

# The Elliott Wave Financial Forecast

Edited by  
Steve Hochberg and Pete Kendall



12 Monthly Issues plus Special Reports and Interim Bulletins

A publication of Prechter's **Elliott Wave International**

© September 2010

(data through September 2)

| DJIA WAVE STATUS: SUMMARY & OUTLOOK |               |             |                   |                        |                     |           |                 |
|-------------------------------------|---------------|-------------|-------------------|------------------------|---------------------|-----------|-----------------|
| Wave Degree                         | Date Began    | Wave Number | Current Direction | Significance To        | Optimum Strategy    | Target    | Next Best Count |
| <b>GRAND SUPERCYCLE</b>             | JAN. 14, 2000 | ④           | DOWN              | U.S. SURVIVAL          | PRESERVE CAPITAL    | Below 400 | --              |
| <b>SUPERCYCLE</b>                   | JAN. 14, 2000 | (a)         | DOWN              | ECONOMIC CONDITIONS    | DEPRESSION UNDERWAY | Below 400 | --              |
| <b>CYCLE</b>                        | OCT. 11, 2007 | c           | DOWN              | INSTITUTIONAL INVESTOR | HOLD CASH           | Below 400 | --              |
| <b>PRIMARY</b>                      | APR. 26, 2010 | ③           | DOWN              | INDIVIDUAL INVESTOR    | CASH OR SHORT FUND  | --        | ②               |
| <b>INTERMEDIATE</b>                 | APR. 26, 2010 | (1)         | DOWN              | TRADERS                | HOLD SHORT          | --        | (C)             |

## BOTTOM LINE

Every short-term upward stab in stocks keeps investors hoping that the bear market is finally over. It is not. The larger downtrend returned back in late April, and stocks are setting up for a powerful leg lower. Credit spreads continue to widen, which is consistent with EWFF's core bond forecast. Optimism toward U.S. Treasury prices has reached an extreme in conjunction with the end of a four-month rally. An intermediate-term trend reversal is at hand. The psychological environment that attends most market highs is present in precious metals too. As a result, gold and silver have made little to no upside progress from May through August. The U.S. Dollar remains in a large advance. The latest up leg started on August 6 at 80.09 and should eventually carry well into the mid-90s.

## ANNOUNCEMENTS

Meet Bob Prechter and Steve Hochberg at the **New Orleans** Investment Conference on October 28, 2010. This yearly event is truly a do-not-miss occasion with some of the biggest names in the investment world scheduled to speak. See for yourself and sign up at [www.elliottwave.com/wave/NewOrleans2010](http://www.elliottwave.com/wave/NewOrleans2010) to hear EWI's most up-to-the minute forecasts.

EWI's 8-part online trading course, "How to Trade in a Fast-Moving Bear Market," quickly filled up to our planned maximum capacity. In order to accommodate demand, we've made five more seats available for the September-October session, which begins September 16. We've also added a session that starts on October 12. Learn more about this exciting new online event and reserve your virtual seat now at [www.elliottwave.com/wave/EWTutorialOnline](http://www.elliottwave.com/wave/EWTutorialOnline).

One-on-one "Coaching for Elliott Wave Traders and Investors" is now available! We're excited to announce that Beacon Learning Group is expanding their personal coaching services with the launch of their new Elliott wave program. If you're interested in this personalized service, check out Beacon's new coaching program at [www.elliottwave.com/wave/announcingEWCoaching](http://www.elliottwave.com/wave/announcingEWCoaching).

The response to EWI's new Certified Elliott Wave Analyst program for individuals and financial professionals has been very positive. Years in the making, this painstakingly-crafted testing program will objectively confirm, and certify, your Elliott wave knowledge. Learn more about the new CEWA program now at [www.elliottwave.com/wave/announcingCEWA](http://www.elliottwave.com/wave/announcingCEWA).

EWI's newest on-demand trading course, "The Wave Principle Applied — How to Spot a Pattern You Recognize and Put Your Trading Plan into Action," is now online. Jeffrey Kennedy shows you how to spot an actionable pattern, formulate your trading strategy and see it through to completion. Learn more at [www.elliottwave.com/wave/TheWPApplied](http://www.elliottwave.com/wave/TheWPApplied).

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**THE STOCK MARKET**

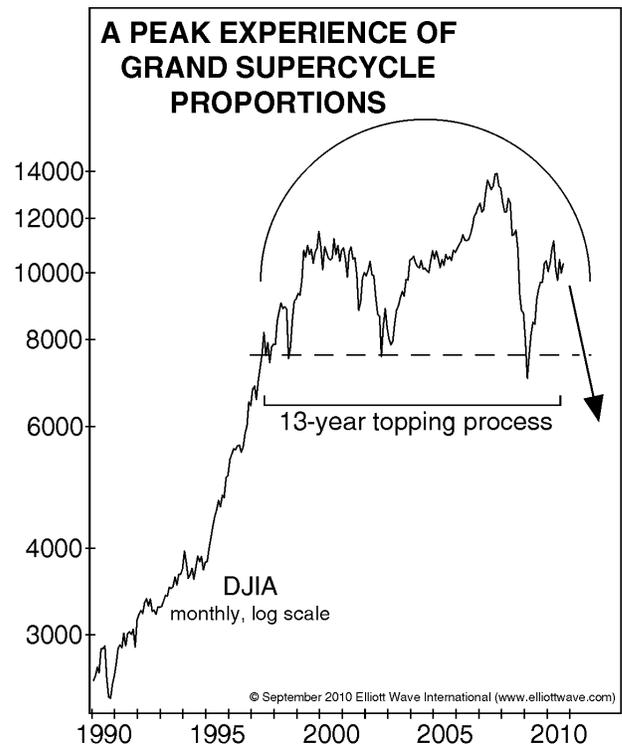
The DJIA's worst August in nine years (-4.3%) should signal the resumption of the downtrend that began in April, as *The Elliott Wave Financial Forecast* called for a month ago. As we also pointed out last month, August can be a big month for trend changes. We were specifically referring to a long line of stock market reversals discussed in EWT and EFFF (see page 2 of August issue). As the Dow now abandons the territory traversed through this 13-year topping process, the last vestiges of extreme optimism produced by the Great Bull Market will be wrung out and a dramatic bear market alteration of the social order will pick up speed.

On a shorter term basis, the chart below shows that the stock market completed the right shoulder of an eight-month-long head-and-shoulders topping pattern on August 9 when the DJIA pushed to 10,720, essentially matching the termination level of the left shoulder at 10,730 on January 19. A close beneath the down-sloping neckline at 9500 will confirm the completion of the pattern and target the area near 8000 for a measured move. Eventually, the March 6, 2009 low of 6470, the low point within the entire 13-year top shown on the upper chart, will fall in conjunction with a significant spike in volatility.

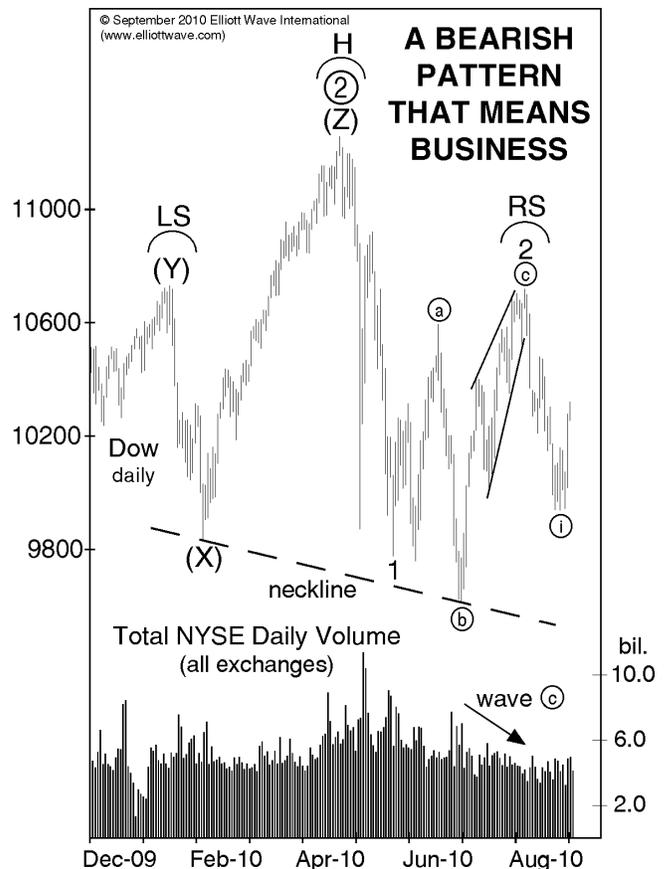
**Elliott Wave Analysis**

The August 9 high — 10,720 in the Dow and 1129 in the S&P — marks the top of Minor wave 2, which traced out an upward expanded flat (see text, p.46), labeled (a)-(b)-(c). Wave (c) formed a wedge, which is a classic ending pattern. Observe the waning upside momentum in the rise to this high, as depicted by the contracting daily NYSE volume, another attribute of a terminating wave. The secondary indexes such as the small caps and the Value Line failed to confirm the high in the blue chips by remaining beneath their respective late-July highs, thereby creating a bearish divergence, a common occurrence at market highs. September and October in the second year of the four-year presidential cycle sport a seasonally bearish bias, which is consistent with our view of the wave structure. In summary, the evidence is strong that the bear market's next leg down is underway.

The DJIA remains down about 1,000 points from its April high at 11,258, tracing out a series of first wave declines and second wave rallies. The hope rekindled by each upward move fits perfectly with the psychology second waves are designed to engender, as described in the May issue of *The Elliott Wave*



*Theorist* (see p.10). It is the same hope that prevailed with each countertrend push in 2008, as the stock market was setting up for a hard decline into the fall months. The August 2008 EFFF issue said, "One



trait of a third wave is the persistence of the selloff.” This observation should be kept in mind through the coming months. Near-term rallies may be sharp, like Wednesday’s 255-point pop, but they should also be relatively brief.

### **Investor Psychology**

On August 2, a popular investment website announced “Bulls Feel Vindicated,” while another revealed “Bull Redeemed.” A parade of optimistic expert assessments, which EWFF first observed in the July 30 issue, continued with a hedge fund official saying, “the largest U.S. companies are cheap and the odds of a second recession in three years are about one in five.” The vice chairman of a top private-equity outfit predicted a return of 8.1% a year for the S&P and a near doubling by 2020. “Two disastrous decades in a row is extremely unlikely.” These remarks place sentiment a long way from a major stock market low. At bottoms, virtually everyone believes that further decline is inevitable. But this sentiment is consistent for the end of a countertrend rally; hope continues to be expressed even as a third wave down begins. According to Bank of America/Merrill Lynch’s short interest figures, adjusted short sales for the S&P 1500 total less than 10 million shares, only slightly higher than its low point for the year as well as the low of October 2007. As the downturn gains speed, the short side should become more popular. Third waves are the “recognition” wave, so expect sentiment measures and eventually the lagging fundamentals to fall in line with a declining stock market trend.

We keep hearing that the stock market cannot decline because “pessimism about the future is high.” Here’s another headline from today’s Bloomberg offerings that reputedly shows just how positive all the negativity is for the market’s prospects:

### **U.S. Stock Pessimism Brightens September Outlook**

A key aspect of the biggest stock market collapses is that they often start from lower price highs, when optimistic feelings are already on the wane. The current market sentiment is quite like May 2008, just before prices fell another 40% in five months. The June 2008 issue of EWFF discussed a splintered sentiment picture and stated that “pessimistic sentiment readings will become more common in the next phase of decline.” Then, as now, many fund managers insisted that the “Crisis Is Near End” and

one manager even urged investors to “Buy Panic.” After a decline into the middle of July 2008 and another smaller-degree second wave rally into early August, bad news became more of a staple, as July 2008 car sales hit their lowest point since 1992. Now, bad news is again on the ascent; August car sales just experienced their worst month since 1982. Recall too that in August 2008, even veteran value investors were starting to lose heart. The August 2008 issue of EWFF noted that Warren Buffett offered encouragement to a dejected assembly of fund managers by saying, “We should be happy if stock prices decline a lot more, so we can buy even better bargains.” They got what Mr. Buffett wished for. At this point, some of the same veteran fund managers are looking higher not lower. One former bull-market leader of that group just pulled out all the stops with a wildly bullish opinion piece in the August 31 edition of the Financial Times:

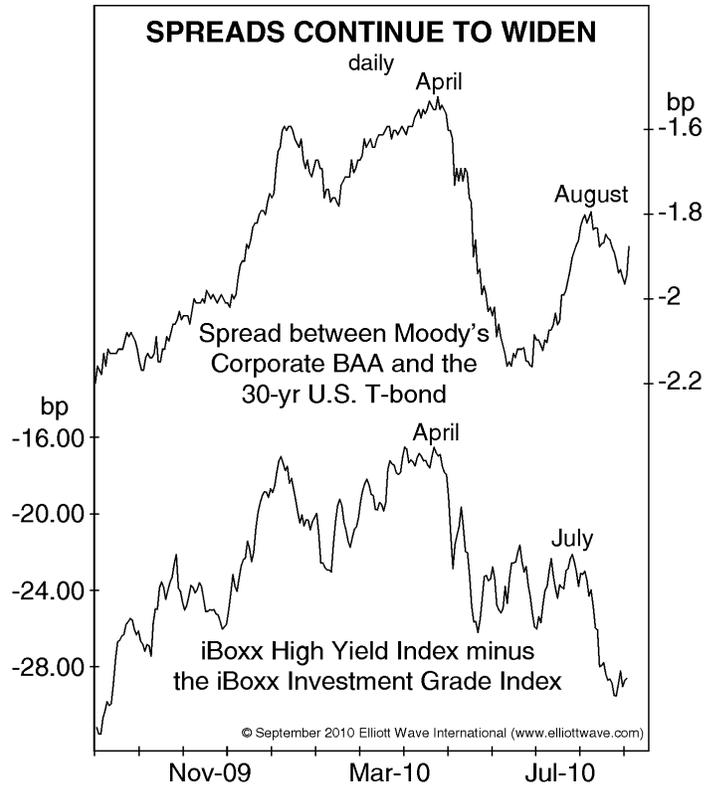
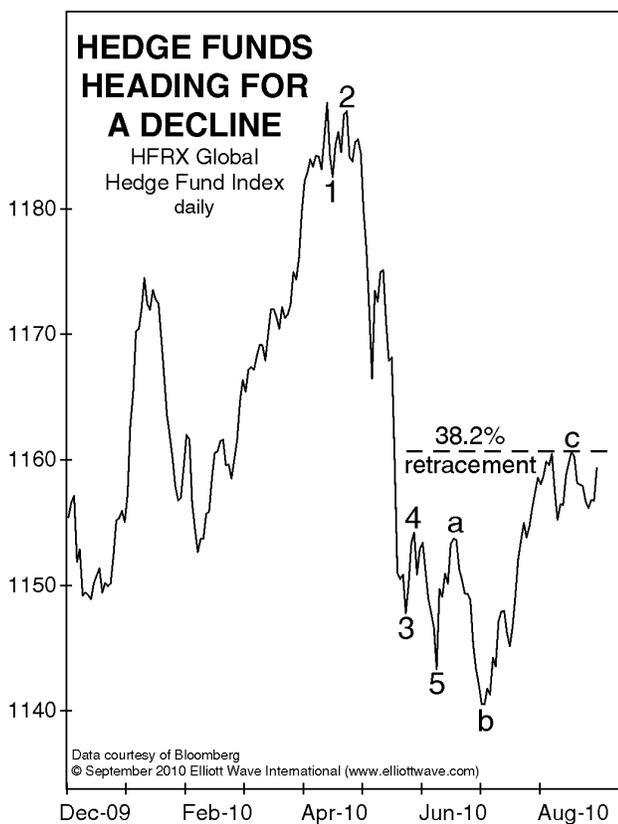
### **U.S. Large-Cap Stocks Are Bargains of a Lifetime**

At this stage of the wave structure, lower optimistic extremes should coincide with the start of extended declines. As noted last month, animal spirits are reversing direction, so a certain amount of angst is appropriate, as the last vestiges of the financial mania are swept away. Analysts and investors are more contrary and divided than outright negative. While one article about price/earnings multiples concludes “Stocks Are Dirt Cheap Now,” another says the value of the P/E measure itself “Is Diminishing.” Bloomberg reports that 29% of brokerage firm ratings on stocks are “buy” recommendations, the lowest total since they began monitoring the data in 1997. But these analysts are not bearish. More than 54% of ratings in the U.S., U.K., Japan and Brazil are “holds,” the highest since 1997. “Sell” ratings in the U.S. fell to 5.1%, half the level of 2003. “Everyone is a little nervous,” explains a strategist — and he insists that’s bullish. “It gives the opportunity to buy stuff that should be somewhere else.” It’s not the shoot-for-the-moon recklessness of 2000 and 2007, but analysts and investors expect to muddle through. In this bear market, it should prove a costly miscalculation.

*When Unrealized Gains Become Hedge Fund Losses*  
According to the HFRX Global Hedge Fund Index, the average hedge fund lost 26.3% from July 2007 to December 2008, which was much “better” than the 50% decline for most stock averages. This next chart of the HFRX Global Hedge Fund Index shows that

the index is, once again, holding up relative to the S&P, down just 2.45% compared to an S&P decline of 10.5% since the April high. At this point, however, there are reasons to suspect that hedge funds will still experience losses that are at least commensurate with the stock averages. The index sports the same bearish wave formation as the S&P, which means that prices face an imminent nose dive. According to the website Zero Hedge (zerohedge.com), hedge funds are crowding into the same shares. “Little by little most hedge funds are now moving to the 100 or so stocks that account for 50% of market volume.” This behavior is akin to what occurred with the “Nifty 50” in the early 1970s. The brutal 1973-1974 bear market wiped out many investment portfolios that held these shares. We’re also willing to bet that many hedge funds still hold plenty of less-liquid assets, with “unrealized gains” in their portfolios. When leveraged funds try to exit the same stocks at the same time, the margin calls should come all at once and a massive fire sale will turn those unrealized gains into realized losses.

Grade spread is at its widest level in a year, since September 2009, while the Moody’s Corporate-to-Treasury spread continues to widen. These trends are in line with EWWF’s overarching bond market forecast calling for a record-widening spread between these two classes of debt.



**THE BOND MARKET**

Right on schedule, the trend away from lower-grade corporate debt toward higher-grade debt is regaining momentum. The iBoxx High Yield-to-Investment

While the financial media and pundits debate whether the bond market is in a “bubble,” our perspective is that bonds are behaving according to the forecast in *Conquer the Crash*. Bonds that are perceived to be of the highest quality, such as U.S. Treasuries, are in high demand. The 2-year U.S. Treasury Note is at a record low yield of 0.45%, while the 10-year Note yield is at 2.6%, a little more than ½% from its all-time low of 2%, which occurred in December 2008. As of June, the Investment Company Institute reported that bond funds attracted more money than their stock fund counterparts for the 30th straight month. Naturally, supply is rising to meet demand, as companies try to lock in the low rates for as long as possible. On August 3, IBM raised \$1.5 billion with an offer of 1% on three-year notes, “the lowest [corporate] interest rate on record.”

With Treasury yields so low, the reach for yield, one of the deadliest sins an investor can make, is busting back on the scene. “Investors are scrambling for every

bit of yield that they can get,” said the co-manager of a \$19 billion bond fund. “Corporates are probably one of the most attractive places in the capital markets right now.” In the week ended August 13, corporate borrowers with “less than investment grade ratings,” i.e. issuers of junk, sold a one-week record of \$15.4 billion in bonds. At \$155 billion, the annual total is on a pace to surpass the record total of \$163.6 billion in 2009. “Having grown frustrated with stocks and with the meager yields on safer government bonds,” investors are “snapping up the new non-investment grade bonds.” The “strong appetite of buyers” is also generating interest in longer-term debt. How long? How about 100 years! In 2110, when these bonds come due, the people trading in them won’t be here and the companies issuing them probably won’t be around either. Yesterday’s Wall Street Journal notes, “Toxic Debt Returns to Fashion.” Even the private, non-agency mortgage bond that singed investors so badly just two years ago is coming back. Together, the record low rate, the record long maturities and investors’ willingness to “reach” into riskier debt instruments is a sure-fire sell signal for corporate bonds. Here again, demand for income is trumping all other considerations, including safety, when the latter consideration should be paramount. It soon will be. The corporate bond frenzy of August 2010 is another wrong turn for investors.

As discussed here last month, Treasuries should do better on a relative basis — for now. But “relative” does not mean a straight-ahead bull market for U.S.

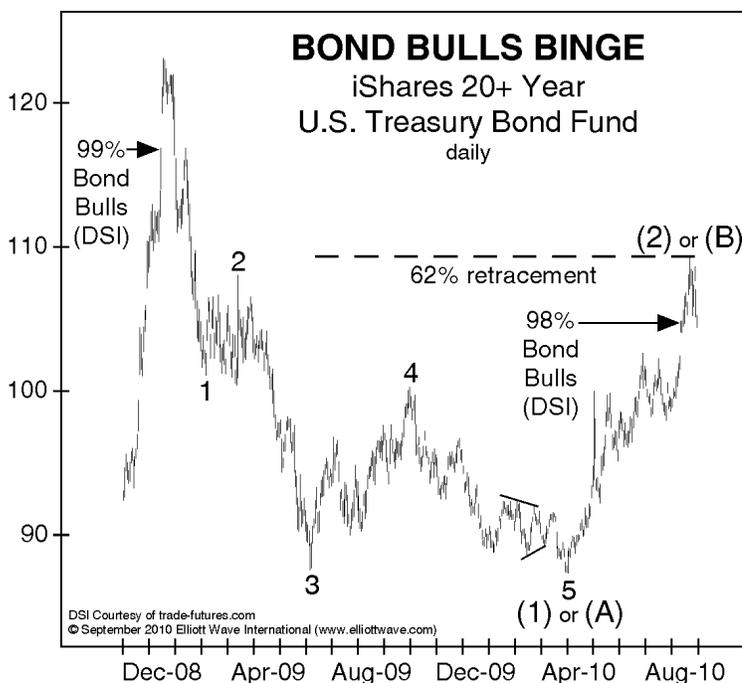
Treasuries. On August 16, the Daily Sentiment Index (trade-futures.com) surged to 98% bond bulls, almost matching the record extreme of 99% bulls on December 16, 2008, two days before the all-time price high of 123.15 in the iShares 20+ Year Treasury Bond Fund (TLT). The most recent 98% bullish reading was in the U.S. Dollar on May 14, 2½ weeks prior to the June 7 wave (1) high at 88.71. The index declined 10% thereafter. As shown on this accompanying chart, TLT rallied to a Fibonacci 62% retracement of wave (1) or (A) down. When combined with the recent optimistic extreme, odds are high that prices are starting an intermediate-term decline.

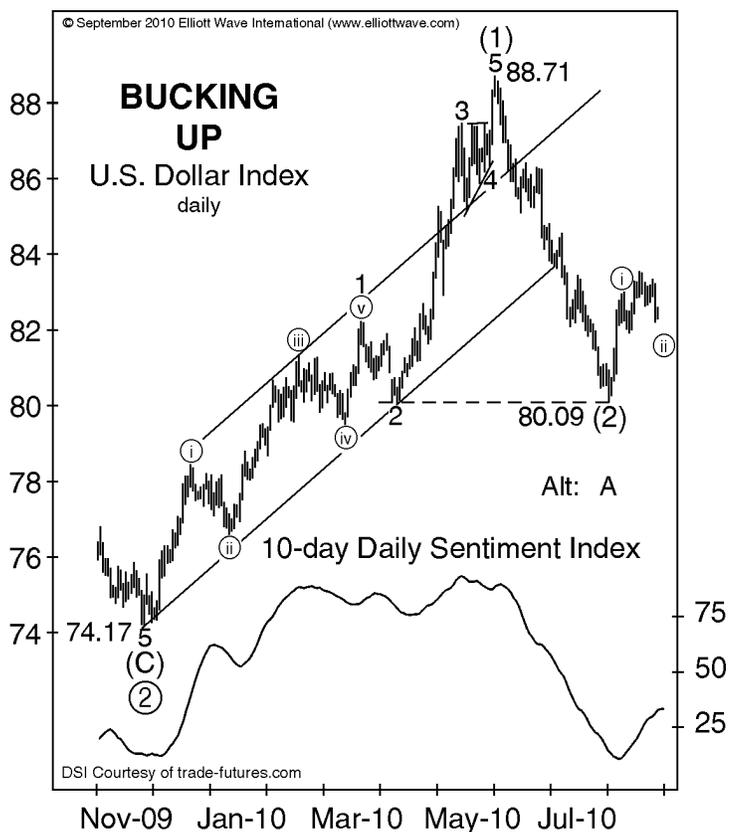
### GOLD & SILVER

An analyst at a German bank succinctly sums up the prevailing view with respect to gold: “Either a swift economic recovery or further dismal economic performance should bring new buyers into the market.” Set aside the faulty causality assumption that gold moves on the economy; what this view implies is that gold prices can never go down. If the economy gets really bad — or really good — gold will go up even more. This appears to be the logic upon which hedge funds have poured money into gold, led by the high-profile George Soros and John Paulson, each with sizeable positions in the SPDR Gold Trust. To top things off, the latest issue of Bloomberg/BusinessWeek sports a cover of “The Gold Digger,” another hedge fund manager who calls himself an “evangelist” for the yellow metal. On May 12, with spot gold prices pushing to \$1249.00, the Daily Sentiment Index (trade-futures.com) registered 98% bulls. It’s now been three months, and gold and silver prices are essentially unchanged from their levels that month. Unfortunately, the wave pattern is not definitive, so all we can do is point out the background condition of persistent optimism. Such readings gave stocks their worst decade on record, while oil blew off on the upside and then crashed. We don’t know which of these paths the metals will take.

### U.S. DOLLAR

“Investors are beginning to see currencies as assets, like commodities and stocks,” said the manager of foreign-exchange trading at a Japanese bank. But they are not. There is no underlying asset to a currency, only the price, which is simply a ratio of one currency relative to another. Since no currency is backed by anything with intrinsic value, currency values often conform well to wave analysis. Last month EWFF was anticipating a wave (2) low in the U.S. Dollar index.





Prices bottomed within our cited range, at 80.09 on August 6, one trading day prior to the Dow's wave 2 high on August 9. As stocks continue to decline in a third wave, the dollar should rise steadily. As shown on the bottom of the chart, the 10-day Daily Sentiment Index (trade-futures.com), which had declined to 10.4% in conjunction with wave (2), has plenty of room to rise with prices.

With stocks still descending in a long-term bear market, interest in stock trading has waned, as seen in the dearth of daily trading volume on the NYSE. By some estimates, it is at an 11-year low. But traders need to trade, and Wednesday's Wall Street Journal article, "Currency Trading Soars," says currencies are the new thing. At \$4 trillion a day, the volume of currency trading swamps that of stocks and bonds, which averaged about \$134 billion and \$456 billion, respectively, in April. According to the WSJ there are now 44 currency exchange-traded funds, up from just one in 2004. Currency trading, however, is not like buying a stock on an exchange, as there is no formal currency exchange, only a labyrinth of bank dealers and electronic trading systems. In fast market conditions, bid/ask spreads can become wide and liquidity in some ETFs can dry up. So we cannot recommend currency ETFs as a long-term investment

holding. But the U.S. dollar exchange-traded fund (UUP) does appear to track the main trend of the Dollar Index.

## ECONOMY & DEFLATION

### *The Words Right Out of Our Mouths*

Our contention last month was that the economy is moving into a critical new phase, an outright deflation in which "prices fall *because* people expect falling prices." Obviously, this implies an element of recognition, as efforts to protect against indebtedness and falling prices contribute to further declines. We can tell deflation is entering a new stage because of the language and ideas that financial observers now use to describe it; in many cases, they are the very same language and ideas that EWI used in *anticipation* of deflation's arrival. Consider this quote, which appeared originally in *At the Crest of the Tidal Wave* as well as several more recent editions of EWT and EWFF:

Investors are focusing only on the promised rate of interest and not on the safety of their principal. Because only yield, not quality, is the overriding issue among investors, their clamoring to invest in junk bonds has been of historic proportion. First waves are surprises, but third waves feed on bad news. The entrenched belief that the economy is safe will dissolve quickly when the economic statistics begin coming in below expectations. Then owners of junk bonds will become concerned not with the return on their principal, but with the return of it.

As we noted on page 4, the "yield grab" is not over. But the chief executive officer of the world's largest bond fund confirms deflation's presence, as well as our view placing stocks in a third wave decline, by relating that most investors are still positioned for the "Old Normal, not the New Normal. In the New Normal, you are more worried about the return of your capital, not the return in your capital."

Japan's deflationary turmoil is an important parallel that EWFF has used to gauge deflation's approach in the U.S.. Back in January 2000, EWI compared trading in the Nikkei in late 1989 to the NASDAQ then. We observed that the Nikkei subsequently declined 65% over the next two years and forecasted a similar decline for the NASDAQ. The NASDAQ complied with a 73% retreat over the following 30 months. In late 2006, we extended the analogy to Japan's economy with a piece titled "The Japanese Model Points Lower." Since then, EWFF has referred to the analogy at least five more times (see June 2010, April 2010, June 2009, October 2008 and April 2008)

and warned that the U.S. faces “the same deflationary pressure.” Now, Bank of America/Merrill Lynch has just produced an extensive research report that asks, “Is The U.S. Becoming Japan?” Despite 30 charts and tables that make a powerful case, it concludes that there is just a 20% chance of it.

Deflation is way past the point of no return. The main reason many believe otherwise is they think that the Fed and the U.S. government will not allow it. But the truth is that it was the government that locked in the case for deflation with its commitment to a credit-based economy decades ago. In response to claims that the Fed would simply “expand credit for the good of the economy,” a 2004 issue of *The Elliott Wave Theorist* compared the situation to what would happen if the government decided that economic growth depended upon the production of Jaguars and provided them to as many people as possible (<http://www.elliottwave.com/wave/jaguar-inflation>). Eventually, “nobody wants any more Jaguars. They don’t care if they’re free. They can’t find a use for them.” As absurd as this sounds, it is *exactly* what has happened with credit, as the government decided that “the health of the nation depends upon producing credit and providing it to as many as people as possible.” Here’s how EWT, back in 2004, said this all-out commitment would play out:

To facilitate that goal, it begins operating credit-production plants – called Federal Reserve Banks, Federal Home Loan Banks, Fannie Mae, Sallie Mae and Freddie Mac – all subsidized by monopoly powers or government guarantees to funnel credit to the public. To everyone’s delight, banks begin reducing collateral requirements and thereby offering credit for sale at below-market rates. People flock to the banks and buy. Later, sales slow, so banks cut the prices again. More people rush in and buy. Sales slow again, so lenders lower the price to 1%. People return to buy even more credit. Look how cheap it is! Alas, sales slow again, and the government and banks start to panic. They must move more credit, or the economy will recede. People are working three days a week just to pay the interest on their debt to the banks so the banks can keep offering more credit. If credit stops moving, the economy will stop. So the government announces stimulus programs and begins giving credit away at 0% interest. A few more loans move through, but then it ends. *Nobody wants any more credit.*

The 90-day T-bill rate fell to 0% in late 2008, essentially making credit *free*. More loans were offered in 2009 and 2010, but the end appeared in the form of

slack demand. Here’s an August 2010, CNNMoney headline that marvels at its appearance:

### Credit Is Finally Available, But No One Wants It

As the credit bubble cracks wide open, the crazily persistent delusionary belief in the old credit-production plants is also crumbling. This cartoon of Fannie Mae and Freddie Mac captures the acceptance of a reality that *Conquer the Crash* displayed eight years ago, using the very same imagery:

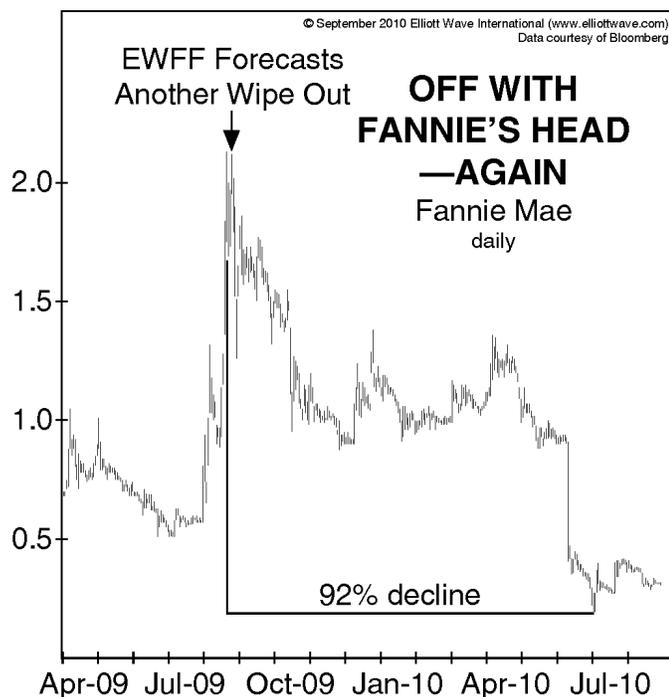
Major financial institutions actually invest in huge packages of these mortgages from Fannie Mae, Freddie Mac and the Federal Home Loan Banks, an investment that they and their clients (which may include you) will surely regret. Confidence is the only thing holding up this giant house of cards.



As late as September 2009, when the Primary-degree rally was still unfolding, Fannie Mae became the object of intense speculation. Apparently, investors thought the company would recover. At the time, EWFF offered the following forecast:

Like down-on-their-luck gamblers, investors always try to win it back in the exact same place where they lost it all the last time. As wave ③ kicks off, it will be brutally apparent that Fannie Mae cannot pay back bailout loans.

The chart on the next page shows what has transpired since. More important is what Fannie Mae’s latest collapse means to the stock market, housing and the economy in general. It is as bearish for these markets as it was from 2000 to 2007, when EWFF issued seven predictions based on Fannie’s peaking stock price. For the history of EWFF’s Fannie Mae forecasts, please see the conclusion to *Mania Chronicles*. As that section, titled “Fannie Mae and the Infinite Possibilities In A Journey Toward Zero,” pointed out, “investors are impervious to the potential for further



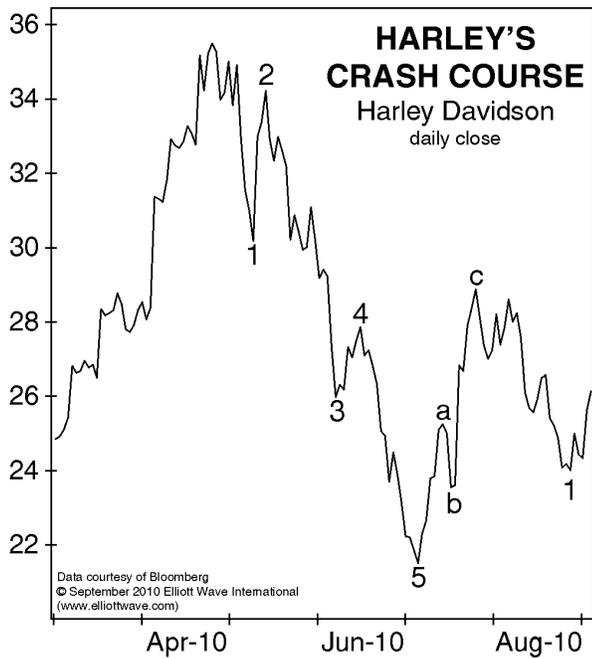
damages, even in the face of massive declines.” That statement is just as true today, even though deflation is much harder now to miss. In July, home sales renewed their downtrend, with existing homes falling 27.2% from June and new home sales falling 12.5% to the lowest level in 47 years of record keeping. Meanwhile, headlines announce the “Death of the ‘McMansion.’” “McMansions just look and feel out of place,” said the vice president of research for the National Association of Realtors. This is one more realized forecast that comes right out of EWI’s deflationary playbook. Back in 2004, the second edition of *Prechter’s Perspective* stated, “In the past five years people have been erecting ‘McMansions’ all over the place. It’s all financed with credit, and that game is ending. The trap is set.” The trap sprang closed in 2005-2006 when homebuilding stocks and house prices topped. But the prior momentum of inflationary forces, the borrow-spend binge of the last 30 years, kept the brunt of the deflationary purge at bay, until now. With housing locked in a downtrend and the absurdity of McMansions occupying the front pages of newspapers, even the few analysts who recognize the potential for deflation give it no better than a 25% chance of actually happening. It is happening. Sooner or later, investors and pundits will admit to it.

### CULTURAL TRENDS

The downtrend in social mood is attaching itself to bull market sports such as golf, baseball and basketball,

where it is finding all kinds of ways to undermine the very heroes whom the preceding bull market draped in glory and wealth. With a career that spanned from 1984 to 2007, through most of the prior bull market, Roger Clemens was the most dominant pitcher of his era, winning 354 games and seven Cy Young awards. On August 20, a grand jury indicted Clemens on charges of perjury for previously denying that he used steroids or other performance-enhancing drugs. In basketball, the boos started in July when LeBron James, the premier professional basketball player, decided to leave the Cleveland Cavaliers to join two other superstar players in Miami. “LeBron James has been jeered seemingly everywhere he goes ever since he decided to leave Cleveland,” says one account. Fans are also displaying their displeasure to James’ new teammate, Chris Bosh; “The 6-10 forward was heckled as he rang the bell at the New York Stock Exchange.” The career of Tiger Woods, the dominant golfer through the mania era, is unraveling altogether. The role of a social mood reversal in Woods’ downfall is so powerful that The Wall Street Journal nearly recognized its causality in a recent article, stating, “Mr. Woods surfed [an] irrational wave of exuberance. Few thought his greatness could ever stop. After years of prosperity there’s been a harsh correction.” The retreat extends across the breadth of the sport, as golf itself is spiraling lower. According to the National Golf Foundation, the number of golfers is down 30% from 2005. Courses are edging “perilously close to bankruptcy.” In Myrtle Beach, S.C., which calls itself Golftown USA, the number of courses is down 25% to about 100. Private golf clubs lost up to 15% of their members last year. For course owners, shop pros and caddies, these are life-changing experiences, as EWFF discussed in June. Rest assured, bigger changes are on the way.

Further evidence of a transformation is everywhere. It stretches from music, where a 10-year slump in album sales extended to a record low in 2009, to the movies, where top stars such as Julia Roberts, Tom Cruise and Nicolas Cage no longer reign at the box office. “R.I.P., movie stars,” says USA Today. “A-list celebrities are finding their stock fading at the multiplex.” There is even a significant change in another American icon, the motorcycle, which came of age in the bull market of the 1950s and continued to break sales records through 2006, when 681,000 new street bikes were sold. Last year sales were down 52% from the 2006 peak. In the first half of



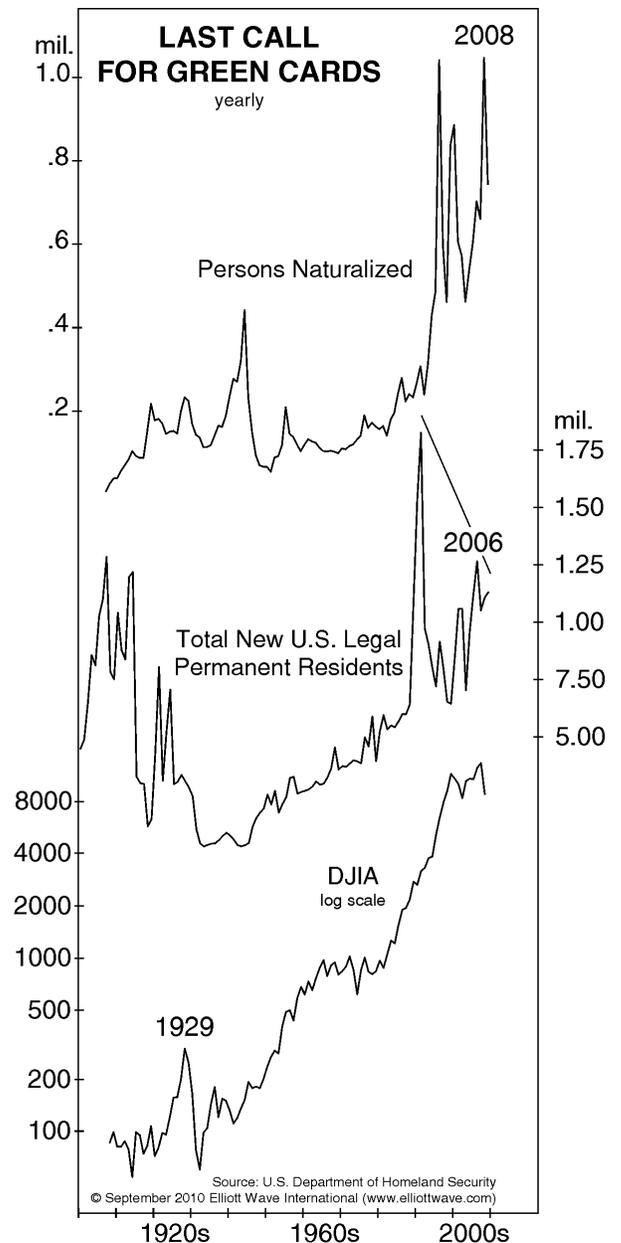
2010, the total fell another 14.4% from 2009. “The heyday is over,” says the proprietor of a Marietta, GA motorcycle shop who now does more oil changes and less bike modifications. “It’s back to reality.” Harley Davidson’s stock price captures the culprit behind the changeover. After an 89% price decline from its all-time high of \$75.87 in late 2006 (not shown), Harley made a countertrend rally high at \$36.13 on April 20. It is now falling again, down nearly 30% from April. Harley should power through its March 2009 low of \$7.99 a share, suggesting that the premier American motorcycle maker will be struggling for survival before the bear market is over.

*The Emigration Boom Begins*

These graphs of new legal permanent residents (green-card recipients) and naturalized citizens show another beneficiary of the former bull market in social mood, immigration. As shown by the top line on the chart, the all-time high in the number of people filing for citizenship came in 2008, when 1.05 million people were naturalized. Since petitions for citizenship take months to process, that makes 2007, the year of the Dow Jones Industrial Average’s all-time peak, the top year for successful filings. The next line on the chart illustrates a telling divergence in the number of green cards issued by the U.S. government. The total peaked at 1.26 million in 2006, before the peak in naturalizations (and the peak in stocks) and down from higher totals in the early 1990s.

In 1929, as stocks peaked and a Supercycle-degree bear market took hold, these measures experienced

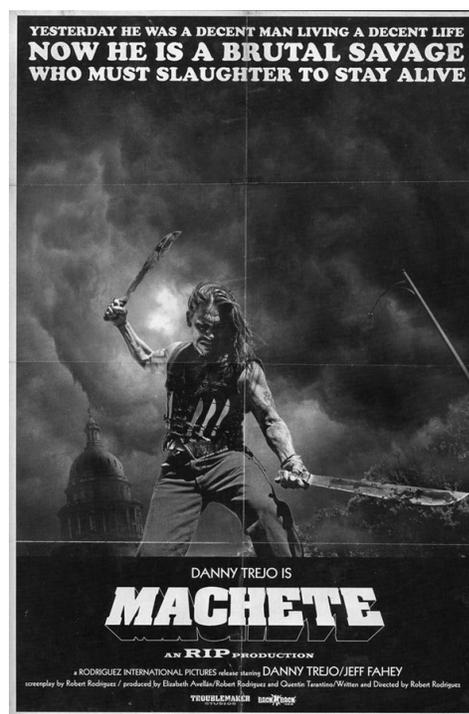
the same divergence. As the Dow plunged 89%, naturalizations fell by 50% through 1933 and green card issuance plunged 82%. The source of the change is identified by this quote in *The Wave Principle of Human Social Behavior*: “A waxing negative social mood accompanies increased exclusionary tendencies in every aspect of society.” Bear markets induce countries to act to exclude. “Aliens” are restricted from work and fewer foreigners are welcome into the body of citizens. In 1929, the U.S. instituted a policy of forced repatriation to Mexico when the U.S. State Department told Mexican consuls to enforce existing laws strictly. By the last quarter of 1931, “repatriation reached massive proportions; the roads leading to the Texas-Mexico border became congested with returning repatriates.” It happened in 1929, and it’s beginning



again in Arizona and other states where laws, which were instituted in more optimistic times but laxly applied, are suddenly being more stringently enforced. Activists have responded with protests and boycotts. And while a Federal judge has blocked key parts of the Arizona law, history says that action won't stop the anti-immigration wave. According to the Pew Hispanic Center, the number of illegal immigrants in the U.S. is down almost 1 million, or 8% from "a peak of 12 million in 2007." This is just the first step. As the bear market clamps down, deportations will rise, and green card issuance and naturalizations will plunge to multi-decade lows. In the depths of the ongoing bear market, property seizures and the forced exit of citizens will happen again. It wasn't until 2005 that California passed the "Apology Act for the 1930s Mexican Repatriation Program," officially recognizing the "unconstitutional removal and coerced emigration of U.S. citizens and legal residents of Mexican descent." The next year, green card issuance peaked, and the trend back to the type of actions that eventually led to California's historic apology started all over again. Isn't history ironic? Only from a socioeconomic perspective does it make perfect sense.

The bearish cultural imprint of this trend is visible in this poster for a new movie out today — *Machete*, the story of a savage street war in which Mexicans battle racist gringos. "Central to this conflict is the divisive border issue." One review says the film is "designed to create animosity between Americans and Mexicans."

But an NPR review rates *Machete* as "fun," even though it features heads and limbs being separated with "brutal efficiency." It "works because at no time does it ask the audience to take any of this too seriously." Serious is for later, when the stock prices are long removed from the peaking process depicted on page 2 and the bear market's effects are more encompassing.



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