Alan M. Newman's Stock Market

CROSSCURRENTS

U.S. STOCK MARKET OUTLOOK for MARCH 30, 2009
DJIA 7776 - SPX 815 - NASDAQ 1545

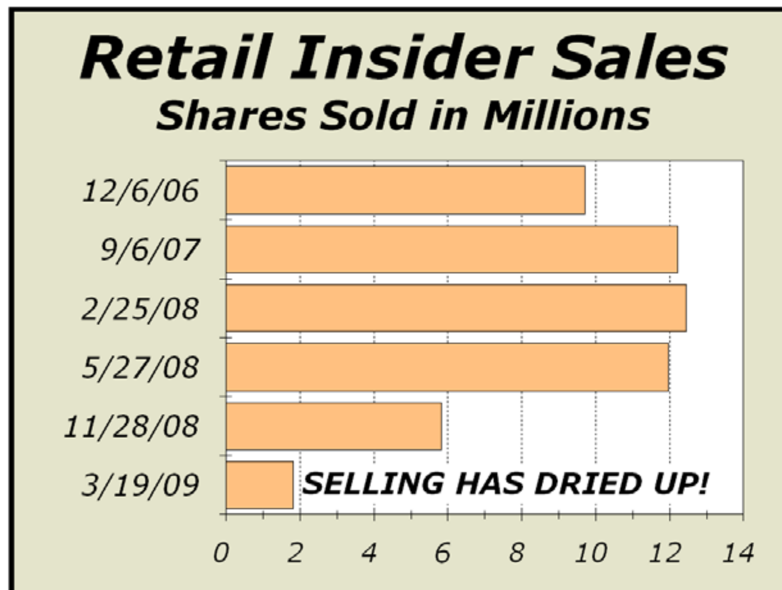
RETAIL SECTOR INSIDERS ARE AVOIDING STOCK SALES, EVIDENCE THAT FEARS OF AN ECONOMIC DEPRESSION MAY BE OVERSTATED. ETF TURNOVER STILL IMPLIES MECHANICALLY DRIVEN OVERVALUATION. *- NEXT ISSUE - APRIL 20, 2009 -*

Evidence That The Retail Sector Is Sold Out.

Over the last few months, we have witnessed tremendous concerns about a collapsing economy, even speculation that we are entering a replay of the "Great Depression" that took unemployment as high as 25% in 1933. Given the rapid contraction in auto sales and the plummeting of retail sales into the 2008 holiday season (see http://tinyurl.com/a6uxqo), these fears certainly did not appear totally unreasonable. Retail sales account for roughly one-third of the economy. When the retail sector slows to a halt, the entire economy suffers.

In the December 15th issue, we noted that insider activity in the retail sector had vastly improved from prior readings, affording at least a modicum of evidence that the crisis might not achieve the status of a worst case scenario. The insider seller to buyer ratio had been as high as 23.7 to 1 in September 2007, coincident with the peak in prices for the Dow, and had averaged over 16 sellers for each buyer for several years. But by our December report, there were only 4.7 sellers for each buyer.

At first glance, today's fresh examination of retail sector insider activity appears to be less favorable than in December. The seller/buyer ratio has edged up to 5.5 to 1 and the ratio of shares sold to shares purchased has climbed as well. However, perspective is everything.



The chart above comprises activity at the top ten constituents of the Retail HOLDRs Trust, an exchange traded fund traded on the Amex (symbol RTH). These ten companies comprise over 85% of the index. The RTH peaked in late June 2007 at $108.73 per share and had a secondary top in late September 2008 at $101.50. As of this writing, the RTH was $69.98, down 35.6% from the peak and down 31% from the September '08 high. By comparison, the Dow, Nasdaq Composite and the S&P 500 had all fallen at least 50% from high to low. Despite the importance of retail sales, the sector has outperformed the averages.

We are very impressed that both the number of sellers and total shares sold have contracted significantly. In fact, as you can see above, the number of shares sold by insiders has declined 69% from our last sampling and is down over 85% from the February '08 high in selling activity.

While this one perspective cannot possibly act as a guarantee that the economy is poised to turn, it does provide some evidence that the sector is thoroughly sold out. Clearly, there have been a large number of bankruptcies over the last year, including Levitz, Bombay, Sharper Image, Linens 'n Things and Fortunoff's plus huge numbers of store closings for retailers such as Foot Locker, Ann Taylor

(Continued on page 2)

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(Continued from page 1)
and Zales. If there is any slack at all, the dearth in insider sales for the top ten becomes quite logical. As well, given the background in sentiment with media headlines focused on depression mentality, contrarian logic validates our claim that things may not be quite as bad as feared.

One Hour & 43 Minutes

In the March 11th issue of Systems & Forecasts (www.systemsandforecasts.com), Editors Dr. Marvin Appel and Gerald Appel make some very intriguing points about leveraged long and short ETFs, claiming they "*are designed to lose money.*" The explanation is logical and mathematically correct and while we cannot go into the details in our limited space, suffice it to quote the Editors "*the fixed relationship between the ETFs and their benchmarks guarantees that there will be frequent buying at market tops and selling at market bottoms.*" The math implies a bias that works in favor of very short term trades and works against holding positions for longer than even one day.

One example cited is the UltraShort QQQ ProShares (QID), which functions as a perfect example. QID purports to "*correspond to twice (200%) the inverse (opposite) of the daily performance of the NASDAQ-100 Index®.*" The Editors relate that since 9/29/08, although the QQQQs have lost 30%, the QID did not gain twice as much as one might have thought, but gained only 28%. If instead, an unleveraged short position was taken in the QQQQ instead, the gain would have been almost as much, 23%. The Editors correctly claim, "The *double leverage incurred double risk for you, but not double profits.*"

We have pointed out on many occasions that it's all about product. As usual, Wall Street has succeeded in devising additional ways to part investors from their hard earned money. We have wondered for several years about the effects of program trading and have lamented that prices are increasingly determined by mechanical processes, including programs that are likely to impart little or no benefit for individual investors. Given the mathematical disparities cited by the Appels, it is patently clear that many ETF products have enabled a vast increase in the ways temporary discrepancies and pricing inefficiencies can be arbitraged. The more products in play, the more likely some must be to reflect pricing inefficiencies, no matter how fleeting. While ProShares admits "results over longer periods (than daily) may differ," they do not at all stress that longer holding periods are *designed to underperform*, an inexcusable error of omission. Although the Pro in ProShares might imply the ETFs are not for the little guy, the company nevertheless claims their products "*make it simple to execute sophisticated strategies, like shorting or magnifying your exposure to major indexes. No margin account. No margin calls. It's as simple as buying a stock.*" However, in fact, it is clearly not as simple as buying a stock. If you hold a leveraged ETF at the close of trading on Monday, the math may already be working against you after the market closes on Tuesday.

We wondered about the WSJ headline on December 15th, that asked, "Are ETFs Driving Late-Day Turns?" (see http://tinyurl.com/66phre). Program trading has recently averaged roughly one-third of NYSE volume, double what it averaged only five months ago. Now the recent surge in program activity becomes a lot more understandable. The WSJ article goes on, "*The final hour of trading has become significantly more active. In November, an average 26.2% of trading volume in the stocks in the Standard & Poor's 500-stock index took place in the final hour and 17.1% in the last 30 minutes, according to data from Credit Suisse. That's a much higher share than before: In 2006 and 2007, 20.7% occurred in the last hour and 12.9% in the last half hour.*" Data show that big swings and big reversals were about evenly split, thus whatever trend was in place was clearly not the catalyst. The WSJ article implies that late market swings may be explained by leveraged ETFs and claims more than 100 leveraged ETFs are now available, with two dozen launched last year. But the WSJ story was dated in December. As stocks bottomed in early March, the impact of ETFs on late trading may have been even worse.

In our June 2, 2008 issue, we even showed how some ETFs trade their entire capitalization in just over four hours. Toss that record aside. *The QID does it in only one hour and 43 minutes*, which likely enables a crescendo of arbitrage at numerous points during the trading day and especially in the last hour of trading. It is certainly logical that derivatives, such as leveraged ETFs, are arbitraged against the underlying constituents (the companies that actually comprise the index, or the theoretical opposite). The process leads to a vast increase in short term trading (see article on dollar trading volume, http://www.cross-currents.net/charts.htm) of individual issues. What follows is all you need to know; as we said nine months ago, "*the more stock trades on a short term basis, the less relevant are fundamental*

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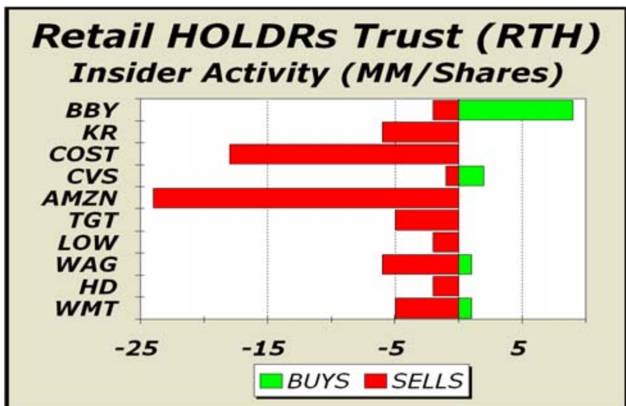

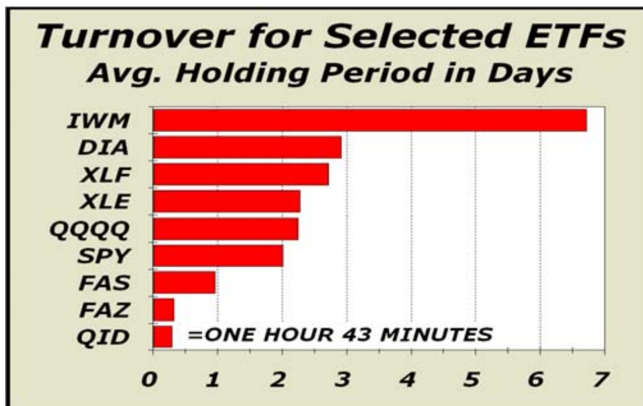

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valuations and corporate prospects. Subsequently, individual stock prices have a smaller correlation with their prospects and a larger correlation based simply upon their relative position in a sector or index or other momentary considerations. Pricing inefficiencies are far more likely to result in overvaluation, rather than under valuation, since holding periods are so brief." The metamorphosis of the U.S. stock market that we have railed about for several years may now have guaranteed a losing proposition for the small investor who must invest for the long term.

By the way, the QID is not only marginable, QID options are traded, which begs the question, is there *any* amount of leverage or risk that regulators are willing to enforce? On December 1, 1995, former Fed Chairman Alan Greenspan urged an end to any margin requirements at all (see http://tinyurl.com/dm4ysm), thus enabling the commencement of a mindset that equaled the leveraged insanity of the Roaring Twenties. Despite the increased sway of the markets away from John Q. Public towards hedge funds and other professionals, the late year '08 experience of the billions lost by professionals is testament that leverage can wreak havoc on even the sophisticated. In the current era, the overall impact of leverage in our markets has cost John Q. Public *trillions* of dollars. Less than four months ago, Direxion launched eight triple leveraged ETFs, including the Financial Bull 3x Shares (FAS) and the Financial Bear 3x Shares (symbol FAZ). Imagine those who upped the ante to 6x with margin or still higher using options. In 1929, margin rates of 10% enabled the public and professionals to up the ante to ludicrous extremes and the nation paid the price. *We are again paying the price.*

CNBC Anoints A "Cult Hero"

If you can believe CNBC, reporter Rick Santelli spoke for all Americans from the Chicago Mercantile Exchange on Thursday, February 19th, taking President Obama and the legislative branch of the government to task for plans to alleviate the mortgage crisis. We can state emphatically that we are not fans of the administration's strategies thus far but Mr. Santelli's meteoric rise to economic sage is ludicrous. Most of CNBC's "reporters" have editorialized to their heart's content in recent years with not one we can remember ever questioning the flip side of the huge boom in credit derivatives and the increasing use of leverage by banks and brokers. In our view, both circumstances are entirely to blame for the current crisis, not Obama and not the stimulus.

Jon Stewart vs. CNBC and Cramer

http://tinyurl.com/cn2c3e
http://tinyurl.com/dkzu4t
http://tinyurl.com/cwgejl
http://tinyurl.com/b2b3k3
http://tinyurl.com/d7hr3f

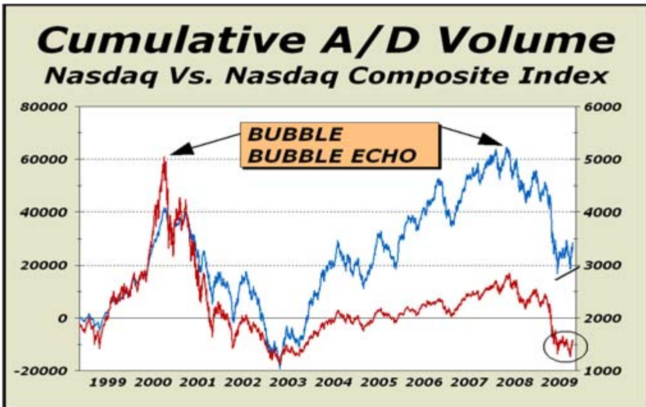
Where was Mr. Santelli's outrage when it was reported (see tinyurl.com/2z5euk) back in November 2007 that just six banks & brokers had accumulated over a third-of-a-trillion dollars in Level Three assets? [also see Crosscurrents, November 26, 2007] Where was Santelli's outrage when it was revealed banks and brokers were operating on 30 to 1 leverage as the crisis hit? Instead of blaming those who were hoodwinked into taking mortgages they could not afford, why is Santelli not outraged at the bankers that permitted financial atrocities (see http://tinyurl.com/bzldbo) such as Jupiter High Grade CDO V?

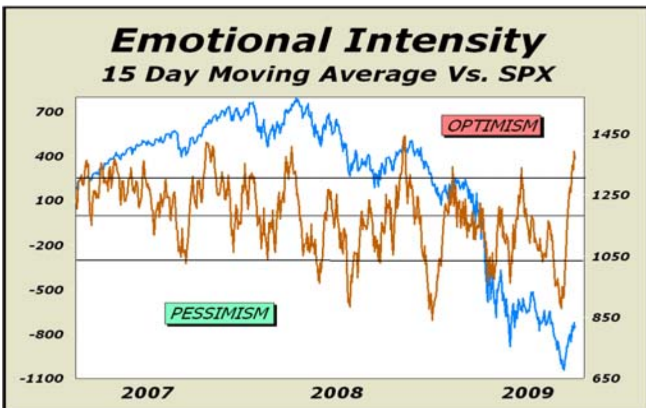
Mr. Santelli's reach out to those in the pits to voice their own votes was bizarre, since commodities and futures traders clearly do *not* represent the majority of Americans. Clearly, the financial network's attempt to make Santelli's comments the focus of the economic news that day was a serious error in editorial judgment. The day after Santelli's rant, another CNBC reporter referred to the reporter as a "cult hero." *Heaven help us all.* Like you, we look for words of wisdom in all the usual places, most of which come up empty in times like this. Unfortunately, it appears we have to endure the recession in wisdom for much longer. We need a much better "cult hero."

And it certainly will not be Jim Cramer, either. In March 2005, CNBC advertised the debut of the Mad money show with Jim Cramer wearing a strait jacket. The anointed "hero" of CNBC's foray into entertainment made dozens of forecasts in individual stocks each and every day. The quest for audience even included cow bells, whistles and all sorts of patently stupid sound effects but to what end? Not long ago, Barron's attacked Cramer's forecasting track record for the second time, presenting evidence that investors and traders were worse off with Cramer's advice.

CNBC continues to portray Mr. Cramer in the most favorable light. One recent CNBC ad prominently displayed "In Cramer We Trust." Heaven forfend. If we have trouble admiring Rick Santelli as a cult hero, we certainly have trouble imagining Mr. Cramer as a forecasting whiz. We have previously pointed to Cramer's comments (see http://www.thestreet.com/funds/smarter/891820.html) at the very top of the mania, exhorting all to buy and hold his "10 top stocks" that somehow managed to decline by more than 90% and now we take the opportunity to point to more recent comments (see http://nymag.com/news/businessfinance/bottomline/31275/) wherein Cramer exhorts that the gazillions paid to Goldman Sachs' Lloyd Blankfein, Bear Stearns' Jimmy Cayne, Lehman's Dick Fuld, Merrill Lynch's Stan O'Neal and Morgan Stanley's John Mack were well deserved. Cramer claimed, *"Those five men are underpaid because they are about to make you very rich if you buy their stocks.*" The date was April 30, 2007, only 32 days before U.S. financial stocks peaked. *Whoops.* By February 20, 2009, an equal investment in each of the five companies mentioned would have declined a resounding 81.1%.

Recently, comedian Jon Stewart took on both CNBC and Mr. Cramer, ripping both a new one about as emphatically as one could possibly imagine. We've placed links to all the pertinent clips in the call out on this page and strongly urge you to view them. The most significant point for us as observers was when Stewart observed that, "*To a certain extent, we're snake oil salesman*" and amazingly, Cramer responded, "*I'm not disagreeing,*" a tacit admission that his entire stint on CNBC has been about as relevant to stocks as a medicine man's dance in New Guinea. Watch the clips and decide for yourself. At the very least, it's much better entertainment than Mad Money. ☑☑☑☑☑





At top left, the ratio of Nasdaq volume to NYSE volume has been falling, which we interpret as a sign that speculation is still contracting. The theory behind the indicator is that Nasdaq's typically lower priced issues trade more heavily in a more speculative environment. Many weeks ago, we claimed that Nasdaq action was diverging positively against the other major indexes and at one point last week, Nasdaq was actually up for the year. *The chart implies Nasdaq will continue to act well versus the S&P 500 and the Dow Industrials*.

In our last issue, we pointed out the possibility of a positive divergence in Cumulative Advancing/Declining Volume and indeed, that is precisely what occurred as the line turned up. The divergence bodes well for the intermediate term but *much of the rally we were looking for has already taken place*. At this juncture, the market will have to prove that considerably more is in store for any additional long side risks to be worthwhile.

Most of our indicators of emotion are running to levels consistent with a short term downside reversal but the 15-day indicator shown at left is best interpreted as an early warning, *not a sell signal*. It will likely take a lot more optimism for anything more than brief pullback. Given the horrifically oversold market and the palpable pessimism in place three weeks ago, some excess on the upside was inevitable, but much more will spell the end of the fun and games.

Initial Claims

As long as the economic background remains as bleak as the stats have indicated, one can only wonder if the fears about an economic depression are well founded. Clearly, the loss of wealth has been dramatic and when wealth declines to so great an extent, the ability and desire to spend evaporate. Companies earn less, or worse yet, lose money and begin the process of layoffs and job cuts in order to survive, thus reinforcing the cycle of less spending and more job cuts. A vicious cycle.

In the fallout from the collapse of the mania after March 2000, total stock market capitalization declined by roughly $9 trillion. From the 2007 highs, the loss has been as high as $10 trillion. The double whammy of momentous stock price declines and a bum housing market has created a vacuum unlike any seen in decades. The Federal Reserve estimates Americans lost 18% of their wealth in only one year—2008 (see http://tinyurl.com/dnz88c).

Nevertheless, for reasons offered in our lead article, we are somewhat mollified that the worst case scenario will be avoided. Thus, our quest is to forecast an economic turn to the upside well before the stock market discounts such a turn. We believe weekly Initial Unemployment Claims are likely to turn out to be the best advance indicator of a turn. The Department of Labor stats can be viewed at http://tinyurl.com/49nuu. Claims are 78% higher than last year and the four-week moving average edges the number up to 82% higher than a year ago. We intend to keep a close eye on this. Bear in mind, we do not expect a quick turn for the economy. Our best guess is still the autumn of 2010.

☑☑☑☑☑

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3280 Sunrise Highway #125
Wantagh, NY 11793
(516) 557-7171
Alan M. Newman, Editor
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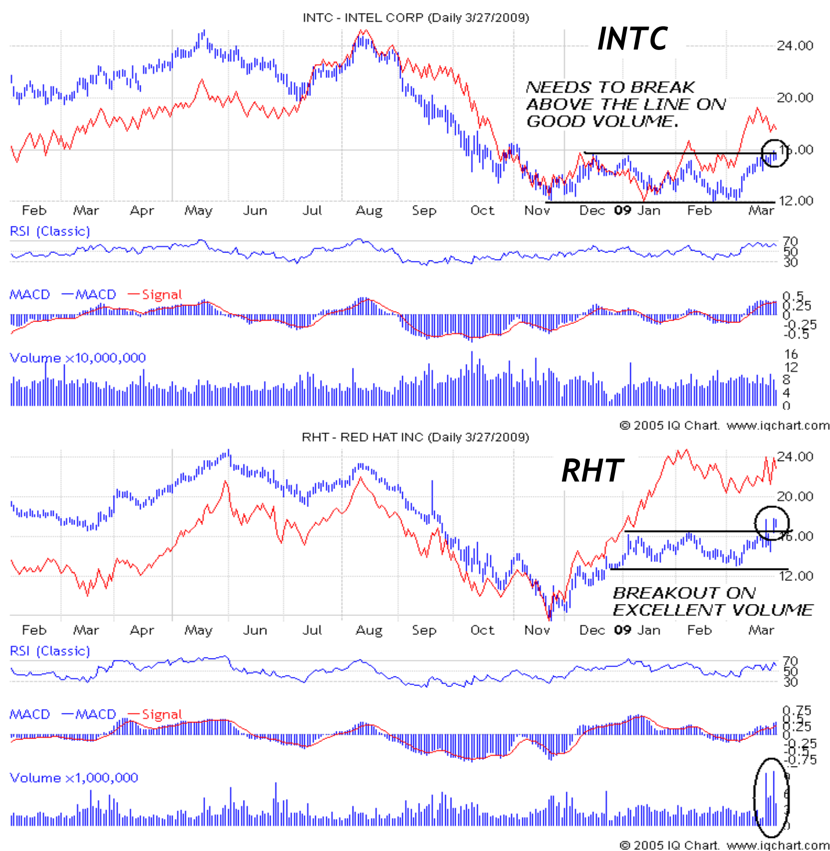
- Rationales & Targets -

On March 6th, the Dow printed as low as 6469, less than 33 points from a target we termed "poetic justice," the same level the Dow traded when Alan Greenspan pondered "irrational exuberance" in December 1996. Although volatility has played havoc with a few of our recent forecasts, we clearly pinned the Intermediate Term Forecast in our last issue, claiming the "**DOWNSIDE SHOULD BE PLAYED OUT**" & "**BEST REWARD/RISK RATIO IN YEARS**." We offered upside potential of 28% and the Dow advanced just over 20% before Friday's pullback. ***It is clear the odds have now changed considerably***. The upside is no longer the great bet it was three weeks ago. Very strong support should lie at Dow 7200, an exact 50% retracement of the rally. However, there is still sizeable risk that after a brief consolidation/corrective phase, the next rally may be followed by a test of the March lows. Simply put, the charts of Citigroup (C), Bank of America (BAC), Wells Fargo (WFC) and JPMorgan Chase (JPM) remain fraught with risk. Goldman Sachs (GS) is likely the key. As long as GS remains in a visible up trend, we are likely to survive the bear market.

In our last issue, we stated, "when they do [rally], the stocks with the best charts should perform quite admirably" and the two charts shown were BKE and CERN. The former closed Friday up a humongous 43.3% in only three weeks and the latter was ahead by nearly 29% at one point.

The SOX index has been in an up trend since November, another reason to suspect a worst case scenario is not on the horizon. We can't find anything to dislike about many of the charts, especially Intel (INTC), on the verge of a significant breakout. The dividend yield is now 3.6%. Honorable mentions; Applied Materials (AMAT) and Micron Tech. (MU). Best looking chart this week is Redhat (RHT). Takeover rumors abound.



Our latest interview with Aegean Capital's Ike Iossif
http://audio.marketviews.tv/audiofiles/synd/newman15.mp3

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The Psychology of the Market

Invest. Intelligence: 10 Wk. Bull/Bear Ratio 0.8 Pessimistic
AAII: 3 Week Bull/Bear Ratio: 0.8 Concerned
Mutual Funds: 5.8% cash: Turning Fearful
Crosscurrents Emotion-Based Indicators: Rapid Swing Back To Optimism

Short Term Forecast

CORRECTION/CONSOLIDATION
UPSIDE POTENTIAL = 8.5%
DOWNSIDE RISK = 7.4%
ODDS HAVE CHANGED CONSIDERABLY!

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%
Crossscurrents '08 Investment Stance
AVG. LOSS FOR ALL POSITIONS –14.3% Vs. DJIA –.33.8%

Crosscurrents '09 Investment Stance

RETAINED FROM PREVIOUS YEAR OR EARLIER
Newmont Mining (NEM) 15% LONG +10.8%
Vimpel-Communications (VIP) 5% LONG –27.1%
China Medical Tech. (CMED) 5% LONG –29.6%
Paraxel Int'l. (PRXL) 5% LONG –12.6%
AVERAGE LOSS –5.9%
Vs. DJIA –11.4% SPX –9.7% Nasdaq –2.0%
"Retained" ideas priced from inception
Percentage gains (losses) include dividends

POSSIBLE ADDITIONS FOR 2009

Pfizer Inc. (PFE) 5.2% dividend yield
Altria Group (MO) 7.4% dividend yield
AT&T Inc. (T) 6.4% dividend yield
ShengaTech Inc. (SDTH) 5 P/E - China/Speculative
Potash Corp. of Saskatchewan, Inc. (POT) 8 P/E
Express Scripts Inc. (ESRX) - 10.2 forward P/E
Suntech Power Holdings Co., Ltd. (STP) 12 P/E - China
TransMontaigne Partners LP (TLP) - 13.5% yield

NO POSITIONS TAKEN YET

Crosscurrents '09 Trading Stance

Express Scripts (ESRX) 5% LONG –22.6%
Paraxel Int'l. (PRXL) 5% LONG –10.3%