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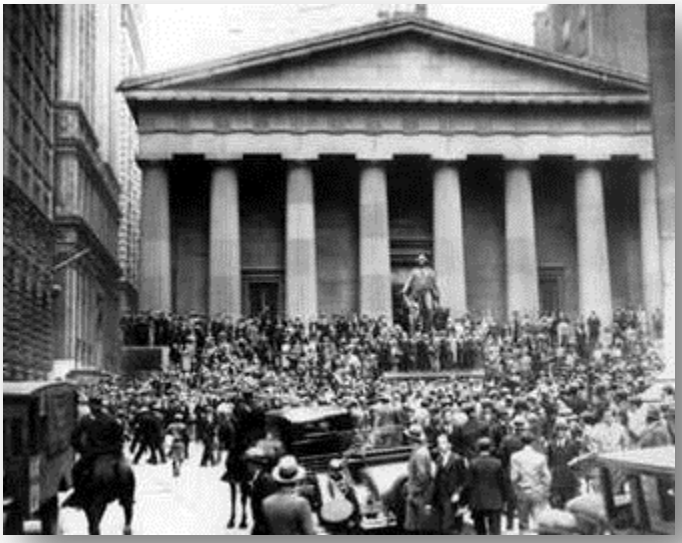


Can the Stock Market Really Drop by 90%?

Americans keep reliving the Great Depression just as the Germans relive the Hyperinflation. The analysis in both sectors has been also colored by such events. Neither group dig deeper to try to even understand why such events took place. In the US, the doom & gloom always emerges with the only blueprint being constantly the Great Depression. Overlooked was that money was tangible (GOLD) and thus hoarding "cash" was an escape from both government and the private sector. It was neutral. This is why Roosevelt confiscated gold to end the hoarding and devalued the dollar. These major factors are just not present today. For the stock market to drop 90%, that means people will

hoard **PAPER DOLLARS.** But debt is at record highs. This means the stocks would decline and the bonds would rally taking interest rates to about -5%.

Germany went into hyperinflation because it had Reparation Payments it could not make. Real wealth was fleeing. This is why even John Maynard Keynes argued against that the actions against Germany were punitive and would do more harm than good. On that score, he was correct. Germany had no choice **BUT TO** print money. Hyperinflation **CANNOT** take place until you reach that point of no return. As long as there are still bond markets and buyers, we will not see hyperinflation anywhere. Eliminate the bond buyers, real wealth flees, and what is left is only printing to make ends meet.

Nevertheless, this said, the market is not yet ready for prime time. The rally that unfolded after the 2011.45 turning point surprises most who were calling for the end of the world as usual. Now they are back yelling see I told you so, it will collapse. I previously warned that taxes were going to rise sharply come January and that those with capital gains would take profits before year end. That does not support a collapse by 90%. Yes, even the tax bull telling Obama to raise taxes on the rich appears to be speaking out of both sides of his mouth as he was not the Oracle – but the Roam god Janus. Despite the 6.5% stock market rally over the last three months, a handful of billionaires are quietly dumping their American stocks and that includes Buffett. He has sold Johnson & Johnson, Procter & Gamble, and Kraft Foods for example. Consumer dependent companies signally he expect an economic decline.

Even John Paulson, who sold the subprime mortgage meltdown, is selling some U.S. stocks as well. During the second quarter of the year, Paulson's hedge fund, Paulson & Co., dumped 14 million shares of JPMorgan Chase a bank stock. The fund also dumped its entire position in discount retailer Family Dollar and consumer-goods maker Sara Lee. Even George Soros recently sold nearly all of his bank stocks in the USA, including shares of JPMorgan Chase, Citigroup, and Goldman Sachs.

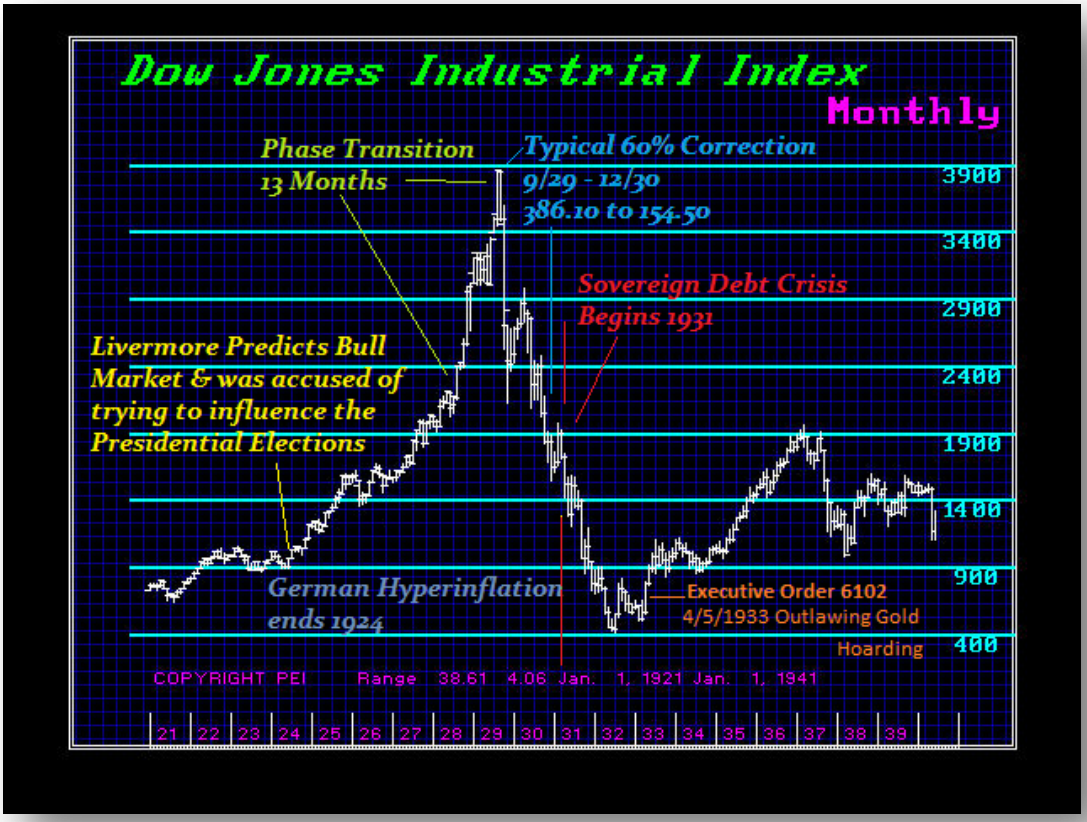
An interesting phenomenon is that for the first time in five years some real estate is actually rising in many locations. And the unemployment rate seems to have stabilized within the private sector, but state and local governments will continue to shed jobs.

There are those touting these sales are proof that the “in-crowd” see a 90% collapse on the horizon. Very interesting nonsense since at the top in 1929, this same “in crowd” type were loaded to the gills. Robert Wiedemer, author of the New York Times best-selling book *Aftershock*. True, his 2006 book warned of the housing bubble, but a lot of people saw that coming. What they missed, however, was how leveraged it was so that even Goldman Sachs needed a bail out. Wiedemer claims the explanation as to why a large drop in the US stock market is a virtual certainty, begins with the strategy of the Federal Reserve to print a massive amount of money out of thin air in an attempt to stimulate the economy.

Wiedemer argues that once the funds created by the Fed actually hit the market, then inflation will surge. He insists that once 10% inflation reaches 10%, the 10-year Treasury bonds will lose about half their value and that all value will be gone by 20%. Interest rates will increase dramatically at this point, and that will cause real estate values to collapse. And the stock market will collapse as a consequence of these other problems. He insists that companies will be spending more money on borrowing costs than business expansion costs lowering profit margins, lower dividends, and less hiring. He then follows this line of logic claiming that no investors will want to own stocks with falling profit margins and shrinking dividends. All of this doom and gloom fails to answer one question. So if inflation is coming, you sell everything, then you go to cash and hoard dollars that are being printed like crazy? Of course some will argue you buy gold. However, let us be practical. Not everyone will buy gold. Secondly, the governments are attacking the gold market intensely. It has been virtually destroyed in France where dealers can no longer buy gold for cash.

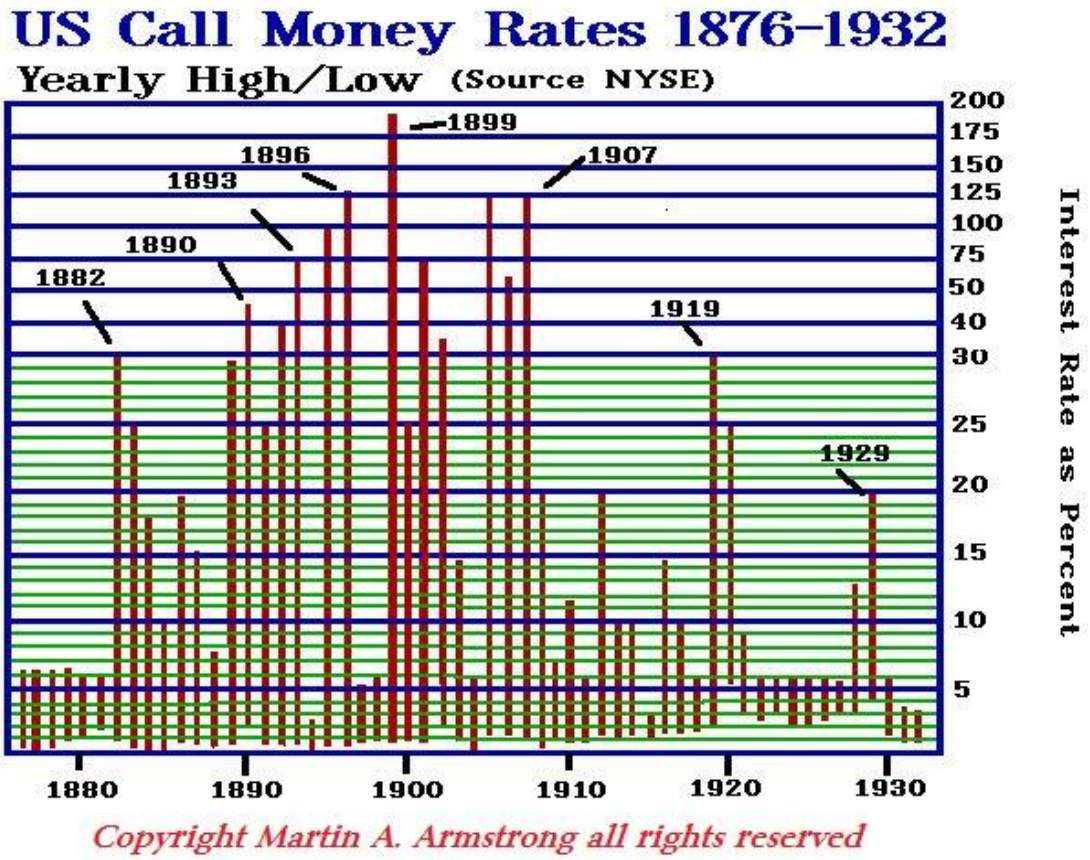
If you are going to analyze something, you better damn well do it through everyone’s eyes. The economy is global. These “opinions” are based on a very parochial view of the world purely from a domestic perspective. They do not step out of the traditional economic theories that are so antiquated it is pathetic. It would be far easier for me to go to some beach and say the hell with the world; I will wait for the mushroom cloud to appear on the horizon before I come out. I was recently asked; What was I the most proud of in my career of accomplishments? I really had to stop a moment and think. Then I responded. It was when Milton Friedman showed up at one of my seminars and said it was the best speech he ever heard. He encouraged me to write and to explain to the world what I had experienced. He told me I was doing what he had only dreamed was possible.

What he meant by that was I was a trader. I was running around the globe trying to solve problems and in doing so, I had to see everything from the different eyes of the client’s perspective. I have said many times I am the product that had been shaped and molded by my clients – not the other way around. Everyone acts out of their own self-interest as Adam Smith states. Currency is a language. If I said I will give you a million of various currencies and you could choose only one, you would immediately look at each currency and translate that into you own currency in which you actually think. A million Swiss francs to an American will be translated to dollars and vice versa. SO looking at the Great Depression solely from a dollar perspective is only a slice of the pie. To understand the event, you have to see the whole pie.



The problem with this scenario that the Dow will collapse by 90% as 1929 is constantly relived in the minds of too many is quite frankly just far too simplistic. It is a repeat of the Great Depression lacking the depth of understanding what that event really was all about. It was a normal correction between 1929 and 1930 with the Dow Jones Industrials falling from 386 to 154 – about a 60% decline. This would not have been anything to write home about or constantly relive time and time again. The history books and even Galbraith's book on the Great Depression omitted the fact that there was the **Sovereign Debt Crisis** in 1931. This was the event being ignored that wiped out the economy, the banks, and the share market. It drove the dollar to record highs because it was Europe collapsing, not the United States, which was akin to the position of China today. Yes history repeats. However, the players always change.

It takes a "real" trader to smell the blood and the "tape". I have always been fortunate for whatever reason, I had such a talent. I believe because I kept a paper tape into the early 1980s along with a screen but I liked the sound. It was an input that stimulated another sense where prices blink in silence on a screen. The one person I could relate to was Jesse Livermore. He too called it like it was. In 1924 he saw that interest rates were below dividends. He came out and said the market was going to explode. He was accused of making a political forecast to help the White House in the Presidential election because he knew the President. The majority and the press were all loking for doom and gloom. They accused Jesse of just about everything because they did not like what he had to say. Indeed, it had gotten so bad, the Wall Street Journal refused to ever quote Jesse convinced he was a market manipulator.



While I have been likened to Jesse Livermore I consider a compliment, it has been noticed that the press and some in government were desperate to try to discredit any forecast because they do not like also what I have to say. The only truth is just that – unbiased truth. I was recently asked if I was a Republican or Democrat. My response was NEITHER! I believe in Adam Smith who observed and reasoned rather than Marx and Keynes who saw how the economy functioned, and then presumed the arrogance to change it into what they desired. It is what it is. That is science. Opinion has no place in science only in rhetoric.

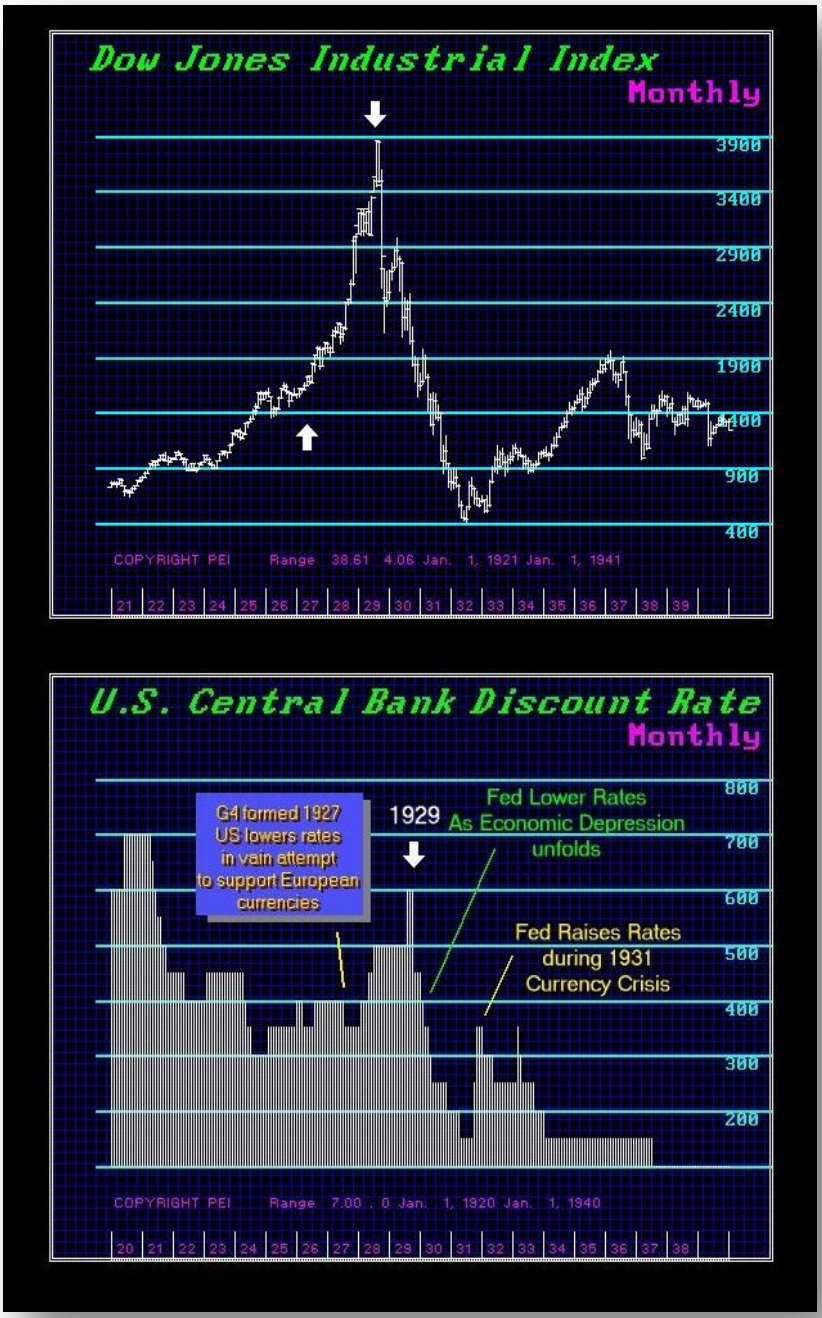
These scenarios how interest rates will rise and that will force the stocks down are shallow at best. We have conduced actual real live studies. After all, we had a staff of about 240 employees. There was no stone left unturned. If the world could be predicted based upon the level of interest rates, I would be the first one standing up and screaming – hey look at this. We live in a complex dynamic nonlinear world with countless variables. History repeats because the passions of man never change, but it is like lightening – it never strikes in the same manner and place twice. Here is a chart of interest rates. You will easily see that the stock market never peaks twice with the same level of interest rates. It is not the empirical level of interest rates that matters. It is the difference between the perceived potential profit and the cost of borrowing money. If you believe you will double your money in one year, you will pay 25% annual rate of interest. It is the differential that counts – never the level.

Now we come to the argument that if interest rates rise the stock market will decline. I am sorry. That is pure bullshit! Interest rates rise with bull markets and decline with bear markets. Look at Japan. Here is the Great Depression and the Fed kept raising interest rates as the market rallies. They then cut rates sharply as the market declined. So just where does this nonsense come from.

The idea that the stocks will go down if the interest rates go up because it will cost more to borrow presumes everyone is leveraged. It also assumes the cost of business will rise lowering profits.

The sad part of this reasoning is that it has been so prevalent. This is the reasoning that dominates the TV shows and spread the nonsense perpetually.

Interest rates ALWAYS rise in bull market because people are investing. As the economy is expanding, people bid for capital because they see an opportunity. In Japan, interest rates are virtually zero. The market still does not rally because they see no opportunity. That is the key that is being ignored in this very shallow reasoning. All you have to do is actually demonstrate with evidence where this idea even comes from. Nobody can show the stock market rising with a bear market in interest rates. Impossible!



The most important point to walk away with here is that not everyone experienced the same thing as the United States during the Great Depression. Great Britain was forced off the gold standard and suspended payments on its debt. So, under the reasoning that is circulating around today, the world will come to an end, we must look closely at all countries, not just that of the United States. Here is a yearly chart of the London share market and its performance during the Great Depression. The US devalued the dollar in 1933 and that began the rally into 1936-1937. However, that was a reasonable recovery. But the dollar was still tangible. Now look at Britain where the pound became pure fiat currency backed by nothing. That same rally into 1936-1937 produced NEW highs above that of 1929.

This is the likely outcome from a Sovereign Debt Default today. The stocks will rally to new highs as a hedge against the declining bond market an purchasing power of the currency. So sorry. I cannot find any set of circumstances in history that will signal a 90% drop in stocks with a Sovereign Debt Default. So look to even stocks as a hedge against the future.

So what Now?

Here is a look at the Down Jones Industrial index on the weekly level. We have not yet elected any Weekly Bearish Reversals. Even the main Daily Bearish Reversals are in the 1260 range. This is the key area to watch. Can there be a correction? Absolutely. We do not see the market breaking out for new highs until after the summer of 2013 and the midpoint on the **Economic Confidence Model**.

Nevertheless, here is the Forecast Array for the weeks ahead. The top line provides the key targets for turning points. If you look at the pattern in the Dow on a weekly level, you will notice the flat top. To get a 90% drop, any serious trader will tell you there has to be a Phase Transition type of top. That does not exist. Without the spike high that create the energy to swing in the opposite direction, there will NEVER be such a collapse. So to get that, the market must act like a pendulum and move to the extreme in one direction to get to the other side. So no worries. Be happy. There will be no 90% drop. That is just absurd.

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