ROBERT PRECHTER
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data through April 15

A DEADLY BEARISH BIG PICTURE

As far as Elliott waves go, the rally since last March is totally normal. Two weeks off the low of March 2009, our Short Term Update published an upside target of Dow 10,000. So we knew a big rally was coming. The August issue listed the range for a typical retracement as being from 9368 to 11,620. This is a wide range, but there is nothing we can do about it; second waves have a lot of leeway. The illustration shown in that issue is reproduced below alongside an update of market prices. The Dow has so far stayed within the normal range.

From the August 5, 2009 EWT

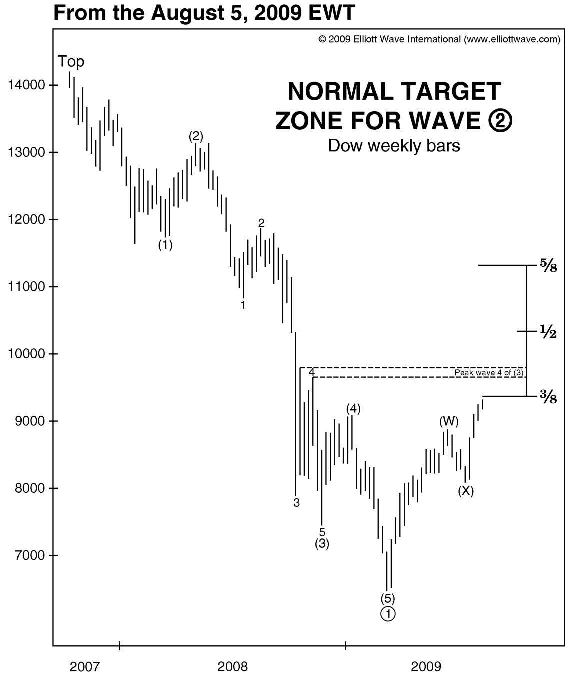

Figure 1

Same chart with prices updated

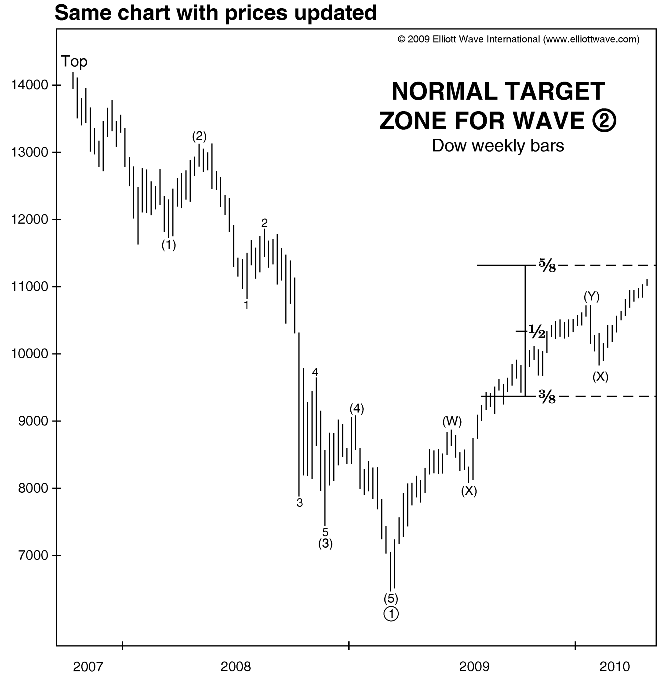

Figure 2

Even so, I expected the rally to peak in the lower half of the target range and then reverse. In August 2009, after 5 months, and in November, after 8 months, I was quite sure that the rally was ending. But instead of stopping near 10,000 at a 50% retracement, it has reached a 60% retracement. Whenever a market surprises me, I try to figure out why.

THE OUTLOOK FROM TIME CYCLES

For newer readers, I should reiterate that my view of time cycles is that they are transient epiphenomena of the Wave Principle. This means that cycles are not the fundamental regulator of stock prices. They merely show up for a time, like the appearance of the occasional perfect oval in a fractal video. Cycles can be quite useful for a time. When they disappear, you look for the next "oval."

For some time, I had tracked a 3.3-year cycle, which was distinct from 1978 to 1997 and then disappeared. The venerable 4-year cycle was distinct from 1962 to 2002. There was a minor pullback into late 2006, and if the 4-year cycle were still operating, its next low would be due in late 2010. This is one reason why I expected a sharp rally off the 2009 low and then a crash. This rally has been sharp, but it has gone on too long to fit into a four-year cycle profile, so we have to treat the 4-year cycle as also gone.

This outcome prompted me to go back to the charts to see if there have been any consistently reliable cycles since the beginning of Cycle wave V to now. I think I have found something very interesting.

But First, Some Background

The April 1983 issue of EWT (see Appendix to *Elliott Wave Principle*) observed that a 16.6-16.9-year span had marked key turning points in the constant-dollar Dow from 1932 to 1982. It forecasted another major turning point to occur in 1999. The constant-dollar Dow went up persistently until that year. In February 1999, EWT narrowed the time target to **February 6-July 18, 1999**. The Dow/gold ratio topped on **July 15, 1999** and since then has plummeted just as relentlessly as it rose. The story of this span is recapped in Chapter 18 of *Market Analysis for the New Millennium*. Figure 3 shows an updated picture of this study.

Chart updated from *The Elliott Wave Theorist*, April 6, 1983

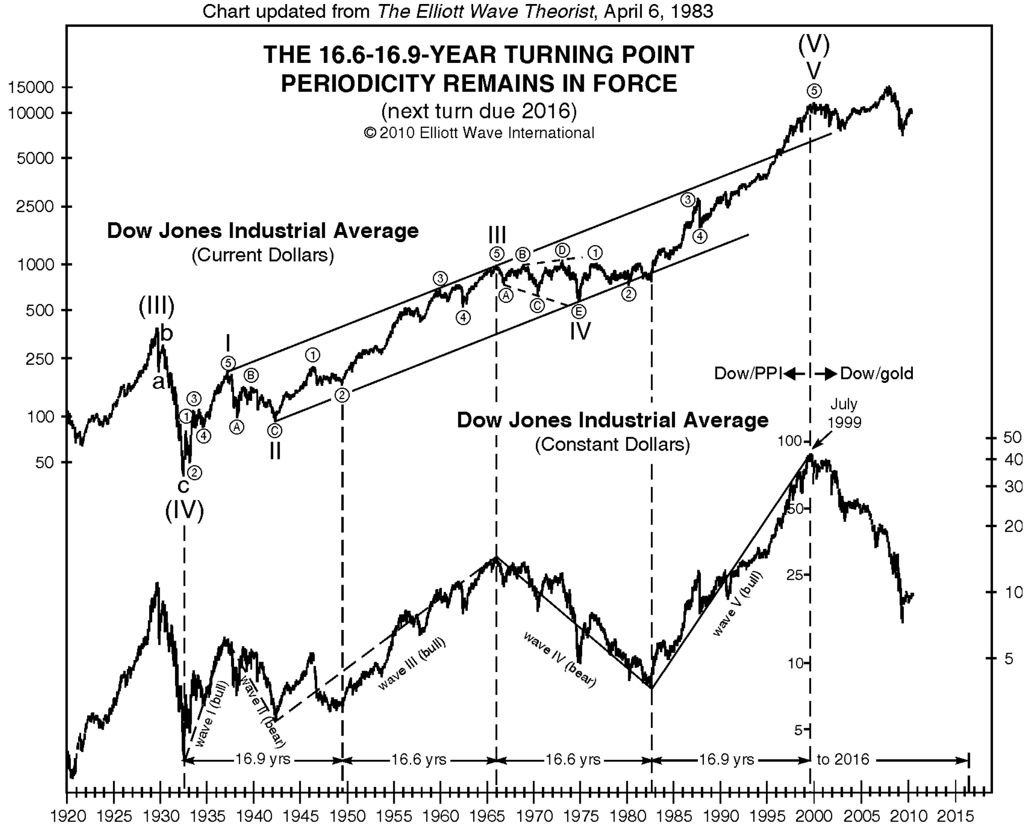

Figure 3

In 2002, *New Millennium* forecast the next turn to occur "in the first half of the year 2016." The June 2008 issue narrowed the range: "If real stock prices carry lower for 16.6-16.9-years, they will bottom in the area of **February 19-June 9, 2016**." Keep this time in mind.

A 34-Year Stock Market Cycle

The time span in Figure 3 implies the possibility of an operative time cycle. As *New Millennium* pointed out, the year 2016 is a Fibonacci **34** years from 1982, the last low for the Dow/PPI ratio. That low is in turn **34** years from the Dow/PPI low of 1948 (the ratio double bottomed in 1949), which is **34** years from the

Figure 4

low of 1914. These are highly significant lows. In 1914, conditions were so severe due to World War I that the stock market was shut down. In 1948-49, the P/E ratio reached its lowest level of the century (see Figure 6-4 in *Conquer the Crash*). Two years before the 1982 low, the Dow/gold ratio reached its lowest level since 1896 (see Figure C-1 in *At the Crest*). As shown in Figure 4, the average cycle length is 33 years 10 months, which gives a projection for the next low to occur in **June 2016**. If our Elliott wave analysis is correct, the next low will mark the end of the deepest bear market since at least 1720-1722, so it will fit the importance of the previous 34-year cycle bottoms.

More Background: The Crisis Cycle

The March 2004 issue of EWT postulated a 7-year crisis cycle going back to 1973 and used it to predict another crisis in 2008. Here are the table and the forecast from that issue:

—**1973**: Arab oil embargo, with spillover into 1974 stock market low of wave IV.
—**1980**: peak in the inflation rate; top in gold, silver and mining stocks, interest rate spike, stock-market "massacre" and low of wave 2.
—**1987**: stock market crash and low of wave 4.
—**1994**: "Republican Revolution;" suspicion of government due to Waco attack (1993), "black helicopters," etc.; stock market breaks uptrend line at low.
—**2001**: successful terrorist attack on the World Trade Center; low of wave (3) of 1 [actually 3 of **a**].

Seven years after 2001 is **2008**, so that is the next year to look for an extreme in social fear.

There was certainly a crisis and plenty of social fear in 2008, so this cycle performed as it should have. This rhythm prompted me to wonder if there might be a 7-year cycle in the stock market that would explain the regular appearance of these crises.

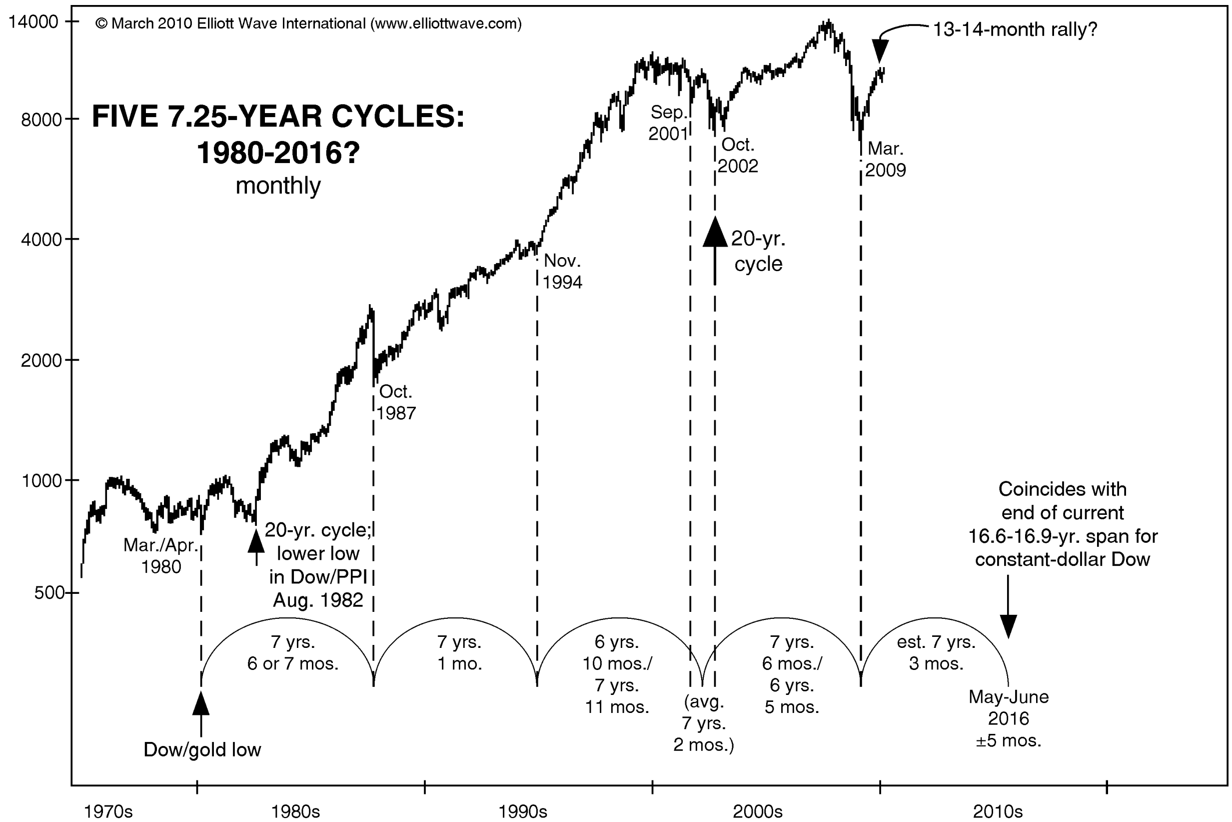

Figure 5

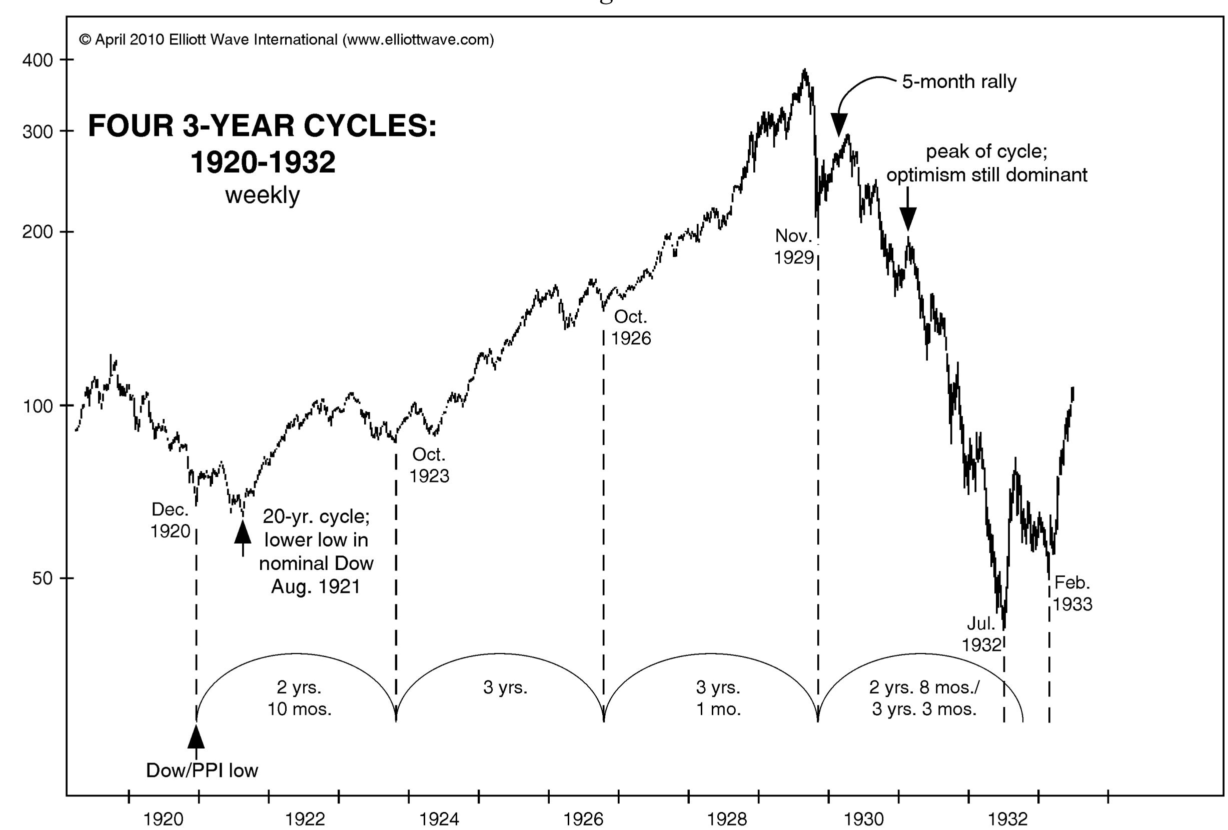

Figure 6

The 7.25-Year Stock Market Cycle

I do not recall anyone talking about 7-year cycles in stock prices. I've heard about 3-, 4-, 6-, 8-, 9-, 10-, 11-, 12-year cycles and longer but not a 5- or 7-year cycle. As it turns out, seven years has been the most important cycle duration since Cycle wave V began. It marks the lows of 1980, 1987, 1994, 2001/2 and 2009, as shown in Figure 5.

This cycle was not readily evident, partly because the 1994 low occurred at such a high level. But that is the only low after 1982 that broke the lower line of the trend channel (not shown) for Cycle wave V, and the market's acceleration out of that low confirms a strong cyclic upturn. The double lows of September 2001 and October 2002 are also a bit anomalous, as the market straddled the ideal time for the 7-year cycle to bottom. But we can easily attribute the first low to the 7.25-year cycle and the second low to the 20-year cycle, which is also responsible for dual lows in 1920/21 and 1980/82, as noted in Figures 5 and 6. For the most part, it is about as clear a cycle as we generally see.

The average length of this cycle is very close to 7 years, 3 months. The next major bear market bottom is thereby due 7 years 3 months after the March 2009 low, i.e. in **June 2016**. *This is the same month that the 16.6-16.9-year span and the 34-year cycle end for the constant-dollar Dow*. We will give this target five months' leeway because of what happened in 2001/2002. But with one straddled cycle low behind us, the next cycle bottom should provide a singular low. Thus, we have quite a narrow expected time zone for the final bear market bottom, in both nominal and constant-dollar terms. To summarize the outlook, the bear market will continue for another six years. We can be fairly confident about this time target.

The January 2010 EWT attempted to reconcile the idea of a nominal low in 2014, the expected year of the low based on the 4-year cycle, and the idea of a constant-dollar low in 2016. Such reconciliation is no longer necessary. It appears from our three studies, summarized in Figures 3, 4 and 5, that **2016** is the year for a bear market bottom across the board, in both nominal and real-money terms.

Variations in cycles' lengths do not allow for precise projections, but applying the exact average length to the 7.25-year cycle has an interesting outcome. The 1980 low is distinguished by a wide separation between the intraday and closing lows, which occurred on March 27 and April 21, respectively. So, let's apply them both. Using closing lows (April 21, 1980 to March 6, 2009), the entire span (including seven leap years) is 10,546 days, giving an average cycle length of 2636.5 days, which from March 6, 2009 comes out to **May 24-25, 2016**. Using intraday lows (March 27, 1980 to March 9, 2009) brings the dates to **June 3-4**. These results are just days from the end of the 16.6-16.9-year span (per Figure 3), which, as noted above, occurs on **June 9, 2016**.

Relationship to 1920-1932

There is something even more exciting about this profile. In 1978, *Elliott Wave Principle* explained why the great bull market ahead would be a cousin to that of the 1920s: It would be a *fifth* wave of *Cycle* degree, like its predecessor. The bull market of the 1980s-1990s was indeed much like the Roaring Twenties, but it was much bigger and lasted much longer. As noted in *Beautiful Pictures* (p.18), "Overall, the 1974-2000 advance produced **3.2** times the percentage gain of the 1921-1929 advance in **3.1** times the time. In other words, these two bull markets' net non-compounded percentage gains over time are essentially identical."

As EWT has pointed out in the past, the 1920s sported a cycle that averages 2.9 years. It averages exactly 3 years when taken to the logical point between the lows of July 1932 and February 1933 (see Figure 6).

The duration of this set of cycles dominating the December 1920-July 1932 period is 11.66 years, and the set of cycles expected to dominate the March 1980-June 2016 period would last 36.25 years, which is **3.1** times as long. So the time relationship already found in the two bull markets using orthodox turning points would hold for the two periods' times of single-cycle dominance if the current bear market carries to June 2016.

Furthermore, the span from the 1920 low to the post-crash rally peak in 1930 is roughly ten years, while the span from the 1980 low to a projected post-crash rally peak in 2010 is roughly 30 years, again about three times as long. The decline from the 1930 post-crash peak to the 1932 low took two years, and our projected decline from the 2010 post-crash peak to the low of 2016 is six years, also three times as long. This pair of pictures is quite symmetrical.

One might have thought that the ideal cycle duration for the present time would be nine years, three times as long as the previous cycle, which would have allowed the current period to subdivide into four cycles as happened from 1920 to 1932. But for whatever reason, it seems to be subdividing into five cycles of 7.25 years.

The 7.25-year cycle of recent decades is 2.5 times the length of the 2.9-year cycle of the 1920s. This theme of a rough relationship of 2.5 to 3.2 between the durations, gains and cycle lengths of the two periods is compatible with the long-standing Elliott wave case that Cycle wave V would cap an uptrend *one degree larger* than occurred in 1929.

Even the starting configuration for the two periods is similar. The earlier period (Figure 6) began when the first 3-year cycle turned up with the Dow/PPI ratio in December 1920. Then the nominal Dow made a lower low in August 1921. The latter period (Figure 5) began when the first 7.25-year cycle turned up with the Dow/gold ratio in 1980. Then the Dow/PPI ratio made a lower low in August 1982. Both of these later lows (August 1921 and August 1982) coincide with bottoms in the 20-year cycle, shown in Figure 8.

The 1929 crash occurred into November 1929, at the second-to-last 3-year cycle bottom. The 2007-2009 collapse occurred into March 2009, which should prove to be the second-to-last 7.25-year cycle bottom. This brings us to the present.

Cycle Analogy Suggests End Time for the Current Rally

EWT has been using the rally of November 1929 to April 1930 as an analogy for the rally that started in March 2009. That analogy still holds. But instead of dealing with a 2.9-year cycle, we are dealing with a 7.25-year cycle. Therefore the power of the swings has been greater, and the time between turns has been greater. The 1929 crash brought the Dow down **48%**, whereas the 2007-2009 decline brought it down **54%**. The disparity in the S&P was even greater: 45% vs. 57%. The ensuing rallies have likewise reflected the different-sized cycles: The 1929 crash led to a Fibonacci **5**-month rally and provided a **52%** retracement (58% in the S&P); the 2007-2009 decline has so far led to a **13**-month rally and a **60%** retracement (in both indexes). This cycle picture shows why both the fall and the rise since 2007 have been stronger than their predecessors: The operative cycle in the current period is two and a half times as long and therefore more powerful.

If the duration of the current rally were to take the same portion of its ruling cycle that the 1929-1930 rally did, when would it end? The 1929-1930 rally lasted 155 days out of 968 in the cycle (1932 was a leap year), for a ratio of 0.1601. The 16.6-16.9-year span ends between February 19 and June 9, 2016. Applying the 0.1601 ratio to this period of 2541-2652 days from the March 6, 2009 low would give rally durations of 406.81-424.59 days, suggesting a peak in the current rally between April 16 and May 5. Using intraday turning dates projects exactly the same range. *As Beautiful Pictures* shows, time targeting usually works out to within 3 days. With April 14 already behind us and May 8 a Saturday, we can project a top on this basis between **April 15 and May 7, 2010**. April 16, by the way, marks the anniversary of the 1930 rally peak. These dates pertain only if the current rally matches its predecessor in percent-of-cycle terms, which is conjecture, but given all the other evidence it seems a reasonable expectation. By this scenario, the market should peak within three weeks and then fall for six years.

The 20-Year Cycle

At the Crest of the Tidal Wave (1995) made a projection based on this very consistent cycle:

> The 20-year cycle, which has lasted between 18 and 21 years, produced the dramatic stock market lows of 1884, 1903, 1921, 1942, 1962 and 1982. This cycle projects another low in the year 2002, + or - 2 years. (p.462)

The market did find a bottom in 2002. I regret not having given it more weight at the time, but despite the two-year drop the stock market had no value, no pessimism and no clearly terminal wave count. Cycles were the only bullish factor, and with no other signs of a major low, they weren't enough to be convincing. As EWT noted in July 2000, "The 20-year cycle bottoms in 2002, [but] there seems to be too little time for the stock market to bottom that quickly." In other words, it was likely to be *a* bottom but not *the* bottom, and

Figure 7

that ultimately proved to be the case. As for the Dow/gold ratio, it bounced anemically for about a year and then kept plummeting, as if there were no 20-year cycle at all. This cycle peaks in 2012, which is when the 7.25-year cycle peaks. This cycle matters because it will add downside pressure to the 2012-2016 period.

Figure 7 shows that the 20-year cycle next bottoms in 2022, + or – 1 year. This is an interesting time, because if the 7.25-year cycle bottoms in 2016, its next low will be due in 2023. The Decennial Pattern (see EWP, Chapter 7), a 10-year cycle, bottoms in 2022, + or – 2 years. So the early 2020s should see a bottom of some consequence. According to the 16.6-16.9-year span and the 34-year cycle, that time will not see a lower low in the stock market.

THE OUTLOOK FROM TECHNICAL ANALYSIS

A Head & Shoulders Top Is Nearly Complete

Edwards and Magee[1] define a head and shoulders pattern carefully. They say several pertinent things about it, beginning with a description of its three main components:

> [Left shoulder:] *A strong rally, climaxing a more or less extensive advance, on which trading volume becomes very heavy*, followed by a minor recession on which volume runs considerably less than it did during the days of rise and at the top. (p.50)
>
> [Head:] Another high volume advance which reaches a higher level than the top of the left shoulder and then another reaction on less volume which takes prices down to somewhere near the bottom level of the preceding recession, somewhat lower perhaps or somewhat higher…. Roughly estimated, about one third [of them] show more volume on the left shoulder than on the head, another third shows about equal volume, and the final third show greater volume on the head than on the left shoulder. (pp.50, 53)
>
> [Right shoulder:] A third rally, but this time on *decidedly less volume* than accompanied the formation of either the left shoulder or the head, which fails to reach the height of the head…. (p.50)
>
> The neckline may slope up (from left to right) or down. [A] down-sloping neckline indicates an unusually weak situation. (p.57)

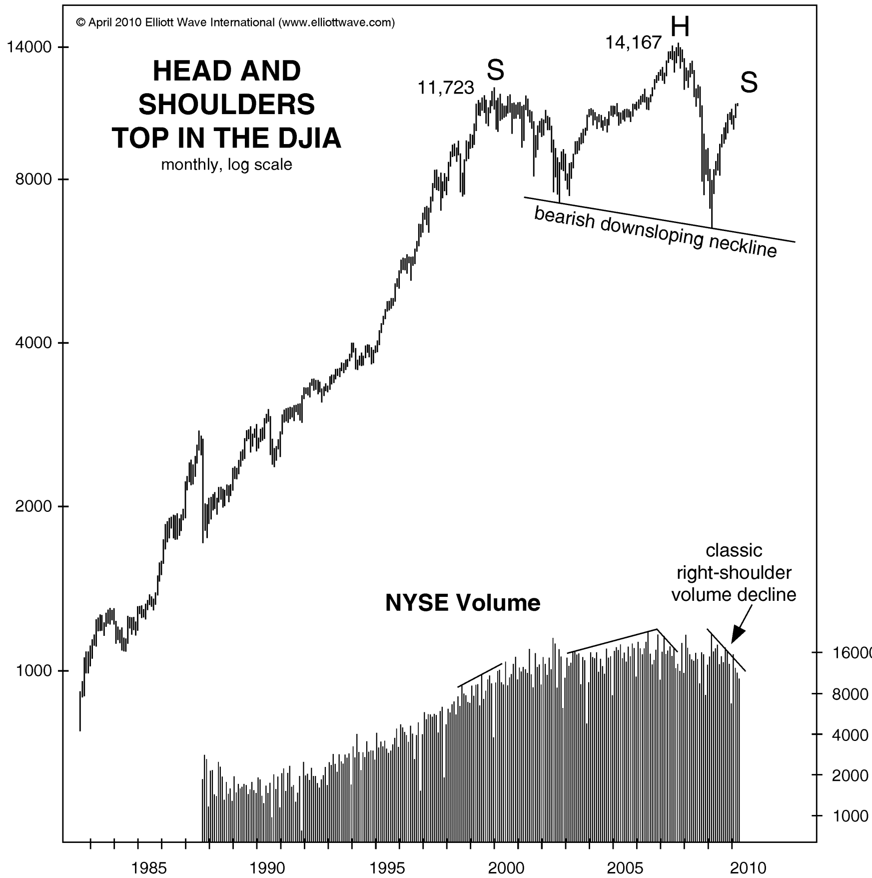

Figure 8

Observe first of all that a head and shoulders pattern is valid only if it follows an "extensive" trend. The purported "head and shoulders bottom" in gold from December 2009 to now, for example, is *not* a valid pattern. In other words, if gold goes up, it won't be because it formed a head and shoulders bottom. But the Dow's rise from 1982 to 2000 certainly qualifies as an "extensive advance."

Both the left shoulder and the head are supposed to occur on "high volume." High volume certainly reigned from 1998 through 2007. In the current case, there was more volume on the head, but it slacked off in 2007, giving advance warning of a turn.

Perhaps most important, the right shoulder must occur on "decidedly less volume." Figure 8 shows the persistent slackening of trading volume from the bottom in March 2009 right through today. Bulls have tried to excuse this condition for a variety of reasons, but it nevertheless accords to the classic pattern.

Moreover, the neckline slopes downward, indicating an underlying weakness to the formation. Generally, when the neckline slopes downward, the right shoulder does not rise to the level of the left shoulder, which in this case had a peak daily close of 11,723 in January 2000. The highest level within the normal range for the rally, as published in EWT last August, is 11,620. So, on two different bases we should continue to expect the peak of the current rally to occur below that of the left shoulder.

The only item not quite ideal is that volume did not contract during the declines of 2000-2002 and 2007-2009. But Edwards and Magee were discussing conditions attending individual stocks, not the averages at the peak of a Grand Supercycle, and I would rate it bearish that volume stayed heavy on these declines, particularly in light of the slackening volume over the past year.

Here is how Edwards and Magee explain targeting the decline following a head & shoulders top:

> Measure the number of points down vertically from the top of the head to the neckline as drawn on the chart. Then measure the same distance down from the neckline at the point where prices finally penetrated it following the completion of the right shoulder. The price level thus marked is the *minimum probable* objective of the decline. [emphasis in the original] (p.60)

The time-consuming left shoulder in Figure 8 might seem to suggest an equally time-consuming right shoulder. But there are many reasons why this development is unlikely. First, for the market to reach a Supercycle-degree bottom by 2016, the current time cycle is likely to be severely left-hand translated, as was the final time cycle in 1929-1932, per Figure 6. Second, the rally is progressing relentlessly, exactly as its counterpart did in 1929-1932. When it ended, it ended; there was no top-building. Third, the rally is stretching to the upper end of a normal range given in Figures 1 and 2. It need not hang around the high once it is achieved.

The number of points from the top of the head to the neckline in Figure 8 is 7000. By Edwards and Magee's instruction, the Dow's downside target is below zero. Given my Elliott wave target, the difference may be a minor quibble. Taking our measurements on log scale would give a downside target for the Dow of below 3000. But as Edwards and Magee noted, this measurement provides a *minimum* target. This head & shoulders formation, then, certainly accommodates our expectation from wave structure for a triple-digit Dow.

Technical Indicators

It is rare to have technical indicators all lined up on one side of the ledger. They were lined up this way—on the bullish side—in late February-early March of 2009. Today they are just as aligned but on the bearish side. Consider this short list:

1. The latest report shows only 3.5% cash on average in mutual funds. This figure matches the all-time low, which occurred in July 2007, the month when the Dow Industrials-plus-Transports combination made its all-time high. But wait. The latest report pertains only through February. In March, the market rose virtually every day, so there is little doubt that the percentage of cash in mutual funds is now at an *all-time low*, lower than in 2000, lower than in 2007! We will know for sure when the next report comes out in early May. Regardless, the confidence that mutual fund managers and investors express today for a continuation of the uptrend rivals their optimism of 2000 and 2007, times of the two most extreme expressions of stock-market optimism ever.

2. The 10-day moving average of the CBOE Equity Put/Call Ratio has fallen to 0.45, which means that the volume of trading in calls has been more than twice that in puts. So, investors are interested primarily in betting on further rising prices, not falling prices, and that's bearish. The current reading is less than half the level it was thirteen months ago and its lowest level since the all-time peak of stock market optimism from January 1999 to September 2000, the month that the NYSE Composite Index made its orthodox top (see p.73 of *Beautiful Pictures*). The 30-day average stands at 0.50, the lowest reading since October 2000. It took *years* of relentless rise following the 1987 crash for investors to get that bullish. This time, it's taken only 13 *months*.

3. The VIX, a measure of volatility based on options premiums, has been sitting at its lowest level since May 2008, when wave (2) of 1 peaked out and led to a Dow loss of 50% over the next ten months. Low premiums indicate complacency among options writers. The quants who designed the trading systems that blew up in 2008 generally assumed that low volatility meant that the market was safe, so at such times they would advise hedge funds to raise their leverage multiples. But low volatility is actually the opposite, a warning that things are about to change. The fact that the options market gets things backward is a boon to speculators. Whenever options writers are selling options cheap, the market is likely to move in a big way. Combined with the readings on the Equity Put/Call Ratio, puts right now are a bargain.

4. In October 2008 at the bottom of wave 3 of (3) of 1, the Investors Intelligence poll of advisors (which has categories of bullish, bearish and neutral), reported that more than half of advisors were bearish. In December 2009, it reported only 15.6% bears. This reading was the lowest percentage since April 1987, 23 years ago! As happens going into every market top, the ratio has moderated a bit, to 18.9% bears. In 1987, the market also rallied four months past the extreme in advisor sentiment. Then it crashed. The bull/bear ratio in October 2008 was 0.4. In the past five months, it has been as high as 3.4.

5. The Daily Sentiment Index, a poll conducted by Trade-Futures.com, reports the percentage of traders who are bullish on the S&P. The reading has been registering highs in the 86-92% range ever since last September. Prior to recent months, the last time the DSI saw even a single day's reading at 90% was June 2007. At the March 2009 bottom, only 2% of traders were bullish, so today's readings make quite a contrast in a short period of time.

6. The Dow's dividend yield is 2.5%. The only market tops of the past century at which this figure was lower are those of 2000 and 2007, when it was 1.4% and 2.1%, respectively. At the 1929 high, it was 2.9%.

7. The price/earnings ratio, using four-quarter trailing real earnings, has improved tremendously, from 122 to 23. But 23 is in the area of the *peak* levels of P/E throughout the 20th century. Ratios of 6 or 7 occurred

at major stock market bottoms during that time. P/E was infinite during the final quarter of 2008, when E was negative. We will see quite a few quarters of infinite P/E from 2010 to 2017.

8. The Trading Index (TRIN) is a measure of how much volume it takes to move rising stocks vs. falling stocks on the NYSE. The 30-day moving average of daily closing TRIN readings has been sitting at 0.90, the lowest level since June 2007. This means that it has taken a lot of volume to make rising stocks go up vs. making falling stocks go down over the past 30-plus trading days. It means that buyers of rising stocks are expending more money to get the same result that sellers of declining stocks are getting. Usually long periods of low TRIN exhaust buying power.

Such readings are consistent with our case that the rally since March 2009 is a maturing, partial retracement of a first bear market wave, the case that the current 7.25-year cycle will be left-hand translated, and with the case for an approaching peak of the right shoulder of a head & shoulders top. Waves, cycles and technical indicators combine to identify this time as the greatest short-selling opportunity in history.

On top of these indicators, we have some powerful anecdotal evidence in the appearance of highly optimistic editorials in both The New York Times and The Wall Street Journal. On April 5, the Times headlined "Relax, We'll Be Fine." Near the beginning comes this line: "This column is a *great luscious orgy of optimism*. Because the fact is, despite all the problems, America's future is exceedingly bright." On April 7, the Journal headlined "Dow 11,000 Is Only the Beginning." (And we thought Dow 6500 was the beginning.) The magazine industry is no less excited. The Economist's cover (April 3) is titled "Hope at Last," and Newsweek's cover (post-dated to April 19) declares "America Is Back." Time magazine (April 16) just interviewed two professors who are "advocating that people in their 20s and 30s take *all* their retirement savings and buy stocks *on margin*." The content of these articles is irrelevant; all that matters is their sentiment. The Wall Street Journal ran similar editorials on July 30, 1998, three months after the Value Line Composite Index registered its all-time high, and on December 31, 1999, three weeks before the orthodox top in the Dow, at the peak of the left shoulder of the head & shoulders pattern. Optimism toward real estate, stocks and commodities in the 2005-2008 period was no less intense.

I always feel obligated to say that indicators such as these do not necessarily pinpoint turns. From October 1998 through May 2008, technical indicators repeatedly reached extremes such as these, and sometimes the market kept going up anyway, at least for awhile. But this is one reason why the decade of the 2000s was ultimately the worst decade on record for the S&P—and that's in bloated-dollar terms! In real terms, it was an unmitigated disaster, with the Dow/gold ratio falling 83% from 1999 to 2009. Persistent optimism is *poison* to the market. It's hard to believe that in just 11 years' time we will have experienced the *three* most extreme stock-market tops *ever*. You can tell your grandkids about it.

Note: The May issue will update the stunning long-term Elliott wave picture.

NOTES

[1]Edwards, Robert D. and John Magee, *Technical Analysis of Stock Trends*, Springfield MA, John Magee, 1948; 5th edition 1966.

Announcement:

This month is the Fibonacci **34**-year anniversary of my first Elliott wave report, which was published by Merrill Lynch in April 1976. It has been a pleasure serving you all this time.