

September 2009

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9/28/2009 2:05 PM **The big move up in stocks**

Good Afternoon,

The only sensible explanation of why stocks are up 150 points today is because the Detroit Lions won their first football game in a year and a half. That is certainly bullish for stocks and the economy because it is a sign that Detroit, including Ford and GM are on their way back! It is a sure sign of economic recovery. I mean if the Lions are winners, then GM and Ford can be winners as well. And if GM and Ford turnaround, that means Detroit turns around. That means houses start going up in price and jobs return. And if Detroit can turn around then why not the rest of the country. See, all it takes is one football win and the entire economic picture brightens.

Obviously, all of New York traders are closer Detroit Lion fans because they are ramping stocks for no other reason. Except, as we said in Friday's FLASH, this is the traditional end of the month, end of the quarter window dressing where fund managers gun these stocks to put the icing on the cake for their quarterly performance. So no real surprise right here as far as direction but a huge surprise in terms of the amount the market is up.

All of our "tells", that is the other markets that give us a sense of direction for stocks are not working at all today with the exception of oil. The dollar is rallying and the Euro is getting crushed, now down 100 points against the greenback. For the past year, this type of move in the Euro would have meant a 200 point down day in the DOW. The bonds are up 21 ticks and the 30 year yield has broken support at the 4.12% yield area and yields are all the way down to 4.04%. Over the last year, this type of move in bonds would have meant 100 points down in the DOW. Oil is up 92 cents to \$66.95 a barrel and that is the relationship that is working today in terms of confirming the stock market move.

Either bonds, the dollar and the Euro are right, and stocks are wrong or vice-versa. Over the years, we have been shown time and time again, and most times at great expense, that the bond market is almost always right. As David Rosenberg says, Mr. Bond usually has his way as compared to Mr. Market. Today, that is not happening and we are just plain confused.

Volume today is very light and it is Yom Kippur (happy holiday to all of our Jewish friends and readers!!) so maybe that has something to do with the lack of two way trading today since there has been none...nada...zero.

We think that maybe the bonds and dollar and Euros have it right and this rally is strictly the quarter end shot for managers and they were bound and determined no matter what to get this market higher over the next three days. If that is the case, especially if the unemployment numbers due out Friday are worse than expected, and the Bonds keep rallying, the Euro keeps sliding and the Dollar keeps rallying, stocks will be in for a rude awakening come Thursday and Friday.

It will see if Bond.....Mr. Bond.....is right again.

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9/28/2009 6:05 PM **Deflationary trends are returning.**

Good Afternoon,

30 year bond yields closed at 4.04% today, the lowest rate since May 15 and that 4.04% rate was hit as the 30 year yields were rising on their way up to 4.84% which was hit on June 10th. The yield on the 30 year is at new lows today, down 16% from the highs. As we said earlier, this drop in rates is getting serious and we think that if they drop below 4%, their next support won't hit until way down at 3.79%. Bond traders moving yields lower like this are telling us that they are not too excited about near term economic growth or near term inflation for that matter. All of this talk about \$100 oil and such may be just that, talk, because Mr. Bond is pushing yields to 4 month lows amid this chatter.

So what are the facts right now concerning inflation or deflation?

Money figures are telling us there is much trouble ahead. And it is on a global scale. The M3 money data is already giving us an early warning with a downward sloping line that makes us think we will see some serious deflation problems in 2010. And these same downward sloping M3 numbers are showing up in over half the economies in the world. And a good deal of the emergency schemes that have been invented since last year are being withdrawn.

Worldwide, we are seeing unemployment benefits starting to expire with serious effects to the global economy. In Spain, for example, weekly unemployment checks are ready to be reduced to the equivalent of \$159 as Spain faces near depression-like conditions. Unemployment levels are approaching levels not seen since the Second Republic of the 1930s and some reports are saying that Spain's recovery will not take place well into the next decade. In Estonia, the weekly unemployment check will average only \$25.

In Germany, they have adopted the Hoover policy of 1930 where the government subsidized wages as well as companies that do not fire workers. The Kurzarbeit, as it is known will run out by November and their "Cash for Clunkers" program is ending this month. Car sales were up 28% in August but like the US, only by stealing from the future. The German Center for Automotive Research says car sales will fall "by a million next year. It will be the largest downturn ever suffered by the German car industry."

In Italy, Fiat's Sergio Marchionne warns of "disaster" unless Rome renews its car scrappage "cars for clunkers" subsidies immediately. He warns America may see car sales slump by 40% in September. They will be announced the first week in October.

Here in the US, shipments of capital goods fell 1.9% in August. New home sales are stuck at 430,000 which is now down over 70% from their peak. All this despite the \$8,000 tax credit for new home buyers which expires in November.

It seems that we are getting close to where countries throughout the world, big and small are going to be forced to cut budgets and spending and some in a huge way. Britain is about to enter the process and present Prime Minister Gordon Brown is on his way out because of it. Spain has told ministries to slash 8% of discretionary spending and the IMF just said that Japan risks a funding crisis without broad cuts. Can you imagine the current Congress deciding to drastically cut spending? We think they will be forced to after the 2010 elections because the deficit will be "nuclear" by then, especially if health care passes.

And this leads us to ask the question, "What will the world look like WITHOUT these massive stimulus programs being in place?" If you look at the massive scale of global stimulus, we first have to ask, "Did it do any good?" Sure many people say it saved us from depression or the total collapse of the world monetary system and maybe it did. But our question has to do with stimulus.

Since all of the stimulus has been in place, China's exports were down 23% in August, Japan's were down 36%. Industrial production in Japan has dropped 23% since global stimulus was unleashed. Industrial production in Italy is down 18% in the same period. Germany's industrial production is down 17%, France is down 13%, Russia is down 13% and the US is down 11%. As we have said before, it seems markets all over the world are pricing in an economic recovery that up to now, is not occurring and in fact, statistics show it is starting to once again turn lower.

Remember in our Great Depression series, government stimulus was actually shown to push the country deeper in depression.

The facts are that private spending, that is again decelerating in the deficit countries (which the US is now a proud member) has not risen enough in the surplus countries (Germany and East Asia) to compensate and this is leading to deflationary tendencies throughout the globe. Excess capacity...an economic situation in which actual production is less than what is achievable for companies...remains at post-World War II highs, across the world. High excess capacity is a major ingredient in a deflationary economic "soup."

Tim Congdon from International Monetary Research says that US bank loans have been falling at an annual rate of almost 14% since early Summer. He writes, "There has been nothing like this in the USA since the 1930's."

M3 has been falling at a 5% rate; M2 fell by 12% in August, the Commercial Paper market has shrunk from \$1.6 trillion to \$1.2 trillion since late May; the Monetary Multiplier at the St. Louis FED is below zero (.0925) and in Europe, M3 has been falling at a 1% rate per month since April.

Private loans have also fallen by \$176 billion since January.

The US government is adding to the problem by borrowing money like never before. The national debt is up by more than a THIRD over a one year period, more than any other time since World War II.

This week the FED published its quarterly report on debt levels in the economy. The startling fact for us was the fact that while the government was borrowing a lot more, the private sector borrowed less. Total domestic debt which is the amount owed by individuals, governments and businesses increased by only 3.7% from the second quarter of 2008 through the second quarter of 2009. This is the SMALLEST increase since the FED started keeping these records in the early 1950s.

Domestic debt FELL in the second quarter by 0.3% to \$50.8 trillion. This was the first such decline since the first quarter of 1954, when total debt was less than \$500 billion. These figures tell us how much trouble this economy is in and how deflation is creeping back into the picture.

This report also pointed out that nonfinancial businesses did increase their debt but only by 1.3% over the last 12 months. Do the math and since that rate is well below the interest rates most of these companies pay on their old loans, it shows us that these companies were paying back the old loans faster than receiving new ones.

Total household debt fell by 1.7% year-over-year and mortgage debt, the largest component of total household debt fell at a 1.8% rate. There have been 10 recessions since the FED started taking this data and this is the FIRST one where mortgage debt has fallen. Some of this decline is due to massive foreclosures where the upon foreclosure, the debt is canceled and the lender is left with the loss.

This FED report is an eye-opener in that it shows us how this economy is shrinking and most of it because the consumer is not borrowing either because they decided not to or they can't. Whatever the reason, in an economy where consumer spending accounts for over 70% of the GDP, this is not good news. The fact that the big exporting countries like China and Japan have seen the bottom fall out of exports in August is not a good thing. The "ghost ship fleets" at anchor throughout the world's oceans is another sign saying the consumer is tapped. And when the consumer is tapped, the economy is tapped.

The stock market is valued today for 4.2% GDP growth and \$83 a share in S&P500 earnings next year. We continue to warn that these numbers are not going to happen. As we have said before, there is too much debt and the world is tapped out. Loans are plunging and this global economy cannot recover in any meaningful way without loans increasing and businesses and consumers able to borrow money again.

But what is more worrisome is the signs of deflation starting to emerge once again. The smaller countries are the ones to watch over the next six months. Eastern Europe, Spain and Iceland all need to be watched. In the Great Depression, the national Bank of Austria triggered the domino effect in Europe. We think the next shoe to fall will be there, in the East. Pay attention.

As Julian Robertson said, the debt is so large that we will never be able to repay it. We are no longer in control of our economic future, the countries that buy our debt are. So any event, no matter how small, can affect our economic future. We can no longer be proactive because of it, we are forced to be reactive. If Japan's economy suffers internally, and they choose to spend more of their money internally versus buying our debt, it will be a disaster for this country. If China joins them, as Robertson said, it would be "Armageddon."

Add it all up and to us, things are looking pretty dismal and as we have said before, everyone needs to be paying attention and we mean now. We think things will start to unwind at a fast clip.

As Jimmy Buffett says, "I can't see the future, but I know it's coming fast."

Attachment:

9/29/2009 4:30 PM **Real Estate Thoughts.**

Good Afternoon,

The Case Shiller numbers were out today, the Composite 10 and Composite 20 Home Price Indices and both of them showed strong monthly gains. While both are still negative on a year over year basis, home prices have shown gains over the previous quarter. Many analysts, as a matter of fact, all of them took this report to declare that the housing market has turned and the bottom in many locations may be in.

The S&P500 futures were lower pre-market but as this report was released, they shot up and pushed the markets higher on the open. CNBC had the flashing green boxes going with comments from analysts telling the bottom is in. But is it?

We still want you to focus on inventory in the housing market today. If inventory has in fact improved, which the report stated, then why have prices of homes continued to deflate? Economics 101 would conclude that prices deflate when there are more sellers than buyers which in housing case means there is more supply than demand. According to our research, this "shadow" housing inventory that does not show up in official data is the cause of these continuing slumping prices. They are the reason supply is still exceeding demand. David Rosenberg estimates that the shadow inventory that doesn't show is closer to 7 million housing units which is equivalent to two years of supply when you add up all the FORECLOSURES, the current homes ENTERING the foreclosure process and the number of homeowners who have NOT made a payment in the PAST YEAR.

The Wall Street Journal published the data....

"The shadow housing inventory in the US is closer to 7 million units (equivalent to two years supply!)."

"As of July, there were 1.2 million loans that had just entered the foreclosure process. "

"There are an additional 1.5 million existing units making their way through the foreclosure process."

"And, a further 217,000 homes in which the borrower has not made a mortgage payment in the last year, but the lender has yet to file notice. In other words, 17% of homes that are a year past due or more are not yet in foreclosure, up from 8% a year ago."

The important thing to remember here is that this inventory has yet to hit the market. It is not included in the Case Shiller numbers but eventually it will. We can only conclude that more DEFLATION is coming in the housing market. And also remember, homes that are foreclosed typically sell for discounts ranging between 10% and 50%.

Our conclusion is that people calling the bottom here obviously haven't done their homework and are simply "cheerleading" and "hoping" for a turn. When you see where we are now in terms of inventory, and then add in all of the foreclosures slated for next year due to the huge number of sub-prime adjustable mortgages scheduled to reset, and we can see many more problems ahead.

Bob Shiller himself stated that he thought it could be a least a decade before you saw a meaningful rise in prices. So all of these real estate speculators buying condos in Miami at steep discounts today....our advice is you better like the view because you could own that puppy longer than you think!

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9/29/2009 5:28 PM Aussie Update

Good Afternoon,

Made my way to the Voodoo Shack to check out the Aussie for a spell. All of the markets are in exactly the same state that they were in last week and the week before. All are calling for a small correction here followed by moves higher. The DOW is still projected into the low 10,000, the S&P500 into the low 1100s, the Russell into the mid 600s and the NASDAQ into the mid 2100's.

BUT, we have gotten a new pattern in the S&P500 that came out of the blue today and has not been confirmed by any other index nor ETF.

The pattern is rated 344, which is pretty high. It has the S&P500 topping here, correcting down to the 940 area by the middle to end of October and then moving higher with targets in the 1250 to 1300 price range by Christmas.

This is a huge upside move and if it happened would probably delay for a long time, the development of the major "C" wave to new lows under 666. As a matter of fact, when looking at this pattern, if it did occur, the stock market moving up to these levels would mean the dollar being decimated to all-time lows, bond yields rising dramatically and commodities such as oil and gold rising to old high levels meaning oil at \$150 and gold to \$1200. The only way we see the S&P500 near 1300 is in a highly charged inflationary environment.

While we may disbelieve this forecast and we will monitor it, we would not take serious consideration of it UNTIL we received confirming counts from all of the other averages and ETFs. As I said before, we have not. This index is the ONLY one giving us this pattern setup.

BUT, as we have said before, we will always give you the truth about the Aussie and what comes up on it. And since this pattern came up today, we owe it to you to report it. It is a very bullish pattern and one that puts a HUGE dent in our bearish stance and fundamental opinion. BUT, we have also said that no matter how bearish we are, we will go with the Aussie and this pattern is the first of its kind at this time in the trend to give us a new pattern to consider. And if we get confirmation from other patterns, we will take it more serious and position accordingly.

Now, the Aussie has been very temperamental lately and we are seeing patterns and ratings all over the place. We think this is because we are nearing a trend change, a topping action. So be ready as this pattern may be gone tomorrow. We have found that once the Aussie has locked onto a pattern, it doesn't let go and doesn't keep changing it day after day. It sticks with it and the longer it continues to come up, the stronger the pattern.

This is the very first day that we got this pattern. So let's see what tomorrow brings.

Attachment:

Good Afternoon,

We have had two other indexes join with the S&P500 this afternoon in projecting stocks lower thru the first week in November and then forecasting a big push back up into year end. The Aussie has refined some of the details and here they are....

S&P500: Rating is 408 which is a strong rating. The Aussie is labeling this as a zigzag wave with the wave A top in and we are now in the B wave. They have this B wave projected down to the 980 to 960 price level. From today's level, we would be looking at about an 8% correction. The time frame on this move is into the first week of November. Then the Aussie is projecting the "zag" of the move as a rally projecting up to the 1236 to 1285 range.

A word about these projections. As we know, as the market moves the Aussie software moves as well. It is a dynamic system verses a static one in that it will change projections and time frames depending on the extent of price movement. So while it projects 980 to 960 on the move down, if we hit 960 and the Aussie thinks the pattern has more room to go, it will project a lower target. Elliott Wave despite what you have heard, is a trend following system. It is not predictive. Therefore, if the trend is still intact in a strong way, the Aussie will stay with it and project lower prices.

The same can be said for the upside. Right now, it is projecting that after this B wave is completed, we will go up and make new highs near year end. But first things first. Those projections are the farthest things from our mind right now.

The only thing to take away from this pattern change is that this looks like a zigzag wave developing that projects higher prices to come before this cycle B wave is complete. But for now, we should just focus on the fact that the Aussie has given us a downside target and right now, thinks that this market will in fact correct to the downside.

The other great thing about Elliott is that it identifies the price level where you are wrong. The Aussie does as well. If the S&P500 moves up through the 11080.15 price level, which is 2% higher than where we are now, then the Aussie will be wrong and I'm sure will be labeling this wave as simply another extension on the way to 1100.

NASDAQ: This market has also joined in with the same zigzag pattern. The rating is lower at 256 but still a decent rating (Remember , a rating over 175 is a tradable pattern). Again, the Aussie is saying that this index has topped and they are projecting a move down to the 1650 to 1700 price area before turning up toward year end. Aussie is wrong on a move over 2167.70.

RUSSELL 2000: The Russell has the same zigzag pattern with a rating of 425. It is looking for a drop by the first week in November down to the 530 to 540 area, an 11% drop. The zag of the C wave is projected to the 724 area by year end. Aussie is wrong on a move over 625.31.

DOW JONES INDUSTRIALS: This is the only major index NOT to give us a pattern change. It is still projecting a move to 10,300 FIRST and no downside pattern changes are present.

Interestingly enough, we also had a change in a couple of the inverse leveraged ETFs we follow and their new counts and projections mirror a couple of the indexes and the DXD, which is the DOWs leveraged inverse ETF is one of them. So while the DOW hasn't given us a change yet, it's inverse ETF has. We don't know what to make of this so we will watch it together to see if the index or the ETF was right!

DXD: Rating is 275. Pattern has the DXD bottoming and moving up to the \$40 to \$42 level in a B wave correction by November and then sliding to 15 by year end. From levels here at 35, that would represent a 15% move up. Stops would be placed under the double bottom at \$33.23.

TWM (Russell 2000 leveraged inverse ETF): This rating is 289 and has the B wave up move pattern projected to the \$35 area. The TWM closed at \$28.50 a move up in the target zone would represent at 22% move higher. A stop would be warranted under the \$26.66 lows.

So there you have it. We will be in the voodoo shack morning, noon and night monitoring these changes to make sure this isn't a big Aussie boomerang head fake! As we said before, at turns, the Aussie can act up a bit so on the first day of changes, we are very cautious. We can say from experience that if the Aussie stays in this pattern mode for the next 4 to 5 days, AND we see the ratings increase as well as the DOW get on board, our confidence rating will be very high and we will be positioned accordingly.

We think small positions can be taken here with stops in place for a pretty low risk trade. Buying some DXDs, SDS and TWM or the DOG, RWM and SH for more conservative players with stops under the lows seems like a decent risk reward trade. For example, buying the TWMs here, the risk is \$2 bucks or 7% and the reward is \$6.5 bucks or 22%. 3 to 1

isn't our favorite ratio, but it still is decent.

The market after hours is trading flat so let's see where things open in the morning. There are a HUGE amount of economic reports out tomorrow and Friday that WILL move the markets these patterns could go any which way. BUT, we have vowed to follow the Aussie and we think it is a decent set-up so we will be inclined to try and set up some trades tomorrow to the short side and see where the market takes us.

We will be back at you in the AM.....

BY THE WAY: Is this the top of the B wave and we are now heading lower in the big wave C? Way, way too early to tell. The C wave down will subdivide into 5 waves and IF this is the beginning of it, there is a long, long road ahead. So there is no way we can even begin to identify this probability. We may not know that until well into next year. Our only interest now is seeing if this new pattern is for real and if it is, seeing how far down we can go. The way this market is acting, it would be a major negative event just if the S&P500 breaks 1025 and threatens 1000, much less 950. So as we always say, baby steps....baby steps.

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## October 2009

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10/1/2009 8:20 AM **Oil and the Dollar**

Good Morning,

Just a quick note. Watching oil move from down \$1.05 last night to up \$.56 cents now and back over \$71 a barrel. At the same time the dollar is rallying across the board and bonds are rallying as well with the 30 year yield at 4.02%. Stocks are down a small amount pre-market.

We are wondering if Iran is suddenly on the minds of oil traders, currency traders and bond traders.

It makes some sense. Connect the dots. Oil rising while "flight to safety" assets go up. When is the last time both oil and the dollar rose 2 days in a row?

Let's see how this turns out today.

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10/1/2009 8:48 AM **30 yr yield dips under 4%**

Good Morning..

Another quickie here but the 30 year yield is at 3.99% and the 10 year is under 3.35% at 3.24%.

The dollar is still moving higher and oil is still up.

This really bother us and it seems the Mr. Bond is smelling something and it "ain't" inflation!

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10/1/2009 4:44 PM **A Very Interesting Day.**

Good Afternoon,

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