HOW WILL THE NEXT FEW YEARS BE CHARACTERIZED?

INFLATION, DEFLATION OR BOTH?

featuring Robert Prechter, CMT, President of Elliott Wave International
& Martin Pring, Chairman of Pring Turner Capital, moderated by
Ron William, CMT, MSTA, Founder & Principal Strategist of RW Market Advisory

During the annual symposium of the Market Technicians Association, April 2013, two of the world's most renowned veteran market technicians, Robert Prechter, CMT, President of Elliott Wave International and Martin Pring, Chairman of Pring Turner Capital, shared their key insights during a moderated panel discussion with Ron William, CMT, MSTA, Founder & Principal Market Strategist of RW Market Advisory, on one of today's most widely debated questions about Inflation & Deflation pressures and how both risk scenarios would impact your investment decisions and portfolio returns. Please select link to review the full online video.

Robert Prechter, Martin Pring and Ron William

Ron William: What is the best strategy to help preserve capital given your stances on either of the inflationary or deflationary pressures ahead?

Martin Pring: Our firm (Pring Turner Capital) has just come out with a new ETF (The AdvisorShares Pring Turner Business Cycle ETF) (DBIZ) and I think that would be the place to go. In the past, obviously, being long commodities has been a good place to be or commodity resource-based stocks or basic industry stocks have also been good places to overcome inflationary trends. So I see no reason why they wouldn't still be a good idea.

Robert Prechter: I think it's extremely hard to preserve capital. With the abandonment of real money in the monetary system, it's become nearly impossible to be a quiet little saver, because wherever you put your money other people are going to get their hands on it. Or it's possibly going to disappear overnight. So it's one of the hardest tasks in the world. That's why one of the things that I have been recommending in the past few years is actual cash. I mean cash stored away in a nice safe place or in multiple safe places. I think it's going to become very handy.

Gold is the only real money. I believe Bitcoins will become real money eventually, but it's gold at the moment. Gold, however, is extremely overpriced and overvalued in my view, and I don't think it's a good buy at this time. Of course, I didn't see it going this high in the first place. Still, I think we will have another buying opportunity for gold later on, when everything bottoms.

Preserving capital is kind of tough. You might decide to have cash in different currencies such as the Swiss franc. But the world is always changing and we are always keeping our eyes open for where the dangers can be. As we saw in Cyprus, even if someone had a million Euros in cash stashed away, suddenly they couldn't transport it out of the country.

In some of the countries that I mentioned earlier such as Norway, France and Sweden, they are talking about making it illegal to spend more than a thousand Euros in one transaction. So there are so many ways that your prudence can be thwarted. It's a very difficult environment to preserve capital.

RW: Switching to the currency world, there is a growing debate on how either inflationary or deflationary pressures are likely to affect on the US dollar. What is your current view on the US dollar and how do you see that trend playing out?

> *"The history of [interest] rates is that they are tied into two things; one is the amount of commodity or CPI inflation... Then of course, the other one becomes the credit default risk and if that becomes pretty high, then that will send up rates too. But that tends to be more of a temporary thing, rather than a [long-term] trend driver. But still, even those temporary moves as we saw in the 1930s, or more specifically, between the years of 1929-1931 can be pretty violent." - Martin Pring*

MP: Well as I highlighted in my presentation, on monthly charts, the US dollar looks very strong here. I did an exercise last month looking at the long-term momentum of all the principal cross rates including the Euro, the Japanese yen, the Canadian dollar, the Australian dollar and the British pound and they all favoured the US dollar on a long-term basis. So it seems to me that the proof is the US dollar is likely to move up, not as I said before, because it's a great currency, but because all the others are so much worse.

RP: I agree with Martin on this and the way that he put it in his speech is exactly right. When we look at the dollar index we are not looking at the purchasing power of the dollar, we are only looking at the dollar's performance related to other currencies. So my opinion about the question is, which currency is likely to be deflating the most? That's the one that is likely to go up more, because as debt starts to dissolve and disappear, remaining dollars and euros will be more valuable. That's why cash is always worth something in a deflationary situation.

Despite this factor, my shop has been bullish on the dollar index for quite some time, mostly because of the very aggressive number of vocal bets against it, all the people who have been saying the US dollar is likely to crash, or it's going to zero, thanks to the US Federal Reserve. We felt that was an impossible psychology for a continuing falling dollar. We don't think the bull market is over yet; it still has a long way to go.

RW: One of the interesting points in both of your presentations was the similar perspectives on long-term US Government yields, suggesting an exhaustion and potential (upside) reversal, in terms of both the cyclical and secular trend. Can I ask the both of you about the potential psychological drivers behind that within either an inflationary of deflationary cycle?

MP: The history of rates is that they are tied to two things; one is the amount of commodity or CPI inflation that takes place which is about the closest correlation that you can come to on any particular relationship with bond yields. Then of course, the other one becomes the credit default risk and if that becomes pretty high, then that will send rates up, too. But that tends to be more of a temporary thing, rather than a [long-term] trend driver. But still, even those temporary moves as we saw in the 1930s, or more specifically, between the years of 1929-1931 can be pretty violent. So those are two of the key determinants of yield on a long-term basis.

RP: I think yields will go up if we have inflation, surely, and I believe they will go up if we have severe deflation for the reasons that I went over. In fact, when Greece went through its period of austerity, rates soared into double digits. That's the type of risk you have within a deflationary environment. It sucks buying power from all the other places like a black hole.

One thing to keep in mind is that the Federal government currently pays out about 6% of its budget just to cover interest. So if Treasury rates start to go up, it would be a really bad sign for the budget.

RW: The next question, on the current US stock market outlook, is probably one that I received the most number of requests [from leading institutional representatives and many MTA symposium delegates]. The US stock market has recently posted new all-time highs, driven by relatively strong breadth and a historically strong four-year cyclical recovery. How sustainable is the current bull-trend and what parallels may exist from prior secular bear trends, notably the 1973 peak, which many industry analysts are highlighting as a potential road map template.

MP: I don't know because my work does not forecast magnitude or duration of trends, unless I have a price pattern or something similar that would just give me an objective. All I can do is follow the direction of the indicators and right now my longer-term indicators, the ones that measure the primary trend, the majority of them are suggesting that prices are going to go higher and the trend is up. One of the really strong characteristics of a typical bull market in stocks is usually when short-term interest rates start to move up and as we know the Fed had kept rates down to zero and so we don't have a sign of a top at this point.

So I can't tell how far it's going or when it's going to get there, all I can say is that right now all my indicators are bullish and therefore I am bullish, notwithstanding a short-term correction, obviously. But until that stuff starts to turn, I've got to stay bullish. I've learnt the lesson the hard way, that if I tell the markets what to do, then I am usually wrong and end up with blood on my face.

RP: Well I should have learnt more lessons the hard way, but I can tell you flat out that I am as bearish as I can possibly be in studying 200 years – well 300 years really when you throw in Britain – of stock price movements. This is one of the most amazing junctures that I have ever seen. Now, I felt the same way in 2000 and the same way in 2007. In fact, I couldn't believe investors got a second chance, much less this third one. In the decline of 2009, how many people said "Oh if I could just get to breakeven, I would get out of the market". Well okay, now they are more than breaking even, but are they getting out of the market?

We just had a record in January of inflows into mutual funds, and the last time it was that high was during September-October of 2007. So for the third time we have had peak indications within the stock mania. I think we are setting up, for the first time, a reversal in all three markets: stocks, commodities and bonds. So I think that we have a triple whammy coming up. I certainly would not want to own anything. I think it's pretty safe to be short, personally. But I have been wrong plenty of times, so please don't do what I tell you to do.

When Frost and I wrote our book way back in 1978, we said there is a big bull market coming and it's going to lead to what we called grand super cycle top, and I think the fact that we have had these multiple manias is a reflection of that model working. For example, in 2000 we had the all-time high in the NASDAQ; you know, that's the only index that rose a hundred times, just like margin debt did. In 2006, 2007 and 2008 we had three manias packed in together. We had the peak in real estate in 2006, we had stocks in 2007 and commodities in 2008, packed together very closely.

- Robert Prechter

RW: What about the psychology in prior secular bear markets? What key lessons are important and are there any parallels that we should be aware of for now and the eventual endgame of a secular bear market?

MP: Well having said that I am bullish on the primary trend, of course, my work suggests that we are still in a secular bear market for inflation-adjusted stocks. We are still about 20% from the peak in the S&P 500, so we could still see a 20% rise and still remain with a secular bear market or trading range.

The things that I'm looking for to suggest that I am seeing an end to the secular movement, or a downward movement in real-adjusted rates in stocks, would be things like the S&P/Case-Shiller price earnings ratio which typically registers to a number of 6 times at the end of a bear market, yields on the S&P 500 are usually 6-7%, they are currently 2-3% and currently the Shiller ratio is about 23 times.

Moreover, the Tobin Q ratio which measures the replacement value of stocks typically peaks at a secular peak at $1.15 or something like that and ends the secular bear at around $.30. Last I saw about three or four months ago it was about $.80. So I would be looking for a lot of these fundamental indicators, which I really regard as sentiment indicators, to be moving to those extremes.

RP: I agree 100% with that. We have not seen a classic bear market low since 1982, which is the last time those figures where in bear market bottom territory. We also saw them in 1974, 1942 and 1949, which were all great buying opportunities.

We have seen nothing like them. There have been no corrections worthy of a major bear market low. We got a nice panic in 2008-2009, but it was from really high levels, and some of the indicators that I showed you never even corrected from the high of extreme optimism and extreme complacency. But it's coming up. You know, markets go up and they go down, and the world is never going to be a place where we are always optimistic or always pessimistic.

When Frost and I wrote our book way back in 1978, we said there is a big bull market coming and it's going to lead to what we called grand super cycle top, and I think the fact that we have had these multiple manias is a reflection of that model working. For example, in 2000 we had the all-time high in the NASDAQ; you know, that's the only index that rose a hundred times, just like margin debt did. In 2006, 2007 and 2008 we had three manias packed in together. We had the peak in real estate in 2006, we had stocks in 2007 and commodities in 2008, packed together very closely.

This time gold made a new all-time high along with stocks. Stocks have continued for another year, but I still think that this is a lagging sort of exhaustion move. With new highs peaking last year, I think that's the beginning of the end, the beginning of the turn downward. But we will see. We have seen things stretch farther than normal, twice already. As I have said several times, maybe hedge funds will go from thirty times leverage to a hundred and fifty times leverage. Who knows?

RW: A question in line with the title "Inflation, Deflation or Both?" What are each of your views on the potential fusion (or duality) between inflation and deflation? Part of this will be down to timing (i.e. long-term structural deflation, interrupted by short periods of cyclical inflation or vice versa).

MP: We have the cycles that alternate between inflation and deflation. In fact, inflation breeds its own deflation, because if you have a huge run up in commodity prices for example, that means oil and food prices go up and that sucks out purchasing power and also pushes up interest rates, causing the economy to correct. So I believe that it's a transitional continuation of the two. The only thing different is the degree that happens in each cycle.

RP: I'm pretty much in agreement. I think that we started to see a change to deflationary psychology between 2000 and 2006 on a very long-term basis. It takes time for these things to develop. People talk about austerity. You know the Federal government is even scaling back its budget by a small amount. They are arguing about it, and that's something new. The psychology is slowly seeping to another side of the ledger.

On a short-term basis, yes, it is cyclical. Between 2006 and 2008 we had deflation. Since 2009 we've had a reflationary trend, and that's the one that I think has lost its upside momentum. It hasn't quite rolled over in the US, but it has already rolled over in Europe. Now that the cyclical is joining the secular its looks like a very interesting time in the years ahead.

RW: On a final note, I would like to ask Robert Prechter if he could kindly share a few words of insight on the study of Socionomics and its focus on causality ahead of your up and coming annual conference.

RP: ["Socionomics is the study of social action that expresses social mood. Social mood arises endogenously from unconscious herding impulses inherited through evolution, and is patterned according to the Wave Principle"]. The following week we have our third annual Social Mood Conference in Atlanta, Georgia.

It's a great gathering of minds, really brilliant people, from academia to the professions. It is one long day with 12 different speakers. We discuss social mood and the effect of social mood on markets, culture and society. So come join us if you can. Look it up on the web for more information at www.socionomics.net (Read more: Socionomics Explained and follow on Twitter: @ Socionomics).

Investing in the Second Lost Decade
by Martin J. Pring, Joe D. Turner & Tom J. Kopas
Part One & Part Two Video Series
that accompany the book.

Conquer the Crash: You Can Survive and Prosper in a Deflationary Depression by Robert R. Prechter, Jr.
The world's few deflationists: www.deflation.com

Financial and Socionomic Theory, new DVD:
"Robert Prechter at Oxford, Cambridge and Trinity";
read about it at www.socionomics.net

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