

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

U.S. STOCK MARKET OUTLOOK for APRIL 26, 2010
DJIA 11,204 - SPX 1217 - NASDAQ 2530

THE DEAD ZONE IN THIS YEAR OF THE ELECTION CYCLE IS BY FAR THE WORST OF THE FOUR. DESPITE ROBUST BULLISH SENTIMENT, STOCKS ARE VERY OVERVALUED AND A HUGE CORRECTION IS STILL INDICATED. - NEXT ISSUE - MAY 17, 2010 -

⌘ The Dead Zone (Annual Reprise). ⌘

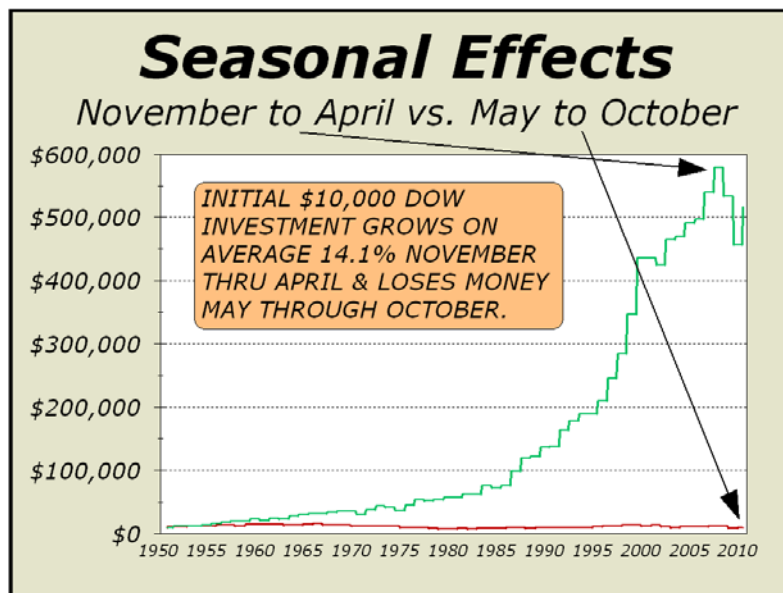
Soon after we commenced publishing Crosscurrents in 1990, we were impressed by a pattern previously discovered and analyzed by Norman Fosback, Yale Hirsch and Sy Harding. Simply put, the market's seasonal effects have been nothing short of phenomenal. For six decades, if you invested money only during the months from November through April, you made lots of money. If you instead invested money only during the months from May through October, you lost money. You heard that right. *Over a period measuring six decades, you would have lost money.*

The statistics represent far and away the most significant dichotomy ever seen in stock investing. If you invested \$10,000 in the Dow from November through April, you'd have almost \$517,000 now, an annualized rate of gain of 14.1%. The same \$10,000 invested solely from May through October would now be worth only \$9579. Both figures do not include dividends, but the point must nevertheless be clear. The long term is clearly not all it is cracked up to be since for half the year nothing tends

to occur. The effect is so disparate that we have nicknamed the market's unfavorable season the "Dead Zone."

Our featured chart illustrates the market's seasonal effects dating back to 1950. Note how the trend

has been on the receiving end of a barrage of criticism, based on speculation that it no longer works and claims that the "system" of investing for only six months of the year is irrational. Yet, the evidence continues to favor the opposite. The bulk of the criticism centers on activity in recent years. First, from 2003, the Dow gained in four of five Dead Zones; 15.6% in 2003, 2.8% in 2005, 6.5% in 2006 and then 7.5% in 2007, and losing only 1.9% in 2004. As well, in 2009, one of the most unusual years in stock market history, the Dow lost 12.5% in the market's good season and then gained 18.9% in the Dead Zone. However, bear in mind that the Dow has been cut in half two times in the last decade. To say the least, these were unusual times.



for the stock market's good season appears intact with only very brief interruptions while the trend for the market's dead zone is nearly a straight line across from left to right. Almost no activity. Flat lined, like a corpse.

In recent years, seasonality

The fact is, the Dead Zone also put together a great string of five up seasons from 1993 through 1997, averaging gains of 7.6%. Sounds terrific, right? Trouble is, if you had invested \$10,000 just before the first of those up seasons, you'd still have been down by 2003,

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down a lot by 2008 and now would only be ahead only \$484. For the entire 17 year stretch, you would have gained an average of 0.3% per year. *Still dead.* Simply put, the Dead Zone has worked its perverse black magic for six decades and there seems to be no reason the effect cannot continue.

Below left, the primary reason for this anomaly appears to be the historic pattern for mutual fund inflows, which are emphatically robust in January and April and then wane substantially as the summer heat grows in intensity. There has been ample speculation for the rationale behind the pattern as year end bonuses are paid in January, as IRA contributions are made in April and as vacations take precedence over investing during the summer. Whatever the reasons, the pattern has been repeated so often that it is impossible to chalk up to some mathematical quirk.

January's inflows of \$16.9 billion were the second largest since April 2007. Although inflows were flat in February, it appears inflows will be over \$9 billion in March and judging from the movement of stock indexes, will have increased again into April. Past the month of April, if the pattern repeats, inflows will again slow and provide no impetus for prices. For the last seven years, inflows during the market's Dead Zone have averaged a paltry \$2.6 billion per month. For comparison's sake, September has typically been the worst month for stocks. September's take historically has been inflows of just under \$2 billion.

Analyzing the Dead Zone even further afford another and likely very important factor that lends credence to a rough patch ahead; *where we stand in the election cycle.* If we break the Dead Zone down into four separate periods, one for each phase of the election cycle, the second year (where we are now) is by far, the very worst of the bunch. If you had invested \$10,000 just before the first episode in 1954 and kept your money in stocks only during the Dead

vious year's Dead Zone and last year's Dead Zone was a huge gainer. Despite the obvious notion that the stats imply it could go either way, we have already seen a very steady incline in price with very little corrective activity for well over a full year. Our forecast of an end to the secular bear market by October can only prove correct if stocks correct in a big way from this point. We see nothing in our analysis that argues against our previous forecast, thus we remain quite guarded on the market's prospects for the six months ahead. A 15% correction still appears to be indicated.

Versus Goldman

The news on Friday, April 16th about Goldman Sachs hardly came as a surprise to us. Over the past many months, you may have noticed our contempt for the financial industry in general and Goldman Sachs in particular. That Goldman can even be alleged to have committed the vampiric misconduct cited by the

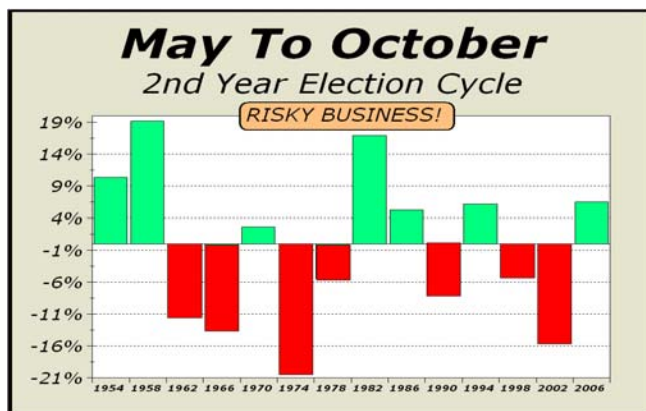
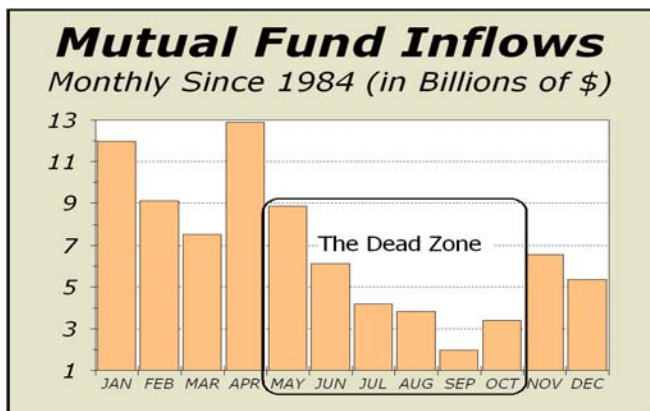
SEC (see tinyurl.com/y6wxrjq or better yet, see <http://www.sec.gov/news/press/2010/2010-59.htm>) is testament to the incredible abuses that greed has empowered and enabled, especially via the construction of derivative products, like the Abacus synthetic CDOs (collateralized debt obligations) that seemed to exist for only one purpose; to enrich John Paulson and his hedge fund. Paragraph 16 of the SEC complaint is

(Continued on page 3)



Zone during the second year of the Election Cycle, you'd have lost over 20% of your initial stake. That's right, you'd now have only \$7958 to show for your patience.

Thus, we see the next six months as very "risky business." Of the prior fourteen episodes, seven were up and seven were down. Upsides averaged 9.6% but downsides averaged 11.4%. Volatile, to say the least. Five of the seven rotten episodes occurred after gains in the pre-



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about as flagrant an indictment of the kind of unethical behavior (at the very least) that drove the country to the edge of the abyss; "16. Paulson discussed with GS&Co possible transactions in which counterparties to its short positions might be found. Among the transactions considered were synthetic CDOs whose performance was tied to Triple B-rated RMBS. Paulson discussed with GS&Co the creation of a CDO that would allow Paulson to participate in selecting a portfolio of reference obligations and then effectively short the RMBS portfolio it helped select by entering into CDS with GS&Co to buy protection on specific layers of the synthetic CDO's capital structure." Just one page later, in paragraph 18, it is disclosed that Goldman's Fabrice Tourre, who put together the deal, knew full well what the outcome would be, claiming in an email that *The whole building is about to collapse anytime now.*"

Logically, the SEC's claim of fraud is not likely to have been based on an isolated incident; we can fairly assume despicable episodes such as this may have occurred on many occasions, and been committed by other firms as well. In the past, the SEC has always bowed to pressure from the financial industry it is supposed to monitor in the interests of investors, and has never adequately meted out punishment sufficient to prevent recurrences, only the merest slaps of disdain, modest monetary penalties and warnings. Ironically, it probably no longer matters whether the SEC hangs Goldman Sachs by their collective corporate balls. Bit by bit, piece by piece, the public has paid too dear a price and it will take many years before any semblance of trust can ever again be placed in the financial industry. However, the SEC now has a chance to recover the trust of the people it serves. The mission statement of the SEC is quite clear; "...to

protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." We'll believe it when we see it in action. To date, with regard to their primary mission, the SEC has come up completely and utterly empty.

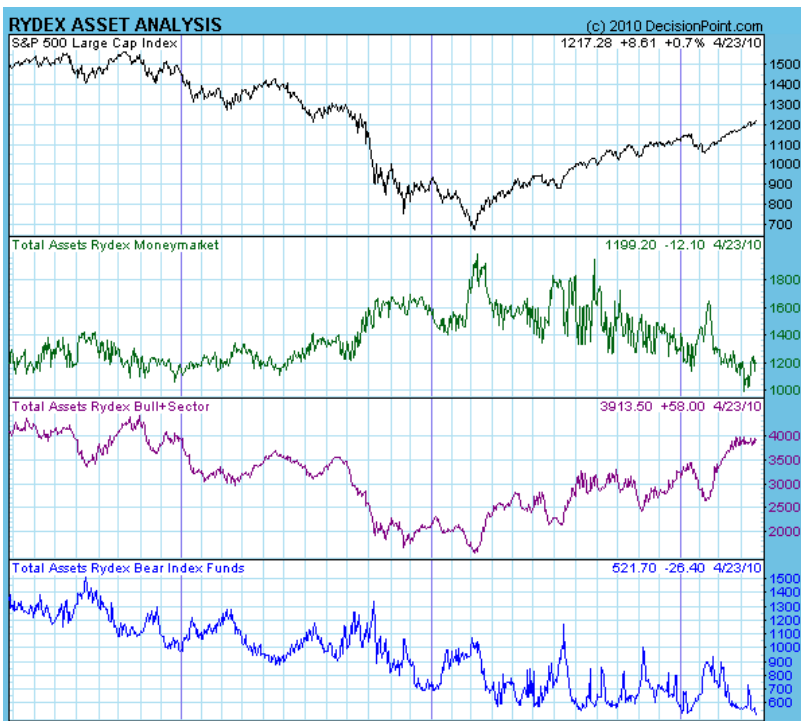
In the meantime, there are now indications that the financial industry is not only NOT getting its act together but that the repercussions from the SEC claims may be just the beginning. First, we have the claims (see tinyurl.com/y7fpf9f) that the

In recent days, there has been ample speculation John Paulson aide Paolo Pellegrini told the government that he informed ACA Management that Paulson intended to short the portfolio of mortgages ACA was assembling. Given the history of Goldman alumni to always fall in line with the company line, we should not be surprised. We can only wonder if ACA management stands ready to confirm this claim.

In the meantime, Goldman is already attempting to distance the company from Mr. Tourre, claiming the company would never willingly mislead investors. Less than five months ago (see the November 30, 2009 issue), we ridiculed Goldman Chairman Lloyd Blankfein's comment that the firm was doing "Gold's work." *Clearly, they are not.* We also claimed this sorry chapter in our history had not concluded, not by a long shot. We believe there is a lot more to come.

Bulls & Bears

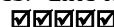
If you were looking for a peak in sentiment to mark the top of this bull phase, you've got it. As shown by the Rydex



banks are masking risk levels by "temporarily lowering their debt just before reporting it to the public." As we showed in our April 5th issue, the credit exposures of the top five banks averages close to three times their risk based capital and in the case of Goldman, credit exposure is a resounding 766% of risk based capital.

Secondly, the fraud contention has catalyzed others to action; AIG is considering suing Goldman. What's left of Lehman is considering the same. And foreign governments are now considering their options as CDOs have gone horribly wrong, imploding despite assurances offered that they were proper transactions.

charts on this page, courtesy of Carl Swenlin's marvelous Decisionpoint website (www.decisionpoint.com), can there be any doubt whatsoever? Recently, money market and bear fund assets both fell to multiyear lows while bull and sector fund assets climbed to their highest since the October 2007 bull market peak. Currently, there are roughly \$7.50 in bull and sector funds for every \$1 in bear fund assets, the most ridiculously one sided sentiment we have seen since the tech mania convinced folks that no price was too high to pay. There is a tremendous amount of conviction in these charts, precisely as you would suspect just before a very significant downside reversal commences. *Like right now.*



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At this juncture, it is impossible to ignore sentiment, which has run to extremes at least as significant as the mid-January highs. At top left, we illustrate a measurement of the intensity of speculation that is simply beyond the pale. A portion of the growing divergence between NYSE and Nasdaq volume is likely due to the NYSE losing business to other market makers, especially electronic, but there is no way to explain away the staggering divergence visible in the chart. Since January 1st, 21-day average NYSE volume is up 3.2%. *By comparison, 21-day average Nasdaq volume is up 40.8%.* Clearly, the action is taking place in the more speculative, higher P/E and lower dividends paying issues on Nasdaq, and that's a bad sign for investors.

The Investors Intelligence survey of newsletter writers is once again showing the kind of one-side sentiment often seen at times of major reversals. The combination of a rapidly growing bullish contingent and the evaporation of bearish sentiment is again, at least as significant as occurred when stocks peaked in mid-January. Take into account that this is a repeat performance of excess optimism in only three months. The correction from the January high measured 8.3%, but it seems clear this last rally may have brought those remaining on the sidelines to "all in."

Emotional Intensity has once again registered a sell signal. While the indicator has certainly not been reliable vis-à-vis sell signals during the long rally phase, most prior peaks and accompanying sell signals over many years previously represented excellent turning points. Historically, we can expect at least two episodes of extreme bearishness each year, thus we are overdue for another such episode. Another sell signal was issued last Thursday. Check out the Rydex charts on page three.

Pandora's Box

The Goldman fraud may just have opened Pandora's Box. According to Reuters, *"The special inspector general for the government's bailout program said he would probe whether securities sold by Goldman Sachs Group Inc....led to losses at AIG and if the American taxpayer was a victim of fraud."* If the investigation finds fault, it could conceivably extend far beyond AIG's claims. Expect others to fall in line to sue. Total notional values of Goldman's derivatives is almost \$41.6 TRILLION, one-fifth of all derivatives outstanding for U.S. commercial banks.

And Pandora has other ills to offer. There will likely be a huge downside catalyst ahead as interest rates surge. The price of Greek CDS jumped to a new high and Greek 10-year bond yields have climbed above 8% on a rumor the country will seek the equivalency of bankruptcy. Other countries, such as Portugal, may also have huge problems going forward. And of course, the U.S. will also need to sell bonds to finance its own gigantic deficit. As the very savvy Jim Bianco pointed out recently (see tinyurl.com/y362wqp), "punishingly high" interest rates are coming in a second wave of the financial crisis. *That can't possibly be good news for stocks.*

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THANKS TO:
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NEWSDAY
 (see tinyurl.com/2d6rs7d)
FOR COVERAGE OF
OUR COMMENTARY
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CROSSCURRENTS - The Three Weeks Ahead - April 26, 2010

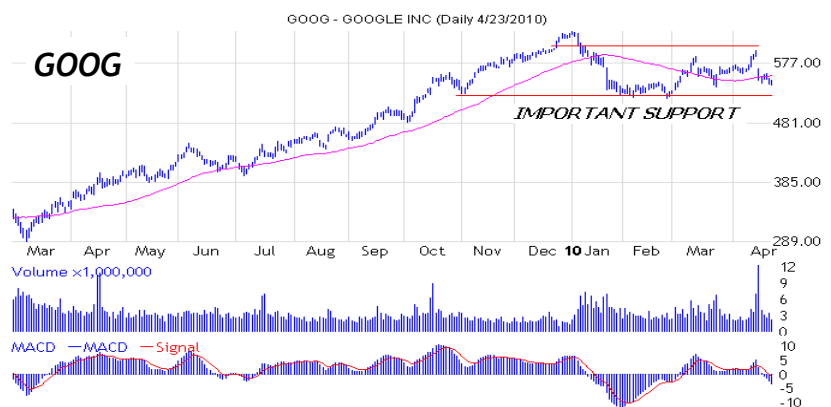
- Rationales & Targets -

Talk about conflicting indications for the economy, bulls are crowing about the statistically faulty (done by survey with "seasonal adjustments") new home sales rise of 27% but we are far more impressed by foreclosures spiking 7% in the first quarter (see tinyurl.com/2cek7tc). Meanwhile, weekly initial unemployment claims are still far from numbers that would indicate a sustainable recovery. Thus, at close to 24 times earnings and a 1.8% dividend yield, the S&P 500 are quite overvalued, as much so as they were in October 2007 before it all came apart.

We believe the Goldman fraud has the potential to greatly undermine the hopes for investors in the next few months. The very words of Goldman's Lloyd Blankfein, "*We lost money, then made more than we lost because of shorts. Also, it's not over, so who knows how it will turn out ultimately,*" clarify the Goldman raison d'être. If Goldman can make money, they intend to do so, regardless of the cost to the rest of the nation or even the rest of the planet. The potential for a groundswell is enormous. We've been wrong for too long but this time, the top should be in.

At this juncture, it seems apparent that Nasdaq has far outdistanced the good news, up 20% in less than three months. Two key charts tell us a lot. Vis-à-vis Google (GOOG), the breakout in late December is now ancient history. Two subsequent rallies fell far shy of the original breakout and the shares are threatening support at roughly \$525. Trouble with the 50-day moving average is yet another sorry factor.

Apple (AAPL) es en fuego, no? The gap in late October took the shares to 15% above the 50-day moving average and this gap is now 20% above the 50-day MA. Time for a correction? Yes, with the Relative Strength Index (RSI) insanely high at 85, a *sizeable* correction is indicated.



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The Psychology of the Market

Invest. Intel.: 3 Wk. Bull/Bear Ratio 2.8 Highly Optimistic

AII: 3 Week Bull/Bear Ratio: 1.4 Neutral

Mutual Funds: 3.5% cash: Euphoric

Crosscurrents Emotion-Based Indicators:
NEW SELL SIGNAL IN EFFECT

Short Term Forecast

TOP SHOULD BE IN
REWARD/RISK RATIO INSANE
UPSIDE POTENTIAL 0%-1%
DOWNSIDE RISK 12%

Intermediate Term Forecast

THROUGH OCTOBER 2010
REWARD/RISK RATIO HORRIFIC
UPSIDE POTENTIAL = 1%
DOWNSIDE RISK = 20%+

Investment Stance Results 2004 to 2009
<http://www.cross-currents.net/outlook.htm>

Crosscurrents '10 Investment Stance

RETAINED FROM PREVIOUS YEAR OR EARLIER

Newmont Mining (NEM) 15% LONG +29.1%

China Medical Tech. (CMED) 5% LONG -30.2%

Goldcorp (GG) 5% LONG +2.9%

Mindray Medical (MR) - forward P/E 24- under \$33 (new)

AVERAGE GAIN +12.0%

Vs. DJIA +7.4% SPX +9.1% Nasdaq +11.4%

"Retained" ideas priced from inception

Percentage gains (losses) include dividends

AVERAGE GAIN IS WEIGHTED

POSSIBLE FUTURE ADDITIONS

Pfizer Inc. (PFE) 4.4% dividend yield

Altria Group (MO) 6.6% dividend yield

AT&T Inc. (T) 6.4% dividend yield

ShengtaTech Inc. (SDTH) 17 P/E - China/Speculative

TRADING STANCE—STILL OPEN

Powershares QQQ Trust (QQQQ) 10% SHORT -49.5%

This hedge will be eliminated before the end of October.

Next Issue: May 17th
See our special commentary on the financial markets