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THE FRIGHTENING SIMILARITIES BETWEEN THE MARKET IN MID-2008 AND NOW...

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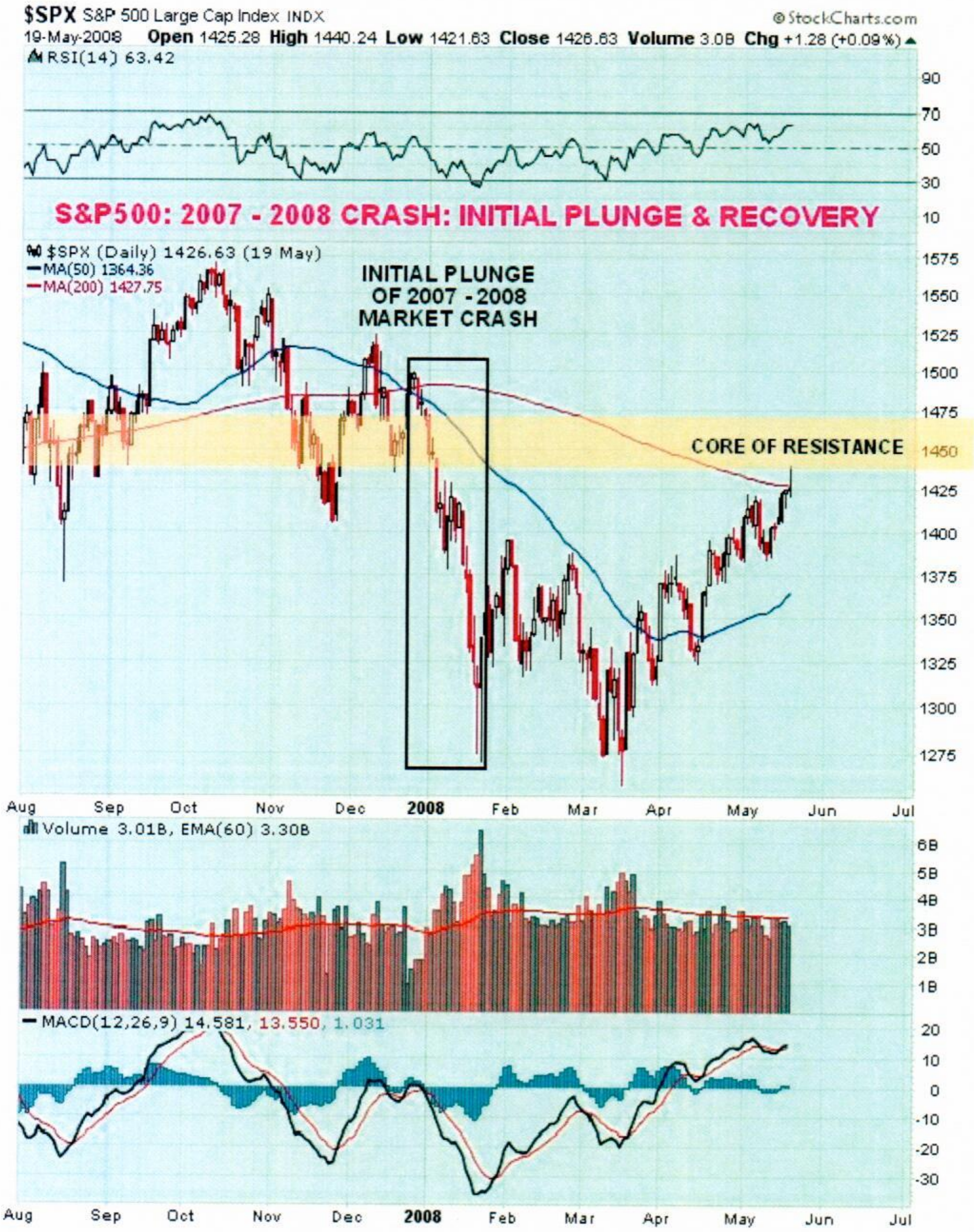
Given that many investors are being deceived by the apparently strong recovery rally of the past month in major US stock indices, it is considered worthwhile for us to go back and look at what happened during the early stages of the last major bearmarket of 2007 - 2008, because there are some similarities.

We'll start by looking at the initial plunge of this bearmarket which occurred in December of 2007 and January of 2008, and the recovery rally that followed for several months into mid-May, which has similarities with the current recovery rally. By that time many investors had got taken in by this recovery rally, and it looked to them like the "buy the dip" crowd were right, and that new highs were not far over the horizon, but to the competent technician there were plenty of warning signs that all was not well. Among the most important were that moving averages were in bearish alignment, with the 50-day well below the 200-day, and the latter sloping downwards, and the fact that the indices had risen up into a zone of heavy core resistance arising from trading near to that level in 2007 and finally the market had gotten overbought again after a 2-month rally.

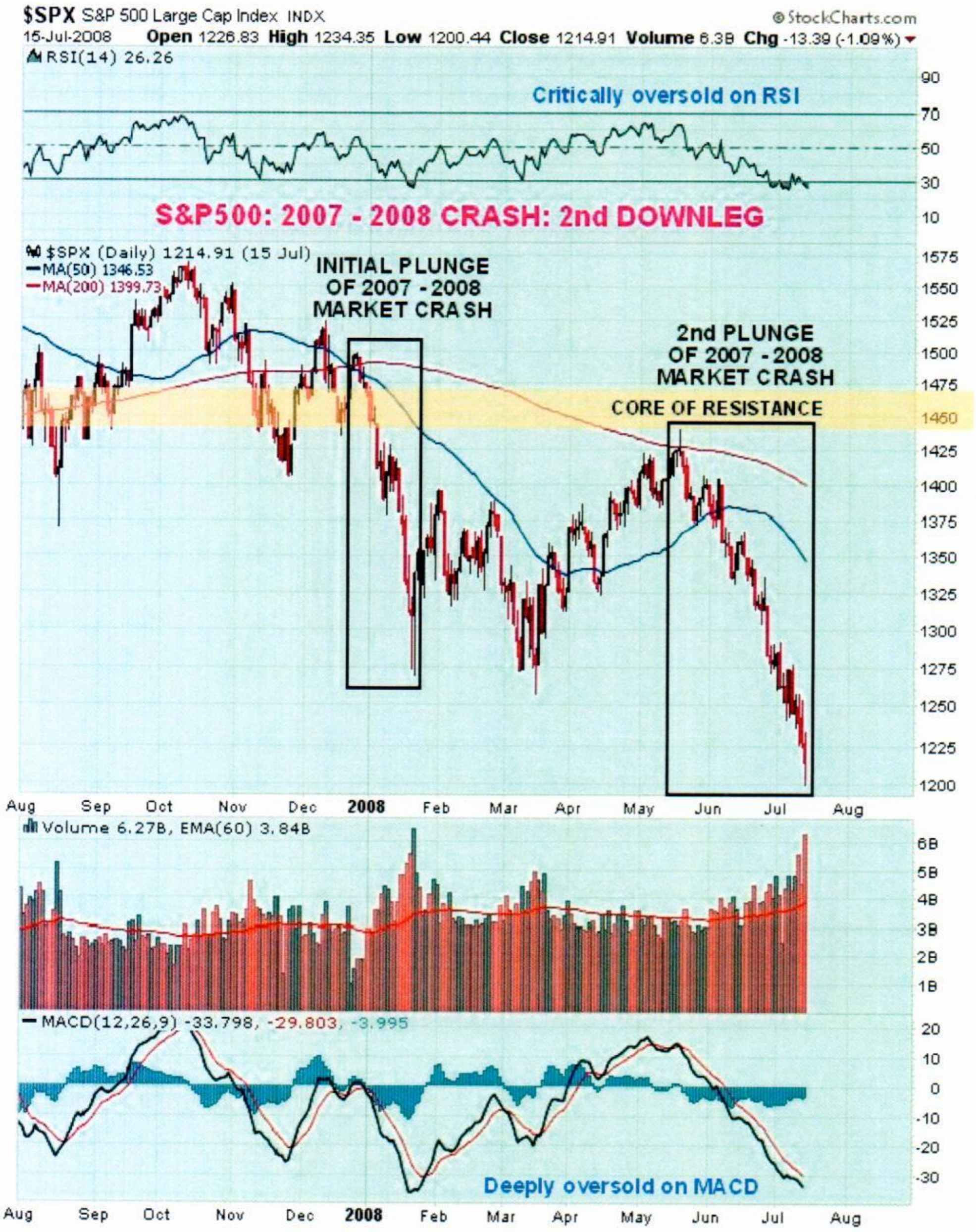
Take yourself back to the Spring of 2008 - the market didn't look too bad to many at the time. The "buy the dip" crowd were starting to look smart and of course the market would go on to make new highs in due course. There was the small matter of moving averages being in bearish alignment and the 200-day falling...



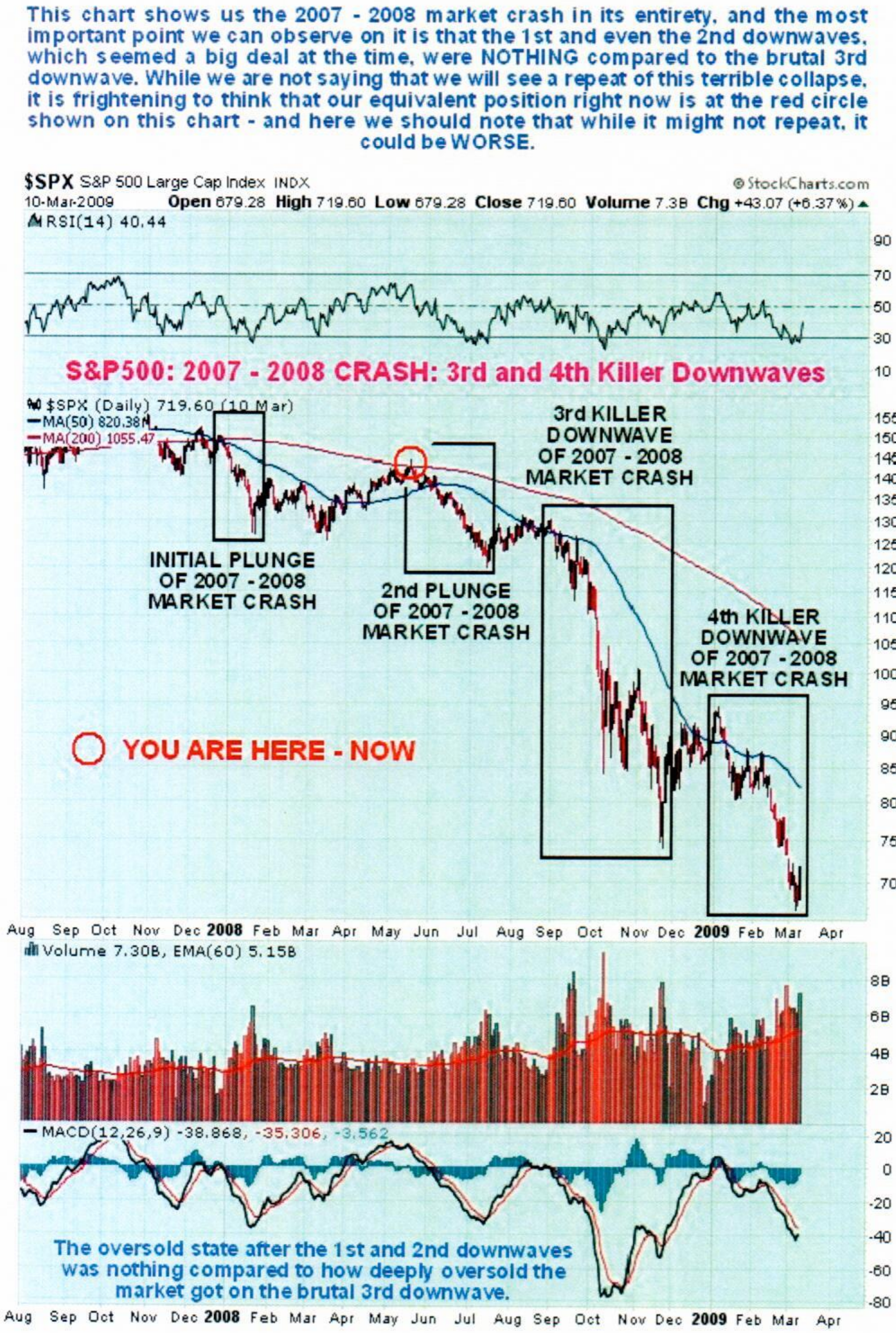
So what happened next?...

The market plunged into it's 2nd crash downwave, that's what...

OOPS! - that didn't turn out so well. The 2nd downleg hit and was slightly worse than the 1st. Surely this warranted a recovery??...



After such a heavy drop, the market was entitled to some sort of recovery, was it not? It was, but after a weak countertrend rally back towards its 200-day moving average, lasting about 6 weeks, it then dropped into its most brutal 3rd downleg of the bearmarket. Even that didn't finish it and it had another downleg, although this time not so severe, in early 2009.

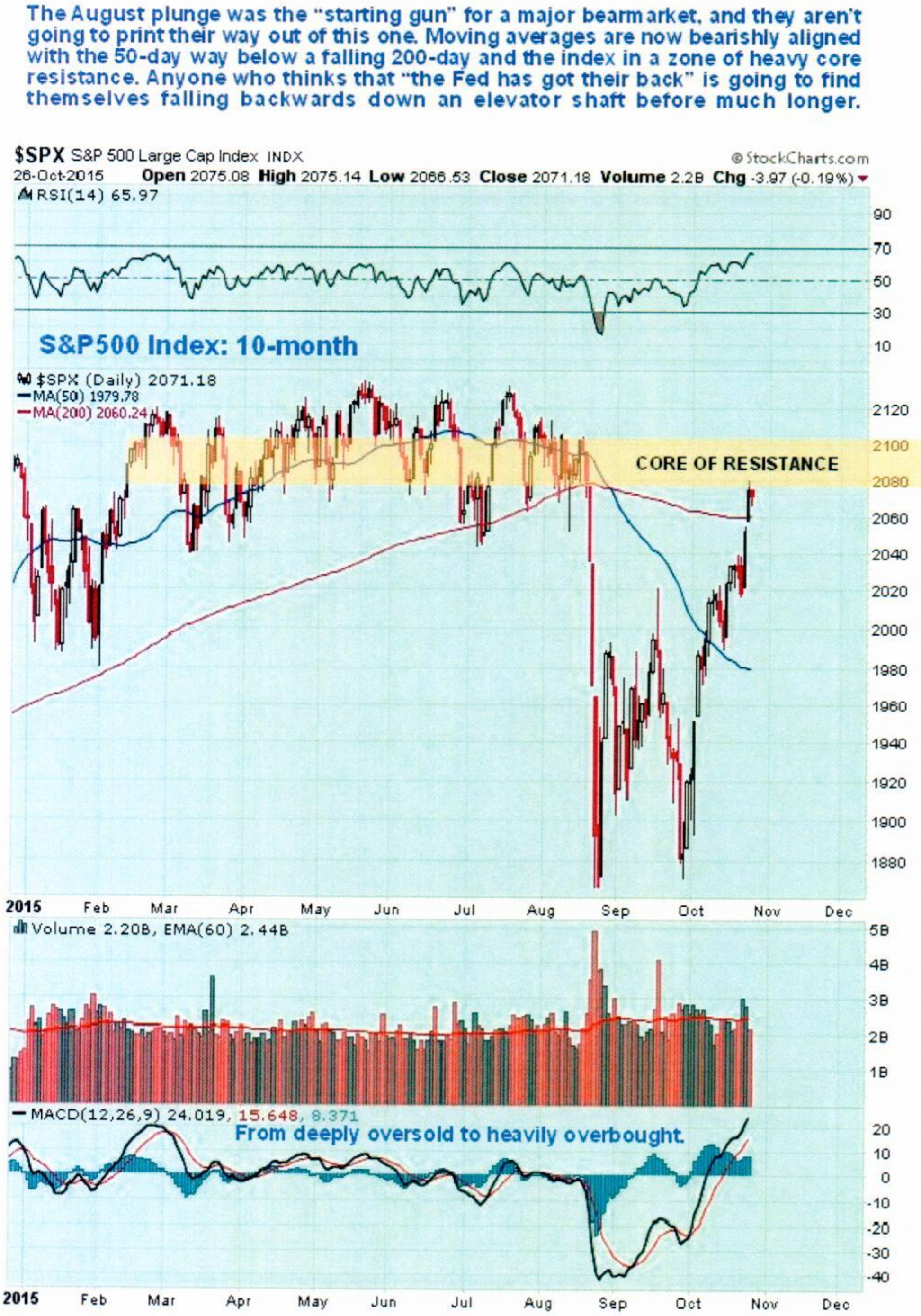


By the time the bearmarket was done the losses were huge with the market having lost over half its value, which considering the capitalization of US markets means that the losses were staggering.

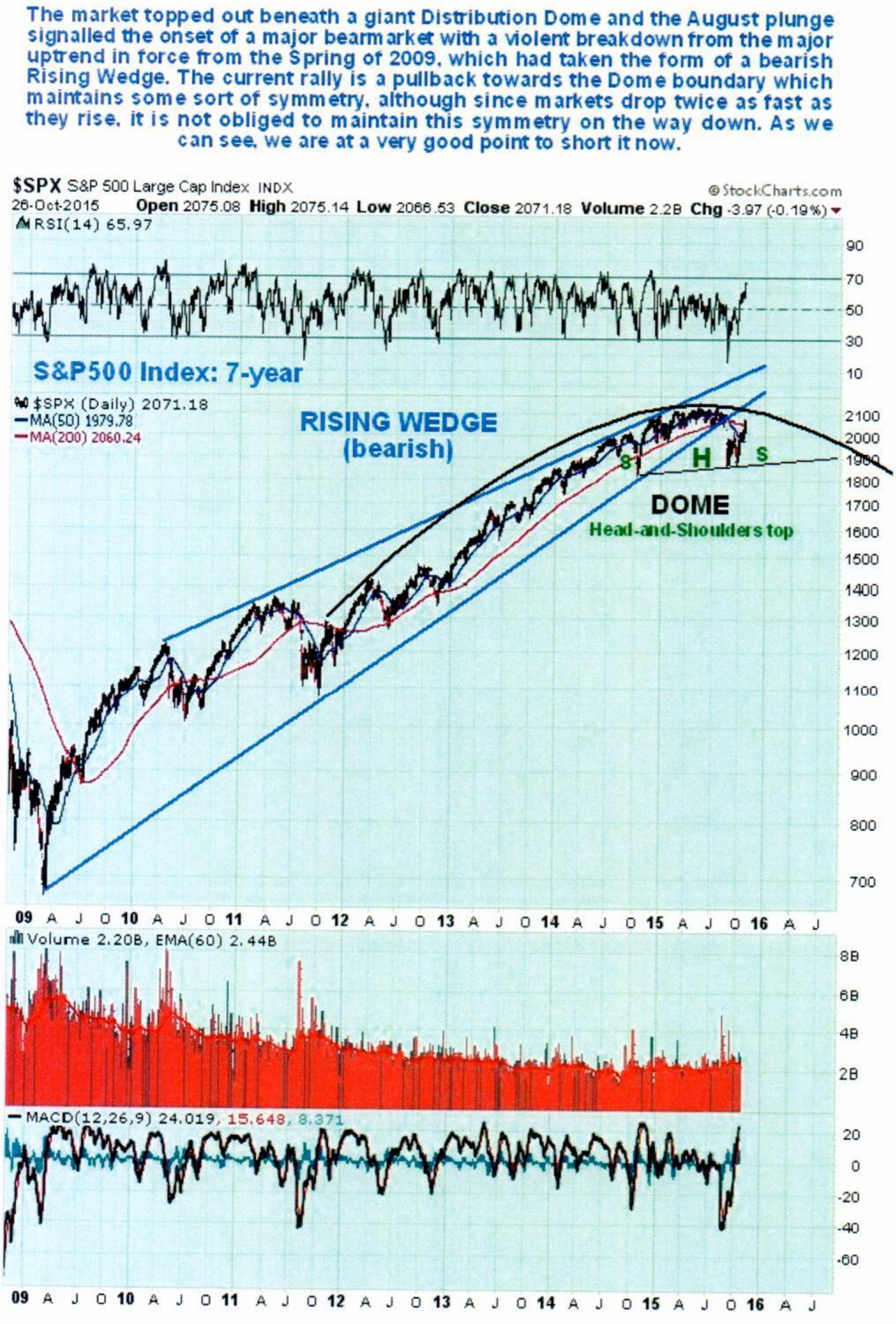
Now, we are not saying that we are going to see a repeat of the 2007 – 2008 bearmarket, because the fundamental situation is very different – in many respects it's WORSE. Debt is at vastly higher levels as a result of the dangerous complacency bred by ZIRP, the derivatives pyramid has ballooned to vastly greater levels. There are bubbles all over the place bred by easy money at 0 interest rates and carry trade speculation, resulting in terrible misallocation of capital, and finally, because interest rates are already at 0, no relief can be provided by lowering rates. So what "policy tools" are left to fight the deflationary juggernaut caused by all this debt overhanging the system, that is already wreaking havoc? – the only one they have left is to print money, which is pushing on a piece of string, but will at least allow those in power to avoid a liquidity crisis at public expense - and we shouldn't overlook that in their desperation they can resort to robbing bank accounts via bail-ins and the plundering of pension funds. The result of all this must be a hyperinflationary depression.

Against this appalling background there is the growing risk of various "black swan" events tipping the train off the rails, two of the most dangerous ones being the implosion of China, which is a gigantic debt fuelled bubble that is dependent on now shrinking overseas markets, and is now imploding, and the collapsing European Union, for whom the refugee crisis looks like being the "last straw". So the prospects really don't look good, and the only reason that the stockmarket has stayed buoyant up to now is that you cannot earn anything on your money from banks deposits or the bondmarket, but when corporate profitability falters as it must as the depression deepens, this bolthole is likely to fail too.

Alright, so if we attempt to make some kind of comparison between where we are in our fledgling bearmarket, and the early stages of the 2007 – 2008 bearmarket, where do we find ourselves? That's easy to see. On the 10-month chart for the S&P500 index shown below, we can see that the rally of the past month off a Double Bottom has brought the index up into a zone of core resistance, where it is now overbought. In addition, and most ominously, moving averages are bearishly aligned, with the 50-day way below the 200-day and the latter flat / downtrending. Now, if you go back to the 1st chart above, showing the first plunge of the 2007 – 2008 bearmarket and the post plunge rally that followed, **YOU WILL SEE EXACTLY THE SAME SETUP** – the market rallied off a Double Bottom up to a zone of core resistance and its falling 200-day moving average, where it was overbought, and you know what happened next because its shown on the 2nd chart.



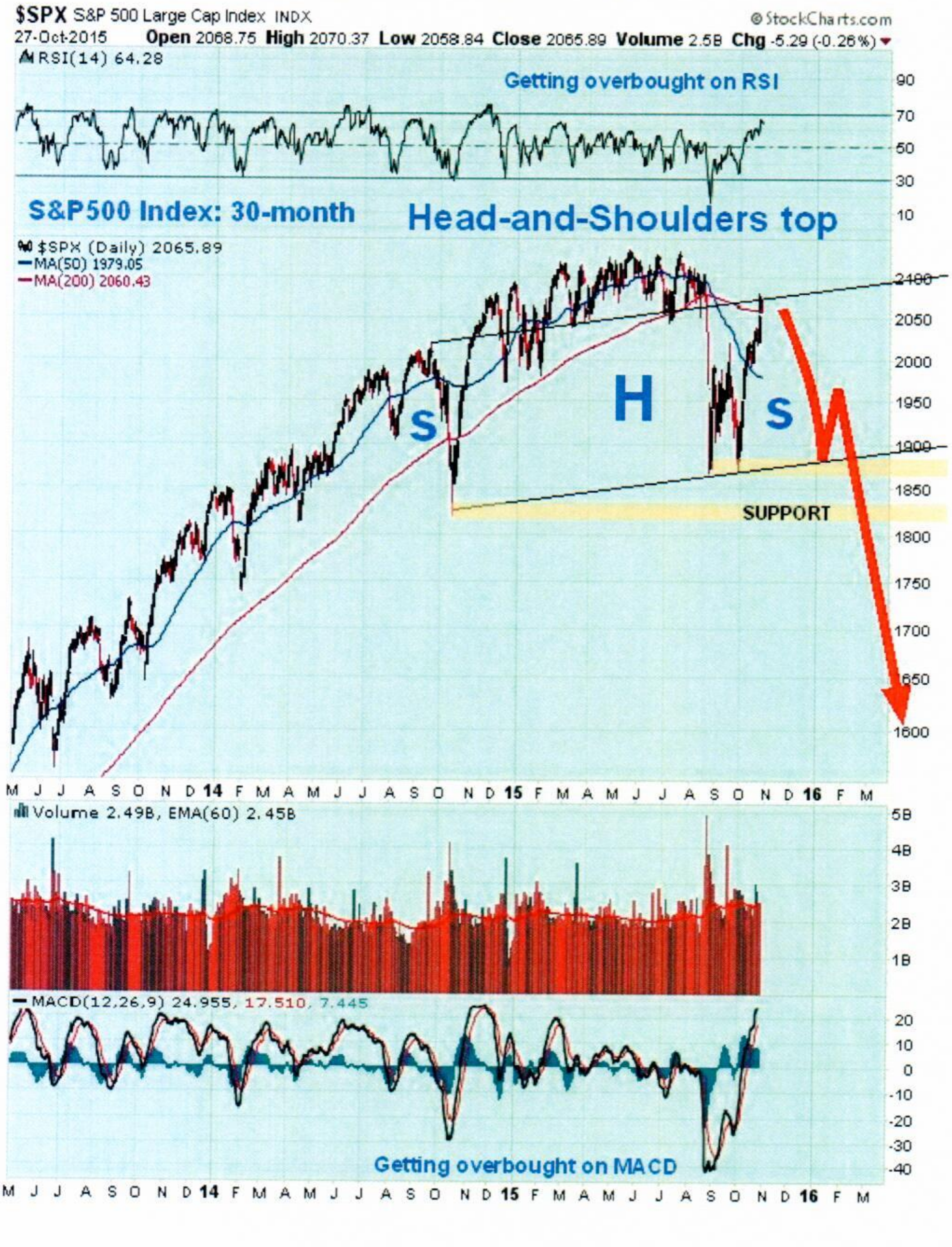
What about the big picture? – let's take a look on the 7-year chart for the S&P500 index. On this chart we see that a major bearmarket is just getting started. The market has been forced into breaking down from its major uptrend, which took the form of a bearish Rising Wedge, by a giant Distribution Dome. This is the reason why the August plunge was so violent – it was a clear breakdown from an uptrend in force from 2009. We can also see on this chart why the market is dithering around a bit before really getting going on the downside – it is building out the Right Shoulder of a large Head-and-Shoulders top, which means that we are at the optimum point to short it RIGHT NOW, and the big downside action will follow the failure of the neckline support at the bottom of this pattern, which is shown as a thin black line on the chart. This is now a little above the August and September lows, but for practical purposes is at these low. While we can see that the market is about at its Right Shoulder highs here, we also know that the silly season is almost upon us, when for some unknown reason, investors' minds turn to mush ahead of Christmas, and normal judgment appears to be suspended, perhaps because of the resurrection of childhood fantasies, so it might take until the New Year before the Right Shoulder of the Head-and-Shoulders top is built out and completed and the market drops in earnest – unless some nasty Black Swan intrudes in the meantime that is. Overall, however, the charts look terrible and presage a brutal bearmarket with the 2nd phase set to strike soon.



As we know, Central Banks now have no option but to print and print, which means QE ad infinitum. The talk about raising rates at some indeterminate point in the future is to deter dumb bond investors from jumping ship, but the reality is they will never be able to raise rates again, except perhaps by a trivial token amount to try to recapture some credibility amongst the gullible. Will more QE fuel another ramp in the markets, even against the background of an atrophying stagnant economy and shriveling corporate profits? Well, it could, and we need to be aware of the possibility - don't forget that the Fed's priorities are serving the interests of its Masters in the big banks and on Wall St, it has no interest in the health of the economy or the welfare of the American people. The signal for another ramp in the markets will be an upside breakout from the giant Dome shown on our 7-year chart. However, right now all the technical indications are that a major bearmarket is starting, so what could be about to happen is a "black swan" event strikes as in 2008, such as an acceleration of the collapse in China, as its massive debt fuelled bubble continues to implode, or the disintegration of Europe, which is drawing closer by the day. There is some truth to the argument that capital flight out of Europe (and other places) will tend to drive the dollar and US stocks higher, but not if European markets crash - if that happens world markets will all go down together. So we are going to stay with the bearish case unless and until we see an upside breakout from the Dome.

The 2-year enables us to see the Head-and-Shoulders top in more detail, and in particular that the market at a target for the Right Shoulder high. It should go into reverse here, or at least stop advancing and churn for a while before dropping back.

The market has risen further than expected to arrive at our parallel tracker trendline mentioned as an upper target in the update of 20th. Now we will find out if our assessment of the pattern in the S&P500 index as a giant Head-and-Shoulders top is right or not. The Fed meeting is occurring right now, so the market should reverse sometime this coming week or at least stop advancing and churn - if it doesn't it's "back to the drawing board". Note that with the silly season almost upon us, it might take until the New Year for the market to break down from this top pattern, or even a little later.



End of report.

Posted at 8.30 am EDT on 27th October 15. S&P500 index 2-year chart added on 28th.