ROBERT PRECHTER
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May 2010 issue

This issue was written last month, except for sections one, two and four, which incorporate the latest development. Figure numbers continue from the April issue.

THE OUTLOOK FROM ELLIOTT WAVES AND FIBONACCI TIME RELATIONSHIPS

A Fibonacci Price Retracement

The August 2009 EWT provided a list of Fibonacci price retracements of Primary wave 1 down using intraday price extremes. Once the Dow passed the 50% retracement at 10,334, the next cluster was roughly 1000 points higher, with only these levels remaining:

.600 (3/5) = 11,107
.618 (ϕ) = 11,246
.625 (5/8) = 11,300
.667 (1/3) = 11,625

The Dow met the .618 retracement level when it reached **11,258** at 11:15 a.m. EST on April 26. Then it reversed, as shown in Figure 9.

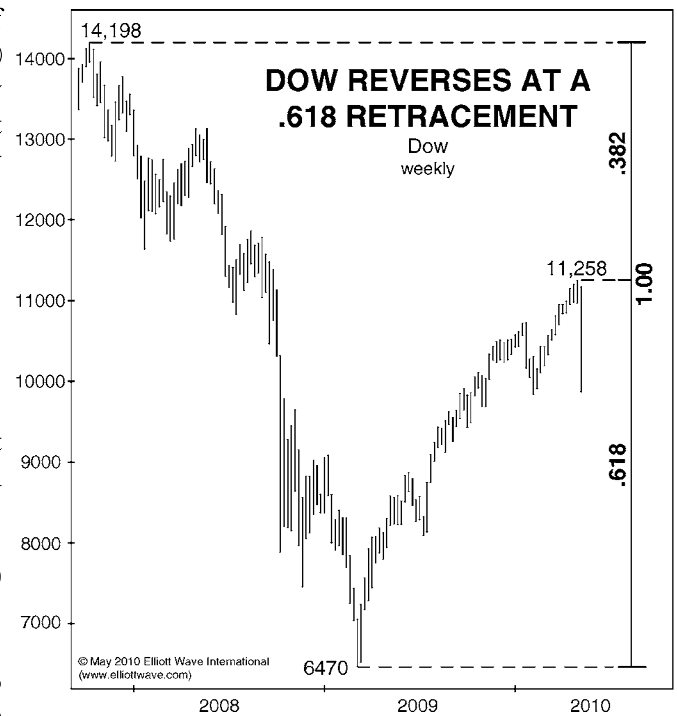

Figure 9

More Support for the Analogy to the 1929-1930 Rally and the 16.6-16.9-Year Span

Here is the time forecast from April:

> If the duration of the current rally were to take the same portion of its ruling cycle that the 1929-1930 rally did, when would it end? The 1929-1930 rally lasted 155 days out of 968 in the cycle (1932 was a leap year), for a ratio of 0.1601. The 16.6-16.9-year span ends between February 19 and June 9, 2016. Applying the 0.1601 ratio to this period of 2541-2652 days from the March 6, 2009 low would give rally durations of 406.81-424.59 days, suggesting a peak in the current rally between April 16 and May 5. Using intraday turning dates projects exactly the same range. *As Beautiful Pictures* shows, time targeting usually works out to within 3 days. With April 14 already behind us and May 8 a Saturday, we can project a top on this basis between **April 15 and May 7, 2010**. April 16, by the way, marks the anniversary of the 1930 rally peak. These dates pertain only if the current rally matches its predecessor in percent-of-cycle terms, which is conjecture, but given all the other evidence it seems a reasonable expectation. By this scenario, the market should peak within three weeks and then fall for six years.

The top in the Dow and S&P to date occurred on **April 26**, right in the middle of that range.

But there is more of interest here. There were two other nearby tops. The New York Composite Index peaked on **April 14** (intraday April 15), and the Dow Jones Composite Index peaked on **May 3**, as shown in Figure 10.

If you read the above paragraph carefully, you will see that accounting for the typical three days' leeway on either side of the ideal projection targeted a high between **April 13 and May 7**. The Dow was still rising, so I chopped the first two days off the forecast. But behind the scenes, the NY Composite had just made its high. The topping process indicates that our projected 16.6-16.9-year span is going to work out, since *all three of these highs* occurred in the projected range *based on that span*.

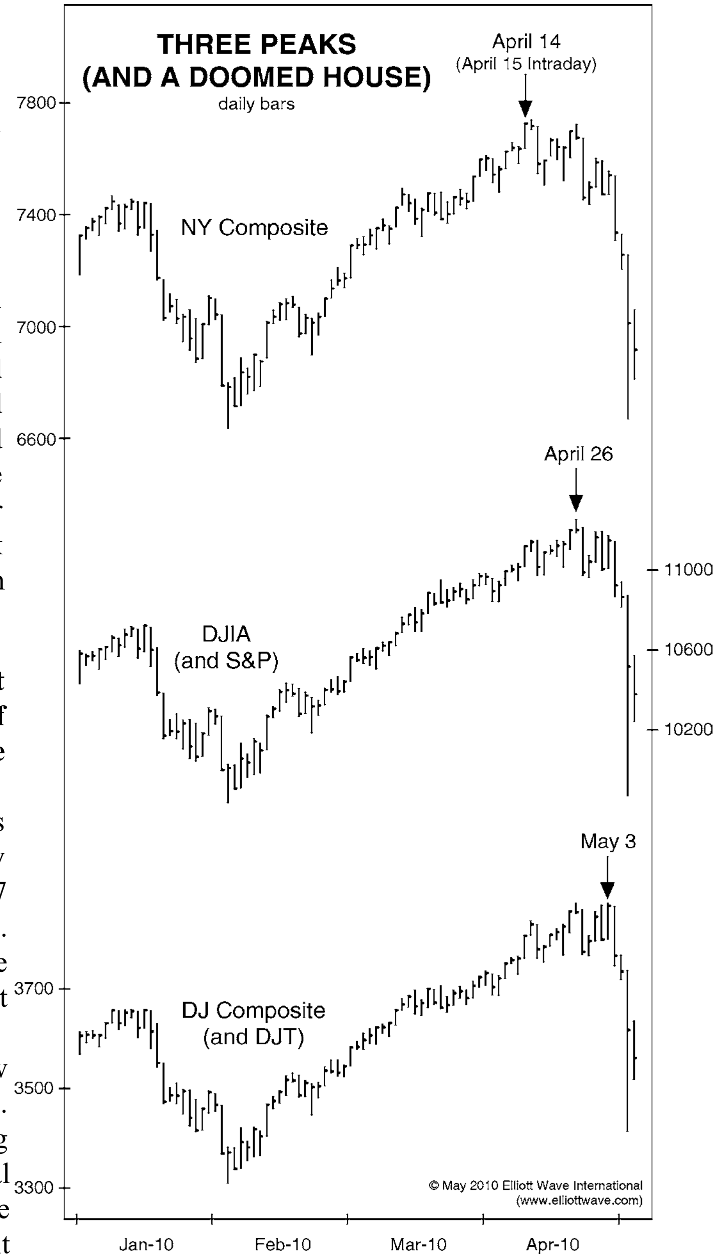

Figure 10

Fibonacci Time Relationships Suggest That the Biggest Stock Market Top Formation of All Time Is Ending in 2010 and That a Price Collapse Will Last Six Years, Until 2016

Beautiful Pictures shows how durations of stock market waves in the 20th century are related by Fibonacci ratios. Figure 11-7 in that book is reproduced here as Figure 11. Developments to date allow us to apply the same type of matrix to derive a possible time target for the next major bottom.

The great wave V bull market in the Dow lasted from 1974 to 2000, a period of 26 years. From 2000 to the present has been a frustrating time. The value of the DJIA in terms of real money has plummeted persistently for an entire decade, yet the greatest expansion of credit (denominated in dollars) in the history of the world has kept the nominal price of the Dow elevated. Even though a "silent crash" has devastated real stock prices, the falling value of the monetary unit due to credit creation brought the Dow to a new nominal high in 2007, and it is once again in five-digit territory. This period of levitation has lasted 10 years.

The only way for the developing configuration to satisfy a perfect set of Fibonacci time relationships is for the stock market to fall over the next six years and bottom in 2016. This outcome will produce the following ratios, as shown in Figure 12:

1. A bull market of 26 years will be followed by a bear market of 16 years, giving a time ratio between them of **13/8**.
2. The bear market of 16 years will subdivide into a topping period of 10 years followed by a crashing period of 6 years, for a ratio of **5/3**.
3. Thus, the *bull-market* portion of the entire cycle will be in phi proportion to the *bear-market* portion; and the *inflated, levitating* portion of the bear market will be in phi proportion to the

As published in *Beautiful Pictures*, 2003

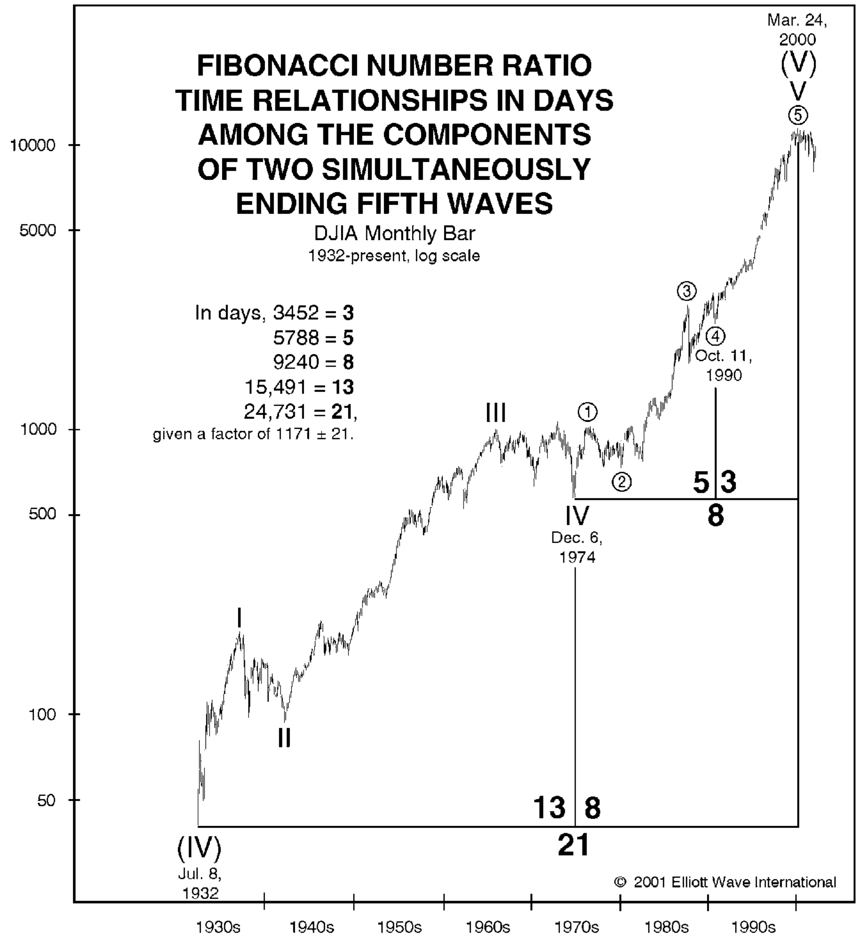

Figure 11

deflating, crashing portion of the bear market. In other words, the bull/bear split of the bear market portion and also of the entire cycle will form a Fibonacci section within a Fibonacci section.

4. The full cycle will last 42 years, providing a ratio of **21/13** to the bull market and a Fibonacci ratio to each of the other durations.
5. The larger bull market from 1932—wave (V)—lasted 68 years, providing a **34/13** ratio to wave V.
6. The combined time ratios use the numbers **3**, **5**, **8**, **13, 21** and **34**, creating a progression of Fibonacci numbers.
7. Designating the entire cycle as lasting **1** time unit makes the smaller durations equal to ϕ, ϕ^2, ϕ^3 and ϕ^4.
8. The actual numbers of years in these durations (6, 10, 16, 26, 42 and 68) reflect a progression of phi ratios: 0.6, 1.0, 1.6, 2.6, 4.2 and 6.85.

If the stock market bottoms in 2016, its time interrelationships will look much like those of the entire bull market from 1932 to 2000, shown in Figure 11. *This analysis perfectly dovetails the forecast from cycles, an entirely separate discipline, as presented in the April issue*.

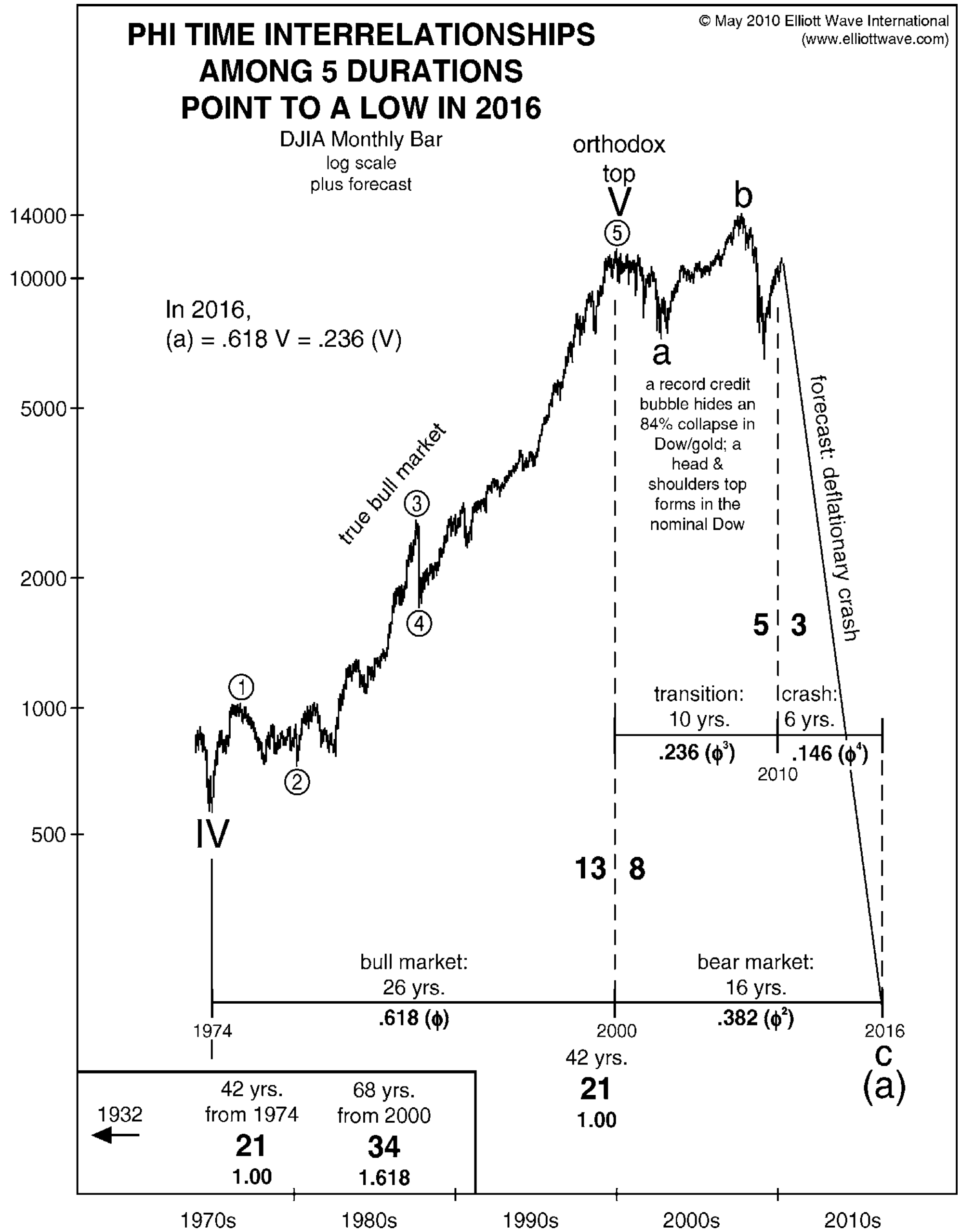

Figure 12

Overlapping Fibonacci Durations in the Topping Formation

The ten-year topping formation displays a set of near-Fibonacci durations, as shown in Figure 13. As in Figure 11, the March 2000 high in the S&P—not the January 2000 high in the Dow—appears to be a focal point for these relationships. The orthodox low of wave **a** in March 2003—not the October 2002 low—is the next focal point. The top in July 2007, when the Dow Industrials + Transports peaked, is the focal point for that year. The following list uses these times unless otherwise noted. The citations of .618, .382 and .236 are approximate.

—The first decline lasted 36 (**34** + 2) months.

—The first advance lasted 52 (**55** - 3) months. To the Dow's high in October is **55** months.

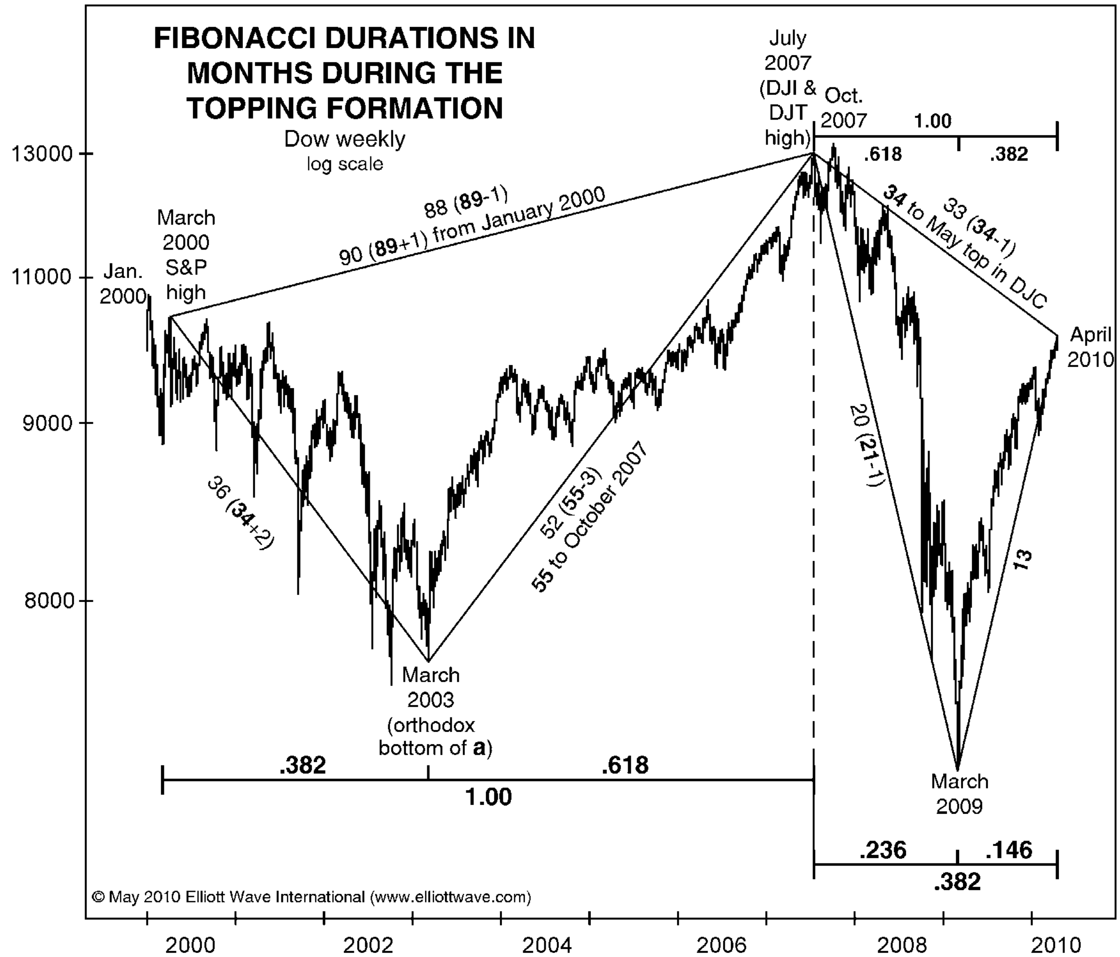

Figure 13

—The second decline lasted 20 (**21** - 1) months.

—The second advance, to April 2010, lasted **13** months.

—From the first top to the second top took 88 (**89** - 1) months.

—From the second top to the third top took 33 (**34** - 1) months. (It is **34** months to the Dow Jones Composite Index peak on May 3.)

—The six durations last approximately **13**, **21**, **34**, **55** and **89** months, reflecting the Fibonacci sequence.

—Each duration is a Fibonacci multiple of the other durations.

—The March 2003 low divides the first top-to-top duration into a Fibonacci section.

—The March 2009 low divides the second top-to-top duration into a Fibonacci section.

It is convenient that the top on April 26, 2010 satisfies the **13**-month time count from the March 2009 low, while the DJC top on May 3, 2010 satisfies the **34**-month time count from the July 2007 high.

An equally good matrix would form with a top 21 months from now, in January 2012. This is also about the time that the 7.25-year and 20-year cycles (see Figures 5 and 7 in the April issue) top out. But as explained in the April issue, these cycles are expected to be left-hand translated—meaning that the market should peak early in these cycles—because all larger cycles are hard down. Figure 12 supports this argument, as does the analogy to the market's action within the 2.9-year cycle of 1929-1932, per Figures 5 and 6 in the April issue. (Perhaps some other event—the last wave-two peak in the sequence?—will occur near January 2012.)

A Postulated Path for the Grand Supercycle

This massive stock market top is preparation for something big. To understand why a major collapse in stock prices lies ahead, we need to begin with the long term perspective.

Figure 14 updates the outlook for Grand Supercycle wave IV first published in Chapter 5 of *At the Crest*. It shows that Grand Supercycle wave III, an advance lasting more than two centuries, has ended. The peak in the 2000s is akin to the peak of wave I in 1720 in England. It is ushering in a corrective process commensurate to the last corrective wave of Grand Supercycle degree, wave II from 1720 to 1784.

Wave II was a zigzag, so according to the guideline of alternation (see text, p.63), wave IV should be a flat (p.45) or a triangle (p.49), the latter form occurring only in the fourth wave position (p.51). Which form is more likely? Because financial bubbles have always resolved with an immediate collapse, the deepest drop should probably occur in the first wave of the correction. The two forms that accommodate this expectation are the contracting and barrier triangle (see text, Figure 1-42). Figure 14 shows that a drop in wave (a) of a contracting triangle would bring prices swiftly down to the lower trendline of the Submillennium-degree channel, which touches the lows of 1842, 1857 and 1932. In 2016, the lower channel line cuts through prices at around Dow 300. The plot in this graph is of *annual closes*, so the Dow can go even lower intra-year and not break channel support.

The correction could take other shapes, as illustrated in *At the Crest*. Figure 15 shows how a flat correction for IV wave would look. It would not bring prices as low as they would go under the triangle form. Whatever the precise configuration, these pictures provide perspective on the kind of wild century it will be for stock prices.

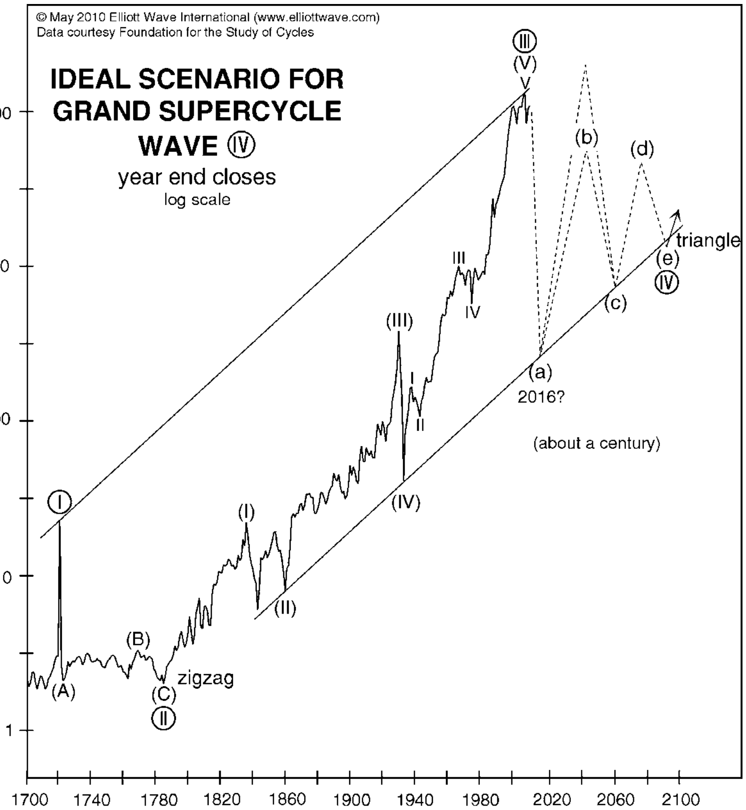

Figure 14

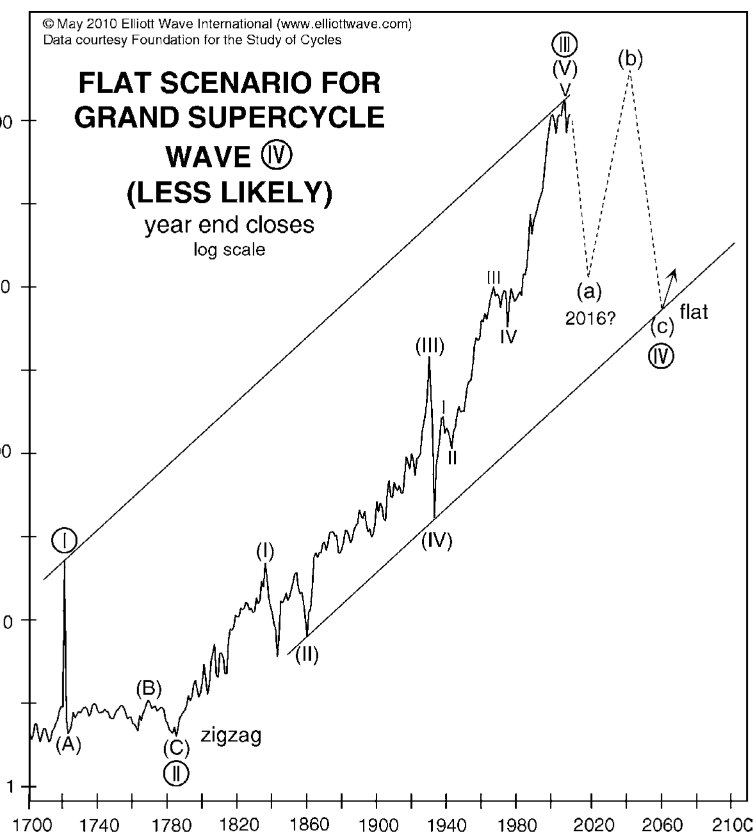

Figure 15

Why a Historically Large Collapse Is Likely

Stock-market bulls and most economists think that a new bull market and economic recovery are underway. Most bears are looking for either a long sideways bear market a la 1966-1982 or a hyperinflationary run to infinity. Our Elliott wave outlook opposes both of these scenarios. The most likely profile is a stock market crash of historic proportion. There are a number of reasons why the Dow should decline into *three-digit territory*:

Technical Reasons

1. The bear market is of Supercycle degree, the biggest since 1720-1784. It should therefore include a decline deeper than the 89% decline of 1929-1932. A decline of 91.5% or more would carry it below 1000.
2. One guideline (see text, pp.66-68) of Elliott wave formation is that a bear market will generally carry into the price territory of the preceding fourth wave of one lesser degree. A.J. Frost and I cited this guideline in our 1978 book in anticipation of the aftermath of our forecasted great bull market. We said then, "once the current Supercycle V has ended...the Grand Supercycle bear should carry to its expected target within the range of the previous Supercycle fourth wave, between 41 and 381 on the Dow." This is the origin of EWT's long-standing forecast for the Dow to fall "below 400." The extreme height that the bull market attained is irrelevant to this target area.
3. Declines following manias always carry *below the starting point of the mania*. In May 1997, EWT published a study titled "Bulls, Bears and Manias," which is reprinted as the first chapter in *View from the Top*. The crashes following the Tulip Mania of the 1630s, the South Sea Bubble of the early 1700s and the Roaring 'Twenties bull market all brought prices to below the level of the bull markets' starting points. In this case, the mania-style bull market—Cycle wave V—started in 1974 at Dow 572. The 1982 low, a possible orthodox end of Cycle wave IV (see the Appendix in *Elliott Wave Principle*), is at 777. On this basis, the coming crash should take the Dow below 777 and probably below 572.
4. The trend channel for the Submillennium-degree wave (see Figure 14) indicates support in the area of a triple-digit Dow. If Grand Supercycle wave Ⓘⓥ turns out to be a contracting triangle, as expected, the first wave down in that formation will be its deepest; in the current case, it would meet the lower channel line in the *low* triple digits, as illustrated in Figure 14.

Socionomic Reasons

1. Thanks to the great rise in positive social mood, the stock market remains historically overvalued in terms of dividends and earnings. Declining social mood will cause a decline in stock valuation. A return to the bear-market-bottom valuation levels of the 20th century would require that the stock market averages fall 60-70% from current levels, *even with no decline in dividends or earnings*.
2. The trend toward negative social mood will lead to an economic contraction. Small bear markets lead to recessions; big bear markets lead to depressions. The current bear market will be the biggest in nearly 300 years, so the depression will be correspondingly deep. During the slowdown in economic activity, corporate profits will become losses, earnings will go negative (again), dividends will fall, and the worth of corporations will fall. A depression deeper than that of 1933, which the waves portend, could reduce the general value of corporations by 80%. Stock prices will reflect these changes in corporate value.
3. The greatest extreme in positive social mood in centuries has led to the greatest expansion of credit in history. The level of outstanding debt is unsustainable and will be unserviceable and unpayable in the deepest depression in 300 years. The trend toward negative social mood that has been in progress since 2000 and which is about to accelerate will continue to curtail lending and lead to a tidal wave

of defaults and a terrific deflation. (For a detailed argument for this case, see *Conquer the Crash*.) Every one of the three manias cited in item #3 above—all fueled by credit and leverage—led to deflation. The amount of outstanding credit today is so large that system-wide defaults could lead to as much as an 80-90% decline in the volume of dollar-denominated credits worldwide. Prices of everything, including corporate shares, would fall to reflect this change in the total supply of credit. In such an environment, surviving dollars and dollar credits, representing the denominator of the DJIA, will rise in value, and the Dow—along with everything else not used as money—will fall in dollar price.

4. A trend of Grand Supercycle degree toward negative social mood will bring a frightening degree of social unrest. Under such conditions, people will desire money, not stocks.

Obviously, this outlook is extreme beyond all investors' present imagining. But consider how these socionomic expectations combine to indicate much lower prices: Downward adjustments in stock-market valuations by 60%, corporate worth by 80% and the dollar-based credit supply by 80%—*all at the same time*—would produce an overall stock-price decline of 98-99%. I consider a forecast of a 92% decline or more—i.e. calling for a triple-digit Dow—to be conservative.

Support Levels for the Ultimate Bottom

Structural support levels within the preceding fourth wave of one lesser degree, as listed in Chapter 5 of *At the Crest*, are **95**, **161**, **195** and **295.** These are the values at the 1938 and 1942 lows, the 1949 low, the 1937 high and 1929 low (matched at the 1948 high), and the 1930 high (matched at the 1953 high) respectively, as shown in Figure 16. If the Dow falls into the area of wave (IV), it may stop at one of these levels, which would complete a fall of 98-99%.

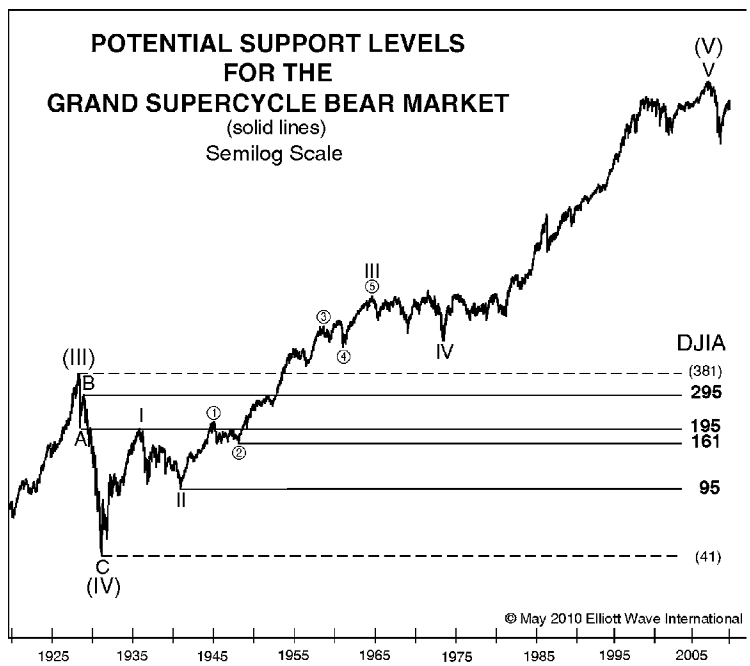

Figure 16

The 2010-2016 Bear-Market Wave

Look at the price pattern of the 1930-1932 decline in Figure 6 from the April issue. It was a stair-step affair, with five or six significant rallies along the way. If this is the model for the 2010-2016 period—as I believe it is—then the market will stage a series of collapses and rallies over the next six years until it reaches its final low in 2016.

Figures 17 and 18 update my Elliott wave forecast using the two valid orthodox tops of 2000 and 2007, as discussed in detail in the April 30, 2007 issue. Figure 17 uses our preferred count. Figure 18 is compatible with the **a-b** wave labeling of November 1929 and April 1930 (see Figure 5-5 in *Elliott Wave Principle*). All in all, there won't be much difference in the outcome.

Several issues of EWT in recent years discussed the potential for cycle bottoms in 2010, 2012, 2013 and 2014. The profiles in Figures 17 and 18 suggest that we will in fact get temporary bottoms just about every year on the way down. Whether we choose to call it one big crash or a series of crashes, it's going to be a memorable time.

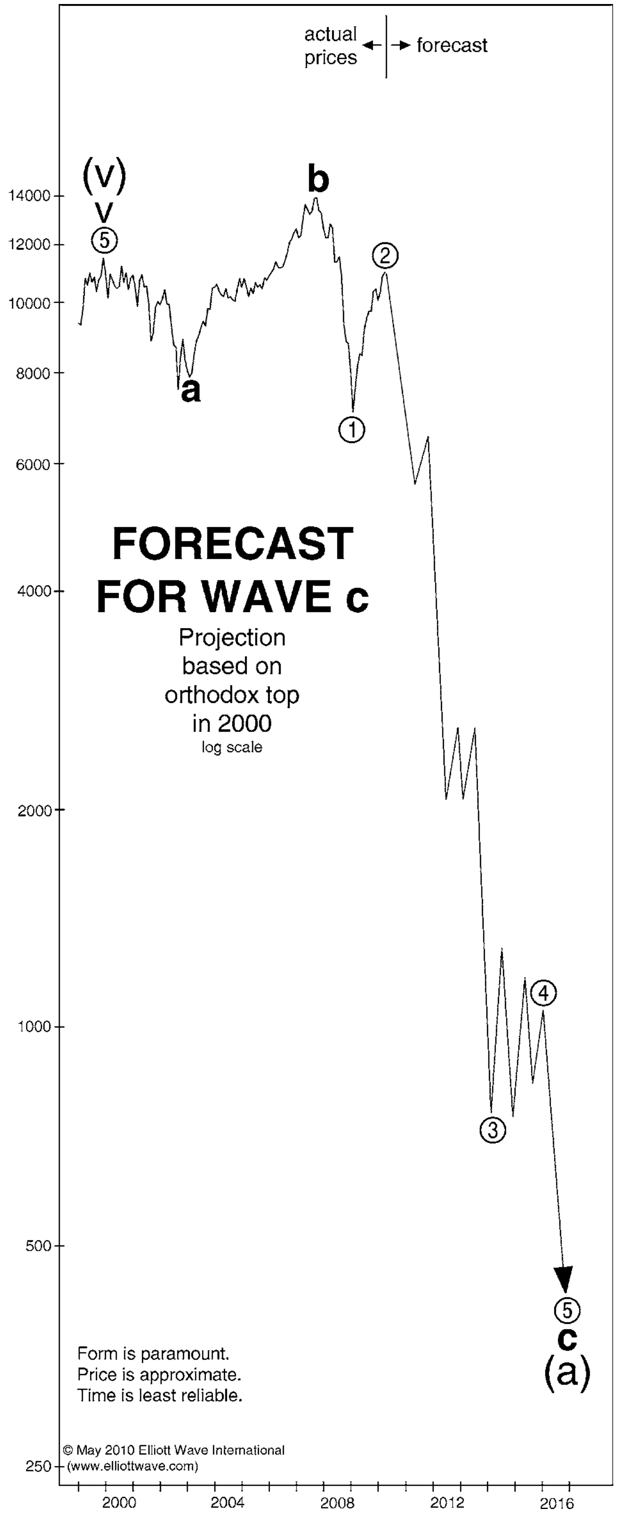

Figure 17

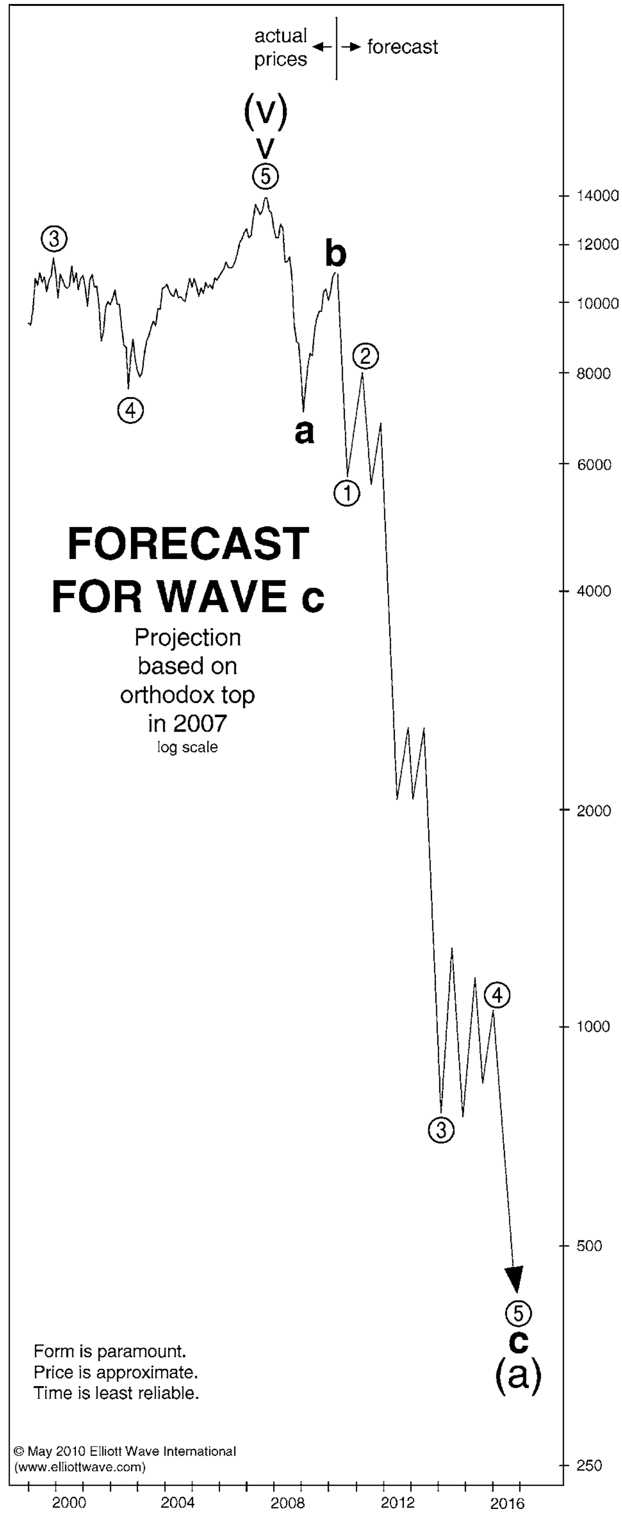

Figure 18

Timing the Demise of Hope

One of the most interesting things about the coming decline will be its initial slide down the Slope of Hope. The past ten years have seen an unprecedented sustaining of optimism in the face of deteriorating financial market and monetary conditions and a deteriorating economy. Even though the market is about to begin its greatest decline ever, the era of hope is not quite finished.

Second waves rekindle optimism. Recall the environment after the peak of October 2007. The stock market slipped for a month and then rallied in Minor wave 2 into December; the consensus called for new highs. The market slipped again, harder, into January-March 2008 and then had an even bigger rally—Intermediate wave (2)—into mid-May, as optimism soared again. In June-July, the market plummeted, but the bounce of wave 2 of (3) into August, against a background of promises and actions from the Fed and the government, kept alive beliefs that the market was making a bottom. It wasn't until the third wave of the third wave (see text, p.80 and the discussion in the January EWT) in mid-October—*a full year after the high*—that investors gave up and began to fret about how low the market would go. The decline that begins in 2010 will proceed along similar lines. But this time the entire decline will last four times as long as the 17 months of wave 1, so the entire process of dashed hopes will take longer. The fall will also be much deeper, so it will be impressive to watch how tenaciously investors, government and the Fed cling to hopes despite the market's continual falls to new lows. The era of hope will end when the last second wave is over and the last cycle has topped, just before the center of the declining structure.

The outlook from time cycles presents precisely the same picture. Look at Figure 6 from the April issue and notice that at the rally peak of February 1931, the 3-year cycle was topping out. On the chart it is marked, "peak of cycle; optimism still dominant." At that time, the Dow had rallied back to the level of the 1929 low, and records show that investors and economists continued to declare that the worst was over. The same thing should happen this time, on a larger scale: The 7.25-year and 20-year cycles are both scheduled to top in 2012, suggesting that 2012 will mark the end of the last vestiges of self-destructive hope. Then the final years of decline will usher in capitulation and finally despair.

This scenario implies that the banking system will not close down all at once; the crisis will come in waves, each one more devastating than the last. The good news is that, by utilizing the safest possible institutions, we may be able to profit from the short side for several years to come before the financial payment system breaks down. It also implies that the accompanying bear market in commodities will be drawn out over the entire time, keeping inflationists committed until the bitter end. The process will ultimately generate thousands of bank failures and many personal, corporate, municipal and sovereign-government bankruptcies. Continue to keep the bulk of your money in the safest possible forms.

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