

Alan M. Newman's Stock Market **CROSSCURRENTS**

U.S. STOCK MARKET OUTLOOK for SEPTEMBER 7, 2009
DJIA 9441 - SPX 1016 - NASDAQ 2018

PRIMARY RATIONALE FOR GOLD BULL MARKET EVOLVES AGAIN BUT OUR UPSIDE TARGETS REMAIN. POTENTIAL TO \$2000 PER OUNCE. STOCKS SLATED TO TEST JULY LOWS OF DOW 8100.
- NEXT ISSUE - SEPTEMBER 28, 2009 -

⌘ Gold: Upside To \$2000 Per Ounce. ⌘

After a six month hiatus, it is time to revisit the outlook for gold and gold stocks. We last examined the potential for the yellow metal and the more well known gold mining companies in our March 9th issue (see <http://www.cross-currents.net/m030909r.pdf>), the same issue in which we cited the "best reward/risk ratio in years" for the stock market. We highlighted five "selected popular" gold issues and offered an average upside potential of 70%. Our call on the gold stocks came right on the nose and the subsequent rally took our five selections up an average of 29% over the next two months and change. Underwhelming? Not at all. Most importantly, we posited that "the five gold stocks.... offer excellent potential for the long term and will eventually exceed their old highs, likely with much room to spare." Given the consolidation mode in place for both bullion and gold stocks, we believe our forecast is still on the mark.

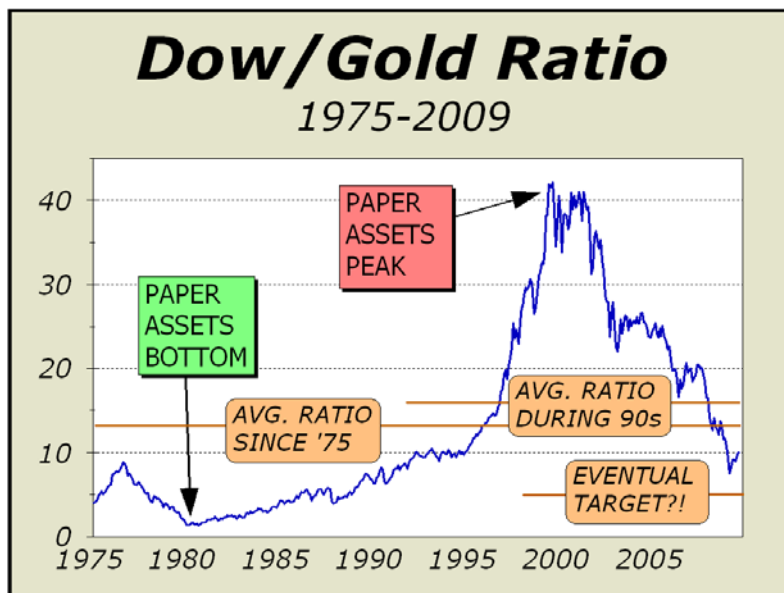
We have been super bullish on both bullion and gold stocks since the terrorist attacks of 911 and

have repeatedly stated that although the catalyst may have been terror and the uncertainty promoted by same, our principal rationale was the threat of a derivative event unlike any seen before. Clearly, the fiasco that unwound last year and into the spring of 2009 met our criteria. The

other shoe will drop. These threats will most likely be covered in the October 19th issue of Crosscurrents, so mark your calendar in anticipation of several amazing charts.

We expect our rationale for the continuing super bull market in gold and gold issues to morph again soon, from terror to derivatives to an unexpected surge in inflation when the secular bear market finally concludes in the latter half of 2010. Given that the threat of terror has not yet been eradicated and that another derivative event is inevitable, the rationales for gold grow brighter and brighter every day. Despite the phenomenal rally in stocks, up as much as 48.2% from the March 6th print low, the Dow/Gold ratio has "corrected" only nominally from the February low of 7.5 to 1. Interest in gold and gold issues has not declined and instead, appears to be tracing out a very bullish consolidation pattern within the super bull market. Our "eventual target" ratio of 5:1 was last seen in the latter part of 1988 and we see no

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meltdown threatened to rupture the financial system and likely came within hours of causing irreparable damage. We have continued to follow the course of the derivative markets and believe huge threats to the system still exist. We're satisfied that another shoe is not likely to drop tomorrow, but inevitably, the

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reason to prevent a return to these levels. Even a return to the February '09 level would likely mean a significant rise in bullion and gold stocks. If the Dow traded at only 8000, a Dow/Gold ratio of 7.5 to 1 would equate to bullion trading at \$1067, 14% higher than today. At Dow 10,000, a Dow/Gold ratio of 7.5 to 1 would equate to bullion trading at \$1333 per ounce. At Dow 10,000, a Dow/Gold ratio of 7.5 to 1 would equate to bullion trading at \$1333 per ounce, 43% higher than today. And if we are correct about an end to the secular bear market for stocks and the Dow trades at 15,000 within five years, bullion has the potential to reach at least \$2000 per ounce.

To date, the resistance levels shown in previous charts have worked quite well, but we have made a slight adjustment to the chart at left below. While the first resistance level is precisely the same as before, the labeling for the second level has been altered to read "inflection point." Technically, this level should still represent resistance, but once breached, we expect a sudden and widespread realization that the rationale for ownership of bullion has changed again, this time to the fear that inflation is about to rapidly erode the value of fiat money. Despite the negative rate in the CPI since May 2008, there is clearly a precedent for a surprising reversal. The CPI bottomed in June 1972 at a modest 2.7% but a year later was at 6%. Another year later, the CPI was 10.9%, before peaking at 12.3% in December 1974. Given the background of the greatest debt intensification ever seen, it makes sense that we inflate our way out of

the mess. Deficit reduction and tax increases can go only so far towards paying down \$9 trillion (see <http://tinyurl.com/mjquse>). Thus, our "inflection point" now takes on a special significance and once bullion is past \$1075 per ounce, clear sailing should be expected. Bear in mind, higher inflation will raise our targeted levels by roughly the same amount.

The veracity of gold's bull market is illustrated in our chart below right. We have arbitrarily selected the inflation adjusted September 2002 low for the Dow vs. gold for our comparison. In the span of time

Regarding the five issues we selected for our March 9th issue focus, there should still be plenty of upside remaining once bullion breaks through resistance and especially when the "inflection point" is breached. The list has been updated for your perusal. The "upside" shown simply represents the old highs. *Given an environment of sustained high inflation, we would expect the old highs to be surpassed by a country mile.*

The Inflation Rationale

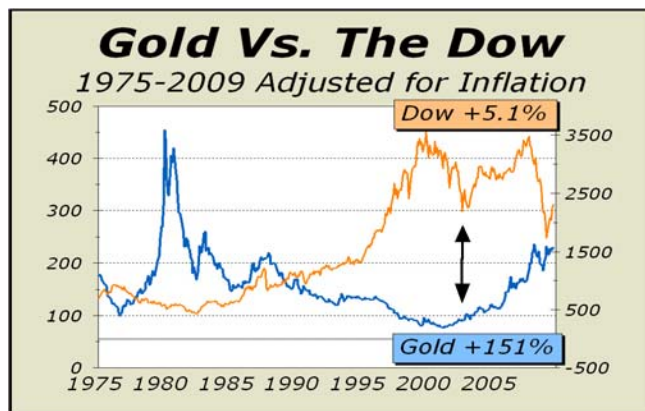
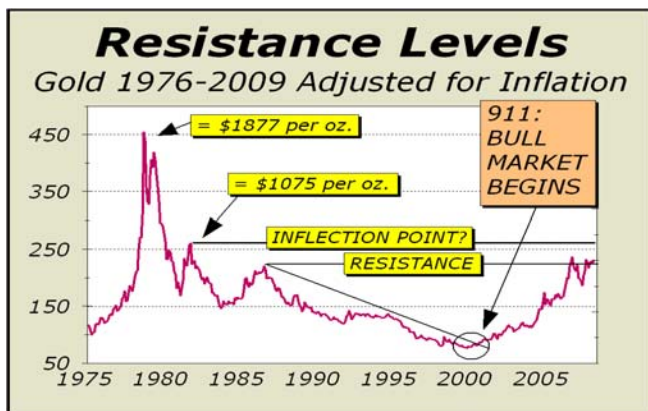
How can we expect to repay the \$9 trillion in federal debt that will pile up over the next decade? (see <http://tinyurl.com/mjquse>) Simple, really. Ensure that the currency is cheapened to the extent that a dollar is no longer worth a dollar. If a dollar is only worth 20 cents in ten years, then the debt is eventually going to be a lot easier to repay.

While inflation as measured by the Consumer price Index (CPI) is effectively minus 2% today, annual CPI was 5.6% a year ago. The statistic can be quite volatile. In January 1965, the CPI was less than 1%. Before a decade had passed, inflation was raging at a rate of 12.3%. After backing off to 4.9% within two years, inflation again surged to a record 14.8% in a little more than three years. Given that Deflation (negative CPI) means greater difficulty in paying off government debt, it is in the interests of the federal government to see inflation soar. Just for kicks, we'll throw in the views of Warren Buffett (see <http://tinyurl.com/mackpq>). If that's not sufficient to curl your toes, visit <http://www.usdebtclock.org/>.

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5 Selected Popular Gold Issues (reprised)			
	Old High	Current Price	Upside???
ABX	\$54.74	\$40.04	+36.7%
GG	\$52.65	\$41.55	+26.7%
AEM	\$83.45	\$67.23	+24.1%
KGC	\$27.40	\$21.88	+25.2%
NEM	\$62.72	\$46.23	+35.7%

since that date, the Dow has risen just 5.1% versus a 151% surge in gold. Despite the huge run up in stocks since the March '09 lows, the inflation adjusted Dow is only bumping up against the '02 low while bullion is fighting to break out to a new generational high and indeed, seems destined to achieve the pinnacle. The last time the inflation rate went bonkers, gold prices exploded from the August 1976 low of \$102 per ounce to \$850 per ounce in January 1980. The annualized rate of inflation as measured by the CPI, reached over 14%. A similar run from the 2001 lows for bullion would place the precious metal above \$2000, an additional precedent for our forecast.



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Ironically, a resurgence of inflation is one excellent reason why we believe the March 2009 stock price lows stand an excellent chance of holding any subsequent retest and that a new bull market is probably only a year away, at worst. A resurgence of inflation will likely mean everything will eventually cost more, including stocks (and especially, gold).

Correction In Progress

It's been a grand run. The upside has measured as much as 48.8% print low to print high for the Dow, 55.6% for the S&P 500 and a resounding 62.8% for Nasdaq in only five-and-a-half months. This has truly been one of the most spectacular moves in stock market history. In the interim, bullish advisors measured by Investor's Intelligence have gone from 26.4% on March 11th to 51.6% as of August 26th. On the same day, the bearish contingent fell to only 19.8%, the lowest since October 17, 2008, when the Dow traded 4757 points and 52% higher. Time for a correction and perhaps a pretty stiff correction as well. Below left, September is by far the worst month of the year. We expect the current month to again fare poorly. After the June 11th highs, stocks corrected by a modest 7% closing basis. A 15% correction would test the July lows of Dow 8100 & SPX 880. At this point, we are not yet looking for a full scale retest of the March lows, but still believe a retest to somewhere between Dow 6400-7000 will eventually occur to mark the end of the secular bear, most likely in the latter half of 2010.

Ultra High Frequency Trading

We have argued since our presentation to the International Fed-

eration of Technical analysts in November 2003 that the U.S. stock market was in the midst of a dramatic transformation, a huge metamorphosis. Evidence has continued to pile up over the years and a recent blog from Zerohedge (see <http://tinyurl.com/kjtgn8>) reveals another piece of a depressing problem; investors are no longer the slightest bit relevant. It's all about high frequency trading (HFT). More on the subject is available from Karl Denniger at Seeking Alpha (see <http://tinyurl.com/mc6qoy>), who muses, "So let me see if I get this right. 2.126 billion shares traded in four stocks, two of which that accounted for some 900 million of those shares are in companies that by any measure of accounting have absolutely zero common equity value whatsoever (and never will under any rational view of the future), yet NYSE Euronext continues to list them. These four stocks represented thirty seven percent of all shares traded Tuesday." Mr. Denniger's conclusions clearly do not differ from any we have previously presented. After 45 years of observation, we are fairly certain that any increase in transactional opacity does not serve the public. If just four stocks can represent 37% of all shares traded, why do we even need a stock market?

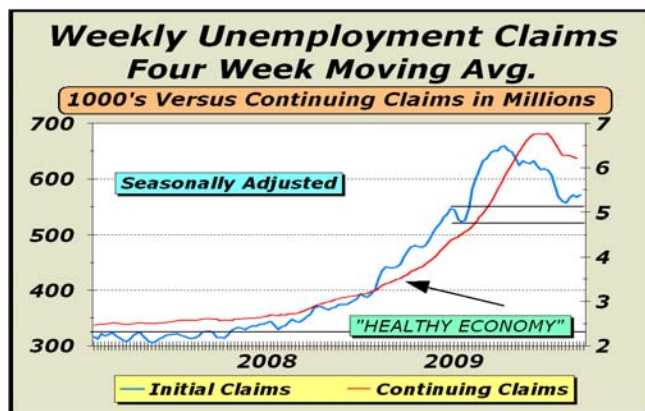
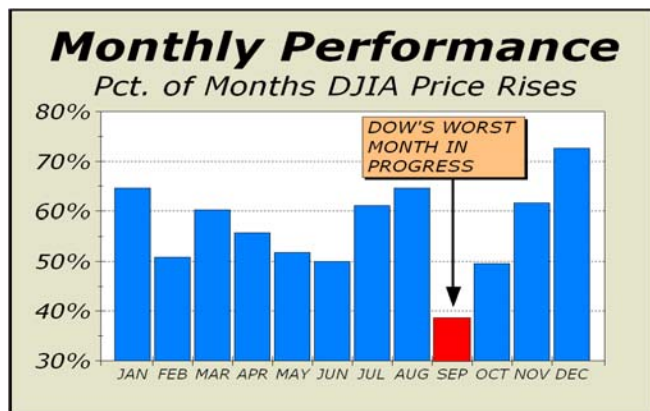
We are increasingly worried that the capital formation system is threatened by this metamorphosis. We have previously explained how certain exchange traded funds (ETFs) are precisely the wrong vehicles for investors since holding periods of longer than one day have an inherent bias towards lower prices. Now that class actions are planned (see <http://tinyurl.com/nwny2a>), the industry is fighting back. Profunds Group is staging a "webinar" to illustrate "how a simple rebalancing strategy can help investors achieve leveraged or

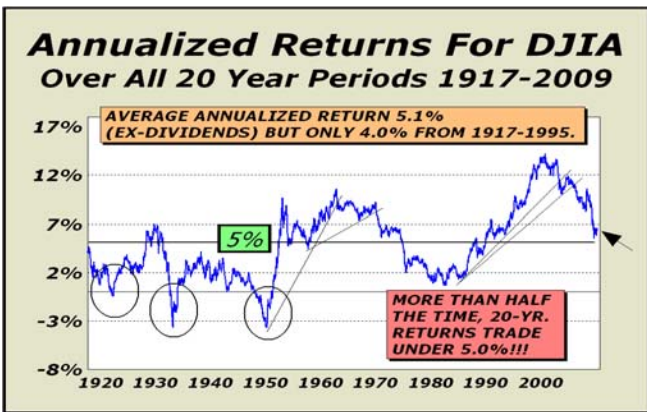
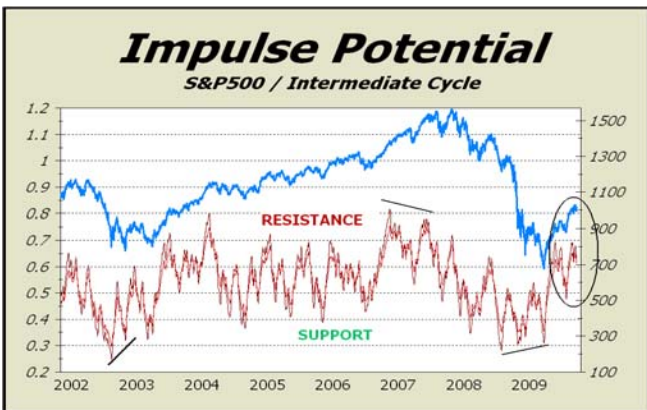
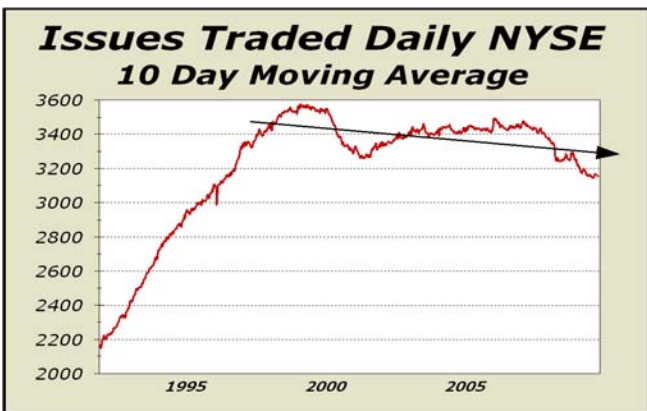
inverse index exposure over extended holding periods." Rebalancing means more transactions and more business. Wall Street's continues to perpetuate rewards for Wall Street despite the cost to investors remains a constant threat. We hasten to remind that the week of June 26th, nearly half all NYSE volume was a result of program trading. This is not your father's stock market anymore. Nothing can be trusted.

Where Are The Jobs?

Where's the beef? You can't have a hamburger without beef (see <http://www.youtube.com/watch?v=Ug75diEyiA0>) and you can't have an economic recovery without jobs. The \$787 billion American Recovery and Reinvestment Act of 2009 has applied an electric jolt to the economy and there is certainly still a pulse, but it is difficult to see how sustained growth is going to be possible without the creation of jobs. Despite our expectation of positive GDP stats for the third quarter, it is unlikely that stimulus already appropriated by Congress can be repeated and downside pressures may be inevitable past the fourth quarter, when retail activity will expand during the holiday shopping season.

Employment statistics still imply a very weak economy moving forward. Without a consistently positive tally of new jobs created each month, there seems little likelihood that GDP will expand significantly and beyond the third quarter and fourth quarter, we could easily slip back into negative mode. Initial weekly unemployment claims have shown a modest improvement but 6.2 million are still on the dole, as many as back at the end of April. We've got a ways to go before declaring good times ahead. ☑☑☑☑





Alan M. Newman's Stock Market
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The number of issues traded daily on the NYSE remains in a downtrend. An indication of a secular bear trend. The capital formation system appears threatened as Individual companies take a back seat to constructed products, such as exchange traded funds. Note the huge buildup in listings during the best time of the super bull market and note how prices topped only months after the peak in issues traded. The divergence on Nasdaq is enormous. In the 1997-1998 period, when investing in Nasdaq was actually reasonable, over 5700 issues were traded each day. Today, issues traded have been cut in half! Together with the trend towards high frequency trading, the stock market is no longer an investment market. As stocks overvalued? Given the shorter timeframes speculators are holding stocks, it is painfully obvious that profits need only be minimal. The impetus not only permits overvaluation, but encourages it. Without a doubt, stocks are overvalued.

Our Impulse Potential measure is intended to present a different perspective for resistance and support. As you can see, divergences have the ability to signal the beginning of changes in trend. The circled area illustrates a recent negative divergence, suggesting significant odds for a downside reversal.

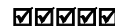
At bottom left, annualized returns for the Dow Industrials over all 20-year periods remains quite high despite the two drubbings of 2000-2002 and 2008-2009. Nevertheless, the average annualized return is still only 5.1% and there is clearly a reasonable expectation that 20-year returns will eventually decline to a mere 5%, a level they have achieved more than half the time. What would it take for a return trip to 20-year returns at 5%? For instance, a Dow closing at Friday's close in mid-July 2013. Are we being too bear-

ish? Okay, let's try Dow 10,000 and 20-year returns at 6%. That would occur just before the end of 2011. There is still plenty of time for the bear to wreak a bit more unhappiness.

Threatened Again

The ugly specter of more bank failures seems to be looming larger in recent weeks. As shown by portal-seven.com's chart (<http://tinyurl.com/kpt5zq>), the pace of failures accelerated into the summer and include Colonial Bank's mammoth \$25 billion rupture. The number of failures has reached 84 for this year, 39 in July and August alone. Worse yet, there is growing evidence that the FDIC has their hands full. The fund had \$13 billion on March 31, and the 56 bank collapses since March 31 cost an estimated \$16 billion. Whoops.

However, the worst news we have seen lately is the possibility that China is considering defaulting on derivative contracts with six major banks (see <http://tinyurl.com/nh4qe7> and <http://tinyurl.com/kjasvf>). We believe these developments have the potential to be major news events. Bear in mind that the unwinding of derivatives trades was the catalyst for the collapse of Bear Stearns and Lehman Bros. and resulted in the huge stock decline into March 2009. We strongly suggest you re-read our June 1st issue on derivatives, available at <http://www.cross-currents.net/q060109b.pdf>. The genie is out of the bottle. There are no wishes left to grant.



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- Rationales & Targets -

The enormous momentum generated by the six month rally is the only factor that longs have going for them. Since the trend towards high frequency trading means players need only make pennies to profit, valuations are not the slightest concern. What counts is where the price will be in an hour, or worse yet, only a minute from now. Last Monday's articles about the possibility of Chinese defaults on certain derivative contracts (see page four) were clearly the reason for the dumping of financial issues and the catalyst for the overall market rout last Tuesday. **Finally, a reaction to bad news.** That development alone suggests the gestalt is ready to shift to a more realistic view that a price correction is inevitable. Given the continuing momentum, the odds for a full retest in the fall have actually declined and a more benign correction is now expected. We have altered our "downside risk" parameters accordingly. Dow 7800-8100 represents a zone containing the first pullback low in April and the low of the last correction in July. However, despite our higher downside target, the odds for longs remain dreadful. **We should turn down again by late this week.**

The Regional Bank HOLDRs (RKH) consists of some mighty big names and is threatening to flunk after the early August breakout. The MACD indicator has turned negative and RKH seems unable to keep consistently above the support line (old resistance = new support). There should be good support down around \$61, which would fit together well with our forecast of a correction for stocks.

The Internet HOLDRs Trust (HHH) is also having problems with the old resistance = new support proposition and the pattern of declining highs does not auger well. A breakdown here would be serious stuff. Caveat: this is a lightly traded issue averaging less than 20,000 shares daily.



Pictures Of A Stock Market Mania
<http://www.cross-currents.net/charts.htm>

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The Psychology of the Market

Inv. Intell.: 3 Wk. Bull/Bear Ratio 2.2 Highly Optimistic
 AAI: 3 Week Bull/Bear Ratio: 0.8 Pessimistic
 Mutual Funds: 4.2% cash: Highly Optimistic
Crosscurrents Emotion-Based Indicators:
OPTIMISM HAS LIKELY PEAKED

Intermediate Term Forecast

REWARD/RISK RATIO
IS EXTREMELY NEGATIVE
UPSIDE POTENTIAL = LESS THAN 2%
DOWNSIDE RISK = 14% TO 18%
THE AUGUST 28th PEAK SHOULD HOLD

Crosscurrents '04 Investment Stance
 AVG. GAIN FOR ALL POSITIONS +17.0% Vs. DJIA +1.9%
Crosscurrents '05 Investment Stance
 AVG. GAIN FOR ALL POSITIONS +32.0% Vs. DJIA -0.6%
Crosscurrents '06 Investment Stance
 AVG. GAIN FOR ALL NEW IDEAS +29.2% Vs. DJIA +16.3%
Crosscurrents '07 Investment Stance
 AVG. GAIN FOR ALL NEW IDEAS +53.5% Vs. DJIA +6.4%
Crosscurrents '08 Investment Stance
 AVG. LOSS FOR ALL POSITIONS -14.3% Vs. DJIA -33.8%

Crosscurrents '09 Investment Stance

RETAINED FROM PREVIOUS YEAR OR EARLIER
 Newmont Mining (NEM) 15% LONG +12.2%
 Vimpel-Communications (VIP) 5% LONG +74.3%
 China Medical Tech. (CMED) 5% LONG -39.3%
 Paraxel Int'l. (PRXL) 5% LONG +12.0%
AVERAGE GAIN +14.2%
Vs. DJIA +7.6% SPX +12.5% Nasdaq +28.0%
 "Retained" ideas priced from inception
 Percentage gains (losses) include dividends

POSSIBLE ADDITIONS FOR 2009

Pfizer Inc. (PFE) 4.0% dividend yield
 Altria Group (MO) 7.5% dividend yield
 AT&T Inc. (T) 6.5% dividend yield
 ShengtaTech Inc. (SDTH) 13 P/E - China/Speculative
 Potash Corp. of Saskatchewan, Inc. (POT) 11 P/E
 Express Scripts Inc. (ESRX) - 16 forward P/E
 Suntech Power Holdings Co., Ltd. (STP) - China
 TransMontaigne Partners LP (TLP) - 8.8% yield
NO POSITIONS TAKEN YET

Crosscurrents '09 Trading Stance

Express Scripts (ESRX) 5% LONG +6.5% CLOSED
 Paraxel Int'l. (PRXL) 5% LONG +1.5% CLOSED
 Powershares QQQ Trust (QQQQ) 10% SHORT -19.1%