The Swiss Association of Market Technicians

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Interview with Bruno Estier, Independent Market Strategist Geneva

by Ron William, CMT, MSTA,
Vice President & Head of the SAMT Geneva Chapter

Bruno Estier, MFTA, *Independent Market Strategist, former Chief Technical Strategist at Lombard Odier and former Senior Technical Analyst at JP Morgan. Mr. Estier was a guest speaker at the SAMT Geneva Chapter July 2012 Meeting.*

"Perspective on long term cycles and market outlook: Basing phase after a mid year correction in US Equities."

Bruno Estier and Ron William appeared on Dukasopy TV in Geneva to talk about technical analysis education and the CFTe designation, exam and this immersion course.

For additional information about Bruno Estier, go to
http://bruno.estier.net/

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Ron William: When did you learn the importance of using technical analysis early in your career?

Bruno Estier: When I joined JP Morgan in 1981, in the Foreign Exchange trading room in Zurich, my first job was to enter the open, high, low and close of the four major currencies, USD/JPY, USD/DEM, USD/CHF and GBP/USD into an Apple 2E to create charts for the next day. The charts were helpful to advise our clients, as my first assignment was in foreign exchange sales. Then in 1988, a former boss who had moved to JP Morgan Paris, asked me if I wanted to become a technical analyst for foreign exchange and bonds in the treasury room in Paris. That's basically how I started in the profession of technical analysis.

RW: How would you describe the evolution of technical analysis during that time...?

BE: In 1988, technical analysis was relatively new to France. There were only a few expensive charting systems available and technical analysis was considered a mysterious craft only used on the exchanges in the U.S. and the UK. Certainly the October 1987 equity crash was a catalyst, because people claimed that they were able to predict the crash using technical analysis. The management at JP Morgan's Paris trading floor decided to create a full-time position dedicated to technical analysis for foreign exchange and bonds to serve the traders and treasury department clients.

RW: What educational resources were available then?

BE: You have to realise that although I was sent to Paris to be a specialist in technical analysis, in fact I had to train myself almost from scratch. So one of the first ways to learn the skills was to attend seminars. So several times I went to London to attend seminars given by David Fuller, a leading technical analyst in the UK. I then got in touch with the English technical analysts society (STA), attended technical analysis conferences at Kings College Cambridge, and passed the MSTA exam. Also in Paris, I got in touch with other French technical analysts and became the founding president of the French Society of Technical Analysts (Association Francaise des Analystes Techniques - AFATe) in 1990.

RW: You later on progressed to become President of International Federation of Technical Analysis (IFTA) and the Swiss Association of Market Technicians (SAMT). What role did you feel technical analysis societies played then, now and looking out into the future?

BE: My first impression at the time was that these societies were great for networking. Then I quickly realised that there was a lot to learn by listening to senior technical analysts who were sharing their

tools at conferences. I was very lucky that my employers, JP Morgan and later Lombard Odier & Cie, sponsored my attendance at the annual IFTA conferences and at many MTA and STA seminars. So clearly the seminars of the large, well-structured technical analysis societies were and are still providing education to the junior technical analysts.

In newly-created societies, like the French AFATe, Paris in early 1990, their role was to provide a structure to discuss market views among technical analysis peers working at different organisations. At the time technical analysis was not a new profession, but fashionable, and that's why the French society grew so quickly to 30 members. AFATe had the honour of organising the 1994 annual IFTA conference in Paris, where Ralph Acampora, the late Ian Notley and the late John Brooks were keynote speakers.

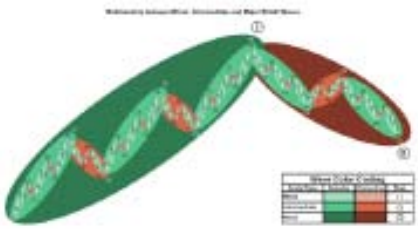
This was a time when Paris was seen as an important financial centre. I remember that between 1988 and 1994 the French Treasury made several innovations in financial products, for example stripping long bonds, which was something that had not been done in France before. Unfortunately after 1994 their innovative spirit slowed down and many financial specialists left Paris to move to London. At that time I moved to Geneva and joined Lombard Odier & Cie where I not only worked on foreign exchange and bonds, but also on equities as an advisor to the Chief Investment Officer. Back in Geneva I joined SAMT, a tri-lingual society with a Swiss German chapter in Zurich, a French chapter in Geneva and an Italian chapter in Lugano. SAMT Lugano hosted the 2006 annual IFTA conference, attended by many famous international speakers and authors in the technical analysis community like John Bollinger, Robin Griffiths, Perry Kaufmann, John Murphy, Hiroshi Okamoto and Martin Pring. SAMT is a good example that beyond cultural differences passionate members meet together because technical analysis is a universal language. This is the role that technical societies should keep playing in the future. Indeed, the next IFTA conference in October 2012 will take place in Singapore.

RW: What are your preferred analytical techniques and strategies?

BE: My techniques are simple. They rely on three things. First of all the price action, is there any pattern on the price action? Second, I look at Bollinger Bands, because they give me an indication of price volatility. Third, as a subsidiary instrument, I look at the momentum of price. To measure momentum, I prefer to use a slow Stochastic and MACD indicators. The former is more geared to trading ranges, the latter more to trending markets. While I apply these on three time frame horizons, usually monthly, weekly and daily, I keep the same parameters for all time frames, as it is easier for my brain to understand the interactions between time frames. Concerning price analysis, I look at classic Edward & Magee patterns. Though I do not have one exclusive religion, I use diverse techniques like Point & Figure, Market Profile, Ichimoku charts and still use these from time to time for specific purposes. I would say that my eye tends to analyse price evolution with one of the first techniques that I used in foreign exchange, Elliott Wave.

RW: How did you discover Elliott Wave?

BE: My primary focus while in Paris was technical analysis of foreign exchanges. The FX traders were already using



technical analysis tools, but very few people were knowledgeable about Elliott Wave. In 1989 a famous analyst, Robert Balan, wrote one of the first books on Elliott Wave for foreign exchange. I had met him and he recommended that I read his book. I learned mainly from that book and started practising the technique. Later I went to Atlanta, GA (USA) to attend seminars with Robert Prechter of Elliott Wave International.

RW: Within your Elliott Wave analysis, do you also overlay other road map-based type of analysis, such as Cycles or Gann?

BE: I know very little about Gann. Meanwhile, cycles represent an interest for more medium- to long-term time horizons. This is a tool that belongs to both technical analysis and macroeconomics. Thus is not surprising that technical analysis does not exist in a vacuum. It is about financial market expectations of the economic business cycle.

RW: There are notable studies that suggest a correlation between astronomic cycles and the financial markets. How much value can such observations provide with the analytical process?

BE: Statisticians point out that correlation does not mean causation. We know that the financial market is a discounting mechanism, reflecting expectations of market participants. May be one day we may have neurologists tell us something about the influence of astronomic cycles and the human brain. Then it will be time to elaborate more about such observed correlations. But to the best of my knowledge, it seems that we do not know about the causation process and that theories about such correlations are quite debatable.

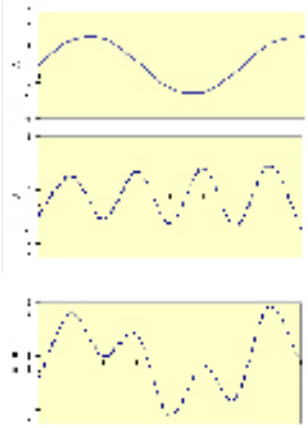
What is important to realise about cycles in the financial markets is that cycles are usually represented as having a fixed periodicity, but such a description is a short cut for communication purposes and does not exactly represent what is going on. Indeed we should be aware that the periodicity and cycle's skew changes depending on the interaction between diverse cycles. For example, a rising larger cycle can influence the skew of a smaller cycle. This may create the right skew; i.e., the fact that this smaller cycle may spend more time on the way up than on the way down. Within technical analysis, cycle theorists have developed a few principles. For example, cycles that are related tend to bottom together and so on. There are few a properties of cycles that try to explain their behaviour. As long as market analysts can observe some kind of regularity in the rhythms of the financial markets, then at certain times that helps these analysts adopt a contrarian attitude to the main thinking. Market analysts do not need to know the whole causation process, though it may be interesting intellectually to know one day why.

RW: How do you suggest that a first-time practitioner can best apply cycle analysis?

BE: Cycles are often difficult to pinpoint because they seem to be irregular. Fixed cycles are, as we said, only a theoretical representation. For a first-time practitioner, it is probably better to focus on the classical tools of technical

analysis, which are geared to measuring a trading range or a trend. A tool that would measure trading-range conditions, for example, could be slow Stochastics to gauge a top, bottom, or a trading range. Conversely, one could use moving averages or MACD to try to determine in which direction the trend is going.

The risk of focusing too strictly on a supposed cycle that you have discovered, is that at a certain time, you can lose your critical sense and not realise that your expectation about that cycle is wrong, hindering you to adapt to the current market evolution. Possibly you may lose sight that other cycles may influence the only cycle that you were focusing on. There are so many interactions between diverse cycles that you might not be sure that the cycle, which has been pinpointed, is the only one that will remain important in the future.



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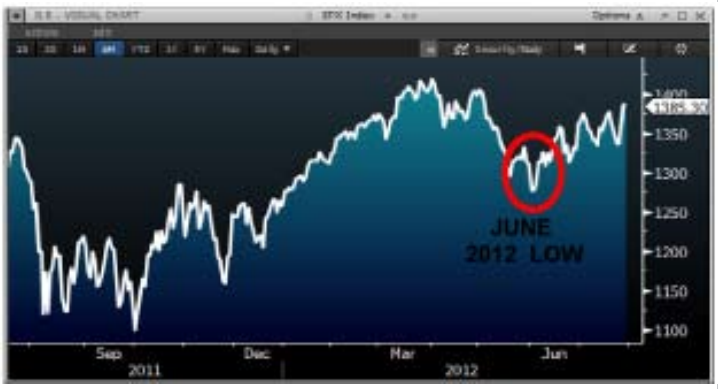
It could also be by chance that you have the opportunity to be the perfect contrarian at one time, but next time there might be another cycle that changes the reality. If you do not take care and do not have risk management in your own view, then you can end up as a fool by hanging on to the expected bottom of your cycle, while the market is moving further down, beyond the time window of the expected bottom. Therefore, when you use cycle analysis, you should be cautious and always leave the last word to the market by respecting risk management.

RW: One of the key themes within your presentation highlighted 2012 an important year for two cycles. The 10-year (Juglar) and 4-year presidential (Kitchin) cycle. What does that suggest to you about the market outlook for the remaining half of 2012?

BE: I currently believe that 2012 is probably a time window for the 10-year cycle to bottom, assuming that 2002 was a previous cycle low. However, as you may have already noticed, 2012 is not the official cycle low for the classic 4-year cycle which bottomed in 1990, 1994, 1998, 2002, and should have theoretically bottomed in 2006 and 2010, and should display an important low in 2014.

Based on the theoretical lows of the 4-year cycle, we notice that this time the 4- and 10-year cycles are not bottoming in the same time window. In theory, we have a situation where the 4-year cycle is starting to go down into 2014, while the 10-year cycle might have already been rising since March 2012. The interaction of these two cycles would suggest a subdued decline for the coming 4-year cycle low, i.e., a decline smaller than during previous 4-year cycle. However, at the present this is only a hypothetical thesis.



Source. Bloomberg Finance LP

The other interesting point is that if we multiply the 10- and 4-year cycles, we get 40 years. If we recall that 1974 was an important low for U.S. equities during the previous secular bear phase and going forward 40 years, we arrive at 2014. So that means, in addition to the 4-year cycle, there could also be a bottoming phase for a 40-year cycle. There is a debate about this 40-year cycle and it may be more a rhythm than a classic cycle (some call it an "asymmetric cycle" as it has a strong right skew). Some analysts claim that one should look at a 37-year period instead of 40 years.

But, at least we may agree that the period between 2012 and the end of 2014 represents a time window where different major cycles may bottom. Therefore, during this time, we may witness some kind of excess pessimism, similar to what existed between September and December 1974. Of course, 2012-2014 may not display a similar macro-economic setting to 1974, but it would not be surprising to discover a similar psychological setting: a sentiment of relatively high pessimism.

On a short-term basis, the big question amongst technical analysts is to determine if there is going to be a major low in October 2012. Some argue that the low in June 2012 was already important and that historical statistics suggest that in years ending in 2, and being a U.S. presidential election year, the annual seasonal bottom is in the first half of the year and not during the autumn as it often happens in many years along the annual seasonality.

So far I believe the June phase is probably the lowest point for U.S. equities for 2012 and I would possibly expect a bottoming phase through July and August, with a low that is higher or equal to the low that we just had in June, and not much lower. So far the European equity market has acted as a higher beta proxy of the U.S. market. It is unclear how long it will continue to under perform the U.S. If we go back to 2002, we should remember that the U.S. market made its 4-year cycle low in October while the European market made its final low much later in March of 2003. Most of the time it used to be the U.S. equity markets which leads and the European market which follows.

RW: Given that we have already experienced two dramatic stock market crashes in the last decade, what are the probabilities of another one occurring?

BE: I am not sure anyone knows the probabilities of another crash. History can be a guide, and many market analysts consider that we should compare the current period from 2000 to a period where the U.S. equity market remained in a wide trading range, like 1966-1982, or even the previous period 1929-1945. So it would only be the third time within the last 100 years that we have experienced a long-term horizontal consolidation phase for the U.S. equity market indices. Three is not a large enough sample data to make a lot of statistical observations.

If we try to make analogies between the previous period between the 70s and now, we can hope that the low of March 2009 could be compared to the 1974 low. It was around 12 years after the low in 1966, when the Dow stayed beneath

1000, and then took another 8 years to go up (1974-1982) out of this trading range into a secular bull market. If 2009 is comparable to 1974, then we would expect another 8-12 years before getting out of this current long-term trading range phase. 1974 was the lowest low and the following lows, in 1978 and 1982 were higher. So we can hope that after the 2009 low, in 2013 or 2014 we might have a higher major low and possibly four years later another higher major low. Maybe things will go faster on the way up and before 2018 we might break out of the current trading range that we have been in since 2000.

RW: You mentioned important historical similarities between the secular bear market of 1966-1982 and the current period. What differences do you see? Technical or macro?

BE: If we do not take inflation into account and consider the Dow in nominal terms, then we can say that we somehow have similar horizontal trading ranges. Of course, from the macro economic backdrop there are quite a lot of differences. Big structural changes were not the same; for example, the oil crisis in 1974 versus the financial crisis into the low of 2009. Of course, the economists will point out many more differences. Along with many other market analysts, I tend to think that we can try to compare both periods in terms of the psychological viewpoint of the investors. The sentiment during these periods was probably a bit more cautious, more pessimistic than in other periods when sentiment was more positive or even exuberant, as was the case at the end of the secular bull rise between 1982-2000.

So as the 1966-1982 period was followed by a major bull market in equities, it is probably not so wrong to hope that the current "sideways period" could be followed, after lasting the same length of 16-18 years, by a period in which financial assets and also the real global economy could do as well as between 1982-2000.

RW: What role do you believe the frontier markets of Asia will offer in a potential long-term global recovery?

BE: The theme from 2002 was that the emerging markets were outperforming the developed markets. The reason for this was there was a commodity-driven equity bull market, partly because of the industrialisation of the new BRIC markets, which in turn increased demand for commodities. As a consequence, we started to see major bullish moves on commodities, as reflected by the broad CRB Index and precious metals.

We hope that this secular uptrend in commodities, which so far has lasted 12 years, continues for at least another 10 years. Usually a long-term secular trend can last 20-30 years. Meanwhile, the current weakness we see in the financial assets of emerging markets, compared to the U.S. S&P 500, is likely only to be a pause, after the relatively strong performance years between 2001-2008. The current pause has lasted about 18 months and could last more, but these secular bullish trends for emerging markets and commodities are likely to come back and help other financial markets in the coming years.

RW: What key lessons have you learnt from your experience within the financial markets?

BE: As a financial market analyst it is important to use a few simple principles:

- You can have big theories, but what really matters is the behaviour of the financial markets and that your theories are tested in light of what actually happens in the financial markets.
- When you analyze price behaviour, you need to decide whether price is within a trending mode or within a trading range situation in each particular time frame you scrutinize. Then you need to decipher the message of the specific tools that can be applied to these two different situations.
- If you are interested in cycle analysis, and not only in "trend following" market analysis, it is important that while you try to spot turning points, to be patient and not to be too early. That means that you need to wait for the evidence to accumulate in order to be able to go against the crowd and to allow yourself a contrarian attitude, when you feel you are in an extreme situation. This usually occurs when the price is overextended and sentiment is rock bottom pessimistic or extremely optimistic. We think that the sentiment of people is often a reflection of the positions they may have in the market. That means that usually a majority have sold when they express deep pessimism or have bought after a long period of euphoria. Therefore, when everybody has bought there are no more buyers, and the only thing that can happen is that some of the former buyers will begin to sell, driving prices down. The same process occurs in reverse at a major bottom.
- In addition to applying your simple principles and technical analysis toolbox, it is critical to use risk management that allows you to control your perceptions of the market, based on either discretionary or quantitative tools, versus the reality of the market, which is mostly given by the market price, as most people are market to market. If you are wrong then you need to deal with the consequences. If you are right, then you can maintain your theory until the market tells you that it is no longer valid. In short, in the financial markets, as in many aspects of life, the expectations need to be revised in line with reality.