

## Ag Financial Strategies

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### **Business Cycle Trends of the Stock Market.**

Although the models include fundamental such as economic indicators, commodities, interest rates and inflation, the core or primary focus is one of time cycles of price of the stock index with an emphasis on Cycle Series Analysis price only model with similarity to economist Schumpeter's business cycle concept. The long term portion of the CSA model begins with a 3yr cycle and ends with the 216yr Posson cycle.

With the creation of business cycle models during the early 1990s a forecast was made for a significant bull market for commodities this decade, a bull market for stocks to 2000 and a stock bear market that should end with a crash this decade to early next. Within the models is a cycle of 72 years (of wide range however) that is believed to relate to price decline of 70% to 90%. Earlier this decade the NASDAQ 100 collapsed by 85% and although well ahead of a similar peak for the Dow index, the occurrence of a top was on time. From 2007 into 2008 other indexes declined by 70% to 80%. History does not repeat but does rhyme and for price the performance is closer to a repeat of history than many believe. It was in 2006 that research suggested a chance for a more diverse stock market and for chance for new statistics of bear market performance for price relative the model forecast for this decade. The result was causation for consideration that an index like the Dow would not repeat history for the 72 yr cycle with decline by 70% to 90% and with chance the maximum down side potential would be 60%. Most of the causation relates to an exponential growth of global economies, capitalism and consumerism. And the potential for government based risk management.

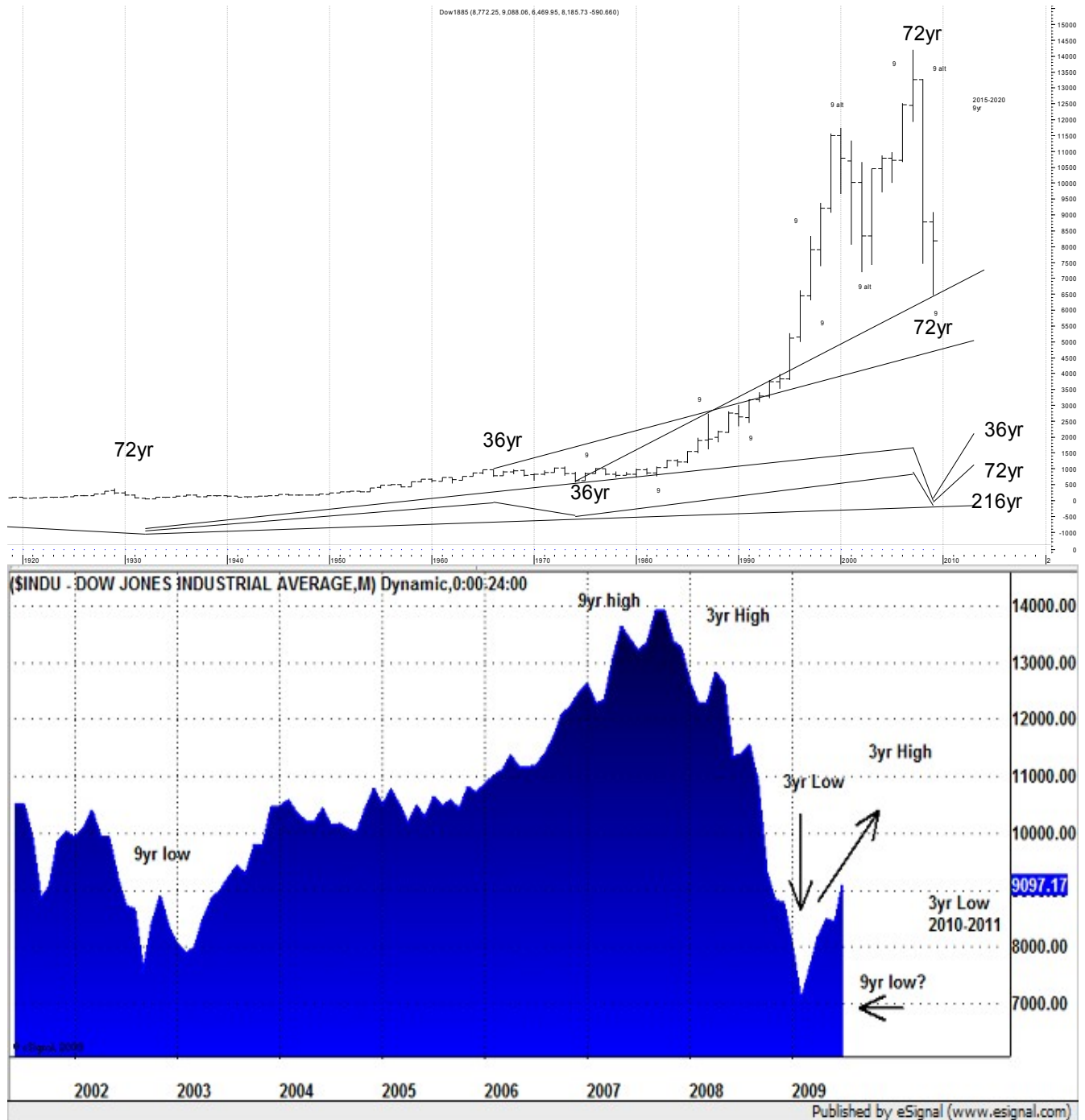
With the intervention of the Federal Reserve and the Treasury and global central bank participation the risk management factor(s) were done in a timely manner and the forecast is one that favors a deflation depression will not occur but a deep recession is now obvious. Risk management that is effective is often a thank less process as skeptics never quite see the risk and non skeptics often can not see the reason for the degree or type of risk management in that if correct the risk management should have mitigated the risk and with this specific occurrence saved the US from a collapse. In other words the evidence that risk management was necessary disappears with introduction of risk management.

### **Trends**

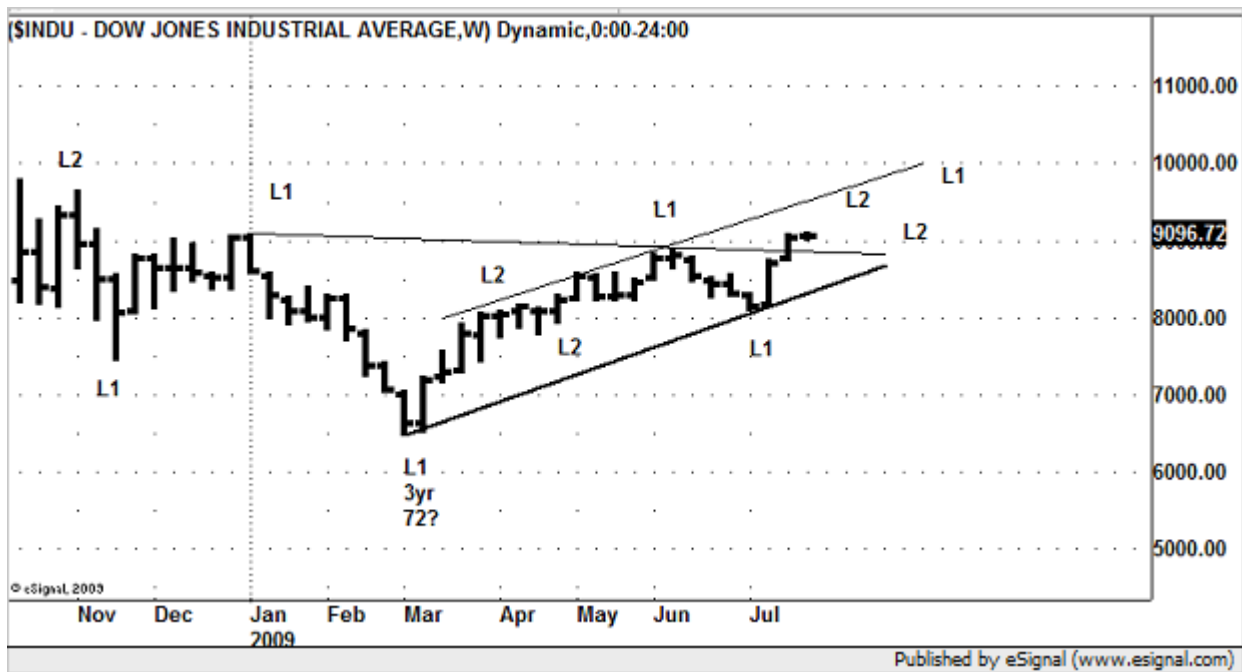
The models show a 216yr business cycle trend that peaked in the 1850s and bottomed with a crash from 1929 to 1932 and the higher high of 1929 than the high of 1850s was evident of a more dynamic market place and related business sector which in turn is evidence of a still larger but unknown trend that is bullish --unknown due to lack of data. The crash of 1929 however was evidence that the stock market could not ignore its apparent bearish cyclical obligation. From 1932 the trend should be up into 2070 plus or minus several years. Within this trend there should be two bull market trends relating to the 72yr business cycle and the first trend or leg of this mega bull market came to an end in 2007. And within these trends should be two trends or bull market legs with the first beginning in 2009 but can delay to 2010 to 2011 and the second to begin in the 2040s following a bear market the same decade. This type of trend relates to a 36 yr business cycle and it is this trend that was used as first input from the idea that the bear market/crash due late this decade would not live up to the 72yr statistics of past cycles. The 36 yr business cycle is believed to relate to a bear market of minus 40% to 60% which the Dow index as of 2009 low was well within range.

### 36yr business cycle trends for the bulls-

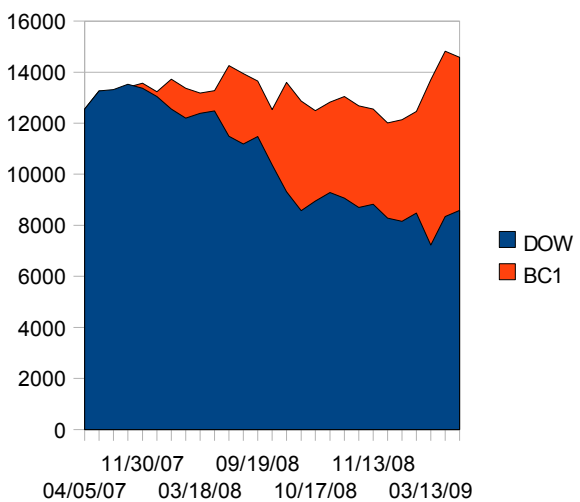
- 1896 to 1929 (1896 to 1932 for cyclical lows)- The trend was up for 33 years with an annual increase near 8.5%. This trend was the final leg of a 72 yr business cycle based trend.
- 1932 to 1966 (1932 to 1974 for cyclical lows)- The trend was up for 34 years with an annual increase of over 10%. This trend was the first of two legs of a 72yr business cycle trend.
- 1974 to 2007 (1974 to 2009/11? for cyclical lows)- The trend was up for 33 years with an annual increase of over 10.5%. This trend was the final leg of a 72yr business cycle trend.



Within the models are trends of greater frequency and one of these is the 3yr business cycle which may relate to the Kitchin business cycle mentioned in Schumpeter's Business Cycles. I have often stated the 3yr business cycle can make or break the business or investment year. This trend peaked in 2007 with convergence of much larger trends and this trend bottomed at the low of 2009. The trend is forecast to be up until year end to early 2010.



The models called a L1 intermediate trend bottom 7/13 and a bullish forecast was made with trend to be up into mid to late August. The lagging trend following BC1 system turned bullish 7/15 to offer confirmation that the most important intra year model trend was up. The models suggest this larger intermediate trend is up from the July low into year end and this suggests two legs higher into year end with a correction during September.



The BC1 from April 2007 is a system that contains a Model Correlation Factor (MCF) that relates to model L1 intra year, intermediate trends. It is trend following based and has outperformed the DOW index in terms of buy and hold for same period of time. Performance shown was of long and short combined, always in the market and of absolute return concept. The short side has potential to assist the buy and hold investor with macro market risk management.

## **The Forecast-**

Super long term- A bottom was placed during 2009 that was a buy of a lifetime with the risk point of low of 2009 and chance for a second opportunity for a bottom during late 2010 into 2011. If the DOW index returns to 7100 or lower the models will be forced to consider a late bottom and a new low relative the 2009 low will force the models to continue to seek said bottom. A forecast is made for 7% to 11% annual return next several decades but this with inflation averaging near 5% next 25 to 35 years versus a 100 year average under 3.5%. This level of inflation should not be a concern as some sectors of the economy are better off with a higher inflation rate than seen past two decades. And such a performance would be typical as intra -100 year average fluctuation. In addition the US and global economies are in the early stage of cyclical inflation which is more of a benefit than detriment and is of positive correlation for stocks and commodities. It is my opinion that stocks and commodities have been of far more decades of positive correlation than negative which is probably counter to the thinking of many an analyst. In addition super long term business cycles are bullish commodities into 2030s. Anti-inflation measures should not occur until inflation of 7% or higher. Late inflation is of the negative version of inflation and is of less number of years and present near end of mega business cycles which in this case will not occur until the 2030s. I do believe the stock market can be of low performance well into next decade and rate of return is likely to be exponential. I also fear that without dramatic reduction of health costs and education system revision the stock market is vulnerable for 4% to 5% return versus the 7% minimum. A forecast is made that if the recession has not already come to an end that it will by year end and a recession trend following indicator is poised to reverse by October.

Long term- The 3yr business cycle is up into year end to early 2010 perhaps to mid 2010 with potential for as high as 11,000 DOW. When this trend is down for late 2010 we will learn if 2009 was the super long term bottom or not. Current expectation is the down trend will cause only a correction of the 2009 rally –bull market. The 9yr business cycle trend relates to the decadal recession and decadal boom bust cycle. This cycle is up from low of 2009 but with risk of delay of bottom to late 2010 to 2011 if the super long term trend did not bottom in 2009. From a bottom this trend suggests economic expansion into late next decade.

Intermediate trend- Up to 9,200 to 9,600 by mid to late August, a correction in September and a rally to 9,400 to 10,500 by year end. The potential for 11,000 seems more for 2010 than 2009. The BC1 could turn bearish in the 8600s DOW and will now act like a trailing stop.

## **Cyclical cultural factors-**

There are those who believe the stock market is in a 100 year bear market. And there are those who believe the market will not bottom until 2012 or later. I do not. I think the research suggests they will be out right wrong. And yet, I see negative factors that can reduce the 7% to 11% annual stock market increase to 5% or lower and an inflation adjusted basis to zero or lower and not for a few years but a few decades. Sense the forecast is one of high probability (in my opinion) then I assume we will take the appropriate actions to reduce risk and increase economic growth. The following are some ideas I have dialed in for the super long term forecast.

Health care- Costs need to decline by a dramatic amount as health care is a tax on the economy and can bankrupt the nation. It seems the health sector has no end to demand and so the system is rigged for little competition and the sector can increase its price by any amount at any time and as often as desired. There is something about health care companies that report record earnings that I find irritating – it almost seems immoral. Over the next 20 years expect importation of drugs and supplies to increase, performance measures to change more toward less and more appropriate tests and increased use of salaries over fees for doctors and others. I recently was told that a hospital was ranked in top 10% of

hospitals for health care performance and was of lower cost than 90% of hospitals and doctors were salaried.

Education- Degrees like BA, MS and PhD will go by the way side over the next 20 years. New degrees will be developed. Students will graduate in shorter amount of time with less debt and this will relate to longer careers and greater tax revenue and with less formal education expense. Online education will continue to increase if for no more than to cut costs of living on campus. Some businesses will learn that current degrees are not necessary for some jobs. I believe 50% of today's students do not need nor do they benefit from the degrees that they receive along side large debt. Mathematics and science to increase as desired education over the next 20 years and we need this to maintain the competitive advantage the US has enjoyed past 100 plus years.

Retirement- A high valued retirement will be look down upon from a cultural perspective. Social Security to evolve into a national retirement fund. I was against President Bush's concept of allowing stock investing within Social Security as I viewed it as welfare for Wall Street and was of concern the cyclical forecast for a crash. With the latest of research, I am now of the opinion that stock and bond investing in a Social Security fund would now be timely and a benefit. In addition I think one way or another we will pay taxes during the remainder of this century to provide for retirement for those with low to no retirement. We can not win on this one. And so it seems to me a national fund providing bare minimum retirement can be proactive rather than reactive and of benefit to the economy and for future generations. Those who feel such a tax would be too great can reduce IRA, 401K contributions to balance with the national fund contribution (tax) for their desired retirement amount. The age of retirement will move from 65 years to 75 years with introduction of semi retirement from 65 years to 75 years and businesses will be expected to provide semi retirement employment.

Free markets- Next 20 years there will be a global initiative to create floor pricing for at least commodities markets. The concept will be to reduce risk of a depression from an extremely low priced market that is irrational. The concept will lead to reduction if not elimination of price based subsidies for producers and revised risk management strategies in relation to the new level of zero (idea that commodities can not go to zero). And this will allow for continued growth of futures and options industries for both speculators and hedgers but with parameters to protect from self destruction. And said floor prices will be low enough to allow for the free market message to put supply and demand in balance but not to self destruct. Free markets do not work well with low prices but the concept works very well and quickly with high prices balancing supply and demand. Futures markets will split size of contracts and I hope the split will be aggressive enough for a better balance for small user (retail) versus institutional and commercial. And of course fees and commissions will split accordingly and for delivery there will be a unit of contracts. It would not surprise me to see exchange made markets to evolve to a forex concept (which is a better concept) and if not then at least a much smaller sized contract. There could be the development of Collar zero cost futures contracts with limited loss and limited profit potential. Expect increased use of exchange traded swaps.

Cultural consciousness- Next 20 years we will see a greater consciousness that chaos theory works. That one's actions today can not only impact one's future but impact the lives of others and long term. When chaos theory is placed along side the cyclical based models it is clear that small waves (ripples even) can turn into tidal waves. That short term cyclical fluctuation evolves into massive boom and bust cycle trends. The financial crisis this decade began with good intentions within the real estate market that evolved into a bubble that also created a wave for a financial bubble that in turn created a wave for a national financial crisis that created a wave for a macro and deep recession. And with this idea I close with ---

For want of a nail, the shoe was lost; For want of a shoe the horse was lost; For want of a horse, the rider was lost; for want of a rider, the battle was lost; for want of a battle, the kingdom was lost!  
And all for the want of a horseshoe nail.  
John Gower 1390