

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

U.S. STOCK MARKET OUTLOOK for MAY 17, 2010
DJIA 10,620 - SPX 1135 - NASDAQ 2346

MUTUAL FUND CASH-TO-ASSETS RATIO GOES TO AN ALL-TIME RECORD LOW, INDICATIVE OF THE MOST EXTREME OPTIMISM IN HISTORY. MAY 6th FLASH CRASH PROOF MARKET MECHANICS COMPLETELY BROKEN. - NEXT ISSUE - JUNE 7, 2010 -

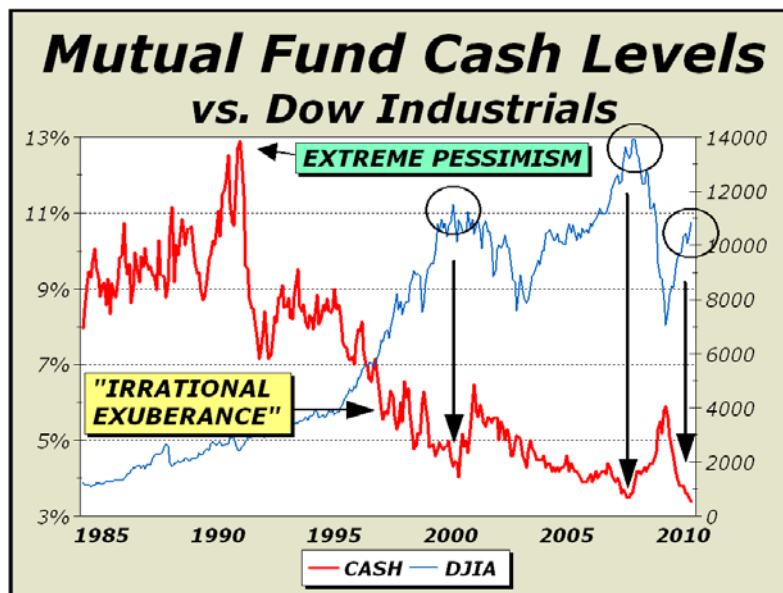
⌘ Record Breaking Optimism, Right At The Top. ⌘

After the stock market was cut in half during the fallout from the tech mania in 2000, we had some difficulty in maintaining our point of view that a veritable mania was *still* in progress, but as the many charts we had presented in our popular Pictures of a Stock Market Mania web feature (see <http://www.cross-currents.net/charts.htm>) amply illustrated, our rationale and logic were still quite pertinent.

After the stock market was cut in half yet again in 2008-2009, our rationale that the mania was ongoing was tested again, but the incredible increase in the velocity of trading as seen in our dollar volume charts was solid evidence that the mania never ended. However, even if we were not 100% certain before, the ridiculous extremes of sentiment seen in recent months would have surely shifted us to the view that the mania endures and rules. We have repeatedly pointed out several measures that fairly screamed a major top was in the making, such as the Investor's Intelligence tally of newsletter writers such as ourselves (see page four). In the April 26th issue,

we displayed a huge chart of assets in Rydex funds lifted directly from Carl Swenlin's terrific DecisionPoint website (see <http://www.decisionpoint.com>), showing an unbelievable 7:1 plurality of optimism to pessimism. Our own proprietary Speculative Intensity indicator of av-

ter of the page—the mutual fund cash-to-assets ratio at yet another record low. The only chart points that matter are the three that are highlighted. The two previous occasions were accompanied by a halving of the major averages as relative cash ran to extremely low levels. In 2000, the March low in cash at 4% threatened to break a record dating back to December 1972. Incidentally, that particular record low was also accompanied by a huge bear market, albeit not quite a halving in the major averages, but still, an enormous 45% drubbing that required another eight years before a new secular bull market was enabled. The second highlight is the June and July 2007 lows of a cash-to-assets ratio of only 3.5%, less than three months from the index highs.



erage NYSE/Nasdaq volume went repeatedly to record extremes for months, implying a vast increase in speculative activity. And for well over a full year, our short term Emotional Intensity indicator showed continued optimism and/or complacency. However, the most astonishing development of all is at the cen-

The new record low announced by the Investment Company Institute (ICI) on April 30th is simply unbelievable. Mutual fund managers now hold a mere 3.4% of their assets in cash. While, we have commented for years that a steady

(Continued on page 2)

Please note: Information contained herein has been obtained from sources believed reliable but is not necessarily complete and accuracy is not guaranteed. Any securities mentioned in this issue are not to be construed as investment or trading recommendations specifically for you. You must consult your own advisor for investment or trading advice. This report is for informational and entertainment purposes only.

(Continued from page 1)

decline in relative cash levels was inevitable, based on the secular trend towards indexing, the take away is obvious; less cash means less potential buying power and less flexibility when the inevitable correction or bear market arrives. The two prior halvings are proof that the policy of maximum exposure to stocks by mutual fund managers is flawed. *It does not work.*

Thus, we believe we can expect if not a similar outcome to the previous halvings, a substantial correction that will only end when funds expand relative cash levels to where they can be comfortable accumulating stocks once again. We estimate the ratio may have fallen further in April to 3.3%. By the end of February 2009, only days before prices bottomed, cash levels had expanded to 5.9%. Although we do not expect a replay, an expansion to over 5% cash appears likely and that would require a significant downside from here.

Below left, the timing for a correction is clearly appropriate. Historically, average three month net inflows peak by April and begin going downhill quite rapidly by the end of June. While this raises the possibility that this leg of the decline will be followed by another rally phase, it also strongly implies another and possibly more significant leg down will begin during the summer. We have argued for an October low on so many occasions and this is another indicator that suggests an October low. The justification for the Dead Zone (see April 26th issue) is once again apparent. If history is any guideline, inflows will fall into the summer and the autumn.

The importance of inflows cannot be underestimated. As we illustrated in

our last issue (see page two), inflows on a monthly basis fall quite sharply, declining to near nothing by late summer. August, September and October are 25% of the entire calendar year, yet average only 11% of annual inflows. Our chart at lower right shows why inflows are so important. When inflows rise from month to month, stock prices rise more than 80% of the time. When inflows are down from the previous month, prices fall close to 60% of the time. Since inflows are expected to decline from May through October, our logical expectation is that stock prices must decline, concurrent with a significant reduction in optimism. We have previously forecast "downside risk" in excess of 20%. Very strong support to expected to surface between Dow 8100-8400, thus our expected worst case scenario is actually as much as 27.7% from the late April highs. More likely, a move to just below Dow 9000 would be accompanied by a fair amount of panic and capitulation, sufficient to end the damage. Could the averages trade down to their March lows? See our next commentary. Unfortunately, May 6th proved anything can and probably will happen.

Flash Crash!

The May 6th "flash crash," wherein the U.S. stock market inexplicably collapsed in a matter of mere minutes is in our view, absolute verification that the arena is horribly broken. The system simply does not work anymore. We have swapped an investment arena ruled by open and human controlled auctions for a trading casino ruled by computers and *invisible* bids and offers (see our many references to "dark pools" over the last year and change). In the former, value is paramount. In the latter, value is relatively meaningless

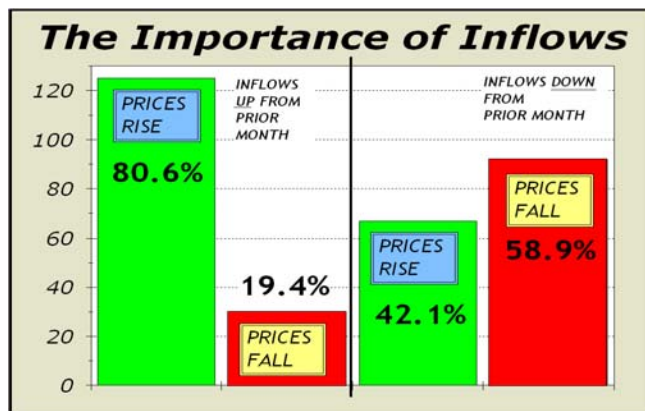
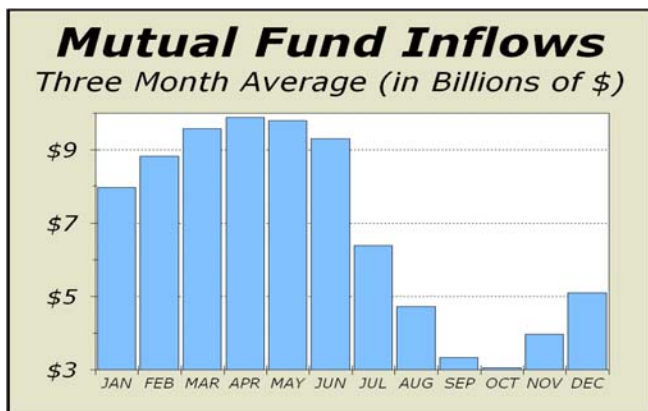
since holding periods may only be hours or minutes and perhaps even seconds.

Is it pathetic or amusing that SEC head Mary Schapiro has commented that the SEC has no clue how this happened? We'd say both. No one knows and although many guesses have been hazarded, no one but no one is willing to hazard a guess that PERHAPS optimism rose to a historic extreme and that PERHAPS stocks were overvalued. As far as your Editor is concerned, you can strike "perhaps" since we are certain that both the conditions of extreme optimism and overvaluation existed at the April 26th peak in price.

The removal of human involvement and interaction has been significant and as a result, price is typically only a momentary consideration. Trading on a very short term basis is thought to mean minimal exposure. Supposedly. Realistically, once the arena is saturated with *presumptions* of minimal exposures, it is also saturated with risk. In this case, since holding periods are minimized, there isn't even time for trading entities to be concerned with details, *such as valuations.*

Simply put, if it is possible for 512 Dow points to be erased in the span of only four minutes as occurred on May 6th, then there is no way for investors to make rational decisions. The four minutes lopped \$743 billion from total stock market capitalization. How rapid was the flash crash? At the same pace, it would have only required 80 minutes for stocks to reach zero. In our view, the establishment of new "circuit breakers" changes nothing. Stocks have become commodities and investing, for all intents and purposes,

(Continued on page 3)



(Continued from page 2)

is dead. The best evidence that stocks can reverse upwards for any length of time will be when bears multiply like rabbits and bulls disappear like the dodo. We're not holding our breath.

What is even worse is that there is seemingly no explanation for what occurred. What does that tell you about the U.S. stock market? Since 1987, we have suffered quite a few instances of totally bizarre situations that are so many standard deviations from the norm that each would be expected perhaps once in a thousand years, if that often. The 1987 crash, the LTCM fiasco, the tech bubble, the derivative fraud that caused the 2008 meltdown and now, the flash crash. *None* of these events were ever supposed to occur in our lifetime. *They all have.*

Worse yet is the explanation that has surfaced of a lone trade (see <http://tinyurl.com/3y36adc>) involving 75,000 "e-mini" contracts by Waddell & Reed Financial Inc. during a twenty minute period on May 6th. If true, this would act as further proof that investors are screwed no matter what they do. If not, the fact that there is no explanation serves the same purpose. How ironic. The salient fact is that investors are screwed either way. The U.S. stock market has been completely and irrevocably hijacked by technology; investors need not apply.

No Love Shown Here

From time to time, we attempt to take the pulse of a sector or industry through the activity of corporate insiders. This is definitely not a timing indicator since the market typically lags insiders and our intent is simply to illustrate the value of said sector or industry. It's been awhile since we checked in on the top is-

sues comprising the Powershares QQQ (symbol QQQQ) and we're not surprised by what we see. The last time we checked was back in January 2009 and Nasdaq was already well on the way towards the bottom, down 41% from the '07 highs. We only monitored the top eight issues, since two of the top ten (Teva Pharmaceutical—TEVA, and Research in Motion—RIMM) are foreign companies and insider data is not available. There were a grand total of 250 sellers against four buyers, a ratio of 62.5 to 1. There were 47.7 MILLION shares sold and 97,000 shares bought, a ratio of 490-1. *It's worse now.*

In our May 10th tally, there were 231 sellers and only three buyers a ratio of 77 to 1. Shares sold were 59.8 million versus only 15,200 purchased, an astounding sell/buy ratio of 3933 to 1. So few shares were purchased that our chart is not capable of displaying the buy side. While the stats are nowhere near depressing as they were at their record worst, for our March 2008 tally, they are clearly indicating a lack of faith by corporate insiders. If their shares were worth holding onto, the assumption is they would hold onto them. Yes, the "Qs" had been en fuego for the longest time but then again, it's about trading and it's about glamour, and not at all about value.

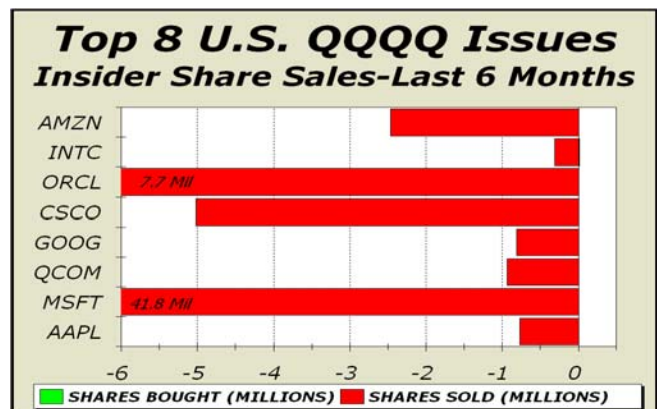
Perhaps most interesting of all, analysts are roughly just as positive on this group as they were back in March 2008 before a 37% collapse in price. At that time, 74.1% of recommendations were "buys" or "strong buys" and 2.9% were "sells" or "strong sells." As of May 10th, 77.7% of analyst's recommendations were buys/strong buys and 3.6% were sells/strong sells. We do not see this comparison as good news for the top issues of the QQQQ.

Goldman's Shitty Deals

The more we read about the Goldman fraud, the more incensed we are by the culture of greed that permitted at best, unethical lapses on the most massive scale in history. As for the possibility of criminal behavior, we will allow the many actionable suits we expect to do the talking. In the meantime, we see Goldman as the devil in their own documented details, hanging themselves by the bootstraps via intraoffice emails. Goldman CEO Lloyd Blankfein has been especially vocal in the company's defense but his comments have shattered any semblance of faith we might entertain. In a November 18, 2007 email to colleagues, Blankfein admitted the company "... *made more than we lost because of shorts.*" Given that Goldman supposedly required a taxpayer financed bailout, we can only wonder why they accepted the \$12 billion in the first place. But then again, the bailout funds were soon accompanied by \$14 billion in bonus payouts to those who put together crap such as the CDOs sold by Goldman that soon traded down to near zero. *Made more on shorts? They did quite well!*

Of course, we should expect that Goldman made tons on the downside, since their raison d'etre is trade, trade, trade. And the more we think about it, why is this company even categorized as a commercial bank? They are not a bank by any stretch of the imagination. Blankfein's defense of a culture and business that can allow "*shit!*" like the Timberwolf deal (read on) to be marketed to the long side is so off the charts, it is clear that Goldman's mission and objectives place Goldman first and clients second by design. Part of the Goldman defense of the

(Continued on page 4)



(Continued from page 3)

Abacus deal is that those who took the long side were told that hedge funds (read Paulson) "could" take short positions. There is a world of difference between "could" and "would" and obviously, a world of hurt as well. In this case, the word "could" was both inappropriate and misleading, since there was never a doubt that Paulson's fund would take a short position. Once Mr. Paulson was involved in any way with selecting how this derivative was to be structured, "could" was a lie, certainly unethical, perhaps criminal.

The words of a former Goldman head of sales and trading speak for themselves. Characterizing a cobbled together \$1 billion CDO, Thomas Montag said in an email "Boy that timberwo(lf) was one shitty deal." Who did the email go to? Daniel Sparks, who ran Goldman's mortgage business at the time. Before five months had elapsed from when Timberwolf was cobbled together with crap and excrement, the CDO had lost 80% of its value. Who was on the short side? Goldman. This was one of the CDOs Goldman sold to clients after deciding they needed to reduce mortgage holdings. Given how Abacus subsequently performed, only nominally better than Timberwolf, we believe a categorization of Abacus as "shit" is also appropriate. Goldman employee Tetsuya Ishikawa was involved in Abacus deals and later wrote a novel called "How I Caused the Credit Crunch". Goldman did 25 Abacus deals from 2004-2008 and a Gretchen Morgenson NY Times article claimed Goldman tried to pressure Moody's to rate its products higher than they should have been. Morgenson's 2009 story went on to cite Goldman for creating and selling CDOs that they subsequently shorted. Goldman's defense that the buyers of any of these poorly fabricated financial products were "sophisticated" cannot possibly be allowed to pass muster. The existence of Timberwolf and its characterization as "shit" is solid evidence of wrongdoing.

Not content with his notion

that Goldman was "doing God's work," Blankfein later complained after the SEC's case surfaced that the move was politically motivated and would "hurt America." Hubris on quite probably the grandest scale ever. We are to assume that both God and America are served by trading and fraud. Blankfein would do well to make less arrogant claims, and perhaps state the truth, that Goldman is doing Goldman's work. From what we see, what has been good for Goldman has not exactly coincided with an attendant increase in wealth for Americans. Clearly, the company has done well even after two stock market crashes. On bonuses alone over the last 11 years, no one who worked at the company has gone hungry.



But the sad fact of the matter is that total stock market wealth is exactly the same as it was way back in November 1998. *Goldman's contribution to wealth has been zero for everyone else.*

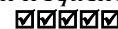
In our view, Blankfein has irretrievably and irrevocably alienated the public with comments such as "Could/should we have cleaned up these books before and are we doing enough right now to sell off cats and dogs...." from an email dated Feb. 11, 2007. Blankfein now wishes to clarify that "When I use the expression 'cats and dogs' I mean miscellaneous stuff...." However, in the real world, not the fantasy he resides in, the meaning of cats and dogs is "A slang term referring to speculative stocks that have short or suspicious histories...." (underline ours - see

<http://tinyurl.com/29az5zz>). Cats and dogs are not "miscellaneous." They are securities that Goldman considered below grade but did not sell as such. They had a duty, responsibility and obligation, morally and ethically, to inform all their clients on the other side of these trades and they did not. Goldman's real business was to avoid responsibility for their own sorry mistakes by lashing their own clients to merchandise they no longer deemed suitable.

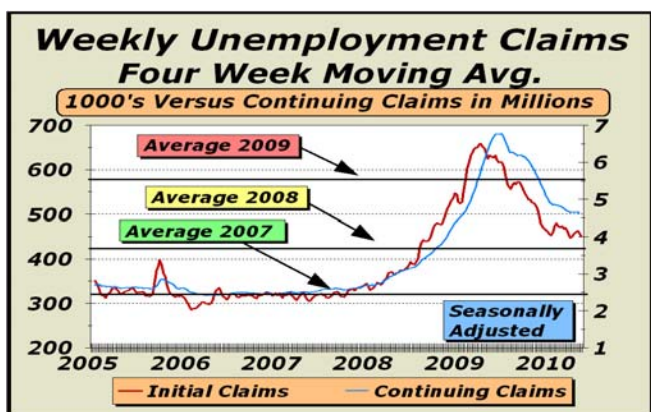
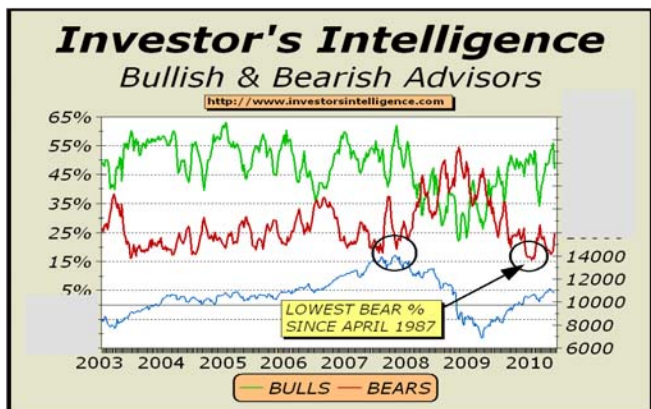
So there is no mistaking our views, in no way do we believe Goldman is alone responsible for the fate that has befallen the markets and the country, but the corporate culture of greed at any price certainly is. The urge to trade and profit via the short side with any security imaginable (even if they have to be created from scratch), led to competition of the worst kind; burn it down, burn it all down. On December 15, 2006, Goldman CFO David Viniar emailed a colleague "My basic message is let's be aggressive distributing things because there will be very good opportunities as the markets goes (sic) into what is likely to be even greater distress and we want to be in a position to take advantage of them." The game was profit by any means possible and the more aggressive, the better. The economy be damned, the markets be damned, the public be damned; *business as usual.*

Liquidity? What Liquidity?

One of the many stories to make the rounds about the flash crash was that Tradeworx, a New Jersey hedge fund responsible for 5% of all trading volume, had temporarily withdrawn from the arena when prices began to go awry, causing a monumental collapse of liquidity. Ironically, high frequency trading firms like Tradeworx are believed to create liquidity and as a result, are important to the market. Read this six month old article (see <http://tinyurl.com/29hmmlj>) for a quick "head's up." Then bear in mind, *stocks have gone nowhere since the advent of high frequency trading.*



EDITOR'S NOTE REGARDING OUR TINY URL REFERENCES: Do not copy and paste Tiny URLs from the .pdf file of the newsletter since the embedded typeface we use is not what Adobe Reader expects and will not translate it correctly. Best bet is to just type in the complete TINY URL and actually, in most cases, you do not even need the "http://" at the beginning of the web address.



Alan M. Newman's Stock Market
CROSSCURRENTS
 entire contents ©2010 Crosscurrents Publishing, LLC
 3280 Sunrise Highway #125
 Wantagh, NY 11793
 (516) 557-7171
Alan M. Newman, Editor
 Information contained herein has been obtained from sources believed reliable but is not necessarily complete and accuracy is not guaranteed. Any securities that are mentioned in this issue are not to be construed as investment or trading recommendations specifically for you. You must consult your own advisor for investment or trading advice.
 The entire contents of CROSSCURRENTS are protected by federal copyright laws. The federal Copyright Act imposes liability for violations of this law, including any unauthorized reproduction of this issue, in part or in whole.

At top left, the Investor's Intelligence weekly tally of newsletter advisors comprises one of the most amazing charts we have ever seen. Just imagine, a one-day decline of nearly 1000 points has catalyzed almost no reaction. Phenomenal! As well, the top came in three weeks ago, the Dow is down 5% from the closing high, looks to be rolling over again and there is barely a visible reaction. Participants are still palpably bullish and that is bearish for stocks.

For a change, our Emotional Intensity sell signal worked. Given the swift downside, we would have expected the indicator to have already shifted to extreme pessimism but that has yet to occur. If stocks stage any kind of rally attempt from here, the indicator will remain shy of extreme pessimism and no buy signal can be registered until we have experienced extreme pessimism. After the 2007 top, there were five separate excursions into extreme pessimism before prices bottomed. We have yet to see one.

While weekly unemployment claims are not a "technical indicator," it seemed appropriate to give the chart some space this week. Despite recent claims of the burgeoning economic recovery and job creation, claims seem to be mired well above levels that would indicate a healthy economy and concomitant job growth. Both initial weekly claims and continuing claims are stuck at the same level we averaged throughout 2008 as the economy caved. There's reason to believe many of the jobs lost will never return (see <http://tinyurl.com/29fq6k>).

Rumors Killed Bear

In a recent Senate panel inquiry, Bear Stearn's CEO James Cayne's prepared testimony recounted "unfounded" concerns and "rumors" in the market about Bear Stearn's

solvency during the week of March 10, 2008. With stories about an imminent collapse swirling about, the firm's brokerage customers pulled out assets and other firms canceled special loans known as repurchase agreements. Besides Cayne, others including the CFO and COO testified that all efforts to strengthen the firm were "reasonable and prudent...but the market's loss of confidence, even though it was unjustified and irrational, became a self-fulfilling prophecy." On March 11th, SEC Chairman Christopher Cox said, "We have a good deal of comfort about the capital cushions at these firms at the moment." Given the establishment of put options series that amounted to a bet on a total Bear Stearns collapse only days before it occurred, we would hope the Senate investigates who was on the short side of Bear and how those "unfounded" concerns and "rumors" began life. The same day as Cox's statement, an unknown entity purchased 55,000 puts to sell BSC at \$30 when it was trading at \$65 only ten days before their expiration. Clearly, as we have pointed out in at least a dozen articles over the few years, the short side rules and companies can and are driven out of business regardless of the consequences to investors. Everything about the U.S. stock market smells, from the horribly broken mechanics of the short side to the Goldman Sachs fraud.

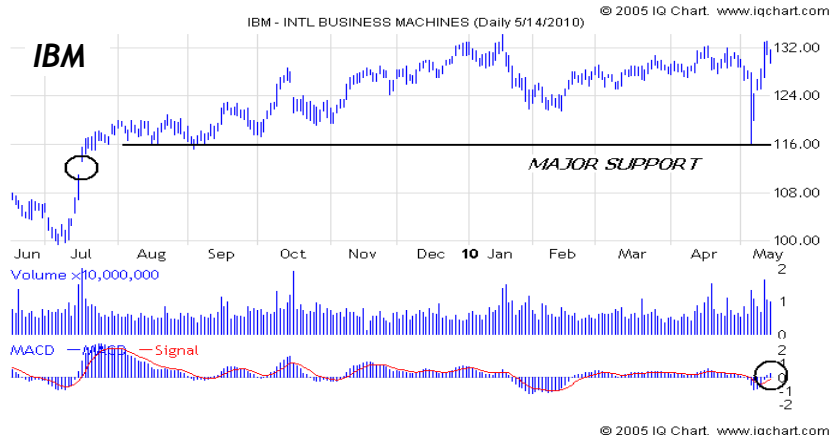
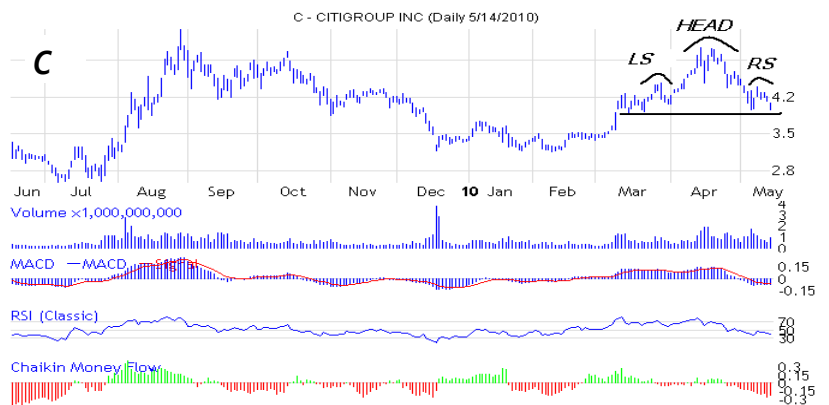
☑☑☑☑
THANKS TO:
ALAN ABELSON
BARRON'S
JIM PUPLAVA
www.financialsense.com
FOR COVERAGE OF
OUR COMMENTARY
 ☑☑☑☑
CROSSCURRENTS
POWERFUL COMMENTARY
UNIQUE PERSPECTIVES
ONE YEAR—\$189
SIX MONTHS—\$100
WWW.CROSSCURRENTS.NET/
SUBSCRIBE.HTM
NOW IN OUR 21st YEAR!

CROSSCURRENTS - The Three Weeks Ahead - May 17, 2010

- Rationales & Targets -

Last time out, we admitted we had been wrong for far too long, "...but this time, the top should be in." And it was. Prices tanked immediately thereafter and in the case of the Dow, actually (albeit briefly) made it all the way back to the February lows, which we had also correctly pegged as our short term downside target. Although we appear to be somewhat in the middle between "upside potential" and "downside risk" (see short term forecast at right) right now, the odds for downside risk probably outweigh the odds for upside potential at least two-to-one, thus we believe any upside play at this time is way too dangerous. We could rally at any point simply based on nominally oversold levels achieved Friday, but our principal concern is a perfect storm is brewing, one that can kick stocks while they're down. Gold seems destined to supplant all major currencies as more insurmountable sovereign debt problems surface in the weeks ahead. The story is not yet complete. For all intents and purposes, we view the recent action in gold as a game changer. All the more interestingly, fear has yet to put in an appearance. We believe it will.

Last issue's short focus on Apple Computer (AAPL) and Google (GOOG) were timely. Both are down 6%+ and still look quite dicey, especially GOOG. Citigroup (C) is almost always in our radar. Despite the nice run into the April highs, threats now abound. We see a potential head-and-shoulders top with a neckline that will be penetrated below \$3.80 and if that occurs, a test of the early year lows at \$3.11 is indicated. Just to show we're not entirely negative, check out IBM. The shares came within shouting distance of a new high on Thursday and Wednesday's volume was excellent. Nice. We're not too worried about the gap dating back to last July, since it is below major support. IBM should outperform the averages.



FAIR WARNING & DISCLAIMER:

The publisher of this newsletter and one or more of its affiliated persons and entities may have positions in the securities or sectors recommended in this newsletter and may therefore have a conflict of interest in making the recommendations herein. For example, if an affiliate has an existing long position in a security that this newsletter recommends for a long position, the buying activity that recommendation generates may cause the price of such securities to rise, potentially allowing the affiliate to exit the position at a profit. Any securities mentioned in this issue are not to be construed as investment or trading recommendations specifically for you. You must consult your own advisor for investment or trading advice.

The Psychology of the Market

Invest. Intel.: 3 Wk. Bull/Bear Ratio 2.6 Highly Optimistic

AII: 3 Week Bull/Bear Ratio: 1.2 Neutral

Mutual Funds: 3.4% cash: Euphoric

**Crosscurrents Emotion-Based Indicators:
SELL SIGNAL STILL IN EFFECT**

Short Term Forecast

**REWARD/RISK RATIO UNSOUND
UPSIDE POTENTIAL 5%
(A RETURN TO THE HIGHS)
DOWNSIDE RISK 7%-8%**

Intermediate Term Forecast

**THROUGH OCTOBER 2010
REWARD/RISK RATIO INTOLERABLE
UPSIDE POTENTIAL = 5%
DOWNSIDE RISK = STILL 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 +40.0%

China Medical Tech. (CMED) 5% LONG -37.4%

Goldcorp (GG) 5% LONG +16.3%

Mindray Medical (MR) - forward P/E 24- placed on hold

AVERAGE GAIN +19.7%

Vs. DJIA +1.8% SPX +1.8% Nasdaq +3.3%

"Retained" ideas priced from inception

Percentage gains (losses) include dividends

AVERAGE GAIN IS WEIGHTED

POSSIBLE FUTURE ADDITIONS

Pfizer Inc. (PFE) 4.3% dividend yield

Altria Group (MO) 6.5% dividend yield

AT&T Inc. (T) 6.5% dividend yield

ShengtaTech Inc. (SDTH) 15 P/E - China/Speculative

TRADING STANCE—STILL OPEN

Powershares QQQ Trust (QQQQ) 10% SHORT -38.9%

This hedge will be eliminated before the end of October.

Pictures Of A Stock Market Mania will be updated by May 19th
<http://www.cross-currents.net/charts.htm>