



Stock Market Barometer



2014 Will Be The year of Two Market Panic Attacks (01/01/14)

Well today is a New Year. 2013 has come and gone. At this time of year I sit down and plan ahead for the coming year. The holiday's make for a great time to step back from the market and take a look at what the big trends have been this year and what is likely to be the big trends of the coming year so that we can prepare for them and come up with a game plan to invest and trade in the markets accordingly. Each year things change so we need to adjust to those changes and be ahead of the game.

A year ago people were worried about the "fiscal cliff." We even had a government shut-down in the Fall. In the beginning of 2012 for a few weeks there were also worries about Europe on CNBC. But the European markets went up big time anyway and the idea of European troubles is totally out of people's consciousness now - and they should be as things were never as bad as people imagined them to be. One of the secrets to investing is to be willing to invest when most people are too frightened to do anything. People sell out on bottoms and declare themselves to be bears and the TV talking heads merely reflect the psychology of the Wall Street herd.

Investing in markets outside of the US is trend that helped me make a lot of money and probably you too last year, as I've been talking about investing in Europe now since the last bear market there ended in 2012. I still have the bulk of my account in European markets and still think they will continue to do well over the course of the next few years.

But what is important now is that no one is worried about Europe like they were a year ago. That was a big story on TV that is totally gone now. The fiscal cliff story is gone too. Congress passed a bipar-

Quote of the month:

“Ben Bernanke is the hero of this era” - James Cramer on Mad Money

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tisan budget deal so now there are no longer political angles for the politicians to play over the budget on TV. Therefore the reporters that do nothing but repeat talking points no longer have anything to talk about.

If you want to think about what 2013 was for the stock market we can say that it was a year in which people began the year worried and ended the year totally excited. All worries about the market or anything bad happening to the economy or stock market are now gone. According to last week's Investors Intelligence survey of investment advisers those polled are now 59% bullish on the stock market while only 14.1% are bearish. This is the fewest number of bears since a few months before the stock market crash of 1987 and the most number of bulls in over six years.

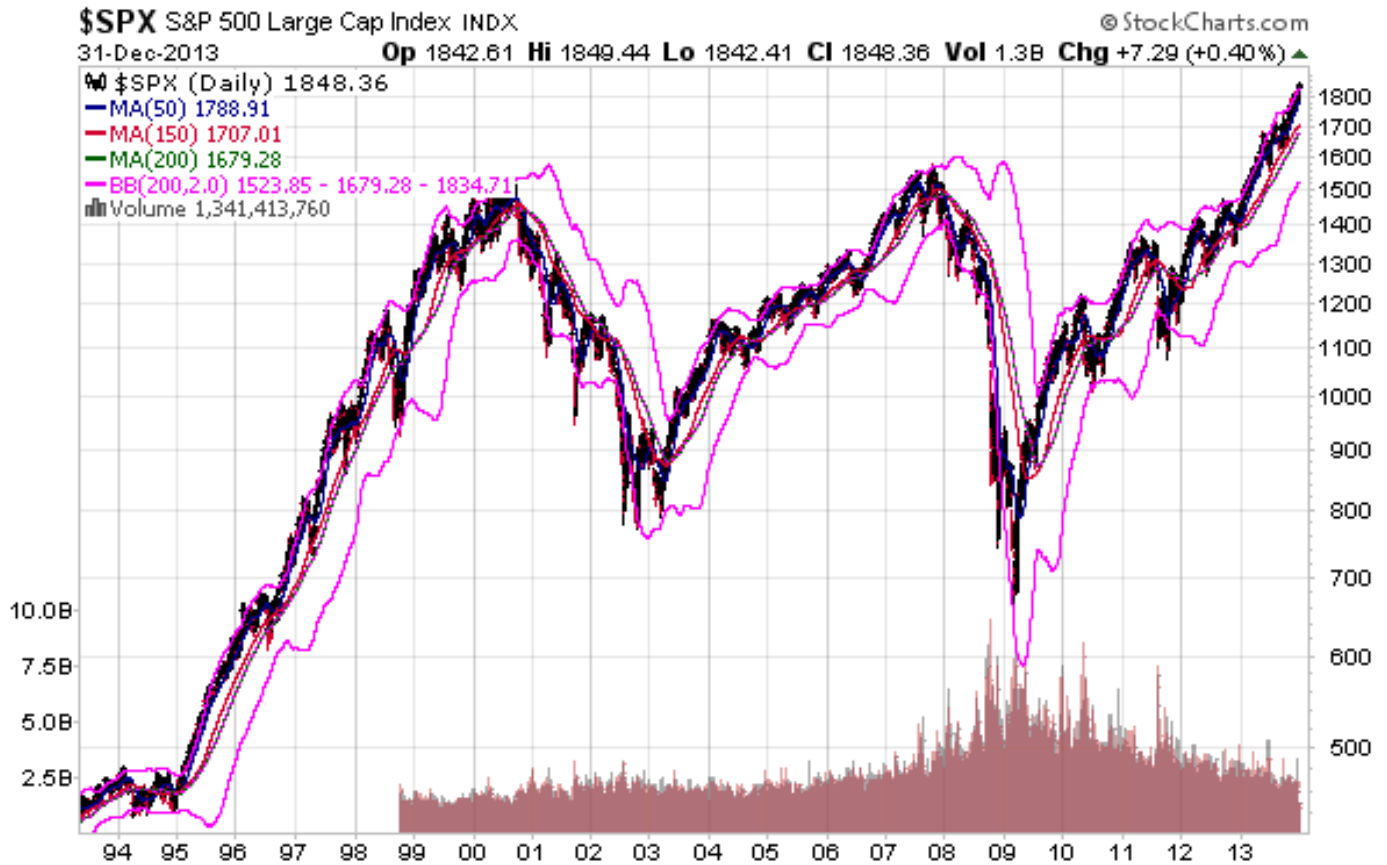
The "bad news" seems to be gone. The TV reporters are no longer talking about anything negative when it comes to the stock market. When the Fed decided to cut back on its QE bond buying program I watched CNBC and saw a collection of talking heads appear on my screen and declare that the Fed had now managed to perfectly time its FOMC policy and was going to create a zero interest rate policy now until 2015 while managing to control its bond buying program and keep everything in perfect order. These experts said that meant the stock market had nowhere to go but higher for the foreseeable future. CNBC's head "economist" Steve Liesman said Ben Bernanke was a genius.

James Cramer declared on his December 20th "Mad Money" show that we are now in an "all out bull market" like he hasn't seen since the mid-1990's. He listed a dozen reasons to believe it will keep going, including low inflation, "bad news" like Europe being quickly fixed, and jobs growth. He said all together of these reasons that "they're powerful. And that's why we're going higher." He declared himself to be a "champion" of the bull and Ben Bernanke to be "hero of this era."

I posted a clip of his declaration on the home page of wallstreetwindow.com. He ends by saying that 2014 will be "the year of the bull." Actually I believe 2014 will be the year of two panic attacks.

Now I don't mean heart attacks here. I'm not trying to scare you. I do not think we are going to see a bear market begin in 2014 or a big crash or something. I've never had a panic attack, but people who suffer from them tell me that when they have them they feel like they are going to die. They say they go through hell. But they do not die. And the stock market is not going to die in 2014, but most people invested in it will go through hell for a period of time.

Giant rallies in any market always lead to a big correction. In a bull market you typically get a 10% drop every year that takes it down to its 150 or 200-day moving average, which acts as support. We have seen such corrections in this bull market in the United States in every year since 2009 until 2013. Think of the "flash crash" of 2010 and the Euro-



pean market debt crisis bottom of 2012. In the summer of 2011 the S&P 500 fell from the 1350 area down to 1100 in a quick drop. So we are overdue anyway for a correction to start and every day the market goes without one makes it more and more likely to occur.

Corrections shake out weak hands and actually help a bull market continue longer. It is when a market goes up and up that you need to get worried even though it is during those times that all worries seem to go away and people talk as if the market is going to just go up forever, as Cramer did last week.

Market rallies are fueled by buyers. It takes more and more money flowing into a market to keep it going higher. If you talk to someone not in the stock market he will likely give you a reason to be skeptical of the market or to think it will fall. But once that person buys if you ask him he'll suddenly proclaim himself to be a believer in the market. For the most part people do not base their opinions on the stock market on any real facts or deep thinking, but simply create opinions that justify their investment positions.

What this means is that at market bottoms you tend to see widespread bearishness about the market, because people sell out on bottoms and then proclaim themselves to be negative on the market. At market tops and the end of rallies the opposite happens and most people get bullish. That is why from a contrarian standpoint the current investor surveys, which show widespread and manic bullishness in the stock market right now, are a huge

warning sign that a correction is coming in 2014.

I believe it will be a panic attack for investors, because most people are so bullish about the market that they will be taken by surprise by any drop. People are in fact so bullish that they are racking up near record margin debt just to buy stocks. According to the Wall Street Journal, investors borrowed a record for one month in their brokerage accounts in November to buy more stocks on leverage.

Total margin debt stands at about 2.5% of nominal GDP. That compares to 2.6% of GDP in July 2007 and about 2.8% in March 2000.

People that go on margin at this point in the stock market to buy more stocks using leverage are people who do not have any fear at all of a market pullback. And in fact a margin player is someone who falls into pure panic when a market correction happens. The existence of so many margin players makes the odds of a market panic attack very high in 2014.

Buying stocks now on margin or continuing to hold positions on margin now at this point after the stock market has gone up so much and for so long without any pullback of any significance is a form of madness. But the herd goes mad at market tops and bottoms and the typical person does nothing in his life, but conform to the mass herd and follow it wherever it goes. By staying with the herd he feels accepted by others and safe. To deviate from the herd makes him feel subconscious fear, so he stays in it.

This is why in the financial world people seem to learn absolutely nothing from the experience of going through repeated boom and bust cycles. It is why so many of the so called professionals do nothing, but chase the market.

Imagine that you are an investment adviser worried about the market right now. If you were to sell your clients' positions to protect them and the market then continued higher anyway it is a good chance that your clients will turn on you and take your money away and give it to someone bullish. They'll lose confidence in you and think you are a coward to get out of the market. They'll hate you for the fact that people they know are still making money in the market while they aren't. In other words if you manage someone's money cautiously and get out you risk getting eaten alive by the herd.

Now if you are the same investment adviser and just stay in the market with your client's money and the market drops your client may get nervous, but all you need to do is tell him that things will come back and that everything is fine. This is what your client wants to hear. He fears getting out of the market and missing out on the next big rally. And as long as everyone else is losing too he doesn't care so much.

So the investment "professional" world does nothing, but cater to the psychological demands of the masses. That is why hardly anyone saw the

2008 market crash coming even though the signs were totally obvious to anyone who wants to pay attention. That is why some money managers are going on margin to catch up with market gains even if doing so from a true investment standpoint makes no sense at all anymore.

From the stand point of following the herd though it makes perfect sense. And we can see the herd now that has developed in the financial markets. It's very desperate. It lost money in 2008 and the housing bust and learned nothing from them. It got banged up in the internet bubble, but no longer has any memory of it. This herd is now fat and happy and its arteries are all clogged up and thinks that it is healthy. This is a herd that is set up for a panic attack in 2014.

That attack will begin once this current market rally comes to an end, which could happen at any moment now. My guess is we'll probably see some quick profits taking at the start of the year and then a week or two later another move to new highs that will trap one more round of people by putting them into the herd. And then the US stock market will rollover for a quick and fast correction that will take it down to its 150 and 200-day moving averages.

There are many who seem to think that a correction is not possible now, because the economy is supposedly growing and Obama is creating jobs. They think that even though stocks have gone up for years now they are not overvalued, because interest rates are so low.

Well the masses are ignoring it now, but interest rates have slowly move up a bit over the last six months. The yield on the ten year treasury bond closed at 3.03% on the final day of 2013. Last May they were at 1.60.%. That is a big move in a few months that the masses have been totally unaware of.

I expect they will open their eyes up very soon to this reality and go into a panic. They will begin to sell stocks and as the selling picks up the margin players will go into a panic as they are forced to liquidate. All of the recent bull talk people have been making recently, of which James Cramer is just one example of, will be forgotten.

So one of the big events of 2014 will be a correction in the stock market associated with fears of higher interest rates. This will be the first panic attack of 2014.

The second panic attack will come inside the Federal Reserve. It will be the so called "heroes" and "geniuses" at the Federal Reserve that will panic. And they will panic over the stock market correction and move higher in interest rates.

The worst thing that can happen in the eyes of the Federal Reserve is if interest rates were to move out of their control and go up so high that they could no longer afford to finance the cost of the deficit. It would take a move to just over 5.2% on the ten year treasury bond for this to

happen. If rates went that high the Fed would be forced to completely monetize the debt. This isn't me just saying this, but an internal Federal Reserve study done in 2012. I have written about it several times in the past few months. If you never read it do a google search for "wallstreetwindow crunch time."

This is the Fed's greatest fear. And if it even appears to them that rates are going up out of their control then they will panic. What would they do? They would abandon their so called "tapering" policy announced at their last FOMC meeting. They may even increase their QE program or come up with some new money printing initiative with a new name.

Such actions would be extreme and make the Fed "heroes" look like they do not know what they are doing, but the Fed will take extreme actions if it panics. And I think it will in 2014. So in my view a wild shift in Fed policy to more money printing will be the second panic attack of 2014. It will come as a direct result of the first panic attack among the complacent masses in the stock market right now.

What will these two panic attacks do? They will cause many people in the market to suffer. Yes the market rally of 2013 has been a nice thing to see. It has enabled people to make money in the stock market and once again feel confident about investing. Many people have sold stocks and their funds in the years following the 2008 crash and gotten out of the market and into CD's. But those people have now been getting back into the market.

That's good. The problem is they do not know anything about investing or managing money and just follow the herd. And they seem to be unwilling to try to learn.

When a market goes up like this it makes it seem like it is easy to make money. All you need to do is buy something, turn on CNBC, and believe. It's gets to be so easy that people stop thinking. They stop actively managing their money. They lose all sense that there are any risks to this game at all. They go on autopilot.

And then just as they lose their fears the bear comes out and they go into a panic. The stock market falls as everyone tries to get out of the door at the same time and the masses sell on a bottom. The smart investor though never stopped managing his money wisely and is prepared to use the selling panic to take new positions.

So what you need to do is not be scared about the two coming panic attacks of 2014, but simply get ready for them. That means making some adjustments in your portfolio now so that you will have some cash to use when stocks go lower and to have the patience at this point to let that happen before you do any new buying. By taking steps now to be prepared so you can act confidently when the panic happens you will separate yourself from the dangerous and neurotic herd that has now formed in the stock

market. In the financial markets you become cautious when everyone is bullish and buy when everyone else is scared.

And the masses will get scared in 2014. You just have to wait for the fear to appear. The typical investor is thinking right now that they have made a lot of money in 2013 and all they have to do in 2014 to continue making money is the same thing they have been doing in the past year.

But market trends change and the tactics that work best in a market often change from year to year. This is going to be the case in 2014. Most people do not adjust after a trend changes and end up losing a lot of money. But there is always money to be made in the markets. On Sunday I will put together a follow up report for you looking at the best ways to make money in the market in 2014 and the type of new tactics that you will need to use if you want to keep making money in the US stock market, because what has been working for most people in the past twelve months is about to completely stop working.

So look for my Sunday presentation. We are going to make 2014 a great year for you in the stock market.

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