PRIVATE WEALTH ADVISORY

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Not Quite There Yet

I'm putting the finishing touches on my special report ***The Debt Default*** which will identify three specific investments that will explode when the US defaults.

The reason I'm not publishing this tonight is because I believe the US will not default now (you'll see why later in this issue). But I will have this report to you by next Wednesday.

With that in mind there are two key issues at play today in the world today. They are: the European bailout and the US Debt Ceiling.

Regarding the former, the primary issue for Europe has been, is, and will be Germany. True, the ECB is the alleged central bank for Europe, but without Germany's support, the ECB is simply a monetary figurehead representing bankrupt European nations.

The reason for this is because Germany is the largest, strongest, most solvent economy in Europe. And Europe is *not* the US.

In the US, most people call themselves "Americans." Even those individuals who like to refer to themselves by ethnicity, the word "American" remains part of their self-description e.g. African Americans, Latin Americans, Native Americans.

This mentality creates a cohesion in the US that does not exist in Europe. While New Yorkers may not especially like Americans from California, they still consider California an important part of the US and a place that is ultimately part of their "home" country.

In contrast, the European Union is the union of 17 separate countries most of which speak different languages, have entirely different cultures, and long-standing histories with their neighbors that usually involve multiple wars.

Short-Term Trends

-Debt talks are irrelevant, the banks will be supported

-Stock market on red alert

-Euro in danger going into September

Intermediate Trends

-Fed FOMC in August with likely mention of QE3 (especially if markets crash)

-End of European Union

-Second severe global economic contraction underway (2008 only worse)

Long-Term Trends

-US debt default

-Second Round of Systemic Risk

-China hard landing

-Bull market in alternative energy

In simple terms, the people in European countries take pride in their individual countries, NOT in the EU.
In fact, they only bought into the notion of the EU because of the alleged economic benefits it was meant to bring them.

Now that the economic benefits of the Euro are falling to pieces, these underlying tensions are coming out. Consider France and Germany, the two largest economies in Europe (and neighbors). France, a country with strong socialist tendencies is extremely supportive of the Euro (67% want to keep it). In contrast, Germany, which eschews loose money policy in general, wants out (only 30% of Germans want to keep the Euro).

And as diverse as Europe is, it is Germany that will decide the Euro's fate. Without Germany's backing, the ECB has no clout for the simple fact that it's nothing more than a Central Bank, un-backed even by a particular country.

Put another way, *someone* actually has to foot the bill for the ECB's moves. As the largest most solvent economy in Europe, that *someone* is Germany. Which is why rather than looking at the ECB's moves, we need to consider the German political climate today.

Consider the following:

- 86% of Germans think the Euro is at risk.
- 71% of Germans are doubtful about the common currency.
- 56% of Germans say the Euro has brought them economic disadvantages.

These statistics are having a major political impact on German political elections. To whit, current German Chancellor Angela Merkel's political party took a serious thrashing in the March 2011 regional elections. The results made it clear that Merkel's pro-nuclear energy and pro-bailout stances have cost her and her party dearly.

On top of this, it's now clear that the German economy may once again be rolling over. German manufacturing and services data both cooled falling to Mid-2009 levels this month. As leading indicators, these two items imply a much weaker German GDP is coming fast.

Two key surveys of German financial analysts and executives (the ZEW Economic Sentiment and IFO Business Climate, respectively) fell as well indicating that business leaders are concerned about an economic slowdown as well.

So here we have the majority of Germans concerned about the Euro or wanting out of it at a time when the German economy is starting to roll over again and another round of German political elections coming in September.

This is a perfect recipe for another political upset with Angela Merkel and her party losing badly. Remember, politics is all that matters in Europe (not economics). So if it becomes political suicide to back the Euro in Germany even the staunchest supporters of the currency will withdraw support of it. When this happens then the EU and the Euro will collapse soon after.

I fully believe this will prove to be the case this coming Autumn. However, the likelihood of the EU collapsing before then is relatively small due to the seasonal impact of European politics..

In simple terms, *no* major political decisions are made in Europe during the Summer months. Summertime marks a time of "perceived" economic improvement on the continent with many of the tourism-heavy economies (Spain, Portugal, Greece, Italy) seeing an uptick in economic activity.

So Europe will be "kicking the can" as much as possibly until September. However, at that point the real fireworks could begin.

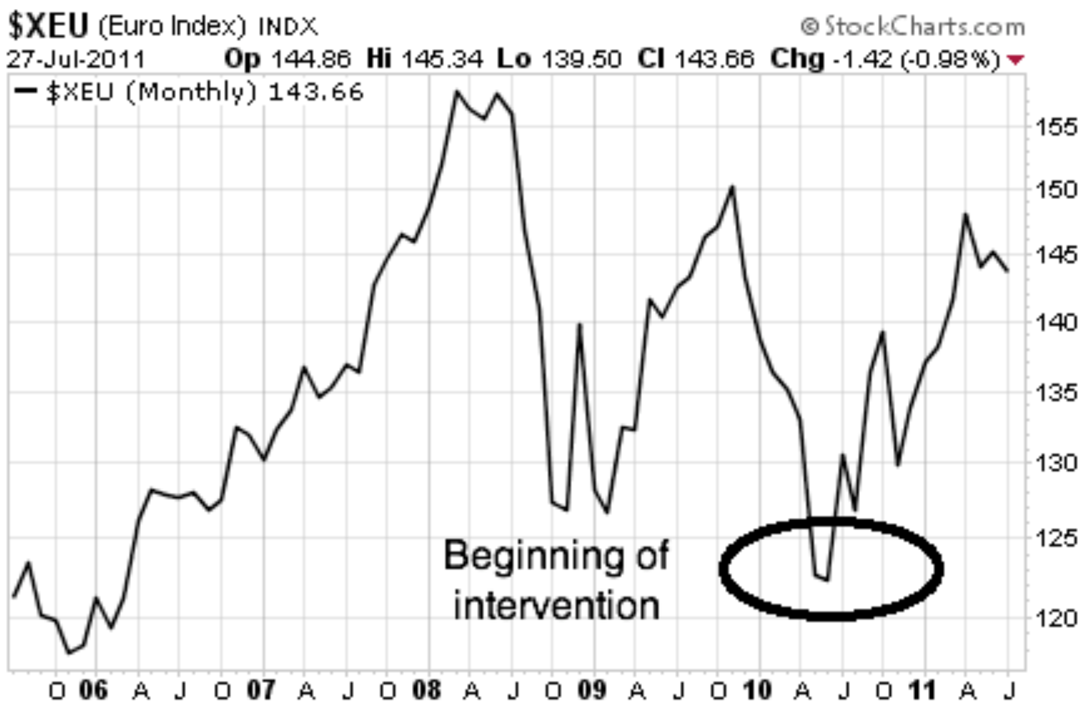
However, in the meantime, the Euro is primed for a brief drop to 140 or so.

I like this set up enough to have us open the **UltraShort Euro ETF (EUO)** here. I'm not looking for a huge gain, just a solid 5% in a few weeks' time.

Action to take: Buy the UltraShort Euro ETF (EUO).

This is going to be a short-term trade for us. However, in the big picture, I expect the Euro will be breaking down into its wide descending trading range again. This forecasts a break to below 118.

When this happens, the Euro will be finished. A break to 118 will be the move that makes it clear the markets have given up on supporting this currency:



I expect this drop in the Euro will coincide with a rally in the US Dollar. Indeed, the greenback absolutely HAS to rally now if it is not going to break into uncharted territory:

As you can see, the US Dollar rallied hard today off of support. It absolutely needs to continue to do this if we're not going to take out the final line of support (73) and break into all time lows.

This collapse has all come as a result of two things:

1) Bernanke hinting at QE 3
2) The moronic soap opera in Washington about the debt situation

The situation in the US Congress marks a new low for politics in this country. I'm not going to bother going into details related to the various plans that have been proposed because all of them fail to be relevant.

What I mean by this is that all of the various cuts ($1 trillion or so over however many years) are in fact irrelevant given the fact that the US is running deficits north of $1.5 trillion PER year already.

As for the debt ceiling, whether we raise it or not is also irrelevant in the grand scheme of things. The US is broke and has been for a long time now. There is absolutely no way we will ever pay back our debts which now stand at $44K per man woman and child in the US.

This of course fails to include social security, Medicare and other unfunded liabilities which put the US debt levels closer to $60 trillion.

What I'm trying to say with all of this is that the US welfare state, or the notion of politicians dishing out handouts in exchange for votes, is soon coming to an end. Social security, Medicare and many other government spending programs will be cut in the coming years. Regardless of your feelings regarding these programs, they are not funded and with tax receipts falling (and will fall further as the Depression deepens) the US will simply not have the money to pay for these programs.

We will also see the US defaulting on its debts with some kind of debt restructuring included. This is absolutely guaranteed to happen. And *THAT* is the item of most import for the US financial system.

The reason for this is that the entire financial system is based on the ratings of specific securities with US Treasuries as the highest rated AAA. So if US debt takes a downgrade this will result in systemic volatility on a mass scale.

For one thing pension funds, investment funds, and other entities that are required to only invest in AAA-rated securities will have to move out of Treasuries when this happens.

On top of this, US banks will undergo another Crisis based on the fact that Treasuries are the senior most assets on their balance sheets. To understand how this works, you first need to understand the Primary Dealer system behind the Federal Reserve banks.

If you're unfamiliar with the Primary Dealers, these are the 18 banks at the top of the US private banking system. They're in charge of handling US Treasury Debt auctions and as such they have unprecedented access to US debt both in terms of pricing and monetary control.

The Primary Dealers are:

1. Bank of America
2. Barclays Capital Inc.
3. BNP Paribas Securities Corp.
4. Cantor Fitzgerald & Co.
5. Citigroup Global Markets Inc.
6. Credit Suisse Securities (USA) LLC
7. Daiwa Securities America Inc.
8. Deutsche Bank Securities Inc.
9. Goldman, Sachs & Co.
10. HSBC Securities (USA) Inc.
11. J. P. Morgan Securities Inc.

12. Jefferies & Company Inc.
13. Mizuho Securities USA Inc.
14. Morgan Stanley & Co. Incorporated
15. Nomura Securities International Inc.
16. RBC Capital Markets
17. RBS Securities Inc.
18. UBS Securities LLC.

These are the firms that buy US Treasuries during debt auctions. Once the Treasury debt is acquired by the Primary Dealer, it's parked on their balance sheet as an asset. The Primary Dealer can then leverage up that asset and also fractionally lend on it, i.e. create more debt and issue more loans, mortgages, corporate bonds, or what have you.

Put another way, Treasuries are not only the primary asset on the large banks' balance sheets, they are in fact the asset against which these banks lend/ extend additional debt into the monetary system.

So if the US defaults or loses the AAA rating on its Treasury debt, the impact will be severe for the large banks. It will affect lending both to the public and between the banks themselves. And it will also trigger massive margin calls.

Which is why the White House is telling the banks that the US won't default behind the scenes:

> While officials from the Obama Administration raised their rhetoric over the weekend about the possibility of a debt default if the debt ceiling isn't raised, **they privately have been telling top executives at major U.S. banks that such an event won't happen, FOX Business has learned.**
>
> In a series of phone calls, administration officials have **told bankers that the administration will not allow a default to happen even if the debt cap isn't raised by the August 2** date Treasury Secretary Tim Geithner says the government will run out of money to pay all its bills, including obligations to bond holders. Geithner made the rounds on the Sunday talk shows saying a default is imminent if the debt ceiling isn't raised, and President Obama issued a similar warning during a Friday press conference after budget negotiations with House Republicans broke down.

Make no mistake, something big is afoot behind the rhetoric and political talking points being thrown around by the White House and the GOP. That something will be some means of letting the banks get through this period without getting crushed.

Remember just who helped get Obama in office in 2008:

Top Obama Donors '08	**Contributions**
University of California	$1,591,395
Goldman Sachs	**$994,795**
Harvard	$854,747
Microsoft	$833,617
CitiGroup	**$701,290**
JP Morgan	**$695,132**

Obama ran on a platform of Change, but as his actions have shown since election (the day after his election he put two Citigroup executives on his economic transition team). These are the folks who got him in office (the Finance industry accounted for over $24 million of fundraising for Obama). And they're the folks whose economic interests he takes to heart the most.

The same goes for Congress, which received over $37 million in donations from Commercial Banks in the 2008 elections.

Total Donations	**Donations to Democrats**	**Donations to Republicans**	**% to Democrats**	**% to Republicans**
$37.5 million	$17.9 million	$19.5 million	48%	52%

When you consider that banks have donated over $221 million to politicians since 1990, it becomes very difficult to find a member of Congress who hasn't been on the receiving end of this largesse. So Congress is just as, if not more inclined as the White House to insure the banks get taken care of.

So while the US *will* be defaulting on its debts down the road, I don't believe we'll see it happen anytime too soon. All of the political drama is just that, drama. The banks will be helped out no matter what. The impact of the US losing its AAA credit rating is too enormous for the politicians to let it happen right now.

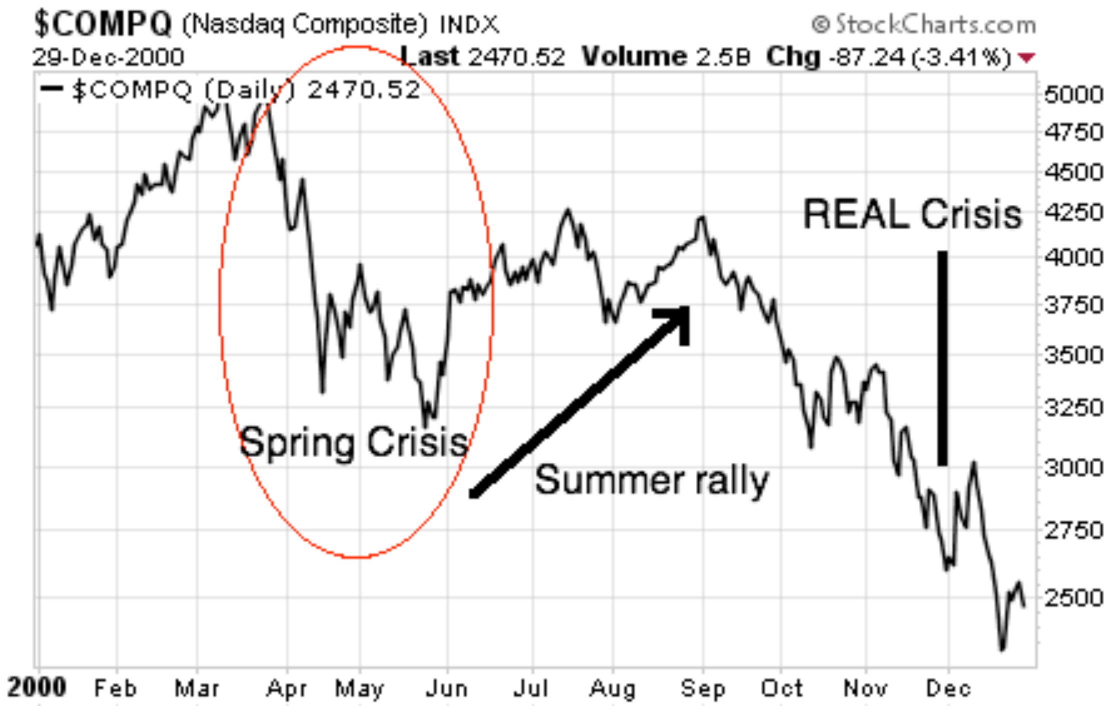
But that doesn't mean that we won't have a stock market Crash in the meantime. Indeed, we are currently witnessing a pattern in the stock markets that has occurred multiple times in the last century.

That pattern is:

1) a Spring Crisis
2) a Summer rally (on light volume)
3) The BIG Crisis

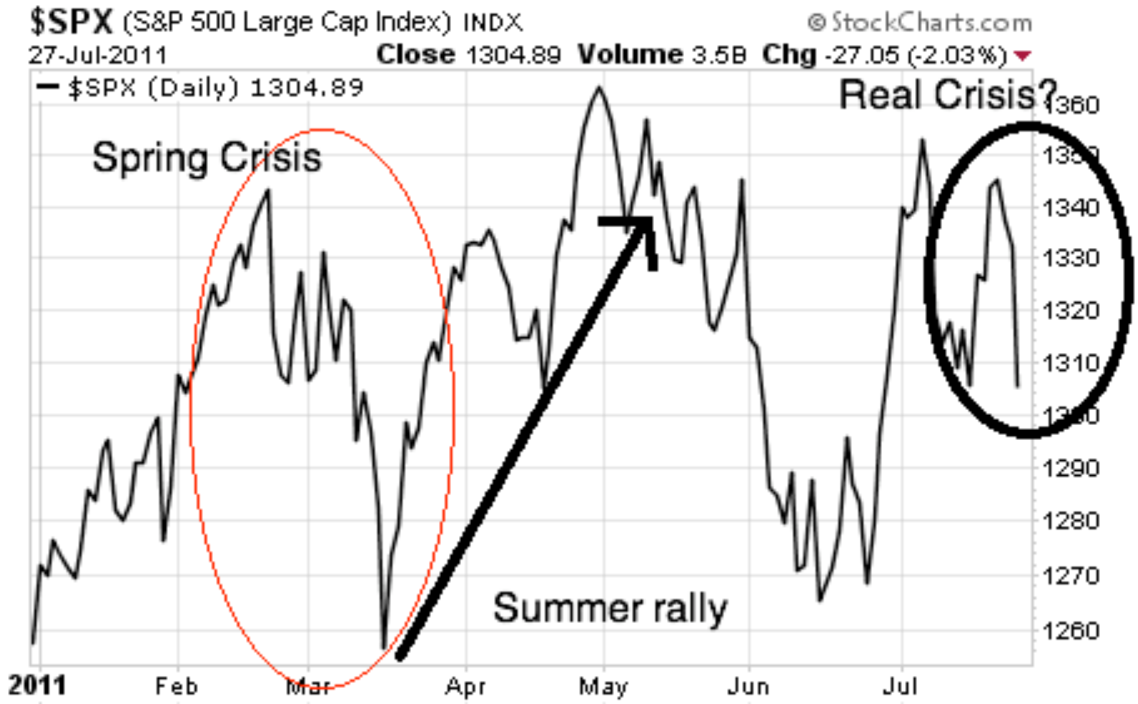
This pattern has occurred in 1907, 1929, 1931, 1987, 2000 and 2008. In each of these years, stocks came undone via some kind of Crisis during the March –May period. There was then a brief summer "relief" rally, and then things got VERY ugly in the fall.

Here's the pattern for 2000:



Here it is in 2008:

So far, the market has been trading sideways for most of 2011, but the pattern is emerging:



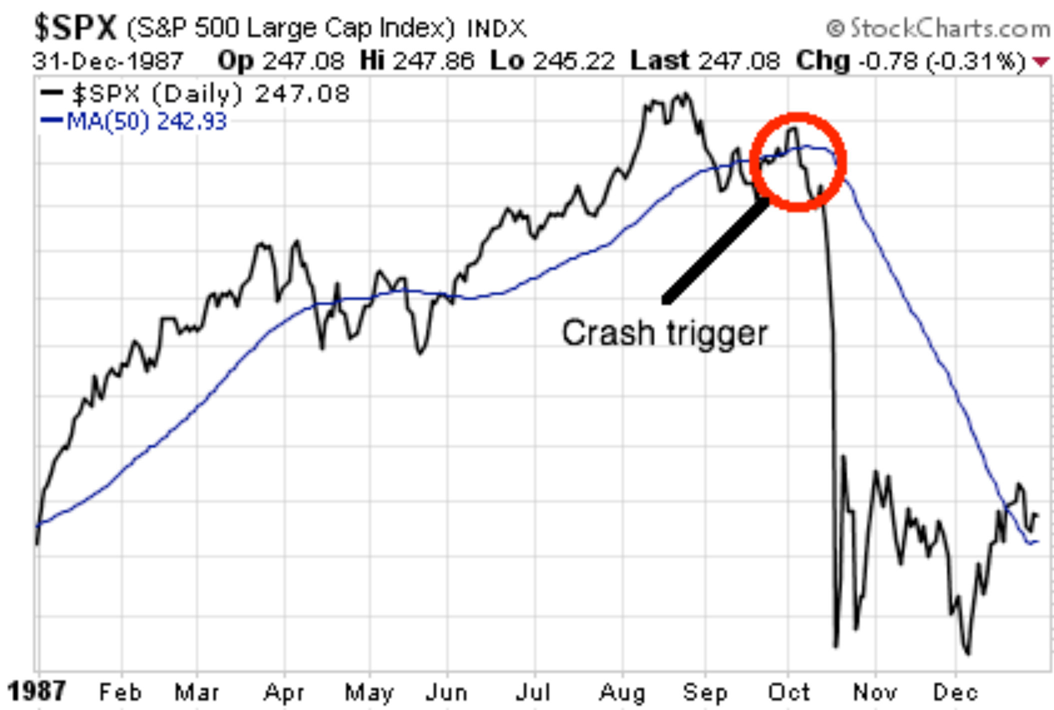
The key metric I'm using for distinguishing if stocks are going to enter another Crash is my Crash Indicator.

For those of you who are unfamiliar with it, my Crash Indicator works as follows: when the market breaks below its 50-DMA (the initial drop) and then rises to test the 50-DMA from below (the bounce). If it FAILS to reclaim or stay above the 50-DMA and rolls over… then you have a confirmed "Crash" trigger.

In order for this metric to be accurate, the market has to have rallied hard for some time and be overextended. Given the market's action since the 2009 bottom, we're definitely in this sort of climate.

As the following charts will reveal, in this context (when the market is very overstretched) my "Crash" indicator can be unbelievably successful.

Here's how it worked before the 1987 Crash:



As you can see, we had an initial drop below the 50-DMA in August 1987. There was then a brief bounce to retest the 50-DMA… and THEN came the Crash. The trigger hit right on time and those who followed it made a fortune as the market plunged 28%.

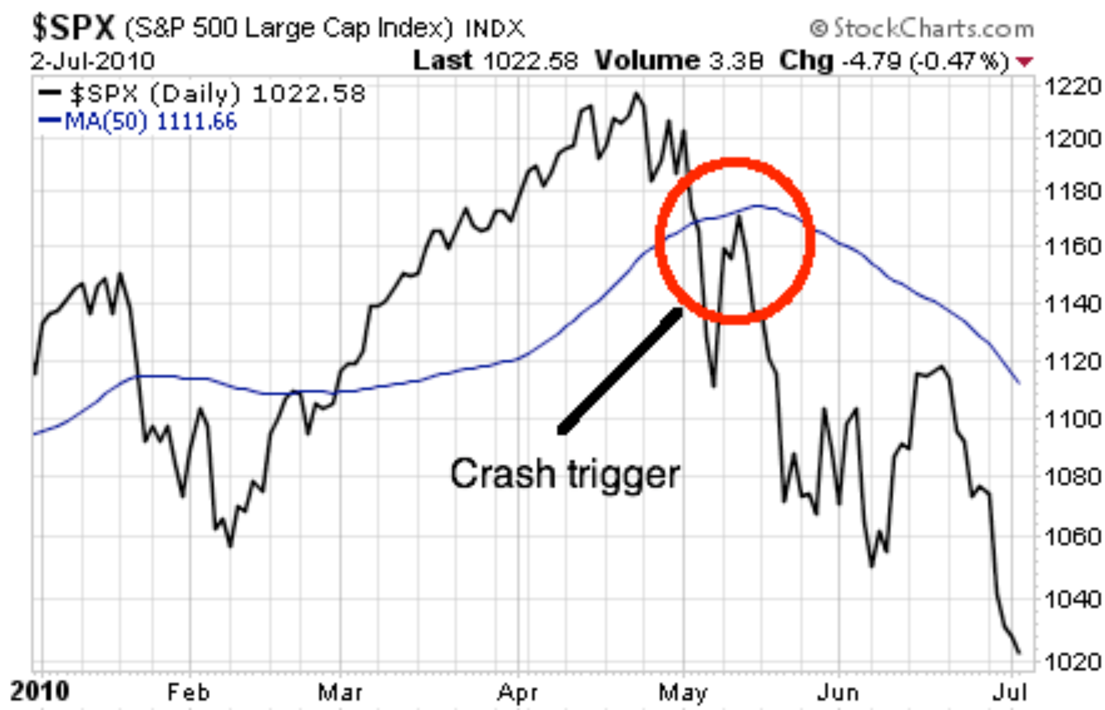
Now let's take a look at the Tech Crash…

Once again the Crash indicator went off, although this time the retest of the 50-DMA took longer. However, as soon as the NASDAQ fell below the 50-DMA with conviction, we had a confirmed "Crash" trigger. What followed was 40% drop.

Here's the 2008 Crash:

Again, the same pattern: a break below the 50-DMA, at attempted retest, and then a confirmed Crash trigger. What followed was a 42% collapse.

This trigger also caught the European crisis of May 2010.



Once again we see the initial drop followed by a brief bounce and then a confirmed "Crash" trigger. What followed was a 12% drop in stocks. The only reason the collapse wasn't bigger was because the world central banks made a concentrated effort to pump the system full of liquidity.

So I'm watching the S&P 500 relative to its 50-DMA closely. We've yet to break below the 50-DMA today, but once we do, I expect a rally to re-test it followed by a potential Crash trigger:

I'm watching this situation closely. It's too early to engage any other Crisis trades, but if the market continues to deteriorate we'll get "buy triggers" on all of them in short order.

On a different note, our UltraShort Agriculture ETN(AGA) is not acting properly. Case in point, Agricultural commodities have been in a steep decline for weeks now:

Yet, AGA has failed to rally in any way:

Something very wrong is happening here. Our investment these is proving correct (agricultural commodities are falling) but yet this play is NOT showing us positive returns. So we're closing out this position.

Action to take: Sell the UltraShort Agriculture ETN (AGA)

Another one of our trades is getting close to a buy: Santander (STD) has broken out of its triangle pattern to the downside.

I want to wait a few days to see if this breakout is confirmed. But I'm darn close to selling this bank short: once it is confirmed STD will be working its way to $5 or so per share.

On a final note, I'm currently researching several alternative energy plays. I'm particularly interested in Geothermal companies as this form of alternate energy is economically viable (as opposed to ethanol) and politically friendly. Three of the names I'm reviewing are Ram Power (RPG.TO), Magna Energy (MXY.TO) and US Geothermal (GTH.TO). I'll have my work on these investments as well as my ***Debt Default*** Special Report to you next week.

Until then…

Good Investing!

Graham Summers

OPEN POSITIONS

Inflation Portfolio (OPEN BUYS NOW)					
Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Gold bullion	N/A	3/17/10	$1,120	$1,615.00	44%
Silver bullion	N/A	3/17/10	$17.50	$40.44	131%
IamGold	IAG	5/25/11	$20.95	$20.77	-1%
Centamin Mining	CEE.TO	5/25/11	$2.01	$2.09	4%

Deflation Portfolio (OPEN BUYS NOW)					
Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Dollar ETF	UUP	5/23/11	$21.79	$21.09	-3%
UltraShort Materials	SMN	5/23/11	$18.31	$17.19	-6%
UltraShort Brazil	BZQ	6/23/11	$17.05	$16.31	-4%
UltraShort Agric.	**AGA**	**6/23/11**	**$18.88 SELL!**	**$15.27 SELL!**	**-19%**

Watchlist (Waiting to Buy)	
Company	**Symbol**
UltraShort Russell 2000	TWM
UltraShort Emerging Mkts	EEV
UltraShort Euro	EUO
Banco Santander (Short)	STD