The Easy Money Addiction Exit Plan October 2, 2013

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On September 13, 2012, the Federal Reserve announced its latest "QE", or "Quick and Easy" money plan for Wall Street banks. If we look at the price of US stocks since that time, we can see why investors were so optimistic about the PAST 5 years of "Quick and Easy" money that they poured their own money into equity mutual funds at record levels right before the latest Sept 18th announcement from "the addiction dealers".

Stock Funds Worldwide Have Record $26 Billion Inflow, BofA, Friday, Sept 20th

> "Investors poured a record $26 billion into stock funds worldwide in the week ended September 18 as global markets rallied on expectations that the U.S. Federal Reserve would maintain its easy-money policies, data from a Bank of America Merrill Lynch Global Research report showed on Friday.
>
> The inflows into stock funds were the biggest on records dating back to 1992, according to Bank of America Merrill Lynch."

And while Sept 18th is currently the second "all time high" since the May 22nd high - the Japanese Nikkei stopping dead in its tracks right under 16,000 on May 23rd -the Russell 2000 managed to produced another all time high on the day the US government started its [first shutdown in 17 years](), and 12 days before the "drop dead date" for increasing the US debt ceiling since the firestorm in Congress during July 2011.

[It's Official: October 17 is the Debt Ceiling Drop Dead Day](), Business Insider, Sept 25 '13

> "Treasury Secretary Jack Lew drew an official deadline of Oct. 17 for Congress to raise the nation's debt ceiling, after which he said the Treasury would not be able to meet all of its obligations....
>
> After Oct. 17, Lew said, the Treasury would have only approximately $30 billion to meet all of its commitments. On some days, expenditures can go as high as $60 billion."

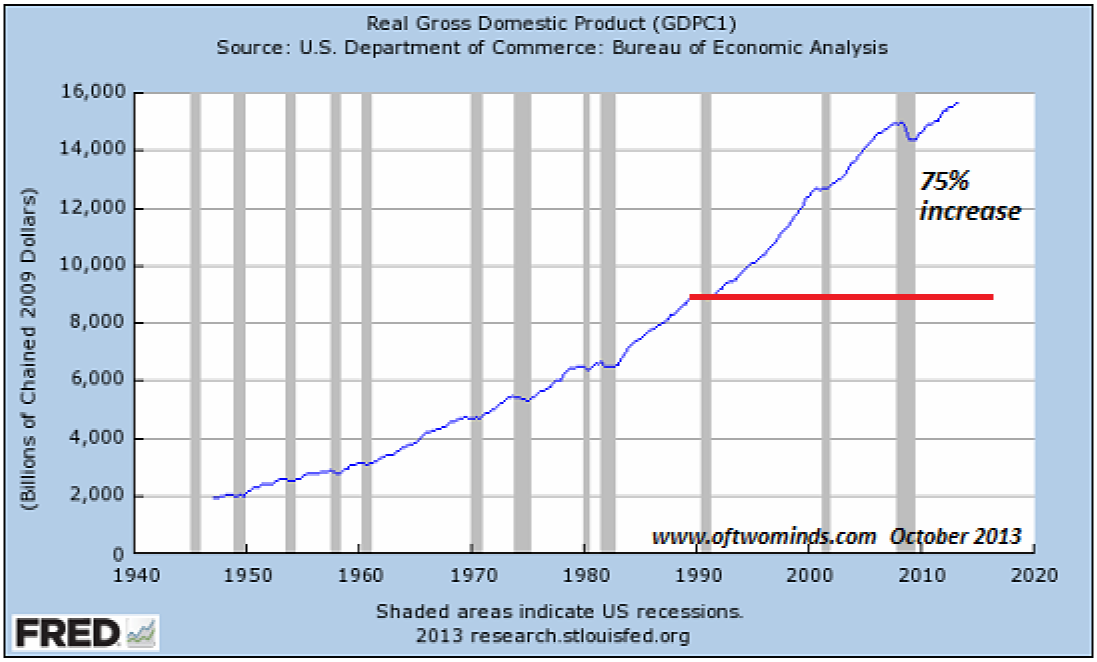
I know, I know, we have entered a new paradigm, where this time it really is different, and no matter what real world problem we face, stocks will never show fear again. With the "Quick and Easy" money dealers on watch, everything else is merely scary noise that none of us need worry about. The money dealers will always keep things running at "all time high" levels, no matter what!

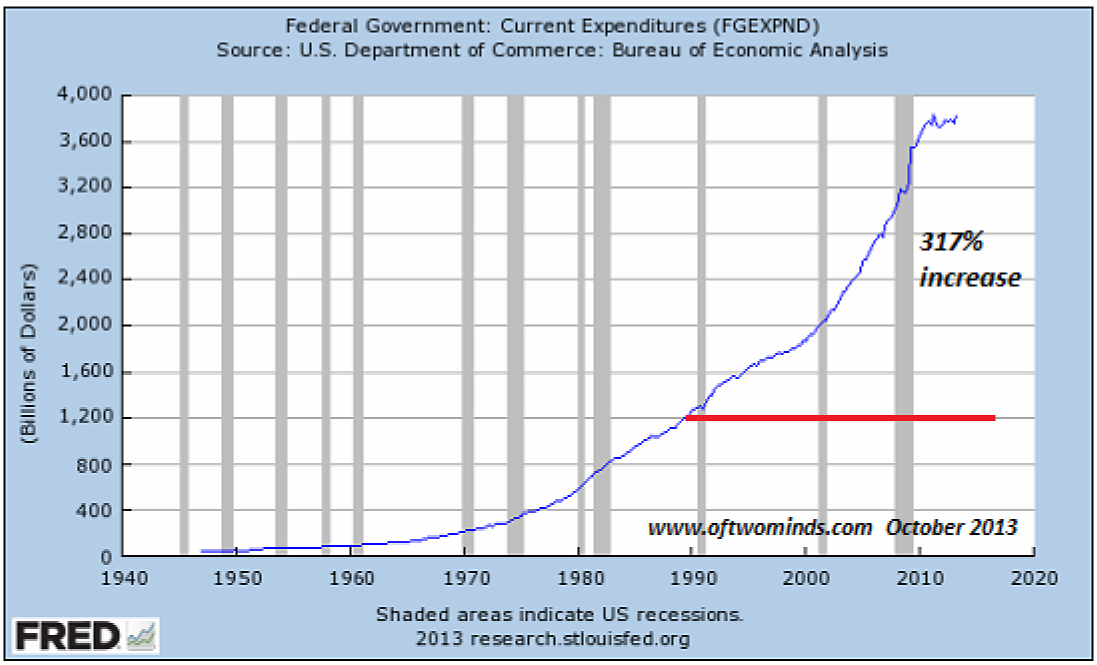
Now I ask you, has the lack of fear or pain from owning stocks and the ongoing image of complacency thanks to the "invisible hand" removed us from the ability to evaluate much larger risks, yes risks at the national security level? Notice the source of the comments below. They were made three years BEFORE arriving at the current government shutdown.

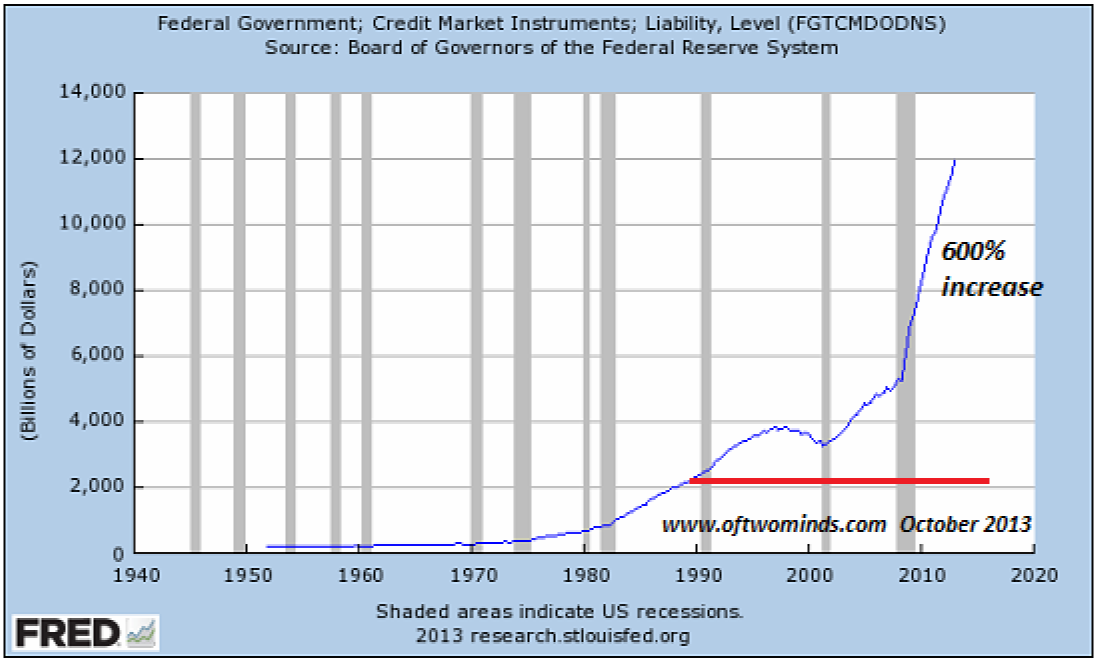
> "The country faces a fundamental disconnect between the services people expect the government to provide...and the tax revenues that people are willing to send the government...The fundamental disconnect will have to be addressed in some way if the budget is to be placed on a sustainable course." – Douglas Elmendorf, Director of CBO, November 24, 2009 – Joint Operating Environment 2010, published by the U.S. Joint Forces Command, pg 21

Have we come to a point where we believe that the highest levels in our military and in government accounting are irrelevant, because the "Quick and Easy" money dealers have removed the ability to fear from our brain? Are we so delighted to have become addicted to direct market intervention, that we have totally lost the ability to understand that this behavior collectively is unsustainable?

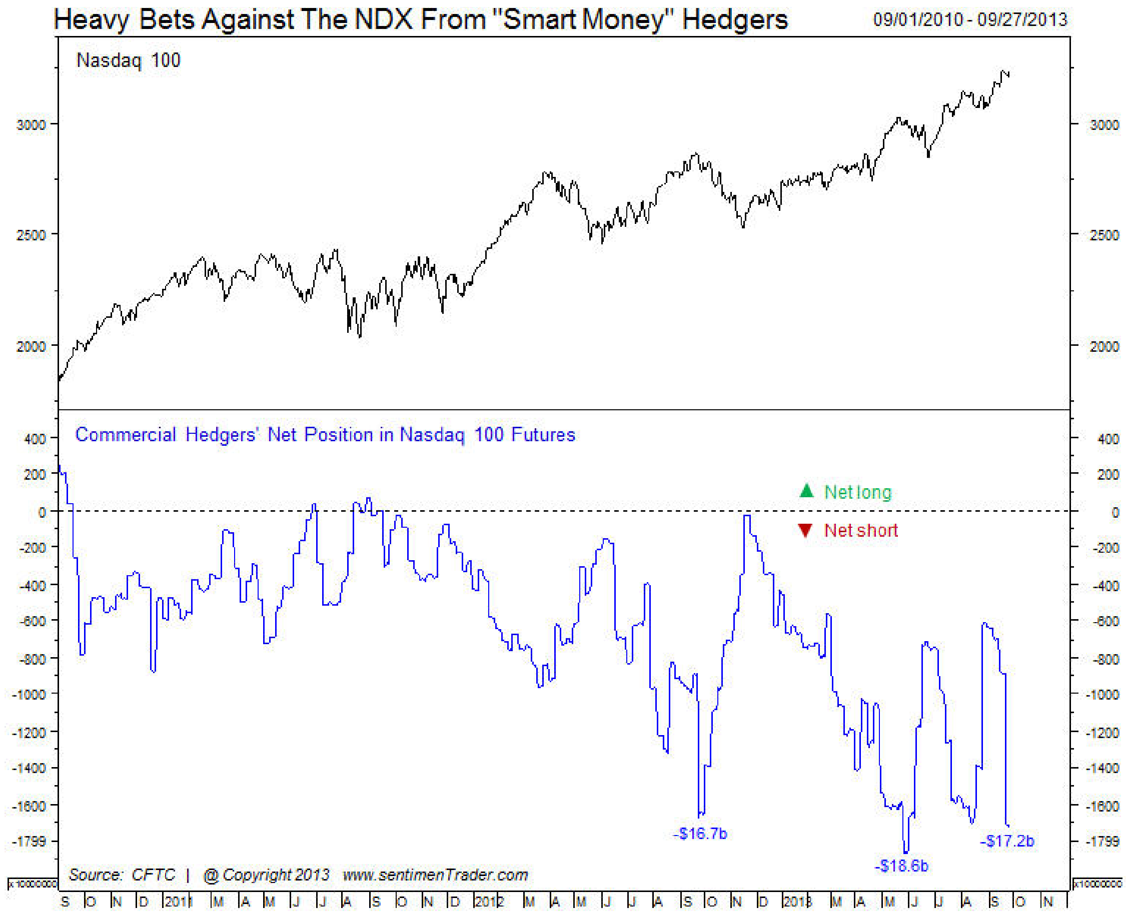
Look at these three charts I pulled from a recent article by economist Charles Hugh Smith, *Have We Reached Peak Government?*. With the US government in shutdown mode, and the Treasury Secretary telling us the new debt ceiling must be solved by October 17th, do these charts have any meaning to our own daily lives and plans?


Real Gross Domestic Product (GDPC1)
Source: U.S. Department of Commerce: Bureau of Economic Analysis
(Billions of Chained 2009 Dollars)
16,000
14,000
12,000
10,000
8,000
6,000
4,000
2,000
0
1940
1950
1960
1970
1980
1990
2000
2010
2020
75% increase
www.oftwominds.com October 2013
Shaded areas indicate US recessions.
2013 research.stlouisfed.org
FRED


Federal Government: Current Expenditures (FGEXPND)
Source: U.S. Department of Commerce: Bureau of Economic Analysis
(Billions of Dollars)
4,000
3,600
3,200
2,800
2,400
2,000
1,600
1,200
800
400
0
1940
1950
1960
1970
1980
1990
2000
2010
2020
317% increase
www.oftwominds.com October 2013
Shaded areas indicate US recessions.
2013 research.stlouisfed.org
FRED



Even outside the military, the CBO, the explosion of government spending and debt that is outstripping our economic growth, there are two more patterns I saw as we came through September that told me we are right now at an extremely unstable situation.



[Source – Jason Goepfert, www.sentimentrader.com]

Anyone with knowledge of the futures markets understands that futures are a zero sum game, or as futures legend, R. Earl Hadady states in his book, **Contrary Opinion: Using Sentiment To Profit in the Futures Markets** (2000), "the money lost by some speculators and hedgers is exactly equal to the money won by other speculators and hedgers".

To make certain we all understand what the chart above reflects, the commercials (the primary dealers and largest financial institutions in our markets) were net SHORT the second highest level on record – the largest since May of this year - against the NASDAQ on September 24th, having tripled the number of short contracts in only 3 weeks. In fact, as stocks were soaring into the Fed's Sept 18th announcement, we find from Goepfert that "it is a record in terms of single-week increases in hedgers' net position against the NDX. Never before had they increased their short position by more than $8 billion in a single week."

So while retail investors are pouring into stock funds to produce the “largest inflows into stock funds on record back to 1992”, according to Bank of America Merrill Lynch, the commercial hedgers (largest financial institutions) were producing “a record in terms of single-week increases in hedgers’ net position against the NDX”, according to Jason Goepfert’s research of www.sentimentrader.com.

One thing has become more and more obvious with each passing quarter since the July 2011 debt ceiling showdown; investors have been groomed to DEPEND on more and more debt, a pathway which the most basic lessons in the history of finance have proven are totally unsustainable. We have been told that these policies of constant intervention into what remains of our free markets is essential for our “recovery”. Only when we admit that we have ACCEPTED central planning in our markets like we do from our government, will be start to understand why current patterns of behavior were NEVER sustainable to begin with. Ultimately we must accept that we have returned to a crisis situation like we faced 5 years ago.

On Sept 18, 2013, the Federal Reserve made it clear to all investors. They have no exit plan, so expect severe withdrawals when the current stock nirvana breaks.

BIS Veteran Says Global Credit Excess Worse Than Pre-Lehman, The Telegraph, Sept 15th

> “‘This looks like to me like 2007 all over again, but even worse,’ said William White, the BIS’s former chief economist, famous for flagging the wild behaviour in the debt markets before the global storm hit in 2008.
>
> The BIS said in its quarterly review that the issuance of subordinated debt -- which leaves lenders exposed to bigger losses if things go wrong -- has jumped more than threefold over the last year to $52bn in Europe, and jumped tenfold to $22bn in the US.
>
> The share of ‘leveraged loans’ used by the weakest borrowers in the syndicated loan market has jumped to an all-time high of 45pc, ten percentage points higher than the pre-crisis peak in 2007-2008.”

Oh, and lest you need encouragement that it was time to worry about the markets, look only to the President of the United States. This is surreal.

> As Shutdown Continues, Obama Says Wall Street "Should Be Concerned", CBS News, Oct 2, 2013
>
> "Gridlock may be all to common in Washington these days, but President Obama said that Wall Street should be worried about more serious consequences now that the government is closed for business and the debt limit deadline is just around the corner.
>
> 'This time's different,' Mr. Obama said in an interview with CNBC that aired Wednesday afternoon. 'I think they should be concerned.'

If you are challenging your own thinking, and are seeking ideas that are outside those presented by our illustrious central planners, then I would encourage you to subscribe to my most comprehensive research and trading commentary with a 6 month subscription to **The Investor's Mind: Anticipating Trends through the Lens of History.** Using the logical side of our brains, rather than enjoying the emotional comfort of unlimited mania, has never been more crucial in our markets.

Seven years after its release, I still refer back to my research paper **Riders on the Storm: Short Selling in Contrary Winds** (Jan '06). I would encourage you to click here to download it for free if you have never read it.

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