WallStreetWindow Monthly

Stock Market Barometer

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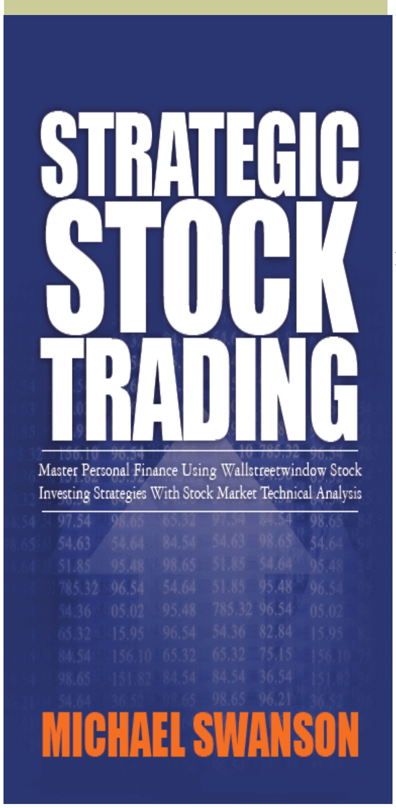
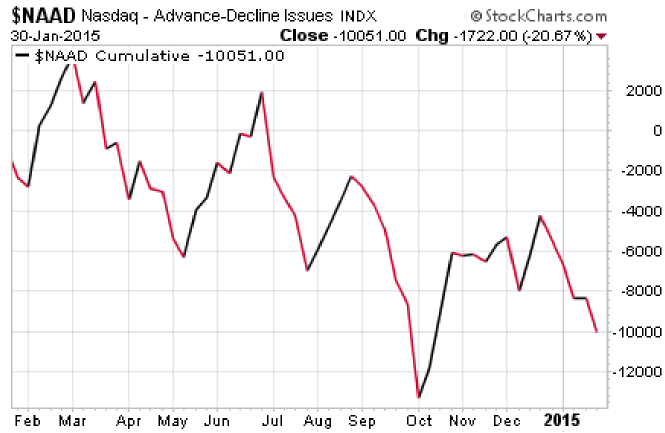
Brace Yourself For A Stock Market Drop! — (02/02/2015)

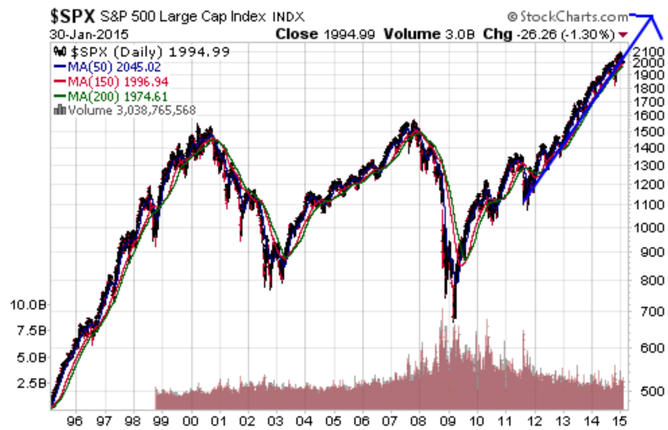
TREND ALERT — Market internal deterioration continues—brace yourself for stock market drop!



The stock market has now approached the edge of a cliff and the stage three topping process in the market that began last year is nearing completion. Look at the above chart carefully, because it tells you everything you need to know right now. What it shows you is the percentage of stocks above their 200-day moving average for the S&P 500. The number of stocks above this level has been in decline for over six weeks now. What this means is that when the market rallies fewer stocks have been going up and when it drops more of them have been falling harder than the market averages.

Now the stock market ended down for the month of January, but it spent most of that month trading wildly in a trading range. But while this has hap-





pened internal deterioration has taken place. This is important, because this is the sort of thing that precedes a market drop. For instance it occurred in September before the marked dumped hard in October and it happened in July before the market had a quick correction in the first week of August. This sort of thing never happened though during the big stairway to heaven rally that began in December of 2012, until it started to occur this last July.

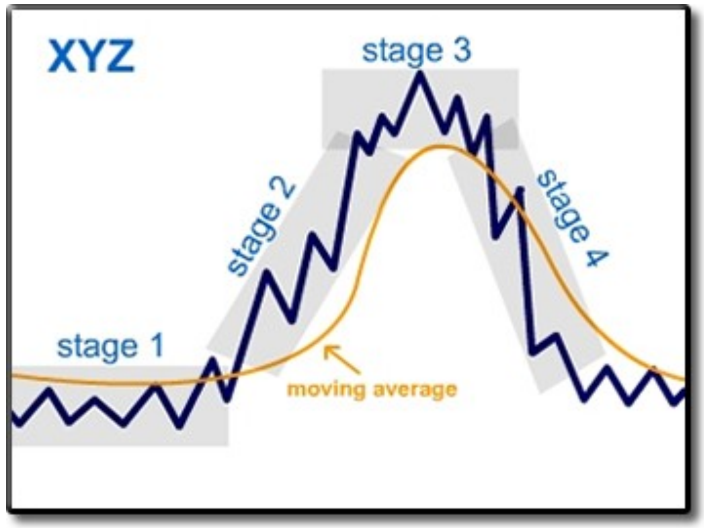
You can see another example of the internal deterioration in advance/decline line for the Nasdaq. It consists of a simple running tally of the number of advancing stocks compared to declining stocks every day. It has been in decline since February.

Most people remain bullish on the stock market. The number of bullish investors according to Investors Intelligence is over 54%, which is a level associated with overly bullish sentiment while the number of bears has not gone up at all for months.

All most people look at is what the stock market does on a daily basis. They look at their account or the ticker on the TV and are influenced by the daily action in the market. As the market goes up on a daily and weekly basis they feel better and better about things. So the longer the market goes up without pulling back the more bullish people get and the more convinced they get that the market will never pullback again. In fact they begin to fear missing out on further gains.

This is where we are now, because as you can see from the chart of the S&P 500 it has gone up at a 45 degree angle "stairway to heaven" rally that has made people so bullish on the market that they are literally borrowing records of amount of money to buy more stocks. These people do not look at charts or anything. All they do is respond emotionally to the market. This is a dangerous and frightening herd that has existed in the market now for over a year, but is now reaching a tipping point. It has walked right up to the ledge.

Valuations mean nothing to them, because the valuation of the stock market is now just as high as it was in 2007 when the market topped if you look at the cyclically adjusted P/E ratio. The only time it was higher was in 1999, and 1929. At the same time if you look at the PEG ratio for the DOW stocks it is actually more highly valued than it was in 1999. Now



everyone has known for awhile that the market is overvalued, but the experts on CNBC say that valuations do not matter, because interest rates are zero so paying any prices to get dividends is justified and the masses have seen the market go up so have internalized those beliefs.

The problem is that the internal deterioration taking place in the stock market not only precedes corrections in the market, but when it goes on for over six months like it has it also typifies a stage three topping process that precedes a full blown stage four bear market.

At the moment the action is very similar to what we saw at the very end of September. If you recall that is when I went to the Bahamas and visited with David Skarica and did a video with him in which we pointed out what was happening inside the stock market and warned of a coming drop.

And in October that drop came. I had been warning all year in 2014 that the market was overvalued and getting more risky, but it wasn't until that moment that I told people to take action and start to sell.

And since then I have been telling people to reduce their positions in the US stock market and to diversify out of it. Few people have done it. I fear that people are simply so scared of missing out on further gains that they rather risk everything than take the chance of missing out.

But diversification actually leads one to make more money in the long-run than they would have otherwise if done properly. This is why I devoted the January issue of this newsletter to showing you how you could have diversified in 2007 in bonds, gold, and the US stock market and barely lost anything during the 2008 crash and beaten practically every single mutual fund and hedge fund on the planet and the typical buy and hold only US stocks American investor in the years since.

If you have not read this issue than go here:

http://wallstreetwindow.com/wswmonthly/wswmonthly01012015.pdf

Now in October the US market averages had a very fast decline that took them down to their 150 and 200-day moving averages and then bounced back up into November in the space of two weeks. Since then internal deterioration has taken place and in the past six weeks volatility in the stock market has picked up while the deterioration has accelerated. I take this as a big warning sign that another stock market drop similar to what happened in October is going to play out again over the next six weeks.

I know no one on CNBC is saying this and Cramer and all of the Yahoo Finance people are telling people not to sell. The problem is that the worst thing someone can tell someone else about the stock market is to get out of it. For one thing almost no one will listen to that advice and it only makes most people angry. And what is more if you are wrong you will be smeared and ruined. But I do not care, because I plan on writing and talking about the market for years to come and as a result I do not bother myself about trying to please people who are here right now but will be eliminated if the market goes into a bear market, but instead I write for the people who are capable of playing this game in the long-run with me. The next bear market is going to take many people out of the stock market for good. As I wrote last year, this 2012-2014 “stairway to heaven” is essentially the last hurrah for a generation of US stock market bulls.

You have no excuse for yourself if we go into a bear market this year and you end up losing everything you own over the next few years. I know that is what will happen to most US stock market investors, but there is no reason why it should happen to you. You simply know more than most people in the market do. All you need to do is apply that knowledge and take action. In fact there is no reason you cannot make money even if a bear market happens.

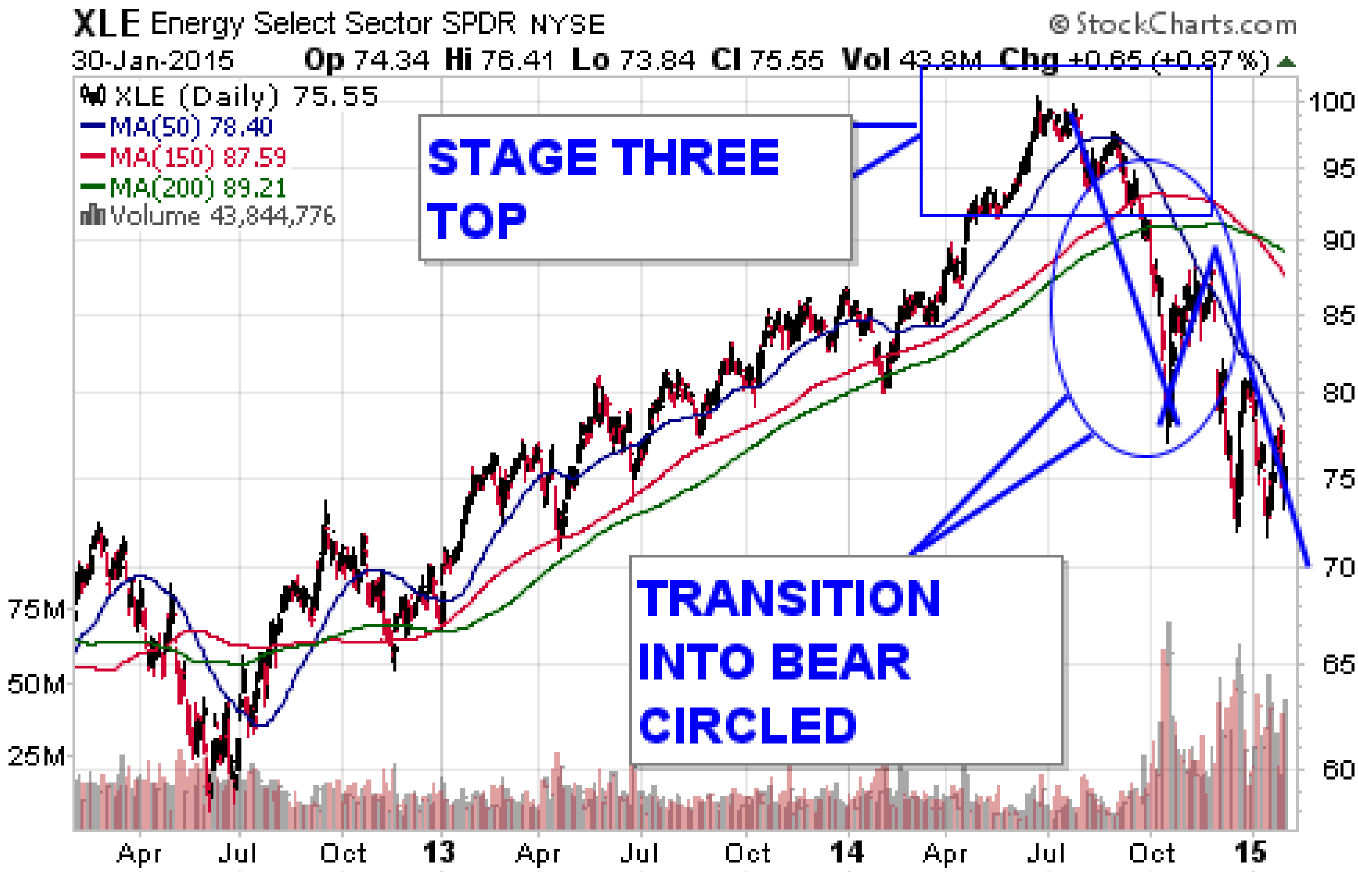
For one thing you can bet against stocks and the US stock market and make money during declines. Secondly, if the market dumps the Fed will start to talk QE again and gold will soar, so gold investing will thrive. There are bear market bottoms coming for other commodities and places to invest outside the US that can do well in the coming years too. Simple diversification can enable anyone to beat the market.

But no one wants to tell people to diversify, because all most people want to do is buy into the US stock market and believe it will go up forever. Few people can be a contrarian and go against their CNBC TV programming.

Frankly people take comfort in believing what ever their TV box tells them, because it makes them feel like they are part of a powerful crowd. So people in North Korea who watch their TV boxes hate the United States and Americans who watch the TV news hate and fear the entire world and believe that the Federal Reserve will make the stock market go up forever, because that is what they are told. They are even willing to give up their own freedoms and civil liberties, because TV tells them it is right.

In order to be successful going forward you will have to separate yourself from the crowd. And you will need to understand how market cycles work.

Are we going to just have another drop like October or will the next drop when it happens mean that we are truly starting a stage four bear market? How will we know? Well there is a pattern that tends to play out



at the start of a new bear market and we actually just saw it happen with oil stocks.

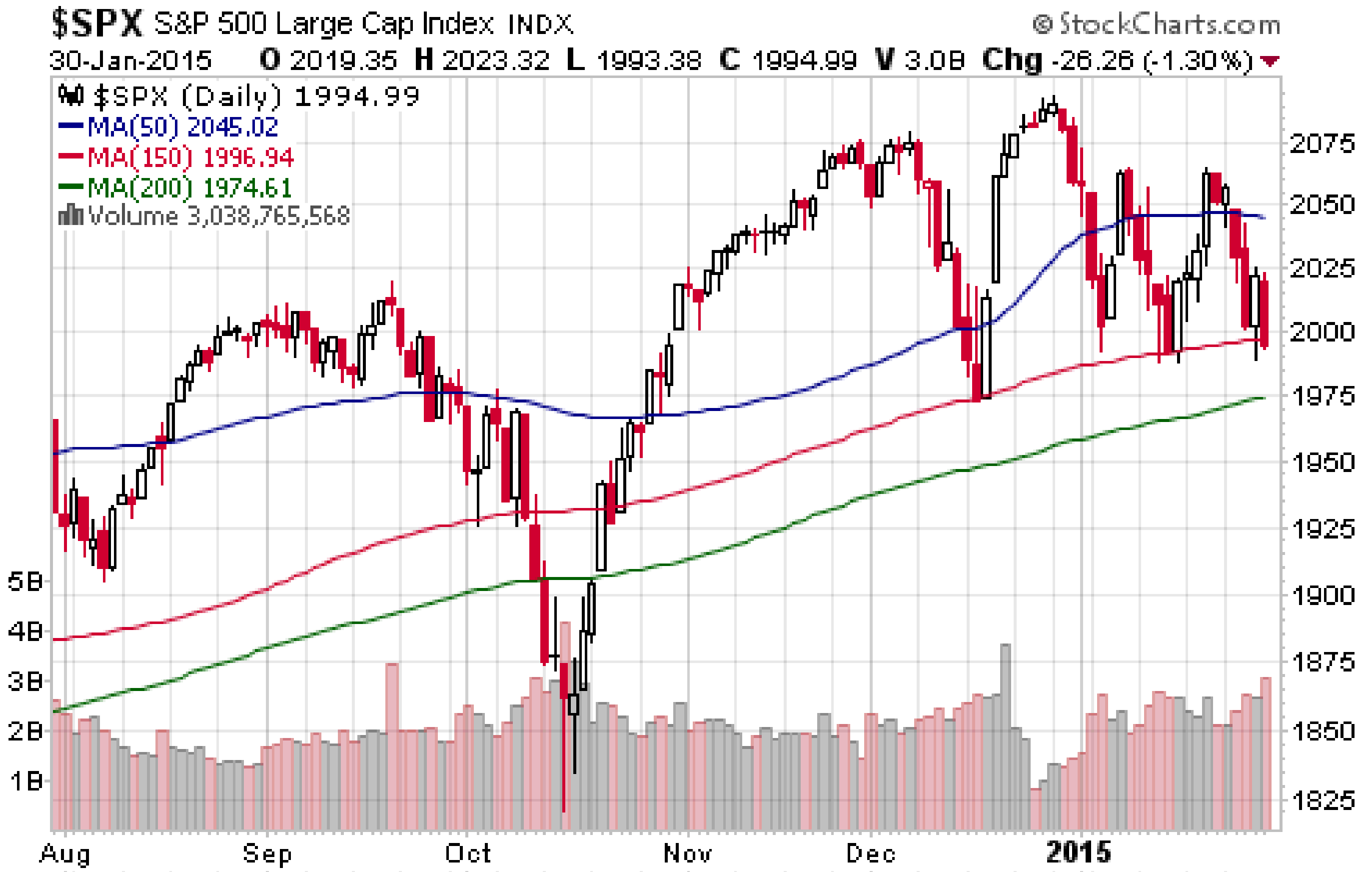
During a stage two bull market the 150 and 200-day moving averages act as support. During a stage three topping phase volatility picks up in a market and momentum fades. At the very end of a stage three phase as a market tips into a bear market you get a drop that takes the market averages below their long-term 150 and 200-day moving averages so far below them that those moving averages now act as resistance.

So in the fourth quarter of last year we saw the XLE energy stock ETF fall below these moving averages in September and then make a bottom in October.

As the US stock market as a whole rallied in the second half of October XLE went up too, but not enough to get back above its long-term 150 and 200-day moving averages. The rally failed and XLE moved lower. The moving averages are now in a downward slope and will act as resistance for months to come, maybe even or a year or two.

The point is that the price action that takes place as a stage three phase ends consists of a sharp enough drop that the market goes through the long-term moving averages and then those long-term moving averages act as resistance.

In October the US stock market only went below these moving averages for a week and then rallied back above them. But a drop at this point will likely take the market averages well below their long-term moving av-



erages, because the S&P 500 already closed below its 150-day moving average on Friday and is only 20 points away from its 200-day moving average. That means that if we get a 10% drop from here over the next six weeks that takes the S&P 500 down to 1800 or so then it will end up falling so far from it that those moving averages will then act as resistancexx.

This is why I am saying that I believe the US stock market bulls have now marched themselves right up to the edge of a cliff.

I think the market is going to drop over the next six weeks, but it may easily bounce for a few days this week. Such a bounce would be a good time to move some money out of the US stock market and into cash or other asset classes in my opinion. You need to talk to a financial advisor about it. You need to really study how you are invested and see if you are truly diversified or not.

Here is a simply question. If the US stock market were to fall 30% from here would that cause you much harm?

I have been warning about the dangers in the stock market now for a year and telling people to reduce their risks in the market by selling since the end of September. I have been teaching you about real diversification so that you can see that selling stocks does not mean "missing out" on gains, when in fact real diversification means generating even greater gains with less risk over the long-run. I do not know how you are invested or what you are doing, but if you are 100% in the stock market it is now time to recognize reality and consider making some serious changes.

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