Private Wealth Advisory

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The Fed Disappoints…

Today the US Federal Reserve announced that it will sell $400 billion of its short-term holdings to buy long-term Treasuries.

This decision indicates several items. Among them:

1) The Fed will not be openly monetizing debt with money printing going forward
2) The Fed is rolling back its involvement in the markets
3) The Fed will only engage in large-scale programs if catastrophe strikes

Regarding #1, the Fed is NOT simply printing money this time around. Instead it is SELLING some of its current holdings to buy long-term US debt.

This is a MAJOR disappointment for Wall Street and the markets (more on this in a moment). Among other things it signals that the Fed will be less accommodating going forward.

Regarding #2, $400 billion is the smallest major intervention the Fed has announced since it began implementing QE in 2009 (QE 1 was $1.25 trillion while QE 2 was $600 billion). Indeed, this move is on par with the Fed's implementation of QE lite which to date has been about $300 billion give or take in scope.

For the Fed to announce a program of this size and scope after the worst August for stocks in 10 years, a collapse that wiped out an entire year's worth of gains in just a few weeks, indicates that the Fed is stepping back from market intervention in a big way.

It also confirms our belief that the Fed is now a political entity and will only engage in large programs if catastrophe strikes. And as we grow closer to the Presidential 2012 election, the Fed will have less and less flexibility to intervene in the markets.

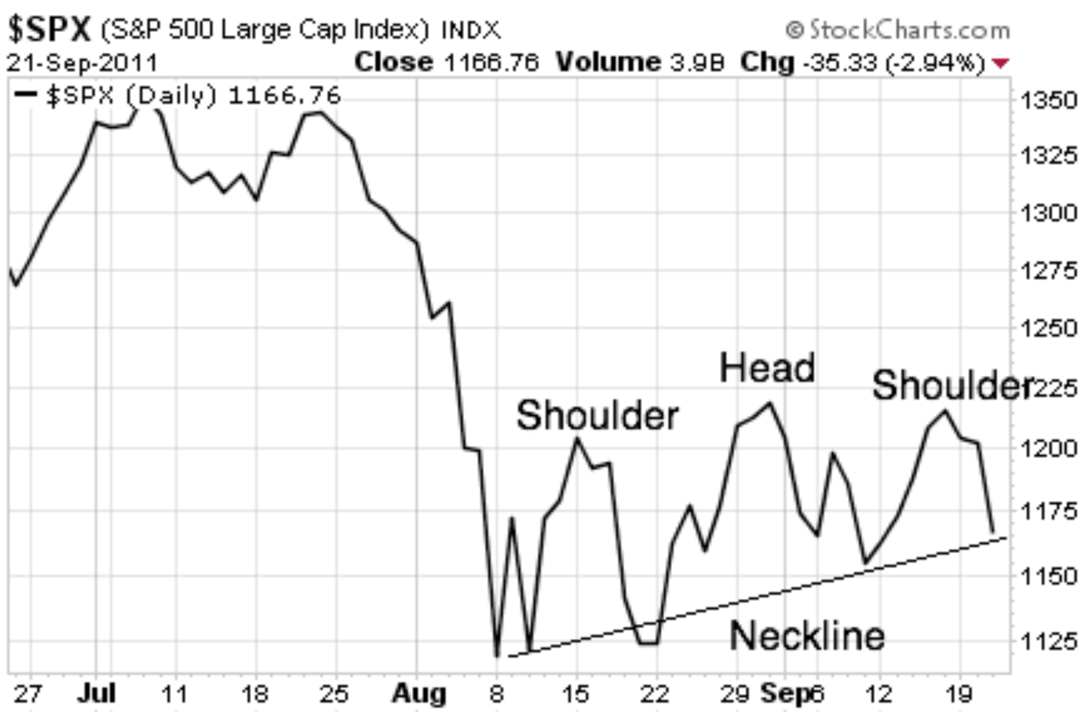
Short-Term Trends
-Fed disappoints, markets collapse
-Euro free-fall
-Gold and precious metals correcting

Intermediate Trends
-Return of deflation in late September/ early October
-Dollar rally/ Euro weakness

Long-Term Trends
-US debt default
-Bernanke legal problems/ crackdown on the Fed
-Civil unrest and Government shutdown in US
-End of the EU in current form

The market senses this, which is why it collapsed shortly after the Fed announcement was made. We are now on the verge of breaking both the bearish flag formation…

… as well as the Head and Shoulders formation I've noted in previous issues.



We get further evidence from the markets that the Fed is scaling back its interventions from the US Dollar, which exploded higher despite the Fed stating, "there are significant downside risks to the economic outlook."

Previously, any admission of economic deterioration from the Fed resulted in the US Dollar selling off sharply as traders expected additional easing/ printing. This time around, the market senses that the Fed has disappointed and that the Fed's move is largely symbolic more than anything else.

Speaking of the US Dollar, it's now taken out key resistance at 76 AND 77 (red lines).

The bearish wedge pattern we've discussed before (black lines in the chart above) forecasts a move to the mid-80s. So this move is only just getting started.

On the flip side of this move, the Euro has collapsed below the critical support line of 137.5:

With no decision made regarding Greece until October and continued deterioration in the European banking system (more on this in a moment), the stage is set for the Euro to break down south of 130 in the near term.

Which means it's time to re-open our **UltraShort Euro (EUO) trade.**

Action to Take: Buy the UltraShort Euro (EUO).

Indeed, the situation in the European banking system has become dire. Only last week, five Central Banks (the Fed, ECB, Bank of England, Bank of Japan, and Swiss National Bank) performed a coordinated intervention to help European banks with liquidity. <u>Already the effects of that intervention have been erased</u>.

Dollar Funding Costs Rise As Central Banks' Plan Seen Inadequate

European banks are finding dollars an expensive commodity once again, as the afterglow fades from a coordinated central bank plan to improve liquidity.

Swapping euros for dollars now costs about as much as it did before the European Central Bank said Thursday it would work with counterparts in the U.S., Europe and Japan to provide dollars for banks struggling to access U.S. currency.

http://online.wsj.com/article/BT-CO-20110919-708511.html

Things are now so bad in Europe that corporations are now pulling their money from private banks and depositing directly with the ECB:

Siemens shelters up to €6bn at ECB

Siemens withdrew more than half-a-billion euros in cash deposits from a large French bank two weeks ago and transferred it to the European Central Bank, in a sign of how companies are seeking havens amid Europe's sovereign debt crisis.

The German industrial group withdrew the money partly because of concerns about the future financial health of the bank and partly to benefit from higher interest rates paid by the ECB, a person with direct knowledge of the matter told the Financial Times.

http://www.ft.com/cms/s/0/dca4cc08-e096-11e0-bd01-00144feabdc0.html#ixzz1YUDV8yBw

Lloyd's of London Pulls Euro Bank Deposits

Lloyd's of London, concerned European governments may be unable to support lenders in a worsening debt crisis, has pulled deposits in some peripheral economies as the European Central Bank provided dollars to one euro-area institution.

"There are a lot of banks who, because of the uncertainty around Europe, the market has stopped using to place deposits with," Luke Savage, finance director of the world's oldest insurance market, said today in a phone interview. "If you're worried the government itself might be at risk, then you're certainly worried the banks could be taken down with them."

http://www.bloomberg.com/news/2011-09-21/lloyd-s-of-london-posts-697-million-pound-loss-on-disasters-1-.html

Adding to this mess is the fact that China appears to have abandoned its European backstop:

China bank stops FX swaps, forwards with some European banks –sources

A big market-making state bank in China's onshore foreign exchange market has stopped foreign exchange forwards and swaps trading with several European banks due to the unfolding debt crisis in Europe, two sources told Reuters on Tuesday.

The European banks include French lenders Societe Generale , Credit Agricole and BNP Paribas .

"Apart from spot trading, all swaps and forwards trading (with the European banks) have been stopped," one source who is familiar with the matter told Reuters.

http://www.reuters.com/article/2011/09/20/idUSB9E7K102K20110920

China to keep buying U.S. Treasuries: report

China, the largest foreign holder of U.S. government debt, will keep buying U.S. Treasuries, the official People's Daily, the ruling Communist Party's mouthpiece reported on Tuesday, citing government researchers.

In an article about the reasons for China's increased purchase of U.S. Treasuries, the newspaper cited Yan Xiaona, a researcher with the Chinese Academy of Social Sciences, as saying that the dollar "is relatively safer than the euro" because of the unfolding sovereign debt crisis in Europe.

Yan was quoted as saying that dollar-denominated assets remained attractive for investors around the globe.

Wang Chaocai, a Ministry of Finance researcher, was quoted as saying that **"what else we can buy if not U.S. Treasuries? It's more risky to buy into equities."**

http://www.reuters.com/article/2011/09/20/us-china-us-treasuries-idUSTRE78J0BL20110920

On top of this, yesterday the IMF announced that European banks have an additional $410 billion in credit risk. Combined, these issues have resulted in the European debt contagion spreading rapidly from Greek and Irish banks to those of the allegedly more stable EU countries such as France and Germany.

In the case of Greece, France has $92 billion in exposure to Greece debt. Germany is on the hook for $69 billion. As for Spain, France is on the hook for $224 billion and Germany is on the hook for a whopping $244 billion.

This, combined with the potential of a sovereign downgrade, is why French Banks BNP Paribas and Credit Agicole are now collapsing rapidly:

I cannot formally recommend shorting these banks as they cannot be shorted via the US exchanges. However, for those of you with international accounts who are able to do so, shorting these firms as well as the Italian banks should prove quite profitable. As the National Bank of Greece has revealed, once a Crisis gets underway, the downside for a bank can be as high as 90%.

While I cannot recommend shorting BNP Paribas or Credit Agricole, I will be recommending that we short Spanish bank Santander (STD) in the near future:

As you can see, we've broken the massive triangle formation to the downside. We're now at the last line of support at $8 per share. Once we get a definite break below this line, I'd recommend shorting STD.

Another bank I'd recommend shorting once we break below critical support is the German bank Deutsche Bank (DB):

Germany is the largest most solvent banking system in Europe (aside from Switzerland) which is why DB remains north of $30 per share. However, the technical picture here is clear: once DB breaks below $30 per share with conviction, it's going to sub-$20 with ease.

It's too early for us to trade Santander or Deutsche Bank, but rest assured I will send out an update telling you when it's time to short them.

While the European banking collapse is grabbing the most attention, the US banks, particularly the Too Big To Fails are showing serious sounds of distress as well.

As you'll recall from previous issues of ***Private Wealth Advisory***, the TBTFs are the institutions most favored by the Federal Reserve and Treasury during the bailouts/ interventions of the last four years. With the greatest derivative exposure, the greatest leverage, and the greatest toxic debts on or off their balance sheets, these firms provide a glimpse into the US financial system's inner workings.

With that in mind, I want to draw your attention to the fact that all of these firms' share prices have recently dropped below their critical support lines established during the relief rally following the market bottom in March 2009.

Here's Bank of America:

As you can see, the market drop of August 2011 has brought shares of BAC below the support level established by the first major rally coming off of the March 2009 lows (when the Fed first announced QE 1).

The same is true of Citigroup:

As well as Wall Street darling Goldman Sachs:

Indeed, the only TBTFs that haven't fallen below their post bottom support lines are JP Morgan and Wells Fargo. But by the look of things, they're both going to break down soon:

These charts tell us in no uncertain terms that the US financial system is once again under extreme stress. I'd recommend shorting any of these firms (BAC, C, GS, JPM) once the market adjusts to the Fed's announcement and we get a clear picture of the next trend for the major asset classes.

So stay put for now. I'll send out an alert as soon as it's time to short these positions.

Regarding Emerging Markets, in a deflationary environment such as the one we've recently entered, US indexes will outperform their Emerging Market counterparts. This is quite evident when you price the Emerging Markets by the S&P 500:

As you can see, when we price Emerging Markets by the S&P 500, we have a massive triangle pattern, which has recently broken out to the downside.

Put another way, we've entered a period in which Emerging Markets will dramatically underperform the S&P 500. And if the above formation is anything to go by, this trend is going to continue for some time.

With that in mind, those of you who must remain invested in stocks to the longside for whatever reason should shift out of the emerging market space into US stocks, particularly large-cap companies with strong balance sheets and minimal debt.

I wanted to devote a final portion of this letter to address the Fed's decision to buy longer-term US debt.

Because of the August collapse in stocks, long-term Treasuries have already rallied quite sharply. Indeed, the 30-year Treasury just hit a new ALL TIME high this afternoon after the Fed announcement. That's correct, the 30-Year Treasury is now trading even HIGHER than it was at the absolute nadir of the 2008/2009 Crash:

The fundamental picture here couldn't be worse. The US is running a deficit equal to 10% of GDP. The US's debt to GDP level is north of 100%. And the 30-Year Treasury is at an all-time high.

To be blunt: for the Fed to be buying Treasuries at this level is akin to buying Tech Stocks in 2000 or Housing stocks in 2007. Treasuries are in a bubble. And this bubble will end as all bubbles do: with a bang.

As noted in previous issues of ***Private Wealth Advisory***, interest rates are already at or near all time lows. So why would the Fed choose to buy longer-term Treasuries at all?

The answer lies in new US debt issuance. While everyone focuses on Europe's mess, the US has once again raised its debt limit in September (the huge debt-ceiling debacle of August was just smoke and mirrors). With deficits and debt-to-GDP ratios on par with Greece, the US will be following Europe in the global debt implosion.

The Fed's decision to buy $400 billion of longer-term US Treasuries in this environment is essentially the Fed announcing that it will be covering a significant portion of new debt issuance going forward as a means of putting off the inevitable US debt default. At most the Fed has bought 2-3 months of time for the US. I fully believe that before the end of this year, the bond market will shift its sights away from Europe to the US. At that time, the US debt bubble will burst resulting in systemic failure.

In plain terms, very, very interesting times are ahead. Here's a brief recap of the issues discussed in this report:

1) The Fed's announcement today was a big disappointment and largely a symbolic move
2) The European banking system has now seen contagion spread to the stronger countries of France and Germany at the very time China has pulled back from further investment
3) Equities are due to larger downside risk though US indexes will outperform the emerging market space
4) The US debt market has officially become a bubble. After Europe is done imploding the US is up to the chopping block.

If anything changes I'll issue an alert via email. Otherwise you'll next hear from me two weeks from now. Until then…

Good Investing!

Graham Summers

PORTFOLIO WATCH LIST

Company	Symbol	Buy Date
Bank of America (short)	BAC	NOT YET
Citigroup (short)	C	NOT YET
Goldman Sachs (short)	GS	NOT YET
JP Morgan (short)	JPM	NOT YET
Deutsche Bank (short)	DB	NOT YET
Santander (short)	STD	NOT YET

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	$1,787.00	60%
Silver bullion	N/A	3/17/10	$17.50	$39.65	127%
Centamin Mining	CEE.TO	5/25/11	$2.01	$1.68	-16%

Deflation Portfolio (OPEN BUYS NOW)					
Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Dollar ETF	UUP	5/23/11	$21.79	$22.03	1%

Crisis Portfolio					
Investment	**Symbol**	**Buy Date**	**Buy Price***	**Current Price**	**Gain/ Loss**
UltraShort Russell 2000	TWM	8/9/11	$57.36	$55.83	-3%
UltraShort Real Estate	SRS	8/9/11	$17.31	$16.44	-5%
UltraShort Financials	SKF	8/9/11	$82.59	$83.22	1%

*Average price of buy prices: August 9th at 3PM and September 2 at 10:15AM

RECENTLY SOLD POSITIONS

SOLD 9/12/11 at 2:30 PM					
Company	**Symbol**	**Buy Date**	**Buy Price***	**Current Price**	**Gain/ Loss**
UltraShort Euro	**EUO**	7/28/11	$17.32	$18.87	9%

SOLD 9/21/11 at 9:40AM					
Company	**Symbol**	**Buy Date**	**Buy Price***	**Current Price**	**Gain/ Loss**
UltraShort China	**FXP**	**8/9/11**	$34.63	$37.60	9%
UltraShort Emerging Mkts	**EEV**	**8/9/11**	$37.27	$39.60	6%
UltraShort Brazil	**BZQ**	**8/9/11**	$20.72	$21.90	6%

*Average price of buy prices: August 9th at 3PM and September 2 at 10:15AM

SOLD 9/21/11 at 2:45 PM					
Company	**Symbol**	**Buy Date**	**Buy Price***	**Current Price**	**Gain/ Loss**
IAMGOLD	**IAG**	**5/25/11**	$20.95	$23.10	10%