WallStreetWindow Monthly

Stock Market Barometer

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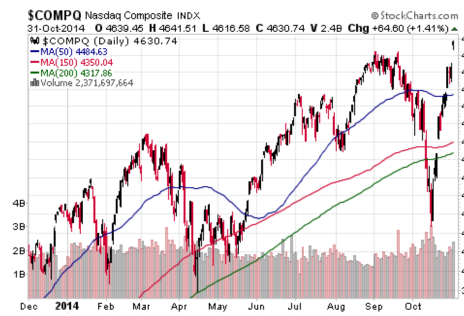
TREND ALERT — STAGE THREE TOP IN PROCESS

Panic Buying & Panic Selling—Mike Swanson (11/02/2014)



They say a picture is worth a thousand words. Well here are two charts on this page. We got the Nasdaq and the HUI mining stock index. What do you see?

I see pure panic. The Nasdaq and the US stock market as a whole got smashed in the first half of October and then rallied straight back up. I have never seen the US stock market trade like this before and cannot find a similar move for it going back in history. What we saw was a sharp correction and then people buying into panic. When you buy stocks you need to have some sort of strategy or method. You need to buy stocks using some sort of valuation metric or a technical pattern that makes sense, such as buying on a pullback or after a consolidation period. But the people who have been stocks in the past week are not doing this, because they are not waiting for pullbacks or good buy points. For whatever reason these buyers feel like they cannot do this and are therefore in a buying panic.

At the same time this past week we have seen a panic sell-off occur in mining stocks. There are now people calling to short them or to short gold. I myself got caught up in this panic and it has not been fun. Just as moves in the market have forced people to buy big drops can force people to sell. So that is what has happened to me in my mining stock positions. But I am now stepping back and ready to buy back at some point. There are specific things I'll be looking for in order to see that a real bottom is in. And I also plan on shorting the US stock market at some point when I believe it has topped out.

I have no idea when or at what price levels either of these things could happen at though. I have no way to predict that. I want to talk about something really important.

I have been playing the stock market game now for over 15 years and have seen many major turning points in various financial markets. Some of them I took big advantage of and others I missed. When I look back at my investing and everyone else's I realize that everyone is always caught up in the moment and is being forced to adjust to that. Very few people are able to have a long-term time frame. They say they do, but they don't, because they simply cannot.

You can. Any individual investor is able to do whatever he or she wants to do. But if you manage people's money (and there are people reading this who do) it is impossible, because you are dealing with people who only care about what is happening in the moment. Track records of success really do not matter. Oh they can help you attract money, but in the end they won't matter. You see if you run a hedge fund you can make money and beat the market ten years in a row and then lose 10% in a year the market goes up and lose so many investors that you are forced to shut down. The reality is people do not really care what you did in the past all they care about is what you are doing now.

People simply demand that money managers make money in up years and one cannot be cautious and risk missing out on a market gain. If you handle people's money and lose money they do not care if that happens when the stock market falls, but if you put them in cash and the market goes up they will take their money away from you.

The result is that the whole investment advisor world and money management world is forced to be bullish on the stock market all of the time no matter what.

If you are some expert specializing in some sector of the market or a specific market the same thing is true. If you turn bearish the followers will run off to hear someone tell them what they want to hear. So it's very difficult for someone talking about the markets or writing about them or investing people's money to be bullish on something and then change their views.

All of this means that rigid thinking dominates the financial markets. You get permabulls and permabears and typically what you see are people who hold one rigid view on a market or particular sector forever. That's why everyone on CNBC is simply bullish on the stock market all of the time no matter what with the exception of a few permabears they put on.

Now when it comes to individual investors the way they experience the financial markets is by watching CNBC, hearing these experts, and then seeing what the stock market and their account does on a day-by-day basis.

They obsess about the three major market averages. When they turn on CNBC typically they'll hear about some big gainer of the day. That creates the illusion that giant moves are happening all over the place even on a flat day and that a stock they own has the potential to explode higher for them at any moment. The problem is such illusions become dangerous in a topping market.

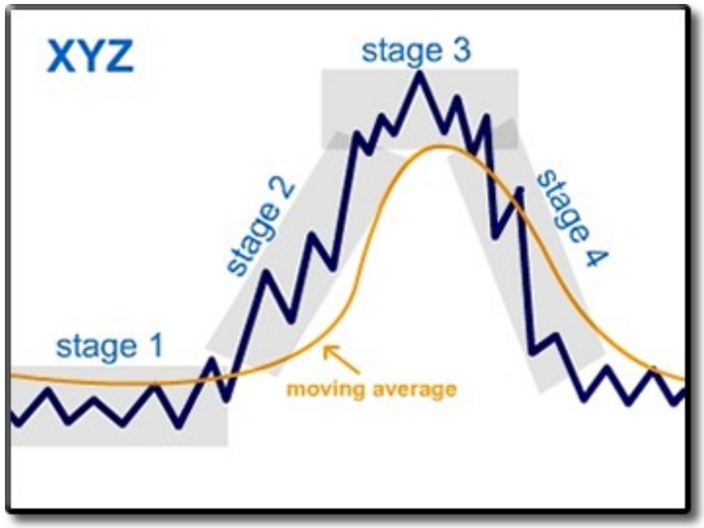
The point is it is easy to get caught up in some sort of tunnel vision when dealing with the financial markets. It is like someone walking in a forest and walking right up to a tree and staring at it for a few hours and claiming to know what is going on in the forest.

That is all good and fine for as long as the trend you are betting on goes your way. And trends can last for years. And the longer they go on the more people believe they are going to continue forever and the more tunnel vision they get. So on major market bottoms and before new bull markets begin almost everyone is bearish and at major tops almost everyone is bullish too.

What makes or breaks an investor, money manager, hedge fund manager, or anyone interacting with the financial markets is being able to adjust when major market turning points come. People like to talk about Warren Buffett as being a buy and hold investor, but Mr. Buffett had sold almost all of his stocks by around 1970 ahead of the giant 1974 bear market and was able to start investing on the bottom of it. He actually started his career by creating investment partnerships in the 1950's which were akin to hedge funds and made his billions thanks to 1974.

Getting in the start of one major market turning point like Warren Buffett did in the 1970's can make a career or build a fortune. George Soros and Jim Rogers got big in the 1970's in commodity investments. John Templeton had an investment partnership that he was running in the 1960's that he almost shut down, because he was lagging the stock market during that entire time. Then in the 1970's he beat the market by investing in Asian markets when the US stock market was in a secular bear market. It is that move that launched his big billion dollar career and he almost retired for good before it happened.

Getting ruined by one big bear market though can also knock people out of the game for good. That's what happened to millions of Americans

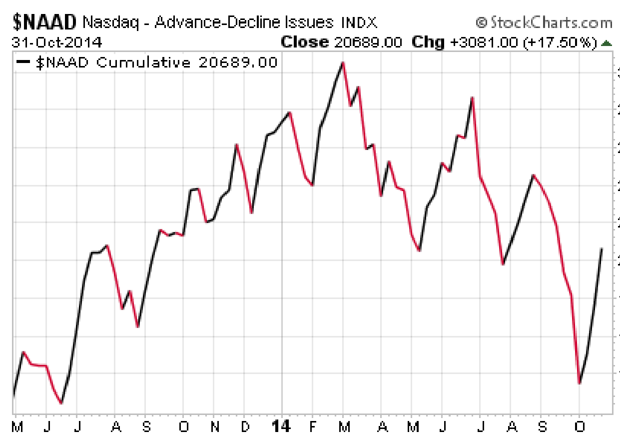


in 2008. Many people got out of the stock market forever after that bear market and will never get back in it. My Dad actually had a brokerage account playing the stock market in the 1980's and got smashed by the 1987 stock market crash and closed his account.

It is critical to identify market turning points. It is absolutely critical. And I believe such market turning points are what are ahead of us in the coming weeks and months when it comes to gold, mining stocks, and the US stock market.

The big drop and crazy rally in the US stock market is a sign that we are in a bear market or stage three topping process. You see bear markets bring crazy volatility with giant drops and fast and short-lived rallies.

Stage three tops come at the end of a bull market and before a bear market really gets going. That's really what is going on now.



Bull markets end when you get crazy valuation levels and insane investor sentiment.

As I have written many times this year that was the case when this year started.

But there is a third thing that happens as a bull market reaches its end and a stage three top plays out. And that is that the number of stocks and sectors participating in the market rallies diminishes. At the end few stocks in fact go up at all, but the market averages continue higher with the help of a few pet stocks or one or two sectors doing all of the lifting.

On this page are charts of the advance/decline line for the NYSE and the Nasdaq. It measures the number of stocks going up and going down. When it trends up more stocks are going up then down. You can see how for the Nasdaq the a/d line topped out in February and has been in a downtrend all year. The a/d line for the NYSE is also not confirming last week's market move. On the October drop many stocks and sectors got smashed and have barely rallied. That is what is contributing to the a/d line non-confirmation.

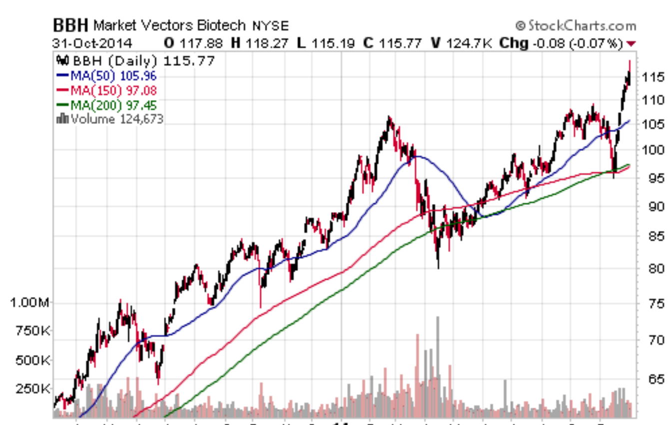
At the end of September I did a video with David Skarica in which we pointed out that a rapid deterioration in the internals of the stock market had taken place that would lead to a big drop. I said it was a sign that the bull market was over. Now if you are bullish now because you have seen last week's market rally I think what you should do is take all of this as a sign that the bull market is now on borrowed time.

It is a sign that we are going through a transition period that will be just as important as the tops of March of 2000 or October 2007 were when it is complete and lead to giant losses for those that fail to adapt.

There are certain things I'm looking for and have talked about in recent Power Investor reports to spot the end of this rally to bet against the stock market. But I am not sure when the rally will really roll-over and bring a drop. It could be by the end of this month or the end of the year. At this point all I am doing is watching various indicators and the sectors inside the market to see when things start to breakdown again like they did in September before the averages dumped.

Most people participating in the US stock market now that have been buying into it or trading it are doing so because they have to. Valuations are high and they are not buying, because they see good value, but because they must. Most stocks and sectors have lagged the market and the averages have been pushed higher by a few stocks and one magic sector in particular. That makes it difficult for mutual funds and hedge funds to beat the market. And now many cannot afford to miss out on a potential end of the year rally. So they had to buy last week in panic and will continue to buy until it ends.

With the exception of Facebook, and its stock just ran into trouble last week, almost every one of the highflyer hype stocks that did so well last year and early this year have gotten smashed and are performing very poorly now. Stocks like TSLA, GOOG, and NFLX are now broken. Retailers have gone down the toilet. What is making the market go up now are a few big cap stocks like MSFT and the biotech sector. The biotech sector is perfect for a market in which no one invests using valuations anymore, because biotech stocks are not bought by people on the basis of today's earnings, but the hope that they will invent the next wonder drug tomorrowx.



There is a biotech stock going

up now like crazy that is claiming to be in the process of creating a drug to cure dementia. I remember it, because about ten years ago it was claiming to be working on a vaccine for AIDS and was testing it on people in Asia, because it legally couldn't do the tests in the United States. It was a complete and total scam and it crashed back then. And now last week people were chasing it higher. I couldn't help but wonder if its current drug research is just another big scam too. Whether it is or not the people buying don't know anything about its past history or care. All they care about is buying something that is moving.

That's where we are in the stock market. We have a market internally breaking down and people chasing it up. Maybe you are daytrading and making money playing stocks. All most people are doing is focusing on what the averages are doing. What I'm going to do is continue to watch the internal action to see if what happened in September happens again.

If it does we'll know to watch out for another big decline and the potential completion of a stage three topping process and start of a full blown bear market.

It is easy for people to miss that when it happens. It is the forest and everyone is watching their favorite tree.

But right now it is critical to be able to keep as objective of a perspective as possible on things. You may be trading and making money in the market or be happy to see it go up, but if the market ends up going into a bear market it is the coming weeks and next few months that will be among one of the most important turning points we'll ever experience in the financial markets. So we have to be on top of things now more than ever.

And the same thing goes for the gold and mining stocks. They peaked out in 2011 and had a vicious decline that ended last year. After that they went sideways in a stage one base that I thought was leading to a new bull market, but have since gone lower and are going through another panic drop. They are crashing really.

Now when a market crashes after having already topped several years ago and gone through multiple bear drops it is usually something that actually happens towards the end of a bear market. Not all bear markets end with a meltdown, but sometimes they do.

And when they end like that everyone gives up and thinks the market is dead forever. That is what happened in Greece in 2012 when I bought Greek stocks. It had already fallen 90% over several years and then Greece and European markets fell over 20% in just a few weeks to bring a final crash bottom.

The bear market and crash bottom made for super cheap valuations. The same thing happened that year in shipping stocks. They fell so much that they were priced as if they were going bankrupt. And of course the shipping industry was not going to disappear.

And think back to the US stock market in first quarter of 2009. It had the crash of 2008, but in 2009 it went straight down again to make a March bottom.

Take a look at the chart on the right. The S&P 500 fell from 850 to 700 in just four weeks at the end of its last bear market for a drop of 18%.

The last time gold and mining stocks had a bear market that lasted for years was in the 1990's as you can see in the next chart. That one ended in the Fall of 2000 with a drop in the HUI from about 50 to 35 over the course of six weeks. It was a loss of about 30% in that short of an amount of time.

So even though I got a punch in the face from this big drop in mining stocks I am not throwing in the towel and saying they are dead forever or some new giant bear market is starting. To me this looks like the type of panic crash bottom that can come before a real bull market starts. I have no idea though where or when it will end though. All I can do is watch it closely for a sign that it has bottomed and prepare myself to do some buying then.

It could prove to finally be the turning point gold investors have been looking for and one that will prove to be the key moment when we look back on things a few years from now. The last big bottom was six years ago in 2008. Before that was back in 2000. So they don't happen that often in any financial market. Same goes with potential tops in the US stock market too.

There is one big point I am trying to make in this newsletter and I'll do it for you talking about gold.

It is one thing to own gold stocks and ride out a drop and then come out on top in a few years. To do it you gotta risk more losses though and be willing to ride through them. And it is another thing to have cash on hand ready to buy more or get into the sector for the first time if you have never done so before.

It is looking for a potential bottom that is the most important thing to do when it comes to gold. There are people who have shorted gold though and have made money in the past few weeks. They may be riding high right now, but they could be making the biggest mistake possible. You see if you short gold and hold gold short positions you'll likely end up looking for more drops and having the mentality that big bear attacks are coming. When you hold any position its easy to convince yourself the trend you are betting on is just going to continue.

This can easily lead to tunnel vision. I speak from my own experience from being short the US stock market in 2002 and 2008 and not adapting to the next bull market until well after the bottom. In my opinion gold shorting is a very dangerous thing to do now, because it can lead to one missing the turn up in gold when the next bull market arrives. And if one continues to hold a short position after the bottom then one can be destroyed by that position.

So gold shorting is very dangerous right now. Now take that idea and apply it to the stock market. If the stock market is in the process of going through a stage three top then you have to be on guard for that and open minded to that possibility as much as possible. It is not time to be on margin and is time to be cautious and reduce positions and get yourself in a position to be able to adapt and adjust.

That is what I'm focused on now. For me trying to trade stocks at the moment for quick gains is a distraction from what I think is really important and that is the development of these two key market turning points. These are turning points that I believe will lead to new trends that will last for the next few years and therefore cannot be missed. So that is what I'm focused on right now.

Stage three tops lead to panic buying and panic selling often comes at the end of bear markets and at the start of new bull markets in some final shakeout or selling climax. These actually become the most difficult and challenging times to make money in and there are moments when it is best to trade less and step back from things as much as you can so you won't miss what is happening and be objective as possible. That is how I feel right now. I think we are heading to some of the most important weeks and months in the US stock market and metals and mining stocks seen in years.

As for other world markets almost all of them are in bear markets now. They rolled over this summer and have not been rallying much at all the past two weeks. European markets are in a bear market again. So are the markets in South America. The EEM emerging markets ETF dumped hard on this drop and is still below its 150-day moving average. The world stock ETF GWL looks terrible. Only China really looks bullish now while the US looks like a stage three top to me and Japan has been forced higher. So the only way to buy and hold on the long side now is to forget about valuations and buy and hope money printing drives things up into a 1999 parabolic blow-off. That's a long-shot to bet on in my book.

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