



WallStreetWindow PowerInvestor

Pop and Sizzle - Mike Swanson (02/03/13)

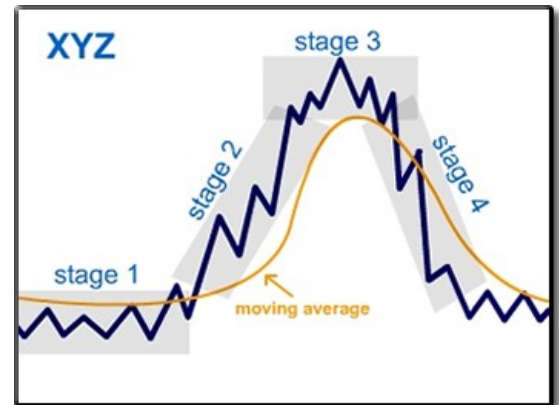
Well this January brought us a nice pop in the stock market! The S&P 500 has gone up 5.4% so far this year. Of course most of the European markets have gone up more than that—Italy is up 6.2%, Greece is up 6.4%, and Belgium is up 6.6% to name a few of them, and they are even up much more than that if you look at what they have done since this summer. I don't need to tell you that though, because you know that already, but most US

investors don't know that other markets across the world are going up faster than theirs are, all they know is that the US stock market has gone up nicely this year, and that's enough to make them happy. That is all their television sets are telling them so that is all they know.

In just a few weeks we have come a long way since Christmas time. It was a fun holiday, but when it comes to investor sentiment it seemed downright scary. Back then all people were talking about on TV and in the financial press was the fiscal cliff. Elliot Wave theorists were claiming that wave 85 was going to hit the market and cause a huge crash. People had all kinds of reasons to be worried about the stock market, a few of them were real, but most of them were just fantasies in their mind.

But now those worries seem to be gone. Now people are excited. American investors put over \$20 billion new dollars into stocks this January - that's after they had pulled money out of stocks 20 months in a row according to Reuters "Fund Flows Insight Report." This has caused some on CNBC to talk of a "new rotation" out of stocks and into bonds that will go on for the rest of the year, thereby driving the market higher for months to come.

In reality though it's hard to make much out of one month of money flows - and normally January sees a big flow of money into stocks thanks to New Years positioning and retirement plans anyway. Back in 2011 over



\$20 billion was put in and the market ended up going pretty much nowhere that year.

What news like this does though is make it feel good to buy stocks right now. It makes it easy to do. You have seen the stock market go up. So you know others are buying too. If you buy too you can join in the fun. They are talking about it on TV.

If you buy and something goes wrong, oh well. Everyone else will lose too so you won't be alone. If you buy you won't be alone and who wants to be alone. You can be a part of the market. All you have to do is buy.

Imagine if you got scared when the TV told you to be scared back when they talked about the fiscal cliff and you sold out and went to cash, afraid the wave 85 was going to crash the market. Then as the market went up this January you just sat and watched and missed it. How would that make you feel? Terrible I'm sure!

Now imagine that you are a hedge fund manager that started the year in cash and didn't buy. Now that'd really suck. You would have people calling you on the phone pissed and some of them would be pulling their money out. Now you would be under pressure to do something to make up for the return that you missed. You might do something stupid and make a mistake, but you'd feel you had no choice now. So you buy. Maybe you'd use options or futures. You simply cannot miss out on more.

You make your buy. Instead of admitting to yourself that you are buying in response to the emotional pressures you are feeling you rationalize your decision by looking at the news and telling yourself, yes CNBC and Maria Bartiromo are right, "new rotation" is going to make the stock market go up so I must buy. Or you tell yourself that Obama is a genius and his policies are going to make the economy boom. You tell yourself something and you convince yourself that this something is real. You explain these reasons to your clients and you sound smart.

Now the Investors Intelligence survey people come and contact you. When they talked to you in New Years you were in cash and told them you were bearish. You believed in those bear market reasons. Now that you bought though you tell them you are bullish on the market. Yes I'm now a bull!

This story in a nutshell is how the stock market really works. All of the talk on TV about why the market will go up or down is mostly just a bunch of rationalizations used to justify decisions by the guests that they really made on pure emotion or for reasons they don't even know them-

selves. The financial news is garbage and the regular news CNN, MSNBC, or FOX is propaganda.

As a general rule of thumb major buying opportunities come AFTER bear market bottoms and corrections in bull markets which cause people to sell and get bearish. Tops though tend to come after the market rallies long enough to get everyone excited and bullish about it again. Tops come when those



that sat out the rally in disbelief finally become the last buyers because they feel forced to buy in fear of the repercussions they will face if they "miss out." The masses are generally fools, but when the so called professionals get confident and cocky then watch out. There is no one about to lose their money faster than a stock trader who is excited about the unrealized gains he is sitting on. Fast money is fast because it comes and goes at the change of a digit. Successful investing means making money overtime and fighting back such demonic temptations.

So this Wednesday I got a little worried about you when I got the results of this week's Investors Intelligence Survey, which showed that the number of bullish respondents is now at 54.3%. From a contrarian standpoint that's not a good sign, because at the last two tops of last year the number of bulls clocked in at 54.2% and 54.8%. It makes me worry that some of the people reading this could be joining the crowd and buying right now too. Of course we got real low readings in the VIX and put/call ratio to top things off too.

Now this survey is not an exact timing mechanism. It's a warning and that's how I take it. It tells me that now is not a good time to be buying new positions. My plan right now is exactly the same plan I told you I was coming into 2013 in my New Years newsletter with. That plan was to be happy to hold what I have and to look to buy more when the stock market eventually has a correction. Until that happened I told you I would be happy to simply be patient. And that is still where I am now.

I do not think the overly bullish reading in this survey means that the stock market is going to crash or go into a new bear market. There is absolutely no sign or evidence to suggest either thing. Nor do I think you should just go out and sell everything and hope to buy back later. But if you want to do new buying what the survey suggests - and the market

action too for that matter - is that it is prudent to be patient and wait before you buy. You make money not by chasing news and rallies, but by having an investment game plan and sticking to it. It doesn't matter what happens this week in the stock market, what matters is what you do in the stock market for the rest of your life. I don't know and don't care if the stock market goes higher this week or not. If it does the positions I have will go up more and if it goes down then we'll eventually get a real opportunity to buy more. Either way I will win in the long run.

As human being we are rigged to always want to know what is happening and why. We try to make meaning out of every little market gyration to satisfy that craving. Does this January move mean the market will go up like they say it will on TV? Or is it a sign of a scary top coming and crash?

Well, I think the real opportunities to make money this year are NOT in the US stock market, but in European markets which are just starting new bull markets and in commodities and commodity related stocks which have not started one yet, but will likely do so in a few months. Before I get to that let's talk about US stocks.

The big gains in a bull market typically come in the beginning and then if a bubble develops in the end. The US stock market has been in a bull market now since 2009 and the bulk of the bull market gains so far came in the first year of the bull market. Once you get into the middling phase of a bull market like we are in now volatility tends to die down and you end up with more of a sideways market with a lot of fake breakouts and breakdowns. When you do get successful breakout rallies they bring short-lived volatility expansions which lead to quick corrections and then a long period of low volatility.

That means when this current market move comes to an end instead of a big crash or new bear market we will likely see the market pullback a bit and then - more importantly - see the market volatility shrink even more. We may see the market go one for weeks with very tiny intraday moves of less than 1/2% a day. The market could peak here, or next month, and then not make a new high until the end of the year or even next year and simply drift sideways - going seemingly nowhere.

I've been in this game long enough to have lived through several market years like this. We have already seen the US stock market act like this last year. It did the same thing in 2010. In the last bull market from 2003 till 2007 it did this sort of thing three times three years in a row. In 2004 the stock market peaked out in the first quarter and fell slowly for the rest of the year. In 2005 it peaked and ended the year es-



essentially even and spent much of 2006 doing the same thing before it broke out at the end of the year to begin its final bull move higher.

Interestingly while the market had times during the 2003–2007 bull market in which it did nothing for months on end during these times gold and gold stocks often did great and so did some of the markets outside of the United States. The action in oil, gold, and other commodities diverged away from the US stock market.

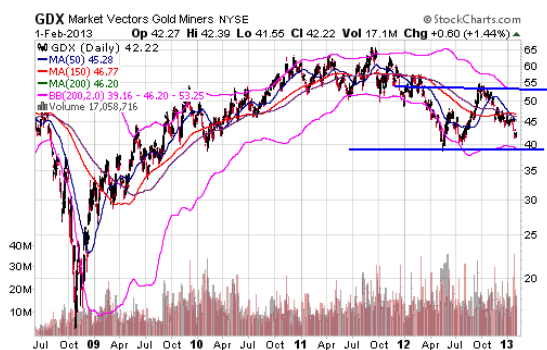
I think the same thing is going to happen this year. Once the US stock market makes its next peak I don't think it will really do much the rest of the year, but I think after that peak comes we'll see the European bull market pause and then accelerate and commodity related stocks begin new bull markets and lead for the rest of the year. In the United States stock market we'll see a rotation into energy stocks that make up a big enough portion of the S&P 500 that they can help the market stay afloat even if some of the more popular stocks such as Apple drop even more than they have already. That will be the real "new rotation" that takes place.

We saw the opposite happen in the last six months of 2011. During that time the US stock market went up while just about every other market in the world, and gold, peaked out and fell into bear markets that ended in the summer of 2012. Since then European markets and almost every other stock market in the world has performed better than the US stock market. This divergence is likely to become even larger this year, especially once the current US stock market rally sizzles out. That's what I think we are seeing the pop now for US the market averages and will get a sizzle in them once it ends.

Commodities bottomed last year too but are still in the stage one transition phase. They are not yet in a new cyclical bull market. Instead they are going through the stage one basing phase that precedes a new bull market. During such phases you get a lot of up and down movement that leads to nowhere. You get people who are bullish and believe in a new bull market get upset when they see their market go up to resistance and then just come back down. Most don't understand what is happening and eventually sell out. What is happening is that volatility is shrinking and then all of a sudden a real breakout comes and a new bull market starts just as just about everyone involved gets shaken out. Few are bullish and normally the market has bored so many people that CNBC never mentions it anymore. When is the last time you saw Jim Cramer pound the table on Newmont or energy stocks?

Now if you have been paying attention to my writings the past few month than you should know what a stage one base breakout looks like, because we've been seeing them happen in markets all over the world. Austria and Ireland are two examples.

Stage one breakouts happen when a market consolidates for at least six months, often longer, and then breaks through its upper 200-day Bollinger Band and resistance level. Shipping stocks, as you can see from the SEA ETF, are right at this point now. So are many energy stocks and metals stocks. They will likely pause for at least a few more weeks before they finally breakout. Gold stocks also are still in a stage one base, with support on the GDX at 40. Right now I'm not really focused on the US stock market, but on entry points in these sectors. I want to buy them before they enter new bull markets and looking for a stock market top first. You see the BIG money is not made flipping coins in the US stock market to try to make 5% returns, but playing new bull markets where you can make 30-50% in a year. It's my job to help you do this in 2013.



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