April 12, 2009

Why this is the most likely scenario for the unfolding Bear Market

Question: As someone who has just a passing knowledge of Elliott, but is an active trader, I really want to understand what gives you such certainty (hubris?) to make statements like this?

"*Deductions gleaned from Anatomy of the Bear by Russell Napier "The implication Bear Markets from peak to trough occur over a period of roughly 14 years would indicate that 1921 was the Market Top corresponding with the Great Depression, from **1921-1929 was a Bear Market Rally**.(See Long-term count below) In our current situation, instead of a single long Rally, we have an accordion-shaped move of alternating highs and lows...which like many forms in nature, sub-divides into 5: 2 peaks and 3 valleys. Secondly, a Bear Market bottoms only occur when the market is selling at a **30% discount to replacement value, called the q ratio.** Those who have read my long-term forecast know that the coming trough is NOT the bottom. We must still complete the Mother of all Rallies, culminating in a Market Orgy-Bubble followed by the CRASH of all-time.....only then will we likely meet or exceed the required "q" value". With the ball rolling long ago, Fiscal and Monetary policy while temporarily appeasing the angry mob, merely aggravate the eventual misery of the entire populace. Democrat or Republican, liberal or conservative these are labels for the scapegoat. History is always written for the benefit and legacy of the victors. Like all the chief executives whose heads rolled in the past year, their replacement's ability to tame the Bear was no better".*

It is hard enough, but statistically possible, to gain a small edge projecting just tomorrow's S&P direction. But over multiple years, absolutely no one has a clue what might transpire. For example, the world might get into a nuclear war and obliterate itself. That would certainly make the next trough "THE BOTTOM" - What becomes of the "Mother of all Rallies" under those circumstances? Not in your lifetime. Conversely, the US might throw out all the liberals from Congress, implement a Fair Tax, reduce taxes on corporations & individuals to attract capital, and the markets would likely be biased up for the rest of our lives. So I really don't understand how you can be so

certain of distant calls. While I know you had a good track record last year, the fact is, your track record is based on your day to day analysis. So what is the basis of such sweeping long term predictions?

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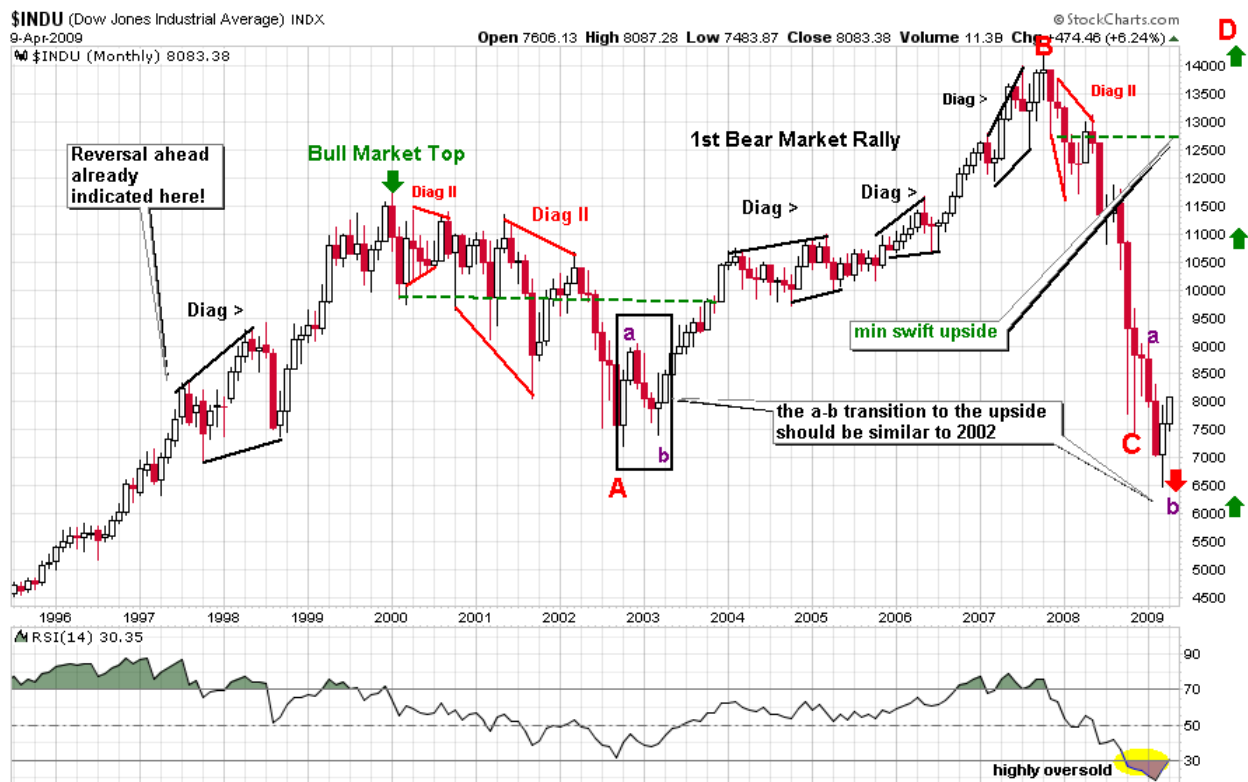
Answer: Like tremors which forewarn of a major Earthquake, once in motion <u>it cannot be reversed by any means</u>, so too is the accordion-like Supercycle *Diag II.* These “tremors” began as early as 1997, when the last bull move morphed into a ***Diag >,*** signaling dramatic reversal from Bull to Bear.



As shown below we have competed **C** and are transitioning up to **D**, the final bubble top. What’s more, since the size of the transitional structure is much larger than in 2002, we can expect a proportionally larger follow through. Like a puppy with oversized paws, you know its going to grow up to be a *<u>big</u>* dog.

Take for example the Dow chart above, the ***Diag II*** in September 2008 (top left), indicated the plunge preceding the demise of Bear Stearns & Lehman, long before these became evident. Some traders saw it coming and acted their convictions by shorting the Market. On the other side of the trade were those less informed *buy & hold* investors who continued to "buying on dips" creating the ***Diag II*.** The market is anything but Democratic, those with certainty and the capital to back it always reveal their cards by their predominate actions, in Elliott these patterns read like inside information…these traders who commit the most capital are usually better informed, while others dependent on the "news" who bet against them, invariably lose. Over time their cumulative gains allow for bigger bets, while the ones on the losing side fade away or quit trading.

In our society, conditioned to expect instantaneous gratification, the time lag for the stimulus kick in has been grossly underestimated, we're like kids in the back seat constantly asking "*are we there yet*"*?* The stimulus is similar to taking a party drug with food in your stomach, after an hour - no effect, "*it must have been a bad batch*" you think. So you take a second larger dose an hour later still nothing, so you take a third dose. Then all of a sudden your digestion completes and the first two doses hit at once! Euphoria & irrational exuberance are back again, but before you know it you pass out from an overdose, similarly the Market can only Crash from a similar monetary stimulus overdose. The rally just around the corner should exceed even the all-time record climb between July 1932 and March 1937 of 376%. Bear Market Rallies are much swifter than Bull Moves - but they are phonies, lacking lack lasting power.

Our track record is *based on day to day projections being consistent with the big picture* described in the long-term forecast. Once you know the forest, the trees, branches and even leaves are far easier to negotiate. Within this framework, an early call remains manageable and requires no further action. In practice, the wave principle often departs from descriptions chronicled in Frost & Prechter's Elliott Wave Principle. Likewise *Prechter & Frost* ignored some of Elliott's empirical observations, attributing them to an old man's failed attempt to force the wave principle into a neat little box. What's more modern computer programs allow us to chart accurately, even in 1 minute increments, while Elliott was limited to the hourly prices published in the Wall Street Journal, which he would plot on a graph by hand. He started at age 63. Now that we are able to dissect his waves, it is obvious that the count often does not complete at the highest point, particularly in a correction, and in nature everything is either a 3, 5 or a multiple of these.

The ***Diag II,*** which was discovered post-Elliott, and the ***Diag >*** are given little credence, while in fact they are the two most noteworthy patterns for forecasting directional changes, and the extent of the subsequent move. An Elliott practitioner who lacks mastery of these tools will always be mediocre at best. Like the Catholic Church controlled the masses for centuries by keeping them in the dark through mystery, miracles and mysticism. Likewise some so-called "experts" lazily gloss over the charts without actually counting any waves; they create similar mystery to their counts, which change drastically without explanation. Others without an iota of perspective would have you believe the degree of trend is unimportant or it has not changed since *they* began counting waves. Still others claim that this is the second Bear Market since 2000, as if dissecting the Bear into body parts, rather recognizing it as a long-lived organic whole. These shortcomings account for Prechter's miss-guided long-term forecast being twenty years early, 10,000 Dow points short and a degree of trend off the mark. Although his calls are occasionally right, it's a short term coincidence, since the big picture bears no relation to the actual Market. An erroneous foundation; buttressed by "set thinking" will invariably lead to money-losing investments. He's now got his followers invested against the trend. *It is not the wave principle that's flawed,* any more than Bubbles are greatly magnified by the Fed, its misguided monetary policy, and misguided Elliott interpretation. A transition such as the current separates the skilled from the mediocre. Meanwhile we provide a road map, which is constantly adjusted to keep you on track, just as you would a sailboat. If the market takes a minor detour, you're still on track. Within this framework, an early call remains manageable and requires no further action.

Elliott is a study of history from the perspective of social mood, which swings like a pendulum from extreme optimism to extreme pessimism and back again. This occurs *simultaneously on many time frames, where the long-term, especially in Bear Markets, often runs contra the intermediate trend, while the short-term trend vacillates between the two. These are called degrees of trend.* Supercycle degree, which currently provides the big picture, operates on a chart where each candle represents either an entire

month or better a year. Although the hourly charts are the level used most often for trading, without the big picture, they provide only a myopic view, without any relation to the path up ahead, and leave you highly vulnerable.

The 5 and 10-min charts allow us to feel the Market's pulse, as through a microscope. Diagonals, which signal directional changes, will often not show up on the hourly charts until much later, if at all. This explains why my calls tend to be early. Since the Market is a ***fractal***, the whole is repeated over and over in its parts. There's usually a sneak preview available on a shorter time frame. Simplistically the market is analogous to that one of those wooden Russian eggs, nested into infinity with smaller slightly different versions inside. When I was first learning to count waves, I charted by the minute in real time for two years, in terms of experience, that's the equivalent of 120 years of charting the hourly charts.

When the degree of trend changes, its like stepping off a 3x5' Persian rug to a 10x12' of the same pattern, rather than more swirls and arabesques, their number remains constant, while their size increases geometrically. When we transitioned from primary to Supercycle degree in 2000, volatility greatly increased of necessity, analogous to the larger dimensions of the Supercycle degree. Without a sense for the big picture, you could be going along fine for a while, and then suddenly get blind-sided, or fall off a cliff. Again its not the wave principle that's at fault, but a bad interpretation. "Holding long-term" as successful investors have been conditioned to do in Pavlovian-style over the course of the long Bull Market, now becomes a handicap. Yes, both the rules and the stakes have changed. That's why knowing the degree of trend is so critical. It should be no surprise that Rallies of Supercycle degree will dwarf previous bull moves two degrees of trend lower.

Although the Waves progress ever higher, paralleling the progress of civilization, this process is never a straight line. Rather it moves ***three steps forward, two steps back.*** *At the current juncture, the three steps forward began in 1932, with the start Supercycle Wave **(III)** below, so two steps back will likely take us to the area of 1974-1983 prices. (this range spans the first **Diag II** on the long term forecast, which is the minimum trough, and the extreme of the previous 4th wave of one lesser (cycle) degree, labeled **A** with the arrow at Dow 555 below. This is the likely maximum retracement for Supercycle Wave **(IV)**.*

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