Market Shadows

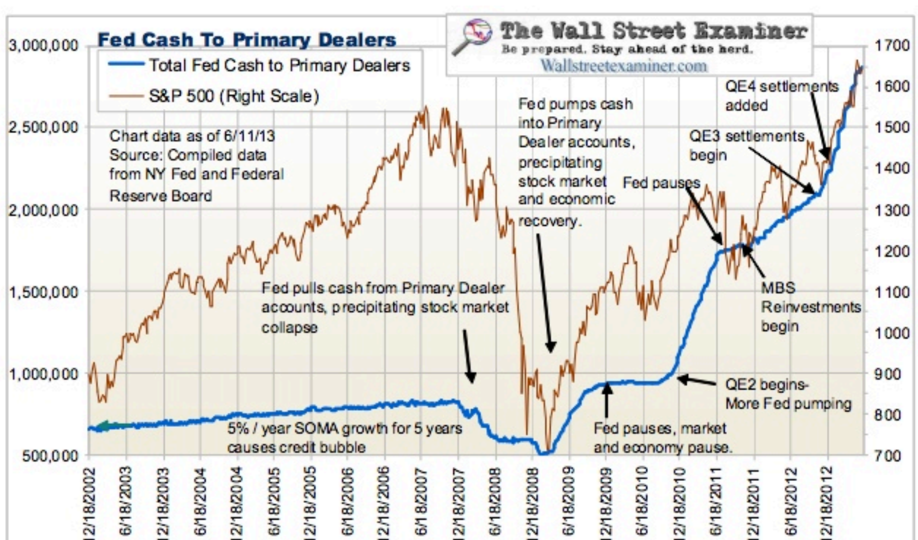
THIS WEEK

Don't Fear the Taper

Quantitative easing (QE) programs, courtesy of the Federal Reserve, have pushed cash into Primary Dealer accounts at the fastest rate in history. This has been massively bullish for equities over the past four years, as the Primary Dealers used some of that cash to bid up equity prices. This will likely continue until the Fed significantly curtails or discontinues its QE operations.

US stock indices have been marking time during the past four weeks gauging "talk" about whether Chairman Ben Bernanke will slow down his printing presses. Notwithstanding the rumors, we doubt that QE tapering is on the horizon.

In our view, unless the Fed stops funneling money to the Primary Dealers, which we deem doubtful, pullbacks in stock prices are likely temporary pauses along an upward path. Therefore, in both of our Virtual Portfolios (Value and Put Selling), we are remaining long and unhedged.



The Fed is Unlikely to Taper

America's national debt now runs approximately $16.5 trillion. President Obama use his power to hold rates down because the cost of higher debt service would devastate his political agenda.

Bernanke does Washington's bidding so he is probably just 'talking down' market enthusiasm by leaking news of a coming 'taper.' In this fashion, he uses fear of reduced QE to contain equity prices without actually changing the Fed's policy.

During the fiscal cliff debate in December 2012, people assumed tax rates would be much higher in following years. That precipitated an enormous amount of accelerated income and dividend payments that would have been made in 2013. Because of the higher income booked in Q4 2012, estimated tax payments due January 15, 2013, soared. This reduced the size of the expected Q1 deficit.

Bernanke's primary mission is to monetize the debt created by federal budgets that far exceed revenues. We see no way for the Fed to reverse course on QE regardless of the whispers to the contrary.

The Fed has painted itself into a corner and there is no way to unwind the QE trade without debt service costs eating everyone alive. Unwinding would cause interest rates on U.S. sovereign debt to soar, because no one would buy debt at interest rates the government could manage. For every one percent rise in interest rates, there would be an estimated $80Bn in increased annual debt service costs at the federal level. The payment of interest would overwhelm all other spending.

In Love with TINA explains why stocks are attractive. There are no viable competing investments if you seek to protect your life saving's long-term buying power. Absent a major change in policy, a full allocation to equities seems reasonable, as does avoiding fixed income. Bonds today are in a bubble, and a pop of the fixed income bubble is apt to be louder and more astonishing than anything we will see in the equity markets.

As Lee Adler notes in The Times, They Are A Changin', Fed-generated cash has been going out to Primary Dealers at a slower pace over the past few weeks. The pace may pick up again as the Fed pays for its latest round of mortgage backed securities (MBS). We will know more after the Fed's mid-June meeting.

The Times They Are A Changin'

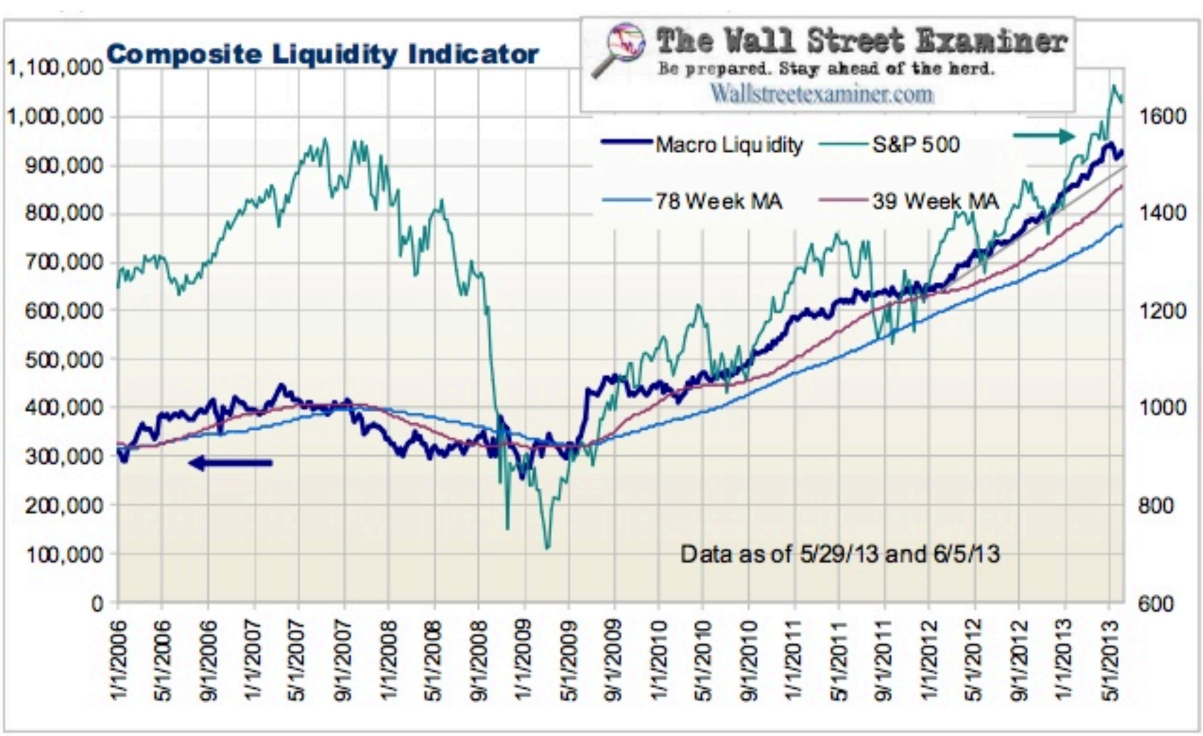
By Lee Adler of the Wall Street Examiner

It may be too early to call an end to the bull market in stocks, but in terms of the forces of macroliquidity, it's clear that change is afoot, and that change isn't in a bullish direction. This week, when the Fed holds its regular mid month settlement of its forward mortgage-backed securities (MBS) purchases from Primary Dealers, should give us some signals of where this is headed.

Composite Liquidity Indicator

The Fed's usual mid month round of MBS purchase settlements June 13-20 will add cash to Primary Dealer accounts this week and boost the composite liquidity indicator, which has stalled over the past couple of weeks. Many components have pulled back. Fed Cash to Primary Dealers slowed its growth path for a couple of weeks as only Fed Treasury purchases have settled since May 21. In spite of the pullback, the index remains in a powerful uptrend.

This looks like just a minor pause, but we need to keep an eye on slowing deposit growth. That could be a sign of a renewed trend of debt liquidation which is often accomplished through the sales of securities, in particular fixed income, in order to pay down debt. We are seeing the effect of that selling on the prices of Treasuries. The drop in stocks this week may be a taste of



things to come. It will be interesting to see how the market responds to the big wad of Fed cash that will hit dealer accounts over the next 8 days.

Macroliquidity Component Indicator: Fed Cash to Primary Dealers (chart on page 1)

Fed Cash to Primary Dealers measures the flow of cash into Primary Dealer accounts from Fed securities purchases. This indicator has the heaviest weighting in the composite. The current growth under QE3/4 is the fastest in history. It will be bullish until the Fed ends QE. Stocks will stall or pull back from time to time, occasionally hemmed in by trend resistance and buffeted by news flow, but the Fed's cash will find its way into equities sooner or later.

Click here to try Lee Adler's Wall Street Examiners' Professional Edition risk free for 30 days!

Trading in Turbulent Times

Despite the first three-day losing streak of this year, our Virtual Value Portfolio continues to perform well. We're ahead by 21.9% (+ 34.5% annualized) since our October 26, 2012, inception date. That compares well with our benchmark, the S&P 500. As of June 14, our portfolio is outperforming the index by 28.6%.

We made two new stock buys this week. First, we added 40 shares of Deere (DE) to the Virtual Value Portfolio. Second, we bought 182 shares of the Templeton Emerging Markets Fund (EMF), which is currently a good buy.

My Deere

Market Shadows added agricultural machinery manufacturer Deere (DE) to our Virtual Value Portfolio on Wednesday, June 12.

We bought 40 shares of DE at $84.39 for a total of $3,375.60. Deere pays a 51-cent quarterly dividend which provides a 2.42% current yield. The next ex-dividend date is on June 26, 2013.

When Tear-Gas Flies, It's Time to Buy

The Templeton Emerging Markets Fund (EMF) is a good proxy for the emerging market sector. EMF closed out the week at $18.06 per share. It's trading at a substantial discount to its net asset value (NAV).

We bought 182 shares for the Virtual Value Portfolio at $18.06 on Friday, June 14, for a total commitment of $3286.92.

Our market-beating Virtual Value Portfolio now owns shares in about 30 different companies. Our Virtual Put Selling Portfolio is also performing well. We believe that there are no better vehicles than equities for holding long-term purchasing power.

We have updated our Index of Educational Articles on page 5 of this newsletter. New educational articles are added in the Education section. Timely trade ideas are presented in the Value Investing section. Signing up for email delivery of the Market Shadow Newsletter is the fastest way to receive notification of new posts and new trade ideas.

EDUCATIONAL ARTICLE INDEX

BUILDING A VALUE STOCK PORTFOLIO

Building a Portfolio from the Ground Up – Part One.

Building a Portfolio from the Ground Up – Part Two.

Make Money – Adopt a Dog. "And the last shall be first."

"You're Nuts to Average Down." Not true, but keep your position sizes under 5%.

In Love with TINA. Because There Is No Alternative.

Why We Diversify. To avoid disaster.

The Trouble with Tech & the Dethroning of Darlings. APPL is transitioning from Darling to value stock.

Whether stocks are cheap is besides the point. Owning equities provides a chance to preserve value as paper money is marked down.

P/E 10 as a Valuation Gauge = Incomplete Information. Price/Earnings ratios are not set in a vacuum.

Individual Investors Remain Perfect Contrary Indicators. Buy only when you find good value for your money.

Unloved Stocks Rocked in 2012. The requirement that shares exhibit technical strength prevents analysts from naming the best bargains as their top picks.

Never Met a Rich Pessimist: Interview with Dr. Paul Price. Trying to predict the unpredictable is a fool's game.

Recognize Market Insanity. This time it's different isn't a game-plan.

BUYING STOCKS

Frustrations and Rewards of Value Investing. Buy the unpopular. Sell the beloved.

Equities not yet pricey enough to entice retail investors.

"You're Nuts to Average Down." A myth.

Make Money – Adopt a Dog. Least loved equities often outperform.

Year–End: Investors were Penalized for Holding Cash. Waiting for better prices proved costly.

It's a confidence game. There are indicators, and there are contrary indicators. (Video)

Recognize Market Insanity. Pricing isn't efficient; it's better seen through the prism of "Extraordinary Popular Delusions and the Madness of Crowds."

When a Great Company is NOT a Good Stock. Buy bargains.

SELLING STOCKS

Sell Discipline - Have a plan. And don't ditch it.

Call Me Maybe - Covered calls impose sell-discipline.

OVERTRADING

March Madness and Your Trading Decisions. Downside to flipping in and out of stocks.

Most investors underperform their already underperforming funds. (Courtesy of Joshua Brown, the Reformed Broker).

SELLING PUTS

Shares plus Covered Calls Vs. Selling Naked Puts? Selling a covered call (buying stock and selling call against it) versus selling a naked put.

Selling Puts on Value Companies - A New Virtual Portfolio Selling a put is a bullish position.

Selling Puts on Value Companies (Part Two).

COVERED CALLS

Call Me Maybe. Selling a call against a long position brings in income and imposes sell-discipline.

Covered Calls – The Hidden Risk for 2013 and Beyond. Bad time to sell calls.

Shares plus Covered Calls Vs. Selling Naked Puts.

HEDGING & TIMING

The High Cost of Hedging. Why pay those high insurance premiums?

Year–End: Investors were Penalized for Holding Cash. Waiting for better prices proved costly.

March Madness and Your Trading Decisions. Flipping your positions has more downside than you think.

Never Met a Rich Pessimist: Interview with Dr. Paul Price.

INFLATION

Washington's Biggest Lie. Price inflation exists.

GOLD

What have you done for me lately? Precious (metals) little. Invest in something tangible.

All That Glitters… Avoiding falling gold bricks.

Hidden Dangers in Gold - Part One. When the guy loading the beer knows the price of a gram of gold instantly, worry.

Hidden Dangers in Gold - Part Two. Gold is not a great hedge against inflation.

Gold's 'Highly Inflated' Track Record. Gold's track record is highly inflated.

Mettle Trumped Metal. Fundamental investing won.

BEWARE OF MARKET GURUS AND DON'T CHASE HEADLINES

Schizophrenic 'Rear-View Mirror' Covers from Barrons. Invest based on fundamentals rather than whimsical backward-looking data.

You don't need a weatherman. Tune out the noise.

Always Question Assumptions. The rationale for a price goal may be built on quicksand.

Wall Street Cheats – Don't be fooled. We can all be market geniuses with the benefit of hindsight.

You only see what they want you to see. Selective advertising.

Market Comments: Lots of Words, Little Meaning. The market always goes either up or down.

Individual Investors Remain Perfect Contrary Indicators. Ignore the news.

Scare Tactics – Prepare Yourself to be Bombarded. Bad news sells.