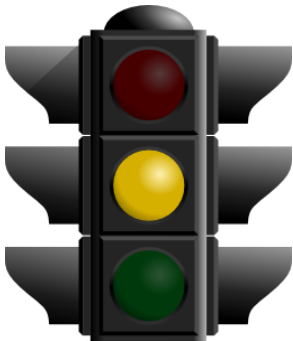




Stock Market Barometer

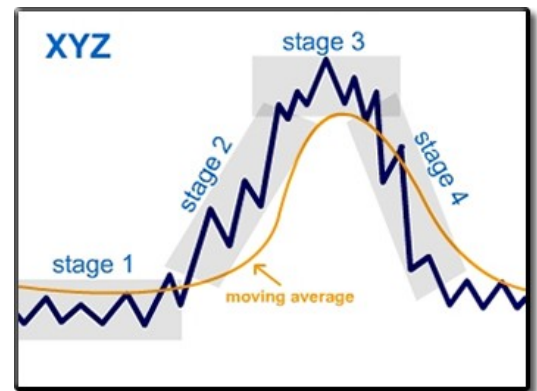
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**TREND ALERT—
BROAD MARKET
TOPPY SIDEWAYS,
BOTTOM IN GOLD**

Stage Three Tops Bring Misery Markets—Mike Swanson (05/01/2014)

Before I get into what is happening in the stock market right now I want to address something very important with you. There is a giant myth going on in financial world that most people believe in and it's a myth that in the end I believe is going to ruin many people financially. Everyone knows that the stock market is overvalued. I have been telling you for months that the cyclically adjusted P/E is over 24 and that many of the stocks in the DOW and S&P 500 which are household names are trading 30-50% over their historical valuation. I'm talking about the "safe" names like Proctor & Gamble and Johnson and Johnson.



These are big cap stocks that are paying dividends. So the argument has been made that it makes sense to buy them, because interest rates are zero, no matter what price they are trading at. That's true that rates are zero and people cannot make money in CD's, but one day interest rates will go up. No matter say the bulls, because the Federal Reserve won't let the stock market fall. They'll just print more money.

We have seen the Federal Reserve lower rates to zero and engage in quantitative easing money printing operations to help fund the Federal spending

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deficit and send the stock market higher. Last year I shared with you an internal Federal Reserve report that says that the Fed cannot allow interest rates to go beyond 5.20% on the 10-year Treasury bond or else the cost of funding the debt will go so high that the Federal Reserve will be forced to engage in massive money printing. This study says that if things continue on the path they are on this could in fact happen by 2017.

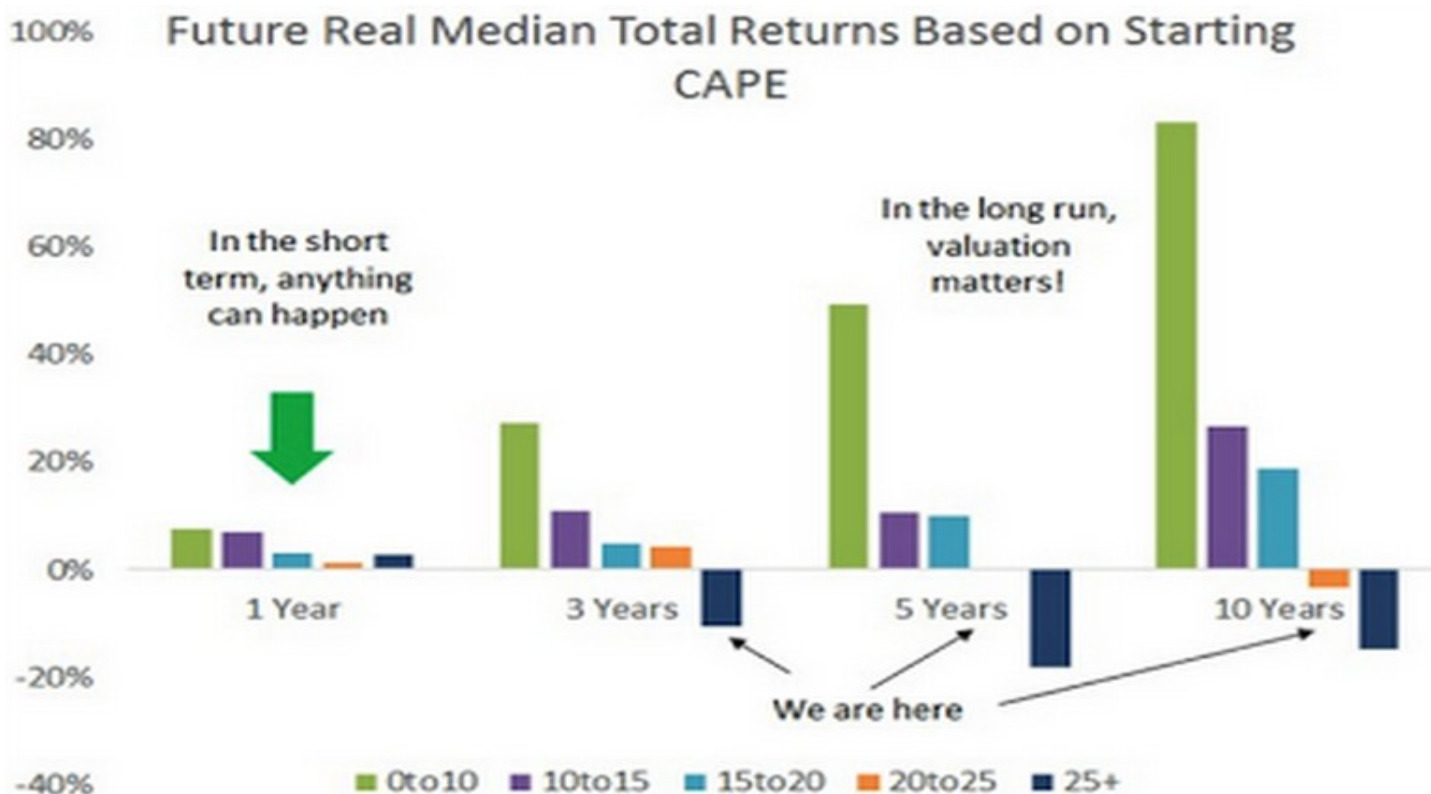
You can find the study by going to this link:

<http://research.chicagobooth.edu/igm/events/docs/13usmpf.pdf>

You may conclude from this that if the Fed engages in some massive inflation that you should best be in the stock market then. Inflation should help stocks you would think.

That's an idea shared by just about everyone. There is hardly anyone out there that argues that the stock market is cheap, because you simply can't. By all metrics it is not cheap, it is just a question of how expensive and overvalued it is.

In my view this is one of the reasons you should be very careful about the stock market right now, because the high valuations limit the upside potential return you may experience in the market going forward. History shows that the markets that provide the greatest return over the next five to ten years are ones with low cyclically adjusted P/E ratios and those with ratios over 20 tend to generate flat to down returns. Now valuation levels don't really mean anything for what happens in the next month or even the next twelve months, but in the long run they mean everything.



And I believe that what we are actually seeing this year is the formation of a stage three top for the US stock market that will usher in a new bear market. I cannot predict whether this bear market will fully emerge this fall or next year, but we are seeing all of the signs that the US stock market is now in the transition phase between a bull and bear market.

First we saw MANIC sentiment levels as people in the Investors Intelligence survey got as bullish as they were at the 2007 market top and right before the stock market crash of 1987 at the start of this year. We also got record margin debt levels. We got simple stupidity as people began to chase so called "momentum monster" stocks in the first few weeks of the year.

Then March came and the "momo" bubble popped. The Nasdaq closed April down 6.5% from its March high. It bounced off of its 2000-day moving average in April, put on a weak bounce, and instantly fell towards last week. Biotech stocks have crumbled, Facebook dumped, and YELP gave up the ghost. The "momo" game is over. In stage three tops what you see is the indices do "ok" while the sectors that make up the start market as a whole begin to deteriorate. Money starts to flow out of most sectors and only a few sectors continue to do well.

But people do not realize what is going on, because the S&P 500 and DOW look fine. Many see them near their highs and are excited by that fact. So we are in an invisible top where the market isn't really going anywhere and yet almost everyone is bullish.

In tops fewer stocks participate in the rallies. The averages look good, but the internals that no one pays attention too are weak. So while the S&P 500 is up for the year right now 207 of the 500 stocks that make it up are in the red. It is really about 30 stocks that are responsible for most of the gains and they are dominated by energy and utility names now.

I use TC2000 to analyze the stock market. It breaks the market up into 239 sectors. 115 of them are in the red so far this year. That's almost half of them. Now before bear markets get going you don't just see many sectors in the red, but many are below their 200-day moving averages too. We are not at that level of deterioration yet. What happens is that once a critical mass of sectors enter bear markets of their own they take the US market averages down with them and then a real bear market begins. Mutual funds go down the toilet then.

That means that this is a warning. If the deterioration gets worse I will have to at some point declare this to be a bear market. But I fear that if I do no one will pay attention and that right now everyone is too bullish to want to hear someone warn them. So I have to wake you up!

Now I am saying you should be careful in the market and you should get ready to sell. We are in a correction now in the Nasdaq. It could get scary, but it will end. And when it does there will be a rally. If the sector deterioration continues on that rally then you MUST get out of this stock market, because it will be heading for a full blown bear market and they can be bad - or at least do some selling and take some measures to protect yourself.

Ok, now if you email this newsletter to an investment adviser he will tell you that it is crazy to sell out of the stock market. He may even tell you that it doesn't matter if the stock market is overvalued. He might even say that valuations do not matter, because that is exactly what a parade of the Wall Street talking heads have been saying on TV.

The reason why they say these things is that the biggest risk they face is selling out of the stock market - or telling you to get out of it - and then having it go up. If that were to happen you would crucify them. You would take your money and put it with someone else.

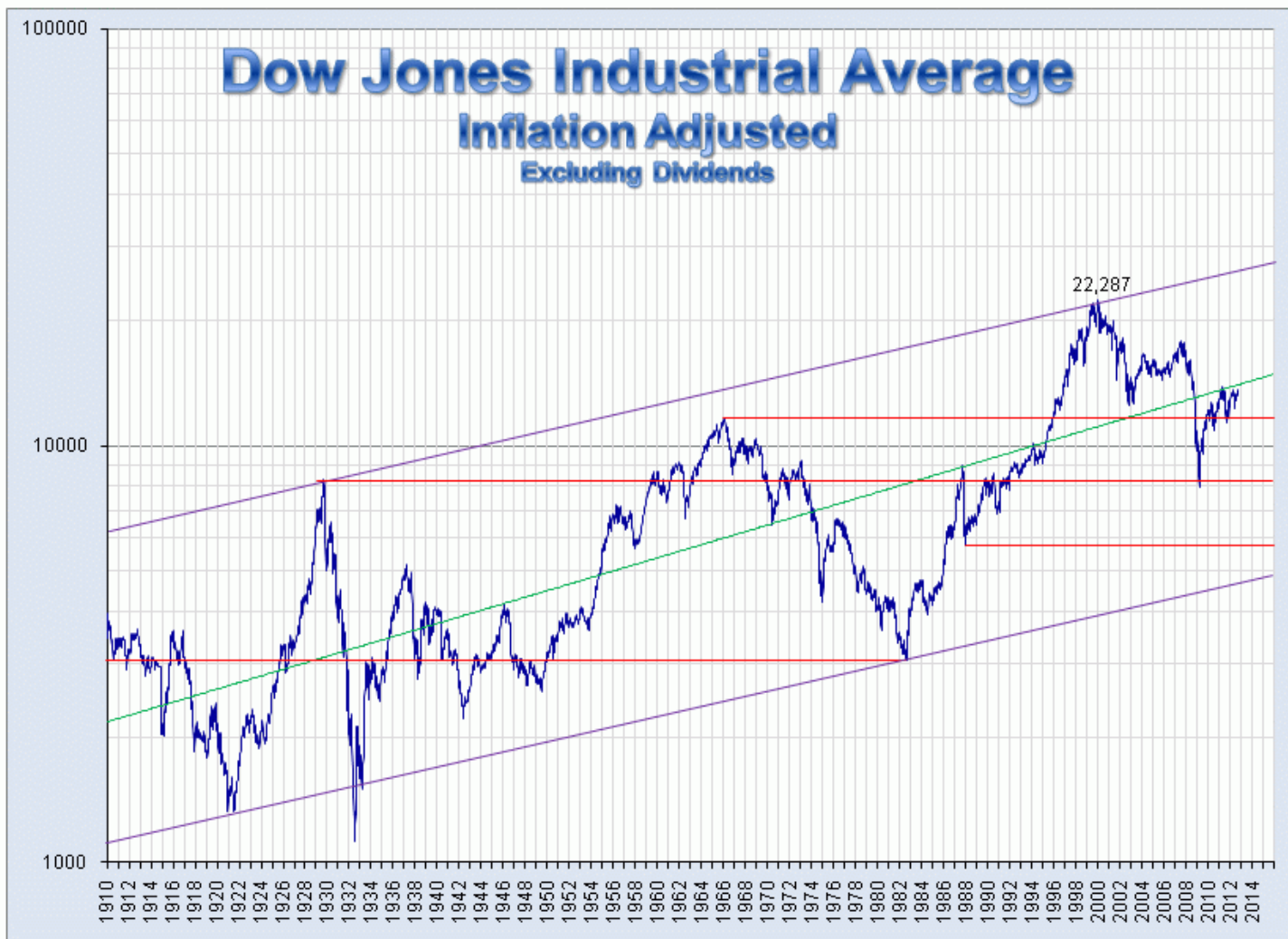
But if you hold and the market falls as long as everyone else loses too you will likely keep your money with your investment adviser. He may not consciously realize what he is doing, but such always be bullish advisers do nothing but argue for what is in their best interests - keeping you in the stock market at all times. If you did something like sell you might take your money away from them and put it into something solid like real estate or precious metals. And they won't make any money off of you then. And if they encouraged such behavior their bosses would fire them anyway. They would not be helping their firm.

Most of these people are not lying to you. They have completely drunk the cool aid and simply parrot the Wall Street talking points. Those though who are intelligent and do the work to think for themselves and have much of a conscience end up leaving the business. Wall Street is a corruption of moral rot. These CNBC bubbleheads are going to ruin people when the bear comes.

So you are in a situation where everyone in Wall Street is interested in seeing the market go up more and just hopes it will for them. So in their world valuations never really matter. They didn't matter in 2000. They didn't matter in 2007 and they don't matter to them now.

And they have another argument that seems to make sense - which is the big thing I want you to take away from this month's newsletter. That argument is that well if the stock market drops the Fed will do more money printing to make it go back up.

In February when the DOW fell for a week Steve LIESman received word from the Federal Reserve that they were considering bringing a halt to their QE tapering. The market then went up. So you may think they can print money if they have to in order to make it go up. It seems like a



logical thing to believe. And if it's true than valuations don't matter.

Well if you actually go look at what has happened to stock markets at times of high reckless inflation in almost every instance the people who invested in them lost money in terms of real wealth. And not just a little bit of money, but tons of it.

In the 1970's the US stock market spent most of the decade going sideways, but people invested in it lost massive amounts of their real wealth due to inflation. Yes there was a big bad bear market in the 1970's, but even in years when the stock market went up people often lost money too, because the inflation was horrible.

In fact when you look at the DOW adjusted to inflation the years from 1968 to 1981 were a total disaster. So was the decade of World War I. If you look at other countries during times of high inflation the same thing happen. Take a look at what happened in Argentina a few years ago.

The problem is inflation often comes in times of a sour economy. It is often the result of bad monetary policy, which is a reaction to structural problems in the economy. I believe inflation is ahead of us and when it hits will result in a tough time for investors.

You see stock market bear markets often occur in times of inflation. Inflation does not stop them. When stocks are overvalued and a bull market cycle plays itself out they fall whether there is inflation or not.

We saw the Fed try to stop the last two bear markets by rapidly lowering interest rates and it was not able to stop the bear attack. And it won't be able to stop the next one either.

And even at times when a market goes sideways high inflation still devastates people in terms of their real wealth.

Ok, the point of all of this is tell you do not be complacent in this stock market. Do not just think that the Fed will print money for you and you will be ok. The Federal Reserve and its money printing operations is not your insurance policy. You are not a Wall Street bank. Janet Yellen WILL NEVER BAIL YOU OUT!

And she won't be able to even if she wants to. Now I'm not saying the end is here right now. I'm not saying sell all of your stocks. I'm saying that you need to be careful and you need to understand that a bear market is on the horizon and there will come a time that you will need to make changes in your portfolio - because those that do not will suffer the consequences. We will keep our eye on the horizon to identify the emergence of the bear. Things are ok now. But we must keep our eyes open.

In my last monthly newsletter I said that we were entering a time in the stock market in which very few people would make any money at all. I said the easy money game was over and now things were going to be very difficult for people.

And that is exactly what is happening. Despite all the swings this month the S&P 500 ended in the red and the Nasdaq had losses too. That is what happens during stage three tops in which people still believe in the market and don't understand what is happening so they get fooled by the up days in the market and buy into tops and get trapped by rallies that just fade out on them.

At the same time though bears get fooled by the declines into thinking a crash is coming or a bear market is starting when neither is happening yet. Stage three tops are characterized by deteriorating market internals and silly sentiment, which is exactly what we have. They play out with a market that tends to go sideways and cause traders to churn their money over and over. That is exactly what is happening now.

And that's the main reason I was saying this would be a tough market now to make money in. That will change one day though. For now though it's a misery market for traders trying to play the game. But most investors aren't really suffering, they just aren't going anywhere. They are seeing the market go up and down and just saying oh well I gotta hold because everyone else is and I'm being told by the "experts" to so I must obey. Besides few know what else to do. Their misery will come when the

bear market comes and they hold all of the way down.

At the same time we are in a stage one phase in metals and mining stocks that precedes a new bull market. That is not an easy phase to make money in either, because it is also characterized by up and down action and rallies and drops that don't really go anywhere. So in March we saw the HUI break through its 250 resistance level and then come back down.

But one thing that is different between a stage three top and a stage one basing is that during a top almost everyone remains bullish and gets excited on rallies while during a stage one basing phase almost everyone is negative on the market. So when they see down days they think it means another giant drop is coming or they think that there is still a big bear market going on.

Stage three tops cause people to buy in and lose while stage one bottoms cause people to sell out of what they already own and miss out, because when they end a giant new bull market begins that rewards those that got in early the most. So that's where we are in gold stocks. Once the HUI clears through 250 and rallies a new bull market will begin. That's where the real money is to be made going forward and is what you need to focus the bulk of your attention on now. The "momentum monster" game is over. The gold game is about to begin. Right now it's tough for people to get in and hold metals and mining stocks, because of the basing gyrations, but once the gold bull market fully launches it will be the place where the most and the easiest money to be made going forward will be.



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