

The End of the Long Game 2009-2018

(Updated 24/12/2014)

Just when we thought the climate had cleared the scenario ahead, once again it has polarised, again presenting two clearly different scenarios. The question is whether we are, like the Titanic, about to experience the final plunge or will our economic boat remain afloat for a few more months or years to come? This article does not attempt to make trading or investment recommendations. Let's look at both scenarios in two parts

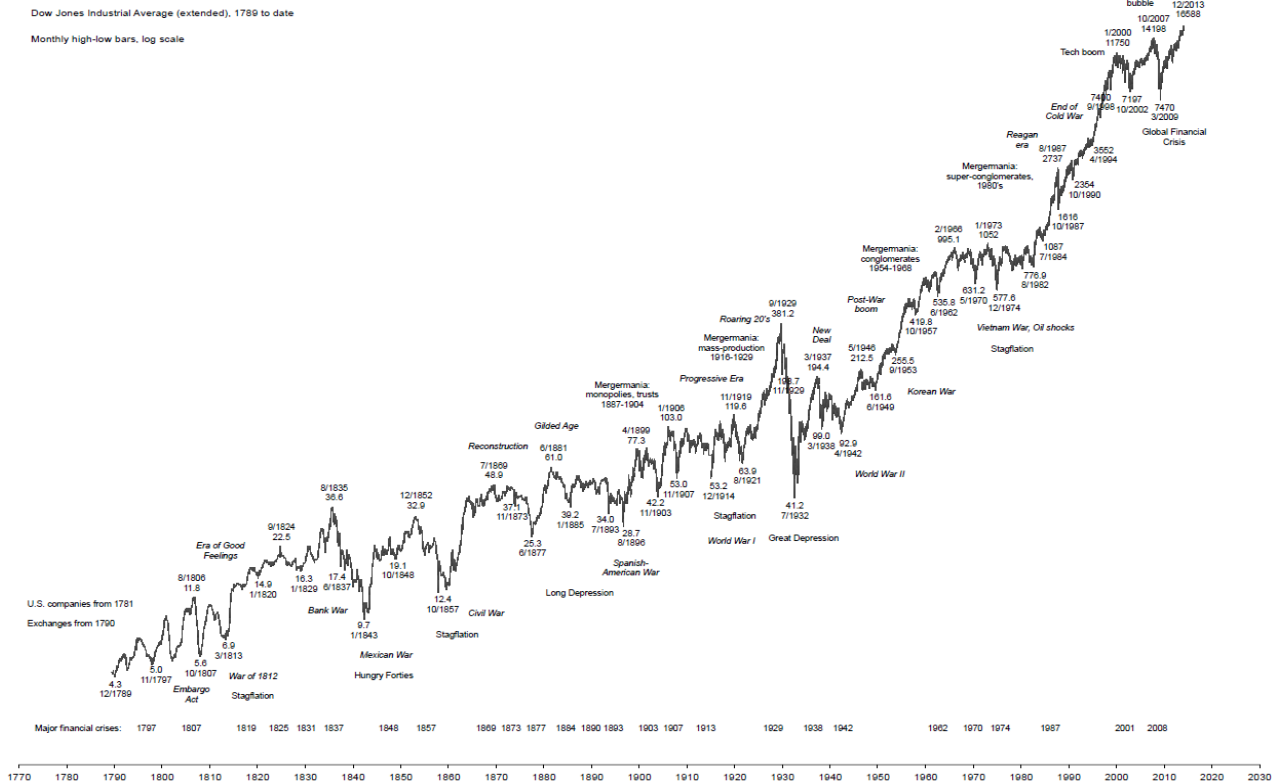
Background

The recovery from the GFC is the last gasp of the fiat money boom that has been in effect since Nixon left the gold standard. This was the last restraint on politicians and their ability to borrow and spend forever. Economic growth since the late sixties has been largely sponsored by credit that has left the liberal democratic economies bloated with debt, regulation and fiat money. To see how this pans out graphically, refer to the [accompanying chart](#). The recovery since 2009 has been boosted by massive cash injections (read printing) of money into industrialised economies boosting asset prices (read inflationary) as Keynesian orthodoxy suggests boosting asset prices will eventually lead to a follow through in consumer spending. Industrial nation governments have been doing their best to boost spending in the finest tradition of neo-Keynesian economics. The printing however is having the harmful effect of dislocating markets and the traditional matrix of pricing set by markets is breaking down – most clearly illustrated by the worrying disconnect between Wall St (stock market prices) and Main St (economic activity, employment). There is divergence between assets such as stocks, real estate and commodities indicating we are at or near the top of the business cycle. Commodity markets are off their 2012 highs and yet, in spite of that, stock markets continue to climb a wall of worries and this gives rise to our market predictions.

Cyclic History

To step back further, we are witnessing in our lifetime the completion of large scale cycles of human endeavour and activity with the attendant dislocation and reallocation of social, economic and political activity and resources. An understanding of the broad brush strokes economically, socially and politically may serve to enhance your perspective on what emerges next. The scale of forces at work in societies and economies is so huge that the current drama is taking decades to unfold. This is the topping and completion process of an economic cycle that has been going on for over 200 hundred years. By the time this top and the ensuing drama is finished, it may well have spanned generations of people. On a historical note, we are witnessing the completion of the growth phase of the industrial revolution that began around 1783-5. To be clear about the term ensuing drama, let's be clear we are talking about the emergence of a new 'dark age' for society. These cycles affect all industrialised nations including China which joined the industrial revolution much later. Given the length of time involved we anticipate this having a generational impact and may not be completed for decades to come.

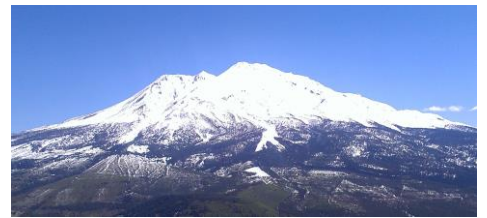
Stock Prices



The phase 2000 to 2009 which included the dotcom bubble collapse, the post 9/11 recovery and Iraq War followed by the subprime mortgage debacle were all part of a major degree of correction occurring in the late stages of the Industrial Revolution Cycle that began around 1785. We had concluded that the logical outcome of the economic peak in 2007 and the following financial crisis (GFC), that a major downturn with attendant declines in asset values and income levels was underway and that this process would continue into 2016 and possibly as late as 2024. The tenacious strength of the recovery since the GFC surprised us but also revealed alternative cyclic viewpoints. The 'animal spirits' that drove bull markets and buoyed economic activity from the 80's to 2000 along with the animal spirits of the politicians and central bankers whose hubris has now reached giddy heights illustrates the scope of the long term cycles discussed and gives rise to our predictions that a major cycle is currently making its top.

Part I: The Bull Argument

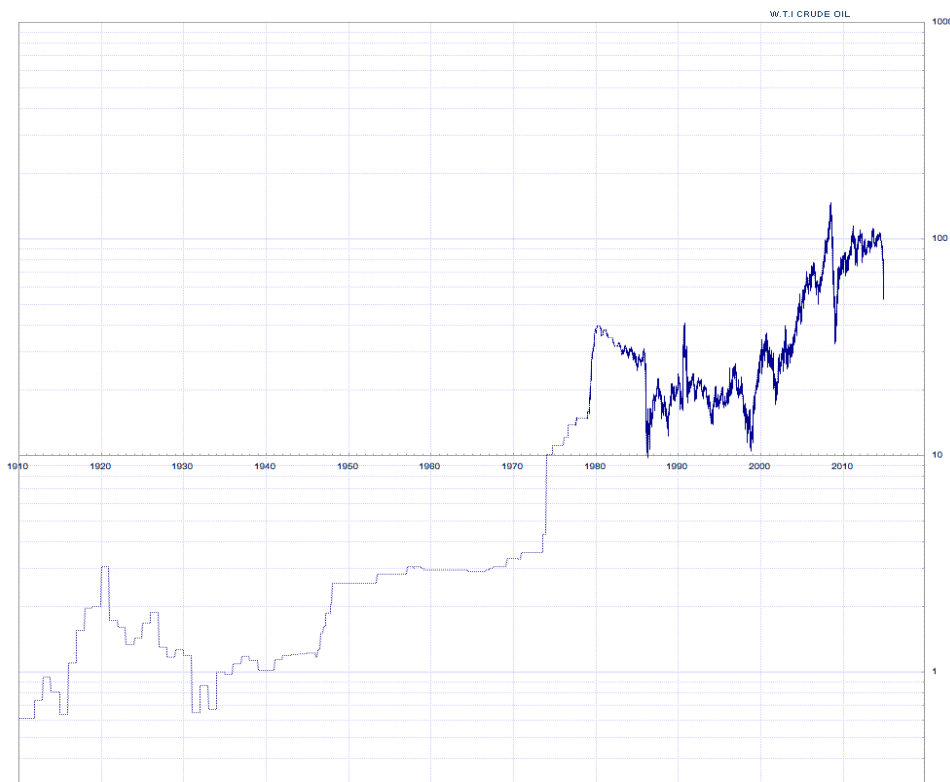
2014 saw only mild pullbacks in line with our recommendation in US stock markets and a slowly improving economic climate for the US. In August/September there was a clear switch in confidence as people began to realise the recovery was not going away. Economic data has generally been steadily improving and brought the boost in confidence. This has brought us back to the tipping point. On one hand we have a potential inflationary scenario ameliorated by falling oil prices – a bull market scenario lasting into 2015 and possibly extending for the next three years. This is our main scenario and we see this trend set to continue after a deeper consolidation. In fact most of 2015 may see stock markets undergoing corrections as the large moves of 2012-2014 have left the market vulnerable and overbought. Most sentiment indicators are at extreme readings. Any corrections that occur should be held by the levels recommended by our previous updates 14720, 15340 (DJIA) and 1738, 1814 (SP500). If however 11,250 (DJIA), 1219 (SP500) is breached any bull market potential is eliminated. Take precautions on any subsequent rallies. Once the correction/consolidation phase has been completed in late 2015 we expect the last leg of our inflationary/bullish scenario to play out resulting in some spectacular moves in stock markets upwards. Given that central banks are willing to engage in any amount of quantitative easing (QE) any economic deterioration will quickly be met by further printing. It is possible that we may have continuing asset price inflation whilst economies continue to struggle bringing back the spectre of stagflation – the combination of inflation and high unemployment and poor economic growth.



The End of the Long Game 2009-2018

Our scenario suggests that blue chip, quality performing stocks and real estate will continue to climb after dipping in 2015, even as incomes decline and other asset values fall or move sideways. Stocks and properties are seen as the main ways to hedge against inflation. Translating that into index levels implies, for example seeing the DJIA advancing to new highs from late 2015 onwards, to in excess of 20,000 whilst the S&P500 reaches towards 2200-2500. Given the QE printing stimulus to asset prices over the last few years, such a move could be characterised by a final exponential rise followed by a collapse of these two indexes any time from late 2015- 2018. Of course we must also be aware of the possibility due to the growing fragility of global economies that we see stock markets and real estate prices advance weakly before failing.

The late 2014 crude oil price declines are potentially very bullish for stock markets and economies alike. We view the oil price decline as part of a major move by oil to our long term target of US\$12 per barrel. (See our Financial Markets page). It also means the death of the Peak Oil scenario. It may be the one factor that ameliorates the inflation scenario that has quietly been building over the last five years. In economic history this present phase may well be a replication of 1921-29 also known as the “Roaring Twenties”. This culminated of course in the exponential rise of stocks followed by the Crash of 1929 and we are suggesting that the circumstances are building for a repeat performance. The scale and scope however of the coming crash, will dwarf the events of 1929-33. At the cusp of 2014/15 we would pinpoint 1923/24 as the mirror of this current time. A steadily improving economy, low inflation, rising stock and real estate markets; all giving way to boom times for the next few months to 3 years. In 1921 crude oil prices fell sharply as well, setting up the low consumer price inflation that characterised the 20’s.



Such a 1929 style top in the next few years would mark the completion of the entire Industrial Revolution upward phase of this long term cycle and indicate we are entering into a prolonged period of economic, social and political stagnation and upheaval. Whilst these highs are being made the discrepancy between Wall Street and Main Street will be acutely emphasized with further deterioration of the economic, social and political fabric of industrialized nations. This may well be accompanied by

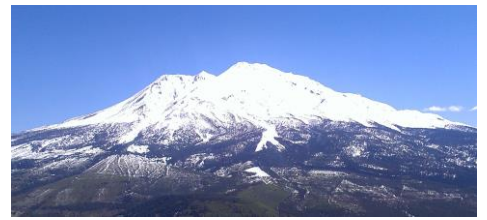
dramatic movements in interest rates, commodities, currencies, gold and silver. You can also anticipate the emerging market economies to suffer as more cash gets sucked back into leading economies – the US, UK, Germany and Japan at the expense of peripheral economies. Anticipate the US dollar to continue to strengthen with attendant corrections along the way.

Using the stock market as a barometer or benchmark of prosperity is a recent development by the US Federal Reserve and illustrates how far we have travelled from liberal style economics to justify the level of intervention by government and the Fed. The severity, speed and relentlessness of the events following will shock. For this scenario to unfold there still needs to be a consolidation of stock markets during 2015 before the final advance continues. Social mood in the US and other leading economies will be ebullient just as they were in 1928-29. We believe however that the time scale to complete the End Game is small, measured, at most, by a few years, before the next major sell off phase.

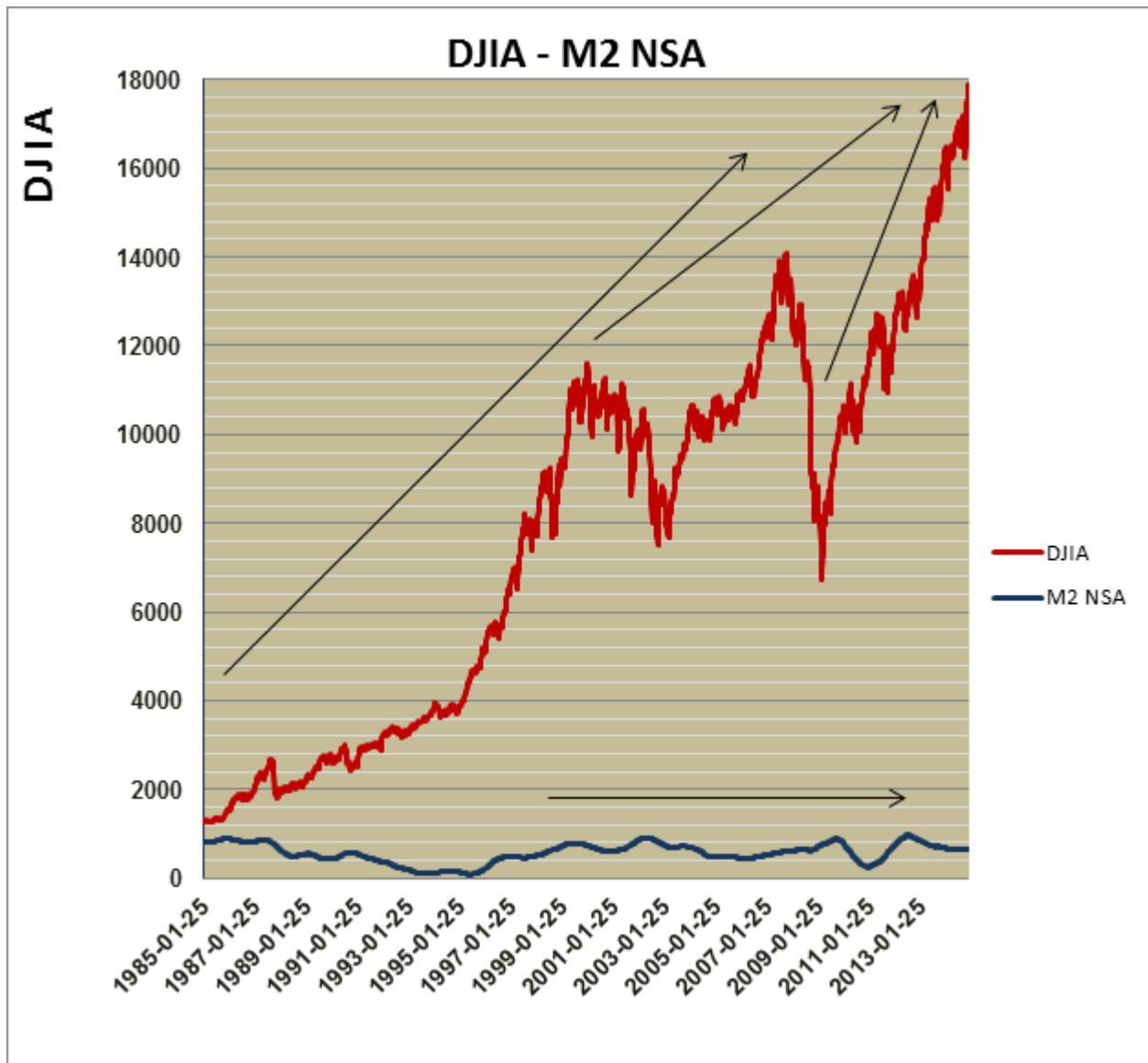
Part II: The Bear Argument

We also point out our alternative scenario which, if, going to happen, is starting now. This scenario suggests stock market prices are peaking in what was a false move to the upside over 2009-2014. This implies that the stock market correction which began in 2000 is still underway and has many years left to unfold. It also implies that stock markets are about to undergo a rapid and relentless decline to their 2009 low points and most probably lower. Falling oil, gold, metal and bond prices over the last few months support this scenario which suggests economies are still undergoing this huge consolidation.

The current divergence between stock markets and commodities indicate a major topping process is underway. In addition Austrian Business Cycle Theory suggests a massive divergence between the amounts of new money coming into the system on a year on year basis is diverging with capital goods prices such as stocks and real estate. This implies the system cannot support asset prices at their current high levels. Even if the US Fed were to begin another round of quantitative easing it would not be enough to sustain asset values – especially stocks at current levels. If this scenario emerges over the next six months we can predict this will give rise to an economic depression lasting 8 to 13 years before an economic recovery gets underway. See the chart below to get a sense of the disparity between M2 Money Supply growth – non seasonally adjusted compared to the weekly DJIA close.



The End of the Long Game 2009-2018



The alternative view suggests it is the resumption of the bear phase of an ongoing correction since 2000. The massive money supply pumping had created the sub-prime bubble that should have been left to sort itself out in the 2008-2009 phase. Since then we have seen bubbles in commodities, education, shares and real estate. The divergence seen in the above M2 NSA Money Supply – DJIA graph illustrates how much worse the situation has grown with stock prices occupying high levels and the amount of new money coming into the system remaining static. This is untenable.

Summary of expectations – short term bull market scenario

- Expect stock markets to correct more deeply over 2015 (14720, 15340 (DJIA) and 1738, 1814 (SP500)) against a growing bullish optimism before beginning an upward exponential surge in stock, commodity and real estate prices. Anticipate any decline of stock markets or economic data to be met by central banks restarting their QE programs. 14720, 15340 (DJIA) and 1738, 1814 (SP500)
- The collapse of oil prices in the last quarter of 2014 creates a potential game changer for most economies as cheaper energy prices flow through to Main Street. It is likely Crude Oil prices will be capped for the next few years at around US\$80 per barrel. This takes the pressure off consumer prices but once again translates into higher share and real estate prices.

- Anticipate consumer price inflation to remain low in the US, UK, EU and Japan. At the same time higher than normal unemployment and the potential for continuing stagnant economic activity will prevail. Interest rates will start to rise in 2015 as central banks try to normalise credit markets.
- Expect credit markets to re-price themselves if inflation does kick up creating a liquidity trap for central banks.
- Anticipate the US, Japan, UK and German stock markets to benefit at the expense of emerging markets as cash gets sucked from the periphery to the centre. Similarly the US dollar will continue to strengthen as money floods back to the centre from the periphery.
- Expect a collapse in stock and commodity prices followed by economic contraction where both inflation and high unemployment are experienced at the same time after this spike in stock and commodity markets prices. This may not happen for another 3 years as the 'Roaring Teens' finishes up.
- Anticipate social and political dislocation in many countries including the US to continue to escalate.

Summary of expectations – short term bear market scenario

- Expect stock markets to begin a relentless stair step down punctuated with savage counter rallies. The nature of the decline will tell us if this is a correction in a broader ongoing bull market or the beginning of the bear market. One clue would be if the correction points mentioned here are taken out in one continuous uninterrupted decline (14720, 15340 (DJIA) and 1738, 1814 (SP500)). Anticipate any decline of stock markets or economic data to be met by central banks escalating their QE programs. 14720, 15340 (DJIA) and 1738, 1814 (SP500)
- We might also anticipate inflation to break out in an unprecedented way especially in the US, UK and Japan and central banks will be unable to contain it. At the same time higher than normal unemployment and continuing stagnant economic activity will prevail. Interest rates may rally sharply on rising inflation and start to rise as central banks try to normalise credit markets in 2015 before plunging as evidence of the growing bear market gathers.
- The coming phase will be difficult to read as markets enter their final death throws and competing bullish and bearish forces play out.
- The coming depression that unfolds will last 8 to 13 years.
- Anticipate increasing social and political dislocation in many countries including the US.

Conclusion & End Game

Whether we have a few more months or years of twilight before the beginning of a new “Dark Age”, suffice to say, that from now onwards we can expect increasingly tough times punctuated by phases of optimism. This is the nature of major long term tops. And of course the coming generation of correction will not merely be confined to asset prices and the vagaries of fiat money and bad economics, but also to societies and politics, both domestic and geo-political. Generations of people will learn about long forgotten natural laws and how it applies to human behaviour. Social mood will have become dark and this will also express itself through every aspect of society, both culturally and economically. Music, the arts, fashion, crime, politics, social mood and drama will all reflect the new paradigm. The growing social political and economic tensions we have witnessed a harbinger of what is to come. This phase will reset the stage for a new beginning for people from which a new and sustained social and economic recovery will slowly begin. By the time that point has arrived however, the nature of our societies and the way we relate with people and between nations will have changed. The wrangling about [why it had to happen](#) will be well underway.

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