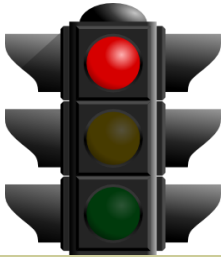




Stock Market Barometer

My new Book Strategic Stock Trading is due out later in September—will let you know when it is for sale—Mike



Quote of the month:

“Titan Capital Group...has raised bets on extreme market moves because investors’ views on the economic outlook have polarized” - Bloomberg.

Stock Market Barometer Goes to Red –Mike Swanson

Notice I just changed the stock market barometer you see on the top left of this page to red. It has been yellow for the past few months as the market conditions have continued to deteriorate.

In July we had a market rally that took the market back up to its long-term moving averages where it completely stalled out. That failure to break through resistance strengthened the bear trend and has caused me to move the barometer to red.

It is a complete confirmation of the bear trend of the market.

The biggest problem investors have right now are ones of their own making. There is no excuse for losing money in the stock market anymore. We have seen all sorts of different market environments over the past decade from wild booms to vicious busts and everything in between so there isn't a market environment that you have failed to experience or never seen before. If you are losing money it is due to muddled thinking.

It was understandable if someone lost a lot of money in the 2000 bear market, because the stock market had been going up for almost 20 years. Most investors got into the market in the 1990's and had no experience with a bear market until 2000 so they didn't really understand what was happening.

But after that bear market and the bear market that started in 2008

there are very few investors now who have not seen a bear market. So if the market keeps falling the rest of the year in its current overall bear trend there really is no excuse for anyone to lose money.

But most will.

Few will adapt to changing market conditions, because they are so terrified that if they sell out the market will go up without them and other people will make money while they don't. They can't stand taking that chance so they rather just hold and lose big time with everyone else.

It's a problem of ego and also one of muddled thinking.

Investing is and should be simple. If it's a bull market you buy and hold for as long as you can and if it is a bear market you simply raise a nice cash position so you can buy in cheap when its over and if you want to be aggressive you short stocks or make tactical bets against the market using the reverse ETF's like SDS.

That is simple.

But people make things way to complicated for themselves. The problem is what I wrote sounds like common sense, but people have never really defined for themselves what a bull or bear market is and as a result they never act appropriately.

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To most a bull market is just a market going up and a bear market is a market where they lose a lot of money. A bear market is when their losses get so big that they actually feel emotional pain from them.

That really is how most people operate.

If they would stop and try to think what a bear market is and figure out how they could identify one then they would be able to act appropriately. But most investors refuse to do any thinking at all and therefore they get the exact results they deserve. The cause in each person is often different, but is always some combination of laziness, stupidity, and a lack of confidence in oneself. The result is inaction and a tendency to follow and believe in market commentators who tell them what one wants to hear.

Even financial commentators fail to provide a good definition of what a bull market or bear market is. Once the market falls enough, usually 30%, then you start to hear CNBC talking heads say that it is a bear market - as if 30% is some magic number. But by the time a market has fallen that much it is often too late to sell.

I operate with a clear and simple definition of a bear market and that makes making investment decisions much simpler for me. If the market averages are below their 150 and 200-day moving averages and those moving averages are acting as resistance then you are in a bear market.

The opposite occurs when you are in a bull market.

This is such a simple definition that a small child could be taught to recognize it on a chart, but more importantly it is clear, objective, and requires no guess work. It is simple concepts and principles put into action that make you money in the stock market.

For over three months now the broad market averages have been below those moving averages and those moving averages have been acting as resistance ever since. People going long and trying to guess new bull markets have consistently lost money during this time.

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Bear markets make people upset and they have made me upset in the past too. I did not like to think that the government messed things up and did not like the fact that they meant people would lose money.

But I am doing all I can to warn people about it and try to help as many people as I can. I care about you and the others reading this. I don't like it when people lose money either, but at some point people have to take responsibility for their money too. You don't need to be a victim of a bear market or bad economy.

And you do not have to despair about either of these things either because neither last forever and both lead to opportunities to those who understand what is happening and take advantage of them. This is what we need to focus on together going forward. How to take advantage of this situation and make money.

One thing that happens in a bear market is lots of volatility. In a bear market markets move up and down much faster than they do in a bull market, but often in moves that are simply unsustainable - especially moves to the upside.

You get rallies that appear out of nowhere and create big moves in the market, but then instantly fizzle out. What those rallies tend to do is suck people in who don't or cannot get themselves to believe that there is a bear market. They get people to double down to try to make their money back - and they also start by squeezing short sellers who tried to bet against the market after it has already fallen for several weeks and it is really too late to short.

The best way to handle a bear market is not to buy into rallies - because they end so quickly - but to use rallies to sell positions that are lagging the market so you can raise cash and be able to buy when the bear market is over - and STOP LOSING MONEY - and if you want to be aggressive to use rallies to bet against the market through reverse ETF's or to short individual stocks.

I really think it is critical to stop trying to make money playing rallies. There are two main reasons. First of all it requires you to jump in and out of the market and trade rapidly, which is very difficult and means going against the overall trend of the market.

It makes absolutely no sense to try to short stocks in a bull market. You want to buy on dips in a bull market. If I told you to short stocks during a bull market you would think I was insane and rightly so. Well, apply that

exact same principle to a bear market and just think about things a bit.

The most important thing for you to do is to see the trend clearly. If you trade both sides of the market you'll have difficulty doing this and can even lose your objectivity.

QE Is Now All the Rage

If you recall back in the August issue of this newsletter I told you about the study by Federal Reserve Governor James Bullard in which he advocated that the Fed engage in quantitative easing if the economy continues to slow down or another international economic shock such as the Greek debt crisis hits the world markets.

Now you can't turn on CNBC or read the Wall Street Journal without hearing or reading a story about quantitative easing.

At the beginning of the year most economists were predicting a continuation of the economic "recovery" that started last year throughout the rest of this year thinking that the economy had to grow thanks to interest rates practically at zero and government spending, but now everyone accepts the fact that economic growth hit the brakes in May and has continued to decelerate ever since.

Last Friday the US commerce department revised down its 2nd quarter GDP growth figures from 2.4 to 1.6 percent. The GDP needs to grow at about 3% in order for employment to increase.

The real economy only grew by 0.80 percent in the second quarter, because half of the 1.6 percent GDP growth came from government spending and half of government spending was due to defense spending. About half of that defense spending was for investment in new weapons and the rest went to the wars in Iraq and Afghanistan. Maybe if Obama makes his secret war in the Horn of Africa and Yemen official the spending can go up even more. You'll have to google that one. Right now those wars are off the books so aren't counted in the overall defense budget, but they give him lots of maps and charts to look at and chess pieces to move around. It is hard to know what is really going on there as an American, because the press doesn't report on the wars anymore.

What we do know is that a lot of military spending does not go to the troops but might as well be flushed down the toilet. According to an Associated Press article published Sunday US taxpayers funded a \$40 million prison and \$165 million children's hospital both of which are sitting empty in the middle of the Iraqi desert. And Fallujah has a \$100 million nonfunc-

tioning waste water treatment plant that doesn't work. Of course contractors such as Betchel have gotten rich off of this type of pork barrel spending.

The AP estimates that 10% of the \$50 billion that the US has spent rebuilding Iraq has been wasted on hundreds of abandoned or redundant pork barrel projects.

It is just interesting that a full 1/4 of the entire US GDP growth went to military spending last quarter. The US now spends almost as much as the rest of the world combined on military spending and nine times more than China - the nation that ranks second in military spending.

We live in a completely militarized society, but it is impossible for a civilian to see that in day to day life. But it is fact that without the defense spending we'd probably already be seeing negative GDP growth right now.

It is all too crazy to try to figure out or make sense of. It is too hard to figure out what is going on in the rest of the world.

Let's just stick to the stock market and what is happening at home.

In the United States home sales in July fell to the lowest level on record. The buzz phrase "double dip recession" has overtaken "green shoots" when it comes to talking about the US economy.

Neither one of these phrases are apt in describing the economy in my view, because I do not believe the US economy ever got out of its recession in the first place. We just had a temporary blip, thanks to Obama's trillion dollar stimulus program and the fact that no trend goes straight down. When recessions end you get big a booming recovery that takes the economy back up to the size that it fell from.

That has not happened - so therefore I do not believe we have had a real recovery.

Ben Bernanke spoke last Friday and stated that the Fed "will do all that it can" to keep the economy growing and will take action if it continues to deteriorate. He presented three options that the Fed can pursue - lowering the rate of interest that the Fed pays for bank reserves, changing its policy statements, and quantitative easing - which means printing money out of thin air and then using that money to buy treasury bonds from the government or bonds and securities from banks.

However, former Federal Reserve Vice Chairman Alan Blinder thinks that Bernanke "is not on the verge of doing anything." The problem is that none of these options are likely to do

much good and can actually backfire. If you have been paying attention then I'm sure you've noticed that not all Fed officials are for any of these measures. This is the reason why.

For one thing interest rates are already practically at zero so lowering the Federal Reserve interest rate for banks from 0.25 to 0.00 is unlikely to do much good.

FOMC policy statements are simply words and words are not enough to make things happen.

As for quantitative easing Japan did it three times through the 1990's and 2000's and it had no helpful effect on their economy. The idea behind it is that by printing money and giving it to banks that the banks will lend more money out and therefore help the economy.

Richard Fisher, the President of the Dallas Fed told the Wall Street Journal that he is concerned that it won't work, because "businesses weren't using already ample, cheap credit to fund investments because they were uncertain about many other problems, including government deficits and new financial regulations."

As Gabelli & Company puts it "the problem, though, is that after TARP, the stimulus plan, Fed purchases of \$1.7 trillion of government securities and near-zero interest rates, there is little more the Fed can do that they haven't already done. At this point the Fed cannot use monetary policy to force companies, banks and consumers to take credit that they do not want to use. In economic literature, this situation is known as a "liquidity trap", a phrase you will probably hear a lot in coming months."

In my view the economy will bottom out once real estate prices put in a final bottom - probably in the second quarter of next year. I see no reason for banks to lend money in mass until real estate bottoms out. Once the real estate market firms up then we should see more lending and liquidity enter the real economy. People will start to hire construction workers again and some improvement across the board in the employment picture will occur.

Of course until this bottoms comes I expect the economy to continue to be weak and the overall trend of the market to remain a bear one.

The problem is that the Fed cannot force housing prices up nor should they try to. They should let housing prices fall to a natural level and then the economy will simply take for itself. Trying to forestall this simply delays the inevitable bottoming process.

I suspect though that the Federal Reserve will engage in quantitative easing. Probably not at their next meeting in September, but probably at the one they will have after that in November. Until it happens QE will be the talk of CNBC and will mesmerize bulls who believe that the government will force the stock market up for them.

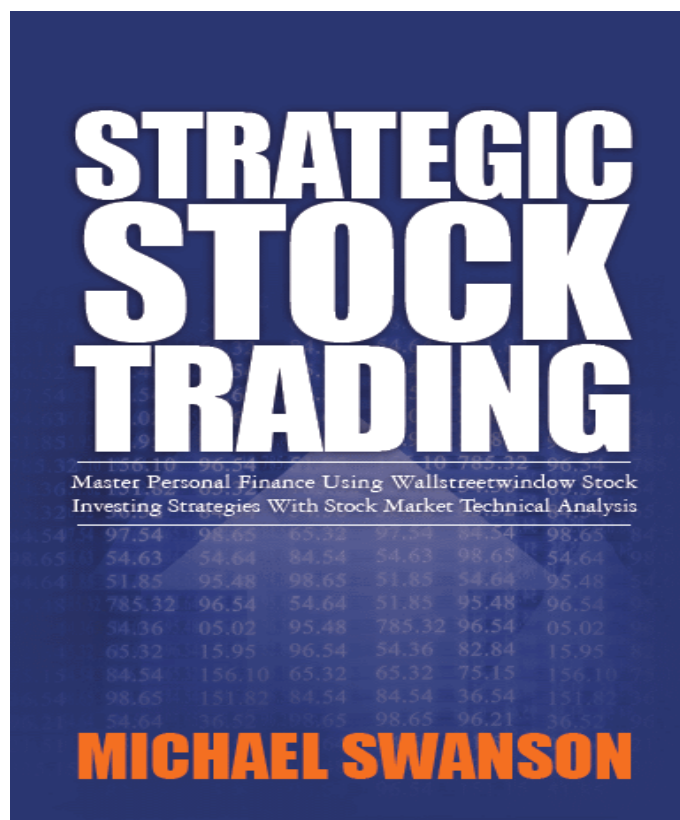
However, once QE occurs there is a danger that it could blow up in everyone's face. If QE does not stimulate the economy - and I do not think it will - then many people will sell stocks in disappointment and may even panic.

They'll think if this doesn't work then nothing will. We could then see months of selling and pure total panic that would lead to a climatic end to this bear market to coincide with a real bottom in the economy - just when everyone things the end is near the real bottom will be on hand.

Ironically once a final trough to this recession comes in the economy is likely to grow for a year or two at a much faster rate than anyone even expects now.

But over the coming weeks you can expect the focus in the media and the trading world to be on QE and how they think it could magically make everything go up.

Coming soon:



Market View

Andy Emerson & Kevin Amos

The topping action we've been warning of in the markets continued last month and gives us more reason to be concerned now. We saw deterioration across the board in all the indices and think that there can be more to come. As you can see from the chart below the position we sit in now leaves us in a vulnerable place if the slide here continues .



Long term

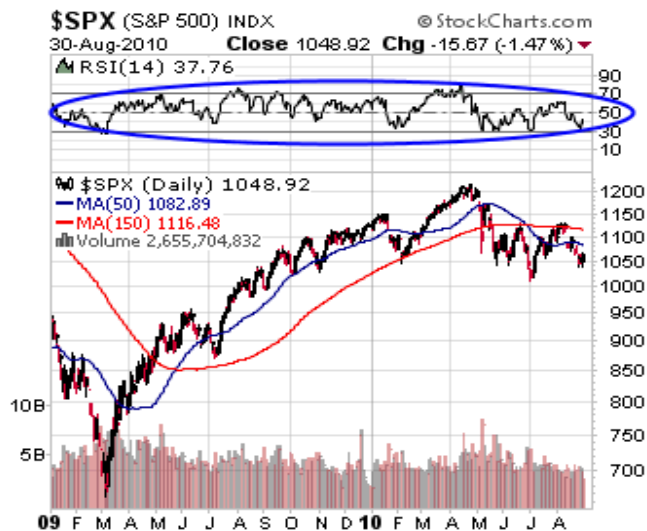
The neckline that has been formed here has acted as support and if broken will start a new leg down. Looking at the internals of the market the longer term moving averages are curling over as seen in the 150 day average above and has started to turn down which doesn't look well for the trend of the market. The percentage of stocks that make up this index that now are in stage four declines is sixty nine percent compared to only thirty percent that are still in a stage two. This number has continued to worsen over the last month, just another reason to be more cautious now than before. Looking ahead to the short term, while we think the market is in a dangerous position here, the market is oversold and is in a position where you could have a short term rally. We are not looking for anything significant, with the upper trend line shown above, being a best case scenario. With that being said a rally breaking above the trend line and the 1130 range is what we would need to see to think this market has a chance to change its course here. Also an improvement in the advance decline line, which we will be watching closely. But for now it is our opinion that the internals of the market have been and are showing further evidence, that they are weakening and will continue to do so.



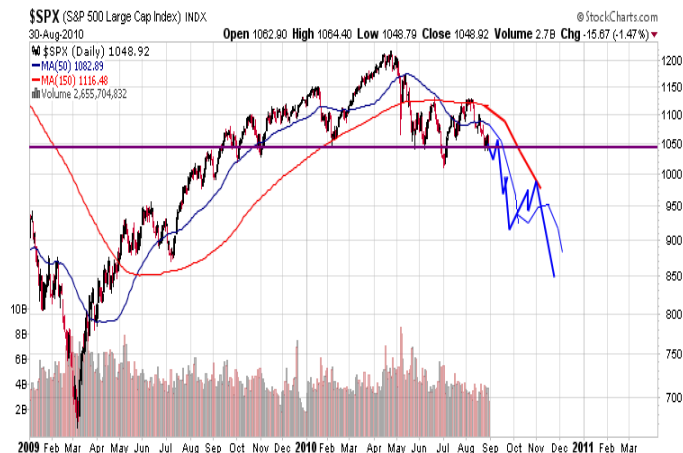
As you can see the Nasdaq Composite which had been leading the markets in the uptrend has now shown increasing weakness and has actually been leading the indexes down. It is resting on its neckline and a break below this support range would be damaging to the chart and would look to signal another leg down is coming. As can be seen with both of these chart patterns a Head & Shoulder formation has formed with all that is left to complete them is a move below the neckline. There is never a guarantee this will happen, but again this gives us reason to be cautious here and to advise everyone to position themselves accordingly.

Short term

First the positives for the averages is that the daily stochastic are over sold and the markets are near the lows of July, the neckline or the July lows of 1010 should act as support and prompt a bounce for the markets here. Also as seen on the chart below when the RSI number has reached the extreme level of thirty, this is an area you can expect some sort of a bounce.



Below the chart of the SP-500 is drawn out how we think it may look going forward. Watch the fifty day moving average because it usually acts as resistance once the market trades below it and it turns down on top of the market.



Now the positives again for the short term is the market is over sold and we could see some kind of a bounce but we're still not expecting to see much of a bounce before the market breaks lower.

Bullish case scenario

If the market is going to turn out to be bullish in the months ahead then the chart below will explain what's got to happen.

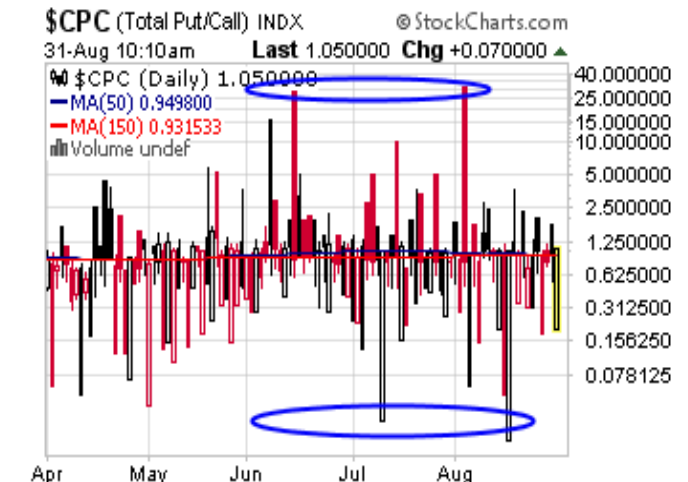
First and most important the market has got to trade back above the descending trend line. Second the market then has to make a run at the April highs. If the market were to turn bullish later this year the market again will have to get above the long term moving averages (150) on the chart below.



One of the more important indicators to keep and eye on is the VIX. We feel that the markets are going to make new lows in the coming weeks. After a break down of the July lows the market will probably bottom for awhile after some sort of panic washout like you see on the daily chart of the SP-500 to your left. The VIX below shows an example of what we think it would look like if that happened and we don't think you'll see a bottom until you see panic in the markets as indicated on the chart below. Also worth noting is the markets are near their lows presently and the VIX shows there's no fear in the markets. Therefore we don't expect to see much of a bounce here until you see the VIX start moving higher.

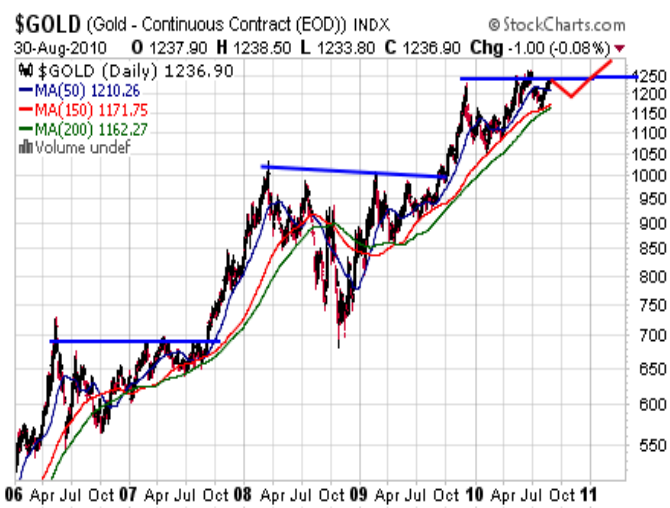


The Put/call ratio which shows the sentiment of traders and can be used as a contrarian indicator. Below shows what we would look for in either a move down or move up before you can expect a short term move in either direction. Here we will be looking for a move lower before we think the markets will bottom temporarily along with the move up in he VIX.



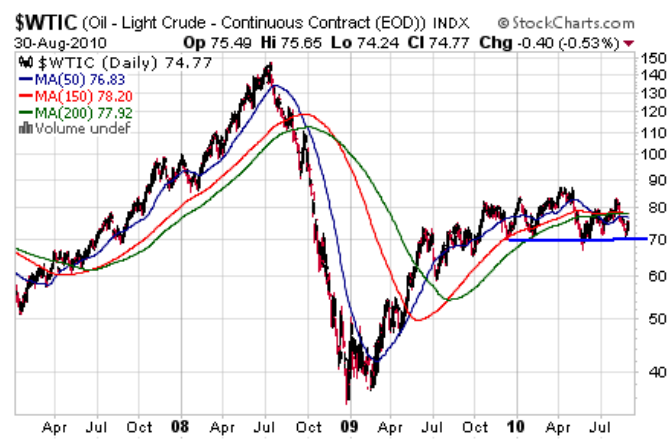
Commodities

GOLD was and still is in a bull market. Major resistance is the 52 week highs. It appears that the metal is short term over bought. The first line of support is the fifty day moving average. Long term support appears to be the long term moving average on the chart below in Red (150 day). Gold is a buy on pull backs near the long term moving averages.



OIL

Oil which is clearly in a stage three topping phase has started to show signs of weakening. Support on the chart below is the horizontal trend line. A break below that and oil will have entered a stage four bear market. If the markets break down then we expect oil to follow suit.



The world markets Index

On the chart below of the world market it's clear that the index is already in a bear market making new lows back in May of this year. Now after a good bounce the world markets got over bought and turned back down. It is well below the 150 day moving average and then falling through the fifty day moving average now.



The thirty year bonds are over bought but we're not saying short it just yet. We feel the bonds could easily test the all time highs over the next few weeks.



Sectors

Here below is some of the best performing sectors.

GOLD



REITS



TELECOM



UTILITIES



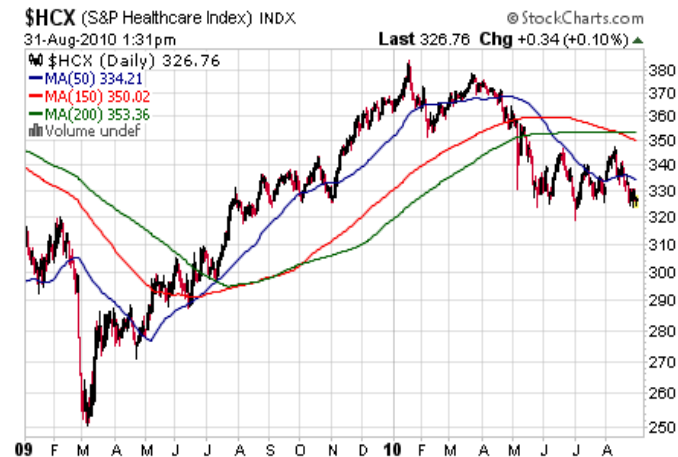
REITS and Utility stocks act as a defensive play for those that seek to buy and hold because of the dividends.

Below are some of the sectors leading to the downside.

BANKS



HEALTH CARE



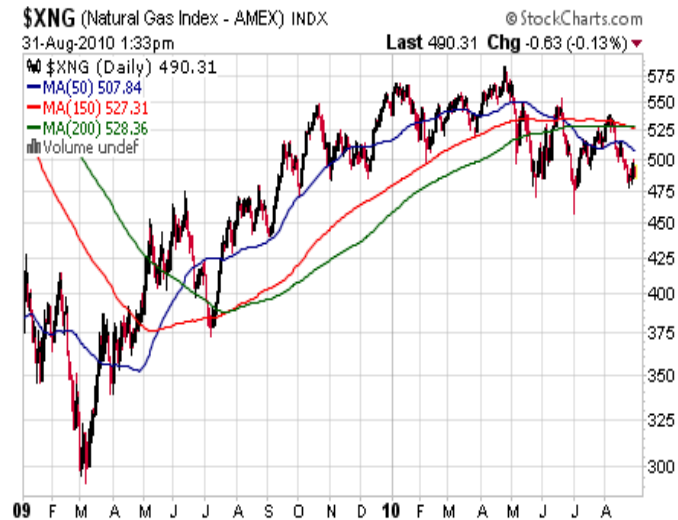
HOSPITALS



RETAILERS



NATURAL GAS



SEMICONDUCTORS



OIL SECTOR



OIL SERVICES



Mike's Mail Bag: A Question From a Reader

"I'm a newbie. Been following the markets action from day to day. Markets seem to react to the day to day news. A newbie question- Can we really trade based on chart patterns? and indicators? Charts seem to show where we've been, but may not necessarily indicate where we are going. Its still seems to be guess work at predicting future moves."

It is tough to follow day to day action and hourly action on charts and be able to predict where the market is going to go the next day.

Sometimes there is a good setup and you can, but 99% of the time the hourly action is often influenced by news and random events and that makes it almost impossible to draw a lot of meaning from it or to try to play such short-term swings.

In fact as a general rule of thumb when it comes to charts the shorter the time frame you are looking at the more prone you are to making inaccurate judgements.

This makes it so if you watch the market to day by day and pay attention to the news the stock market looks like a confusing jumble. Then you get caught up hanging on to what some talking head says that you want to hear and just accepting that whether it is or right or not.

Yes chart patterns work. Yes indicators can be useful. If you want to trade patterns all you need to do is focus on a few patterns that consistently work and when it comes to indicators I do not think decisions should be based on indicators alone, but instead they should be used as useful supplements to overall patterns you are watching and then you only need to just use a few of them.

If the day to day action can be confusing then what is one to do?

Simple - focus on the big trends of the market.

The market is either in a bull market, bear market, or sideways market and all you need to know to make money is know which one and then position yourself accordingly. When you look at the market that way then the one day fluctuations become meaningless.

The funny thing is that almost no one focuses on this. They just assume the market is always bullish then obsess over day to day news. Or else if they think it is bearish they try to play rallies - which means going against the trend of the market and trying to time the much more difficult day to day fluctuations.

So for instance I try to trade by taking a position with the broader trend of the market that I plan on holding for at least several weeks (weeks in a bear market and hopefully months on end in a bull market). You can quickly identify the large trend of the market by using stage analysis and the 150 and 200-day moving averages. There is no guesswork needed.

It is all a matter of what you focus on. If you look at the large trends then day to day news becomes completely meaningless and then investing and trading becomes a lot easier.

I think we are in a bearish stage three topping phase and until I think we are either at the end of a bear market or starting a new bull market I have no interest in trying to go against the trend by going long. Instead I look to short rallies.

In bear markets you get drawn out downtrends that last for several weeks to several months (I think we are in one now) that get interrupted by fast short-lived rallies like the one we saw in July that basically fell a part in one day.

The masses get mesmerized by such rallies and sucked into them, often buying in at a top and then getting trapped when the market starts to drop. As it falls they get mesmerized by day to day news and action and look for signs that things will go up for them. If they would just focus on the longer-term trend this wouldn't happen to them, but they have trouble doing that.

People have a tough time doing this, because the human mind craves information and tries to draw meaning and importance out of information given to it. So for example since I am bearish on the market I decided to take a position against the market after it rallied in July and peaked in August. I think I am in at a nice level and expect the market to decline for several weeks until it makes a new low and then has another short-lived bear market rally to short again

The market has fallen in a downtrend for 15 days and then on Friday it rallied after Ben Bernanke gave a speech. The DOW went up 150 points. Now one could see that move and watch the news and try to draw all sorts of conclusions about it - they may think they should buy, or now the market is going to be bullish and rally for a long-time.

But that means ignoring the big trend of the market. But the big trend isn't news and isn't something grabbing your attention. That is why

people don't focus on it and just get caught up in the meaningless day to day news and action.

So to invest with the big trend of the market means identifying that trend, accepting it, and then being willing to pretty much ignore 99% of the news items and hourly moves that the market makes and just look at the bigger moves and invest in those in alignment with the broad trend of the market.

Book Review: More Money Than God by Sebastian Mallaby

More Money Than God is one of the top ten best selling investment books on Amazon right now.

Half of the book is a history of the hedge fund industry while the rest of the book looks at their role in the investment world both good and bad. Although the whole book is written in a narrative style I noticed this pivot about half way through it.

The author spent thousands of hours interviewing some of the top hedge fund players and his hard work shows. This is the best book I've read on the topic of hedge funds. It shows you how the industry started out with the first hedge fund created by Alfred Winslow Jones and continues up until the present day, with a penetrating discussion of the financial crisis, and interesting studies of the biggest and most successful hedge fund managers in between, such as George Soros, Michael Steinhardt, Julian Robertson, and Paul Tudor Jones.

Mallaby asserts that hedge funds are not the big villain that people make them out to be.

In contrast with the big banks that had to be bailed out hedge funds did not need to be bailed out in the financial crisis. Mallaby believes that the best and brightest managers run hedge funds and unlike banks they put the bulk of their own money into the funds themselves so that the managers interests are totally aligned with their investors. If their investors lose money than they will lose too.

This stands in stark contrast to the Wall Street banks which saw management awarded with giant bonuses even after the banks they supposedly were managing went under and even after the trillion dollar government bailout was rushed into law over a terrified and manipulated body politic.

What is more hedge funds - except for the exception of Long-Term Capital Management - are never too big to fail.

If you spend some time reading Mallaby's book

you'll get a good idea of the secrets behind the most successful hedge fund managers.

People look at them in awe and think of them as total genius, but one thing worth nothing is that none of them were right all of the time.

All of them had a year or two when they were positioned incorrectly or else made the wrong bet at some time or another - and these are the best of the best. But what they all had was longevity and perseverance and knew how to take advantage of things when they were right.

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