A Special Issue of WSW Monthly – January, 2, 2011 – Stock Market Forecast for 2011

Every year this time of year I think it is best to look back on what you have done in the past year and plan ahead for the coming year in all aspects of your life. Every year when it comes to the stock market and investing I take a step back for a few days and spend a lot of time thinking ahead.

Exactly a year ago I released my stock market forecast for 2010 and everything I said in it was spot on. I argued that the stock market would end up peaking out in January and having a short-term correction and would then go sideways throughout the summer in a wide trading range. This is more or less what happened. The stock market did make a new high in April, but then collapsed in May in the "flash crash" and then just went sideways.

Now when I made this sideways call for a market I said I had no idea at the time what would happen once the sideways range ended, we'd have to get hints from the market and that would take time. I also thought going into 2010 that the best thing to do for most people would be to just raise as much cash as possible and not try to trade during the sideways phase until it came to an end and the direction of the next big move became clear.

This was good advice, but unfortunately I ended up not taking it myself and just about everyone I know ignored it too. When you look at the stock market every day and talk about it all of the time it is hard for people not try to involve themselves in it. I took some short positions in January that made me

some nice profits and then bought a basket of stocks almost exactly on the February bottom to ride a rally for a few weeks and got my account up to a 15% gain by doing this. In the end though the best thing anyone could have done last year is gone on vacation until the end of the summer when the trading range pattern ended.

I was happy to be in cash when the "flash crash" happened, but that drop sparked panic and wild emotions in most investors. Almost no one listened to me in April when I warned that another correction was coming and after it happened many got desperate thinking they needed to do something to make up for their losses or simply got mesmerized by the big swings and felt like they had to be a part of it.

I felt enormous pressure from people to trade the market as a result ended up making several losing trades in the summer during the big sideways trading range that made me take back the bulk of my gains. So when I look back on 2010 I see that I got the big picture right, but I made some mistakes in overtrading – which is the most common mistake just about everyone involved in the stock market makes.

I realized I had made this mistake just as soon as I made it and took a break away from the market to evaluate things and try to learn from what I have seen and done. I have been in the stock market now for over 10 years and seen giant bull markets and bear markets too and have been wildly successful over this time, starting with practically nothing and growing that little sum into a nice grubstake.

As a result I've made some changes to the site and WSW Power Investor trading service to improve my own decision making and make the information I give to people of even better quality. Long-term members of the site have seen the changes inside, but one big change is to let people into the service even less often – and only when I think some good trades will be lining up over the next few

months. That way I won't have new people pressuring me to make trades unless I actually think it is a good time to do so. I'm going to make sure people only join this service at the right time.

Most investment advisory services simply put out a list of stock picks or "portfolio" and just tell people to keep buying them with no regard to what the stock market does or what position the picks are in. This is the standard thing to do, but the problem is the best picks go up after a recommendation so it makes no sense to buy them six months later. I really think lists of stock picks don't do people very much good even though they seem to crave them.

In reality what people need are investment ideas in real time – not a list of picks that are several months old and are now not of much use since they have already gone up. Instead of a list of picks what I'm doing is giving people stock investment and trading ideas as I see them. So instead of just filling up a list with stocks and talking about them all of the time I try to find new ideas all of the time and make recommendations with good entry points and risk to reward ratios to them.

I bring all of this up to you, because it easy to just focus on the money you are making in the market or the things you are getting right and ignore the things that you really need to learn from. So when I start out the New Year I first think about things that I need to learn from and improve. This is how you become a better investor overtime – in fact I think the real difference between successful investors and the majority that just get lackluster results is that the successful people learn from mistakes they make and are willing to cut their losses at times in order to stick with the overall trend of the market. Most people refuse to do either and when they take a loss or two – which happens to everyone at some point – they freak out and think they have to quickly make it back up – which usually ends up causing them to make another mistake and then they get into a cycle of compounding mistakes instead of compounding knowledge and profits.

In fact the biggest time of danger in the stock market is after you have made a whole lot of money. Traders with fat profits tend to go out on a limb and get cocky and take bigger risks. Then when the trend they have been riding to their benefit comes to an end they get caught on the wrong side of things and if they have leveraged themselves up they can even wipe themselves out. This is in effect what happened to hundreds of hedge funds in 2008.

It is also part of the reason the "flash crash" probably happened. In the weeks going into it investor sentiment according to various sentiment surveys had reached manic levels of bullishness – which can be dangerous, because it is often a sign of fully invested investors or investors on leverage and margin who are now in a vulnerable position.

What are the things you need to learn from in 2010 to improve your own results going forward? I don't care what kind of success you may have had in the past there are things I'm sure you need to improve in your own trading and investing. You should make a list of them and think about them carefully and see what you need to do to make more money in the future and manage your risk even better.

The Stock Market in 2011

Now let's focus on the year ahead. The stock market at the moment is in a similar short-term position that it was at the start of the year in 2010, which means that a correction in the first quarter of the year is extremely likely. In December 2009 and this past December the market went higher, but the sectors and world markets that had been the strongest throughout the year started to lag the broad market averages. This is important, because such a negative divergence often leads to eventual weakness in the rest of the market.

What is more at the end of both 2009 and 2010 investor sentiment reached manic levels of bullishness. According to Investors Intelligence the number of newsletter writers who declare

themselves to be bulls on the stock market has reached the level last seen at the last the peak of the last cyclical bull market in 2007. At the same time the American Association of Individual Investors poll has the highest number of bulls in over 6 years while the number of individual investors who responded as being bearish is only 16% - a level not seen in over 5 years.

From a contrarian standpoint this is a negative for the stock market. Generally speaking you want to be buying stocks after the market has fallen for a bit and everyone is negative and you want to be cautious when everyone else is bullish. What happens is people get bullish on the market after they buy in to it and once everyone buys into it there is no one left to buy – until the market corrects and the weaker hands sell out. Once people sell they suddenly become bearish on the market.

So sentiment is a useful tool to use when analyzing the market, but it is not the only tool. One other tool is simple historical price patterns. Normally when there is a correction in a bull market there is a pullback down to the 150 and 200-day long-term moving averages. From here that would be about a nine percent correction for the major market averages, which is also inside the historical norm.

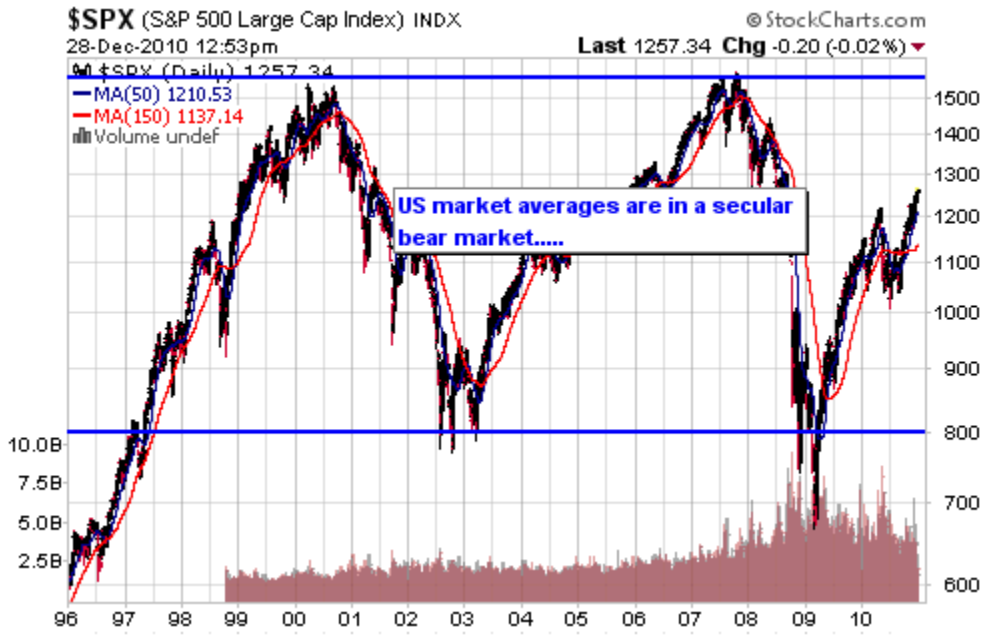
However, one thing that is different than from a year ago is that last year the market had just came out of a big bear market – one of the biggest seen since the Great Depression in fact. Now normally when a market has a big bear market and then the next year bottoms and has a huge rally like we saw in 2009 it becomes so overbought that it spends 6-10 months going sideways in a consolidation pattern in which it digests those gains before making another move higher. This is the type of thing we saw the market do in 2004 and it also occurred after the 1974 stock market bottom. In the 1930 though the stock market just continued lower.

This isn't just a pattern that has happened a few times in the United States, but has happened multiple times in markets across the world. This made it almost certain that the market would spend a good deal of 2010 in a trading range. Right now though the market is just as frothy in regards to sentiment as it was when it started 2010 and is just as likely to correct in the first quarter of this year just as it did last year, but what is different is that on a long-term perspective it is not setup in a way that it must go sideways like it was last year, because the context of the move from August till the end of 2010 is much different than the action towards the end of 2009.

This Fall the market did not rally out of a bear market like it did in 2009, but out of a period of consolidation within a cyclical bull market. This means that if the market corrects now for several weeks it could easily simply pause and then continue higher. However, one should not get too carried away from an investment standpoint when it comes to the US stock market, because this current bull market is a cyclical bull market within a secular bear market.

This means that the overall upside for the US stock market in the years to come is limited. A secular bull market is a market that is making all time new highs and going higher and higher. A secular bear market is a market that is not making new all time highs, but is either going sideways or making new lows. Inside of a secular bear market you have cyclical bull markets that can last several years, but

when they come to an end the market ends up going down substantially or just fizzling out and going sideways for a long period of time. The market is capped by the secular highs, which acts as very tough resistance on it. It usually takes a cyclical bull market that takes the market up to these highs and then one last cyclical bear market before it can break out into a new secular bull market.



The last time the US markets were in a secular bear market were back in the 1970's and before that during the 1930's – and then there was one in the decade dominated by World War I. US baby boom investors are still conditioned by the last secular bull market, which ended in 2000 to think that the stock market is the best investment in the world and all they need to do is buy into it and hold for a long enough time and it will make them rich. The last bear market succeeded in scaring people for a period of time, but judging by the sentiment surveys the individual investor faith in the market has now been restored.

There is much to be learned from studying the 1970's secular bear market and using it to help get some ideas about how to manage your money in this one. Indeed Dave Skarica's book the Great Supercycle is all about this. Back in the 1970's even though the US markets went nowhere, people who

invested in gold and commodities got rich, because they were in secular bull markets. Now gold has rallied to new all time highs in 2010, which puts it in a secular bull market and the same thing has happened in a few select emerging markets countries in Latin American and East Asia. These are the places in which the most money will be made going forward – and not in the US stock market.

It would take a rally right now of less than 27% to get the S&P 500 back up to its highs of 2007. It would be great if this cyclical bull market were able to take the market up that far over the next few years, but it is just as likely to peak out this year or next year at a lower level. This means that the potential upside for the broad US stock market averages is capped. At some point there will be another cyclical bear market and a great time to buy and invest forever, because that could be a final bottom before the next secular bull market begins – perhaps the best buy time for the rest of our lives for US stocks – but such a buy point is years away.

What this means is that the US market averages and US stocks in general should be treated as trading vehicles while gold, emerging markets stocks, and some commodities should be treated as investments. You see, because gold and these other markets are in secular bull markets their upside

potential is not limited to 27%. There simply is more money to be made in these markets than there are in US stocks. On dips in the markets these are the places to put investment money to use.

I say this not to try to predict the future but simply to flat out tell you what the big picture is. It is pure logic. I really cannot tell you though right now when the next time the US stock market is going to top out and go into a new bear market is going to be or from what level. If I tried to tell you it would be just a guess as good as any other.

What I can tell you though is that there is a very high probability of a correction occurring in the first quarter of 2011 – probably starting around the time of the next earnings season, which should be used once it is over as a buying opportunity in the strongest stocks and sectors. Once the market has a correction, bottoms, and then goes up again we will simply have to gauge the strength of the rally and participation in it to see if anything changes to make us be concerned about a coming bear market. So far right now there is no sign of such a thing. All we need to do is understand the big picture and let the market tell us what it is going to do and when the cyclical trend has changed in order to change our positions accordingly.

Shoes to Drop

Most of the time when the market corrects all of a sudden a bunch of bad news comes out that gets everyone's attention. If you recall during the time of the "flash crash" it was the "Greek debt crisis" that had everyone on CNBC all worked up. In reality there are good and bad things happening all of the time in the world and as long as the market is going up no one seems to pay attention to the bad news, but when the market drops it becomes all they can think about – and the news tends to focus on some big story and even magnify its importance even more than what it really is.

In the past few months we have seen the nation of Ireland collapse thanks to another man made banking disaster. As this has happened there is danger that debt problems will next erupt in the next few

months in Italy, Portugal, and Spain. It seems that international bankers have a habit of ruining nations. Right now no one in the US stock market seems to care about these things, but if the market corrects like I think it will don't be surprised if this suddenly becomes nonstop news.

What is more there is a serious problem in the United States municipal bond market that most people are pretty much ignoring. There are several states, such as California, New Jersey, and Illinois with serious budget problems and those states have localities that investors fear may end up defaulting on their municipal bonds. This raises the specter of another Federal government bailout which would only increase the already bloated budget deficit even more.

This story got some play a few weeks ago on 60 minutes when Meredith Whitney, one of the few honest Wall Street analysts, was interviewed on the show and made statements predicting municipal bond defaults across the United States by the summer. Her warnings were pretty much laughed off on CNBC the next morning and some of the CNBC talking heads even went low enough to personally attack her. Mutual fund managers hate anything that might make people lose faith in the market and make them move their money out of their funds.

As a result of these worries municipal bonds have been crashing over the past few months. You would think that this would bother stock investors, but as long as the stock market goes up they won't pay any mind to it at all and neither will the financial news. But if the market corrects the way I think it will then it is a story that will likely get a lot of air time in 2011.

In fact one could make a lot of money this year by simply walking away from the stock market right now and buying a few months later once you see the talking heads on CNBC start to talk several days nonstop about how terrible the debts problems are in Europe or how troubled municipal bonds are – and not just talk about them, but talk about them in fear and nervous agitation. When Maria Bartiromo and Steve Liesman get in this mood they talk faster and Jim Cramer moves around his TV set more franticly.

You probably could make money from all of this by buying puts on the MUB municipal bond ETF and then selling them when the news hits the 6:00 PM network news channels. Or you could short Spain and just get out when European debt problems become big news again.

Those are just trading ideas. For investment ideas though we need to wait for the market to have its next correction and see what stocks and sectors hold up the best. Then buy. And we must do so with a close eye on mining stocks, energy, commodities, and emerging markets. Maybe some few select US stocks in sectors in real bull markets of their own – like we have seen in auto parts in 2010. This is a simple money making roadmap for 2011.

Let Me Help You Crush the Market in 2011

On Tuesday January 4th I'm going to open up the WSW Power Investor trading service to 500 new people by sending out an email to my entire list of 50,000 people at 12:00 PM EST on that day.

The last time I opened up to new people was way back in April and I think this is a great time for you to join, because I see huge potential in 2011 by being invested in the right stocks and right sectors.

I keep the service closed most of the time, because I only want people to get in when I think the market is in a good position to provide some nice entry points in the next few months or I know of some stocks that are looking good to buy. I don't want people just getting in at any moment, but at the right time.

I also spend a lot of time helping people when they sign up by personally answering their email questions about the site and investing. In the past so many people were signing up that I decided I really could no longer handle it, because I no longer had the time to constantly answer emails from new people. So I decided to just accept new people once or twice a year so the influx of new people would happen in a narrow window of time instead of all of the time. I also wanted to make my service more valuable to current subscribers and by keeping it limited to a small number of people this does that for them.

This year I think you will look back six months from now and see signing up to my service as a critical decision in your investing. You see I think the picture for the broad stock market averages and the typical mutual fund is a bit murky. We should see a correction in the first quarter of 2011 and then a nice rally back up, but after that I'm not sure what the stock market will do and things will only become clearer once we can judge the strength of that rally. A rally up to its highs would bring a nice gain of roughly 27% for most people, but the potential downside if the year were to turn negative would bring a similar drop.

Yet big gains are likely in emerging markets, commodity related stocks, and a few select sectors in bull markets of their own that will beat the market no matter whether the market goes up or down by the end of 2011. The truth is we have been in a two year cyclical bull market within a secular bear

market and as such a bull market matures it becomes even more imperative to be selective about what you invest in and to only invest in the best stocks and sectors.

My whole goal is to do exactly that and to help you do the same thing with the WSW Power Investor service. I expect the 500 spots to go quickly, because since the last time we opened it up my email list has grown by leaps and bounds thanks to the release of my best-selling book Strategic Stock Trading. Book sales are steady as it has remained one of the top business and investing books on Amazon.com. Today if you go to Amazon.com and type stock trading in the book search it appears at the number one spot. It is an amazing thing to see and more than I ever expected.

The service includes daily pre-market commentary, stock picks, weekly strategic analysis, a stock trading course, and a complete blogging community system where you can communicate with me and the other members of the site and more. Once you join you'll never invest alone again, but instead will invest right alongside people who know what they are doing in the stock market.

To get the full details about the service just check your email on Tuesday. Obviously I'm biased, but I firmly believe that joining the WSW Power Investor service is the best possible investment decision you can make right now. And I'm going to prove this to you. This is my promise to you.

There is nothing more important to your long-term investment success and even dreams than using a strategy that can make you real money in the stock market – a strategy that maximizes gains and limits risks by getting into the best possible trades that you can.

That is what I teach and have shown you a glimpse of in the information you have already gotten from me. But there is so much more I have to show in the Stock Market Mastery Course that you'll get as a free bonus when you sign up to the Power Investor Service. With seven modules full of videos and instructional pdf files this is the type of complete trading course people charge $2,000 for on the Internet, but I am just going to give it to you for free as a free bonus for signing up, because my goal

isn’t to make a quick buck with a course but to really provide real value for you so that you will gladly want to be a long-term member of my site and trading community. I want you to learn exactly how to manage your money properly in the stock market, identify profitable trends in the market, and know which indicators are the best to use – and I’ll be there to answer your questions and help you work through this.

Investing is simple. You identify the big trend and invest with it. I can help you do this. I absolutely guarantee it. I have been doing this for over ten years and deliver results. I also have a simple refund policy if you join the Power Investor service and decide it isn’t for you – you just get your money back no questions asked! There is no risk in trying it out. So just go to your computer Tuesday at noon EST and open the email I’m going to send to you. The title of it will be WSW Power Investor Is Now Open.