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Inside this issue

They Took My Bed Away

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FYI, this issue will likely print longer than usual given the number of charts I have included in the crash article below.

My back has been a little stiff this week and I just figured out why. Last Sunday was a washout day in the northeast with rain measured in inches. The kids were inside all day, taking every sofa pillow, bed pillow and throw pillow into their playroom to build piles, tunnels and forts.

After much pleading, we agreed to let them sleep in their creation as long as they went to bed on time. Somehow, in that negotiation, I got roped into sleeping in the little spot they made for me. So instead of my super comfy bed, I fell asleep on the hard floor, surrounded by pillows and sheets hung above and blankets, and of course, my three kids.
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History of Crashes

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In this article, I put together other crashes and mini crashes over the past 25 years. It doesn't really matter what we call them, they all have a small decline that accelerates into a waterfall type decline, culminating in a few very large down days and increased volatility for a period of months. Many see the initial bottom revisited at least once and sometimes multiple times as the process of building a low takes time.

There is no scientific reason I chose to begin with the crash of 1987 other than the charts are easier to print from that point on. There were plenty of other mini crash episodes each and every decade back to 1900.

Below you can see what 1987 looked like as Alan Greenspan committed the first in a career of blunders by draining liquidity coupled with Treasury Secretary James Baker saying that the government would not defend the dollar. The whole mess was accelerated by portfolio insurance that was being sold around the country and carried out by computers. The more stocks went down, the more the computers sold. The more they sold, the more stocks went down.

A now familiar pattern developed with the crash low, rally and secondary low some weeks later. If you look closer at the actual crash, you will see a quick and sharp rally that revisited the crash low a week later.
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In October 1989, the leveraged buyout boom ended as major airline hostile takeovers in United and American collapsed. That was the beginning of the end for famed Wall Street junk bond firm Drexel Burnham Lambert during the mini crash in January 1990. Again, both crash lows were revisited several weeks later before more meaningful rallies began.

These two episodes began a trend of me being out of the office during some of the most excessive periods of volatility! Short Hills, NJ in October 1989 and Bakersfield, CA in early 1990.

The mini crash in 1994 was caused by Alan Greenspan once again, raising interest rates without any warning and arguably, probably cause. It was also the beginning of the worst mortgage bond mess to date at that point. After the mini crash, we saw that low revisited twice over the ensuing six weeks. And I was in Wyoming.

In 1997, there was a collapse in the currencies of several Asian countries with fear of widespread contagion as the emerging markets boom was just starting. After the crash low, prices did not fully revisit the low level in the S&P 500. It did in the NASDAQ, but that's not in this study.

The August 1998 mini crash was caused by Russia defaulting on her debt with many major U.S. banks exposed. Hmmm... sound familiar? The crash low was revisited during the Long-Term Capital Management hedge fund debacle six weeks later as Alan Greenspan laid the foundation for Dotcom bubble by flooding the system with money and bailing out a private hedge fund. I was in South Carolina. If you look closely at the crash low, you can see a muted two day rally and revisit two days later before a more substantial rise.

Cowardly idiots flying planes into buildings caused the 9/11 crash in 2001. In the midst of a bear market, the crash low was not revisited and the rally soon petered out. Having just arrived back into town on 9/10, I left for Wisconsin shortly after the markets reopened.

In January 2008, the looming financial crisis was just unfolding in the public as recession talk was everywhere, derivative collapse was the tip of the iceberg and some rogue trading at French bank Societe Generale caused a downward acceleration. That was also the single worst month I have had in my 23 year career. The crash low was revisited seven weeks later during the collapse of Bear Stearns and the birth of my youngest, which I was there for!

The Lehman/AIG crash brought back Great Depression memories. For all those who believe that the government or Goldman Sachs controls the markets, I ask how is that possible with such widespread devastation. The crash low was followed by a quick and sharp two day rally, revisit, rally and revisit. This led to an 18% rally that is hardly seen in the chart. By November, the bottoming process had failed and began all over again.

During the Flash Crash in May 2010 when I was in Florida, the supercomputers ran amuck as the Dow plummeted almost 1000 points in very short order. After a few days of rally, we saw the first of two revisits before the final plunge to the major low on July 1. From there, the stock market did rally to new highs as the "Just to Keep it Interesting" bottom coincided with Ben Bernanke's speech at Jackson Hole laying the groundwork for QE2. Interestingly, Bernanke is making another speech in Jackson on August 26. What kind of bullets do they have left or has the Fed done as much as they should?

And now we see the mini crash of 2011. Are the last two days action one of those initial revisits like 1987 and 1998 before another rally and subsequent revisit as I painted in blue?

Or is another scenario in play right now? Some have offered the path in orange below with the crash low being briefly exceeded at least two more times before a more substantial rally takes hold.

And even some on the more extreme ends believe last week's selling is not over and a move below 1000 on the S&P is next. But their counterparts say that stocks are so oversold and washed out, they will scream higher and recoup the lost ground over the next month. At this point, we will watch for clues as to which scenario is playing out.

Please don't hesitate to hit REPLY or call me directly in the office to discuss any of this in more detail.

Supercomputers Run Amuck?

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Given the outsized moves this week, it's hard to believe that it's actually been less volatile than last week, but it has. The sharp rally off the mini crash low ended on Wednesday and Thursday saw a return of the selling pressure. I continue to believe that triple digit moves in the Dow are going to be here on an almost daily basis at least into fall. You can see in the crash article that after such extremes moves, it takes the market a
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while to settle down again.

I have written a fair amount about the supercomputers influence on the markets so this will be nothing new. While I believe in the free market and capitalism, I am also a realist and know that the current infrastructure of the stock market cannot handle the surge in high frequency trading (HFT). HFT involves placing millions of electronic stock market orders run by very sophisticated computer programs over the span of milliseconds.

When stocks began to trade in decimals, the human beings on the floor of the New York Stock Exchange lost their "edge". When the SEC did away with the uptick rule in 2007, which required traders to sell short stocks at a higher price and therefore prevent piling on the downside, HFT was really born.

I don't begrudge anyone for finding a new way to profit, especially if the landscape changed to make this possible. But the unintended consequences of HFT far outweigh the benefits. Simply put, the infrastructure is not sufficient enough to support orderly markets with HFT that trade in milliseconds. The markets need to be slowed down by even a fraction of a second to catch up with the supercomputers or their dominance of 50-60% of the volume is only going to increase.

FYI, I heard that the day the stock market closed down 600, the HFT industry saw its most profitable day ever. While I am glad that at least one industry is thriving, should it be at the expense of everyone else? Do we really want our stock market to be reduced to just computers trading with each other? Computers are absolutely necessary in the markets, but they also need to be an additive not a hindrance to capitalism.

Upcoming Appearances

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CNBC's The Call - September 2 at 11:05am

World Cup of Trading ETFs - November 15 - 16, West Palm Beach FL

You can view most of the past segments by clicking below.

Media Appearances

(http://www.investfortomorrow.com/InMedia.asp)
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Investment Quotes/Adages To Live By

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"When in doubt, get out!"

"If it's obvious, it's obviously wrong."

-Joe Granville

"It's ok to be wrong, but it's not ok to stay wrong."

"This time is different."

"The markets require the patience of a dozen men."

-Robert Rhea

"Luck is the residue of effort."

"The most bullish thing a market can do is go up in the face of bad news."

"The most bearish thing a market can do is go down in the face of good news."

"The market can stay irrational longer than you can stay solvent."

-John Maynard Keynes

"Government is best which governs least" - Thomas Jefferson

Inflation is the one form of taxation that can be imposed without legislation.

-Milton Friedman

"You cannot legislate the poor into freedom by legislating the wealthy out of freedom. What one person receives without working for, another person must work for without receiving. The government cannot give to anybody anything that the government does not first take from somebody else. When half of the people get the idea that they do not have to work because the other half is going to take care of them, and when the other half gets the idea that it does no good to work because somebody else is going to get
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what they work for,that my dear friend, is about the end of any nation. You cannot multiply wealth by dividing it." - Dr. Adrian Rogers, 1931

"Bear markets seem to be divided into three phases: the first being the abandonment of hopes upon which the final uprush of the preceding bull market was predicted; the second, the reflection of decreased earnings power and reduction of dividends, and the third representing distressed liquidation of securities which must be sold to meet living expenses. Each of these phases seems to be divided by a secondary reaction which is often erroneously assumed to be the beginning of a bull market."

- Robert Rhea via Tim Woods

"Free enterprise is a rough and competitive game. Nobody too big to fail. Nobody too small to succeed. It is a hell of a lot better than government control." - Ronald Reagan via Dan Kennedy

"A government big enough to give you everything you want is big enough to take everything you have." - Gerald Ford via Dan Kennedy

"The problem with socialism is that, sooner or later, you run out of other people's money." - Margaret Thatcher via Casey Research

"Diversification alone is no longer sufficient to temper risk... You need something more to manage risk well."

- Mohamed El-Erian

Friends And Family Plan

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Finally, as you know, our firm and this newsletter continues to grow mostly from your referrals. If you know anyone who is interested in securing their retirement, planning for it or just plain worried about it, please send them here. As always, thanks for thinking of us with your circle of family and friends.

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You can also forward this email to family and friends by hitting the "forward email" hotlink at the bottom of this email.
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