GLOBAL MARKET PERSPECTIVE

STOCK MARKETS
CURRENCIES
INTEREST RATES
GOLD
ENERGY
ECONOMIC OUTLOOK

AUGUST 2011

e156883

Prechter's
GLOBAL MARKET PERSPECTIVE

© 2011 Elliott Wave International

Global Market Perspective provides a comprehensive, up-to-date "snapshot" of EWI's long-term market opinions. The analysis presented here is updated throughout the month in EWI's intensive *Specialty Services* and regional *Short Term Update* services. To access this timely information for the market(s) you follow, please visit www.elliottwave.com or call customer service at either 1-800-336-1618 (U.S.), or 770-536-0309 (international).

This report utilizes data through August 4, 2011.

EDITOR'S NOTE

Both private and institutional investors need analysis based upon ideas that work, analysis that provides a high percentage of useful observations and accurate conclusions. Projecting today's conditions, trends and relationships into the future will result in errors of judgment at the worst possible times. "Diversification" for its own sake can provide some protection, but the more it is practiced, the closer one's performance comes to achieving mediocrity.

In contrast, analysis of market behavior delivers what it promises: a sensible basis upon which to make sound investment decisions, reduce dangerous exposure and protect against risk. Such an approach provides for fewer errors, more successes, and overall, an edge over the competition. Thank you for adding *Global Market Perspective* to your decision-making process.

Sincerely,

Robert R. Prechter, Jr.

ANNOUNCEMENTS

Steve Hochberg will be at the upcoming **San Francisco** Money Show on **August 10-11**, where he will conduct two workshops. Come meet Steve and hear EWI's latest analysis of the excitement unfolding in the financial markets. Register to attend for free: www.elliottwave.com/wave/1105SFMS. Steve will also be at the **Chicago** Money Show on **October 20-22**. Registration is free here too at http://www.elliottwave.com/wave/1110ChicagoMS.

Forex Traders: There are only a few weeks left to register for EWI's online forex trading course, "How to Use the Wave Principle to Maximize Your Forex Trading." Senior analysts Jim Martens and Jeffrey Kennedy walk you through their approach to trading in four engaging online sessions beginning Aug. 17. Learn more: www.elliotwave.com/wave/ForexTutorial.

Veteran commodities trader and author Peter Brandt kicks off his exclusive 2½-day boot camp, "How to Trade for a Living: Lessons in Long-Term Success from a Professional Trader," in **Atlanta**, **Oct. 20-22**. Join Peter's small group for a highly interactive, hands-on experience. Learn how to overcome the human element in trading, which is indispensable to long-term success. Learn more: www.elliottwave.com/wave/BrandtBootCamp.

For the first time in eight years, veteran trader Dick Diamond is taking his popular four-day trading course outside his home state of Florida! Join Diamond Nov. 6-9, 2011 in **Chicago** for his intensive, real-time trading course. You'll spend 4 days absorbing his methodology and the trading principles that have kept his successful trading career going for 45+ years. Learn more now: www.elliottwave.com/wave/DiamondANN.

The Socionomics Institute is looking for a statistics professor to vet methodologies for academic papers. The research projects involve quantitative analyses of various time series. The ideal candidate possesses a strong working knowledge of theoretical and applied statistics, affiliation with a recognized department and effective communication skills. For more information, please contact Matt Lampert, the Institute's Research Fellow at the University of Cambridge, at institute@socionomics.net.

e156883

MARKETS AT A GLANCE

Stock Markets

A complete head-and-shoulders topping pattern, a big break of key trendline support and a classic Dow Theory bear-market signal all occurred this week to fall in line with the Elliott wave structure and confirm the start of a third wave decline at Primary degree. The bear market in European markets thundered back this month with all the uproar of a Primary degree decline. This week's mini-crash will likely prove to be just a small taste of the stock market's future in wave ③ of **c**. The sell-off marks the end of Primary wave ② at the February 2011 high of 4169.87 in the CAC 40 and 3077.24 in the Eurostoxx 50. The FTSE and DAX, too, have likely topped, meaning Europe is now working uniformly lower in a Primary degree third wave that isn't over by a long shot. Several Asian-Pacific markets have continued their corrections of the past several months, but the next move in the region should be up, reaching new highs in the rally since the 2008-09 lows.

Interest Rates

U.S. government yields are near historic lows in nominal and inflation-adjusted terms, as investors seek safety. These yields should remain low relative to non-U.S. government bonds until the most virulent portion of deflation grabs hold. Global interest rate vehicles enjoyed what most perceive as a flight-to-safety rally as rates stayed soft. Don't get complacent because many of these patterns are nearing completion.

Currencies

The dollar has bottomed against some competitors and is on the verge of bottoming relative to others. Once the final lows have been established, the buck should start a rally that reaches levels not seen since early 2009. The euro looks to be headed lower versus every other major currency.

Metals & Energy

Silver completed an upward correction from early May and has started another major declining phase; gold should follow soon. The U.S. Dollar Index is in a long-term advance. Crude Oil rallied as expected, but collapsed contrary to expectations. WTI's break below its June low suggests that the spring peak marks a major top. Lower lows should be the theme for months if not years to come. Natural Gas followed its script to a "T" and should be in the early stages of a significant down leg.

CONTENTS

World Stock Markets 4
- World Stock Index 4
- United States. 5
- Europe 11
- Asia-Pacific 18

Global Interest Rates 28
- United States. 28
- Europe 29
- Asia-Pacific 32

International Currency Relationships 33

Metals & Energy 38
- Gold & Silver 38
- Crude oil 40

Economic, Monetary and Cultural Trends 41
- United States. 41
- Europe 44

A Capsule Summary of the Wave Principle 45

Glossary of Terms 48

MARKETS AT A GLANCE

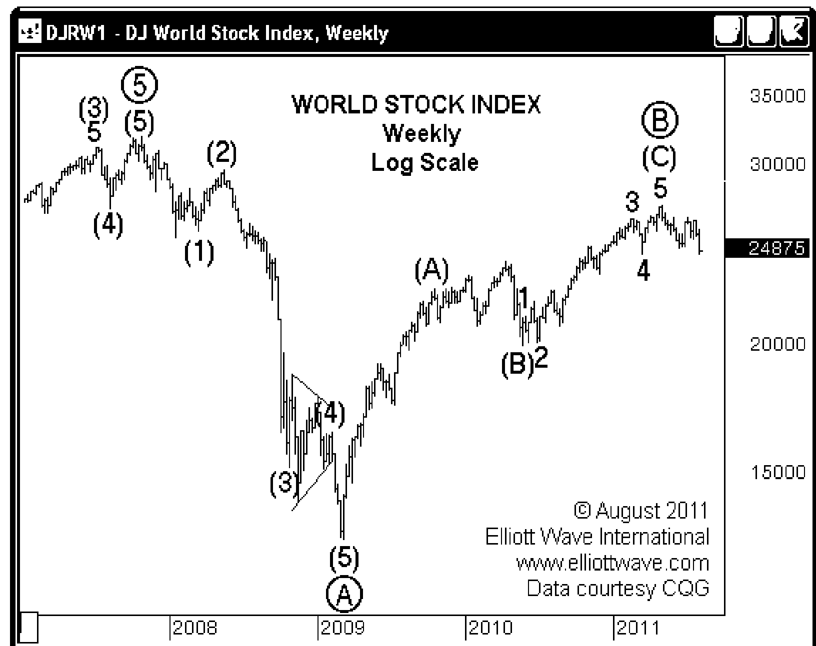
A complete head-and-shoulders topping pattern, a big break of key trendline support and a classic Dow Theory bear-market signal all occurred this week to fall in line with the Elliott wave structure and confirm the start of a third wave decline at Primary degree.

The bear market in Europe thundered back this month with all the uproar of a Primary degree decline. This week's mini-crash will likely prove to be just a small taste of the stock market's future in wave ③ of **c**. The sell-off marks the end of Primary wave ② at the February 2011 high of 4169.87 in the CAC 40 and 3077.24 in the Eurostoxx 50. The FTSE and DAX, too, have likely topped, meaning Europe is now working uniformly lower in a Primary degree third wave that isn't over by a long shot.

Several Asian-Pacific markets have continued their corrections of the past several months, but the next move in the region should be up, reaching new highs in the rally since the 2008-09 lows.

WORLD STOCK INDEX

Most world stock indices have been under pressure over the last month with many having just made new lows for the year. Europe as a whole has shed over 20% from the peak, a good indication that world markets have rolled over. After a five-wave decline from the 2007 high to the 2009 low, the World Stock Index rallied in three waves to the peak in May. This move completed a Primary degree corrective advance and sets the stage for a multi-year slide headed back below the 2009 low at 129.79 in the Dow Jones WSI. The longer-term outlook has been clear; the break of the June low clarifies the intermediate-term picture as well: the next leg of the bear market for global equities has begun.



Subscribers who desire intraday updates of the outlook for the major stock indexes should subscribe to *Specialty Services Intraday Stocks*. To choose the coverage that is right for you, visit our *Specialty Services* selection tool (www.elliottwave.com/wave/SS_GMP) or call customer service at either 1-800-336-1618 (U.S.), or 770-536-0309 (international).

e156883

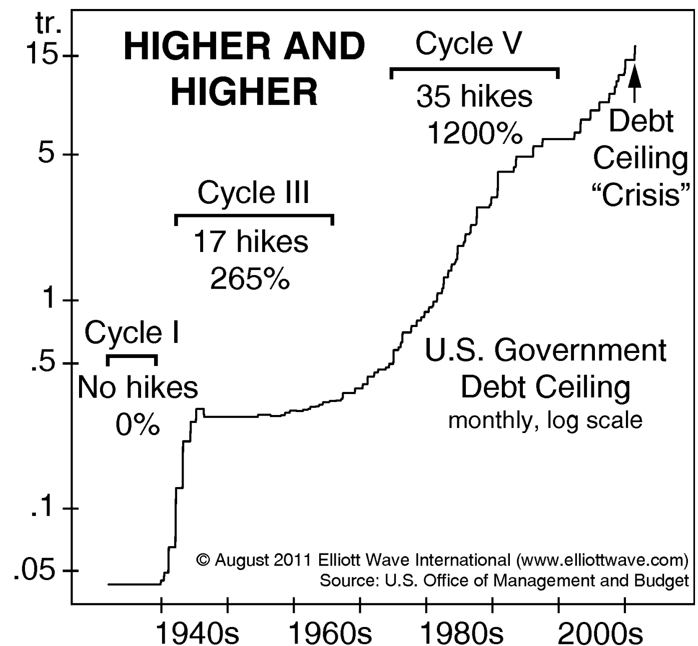
THE UNITED STATES

Special Section
ONE MORE HIKE FOR THE DEBT CEILING; A GIANT COLLAPSE FOR DEBT

Most bears on the economy and the monetary system are incorrectly positioned for runaway inflation because they fail to comprehend the critical role debt plays in the unfolding deflationary depression. *Conquer the Crash* explains that as the long uptrend makes the turns into a negative social mood, the popular enthusiasm for betting on the future by lending and borrowing is replaced by a desire to conserve money. The desire to extend and use credit changes to a desire to withdraw and repay it. Here's the basic outline of the trap as envisioned in CTC:

> A deflationary crash is characterized in part by a persistent, sustained, deep, general decline in people's desire and ability to lend and borrow. A depression is characterized in part by a persistent, sustained, deep, general decline in production. Since a decline in production reduces debtors' means to repay and service debt, a depression supports deflation. Since a decline in credit reduces new investment in economic activity, deflation supports depression. Because both credit and production support prices for investment assets, their prices fall in a deflationary depression. As asset prices fall, people lose wealth, which reduces their ability to offer credit, service debt and support production. This mix of forces is self-reinforcing. …A downward 'spiral' begins feeding on pessimism just as the previous boom fed on optimism. The resulting cascade of debt liquidation is a deflationary crash.

When the deflationary depression first started in mid-2006, only the real estate market turned down at first. Then in 2007 the stock market turned down, and in 2008, commodities turned down. The new trend was clear to us early in that process. A Special Section in the August 2007 issue of *Global Market Perspective*, "The Credit Bubble Bursts," offered a collage of more than 20 major headlines and news clips attesting to a "Climate of Fear" that was locking down various sectors of the credit markets. GMP identified the blast of recognition as the onset of the credit crisis and the start of a "new conservatism [that] would drive the greatest credit crisis in history." That was two months before the all-time high in the Dow Industrials, which was soon followed by the biggest economic contraction since the Great Depression.



The countertrend rally in stocks that started in March 2009 produced a revival of optimism and thus a temporary reprieve of the great credit squeeze, but economic activity is once again flagging (see Economy & Deflation section) as stocks turn and headline warnings start to swirl. Once again, the process is ready to feed on pessimism. If anything, the latest barrage of "Debt Crisis" admonitions is even more pronounced than it was in the summer of 2007. For anyone who missed the media frenzy that surrounded the debt ceiling debate, here are a few representative samples:

Debt Crisis Is Reason to Worry
—*The New York Daily News*, July 28, 2011

Debt Debate Darkens U.S. Mood
—*The Denver Post*, July 31, 2011

Debt Showdown Raises Alarms Around the World
—*The Wall Street Journal*, July 31, 2011

Debt Fight Saps Confidence
—*USA Today*, August 1, 2011

e156883

These expressions reflect rising conservatism, a trend that was covered at length in the July issue of EWT and which lies at the heart of the deflationary trend. The trend is not yet strong enough to overtake the after-effects of a Grand Supercycle degree bull market, which is clearly behind the spectacular 70-year rise in U.S. government borrowing. The chart on the previous page shows how the U.S. government debt ceiling increased as the Supercycle degree bull market advanced. Notice the greater frequency and volume of debt ceiling hikes in Cycle wave V versus Cycle wave III, and a complete lack of any increases during Cycle wave I, when a deflationary depression was in force. When we include each wave's speculative aftermath, Cycle wave III (through the May 1969 peak in the OTC stock average) featured a 300% expansion on 21 separate debt ceiling increases, while Cycle wave V and its follow-up bubbles benefited from a 3,300% increase on 46 separate debt ceiling hikes. This is a classic difference between third waves, which are relatively healthy fundamentally, and fifth waves, which are built, comparatively, on hopes and dreams (see *Elliott Wave Principle*, p.80).

The sudden emergence of a vigorous opposition to the latest debt ceiling boost is a consequence of the turning tide of social mood. As one article notes, "George Bush raised the debt ceiling seven times and did it pretty much without a whimper." In mid-July, by contrast, a Gallup poll found that 42% of Americans wanted their congressman to vote against raising the debt ceiling, while just 22% were in favor of the vote.

The transformation of a credit agency's attitude from credulous to skeptical is another signal that CTC's "process of society-wide debt liquidation" is taking hold. On July 28, Goldman Sachs and Citigroup scrapped a $1.5 billion commercial mortgage bond when S&P refused to rate the issue. After initially agreeing to cooperate and after rating $21 billion in commercial-mortgage bonds earlier in 2011, S&P said that it is "reviewing its criteria for commercial mortgage bonds." Following the dictates of a negative trend in social mood, the credit-rating industry is putting its foot down. Here's another headline that reflects the reversal:

Savaging Nations Shows Ratings Firms Find Their Backbone

In recent days, S&P even said that the chance of a U.S. government debt downgrade from AAA to AA stood at 50%. When it happens, it will help accelerate leverage reductions throughout the debt markets, as more collateral will be needed to cover the lower-ranked loans. This is just one more way that the downward spiral reinforces itself. This process, which is still only just beginning, extends well beyond the shores of the United States. In the initial stages of the deflationary contraction, CTC envisioned money flows *into* U.S. Treasuries, as historically overpriced stocks, emerging-market debt and junk debt are abandoned for perceived safe investments that provide income. In Europe, the chief rival for the role of a safe haven, credit troubles are more pronounced. Ratings agencies finally acknowledged as much with the inevitable downgrade of Greek, Irish and Portuguese government debt to junk status. In July, contagion advanced to Spain and Italy, as yields on Italian and Spanish bonds rose to the highest level in 14 years. Many now say, "it may spread yet further to France." As we keep saying, it's just a matter of time before nearly all debtors are affected.

As Europe quakes, emerging markets, which somehow came to be seen by some as a "pocket of stability," are undergoing a reassessment. In Brazil, consumer defaults hit a 12-month high in June and bad debts may jump to 30% of total loans. At the State Bank of India—India's largest lender—loan loss provisions surged 77% in the first three months of 2011. In Russia, the country's fifth biggest bank was quietly bailed out after it accumulated $5.4 billion in unsecured loans. One writer concluded, "Russian lenders' health may be 'substantially worse' than most investors judge." In time, the depth and global breadth of creditors' misjudgment will stun the world. It will also preserve the U.S. Treasury's safe haven status, at least for now.

e156883

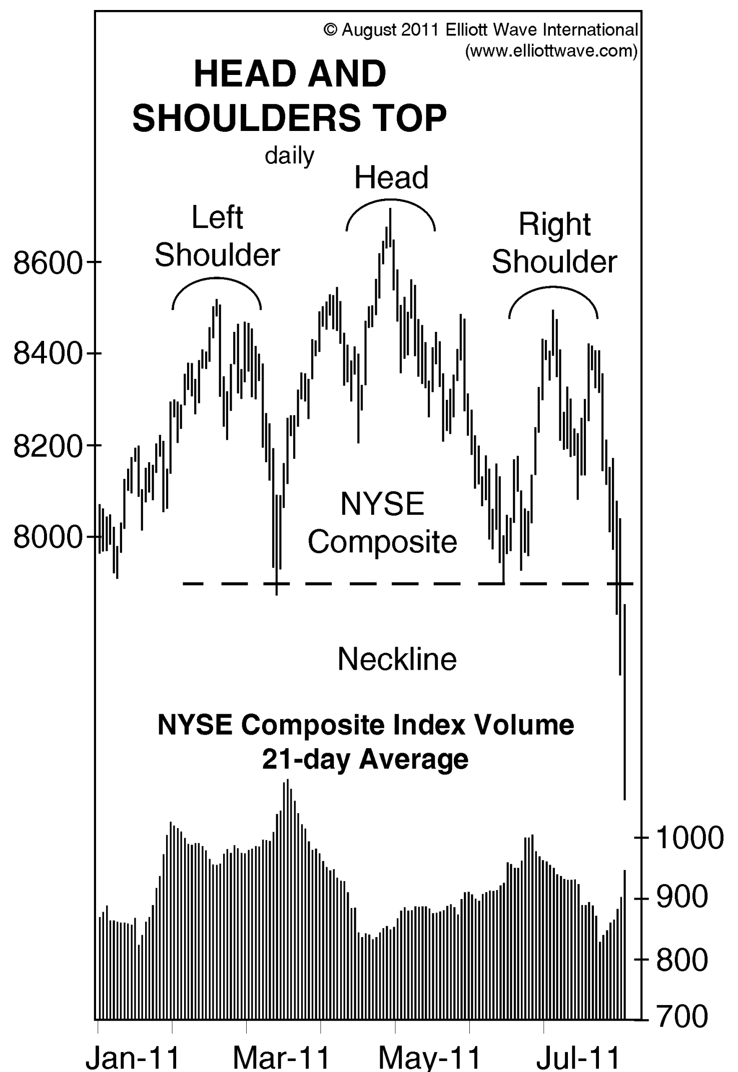
The decline from 2007-2009 set the tone, but it provided only a hint of the deflation to come. Here's the outlook from CTC:

> Debts are retired by paying them off, "restructuring" or default. In the first case, no value is lost; in the second, some value; in the third, all value. In desperately trying to raise cash to pay off loans, borrowers bring all kinds of assets to market, including stocks, bonds, commodities and real estate, causing their prices to plummet. The process ends only after the supply of credit falls to a level at which it is collateralized acceptably to the surviving creditors.

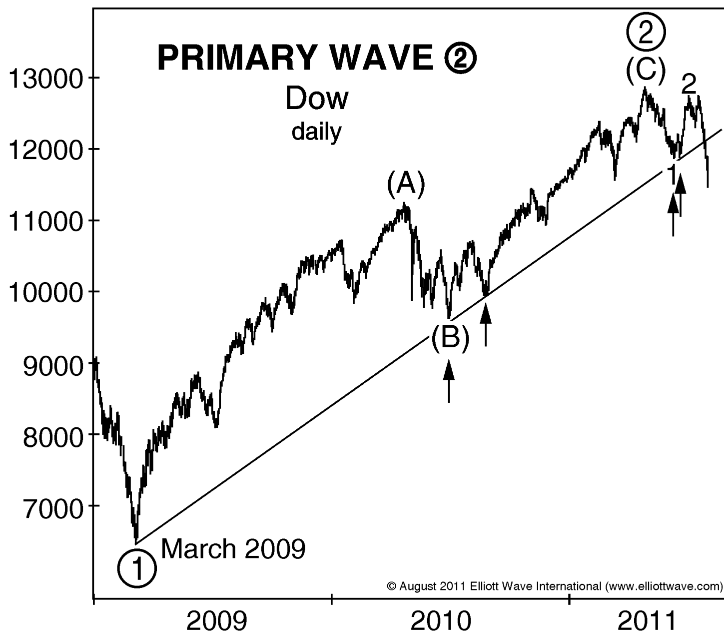
The initial downturn produced just nine months of year-over-year declines in consumer prices and a small fraction of the eventual defaults. Paying down or restructuring debts has gotten harder now, because overall liquidity levels are lower and cash—despite the QE's—is scarcer. Persistently high unemployment and the European sovereign debt crisis reveal that deflationary forces continue to grind away. The flight to safety and the decline in the acceptability of collateral will be that much more intense as a result. With its latest bailout, Greece was spared the indignity of handing over the Parthenon as collateral. Of course, the agreement rests upon the EU's faith in prosperity, which is vanishing. As the contraction accelerates, crown jewels and state properties will go on the block, and buyers will turn up their noses.

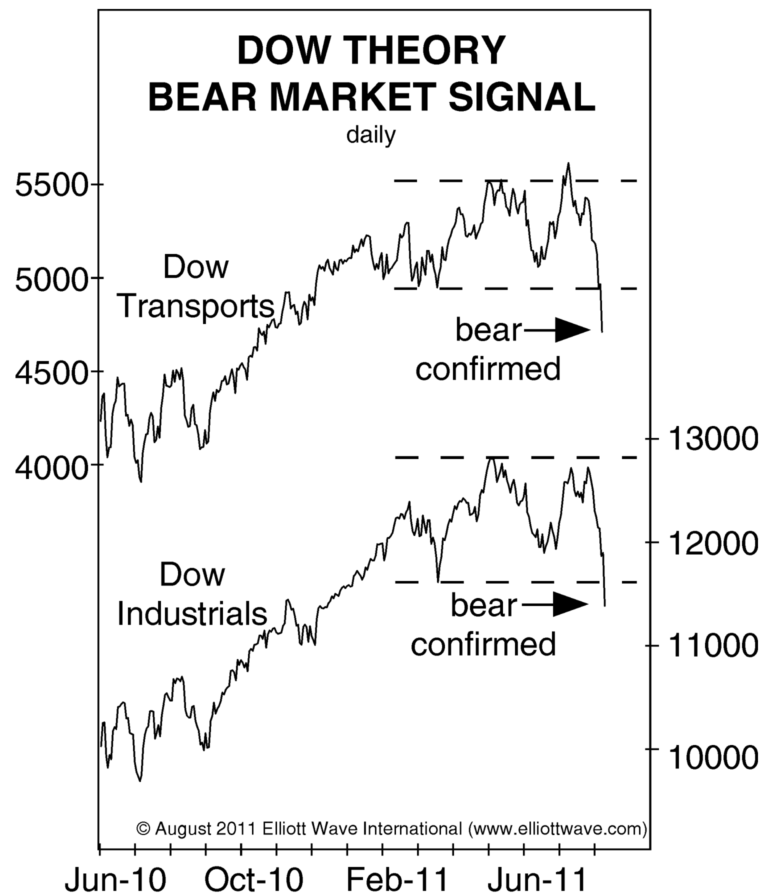
Elliott Wave Analysis

With this week's stock market decline, the NYSE Composite Index completed a head-and-shoulders topping pattern that started on February 18, the date of the top in the left shoulder. As this chart shows, the head peaked on May 2 and the right shoulder ended on July 7. Note the tepid volume in conjunction with the right shoulder relative to the left, an important trait that validates the pattern. Volume levels rose as the index broke the neckline, which crosses 7900, another confirming characteristic. Sometimes a short-to-intermediate-term target can be derived by taking the number of points between the head and the neckline and subtracting that total from where prices break the neckline. That level predicts a minimum fall to 7080, but eventually Primary wave ③ down should draw prices far lower than that.



This next chart shows that the DJIA has just broken a significant support line that dates from the March 2009 low. After four separate touch points over the past 2½ years, this week's break is another important piece of evidence that the top-building process is over. Both the NYSE Composite and S&P 500 have broken their respective trendlines, too.





A Dow Theory bear market signal occurred at yesterday's close, another important indicator that confirms a stock market top. The signal's set up came when the Dow Jones Transportation Average made a new all-time closing high on July 7, which was not confirmed by the Dow Industrials, as shown on this chart. The official bear signal by this granddaddy of technical indicators happened when both the Transports and Industrials closed beneath their respective March lows, as indicated by the horizontal lines on the chart. This is a classic conclusion to the 2½-year countertrend rally and a perfect fit with the Elliott wave pattern in the DJIA. Primary wave ③ down should continue to draw various indicators into line with its potential; a major market decline.

These developments are consistent with the view that Primary wave ② ended on May 2, completing an (A)-(B)-(C) rally from March 2009, as shown in the July GMP (p.12). The sub-waves of wave ② are not as clear as we would like, but the entire upward push looks like three waves, which defines it as a countertrend rally.

The stock market's turn lower is not confined to just the U.S. stock indexes. The MSCI World Stock Index also broke a support line similar to the Dow's. The Euro STOXX 50 Index made a countertrend rally high in February and is not only down for the year, but has also closed beneath its 2010 low. And the NYSE World Leaders Index, which comprises the top 100 NYSE-listed U.S. companies and the top 100 non-U.S. companies, measured by market capitalization, has declined to its lowest level since October 2009. Bear markets always unfold faster than bull markets, and the take-back of more than a year's worth of gains in just three months is typical market action in a bear trend. Primary wave ① from 2007-2009 was a world-wide selloff; in doing its normal job (see text, p.80), Primary wave ③ will be an *even broader* world-wide selloff.

Small cap stocks were among the last sectors to register a new all-time high, but as we said during the Dow's countertrend rally, one of the great market myths is that small stocks are the place to be. Because these stocks

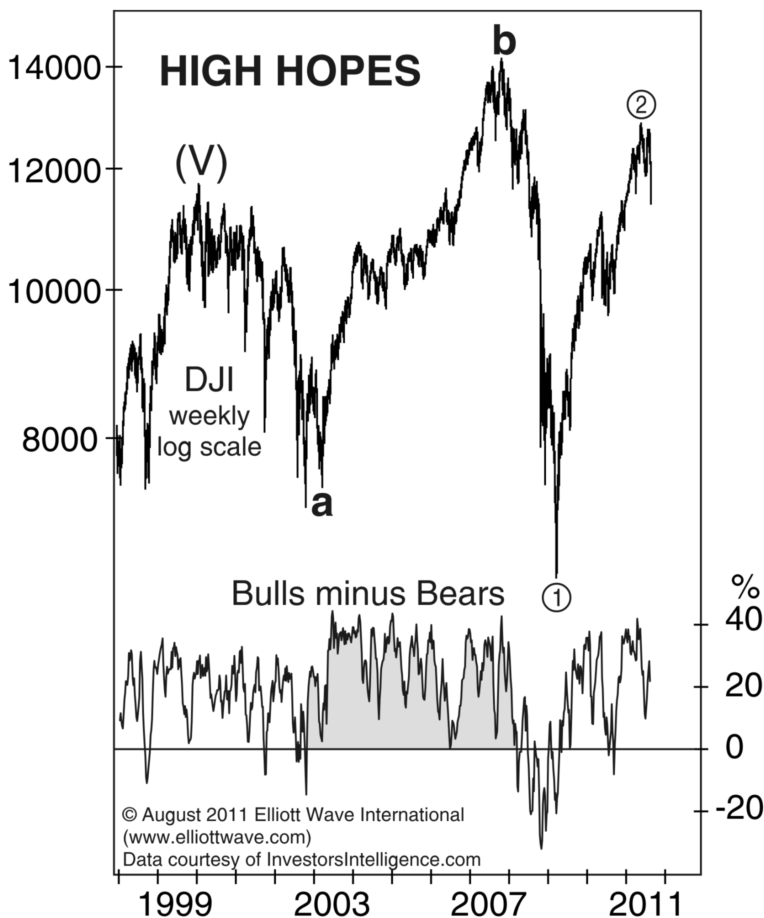
e156883

are less capitalized, they are more susceptible to price wars, spiraling asset devaluations and tighter credit conditions. So they'll get the worst of the unfolding deflation. The S&P Small Cap Index has had a stunning reversal from its July 7 high, down 14% in just four weeks. This sector should continue to fall even faster than the broader market.

Once the stock market averages complete five waves down from May 2, a significant countertrend rally will begin. The Short Term Update is forecasting the market's near-term swings and will keep readers abreast of developments.

Investor Psychology

Even as stocks failed to muster a new high in July, optimism continued to edge higher, with the Investors Intelligence poll of investment advisors pushing to 49.5% bulls on July 26, close to the 50% level where it resided from November 15 to May 10. Market advances generally end after advisory sentiment spends time above the 50% line. The return to this vicinity so soon after the sell-off from May 2 is a bearish sign. Don't forget that the bear market has yet to answer the incredible run of net bullish weeks that stretched across the Dow's long topping process, as shown on this chart. The gray area denotes the poll's longest net bullish plurality, a period of almost 5½ years, from October 2002 to March 2008, in which the percentage of bears failed to exceed the percentage of bulls. So far, the bears have not come close to dominating in a similar manner. The bear market will not end until they do.



As the U.S. government debt showdown approached its climax, with a U.S. Treasury bond default allegedly hanging in the balance, bullish investors did not flinch. Another "closely watched survey," the Bank of America-Merrill Lynch poll of global fund managers, showed that a net 35% of managers (overweights minus underweights) were overweight equities, up from 27% in June. According to CNBC, some Capital Hill operatives were "Annoyed at Wall Street's Failure to Panic." "Washington D.C. expected that this would be a week marked by panic in the markets. Stocks would tank. And this would help convince lawmakers that they had to reach a compromise." Naturally, (1) the compromise came anyway and (2) Wall Street celebrated the "news" by promptly selling off. The plunge below the March and June lows in most stock indexes failed to change the bullish mindset. "Said a typical asset manager, "Those with a time horizon of 18 months or more should buy stocks." Stocks are "rapidly becoming a very strong buy," said a leading bull. "Maybe you put an extra finger of scotch in the glass," said another. Nothing like a good stiff belt to keep the complacency intact.

We can tell sentiment is ripe for a long bear market because the renewed demand for stocks of high-tech companies—which we discussed in June and at the beginning of July—spread further through the end of last month. According to recent articles, "Google Is Going to $1,500," Apple is "heading straight toward" becoming "the first company with a $1 trillion market cap," and

e156883

dot-com offices are putting in skate ramps and chocolate fountains. There's no getting around it. If they want to compete for "the hottest coders in town," they must "Party Like It's 1999." To complete the flashback to the NASDAQ's March 2000 all-time high, USA Today ran the following headline on July 21: "Investors Again Pay Big For Dot-Com Stocks." These are headlines one sees at market tops, not bottoms.

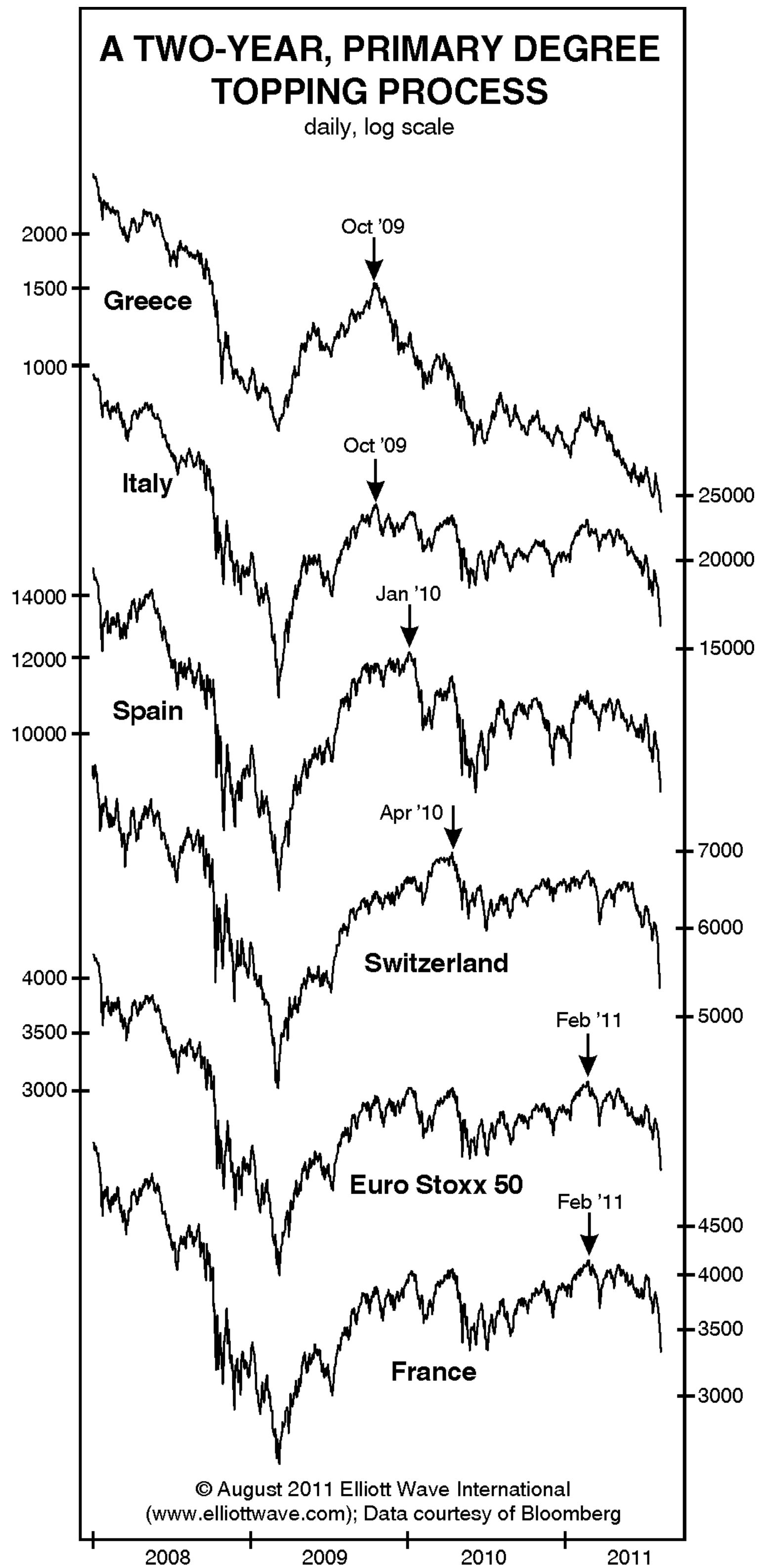
The IPO market, however, continues to display a conspicuous lack of speculative follow-through. In June and July, GMP illustrated this shortcoming in the form of fizzling aftermarket re-entries by LinkedIn and Pandora, two new issues. July produced another one, Zillow, a real estate information service that allows homeowners to check the current value of their house as well as others. As one Wall Street Journal columnist put it, "What could be more enjoyable than watching the value of your largest investment plunge with the weedy bank-owned property next door?" The company has yet to earn its first dollar. IPO investors loved the concept—at least initially. After being offered at $20 per share and tripling to $60 per share in the first few moments of trading, Zillow fell hard, to $27 a share on August 2. Meanwhile, the Philadelphia Semiconductor Index, one measure of high-tech stock prices, is nowhere near its February peak and is down for the year. In fact, it's helping the banking index to lead the overall market lower with a decline of over 25% from February. The latest high-tech boom is a dull roar compared to the one that ended the Grand Supercycle bull market. The past 11 years is one giant top, and, like any expiring mortal, it is re-living one of its finer moments as it breathes its last breaths.

If you would like thrice-weekly coverage of U.S. stock indexes, U.S. bonds, the U.S. Dollar Index, gold and silver, we recommend you add the *Financial Forecast Short Term Update* to your subscription. It is published each Monday, Wednesday and Friday evening via the Internet. You can add *STU* to your *GMP* subscription for an additional $20 per month (a savings of $228 per year). Call 800-336-1618 or 770-536-0309 to subscribe risk-free.

e156883

EUROPEAN STOCK MARKETS

There's a lot to discuss this month, but let's first get everyone caught up with a short trip down memory lane. Europe's Primary degree topping process may feel like an eternity, but, as the chart at right shows, less than two years have passed since Europe's first bourses began peaking in wave ②. In fact, the succession of tops started 21 months ago in Greece and Italy. As stocks staggered lower, the October 2009 issue of *Global Market Perspective* insisted that the emerging decline would "grip all sectors and averages." Greece not only provided an early tip-off for nearby markets, the country originated a bigger, badder version of the 2008 credit crunch: the sovereign debt crisis. Seven months after Athens' stock market peaked, Europe's first wave of losses arrived, along with the continent's first €110 billion bailout.



The third line on the chart depicts Spain's January 2010 countertrend high. As 2010 dawned and financial pundits shed the pessimism that surrounded the March 2009 low, GMP advised subscribers to "cork the champagne, and break out the aspirin," arguing that the process of deflating Europe's credit bubble was not nearly over. Along with the Spanish IBEX index, Portuguese stocks (not shown) double-topped that month, and European credit markets began a debilitating seizure that continues to this day.

The next line on the chart is significant, too, because it shows exactly what we anticipated — that the downturn would migrate into Europe's core economies. The Swiss Market Index quietly recorded its countertrend high in April 2010. The following month, we labeled the rally complete, while observing a vitally important wave relationship: "[T]he SMI index turned lower less than nine points, or 0.1%, below its Fibonacci .618 retracement of Primary wave ①." Swiss shares are down nearly 20% since.

European blue chip companies (the Eurostoxx 50) finally caved to the Primary degree topping process in February 2011, having managed to eke out a slight new countertrend high along with France's CAC 40 index. But as the rally maintained its three-wave structure, that allowed us to maintain our conviction that the rise was merely correcting the 2007-09 impulsive decline. The February 2011 issue cited two downside price objectives

e156883

— 3350 in the CAC and 2500 in the Eurostoxx — and stocks are achieving these targets now. Moreover, prices have recently provided the strongest evidence yet that these indexes are again falling at Primary degree.

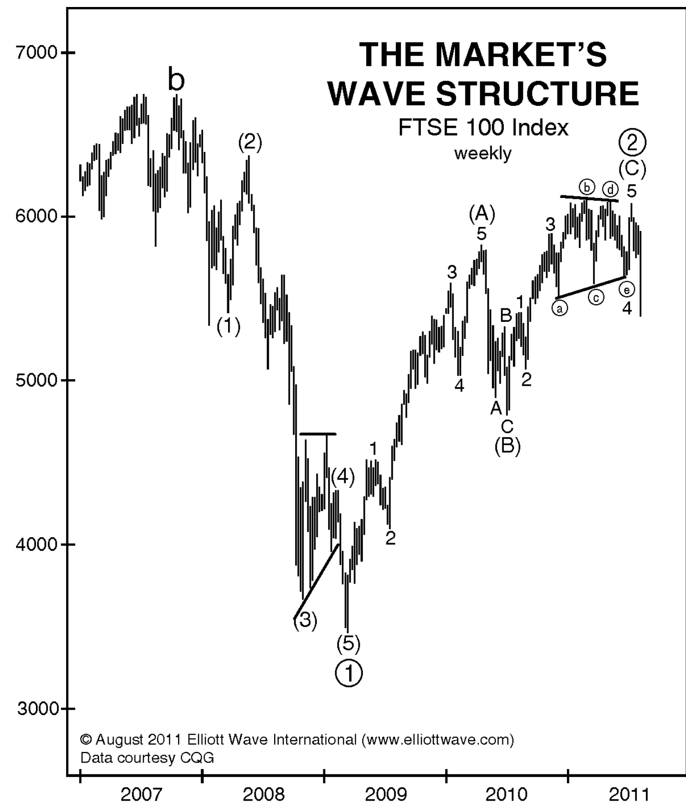
Last month, we illustrated how the Eurostoxx and CAC 40 broke a crucial year-long support line that extended back to May 2010. As we describe below, stocks reversed last month after returning to the underside of this line. This telltale technical failure tips the scales heavily in favor of the bears.

Europe's two holdouts, Britain and Germany, are now providing the final pieces to the continent's long-term bearish puzzle. Both indexes' peaks have been hard to pin down. Yet, the FTSE 100 and DAX have arrived at a point where one likely wave interpretation remains. Yes, big stock market tops can be exhausting, as time is required for investors' optimistic emotions to give way to unease ... then anxiety ... then fear ... and, lastly, outright panic. But there's more to come: The next installment of Europe's Supercycle narrative will likely contain some of the biggest bombshells yet.

Elliott Wave Analysis

The FTSE 100's rise from March 2009 remains a three-wave move, which, by definition, runs counter to a prior impulse. So we continue to consider the rally from March 2009 to be a partial retracement of the 2007-09 decline. At the February 21 high of 6105.77, the FTSE had retraced 80% of wave ①. At the DAX's equivalent high of 7600.41 on May 2, stocks marked an 88% retracement. Both are deep for second waves, but they still comply with Elliott's rules of wave formation.

Near term, the FTSE penetrated both of the levels that last month's issue called "key for the FTSE's remaining bullish potential." This week's sell-off, moreover, has all the characteristics of a third wave, so the potential is high that the longer-term bear market is back. If so, there are multiple ways to label the final subdivisions of Primary wave ②. The interpretation here considers Minor wave 5 to have ended in a small failure at the July 8 high of 6084.08, meaning that stocks are tracing out a



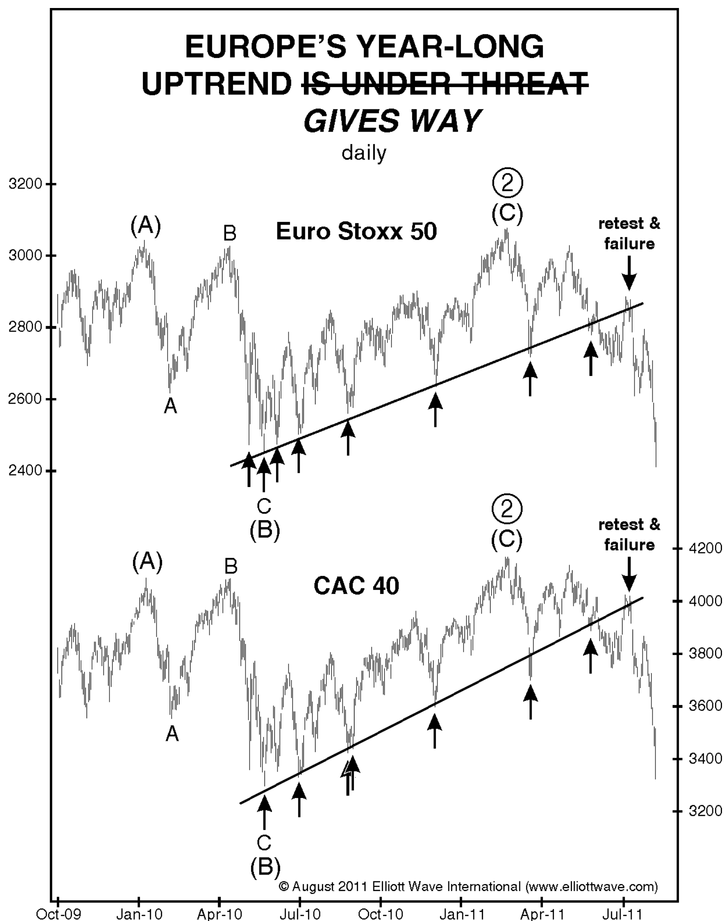
small-degree downward impulse. The market is near-term oversold, but any snapback rally that develops should hold beneath 5752.51 and lead to another wave of selling.

The DAX's wave structure is more complicated, but, as the chart on page 6 indicates, the downside potential in the German market remains massive. This week's selloff argues strongly that the DAX is falling again at Primary degree.

The Trend Is Our Friend, Again

There are no guarantees in market forecasting, but, when faced with competing wave interpretations, an important trendline that either breaks or holds can greatly improve the chances of making a successful prediction. Pages 28 and 29 of the July 2011 issue of *Global Market Perspective* illustrated a slew of European bourses where stocks had penetrated critically important support lines. Recapping, stocks broke through year-long uptrends in Belgium, Portugal, Italy and The Netherlands. In five more markets — France, Britain, Norway, Austria and the Eurostoxx 50 — prices breached support lines from the March 2009 lows.

e156883



Notice the title change on the following chart from last month, which updates price action in the CAC 40 and Eurostoxx 50. Both indexes turned lower last month after nudging up against the underside of their respective support. Adding to the bearish message, stocks dropped beneath their June lows, keeping intact a series of lower lows and lower highs from February 2011. Moreover, last month's downturn was broad based, affecting nearly every average and sub-average. Spanish shares, for instance, are down 17% since July 1. Italian shares are down 20%.

Banks, too, which we continue to believe will play a key role in the coming deflation, plunged as well. From its July 1 peak, Bloomberg's European banks and financial services index declined 19% to yesterday's low, while the FTSE 350 banks index dropped more than 14%. The index further penetrated the shelf of support that we illustrated last month. From the standpoint of Elliott waves, the critical implication is that February 2011 marked the high of wave (C), thereby completing an (A)-(B)-(C) rally from March 2009. The clinching piece of evidence for the bearish case should now come in the form of a five-wave decline on the weekly chart, indicating that the market's larger-degree trend is down.

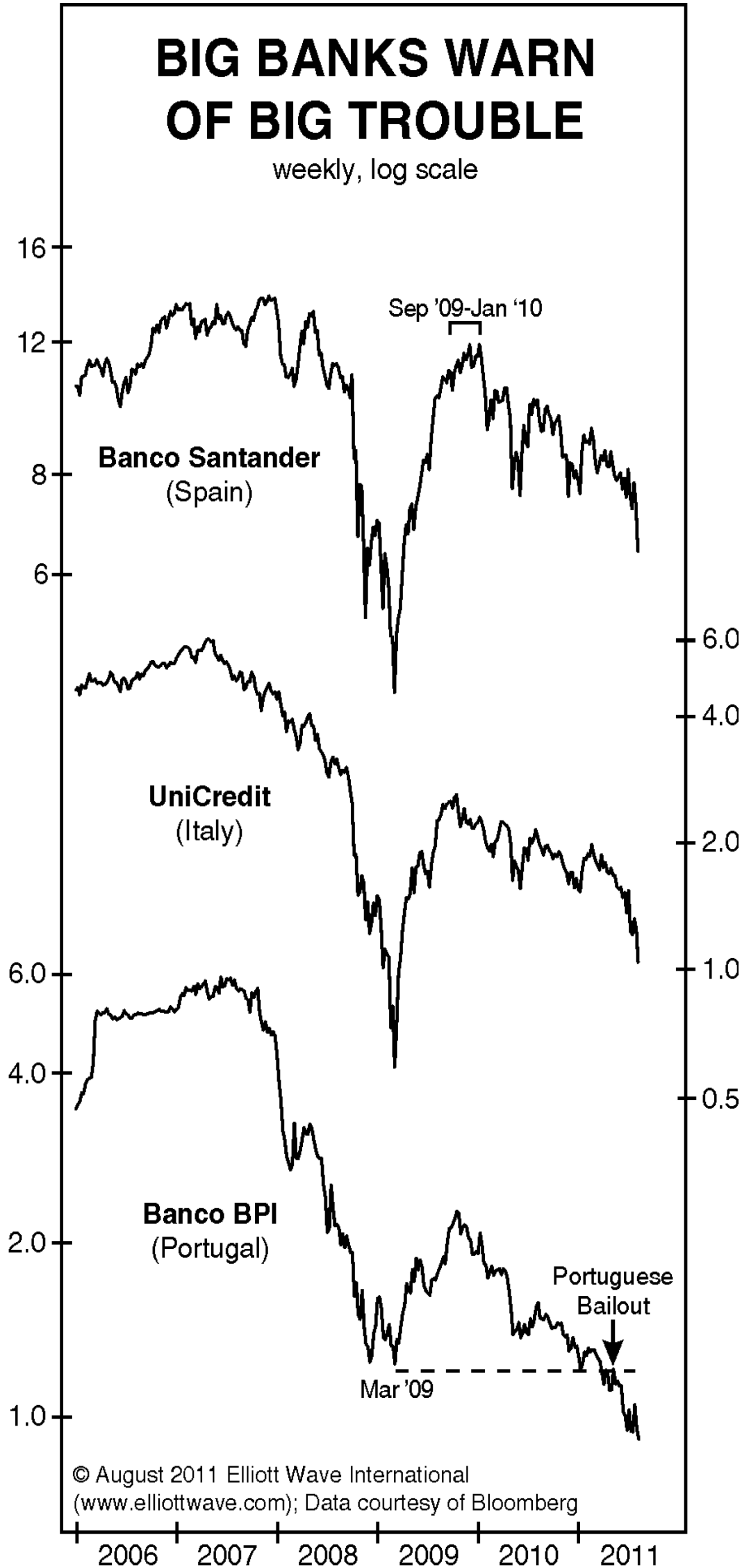
Market Psychology

Every passing month brings new evidence that the March 2009 lows did not end but merely interrupted Europe's bear market. The lower line on this chart plots the share performance of BPI, one of Portugal's biggest investment banks. It's one of countless European banks that have dropped through their March 2009 lows. The top line shows the stock price of Spanish banking giant Santander, which holds €1.2 trillion in assets and operates in 40 countries. If you think that European economies are unraveling now, wait until this behemoth starts plumbing multi-year lows.

Meanwhile, Unicredit (the middle line of the chart on the next page) is Italy's largest banking conglomerate. For the second time in as many months, extreme volatility forced the Milan stock exchange to halt trading in the bank's shares last week. Not shown on the chart is Italy's largest retail bank, Intesa Sanpaolo, which also appears to be fighting for its life. Like Unicredit, prices retraced 38.2% of their 2007-09 decline, then turned lower more than 19 months ago, and have plunged 43% since March. Intesa now sits within 10% of its March 2009 nadir.

These developments are critically important to our deflationary case, with widespread implications that extend well beyond the banking sector. Italy and Spain are Europe's third- and fifth-largest economies, respectively. And, at €1.6 trillion, Italy boasts the world's third largest burden of sovereign debt, behind only the U.S. and Japan. Something is clearly amiss, and if the template of the past two years holds, the declining fortunes of these countries' biggest banks are foreshadowing a worsening turn for the countries themselves.

e156883



The Jig Is Up

Of course, both Unicredit and Santander passed last month's stress testing of 91 European banks, despite their sinking share prices. They had plenty of company, too. Fully 82 banks passed, meaning that 91% of Europe's financial institutions are deemed adequately capitalized. Before you run out and open up an account, though, recall this assessment that we made following the first round of stress testing one year ago: "The CEBS is utilizing a woefully diluted version of the economic deterioration that is about to grip the continent." The August 2010 GMP added, "[M]any of the banks that passed [July's] stress test will collapse in the coming years." In fact, the Bank of Ireland and Allied Irish bank did collapse in September 2010, shortly after they received passing grades from European banking supervisors.

Today, one year and two sovereign bailouts later, the public has clearly come to understand that Europe's banking stress tests are a joke. "Stress-Test Magic Makes Greece's Bust Disappear," quips a Bloomberg columnist. "EU stress test pass rate under fire," says the Financial Times. "The EBA are stress-testing the wrong thing," argues a London-based bank strategist. "[W]ho is going to bail out the sovereign?" he asks.

Up to now, the answer to that question has been Europe's hastily contrived rescue facilities. The big problem, of course, is that these funds themselves rely solely on the eurozone's ability to borrow more money. Here, for instance, is how the October 2010 GMP assessed Europe's existing bailout fund, the €440 billion European Financial Stability Facility (EFSF):

> [T]he structure of the EFSF ... showcases the continent's ill-preparedness for the next crisis. The plan, in fact, is to have the Facility itself borrow the money it needs, when it needs it. [M]uch like the IOUs they will issue, the Facility at this point is merely a €440 billion pool of promises.

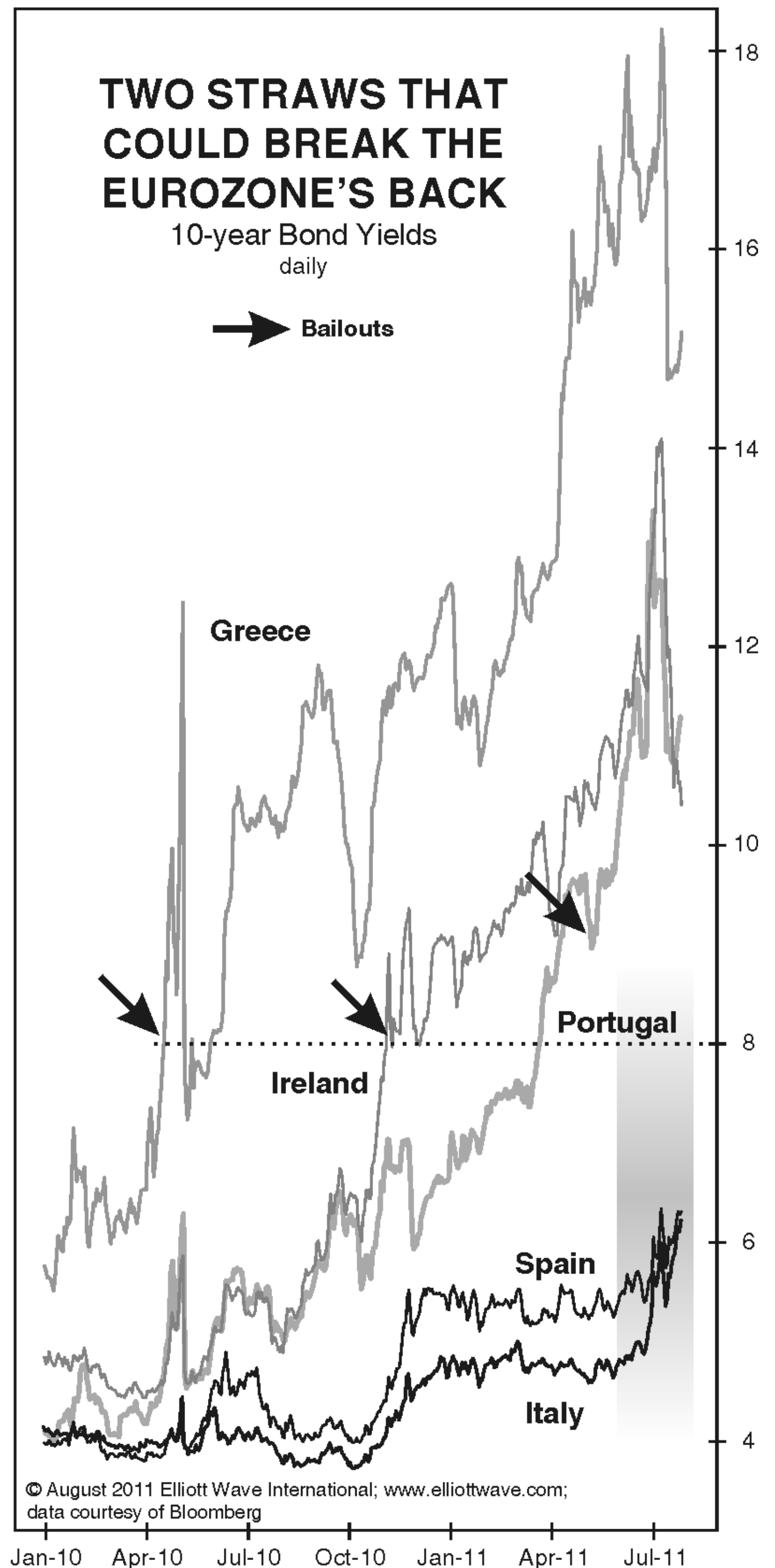
e156883

If this article from the July 30 Wall Street Journal is any indication, Europe's pool of promises is about to spring a big leak (emphasis added):

> **Italy, Spain Worries Complicate Greece Aid**
> BRUSSELS – Investor concerns over Italy and Spain are complicating efforts to deliver Greece its next chunk of rescue aid.... Greece is due to receive the next installment of its original, €110 billion ($158 billion) bailout in September. But Italy and Spain, both of which committed to extend bilateral loans to Greece with other euro-zone countries, have seen their own borrowing costs rise recently. *Euro-zone finance officials are now considering allowing Italy and Spain to opt out of the payment....*

Opt out? How do you think German, French and Dutch authorities – who make up the bulk of the commitments to the EFSF – will react if their fellow EU partners start reneging on their obligations to Europe's rescue packages? The answer is, they will opt out, too, and that day of reckoning may be fast approaching.

The following chart of 10-year borrowing costs in Greece, Ireland and Portugal is an updated version of one we showed three months ago. At the time, 10-year Portuguese yields were crossing the critical 8% threshold, prompting the April 2011 GMP to warn, "[A] default and bailout for Portugal is days away." EU authorities approved Portugal's €78 billion rescue package the following month. The two lower lines are the key additions to the chart, as both Spanish and Italian yields spiked to multi-year highs last month.



The essential observation is that EU authorities are now fighting on two fronts: The group of insolvent states that require rescue funding is expanding, while the group of solvent ones that provide such funding is contracting. The unsustainable situation is fast approaching a ruinous climax.

Is It Enough To Be Contrarian?

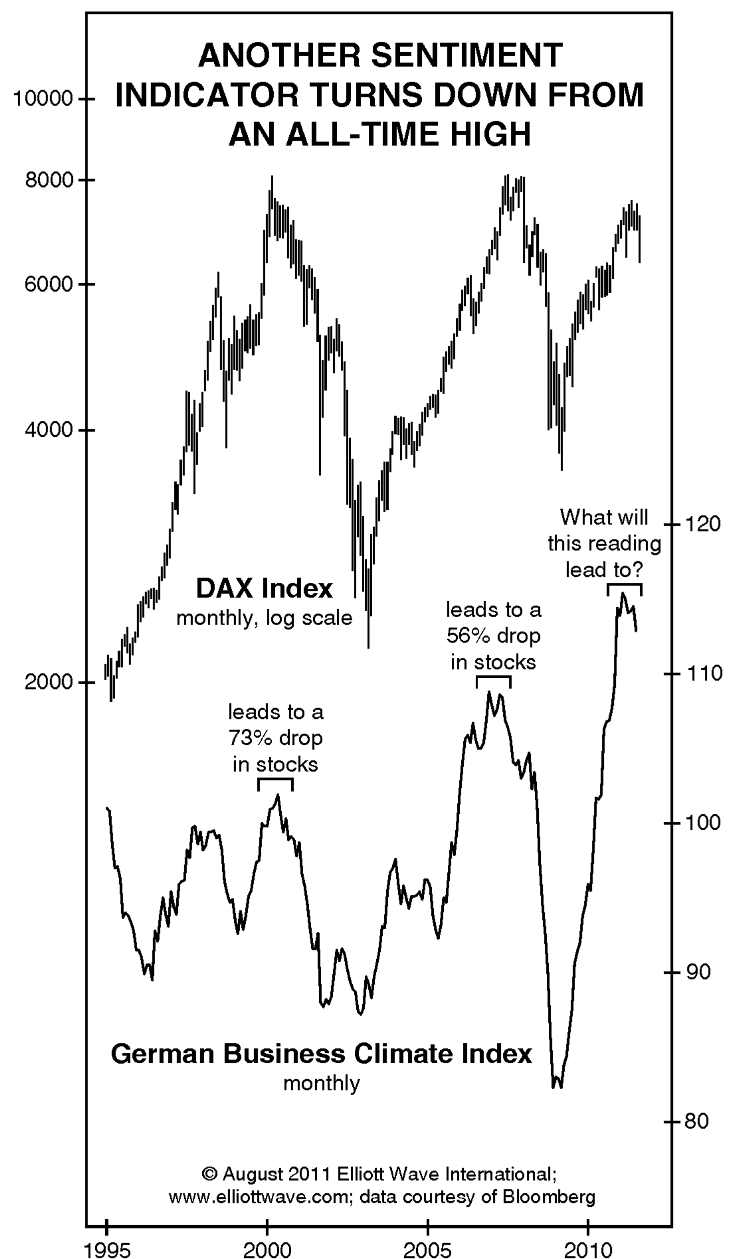
This July 28 Bloomberg article proposes a bold play in one of Europe's most beaten-down sectors: "A Daring Mutual Fund Bet on European Banks." Europe's financial sector looks so bleak, says the logic; now must be a fantastic buying opportunity. We relate to this kind of contrary thinking. And it's true that a strict adherence to the wave model habitually puts wave analysts where they should be: against the market crowd.

But not always. At specific points in the market's wave structure, wave analysts run with the herd. For example, *Elliott Wave Principle* describes declining C-waves as recognition waves, when the "illusions held throughout waves A and B tend to evaporate and fear takes over." The description characterizes third waves, too, when the trend is "unmistakable," according to EWP. In essence, it's during these times that public opinions transform en masse, and betting against the market crowd becomes a recipe for financial disaster.

In fact, if we forecasted markets exclusively by being contrary, we almost certainly would have turned bullish on Europe's peripheral markets back in early 2010, just as they were topping. At the time, the contrarian logic appeared bulletproof, as countless gauges of credit stress had returned to the fearful readings seen at the 2009 lows. Instead, GMP maintained that markets verged on a third wave, not merely a first wave, meaning it was only natural for the 2008 credit crunch to escalate. That's exactly what happened. Credit markets vaulted right through the fearful readings that pervaded earlier as stocks began dropping again.

There's a more basic question, however: Does a bullish stance right now constitute a contrary opinion in the first place? That is to say, are European stocks really at some sort of pessimistic low point? The March 2011 EFF showed the Ifo Institute's Business Climate Index, a gauge of German business sentiment based on survey responses from 7,000 executives. Not only was German business confidence not plumbing new lows, the index had actually breached its most optimistic readings from the stock market's 2007 high.

The updated chart below plots the index across the entirety of Germany's Supercycle-degree topping process. Observe two things: First, the DAX's current rally has propelled business confidence to its most



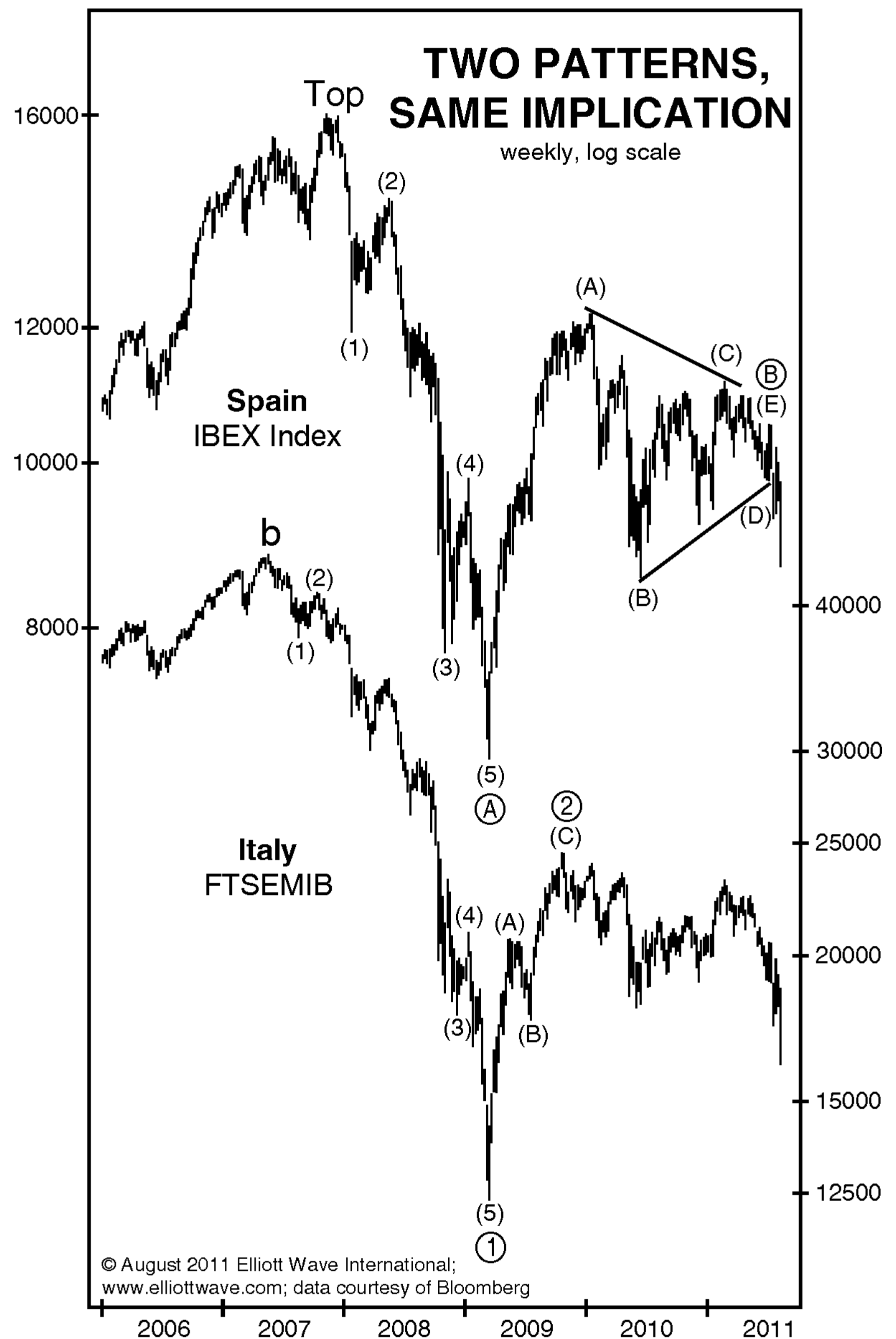
e156883

optimistic readings in the survey's history, far beyond the extremes seen in either 2000 or 2007. And, second, business sentiment now points back down after a nearly uninterrupted rise since March 2009. The consensus opinion is that the fate of Europe now rests exclusively on Germany's economic powerhouse. This chart, however, portrays the market's own powerhouse downside potential that will ultimately grind the continent's economic engine to a halt.

MARKET SPOTLIGHT

Italy

As far as Elliott waves go, peripheral European markets are following the script. By dropping beneath 17,626, the Italian MIB index eliminated the possibility of a contracting triangle from the October 2009 high of 24,558. Equally important for the bearish case, last month's drop penetrated the wave (B) low from July 2009, meaning that no technical support remains until prices reach the March 2009 bottom. Italian shares are oversold, so a near-term bounce looks likely. If so, prices should hold well beneath 20,560 and lead to another wave of decline.



Spain

Spanish shares have declined and advanced exclusively in three-wave structures since the January 2010 countertrend high of 12,240. This means that the entire pattern since March 2009 is most likely a large-degree contracting triangle. The decline since 2007 is therefore a 5-3-5 zigzag, to be labeled Ⓐ-Ⓑ-Ⓒ. Wave Ⓐ ended at the March 2009 low of 6702; wave Ⓑ ended last month at 10,536; and Spanish shares are now moving lower in five Intermediate degree waves since wave Ⓒ has further to go.

If you would like thrice-weekly coverage of European stock indexes, we recommend you add the *The European Short Term Update* to your subscription. It is published each Monday, Wednesday and Friday evening via the Internet. You can add *ESTU* to your *GMP* subscription for an additional $30 per month (a savings of $228 per year). Call 800-336-1618 or 770-536-0309 to subscribe risk-free.

e156883

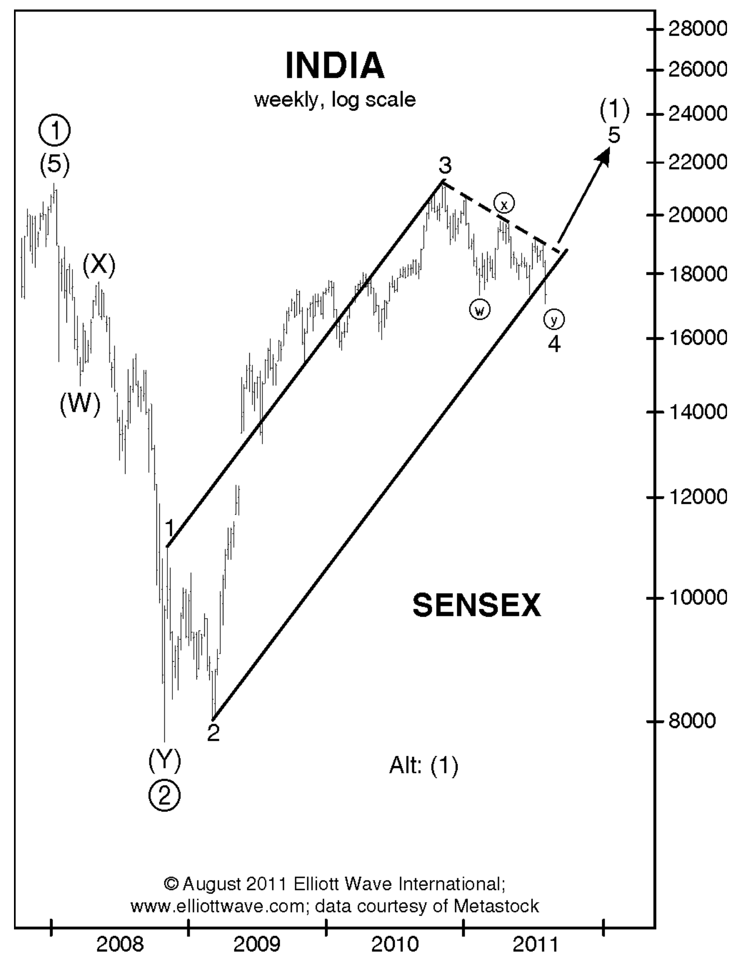
ASIAN-PACIFIC STOCK MARKETS

Overview

The same waves of social mood that create patterns in stock indexes can sometimes produce extreme negative events in society after corrections have continued for some time.

Not every major decline generates extreme social behaviors, but bad news erupts after major stock market declines often enough that contrarian investors are prepared if it happens. For example, just days after the 2008 low, technical and sentiment conditions seemed so ripe for an extreme expression of negative mood that we even warned of it in the October 2008 issue, citing the dramatic events that occurred during the region's previous great bear market:

> The most spectacular violence of 2001 in the Asian-Pacific region — the U.S. invasion of Afghanistan and the terrorist attacks on India's Parliament — took place weeks and months, respectively, after the September lows in the region's stock markets. The recent escalation of grassroots violence in Afghanistan, Pakistan and India shows the potential for a sequel to those violent events.
>
> —*Global Market Perspective*, October 31, 2008



Back then, less than a month after the 2008 low in Asian stocks, terrorists attacked downtown Mumbai, killing 164 people and injuring 304.

This February, near the end of wave Ⓦ of 4 down in the SENSEX, we warned subscribers that an outbreak of violence might occur:

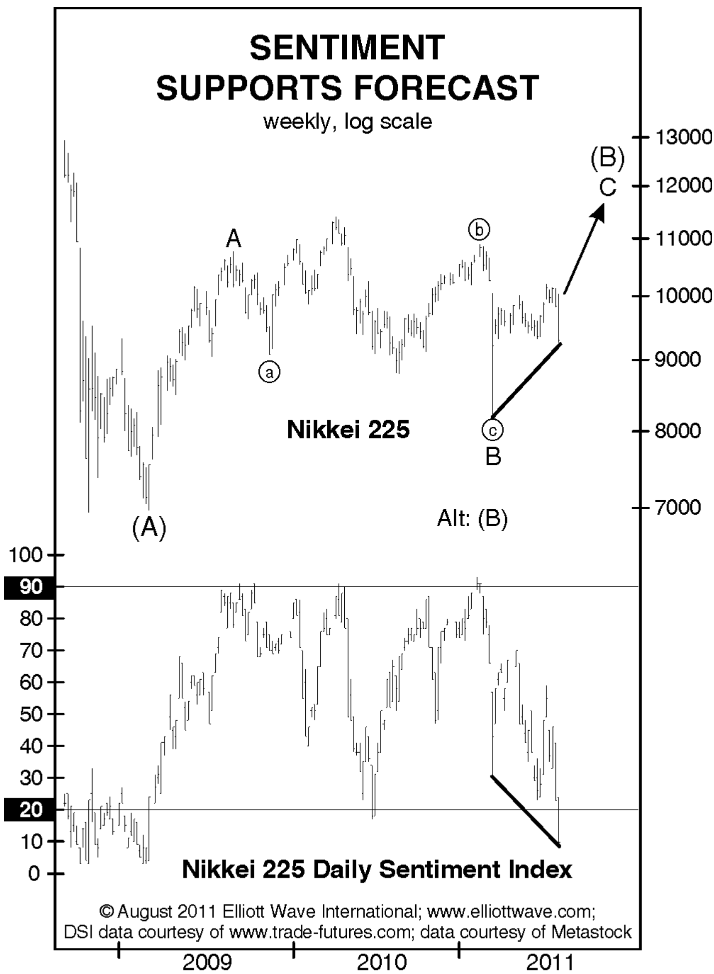
> Following the January-February 2010 decline, terrorists detonated a bomb in Pune, which killed 17 people and injured 60 others. The current correction could generate violence of similar magnitude.
>
> —*Global Market Perspective*, February 4, 2011

This time, terrorist bombs exploded in mid-July at three sites in downtown Mumbai, killing 26 people and injuring more than 130. The scale of the attack was smaller than the one in 2008, which is consistent with our observation that the severity of the negative mood event is generally proportional to the severity of the decline that precedes it.

Wave 4 in the SENSEX has fallen below the lower trend channel line of the rally since the 2008 low in a throw-under, which is how fourth waves sometimes end. If this view is correct, prices should recover soon. If the index fails to recover quickly, it would raise the probability that wave (1) up ended at the November 2010 high.

The Mumbai bombings were just one of several extreme negative events that occurred in July as the region's stock markets continued correcting. Every major correction usually generates at least one defining negative mood event, and this one gave us several. The clustering of several extreme negative events so close in time adds more evidence that the region may be in the process of

e156883



forming a significant low. The behavior of our regional sentiment indicator, the Nikkei 225 Daily Sentiment Index, which this week fell to its lowest level since the March 2009 lows, supports that view. (See chart.)

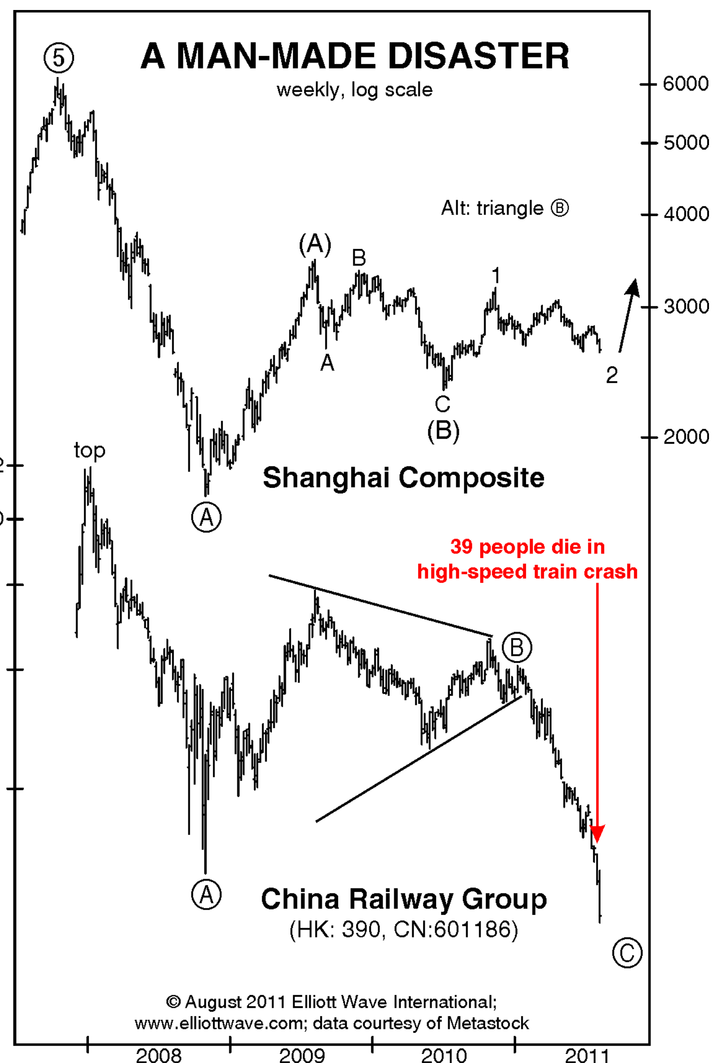
Let's now look at the patterns in other markets and the dramatic events that attended them.

China

The Shanghai Composite continues its sideways consolidation of the past three years. The wave 2 correction has turned more complex, but any continued decline will probably be limited. We base that forecast on the behavior of the Shenzhen Composite compared with the Shanghai. The Shenzhen is leading Chinese stocks again, which is significant, because it comprises smaller, faster-growing companies than the Shanghai index does. It had played the role of the hare to the Shanghai's tortoise during the rally since the 2008 low until the end of 2010 when the Shenzhen began to underperform the Shanghai. But since June, the hare has leaped ahead again. It's usually bullish when a former leader resumes its lead coming out of a correction, so we can expect Chinese stocks to continue rising in wave (C).

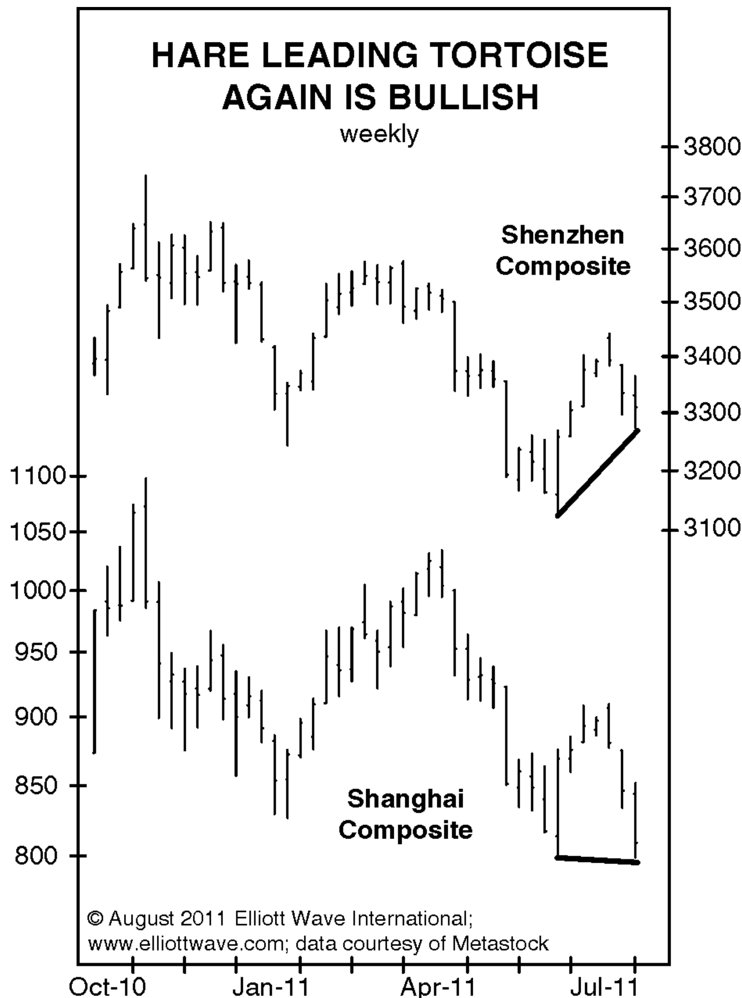
An event to mark a major turn

Here's a second piece of evidence that Chinese stocks are poised to turn up from their sideways consolidation. *Elliott Wave Principle* states that E-waves of triangles "almost always are accompanied by strongly supportive news." In the case of large-degree corrections, that means bad news. In recent issues, we have shown charts that indicate that the bear market since the 2007 high in the Shanghai Composite may be a fourth-wave



contracting triangle (see July 2011 issue, for example). If it is a triangle, then the tragic high-speed train crash that killed 39 people and injured 192 others in late July is probably the defining event that will mark its end. Even under the count on the Shanghai Composite shown in the chart above, which remains our preferred count, the crash is probably an indication that the sideways consolidation of the past two years is near its end.

Commercial and industrial fatalities tend to increase during bear markets (See the November 2007 issue of the *Elliott Wave Theorist*). We're not exactly sure why that is so, but it appears that people perform worse when the world around them is falling apart. The pressures on China's rail industry prior to the crash must have been quite heavy, judging from the stock price of China Railway Group, which is the nation's largest rail



company by market capitalization (see chart). It has fallen in a steep C-wave during most of the correction of the past nine months in the Shanghai Composite.

In February this year, soon after the start of wave Ⓒ down, the nation's Railway Minister was removed from office on charges of corruption, followed by delays in construction, environmental objections, service suspensions, and declining passenger numbers. Then came July's train crash. The government's desperate response to the accident only added to the mess: It attempted to mute coverage of the crash by burying sections of the train and ordering the media to accentuate the positive, such as the discovery of a 2-year old girl who was found in the wreckage after search crews had declared their mission complete.

The Chinese public isn't buying it. Anger followed the outbreak of industrial scandals earlier in the bear market, such as the poisoned milk scandal of 2008, but the dark mood this time has prompted almost unprecedented degrees of government criticism. The host of a prominent government-controlled national news program, 24 Hours, seemed to speak for the whole nation when he stated on air:

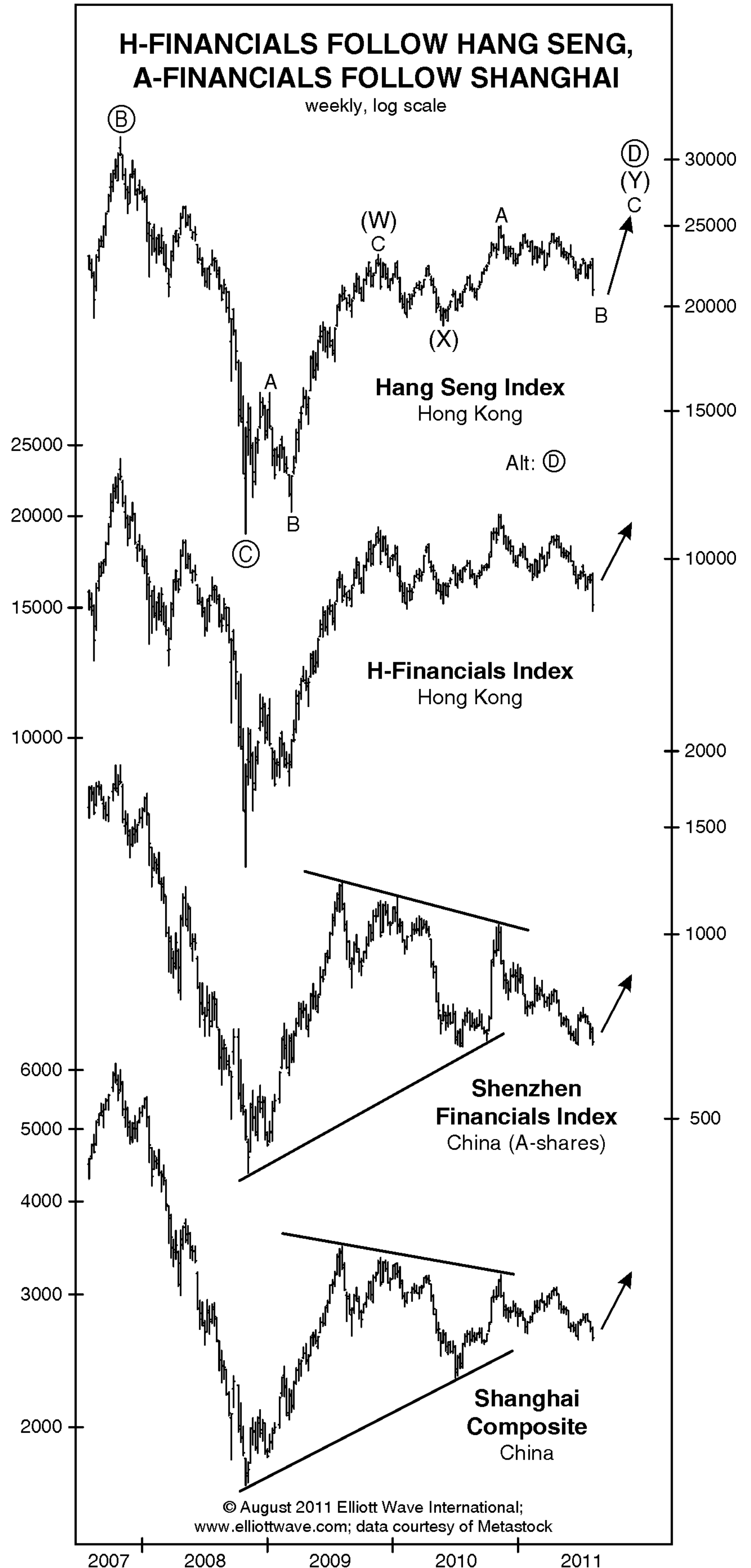
> If nobody can be safe, do we still want this speed? Can we drink a glass of milk that's safe? Can we stay in an apartment that will not fall apart? Can the roads we travel on in our cities not collapse? Can we travel in safe trains? And if and when a major accident does happen, can we not be in a hurry to bury the trains? Can we afford the people a basic sense of security? China, please slow down. If you're too fast, you may leave the souls of your people behind.
>
> —The Shanghaiist

Such a bold statement by a government media representative shows that Chinese society is in the mood for change, as societies usually are at major turning points in their wave patterns. The public's response to the incident is also consistent with our view that a major social mood low is forming in China.

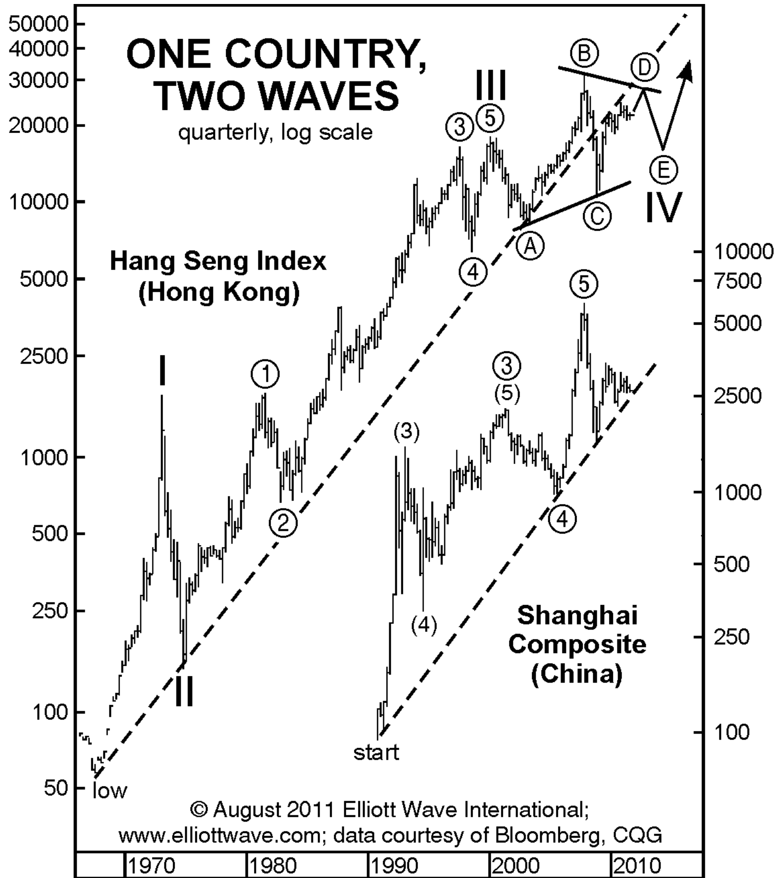
e156883

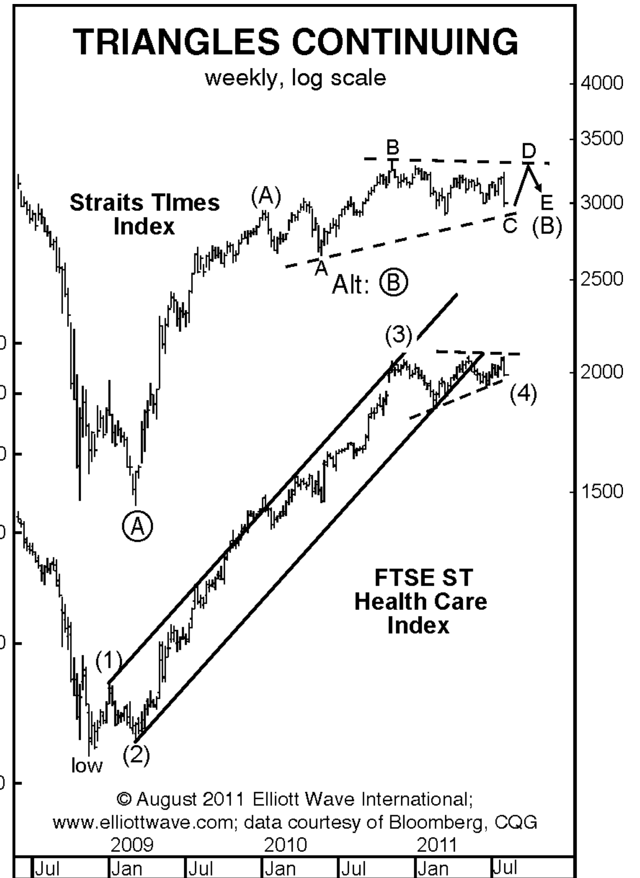
Hong Kong
The Hang Seng Index has continued correcting in wave B of (Y).

Bashing the banks at the bottom
The spell of gloom that investors have cast over the China story in recent months darkened even more in July, which is consistent with our wave patterns in Hong Kong and China. Credit rating agency Moody's said that the "scale of problem loans to Chinese local governments [is] greater than anticipated." The next day, a Singapore sovereign wealth fund, Temasek Holdings, sold large stakes amounting to $3.6 billion in two major Chinese banks. The fund claimed that the sales were part of normal "portfolio rebalancing," according to a Reuters article, but its behavior strikes us more as institutional selling near a low. We say that because the Shenzhen Financials Index appears to be near the end of a triangular consolidation since its 2007 high, mirroring the similar pattern in the Shanghai Composite, while the Hang Seng H-Financials Index looks likely to follow the Hang Seng during the next leg up.



e156883





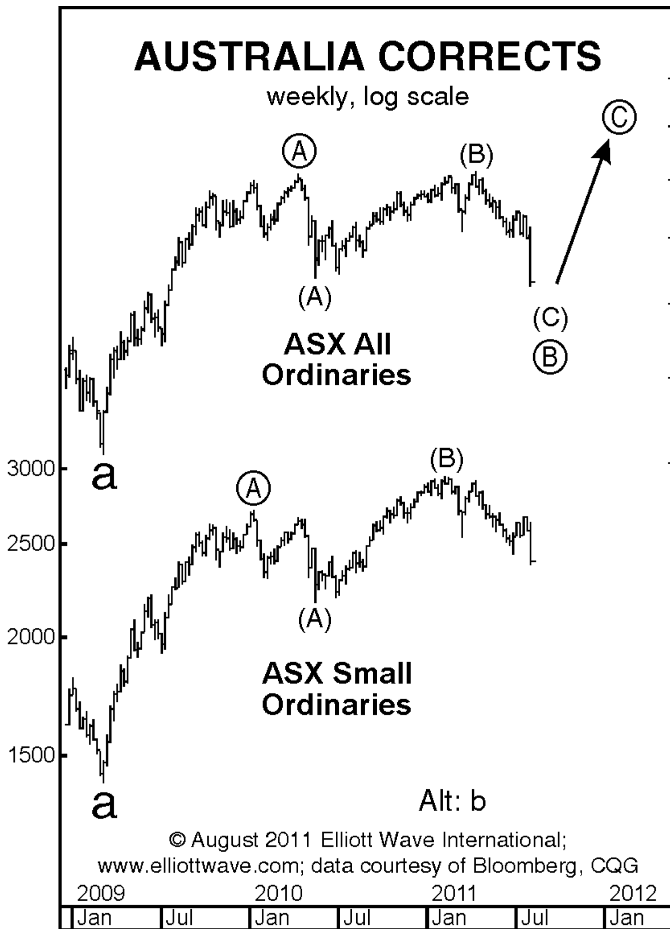
Singapore
The Straits Times Index has continued sideways in its wave (B) triangle. Health Care, the second-best performing FTSE Straits Times Index since the 2008 low, is holding up better and may be completing its own fourth-wave triangle.

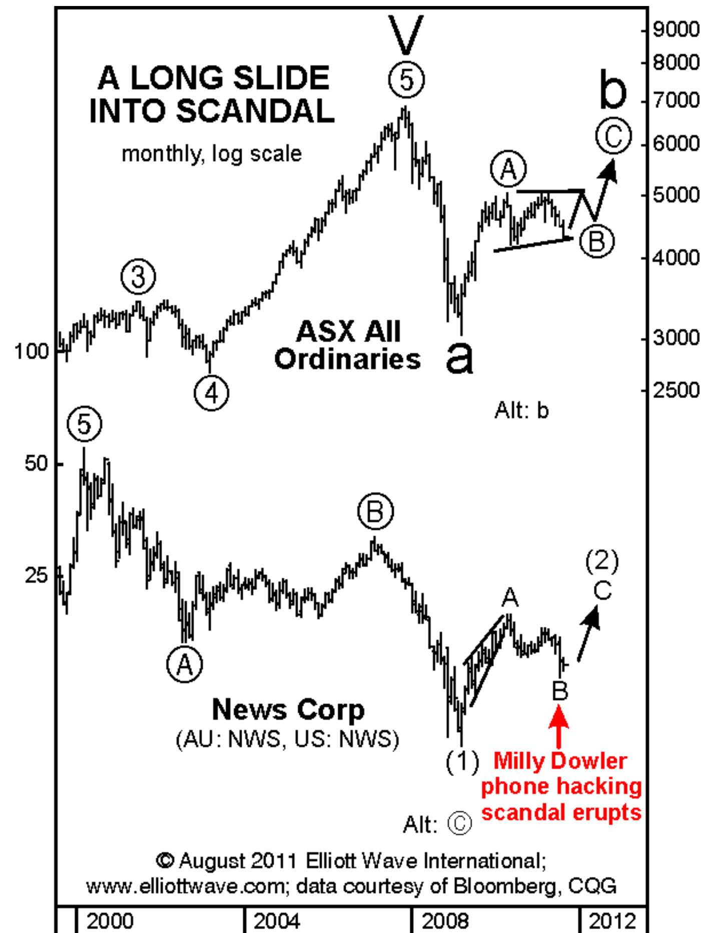
A semi-annual survey of experienced Singaporean investors conducted by JP Morgan Asset Management suggests that sentiment in the city has fallen, in line with that in other markets in the region. The Singapore Investor Confidence Poll Index fell from 134 during the second half of 2010 to 121 in the first half of 2011. "We see a drop-off in terms of clients wanting to make concentrated bets in certain areas, whether it's an asset class or a country," said a manager at the company. (Bloomberg) Many of those investors will probably increase their risk-taking again later as the rally approaches its final top.

Australia
Wave Ⓑ in the ASX All Ordinaries is unfolding as a flat. The relative strength in the ASX Small Ordinaries suggests that wave Ⓑ in the index may be unfolding as a triangle. We will watch how the price action unfolds and reconsider that possibility at a future date.

Update on News Corp. and the Australian market
Our March 2011 analysis of the history of News Corporation showed how the company's major acquisitions have tended to mark intermediate-term peaks in Australian stocks. At the time, we anticipated that the company's largest-ever proposed deal to purchase Britain's BSkyB network would eventually be completed. If things had gone according to plan, we expected that that deal would signal the beginning of the end of the rally since 2009.

e156883





Instead, the correction of the past several months dealt News Corp. one of its harshest blows ever, burying the BSkyB deal and thus eliminating our potential sell signal. But not all was lost. The scandal at the heart of News Corp.'s troubles did give us an intermediate-term buy signal for the company's stock and, secondarily, for the All Ordinaries, since the two have similar wave patterns.

The uproar this time was the revelation in early July that a private investigator hired by one of the company's British tabloids, News of the World, had almost a decade earlier intercepted and deleted the voice messages of a missing teenager, Milly Dowler, who was later found murdered. News Corp.'s tabloids have a long history of hacking into phone messages and engaging in corrupt activities, such as paying police for information, which dates to at least the early 2000s, and which also marked the early years of the bear market in the company's stock price.

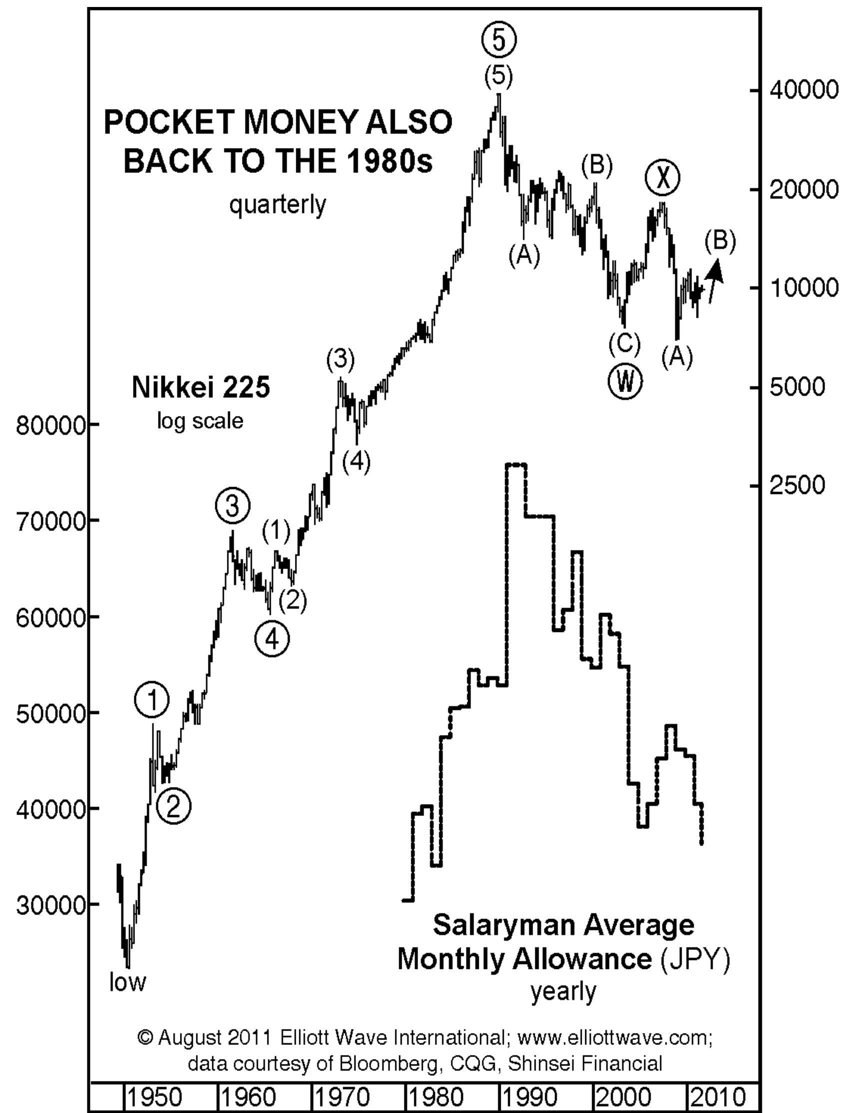
Now, a decade later, whistleblowers have further humbled the former bull market media icon. Scandals, like terrorist attacks and other negative mood expressions, tend to break out after stock prices have corrected for some time. The increasing negative mood sometimes spurs the disgruntled to action.

The recent ruckus hurt the company by scuppering deals and forcing the closure of News of the World, which, ironically, was one of News Corp. founder Rupert Murdoch's first investments outside of Australia in the late 1960s (see March 2011 issue). The enormity of the scandal reflects the long bear market in the company's stock price. But News Corp. has weathered scandals before. For now, we will take the scandal as a sign that News Corp's and the All Ordinaries are in the process of forming significant lows.

e156883

Japan

More than a year ago, Foxconn International, the world's largest contract manufacturer, was hit by a string of suicides by low-wage workers at its factories in China. We correctly identified that the incidents reflected a negative mood extreme in the region and thus signaled that the correction of 2010 was nearing its end.

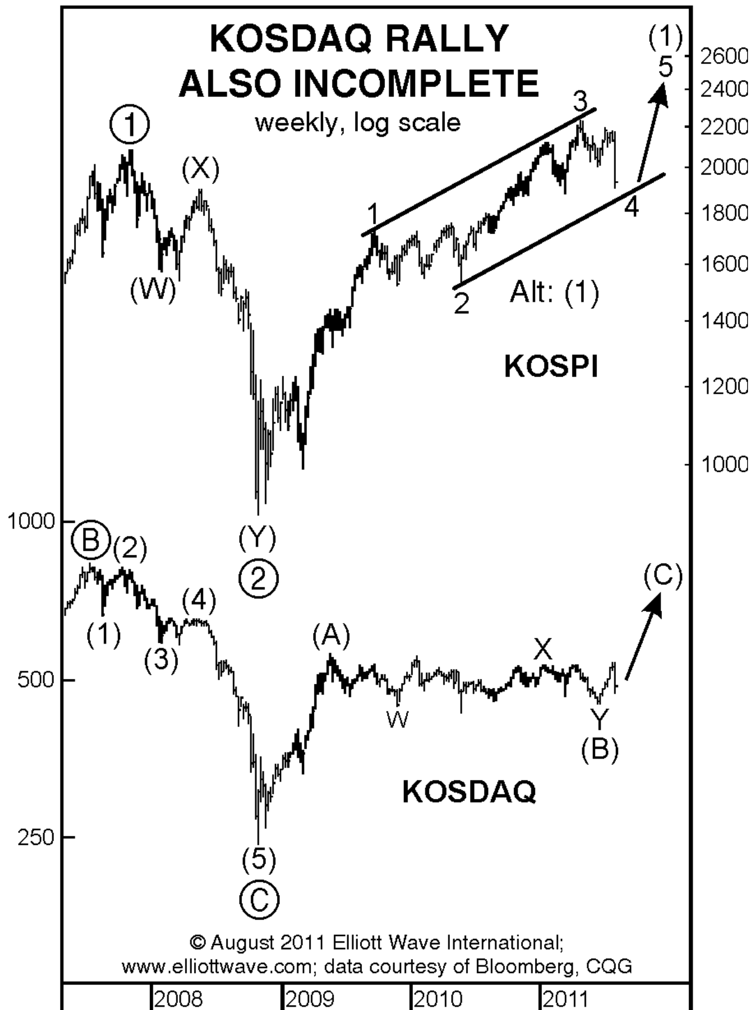


At the same time, we also identified the early stages of a thrust out of a 23-year-long contracting triangle in the stock price of Japan's Fanuc Ltd., the 800-pound gorilla of the global factory automation industry, and said that it meant that "The industrial robot era ha[d] arrived." (See July 2010 issue). Fanuc's thrust has continued to advance strongly since then, having recently risen to within a tenth of a percent of its 1999 all-time (wave Ⓑ) high. (See July 2011 issue). Interestingly, Foxconn's CEO this week added more support for our industrial robot thesis when he announced that, within three years, the company will import 1 million robots to increase productivity and efficiency. Foxconn at present has 10,000 robots. We believe that Fanuc will receive at least some of those new purchases, as Foxconn already uses the company's products. Having not yet exceeded even its wave Ⓑ high, Fanuc's stock price still has plenty of upside left.

Fanuc's success stands in marked contrast to most of the rest of Japan, which is still languishing in chronic recession 21 years after the 1989 top in the Nikkei 225. An annual survey by Shinsei Financial revealed just how austere Japanese spending habits have become. The survey measured male salaried workers' daily spending allowances, which in Japan are customarily determined by wives, who generally manage household finances. It indicated that husbands receive only 36,500 yen ($456) per month, or about $15 per day, which is less than half of the peak amount in 1990 and the lowest amount since 1982 (see chart). To save money, more salarymen said that they now bring their own lunch to work and eat out less. When they do eat out, on average they spend 490 yen ($6) for lunch, or enough to buy a double cheeseburger with small fries and a drink at McDonalds. They eat out after work about three times a month, spending an average of 3,540 yen ($32) each time, according to the survey. "This makes me a little sad," said the chief economist at a Tokyo asset manager. "Unfortunately, this trend's going to continue." (Bloomberg) To our contrarian ears, that sounds longer-term bullish.

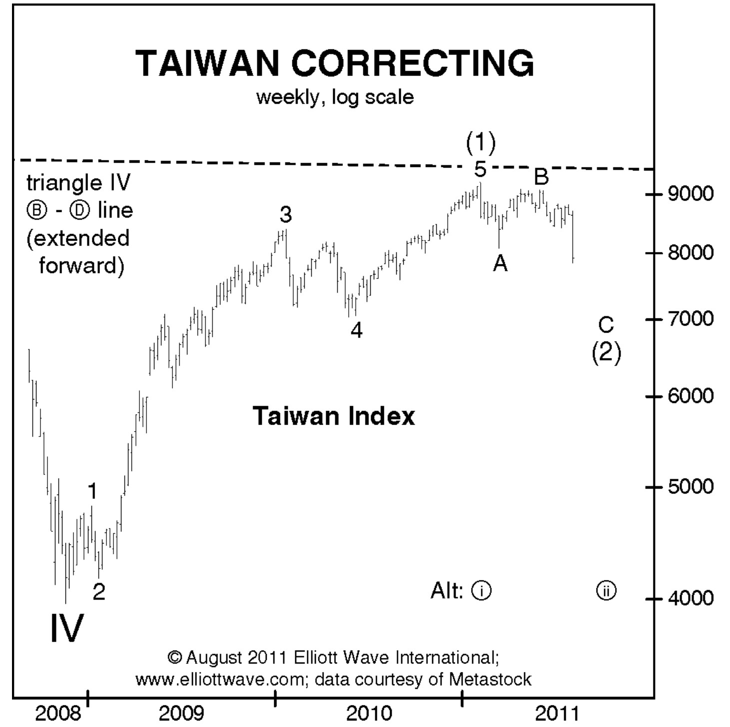
e156883

Korea



Wave 4 in the KOSPI remains in progress.

Taiwan



The decline since the February high in the Taiwan Index looks corrective, but it now rivals the 2010 correction in duration and depth. For now we will consider wave (1) up in the Taiwan Index to have ended at the February 2011 high.

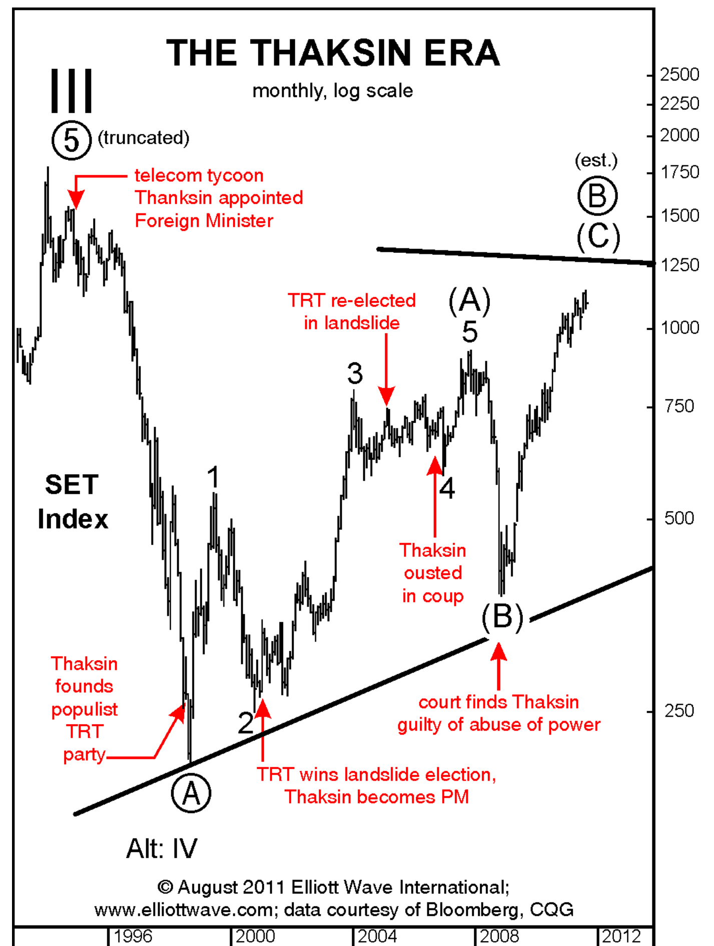
e156883

Thailand

The weekly chart of the SET Index sports one of the clearest wave counts in the region — a fifth wave up in its early stages.

Thai General Election 2011

Large-degree stock market corrections tend to produce calls for political change: Thai voters voiced that sentiment loudly in early July, following the wave 4 low in the SET Index. A political neophyte, Yingluck Shinawatra, became Thailand's first female Prime Minister after her party won a landslide victory in parliamentary elections. But on closer inspection, the real winner of the election was her older brother, the billionaire businessman and former prime minister, Thaksin Shinawatra, who lives in exile in Dubai. Let's look at the fascinating story of this man, whose career has mirrored the major waves in the SET Index almost perfectly, and who now again wields enormous influence in Thailand through his sister and her party's parliamentary majority.



After a series of failed business ventures in the 1970s and early 1980s, Thaksin finally hit the big time during the 1980s bull market, when he leveraged his connections in the police and military to supply computers to the government and procure telecom licenses. By the 1990s, his companies provided 90% of the Thai government's computers and operated the nation's largest cellular network. Along the way, Thaksin became one of Thailand's richest people. Having listed four of his companies on the stock market during the SET's run up to its 1994 high, he then decided to get into politics.

A few months after the SET's orthodox wave III high in late 1994, he joined a political party that was part of the ruling coalition and was made Foreign Minister. Looking at the chart, it's easy to see that he had bought into a major top in social mood.

Thaksin shifted his political allegiances a few times during the 1994-1998 collapse in the SET, but his entrepreneurial sense eventually helped him to find opportunity in the crisis. Two months ahead of the 1998 low, he founded a populist party, called Thai Rak Thai (TRT), or Thais Love Thais, whose policies appealed to the politically underserved masses in the countryside. During the 2001 general election, which took place near the 2001 low in the SET, the upstart TRT defeated the incumbent party by a landslide, and Thaksin became prime minister. Then, after riding a four-year bull market, Thaksin and the TRT, now incumbents, won a landslide re-election near the 2005 peak in the SET. Socionomically, his timing during those years was flawless, as our studies show that bear markets favor challenger candidates while bull markets favor incumbents.

Then hubris tripped him up. He had earned a reputation for corruption while in office, although Thai society was willing to overlook it during the bull market. But toward the end of the 2004-2006 (wave 4) bear

market, he caused a national uproar when he brazenly sold his US$1.88 billion stake in his telecommunications company, Shin Corp, to a Singaporean sovereign wealth fund. Critics blasted him for forcing changes to the country's laws to allow him to sell a strategic national asset to a foreign entity while paying no capital gains tax.

The opposition boycotted the next election, and the military removed Thaksin from power in a coup near the end of the SET's 2004-2006 correction. His political enemies then dissolved the TRT and used the courts to freeze funds that they claimed he had acquired illegally. A month ahead of the 2008 low, the Supreme Court ruled that he had abused his powers by helping his wife buy public land. Shortly after the 2010 correction, the court decided that the government could seize the assets it had frozen, an amount equaling about US$1.5 billion, which led to violent battles between Thai security forces and mobs of Thaksin's "red shirt" supporters on the streets of Bangkok.

Which brings us back to Yingluck's victory in July. It appears to begin another chapter in Thaksin's career, which has often been shaped by large-degree waves in Thailand's stock market. The recent correction benefitted Thaksin, but his second honeymoon may not last long. The SET has tripled since its 2008 low, so the correction of that advance is sure to test the Shinawatras while emboldening their enemies. But Thaksin still has plenty of money outside Thailand to fund his ambitions, so the political drama promises to be fierce.

If you would like thrice-weekly coverage of Asian-Pacific stock indexes, we recommend you add the *The Asian-Pacific Short Term Update* to your subscription. It is published each Sunday, Tuesday and Thursday evening via the Internet. You can add *ASTU* to your *GMP* subscription for an additional $30 per month (a savings of $228 per year). Call 800-336-1618 or 770-536-0309 to subscribe risk-free.

e156883

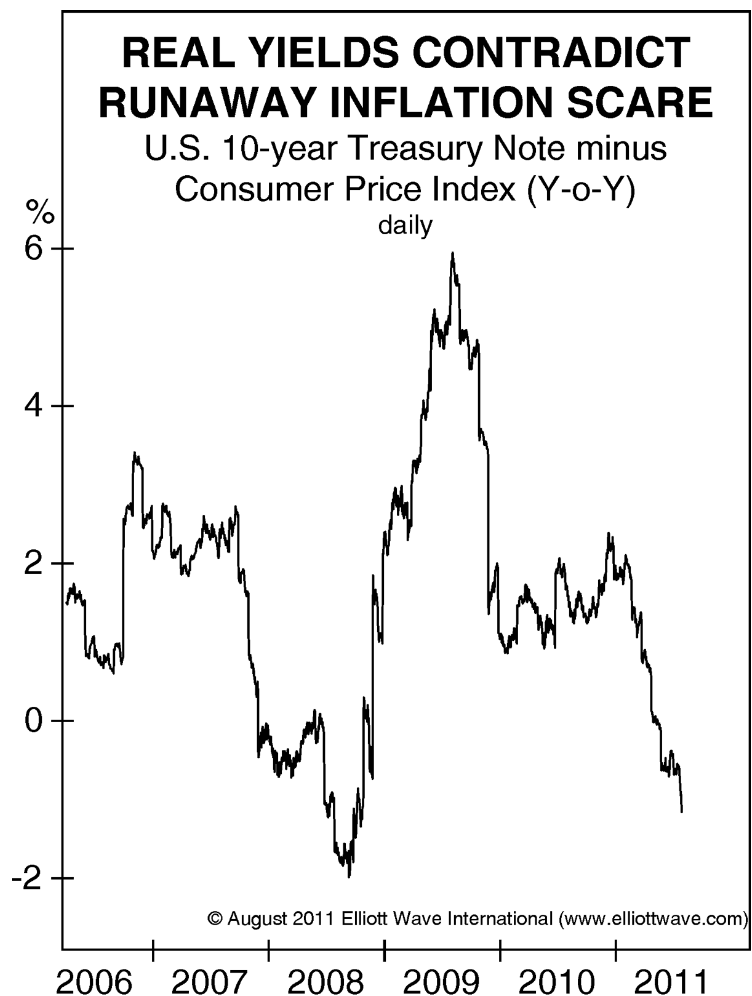
INTEREST RATES AROUND THE WORLD

U.S. government yields are near historic lows in nominal and inflation-adjusted terms, as investors seek safety. These yields should remain low relative to non-U.S. government bonds until the most virulent portion of deflation grabs hold.

Global interest rate vehicles enjoyed what most perceive as a flight-to-safety rally as rates stayed soft. Don't get complacent because many of these patterns are nearing completion.

U.S. TREASURIES

This week, the Real Yield on U.S. Treasury notes (the yield on 10-year T-note minus the year-over-year change in CPI) declined to negative 1.15%, the lowest level since October 2008 when the deflationary pressures of Primary wave ① were most intense. Incredibly, amidst the threat of a U.S. debt default, market pundits and the media continued to fret about inflation. On September 8, the Bloomberg Global Inflation Conference will "convene leading economists, finance ministers, institutional investors and members of the news media to examine the latest strategies for investing in the global inflationary environment." As recently as April, the world's largest bond investor bet heavily on this scenario with a $7 billion short position on U.S. government debt (i.e., a bet that U.S. gov't bond prices would fall). But the U.S. government bond market is not buying the inflation scenario. Deflation, not inflation, is buffeting the economy, and bond yields reflect that reality. Real Yields made a countertrend rally high on December 15 of last year at 2.39% and have been falling steadily ever since. The decline is right in line with the increasing deflationary forces described in GMP and EWT, and it foreshadowed the weakening economic statistics, which are now emerging.



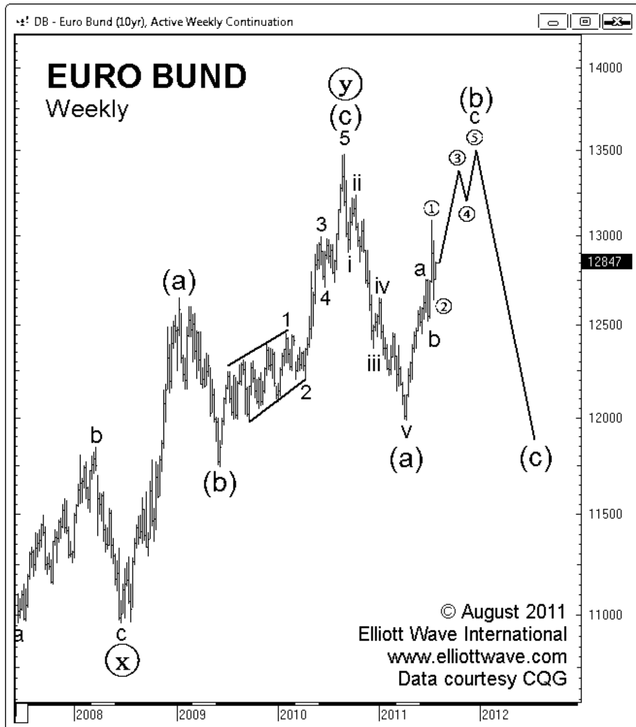
Near-term optimism toward bonds has become extreme, with the Daily Sentiment Index (trade-futures.com) at 98% bond bulls. So there is probably a countertrend move coming. Eventually, however, the low in Real Yields should eclipse the October 2008 extreme of negative 1.99%.

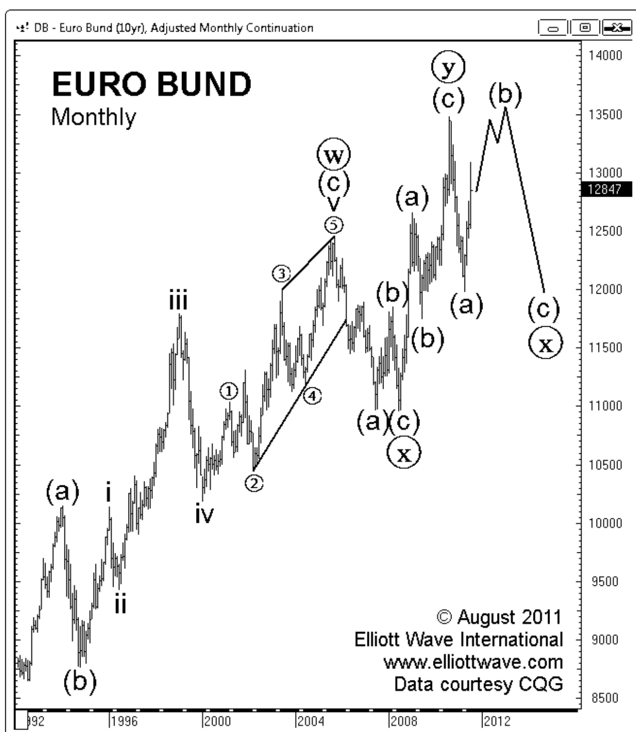
e156883

EUROPE

The Bund

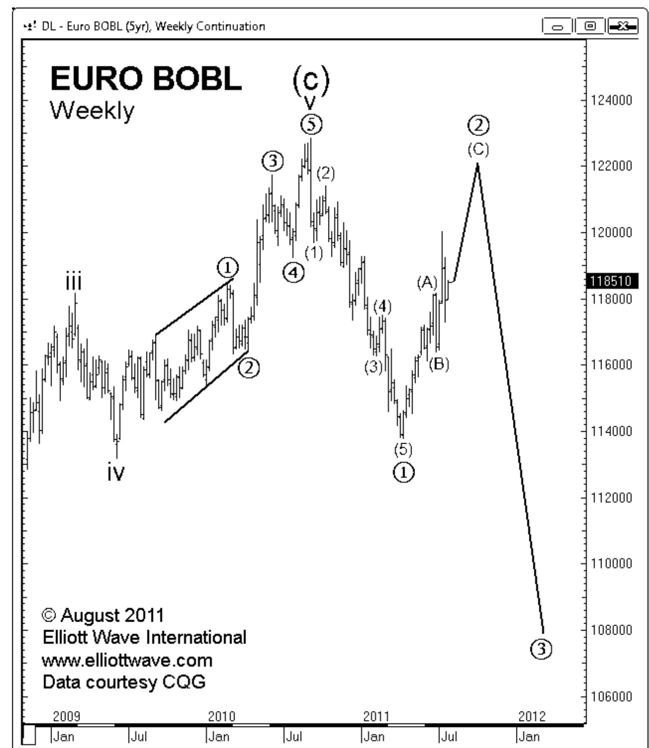
The short-term focus remains higher, as the wave count projects strength over the coming weeks to approach the 2010 peak. We maintain a corrective interpretation off the April 2011 low following the five-wave structure off the 2010 peak, but this will be a deep correction for wave (b) within this zigzag. The 131.34 area is a viable target in the September contract. Higher prices are projected with confidence against 128.29, and pivotal, short-term support lies at 127.66.



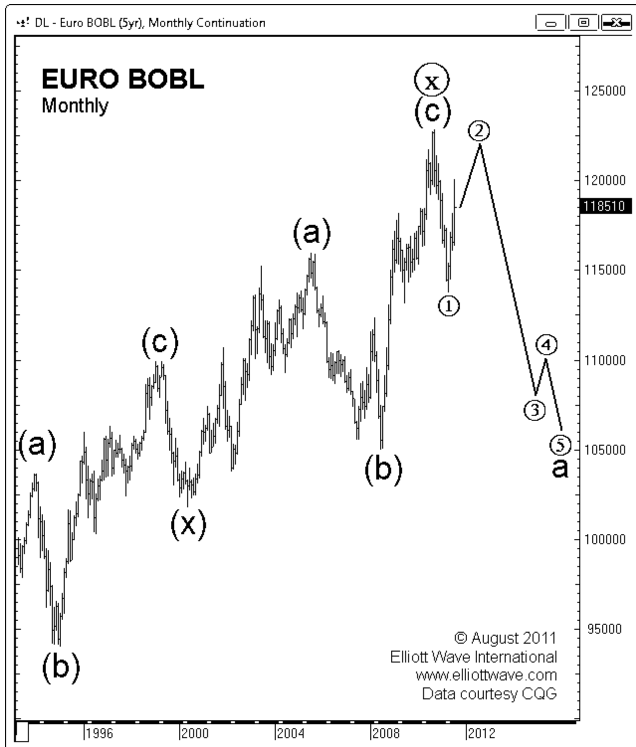


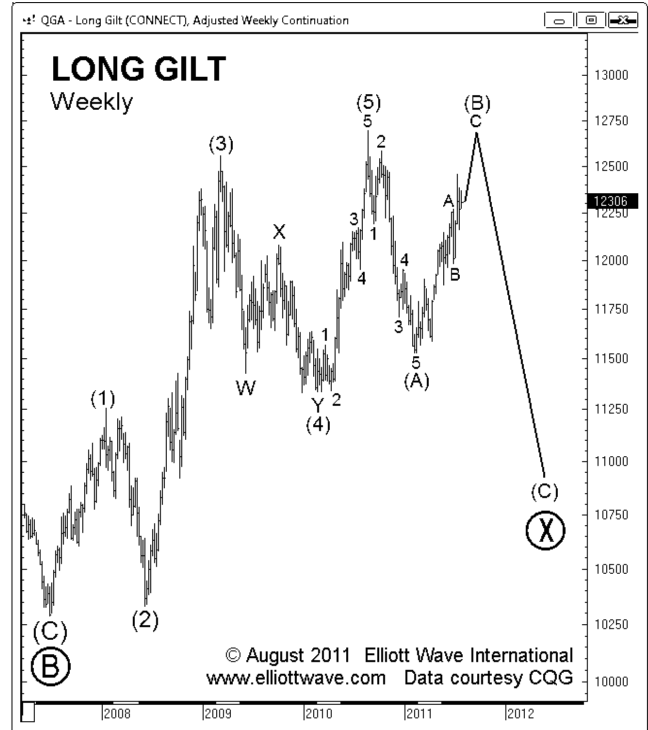
The Bobl

Debt fears and persistent deflationary pressures in Europe have resulted in a rapid decrease in yields, and, as in the Bund, we anticipate a deep wave ② correction that will likely carry the five-year to new contract highs. Ideally, this advance will fall short of the September 2010 highs, but the 120.04/121.04 area is a probable target basis September. Only weakness below 117.80 would pose a significant challenge to our outlook for substantially higher prices on the weekly chart in wave (C) of ②.



e156883





The Long Gilt

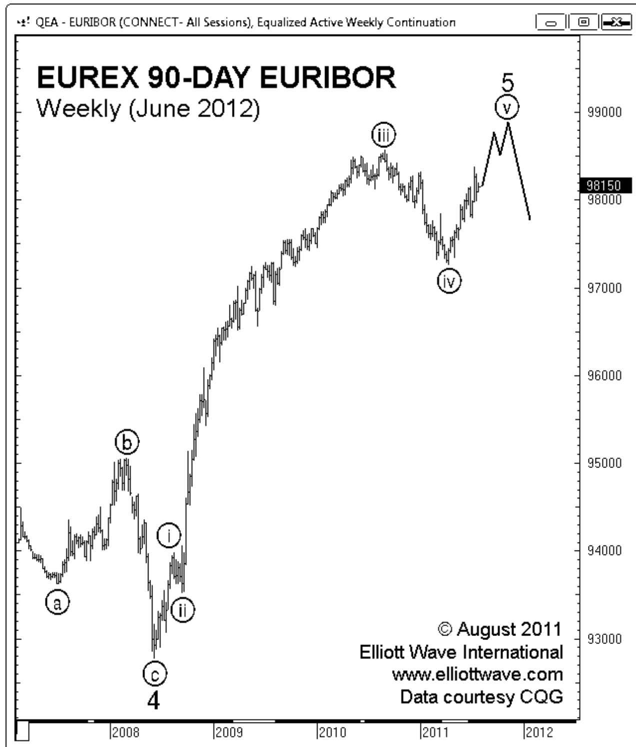
Economic growth in the UK has almost come to a standstill, and the projected cuts in government spending have yet to result a reduction in deficits or the public debt. Slower growth is resulting in diminished tax reversal, and debt/GDP ratios are fast approaching alarm levels. Combine this with European debt problems, and we see a rapid rise in price in Gilts as preservation of capital is a symptom of the fear trade evident in German bonds as well.

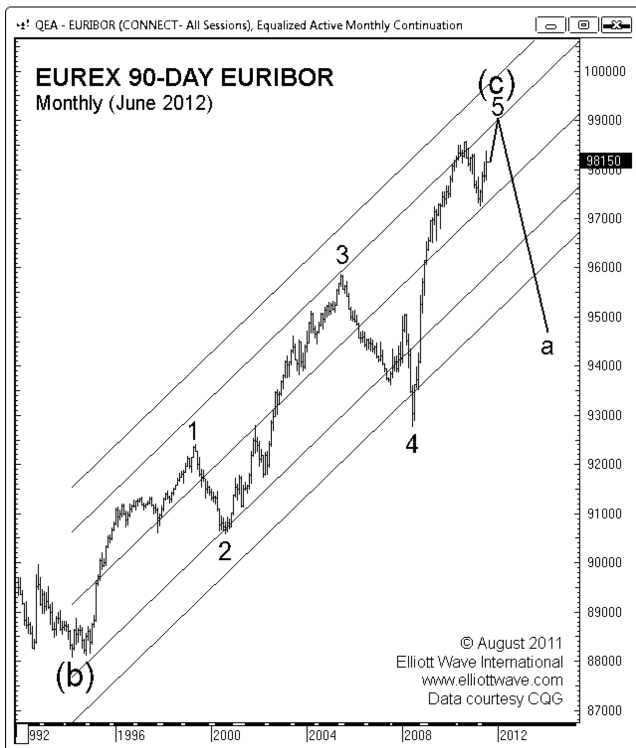
The wave count anticipates a deep correction here in wave (B), and whether it takes out the August 2010 peak will be a close thing. Minimal projections over the coming weeks lie within the 125.55/126.31 area with confidence against 122.32 Fibonacci support.

e156883

Euribor

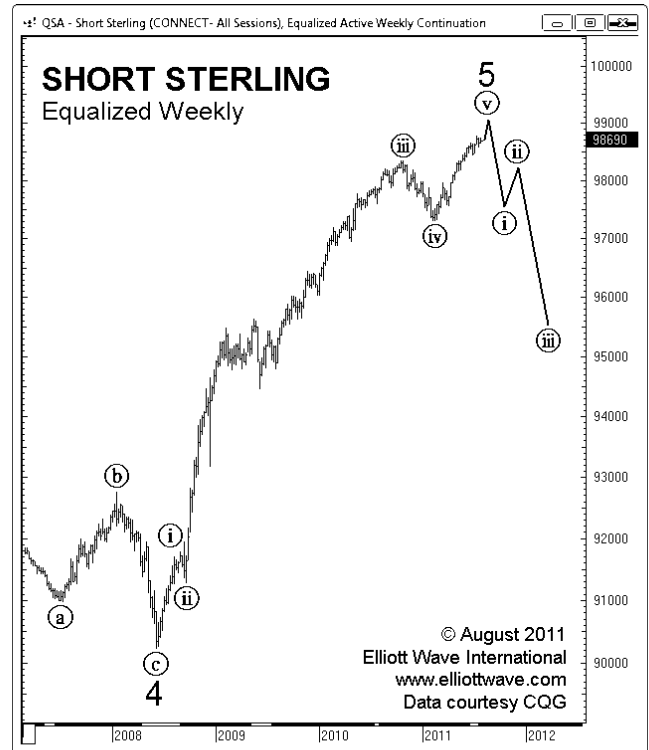
As we discussed last month, the decline in price we saw was only a temporary decline in the wave (iv) of ⓥ position. Traders have aggressively resumed buying in a curve flattening, allocation shift, and the 98.245/430 area is a minimal wave ⓥ target with confidence against 97.945 basis March 2013.





Short Sterling

Last month's wave (iv) of ⓥ correction was short-lived, and the uptrend has resumed in earnest. The minimal, wave ⓥ target lies at 99.155 basis March 2012 against 98.835.



Australia

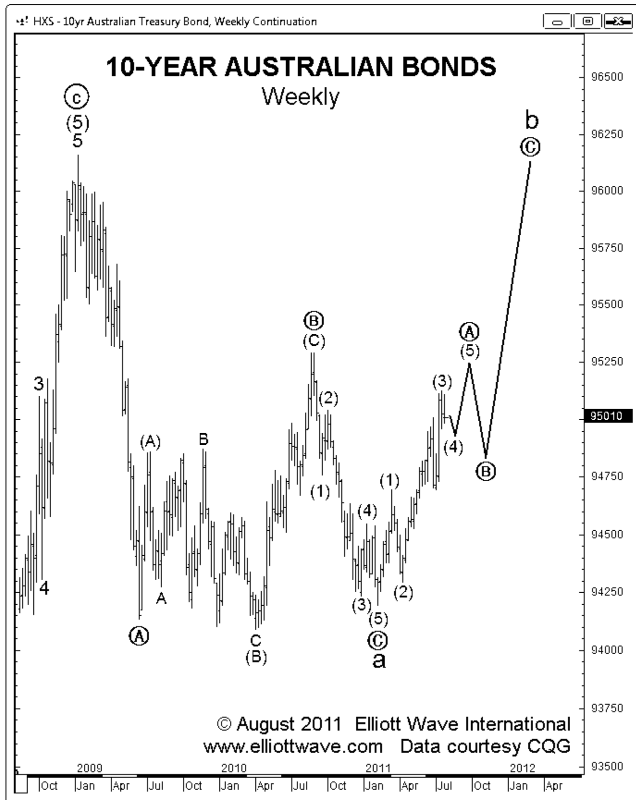
The count continues to project a return to the low yields of early 2009 in a zigzag. A short-term top is anticipated near then 2010 highs, but this should prove only a temporary setback. The focus is up in wave Ⓒ of b against 94.695 basis September.

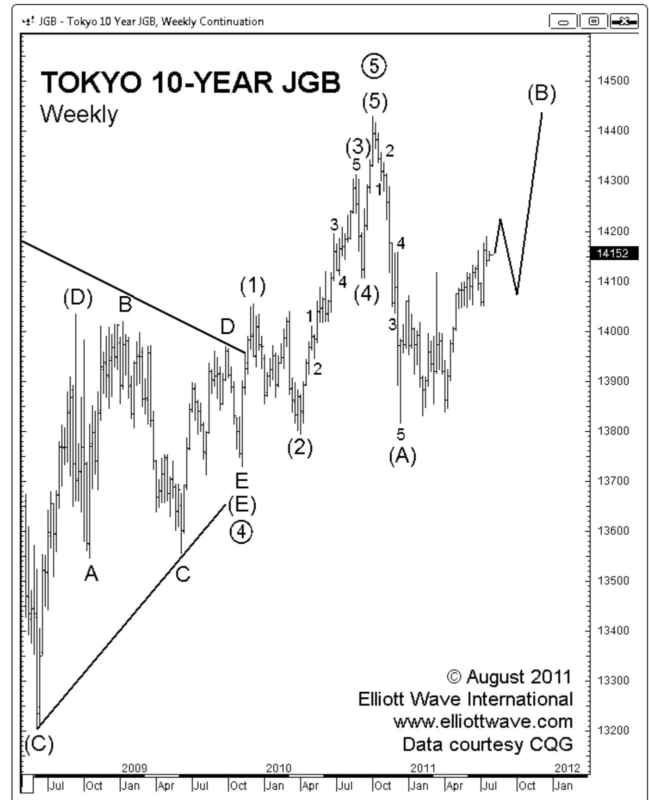
Japan

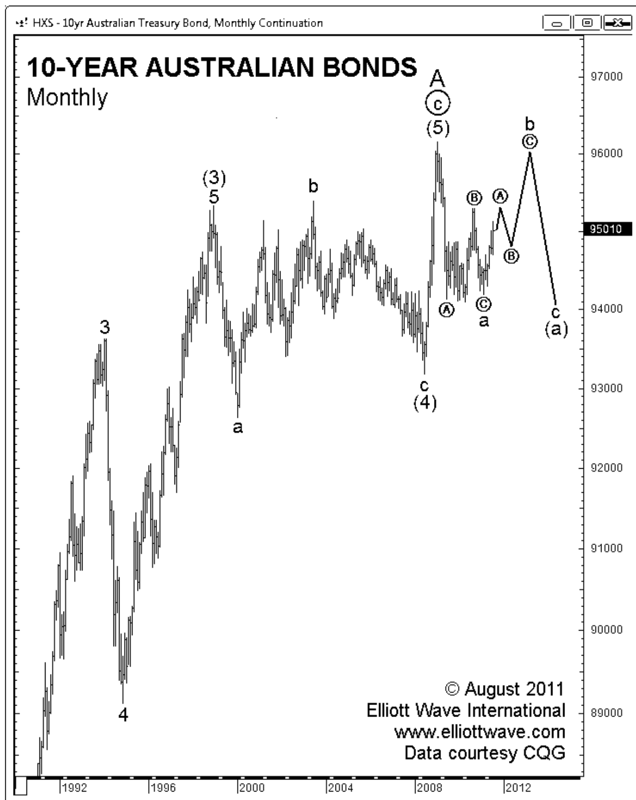
The Japanese savings rate remains high, allowing domestic funding for the post-earthquake recovery needs, and the debt crises in Europe and the United States are keeping the yen firm relative to the dollar and euro. As a result, the focus is off Japan's massive debt/GDP ratio, and the country still manages to maintain a current account surplus that allows them to easily service the debt.

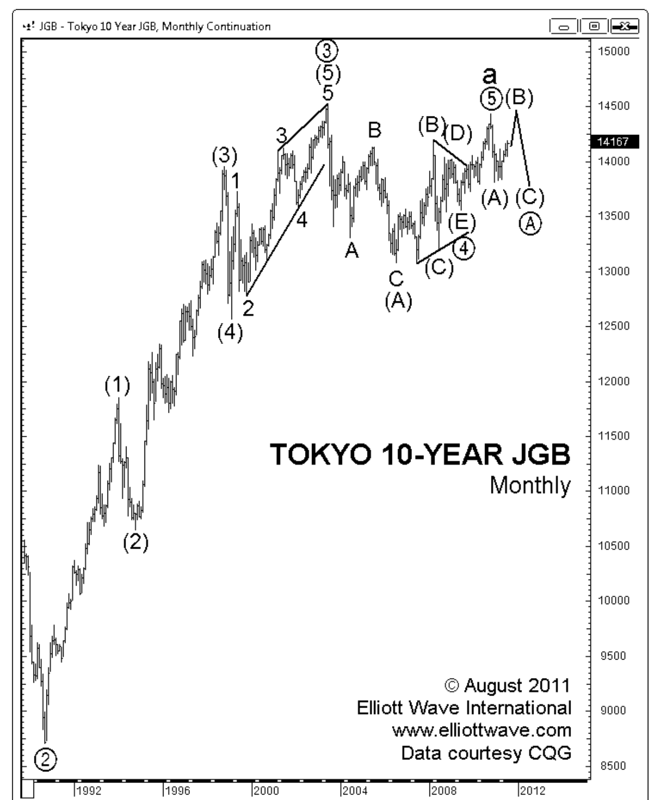
e156883

We have altered the weekly count to reflect expectations of extended strength over the coming months the conclude a double zigzag in the wave (B) position. This bullish outlook is maintained with confidence against 140.02 basis September.









CURRENCIES AROUND THE WORLD

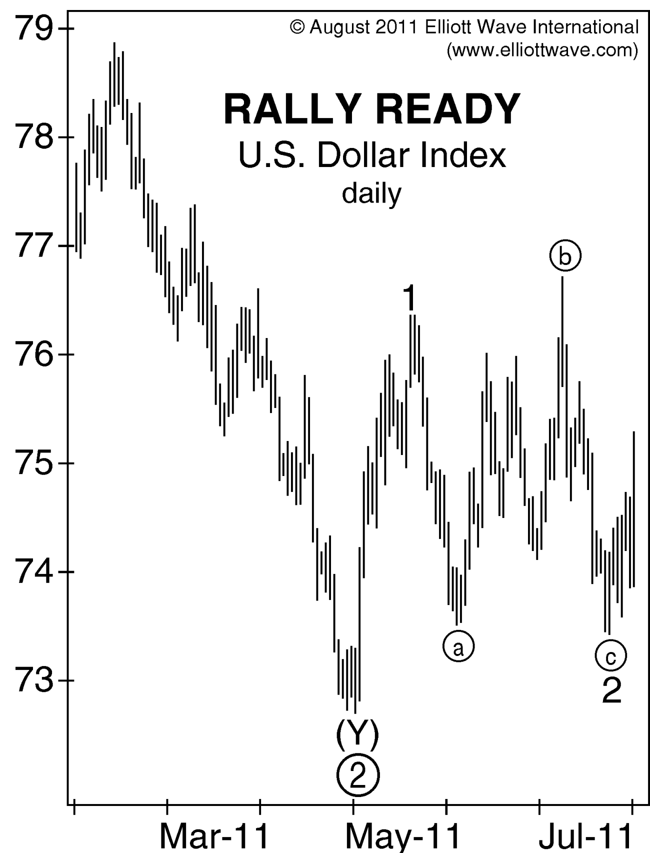
The dollar has bottomed against some competitors and is on the verge of bottoming relative to others. Once the final lows have been established, the buck should start a rally that reaches levels not seen since early 2009.

The euro looks to be headed lower versus every other major currency.

THE U.S. DOLLAR

The dollar's decline to 73.42 last Wednesday appears to have completed Minor wave 2, which started at 76.37 on May 23. Wave 2 developed as an expanded flat (see text, p.46), as shown on this chart. The dollar's low was not confirmed by the euro, which remains below its equivalent June 7 extreme at 1.4698, creating a bullish divergence for the buck (bearish for the euro). Despite the sturm und drang surrounding the dollar's supposed demise, prices remain above the May 4 low at 72.70 as well as the March 2008 low at 70.70.

The rally that we forecast during the deepening deflationary trend has taken longer to start than we anticipated, but this week's jump should get the uptrend in high gear. Wave 3 up should carry the dollar toward 80.00 in the months ahead. A break of the May 4 low would rescind this forecast.



This Currencies section presents the same long-term analyses that we include and continuously update as part of our daily and intraday on-line *Specialty Services*. Be advised that these opinions can change intramonth, in which case we make them instantly in *Specialty Services*.

Subscribers who desire constant monitoring of the outlook for currencies for all time horizons, including daily and intraday, should subscribe to *Specialty Services Currencies*. To choose the coverage that is right for you, visit our *Specialty Services* selection tool (www.elliottwave.com/wave/SS_GMP) or call customer service at either 1-800-336-1618 (U.S.), or 770-536-0309 (international).

e156883

THE EURO

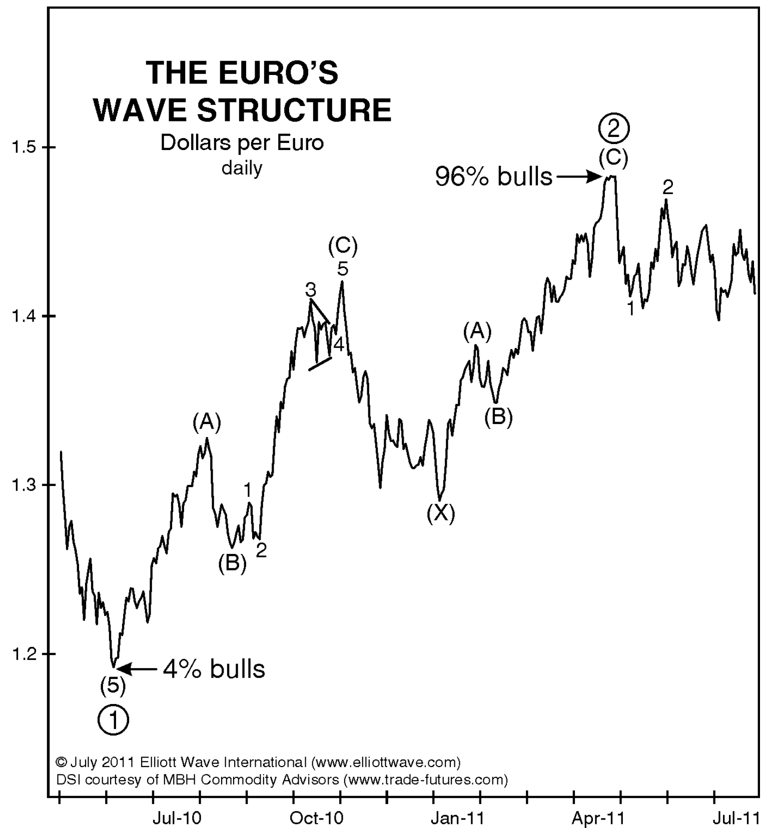
The euro's three-month levitation act is reshaping the consensus opinion toward the common currency. "Bold Investors Make Bullish Bets on Euro," says a July 21 piece in the Wall Street Journal. The article cites a host of investment officers and currency traders who say Europe's debt crisis may be net positive for the single currency, particularly if "shaky countries like Greece, Ireland and Portugal were forced to leave the union."

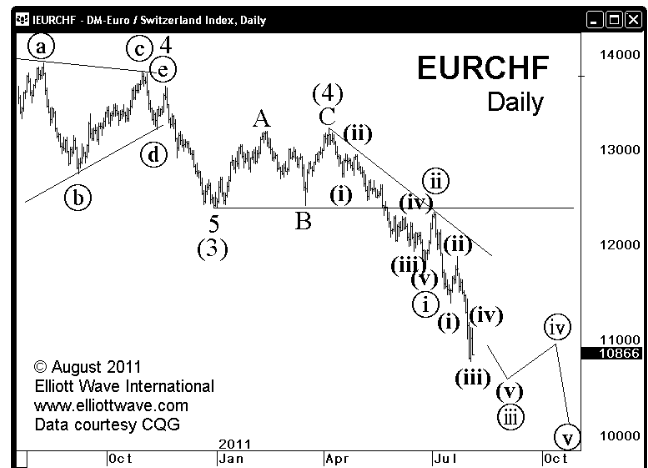
"[I]f Italy and Spain face funding problems," continues the piece, "European leaders would respond with overwhelming force to support the currency." We disagree. European leaders have already responded with overwhelming force, yet the crisis is escalating, and they'll soon be out of ammunition.

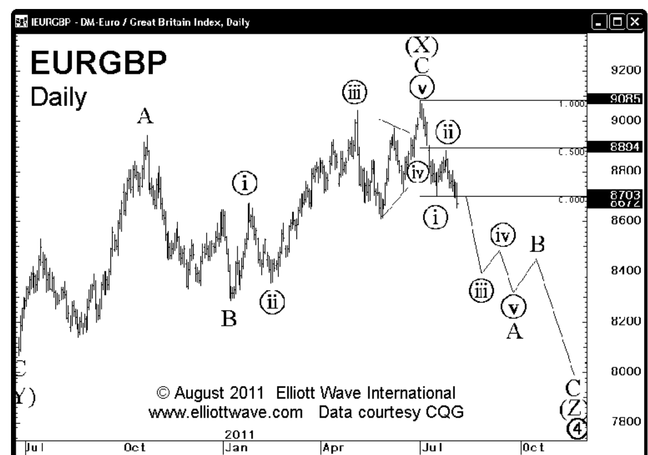
Still, if our wave labels on the daily chart are to hold, the euro needs to get moving, in this case to the downside. We're considering the euro's pattern since May 4 to be a series of first and second waves, meaning that the next significant move should be a persistent decline to below 1.3837. According to the chief investment officer at a California-based currency management fund, "Everybody hates the euro, so, to me, that's a value." Our contrasting view — that the U.S. dollar remains the world's most despised currency — argues for a significant dollar rally. By implication, that means a decline in the euro, but the June 7 high of 1.4698, which is labeled wave 2 on the chart, is critical for the wave structure. A rise above it will open considerably more bullish potential.

EURO RATES

The euro looks to be headed lower versus every other major currency. The newly minted European Monetary Fund should prove to be every bit as ineffective as the Federal Reserve or the European Central Bank — they will appear to stand at the ready, not preventing crises, but reacting to social mood's deteriorating condition.

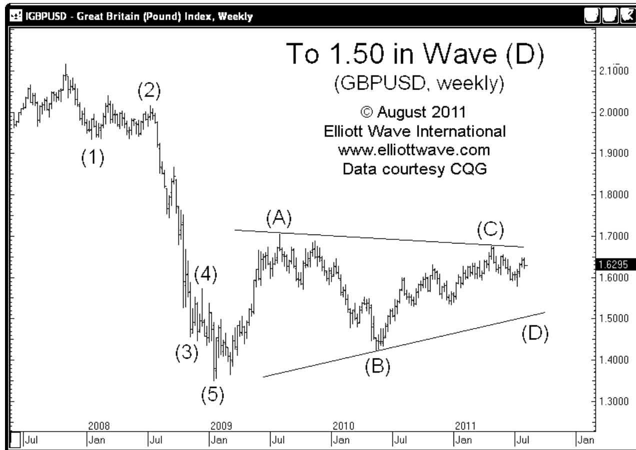


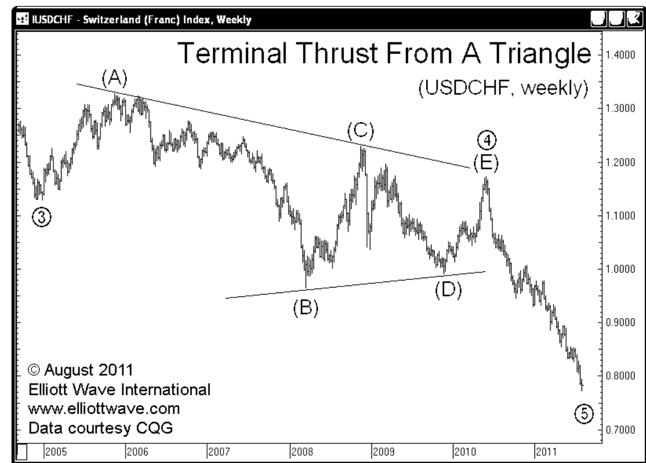


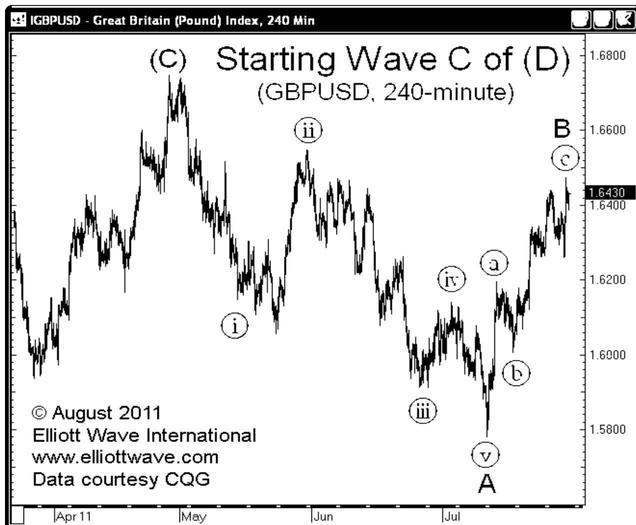


e156883

DOLLAR RATES





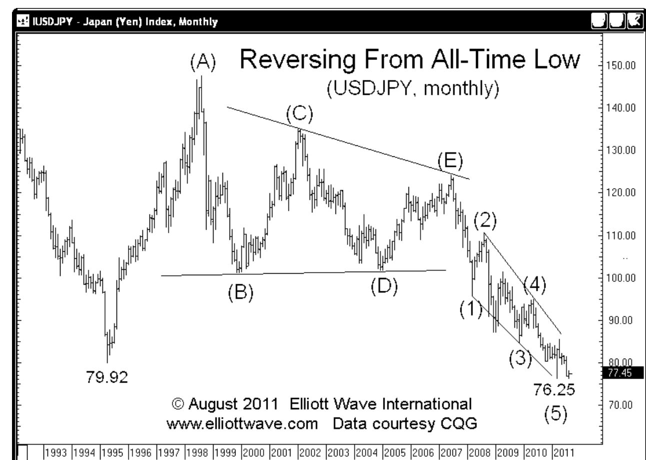


With the buck near its lows relative to the franc, there is no evidence that it has bottomed, though the thrust from a triangle underway since May 2010 is terminal and warns a bottom is due.

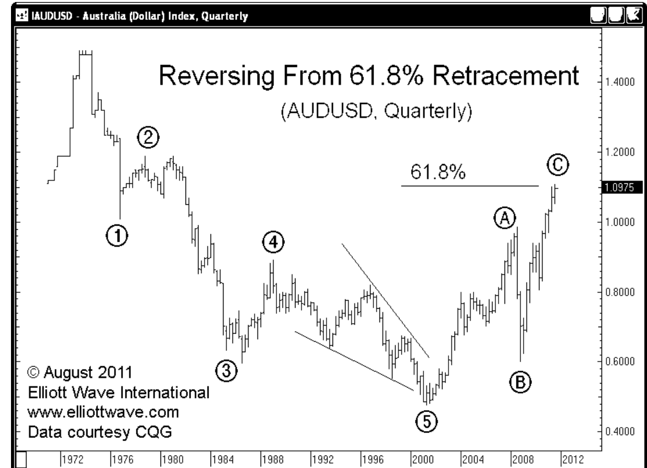
USDJPY is also completing a terminal thrust from a triangle. The buck is testing its low from March, which was established shortly after the earthquake and tsunami that devastated portions of Japan. A successful test of this emotionally charged low could signal the end of the thrust and start of a rally to the end of the triangle near 120.00. The ending diagonal wave (5) warns the turn could be abrupt and the dollar rally could be swift.

One dollar pair in particular has been steadfast in pointing to a strong dollar outcome. Cable staged a nearly one-year rally from May 2010 that ended below the prior high from August 2009, 1.6748 vs. 1.7044. As a result, the best pattern is a bearish triangle from January 2009. Additional consolidation in waves (D) and (E) that takes place below current levels to complete the formation should only delay the breakdown that lies head. Cable should reach levels not seen since the mid-1980s.

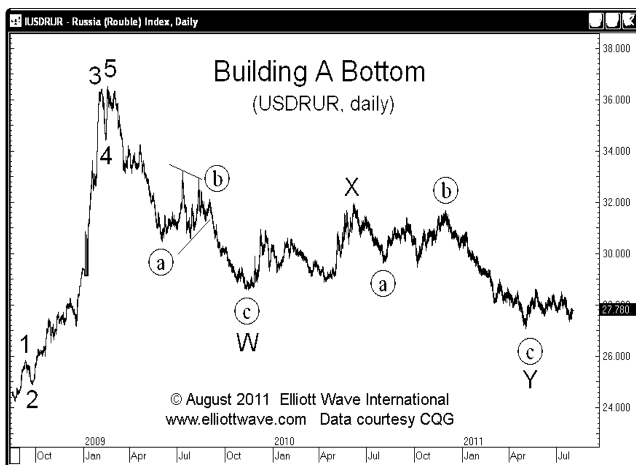
The uncertainty in Europe (PIIGS) and the United States left the Swiss franc as the safe haven currency.

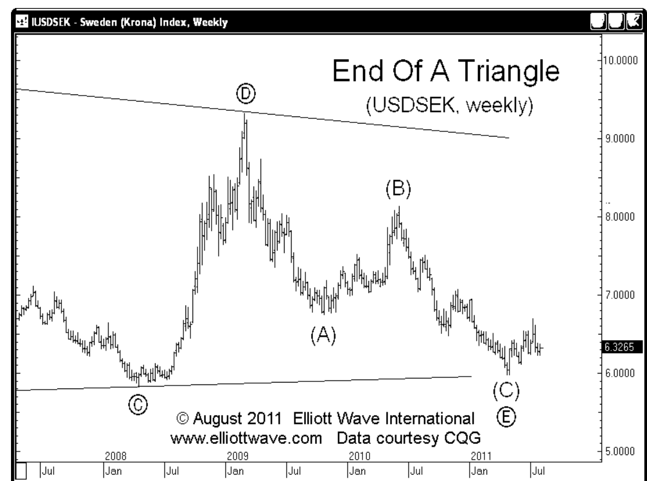


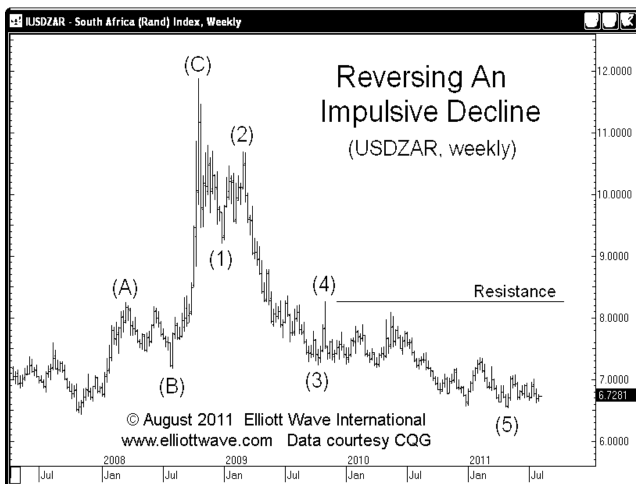
The general outlook for the dollar and Aussie's three-wave correction of the 28-year impulsive decline from 1973 leaves it poised to reverse course. The decade-long recovery from 2001 should be fully retraced within the next few years.

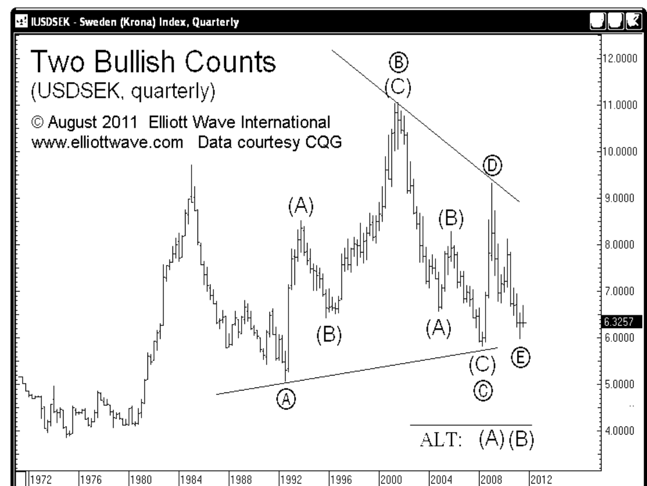


Relative to the ruble, rand, and krona, the dollar has held the equivalent of its May low. We'll refrain from rehashing the outlook and suggest that it's simply a matter of time before the dollar resumes its advance relative to all three.

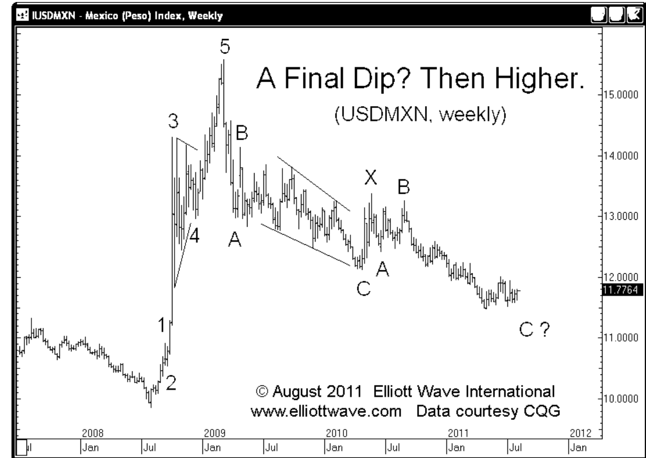




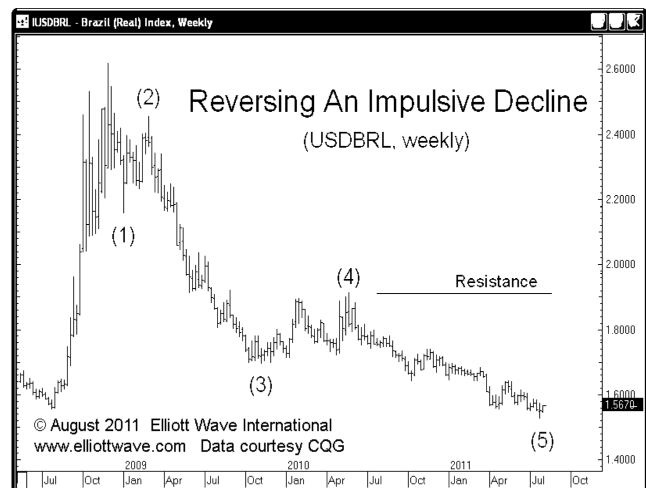




The dollar has held above its May low relative to the Mexican peso, but a possible consolidation since leaves it vulnerable to a new low in a thrust from a triangle. This should only delay the reversal since thrusts from triangles are ending waves, typically fifth waves or C waves.



The dollar has reached a new low relative to Brazil's real, but the new low best counts as the latter stages of wave (5) to complete the decline from December 2008. The decline from May to the new low may have taken the form of an ending diagonal. Similar to the thrust from a triangle referenced relative to the peso, the diagonal triangle is an ending pattern and warns the ensuing turn should be abrupt.



e156883

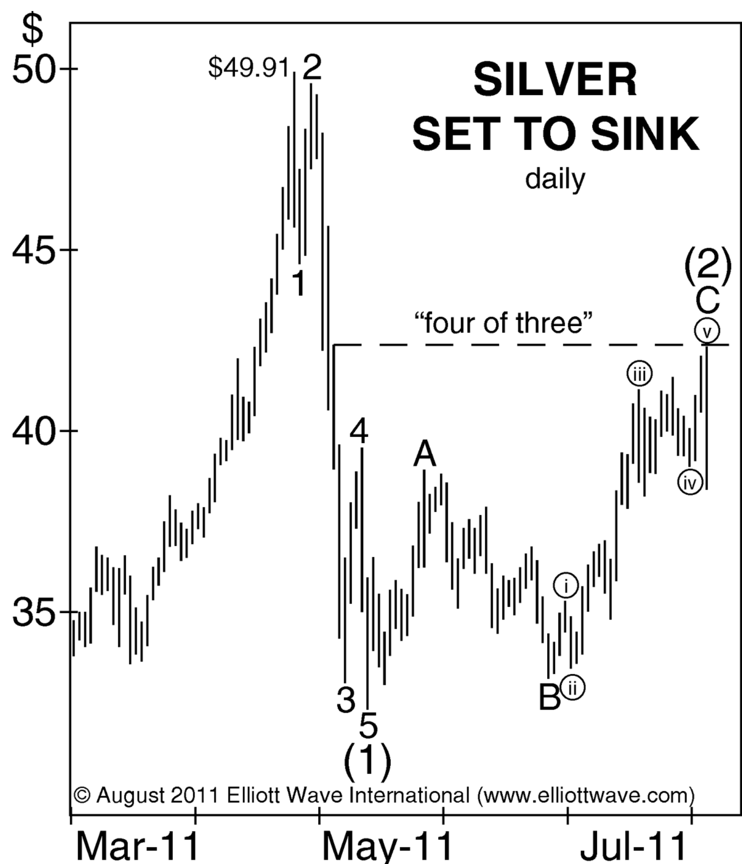
METALS & ENERGY AROUND THE WORLD

Silver completed an upward correction from early May and has started another major declining phase; gold should follow soon. The U.S. Dollar Index is in a long-term advance.

Crude Oil rallied as expected, but collapsed contrary to expectations. WTI's break below its June low suggests that the spring peak marks a major top. Lower lows should be the theme for months if not years to come. Natural Gas followed its script to a "T" and should be in the early stages of a significant down leg.

GOLD & SILVER

A few trading hours ago, silver completed its wave (2) retracement, perfectly pushing to a wave "four of three" notch at $42.29 basis spot. Wave (2) traced out a 3-3-5 upward flat (see text, p.45), as shown on this chart. Since July 12, silver has failed to confirm gold's new high, a strong bearish condition. The broader economic implication of an impending wave (3) down is important, because it fully conforms to the increasingly weaker economic figures discussed in GMP. The growing trend toward conservatism—covered above and in the July EWT—and the resulting lower level of investor risk tolerance should also contribute to lower prices for nearly all "risk" assets, among which silver is at the forefront.



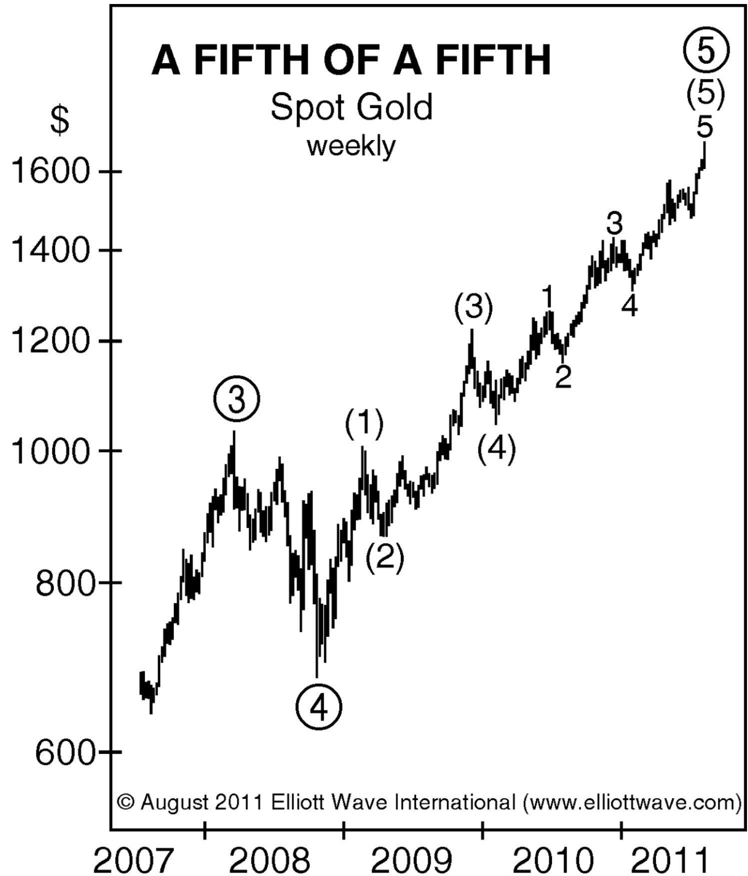
Gold's rise has continued to thwart our call for a significant decline, and we are not satisfied with the accuracy of our forecasting with this asset. But the evidence becomes more one-sided every day,

This section presents the same long-term analyses that we include and continuously update as part of our daily and intraday on-line *Specialty Services*. Be advised that these opinions can change intramonth, in which case we make them instantly in *Specialty Services*.

Subscribers who desire constant monitoring of the outlook for metals, energy or commodities for all time horizons, including daily and intraday, should subscribe to *Specialty Services Metals*, *Specialty Services Energy* and *Specialty Services Commodities*. To choose the coverage that is right for you, visit our *Specialty Services* selection tool (www.elliottwave.com/wave/SS_GMP) or call customer service at either 1-800-336-1618 (U.S.), or 770-536-0309 (international).

e156883

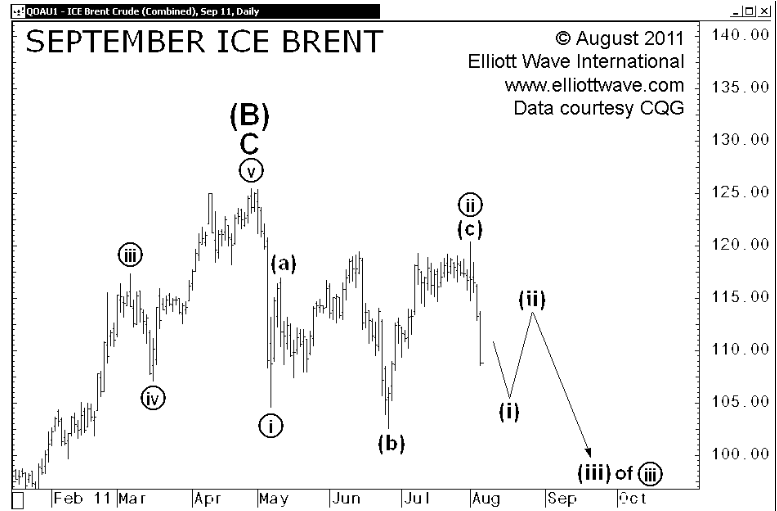
so there is no way we can adopt a different view. The June GMP illustrated central banks' tendencies to sell gold near the end of long price declines and buy near the end of long rallies (see chart on page 8 of that issue). Gold lost 70% of its value from 1980 to 1999, after which central bankers started selling the bullion. According to Bloomberg, as prices nearly tripled from 1999 through 2008, world central banks sold more than 4,000 tons. In 2011, central bankers are big buyers. The World Gold Council notes that in just the first five months of this year, they bought twice their 2010 total. The belief in further gains, then, finally permeates all sectors of the bullion market. Bloomberg data show that exchange-traded gold funds hold more gold than all but four central banks. Gold futures speculators increased their bets on even higher prices to nearly the largest total since October 2009. Equally important, the pattern of gold's rally from 1999 continues to look like a nearly complete five-wave structure. When gold's rally reverses, the ensuing decline should last years.



e156883

CRUDE OIL

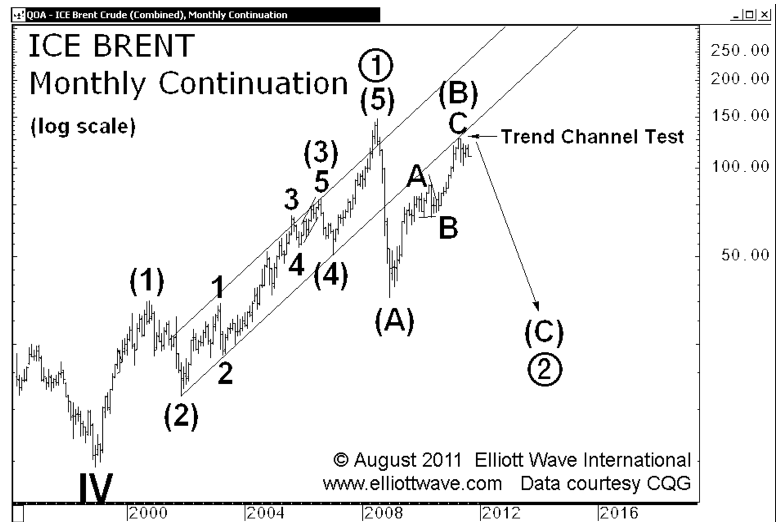
WTI and Brent rallied on cue, but WTI's collapse back through its June low on August 4 was unexpected. The break makes a compelling case for labeling the Intermediate wave (B) advance complete at the spring peak complex-wide. The wave (C) decline should erase all of the wave (B) gains. We may need to re-visit wave (C)'s internal wave degrees, but directionally, it's irrelevant at this juncture. The market should move sharply lower from the wave ⓘⓘ peak.

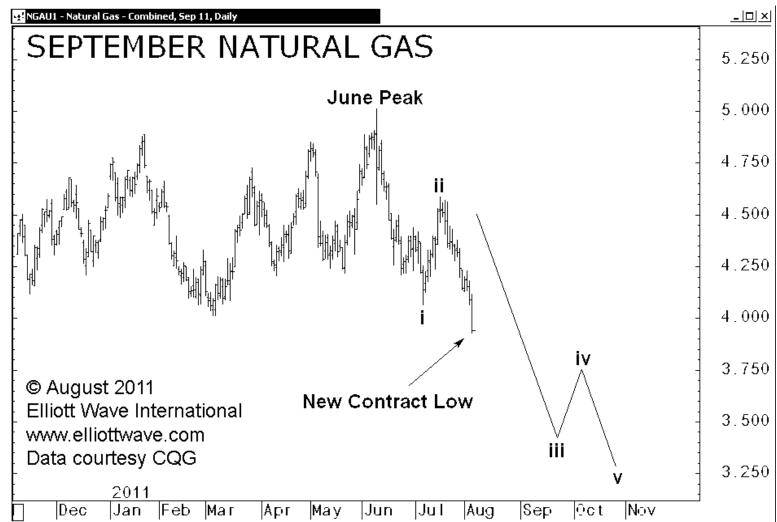


NATURAL GAS

So far so good…. We still need to see additional structural development to sort out competing wave counts, but our outlook for a "much larger five-wave decline from the early June peak" is unfolding in line with expectations. Bolstering our bearish conviction is the September contract's new contract low, which fits well with the idea that the larger downtrend has re-emerged. The market should be in the early stages of a significant leg lower. The next big downside hurdles are 3.731 and more importantly, 3.212.

Note: Since the inception of trading, Natural Gas has posted a number of significant lows between August and October. If our count prevails, we'd expect any "seasonal" influence this year to exert itself in the back half of the time frame if at all.

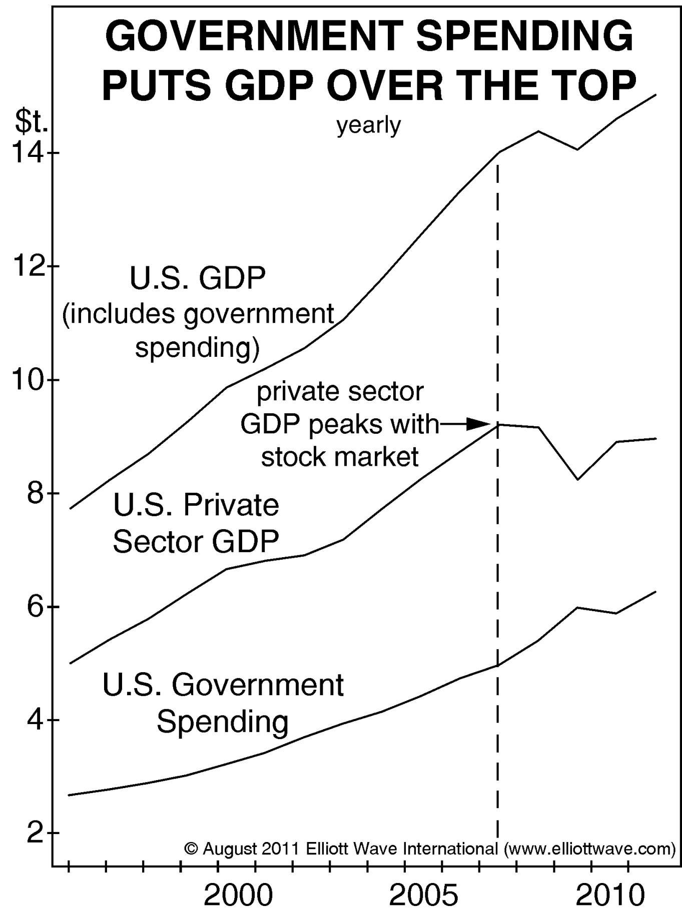




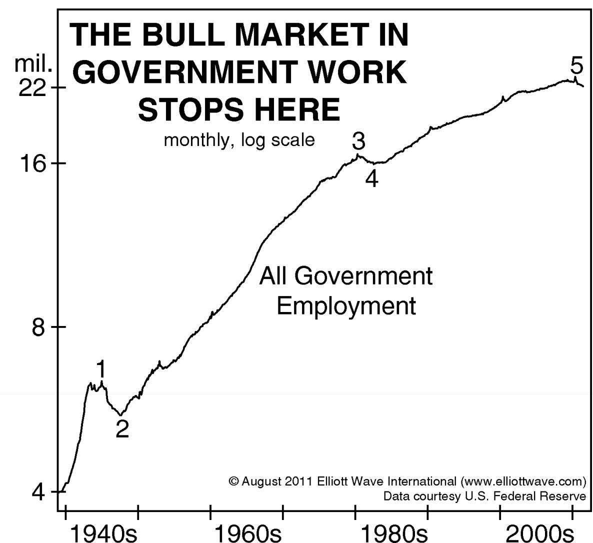
e156883

U.S. ECONOMY & DEFLATION

The persistently rising U.S. government debt ceiling, shown on the chart on page 5, exposes the inherent instability of recent economic growth. As the ceiling kept going up and up over the last 50 years, there was a clear loss of economic vibrancy from Cycle wave III to Cycle wave V, and then to Cycle wave **b**, as shown in *Conquer the Crash.* The charts on page 96 in the April and page 89 in the July issues of GMP show that the comparison now extends through Primary ②. This deterioration is occurring despite an astronomical rise in federal debt (Keynesians take note) and is a powerful picture of an economy that is slowly coming off the rails, as the influence of a 200-year uptrend in social mood fades away. At this late stage, GDP growth is mainly reliant on government spending. This chart breaks down U.S. GDP and reveals that private sector GDP (middle line on the chart) topped in 2007, right along with the all-time peak in the Dow Jones Industrial Average. Only government spending has increased.



Government represents a weak source of growth, because it's incapable of efficiently allocating capital, it produces no self-sustaining commercial activity, and it gets its money not by trade but by taking it from others. Government also moves by consensus, which means it acts only once the trend is well established or over. The next chart of total government employment represents a case in point. The completed five-wave pattern suggests that, after four years of persistent national unemployment, government will now throw its considerable weight behind the trend. Government just made a big down payment, contributing 39,000 job losses to a "surprisingly weak June employment report, easily the biggest category of losses (financial activities were second at 15,000). The biggest contributor to government job growth over the last 50 years is at the state and local level, so this outlook confirms our forecast for record levels of cuts and defaults among state and



e156883

local governments. The July discussion in *The Elliott Wave Theorist* on "An Emerging Public-Sector Frugality," notes that the brakeman on the government-driven inflation train may not have done much yet, "but he's pulling on the gloves." As real estate-based tax revenue continues to plunge and sales and income taxes get hit by another economic slump, the trap door will fly open for many who believed that government work offered shelter from the storm.

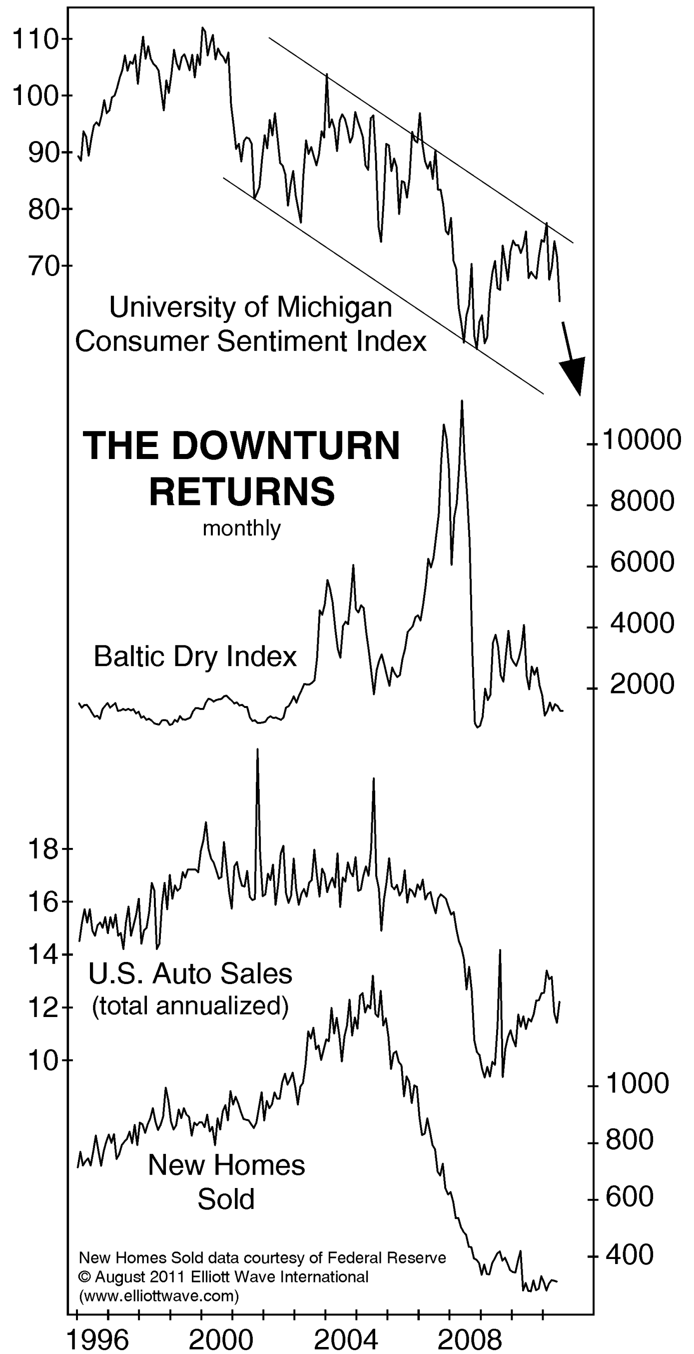
It's The Stupid Economy

As stocks and commodities topped out in April and early May, GMP made the case for a coincident downturn in the economy:

> Contraction dead ahead. It should last longer and dig deeper than the "Great Recession" of 2007-2009.
>
> —May, 2011, GMP

At this point, "unexpectedly" steep declines are accumulating in one economic time series after another. Consider the four key measures shown on this chart relative to the chart of The Big Top on page 10 of last month's GMP. As one stock index and asset class after another ended its respective bull market, these fundamental reflections of a reversal in social mood also tipped to the downside. Now, after a relatively weak rally from the late 2008/early 2009 lows, each measure is rolling over and beginning a renewed decline from much lower levels.

The consumer accounts for the bulk of buying in the U.S. economy. The first line on the chart shows the University of Michigan Consumer Sentiment Index, which is similar to the Conference Board's Consumer Confidence Index, shown in the May issue of EWT. Both measures are locked in downtrends and carry the same bearish implications. This outlook is confirmed by the latest figures on consumer spending, which fell 0.2 percent in June, the first decline in almost two years. Consumers are already being pinched so severely that many are using credit cards to pay for necessities. In June, credit card purchases of food rose 5%, while credit-card gas purchases rose 39%. Walmart reports that its core customers are "cash strapped." The repercussions are rippling through to the front edge of the consumer-goods supply chain. Rates for chartering



container vessels that "carry sneakers, furniture and flat-screen TVs" to U.S. consumers are "plunging." The Howe Robinson Container Index of fees for vessels is down 9.3% since the end of April. Shipping lines have also delayed peak-season surcharges. After rising 18 straight months, container traffic into Los Angeles and Long Beach, California, the two busiest U.S. ports, dropped 4.6% in June. The Baltic Dry Index is another measure of long-haul shipping rates. After crashing in 2008, the index made a weak bounce that ended in

e156883

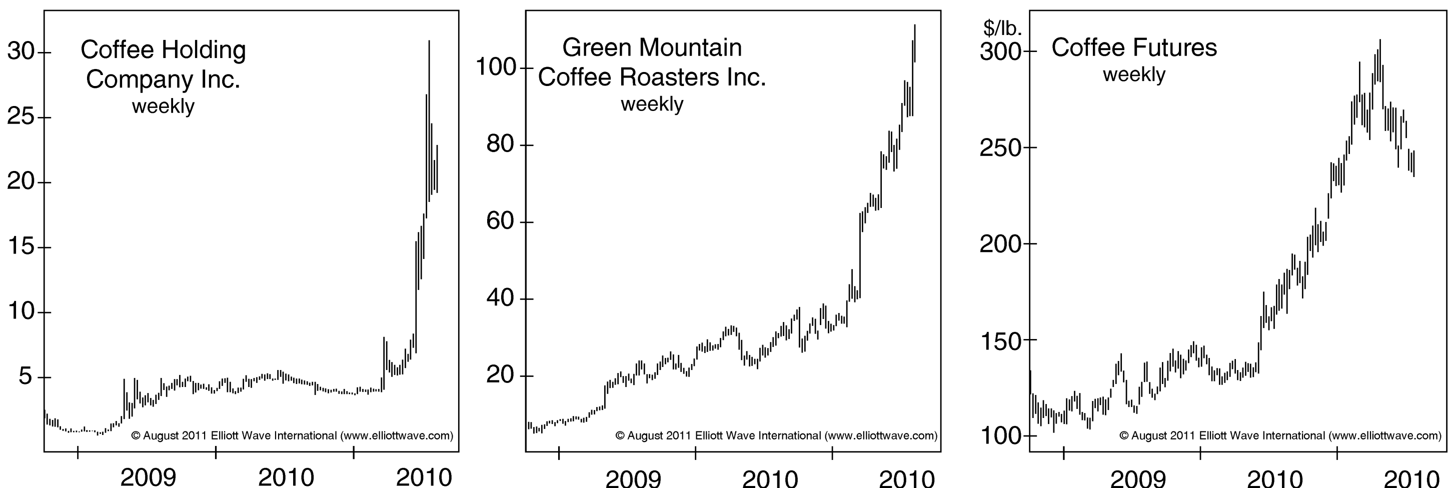
November 2009. A succession of lower highs since then has locked the index in another downtrend. The Baltic is already near its December 2008 low.

The bottom two lines on the chart show two more economic engines: sales of new homes and cars. Neither one managed to make a serious run for its former bull market highs. Both measures appear to have rolled over after weak countertrend bounces. Another economic measure, The Institute of Supply Management's factory index, fell to 50.9 in July. With a sharp decline from a high of 61.4 in February, the latest reading places manufacturing on the brink of another contraction, signaled by a reading of less than 50. New orders went over the line in July with a 49.2 reading. The downturn's global reach is evident by July's factory index figures for the United Kingdom, Russia and Australia; all slipped below 50. Oil and the CRB Index are now down for the year after retreating from the key retracement levels shown in the May issue of EWT (see p.8). The Dow Transports' decline past its March low confirms that world economies are contracting fast. Events will happen quickly now. Yesterday's major headline was, "Japan Follows Switzerland in Acting to Weaken Currency to Protect Exports." The effort to "protect exports" leads to all kinds of exclusionistic exercises, which is part and parcel of a bear market. The race lower is on.

U.S. CULTURAL TRENDS

Back in 1996, EWT identified the coffee-house craze as a classic expression of the surging positive trend in social mood. In August 2006, when Starbucks was approaching $40, *Global Market Perspective* traced out the 300-year, bull market history of coffee shops and called for an imminent peak. Starbucks fell more than 80% to a low of $7 in November 2008. Of course, it didn't stay down through Primary ②'s rally In fact, the stock made it all the way back to register a new high of just over $41 on July 8. And it's not just Starbucks; the shares of several other coffee house stocks have been in full ascent. These charts show Coffee Holding Co., and Green Mountain Coffee Roasters rocketing higher in exponential fashion through July, as two caffeine-based IPOs, Dunkin' Brands and Teavana Holdings, came to market. In a critical divergence, however, coffee futures topped with the major stock indexes on May 2. In another sign of an emerging bear market, Reuters reports that "relaxation" drinks are seeing "Energetic Growth." It's a battle between the old bull and the new bear market forces. The persistence of the coffee craze combined with the diverging futures price and an emerging, grass-roots demand for drinks that have the opposite physiological effect, signals powerfully that this is java's last jolt. If you are in the market for a drink with growth prospects, you might try moonshine whisky. New "micro-distillery laws" make it legal to produce and sell the stuff; it will sell well in the new bear-market mood.

IN THE HOLY DUSK
NIGHTINGALES BEGIN THEIR PSALM...
GOOD! THE DINNER-GONG!
—BUSON



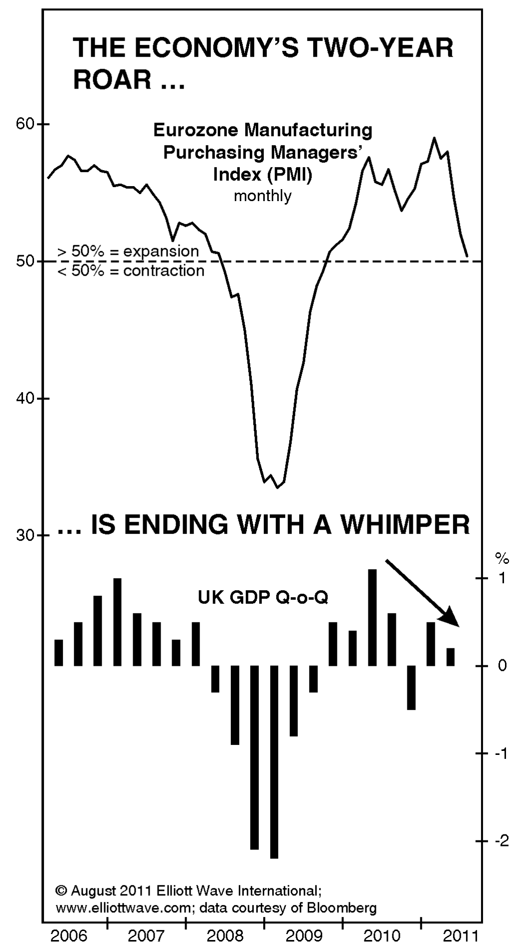
e156883

THE EUROPEAN ECONOMY AND DEFLATION

The July 29 Wall Street Journal sums up academia's preeminent economic dispute: "Economists still debate whether this is the start of a new downturn or just a temporary slow patch in the world economy."

We disagree with both sides. It's not a recovery, and it's not two recessions. It's a depression ... with bounces. The most important thing to realize is that, as stocks fall, the current two-year economic bounce will roll over into a marathon period of inactivity.

It's happening already. The upper line on this chart shows the eurozone's manufacturing PMI, which measures the health of the region's manufacturing sector. Not only was May's decline the sharpest deceleration in more than two years, the index has fallen from an all-time high to scarcely above 50 in just five months. The critical level of 50 divides a manufacturing expansion from a manufacturing contraction, and the last time the index crossed below 50 was June 2008, three months before the financial crisis hit full force.



In the UK, economic growth (lower line) slowed again in the second quarter, coming in well below expectations. "[G]rowth was 0.2 percent, but it was probably stronger than that," said the chief economist with the UK Office of National Statistics. Pardon? No, we don't understand this statement either. What remains clear, however, is that British GDP is on its way back toward contraction. As stocks fall, economic growth should continue to disappoint, likely by wide margins.

On the jobs front, British unemployment persisted at 7.7% in the three months to May, while the number of people claiming out-of-work benefits shot up by 24,500. Here, too, the jump is the largest in two years, according to the Office for National Statistics. The number of workers who are working part-time because they cannot find full-time jobs is also at a record level of 1.25 million. And youth unemployment remains at its highest levels in 20 years, with one in five 16- to 24-year-olds out of work.

One potentially important observation: Just as the banking sector is leading the way down in the markets, it also seems to be far out in front of the employment trend. In June, Britain's biggest mortgage lender, Lloyds Bank, announced it would cut 15,000 British jobs, while Europe's largest bank, HSBC, is set to retire 10,000 positions in the next few months. The number represents about 3% of HSBC's global workforce, but it could triple, given the bank's planned overhaul in the coming years, according to the Financial Times. So, too, have Barclays, Credit Suisse, UBS and Goldman Sachs recently announced plans for massive layoffs.

Finally, economists expressed relief at the UK's surprise dip in consumer prices for the month. "The Bank [of England] will breathe a little easier," said the chief economist at the economic forecasting firm IHS Global Insight. We maintain our stance, however, that the looming threat is not inflation, but deflation. And if Primary wave (3) down has begun in earnest, now will probably be the one of the last times you read about the dreaded inflation boogeyman for years, perhaps even decades. Far from a sense of relief, the Banks' paramount feeling should soon devolve into an unrelenting dread.

e156883

A Capsule Summary of the Wave Principle

The Wave Principle is Ralph Nelson Elliott's discovery that social, or crowd, behavior trends and reverses in recognizable patterns. Using stock market data as his main research tool, Elliott isolated thirteen patterns of movement, or "waves," that recur in market price data. He named, defined and illustrated those patterns. He then described how these structures link together to form larger versions of those same patterns, how those in turn link to form identical patterns of the next larger size, and so on. In a nutshell, then, the Wave Principle is a catalog of price patterns and an explanation of where these forms are likely to occur in the overall path of market development.

Pattern Analysis

Until a few years ago, the idea that market movements are patterned was highly controversial, but recent scientific discoveries have established that pattern formation is a fundamental characteristic of complex systems, which include financial markets. Some such systems undergo "punctuated growth," that is, periods of growth alternating with phases of non-growth or decline, building fractally into similar patterns of increasing size. This is precisely the type of pattern identified in market movements by R.N. Elliott some sixty years ago.

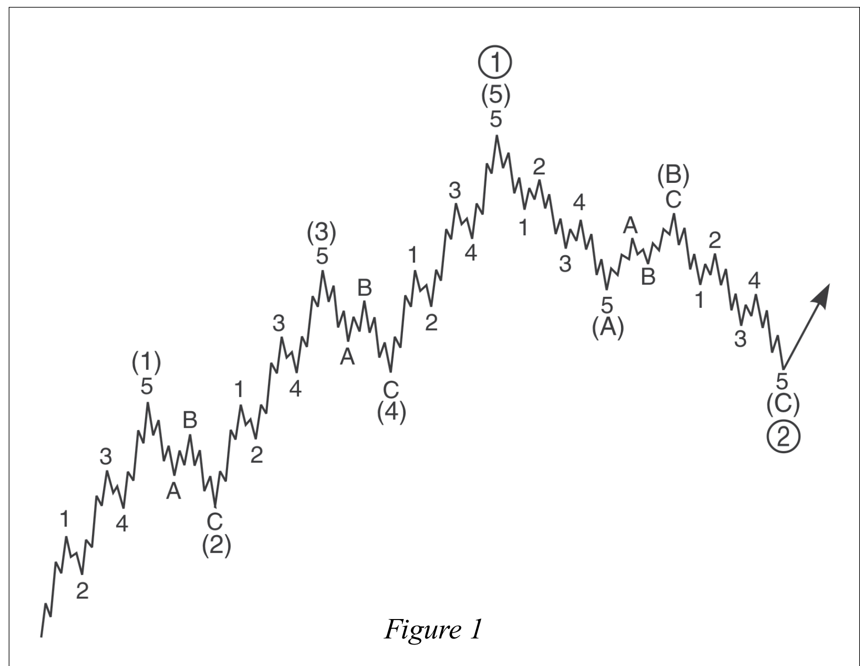


Figure 1

The basic pattern Elliott described consists of *impulsive waves* (denoted by numbers) and *corrective waves* (denoted by letters). An impulsive wave is composed of five subwaves and moves in the same direction as the trend of the next larger size. A corrective wave is composed of three subwaves and moves *against* the trend of the next larger size. As Figure 1 shows, these basic patterns *link* to form five- and three-wave structures of increasingly larger size (larger "degree" in Elliott terminology).

In Figure 1, the first small sequence is an impulsive wave ending at the peak labeled 1. This pattern signals that the movement of one larger degree is also upward. It also signals the start of a three-wave corrective sequence, labeled wave 2.

Waves 3, 4 and 5 complete a larger impulsive sequence, labeled wave (1). Exactly as with wave 1, the impulsive structure of wave (1) tells us that the movement at the *next* larger degree is upward and signals the start of a three-wave corrective downtrend of the same degree as wave (1). This correction, wave (2), is followed by waves (3), (4) and (5)

to complete an impulsive sequence of the next larger degree, labeled wave ①. Once again, a three-wave correction of the same degree occurs, labeled wave ②. Note that at each "wave one" peak, the implications are the same regardless of the size of the wave. Waves come in degrees, the smaller being the building blocks of the larger. Here are the accepted notations for labeling Elliott Wave patterns at every degree of trend:

Wave Degree	5s With the Trend					3s Against the Trend		
Grand Supercycle	I⃝	II⃝	III⃝	IV⃝	V⃝	ⓐ	ⓑ	ⓒ
Supercycle	(I)	(II)	(III)	(IV)	(V)	(a)	(b)	(c)
Cycle	I	II	III	IV	V	a	b	c
Primary	①	②	③	④	⑤	Ⓐ	Ⓑ	Ⓒ
Intermediate	(1)	(2)	(3)	(4)	(5)	(A)	(B)	(C)
Minor	1	2	3	4	5	A	B	C
Minute	ⓘ	ii⃝	iii⃝	iv⃝	ⓥ	ⓐ	ⓑ	ⓒ
Minuette	(i)	(ii)	(iii)	(iv)	(v)	(a)	(b)	(c)
Subminuette	i	ii	iii	iv	v	a	b	c

Within a corrective wave, waves A and C may be smaller-degree impulsive waves, consisting of five subwaves. This is because they move in the same direction as the next larger trend, i.e., waves (2) and (4) in the illustration. Wave B, however, is always a corrective wave, consisting of three subwaves, because it moves *against* the larger downtrend. Within impulsive waves, one of the odd-numbered waves (usually wave three) is typically longer than the other two. Most impulsive waves unfold between parallel lines except for fifth waves, which occasionally unfold between converging lines in a form called a "diagonal triangle." Variations in corrective patterns involve repetitions of the three-wave theme, creating more complex structures that are named with such terms as "zigzag," "flat," "triangle" and "double three." Waves two and four typically "alternate" in that they take different forms.

Each type of market pattern has a name and a geometry that is specific and exclusive under certain rules and guidelines, yet variable enough in other aspects to allow for a limited diversity within patterns of the same type. If indeed markets are patterned, and if those patterns have a recognizable geometry, then regardless of the variations allowed, certain relationships in extent and duration are likely to recur. In fact, real world experience shows that they do. The most common and therefore reliable wave relationships are discussed in *Elliott Wave Principle*, by A.J. Frost and Robert Prechter.

Applying the Wave Principle

The practical goal of any analytical method is to identify market lows suitable for buying (or covering shorts), and market highs suitable for selling (or selling short). The Elliott Wave Principle is especially well suited to these functions. Nevertheless, the Wave Principle does not provide *certainty* about any one market outcome; rather, it provides an objective means of assessing the relative *probabilities* of possible future paths for the market. At any time, two or more valid wave interpretations are usually acceptable by the *rules* of the Wave Principle. The rules are highly specific and keep the number of valid alternatives to a minimum. Among the valid alternatives, the analyst will generally regard as preferred the interpretation that satisfies the largest number of *guidelines* and will accord top alternate status to the interpretation satisfying the next largest number of guidelines, and so on.

e156883

Alternate interpretations are extremely important. They are not "bad" or rejected wave interpretations. Rather, they are valid interpretations that are accorded a lower probability than the preferred count. They are an essential aspect of investing with the Wave Principle, because in the event that the market fails to follow the preferred scenario, the top alternate count becomes the investor's backup plan.

Fibonacci Relationships

One of Elliott's most significant discoveries is that because markets unfold in sequences of five and three waves, the number of waves that exist in the stock market's patterns reflects the Fibonacci sequence of numbers (1, 1, 2, 3, 5, 8, 13, 21, 34, etc.), an additive sequence that nature employs in many processes of growth and decay, expansion and contraction, progress and regress. Because this sequence is governed by the ratio, it appears throughout the price and time structure of the stock market, apparently governing its progress.

What the Wave Principle says, then, is that mankind's progress (of which the stock market is a popularly determined valuation) does not occur in a straight line, does not occur randomly, and does not occur cyclically. Rather, progress takes place in a "three steps forward, two steps back" fashion, a form that nature prefers. As a corollary, the Wave Principle reveals that periods of setback in fact are a requisite for social (and perhaps even individual) progress.

Implications

A long-term forecast for the stock market provides insight into the potential changes in social psychology and even the occurrence of resulting events. Since the Wave Principle reflects social mood change, it has not been surprising to discover, with preliminary data, that the trends of popular culture that also reflect mood change move in concert with the ebb and flow of aggregate stock prices. Popular tastes in entertainment, self-expression and political representation all reflect changing social moods and appear to be in harmony with the trends revealed more precisely by stock market data. At one-sided extremes of mood expression, changes in cultural trends can be anticipated.

On a philosophical level, the Wave Principle suggests that the nature of mankind has within it the seeds of social change. As an example simply stated, prosperity ultimately breeds reactionism, while adversity eventually breeds a desire to achieve and succeed. The social mood is always in flux at all degrees of trend, moving toward one of two polar opposites in every conceivable area, from a preference for heroic symbols to a preference for anti-heroes, from joy and love of life to cynicism, from a desire to build and produce to a desire to destroy. Most important to individuals, portfolio managers and investment corporations is that the Wave Principle indicates in advance the relative *magnitude* of the next period of social progress or regress.

Living in harmony with those trends can make the difference between success and failure in financial affairs. As the Easterners say, "Follow the Way." As the Westerners say, "Don't fight the tape." In order to heed these nuggets of advice, however, it is necessary to know what is the Way, and which way the tape. There is no better method for answering that question than the Wave Principle.

To obtain a full understanding of the Wave Principle including the terms and patterns, please read *Elliott Wave Principle* by A.J. Frost and Robert Prechter, or take the free *Comprehensive Course on the Wave Principle* on the Elliott Wave International website at www.elliottwave.com.

e156883

GLOSSARY OF TERMS

Alternation (guideline of) - If wave two is a sharp correction, wave four will usually be a sideways correction, and vice versa.

Apex - Intersection of the two boundary lines of a contracting triangle.

Corrective Wave - A three-wave pattern, or combination of three wave patterns, that moves in the opposite direction of the trend of one larger degree.

Diagonal Triangle (Ending) - A wedge-shaped pattern containing overlap that occurs only in fifth or C waves. Subdivides 3-3-3-3-3.

Diagonal Triangle (Leading) - A wedge-shaped pattern containing overlap that occurs only in first or A waves. Subdivides 5-3-5-3-5.

Double Three - Combination of two simple sideways corrective patterns, labeled W and Y, separated by a corrective wave labeled X.

Double Zigzag - Combination of two zigzags, labeled W and Y, separated by a corrective wave labeled X.

Equality (guideline of) - In a five-wave sequence, when wave three is the longest, waves five and one tend to be equal in price length.

Expanded Flat - Flat correction in which wave B enters new price territory relative to the preceding impulse wave.

Failure - See Truncated Fifth.

Flat - Sideways correction labeled A-B-C. Subdivides 3-3-5.

Impulse Wave - A five-wave pattern that subdivides 5-3-5-3-5 and contains no overlap.

Impulsive Wave - A five-wave pattern that makes progress, i.e., any impulse or diagonal triangle.

Irregular Flat - See Expanded Flat.

One-two, one-two - The initial development in a five-wave pattern, just prior to acceleration at the center of wave three.

Overlap - The entrance by wave four into the price territory of wave one. Not permitted in impulse waves.

Previous Fourth Wave - The fourth wave within the preceding impulse wave of the same degree. Corrective patterns typically terminate in this area.

Sharp Correction - Any corrective pattern that does not contain a price extreme meeting or exceeding that of the ending level of the prior impulse wave; alternates with sideways correction.

Sideways Correction - Any corrective pattern that contains a price extreme meeting or exceeding that of the prior impulse wave; alternates with sharp correction.

Third of a Third - Powerful middle section within an impulse wave.

Thrust - Impulsive wave following completion of a triangle.

Triangle (contracting, barrier) - Corrective pattern, subdividing 3-3-3-3-3 and labeled A-B-C-D-E. Occurs as a fourth, B, X (in sharp correction only) or Y wave. Trendlines converge as pattern progresses.

Triangle (expanding) - Same as other triangles, but trendlines diverge as pattern progresses.

Triple Three - Combination of three simple sideways corrective patterns labeled W, Y and Z, each separated by a corrective wave labeled X.

Triple Zigzag - Combination of three zigzags, labeled W, Y and Z, each separated by a corrective wave labeled X.

Truncated Fifth - The fifth wave in an impulsive pattern that fails to exceed the price extreme of the third wave.

Zigzag - Sharp correction, labeled A-B-C. Subdivides 5-3-5.

e156883

A WORD ABOUT BOND NOTATION

GMP is directed toward an institutional bond audience. As such, some of the expressions used may seem counter-intuitive at the outset, specifically the terms "support" and "resistance." Every bond yield has an equivalent value on a cash or Futures chart and these levels are often expressed interchangeably. But the same level cannot be both support and resistance. In technical theory, a support level is where buying is expected to come into a market while a resistance level is where selling is to be expected. If bond buying takes place, a yield chart will go lower due to the inverse relationship between the price and yield. It would therefore be counterproductive to call the yield level from where the buying took place resistance since selling of bonds would actually take the yield chart higher. The same holds true with the use of the terms "bullish" and "bearish." A decline on a yield chart is bond bullish since it implies that prices are going higher. On the opposite side, an upside move on a yield chart means bond prices are declining and this is therefore referred to as bond "bearish."

The Elliott Wave Principle is a detailed description of how financial markets behave. The description reveals that mass psychology swings from pessimism to optimism and back in a natural sequence, creating specific Elliott wave patterns in price movements. Each pattern has implications regarding the position of the market within its overall progression, past, present and future. The purpose of Elliott Wave International's market-oriented publications is to outline the progress of markets in terms of the Wave Principle and to educate interested parties in the successful application of the Wave Principle. While a course of conduct regarding investments can be formulated from such application of the Wave Principle, at no time will Elliott Wave International make specific recommendations for any specific person, and at no time may a reader, caller or viewer be justified in inferring that any such advice is intended. Investing carries risk of losses, and trading futures or options is especially risky because these instruments are highly leveraged, and traders can lose more than their initial margin funds. Information provided by Elliott Wave International is expressed in good faith, but it is not guaranteed. The market service that never makes mistakes does not exist. Long-term success trading or investing in the markets demands recognition of the fact that error and uncertainty are part of any effort to assess future probabilities. Please ask your broker or your advisor to explain all risks to you before making any trading and investing decisions.

Prechter's ***GLOBAL MARKET PERSPECTIVE*** is published by Elliott Wave International, P.O. Box 1618, Gainesville, Georgia, 30503, USA. Phone: 770-536-0309. Fax: 770-536-2514. E-Mail: customerservice@elliottwave.com.
All contents copyright © 2011 Elliott Wave International. All rights reserved. Reproduction is illegal and strictly forbidden. Otherwise, feel free to quote, cite or review if full credit is given.
GMP is published usually at the beginning of each month, although the schedule can vary to allow publication to occur when the analysts judge their thoughts to be most timely and/or conclusive. Subscription rate: $49/month.

e156883

Robert R. Prechter, Jr., CMT

Founder and president of Elliott Wave International, Robert R. Prechter, Jr. has published financial books and commentary since 1976. During the 1980s, Prechter won numerous awards for market timing as well as the United States Trading Championship, culminating in Financial News Network (now CNBC) granting him the title, "Guru of the Decade." Bob served for ten years on the Board of Directors of the Market Technicians Association and in 1990 was elected its president. He has served on the board of the Foundation for the Study of Cycles and currently serves on the advisory boards of the MTA's Educational Foundation and the Journal of Technical Analysis. Prechter has made presentations on his socionomic theory of finance to the London School of Economics, Cambridge University, MIT, Georgia Tech, SUNY and academic conferences. Prechter created the Socionomics Institute to research and apply socionomics. Before starting out independently, Bob worked with the Merrill Lynch Market Analysis Department in New York as a Technical Market Specialist. He obtained his degree in psychology from Yale University in 1971. Bob serves as managing editor of *Global Market Perspective*. For more information, visit www.robertprechter.com.

Steven Hochberg

Steven Hochberg began his professional career with Merrill Lynch and joined Elliott Wave International in 1994, providing institutional commentary for global markets. He can be heard as a regular guest commentator each Thursday morning on www.webfn.com. Steven is a graduate of the University of Vermont and received his MBA degree from Northeastern University. For *Global Market Perspective*, Steven provides commentary on the U.S. stocks and precious metals markets. He also edits the *Elliott Wave Short Term Update*.

Peter M. Kendall

Peter Kendall served as a financial reporter and columnist from 1983 to 1992. He wrote the "On the Money," a column for *The Business Journal* from 1991 to 1997. Pete joined Elliott Wave International as a researcher in 1992 and has been contributing to GMP since 1995. Pete is Director of EWI's Center for Cultural Studies, where he focuses on popular culture and the new science of socionomics. Pete graduated from Miami University in Oxford, Ohio with a degree in Business Administration. For *Global Market Perspective*, Pete provides commentary on cultural trends, the economy and the U.S. stock market.

Robert Kelley

Robert Kelley began his career in 1987 as a futures broker. He joined EWI in 1990 and edited *The Elliott Wave Short Term Update*, the *Currency and Commodity Hotline* and the currency section of *The Elliott Wave Currency and Commodity Forecast* newsletter. In 1994, he left EWI for New York to become a Vice President of JP Morgan (Securities), where he was in charge of the technical market research department. He later served as a consultant for HSBC Securities and thereafter developed a proprietary options trading system. In May 2000, Robert rejoined EWI where he now provides analysis for the World Stock Index for *Global Market Perspective* and daily and intraday analysis for the on-line *Specialty Service Stocks* coverage.

Brian Whitmer

Brian Whitmer's analytical proficiency extends to two professions: He received a degree in civil engineering from the University of Maryland and has served as a designer, planner, and project manager for $100-million-plus civil and residential developments. Brian also is an Elliott-savvy technical analyst who is proficient in socionomics, the science of history and social prediction. He describes himself as self-educated in Austrian economics and thus well-versed in the *mis*understandings of mainstream economics. Joining Elliott Wave International in 2009, Brian serves as editor of *The European Financial Forecast* and contributes the European stock section of *Global Market Perspective*.

e156883

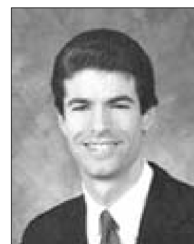
Mark Galasiewski

Mark Galasiewski (gala-SHEV-ski) began his analytical career in 2001, researching company fundamentals at an institutional brokerage in Stamford, Connecticut. After joining Elliott Wave International in 2005, Mark contributed to Robert Prechter's *Elliott Wave Theorist* before joining EWI's *Global Market Perspective* team covering Asian stock indexes. For six years during the 1990s he lived in Japan, where he observed that country's extended bear market first-hand. Mark has traveled to many of the countries whose markets he analyzes. A graduate of Middlebury College in East Asian Studies, he is fluent in Japanese and conversant in Mandarin Chinese.

William F. Fox

Bill Fox originally joined Elliott Wave International in 1994 after managing assets for the institutional trust division of SunTrust Bank. He has also managed futures money for a diverse clientele. Bill has been involved in market analysis since graduating in 1988 from Vanderbilt University, where he received a Bachelor of Arts degree with a major in Communication. For *Global Market Perspective*, Bill provides commentary on the European fixed-income markets. He also provides full coverage of European fixed-income markets for EWI's online *Specialty Services Interest Rates* coverage.

Jim Martens



Jim Martens began using the Elliott Wave Principle in 1985 and by 1989 was making insightful market calls for his metals trader colleagues on the Commodity Exchange Center in New York. Jim joined Elliott Wave International in 1993 as a commodity specialist. He also oversaw EWI's currency analysis before joining Nexus Capital Ltd., a Soros-affiliated hedge fund in 2001. He rejoined EWI in 2005. Jim received a degree in finance from Florida Atlantic University. He covers currency relationships for *Global Market Perspective* and provides full coverage of dollar rates and major cross rates in EWI's online *Specialty Services Currencies* coverage.

Jason Farkas

A chance reading of a book on technical analysis and the Austrian school of economics eventually led Jason Farkas, to Elliott Wave International. Prior to joining EWI, Jason worked for 14 years as a futures, options and equity trader as well as a technical analyst and advisor. Jason is a Chartered Market Technician, with a background in finance, accounting and quantitative methods. He has been tutored by some of the best investment minds, including legendary trader Dick Diamond. A triathlete and Phoenix native, Jason is an avid student of financial markets and market psychology with a keen interest in proper position-sizing and risk controls, which help to differentiate gambling from speculating in investment markets.

Steven Craig

Steve has been involved with the energy industry for well over a decade and joined EWI in January 2001 as senior energy analyst. His industry focus was on trading and risk management, and he is intimately familiar with the production and consumption side of the business. Steve's most recent positions were at Central and South West (now American Electric Power) and with Kerr-McGee. His extensive experience with the physical and financial aspects of crude oil, natural gas and electricity adds a valuable dimension to his analytical approach. He is responsible for EWI's online *Specialty Services Energy* coverage, and his crude oil and natural gas views are featured each month in *Global Market Perspective*.

Acknowledgments

Our production team is indispensible in getting out each issue of GMP. For this issue, Angela Hall, Pam Greenwood, Cari Dobbins, Sally Webb, Susan Walker and Dave Allman handled charts, fact-checking, proofreading, layout and other details.

e156883