



# PHIL'S STOCK WORLD

HIGH FINANCE FOR REAL PEOPLE | FUN AND PROFITS

Dow Jones	11,410 (+0.2%)
S&P 500	1,240 (+1.2%)
NASDAQ	2,637 (+1.8%)
NYSE	7,823 (+0.9%)
Russell 2000	777 (+2.6%)
Oil	87.79 (-1.7%)
Gold	1,384 (-2.1%)

## THIS WEEK'S NEWSLETTER:

### MONDAY MARKET MOVEMENT - PULLING ON GLOBAL THREADS

Bernanke says he is "100% Certain" he can control inflation

### TRILLION DOLLAR TUESDAY - MORE FREE MONEY!!!

Phil nails six for six trade ideas

### WEDNESDAY WORRIES - IRELAND "FIXED" - WHO'S NEXT?

Ireland takes another step towards accepting a bailout, but at what cost?

### THURSDAY - LIVING IN BEN'S STOCK AND BOND FANTASY

How disconnected have the markets become from reality?

### FRIDAY FIZZLE - WEEK ENDS WITH A WHIMPER

The Dow fails to confirm our breakout targets

### THE WEEK AHEAD

Fantasy can be a wonderful thing. It can be the basis of charming and whimsical tales that entertain and inspire. Unfortunately, in the world of finance, fantasy is not a good thing at all.

There is nothing worse for investors than to find out that a fundamental premise of their investment decisions was incorrect, not based on reality, but rather based upon some fantasy built upon mendacity or false assumptions. The more detached investors become from reality, whether due to bad information or deliberate lies, the less likely they are to make good investing decisions. So it is critically important for investors to be able to separate reality from fantasy; those incapable of doing so won't remain investors for long.

So what are we to make of it when Ben Bernanke, the Chairman of the Federal Reserve Bank of the United States of America, contradicts himself in a truly spectacular way and gets called on it, not by the mainstream financial media, but by Jon Stewart on the "Daily Show?" Isn't Bernanke supposed to be a smart man, having been a professor of Economics at Princeton? Why is he making statements that make us wonder if he's living in a fantasy world?

Watch John Stewart running [two back to back clips of Ben Bernanke](#) responding to questions from "60 Minutes" interviewer Scott Pelley about quantitative easing. In the first clip, Bernanke says *"One myth that's out there is that what we're doing is printing money. We're not printing money."* The Chairman of the Fed says, on camera and on the record, that quantitative easing is not printing money. Period. *"We're not printing money"*. Hold that thought for a moment and hang on...

We then see the next clip, the one filmed during an interview with the exact same interviewer, on the exact same show, 21 months ago. A clip where Bernanke says *"To lend to a bank, we simply use the computer to mark up the size of the account they have with the Fed, so it's much more akin, although not exactly*

*the same, much more akin to printing money than it is to borrowing."*

What are we to make of this? 21 months ago, quantitative easing was, in fact, essentially "printing money", according to what Bernanke said on camera during an interview with "60 minutes". Yet just this week, Bernanke goes on the same show, talks to the same interviewer, and says "We're not printing money." In his defense, Bernanke would argue that purchasing debt from banks with freshly printed Dollars is not the same as purchasing debt from the government using freshly printed Dollars, which is the sort of hair-splitting that leads most people to conclude their leaders are two-faced weasels.

This kind of bald-faced twisting of the truth is exactly the kind of thing that destroys trust in institutions, and once that trust is lost, institutions can find themselves becoming very unpopular very quickly. When people no longer believe Bernanke when he says that quantitative easing is not printing money, how can anyone expect people to believe him when he then insists that quantitative easing is also not inflationary? And as Phil notes, *"When you are running the World's largest fiat currency system,*

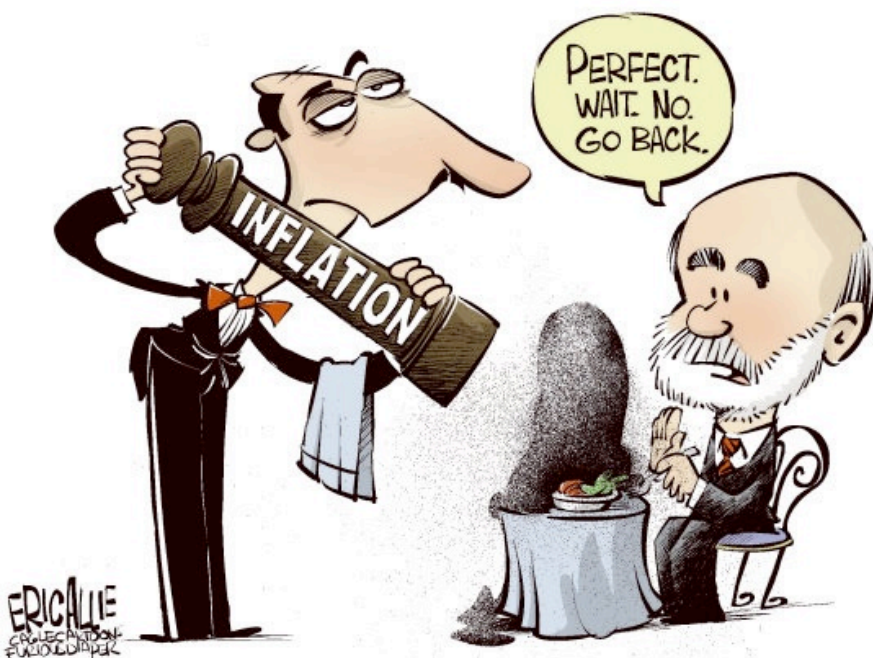
*trust is pretty much all you do have going for you - unless you plan to resort to force, of course."*

Meanwhile, the markets keep climbing (as long as the Dollar keeps dropping, no inflation here), the financial media bangs the drum telling people what a great time it is to buy stocks, and billions of Dollars in POMO money gets pumped into the markets via the Primary Dealers, helping to compensate for the **\$93 Bn in outflows from domestic equity funds over the last 31 weeks.**

Ah, the financial media didn't tell you about that one, did they? Just last week we saw **\$1.8 Bn withdrawn from domestic equity funds by retail investors.** But no worries, the hundreds of billions of Dollars in POMO funds are proving to be more than enough to compensate for all of those billions in outflows, while simultaneously pumping up the equity and commodity markets and keeping the good times rolling on Wall Street.

It's difficult to imagine all of this is laying a strong foundation for a bull market. Not when we see that speculators are holding **the largest commodity positions on record**, up 13% from 2008 highs, while oil is in a **GLUT** and demand has fallen off a cliff, **mortgage applications are falling again**, and US Retailers are **cutting earnings forecasts and sitting on big inventories.** It is, however, extremely easy to imagine quantitative easing laying the foundation for raging inflation.

While we continue to carefully monitor the markets, we have yet to see anything to persuade us to change our current stance of remaining mostly in cash, while looking for short-term opportunities to make profitable trades.



# Monday Market Movement - Pulling on Global Threads and the SEP



What is an “SEP”? S.E.P. stands for *“Somebody Else’s Problem”*. As “Hitchhiker’s Guide to the Galaxy” author [Douglas Adams](#) explains it, *“An SEP is something we can’t see, or don’t see, or our brain doesn’t let us see, because we think that it’s somebody else’s problem... The brain just edits it out, it’s like a blind spot. If you look at it directly you won’t see it unless you know precisely what it is. Your only hope is to catch it by surprise out of the corner of your eye. It relies on people’s natural predisposition not to see anything they don’t want to, were not expecting, or can’t explain.”*

As Phil explained, *“SEP’s are commonly used by politicians to justify ridiculous policies like kicking crises down the road, ignoring pension and other unfunded obligations (that’s going to be your children’s problem), massive deficits (grandchildren’s problem), unemployment (lazy people’s problem), global warming (someone living south of you’s problem) and, of course unfair tax policies (poor people’s problem). They are also used by analysts, CEOs, their lobbyists and journalists (especially TV ones) to distract the ‘beautiful sheeple’ from focusing on what’s really happening.”*

So what is likely to become the biggest SEP of them all? We’re thinking it’s going to be inflation, what with [vegetable prices in China up 62%](#) from a year ago, oil rising 100% from \$45 a barrel in April of 2009 up to \$90 a barrel in December of 2010, and natural gas up 42% from 140 to 199 in the last six months. Of course, the “official” inflation reports are saying that inflation is “extremely low”, bordering on deflationary. However, [Jim Rogers says that’s nonsense](#), and that the US government’s inflation data is a “sham”, and he’s not the only one.

Joshua Brown, writing at the Christian Science Monitor, [reported on “Agflation” in the](#)

[supermarkets](#), as the prices of some food staples are climbing at double-digit rates. Joshua lamented: *“Our officials are really into CPI as their inflation measure, which is a shame because it doesn’t actually take into account, well, inflation. ‘Inflation ex-food and energy’ is the most oxymoronic phrase in the economic glossary.”*

The markets went mostly sideways on Monday, with the Dow and S&P down around .15% while the Nas was up .13% on a lightly traded day with little news. After the markets closed news came out that President Obama had reached a [“tentative deal” with Republicans to extend the Bush tax cuts](#), while also extending unemployment benefits for another 13 months.

Traders were still wary after the bombshell unemployment numbers that came out on Friday, December 3rd, numbers that were so awful ([39,000 new non-farm jobs created](#) in November, compared to [168,000 expected](#)) that [Ben Bernanke felt compelled to appear on “60 Minutes”](#) to defend his policies in general, and “quantitative easing” in particular. During the interview, Bernanke expressed concerns about high unemployment, and said *“Inflation is very very low... and we’re getting close to the point where prices would start falling.”* The consumer price index (CPI) of course doesn’t include things everyone needs, like food and energy.

At one point interviewer Scott Pelley asked about QE2, saying that *“Some people think the \$600 billion is a terrible idea... that (it) could be highly inflationary”*, to which Bernanke replied *“Well, this fear of inflation, I think is way overstated.”* When asked *“Can you act quickly enough to prevent inflation from getting out of control?”* Bernanke replied *“We could raise interest rates in 15 minutes if we have to. So, there really is no problem with raising rates,*



*tightening monetary policy, slowing the economy, reducing inflation, at the appropriate time.”* When Pelley asked what degree of confidence Bernanke had in his ability to control inflation, Bernanke replied *“One hundred percent.”*

Bernanke's "100%" confidence in himself prompted (we're leaving a humble margin for error) nearly 100% derision from financial bloggers.

Bruce Krasting noted that *“Bernanke’s TV fireside chat was a bomb as a result of this gross misstatement of the risks of the Fed’s monetary policy. There is a “zero” chance that QE will end badly? Please, that is idiotic and insulting. The thousands of people around the world who have stood up and said it is voodoo economics are all wrong? Talk about hubris.”* (100% Sure Thing?)

Mish Shedlock commented: *“Bernanke is a man with 100% confidence who did not see the housing bubble, who did not see a recession, whose worst case scenario for unemployment was 8.5% when it was already over 8%. Bernanke cannot find his ass with both hands and a roadmap, yet he is one hundred percent certain about his ability to control things...”*

*“The idea that rising prices is a good thing when there are 15 million unemployed is moronic. Moreover, if Bernanke does manage to hold down interest rates while getting his wish for higher prices, those on fixed incomes will be crucified.*

*“Inflation is a tax on the poor and middle class, benefiting those with first access to money: banks and the wealthy.”* (Lies, Half-Truths, and 100% Hubris on 60 Minutes; Deficit-Chicken Republicans; Middle-Class Crucifixion; Ron Paul Needs Your Support)

Jr. Deputy Accountant mused: *“100% confidence huh? By my calculations that would require bulletproof faith in the exit strategy he doesn’t have, surely Ben Bernanke is smarter than*

*that?”* (Bernanke on 60 Minutes: I Did Not Have Sexual Relations With That Free Money)

Jim Quinn wrote: *“The hubris in this statement is breathtaking. The U.S. economy is a complex interaction of thousands of variables and is intertwined with the policies and actions of hundreds of other countries throughout the world. No one has a handle on the worldwide economy and no model can predict anything with any amount of accuracy. And still, this pompous professor from Princeton who has never worked a day in his life in the real world is 100% SURE that HE knows what will happen and when it will happen. I’m sure his track record of predictions and analysis will give you comfort in this statement.”* Click [here](#) for a list of all the times Bernanke has been wrong. (Bernanke Is 100% Sure).

“*“The Bernanke was on 60 Minutes last night and he said he is “100 percent” confident that, when necessary, the central banks can control inflation and reverse accommodative monetary policy. No, I’m not kidding - he actually said that! I know, what a friggin’ tool...”* - Phil

Hubris is a very old word, with roots going back to ancient Greece. In fact, it was considered to be [a serious crime in the ancient Greek world](#). Hubris is often the harbinger of nemesis, as in fatal retribution or destruction, and was often the cause of the downfall of heroes, as well as the powerful and the rich.

It is our hope that Chairman Bernanke could take a moment to consider the consequences of hubris. We suggest that it would be a good idea if he were to allow himself enough room in his decision making process to include the possibility of error on his part.

## Trillion Dollar Tuesday - More Free Money!!!

Tuesday was an interesting day. Officially, it was a go-nowhere day, with the major indexes all closing near where they opened. If you just looked at the financial news headlines, you might think it was a slow, boring day that offered little opportunity for traders. That is, this is what you'd think, unless you happened to be tuned in to [Phil's Stock World](#).

Anyone who has followed [Stock World Weekly](#) over the last few weeks knows that our preference has been to stay in cash, and wait to see if the indexes are going to confirm our breakout targets.

*“While I still think this will all end in tears, we’ve been patiently waiting for our range tops to be broken at Dow 11,500, S&P 1,220, Nasdaq 2,600, NYSE 7,750 and Russell 725. We should open this morning with all but the Dow over the line and, as we did in early November, we will sit PATIENTLY waiting for the Dow to confirm the move up, at which point we can safely go with the flow, using those numbers as our new breakdown watch levels.” - Phil*

It can be difficult to stay on the sidelines in cash, waiting for the right moment to make high-quality trades that have a good potential for paying off. “Cashy and cautious” sounds great in theory, but sitting tight, waiting for the right opportunity, takes a lot of discipline for most traders, and discipline is something that many traders don't have.

But by exercising discipline, you can position yourself to take advantage of those days when everything comes together and the trade ideas line up like ducks at a shooting gallery, and you can just draw a bead on one after another,

knocking them down and racking up the points shot after shot.

This is what Phil did on Tuesday. At 7:22 am Phil sent out a [Morning Alert to Members](#), based on [trade ideas in his virtual “10k to 50k Portfolio”](#), aka “1050P”. Feeling bearish and not trusting the higher open, Phil reasoned: *“This is either an amazing breakout that reflects the New World Order or a double top that reflects the same old BS - I wish I was sure which it was - obviously, I'm smelling the BS but we can't keep fighting the Global Fed forever as it seems to come up with a new way to pump up the markets every week.”* Phil decided it was BS, got out his popgun, and took aim at some juicy targets...

So what happened with Phil's trade ideas on Tuesday? For starters, Phil drew a bead on QID Jan \$10 calls, picking them up at \$1.80 at the open and finishing at \$2.00, up 11%. *Bang!* Not a square hit, more like he winged it, but it fell over in the plus column and was a solid win. Ah, but Phil was just warming up. He then took aim at the DIA Dec \$114 puts, which opened at \$0.80 and finished at \$1.33, up 66%. *Pow!* Nailed it square. Without pausing, he sighted in on the XRT Jan \$44 puts, which opened at \$0.35 and finished at \$0.55, up 57%. *Ping!* Another bullseye.

Pausing a moment as the next row of ducks came around into view, Phil lined up his crosshairs on three in a row. First, the USO Jan \$36 puts, those opened at \$0.66 and closed at \$0.90, up 36%. Then the PCLN weekly \$400 puts, which opened at \$0.50 and finished at \$1.40, up 180%. Last, the NFLX Jan \$155 puts, which opened at \$1.70, and ended up being closed out by Phil on Wednesday with 1/2 out at \$3.20 (up 88%) and the other half out at \$2.75 (up 66%). *Ding! Ding! Ding!*

Not a bad morning. Six trade ideas, six shots, six hits. This was a day when our Members had more good trade ideas before breakfast than many other traders have all week.

## Wednesday Worries - Ireland "Fixed" - Who's Next?



News that Ireland was making progress towards accepting billions in aid to bail out its banks came out early Wednesday when two independent Irish lawmakers signed on at the last minute to support a new budget. If it passes, this new budget will qualify Ireland for the €67.5 Bn financial aid package from the European Union and the International Monetary Fund.

Ireland has not yet voted on the budget, having pushed back the vote to next Wednesday, December 15th. Support for the budget is still in doubt, partly due to outrage about sweeping budget cuts that, among other things, reduce the minimum wage by €1 to €7.65. Popular support for the budget is extremely weak, although public protests in Ireland have been remarkably quiet this week.

Deputy Member of the Irish Parliament, Mattie McGrath of the Fianna Fáil party said that he would vote against the loan deal, describing it as a bad deal that was more like "a clearout" than a bailout. He then said the payment of bonuses to senior bank staff while welfare benefits and the minimum wage were being cut was the last straw for him, and also claimed that he had been "double-crossed" by Finance Minister Brian Lenihan, who had promised he would heavily tax bonuses but then revealed later that he could not do so retrospectively.

“At least Ireland gets to vote for their obligations, we have a Federal Reserve System where a single man, known as *"The Bernank"* is able to spend what is now heading towards \$3.5Tn of OUR MONEY to bail out his banking buddies. That's \$31,818 per American family spent over two years..." - Phil

Phil talked about Tuesday's trade ideas in Wednesday's posting, saying *"Yesterday is the reason we have sat patiently (well kind of patiently) in cash for a month as we finally got an opportunity to commit to a whole bunch of very obvious trades, the most trade ideas I've had in a single day since early September, when we jumped on Uncle Ben's bullish bandwagon. Sure we find things to trade every day but these are the opportunities we wait for."*

Commenting on how the prevailing "logic" of *"Just Buy the F'ing Dips"* has come to dominate the market, Phil pulled his December short plays off of the table. Phil wrote *"As I keep saying, I don't enjoy day trading - it's not satisfying but it's what we do while waiting for real investment opportunities to come along. While it may be exciting to make 100% on a trade in a single day - it's small money and a tedious (and stressful) way to build up a portfolio. I suppose at heart, I'm a long-term investing coupon-clipper but those kind of investors are being chewed up and spit out in this market and, while we found many, many things to buy earlier in the year, now we're down to one or two long-term opportunities a day while most of the rest of the market looks better as a short."*

At it was, Wednesday ended up as a dull day in the markets, with the Dow up 0.11% to 11,372, the S&P up 0.36% to 1,228 and the Nas up 0.41% to 2,609. The Dow continued to fail to support our breakout levels, unable to break above 11,500 and then hold it for a couple of days. The lack of any conviction in Wednesday's markets led Phil to say *"So we're still betting down but we're resigned to the possibility of up. Have I mentioned cash is king?"*

Yes, cash is boring, but having your powder dry and ready makes days like Tuesday possible.

# Thursday - Living in Ben's Stock and Bond Fantasy



The classic rock song "Rock 'n' Roll Fantasy" by the Kinks has the lyric "Don't want to spend my life living in a rock 'n' roll fantasy." The question is, are we now all living in Ben Bernanke's Stock and Bond Fantasy?

We started this week's newsletter talking about Bernanke's policy of "quantitative easing", and the double-speak that has been spun for public consumption about whether or not this policy actually represents "printing money". But this is not the only controversial issue causing confusion among investors.

For example, consider these two statements by two well-known Ph.D.s on the effect of interest rates on the economy and stocks. Paul Krugman, Professor of Economics and International Affairs at Princeton University, and a widely cited expert on economics, [wrote in his blog this week about the economic impact of interest rates](#): *"Rates began rising a few weeks ago as data began to suggest a somewhat stronger recovery than previously anticipated (stronger, not strong – we're still looking at years of very high unemployment). They rose again in the past couple of days on the belief that the stimulus part of the tax deal would actually lift the economy to some extent."*

But wait, just one moment. Because now, in the opposite corner, we have none other than [Ben Bernanke](#), a former professor of economics at Princeton University and Chairman of the Federal Reserve saying the following: *"For example, lower mortgage rates will make housing more affordable and allow more homeowners to refinance. Lower corporate bond rates will encourage investment. And higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending. Increased spending will lead to higher incomes and profits that, in a virtuous circle, will further support economic expansion."*

As [Tyler Durden of Zero Hedge](#) so aptly summarized it, *"So there you have it: lower rates are good for the economy and stocks, and higher rates are, wait for it, even gooder for the economy and stocks."* When two professors of economics can simultaneously say that higher and lower interest rates are both good for the economy, again, our prevailing theme of "are we living in some kind of a fantasy world" comes back to mind. On Krugman's behalf, he was quoting facts -- rates began rising and some indicators are showing improvement, but he was not saying that higher rates, in the long run, will cause the economy to do better. He acknowledges that we're still looking at years of unemployment.

On Wednesday, White House Economic Advisor [Larry Summers](#) said that if Congress were to fail to pass a tax deal in the next couple of weeks, it would "materially increase" the risk of the recovery stalling, leading to a double-dip recession. Investors watched closely as the tax deal was debated in Congress, [although House Democrats initially rejected the proposal](#), it is expected to eventually pass in one form or another.

Thursday was a mixed day for the markets, with the Dow closing very slightly down at 11,370, while the S&P was up 0.38% at 1,233 and the Nas was up 0.38% to 2,617. Phil had a trade idea involving EDZ which we have in the inset box (below).

“EDZ Jan \$20 puts can be sold for \$1 and that pays for the \$21/24 bull call spread at \$1.10 so .10 on the \$3 spread is very good protection against emerging markets falling down and that can make a nice commodity hedge as well because those guys tend to depend on those exports.” - Phil

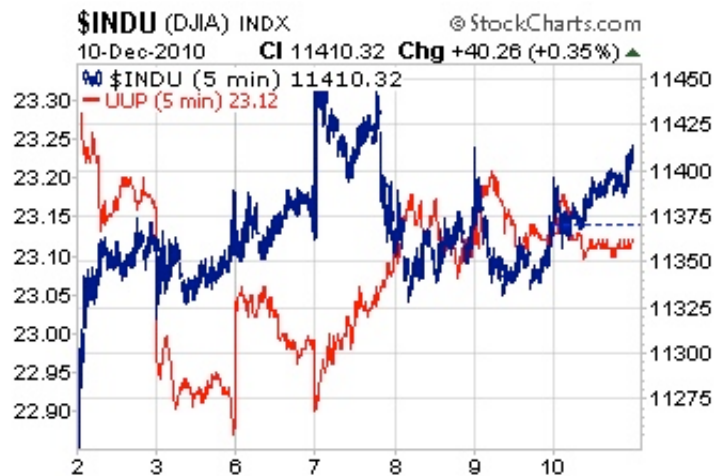


# Friday Fizzle - Week Ends with a Whimper

One of the tools we use to help anticipate movements in market indexes is our “Market Target” levels, which is a regular feature at Phil's Stock World and included as part of every Stock World Weekly newsletter. These levels have been very useful for confirming rallies or, conversely, break downs. Consequently, these levels are one of the main parameters we watch on a daily basis.

When the market closed higher on Friday (Dow up 0.32% to 11,406, the S&P up 0.54% to 1,240 and the Nas up 0.8% to 2,638), four of our five market targets had not only broken to the upside, but in the case of the Russell 2000 and the NYSE, had surpassed our Market Target levels with plenty of room to spare.

The Dow, however, has been a major laggard. It seems unable to climb above 11,400 and stay there. As a result, although we might like to jump



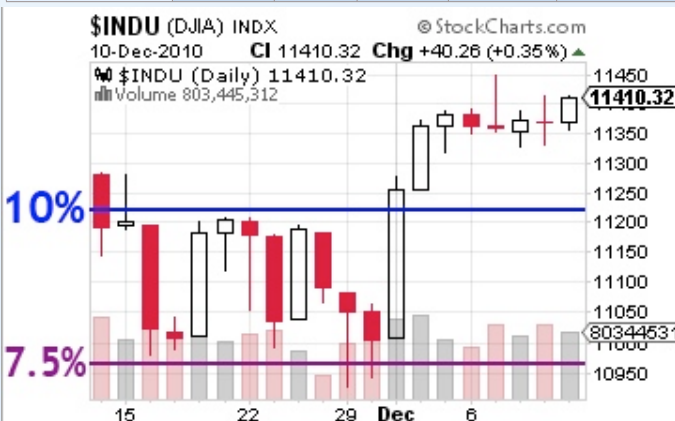
on the bullish bandwagon and drink POMO Kool-Aid with the bulls, we remain skeptical and are watching to see if the Dow joins the break out party.

In the meantime, we're still more comfortable with small “hit and run” plays using small portions of our portfolio. We are also taking upside hedges against our short positions such as the ones Phil wrote about on December 3rd involving upside “hedging” trade ideas based on the Direxion Daily Financial Bull 3X Shares (FAS) and the PowerShares DB Commodity Index Tracking (DBC). These are featured in the inset box on the next page.

We have included this week's UUP (US Dollar proxy) versus the Dow chart (see above). As you can see, the general pattern of “As the Dollar pops, the market drops” continues to apply.

## Watching Must Hold Levels

12/12/10	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



**Dark Horse Hedge** - a virtual portfolio by Scott of Sabrient and Ilene of Phil's Stock World had been short Green Mountain Coffee Roasters (GMCR) when the stock tumbled on Friday in reaction to its earning release after hours on Thursday. It was hit by a combination of factors, including weak earnings guidance and disclosure that the SEC was not finished with its informal inquiry. (“We are fully responding to all information requests. Nevertheless, we do not control the timing of the process.” Prepared



Remarks, filed with the Securities and Exchange Commission, emphasis added). The increasing price of coffee is biting into the company's profits, and its decision to **not provide shipment guidance** for its K-Cup line additionally clouded the picture as over 80% of its sales come from K-Cups and its Keurig machines ([CNNMoney.com](http://CNNMoney.com)). While the short trade initially went against Dark Horse Hedge, it has no plans to virtually cover its virtual short position.

We have featured Phil's "Beta 3" pattern for several weeks. It showed an uncanny similarity between the current rally and the rally that happened earlier this year, starting last March. The pattern had proven to be remarkably prescient for a while, but has been convincingly broken over the last two weeks due to the impact of tens of billions of Dollars worth of POMO money hitting the markets.

We'll continue to watch this pattern to see how it works itself out over the next few weeks, but as of now the power of POMO proving to be very impressive.

“Last Friday (December 3rd), we had two high-reward trade ideas featured in the main post. The first one was the FAS April \$20/25 bull call spread at \$2.70 (now \$3.20), selling the April \$21 puts for \$2.55 (now \$1.75) and that net .15 spread is already net \$1.45 so a pretty good gain (833%) for a week there. Our other upside hedge was DBC and again I liked April for a simple play to just buy the \$27 calls for \$1 (now \$1.10) as well as the more complex spread of the short 2012 \$22 puts at \$1.10 (now \$1) to offset the cost of the 2012 \$26/30 bull call spread at \$1.40 (now \$1.50). That one is, obviously, still playable if you need an inflation hedge and the LACK of commodity performance during this week-long stock mania is what still gives me pause so please keep in mind that I do think this is all BS but now we have support lines to play off and, as you know, losing 3 of 5 is a signal to flip bearish again for sure!” - Phil



## The Week Ahead

We've been watching Dow 11,500, S&P 1,220, Nasdaq 2,600, NYSE 7,750 and Russell 725 for a long time and, other than the Dow, these indexes smashed through their upside resistance levels and look like they are heading to the moon - especially the Russell 2000, which is up 25% for the year!

Phil discussed the breakouts on Saturday morning in a special weekend article for Members. He noted *"Small-caps may not be hiring, or making a lot of profit, and they may not have the ability to get loans from the bank, and their customer base may be hurting, but BOY, just look at that performance! As I've said before, once you break the orbit of a fundamental market, then 'Stock Market Physics' no longer applies and there is no limit to the madness that lies ahead of us when (and if) the Dow breaks that 11,500 line. With the Russell up 25% and the Nasdaq up 17%, the Dow, NYSE and S&P are looking kind of pokey hanging around the 10% lines, aren't they?"*

We've included a multi-chart showing the five indexes we track for our Market Targets below. As you can see the Russell 2000 and the Nas have been impressive performers. The current difference in performance between the RUT and Nas as compared to the Dow, NYSE and S&P makes us think that either the Dow has a long way to run

higher, or the RUT and Nas are going to hit an air pocket and drop.

Last week investors worried that the European Union would collapse, and now this week everyone is placid and complacent, and the VIX (which measures market volatility) is down so low that it is having its mail delivered by gophers. Investors are so calm that we are starting to wonder whether lithium is leaching out of batteries dumped in landfills, working its way into the water supply, and rendering people incapable of worrying about anything.

Although "Market Targets" are invaluable for trading purposes, market valuation indicators often play a role in long-term investing decisions and are another factor "investing coupon-clippers" might consider. Doug Short wrote an interesting post showing that ["Three Market Valuation Indicators All Signal Caution."](#) In this article, he finds, *"Based on the latest S&P 500 monthly data, the index is overvalued by 59%, 42% or 37%, depending on which of the three metrics you choose."* (More charts by Doug [here.](#))

In [another piece](#), Doug explains the Q Ratio, one of the indicators he uses to determine whether the market is under-priced, over-priced, or in-between: "The Q Ratio is a popular method

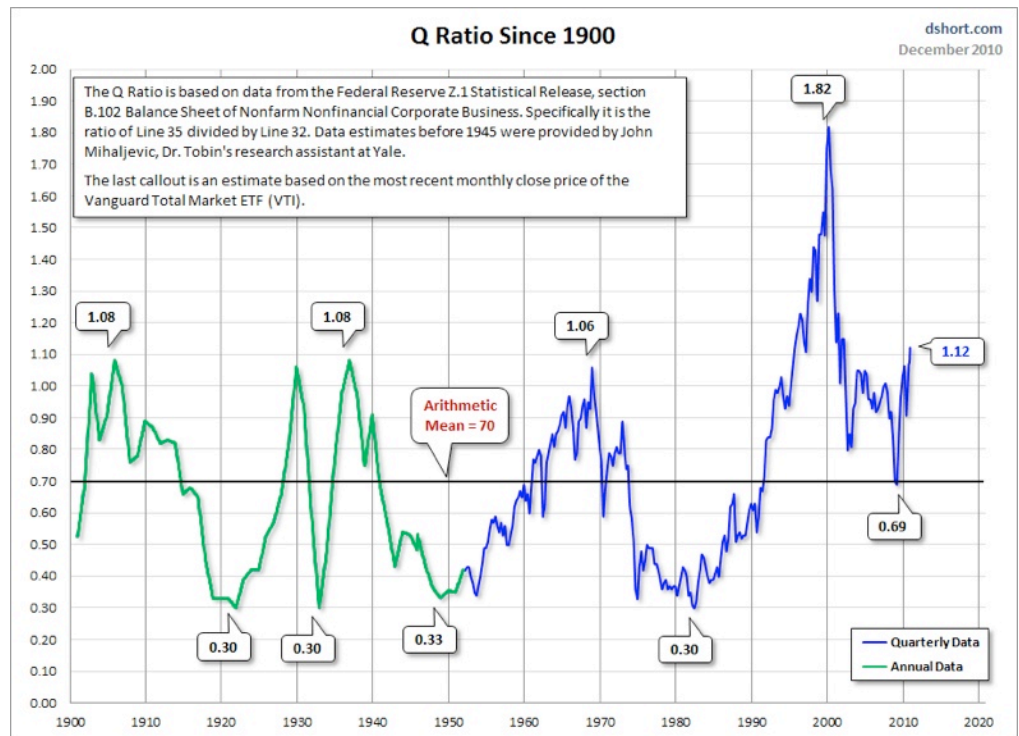


of estimating the fair value of the stock market developed by Nobel Laureate James Tobin. It's a fairly simple concept, but laborious to calculate. The Q Ratio is the total price of the market divided by the replacement cost of all its companies. The data for making the calculation comes from the Federal Reserve [Z.1 Flow of Funds Accounts](#) of the United States, which is released quarterly for data that is already over two months old."

Doug concludes "the market remains significantly overvalued by historical standards — by about 59% in the arithmetic-adjusted version and 72% in the geometric-adjusted version. Of course periods of over- and under-valuation can last for many years at a time." See Doug's chart above. For a more detailed explanation of the Q Ratio please read ["The Q Ratio Is Moving Into Nosebleed Territory."](#)

It behooves us to keep in mind "value" when we are evaluating a market. Technical factors may dictate near term moves, but in the long run, value has a way of eventually asserting itself.

Speaking of the concept of value, we are, as always, keeping an eye on the Dollar and other major currencies. A report released this week by [Bloomberg](#) talks about expectations of "super volatility" in foreign-exchange rates over the coming year: "Annual exchange-rate price swings may double on some major currencies, predicted strategists at UBS, the world's second- biggest currency trader. The euro may range from \$1.1 and \$1.5, compared with \$1.1877 to \$1.4579 so far this year; and U.S. dollar may touch as low as 70 yen and high as 100 yen in 2011, two times its 80.22 to 94.99 year-to-date range, the firm said."



In a telephone interview with Bloomberg, Mansoor Mohi-Uddin, head of global currency strategy at UBS, said *"The divergence between the strength in emerging markets and the unusual levels of uncertainty in the world's major economies will cause this super volatility. There is also high risk of policy-maker error in relation to interest rates, quantitative easing and fiscal tightening."*

Meanwhile, as our economy continues to muddle along, China is dealing with the problem of rising inflation. On Friday [China raised its reserve bank requirements 0.5%](#), after its markets closed for the weekend. China took this step to cool its economy after new data showed a sharp increase in exports and a continued pickup in the property market.

On the China topic, [Bruce Krasting](#) writes: *"Lots of concern about Chinese inflation. Up a whopping 5.1% in the most recent read. This might be the big story of the week. China is not going to let food prices run up 10 or 20 percent in a month. There are too many mouths to feed... We live in a global village. If China is*



*going to see significant food price inflation, so will we."*

We have a trade idea courtesy of Pharmboy, who writes *"I like IRWD May 11 10 Straddle for ~3.60. Ironwood Pharmaceuticals (NASDAQ: IRWD) is in Phase III clinical trials with Linaclotide, a first-in-class compound being evaluated for the treatment of irritable bowel syndrome with constipation and chronic constipation. Forest Laboratories is in a 50/50 joint venture with IRWD, and the data are compelling. Forest needs to fill the pipeline, and if Linaclotide is approved, IRWD is a takeout candidate. I like setting up the entry on IRWD by buying the stock and selling the May 11 \$10 straddle for about \$3.60 or better."*

By selling the straddle, Pharmboy means selling the \$10 calls and puts. This is an example of [Phil's Stock Buying Strategy for a 15-20% discount](#). If you buy 100 shares of stock at \$10.80 and sell one call at \$1.95 and one put at \$1.30, the initial investment is \$7.55. By buying half of a position in the stock (e.g. 100 shares), and selling a call and a put, if the stock is called away, then you make \$2.45 (\$1.95 + \$1.30 - \$0.80) on your initial \$7.55 investment. If it is put to you (stock below \$10 at expiration), you are obligated to buy more, lower than the original purchase price (you keep the \$3.25 option premium).

As always, be careful out there!

## Next Week's Economic Calendar

Monday 13	Tuesday 14	Wednesday 15	Thursday 16	Friday 17
11:00 AM: 4-Week Bill Announcement	8:30 AM: Producer Price Index	8:30 AM: Consumer Price Index	8:30 AM: Housing Starts	10:00 AM: Leading Indicators
11:30 AM: 3-Month Bill Auction	8:30 AM: Retail Sales	8:30 AM: Empire State Mfg Survey	8:30 AM: Jobless Claims	
11:30 AM: 6-Month Bill Auction	10:00 AM: Business Inventories	9:15 AM: Industrial Production	10:00 AM: Philly Fed Survey	
POMO DAY	2:15 PM: FOMC Meeting Announc.	POMO DAY	POMO DAY	POMO DAY

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