

Graham Dyer's Newsletter

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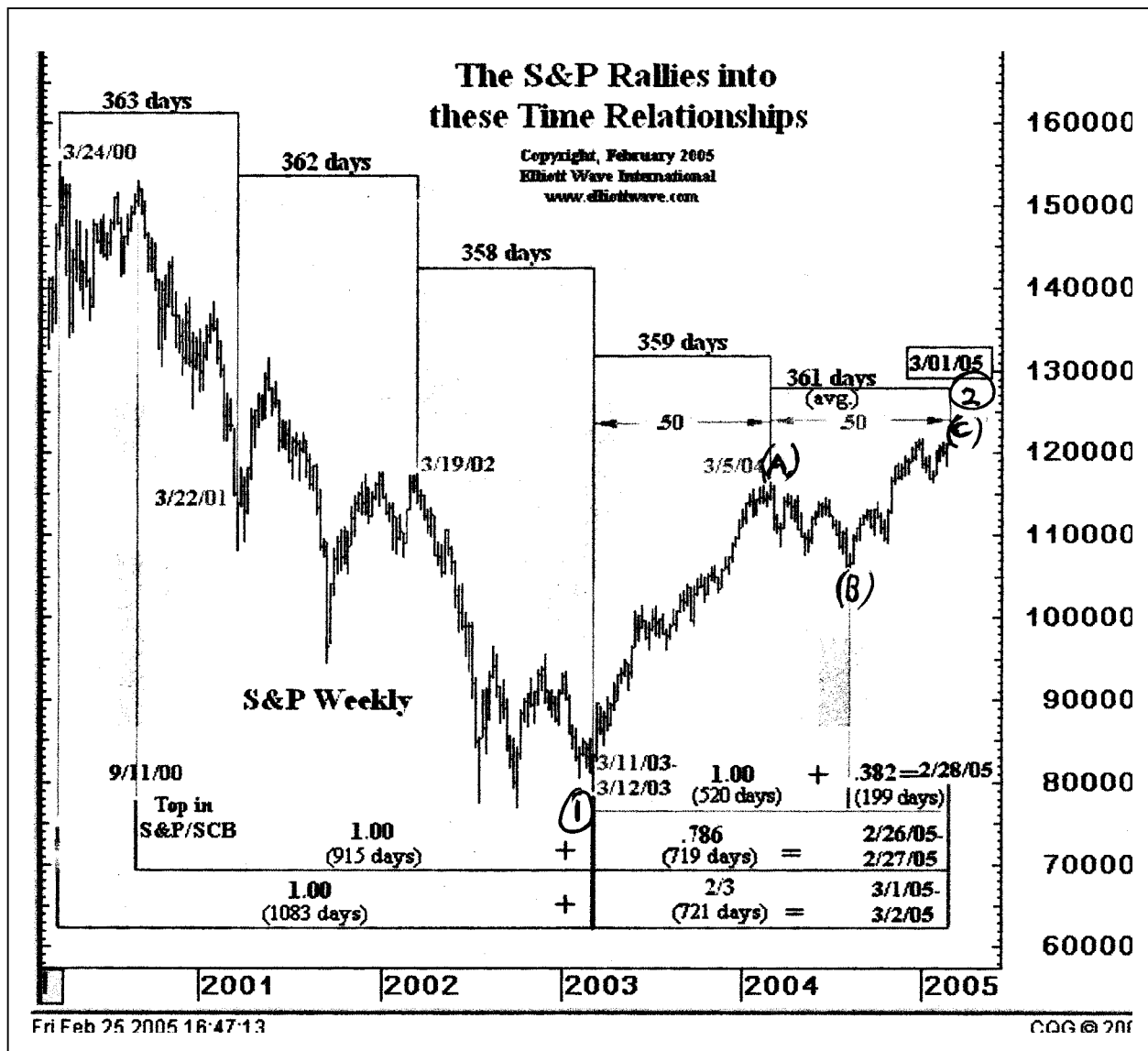
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	This Month	Last Month	Last Year
All Ordinaries Index	4156	4107	3372
90 Day Bank Bill	5.77%	5.47%	5.63%
10 Year Bond	5.56%	5.40%	5.54%
\$A/US	79.14¢	77.41¢	77.03¢

This Month ... Round-up of Major Financial Markets

IS THIS IT? FINALLY?



Phone 1 900 933271 after 11am each Monday for weekly update.

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Have we finally reached the end of **Primary** wave ② in the Dow Jones index and the S&P 500? Can we expect wave ③ down to get underway now, at last?

The chart on page 1 is the one I have been asking you to visualise in my telephone updates. Ignore all the time cycle stuff, which is interesting, if not remarkable, in that it shows significant market turning points at almost the same time each year in this decade so far, suggesting another one is due now. And it all fits with various Fibonacci numbers. However, you know my view on time cycles and time cycles are not my reason for using this chart.

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The chart shows the S&P 500 index on Wall Street for the last five years. What you are looking at is the first two waves of **Primary** degree in what is potentially the biggest bear market for more than 200 years. Wave ① down lasted about three years and saw the S&P fall exactly 50% from 1550 points to 775 points. Wave ② has lasted two years and has seen the index rally back up to 1203 points as at the end of February 2005. There is some conjecture as to where the first wave down ended and the second wave up began. The bottom of wave ① was either October 2002 or March 2003. How we count the five waves of smaller degree that make up that first wave down depends on which of the two dates we choose. What makes it difficult is that so much of the apparent strength in the second wave has been due to a fall in the US dollar, and the chart in any other currency looks different and heavily suggests the March 2003 alternative.

None of that is terribly important here. Let's assume, for the sake of the exercise, it was March 2003. What we need to determine now is: has the second wave up ended yet? If it has, then **Primary** wave ③ down is about to get underway, and as third waves are usually the longest and strongest, some devastating falls on Wall Street lie directly ahead, and this third wave will not be over until the S&P 500 index reaches a level much lower than most "experts" could even imagine at the moment, especially the perpetually bullish ones (like most of them). If it has not, then there are very bullish implications for the share market and the American economy in the months and years ahead.

THE FOLLOWING DISCUSSION MAY SEEM VERY TECHNICAL AND BORING AGAIN, BUT IN THE LIGHT OF WHAT I JUST SAID IT IS ACTUALLY VERY IMPORTANT AND EXCITING, ESPECIALLY FOR BEARS AND/OR THOSE WHO ARE SHORT THE S&P.

Where did we go wrong last time?

Exactly twelve months ago we thought we were exactly where we are now (i.e. at the end of wave ②). Why?

As I have been discussing in my phone updates, the Wave Principle is not a perfect method of forecasting. But it is light years ahead of whatever comes second. It reliably tells us **what** lies ahead, but it cannot always tell us **when**. Wave patterns are about shape and structure but not time or size. What waves reflect is the **mood** of the herd and in particular **changes in crowd mood**. They cannot always reveal **how long** public sentiment will stay the same before changing from optimism to pessimism or vice versa. Also there are short term and medium term and long term mood phases. Thus within a long term bear market (like now) it is not unusual to see short term rallies that seem to be very bullish. Should that be surprising? No. Even on a bad day you can have a positive moment; or when things are going well you can have a temporary setback which only throws you momentarily. As with individuals so with the crowd. The wave ② rally of the last two years has been quite impressive. But we have to look at it in perspective. It is not a new bull market. It is a **medium term rally in a (much) longer term bear market**. That

means a **temporary** period of optimism within a **continuing** period of pessimism. Once the temporary euphoria is over the all-pervasive gloom will return.

Generally speaking the larger the degree of wave we are looking at (the longer the **term** of the mood) the more confident we can be about how it will unfold. However, even with trend changes of large degree there are always alternative ways in which the structure can develop. And wave ② of **Primary degree** has led us on a merry dance for twelve months.

If you look at the chart closely you will see that commencing in March 2003 wave ② took off from just below 800 points and climbed for almost exactly twelve months, peaking at 1163 points on 5 March 2004. **At that time** that looked like the completion of a perfect **(A)-(B)-(C)** rally to complete wave ②. As expected, the S&P began falling in what we thought (at the time) was the early stages of **Primary** wave ③ down. But then in early November 2004 a surprising thing happened. The S&P sailed past its March peak of 1163 points, negating our assumption that March 2004 had been the end of wave ②. It would appear now that the entire move of 370-odd points from March 2003 to March 2004 was only the **(A)** part of wave ②. The **(B)** part saw the S&P fall to 1060 points by August 2004 and we have been in the **(C)** part ever since. (I have hand drawn labels for these waves on the chart).

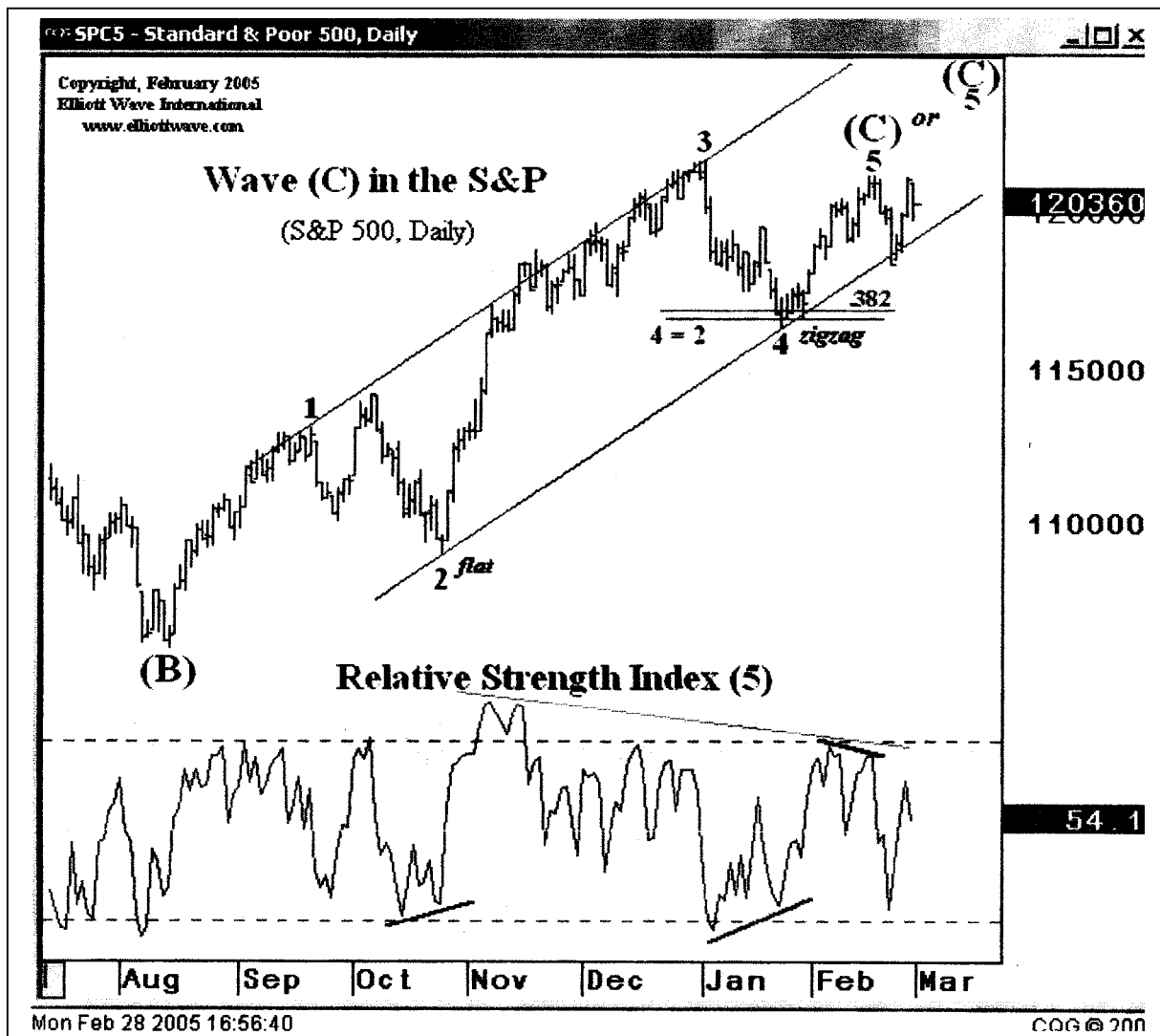
In Elliott Wave terms what has unfolded is a **zigzag**, which is a **5-3-5** structure. Wave **(A)** was made up of five waves. Wave **(B)** was a three wave move. Wave **(C)** will be made up of five waves. We appear to be in the fifth of those waves at the end of February. Once the fifth wave is complete the market should start falling in **Primary** wave ③. This wave may well be much faster and more devastating than the first two waves of **Primary** degree. It will take the S&P 500 well below the wave “bottom” of 775 points. We cannot say how long this will take. Given that the first two waves took an aggregate of five years this one could last for years rather than months. But given that the “point of recognition” is usually reached about half-way down wave 3, we should not be surprised if the downturn accelerates, perhaps after a slow beginning to the wave (see later).

Our next chart (see next page) zooms in to give us a closer up view of the **(C)** part of wave ②. In my phone updates I have been discussing the possibility of a “fifth wave failure” or “truncation,” a rare but not unheard of pattern where the fifth wave fails to pass the extremity of the third wave. You can see from the chart why this has been a dilemma right up to the end of the month. What has made failure a possibility has been the pathetically weak technicals (volume, breadth, momentum, etc.) behind the market, giving the impression that it might not have the strength to finish off the fifth wave. By the time you are reading this we should know how the wave unfolded, but as at February 28 the jury is still out.

So, in answer to the question posed in the heading of this article, (Is this finally the end of the second wave of **Primary** degree and hence the beginning of the big third wave down we have been anticipating?) we can say: Yes, or at least almost. If wave ② is not over at February 28 it is almost so. Once wave **5** of **Minor** degree is over, so will **(C)** and ② be over. Then wave ③ down will begin and we will see real fireworks on the downside. Maybe this year the “Ides of March” will be significant for Wall Street.

Not as bad as economists

Do we need to feel embarrassed or apologise for “getting it wrong” twelve months ago? Good grief, no! If we need to feel bad for not being able to pick the “when” correctly, then economists and other mainstream “experts” would have to apologise **every day** for getting both the “what” and the “when” wrong constantly. And even “The Oracle of Omaha,” Warren Buffett, head of the giant Berkshire Hathaway investment conglomerate, the second richest man in the world (according to Forbes Magazine) and probably the most revered investor in the world, admits



that he “struck out” last year and Berkshire profits fell 10%. Looking at his “reasons” for investing the way he does I won’t be surprised if there are more profit falls to come.

On any day of the week or year we could shoot a cannon through the “logic” that economists serve up to the public. In my phone update on Monday February 28 I drew attention to what the “experts” had to say about the previous day’s “events,” as I often do. It is a typical example of how economists completely reverse their “explanations” within the space of just a few hours and not only don’t apologise, but never even acknowledge the about-face. And so conditioned is the public to this garbage that not only does nobody question the drive; **nobody even notices**.

When revised US GDP figures for the December quarter were announced in the morning, the growth rate of 3.8% that was reported was slightly higher than what economists had expected. And when the share market opened it began falling. Not a problem. Here’s the “explanation” by the “experts” in the media, as told in the headlines:

Stocks slip as stronger than expected growth in the nation’s GDP raised Wall Street’s fear of higher prices. (Fox News)

Stocks head lower on inflation concerns. (ABC News)

Wall Street’s enthusiasm was muted by concerns that stronger economic growth would lead to faster and more aggressive interest rate hikes. (New York Times)

But then a funny thing happened. The market stopped falling and began to rise. And it kept rising. Take a look at how the headlines did a complete somersault, without a blink of the eye:

Stocks move higher on strong GDP report. (Associated Press)

US stocks climbed amid a bullish economic report on fourth quarter growth ... It should reinforce to people that everything is OK with the economy. (CBS Marketwatch)

How ridiculous is that? In the morning the share market was falling **because of the GDP report**. Later in the day the share market rose **because of the GDP report**. That sort of thing goes on every day yet nobody even notices, let alone complains. So why should we feel bad because we thought wave ② ended a year ago when it is only ending now? At least we haven't fallen for the trap of believing that the rise in share prices in the last two years is a new bull market. We know it is merely a second wave rally in a bear market that has some devastating falls ahead of it. We were just premature in expecting the onset of the third wave. In any case, in terms of price, the market has gone virtually nowhere in that twelve month period. The Dow in particular is almost exactly where it was twelve months ago. So apart from the erosion of time no harm has been caused by "getting it wrong." Our patience has been tested and it has been frustrating, but if you sold out twelve months ago you have not "lost" anything. Even if you went short twelve months ago, provided you bought long term puts (e.g. December 2006) you would have only "lost" if you panicked and sold prematurely.

Why do economists get it so wrong so often? I know I harp on this and you may well be sick of me talking about it. But until this becomes automatic in your thinking process you have not grasped the socio-economic insight and you remain easy prey for these pretenders who don't even know they are talking codswallop themselves. They too have probably been conditioned in universities that are funded by vested interests and where they too are taught not to question the "orthodox" view, ridiculous though it may be.

Sorry for appearing to digress here, but a recent experience brought home to me just how difficult it is to change your mindset in this regard. I was talking with a friend who has been reading my newsletter for sixteen years. He agrees with pretty much all I say. Yes, he believes an economic depression lies ahead, and yes, he agrees now is not the time to buy property or shares and yes, he understands the "mood governs events" concept. Well, he thought he did. And I thought he did too. We were having a discussion about the gold price, as he is a bit of a "gold bug." I thought he understood why I believe gold will fall to "below \$US200 an ounce." I showed him the charts and went through the waves (the triple zigzag correction that has been unfolding since 1980, etc.), which he understood reasonably well. But he kept saying: "Yes, but what will **cause** gold to fall?" My answer, of course, was the mood of the herd, the wave pattern, etc. But he would ask me again: "Yes, but what will **cause** it?" And then I realised. He was still infected with the "events govern mood" thinking of economists. He was still looking for an economic or geopolitical "event" to "cause" the gold price to fall, and he just could not conceive of anything that was likely to happen on the world scene or in the financial world that could "cause" the gold price to fall by 50%. Although he thought he understood what is meant by "mood governs events," he really didn't. Because he was so conditioned to mainstream thinking that requires an "event" to "explain" the rise or fall in the market price of some asset, he could not let the socio-economic insight penny drop. And I suspect that nearly everyone reading this newsletter may be having the same problem. That is why I seem to harp on this subject so much.

I hope that in reading here what I said to my friend the penny might drop for a few more of you. I am not scolding anyone for not being able to grasp this yet. I know it is hard. I have always said it is like discovering that the earth is round when all of your life you have believed it was flat. It takes a long, long time to replace old embedded ideas with new ones, especially when the subconscious is involved, and even more so when you are bombarded every day by old thinking through the media and in adopting new thinking you are so out of step with the mainstream that you risk alienation for even opening your mouth. But the advantage you have when the

socioeconomic perception is an automatic part of your thinking process is enormous. Here's what I said to my friend. I think the penny might have finally dropped. I said:

"There doesn't need to be any 'cause,' as in economic or geopolitical 'event,' for the gold price to fall. It will just happen when the mood of the crowd changes. There does not need to be a reason for the herd mentality to change from optimism to pessimism. It just does. And on such a regular basis that there is a pattern to the mood of the masses. And that's what the waves are about. They tell us which way the mood will change next. They might not tell us how long it will take for the next phase in crowd sentiment to unfold, but they sure do tell us which way it will go. So I can't tell you how long it will take for gold to reach \$200, but I know that's where it is headed next. You are looking for something like inflation or deflation or world war or recession or depression or whatever to "cause" even diehard "gold bugs" to turn against gold. **That is back to front.** The first thing that will happen is that **the sentiment toward gold will change for no apparent reason.** Once the sentiment changes the economic, social and geopolitical "events" you are looking for will follow. But they also will be caused **by the change in sentiment.** They will not be the **cause** of the mood change.

The same thing happened (in reverse) four years ago. When gold was \$US250 an ounce in early 2001, the media was full of "reasons" why gold was a "tarnished relic" and "finished as a financial commodity" and "going nowhere" and relegated to being "just another commodity" like copper. Consensus economic thinking was virtually unanimous: Why would you want to own gold, when it pays no interest, and you can invest in "freely exchangeable" currencies and bonds?

But suddenly the gold price turned around and started rising. Over the next 3 or 4 years it nearly doubled. Why? There is no "reason." All that changed was the **sentiment** of the herd. So much so that **now that the price has almost doubled, everyone wants to own gold** these days. And in February 2001 who were the only ones forecasting a rally in the gold price? Elliott Wave International. Why? Because **they were the only ones with the socioeconomic insight.** They were the only ones who understood the Wave Principle. They were the only ones not looking for "events" to "cause" something to happen to the price of gold. They realised that the mood change of the herd would come first, for no apparent reason, just according to the **pattern** of the waves, and any "events" in the economy or in the world that followed would be **consequences of the mood change** and not the other way around.

So I expect we will see deflation and depression in the future **after** the gold price falls. But these will not be the **cause** of the fall in the price of gold. On the contrary. It is the other way around. It is simply a huge change from crowd optimism to mass pessimism that will cause both the fall in the gold price **and** the deflation and depression that will follow. Forget economists. Forget the economy. Forget what George Bush or John Howard or Alan Greenspan are up to. **If you want to know what is going to happen next look at the waves.** They are the only thing that will tell you which way herd sentiment is likely to change next. Everything else will **follow** the mood change."

I am still not sure whether he "got it" yet or not. He is certainly a lot closer than most to understanding it. Here's another attempt to use a simple illustration to help you get the point.

How mood governs events

Say you wake up in the morning feeling really good, for no apparent reason. You bounce out of bed and go for a rare early morning run before jumping into the shower. You feel so good you decide to tackle the lawn mower, which needs repairing, something you have been putting off for weeks. Or you get into the garden or decide to wash all the blankets or all the windows or

walls. Then you go shopping, and while you are out you decide to buy some new jogging shoes. Why did you buy new joggers?

Those who believe that 'events govern mood' (like economists) would say you bought new joggers because you went shopping or because you went for a run. Or if they knew none of that but knew you fixed the lawn mower they might say you bought new joggers because you fixed the mower or washed the walls. Seriously. Economists do this every day and you don't laugh. In fact nobody ever questions them. Economists have to tie your purchase of joggers to some "event" that occurred during the day.

Why did you really buy new joggers? **Because you woke up feeling good, and you have no idea why.** Nor does it matter why. In fact everything you did was because of the mood you were in. **Mood governs events. Not the other way around.** How ridiculous would it be to suggest you are in a good mood because you did some gardening today? Or because you bought new joggers? But that's what an economist would say if that's all the information he or she had about you on the day. And on the face of it, who would question that? You did some gardening and you're in a good mood. You bought new joggers and you're in a good mood. Logic says you must be in a good mood because you did some gardening or because you bought new joggers. But are you in a good mood **because** you worked in the garden? No. **You worked in the garden because you were in a good mood.** See how the economist gets it back to front? The 'event' (working in the garden) did not cause your mood. The 'event' was **a consequence of your mood.** So it is with economic and social and geopolitical 'events.' They do not **cause** the mood of the crowd to change. Herd sentiment changes first and the 'events' that follow are **a consequence of the mood change.** Hence our mantra: **Mood governs events. Events don't govern mood.**

Now what if you knew what sort of a mood you would be in when you wake up tomorrow morning. Would that help you plan your day tomorrow? Of course it would. But economists can only forecast what you will do tomorrow on the basis of what you did today. If asked to predict what you are likely to do tomorrow they would probably say you will go for a run in your new joggers, water the garden you worked in today and mow the lawn, now that your mower is fixed.

But let's say you know you are going to wake up feeling depressed in the morning. Will that affect your plans? You bet it will. You decide to stay in bed, read a book, watch television and eat, in the hope that food will make you feel better. But then you feel worse, because you know you're putting on weight, and you know you have lots of work you should be doing. How would economists explain why you did not mow the lawn etc? Easy. You stayed indoors. Sounds logical? Yes, and who would question it? But it's wrong. It was all **because you woke up depressed.** What if after lunch you were feeling better but because it looked a bit like rain you decided to paint the bedroom and rearrange the furniture instead of mowing the lawn? Economists' explanation? The same. It was because you stayed indoors or it was the weather.

Can you see the point I am trying to make? **What you do depends on the mood you are in. Not the other way around.** Economists say what you do **causes** the mood you are in. That's back-to-front and rubbish. So when you hear: "The share market went up today because ... this and this ..." remember; no matter what 'this and this' is, the 'explanation' will be back-to-front. The 'this and this' happened because of the mood of the crowd, which was probably reflected in the share market weeks or months ago.

For some reason any change in crowd sentiment appears to be reflected **first** in the share market. This is a global phenomenon. The only explanation I have seen for this is that the share market is the only place where mankind can put their own dollar value on their aggregate productive capacity. I hope one day we discover a better explanation. Maybe our old friend

Richard Russell has come up with one. Recently he is reported as writing: *The stock market is the place where the best minds, the most powerful money, the most people – all put their cash on the line. In the end the stock market tells the story.*

Unfortunately we cannot predict how we as individuals are going to feel tomorrow. But amazingly, in the case of the mass social mood (the herd, the crowd, the public) we can predict what mood they are going to be in because **there is a pattern to the mood of the crowd.** That's what the waves are all about. And that's why our method of forecasting, while not perfect, is infinitely superior to and more successful than the economist's flawed approach.

The pattern is not always clear cut. Neither is it in nature, where we see the same patterning. A tree may be tall and straight or it may be squat and sprawling, but we still know it is a tree. Even from a distance we can tell it is a tree, though we may need to get closer before we can identify what kind of tree it is. Similarly a corrective wave (e.g. wave 2 or 4) may unfold as a zig-zag or a double or triple or an expanded flat or a triangle, but we still know it is not an impulsive wave. So **Primary** wave ② took two years to develop rather than one year. But it is still a **corrective** wave. Only if the S&P soared above its February 2000 peak of 1550 points would we have to change our view on that. Looking at the fundamental backdrop to the market, I think we can relegate that to the status of a very improbable alternative.

HOW QUICKLY CAN THINGS CHANGE?

The Australian economy has been riding the crest of a wave for some time now, as has the share market. As one of the "best performing" countries in the OECD block, we have not had a recession for 14 years, and in that period our GDP growth rate has been nearly 4% per annum. Not quite China speed, but pretty good for a "mature" industrialised economy.

And there are no major clouds on the horizon. In fact, Ian MacFarlane, governor of the Reserve Bank, told the pollies last month, in his mandatory semi-annual report to Government, that the reason short term interest rates are likely to be raised soon for the first time in more than a year is "full capacity," "bottlenecks" and "shortage of skilled labour." Did you get those new buzz words? If we hit you with them often enough through the media, they will be into your subconscious and you will no longer ask what they mean.

Like "Iran and 'nukular' weapons." If ever you questioned whether a country that couldn't even beat Iraq in a ten year war could possibly pose a threat to the United States of America, you will soon forget your doubts because we are going to blast them out of your mind by repeatedly reminding you in the media. You must stop imagining that there could possibly be a different agenda, like oil or Israel. It's "'nukular' weapons." Look how you came to accept "weapons of mass destruction" after we reminded you a thousand times. The fact that they never existed is beside the point. We need you to support our agenda, **whatever it is**, so you will be manipulated by our media until you submit, whether you like it or not. If you resist, we will tell everyone that you are a left wing, right wing, extremist, conspiracy theorist, even terrorist threat – there, that should do it; nobody will believe you now. So, like the phoney "war on drugs" and now "war on terror," we are planting some new economic words into your subconscious. Even "war on terror" will be changed to "war on tyranny." Watch for it. And notice too that all the "outposts of tyranny" will be strategically important to the oil cartel.

Incidentally, Scott Ritter, that pesky former UN weapons inspector who kept saying the story that Iraq had weapons of mass destruction was a lie, is now saying the US is preparing to bomb Iran in June. That's why the snow job is being done on us now. (www.rense.com/general63/IRAN)

I realise I am getting off the point a bit here. But I just want you to know that politicians are not the only ones who use spin (via the media) to manipulate your thinking. Alan Greenspan does not speak psychobabble for no reason. In my phone updates I have been warning you to be on the look-out for the repetitive use of words like “skilled labour shortages” and “bottlenecks” and “full capacity.” These catchwords are going to be repeated over and over until you accept that there is a “reason” why interest rates have to rise. The idea that interest rates should be raised in Australia when GDP growth is already expected to fall 50% this year to 2%, and the strong Aussie dollar is already killing our exports, is a nonsense. Retail sales are already falling, inflation is low, wages are low, unemployment is nowhere near eradicated yet, the housing boom has already slowed, business and consumer confidence are admittedly still high but starting to tumble, and the share market is roaring. But even Ian MacFarlane says that is based not on speculative frenzy, but on fundamentals, namely higher profits, which are in turn due to “cost-cutting, strong global and domestic demand and benign wages growth.”

So either the RBA governor does not believe any problems lie ahead for the Australian economy or he has a hidden agenda in raising interest rates. (As if. A central banker?)

Here’s the scenario, then: The share market is at an all time high. It keeps setting record after record day after day. Property is still hot. Lending demand is up yet again. The “miracle” economy is booming. Interest rates are up a bit. They need to go up much more.

Australia February 2005? No. Japan December 1989. What happened next?

On New Years Eve 1989 Japan’s Nikkei index was racing towards 39,000 points at the end of a fifth wave. The property bubble was way out of control but nobody was worried because Japan was “different.” Nine months later the Nikkei index was struggling to hold on to 20,000 points. That’s **a fall of nearly 50% in less than a year!** Interest rates were raised and the property crash and bank collapse that followed were among the greatest ever seen in history. It’s just as well the Japanese are “different” in one respect, because if there had been a major “run” on the banks, as there probably would have been in almost any other country, there is no doubt the decade or more of economic depression that followed would have spread to the rest of the world and not been confined to Japan.

What am I trying to say? Am I suggesting that within nine months the Australian share market will be down 50%, the property crash will be underway, the economy will be spiralling into recession, if not depression, and banks will be collapsing left, right and centre? No. But **neither am I saying that is impossible, just because at the moment it looks impossible. It looked impossible in Japan in December 1989.**

“Oh, yes, but Japan is an extreme example. “ Isn’t it funny that nobody would have said that **before** the turnaround happened? On the contrary; Japan was an extreme example of the exact opposite. In any case what happened in Japan is not at all unusual. Come forward more than a decade to March 2000. The NASDAQ on Wall Street is racing past 5,000 points. Despite repeated warnings that crazy prices for “dotcom” stocks could not be justified (like share and property prices in Japan in 1989/90) investors were still laying into them with their ears pinned back, even though many of these technology companies had never made a sale, let alone a profit. Why? Because this was “different.” This was new technology that was going to revolutionise the world. The “information superhighway,” etc. etc. **Within two months the NASDAQ was down nearly 40%! Six months after that the American economy hit the brick wall suddenly** and the Fed began its panic interest rate-cutting spree.

What I am trying to say is that **the situation can change very quickly**. Just because the bear market on Wall Street has unfolded incredibly slowly so far does not mean that it will continue to do so or that Australia will follow the same pattern. Just because we keep on outperforming the economies of other countries quarter after quarter, or we keep setting new records almost every day on our share market when other countries are not, or that our interest rates are among the highest in the world **does not mean that the situation cannot change very quickly**.

The other thing to note is that in the case of both Japan and the United States **the share market move came first. The economic “events” followed some months later**. Naturally. The share market is the place where a change in mass social mood is **first** reflected. It **precedes** changes in “consumer” spending, saving, fighting, loving, etc.

In Australia the share market right now is telling us that all is well as far as the local economy is concerned **for at least the next few months**. For the time being we can shrug off record trade deficits, interest rate rises, slowing economic growth, etc. because we are still in a good **mood**. But at some time, probably very soon if Wall Street goes in the tank, the Australian share market will peak and begin its long descent. When that happens we will know the mood has changed and the economy is in for really stormy weather. The turnaround in the share market could happen quite quickly. Nobody will ring a bell to tell us when the top is in. Our best way of judging will be to keep studying the waves. They are by far the best indicator of mass social mood. And because herd behaviour has a pattern to it, the waves tell us the most likely direction the crowd will follow next.

Yes we are still in a fifth wave. Yes the market keeps going higher and higher. But as in Japan so in Australia; **this fifth wave will end** – in tears. I cannot tell you **when** it will end. Fifth waves have a habit of “extending,” as did the Wall Street indices in 1998/99. And when it ends there will be disbelief that it’s all over for quite some time after prices reverse and start falling day after day instead of rising. And when the first rally after wave 1 down (i.e. wave 2 up) retraces a substantial part of the losses in wave 1, that disbelief will be reinforced. And then will come the devastating wave 3 down. And halfway down wave 3 will come the “point of recognition” that the party is well and truly over. And that will be too late for most people to take evasive action.

Late News: As this newsletter goes to the printer, the Australian share market has just been hit with an avalanche of bad fundamental economic news (March 1 and 2). First came the announcement of the worst quarterly current account deficit in history – equal to 7% of GDP. Then the Reserve Bank raised interest rates another 0.25% to 5.5%, to the surprise of no-one, but against the better judgement of most. Then the national accounts were released, showing the weakest economic growth since the shock reaction to the GST tax four years ago. GDP for the December quarter grew by just 0.1%. And this follows 0.3% for the September quarter. That’s just above recession level. (And the RBA is **raising** interest rates? Oh, sorry, I forgot; “bottlenecks,” “shortage of skilled labour,” “full capacity,” etc. Silly me.) Then the copper price suffered its biggest fall in eight weeks, and the gold price is on the way down. Then came the announcement that health insurance premiums are going up another 8%. All this against a backdrop of a very twitchy Wall Street jumping up and down on a daily basis but going sideways overall. How much can a share market take? (If you believe the share market is influenced by economic fundamentals, that is.) It was surely only a matter of **how far the ASX would fall**. What did it do?

On March 2 the ASX 200 index passed 4,200 points – yet another all-time record high - for the first time in history. As I said in my telephone update on Thursday morning March 3, what this tells us is:

... two things we already knew, apart from the obvious one that the Australian economy is in big trouble. It tells us that rises and falls in the share market have nothing to do with

economic fundamentals and it tells us that the Australian share market is still in a bullish fifth wave that shows no signs of ending yet. The 'Goldilocks' economy (not too hot, not too cold) that Australia has been enjoying, similar to Bill Clinton's fairy tale run in the 1990s, is over. But the mood of the herd in the share market is still euphoric, so at this stage reality is not going to deter investors from continuing to buy shares. Of course, at the bottom of the next bear market good news won't stop them from selling, either. And none of this will deter economists from continuing to tell us that rises and falls in the share market are dictated by economic and other "news."

I think you all know that I am apolitical, so none of the following should be construed as in any way supportive of one party over another. (I see both major parties as puppets in a side-show, where the strings are pulled by masters they don't even know. The main reason for their existence is so that the media can use them to distract the public's attention from what is really going on behind the scenes). When I heard John Howard hammer interest rates the moment he called the last election, telegraphing his intention to fight the election on this issue, I could hardly believe the deliberately dishonest impression he was creating that interest rates were an issue to fight an election on at the time, any more than I could believe the breathtaking weakness the other side showed in letting him get away with it. His fear tactic that interest rates would be higher under a Labor government (which is only sometimes the case) worked on a public that has been so dumbed down and so laden down with debt that just the mere suggestion that their mortgage might be in jeopardy was enough to frighten people into sticking with the status quo. I still shake my head that the opposition didn't fight back. But what it showed was that deep down Joe Public knows that household debt really is a big problem, and whatever else John Howard may or may not be, he is a brilliant politician and he knew Joe Public has that innate fear about his mortgage, and he played on that. John Howard may also know that when all the Joe Publics panic at the same time about their debt level, **regardless of interest rates**, and close their wallets and start saving, the consequences for the Australian economy are going to be devastating. Already retail sales figures are the worst for nearly nine years, with forecasts of worse to come. But who cares about important stuff like that when there is an election to be won? And now finally interest rates are an issue. But not for Labor.

The political slogging match that erupted after all this bad economic news came out has been hilarious. The last time the current account deficit was so bad that it became a talking point in the media was in 1986, and at that time the then Labor prime minister Paul Keating made an off-the-cuff remark to radio talk show guru John Laws about the next step being a "banana republic" if Australia didn't solve its international debt problem. What a windfall for the media that was. They have dined out on that obscure aside for years. Naturally Paul Keating is now crowing about the plight of John Howard and Peter Costello.

Treasurer Costello, of course, retorts that things are "different" this time. Interest rates, inflation and government debt are all low compared to the Keating days. Keating responds by chiding Costello with one of his illustrations: if you cut back on costs by not repairing and servicing your car as you drive it into the ground, sure you will save money in the short term; but in the longer term you will have a car that won't go. That was his way of saying that the "bottlenecks" and "full capacity" problems and "shortages of skilled labour" now surfacing are the result of neglecting expenditure on infrastructure on ports, etc. over the years for the sake of getting the budget deficit down.

I often have to chuckle at the spin that politicians (and central bankers) use. The reason our trade deficit is so bad (that is, our imports exceed our exports by so much) is because our ports are all run down and hundreds of ships are tied up waiting to be loaded or unloaded at any time, and so we can't take advantage of good world prices for our exports of agricultural and mineral products, etc. etc. And all this is due to infrastructure neglect and government mismanagement,

etc. etc. But hang on a minute; if we can't get our exports out, and that's the reason for our lousy economic performance, and it's because of our ports, then how did we get our imports in? I thought they came through ports as well. Yet nobody seems to ask that question.

Another question that is never asked (and never discussed in the media) is: what makes up the difference between the **trade** deficit and the **current account** deficit? The trade deficit (the Government likes to give it its new, more "respectable" name of 'balance of trade in goods and services') is simply the difference between imports and exports. And that deficit has been running at record levels of \$2 billion or so a month. But that doesn't make \$15 billion for a quarter. Where does the other \$8 billion come from? Ah, we don't like talking about that. That is made up of "invisibles." What are they? Oh, interest and dividends, etc. paid offshore. You mean to our owners? Next question, please. We don't talk about that in the media, thank you.

	1996	2005
Interest Rates	7.5%	5.5%
Growth (GDP)	5.1%	1.5%
Inflation	3.7%	2.6%
Unemployment	8.5%	5.1%
Household Debt	\$289 billion	\$818 billion
Current Account Deficit	\$23 billion	\$54 billion
Foreign Debt	\$193 billion	\$422 billion

The Howard and Costello act still try, at every opportunity, to sheet home all of our current problems to the "terrible mess" they inherited when they came to power in 1996. Tim Colebatch made an interesting comparison between then and now in *The Age* on March 3 (see table above).

Perhaps the greatest irony in those figures is the fact that before the 1996 election the Coalition's "debt truck" travelled the country drawing attention to Labor's "shocking" foreign debt problem. Just look at it now.

All of the above discussion on economic fundamentals is interesting but useless in trying to forecast where the share market and other financial markets are going next. If the fact that the stock market continues to rise and rise in the face of these monumental tell-tale danger signs doesn't convince you that rises and falls in share prices have nothing to do with economic fundamentals I don't know what would.

Neither do newspaper headlines. Here are a few from the *Australian Financial Review* 3/3/2005:

Agents brace for tumbling property prices
Gearing pushes housing speculators close to brink
Howard and Costello's porridge goes cold
Party's over, but no need to panic yet
Consumers lose appetite for shopping
Lenders to waste no time in passing on the pain
Truss (Minister for Agriculture) leads rural dissent
Get ready ... another increase is on the cards
Clouds gather over surplus forecast
\$A swept lower by selling wave

But the headline I was interested in was the one that would explain why the share market rose instead of falling in the face of all that gloom. And here it is:

Warning signs ignored as prices peak

Just like that. Not even the slightest suggestion of an admission that the whole idea of expecting the share market to "respond" to "news" might be totally flawed. Just glossed over, as usual.

And who questioned it? I am aware of no-one. And what did the share market do the next day, after all those headlines came out in that one issue of the paper? It rose again. So how about this item on *yahoo* at the end of the day, under the banner: *Reuters.com. No spin. No agenda. Just the facts. As they happen:*

... A continued strong commodity price outlook and renewed confidence after weak economic growth data on Wednesday helped drive the market higher, analysts said ...

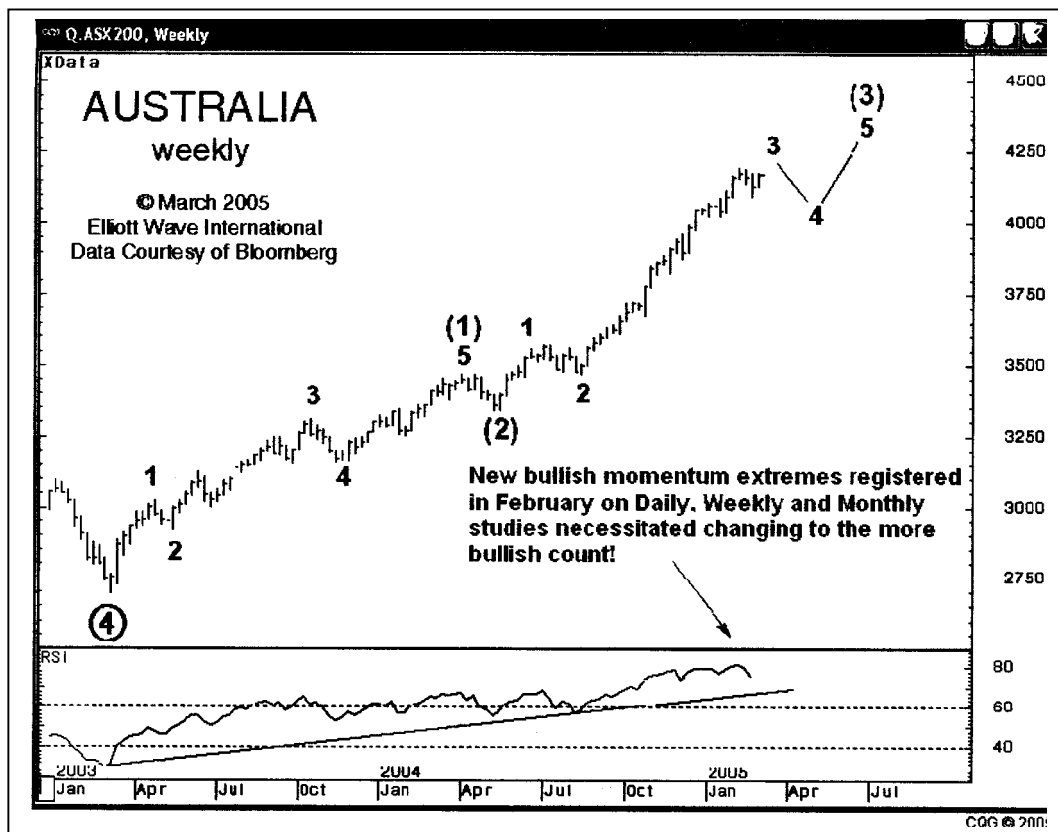
Can you believe this rubbish? Honestly, my job gets funnier every day. I suppose, in fairness, if you believe the earth is flat, then you have to explain everything in that perspective.

THE AUSTRALIAN SHARE MARKET

The only reliable explanation for moves in the stock market and in all financial markets is the Wave Principle. So what are the waves telling us about the Australian share market?

The juggernaut seems so unstoppable that EWI (www.elliottwave.com) have resorted to their alternate count for labelling the waves. So instead of being in the terminal fifth wave of **Intermediate** degree, they are suggesting we are only in the third, and the fourth wave correction we 'have to have' (that 200 to 300 point setback we have been waiting for) will only be of **Minor** degree, with waves **(4)** and **(5)** of **Intermediate** degree still to come. That means there could be quite a lot more bullishness ahead in the Australian share market before it all ends in tears (as in Europe, if our labelling of the waves is correct).

This means I have the same dilemma I had a year or so ago when EWI were making bullish forecasts for the Australian share market while predicting horror for Wall Street in **Primary** wave ③ down. I couldn't see how both could be true at the same time and I thought one would be wrong. As it turned out the forecast for Wall Street was the wrong one and I under-estimated the potential in the Australian bull market.

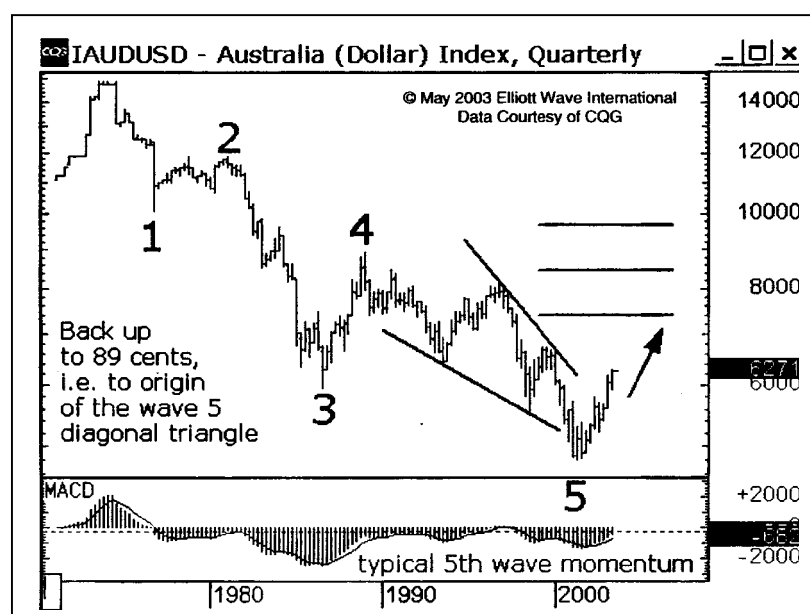


I cannot see that happening again. So we are left with the puzzle: If the Dow and S&P etc. start taking massive losses in wave ③ down, how will the Australian market continue soaring to new heights at the same time? Of course markets in various countries are independent of each other, and it is possible for one to go its own way. But there is also an as yet unexplained synergy within the global herd, and the scale of the carnage in New York is expected to be such that a country like Australia could hardly avoid being affected. Maybe wave ③ down on Wall Street is going to unfold slowly like waves ① and ② (oh, no!), which would give the Australian market time to continue its bull run. Or maybe, as I said earlier, things could change very quickly in Australia and the final waves in the ASX 200 will be short and sweet. We will watch and wait as the waves unfold and tell us. Never forget what the waves represent. We are talking about human crowd behaviour, which, while patterned, can have contrasting extremes. Amazing complacency, sometimes for lengthy periods, and often in the face of serious problems (e.g. the Australian share market at the moment) can quickly change to panic motivated by either greed or fear (e.g. the 1987 crash or the oil price at the moment.) Like a new fashion craze or yo-yo's or hula-hoops or Cabbage Patch dolls or "weapons of mass destruction" or "terrorist alerts" the panic can spread around the world in an instant, especially if fed by the media.

AUSSIE DOLLAR – DUE FOR A CORRECTION BUT GOING HIGHER

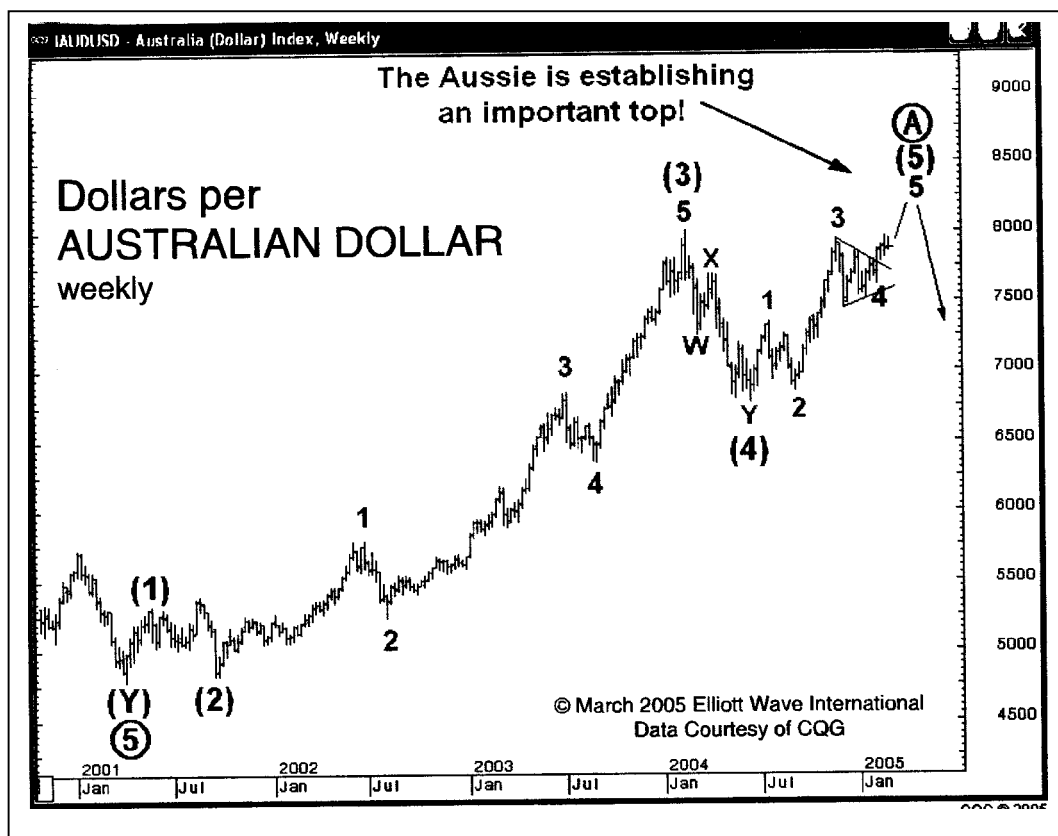
I thought we might take a longer look at the Australian currency this month to get a bigger perspective on what, like the Australian share market, appears to be a relentlessly bullish chart.

First the chart below (though nearly two years old) shows us how, back in the early 1970s, the Aussie dollar was worth 1.5 American dollars. (Ah, what used to be!) One thing this chart tells us is that the "Little Aussie Battler" was in free fall long before it was "floated" (set free to be valued by the international market rather than by local politicians and bureaucrats) in December 1983, which makes a mockery of the contention of those who claim the weakness in the Australian currency is due to deregulation. Yet another example of the fact that financial markets are not governed by fundamental economic 'events.' The market has its own **mood** regardless of 'events' even as major as changing a currency from fixed to floating.



The next thing this chart shows us is that when the Aussie 'bottomed' at US47.75¢ in March/April 2001, that marked the end of five waves of **cycle** degree down since the peak back in 1972. Our next chart shows that all the action since then has been five waves of **Intermediate** degree in the **A (in a circle)** part of an A-B-C move that should take the Aussie dollar back to the region of the end of the fourth wave in the preceding impulse move, which is around US89¢.

The Australian dollar, at around US79¢ at the end of February 2005, appears to be finishing off the fifth wave of **Intermediate** degree, which will also complete wave **A** (in a circle) of **Primary** degree. So after reaching the 80¢ to 82¢ area we should see a sizeable wave **B** (in a circle) correction in the Aussie before the final run up to the 89 cent area. How deep this



correction will be and how long it will take we cannot be sure of until the waves begin to unfold. Wave **V** of **Cycle** degree, from 1989 to 2001, took twelve years and saw the dollar fall from US89¢ to 48¢. The **A** (in a circle) part of the correction has taken four years and retraced about 78.6% of the loss (an important Fibonacci ratio). The US68¢ area is interesting, but we are probably getting a bit ahead of ourselves. As to the time it will take I would not even go there.

The fundamental backdrop to all this, of course, is the hoo-hah surrounding the latest interest rate rise in Australia and commodity prices, which have been very strong. But in the end we (and few others) know these count for nothing. It is the **mood** in the currency market that will determine any change in trend. This may well **lead to** changes in interest rates and commodity prices, but will not be **caused** by these economic fundamentals.

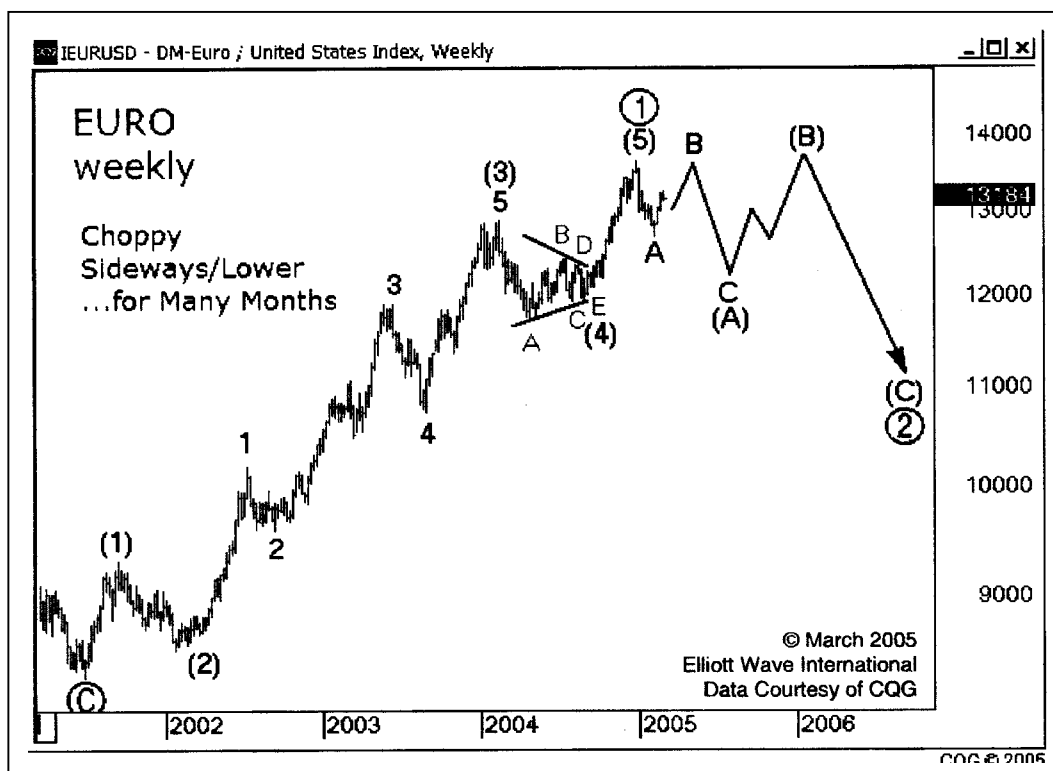
HOW FAR WILL THE US DOLLAR FALL?

And will it be swift or gradual? And how good will this be for gold?

That's the consensus attitude toward the reserve currency of the world. It's not a matter of **if** it keeps falling. It's only a matter of **how far** and **how fast**? Central banks in China and Japan and other Asian countries are not going to keep funnelling their profits from trading with America back into US bonds with US dollars unless the "Greenback" (how I hate the use of that most inappropriate catchword for the US dollar) is discounted further. And there is no way that America can get its humungous trade/current account deficit down unless they can become more competitive in the export market with a cheaper currency. So it's all a foregone conclusion.

Well, that's not quite how we see it in the short to medium term. Longer term the USD might be going to hell in a handbasket, but to the surprise of most, it is likely to have a long, drawn out rally first. The best way to chart the US dollar is to show its exchange rate with its biggest

competitor, the euro. Notice how similar the chart is to the Aussie dollar chart we have just been looking at.



When the US dollar started to rally against the euro at the end of last year we were one of the few to be surprised. In fact, that is exactly what we had been forecasting, on the basis of the wave count. But the rally has been very sloppy and EWI are now suggesting that it will be a “heavy, wide-swinging movement with repeated tests of the lows.” They are suggesting that it will take a couple of years for **Primary** wave ② to work its way down from around \$1.36 to say \$1.13 against the euro. And that sure ain't the consensus view of economists. I don't have a high confidence in this projection because the wave count is not clear cut and time forecasts always worry me. But it will certainly be fascinating to watch.

The question that jumps out at me is if the first wave up, which took about 3 ½ years, saw the euro rally from about US86¢ to \$US1.36, how high will the euro go in wave ③ once this second wave “correction” is over? And what will that mean for the US economy, and, for that matter, for the European economy. And will the gold price maintain its nexus with the US dollar? If so, will that mean the beginning of the new bull market for gold? We await the next exciting episode.

GOLD AND SILVER HAVE COMMENCED THEIR DESCENT

Like the charts for the Wall Street share indices, the gold price fooled us into picking a top prematurely last year. However, the ‘behaviour’ of the gold chart since then has been just about textbook perfect.

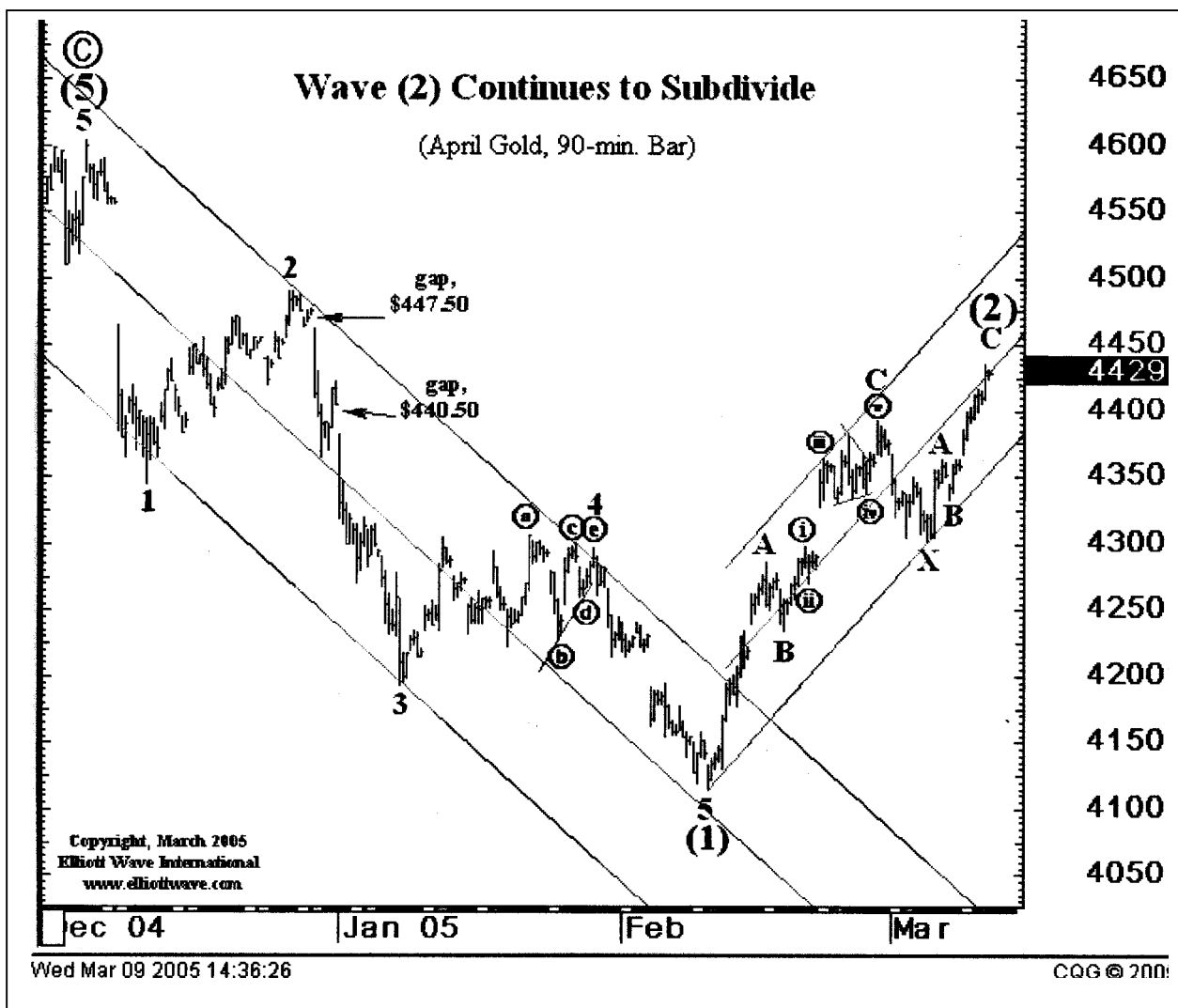
On April Fools Day (April 1) 2004 the gold price hit \$US433 an ounce and then began falling. It looked as though the **C (in a circle)** wave rally that began in February 2001 was over, which also meant the final **X** in the huge triple zigzag bear market since 1980 was also over, meaning that the final **Z** wave down (which will be made up of three legs **(A-B-C)**) was now underway. The wave count was perfect and the structure looked complete.

But gold went on to reach a new high of \$US458 in December 2004. How come? As is so often the case, the fifth wave “extended.” Here’s the chart:



Can we safely say the four-year rally is now over? With my fingers crossed, “Yes.” Nothing is ever impossible and we have to allow the waves to tell us how the herd is thinking. But as the next chart shows, the action since December has been a clear five down-three up move, which has been labelled **Intermediate** waves (1) and (2). However, there is a chance wave (2) could go a little higher before we can call it complete. Next should come wave (3) down, which will take the gold price way below \$US400 an ounce, to the surprise and dismay of all the gold bugs who are convinced gold is in a new bull market. (And most commentators, including those who were rubbishing “the tarnished yellow metal” just a few years ago, could be included in the ‘gold bugs’ description now that the price has nearly doubled. Such is human nature. Such is the impulsive urge to herd and to do what everyone else is doing.) By the time wave Z is over, gold will be “below \$US200 an ounce.” Wave Z will be made up of three waves A-B-C which will probably be a 5-3-5 structure. We appear to be about to enter the third of the first five.

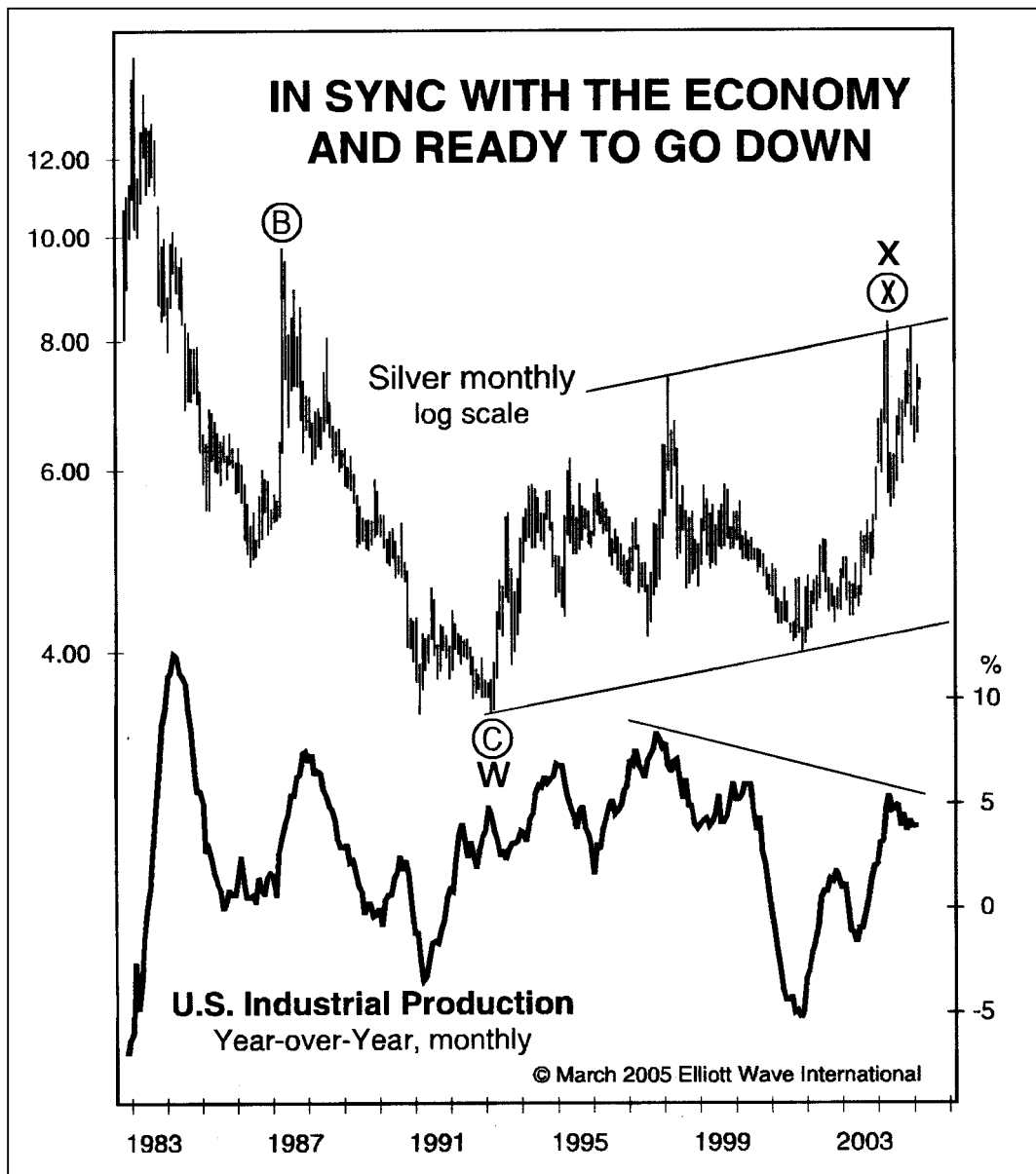
Our next chart shows the action since gold peaked on 6 December 2004:



Silver

I thought I might include some comments from EWI's 'Global Market Perspective' for March. (I hope you went to www.elliottwave.com during "free week." You could have read February GMP for free.) Their remarks about silver are self-explanatory:

Silver's decline in coming months should be even more dramatic than that of gold. One reason is that silver continues to behave more like an industrial than a precious metal ... The chart shows the ebb and flow of silver prices over the year-to-year change in US industrial production. Silver prices basically mirror the economy. Silver should decline more or less in sync with the economy ... Wave 3 of (3) down is due next and should draw silver initially toward \$5.00 and then eventually lower (As at 28/2/2005 it is \$US7.395 an ounce). This outlook implies that the US economy will start moving toward another period of contraction. Japan and Germany, two of the largest G7 economies, are already in recession, and Italy is one quarter away from joining the list. Silver's wave pattern suggests that the US may not be far behind. Note also the divergence between 1997 and 2004, with the dramatic lag in industrial production. We think this is a precursor to depression.



Note that the chart for silver shows a double zigzag since the 1980 peak, compared to gold's triple zigzag. From here on, though, the pattern should be similar – a 5-3-5 A-B-C down in wave Y to “below \$US3.50 an ounce.”

FEEDING FRENZY BACK IN THE OIL MARKET

Back in my October 2001 newsletter I showed you EWI's forecast for the oil price and summed up by saying:

Prechter sees oil at record price levels in years to come. We have never known oil at \$US50 a barrel, let alone higher.

It is now history that oil soared to \$US55 a barrel in October 2004. Two years earlier it was half that price. I have since dealt with economists' nonsense that the rising oil price is “bad” for the share market. In the two years that the oil price doubled the Dow Jones index soared nearly 50%. Yet still this totally erroneous proposition is touted in the pop media on almost a daily basis and never questioned. Thus have the sheeple been dumbed down.

But that is not what I want to focus on here. With the oil price racing into the \$US50s a barrel again, what lies ahead? Could the oil price actually go higher than \$US55 a barrel? What are we to make of this article on *CNNMoney* 3 March 2005?

Oil to hit \$80?

A supply disruption could send crude prices to \$80 a barrel, according to OPEC's Secretary-General.

KUWAIT (Reuters) – Oil prices may temporarily spike to \$80 a barrel during the next two years if there is a major supply disruption, OPEC's Acting Secretary-General, Adnan Shihab-Eldin, was quoted as saying by a newspaper on Thursday.

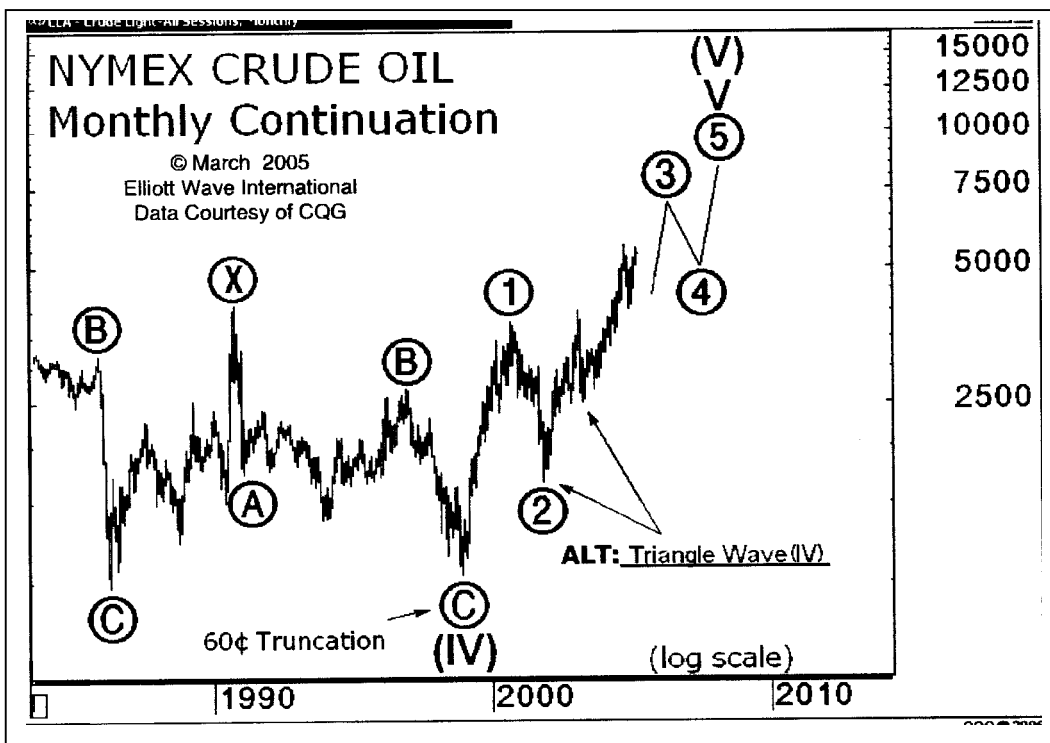
"I can stress that the probability that the price of a barrel of crude rises to \$80 in the near future is a low probability," Shihab-Eldin told leading Kuwaiti daily al-Qabas in an interview in Vienna. "However, I can't rule out the rise of a barrel of oil to \$80 in the coming two years," he said.

If that's not the OPEC chief **and the newspaper** 'talking their book' I don't know what could be.

How seriously should we take this cheeky free plug? **Very.** But not for the reason he gave (supply disruption). That is economists' hogwash. Six years ago (December 1998) oil was \$10 a barrel. A little over two years ago (October 2002) it was \$28 a barrel. Two years later it was \$55. Two months later again it was \$40. Now it's over \$50 again. In what way has supply been disrupted to cause those incredible price fluctuations? The answer is it hasn't been. The stupid media has beaten up the price frenzy with daily stories designed to make us all **think** there is a problem with supply. And even more stupid people, including economists, believe this rubbish.

But **the only reason the oil price has been so volatile is the frantic mood changes of the panicking herd. Nothing else.** And this is exactly what EWI predicted back in 2001.

So, what is the oil price chart telling us now? Take a look. This is updated from October 2001, when oil was a little over \$US20 a barrel and we were making the ridiculous forecast that the price could go above \$US50.



So, could oil go as high as \$80? You bet it could. But the oil price has nothing to do with fundamentals like supply and demand, despite all the hot air from economists. It is a function of **psychology**, as is any financial market. What the waves in the above chart tell us is that the herd is going to be anxious about the price of oil for quite some time yet, and in their panic they are likely to push it quite a lot higher. How do we know? Because herd behaviour has a **pattern** to it. If our wave count is correct, we are in the final part of the **third** wave of **Minor** degree in

the **third** wave of **Intermediate** degree in the **third** wave of **Primary** degree within the fifth wave of **Cycle** degree in the fifth wave of **Supercycle** degree. Did you notice all those “**thirds?**” That’s why the price is flying. Third waves are usually the longest and strongest, but when you see a number of simultaneous third waves of varying degree (“third of a third”) you can usually expect fireworks. An oil price above \$US60 a barrel within weeks should not come as a surprise. However, neither should the corrections when they come. Nothing ever rises in a straight line, and when the price spikes up like oil has been for a while now, it often spikes down just as quickly when it is time for a correction. Enjoy the show.

PROPERTY – WHY RIG THE FIGURES?

When first the share market and then the property market crashed in Japan at the beginning of the 1990s, the damage to the banking system was possibly the greatest financial debacle in history. Yet it was covered over for many years (postponed, not avoided) and a “run” on the banks never eventuated. However, to this day Japanese banks are still trying to grapple with a bad debt mountain the size of which makes Australia’s total banking system look like that of a tiny Pacific Island. How did the Japanese manage to paper over their reality and hide their shame? Easy. **Change the basis.** The banks were allowed (by the Government authorities) to value shares and properties in their balance sheets not at market value (what they are worth at the time) but at historical cost (what was paid for them initially). While this denial did nothing to help solve the problem – in fact made it worse in the long term – it has to be said in Japan’s case that had the public known how bankrupt their banks were there could have been a “run” on them, which may have had even more disastrous consequences, and not for Japan alone.

Much has been said and written about the lengths that Asians will go to in order to “save face,” and how markets in Japan are blatantly “rigged.” But is America any different?

In the late 1990s price/earnings ratios on S&P 500 stocks reached such ridiculous heights that instead of reading P/Es of more than double what is normal (quadruple those in a bear market) those in control **changed the basis** for calculating P/Es. They were to be now based on **future** earnings forecasts rather than past proven results, so they would not look so absurd.

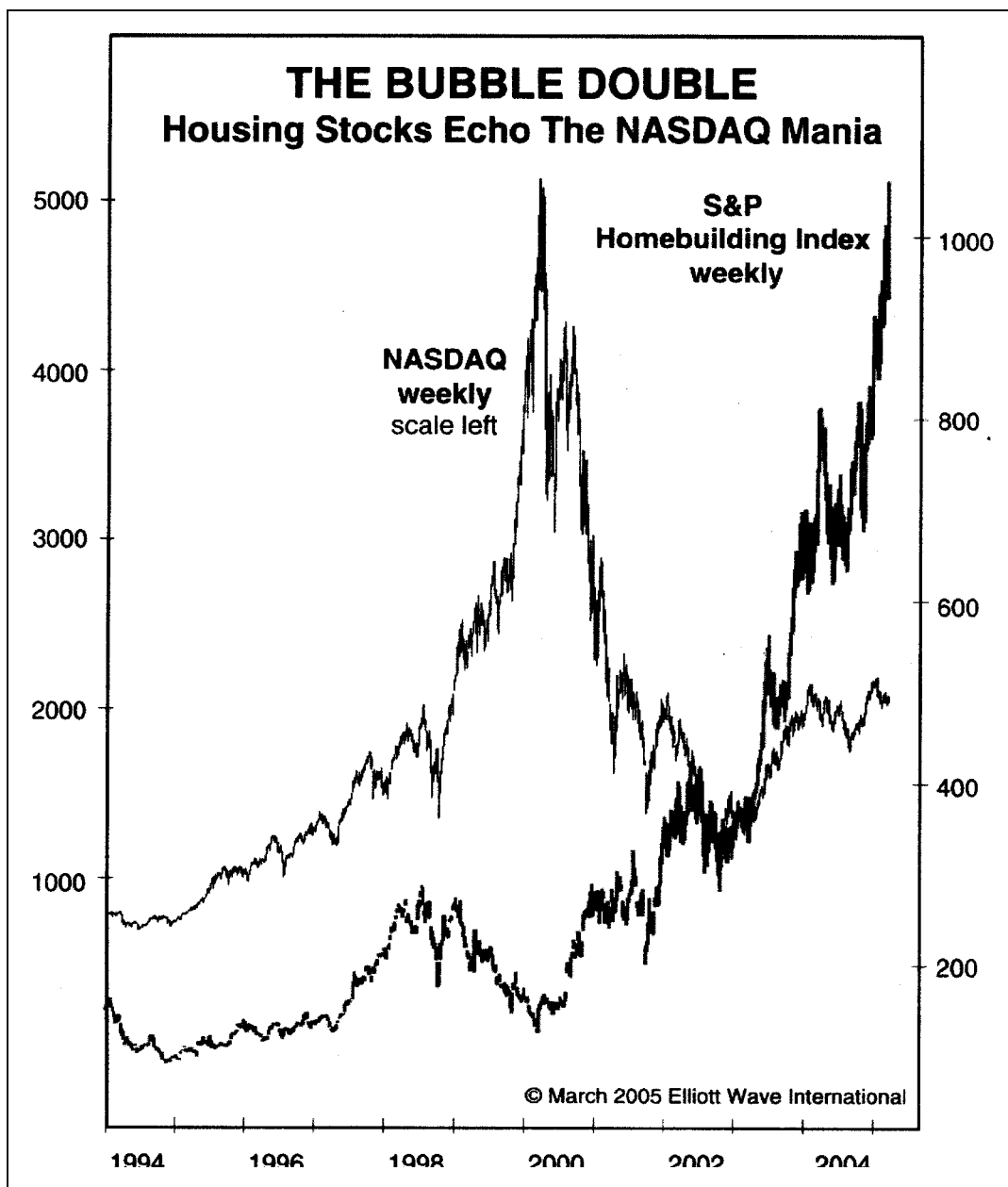
Then the savings ratio in the US became so ridiculous that it was net negative. That is, Americans were spending more than they were earning. Not to worry. Once again just **change the basis** for calculating the savings ratio so it remains positive (for a while longer, anyway).

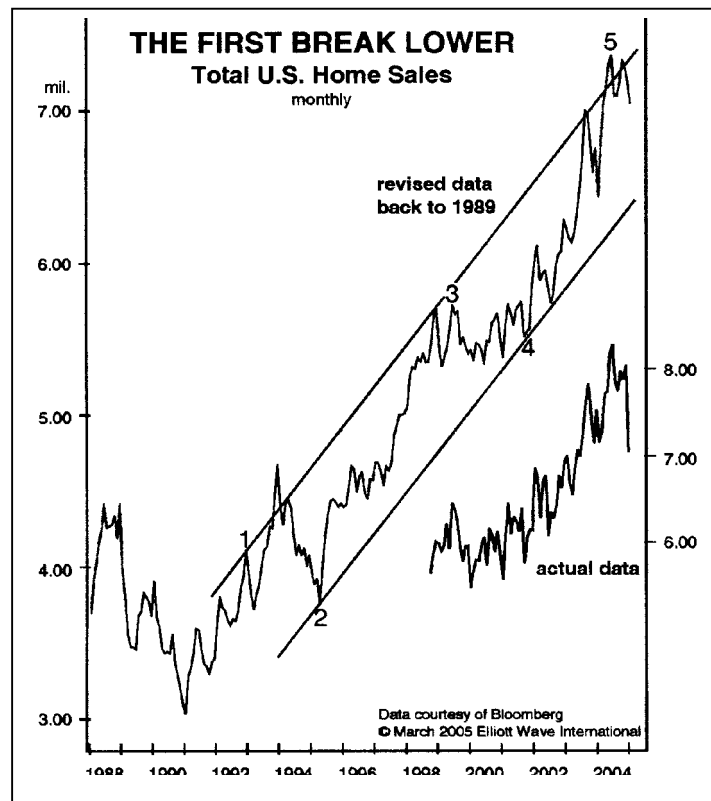
Why am I mentioning this here? Because in January this year the median sale price of a new home in the US fell 13% from \$229,700 to \$199,400. That is the biggest one-month decline since records began being kept in 1963. Also disturbing was the 9.2% drop in January in the number of new homes sold. Before this information was released to the public the National Association of Realtors decided to **change the basis** for recording its data on home sales. In the chart on page 23 below (thanks, as always, to EWI monthly “Financial Forecast - www.elliottwave.com) you can see US home sales back to 1988 (a beautiful 5-wave rise, by the way). The snapshot on the right of the graph shows how the chart for the last seven years would have looked had the basis not been changed. That’s a pretty steep fall in January, is it not?

Why do “authorities” tamper with the basis for calculating data that in many cases has stood the test of time for many decades? Vested interests is obviously one reason, but the mass social mood plays a large part in this as well.

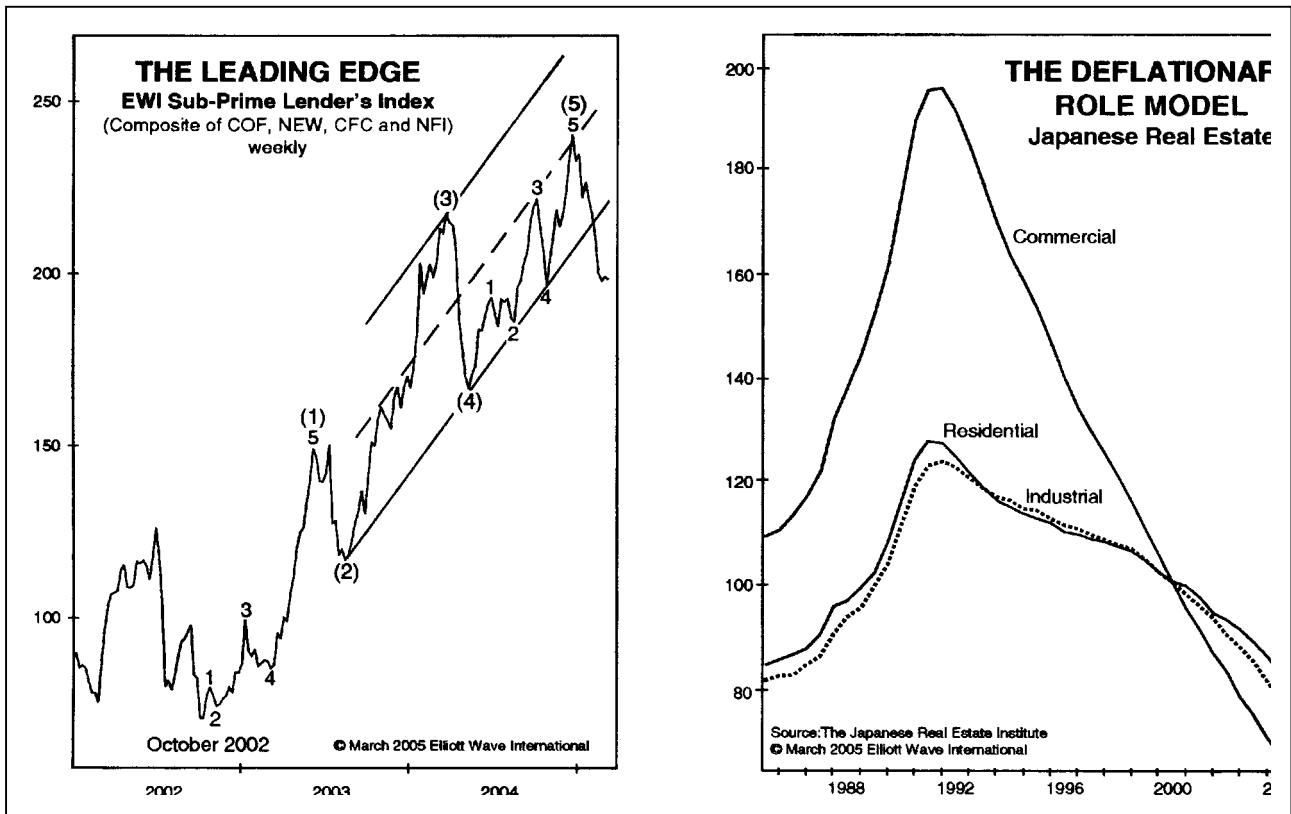
First let's remember that the end of the 1990s marked a peak in optimism of **Grand Supercycle** degree. The previous peak in herd optimism of this magnitude was 220 years ago. So it is not likely to dissipate quickly or quietly. The momentum in positive crowd psychology built up over two centuries is going to take some changing. Inevitably come "shocks to the system," like the "dotcom" crash exactly five years ago. But the first reaction to "reality bites" like these is to **change the basis** because they clash with the prevailing optimism and are just too uncomfortable to accept. As one market goes down interest quickly shifts to another, and before long that reaches manic levels as well.

We often lament the fact that we don't have an 'index' for property. But we can construct de facto ones, and the chart below shows how **just four days after the NASDAQ peaked** five years ago, the S&P Homebuilding Index, which embodies all the companies in the broad index that reflect the housing market in the US, took off. It has since mirrored the NASDAQ in the property boom of the last five years (in America).





EWI has constructed another 'index' in the chart on the next page (left side). It is a composition of four major subprime lenders in the US. I have written about these before. They are the companies that lend to desperados who cannot qualify for a home loan elsewhere. You can see how the chart has already broken out of its trend channel, even at this very early stage of the unravelling of the property market. Are we seeing the early beginnings of "the property crash they have to have" in America? Possibly. The other chart on the next page shows how frighteningly quickly the tide can turn once the mood does finally change. Is there any difference between Japan 1990 and USA 2005? Yes. In 1990 the US and European economies were growing, and the way they survived the recession in the early part of Japan's demise was impressive. This time, when America goes in the tank, Japan and Europe are already there. There will be no "safety net" this time.



Which comes first – the share market boom and crash or the property boom and crash? Who leads – America or Australia? There is no definitive answer to these questions. All booms and busts in financial markets are simply the manifestation of excessive crowd optimism or pessimism. As these moods, and, more importantly, mood changes, unfold they find an outlet in one or more places. Back in 1987 the property boom in Australia **followed** the share market crash. This time the fifth wave share market rally we are experiencing has come **since** the property market peaked at the end of the third quarter in 2003.

The Australian share market **appears** to be about five years behind America. But we usually **lead** America in property trends, as we have this time. In the US the herd is only now catching on to the idea of real estate as an investment, with books like *Building Wealth One House At A Time* hitting the best-seller lists. We have been at that for many years. Interestingly, the National Association of Realtors in America has reported that a “stunning” 25% of the 7.7 million homes sold in 2004 were purchased strictly as investments. Our percentage is more like 40 and has been the case for years.

We can never be certain **when** a market will change or **how long** it will take to move through a phase. But we always know **what** lies ahead. It is painfully obvious that no matter how quickly or slowly the collapse unfolds, the biggest debt bubble in history is going to leave a terrible mess when it bursts. At the moment America seems to have the running in the share market, whereas Australia appears to lead in real estate. What we do know is sufficient to keep us out of the danger zone, so that no matter when it happens or where it begins or how long it takes, we won't be there.

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