PRIVATE WEALTH ADVISORY

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Europe's Burning

There are three primary issues we need to be concerned with today. They are:

1) Europe's banking collapse
2) The US economy rolling over
3) A stock market Crash

Regarding #1, we are now finding out that not only were the latest European stress tests a complete joke, but that the banking Crisis is indeed systemic, involving institutions and countries that were formerly not on the "danger" radar.

Let us consider the finances of the latest European institution to come under fire: the Belgian-French bank Dexia.

For starters, Dexia had 566 billion euros in debt and 19 billion euros in equity as of the end of 2010.

Right off the bat, that's a leverage ratio of 29 to 1. Lehman Brothers was leveraged at 30 to 1 when it collapsed.

Now consider that Belgium's entire GDP is just 340 billion euros. **Dexia has 566 billion euros in assets.** Of this 352 billion are loans.

Put another way, Dexia's loan portfolio alone is larger than its home country's entire economy. Add to this the fact that Belgium is running debt to GDP ratios of 100% as well as Dexia's exposure to PIIGS' debt…

Country	Dexia's Exposure
Portugal	5.7 billion euros
Ireland	1.2 billion euros
Italy	49 billion euros
Greece	4.8 billion euros
Spain	32 billion euros

Short-Term Trends
-Financial markets on red alert.
-European banking crisis accelerating.
-Potential for Crash is high.

Intermediate Trends
-Greek default
-End of the EU in current form (Greece out?)
-Growing civil unrest in US and abroad.

Long-Term Trends
-US debt default
-Bernanke legal problems/ crackdown on the Fed
-Trade war leading to REAL war

… and you've got a recipe for disaster. I do not know what percentage of Dexia's loans are junk, but the market is telling us in no uncertain terms that it's a lot… and that Belgium cannot possibly handle this problem:

As you can see, shares of Dexia are currently LOWER than they were during the nadir of the 2008-2009 Crash.

Now consider that Dexia PASSED the European stress tests just three months ago.

My point with all of this is that the European banking system is at far FAR greater risk than is commonly understood. No one was even talking about Belgium as a problematic country six months ago. Here we find that one of its largest banks not only has a loan portfolio greater than the country's entire GDP (imagine if Fannie Mae had a $15 TRILLION loan portfolio) but that its leverage levels are on par with Lehman Brothers.

And it *passed* the stress tests.

Suffice to say, the stress tests were a sham and the European banking system is in serious danger of collapse. What *other* European banks are hiding systemic risk on their balance sheets?

Take a look at the below chart from the *Wall Street Journal* showing the PIIGS' exposure for banks that participated in the stress tests. The Spanish banks that participated in the stress test have $2.1 trillion in PIIGS debt. Italian banks have $1.2

trillion. France and Germany have $419 billion and $287 billion respectively. Belgium which I was just writing about has only $122 billion.

Again, the European banking system is facing systemic collapse. I would have minimal, if any, exposure to the European markets **especially the financials** at this time.

While Europe is facing systemic collapse, it's still too early to establish our short for Santander (STD):

I'm using the weekly chart to smooth out the day-to-day volatility. As you can see, STD is sitting on support at $8. Until we take out this level with conviction, it's too early to go short here.

We're a lot closer to shorting our other watchlist short: Deutsche Bank (DB).

As you can see, DB has recently bounced hard and is now at resistance. If we get a breakdown from here it will be time to go short.

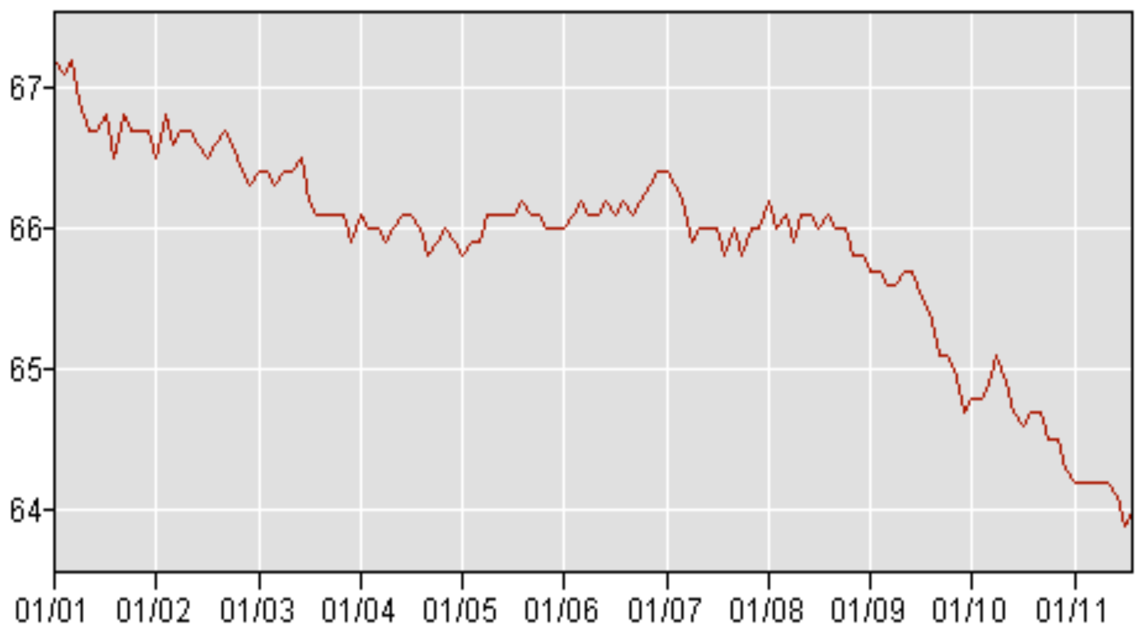
I'll send out alerts as soon as it's time to short either of these banks.

Meanwhile, it is clear the US economy has broken down in a BIG way. Indeed, no less than Ben "green shoots" Bernanke has stated that the recovery is "close to faltering." This, coming from a cherrleader like Bernanke is essentially an admission from the powers that be that the US economy is a disaster.

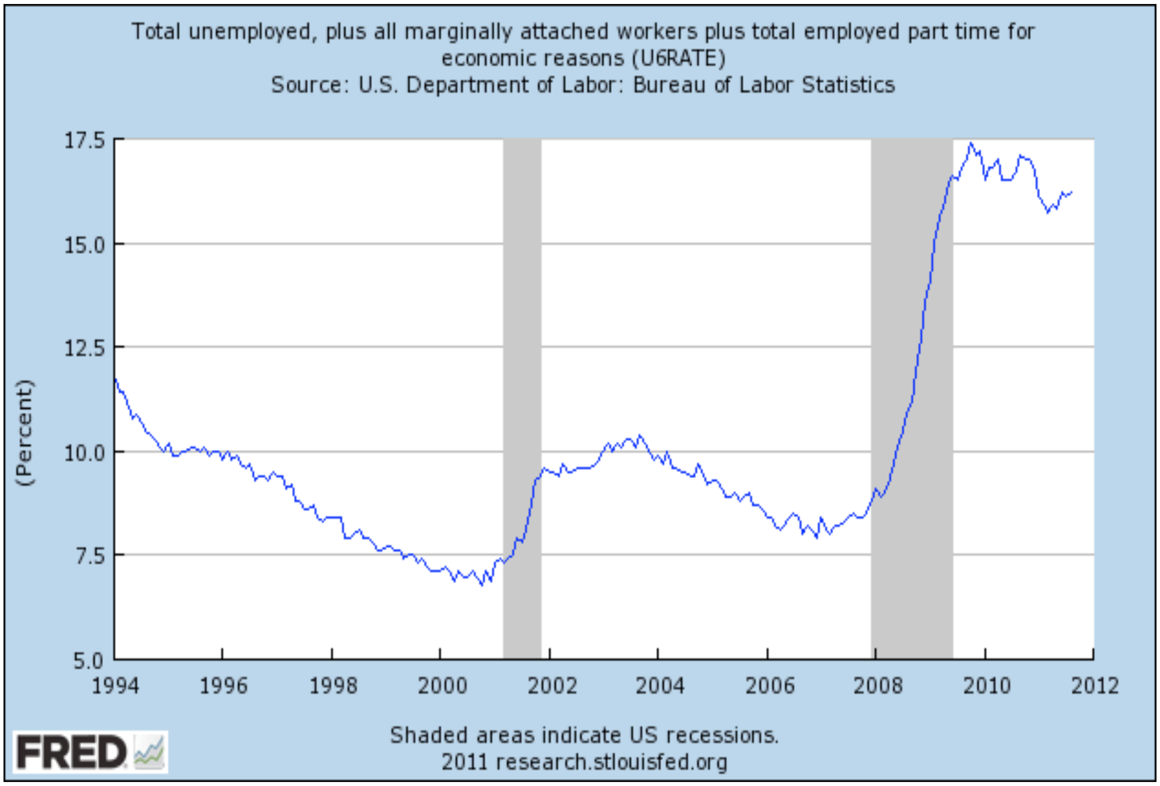
Indeed, the recent manufacturing survey just posted its second consecutive month of contraction. **The collapse in this economic metric has been greater than any two-month period in the last ten years, *including* 2008.**

We also see that the ISM purchasers managers' index, the Philly Fed index, payrolls, and the ECRI weekly leading index are all at or about to break into recessionary levels.

These are, of course, mainstream indicators of economic activity, which are heavily massaged. The economic realities in the US are far worse than even they proclaim as food stamp usage (43 million a record high), the labor participation rate:



… and U6 unemployment numbers reveal:



Suffice to say, the US economy is a disaster. And yet, analysts are expecting another earnings season of double-digit growth (the eighth quarter in a row). Somehow I think we're in for some major surprises to the downside this earnings season.

And this is coming at a time when the markets are already shows signs of MAJOR duress.

Indeed, I truly cannot stress enough how dangerous things are right now. This is the most dangerous market I've ever seen. We're seeing moves of 4-% in just HOURS, not even days.

Consider yesterday's action in which an unfounded rumor concerning yet another European bailout produced a 4.2% move in the S&P 500 in the span of 40 minutes:

The effect was even more pronounced in the Russell 2000. In that case the market moved over 6% in the span of 40 minutes:

That's a 6% move… in less than one hour... based on another rumor pertaining to a European bailout (what is this… the 12th?).

This is absolutely extraordinary and shows in no uncertain terms just how broken ad fragile the market is.

This volatility works to the downside as well. At any time during the day, an ugly announcement or news from Europe can trump even the most ingrained trader proclivities.

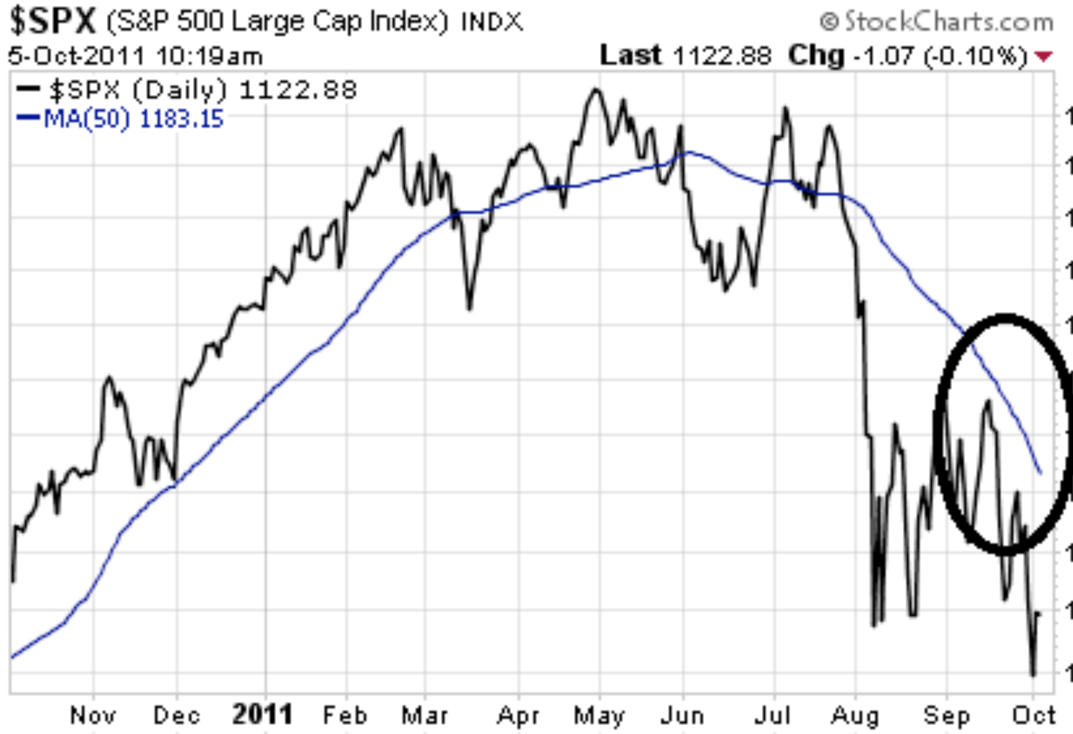
A perfect example is Monday's action in which traders tried to kick off the usual manic Monday rally (along with start of the month/ quarter buying). Then bad news hits out of Greece (no more concessions) and the market rolled over hard.

The Monday rally/ start of the month buying trend has been THE definitive upward bias throughout the last two years. **Indeed, action on the first day of the month accounted for 94% of ALL market gains in 2010 (put another way, 94% of ALL the market gains in 2010 came from 12 days' action).**

So for the market to roll over now at the beginning of a new month (and quarter) tells us that we are in a climate in which fundamentals are trumping even the most ingrained trader games. This is a MAJOR warning that the market could collapse as even the most well known market props are failing to keep things up.

Indeed, we are getting signs that a Crash may be just around the corner.

For starters, we now have a confirmed SELL signal on my Crash indicator: a move in which the market falls from a sharply overbought level below its 50-DMA then fails to reclaim it.



Indeed, the similarities between the recent market top and the 2007 top are quite striking in their formation.

As you can see, the topping formation is quite similar: in both instances we had a choppy range at the top, followed by a sharp sell-off, then a brief rally, and then the Crash.

Judging from 2008's action, we need a small rally here (the bounce) and then a Crash could hit. The first sign of it would be for stocks to break with conviction below the critical line of 1,100 on the S&P 500:

However, until we break below that level, we're in bounce mode as of yesterday afternoon when the ramp job began.

Now, it is difficult to gauge how far this bounce could go. The Fibonacci retracement levels show the most likely level would be 1,200 on the S&P 500.

Most trading models follow Fibonacci ratios, so in some ways a move to 1,200 on the S&P 500 could be self-fulfilling: traders would see where the retracements would be and so buy the market, pushing it to that level.

However, I'm not interested in playing the market to the longside here as the downside risk is huge. Indeed, the only reason I can see for going long at all would be in expectation of additional short-covering and trader games. That's not a reason to risk money, especially when the likelihood of a Crash grows by the day.

Let me explain.

As I've noted to you in prior issues, mutual fund cash levels today are at all time lows. Put another way, the vast majority of institutional investors are more invested in the market to the longside than at any other point in the last 40+ years.

With most funds and institutions deep in the red on their positions this year, fund managers are desperately staying invested in the market, hoping that something will affect a significant rally so they can end the year with a stronger results.

Consider that the market rout in August has done little to change mutual fund cash levels. So despite the worst August performance in 10 years, fund managers have refused to lighten up on their long positions.

Put another way, we have *yet* to see REAL selling pressure come into the markets.

At some point before year-end, and I cannot say exactly when, fund managers will finally bite the bullet and have to close out some of their positions. The most likely reason for this will come from redemptions (investors have already pulled $89 billion from stock-based mutual funds this year).

At some point, redemptions will be bad enough that mutual funds will have to start selling their positions. When this happens we could EASILY see a death spiral begin as the selling pressure pushes the market sharply down, resulting in even more redemptions, resulting in funds having to sell even more of their positions, and on and on.

We're not quite there yet. But every day that passes it's becoming more and more apparent that Bernanke is pulling back from market intervention. When asked during his recent testimony if the Fed planned more QE, he responded, ""We never take anything off the table because we don't know where the economy is going to go. **We have no immediate plans to do anything like that."**

The take-home message is simple: in*vestors are on their own as far as stocks go* (unlike Treasuries where the latest game is to front-run the Fed's Operation Twist purchases on the long-end).

So I expect we'll see some SERIOUS selling pressure come into the market at some point in the next six weeks. When that happens it's very possible we could see a full-scale Crash with the S&P 500 breaking into the triple digits short-order.

So for now, the most sensible position to be in is on the sidelines. There is no reason to commit to the longside as the downside risk is HUGE (even more than in 2008).

However, it's also too soon to re-establish our shorts while the market is in a snap-back short-covering rally. So we remain in cash ($USD) and bullion (Gold and Silver). We also have our Gold miner Centamin (CEE.TO) which is a long-term asset play and our Euro Short.

Regarding Centamin, I am waiting for shares to bottom out for us to average in a lower buy price to maximize our gains. That is why we're sitting on this position.

As for the Euro, keep an eye on that currency as stocks are following its moves closely:

With that in mind, the Euro will probably go to 134 before it rolls over again:

However, once the Euro rolls over, it's going to sub 130 in short order:

To recap, here are the primary points of this issue:

1) Europe is facing systemic failure
2) The US economy has broken into a second recession in the context of a larger depression
3) The stock market is at MAJOR risk of a full-scale Crash before year-end.

While we're not yet establishing any new shorts, I'm adding both our TBTF shorts and our Crisis Trades back to our watchlist for when the next collapse begins.

By the look of things this *could* come at any point in the next two weeks, so be on the lookout for alerts from me at any point during that time period.

Aside from that, you'll next hear from me on Wednesday October 19th after the market closes. Until then…

Bets Regards,

Graham Summers

PS. I'll have a short article to you concerning Gold and Silver in the next few days.

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
UltraShort China	FXP	NOT YET
UltraShort Emerging Markets	EEV	NOT YET
UltraShort Brazil	BZQ	NOT YET
UltraShort Materials	IYM	NOT YET
UltraShort Real Estate	SRS	NOT YET
UltraShort Financials	SKF	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	$1,644.00	47%
Silver bullion	N/A	3/17/10	$17.50	$30.46	74%
Centamin Mining	CEE.TO	5/25/11	$2.01	$1.57	-22%

Deflation Portfolio (OPEN BUYS NOW)					
Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Dollar ETF	UUP	5/23/11	$21.79	$22.35	3%
UltraShort Euro	EUO	9/21/11	$19.13	$19.84	4%

RECENTLY SOLD POSITIONS

SOLD 9/30/11 at 3:33 PM					
Company	**Symbol**	**Buy Date**	**Buy Price***	**Current Price**	**Gain/ Loss**
UltraShort China	FXP	**9/28/11**	$41.04	$45.02	10%
UltraShort Emerging Markets	EEV	**9/28/11**	$42.90	$46.00	7%
UltraShort Brazil	BZQ	**9/28/11**	$24.07	$26.28	9%

SOLD 10/3/11 at 11:21 AM					
Company	**Symbol**	**Buy Date**	**Buy Price***	**Current Price**	**Gain/ Loss**
Bank of American (Short)	BAC	**9/28/11**	$6.46	$6.06	6%
Citigroup (Short)	C	**9/28/11**	$26.84	$24.90	7%
Goldman Sachs (Short)	GS	**9/28/11**	$98.97	$93.60	5%
JP Morgan (Short)	JPM	**9/28/11**	$31.64	$30.19	5%