



Knowledge is Power

A Registered Investment Advisor

www.bigwaveresearch.com

September 2008

Commentary

The Stock Market's Future Path

The bear market of 2000-2002 consisted of a series of lows, spread out and finally bottoming in March 2003. Previous to this more normalized bear market, the sell offs in 1998, 1997, 1990 and 1987 were all short lived violent affairs associated with events and not real business conditions. Many analysts say that is what we will experience with this current bear market. They feel that there is an "event" out there that will mark the end of this bear market. They are looking for what market technicians call a "V" bottom where stocks drop in a one or two day violent move and then stage an even more violent snap back rally finally to move steadily higher. The 1987 stock market crash is a great example of this phenomenon.

We do not buy that analysis. We have to go back to the long series of false starts and incessant declines in the 1970s to find a good comparison to this market. Even though there are a lot more complicated trading systems in place today, the economic conditions of that period are very similar. Slow growth, inflation, poor profits and a leadership vacuum all shared the stage in the 1970s and today. During the 70s sell offs were not violent but dreary. The markets just dragged lower and lower until public interest in stocks became non existent.

The Japanese stock market has been going through a multi year process of demoralizing its investors too and its model may be used as a technical model of our market today. The Japanese market has been making new lows for almost two decades. It rallies and then sells off

to new lows, repeating the process over and over again. Participation by the public in this market as measured by trading volume is a mere shadow of itself when compared to 20, even 10 years ago. The net result in Japan is that those investors who have been looking for a capitulation "V" bottom have been sorely disappointed and after 9 or 10 years of frustration, have all but given up on the market.

The nationalization of Fannie Mae and Freddie Mac has extended the bottoming process of our stock market further by transforming a violent "V" bottom of asset prices into a far more prolonged adjustment. Every time the government steps in to try and stop the inevitable bankruptcy, the market suffers. This years market lows all correspond to a government bailout announcement and all of these lows have not held.

Over the last 10 years as measured by the S&P500, returns on stocks have averaged only 3 percent per year. These low returns are similar to Japan's returns right after their stock market top. Now we may be entering the next 10 year Japanese pattern whereas stock prices continually grind lower and new low after new low are realized and investors become more and more disinterested.

The continuing national perception that we can save ourselves and our economy by some new form of financial engineering will lead to disappointment. We think the actions taken so far are leading the stock market to years of

below-trend growth. The simple truth is that years of artificially low interest rates propelled asset and home prices to unsustainable and artificially high levels. What we enjoyed in excess consumption and inflated asset prices had to be paid at some point. We are now experiencing the beginning of the downside of this asset bubble curve.

I feel and I fear that we are now locked in to the Japanese experience. Their stock and real estate markets peaked nineteen years ago this December and in the meantime, they have adopted zero interest rates, massive government easing and historic public debt to try and stimulate those two areas, all to no avail.

The stock market's future path is always uncertain and unpredictable to say the least. But we have "seen this movie before" and Japan is the model. Our FED is following the same path as Japanese officials did nineteen years ago. If we look down that path, one can see a weak economy and stock market for longer than most people think possible. One can hope that our FED is also looking down this path and deciding not to go down it.

A quote that comes to mind is "those who do not learn history, are doomed to repeat its mistakes." That applies to stock market history as well.

Big Wave coaches traders, online investors and individuals. Through our coaching and trading seminars we develop trading systems to help you become a better trader. Workshops are held on a regular basis to teach you're the ins and outs of trading. If you would like to learn more about trading workshops and private coaching, check out website at www.bigwaveadvisors.com or email me at dave@bigwaveadvisors.com or call at 630-682-5520.

Copyright © Big Wave Advisors Inc.

This message is intended only for the personal and confidential use of the designated recipient(s) named above. If you are not the intended recipient of this message you are hereby notified that any review, dissemination, distribution or copying of this message is strictly prohibited. Big Wave Advisors makes no representations or warranties that the information contained in this publication is suitable for the particular purposes of the subscriber or any other party. Big Wave Advisors assumes no responsibility or liability of any kind for the use of the information contained herein. This communication is for information purposes only and should not be regarded as an offer to sell or as a solicitation of an offer to buy any financial product, an official confirmation of any transaction, or as an official statement of Big Wave Advisors, Inc. Individuals or entities should consult their financial advisors and address their risk profile before acting on any financial research or commentary. Email transmission cannot be guaranteed to be secure or error-free. Therefore, we do not represent that this information is complete or accurate and it should not be relied upon as such. All information is subject to change without notice.