



# PHIL'S STOCK WORLD

HIGH FINANCE FOR REAL PEOPLE | FUN AND PROFITS

Dow Jones	11,382 (+2.6%)
S&P 500	1,225 (+3.0%)
NASDAQ	2,591 (+2.2%)
NYSE	7,752 (+3.4%)
Russell 2000	757 (+3.4%)
Oil	89.33 (+6.5%)
Gold	1,413 (+3.7%)

## THIS WEEK'S NEWSLETTER:

**MONDAY MARKET MOVEMENT - "LIKE MOTHS TO A FLAME!"**  
Two POMO's on one day!

**TIMID TUESDAY - IS IT SAFE?**  
Irish bond yields climb over 9%

**WHIPSAW WEDNESDAY - DOLLAR DOWN, MARKET UP ON RECORD STIMULUS**  
Markets take off as the Dollar declines

**THURSDAY THRUST - JUST BUY THE F'ING DIPS!**  
But is the prevailing wisdom a viable investing strategy?

**FRIDAY ALREADY? WHAT NEXT?**  
The Non-Farm Payroll numbers disappoint

**THE WEEK AHEAD**

**BONUS SECTION: WEDNESDAY'S BEIGE BOOK WITH PHIL'S COMMENTS**

Last week we discussed Phil's "Beta 3" pattern which we've been tracking for weeks now (chart on p. 2). We questioned whether the Beta 3 pattern would hold up or whether the Federal Reserve's Permanent Open Market Operations ("POMO") force would override it to weaken the Dollar and propel equities upwards. This week, our question was answered, as the Beta 3 pattern got blown to flinders. In last week's newsletter we wrote "every day next week is going to be a POMO day, with a total of approximately \$39 Bn worth of purchases to be made during the week" and it turned out to be \$40Bn. Our explanation for the break out in stocks, rather than a reversal suggested by the Beta 3 pattern, is simple -- POMO.

The Federal Reserve's massive "money printing" operation results in billions of POMO dollars being funneled to the Primary Dealers (banks such as Goldman Sachs and JP Morgan). The POMO liquidity seems to be making its way into equities via the Primary Dealers while simultaneously trashing the dollar. The result is a strong rally in the markets along with a resumed devaluation of the U.S. Dollar.

Early in the week, political tensions and concerns about the Irish banking crisis continued to plague the European Union. [Over 50,000 people marched in Dublin on Saturday, November 27th](#) protesting the Irish government's plan to impose \$20 Bn Dollar's worth of austerity measures to reduce the budget deficit. This drove investors to seek the relative safety of the Dollar, and the strength in the Dollar was reflected in the weakness in U.S. equity markets. However, the concerns vanished by Wednesday, after the European Central Bank (ECB) [President Jean- Claude Trichet addressed the European Parliament's Committee on Economic and Monetary Affairs.](#)

Trichet's comments were interpreted to [suggest that the ECB was now willing to consider making additional bond purchases](#) to help resolve the eurozone crisis. His previously stated view was that making additional bond purchases was "off the table." Trichet's comments calmed investors' concerns, leading to a rally in the Euro. The Dollar dropped sharply and continued dropping through Friday while the stock market rallied strongly through the end of the week.

In our opinion, Trichet's comments may have strengthened the Euro at the expense of the Dollar, but the primary force propelling the market higher this week was the POMO factor.

A shock and awe rally on Wednesday was followed by additional, smaller rallies on Thursday and Friday that pushed the markets even higher. A relatively positive Beige Book report from the Fed, a strong ADP jobs report (Automatic Data Processing, Inc. a company that processes payrolls for thousands of businesses), and strong retail sales figures all helped to propel the markets higher.

More significantly, and evident from Friday's trading after dismal Non-Farm Payroll numbers were reported by the Bureau of Labor Statistics the market continued its rally mission and the dollar kept on dropping. We've been writing for weeks about what a powerful force POMO is, and here it is in its first major week of operations. It is powerful enough to break Beta 3 and powerful enough to overcome bad jobs number that would usually send the markets tumbling down.

The strong negative correlation between the stock market indexes and the dollar persisted, as this week's UUP (proxy for the Dollar) versus INDU chart maintained its "when the Dollar pops the markets drops" pattern. Movement in the Dollar is subject to multiple factors, but the primary forces are the European debt crisis and the Federal



Reserve's implementation of a second round of quantitative easing, aka "QE2", via the mechanism of POMO.

Phil's Stock World has repeatedly expressed a preference for cash since October. While we've discussed multiple trade ideas since then, our preferred place to preserve wealth during the last few weeks has been in U.S. Dollars. On Wednesday, Bloomberg ran an article titled "Dollar Defying Skeptics as Best-Returning Asset", which stated that "The dollar proved to be last month's best investment, beating stocks, bonds and commodities, confounding officials around the world who said Federal Reserve policies would debase the U.S. currency." It's nice to see that Bloomberg is agreeing with us. However, with the latest example of the POMO force, we have to wonder if the Dollar has made its last show of strength for immediate future.



Not surprisingly, weakness in the Dollar emerged simultaneously with the stock market staged its massive rally on Wednesday. The indexes ended the week up -- 2.2% for the Nas, 2.6% for the Dow and 3.0% for the S&P. Again, as you can clearly see in our UUP vs. INDU chart, as the Dollar dropped the markets rose.

# Monday Market Movement - "Like Moths to a Flame!"



"Investors are drawn to China like moths to a flame" - Neil Woodford.

Mr. Woodford, Head of Investment with Invesco Perpetual, has expressed serious concerns about China's growth story, saying "I do not deny that in the long term an economy like China will grow much more rapidly than the West. But I think one has to be very careful about correlating growth necessarily with economic opportunity, and opportunity to make money."

Mr. Woodford's concerns come as new reports show that food prices in China have gone up 10.1% in the last year, a level of inflation not seen since 2007, amid mounting

concerns that China's economy is overheating. Furthermore, many Chinese feel that those official inflation estimates do not represent actual inflationary pressures. Li Mingwei, a shopkeeper at Xinfadi, a wholesale food market in Beijing, said "Ten per cent? That's a joke, the price of leeks has doubled from last year; cooking oil is up by 25pc since the summer and rice by even more. Everything is going up."

As *The Globe and Mail* reported, "The rising cost of food has sparked grumbling in the grocery aisles and growing concern among those who govern China's 1.3 billion people. With most families spending half their income on food, the ruling Communist Party has long kept a close watch on food prices, viewing them as a possible trigger for unrest."

While authorities in China are worried about potential civil unrest, Europe is dealing with multiple outbreaks of very active civil unrest, including general strikes and mass protests. Ireland's continuing fiscal crisis and proposed bailout are spurring public outrage, as 50,000 marched in Dublin protesting against spending cuts and tax increases to be implemented as part of a package of austerity measures accompanying the \$130Bn bailout of Irish banks.

Ireland had very little public debt before their banks went bust. Now the Irish public is being asked to agree to a bailout that amounts to roughly half of their annual GDP. Phil made the analogy, "This would be like forcing the US to borrow \$8Tn at 7% - it would wreck our country and we wouldn't stand for it - why should we expect the Irish people to roll over and play dead for the EU?"

European markets had a rough day Monday, dropping about 2% and closing at the day's lows. Floating \$130Bn to Ireland in bailout money

“I honestly cannot tell you who is the more vile, despicable villain in this debacle. Is it the banks, who started this mess with their idiotic lending practices? Is it the lobbyists and lawmakers, who turned Ireland into a tax haven for EU Corporations and destroyed the economy by funneling tax breaks to the wealthy? Is it the Irish Government, who stupidly bailed out the failing banks with guarantees that put the nation on the hook for more money than their entire GDP? Is it the bondholders, who drove up the cost of financing Ireland's newfound debt to levels that threatened to break the National Bank? Or is it the EU & IMF, who are effectively playing the role of loan sharks, borrowing \$100Bn at 2.5% and forcing Ireland to borrow it back from them at 5.8%?”

“Perhaps that's the answer, this is all just a gigantic global shakedown where the bigger, more liquid nations who can still borrow cheaply, are making a little spare change by forcing smaller, weaker nations to go into debt at much higher rates.” - Phil

apparently wasn't enough to counter the prevailing gloom caused by the continuing Euro crisis.

Monday was also notable for being a double POMO (Permanent Open Market Operation) day. This on a week where every single day has a POMO happening, with a total of approximately \$40Bn worth of purchases to be made by Friday. The very necessity of a second round of "quantitative easing" helps to make the case that the U.S. economy is not exactly booming.

Phil, in his daily posting, reiterated his current preference for being in CASH and went on to talk about a quick day-trade idea involving DIA. The history of Phil's DIA trade from Member's Chat on Monday is in the box on the right, and a chart showing how it worked out is below.

We are conducting our annual "Holiday Shopping Survey" on the Phil's Stock World website for the purpose of providing a non-biased, alternative source of information about how the economy is doing in various markets across the country. We'll be taking a close look at what our Members have to say about what they are seeing at their local malls and outlet stores as this holiday shopping season unfolds.

DIA Trade Idea history from Inside Chat:

At 9:46 am Phil posted in Member's Chat about the Dollar and his market targets, then wrote "These are our SLOW-moving indicators and should be taken very seriously. Now we lost the NYSE unless they bounce here but let's bet that bounce using Dow 11,000 as a stop and grabbing the DIA \$112 calls for .94. 20 of those are \$1,880 and that's a good play for the 1050 Portfolio, looking to make our first \$500 with a .13 gain or stopping out with a \$380 loss (.75) or less under the 11,000 line."

At 9:54 am Phil then said "Looks like those DIA calls are not going to work so a quick dime loss is prudent to take off and we can reload if we recover."

At 11:12 am Phil added "OK - Time for a day-trading note. So now I regret not waiting for .75 on those DIA \$112 calls and it looks like we've got another shot at .75. I'm watching the dollar (which is holding at 81.1) and oil (rejected at 84.50) and copper (having trouble holding \$3.75) for more bullish signs to get back in on the bull side but not finding them yet so a very tentative entry with tight stops (.70)... keep in mind what we're actually doing here is spending \$150 (our loss at .70) to take a 2nd swing at the trade we already blew \$200 on."

At 3:29 Phil posted "That's cash on the DIA \$112s at \$1.05 (.05 trailing)" - This closed the trade idea while it was up .30 from .75



## Timid Tuesday - Is it Safe?



“Is it safe?” Bonds, stocks, commodities, even currencies? Are any of those safe? This is the question Phil asked in Tuesday’s article. The uncertainty in global markets, and in particular the Irish crisis, is fueling a flight to safety that is largely benefiting the Dollar.

The Irish crisis has gotten a lot of attention, but the sheer magnitude of the size of the crisis and its implications are not as well understood as they should be. [Martin Weiss has pointed out what the global markets are telling us about the debt crisis](#), by way of the current rates being charged for insuring Irish debt. As of Tuesday the cost of insuring €10 million of 5-year Irish government bonds has skyrocketed to €600k.

By way of comparison, that’s 55% more than it cost for the same insurance shortly after the failure of Lehman Brothers in 2008, a time of extreme financial stress and instability. It’s 50% more than the cost of insuring the equivalent in Greek debt earlier this year. It’s at least double the cost of insuring the debt of countries like Romania, Lebanon, Latvia or even Iceland.

### Inside Chat:

Phil said “Harmony Gold Mining (HMY) is still a good deal at \$11.25 if you want to play gold long-term and you can sell the 2013 \$12.50 calls for \$2.50 and the \$10 puts for \$2 and that’s net \$6.75/8.38 with a 100% gain in 25 months if called away at \$12.50 so nice upside inflation protection and not a bad stock to own long-term if it’s put to you at \$8.38.”

*At the end of the week, the 2013 HMY \$12.50 Calls were 2.70 and the 2013 HMY Puts were \$1.40, for a net gain of .40 to date on the options. HMY stock is \$12.41 so that’s another \$1.16 gain, that’s a total of \$1.56 off \$6.75 invested (23% in 3 days)!*

But even more shocking is the fact that Tuesday’s price for Irish default insurance is even higher than it was *before* the EU and IMF announced their intent to engineer a bailout for Ireland. The yield on Ireland’s 10-year government bond climbed over a full percentage point over the last week, up to 9.17% on Tuesday. As Weiss said, “*That extra interest cost alone threatens to eat up a big chunk of the bailout money. The authorities had hoped - and prayed - that their earlier bailout of Greece would have been enough to contain the cancer. Instead, it has metastasized - not only to Ireland, but also to Spain and Portugal.*”

The continuing financial crisis in Europe made the Dollar more attractive to investors. The U.S. Dollar went from a low of 80.8 early Tuesday to a high of 81.4 by late morning, a significant move for such a short time frame. The markets declined Tuesday, with the Dow down 0.42% to 11,006, the S&P down 0.61% to 1,181 and the Nas down 1.07% to 2,498.



## Whipsaw Wednesday - Dollar Down, Market Up on Record Stimulus

Wednesday saw a powerful rally in the markets, with the Dow up 2.26% to 11,255, the S&P up 2.15% to 1,206 and the Nas up 2.05% to 2,549. The most commonly cited reasons for the rally were the [Fed's Beige Book](#) and [ADP's jobs numbers](#). The Dollar declined from Tuesday's high of 81.4 down to a low of 80.5 around noon on Wednesday, a 1.1% drop in only 24 hours.

Again we see the correlation between the Dollar and the Markets, but there were other forces at play in Wednesday's rally. As Phil noted, *"The big pump in Europe today was caused by what is being considered softening language in Jean-Claude Trichet's testimony to the Euro Parliament, which suggests future bond purchase decisions were 'on-going.'"* This is a dramatic change in Trichet's position. *"Trichet has that Greenspan quality where the markets move based on the slightest nuance in his statements."* The Euro went up after Trichet's testimony, the Dollar went down, and the markets rallied.

Another factor moving the markets was reported by Tyler Durden of Zero Hedge, pointing out that [Goldman Sachs distributed an email to clients](#) reflecting a dramatic shift in its expectations, as they have changed their outlook on the US economy from bearish to bullish, saying it expects real GDP growth to average 2.7% for 2011.

Meanwhile, we continue to closely monitor our market watch levels, especially the "must hold" 10% levels and our breakout levels of Dow 11,500, S&P 1,220, Nasdaq 2,600, NYSE 7,750 and Russell 725. Phil re-opened his "10k to 50k Portfolio" (aka 1050P), which was up a virtual 160% when we lost interest in risk in early October. Since we've had success with our short-term trading we are going to try some ideas to see if is still possible to get to the original goal of \$50k by Jan 21st.

One short candidate for the 1050P is Netflix (NFLX). As Phil pointed out, its business model is based upon using huge amounts of inexpensive internet bandwidth to deliver movies to customers. Comcast decided to charge an additional fee for delivering Netflix's streaming movies to its customers who use Comcast's cable internet services, in order to compensate Comcast for the expense of delivering petabytes of content to end users.

Netflix and Level 3 Communications, a company that Netflix uses to provide their streaming content, have argued for "net neutrality", saying that Comcast should not be allowed to charge additional fees for delivering content, regardless of how large those files may be. Late Wednesday evening, [FCC Chairman Julius Genachowski endorsed the idea of allowing internet providers](#) to manage network congestion and charge consumers based on internet usage.

### Inside Chat:

Doubled said to Phil: *"Do you still feel that NFLX is a blowoff topper?"*

NFLX/DD - I think the whole market is topping off here and all it takes is for one reputable analyst to question their model and down they go.

Phil then posted the following trade idea for the "10k to 50k (aka 1050P) Portfolio" - 5 NFLX Jan \$155 puts at \$2.

*At the close of the week the NFLX Jan \$155 Puts were \$3.10, a gain of 55%.*

Netflix dropped on the news, we have details of one of our NFLX short trade ideas in the inset box above.

## Thursday Thrust - Just Buy the F'ing Dips!



*"Just buy the F'ing dip!"* This is the advice of "Captain Broccoli," the animated character dispensing the prevailing wisdom of Wall Street in the video we have linked here. *"Buy the dips, and don't forget this only works if you go out and tell all your friends and family to do the same. That way, when they are buying more expensively than you, you can sell back to them and collect your money."* (Warning: Language in video is not PG or safe for work.)



While Captain Broccoli may be somewhat lacking in tact, and more than deserving of a refund from whatever "economy" charm school he may have attended, his advice handily summarizes the entirety of the market strategy of the mainstream financial media's talking heads.

Maybe it's a lack of useful advice, maybe a lack of credibility, or maybe even a lack of [cute animated cartoon bears](#) to explain the Fed's policies, but ratings for CNBC have [dropped 36% from where they were a year ago](#), while features like the "Fast Money Halftime Session" has declined 56% for the last year. Why is CNBC

doing so poorly in the ratings? Because, as Phil noted, *"they put people like Kudlow and Cramer and Adami and Najarian on TV instead of people (yes, like me) who are going to provide the real news and attempt to actually inform you. Now, here's the thing you need to think about - what kind of TV show(s) have you ever heard of that lose half their audience in a year and remain on the air? The answer - PROPAGANDA!"*

The markets continued rallying Thursday as concerns about Europe's sovereign debt crisis were eased by a rally in Euro Zone government bonds, [powered by reports from dealers that the European Central Bank \(ECB\) had stepped up its purchasing of Irish and Portuguese government debt to help steady the markets.](#)

Further impetus was provided by rumors that the ECB would pursue a policy of future bond purchases "calibrated by the market conditions", but those expectations were dampened when the ECB released a [statement on Thursday](#) that included no commitment to stepping up the pace of its bond-buying program.

Klaus Baader, chief European economist at Societe Generale SA, said *"It's a huge disappointment ... our expectation was that it was unlikely that he would announce a bond purchase program, but at least there would be a chance that he would indicate that the ECB does plan to step up its bond purchases through the existing structure, the Securities Markets Programme (SMP.) But he hasn't even done that. He kind of hinted at it by saying that the purchases would be calibrated by the market conditions. That's kind of an indication that if you get a lot of tension, they'll be buying more. ... But there's no quantum leap, that's for sure. There's not even a little hop."*

While news of the ECB purchasing Irish and Portuguese bonds was welcomed by the markets, traders [noted that the volume of the purchases](#) was “thin,” which makes the validity of the resulting rally in European stocks debatable at the least.

Although the ECB said little to encourage the bond markets, its actions sparked a powerful rally in European bonds, and *“the markets are acting as if large-scale purchases are being made a la the Federal Reserve’s quantitative easing”* according to [Barron’s Randall Forsyth](#). Yields on Irish and Portuguese bonds plunged, and yields on Spanish and Italian bonds also dropped significantly. This helped to support the Euro as the Dollar dropped Thursday, ending the day down to 80.25 from Wednesday’s close of 80.7.

For all of their troubles in the Eurozone, “Black Swan” author Nassim Taleb thinks they have one up on the US, [saying in an interview with CNBC](#) “At least we know that we need

“*“The bottom line on the markets is there is a huge amount of rumors and misinformation driving things right now and it will take a while to sort things out. We read the Beige Book yesterday and the media is generally ignoring that and trying to celebrate “just” 436,000 jobs lost this week. We get Non-Farm Payroll in the morning tomorrow and that will give us a better view on employment.*”

*“On the whole, I think the market is wrong or in denial this morning and it’s a fine time to pick up any puts you might have missed but it’s a risky play with jobs tomorrow and the Irish vote on Monday, both of which can be latched onto as market movers so, as always - CASH IS KING!” - Phil*

austerity (in Europe). People can’t spend money they don’t have. They’re ahead of us in that they have identified the problem further. We over here (in the U.S.) still don’t know that we’re living on borrowed money and we’re borrowing more.”

Taleb then took Federal Reserve Chairman Ben Bernanke to task for bailing out institutions that took on excessive risk, arguing that using the money of taxpayers to rescue those who jeopardized the system in the first place is morally unacceptable, saying *“(Bernanke’s) trying to bail out those who made mistakes with retirees’ money. We have a subsidy.. of those who made a mistake, taking money away from those who are innocent. To me that is immoral...it’s beyond unwise.”*

While the cheerleaders of the mainstream financial media found reasons to cheer on the markets, we found some articles that have us rather concerned. Kroger Co, the largest grocery store chain in the US, tumbled 9% on Thursday after [CEO David Dillon lowered earnings expectations during a conference call with analysts](#). Dillon said that the slow economic recovery is hurting grocery sales and that consumers are cautious in their spending as the recovery has proven to be slower and weaker than Kroger had anticipated. Things may be booming for stocks on Wall Street, but over on Main Street where the people spend their money on little things like food, the economy is not doing nearly as well.

Another cautionary note on the economy was sounded by Albert Edwards of Society Generale, who points to the Organization For Economic Co-operation and Development’s [\(OECD\) leading indicator for China](#) and warns that the current readings are flashing a warning signal, as the last time China’s OECD leading indicator was this low was back in 2008, just before the commodity bubble burst.

# Friday Already? What Next?



The markets went mostly sideways on Friday, hanging on to gains from Wednesday and Thursday, and ended the week on a high note with the Dow closing at 11,381 while the S&P closed at 1,225 and the Nas closed at 2,591.

The Non-Farm Payroll numbers released by the Bureau of Labor Statistics early Friday morning showed a very disappointing 39,000 new jobs created in November, far short of the median forecast of 168,000 new jobs.

The jobs report was so dismal that it led Bank of America-Merrill Lynch economists Neil Dutta and Ethan Harris to conclude that once QE2 wraps up this coming summer, that the Fed will then launch QE3. As Dutta and Harris put it, *“nothing prepared us for the weakness in today’s report ... household employment cratered ... wage growth is essentially non-existent ... who will ask for a*

## Inside Chat:

Yshen asked Phil: *“With the Dollar jammed down so much in the past 3 days - do you still like the UUP plays?”*

UUP/Yshen - Yes I do. I do not, however, understand how the dollar can be pushed down like this. As I mentioned yesterday, a 1% drop in the dollar = a \$1Tn loss in dollar-denominated assets which is 2% of the Global GDP disappearing in 5 minutes. Now we’re down 2% so we’ve lost the entire planet’s GDP growth in 2 days. Does that make sense? How can a \$4Tn FOREX market be manipulated - it scares me to think someone has that kind of power but clearly strings are being pulled with the agenda of keeping the US markets at this top. How long can it last? I don’t know but I still don’t think much longer.

## Watching Must Hold Levels

12/3/10	Dow	S&P	NAS	NYSE	Russell
BREAKOUT LEVELS	11500	1220	2600	7750	725
UP 10% (MUST HOLD)	11220	1177	2420	7500	700
UP 7.5%	10965	1146	2365	7280	672
UP 5%	10710	1123	2310	7140	666



*raise with 5 or 6 people competing for each available job? ... It is clear that some of the damage to the job market is structural.”* While employment is generally a lagging indicator of a recovery, the current employment reports do little to inspire confidence in this market.

The breakout levels we’ve been tracking for weeks are Dow 11,500, S&P 1,220, Nas 2,600, NYSE 7,750 and Russell 725. What happened with these targets this week? The Russell dropped back and retested that 725 line Monday, Tuesday and Wednesday before breaking up on Wednesday and never looking back, the S&P finished at 1,224 (+4), the Nasdaq at 2,591 (-9) and the NYSE at 7,751 (+1). Ask yourself this: Who else out there comes up with market targets like these?

We have 3 indexes finishing the week almost exactly at our levels, the Russell running wild at 756 and the Dow dragging along at 11,382 - JUST like early November!

## The Week Ahead

In last week's newsletter, Phil commented on Tuesday's Fed Minutes, saying "They are HAPPY that low wages plus commodity inflation and rising import prices will allow inflation to increase." This week we got a huge run up in commodities, and a jobs report showing that wages are going nowhere. So, if nothing else, the Fed should be happy with how this week turned out.

The Dollar dropped sharply on Friday, going from a high of 80.3 early in the day all the way down to 79.15, falling nearly 1.5% in a single day, and down 2.8% from the week's high of 81.4. This is a rather large move for a currency that is over 60% of all of the money in the World. The Dow was up 2.6% for the week while the S&P was up 3.0% for the week. So the S&P and the Dow were up an average of 2.8%, while the Dollar was down 2.8% - as we've been saying, the stock market and the Dollar are strongly inversely correlated and this relationship is persisting.

In [last week's newsletter](#), we featured Phil's Thanksgiving Trade Idea on JPM which was buying the Jan \$35/37.50 bull call spread for net \$1.70 and funding it with the sale of the March \$35 puts at \$1.55 for net .15 on the whole spread. This week already, the Jan \$35/37.50 bull call spread has gone up to net \$2.08 while the short March \$35 puts have dropped to \$1.08 for a total net of \$1, a gain of 566% in just one week!

Phil's had a similar trade idea in Friday morning's post with FAS, buying the April \$20/25 bull call spread for \$2.70 (now \$3.25) but he modified the short put sale to the less volatile March \$50 puts at \$2.65 (now \$2.50). While this trade may seem to have gotten away already (up net 400% in a day), it's a highly volatile pair that has an ultimate potential net gain of 3,233% so, odd as it may seem - you may not have missed much!

There was also a trade idea for DBC, using the longer Jan 2012 \$26/30 bull call spread at \$1.40

(still \$1.40) and offsetting that with the sale of the \$22 puts that are still trading at \$1.10 despite DBC's .33 rise on Friday. This is an excellent long-term trade to hedge against commodity inflation and has an upside potential net gain of 1,200%. Keep in mind Phil still is not really buying into the rally but, as he points out - it's time to dip our toes back into long positions, just in case we break higher.

While the technicals in the market look strong, with the trouncing of the beta 3 pattern and three of the five indexes we track at break out levels, we still have reservations about the market's ability to continue its ascent. Stock valuations do not appear to be based on fundamentals as much as technical factors, and it appears to us that the Fed's POMO activities are propping up stocks and weighing heavily on the Dollar. We saw this week a clear demonstration of how powerful the POMO force is.

On the other hand, we have a disconnect between valuations and economic reality. Moreover, as [The Pragmatic Capitalist](#) notes, **BULLISH SENTIMENT STILL EXTREMELY HIGH**: "*The latest investor sentiment surveys show continued levels of high bullishness. This week's AAI sentiment survey showed another increase in bullish sentiment to 49.7%. Charles Rotblut of AAI detailed the results: 'Optimism among individual investors that stock prices will rise over the next six months remained above its historical average of 39% for the 13th consecutive week.'*"

As [The Pragmatic Capitalist](#) writes in "**SMALL INVESTORS POURING INTO STOCKS**," "*Small investors aren't just feeling bullish - they're acting bullish. According to the AAI's November allocation poll small investor equity allocation reached an 11 month high... Naturally, small investors are chasing the rally.*" Small investors chasing this rally gives us pause. But for POMO, we'd be decisively more bearish. For now, we continue to stay primarily in cash while looking for short-term trading opportunities.

# Special Bonus Supplement - Wednesday

## Beige Book Highlights



*Editor's Note: Below is the "Summary of Commentary on Current Economic Conditions" (aka "The Beige Book") as released by the Fed on December 1st. Phil uses colors in the text of the FOMC minutes to indicate what he sees as positive (green) and negative (red) for the economy. Phil's comments (blue) appear in this section in quotes and bold Italics.*

Reports from the twelve Federal Reserve Districts indicate that the economy continued to improve, on balance, during the reporting period from early/mid-October to mid-November. Economic activity in the Boston, Cleveland, Atlanta, Dallas, and San Francisco Districts increased at a slight to modest pace, **while a somewhat stronger pace of economic activity was seen in New York, Richmond, Chicago, Minneapolis, and Kansas City.** Philadelphia and St. Louis reported business conditions as mixed.

**Manufacturing activity continued to expand in almost all Districts, with relatively strong growth seen in metal fabrication and the automotive industries.** Reports also showed steady to increasing activity for professional and nonfinancial services. **Two Districts noted a decline in demand from government agencies due to budgetary shortfalls.** Reports on consumer spending tended to be positive. Nonetheless, **several Districts noted that households remain price sensitive and focused on buying necessities.** Expectations for the holiday shopping season were **generally** positive, with several Districts **expecting** higher sales **when compared** to year-ago levels. Sales of new cars and light trucks were largely higher than in our last report. Tourism improved in all reporting Districts.

So forward-looking expectations with **couching language** on consumer spending. Keep in mind this report is anecdotal and you have to pay attention

to what is real reporting of activity and what is HOPE and what is SPIN!

**Housing markets remain depressed**, with **several Districts reporting further weakening during the past six weeks.** Conditions in commercial real estate were mixed, and **activity stayed at low levels.** Agricultural conditions were generally favorable, with several Districts reporting **yields nearing historic highs.** Agricultural sales to off-shore buyers increased. Overall **activity in the energy sector continued to expand.**

“ **Is depressed really a word you associate with Market Rally?** ”

Lending activity remained stable across most Districts. Credit quality has been steady to improving **for most of the Districts that commented on it.** Prices for final goods and services were **fairly stable**, despite **rising input costs, especially for agricultural commodities, metals, and fuel.** Hiring activity showed **some** improvement across most Districts. Wage pressures were contained.

### Manufacturing

**Manufacturing activity continued to expand in most Districts.** New York was the only District where manufacturing activity was reported to have weakened, while Dallas reported that manufacturing was mixed. Metal fabrication increased in Chicago, Kansas City, Dallas, and San Francisco. Contacts in automotive industries reported gains in Boston, Cleveland, Richmond, Atlanta, and Chicago. The Boston, Kansas City, and San Francisco Districts reported increased sales for high-technology manufacturers, though Dallas noted that growth in orders and production in high-technology industries had slowed from earlier in the year. Steel producers and service centers in the Cleveland District reported that volume was either flat or improving, while Chicago noted some temporary softening in steel demand. Refiners in

the Dallas and San Francisco Districts noted reduced production levels. The Philadelphia and Dallas Districts indicated little improvement in demand for manufacturers with ties to residential housing and construction. The Philadelphia, Cleveland, and Kansas City Districts reported that capital spending or spending plans had increased. On net, manufacturers in the St. Louis District reported they planned to expand operations. **Contacts in Boston, New York, and Richmond commented on increasing input costs.** Several Districts noted an **optimistic outlook** from manufacturers. Boston and Richmond described manufacturers as upbeat; New York and Chicago reported contacts as more optimistic; and Philadelphia and Minneapolis manufacturers **expect** increases in activity in the near term. However, several contacts in Dallas expressed concern about **a decline in demand from government agencies, as budget shortfalls continue.**

“ **Always keep in mind there are 12 districts so when they say 4 reported good stuff - we don't care unless it's more than 6. Pretty obvious actually.**

#### Nonfinancial Services

**Activity was steady to increasing for professional and nonfinancial services across most Districts.** The exception was the St. Louis District, which reported a decline in service sector activity. Boston, Philadelphia, Minneapolis, and San Francisco noted growth in information technology services. Accounting demand remained stable in the Dallas District, bolstered by consulting and merger and acquisition work. The healthcare sector was said to be expanding in reports from Philadelphia and St. Louis, though Richmond noted no change in demand. **Firms that provide services to governments in the Philadelphia District indicated that their clients were using less of their services because of the tight budget environment.** Demand for

transportation services increased in several Districts. Freight companies in Cleveland noted that volumes increased **slightly** during the past six weeks, and contacts in Atlanta said freight volumes had improved from a year ago, with both Districts recognizing **gains in chemical shipments.** Regional rail contacts in Dallas noted strong increases in volume. Contacts in Dallas said that **intermodal transportation firms experienced increased cargo volumes, buoyed by demand from international clients, as well as a rise in international container trade volumes.** Kansas City reported that the transportation sector stabilized but noted **a shortage of qualified drivers.**

#### Consumer Spending and Tourism

**Retail spending showed improvement across most Districts,** with the exception of Boston, Cleveland, Richmond and St. Louis, where results were mixed. A return to more seasonably cool weather was credited for boosting sales in the New York and Dallas Districts. Grocers reported rising sales in Cleveland and Richmond, while sales dropped off in San Francisco. Purchases of apparel improved in the Philadelphia, Chicago, and Dallas Districts. **Expectations for the holiday shopping season were positive across Districts;** however, in Richmond, retailers expected holiday shopping to be restrained. Reports from the Philadelphia, Cleveland, Atlanta, and Chicago Districts indicated that **consumers remained value conscious and tended to focus on buying necessities.** Purchases of big ticket items were soft in Richmond, St. Louis, and Kansas City.

**Sales of new automobiles and light trucks rose in nine Districts during the reporting period, with several Districts indicating that vehicle inventories are now at appropriate levels.** Dealers expect new vehicle sales to continue rising through year-end in the Philadelphia, St. Louis, and Kansas City Districts.

“ **This is pretty good stuff!**

Tourism was characterized as stronger or improved in the Boston, New York, Richmond, Atlanta, Minneapolis, Kansas City, and San Francisco Districts, while business travel to destinations in the New York, Atlanta, and San Francisco Districts increased. Occupancy rates at hotels in Manhattan and Atlanta's major markets were higher than a year ago. The Richmond and Atlanta Districts noted a pickup in international visitors. In Boston, increased tourism was attributed to generous travel incentives and perceived value, while Richmond noted that discretionary retail spending by tourists was lower.

### Real Estate and Construction

Residential real estate and construction activity remained at a low level in all Districts. The Philadelphia, Atlanta, St. Louis, and Minneapolis Districts reported some further weakening in home sales. Boston, New York, and Richmond characterized the market as soft; while Cleveland, Kansas City, Dallas, and San Francisco described the market as sluggish. The Chicago District reported that high inventories of unsold homes continued to be a drag on new residential construction and home prices. Residential house prices were mixed. Price declines were observed in New York, Philadelphia, Atlanta, and Kansas City; prices were flat to up in Minneapolis, and prices edged up in Boston. The Dallas District reported that home prices increased on a year-over-year basis. The rental market continued to offer incentives to tenants in New York, while strong demand for rental units was reported in Richmond and Dallas. Outlooks for 2011 were mixed.

“ This may be my new favorite Fed spin ever! 4 districts say "further weakening," 3 districts say home sales are "soft," and Chicago says it's a "drag." That's 8 of 12 with very negative comments and the other 4 say they are only

declining. No wonder the Fed is scared to death - if housing drops another 10% then we have another 200 banks that will probably turn insolvent. Not only that but Case-Shiller just told us that EVERY district sucks so the ones who say anything less than sucked are just hopeless optimists...

Conditions in the commercial real estate industry were mixed during the reporting period. Several Districts reported flat demand and high vacancy rates, which translated into limited nonresidential construction activity. The New York, Atlanta, and Kansas City Districts noted some weakening in nonresidential activity, while the Boston and Dallas Districts indicated some modest improvement in commercial real estate. Reports from Cleveland and Chicago noted that most new projects fell generally into the infrastructure category. Contacts in Boston, Richmond, Kansas City, and Dallas expressed some optimism about the near-term outlook in their Districts, but contacts in several other Districts expressed a more cautious outlook.

### Banking and Finance

Banking conditions remained stable across most Districts. Lending activity was reported as steady or unchanged in New York, Philadelphia, St. Louis, Kansas City, Dallas, and San Francisco, while a slight improvement was noted in Cleveland, Richmond and Chicago. The Atlanta District reported constrained credit conditions and weak loan demand. Contacts in Chicago and Dallas said that increased competition for high-quality borrowers resulted in more aggressive loan pricing. Demand for commercial and industrial loans was generally stable, though several Districts noted improvements in specific loan categories. The Cleveland and Chicago Districts reported increased lending for mergers and

acquisitions, and access to credit by small businesses in Atlanta improved slightly. Consumer lending has remained stable at weak levels in most Districts. The San Francisco District reported that loan demand declined slightly as a result of households' desire to deleverage, while Chicago saw a small pickup in consumer lending. Several Districts reported increases in lending related to residential real estate, and, in particular, to refinancing activity. Reports on changes in credit standards were mixed. Bankers in New York reported a tightening in credit standards across all loan categories, Kansas City contacts indicated no change in lending standards, and Atlanta reported an easing in standards for small firms. Contacts in the Cleveland, Richmond, and Chicago Districts reported improved credit quality, but San Francisco bankers noted ongoing struggles with credit quality. **The Cleveland and Richmond Districts both reported declines in delinquencies.**

“ **This is actually disturbing because it's not the availability of money that is holding things back which means QE2 is wasteful AND dangerous as it's clearly misallocated. The problem is there is not bottom-up driven demand, pure and simple and we're not going to get any with a jobless and homeless recovery. By the way, extended unemployment benefits begin terminating tomorrow and will be all gone for 2M people as of Monday. Merry Christmas!**

#### **Agriculture and Natural Resources**

Mainly favorable weather conditions helped facilitate early harvesting and the planting of winter crops. The Chicago, Minneapolis, and Dallas Districts reported **large to record-setting yields**

**for certain crops. Agricultural prices continued to climb, boosting farm incomes.** Reports from several Districts indicated that **higher grain prices were raising feed costs for livestock producers.** Nonetheless, contacts in Chicago noted that **even with higher feed costs, margins for livestock producers remain positive.** Strong global demand and tight supplies pushed cotton prices to near historic highs for growers in Atlanta and Dallas. San Francisco noted that reductions in overseas yields, combined with the lower value of the U.S. dollar, are helping boost domestic farm sales.

Activity in the energy sector was expanding. **The number of active drilling rigs increased in the Atlanta, Kansas City, and Dallas Districts.**

Although producers are interested in returning to the Gulf of Mexico, drilling remains well below pre-oil spill levels as permit issuance lags. Producers in Kansas City expressed concern about future production due to labor and equipment shortages. Cleveland reported an increase in production from Marcellus shale. In the Minneapolis District, wind energy continued to expand, but at a slower pace than a year ago, while mining activity increased.

“ **So plenty of supply of food and energy but they are jacking up the prices anyway. It's very encouraging to know that higher feed costs are already being passed down to the consumers (as long as you are one of "us" and not one of "them," of course).**

#### **Labor and Prices**

Hiring activity showed **some improvement across most** Districts, although employers are waiting for clearer signals of expanding business prospects before adding significantly to payrolls. A preference for part-time and temporary workers was reported in the Atlanta and Chicago Districts.

Seasonal hiring in retail trade is expected to be higher this year in Chicago and San Francisco than in the previous two years. **Employers in the Boston, Richmond, and Minneapolis Districts reported having difficulty finding skilled workers.** Employment agencies in the New York, Richmond, and Chicago Districts reported a moderate increase in new job openings, while **staffing firms in Dallas said that hiring activity is strong.** Boston staffing contacts noted that **labor demand has strengthened, particularly in the information technology, medical, manufacturing, and legal sectors.** Wage pressures remain subdued across Districts. Contacts in Richmond and Kansas City noted that they expect little change in wage pressures during the upcoming months. However, **employers in San Francisco reported significant increases in employee benefit costs.**

Prices of final goods and services were fairly stable across Districts despite rising input costs, especially for agricultural commodities, metals, and fuel. Companies in the Atlanta, Chicago, Kansas City, and San Francisco Districts reported **a limited ability to pass through higher input costs to customers given the relative softness in demand.** However, **some** manufacturers in the Boston, Cleveland, Atlanta Districts have announced **plans** to raise their product prices **in the near future.** Retailers in Philadelphia and San Francisco noted **price increases on selected products imported from Asian countries.** Reports from the Chicago and Dallas Districts indicated that that **record-high inventories and forecasts for a warmer-than-normal winter are putting downward pressure on natural gas prices.**

**Maybe jobs ARE coming back!**  
**“ Too bad upside down mortgages prevent people from going where the jobs are - another great reason to rent and not**

**own. This is definitely not going to be Nat Gas' year it seems...**

**Overall, not a bad report and we're up nicely but just 117M volume on the Dow at 2:45. Still, the market is looking very much like a runaway train and if we get another day of this we break the pattern as well as our break-out levels but the ECB meets tomorrow and if Trichet doesn't put up, the market will shut up so I am in favor of holding our 1050P (\$10k to \$50k Portfolio) shorts overnight unless we do get an opportunity to get them off the table with profits into the close.**

## Next Week's Economic Calendar

Monday 6	Tuesday 7	Wednesday 8	Thursday 9	Friday 10
11:00 AM: 4-Week Bill Announcement	7:45 AM: ICSC-Goldman Store Sales	7:00 AM: MBA Purchase Applications	8:30 AM: Jobless Claims	8:30 AM: International Trade
11:30 AM: 3-Month Bill Auction	8:55 AM: Redbook	10:00 AM: Quarterly Services Survey	10:00 AM: Wholesale Trade	8:30 AM: Import and Export Prices
11:30 AM: 6-Month Bill Auction	3:00 PM: Consumer Credit	10:30 AM: EIA Petroleum Status Report	10:30 AM: EIA Natural Gas Report	9:55 AM: Consumer Sentiment
POMO DAY	POMO DAY	POMO DAY	POMO DAY	

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