Jack Adamo's Insiders Plus

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Dear Friend & Client,

The big market-moving news this week was that the European Central Bank announced a large USA style stimulus plan. This pleased both the stock and bond markets, though mostly on the longer durations of the latter. With Europe probably closer to the beginning than the end of its rate suppression strategy, it can be assumed that more money will flow to our shores. That, in fact, has been the case since the beginning of May when the ECB's plans began to come into focus. Nonetheless, the market celebrated the news confirming the plan.

The three major indices rose an average of 1.5%, led by the once-again hot NASDAQ. Notably, the speculative fever spread to the small caps, which had been out of favor while money moved into more solid, larger companies like those in the S&P 500. The Russell 2000 (small cap index) shot up 2.7% for the week and may try to catch up to its bigger siblings.

We did okay too, although we underperformed the market. Our Main Portfolio rose 0.8%, while our High Income Portfolio eked out a 0.1% gain, hurt mostly by a slide in almost all of our preferreds. In a vacuum, one might think this was a sign of inflation fears, but clearly the bond market contradicts that interpretation. The drop in the preferreds is simply another manifestation of *Risk On*. Solid dividend payers seem less attractive if you can get rich overnight in high fliers.

The speculative fever is particularly ironic in the high tech space. There are a few reasonably priced big tech firms, like Apple and Microsoft, although I haven't done the math on how much their results have been helped by buybacks. However, most of the sector is overpriced, especially the darlings like Amazon, Google, Tesla and anything having to do with 3-D printing. Every month I get detailed reports from Fred Hickey, the best tech analyst extant, and the outlook is truly abysmal. If there's a big resurgence in the wings, it's hiding extremely well.

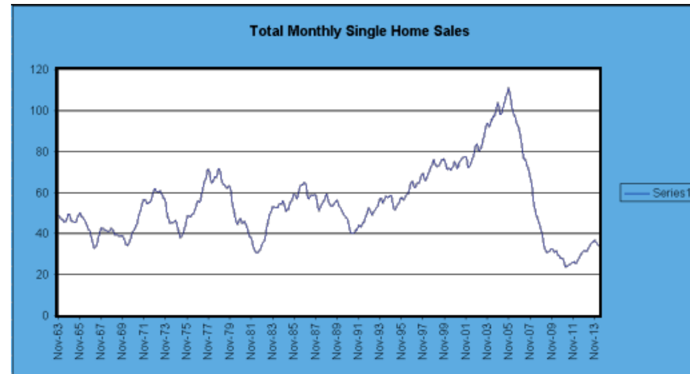
I mentioned a few letters ago how GMO Capital (Jeremy Grantham's firm) said their shop had never before seen such uniformly overpriced assets. Note that they're not just talking about the last few years; they're talking about going back into the 19th century at least. We are seeing this trend accelerate in the more speculative spheres.

Look at these year-to-date price moves:

- S&P 500 + 5.7%
- NASDAQ +5.64% (but will probably surpass the S&P this week)
- Gold +4%
- HUI Gold Miners Index +5.5%
- GDX Gold Miners ETF +7.15%
- Junior Gold Miners ETF + 12.4%
- Commodities Research Bureau Index +8.95%
- Ten Year U.S. T-bond +2.15%
- Thirty Year U.S. T-bond +6.5%
- West Texas Intermediate Crude Oil +4.14%

Except for the S&P and NASDAQ, which should reverse positions soon, note how all the more speculative positions have risen more than their more conservative counterparts. Gold bullion is most conservative, the gold miners index is less conservative, then the GDX ETF, then small cap gold ETF, etc. in progressively larger rising trends proportionate to their speculative elements.

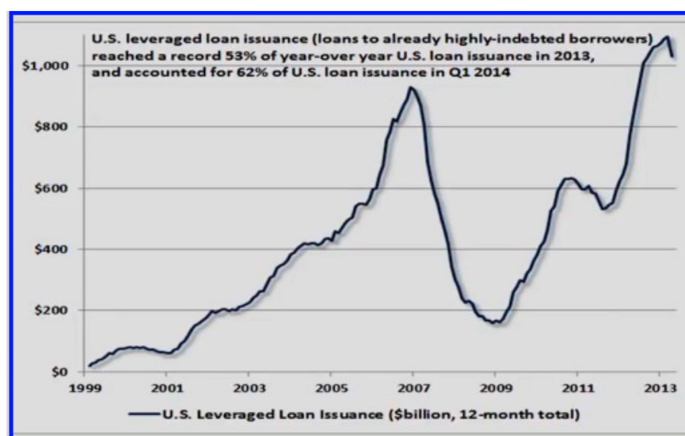
Just as in the tech and housing bubbles, the Fed's orgy of money printing has caused gross speculation in assets. The difference in this latest bubble is that it has done virtually nothing to stimulate the real economy. For example, although housing prices have finally recovered to pre-crash levels, units sold are nowhere close. This coincides with the remarks by Stephanie Pomboy I quoted last week that 90% of increase in consumer spending since the crash has been due to higher prices, not higher unit purchases, showing that consumers are running in place, just to keep up.



As you can see, not only have unit sales not recovered their prior glory, they are nowhere near the pre-bubble sales of the 1990s. It is no wonder then, that the two assets that have not joined the inflation bubble party are copper, down 10% year-to-date, and lumber, down a whopping 17%. And yet, stocks and ETFs relating to housing are near all-time highs. This includes most timber and home builder related stocks. The optimism is as boundless as it is baseless.

Don't misunderstand me. There are some indicators that the economy is picking up in certain areas -- auto sales and capital goods stand out. But as David Blitzer, the chief economist for S&P observed last week, the move in stock prices seems out of proportion to the positive indicators.

One more chart:



This may look familiar, but we haven't looked at it before. It's the dollar figure of leveraged loans (junk bonds, etc.) in the last 15 years. The reason it looks familiar is that it has the same shape as many other charts we've looked at lately, such as margin debt, CAPE ratio, the percentage of corporate profits to GDP and others. Other than their new record or near record ratios and dollar amounts, what these series share is the quality of being *absolutely, no exceptions ever, mean-*

reverting statistics. That is, they naturally and inevitably return to something at least approximating their averages. As in 2011, we see that the Fed can step in and stop gravity for a while, but history shows they may be stalled, but not stopped.

That's not to say a crash is imminent. These trends may continue for longer than I think possible. The great, though often misinterpreted John Maynard Keynes sagely said, "Markets can remain irrational longer than you can remain solvent."

I'm clueless about market moods, but the well-regarded technical analyst Louise Yamada said last week that although there was a thinning of participation (lower volume, lower new highs to new lows ratios), such conditions could persist. She thinks this still looks like a bull market. Laszlo Birinyi whose track record on the market is outstanding, said last week that he doubted the volume and other weak metrics would be a problem. The equally talented Ed Yardeni recently averred that although the basis for the current rally is economically tenuous, he thought the market could hit 2014 in 2014. After the last two weeks, his forecast seems almost quaintly conservative.

So, the temptation to try to ride this wave gets stronger. I am not giving in, at least not until/unless I see some real signs of a sustained economic pickup. We've seen in the past that markets can melt up as long as there's any trace of economic growth, but that's a case of diminishing returns in an increasingly dangerous market. I would only commit more cash if it looks like I've been wrong on underlying fundamentals, outlook, etc. It looks to me as if the market has already priced in more growth than we are likely to get.

I am, however, feeling increasingly confident in the long-term outlook for gold. Unfortunately, we are mostly invested in quickly disintegrating options, but beefing up gold and silver looks like we would put basic physics on our side. June is historically a terrible month for gold and recent trends look weak, even though we're still up for the year. Hence, I'll wait for a little more visibility on this.

PORTFOLIO UPDATES

Speaking of gold, we had two polar opposite moves this week in our **Goldcorp** and **Newmont Mining** options. Moreover, both were highly counter-intuitive, at least by my way of thinking. Our Goldcorp options fell more than 10% and Newmont rose the same amount.

The Goldcorp plunge is understandable, though not rational. The company announced a $1 billion bond offering consisting of $550 million of 3.625% notes due June 9, 2021 and $450 million of 5.45% notes due June 9, 2044. Knee-jerk investor reaction could view the debt offering negatively, especially if you don't actually read it. The offering doesn't increase debt, it trades older, convertible debt for newer debt, which is not convertible. Getting rid of the convertible debt avoids possible share dilution down the road, and the interest rates on the new bonds are good for the mining industry or any industry for that matter. I take this as a good sign and a good corporate move.

The shocker to me was the Newmont rise. On June 5, the company invoked *force majeure* due to ongoing export restrictions from Indonesia. Newmont says it is unable to deliver previously contracted production because of challenges beyond the company's control. The company is placing 3,200 employees in the country on leave with reduced pay.

The background here is that Indonesia recently imposed a 25% tax on exports of copper concentrate, it's biggest export. The purpose of this tax is to force mining companies to build smelting plants in country, creating more jobs there. I have an enquiry in to the company to find out why it does not want to oblige Indonesia in this matter. Once past the startup costs, it seems to me that labor costs there would be quite cheap and transportation of smelted copper would be cheaper than the much heavier, unrefined ore.

Of course, there may be factors here I'm unaware of. It could be, for example, that smelted copper can't be shipped in dry bulk, as ore is, and the alternate mode is more expensive. I'm sure there are other possibilities as well. In any case, this trouble certainly sounds like bad news for

Newmont, yet the stock rose steadily all week. Is it possible investors are applauding the company's tough stance and thinks it will win? That's one explanation. Another is that speculators may believe that a merger with Barrick Mining is now on the table again, as Newmont looks for alternate sources of ore. Given the speculative tone of the market, I put more weight on the latter guess. However, Freeport McMoran, the other big international miner in Indonesia, is also refusing to pay the new tariff. So, this solidarity gives the companies more bargaining power.

Also in the mix is that Indonesia has a Presidential election coming up in July. Having too many people in a distressed employment position may prove uncomfortable for the incumbent party. However, this depends on how the company (companies) are viewed by the general public. If they feel the miners are exploiting them, a backlash could develop. It was wise of the company to now outright layoff the employees. The reduced hours and pay give it a chance to gauge the public's reaction.

I doubt this brouhaha or its resolution will save our option positions, but it will influence my decisions regarding precious metals purchases going forward. Right now, I'm more interested in Goldcorp.

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http://www.jackadamo.com/main.asp?fn=portfolio_view.asp

The password is: **MarkTwain**

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I know sometimes it's a bit painful to look at the totals at the bottom of our Main Portfolio. The option positions are awful, and are unlikely to change. (The portfolio is up 2.6% excluding the options.) On the other hand, the High Income Portfolio is beating the market soundly year-to-date with its 8.4% gain. That is due to investors' continuing search for yield.

Our high cash positions are a drag on our overall returns, and I know it's increasingly difficult to stand by and watch that in such a strong market. All I can say is that I believe that it will be worth our while, even if we have to wait another year. If you can't take the wait emotionally, I'd advise you to put more money into positions in the High Income Portfolio that are within their buy ranges or very close to them. I don't think we'll get hurt in them in the long term, and if they pull back more in the risk trade, as they've done lately, I may recommend adding to them anyway.

As to the Main Portfolio, I remain Risk Off. I like our cash there. If I put any more to work, it will almost certainly be in precious metals, especially miners with at least a yield of 2%. I once again considered taking short-term trading positions in some index funds, but my handling of them has never been good, so I'll stick to my strong suits. We may add more to the Korean ETF, especially if it pulls back. I'm also mulling a currency ETF, but that's not an area of expertise, so I'll have to do a lot my work on that before I'd feel comfortable.

One last note. *I will probably not publish next weekend*, June 14. I'll be traveling and I'm not sure if I'll have data access often enough in a form I can use. Hence, I am taking one of my vacation weeks early this year. If that changes, you'll know when I show up in your email box, cramped as it is. Of course, if there's a major, market moving event, I'll find a way to get a bulletin to you.

Last but not least, here's a video you may find edifying. It is mostly on subjects we've discussed many times before, but this is one of the most cogent, well-researched, well-directed discussions I've ever seen by an analyst. It is by Stephanie Pomboy, whom I quoted last week.

http://www.advisorperspectives.com/dshort/guest/Shedlock-140531-Wine-Country-Videos.php

That’s it for today.

I look forward to talking with you again soon.

Jack

Questions? Write to Jack at: jack@jackadamo.com

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