FLASH REPORT DIGEST

Week of April 27, 2009

MON, APR 27, 2009 9:49 AM - STOPPED OUT ON DXD

Good Morning,

We just didn't like that DXD trade that much and sure enough, we were just stopped out at break even. Oh well. No pain.

The market moved form down 80 points to up 25.

We are running the Aussie software now and will get back to you on any changes.

TUE, APR 28, 2009 9:15 AM - WAIT FOR IT.....

Good Morning,

The market opened up much lower this morning on swine flu concerns as well as a report that both Citibank and Bank of America had failed the stress test (I will believe it when I see it) but consumer confidence numbers just came out much better than anticipated and stocks have turned positive as we write.

Case Schiller home index also came in a little better than expected with home prices down on average 19% so stocks are recovering.

Last night we told you that the Aussie model was getting more bearish but also advised waiting until later in the week to start to short the market. We have numerous economic reports ahead including GDP tomorrow, which could influence prices. And obviously, the stress tests look like a non event as the Citi and B of A news has been sidestepped.

So we still think an opportune time to start a DXD position is after a good rally which may be starting today.

This market is still shrugging off bad news and any market that does that consistently, as this one has for 7 weeks now, is telling you something. Technicians like to call it **"climbing a wall of worry"** and these types of markets are very hard to short. You need to be patient and wait for it.

That is what we recommend to you if you are inclined to be short. Patience and wait for it.

WED, APR 29, 2009 10:04 AM - B WAVES DEFINED.

Good Morning,

The leaks are springing once again in the government and results are starting to come out about the bank stress tests. The market loves what it is hearing as it is up 150 points this morning despite the worse than expected drop in GDP to -6.1 percent. How can this be happening? It is not rational.

Well the answer is simple. We are in a B wave. As we have said before, B waves are fooler waves. Let me quote from Elliott himself.**"Upward B waves are phonies**. They are sucker plays, bull traps, speculator' paradise, orgies of odd-lotter mentality. They are often emotional, rarely technically strong and virtually always doomed to complete retracement by wave C. If the analyst can easily say to himself, "There is something wrong with this market" chances are it's a B wave."

The upward correction of 1930 was a B wave within the 1929-1932 A-B-C zigzag decline (exactly the same pattern the Aussie software thinks we are in now). Robert Rhea describes the the emotional climate well in his book, "The Story of the Averages" written in 1934.

"Many observers took it to be a bull market signal. I can remember having shorted stocks early in December 1929, after having completed a satisfactory short position in October. When the slow but steady advance of

January and February carried above the previous high, I became panicky and covered at considerable loss. I forgot the that the rally might normally be expected to retrace possibly 66 per cent of the 1929 downswing. Nearly everyone was proclaiming a new bull market. Services were extremely bullish and the upside volume was running higher than at the peak in 1929."

B waves are always very hard to short and I can tell you, it will be very hard emotionally to short the market and buy the DXD as we near the top. All you read and hear from the government and the analysts will be telling you to buy stocks not sell them. All your friends will be telling you to buy. News will be negative and yet markets will rise.

It is human arrogance that we always think we know more than the next person. Or we are smarter than the markets. All of the people who told us that we would not go into recession, that home prices would never fall are now telling us that things are looking good. That the worst is over.

And for a while, people believe them because they need to. People can only take so much pessimism and negative news and thoughts before they say, "enough is enough". And hence, you get a B wave. This is what we are seeing now.

But Wave C lies just ahead.

Let me share with you what Elliott wrote about C waves.

"Declining C waves are usually devastating in their destruction. They are third waves and have most of the properties of third waves. It is during this decline that there is virtually no place to hide except cash. The illusions held throughout waves A and B tend to evaporate and fear takes over. C waves are persistent and broad. 1930 to 1932 was a C wave."

CONCLUSION

As we have said all along, we think the market is still in the B wave. As overlapping and crazy and irrational as this market has been, this in itself tells us we are still in B.

How will we know we are in C? I think it will be unmistakable. You will see and feel an undeniable shift in market movement and mood. The bad news will become bad again and fear will start to reassert itself. The feeling of hope will diminish.

So enjoy the ride for a while longer. We will let you know if the Aussie ratings are changing after we run our morning scan.

Wed, Apr 29, 2009 1:30 pm - Fed makes announcement

The FED has decided to leave interest rates unchanged....no surprise, but the real surprise to us is that they also decided to not increase the amount of money used to buy bonds. We thought that would be expanded from $300 billion to $600 billion but the FED left it alone.

The FED hinted that the bottom was in for the recession saying that they are starting to see signs of stability and consumer buying that was not there last month. This helped stocks hold their rally.

This has caused a pretty good size sell-off in the bond market as the 10 year yield soared to 3.08% and the 30 year moved over the 4 % level to 4.02%.**The TBT moved over $49 on the news**.

The stock market was up 190 points before the announcement and is now up 177 so no real movement there. We think the market could really zoom higher in the last hour given no action by the FED. We thought if the FED increased their bond buying, it would cause a sell off in stocks.

So bottom line, no real change at all in FED policy. But they are hinting that things are getting better and the worst is behind us and stock bulls love that news. Up 350 by the close?

THU, APR 30, 2009 10:15 AM – AUSSIE UPDATE

Good Morning,

The Aussie has changed its Elliott counts this morning and is looking at a target of 902 to 929 in the S&P 500 which is a little higher than before.

The most important reading is the rating of the pattern which moved up to 351 which is a solid rating.

It examined over 20 million patterns and found matches on only 5,224 so we consider this a pretty good projection.

So hold off on the DXDs until we see the S&P 500 move at minimum into the 902 price zone, which given today's move is not far away.

THU, APR 30, 2009 1:31 PM - INFLATION AND THE STRESS TEST

Good Morning,

We were on a conference call with Jim Bianco, from Bianco Research and Jim was talking about the credit crisis as well as the outlook for inflation. He also discussed the coming results of the bank stress test.

Jim Bianco not only has been consistently right about analyzing this crisis but is a very low-key calm guy. He is not an alarmist and does his work, presents it brilliantly and offers conclusions, that over the past 2 1/2 years we have been research partners, have been "dead on". He is a bond/credit guy and we have said before, the bond traders have always been not only right about foreseeing this crisis, but way ahead of the crowd.

We pay attention to Jim's research and we use it a great deal in our FLASH REPORTS.

We wanted to highlight a couple of major points that Jim made.

We feel that Jim's fundamental scenario could become the background for Wave C that we are expecting.

First off, the world-wide financial system so far has lost $1.346 trillion dollars. They have raised capital to the tune of $1.114 trillion.

The "shadow banking" system is all but dead at this point.

This is significant in that the securitization market played such a huge role in absorbing the massive amount of debt being piled up over the past decade. Total ABS (Asset Backed Securities) Issuance peaked in June 2008 when in that month alone, $164 billion in asset backed securities were issued. Last month in March, there were $10 billion issued and these were the first deals done in some months.

Since 2002, total securitization securities as measured in dollars, (which includes Agency and GSE_Backed Mortgage Pools and all ABS securities such as credit cards and student and car loans), surpassed all bank loans and advances(including consumer loans) and by last year, had grown to represent over $1 trillion more in lending than traditional bank type loans.

In other words, total bank lending was way before securitization lending.

The fact that this market has totally evaporated is a huge worry to Bianco. There is a tremendous hole in the lending process that banks and other lenders could rely on to "lay off debt".It is far more difficult to lend money with this market non existent. Bank lending has actually increased by 2% year-over-year, which is unusual in a severe recession. So banks ARE lending money. It is the death of the securitization markets that is responsible for the total fall in lending.

Bianco also pointed out as have in a FLASH from last week, that this government has passed out more stimulus than at any other time in history. So far this government has given out funds that represent 29.9% of GDP. During the entire Great Depression, FDR's stimulus was only 8.3% of GDP.

What is even more stunning is when you compare this to Japan's "lost decade". Many people are saying that what the U.S. is doing now is comparable to what Japan did in the fall of 2000. So far, the U.S. isn't even on the same page as Japan and we do not mean that in a good way.

In Sept 2000 Japan started their stimulus program to bail out their banks, resuscitate real estate prices and grow their economy. They started with a program that was about 4% of their GDP.**They continued to stimulate for the next four years and by March 2004, they had a pushed enough money into their system that represented 29.5% of their GDP.** It took Japan 4 years to get to that 29% number and it has taken the U.S 8 months!**Add to this fact that Japan ENDED their stimulus program (because it failed miserably) with it costing 29% of GDP.** The U.S. is just STARTING our journey and we are already at that 29% number.

The IMF has estimated that before this economic crisis is over, the world will experience over $4 trillion in losses. Other prominent economists are estimating $6 to $7 trillion in losses. We think that we have a long way to go yet before this crisis has passed. With maybe $3 trillion more in losses ahead, we do know that more stimulus will be needed and that 29% figure is going to rise rather dramatically. And as with Japan, we have our doubts that in the long run, it will even work.

Bianco pointed out that the deficit has gone parabolic. In April, 2004 the deficit stood at $454 billion dollars. Under George W Bush's last four year in office, the deficit actually shrank despite the Iraq war and by May 2007 stood at only $169 billion. As the financial crisis took hold and the government bailouts began, as Bush left office it was back at $450 billion.

Now, as of March 2009, it stands at $1.081 trillion and with the passage of current legislation, the GAO is estimating that by Sept '09, it will be at $1.845 trillion.

Bianco estimated that to reverse this with taxes alone, every person working would have to be taxed at a 175% tax rate. Obviously, raising taxes is not the answer but we still believe taxes will have to be raised and not by a small amount. **As an aside, talk to your tax advisor and financial advisor about selling all stocks with long term gains BEFORE year end to take advantage of the 15% rate. We will never see a rate this low in our life times. It is your last chance.**

Obviously, the FED can not lower interest rates any longer. With the FED Funds rate effectively at zero now, they have no room to go lower. As a matter of fact, according to the Taylor rule, which is a monetary policy rule that stipulates how much a central bank should change interest rates in response to changes in GDP and inflation, **the FED Funds rate should be at a NEGATIVE 5% right now. The head economist at Goldman Sachs thinks it should be at a NEGATIVE 8%.**

Obviously we can not go negative so what can the FED do to stimulate the economy WITHOUT interest rates as a tool? The answer is to print money and use quantitative easing, the printing of money to buy our own debt, as a quasi easing policy.

Using back of the envelope math, Bianco figured how much money the government needs to print in order to get the Taylor Rule interest rate back to zero. His answer is about $7 trillion dollars. Goldman is saying it is closer to $10 trillion. Bill Gross, from PIMCO has stated he thinks it is closer to $3 trillion and today PIMCO announced it is favoring European Bonds as compared to U.S bonds due to clearer policy transparency from their economic leaders. He seems pretty confused by U.S. Treasury policy.

No mater whose number becomes reality, the point here is that there is a tremendous amount of stimulus still to come. And to us, that spells tremendous inflation down the road and stunningly higher interest rates.

One thing to be clear about and that is the FED has only one way to stimulate the economy and that is with new government programs and bail-outs. They have no where else to go. Yesterday, the bond market sold off because the FED did not announce a new bond buyback program, therefore bonds took it as the FED not easing. There are $2.3 trillion in Treasury auctions ahead of us through December. With losses mounting by year end, we come up with two conclusions. A much higher deficit and a lot more government programs.

Bianco also talked about foreign purchases of U.S Treasuries and they are definitely shrinking but not in the way you may think and this is a HUGELY IMPORTANT POINT. You can not think of their purchases in simple dollar amounts because by looking at that statistic, you would think they are holding in there and actually buying a little more than before.

You need to look at this is a percentage of what the U.S needs to fund our budget. If foreign purchase as a percentage of our budget is shrinking, then we have to find other sources to make up the difference. **And it is shrinking at a dramatic rate and the biggest reason why is because or budget and deficit rate of growth is far outpacing the foreigners rate of purchase.**

Look at it this way. In Sept 2007, foreign purchases of Treasuries topped out at 260%. What this means is that foreign purchases covered 260% of our budget total. Ideally, taxes should cover 100% of the budget to have it balanced but we didn't need taxes to cover our budget. Foreigners buying our bonds covered it plus some. Since 1995, foreign purchases of Treasury debt covered the entire budget and that is why politicians could talk about lowering taxes etc because we had a good deal of funding help from overseas.

That percentage started falling since Sept 2007 and today, foreign purchases of U.S Treasury Issuance only covers 24% of the budget. China, which peaked at 27% coverage in March 2007, is now down to 6%.

The point here is that as our budget and debt rise dramatically, while foreigners are still buying, they are not keeping pace with our spending. A marathon runner who leads the race at the 20 mile mark and then starts slowing down is still running, but she is not keeping pace like she once did. The foreigners are still buying but are falling off pace and again, this is another huge reason Bianco thinks the deficit and losses will continue to rise dramatically.

Bianco also points out that we are not the only country doing this. Every country in the world is printing money and stimulating their economies so the competition for debt as well as the magnitude of the deficits all over the world will continue to rise.

And finally the bank stress test coming next week. Bianco thinks the losses incurred by the banks that need to raise capital will amount to enough that he is calling it TARP 2.0. Jim believes that the government will need to recapitalize banks to the tune of $200 to $300 billion by the time all is said and done and the only question is where will they get the money. Bianco thinks that the government could go after the bond holders, ala GM and recapitalize by converting bonds and preferreds to common and therefore nationalize the banks without the title. The government would then be the majority shareholder of the bank.

But Bianco also thinks that the "most adverse" scenarios laid out in the stress test are not adverse enough (he points out the most adverse unemployment rate was 9% in 2009 and we are already basically there now) and if things get worse, the bail-out numbers will just keep increasing.

Conclusion.

After listening to Jim Bianco we can only have one conclusion and that this crisis is far from over. Jim did not even discuss the commercial real estate, mortgage and credit card default problems but add all those in there and there is nothing but more losses in the future. Bianco pointed out that the financial system is just too small for the amount of losses being incurred. The loss of the securitization market is huge and TALF and PPIP are complete failures.

We have always from the beginning that the one consistent thing the government has done throughout this crisis is to underestimate the losses. In our view, that continues and with the small financial system trying to absorb huge and always unexpected losses, the government has become the "plug" in the form of government spending to stop the leak.

This administration and Congress have already proved that they agree with the Keynesian economic model that the more government spends in a crisis, the better. And they have the votes to get anything passed that they want. Whether you agree with that economic theory or not, the conclusion is the same. It is non-political. The government believes the Keynesian model and therefore there will a good amount of new spending ahead, a large amount of new government programs and a vast increase in the deficit.

In our view, this can only end one way and that is with massive inflation and historically high interest rates. As Bianco said, if you believe that the stock market lows and economic lows were put in on March 6th, then higher interest rates are coming soon. We have said it before, we think shorting bonds will be the trade of a lifetime.

After hearing Jim Bianco today, we are more convinced than ever.

Thu, Apr 30, 2009 2:50 pm - Swine Flu...a sign of the times

Good Afternoon,

We are hearing from our international research partner while the Swine Flu news continues to dominate, there is now doubt not only about how many actual cases are out there, but also how lethal it actually is.

Seems the core of the problem is that the data thus far could be COMPLETELY UNRELIABLE. It seems that much of the testing used so far to identify the presence of the specific new A(H1N1) strain generated many FALSE POSITIVES. And because of this faulty data, the testing is now going back to the beginning. Until this new testing is completed, it is impossible to say how lethal this flu strain is. **Have we seen this movie before?**

This is so typical of today's government as well as financial markets.

The thing to do these days is to act BEFORE you get reliable information. To spend billions putting into place precautions and emergency procedures **BEFORE** you analyze the data. To cause the airlines and cruise ships and hotel business massive losses and cancellations **BEFORE** you analyze the data. To rev up the press and politicians and worldwide health organizations **BEFORE** you analyze the data.

Well now the data has been analyzed and it is bogus data. The entire world has spent billions in precautions and created millions in losses to businesses, all based on bogus data. What if the new data proves that this is just a more virulent form of the flu and is not Swine Flu or a new deadly strain.

I **hope it is not and this was all just another post Katrina over reaction by government officials and elected leaders. I would prefer that outcome to a true Pandemic outbreak!**

But our point is that this Swine Flu reaction by government is no different than their reactions to the economic crisis. Do not dare analyze or more important verify the validity of the data. **Just react BEFORE you have all the facts and are certain of your conclusions.**.

Webster defines "panic" as being overcome by sudden irrational fear. It seems we are all panicking here and doing it without knowing any of the facts. **Just like trading!**

No, more importantly, just like a B wave!!!

Fri, May 01, 2009 11:33 am - PDF Attached RSI weakens

Good Morning,

The attached PDF FLASH is something we wanted to pass on to you. It is a chart put together by Peter Beuttell, a very good Elliottician as well as market chartest. It lays out what we are seeing now, just not on the Relative Strength Indicator, but other price oscillators such as simple stochastics.

The bottom line here is that we are seeing plenty of technical non confirmations of the high put in yesterday and we think a decline is near for stocks.

Is it Wave C starting. Probably not. It is too early to even guess on that one. What it probably will be is a decline within a rising Wave B and could set the stage for the next rally with B and this rally could mark the end of the move higher.

So be on the lookout for a downdraft...maybe 200 to 300 points.

Stay tuned.

See Attached PDF