PRIVATE WEALTH ADVISORY

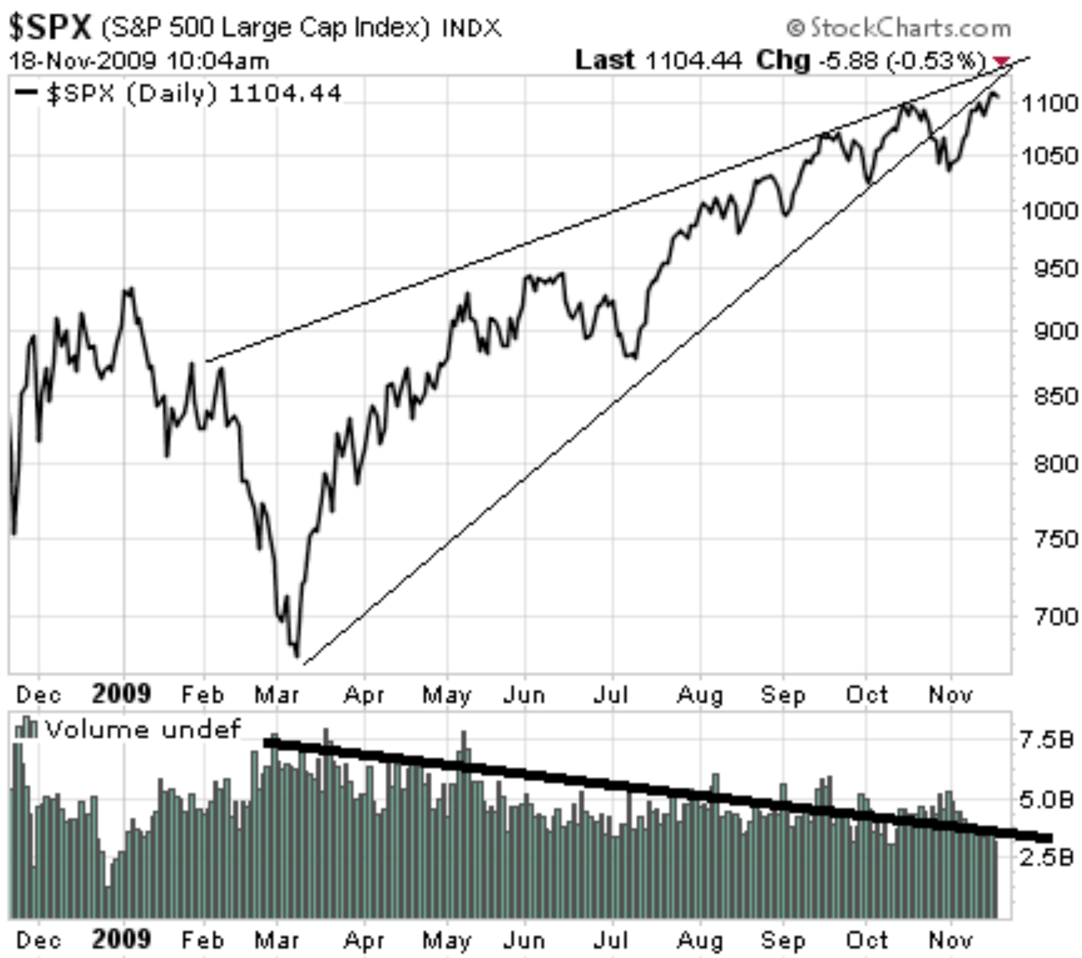
AN OMNISANS RESEARCH PUBLICATION NOVEMBER 18, 2009

Bailout Ben Takes Us to 2007

On Monday and Tuesday, stocks ramped higher to a new 2009 high with the S&P 500 closing at 1,110. As one would expect, the mainstream financial media high-fived over the event proclaiming it to be a sign that the good times are back and that the correction in October was just a minor blip in a never-ending push higher. Those of us with working brains however have become truly concerned about what's going on in the market.

Let's dig in.

For starters, while this latest push DID bring stocks to a new high for the year, it DID NOT bring the S&P 500 back within the trading range of the ascending bearish rising wedge it has formed since the rally started in March 2009. In simple terms, this tells us that the new high has NOT reclaimed the REAL upward momentum of the rally.



As you can see, the S&P 500 is now bumping up against its trend-line but has so far FAILED to break above it. This tells us that the latest rally is a bounce, not the beginning of a larger move up: we would need to see a DECISIVE move to 1,120 or higher for this to be the beginning of another leg up.

Secondly, I want to draw your attention to the MASSIVE drop in volume (the lower part of the chart with the vertical columns) that has occurred since the market bottomed in March 2009. No exaggeration, market volume has dropped by 66% since the March bottom. That is absolutely astounding. At no point in history can I recall seeing volume drop this dramatically. And it is a MASSIVE warning that this rally should not be trusted: the higher the market moves, the fewer investors are participating in it.

I should also add that REAL volume today is even lower than it looks. Back in June and July I wrote about how most of the market's volume was being generated by high frequency trading programs and consequently was NOT indicative of REAL buy and sell orders.

I wrote:

… High Frequency Trading Programs (HFTP) collect a ¼ of a penny rebate for every transaction they make. The example I use to describe how these HFTPs work is as follows…

Let's say an institutional investor has put in an order to buy 15,000 shares of XYZ company between $10.00 and $10.07. The institution's buy program is designed to make this order without pushing up the stock price, so it buys the shares in chunks of 100 or so (often it also advertises to the index how many shares are left in the order).

First it buys 100 shares at $10.00. That order clears, so the program buys another 200 shares at $10.01. That clears, so the program buys another 500 shares at $10.03. At this point an HFTP will have recognized that an institutional investor is putting in a large staggered order.

The HFTP then begins front-running the institutional investor. So the HFTP puts in an order for 100 shares at $10.04. The broker who was selling shares to the institutional investor would obviously rather sell at a higher price (even if it's just a penny). So broker sells his shares to the HFTP at $10.04. The HFTP then turns around and sells its shares to the institutional investor for $10.04 (which was the institution's next price anyway).

In this way, the trading program makes ½ a penny (one ¼ for buying from the broker and another ¼ for selling to the institution) AND makes the institutional trader pay a penny more on the shares.

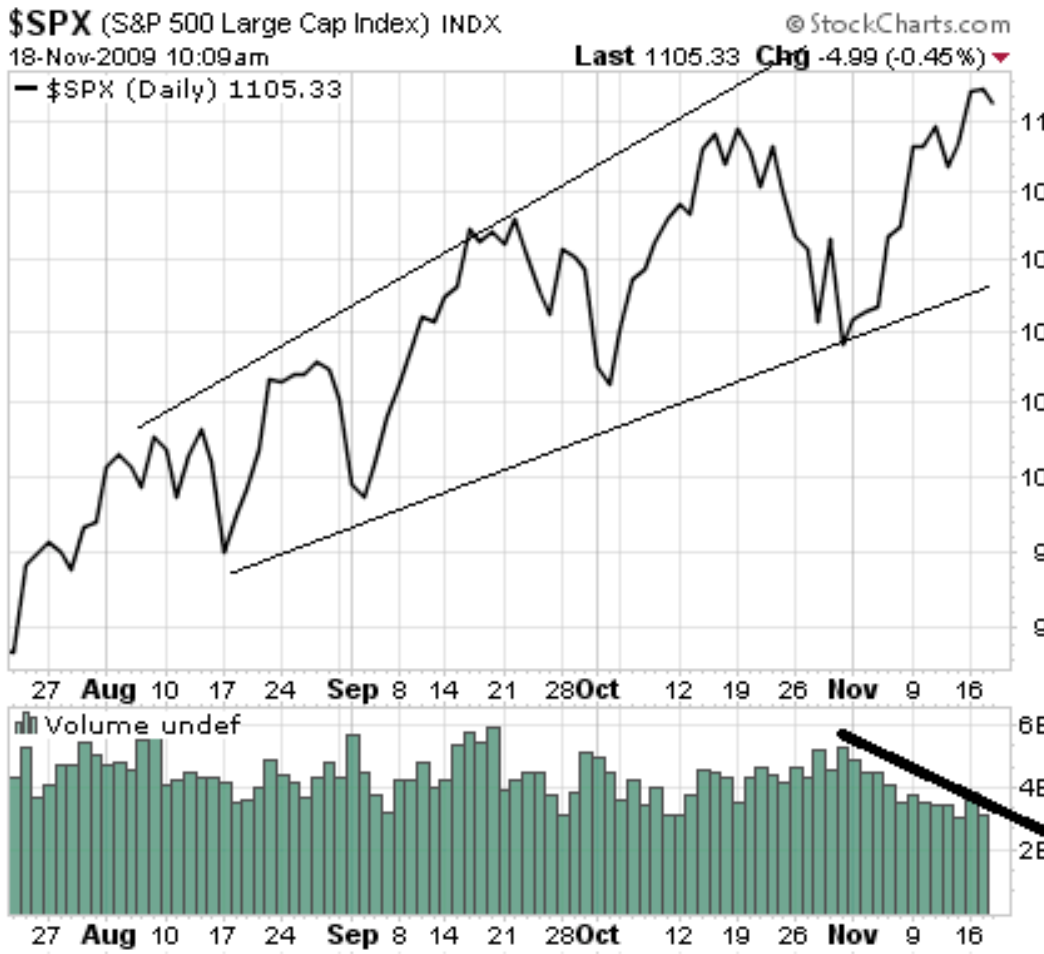
From: *Crooks, Computers, and China*
7/22/09

At one point, these programs accounted for as much as 70% of the NYSE's volume. I cannot tell you how much they account for today (the NYSE decided to no longer publish this information). However, we do know that the last time the NYSE published this data, programs were accounting for at least 30% of daily market volume.

Now, given how Wall Street usually behaves without any oversight (by going nuts with excessive risk)… what are the odds that program trading has stopped playing a large part in market volume?

NEXT TO NONE.

I would wager that today program trading accounts for at least 30% if not 50% of total market volume. This would mean that today, virtually NO ONE is trading the market.



The above chart shows volume has nearly cut in half since for the month of November (from 5.5 billion shares to 2.5 billion shares traded on the S&P 500). Take away the 30-50% of trading volume coming from programs that only hold shares for a few microseconds and you've got REAL daily volume somewhere between 1.25- 1.75 billion shares. You've got to go back to the late '90s at the peak of the Tech Bubble to find volume this low. And we all know what occurred after that (CRASH).

The above chart also shows the expanding rising wedge the S&P 500 began forming in August. If you are unfamiliar with this pattern, it occurs when the market continues to rise but with greater volatility (thus the trading range widens). This is ALSO a classic sign that a MAJOR downturn is coming (we saw it in 1987, 2000, 2007, and 2008).

Thus we have:

1) An ENORMOUS drop in volume
2) A market that has FAILED to reclaim its uptrend
3) Increased volatility

This is THE recipe for a major market downturn/ Crash. In fact, the similarities between today's market and the ALL-TIME top in 2007 are astounding.

As you can see, from 2006-2007, the market formed a rising bearish wedge very similar to the one it formed this year. In fact this year's pattern is even better defined than the one that occurred in 2007!

In 2007, we also saw the rising bearish wedge pattern broken followed by a large bounce that brought the market to a new high but did NOT reclaim the rising uptrend (AGAIN, just like today). In fact, the S&P 500 rallied hard to test the line, was rejected and then rolled over— a perfect example of our Collapse formula: #1 the initial drop, #2 the bounce, #3 the REAL fireworks.

The mainstream commentators, seeing the S&P 500's new high in October 2007 proclaimed that the drop that had occurred from July to August was just a minor blip (just as they are referring to the correction in late October '09) and that the S&P 500 was never going to truly break down. However, as the below chart reveals, the investors who believed this lunacy and bought stocks in October '07 were in for a REAL surprise.

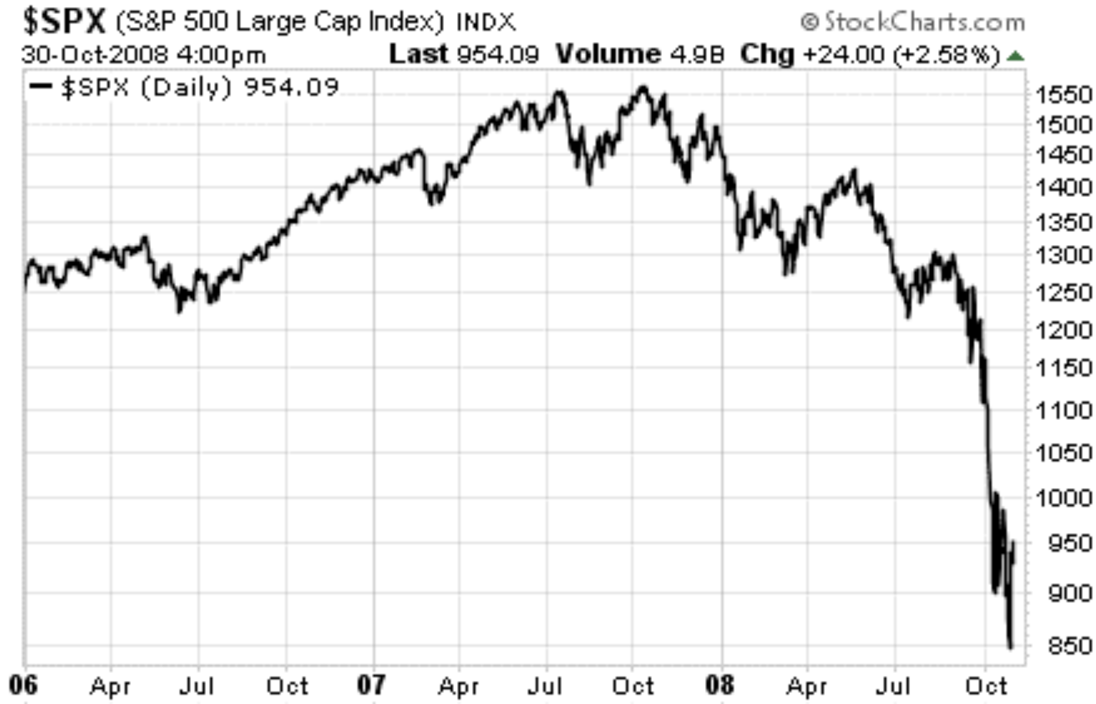
I should also point out that in 2007 the economic picture was not nearly as bleak for the US as it is now. The US's debt was not nearly as large, nor were the Federal and State deficits.

Indeed, having shifted trillions of dollars worth of junk debt onto the US balance sheet, you can easily argue that our current economic conditions are far WORSE today than they were in 2007. Our Fed Chairman (who incidentally oversaw the 2000-2007 bubble as then-Fed Chairman Alan Greenspan's right-hand man) has literally "bet the farm" that we can print our way out of a debt Crisis. He's done this by:

1) Printing nearly $1 trillion in money and giving it to the banks
2) Shifting more than $1 trillion in junk debt onto the Fed's balance sheet
3) Back-stopping the entire financial system through various lending windows

Thus Bernanke has "solved" one Crisis (bank insolvency… which isn't really solved either) by blowing another asset bubble and creating a even BIGGER Crisis: the US debt crisis.

Here's what happened when Bernanke's last asset bubble "popped":



The main points I am trying to make here are as follows… **the very same guy who orchestrated the 2007 top and subsequent Crash has resorted to the only tactic he knows: blowing ANOTHER bubble while simultaneously rendering the US insolvent.**

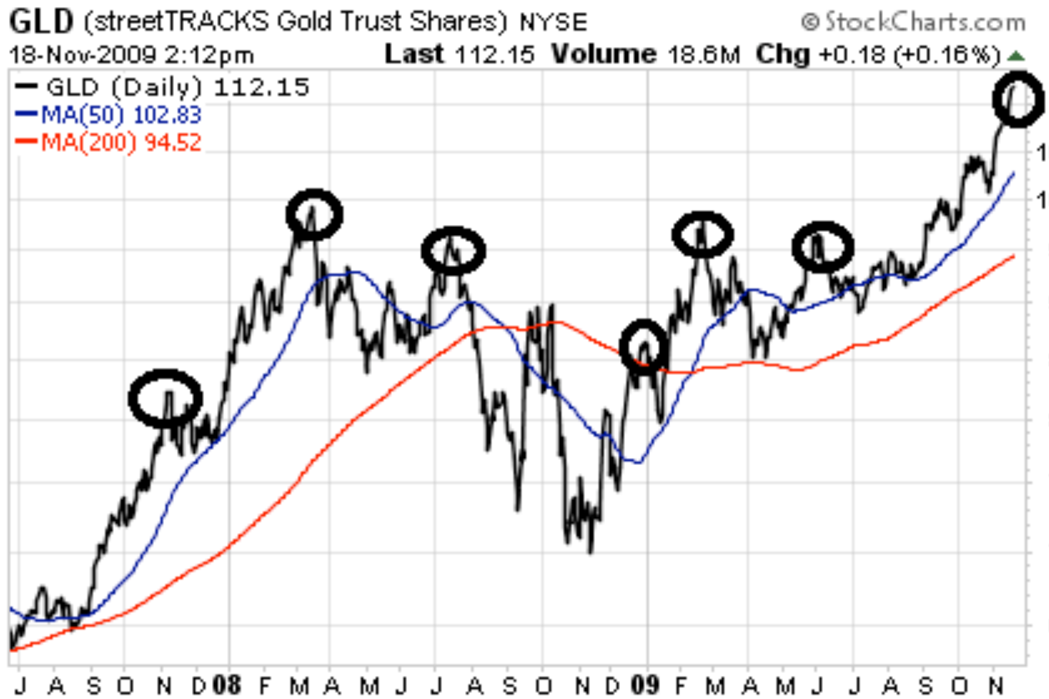
The fact that the market today is mirroring what happened in 2007 is NO surprise: we've got the EXACT same Fed and bankers calling the shots!!! The only difference is that THIS time the economy and market are even more fragile. So the Collapse will be even MORE extreme.

Indeed, Gold and Treasuries are already flashing several warning signs that something major is about to happen.

Gold: I'm Bullish But It NEEDS to Cool

Gold has erupted higher in the last two weeks: a sure sign that trouble is afoot in the financial markets. To be sure, Gold is in a long-term bull market. And I personally think we'll see the precious metal trading at $2,000, if not $5,000 per ounce within the next three years. However, in the near-term, Gold is extremely overextended above its 50-day moving average.

Indeed, Gold has been this overextended SIX times in the last three years (I've circled them in the chart below). Only one of those times did it NOT stage a dramatic correction before moving higher:



As you can see, every time Gold gets this far away from the 50-day moving average (blue line) a sharp drop follows. The one exception to this was in November 2007 when Gold dropped a bit and then traded sideways for a few months before starting its next leg up.

So, while I am a big Gold bull in the long-term, I need to see one of two things happen in the short term before we buy:

1) Gold correct back down to $1,120 or even $1,100, or…
2) Gold trade sideways for a month or more while the moving averages catch up

Be patient here. I know the world is now ablaze with commentators railing about Gold hitting $5,000 soon. But Gold took 10 years to quadruple. It's not going to quadruple again within one year. And if stocks stage a major collapse like they did in 2008 (a scenario I view as quite possible) Gold will get pulled down just like it did then.

However, Gold's move does indicate a flight to safety is currently occurring in the markets. Even Central banks have gotten in on the deal with both India and Mauritius (an island nation) buying the precious metal recently. If that isn't a sign of a short-term top (Central Banks are some of the dumbest of the dumb money on the planet) I don't know what is.

The Treasury market is also sending us some warning signs that a stock collapse is imminent.

Treasuries: Still a Safe Haven

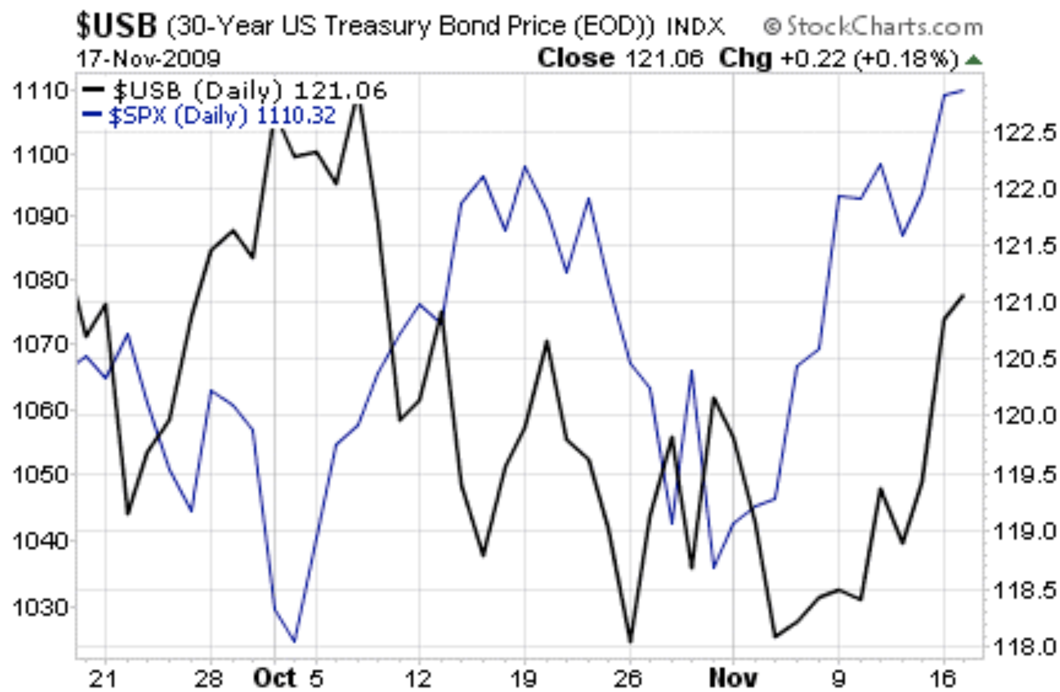
As I've noted in previous issues, Treasuries have been trading in a well-defined upward range for the last five months. Back in September and October it actually looked like Treasuries might stage a breakout (a sure sign that a Collapse in stocks is about to occur), but they were rejected at the top of the range:

Seeing this, as well as the dramatic drop Treasuries started in October, I grew **extremely** worried that we might see a Crisis in which both stocks AND bonds fall. The bond market is twice as large as the stock market and a bear market in bonds would make the 2008 Crisis seem like a picnic.

Because of this, my eyes were glued to the above chart during the last few weeks, looking for signs of whether or not Treasuries would break their trading range to the downside. Fortunately they DIDN'T. Instead, they've begun spiking higher again.

Now, with the Fed increasing the US debt load at a staggering rate, Treasuries have only one reason to rally: flight to perceived safety. And for some reason, investors have been fleeing to Treasuries in the last two weeks DESPITE stocks rallying higher (see the chart below).

Let's be blunt here. Bond market investors are typically far more astute than their stock counterparts. Consequently, stocks are typically the last to "get it" when real trouble occurs. The fact that Treasuries are now rallying strongly implies that something bad is coming soon. Stocks meanwhile are totally disconnected from reality…



So why are stocks rallying in the face of several SEVERE warning signs?

You guessed it… it's OPTIONS WEEK.

As I've noted in numerous issues in the past, options week is a time when Wall Street traders gun the market higher to put their call options in the money. For instance, there are currently nearly one million open options contracts for the S&P 500 ETF (SPY) most of them "in the money" if SPY goes higher than 104 this week.

In simple terms, the bulk of Wall Street options traders have bet that by this week, the S&P 500 ETF (SPY) would be trading somewhere between 104 and 113 (right now it's 111). **Of this one million open contracts, <u>more than half (534,000) bet that SPY would be at prices higher than 110 or 113.</u>**

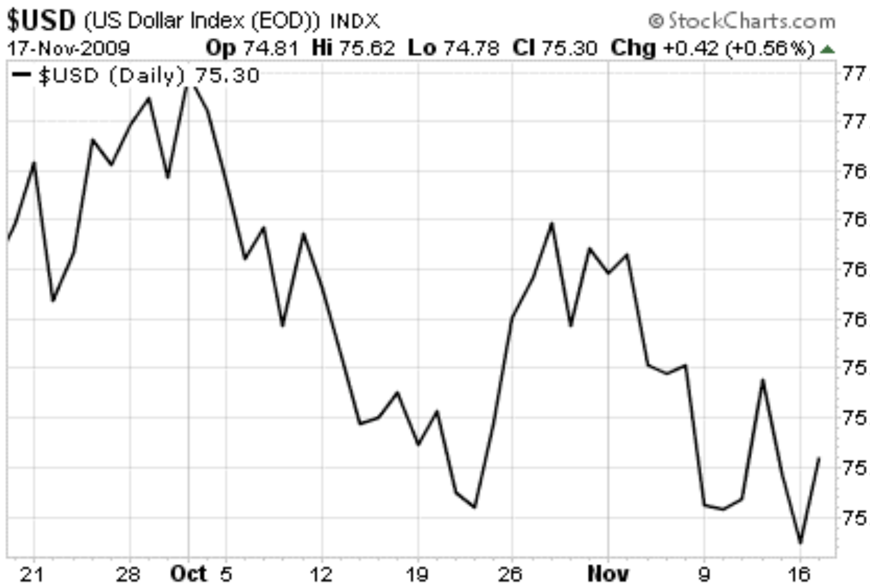
What are the odds that Wall Street is taking advantage of the lightest trading volume in years to gun the S&P 500 higher so they can close out their options trades at a gain? Looking at the end of today's action with the SPY rallying strongly into the close at 110, I'd say the odds are pretty DARN high.

To be blunt, options week is ALWAYS a wash for sensible invetsors. It is hands down the most manipulated week of the month for investing. Thus, the key developments in the market this week are:

1) A massive flight to safety is occurring even in the face of stocks rallying to new highs for the year.
2) Stocks are rallying on extremely thin volume during a week in which Wall Street traders NEED stocks to rally so they can close their options trades at a gain.

Seeing this, I believe that options week has essentially put off the inevitable (the coming Collapse) by a week. Looking at the trading volume this week, it is clear that NO ONE but Wall Street's computers are participating in the rally pushing options "in the money."

Meanwhile a flight to safety is occurring in Gold and Treasuries. The US Dollar is also showing some signs of strength despite various moron government officials talking it down.



As you can see, the US Dollar continues to bounce around the 75 level. This is critical as the Dollar is largely the currency acting as a carry trade for stocks and commodities. The fact the Dollar refuses to totally breakdown despite this recent ramp up in stocks is a serious sign that something is afoot in the markets.

Because the market is likely to be highly manipulated for the remainder of the week, we're not opening any additional positions. However, looking at what's happening (flight to safety, stocks HUGELY overextended and overbought) I believe the collapse we've been waiting for is just around the corner. Once this week's manipulations end, stocks should catch up with Gold and Treasuries, which are already flashing warning signs that real trouble is afoot.

To conclude the primary points of this issue:

1) Stocks are being gunned higher on no volume so Wall Street can close their options trades at a gain

2) Despite the manipulation, stocks have failed to reclaim their bearish rising wedge uptrend thus identifying this latest move as a bounce NOT a real rally
3) Treasuries and gold are already flashing signs that REAL trouble is ahead

As I have said countless times, stocks can break their rising bearish wedge and rally to new highs and STILL Crash. This is precisely what happened in 2007. It's precisely what is happening right now too. This should not surprise us given that Ben Bernanke was in charge of the market during both times.

For this reason, I am unconcerned about the current losses of our trades. Market collapses take time: in 2007 the bounce took nearly two months to complete. However, once it did complete, the collapse wiped out nearly two years' worth of gains in less than six months. And this was at a time when the US debt, US deficit, and unemployment were DRAMATICALLY lower while corporate profits were DRAMATICALLY higher.

In simple terms, the market today is far, FAR unhealthier and more fragile than it was in 2007. So you can expect that when the Collapse does happen it will be EXTREME.

Just sit tight for now. Let Wall Street run its games with the options markets. We're already getting signs from the smart money (the gold, forex, and bond markets) that something is BAD right around the corner. It's only a matter of time before stocks figure out what it is. When they do, you can rest assured that your patience will pay off BIG TIME.

Good Investing!

Graham Summers

Ps. A number of you have written in telling me that you've had trouble shorting the Bank ETF (KBE) and Saks (SKS). I'm looking into the situation and will have a full update on this shortly. Previously I had spoken to individuals at Optionsxpress, Ameritrade, and eTrade who told me they can fill these orders without any trouble. I will double-check with them again to make sure this is correct.

I will also be looking into alternative trades if I find that not ALL brokerages can fill these orders. So look for an update on this matter in the next few days.

OPEN POSITIONS (where we're invested now)					
Company	**Symbol**	**Buy Date**	**Buy/Short Price**	**Current Price**	**Gain/ Loss**
Ultrashort Russell 2000	TWM	11/2/09	$31.74	$27.75	-13%
Ultrashort Nasdaq	QID	11/2/09	$24.13	$20.51	-15%
Ultrashort Semiconductors	SSG	11/2/09	$26.00	$21.69	-17%
SHORT Bank ETF	KBE	11/2/09	$21.13	$22.20	-5%
SHORT SAKS	SKS	11/11/09	$6.30	**$6.77**	-7%

ON DECK PORTFOLIO: TRADES THAT NEED OFFICIAL "SELL" SIGNALS		
Company	**Symbol**	**What We Will Do**
UltraShort China	FXP	Buy
UltraShort Financials	SKF	Buy
UltraShort Long-Term Bonds	TBT	Buy
Russian ETF	TRF	Go Short