Private Wealth Advisory

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A Warning Shot, Pt. 1

This week's issue is a double header that will be published over two days (one half today, the other half tomorrow). The reason for this is because the issue will be longer than usual and covering a great deal of information. Indeed, a huge amount has changed in the last two weeks, and I want to insure you find out about all of it.

First and foremost we need to address a major change that is taking place in the US political system/ financial markets. As I detailed in our last issue there are two forces at work in the financial markets today: Market Forces (deflation) and Government Intervention (re-flation). The period from late 2007 to March 2009 was dominated by the former. The period from March 2009 to the present was dominated by the latter.

This recent period of Government Intervention was dominated by endless bailouts/ Stimulus, and the Federal Reserve juicing the markets. Indeed, few investors realize just how propped up this market has become. I wrote extensively about the "prop" scheme in today's e-letter at Gains Pains & Capital. You can read that article here.

For those of you who don't have time to read that article right now, the primary points are the following:

1) Over 80% of ALL market gains since March 2009 have occurred on Mondays. This indicates someone is pushing the market higher during the lightly traded futures sessions over the weekend
2) The Federal Reserve is openly JUICING the market during options expiration week.

Regarding, #2, I know I've been harping to you that the Fed is literally pumping the market higher. However, this time I've got concrete evidence. Options expiration week is a monthly occurrence that typically features a ramp job in stocks as Wall Street traders push the market higher to close out their options positions at a profit.

However, what's truly eerie is that since July, the Federal Reserve has been making its largest capital infusions into the markets on options expiration week. I've laid out the Fed's weekly actions in the chart below. Those weeks in bold are Options Expiration weeks.

Week	Fed Action
December 31 2009	-$1 billion
December 28 2009	+$35 million
December 17 2009	**+$49 billion**
December 10 2009	-$17 billion
December 3 2009	-$2 billion
November 27 2009	-$2 billion
November 19 2009	**+$73 billion**
November 12 2009	-$30 billion
November 5 2009	+$3 billion
October 29 2009	-$39 billion
October 22 2009	+$8 billion
October 15 2009	**+$54 billion**
October 8 2009	-$3 billion
October 1 2009	-$17 billion
September 24 2009	+$18 billion
September 17 2009	**+$51 billion**
September 10 2009	+$4 billion
September 3 2009	+$8 billion
August 27 2009	+$14 billion
August 20 2009	**+$46 billion**
August 13 2009	+$25 billion
August 6 2009	-$11 billion
July 30 2009	-$38 billion
July 23 2009	-$33 billion
July 16 2009	**+$80 billion**

Notice that on non-expiration weeks, the largest Fed move was a $38 billion capital infusion. However, ON expiration weeks the SMALLEST move was $46 billion (even LARGER than the LARGEST non-expiration pump). **You'll also notice that the two LARGEST Fed pump jobs occurred in mid-July ($80 billion) and mid-November ($73 billion) both times when the market was close to breaking down in a major way.**

Thus, the above chart makes it clear in no uncertain terms that the Fed is openly pumping the markets at critical times. And remember, the above data is merely that which is open to the public!

Back to the Market Forces/ Government Intervention dynamic.

I've commented for several months now that at some point Market Forces would raise its head again. Indeed, I believe that the last few months have been the tipping point. I base this belief on the following points:

1) The impact of the Government's intervention has greatly diminished in the last few months. This is clear in the below chart:

2) Several key economies (particularly China) have signaled that they will begin tightening liquidity.
3) Public outrage and voting has begun to butt heads with those propagating Government Intervention (Obama's polls are the lowest of any President at this point in his Presidency, the Massachusetts upset election, etc).

In light of all this, I believe we are at the literal "tip of the iceberg" regarding a shift from Government Intervention to Market Forces. I do not think this shift will be rapid or sudden. Instead it is likely to be gradual with an acceleration into the election in the Fall.

However, the beginnings of the shift are clear. Heck, even Ben Bernanke, our smug, conceited Central Banker has agreed to allow the public access to the AIG bailout documents. Compare this to several months ago when he refused to allow ANYONE to see ANY of the Fed's moves.

Market Forces Raises Its Head

Again, I think the markets are getting their first whiff of Market Forces (deflation) since March 2009. However, it will take time for this to fully take hold. In light of this, I believe we shall see a brief correction in stocks and commodities now, perhaps say 10% in stocks and a little more in commodities. **We will also see a jump in the Dollar, perhaps to 81-83 or so on the Dollar index. This will mark the beginning of a**

MAJOR reversal that will result in stocks slowly grinding lower over the coming months culminating in a truly nightmarish Fall.

Let's think about this for a moment. The stock market and US economy are both largely on life support courtesy of the Government. What do you think would happen to both if that life support were removed?

I believe it will be. Why? Because BOTH political parties are now competing for votes in the Autumn of 2010. The GOP will run largely based on ending bailouts and Stimulus. This effect of a GOP win in the House and Senate based on these policies would easily result in ANOTHER FULL BLOWN CRASH.

Unless they want to commit Political Suicide, the Democrats MUST run on a similar platform (even if it's simply that of reducing but not ending the bailouts/ Stimulus) if they are to have a hope of retaining the House and Senate.

Again, both parties must now run on policies that are market negative. However, Government Intervention forces will not go down without a fight. Politicians NEVER and I repeat NEVER say "oops we were wrong." Instead what they do is gradually terminate policies so they can later take credit for ending them (despite also instigating them).

Thus I do not think we shall get a HUGE collapse or Crash in stocks in the intermediate-term. Instead, we shall likely see a summer rally or sideways chopping action as various Stimulus/ Bailouts schemes are slowly undone.

To reiterate, I believe that we are going to see the following occur:

1) Stocks and commodities stage a brief correction now (say 10% or so)
2) A summer rally or sideways action for the remainder of the first half of 2010
3) A nightmarish late Summer/ Autumn (Crash/ Collapse time!)

I put the likelihood of this outcome at 70-80% (more on this later). For this reason we are making serious adjustments to our portfolio. First and foremost, I am relabeling our **current open positions** as the **"Correction Now"** portfolio. Most of these are hedges and investments that will profit from stocks falling while the Dollar rallies. As such, they should all perform well over the next month or so as the correction takes hold in stocks while the Dollar rallies.

Secondly, I am moving most of our "**On Deck**" trades (as well as some new investment ideas) to a new portfolio titled the "**Coming Crisis Portfolio."**

This portfolio will consist entirely of positions that we INTEND to open WHEN the next Crisis unfolds. There is no doubt, not even a hint of a doubt in my mind that we are going to re-visit the March 2009 lows (and possibly even break below them). This portfolio will contain the positions we shall open to profit whenever stocks enter a free-fall. These investments will all have short-term horizons (meaning we will hold them for perhaps a number of weeks tops). Most of them will be UltraShort ETFs. And ALL of them will produce huge gains when the next stock Crash occurs.

I will be detailing this portfolio at length in the second half of this week's issue to be published tomorrow after the market's close (4PM Eastern Time). Again, these are NOT investments we are buying NOW, they are investments we INTEND to buy when the market begins to Crash again.

Thirdly, we are opening a new portfolio called the "**Kick the Can**" portfolio. This portfolio will consist of investments related to the Government's current policies of "kicking the can" down the road or prolonging its stimulus efforts/ relationship with various firms.

In simple terms, this portfolio will be filled with investments that have close ties to world Government both US and international. As I mentioned earlier, I do not believe that the world's Governments are simply going to remove ALL market props OVERNIGHT.

Indeed, many industries will remain partially subsidized or favored by the Government for years to come (some already have been for decades). These industries will outperform others thanks to their close relationships/ Government favoritism. As the financial crisis has demonstrated, those industries closest to the Government can get some pretty sweet deals (many financial stocks are up 300%+ since the March lows while the S&P 500 is up roughly 72%).

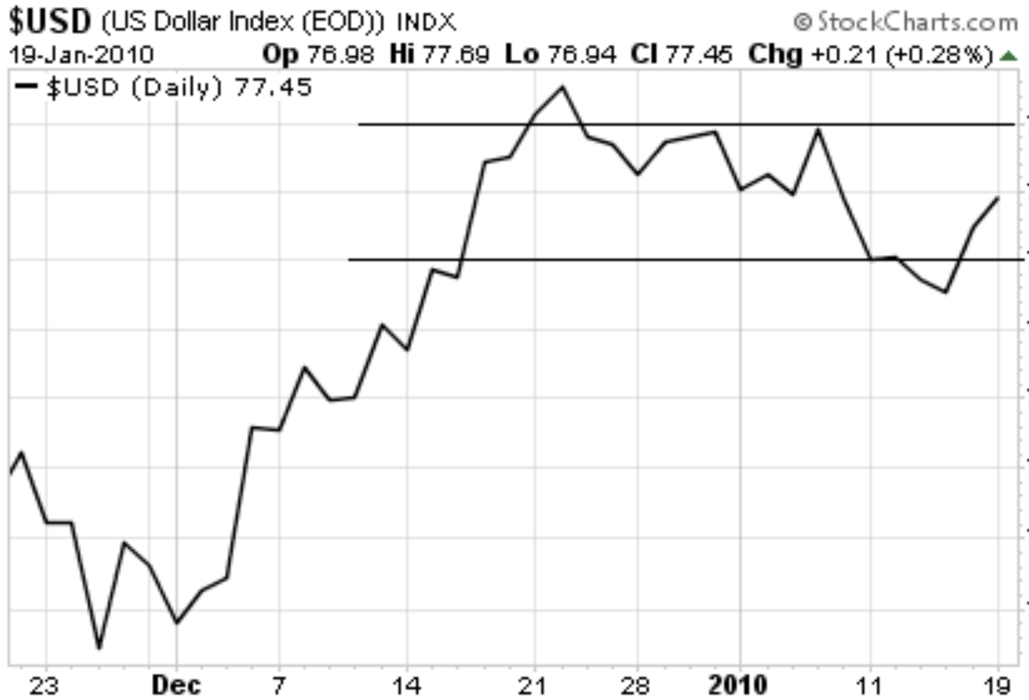
I will ALSO be detailing the first few ideas for this portfolio in the second half of this week's issue which will be published tomorrow Thursday January 21 2010 AFTER the market's close (4:00PM Eastern Time). We shall be adding to this portfolio periodically going forward whenever I find an investment/ company that profits from Government favoritism.

With that out of the way, the remainder of the first half of this issue (today's) will be devoted to what's happening right this minute in the markets.

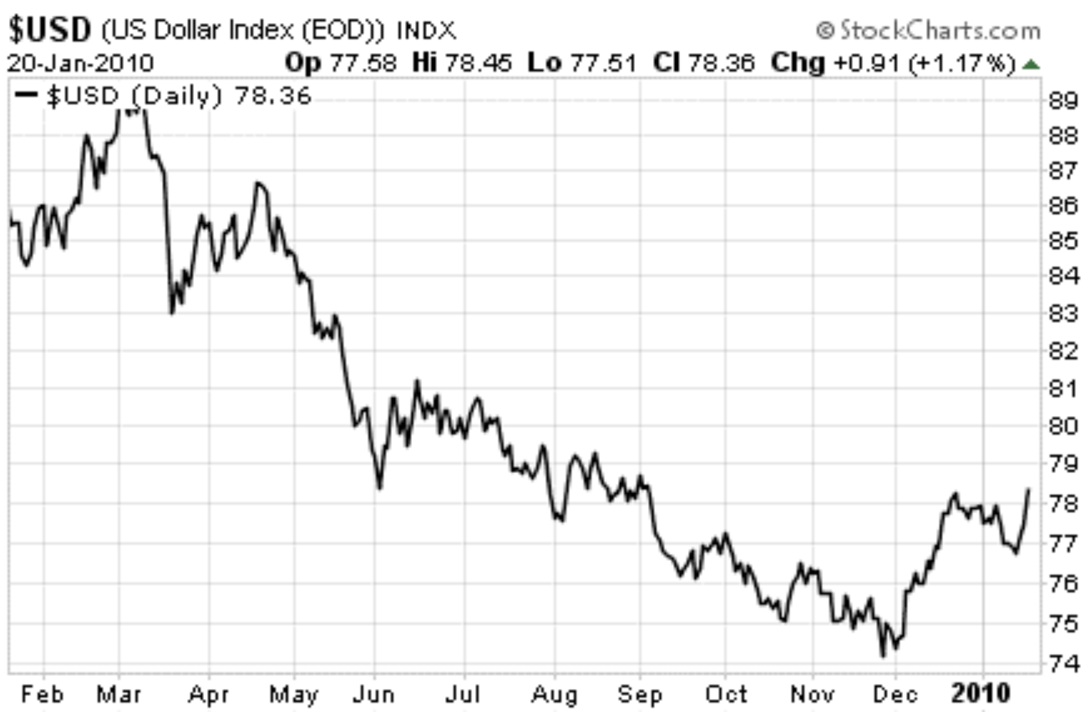
The Political Landscape is Changing… Policy Changes Will Follow

The Massachusetts' election is a serious warning shot to the Democrats. They now realize they will have to rollback the Stimulus/ Bailouts if they want to have any chance of re-election come Autumn. The market has already begun discounting this, which is why stocks rolled over today while the Dollar rallied hard.

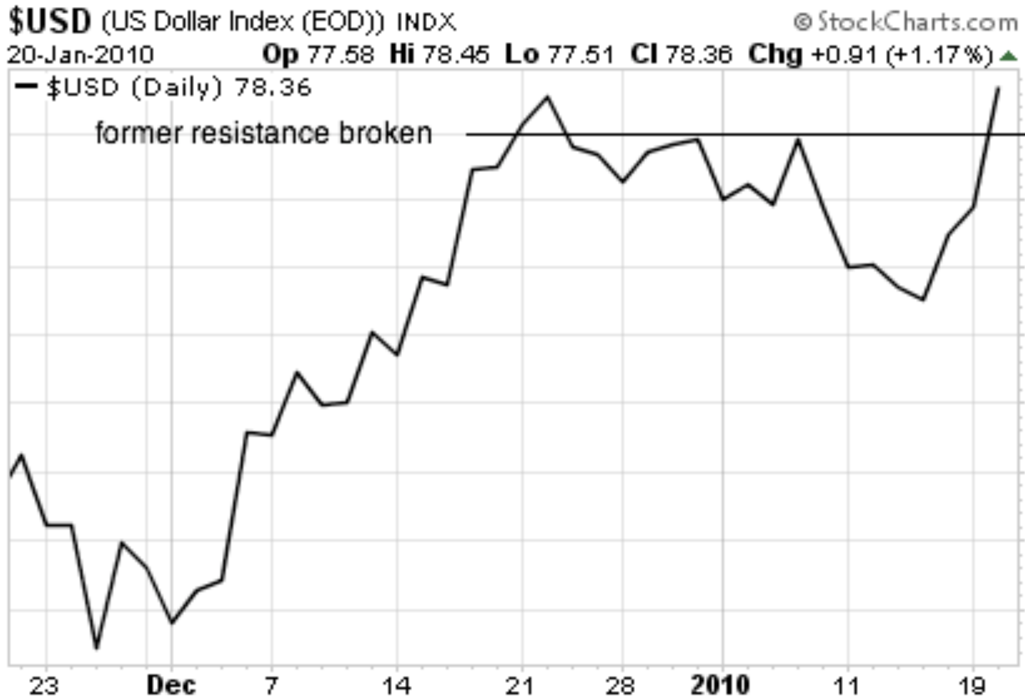
Over the last month, the Dollar has been trading in a tight range between 77 and 78 indicating that the currency markets hadn't yet made up their mind whether Market Forces were back or if we'd continue to see Government Intervention dominate.



However, the Massachusetts election combined with increased trouble in the Euro-zone (Greece on the verge of default) have sent a clear signal that Market Forces are creeping back. Consequently, the Dollar index has spiked above critical resistance at 78.

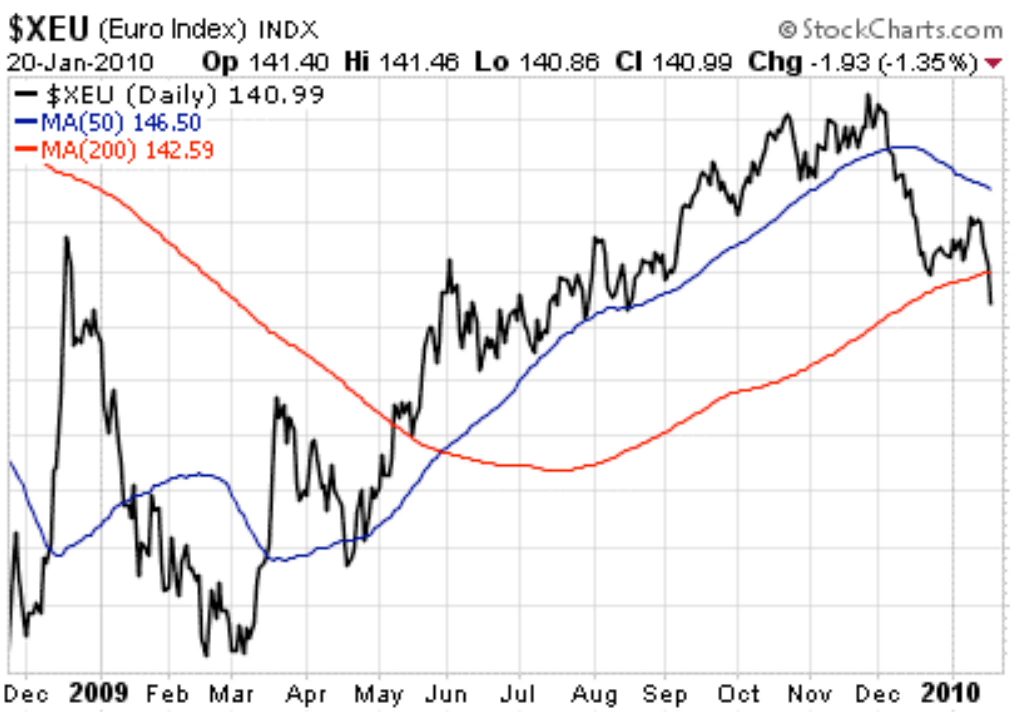


Here's a close up look with the former resistance line drawn in:



I believe this move will kick off a short-covering rally pushing the Dollar to 81-83 (possibly higher) in the coming weeks. We already have exposure to this via the US Dollar Bullish Index (UUP).

As Dollar rallies I believe we are going to see continued weakness in the Euro. Indeed, as of today's close, the Euro has sliced through major support at the 200-DMA with no effort:



Here's the same chart with support drawn in. As you can see, the Euro sliced right through it with no trouble at all.

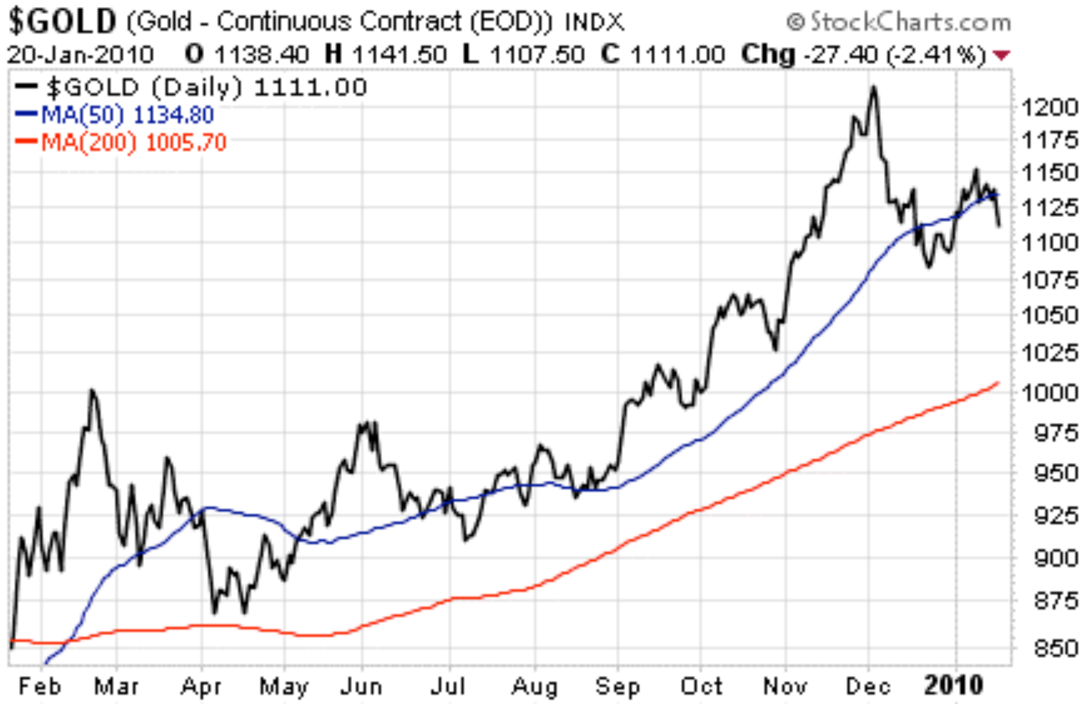
The European Union/ Banks have made it clear they will NOT be bailing out Greece. This is ominous for Spain, Portugal, Italy, and Ireland which all face budgetary Crises of their own. In fact, we may even see a break-up of the European Union in the coming months. **For that reason, VERY SOON (but not today), we're going short the euro with the UltraShort Euro ETF (EUO).**

EUO returns 2X the inverse of the Euro ETF (FXE). So if FXE falls 5%, EUO should rally 10%. As such, it's a great way to profit from additional weakness in the euro.

However, I want to be clear here… I AM NOT issuing a formal buy on this investment NOW because it spiked earlier today and is overbought. So rather than buying today when there's a high probability of a euro bounce, we're going to wait for the bounce to occur and THEN buy so we get a better entry point.

Looking at the chart, this should occur within the next few days. When it does I will send out an update telling you it's time to buy. Again, DO NOT rush out and buy it just yet.

Aside from the euro, the Dollar's rally today is also kicking Gold in the teeth.



As you can see, Gold has broken down in a major way. I suspect that very soon we will break the December lows and fall to test the 200-DMA at $1,000 per ounce. For that reason VERY SOON BUT NOT NOW we are going short Gold via the **UltraShort Gold ETF (GLL).**

GLL returns 2X the inverse of the Gold ETF (GLD). So if GLD falls 5%, GLL returns 10%. As such it's a great means of profiting from continuing weakness in Gold.

Just like EUO, GLL has run too high today so I am waiting for a bounce in Gold to give us a better entry point. I will send out an update when it's time to buy GLL.

I wish to be clear here. I am NOT bearish on Gold in the long-term. GLL is merely a short-term trade (holding period a couple of weeks) that we will be making to profit from the Dollar's strength. **Again, it is NOT time to buy it NOW. Wait for me to send out an update first.**

This brings us to our final idea for this week…

US Treasuries: Still Seen As a Safe Haven… For Now

In last issue of *Private Wealth Advisory*, I pointed out that US Treasuries had formed a chart pattern that could be interpreted as either bullish (a potential bounce off key support) or bearish (a head and shoulders). Here's both charts as a quick review…

The Bearish pattern:

And the Bullish pattern:

Well, the last few days US Treasuries flashed a signal that the bullish pattern, NOT the bearish pattern is in effect. Indeed, long-term Treasuries have bounced hard off of support, indicating that investors are still willing to utilize them as a safe haven:

This ties in well with the re-emergence of Market Forces (deflation) which is US Dollar positive.

In light of this, we will be opening a short-term trade to play this trend. Again, this is a SHORT term play. Long-term I am VERY bearish on US debt. But the market has indicated that the trend is up for now, so that's the trend we're playing.

We will be playing this trend with the **iShares Long-Term Treasury ETF (TLT).**

TLT is essentially a proxy for long-term US debt. So if long-term Treasuries rally, so will TLT. If gives us exposure to any potential rally in long-term US debt as investors flee there for safety.

However, as is the case with EUO and GLL, the spike in TLT today has made me hesitant to open a position right this minute. So we'll wait for a brief correction to get a better entry point. This will likely come later this week or early next.

So those are three trades (EUO, GLL, & TLT) that we're WATCHING but NOT BUYING right now. As soon as it's time to buy any of them I will be sending out a market update. I expect this to be sometime in the next week.

Now, I am sure that given the rapid drop in stocks/ US Dollar rally that we saw today some of you might be asking…

Could a REAL Collapse Be Starting Now?

I don’t think this is the case… but there is a small possibility that what’s beginning now in the markets could be a full-blown deflationary Collapse: the very Crash that I’ve been forecasting since November.

I put the likelihood of this outcome at a much smaller probability (say 10-20%) than the correction now/ brief rally/ autumnal Collapse outcome.

However, if the Democrats wise up to the ongoing change in the political landscape, we could see an accelerated removal of various market props which would precipitate a steep decline in stocks SOONER rather than LATER.

Similarly, the Dollar could potentially be starting an explosive rally akin to that of the Fall of 2008. Remember, right now the Dollar is the biggest short in the entire world. Any significant rally could kick off round after round of short-covering (just like in 2008) which would instigate a massive wave of deleveraging/ deflation.

If this were to occur, then a full-blown Crash becomes a likely outcome.

Again, I think this is a lower probability situation than the 10% correction now/ sideways action for a few months/ Collapse in the fall situation. However, given how leveraged the system has become again (it’s back to 2007 levels) and given that the smart money is fleeing the market (insiders are selling at 2007 levels) and given that the bond market is already flashing major warning signals (short-term Treasuries continue to yield 0.00%), a Market Crash in the next few weeks/ month or so is NOT completely off the table.

All of this hinges on the Dollar. If the Dollar breaks above 81 or really starts to take off, then LOOK OUT in the stock and commodity markets. Rest assured, I will be watching for this very VERY closely.

This concludes the first half of this week’s issue. I will be publishing the second half of this issue which will focus on our two new Portfolios (the “Coming Crisis Portfolio” and the “Kicking the Can” portfolio) tomorrow after the market’s close (4:00PM ET). So please be on the look out for that.

I realize some of this portfolio jargon may be a little confusing, so I will summate everything here. Going forward, our portfolio will be broken into three categories based on different investment themes.

The **CORRECTION NOW PORTFOLIO** consists of the hedges and positions we’ve already opened to profit from any decline in stocks/ rally in the Dollar. This portfolio is accompanied by a WATCHLIST of positions we intend to open in the very near future as soon as we get a better entry point (currently these include EUO, GLL & TLT).

The **KICKING THE CAN PORTFOLIO** (to be revealed tomorrow) will consist of investments that we will buy or be buying based on their close relationship with/ favoritism by the Government.

The **COMING CRISIS PORTFOLIO** (to be revealed tomorrow) will consist of short-term trades we INTEND to open when the market begins a full-scale COLLAPSE (some time later this year).

After I publish the second half of this week's issue tomorrow, ALL THREE PORTFOLIO CATEGORIES WILL BE PUBLISHED and TRACKED IN EVERY SUBSEQUENT ISSUE OF *PRIVATE WEALTH ADVISORY*.

So until tomorrow…

Good Investing!

Graham Summers

CORRECTION NOW PORTFOLIO					
Company	**Symbol**	**Buy Date**	**Buy/Short Price**	**Current Price**	**Gain/ Loss**
Ultrashort Russell 2000	TWM	11/2/09	$31.74	$23.86	-25%
Ultrashort Nasdaq	QID	11/2/09	$24.13	$18.83	-22%
SHORT SAKS	SKS	11/11/09	$6.30	$7.08	-11%
UltraShort Financials	SKF	12/9/09	$25.23	$22.20	-12%
US Dollar Bull ETF	UUP	12/22/09	$23.16	$23.12	0%
UltraShort China	FXP	12/23/09	$8.58	$8.73	2%

Watchlist: Positions We Are About to Open	
Company	**Symbol**
UltraShort Euro ETF	EUO
UltraShort Gold ETF	GLL
iShares Long US Treasury ETF	TLT