The #1 Way to Triple Your Money as the Stock Market Implodes

The casino has become so unhinged that analysis is almost beside the point. In fact, we are quite sure that the picture below sums it all up succinctly.

To wit, after seven years of unrelenting financial asset inflation, which has lifted the S&P 500 by an incredible 225%, the stock market is finally heading for an encounter with the grim reaper.

Current earnings for the S&P 500 are near $86.44 per share in the last twelve months (LTM) ending in March 2016. If you value earnings at a generous 15X PE multiple, the implied value of the S&P 500 index is about ***1300. That's a vertiginous 865 points or 40% plunge from here***.

So we recommend that traders simply short the S&P 500 and wait for the visage pictured below to make his appointed rounds.

Meanwhile, there is little doubt that the stock market entered the zone of pure mania in 2016. From a technical viewpoint, it is egregiously overvalued at PE ratios in the nosebleed section of history. At the same time, the global and domestic economies are heading into a prolonged patch of deflation, recession and slumping profits.

These conditions alone would be enough to leave the market vulnerable to a black swan-type shock. But what is truly different this time is that the bubble-makers at the central banks are finally out of dry powder. They are facing a drastic and sudden loss of credibility.

Two decades of central bank financial repression have destroyed honest price discovery on Wall Street. So the most recent 19% market surge from the Feb. 2016 low is just the last gasp of the greatest speculative bubble in history.

Indeed, the boys and girls on Wall Street are now riding their bikes with no hands and eyes wide shut. That's the only way to explain the most recent lunatic buying spree in the wake of the Brexit shock.

Let's start with valuation as measured by the PE ratio for the broad market represented by the S&P 500.

Valuation for the Broad Market

When the S&P 500 first peaked at 2130 back in May 2015, reported LTM (last 12 months) earnings were $99.25 per share. That was already down 6.4% from the cyclical high of $106 per share in September 2014. Thus, stocks were being valued at a nosebleed ***21.5X in the face of falling earnings***.

During the four quarters since then, reported LTM earnings have slumped by a further ***13%*** to the $86.44 per share indicated above for the LTM ending in March. Beyond that, even the talking heads on bubble vision agree that earnings are still shrinking by a few percent from the prior year.

Final S&P 500 earnings numbers are not yet in for the June quarter as of this writing. So let's give it the benefit of the doubt and assume LTM reported earnings for June come in no lower than $85 per share. Yet with the S&P 500 now at 2165 that brings the PE ratio to ***25.5X earnings that will have shrunk by nearly 20% over the last seven quarters***.

Needless to say, in a world economy that is visibly grinding to a halt, and with strong headwinds assailing Japan, China, the euro zone, Brazil, Canada, Australia and most of the rest of the EM (emerging market) economies, current stock market valuations are just plain nuts. But as is typical of a mania, the revelers do not see their precarious position until after the bubble bursts.

For that reason, May 16, 2008 is instructive. That was the last time PE ratios on an honest GAAP basis (generally accepted accounting principles) were near current nosebleed levels. It was also a time when the U.S. economy was already in its sixth month of recession. But no one had bothered to tell the Eccles Building or the Wall Street punters.

In fact, at the time the White House Council of Economic Advisers said there was absolutely no recession in sight. Likewise, Fed Chairman Ben Bernanke had proclaimed that the subprime problem was "contained" and was forecasting mainly blue skies ahead.

At that crucial turning point in the financial and macroeconomic cycle, however, LTM earnings for the most recent period (March 2008) had posted at $60.39 per share. So when the market hit an intraday high of 1430 the implied multiple was nearly ***24X***.

Needless to say, it was a long way down from there. In fact, 10 months later the market was ***53% lower***. S&P reported earnings actually bottomed that quarter at $6.86 per share, or ***90% lower***.

In truth, the current unhinged mania is worse than deja vu. That's because the casino's financial narrative has been so corrupted by recency bias and accounting promiscuity that it has no idea what the profits picture really is — or where it is going.

As the *Wall Street Journal* has documented, the heavily medicated and manipulated version of corporate earnings, usually referred to as "ex-items" or "operating earnings" came in at $1.04 trillion in calendar year (CY) 2015.

Now that compared to only $757 billion in GAAP earnings. It would appear that CEOs and CFOs — who filed their SEC statements on penalty of prison time — averred that their actual profits were exactly ***$256 billion smaller*** than what they told their investors.

As it happens, that quarter trillion-dollar fib is exactly the size of the ex-items charade back in 2007. It seems as if companies actually need a periodic recession so that they can toss into the kitchen sink the write-offs for all the dumb deals and investment mistakes they made while the bubble was still inflating.

The gap between GAAP and pro forma earnings is growing. Just like this phenomenon was a loud warning for the S&P 500 Index in 2007–08, it is a loud warning today.

In any event, not only are Wall Street's hockey sticks extremely crooked from an accounting point of view, but they are also egregiously predictable in the magnitude by which they deflate. Eventually, reality overtakes Wall Street's one-year forward earnings estimates.

What's Really Happening with "Operating Earnings"?

So let's briefly consider what has been happening with "operating earnings" as Wall Street construes them. The crucial initial point is that they are always presented on a one-year forward basis. This is based on the pretext that the stock market is still a "discounting" machine with respect to the unfolding future.

But the real reason is that on a current basis, the PE multiple on "operating earnings" is still scary high. Based on the most recent estimates, operating earnings for June LTM are expected to be about $100 per share. So even that is pushing a PE multiple of ***21.7X***.

Here is where the perennial "sell-side" scam comes in, and especially late in the business and profits cycle. At 87 months this one is surely long in the tooth already. But nevertheless the Wall Street brokers keep projecting "consensus" earnings growth of 30% for the year ahead — even as it never remotely materializes.

For example, back in March 2014, the one-year forward estimate for CY 2015 came in at ***$135*** per share of "operating earnings" for the S&P 500. At length, CY 2015 unfolded — bringing with it a collapse of oil and materials prices and a sharp slowdown of global growth that came as a big surprise to Wall Street.

Accordingly, the official statistician for Standard and Poor's, Howard Silverblatt, now certifies that actual operating earnings for CY (calendar year) 2015 came in at ***$100.45*** per share. Apparently, in a world where "one-timers" don't count, that gigantic ***26%*** miss doesn't count, either.

That's because in March 2015, Wall Street's "bottoms up" consensus for the next year ahead — 2016 — was pegged at, yes, $135 per share, again.

The problem is that the 2016 hockey stick has already been rolled-down to just $117 per share. Yet even if Q2 comes in at the current estimate of $29 per share and there is no further earnings decline in Q3 and Q4, earnings will total just $100 per share for 2016. ***That would be another 25% miss.***

Never fear. The street consensus estimate for 2017 is — to no great surprise — ***$135*** per share for the third year in a row!

You might conclude that Wall Street mendacity has no bounds — and that would be correct. But the more important takeaway is that Wall Street never, ever sees a recession coming, either.

Factoring in the Monthly BLS Jobs Report

As we have argued many times, the BLS (Bureau of Labor Statistics) monthly jobs report is not worth the paper it is printed on. This is because of seasonal maladjustments, the phony birth/death imputation of hundreds of thousands of phantom jobs each month and something we call trend cycle adjustment.

The latter means essentially that the initial estimates published by the BLS are ***modeled, not counted or surveyed***, as Wall Street would have you believe.

That's why the BLS job count is a lagging indicator and is always substantially overstated when the economy slides into recession. During the last cycle, for example, the BLS over-counted jobs by an average of ***560,000 per month*** between September 2009 and February 2009. That's based on its own "revisions" years after the fact.

So we give zero credibility to headline job numbers, which get day traders and robo-machines so excited.

In fact, you don't even have to puzzle through the wild swings emanating from the BLS random numbers generator to know that the actual U.S. economy and labor market is weakening.

There is absolutely no need for the essentially useless BLS employment report in the first place. That's because the daily payroll tax withholding receipts of the U.S. Treasury tell you all you need to know, and with one huge advantage to boot.

To my knowledge, there is no sentient employer in the U.S. who sends payroll tax money to Washington based on phantom jobs owing to seasonal adjustments, birth-death imputations or trend-cycle adjusted models which recalibrate shop floor headcounts to fit a prior trend.

Accordingly, if you strip from the payroll tax data an allowance for any tax policy changes, and allow for the going rate of nominal wage increase, ***you essentially get a proxy for real units of labor input to the American economy***.

That is to say, you get real time estimates of labor hours worked. You don't get medicated and manipulated statistical model projections of what a handful of GS-16s think the census count in the nation's workplaces *should have been*.

Let's revisit the June 2016 jobs report. According to the U.S. Treasury's cash box, June employment did not come "roaring" back at all. To the contrary, it has continued to skid, and has been for several months now.

To wit, compared to a 5–6% average annual gain late last year, the collections trend had fallen to just 3%. Strip out of that the 2.6% annualized rate of hourly wage and salary inflation reported for June and you get hardly a 0.5% growth in real labor inputs.

And that's not the half of it. The above data probably understate the slowdown because they represent a three-month moving average designed to filter out seasonal and calendar effects. More recent tax collections data suggest the U.S. economy may be barely treading water.

Daily Confirmation of Recession

A looming recession is confirmed almost daily. For instance, the recent batch of data for freight shipments was especially dispositive. That's because the movement of goods and commodities directly tracks the pace of business activity in the $18 trillion U.S. economy.

The Cass Freight index is now near a four-year low and ***13% below*** its level of June 2014. Indeed, it is no coincidence at all that the S&P 500's peak earnings occurred in mid-2014 just as freight throughput in the U.S. economy was also peaking.

Finally, the most recent data for business sales and inventories leave little to the imagination. Total business sales as reported by the Commerce Department is the big enchilada because it captures the sum of retail, wholesale and manufacturing activity in the U.S. economy.

Total business sales are clocking in at $1.35 trillion, meaning about $16 trillion at an annualized pace. That's down nearly 4.5% since the peak in July 2014.

Here's the thing. On an annualized basis, total business sales have dropped by nearly $700 billion over the past two years. During that same period, however, total business inventories continued to rise. They currently clock in at $1.81 trillion, representing a $50 billion gain even as business sales have been steadily shrinking.

The result is what always happens on the eve of a business cycle downturn. The inventory-sales ratio spikes, triggering a period of liquidation and reduced output and employment.

That's a recession. And it doesn't take too much chart gazing to see that we are close to the 2001 and 2008 triggering points.

Bring on the Helicopter Money Scam

That gets us to the final prop under the market's bottled air: helicopter money.

The key point is that there is nothing new or magic about it at all. It's just more of the same aggressive monetization of the public debt that has been going on for nearly two decades.

That is, whether the central banks buy public debt from the inventories of the 23 prime dealers and other market speculators or directly from the U.S. Treasury makes no technical difference whatsoever.

The end state of "something for nothing" finance is the same in both cases. In fact, helicopter money is just a desperate scam emanating from the world's tiny fraternity of central bankers. The same central bankers who have walked the financial system to the brink, and are now trying to con the casino into believing they have one more magic rabbit to pull out of the hat.

They don't. That's because it takes two branches of the state to tango in the game of helicopter money. The unelected monetary central planners can run the digital printing presses at whim, and continuously "surprise" and gratify the casino gamblers with another unexpected batch of the monetary drugs.

By contrast, helicopter money requires the peoples' elected representatives to play. That is, the Congress and White House must generate large incremental expansions of the fiscal deficit. They have to do this so that the central bankers can buy it directly from the U.S. Treasury's shelf, and then credit the government's Fed accounts with credits conjured from thin air.

To be sure, the cynics would say "no problem!" When have politicians ever turned down an opportunity to borrow and spend themselves silly, and to then be applauded, not chastised, for the effort?

But that assumes we still have a functioning government and that today's politicians have been 100% cured of their atavistic fears of the public debt.

Alas, what is going to cause helicopter money to be a giant dud — at least in the U.S. — is that neither of these conditions are extant.

Regardless of whether the November winner is Hillary or the Donald, there is one thing certain. There will be no functioning government come 2017. Washington will be the site of a political brawl of deafening and paralyzing aspect — like none in modern U.S. history, or ever.

At the same time, the existing budget deficit is already reversing. It will end the current year at more than $600 billion. That's baked into the cake already based on the recent sharp slowdown in revenue collections. It means that the FY (fiscal year) 2016 deficit will be one-third higher than last year's $450 billion.

Moreover, when the new Congress convenes next February the forward budget projections will make a scary truth suddenly undeniable. ***That is, the nation is swiftly heading back toward trillion dollar annual deficits under existing policy and even before the impact of a serious recessionary decline.***

The reality of rapidly swelling deficits even before enactment of a massive helicopter money fiscal stimulus program will scare the wits out of conservative politicians, and much of the electorate, too. Fools like former Fed Chairman Ben Bernanke don't recognize that the very idea of helicopter money strikes most sensible people as preposterous, offensive and scary.

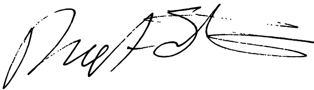
Even if Wall Street talks up helicopter money, there will be massive, heated, extended and paralyzing debates in Congress and the White House about it for months on end. There is virtually no chance that anything resembling the Bernanke version of helicopter money could be enacted into law and become effective before CY 2018.

Will the boys and girls still in the casino after the upcoming election gong show patiently wait for their next fix from a beltway governance process that is in sheer pandemonium and indefinitely paralyzed?

We think not.

As the grim reaper makes his appointed rounds, the S&P 500 has a long way to fall to reach a more reasonable value near 1300. The S&P 500 ETF puts described below by Dan Amoss, offer great profit potential.

Regards,



David Stockman
Editor, *David Stockman's Contra Corner*

A Path to 50–350% Profits from the S&P 500 Bubble's Pop

Dear *Contra Corner* Reader,

David argues that the S&P 500 is floating higher in an epic bubble's last gasp.

Take away the bubble environment, and a realistic value for the S&P 500 index is close to 1,300. A 15 P/E ratio, applied to $86 per share in GAAP earnings, equals 1,300.

We consider 1,300 a realistic target for the S&P 500 over the next few years.

If that target is reached, there is great profit potential in put options on the **SPDR S&P 500 ETF (SPY: NYSE)**.

SPY is the most popular ETF tied to the S&P 500. Put options on SPY are very liquid.

If the S&P falls to 1,300, SPY would crash from today's level of $216 to $130.

However, if you buy put options on SPY, you don't need the S&P to fall nearly that far to make a big profit…

If the S&P 500 declines to 1,700 (only part of the way to its true value of 1,300), then this trade would result in a profit close to 350%.

Action to take: "Buy to open" the SPY June 2017 $200 put option up to $8.50 per contract. As of Oct. 10, the asking price for this option is $6.72 per contract. The bid is $6.67. If you set a limit order somewhere between the bid and ask prices (near $6.70), your order should get filled. Click here for the latest option pricing.

If SPY falls to $190 by June 2017, the SPY June 2017 $200 puts would rise 50% in value, to $10 per contract. If SPY falls to $170, these puts would rise 350% in value, to $30 per contract.

You do not want to hold these puts beyond May 2017. After that, if they are out of the money, their value can decay rapidly. We'd recommend closing out this trade as investors' fears of a looming recession grows, and volatility rises.

Your profit may be large, small, or may even be a loss by next May. It all depends on where SPY is trading. This trade is based on our expectation that SPY will have a sharp move lower by mid-2017. But nothing is certain, so only risk money you can afford to lose.

Regards,

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