# MARKET INSIGHT REPORT

## Three Strikes and You're Out

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For those not familiar with the American game of baseball, a batter gets three tries to hit decent pitches and if he fails, his turn is over – he is out. The current global economic recovery has failed in three ways since the start of the year, only four weeks ago, and the current hopeful picture most economists are still painting for 2010 is already over. In the United Kingdom, a fourth quarter growth blip of 0.1% should be the only plus number for the next year or more, but the picture will be no different, or even worse, in the rest of the European Union. Our cycles for the equity market, discussed in the attached *The Bear Market Rally Nears Completion*, tell us probabilities strongly favor a global equity decline starting before the end of March. Using nothing but our quantitative and technical methods, we would argue that equities, commodities, and emerging currencies should begin a major decline very soon, that credit spreads should widen, and that the dollar should begin a major rally, with the Swiss franc and the Japanese yen tagging along. Although our cycles and other methods are probabilistic and can lead us astray, at this time we brazenly tout their conclusions because the fundamental picture compliments our own methods so well.

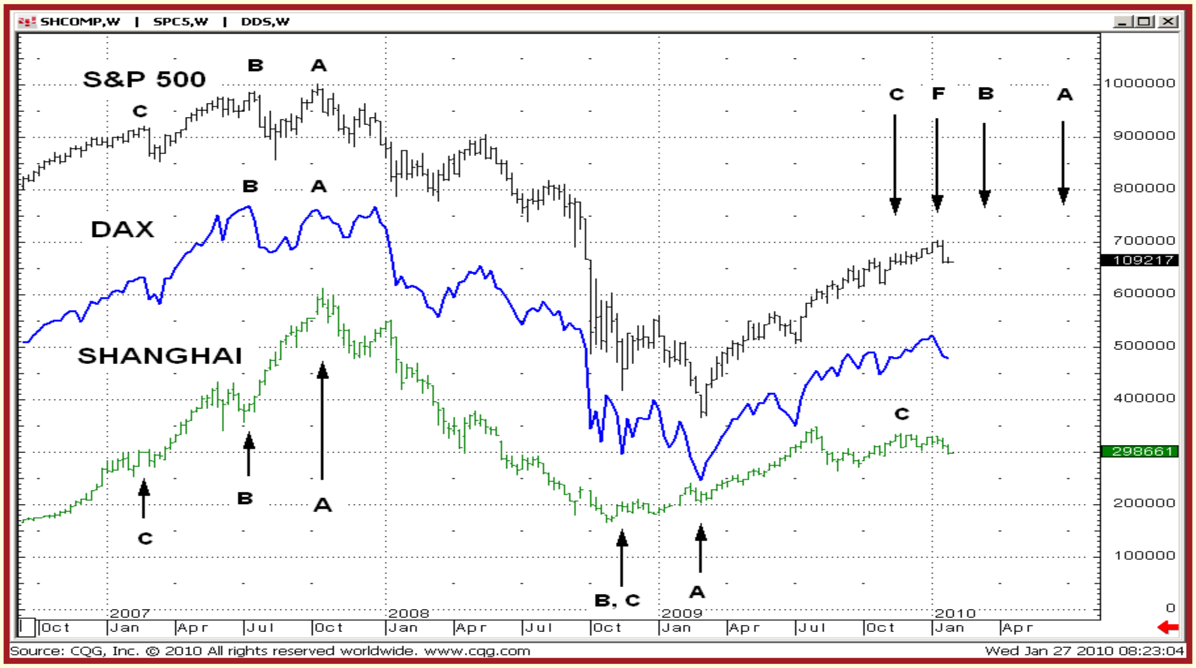
Whether you favor the Republican or the Democratic Party in the US, two events of the past eight days, and the current administration's reaction to them, seem certain to send the American economy into an early recession. The depth of the recession might be a hot political issue, but its imminence should not be. When the Republican Scott Brown won the Senate seat vacated by the death of Ted Kennedy, he robbed the Democrats of their filibuster-proof majority in an election where 9 out of 10 voters said they cast their vote because of the health care issue. If they hate this issue in Massachusetts, possibly the most Democratic state in the nation, they will hate it everywhere. This effectively kills that high priority Obama goal, implies fiscal retrenchment and a Democratic rout in November. A perverse coalition of the far left and the far right, united by vehement populist distrust of Wall Street and the major banks, is threatening to block Ben Bernanke's re-confirmation. Supporting banks is now a cardinal sin in Washington and a large majority of both houses would support any bill to clip the banks' wings. The Obama administration has reacted to its defeat and the clear wishes of the voters to adopt a fiscally conservative posture and to excoriate the banks. With the current recovery so tied to government handouts and excessive liquidity, the guaranteed reduction of fiscal and monetary stimuli will send the US economy into a double-dip recession. Shrinking liquidity and further bank restrictions, bandied about by Paul Volcker and supported through much of Europe, will lead to a dollar shortage once again.

Strike two is in Europe. The Greek crisis, covered several times here, is the Eurozone's swiftly mutating version of America's sub-prime issue. It looks small, but larger countries with slightly better credit are falling too, just as the larger pools of "near prime" mortgages began falling as subprime melted. The European authorities have reacted in the worst way, forcing the Greeks, and the others by proxy, to cut fiscal deficits by raising taxes and slashing spending. Severe recessions are likely throughout the European periphery, and these should continue until a major euro-crisis occurs. Considering the stances of the economic elites, this crisis will probably encompass massive political protests and at least one government overthrow. The third strike is in China. Nothing wrong there, but Beijing is tightening up to keep the economy off the boil. The victims will be the other Asian countries, especially Japan, and the global commodity producers. Although the world needs more final demand, it is being cut on three continents, and with dollar liquidity under threat, the next recession is approaching quickly.

# EQUITY – Long-Term View

## The Bear Market Rally Nears Completion

*By John Taylor*




The global stock market has been in a long bear-market upmove that has continued 45 weeks since the last low (A) in early March of last year or almost 60 weeks from its low in November (B,C), and it is probably near the end of this rally. By analyzing the cyclical relationships in various equity markets we are able to project possible topping points for this upmove. Although this is far from an exact science, the medium term equity cycles tend to last from 2½ years to 4 years in length with a raggedly bi-modal pair of peaks at the 2¾ and 3¾ points. With this little bit of statistical knowledge and some other tricks we can estimate when the reversal points are likely to come.

The first possible peak in the stock market was in February 2007 (C) when the Shanghai market broke sharply lower and the global liquidity crisis first began. Although this looks unlikely, the low in November 2008 (C) fits that top perfectly and implies that the next peak would have been in late November 2009 (C), which was a peak in Shanghai and did see the dollar end its decline as well. A more likely peak was (B) in the summer of 2007, when the London market peaked, as it also matches the low in November 2008, and implies a high in March 2010 (B). We believe this is the most likely outcome. However, the real top at (A) in October 2007 matches with the March 2009 low (A) and would mean that the equity rally continues into July 2010 (A). The high marked (F) occurred this week and is a perfect Fibonacci ratio between the decline to last March and the rally since then. We will bet on March until evidence changes our mind.