Private Wealth Advisory

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The Crash IS Coming

Dear Subscribers,

A number of you have written me in the past week asking, "where is the Crash?" After all, there were multiple signs that one was about to begin a few weeks ago… and there are now even more signs that one is coming… but it is not here YET. Indeed, it is quite possible traders shall gun the market for a "blow off top" in the next few weeks (more on this in a moment), but this does not change the fact that a Crash is coming.

Consequently, I am devoting the entirety of this week's issue to addressing the issue of Crashes and answering your questions as to why I remain convinced one is coming. There are HUGE glaring signs that all is not well in the financial system. In addition, we have already begun to see a Crash begin in Japan (the Japanese Nikkei has fallen more than 15% in the last month). I'm detailing all of this (and much more) in the pages ahead. Please bear with me as this week we are covering an even larger quantity of material than usual.

For starters, you must understand that forecasting a Crash is a bit like forecasting an earthquake or hurricane: you can take note of the symptoms and conditions as they develop, but targeting the precise point at which is hits is virtually impossible. It becomes even more difficult when you're investing in a market that is completely dominated by manipulation. If any of you doubt that this market is being manipulated consider the following…

Now, US stocks only trade from 9:30AM to 4PM ET. However, the futures markets trade 24 hours a day almost every day of the year (including Thanksgiving). Last week, when Dubai asked for a six month extension on $60 billion of its debt, the US futures markets (which were open UNLIKE the US stock markets) entered a virtual free-fall: dropping more than 2% in a matter of hours. That same day, the UK FTSE stock market was halted for three hours. **Yes, they froze the entire market for three hours.**

In simple terms, one of the few days of the year that the Fed was closed (especially the NY Fed which is in charge of the various liquidity AKA manipulation schemes) the markets began a full-scale collapse on a minor ($60 billion) debt default. But then what happened? Someone stepped into the US futures markets in the wee hours of the morning (when Europe's stocks were open but US stocks were closed) and piled into bullish bets.

Consequently, on Friday, US stocks opened WAY below Wednesday's close… but were immediately gunned higher:

Then, we had the EXACT SAME gunning of the futures markets over the weekend, resulting in the S&P 500 exploding higher on Monday. And the same thing happened again yesterday.

So to review… the day the Fed and most of Wall Street were closed, the market enters a free-fall. The next day as soon as Wall Street and the Fed are open again, the US futures markets are gunned higher every day during the wee hours of the morning before ordinary stocks open.

Have you noticed that on ALL of these days we've seen a massive rally into the open, followed by an extremely tight trading range OR retreat (both of which indicate a lack of real buyers and sellers)? The reason: **MANIPULATION** in the futures markets.

With that out of the way, let's move on to…

The Glaring Signs (Fundamentals) of a Coming Crash

In 2008, there were numerous signs of an impending Crash… though they rippled beneath the surface and were largely ignored by the mainstream financial media and general populace. I, and a handful of others, noticed them and warned about them for months (I actually started warning in April 2008). However, it took months before the warning signs erupted into a full-scale Collapse. The reason for this is the ENORMOUS amount of manipulation and media spin.

The same thing is happening again this year. And again you're not seeing the signs because the ripples are appearing below the surface.

Glaring Sign #1: the NYSE Invokes Rule 48

First and foremost, the NYSE invoked Rule 48 on November 27, 2009. This is a little known rule in which the NYSE gives itself permission to open the market without providing "price indications" due to "extreme volatility." In simple terms, Rule 48 was devised so that the NYSE doesn't have to broadcast expected stock prices before opening the market should the market have to be **halted or if it Crashed overnight.**

Usually when the NYSE opens in the morning, it puts out the expected opening prices (based on the previous close or overnight trading in the futures markets). So if ABC company closes at $10.10 per share last night (and doesn't tank during futures trading) the NYSE would notify investors that it is likely to open around $10.10 the next morning (sort of like the "pre-market" pricing you see on Yahoo! Finance).

However, IF the market had to be closed (trading suspended) because of a systemic collapse… or if the futures market CRASHED during the night resulting in the market opening FAR FAR lower the next morning, Rule 48 allows the NYSE to simply open trading without having to post the "pre-market" prices. It's effectively an order that was created to allow the market to re-open as quickly as possible rather than having to upload all the new (much lower) price points.

This rule has only been invoked a handful of times in the last two years. The dates are:

- December 12 2007,
- January 22-23 2008,
- March 11 2008
- March 17 2008

If these dates sound familiar, they're the ones in which the market REALLY became unhinged just before and during the Bear Stearns collapse (when everyone thought the financial world was about to implode). I've circled the dates on the following chart and drawn in where the Bear Stearns deal was:

During the period in which the NYSE invoked Rule 48, stocks collapsed 15% in less than three months on HUGE volatility. The fact that the NYSE just invoked the same rule last week during the Dubai crisis tells us:

1) The Dubai situation was anything but minor (we're likely to see more trouble ahead)
2) The NYSE viewed the situation as being equally dangerous to the Bear Stearns collapse (BAD)
3) The systemic risks to the financial system have NOT been fixed.

Glaring Sign #2: Short-Term T-Bill Yields Go Negative

Short-term T-bill yields (Treasuries that mature in less than three months) are an extremely effective means of gauging investor panic. Despite the insane monetary policy of the US, short-term Treasuries are still considered a major safe haven because no matter what happens the US government can print dollars to return the money to investors. Because of this, investors will often pile into short-term T-bills during times of Crisis because they know that no matter what, they will very likely get their money back.

Now, T-bills, like any bond, offer certain yields based on where they trade. If prices spike high enough, yields can actually go negative, meaning that investors are willing to LOSE money (collect NO yield) by lending to the US government just for the security of knowing that they are likely going to get the money back. This only happens during

SERIOUS times of Crisis: indeed the last time this happened was right after Lehman Brothers went under and just before the 2008 nightmare began.

Well, on November 19, 2009, short-term T-bills yields went negative for the first time since Lehman Brothers collapsed. This alone should tell us that something very, VERY nasty is lurking under the surface of the financial system. Some commentators believe this came about because of the Dubai default… but even today, nearly a full week after that, one month T-bills are yielding less than one tenth of one percent (0.09%). So whatever is happening, investors got SPOOKED and have STAYED that way.

Even more strangely the short-term T-bill yield curve has gone NEGATIVE meaning that investors were MORE desperate to have their money locked up with the US Government for three months rather than just one: today three month T-bills yield 0.06% while one month T-bills yield 0.09%. **This means that investors are EXTREMELY concerned about something happening in the next three months (by February 2010).** In fact, they're so spooked that they're willing to make even LESS to lend their money to the US government LONGER. Again, something is very VERY wrong here and some very deep pockets are desperate to lock up their cash for three months.

As I've noted before, bond investors are a lot more astute that stock investors. The fact the bond market is making the same moves it did right after Lehman Brothers went under should tell you that something BIG is coming down the pike.

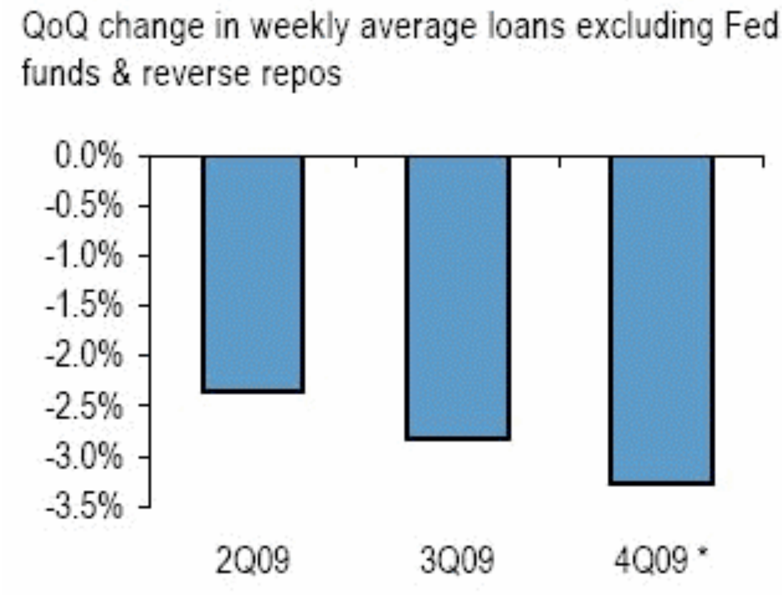
Glaring Sign #3: Banks Aggressively Increasing Cash Holdings

If you've been reading me for a while you know that this Financial Crisis is all about BANKS. The banks created this mess by taking on too much debt (leverage), making too many junk loans, and taking on too much risk. Consequently, the banks have gotten the bulk of the bailout money, the greatest privileges in terms of regulatory amendments, and **the closest access to Fed/ Government officials in terms of knowing what's to come.**

Now, banks make their money in a two primary ways: lending and securitization.

When it comes to lending, banks issue interest on deposits at one rate, lend money at a higher rate, and pocket the difference. Historically (before the '90s) this is how banks have made the bulk of their profits. However, with most banks now effectively insolvent from too much debt (and cash-strapped consumers unwilling to borrow), bank lending has all but disappeared as the below charts (from JP Morgan) illustrate:

General lending DROPS:

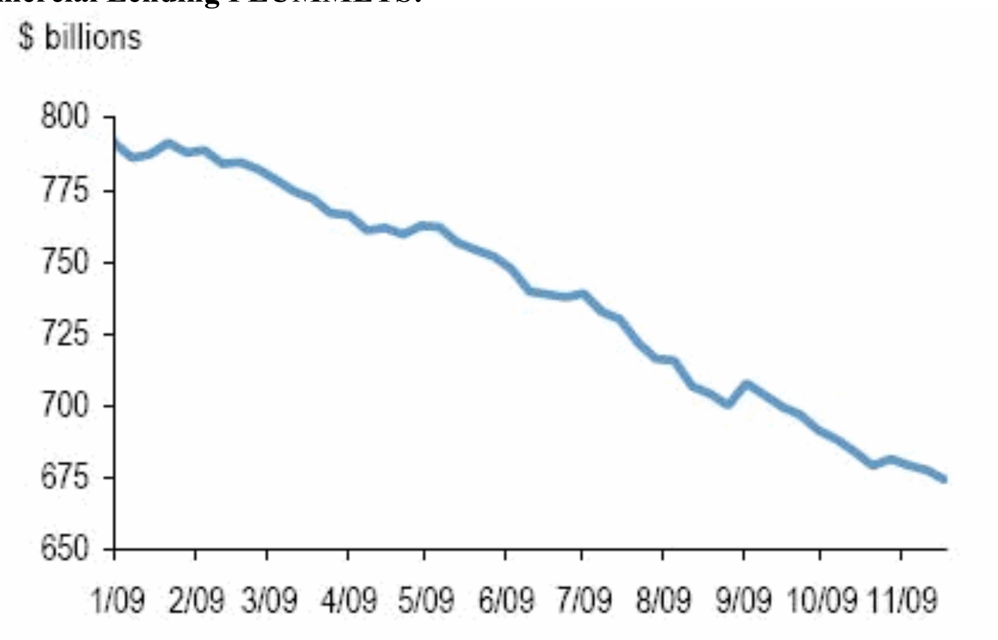


Source: Federal Reserve.

Note: Adjusted for non-bank conversions and acquisitions.

* 11/18/09 vs. 3Q09 weekly average.

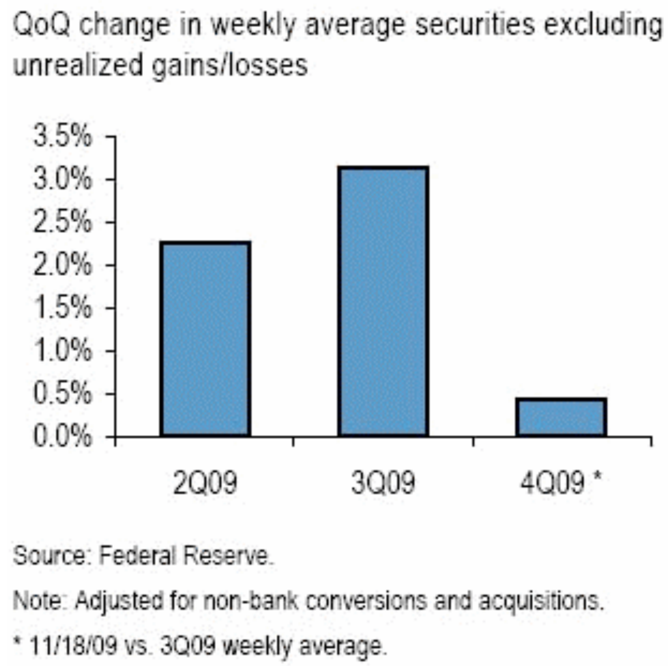
Commercial Lending PLUMMETS:



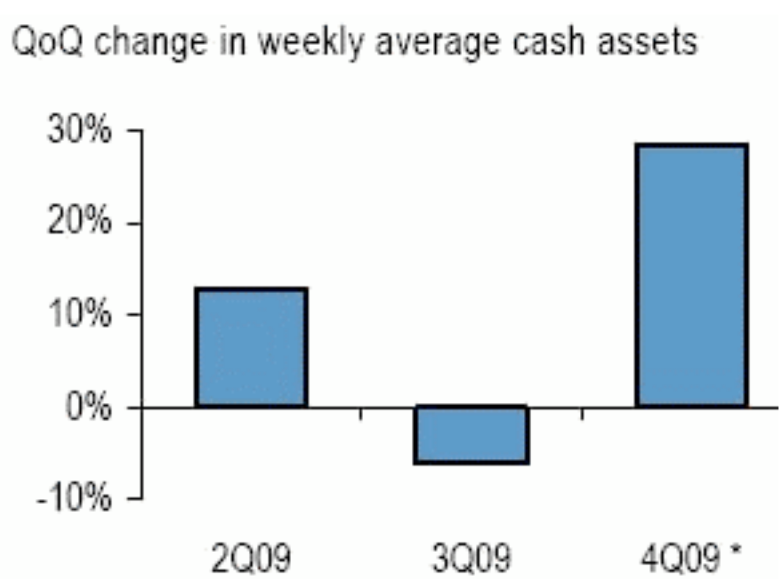
Source: Federal Reserve.

Regarding securities, bank historically make money by trading them (trading bonds, stocks, etc), repackaging and selling them (like they did with subprime mortgages) or simply sitting on them (taking in income from their yields if they're debt instruments). Securities were THE profit center for banks during the housing bubble.

The banks stopped engaging in these practices briefly during the Financial Crisis. However, now that the Fed has given them carte blanche to do whatever they want in terms of accounting practices and market manipulation, banks have gone right back to securities trading, repackaging, and selling like pigs to slop… that is, until last week.



As you can see, bank securities exposure suddenly dropped aggressively in the first few weeks of this quarter (4Q09). This, coupled with the drop in lending, means that banks are no longer growing lending or securities: their two primary assets of choice. **Instead, they're raising cash… A LOT.**



In simple terms, the above chart tells us that banks have increased their cash holdings an incredible 28% thus far this quarter. Remember, holding cash today yields less than 0.25%... so why would banks increase their cash holdings when they could (supposedly) get higher returns from stocks, commodities, or any number of other investments.

I'll tell you why: **because they foresee BIG trouble ahead**.

Again, this Financial Crisis is all about the banks. The Federal Reserve has the banks (especially Goldman and JP Morgan) on speed-dial. If banks are suddenly raising cash (at a 28% increase no less) it's because they KNOW that something bad is coming down the pike and are stock-piling cash to deal with future losses and write-downs. This stands in stark contrast to any proclamations that the Crisis is over or banks are done marking down their junk assets.

Again, banks are choosing to hold CASH rather than any other investment right now. That's a MAJOR RED FLAG.

Glaring Sign #4: Japan is Already Crashing

Since the Financial Crisis began in earnest in 2008, the S&P 500 and Japanese Nikkei have traded in virtual lockstep with one another. Indeed, since the Fed announced its Quantitative Easing Program in March 2009, the correlation between the two has been 0.91 or 90%. That is an ASTOUNDING correlation.

However, in the last two months, a MASSIVE divergence has formed between Japan's Nikkei and the US stock market. I present a close-up of this below:

There are a lot of similarities between Japan and the US today: both countries currencies fund carry trades, both economies are experiencing deflation, both are performing Quantitative Easing and running the money printers to prop up their stock markets.

And yet, in Japan, the market is Crashing, having fallen more than 15% in the last month. This is a MAJOR divergence and does not bode well for US stocks. Indeed, we're seeing similar divergences between the S&P 500 and Financial stocks:

These charts, by themselves, do not necessarily mean that a Crash is imminent. But taken together with the other warning signs they are EXTREMELY bearish. Remember, this

Crisis (and rally) are all about financials (banks). So why are banks hoarding cash while bank stocks are failing to confirm the market's new highs?

Because they know trouble is a-brewing in the markets…

So…

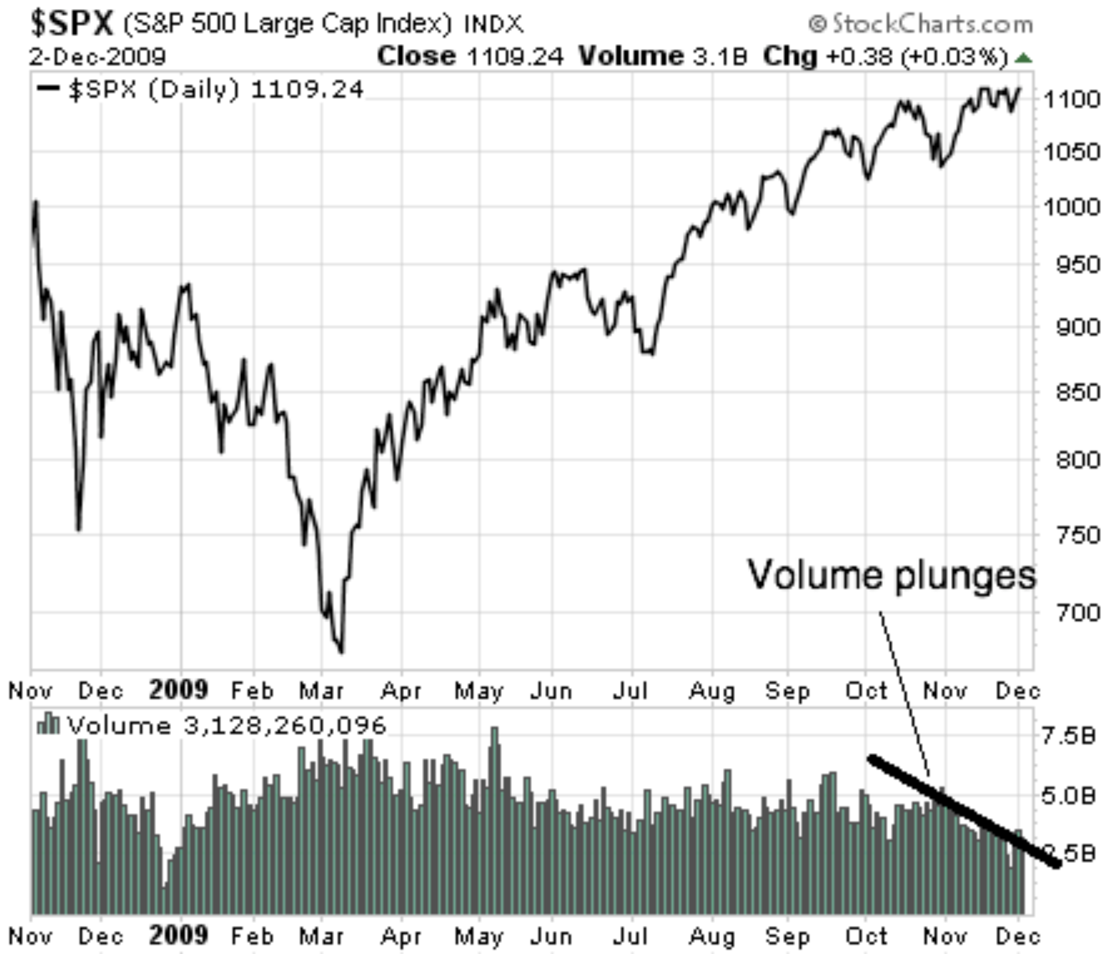
What Do We Need For the Crash to Start?

The short-answer is a catalyst. And there are several on the horizon. These include:

- A new spike in mortgage rate resets (we had a brief window from May-November 2009 when resets were at a multi-year low).
- Commercial real estate (half of the $3.4 trillion in commercial real estate loans are owned by banks… which means HUGE losses are coming as the economy worsens)
- A Dollar rally (the buck refuses to break below 74 despite repeat efforts)
- Another sovereign default (Greece, the UK, and others are on the verge)
- Other, as of now, unforeseen issues

As I have stated repeatedly this year, TOPS are THE most frustrating time to be an investor. And to be blunt, the last three weeks have been a total wash for us (and everyone else) as the market trades in a tight range between 1090 and 1110.

We are essentially in investment limbo. Stocks are not breaking down completely because traders expect the Fed to step in with more liquidity to pump the system. At the same time, stocks are refusing to break higher because no one believes in this rally: a fact that is clear in the HUGE drop in volume during the last month:



Indeed, I've been feeling like a broken record since November 16, but the facts are still the same: stocks have broken and failed to reclaim their upward trend-line (chart below), the market is moving on next to no volume, and economic fundamentals are worsening. I see no reason to change my thesis that we remain in the bounce stage (stage #2) of the Collapse in stocks.

As I mentioned in previous issues, bounces can range in length from a few weeks to a month or more. This current bounces looks as though it will be in the latter category. It's frustrating for me just as it is for you. And I can say that I personally know several professional traders/ money managers who are just like us, sitting with their fingers on the trigger just waiting for the market to come unhinged so they can sell the farm. However, until we get a decisive break below 1,090 on the S&P 500, we're stuck in this range bound market.

As you can see, we've tested 1,090 on the S&P 500 three times in the last three weeks. However, until we break below it, we're still in the "bounce" category waiting for the REAL fireworks to hit (remember, the pattern for Crashes is 1) the initial drop 2) the bounce 3) the REAL fireworks).

My gut feeling on all of this is that we will likely repeat the 2007 top, meaning one final push in stocks to a new high (likely1,121 on the S&P 500) and then the beginning of a three month long nightmarish grind lower with a few bounces on the way before a final re-test of the March 2009 lows sometime in 1Q or 2Q10. There is clearly now dissent growing even amongst Fed officials on the monetary policies put forth by Ben Bernanke.

I should add that as I write this, I've just discovered that Senator Bernie Sanders of Vermont is putting a "Hold" on Bernanke's re-confirmation hearing tomorrow (a move than will require 60 Senate votes to override). If Bernanke is NOT reconfirmed, then look for stocks to begin breaking down immediately (it will be a clear signal that the Fed's "juicing" of the system will not continue).

Overall, my primary points are this:

- The stock market has traded sideways for three weeks now and is hanging by a thread.
- Those "in the know" (the banks) have already taken numerous steps to prepare for a Second Wave of the Crisis (judging from the moves, they're expecting it sooner rather than later).
- There are HUGE historic divergences in the market (low volume, credit spreads widening, market exchanges passing "extreme" measures) signaling SEVERE distress behind the scenes.
- The financial system has not been fixed and the US economy is worsening dramatically

This is THE recipe for a Crash. I realize that we're early on it, but I'd rather be too early than TOO LATE. If you have followed my suggestions you are mostly sitting in cash right now and do not have massive exposure to the market at all. You also would have only put a small portion of your portfolio into the shorts we've opened so far. In simple terms, little of your capital should be at risk and the fact our positions are currently in the red should not be a huge cause of distress.

Again, market tops are extremely frustrating times to be rational. I know a lot of commentators are pronouncing that all is well, that the recession is over, and that we're in a new "bull market." To be blunt, I have no idea what these people are talking about. Either they believe everything the mainstream financial media and Federal Government tell them OR they don't actually bother doing their own analysis. Neither of those is very promising to me.

All I can do is look at the facts, perform my own extensive research, and make suggestions based on what the facts tell me. The facts are:

1) The market IS manipulated and gamed with the Government's approval
2) The banking system is for all intensive purposes insolvent
3) The US economy is in a full-blown depression and worsening steadily
4) The Government lies or massages its economic data
5) The US consumer (the motor of the economy) is tapped out and desperately trying to stay afloat

6) Corporate earnings and revenues are down EVEN from last year's Armageddon levels
7) One in eight Americans are in foreclosure, unemployed (or underemployed) and on Food Stamps
8) The market is set up for a Crash of epic proportions

We are close… SO CLOSE to the "breaking point." The Central Bankers cannot monetize the entire financial system (even if they try the system will crash as inflation destroys profit margins). In the end something will give. There are serious signs of distress showing up beneath the surface. All we need is a catalyst.

So just sit tight for now. We're right… just early. I'm currently preparing a report on what will come in 2010. It should be available within the next two weeks. But here's a brief overview of what I believe is in store for the markets:

1) Another round of deflation that re-tests or breaks the March 2009 lows (anytime before March 2010)
2) Gold to correct to $1,000 or even $970 within three months
3) Commodities to correct substantially (anytime before March 2010)
4) Treasuries to rally briefly and then collapse in 1Q10
5) Agriculture to begin a bull market brought about by trade wars (within six months)
6) A potential Food Crisis to begin courtesy of the bull market in agriculture/ trade wars
7) Emerging markets to follow the US but outperform overall during the next three years (we'll be getting more exposure to emerging markets once the Collapse finishes)

In short, I expect we shall have an INCREDIBLE and I mean INCREDIBLE buying opportunity for many great businesses within a year. In the meantime the reward for going long is pathetic whereas the downside risk is ENORMOUS. Remember, we are in a BEAR market and bear markets end when the market trades at a single digit P/E and dividends are yielding 8-10%. Even at the March lows we were about HALWAY there.

Bernanke and pals have thrown everything they've got at the markets and fixed nothing. At some point the current bubble (and it is a bubble) in stocks will burst and everything will come crashing down. The signs are already there and they indicate it will be sooner rather than later.

Let the Wall Street crooks game the market all they want. For the most part we're out of the market and simply waiting for the fundamentals to take hold. They will. And it's not far off.

Thank you again for your interest in *Private Wealth Advisory*. Never be afraid to be contrarian. I was considered a nutcase for six months in 2008 (I forecast a Crash from

April onwards). But the fundamentals dictated a Crash was coming… and ultimately fundamentals ALWAYS trump gimmicks, cheats, and frauds. This time it's no different.

Good Investing!

Graham Summers

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	$28.05	-12%
Ultrashort Nasdaq	QID	11/2/09	$24.13	$20.69	-14%
Ultrashort Semiconductors	SSG	11/2/09	$26.00	$21.25	-18%
SHORT Bank ETF	KBE	11/2/09	$21.13	$22.15	-5%
SHORT SAKS	SKS	11/11/09	$6.30	$6.21	1%

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