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**The Elliott Wave**  
**THEORIST**

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**THREE SETS OF PEAK EVENTS  
WITHIN THE GREATEST FINANCIAL TOP OF ALL TIME**

Figure 1 adds new notes to the “Head & Shoulders Top” illustration from the April 16, 2010 issue of *The Elliott Wave Theorist*. Now is a good time to examine some of the details of this historic, ten-year peaking process.

Each of the Dow’s three peaks—Left Shoulder, Head and Right Shoulder—has featured certain major markets and ratios making all-time highs. All of the market peaks at the Left Shoulder and Head concluded manias, some of which were credit-fueled bubbles. The Right Shoulder is the last of the series. None of these manias’ all-time highs will be breached for decades.

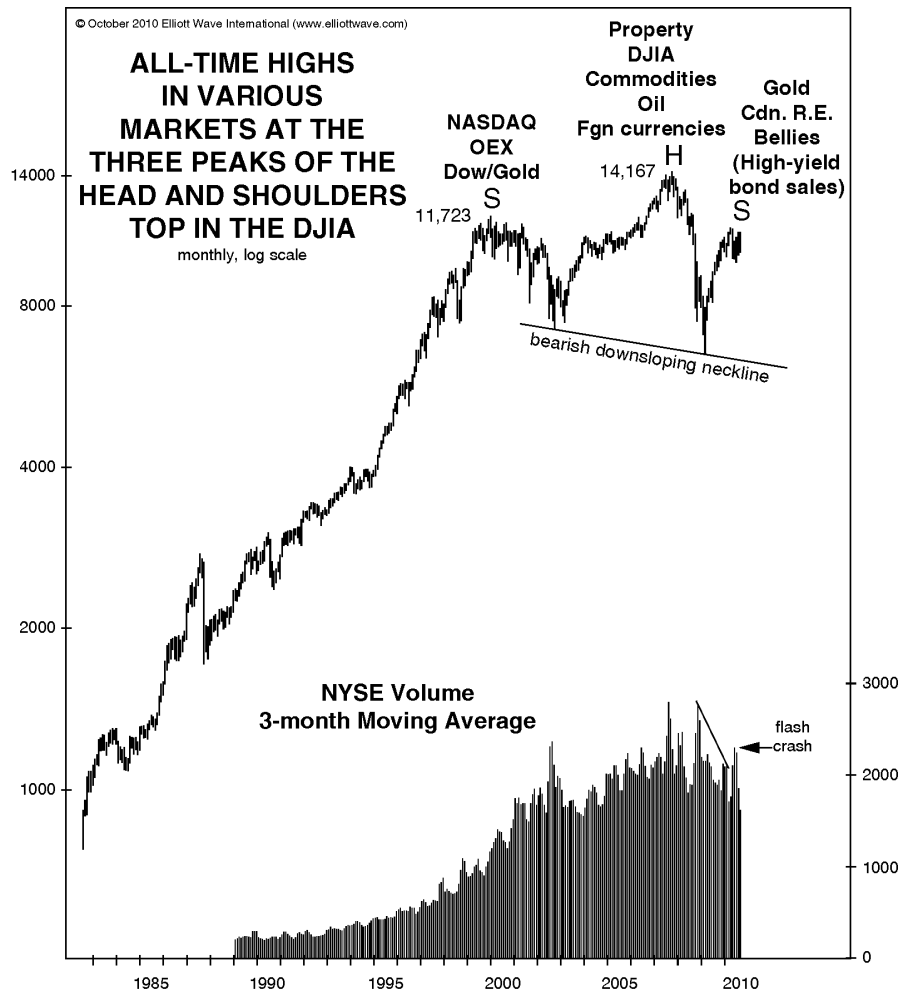


Figure 1

**The Left Shoulder: 1999-2000**

The February 5, 1999 issue of *The Elliott Wave Theorist* applied an established 16.6-16.9-year time span between market turns (see April issue) to predict that the constant-dollar Dow would peak between February 6 and July 15, 1999. It topped on August 25. Figure 2 is the ensuing long-term forecast from an Appendix added to the second edition of *At the Crest of the Tidal Wave* in 2001. It forecast that the Dow/gold ratio would drop all the way back to below the low of 1980. In other words, wave (C) would carry the gold price of the Dow, which had hit an all-time high of 44.85 ounces in August 1999, down to 1 ounce, making the dollar price of the Dow and gold equal. Figure 3 shows what has happened so far. The value of the Dow in real money dropped from nearly 45 ounces of gold to 7 ounces, a collapse of 84%. It currently sells for 9 ounces. This index is not coming back.

**All-time Highs on the Left Shoulder**

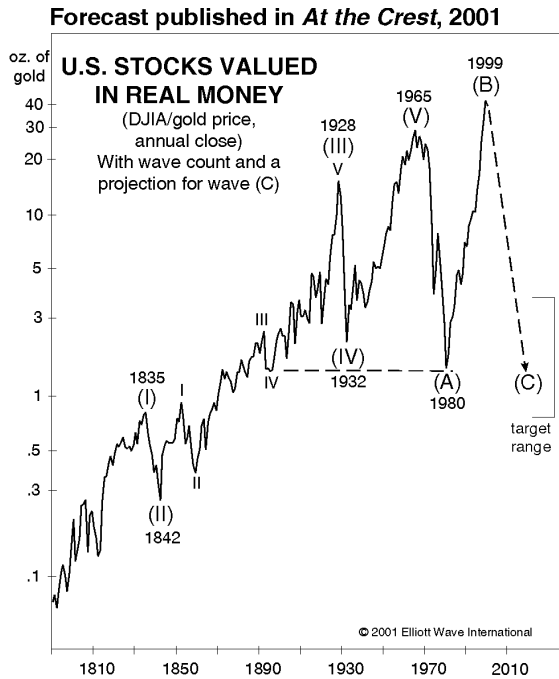


Figure 2

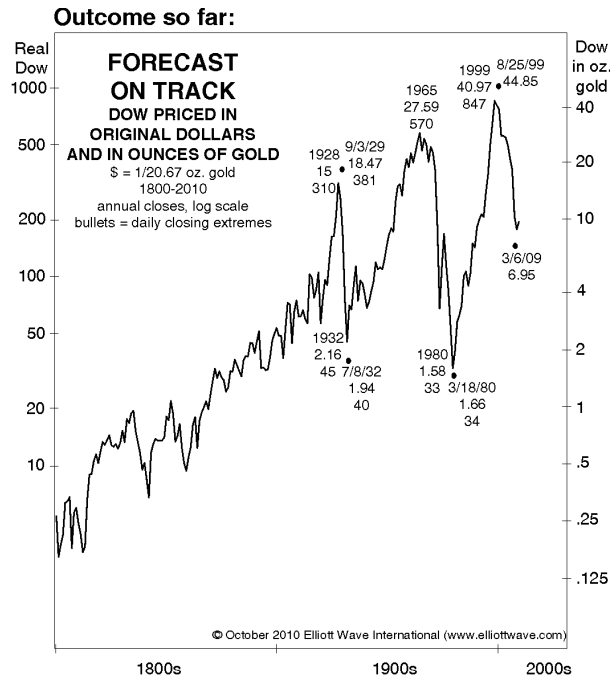


Figure 3

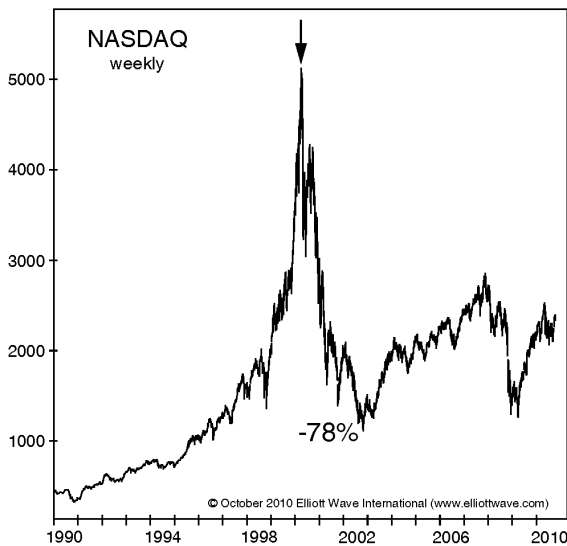


Figure 4

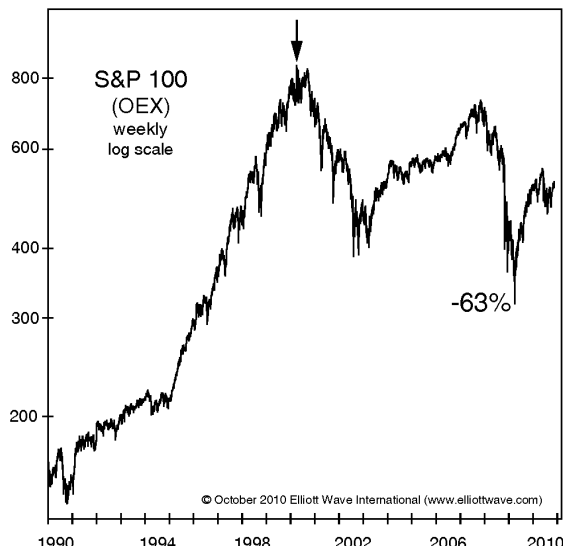


Figure 5

The Dow's Left Shoulder, then, was the true top in the value of the stock market. Almost no one sees the stock market's 11-year stealth massacre, because the Dow is priced in dollars, and massive dollar-based credit creation since 2000 has twice returned the nominal Dow to quintuple digits.

The NASDAQ (see Figure 4) peaked a few months later, in March 2000. It was a dual mania, supported by both tech-stock buying and floods of venture capital into the companies themselves. In the final year of rise, investors were buying stocks based not on companies making money but on their "burn rate," the rate at which they spent incoming investment capital. After the peak, the NASDAQ index collapsed 78%. This index is not coming back.

The S&P 100 (OEX) comprises the 100 highest capitalized stocks in the U.S. As shown in Figure 5, this stock index also topped in March 2000. Even though in 2007 the 30 Dow blue chips made a new high and the S&P 500 matched its 2000 high, this index held back. Based on Figure 3, I think the OEX has presented a truer picture than the Dow.

### **The Head: 2006-2008**

The "Head" of the pattern traced out its own subtle version of a Head & Shoulders Top, with major peaks in 2006, 2007 and 2008. The S&P Homebuilders stock index—shown at the time in *The Elliott Wave Financial Forecast* as a major peaking market—hinted of trouble by topping out in 2005 (see Figure 6). In 2006, one of the biggest financial bubbles of all time ended: that of U.S. residential real estate (see Figure 7). This was the first mania to exhaust itself at the "Head" of the pattern.

In 2007, commercial real estate prices peaked and started crashing (see Figure 8), and the Dow Jones Industrial Average made its final high and fell 54% (see Figure 9). The S&P (not shown) fell 57.7%.

In 2008, most foreign currencies topped against the U.S. dollar, which since 2001 had been inflated through credit creation at a stunning rate. Figure 10 depicts the euro and shows that the two rallies since the high, despite reaching lower peaks, have generated increasingly intense bullish readings. This is probably a setup for a third-of-a-third-wave decline (see text p.80).

Also in 2008, commodities ended their run and collapsed (see Figure 11). The CRB Commodities Index fell 57.8%, almost exactly the same amount as the S&P. Incredibly, this index erased virtually its entire seven-year bull market in five months, falling 16 times faster than it had risen. After eight months, it dribbled to a lower low on February 24, 2009, the day after EWT recommended covering shorts in the stock market.

Within the commodity sector, the most dramatic reversal occurred in oil. On June 9, 2008, EWT put out this headline and comment:

#### **The Top of Wave 5 in Crude Oil is Fast Approaching**

I am publishing this issue a bit early in order to alert you to an opportunity developing in the oil market [where] one of the greatest commodity tops of all time is due very soon.

We received no emails or letters about this call. It seems no one thought a reversal possible. The "Peak Oil" case for higher oil prices was seemingly airtight, as the fundamental case always is—in the wrong direction—at a major turn. (Remember the "New Economy" of 1999?) But five waves up were ending, and on July 3 (close)/July 11 (intraday) oil topped at \$147.50/barrel (see Figure 12). Oil's ensuing collapse of 78% in five months is probably the fastest-ever commodity decline of this size, aside from the crash in frozen orange juice in the movie *Trading Places*.

None of these markets is coming back.

Two other major reversals occurred at the Head: The trend in the overall economy went from up to down (see Figure 13), and the multi-decade trend of ever greater inflation rolled over into deflation (see Figure 14). The advance in financial markets from 2009 has accompanied a wave of reflation, which is keeping the quantity of money + credit aloft. But when the Right Shoulder gives way to decline, credit will follow.

### **The Right Shoulder: 2010 (with Echoes through 2012?)**

Here on the Right Shoulder, one would think that the world's financial markets must be leaping beyond old highs, because talk of Fed-created hyperinflation is once again cramming the blogosphere. But I can find

# All-time Highs at the Head

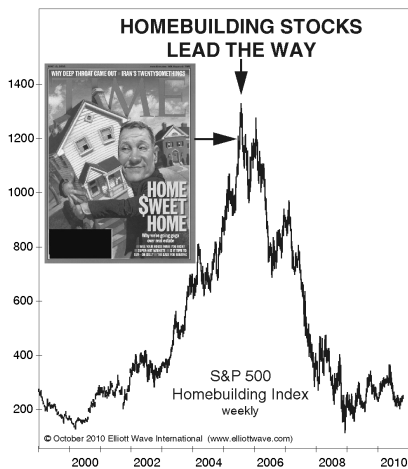


Figure 6

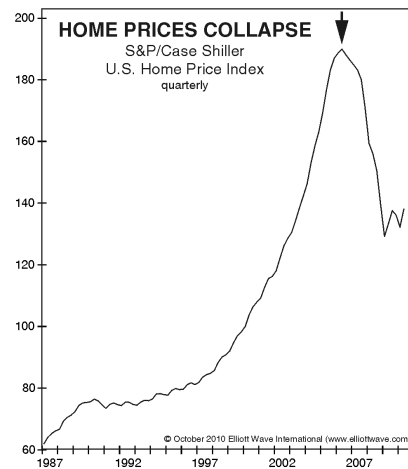


Figure 7

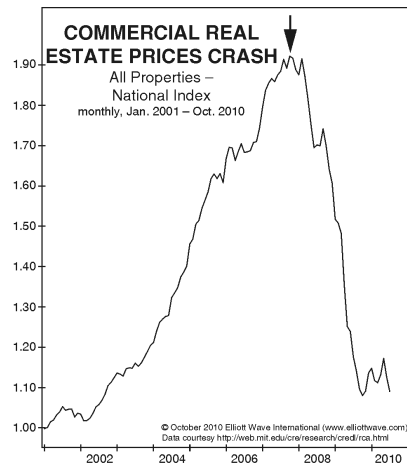


Figure 8

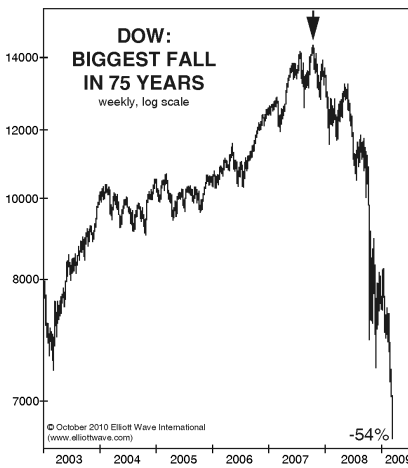


Figure 9



Figure 10

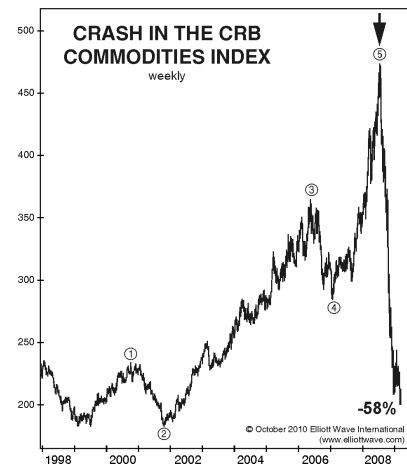


Figure 11

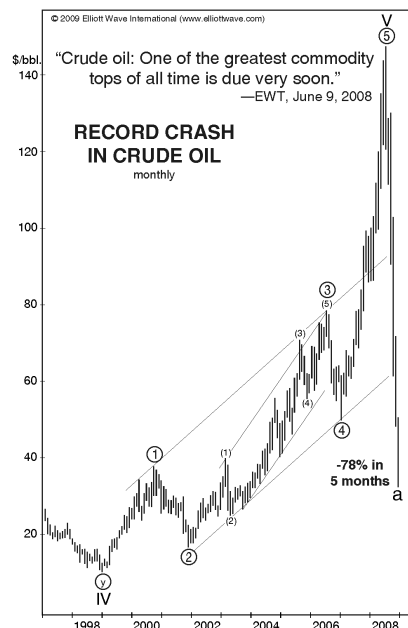


Figure 12

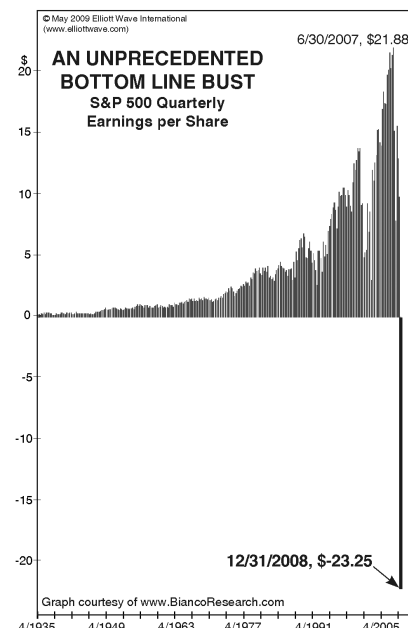


Figure 13

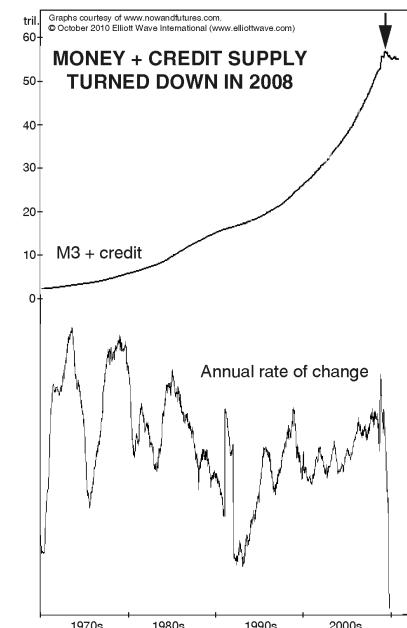


Figure 14

only three actively traded, major markets that made new all-time highs this year: Canadian real estate, pork bellies and gold. The issuance of junk bonds is also setting a record.

Canadian property prices (Figure 15) peaked around April, at the high in the Dow's bear market rally. I've often been told that Canadian banks, unlike American banks, are safe. But Canadian banks have become flush with mortgages, and housing prices in Canada are getting ready to plunge. They won't fall as much as in the U.S., because the Canadian government did not push housing debt as hard as Congress did through its agencies and GSEs. Perhaps that is why Canada was able to manage one last lunge in its housing mania.

Pork bellies (Figure 16) made a new all-time high in August. They have since slipped back into their historical range. No doubt had they held up there would be pork belly booths at the next investment conference.

As noted in the September issue, a fifth consecutive major disaster is developing for investors. The history reviewed above shows that investors have been attracted like moths to a flame to four consecutive pyres: the NASDAQ in 2000, real estate in 2006, the blue chips in 2007 and commodities in 2008. Now they are flitting across the veranda to a mesmerizing blue flame: *high yield bonds*. Bonds pay high yields when the issuers are in deep trouble and cannot otherwise attract investment capital. The public is chasing a large return on capital without considering return *of* it. The following excerpts from a New York Times article dated Friday provide some perspective on this rush to own what will surely prove to be certificates of guaranteed self-destruction:

#### **Junk Bonds Are Back on Top**

The market for high-yield securities, as junk bonds are more politely known in the business, is booming as never before. Interest rates have fallen so far — the yield on two-year United States Treasury securities sank to a record low of 0.36 percent on Thursday — that investors are turning to riskier and riskier securities for relatively high yields. The typical junk bond pays an annual rate of 7.5 percent. "In high-yield, it's undeniable that these are the best years that anyone has seen in their career."

While no one foresees a junk-bond bust on the Drexel scale, the explosive growth of the market for risky corporate bonds has some people worrying. "These deals are getting done more easily than they should, given that the economy is not on solid ground," Ms. Vazza said. Junk-bond veterans like Mr. Casey insist Wall Street is being careful this time. "I don't think there's any question that the risk profile of the companies has gone up, but things are not out of hand," he said. Defaults on junk bonds are the lowest ever, he added. (NYT, 10/8/10)

Times of (1) low default, (2) high demand and (3) little worry are times to *sell* junk bonds, not buy them. Junk bond prices are not quite at new all-time highs, but their pace of sales is (see Figure 17), so I am taking some leeway in adding this chart to the short list of Right-Shoulder extremes. Junk bonds are likely to turn out to be the most important component of the Dow's Right Shoulder, the only one that will go to flat zero, in both prices and issuance.

Gold is the only market that hyperinflationists currently cite as proof of their case, because it is currently the only investment market at a new all-time high. Is it starting a big wave or ending one? In May, gold reached a record-high 98% bulls among futures traders (as polled by trade-futures.com), and it just matched that reading on October 6 with another 98% reading. Gold has never registered back-to-back readings this high. The price rise, moreover, has been losing upside momentum since 2006. There is also a significant non-confirmation, as gold is 30% above its 2008 high while gold stocks have not even matched their corresponding level. Silver has been tracing out overlapping waves, which are more typical of bear market rallies than bull markets, and it has just reached the upper line of a two-year trend channel. All of these conditions (see Figures 18-20) suggest that gold will top very soon and be the last market to register an all-time high in the environment of the Dow's Right Shoulder, which in turn is ending the entire topping process since 1999.

Given that the 7.25-year cycle in the stock market is up through 2012 (see April issue), we still entertain the remote possibility that investors will channel their financial optimism into just one market and thereby get gold to spike as oil did in 2008. As long as stocks hold up, as long as credit is plentiful (per this year's record junk-bond sales) and as long as the economy is in expansion mode, gold has the potential for a blowoff. For reasons cited below, I still doubt it will happen. Whenever gold tops, it is likely to bottom in

## All-time Highs at the Right Shoulder

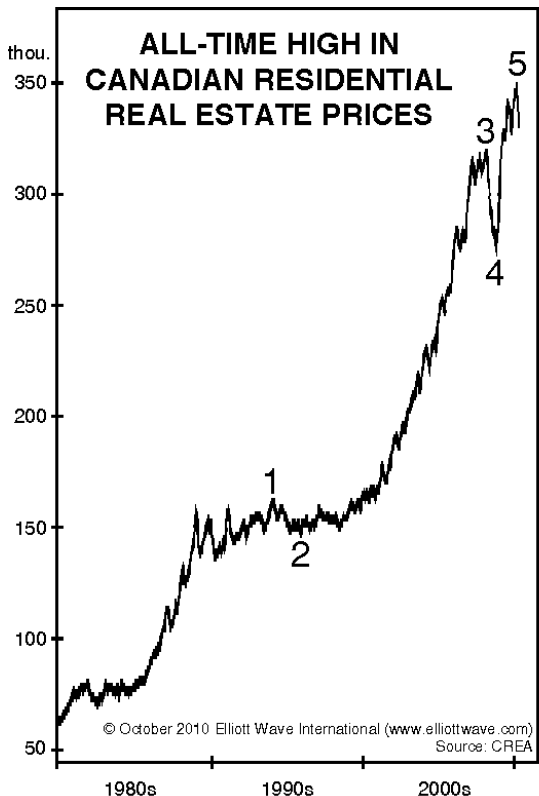


Figure 15

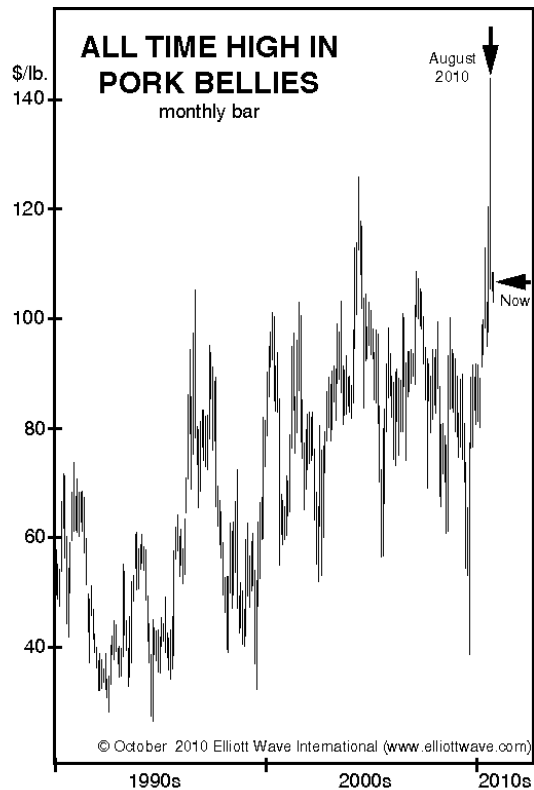


Figure 16

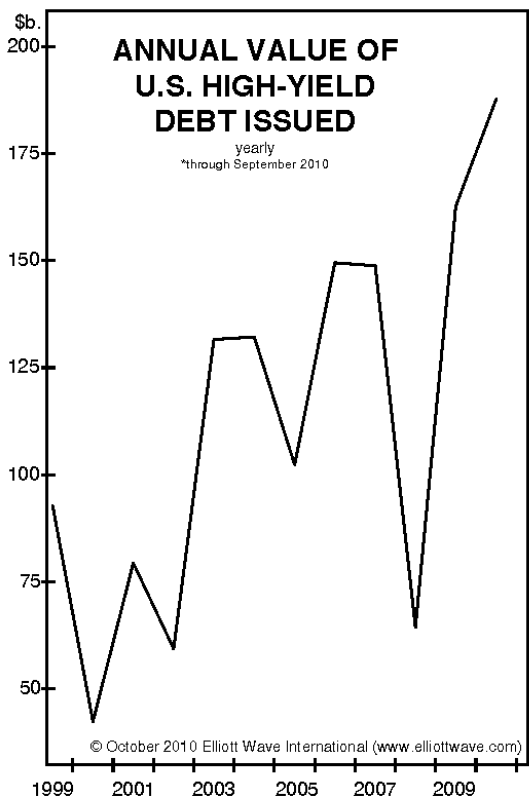


Figure 17

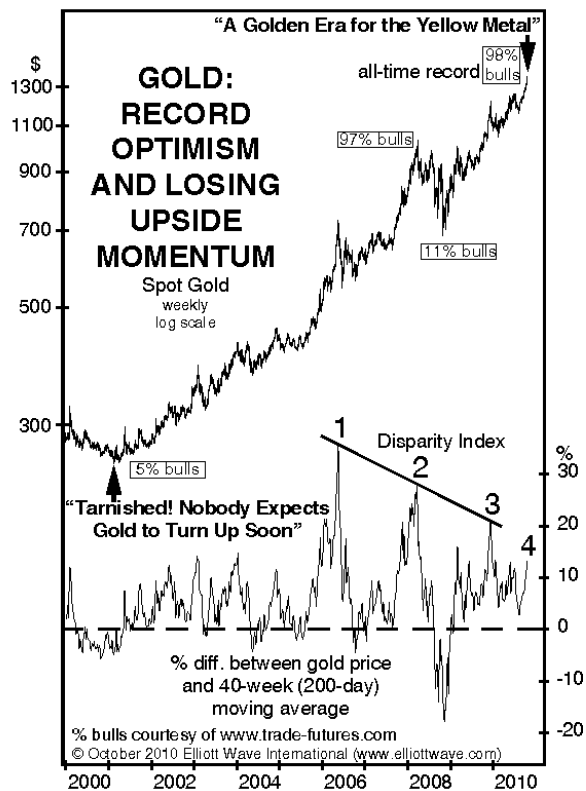


Figure 18

# Lower Highs on the Right Shoulder

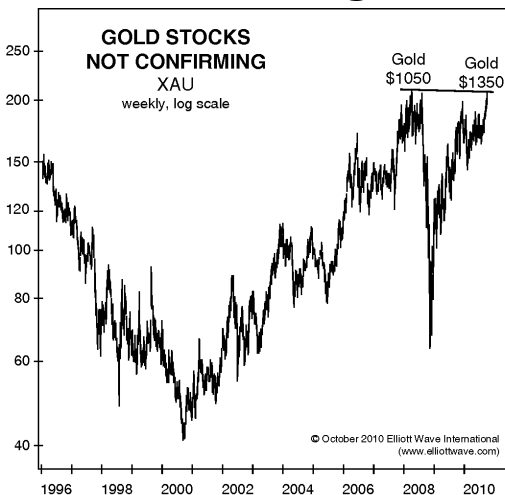


Figure 19



Figure 20

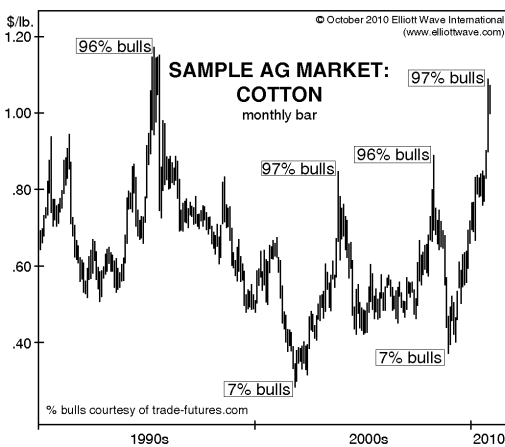


Figure 21

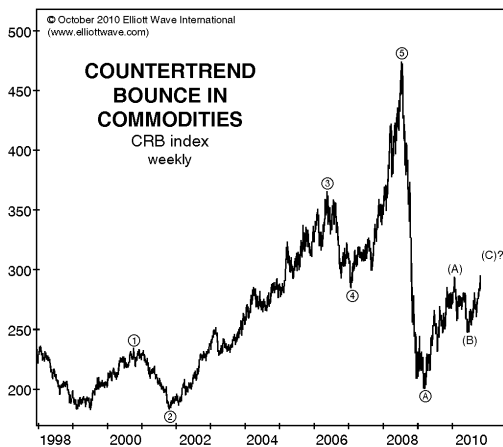


Figure 22

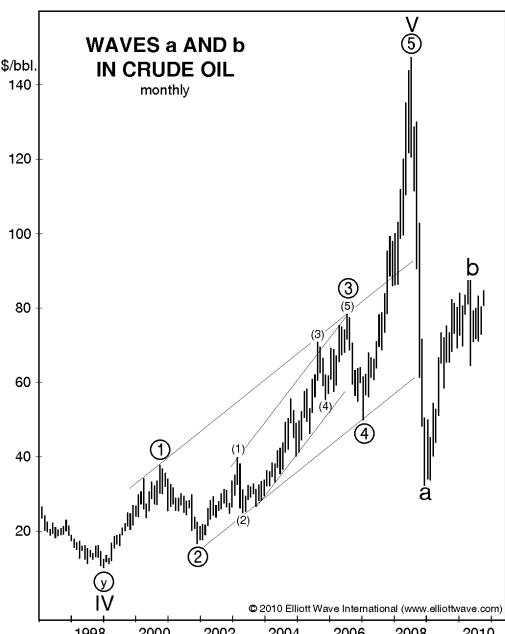


Figure 23

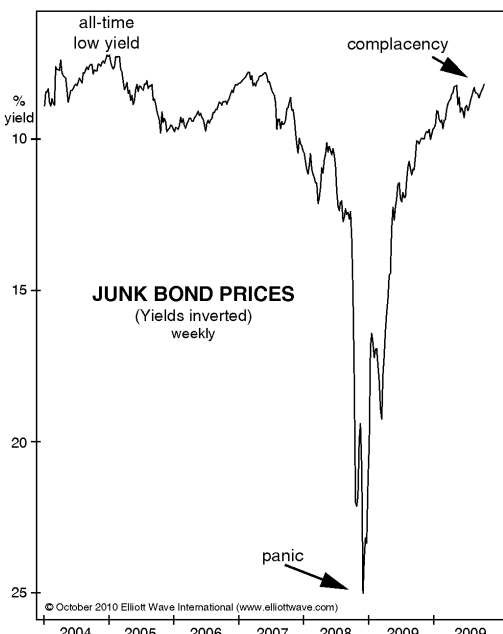


Figure 24

dollar price along with all other financial markets, probably in or near 2016, our projected year for the stock market bottom per the April issue.

#### *Lower Peaks in Many Other Markets*

Since October began, I have heard several times, “Silver is at a new 30-year high.” This is true. Saying so is also deceptive, because one can also say, “Silver is selling for less than half its peak price of the past 31 years.” In 1980, silver hit \$50/oz. in January, crashed to \$11 in May, rallied to \$24 in September and then ultimately fell to \$3.505 in February 1993 (which is the only time in its 31 years that EWT explicitly recommended buying physical silver). It is now at \$23. Even here, then, evidence of the well advertised hyperinflation seems lacking. If gold blows off, silver will probably trace out a manic spike, as it has at each of its important major highs. It is the least exploited commodity of this cycle. But it was also the most exploited commodity of the last cycle, and leaders in one cycle almost never repeat their performance in the next. Today 97% of futures traders are bullish on silver; this is one point shy of the peak reading at silver’s last major high in March 2008. I think silver should turn down very soon along with gold. Whatever path it takes, it seems to be another market that will peak along with the Right Shoulder in the Dow.

Some agricultural commodities have jumped enough to excite inflationists, but wave patterns suggest they are in bear market rallies. Jeffrey Kennedy, editor of our *Futures Junctures*, just issued a [major report](#) on the long term outlook for the prices of various commodities. Crop disruption, not inflation, is behind some of the rises, such as in wheat and corn. Cotton is close to a new high, but look at Figure 21 and notice that 97% of traders are now bullish on that market. Other agricultural markets in the past month have sported similar sentiment numbers: corn 96%, oats 96%, soybeans 95%, coffee 93%, sugar 98% and cattle 98%; in August, wheat hit 97% and pork bellies 96%. This is not the start of a big commodities rally; it’s near the end.

You can get the right perspective by looking at the recovery in the CRB index since its low a year and a half ago. As shown in Figure 22, it has had a “dead cat bounce,” far weaker than stocks (but not as weak as real estate, where an unprecedented credit bubble popped). Do commodity traders *feel* the way this chart *looks*? No, their optimism is way outpacing prices. The same thing is happening in stocks, where a sideways movement for nine long months does not have commentators cautious about the market’s downside risk but enthusiastic over its upside potential. This sentiment is characteristic of a topping market, not a basing one. This is one reason why the sideways trend of stocks in 2010 is more likely to be a Right Shoulder than the launch of a new bull market.

The “bear market rally” label is clear in oil, too. Figure 23 shows a **b**-wave label at the recent high, implying another wave down to new lows.

Foreign currencies are once again the focus of investors’ devotion. Futures traders completely abandoned the euro in June when it bottomed, and now, after a rally, they are more bullish on it than they were at the major top of November 2009! (See Figure 10.) Structurally, the euro remains one of the worst currencies in the world. Now it is back to being one of the worst investments from a technical point of view. The Daily Sentiment Index readings in the foreign currencies have reached extremes in the past month: euro 97%, swiss franc 95%, yen 92%. All these uptrends are terminal.

Junk bond yields are nearly back to their all-time lows of 2004, as shown in Figure 24. If they achieve a new low in coming months, we can add this chart to the group on page 4.

Investors today seem to feel about all these rising markets—most of which are not anywhere near new all-time highs—the same as they did at each of the other two major highs: bullish to the point of madness. This is the third time we have had to live through such fevered buying, which is courtesy of recurring optimism in a world of fiat money and potentially unlimited credit. When sentiment finally turns negative, the credit edifice will collapse faster than it did in 2008, and sentiment extremes in financial markets will become even more intense, in the opposite direction. The April issue argued that prices should peak early within the 7.25-year cycle, and so far April has been the high. But that cycle remains up through 2012, so episodes of optimism are likely to recur through that time, probably from lower levels in the Dow. If you have trouble thinking that investors could become just as optimistic at lower highs, consider the extremity of optimism today even though the S&P is still 50 points below its April high.

### Turns Occurring Now

The September issue reiterated that optimism will remain dominant for another two years even though markets will be resuming bear trends. This month, optimism has become too extreme to sustain. Elliott waves combined with sentiment measures indicate some imminent turns.

The U.S. Dollar Index is completing an (A)-(B)-(C) zigzag correction (see text, p.42), and the percentage of bulls on the DSI has fallen to 3%, matching the lowest extreme of the past five years (see Figure 25). We were very patient during the dollar's recent decline, from 88.70 all the way down to 80, turning bullish then and listing 79.70 as an ideal target. It has since slid to 76.90. In doing so, the bullish case has gone from strong to compellingly strong.

In late August, stock market investors were worried, because headlines warned that September historically has produced the largest average loss for stock prices. The result of that worry was the biggest September gain in 71 years. A national newspaper headline dated October 1 has announced the psychological transformation: "September Turns Investors into Believers." The media have not mentioned that the year of that previous super September was 1939, and it marked the end of a major bear market rally. Lest we forget, September 1929 saw an even more famous top, and the all-time high for the Dow in 2007 occurred in October.

Internet pundits are swaggering with certainty about further gains. They say that Ben Bernanke has promised intense inflation, so intense inflation is what we will get. A famous money manager recently attracted a standing-room-only crowd in New York by calling the inflation-guaranteed, invest-in-everything trade one of the easiest of his life. It's not the optimism *per se* that matters but its popularity. The worriers of early July have turned into the cheerleaders of early October. Waves of optimism and pessimism drive markets, and *they also determine investors' market opinions*. The herd's logic is now cemented: *It's a win-win situation: If the economy expands, stocks will go up; if the economy contracts, the Fed will launch QE2 and stocks will go up. You can't lose.* Seemingly airtight fundamental logic does have immense value, *but it is in the opposite direction from what everyone thinks*. How else can the percentage of bulls have reached 90-98% on over half (26 out of 47) of the futures markets around the world that trade-futures.com follows? At the April high in stocks, the airtight case for optimism was based on projected earnings. Now it is based on the Fed Chairman's promises. On the morning of October 11, a CNN headline reads, "Stocks open higher on growing optimism that the Fed will buy up more Treasuries." An observant subscriber translates this headline: "Stocks open higher on optimism that the economy is worse than everyone hoped." If you learn anything from EWT, it is that fundamental stories are rationalizations of social mood. When optimism reigns, people cite bullish fundamentals. When pessimism reigns, they cite bearish fundamentals. The more extreme the mood, the more certainty attends the accepted fundamental case.

As another subscriber points out, similar logic attends gold and commodity investing: *If we get inflation, gold will go up; if we get deflation, gold will go up. If the economy roars, gold will go up; if the economy*

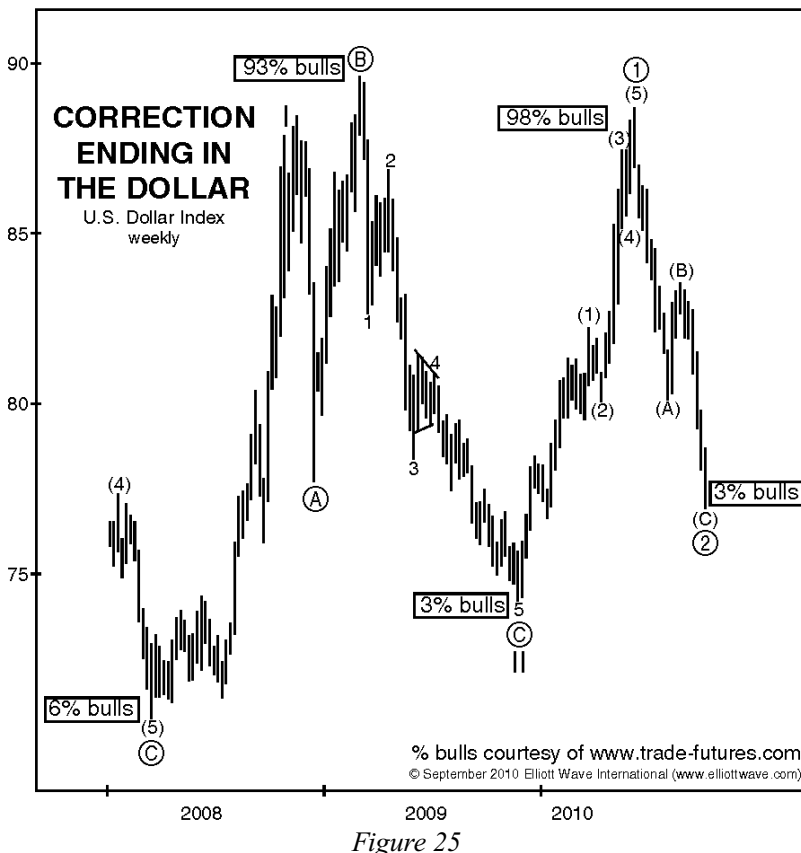


Figure 25

*collapses, gold will go up. If the dollar drops, gold will go up; if the euro drops, gold will go up.* But this is another example of how fundamental arguments reflect the mood of the herd. On February 12, 2001, four days before the low for gold at \$253.50, a headline in Barron's read (quite accurately), "Tarnished! Nobody Expects Gold To Turn Up Soon." All the quotes were bearish, such as "there is nothing positive on the horizon." I published the entire article at the time in EWT. Now, over nine years later, a headline in Barron's' October 9, 2010 issue reads, "A Golden Era for the Yellow Metal." Opinions expressed in the article range from bullish: gold will rise from its "fairly solid plateau" at \$1350 up to \$2000 on its way to an annual average price of \$1500 over five years; to really bullish: gold is "the only haven left." If you contemplate the timing of these articles as shown in Figure 18, you should come to a priceless revelation about the perverse role of fundamental arguments in every market's waves.

Here's some fundamental logic that no one is using: When the credit crunch resumes, banks will accelerate their already mad rush to get *cash*—not pork bellies, not property, not stocks, not gold, but *cash*. The only way they can get cash is if their debtors sell something, or they sell it for them. And when the banks finally fail, *everyone* will be desperate for cash. Accumulate as much as you can now, before the rush.

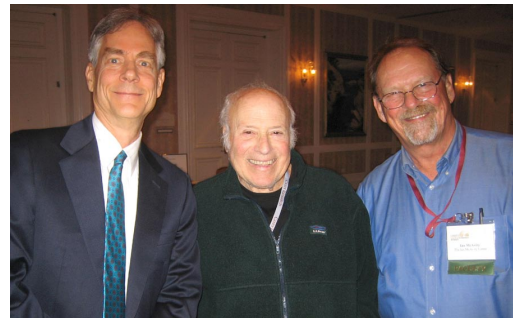
*The Elliott Wave Financial Forecast* made the case that Minor wave 2 in the stock market is ending. Overall breadth today was again very narrow, and the NASDAQ may have completed an ending diagonal (see text, p.37) at today's close. Minor wave 3 should carry the S&P down about 400 points over the next few months. A drop of that magnitude would close the chapter on the Right Shoulder of the great Dow top.

Strategy update: The only bullish chart in the financial pantheon is that for the U.S. dollar. Investors should avoid everything else. Traders should stay short the S&P and sell short the euro. If you are a speculator who joined us after January 2010 and are not already short the stock market, use this opportunity to take a maximum leveraged short position. If you want to take a flyer shorting precious metals or certain commodities, our [Metals](#) and [Commodities](#) Special Services track these markets daily.

## Miscellany

Support the Market Technicians Association's Educational Foundation. October 13 is the last day you can bid on taking your favorite market analyst to lunch or dinner. There are many great names on the list, including our own Steve Hochberg. Remember, this is a charitable fundraising event, so the expense is tax deductible. For details, go to [www.elliottwave.com/MTAuction](http://www.elliottwave.com/MTAuction).

Doug Casey and David Galland put on a great conference in San Diego last weekend. I got to say hello to old friend Ian McAvity and enjoyed a chat with my inspiration for going into this business, the still inspiring Richard Russell. He was jealous of my tie and tried to buy it, but I reminded him that Southern Californians didn't need to dress up.



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