Alan M. Newman's Stock Market

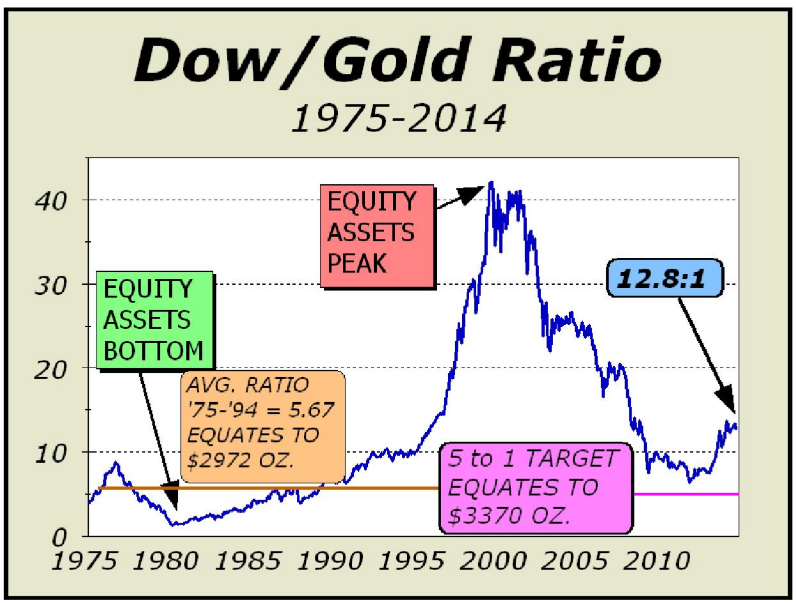
# CROSSCURRENTS

U.S. STOCK MARKET OUTLOOK for JUNE 29, 2014
DJIA 16,851 - SPX 1960 - NASDAQ 4397 - GOLD BULLION 1316

**THE JUNE 19TH SURGE IN GOLD BULLION WAS THE EQUIVALENT OF A 500 POINT MOVE IN THE DOW INDUSTRIALS. CONTINUED WEAKNESS IN SEVERAL OF THE TOP TEN BANKS SUGGESTS SOMETHING IS AMISS.** ***- NEXT ISSUE - JULY 30, 2014 -***

## Our 5:1 Ratio Forecast Is A Conservative Target.

A little history is in order. From 1975 through 1994, a time in which the Dow Industrials had already busted out of a 16 year long secular bear market, the Dow/Gold ratio remained in a range bounded by roughly 10-1 on the high side. In 1995, the ratio began to rise sharply. In retrospect, this rapid rise from a boundary that had existed for a generation was a signal that stocks were entering a mania phase. By the end of 1995, the ratio was 13.2. By the end of 1996, it was 17.5. Then 27.4 at the end of 1997 and 31.3 at the end of 1998 and finally, the ratio hit 42.2 in August of 1999, only six months before the mania finally concluded with Nasdaq crashing 35% in only six weeks. The phenomenal rise in the ratio had clearly indicated a stock market mania in progress but no one seemed to care until Nasdaq finally cracked the 5000 mark and the price of the growth index stretched north of an impossible 250 times earnings. Of course, it all came apart and in less than two years, Nasdaq was down nearly 80%. Despite this precipitous slide, paper assets in the form of stocks remained the obvious choice and the ratio remained above the pre-mania boundary of 10:1. However, the ratio continued to fall as stocks reached another major mania peak in 2007 and continued to fall right into the recession and another bear market bottom in 2009. The subsequent low for the Dow/Gold




ratio was 7.5 in February 2009, one month before the Dow low of 6469.

The ratio remained below 10:1 from January 2009 to February 2013. During that time, the Dow more than doubled to just over 14,000 but gold had been quite competitive, rallying another 68% on top of the previous 277% super bull move. As the ratio once again moved beyond 10:1 to as high as 13.76 in November 2013 (and currently at 12.81), we believe the high ratios are again evidence of a stock market mania. However, this is not a mania in the traditional sense but rather a conceptualized contrivance of the Federal Reserve in their quest to achieve a "wealth effect" to ensure a robust economic recovery for years to come. Ironically, although 401K and pension plans have recovered the losses of the two prior collapses from manic highs, as our chart at bottom left page two clearly illustrates, the gains are nothing to write home about. The 26% total gain referred to for stocks is from 911, the date at which we believe the super bull market commenced for gold. From the prior tech mania peak, the gains are 18.5% or only 1.2% annualized. Bear in mind we are using the CPI as announced by the government. However. if you believe as we do, that inflation is drastically understated, investors are actually still in the loss column, not only from 911

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but they remain under water from the tech mania peak over 14 years ago.

If the first quarter report of minus 2.9% GDP is any indication, this contrived mania has clearly not helped most people but has certainly profited those firms who utilize mechanical trading immensely. What other take away can there possibly be when so many HFT firms can announce a quarter in which they suffered a daily loss of perhaps only one day? To be sure, this is an unusual mania—there isn't even the illusion that the little guy is doing well and that is the reason why the manufactured boom in stock prices has fallen far shy of the desired "wealth effect." We can only repeat the obvious; if the "wealth effect" was a legitimate objective, we would not still have 46.1 million people (one of every seven people) receiving food stamps in this country. Nor would the labor participation rate be near its lowest point in 36 years. Nor would four-fifths of the long term unemployed still be under so much pressure (see page 4). The Fed's thesis has been faulty from the get go. If second quarter GDP comes in below 2%, we believe the Fed will have no choice but to *accelerate* the process of printing money. In the long run, this will sharply increase the odds of a period of high inflation, exactly the kind of environment that will favor gold bullion and gold stocks.

In our view, the long move down in bullion since the August 2011 price high of $1920 per ounce and the subsequent consolidation phase finally concluded with the Thursday, June 19th breakout that witnessed a huge 3% surge, *a move equivalent to a 500 point one day gain in the Dow Jones Industrials*. If we are correct in our analysis of a super bull market in progress, *prices have a very long way to go*. At Friday's close, the Dow/Gold Ratio was 12.81 to 1, after peaking at 13.76 to 1 in December. The sideways consolidation in recent months was a constructive sign, precisely the kind we would expect within the framework of a super bull market. But is our 5:1 target for the Dow/Gold ratio a reasonable expectation? The ratio remained below 5:1 from January 1978 through January 1986 and flirted below 5:1 through September 1988, so history clearly supports a much lower ratio. As our featured front page chart shows, a 5:1 ratio implies potential for bullion to $3370 per ounce if the Dow remains exactly where it closed on Friday. If we are too optimistic on gold's prospects, then we would expect at least the 5.67:1 ratio target, representing the average for the 20 years from 1975 through 1994. That would still take bullion to $2972 per ounce. Of course, higher or lower prices for the Dow would have similar effects for bullion. If a lengthy phase of high inflation lies ahead and the Dow rises modestly, gold will trade higher. If we assume 6% inflation per year for five years and the Dow gaining only 3% per annum, a 5:1 ratio would have gold approaching $4000 per ounce. Finally, we should stress that the Dow/Gold ratio was as low as 1.3:1 in 1980, *thus our forecast of a return to a Dow/Gold ratio of 5:1 is likely a <u>conservative</u> view*.

Could there be even higher targets for gold bullion than those mentioned above? At right below, over a century, the average annualized return for the Dow over all 20-year periods is roughly 5%. It was only 4% from 1917 to 1995 but then the super bull market for stocks happened and drove average returns far higher. However, we have always believed the concept of regression to the long term mean is too powerful to ignore. At some point, annualized 20-year returns will decline once again to 5%. They declined as low as 5.57% at the March 2009 bottom and another trip to 5% need not be accompanied by much lower stock prices. *All we need is time*. If a return to the 5% level is achieved in exactly five years, the Dow will be at 28,017, 66.2% higher than today. While that might seems fantastic for stock fanatics, consider that our Dow/Gold ratio targets would then see bullion somewhere between $4941 and $5603 per ounce, 275% to 326% higher. *However we might extrapolate future prices, a <u>lower</u> Dow/Gold ratio favors gold by a wide margin and implies vastly higher prices for gold stocks*.

A resumption of the super bull market for gold will mean enormous profits for miners, especially those with proved reserves and low cost mines. Our two core positions of Newmont Mining (NEM) and Goldcorp (GG) have treated us well, as both have been traded in and out profitably several times in the past. In the case of Eldorado Gold (EGO), costs are roughly 25% lower than today's price of bullion which affords protection if gold happens to slump a bit further before resuming the bull run. Cash on hand exceeds long term debt, so the financial position is solid and even suggests room for acquisition of depressed assets. We have mentioned a few much smaller miners in past issues, such as Asanko Gold (AKG) and IAMGOLD (IAG) and reiterate they are still favored but would stress again their very speculative nature. *We do not expect instant gratification. The nature of this secular trend will likely take years to play out*.

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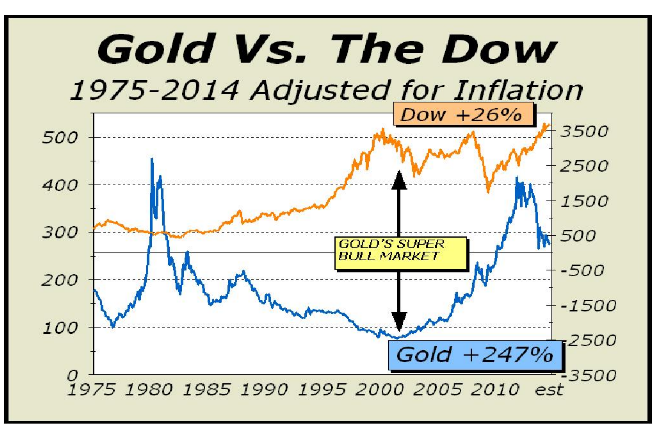


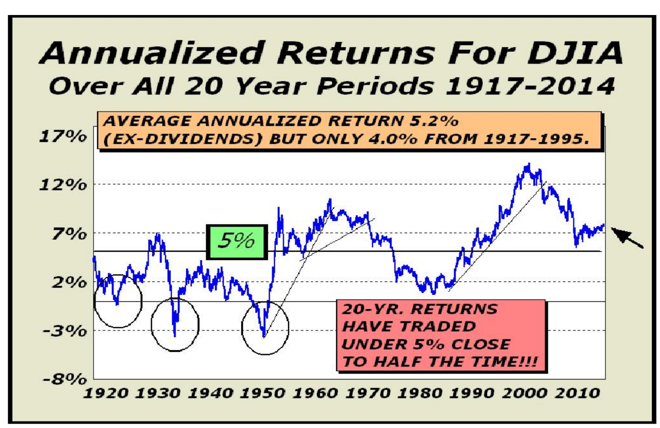

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## Something Is Amiss

We have seen wide and disparate estimates of the total expended on bailouts but let's go with the $29.6 trillion shown by Barry Ritholz on his Big Picture blog (see http://bit.ly/1yRuBBn). The most pertinent observation we can offer today is that the bailouts and five-and-a-quarter year long bull market have done little if anything for the consumers who drive two-thirds of the overall economy. It has instead been a boon for the financial industry and for the wealthiest in our nation. The governmental notion that there is a wealth effect clearly lacks evidence. It is with some measure of irony that after a gain of 10,000 Dow points in five years, we can report the Senate's Permanent Subcommittee on Investigations is holding a hearing on "*Conflicts of Interest, Investor Loss of Confidence, and High Speed Trading in U.S. Stock Markets*." It is also with some measure of irony that we report more wealthy Americans are giving up their citizenship than ever before to avoid taxes. What the Fed hath wrought seems to be diametrically opposed to the intent of their historic monetary accommodation. If this is what an economic recovery is about, we may very well be up the proverbial creek without a paddle.

Much of the largesse has been directed at the nation's financial industry and it is exceedingly troubling to see so many banks continue to trade far, far below their former highs. At center, our table shows notional values for the ten banks with the largest derivative portfolios, representing 99.4%, or $235.5 trillion of the $237 trillion total in notional values of derivatives for the banking industry (see second column—trillions of dollars). If those exposures were not sufficiently startling, consider that of the ten banks, there are only three daily charts that we would consider impressive from a technical perspective, WFC, PNC & BK. *These three banks have $6.5 trillion in notional values of derivatives, 2.7% of the entire total*. Of the other top ten banks, we see four neutral charts and we see three very negative charts, C, BAC and HSBC. *These three banks have $105.7 trillion in notional values of derivatives, 45% of the entire total*. In the two charts below, "OBV" stands for On Balance Volume, an indicator popularized by the late and great Joe Granville. Both HSBC and C display startling price weakness versus the major averages and OBV suggests the smart money has exited.

**Too Big To Fail = Too Big To Succeed**

| SYMBOL | DERIVS. | PREVIOUS MANIA PEAK | TODAY |
|---|---|---|---|
| JPM | $70.1 | 5/2007 | +7.8% |
| C | $62.3 | 1/2007 | -91.5% |
| GS | $48.6 | 11/2007 | -30.3% |
| BAC | $38.9 | 11/2006 | -71.9% |
| HSBC | $5.4 | 11/2007 | -48.4% |
| WFC | $4.9 | 9/2008 | +17.5% |
| MS | $2.6 | 6/2007 | -57.6% |
| BK | $1.2 | 12/2007 | -28.4% |
| STT | $1.1 | 1/2008 | -22.0% |
| PNC | $0.4 | 9/2008 | +0.7% |

Consider how prices differ for the top ten banks from their price peaks of the previous mania beginning in 2006 (see table last column). *Despite the bailouts and tremendous monetary accommodation, the average loss is still 32.4% for the group against a 25.3% gain for the S&P 500*. Note: JPM is actually down 13.2% from its all time high in 2000 and has the largest derivative portfolio of all.

The five largest derivatives players of the top ten banks control 93.8% of total notional values. They are up an average of 4.9% year to date and are up 16.5% since 2013 as the rising tide has lifted almost all boats. In comparison, the second five largest derivatives players control only 4.3% of all notional values but are doing much better, up 7.7% year to date and a resounding 48.9% since 2013 arrived. *These comparisons are simply too startling to ignore and imply the possibility of burgeoning systemic problems and/or lingering imbalances from the previous financial crisis*. Given the procession of financial crises in 1987, 1998 and 2007, we believe our worries are well placed. As well, given the Federal Reserve's policies since the financial crisis have benefited the banking industry to such a large extent, one is extremely hard pressed to excuse even the slightest bit of price weakness. The Fed routinely goes the extra mile and even advertises when their next bond buying binge will occur to allow the banks to position as profitably as possible. Why is the entire bank sector not surging to new highs every single day? There is no question the biggest banks were too big to fail in 2008 but they may have also been too big to succeed under an accommodation policy that still encourages risky exposures. *Clearly, something is amiss*.

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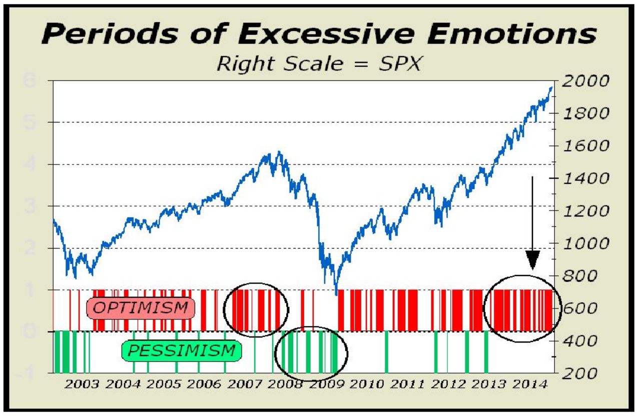


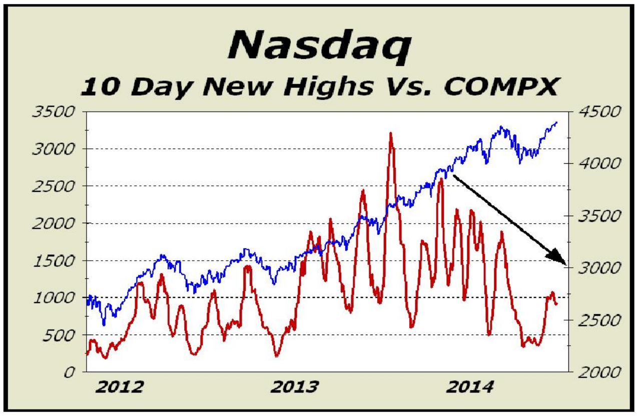


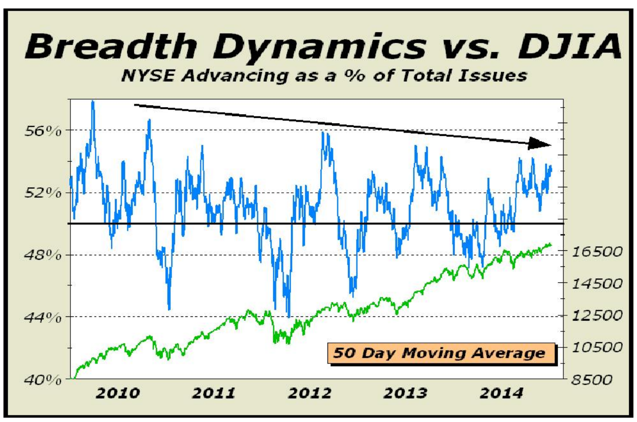


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Alan M. Newman, Editor



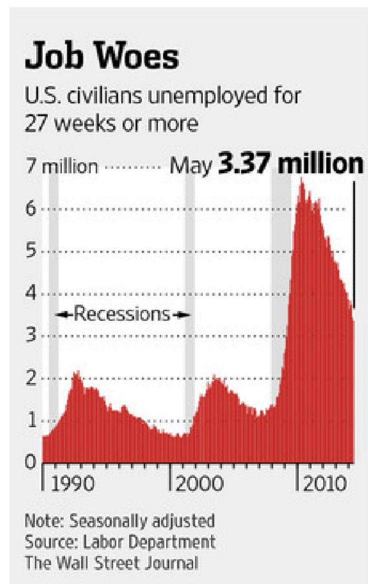
The most recent highlighted portion of our top left chart measures from January 21, 2013 when the latest leg of the mania got underway. Since then, our Emotional intensity indicator has displayed a level of extreme optimism on 59% of all sessions. Not one session has been accompanied by extreme pessimism. This is far removed from anything we have ever seen before. The previous highlighted area into the 2007 stock market peak was what we typically see into a major peak. The present situation is bizarre. In normal times, index puts lose value at a slightly higher pace than calls. However, over the time frame represented by the highlighted area, puts are losing value at almost triple the rate of calls. The Investor's Intelligence measure of investment advisor sentiment remains at euphoric levels. Bears have been under 20% for eight straight weeks, averaging 17.8% while bulls have averaged 59.1% and have been over 60% for all of the last four weeks.

Given Nasdaq's propensity for price improvement, the chart of 10-day new highs at center left is pathetic. This negative divergence has now endured for a year and clearly illustrates that the price run is accompanied by fewer stocks making new highs. Only the most overvalued remain in the fray.

It's not only new highs that are acting punk, breadth is showing signs of deterioration as well. Our chart at bottom left is a 50-day moving average of advancing issues on the NYSE as a percentage of total issues traded. The length of the moving average corresponds to the intermediate term and gives us a good picture of the market's internal dynamics. The divergence goes all the way back to the . initial rally off the 2009 lows.

## Good Times? Not Quite

The government and the media have done a great job trying to convince the public that the good times are here again and on the surface, you might just be persuaded. Four years Ago, 6.8 million were out of work for six months or more and now half that number are in a similar situation. Sounds great but the truth is that almost four of every five in that category four years ago and still underemployed and are either part timers or in temporary jobs. Since 2008, only one in five has returned to full time steady employment. As the chart below illustrates, a comparison with past recessions is unfavorable (see http://on.wsj.com/1lxIdgp). Long term unemployment will continue to put a collar on the potential for any economic expansion.



## - Rationales & Targets -

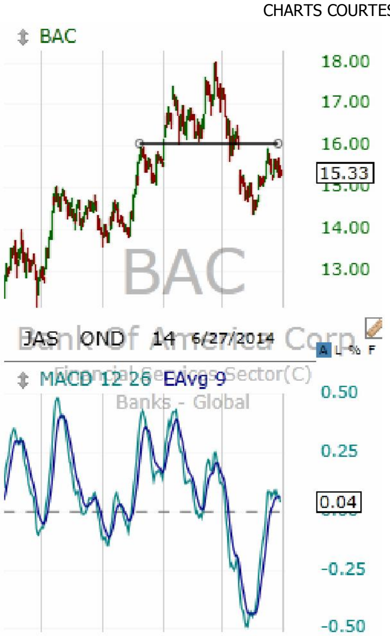
The NASD released margin debt stats for the month of May on Friday and we expect to cover our views on leverage again in the July issue. Total margin debt (NASD + NYSE) remained steady at $475 billion, 2.8% of GDP. There have been only nine years when margin debt exceeded 2% of GDP. It happened in 1929 and has now occurred in eight of the last 16 years. The Fed has taken desperate measures to ensure higher stock prices for their targeted "wealth effect." The accommodation of risk to the extent we see today equates to all cards played. There are no Aces left up the sleeve and risks are as high as they have ever been. While GDP is certain to improve in the second quarter now ending, any disappointment should prove quite unsettling and act as conclusive evidence the Fed's policy is failing. Ironically, it will only ensure continuing accommodation as far as the eye can see.

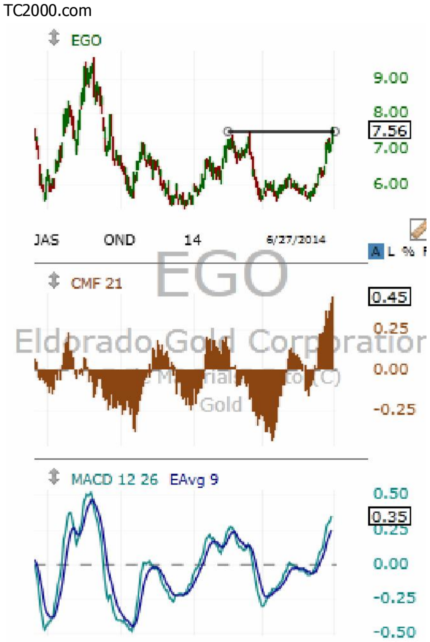
Virtually every sentiment measure we look at is troubling. Vis-a-vis our Rydex measure, we simply divide the amount of assets in bull and sector funds by the assets in bear funds. At week's end, the ratio was 17.6 to 1, a level we have never seen before. Despite any lip service you might see about the possibility of a correction or bear market, the bear camp is noticeably bereft of sponsors. If the Dow fades to below 16,700, the uptrend line in place from the February low will break and offer the few remaining bears evidence the long awaited reversal is at hand.

We had no room for **Bank of America's (BAC)** chart on page three but the article would be incomplete without this picture as well. Note how old resistance in December acted as new support for much of the Spring. The gap from the breakdown has now been filled and the failure at the new resistance line coupled with MACD turning negative suggests BAC is headed lower. *There is still room for a test of resistance at $16*.

**Eldorado Gold (EGO)** is one of the best gold miner charts at this point. Resistance established by the February and March peaks has now been broken as EGO closed above the line on Friday with decent volume. While there could easily be a pullback, we believe $6.91 should hold and a pullback would be a good time to add to holdings. If bullion makes a new high, EGO will be posed to attack its 2011 high of $21.46.

CHARTS COURTESY TC2000.com






### The Psychology of the Market

Invest. Intelligence: 10 wk. Bull/Bear Ratio 3.3 Extreme
*Rydex Assets: Bull & Sector/Bear Ratio: 17.6 Extreme!!!*
Mutual Funds: 3.7% cash: Excessive Optimism

***Crosscurrents Emotion Based Indicators:***
***Extreme Optimism***

### Short to Intermediate Term

***WE STILL CANNOT RULE OUT HIGHER PRICES ENTIRELY, BUT TECHNICAL MEASURES INDICATE EXCELLENT POTENTIAL FOR A MAJOR REVERSAL NOW. DOW BELOW 16,700 WOULD DAMAGE THE BULL CASE CONSIDERABLY.***

### Current Support & Target Levels

***IMPORTANT SUPPORT DOW 16,015 (-5.0%)***
***LINE IN THE SAND DOW 15,340 (-9.0%)***
***CORRECTION TARGET DOW 14,719 (-12.7%)***
***BEAR MARKET TARGET DOW 12,471 (-26.0%)***

***OUTLOOK FOR 2014 REMAINS UGLY***
***A STOCK MARKET CRASH IS STILL POSSIBLE***

### *Spotlighted in recent issues:*

As expected, both JPM and GS rallied but are still expected to fail over the longer term. GS is the stronger chart and should be respected for now. NFLX appears to be putting in a very significant double top and support is at least 70 points below. Despite our previous suggestion to close out shorts, we're still following AMTD and ETFC as new short candidates with great interest.

### 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.*

***New interview with Aegean Capital's Ike Iossif***

***http://marketviews.tv/paidservices/guests/other/audio/newman.asx***

***New interview with Financial Survival Network's Kerry Lutz***

***http://financialsurvivalnetwork.com/2014/06/alan-m-newman-out-of-stocks-and-into-precious-metals/***