Alan M. Newman's Stock Market

CROSSCURRENTS

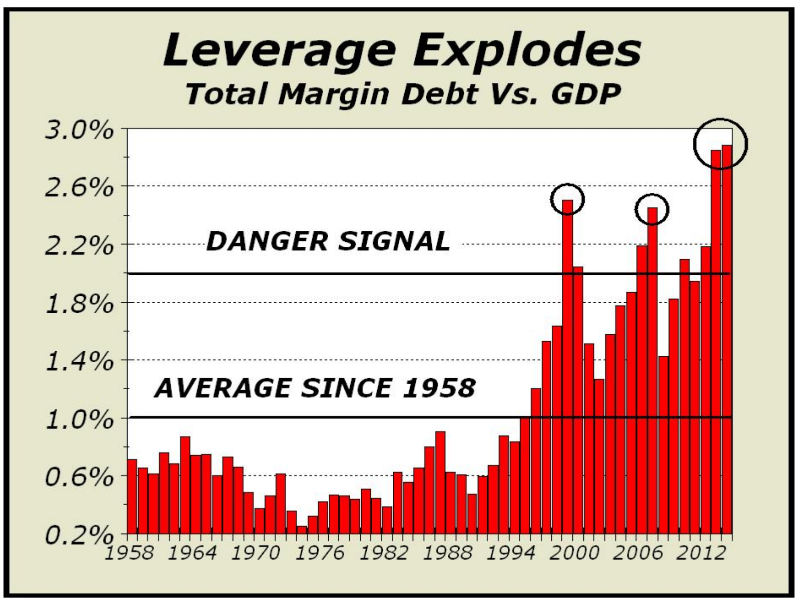
U.S. STOCK MARKET OUTLOOK for SEPTEMBER 29, 2014

DJIA 17,113 - SPX 1982 - NASDAQ 4512 - GOLD BULLION 1218

ONE-SIXTH OF THE TOTAL INCREASE IN MARKET CAPITALIZATION SINCE 2009 BOTTOM IS DUE TO COMPANIES BUYING THEIR OWN SHARES. INFLATION ADJUSTED CAP IS STILL SHY OF DECEMBER 1999 PEAK. **- NEXT ISSUE - OCTOBER 30, 2014 -**

The Most Bizarre Stock Market In History.

We're not about to change our editorial mind. The prospects for U.S. stock prices are extremely poor. Frankly, the consensus that stocks are headed higher, perhaps much higher in the next five years, scares us half to death. Strategists are pinning their forecasts on the dependability of earnings growth and a continued pick up in GDP. However, companies can create the illusion of growing just by buying their own shares, which has been the case for much of the last few years. Worse yet, share repurchases are now taking place at vastly inflated prices. Since the bottom in March 2009, companies have spent roughly $2.3 *trillion* to repurchase their own shares, one-sixth of the entire increase in total market capitalization. While we can argue the $340 billion of buybacks in 2010 might have been an excellent value, the same sum spent thus far this year is totally bonkers. Buying shares does absolutely nothing for growing a corporation's business and creating new jobs. It does, however, increase earnings per share. Therein lies the rub. Increased earnings typically lead to higher stock prices. More interest is generated and multiples expand. The cycle perpetuates and the happiest of all are the corporate executives who are able to dispose of stock via options granted at far lower prices. And despite the revelation of robust second quarter growth of GDP, too much else, like the growing ranks of part timers and dropouts from the labor force suggests far weaker growth, if any, is on the horizon. *So much of what we see is just an illusion.*



At the same time, strategists totally ignore the fundamental significance of valuation extremes and record leverage. Strange, since the exact same circumstances prevailed at the peak in March 2000 and again in October of 2007. Is it truly different this time? The primary difference is a compliant Fed, completely dedicated to the theory that inflated asset values will create jobs and wealth. The evidence is just not there. The lowest labor participation rate in 36 years says precisely the opposite. As well, the wealth created has gone almost exclusively to the wealthiest ten percent. *The net worth of most Americans has actually decreased over the last decade.* Something is very wrong with this picture.

How can such a dichotomy exist? Simple. The government's statistics are rigged. Not only for the employment picture, but regarding inflation and employment. We've mentioned John William's Shadow Government Statistics website many times before (see www.shadowstats.com). Mr. William's alternate GDP chart "*reflects the inflation-adjusted, or real, year-to-year GDP change, ad-*

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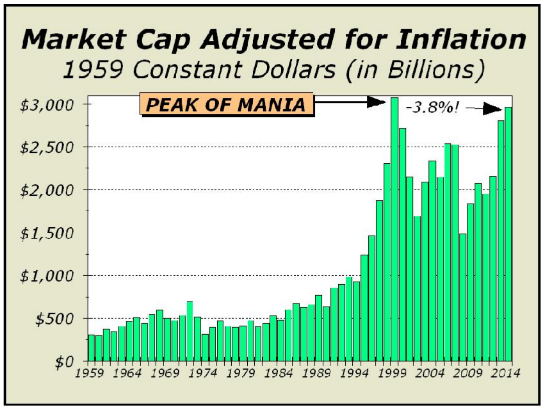
justed for distortions in government inflation usage and methodological changes that have resulted in a built-in upside bias to official reporting." The alternative GDP chart is frightening, illustrating negative growth for almost the entire period since the tech mania peaked in 2000 and currently running at close to minus 2%. We are not inclined to treat either interpretation as gospel but infer from our own observations that the economy and job growth remain slack.

If we are looking for patently obvious statistics, all we need to do is look at pictures like today's featured chart, solid proof of the most leveraged stock market since 1929, leveraged far higher than in 2000 or in 2007. And if that chart doesn't convince you, a gander at the picture at bottom left should suffice. *Liquidity has never before been this negative.* Since the Fed's actions have been expressly designed to raise stock prices, this expansion in leverage was a guaranteed side effect. Nevertheless, excessive leverage equates to excessive risk and when leveraged markets turn, they do so with a vengeance as overexposed participants rush for the exits. After the manic peak in 2000, margin debt fell 55%. From peak to bottom in the 2007-2009 bear market, margin debt fell 52%. If we infer an eventual repeat scenario, the draw down in leverage alone would equate to at least $250 billion scurrying for the sidelines. That amount is more than the entirety of net outflows from mutual funds during the previous bear market.

At center, market capitalization adjusted for inflation remains 3.8% shy of the 1999 year end peak. This is where you truly begin to understand that it's not just about creating wealth, it's about regaining all the wealth that was lost as a result of two burst bubbles. The tech mania bust is where the consumer began to go downhill. The loss of $6 trillion in stock wealth brought economic growth down sharply. The loss of $9 trillion after the following bust, coupled with another $6 trillion lost in housing values, has soured consumers considerably. Despite so many record highs in the major indexes, a recent Gallup poll found 76% of



those polled are not satisfied with how things are going (see http://bit.ly/1m8NKvv). The chart is quite revealing. Again, we can see things were just fine when the tech mania peaked and began heading south soon after. A dissatisfied population is simply not going to spend as much as a satisfied population. Record index highs have been very good to the wealthiest 10% but have not been all that kind to those in the bottom 80%, who are overwhelmed by debt. Zero Hedge covered this angle quite nicely two weeks ago (see http://bit.ly/ZpXPtA). The first of the two charts appears to be a disaster in the making.

Yet trading in stocks continues as if nirvana is close at hand. At the present pace, total dollar trading volume will come in at its second highest total ever, less than 2% below the 2011 record of $65 trillion. Despite the best intentions of the Federal Reserve, the U.S. stock market is no longer the asset building vehicle it wishes Americans would utilize. The two previous burst bubbles were enough to send the flock to the sidelines and those events will keep them there until another generation can be easily fooled. The stock market is now mostly mechanical trading and whatever comes in over the transom is flung haphazardly into the S&P 500 index via index funds. Active management gladly takes a backseat nowadays, since responsibility no longer requires actually analyzing stuff. Press a button, buy the index. Valuations do not matter anymore. *It's the most bizarre stock market in history.* How else could margin debt soar to all time record highs? How else could you see high frequency trading (HFT) account for more than half of all trading? How else could you see an average of just one S&P exchange traded fund (SPY) trade $6 trillion in only one year, more than one-quarter the value of the entire U.S. market?

We maintain the position that stock prices cannot be relied upon; given the extreme short term horizon for participants (see chart at bottom right), they can no longer represent fair value. Stocks fail as an investment vehicle because the long term is of no consequence. Trades are not entered because a company has a great new product or exited because sales are expected to slow. The criteria by which stocks *should* be evaluated just do not matter anymore. Thus, any price is acceptable...until like March 2000 or October 2007, *it is not.* ☑☑☑☑☑

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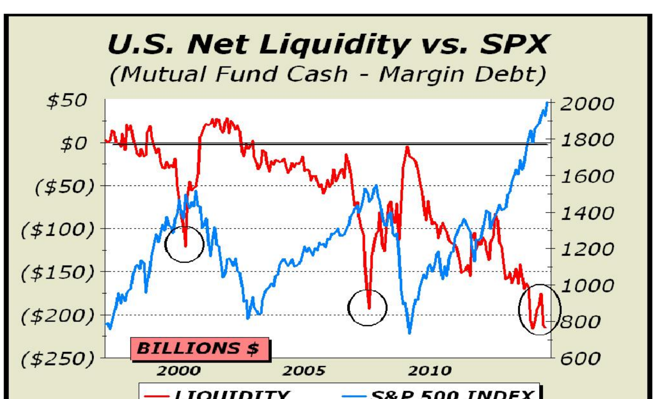

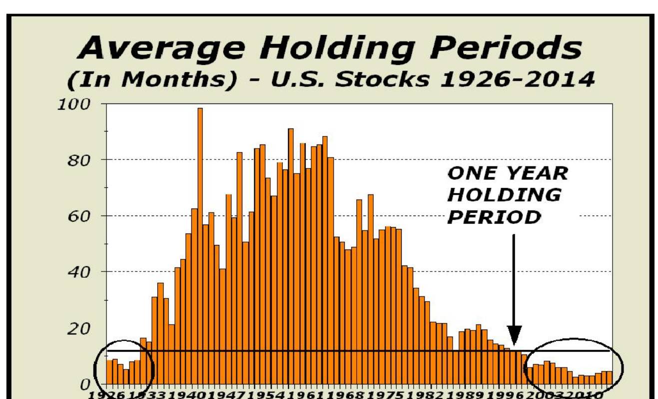

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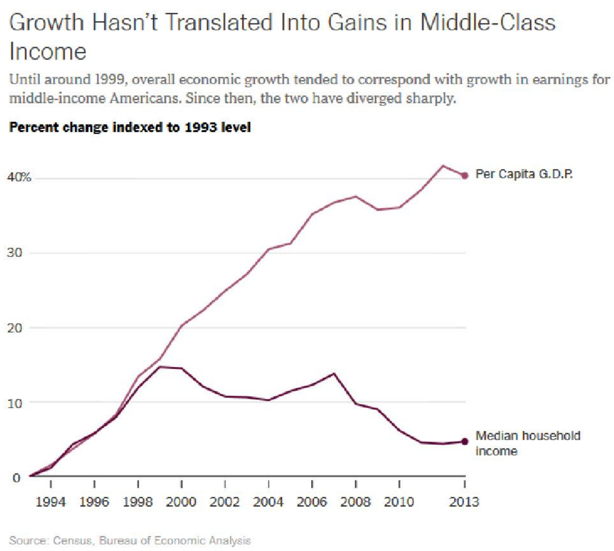
Gold Still Precious

Gold has been down for so long, sentiment has turned completely negative and a bear market has been proclaimed. The venerable Warren Buffet believes gold is a "stupid" investment. Sentiment is so rotten that short term timers are telling clients to go short on half their holdings. That's pretty drastic. And of course, we clearly see bullion off close to 36% from the August 2011 highs. However, we also see the precious metal up 234% from the August 2001 lows, just days before the 911 terror event that changed the world. Which is more important, the 13 year advance or the last three years of declining prices? Is gold's super bull market over?

No. In our view, it has a very long way to go. Even the super bull market for stocks from August 1982 to March 2000 had its share of corrections, which notably included a veritable stock market crash that lopped off 36% in less than two months and close to 23% in one day. The thesis of a super bull market for gold has not changed. The fiat world of currency backed by nothing but promises is now endangered (see http://on.ft.com/1u1UD35).

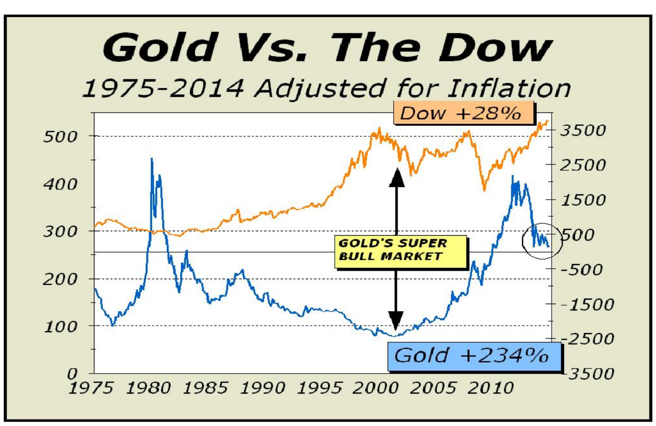
Paper assets have done remarkably well, so much so that governments have decided we can't have too much money. Just print more and by definition, we will all be wealthier. However, the last few years have damaged the theory that we can fix everything by printing money, borrowing more money and then printing even more to cover the cost of borrowing. We are likely the most heavily leveraged society in history, from the half-trillion dollars of margin debt to the more than $17 trillion in national debt to the $237 trillion in notional values of derivatives products which we can only pray do not rupture as they did in 1998 and 2008. ***[Ed note: While derivative contracts do not directly equate to leverage, they nevertheless enable leverage.]***

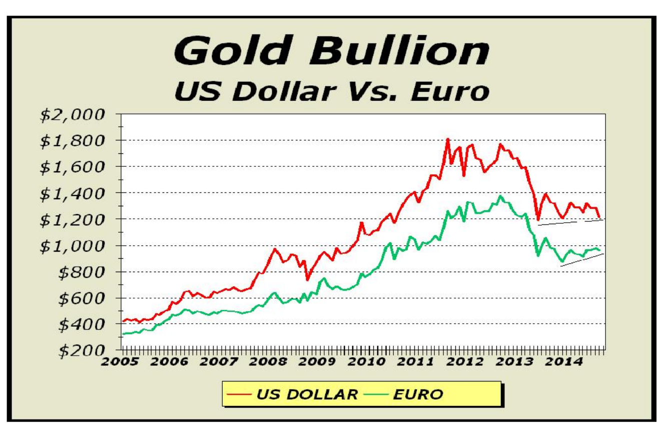


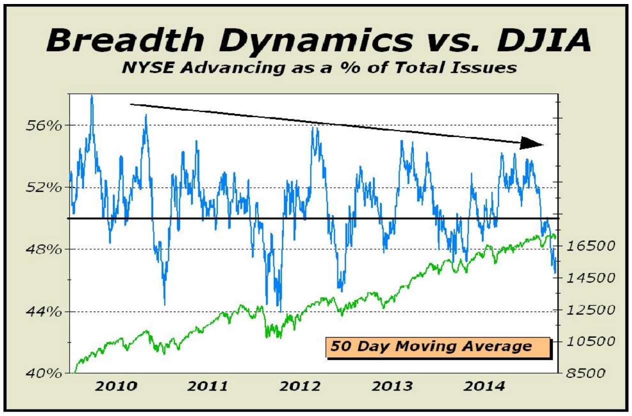
Despite recent record new highs in the Dow Industrials and the S&P 500, all is *not* well. The chart at center clearly illustrates the huge divergence between money and wealth and it begins quite coincidentally, with the tech mania peak, the point at which we believe paper assets peaked. Neil Irwin explained this chart very well in his recent NY Times article, "You Can't Feed a Family With GDP" (see http://nyti.ms/1uEvNWS) The "*The 2013 median income remained a whopping 8 percent...below where it was in 2007....And 2007 household incomes were actually below the 1999 peak.*" Despite far more money in play, money buys less, one of the principal reasons we look to gold as a constant, a storehouse of value that admittedly changes value at a rate that is not always comforting.

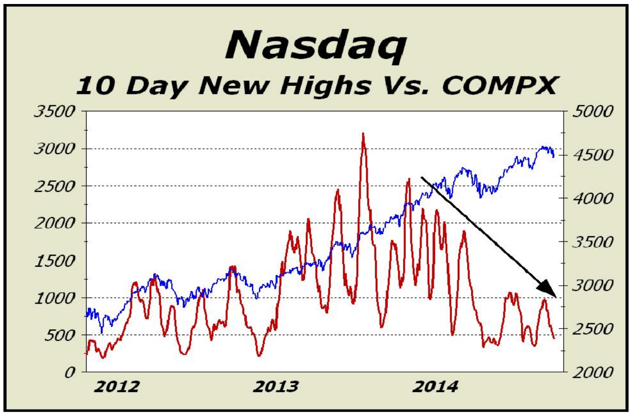
However, there are more ways to look at bullion's performance than Friday's close down to $1218 per ounce, the lowest seen since November 2013. As we show in both our charts below, gold appears to only be consolidating the sell off from the August 2011 peak of $1921 per ounce. Bullion actually traded down as low as $1192 per ounce in June 2013. Then again, why should we just be focusing on the price of bullion in U.S. dollars? What about other currencies? Looking at gold's performance in terms of the Euro, we see a better picture (see chart at bottom right). Why the Euro? The U.S. and the Eurozone compare favorably, nearly the same GDP and the same population. While gold priced in dollars is again nearing support, gold priced in Euros has actually found support above the previous low. We believe the picture for gold is nowhere near as dire as the fans of paper assets would have you believe.

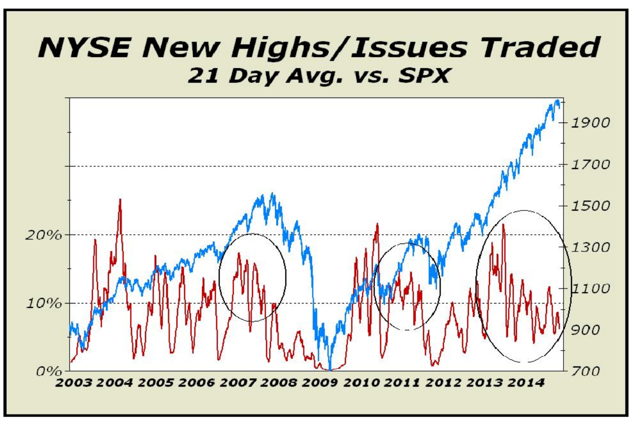
We are very much still in the super bull market camp for gold bullion and especially gold mining stocks. The prospects for fiat money are not encouraging. We expect the Dow/Gold ratio to eventually reach 5:1, which favors gold in any iteration of the two. *The shares of many gold mining companies are now extremely attractive*. We cannot guarantee an immediate turn around but believe the odds favor a rally in bullion. We would continue to accumulate the shares of those companies we have featured in our Investment Stance. *It is not so much an investment as it is insurance.* ☑☑☑☑☑











It's not only new highs versus new lows, as we showed in a special email to subscribers last Saturday, it's breadth. Breadth stinks. When the Dow and S&P 500 hit their peaks six trading sessions ago, our indicator was at 48.1%. Even at all time record highs, less than half of all NYSE issues were advancing over the previous 50 days. Most of the prior price peaks were accompanied by similar situations with breadth under performing. We see the same circumstance as very high odds. Considering the action last week with three awful days and increased volatility, we believe the long awaited corrective phase has commenced.

Whether we look at Nasdaq or the NYSE, new highs are awful as well. You can't have new price highs unless the constituents are also making new highs, and we see less stocks participating as time passes. This is a really dreadful sign of a market way past its prime and about to turn seriously south. All the sentiment indicators we follow are at ridiculous extremes and our Emotional Intensity indicator issued a sell signal last Monday. The increase in volatility strongly suggests this time the downside is for real. *This is a huge change in character.*

The Scariest Story Of The Year?

Potentially the most important and scariest story of the year is $2 trillion in public pension shortfalls recently estimated by Moody's (see http://www.cnbc.com/id/102036184#). Since this comes on the heels of a five-and-a-half year surge in stock prices, now almost triple what they were at the March 2009 lows, one wonders how these pension funds can ever pay what they owe to current and future retirees. *The shortfall has tripled in less than a decade*. The unfunded liabilities of the 25 biggest public retirement systems cover 40% of the total of $5.3 trillion in public pension plan assets. *This is horrible news*.

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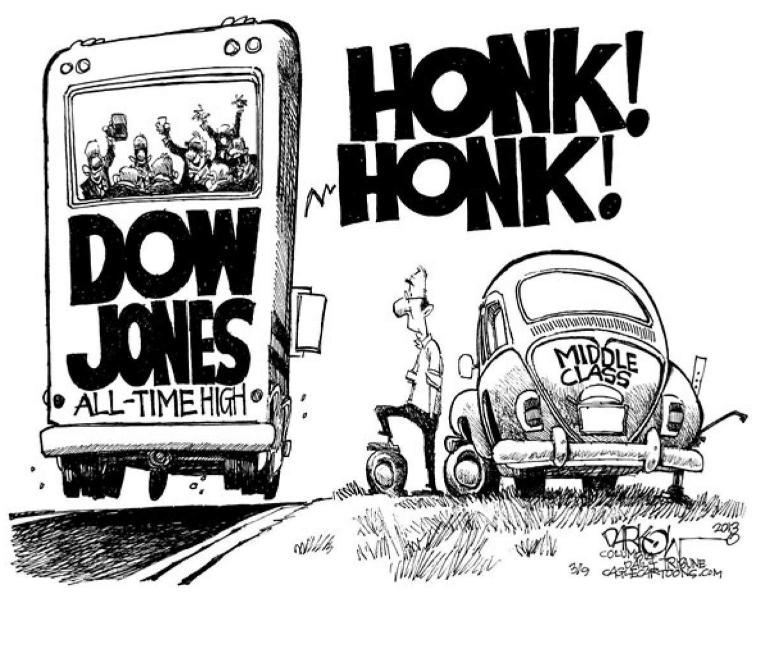


- Rationales & Targets -

We sent out a special email to subscribers on Saturday, September 20th, featuring "The Worst Chart of the Year," a chart we admitted might be the worst we had ever seen. We ended with the conclusion that *"….stocks are extremely vulnerable at this juncture."* Over the following five days, the Dow has had daily changes of –107, -116, +154, -264 and +191 points. Volatility has returned. Rising markets abhor volatility. We see this huge change in character as the first step leading to a far more significant decline in price.

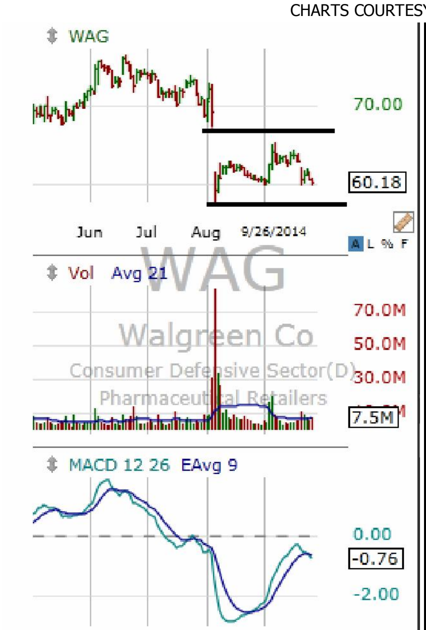
We cannot stress too strongly how lopsided sentiment measures are. For every dollar in Rydex bear funds, there are $16.90 in bull and sector funds. The mutual fund cash reserve ratio at 3.5% is far too small to offer support for stocks. Investment advisor bears have been below the 20% level for 20 weeks. Almost no one believes the downside has a prayer or occurring.

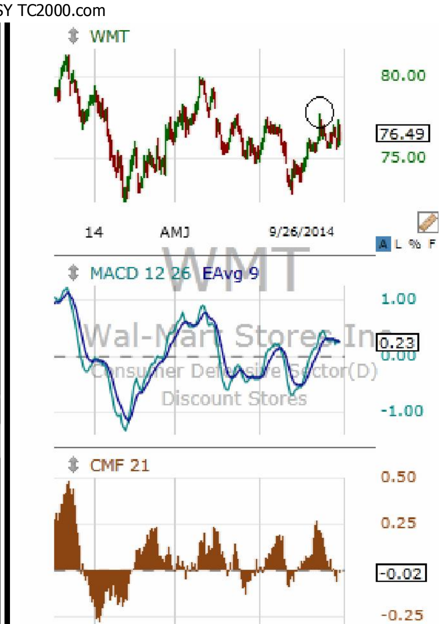
The divergences in new highs and breadth would appear to be the final nail in the bull's coffin. After averaging 414 new highs for the last 119 weeks back to August 2012, weekly new highs for the NYSE were only 88, versus 315 new lows. There are way too many changes in character to ignore and this clearly includes the Fed's money pump. We're still waiting for a break of support, which we have tabbed as Dow 16,587. Our correction and bear market targets remain viable conclusions.

Walgreen's (WAG) has suffered a huge breakdown, the kind of gap that generally distances supporters of the shares for quite some time. The lines in the sand are clearly drawn. The August 5th low of $66.50 is now strong resistance and the August 6th low of $57.75 is extremely important support. The up trend of the last two years has clearly broken and the shares should eventually head lower.

When a market and retail giant such as **Walmart (WMT)** starts to under perform, you know something is very wrong. After years of great growth, sales were up a scant 1.6% in the last fiscal year. Much of the retail sector indicates consumers are not biting and this remains the primary reason why we cannot be positive about the U.S. economy. Expect resistance at the circled September 5th high of $77.73.

CHARTS COURTESY TC2000.com





The Psychology of the Market

Invest. Intelligence: 10 wk. Bull/Bear Ratio 3.4 Extreme!
Rydex Assets: Bull & Sector/Bear Ratio: 16.9 Extreme!!!
Mutual Funds: 3.5% cash: Excessive Optimism

Crosscurrents Emotion Based Indicators:

Sell Signal Issued Last Monday

Short to Intermediate Term

LAST WEEK'S EXPANSION IN VOLATILTY WAS A HUGE CHANGE IN CHARACTER. WE EXPECT MORE OF THE SAME. ANY RALLIES SHOULD LAST NO MORE THAN TWO DAYS.

Current Support & Target Levels

INITIAL SUPPORT DOW 16,587 (-3.0%)
IMPORTANT SUPPORT DOW 16,333 (-4.5%)
CORRECTION TARGET DOW 14,719 (-14.0%)
BEAR MARKET TARGET DOW 12,471 (-27.1%)

OUTLOOK FOR 2014 REMAINS POOR
VOLATILTY EXPANSION UNDERWAY

Spotlighted in recent issues:

As expected, NFLX found support just below $450. *We hate the shares.* We expect BAC to soon run out of steam. AAPL still looks weaker. We were right on the downside for UTX and are now neutral. We are still negative on HSBC and BBY, which ran to resistance and promptly folded. Although we're not interested in the long side, we do look. It's getting almost impossible to find any good charts.

Crosscurrents '14 Investment Stance

Newmont Mining (NEM) 15% LONG
Global X Gold Explorers ETF (GLDX) 5% LONG
Eldorado Gold (Ego) 5% LONG
PetroBras (PBR) 5% LONG
Goldcorp (GG) 5% LONG
35% LONG (30% GOLD)

Powershares QQQ Trust (QQQ) 10% SHORT
We intend to close out the QQQ hedge as soon as practical.

Pictures of a Stock Market Mania

http://www.cross-currents.net/charts.htm