ETF PROFIT STRATEGY NEWSLETTER

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Profit With Insight **June 2010**

Market Meter (The U.S. Equity Markets at a Glance)

Short-term (1-15 days)	Snapshot: The outlook is bearish as long as the S&P stays below 1,182. Expanded: The S&P was repelled by the 1,170 - 1,182 resistance barrier outlined in Wednesday night's (5-12-10) Technical Forecast. Prices should now work their way below Thursday's (5-6-10) intraday low of S&P 1,066 and DJIA 9,787. A break above S&P 1,182 would increase the odds of a rally to new highs. Last month's recommendation to manage profits in short postions with trailing sell stops remains valid.
Mid-term (1-5 weeks)	Snapshot: We might be at the cusp of a long-term trend reversal. Expanded: Wall Street is rediscovering that stocks can actually go down. The fear ignited by European debt woes could spiral into the negative feedback loop we've been expecting and push the S&P 500 into the 1,000 range before sparking a noticeable counter trend rally.
Long-term	Our forecast of Dow 5,000 by 2010 - 2011 remains intact. Recent price action is building the foundation for a fast and furious decline. The target for the ultimate market bottom is 3,000 and below within the next 2-4 years. For more details refer to the following articles: "The Four Horsemen ..." (November 2009 issue, page 6) and "Dow 2,000, Why?" (June 2009 issue, page 5).

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Keeping up-to-date with the Technical Forecast and Weekly Pick

Last month we launched the Technical Forecast and wanted to take a moment to evaluate this new service and thank you for your feedback. We didn't realize how popular the Market Meter was until we removed it from the Weekly ETF Pick. The Technical Forecast will now include the Market Meter and we'll make the pivot charts bigger too.

In terms of accuracy, the Technical Forecast has over-delivered on the 60-70% accuracy rate we expected. We can't promise the accuracy rate will always be as high as it's been, but we'll certainly do our best to perform.

It looks like the market is done lulling investors asleep. With more volatility likely, make sure to check out the Technical Forecast for Sunday night and Wednesday night updates.

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ETF Profit Strategies (By Simon Maierhofer, Co-Founder)

From bailing out corporations to bailing out countries

Aside from the fact that the world has gone from bailing out corporations to bailing out entire nations, the biggest event since the March 2009 market bottom was the 998-point top-to-bottom selloff on Thursday, May 6, 2010. From 11:26 to 11:46am, the Dow Jones Industrial Average (DJIA) lost 635 points, the swiftest 20-minute decline in history. At one point, the decline erased three months worth of gains – yes, three months worth of gains vaporizing in about one hour!

Wall Street was hard-pressed to come up with an explanation for the meltdown. Of course, Greece was the obvious scapegoat, even though we've known about Greece's near-insolvency for over a month. Quickly reports of a clumsy fat-fingered trader who confused a million and a billion popped up in the media. Computerized high frequency trading, communication problems between the exchanges and the lack of circuit breakers were other possible causes dug up within a matter of hours. None of those could be confirmed. In fact, as per a Reuters report, "the top U.S. securities regulator said no single event had been found to explain Thursday's mysterious market plunge." I guess that's why they still consider it " a mystery."

Crusin' for a bruisin'

The simple fact is that the market has been cruisin' for a bruisin'. After nearly three months of not losing more than 1%, the major indexes had become extremely overbought and sentiment extremely optimistic. Protective options buying had all but vanished from Wall Street. The May issue of this newsletter clearly pointed to the dangers of the 0.32 CBOE Equity Put/Call ratio: "The message conveyed by the composite bullishness is unmistakably bearish. The put/call ratio in particular can have far reaching consequences. Protective put-buying provides a safety net for investors. If prices fall, the value of put options increases balancing any losses suffered by the portfolio. Put-protected positions do not have to be sold to curb losses. At current levels however, it seems that only a minority of equity positions are equipped with a put safety net. Once prices do fall and investors do get afraid of incurring losses, the only choice is to sell. Selling results in more selling. This negative feedback loop usually results in rapidly falling prices."

But prices didn't stay low. The DJIA rallied more than 600 points the same day and managed to record the third-largest gap-up open two days later. The two largest pre-market open gains were scored on September 19, 2008 and October 13, 2008. The September/October 2008 period hosted some of the biggest gains and losses in trading history (see November 2008 newsletter, page 6, "Are big point gains an indicator of major market bottoms?").

Monday's (5-10-10) trading session added another 405-point bounce to Thursday's rebound. At first glance this seems bullish. But, history tells us it's not. We've found 16 instances where the DJIA rallied 400 points or more, 12 of them hit during the post-2007 decline, most of them in September/October 2008.

This is not an infallible sell sign, and the picture would look somewhat different if you use percentage instead of point declines (most of the biggest percentage declines occurred during the Great Depression and post-2007 decline) but huge rallies are certainly no reason to turn bullish (see charts on page 3).

Regardless of the post-meltdown meltup, *the key question is whether Thursday decline was the first installment of the major bear market we've been waiting for?*

Unfortunately the question is simpler than the answer. To bring the current situation into context, it might help to look back at some of the parameters we had set previously. The April 2010 newsletter stated there "there are no major resistance levels to speak of until S&P 1,220 and DJIA 11,255 (61.8% Fibonacci retracements)." The 3-24-2010 Market Meter (ETF Pick on EPV) added: "The next longer-term resistance,

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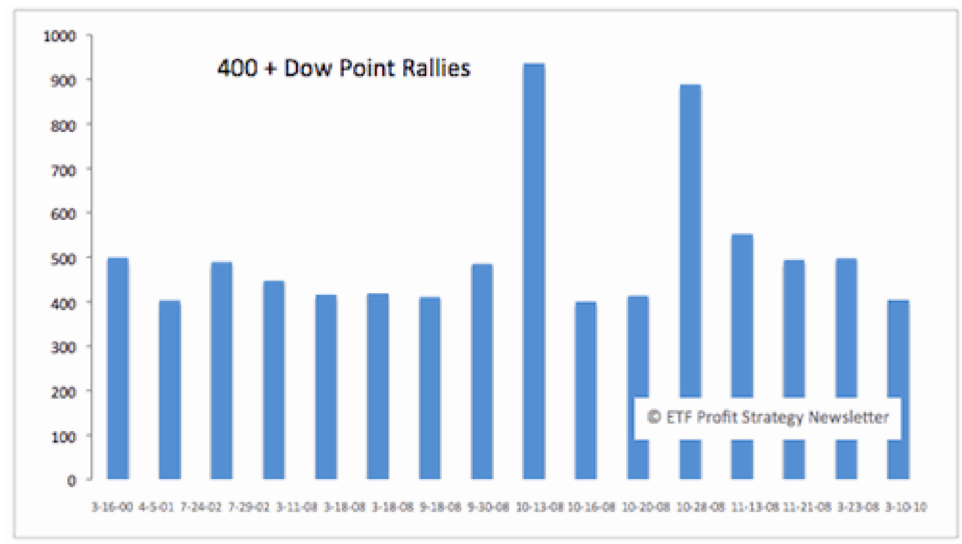
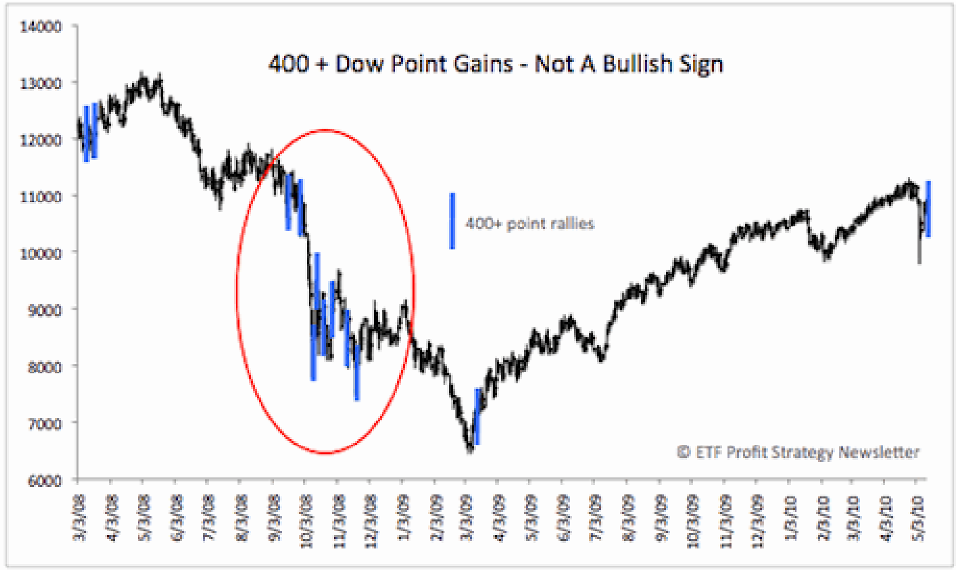
and possible the eventual stopping point for this rally, is S&P 1,220. If we get new recovery highs and new sentiment extremes, the stage would be set for a major correction, which would coincide with the worst six months of the year time period."



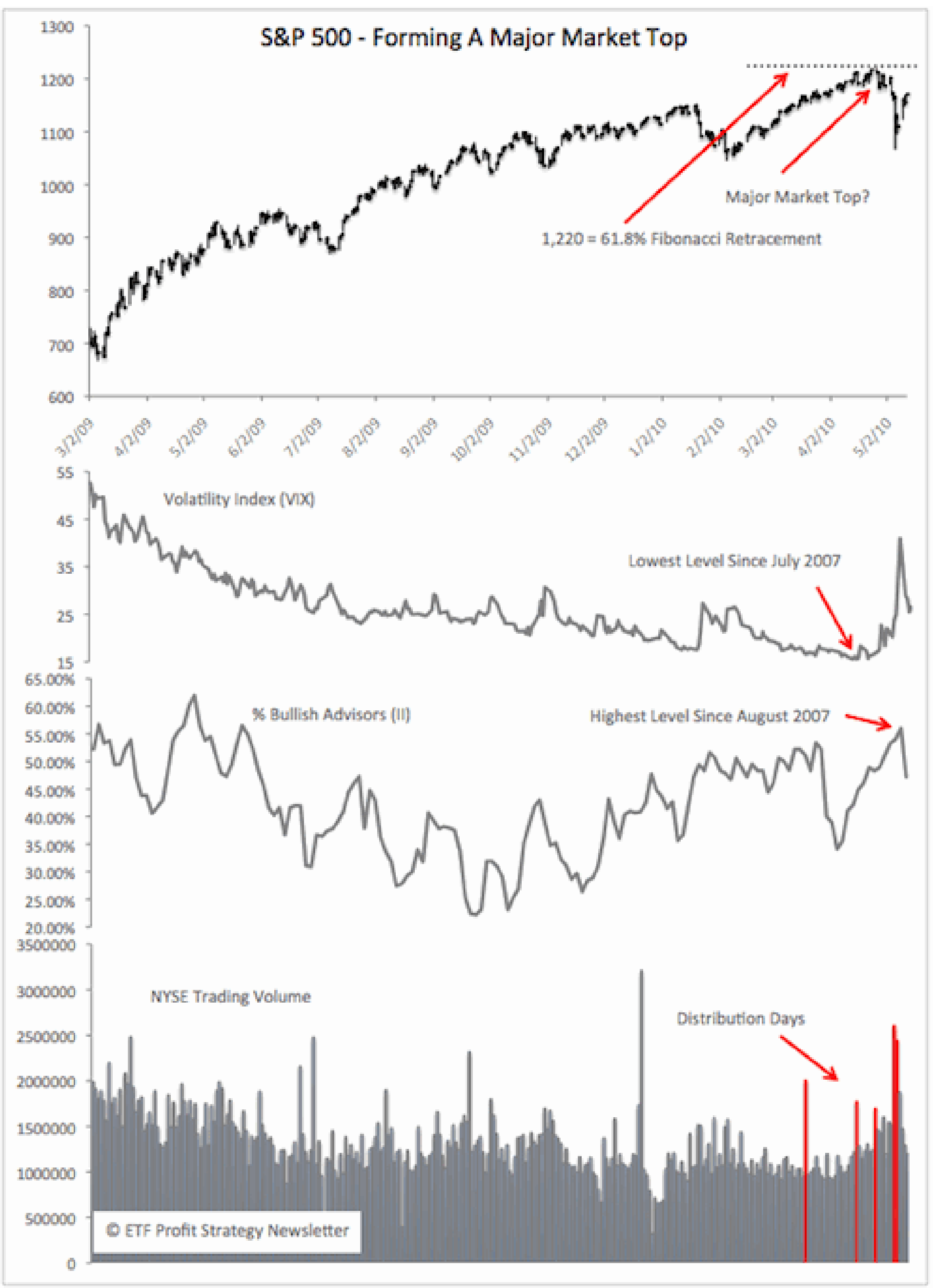


The S&P peaked at 1,219.80 on April 26, the DJIA at 11,308 on April 26. Even the percentage of bullish advisors tracked by Investors Intelligence (II) reached a new peak of 56% (highest reading since December 18, 2007 – 56.5%) on May 5, 2010. We've also had plenty of distribution days on heavy trading volume (see chart on page 4). The Thursday selloff fits the bill of a "fast and powerful next leg down."

As the chart on page 4 shows, all requirements for a major market top have been fullfilled. But are there any flies in the ointment? Yes, as always there are. But there are two safety levels that will help us eliminate further upside potential.

ETF Profit Strategies (continued from previous page)

The fly in the ointment is described in the May 9, Technical Forecast: “The market has been full of head fakes and we’ve come to know better than to jump all in. Back on January 2010 the S&P had a similar weekly down move that pierced through the 20-day SMA and following a two-week selloff kissed the 2 standard deviation lower band before continuing its rally. In plain English, this means that even though the technicals are showing the beginning of a trend roll over, a longer-term trend change has not yet been confirmed.”



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The February decline pushed the S&P down to 1,044.5 compared to 1,066 on Thursday (5-6-10). The next leg of the decline, if underway, should reduce the indexes to levels lower than seen on Thursday (5-6-10) and significantly below the lower acceleration band at 1,042. What about upside risk?

A normal 61.8% Fibonacci retracement of the losses occurred from the S&P 1,220 to 1,066 drop would lift the indexes to 1,160. The 50-day simple moving average (SMA) is at 1,172. The last few corrections have retraced a much higher percentage und ultimately resulted in new highs. Therefore we do not want to give this bounce much more leeway and don't want to be surprised by another extended rally leg. S&P 1,160 – 1,182 hosts a number of resistance levels that should repel the market if this decline is for real. A break above 1,182 (the 1,181.62 level was highlighted in the May 2 Technical Forecast and served us well) would be a first indication that new highs might be on the horizon. If you own or intend to buy short ETFs, we recommend to use 1,182 as a stop-loss (corresponding DJIA level is 10,965).

Summary

The market is giving us all the right reasons to be bearish, so bearish we are. Unless S&P 1,182 and/or DJIA 10,965 is broken, odds are that the April highs mark a historical market top. The indexes should work their way lower in a powerful manner. A rally above 1,182 would be a strong indication that new highs are forthcoming. 1,182 should be used as an "across-the-board" stop-loss, safety level. It is prudent to protect gains on the downside with trailing sell stop orders (see February newsletter, page 15 for an explanation of order types).

Below is a list of short ETFs sorted by level of aggressiveness. Before investing in (leveraged) short ETFs we highly recommend reviewing "The basics of short and leveraged ETFs" (April 09 newsletter, page 1).

Domestic Short ETF Profit Options		
ProShares Short Dow Jones	DOW	Inverse large cap
ProShares Short S&P 500	SH	Inverse large cap
ProShares Short Mic Cap 400	MYY	Inverse mid cap
ProShares Short Russell 2000	RWM	Inverse small cap
ProShares Short QQQ	PSQ	Inverse Nasdaq
ProShares Short Financials	SEF	Inverse financial sector
ProShares Short Real Estate	REK	Inverse real estate, new ETF
ProShares UltraShort Dow Jones	DXD	2x inverse large cap
ProShares UltraShort S&P 500	SDS	2x inverse large cap
ProShares UltraShort Mid Cap 400	MZZ	2x inverse mid cap
ProShares UltraShort Russell 2000	TWM	2x inverse small cap
ProShares UltraShort QQQ	QID	2x inverse Nasdaq
ProShares UltraShort Financials	SKF	2x inverse financial sector
ProShares UltraShort Real Estate	SRS	2x inverse real estate
Direxion Large Cap Bear	BGZ	3x inverse large cap
Direxion Mid Cap Bear	MWN	3x inverse mid cap
Direxion Small Cap Bear	TZA	3x inverse small cap

International ETFs

Greece has been hogging all the attention reducing other international issues to mere crumbs. The ugly overleveraged debt beast has a strangle hold on Europe (it will probably soon stage its comeback in the U.S. as well). In my humble opinion, the European $1 trillion + bailout is just another bandage, a drug that

ETF Profit Strategies (continued from previous page)

temporarily masks the symptoms but doesn't treat the disease. Various governments are (or will be) unable to service their debt. Is issuing more IOUs for those who can't even pay their current IOUs really the solution? Our belief is that the bailout of entire governments will have similar results as the 2008 series of corporate bailouts; deeper deficits will be discovered and stock prices will fall even lower.

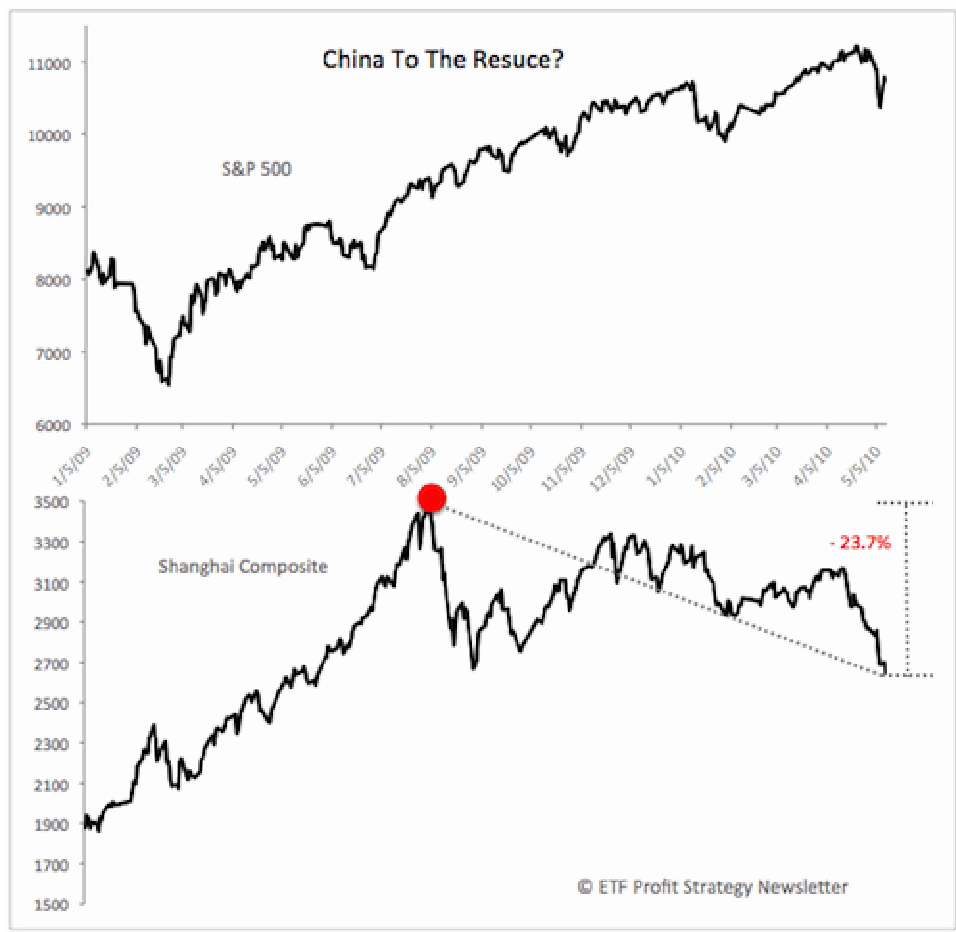
For those who agree, we've put together a table of vehicles to profit from the European debt crisis. Items in blue include short ETFs and other heavily traded ETFs suitable for short or put options strategies. Items in gray are lightly traded and/or on the riskier side. Keep in mind the euro might be due for a counter rally (see page 8 for more details).

European ETF Profit Options		
UltraShort MSCI Europe ProShares	EPV	2x inverse Europe ETF
UltraShort Euro ProShares	EUO	2x inverse euro currency ETF
Market Vectors Double Short Euro ETN	DRR	2x inverse euro currency ETF, less popular then EUO
PowerShares DB US Dollar Bullish	UUP	Long dollar ETF
iShares MSCI Italy	EWI	PIIGS country ETF – available for short strategies
iShares MSCI Spain	EWP	PIIGS country ETF – available for short and option strategies
Vanguard European ETF	VGK	Broad Europe ETF – available for short and option strategies
iShares S&P Europe 350	IEV	Broad Europe ETF – available for short and limited options strategies
SPDR Dow Jones EURO STOXX 50 ETF	FEZ	European ETF – available for short and option strategies
iShares MSCI Germany	EWG	Not one of the PIIGS countries but likely to suffer from debt crisis – available for short and options strategies
iShares MSCI United Kingdom	EWU	Not one of the PIIGS countries but likely to suffer from debt crisis – available for short and options strategies
PowerShares FTSE RAFI Europe Portfolio	PEF	European ETF – available for short strategies – trades on low volume
WisdomTree Europe SmallCap Dividend	DFE	European small cap dividend fund – available for short strategies – trades on low volume
SPDRs S&P Emerging Europe	GUR	Emerging European countries ETF (Russia, Turkey, Poland) – available for short and limited option strategies
iShares MSCI Emerging Markets E. Europe	ESR	Emerging Eastern European countries ETF (Russia, Poland) – available for short strategies – trades on low volume
iShares MSCI Europe Financial Sector	EUFN	European financial ETF – available for short strategies – new ETF, trades on low volume
iShares FTSE EPRA/NAREIT Europe	IFEY	European real estate ETF – available for short strategies – trades on low volume

Thus far, the noise coming from Greece has completely blocked out the weakness in Asian markets. China has been declared the savior of the global economy, yet the Shanghai Composite has lost as much as 23.7% since it's recovery high that dates back to August 2009.

ETF Profit Strategies (continued from previous page)

If China can't come to the rescue, who can? In 2008 it was believed that emerging markets and frontier markets would be spared from the U.S. debt crisis. Now we hear reports suggesting that frontier and emerging markets won't be affected (as much) by the European debt crisis. Chances are, frontier and



emerging markets will get hit as hard if not harder than developed markets. Below is a list of international short ETFs.

International Short ETF Profit Options		
ProShares Short MSCI EAFE	EFZ	Inverse international ETF
ProShares Short Emerging Markets	EUM	Inverse emerging markets ETF
ProShares Short China	YXI	Inverse China ETF
ProShares UltraShort MSCI EAFE	EFU	2x inverse international ETF
ProShares UltraShort Emerging Markets	EEV	2x inverse emerging markets ETF
ProShares UltraShort Pacific ex-Japan	JPX	2x inverse Asian markets ETF
ProShares UltraShort China	FXP	2x inverse China ETF
ProShares UltraShort Japan	EWV	2x inverse Japan ETF

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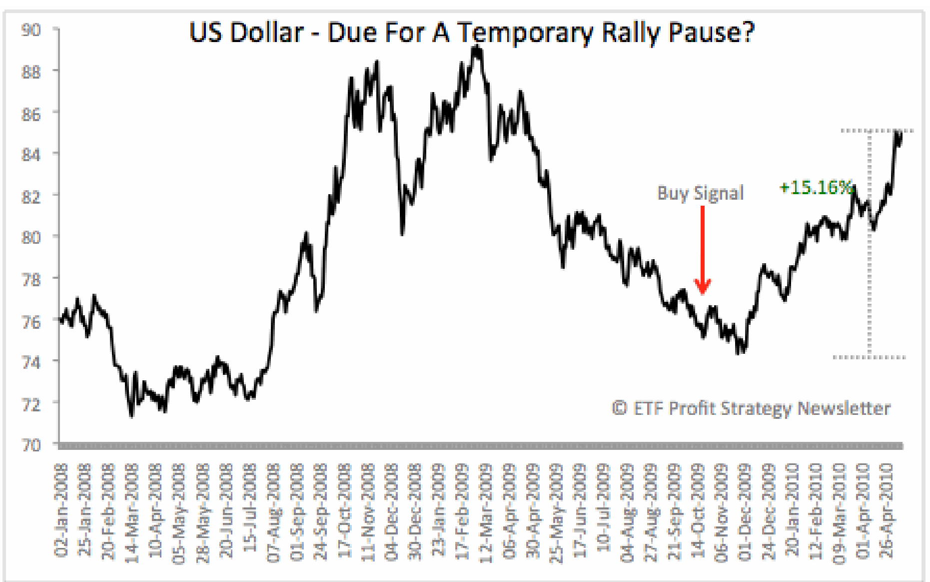
U.S. Dollar

It wasn't too long ago when headlines such as the ones below graced the front pages of major newspapers and websites (Also see the cartoon on page 9):
- "Dollar to weaken as reserve status erodes" - 8-19-09, PIMCO
- "Buy stocks because the U.S. dollar will be worthless" - 9-22-09, Marc Faber on Yahoo's Tech Ticker
- "Strong dollar turns relic" - 10-13-09, Blommberg
- "Dollar loses reserve status to yen & euro" - 10-13-09, New York Post
- "Dollar is dying a slow death" - 10-20-09 - Niall Ferguson on Yahoo's Tech Ticker

This kind of pessimism was our clue to turn bullish on the U.S. dollar. Admittedly, we were too early. But as the chart below shows, the rally from last year's low was strong enough to make up for any timing errors and generate generous profits.



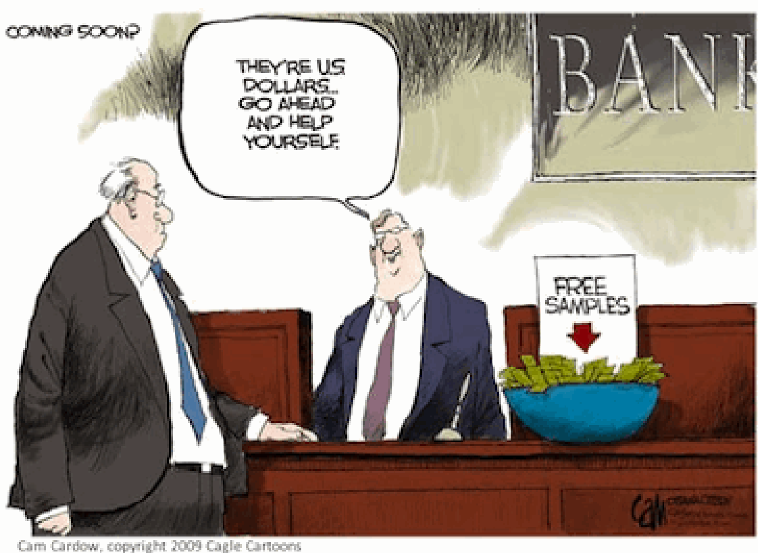
While we maintain our longer-term (longer term in this instance means 6 - 18 months) stance we can't help but notice that the extreme dollar pessimism has turned into extreme euro pessimism. Often this is an indication that prices are due for a temporary correction. Additionally 86.39 would mark a Fibonacci 0.786 retracement of the 3-4-09 to 11-26-09 decline (from 89.71 to 74.21) of the U.S. Dollar Index. On Friday (5-14-10), the Index rallied as high as 86.395. A temporary dollar top could occur any day.

Why are we longer term bullish the greenback? Even though inflation has been declared the biggest problem, our analysis shows that deflation will reign for the foreseeable future. Once the post-2007 bear market resumes, deflation will further reduce the value of stocks, real estate, commodities, etc. Dollar denominated assets (especially debt) will implode at a rate faster than the government can print money (similar to what we saw in 2008). As US dollar denominated assets dwindle, every remaining greenback becomes more valuable. This is a very simplistic forecast, but we believe it's the correct one.

We are not sure how long the US dollar rally will ultimately last, but for right now stick with our forecast that the greenback can reach parity with the euro. Today this sounds far less fetched than when we first issued that forecast in 2009.

ETF Profit Strategies (continued from previous page)

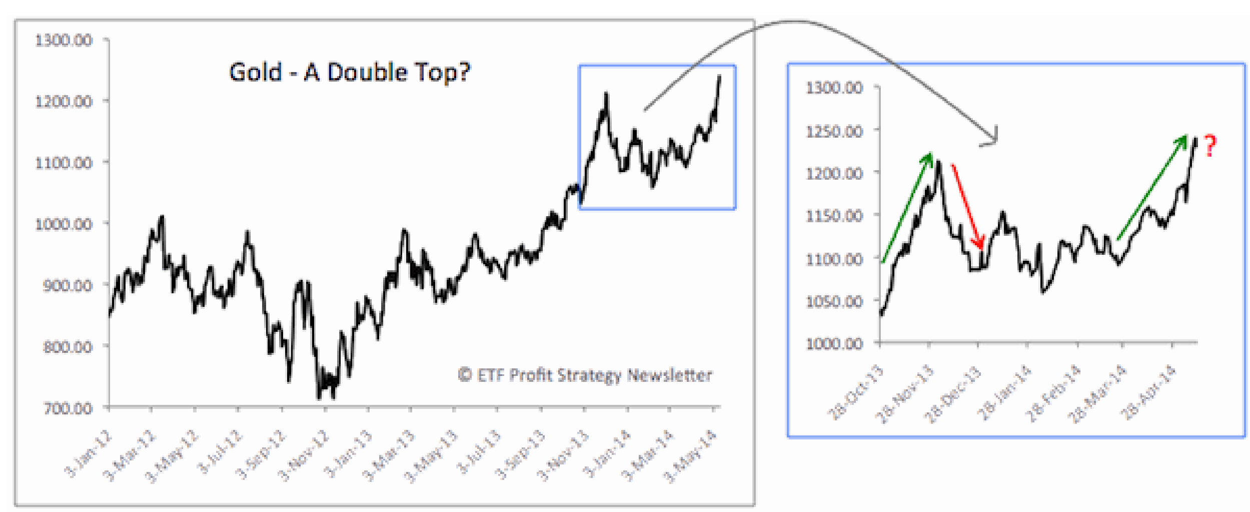
How fast things change. The below cartoon was published in our January 2010 newsletter.



Cam Cardow, copyright 2009 Cagle Cartoons

Gold/Silver

No doubt due to the Greek-debacle, gold and silver have gone straight up for three weeks. It's almost been two months since we turned neutral on gold and silver and it's tempting to go short again. Sentiment for gold and silver has once again become astronomically bullish. According to the Daily Sentiment Index, 97% of traders are bullish. Even though sentiment doesn't prohibit higher prices, it certainly doesn't support higher prices. Since sentiment gauges try to anticipate tops and don't confirm them, going short precious metals would be a risky but possibly very rewarding trade. The last time we saw prices spike in this manner, they retraced just as fast. The same may happen this time. Short metals ETFs include the UltraShort Gold (GLL) and UltraShort Silver ProShares (ZSL). This trade is only for aggressive investors.



Artificial Earnings Growth - How Long Before Investors Catch On?

By Simon Maierhofer, Co-Founder

“The whole damn industry lost its moral moorings,” was Charlie Munger’s - Warren Buffett’s business partner - response when asked about Goldman Sachs’ “socially undesirable” business dealings. He added: “They were very competitive in maximizing profits in a competitive industry that was permitted to operate like a gambling casino.”

Munger’s assessment echoes what Timothy Geithner said when interviewed by the Today Show in March: “What happened in our country should never happen again...people were paid for taking enormous risks. It was a crazy way to run a financial system.”

Blackmailing America

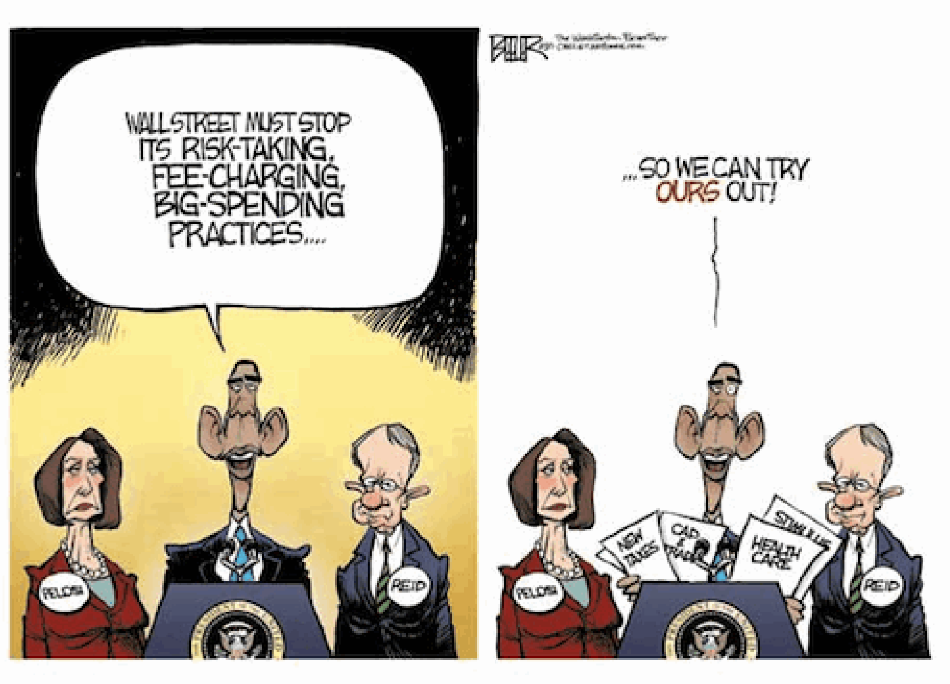
Jim Reid, a Deutsche Bank AG strategist in London, noted, “it seems incredible that financials are now scaling their 2006-07 heights again. The dramatic imbalances that fueled the credit crisis are re-occurring.” The question back to Mr. Geithner should have been: “If it was so crazy, why do you allow it to happen again, even though you said it shouldn't?” Simon Johnson, professor of MIT’s Sloan School of Business and author of *13 Bankers*, claims that bankers even leverage their position to blackmail the nation. Any time there is mention of a banking or financial reform, you’ll hear the banks respond, “oh my goodness, there maybe a double-dip recession.”

Obstructing the truth

But we know that banks don’t just indirectly blackmail the nation, they actively work on obstructing the truth, and as allegations against Goldman Sachs show, do whatever it takes to get ahead. On March 19, 2010, the U.S. Court of Appeals in Manhattan ruled that the central bank must release documents

Artificial Earnings Growth (Continued from previous page)

pertaining to the central bank's $2 trillion emergency lending extended to financial institutions in 2008.



Paul Saltzman, the banking group's general counsel, said they would repeal the decision. If the ruling is again unfavorable, the bank group will petition the Supreme Court. Why all this resistance? Saltzman says: "Our member banks are very concerned about real-time disclosure of information that could cause a run on the banks." Wow! That's a heavy-duty statement. By the way, member banks include Bank of America, Citigroup, BNY Mellon, Deutsche Bank, HSBC, JPMorgan, PNC, UBS, U.S. Bancorp, Wells Fargo, etc.

Buffett on ethics

Another red flag is Warren Buffett's resistance against legislation that would force companies to put up collateral for existing derivatives positions. Berkshire Hathaway owns a $63 billion derivatives portfolio and Buffett himself has warned of the dangers of derivatives, famously branding them "financial weapons of mass destruction." It is understandable that Buffett, a shrewd businessman, wants to avoid setting aside cash and doesn't want the rules to be changed after the game started. However, the fact that Nebraska Senator Ben Nelson proposed the exemption is suspect. Ben Nelson owns an estimated $6 million worth of Berkshire stock. Additionally, Berkshire is Nelson's largest campaign contributor.

At Berkshire's annual shareholder meeting, Buffett took a lot of his most faithful fans aback as he gave a full-throated defense of Goldman Sachs. Whether or not Goldman committed outright fraud, Goldman's me-first attitude and conflict of interest are beneath Buffett's ethical standard, you'd think. Munger assessed Goldman's activities politically correct as "socially undesirable." Our March 2010 newsletter stated the following regarding Goldman Sachs: "By the time this recession is over, GS will have morphed from powerhouse into scapegoat." The Wall Street Journal explains why all the rage against Goldman: "The development comes amid public calls for more Wall Street accountability for the industry's role in the financial crisis." Such public calls are one facet of crowd behavior set in motion by a larger bear market.

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The fact that such calls persist despite a 75% rally in equities is testament that the bear market is not yet over.

Focus on earnings

Despite turmoil in the financial industry, earnings have been nothing short of outstanding. Profits from the financial sector soared 300%+ year-over-year while total U.S. corporate profits are up 50%+ year-over-year. Financial sector profits account for roughly 80% of the overall increase in corporate earnings. Without financials, the rebound in corporate profits would be minimal. With financial profits being the big story, it makes sense to read between the lines and see if those profits are real. Not all that shines is gold.

Repo 105 – How Lehman almost got away

The bank-appointed examiner's report on Lehman Brothers released in mid-March 2010 revealed some startling accounting maneuvers. Lehman took advantage of Repo 105, an accounting trick that hid its leverage. In a nutshell, here's what happened: The Repo market is a way for banks to borrow money against collateral, i.e. a bond. If the borrower goes bankrupt, the lender gets to keep the bond. If the borrower repays the loan as planned, the lender gets to keep a fee and interest. In reality, the bank isn't really selling a bond, its simply borrowing money. But Lehman wanted to hide how much money it was borrowing. To do just that, Lehman would sell a bond that was worth $105 on the repo market for $100 (Lehman put up collateral equal to 105% of the cash it received. Hence the nickname Repo 105). For accounting purposes, Lehman got the cash infusion, which was used to pay off debt. Then, after it had issued its quarterly report, Lehman would borrow more money to repurchase the bond.

As per Lehman's bankruptcy examiner's report, it did not disclose its use of Repo 105 to the government, to its rating agencies, to its investors, or to its own Board." In fact, according to MarketWatch, Lehman couldn't get a single U.S. firm to sign off on the practice, so it went to a U.K. law firm to OK the move.

Artificial Earnings Growth (Continued from previous page)

MarketWatch also reports “there are plenty of ways financial firms can massage the numbers to make them look more profitable, stable and solvent than they really are.” Let’s take a look at another loophole.

Rule 157 – License to survive

Imagine you bought a house for $500,000 that is now worth $300,000. Rule 157 for banks is similar to you being able to sell your house for $500,000.

CFO.com reports that the change to rule 157 allows banks with impaired financial securities to move billions of dollars in losses off of their income statements, which will benefit their regulatory capital calculations and artificially increase profits.

The rule revision approved on April 2, 2000, addresses how companies account for assets whose market value has fallen below the reported balance-sheet value. Although companies will still record the paper loss, it will no longer affect their bottom line. As always with accounting, you can make things more complicated. For those who want to understand the implications more fully, we’ll do our best to decipher the CPA lingo.

Credit loss vs noncredit loss

Before we get into this, it is probably best to define credit loss and noncredit loss. In an oversimplified example, bank A holds a securitized pool of mortgage-backed assets originally valued at $100. After modeling the future cash flow of the pool, the bank determines it will ultimately collect $95. The credit loss is $5. However, due to economic factors, the MBA pool is currently worth only $40, a $60 loss. The difference between the two calculations ($60 - $5) is the noncredit loss - $55. As a result of the revised rule 157, banks can grab all their noncredit losses and dump them into a balance-sheet bucket called other comprehensive income (OCI). OCI is comprised of income and expenses (realized and non-realized) that are not recognized in the income statement. The noncredit losses that wind up in the OCI appear on the balance sheet but are not run through the income statement. (The balance sheet details an entity’s financial condition and lists assets and liabilities. The income statement provides the current years revenue/expense and profit information.) That means that noncredit losses never hit earnings. Reported earnings therefore do not include much of the noncredit, real estate related losses.

How big is the noncredit loss problem?

How high are such noncredit losses? Nobody knows for sure but a look at the FDIC’s list of failed banks provides a scary glimpse of what might be ahead. Frontier Bank was closed by the Washington Department of Financial Institutions on April 30, 2010. According to the FDIC’s website, Frontier Bank had approximately $3.5 billion in totals assets and $3.13 billion in total deposits. Subtracting the liabilities from the assets, the bank’s book of business should be worth around $370 million. The FDIC’s website states the following: “The FDIC estimates that the cost to the Deposit Insurance Fund (DIF) will be $1.37 billion.” Where does the $1.74 billion difference come from? Apparently the bank’s actual assets where less than reported, 50.3% less.

Another example is Champion Bank, which was closed by the Missouri Division of Finance on April 30, 2010. According to the FDIC’s website, Champion Bank’s had approximately $187.3 million in total assets and $153.8 million in total deposits. The bank’s book of business should be worth around $33.5 million. Yet, the FDIC had to cough up $52.7 million, apparently because Champion Bank overstated their actual assets by around 28%. There are plenty more examples available on the FDIC’s website, in plain sight of investors. As a point of reference, Bank of America, Citibank, JPMorgan and Wells Fargo have about $7.5

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trillion in combined assets. Assuming those banks are overvaluing their assets by just 25%, about $1.8 trillion of unrealized losses could yet be waiting to hit the fan.

Fool me once, shame on you. Fool me twice …

Guess who gets swindled and doesn't even know it? It's the American taxpayer. But it doesn't stop there.

Darrell Issa, the ranking member of the House Oversight and Government Reform Committee, said in a letter addressed to GM Chairman and CEO Edward Whitacre (obtained by the Detroit News), that the company "has come dangerously close to committing fraud and that you might have colluded with the U.S. Treasury to deceive the American public." GM ads featured the GM CEO touting that "GM repaid our $6.7 billion government loan in full, with interest, five years ahead of the original schedule." In reality, GM received $50 billion in U.S. government bailout funds. About $43 billion of the funds were swapped by the government in exchange for a 61% stake in GM (GM now nicknamed Government Motors). Senator Charles Grassley wrote in a FoxNews.com column that "it is far from clear how GM and the Obama administration could honestly say, much less trumpet in prime time television ads, that GM repaid its TARP loans in any meaningful way."

Grassley said lawmakers are being told government losses on GM are expected to exceed $30 billion. The TARP inspector general, Neil Barofsky, bluntly told the Senate Finance Committee that the repayment "is just other TARP money" and lawmakers should not exaggerate the feat. Senator Tom Carper hits the nail on the head with his astute observation that "it sounds like they're kind of taking money out of one pocket and putting it in the other." The last I checked, the Senate is still waiting for a response from Timothy Geithner about why GM was allowed to run this ad.

On April 26, 2010, Bloomberg reported that "Bankers said anything to get a high rating." It seems like corporations and the government will do anything to give the economic recovery an air of legitimacy.

Ripple effects of the new healthcare bill

Artificial Earnings Growth (Continued from previous page)

Carl Denninger wrote an interesting post about the ramifications of the healthcare bill. The promise was that there would be no "material" healthcare related impact to finances until 2010.

Caterpillar, John Deere and AT&T already announced non-cash charges of $100 million, $150 million and $1 billion for 2010 (AT&T's filing with the SEC): . This is based on the impact this bill has on forward retiree health care costs. Again, it pays to put things into perspective. Caterpillar reported profits of $895 million, John Deere's profit was $912.80 million and AT&T's profit was $12.54 billion. The unexpected healthcare charges make up 11%, 16% and 8% of profits. These expenses should eventually hit the earnings per share (EPS) and by extension the P/E ratio. Based on the above three examples, stocks could be overvalued by 8% - 16%. The above-mentioned charges were for retired employees only. Current employee healthcare costs were not considered yet.

Conclusion

When reading between the lines, two themes become obvious: 1) Corporate earnings, especially from the financial sector, seem to be overstated, and 2) You cannot believe everything you see or hear. We started out with one of Charlie Munger's tasty quotes, thus it seems fitting to conclude with more of his words of wisdom: "If you give human beings flexibility to do anything they damn well please, they will go plum crazy." Thus far, rising stocks have kept a lid on investors' disappointment with the government and corporate America. Once the market begins to fall, the combination of falling prices and negative news will bring more "oddities" to the fore and create a negative feedback loop a la 2008. Bear markets are always the best auditors.

Did we forget to mention that the respective trading desks at Bank of America, Citigroup, Goldman Sachs and JPMorgan Chase recorded a "perfect quarter?" According to regulatory filings, all four banks had zero days of trading losses in Q1 2010. Aside from the bitter aftertaste this leaves, what happens when the market doesn't go only up? Didn't we just see the market can actually move in both directions?

New ETF/ETN Launches

Inc. Date	Name	Ticker	Exp. Ratio
4-1-10	UBS E-TRACS Alerian MLP Infrastructure ETN	MLPI	0.85%
4-6-10	GlobalShares FTSE All Cap Asia Pacific ex Japan Fund	GSZ	0.50%
4-6-10	GlobalShares FTSE All World Fund	GSW	0.35%
4-6-10	GlobalShares FTSE All-World ex U.S. Fund	GSO	0.35%
4-7-10	Market Vectors Latin America Small-Cap Index ETF	LATM	0.63%
4-8-10	Ultra Nasdaq Biotechnology ProShares	BIB	0.95%
4-8-10	UltraShort Nasdaq Biotechnology ProShares	BIS	0.95%
4-9-10	JETS Contrarian Opportunities Index Fund	JCO	0.58%
4-13-10	First Trust BICK Index Fund	BICK	0.70%
4-14-10	IQ South Korea Small Cap ETF	SKOR	0.79%
4-15-10	Credit Suisse Cushing 30 MLP ETN	MLPN	0.85%
4-20-10	Global X Copper Miners ETF	COPX	0.65%
4-20-10	Global X Silver Miners ETF	SIL	0.65%
4-22-10	Ultra KBW Regional Banking ProShares	KRU	0.95%
4-22-10	Short KBW Regional Banking ProShares	KRS	0.95%
4-29-10	Ultra MSCI Europe ProShares	UPV	0.95%
4-29-10	Ultra MSCI Pacific Ex-Japan ProShares	UXJ	0.95%
4-29-10	Ultra MSCI Mexico Investable Market ProShares	UMX	0.95%
4-29-10	Ultra MSCI Brazil ProShares	UBR	0.95%

ETF Closures (as of May 21, 2010)

Name	Ticker
Rydex 2X Russell 2000	RRY
Rydex Inverse 2X Russell 2000	RMM
Rydex 2X S&P MidCap 400	RRZ
Rydex Inverse 2X S&P MidCap 400	RMS
Rydex 2X S&P Select Sector Energy	REA
Rydex Inverse 2X S&P Select Sector Energy	RFL
Rydex 2X S&P Select Sector Financial	RHM
Rydex Inverse 2X S&P Select Sector Financial	RTG
Rydex 2X S&P Select Sector Health Care	REC
Rydex Inverse 2X S&P Select Sector Health Care	RFN
Rydex 2X S&P Select Sector Technology	RHO
Rydex Inverse @X S&P Select Sector Technology	RTW

Are Stock Exchanges Ready for the Next Meltdown?

By Ron DeLegge, Editor

"Market Plunge Baffles Wall Street," was the comical headline story for the May 7th *Wall Street Journal*. To its credit, the Journal attempted to answer the reasons behind the previous day's historic intraday 1,000 point fall in the Dow Jones Industrial Average that occurred within a half-and-hour's time, but it still came up short.

We can't but help ask a few important questions: How much progress have major stock exchanges really made since embracing electronic trading? Is it any better than the old floor specialist system? Are stock exchanges really ready to handle a major meltdown?

Identifying the Problem(s)

There are various explanations of why the stock market went haywire on May 6th and none of them, based upon my observation, are satisfactory.

One explanation was that a trader accidently pressed the "B" for billion on his keyboard instead of "M" for million. Memo to all trading desks: No more cell phones, coffee drinking or texting during market trading hours. Focus on your screens and don't press enter when you really mean delete.

According to Morningstar, 210 out of 980 ETFs and ETNs changed hands during May 6th's trading session more than 50% below their final closing price. That was enough to trigger a mess of new false 52-week lows. At one point, the iShares Russell 1000 Growth ETF (IWF), which tracks large cap growth stocks, traded for a penny! Other extremes were recorded too.

A disproportionate amount of unusual trades on May 6th affected both ETFs and ETNs. IndexUniverse.com reports the 68.7% of questionable NASDAQ trades that day involved ETFs and ETNs. Meanwhile, the NYSE said 64.2% of questionable trades on its exchanges involved ETFs and ETNs.

How was it possible for the price of certain ETFs to drift so drastically from their underlying net asset value (NAV)? Two factors come into play. First, computerized programs that arbitrage price differences between an ETF's trading price and the fund's underlying NAV obviously went array. Second, market makers, who are charged with the responsibility of maintaining ETF liquidity, obviously failed.

Are Exchanges Ready for the Next Meltdown? (Continued from previous page)

Finding Solutions

Both the NASDAQ and NYSE should be embarrassed by what occurred during the May 6th trading session. Yet, both exchanges deny any problems or technological breakdowns. “Things could have been gotten much worse,” is their standard defense.

For years, the NYSE has touted its hybrid trading model which uses both humans (floor specialists) and computers (electronic networks). They hybrid system was supposed to be the panacea to market extremes created by frenzied panic. It offered the best of both worlds.

But as stocks nosedived on May 6th, the NYSE’s hybrid model kicked in and so did the panicked selling fear. For brief moments, NYSE computerized trading in certain securities were halted and delegated to floor specialists. The general idea was two-fold; to slow down a fast moving market and to have humans verify the transaction prices for the securities trading hands. Did it work? The answer is no. And even other stock exchanges like the NASDAQ that only use computerized trading systems, came up short. In both cases the market that day was flooded with a huge volume of sellers and almost no buyers.

“There is more sheer larceny per square foot on the floor of the New York Stock Exchange than any other place in the world,” wrote actor turned investment advisor Richard Ney in his 1970 book The Wall Street Jungle. Even though those were the days before large electronic trading networks largely replaced the human floor specialist, Ney’s point still applies. Instead of owning up to their technological shortcomings and showing some accountability, the NASDAQ and NYSE decided the best fix was to cancel trades caused by their faulty systems. Put another way, people’s financial outcomes were altered because of other people’s mistakes.

Conclusion

May 6th's market action should serve as a wake-up call to all investors everywhere. I believe the root causes for the massive intraday drop was not a mistake, as some allege. It was due to legitimate marketplace fear about Europe's unfolding debt crisis exacerbated by market trading networks ill-equipped to deal with the madness.

As easy as that explanation of what really happened is to understand, financial regulators like the S.E.C. have yet to identify any single or direct causes of the May 6th market plunge. Instead, they’re already focused on preparing a host of new rules. Who in their right mind proposes solutions without first knowing problems? Upon closer analysis, the proposed regulatory "safeguards" are ad hoc solutions, so long as specific causes for the erroneous trades aren't identified and fixed. Furthermore, the S.E.C.’s goal to "slow down" the market is meaningless, if transaction inaccuracies by major stock exchanges are allowed to persist.

Unfortunately, anyone that invests in exchange-listed securities is at the mercy of the places where they trade. Whether major stock exchanges operate efficiently or inefficiently, effectively or ineffectively, fairly or unfairly, remains a big unknown. Feel free to add this to the long laundry list of hidden risks. And while it’s doubtful major stock exchanges are ready for a major financial meltdown, one thing that isn’t in doubt is the criminal appeal behind their lunatic economics.

Just before being deported back to Italy, mobster Lucky Luciano was granted a visit to the New York Stock Exchange. After the operations of trading and the floor specialist system were thoroughly explained to him he said, “A terrible thing happened. I realized I joined the wrong mob.”

ETF Performance Corner

Best and Worst ETFs of 2010 (inverse & leveraged ETFs not included, data as of April 30, 2010)

Name	Ticker	2010%	3-Mo%	Name	Ticker	2010%	3-Mo%
iPath DJ-UBS Nickel ETN	JJN	+41.81	+42.27	iPath DJ UBS Sugar ETN	SGG	-43.67	-49.24
SPDR KBW Bank	KBE	+30.68	+19.89	iPath S&P VIX Short Term Fut. ETN	VXX	-37.41	-33.63
iPath Global Carbon ETN	GRN	+27.90	+24.41	iPath DJ UBS Natural Gas ETN	GAZ	-32.71	-27.19
FT NYSE Arca Biotech	FBT	+27.01	+24.14	US Natural Gas Fund	UNG	-32.08	-26.47
iShares DJ US Regional Banks	IAT	+26.98	+16.36	US 12-month Natural Gas	UNL	-24.54	-19.08
iShares DJ US Home Construction	ITB	+26.95	+23.33	Market Vectors Solar Energy	KWT	-18.49	-2.98
SPDR S&P Homebuilders	XHB	+26.66	+26.77	PowerShares Global Wind Energy	PWND	-18.03	-8.84
SPDR KBW Regional Banking	KRE	+25.71	+16.18	iShares MSCI Spain	EWS	-17.35	-8.28
PowerShares Dyn. Leisure & Entert.	PEJ	+23.93	+25.25	Claymore/MAC Global Solar	TAN	-17.27	-3.42
SPDR KBW Mortgage Finance	KME	+23.83	+19.50	iShares S&P Global Clean Energy	ICLN	-15.82	-4.37

ETFguide's HOT List

Fund Name	Ticker	YTD	Comments
iPath DJ-UBS Nickel ETN	JJN	+41.81%	Nickel beating out all commodities, including gold.
SPDR KBW Bank	KBE	+30.68%	Does anyone really believe bank's balance sheets, besides the banks?
FT NYSE Arca Biotech	FBT	+27.01%	Biotechs bucking weak healthcare sector.
iShares DJ US Regional Banks	IAT	+26.98%	FDIC continues to shutter more and more regional banks. Whoever's left is deemed winner.
iShares DJ US Home Construction	ITB	+26.95%	Building stocks up even though they're not building.
PowerShares Dyn. Leisure & Entert.	PEJ	+23.93%	Tapped out consumers still spending.
SPDR KBW Mortgage Finance	KME	+23.83%	Consumers can't get loans, but lending stocks are up. Go figure!
PowerShares Zacks Microcap	PZI	+19.29%	Risky stocks with the tiniest market caps are outperforming.
Vanguard Consumer Discretionary	VCR	+19.02%	A top performing MSCI US industry sector.
Market Vectors Indonesia ETF	IDX	+18.60%	Despite recent natural disasters, IDX is a top country ETF.

ETFguide's COLD List

Fund Name	Ticker	YTD	Comments
iPath DJ UBS Sugar ETN	SGG	-43.67%	After hitting 29 year highs in '09 the sugar market was overdue for a correction and it's getting one.
iPath S&P VIX Short Term Fut. ETN	VXX	-37.41%	Volatility heading up after May 6th market madness.
iPath DJ UBS Natural Gas	GAZ	-32.71%	Falling nat gas prices are one major reason why utilities stocks have underperformed.
Market Vectors Solar Energy	KWT	-18.49%	Solar industry undergoing a major test. Can it turn profits?
iShares MSCI Spain	EWS	-17.35%	Bear market for Spanish stocks is just beginning.
iShares S&P Global Clean Energy	ICLN	-15.82%	Entire clean energy sector being dragged through the mud.
iShares MSCI Italy	EWI	-13.43%	Italy's sovereign debt problems weighing on its public stocks.
SPDR STOXX Europe 50	FEZ	-11.58%	European equities are at the mercy of Europe's debt crisis.
iPath DJ UBS Grains	JJG	-11.33%	Grains are among weakest performing commodity sectors.
iShares MSCI France	EWQ	-8.93%	Europe's financially stronger nations being dragged down by weaker ones. It's called "contagion."