Our last analysis of insider activity for the top constituents of the QQQ Nasdaq Trust was reported back in June. We typically do this exercise several times each year and given close to another 1000 Dow points to the upside we wondered if insiders were displaying as much confidence about the future as prices might indicate. Nope, not a chance.

Insider activity at the top QQQ issues remains solidly in the sell camp and the pace of selling is just as frantic as before. In fact, the stats are almost identical to more than three months ago. However, before we get into the phenomenon, wherein insiders flee from their own company’s stock as if another day of holding would ruin everything they’ve ever worked for, we’re going to cut into one of the most interesting pies ever tasted on Wall Street.

Our featured chart illustrates the top nine constituents of the QQQ Nasdaq Trust as of September 21st and Apple (AAPL) at $700. Lest you fear we’re presenting a very small slice of the investment universe, rest assured the nine issues here are a good sized chunk of the total picture. Why nine? It’s hard to compare the top ten since Amgen was replaced with Kraft, so we’re probably better off just comparing the same nine that were in there when APPL put in a significant low in June 2011. Thus, at last count, the natty nine total $1.85 trillion in market capitalization, 10.6% of the nation’s total (roughly) $17.45 trillion in total stock market capitalization.

That’s a huge fraction and likely represents the prevailing mood for speculators. We have no qualms that some stocks will rise or fall in price more than others, that’s the natural state of affairs for stocks. If all rose or fell at the same time and at the same pace, there would be absolutely point in even attempting to gauge a company’s prospects and one would be better off just buying or selling the entire market. Ironically, this also provides us with the evidence that indexing is the worst idea to ever come down the pike. Indexing accepts the notion that one cannot possibly outperform the major averages, so why even try?

There are now thousands of hedge funds with over $2 trillion in assets and there is no way they can remain in business with average performance, thus they are all stock pickers. And it appears they are increasingly dependent on one stock. A couple of months ago we learned that as of June 30th, 250 hedge funds were long AAPL (see http://bit.ly/PnQpfR), up by one-third from 175 at the end of the first quarter in 2011. Noting a near doubling in price, we would guess they’re happy.

(Continued on page 2)
However, if there’s one thing we have ever learned about Wall St., it is that the common wisdom is not wisdom at all. Thus, the piling on board AAPL’s shares must be met at some point by a rush for the exits. Let’s state our case in several different ways. We doubt that AAPL’s present capitalization of $625 billion can fairly represent 3.6% of the stock market’s entire capitalization when revenues represent only 0.7% of GDP. Yes, the company is huge. Everyone wants their products. But everyone wants their stock as well, meaning there are fewer and fewer buyers left on the sidelines. For comparison’s sake, Walmart’s (WMT) capitalization is 38% of APPL but revenues are more than quadruple that of APPL.

Amazingly, since AAPL bottomed out in mid-June of 2011, it has accounted for 16.1% of the entire increase in U.S. stock market capitalization and 71.4% of the increase in capitalization for the top Nasdaq issues. Perhaps we could take some measure of comfort from these stats if those in the know—corporate insiders—were in a buying mood, but sadly, that’s not the case, not for AAPL and not for any of the other top Nasdaq issues either. We admit that one Director did indeed buy $1 million in AAPL shares last November at $375 per share. However, every other insider transaction listed for AAPL is a sale, and for a total of roughly $220 million, or 220 times as much as was bought. The amount of non-confidence shown by the other eight top QQQ constituents we examined was far worse. Amazon (AMZN) was the only company that had multiple buys, two of them but for a miniscule total of only 165 shares. In contrast, there were 34 sales for 193,663 shares. Overall for the natty nine, there were 5 buys totaling just over 9100 shares and 299 sells for more than 55 million shares, a stunning ratio of 6066 shares sold for each share bought.

While P/E ratios are nowhere near as insane as they were in the tech mania of 2000, they are nevertheless a tad rich for companies that are far more mature a dozen years past the mania. Including AMZN’s current P/E of 313 places the average quite high, so perhaps it’s better to focus on price-to-sales ratio. Scott McNealy, the former CEO of Sun Microsystems once commented about "There is no way to justify anything. Two (2) times revenue implies a 15% annual compound growth rate forever." The price-to-sales ratio for the group averages a lofty 3.75, implying continuing growth for the group well in excess of 15%. A dozen years after the peak of insanity, we’d feel a lot more comfortable if the P/S ratio was lower. Given that the group now yields 1.79% in dividends, we are clearly not looking for more than the rigors of a price correction to provide evidence of excellent prospects for investors. A 20% decline would lift yields to roughly 2.25%, a circumstance we believe is entirely possible.

Just to illustrate how lopsided insider activity is, note our chart at bottom right does not appear to show a single share of buying activity, although there were over 9100 shares purchased. That activity is not visible only because we can’t make the chart large enough. If you could actually see the bars, as we revealed in our June 25th coverage of insider activity, the chart and your newsletter would need to be about 27 feet wide.

Another important factor is the following: despite the astonishing lack of confidence shown by insiders at these companies, analysts continue to pile on praise. Of all recommendations, 73.2% are either “buy” or “strong buy” and if you include those who still believe that prices are going higher, thus recommend “hold,” the percentage of those forecasting good times rises to 96.3%. Wow. Less than 3% of all recommendations are “sell” and only 0.7% are “strong sell.” Clearly, insiders are profiting handsomely from these forecasts, selling as much as they can while investors and speculators continue to pile on. Unloved and unwanted typically means great value. Over loved and over owned should mean precisely the opposite.

Another Warning Signal

Another warning signal has surfaced. Both the 2000 tech mania peak and the 2007 stock market bubble came about as result of extreme leverage as optimism expanded to insane levels. In the former instance, margin debt nearly tripled in just over three years. In the latter example,
leverage took five years to triple. At the peak, margin debt stood at the equivalent of 2.3% of GDP, a level seen only once previously in stock market history, when the Roaring Twenties roared their last. While margin debt did not expand significantly with the recent rally, it nevertheless remains at a very hefty 2% of GDP, which in the past has functioned quite well as a danger zone for stocks and this danger zone has been visible for quite some time. At left below, the difference between what passed for normal in much of modern stock market history and the last dozen years is astonishing. Leverage can be a useful tool but its force tends to be hugely destructive over the long term. For the 42-year period of modern stock market history preceding the dozen years of extreme leverage and mania, when leverage was maintained at dramatically lower levels than now, the Dow Industrials gained ground at the rate of 8.1% per year. The rate of gain was far higher than the 5.1% average gain going back over a century as the period was hallmarked by the most robust super bull market of all time, lasting from 1982 through 1999.

Longer term, modest use of leverage can be greatly beneficial. For 42 years, margin debt averaged 0.67% of GDP. Since then, margin debt has averaged 1.94% of GDP, meaning it has remained very close to or in the danger zone more than a dozen years. The 42-year period of modest leverage was even more unique when you consider that total stock market capitalization roared ahead by an annualized rate of 11.4%, building more wealth than anyone could possibly imagine. But of course, the human condition must prevail; wealth is prelude to greed, greed is prelude to leverage, and leverage is prelude to disaster.

At bottom right, we utilize two measures of margin differential to gauge the potential for stocks, a one-year differential and a six-month differential, which seems to work best. The six month differential has turned negative. Going back over the history of our chart, we see good gains for stocks as the indicator turns from negative to positive and losses for stocks when the indicator turns from positive to negative. Thus, we see another clarion call for an end to the rally phase. Prices are too high and are no longer attractive. The demand for stocks is contracting.

About The Road Ahead....

We hear a lot nowadays about “QE Infinity,” the presumption being that if QE1, 2 and 3 can’t do the trick, then there will be no end to the number of times the Federal Reserve steps in to stick a finger into the dike. However, there are consequences to any continuation of this policy. The Fed’s balance sheet has ballooned from very nominal levels in recent years to more than $2.8 trillion as of early September. Although Fed Chairman Ben Bernanke stated last week that the Fed can pare the balance sheet when it needs to without affecting the markets, we do not believe it can. It is one thing when the Fed buys securities and banks profit from tiny spreads, it is quite another when the Fed eventually needs to sell trillions in securities. Sell to whom? It is becoming increasingly unlikely that the Fed can paint its way out of the corner it now occupies without sending interest far higher. This may prove not just problematic, but disastrous. While the Fed has clearly stated it is targeting both the housing and stock markets to increase wealth, the policy of building bubbles has worked out quite poorly in the past.

Sam Zell’s take on CNBC’s Squawk Box (see http://read.bi/SlaJnl) last week has us on the brink of recession, citing a lack of confidence and why should we be even the slightest bit surprised? Even now, with the major averages continuing to work their way upwards from the June 4th correction bottom, investors have pulled money out of mutual funds 15 of 16 weeks and the only week of inflows was very modest. In the three months after Q1 was expanded, stocks rose 47%. They rallied 21% in the three months after QE2 was hinted. And they rallied 10% with the advent of Operation Twist. The impact is growing smaller. If stocks cannot make significant progress now with the Fed firing on all eight cylinders, there will be hell to pay.
At top left, Speculative Intensity has pulled back modestly from another new record achieved a little more than a month ago. However, it is important to realize the current reading of 2.36 remains consistent with prior price peaks and in sharp contrast to what has passed for normal over the last few years. We admit that high frequency trading (HFT) has something to do with the overall trend but we regard HFT as a potential liability for stocks. Typically, Speculative Intensity has big runs accompanied by a price peak and subsequent correction and at the lows, a rally ensues. We see no reason to doubt the validity of this pattern.

At center, 21-day Cumulative Advancing and Declining Volume for the combined NYSE and Nasdaq is barely above zero, despite yet another cycle high for the Dow Industrials on Friday. In fact, we see a decidedly lower trend for peaks in this indicator. Both circumstances represent significant negative divergences. If up volume minus down volume cannot make headway as prices go to new highs, it likely means the troops are no longer following the Generals.

At lower left, the overall Cumulative measure has also diverged significantly. Going back the better part of two years, whatever the rallies have to offer does not include higher highs for Cumulative A/D volume. This clearly places the dynamics of the bull phase in doubt. Of course, none of the previous divergences have stopped the rally phase, thus we’d caution against betting heavily on the bear side just for technical reasons. The correction we expect will likely be triggered by an unexpected news event.

The fiscal mess has now become a fiscal cliff and 2013 threatens to witness a powerful unwinding of the sort even bears shudder about. We strongly suggest readers take a look at these three links; Peter Robinson’s interview with Thomas Sowell at http://bit.ly/NR94U6. It’s almost 40 minutes but is well worth the investment of your time. We would also direct your attention to a US News & World Report piece by Mort Zuckerman at http://bit.ly/TBIguw and finally, http://bit.ly/RYEVnZ, where “the magnitude of the mess we’re in” is explained by five former Administration members. Scary stuff.

THANKS TO:

ALAN ABelson
HEARD ON THE STREET
http://www.barrons.com

DAVID ROBINSON
Bull & Bear Financial Report
www.thebullandbear.com

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- Rationales & Targets -

What happens when an Editor does an interview with a journalist who says everyone else is bullish? The Editor remains bearish. This actually occurred last week and is one excellent reason why we’re content to stick with our scenario that stocks are overdue for correction. While some sentiment measures have displayed continuing skepticism, like the American Association of Individual Investors (AAII) survey, we see others like the Rydex ratio of assets in bull and sector funds versus bear funds illustrating if not euphoria, something akin to an outsized dedication to the bull case. The latter represents real money, the former is only a survey. Besides, it is clear that American investors have been headed to the sidelines for many, many months. Only one month in the last 16 has witnessed inflows for equity mutual funds and the inflow was minimal. We see no reason for these trends to change, thus our take on sentiment is going to stay contrary. The stock market’s bull phase, like Apple, is over owned and over loved. No one wants to see it end, even us. It always seems to end this way.

Perhaps the great love affair with Apple Computer’s (AAPL) shares is finally going to take a significant breather. While we absolutely love the company and its products, we believe the shares are way too popular. The shares are off 7.4% in only two weeks and are only $8.59 away from what we view as important support at the April high of $644. Old resistance is supposed to function as new support. If that doesn’t hold, risk probably extends to under $600. Google Inc (GOOG) has taken the play away and is up an astonishing 36.6% in only three months. Unfortunately, the shares are now overbought on almost every level and have left supports far behind. We see risk down to the September 12th low of $680.88.

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The Psychology of the Market
Invest. Intel.: 3 Week Bull/Bear Ratio 2.0 Optimistic
Rydex Assets: Bull & Sector/Bear Ratio: 9.7 Euphoric
Mutual Funds: 4.0% cash: Complacent

Crosscurrents Emotion-Based Indicators: EUPHORIA BEGINS TO FADE

Short to Intermediate Term
MARKET SHOULD NOW BE PARTICULARLY SUSCEPTIBLE TO A BAD NEWS EVENT. KEY SUPPORT AT DOW 13,367. CORRECTION STILL EXPECTED.

Projected Range for rest of 2012
PROJECTED DOW MAX 13,746 (+1%)
PROJECTED DOW MIN 12,035 (-11.6%)

YEAR END CLOSE DOW 12,500-12,800
RISK/REWARD = GREATLY FAVORS BEARS

Spotlighted in the last issue:
The Dow Transports ($TRAN) finally came to life last week, rallying 3.1% but strong resistance is another 3.7% higher. The counter tend rally is not the slightest bit unusual. Keegan Resources (KGN) seems to be consolidating just fine and should have very strong support under $3.

Crosscurrents ’12 Investment Stance

Newmont Mining (NEM) 15% LONG
China Medical Tech. (CMED) 5% LONG
Global X Gold Explorers ETF (GLDX) 5% LONG
Eldorado Gold (EGO) 5% LONG
PetroBras (PBR) 5% LONG
Goldcorp (GG) 5% LONG
40% LONG (30% GOLD)

**RETAINED FROM PREVIOUS YEAR

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

This feature will be updated later this week
Pictures Of A Stock Market Mania
http://www.cross-currents.net/charts.htm