Market Shadows

THIS WEEK

Fables and Fairy Tales

Leaving success to luck is for gamblers. Chances are good that we're not going to win the state lottery, strike it rich in Vegas, and be recognized as day-trading prodigies. Serious investing requires following a rational plan, managing risk wisely, and not letting greed and impatience change our course.

When Aesop, a slave and storyteller in Ancient Greece, wrote The Crow and the Pitcher, he was not thinking about stock exchanges and dollar cost averaging. However, the fable is clearly about making a plan and following through with it.

It begins, "A Crow, half-dead with thirst, came upon a Pitcher which had once been full of water; but when the Crow put its beak into the mouth of the Pitcher, he found that only very little water was left in it, and that he could not reach far enough down to get at it. He tried, and he tried, but at last had to give up in despair."

The Crow and the Pitcher, illustrated by Milo Winter in 1919.

The story doesn't end in failure. Like a smart bird, the crow thought about his predicament and devised a plan.

"He took a pebble and dropped it into the Pitcher... Then he took another pebble and dropped that into the Pitcher. Then he took another pebble and dropped that into the Pitcher. At last, at last, he saw the water mount up near him, and after casting in a few more pebbles he was able to quench his thirst and save his life." (Jacob's translation of Aesop, 1894.)

The moral of The Crow and the Pitcher: "Little by little does the trick." **When investing, it's better to get rich slow than to get poor quick.**

Say Hello to Inflation, Inflation is Dead

Quantitative easing (QE or "money printing") will continue despite Bernanke's rhetoric about cutting back. (See Don't Fear the Taper). Funding trillion dollar annual deficits requires monetization of debt. America is almost $17 trillion in debt. Interest rates rising just a few ticks closer to their long-term, normalized levels, would be an insurmountable strain on future budgets.

Admitting the true rate of inflation would trigger Cost of Living Adjustment (COLA) raises for government workers, pensioners and social security recipients. Private sector unionized labor and nonfederal government employees would likely demand raises too. Bond buyers would insist on higher coupon rates (interest rates).

Our leaders have sacrificed integrity over fixing the underlying problems. Paul Price discuss the situation in Inflation Will Never Go Up Again. In his view, there is no plausible exit strategy from QE without risking societal breakdown as lifelong promises get broken (pensions, salary adjustments and social security payments). Civil uprisings have already occurred in Greece, Iceland and Cyprus. The masses are rebelling in Egypt today. The U.S. has avoided riots because QE is holding interest rates artificially low. The Bureau of Labor Statistics' (BLS) manipulation of Consumer Price Index (CPI) allows the government to pretend inflation is not serious. If the public realizes the extent of the government's deception and lenders begin demanding higher interest rates to compensate for inflation, the U.S. will be in a world of hurt.

Excerpt from Inflation Will Never Go Up Again:

People generally think of annual inflation as the cost of a basket of goods and services today versus the cost of the identical basket one year earlier. While that makes sense, it is NOT what the BLS measures and reports.

Core CPI specifically excludes food and energy costs. Dismissing those items only reflects reality for people who don't move, eat or buy products requiring transportation.

Rapidly rising income, property and sales taxes are NOT included in any of the BLS inflation numbers. Taxes add to the cost of living.

Excluding food, energy and taxes from core CPI allows the BLS to understate increases in the true cost of living. After high inflation years in the late 1970s, the government changed how it calculated CPI. This happened again in 1990. Each time, the BLS manipulated the measurement techniques to downplay the extent of increases in the cost of living. This lessened the government's need to increase the Cost of Living Adjustment (COLA) applied to employees and retirees.

The excellent ShadowStats website provides monthly updates on what CPI would read today if the rules were as they were in 1980. The difference is startling (right).

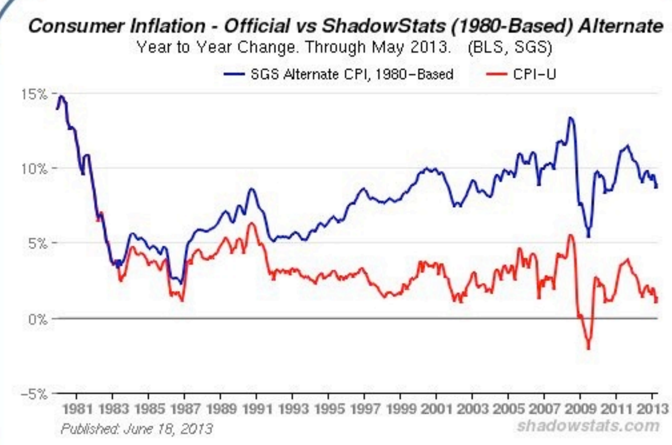


Chart: Courtesy of ShadowStats.com

B.S. brought to us by the BLS

The Intuit Spending Index v. the Official BLS CPI Rate

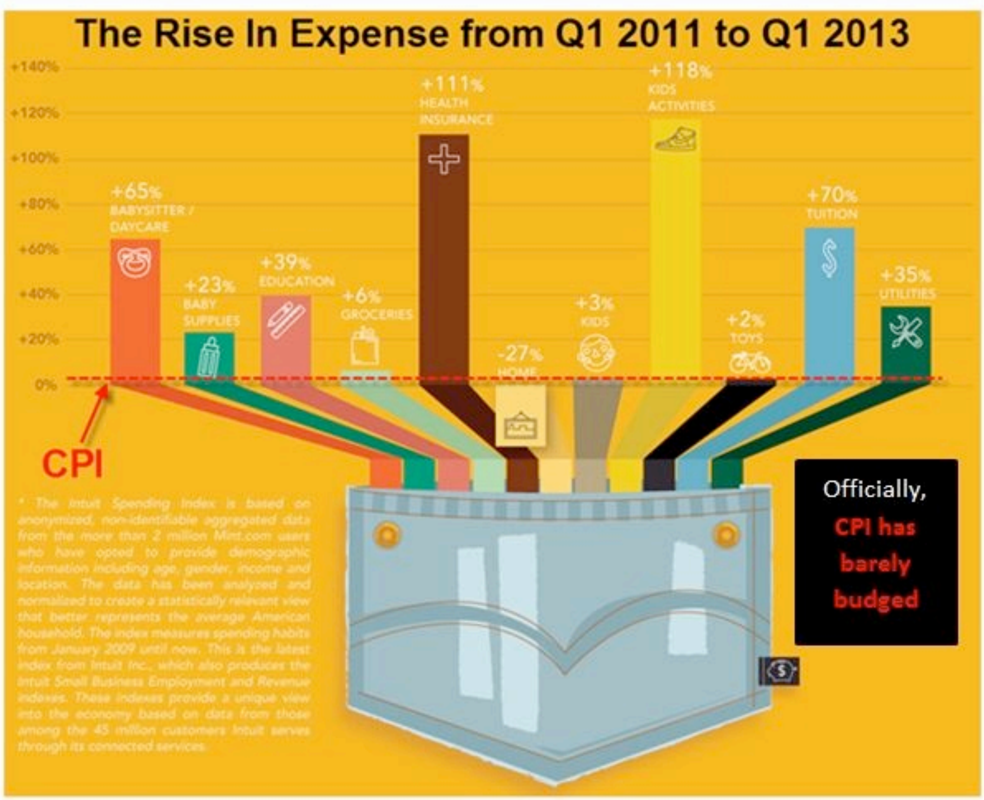


Chart: Mint.com / Intuit

Intuit's numbers are believed to be statistically accurate but cannot be scientifically verified.

The BLS uses other tricks to lower reported inflation rates. The 'substitution principle' says that when the price of a particular item, e.g., rib-eye steak, rises, consumers will switch to lower-priced alternatives such as ground beef.

The cost of living has been rising quickly. Inflation, as measured by the CPI, will never go up significantly unless politicians abandon their deceptive practices. Unfortunately, Washington D.C. has a very strong interest in keeping the public uninformed.

Read the full article: [Inflation Will Never Go Up Again](#).

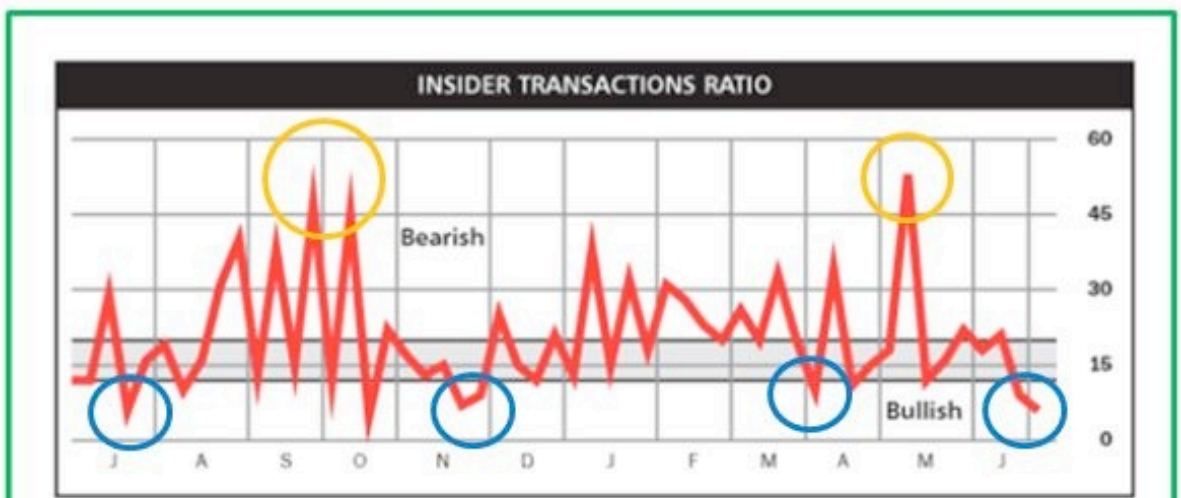
Most Bullish Since November

At least one indicator, the Thomson Reuters Insider Transaction Ratio, turned bullish last week.

The Insider Sell/Buy transaction ratio has turned decidedly positive. This indicator correctly called for buying last July and again in the fall. It turned bearish in early May this year.

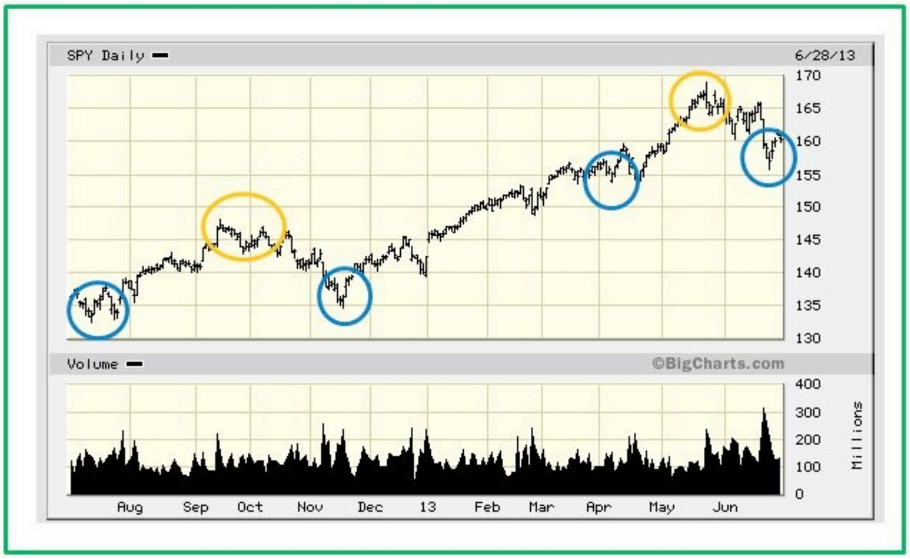
These signals are usually accurate over weeks or months. They can swing rapidly and thus are not good long-term indicators.

No technical indicator is infallible. This one is more meaningful when the readings are extreme.



Ratio of Insiders Sales to Buys. Readings under 12:1 are Bullish. Those over 20:1 are Bearish.
Source: Thomson Reuters

An insider is any officer, director or owner of 10% or more of a class of a company's securities. In most cases, an insider must report any trade to the SEC within two business days. The tables highlight companies that filed with the SEC through last Wednesday. The tables do not include pension-plan or employee stock-option activity, trades by beneficial owners of 10% or more, trades under $2 per share or trades under 100 shares. The "Purchases" column includes only open-market and private purchases; the "Sales" column includes only open-market and private sales, and excludes trades preceded by option exercise in the 12 months prior to the reported event.



The chart above shows the action of the SPY (S&P 500 ETF) with the bullish (blue circles) and bearish (yellow circles) signals of the Insider Sell/Buy transaction ratio superimposed on its movement.

Market Shadows' Half Time Scoreboard

We are happy to report the results from the Virtual Value Portfolio, started on October 26, 2012, through the first half of 2013.

In slightly more than eight months, our original $100,000 stake grew to $119,516. That includes $1,950.07 in cumulative dividends.

Explore the details of our open and closed positions in the Virtual Value Portfolio here.

Last Week - We Sold Puts

We 'sold to open' three new put options in our Virtual Put Selling Portfolio last week.

Our newly written (sold) Walgreen's (WAG) put expires on January 18, 2014. The Accenture (ACN) and Franklin Resources (BEN) puts expire on January 17, 2015. (See also Top Quality, Value Price – Accenture, I'm Taking Drugs and Another, more predictable BEN.)

We have closed two profitable positions. One expired. The other we bought back for a fraction of the original sales proceeds (i.e., the premium we collected selling the put).

Final profits or losses on short put options cannot be calculated until we 'buy to close' or until the particular options expiration date is reached. Until then, we have a paper profit as long as the current stock price is higher than the break-even level indicated on our Virtual Put Selling Portfolio page.

The Home Team is Ahead

Portfolio Inception Date: Oct. 26, 2012	Virtual Value Portfolio	Standard & Poors 500 ETF
Total Return since 10/26/12	+ 19.52%	+ 14.57%
Return percentages include dividends		

This week, Paul sold another put. Noticing that Mead Johnson Nutrition (MJN) was selling off, he sold one put on MJN with a $70 strike price and a November 16, 2013, expiration date. In the following section, Paul explains his reasoning.

Formula for Put-Writing Success

Infant formula manufacturer Mead Johnson Nutrition (MJN) took a big hit because China is investigating the company for possible price fixing in that country.

The shares were down to $67.62 this morning from a 52-week high of $86.87.

This type of event typically triggers overreactions in near-term stock market action. Remember the Wal-Mart (WMT) Mexican bribery scandal and WMT's very quick recovery?

Market Shadows sold one November 16, 2013, expiration put with a $70 strike price for $6.60 per share today in our Virtual Put Selling Portfolio.

Our maximum gain is capped at 100% of the premium received ($660). That will be realized if MJN closes at $70 or higher on the put's expiration date.

If MJN closes below $70 on November 16, we will be forced to purchase 100 shares for a net cost of $70.00 - $6.60 = $63.40 per share.

MJN could drop by up to $4.22 per share (-6.2%) from its already depressed price without causing a loss on this trade.

Click on this link to see the entire Virtual Put Selling Portfolio…

Bonded

By Lee Adler of Wall Street Examiner

US Banks

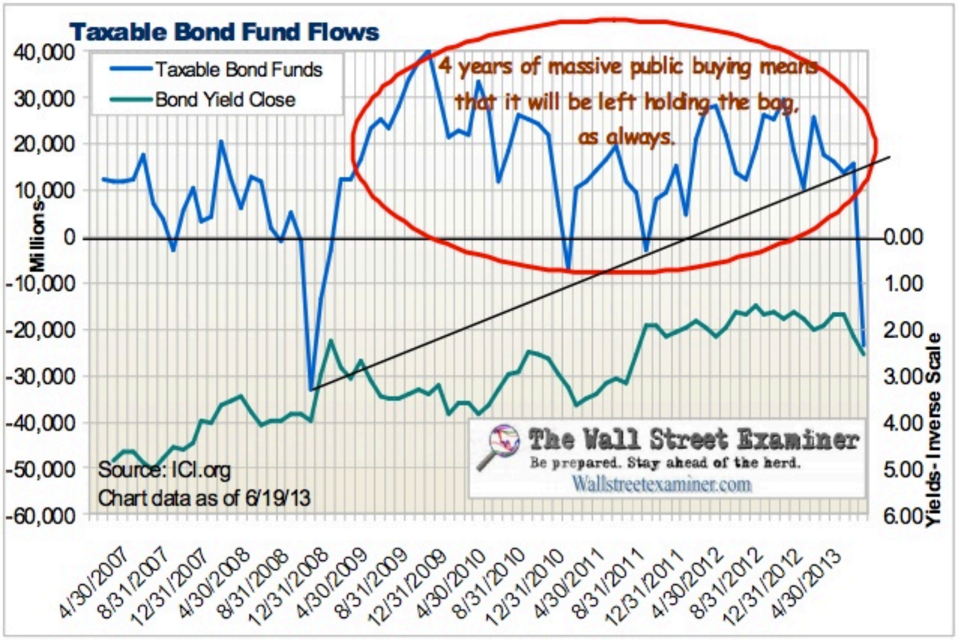
The Fed reports bank trading activities weekly with a 10 day lag in its H8 report on Friday evening. Commercial banks' Treasury and Agency (GSE) holdings declined by $9.7 billion in the week ended June 19 after a $5.3 billion decrease the week before. A weekly decline of $12.4 billion in the beginning of May was the heaviest week of selling since June 22, 2011. The rate of selling backed off a little since then but the intensity picked up in the latest reported week. There have been only 6 weeks this year that they have been net buyers.

Being reluctant buyers is one thing. The market can handle that given all the buying by the Fed. But if the banks are aggressively dumping, and dealers and FCBs are also sellers, that would remove liquidity from the Treasury market, with some likely shifting into stocks. A continued pattern of selling by banks is a negative, and **the increased level of selling of the past two weeks had an impact on the market. If this is sustained, the bond market could crash**.

That might not be negative for stocks initially, but keep in mind that in 1987 the bond market crashed about 5 months before the stock market.

Bond Fund Flows

Unless there's a massive surge of inflows by the end of June, there will be a breakdown in the pattern of strong retail buying. I've drawn a line on the chart that depicts the minimum trend level. A break of that



Monthly data actual through April. May estimated and June projected based on weekly rates.

trend would indicate the end of the public's forced march into bonds. Such a break should be the final nail in the bond market's coffin. It wasn't exactly a love affair in the first place, as there were no logical positive choices. The divorce could be ugly.

The ICI reports mutual fund inflows weekly with a one week lag. Taxable bond funds had net outflows of $4.6 billion in the week ended June 19, down from outflows of $10.2 billion the prior week. The pace of selling for June so far represents a huge collapse from the buying of the past 4 years.

The Fed's Fears

Massive increases in the trend of Federal tax collections, while outlays have been flat are reducing Treasury supply. That is the real reason the Fed is floating Taper Talk trial balloons. It is deathly afraid that the excess Fedbucks it is printing will flow where the Fed doesn't want them to flow, into the burgeoning stock market bubble and, horror of horrors, possibly back into commodities speculation.

At the same time the Fed can't bear the thought of a selloff of any magnitude. Stocks sold off 9% and all the Fedheads started peeing their pants and crying to Mommy. That's what last week's round of frantic speeches looked like. It was a disgusting and horrifying spectacle. These are the people in charge of monetary policy. God help us all.

Lee Adler, Russ Winter and Ilene discuss gold, and whether the Fed is directly manipulating stock prices. Click here to access the June 21 podcast - The Bull In China Crash Heard Round The World. Also listen to Lindsay William's July 1 interview Lee Adler for Fine Business Radio – South Africa.

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