PRIVATE WEALTH ADVISORY
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Weekly Market Update: 9/2/15

Dear Subscribers

The bounce of last week appears to have been a dead cat bounce, not the REAL bounce (more on this shortly). I suspected this would prove to be the case for the following reasons:

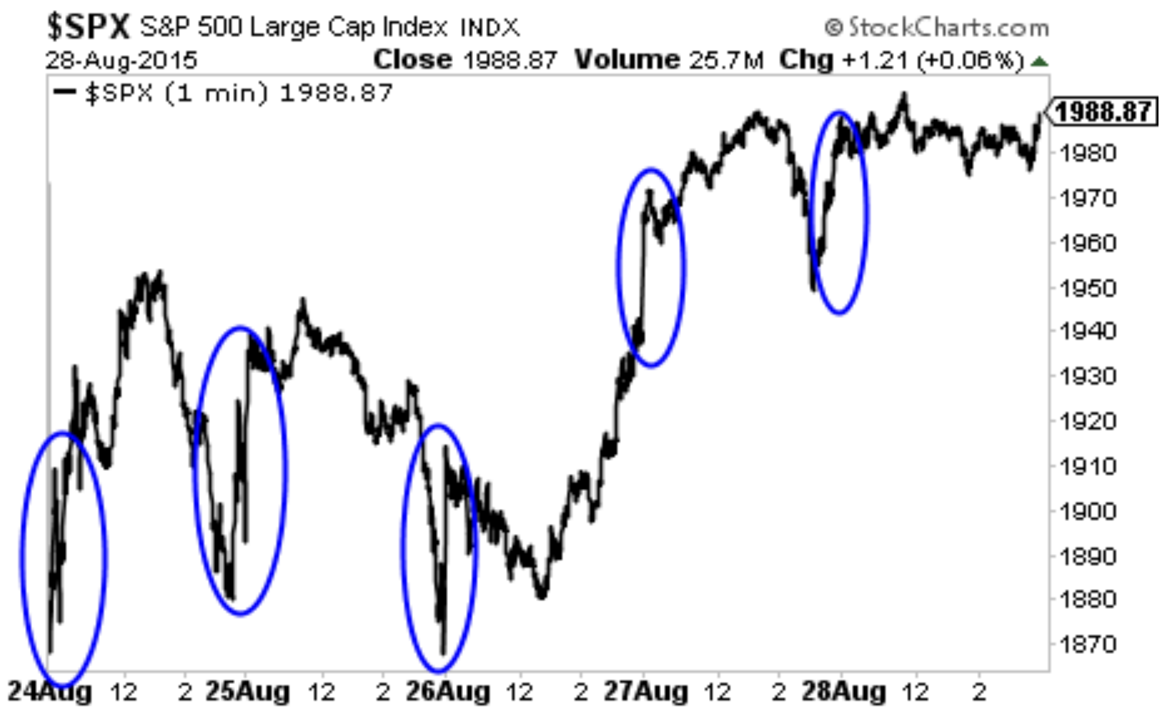
1) The bounce showed clear signs of Central bank manipulation.

2) It was the end of the month and fund managers were desperate to generate a rally to close out a terrible month with the best possible returns.

Regarding #1, as I've noted before, REAL buyers or investors do not indiscriminately put in "buy" orders for billions of Dollars' worth of stocks at the market's open. Indeed, it was telling that the buy orders were all coming in during the first hour of trading (usually when the markets were broken).

This is the hallmark of Central Bank market manipulation: use the futures markets to gun the market higher in the overnight session when liquidity is low so that traders will pile in at the open.

As you can see in the below chart, all of these ramp jobs occurred during the first hour of trading. And with few exceptions the market peaked by 10:30AM at which point stocks drifted lower (a clear signal that there are few REAL buyers of stocks).



Technically, the Fed is not permitted to buy the markets directly. However, legislation that was introduced to the Federal Reserve Act in 2010 opens the door to the Fed buying stocks using other institutions are "proxies." The most obvious proxy would be another Central Bank, most likely the Swiss National Bank, which openly buys stocks.

> *It turns out that the Swiss central bank, in addition to its Apple stock, holds very large equity positions, ranging from $250,000,000 to $637,000,000, in numerous US corporations — **Exxon Mobil, Microsoft, Google, Johnson & Johnson, General Electric, Procter & Gamble, Verizon, AT&T, Pfizer, Chevron, Merck, Facebook, Pepsico, Coca Cola, Disney, Valeant, IBM, Gilead, Amazon.***
>
> *Among this list of the Swiss central bank's holdings are stocks which are responsible f**or more than 100% of the year-to-date rise in the S&P 500 prior to the latest sell-off.***
>
> *The Fed is prohibited from buying equities by the Federal Reserve Act. But an amendment in 2010 – Section 13(3) – was enacted to permit the Fed to buy AIG's insolvent Maiden Lane assets. This amendment also created a loophole which enables the Fed to lend money to entities that can use the funds to buy stocks. **Thus, the Swiss central bank could be operating as an agent of the Federal Reserve**.*
>
> *http://www.economicpopulist.org/content/are-central-banks-corrupted-5829*

Regarding #2 (fund managers gaming the markets to lock in the best possible returns), this is a very common practice. Many investment funds must post their monthly returns. As a result of this, there is almost always a concerted effort to gun the markets higher on the last few days of the month. This is particularly true for months in which market performance was particularly bad (such as August 2015).

With that out of the way, we need to assess the “big picture” for stocks.

If you’ll recall, I first pointed out that the monthly MACD (a momentum indicator) had triggered a “Sell” signal back in April. Previously ALL “Sell” signals had preceded stock market declines of 20%-50% in the last 20 years (see the red circles in the chart below). The one exception to this was in 2007, but that “Sell” signal was quickly negated when stocks exploded higher (as with all technical indicators, there are exceptions to the rule).

However, the carnage of the last few weeks has shown us that the April signal was the real deal. The MACD has fallen sharply since then, indicating that market momentum has collapsed (see the red circle furthest to the right),

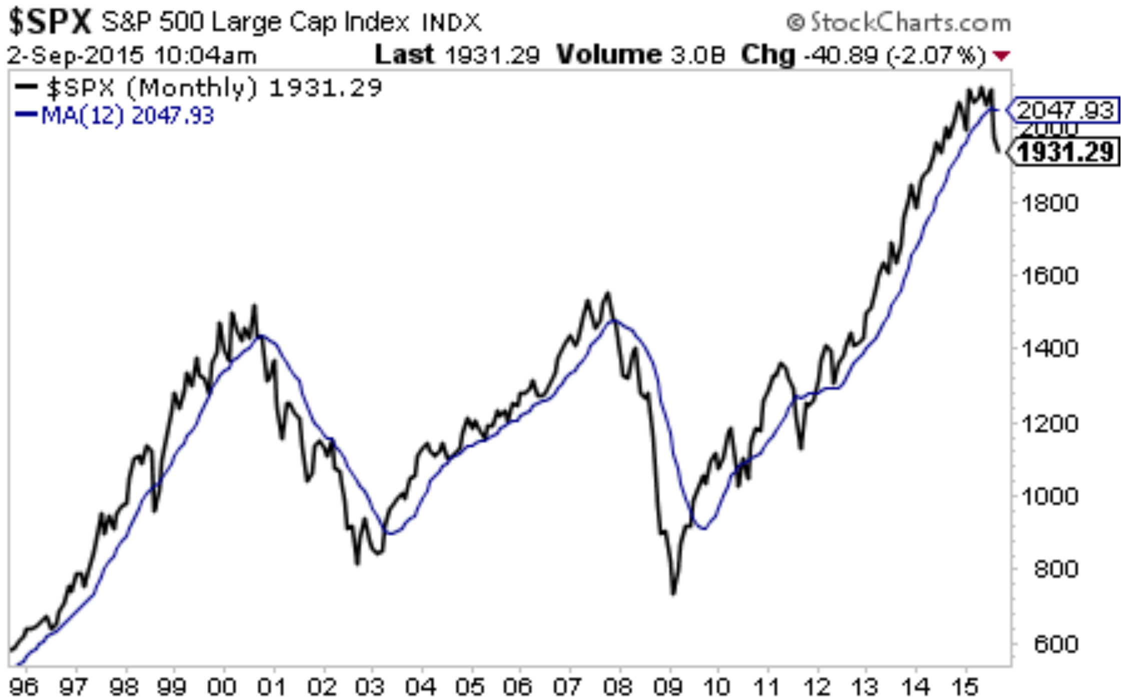
Moreover, the Relative Strength Index (RSI), which is another measure of momentum, has weakened in much the same way as it did during the 2000 and 2007 tops (see the blue lines at the top of the chart).

What does all of this mean?

That the market has very likely put in a MAJOR top. Momentum has collapsed. Relative strength is weakening by the week. And unless stocks absolutely EXPLODE higher in the next month or so, the bull market begun 2009 has ended.

Another momentum signal I like to watch is the 12-month moving average (MMA).

Generally speaking, over the last 20 years, this has been an excellent gauge for whether or not the market is in a bull market or breaking down. We had a few "false breakdowns" in 2010 and 2011. However, those signals were negated when the Fed launched QE 2 and Operation Twist respectively: both policies ignited stocks higher.



The Fed is unlikely to launch a similar program now due to political pressure... which only adds to the odds of a bear market beginning.

However, there is one thing I want to alert you to. Bear markets do not happen all at once. EVERY time a major top has formed and stocks have taken out this line, we've had a bounce to "kiss" the line one last time before the bear market *really* took hold.

This is why we've yet to open any new trades, particularly shorts: the risk to reward ratio is not there.

Let me explain.

If this is indeed THE top for the bull market begun 2009, stocks should rally to "kiss" the line before beginning the next major leg down. If this is NOT the top for the bull market begun 2009, stocks should rally hard and take out the line and resume their upward momentum.

In both scenarios, stocks should be rallying right now… which is why I haven't had us open more shorts.

Moreover, the weekly RSI has fallen to "oversold" levels that have been associated with sharp upwards rallies for the last 20 years. As the below chart shows, a weekly RSI similar to the reading today has almost ALWAYS presaged a market rally of 10% or so.

For today's market, this would indicate a move back up to 2,000 or possibly higher.

The catalyst for this would likely be actual investors moving back into the market, confident that the Fed's intervention of the last week or so has put a floor beneath the decline.

With that in mind, I suggest opening a number of small "rally hedge" positions to profit from this. **Keep these positions smaller than usual as they are more speculative in nature.**

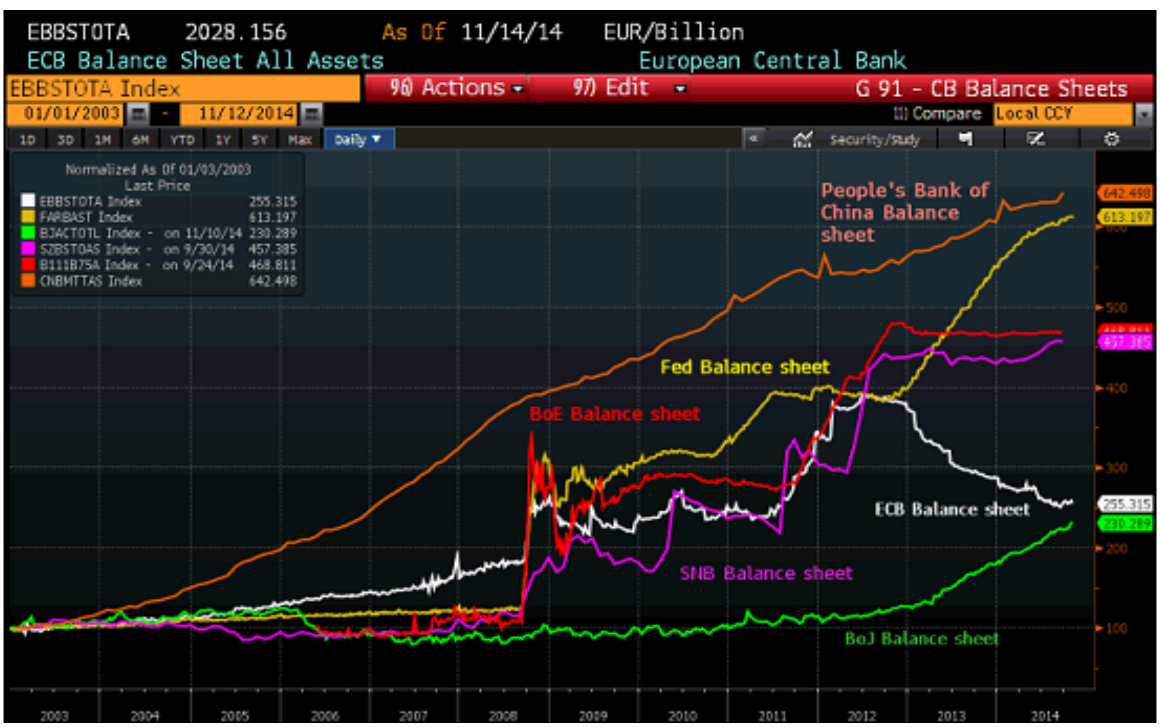
Action to Take: Buy the UltraLong S&P 500 ETF (SSO).

Action to Take: Buy the UltraLong Russell 2000 ETF (UWM).

I wish to stress that these will likely prove to be short-term trades that we hold for only a week or two. I do not believe we will see a major leg up to new highs begin. If anything, I believe we are entering a bear market.

Indeed dark clouds are forming on the horizon. As I noted previously China is now actively exporting deflation into the West. This process will continue for some time as China desperately hopes to "inflate away" its massive debt problems.

As I've noted before, China's Central Bank has expanded its balance sheet by over 600% since 2003, dwarfing every other Central Bank's efforts (the Fed only *just* began to catch up in 2013).



H/T Wolf Richter

Throw in China's shadow banking industry which is around $18 trillion and you've got a financial system that is in debt up to its eyeballs.

The political class in China is able to remain in control as long as the economy is strong enough to keep people out of the streets. With that in mind, the Chinese Government will be going to absolutely extraordinary measures to stimulate growth in the coming months. This will mean more Yuan devaluation.

Which I believe will result in a massive Crash in Chinese equities.

One of the most critical issues investors need to be aware of in today's markets is the pattern of a "false breakout."

Most of the most famous technical patterns (head and shoulders, triangle, a rising wedge, etc.) are in fact **consolidation** patterns. That is, there is no guaranteed outcome in terms of direction: the market can break either up or down out of them.

The key issue is what happens after the initial breakout. If the move is sustained, then it's the real thing. But if the move is short-lived, and the market reverses… then **it's called a "false breakout."**

False breakouts matter a lot because typically they are followed by VERY rapid VERY VIOLENT moves. The reason for this is that the investors who took bets on the initial consolidation pattern resolving a particular way quickly discover they are wrong and rush to the exits.

China's bubble of the last 18 months (a breakout from a massive triangle pattern) is looking more and more like a "false breakout" to me. If we take out the lower blue trendline, we're going to 15 here.

It's too early to re-open the UltraShort China ETF (FXP), but we're getting close…

As goes China, so does the rest of the world. If China takes out its long-term bull-market trendline…

… the emerging market complex will not be far behind…

And the US will eventually catch up. This would mean the S&P 500 falling to 1,500 and likely breaking even that line.

However, all of this is down the road a ways.

Remember, when bear markets begin, the market is an absolute roller coaster as it works its way down to its bull market trendline. Below is the Tech Crash. As you can see, we had EIGHT moves of 16% or greater as it worked its way down over the course of 12 months.

For now, markets should bounce briefly (say 1-2 weeks). At that point we'd be ready for the next leg down.

This concludes this Weekly Market Update. I'm watching the markets closely and will issue updates as needed. Barring any new developments, you'll next hear from me next week in our usual Weekly Market Update.

Until then…

Best Regards

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Phoenix Capital Research