Saturday, November 7, 2009.

.pdf attachment to email 43.

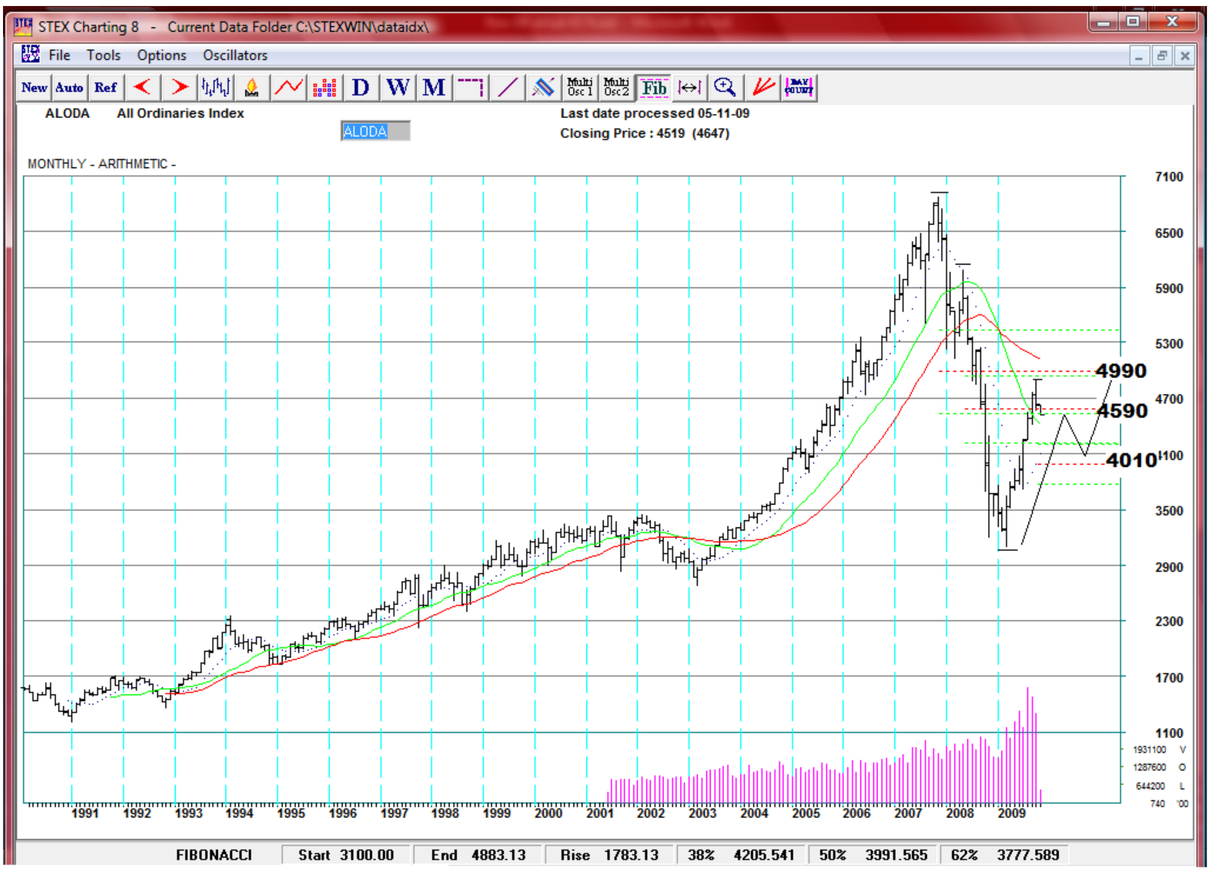
Took me a while to gather my thoughts on this one:

Stocks.

Western stock markets, and so too their real estate, exhibit reliable (approximate) 18-year cycles, best measured from trough to trough. The cycles originate in the enclosure of the economic rent. Stock markets exhibit more volatility than real estate, but when real estate prices decline, the stock market declines will be more severe and generally longer lasting. For those highly leveraged at the peak, the decline is often life changing. This is what the West has just been through. Remember, at the trough of each 18-year cycle, the stock market will bottom first, before real estate.

So goes the theory.

Below, the Australian market, All Ordinaries index, XAO, where you can easily see the lows of 2009, and 1991. The 18-year cycle low before that was 1974.



For this present 18-year cycle, I believe stock markets world-wide have seen their lows, being March of 2009. We will know that for sure when the next low on the monthly charts occurs. Readers would be aware, I had forecast markets to have a March 2009 low, recover from March, for an approximate 180 day run into September, then a decline into early January. As for the prices of what might have happened, one could anticipate the usual scenario, a recovery back up of half the run down, then a retrace of half that run up, the market would then be roughly balanced. I have tried to illustrate what this would look like, on the above chart, the mid points being the red dotted lines, approximately. Ideally, from March '09, we might have seen a rise up to 4590 through September, back down to 4010, January, then up to 4990 into April 2010.

Markets do not look like eventuating quite in this manner. My March low and 180 day run into September of this year were good calls. I got some trades away like that, so no complaints. Markets have kept running. This adds weight to the March low being the final 18-year low of the current cycle. Ideally, we do really need a higher low on the monthly charts to confirm it. A higher low is yet to occur. It will be years, not months, before markets again approach those highs of 2007. An extended move sideways, base-building, would be normal at this point. Plenty of stocks though can perform well whilst markets in general move sideways. 52 week, or all time new highs are what to look for.

On the smaller timeframe for stock markets, I am not at all sure what they are doing presently. When that is the case, it is important to say so. Except to say that we are not going to see stock markets collapse from here. The current stock market 18-year cyclical lows are in place.

Markets are due a retracement, however. The Australian market should correct this month, November, around 10%. Strong support is at just above 4200. Any decline is doubtful to go below this. The "great recession", GFC, call it what you will, is just about over, and stock markets are on the way up, recovering, and not going to have lows lower than the March 09 lows. Key months will still be January and April of 2010. These months should see solid trend changes in the US, and emotions in other markets as well. The smaller weekly cycles give reason to now suspect US markets will continue upwards until April of 2010, but with retracements along the way. That date, for US markets, needs to be watched closely. Other than that, I am not in a position to make a further forecast for stock markets presently, subject to the caveat at the end of this document. To repeat: on the smaller timeframe for stock markets, I am not sure what they are doing presently.

Having said that, what to expect from now until 2013, there are three things you could do, so that you can work it out for yourself:

First, re-read the *Secret life* chapters, the beginning few pages of each historical chapter, which describe the move out of each real estate cycle trough, but especially pages 298, "the turn", and then page 300, "the acceleration" out of the 1991 lows. Note particularly the 1994 Fed interest rate policy reversal. This took place in February of 1994, Feb 3 to be exact (good Gann date). Go back and have a look at the charts and see what happened at that time. The chart above, even though it is the Australian market, provides an illustration.

Anticipate a repeat.

Bernanke is going to keep rates in the US as low as possible for as long as possible. Stock markets will rise (or perhaps it is better put: stock markets will not fall) whilst he does this. His eventual policy reversal should again mark a stock market peak. Last cycle, the policy reversal waited three years from those 1990/91 lows, and I can tell you, every time markets took a dip, 1991 through 1994, all the bears came out and forecast doom, gloom and absolute collapse. Expect that to repeat too: all the bears coming out. 3 years again for the policy repeat, don't know, but seems reasonable.

Stock markets climbed every worry that surfaced back then, and are highly likely do so this time as well. I illustrate the previous 1991 cycle history on pages 291 to 302 of *Secret Life*.

If you think about it, this is how you know we are at lows; at lows, markets climb these worries. Notice how at extreme peaks, no one is worried about anything at all! This is what brings tops. By the late 1920's, there was even a song, subsequently made famous, that caught the feeling of the times: 'Blue skies, smiling at me, nothin' but blue sky, do I see...'

Second, read Martin Fridson's *It Was a Very Good Year*. Every trader should have this book in his/her library, amongst others:

http://www.businesscycles.biz/subscriber/essentialread.htm

I quote it at key times in *Secret Life*. Combine the two books, how Fridson links easy money to the best stock market years, with my description of an 18-year cycle, and you have a most useful forecasting tool. Personally though, I find the best stock market years are when prices decline, but that's just me.

Third, for those subscribers that have not listened to the May 12, 2009 class we ran, this is a must listen:

http://www.businesscycles.biz/classes.htm

and scroll to "a study of Gann's financial time table". It is the amended version of Gann's table that you want, which we updated towards the end of the presentation. From 2009, you will see the forecast repeat action out of 2009A, extreme low stock prices, into 2013B, high stock prices. Gann put that together in 1909, remember. 100 years ago. An impressive document and one you would do well to be familiar with. The timing looks about right *yet again*, I think, as it was out of the 1991 lows, 1974 lows, and the lows before that. Gann's financial timetable document was of course for the Dow, being the main Index at that time. The US leads, still, so other markets will follow a similar pattern albeit with local fluctuations.

Seriously, take the time to do the above three things. Your wealth, next cycle, may well depend on it. Know your history, it repeats.

Real Estate.

I expect US real estate to bottom in 2010, but would not expect any real price recovery there for some years. Some areas of the US may in fact see real estate prices go nowhere for the entire next cycle. UK real estate can be expected to low in 2011, Ireland in 2012. There will be very little capital growth in all three markets for several years to come, as per past cycles. China, however, will continue to charge ahead. On the real estate clock, the western world's real estate is oscillating between 22 and 24 o'clock.

Australian real estate represents a bit of a challenge, at present, to see that. Australian real estate certainly had its cycle, commercial property is well down, credit hard to come by, and every single listed real estate investment trust lost a substantial proportion of its listed price. Some REIT's never recovered. That represents a cyclical low. Australia's residential sector is another matter. Prices in the lower end hardly moved. It looks like the Australian government has been successful in its attempts to prevent a decline here. A cyclical first, but it appears that way. (Condemning a far larger proportion of first home buyers to a life of debt slavery than in previous cycles.) For those looking to buy into this sector, the home owners grants, when stopped, and the interest rate drops, once they normalise and go back up, will see better buying prices. The cycle is past though, and residential prices are not going to collapse.

Gold.

Gold has convincingly broken into all time new highs, as forecast. A rough price projection can now be done as follows:

Take the 2008 high, 1034, less the 2001 low, at 256, equals 778, and add this to 1034, giving 1812. This should work because past *all tim*e highs, once exceeded, usually become mid points. Too simple for some, but I think this will happen, and 1812 only as the first initial target as I am of the view gold will continue higher even than $1812, eventually. For those trading gold and want to do a bit more work, see Gann's examples in his book *45 Years in Wall Street*.

I urge subscribers, if you are seriously interested to learn how the world works, to chart gold for yourself, by hand, over the next year. Best to get some graph paper, 8 lines to the inch, price scale, \$1 per line, \$8 per inch square, 8 calendar days per inch square on the time scale, and see how you go. You will be able to observe for yourself how the price will move mostly only between key dates, the monthly Gann dates, which will form the highs and lows. Watch for repeat ranges, and mid points, which will occur more often than not, on the key dates: price into time, being the best trades to be on. Two additional key dates to watch for gold each month, around the 11th, and 28th. Do your price and time counts on the chart. And if you have access to the net each day, try following the gold price via barchart.com, which updates prices about every 15 to 20 minutes. So far, any down moves each day are being aggressively bought. It's interesting to watch, especially if you have pre-done your maths...

[Just as an aside, if you study Gann's 1929 forecast, published by Gann as usual at the end of 1928, and then posthumously by Billie Jones at the back of *Truth of the Stock Tape and Wall Street Stock Selector*, you can see just how close Gann came to picking, in advance, every single high and low for that year 1929. No-one, as far as I know, has repeated this feat, or, if they have, isn't saying so publicly. This is the next project; useful trading information as I am sure would be obvious to you.]

US dollar.

Further to fall. On the dollar index, 70.69 is the figure to watch. If that breaks, a fall to the mid '50's is likely.

Generally:

Over the course of the next cycle, the best performing areas:

Shares, (best to be in those trending up, and breaking into all time new highs)

Commodities generally, and gold.

The worst place to have one's money, after 2010, bonds and cash. This is because I expect, eventually, to see much higher inflation as the next property cycle really gets underway. I maintain the view - which I have stated many times in past classes - that the next 18-year real estate cycle will be even bigger than the one we have just been through. Recent G20 actions (or better stated, inactions) will help this along. This will be felt particularly by China, India, Japan, Singapore, Australia and possibly Vietnam. China will come under sustained World Bank pressure to privatise (freehold) its real estate, to release the economic rent so that western banks can create further credit on its value, backed by the mortgages. Western bankers would love nothing more than a fresh supply of mortgagable real estate...

Just one caveat and the only thing to truly worry about:

The gold price. It is possible that the rise in the gold price may be signalling the markets - or at least an increasing percentage of people's - loss of faith in the ability of government (especially the US) to pay their debts. There has, this time, been a truly massive, indeed staggering, (it never ceases to amaze me how the public allow the financial elite to get away with this) transfer of risk from the private to the public sector. (Socializing the losses.) In other words, the gold price could be seen as a barometer of confidence in the system. It might be saying that this time, the debts are simply beyond anyone's ability to repay, even government. Wiping off the debts, via a new currency, may end up as one possible solution. Gold would help, perhaps, preserve one's wealth should that eventuate. This has ramifications beyond my ability to understand, but is something we should consider. Creating more debt, the size of which is being done at present, to pay off the existing collapse in asset prices, fuelled by debt in the first place, is a risk. In fact it's a gamble: a gamble against future growth in the economy being able to absorb this risk. Rising gold prices are telling us something. Just what, I'm not exactly sure yet. Of course, as a trader, I don't care: just get long on the thing. However, it could be that something is not quite right. What's not right will of course show up in markets first, long before the cause is public knowledge.

My belief over all though:

I'll wager that history will continue to repeat, (the base structure has not yet been altered) and that eventually, over the next several years, the economy will improve enough to allow governments world-wide the ability to unwind the debts they took over from the banking sector, - the debts this cycle given the label "toxic assets", last cycle it was "junk bonds" - allowing the bankers, yet again, to have successfully transferred the risk of all their bad loans, thereby allowing the banks to recapitalise and the whole process to begin anew, with new banking laws introduced by governments in the belief this will stop the next GFC from happening, and the world will enter yet another 18-year real estate cycle.

An improving economy will also allow governments to discover new ways in which to tax its citizens; someone, after all, has to pay off what isn't wiped off. And the bankers live to make another loan...

However, if, in fact, we are seeing the beginning of the markets' loss of faith in the ability of governments to pay their debts, and the price of gold really does escalate, and western governments really do begin to have trouble with the debts, then we are in for a most interesting 2010 and 2011, to say the least. As at today's date, the gold chart (December Gold, GCZ9) is exceedingly bullish and most unlikely to go substantially lower any time soon. Time will tell. We'll keep an eye on this, for further updates.

Remember; trade the market action, not the forecasts. Use Gann's overbalance rules as a guide.