

PRIVATE WEALTH ADVISORY

AN OMNISANS RESEARCH PUBLICATION

JAN. 21, 2010

A Warning Shot, Pt. 2

It's all just kicking the can down the road.

Most commentators believe that the latest round of Government Bailouts/ Stimulus is without precedent. It is true that we have never before seen this LEVEL of Government Intervention in the markets. However, the reality is that Government (both in the US and abroad) has been intervening in the financial markets for decades.

After all, there are countless ways that Governments issue handouts or unfair deals to favored corporations. Just a handful of the more popular ones include:

- 1) Selling off natural resources at a steep discount to market values (Brazil, US, Russia, etc)
- 2) Allowing various accounting loopholes to cover up potential losses (the banks in the US)
- 3) Passing legislation to benefit certain companies over others (the US and Goldman Sachs is a great example)
- 4) Passing off inside information on planned policy before releasing it to the public (Bill Gross seems to always know what the Fed's next move will be)

Those "on the inside" of these kinds of deals make vast fortunes that your average investor would never get access to. After all, if you or I approached Nigeria and asked about drilling for oil, we'd likely be arrested or thrown out of the country. But when Exxon or some other multinational comes knocking, it's open arms and celebratory deal signings.

Thus, the Government moves of the last 18 months are really nothing more than a continuation of a long-term trend: that of kicking the can of Crony Capitalism as far down the road as possible. This will not end with the current Financial Crisis. Barring a full blown revolution in the US and elsewhere, the Government will continue engaging in the same kick-backs, unfair deals, etc. that it has perpetuated for decades.

And we are going to be profiting from it with our "Kicking the Can" portfolio.

The Kicking the Can portfolio focuses on investments with three key items: Government Connections, Strong Fundamentals, and Strong Technicals. Any potential Kicking the Can pick will be rated in these three categories on a scale of 1-to-5. And we will never buy an investment unless its total score is 11 or higher.

Let's take Goldman Sachs for instance. Goldman has perhaps the best government links in the entire world. Its former CEO was Treasury Secretary for the US from 2006-2008.

And numerous US Government organizations/ bodies are filled with former-Goldmanites (including the SEC). In simple terms, Goldman is deep in bed with the US Government, so it'd get a 5 for Government Connections.

Regarding fundamentals, Goldman is most assuredly hiding major losses on its balance sheet. Indeed, the company is very likely insolvent based on its derivatives exposure alone. However, it IS now largely the only company it is space (bear Stearns and Lehman are gone while Morgan Stanley and Merrill Lynch were swallowed up by larger entities). And because the SEC is asleep at the wheel, Goldman is legally permitted to front-run its clients AND dominate the High Frequency Trading Market where it scalps millions of dollars per day. So for Fundamentals Goldman would get a 2 or 3.

Finally regarding Technicals, Goldman's stock failed to break to new highs after October. Indeed, the Goldman chart could be viewed as a Dome Pattern:



However, Goldman's chart could also be seen as a Head and Shoulders pattern:



Both of these patterns are massively bearish. Indeed, the fact Goldman has been putting in lower highs and lower lows since October is a MAJOR red flag. Thus Goldman would get a 1 for Technicals.

Here's Goldman's total score based on our methodology:

Government Connections	5
Fundamentals	3
<u>Technicals</u>	<u>1</u>
Total Score	9

Thus, we would not even consider buying Goldman for the Kicking the Can portfolio.

Let's do another example, this one being Total SA (TOT)

TOT is the fifth largest oil and gas company in the world. Based in France, the company was originally created as a holding company for various French interests in Middle Eastern oil and gas fields. Indeed, the company acquired a sizable stake of a large Turkish Oil Company as part of WWI reparations.

The French Government owned as much as 34% of TOT at one point, but no longer has any holdings. However, the company maintains very close ties to the French Government even today. It's also worth noting also that one of China's sovereign wealth funds owns about 1% of the company. So TOT gets a 5 for Government Connections.

In terms of fundamentals, TOT is cheaper than AND produces more cash and greater dividend payouts than its competitors.

Company	TOTAL	EXXON	Chevron
P/S	0.9	1.1	0.9
P/E	16.8	15.7	12.7
P/CF	6.8	10.9	8.9
Dividend Yield	7.3%	2.4%	3.4%

That dividend yield alone is enough to warrant a 4 for TOT's Fundamentals score. The fact the company has next to no debt and produces high returns on equity gives it a 5.

Finally, from Technical standpoint, TOT has recently broken below its 50-DMA and is now on its way to testing the December lows. A break here would be seriously bearish and could set up a head and shoulder pattern.



Indeed, it looks as though TOT has *just* broken its uptrend line since May.

TOT (Total Fina Elf S.A.) NYSE

© StockCharts.com

21-Jan-2010 1:42pm

Last 61.49 Volume 1.6M Chg -1.51 (-2.40%) ▼

— TOT (Daily) 61.49



Thus I would give TOT a 1 or 2 for Technicals. Here's its total score

Government Connections	5
Fundamentals	5
<u>Technicals</u>	<u>2</u>
Overall Score	12

This brings Total's overall score to 12. This is high enough that it could potentially qualify for the Kicking the Can Portfolio. However, given that TOT's chart is SUPER bearish, I wouldn't invest in it just yet. Instead, I'd put this company on a watch list rather than buying now.

Those Were Just Examples... Now, Here's How the Kicking the Can Portfolio Will Really Work

Please understand that the above analyses of GS and TOT are extremely short and abbreviated. They are in a sense just rough sketches of the two companies. If I were performing REAL analysis in an issue of *Private Wealth Advisory*, we'd delve deep into the company's connections by:

- listing the company's specific connections to various politicians/ legislative bodies.
- looking into whether any members or former members of the government are on its corporate board
- examining how many senators/ representatives in Congress own its stock

- examining its previous dealings with local governments
- other relationships as needed

Similarly, we'd apply the same intensive analysis to the company's fundamentals and technicals. After all, the Kicking the Can Portfolio is meant to be comprised ONLY of THE best, most profitable and favored investments on the planet. So the selection process for any pick will be both intensive AND thorough.

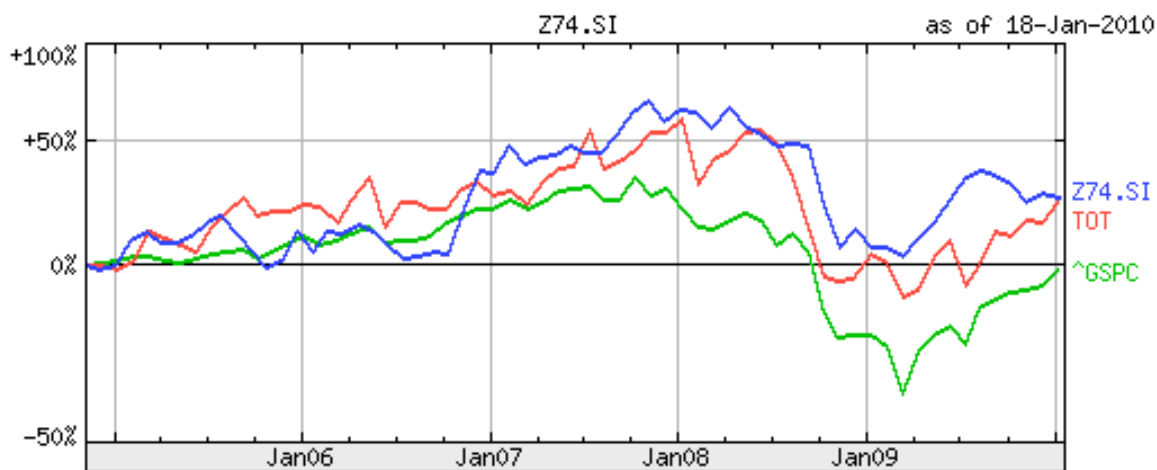
For this reason, we will be making relatively few investment recommendations in the Kicking the Can portfolio. However, the ones we DO recommend should all prove home runs. These will be companies with outstanding fundamentals (strong sales and earnings growth, high returns on equity, little debt and large payouts to investors via dividends and buybacks) that are favored by the government (privy to unfair deals and the like) whose charts are all screaming "BUY!"

As you can imagine, it's hard to go wrong with that combination.

For that reason, Kicking the Can picks will not be a regular fixture of *Private Wealth Advisory*. After all, you don't often come across a home run investment like that. However, when we do, we shall load up and hold on to these positions for the long-term (months if not years).

To illustrate why, consider the below chart showing the performance of Singtel (a massive emerging market telecom company partially owned by the Singapore Government), Total (which we covered in the space above) and the S&P 500.

Singtel is blue, Total is red and the S&P 500 is green.



As you can see, not only did Singtel and Total dramatically outperform the S&P 500 on the upside from 2005-2008, but they also both held up far, far better during the Financial Crisis in 2008. And why not, these are two of the best, most favored corporations on the planet. They are, in a sense, the best of the best. These are precisely the kinds of

opportunities we'll be looking to invest in for the Kicking the Can Portfolio (however, right now both Singtel and Total's charts have me wanting to stay away).

Now, onto the Coming Crisis Portfolio

The Coming Crisis Portfolio

As you know, I firmly believe that we are headed for another Crisis in the near to intermediate future. All told I've probably devoted 100+ pages of editorial to this theme, but the core arguments are as follows:

- 1) This stock market rally has been largely the result of excess liquidity and manipulation (80% of all gains since March '09 occurred on just 30 Mondays)
- 2) The real economy continues to fall off a cliff (this morning's unemployment data shows a 652K increase in people seeking emergency unemployment for a total of 5.6 MILLION people on emergency benefits)
- 3) The large banks remain insolvent and would be recognized as such if it weren't for government intervention and the suspension of accounting principles
- 4) Market volume has fallen to a trickle with only algorithms and hedge funds trading (speaking of which, Obama is proposing to BAN prop trading. Look how the market reacted today.)
- 5) The housing bubble continues to detonate with the next major round of mortgage rate resets hitting this year
- 6) The US has a Debt Crisis with TRILLIONS in old debt needing to be rolled over while we issue \$2 trillion in new debt at a time in which fewer and fewer investors want to lock their money up with Uncle Sam for month than a few months/ years
- 7) Sovereign debt defaults are on the rise (Dubai, Greece, Portugal, Spain, Ireland, the UK, etc.)
- 8) China is now curbing bank lending and stimulus (the beginning of the end for the liquidity pump)

If you need additional evidence that ALL is not WELL in the world, I suggest going back and re-reading ALL of the December 2009 issue of *Private Wealth Advisory*.

All of this adds to up another Crisis at some point in the future. It could be a stock crisis, bond crisis, or currency crisis. Ideally it'd simply be stocks, but given the increase in sovereign debt risk I no longer think that will prove likely.

Now, I CANNOT tell you when this Crisis will hit. Personally I thought it had started back in November 2009, but the Fed juiced the market again and we were off to the races with the bulls in charge of the market.

However, at some point the market WILL begin to break down in a major way. I fully believe we shall re-test if not BREAK the March 2009 lows.

With that in mind, starting today I'm lining up investments in our Coming Crisis portfolio to profit from the next round of the Financial Crisis whenever it happens.

Again, ALL of these picks are for WHEN the Crisis hits (DO NOT BUY THEM NOW). They are all intended to be short-term trades that we will hold for several weeks or at most, one month once stocks come truly unhinged.

You'll recognize most of them. One is totally new. But ALL of them should profit handsomely from the very sectors/ industries that should fall farthest.

I've left brief explanations of each pick next to its name and symbol.

Investment	Symbol	Reasons to buy when the Crisis hits
UltraShort Emerging Markets ETF	EEV	Sovereign debt default, end of liquidity rally, capital withdrawals on flight to safety
UltraShort Russell 2000	TWM	The WORST index in the US, comprised of junk and unprofitable companies
UltraShort Real Estate	SRS	Second wave of mortgage rate resets, continued increase in defaults in housing, real estate stocks trading at complete and utter disconnect from reality
UltraShort Materials	SMN	Complete and utter disconnect from economic realities. Economy is in depression and materials should be plunging as a result.

Please understand that this is just a start. The Coming Crisis portfolio will be altered/ edited as I do more research on which companies/ investments are most likely to tank whenever stocks roll over in a REAL way.

I want to also add that I'll be altering this portfolio going forward depending on how the market acts. Markets are living beasts and it's virtually impossible to predict where they will be when the next Crisis takes hold. But for now, these are the picks I like the most for this portfolio (at least until I find more/ swap these for others).

So there you have it, the Kicking the Can Portfolio and the Coming Crisis Portfolio. Going forward both will be addressed/ edited/ and published in EVERY issue of *Private Wealth Advisory*.

This concludes this week's issue. We've currently got three investments we're waiting to buy (EUO, GLL, and TLT) which I detailed in the first half of this week's issue yesterday. Aside from that, and barring any major developments in the markets, you'll

next hear from me on February 3, 2010 when I publish the next issue *Private Wealth Advisory*.

Thank you again.

Best
Graham Summers