NEWSLETTERS & RECOMMENDATIONS - April 17, 2010

Dear Friends and Fellow Traders,

This was supposed to be the week of earnings and the S&Ps soaring to 1250 but the week was overshadowed Friday morning when the SEC charged Goldman Sachs (GS) with fraud. Most traders and investors shot first and asked questions later. Financials were hit hard in the market selloff. The timing couldn't have been worst for the financial industry as big banks had been aggressively making their case to resist increased oversight on their derivatives trading operations. Obama quickly announced he will veto any bill that does not regulate derivatives and have them trade on an exchange. Finally, one of my favorite naked puts sales, the CME Group, should benefit greatly.

Months ago on 12/24/09, Gretchen Morgenson of the NY Times exposed GS practice of these deals. See Banks Bundled Bad Debt, Bet against it and Won . To date, while appalling, the case has not been made that these CBOs were fraudulent. This week's hammer blow will unleash waves of "Schadenfreude". It seems the Germans have a word for everything. This means "satisfaction or pleasure felt at someone else's misfortune." which seems quite apt here. GS is now the most envied and yet hated company in the world.

No where have I seen anything in the media regarding the GS answer to the SEC charges. I'll provide a few salient points. First, GS answered that extensive disclosure was provided. Second, the risk associated with the securities was known to the two rather large institutional investors who were among the most sophisticated mortgage investors in the world. Third, in normal business practices, market makers do not disclose the identities of a buyer to the seller and vice versa. Fourth and finally, any investor losses resulted from the overall negative performance of the entire housing sector, not because of which particular securities ended in the referenced portfolio or how they were selected.

A class action lawyer commented on a cable network channel Friday that this case is analogous to a client approaching GS asking that GS build him a house where the client would supply the building materials which were highly flammable. GS would then find a buyer for the house and then the client would take out a fire insurance contract and wait for the house to burn down shortly to collect the insurance proceeds. That's nice work if we could get it.

What do I think and what this means looking ahead:

My first observation is why now and why in the middle of a trading day and not before or after hours? Maximum impact! Punish investors! Populism! It's Obama and Main Street against those greedy Wall Street fat cats. Everyone is talking about it now. We've pushed rampant spending, record deficits, health care and the Tea Party right off the front pages. It's officially the golden age for attaching the world's leading investment bank. It's likely other suits will follow.

Last year I was really happy to having Obama as President, looking forward to a breath of fresh air. Instead now I find out Obama is out to control huge chucks of the economy: ENERGY, PUBLIC EDUCATION, NATIONAL HEALTH CARE and FINANCIAL INSTITUTIONS. We even threw in the AUTO INDUSTRY for free. It's hardly a coincidence. I suspect that the SEC's move against GS comes as Congress is wrangling over financial reform. The complaint, whatever its eventual disposition strikes me as odds-on favorite to yield a much tougher reform bill as appeared as early as this past Wednesday.

Many more reasons for this action come to mind but that principle reason is that if the SEC can get a favorable ruling or a large settlement out of GS, the SEC can use these settlements as leverage in future suits against other banks and financial institutions. This scepter of potential lawsuits will chasten other institutions and potentially bring them to the table to avoid costly and disruptive litigation especially as Friday morning's news had hardly sunk in before Goldman Sachs stock closed down over 12% or a $10 Billion cap hit. Ugly!

There is a rage of populism which spilled over at Thursday's nationwide tea parties. These people may not quite understand what Wall Street and specifically Goldman Sachs does but it seems these Tea Partiers are mad as hell to see the financial sector enriched as the traditional economy crumbles. While the SEC has more independence than most other government agencies the commission's actions are ultimately computed back to the President and it's good press to go after the great Wall Street money machine. Just a reminder - Obama greatly rewards his friends and seeks to punish his perceived enemies. Obama makes former Presidents Richard Nixon's famous "Enemies List" now look like child's play in hindsight.

Summary:

Regardless of the outcome of the GS suit investing in financial stocks may never be the same. Risk is back according to the WSJ's Saturday's Heard on the Street column article, "Goldman's Grief may be Shared". The article goes on the relate, if reform results in stricter than otherwise previously expected legislation surrounding derivatives and trading activities as proposed by former Federal Reserve Chairman Paul Volcker and the Obama Administration, profits may suffer elsewhere. However, the bigger risk for Wall Street is how much the latest assault damages reputations and upends profitable activities. Financials are one of the largest sectors in the market and one of the fastest growers looking ahead into the next few years without further restrictive legislation.

Right now all I can say is we have to watch this case closely. Until then the market just might consolidate or even correct for awhile. NET traders do make more money with a two-sided market than only one.

Meanwhile, the fundamentals continue to look good. The U.S. is no longer the only train pulling the economic engine out there. Asia is exploding so much so that some of the BRIC countries are raising rates. The FED is on hold. Nothing should happen to upset the apple cart before the late June FOMC meeting at the earliest. So party on but be alert.

Trades of the Week in Review:

The good news was there was a great IRA Tax Trade for the 17th straight year which I'm happy to say a few of you caught for a handsome return. Congrats! The bad news, for me, is that I missed it for the first time in 17 years. The market over the last 60 days had not corrected by 1%. Tuesday's action had the market pulling back the usual shallow 10 S&P points but to a great 40% buy retracement at a multi-week breakout level as well. In the Chat Room I thought we could wait and buy the calls on any retest. A retest if this level never happened. The S&P rallied straight-up right into the close and into super INTC EPS number. The OTM 555 calls rallied from $0.85 Tuesday morning to a high of $5.60 Thursday afternoon from a 5X return versus a normal 2-3 bagger.

The Tax Trade has us buying any weakness into 4/13-4/15, staying long generally 2-3 days as IRA monies are invested into the Equity markets. See the 30" Friday NET Money Chart of the Week 2010-04-16D. This year sell offs of any size during the last 8 weeks were near impossible to find until Friday.

Thursday afternoon I sent an Alert Email to buy the ATM 555 puts (trading over $3.00 at the time) near $2.00 and scale-in lower as the S&P retested the 1209-11 area a multi-day (MD) and multi-week (MW) Target 2 level from both the 5" and 30" time frames. The puts traded down as low as $2.00 and hit $12.00 at Friday's lows or 6X was possible!

I must say I did send an Alert Email to close out the puts near $5.00 but I recommend buying the 550 calls near $1.50. Again I emphasized the hedging because the market wasn't ready to rally yet. Some of you did hold the puts. Way to go! We lost over 70% of the call price but 2 S&P E-mini hedged trades netted over $400 profit per long call for over 3X returns and more if you parlayed once. Before 12:00 I sent another Alert Email to start hedging with the 545 OTM calls as the 550s were too far OTM.

The 545s calls rallied from a low of $0.65 to $2.30 quickly but pulled back to $0.50 for another long setup. The calls then rallied back to a $1.50 where another Alert Email recommended a sale. See Friday 5" 2010-04-16C chart . Overall I put out 7 Alert Emails on Friday for a record.

I'll count these 2 call trades as my IRA Tax Trade for over a 2X return plus hedging profits which only increased the return. That’s 17 straight winners over 17 years. I truly do not know of a better trade and it only goes long and works well in bear markets too.

Keep those cards and letters coming. I read everyone of them.

Good trading,

Stan Moore
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