WallStreetWindow Monthly

Stock Market Barometer

The Most Influential Financial Newsletter Read By Over 500 Hedge Fund Managers and Thousands of Elite Investors ~ May 2 2011

Quote of the month:

"Our negative outlook on our rating on the United States sovereign signals that we believe there is at least a one in three likelihood that we could lower our long-term rating on the United States within two years." - Stan-

Profit from Fed Inflation — Mike Swanson

Before we get to the stock market I want you to know that just hours ago President Obama announced that Bin Laden is dead. According to the British Guardian the US attacked a one million dollar plus residence outside of Islamabad Pakistan. The compound was surrounded by 18 feet falls and topped with barbed wire. US intelligence agents got on the trail by tracking a courier for Bin Laden that went between him and several other members of his inner circle.

They had been tracking this courier for four years and his trail finally led to this compound. The CIA got suspicious when the two brothers who owned it had no visible source of income.

By February the CIA was fairly certain that this location was Bin Laden's whereabouts and at an April 29th national security meeting President Barack Obama gave an order to attack the compound.

The attack was executed by a small team of Navy Seals and lasted 40 minutes.

Bin Laden and three other men were killed. US forces gave Bin Laden the chance to surrender, but he refused and was killed in a firefight.

It's great news and finally a good victory, but you are reading me not to hear about that, but to figure out how to make money in the financial markets. I want to celebrate right now, but when it comes to the stock market you can't get emotional. That means thinking about charts and also the big picture. Right now that means what is the Fed and Ben Bernanke going to do next?

Federal Reserve Chairman Ben Bernanke is a liar. Either that or he is totally incompetent. You can take your pick. Back in 2007 he said that real estate prices would not go down and that subprime mortgage debt wasn't a problem. Then in 2008 right before the big stock market crash he said the banks were in fine shape. The problem is many unwitting investors simply believed what he said and as a result lost lots of money. One could have simply read the news headlines at the time and used your own common sense to know that neither of his claims here were correct.

Last week the Federal Reserve released an FOMC statement, which contained one of the biggest whoppers I've ever heard in my life. But in this embellishment lays an important clue to the future of Fed policy. In the statement Bernanke recognized the reality of inflation, but claimed that it is "transitory" and caused by "concerns about global supplies of crude oil" – which I take as a reference to the turmoil in the Middle East and Libya, which holds the ninth largest oil reserves in the world and is in a state of civil war.

This isn't correct, because commodity and oil prices have been rising from the summer when Bernanke began his quantitative easing money printing operation. In fact the rise in food prices was a direct contributor to the revolts in the Middle East. Food prices in Egypt rose over 30% in the months before the demonstrations in that country. So it isn't so much that the turmoil in the Middle East is causing inflation, but the other way around.

You can just look at a chart of commodities and see that they started to up once the Fed started its last quantitative easing program and not just recently.

It doesn't take a genius to realize that the Federal Reserve money printing has something to do with the rise in commodities and inflation. The sad thing is that it takes people like me to point this out, because sycophant reporters like Steve Liesman on CNBC won't do it. But hey that's why Liesman was given the opportunity to ask Bernanke the first question to him at last week's press conference and I'm not allowed in the room.

The reality is that Bernanke does not want you to think that the Fed has anything to do with inflation.

You see part of the Federal Reserve's mandate is to promote stable prices. By claiming that inflation is being caused elsewhere than the Fed can ignore that mandate and keep its hands free to do other things – and in today's day and age that means keeping interest rates low and printing more money down the road if necessary.

Over the past few weeks many people have made a big deal about the end of quantitative easing in June, thinking that it would mean tighter Fed policy. There were worries that commodities and gold would sell-off as a result or that the stock market might pullback. But after last week's Fed meeting the opposite happened. Gold and silver prices are exploding and flashing a red alert when it comes to inflation.

Some of the most bullish people on the market now, such as James Cramer think the end of QE will create a perfect world for stocks, because they think it will cause commodity prices to collapse, inflation expectations to fall, and as a result bring lower interest rates and higher stock prices.

At the same time Bill Gross of Pimco has sold off his US Treasury holdings in the belief that the end of QE will mean falling bond prices and therefore higher interest rates. Gross simply sees no buyer to step in take the place of the Fed's $600 billion bond buying program.

The truth is the end of quantitative easing doesn't really change much. As the FOMC statement explained, the Fed is "maintaining its existing policy of reinvesting principal payments from its securities holdings." In other words the Fed is going to keep on buying more Treasury bonds and securities as existing bonds it has invested in expire.

The Federal Reserve has no choice, but to do this, because it is now financing the bulk the country's fiscal deficit.

Bernanke embellishes on the real causes of inflation, because he wants to continue his loose monetary policies. That means even if commodities were to pullback here temporarily that won't change the underlying inflationary trend.

Dave Skarica in his book the Great Super Cycle has compared the current macro environment to that of the 1970's. In the first few years of the 1970's the US ran into debt problems and as a result Nixon took the dollar off of the gold standard. Through the rest of the decade the country was hit by inflation and sluggish economic growth – called stagflation. But by the end of the decade many of the debt problems were inflated away and once Reagan came in the Fed raised interest rates and smashed inflation, an act which paved the way for two and a half decades of strong economic growth and a wonderful secular bull market for investors. Gold and commodities were the best things to invest in during the 1970's just as they have been in this decade.

Now in 2008 the world got hit by a global credit crisis, which threatened to send most of the world's largest banks under. In response the Federal Reserve and the US government exploded the US budget deficit with bank bailouts and expanded the Fed's balance sheet to take buy many of the securities off of the hands of the banks.

In effect the government saved the banks by taking on the debts themselves. They turned a banking crisis into what will now be a government debt problem.

It seems the Fed's solution to that problem will be to try to inflate away the debt much like they did in the 1970's. That means Bernanke will continue his loose monetary policies while claiming that inflation isn't a problem.

And that means that going forward we can expect even higher commodity prices for the next several years.

For the average American the next few years are going to continue to be tough times. Last week's first quarter GDP release showed that the economy grew at only 1.8% in the first quarter while the Fed's chosen measure of inflation – the personal consumption expenditures deflator rose 3.8%. That is the type of stagnation you would see in the 1970's.

We are in a secular bull market for commodities that will continue for as long as the Federal Reserve Chairman continues to pretend that it is only "transitory" and that he has nothing to do with it. Those that make the money over the next few years will simply focus on this one fact.

Yes it's nice that the stock market has gone up the past two years and there is no sign that the bull market is over right now. But at this point the major market averages are only about 15% off of their highs of the 2007. Assuming for a moment that they are going to reach that level again in this cyclical bull market it probably would take another one or two years to get there while commodities and commodity related stocks will go up at a much faster rate and leave the typical mutual fund investor behind in the dust.

We saw an example of that on Thursday when SunPower Corporation (NASDAQ: SPWRA), which I recommended in the March issue of this newsletter got bought out for over a 40% premium.

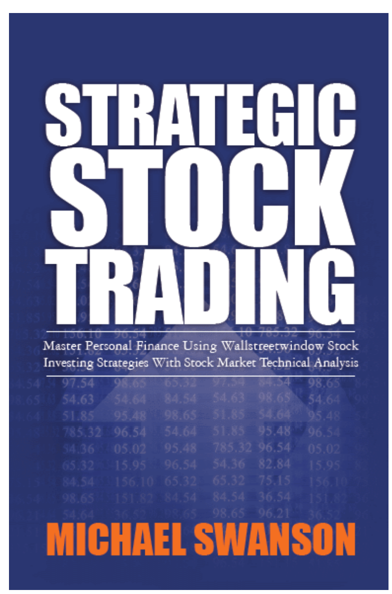
Right now the trade I am most excited about is natural gas. Natural gas futures are in the process of breaking out of a stage one base with increasing volume and open interest.

Historically natural gas prices have tended to follow energy prices, because natural gas is often used as a substitute for imported oil and can be used to generate electricity and heat buildings. However, natural gas prices have fallen the past few years while oil has risen, because of the discovery of a new natural gas drilling technology - hydraulic fracturing - that has enabled natural gas companies to tap into what were once inaccessible shale beds. This has increased the reserves of natural gas companies and brought them a glut of inventory.

The thing about commodity bull and bear markets is that bull markets often peak out when supplies are tight and bear market enter bottoms when there are talk of inventory gluts.

Seasonally natural gas prices tend to have their strongest months from July to late October as energy companies stock up for supplies for the winter and their weakest months from November to the end of February. So if one wanted to trade natural gas you could buy now with the notion of selling towards the end of October.

Last Monday I recommended ETF's UNG and GAZ in the WSW Power Investor service as a simple way to play natural gas. Both are up a little since then, but I believe both can easily double over the next twelve months from here.



Sectors & Stocks—Kevin Amos and Andy Emerson

Give the markets trillions and the markets will go higher. That's exactly what the Fed is doing. Big problem though, it's all borrowed money and we're going to pay the price one day. Well we have already started to pay the price (inflation), but we're only seeing the beginning.

We may have a stock market that's at it's all time highs soon and gas prices that are right there with it. When gas goes to it's all time highs it won't just top out and fall again like it did a few years back. Inflation will be here to stay for awhile and the FED is going to have to deal with it by raising rates on a stagnate economy. Corporate America loves all the money. The stocks markets are showing us this by going higher with out any type of meaningful pull backs. This isn't a normal bull market by no means.

Think about it this way— imagine the stocks market at it's all time highs in twelve months or less and the real unemployment rate well above ten percent and the prices of goods > oil > food > Chemicals etc. going through the roof. Your electric bill going up another fifty percent in one year and they have to start raising the interest rates on top of that.

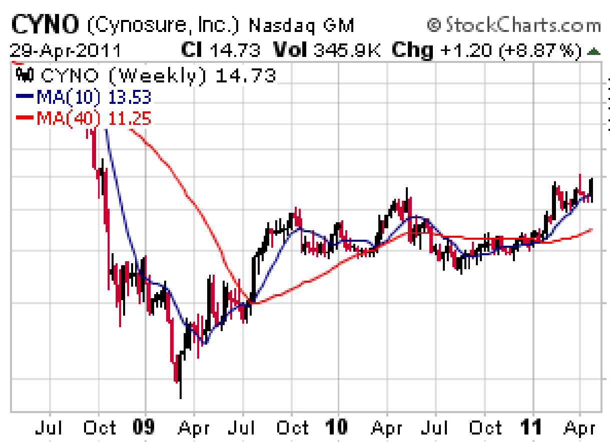
Well in the mist of all of that the market goes higher and they're several stocks / sectors that are going to do well. It's time to be invested in commodities stocks for sure but even other sectors also.

Below is a good example. We really like health services stocks now:

Health Services

CI

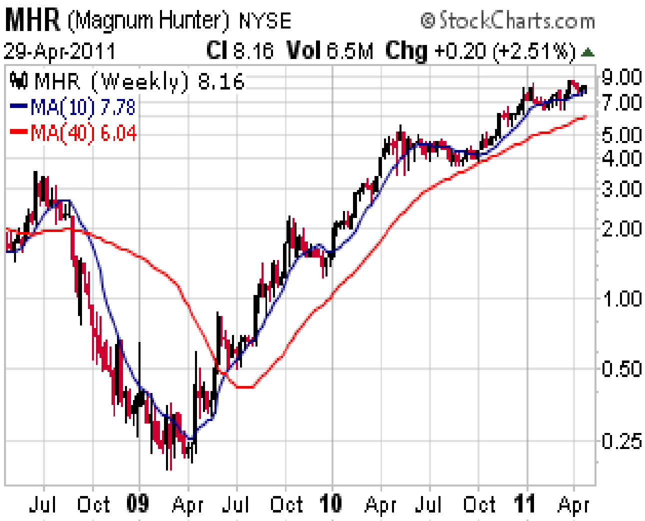
CYNO



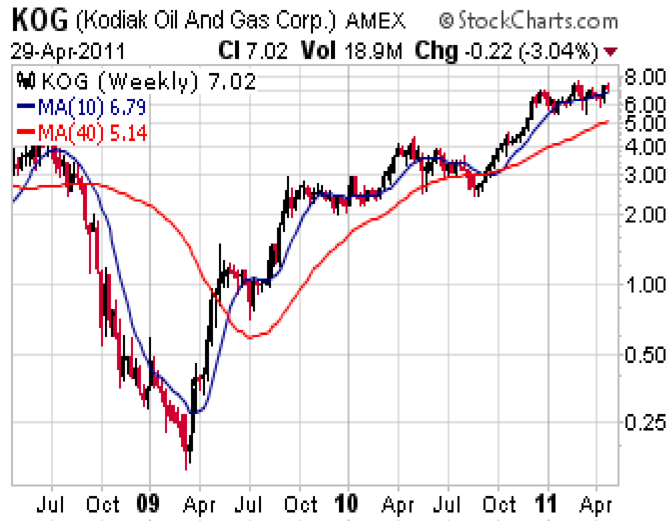
SRZ

Oil and Gas Drilling

MHR

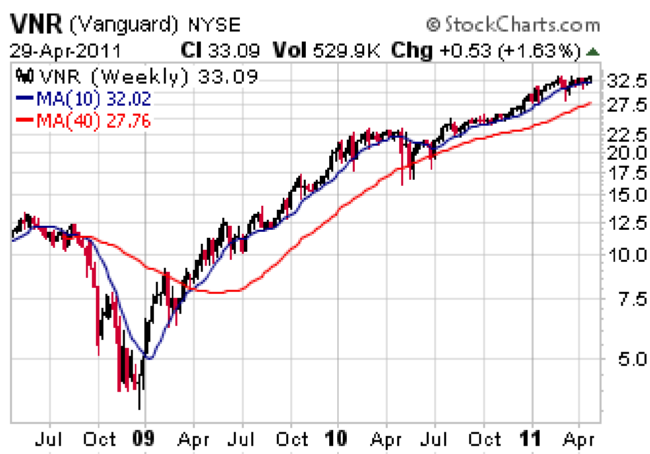


KOG

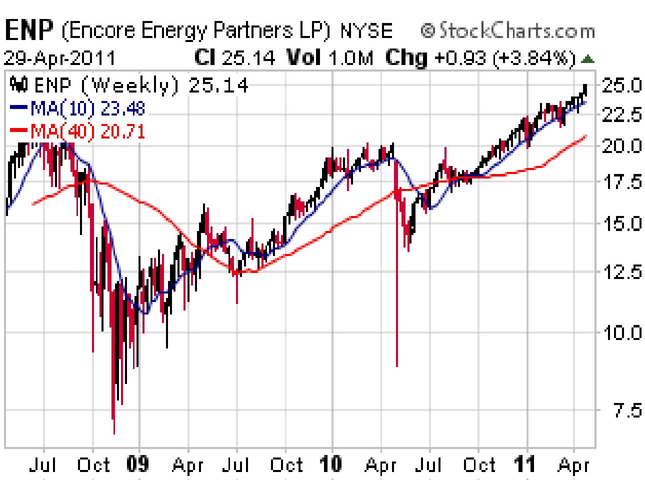


LNG

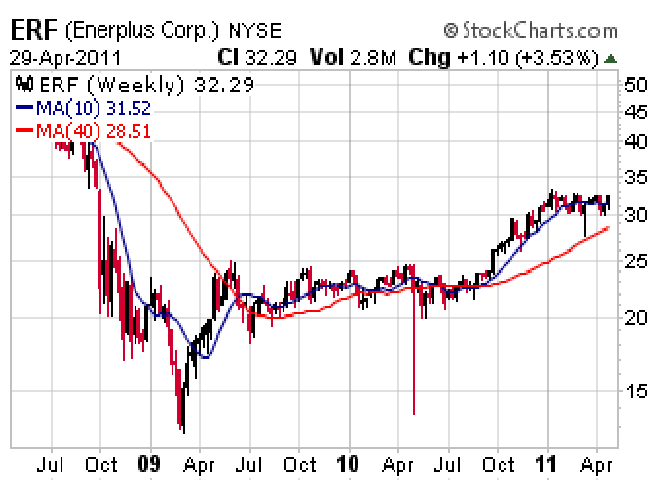
VNR



ENP

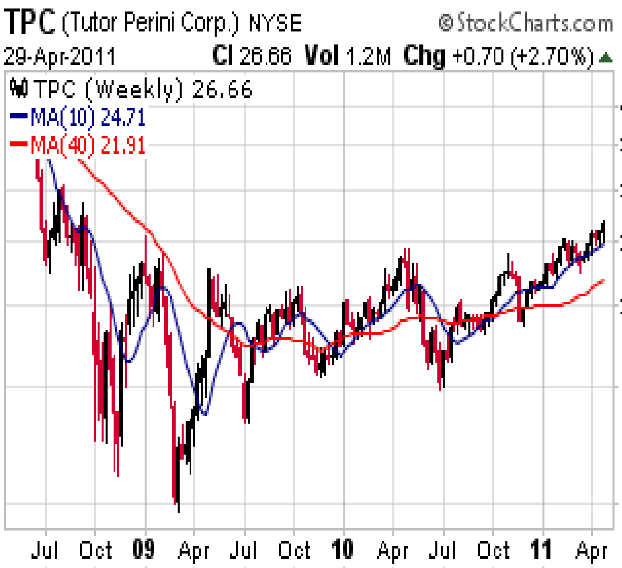


ERF



Listed below are stocks from various sectors that look attractive at this time. They are either being bought on breakouts or a pullback after a breakout.

TPC



ALG

MTRX

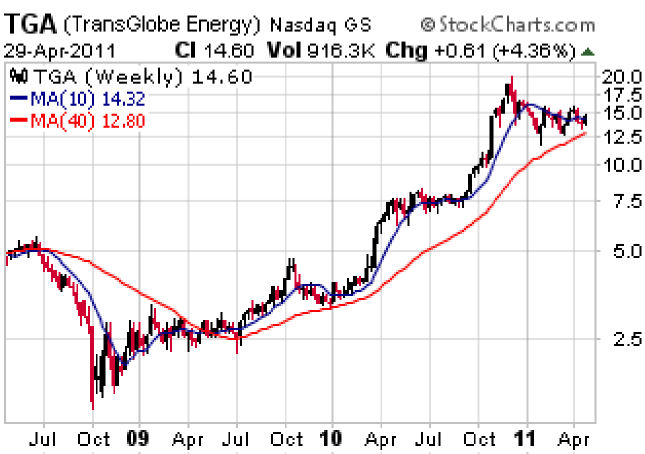
HOLX

HWD

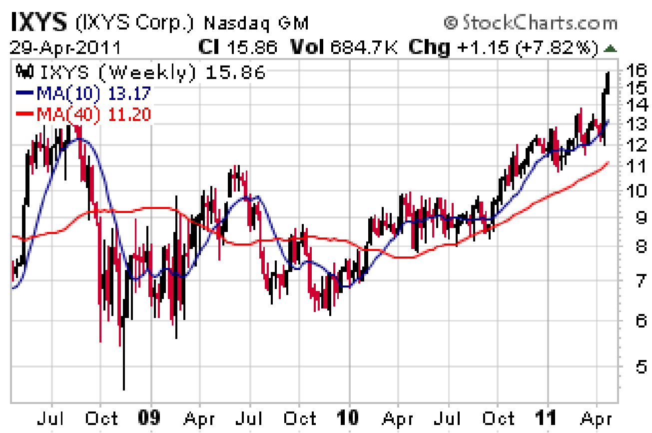
PNM

EQT

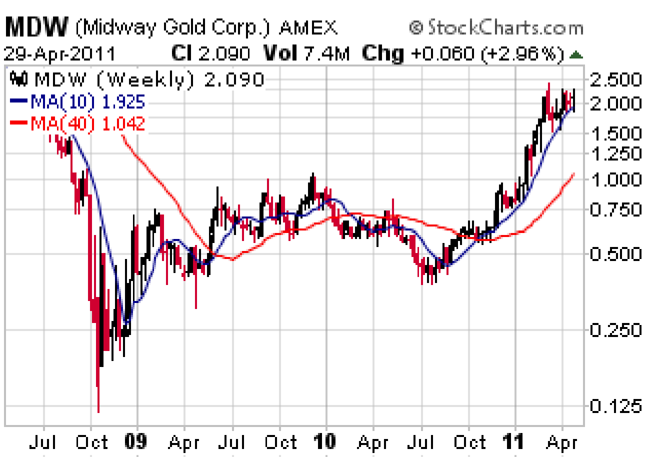
TGA



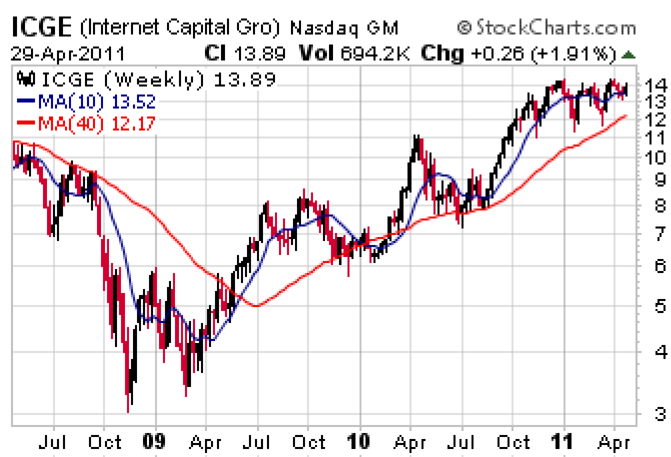
IXYS



MDW



ICGE

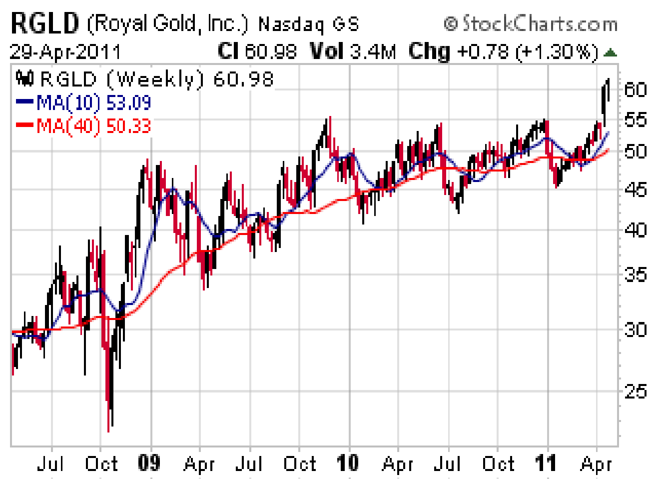


VDSI

GG

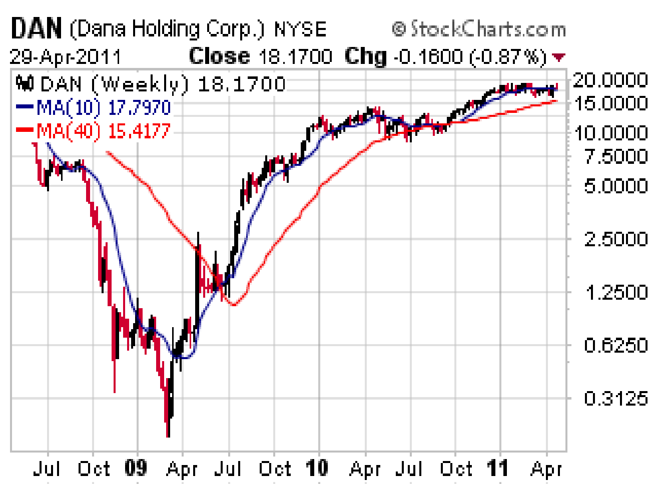
HITT

RGLD



UXG

DAN



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