



From the Trading Turret

Big Wave Flash Report

5-13-2010

“In some ways, it’s a battle of the politicians against the markets. That’s how I do see it. But I’m determined to win this battle.” Angela Merkel

For months, I have been trying to put my finger on how to define exactly how the world has changed in the last few years. When Hank Paulsen and Ben Bernanke drove to the Capital in the dead of night and laid out their plan before the Congressional leaders to begin the grand master strategy of bailing out the world, I knew the world had changed. I have seen all of the Godfather movies and I knew that when you were in a very tight spot and needed a favor or a loan from a very powerful person, like Don Corleone, as soon as you accepted it, you were in big trouble. You were in to a situation that you could never get out of. You were in for life. There was no turning back.

When Paulsen not only offered the banks all that money and then didn’t ask, but demanded they take it, I knew we were in big time trouble. For once down this bailout path, it is all over. But the worst part of the deal was that now, the government, the most powerful in the world had you in their grips. They now had complete control and power over your every move. They had staffs of people in your bank watching you 24/7. They had people telling you how to loan, who to loan to, who needed modified loans, and how much you should pay your employees. And the threat of the IRS was always hanging over you if you stepped out of line. And those grilling by bumbling inept Congress people and Senators calling you a cheat and liar and greedy on national TV. Raking you over the coals because you took a private jet to these hearings where you will be humiliated on world TV while the Speaker of the House spends over \$1 million a year of OUR money flying her and her family and friends from Washington to California in her brand new wide bodied private use aircraft.

But as in the Godfather movies, you can never criticize the Don for riding in fancy cars and living in his mansion. You just kiss his ring, bow down before him and do whatever he says to do or you will be “sleeping with the fishes” the next night. The Don had complete power over you because you accepted his offer...”an offer he can’t refuse.”

Power is what this whole crisis is about. Angela Merkel’s comments are indicative of how most global leaders today define the global economy. She believes as does our President and Sarkozy in France and Gordon Brown in England...oh wait, he was kicked out of office this week...that the free market economy is gone. Free markets have failed. She believes that people who believe in free markets are the enemy and people who believe in the politicians and economies run by the state are her friends. As she said, “it’s a battle of the politicians AGAINST the markets.” She believes, as does President Obama and Nicholas Sarkozy and others around the world, that the free market determining prices and services, that individual business owners determining how they run their businesses, or shareholders who jointly own public companies and electing boards of directors is wrong. And not only is it wrong, it is dangerous because free markets are why we are in the mess we are in. She feels that politicians know better than us how to run a business and an economy. She feels that politicians and therefore states must now control their economies and the free market must be extinguished. And as she said, “I am determined to win this battle.”

The true battle is NOT between politicians and free markets because politicians, as Gordon Brown can attest, can be swept out of office overnight. I predict Mrs. Merkel will follow Brown's exit very soon if the latest regional election results are any indication of future trends. But the real battle is between capitalism where free markets are intact and people freely determine their own fates, or socialism where the state decides what gets built, how much of it gets built, regulates the supply and prices of these goods and the state decides your fate. Merkel believes SHE runs the market and SHE will decide who fails and when. She will also decide who will succeed. Ask any small banker, any community banker in this country right now, if they feel that they have a level and fair playing field when competing against the Chase or Citibank's of the world.

What I find interesting is that the TARP was created in 4 days because the end of the world was coming if it wasn't passed. \$750 billion in funds were approved by Congress in less than a week. Over 90% of the representatives hadn't even read any of the bill before they voted on it. The European TARP for \$1 trillion was voted and approved over a weekend and the driving force in getting it approved as quick as possible was that a press conference MUST take place announcing the approval BEFORE the Asian stock markets opened on Sunday night.

Yet, it has been almost 2 years since the height of the crisis and we have yet to have any financial reform. And the one going to be approved soon has been so watered down that people who have read it say that it may as well been written by the banks themselves.

The Godfather is ready to loan but you have to do it within 15 minutes or the deal is off the table. In that 15 minutes your entire life is going to change and obviously for the worse but that is all the time you have. The unintended consequences are huge but there it is.

The unintended consequences of the creation of all of this debt, without thinking any of it through until after the fact will be the death of the free markets or the collapse of them. It is only a matter of time. At some point, the bill comes due and in the meantime, you can't pay the juice money. As you become late on your payments, the Godfather send over one of his buddies and breaks your finger to get his point across. A small show of force but it gets your attention. This was Dubai at Thanksgiving. Then you miss another payment and this time they break your arm. Again, a bigger show of force. This was Greece. What do you think happens the next time, and you know there will be a next time. This will be Portugal, or Spain or I think, Greece again. I am hearing that the EU may have to add a couple of hundred billion more to that already \$1 trillion package because Greece is way worse than anyone thought.

The result of this discussion is that you never should have taken the money. You should have taken bankruptcy, started all over again and picked up the pieces in a legitimate and legal way. The bailout from the Godfather did nothing for you. You may have used the Godfather's money to pay off your first debt, but YOU STILL HAVE THE DEBT. YOU JUST OWE IT TO A NEW AND MEANER PERSON. And now, just as you couldn't pay the interest before because you had no money, now YOU STILL CANT PAY THE JUICE BECAUSE YOU ARE STILL AS BROKE AS BEFORE. And now, the Godfather is demanding you take on austerity measures and these come in the form of a broken finger and arm. So let me ask you, are you better off now than you were before? AND, did any of this solve your original problem?

But more important, would you have been better off just declaring bankruptcy and getting out of the mess legally and a hell of a lot quicker. After a few rough months, you are debt free, rebuilding your life and trying to get better instead of living in fear, always looking over your shoulder, being involved with mean guys and having a broken finger, arm and still a whole lot of debt.

And if Angela Merkel was the Godfather, she would now want not just the loan money back, but complete control over your life.

In my view, Merkel will LOSE this fight as will Obama, Sarkozy and the rest of them out there that are moving away from the free market and towards a state controlled economy. Throughout history, the market always wins. In recent times, the fall of the Soviet Union and even the emergence of China, even though a communistic government is embracing the free market. So I have faith in confidence that the free market will ultimately prevail.

But the battle is on and this is one of the main reasons I believe we will see violent moves in the markets over the next few years. My conclusion is that any free market under attack by the rulers of the state, is not a bullish economic or market signal. Would you have invested your money in the Soviet Union in 1968 as they were taking down the Czechoslovakia.? Would you invest in Venezuela now? Or Bolivia? Economies that are being pushed by the powers that be from free markets to government regulated markets are never growing economies or bullish for that country. They are the exact opposite.

Therefore, it will be very hard to invest in Europe over the coming years as I expect that area to be ripped apart by politics and austerity measures. Those countries have a long history of war and while maybe this time it will not be a military conflict, I believe the economic war within Europe is just beginning and it will affect every major economy in the world.

Look at the announcement from Cisco today. The stock was down 5% not because of their earnings report. Earnings and revenues blew away estimates. It was what CEO John Chambers said during the conference call. He said Cisco gets over 25% of their earnings from Europe. He has no confidence in European sales forecasts and visibility is zero for the foreseeable future. Therefore, Cisco may have to lower estimates due to the austerity measures getting ready to be put in place over the coming years. Apple sells a lot in Europe as well. European consumers as well as Great Britain are going to have far LESS disposable income for the next 10 years. With massive cutbacks ahead in government pensions, social programs and medical payments, as well as massive tax increases being initiated by most of the countries, where is the money going to come from to buy the new I-Pad? Or the new Cisco router?

The world is running out of money. The Godfather or governments has lots of money because they can print it all night in the basement. But the consumer, the working people, the retired people, they are running out of disposable income. The Godfather charges you 7% interest on that loan money and you are only getting paid .05% at the bank. You have to realize that if you retire with \$1.5 million dollars right now and want to keep it totally safe by putting it a 10 year US Government Treasury Note, your income off \$1.5 million would be \$53,700 a year or \$4,475 a month. After tax, that would be about \$3,220 a month take home. If you have a nest egg that is \$750,000, your monthly after tax interest check would be about \$1,600 a month.

In 2007, before the stock market crash, the average amount in a 401K account totaled \$148,579. I'm sure it is smaller today.

This socioeconomic scenario is perfect for a coming major wave C down. Wave Cs are the most devastating waves and along with declining stock prices, you also get declining social implications. Major political upheavals, rioting and other social unrest. Major C waves are very rare and there is always a time and a place for them. I believe that we are seeing the beginning of the set up for Wave C. They fluid situation in Europe is the beginning. Next, you will see China's real estate bubble burst and that will put a big hurt on any chance of global economic recovery. After this, you can add in Iran and the Middle East as Iran gets the bomb and one of the world's major oil fields is now threatened by a nuclear armed enemy.

And don't forget Russia, the other major oil and natural gas producer, getting stronger by the month and ready to step onto the world stage again with new military power and lots of oil money. Add onto this the massive amount of global debt that will start to drag down these weakened countries one at a time as they just can't pay the interest on their debts.

And don't forget the sister volcano in Iceland. Scientists reported this week that tremors and seismic activity have increased 50 fold under this sister volcano called Katla. Scientists say Katla is the far more dangerous of the two volcanoes and its eruption could be up to 5 times bigger than Eyjafjallajokull and worse, the eruption could last for months. Europe, already in turmoil from the debt crisis could be in even greater economic danger if this second eruption occurs.

This is the social and political ingredients mixing into the C wave scenario. It's like a perfect storm where all of these events, man made as well as natural come together at the same time in a global fashion and push the C wave to an extreme place. Most people think it will take a long time for all of this to happen. I think it could happen quicker than most think. Just last year we were hearing that Iran was 10 years away from having a bomb. Then it was 5 years. Now we hear it is a matter of months. Believe me, if we learned anything from 2008, it was that things happen a lot quicker than you think.

So all of this doom and gloom. I write this to you because no one else does. You must be prepared for the Black Swan event and you must always remember that the world at this point is a very dangerous place and there are many events taking place all at the same time in different parts of the world that can come together and create chaos. And when you mix chaos with record, massive debt and the main population of the world basically broke, you could have a tiny problem up ahead concerning the stock market. Consider this a warning, not a prediction. But please consider it.



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