WallStreetWindow Monthly

Stock Market Barometer

The Most Influential Financial Newsletter Read By Over 500 Hedge Fund Managers and Thousands of Elite Investors ~ May 1 2013

Quote of the month:

“In any investment you expect to have fun and make money” - Michael Jordan

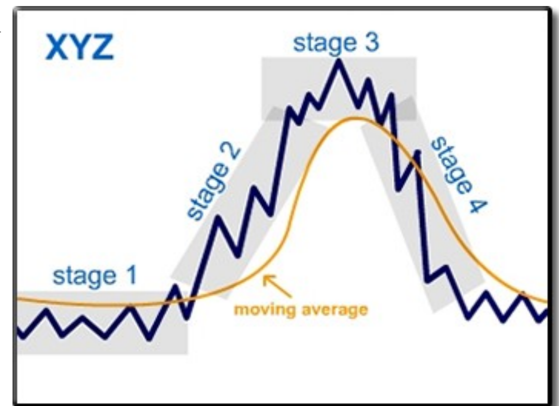
STRATEGIC STOCK TRADING

Master Personal Finance Using Wallstreetwindow Stock Investing Strategies With Stock Market Technical Analysis

MICHAEL SWANSON

Investment Lessons from the Gold Crash—Mike Swanson (05/01/13)

We just ended one of the most interesting months I have ever seen in the financial markets. Not much has happened with the US stock market that was unusual, it just went down in the middle of the month and then bounced into the end of the month. It's typical spring time action and often the market action slows down in the summer as people take vacations and trading activity fades away. You have heard the phrase I'm sure sell in May and go away. European markets also went up during the month after they put in a bottom at the start of April in what looks like an end to a little correction in them that began at the end of January and succeeded in shaking many people out of their positions as all corrections do.



But gold is where the interesting action was at. Gold, silver, and the mining stocks crashed in what appears to be a climatic bottom to a bear cycle that has been pushing them down since the fourth quarter of 2011. Gold and silver prices fell in one week at a faster rate than they have done in over 25 years. In one hour of trading there was more selling volume in mining stocks than had ever occurred in an hour of trading before. So some history was made by the action in the metals market.

To understand that type of activity we have to go back and examine history. When we do that I think the best comparison to make is the 1987 stock market crash that crushed the DOW and S&P 500 in a short amount of time in the middle of its last secular bull market that didn't end until March of 2000. A lot of people lost money in that crash, but those that used it as an opportunity to buy and then held for the next thirteen years made a fortune.

Other comparisons you can look at are the flash crash of 2010, the 1998 fall stock market correction, and the climatic bottom in Europe last year. In all of these big crash situations markets usually go sideways for 8 weeks as they

build a base and then begin a new full blown bull rally.

Normally after a bear market you get a long and drawn out stage one basing phase that can last six months to even a year. You have seen such patterns for example in the Irish stock market last year and in shipping stocks recently. Both went sideways for over a year before beginning new bull markets towards the end of last year.

During a stage one consolidation period what ends up happening is that people get impatient and sell out as a market goes sideways up and down for what seems like forever. The rallies bring hope and then disappoint. People just get impatient. The people buying though are strong hands that look to invest. So the consolidation period transfers stock from weak holders to strong ones and prepares the stage for a new bull market.

A crash though compresses the time period of a consolidation period from months into weeks by causing masses of people to sell out in a panic. By causing people to sell at such a rapid rate they make it so that the stage one basing phase takes weeks to play out instead of months.

I think the same is going to be the case for gold and silver and mining stocks linked to them here. Now I don't know if they are going to go up for 13 years on their next bull run, but I do believe that they are going to go sideways and stabilize for several weeks here - probably into June - much like the S&P 500 an DOW did after the 1987 stock market crash - and then begin a new cyclical bull market cycle that will last for at least several years, thereby making the next few weeks a great buying opportunity for investors.

So I think the way to think about the metals and miners is to think of them like this - they were in a bear market that started in the Fall of 2011 and ended last month in a crash. After bear markets end you normally go through a stage one basing phase that lasts 6-12 months, but since this one ended in a total crash it will probably take just a few weeks instead of months to play out.

That means this month we will see some big swings up and down in the metals market in the aftermath of this crash. It will shake out a lot of gold bugs who get scared by that and transfer their shares to stronger investors. The gold bugs that pay a lot of attention to these moves will probably get all stressed out - that's what causes people to sell during stage one bases.

Personally I'm currently 90% invested so I have about 10% of my money in cash ready to be used. I plan on buying more into the metals and miners when I think this sideways basing process is near its end. I want to give it time to play out to make sure I am correct about what I think is going to happen. Also watching a few more weeks of market action will give me a better idea of which stocks will be best to own on the next bull run. So by my estimates I probably will be buying new mining and metals positions sometime in June.

This crash has made for a busy month for me. A few of my articles on the gold crash got picked up by various financial sites and received a huge amount of attention. As a result one day last month I had over 13,000 people come to my website and I answered several interview requests. I also got a ton of emails from people. Many simply wanted my opinion at one time or another while others told me their story. Sadly a few people were destroyed by the crash as they were all-in before it happened.

Some people had to sell because they were on margin or just owned too much and have become psychologically shaken up by what occurred. The Paulson hedge fund lost billions of dollars and I'm sure there were plenty of other hedge funds that got crushed by the drop in commodities. People are taking different lessons from what happened.

One person wrote me - "the problem I had was I allowed other people to influence my investing style so much that I completely abandoned what had been successful at and bought into the gold mania at its peak or just thereafter. I forgot about technicals completely. Gold stocks are so volatile that you need to trade them when they make big moves and then buy back after they correct. I just held and added dips drinking the Kool-Aid that the gold bull will bail you out even if you are wrong. Adding to positions in a clear downtrend is absolutely a stupid thing to do. I have done as you have described so often, one who buys high and sells low...and then does it again and again. I did it twice, in the last bear market for gold stocks November 4, 2011 and again yesterday . I was selling profitable positions in the general market to add to my losing mining positions averaging my prices down. Originally mining stocks were 20% of my portfolio, as of yesterday they were 90%. As for this time, where I sold yesterday and took a 6 figure loss. This represented all the money I

had made in 7 years of trading. You can imagine how that effects one's psyche. Not to mention how it effects your lifestyle as financially its devastating."

They told me, "it would be very helpful if you would write an article to benefit those of us enrolled in your service who have been consumed by this single sector. Many have been reaching out on the blog to find ideas on how we can best regain some losses we have taken and how to best to do that. Perhaps you could write on how we could, as of now and based on where the markets are today, build a portfolio such as yours, where we are diversified and a move down in any one sector is not devastating to ones portfolio."

This is just one story. The market is always giving us lessons. Often people learn the wrong ones. I don't think this person was thinking this when they wrote me, but right now one reaction a lot of people might have from this gold crash is that gold made me lose money so I will never buy it again. Or gold is dangerous so I will throw all of my money now into the S&P 500 since it has been going up the past few months and there is no sign it will stop.

The biggest lesson I think we should all take from the gold crash is that it is risky to be completely invested in anything and if you are and it goes against you it is devastating. There are plenty of people who got wiped out because they were leveraged up in real estate in 2006 or got hurt in the 2008 market crash or now in this gold drop.

I lost money in the gold crash too. I had positions in GLD and GDXJ that fell 40% from where I bought them at the end of last year and still have now. When I bought them together they made up like 10% of my portfolio. Now they are close to 5%, because they fell and other things I have went up. But the drop didn't bother me and I didn't sell as my other positions didn't fall and did fine - and I'm still up overall nicely. So even though I had stuff that crashed it didn't matter. Now if every single market in the world crashed it would have made me go from being up in my accounts to being down 5-10% and that would have bothered me! But since I am spread out in markets all over the world what happened in gold was no big deal for me.

So diversification is key. Now I have not always handled my account like this and I may end up building a bigger position in metals and mining in a few weeks. It is a fact if you have big positions in a single sector or in the right market and those positions can go in your favor you can make a lot of money, but you can lose just as big too. The faster you try to make a lot of money in the market the greater your risk can be.

I got an email in 2009 from someone who said they were 80 years old and lost all of their retirement because they put all of the money they had into a few penny stocks that went to nothing. That is one extreme example of the risks inherent in taking big positions or putting all of your money into something really stupid to get rich quick. It's easier to get rich slowly. That is something I have learned over the years.

When I first bought gold stocks I did so in the beginning of 2002 and I put 100% of my account in mining stocks. I may have even used a little margin, although it has been so long ago I don't remember if I did or not. What I do know is that I was doing it alongside my friend Andy. I first met Dave at the time, but don't remember what he was investing in at the time, but I'll never forget what happened to Andy and I as we were really talking about it all the time together.

By the summer the XAU and HUI went up over 100%. Since I put so much money into one sector that went up that much that fast I was up huge in my account. It was probably the most amount of money I had ever made in the stock market up to that point. It all happened in about six months.

Then gold and gold stocks made a top. They started to drop down. I was about to go for a week-long vacation so I just sold out. Andy held on. I made like 20-30% or something, but Andy ended up barely breaking even on his positions, because gold corrected so hard and so quickly immediately after I left that he was forced to sell. Our big positions made money fast over six months and then we lost all of the gains in less than a week.

The bigger your positions are the less room you can give them. If you go on margin a correction can eat you alive and a correction is always going to be inevitable. If you have a big position you have got to cut losses if things turn against you and at some point you have to be willing to take profits and not care what happens afterwards. You really cannot invest using margin.

I define investing as holding with a time frame of at least twelve months and hopefully longer. The best way to invest in my opinion is to diversify with a lot of small positions and buy new ones after bear mar-

kets end and provide opportunities to buy things at a true fundamentally low valuation with small PEG ratios, P/E ratios, low book values, and often high dividend yields.

Up until last year I never really tried to do this. I just tried to trade, which I would define as holding in any time frame shorter than twelve months may it be daytrading for minutes or trying to hold positions for several months - which is what I have done throughout the bulk of my investment lifetime - up until a year ago really.

What I used to do is buy big positions and try to make money from big swings. I have always been disciplined and willing to cut losses so never experienced a big loss in my account, but I often got stopped out for small gains and losses and never really held anything longer than a year. What happened is that overall I made a lot of money doing this, but at times I made no money at all for months on end. Most of the money I made was done in quick periodic spurts of a few months at a time and the rest of the time I spent spinning my wheels.

When you have small positions you don't need to worry about any individual one blowing out your account. In fact you don't even necessarily have to use stop loss orders anymore. Right now I'm not. My plan is to just evaluate all of my holdings periodically and sell things I don't think are acting right anymore or just don't want any more then, but best time to do that sort of thing is after big rallies and not during corrections.

I had figured out how to get into bottoms pretty good, but when I simply had big positions I would get shaken out or forced to sell often. I had to pay close attention to all market moves and stayed glued to the market action. What I learned is that smaller position sizes and greater diversification in multiple markets means less risk. But I used big positions because I wanted to make faster money. Ironically in the long-run though you can make more money I believe with the smaller positions and greater diversification if you invest after crashes and bear markets than you can trying to trade short-term market moves.

It also is a less stressful way to handle your money and once I made a certain amount of money in the stock market I decided that I wanted to take less risk in the markets and also handle my money in a way that I do not have to watch things so closely and have time - and the mental energy - to do other things. I wanted to make the market work for me and not have to work at the market 24/7. So in 2011 I decided to make a change and become more of an investor.

During the summer of 2011 I thought the US stock market momentum was going to slow down, maybe even enter a bear market, and I saw that European markets and most world markets were already in bear markets. We were talking about all of this together. I thought Europe would bottom out sometime in 2012 and give me an opportunity to begin to invest with my account there - in my view it is best to invest by waiting to buy at the end of bear markets and not just put your money into a rising market and hope for the best. Bear markets and crashes provide the opportunities to buy cheap and hold and make a lot of money. But if you buy before they are over and don't cut losses if you turn out to be wrong you can lose money doing this. You have to be patient. That's why I'm going to wait right now to make sure gold really does stabilize for a few weeks and prove to me that my thinking that it is a bottom is really correct.

I wrote my Strategic Stock Trading book all about how to pick out stocks and find good sectors, but I need to make a sequel to it with more specifics about investing as that book is really more about trading than investing and is really designed to be an introduction to my stuff. I am thinking about writing another much more detailed book about investing. So I plan to think more about the topic of investing a lot more over the rest of this year and in the process hope to learn more about it myself. I really cannot find any books that talk about the importance of position size and holding periods that really put it all together. I guess in reality almost no one does it at least not the way I am thinking. One of the few examples I can think of is John Templeton, especially in the 1970's when he bought into Japan.

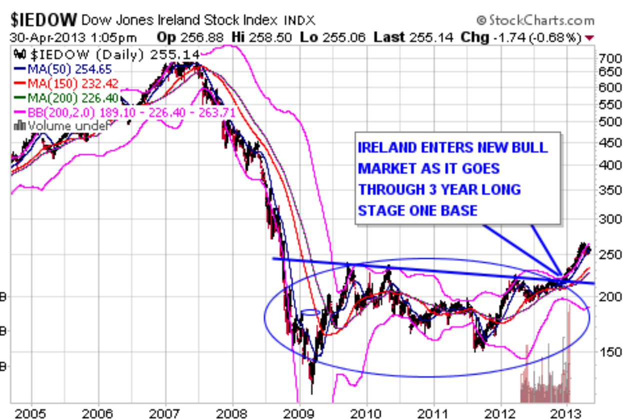
I think the best tools for investing is the stage analysis I have written about and the cyclically adjusted P/E ratios for country markets, and individual sectors, that Robert Schiller created and the only person I know about who really writes about it and tracks is Mebane Faber, who I discovered last year. The only book I know of that applies it to the stock market history of the United States is the book Russell Napier book Anatomy of the Bear. That's where I first learned about it long time ago, but decided to start to apply the concepts last year in Europe. It was too late to do it for the US stock market as it bottomed in 2009.

I'm on a little vacation trip at the beach with a few friends and one of them was asking me about investing last night over some drinks. He is a very cautious investor. He experienced some big crashes in tech stocks in 2000, but has built up a nice nest egg over the years by being invested in some energy and utility companies paying dividends. He has CD's though that have come due and doesn't know what to do with the money. He wants to make a good return on it, but is scared to put it all into the stock market.

I told him the safest way a person could do handle such money is plan to invest it at one third of the time. Just wait for something to crash somewhere and get cheap and put a third of your money into that market in an ETF or individual stocks related to it. If it doesn't work out you won't lose much so you won't have to worry. A 10% drop in a position or group of stocks making up 1/3 of your account would just mean a 3% loss for your overall account.

Then you could sit and wait for another market to drop somewhere to put another third in. If you just invested a third a year you would still come out ahead and do so safely. The rest of the money that isn't invested you could try to trade with it or just put it in something safe. The thing is no one has the patience to invest like this and it could require being in cash for a time while the S&P 500 goes up without you. A money manager or investment advisor could never take the risk of being in that situation, because his clients would curse him and take their money away from him if he did it. They would think he was too scared to do anything with their money. That's why most money managers simply remain fully invested in the stock market at all times and then provide rationalizations for that behavior - they always have a reason to believe the stock market is going to go up. If you watch CNBC that is what you get - the current theme of the market.

To make investing works requires buying stocks when they are at cheap valuations. That means waiting for a market somewhere to get cheap. Putting in a third at a time like that would give you small positions, almost no risk, and peace of mind. But it would take time to get fully invested.

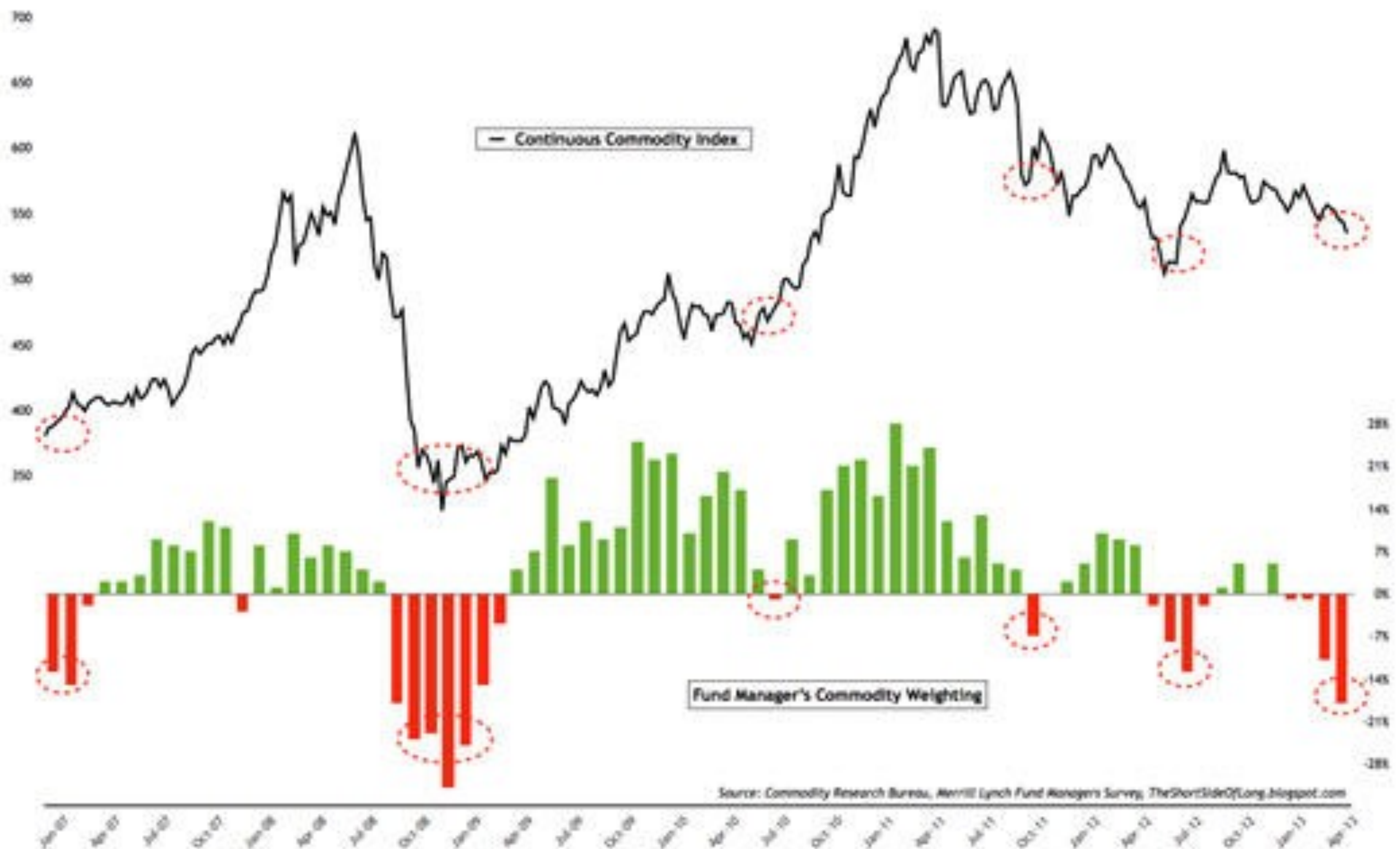


Last year the European markets provided such a great investment buy point when they bottomed in last summer. Now Greece and Ireland are still at historically low cyclically adjusted P/E ratios - the kind seen in the United States at the bottom of the Great Depression - but have already broken out into new bull markets. The best time to buy into them was last year. But they are still good buys on dips. The Russian stock market is also at a low valuation, but has not broken out of a stage one base yet. Argentina is as cheap as Greece and Ireland, but is on the verge of a potential debt crisis so probably isn't worth buying yet.

Cyprus blew up last month after the Cyprus stock market fell 98% in the past three years. Stocks there are trading in the pennies and have incredibly low valuations. Problem is that the Cyprus stock market is so small that the whole market has recently been trading less than a few hundred thousand dollars worth of volume in a day and to buy anything there you would have to open up an account with a broker in that country.

Gold, silver, and the mining stocks just crashed at what looks like the end of a bear market. Many mining stocks are now paying big dividends and some have P/E's now in the 3-5 range, which is pretty crazy for them. So I think the coming weeks will provide us with a great opportunity to invest in that sector. So for now that is what I am focusing on.

One other thing about this sort of investing - when markets crash or go through bear markets people



sell out as they decline and then turn negative on them. People get all bullish at tops, but bearish on bottoms. It's not just regular investors that do this, but money managers too whether they are running hedge funds or acting as investment advisors.

That is why the Cyprus stock market is barely trading right now - all of the institutional money got out. Last year after Greece bottomed the GREK ETF that invests in Greek stocks only had $10 million in assets in it. When markets crash the news is all bad for them and it is embarrassing for institutional investors to have to explain to their clients why they are in them - so they sell them so they won't show up as investments in their quarterly reports.

Right now you can see that according to this chart money managers polled by Merrill Lynch are now as negative on commodities as they were when they were forming a stage one base in 2009. When gold and silver begin their next new bull run they will all be left behind.

One thing I will be contemplating myself over the next few weeks is how much I want to put into them. Do I want core investment position with a trading position around it, which would mean a larger exposure? Or do I just stick with a simple investment position? These are the things I'm thinking about myself now. I will be watching the metals markets closely over the course of the next few weeks and keeping you updated on them. This is the most interesting market to watch now.

Disclaimer

WallStreetWindow.com is owned by Timingwallstreet, Inc of which Michael Swanson is President and sole shareholder. Both Swanson and employees and associates of Timingwallstreet, Inc. may have a stock trading position in securities which are mentioned on any of the websites or commentaries published by TimingWallStreet or any of its services and may sell or close such positions at any moment and without warning. Under no circumstances should the information received from TimingWallStreet represent a recommendation to buy, sell, or hold any security. TimingWallStreet contains the opinions of Swanson and and other financial writers and commentators. Neither Swanson, nor Timing-Wallstreet, Inc. provide individual investment advice and will not advise you personally concerning the nature, potential, value, or of any particular stock or investment strategy. To the extent that any of the information contained on any TimingWallStreet publications may be deemed investment advice, such information is impersonal and not tailored to the investment and stock trading needs of any specific person. Past results of TimingWallStreet, Michael Swanson or other financial authors are not necessarily indicative of future performance.

TimingWallStreet does not represent the accuracy nor does it warranty the accuracy, completeness or timeliness of the statements published on its web sites, its email alerts, podcats, or other media. The information provided should therefore be used as a basis for continued, independent research into a security referenced on TimingWallStreet so that the reader forms his or her own opinion regarding any investment in a security published on any TimingWall-Street of media outlets or services. The reader therefore agrees that he or she alone bears complete responsibility for their own stock trading, investment research and decisions. We are not and do not represent ourselves to be a registered investment adviser or advisory firm or company. You should consult a qualified financial advisor or stock broker before making any investment decision and to help you evaluate any information you may receive from TimingWall-street.

Consequently, the reader understands and agrees that by using any of Timing-WallStreet services, either directly or indirectly, TimingWallStreet, Inc. shall not be liable to anyone for any loss, injury or damage resulting from the use of or information attained from TimingWallStreet.