF (TRF) peaked back in July and has since broken down aggressively with a series of new lower lows and lower highs.

The one-month chart is even less promising.

As you can see, TRF was rejected at its 21-day moving average (blue line) at $17 and change and has recently staged a new lower low. The momentum on this investment is decidedly downwards and the 6-month chart forecasts a DROP to $15, $14, or possibly even $12 in the near future.

Any meaningful pullback in US stocks will result in a flight to safety away from emerging markets. Russia is the weakest of the BRICs (Brazil, Russia, India, China) and will suffer greatly from this. We'll profit when it does.

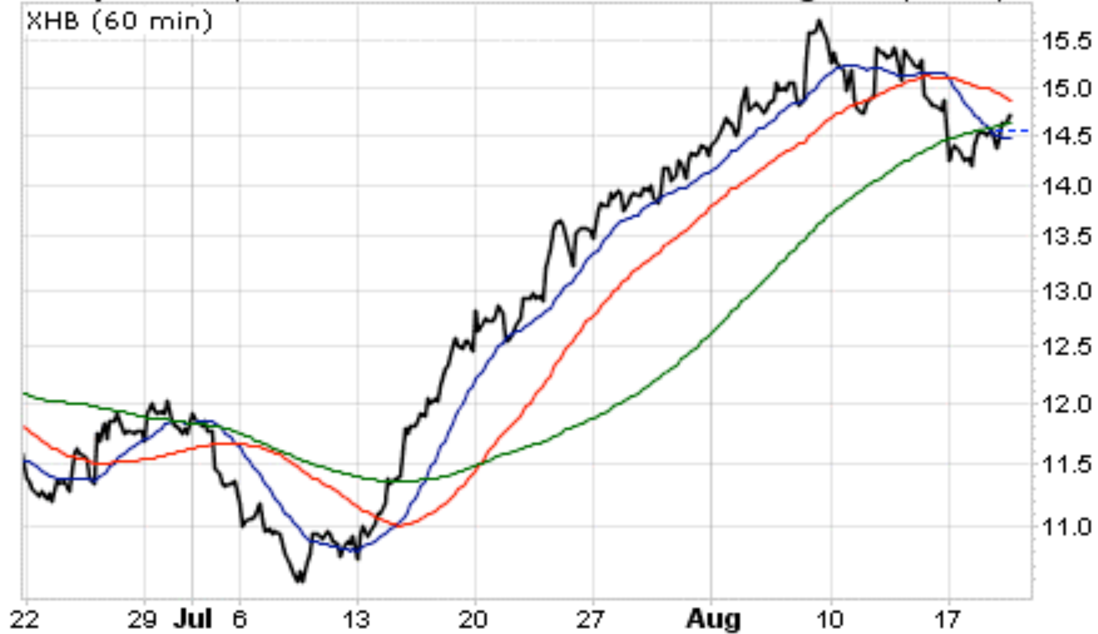
Action to take: Short the Templeton Russia ETF (TRF).

Use $18 as your stop loss.

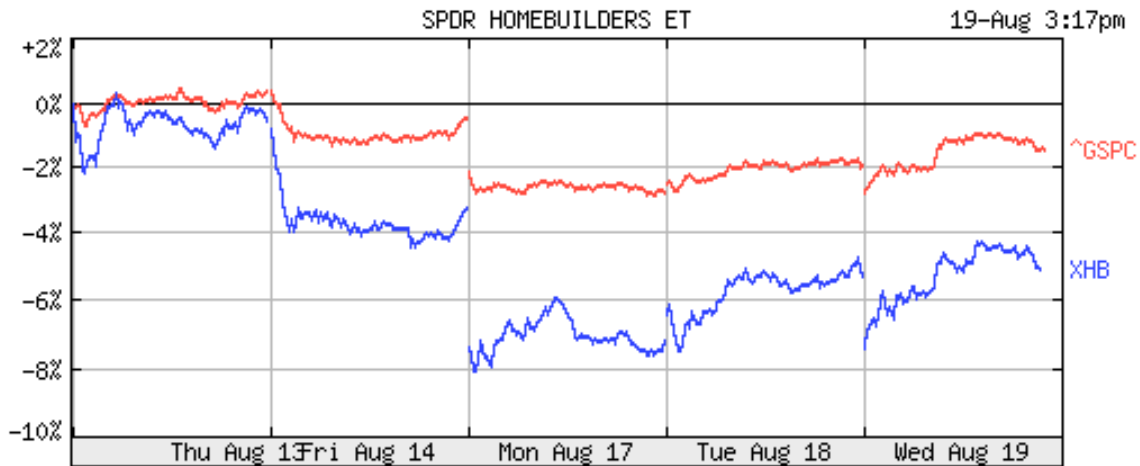
Remember, we are **GOING SHORT** this position, NOT buying it. Talk to your broker about short selling if you're unfamiliar with the practice.

Homebuilders= Ready to Roll Over

As we noted in last issue, Homebuilder stocks are ripe for a fall. The Homebuilder ETF has exploded 50% higher since early July, which is rather striking when you consider that the housing data has not really improved… OR the fact has bank lending (no lending= no mortgages= no home sales).



Last week I was hesitant to short this sector because I thought we might see a brief bounce. We DID get the bounce, but interestingly, Homebuilders (blue line) have begun breaking down even more than the general market (red line).



Looking at the XHB chart above, the first point of REAL substantial resistance is $12.50. After that it's $11.00. Using the last point of upward resistance ($15.50) as our stop loss, and $11 as our profit target, we're risking a 6% loss to make a 24% gain. I'll take that trade any day of the week.

Action to take: SHORT the Homebuilders ETF (EHX)

Use $15.50 as your stop loss.

Remember, we are **GOING SHORT** this position, NOT buying it. Talk to your broker about short selling if you're unfamiliar with the practice.

To conclude, the market correction I've been forecasting for over a month looks to finally be underway. Market leaders are collapsing, economic realities are taking hold, and there are no longer enough bulls to produce the usual late day market rallies (today being the exception due to options expiration).

With today's option expiration rally out of the way, the stage is set for continued downward pressure. I expect we'll see the S&P 500 at 960 and possible even 940 before it's over. In simple terms, stocks NEED to cool off… otherwise we will have a full blown CRASH like last autumn.

We're setting our portfolio up to profit from this by shorting China's bubble (FXP), the NASDAQ (QID), homebuilders (XHB) and emerging market garbage/ oil (TRF).

We've also bought gold and gold miner stocks in anticipation of a major move upward in the next month or two. I view the gold position as a longer-term holding (I expect to hold through year end).

Thank you again for your interest in *Private Wealth Advisory*. I can be reached at graham@gainspainscapital.com if you have any questions or thoughts.

Good Investing!

Graham Summers

OPEN POSITIONS					
Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Gold ETF	GLD	8/25/09	$94.75	$92.50	-2%
Gold Miner's ETF	GDX	8/5/09	$40.93	$38.24	-7%
UltraShort Nasdaq	QID	8/11/09	$27.06	$26.84	-1
UltraShort China	FXP	8/11/09	$9.98	$10.52	5%
SHORT Templeton Russia ETF	TRF	8/19/09	$16.68	**SELL SHORT**	
SHORT Homebuilders ETF	XHB	8/19/09	$14.64	**SELL SHORT**	