Private Wealth Advisory

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We're On Our Own Pt 2

As stated in yesterday's portion of this week's issue, the financial community is currently operating under four primary beliefs all of which are based on lies. Those beliefs are:

1) China's economy is booming
2) The US economy is in recovery
3) The Euro disaster is over
4) Inflation is contained

In general the financial community is comprised of individuals who organize their investment strategies based on basic formulae or ideologies: sell in May and go away, if the US Dollar falls buy stocks, don't fight the Fed, etc. Because of this as well as career pressure (those who stick out their necks with their forecasts often find themselves unrewarded or even worse unemployed), the financial community at large operates in a herd mentality void of critical thinking.

The result of this is that those who take a different approach have the ability to produce outsized gains. However, the difficulty for contrarians is that the financial herd takes a LONG time to change its views. Consequently, the financial world can operate according to views that are outright false if not fraudulent for much longer than most of us can bear.

Case in point, it is obvious, plain as day, to anyone with a thinking brain that the Eurozone as a concept is finished. Aside from the fact there simply is not enough money in Europe to prop up all the insolvent banks, political leaders at the more solvent member states (Germany and France) are getting hammered for maintaining their pro-bailout, pro-EU policies.

So the banks are insolvent… there aren't enough bailout funds to support them… and citizens at European countries that are actually somewhat solvent want out of the Eurozone.

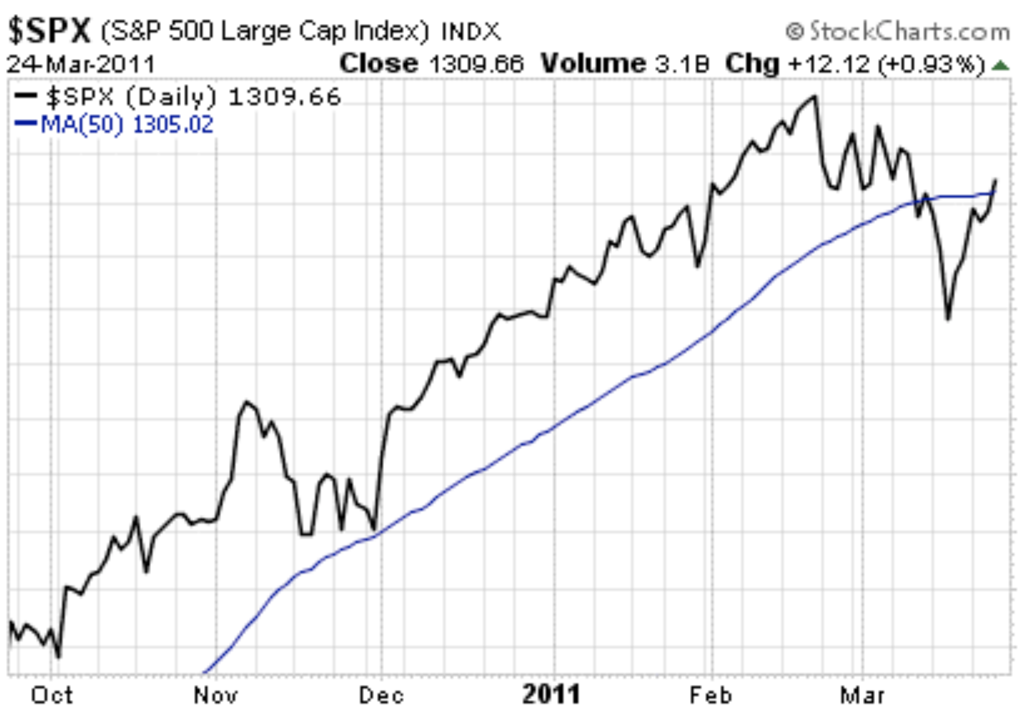
Like I said, the Euro in its current form is FINISHED.

However, the financial community at large continues to operate under the premise that the world's central banks can solve ANY and ALL financial problems. When they finally figure out that this is not the case then we will have the REAL crisis: the one to which 2008 was just a warm-up.

However, while we wait on that, let's take a look at the charts for signs of what's coming.

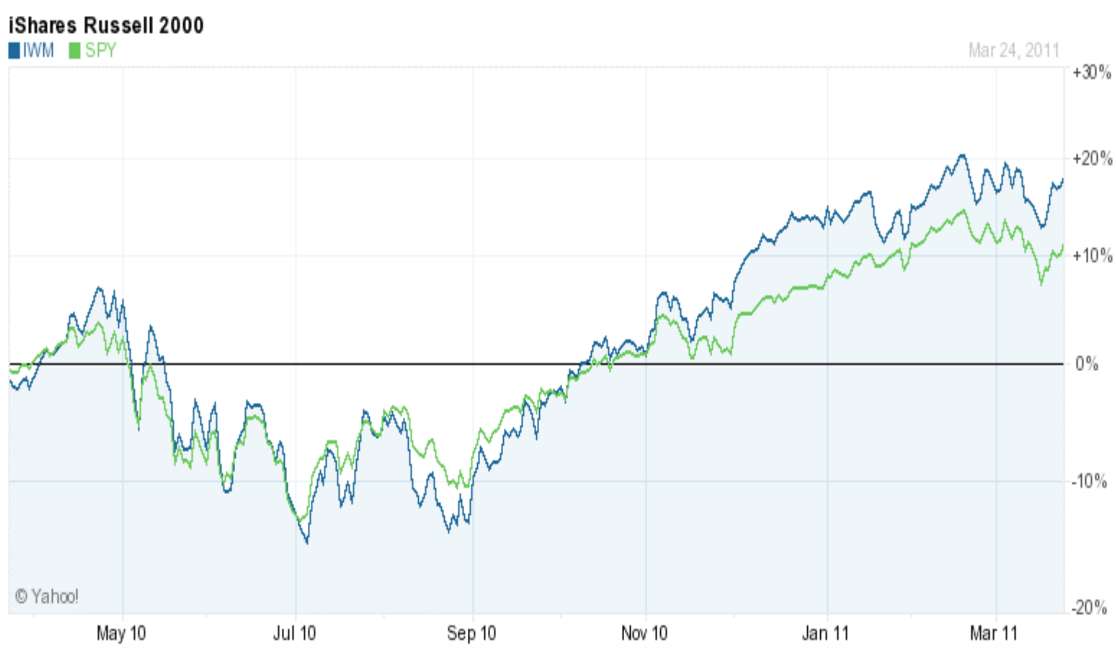
First and foremost, the S&P 500 has come up against the downward trendline formed from the mi-February top.

This is the final resistance level that could kick off another downturn in the near future as the S&P 500 has already taken out its 50-DMA to the upside.



If we hold above this level then we will trigger an inverse head & shoulders pattern that could potentially take us to 1360.

If this happens, I'll be suggesting a few speculative long positions to profit from this. The most likely candidate would be the **Ultra Russell 2000 ETF (UWM).** UWM returns 2X the performance of the Russell 2000 (blue line), which has outperformed the S&P 500 (green line) to the upside for the last few months.



Understand, if we open a position in UWM (or any of the additional speculative longs) it does not contradict my ultimately bearish view of the markets. If we hit 1360 on the S&P 500 I believe it will mark the absolute TOP for the market rally begun March 2009.

So, if we open a position in UWM, it would be a short-term speculative play on a final hurrah in the markets (fueled by additional liquidity).

The same would go for the **Ultra Materials ETF (UYM).**

UYM returns 2X the materials sector. So if materials stocks rally 5%, UYM returns 10% and if materials stocks rally 10%, UYM returns 20% and so on.

Again, UYM like UWM would be a short-term speculative long. DO NOT buy it just yet. I'll send out an alert if and when it's time to buy either of these two investments.

That is the bullish case scenario for US stocks. The bearish case scenario shows that the S&P 500 is bumping up against resistance at current levels.

I would also like to note that this latest move in the S&P 500 is forming a bearish rising wedge pattern: typically an ending pattern that results in a sharp sell-off:

As of yet we have failed to break out of this pattern, but at current levels the S&P 500 is testing the upper trendline. This move predicts a correction to at the lower trendline at 1,300. And if we break below this level, we're going back to 1,260 in short order.

Elsewhere in the markets, the Emerging markets are attempting to reclaim their trendline that has sustained them since the 2008 lows.

This situation bears watching as Emerging markets have generally lead the S&P 500 in most major moves. If EEM stays above this line in a sustained manner, then we're likely getting the last hurrah I spoke about earlier.

We see a similar attempt to reclaim the trend in Brazil:

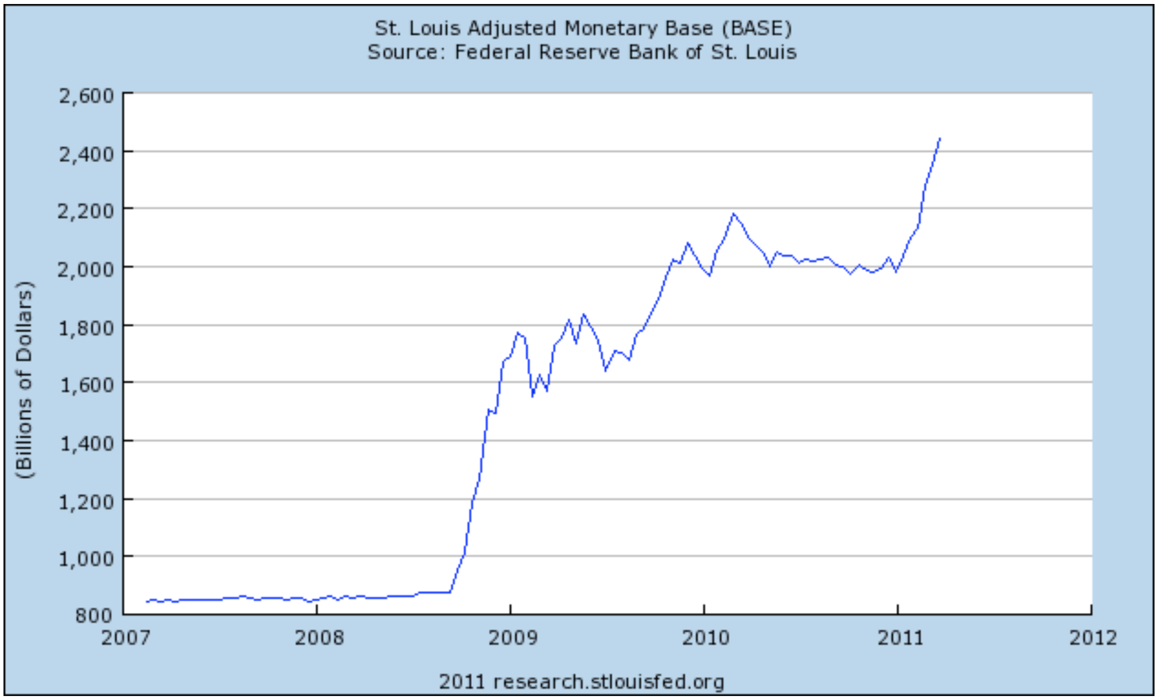
However, China, which has been THE leading economic indicator for the bullish case has so far failed miserably to get back in an uptrend:

This is another reason I'm not willing to go long here right this second. Another reason is the Aussie/Japanese Yen carry trade, which has shown a close correlation to the S&P 500, has yet to come even close to breaking above resistance:

So in a sense the markets are in a kind of limbo. From a fundamental backstop, there is NO reason for stocks to rally. Indeed, if the market was trading based on fundamentals, the S&P 500 should be sub-1000 at this time.

However, since March 2009, we have been in a liquidity-driven market rally. And with QE 2 ongoing, the liquidity continues today. Will the Crises in Europe, Japan, and the Middle East prove enough to topple this? I don't know. But I DO KNOW that we are a LOT closer to the End Game for the Fed's current monetary policy than many suspect.

This is why we are still holding on to our Crisis Trades, because the market is in a VERY perilous situation. One slip up and the whole thing could come crashing down. I know this sounds like a broken record, but really the only thing holding the market together is faith in the US Federal Reserve, considering that the US money has gone absolutely vertical… JUST as it did when the 2008 Crisis hit:



As you can see, the Fed has begun pumping money into the system around the clock, driving the monetary base straight up in the last three months.

The last time the Fed did this was in early Autumn 2008… right around the time it lost control of the Financial System and the whole thing came Crashing down. At that time the Fed put nearly $1 trillion into the system.

This time the Fed has nearly put in $500 billion. Do you think stocks might be on borrowed time?

I do too.

So while I am putting a few speculative longs on our watch list as potential trades, the REAL risk today is for another 2008-type event to hit the markets. Judging from the Fed's current actions something BIG is going on behind the scenes in the markets. And it's NOT something good.

This concludes this portion of this week's ***Private Wealth Advisory***. I will be publishing a final portion regarding specific issues related to Timberwest and Centamin Mining over the weekend.

Until then,

Good Investing!

Graham Summers