



Quote of the month:

“THE US is closer to a Japanese style outcome today than at any time in recent history” - St. Louis Federal Reserve Bank Head James Bullard

What To Learn From Your Results—Mike Swanson

I get emails all of the time from people when they first sign up to my free email list or think about subscribing asking me what my track record is. At times I briefly talk about it on my sales letters, but I normally do not make a big deal about it.

The reason why is that most people use track records to sell people on hype. They'll say they made these huge returns or that their last ten stock picks went to the moon and so forth. By doing this they implicitly promise their potential customers instant riches.

When they sell like this they attract customers that are often completely desperate to make money or have crazy expectations to say the least. What I have found is that the people who join mainly due to a track record have a higher frequency to cancel or demand refunds than those that don't.

They have an expectation of instant riches. They expect —

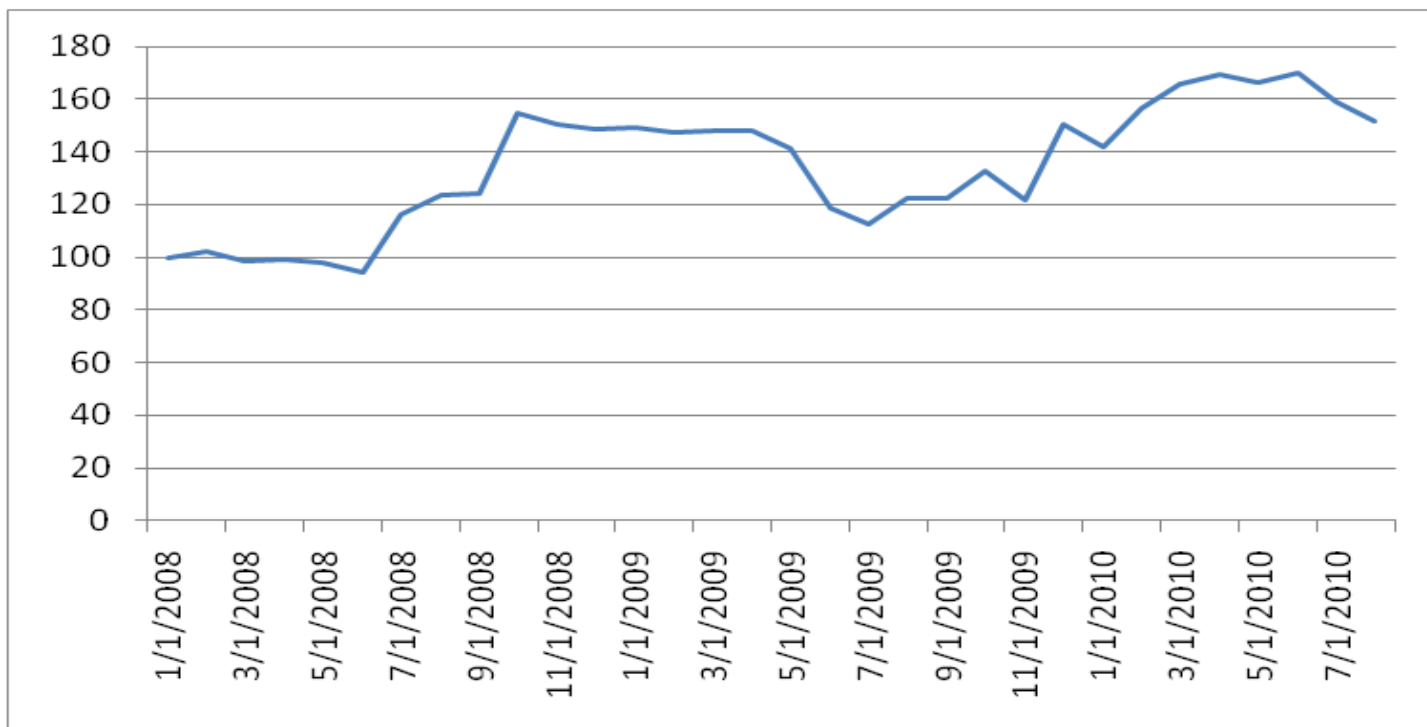
you to make money for them instantly and for the next trade to be a huge winner. If that doesn't happen they cancel and demand their money back. They do not think that the track record is proof that I know what I am talking about and therefore should be listened to, but is evidence that they can get rich on a stock pick.

Investing rarely works that way. It isn't stock picks that make you money, but applying investment principles over time and cutting your losses and letting your winning trades go for you as much as possible. It's about putting the odds in your favor.

The potential customers obsessed with track records are not only usually very desperate, but tend to be skeptical people so if you don't fulfill their demands within a few days they just drop out and go to someone else they think can deliver what they want. They have no interest in actually

Inside this issue:

The Big Picture	5
Breakout to Nowhere	6
The Macro Picture Still Stinks	7
The Federal Reserve Prepares a Nuclear Option	9
Book Review: The Big Short by Michael Lewis	12
Wrapping Your Head Around a Bear Market	14
Charts of Note with Kevin Amos and Andy Emerson	16



learning about investing themselves. They are the worst people you can possibly have as customers and I don't want to attract them since I often communicate directly with my subscribers and don't even like talking with these types of people.

All that said I want to go over my investment results the past two and a half years with you, because I think they are instructive right now. I started out with \$15,000 in the late 1990's and turned that into about \$300,000 by 2003. Then I co-managed a hedge fund with Andy Emerson, from 2003 till 2006, which beat the market averages during that time overall - with one year being in the top 40 out of thousands of hedge funds tracked by hedgefund.net. Then I just put my money in an online account and made around 15% in 2007. Then in 2008 I

moved my money to a different online broker, where it has been since.

This chart above shows you the results I have had since then. The 100 on the left is just an arbitrary number I used to create the chart. You can see that in 2008 I just treaded water until May of that year. What happened was that at the start of 2008 we were in a bear market and I thought it was too late to really take any short positions until the market had a good sized rally so I tried to make some trades on the long-side of the market and just spun my wheels.

Then in May I had a good opportunity to finally go with the market trend and went short. Got out in July and then shorted again in August. That gave me a big gain going into the Fall market crash which I booked.

Then in 2009 I lost some money in the first quarter. I was in cash going into the end of 2008, but didn't see a good rally to short so I again tried to go against the trend with some long

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positions - this time in airline stocks. That caused some small losses, which made me cautious overall so I just went to cash. The market continued lower and I felt pressured to make trades, to do something for people and ended up trying to short the market a few times after it bottomed.

That generated some losses and made me realize that the overall trend of the market had changed, but I needed a good entry point to really go long in a big way. That came in the summer of 2009 and I bought a lot of stocks and made a bunch of recommendations that all did well for the rest of the year.

Then in 2010 I took my account to new heights by taking some short positions in January and then going long in February and taking profits in March before the stock market peaked in May and gave investors a black eye. Since then though I have made three positional trades, which have all resulted in small losses.

I am showing you this for instructive reasons only, because I don't need to hype you up or sell you on anything, since you already are subscribing. You should make a similar chart of your own investment results and see what the chart looks.

I think you'll discover that a chart of your investment account has peaks, valleys, and areas of support and resistance just like any stock chart does. Ideally it should look similar to mine and be in an uptrend, making higher highs and higher lows overtime. If it doesn't look like that now then you should try to figure out what it will take to make it look like that in the future.

If you overlay the S&P 500 on it and

it simply matches that then what you have been doing is simply stayed invested in stocks that are moving with the market. If your investments are falling faster during market drops and going up more in market rallies then you are simply investing in very volatile issues.

One thing to look for is if your results simply match the trend of the market or if at times they diverge from that trend.

What happens when your account takes a dip? Does the dip stop or just get worse and worse? Answering that will give you an idea of how you react to losses in your account. It will tell you if you take measures to keep them small or if they cause you to do something that actually makes things worse.

How you deal with pullbacks in your account is very important. Most people get all upset and beat themselves up over them or don't want to deal with them and then just hold on to their losing positions in the hopes that they will turn around for them. That puts them in a position to suffer devastating losses if things get worse.

Losses in your account should instead be taken as information telling you that you are not investing with the overall trend of the market. Perhaps you were mistaken about what that trend is or that trend has changed. Right now odds are that you had a good return from March to May in your account, because the stock market went up, but since then took a big hit in your investment account.

That should be taken as a sign that the stock market has changed and you probably need to make some adjust-

ments.

I want to emphasize how important it is to stay aligned with the overall trend of the market. In bull markets you want to be long stocks and buy them on dips. In bear markets you don't want to buy stocks, because doing so means going against the trend.

Notice how even though I have made good money the times my account dipped are when I tried to go against the trend by going long stocks in the first few months of 2008 and 2009. Although I lost some money too after the March low in 2009, those losses really were a direct result of me trying to go long in the first part of the year. If I hadn't done that I would have probably been patient enough to wait for a good short entry point - that would have led me to take profits sometime in March and I probably would have gone long sooner. Instead the losses in January led me to make some more investment mistakes that didn't really get straightened out until the summer.

This is why keeping your investments and your mind aligned with the large trend of the market is so important. The most critical time to do this is when the stock market is making the transition from a bear market to a bull market or vice versa. From March of last year until this past May the stock market was in a cyclical bull market. Then in May that changed and since then the stock market has been in a down to sideways trend either in a full bear market or a stage three topping process either of which demand new tactics to make money. Transition times are always the toughest times to try to make money in the stock market, because they are full of fake out moves.

When my account takes a dip I usually take a pause in my trading to make sure I am staying aligned with the overall trend of the market and to study things closely to determine whether or not that trend is changing. Many react to losses by making even more trades with the idea of making their money back, but when you do that it is easy to lose your objectivity. If instead you sit back and be patient for a great trade to line up you often will get some great investment results.

When the trend is down I want to stay aligned with the trend. In bear markets most people still try to play rallies, because they associate the stock market going up with making money. So if the market rallies for a few weeks they feel like they have to be part of it. They also tend to feel a desperate need to make up for their losses so end up taking big risks on those rallies.

But in bear markets rallies suddenly fall apart and almost none of the people who buy into them sell in time to prevent their gains from turning into losses. I do not know of a single person who made money in the last bear market by trying to go long rallies. And even though I made a killer return in that bear market I would have made an even bigger return if I didn't try to do it myself a few times.

That is why right now I have no interest in buying stocks or trying to play rallies. I'll get to this in more detail in a minute, but I believe the market peaked in May and will likely roll over into an even bigger decline over the next few months. I want to stay focused on that trend of the market and make money from it. If I try to go long and mess up that will only

serve to distract me from the larger trend of the market.

I prefer to go long stocks and once I think we have seen a real bottom or a new bull market I'll certainly do so, but until then I really have no interest in buying stocks even if that is what just about everyone wants to do.

You may disagree with me. If you do you aren't alone, because I'm getting dozens of emails a week from people who are either now angry that I'm bearish on the market or just don't believe it. Even if you disagree you should chart out your investment results and honestly look at them, because you can learn so much from them that will help you going forward.

The Big Picture



The S&P 500 finished the month of May at 1101.60. It is now down 1.2% for the year while the DOW is up a whopping 30 points since December 21, 2010. And the Nasdaq? It's down now one tenth of a percent year to date. When looked at from this measurement the stock market has gone nowhere.

That isn't too shocking. If you recall at the beginning of this year I made a stock market forecast for 2010 in which I said in the first half of the year the market would likely go sideways. I said the big gains were already in the market and it would be

tough to make money for most of 2010.

I also said that in the second half of the year the stock market would move out of this sideways pattern and make a large move going into the end of the year. I couldn't tell then whether it would be up or down, just that a sideways movement would lead to a big move later.

The stock market peaked out in May and fell on huge selling volume and put in a bottom around the 1000 level of the S&P 500. The 200-day Bollinger Bands are now acting as long-term support and resistance for the market, with support being 1000 on the S&P 500 and 1200 marking resistance.

In the forecast I made in January I said that the market could very well go sideways and then breakout for a new bull run much like it did in 2004. I doubt it will happen, but if the current rally were to go on for another month or two and the S&P 500 somehow reached the 1200 area you should expect another big decline all of the way back down to 1000 to occur instead of a big breakout into a new bull run. We are either in a bear market or a market making a stage three top which is the prelude to a bear market. Either way the upside potential for the market has a tough cap on it.

The reason why is that unlike in 2004, we are now seeing large selling pressure in the market and internal weakness with sloppy action in sectors with the more speculative and growth oriented sectors of the stock market underperforming. In 2004 selling pressure faded throughout the year while this year it has increased. On this recent rally the Nasdaq has lagged the other three market averages, with the advance/decline line of

the Nasdaq barely moving higher. The Nasdaq 100 index looks terrible in comparison with the other averages and despite being weighted with popular stocks such as Apple and Google.



Once this current rally ends I expect the stock market to fall back down to its July lows. If the S&P 500 goes through the lows it will fall straight through its now long-term support level and its lower 200-day Bollinger Band. Such action would cause the long-term 150 and 200-day moving averages to start to curl down. A full blown stage four bear market decline like we saw in the fall of 2008 would then be in full force.

So if you are still bullish on the market then 1000 is the long-term level on the S&P 500 to watch. If the market goes through that level in the fall then you will want to get out of as many positions as you can, because it would be a signal that months of further declines are to come.

The same picture holds for markets across the globe. The DOW Jones World stock index has long-term support now at 200 and resistance in the 240 area. You can see that it is in the same exact position as the S&P 500. This

means that trying to hide in some foreign market won't do you any good if the US stock markets suffer another bear attack this year. Everything is pretty much trading in synch. I'd even expect gold stocks to get smashed in such an environment.



A Breakout to Nowhere



The stock market rallied off of its long-term support level in July. The S&P 500 first jumped up quickly to the 1100 area and then pulled back down to 1055. It then broke through 1100 and its downtrend resistance line connecting its highs of May and June.

A lot of people were thinking that this breakout would lead to a big rally in the market, much like we saw happen when the market pulled back last year in July. But instead the S&P 500 just traded up to the 1120 area on thin volume and came back

down. There was no big push higher in the market and certainly no high volume breakout. The excitement proved to be short-lived.

1120 is now the resistance level on the S&P 500 to watch. It not only is the point of the last peak, but is where the 150 and 200-day moving averages are sitting too.

Once this rally ends I expect the market to go back down to its July lows. The good news if you want the market to go higher is that I don't think a big decline in the market will start until the VIX - which is currently at 23.50 and measures the premium options players are paying for volatility and therefore acts as a fear index (the lower the premium the lower the fear) - falls down to around 20. It will probably take a few more weeks of the market averages going up to sideways for this to happen.

I tried shorting the market when it was below 1100 and got out once it closed above 1100. I just did it too early. I plan on trying again in August.

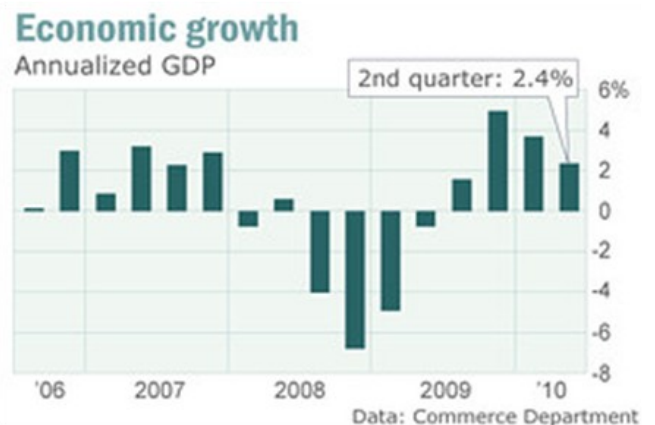
Theoretically the S&P 500 could go through 1120 and make a run all of the way up to 1150 or 1200 and we would still be in an overall negative market environment. I really doubt that will happen though. More likely the market will pause a bit and try to go through 1120 one more time to bring a last gasp of buying into the market.

I prefer not to try to go long in rallies during bear markets. If you can't - some of my readers are hedge fund managers or manage money for clients and therefore feel that they cannot miss out on any rally whatsoever - than you may want to check out the following stocks - BUCY, CAT, JOYG.

These stocks are in the sector that has been performing the best during this rally and are pausing. If the market goes up again they'll jump out of their recent highs and should continue to move up at a faster rate than any of the three broad market averages. You could just put a buy stop order right above their recent highs to play such a trade. If the trade gets executed just put a sell stop on their recent lows and take your profits 3-5 days later.

The top performing sector these stocks are in are farm and construction machinery. Other sectors which have been leading this rally include airlines, resorts, auto parts, chemicals, recreation vehicles, entertainment, international banking, reits, and publishing. The sectors that have performed the worst include home health care, drugs, toy stores, medical laboratories, mortgages, gold, and silver.

The Macro Picture Still Stinks



All signs still point to further weakness in the economy. I still think we are going to see the next trough occur in the economy in the second quarter of next year, which means that from now till then the economic news is probably only going to get worse and worse.

Last week the US government released

its second quarter GDP estimate which came in at 2.4%. The economy needs to grow over 3% in order for unemployment numbers to stabilize. It's growing at a slower rate than inflation and population growth.

Growth needs to be over 5% for a full year to make unemployment fall one percentage point.

The economy shrank at 2.6% last year and started to grow in the third quarter of 2009. Normally after a steep recession you get a powerful rebound that lasts for months on end, but the GDP reached a high water mark of 5% growth in the fourth quarter of last year and the rate of growth has been fading fast ever since.

Although most economists call this a recovery I don't think we have seen a real recovery for the economy, because we have not seen the economy go into a sustainable recovery and the growth we have seen has been too tepid to call a boom. You get booms after deep recessions. So I don't think the recession is really over.

The growth we did see was fueled by Obama's trillion dollar stimulus bill and companies spending money to rebuild inventories that had been depleted in 2008 when they cut back on purchases.

Both of these forces are fading. Instead of being a force to stimulate economic growth the government is going to start to raise taxes on people next year as a result of all of the debt Obama created for his stimulus programs.

"We're headed into the third quarter with little momentum, and most every-

thing is tracking weaker," said Mark Zandi, chief economist at Moody's Analytics. "Because of that, I expect unemployment to rise back to double digits, hitting 10 percent in December and staying there early next year."

As for inventories, the Wall Street Journal reports, "In the second quarter, the change in private inventories added slightly more than one percentage point to the 2.4% increase in gross domestic product from the first quarter, measured at a seasonally adjusted annual rate, the Commerce Department said Friday."

"That is a big change from the first quarter, when inventory-building contributed 2.6 percentage points to GDP growth of 3.7%, and the fourth quarter of last year, when it contributed 2.8 percentage points to GDP growth of 5%."

"The fading inventory effect means growth now largely depends on how much people are willing to spend on finished goods—not the calculus at companies about how much they need to build stocks to meet future demand."

While the government has been going into more debt consumers have been putting their households back into order. Yes many are still defaulting on their mortgages and going bankrupt, but those that are not are cutting back on their spending and increasing their savings in order to pay off their debts more quickly and restore their balance sheets.

Nonetheless, the middle class and the poor are suffering from the unemployment picture while the rich are about to get soaked in higher taxes. As a result consumer spending has been shaky. It grew in the second quarter at a rate of 1.6%, which was the weakest reading since last year. The Thomson Reuters/University of Michigan final index of consumer sentiment declined to 67.8 this month from 76 in June, the lowest level since July of

last year.

That doesn't mean consumers have stopped spending, it is just that many are cutting back on things they may have once bought before to buy the latest gizmo and shiny object. As one Bloomberg headline I read this weekend put it "Americans buy ipads while broke."

This Bloomberg article opened with a story about a man who lost his house and is now totally broke. He was stressing for months over his mortgage payments and when his home finally got repossessed he decided to celebrate by taking his family to Disney World and buying an ipad as a treat for himself.

Companies that produce items considered by people to be commodities are seeing sales that are flat or negative. Bloomberg notes that "Mass marketers have a tougher time seducing consumers with psychological value. Burt Ficklinger, a retail consultant based in New York, says Protcer & Gamble Co. is struggling to keep people from abandoning its Ivory soap and Crest toothpaste for generic brands. According to Flickinger, better-educated shoppers understand how little difference there is in quality on many household items."

Many shoppers are now going to dollar stores to buy such items. Grocery store company Supervalu reports that shoppers are purchasing fewer goods per visit. That is putting pressure on Wal-Mart and Target, but enabling consumers to splurge on shiny objects that make them feel better in times of malaise. They are saving money to buy ipads, ipods, fancy purses, or to take their summer vacations. In the past when they may have used a credit card, now they just save money by trying to be more thrifty when it comes to things they view only as commodities.

Bloomberg continues - "Starbucks is the lower-end corollary to Apple, a purveyor of expensive treats. Stephanie Redmond, the Miami electronics

worker, may not buy the new car she needs, but give up Starbucks? Never. She says she has to have it "every day!"

I'm sure Stephanie doesn't go to Starbucks for the coffee. It isn't a "commodity" for her. Starbucks is probably a place that makes her feel special and going there makes her feel like she is an elite Starbucks customer. For many of the rich though they consider their stocks to be their treats. When some of them own a stock they feel like they are superior to other people who can't afford to be in the market and also have something akin to a lottery ticket that will go up in value and make them rich. Owning stocks provides them with a sense of satisfaction and psychological comfort. For them selling their stocks would mean losing that identity. These are the rubes of the stock market who end up getting completely smashed over and over again in bear markets. They don't even think about the risks they take to stay in a market that has gone nowhere this year.

The Federal Reserve Prepares a Nuclear Option

If you are a long-time subscriber you might remember the Mishkin report. The Federal Reserve puts together research papers and reports to try to decide what to do with interest rate policy and to also provide a justification for its actions.

Back in September of 2008 one of the Federal Reserve Board of governors, Fred Mishkin, wrote a report that advocated lowering interest rates rapidly in response to real estate prices going into a bear market. The report included several projections for the

economy, most of which predicted a decline in real estate prices that would last at least two years.

The report claimed that if the Federal Reserve did what it normally does and gradually lowered interest rates in response to a falling stock market and slowing economy then the country could fall into something akin to the Great Depression. Mishkin argued that the logical thing to do then would be to rapidly slash interest rates.

And that is what exactly what the Fed did.

When this report came out I made a big deal out of it. At the time the stock market was just making its final peak in the last bull market and most people were still bullish on the market.

Almost no one could imagine what was to come, even though this report showed what the Federal Reserve was worried about. This report turned out to be one of the most important things to read that year.

Now the head of the St. Louis Federal Reserve bank, James Bullard, just issued a new Fed paper titled the "Seven Faces of The Peril." In it he makes the case that the biggest problem that the US economy may now face is deflation and claims that a new round of "quantitative easing" may be required to prevent it. The Fed engaged in quantitative easing when it bought over a trillion dollars in mortgage securities in 2008. So he is basically talking about another trillion dollar hand out for the banks.

Deflation is what happened in Japan in the 1990's when the Japanese central

bank lowered interest rates to zero and kept them there for almost ten years with almost no beneficial effect on the economy. The Japanese banks were so blown up in debts that even the ability to get money to loan out at almost zero cost couldn't get them to issue more loans and help the economy.

Bullard writes that "the US is closer to a Japanese-style outcome today than at any time in recent history."

He also says that the Fed may have made some big mistakes when it promised to keep interest rates at zero for even longer back in May.

He writes, "the reaction to a negative shock in the current environment is to extend the extended period even further-delay the day of normalization of the policy rate farther in the future. This certainly seems to be the implication from recent events. When the European sovereign debt crisis rattled global financial markets during the Spring of 2010, it was a negative shock to the global economy, and the private sector perception was certainly that this would delay the date of US policy rate normalization. One might think that this is a more inflationary policy, but TIPS-based measures of inflation expectations over five and ten years fell about 50 basis points."

The problem with all of this is that, according to Bullard, "promising to remain at zero for a long time is a double-edged sword. The policy is consistent with the idea that inflation and inflation expectations should rise in response to the promise, and that this will eventually lead the

economy back... but the policy is also consistent with the idea that inflation and inflation expectations will instead fall, and that the economy will settle in the neighborhood of the unintended steady state, as Japan has in recent years."

"To avoid this outcome for the US policymakers can react differently to negative shocks going forward. Under current policy in the US, the reaction to a negative shock is perceived to be a promise to stay low for longer, which may be counterproductive because it may encourage a permanent, low nominal interest rate outcome. A better policy response to a negative shock is to expand the quantitative easing program through the purchase of Treasury securities."

What this means is that the Federal Reserve is starting to recognize that simply keeping interest rates low is not enough to create a sustainable recovery in this economy. The economy is dead just like Japan's economy remained dormant in the 1990's. Obama's stimulus program is fading away. Government intervention has failed and just trying to stay on the same path - in this case promising to keep rates low until good times come again - isn't enough to magically force the economy out of recession.

The reason why the low rates and even the trillion dollars printed by the Fed and given to banks in 2008 did not create inflation is that banks simply used that money to prune debt from their balance sheets. They didn't lend it out so it didn't go into the real economy. In reality banks are not going to start to lend out money in mass until real estate puts in a final bot-

tom in the US - which is forecast by the futures market to occur in the second quarter of 2011.

My guess is that what is going to happen is that as this year continues the economy is going to continue to slow-down. At some point the stock market will roll over and the S&P 500 will break 1000. Then the deceleration in the economy will pick up steam and the stock market will start to drop rapidly. This could go on into 2011. There will be a public outcry and demand that something be done. In response the Fed will buy a trillion dollars or more in securities from the banks to put more money into their balance sheets.

Quantitative easing is a risky policy, because there are two dangers to it. One is that the banks simply hoard the cash to increase their capital reserves in the face of rising defaults on their loan portfolios. This is essentially what banks did in 2008. The risk to that is that people then lose even more confidence in the economy and the Federal Reserve.

Another risk is that the Fed goes overboard and puts more money into the economy than was necessary. Inflation then results and if there is a high debt environment the inflation can turn into hyperinflation if the economy is completely messed up. It can tempt governments into engaging in wild deficit spending without raising taxes and then risking a collapse in their bond prices and skyrocketing interest rates.

The truth is when a central bank engages in quantitative easing no one really knows what is going to happen,

because it is very difficult for the Fed to precisely predict what the right amount of money to inject into the economy is or even if it will work, because it is essentially a way to try to force an economy to grow through money printing. That makes it a nuclear option for when nothing else works and is an act of desperation for which the ground work is now being laid at the Federal Reserve through the publication of this Bullard report. You can read the report for yourself here:

<http://research.stlouisfed.org/econ/bullard/pdf/SevenFacesFinalJul28.pdf>

Book Review: The Big Short by Michael Lewis

This is one of the top selling investment books of 2010 and you should read it. In fact it may be more important for you to read it now than ever before.

Lewis is a best selling author who wrote *The Blind Side* and chronicled his career at Solomon Brothers in *Liar's Poker*. In this book he chronicles the adventures of several individual traders and out of the ordinary hedge fund managers who made fortunes betting against subprime mortgages and real estate related securities going into the financial collapse of 2008.

The book is an entertaining read and probes several important questions that are worth thinking about. For one thing it reveals what it takes to be successful at betting against a financial market, but also explains exactly why the stock market crashed in 2008.

Lewis claims that only a few people bet against the subprime mortgage market. Although there were people who shorted stocks in general or the market as a whole through exchange traded funds - I know because I was recom-

mending people do just that in May and August of 2008 - very few people were shorting subprime mortgage securities themselves. It took arcane trading in derivatives to do it and only a few individual and individual investors who followed that market were in a position to do so and willing to do so.

Most of the people holding subprime mortgage securities were Wall Street banks and hedge funds who had bought them during the housing boom. It was just a few dozen people who bet against them. Lewis reveals that what these people all had in common were that they did not work on Wall Street.

They were completely independent people who were not a part of the crowd. This book profiles these characters and in doing so will give you an idea of the mentality it takes to make money in a bear market. One has to truly separate oneself from mainstream thinking to accomplish this feat, because almost everyone ends up losing money in a bear market. By that very fact you have to do something different than everyone else to be one of the few who make money. Simply watching TV and doing what you are told like everyone else does won't work. This book can help you with this, by showing you the thought processes of betting against a market in action.

In one passage of the book one of these hedge fund managers who foresaw the collapse in mortgage securities attends a conference in Las Vegas put on by a mortgage security association. All of the big players in the mortgage market are in the room and none of them had any inkling of what was to come. Looking in the conference rooms he saw in attendance the very people he was shorting against.

They weren't crooks. They simply were "the optimists." The mortgage market and real estate had never done anything but go up. Few could imagine that it could stop rising and even fewer wanted to believe it could stop

going up either.

Another central insight in the book is that people believe what they are incentivized to believe in. They simply ignore or don't care about evidence that may contradict these beliefs. This is why so many CEO's in the financial industry guided their companies to destruction in 2007 and 2008. The CEO's job was to make as much money every quarter as possible. Long-term planning was none of their concern, because they were not paid to think long-term. They make most of their money not through their salary, but mainly through stock options and are therefore incentivized to do anything possible to make their stocks go up.

So when every other CEO in the financial industry jumped into the subprime market none of them felt they could be left behind. And as the stocks went up as a result they made money on their options. If any of them thought the market might go bust one day they evidently decided to leave that problem to their successors. And so that is what they did. And many simply chose to believe in the mortgage market to rationalize and justify their self-serving investment in it.

This same type of thinking goes on all of the time in bear markets. Take newsletter writers for example. A newsletter writer typically has an audience of inexperienced investors who subscribe for one thing - to get hot stock picks and to be told that they can be made rich by just being a part of the stock market. If the market gets bearish and he tells his subscribers that he will lose subscribers, because he will be telling people something most of them do not want to hear. However, if he tells them that the market is bullish even if it goes down he would lose less readers than he would have if he told them the truth, because he is telling them what they want to hear.

This is why almost all talking heads

and newsletter writers stay bullish even in bear markets. It isn't that they are liars. They are incentivized to believe that the market will go up, because that is what their readers want to hear so they look for reasons and evidence to back up those beliefs that make them money. Most people look up to the people they see on CNBC, because they wear suits and are on TV were they are presented as experts. As a result they feel intimidated to try to do something they say not to do like sell stocks and go to cash or bet against the market. This book is an antidote to believing in them.

When it comes to investing and thinking about the stock market you need to think about what may be influencing you one way or the other. Are you listening to a broker who is making money off of you holding mutual funds in an account he "manages" and therefore has every reason in the world to tell you to keep holding on? Are you always long the market and therefore always hoping it will go up? Or are you a hedge fund manager with clients who demand a market beating return every single month and therefore are unable to afford missing out on a market rally?

It is impossible not to have a bias of some sort on just about anything you are presented with and when you have an interest of your own in it than it is even more difficult to be completely objective. The best one can do is be aware of this and try to make it so they are less easily influenced or pressured to believe or do something that may conflict with what is best - which when it comes to the stock market means being as clear headed about the real trend of the market as possible so you can invest in it accordingly and help other people do so too if you are in that position.

When it comes to running writing a financial newsletter or trading website like I have, people want to make instant money when they sign up. Most people also want and crave stock

picks. So if someone signs up and sees that I am bearish on the market and think that buying stocks is foolhardy right now they get mad and often will demand a refund so they can go somewhere else and find someone who tells them what they want to hear. That puts pressure on me to give out stock picks or make trades of some sort to make people money when they sign up even if that is not really the best thing for them.

In order to eliminate that type of thing I decided not to let any new people into the WSW Power Investor service until I think the market is back into a bull market - which I don't think will happen until next year at this point - and move more and to charge people more money just once to become a member of it or subscriber of this newsletter. It gives people a bargain, but I think getting rid of rebills also makes it easier to be as objective as I can on the stock market for my readers and myself.

Wrapping Your Head Around A Bear Market

A subscriber sent me an email the other day which said, "I don't understand the philosophy of the SDS ultra-short ETF. I always look for the market to go up to increase my earnings so it is difficult to to wrap my head around what appears to be an opposite philosophy. If the market goes up; the ultra short ETF loses? Do you have a book you could recommend I read?"

I have a review in this newsletter of the Michael Lewis book titled The Big Short. It profiles several traders who make fortunes betting against the sub-prime market in 2008 and gives you an idea of the type of mentality and character traits it takes to be successful betting against a market.

I wrote a book of my own the other month, which should be out towards the end of August or early September, in which I spent a great deal of the book talking about the type of thinking you

need to have to be really successful in the stock market. I have a chapter on short selling in it and think it will be a big help for you.

The idea of trying to make money when stocks or the stock market goes down is new to many people reading this too so you are not alone. Most people's investment lives are spent making money when stocks go up and losing money when they go down and the idea of doing the opposite sounds scary to them or doesn't seem to make sense. Also if other people know you are doing that and they are losing money in a bear market some will even resent you for it. They'll see you as the enemy. And if you tell people to sell almost no one will listen to you either. So it almost pays not to tell people that you think the market is bearish.

Last week I talked with someone who I told to get out of stocks in the summer of 2008. He listened and sold his mutual funds in his retirement account and bought back in last summer. So he missed out on the devastating losses most people suffered through. The other week I called him and told him I thought the market was getting bearish again and it would probably be a good time to sell. This time he said that he doesn't know, it is down and I want it go back up before I get out. He wants it to go back to the May highs. The market has gone up a little since then so he probably wouldn't listen if I tried to tell him again.

Back in the 2000-2003 bear market in 2001 one of the wealthiest people in my town came by my office and showed me his portfolio. He owned nothing but tech stocks bought on the advice of his broker - most of which ended up going bankrupt - and wanted to know what to do with them. Almost all of them were down for huge losses. The account was worth over five million dollars.

I told him he needed to get out of them. That this was a bear market and

these stocks he owned were garbage. He left the office and four weeks later I got a letter in the mail from the state corporation commission opening up an inquiry into me. They wanted to know if I was acting as an unregistered investment advisor. I answered their questions and everything was cleared up fine, but I think probably what happened is that this investor told his broker what I told him and he decided to fight back.

If you go around just telling people you are bearish on the stock market you will win very few friends and probably suffer for it. It's one thing to write about it and communicate with sophisticated investors, but another thing to warn people you just know out and about or at work. Few will listen and some just get mad. Americans just believe what the TV tells them and you are going against the TV. If it was a bull market that is a different story. People love to hear about stock picks and bull markets.

I know I've said this kind of thing before, but people can't sell because they get terrified of missing out on possible gains so they just sit there and hold and hope.

When it comes to shorting the market or trying to make money when the market is going down what you have to realize is that you are not in a market in which money is to be made when the market is going up, because it is not going up in a sustainable manner. The rallies don't last. So if you try to go long the market you need to buy and time things perfectly or else you'll end up just losing money. This pretty much impossible to do consistently and leaves no margin of error. You are better off just sitting in cash and waiting until the bear market is over.

No one makes any money in bear markets playing temporary rallies. I do not know of a single person who made money using that strategy in the last bear market or the one that came before it - even though that is the strategy

most people try to do. The reason why is that even if they make a little money they end up losing much more by guessing bottoms too early or by buying into tops. That is one reason why the market is more volatile during a bear market. The only people who take advantage of a bear market are those that have large cash positions so they can buy when it is over and the only way to make money in a bear market is bet against the market or short sell individual stocks.

If you think like that then you start to realize that the only way to make money is to bet against the market after the market rallies or until the bear market is over. And yes that requires a much different type of mentality than buying stocks in a bull market does, because it takes betting against the beliefs and desires of most people that are in the stock market and the hype you hear and read. It takes doubting rallies, and that is something difficult for people to do.

The idea of being out of the market and then seeing it go up is unbearable to many people, but the idea of possibly losing money when it goes up is even worse to many more. Maybe that is too much of a risk to take for you.

You do not need to short the market or bet against it. Simply having a heavy cash position in a bear market is good enough to come out way ahead of everyone else, because it will give you the ability to buy stocks at low prices when others are unable to. If you don't feel comfortable with the idea of betting against the stock market you don't have to do it.

You can just stick with the idea that you make money by buying something and seeing it go up. And the best time to do that is after it has fallen for a long time and put in a real final bottom. Buying before the real bottom comes in is simply buying too soon. So the best thing to do is just to be patient until that happens.—Mike Swanson

Sectors & Stocks—Kevin Amos

Lets first take a look at some of the sectors as you will see there are some which are still holding up well and continuing to trade up, while there are others which are declining and appear to have topped out. Also in evaluating the sectors and the stocks and breaking those down into two different categorizes those which are still trading above there long term averages and those below. After this last rally that has improved a bit, but we still have more slightly more to the downside which gives us reason to be cautious on the market at this time knowing that this must improve before we get in a position for a sustainable rally. As for some of the sectors doing well you can see the charts below.



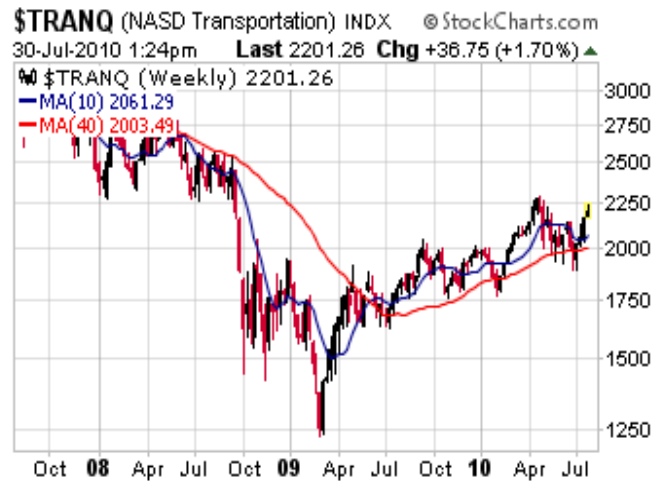
The airline sector



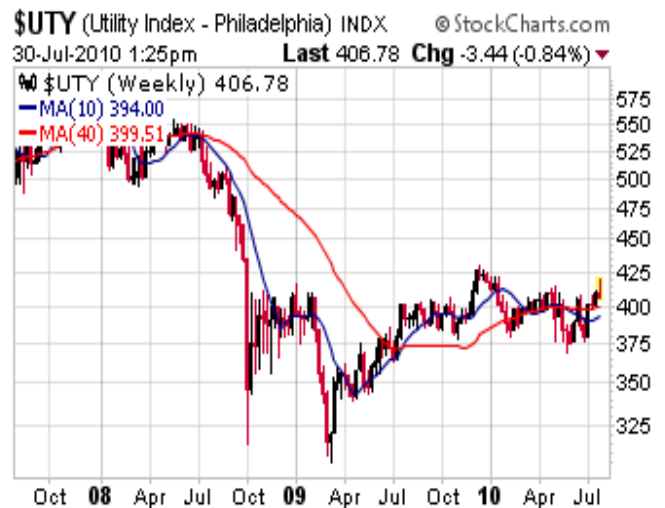
Reits



Telecom



Transport



Utilities

As for some of the underperforming sectors.



Health Care

OIL Services



Health Care Products

Drug



Oil

Retailers

Now lets turn our attention to the stocks themselves. As you will see there are those which are in fine shape technically and still performing very well but this list is becoming smaller making stock selection very important here. All of these stocks have held up well through the decline and have broken out in the last rally and may be accumulated here on pull-backs to those breakouts and you will notice volume has been greater on up days also on these.



CNQR



FNSR



WCN



CROX



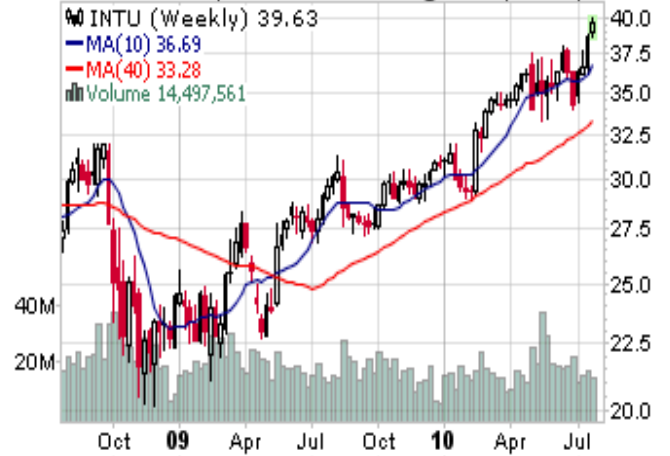
CGI

ARUN (Aruba Networks) Nasdaq GM © StockCharts.com
 30-Jul-2010 2:14pm Last 17.29 Chg -0.53 (-2.97%) ▼



ARUN

INTU (Intuit, Inc.) Nasdaq GS © StockCharts.com
 30-Jul-2010 2:19pm Last 39.63 Chg +0.98 (+2.54%) ▲



INTU

SWKS (Skyworks S...) Nasdaq GS © StockCharts.com
 30-Jul-2010 2:16pm Last 17.47 Chg -1.28 (-6.83%) ▼



SWKS

HRL (Hormel Foods Corp.) NYSE © StockCharts.com
 30-Jul-2010 2:20pm Last 42.82 Chg +0.06 (+0.14%) ▲



HRL

ROVI (Rovi Corp.) Nasdaq GS © StockCharts.com
 30-Jul-2010 2:17pm Last 44.78 Chg +1.24 (+2.85%) ▲



ROVI

EMC (EMC Corp.) NYSE © StockCharts.com
 30-Jul-2010 2:20pm Last 19.85 Chg -0.36 (-1.78%) ▼

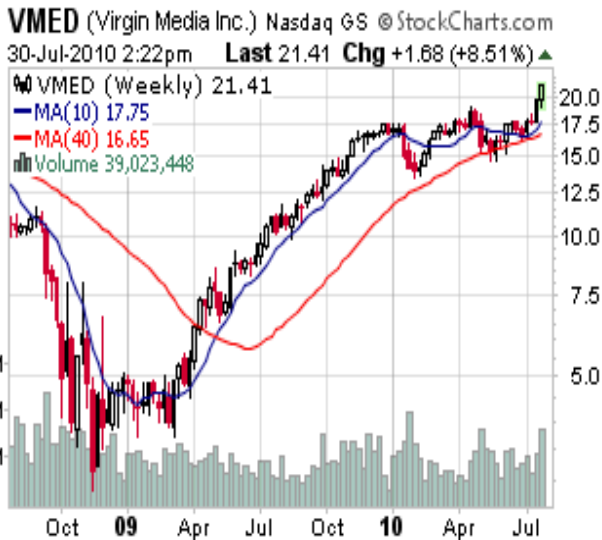


EMC



PSMT

Now looking at the stocks which have underperformed, they have lead the market down and if the market does turn down these stocks could continue to fall. So with rallies in the market itself these should be exited and if money is to be put back in the market long the stocks mentioned previously have much better potential. You will notice these stocks are well below their longer term averages and have overhead resistance levels to work thru.



VMED



BYI



RVBD



WDC

RIMM (Research i...) Nasdaq GS © StockCharts.com
 30-Jul-2010 2:53pm **Last 57.30 Chg +1.80 (+2.87%) ▲**



RIMM

ORN (Orion Marine) NYSE + BATS © StockCharts.com
 30-Jul-2010 2:54pm **Last 12.46 Chg -0.69 (-5.25%) ▼**



ORN

MSFT (Microsoft Corp.) Nasdaq GS © StockCharts.com
 30-Jul-2010 2:54pm **Last 25.68 Chg -0.13 (-0.50%) ▼**



Msft

IPCM Nasdaq GM + BATS © StockCharts.com
 30-Jul-2010 2:53pm **Last 25.98 Chg +1.95 (+8.11%) ▲**



IPCM

APOL (Apollo Grp., Inc.) Nasdaq GS © StockCharts.com
 30-Jul-2010 2:55pm **Last 46.09 Chg -3.18 (-6.45%) ▼**



APOL

BG (Bunge Ltd.) NYSE + BATS © StockCharts.com
 30-Jul-2010 2:59pm **Last 49.46 Chg -5.62 (-10.20%) ▼**



BG

Foreign Markets—Andy Emerson

Below is a chart of the Dow Jones World Markets Index. Since last month the markets have been able to rally back up near their long-term moving averages that are trending down as of now. Once the world markets are below the 50 day moving averages again we expect to see the averages test the lows of June. For the world markets to remain bullish they will have to consolidate and make new highs later this year or the first of next year. A market can't be bullish below the 150 Day Moving average.



The French market is in a clear bear market, but has rallied since last month and is now over bought.



The German market appears is clearly in a bear market decline with new support at 17.71. resistance is the long term averages coming down from above.



The Spain market is really leading the others down.



As for the foreign markets some have bounced better than others and after a re-test of the lows we'll be better able to decide if the lows have been put in place on some of the markets around the world. As for Spain above it did bounce really well and a quick re-test and then a move to new high's later this year would move it in to a stage two bullish chart pattern. We have many months ahead to decide when and where to invest but at the moment being in cash is still king.

US Commodities

The CRB index has improved since last month and is now above the long term and short term moving averages. It's by no means out of the woods though and is still bearish.



Since last month oil hasn't improved or broken down. Oil is in a consolidation phase and if the markets break lower in the months to come then I'll expect oil to follow suit.



Gold continues to trade in a stage 2 advance, but has pulled back to its long term moving averages. At this point before adding to any gold I would like to see the metal trade back up above the 50-day moving average. Even though gold is bullish we still feel that

Gold would be pressured if the markets were to head south in the coming weeks / month. We have gold as a hold and see for now.



Wrapping the commodities up the Energy sector (XLE) continues to show poor relative strength. After the markets bounced from over sold position the past few weeks the energy sector is now back above the 50 day moving average but is in an extremely bearish position. The long term moving averages rolling over top etc. In the case the markets resume a downward trend the energy sector could possible test or even break it's lows of 2009. We have a hold on the energy stocks at the moment.

