

## Executive Summary

We are in the middle of a secular bear market, one of only three in the last 100 years and it is looking like it could be the worst of the three. Overall economic outlook is dire over the next 2-4 years at least. A significant bear market rally is expected in the US and foreign equity and commodities markets later in 2009 but only after another 15%+ leg down in the US equity indexes from current levels. The risk is high that the 2009 bear market rally will be followed by a protracted market fall which will dwarf the 2008 market collapse. This would correspond with the realization that a depression is imminent and that the immense stimulus applied by the US government in 2008 and 2009 has been ineffective. Active money management using an effective market timing methodology is required to navigate through this bear market over the next many years and mine is introduced. I am offering financial advisory and money management services utilizing the same methodology to protect and grow your wealth in this environment, and these services are outlined.

## Introduction

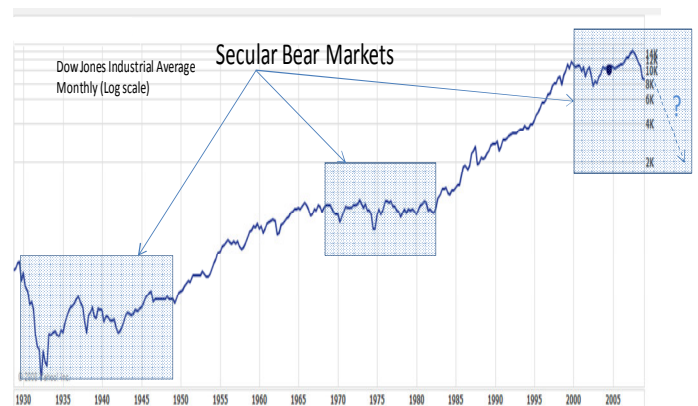
No doubt you have been bombarded with economic news from the media and have either formed your own opinions or are searching for answers to the economic questions of these times. My purpose in this newsletter is to hopefully provide a clearer look at what has happened over the last year in light of economic history, what that implies for the future, and most important of all what can be done to protect and even grow our assets in this environment even from a beaten down state many are in currently.

Why do I think you should listen to this prognostication? I believe I have discovered some key market forecasting principles which can work under numerous market conditions. I have had great success in applying the methodology to a funded account that I managed over the last 18 months while still in the technology industry, and would be happy to share performance details with you in a personal meeting. Some key wins were staying completely out of US stocks through all of 2008 except with inverse allocations from September thru November while the stock market crashed by 35%, and being invested in cash and US Long Treasury Bonds in the middle of 2008 while the Bonds increased by 25%.

In fact by July 2008, it had become clear to me that I could use my market insights to both preserve and grow people's wealth. I continued to foresee a coming economic hurricane, which was when I decided to change my career.

## Market Perspective: A Secular Bear Market

We are in the grip of a secular bear market, have been in one since January 14<sup>th</sup>, 2000, and one I believe that has many more years left in it. It is important to understand the time when the secular bear market started because these markets unfold in a somewhat predictable manner in terms of price structure, and knowing when a trend began gives important clues about how long it will last and how far prices will drop. More on that in subsequent paragraphs, but first some definitions, examples, and support for the argument. A secular bear market is one where prices (stock market prices in this case) do not exceed a previous bull market peak for a period of 5 or more years. There have been 2 secular bear markets before this one since the early 1900's, the first of which lasted from 1929 to 1949 (the first five or so years of which are known as the Great Depression), and the second which lasted from 1968 to 1982. Figure 1 shows the Dow from the 1920's indicating these secular bear markets.

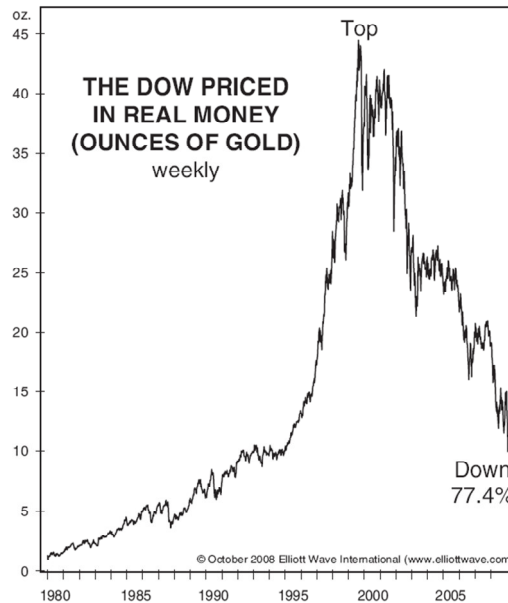


**Figure 1** Chart of the Dow Jones Industrials for the last 100 years with secular bear markets highlighted

The bulk of the market opinion is that this bear market started in October of 2007, however they are incorrect. There are 2 indicators, among many, that strongly suggest (conclusively in my opinion) that this Bear market has been in place since January of 2000 that I will share here. The first is the Nasdaq price history in Figure 2 compared with the Dow Industrials. Technology has been the last

great driver of fundamental progress and the underpinning of the last secular bull market which started in 1983 and culminated in the internet boom of the late 1990's. As you can see, the Nasdaq 100, which is a proxy for the top technology companies in the world, peaked in January of 2000 and its subsequent peak in October of 2007 was at 50% lower levels than its 2000 peak. Most of the world has had its eyes on the Dow Jones Industrial Average (which is the composite of 25 of the largest industrial corporations in the US). This is why they misread the start of the bear market since the Dow, in nominal terms exceeded its 2000 peak by 34%.

The 2<sup>nd</sup> indicator that shows that we are in a secular bear market and that this bear market started in 2000, is the Dow Jones Industrial Average in terms of "real money" which is Gold, which is shown in Figure 3. This is excerpted from Elliott Wave International's October 2008 Theorist newsletter. The Dow in terms of Gold has dropped a whopping 80% from its peak in 2000 as of Dec 31<sup>st</sup>, 2008. This is no mini bear market we are in.



**Figure 3** The Dow Jones Industrial Average (Dow) priced in terms of ounces of Gold. Figure is courtesy of Elliott Wave International from their October 2008 Elliott Wave Theorist Newsletter.



**Figure 2** Comparison of the Nasdaq 100 index (in white) with the Dow Jones Industrial Average (in blue) with a projection forward (in purple dashed lines) for the Nasdaq 100 based on the Elliott Wave Principle. The Dow is expected to follow a similar path. All data is on a log scale.

### Market Outlook: How bad will it get?

There are additional indicators which indicate that this secular bear market is actually shaping up to be the worst of the three in the last 100 years. It could be worse than the Great Depression, at the very least for everyone's real standard of living, if not in nominal terms. In my opinion, there are three scenarios possible for the economic outlook for the US (and to a large extent for other major world economies). Scenario 1 is that of a depression lasting the next 4 or more years. Scenario 2 is that of a recession followed by runaway inflation. Scenario 3 is that of a period of stagflation followed by a resumption of normal growth.

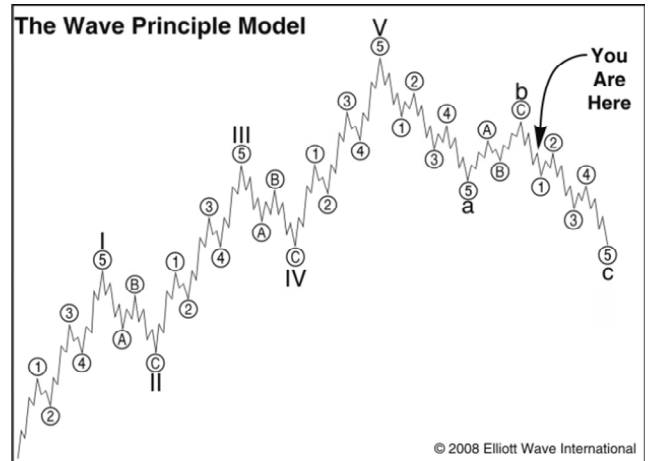
#### SCENARIO 1: Depression for the next 4 or more years

I have many reasons for believing this is what is ahead of which I will mention some.

- A) The major stock indices show an A-B-C corrective structure which is clearest in the Nasdaq in Figure 5. Compare this with the idealized (Elliott Wave) pattern for a bear market in Figure 4 and our current position in this corrective pattern.
- B) The stupendous magnitude of the stimulus that is being applied (\$8 Trillion including Obama's planned

stimulus according to CNN/Money as of Jan 6<sup>th</sup>, 2009 has been committed) is greater than the inflation adjusted cost of the 2<sup>nd</sup> World War (\$5 Trillion) and has already exceeded the stimulus applied in the Great Depression through the New Deal, the Marshall Plan, the Louisiana purchase, the race to the moon, the S&L crisis in the late 80's, the Korean War, the invasion of Iraq, the Vietnam War, and NASA combined (totaled at \$3.8 Trillion in inflation adjusted dollars by Bianco Research). Is this stimulus enough to offset the massive rate of wealth destruction, estimated at \$7.8 Trillion since Q407 thru Q308 and continuing by Weiss Research? Of the \$8 Trillion committed, only \$2.8 Trillion has actually got into the economy so far, far short of what is needed. The government is behind the curve, like they will continue to be, and any plans have minimal benefits to "main street" so far.

- C) The well established fact now that the US and worldwide growth that was seen from 2003 to 2007 was "fake", based in large part upon consumption built on money borrowed from the now bankrupt housing boom.
- D) Another indicator is the Dow to Gold ratio shown as a logarithm of the ratio in Figure 6 with data from 1790. This ratio has approached 1 in both of the last two secular bear markets in 1932 and 1980, i.e. the Dow could be purchased with 1 to 1.5 ounces of Gold. As of Dec 31<sup>st</sup>, 2008, the ratio sits at 10, with the Dow at 8750 and Gold at \$875/oz. As you can see, there is a long way for the Dow to go down (or Gold to go up, or both) before parity is achieved again in this secular bear market.
- E) Finally, you are aware that the Fed dropped the effective short term interest rate to below 0.5% which in itself is unprecedented. What is even more significant is that the Bank of England lowered their interest rate to 1.5% recently, which is the lowest in the Bank's 315 year history. A major worldwide depression looks to be in the making, one that could be worse than anything since the foundation of the USA.



**Figure 4** The idealized Elliott Wave Principle model for a complete bull and bear cycle. I agree with Elliott Wave International's thesis of where we are in this corrective cycle. Also reference Figure for how the Nasdaq 100 index looks in relationship to the idealized model.



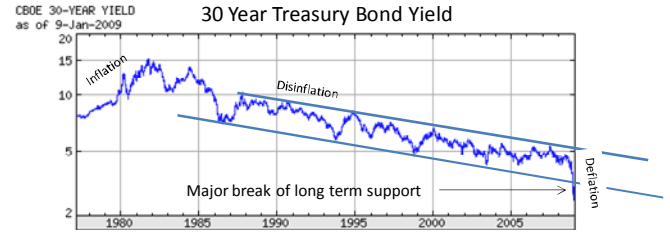
**Figure 5** The Nasdaq 100 index showing a clear A – B – "start of C" corrective pattern which is a classic bear market pattern. The corrective pattern began with the Jan 14<sup>th</sup>, 2000 peak in the Nasdaq 100.



**Figure 6** A very long term perspective on the Dow/Gold ratio from Robert Prechter's 1999 book, "From the Crest of a Tidal Wave". The chart shows the logarithm of the ratio and where the ratio is headed in the current bear market. The logarithm of the ratio was 1 as of Dec 31<sup>st</sup>, 2008 which is roughly halfway down the dashed line from 1999.

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government and consumer debt, deficit spending, and a stock market and then a housing market bubble which were also unsustainable as we know very well now.



**Figure 7** Chart of the 30 Year US Treasury Bond yield (log scale) shows a depressionary break in December 2008 of a long term support line for the yield. The bond yield will indicate as well if we are emerging from a depression into an inflationary climate if the yield rises higher than the upper of the two lines shown in the chart.

**SCENARIO 2: Recession followed by runaway inflation**

This is still a possibility given the unprecedented stimulus that is being applied and the possibility that the economy will be successfully re-flated by these efforts with the re-flation getting out of control. Luckily for us, we have an excellent indicator which will tell us if this is what is going on. Gold has staked out \$1033/oz as a hard demarcation between a depression and inflation. The strength of Gold (and Silver's) rally out of their depression lows (which I believe are yet to form) past this line would be a relatively early sign of this scenario taking place. US Treasuries would also tell us if this is where we are headed. Currently they are clearly pointing towards a depression as shown by the long term picture of the 30 Year US Treasury Bond in Figure 7.

**SCENARIO 3: Stagflation followed by normal growth**

This is the US government's primary goal, where the economy "threads" the fine line between depression and high inflation until the credit market dislocations are gone, without changing the slant towards deficit spending and increasing government debt. I do not believe this will occur simply because it never has in the past. Even the last secular bull market from 1982 to 2000 where Greenspan's supposed success in keeping inflation low while providing an economic boom came on the back of increasingly unsustainable

**Market Investment methods: How to protect and even grow Assets in this Environment?**

So how can we invest in this kind of a market where even Warren Buffett stands humbled with a 32% loss for 2008? A key is to know what not to do. **"Buy and Hold" and the underlying Efficient Market hypothesis, which has been (and still is) the mantra of >90% of the financial advisory establishment, has been a bankrupt (pun intended) philosophy since Jan 14<sup>th</sup>, 2000.** If you had \$100,000 invested in an IRA in 1999 that performed like the S&P (>75% of Mutual funds typically underperform the S&P so you would have probably done worse) you would have a -7% return before inflation adjustment 11 years later and have \$93,000 left. If you invested the \$100,000 in 1999, you would have a -29% return after 10 years and have \$71,000 left. After adjusting for the CPI (which many experts believe understates true inflation by 6% or more), your \$100,000 from 1999 would buy you \$56,000 in today's dollars, a 44% reduction in the value of your investment. The basic reason is that Buy and Hold does not work in secular bear markets, and we have been in one since 2000. Secular Bear markets have their own rhythm and dynamics and there is no silver bullet. One needs to study the behavior of such markets in the past, apply that to the current set of economic circumstances, and be nimble. **One needs to time a secular bear market,** buying low and selling high, taking advantage of the high volatility and underlying market relationships. This is only possible if a bulk of one's assets remain liquid.

I have developed a conservative timing methodology for asset allocation based on the Elliot Wave principle and other technical market indicators and informed by economic fundamentals, focusing on the US and Foreign equity, Treasury Bonds, Precious Metals, and Oil markets. The Elliot Wave Principle, originally discovered and published by Ralph N. Elliot in the 1930's, is a fractal model of market behavior which describes the entire body of market data and can be used to provide a framework for determining when the prices in a market are good buying opportunities and when they are good selling opportunities, to identify major (and minor) market turns with a surprising degree of precision, and to forecast market direction. This methodology has allowed me to make some startlingly accurate market decisions and recommendations on my own accounts over this 18 month period which is reflected in the growth in my account.

### Market Forecast: What will 2009 be like?

My current US stock market projection is captured in Figure 8. Timeframes and price projections are imprecise and can change and one must remain nimble, but I expect the market to adhere to the form shown in the purple lines and yellow lines which indicate my primary view and alternate views. The key point here is that I am expecting one more major decline in the US markets to below the November low in the Dow of 7400 before the markets enter a 6 mo to one year long bear market rally which retraces a significant portion of the decline since October of 2007 with the Dow going back over 10,000. That rally would be followed by a decline that dwarfs the 2008 decline and would take the Dow/Gold ratio down to 1 in the 2010/2011 timeframe. There are many ways to skin the cat at that point and I will be updating the picture as we get closer. I develop similar pictures for each major market I follow including the Dow Jones Industrials, the Nasdaq, the Russell 2000 small cap index, the S&P 500, US Treasury 30 year bonds, Gold, Silver, Gold Mining companies, Oil, Oil companies, Agricultural commodities, emerging markets like China and India, and major world markets like Japan's Nikkei, Australia, and London's FTSE.

I want to emphasize that in my opinion the coming rally later in 2009 could very well be the last opportunity to raise cash and position one's investments defensively for the 2<sup>nd</sup> decade of the 21<sup>st</sup> century. It could be difficult to do so since the rally and the sentiment in the media will likely feel as though all is hunky dory again.

If one of the other major scenarios are unfolding, I can say three things. First, we would still be invested with the market with a goal to capture a portion of the gains expected from the low in 2009. Second, they are key indicators I follow which I believe provide an early warning that I may be wrong, in which case we would get back on the bandwagon once the market picture clears up. Third, other loosely correlated markets could be on a different wave cadence, and allow portfolio diversification and an accompanying reduction in portfolio risk. In general, I am looking at hundreds of charts daily and weekly, reading expert market commentary from a refined list of expert sources to keep abreast of the markets, and developing my own picture of these markets and will not hesitate to change my stance if the weight of the evidence shifts and my methodology indicates something else is afoot.



**Figure 8:** Chart of the Nasdaq 100 index from Jan 07 with a projection thru 2010 (dashed purple, yellow, and white lines. Purple and White are my primary forecast, with yellow being an alternate possibility). The Dow and the S&P500 are expected to follow a similar trajectory.

# Economic & Market Forecast Letter January 2009

## Financial and Asset Management Services offered

I provide a wide array of financial services and products to meet the needs of my clients from financial and retirement planning to retirement oriented insurance products to 401K management to full custom asset management. All my investment recommendations are liquid. All asset management services are provided through H. Beck, Inc., a leading full-service broker/dealer, licensed in all 50 states, with a network of over 400 independent registered representatives. H. Beck reports to the SEC and is a member of FINRA and the SIPC, and is a SEC Registered Investment Advisor (RIA). All assets are SIPC insured upto \$1M per account, and individual cash accounts that are FDIC insured are available through H. Beck currently upto \$250,000 per individual per account. I am a Registered Representative licensed by FINRA and an H. Beck IAR (Investment Advisory Representative) registered with the SEC for providing financial advice and securities products for my clients, and am an associate at RLM Financial Services, Inc. working with Terry Stanfill who has more than 20 years of experience in the financial industry and is one of H. Beck's top financial advisors. He has attended the Wharton School of Business for SEC/FINRA certification, is a graduate of the University of Michigan, and is an Accredited Asset Management Specialist from the College for Financial Planning.

A summary table of services with a brief description is below. The best way to start is to schedule an appointment for a basic financial plan which helps me to understand your financial situation, needs, risk tolerance, and goals. The basic financial plan is at no cost. You can contact me for fee details on the other services. I apply the market analysis and forecasting principles that have already been described earlier in the newsletter to provide any investment advice and management of invested funds. I have no ax to grind, since I am a fully independent advisor. **The best service I provide is that I actively manage all assets invested with me, and am fully available to my clients in person or on the phone.**

| Service   | Description   |
|---|---|
| Basic Financial and Retirement Planning (No Cost)   | Analysis of client's current assets, income, and expenses, along with investment attitudes and financial goals including retirement. I develop a financial plan and make specific recommendations to take the client towards protecting their assets and meeting their goals.   |
| Comprehensive Financial and Retirement Planning   | Same as above, but is enhanced with detailed scenario and what-if analyses, monte carlo simulation of key variables like rates of return, inflation, etc. and tax considerations to get a statistically valid confidence level in the results. A detailed written analysis and plan is provided to the client.  |
| Specific Investment Analysis  | Analysis and short or long term forecasts for individual stocks or specific markets the client may be interested in. Examples include specific advice on when to sell company stock options, exit strategies for current investments, analysis of specific markets like high grade municipal or corporate bonds or even the expected performance of specific mutual funds, etc.   |
| 401K management/ investment direction   | I provide direction on how to invest the client's funds which are captive in a company sponsored 401K plan or SERP (Sheltered Employee Retirement Plan). I would do a comprehensive analysis of available funds within the company's plan and subsequently direct the asset allocation to capture upwards and sideways moves in available markets.  |
| Retirement insurance products (Variable Annuities) with guaranteed <sup>1</sup> minimum income and death benefits | This is one of the best programs in my opinion for retired individuals and those within 10-15 years of retirement. The insurance company provides a 6% guaranteed annual rate of increase on the income and the death benefits. I manage the underlying investment among 40 – 100 world class sub-accounts from top portfolio managers in US and Foreign Equity and debt markets and sectors, timing entry and exit moves. So you either get the yearly return I can provide you with for the underlying account or get a 6% benefit, whichever is greater. You can participate in upwards and sideways moves in select markets in the underlying accounts. |
| RIA Portfolio Management  | This is my premier service which provides the potential for the greatest returns I direct asset allocation in a variety of markets using proprietary Conservative, Growth, and Ultra Growth market timing models utilizing ETF's and protective options strategies if required. Your assets can participate beneficially in upwards, sideways, <u>and</u> downwards moves in the markets and have access to virtually an unlimited set of markets.  |

<sup>1</sup> Guarantees are backed by the claims paying ability of the insurance company and do not apply to the investment performance of the separate account or its underlying investments

## Newsletter follow-up

I plan to publish a client only newsletter with detailed market forecasts, investment strategies, and asset allocation details for my portfolios about 10 times a year. I will publish a more general update (minus the detailed market forecast, investment strategy and asset allocation updates) for the rest of my distribution list at the same frequency. I will also use these letters to communicate any major shifts in the markets or changes to my intermediate and long term outlooks. I appreciate questions and feedback. Hope this was useful to you. Stay tuned for more next month.

Mark 13:28 (Jesus Christ talking about his second coming at the end of the world) **“From the fig tree learn its lesson: as soon as its branch becomes tender and puts out its leaves, you know that summer is near. So also, when you see these things taking place, you know that he is near, at the very gates.”**

## Disclosures

Data from various sources was used in the preparation of this newsletter. The information is believed to be reliable, accurate, and appropriate, but is not guaranteed in any way. The forecasts and strategies contained herein are statements of opinion, and therefore may prove to be inaccurate. They are in fact the author's own opinion and payment was not received in any form that influenced his opinions. This newsletter has been prepared only for informational purposes, and it is not an offer to buy or sell, or a solicitation to buy or sell any security or instrument. Investment strategies described above and portfolio performances detailed, though they may have been profitable in the past ultimately may lose value or prove unprofitable even if the opinions and forecasts presented above prove to be accurate. No representation is being made that the portfolio performance in the past will continue into the future. All that is being represented is that the investment strategies and methodology employed in the past will be applied in the future to a reasonable extent and with continuing improvements and modifications over time. All investments involve varying amounts of risk, and their values will fluctuate. Investments may increase or decrease in value, and investors may lose money. I am not a tax expert nor do we offer tax planning for a fee. Please consult your CPA or a tax accountant for tax related questions. See insurance company prospectus' for further details on the guaranteed insurance products before investing or sending money.