

Is This Rally The Final Kiss Good Bye?

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By Simon Maierhofer Investors tend to love templates and patterns. Why? They provide a market guidance that offers a higher probability of accuracy than most other research. Some say that those who don't learn from history are doomed to repeat it.

How is this for historic irony, the first leg of the Great Depression reduced the Dow Jones (DJI: ^DJI) by 48%. The subsequent rally lifted the Dow nearly 50%.

Fast forward and you will find that the first leg of this recession melted the Dow Jones (NYSEArca:DIA - News), S&P 500 (SNP: ^GSPC), and Nasdaq (Nasdaq: ^IXIC) by just over 50%, while the rally from the March lows - reminiscent of the 1930s rally - also propelled a 40%+ rise in the major benchmarks.

For those hoping that the parallels end there, I'd like to quote Billy Mays, 'But wait, there's more!'

Don't trust what you see - read between the lines

To understand the full severity of what's at stake for investors, consider what author John Kenneth Galbraith observed about counter trend rallies during the Great Depression. While you read this, think about a bait-and switch trap. As the word implies, a trap is less than obvious, otherwise it would fail its purpose as a trap.

'Nothing could have been more ingeniously designed to maximize the suffering, and also to insure that as few as possible escaped the common misfortune.' We will quote another of his sobering observations in a moment, but first let's see what the parallels were between 1929 - 1932 and 2007 onwards.

Become a student of history

Easy money, used first for real estate and then for stock market speculations, was the pump that fed the great bubbles leading up to the 1920's crash and mid 2000's crash. Real estate prices - as reflected by the Vanguard REIT ETF (NYSEArca: VNQ - News) and iShares DJ US Real Estate ETF (NYSEArca: IYR - News) - topped in 2005, two years before the stock market.

The great real estate boom of the 1920s, topped in 1926 three years before stocks. Even back then, new and exotic product structures allowed investors to leverage their real estate investments in never before seen fashion. Florida was the hot bed back then and is so today. The AP reported that a southwest Florida condominium high-rise has 32 stories, but just 1 tenant. In the 1920s, Florida marshland was subdivided and readied for building when the buyers dried up.

It's not official (yet) but the economy is getting worse

Every single sector of the real economy is deteriorating, whether it is unemployment, production, corporate profits, real estate, credit defaults, federal deficits, or construction. The discrepancy between fact and fiction is seen by the SPDR Homebuilders ETF (NYSEArca: XHB - News). Builders have nothing to build, yet XHB has rallied over 30% in less than 30 days.

With almost a year of housing inventory yet unclaimed, one wonders who is supposed to be buying homes? Unemployment rates - calculated the way the government used to do it before it was changed in the 1990s - pegs the real unemployment rate around 20%, or 30 million people. During the Great Depression, unemployment reached 25%, the non-farm peak figure of the 1930s clocked in at 35%.

If you think 30 million unemployed is bad, consider the following which puts a face on an otherwise stale statistic. Each of the 30 million unemployed US residents probably supports a family, whether a spouse with children, or just a spouse. Based on 2-4 dependants per unemployed worker, a range of 60 to 120 million Americans are already affected by unemployment; that's 20 - 40% of the US population.

Light at the end of the tunnel, where?

Research shows that the decline in industrial production over the last nine months has been as bad, if not worse than the nine month following the 1929 peak. The world stock markets have fallen even faster this time around, compared to 70 years ago. The volume of world trade is drying up at a faster pace than the Great Depression and government surpluses are the lowest in 100+ years.

I know this sounds paradox, especially since broad market indexes such as the S&P 500 (NYSEArca:SPY - News) and leading sector ETFs such as the Technology Select Sector SPDRs (NYSEArca: XLK - News), Financial Select Sector SPDRs (NYSEArca: XLF - News), and Consumer Discretionary Select Sector SPDRs (NYSEArca: XLY - News) have been on a tear for several weeks now.

This is on a 'need-to-know basis' and you need to know

To profit in such a self-contradicting market, savvy investors absolutely need to know what caused this rally, how long it will go, whether it is doomed to fail, and most importantly what the downside risk is. The first rule is to keep your hard earned money safe; applying this rule will keep you in a position to grow your wealth.

On March 2nd, the ETF Profit Strategy Newsletter alerted its subscribers that a change in trend - from down to up - is about to happen. A similar trend change alert was given previously in December 2008 when the newsletter recommended buying short ETFs above Dow 9,000, with a target for a bottom of Dow 6,700.

This March 2nd Trend Change Alert outlined the following parameters for this rally:

- gains between 30-40%
- the most intense rally since the October 2007 market top
- financials would be the best performer, Ultra Financial ProShares (NYSEArca:UYG - [News](#)) in particular
- the top of this rally would be marked by a 'the worst is over' attitude

You don't need to have a Ph. D. in economics or work on Wall Street to see that this rally has fulfilled all of the outlined parameters and is - according to our analysis - running on borrowed time.

For a few days now, the S&P 500 has been knocking at round number support near 1,000. In fact, for the first time since November 2008, the S&P actually spiked above 1,000, albeit briefly.

Quite often, such strong resistance points repel the initial advance. A consolidation of some sort would allow the indexes to digest the extremely overbought condition, regroup and gather steam for another push towards new recovery highs above S&P 1,000.

Adrenalin rush for the market

Like an athlete on adrenalin, the market is fueled by investor optimism and perception only. Just as adrenaline doesn't last for long, this rally won't either.

Investors who've experienced a few bear markets (1970s and 1980s) know that a new bull market climbs a wall of worry. In other words, new bull markets rise amidst a climate of 'this rally won't last' predictions, not 'the worst is over' attitude. In fact, based on the extreme levels of enthusiasm, it is pretty safe to say that the next leg down will be quite powerful (similar to January - March 2009).

How did gullible investors, who allowed themselves to be swept away by unfounded optimism, fare during the Great Depression? The author mentioned at the outset of this article, John Kenneth Galbraith, described it like this:

'The man with the smart money, who was safely out of the market when the first crash came, naturally went back in to pick up bargains. The bargains then suffered a ruinous fall. Even the man who waited until trading conditions returned to normal, saw the common stocks they purchased drop to a third, and in some cases even a fourth of their purchase price over the next 24 months. The bull market was a remarkable phenomenon. The ruthlessness of its liquidation was, in its own way, equally remarkable.'

Already, this decline has dwarfed the 1973-74, or 1981-82 bear market. Comparing this recession to the recessions of the 70s and 80s, is like comparing Hurricane Katrina to your average summer storm.

Another identifying mark of a depression is deflation. Unlike inflation, deflation suppresses prices of ALL asset classes. Prior to the rally from the March lows, all asset classes were in the red. In addition to stocks and many bonds, even commodities lost money. Broad commodity ETFs such as the PowerShares DB Commodity Fund (NYSEArca: DBA - [News](#)), iShares S&P GSCI Commodity ETF (NYSEArca: GSG - [News](#)), and even oil (NYSEArca: USO - [News](#)) lost between 60 and 70%.

The only other time the 'red across the board' phenomenon occurred, was.... you guessed it - during the Great Depression. If you tune out the noise and focus on the facts, it becomes clear that historic parallels are simply too powerful to ignore, the downside risk is huge, the stakes are too high.

The most recent issues of the [ETF Profit Strategy Newsletter](#) contains a target level for the end of this rally, the ultimate target bottom (scary!), along with high probability ETF profit strategies and practical advice on how to survive and thrive in the coming years. Savvy investors do not have to fall victim to a false sense of security. Don't become another casualty of 'those who don't learn from history and are doomed to repeat it.'

