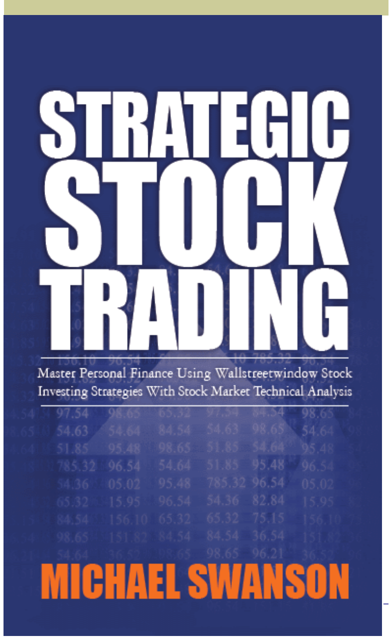
WallStreetWindow Monthly

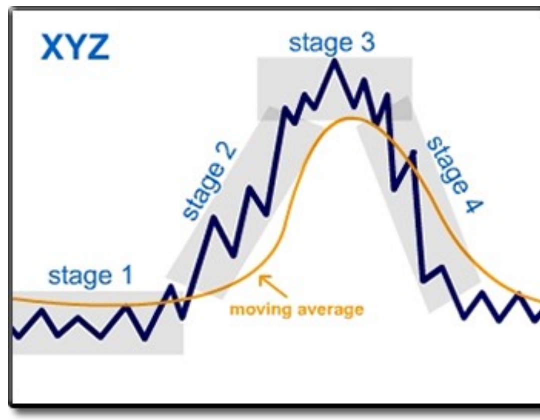
Stock Market Barometer

Quote of the month:

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



Investing Based on Hope Versus Investing In Real Opportunities—Mike Swanson (07/01/13)



Most Americans are suffering financially. Even the so called rich and upper-class Americans have taken a beating in the past few years. People's wealth has gyrated madly. People got caught up in the real estate boom eight years ago and got crushed. Then the 2008 stock market crash smashed their portfolios. Even though the stock market has rallied since 2009 there have been many quarters were more money has gone out of the stock market then into it. People have fled into CD's that pay them low rates of interest and now that many of those CD's are coming due they don't know what to do with the money. At the same time alternative investments such as gold and precious metals have taken hits of their own over the past two years.

People have made a giant mistake. They wanted to make money. They wanted security. They wanted to live the American dream so they thought if they could buy into these markets when they go up they could get rich. But they have gone on a wild boom and bust ride of temporarily building a lot of wealth only to have it disappear. And it's going to happen again. This country is heading for another financial crisis in a few years - one that will involve a bursting bond bubble and higher inflation - thereby wiping out another round of people who thought they did the safe thing by parking their money in bonds and CD's as their cost of living explodes. They'll be paying twice as much for food and gas while making pennies from their savings as it erodes away. And as for the stock market one day there will be another bear market that will hit stock investors too.

The problem is people get greedy and react to big moves in financial markets. They want to get rich so they jump on what seems to be the next big thing when it is too late. They have no real concept of investing. They just pile in when something goes up and the TV tells them to do so. Federal Reserve head Ben Bernanke said in 2006 that there was no housing bubble and people believed him.

Too many people focus too much on making money and end up getting caught up in these boom bust cycles over and over again as a result, seeming to never learn from their mistakes. Ironically the less you focus on making money the easier it is to build real wealth overtime and then transfer that wealth into money when you need it.

I know from my own experience. When I first got into the stock market back in the go-go internet stock days I was trading to make money. I would jump in stocks and try to make a return in a few days. Then I managed a hedge fund for a few years. When I did that I felt like I had to make money every quarter or the investors would be disappointed. It was stressful.

At one point I made a big trade in gold stocks over the course of a few months and then sold out and banked a huge return - was like 30% or so - and then once the stocks continued higher for a few more weeks some of the people in the fund got mad. Of course they soon topped out and had a big correction, but people were upset for awhile thinking they were missing out. If you manage money for people you have to make money all of the time, because that is what people want. If they make money they feel like they are in control of their destiny.

That's part of the appeal to short-term trading. If you can have some sort of trading system that can make you a return every week then in theory you will feel like you are in total control of your destiny. Of course, it's just a theory - in real life it doesn't work that way. But we live our lives chasing rainbows. We are all going to die one day so people spend so much effort accumulating castles in the sky, watching TV, or finding other means to distract them from that fact. And trading can make you feel like you are in control.

The problem is if you go into the stock market with the idea that you are going to trade it and make money from it - or make money for others - you will find that in the end the stock market will end up controlling you. You'll ride the big boom and busts. Instead of having a good time you'll have a stressful one.

That's why I shut down the hedge fund about eight years ago. It is hard enough to trade your own money. When you have to deal with other people's emotions it just gets that much harder. When I made a big return and people still weren't happy I didn't want to do it anymore. Stanley Druckenmiller was one of the most successful hedge fund managers ever. He took over George Soros's Quantum Fund in 1981 and beat the market every single year, with an average 30% return until 2010. His fund was down 5% in the first half of that year and his investors went nuts on him despite the huge returns he had made for him over the years. He couldn't take the pressure and just shut it down.

Investing does not have to be stressful though, but it almost always is. That's because we approach the market in a way that makes it difficult. It took me a long time to figure this out. I have always approached the market with the thinking that it moves a lot up and down so I want to make money by riding those moves. And I've been able to make money by doing just that from time to time and cutting my losses when I was on the wrong side of things. But it was stressful doing it.

So about two years ago the US stock market got into a position where I didn't see any clear trend for it over the next year while other markets all over the world were in big bear markets. I figured that when they bottomed there would be a great opportunity to get into markets and stocks overseas at low prices where there would be tremendous upside. There would be an opportunity to invest and not just trade.

So I got out of the United States stock market. I put a lot of my money into some business partnerships. Loaned it. And simply sat and waited with what I had left. During this time I asked myself one simple question - what is the easiest and best way to build real wealth in the stock market? I wanted to find a way where I could make the stock market truly easy. I wanted to make the stock market actually work for me and not have to feel like I had to work at investing. Ultimately that is what the stock market should be for you too.

The key is investing for real. People tell themselves they are investing, because they buy into some fund with the idea of holding for a long-time, but they have no idea what price they are paying. You invest by focusing on buying with the knowledge that in time you will make a good return on what you buy. Simply buying into some story or believing in a theory about the way the economy should go or the stock market for that matter is not how to invest. You invest by buying something once it has gotten to a truly cheap valuation. If you buy the right thing at the right price than investing becomes easy.

The rub is you can't just do that any day. To find lots of cheap valuations in a sector or entire stock market you need to see a big correction play out or a bear market come to an end. Those things only happen once or twice a year. Right now the S&P 500 is overvalued, because it is trading at a cyclically adjusted P/E ratio over 24 when a level below 10 is considered to be a cheap valuation. It may be years before it gets to that level and the market could go a little higher before it ever gets there.

People simply cannot wait for cheap valuations. What is more investment advisors, TV talking heads, and investing magazines and literature almost never counsels patience. The money manager wants to turn people into clients. So to them it's always a good time to invest in the stock market.

But in the end its people's own fault. All they do is watch the gyrations in the stock market and react to them. So if a market goes up they buy. If it then crashes on them they get out. They never think about the valuations they are getting in or out at. They are motivated by simple fears - and the biggest fear is the fear of missing out. People cannot stand the idea of not being in something that is going up without them. You see this is the reason why most investors are stressed out all of the time riding these giant boom and bust cycles that never get them anywhere.

As a market goes higher more and more people pile into it and the sentiment gets more and more bullish. So this past May as the market made its last peak you could turn on CNBC and listen to supposed experts claim that valuation metrics such as the cyclically adjusted P/E ratio no longer mean anything. People were saying that because interest rates are near zero stocks are worth more for their dividends. These people never thought about what would happen the day interest rates starts to go up. They were simply rationalizing their own investment positions and selling the market to the masses - and people ate it up. I got dozens of emails from people about buying into the US stock market.

The opposite happens in a bear market such as we have seen in metals and mining stocks. Gold prices last made a cyclical bull market top in the fourth quarter of 2011. As they went down and the mining stocks have fallen to even lower valuations people have become more and more bearish on them. Now on any given day you can go to Yahoo Finance and see articles about how gold is dead and will never go up again. Dennis Gartman told CNBC viewers last week to short gold. He is CNBC's favorite "gold expert" and is a madman.

What is crazy is that it is when the market is most enticing that people are the most bullish and it is best to stay away. But human nature makes it hard to do that. People want to feel certain and being a part of the crowd and doing what others do can make you feel like that. Plus you don't want to miss out on what others say will make you rich - so people can't help but buy into tops.

At the same time the news is all bad when valuations are cheap and things make sense from an investment standpoint. So last year Europe was supposed to be an impossible thing to consider buying even though valuations there became super cheap, with countries such as Greece trading with a cyclically adjusted P/E less than 5. And now gold stocks are cheap.

The news simply causes most people to do the wrong thing and scares them when they should be investing. People want to feel certain about what they are doing and after a bear market everything in the news gets negative so people are basically talked out of investing. Most people want a good story to buy into and everything seems negative. They want the news to tell them an economy is going to boom or grow so they will have something positive to buy into, but such news stories just don't exist at a bear market bottom or end of a recession for that matter either. So people just chase the news and get all stressed out from the market gyrations.

Ok, the key to successful investing is not predicting the future, because you don't need to be certain about what is going to happen in the future to invest and make a good return overtime and build real wealth. Predicting the future isn't the secret to investing. The trick is to buy things when they are truly at a low valuation. If you do that it almost doesn't matter what happens. In fact if you buy things right then investing really does become easy, because you don't have to worry so much about what is going to happen. You do not need to predict anything.

To give you an example let's say you want to buy a small business like a restaurant that makes $100,000 a year in profits. Let's say you went to look at it and got excited. You went to the owner and he showed you a local newspaper story praising the food. You got even more excited. The owner offers to sell it to you for $2.4 million dollars and you are so happy to be able to buy it that you run to the bank and get a loan for the money. You tell people you know you are buying this business and people are happy for you. They tell you that you are doing the right thing.

People like you so word gets around once you start to run the restaurant so business grows. You are happy. But you got one little problem. You owe so much money to bank, because you paid such big price for this business that you are barely making anything. One day the economy slows in the area and business drops. You aren't making enough to make your payments and you go bankrupt.

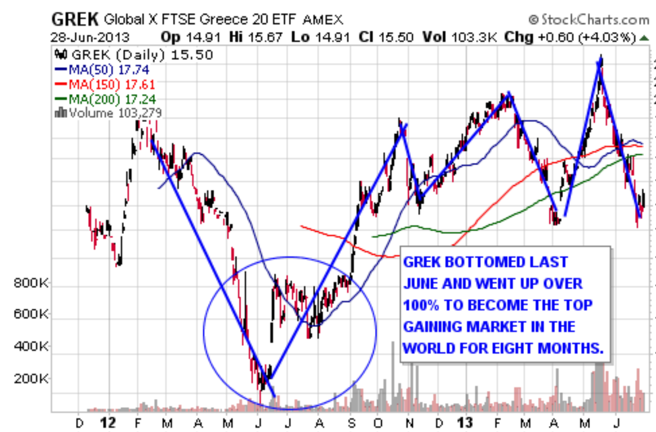
Well in this story what happened is that you paid a stupid price for the restaurant. You paid 24 times earnings for it - which not coincidently is the cyclically adjust P/E ratio that people are now paying for the S&P 500. Twenty-four times earnings means it would take 24 years of profits for you to pay for the business. In this restaurant story you went bankrupt not due to the bad luck of the economy, but primarily because you paid a high price to own it. People told you that you were buying something neat, but no one thought about the price you paid for it.

This is why when most people go and buy a piece of property with the idea of making it a rental property investment they pay around eight times earnings. In eight years they will have paid off the property and from then on can make a lot of income from owning it. That's what investing is really about - buying something at a low valuation that can help you build wealth overtime.

Bear markets and big corrections create opportunities to do this in the stock market. But to do it you have to be patient enough for them to appear. You can't just be chasing markets simply because they go up and you have to be an independent player who isn't just doing what is hot in the news.

The thing is if you buy a stock or even an entire country through an ETF for that matter at a low enough valuation then you do not have to worry about what the economy is going to do in the future or what the news is going to be. Then investing becomes easy. How do you do that?

It's simple. You wait for a bear market to cause valuations to get super cheap. So for example last year the stock market in Greece crashed as the Greek government went through a debt crisis that causes their bonds to crash so much that they paid over 30% in interest. People thought they could default on their debts.



Their stock market crash caused Greece stocks to fall to valuations so low that they were ridiculous. I bought HLTOY - which is the largest telecommunications company in Greece, it also serves much of Eastern Europe - for close to 4 times earnings. I also bought GREK, an ETF for the entire Greek stock market, for around 5 times earnings. I would have a tough time finding a local rental property for such a low valuation.

At the time the news about Greece was terrible. The country had been in what you could call a depression for several years and people were rioting in the streets. People told me investing in Greece was too risky. But I didn't care, because the thing is no matter what the economy does in Greece in the future people there are not going to stop using electricity and eating. When you get in at a low enough valuation it doesn't matter. You don't really need to predict anything. You just buy when most are afraid to invest and sit. Sure the Greece stock market has had its big ups and downs for months at a time since then like all markets do, but I got in so cheap that they don't matter to me. I am building wealth overtime. I am still looking at more Greek stocks I may buy.

The same opportunities came all over Europe last year, with countries such as Ireland also reaching super low valuations. Recently there has been a giant debt crisis in Cyprus and the stock market there has fallen over 95% in the past few years. There are no Cyprus stocks that trade in the United States so there is no easy way to invest there. But someone could get on an airplane, fly to Cyprus, and open a brokerage account there to invest in that country and beat just about every hedge fund in the world over the next ten years. It's a lot easier to "beat" the market doing that then trying to play some crazy short-term trading strategy or computer trading program.

Personally I am not trying to "beat" the market. I do not care what the S&P 500 is doing, what I care about is building wealth by investing at low valuations. I do not expect to beat the market every single month or every quarter, but in the long run I am confident that a real investment strategy will. You see to invest like this you have to stop worrying about what the broad market is doing in any given month. That's why few hedge funds or money managers can invest like this. Most hedge funds are given money by giant institutional fund of fund pools of money that grade them on a monthly basis.

Opportunities to invest in something at a low valuation come in a market somewhere in the world at least once a year. Sometimes they happen in an individual market sector in the United States. They happen most often when a sector or market falls so much that it is almost unbelievable. Big crashes and big bear markets bring big opportunities.

How do you find something worth investing in? First look for something that has collapsed. Mebane Faber figure ran a study of all world markets since the 1970's and found that when they fall more an 90% from their highs they go up on average 156% for the next three years. When they fall more than 70% the average return is over 116% per annum for three years while a drop of 60% generates one of 107%.

The same thing goes for sectors. A sector down 70% tends to make 96% per year for three years while one down 60% turns into 71% per year returns. Gold stocks by the way are down this much. The HUI mining stock index has fallen 78% from its highs of 2011.

Gold stocks are also incredibly cheap from a fundamental basis, with many of them trading with low PEG ratios, low P/E's, and even paying half decent dividends. Of course I was telling you this a few months ago too and they have fallen more since then.

And that's the rub with buying stocks at cheap valuations - it is easy to lose money for awhile before they bottom so you can only average into them and slowly build a position. Also everyone is negative so you have to go against all of the negative talk.

The easy way to do it though is just to wait for a bottom and buy months later as a stage one base develops.

However, at this point gold stocks may have already bottomed. Before Thursday's opening bell in New York gold got hammered. Gold stocks went up that day anyway to display some positive divergence against the metal. On Friday the HUI went up 7.83% for a huge gain off of its most recent low. I did not receive one single email Friday from anyone asking if that move means they have bottomed or if they should buy. NOT A SINGLE ONE.

Most people want to hear a good story that will make them feel certain about buying gold or gold stocks. They want a "fundamental" reason. The simple reality is you invest by buying things at cheap valuations after they collapse. It is also a fact that after a bear market ends you eventually get a bull market. If you invest after a bear market or the start of a new bull market you can hold and make investing easy.

It is the easiest way to build the most wealth. Which of course you can translate into money. It requires patience and a faith in your own ability to believe that you can invest without being given permission by the television set first.

I believe that metals and mining stocks will provide a great return over the next few years. They have dropped much more than I thought they would, but I think that simply means that they will go up just that much more from their bottoms when the next bull market starts. They are at an investment sweet spot.

The S&P 500 and broad US stock market is not. There are some other markets around the world that still remain cheap and one that I have an eye on in South America that has been in a big bear market for the past two years and is on the verge of going through a debt default currency crisis. I think it may be a buy in the Fall, but not yet.

Anyway, what most people are doing is thinking about the US stock market and its current correction, which I think is not over, but will probably end in a few weeks. Instead of saying I am going to let that play out before I buy something, they worry that they will miss out on the next run in the US stock market. So they buy. The market peaked out in May, but every time it has an up day of at least 100 points on the DOW I get at least one email from someone asking if they should buy, and sometimes one from someone angry that I'm not a bull on the US stock market. I'm not a bear either, I just think that after a bull market of four years now and high valuations it is no longer a compelling investment. You can trade it all you want, but if you buy with the expectation of getting a big return over the next few years I think you'll be disappointed - and eventually there will be another big bear market wipeout. It is when that happens that I'll be excited about investing in the US stock market.

Now if you wanna do a trade in US stocks I'd look for ones that are holding up the best on this correction and wait for the correction to end, which I'm posting updates about on WallStreetWindow.com. Once it's over will send you an email. I would then buy and just look to sell in a few months the next time everyone gets all bulled up and crazy like they were in May. Interestingly some sectors I like such as the shipping stocks have been holding up well.

As for investing the wipeout now is in metals and mining stocks - and commodities as a whole. That is where the valuations are compelling and where money will be made getting in early once the next bull market there begins. It is being involved at the start that makes investing easy once the bull market comes. How much one buys or owns is an individual matter. It depends on how much risk you are willing to take and how diversified you want to be.

Right now I'm personally about 20% invested in gold and metals stocks. I also have a short position against the S&P 500 in the SDS ETF that I bought on the day of the May peak. I plan on selling it once I think the broad market correction is over and moving the proceeds into metals and mining stocks.

I think it is simple - they will eventually go into a bull market and generate big gains from here. That's how markets work. Cheap valuations make for easy investing once a bull market starts. As for a story or reason why - I think there is a frightening one, but if I tell you now you simply wouldn't believe me. Go to Google and do an internet search for the report Fred Mishkin presented to a Federal Reserve conference in February titled Crunch Time: Fiscal Crisis and the Role of Monetary Policy about how the CBO projections are wrong and the size of the federal deficit is on a path to create a new financial crisis by 2018 unless Congress immediately cuts the budget deficit and the Fed immediately puts an end to QE - neither of which will happen, because those deficits are needed now to finance Obama's health care program and the bloated American empire. If this crisis happens it will be worse than the crisis of 2008 and be an inflation explosion that will tear our society apart. I'm not going to write about it until there are signs that it is actually starting to happen, because frankly no one will believe it and I want to be sure myself. Everyone on CNBC right now is talking about the economy doing well, because Bernanke says it might, and that QE may end soon and most people only believe what they are told on TV so would just ignore anything otherwise. That's why in 2007 and 2008 they refused to listen to those that warned that the banks were broke. TV said everything was fine. Interesting times. We can't get worried though about what might happen. We have to take advantage of the opportunities we have - and it is this crash in gold and silver that has brought an opportunity for us in this moment in time to focus on.

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