

Does all this talk of green shoots amuse you? Are these “green shoots” an illusion like the “new economy”?

If the market were at a major bottom, the metaphor might apply. But what we have now is some of the old, trampled grass raising its head a bit.

What does General Motors (GM) filing for bankruptcy tell you? How far is General Electric (GE) from eventual disintegration?

GM's bankruptcy is a lagging indicator, a result of the wave 1 decline which ended on 9th March; that was an extreme turn towards pessimism. In the next leg down, that is, during wave 3, hundreds of companies that were not as weak as GM will get weak and file for bankruptcy. GE, along with most other companies, will suffer the most during that down wave.

Was Milton Friedman wrong after all, there is free lunch for all those deemed “too big to fail” on Wall Street.

TANSTAAFL (There ain't no such thing as a free lunch) is a law of nature. The only question is who pays. The government and the Fed decided to make innocent taxpayers and prudent savers pay for speculators' failed bets.

What is the way out for the indebtedness of the US? How does the debt get wrung out of the system? Companies are not growing nor are consumer incomes.

Default and paying off are the only ways out of debt. Most current debt will be eliminated by way of default. The authorities are trying to prop up illiquid institutions, and if they had not done that they would have already failed. People are banking on the Fed to print money to buy all the bad loans. The psychological forces of the bear market will keep the Fed from succeeding whatever they try to do. As we dive into depression, the ability to pay back debt will evaporate so fast that the authorities will not be able to respond in time.

Is there anything the Fed can do to soften the blow now that they have run out of ammunition in terms of lowering rates?

Definitely, it can disband and go away. My guess is that sometime between 2010 and 2016, the Fed will lose whatever credibility it has left.

In your view what has happened to all this credit infusion post Lehman? What is it leaking into?

It is going into shoring up payments on bad debt, such as asset-backed paper and AIG debt-insurance contracts. Over-extension of credit always ends up in deflation. But popular consensus is towards hyper-inflation based on fiat money. If we indeed had hyper-inflation coming, commodities had to stay up; we have not seen that happen yet.

Will the US dollar continue to contradict popular opinion and be a relative outperformer despite “fundamentals” being against it?

The job of the markets is to fool everyone. One of the reasons that I believe in the dollar is because no one else does. Believe is not the term that I would want to stress here but more debt is denominated in dollars than in any other currency. When those IOUs implode, remaining IOUs gain in value. Come to think of it the same cash in 2007 can now buy twice as much stocks, twice as much property, twice as much commodities. It may take months more for the US dollar to complete its basing pro-

cess. But when it turns up again, it will go up because of bad fundamentals.

What makes manias extend their run?

Financial manias run on the increased availability of credit coupled with the net desire of people to employ it. I had thought in 2000 that the country had reached the limit of credit expansion. The savings rate was zero, and lenders were demanding only 10 per cent down on houses. But by 2007, lenders were financing broke people and even covering the closing costs. And people were borrowing off the equity on their homes and spending the money, pushing the rate of savings to negative! Talk about an extreme.

Market extremes can drag longer than one can fathom, how do you deal with these or is there a standard overshooting duration that you have observed?

Sometimes markets turn so swiftly that you will miss them if you don't act. That is why I move when the work de-

Default and paying off are the only ways out of debt. Most current debt will be eliminated by way of default

mands, which makes me early at times, when trends extend past the norm. But markets are returning to normal. After 17 months of falling stock prices, The Elliott Wave Theorist recommended covering shorts in late February, and the market turned up three weeks later. I was happy to be a little early, because anyone who waited had to chase the rally. I called for a short-term turn to the downside on June 11, and that turned out to be the top day. In the long run, it pays to act when you should.

When you wrote “Conquer the Crash” what were you thinking? Where did the clarity on deflation preceding hyperinflation come from?

I started with Elliott wave analysis, where I saw the very high degree of wave that was ending. Then I studied the history of like junctures, and observed that over-indebtedness accompanied all of them. In each case, the ensuing bear market caused credit to implode. From there, it was all about predicting the details that would accompany this scenario. So far, it is working out as it should.

You published “Conquer the Crash” in March 2002. The implosion started happening in August 2007.

The implosion actually started in mid-2005, when real estate turned down. That was about three years after the book came out, giving people plenty

of time to divest themselves of investment property as prices roared into the peak. Then stocks turned down in 2007 and commodities in 2008. Being early was better than being late.

What is noise to you while reading the markets? What are the indicators that you monitor? What are your tools of the trade?

News and market opinions are 99 per cent noise. News is not causal, and most investors waste their mental energy focusing on it.

I monitor Elliott waves, sentiment indicators and momentum indicators. They tell the story of market psychology, and that is the basis of

WHAT IS AN ELLIOTT WAVE?

Elliott waves are the basic building block of the Wave Principle. The wave principle is Ralph Nelson Elliott's discovery that social behavior trends and reverses in recognisable patterns. Elliott isolated 13 patterns of movement, or "waves," that recur in market price data and are repetitive in form but not necessarily repetitive in time or amplitude. He named, defined and illustrated the patterns. These patterns are Elliott waves. These Elliott waves link together to form larger versions of those same patterns. They, in turn, link to form identical patterns of the next larger size, and so on. The result is the illustration you see in chart A.

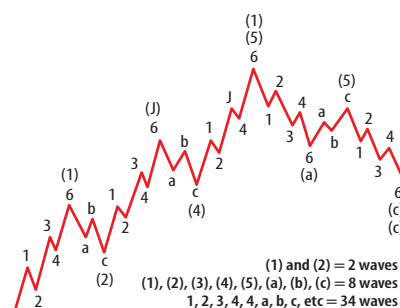
Elliott's pattern consists of "impulsive waves" and "corrective waves." An impulsive wave is composed of five sub-waves. It moves in the same direction as the trend of the next larger size. A corrective wave is divided into three sub-waves. It moves against the trend of the next larger size.

In markets, progress ultimately takes the form of five Elliott waves of a specific structure. As you can see in chart B, in the most basic Elliott wave structure, waves (1), (3) and (5) actually affect the directional movement. Waves (2) and (4) are countertrend interruptions.

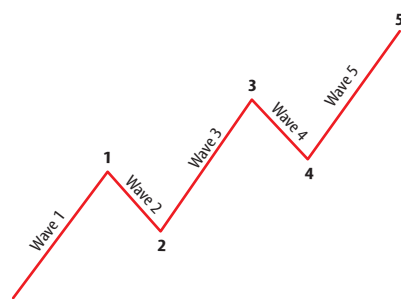
The two interruptions are a requisite for overall directional movement to occur. And though there are several variations of Elliott waves, all of them fit into the basic structure in chart B. The stock market is always somewhere in the basic five-wave pattern at the largest degree of trend. Because the five-wave pattern is the overriding form of market progress, all other patterns are subsumed by it. At any time, two or more valid wave interpretations usually exist. So, it's important for any investor or trader to carefully assess the probability of each interpretation. The Elliott Wave Principle does not provide certainty about any one market outcome. Using the Elliott Wave Principle is an exercise in probability.

Source: Elliott Wave International

A) Elliott wave structure



B) Elliott wave basic pattern



market analysis.

How did you come across Elliott Wave Theory? When did it become your holy grail?

I came across Elliott waves in reading Richard Russell's Dow Theory Letters in the early 1970s. Then I found Elliott's original works in the New York Public Library. Since then, I have published all of Elliott's works as well as those of his successors, including Russell, whom we feted, by the way, at a dinner recently in San Diego.

The Wave Principle became my primary tool about a month after I began tracking waves using an hourly chart. That's all it took. It was an eye-opener.

The general perception is that Elliott Waves are very complex to understand. What is your take on that?

I think the primary theory is simple but like life, the waves in actual manifestation are quite complex. The complexity comes not from the qualitative aspects because waves only take five forms, it's in the quantitative aspect because sometimes a wave will be very brief, perhaps you can short and the price turns, other times it will be very textbook like.

Is there a way to know that we are interpreting the wave right?

If you are applying the wave behavior guidelines properly, this means you are doing it right and that even if you are doing it right means you'll be wrong a number of times. Sometimes the most probable outcome doesn't occur, that's what probability means. Let's suppose the probability of one outcome is 70 per cent; that is almost a statistical guarantee that you'll be wrong one third of the time that you use very same interpretation under very identical circumstances. So I think the way the practitioners handle it is to always have what we call the second best interpretation or alternate count. You know that you are right as long as you do not need to return to that alternative. As long as your primary interpretation of the market is following your expectations, you can assume with some confidence that you are right and continue till the need arises to switch to the alternate count.

What is a typical workday for you like or is there one at all? Looking at your historical charts and depth of market understanding makes one wonder whether you are away from your

"tools of the trade" for long?

I work all the time, even weekends. And it still does not seem to be enough. In 2008, I was asleep at the marketing wheel, too busy doing market analysis. It was such an exciting time for Elliott waves; every move was clear. We were having a ball, and our subscribers were either on the sidelines calmly watching or making a lot of money short.

How does the daily sentiment index (DSI) that you monitor work? Is it a proprietary tool or available for use by the average investor?

The DSI is a poll of traders. When over 90 per cent of traders are bullish on a market, the market is usually near a peak; when 10 per cent are bullish, it's usually near a bottom. At the S&P's bottom in March, only 2 per cent of traders were bullish. Along with the completed wave formation, that reading was a great buy signal. Anyone can follow it. It's published by *trade-futures.com*.

Can wave patterns detect market manipulation; to begin with can markets be manipulated for sustained periods of time or at all?

No person or agency can manipulate

broad markets, at least not for more than a day or two. The natural movements of markets make it appear sometimes that they can. I smile when I see reports such as, "The Fed is losing control of the bond market." As if it ever had control in the first place. When markets go up, the Fed seems to be in control; when they go down, it seems out of control. But the control aspect is an illusion. Market direction is the sole basis upon which people decide whether the Fed is in control or not. And markets go two ways, dictating the changes in perception.

What was your single best trade or investment?

My fastest and largest gain ever came from being short the stock market from July 2007 until late February 2009. What a great ride. The next best one was being long South African gold stocks in 1973-1974. Being bullish on

on the stock market, calling for an end to the correction. The Dow took off like a rocket about two weeks later.

Do you still believe that dividends are the only reason to own stocks, after all dividends though not mandatory are subject to company performance, e.g. Microsoft intentionally came very late into the game.

Practically speaking, the main reason to own or short stocks is for capital gain. But theoretically speaking, the only reason that anyone should care to own stocks is that they pay dividends. Otherwise there would be no payout to the owners. Being an owner without a dividend or at least the promise of a dividend means you own nothing. It doesn't matter if the company ends up ruling the world; you still get nothing. So the whole potential for capital gains is predicated on dividends and the possibility of dividends.

The same cash in 2007 can now buy twice as much stocks, twice as much property

stocks in the 1980s was huge, but the gain wasn't as swift. Being bearish the metals from 1980 to 2001 was also good, especially since I had the rallies, too. There were others, but those are the highlights.

Was taking part in the United States Trading Championship about proving to the world that wave theory works or it was just another point of evolution for you?

In the trading championship, I made many trades in options over a period of four months. At the end, the account was up 444 percent, not to mention that it paid almost the same amount in commissions on top of that. My long term opinion at the time was super bullish, and this period was a choppy, net down market, from February through May 1984. So I think it is fair to say that reading waves on the short term trends was useful. But people are naturally skeptical. For critics, there is never proof. I just try to pile up evidence as I go.

What event or personality has had the biggest influence on your career?

Probably the main positive influence was an article in *Barron's* that appeared in July 1984. I was very bullish

"When money supply rises, inflation rises soon after", what is wrong with this conventional thinking in the current context according to you?

It should read, "When the money + credit supply rises, that is inflation." Economists look at cash and short-term debt and call it money, ignoring longer-term debt. So they keep predicting inflation in a deflationary environment. For the record, dollars are not money. Gold is money. Congress outlawed money in 1933.

You say the dollar is not money; it is still the world's reserve currency at the moment...

It is a currency and it is a substitute for money, but true money has to exist as a form of final payment, which is no one's obligation and one that will hold its value over centuries and dollars don't do that. The dollar is only backed by the taxing power of the US government. This grand supercycle bear market just might be large enough to force a rethinking of the entire idea of fiat money. People do not owe any gold, what they owe today are dollars, Swiss francs, Euro or Yen. As deflation occurs, creditors want to be paid back what they are owed by way of dollars,

and the debtors will have to try to get dollars to make their payment. So what will be in demand are dollars, it is not time for gold to be in demand yet.

Could you explain to us the difference between monetary inflation and credit inflation and how it is the latter that has taken place so far, precise reason why the central banks are helpless in countering the credit contraction?

In our fiat-money world, money inflation is the creation of dollars by the Fed. Credit inflation is the creation of obligations to pay dollars. When the supply of IOUs expands, people have that much more purchasing power, so prices adjust accordingly. When debtors default, the IOUs go away, and so does the amount of purchasing power people had. And prices adjust accordingly then, too. Over-issuance of IOUs is a worldwide problem, but the dollar is the most lent currency of them all.

What kind of contraction have we seen in money supply if at all or is the credit contraction playing out largely by way of destruction in asset prices?

The money + credit supply is contracting. The markets know it, and they are re-pricing assets accordingly. With real estate down 40 per cent, stocks down 58 per cent high to low and commodities down 58 per cent high to low, the financial markets are saying that the contraction in the total value of credit has probably fallen by about 40 percent. People can't see it, because the government and the Fed have created programmes to hide the implosion by trying to keep up an illusion that IOUs are worth 100 cents on the dollar. But on average, they are worth 60 cents, and the financial markets reflect that fact.

Where does one hide in this kind of scenario?

I recommend Treasury bills, Swiss money market claims, New Zealand bonds and some gold. This portfolio has protected everyone who adopted it. If you are going to hold dollars you have to hold it in some form that will survive a long wave of deflation. The dollars that will best survive are cash - actual green dollars. The second safest instrument is Treasury bills. It's the last IOU that the government will allow to fail as they have to borrow short term to keep their operations going.

Jaguar inflation

Edited excerpts from Robert Prechter's *Most Important Writings on Deflation*. The following piece appeared in the February 20, 2004 issue of *Elliott Wave Theorist*

I am tired of hearing people insist that the Fed can expand credit all it wants. Sometimes an analogy clarifies a subject, so let's try one.

It may sound crazy, but suppose the government were to decide that the health of the nation depends upon producing Jaguar automobiles and providing them to as many people as possible. To facilitate that goal, it begins operating Jaguar plants all over the country, subsidizing production with tax money. To everyone's delight, it offers these luxury cars for sale at 50 percent off the old price. People flock to the showrooms and buy. Later, sales slow down, so the government cuts the price in half again. More people rush in and buy. Sales again slow, so it lowers the price to \$900 each. People return to the stores to buy two or three, or half a dozen. Why not? Look how cheap they are! Buyers give Jaguars to their kids and park an extra one on the lawn. Finally, the country is awash in Jaguars. Alas, sales slow again, and the government panics. It must move more Jaguars, or, according to its theory — ironically now made fact — the economy will recede. People are working three days a week just to pay their taxes so the government can keep producing more Jaguars. If Jaguars stop moving, the economy will stop. So the government begins giving Jaguars away.

A few more cars move out of the showrooms, but then it ends. Nobody wants any more Jaguars. They don't care if they're free. They can't find a use for them. Production of Jaguars ceases. It takes years to work through the overhanging supply of Jaguars. Tax collections collapse, the factories close, and unemployment soars. The economy is wrecked. People can't afford to buy gasoline, so many of the Jaguars rust away to worthlessness. The number of Jaguars — at best — returns to the level it was before the program began.

The same thing can happen with credit. It may sound crazy, but suppose the government were to decide that the health of the nation depends upon producing credit and providing it to as many people as possible. To facilitate that goal, it begins operating credit production plants all over the country, called Federal Reserve Banks. To everyone's delight, these banks offer the credit for sale at below market rates. People flock to the banks and buy. Later, sales slow down, so the banks cut the price again. More people rush in and buy. Sales again slow, so they lower the price to one percent. People return to the banks to buy even more credit. Why not? Look how cheap it is! Borrowers use credit to buy houses, boats and an extra Jaguar to park out on the lawn. Finally, the country is

awash in credit. Alas, sales slow again, and the banks panic. They must move more credit, or, according to its theory — ironically now made fact — the economy will recede. People are working three days a week just to pay the interest on their debt to the banks so the banks can keep offering more credit. If credit stops moving, the economy will stop. So the banks begin giving credit away, at zero percent interest. A few more loans move through the tellers' windows, but then it ends. Nobody wants any more credit. They don't care if it's free. They can't find a use for it. Production of credit ceases. It takes years to work through the overhanging supply of credit. Interest payments collapse, banks close, and unemployment soars. The economy is wrecked. People can't afford to pay interest on their debts, so many bonds deteriorate to worthlessness. The value of credit — at best — returns to the level it was before the program began.

See how it works?

Is the analogy perfect? No. The idea of pushing credit on people is far more dangerous than the idea of pushing Jaguars on them. In the credit scenario, debtors and even most creditors lose everything in the end. In the Jaguar scenario, at least everyone ends up with a garage full of cars. Of course, the Jaguar scenario is impossible, because the government can't produce value. It can, however, reduce values. A government that imposes a central bank monopoly, for example, can reduce the incremental value of credit.

A monopoly credit system also allows for fraud and theft on a far bigger scale. Instead of government appropriating citizens' labor openly by having them produce cars, a monopoly banking system does so clandestinely by stealing stored labor from citizens' bank accounts by inflating the supply of credit, thereby reducing the value of their savings.

I hate to challenge mainstream 20th century macroeconomic theory, but the idea that a growing economy needs easy credit is a false theory. Credit should be supplied by the free market, in which case it will almost always be offered intelligently, primarily to producers, not consumers. Would lower levels of credit availability mean that fewer people would own a house or a car? Quite the opposite. Only the timeline would be different. Initially it would take a few years longer for

the same number of people to own houses and cars — actually own them, not rent them from banks. Because banks would not be appropriating so much of everyone's labor and wealth, the economy would grow much faster. Eventually, the extent of home and car ownership — actual ownership — would eclipse that in an easy-credit society. Moreover, people would keep their homes and cars because banks would not be foreclosing on them. As a bonus, there would be no devastating across-the-board collapse of the banking system, which, as history has repeatedly demonstrated, is inevitable under a central bank's fiat-credit monopoly.

Jaguars, anyone?



The US Federal Reserve Building,
Washington DC

As for the Swiss money market claims, the government there runs a conservative book which also reflects on their currency. But I still believe that the US dollar is going to outperform all of them during the next deflationary wave. That could start happening sometime late this year. As soon as wave 2 is over, the stocks rally will be over and we will have a powerful downward wave 3.

Will the deflation wave swamp financial markets worldwide or do the economies of China & India have reason to breathe easy?

Deflation will swamp all financial markets. The US and Europe owe the most, so their economies will suffer the most. But creditor nations, such as China, will lose out, too, because they won't get fully paid.

What is your China call? Does all this talk of it replacing the United States as the world's greatest economic power make any sense to you?

I've been saying for years that China will be a leader, probably the main leader, in the 21st century. But first China has to get past Supercycle wave 2, which has now started. This is the wave that led to the Civil War in the US. After some equivalent difficulty, China should emerge as the main world power. But this scenario will take decades to play out.

Are you implying that there could be civil unrest or even a civil war in China?

We cannot predict something quite that specific. But we can certainly say that tensions within China are likely to grow substantially. You just used the phrase civil unrest. I think we can predict that with near certainty, but exactly the form of that unrest whether it actually goes as far as a civil war is rather doubtful. I think China's wave structure is equivalent to where the United States' wave structure was in 1835-37, that was the peak of its first wave up of supercycle degree. The US corrected from 1835 to 1859 that

its way to making a new low and that should last for the next few weeks. But if you look at a three year perspective the dollar will rise and gold will fall, maybe to 650. It also means that a new high in gold will not make me turn bullish. But somewhere around 2012 may be the time to look at gold and at that point the timing might be more important than the price. So when the dollar eventually ends its rally, gold might be the buy of a lifetime. The next coming wave of deflation is going to make the dollar go up; all the IOU dollars that are expected to add to inflation will default and disappear.

Was gold right through 2001-2008 a beneficiary of liquidity flooding the markets?

Yes, definitely. Commodities went up along with it.

So would that then make it a candidate for correction?

Yes. But it is less volatile than the markets for commodities.

In lieu of hyper-inflation coming to pass, what is your prognosis for gold? Will it rocket the way that gold-bugs around the world are buying for? Incidentally, Alf Field has projected \$10,000; do these targets seem to be in the realm of reality for you?

The current price of gold reflects all the inflation that has taken place since it was priced at \$21 an ounce back in 1932. So obviously super-bulls are counting on more inflation. I think we

Financial manias run on the increased availability of credit coupled with the net desire of people to employ it

are in the midst of deflation, so I do not think gold is going to \$10,000 an ounce, at least not until the deflation is over. During deflations, creditors and debtors both want to be paid in the currency in which they transacted. That has been, and will continue to be, the focus of monetary demand. But gold is money, and this change in social psychology is so large that it may usher in a new financial system in which the world goes back to using money instead of debt as its medium of exchange. This is one of several reasons why I have consistently advocated holding some gold, even while working to call the rallies and declines for traders. If the deflation proceeds in normal fashion, then there may come a time when we will want only gold.

Could you elaborate on the circumstance when we will want only gold?

That is bit of an exaggeration. Once we reach the bottom, if certain political authorities decide to turn to the printing press to print Federal Reserve notes, the kind of cash that you have in your wallet, then that will drive the prices of everything upward. So at that

point you would want to hold a substantial amount of gold because it will be the only real money. However, we don't know that the political class will turn to money printing at that point. If they do, to have real money, meaning gold, at that time would not be a bad idea at all. In fact people should have some even now. I recommended in "Conquer the Crash" that you should have some gold always.

In a worst case scenario there is not enough gold to go around. The total value of all gold mined is about \$4 trillion. So you think it's eventually going to result in the kind of mania that is being talked about by gold-bugs?

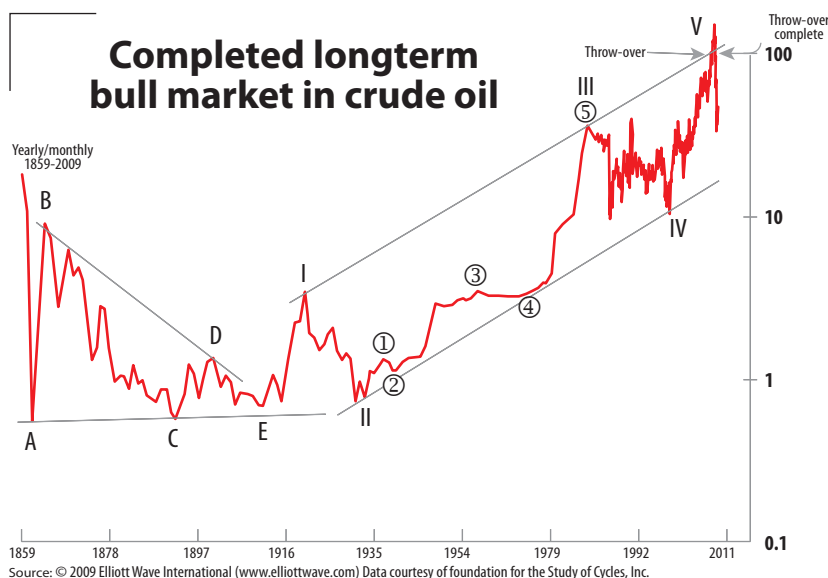
No, because most of the dollars that exist today are not transactional dollars they are credits. They are IOU dollars. Treasury bills, bonds, everything you can name is a IOU to the dollar. The actual monetary base is only about 2 trillion dollars, so I don't think there is a discrepancy there at all.

What kind of upside price action would convince you that gold is another bubble in the making?

It doesn't matter. Bubbles are always retraced. What matters is whether gold is going to go up for real. We watch the waves constantly to make that decision. By a real bull market, I mean one powered by inflation. For that to happen, we would need silver going up along with it. Yet here it is, still stuck at levels down 70 percent from its all-time high.

The Dow has not made a new high in terms of real money; however what is it that has held gold back so far from creating inflation adjusted highs? Is that possible going forward because as per your observation gold does well in an expanding economy and we seem far from that for now?

Gold already reflects all the inflation since 1932. I don't know what you mean by "inflation-adjusted highs," since I adjust for inflation using gold. But one reason it is not soaring in dollar terms is that the economy is not expanding. Gold usually goes up when the economy is expanding. The idea that it goes up in recessions and depressions is a myth. Observe that the last time gold and silver peaked, in March 2008, was almost exactly when the current recession started. And so it goes, again and again, totally contrary to what the one-



WHAT IS SOCIONOMICS?

Socionomics is a comprehensive theory of social behavior that describes the causal relationship between social mood and social action. It believes that social moods determine the character of social actions. The credit boom and bust is a prime example. An increasingly optimistic social mood generated a climate of confidence in which borrowers were certain they could repay loans – even if they were unable to afford a downpayment – and lenders were sure that the debtors were capable of honoring their obligations. Lowered lending standards fostered a run-up in credit and in the real estate mania that followed, homes were viewed as investments and mortgages were securitized and traded. When social mood changed, so did behavior. Lenders became more conservative, borrowers began to question their ability to repay, the value of mortgage backed securities plummeted and half built neighborhoods stood as ghostly reminders of the confidence that once ruled the marketplace.

Source: Socionomics Institute

noters and the media tell you.

I think it's normal that markets are crazy; does that statement of yours pretty much sum up the crux of Socionomics?

Correct! The market is non-rational all the time, not just when it is at mania highs or crashing. But the socionomic hypothesis is about causality: Most people think that social actions regulate social mood; socionomics postulates that social mood regulates social actions.

Was Socionomics the next eventual orbit after wave analysis became second nature to you or is it inextricably intertwined?

Yes, Socionomics was a natural progression of thought. If the stock market

follows wave patterns, then they must be endogenously regulated; otherwise news would have to be patterned to produce wave patterns, which is an untenable position. Then I noticed that other aspects of social expression ebb and flow with the waves in the stock market. This observation led me to hypothesize that waves are fluctuations in social mood, which have consequences in social action.

How does Socionomics differ from behavioral finance?

Behavioral finance finds narrow departures from rationality in human behavior as it relates to finance. Socionomics is a full theory of non-rational herding behavior patterned as a hierarchical fractal. In 2007, I wrote a paper on this idea for the Journal of Behavioral Finance.

Herd thinking makes markets and media does play a role? Why is the financial media such a lousy prognosticator of market turns or any other trend altering event for that matter?

The media fulfill many roles. They usually reflect the sensibilities of the herd exquisitely. So they rarely make good market calls, which require a contrary stance. But in the aggregate they serve as a great indicator. When the media all agree on a market's direction, it is an indication that the herd is aligned one way, which in turn indicates an imminent change in trend.

What is your all-the-same markets index telling you now? Are the components showing any divergence? How far are we from moving into extreme pessimism from extreme optimism?

It shows so far a shallow retracement of the 2008-2009 collapse. The components all peaked in early June within days of each other, except for bonds, which topped in December. In March at the bottom we said we are looking for a big rally that could carry the S&P 500 till 1000-1100. So there is no change in that best guess outlook which would be a normal range of 2/3rds of wave 2.

How do you interpret the recovery in copper prices or the rise in 10 year

yields to about 4 per cent?

Together, they reflect the recent rise in optimism, which in turn is leading to some relief in the economy.

Is the "recovery" that we have got all intervention liquidity driven? Is it then 2003-2007 playing out all over again?

Psychology drives liquidity as well as economic expansion and contraction. The 2003-2007 rise was of Cycle degree. The current rally is only of Primary degree, so it will not re-create the excesses of the previous period. Intervention ruins the economy. But I think it is a normal part of social action and one of the mechanisms that is propelling society into the abyss that the wave structure said was coming.

Is it 1929 all over again or far worse? What is your worst case scenario for the world financial markets and for the US?

The market has gone through a bigger top and trend change than in 1929. My scenario is for the markets to fall further than in 1929-1932, for more banks to fail than in 1933 and for unemployment to exceed the peak level of 1933. To many people, that is a "worst case" scenario. To me, it is the likely scenario.

At what point would you say that the deflation phase is over and now we are moving into hyperinflation? Are we there yet?

Deflation will end when the last weak debtor defaults and the last downtick in asset pricing occurs. We are a long way from that point. Hyperinflation might occur after the low. There is no monetary law that says it must.

Does it mean that after deflation has run its course the world economy will start rebuilding again?

Yes, definitely. In other words the economy will lag the bottom in the market just as it did in the early 1930s. And it will hit its worst low as stocks are rallying but you have to obviously buy before the bottom of the economy. But then yes, we expect the economy to rebuild and go through a super cycle wave B and that will be very strong re-

building but it won't be the start of the great new wave up again.

Your grand super cycle reading calls for the Dow to go to the 400 level.

Well, I keep specific numbers only for subscribers. But what I have been saying publicly is that the Dow could go below 1,000 which is a radical enough statement.

Is there something that will make you reassess that call?

I can't imagine but we have to see an improvement in the technical indicators prior to that level. We have to see a better price earnings ratio, we have to see dividend yield in the Dow and S&P of 7-8 per cent. We have to see extremes of pessimism that are greater than what we saw in 1974, 1942 and 1932. If we saw those and the Dow was still above 1000 I would probably turn bullish.

None of them seem to be happening at the moment...

Oh, not even close. In fact the price-to-earnings ratio has gone worse. I think the dividend payout ratio is about to get worse because the current dividend payout is three times the level of earnings. I think companies in the next year have to be cutting their dividends.

If we come back to the final bottom that you expect between 2010-2016, can we take that as a time frame for the Dow to test the 1000 mark?

Yeah. That's a probability.

What kind of percentage would you attach to that?

I don't think I can be that scientific to give a specific number. It is just that the A wave of the grand super cycle bear market and the 4th wave position is usually the deepest wave much like 1949, 1932 and right now. If this one follows that fold we can probably see those numbers in the coming decade.

What will be the conditions like when the final bottom is expected to materialise?

There will be more unemployment than in 1933, we could have more so-



No person or agency can manipulate broad markets, at least not for more than a day or two

cial unrest than in 1933, there could be more polarisation between government and political factions than in 1933, the economy will contract further and the stock will have fallen a greater percentage than in 1933. Because this is a one degree large wave.

We have a \$15 trillion US economy at the moment or 10 per cent unemployment rate at the moment. How much contraction do you think will happen?

There is an official unemployment rate which is at 9.5 per cent right now. But then there is something more comprehensive called U6 that the government also keeps a tab on. And that is the one in which they monitor people who were looking for a job but gave up looking for a job. It also includes

people who want to work full time but have to work part time and that figure is already at 16.5 per cent. During the great depression about one fourth of Americans were unemployed. I had long predicted that at the bottom of this wave at least one third of Americans will probably be unemployed. But short term, as the rally is going up, the economy is responding accordingly. Though unlikely, we might even have a positive quarter. Junk bonds spreads have improved somewhat. So the optimism is causing a lot of these things to look better.

When the employment rate hits one in three, will that be the point of maximum pessimism?

No, the pessimism will come before that. For example, the point of maximum pessimism was reached in July of 1932 that is when stock markets around the world all bottomed. But the unemployment rate saw its most extreme level in the first quarter of 1933, which is two quarters later and that is normal as the economy lags. So you have to buy stocks when there is no reason to buy them. We are so far from that point it is hardly worth talking about. The extent and duration of optimism from 1995 through today is so extreme that the markets won't bottom until they express a corresponding degree of pessimism.

What is the biggest risk to your analysis? What could go wrong?

I can't see anything that can go wrong. I have been building up for this since A.J. Frost and I wrote a book on Elliot Wave Principle in 1978 stating that there was going to be one of the biggest bull markets of all time on the upside to be followed by a complete retraction. That is what the wave principle called for, and is stilling calling for. It has lasted longer than we thought it would but I see nothing that will stop it from happening. I would attach very low probability for it to go beyond 2016, not that it is impossible. Sometimes waves stretch out in time and nothing is zero probability when you are predicting the future. I still expect a final bottom between 2010 and 2016. □

