November 2009

LONGWAVE group

ECONOMIC AND FINANCIAL ANALYSIS BASED ON THE LONGWAVE PRINCIPLE

LONGWAVE ANALYST

DOW 1,000 IS NOT A SILLY NUMBER

Nobody wants to hear bad news, let alone believe it, even if it's true. So when a virtually unknown financial and economic historian, such as myself, suggests a seemingly outrageous Dow target of 1,000, it is essentially dismissed as a prognostication of a 'know nothing crank'. And everyone continues to buy stocks for the long term - isn't that what the experts are telling them to do?

These experts displayed in the business sections of newspapers and magazines and on the main business channels must be experts; after all, many of them work for the big banks and if the banks don't know money, who does? Aren't they entrusted with investing millions if not billions of customers' money? They must know. "...We compulsively associate unusual intelligence with leadership of the great financial institutions the large banking, investment-banking, insurance, and brokerage houses. The larger the capital assets and income flow controlled, the deeper the presumed financial, economic, and social perception." Galbraith, P. 15

Investment managers must be bullish; they want investors' money because a major part of their income is based on the amount of money that they manage. They won't get that money if they are bearish. As for the media, it can't countenance bears. They want to see the perpetuation of the stock bull market since it holds reader's and viewer's interest. It gets them to buy the newspapers and magazines devoted to investing and gets them to turn to the TV channels that constantly repeat the bullish spin. Bears are bad for business.

Nobody likes a bear. Most people have too much money invested in stocks. They can't afford to lose money and they don't like people telling them that they are going to lose. They are linked together in a common interest. As such, they form part of a crowd and are governed by a collective psychology that is essentially irrational. "From the moment they form part of a crowd the learned man and the ignoramus are equally incapable of observation." Le Bon, P. 23.

The investment crowd refuses to listen to anyone who tries to temper its ardour for the stock market. "An individual may accept contradiction and discussion; a crowd will never do so. At public meetings the slightest contradiction on the part of an orator is immediately received with howls of fury and violent invective, soon followed by blows, and expulsion should the orator stick to his point." Le Bon, P. 37.

Almost everyone has a vested interest in being bullish and they scorn those who dare to "express doubt or dissent. It is said that they are unable, because of defective imagination or other mental inadequacy, to grasp the new and rewarding circumstances that sustain and secure the increase in values." Galbraith. P. 6.

This explains the short shrift that my Dow target was given by some financial reporters. That's okay, time will tell. How would the experts have treated a forecast in August 1982, when the Dow was in the high 700s, proclaiming a future Dow target of 11,750 points? They'd probably have thought it much too high, but bullish is good.

Conversely, if in September 1929, a stock market forecaster had publicly proclaimed that the Dow was about to lose 90% of its value, would he have been subjected to the same ridicule that my Dow 1,000 receives today? Actually, we know the answer. In September 1929, Roger Babson, a well respected figure at that time, who was interested in economics, market forecasting, statistics, theology and the law of gravity foresaw a market crash and said "'it may be terrific, the crash in the Dow could be in the order of 40 to 60 points, and, in consequence, factories will shut down... men will be thrown out of work... the vicious circle will get in full swing and the result will be a serious business depression.'"

His forecast caused a sharp break in the market and the reaction to it was furious. "Barrons said he should not be taken seriously, by any one acquainted with the 'notorious inaccuracy' of his past statements. The great New York Stock Exchange house of Hornblower and Weeks told its customers, in a remarkably resonant sentence, that 'we would not be stampeded into selling stocks because of a gratuitous forecast of a bad break in the market by a well known statistician.' Even Professor Irving Fisher of Yale University, a pioneer in the construction of index numbers, and otherwise the most innovative economist of his day, spoke out sharply against Babson." Galbraith, P. 8.

"After an evening of gloom-lowlighted by Ian Gordon's prediction that the Dow will fall to 1,000-they gave chocolates to the departing crowd. Why chocolates? Why not razor blades, or maps to local bridges?" Derek DeCloet, The Globe and Mail, Thursday April 9th 2009.

"Last Monday I got an invitation from a public relations firm to spend 'A Night with the Bears' at the Elgin Theatre...I declined because these bears have been wearing their bearish views on their sleeves for the past several years and, quite frankly, I would rather have a root canal than sit through that again." Bill Carrigan, thestar.com, Saturday April 11, 2009. There's only one view, that's the bullish one which this investment reporter wants to hear. How can he objectively report the facts to his readers?

"For me, the real test of an expert is can they manage money? Of these four bears, which one would I choose to manage my portfolio? The clear loser is the 'lunatic fringe' cycle expert Ian Gordon with his call on the Dow Industrials hitting 1,000 before this downturn is over..." Ibid

The tone is angry. Why? Is a rising stock market a life-long entitlement, providing for the constant enrichment of all investors? Are those who answer 'no' to this question to be despised and subjected to "violent invective?"

What number would these gentlemen find satisfactory? Would 8,000 be okay? Or even the March 6th, 2009 bottom for a retest of that low? They don't offer any alternative projection to Dow 1,000, but simply dismiss it out of hand. One gets the impression that they are both perpetual bulls and reject any bearish price. Well, they can continue to live their dream and unfortunately, influence their readers accordingly.

The resumption of the bear market is imminent and as stock prices resume their decline, Dow 1,000 will receive renewed attention.

The DJIA is a price weighted average of 30 stocks. It means that the high-priced stocks have a much bigger effect on the average than low-priced stocks. IBM, at $120.82, accounts for 9.4% of the Average. Alcoa Aluminum, priced at $14.14 accounts for only 1.1%. A dollar change in IBM, which is less than a 1% move in price, has the same effect as a dollar change (7.7%) in Alcoa Aluminum.

I can understand why Dow 1,000 seems like such an improbable number. But a decline of this magnitude is not unprecedented. In the 1920s the Dow Jones Industrial Average was comprised of many relatively new companies and would be more akin to the high-tech growth companies of today. The Dow Transportation Index was considered the blue-chip index at that time. This index fell by 93% in the 1929-1932 bear market. A 93% fall from the Dow peak of 11,750 points in January 2000 would take the Dow down to 822.50.

Recently, we've already seen two Dow stocks decline more than 93%. Citicorp fell 93.9% and General Motors 98.2%. Both companies were unceremoniously dumped from the index.

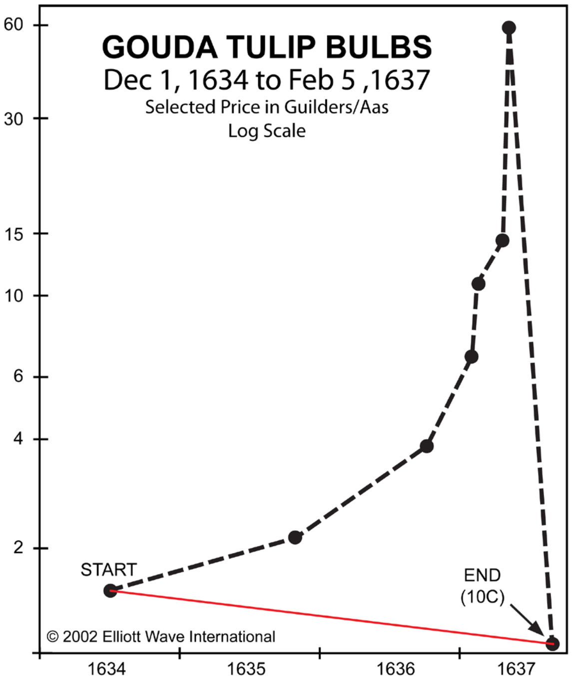
Investment markets are like rugby players, 'the bigger they are the harder they fall.' There are absolutely no exceptions to this rule. The biggest of these investment markets are usually referred to as bubbles or manias. They always fall the hardest, fulfilling Newton's dictum-"To every action there is an equal and opposite reaction."

History has recorded very few financial bubbles. Charles Mackay in his famous Extraordinary Popular Delusions and the Madness of Crowds, which was first published in 1841, covers three: The Mississippi scheme initiated in France by John Law in 1719-1720; The South Sea Bubble, an English experience, 1720-1721; and Tulip Mania, an extraordinary Dutch bubble in 1636. In his book, A Short History of Financial Euphoria, John Kenneth Galbraith writes about the same three bubbles and several American bubbles, including the crashes of 1837, 1873 and 1929, which ended the speculative manias of the 1st, 2nd and 3rd Kondratieff autumn periods and were followed by their respective winter depressions. Charles Kindleberger, in the latest edition of Manias, Panics and Crashes, published in 2005, lists 10, including the three discussed in Galbraith's and Mackay's books, the 1920s autumn stock price bubble, and the Japanese stock and real estate bubbles that burst in 1990.

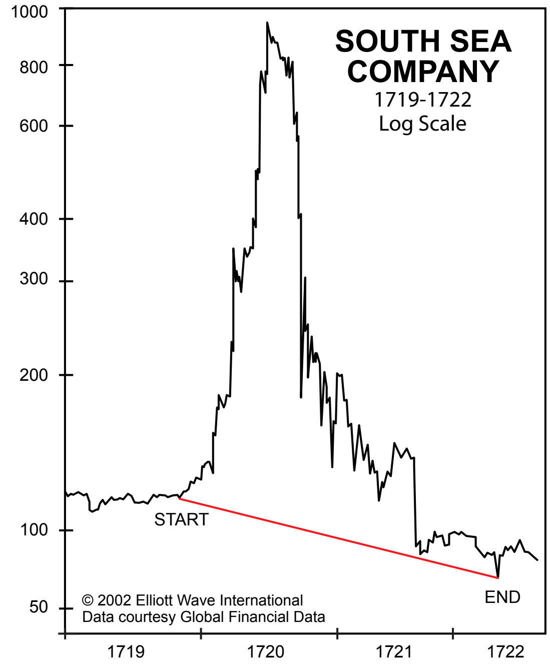
What is yet to be documented in any detail are the mania markets of the 1980s and 1990s, which far surpassed the bubble of the 1920s in both size and diversification. There were no derivatives of any consequence in the 1920s. The real estate bubble that was fostered by the past chairman of the Federal Reserve, Alan Greenspan, far outdid the real estate bubble of the 1920s, which was centred on the development of suburbs outside the cities and the building of skyscrapers close to the city centres.

"Speculative manias gather speed through expansion of money and credit." Kindleberger, P. 64. Every bubble depends on credit (debt). The Tulip mania was financed through credits by the sellers of the bulbs, a 17th century form of 'vendor financing.' The Mississippi scheme owed its manic development to the Banque General later the Banque Royale. The South Sea Bubble owed its status to the Sword Blade bank and also the Bank of England. The 1920s US stock market bubble attributed its growth principally to the benevolence of the Federal Reserve and to a lesser degree a vast array of lenders taking advantage of high 'call rates' (margin). The twin Japanese bubbles of stocks and real estate of the 1980s were financed almost entirely by the Japanese central bank. Finally, the stock and real estate bubbles of the late 1990s and into 2007 prevalent throughout the world, but principally in the Anglo Saxon nations, are the responsibility of the national central banks or, in Europe's case, the European Central Bank. "All crises have involved debt that, in one fashion or another, has become dangerously out of scale in relation to the underlying means of payment." Galbraith. P. 20. The debt bubble that accompanied the recently concluded twin financial and real estate manias is unprecedented.

Bear market in tulip bulbs down 98.4 %



Bear market in South Sea Company down 92.4%



While we don't have a chart for John Law's Mississippi bubble prices, we do know that share prices in the company increased 20-fold in one year and that many of these share purchases were made on credit based on huge amounts of paper money injected into the economy. When the bubble burst, although the company survived, prices were a fraction of what they had been, most likely below the initial issue price of 500 livres.

Bear Market in Nikkei Ongoing - from top to lowest low, so far, down 80.5%

Look closely at these bubble charts and the bear market aftermath, although not the Nikkei, that bear market hasn't yet completed. Do you notice anything sinister? Well, to save you the trouble, let me point out that in the two cases where the bear market was completed, the price bottom finished below the point from whence the bull market started. That fact is especially relevant to the current bear market. As we shall demonstrate, our current bear market is the equivalent of the bear market of 1929-1932. That bear market, like the bear markets that followed the Tulip Bulb Mania and the South Sea Bubble, also ended below the price from which the preceding bull market (1921-1929) began.

These great speculative bubbles are self perpetuating. As the value of the underlying assets increases, so does credit. The constant rise in values attracts a corresponding increase in credit (debt). Moreover, the more speculative prices increase, the more moths are drawn to the flame. These new investors attract additional credit to the bubble. In addition this rapid rise in paper wealth leads to a corresponding increase in credit in all sectors of the economy, but most noticeably in real estate. The sale of luxury goods thrives as the nouveau riche flaunt their wealth.

"The rule is that financial operations do not lend themselves to innovation. What is currently so described and celebrated is, without exception, one that owes its distinctive character to the aforementioned brevity of the financial memory. The world of finance hails the invention of the wheel over and over again, often in a slightly more unstable version. All financial innovation involves, in one form or another, the creation of debt secured in a greater or lesser adequacy by real assets." Galbraith, P.19

It's a sham; eventually the debt bubble priced against outrageously inflated assets cannot be sustained and the whole house of cards collapses, and as we have written so many times, 'bringing down both debtor and creditor alike.'

The collapse of the debt bubble is usually preceded by a crash in the ridiculously overvalued stock market. Not that many stock market pundits at the time recognise that fact or, if they do, they excuse the over-inflated stock prices as justified by the 'new era,' or quite simply by stating 'that this time it's different.' It's never different; human emotion has not changed over the centuries. Typically, when it comes to money, emotion ranges from fear to greed; on a broader scale, it measures between the two extremes of euphoria and despair. Both these extremes are manifested one time only in the Long Wave Cycle: euphoria is exhibited at the peak of the huge autumn stock bull market, as in 1929 and 2000, and despair is evident during the depths of the winter depression, as in 1933.

When the initial crash comes, it takes everyone by surprise. Once it is contained and stock prices begin to rise again, it's viewed as a hiccup on the road to perpetual stock price gains. That's the way it's been since the onset of this fourth Kondratieff cycle in 1949. In that year, the Dow bottomed at 161 points and since then it's been in a rising price trajectory, punctuated occasionally by short reversals. The same is true of the third Kondratieff cycle, which commenced in 1896; that is until the winter bear market started in September 1929.

Since the great autumn bull market started in 1982, stock price gains have been impressive, adding 1500% at the 2000 peak. The bulls have been right for more than 50 years. That's why they are so confident that they are still right. That is why bears get such a short shrift. However, when the great autumn stock bull market ends, as it has always done, in a crash, the bulls, resting on their past laurels, are eventually doomed to extinction.

The stock market crash of 2007-2009 was worse than the stock market crash in the fall of 1929. We have started the winter stock bear market, which promises to be every bit as severe as the autumn stock bull market was good. The bears are now in control.

Financial markets and the economy are interrelated and both are governed by cycles. These cycles are conditioned by changes in collective human emotion. For many years, my focus has been on the Kondratieff cycle. It is approximately 60 to 70 years in length; hence, for all intents and purposes it is lifetime cycle. This means we have never lived, at least in a meaningful way, where we are presently situated in the cycle, making it almost impossible to recognise and understand current economic and financial events.

The key to knowing the probable next phase in any cycle is to understand our current position in the cycle. As long as we know where we are, we know where we are going. W. D. Gann, the great trader and financial cycle market expert, wrote in his book, Tunnel Thru the Air, which was published in 1927-"....that in order to know and predict the future of anything you have only to look up what has happened in the past and get a correct base or starting point." P.75.

If you have difficulty believing in the existence of economic and financial cycles, you should just check the accuracy of my predictions based upon my interpretation of the Long Wave. I was able to predict the housing crisis and the banking crisis that followed. I predicted the stock market peak not only in 2000, but also in 2007 and the ensuing bear market and concurrently the onset of the gold bull market, which started in 2001. Moreover, I warned several times of the impending pension crisis, when I said and wrote "pensioners will not receive what they've been promised."

In early November 2007, I wrote a special edition of my publication 'The Long Wave Analyst' entitled "This Is It." The opening paragraph read as follows-"This is it. The Kondratieff winter is now underway in earnest and nothing can stop it. The huge credit expansion initiated by the Maestro, the past Federal Reserve chairman, Alan Greenspan, has now reversed. The ensuing credit contraction will be devastating. It will take down creditor and debtor alike and will result in a destructive and frightening deflationary depression."

A few paragraphs later in the same edition I wrote- "All cycles are forecasting a major peak, not only in stock prices but also in the economy."

How did I know this? I knew because the Long Wave was at the exact same point as it had been in 1929, or for that matter 1873 or even 1837. Also, I knew what had to follow: a collapse in stock prices and banking failures caused by the bursting of the debt bubble.

There is only one phase in the Long Wave (lifetime cycle) when a massive speculation occurs, principally in stock, bonds and real estate and, concurrent with that, an enormous expansion of credit. This always happens in the autumn, or the third phase, of the cycle. When it ends, flagged by the crash in stock prices, it signals the onset of the Long Wave winter. In winter, much of the debt is eliminated, causing the deflationary depression. The extreme low level of stock prices at this time reflects this traumatic economic upheaval.

In November 1928, W. D. Gann published his 'Outlook for 1929' for his subscribers. What follows, are the opening three paragraphs of this publication.

"This year occurs in a cycle which shows the ending of the bull market and the beginning of a prolonged bear campaign. The present bull campaign has lasted longer (1921-1929) than any other previous campaign in the history of this country. The fact that it has run longer and prices have advanced to such abnormal heights means that when the decline sets in it must be in proportion to the advance. The year 1929 will witness some sharp, severe panicky declines in many high-priced stocks."

"During the year 1928 the public have entered the stock market on the largest scale ever known in history. Foreigners have bought our stocks more than at any time since or prior to the outbreak of the World War. The American public is no longer making safe investments in stocks. They have the gambling fever and are buying everything regardless of price, simply buying on hope that stocks will continue to go up. This is a dangerous situation and has always resulted in a big decline. There will be no exception in this case."

"As long as the public believes that everything is all right, they will hold on and hope, but when public buying power has exhausted itself and the largest number of stock gamblers in history lose confidence and all start to sell, it requires no stretch of imagination to picture what will happen.....Gamblers do not think: they always gamble on hope and that is why they lose. Investors and traders must pause and think, look and listen, and get out of stocks before the great deluge comes." W. D. Gann, Outlook for 1929.

I think you'd have to agree that it was a pretty impressive call. The accuracy of Mr. Gann's prognostication is a testament to his unique skills in his interpretation of cycles. He died in 1955, but his exceptional trading skills, based upon his financial cycle knowledge, is likely never to be surpassed.

What Mr. Gann did demonstrate, time and time again, is that the correct interpretation of economic and financial cycles is an exceptional method of determining the most probable course of future events.

The most important thing to understand about financial and economic cycles is that they are just like their counterparts in the natural world. They are as predictable as are the tides, the moon phases, the annual seasons and, yes, a human lifetime. Like a human lifespan, financial and economic cycles follow a similar path from birth to death. The Long or Kondratieff Wave follows this path over 60 or 70 years, which is typically a meaningful human lifetime. In the cycle, spring is the birth of the economy. In winter, the economy dies. It dies because it is overcome by too much debt. During winter, most of the debt is purged from the economy, which enables its rebirth in the following spring.

All cycles are natural phenomena; financial and economic cycles are also. This means that man is powerless to intervene. Nature must take its course. "There is no power, Divine or human that can oblige a stream to flow back to its source." Le Bon. Gann wrote in November 1928 in his Outlook for 1929, "When the time cycle is up, neither Republican, Democrat, nor our good President Hoover can stem the tide. It is natural law. Action equals reaction in the opposite direction. We see it in the ebb and flow of the tide and we know from the full bloom of summer follows the dead leaves of winter." He was right; there was nothing that anyone could do to halt the vicious stock bear market or the economic depression. Here we are again; current world leaders think that they can stop the natural course of events that follow a debt bubble that is unprecedented in scale. They and we are to be hugely disappointed. Spring doesn't occur until winter has run its course. In the Long Wave, these leaders think they have the power to circumvent winter. They don't.

The onset of the 3rd Kondratieff autumn stock bull market was heralded by the bear market bottom with the Dow closing at 64 points in August 1921. By 1928, the rising tide of stock prices had caught the attention of the public. "Sensitive to the public's enormous appetite for stocks, Wall Street expanded its bill of fare, creating nearly $12 billion in new shares for sale. Well over $2.3 billion of that was in investment trust paper (the mutual funds of the modern era). Hundreds of funds were promoted, many of them highly leveraged." Brown, P. 57.

"This 'professional management' would be the last great sales cliché of the 1920s. By the record, it worked only as long as the market kept going up (It's the same today). United Founders, a flagship of one group, with assets of over $300 million, saw its stock price fall from $75 to $0.75 during the next few years." Ibid

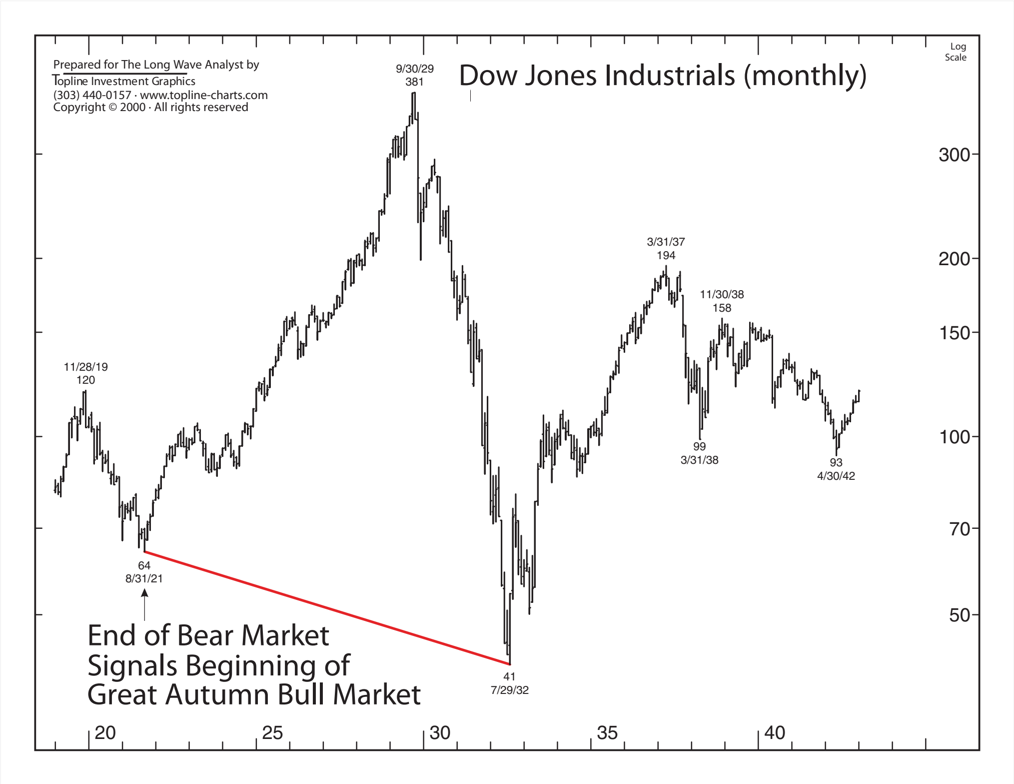
In September 1929, investment trusts with a combined value exceeding $600 million were brought to the market. This was an issuance far greater than in August. One of the principal issuers of trusts at this time was Goldman Sachs.

“By the end of summer, stock prices, margin debt, and speculative fever were all at record levels, as were price-earnings ratios. Banks, the cozy part of pools, and investment underwritings, were seen as the best ‘play’ on the great securities boom, since brokerage firms were not publicly owned. National City (a bank) was valued at 100 times earnings, and ratios of 50X were common for the money-center banks.” Ibid

On September 3rd, 1929 the great autumn stock bull market reached its peak, and the Dow Jones Industrials topped at 381.17 points. A panic started in October and the collapse in prices was awesome; finally a temporary respite was reached on November 13th, 1929. In just 13 weeks the Dow had lost 48%. The September high was not to be surpassed for another 25 years.

Stock prices recovered into April 1930. Thereafter the stock market began to cascade into a freefall. Each new low was followed by a hopeful recovery in prices. The bear market finally reached its bottom on July 8th, 1932, with the Dow closing at 42.22 points, a little less than 90% below the bull market peak of 381 points reached on September 3rd 1929.

The 3rd Kondratieff Autumn Bull Market 1921-1929 and the Winter Bear Market 1929-1932

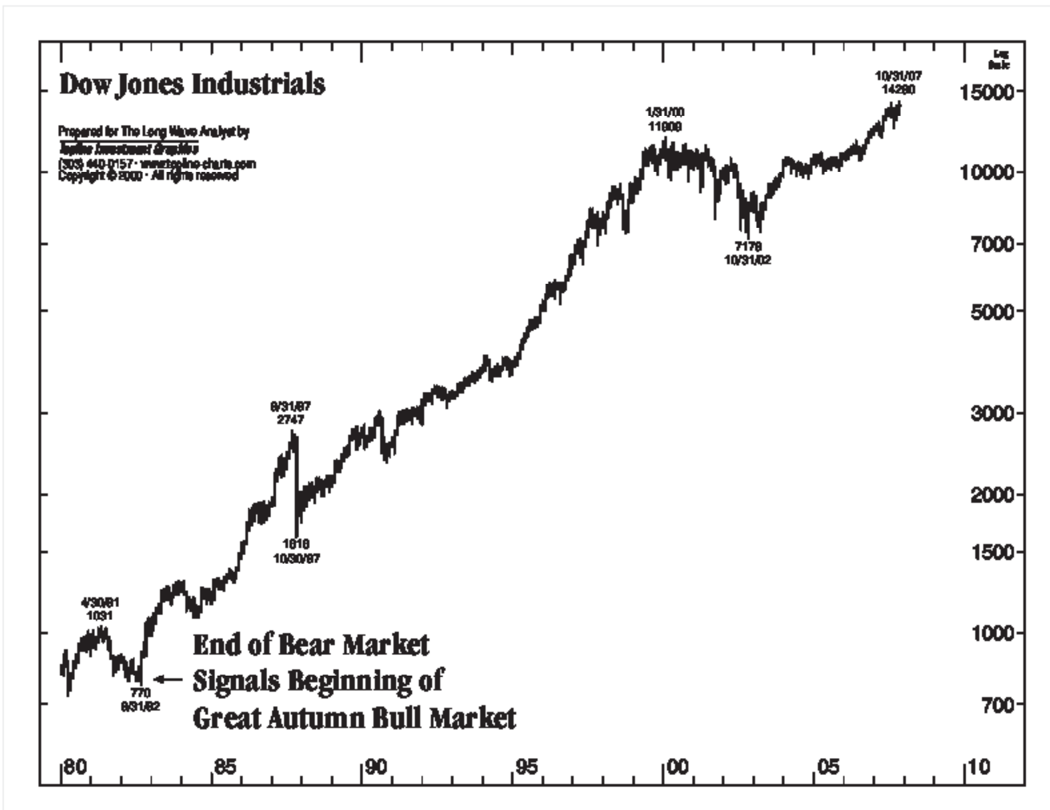


The fourth Kondratieff autumn bull market started from a bear market low with the Dow at 777 points on August 12th, 1982. Like its predecessor of 1921-1929, the crowd joined the party a little late, but by the late 1990s the party was in full swing and almost everyone was getting drunk at the Fed punchbowl.

The crazy stage was reached in 1998 and 1999, when the demand for ‘high-tech stocks’ went ‘ballistic’. New ‘dotcom’ companies were being brought to the market every day, most of them with dubious business plans that had little or no chance of success. The brokerage firms marketing these offerings reserved the majority for their favoured clients. Pent–up demand by those excluded from the offering drove up prices to levels far in excess of the offering price. It was all so easy.

Like its counterpart bull market of the 1920s, managed money in the form of mutual funds became a massive industry during the 1990s fostered by an ever rising stock market. In 1980, just before the onset of the autumn stock bull market, only 4.6 million US households owned mutual funds. By 1988, this number had grown to 22 million and by 1998 it had doubled again to 44 million households. In 2000, some 93 million Americans owned mutual funds. In 1980, the value of mutual fund assets was a paltry $135 billion. By 1985, this value had increased to $500 billion. By 1990, the value of mutual fund assets surpassed $1 trillion. The growth rate during the 1990s reached an astonishing 20% per annum so that by 2000, the value of these assets was $7 trillion. That's a lot of money and it's also a lot of money that will likely be lost. Source-Charles P. Jones, FT Press. November 15, 2002.

The 4th Kondratieff Autumn Stock Bull Market -
Born 12th August 1982 -777 points. Died January 15th, 2000-11,750 points-Gain 1500%



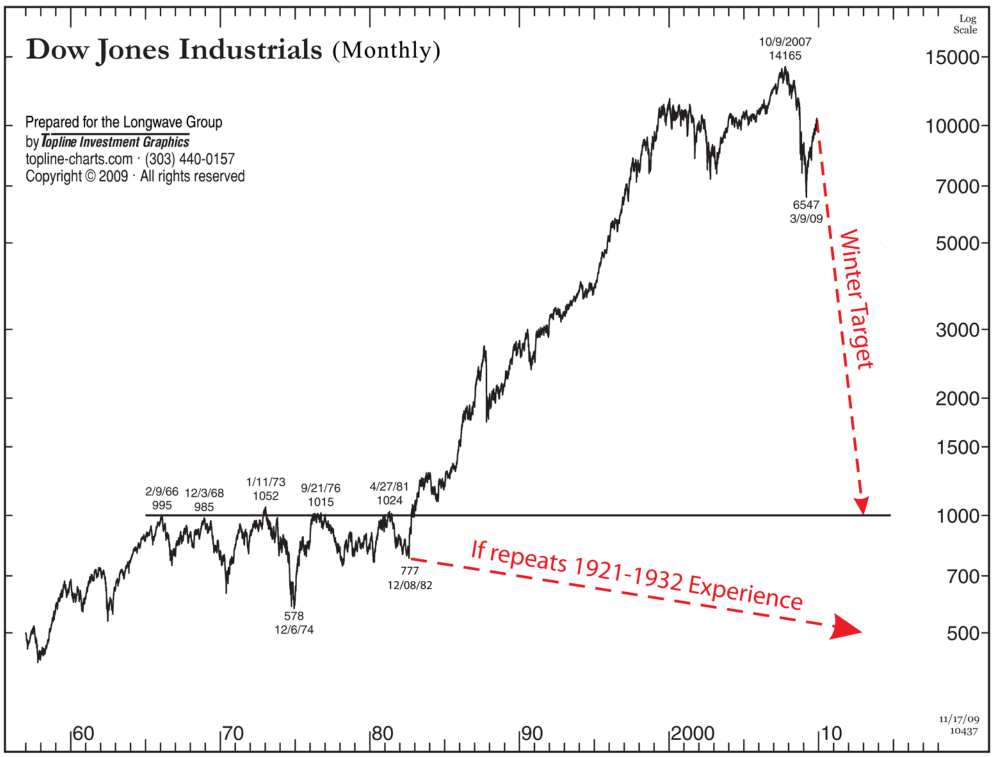
The autumn bull market reached its peak in a collective state of euphoria in early 2000. Money was plentiful. Investing in all stock indices and in particular the major speculative market, the NASDAQ, had reaped huge rewards for millions of investors.

The collapse started in the early months of 2000. The initial drop in stock prices lasted into October 2002. The major US markets fell considerably; particularly the Nasdaq, which had been host to the largest speculation.

But Alan Greenspan, to the rescue as always, was able to rekindle an appetite for stocks, but not with the same greed which had been evident during the high-tech boom of 1998 and 1999. Only the Dow was able to surpass its 2000 peak by a large margin, whilst the S & P double topped and the Nasdaq failed by a significant margin to regain its 2000 peak. Regardless, everything came to an end in October 2007 and the great stock bull market of 1982-2000 could not be revived a second time.

How low will the bear market go? It'll go a lot lower than the 6,470 points that the Dow reached in early March 2009 because this is the Long Wave winter bear market, which follows the huge autumn bull market. This autumn bull market was two and a half times bigger than its predecessor of 1921-1929. The bear market which followed caused the Dow to decline by 90%. Considering the difference in size between the two respective bull markets we expect that this bear market would be bigger in percentage terms than its 1929-32 counterpart. Perhaps the 93% drop experienced by the Transportation index between 1929 and 1932 would be a fitting reversal. This would drop the Dow to 822 points. If we used the Dow peak of 14,200 points reached in October 2007, a 93% reversal from this point would see the Dow bottom almost exactly at 1,000 points.

The Dow Jones Industrial Average was showing considerable resistance at 1,000 points, that number being touched at least twelve times beginning in 1966. The breakout above 1,000 points occurred at the onset of the great autumn bull market in 1982. The resistance number of 1,000 points on the Dow now acts as support.



Typically, the recovery in stock prices that is now evident has brought renewed hope that a new bull market is underway. A similar hope was prevalent during the initial recovery into April 1930, following the crash of 1929.

When the great crash in stock prices occurred in October 1929, the Federal Reserve fought like the devil to right the ship. In the space of 6 weeks interest rates were cut from 6% to 3.5% and the Federal Reserve banks were flooded with money; so much so, that according to

Murray Rothbard in his book The Great Depression, the money supply was increased by 10% in one week alone. These actions had the desired effect, at least for the time being. The market began to rally, urged on by official bullish pronouncements and people like the Rockefellers publicly announcing that they were buying stocks.

By April 17, 1930, the Dow had recovered 48% of its September - November 1929 losses. Confidence had returned. President Hoover declared that the worst was over and that recovery would be rapid. In May 1930, responding to a delegation requesting money for a public works programme, the President said, "Gentlemen you have come 60 days too late, the depression is over."

This bullishness was reflected in several other official pronouncements, some of which we show below, that have been excerpted from the Wall Street Journal. (courtesy-newsfrom1930.blogspot.com). Note, in particular, the bullishness of the various brokerage houses. We have also shown the closing level of the Dow on the particular day of the quotation. These levels were not exceeded until 1951.

Monday June 9, 1930. DJIA-257.82
"Business is seasonally slow and upcoming earnings reports in July will be unfavourable. However markets improve before upturns begin, in anticipation; that is why 'investment trusts and powerful banking groups' are now accumulating stocks."

Friday June 20, 1930. DJIA-228.97
"The time to have been pessimistic was last fall rather than now. 'In the past we have always emerged from a period of depression with industry on a better basis because of efficiency and economy made necessary when business was bad."

Tuesday July 8, 1930. DJIA-218.33
"Winthrop, Mitchell believes market is in much better condition after recent liquidation, believes stocks 'getting near rock bottom levels; would buy many major stocks on further selling. They may go lower, but not worth trying to pick a bottom: The long pull prospect of larger profits is too good to be concerned about 5 or 10 point dips, which later will be regarded as only minor setbacks in a major upturn."

Wednesday July 16, 1930. DJIA-233.79
"Dresser and Escher say 'American industry is in the healthiest condition it has been in years; inventories low, the cash position strong, operating efficiency everywhere developed as it has seldom been developed before. 'They note that stocks recently almost hit the panic low from last November (DJIA-198.69, November 13, 1929); 'What a chance for a man who hasn't lost his head (To lose his shirt - Editor's comment) to lay the foundation of an everlasting fortune.'"

The current recovery in stock prices is comparable to that of November 1929 to April 1930. Both recoveries were the initial recoveries from the crash lows of November 1929 and March 2009, respectively. Both recoveries were aided and abetted by a panicked Federal Reserve. The stock market crash of the fall of 1929 was the precursor to the 3rd Kondratieff winter deflationary depression. The crash of October 2007–March 2009 has signalled the onset of the 4th Kondratieff winter depression. Each crash ended their respective stock market autumn bubbles. The November 1929 to April 1930 bounce recovered 48% of 1929 crash losses. So far the Dow has recovered a little better than 50% from the March 6th, 2009 recent low. As in the early summer of 1930, following that stock market recovery, bullishness is now pervasive.

"The prospects for a return to growth in the near term appear good." Ben Bernanke, Federal Reserve Chairman, August 18, 2009

"Today's bullish investors see the major stock indexes making steady progress through next June, amid signs the US economy is on the mend after a searing recession.' The publication said in its fall survey of money managers." Reuters, 1st, November 2009.

"The percentage of investment newsletter writers who are bearish fell this week to the lowest level since October 2007." (The all-time high in the Dow) Los Angeles Times. August 26, 2009.

"Buffett's Berkshire Hathaway said it's going to pay $100 per share to buy the 77% of Burlington Northern Santa Fe it doesn't own. The price includes $10 billion of debt. 'It's an all-in wager on the economic future of the United States' said Buffett in a statement. 'I love these bets.'" Dow Jones Newswire, Tuesday, November 3, 2009.

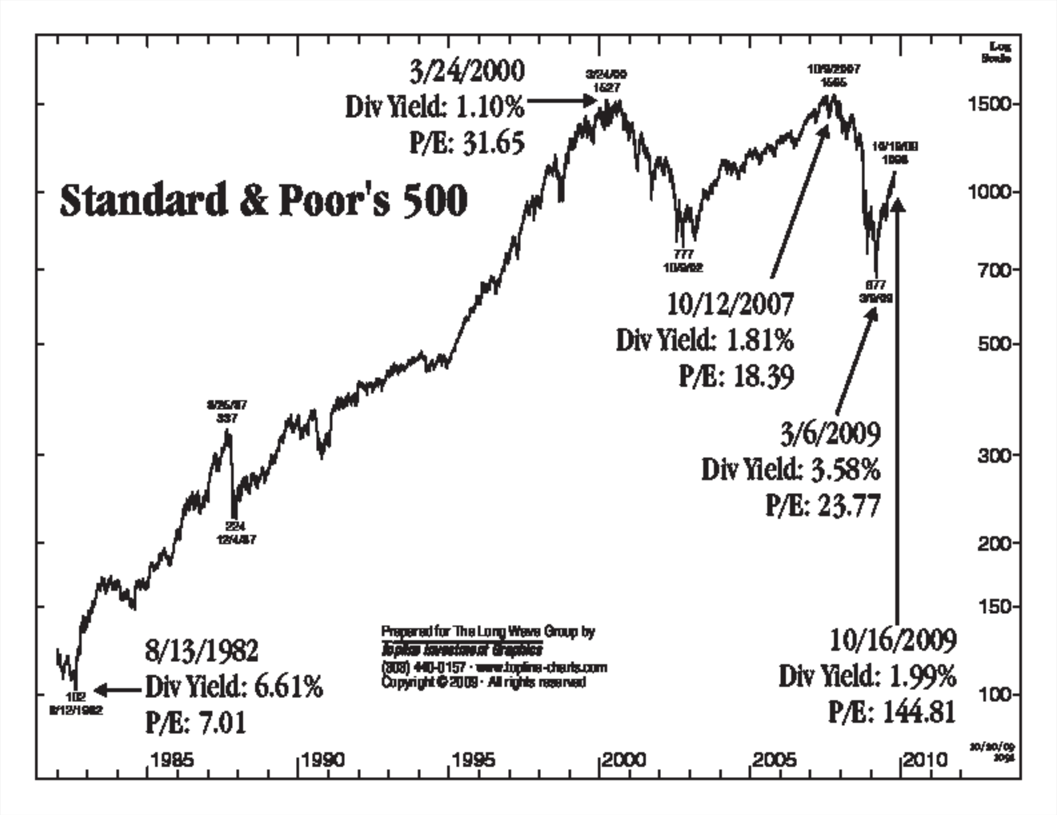
"'We've really moved in nine months from the threat of another Great Depression to a really powerful recovery,' said Burt White, chief investment officer at LPL Financial in Boston, which oversees $234 billion. 'We've done that all in just a few months and that's pretty astounding. That's what happens when companies are lean and focused.'" Bloomberg, October 14, 2009.

Here's a permabear gone over to the bullish camp-"From Bull to Bear - James Grant (Grant's interest rate observer) argues the latest gloomy forecasts an important lesson of history: The bigger the slump, the zippier the recovery." Leader to an article written by James Grant in the Wall Street Journal, September 19, 2009.

"This is a bull market and the last cycle did end in typical fashion. Valuations got too high, optimism was too strong and confidence was rampant. I actually don't think the rebound has been that atypical. The difference this time is the speed at which companies adjusted and cut their costs. We all know that when a recovery does take hold, the rebound in earnings is going to be very dramatic. Investors are anticipating that the impact on stocks prices will be very strong and will continue for some time so they are buying stocks in advance of the evidence. The thinking is that if you're not there when the rubber hits the road, you are going to be left behind. It is a question of when, not if, the stock market has a sustainable rally, unless of course something comes along and derails the enormous optimism created by the low interest rate, government stimulus landscape." Gaelen Morphet, CIBC Asset Management. Buy and Sell Round Table, The Financial Post, Wednesday, October 21, 2009.

Was Ms. Morphet reading this? "During the depression, industrialists have been cutting costs and increasing efficiency. This will increase profit margins when the recovery comes." Wall Street Journal, Friday July 11, 1930 quoted in www.newsfrom1930.blogspot.com

So let's examine Ms Morphet's assumptions that values are now in line. It's generally been accepted that new stock bull markets begin from low price-earnings ratios (6 or 7) and high dividend yields (6%-7%). These were precisely the numbers that were evident in August 1982, which was the start of one of the greatest stock bull markets in history.

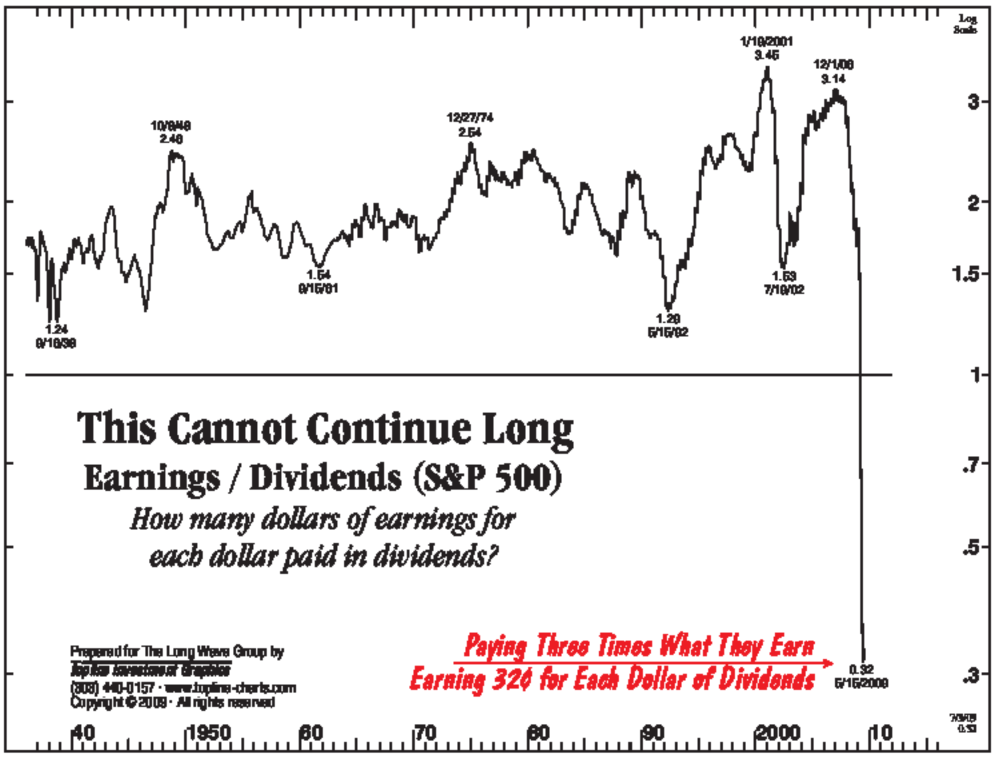


When the bull market peaked in March 2000, the dividend yield had sunk to a paltry 1.1% and stock prices were 32 times earnings. At the double top in October 2007, the price earnings ratio had dropped to 18.39%, due in no small part to financials, homebuilders and other companies directly associated with the Greenspan induced boom; the dividend yield however had not been increased to reflect these large earnings and remained at less than 2%.

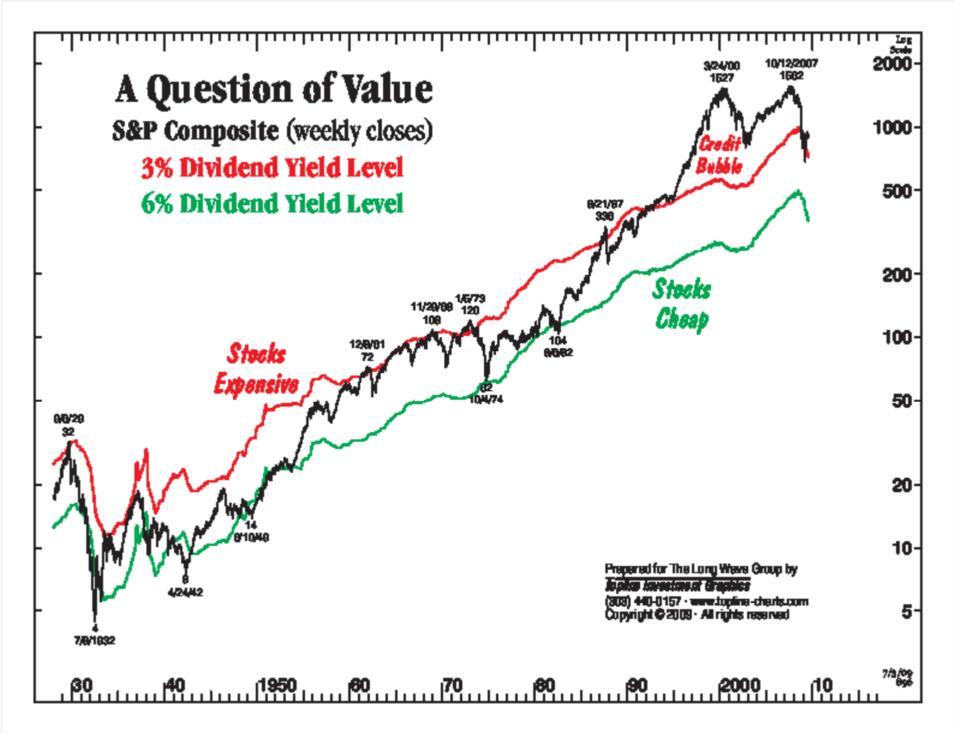
In March 2009, at the bottom of the initial leg of the bear market with the S & P down 56% from its peak, dividend yields had risen to 3.5%, indicating that dividends had not been cut. At the same time, the price-earnings ratio stood at 23.77, which was higher than they were at the stock market peak in October 2007. Sorry Ms. Morphet, these are hardly values seen at the onset of a new bull market.

And today? Well, as you can see from the preceeding chart, PEs have risen to a mind boggling 144.81%, reflecting a crash in earnings. The yield is just below 2, indicating that companies have been reluctant to cut dividends and must be hoping for a rapid recovery in the economy. That's not going to happen.

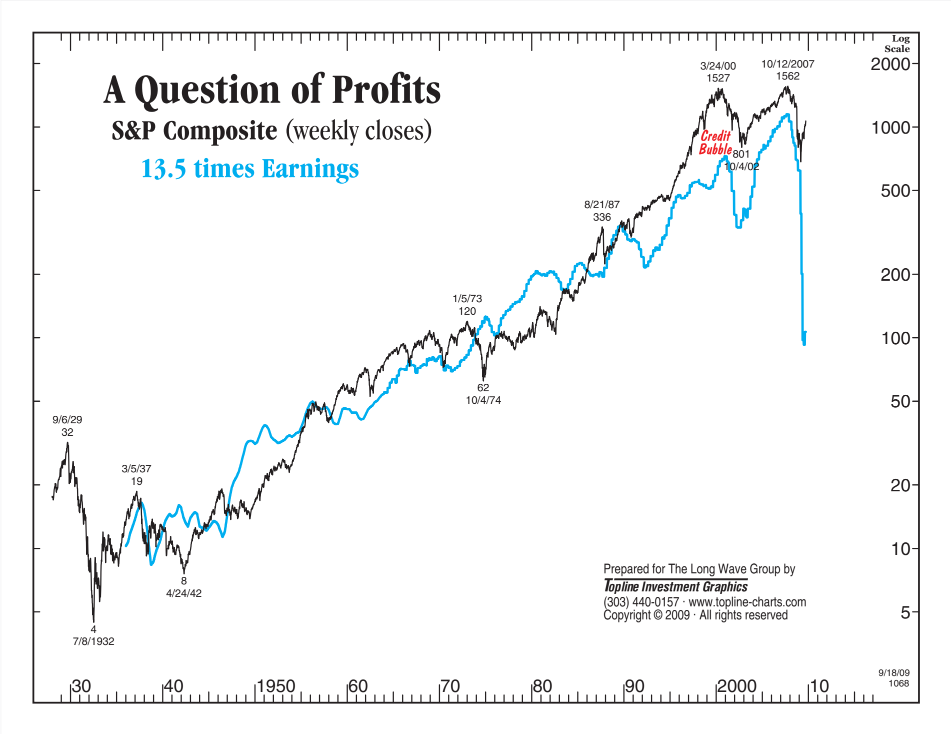
This truth is reflected in the following chart, which shows that companies are paying out three times more in dividends than they are earning. And as the headline in the chart says-"This cannot continue long." If earnings don't recover in short order, dividends will have to be cut and by as much as 75%.



We can assess value in another way. We know that at bear market bottoms, dividend yields typically reach 6% or even 7%. They are currently just below 2%. To reach a 6% yield, the S & P 500 would have to fall to about 375 points 65% below where it stands at present. This assumes no cut in dividends, which as we have just discussed, is a virtual impossibility.



If current dividend yields speak to much lower stock prices, what about earnings? Well as the following chart illustrates, much lower prices are in the offing. In fact, if the S & P was trading at its mean of 13.5 times current earnings, it would be priced at 100 points; that's about Dow 1,000.



The fundamentals are pointing to significantly lower equity prices and so are the technicals. Two Elliott Wave theorists whom we follow closely are calling for a cataclysmic bear market. Robert Prechter and Robert McHugh through their publications, to which we subscribe, are both calling for a bear market that is even worse than that experienced between 1929 and 1932.

The initial recovery in the winter stock bear market brings with it a renewal of optimism. Hope that stock prices will recover to new highs, as they've always done; hope that the depressed economy will recover and that everyone will be working again, earning big wages which they can spend on frivolous items that they don't really need; hope that the recovery will bring back the stupendous values in real estate; hope that everything will be as it was once; hope that the leaders can deliver all that they've promised. That's way too much hope and way too little realism.

The initial stock market recovery always occurs as a result of a huge monetary stimulus, which leaders believe will return everything to the point where it was before the bear market ever reared its ugly head. The leaders and the people who believe in them are always sadly disillusioned. Once the winter bear market is set in motion, it must reach its proper conclusion, which is a reverse of the bull market that has gone before it.

Once the price high had been reached, in Tulip bulbs or in John Law's Mississippi bubble or in the South Sea stock bubble or any other bubble, don't think for a moment that prices went straight down. They didn't. Everyone had a huge pecuniary interest in keeping the bubbles filled with air. Their response to the first crash in prices was no different than that employed by the central banks today. They created even more money believing that that was the solution to the problem. It wasn't. "We can't solve problems by using the same kind of thinking we used when we created them. " Albert Einstein.

We're now at the same point as we were in April 1930. Most people believe that stock prices have just begun a new bull market in anticipation of a burgeoning economy. We know better; the economy can't recover until debt has been expunged. That process has only just begun. All governments are trying to thwart the debt elimination process. They are transferring debt from the principal creditors to themselves. That is clearly unsustainable. There is simply too much debt, which in the US is approximately $58 trillion.

Much of this debt has yet to be destroyed. The process will be very painful and, as we've said so many times, it will bring down both creditor and debtor alike. This will effectively destroy the economy. By 1933, in the previous Kondratieff winter, debt destruction had contracted the US economy by 45%. Stock prices reflected this reality.

Investing in the stock market is an inappropriate lifetime strategy. It's a money-losing proposition. Buying stocks in the spring of the Kondratieff cycle leads to significant gains, because spring signifies the rebirth in the economy. In the current cycle, spring started in 1949 with the Dow at 161 points and it ended in 1966 with the Dow at 995 points. Buying stocks in the Kondratieff summer leads to losses. Summer began in 1966 with the Dow at 995 points and ended in 1982 with the Dow bottoming at 777 points. Buying stocks in the autumn amasses huge gains because in this Kondratieff season a massive speculative bubble always develops. Thus, buying stocks in 1982 with the Dow at 777 and selling them at the end of autumn in January 2000 with the Dow at 11,750 points would have led to a gain of 1500%. However, buying stocks in the Kondratieff winter leads to huge losses, as between 1929 and 1932.

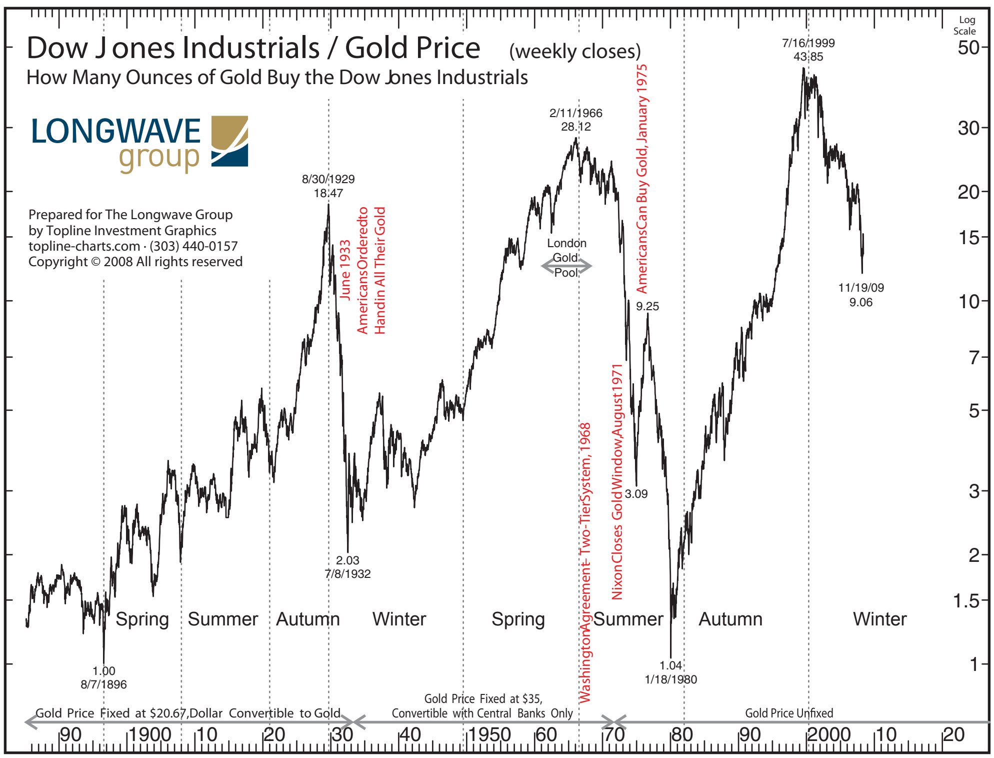
Stocks should have been sold in 2000. There was a second chance to sell them in 2007 and now we are being presented with another opportunity to sell before the deluge of the winter bear market hits with a frightening force. (See: Lifetime Economic, Financial and Investment Map in Winter Warning Volume 10 / Issue 1. October 19, 2009 -'All That Glitters Is Gold.')

The Long Wave Analyst, since its initial publication, has anticipated the end of the booming autumn stock market and the beginnings of a huge winter bull market in gold and gold shares. In the September 1999 publication, I wrote "if past history is anything to rely upon, then a crash of US stocks is imminent and the Kondratieff winter of deflation and depression will follow. This will usher in the age of gold." In the April 2001 publication, I wrote "...a stock market top has undoubtedly been recorded. This means that there will be a complete reversal in asset choices occurring through the Kondratieff winter. Stocks, bonds and real estate, all of which performed so magnificently during the Kondratieff autumn, will suffer huge losses, whereas the price of gold and gold equities which have been in a bear market since 1980, will soar to unbelievable levels." Clearly the advice to shift out of stocks and into gold and gold shares was correct. This is best evidenced by the Dow/gold ratio, which measures the price of the Dow divided by the price of an ounce of gold.

The ratio reached its peak in July 1999, when it took 44 ounces of gold to buy the Dow Jones Industrials. Today, the Dow is worth about 9 ounces of gold. In 2001, the HUI, which is commonly referred to as the 'Gold Bugs Index,' because it comprises a number of major unhedged gold producing companies could be purchased for $35 in 2001. Today the HUI trades at $450.

The Dow/gold ratio reaches extreme highs or extreme lows around the changes in the Kondratieff seasons. (See chart below). In the depths of winter, or at the peak of the inflationary summer, the ratio falls to an extreme low because of high gold prices and low stock prices. In 1932, at the bottom of the winter bear market, the ratio stood at 2. There was a huge demand for physical gold but the price of gold was unchanged at $20.67, because it was then pegged to the US dollar. Without this peg the price of gold would have risen substantially, based on this demand.

This winter, gold is not priced at a fixed rate to the dollar. We've already seen what has happened to the gold price during the initial stages of this financial crisis, but things are going to get a lot worse, which means that the price of gold is going much higher. We expect that the Dow/gold ratio will ultimately reach 0.25, based on Dow 1,000 and a gold price of $4,000 per ounce.



The demand for gold will increase exponentially as the Long Wave winter ravages the economy and the financial system.

Not only are cycles projecting that this recovery rally is close to its end, but so are fundamentals and technicals. We've already demonstrated how much this stock market is overvalued on a fundamental level, but technical indicators are very bearish. We'll only cover a few, but that should be enough to prove our point. Weekly MACDs are rolling over from deeply overbought conditions. Volume is in a downtrend and falls on days when equity prices are rising. The ratio of advancing stocks versus declining stocks is pathetic. Most indices have formed very bearish rising wedge formations that are at, or close to, completion. As of late September, there was an over abundance of bullishness with 92% in that camp. This is in contrast to the percent bullish in March 2009 at the bottom of the bear market when only 3% were of the bullish persuasion. Clearly, insiders are contrarian, they are huge sellers. It's time to leave the game.

Now what? Well this next down-leg in the bear market will undoubtedly take stock prices to new lows. We would expect that the Dow will sink another 50% below its current recovery high; that is to about 5,250 points. From that new low a recovery will follow, which will once again raise hopes. Then another drop followed by recovery until the final low, Dow 1,000 is achieved, and by that point all hope will have been extinguished.

Why Dow 1,000 is the target.

1. Manias: If the stock bull market of 1921-1929 was a mania and all writers of financial bubbles after 1929 consider it that, then 1982 to 2000 must also be considered a mania or bubble, because its price increase was two and a half times greater than the 1921-1929 bubble. The subsequent bear market following a bubble has always caused prices to fall below the starting price of the bubble. In the 1929-1932 bear market, prices fell 35% below the bull market starting price in 1921. 35% below the Dow August 1982 starting price of 777 would see the current winter bear market price collapse to Dow 500.

2. Size: 'The bigger they are the harder they fall." The 1982-2000 stock bull market was huge; two and a half times bigger than the bull market of 1921-1929. We should expect the bear to be equally as bad as the bull was good. A 55% decline doesn't cut it. "When the decline sets in it must be in proportion to the advance." W. D. Gann. Or to quote Epicitus, "the true extreme of any position will ultimately become its opposite."

3. The Kondratieff cycle winter bear market: This is the biggest bear market of the cycle and the biggest bear market of our lifetime, just as the preceding autumn bull market was the biggest bull market of the cycle and our lifetime. The 1929-1932 winter bear market saw the Dow Jones Industrial Average fall by 89.2%. A drop in prices of equal size would take the DJIA down to 1266 points. But a 93% point decline as experienced by the Dow Transportation Index, arguably the most important index of that era, would take the DJIA down to 820 points.

4. Support/Resistance. The fact that Dow 1,000 was attacked 12 times between 1966 and 1982 and was not bettered until the great autumn bull market was underway in December 1982 means that it provides significant support to stock prices in this winter bear market.

5. Values: Earnings and dividends are depressed. They are expected to decline significantly into the winter depression. Already, their respective levels infer much lower stock prices. By some measures, they are already indicating a 90% stock market drop from current price levels. Neither is anywhere close to providing values that are seen at bear market lows.

6. Elliott Wave projections: I subscribe to two Elliott Wave theorists; Robert Prechter's Elliott Wave International (www.elliottwave.com) and Robert McHugh's Main Line Investors, Inc (www.technicalindicatorindex.com). They are both, independent of each other, calling for a cataclysmic bear market. Prechter's latest 'Financial Forecast' projects a Dow bear market bottom below 400. This makes 'Dow 1,000' look positively benign.

McHugh doesn't give a target, but he has referred to the coming decline as 'catastrophic.' "So, we see large bearish divergences in three key underlying components that tend to forecast future stock prices: volume, momentum (as measured by the MACD), and advances versus decliners. This fits with our Elliott Wave pattern and work, that a massive decline is coming sooner rather than later." November 13, 2009.

7. The economy: The process of debt elimination ($58 trillion) will effectively plunge the economy into a frightening deflationary depression. Stock prices will reflect this reality.

8. Financial markets are governed by cycles. All cycles are natural; they cannot be controlled by man. The people in power who believe that they can change the course of nature are trying to fool all of us and they are suffering from delusions of grandeur and massive hubris.

So there's what I think are pretty compelling reasons for Dow 1,000. I challenge you to give one good reason why that target is ridiculous. By the way, "This time it's different" or "the Government and the Federal Reserve know what they are doing" receive an 'F' grade.

We are not oblivious to the meaning of Dow 1,000. After all, our work on the Kondratieff cycle has long forecast the winter depression brought about by too much debt. We don't take any pleasure in making these forecasts. We know that if they come to fruition many people will be financially destroyed. Such destruction will wear heavy on personal relationships and on people's health. It will engender massive anger from those who have been dispossessed of their wealth and livelihood. We don't want it to happen but we are frightened that it will. So far everything that we have anticipated through our knowledge of the Kondratieff cycle has happened. The future looks particularly bleak. See "This Is It" @www.longwavegroup.com

Bibliography

Brown, John, Dennis, 101 Years on Wall Street-An Investors Almanac. Prentice Hall, New Jersey, 1991.

Galbraith, John Kenneth, A Short History Of Financial Euphoria. Whittle Books, 1990.

Gann, W. D., Outlook for 1929 published in Wall Street Stock Selector, Financial Guardian Publishing Company, NY. 1930

Gann, W. D., The Tunnel Thru The Air. Lambert-Gann Publishing, Pomery, 1990.

Gleeson, Janet, Millionaire - The Philanderer, Gambler and Duelist Who Invented Modern France, Simon and Shuster, New York, 1999.

Kindleberger, Charles P. Manias, Panics and Crashes, A history of Financial Crises, Basic Books, NY. 1978. See also, 5th Edition, John Wiley and Sons, 2005.

Le Bon, Gustave, The Crowd-A study of the popular mind. Larlin Corp, Georgia, 1982.

Longwave Group, www.longwavegroup.com

Mackay, Charles. Extraordinary Popular Delusions and the Madness of Crowds, Wordsworth Editions Ltd, Hertfordshire, 1995.

McHugh, Robert, www.technicalindicator.com

Prechter, Robert, www.elliottwave.com

White, Andrew Dickson, Fiat Money Inflation in France, The Foundation for Economic Education Inc, New York 1959.

Other Recommended Reading

Brooks, John. Once in Golgonda-A true drama of Wall Street 1920-1938, John Wiley and Sons, NY. 1969.

Galbraith, John, Kenneth, The Great Crash, 1929, Houghton Mifflin Co, Boston, 1961.

Garrett, Garet, A bubble that Broke the World, Published by the Cato Institute, 1980, in conjuction with The New Deal and the Monetary System by Murray Rothbard.

Graves, Lloyd M. The Great depression and Beyond, The Brookmire Economic Service, NY. 1932.

Prechter, Robert, Conquer The Crash, John Wiley and Sons. 2002.

Rothbard, Murray, America's Great Depression, Richardson and Snyder, NY, 1983.

Sobel, Robert, The Great Bull Market-Wall Street in the 1920s, W. W. Norton & Co. NY, 1968.

Tilden, Freeman, A World in Debt, Friedberg Commodity Management Inc, Toronto 1983; in arrangement with Funk and Wagnalls, NY, first published 1936.

Written By: Ian Gordon