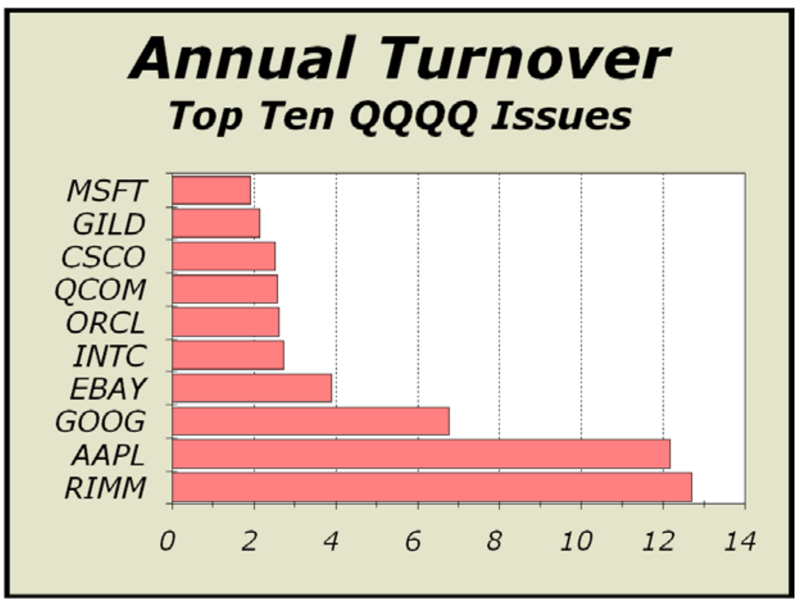
Alan M. Newman's Stock Market CROSSCURRENTS

U.S. STOCK MARKET OUTLOOK for JUNE 2, 2008
DJIA 12,638 - SPX 1400 - NASDAQ 2522

RAPID TURNOVER INDICATES CORPORATE PROSPECTS AND VALUATIONS CONTINUE TO BE IGNORED. ETFs STEP UP THE LEVERAGE—HOW MUCH IS TOO MUCH?! RETAIL INSIDER ACTIVITY UNIMPRESSIVE. *- NEXT ISSUE - JUNE 23, 2008 -*

Four Hours, Eight Minutes & 40 Seconds.

Last September, we presented a piece entitled "The Death Of Investment," wherein we portrayed the immense and stupendous turnover in a half dozen selected Nasdaq issues along with five popular exchange traded funds. We termed our lead chart of ETF turnover, "without any reservation, the most stunning we have ever presented in these pages." Through 1187 words and three pictures, we attempted to establish beyond any doubt that the investment arena had been totally transformed in the modern era. A metamorphosis, if you will.



We believe this process undermines the consideration of fundamental values as a measurement for price. The public holds a large fraction of their retirement wealth in stocks through mutual funds, IRAs, 401k plans and the like. For the most part, they are content to have professional money managers do the hard work of earning the security for their retirement by investing in the right companies and at the right price. *However, in the modern era, trading is paramount, not investment.* The psychology of managing stock assets has changed radically and has degenerated into something that cannot be accurately termed investment. Whereas years ago it may have been prudent for managers to invest for results over the long term, the competition for assets is the greatest in history and *immediate* results are required for survival. Those who post the better results over shorter periods are those most likely to survive. Results are advertised with increasing frequency and increasing scrutiny. Managers are now too impatient for the big payoff, thus academics and institutions have given us new methodologies to "play" the market and to even utilize black box formulas and arbitrage opportunities of every description and size, including the almost infinitesimal. The smallest differentials in stock prices can now be multiplied sufficiently against derivatives for profits to be *constructed*. If the process is repeated often enough, profits can be enormous. Whereas most stock was once purchased for investment using tried and true fundamental factors, most stock is now turned over too quickly for those factors to even rate consideration. *As a consequence, for the most part, stocks are not fairly valued per se.*

Clearly, we can make the case that the more a company's capitalization trades, the less the company's stockholders are interested in a long term driven by fundamentals affecting the company's future. If a company's capitalization turns over once a year (or less), perhaps we can safely assume investors are aboard and banking on longer term prospects. However, if a company's capitalization turns over rapidly, we can probably assume it is only the moment that counts. The longer the holding period, the more likely fundamental prospects are important. The

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shorter the holding period, the less likely fundamental prospects are important. Cases in point; prices were so overvalued in 1929 that there was no point in holding positions, thus turnover was enormous. The same was true in 2000. In both cases, dollar trading volume tripled in the three years to the top. Extremely high turnover equates to OVERvaluation. By contrast, total turnover during the entire period of 1940-1954 was minimal, *less than in the single year of 1928*. Dividends *averaged* 5.5%. Stocks were incredibly UNDERvalued. *Values remain hidden when trading slows to a crawl and value is no longer even considered when trading overwhelms investment.*

Rather than purposely "selecting" individual issues for examination as we did last September, we choose today to highlight the annual turnover of the top ten issues trading in the Nasdaq QQQQ Trust. The top ten issues represent 47% of the entire trust and total over $1 trillion in market capitalization, clearly a significant portion of the entire U.S. stock market. As our featured chart illustrates, investment has been left far behind by trading. The largest issue of the top ten is Microsoft, which sports a market capitalization of $273 billion, a relatively staid and stodgy companion to some of the more high profile high flyers. MSFT is surely a linchpin of many a mutual fund, IRA, 401k and the like, yet even "softees" entire capitalization trades almost twice per year. In what must go down as the most fickle market in all history, the average of the top ten trades its entire capitalization more than five times per year. Incredibly, the entire capitalization of Apple (AAPL) and Research in Motion (RIMM) turnover at a pace more rapid than once per month.

However, these astonishing rates of turnover do not even remotely compare with those of the most heavily traded exchange traded funds, where holding times are best expressed in terms of days, not months. As illustrated below, despite promotional advertising touting many ETFs as "investments," nothing could be further from the truth, patently visible to even the blindest of observers. Three of the ten most heavily traded ETFs turn their entire capitalization within the span of one day. In fact, by 1:38 pm, both the Retail SPDRs and the Financial SPDRs are likely to have turned over their entire capitalizations from the market opening at 9:30 am. *A grand total of only four hours, eight minutes and 40 seconds will have elapsed from the opening gong heralded by the New York Stock Exchange!*

Legend for ETF Turnover Chart (Below)	
MDY	***MidCap SPDRs***
DIA	***Dow DIAMONDS***
XLE	***Select Sector SPDR-Energy***
XHB	***SPDR Homebuilders ETF***
SPY	***SPDR S&P 500***
SDS	***UltraShort S&P500 ProShares***
TWM	***UltraShort Russell2000 ProShares***
QID	***UltraShort QQQ ProShares***
XLF	***Select Sector SPDR-Financial***
XRT	***SPDR S&P Retail ETF***

The words "heavily traded" are insufficient to define or describe the sheer velocity at which many ETF shares pass from one owner to another. At current rates for the ten issues shown below, close to $12 trillion in dollar volume will be traded this year. The S&P SPDRs alone are quite likely to be responsible for over $8 trillion in dollar volume. Three of the issues are *short* their respective sectors and will trade nearly $1 trillion in dollar volume. A list of the top 25 most heavily traded ETFs also includes three additional issues that trade their entire capitalizations in less than one day; the Retail HOLDRs (RTH), Ultra QQQ Proshares (QLD) and the Oil Service HOLDRs (OIH).

Bear in mind that each long trust holds shares of the underlying companies in the respective index or sector and those that are short the respective index or sector are short either the shares or have derivative positions that equate to the short side. In the case of those that own put options, bear in mind that market makers retain the right to short shares without locating shares that can be borrowed. As a consequence, they are likely to *fail to deliver* shorted shares, creating additional supply out of thin air, since each shorted share necessarily must wind up as a long share "entitlement" in a customer's account. The U.S. stock market has been totally transformed by this institutional lunacy, wherein investment has taken on a far smaller role than anytime before.

We can only reiterate the obvious; the more stock trades on a short term basis, the less relevant are fundamental valuations and corporate prospects. Subsequently, individual stock prices have a smaller correlation with their prospects and a larger correlation based simply upon their relative position in a sector or index. Pricing inefficiency is far more likely to result in overvaluation, rather than under valuation, since holding periods are so brief. *The shorter the holding period, the less risk is incurred, thus the more risk*

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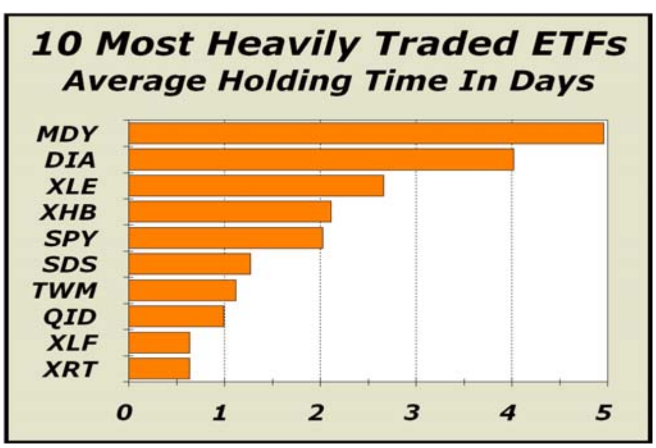

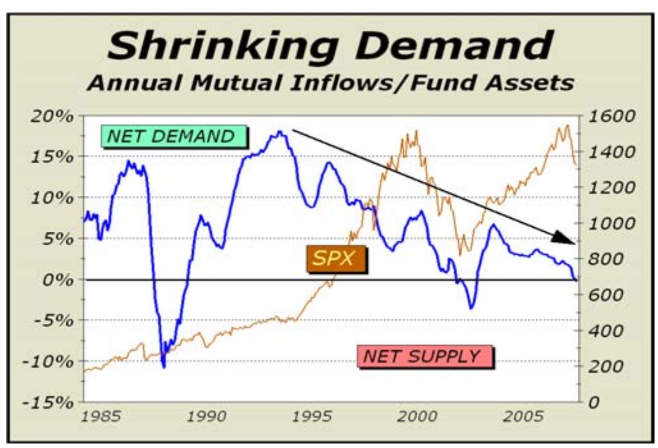

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can be accommodated. The result for the modern era has been a perennially overvalued market. Those who only two months ago cheered as the S&P 500 P/E ratio fell to the lowest level in years (!!!), have now been blindsided by earnings shortfalls that have ballooned the P/E back to a grossly high 22.9 P/E. Never mind that the historical median P/E ratio of 15.2 has not been seen in nearly two decades!

At bottom right page two, it is no wonder that mutual fund inflows continue to contract relative to assets. The new era of sponsored institutionalized velocity means less relevance for long term investment, hence less reason for investment in mutual funds. Exchange traded funds are winning the battle for assets and in the process, may have mortally wounded the investment arena. Annualized net outflows occurred only twice before in the last two decades but as of the end of April, net outflows are again in view. *The most striking aspect of the chart is the long term trend.* As long as turnover is the name of the game, as long as short term trading takes precedence over long term investment, mutual fund inflows will continue to contract relative to ETFs. Worse yet, mutual funds may experience *constant* outflows. In either case, prices must eventually suffer. *The measurement of fair value for corporate prospects requires a far longer time horizon than four hours, eight minutes and 40 seconds.*

3X The Fun, 3X The Risk.

A mere double dose of opportunity is apparently insufficient to hold the interests of traders, so Direxion Funds is now proposing the first of its kind, ETFs that will afford *triple* the return of mainstream stock indexes. But as John Spence recently noted in the WSJ (see http://tinyurl.com/4pmxs9), the required leverage will by necessity magnify the potential for losses as well.

Good grief, where does this nonsense all end? Is there any better example of why this is no longer an investment market of individual stocks? Our colleague Jim Bianco (www.biancoresearch.com) has likened the progression of leverage to the progression of the number of blades for popular razors (see http://www.schickquattro.com/) and even asks "How long will it be before ETFs offer average investors the 30-1 leverage that we have read about the hedge funds achieving?"

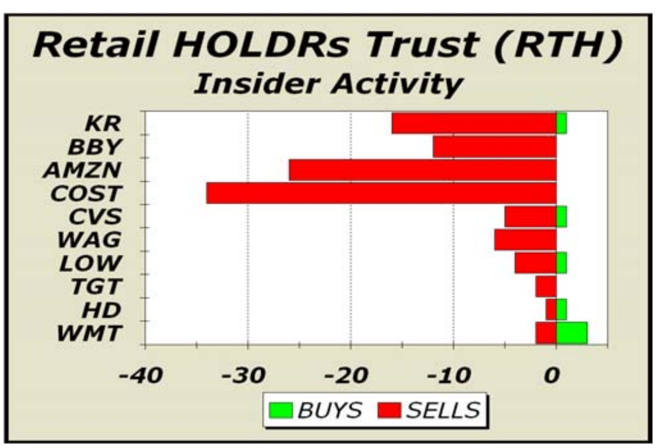
After two veritable manias in the span of a mere seven decades and a substantial echo of the most recent madness in 1999-2000, can it be any clearer that leverage typically comes with a price that investors cannot possibly afford?! Those who invested anywhere near the top in 1929 required 26 years to break even. Despite dividends paid out in the interim, investors also suffered as inflation cut the purchasing power of the 1929 dollar to only 55 cents in 1955. Eight years past the phenomenal blowoff in 2000, stocks continue to reel in the face of a seemingly permanent overvalued environment. In the interim, the purchasing power of the dollar has been cut by 23%. *The last thing the U.S. stock market needs is additional products utilizing leverage.*

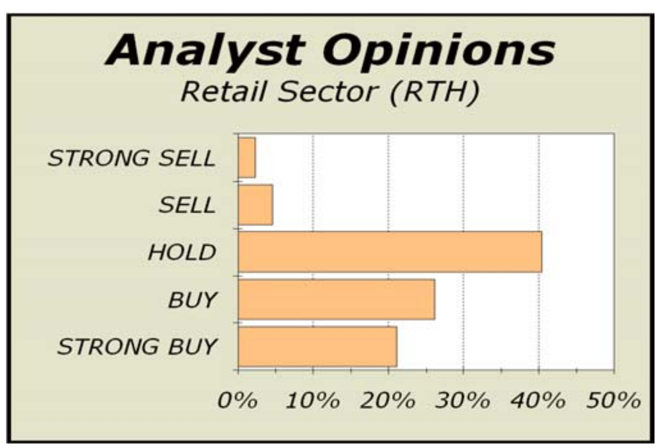
Taking The Retail Pulse Again

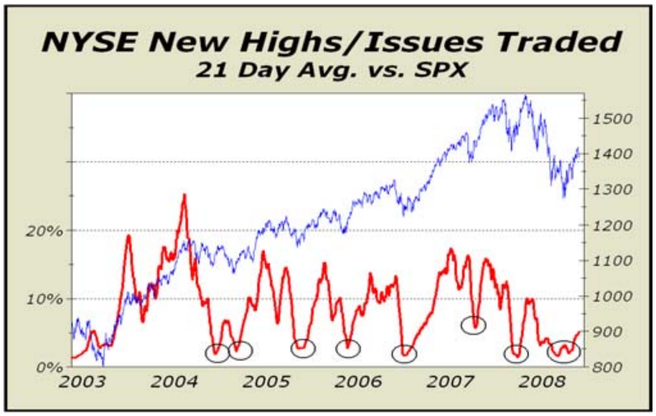
Almost three months ago (Crosscurrents, March 10th issue), we offered a view of insider activity for the Retail HOLDRs Trust. Our analysis implied "*the worst case for the economy may only be a brief and shallow recession.*" Despite subsequent episodes of volatility, humongous losses suffered by banks and brokers, awful news on jobs and the pressure of a huge spike in oil prices, stocks are holding up quite well. The major indexes are modestly higher. (s 1293). As well, recession odds as forecast by traders at Intrade (http://tinyurl.com/yp6hwg) have fallen from 68% to 30%. Perhaps our March analysis was correct? Thus, we checked the retail sector again last week, to note the possibility of any changes in insider activity. The ten issues shown in our charts account for 82% of the entire Retail HOLDRs Trust (RTH).

If it were not for the one million share buy of Home Depot Director David Batchelder, the shares sold to shares bought ratio would not have even matched March's 194-1. Although we accepted Batchelder's buy as a vote of confidence for HD, the buy was the only confident stance recorded against 108 sales. Our February report noted seven buys and 115 sales, so this report is a nearly precise replay. The same is true for total shares transacted. In February, we reported 12.4 million shares sold. That number has barely changed to 12 million.

Wall Street's analyst community are modestly more conflicted than they were in February and of course, far less positive than they were back in September of 2007. Judging by their stance, the last three months have shown additional reason for concern about the economy, but nothing earthshaking. Our earlier forecast remains intact. A brief and shallow recession is still the high odds probability. ☑☑☑☑☑







Alan M. Newman's Stock Market

CROSSCURRENTS

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Alan M. Newman, Editor

The complex bottom seems to be developing just as we thought it would—a series of feints and reactions resulting in a base built on repeated testing of lower prices. Note how each prior bottom resulted in a solid rally. This time, we have a "W" rather than a "V" bottom, a characteristic of the changed trend. Lest we mislead or misconstrue, we have very low confidence in the bull case and believe a secular bear market is ongoing. However, the bulk of our work suggests higher odds for a strong close to the year and we cannot get there if prices collapse before then. Thus, the March lows are likely to hold and volatility should contract, leaving a boring market until the expected rally in the fall.

For the shorter term, we now see a huge potential for underperformance by Nasdaq. As illustrated by Nasdaq's cumulative breadth at left, there is a serious negative divergence between price and breadth. The 16.3% rise in price has been supported solely by the action of high flyers such as Apple (AAPL) and Research In Motion (RIMM), stocks that trade their entire capitalizations in less than one month. Under the circumstances, it is impossible to make a case that value enters the picture at all. Nasdaq has become a trader's arena only. Shorter holding periods means the accommodation of increased risk. Clearly, Nasdaq's share of volume has increased to the point at which a reversal should occur. Previous reversals have all been accompanied by lower prices for Nasdaq's Composite Index and we see no reason to expect a different outcome this time. In the last issue, we said "we do not yet believe the odds are compelling for the downside (for Nasdaq)." *We now believe they are.*

Credit Shortfall

The derivative fiasco we forecast for the last several years has now encompassed losses totaling over $382 billion. On the flip side, financial firms have raised roughly $270 billion in new capital, which still results in a shortfall of at least $112 billion for the purposes of issuing new credit. Using a typical ratio for leverage of roughly 14:1, we see current estimates that there is $1.5 trillion less credit available now. Given our colleague Ian McAvity's estimate that $5 of credit are required for each dollar of expansion in gross domestic product, there will likely be tremendous pressure on the economy for quite some time.

The evidence of slower growth is now visible in a rather startling contraction in gas consumption by consumers, just as the typically heavily traveled Memorial Day long weekend arrived. MasterCard claims that gas consumption based on credit card charges, has fallen by more than 6% over the last four weeks. In the seven days into the same Memorial Day weekend as last year, Americans bought 28.8% less gas, an incredibly huge drop! Clearly, soaring prices have finally had an impact. For this reason and the obvious parabolic nature of the crude oil chart, we believe oil prices have peaked for the time being. *A correction to as low as $80 per barrel is possible.* Good news? *Indeed.* We hope to dwell a bit more on the subject in our June 23rd issue. *Stay tuned.*

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'08 RECESSION WATCH
SEE WWW.INTRADE.COM
HTTP://TINYURL.COM/YP6HWG
RECESSION ODDS = 32%

☑☑☑☑☑

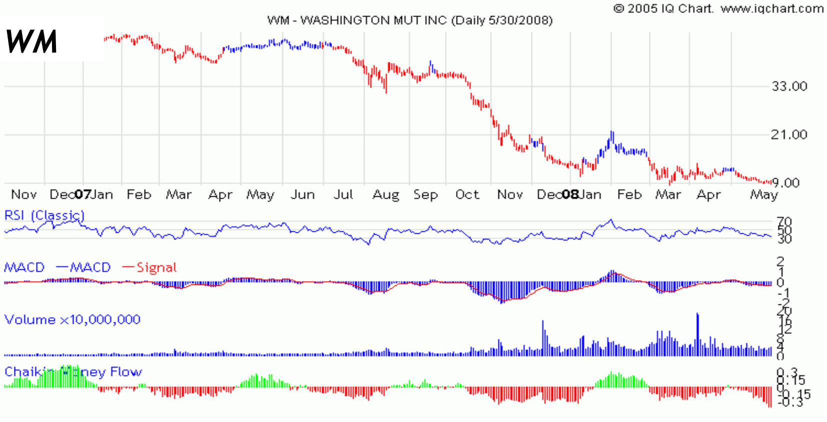
- Rationales & Targets -

Last time out, we wrote "*our best trading indicators do not reveal any substantial downside in store. However, some further retreat before the next rally seems to be the best bet*." The Dow rose another 1.7% closing basis and fell 3% thereafter to Tuesday's close. Late in March, the Dow was averaging moves of 200 points per day over the previous 10-days. The average is now 80 points. Volatility has been declining and should fall further during the summer. We still see at very worst, a test of the early year lows ***but those odds are rapidly contracting***. Such a test would require a news shock, which we believe is somewhat unlikely to occur. The stock market has already suffered an enormous amount of bad news thus far in 2008 and if anything, participants may be dulled into a state of acceptance, rather than action. The gestalt is peculiar and seems to rest on hopeful waiting. Of course, this adds to our concerns and leads us to increase the range of downside risk for our current forecast, seen at right. Long term, the bear market is intact. However, any pullback in oil prices will assuage fears. We believe the odds for same have significantly improved.

We came close to committing to the short side for QQQQ but prefer to stand aside and not risk the Trading Stance record to date. Another opportunity will arise. Below, two reasons to be scared witless about the financial sector. Bear in mind that Bear Stearns (BSC) was taken apart in nothing flat, done in as much by waves of rumors as the sordid fundamentals. Given the continuing weakness with Wachovia's (WB) new low and Wamu's (WM) near new low this week, it would not take much to bring both companies to the same sorry fate. But given the dicey nature of how the BSC situation pointed to a potential collapse of the system, it will not be as easy for players to promote the rumor mill. We're watching, not shorting.

WB

WM



The Psychology of the Market

Newsletter Writers: 3 Wk. Bull/Bear Ratio 1.4 Neutral
AAII: 3 Week Bull/Bear Ratio: 1.1 Neutral/Pessimistic
Mutual Funds: 4.2% cash: Complacency grows!
Rydex Ratio Sentiment: 3.8 Grossly Complacent!
(Bull & Sector Funds vs. Bear Funds)
Crosscurrents Emotion-Based Indicators: Negative

Crosscurrents Current Forecast

SHORT TERM = ODDS FAVOR DOWNSIDE
BOTTOMING PHASE STILL IN PROGRESS
SHORT TERM UPSIDE POTENTIAL = 3%-4%
SHORT TERM DOWNSIDE RISK = 6%-7%

Crosscurrents '04 Investment Stance
AVG. GAIN FOR ALL POSITIONS +17.0% Vs. DJIA +1.9%

Crosscurrents '05 Investment Stance
AVG. GAIN FOR ALL POSITIONS +32.0% Vs. DJIA –0.6%

Crossscurrents '06 Investment Stance
AVG. GAIN FOR ALL NEW IDEAS +29.2% Vs. DJIA +16.3%

Crossscurrents '07 Investment Stance
AVG. GAIN FOR ALL NEW IDEAS +53.5% Vs. DJIA +6.4%

Crosscurrents '08 Investment Stance

RETAINED FROM PREVIOUS YEAR OR EARLIER
iShares Japan Index (EWJ) 5% LONG +4.7%
Newmont Mining (NEM) 15% LONG +14.5%
Archer-Daniels-Midland (ADM) 10% LONG +63.9%
(ADM POSITION CLOSED OUT)
CNOOC LTD. (CEO) 5% LONG +92.5%
PowerShs China Portfolio (PGJ) 5% LONG +43.2%
NEW IDEAS FOR 2008
Petroleo Brasileiro (PBR) 10% LONG +24.1%
Companhia Vale Rio Doce (RIO) 5% LONG +26.1%
Vimpel-Communications (VIP) 5% LONG –12.0%
China Medical Tech. (CMED) 5% LONG –19.1%
Paraxel Int'l. (PRXL) 5% LONG –10.7%
Vs. DJIA –4.7% SPX –4.6% Nasdaq –4.9%
"Retained" ideas priced from inception
Percentage gains (losses) include dividends

Crosscurrents '08 Trading Stance

Newmont Mining (NEM) 5% LONG +35.2% CLOSED
Nasdaq 100 (QQQQ) 15% SHORT +10.7% CLOSED
JP MorganChase (JPM) 10% SHORT +6.9% CLOSED
Paraxel Int'l. (PRXL) 5% LONG –6.6% CLOSED