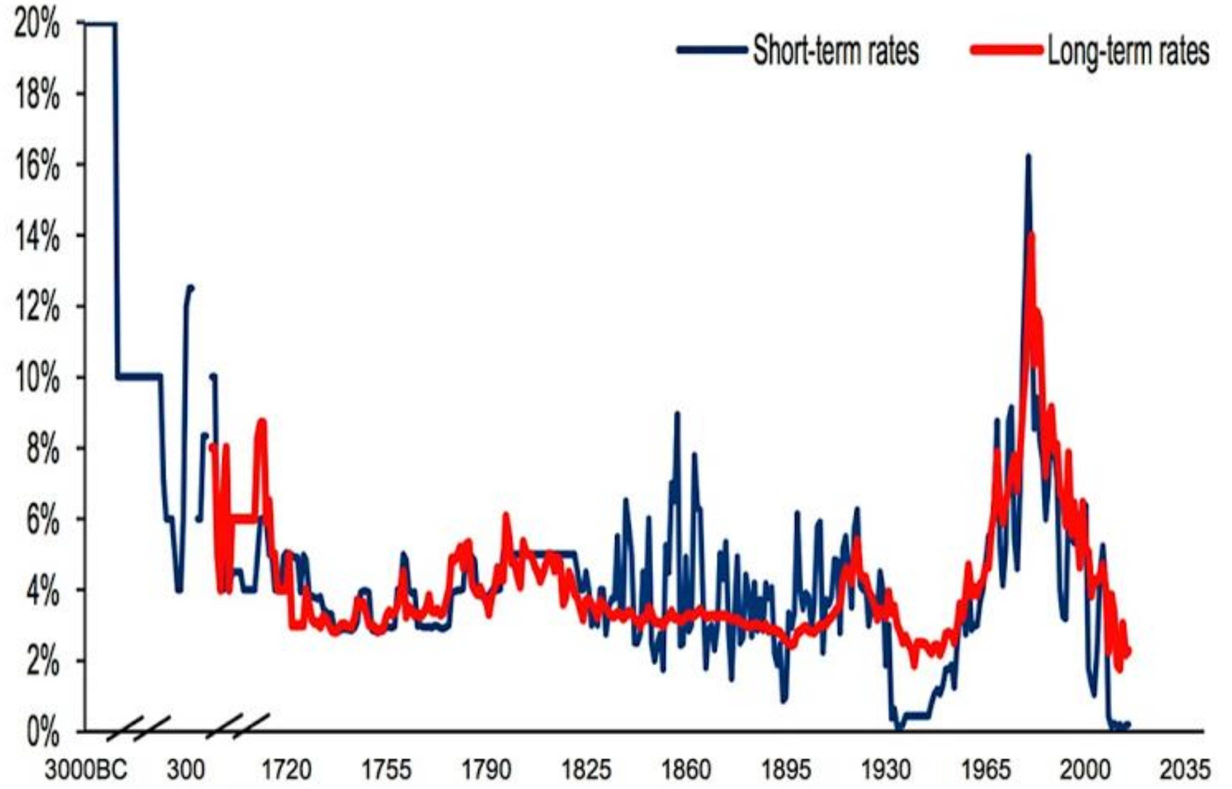
WallStreetWindow Monthly

**August 3, 2016**

# This Indicator May Determine the Future of Your Portfolio – Mike Swanson

**Chart 1: Still the lowest interest rates in 5000 years!**




Sources: Bank of England, Global Financial Data, Homer and Sylla "A History of Interest Rates"
Note: the intervals on the x-axis change through time up to 1700. From 1700 onwards they are annual intervals. Full methodology available upon request

Look at the chart above, because it is ultimately going to wreck the stock market and drive gold prices higher. We are seeing something never before seen in human history and that is negative interest rates on sovereign debt in parts of the world such as Japan. We are in a moment like 1999. Back then I saw some internet stocks trade at valuations never really seen before in the history of the US stock market. At the time CNBC talking heads said it made sense and meant a "new economy" was being built, but then it peaked and bust. I shorted and made a killing in that bear market.

Today CNBC talking heads are saying that stock market valuations do no matter, because interest rates are so low. They seem to think that this is just going to continue forever and that means that the stocks should go up forever. That has never happened before in history, but they believe that they live outside of history and that stock market cycles have been abolished and that a bear market will never happen again.

You hear stock market predictions all of the time for gains or crashes or losses. I have been investing in gold stocks and mining stocks this year and that has helped me generate a big market beating return in my accounts. But I did not buy based on predictions for gains by others and in fact every week someone forwards me a prediction for a gold pullback or crash!

What I did instead was invest on the belief that there would eventually be an end to the gold bear market that began in 2011 and that would mean a new bull market would begin. And so this year it began.

And ultimately the US stock market will decline too, because markets go in cycles. Cycles have not been abolished no matter what the stock market bulls on CNBC say.

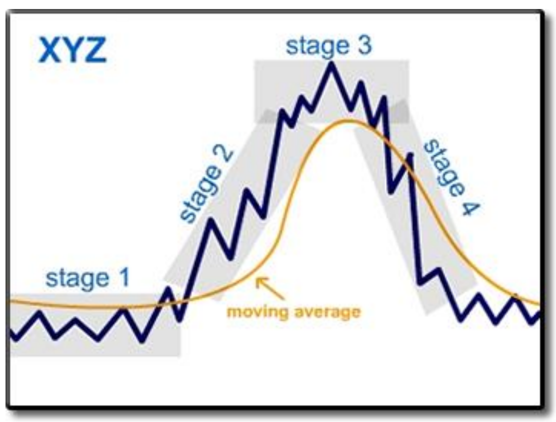
They never offer a strategy or say when you should get out. All they do is yell BUY!

I believe that the stock market is about to run into big trouble again, but I do not want you to take this as a prediction to agree or disagree with. Predictions are useless when it comes to making money.

Instead I want to show you an indicator you can use to KNOW when this is about to start. It is starting to flash a warning sign and if this warning sign is still going on by the end of this month then you will know that the market is going to decline in the Fall and can act. Investing is about understanding how markets work and not chasing crazy predictions. It is up to you whether you want to know and then be responsible for your money or just sit there and hope the stock market will go up forever and ignore any risks and just obey the CNBC people.

There is no stock pick in this month's newsletter. IDM Mining, which I talked about last month and trades on the TSX is still a big buy in my opinion (I own a position in it in a private placement I bought) and I have bought several other mining stocks in the private Power Investor group in the past few weeks and am looking at more. But in this weekend's Power Investor report I also listed several stocks I was considering shorting and actually shorted them on the open on Monday.

If you are not in the Power Investor group you cannot get in it right now, because it won't be open to new people until after Labor Day. So I have nothing to sell you in this newsletter. I want you to only focus on this one indicator I am going to show you this month and if I sell you something I fear that some will use that as an excuse to ignore what I have to show you and bury their heads in the sand.

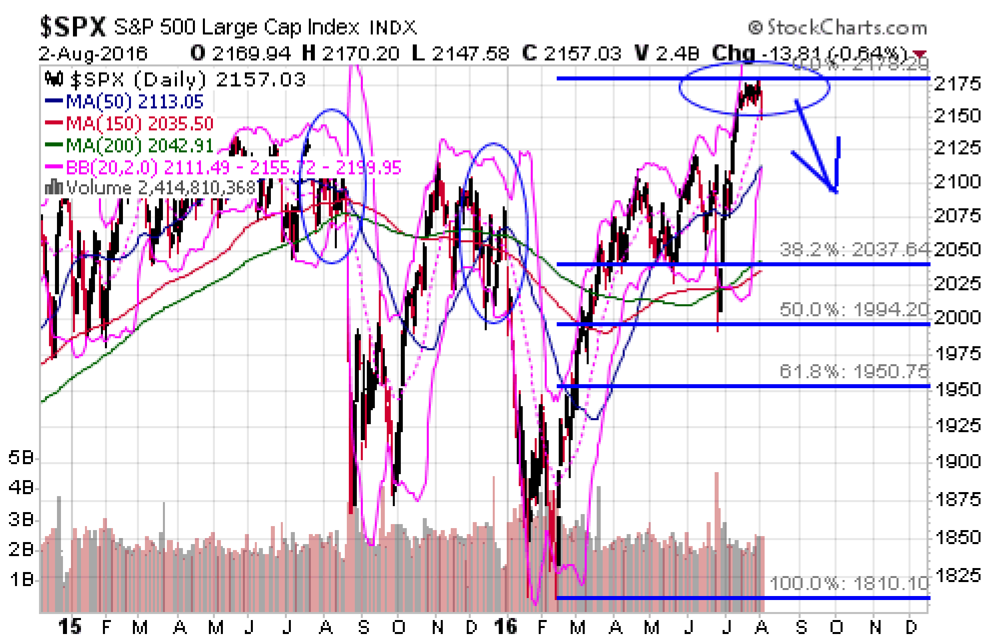



Bull markets are fun to be in and the start of new bull markets bring big gains in the first year. So we are seeing gold, silver, and the mining stocks explode higher this year, because they are in the first year of a stage two bull run. Most stocks in the US stock market are in a stage three top or a stage four bear market. If you take some time and look through all of the DOW 30-stocks you will see that this is a fact. Just take Apple as one example. It is in a stage four bear market and that is why people that own it have been losing money this year. All of this is part of a troubled stock market, but few want to hear about that. They just want to be told if they hold they will get rich.

Yes I have warned on the market at times over the past year. In July 2015 I did a monthly newsletter saying I thought that the stock market was going to top out in terms of price and valuation and in the terms of the latter probably for our lifetimes. The market then dumped in August and again in January, but it has come back.

Most stocks though have not come back and most people are actually spinning their wheels in the stock market, but the rally after the BREXIT event has caused many to now think that the stock market can never drop. Sentiment has swung to an extreme and almost all of the stock market bears have thrown in the towel while the masses are not so much excited about the stock market, but simply totally asleep like they were last August before that dump.

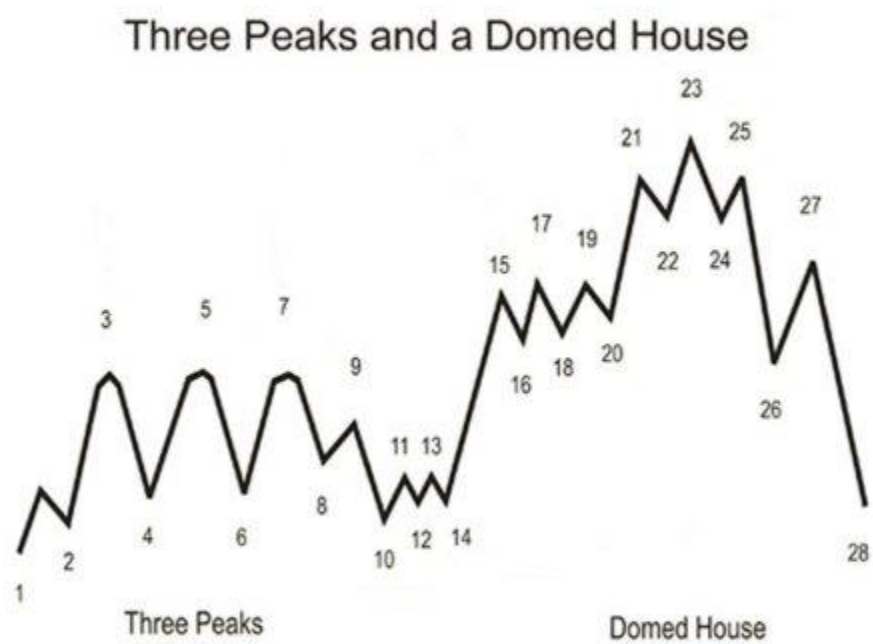
So yes I am betting against some stocks and got some ETF’s that will profit if the market drops, but I am also long more than I am short. I am operating more like a hedge fund than the typical stock market player who just bets on one thing and prays that it works for him and has fun until it doesn’t.




One thing that is starting to happen with the S&P 500 is that the daily Bollinger Bands are starting to come together. The VIX has fell below 12 while the S&P 500 has been drifting for the past few weeks in a narrow range with resistance around 2175 and support at 2150. When that happens when a range is broken a new trend usually begins for a few weeks. Yesterday it closed below it to suggest that the market is now going to decline.

This range began a few weeks ago after the market surged to a new high. So if it does stall out that will have turned out to be a false breakout that trapped buyers and lulled everyone asleep.

Interestingly there is a historical technical pattern called the "Three Tops and a Dome" pattern that is similar to what is happening now. This happened a few times with the DOW to mark the start of big bear markets in the last 100 years. In it the DOW would make three tops to breakout of and then just go sideways in a range for several weeks. When it fell below that range it would then slowly drop for a few weeks, have a weak bounce, and then go into a bear market collapse.




The pattern is like what you see above. If you want to see historical examples of it go here:

http://thepatternsite.com/3peaksdome.html

Now I do not really make investing decisions based on patterns like this and the stock market has not traded like an exact duplicate of this pattern, but what the S&P 500 has formed over the past sixteen months is similar. And that is a final potential false breakout that forms a top.

So the real question we need to ask ourselves is if this breakout actually represents a significant price top, because if it does we all need to make sure we will not suffer when the subsequent drop comes and if we want we can actually profit from it.

There is a way to answer that with the indicator I am going to show you. When a market makes a big top what tends to happen is that individual stocks fall faster than the market averages. More stocks act weaker than the averages do. They fall faster as a whole, because a few big cap strong stocks can hold the averages up.

For instance in the DOW stocks like MMM and V have been able to rally strong this year to hold the DOW up while WMT, IBM, and AAPL have traded so badly.

With the Nasdaq biotech stocks have been creamed this year, but the Nasdaq 100 has been held up with things such as FB, NVDA, GOOG, and Amazon.

Of course stocks as a whole did rebound hard with the market averages during the rally that started in February to cause the advance decline line to go up. Although as you know if you have listened to interviews I have done with Ike Iossif the advance/decline line with volume added to it has not done so well.

Yesterday something interesting happened. The S&P 500 fell 0.64%. 410 stocks in the S&P 500 dropped and more than 300 of them fell more than 0.64%. In fact over 48 stocks fell over 3%. In the Nasdaq 100 only 12 stocks went green when the Nasdaq 100 itself only fell 0.76%. One third of the stocks fell twice as much as the index.

So individual stocks simply traded much worse than the averages did yesterday in a dramatic fashion. Now one day does not make a trend necessarily, but it’s a warning sign and if these stock market internals continue down then the stock market averages will follow for a Fall stock market smash.

A simple indicator to track the internals of the stock market are the percentage of stocks above their 50 and 200-day moving averages.

When this indicator turns down it means fewer stocks are above these moving averages. If this happens it means that there is internal disintegration going on in the stock market.

When the stock market is going up or sideways and this happens it means that a drop is coming and if the market is falling and this is happening it is a confirmation that the drop is real.

This is what these indicators look like now. The chart on the left is the percentage of stocks in the S&P 500 above their 50-day moving averages and the one on the right is the 200-day moving averages.



Take a look at what these indicators did in November and December, because they gave a clear warning that the stock market was going to dump in January. I pointed this out right at the end of the year and the market dumped. It didn't dump, because I made a prediction and was right, but because these indicators told us it was going to happen.

A really good example of this happened in September of 2014. The market rallied strong in August of that year and went sideways in September. At the same time these internals rapidly collapsed and the market followed with a hard October dump.

So stock market bulls believe that the stock market is going to go to new highs and have a big surge. Many are calling for the S&P 500 to go to 2250 now or higher. For that to happen then what we are seeing is a pause and consolidation following the post-BREXIT breakout rally. The market internals will hold up if this is the case and the market will breakout by the end of this month or sometime next month.

If the stock market bulls are WRONG though then the internals will continue to decline. You do not need to rely on other people's predictions to know what is going to happen. All you need to do is watch these indicators. If you look at them at the end of this month and they have been in decline from here to then you will know that the market is going to drop.

You can go to the website stockcharts.com a few weeks from now and see what has happened.

All you will need to do there is type in these symbols:

$SPXA200R

$SPXA50R

Now I want to make a few more points. First of all often before a big bear market drop gets going you see one or two high volume intensive drops going into it that everyone ignores. So for instance in 2007 that happened in February of that year and in August.

In 2000 that happened in March twice before the Nasdaq began to crumble in April.

Now the year 1929 is also interesting, because in 1929 the same thing happened in the spring. There was a big volume short-lived drop. The market continued higher after that for a few more months, but interestingly stock markets all over the world were falling in the summer and most world economies were in recession while the US economy was stalling out and corporate earnings were too.

But the stock market went up and ignored all of that and in fact was the only global stock market that went to a new high before the crash of 1929. The bubble bulls of today though do not know any of this, because they think we are in a new era that has abolished all stock market and economic cycles so they think there is nothing worth knowing about the past.

But this year this same thing has happened again. We saw two high volume drops this year. The first came in January and the second came in the two days of trading action after BREXIT. If you go look at a simple price and volume chart of the S&P 500 you'll see how big the selling volume was on those two BREXIT days.

At the same time US corporate earnings are posting quarterly declines again as a whole and are weak while valuations are high. Global markets around the globe have been in bear markets all year. There is bizarre action with bond yields and interest rates and the Fed cannot raise interest rates when saying they would.

Gold is soaring and acting as a safe haven and will simply continue to go up for the next few years.

So there are warning signs everywhere, but the S&P 500 briefly hit a new high a few weeks ago. That fact alone is all the US stock market investors are focused on and that event has put them all to sleep.

In 1929 all the problems were ignored until one day people woke up and began to sell. The market slowly came off of a high in a drop that sped up and became a crash.

I'm not saying the market is going to crash like 1929. What I am saying is that everyone is asleep. People fell asleep too in the summer of 2000 and in the summer of 2008.

You can watch these indicators though so you can keep awake and keep your hands on the wheels of your investment accounts.

You do not need to drive with your eyes shut and can take action to get out of the way of a bear attack.

I do not think the market is going to have a big crash or something tomorrow or next week. A topping process can take a few weeks to play out. We'd probably pullback a little more and have a little bounce or pause before a real drop gets going.

I will talk more about specifics in this weekend's private Power Investor update and have an interesting idea on some stocks to actually buy that can go up big due to ETF dynamics.

I just want to give the general public a key tool here that they can use themselves to see what is happening in the markets. I want people reading this to print this out and read it again at the end of this month and the start of September and see where things stand. They can then act or take this information to their investment advisor and make sure they are diversified and not in some crazy position where they are 100% invested in the stock market as advocated by so many on CNBC. They MUST be properly diversified. Watching this indicator may determine the future of your portfolio!

Disclaimer:

Michael Swanson the author of this reports owns 140,000 shares and 70,000 share warrants in IDM Mining that he can sell or exercise at any time after August 28, 2016 if he were to choose to do so.

You may get the impression from watching the financial media that all stocks go up forever. This is not true and in fact the majority of stocks end up going to zero eventually. All investments in stocks carry risk and go up and down from time to time and sometimes for no discernable reason at all. There is no such thing as free money. It takes work and risk to make money in the financial markets.

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