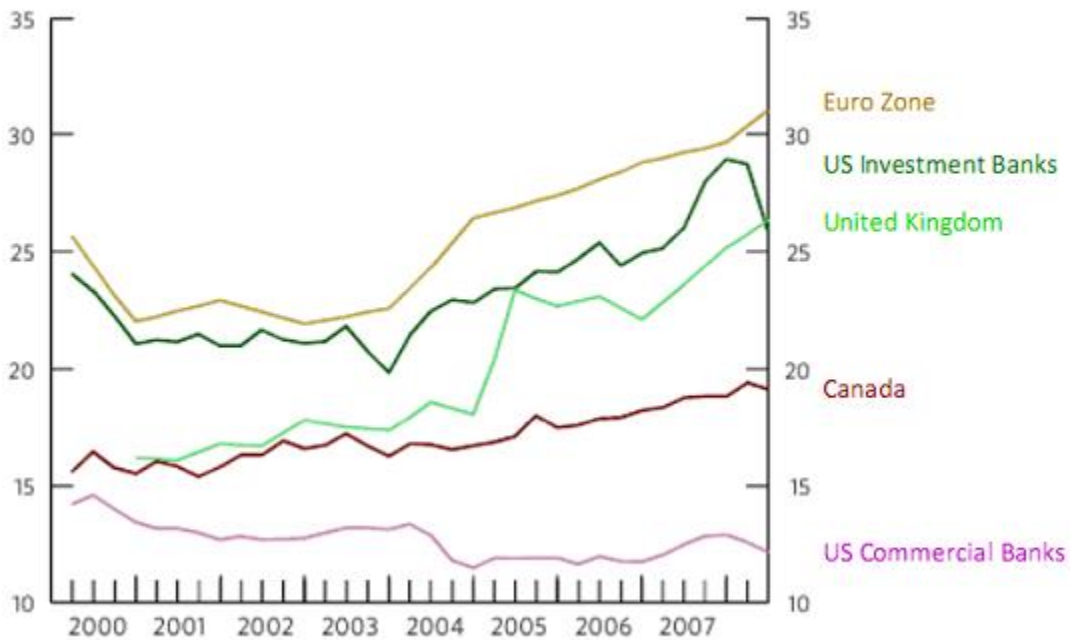


# GARBAGE IN, GARBAGE OUT

## WEB BUZZ 2011.10.31

The seriously over-indebted European Union is reportedly going hat in hand to China for a bailout. You may recall, it was rumored months ago that China was going to come to the rescue; however, they later backed off or, better said in our opinion, came to their senses. Europe, of course, is a large buyer of Chinese goods, therefore they may vendor finance them just as they do us. Note the chart on bank debt. It just gets worse.

**Banking Sector Leverage**  
Assets as a multiple of capital



Sources: Bloomberg and bank financial statements

Adapted from Pragcap.com

We keep thinking - just how does propping up a foolish spendthrift help them out? Does additional cocaine help a drug addict? As far as we can tell, doing so will only prolong the ultimate economic crash; however, in the meantime it makes for lots of trading profits and losses in the zero sum game of magic

formulas and computer programs. With that in mind, please note the following taken from *Contrary Investor* writer Brian Pretti:

*"I forgot where I originally saw this important quote I believe attributable to Ned Davis. The markets trend on fundamentals, but trade on technicals. I suggest this is clearly applicable and very important to our current circumstances. Equity markets over the recent past have both anticipated and discounted meaningful intervention by the Euro powers that be, yet as of this writing with no explicit or detailed plan for debt reconciliation. As of the week ended the 20th, we've blown past key Fibonacci levels to the upside like a hot knife through butter. The rally has produced the first trip above the 50 day moving average for the S&P since late July. Relative strength and MACD formations are looking much more positive on both the daily and longer term charts. Technically, life is looking a whole lot better than it did three short weeks ago. Got it. So what about trend?"*

*"First, the glaring divergence of the moment is that credit markets have not followed the equity market lead at all. The last time we saw a divergence such as this was in late 2007 and into 2008. Not a fun time, but certainly not a guarantor of current period darkness to come. Rather, a key point of divergence to monitor. We need to remember that in the land of global credit markets there are no "freqs" (high frequency traders) running the show and gunning for quarter and half pennies throughout the day. The credit markets represent human decision making. Short term equity market movement much more reflects computerized algorithmic rhythm."*

*Adapted from FinancialSense.com*

As previously mentioned ad nauseam, the economic fundamentals point to recession. The bond market tends to believe it, but the stock market has no clue. Once the day of realization comes both markets will explode - down in yields and down in the stocks. Computer models will not save anyone.